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The PZU IPO supported by social engineering

Shooting in the dark with metered-out artificial lighting and fireworks

The commencement of the sale of PZU shares constitutes the continuation to fulfill EUREKO's most secret dreams. It seems like all expectations of the Dutch company have been reflected in the actions of a group of officials of the Polish Ministry of Treasury with Minister Aleksander Grad leading the way. Earlier, the current crew in charge reached a controversial agreement, which was beneficial for EUREKO.

The Treasury in the hands of a minister

The previous privatization of PGE by Polish government had become the object of widespread criticism. The treasury minister consented to the issue price for PGE shares to be lower than the demand at the time dictated. On one hand, a group of privileged business entities received no-reduction shares, on the other hand, other entities and natural persons in order to acquire anything had to aid themselves with the costly financial levering of subscriptions. Therefore, two different costs of acquiring the same shares were in existence – one price for privileged persons, who had managed to get into the good books of the offering party and a second price for everyone else.

The sale of PZU shares is fundamentally different to the PGE offer. In the case of PGE, it was a new issue of a state-owned company, currently the shares are primarily being sold by a private shareholder - EUREKO (directly and indirectly via special purpose company Kappa). Bearing in mind the understanding, with which minister Aleksander Grad has treated the reasoning by EUREKO, it should be anticipated that in the case of the sale of PZU shares (as opposed to the PGE offer) the aim is to achieve the highest possible price. On the other hand, that should be the very motto of every offer, as selling something below its value requires no particular skill and has no real merit – then the selected few most often make money at the seller's cost.

Share rationing

The sale offer of PZU shares has been based on the idea of reglamentation. Those selling the shares became convinced that public opinion should be swayed into believing that reglamentation is necessary due to the unprecedented attractiveness of its subject.

Back in the days when Poland was socialist, products such as meat, butter, cigarettes, as well as many others, were all rationed. If something is rationed then it means it must be valuable and during the war the civilian population also received coupons for essential products. The public relations exercise has a great chance of success, bearing in mind that the privatisation of the largest companies is often regarded in Poland in the same way as selling your family heirlooms would be. In the turmoil which follows, it may escape the general public's notice that PZU has already been sold once before… to the party presently selling the shares.

A lesson in speed reading

The prospectus, which consists of over 700 pages, was publicised on 19 April, 2010, whilst the placing of subscriptions by natural persons has been taking place from 20 April until 28 April. At the same time, the media is busy spreading the notion that queues may start forming and therefore there is a suggestion that one should subscribe as early as possible. On the first day of subscription, broker's offices were suddenly filled with people, who until that point had little to do with the securities market; in Poland these are typically older, retired people. Information about queues (even the virtual ones) had a single objective – to make these queues happen and these – as is known – tend to act as signposts for the masses

In accordance with the prospectus "subscription to the Shares Being Sold is unconditional, irreversible, cannot include any reservations and binds the subscriber until the time the Shares Being Sold in the Public Offer are allocated, or until the day the Offer is cancelled" (only the appendix to the prospectus by right of law gives the option to cancel the subscription). If irreversible subscriptions are being accepted from the very next day following the publication of the prospectus, then we should ask the Ministry of Treasury what was the point of preparing the prospectus in the first place? It is obvious that nobody can read the prospectus within the space of one day and become familiar with its finer detail.

Mr Minister,

What is in your opinion the role of the prospectus and who should it benefit (apart from the people who received millions of dollars for preparing it)?

The less someone has to do with the market, the more time they need to analyse the prospectus and the company. However, it would transpire that the Minister has offered investors a lesson in speed reading, and assigned supernatural skills to those persons, who wished to subscribe at the beginning of the offer. In the same manner, subscription could have been commenced a few days before the prospectus was made public, there would be no significant difference as far as acquiring solid knowledge of the document was concerned.

In the civilised world, prospectuses are made available so that potential investors can familiarise themselves with their content, as well as with any reports and opinions created on the basis of data they contain, prior to placing a subscription. This seems only too obvious.

