Warren Buffett's no-dividend policy on thin ice

04 March 2013

Warren Buffett's stance against paying Berkshire Hathaway shareholders a dividend looks to be on thin ice. In his annual letter to shareholders the Sage of Omaha defended his long-held objection to cash payouts. But the firm performance over the past four years has been disappointing and Buffett reckons it won't match its glory days again. That's likely to increase the chances of a cash payout, whether from Buffett or his successor.

In his must-read missive, Buffett used a fair bit of ink to beat himself up about the "subpar" showing in 2012. He and his lieutenants created $24.1 billion of value for shareholders, but it wasn't enough to beat gains in the S&P 500 - a breach of the Oracle's code of success. If 2013 disappoints, Berkshire will, for the first time ever, lag the index over a five-year span.

This has unnerved some of his friends, according to Buffett's letter, who are giving him grief about not paying a dividend. With $42 billion of cash sitting idle at the end of 2012, their impatience is understandable. Last month's $28 billion Heinz deal will only chew up $12 billion. He even admits there are very few potential deals left that would be large enough to boost returns. Better, surely, to give investors some cash back to invest elsewhere.

But for Buffett, issuing a dividend is akin to admitting failure. In his letter, he argues that selling just 3.2 percent of stock each year should, over a decade, be more profitable - assuming Berkshire keeps delivering double-digit returns - than paying out a third of annual earnings over the same period as a dividend.

Buffett has built up enormous clout with investors. But the more that subpar growth appears to be the direct result of scale - Berkshire had $73 billion to invest in 2012 compared with $39 million in 1970 – the more their faith is likely to falter. That's likely to be even more the case for Buffett's successor.

Perhaps Buffett is hoping that airing his thoughts will alleviate such concerns. He is even, for the first time, allowing a bearish analyst to take part in a panel at Berkshire's annual meeting in May. Of course, such openness may actually provide more grist for the dividend mill.

Context News

In his annual letter to shareholders published on March 1, Warren Buffett said Berkshire Hathaway created $24.1 billion for shareholders in 2012. He called the performance subpar since the book value per share net gain of 14.4 percent lagged that of the S&P 500 by 1.6 percentage points. If Berkshire underperforms again in 2013, it will be the first time Buffett has failed to beat the broad index over a five-year period.

The Berkshire chairman also reiterated that the company would not issue dividends to shareholders despite calls for him to do so. At the end of 2012, Berkshire's insurance unit had $42 billion in cash on the balance sheet.

Swiss may show the way on pay

04 March 2013

Voters in Switzerland have adopted a law by referendum that will give shareholders extensive powers to limit pay for executives, force them to exercise their rights seriously and will establish across-the-board transparency on management compensation. Golden handshakes, or special bonuses like those awarded to chief executives after a merger, will be banned. Non-compliance with the new law will be a criminal offence punishable by jail terms of up to three years.

Corporate boards had better take notice: public outrage at what looks like persistent and unapologetic greed in the most severe economic slump in decades is forcing governments to step in. Throughout Europe, indignation at private excess has become a policy problem for administrations trying to explain the need to cut public spending.

The Swiss approved the new initiative by an overwhelming majority of 68 percent in spite of a multi-million Swiss franc campaign launched by business lobbies to fight it. The new regulation is in many ways stricter and wider than the European Parliament and member states' decision last week to go ahead with a controversial law that will limit bankers' bonuses, if only because it will hit all industries.

Self-moderation doesn't work and self-interest continues to prevail. Throughout the Western world, corporate boards have paid lip service to the need to take into account public opinion, and nothing much has changed either in the banking industry - the symbol of immoderation - or in the wider corporate world. In desperation, governments are taking more forceful action - sometimes reluctantly: the Swiss referendum followed a failure by the country's parliament to heed to public indignation.

Government intervention can often be clumsy, and it is fraught with the risk of unintended consequences. But it is the right of governments to legislate on social ills - and excessive and provocative private-sector pay has become one. Meanwhile the lobbies promising economic apocalypse have failed to make their case - and to scare anyone with warnings that "talent" - as they call it - may relocate to friendlier countries. It would be in the interest of all if they stopped turning a deaf ear to calls for decency emanating even from countries like Switzerland, which is hardly a hotbed of Soviet-style command economics.

Context News

Swiss citizens voted on March 3 in favour of the so-called "Minder initiative" to impose some of the world's strictest controls on executive pay, forcing public companies to give shareholders a binding vote on compensation.

The government said 67.9 percent of voters had supported allowing shareholders to veto executive pay proposals as well as banning big rewards for new and departing managers, one of the highest approval rates ever for a popular initiative.

HSBC again proves itself too big to damage

04 March 2013

HSBC is not only too big to fail: it's too big to damage. Even as mis-selling charges and the biggest-ever bank fine knocked its performance in 2012, the lender's bottom line was barely blemished. Future accidents are bound to happen, but it's hard to imagine a shock that HSBC couldn't absorb better than its peers.

Few banks could pay a $1.9 billion fine for money laundering, return $1.4 billion to UK customers who bought unnecessary products and still report an increase in underlying pre-tax profit. HSBC pulled off the trick. Chief Executive Stuart Gulliver's cost-cutting drive, completed a year ahead of target, helped limit the pain. So did a sharp drop in bad loan charges.

While last year was a miserable one for HSBC's reputation, there's no sense of that looking at the balance sheet. The core Tier 1 capital ratio is 10.3 percent under new Basel III rules, enabling HSBC to take that rare step for a UK lender - upping the dividend. As long as regulators don't shift the goal posts - admittedly a big “if”- and Gulliver steers clear of big acquisitions, shareholders can look forward to HSBC's surplus capital pouring into their pockets.

The flipside of stronger capital is potentially lower returns. Group return on equity is a value-destroying 8.4 percent, dragged down by Europe and North America - still HSBC's two biggest regions in terms of assets. And after tens of billions of dollars of losses on U.S. sub-prime mortgages, the money-laundering charges reinforce the impression that HSBC is simply too big to manage. Gulliver has beefed up compliance and promised to steer clear of businesses that carry a risk of financial crime. Even so, the bank's size and geographic spread mean it will struggle to avoid future shocks.

The shares still trade at a premium to book value. Perhaps investors think returns will improve as emerging markets account for a larger share of the total, and the safety benefits of scale and diversity outweigh the hazards. Or they are seduced by a dividend yield of 4.5 percent based on the promised interim payout for 2013. Either way, it's hard to disagree with their sense of security.

Context News

HSBC, Europe's largest bank, pledged to increase its dividend as strong growth in Hong Kong and other core Asian markets boosted its capital even though annual profit fell short of expectations.

The bank on March 4 said it made a 2012 pre-tax profit of $20.6 billion, down 6 percent from the previous year and below the average forecast of $22.7 billion from 28 analysts polled by Reuters. Profit was hurt by a $5.2 billion loss on the value of its own debt.

HSBC, already one of the highest dividend payers among Britain's blue-chip companies, said it plans to bump up its first three interim payouts on 2013 earnings by 11 percent to 10 cents per share.

At 1100 GMT, HSBC's London-listed shares were down 2.8 percent at 708 pence.

QInvest-EFG Hermes deal tests new Egypt

04 March 2013

QInvest's bid to carve up EFG Hermes is a test for the new Egypt. Ten months have passed and the Qatari firm is still waiting for regulators to approve its deal with the Cairo-listed EFG Hermes, the region's top investment bank. The decision is a political hot potato.

Under the agreement, EFG would initially inject its core business into a joint venture, 60 percent controlled by QInvest. The current terms are only valid until May 4, according to sources familiar with the transaction. If a green light isn't given by then, the firms will have to decide whether to extend, renegotiate or walk away.

The Egyptian Financial Supervisory Authority is in an awkward spot. EFG's co-chief executives, Hassan Heikal and Yasser El Mallawany, have been accused by Egyptian authorities of illegal share dealings in relation to a 2007 transaction, alongside the two sons of the deposed President Hosni Mubarak. If the Qatari deal is approved, the regulators would be criticised for letting executives who profited during the old regime gain handsomely in the new order.

But rejecting the deal is not easy. Qatar has provided both financial and political support to Egypt's new Muslim Brotherhood government, and the Egyptian government says it doesn't want to alienate businessmen.

Doing nothing would also leave both buyer and seller in a difficult position. QInvest is banking on the deal to transform it from minnow into major regional player. It has almost halved its headcount in anticipation of the tie-up, according to two people familiar with the bank. EFG also faces a tough time in its home Egyptian market, which accounts for the bulk of its fees and commission. The hope is that QInvest's Qatari connections will give it new business from the sovereign, and help the bank expand in Africa and Asia.

EFG shareholders have been promised a dividend equivalent to 35 percent of its current share price after the transaction. That's made a deal tempting to large shareholders that want to get cash out. But the investors may be disappointed. Most bankers now expect Egypt's regulator to avoid any decision until the insider trading charges are resolved.

Context News

A joint venture agreed between Qatar's QInvest and Egypt's EFG Hermes will lapse if the tie-up does not obtain regulatory approvals by May 4, according to two sources familiar with the deal.

The Egyptian Financial Supervisory Authority has not yet ruled on the agreement struck 10 months ago that would see the Middle East's top investment bank inject its core businesses into a joint venture 60 percent controlled by QInvest.

The transaction includes EFG's brokerage, research, asset management, investment banking and infrastructure businesses. QInvest would inject $250 million into joint venture and have the right to buy the remaining 40 percent between 12 and 36 months after the close of the transaction for $165 million or a fair market valuation.

EFG shareholders will receive a one-off dividend of 4 Egyptian pounds per share following the close of the deal, which was originally expected in the third quarter of 2012. EFG's private equity business and the firm's majority stake in Credit Libanais were to be excluded from the joint venture and will remain listed in Cairo.

