Citi team linked up big freight sale chain

JAMES DUNN

If Seneca was right, and luck is what happens when preparation meets opportunity, then Rob Jahrling and his equity syndication and block trades team at Citi were lucky to pull off 2018-19's largest block trade, the 202.5-million-share, $813.9 million block trade they ran in September 2018.

It transacted a 10.2 per cent stake in Australia's largest rail-freight business, Aurizon.

But the deal — which took out Block Trade of the Year at the 2018-19 Australian Stockbrokers Foundation Awards — was seven years in the making. Since 2011, Jahrling — a former Olympic rower — and his team had talked to the stake's owner, a British institution, The Children's Investment Master Fund (TCI), at least 300 times. "We gave them weekly updates, put term sheets to them, general coverage updates. It was a concentrated effort over a long period of time," he says.

So, when TCI was looking to exit more than half of its 19.2 per cent economic interest in Aurizon, Citi was in the prime position to do the deal.

"We had a good idea that they would be a vendor, and part of doing what we do is at all times to be aware of the status of the key blocks that we follow, and who might be interested parties to buy it," he says.

The Aurizon deal was not straightforward, given that TCI did not physically hold the shares: it actually had 7.8 per cent of the 10.2 per cent position on swap with HSBC, and the remaining 2.4 per cent on swap with Citi.

"The structuring of the deal was quite innovative, because it represented the unwind of these swaps," Jahrling says. "First, TCI had to terminate the swap with HSBC for 7.8 per cent, then call Citigroup and effectively increase its swap by 7.8 per cent from the existing 2.4 per cent that we already had on behalf of TCI — increase that to 10.2 per cent — and then terminate the swap. Effectively, the seller of the block was actually Citigroup: the counterparty was not the client in London, because it did not have the physical shares. TCI had the economic exposure, but the physical shares were sitting with Citi as the collateral for the swap."

It was not only a matter of knowing the client, Jahrling says: a number of disparate aspects came together to make the deal work. "We knew that HSBC doesn't have an equity capital markets presence in Australia, which would have made it very difficult for them to do a block trade in Australia. Another thing that worked in our favour was that TCI is a London-based investor, and not only did I know them well, but a couple of months earlier our infrastructure team in London had sold for TCI a block trade in a Spanish airport business, so they knew TCI well, too.

"The other spokes in the wheel that made the deal work was the Citi Australian equity capital markets team as well as our global equity derivatives team," he says.

"We had the coverage and also the execution capability and the global reach — the investment banking, the equity capital markets presence and equity derivatives expertise necessary to execute something like this. Add to that the fact that we had the risk appetite to actually give the client an underwritten price, at $4.02, before it even launched the deal," Jahrling says. Once his team hit the phones, the deal was salted away within the hour. "Aurizon is one of the Australian market's highest-quality infrastructure exposures — comparable with Sydney Airport and Transurban," he says.

"Those kinds of stocks are generally very well-supported by superannuation funds as well as domestic long-only investors, but also, given the quality of their operations, and unique operating characteristics, and market capitalisation, they are also well-supported by international investors, so you generally have a pretty good comfort level in terms of your ability to distribute.

"Whereas, in the small and mid-cap space, sometimes your addressable investor universe can be quite narrow," Jahrling says.

Another "major challenge" in the deal was the regulatory uncertainty, he says: at the time, Aurizon was challenging the Queensland Competition Authority, which had published its draft decision on the access undertaking, UT5, that will regulate Aurizon's coal-haulage network between July 1, 2017, and June 30, 2021. It helped that TCI agreed to a 90-day escrow of its remaining 9.7 per cent stake, at the end of which, in December 2018, it exited its Aurizon holding completely.

"An escrow just gives investors some comfort — in this particular instance, that TCI still had a significant economic exposure, it wasn't cutting and running," Jahrling says. "The share price was trading at $4.10 —$4.20 levels at the time, and today it is trading at $5.50 —$5.70. That is because the low-interest-rate environment is positive for infrastructure companies, and also, the regulatory uncertainty has been removed. It turned out very well for the investors who bought the stock in the block trade."

Jahrling is proud that the deal won Block Trade of the Year. "2018 was the first time we had the number-one position in equity capital market block trades. UBS had been the standout in that particular product set, so we took dethroning them as a great achievement. This deal was an important part of that — it was a nice deal," he says.

JUDITH LEHMANN

Rob Jahrling of Citi, centre, celebrating Block Trade of the Year with presenters Ella Macnish and Martin Lakos

See shares, companies differently: researcher

JAMES DUNN
ANALYSIS

What makes a great analyst? Is it simply being able to rip apart a set of financial accounts? Is it being responsible for running a manufacturing plant or managing a civil-engineering project somewhere before becoming an analyst? Perhaps having a degree in a totally non-financial discipline helps?

Is it spending more time visiting companies, customers, suppliers and competitors than sitting in front of a computer screen? Is it just being a good communicator and marketer? Or is it being strong enough to ignore what your peers think and recommend whatever you like? Maybe it's more about timing, and luck.

Given the number of earnings downgrades made by companies — and the brutal volatility of a market that can strip 25 per cent or more from the value of a company in a day for unexpected bad news — every firm that issues research has been on the wrong side with a recommendation. Quite simply, it is an unavoidable occupational hazard.

Often it can simply be bad luck. Take Morgan Stanley, which issued a "research tactical idea" — that is, a short-term trade opportunity — on corporate travel company Corporate Travel Management Ltd (CTD) in late October 2018, with a share price target of $35.00. CTD was trading at $27.64. The firm said there was "80 per cent probability of a share price rise, relative to the country index, over the next 15 days".

Unfortunately, this call was released one day before Sydney-based hedge fund VGI Partners released its short-trade strategy on CTD, causing a 20 per cent fall in the share price.

It was a similar story for Citi when it initiated coverage on gold miner Dacian Gold in May, when the stock was trading at $1.81. Citi slapped a share price target of $3.00 on the stock, but — mindful that Dacian had issued an unexpected production downgrade in March — the broker labelled the stock "high-risk".

It certainly was. Another shock production and costs guidance downgrade in June broke the market's patience, and saw two thirds of the company's valuation stripped from it. Again, these are occupational hazards — and the secret of research success is to get more calls right than wrong.

In deciding the Research of the Year award, the Australian Stockbrokers Foundation looked at what analysts were recommending on 28 companies prior to an earnings downgrade, and another six prior to a takeover bid being announced. (There were many more in both categories, but inadequate research coverage.) ASF allocated a positive score if the firm held a negative recommendation at the time of the profit warning, and a positive recommendation at the time of the takeover announcement.

On straight correct number of recommendations, Morgan Stanley's researchers scooped the pool, with 52 per cent of recommendations correct. If counting "neutral" or "hold" calls as positive, Morgan Stanley's success rate increased to 57 per cent; if counting them as negative, the firm also took out top spot, with a win rate of 76 per cent, ahead of Deutsche Bank on 72 per cent and Morgans on 68 per cent.

Head of equity research at Morgan Stanley, Richard Wiles, says it is crucial that analysts are able to pick up and examine themes that will affect the market, key industries and companies over the next five years or more. Also, he says the firm wants its analysts to "take views on stocks, rather than on companies".

"You can have a very positive view on a company, but if high expectations are already reflected in valuations, then you could have an underweight on that company or a cautious view on that industry. We think it's important for analysts to differentiate between views on companies and views on stocks," he says.