ACME INTERNATIONAL CASE STUDY

"One of the things that I liked about Acme – and studied hard before coming in – was its ability to generate cash. The company had great businesses. They were in the right sectors. The foundation was very strong."

– Chairman and Chief Executive, Acme International

In 2006, Acme International was facing an epic liquidity crisis. The US-based industrial conglomerate with $36 billion in global sales and presence in 90 countries worldwide faced a real threat of having to declare bankruptcy.

Already highly regarded in the industry as a turn-around specialist, newly hired Global Treasurer was always up for a challenge. Quickly shelving thoughts of taking a break, she agreed to join Acme's new management team in fighting to save the company. At an Acme press conference, Global Treasurer announced,

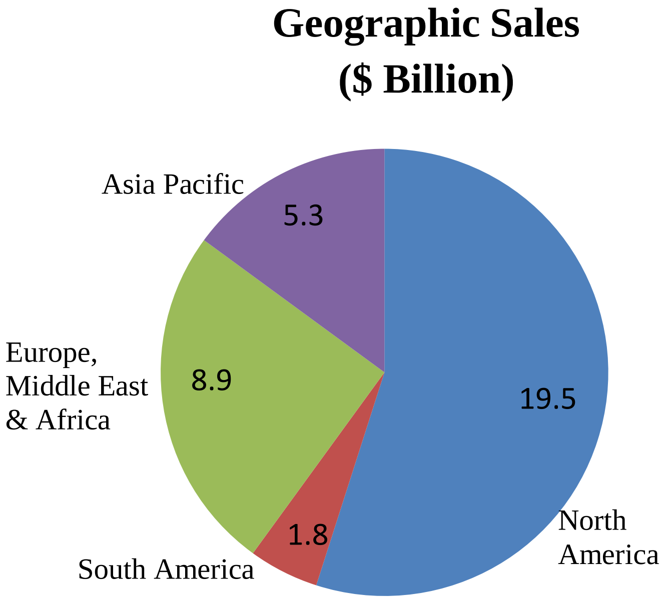
> *"I believe that Acme, with its solid operating businesses and strong market positions, has the potential to be one of the most exciting companies of the future."*

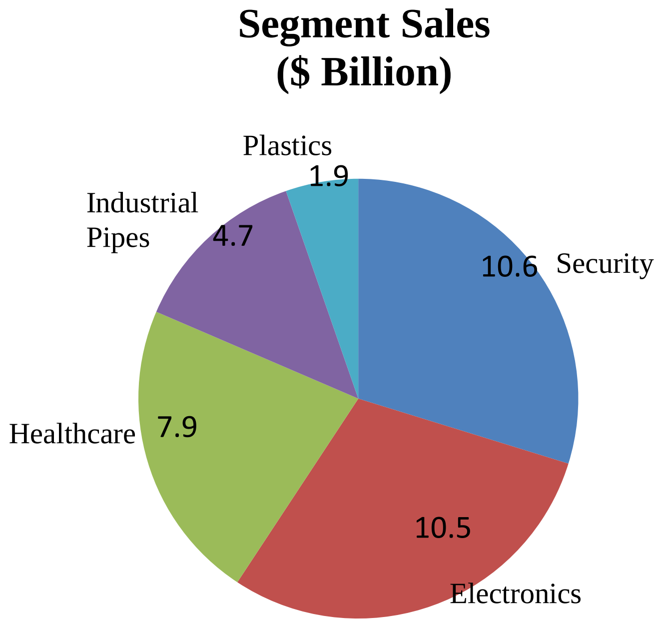
Company History and the 2006 Liquidity Crisis

Over the past decade, Acme had grown rapidly through acquisition, snapping up more than 200 firms and creating a highly complex conglomerate in the process. By 2006, Acme had become one of the world's largest and most diverse companies, producing a wide variety of products. As illustrated in Exhibit A, Acme was structured into five business segments, each of which was bigger than most of their competitors' entire companies.