The Egyptian bank's co-chief executives, Hassan Heikal and Yasser El Mallawany, face allegations of insider trading relating to Al Watany Bank in 2007. The board of EFG has previously stated its full support in the firm's CEOs.

State-backed Qatar Islamic Bank is the single largest shareholder in QInvest.

European banks were asking for a slap

04 March 2013

European banks were asking for a slap when new rules on pay were unveiled last week. Just consider this year's bonus round. Lower payouts had been predicted, reflecting the relative weakness of the business environment. In fact, pay for the average investment bank employee at Europe's top four firms fell just 2 pct last year, to $313,000. Deferred awards cloud the picture, but there's little sign of pay restraint.

Of the big four European investment banks, UBS paid out the most to its investment banking staff last year - $350,000 on average. That was only a 3.5 percent drop from the previous year, despite the Swiss bank's $1.5 billion fine for Libor rigging. Average pay at Credit Suisse fell a mere 2 percent to $330,000. Barclays, which also settled with regulators over Libor, slashed deepest: pay fell 7 percent to just shy of $300,000. But compensation rose 5 percent at Deutsche Bank to $290,000.

The modest overall drop comes despite fees in the Europe, Middle East and Africa region slumping 16 percent, against a 5.5 percent rise in the Americas, according to Thomson Reuters data. U.S. bank employees have understandably fared better where pay was flat to up. All the same, one might have expected European bank bosses to show more contrition in the year that the Libor scandal erupted.

True, the proportion of compensation paid out of revenue has fallen across the board. Banks have also shed staff, leaving greater rewards for those who remain. And compensation data are muddied because about three-quarters of all banks' numbers are comprised of salaries and deferred awards made in prior periods.

But it's not as if shareholders are doing that well. Deutsche Bank and Credit Suisse intend merely to hold dividends per share steady from last year. Barclays has recommended a modest increase. UBS, in recovery mode, has offered a larger 50 percent bump, but that's still only a paltry 0.15 Swiss francs per share.

The staggered nature of pay awards means it will take time for recent bonus reductions to show fully. But it looks bad that this was meant to be disappointing bonus round and overall pay numbers are barely down. No wonder the banks are being thwacked.

Bertelsmann's new BMG tune strikes the right chord

04 March 2013

Superficially, Bertelsmann's decision to re-take full control of BMG looks like the latest episode in a decidedly quirky odyssey. In fact, Bertelsmann CEO Thomas Rabe is implementing a new strategy outlined in September last year. Within a decade, Rabe wants to turn an ossifying media behemoth into a globalised, fast growing digital media company.

Apart from the name, indeed, today's BMG has little in common with the Bertelsmann Music Group that was hived off in a pair of deals involving Universal and Sony in 2006 and 2008. Old BMG mainly made records. New BMG, which owns media rights, was only founded in 2008. It has grown quickly to carry an estimated value of about 1.1 billion euros. Five years ago it managed intellectual property rights associated with just 16,000 songs. Helped by financial clout provided by KKR, new BMG gobbled up catalogues on a scale that means it now has a million songs. On the register, among many others, are Blondie, Cat Stephens and Johnny Cash.

With annual sales in 2012 of about 200 million euros, the company is small by Bertelsmann's standards. But it is growing rapidly - revenue is expected to grow 80 percent between 2012 and 2014. Profit margins, at around the industry norm of 25 percent, are also sweet.

Precise numbers for the BMG deal remain undisclosed, but the stated enterprise value, at three times 2014 revenue, is well above peers. The average for the quoted European media sector, according to Starmine, is two times. Bertelsmann is unlikely to reap much in the way of synergies. The sales growth projections, however, suggest BMG has qualities over and above quoted peers.

For Bertelsmann, the strategic signals sent may be as important as the economic value derived from BMG. It certainly contradicts the notion that the German media giant is incapable of seizing entrepreneurial opportunities that arise in what is a radically changing business environment. Further deals - potentially involving Springer Science, an academic publisher Bertelsmann sold in 2003 to two private equity companies - are said to be in the pipeline. To drive returns from the newly sharpened strategy, Bertelsmann may have to act more boldly.

Context News

Bertelsmann AG, Europe's largest media company, is to buy out KKR, the private equity group and partner in music rights company BMG. Bertelsmann currently owns 47 percent of the company. Bertelsmann said the deal gives BMG an enterprise value of 1.1 billion euros.

Reuters reports that the purchase price was between 700 and 800 million euros, including debt.

Hess rejects activist push - by caving to it

04 March 2013

Hess is rejecting an activist push - by caving to it. The $24 billion oil company's inefficient sprawl and cozy board made it a ripe target for Paul Singer's Elliott Management. Hess claims the hedge fund's prescriptions, unveiled in January, are wrongheaded. But the company is selling assets, nominating new directors and returning capital. That's much of what Elliott was after.

As Hess points out, the company has long been moving toward becoming a pure play. Since 1995, revenue from exploration and production has moved upward, and over the past two years the company has moved to exit the refining business. The decision to divest Thai and Indonesian units, sell its Bakken midstream assets and exit its retail and trading businesses should finish the process.

Yet rivals like ConocoPhillips and Murphy Oil long since beat them to it, racing ahead with plans to focus on E&P and being rewarded by investors for doing so. Hess's lethargy is one reason for the company's lingering discount to peers of about 20 percent on estimated 2013 EBITDA.

The presence of Elliott and activist ally Relational Investors sped up the slow process - especially on the company's board. Hess's 14 directors are a cozy, long-serving lot with little energy experience. Only three had any background in drilling and several have ties to the founding family and its charity. Elliott suggested five new candidates. Hess countered by nominating six new directors, four of whom are industry veterans.

The new batch of directors should help focus management's attention on operational efficiencies. While Hess has excellent assets, development costs have been higher than rivals and heavy capital expenditure has only had mediocre results. Plans to return more cash to shareholders by upping the dividend and buying back more stock should increase the firm's capital efficiency. Hess's willingness to discuss measures such as placing assets in tax-advantaged master limited partnerships should please investors.

Elliott has not had all its wishes granted. Hess is not separating its domestic and overseas operations because it argues the two share technical expertise. The board still appears relatively cozy despite the new addition - independent lead director John Mullin III, for example, is a joint executor of the Hess estate. But activists have largely won this battle.

Context News

On March 4 Hess announced it would exit its retail and energy trading businesses to concentrate on energy exploration and production. The oil company has been under pressure from activist investor Elliott Management to spin off its U.S. onshore assets and sell its retail operations. Elliott has nominated five directors for Hess's board.

Hess also announced it would divest Thai and Indonesian assets, sell Bakken midstream assets and return more capital to shareholders by increasing its annual dividend from 40 cents to $1 and repurchasing up to $4 billion of shares. It also nominated six new independent directors.

In a letter to shareholders, Hess said: "We are convinced that our transformation is driving superior value creation far beyond Singer's short-term time horizon."

Travel budgets could spare U.S. boards legal bills

04 March 2013

Travel budgets could spare U.S. boards some hefty legal bills. Financial fraud is often more easily hidden abroad. That's the trap Caterpillar fell into, and now it has snared directors of mining company Puda Coal. Delaware Chancery Court Judge Leo Strine recommends on-site visits. They're not always necessary, but boards owe investors closer scrutiny of assets abroad.

Puda Coal is an extreme case. The company's chief executive officer allegedly swiped and sold its primary asset, a 90 percent interest in a Chinese coal company. The U.S. directors didn't notice for almost two years, even though the transaction was recorded in Chinese government documents. Investors sued and Strine refused to dismiss the case against board members.

In typically colorful fashion, he berated the directors for failing to learn Chinese and visit the coal company regularly. "There's no such thing as a dummy director in Delaware," he fumed. Most notably, Strine suggested that the board members could be personally liable for potentially violating their duty of loyalty to the company.

The judge may have had a broader audience in mind. Last month, Caterpillar took a $580 million writedown on a Chinese mining equipment producer acquired less than a year before. The adjustment for accounting fraud wiped out three-quarters of the deal's value. Though stressing that it had been duped, Caterpillar might have avoided trouble with more thorough due diligence.

That could mean, as Strine advised, hopping on a plane and chatting with the locals from time to time. Independent directors of U.S.-listed Chinese companies would be wise to kick the tires of foreign assets, if only to make sure they exist. It's not always practical, of course: board members at the likes of General Electric could spend their lives on the road regularly checking the company's global assets.

Even established multinationals, however, should pay closer attention. Bribery investigations of Wal-Mart in Mexico, China, India and Brazil, for instance, suggest that no company is immune from scandal. Trusted professionals can enforce accounting and legal standards, but ultimately directors may be on the hook. The extra cost of jetting around the world may be a price worth paying.

Context News

The Delaware Court of Chancery on Feb. 6 ruled that independent directors of Puda Coal could be sued for failing to discover that the company's former top executives had allegedly stolen its main asset, a 90 percent interest in a Chinese coal company. In ruling from the bench, Chancellor Leo Strine criticized the U.S. directors for not learning Chinese and making regular visits to the company in China.

StanChart risks remain economic, not regulatory

05 March 2013

Standard Chartered is unique among its Western peers: the London-listed bank's main concerns are economic rather than regulatory. The emerging-market lender shrugged off a $667 million money-laundering fine to record its tenth consecutive year of pre-tax profit growth. Though UK rules and taxes are a drag, StanChart's fortunes remain firmly hitched to emerging markets.

It's only seven months since New York banking regulators sent the bank into a tailspin with allegations of sanctions-busting transactions, yet the saga now seems a distant bad dream. StanChart paid through the nose to settle the charges: even after the recent rash of Libor-rigging penalties, its overall fine still ranks as the fourth-largest ever paid by a bank. But it barely registered in the results.

