Europe’s investors miss value cues, again

18 October 2013

It is one of the oldest rules in the investment book: buy what’s cheap, sell what’s expensive. The current crop of European fund managers must have slept through that lesson.

Throughout the second half of 2009, the forward-looking price-earnings ratio on the MSCI world index was persistently 14 or higher. That’s expensive by historical standards, but it didn’t deter investors. Data from Goldman Sachs shows net inflows were buoyant, topping 20 billion euros in December 2009, well above the monthly norm, and 158 billion euros for the year as a whole, a level not subsequently matched. Valuations then became more attractive as flows slowed in 2010 and 2011, bottoming at a forward p/e of 10 in September 2011. But cheap stocks did not attract buyers. On the contrary, European investors were net sellers of equities for the rest of that year.

It has been the same story in 2013. Equities have enjoyed strong net inflows, holding up even as the forward p/e ratio pushed up over 13. Of course, there is a direct interplay between flows, equity prices and valuations. Moreover, it makes sense to buy shares when economic clouds appear to lift. Higher valuation ratios may be justified if the medium-term earnings outlook improves. Yet the fact remains. European asset allocators generally get stuck in a rut of selling when they ought to take advantage of bargain prices. Now stocks are getting more expensive, investment managers seem hooked on buying.

The pattern recurs through history. Figures from Bank of America Merrill Lynch show that the flow of money into stocks was notably strong in 1999 when the average IBES forward earnings multiple was 23 times. When despair reigned, the end of 2008, the multiple for global shares fell below 9, the lowest in recent history. At the trough, needless to say, investors couldn’t take their money out of the stock market fast enough.

It may only be smaller, nimbler investors that can go against the trend. That said, past performance suggests that the current pro-stocks momentum could push valuations higher yet. But rather than rushing to buy stocks, clever money managers should be starting to think about the best time to sell.

Context News

Equity markets have recently seen some of the biggest weekly inflows of capital on record, according to research from Bank of America Merrill Lynch released on Sept. 19.

Research from Goldman Sachs published on Sept. 27 reported trailing 12-month inflows of 79 billion euros from European investors in July, against net outflows of 67 billion euros a year earlier

Shareholding mishmash is new risk for Peugeot

14 October 2013

There is no doubt that PSA Peugeot Citroen needs to raise capital. This has long been seen as the next logical step in the stricken French carmaker's tentative turnaround. The fact that the Paris-based carmaker is currently mulling a capital hike worth 3 billion euros should be a welcomed move, if the chosen way to do it wasn't highly problematic.

According to a Reuters report, Peugeot is turning to state-owned Chinese carmaker Dongfeng and to the French government. Peugeot needs the cash, but not two governments in its share register.

PSA sells 59 percent of its production in Europe and was hit particularly hard by the collapse of that market. The company burnt 3 billion euros in 2012 alone, with another 1.5 billion euros on the way this year. The group's restructuring involves painful and politically acrimonious decisions. The company is cutting 11,200 jobs by 2015, and is closing one of its six French production plants.

Based on market prices before the news broke, the deal would give each of the two new shareholders a 20 percent stake in Peugeot - more if a discount was applied, as would be the case under normal market conditions.

But PSA would have to pay a high price in the long run, with a mishmash of a share register that will include the French government, a state-owned Chinese group, the diluted Peugeot family and General Motors. The supervisory board may struggle to find common ground. Future restructuring of the French production base would become more difficult. That, or the fear of the ever-meddling French government, was enough to send Peugeot shares tanking 9 percent on the news.

Another danger is that the deal may turn off General Motors, which owns 7 percent of PSA shares, and has a get-out clause. PSA cannot afford to put its alliance with the U.S. carmaker at risk - it is supposed to deliver annual cost synergies of 800 million euros by 2017.

Bringing in Dongfeng has some industrial logic. Bringing in the French government as well looks geared towards French domestic opinion. With its restructuring on track, its fleet modernised and the share price up 126 percent since January, and the European car market bottoming out, Peugeot could tap markets on its own.

Context News

PSA Peugeot Citroen is preparing a 3 billion euro ($4.1 billion) capital increase in which Chinese partner Dongfeng and the French government would take matching stakes in the carmaker, Reuters reported on Oct. 12, citing people familiar with the matter.

The French carmaker published a press release on Oct. 14, confirming it "is examining industrial and commercial developments with different partners, including the financial implications that would result from them." The company also said that "none of these projects has reached maturity yet."

In morning trading on Oct. 14, PSA's share price dropped by 9 percent.

According to three sources, the deal could be signed within weeks. A French delegation of executives, government officials and bankers are reportedly heading to China for talks to flesh out the details. The Wall Street Journal Europe reports that Peugeot's supervisory board is scheduled to decide about the deal on Oct. 22.

State-owned Dongfeng Motor Co Ltd and the French government would each contribute 1.5 billion euros and acquire 20 percent to 30 percent of the carmaker. Peugeot and Dongfeng already operate a joint venture in China.

Last year Peugeot entered an alliance with GM, which acquired a 7 percent stake in the French company.

UK corporate broking market really is contestable

14 October 2013

The long-term relationships of corporate broking are meant to be hard to crack. Yet new entrant Barclays has snared six blue-chip mandates this year and 15 since 2010, in spite of its own capital and reputational challenges. Its success suggests the corporate broking business is more contestable than it seemed.

UK corporate brokers are an anomaly. In the United States and continental Europe, banks pitch for lucrative work on takeovers or capital-markets raising separately. In London, big corporations generally retain two equity market brokers, who offer day to day counsel advice on market matters ranging from regulatory disclosures to capital raising. This advice doesn’t generate upfront or retainer fees in itself, but it does put the brokers in pole position to receive a mandate when the client does a transaction.

As Barclays has surged, so corporate broking’s “big three” have lost ground. In mid-2010, JPMorgan Cazenove, UBS and Bank of America Merrill Lynch had 98 of the 184 FTSE 100 sole or joint mandates claimed by the top 10 brokers, according to Morningstar and Adviser Rankings’ data. Now the big three’s mandates have fallen to 87, with Barclays recently pinching UK retailer Tesco from under JPMorgan’s nose. Deutsche Bank’s FTSE 100 relationships have slumped to 14 from 20 since 2010, although it recently picked up mandates from three midcaps that have all issued equity.

