

# What Will Corporate America Do With ALL That Cash? Share Buybacks? No. Bond Buybacks.

*Last Tuesday, the FT asked the question "Where will corporate America's overseas cash pile go?"* Excellent question.

Until Trump proposed a repatriation tax and lower overseas corporate taxes, the share buyback binge which has propelled the US equity market for the past 7 years was set to peak. Goldman Sachs estimates that the tax holiday will result in 200 billion USD of repatriations. The expectation is that most of this cash will be directed at share buybacks and dividends, although share buybacks will likely dominate as the more tax efficient shareholder reward.

Let's try to argue against this consensus scenario. There are basically three things you can do with corporate cash, you can buy back shares, you can buy other companies, you can invest in capacity, or you can retire debt. Interest rates are rising which implies that, one, indebtedness is expensive, and two, investment in capacity faces a higher hurdle rate of return. Buying back shares raises the leverage of the company making it relatively more indebted. Buying other companies raises leverage far faster than share buybacks. Investment in capacity may be justified if final demand picks up but, ceteris paribus, higher interest rates means less investment. How about retiring debt either through buy backs or simply attrition.

Net debt to EBITDA for S&P 500 companies rose from 1.1X in 2013 to 1.7X while total debt to EBITDA rose from 3.6X to 4.6X. This is a considerable increase in leverage in a short time. The scope for a deleveraging cycle is ample. If US companies embark on strengthening their balance sheets, by

eschewing share buybacks and reducing indebtedness, the impact on credit spreads could be significant.

From 2002 to 2007, credit spreads tightened as leverage fell. From 2007 to 2008, leverage rose and credit spreads surged, although the catalyst to be fair was not in the corporate credit market but in the housing market. The credit rally from 2010 to 2014 coincided with balance sheet deleveraging. What is remarkable about the credit market has been the rally from February 2016 to date which has occurred while corporate leverage is still increasing. If corporates start reducing their leverage, we could be seeing a more sustained rally in credit and spreads reaching for the lows of the 2004 -2006 period.