ANALYSING TREASURY PERFORMANCE case study on CRH plc

IACT BRIEFING

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ANALYSING TREASURY PERFORMANCE

A. BACKGROUND

B. AIMS

- **AIM 1: to explore treasury management techniques on cash/debt.**
- **AIM 2: to analyse metrics of well-run companies – the example of CRH plc.**
- **AIM 3: learning issues.**

A. BACKGROUND

CRH plc: a FTSE 100 & Fortune 500 company, is a diversified international building materials group, headquartered in Ireland. Since the merger of Irish Cement and Roadstone in early 1970s (CRH stands from Cement Roadstone Holdings), it has expanded organically and by acquisition to become one of the sector's global leaders and the consistent top company in Ireland by value of capitalisation (€11.1bn in the end of 2012).

CRH employs appr.76,000 people at over 3,600 locations in 35 countries worldwide.

AIM 1: to explore treasury management techniques of the availability of cash & debt.

1.1. General Priorities of a Treasury Department (within set policy guidelines):

1. **Security management**:
   a) financial assets & liabilities, incl.investment & loan strategy
   b) risk management cover (FX, interest rate, commodity, counterparty/CDS limits, ST v. LT risk cover, forecasting)
   c) separation of duties (manual procedures, SOX tests)
2. **Liquidity & cash management:**
   a) unrestricted accessibility of cash positions, incl.by currency
   b) accurate forecasting to maximise cash returns
   c) allocating financial assets efficiently
3. **Performance management:**
   a) maximise yields
   b) minimise costs
   c) concentration of expertise

1.1.1. Priority 1: Security management

a) financial assets & liabilities (investments & loans):

i) overview net cash positions by maturity & currencies

ii) select investment & borrowing strategy to execute in appropriate markets, incl. issues on credit limits, mix of bank (cost of debt) & capital market (cost of equity) funding.

b) risk management cover (FX, interest rate, commodity, counterparty/CDS, forecasting analysis, etc):

i) understand the risk exposures (risk matrix)

ii) establish risk policy & strategy

iii) create & manage set counterparty credit limits (CDS levels, current positioning, prior relationship)

1.1.2. Priority 1: Security management, continued

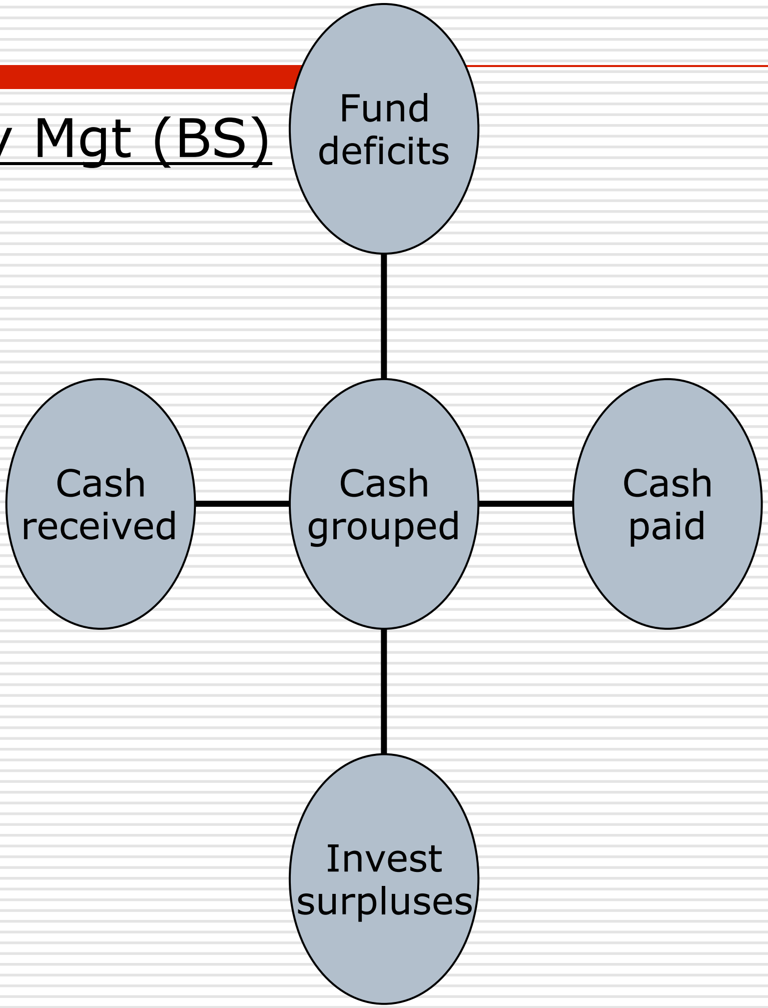
iv) treasury metrics for regular overview:
- qualitative commentary of 3-5 main industry events
- FX, interest rate and Stock Markets positions
- sector's share prices, ratings and capitalisation
- counterparty share prices, ratings and capitalisation
- selected countries review and ratings
- graphs on share prices, Stock Market, FX and interest rates, 10Y country bonds, yield curves of certain FX/ commodities, interest costs v. average debt levels
- banking costs (interest rates, upfront, commitment, utilisation, IBOR, cash pool and other fees)

