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This investment can fly because it's transparent



Business Commentary

Even the most naive investor has to be sceptical about much of the innovation in the City of London. Too often, new products turn out to be wheezes whose brain-boiling complexity seems designed to befuddle.

As Paul Volcker, former Chairman of the US Federal Reserve, harrumphed as he attacked credit default swaps, the greatest innovation to come out of the financial services industry in recent decades has been the humble cash machine.

But on the face of it, a novel aircraft investment vehicle that floated on the London Stock Exchange yesterday offers something different and useful to long-term investors such as pension funds. There's a strong, reliable income stream and the prospect of a capital gain. The company is backed by concrete physical assets — airliners. It's listed and transparent. It has a finite lifespan after which it is wound up. But above all, it's relatively simple to understand.

Doric Nimrod Air Two (DNAT) has raised £145 million of equity from institutional investors. It plans to borrow twice as much more from the banks and will use the money to buy three double-decker Airbus A380s, which it is leasing to the Emirates airline for 12 years. Over that period, the lease fees not only finance a planned dividend of 9 per cent a year, but are also sufficient to pay off the debt entirely.

At the end of the 12 years, Emirates hands back the planes and DNAT sells them for cash in the second-hand market, returning the proceeds to shareholders. It reckons that on the past performance of prices in the used aircraft market, the planes will depreciate by about 45-55 per cent. But with all the debt paid down, the proceeds will still be enough to produce a 60 per cent capital gain.

The high yield, the asset-backing and the quality of the lessor — Emirates is the most profitable airline in the world — have made this an attractive investment.

Doric Nimrod Air One, a smaller but similar beast launched last December, has attracted a string of blue-chip institutional investors including Baillie Gifford. Charles Stanley and Killik & Co have also been buying the shares for private clients.

Emirates is responsible for the

upkeep of the planes and for insuring them. It pays the rental in sterling, which reduces the currency risk. The interest on the bank debt is fixed and agreed in advance, so there can be no nasty surprise on that front.

Aircraft leasing has a long and inglorious past. Guinness Peat Aviation crashed in spectacular style in the 1990s. Parts of the Arizona desert are carpeted with rusting, unwanted second-hand planes that will never fly again.

The point is not that things can't go wrong with these ventures. They can: Emirates could go bust; the A380 could prove to have some calamitous flaw — like the de Havilland Comet in the 1950s, whose lovely big picture windows made it catastrophically vulnerable to metal fatigue; there could be some breakthrough in aviation that makes the 525-passenger A380 redundant; inflation could quickly erode the real value of that mouth-watering yield.

The point is that the dangers are easily understood. Both institutional and sophisticated private investors have the necessary information, including the extent of the leverage, and can weigh up the risks themselves. The shares got off to a strong debut yesterday, rising 15p to 215p.

Interestingly, the venture is not the idea of large investment banks, but of two small City boutiques. The big banks are still too often wedded to the wrong sort of innovation.

Out through the in door at M&B

To lose five chairmen in the space of three years is going it. Casual waitresses at Harvester seem to have better job security than the chairmen of the parent restaurant and pubs group, Mitchells & Butlers. The revolving door has been spitting out senior personnel faster than a bouncer at an O'Neill's on a Saturday night.

The latest chairman to go, Simon Burke, the former Hamleys chief executive and Majestic chairman, lasted only five months. He is succeeded by Bob Ivell, a former senior executive at Scottish & Newcastle, who takes the position on an "interim" basis.

With the chief bottle washer Jeremy

Blood also only "interim chief executive", the entire business has a smell of impermanence. Burger vans have more solid-looking governance arrangements.

Mr Burke isn't talking, but it seems likely that having 26 per cent shareholder Joe Lewis breathing down your neck is not the most comfortable position. Two of the five board members are Lewis representatives and there is a question mark over the independence of a third. There are also concerns that Mr Lewis is not acting alone, although a Takeover Panel investigation could find no evidence of an alleged concert party — a group of shareholders operating in cahoots.

Ideally, Mr Lewis should buy out the other investors in M&B if he wants to treat it as his private fiefdom. Some people think he is achieving just that outcome without the inconvenience or expense of making an actual bid.

Single point of the great divide

It's difficult to argue with \$9 billion. That was the amount immediately added to the stock market value of ConocoPhillips yesterday after the oil major announced plans to break itself in two. Its oil exploration division and its refining divisions are, miraculously, worth far more apart than when combined in a single entity.

The demerger plan has implications for other consolidated oil groups including BP and Shell.

Demergers are curious. No one is seriously suggesting that the two Conoco divisions will produce more profits simply by virtue of separation. There can plausibly be some benefit from the extra focus, but not \$9 billion worth.

This is all about share market valuations, sector categorisations and investor fads — market aberrations gleefully exploited by advisers in pursuit of fees.

For long-term investors, these are ephemeral factors. In another twenty years the fashion may once again be for scale and vertical integration. Unless there are good operational reasons for these divorces, shareholders should look on them with suspicion.

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