

# 10 Minutes on Bolstering Corporate Liquidity\*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

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## With credit still scarce, cash is king

### Highlights

- Credit is very tight, with some companies facing a cash squeeze.
- Short-term cash management and tax strategies can provide some liquidity relief.
- In the medium term, organizations should focus on broader initiatives, such as improving demand forecasting and reducing capital expenditures.
- Over the long term, the end of easy credit could spell a slowdown for debt-fueled transactions and place a renewed premium on organic growth and performance improvement initiatives.

**While partial revitalization of the commercial paper market has enabled the most creditworthy companies to access funding for operations,<sup>1</sup> many organizations are still suffering from a short-term lack of liquidity.**

**Additionally, corporate America faces a collective reckoning in 2009 for the credit binge of the past few years. According to ratings agency Standard & Poor's, corporate loans totaling more than \$700 billion will come due this year.<sup>2</sup>**

**Factor in a recession and declining profits, and many organizations could have a tough time meeting their operational and loan re-payment obligations.**

**Short term, there are many viable and easily implementable tools to generate cash. More long term, companies need to develop an ongoing strategy to bolster liquidity.**

<sup>1</sup> "Commercial Paper Market Hits Speed Bump."  
Dow Jones (January 22, 2009).

<sup>2</sup> "Cost of Borrowing Zooms Up for Corporations."  
New York Times (January 18, 2009).

**A new landscape requires a more long-term approach to liquidity planning.**

1. Risk spreads at historical highs. Historic spreads in closely followed indicators of global liquidity suggest that companies may not enjoy pre-2007 credit conditions for a long time to come.
2. New standards at ratings agencies. Credit ratings agencies have toughened standards for corporate and structured finance ratings, potentially making it more difficult for companies to raise capital.
3. Tightened bank lending. Banks have tightened both consumer and corporate lending and may continue to do so to meet possible new capitalization standards.
4. A prolonged economic slump. The weak economy means that companies may need to generate cash from unexpected sources. A good example is cash tax planning that produces quick refunds and, perhaps, even improves long-term liquidity.

## At a glance

While meeting short-term liquidity needs...

- Funding working capital
- Enabling operational improvements
- Providing a dividend to investors
- Continuing a stock buy-back program
- Completing an acquisition
- Making capital improvements

...Companies should also develop a long-term approach to managing liquidity

- Forecasting sources and uses of cash
- Layering debt maturities to minimize refinancing risk
- Including the appropriate amount of debt in the capital structure
- Maintaining adequate cash reserves
- Creating the right incentives to reward management
- Setting realistic growth goals
- Building an efficient and cohesive operational infrastructure

## Back to basics to boost short-term liquidity

“Companies don’t go bust because they don’t make money; they go bust because they don’t have any cash.”

Manufacturing CEO—PwC’s 12th Annual Global CEO Survey

Over the short term—say, the next few fiscal quarters—techniques abound for a company to find hidden sources of liquidity through better understanding of pretax cash flows and managing the impact of tax laws in various jurisdictions.

### Levers of liquidity

A good first step for any management team developing its plans to continue operating as a going concern is to gain an understanding of the company’s cash drivers, or those activities that create cash flow. Cash can be generated from revenues, working capital, capital assets, property holdings, various contracts and sales agreements, and many other sources.

### Accelerating cash realization

Once these levers of liquidity are identified and understood, companies can better forecast short-term cash flow and focus on eliminating nonessential spending. The actual cash-saving initiatives can run the gamut: reining in spending with suppliers and nonessential vendors, consolidating purchases of materials, reducing travel and entertainment costs, tightening inventory management,

improving collection strategies around accounts receivable, and optimizing payment timing and terms.

### Tax opportunities

Companies may generate additional cash flow by scrutinizing their federal, state, and non-US tax profiles. These reviews can potentially identify short-term cash benefits, as well as produce significant long-term earnings by lowering a company’s global effective tax rate.

Several tax strategies that may quickly increase cash flow include:

- Accounting method reviews to defer income and accelerate deductions
- Enhancements of various federal and state tax credits and incentives
- Reviews to take advantage of both domestic tax deductions and foreign tax credits associated with foreign earnings repatriation
- Quick refunds of current-year estimated tax overpayments, as well as credit and loss carrybacks to recoup tax payments made in previous years.

## In the medium term, a broader approach to improving liquidity

Even as companies act to meet short-term cash needs, a likely long-term repricing of credit demands that they consider liquidity issues looming just over the horizon.

### **Beyond US borders**

Jim Rogers, cofounder of the Quantum Fund with George Soros and today the chairman of Rogers Holdings, recently told the *Financial Times*, “The financial center of the world is moving east...all the money is in Asia. Why would it go back to the West?”<sup>3</sup>

The US certainly remains a safe haven, as evidenced by the flight to the safety of US Treasuries during this financial crisis. But companies should consider raising capital from a variety of sources in both domestic and foreign markets, including short-term and long-term, financial and strategic investors.