That's because StanChart had plenty of bright spots to offset the pain. Its consumer banking division generated an 8 percent increase in operating profit, while the larger wholesale banking business - which now accounts for two-thirds of the bank's income - was up 11 percent, before fines. Though bad loan charges jumped by a third, the bank kept a tight grip on expenses.

StanChart has thrived largely by investing in the right parts of the world. China, a tough market for foreign banks, generated more than $1 billion of income in 2012, up from just $44 million in 2003. And StanChart's Asian business ought to carry on expanding as long as China continues to power economic growth in the region. In that sense, the bank remains an almost pure play on the opportunities - and risks - in emerging markets.

Of course, StanChart cannot ignore regulators entirely. UK demands that it hold buffers of spare liquidity were a drag on earnings in 2012, though the rules are due to be loosened. The UK's bank balance sheet levy, recently increased again, is another irritant.

Investors can clearly live with these worries. StanChart shares, which rose almost 3 percent in early trading on the results, are up almost 50 percent from their low point last August. Absent a slowdown in the East, it's hard to see what would trigger a reversal.

Context News

Standard Chartered notched up a tenth successive record year with a 1 percent profit increase in 2012, just below expectations after a big fine for breaking sanctions on Iran countered strong growth in Asia. The emerging-market bank reported a pre-tax profit of $6.9 billion for 2012, up from $6.8 billion in 2011 but short of the average analyst forecast of $7 billion.

"Standard Chartered remains a growth story and we are sticking to our strategy, focusing on the basics of good banking, in markets we know well, with clients and customers with whom we have deep relationships", Chairman John Peace said.

The group's operations in China and wholesale banking business in Africa achieved $1 billion of income for the first time, it said.

Standard Chartered said it cut its bonus pool by 7 percent after its $667 million fine from U.S. regulators for breaching its sanctions on Iran and three other countries.

Shares in Standard Chartered were up 2.7 percent at 1130 GMT, outperforming a 1.6 percent rise in the European bank index.

The bank is paying a dividend of 84 cents per share, up 10.5 percent on the previous year.

Bonus-rule get-arounds would invite retribution

05 March 2013

The banking industry has a history of treating regulation as a challenge to be overcome. The proposed European rule capping bonuses as a percentage of base pay is already looking typical. Some banks are thinking of mounting a legal challenge, according to the Financial Times. If they proceed, the chances of success are slim and the process will last years.

While waiting for a final judgment, the banks have a choice: comply with the spirit of the law or remain true to the industry's form and try to find legal ways to follow the letter while ignoring the spirit. Inside the banks, there is likely to be intense pressure for the latter.

It could probably be done. With variable salaries, non-bank subsidiaries and who knows what else, bonuses can continue to reward successful risk-taking pretty much as they always have. Such thinking comes all too easily in an industry which has routinely used disclosure rules - which are supposed to make business fair - as a defence when naive clients complain that they were misled by canny salespeople. This approach is also in line with the standard industry practice of putting the interest of employees well before that of shareholders, taxpayers and customers.

The thinking needs to change. The European Union rules may prove counterproductive. But there is no doubting the popular support for the spirit of the law: to restrain at least one of the industry's excesses. So if public spiritedness is not a powerful enough motivation, then self-interest should be.

Bankers beware. If the spirit of the law is widely flouted, the public's ire will only increase. Bankers who are unwilling to accept some pay restraint now are likely to end up with much more later. They're not in a good position to defend high pay packets, since they are mostly received in return for services of dubious social value.

It may take a little while before the EU comes back with tougher curbs. It may even take another crisis. But when the time comes, bankers will reap in regulation what they have sowed in oblivious self-interest.

Context News

Some European banks have taken legal advice on the possibility of challenging a EU law which limits the ratio of bonuses to salaries in banks, according to the Financial Times.

Glencore/Xstrata results herald tense integration

05 March 2013

If Glencore wasn't taking over Xstrata, it would find boasting about the companies' relative performance last year much easier. As the metals cycle turned, the commodity trader outshone its mining merger partner. That difference sets the tone for what will be a tense "Glencorisation" of Xstrata's ambitious culture.

Ivan Glasenberg, Glencore's chief executive, was publicly scathing about unrestrained spending by big miners, even before they all took impairment charges on greenfield and acquired assets in the current reporting season. Xstrata's annual results included a $978 million impairment charge on its own operations, plus a comparable $944 million hit from investments in other miners. True, Glencore got thwacked by one-offs too - mainly $1.2 billion of losses on its stake in Russian aluminium group RUSAL.

Glencore's charges, and the consolidation of the 34 percent of Xstrata it currently holds, meant that both companies saw a 75 percent fall in pre-tax profit. But at the operating level, Glencore looks much stronger. Before exceptional items and Xstrata's contribution, Glencore's operating profit fell only 6 percent to $3.3 billion while Xstrata's was down 43 percent at $4.8 billion. The main difference was Glencore's less cyclical trading business, in particular in agricultural commodities.

The gap underscores how Xstrata's big mining operations will dilute Glencore's trading business in a merged company. The two have different cultures. Xstrata's emphasises investment and growth; its managers are accustomed to pitching long-term projects and getting the funds. Glencore runs its own mining business primarily to supply commodities for the trading arm. Glencore's culture will now prevail.

Glencore shares, at 376 pence, are still 30 percent below their 2011 offer price. A fierce attack on capex may help push up profit enough in the short term to make IPO investors whole, especially after a big-spending year for both companies. But Glasenberg needs to take care. Mining is inevitably a long-term business. A fixation on profit now could ultimately do more harm than good.

Context News

Glencore posted pre-tax profit down 73 percent at $1.08 billion in 2012, hit by a weaker contribution from the commodity trader's mining operations and from associate holdings. One-off charges totalled $2.1 billion. Operating profit from its trading arm was $2.1 billion, up from $1.9 billion.

Xstrata posted pre-tax profit down 75 percent at $2 billion, after the miner took $2.6 billion of one-off charges.

The merger of Glencore and Xstrata is still awaiting regulatory clearance.

How to get richer than Warren Buffett, Zara-style

05 March 2013

Where style magazines have “what’s hot and what’s not” columns, finance has rich lists. Straddling the two worlds is Zara founder Amancio Ortega, now the world’s third-richest man, according to Forbes. He has amassed $57 billion by flouting many of the rules of fashion retail.

Shopkeepers get less press than tech visionaries. Yet the annual tally of billionaires shows that retail is a money machine. Aside from Ortega, who owns 59 percent of Zara’s parent company, Inditex, huge fortunes have been made selling clothing, groceries and furniture by the people behind H&M, Uniqlo, Wal-Mart, Aldi, IKEA, and others.

Most retailers are recession-resistant and have huge potential customer bases. And they rarely need much capital to get started. Shops can usually be rented rather than bought, and suppliers can be paid after goods are sold. For successful formats, it’s a story of high margins, fast growth and self-made billionaires.

Inditex’s special trick is its agility. New designs appear constantly. Suppliers are mostly in nearby Iberia, Morocco and Turkey, rather than the Far East, so new clothes arrive faster. Short production runs mean fewer discounted leftovers. Zara and its seven sister brands also eschew advertising. They bring in customers by putting the stores in glitzy popular locations.

Flabbier rivals such as Gap and H&M have been left far behind. But Inditex is not yet done. Nomura reckons it has just 1 percent of the world’s $1.8 trillion apparel market. It could do much more online, too.

For investors, the catch is that this is the worst-kept secret in retail. At roughly 27 times expected 2013 earnings, and up 50 percent in a year, Inditex’s shares are already painfully expensive.

That hardly discounts the risk that Inditex will become less nimble as it expands or that it will lose out in the digital retail revolution. But even if margins stay at current levels while sales double from today’s 16 billion euros, Credit Suisse reckons the group is worth no more than 98 euros a share - versus today’s 106 euros. In fashion, it often pays to ignore today’s trend and seek out the next big thing.

Context News

On March 4, Forbes said Spanish businessman Amancio Ortega was the world’s third-richest man, with an estimated net worth of $57 billion. Ortega is the co-founder and majority owner of Inditex, the world’s biggest clothing retailer, in which he owns a 59 percent stake.

Ortega overtook U.S. investor Warren Buffett and French businessman Bernard Arnault in the business magazine’s annual rankings. The first and second places were held respectively by Carlos Slim, the Mexican telecoms billionaire, and Microsoft co-founder Bill Gates.

Inditex, whose biggest brand is Zara, said at its last quarterly results that it has nearly 5,900 stores in 86 countries. Net income rose 27 percent in the first 9 months of 2012 to 1.655 billion euros ($2.16 billion), on sales of 11.36 billion euros.

Inditex shares closed at 101.05 euros on March 4. Shareholder returns since March 2001, when the company floated at 14.70 euros a share, have totalled 729 percent, according to Datastream. Spain’s IBEX-35 index has returned 36 percent over the same period.

RWE will find it tough to renew its powers

05 March 2013

RWE has managed a rare thing: it is a leading German utility that has surprised on the upside. Not only did it exceed its profitability targets for 2012 by 10 percent, it also said it wanted to sell its oil and gas unit. It is a move that will generate about 4 billion euros of cash - and obviate the need to invest in expensive exploration.

Yet investors have good reasons to be wary. Germany's decision to phase out nuclear power and to promote renewables upsets RWE's established business model. While RWE has swallowed the hit on the value of its four German nuclear power plants, its coal and gas power stations are also impaired. RWE has already written off 1.7 billion euros of value in its gas power plants in the Netherlands. Meanwhile, German law stipulates that energy from renewable sources is fed into the grid on a priority basis. While beneficial for the climate, it's bad for RWE, Europe's largest emitter of carbon dioxide. CEO Peter Terium forecast on Tuesday that in 2013 wholesale prices for energy from conventional sources will fall significantly. If the pattern becomes entrenched, RWE's will suffer an extended period of pain.