c) separation of duties (derived from bank deal rooms):
"Front office": dealing tasks and decision-making
"Middle office": checking and reconciling on Front office tasks
"Back office": settlement and accounting

1.2.1. Priority 2: Liquidity & cash management

Liquidity Mgt (BS)

Cash
Mgt
(flows)



1.2.2. Priority 2: Liquidity & cash management, continued

a) unrestricted accessibility of cash positions
b) accurate forecasting to maximise cash returns
c) allocating financial assets efficiently

a) unrestricted accessibility of cash positions:

i) efficient mgt of cash in- & out-flows (i.e. optimise payment methods of transmission & WCap.mgt, ST mgt of cash, cashpooling to min.transaction & interest cost)

ii) establish net cash/debt requirements in each currency (reliable and speedy cash information)

iii) opportunities to sweep and hold cash in various bank accounts/locations (segregation of cash flows)

1.2.3. Priority 2: Liquidity & cash management, continued

b) accurate forecasting to maximise cash returns (ACT v FC)

i) comprehensive ST and rolling maturity forecast, by category & currency: management input to predict future short & long positions & assess resources' use.

ii) accelerate collections: integrate internal systems & improve sales projection quality & mgt focus.

iii) control payments: on time or earlier if % less. Liquidity mgt focuses on meeting cash obligations.

1.2.4. Priority 2: Liquidity & cash management, continued

c) allocating financial assets efficiently, i.e. asset financing options to release cash from WCap:

- factoring: sell receivables (with or no-recourse)
- invoice discounting: borrow on receivables as collateral
- vendor finance: manufacturer sets up VF plan
- securisation: sell consolidated debt, secured by assets (receivables, stock, PPE, intellectual) as SPV, ie. bonds
- leasing: optional uses of assets (IAS 17 to be replaced)

1.3.1. Priority 3: Performance management

a) maximise yields:

- regular market overview of reputable players
- focus on constructive banking relationships
- use of derivatives for operational/financing purposes

b) minimise costs

- "Cash-pooling" involves a Pool Leader set to manage in a concentration of bank accounts, a mix of cash positions/currencies/interest rates/credit limits, as applicable by the bank. Interest rates are then recharged to participating bank accounts, as ICO transfers.

c) concentration of expertise/economies of scale

- cost v profit centre
- buy/sell bulky liabilities/assets for stronger negotiation

AIM 2: to analyse metrics of well-run companies – the example of CRH plc.

2.1. CRH plc Annual Report 2011.

Finance Review highlight:

"The combination of strong debt metrics, significant liquidity and a well-balanced profile of debt maturities over the coming years means that CRH continues to have one of the most flexible balance sheets in the sector".

2.2. CRH plc Annual Report 2012. Finance Review highlight:

"The Group remains in a very strong and flexible financial position with €1.8bn of cash, cash equivalents & liquid investments together with €1.8bn of undrawn committed bank facilities. Year-end cash balances would cover all debt maturities in 2013 and 2014".

2.3. Key Financial Performance Indicators (Finance Review extract)

Year-End	2012 €m	Mov't #	Mov't %
1. EBITDA	1,640	-16	-1%
Revenue	18,659	578	3%
EBITDA margin	8.8%	-0.4%	-4%
2. Operating profit	845	-26	-3%
Revenue	18,659	578	3%
Operating profit margin	4.5%	-0.3%	-6%

2.4. Key Financial Performance Indicators (Finance Review extract), continued

Year-End	2012 €m	Mov't #	Mov't %
3. EBITDA	1,640	-16	-1%
Net Interest	289	32	12%
EBITDA / Interest cover	5.7x	-0.7x	-12%
4. Net Debt	2,964	-519	-15%
Total Equity	10,573	-10	-0%
Net debt as % of equity	28.0%	-5%	-15%

