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Bosses try unusual remedies to solve pension ills

GENERAL FINANCIAL

News analysis

Cash is not the only way to plug holes in employee benefit schemes, writes **Norma Cohen**

In what is surely one of the more unusual approaches to a pensions shortfall, Diageo, the drinks group, has offered up a veritable lake of its whisky as collateral for the growing shortfall in its benefits scheme.

Under the deal's terms, the scheme's trustees will form a partnership with Diageo that will own up to £430m of maturing whisky that will be transferred in by the company over time. As the batches mature each year, Diageo will have an option to buy £25m of the whisky, with the trust using proceeds to fund the pension scheme. The company said the deal was cash-flow neutral.

Diageo said it was not doing the deal because it could not afford to pay. It has an A credit rating and £1.2bn of free cash flow. Instead, it wanted to do this deal because "it allows us to use free cash flow to return cash to shareholders".

The deal has not yet been approved by the Pensions

unlikely, the whisky brands would remain with the company and be sold for the benefit of creditors, not the pension scheme. The scheme would then be left owning immature, unbranded whisky.

It is not impossible to establish a value for a commodity that has been shorn of its brand; indeed, such valuations happen all the time. It is just that, in these cases, some objective market value must be established and, inevitably, this is a lower value than that which would attach to the branded product. Specialists know this as "managed distress value".

But even if Diageo is using goods with some intangible value as collateral, the broad outlines of its deal are very familiar. Pensions advisers said they were increasingly attractive to companies, particularly those saddled with legacy liabilities and which are much smaller than they once were.

Earlier this year, GKN, the engineer, created a similar vehicle to hold a £331m collateral pool for its pension scheme. The vehicle receives rental income from several properties owned by the company, as well as cash coming from company trademarks.

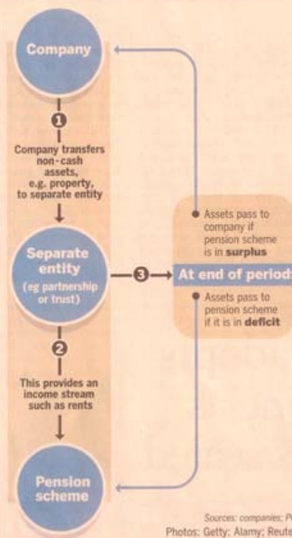
The company wants

Pensions

Company	Details	Deficit				Members
J Sainsbury	£600m of deficit to be addressed by a new property partnership with pension sheme. Annual payments of up to £35m for 20 years from this agreement	**Deficit** (Mar 2009) £1,227m	**Value of collateral** £750m			**Members** 85,000
Diageo	Pension scheme will hold whisky as an asset. Diageo will pay a fee to gain access to these stocks. This will generate an annual income stream of £25m for the next 15 years	**Deficit** (Apr 2009)* £862m		**Value of partnership** Up to £430m		**Members** 62,000
Marks and Spencer	Adds a further £300m to existing collateral, generating a fixed income stream of £36m for 15 years starting in 2017	**Deficit** (Mar 2009)* £1,300m			**Net present value of deal** £800m	**Members** 123,000

* UK scheme

Non-cash funding of pension schemes



Sources: companies; PwC
Photos: Getty; Alamy; Reuters

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● **Hamleys**
Hamleys, the toy retailer, reported its first pre-tax profit in six years as it starts to stock up on a range of new toys for Christmas.

In the year to the end of March, Hamleys made a pre-tax profit of £100,000 compared to a loss of £4.1m last year. Total sales grew 5 per cent to £60m

● **Carlyle**
Carlyle, the private equity group, has completed the £671m acquisition of central London properties that were part of the property empire previously owned by the family trusts of Simon Halabi.

The deal represents the largest UK disposal from the workout of a distressed real estate loan since the credit crisis

● **BP oil spill disaster**
An interactive timeline charting events since the accident, including oil leakage estimates and the clean-up costs
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company to use operating assets rather than cash to try to plug the hole in its pension scheme. A combination of the stock market crash, low bond yields (which increase liabilities) and longer lives for retirees has pushed a string of other companies into similar schemes, which will allow them to improve scheme funding while saving cash.

J Sainsbury, Marks and Spencer and Whitbread have announced similar schemes and pensions advisers said several other companies were working on transactions that will be unveiled over the next few months.

But what makes the Diageo deal different from these others is the nature of the collateral. In the other cases, the collateral is cash-generative property. If the employer were to become insolvent, the properties revert to the pension scheme and can be sold vacant. Britain has an army of professionals with expertise in valuing these assets.

But the value of the Diageo collateral depends, in large part, on the brand that attaches to each of the whiskies in its pool, according to Stuart Whitwell, joint managing director of Intangible Business, which specialises in valuing brands and other obscure assets.

"Lots of products would have no value without the brand," Mr Whitwell said. He added that his firm was in talks with several companies, including one in the FTSE 100, which are looking at using some of the intangible value of their products to use as collateral. "Take vodka. Without the brand, it is just a commodity," Mr Whitwell said.

Diageo said it was not transferring ownership of the brands to the trust. Mr Whitwell said that it was likely that if Diageo went bankrupt, which is highly

Marc Hommel: cash is currently in short supply

because it allows us to . . . return cash to shareholders'

David Robbins, pensions partner at Deloitte, noted that ITV recently gave comfort to trustees of its scheme by placing ownership of a subsidiary, SDN, into a structure similar to that used by Sainsbury, Diageo and the others.

Deloitte also recently advised an employer on a deal in which a similar structure became entitled to some of the cash flow from the company's book of receivables.

Mr Robbins said that Deloitte is advising on several deals that involve assets that have intangible value such as brands, patents and trade marks. "These are very pervasive deals," Mr Robbins said, noting that they were time consuming to complete. "They affect your relationships with banks, your accounting, everything."

For banks, the creation of these structures affects the value that they could extract from the company in the event of bankruptcy. The assets that are in the new partnerships would be claimed by the pension schemes rather than the creditors. Usually, pension schemes are last in the creditors' queue when companies go bust.

Marc Hommel, pensions partner at PwC, said that some companies were attracted to the arrangement because of tight credit markets. "Cash is in short supply," Mr Hommel said. "The company may decide 'We need cash to pay our dividends and invest in the business'."

It is not just cash-strapped companies that are looking to set cash-producing collateral aside for their pension schemes. "If an employer wants a scheme to follow an investment strategy with a high concentration in risk assets, then the trustee might seek a charge on assets," he said.

Also, Mr Hommel added, employers may feel that market values are unusually depressed at present.

As time passes, they could find themselves with schemes that are in surplus and there is no legal mechanism to extract surplus for the benefit of shareholders. Indeed, he said, that was the reason that some collateralised arrangements had been set up in the first place.