Managing a Corporate Treasury Department

Session 1: Treasury Scope and Objectives

A Presentation to the

New York Cash Exchange

by

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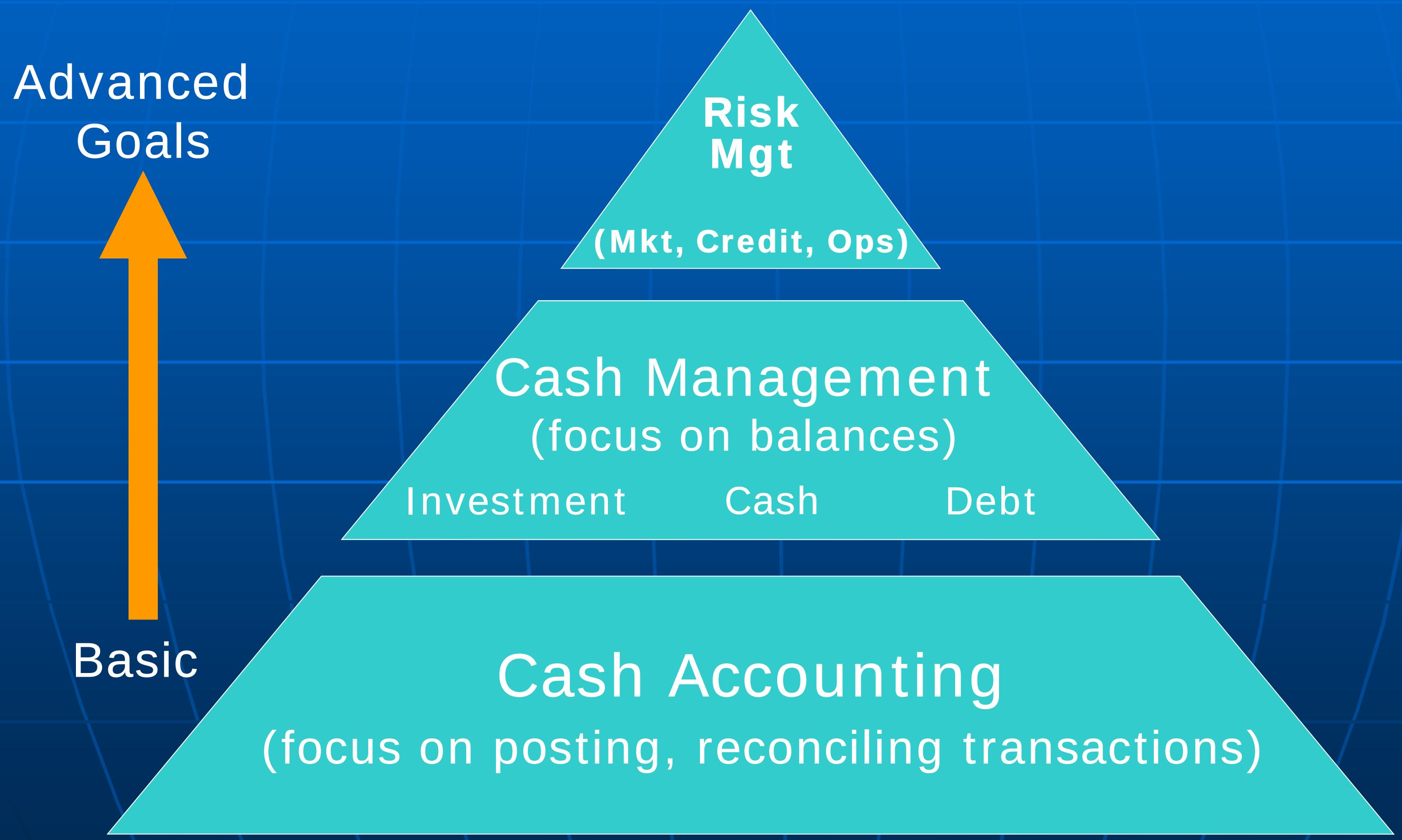
Agenda – Part 1

- The traditional role of corporate treasury
- Why treasury's scope needs to change
- Key policies and procedures for the modern treasury function
- Best practices for the modern global corporate treasury
- Making it happen – how to transition from traditional to modern (Session 2)
- Q & A, discussion

The Traditional Treasury

- Focused on Processing
- Resources devoted to repetitive tasks



The Traditional Corporate Treasury (3)

- Daily cash management operations
  - Obtain yesterday's bank transaction data, identify exceptions, update A/R and A/P records
  - Prepare today's cash worksheet, identify borrowing/investment levels, execute transactions
  - Heavy transaction processing workload
- Bank Relationship Management
  - Maintain lists of banks, contacts and accounts
  - Periodically review / negotiate credit facilities
  - Monitor activity / fees via account analyses

