Corporate America = Vapourware?

In 2018 Nov 3, I wrote about "The Hollow Shell That Is Corporate America" in which I highlighted that 27 out of the 50 largest S&P500 companies that are not banks/financials or technology-related have NEGATIVE net tangible assets.

As I delved into the balance sheet, even more troubling numbers emerged.

In Dec 2007, these 50 companies had a combined net debt of $227 billion. As of Dec 2018, that number is $2.15 trillion. Actually, if one omits Berkshire Hathaway, the net debt has grown from $344 billion to $2.38 trillion.

During the same period, combined shareholders' equity has only grown from $1.61 trillion to $2.27 trillion. This means that the collective net debt to equity ratio has jumped from 14% to 95%. Once again omitting Berkshire Hathaway makes the numbers worse – going from 23% in Dec 2007 to 124% in Dec 2018.

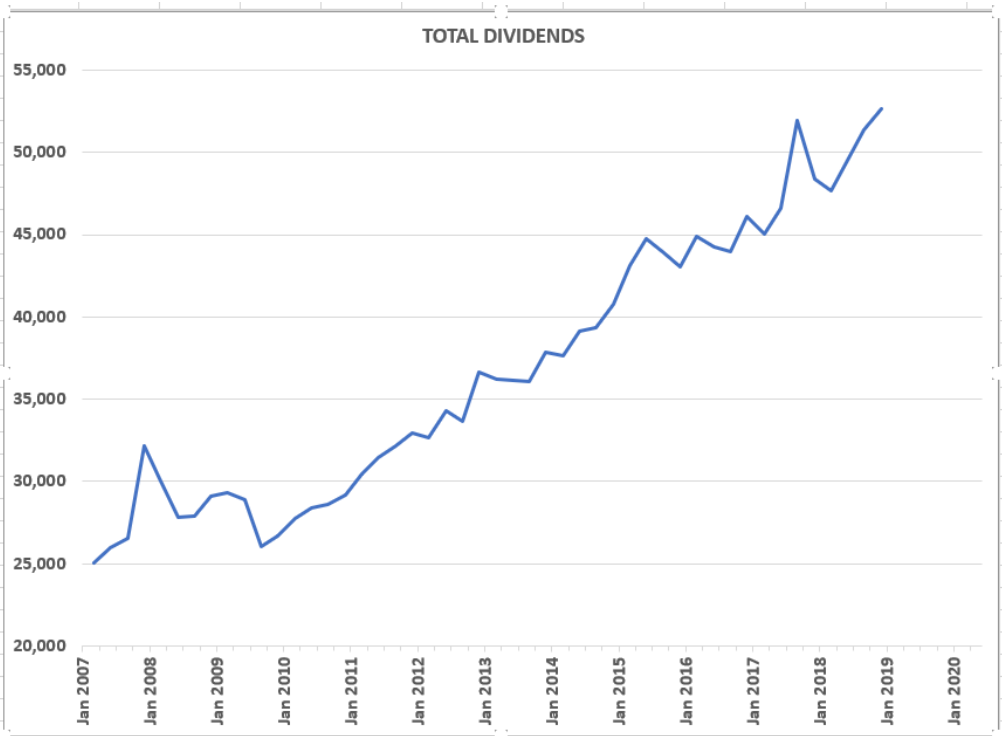
These 11 years have been great for US corporate profits and stock prices. One would have thought that corporate America's balance sheets should have been in the pink of health and stronger than they have ever been.

Why is this not so?

One reason is the excessive M&A highlighted in my Nov 2018 essay. Total intangibles have more than doubled from $998bn to $2.12 trillion.