True, RWE has invested 4 billion euros in renewables generation. But it still earns 51 percent of its operating profits from conventional sources and only a small slice of the remainder comes from renewables. RWE's high debt burden of 33 billion euros - 3.5 times its current earnings before interest, taxes and depreciation - limits its room for manoeuvre. RWE's asset disposal programme - launched to bring down debt and originally supposed to generate 7 billion euros of cash until the end of the year - is also behind schedule.

Investors may be relieved to see that RWE is paying an unchanged dividend of 2 euros per share. The yield - at 6.9 percent - is high. It is so high, in fact, as to suggest worries. To be assured of its sustainability, RWE may need to pursue a more fundamental renewal of its resources.

Context News

RWE AG, the largest German energy producer, increased its revenue by 3 percent to 53.2 billion euros in 2012. Operating profit came to 6.4 billion euros, up 10 percent.

CEO Peter Terium indicated that the profitability of RWE's conventional power generation unit will deteriorate significantly in the coming months. The company also said it would sell its oil and gas producing unit. RWE DEA generated revenue of 1.85 million euros and operating profit of 685 million euros.

Shareholders must remind lawyers who's in charge

05 March 2013

Shareholders must start reminding lawyers who's in charge. Legal eagles are eyeing complaints over stock-plan violations after pouncing on say-on-pay votes and proxy disclosures. The new litigation against the likes of Caterpillar and Viacom supposedly benefits stockholders. But it seems more of a feast for lawyers. Pension funds and other big investors ought to call out the weaker cases.

The plaintiffs' bar is nothing if not resourceful. After Congress limited federal class-actions that blamed stock losses on fraud, legal challenges to M&A deals boomed. And when the Dodd-Frank Act required shareholder votes on executive pay, attorneys saw an opportunity.

Though results weren't binding, the few companies that failed to win enough investor support got sued. About half the cases were dismissed, but some were settled for more than $1 million in legal fees. None was filed after last September, according to law firm Pillsbury Winthrop.

Instead, investors started suing over pre-vote disclosure that supposedly omitted important information like the data reviewed in calculating executive compensation. At least 24 companies were hauled into court last year. Some settled for legal fees of up to $625,000, but almost all squelched efforts to delay balloting, according to Pillsbury.

The latest edition of shareholder suits certainly sounds promising. It typically accuses management of awarding more stock options than authorized and then claiming in proxy statements that the options are valid. It's a technical violation that, if true, could cause trouble. But it's also easy to avoid or fix: companies merely need to check the limits of their stock plans.

Whether stockholders will benefit from going after Bank of New York Mellon, Caterpillar, Viacom and eight other companies sued so far is another matter. Past cases indicate the best they'll get is more disclosure and a settlement for legal fees. That's a good deal for lawyers, but not for company shareholders, who will ultimately pick up the tab.

Cases may not even have much merit. Last year a suit against Microsoft for poor proxy disclosures was dropped after a major shareholder, the California State Teachers' Retirement System, told the court the disclosure was fine. That should serve as a reminder that investors, not lawyers, should be calling the shots.

Context News

Shareholders have sued Bank of New York Mellon, Caterpillar, Viacom and at least eight other U.S. companies for allegedly awarding stock options in excess of plan limits described in proxy statements. The cases are the latest version of litigation related to proxy statements and shareholder votes.

Scores of firms have been targeted over the past two years for losing advisory votes on executive pay or failing to disclose enough information about management compensation. Most of those suits have been dismissed or settled for legal fees. None of the new cases has yet been resolved, according to law firm Pillsbury Winthrop Shaw Pittman.

Samsung cash injection still leaves Sharp short

06 March 2013

Sharp has found an unlikely friend. The cash-strapped Japanese electronics group has secured a $111 million cash injection from Korea's Samsung, one of its long-standing rivals. The deal represents an important vote of confidence in Sharp. But with net debt of $11 billion, it will need a lot more equity before it is out of the danger zone.

At first glance, the euphoric reaction to the deal looks exaggerated. Sharp's market value jumped by around $500 million – almost five times the value of Samsung's investment. Yet the strategic benefits are difficult to quantify. Sharp has secured a long-term contract to supply liquid crystal displays, but Samsung was already a customer, so it's hard to argue that the deal unlocks a large new source of revenue. Samsung, meanwhile, was presumably keen to lock in a supplier which might otherwise be tempted to do more business with rivals such as Apple, or aggressive new Chinese manufacturers.

The share purchase is small change for the Korean group, which had more than $11 billion of net cash on its balance sheet at the end of December. But it does little to help Sharp, which ended 2012 with the same amount in net debt. Combined with a similarly-sized investment from U.S. manufacturer Qualcomm in December, Samsung's equity injection is mainly useful as a signal that other electronics firms believe Sharp will turn itself around. It's also significant that Sharp has been able to secure support from outside the closed circle of Japanese banks and manufacturers that traditionally tend to prop up the country's ailing companies.

Nevertheless, Sharp's balance sheet still needs drastic reconstruction. It has bought some breathing room by cutting a deal with banks that covers its refinancing needs to 2014, and cost-cutting delivered a rare operating profit in the most recent quarter. The yen's recent fall may ease the pressure on domestic exports, and has also helped to spark a share price rally. Sharp's shares have doubled in value since November. To secure its turnaround, however, it needs to pay off a lot more debt. Perhaps Sharp can ask its newest shareholder to support a large capital increase.

Context News

Sharp has struck a deal with Samsung in which the Korean group will invest 10.4 billion yen in the ailing Japanese electronics firm.

Sharp supplies liquid crystal display panels to Samsung. Sharp said the March 6 agreement would strengthen existing links. It added that the deal would "continuously provide a long-term, stable and timely supply of LCD panels" for televisions and notebook computers.

Samsung will buy 35.8 million Sharp shares at a price of 290 yen per share, giving it a stake of 3.08 percent.

In December, U.S. group Qualcomm agreed to invest approximately 10 billion yen in Sharp shares in two tranches. In March 2012, Hon Hai, the Taiwanese group that assembles many of Apple's products, announced the outlines of a deal to invest 66.9 billion yen in Sharp. However, that agreement has not yet been completed.

At close of business in Tokyo shares stood at 341 yen, up 14 percent.

Market dislike of Axel Springer is over the top

06 March 2013

Axel Springer, Europe's largest newspaper group, spooked markets on Wednesday. It expects earnings before interest, tax and depreciation to decrease by up to 9 percent this year. Analysts polled by Reuters were expecting an increase in profitability. Subsequently, Axel Springer's shares went down by more than 6 percent. Given the company's solid fundamentals and a successful transition into digital businesses, the reaction smacks of myopia.

The owner of Germany's tabloid "Bild" and national daily "Die Welt" is coping well with the structural challenges to the media business model. In terms of revenue, its fast-growing digital operations have already become Axel Springer's most important segment. In 2012, it surpassed the unit comprising German newspapers for the first time. Digital businesses generated 35 percent of total revenue compared to merely 8 percent five years ago. Besides, only about one-third of its digital sales and profit are generated by classic journalistic ventures like news portals. The bulk comes from digital marketing and online sites based around classified advertising.

Acquisitions have helped. But Springer avoided costly blunders such as News Corp's ill-fated acquisition of MySpace. In an industry famous for burning millions, Springer's deals are bearing fruit. In 2012, digital EBITDA jumped by 53.6 percent to 242.9 million euros. It contributes 38 percent of Springer's total EBITDA.

It is a different story at Springer's traditional print businesses. Declining print advertisement revenue led to a 9 percent drop in profitability of Springer's German newspapers and magazines. But with EBITDA margins of about 22 percent, print still is making decent money. Springer is also better positioned than peers to realise economies of scale on the cost side. After successfully pooling the editorial staff of its national paper "Die Welt", its Sunday paper "Welt am Sonntag" and its Berlin daily "Berliner Morgenpost", it is now integrating its Hamburg daily "Hamburger Abendblatt" into a joint newsroom. This gives rise to short-term restructuring costs - which partly explain the surprisingly gloomy outlook statement from Springer on March 6. But it generates significant cost savings in the long term.

Springer will expand further into digital businesses in 2013. Restructuring of the print units will also continue. Investors should appreciate that rather than take fright.

Context News

German publisher Axel Springer announced sales of 3.3 billion euros for 2012, an increase of 3.9 percent compared to the previous year. A drop of 3.5 percent in circulating revenue was more than offset by 9.4 percent growth in advertisement revenue. Earnings before interest, taxes and depreciation increased 5.8 percent to 628 million euros, beating expectations. Analysts polled by Reuters expected an EBITDA of 619 million euros.

The company gave a cautious outlook on 2013. With regards to revenue, it anticipates a low single-digit percentage increase. Profitability, however, is expected to decline. The management anticipates a single-digit percentage decrease in the group's EBITDA, driven by investment into the digital business and restructuring costs in the print business.

Vodafone should dash for Verizon exit if it's open

06 March 2013

Vodafone should dash for a U.S. exit if it’s open. Shares in the UK telecoms group soared on March 6, on hopes that Verizon Communications could buy it out of their $250 billion-plus joint venture. Ending a long standoff while U.S. assets are at high valuations makes sense - as long as Vodafone doesn’t squander the proceeds on a costly makeover.

Verizon Wireless, the 45-55 joint venture, has been a sticking point for years. The main gripe was once that Verizon blocked dividend payments. Nowadays the problem is about scale. As U.S. telecoms have thrived and European rivals have languished, ever more of Vodafone’s value is bound up in an asset that it does not control. So it makes sense to get out. And U.S. telecoms valuations may be near a peak - the market is likely to get tougher after Japan’s Softbank bought into Sprint Nextel.

