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The four sins of cashed up Australian companies

Hugh Dive, of Aurora Funds Management, is less than impressed with Woodside's pursuit of Oil Search.

by **Jonathan Shapiro** **22 September 2015**

When a company finds itself swimming in cash, you would think that's a good thing for shareholders.

But far too often when a management team finds itself with more cash than it knows what to do with, a rush of blood to the head means they end up frittering it away, costing shareholders billions.

That's the view of Hugh Dive, of Aurora Funds Management, who's less than impressed with Woodside's pursuit of Oil Search.
Woodside is reaping the rewards of its completed $15 billion Pluto LNG project, which has been gushing with cash for three years, allowing it to cut its debt and boost its dividend payments.

But Dive is concerned that by looking to expend those reserves by acquiring Oil Search, it ends up wasting what is a precious resource in itself – cash. Among the issues with the $11.6 billion deal is that it will dilute Woodside shareholders and give Oil Search shareholders access to franking credits, while the synergies of the deal are in question.

CASH BURN HISTORY

Fearful of history repeating itself, he compiled a brief history of Australian corporate cash burn – and how big companies have turned big piles of cash into losses for shareholders.

Dive cites four reasons companies end up destroying value through deals, aside from deal-hungry bankers in $2000 suits. They are overpaying, underestimating the integration cost, buying a business in a geography they don't understand or in an industry they don't understand.

Sometimes they get it right, as Incitec Pivot did when it bought Dyno Nobel, which allowed the company to diversify its earnings "away from volatile domestic fertiliser sales to being exposed to the more stable explosives market by acquiring the second-largest global manufacturer of explosives".

CSL's purchase of Aventis Behring's global plasma therapeutics business, "a company and industry transforming" deal, was another win for sensible management, as was Amcor's 2009 purchase of Alcan's packaging business from Rio Tinto.

But these are the exceptions to the rules, according to Dive. Pride of place in the "hellish hall of fame of poor acquisitions" are Rio Tinto's $US38 billion purchase of Alcan, CSR's glass acquisitions, IAG's foray into UK motor insurance and NAB's purchase of a Florida-based mortgage processor, Homeside.

RIVERSDALE ACQUISITION

Rio's presence in the hall of fame is cemented with its $US3.9 billion Riversdale acquisition, which it sold three years later for $50 million, recovering just 1.2 per cent of the cost.

"In all of these situations, not only was shareholders' capital quickly frittered away but subsequent management teams were forced to expend large amounts of time and money extracting the company from these situations and answering angry calls from investors," he says.

There are other options to deploy excess cash such as developing new assets. This, Dive says, tends to be less painful for shareholders. An example is Rio and BHP's expansion of their West Australian iron ore assets, which have enforced their dominance on the iron ore market and reduced their production costs.

But companies can get that wrong, too as Boart Longyear has done twice, in 2009 and 2014, by taking on debt to ramp up investment in drilling rigs just before a downturn. That's left a company whose equity the market values at just $65 million with $670 million debt.

One of the more favoured options when a company has more cash than it needs is simply to return it to shareholders in the form of a dividend or a buyback but this is often a last resort "as it is invariably more exciting for management teams to be growing rather than shrinking the business under their control and companies worry".

Also companies fear that if they return capital to shareholders, they may need to ask for it back if an opportunity arises.

"If a company is forced to raise money from shareholders for an acquisition – rather than using debt and retained earnings – shareholders can both scrutinise the deal and decide whether or not to commit further capital to the company."

So dividends do in fact enforce some sort of corporate discipline and while Australia's acquisition hall of horrors is well populated, we can take some comfort that our tax regime does encourage companies to prioritise the return of capital.

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