Exhibit A

Acme's Sales by Geography and Divisions (2006)





Acme’s acquisition strategy had been intended to produce a “recession-proof” conglomerate through industry and geographic diversification. Instead, the acquisition spree led to a build-up of debt and resulted in expensive goodwill write-downs. There were also concerns that Acme’s complex structure had become impossible for headquarters to manage effectively, while at the same time masking Acme’s true financial position. With analysts and investors unable to discern whether Acme’s reported profits came from real growth or financial manipulations, Acme’s stock had lost more than two-thirds of its value since the start of 2006.

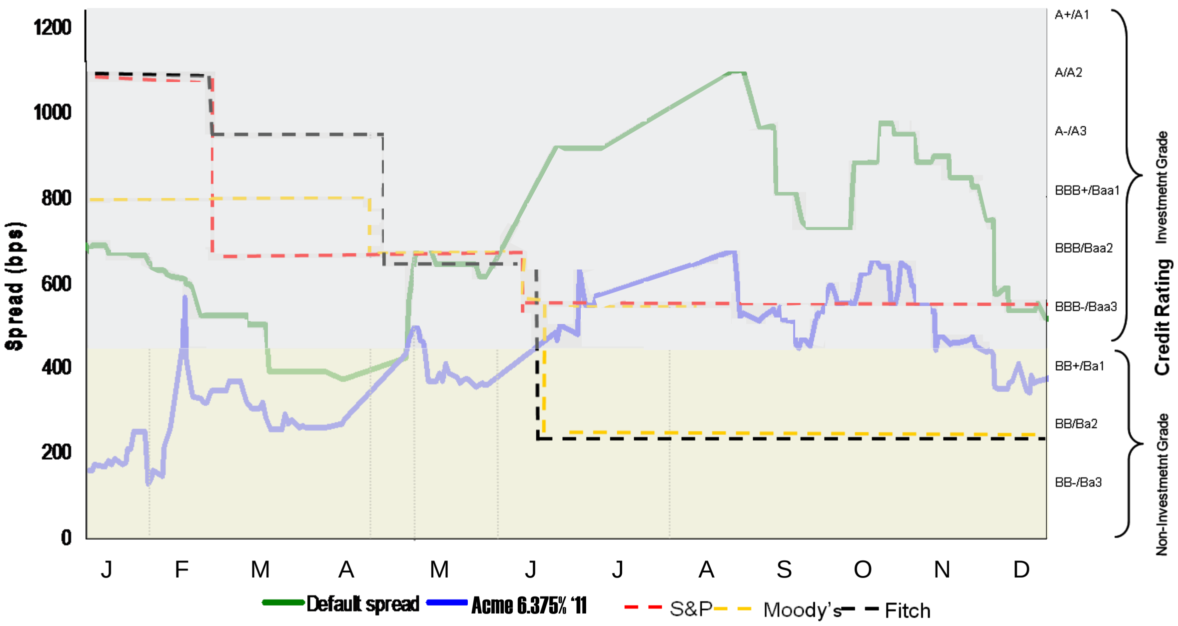
By the time the Global Treasurer moved into her new Acme office, Acme was facing an overhang of $11.2 billion of debt maturing in 2007. More worryingly, she noted that $6.8 billion of it was due in the first quarter of 2007. With little time to settle in, Global Treasurer plunged straight into resolving Acme’s liquidity crunch. Despite having approximately $6 billion of cash and short-term investments on its balance sheet, Acme’s cash was locked up in myriad subsidiaries scattered across the globe – and essentially inaccessible at the corporate level where it was critically needed. In the past, Acme had effortlessly raised funds through conventional debt refinancing means. However, ongoing investigations arising from a fraud allegation involving senior management had attracted media coverage worldwide, preventing the company from raising capital in a similar fashion. In a race against time, the Global Treasurer struggled to secure financing through alternative channels.

Fighting the Fire – the Immediate Response

Despite the drama at headquarters, Acme’s fundamental business remained strong with its businesses generating positive net cash flows of $776.3 million and its financial leverage (assets/equity) seemingly healthy at 2.7 at the end of 2006. However, rating agencies, concerned about how the Acme management was managing its debt maturity commitments, had continuously downgraded its bond rating throughout the year. For example, S&P had rated Acme’s bonds “A” in January 2006 but by June 2006, the rating had plummeted to “BBB-”. Moody’s and Fitch went a step further and rated Acme’s bonds “BB/Ba2”, which were considered non-investment grades. Exhibit B shows Acme’s credit rating and default spreads throughout 2006.