Part of the explanation is that Barclays has been helped by an increased willingness of companies to review their relationships as banks have reduced headcount allocated to corporate broking. Broking boo-boos – for example shareholders’ instant revolt over UK security firm G4S’ proposed bid for ISS – have also helped Barclays pick up business.

It may seem obvious that a pushy upstart should be able to grab business when incumbents drop the ball. But corporate broking has not traditionally been so dynamic. The broking relationship is meant to be enduring, with banks servicing clients for years on a modest or non-existent retainer before the real pay day comes through. If clients are becoming less sticky, that pay day is no longer guaranteed.

Context News

Barclays has built its FTSE 100 corporate broking business from scratch at the end of 2009 into the fifth biggest by number of mandates as of Oct. 14, according to Breakingviews’ analysis of Adviser Rankings data, published in August.

The UK bank now has 16 blue-chip mandates, behind only JPMorgan Cazenove, UBS, Bank of America Merrill Lynch and Morgan Stanley. It won two mandates – for retailer Tesco and engineer Amec – in September alone.

CEO makeover leaves Burberry with plenty to prove

15 October 2013

Burberry's executive makeover leaves the British trench-coat maker with plenty to prove. Angela Ahrendts, chief executive of the $11 billion fashion house, is leaving next year to run Apple's retail operation. That lopped 4.5 percent off Burberry shares on Tuesday morning.

No wonder: her tenure was good for investors. Worse, Burberry is flirting with a risky concentration of power. It is replacing Ahrendts with the company's creative director, Christopher Bailey. But he will keep his current job.

It is easy to see what drew the tech-savvy Ahrendts to California. She'll no longer be the leader. But she will oversee both Apple Stores and online sales. The tech giant is also a more prestigious berth than Burberry, at least in business circles, and is much bigger too. Pay and perks will probably reflect this. Last year Ahrendts got 3.3 million pounds ($5.2 million) from Burberry. Contrast that with the terms of former Dixons boss John Browett. Last year he was, briefly, given a narrower retail role at Apple. That did not work out. But if it had, he would have pocketed $56 million of stock.

There are three obvious reasons for the negative Burberry market reaction. Firstly, simply, investors hate surprises, especially in a glitzy, high-growth company whose shares enjoy correspondingly lofty valuations.

Secondly, the company's owners are losing a good steward of the business. Since Ahrendts became CEO in 2006, Burberry shareholders have enjoyed a handsome 340 percent total return. The FTSE 100 only managed 46 percent. Louis Vuitton parent LVMH has returned 109 percent.

The third reason is Burberry's unusual response. It has elevated star designer Christopher Bailey to CEO. Alongside Ahrendts, the former Gucci womenswear boss has been central to Burberry's renaissance. Yet creative types rarely make successful bosses of big public companies. He will also be paired with an inexperienced chief financial officer, Carol Fairweather, after predecessor Stacey Cartwright left in February. A veteran chairman and a recently hired operating chief mitigate this somewhat.

Still, Bailey may be stretched uncomfortably across the two roles. Burberry sells a $325 check flat cap and a $650 felted wool number. Both are fine bits of headgear, but no one would wear the two together. Likewise, FTSE 100 CEOs look best wearing just the one hat.

Context News

Burberry Chief Executive Angela Ahrendts will leave the fashion house by mid-2014 for a job at Apple, the British company said on Oct. 15. She will be replaced by creative boss Christopher Bailey, who will keep his current role and become chief creative and chief executive officer.

Ahrendts will join Apple as a senior vice president and member of the executive team, reporting to CEO Tim Cook. She will oversee the "strategic direction, expansion and operation of both Apple retail and online stores," the Californian company said in a separate statement.

Shares in Burberry fell 4.6 percent by 0845 GMT to 1,511.5 pence, making the company the worst-performing stock in the FTSE 100 index. The shares had gained 29 percent in the year to Oct. 14, against a 10 percent rise in the index.

Corbat's Citi takes a step backward

15 October 2013

Mike Corbat's Citigroup has taken a step backward. The mega-bank's chief executive ends his first year in charge with third-quarter earnings below estimates and a meager 6.4 percent return on equity. Granted, markets over the summer were hardly amenable. But the breaks Citi got elsewhere make the bank's overall performance look that much worse.

First of all, Citi Holdings is no longer a major drag on earnings. The unit, which houses the bank's toxic and unwanted assets, lost just $104 million in the three months through September. That compares with $3.5 billion in the same period last year and $500 million in this year's second quarter.

Meanwhile, expenses are falling, thanks to Corbat's move early on to speed up previous boss Vikram Pandit's cost-cutting plans. At almost $11.7 billion, running Citigroup is now some $570 million cheaper than it was in each of the first two quarters of this year.

Then factor in the effect of a much lower tax rate this time round. Citi had to hand over just 25 percent to various governments around the world, compared with 28.5 percent in the first quarter and 33.7 percent in the three months to June. That boosted the bottom line by as much as $400 million.

Some deterioration in the core businesses was to be expected, considering the spike in interest rates earlier in the summer and dashed expectations that the Federal Reserve would trim the amount of securities it purchases. So a fall in both the mortgage-lending and fixed-income trading businesses should be no surprise.

The sharp decline in the latter, though, looks a tad worrying. The 26 percent drop from the same period last year is way more than the 8 percent JPMorgan reported last week. If that ends up being the worst among Citi's peers, it'll suggest the bank is not on as strong a path as first-half results implied – though equities trading was up a solid 36 percent. Corbat needs to demonstrate that the overall disappointing third-quarter showing is a one-off.

Context News

On Oct. 15 Citigroup reported third-quarter net income of $3.2 billion, or $1 a share. Excluding the negative impact of improvements in its own liabilities and a $100 million tax benefit, net income was $3.3 billion, or $1.02 a share, below the consensus sell-side estimate of $1.06. Revenue was $18.2 billion, excluding improvements in Citi's liabilities, 5 percent below the same period last year. Return on equity was 6.4 percent and return on tangible equity was 8.3 percent.

Net income was roughly flat with the same period last year, after stripping out the negative impact of improvements in Citi's own liabilities and a $2.9 billion after-tax charge from writing down its valuation of the Morgan Stanley Smith Barney joint venture.

Operating expenses dropped 4 percent to $11.7 billion. Citi Holdings, which houses the bank's toxic and unwanted assets, posted a loss of $104 million, compared with a $3.5 billion loss in last year's third quarter. Citi Holdings now accounts for 6 percent of Citigroup's assets.