### **A comprehensive plan**

Developing a multiyear plan to improve liquidity and cash tax reduction will ensure that a company can optimize cash generation for as long as possible.

The more comprehensive the plan, the better. A broad plan to boost medium-term liquidity might include:

- Reducing capital expenditures, such as delaying factory expansions
- Reducing foreign income and nonincome taxes to enhance repatriation to the parent
- Establishing employee incentive programs for money-saving ideas
- Renegotiating purchasing contracts and real estate leases
- Improving inventory and raw materials forecasting.

The Obama economic stimulus plan will provide opportunities for improving liquidity, particularly in the tax arena. For example, the plan will allow companies to continue to use bonus depreciation for new 2009 capital investments. It also provides relief for companies modifying or repurchasing outstanding debt that trades at a discount.

<sup>3</sup> “Jim Rogers: ‘UK Has Nothing to Sell.’”  
*Financial Times* (January 22, 2009)

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## Long term, a fresh look at the fundamentals

No one knows when credit markets will truly become unclogged or where the cost of capital will find its equilibrium. But there's no doubt that this crisis provides any company sufficient impetus to take a fresh look at its liquidity fundamentals.

### **Reconsidering the liquidity portfolio**

By definition, every organization brings a singular approach to liquidity. No two companies have exactly the same amount of cash reserves, mix of capital, timetable by which debt is retired, and manner of accessing the capital markets. Using different scenario modeling, companies should confirm that their liquidity portfolio has the appropriate profile for their business objectives.

### **Concentrating cash availability and centralizing cash planning**

Many companies need to work on improving their “cash culture.” First, cash holdings should be relatively concentrated, and access to them tightly controlled. Next, cash planning should be coordinated within the finance and treasury functions. With central coordination, the cash plans of individual business units can be better integrated with those of the company as a whole.

### **Looking beyond income tax savings**

Global companies are looking beyond income tax mitigation to “indirect” taxes, such as value-added tax and various customs duties. Some organizations have little idea how much they pay in indirect taxes—which also include sales taxes and property taxes—and are overlooking significant cash savings opportunities.

### **Establishing a larger investor base**

By avoiding overreliance on a few big investors, companies can diversify their sources of liquidity. This may require companies to establish relationships across a number of domestic and international banks as a prudent long-term move.

### **Intelligently leveraging liquidity**

Companies with solid long-term liquidity can gain competitive advantage over cash-strapped competitors by forging ahead with new products, entering new markets, purchasing distressed companies, and generally growing the business. But they need a coherent strategy to take full advantage of their cash position.

## A permanent repricing of credit risk could mean a much different business environment

With an era of freewheeling credit and on-demand liquidity at an end, the question becomes whether conventional business approaches can support a long-term, perhaps permanent, repricing of credit risk.

Several potential developments related to a higher cost of debt would, if they came to pass, require companies to change some basic assumptions.

### **Equity-fueled financing versus debt-fueled financing**

If credit conditions remain restrictive for several years, highly leveraged financing will become increasingly untenable. Companies could be left increasingly financing business combinations, acquisitions and operations through equity. In turn, there could be more pressure to grow earnings to fuel share price growth.

### **Renewed focus on organic growth**

One silver lining of the financial crisis could be a return to somewhat quaint, outdated modes of posting profits through organic growth, operational excellence, superior products, and attentive customer service.

### **More selective uses of capital**

Companies looking to grow organically will need to be more careful in capital allocation. That would mean, for example, more spending on core R&D and less nonessential spending.

### **An emphasis on value-based companies versus growth companies?**

Bereft of the steady cash supply that fueled corporate growth earlier in this decade, equity markets might take some time to recover. As far as the external market is concerned, perhaps dividend-paying companies—those that provide a reliable return—might become more in vogue than companies promising big shareholder returns.

### **Liquidity-driven tax planning**

Companies may improve year-to-year liquidity by broadening their approach to long-term tax planning. A systematic, multiyear approach to harvesting income and non-income tax savings may provide sustainable cash savings.

## Upcoming 10Minutes topics

### **Top concerns for boardroom directors**

After a year of unprecedented challenge and change, directors are revisiting their oversight of risk management and corporate culture. 10Minutes looks at how the ongoing credit crisis affects these and other corporate governance issues, sizing up the potential impact on your business.

### **Realizing enterprise resource planning (ERP) value**

Across industries, at one level or another, enterprise applications sit at the core of a company's ability to weather the current economic downturn—or capitalize on it. 10Minutes discusses how economic downturns may be the best times to undertake a wide range of ERP-related actions.

### **Recently published editions**

Help your company manage through the downturn and, at the same time, position it better for the long term with the help of recently published 10Minutes editions on these topics:

- Rethinking pivotal talent
- Sustainable cost reduction
- Making divestitures successful
- Finance & accounting shared services

## How PwC can help

To have a deeper discussion  
about bolstering your company's  
liquidity, please contact:

Tell us how you like 10Minutes and what  
topics you would like to hear more about.  
Just send an email to:  
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