2.5. Extract from Note 24: Interest-bearing Loans and Borrowings

Maturity profile of loans and borrowings and undrawn committed facilities

At 31.12.12	Loans & Borr. €m	PY Mov't €m	Undrawn fac. €m	% facilities / loans
Within 1 Y	676	157	150	22%
1 – 2 Y	934	330	-	0%
2 – 3 Y	351	(606)	40	11%
3 – 4 Y	1,316	960	1,626	124%
4 – 5 Y	6	(1,351)	-	0%
5+ Y	1,632	443	1	0%
Total	**4,915**	**(67)**	**1,817**	**37%**

2.6. What are covenants?

- Bank facilities and certain debt issued require the maintenance of specified financial covenants (pre-agreed levels of financial ratios and credit rating compliance).

- Non-compliance with specified covenants gives the lenders the right to terminate the facilities and demand early repayment of any sums drawn there under, thus altering the maturity profile of the company's debt and liquidity.

2.7. Covenant Thresholds for CRH plc

Year-End	2012 €m	Mov't #	Mov't %
1) Interest cover:			
PBITDA adjusted	1,658	17	1%
Net interest excl.non-debt	256	33	15%
Times (min. 4.5x)	6.5x	-0.9x	-12%
2) Net Worth:			
Total equity	10,573	-10	0%
Deferred tax liabilities	1,301	-191	-13%
Total (min. €5.1bn)	11,874	-201	-2%

2.8. Credit Ratings: what are they?

1. Expressions of opinion about credit risk
2. Forward looking
3. Comparable across different sections and regions
4. Do not indicate investment merit
5. Not absolute measures of default probability

2.9. Issue Credit Ratings for CRH plc by Standard and Poor (S&P): Ratings since Mar-10

Long Term (2 years+):

"BBB+" Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.

+ / - Each sign shows the relative standing within the major rating categories.

BBB- Considered the lowest investment grade by market participants.

Outlook: potential direction of a rating over the intermediate term, "Stable" Rating is not likely to change (6m – 2y).

Short Term (<6m):

"A-2" is susceptible to adverse economic conditions, however the obligor has satisfactory capacity to meet its financial commitment

2.10. Statement of Cash Flows (IAS 7)

2.10.1. IAS 7 was created under the name of “Statement of Changes in Financial Position” in 1977. Since its adoption in 1994, IAS 7 requires all entities conforming with IFRS to include the Statement of Cash Flows as an integral part of its financial statements.

2.10.2. The impact of the recession to the restricted availability of cash and the expense associated with securing funds, are forcing us to be vigilant about the nature and timing of cash flows. The way that our organisations manage their liquidity is now on a constant radar by internal and external stakeholders.

2.11. Consolidated Statement of Cash Flows (Annual Report 2012)

	2012 €m	Y2Y €m	Y2Y %
Cash flows from operating activities			
Profit before tax	674	(37)	(5)%
Finance costs (net)	289	32	12%
Group share of associates' results	112	154	(367)%
Profit on disposals	(230)	(175)	318%
Group operating profit	845	(26)	(3)%
Depreciation charge (incl. impair.)	748	6	1%
Amortisation of intangible assets (incl.impair.)	47	4	9%
Share-based payment expense	14	(7)	(33)%
Other movements	(152)	(43)	39%
Net movement on WC and provisions	(75)	136	(64)%
Cash generated from operations	1,427	70	5%

2.12. Consolidated Statement of Cash Flows (Annual Report 2012), continued

	2012 €m	Y2Y €m	Y2Y %
Cash generated from operations	1,427	70	5%
Interest paid (including finance leases)	(264)	(25)	10%
Decrease in liquid investments	(4)	(8)	(200)%
Corporation tax paid	(134)	(38)	40%
Net cash inflow from operating activities	1,025	(1)	0%

2.13. Consolidated Statement of Cash Flows (Annual Report 2012), continued

	2012 €m	Y2Y €m	Y2Y %
Cash flows from investing activities			
Proceeds from disposals (net of cash disposed)	751	309	70%
Interest received	19	(13)	(41)%
Dividends received from associates	18	(2)	(10)%
Purchase of property, plant and equipment	(575)	1	0%
Acquisition of subsidiaries and JVs (net of cash)	(420)	87	(17)%
Other investments and advances	(32)	(8)	34%
Deferred and contingent acquisition consid.paid	(30)	(9)	43%
Net cash outflow from investing activities	**(269)**	**365**	**(58)%**