The Traditional Corporate Treasury (4)

- International Support
  - Execute FX spot and forward transactions
  - Assist foreign units to set up pools, netting, etc.
  - Managed as a separate unit within Treasury
  - Limited knowledge of tax impacts of treasury activities
- Capital Markets
  - Support CFO in negotiations for public debt issues
  - Limited knowledge of alternative markets / instruments
  - Intercompany borrowing opportunistic and uncoordinated
- Treasury personnel have limited experience
  - Treasury staff recruited from banking/cash/accounting background; mostly domestic, not involved in the business
  - Promotion usually internal; Treasury staff have low visibility and rarely move into non-financial functions

The Traditional Corporate Treasury (3)

- Bottom line
  - Treasury viewed as a processing (not strategic) unit; cost-center (not a value adding function)
  - Limited planning or policy responsibilities
  - Problems are solved rather than prevented
  - Highly dependent on spreadsheets, emails and multiple bank systems
    - Treasury systems not priority for corporate IT
    - No integrated views of global cash position or future liquidity needs (i.e. forecast)
  - Low headcount - “outgunned” by Controllers or other financial or operating units

Why Treasury needs to change (1)

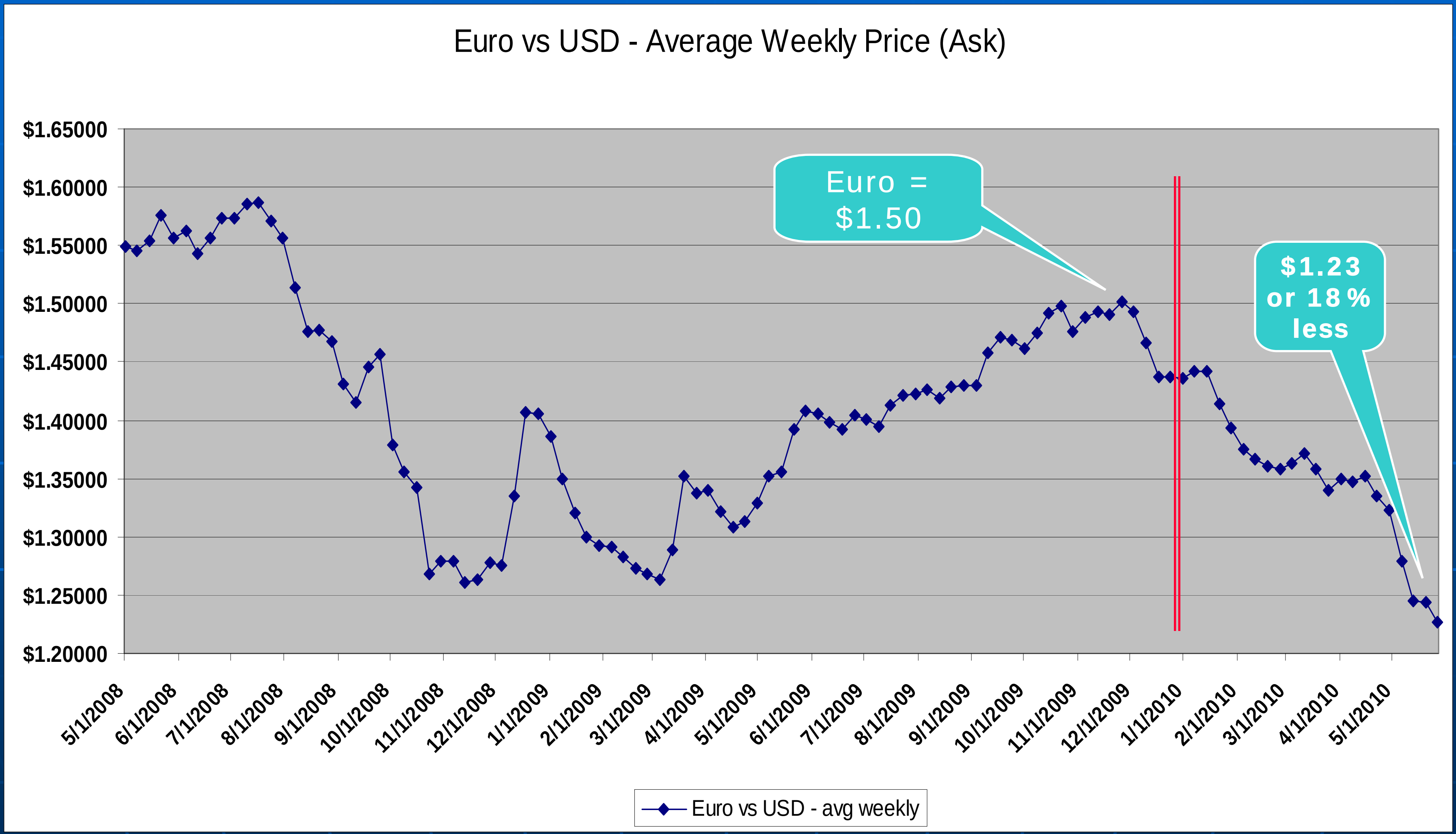
- External factors
  - Competitive nature of business – 24/7 demand for “global cash visibility” and liquidity alternatives to the capital markets (e.g. do I have enough credit?)
  - More interaction with key corporate customers – “my AP is your AR”; not all customers are profitable
  - More competitive/complex/unpredictable financial markets
    - Volatile FX and interest rates, leasing, ARS, credit crunch dislocations
    - More complex transactions - Derivatives expand the scope for pro-active management of FX, interest costs, commodities
  - Regulatory changes, e.g. financial market deregulation, FAS 133, IAS39, SARBOX, SEPA