Exhibit B

Acme Credit Rating and Default Spreads in 2006



Strategic Reform for the Long Term – Migrating to a Centralised Treasury System

Acme's immediate liquidity problem was resolved by issuing convertible debt in August 2006, arranging for credit facility from partner banks, and selling assets. To ensure Acme would not face a repeat crisis in the future, Global Treasurer turned her energy inwards and focused on centralising Acme's Treasury division, which had always been completely decentralised.

Through implementing a global cash management structure and having Acme International Finance Company, the issuer of external debt, as the beneficial owner of a greater percentage of cash holdings, Treasury would have greater visibility and control over cash in the company. Restructuring to optimise liquidity would require Acme's companies to break away from legacy structures, even if it would be met with internal resistance. Given Acme's complexity and challenges, Global Treasurer concluded that long-term benefits would outweigh the short-term pain of centralising the Global Treasury function. In a meeting with Treasury staff, she outlined her objectives for the department:

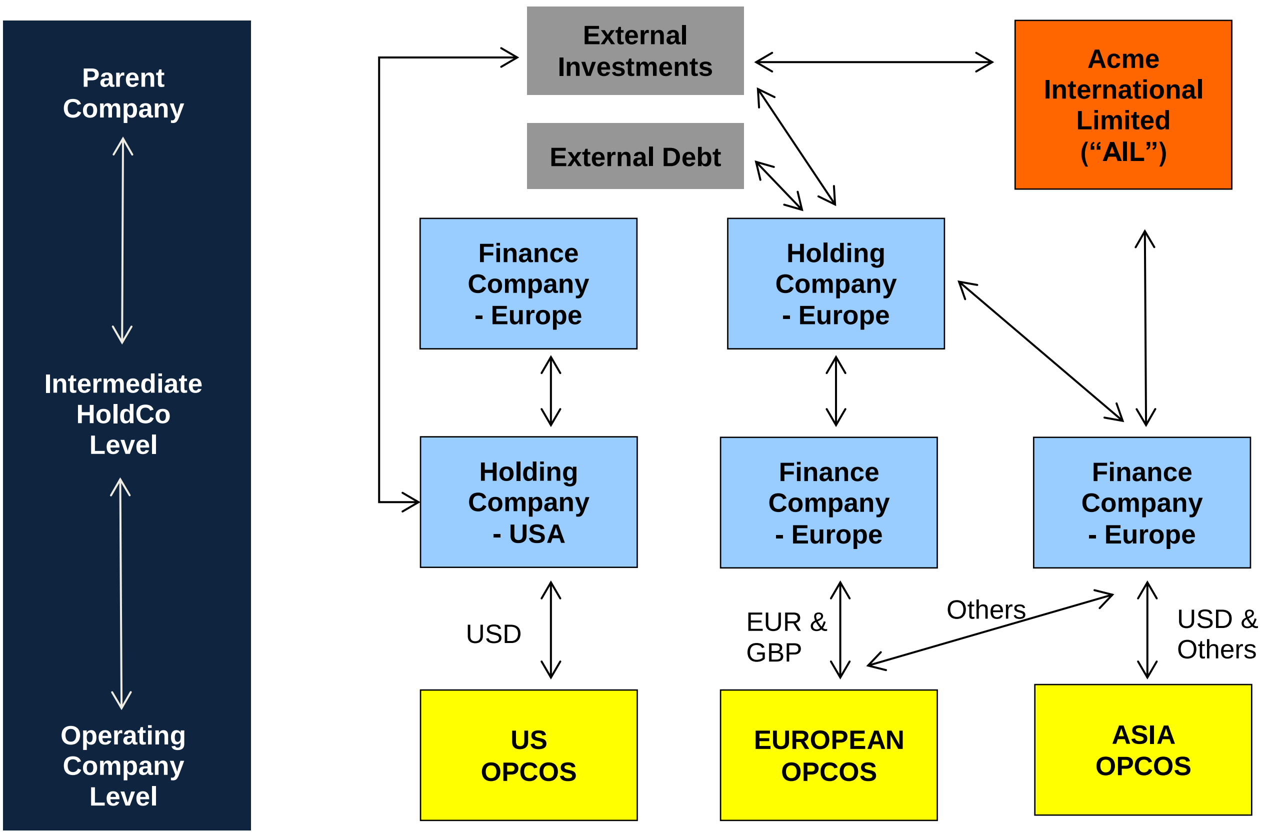
- Ensure adequate liquidity
- Obtain visibility of cash balances
- Have cash available when and where we need it
- Control and protect important assets
- Improve investment performance