The unit may be worth 8 times EBITDA, implying a value of $120 billion for Vodafone’s stake, using Deutsche Bank estimates. Without raising a crazy amount of debt, Verizon could pay $40 to $50 billion in cash, with the rest in its own stock. That would leave Vodafone owning about a third of the U.S. diversified telecom.

A potential $20 to $30 billion tax bill makes agreeing a price that’s acceptable to both sides much harder, although paying mostly in shares could delay the due date. And the UK company would still retain a large, passive U.S. holding, which would probably not be given a full rating by the market and analysts. The obvious alternative - a full Verizon-Vodafone merger - looks unwieldy and unlikely. For all its complications, an exit from the joint venture would be a good result.

Even if a deal can be struck, its real benefit depends on what Vodafone does with the strategic options that come with it. The temptation would be to use the proceeds to plug strategic gaps in Europe, perhaps by pursuing richly valued cable assets such as Kabel Deutschland, Spain’s Ono or even a combined Liberty Global/Virgin Media. But Europe’s telecoms have a terrible track record of creating value through acquisitions. The rally in Vodafone’s shares suggests investors may have already forgotten that.

Context News

Verizon Communications is working to resolve its relationship with Vodafone Group this year, Bloomberg reported on March 5, citing people familiar with the situation.

The U.S. telephone operator and its UK partner discussed a full combination as recently as December but talks stumbled over disagreements on leadership and headquarters location, the newswire said. That makes a full or partial buyout of Vodafone’s 45 percent stake in Verizon Wireless, the duo’s mobile-phone joint venture, more likely, Bloomberg said. All three companies declined to comment.

Vodafone shares leapt in the next trading session. By 1437 GMT on March 6, they stood 7.3 percent higher at 180.9 pence a share.

Mervyn King's RBS bad bank plan is just bad

06 March 2013

Mervyn King's plan for Royal Bank of Scotland doesn't stack up. The Bank of England governor thinks that the UK government, which owns 81 percent of the lender, should split it into a bad bank, to be run off, and a good bank, to be sold. The idea may look like it has merits, but it's hard to justify.

King's plan is strangely timed. RBS is nearing the end of a five-year programme to shrink 258 billion pounds of non-core assets and King himself is nearing the end of his term as governor. That said, it has some logic. RBS's core UK retail and corporate banks made returns on equity of 24 percent and 15 percent respectively in 2012. Yet the bank booked a 5.8 billion pound loss, dragged down by 88 billion pounds of loss-making non-core and Irish assets. If it split off these rotten bits, the government could sell the remaining part for a higher multiple, and the new bank would then be freer to lend.

Unfortunately, getting there could cost the taxpayer. First, the government would probably have to spend 6.7 billion pounds to buy out the 19 percent of RBS it doesn't own. Then there are the bad-bank assets. Assuming RBS holds 10 percent of capital against them, the bad bank could survive losses of 28 percent of its book, factoring in the 15 billion pounds of existing provisions. Yet given these are RBS's dodgiest assets, even this might not be enough.

If investors decided that RBS's good bank merited a valuation comfortably above 50 pence - the price the government paid in 2008 - the loss could be recovered. This looks like an optimistic scenario since the bank has 284 billion pounds of investment banking assets that aren't making their cost of capital, and is exposed to future hits from past mis-selling scandals and a stuttering UK economy. A valuation way above book value - currently less than 45 pence - would be difficult in the short term.

King's idea would be worth a try if there was some certainty that a newly privatised "good RBS" would start lending in earnest. But opinions differ on whether credit is constrained by a lack of supply or of demand by businesses. The UK government might consider it's better off leaving RBS be, rather than spending billions more to find out which it is.

Context News

Royal Bank of Scotland should be split into a good bank to be sold to investors and a bad bank to be wound down, Bank of England governor Mervyn King told the Parliamentary Commission on Banking Standards on March 6.

New high for Dow sends cryptic market message

06 March 2013

The stock market rarely speaks clearly. Milestones such as Tuesday's record closing high for the Dow Jones industrial average are easy to spot. But like the pronouncements of ancient oracles, this one is open to contradictory interpretations.

To start with, as a narrow benchmark of 30 stocks weighted by share price rather than market value, the Dow is not very representative of the wider American market or the economy. And as a nominal metric, it is boosted by inflation. U.S. equities will reach a more meaningful all-time high when the broader S&P 500 Index regains its 2000 peak, adjusted for inflation. To get there, it has to rise by approaching a third.

And stock performance of late has hardly been unequivocally for the record books. The S&P 500 is still down in inflation-adjusted terms from the previous real high more than a dozen years ago - even though the constituent companies' combined profit has increased by almost 40 percent in real terms. Then again, shares have done quite well since the 2009 trough. The Dow, like the MSCI World index, has doubled in that time. Over the very long haul, the rewards have been about as expected. The S&P 500 has returned a real 3.3 percent annually over the last 60 years.

Nor is it clear whether stocks are cheap or expensive. The price-to-current earnings ratio for the S&P 500 is well below bubbly levels - 18 times now, compared to 28 times in 2000, using numbers compiled by economist Robert Shiller. But today's PE ratio is almost exactly on the 60-year average. And if interest rates were not preternaturally low, corporate profits would probably be weaker - so the market could equally be seen as dangerously expensive, adjusted for more normal financial conditions.

Markets have no feelings, but traders and investors are an emotional lot. Are they cheerful or glum? The best answer is probably something like, "Yes, for now." The new high for the Dow shows that there's less fear about than in the darkest times - but there's more than in others. The same goes for greed, hope, caution and whatever else guides buying and selling decisions. Some investors and pundits may celebrate Tuesday's record but it's a milestone, not a signpost.

Context News

The Dow Jones industrial average closed at 14,253.77 on March 5, up 0.9 percent on the day and the highest closing level ever, surpassing the previous 14,164.53 record, set in October 2007.

Venezuelan oil gets a slightly new sheen

06 March 2013

Venezuela's oil is getting a slightly new sheen. Under Hugo Chavez, state-controlled energy giant Petroleos de Venezuela spent twice as much on welfare as it invested in production. Reversing the ratio would better exploit the world's largest reserves. Whoever succeeds Chavez, however, probably will follow his model - at least until the price of oil falls.

Treating PDVSA as a piggy bank has cost Venezuela. By 2011, the country was pumping about 420,000 barrels less a day than it had a decade earlier. At current prices, that amounts to $42 million of lost revenue a day. Venezuela could pump millions more barrels daily, based on the nation's peak output in the 1970s. Neighbors have shown the alternative route. Colombia, for example, has boosted production by about 50 percent over the past 10 years.

The long view looks distant for Venezuela. Chavez showed just how important a political apparatus PDVSA can be. After handing over $24 billion in taxes and royalties to the government, the company was forced to spend another $30 billion on social projects in 2011. Capital spending amounted to $17.5 billion. Even if acting President Nicolas Maduro, the front-runner to win a new election, wanted to implement reform, the risk of slashing PDVSA's social spending would be too big until he could more firmly establish his own power.

The more likely scenario is that markets will dictate the policy. With oil now trading at around $100 a barrel, PDVSA generates enough revenue to provide domestic handouts for the impoverished nation. The Soviet experience when oil prices fell in the 1980s should be instructive, though. Then, the decline in hard-currency revenue exposed economic contradictions in the system.

The prospects aren't far-fetched either. Global oil supplies are increasing rapidly thanks to shale and tar-sands technologies. Eventually, they should push down the price of crude. The next president of Venezuela can't afford to ignore PDVSA's financial realities - or the political repercussions they portend.

Context News

Venezuelan President Hugo Chavez died on March 5 at 58. The country's oil production under his leadership declined by a fifth from 1999 to 2011, according to data from BP. In the decade to 2011, Venezuela's oil output fell by 13 percent. By comparison, in Colombia it increased by 48 percent over the same period and in Brazil by 64 percent.

Newtown effect yields bumper crop for gunsmiths

06 March 2013

The “Connecticut effect” is yielding a bumper crop for gunsmiths. Smith & Wesson’s order backlog hit an all-time high following the Dec. 14 shootings of 20 first-graders and six teachers in Newtown, Connecticut. The company raised sales projections for the third time in a year. The prospect of tighter gun restrictions - however remote politically - has buyers in a panic. The National Rifle Association has earned its keep for another quarter.

Sales at the Springfield, Massachusetts-based firm rose nearly 40 percent and income more than tripled. And the maker of such weapons as the M&P 15 Sport semiautomatic with a 30-round magazine thinks the good times will continue. So do its shareholders: the stock is up 16 percent this year.

Demand for firearms took off early last year as the NRA took a hard stance against President Barack Obama in his campaign, claiming he was conspiring to gut the Second Amendment. The December school shootings made this wild talk seem real to those with an expansive view of the right to bear arms. In January, the president called for a ban on some military-style assault rifles, limits on magazine capacities and background checks on all gun sales.

Other companies have also enjoyed the frenzy. Firearms maker Sturm, Ruger’s stock has gained a quarter so far this year. Wal-Mart had to ration ammunition sales. Hunting-goods store Cabela’s has added $850 million of market value since the start of 2013. Yet the industry knows that Sandy Hook has changed the gun debate. The school shooting dominated Smith & Wesson’s conference call with investors. Smith & Wesson’s boss began the call by “sending our thoughts and prayers to those affected.”

In addition to planned bills on gun trafficking and background checks, polls show a large segment of the American voters favor restrictions on magazines and assault weapons. New York, California and Connecticut - the state that brought the world the Colt 45 - are tightening up rules. State pension funds are withdrawing investment from firearms makers.