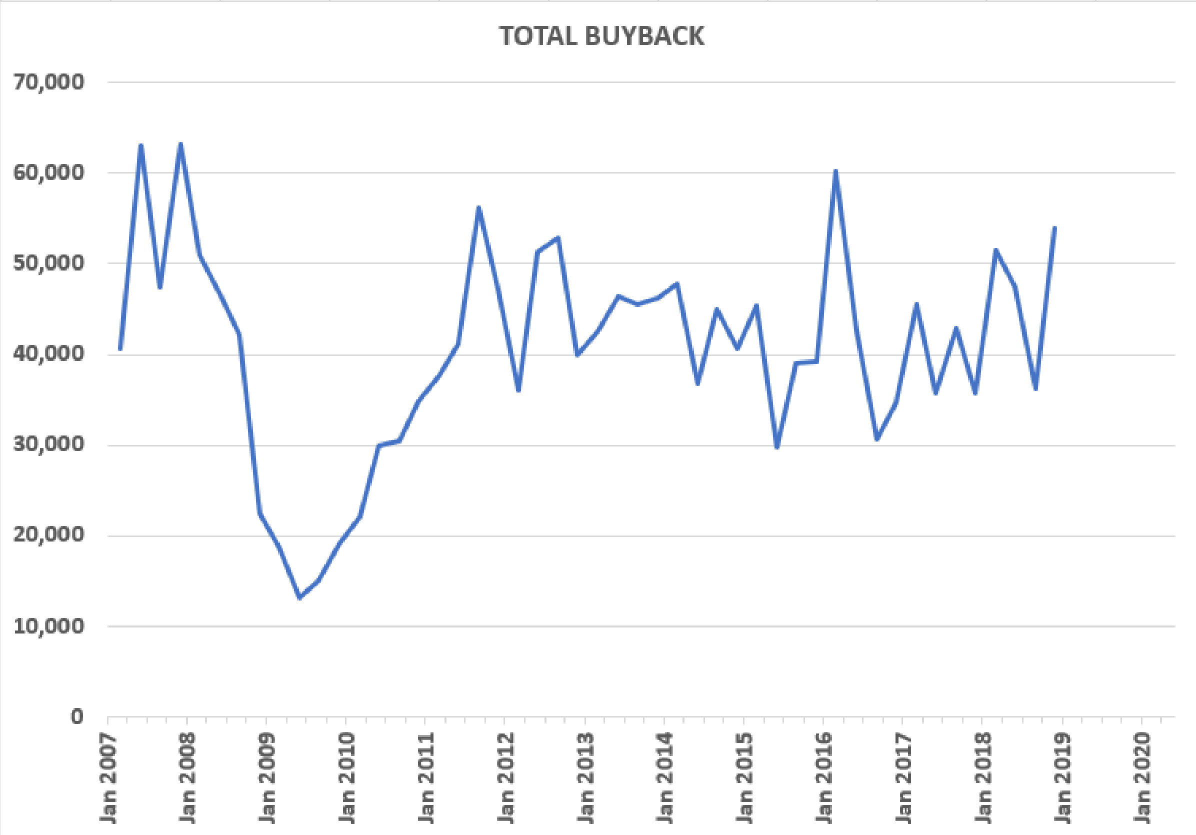
This is compounded by hyper-aggressive dividend and stock buyback policies.

Over the past 11 years, these 50 companies have paid out $1.65 trillion in dividends. Payouts soared to record highs in 2018 due to Trump tax cuts.



Stock buybacks have been even bigger than dividends, at $1.73 trillion over the past 11 years.

During the early stages of this 11 year old bull market, it would have made sense to buy back stock but as the bull market matured and valuations became higher, buybacks didn't ease. They stayed consistently high and in fact, in 2018, they became more aggressive.



For this group of 50 companies, we can observe that over the past 11 years, they have handed over $3.38 trillion of cash to their shareholders while doing so much M&A that their Net Tangible Assets is now a mere $150 billion – an average of just $3bn per company! And they are saddled with near triple digit net gearing ratio.

The experience of Kraft Heinz should be a big warning sign that intangibles can become worthless overnight. The company wrote off over $15bn in intangibles recently which resulted in an >20% reduction in shareholders' equity. The stock now continues to trade at a big discount to its book value presumably because Wall Street has suddenly woken up to the fact that the remaining $52 billion in equity is held at gunpoint by a still bigger $86 billion of now questionable intangibles. The share price is now just one third of the high reached in Feb 2017.

With so little equity relative to their intangibles, the entire corporate America can find itself in quicksand very easily.

Taking a step back, it's as if corporate America has gone to the extreme of running corporations purely on cashflow paradigm. We seem to be way past balance sheet optimisation and well into cash flow optimisation.

Call me a traditionalist, but it looks very fragile. A corporate landscape with no bedrock – just running on fumes.