Why Treasury needs to change (1a)

- Financial marks are volatile

	12 month max	12 month min	Spread Max/min (%)
$/Euro	1.502	1.227	18%
$/GBP	1.674	1.400	16%
LIBOR 1 month	.342	.229	149%
NYMEX oil	86.15	56.34	53%

Need for Change – Market Trends



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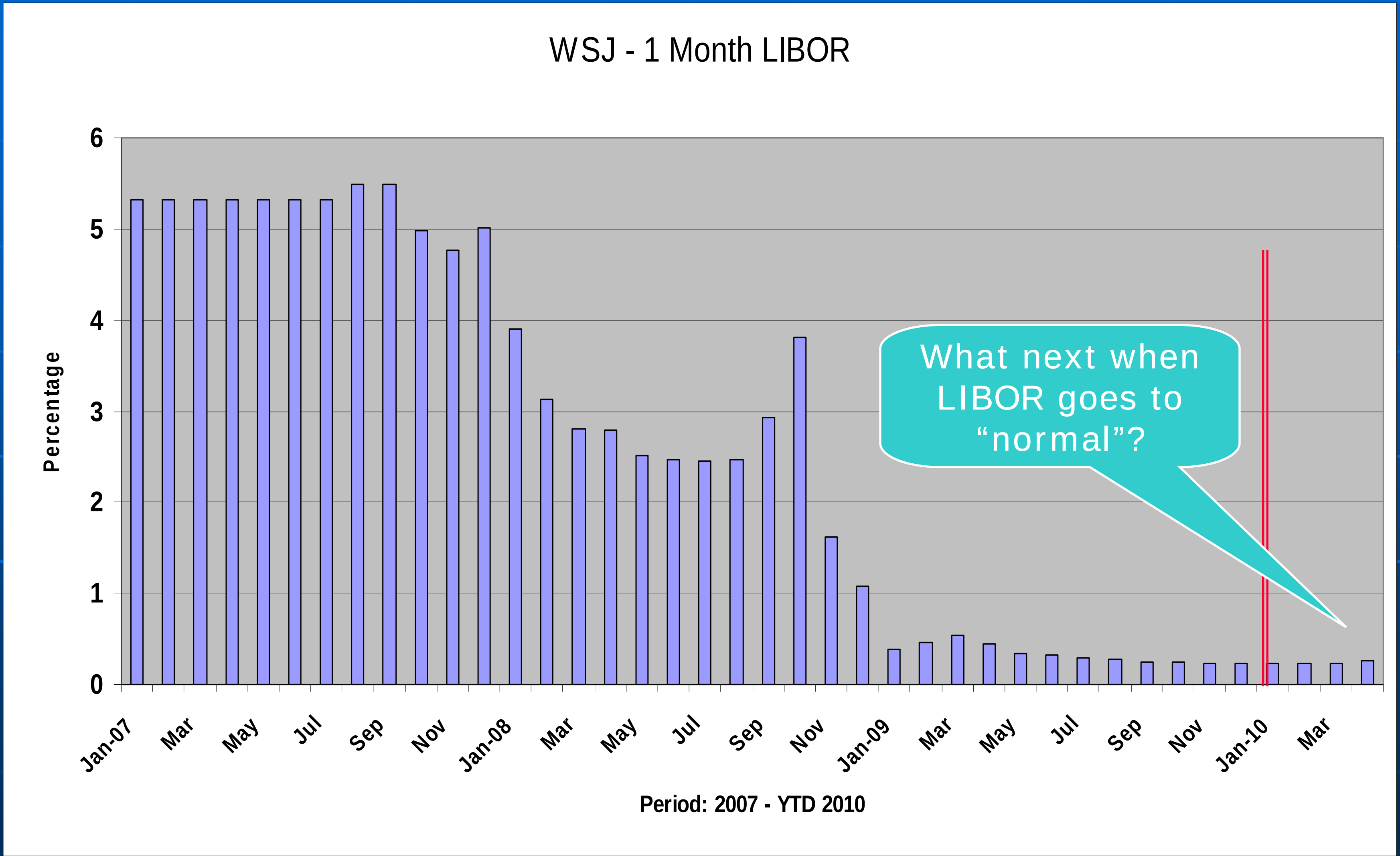
Need for Change – Market Trends