The more an offer is aimed at the general public, the longer the time should be from the publication of a prospectus to the day of commencing subscription for shares. Many individual investors will not bother to read the prospectus anyway, regardless of the amount of time they have at their disposal, however, there are still people out there, who like to know what they are buying! In addition, those who have no intention of reading the prospectus and tend to shoot in the dark, in the event that opinions, reports and recommendations appear, are able to make a more rational decision. In the civilised world, regulating public turnover of securities is aimed at protecting the least experienced, most vulnerable investors, especially those, who act on impulse or are swayed by advertising when making an investment. That, however, is not quite the same as eating a chocolate bar on impulse. In the public domain, the shelf life of a prospectus, before commencing binding subscriptions, plays the role of guarantor of market transparency. That is how things work in the world.

Visible fireworks

Every natural person, who purchases PZU shares and holds on to them for a continuous period of one year, can rely on getting a rebate worth 100 zloty for itemised insurance products. However, those subscribing will get to find out which products the discount applies only once the subscription period is over, and the company has given itself until 30 June, 2010, to make a statement. Neither does the person subscribing for shares know at present, whether they will be able to “claim back” the 100 zloty in future, nor are investors able to assess the incumbent liability on the company due to the declared discount. In the media, a 100 zloty discount is definitely present and is aimed at encouraging us to buy shares, of course, it is best to start queuing now.

On the other hand, the arrangement, linking the sale of shares with the liability of the company towards its shareholders, is a most interesting one. Who will benefit from such a solution?

Let us make the hypothetical assumption that we have a company which loses its shares in the market, the shareholders have just paid themselves gigantic-sized dividends and the competition in the marketplace is getting hotter. The intention of the shareholders is to exit the investment.

The person subscribing for shares is not, in practice, buying shares but a combined product: the shares plus future benefits of the company. The party selling the shares, in order to achieve a higher price, can offer a lot, the more they offer in terms of future company benefits, the more they can rely on a higher price for the shares, particularly, when the potential purchasers are the general public. In such a way, in an extreme case it is possible to offer more that the company will be able to deliver.

Instead of shares with a discount the purchaser can believe to be buying a discount and shares. However, the selling party will certainly make off with the money for the shares.

Linking the benefit of the company with the purchase of shares would look different if, instead of selling shares by the shareholders to date, a new issue would take place, one in which the takings remain within the company. In case of PZU, however, it is a mechanism with an internal risk attached, meaning the more shareholders (via the agency of the board) “add” to the shares, the higher price they will obtain, and the company will be left with increased liabilities.

The value of subscriptions by natural persons

It seems that the average subscription made by a natural person in Poland in recent privatisation offers fluctuated around the 10,000 zloty mark. The maximum number of reglamented shares in the PZU offer – 30 units at a maximum price of 312.50 zloty – has therefore been adapted to the behaviour of investors. That is, due to the value of a subscription, reglamentation can to some small degree limit the demand for shares, whilst it impacts to a great degree on PZU shares being viewed as rare goods. Those tempted by the encouragement to acquire goods from under the counter will still be able to subscribe using their family and friends.

Reglamentation, in spite of an intuitive view, can increase the actual value of investment by natural persons, who originally did not intend to participate in an offer or were looking to acquire the shares for less. This pattern of behaviour, when faced with the appearance of reglamentation, is highly likely and possible to estimate. And chances are that this is what the creators of the offer intended.

Institutional investors

Institutional investors are privileged due to the fact that they have knowledge of the progress of the offer for individual investors and the time to familiarise themselves with the prospectus. The intention of the offer could have been as follows: to develop and use the interest of natural persons in purchasing PZU shares, as well as social instinct (including not having the possibility to reliably assess the company and its prospectus), then on the basis of the demand reported from natural persons to show institutional investors how great the public interest is and the “delayed demand” linked to reductions for part of the subscriptions.

At the conclusion of assessing the offer’s structure, it is worth noting that holding on to PZU shares by natural persons in order to obtain a rebate is a move moderating the market on the supply side. From what can be seen after a superficial inspection of the prospectus, the lock-up for EUREKO is anticipated for a period of merely 180 days and may be released with the consent of the Global Co-ordinators and Co-managers of the Demand Book – Deutsche Bank AG and Goldman Sachs Int.