Fixed-income trading revenue was $2.8 billion, excluding the negative impact of improvements in the bank's own liabilities, 26 percent below the amount of such revenue for the same period last year. Equity trading revenue rose 36 percent to $710 million and investment banking revenue dropped 10 percent to $839 million.

Net income at the global consumer banking division fell 23 percent to $1.6 billion. The bank's loan-to-deposit ratio was 69 percent.

Tesco's big cheeses: still some shelf life left

15 October 2013

Tesco's big cheeses aren't quite past their sell-by date. The UK retailer's Finance Director Laurie McIlwee is under fire after poor first-half results, with some shareholders griping about his "abrasive" manner. It's hardly surprising investors are searching for someone to blame, but it is too early to write off Tesco's turnaround plan.

Identifying current problems at Tesco is disconcertingly easy. Around the start of the year it discovered horsemeat in some of its products. Its first-quarter results were undermined by disappointment in non-food lines. And its first-half results two weeks ago showed a 67 percent slump in non-UK European trading profit. It came in at 55 million pounds, when expectations were for double that.

There are also structural issues. Discounters like Aldi and Lidl, and upmarket stores like Waitrose, are pinching market share of the established supermarkets. Most worryingly of all, Tesco's 0.5 percent sales decline in UK first half like-for-like sales, which strip out the effect of new store space, was way off the healthy growth of its main domestic rival, Sainsbury.

Yet amid the dross, like-for-like sales in the key UK market were flat rather than negative in the second quarter, helped by a 1 percent rise in UK food sales. Optimists might see this as an early sign that a 1 billion pound store improvement programme, launched in April 2012, is paying off. It would be good if it did, given that the UK provides almost three-quarters of group trading profit.

If more Tesco stores looked like its shiny new one in Watford, and if the UK economy keeps recovering, Tesco should be able to increase sales and maintain or improve its market share. Chief Executive Philip Clarke could then avoid having to make the uncomfortable choice between raising prices and cutting costs, or sacrificing its 5.2 percent trading margin.

Tesco's sheer size, positioning in the fast-growing online and convenience-stores sectors, and a decision to rein in new store investment, are pluses. Unless Clarke's medicine can work in Europe, the continent will remain a minus. In the meantime, investor irritation provides an added incentive for Clarke and McIlwee to stay focused.

Context News

Big shareholders in Tesco have questioned whether the UK retailer's top management has a good enough grip on its problems, the Financial Times reported on Oct. 14.

One top 20 investor told the paper that there were worries over McIlwee, citing an abrasive style and poor communication with shareholders. Another top 10 investor described him as "not a world-class finance director."

However, one institutional investor told Reuters Breakingviews that McIlwee was part of an old culture that was in the process of being refreshed, and that there was a lot that was good about Tesco.

Tesco shares rose 0.6 percent to 365 pence on Oct. 15.

UK fund king chooses good time to discover value

15 October 2013

Think Invesco Perpetual, think Neil Woodford. For years, the brand of the UK investment firm has been closely tied to its leading fund manager. Now Woodford is setting up on his own. Like a corporate demerger, the separation will help reveal the true value of each.

Woodford's formidable reputation is based on long-term performance over a 25-year career. At key moments, that has meant going against the grain and enduring short-term embarrassment. He dodged technology stocks during the dot-com boom and banking stocks during the credit bubble, and was vindicated. Woodford's main fund, which focuses on high-yielding equities, has performed more than twice as well as the FTSE-100 since he took the helm – a total return of 2,192 percent since 1988, including 19.5 percent in the last year.

Why break away now? The partnership between Invesco and Woodford has worked well for years. But as an individual fund manager grows in stature, the synergy with a large firm diminishes. The marketing and distribution benefits of being part of an institution are less clear when its marketing power derives so much strength from one person.

For a time, large firms can accommodate high-value stars by giving them more freedom and more pay, and by shielding them from process and bureaucracy.

But as investment banks have found, there is only so much that can be done to stop stars wanting to discover for themselves just what their true value is. It might be hard to convince them that they aren't cross-subsidising colleagues who perform less well, or won't have more fun on their own. That explains the continuing trickle of traders and M&A advisers to hedge funds and boutiques, and of hedge-fund managers from big institutional firms to their own startups.

Woodford is in his early 50s. The timing of his exit means he has a credible record to flaunt, and a decent number of years ahead to exploit it. His challenge will be to build scale rapidly. His activist intervention in M&A situations like British Energy or BAE Systems required sizable holdings. It would be surprising if he didn't succeed. Either way, he will discover his real worth.

Context News

Neil Woodford is to leave Invesco Perpetual in April to set up his own investment firm, the UK asset management firm said on Oct. 15.

The star fund manager, who is to be succeeded by Invesco's Mark Barnett, has delivered a total return of 2,192 percent in his High Income fund since 1988.

Mark Armour, chief executive of Invesco Perpetual, said: "We have planned for succession for many years and have built a world-class investment culture that develops and supports gifted and experienced managers."

Woodford said: "I leave the company on good terms … My decision to leave is a personal one based on my views about where I see long-term opportunities in the fund management industry."

Brazil faces a "lose, lose" in bailing out Batista

15 October 2013

Brazil faces a “lose, lose” in giving fallen entrepreneur Eike Batista extra time to pay his debts. Letting his OSX shipyard collapse along with the rest of his crumbling empire makes it hard for oil drillers, including state-owned Petrobras, to obey “buy local” rules. Yet rescuing the unpopular tycoon is politically pricey for President Dilma Rousseff.

Batista was once expected to be the entrepreneurial face of Brazil’s industrial policy. His EBX group looked on track to boost the nation’s oil output, modernize its aging ports and revive the lost glory of its shipbuilding industry – which was among the world’s largest three decades ago. Instead Batista is turning into an embarrassment for Brazil.

The financial sacrifice is the least of the worries for Brazil’s leadership. Rolling over nearly $460 million of loans to his shipbuilder wouldn’t have any meaningful impact on state banks like BNDES, which lends out about $80 billion a year. Given their seniority in the capital structure these institutions look likely to recover most of the roughly $4.7 billion they committed to Batista’s various companies.