After discussing with Corporate Tax, Global Treasurer unveiled a new corporate cash management structure. In the new structure, Treasury was divided into three distinct layers: Parent, Intermediate Holding Company, and Operating Company (subsidiaries worldwide). The purpose of the European holding companies was to own most of the international subsidiaries in a tax-efficient manner. Europe's strategic location from a time zone perspective allowed overlapping working hours with Asia and the Americas. Also, certain European countries provided tax incentives for managing international Treasury activities from there. Global Treasurer wanted to leverage that structure for Treasury operations by concentrating cash from across all global subsidiaries in various currencies at the intermediate level in Europe. Acme's planned global cash management structure is shown in Exhibit C.

With the goal of migrating banking services to key relationship banks, the team conducted a country-by-country analysis of their bank networks and found that Acme had almost 200 bank relationships for its 2,000 legal entities across the globe. Moreover, as of 2006, Acme Headquarters had visibility of its subsidiaries' bank account balances only at each quarter-end, when amounts were submitted via an in-house web portal. Given their findings, the Treasury team started to map out a process for centralising cash to be executed by each geographic region. The Global Treasury mandate was clear: centralise the subsidiary cash, obtain visibility of cash balances, and have cash available when and where it was needed.

Exhibit C

Planned Global Cash Management Structure



Acme in Asia – Business Overview

In 2006, Acme's Asia Pacific operations accounted for approximately 15% of Acme International's annual revenue (Exhibit D highlights revenue breakdown by country). This figure had steadily risen in the past few years, notably due to expansion in three business segments – Electronics, Healthcare, and Security.

Exhibit D

Acme International – Asia Revenue Breakdown, FY 2006

Country	Revenue ($ Million)
Australia	1,200
China*	1,000
Japan	1,500
Korea	500
Hong Kong	200
Singapore	150
India	150
Taiwan	150
Malaysia	150
New Zealand	150
Thailand	50
Indonesia	50
Philippines	50
Vietnam	40
Asia Total	**5,340**

*80% of Acme International's revenue in China is attributable to Acme Electronics (China)

Acme Electronics supplies a gamut of electronic products, from circuit protection devices to switches to cables and wiring, for use in multiple industries. Electronics operations in Asia was supported by 15 manufacturing sites in China and one in Thailand, which sourced raw materials from suppliers based in and out of their respective countries. With a huge business in China, Acme's Electronics division CFO wanted to improve China's 30-day DPO (Days Payables Outstanding) and make it closer to the Asia average of 42 days. The CFO felt that approximately 25% of their suppliers are stretched on working capital requirements.

Output from the Chinese and Thai factories was sold on 120 days' credit term to large, investment-grade original equipment manufacturers ("OEMs"), many of which were headquartered in developed countries. Sales by Acme Electronics (China) to these OEMs totalled $500 million in 2006. While the company had an ambitious plan to grow its business with large OEM buyers, the divisional CFO wondered how to enhance relationship with these important customers while at the same time managing customer concentration risk. Selected operating metrics for Acme Electronics Asia and China are depicted in Exhibits E and F, respectively.