But markets have their own self-correcting mechanism, too. Smith & Wesson’s backlog of $688 million has tripled over the past year amid fears guns will be banned. That’s not likely to happen and eventually supply will catch up with demand. In 2009, when the last gun bubble collapsed, the company’s backlog fell by about two-thirds in six months as confiscatory worries receded. It may not satisfy gun reformers, but the current buying fever will subside of its own accord.

Context News

Smith & Wesson reported revenue of $136 million for the quarter ending Jan 31. That is a rise of 39 percent from the same period last year. Income more than tripled to 22 cents per share.

The gun manufacturer raised its full-year guidance. It anticipates net sales of $575 million to $580 million in the fiscal year. At the midpoint, that would be 40 percent growth compared to the previous year. The company has raised its full-year guidance three times in the past year.

The company said its backlog of firearms purchases was $668 million, an all-time high. The figure was $199 million for the same quarter last year.

Misguided regulatory chemotherapy threatens banks

06 March 2013

What's one of the biggest threats to the American economy? "Misguided regulatory chemotherapy," is the pull-no-punches answer from Bob Wilmers, the boss of Buffalo, New York-based M&T. That is risqué language coming from the chief at a bank that received money from the U.S. government's financial industry bailout - and only paid them back last year.

But Wilmers' track record makes him one of the few industry veterans whose opinion merits a listen from investors. The bank treated them kindly by never cutting the dividend. And it used the downturn to buy struggling rivals. The strategy paid off as M&T last year earned a return on tangible equity of almost 20 percent.

Colorful metaphors aside, his point on regulation is a simple one - unlike some of the more arcane discussions Wall Street executives have had in Washington. Wilmers is arguing that the welter of new rules is piling on so many extra costs, time and complexity that it risks undermining the basic function of lending. Granted, after the mistakes many banks made extending credit in the last boom, change is needed. Wilmers' call for rules based on "clarity and simplicity," though, is hard to reject.

He applies the same logic to his swipe at the Financial Accounting Standards Board. The result of spending $164 million over five years to come up with 94 new rules, he argues, is confusion, pages of disclosure no one reads and delays in building up loan-loss reserves. In Wilmers' eyes the only beneficiaries are accounting firms.

Both arguments carry merit, as does his broadside on the nation's top six bank bosses being paid 264 times the national average - though at $3 million for his services in 2011, Wilmers is no pauper either.

As with some of his previous letters, this one does at times come across as little more than a list of gripes. But he makes a good, common-man stab at outlining his vision of how banks should function. All in, his 26-page missive remains a must-read. JPMorgan's Jamie Dimon, another CEO whose shareholder letter functions as bully pulpit, will have to polish his prose to compete.

Context News

M&T Bank, a top 20 U.S. bank by assets with a $14 billion market value, published its annual report on March 6. In his letter to shareholders, Bob Wilmers, its 77-year-old chairman and chief executive, referred to excessive oversight as "misguided regulatory chemotherapy - where the treatment meant to eliminate cancer cells damages healthy ones in the process." The analogy is designed to draw attention to his belief that too much regulation crimps banks' ability to lend and help the economy grow.

He also attacked the complexity added to reporting financial statements by the Federal Accounting Standards Board, arguing that only accounting firms benefit - especially the big four. And he argued that compensation at larger firms is still far too high, with the average pay of CEOs at the nation's top six banks equating to 234 times the national average for employees.

Microsoft case shows how tech monopolies get fixed

06 March 2013

The Microsoft case is a study in how technology monopolies really get fixed. European trustbusters on Tuesday fined the U.S. software giant yet another 561 million euros ($731 million) for anticompetitive behavior, this time for failing to give users a choice in browsers, as agreed. Neither Microsoft nor the EU acted on the transgression too swiftly. Rivals moved more aggressively to sort out the problem.

Fighting for over a decade against EU claims that it is an abusive monopolist has sapped some of Microsoft's strength and a fraction of its plentiful treasury. Fines now total 2.2 billion euros. An agreement in 2009 was supposed to at least curtail hostilities. The EU ended an investigation into whether the company was using its dominant position to squelch competition in the browser wars by bundling Internet Explorer with its operating system.

Part of the deal required Microsoft to offer customers a choice of ways to surf the Web. For more than a year, it didn't. After the European Commission came knocking last summer, Microsoft found and admitted that 28 million customers were affected. In what can only be considered a sad irony, it blamed a technical glitch.

The long delay reinforces the idea that the ability of regulators to encourage competition is limited. By contrast, competitors proved more effective.

Firefox retained a big piece of the market and Apple's Safari made inroads. Google also introduced Chrome in 2008 and is using its strength in search to popularize the browser. Google's search engine doesn't place advertisements on its front page, but does use it to push Chrome. In what would have been an unthinkable challenge to Explorer a decade ago, Chrome is now the most popular browser worldwide by page views with over a third of the market, according to StatCounter.

Of course, Google is also now the target of an EU investigation. Regulators may take an understandably dim view of the Mountain View, California-based company's competitive practices. And yet it has done more to curb Microsoft's browser dominance than anything the commission ever did.

Context News

European Union regulators fined Microsoft 561 million euros ($731 million) on March 6 for failing to abide by a commitment it made in 2009 to offer users a choice in computer browsers. Between 2011 and 2012, 28 million users were not given a choice, according to Microsoft.

The European Union has fined Microsoft 2.2 billion euros over the past decade for anticompetitive behavior.

Microsoft said in a statement: "We take full responsibility for the technical error that caused this problem and have apologized for it."

Big Oil finds a new rallying cry: we're green too

06 March 2013

Big Oil has found a new rallying cry: we are green too. ConocoPhillips <COP.N> boss Ryan Lance told colleagues at the industry’s annual CERA conference in Houston on Tuesday that they should take more credit for its role in reducing U.S. carbon emissions. With cleaner gas displacing coal, he has a point. Not everyone will care, but it is a handy extra point to make when lobbying Washington.

Greenhouse gases from energy sources like coal have dropped 13 percent in the United States since 2007. Western European states, which tend to think of themselves are more environmentally friendly, are making less progress. In fact emissions in Germany, the region’s largest by economy and population, were up 1.6 percent last year even though it produces five times more solar energy than America, according to German government figures.

What’s driving the U.S. reduction is a surge in production of gas, the domestic price of which is currently near all-time lows. That does make it a bit harder for the fossil-fuel industry to pat itself on the back - this good deed for the country is more incidental than intentional.

And it may cut little ice with environmentalists. Some are lobbying hard in the District of Columbia against a number of agendas Big Oil is pursuing. Anti-fracking campaigners oppose any move that will lead to wide use of the drilling method, which they claim contaminates drinking water. Environmentalists are also trying to block a controversial oil pipeline from Canada - Keystone XL - that would boost profit at U.S. refineries.

But being responsible, however directly, for an impressive drop in carbon emissions is still better than increasing them. It may make some lawmakers that little bit more inclined to hear them out - whether on projects that impact the environment or other issues such as drillers getting fast-track permission to export natural gas, which can fetch up to five times more in Asia.

It’s no guarantee of success. But publicizing their green credentials is worth a try.

Context News

Ryan Lance, head of ConocoPhillips, said on Tuesday that America’s oil and gas industry deserved much of the credit for lowering the nation’s greenhouse gas emissions. He was speaking at the annual IHS Cera energy conference in Houston. Lance said the industry should demand “credit where credit is due” for helping boost jobs and reduce carbon dioxide emissions.

Switching from coal to natural gas has been one of the main reasons for a 13 percent drop in America’s carbon emissions from energy since 2007. The U.S. emissions levels have declined to the lowest level since 1995, while emissions in Europe have continued to rise.

“The Kyoto Protocols for emissions reductions seemed like they would be a huge leap for the United States in the late 1990s,” said Lance, noting the country was now close to achieving the goals.

Greenhouse gas emissions in Germany, Europe’s biggest economy, rose 1.6 percent last year as more coal was burned to generate power, the nation’s environment ministry said on Feb. 25. Germany plans to open more coal-fired power stations this year than any time over the past two decades following a government pledge to close nuclear plants by 2022.

Goldman-Morgan rivalry gets personal in Asia

07 March 2013

Goldman Sachs and Morgan Stanley are the Montagues and the Capulets of investment banking. It's almost as unusual for a senior banker to quit one firm for the other as it was for members of Romeo and Juliet's feuding clans to consider marriage. That gives Goldman's poaching of Kate Richdale, Morgan Stanley's head of investment banking in Asia, an added edge. But while it's tempting to see the defection as evidence of a decisive shift in the balance of power in the region, the grudge match has proved surprisingly enduring.

Losing Richdale is a blow. A 13-year veteran of Morgan Stanley, she was put in sole charge of investment banking in the region just two years ago. Moreover, she's not the first to leave: several of Morgan Stanley's senior Asia bankers have quit in recent years. In a part of the world driven by personal relationships that take years to build, Goldman must have felt that Richdale's contacts justified breaking its usual practice of filling senior positions from within.

It's tempting to look for signs of a broader cosmic shift. Morgan Stanley has suffered more than its fair share of senior upheaval recently: investment bank co-head Paul Taubman, who apparently was close to Richdale, was pushed out in November. Meanwhile, chief executive James Gorman has put noses out of joint by beefing up Morgan Stanley's retail brokerage arm while talking tough on bonuses for investment bankers.

Yet investment banks are remarkably resilient. Both Morgan Stanley and Goldman have experienced plenty of turmoil over the past decade. In Asia, at least, the rivalry remains as close as ever. In each of the last four years, both firms have been in the top three league table positions for advising on mergers and acquisitions in the region. When it comes to underwriting equity offerings, they have generally both been in the top five. It will take many more senior defections before this rivalry has a clear winner.

