sycamore associates llc

volume I, issue iii

custom treasury solutions

the winter of our discontent

Now is the winter of our discontent
Made glorious summer by this sun of York;
And all the clouds that loured upon our house
In the deep bosom of the ocean buried.
Shakespeare, Richard III, I,i

This certainly has been the winter of our discontent, rife with shaky financial institutions, exposures of fraud and regulatory failures, revelations of mis-priced risk and lack of underwriting discipline. Uncertainty is everywhere, with actual economic contraction greater than that experienced in 50 years, and a range of solutions proposed but not yet proved.

Tim Geithner, the particular son (don't you love Shakespeare's puns!) of New York, charged with setting all things right, is not a miracle worker. The clouds hanging low over the house of the free and the brave have not yet parted or buried themselves in the Atlantic. However, the economic sun is starting to show through the murk: there's hope that the economy has bottomed (more on that later); Chrysler has completed its deal with Fiat; we the people are on our way to becoming the largest shareholders in General Motors, thanks to the bankruptcy courts. We're not sure what to make of taxpayer ownership of GM, and all the implications that suggests, but at least the months of speculation, paralysis and worry are replaced with a few certainties and a process to come.

The times in which we live and work continue to amaze us. For those of us who are financial professionals, those times are in many ways unprecedented. (GM! Bankrupt!) And yet, as spring gives slowly away to summer, we see also those trends and issues that are not new, but recast in the context of today. We have spent a great deal of time this spring working in the capital markets with our clients; on amendments, new issues, and longer term structures, including equity. This issue will focus once again on current events and lessons learned, implied, or recommended as we grapple with the evolution of capital markets and risk management.

in this issue...

the winter of our discontent
back to basics
a glimmer of hope in the bond market
cash is a corporate asset
treasury matters more than ever
so you need an amendment...

Welcome Gina Strumolo!

As of June 1, we welcome Gina Strumolo, our Creative and Research Associate, to the Sycamore Associates team. Gina is a 2009 graduate of Marquette University, and will be working on all things Sycamore from Chicago. Although new in this capacity, Gina has been working with us already for three years as our paid intern. Marcia and Win are delighted to have her support, and you will see her work in this issue and in the future. Gina can be reached at gstrumolo@sycamoreassociates.com, or by phone at (312) 402-5526.

copyright Sycamore Associates 2009

back to basics

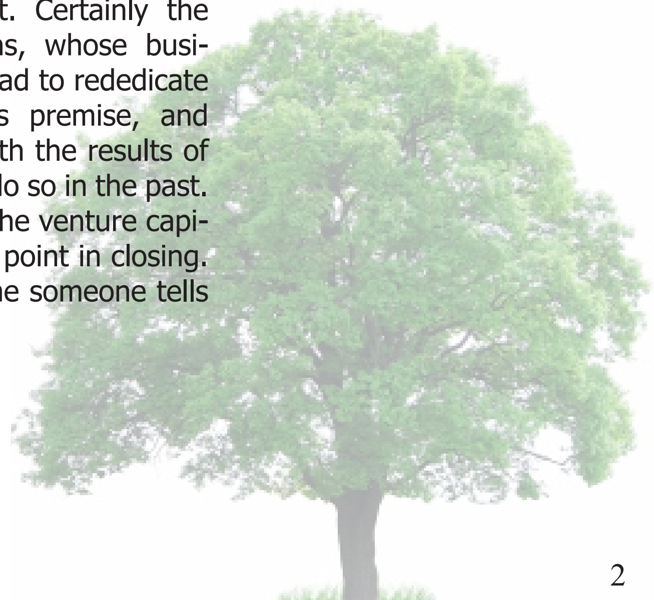
Recently, a friend of ours asked why this financial crisis had taken place when so many of us knew that overall leverage in the economy was unsustainable. And let's face it, when we heard about 110% mortgages, many of us knew that was crazy—that it couldn't and shouldn't last.

We're no more experts on the market than anyone else, but we believe that at least one reason for volatility in the capital markets has been that investors stopped evaluating risk in a disciplined, formal way. There was a great compression-- no separation between high risk and low risk—suggesting that the investors had stopped using proper risk analysis. Obviously, with hindsight being 20/20, we know some financial institutions and professionals would own up to riding the risk wave a bit more than prudent risk management would dictate when times were good, market capacity high, and quarterly earnings the measuring stick for success. There's always been a temptation. We now see that many fine companies have, for example, taken earnings charges to account for investments gone bad. (For more, read Cash is a Corporate Asset.) More than a few fine companies are in the thick of revising their hedging policies (or reviewing them, or establishing them) to address risk management weaknesses that unprecedented volatility ferreted out in 2008-2009.

