Appendix 3.05.3 A note Borrowings and Leverage/Gearing
Leveraging as above is not just the only probable with borrowing and debt. Leveraging and gearing has reached unacceptable highs and this is storing up problems for companies as internet rates rise. For now; as the good times have coincided with a period of record low interest rates, and so all is well. Debt is cheap. Stock markets have been untroubled. But a shock could put the corporate world into trouble. Particularly the US.

The Economist of 10 march 2018 on page 67 said this of corporate US:

> No matter how it is measured, the debt load looks worrying. When calculated as a percentage of GDP, the total debt of America's non-financial corporations reached 73.3% in the second quarter of 2017 (the latest available data). This is a record high. Measured against earnings before interest, tax, depreciation and amortisation (EBITDA), the net debt of non-financial companies in the S&P 500 hit a ratio of 1.5 at of the end of 2016, a level not seen since 2003. And it remained nearly as high in 2017.

We do not have goo data for the UK but it appears the UK follows in the US's footsteps. Interestingly the use of the extra debt was used by companies to finance share buy-backs, essentially for purposes of balance sheet management – instead of big investment projects or expansions or acquisitions.

The retail sector is most at risk. Such companies accumulated high levels of debt after more than a decade of private equity sponsored activity. They must also cope with tough competition from e-commerce. Many that filed for bankruptcy in 2017 cited debt piled on by their private-equity owners as a cause. This includes Toys-r-Us, which was acquired by a consortium of private equity firms in 2005. In the case of Payless ShoeSource, a retailer that also went bankrupt in 2016, creditors argued in court filings that its private equity owners should share the blame for its collapse and the private equity owners agreed to put more than $20 m back into the company. .

The Economist also notes that:

> Energy and utilities are two other industries at risk from their levels of indebtedness. The net debt-to-EBITDA ratio of the energy industry rose to three times by 2016, largely because of the shale-oil boom. But firms then issued a substantial amount of new equity. As earnings recovered with the rise in oil prices, their debt ratio improved to two times by last year. Utilities, meanwhile, which have always borrowed heavily, saw their debt rise to a 14-year high of 4-5 times earnings in 2017.

Though for the US companies now there is a lower corporate tax bill (down from 35% to 21%). However, the new law also caps the previously unlimited tax deductibility of interest payments at 30% of EBITDA until 2021, falling to a more restrictive 30% of earnings before interest and taxes (but after depreciation and amortisation) from 2022.

The Economist commented:

> This provision will hit the most indebted firms hard, notably those owned by private equity, as well as industries such as utilities.

We think that for the UK the hardest hit firms will be retail, utilities, construction and out-sourcing companies (inevitably squeezed by government spending).