Context News

Goldman Sachs has hired Morgan Stanley's Asia investment banking head Kate Richdale, according to an internal memo obtained by Reuters on March 7.

Richdale will be head of investment banking services for Asia ex-Japan, a role that involves managing the firm's client relationships in the region.

A 13-year veteran of Morgan Stanley, Richdale will join Goldman Sachs as a Partner. She was named as Morgan Stanley's sole head of investment banking for Asia-Pacific two years ago to the day, in a shake-up that saw her co-head, Gokul Laroia, become head of the equities division.

Richdale is the second Morgan Stanley Asia veteran to defect to another bank in the last year, after Will McLane, the head of the financial institutions group for Asia Pacific, went to Citi in July. Morgan Stanley named Dieter Turowski and Shane Zhang as co-heads of Asia Pacific investment banking to replace Richdale.

(Research by Robyn Mak)

Aviva's black dividend cloud has silver lining

07 March 2013

Mark Wilson has done the right thing. It is hardly ideal that Aviva's incoming chief executive had to kick off his tenure with a huge annual loss and a 27 percent cut to the UK insurer's dividend. But although peeved investors knocked 12 percent off the firm's share price, they should be reassured that their company is finally taking the right medicine.

Aviva's main problems were a lack of clear strategy and an overleveraged balance sheet. In 2012 the firm made progress with strategy reformulation, albeit at a cost. It was withdrawals from low-return businesses and the attendant goodwill writedowns, in fact, that turned a 1.7 billion pound operating profit into a 3.1 billion pound net loss.

Wilson could have used the 1.5 billion-odd pounds of cash generated from selling U.S., Malaysian and Dutch subsidiaries to hold the dividend at 26 pence. He was right to resist that temptation. Aviva can't afford to pay a dividend on that scale. As in 2011, cash from operations fell short of the sum needed to cover the payout.

Meanwhile, Aviva needs the money to bolster its capital position. Helped by the sale proceeds, Aviva's so-called "economic capital" position - the relationship between reserves and expected payouts on its policies - has jumped from 130 percent in 2011 to 172 percent. That puts it in line with peers. Better still, they give Wilson the latitude to start unwinding Aviva's "internal leverage", which effectively enabled the company to double count capital in its general insurance business and its international subsidiaries. That's good both for shareholders and regulators.

Aviva's troubles are far from over. Fewer than half of its 51 business segments are generating acceptable returns right now, and it is heavily exposed to Europe. The ability of rivals such as Standard Life to boost rather than cut dividends hardly helps sentiment. Aviva stock already trades at a 36 percent discount to the sector average p/e multiple of 12. But the nasty-but-necessary dividend cut does demonstrate that the company is willing to face up to its problems.

Context News

Aviva reported a net loss for 2012 of 3.1 billion pounds, following a profit of 60 million pounds in 2011.

The UK insurer's 1.7 billion pound operating profit was hit by a 2.5 billion pound loss on the disposal of subsidiaries such as its U.S. business, and an 842 million pound goodwill impairment charge.

Aviva cut its annual dividend from 26 pence per share to 19 pence, and used the savings along with proceeds from disposals to increase its economic solvency ratio to 172 percent, from 130 percent in 2011.

By 1200 GMT on March 7 Aviva shares had fallen 12.5 percent to 315 pence.

Carrefour's "headless duck" flaps its wings

07 March 2013

Carrefour’s “headless duck” is taking flight. That was how Chief Executive Georges Plassat described Carrefour after taking charge last year, so dire had things become at Europe’s biggest grocery group. Well-received annual results reflect the turnaround since then. Major worries remain, stemming mainly from Europe’s economic gloom and shifts in how people shop. But Plassat could achieve more.

Having replaced the hapless Lars Olofsson in May 2012, Plassat quickly repaired a creaking balance sheet by shedding unwanted foreign outposts. Debt fell from 6.9 billion euros to 4.3 billion. Extracting blowout prices from buyers in places like Colombia revealed hidden pockets of value, and gave the grocer more financial flexibility as well as a sharper focus.

Sentiment then improved on what was a bombed-out stock. Analysts turned buyers; shareholders enjoyed a 59 percent return, even before March 7’s results; and the company’s price-earnings ratio rose nearly 60 percent, to 14.4 times earnings.

It gets harder from here. The disposals are done, so the focus shifts to operational improvements. Carrefour must justify the premium stock-market rating that it now commands versus peers. The group relies heavily on beleaguered French, Iberian and Italian consumers, and on vast suburban hypermarkets, which shoppers are ditching in favour of online orders and local convenience stores.

Two meddlesome major investors, French billionaire Bernard Arnault and U.S. property magnate Tom Barrack, further complicate matters. With their 2007 investment still deep underwater, they are watching closely.

Happily for Plassat, things are moving in the right direction, with margins improving in the core French market. And he can do plenty more. He is already handing power back to store bosses, and restoring capital expenditure to healthier levels. Credit Suisse has suggested the group could wring out 1.3 billion euros more operating profit in France alone, through measures such as attacking waste, scaling back product promotions, and shifting to more own-brand goods. That would represent a major boost at a group with 2.1 billion euros in total operating profit.

It is too early to hail a definitive turnaround. But if it walks like a duck, and quacks like a duck, then who knows?

Context News

Carrefour booked operating profit of 2.14 billion euros ($2.78 billion) last year, the company said on March 7, which was slightly ahead of the average 2.061 billion euros forecast by analysts in a Thomson Reuters I/B/E/S poll.

The French group, Europe’s largest food retailer, said capital expenditure would increase this year to about 2.2 to 2.3 billion euros, from 1.547 billion euros in 2012. Analysts had expected capex of about 1.955 billion euros.

Carrefour’s shares were up 4.49 percent to 22.345 euros by 1340 GMT, their highest level since July 2011.

Where did Apple's missing market value go?

07 March 2013

Mr Market has slashed Apple's market value by $260 billion in six months. Meanwhile, the combined worth of a wide group of smartphone and tablet rivals has added less than half that. If investors think Apple is fading, the competing Android complex could be worth far more - to someone.

The 40 percent slide in the iPhone and iPad maker's shares since their high last September - cutting Apple's market capitalization to a mere $400 billion or so - reflects a range of factors including concerns about the company's product pipeline and how it can put its $137 billion cash pile to better use. A big issue, though, is the threat as rivals like Samsung Electronics catch up with Apple's technology, many using Google's Android operating system.

Yet over the same period as Apple's decline these two big competitors (though their businesses go far beyond mobile devices) have seen their market values rise by only about $35 billion each. A broader assembly that might benefit if Apple loses out includes at least another 15 companies like BlackBerry, Nokia, Amazon, Sony, Dell, cellphone groups Verizon Communications and Sprint Nextel - which stand to make more money on Android devices than on Apple's - and even Web names like Facebook and Yahoo.

There are other reasons some of these firms have increased in value since September - Michael Dell's planned buyout of the company he founded, for instance. But take all their gains, ignore the share price decreases at Microsoft, chipmaker Intel and HTC, a Taiwanese handset producer, and they still add up to only around $120 billion of new market value.

One way of interpreting this is that some $140 billion has gone missing from the present value of future smartphone and tablet profits. Of course, investors aren't always rational, and Apple now looks undervalued. Moreover the Android complex can't easily be defined, and less obvious constituents may have gained in value. Then again, Apple's wide profit margins are no secret. Perhaps the message is that companies simply won't make as much as investors thought - because competition will erode profitability. In that case, the missing billions have gone from Mr Market to Joe Consumer.

Context News

Apple's shares closed at $425.65 on March 6, giving the company a market value of about $400 billion. Their all-time closing high was $702.10 on Sept. 19, 2012.

Accounting U-turn on loans will make banking safer

07 March 2013

Under current accounting rules, banks have to bury their heads in the sand where loan losses are concerned. They are required to delay recording likely future losses until an actual “impairment event”. That is bad economics and proved to be bad policy. The financial crisis might well have been less severe if investors and market counterparties believed that reported bank balance sheets were realistic. It’s heartening that the rules are changing.

The International Accounting Standards Board’s proposals, published on March 7, are a U-turn. The backward looking, “incurred loss” model will be replaced by a forward-looking requirement. When a loan is made, lenders will have to make provisions based on expected losses during the next 12 months. In subsequent years they must write off all the losses expected until maturity.

The proposals will lead to larger loan loss reserves, aligning the accounting framework with regulators’ desire for larger capital cushions. And the requirement that banks divide the loss provision in two parts makes sense. If big reserves are required right away, banks might be discouraged from lending during downturns - precisely when economies need credit most.

Basically, the IASB is moving back to the accounting approach which predominated a generation ago, before the trade decided to distrust bankers’ judgment on future losses and to give credence to the supposed objectivity of market prices. Still, the past extreme of allowing institutions to hold massive and often not fully disclosed “silent reserves” remains forbidden.

The new proposals have some holes. Investment-grade credit is exempt from any expected loan loss treatment. That could tempt banks to create more of the AAA-securitised assets which were so dangerously loved before the 2008 financial crisis. Also, kinder accounting treatment for one-year loans may encourage unnaturally short maturities.

IASB is going in the same basic direction as FASB, the U.S. accounting rule-setter, but the American group has recommended that loans’ expected lifetime losses be recognised from day one. A single global rule would be better. But even if the two bean-counting bodies can’t reconcile their differences, accountants are making banking a little bit safer.

Context News

The International Accounting Standards Board, a rule-setting body, published a draft proposal on March 7 that will require financial instruments to be accounted for in terms of their expected future losses. Financial instruments are currently accounted for through a so-called “incurred loss” model, which allows reserves to be held against losses only when an impairment event has actually materialised.