At Sycamore, our conversations with clients around risk management and guidance are met with renewed interest and much greater enthusiasm than in past years. This is a good trend, and one that means financial professionals have the ear of executive management when it comes to managing the basics in the tried and true, diversify-your-risk, eggs-in-many-baskets sort of ways proven to be successful through the years.

And therein lies the rub. The measure of appropriate and prudent risk management should not be how it contributes to earnings. In fact, effective risk management should have the effect of smoothing volatility, hence by definition not maximizing any one particular variable. We suspect that managements are re-acquainting themselves with this tenet, and we hope that, although not sexy, the basics of risk management become integral to financial decision-making in instances where perhaps they have taken a back seat. Certainly the financial institutions, whose business is risk, have had to rededicate themselves to this premise, and we are all living with the results of various failures to do so in the past.

Our friend the venture capitalist made a good point in closing. She said, "Next time someone tells me that I just don't 'get it' with a business model that simply does not compute, I will be more inclined to believe the problem is not with our understanding of a new concept, but with the business framework itself." That's a great reminder for all of us to trust our instincts when it comes to unsustainable growth, outsized returns, or crafty new structures, and make sure we can follow the business flows.



copyright Sycamore Associates 2009

a glimmer of hope in the bond market

By far, the silver lining of the capital markets this spring has been the bond markets, primarily in the investment grade space. Issuance was up 16% (to $712.7 billion) from the 4th quarter of 2008 in Q1 2009. We expect that trend will continue when the data is in for Q2. More importantly, what is good for the investment grade space will usually shed collateral benefits to non-investment grade borrowers. By taking the strain off the bank markets and providing some much needed capacity, the strong bond markets allow the banks to recover, shall we say, psychologically from the impression that they are the lender of last resort. It is certainly true that overall capacity in the debt markets has been reduced (significantly, and some suggest permanently) by the exit of the hedge funds, CLOs and other non-bank investors. But a robust bond market encourages the private placement markets, and if current early trends continue, a recovery in the high yield markets is in the works—all of which would be good for borrowers of all credit profiles except those in bankruptcy. This is good news, and we will take it for now, hoping for more as the year progresses.

cash is a corporate asset

One issue that many of our clients are addressing—with great vigor and trepidation—is investment policy. Even if, on average, a company is a net borrower, there is still cash around the system on a daily basis. With bank credit quality an urgent concern, now is a critical time to assess both where money flows and how any excess is invested (or otherwise managed). Risks abound, and some, while not exactly new, are freshly imbued with the shots and sound bites from bank failures, leaving depositors standing outside closed banks, noses pressed figuratively to the glass in search of assurances that deposits are safe.

So, some rules for this new road:

First rule of cash management: the objective is return of 100% of principal, NOT yield. Safety First! Repeat after me: cash is a corporate asset. This is a different investment strategy from managing your or any else's 401K. Right now no one needs to report losses on investments because we chased yield right into some Lehman fund and are now in line with the other unsecured creditors.

Happily, this is one place the TARP and attendant legislation can help. In an effort to avoid more deposit runs on banks, the FDIC raised its insurance limit on all accounts to $250 thousand for any depositor. Some banks are also participating with the FDIC in a program that insures core deposits, non-interest bearing, to an unlimited level. This was originally intended to run through March of 2009, and has been extended to run through December 2009.

Your bank must participate in the program, so make sure they do. All banks are seeking core deposits, so they're likely to readily offer up the information. Your benefit will be in credit earnings given to your relationship, not in any return, since this program doesn't cover any interest-bearing accounts. But do the math: with rates low, you can benefit in offsetting service charges as many banks have dramatically raised earnings allowance rates.

That means: no CD's, no money market funds,

copyright Sycamore Associates 2009

no everyday interest funds, no repos, etc. Only non-interest bearing accounts. Period.

Second Rule: Know your banks. Take a quick look at debt ratings, market cap, and know Tier One capital ratios. This is handy to have in the file drawer when you get a call from the Board or CFO, and is worth an afternoon's time to compare. You may decide to recalibrate or rebalance investments or business as a result. You may decide that you are perfectly comfortable and each provider meets your standards for investments and balances. Either way it's a good exercise.