Even so, the disorderly disintegration of Batista’s corporate edifice presents painful choices. Brazilian government rules compel foreign oil drillers to buy the lion’s share of their equipment locally. OSX has been one of the few options available. A full shutdown of OSX would further slow the development of Brazil’s oil sector – which is already lagging expectations. Easing such local content rules, though the most sensible option, would represent a humiliating political climbdown for the government.

Meanwhile, offering even minimal assistance to Batista is risky for Rousseff, who faces re-election next October. Mass protests in June were motivated partly by public concern over government waste and corruption. With citizens complaining over rising bus fares and poor public services, Rousseff can’t afford to be seen lavishing state resources to help a flamboyant businessman. As it was, the boastful Batista – who once suggested that Brazil erect a statue of him – was not well liked even at the apex of his fortunes.

Rousseff was once happy to be photographed with the entrepreneur. Now she may be wishing she had never laid eyes on him.

Context News

Shipbuilder OSX, controlled by Eike Batista, reached an agreement with Brazil’s development bank BNDES on Oct. 14 to refinance a 518 million reais ($237.6 million) loan for 30 days, local newspaper Estado de S. Paulo reported.

Estado, citing sources who declined to be named, said debt-ridden OSX is also trying to persuade state-run Caixa Economica Federal, Brazil’s No. 1 mortgage lender, to roll over a 400 million reais loan due on Oct. 19.

Representatives from OSX, Caixa Economica and BNDES did not immediately respond to requests for comment on the report, which was published on Oct. 15, when the loan from BNDES was due to be repaid.

Tesco retreat shows cost of China ambition

16 October 2013

Tesco's retreat from China has revealed the true cost of its Asian ambition. The terms of the UK retailer's joint venture with China Resources Enterprise show just how little it has gained from its nine-year attempt to gain a foothold in Asia's biggest market. Even the biggest players can't stomach open-ended losses.

Tesco is folding its 134 Chinese stores, 11 malls and some property into CRE's larger Chinese retail business. It's also making a cash payment of 4.3 billion Hong Kong dollars ($560 million). In return, it gets a 20 percent stake in the combined business.

The cash top-up gave Tesco an extra 5 percent of the venture, according to a person familiar with the matter. This implies the entire venture is worth 86.5 billion Hong Kong dollars. It also suggests that the assets Tesco contributed were worth just some 13 billion Hong Kong dollars - or about $1.7 billion.

Compare that return to Tesco's investment in the business. Based on public disclosures alone, the company has injected more than $1 billion into its China business over the past decade. Tesco has previously published that the Chinese assets it had earmarked for disposal were 2.6 billion pounds ($4.2 billion) - though this includes property the retailer could not profitably develop.

It's safe to assume that Tesco has weathered heavy losses over the years. Recent disclosures show that in the year to February 2013, its China businesses lost close to 3 billion Hong Kong dollars. Though Tesco prides itself on its deep pockets and long-term view, even the largest retailers cannot stomach such losses indefinitely.

The CRE joint venture lifts that burden from Tesco's balance sheet. The combination should also yield cost savings as well as synergies in the area of pricing knowledge, distribution and e-commerce. For Tesco, the venture also has a definite shelf life: Tesco has the option to force a public listing of the JV after seven years, or be bought out by CRE. Its retreat from China may be gradual, but it is only heading in one direction.

Context News

Tesco said on Oct. 1 that it would hand over its retail assets along with HK$4.3 billion ($560 million) in cash to form a hypermarket joint venture with China Resources Enterprise Ltd. China Resources will hold 80 percent of the venture, while Tesco will take 20 percent.

The move follows Tesco's decisions to abandon the United States and Japan and instead focus on its British home market.

Other foreign companies are also giving up on cracking China. Germany's Metro AG said in January it was pulling out of the consumer electronics business in China while Home Depot Inc said last year it would close all seven of its big-box home improvement stores.

LVMH’s move upmarket more painful than planned

16 October 2013

LVMH, which calls itself the world’s largest “fashion and luxury” group, is finding that luxury is a hard sell, and fashion not a big growth driver. The French conglomerate’s revenue numbers in the third quarter were expected to reflect the uphill struggle of its Louis Vuitton brand to ascend the luxury ladder. That is proving even harder than foreseen. Revenue in LVMH’s fashion and leather goods division, which accounts for 34 percent of total sales, declined 1 percent in the first nine months of the year. Investors duly wiped nearly 5 billion euros off the company’s market capitalisation on Wednesday morning.

High-end luxury is proving as crowded as LVMH’s Champs-Elysees flagship store on a Saturday afternoon. That’s part of the problem of trying to break the $5,000-handbag market. Others - such as Hermes or Bottega Veneta - have been taking advantage of the fat margins of that universe for some time. Vuitton is a newcomer.

The group had warned that the new strategy might require 18 months to bear fruit. At least it had seen the need for change. Owner Bernard Arnault appointed a new Louis Vuitton chief executive earlier this year, and showed the special interest he has in the brand by making his daughter the executive vice president. He is now searching for a good replacement for long-time Creative Director Marc Jacobs, who quit a few weeks ago.

Since LVMH doesn’t detail quarterly profit, it remains to be seen how the revenue slowdown impacted the unit’s profitability, considering the costs involved in rolling out the new strategy. For now, growth comes from the group’s other divisions. Champagne and cognac remain crisis-proof, with revenue rising 7 percent in the first nine months of the year, excluding currency movements. The retail division - perfume stores Sephora and a string of duty-free outlets - rose 19 percent in the same period. It now accounts for 30 percent of group revenue.

LVMH is often rumoured to consider shedding its M and H - the drinks division, including Moet and Hennessy. It would find many suitors, Diageo or Pernod Ricard included, if they aren’t deterred by the asking price. In any case, that may have to wait until the Vuitton transition is complete.

Context News

LVMH, the world’s biggest luxury group, reported an unexpected slowdown in sales growth at its fashion and leather business, which includes the Louis Vuitton, Celine and Dior brands.

The Paris-based group, which also owns Krug champagne and Hennessy cognac, said on Oct. 15 that growth at its biggest and most-watched division was 4 percent on a like-for-like basis in the nine months to Sept. 30, against 5 percent in the first half.

Analysts estimated that the division’s organic sales growth slowed to 2 percent in the third quarter from 7 percent in the second and 3 percent in the first.

Shares of LVMH were down 6 percent at 0900 GMT on Oct. 16.

