

* THE INTELLIGENT INVESTOR * MARCH 14, 2009 * By JASON ZWEIG

While many financial companies are thirsting for cash, there's an even bigger group of businesses drowning in the stuff -- to the detriment of their shareholders.



The nonfinancial firms in the Standard & Poor's 500-stock index have a total of \$811 billion in cash and marketable

securities on their books, calculates Goldman Sachs. That's just shy of a record high in nominal terms and up \$43 billion from the depths of the financial crisis last fall.

Squirreling away cash is almost as bad as frittering it away. The returns on idle cash are lousy, and putting cash to productive use is one of management's central obligations to shareholders. Yet with stocks near their lowest valuations in decades, companies are slashing share repurchases; buybacks are running 35% below their levels a year ago.

While some outfits like Ford Motor or General Motors would jeopardize their very survival if they didn't cling to every penny, many big companies are being too cautious with their cash by any measure of prudence. Even as the economy keeps shrinking, their cash balances keep growing. Meanwhile, many

shareholders could use some of that cash to make it through the recession themselves.

This situation echoes 1932, when the great value investor Benjamin Graham lamented that "the typical stockholder is weighed down by financial problems while his corporation wallows in cash." Corporate bosses, said Graham, "are sleeping soundly these nights, while their stockholders walk the floor in worried desperation."

Cash is not trash, of course; the natural urge to set a little money aside for a rainy day feels urgent in a recession. And some companies would take a big tax hit if they brought home the cash earned by overseas operations. But according to Strategas Research Partners, 168 out of the 419 nonfinancial firms in the S&P 500 have at least \$1 billion in cash apiece, and 16 have more than \$10 billion each. Exxon Mobil has \$32 billion in cash, Cisco Systems has \$29.5 billion, Apple \$25.6 billion and Johnson & Johnson \$12.8 billion. Such multibillion-dollar balances are more than a rainy-day fund; they're a 100-year-flood fund.

Over the past 12 months, companies with high cash balances - - largely in the technology sector -- have outgained the S&P 500 (ex-financials) by about 7%. During bear markets over the long run, however, according to finance researcher Mikhail Simutin at the University of British Columbia, stocks with the biggest cash hoards have underperformed those with the least amount of extra cash by an average of 0.3 percentage point per month.

Why? Company managers with cash burning a hole in their pockets may feel they have the luxury of taking bigger risks at times when their rivals are weakening. The result can be lavish capital spending and impulsive stabs at diversification -- and lower future returns.

In 1949, Graham pointed out that "the typical management will operate with more capital than necessary, if the stockholders permit it -- which they often do." But there's no reason

investors must supinely allow their companies to stockpile cash up to absurd levels; the passivity of institutional investors is a particular disgrace.

When a company keeps piling up billions in cash, then its managers and directors owe investors some explanations. Why should a nonfinancial firm cut back on share repurchases when its cash register is full? Why is it unsafe for a company to raise its dividend (or start paying one) if it has billions in cash? Why not, at the very least, pay off some of the company's debt?

It's proxy season. You have a responsibility to monitor what your companies do with your cash -- and the right to get answers. Use the Internet or even the annual meeting to rally other investors together. I don't agree with the standard view that this is a waste of your time and that you should just vote with your feet by dumping your shares. As Graham wrote, "Nothing in finance is more fatuous and harmful...than the firmly established attitude...summed up in the phrase: 'If you don't like the management, sell the stock.' "

Instead of voting with your feet, vote with your proxy ballot against all the directors of any company that will not explain why it will not put your cash to the best use. You may not get answers, but if enough investors start asking questions, companies will start getting the message. It's your cash, not theirs, and they need to make it work for you.

Write to Jason Zweig at intelligentinvestor@wsj.com Printed in The Wall Street Journal, page B1

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved

Questions

1. Why do you think that non-financial firms are currently holding near record amounts of cash?
2. What are the benefits and downsides of a firm holding more cash than is needed to operate the business?

3. Do you agree or disagree with Jason Zweig's statement that "the returns on idle cash are lousy"? Justify your answer.
4. Should companies be buying back shares or increasing dividends rather than holding so much cash? Explain.
5. If you disagree with management, when does it make more sense to try to fight management through the proxy ballot and when does it make sense to simply walk away by selling your shares?