Why Treasury needs to change (2)

- Internal factors
  - International business and the associated FX risks have increased and became more visible
  - Greater management focus on liquidity and working capital management
  - Quality of a company's financial management is increasingly recognized as a key competitive factor
  - FX hedging programs developed skills that Treasury can apply to other risk management issues

Why Treasury needs to change (3)

- The environment that Treasury works in will continue to change rapidly and dramatically
  - Impact of global recession and the credit crunch will affect banks and capital markets for years
  - Changes to US corporate tax system expected
    - Increased US taxes on foreign earnings will require rethink of funding, transfer pricing and cash repatriation strategies
  - Use of technology will continue to expand
    - SWIFT, bank interfaces, integration with ERP systems
  - Manufacturing and new business opportunities will increasingly be outside US/Europe
    - Treasury must be able to support more diverse needs

Summary of the presentation

- So far
  - Where Treasury started from
  - Why Treasury needs to upgrade itself
- Next
  - We will develop a vision of the modern corporate treasury and the challenges for Treasury managers
  - Session 2 - we'll examine how Treasuries are making the transition

Overview of the Modern Treasury Function (1)

- Treasury should be a strategic unit that adds significant value to the corporation
  - Routine cash/banking transactions highly automated
  - Primary workload shifts from transaction processing to strategic analysis/decision making
  - Centralized global approach to funding/banking/FX
  - Major focus is on forecasting and future events
  - Becomes a focal point for risk management expertise
- Treasury is pro-active and visible in the company
  - Problem solving resource for global business units
  - Liquidity and debt management now seen as vital issues
  - Staff have broader career opportunities as they become knowledgeable about global operations and cash flows

Overview of the Modern Treasury Function (2)

- Policies Highly Visible
- Interactive Communications
- Plan, Actual & Forecast in Sync
- Functions & Systems integrated
- Performance Metrics in Place to Demonstrate Value

7 Key Activities of the Modern Treasury

1. Global oversight of financial assets/liabilities/risks
2. Maintain access to sufficient funding at all times
3. Risk management role expanded beyond FX/IR
4. Internal consulting and information resource for corporate management and business units
5. Reduce processing costs and bank charges
6. Prepare and analyze forecasts to enable better decisions on funding, hedging, pricing, investments
7. Actively participate in major company initiatives, e.g. strategic planning, IT, compliance, M&A

1. Global oversight role (i)

- Treasury has policy and oversight responsibility for management of all financial assets, liabilities and risk
  - Transaction execution may be decentralized, but treasury policy and strategy decisions are not
  - Manage treasury by functions, eliminating the traditional domestic vs. international split
  - Treasury must formulate, document, distribute and update corporatewide policies/guidelines,
    - liquidity management
    - FX/IR risk management
    - intercompany transactions and loans
    - bank selection and counterparty risk

1. Global oversight role (ii)

- Corporate Treasury has a control and oversight role over treasury activities at foreign business units:
  - Bank relationships and account structures
  - Cross-border liquidity management: Cash pooling, netting, intercompany loans
  - Foreign exchange risk management
  - Standardized (electronic) reporting
  - Forecasting: Cashflows, debt, FX exposures

1. Global oversight role (iii)

- Works effectively with other company units:
  - Operating
    - Enforces the use of standard market rates
    - Establish currency of billing rules for intercompany and third party trade transactions
    - Forecasts encourage liquidity needs to encourage focus on future business, not just accounting for activities that have already happened
  - Financial
    - Tax - Optimizes capital structure and after tax cost of funds
    - Controllers - Standardize rules for settlement of intercompany transactions
- Bottom line – More planning, less processing
  - Treasury is in the funding business
  - Resources best spent on future activities to control risk