Silicon Valley sun king Larry Ellison riding high

16 October 2013

Silicon Valley's sun king, Larry Ellison, is riding high. Though the American tech industry's old guard is under siege, Oracle's founder has outlasted peers, and almost certainly outspent them. His recent America's Cup sailing win is typical – questionable dealings and near-defeats are overshadowed in time by victory. But a reckoning can't be held back forever.

Ellison's rivals and contemporaries have faded as time or technological change caught up with them. Arch-rival Phil White of Informix is remembered mainly for going to jail. Jonathan Schwartz of Sun Microsystems, Thomas Siebel of Siebel Systems and other rivals saw Ellison take over their companies. Microsoft's Bill Gates is taking a break from fighting noble causes to battle restive shareholders while his henchman Steve Ballmer is retiring. Steve Jobs, photographer for one of Ellison's weddings, is dead.

Oracle and Ellison – the two are difficult to disconnect – are still going strong. Over the past five years, the company's revenue has risen by two-thirds. Earnings per share were up twice as much. The company's shares have doubled, valuing it at $140 billion. Much of the outperformance is due to Ellison's serial acquisition of rivals. Oracle has spent $40 billion on 10 takeovers since 2005. Once acquired, the software firm's expenses are slashed, while a stream of cash from maintenance contracts keeps rolling in.

The biggest beneficiary is Ellison, who owns a quarter of the company. And Oracle rewards him lavishly – he received $78 million of total compensation last year, mostly in stock options. Yet this and over $500 million of Oracle dividends don't appear enough for a man of his appetites. Of the more than $35 billion of Oracle stock he owns, about $7 billion is pledged against personal loans.

Ellison takes billionaire baubles to extremes. He has bought fighter jets and owned one of the world's most expensive yachts, and his living compound – modeled after feudal Kyoto – was built by Japanese craftsman without nails. The constant is a mix of the sublime and showy – his collection of samurai armor is balanced by a giant entertainment system which uses an empty pool as a subwoofer.

The gusto is admirable and Ellison's role in Oracle's success unquestionable. But investors wonder if the king claims too rich a share. They gave a thumbs-down to Oracle's pay policies last year in a non-binding vote the company ignored. This year, CtW Investment Group is trying to foment rebellion, having investors vote against compensation committee members. Institutional Shareholder Services, an influential proxy advisory service, recommended this week that investors vote against eight of 11 directors.

Moreover, the line between Ellison and Oracle is fuzzier than it need be. There's a thicket of related-party transactions between firms Ellison controls and Oracle – including an educational firm, a medical technology concern, a database company, an aircraft leasing company, and a tennis tournament.

Earlier this month Ellison settled a shareholder lawsuit by agreeing to forego up to $575 million of potential payouts from Oracle in relation to its purchase of a data storage firm he controlled. A decade ago, he agreed to donate $100 million to charity after shareholders claimed he had used inside

Context News

Institutional Shareholder Services, the largest proxy advisory firm, recommended that investors vote against eight of Oracle's 11 directors. In a report released on Oct. 15, it said that the board members failed "to provide effective oversight of management on behalf of shareholders" on areas such as executive pay.

information when he dumped $900 million of stock before a profit warning.

Ellison’s sailing team in the America’s Cup had a disastrous start with a cheating scandal, imposed penalties and multiple losses. But winning eight consecutive races and the cup was all that mattered in the end. Investors seem to feel the same. Transgressions such as skipping earnings calls and conferences to attend sailing events are greeted with smirks: “That’s just Larry.” The indulgence, however, may have gone on too long. Ellison’s full attention is needed because he is facing one of the toughest fights of his career.

New rivals like Salesforce.com and Workday are challenging Oracle’s dominance by selling cloud-based software as a service. Their offerings tend to be quicker to set up and cheaper than traditional business software. That’s a big reason why Oracle’s growth has slowed of late: it missed analysts’ top-line estimates for the past three quarters. Meantime, Oracle’s bread and butter – traditional databases for corporate clients – is under threat from smaller rivals such as MongoDB, which specialize in making data from new sources (such as emails, video and web sites) cheaply and simply.

Oracle is fighting back with its own cloud-based software, new databases and, as it has done in the past, acquisitions. But buying rivals is a risky way to control a market, and Oracle has become more difficult to maneuver over the years due to its growth. For example, its purchase of Sun has put it in the unattractive, shrinking business of selling hardware.

Ellison is nearing 70. There’s zero sign that he has tempered his intelligence, canniness, drive or will to conquer. History also suggests it is foolish to bet against him, or Oracle, in any singular fight. But as Hewlett-Packard, Microsoft, Cisco Systems and others have shown, tech empires are fragile things – a lesson that shouldn’t be lost on Ellison and his board.

For a change BofA puts Citi, Wells Fargo to shame

16 October 2013

For once, Bank of America is putting rivals Citigroup and Wells Fargo to shame. The Charlotte, North Carolina-based mega-bank, which reported third-quarter earnings on Wednesday, is still only managing to eke out meager returns five years after the financial crisis. But by one important metric it's holding up better than any of its large U.S. competitors except JPMorgan.

BofA's pre-tax, pre-provision profit in the three months to September fell just 1.6 percent compared to the same period last year after adjusting for one-offs and other noise, according to Citi research. That's pretty impressive on its own, considering the summer spike in interest rates whacked mortgage lending and added pressure on revenue across Wall Street from trading fixed income, currencies and commodities.

But the bank run by Brian Moynihan bested a couple of its peers, too. Citigroup's adjusted profit fell by almost 5 percent, while Wells Fargo's slumped by almost 12 percent. That marks a rare underperformance by the San Francisco-based bank. Of course, much of it comes from the slowdown in extending home loans, in which Wells has of late enjoyed around a 30 percent market share. It may also be a sign of Wells' relative lack of diversity.

Nonetheless, both BofA and Citi trail their West Coast competitor by a country mile in what they provide to shareholders. Wells still managed to crank out a 14 percent return on equity in the third quarter. Citi only managed 6.4 percent while BofA's languished at 4.23 percent – though that would have risen to 6 percent if it weren't for a one-time tax hit in the United Kingdom. JPMorgan's number, meanwhile, grew just over 5 percent – after stripping out its whopping $9 bln legal bill, of course.