Exhibit E

Operating Metrics for Acme Electronics (Asia), FY 2006

Days Sales Outstanding (“DSO”)	70
Days Payable Outstanding (“DPO”)	42
Days Inventory Outstanding (“DIO”)	82
Net Trade Cycle	110

Exhibit F

Operating Metrics for Acme Electronics (China), FY 2006

Revenue	$800MM
Cost of Goods Sold (% of Revenue)	65%
Days Sales Outstanding (“DSO”)	120
Days Payable Outstanding (“DPO”)	30
Days Inventory Outstanding (“DIO”)	80
Net Trade Cycle	170
Cost of Short Term Debt	LIBOR + 100 bps [1, 2]

1. LIBOR = 3.00%
2. Cost of debt for “A” rated OEMs = LIBOR + 50 bps

Acme Healthcare provides surgical supplies and diagnostic devices to hospitals, clinics, and laboratories. Healthcare products sold in Asia were mainly on letter-of-credit (“LC”) basis, and Acme was a frequent recipient of LCs from buyers in emerging markets, where a bulk of revenue was derived.

Acme’s Security division provides state-of-the-art access management solutions, video surveillance technology, as well as alarm monitoring systems to safeguard residential and commercial properties. In its key Asian markets, Acme Security adopted a direct selling strategy via a large distribution network. Australia is one such market whose distributor sales amounted to $500 million in 2006. Distributors had played a strategic role in increasing Acme Security’s product penetration, but the company was worried that their market share would decrease if and when these distributors decided to promote competitors’ products. To accelerate cash flow and to manage counterparty risk on its portfolio of distributors, Acme had previously availed a credit facility under an accounts receivables securitization program and credit-enhanced its receivables. In the past 3 years, the division had prided itself on maintaining an excellent track record in bad debt management, keeping dilution impressively low and delinquency rate at only 0.25%. Their next step would be to improve, among other metrics, DSO ("Days Sales Outstanding") of their Australia security business from 45 days to a target 30 days.

Acme Asia Treasury – Decentralized Treasury System Amidst a Complex Regulatory Environment

Asia's Treasury team, led by the Regional Treasurer, was tasked to set up Acme's new centralized regional treasury structure and processes. With over $5 billion of sales in the region, presence in 14 countries, and 225 active legal entities, the only thing in common appeared to be that they were all under the Acme umbrella. Regional Treasurer conducted a quick "as is" analysis of the existing state of Asia Pacific Treasury. Within a few days the status was painfully clear – poor visibility and control on cash balances was widespread across all subsidiaries (see Appendix 1 for Acme's average cash balance by country in Asia Pacific). Electronic banking was necessary to remotely manage bank accounts from Regional Treasury based in Singapore. To the Regional Treasurer's surprise, however, he found that e-banking was a foreign concept in many local banks in Asia Pacific countries. Exhibit G depicts the state of Acme's Asia Pacific Treasury in 2006.

Exhibit G

State of Acme's Asia Pacific Treasury in 2006

- Decentralized
- 150+ banking relationships
- 1600+ bank accounts
- Different pricing across entities
- Inconsistent banking service
- Sub-optimal cash utilization
- Minimal cash visibility and control
- Scarce usage of e-banking
- No Treasury Management System

Regional Treasurer faced additional internal and external challenges as Acme's organisation in Asia Pacific was particularly complex. The regulatory environment in the 14 countries in which Acme had presence varied greatly. While Australia, Hong Kong, Japan, New Zealand and Singapore had unrestricted markets, many others, including the large markets in China, India, Malaysia, South Korea and Taiwan, had restrictive regulatory environments. Aware that negotiating with the regulatory bodies in each of these countries would be time-consuming and complex – China alone had three different government bodies overseeing capital and monetary flows –, Regional Treasurer faced tremendous pressure to meet the timeline for treasury centralization set by Global Treasury.

Technological issues had also cropped up as the Asia Pacific Treasury team hunkered down for the long and arduous task ahead. As a start, none of Acme's subsidiaries enjoyed autoconnectivity with any of their Headquarters' banking partners. At a recent banking conference, however, the Global Treasury team had learned of a possible solution that would enable better connectivity between banking and ERP systems with regards to payment instruction and reconciliation.

