

# From bad to Wurth

## THE LEX COLUMN

### Arcelor

The Luxembourg Chamber of Commerce is the latest entrant in the contest to find the world's most protectionist organisation. Competition is fierce for this dubious accolade. The US Congress and the governments of France and Spain are all strong contenders. The chamber's proposed amendments to European Union takeover law, before its adoption by Luxembourg, are a blatant attempt to derail Mittal Steel's hostile bid for Arcelor.

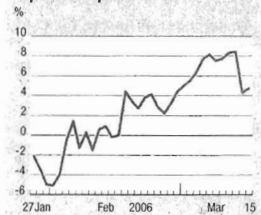
Under the proposals, unless a bidder has a free float of 25 per cent or more, with equal share voting rights, it would be required to offer a full cash alternative in a hostile takeover.

Worse, if approved by parliament, the new law would be applied retroactively. Mittal, which is offering a 25 per cent cash component, currently has a free float of only 12 per cent and unequal voting rights.

Arcelor argues that a cash offer is in shareholders' interests, when the illiquidity of the bidder's stock and governance concerns make a fair assessment of value more difficult. This is valid. It does not mean, however, that it is right to erect poison pill defences which deny shareholders the opportunity to accept a cash and paper bid.

The picture is further muddled by the fact that Michel Wurth, the chamber's president, is also Arcelor's deputy chief executive. Mr Wurth recused himself from signing the chamber's advice to the Luxembourg parliament. Some of the independent

### Arcelor premium/discount to Mittal's implied offer price



Source: Thomson Datastream

legal advice offered to the chamber was also commissioned by Arcelor's lawyers.

While it is normal for a business to lobby its trade body, those who commission advice often receive the answer they want. The views of the country's largest employer will, inevitably, carry considerable weight.

Arcelor has said that shareholders will decide on Mittal's bid. But, if Luxembourg succumbs to the chamber's lobbying, which is clearly influenced by Arcelor's view, investors may not get their say.

### Gulf markets

Who can argue with the recent sell-off in Gulf stock markets? Even after a fall of more than 30 per cent since late February, the Saudi Arabian market, for example, is still trading at more than 30 times 2005 earnings.

More worrying is the risk that a collapse in Gulf stock prices could feed through into other emerging markets, as Russia's 1998 debt default did.

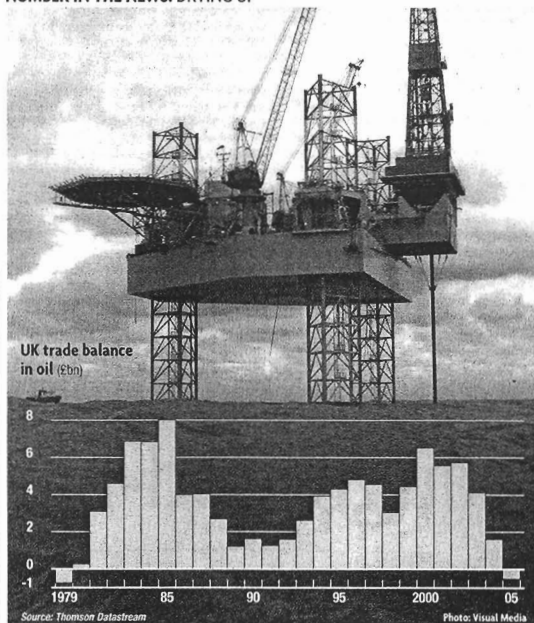
There are structural reasons to believe that this sort of contagion will not happen. For one thing, Gulf stocks are mainly held by local investors. Indeed, the Saudi market is closed to investors from outside the region. Furthermore, the latter stages of the rally, particularly in Saudi Arabia and Kuwait, have been characterised by speculative retail buying, financed by bank lending. This makes the recent slide more likely to be painful for individuals facing margin calls, but less likely to have a knock-on effect in other markets.