2.14. Consolidated Statement of Cash Flows (Annual Report 2012), continued

	2012 €m	Y2Y €m	Y2Y %
Cash flows from financing activities			
Proceeds from exercise of share options	16	10	167%
Acquisition of non-controlling interests	(2)	9	(82)%
Increase in loans, borrowings and fin.leases	502	401	397%
Net cash flow arising from derivatives	13	76	(121)%
Repayment of loans, borrowings and fin.leases	(419)	133	(24)%
Dividends paid to equity holders of the Company	(362)	(52)	17%
Dividends paid to non-controlling interests	(5)	4	(44)%
Net cash outflow from financing activities	**(257)**	**581**	**(69)%**

2.15. Consolidated Statement of Cash Flows (Annual Report 2012), continued

	2012 €m	Y2Y €m	Y2Y %
Increase in cash & cash equivalents	**499**	**945**	**212%**
Rec. of open. to clos. cash & cash equiv.			
Cash and cash equivalents at 1 January	1,295	(435)	(25)%
Translation adjustment	(26)	(37)	(336)%
(Decrease)/increase in cash & cash equiv.	449	945	(212)%
Cash and cash equivalent at 31 December	**1,768**	**473**	**37%**

2.16. Consolidated Statement of Cash Flows (Annual Report 2012), continued

	2012 €m	Y2Y €m	Y2Y %
Reconciliation of opening to closing net debt			
Net debt at 1 January	(3,483)	(10)	0%
Decrease in liquid investments	4	8	(200)%
Debt in acquired companies	(42)	5	(11)%
Debt in disposed companies	108	58	116%
Increase in loans, borr. & fin.leases	(502)	(401)	397%
Net cash flow arising from derivatives	(13)	(76)	(121)%
Repayment of loans, borr. & fin.leases	419	(133)	(24)%
Increase/(decrease) in cash & cash equiv.	499	945	(212)%
Mark-to-market adjustment	9	27	(150)%
Translation adjustment	37	96	(163)%
Net debt at 31 December	**2,964**	**519**	**(15)%**

2.17. Extract from Note 21: Analysis of net debt and Note 24: Interest-bearing Loans and Borrowings

	2012 €m	Y2Y €m	Y2Y %
Cash at bank and in hand	623	194	45%
Investments (ST deposits)	1,145	279	32%
Cash and cash equivalents	**1,768**	**473**	**36%**
Liquid investments	**31**	**2**	**7%**
Bank overdrafts	(60)	4	6%
Bank loans	(68)	87	56%
Leases	(17)	8	32%
Bonds & private placements	(4,676)	(56)	(1)%
Other	(94)	24	20%
Loans & borrowings	**(4,915)**	**67**	**1%**
Net derivatives	**152**	**(23)**	**(13)%**
Group net debt	**(2,964)**	**519**	**(15)%**

2.18. Consolidated Income Statement (condensed, Annual Report 2012)

	2012 €m	Y2Y €m	Y2Y %
Revenue	**18,659**	**578**	**3%**
Cost of sales	(13,562)	(383)	3%
Gross profit	5,097	195	4%
Operating costs	(4,252)	(221)	6%
Group operating profit	**845**	**(26)**	**(3)%**
Profit on disposals	230	175	318%
Profit before finance costs	**1,075**	**149**	**16%**
Net finance costs	(289)	(32)	13%
Group share of associates' PAT	(112)	(154)	(367)%
Profit before tax	**674**	**(37)**	**(5)%**
Income tax expense	(120)	(6)	5%
Group profit for the financial year	**554**	**(43)**	**(7)%**

AIM 3: learning issues

3.1. Cash and debt are critical assets & liabilities to be managed prudently (interest %=>PBT).

3.2. Statement of cash flows provide us with an overview from the reported profit to the balance sheet cash & cash equivalents by type of flows. Further analysis of material items.

3.3. Focus review of debt in terms of type, ratios, maturity and benchmarks (i.e. ratings impact).

3.4. Treasury management techniques to manage actively available cash and debt balances.

3.5. Continuous improvements/communication.

3.6. Aim at ethical & concise treasury analysis to match the needs of the organisation.

Upcoming Events

Irish Association of Corporate Treasurers

- **21st May – Breakfast Meeting, Dublin – Salmon Software/Kingspan**

  14th June – Golf Outing – Dun Laoghaire Golf Club

  11th October – Annual Dinner – Shelbourne Hotel

- **20th November – Corporate Treasury & Cash Management Conference - Gibson Hotel**