Third Rule: If you have international banks, consider consolidating with fewer providers. If there are many accounts, chances are some of your international banks have recently been (at least partially) nationalized. This is a great time to push the projects for transparency forward, consolidate international providers, and consider additional controls. We're spending a great deal of time on these projects and will happily provide more details if this is an area of interest for you.

Remember, cash is a corporate asset. That means reconsidering how frequently it sweeps to central accounts versus remaining at the subsidiary level. With the advancement of electronics, the need for subsidiaries or divisions to have cash around should be diminishing, not increasing. Reviewing the mechanisms for automating this movement, or establishing them if they are not currently in use, is highly prudent at this time.

treasury matters more than ever

Although this issue is almost exclusively devoted to the capital markets, we need to say a few words about other treasury disciplines (with more focus there in our next issue).

Managements have begun to realize that treasury management is not "cash management" but working capital mobilization, that FX is not hedging but risk management, and that these elements have the capacity to impact earnings, efficiency, control, visibility and compliance. We have been spending much of our time working with clients on the following treasury matters:

- Global working capital—marshalling excess via a variety of international treasury projects to maximize funds flow and visibility worldwide
- Tax-efficient structures for intercompany loans—usually related to the prior projects
- Visibility, controls, compliance and cash flow—enhancing both domestically and internationally
- Process review and modernization with emphasis on automation and best practices
- Policies and procedures for FX and investments—this is especially important to clients whose hedging and investing practices left them open for undue risk and earnings volatility in 2008-2009
- Review and consolidation of account structures—there's a new focus on risk ratings for the banking partners employed in those structures, both in the US and abroad

If any of these issues strikes a chord, we are always happy to discuss your situation. Give us a call or drop an email to info@sycamoreassociates.com.

copyright Sycamore Associates 2009

so you need an amendment...

By now, almost everyone has heard about the difficulties of today's credit markets— especially the challenges facing companies seeking credit from the senior bank markets. We have spent a great deal of time so far working on necessary amendments to existing deals (all successful, we might add) and have a few themes to share that may help your company navigate these stormy waters. We will keep it short and to the point:

- Be prepared to enter into a real negotiation, perhaps, depending on credit profile, on a bank–by-bank basis. Gone are the days of "routine" amendments. Even in the investment-grade space, it's best to be prepared with what elements can be negotiated. Have a "what can we give" list ready before entering the conversation.

- Capital counts. We have seen the most consistent request from bank groups center on the return of precious capital, for the obvious reasons that reducing capital employed enhances returns and attracts less regulatory capital on a going-forward basis. So, consider whether it's feasible to reduce the overall amount of the commitments, or if you should shorten the maturity of your agreement. These "gets" are meaningful for the banks and should express your company's willingness to deal in order to get what you need.

- Expect to reprice. Let's say that again: expect to reprice. No exceptions, no loopholes. But when you do, insist on understanding what is market for your credit profile and get a second opinion from your counsel or advisors who see lots of deals. We helped a client avoid an additional100bps this spring when the Agent proposed above-market pricing.

- A shorter maturity may be your friend. If you have visibility on an improving business model two years out or so, the odds that the markets afford a more attractive set of terms then are high. This is a time when going long for the sake of it is not likely to get the best deal in the bank markets.

- Consider alternative covenants. If fixed charge isn't working, which it isn't for many right now, consider some sort of working capital measurement coupled with leverage, or another liquidity gauge. This is a time to be creative. We have seen a few "old" tricks work in thorny covenant situations this spring.

Be calm, creative and constructive. You will be well positioned to get exactly what your company needs by prioritizing and staying flexible.

where in the world is sycamore?

Winifred Pinet this spring spoke on Capital Markets Volatility at several Cleveland meetings. Win's article "Cash is a Corporate Asset" was published by the AFP in the May issue of The Exchange, its monthly magazine.

Marcia Banks, in May, attended the IACPM meeting in Brussels, Belgium, where she moderated a panel discussion on credit portfolio management, attended by many international and US-based multinational banks. Ms. Banks also moderated a panel discussion on the current state of Loan Syndications at a conference sponsored by KeyBank in Cleveland, Ohio.

copyright Sycamore Associates 2009