Speaking of systems, Acme's Asia Pacific Treasury team had discovered that each business unit had its own ERP system (see Exhibit H). There were even several instances where different ERP systems were found within an individual business segment! In addition to ERP systems, Sungard Quantum (a treasury management system, "TMS") was used centrally by Headquarters but not deployed to the businesses. As Regional Treasurer's team dug deeper, they uncovered further startling information: there were more than 150 banking relationships and 1,600 Acme bank accounts in Asia, which resulted in widely varying pricing across its entities. Inconsistent banking services also led to sub-optimal cash utilisation and minimal cash control and visibility. Accustomed to operating independently and free from "headquarters interference", Acme's senior managers in Asia Pacific balked at having to implement the new systems and processes. In order to convince this management team as well as local financial controllers of the benefits of implementing the strategic Treasury solution, Regional Treasurer personally journeyed to over 60 locations to gain their buy-in.

Exhibit H

ERP Systems used by Business Segments

Business Segment	ERP System Used
Security	Baan
Electronics	SAP
Healthcare	JD Edwards
Industrial Pipes	Oracle
Plastics	(Legacy System)

Note: Consolidation of the various ERP systems for financial reporting purposes occur at Headquarter level using Hyperion

Exhausted after months of travelling to all corners of the region and countless meetings, Regional Treasurer still had not found solutions to overcome regulatory challenges in China, Malaysia and Korea, the major roadblocks to successful completion of Acme's Asia Pacific Treasury restructuring. With controls in place to restrict funds movement out of the countries, Regional Treasurer faced the prospect of significant amounts of "trapped cash" in Asia Pacific's emerging markets.

Acme's 40 legal entities in China were wholly owned by Acme China; these entities covered all major business segments and had collectively opened 170 accounts across 17 banks. This, coupled with Acme's significant and diverse operations throughout the country, made the tracking of commercial and treasury flows difficult, to say the least. Consequently, some entities had idle and excessive funds, while unexpected funding shortfalls gave rise to unnecessary borrowings by other entities. As inefficient use of company resources had resulted in higher banking fees and interest costs, Acme's Regional Treasury turned to banks for solutions by issuing cash management RFP. Acme envisaged setting up a three-tiered liquidity structure involving 1) a header (or concentration) account held by Acme China and managed by Regional Treasury, 2) 5 sub-accounts representing each of Acme's 5 business segments in China, and 3) various operating accounts. Cash from operating accounts within each business segment would be swept daily to their corresponding sub-accounts before further aggregation at the header level. Acme's China management and Regional Treasury teams were to jointly evaluate each bank's proposal on 5 major criteria:

- Global and local relationship
- Electronic banking capabilities
- In-country banking network
- Experience in cash management
- Pricing

In addition to having a cash pool within China, establishing a liquidity structure for Asia would enable Acme to gain further visibility and control on its cash. Given a recent third-party study which showed that in-country cash pooling could reduce operating cash by 30% on average, Acme's Treasury team asked banks to help develop a business case to set up the liquidity structures so the team can convince internal stakeholders in business to co-operate in their implementation. Exhibit I and Appendix 1 detail interest rates and balances with respect to the two cash pools.

Exhibit I

Selected Interest Rates

	RMB Cash Pool	Asia-wide Cash Pool [1]
Overnight Deposit Rate	0.72%	3.50%
1-Month Time Deposit	1.90%	4.00%
Cost of Short Term Debt	5.60% [2]	4.75%

1. Regional average rates
2. PBOC Benchmark Lending Rate

Acme's Treasury Policies

An important part of centralizing Acme's treasury organization was treasury policy setting. With operations in many countries around the world, Acme's cash flow and earnings were sensitive to exchange rate fluctuations in multiple currencies. Thus, the company needed to establish clear policies and procedures to achieve consistent and prudent FX risk management. Exhibit J highlights some of Acme's FX policies.

Exhibit J

Highlight of Acme's FX Policies

FX Task	Performed By
Spot transactions above $5 million	Regional Treasury
Hedging of freely convertible currencies	Headquarter
FX exposure forecasting (once per quarter on a rolling four-quarter basis)	Headquarter
Hedging of non-convertible currencies including Non-Deliverable Forwards (NDFs)	Regional Treasury*

* Task is performed by Regional Treasury due to greater liquidity of Asian currencies during Asia hours

The need for sound FX risk management can be illustrated by Acme Industrial Pipes ("AIP"), the division of Acme International which manufactures pipelines and valves to aid water transmission and distribution. AIP India, which sourced raw materials from in- and outside the country and exported finished goods, had been growing rapidly in the last few years. Given a currency mismatch between cash receipts and expenditures, there was an urgent need to hedge against adverse FX movement to stabilize margin. To determine roughly how much to hedge, Acme's Asia Treasurer did a back-of-the-envelope calculation using figures from Exhibit K. He approached the banks to help him figure the right amount to hedge USD exposure for AIP India under the circumstances.