More sophisticated Gulf investors have already been spreading their investments. Turkey and Egypt have been the main beneficiaries – for example, a Saudi-led consortium bought a 55 per cent stake in Turk Telekom late last year. But these markets are too small to absorb the flow of petrodollars, which has also been moving into other, less expensive, emerging markets such as Eastern Europe and Asia.

The available flow of funds is substantial. The International Monetary Fund forecasts that the Gulf's 2006 current account surplus will be \$275bn and HSBC calculates that cumulative excess liquidity generated in the region since 2002 totals \$300bn and is rising rapidly.

If anything, emerging markets are likely to reap the rewards of Gulf investors' scepticism about their own

### NUMBER IN THE NEWS: DRYING UP



Last year's UK trade deficit in oil was a concrete sign that the 25-year boost to the economy from domestic oil is ending. The overall trade account will worsen further as the output of North Sea oil declines – domestic oil production is down one quarter since the peaks of the late 1990s – and the last drop of oil is likely to have been brought ashore within a decade.

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markets. But there is also nothing to suggest that, at more reasonable valuation levels, Gulf investors will not again favour their home markets.

### Sony

Japanese geeks face a dismal summer. Having psyched themselves up for a blissful few months sweating it out in darkened rooms with the latest video games, they might have to brave the great outdoors instead.

Sony's investors might also benefit from some fresh air. Shares in the struggling consumer electronics giant dropped 1.8 per cent yesterday after it announced that the launch date for its PlayStation 3 games console had slipped six months to November. The

only reason they did not fall further was that the market had seen this coming for weeks. The PS3 is not just another gadget. It is designed to be future-proof in an industry where new models pop up every five years or so. The struggle to perfect all its super-charged bells and whistles before it hits the market helps explain the delay.

How worried should Sony's shareholders be?

There is no escaping the fact that the timetable for Sony's most pivotal product launch in years has slipped. Two other particular features of this launch add to its complexity. The PS3 is the main vehicle for launching an entirely new storage format – the Blu-ray disc. The PS3 will also be

launched globally, rather than in the usual staggered roll-out across regions. By November, Microsoft will have had a whole year to establish its rival X-Box 360 console. Meanwhile, Blu-ray's rival, HD-DVD, will hit stores later this month. Sony's renewed commitment to launch before Christmas is, therefore, critical. The PlayStation brand remains strong: the current generation of consoles continues to sell well. It is, therefore, too soon to declare "game over". But this latest setback will keep Sony's investors sweating.

### Lehman Brothers

Shame about the timing. Lehman Brothers churned out another strong set of quarterly earnings the day after Goldman Sachs blew the market away. That left the investment bank distinctly overshadowed by its bigger rival. Lehman's earnings per share rose 26 per cent year on year compared with Goldman's 73 per cent in the first quarter. Lehman's 27 per cent return on equity – its best performance since 2000 – was about 10 percentage points below Goldman's extraordinarily high number.

That might be painful for the egos concerned. But it is only one quarter. In fact, the results underline how far Lehman has come in diversifying its business in recent years. Even with a slowdown in its powerful mortgage business, and without Goldman's strong exposure to commodities and currency trading, Lehman still turned in revenue growth of 17 per cent.

Its investment of recent years in Europe is paying off – international revenues accounted for almost 40 per cent of the group's total. And its equity capital markets put in another good performance, increasing net revenues by 50 per cent year-on-year. Lehman now has to repeat its success in building those two businesses as it pushes into Asia. Investors appear confident. In spite of Goldman's recent outperformance both companies trade on 2.5 times book value.

The question is whether that is the appropriate level. Both have benefited from the large global capital flows of recent years – ranging from mergers and acquisitions to debt and equity origination. And they have demonstrated an increasing propensity to share returns with shareholders, rather than reserving the lion's share for staff. But then again, neither has faced a prolonged economic slowdown for some time.