Polish standards watched by foreign SEC

In Poland, an increasing number of people, who are linked to the capital market, are having serious reservations in relation to the activities of the Financial Authority Commission (The Polish Securities Exchange Commission), where those officials, whose job it is to issue permits for companies to be floated on the public stock exchange, have at the same time provided private, fee-based advisory services to these entities on how to gain the status of a public company in the most efficient way. Companies supervised by the Financial Authority Commission have also paid the highest-ranking officials in the Commission for training…

In the case of the PZU offer, an unparallel event took place: the following day after the prospectus was publicised, binding subscriptions were already being taken from natural persons. Moreover, the principles of share allocation in the event of reductions, favour those who subscribed earlier. This mechanism has been cited in the media and has created a stampede. Those unconnected to the market are being driven by this criteria, as well as by the reglamented product syndrome, as a result, elderly people and pensioners (in Poland they are typically the ones, who are the least aware of market mechanisms) are queuing up in order to subscribe for PZU shares.

The offer is on an international scale and any market behaviours, which vary from the standard, impact on the investment of foreign companies in the Polish market.

For the public market, in particular, for the weakest persons on these markets – natural persons susceptible to sale techniques – it is important that the area of turnover of a product as specific as securities is adequately monitored. As the Polish SEC acts as it does, international authorities in the securities market should examine PZU's offer in terms of guaranteeing investor rights and offer transparency.

The value of PZU

Qualified investors do not need the key role of the book value in terms of pricing financial institutions, explaining to them. In short – the profit source of such institutions is primarily represented by financial assets covered by supervision and safety clauses. Its consequence is to provide relative system safety, but the price is the profitability of financial instruments which fluctuates for the industry little above a return on the investments regarded as quite safe.

In particular, insurers using an actuarial account to assess the value of reserves, applying principles of a safe, as well as a diversified investment portfolio, have similar economic potential (for subjects on a similar scale of activity), therefore, in the vast majority of cases (excluding those firms with extreme results) the pricing of insurers fluctuates with minor variations around a similar P/BV coefficient value. So, for the European insurers cited here, the median of the P/BV indicator is around 1.2.

European insurers	**P/E 2009**	**P/BV**
Aegon	-	0.54
Allianz	8.8	1.03
AXA	11.8	0.82
Generali Deutschland	13.7	1.12
Hannover REG	6.1	1.2
Legal & General Group	6.1	1.26
Mapfre	8.3	1.59
Old Mutual	-	0.77
RSA Insurance Group	10.3	1.21
Sampo	15.7	1.59
Standard Life	26.3	1.33
Uniqa	-	1.3
Vienna Insurance Group	10.3	1.21
Zurich Financial Services	10.7	1.2
Median	**10.3**	**1.2**
PZU	7.2	2.4

Table: The estimates for European insurers

At the same time PZU has a P/BV indicator of 2.4 for the price of 312 PLN. I believe that there is no justification for PZU to be priced significantly above equity capital x 1.2. Someone may decide that such a high P/BV indicator has been influenced by a one-off factor in the form of a payout of the deposit for several years of the mega-dividend. The only thing is that this one-off factor in the form of depreciating the equity capital from around 24 billion to around 11.3 billion PLN, is of a most permanent nature, as far as the financial situation, and the direct value of the company are concerned.

Below, I will summarise some of the other factors, which have an impact on the value of PZU:

1. The leakage of a huge sum from PZU in the form of a deposit for the payout of dividends (net profit for many years) is linked to the necessity to close investment positions. Despite functioning of a fair value, the transactions closing an investment are telling of the definite value of a given asset. The question is: which items does PZU close and which should remain on the balance sheet? This question should be answered by every investor himself, and the potential intentions of shareholders to date relating to the financial result for 2009 taken into consideration. To sum up, what is important is what remains in the financial assets.
2. The rise in stock exchange indices for 2009 impacted on the result for 2009, future trends should be taken into consideration within the context of the real value of PZU assets.
3. The company is being returned to the “State” and the Treasury will have a significant impact on its functioning.
4. PZU has a strong position in the insurance market in Poland. However, is this really an advantage? Perhaps PZU had an established position on a largely monopolised market, however, the market is changing and PZU is losing shares in it.
5. Many PZU employees received big money in the form of employee shares and high mega-dividends, which can have a significant bearing on changing the employee-employer relationship in the company. A significant group of PZU employees may wish to leave the company and, for example, represent the competition in organisations providing comprehensive insurance products sourced from several different insurers. At the same time, PZU is in the process of employment restructuring.

To sum up, the above listed factors do not favour, in my opinion, pricing PZU above other European insurance companies. My personal viewpoint is that the value of PZU shares lies within the 150-180 PLN bracket, in relation to the WIG20 index value at a level of 2500 points.

Jaroslaw Suplacz

www.Polandsecurities.com