Exhibit K

Monthly Cashflows of Acme Industrial Pipes, India

Cash Flow	USD equivalent (MM)[1]	INR equivalent (MM)[1]
USD inflow	2.0	100
USD outflow	0.2	10
INR outflow – no FX linkage [2]	0.4	20
INR outflow – with FX linkage [3]	1.2	60

1. Assume spot USD/INR = 50.0
2. INR expenditure that is unaffected by FX rate (e.g. INR payroll)
3. INR expenditure that can fluctuate with movement of USD (e.g. fuel, imported raw material)

AIP US had set up a representative office in Indonesia for local sales in IDR. Forecasted annual inflow was the IDR equivalent of $100MM (spot USD/IDR = 9,000). With a view that USD would weaken over the next 12 months against the Rupiah barring potential sharp USD pull-backs, Asia Treasurer sought to protect IDR flows against USD weakening using forwards or options. He wondered what would be the best FX hedging strategy to achieve a superior risk-return profile.

Also to be standardized was Acme's investment policy. Acme's primary investment objective was to ensure adequate control and efficient use of the company's cash – available funds should be invested at the highest yield available while ensuring safety of principal and liquidity. Preservation of capital was the paramount consideration for establishing qualifying instruments for investment (see Appendix 2), followed by liquidity and subsequently maximizing yield returns. Furthermore, permitted investments were to be managed in portfolios not exceeding one year in horizon, and any deviation from Acme's investment policy must be documented and submitted for approval by the Global Treasurer and CFO.

The Next Steps

With multiple challenges ahead, Acme's Asia Pacific Treasurer and his team rolled up their sleeves as they set out to centralize regional treasury management in Singapore. There would be internal and external hurdles to overcome, but when the right structures, policies, and technology are in place, the payoffs would be significant cost savings, more efficient use of company resources, and improved financial position – creation of shareholder value which the financial markets will recognize and reward.

Appendix 1: Acme Asia Average Cash Balances

Country	Net Cash In-country	LCY		USD	
		Cash	Working Capital Debt	Cash	Working Capital Debt
Australia	150	120	18	70	22
China	215	185	10	40	0
Japan	100	70	5	55	20
Korea	100	114	18	10	6
Hong Kong	(30)	10	20	5	25
Singapore	75	18	20	80	3
India	30	35	5	0	0
Taiwan	45	35	1	20	9
Malaysia	50	85	36	15	14
New Zealand	25	15	2	13	1
Thailand	20	31	13	2	0
Indonesia	10	23	16	3	0
Philippines	15	17	3	1	0
Vietnam	10	12	2	0	0
Total	815	760	169	324	100

Remarks

1. Figures in USD MM equivalent
2. Multi-entities locally incorporated
3. Cash includes operating cash (80% LCY, 20% USD) and surplus cash (80% LCY, 20% USD)
4. Working capital includes 50% overdraft, 50% short-term debt
5. Data shows average monthly position

Appendix 2: Permitted Investment Instruments

Instrument Type	Minimum Credit Rating [1]	Maximum Maturity	Maximum Portfolio Exposure [2]	Maximum Issuer's Exposure
Government & Agency Securities	AAA/Aaa	1 year	No limit	No limit
Time Deposits / Certificates of Deposit	A1+ / P-1	1 month 3 month 6 month 1 year	No limit 50% 25% 15%	25% 15% 10% 5%
Money Market Funds	AAA / Aaa	1 year	50%	10%
Commercial paper(CP)	A1+ / P-1	1 month 3 month 6 month 1 year	No limit 50% 25% 15%	5%

Remarks

1. Credit ratings by Standard and Poor's or Moody's at time of purchase.
2. Company's investment portfolio is defined as the sum of funds held by the investing entity