Managing Treasury Headwinds:

Risk Management Lessons for Weathering a One-in-100-Year Economic Event

After three years of marketplace turbulence, the aviation industry is once again on a positive glide path. On recent international trips, we have been thrilled to see queues in front of customs and immigration counters on both legs of our trips - It seemed like the old days of travel were back again.

Of course, business travel has not yet fully rebounded to pre-pandemic levels. Much of the travel recovery to-date has been driven by the leisure sector as pent-up consumer demand fuels bookings. Citi research shows business travel recently saw its best month-over-month improvement even though not quite at 2019 levels.

All of this is good news compared to where we were a few years ago when the abrupt cessation of air travel due to COVID-19 restrictions slowed the entire global airline business down dramatically. At the very outset of the pandemic, the large drop in travel bookings and cancellations resulted in a significant drop in cash inflows. While the drop in fuel usage preserved cash, fixed costs and lease payments had to be funded and drained existing reserves. With no end in sight for the pandemic and its impact on the travel industry, the prospect of defaulting on lease payments loomed large, as did the potential for bankruptcy across the entire marketplace.

It quickly became apparent that the aviation industry was facing a one-in-100-year economic stress event. Fortunately, the industry's treasury professionals prepared well in advance for potential disruptions to the business, even though the scale of this event was beyond regular scenario planning.

Treasury took added steps to be prepared for economic stress

Because of the unpredictable nature of geopolitical events, such as wars and other conflicts, along with weather-related disruptions and volatile fuel prices, most airlines historically maintained approximately 20% of revenues in cash as a buffer to address unexpected events. However, treasury and finance

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professionals within the industry quickly recognized that the magnitude of this unprecedented market disruption would require additional reserves.

In response, most airlines increased their cash buffer to in excess of 40% of revenues. Additional cash was secured from as many sources as possible, including banks. While there were a number of bankruptcies and restructuring that happened due to the impact of the crisis, the industry as a whole performed better than expected thus far.

In order to better manage overall liquidity, many treasury departments embraced digital technologies, allowing them to improve visibility into accounts and more accurately forecast cash flows. Making this digital transformation, in some cases literally overnight, required close coordination with banking partners. In the end, gaining a centralized view into cash and the ability to more effectively preserve liquidity has proven instrumental to weathering the storm.

What to do with all that cash?

Now that business travel is picking up and leisure travel is robust, keeping such large cash buffers on hand may no longer be required and could be expensive given rising interest rates. This has left treasury and finance departments to begin considering what to do with all that cash.

For most, the options are three-fold:

- Businesses can take the excess cash and buy back shares, when appropriate.
- They can increase their shareholder dividends.
- Or, they can reduce their debt with lenders and return to the historic levels of cash buffers at 20% of sales.

The process of reducing cash reserves is not something that can be accomplished overnight. It can take months or even a year or two. Because of the ongoing market uncertainty, many airlines may be choosing to keep as much as 30% of sales in cash on their balance sheets. In this case, treasury would be well-served to work with a banking partner to help deploy that cash most effectively, either in simple bank interest rates or financing their supply chains.

In the case of supply chain financing, treasury can take advantage of dynamic discounting, which uses available short-term operational cash to fund early payment of approved supplier invoices to generate discounts and annual improvements to earnings before interest, taxes, depreciation, and amortization (EBITDA). Funds that are freed up can also be reinvested in money market accounts.

Lessons learned from the past

Many industries, particularly those that have a regular cash burn, leveraged the lessons learned from the 2008 financial crisis, immediately drawing down revolvers in order to ensure they had a sufficient cash buffer on hand. These businesses knew exactly what to do when the marketplace began to be disrupted.

The lasting lesson from this latest economic upheaval is that businesses need to plan for the unexpected. Risk management planning should include 10-year, 50-year and even 100-year events. Clearly, no industry is immune from the effects of disruption, but the lessons learned from the past have made it possible for the airline industry to escape relatively unscathed. Others, within and outside the industry, can take these lessons to heart and be better prepared for potential market risk exposures.

Another lesson learned is the importance of digitization of treasury processes. Corporates have learned that having a strong relationship with a banking partner, such as Citi, can enable them to take advantage of next-gen technology and advanced analytics, thus dramatically improving the automation of cash management capabilities. Banks have the treasury expertise to help businesses of all types be better prepared for future stress scenarios.

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