A brief history of Time: an epic M&A tale

07 March 2013

The brief history of Time is a truly epic M&A tale. The gold standard of U.S. magazine publishing proved the ultimate foundation for a giant media conglomerate. Time Warner’s decision on Wednesday to spin off the legacy of Henry Luce’s 1920s vision represents the last step in dismantling the empire.

From a single news weekly started 90 years ago for some $86,000, or about $1.2 million in today’s money, the company eventually grew to be valued at almost $250 billion in 2001. One of Luce’s first deals, buying Architectural Forum about a decade after founding Time, was only a small sign of things to come. An eventual standout in Time Inc’s stable, Life magazine, was the result of an acquisition, too.

Long after Luce retired in 1964, the collection of publications he started, which came to include Fortune and Sports Illustrated, proved a powerful acquisition currency. It was put to use on a grand scale in 1990 when Time Inc bought Warner Communications. What started as a stock swap turned into a cash deal “because of that son of a bitch at Paramount,” as Luce’s son described Martin Davis, the studio boss who interrupted with a hostile bid for Time Inc. A stretch of market-lagging returns ensued for Time Warner.

The purchase of Turner Broadcasting System in 1996 expanded the sprawl. That $7.5 billion deal more prudently relied on Time Warner’s stock for funding, but it also provoked still more resentment throughout the company. These deals set the stage for one of the biggest merger transactions in corporate history: the $180 billion sale of Time Warner to AOL.

Strategically flawed and timed just right for the dot-com collapse, it remains one of the most value-destructive deals ever conceived. Time Inc’s magazines nevertheless proved a steady source of considerable profit. In the decade to March 2003, encompassing both boom and bust, Time Warner’s total shareholder return hit 5,812 percent, according to Thomson Reuters.

The conglomerate that existed then has since been taken apart. The book and music divisions were sold, along with sports teams. AOL and the cable TV operations have been spun off. All told, including the estimated $2.5 billion value of a separated Time Inc, the assets will have generated some $20 billion of proceeds. Despite a 130 percent total return over the past 10 years, Time Warner is worth only a little more today - some $53 billion - than it was a decade ago. It may not be what it once became, but is still quite a story to be spun from a single magazine.

Context News

Time Warner said on March 6 it would spin off its magazine unit, publisher of Time, Fortune, People and many others, into an independent, publicly traded company by the end of the year, after it had explored combining a big portion of the division with titles published by rival Meredith. Laura Lang, chief executive of Time Inc, will leave after the separation.

Goldman banker CDO suit is wrong fight for SEC

07 March 2013

“Fabulous Fab” Tourre’s fight with investors shouldn’t be a priority for the Securities and Exchange Commission. Sure, the U.S. regulator hasn’t targeted enough individuals over the financial crisis. But this saga, centered on a collateralized debt obligation created by Tourre’s former employer Goldman Sachs, involves boneheaded bets by financial firms which ought to have known better.

The SEC last Friday filed juicy new details in its fraud case against Tourre. It argued that the evidence is so clear that he should be found liable without a trial. That seems less a plausible claim than a tactic to get the judge and the public familiar with the emails, recordings and other material supporting the watchdog’s case.

Tourre allegedly hid the fact that hedge fund manager John Paulson was betting against a CDO called Abacus while also helping to pick the instrument’s underlying securities. In one email the banker assured ACA Capital, the company officially hired to select securities, that Paulson aimed to benefit from the CDO’s success rather than its failure. Other missives and phone calls reinforced that notion. ACA employees testified that the company might not have helped create the CDO, or invested nearly $1 billion in it, had ACA known the truth.

But other details suggest ACA should have known. It rejected most of the securities Paulson proposed for inclusion in Abacus, and the media had reported months before the transaction closed that the hedge fund boss had made a killing betting against subprime mortgages. What’s more, ACA was well aware that all synthetic CDOs required investors to take both long and short positions. It had even worked with short investor Magnetar Capital to create a similar CDO a year earlier, according to testimony.

The SEC may be able to show that Tourre misled ACA, and a jury could find him liable as a result. But the evidence also indicates that ACA - like Bear Stearns, Lehman Brothers, Citigroup and dozens of other supposedly knowledgeable and sophisticated players - made overly optimistic bets on subprime and lost. That doesn’t absolve Tourre, if he’s proven to have been at fault. It does, however, raise the question of whether the SEC could find better things on which to expend its resources than protecting expert investors who miscalculated.

Context News

The U.S. Securities and Exchange Commission on March 1 asked a federal judge to find former Goldman Sachs banker Fabrice Tourre liable without a trial for allegedly defrauding an investor in connection with a collateralized debt obligation called Abacus. Created by Goldman in 2007, the CDO was backed by derivatives linked to subprime mortgage bonds.

The bank settled charges involving Abacus in 2010 for $550 million. Goldman neither admitted nor denied wrongdoing.

The SEC has accused Tourre of lying to ACA Capital, the portfolio agent hired to select the securities backing Abacus, about hedge fund manager John Paulson’s motives for investing in the CDO. Paulson, who helped ACA pick the securities, stood to profit if the CDO securities fell in value. ACA claims it was told the opposite.

Financiers failing own version of Hippocratic Oath

07 March 2013

Financiers are failing their version of the Hippocratic Oath. They aren't taking the necessary measures to keep client money safe, the U.S. Securities and Exchange Commission warns. The failure is as basic as doctors not washing their hands, despite reminders from the likes of Refco and MF Global. The extent and severity of the problem should worry customers and investors alike.

Keeping customers' money safe should be an obvious ethical imperative for any firm. But the law also requires it. Yet brokerages fall short on a depressingly frequent basis. Client cash got locked up with company assets both when futures broker Refco went under in 2005 and Lehman Brothers hit the skids three years later. MF Global, which had some Refco assets, tried to head off its 2011 demise with some client assets. And last year Peregrine Financial collapsed after it turned out boss Russell Wasendorf had been misappropriating such funds for years.

These might seem like extreme cases. But the SEC's investigation discovered that 140 - or around one-third - of those firms it examined fell short of the rules.

A number of those deficiencies were particularly troubling. Some advisers kept physical possession of assets like securities certificates, while investor firm personnel sometimes served as the trustee for client accounts - even though qualified custodians generally must perform such tasks. Others underwent "surprise exams" conducted by their auditors. But these occurred at the same time each year, making them easier to pass.

Such sloppiness is bad news for clients. Few retail investors have the ability to verify that their broker is taking all necessary measures to protect their funds. And if client money mysteriously disappears, lawsuits may take years to recoup it - and may well fail to do so.

It's a sad indictment of poor governance. These rules are hardly new - they were brought in with the 1940 Securities Act. If cutting corners on such a basic duty is any indication, there's little reason to give financial firms the benefit of the doubt over whether they'll address the raft of new regulations stemming from the Dodd-Frank Act. Pledges don't seem to count for much.

Context News

The U.S. Securities and Exchange Commission reported on March 4 that approximately one-third of investment advisers it reviewed failed to fully comply with custodial rules. The regulations, from the Investment Advisers Act of 1940, describe how customer assets must be maintained, reported and audited. The SEC has responded with remedial measures and enforcement actions.

Esure's IPO demands careful risk assessment

08 March 2013

Esure’s flotation demands careful risk assessment. The British motor and home insurer’s London listing this month could value the company at about 1.15 billion pounds ($1.7 billion). The successful recent debut of rival Direct Line helps. But the sector is tough - and undergoing dramatic change. Investors need to believe esure’s claims that those changes will help, not harm, its business.

Esure unveiled a price range of 240-to-310 pence a share on March 8. At the midpoint, that gives it a 1.15 billion pound market capitalisation, implying a valuation of slightly more than 10 times likely earnings for 2013. With closest peer Admiral trading on a forward price-to-earnings ratio of 13.9 times, according to Datastream, that looks palatable. A shareholder return of 22 percent for Direct Line since its modestly priced October flotation is helpful too. (That dowdier business trades at about 10 times PE.)

Alas, the big picture in motor insurance is grim. Competition is fierce, customers fickle, and dodgy claims rife. For years, claims and expenses have cost that part of the industry more than the premiums it gathers. To further complicate things, the Competition Commission is investigating potential market failure, while Europe has recently banned the gender-based pricing embodied by esure’s mostly-women “Sheila’s Wheels” unit. All that argues for lower valuations.

Esure has some strong counter-arguments. It is data-driven, prudent, and it cherry-picks safer drivers. That shows in the financials. The “combined cost ratio” of claims and expenses to premiums was a healthy looking 92.8 percent last year. And there are potential avenues for growth, through home insurance, new sales via social media, and more lucrative extra services, like insurance against filling a diesel tank with petrol.

Even the two biggest headaches present opportunities. The commission’s crackdown could cut costs. And Sheila’s Wheels can still thrive. By targeted marketing, it can avoid enrolling men as policyholders, thus keeping a safer customer base that can still legally enjoy lower premiums. Sledgehammer-subtle gender stereotyping trumps legal equality. That may not be an appealing lesson on international women’s day, but it’s a core part of the esure equity story nonetheless.

Context News

British motor and home insurer esure announced on March 8 the indicative price range for its planned London initial public offering (IPO). Esure aims to sell a maximum of about 210.2 million shares, including about 20.8 million new shares, at between 240 pence and 310 pence a share. The free float will be between about 35 and 50 percent.

At the midpoint of the range, the offer would give esure a market capitalisation of about 1.149 billion pounds ($1.72 billion). Esure, owned by industry veteran Peter Wood, Tosca Penta Investments LP, and management, expects to price the deal on March 22.

Royal Bank of Scotland floated Direct Line, Britain’s biggest motor insurer, in October. The company has delivered a total shareholder return of 22 percent since then, according to Datastream.