2. Maintain access to funding

- Funding has suddenly emerged as a challenging issue for many companies
  - Traditional external funding sources now unreliable or “pricey”
    - Bank loans, CP, IPO, equity issues, long term bonds
    - Term loan waivers not routinely granted
  - Risk of shortfalls in sales volume and pricing
  - Minimal interest income on surplus cash
  - Counterparty risks now much more important
- Need to improve internal liquidity management
  - Tighter control of A/R and A/P
  - Centralize and utilize surplus cash more quickly

3. Scope/objectives of risk management

- Treasury must make itself the focal point for risk analysis and management within the corporation
  - Acquired FX/IR skills give Treasury a firm foundation to manage other market or credit risks e.g. commodities, employee option programs, “enterprise risk management”
  - Risk management is a key component of strategic planning
    - Treasury’s forward-looking orientation complements Controller’s “backward look” based on historical GL data
    - Senior management needs analysis of future P&L impacts
- Risk analysis and management is a sophisticated function
  - New SEC rule 33-9089 (Board must disclose its role in risk) will require more highly educated staff with quantitative skills
  - Support will require upgrades and utilization of specialized software

4. Treasury as an internal consulting resource

- Treasury can work with business units to:
  - Increase P&L by upgrading working capital mgt, applying improved techniques and benchmarks
  - Identify market exposures and hedging alternatives, and analyze cost/benefit strategies
    - Analyze FX impacts on product pricing strategies, e.g. currency of billing, fixed price lists
    - Hedge manufacturing costs, e.g. metals, energy, oil, sugar/cocoa/coffee etc.
  - Analyze customer credit risk and develop better customer financing programs

5. Treasury's focus on reducing operating costs

- How treasury can do more with less
  - External cost control
    - Rationalize banks and bank account structures - companies have too many accounts, which create excessive "maintenance" charges
    - Replace paper based services with electronic services e.g. EFT, check imaging, purchase or T&E cards
  - Internal cost control
    - Automate daily bank and cash operations - e.g. treasury workstation as single platform for cash, debt activities across multiple banks
    - Move to portals for managing FX or investments reducing need to process multiple paper statements, spreadsheets on FX contracts, etc
- Identify new ideas to increase liquidity / reduce risk
  - AR collections to increase funds in ?
  - AP disbursements to time funds out?
  - Intercompany settlements to reduce borrowings, FX needs?

6. Treasury's forward-looking orientation

- Treasury can add value by facilitating better financial and business decisions
  - Value of the company = NPV of <u>future</u> cashflows, so managing only current transactions is not protecting stockholder value
  - Reliable forecasts enable better liquidity management, e.g. borrow/invest with longer maturities
    - Identify and hedge FX exposures earlier, i.e. when they already exist but may not yet be booked
    - Avoid surprises and crises rather than having to manage them after they have occurred
- It is not all numbers
  - Bank relationships
  - Debt/ covenant compliance

7. Treasury as a pro-active corporate unit

- Treasury needs to interact within the company at least as much as with financial institutions
  - Works closely with Tax on global capital structures and cash repatriation strategies
  - Internal consulting and support role
  - Should be an active contributor to major corporate initiatives, e.g. ERP, M&A, SARBOX compliance, China strategy, XB factory moves
  - Provides important information to business units via treasury intranet

Best practices for the modern treasury

- Create clear written policies, updated regularly
- Define performance measurement criteria
  - "What gets measured gets managed"
    - Normal business concept (e.g. P&L, ROI, stock price)
    - Adopt measures of liquidity and risk (rarely attempted in corporate treasury today)
  - Benchmark treasury vs. peer companies
- Rotate staff between finance and business units
  - Have staff to visit principal business units at least annually, especially international
  - Require staff to follow a continuing education program

Overview of the Modern Treasury Function

- Policies Highly Visible
- Interactive Communications
- Plan, Actual & Forecast in Sync
- Functions & Systems integrated
- Performance Metrics in Place to Demonstrate Value

Making it happen

- Translating the vision into reality
  - Step 1 - Start with the most important
  - Top 5 from FECG's "Treasury Issues 2010" survey of 430 companies:

Activity (1 to 5 Scale: 1 = high)	**Sales > $1Bn**	**Sales < $1Bn**
Improve Cash Forecasting	1.9	2.2
Act as Internal Consultants	2.1	3.0
Improve Corporate Liquidity	2.2	2.7
Increase Treasury Visibility	2.3	3.1
Manage Working Capital	2.3	2.5
Role in Strategic Plan	2.7	2.6
Optimize Capital Structure	2.4	2.6