Overall, the results are a reminder that recovery is slow at BofA. The relative strength of its income, adjusted for funnies, is at least a feather in the cap for Moynihan. After years of cleaning up the mess left by predecessor Ken Lewis, he needed one. Now his progress can be properly judged.

Context News

On Oct. 16 Bank of America reported third-quarter net income of $2.5 billion, or 20 cents a share. That beat the consensus sell-side estimate of 18 cents a share.

The results included an $800 million pre-tax gain from selling the bank's remaining stake in China Construction Bank, a $400 million pre-tax hit from marking to market improvements in its own credit spreads and a $1.1 billion charge related to a reduction in the UK tax rate.

JPMorgan's Whale mini-mea culpa is no Dr. Evil

16 October 2013

JPMorgan Chase's mini-mea culpa in the London Whale trading case is no Dr. Evil. The bank owned up to recklessness in its $100 million settlement with the U.S. Commodity Futures Trading Commission. But Chief Executive Jamie Dimon's firm confined its admissions to the day it dumped $7.2 billion of credit default swaps - and didn't acknowledge breaking any laws.

Last month the bank shelled out $920 million to four other U.S. and British regulators over the trades that cost it some $6.2 billion. Along with its $200 million share, the Securities and Exchange Commission extracted JPMorgan's admission that it illegally failed to keep accurate books and records. The CFTC, however, held out for more: trading activity details that in the eyes of the agency, if not the bank, amounted to illegal market manipulation.

While the CFTC gets to tout a modest victory, JPMorgan can probably hold the line on lawsuits. It admits to embarrassing facts and aggressive trades that roiled the swaps markets - but little else. What's more, the new Dodd-Frank rule that the CFTC claims the bank violated doesn't give players in the swaps market the right to sue. Even if they could gin up a case, their damages would be limited to trades on one day. And nothing in the settlement limits the bank's legal arguments in other proceedings.

In those respects, it's similar to the SEC accord. Private parties don't have a right to sue for books-and-records violations, and the bank didn't admit to any fraud.

Both settlements, however, reflect progress in holding financial institutions accountable. Before U.S. Judge Jed Rakoff took the SEC to task in 2011 for a CDO settlement with Citigroup, banks and other institutions were routinely allowed to avoid admitting wrongdoing.

New SEC Chairman Mary Jo White promised to toughen up the agency's approach. And its officials have already had some success, such as forcing the likes of hedge fund Harbinger Capital and its boss, Phil Falcone, to admit misconduct. Even if the acknowledged misbehavior is small potatoes legally, the facts behind it are finally coming out.

Financial watchdogs are, at least, dishing out bigger penalties. But when it comes to extracting confessions, they have yet to back up their bark with serious bite.

Context News

On Oct. 16 JPMorgan Chase agreed to pay the U.S. Commodity Futures Trading Commission $100 million and admit to acting recklessly in connection with the London Whale trades that cost the bank more than $6 billion in losses.

JPMorgan in September paid a total of $920 million to the Securities and Exchange Commission and three other U.S. and British regulators to resolve investigations of the scandal.

The CFTC case accused the bank of violating a prohibition on manipulative conduct when it traded in the credit default swaps at issue. By selling $7.2 billion worth of swaps in one day, the CFTC order said, it "recklessly disregarded" the precept that legitimate market forces should set prices.

BSkyB ably defends its turf against BT incursion

17 October 2013

British Sky Broadcasting is ably defending its turf against BT. The satellite broadcaster's first set of results since the UK telecoms group began screening live sports were surprisingly strong. Shares clambered to a 12-year high. Yet, for Sky, there are plenty of technological and cost challenges ahead.

BT is keen to staunch the loss of broadband and telephone subscribers to BSkyB, which re-sells its rival's telecoms services alongside its own flagship television offering. So the former mainstay of UK telephony has spent heavily on top-flight soccer and other sports. It has also established dedicated TV channels which are free for its broadband customers.

This, initially, looked like terrible news for BSkyB. But the worries proved overdone, partly because the newcomer's TV offering is weaker. Quarterly revenue at BSkyB rose a forecast-beating 7 percent to 1.84 billion pounds. Broadband subscriptions and line rentals raced ahead too, showing that the assault on BT's core businesses continues.

Even so, investors cannot afford to be complacent. The rivalry has already forced BSkyB to increase spending on sports rights and on marketing. That was reflected in lower operating profit this quarter. And more eye-watering rights auctions loom, such as that for the Champions League, the tournament for Europe's elite soccer clubs. Nomura reckons BSkyB might have to pay 150 million pounds a year this time round, double the outlay last time.

Technology is changing fast too. The rise of super-fast broadband, via cable or fibre, poses two headaches. The first is that Sky fibre may be less competitive than standard broadband, since regulators give BT more freedom to set wholesale prices. This could slow BSkyB's growth.

The second risk is that faster internet increases demand for online-based services, such as Netflix. In some households these services replace pay-TV. BSkyB is alert to the danger and has brought in mobile and video-on-demand products to make its services more attractive. Still, the average BSkyB user spends 559 pounds a year; some must be tempted to economise.

After a roughly 7 percent rise on Oct. 17, Sky shares are trading at more than 15 times expected earnings. The five-year median is 14.5 times. BSkyB is tackling the BT challenge well. But the stock looks fully priced.

Context News

British Sky Broadcasting Group reported a 7 percent rise in revenue for the three months ending Sept. 30, to 1.84 billion pounds. BSkyB signed up 111,000 broadband users in the quarter, increasing its total broadband customer base to more than 5 million homes.

Shares in BSkyB leapt. By 1425 GMT on Oct. 17 they had risen 7.5 percent to 944 pence a share, their highest level in 12 years. That made the stock the best performer in the FTSE Eurofirst 300 index.

Goldman spares shareholders worst of poor quarter

17 October 2013

Goldman Sachs shareholders can at least console themselves that the firm's third-quarter showing could have been worse. The Wall Street titan's fixed-income traders brought in almost half as much lucre in the three months to September as they did last year – worse than at rivals. That's Goldman's worst showing in years. But the firm sharply cut pay in a sign its executives are trying to keep the bank's owners happy.

Two factors appear to have driven Goldman's poor trading performance. First, it managed its inventory badly in currency trading when making markets got tricky. Effectively, that means Goldman got stuck with some bad trading positions.

