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U.S. Firms Gird for Hits and Draw On Credit Now

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Fearful of tightening credit and bank failures, a growing number of companies are hoarding cash by taking the unusual step of tapping credit lines they don't actually need.

During the past week, large companies like General Motors Corp. and Texas beauty-care retailer Sally Beauty Holdings Inc. have drawn funds typically set aside for short-term working-capital needs, such as retooling a plant or a product launch. These companies say it is best to get the cash now, for fear that a bank may withhold it or be unable to deliver the funds down the road.

This corporate-cash stockpiling stems directly from the collapse of Lehman Brothers Holdings Inc. last week, which continues to reverberate in unforeseen ways. One effect was a virtual closing of the commercial-paper market, which provides short-term, low-cost funding to the most-creditworthy companies. As that market was shaken, so, too, has been the confidence of corporate financial executives charged with keeping cash flowing through their companies.

This presents another challenge for the banking system: How to keep making fresh loans while capital from past commitments goes out the door. In the months ahead, this will be an important factor in maintaining economic growth across the country, say banking analysts.

The drawdown situation "adds one more turn of the screw of available credit," said Roger Lister, chief credit officer in the financial-institutions group at bond-rating firm DBRS Inc.

The nervousness at banks is reflected in their increasingly tight-fisted approach to lending. A July survey conducted by the Federal Reserve found that 60% of U.S. banks in the past three months had tightened their standards on loans to midsize and large businesses, while 80% of banks had increased the rates they were charging on such loans.

When a bank enters into a revolving credit line with a customer, whether it's a business or an individual, the amount of that loan commitment counts against the bank's capital ratios. That means that as companies draw down existing credit lines, it doesn't strain the bank's already-depleted capital levels.

The bigger impact is on a bank's liquidity. Bank treasurers are generally charged with gauging the likelihood that specific loans will be drawn down, and the expected demands that will place on the balance sheet. That in turn influences the bank's decisions about whether to make new loans to other borrowers.

As of June 30, 2007, the latest period for which data are available, banks had pledged to finance about $2.3 trillion in big corporate loans -- those that are more than $20 million and are syndicated by multiple banks, according to the Federal Reserve's Shared National Credit Exam.

Of that, borrowers had drawn down about $835 billion -- meaning that nearly $1.5 trillion remained untapped but available. A caveat: Banks reported that loan data before the credit crisis hit in August 2007, and analysts say it's likely that companies have drawn down many of their credit lines since then.

Lenders say the drawdowns may be a sign that a growing number of companies are worried about troubled times ahead and are trying to create a rainy-day fund -- even though these bank lines typically aren't used that way. They note many of these companies are also dealing with their own liquidity or operational problems. GM, for example, burned through roughly $1.2 billion a month for the year through July amid a major downturn in U.S. auto sales.

Besides GM and Sally Beauty, others to tap their revolvers recently include New York-based consumer-product company Jarden Corp. and communication-services provider Fairpoint Communications Inc. Both cited concerns about liquidity in the financial markets.

Sally Beauty, which has 3,700 stores and annual sales of $2.5 billion, drew down $75 million of a $400 million revolver and cited "dislocation of the financial markets." The maker of hair-care, skin-care and other salon products said it will pay interest of 5.25% on that money.

"We were not affected directly by Lehman, but we thought we should take a guarded approach and wait and see how things go." said Sally Beauty finance chief Mark Flaherty.

GM said it intends to draw down the remaining $3.5 billion of its $4.5 billion secured revolving credit facility to maintain financial flexibility during uncertain financial markets.

Two people familiar with GM's thinking said the auto maker was concerned about the financial health of some of the lenders in its banking syndicate. The move also reflects GM's battle to ensure its own survival. Without the fresh injection of cash, GM would have been more likely to run into trouble meeting its financial obligations by year end.

North Carolina-based FairPoint drew down a smaller amount, $100 million of its previously untapped $200 million revolver. The company, with $1.2 billion in sales, cited uncertain financial markets.

These steps are uncommon, say banking experts, because revolving credit facilities are similar to a credit card that companies are expected to tap just for working capital and then to pay it back quickly, rather than use the debt to keep their business afloat.

"It hasn't happened in quite a while, maybe since the early 1990s," said Robert McMahon, managing director of the restructuring finance group at GE Corp. Lending. "We never before gave them such a reason to worry and take these drawdowns."

Mr. McMahon, who said he was aware of even more companies moving to draw down revolvers in the coming days and weeks, said these actions "are a bit like a shot across the bow of a lender, a way of telling them something bad is coming or that they are unsettled with the market right now."

Companies must pay a predetermined fee, often the London interbank offered rate, or Libor, plus some credit-related interest rate. "We are hearing from a lot of CFOs and Treasurers who are wiling to pay that extra cost, the incremental cost, of drawing that down because they are nervous about their banks," said Joseph C. Stein, managing director with the boutique investment-banking firm of Peter J. Solomon Co.

A dozen commercial banks have failed this year, the largest number since 1994, when 15 lenders failed, according to the Federal Deposit Insurance Corp. In recent months, the FDIC has regularly been shutting down banks on Friday evenings, and regulators, bankers and investors say they are bracing for the collapses to keep piling up over the rest of the year.

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