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U.S. companies wonder where to put all that cash

Excess greenbacks used to fund deals, share buybacks.

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Buck Ennis
CASH BALANCED: CFO Ann Marie Petach says BlackRock has been able to use its cash both to develop business lines and reward shareholders.

Finding itself with $2.8 billion in excess cash this spring, money management giant BlackRock decided to expand. It launched private-equity and renewable-energy investment vehicles, and it hired three new managing directors.

BlackRock still had cash to spare, though, so it paid $500 million and borrowed $2 billion more at ultralow interest rates to buy back shares held by Bank of America. It then spent another $300 million to boost its dividend by 37.5 cents a share.

“We have meaningful opportunities for organic growth and to reward shareholders,” said Ann Marie Petach, chief financial officer at BlackRock. “We have enough cash that we're not choosing between them.”

Though not every company has that luxury, U.S. corporations as a group are sitting on record-high piles of cash—about $1 trillion, by most published estimates—as a result of deep cost cuts made during the recession and prolonged borrowing at next-to-nothing rates.

The total cash stash for public companies in the metro area stands at $206 billion, up 90% since 2007, according to New York-based Fortuna Advisors. Among the flushest of the flush are MetLife, with around $30.6 billion; Pfizer, with $26.9 billion; and American Express, with $22 billion, according to research by Standard & Poor's.

Such sizable stakes can present a puzzler for CFOs and other top brass. What should they do with all that money? Use it to buy another company? Invest it in new machinery and employees? Repurchase stock? Increase dividends? Pay down debt? Sit on it awhile longer, in case there's another recession or financial crisis?

The decisions are not as easy as they might appear. Some options carry risk—maintaining outsize cash holdings might attract a corporate raider, for instance. What's more, ever-changing economic or interest-rate conditions might suddenly make a strong option look weak.

Don't sit there—buy something

A popular but often-maligned use for excess cash is making acquisitions. Skeptics point to overpriced, ill-considered deals such as News Corp.'s 2005 purchase of Myspace for $580 million. In June, just before its phone-hacking scandal erupted, News Corp. took the humbling step of unloading the site for a mere $35 million.

“Far worse than leaving cash to idle in [safe but low-interest investments] would be to substantially overpay for an acquisition,” says Denis Gagnon Jr., who runs the New York practice of consultancy B2B CFO.

Yet optimism apparently springs eternal. Merger and acquisition activity has been increasing, with 1,276 transactions totaling $454 billion in the first five months of 2011—a 39% rise in value from the year-earlier period, according to PricewaterhouseCoopers.

In some cases, companies that are committed to dealmaking as a path for growth are employing approaches that effectively hedge their bets. A spokeswoman for drugmaker Bristol-Myers Squibb, which has one of the 10 largest cash hoards in New York, notes that its strategic priorities include not just acquisitions but also licensing and joint ventures.

Some companies do not see the M&A route as an option because they are absorbing a previous acquisition. That's the case at BlackRock, which Ms. Petach said is still integrating Barclays Global Investors, which it bought for $13.5 billion in 2009.

Reinvesting (and it feels so good)

Some management experts insist that plowing extra cash back into a company to boost production or to expand research and development offers the optimum outcome.

“Companies with a higher reinvestment rate—companies that invest in plant equipment and research—produce better shareholder returns, without question,” said Gregory Milano, CEO of Fortuna, a New York-based advisory firm.

In an analysis of the largest 1,000 nonfinancial U.S. public companies over the 10 years ending in 2009, Fortuna found that those with the highest rates of reinvested cash flow in their businesses also had the highest compound annual growth and total shareholder returns.

New York-based L-3 Communications Holdings, for example, reinvested an average of 135% of cash flow each year over the decade and delivered a cumulative total shareholder return of 318%.

Express Scripts Inc. had even more impressive results. The St. Louis, Mo.-based company reinvested 120% of cash flow and posted a cumulative total shareholder return of 980%.

The key, of course, is that there must be demand for what a company makes or develops. If not, it may simply end up with unused capacity.

CASH KINGS

New York-area companies (excluding banks) with the largest cash holdings as of March 31. In billions.

- **MetLife** $30.57
- **Pfizer** $26.87
- **American Express** $22.03
- **MF Global Holdings** $21.52
- **Verizon** $14.73
- **News Corp.** $11.78
- **Loews Corp.** $8.61
- **Nasdaq OMX Group** $7.44
- **Bristol-Myers Squibb** $6.79
- **Icahn Enterprises** $6.56

S&P defines cash more broadly than Bristol-Myers and Loews do.

Source: Standard & Poor's

Baby got buyback

Repurchasing stock from shareholders is a classic move meant to increase share prices by decreasing the number of outstanding shares—effectively un-diluting the share pool.

In June, Standard & Poor's reported the seventh straight quarterly increase in such buybacks. Among the major repurchasers in the New York area is Bristol-Myers, which announced a $3 billion, multi-year buyback in April 2010.

Some observers are skeptical of this approach and point out that companies too often make the classic mistake of buying stock when its price is high.

Mr. Milano believes that there are often better ways for firms to spend their greenbacks. “Companies that buy back stock are throwing their hands up and saying they can't find anything very good to invest in,” he said.

Buybacks can serve other purposes, however, such as bolstering an organization's image with shareholders. After News Corp.'s troubles sank its stock price last month, the company announced that it would nearly triple its buyback program, to $5 billion.

Dividend shields

S&P reported 255 dividend increases among companies in its 500-stock index last year and has predicted nearly 300 for this year. Bristol-Myers, which raised its dividend by 3% last December, is again a typical local example.

Another high-profile dividend-raiser in the city: JPMorgan Chase & Co. The bank hiked its dividend by 20 cents in March, to 25 cents a share, after getting the go-ahead from federal regulators. CEO Jamie Dimon told an investor conference last September, that his first choice for deploying cash is to “ultimately return” to a dividend of between 30 and 40 cents.

But richer dividends don't make sense for all companies, Mr. Milano said. Though they may be the only way stockholders see substantial gains at “low-growth, low-return companies,” at companies with higher-performing stocks, “dividends don't matter,” he said.

Stay safe on the sidelines

With the global economy in a tenuous state, a company can never have too big a cushion, right?

Loews Corp.—a holding company whose interests range from hotels to insurance to offshore drilling—has $4.6 billion in traditionally safe instruments such as Treasury bills but did spend $200 million in a share buyback earlier this year.

CEO James Tisch isn't thrilled with the T-bill strategy. “If you round Treasury bill rates off to the nearest 10 basis points, the yield is zero,” he said.

Still, Loews can't justify most other uses—including acquisitions—for its cash right now. “We are very particular about what we invest in,” Mr. Tisch said. He sees corporate America's growing cash horde as “a real measure of the uncertainty that a lot of CEOs have,” he added. “Notwithstanding how low interest rates are, they're just not spending.”