Second, the Lloyd Blankfein-led firm's fixed-income, currency and commodities trading business concentrates on big, often customized, trades for large money managers. That leaves Goldman exposed to tepid volumes and more risk. Universal banks like JPMorgan, Citigroup and Bank of America benefit from the flow from other businesses in the bank, like wealth and retail asset management and transaction services.

Equities didn't help much, either. While no embarrassment, revenue was essentially flat, after adjusting for units that had been sold and the gain Goldman made helping to bail out Knight Trading last year. An options glitch revealed in August dented performance, too.

The dismal fixed-income trading results convinced Chief Executive Blankfein and his team to take the unusual step of slashing pay last quarter. While revenue slid by a fifth, at $2.4 billion compensation was targeted more than a third lower than last year. That equates to 35 percent of the firm's top line, down from the 40 percent-plus Goldman usually socks away.

That allowed the bank to beat consensus estimates for net income and prevented the annualized return on equity languishing at the 6 percent mark, which is where it would have been had the comp ratio stayed at the same level as the first half of the year. Even so, a return of 8.1 percent is pretty drab and below Goldman's cost of capital – though for the first nine months of the year the return is a more respectable 10.4 percent.

Blankfein's timely cost management is welcome. Investors who own Goldman for its superior trading nous, though, will be hoping it won't be needed again any time soon.

Context News

On Oct. 17 Goldman Sachs reported third-quarter net income of $1.52 billion on revenue of $6.72 billion. At $2.88 a share, profit beat the consensus sell-side estimate of $2.43 a share.

Revenue from fixed income, currency and commodities trading was $1.25 billion, a 44 percent drop from the same period last year and a 49 percent fall from this year's second quarter.

Equities revenue was $1.6 billion, compared with $1.85 billion in the second quarter and $1.96 billion in last year's third quarter.

Debt underwriting brought in revenue of $467 million, down a third from the second quarter and flat compared with the same period last year. Equity underwriting fell 26 percent from June and was up just over a quarter from last year. Advisory revenue of $423 million was 13 percent and 17 percent lower than the second quarter and last year's third quarter respectively.

At $1.48 billion, investing and lending revenue was 4 percent above the second quarter and 18 percent lower year-on-year. Asset management brought in $1.2 billion of revenue, 9 percent less than in the three months to June and 2 percent above last year's third quarter.

Goldman set aside $2.38 billion for compensation in the third quarter, just over a third below the amount set aside in the three months to June this year and the quarter to September last year. This represented 35 percent of revenue in the most recent quarter.

Goldman's board has decided to increase the firm's quarterly dividend payment by 5 cents to 55 cents a share.

Mark Zuckerberg's new IPO religion wins disciples

17 October 2013

Mark Zuckerberg’s new religion should attract plenty of disciples. The Facebook founder’s early contempt for the idea of an initial public offering was supposed to influence a generation of Silicon Valley entrepreneurs. The stock’s calamitous debut in May 2012 only reinforced the resistance. Zuckerberg and Facebook have come around, though – and many others are set to follow.

Facebook’s antisocial attitude to public shareholders derived from Zuckerberg’s worry that the market glare would distract his engineers and undermine the company’s hacker culture. Even after triggers in securities laws made it all but impossible for Facebook to remain private, Zuckerberg’s hoodie-clad reluctance was palpable. Then, once publicly traded, the shares swiftly halved, confirming the fears of so many wunderkinds with an app and a dream.

Marc Andreessen, a tech high priest whose venture capital firm Andreessen Horowitz has backed dozens of firms including Facebook, shared Zuckerberg’s skepticism. As recently as July, he was saying “the IPO market is deeply broken” with startups growing quickly and delaying the sale of their shares to the public. The new U.S. JOBS Act also makes it easier for private firms to put off the decision to go public and to raise capital by other means.

The Valley’s hymn sheet is changing, though. At a summertime Fortune gathering of technology executives, Bill Gurley, a partner at rival early-stage investment firm Benchmark, exalted founders like Amazon’s Jeff Bezos and Salesforce’s Marc Benioff for embracing Wall Street’s bright lights. And public markets are functioning just fine. In 2010, 70 U.S. venture capital-backed companies went public, according to Thomson Reuters. That’s consistent with pre-crisis 2006 when there were 67 such IPOs, and even pre-tech-bubble 1998, when there were 78.

Zuckerberg is also now a convert. A tripling of the company’s shares to a level well above the issue price will have helped persuade him Facebook’s IPO was a good thing. And new tech issues of late have attracted eager followers. For example, shares of Veeva, a cloud-based software company, nearly doubled in their debut on Wednesday.

Devotees of Zuckerberg’s achievements are dropping the old anti-IPO orthodoxy. Investors and bankers say dozens more venture capital-backed debuts are coming, many of them filed confidentially for now under the JOBS Act. It’s hard not to bow to the almighty dollar.

Context News

Facebook Chief Executive Mark Zuckerberg, who was a skeptic about taking the company public, now says the company is better off for having pursued the initial public offering.

“In retrospect, I was too afraid about going public,” Zuckerberg said at TechCrunch Disrupt on Sept. 12. “I’ve been very outspoken about staying private for as long as possible. I don’t think it’s that necessary to do that.”

In the third quarter, 26 venture-backed initial public offerings raised $2.7 billion, the first consecutive quarter with 20 or more such IPOs since fourth-quarter 2004, according to Thomson Reuters and the National Venture Capital Association.

Fantasy sports re-engineered as fantasy investment

17 October 2013

Wall Street and Silicon Valley have spawned a love child called Fantex. The San Francisco-based marketplace for shares linked to the actual earnings of professional athletes disclosed its first tracking stock initial public offering on Thursday. The proposition sounds like a sports junkie's dream. In reality, it is fraught with risks. Fans should lace up their sneakers and run away.

Americans shell out an estimated $15 billion a year to play at being team owners, according to a fantasy sports trade group. Meanwhile, investors value the next 12 months of estimated earnings at $5 billion Manchester United at a whopping multiple of 41 times. So there's a market ripe for the picking.

A logical extension is to give obsessive sports followers a financial stake in the players they already track. Fantex Holdings is starting with Arian Foster, a top running back in the U.S. National Football League, with plans to use $10 million of IPO proceeds to acquire 20 percent of his future pay – including his salary, any endorsement income and what he makes after retiring from football.

It shouldn't take long for any stat-crunching sports nerd to spot the pitfalls. Athletic careers can be cut short. Though Foster has been in the league for five years, his performance is slipping and he has confronted multiple injuries. Those playing at his position last on average less than three years. Even so, Fantex forecasts a big jump in Foster's brand income.

Financial woes also plague pro athletes. A few years ago, Sports Illustrated estimated that four out of five NFL players had serious money problems within two years of their playing days ending. It's not clear where Foster's tracking stock owners would fall in the pecking order if he goes on a Ferrari-buying binge. Personal scandals are a giant risk in the sports world, the slug of upfront money may have unintended consequences on player behavior and Fantex enumerates plenty of conflicts of interest.

Buyers of the tracking stock would have no say, as Fantex retains voting power. Though music royalties have been successfully securitized, most famously some of David Bowie's, previous efforts to make a market out of athletes have flopped. Hollywood lobbying, meanwhile, prevented trading in box office futures. The leagues, unions or other stakeholders might deal a similar blow to Fantex. The startup looks like fantasy sports re-engineered as a fantasy investment.

Context News

Fantex Holdings said on Oct. 17 it would launch a brokerage service and a marketplace to allow investors to buy and sell shares linked to the value of professional athletes. The San Francisco-based firm also filed a registration statement for the initial public offering of its first tracking stock, which will be tied to the value and performance of Arian Foster, a running back for the Houston Texans.

The chief executive of Fantex is Cornell "Buck" French, co-founder of OnLink Technologies, an e-commerce software company acquired by Siebel Systems in 2000 for about $610 million in stock. Fantex Chairman David Beirne was a general partner at venture capital firm Benchmark Capital for a decade, before leaving in September 2007.

Beware a big and impatient Google

18 October 2013

Beware a big and impatient Google. The internet search giant's third-quarter results suggest the transition to mobile and growth in video are humming along. The steady success, though, may be boring Chief Executive Larry Page. He says he may skip future calls with investors and that Google is struggling to invest in new ideas fast enough. The real danger is the allure of deals that suit the scale of a $300 billion company.

Google is churning out impressive figures. Total revenue rose 12 percent in the period from a year ago. And even that understates Google's success. Internet sales, net of fees to partners, grew 23 percent while the bottom line swelled by 36 percent.

Growth looks set to continue, too. While advertisers are still reluctant to pay top dollar for mobile advertising, there are increasing signs prices should rise. People can see such ads while they're shopping and also make it easier for them to call merchants. That leads to the higher conversion rates advertisers crave. And more devices are leading to more time spent with other Google services. About 40 percent of YouTube is now watched on smartphones or tablets.

The company itself seems to be searching for a bigger challenge. Page said it's hard to motivate employees to spend enough on long-term research and development. He expressed a desire to know how to deploy meaningful amounts of money on speculative investments. The cost of the company's new Calico biotech venture, for example, is largely immaterial given Google's size and its $8 billion annual R&D budget.

Google's dives into alternative energy, self-driving cars and internet access using balloons could have giant payoffs for the company and society. Page concedes, however, that it will take a lot of effort and time for marketable inventions to emerge. Bureaucracy and infighting tend to retard innovation in companies as large as Google.

That means it will need some serious willpower to resist the temptation of trying to buy innovation. The $12.5 billion acquisition of Motorola to get into hardware production is a case in point. Sales in the division are falling and losses mounting. It's admirable that Google is so anxious to find the next big thing. Big deals, though, probably would only provide a shortcut to capital destruction.

Context News

Google on Oct. 17 reported that it had generated total revenue of $14.9 billion for the third quarter, a 12 percent increase from a year ago. Internet revenue, net of fees paid to partners, rose 23 percent. Earnings were up 36 percent to $2.97 billion, or $8.75 a share.

U.S.-EU mistrust scuppers quest for banking grail

18 October 2013

Global banking's quest for its holy grail - cross-border resolution schemes - had a funny old day on Oct. 17. The UK's top banking regulator, Andrew Bailey, used a speech in London to lament the lack of trust between international supervisors. Hours earlier, at the same conference, the EU's top financial regulator, Michel Barnier, showed why this is harder to achieve than it sounds.

Bank resolution unlocks many doors. Were global supervisors able to agree how a bank with a multinational footprint would be recapitalised or wound down, the current debates on how much capital they should hold would be simpler. Such collaboration would also remove barriers to world trade.

Bailey is right to assert that a bank's structure is of secondary importance. If regulators are willing to cooperate with, and trust, each other, then most problems vanish. Banks could equally be resolved whether they had bigger chunks of bail-inable debt at the parent company, or a more federal structure with individual pots of capital spread around many subsidiaries.

That understanding is crucial when the time comes to share international banking assets in a crisis. It didn't surface when Lehman Brothers went bust in 2008. This week, the UK seemed to show a lot of trust in the Chinese regulator, by allowing the country's banks to open branches, instead of subsidiaries, in the UK.

Instead, U.S. and European regulators are circling the wagons. Branches of European banks in New York will have to become subsidiaries. Although the Federal Reserve wants to encourage a more global outlook, other arms of the U.S. regulatory machine want to make their jurisdiction look tougher.

Barnier appears cut from the same cloth. Asked about U.S.-based European banks forced to hold more capital, he responded that if the U.S. persists, he might have to reply in kind.

One of the goals of the euro zone's planned banking union is to encourage more cross-border capital flows than occurred in the heat of the euro crisis. But as long as the global economy remains in flux, that kind of tit-for-tat mindset will scupper attempts to make the same happen on the world stage.

Context News

European Union financial services commissioner Michel Barnier said on Oct. 17 that he could be forced to retaliate if the region's banks were required to raise separate capital by American regulators.

"I don't want to be forced to do the same as the Americans," Barnier told reporters on the sidelines of a British Bankers' Association conference in London.

"My objective is to find agreement with the Americans on foreign banks. My mindset is not one of threats but my objective is to find a free and fair banking relationship. If we don't find such an agreement, we will end up having to do the same thing," Barnier added.

Separately, the Bank of England executive with responsibility for macroprudential regulation of the banking sector said on Oct. 17 that lenders from countries outside the European Economic Area could open wholesale branches in the UK, providing they have reputable regulators and viable resolution mechanisms.

Andrew Bailey, chief executive of the Prudential Regulation Authority, said that this was "part of a broader policy" to stimulate cross-border finance.