Investors suspicious of new holding companies' lack of transparency

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Investor confidence in fund managers' trustworthiness and managerial ability is withering, fund analysts say, following announcements by Harvard Capital and Consulting and two other fund managers that they've converted funds into industrial holding companies.

Amid harsh criticism by a suspicious Prague Stock Exchange chairman and suggestions by analysts that investors should sell their stakes in the former funds, the share price of holdings in funds managed by Harvard, PPF and LinhArt dropped by 9.5-21.4 percent the first four days of this month.

"Investors are concerned about the transparency and future of these funds," said Miroslav Nosal, head of research at Patria Finance.

Around 12 other funds had already made the switch, reported Czech daily Mlada fronta Dnes, but most were small to medium-sized funds that attracted little notice. Attention to the main three has sparked a panic on the market, Michal Snobr of AKRO Capital told the daily, and demand for unconverted funds has also evaporated.

By April 4, the share price of Harvard's former HIF dividendovy fund had dropped by 21.4 percent, that of PPF's former Prvni cesky IF by 13.9 percent and that of LinhArt's former IF YSE by 9.5 percent.

Harvard and PPF each had previously mentioned plans to convert one of its funds into an industrial holding company.

They claimed that the status of a holding company would let funds shed legal restrictions and realize their full potential for stockholders.

But the timing and method used by Harvard, for example, took the market by surprise.

"What we're complaining about ... is the way the change is being done," said Vladimir Jaros, research director at Wood & Company Securities. Conversion could be a smart move, he said. "We'd have no problem with it, if it had been done in a proper, transparent way."

On March 26, Harvard called a little-publicized extraordinary general meeting for 9 a.m. in the south Moravian village of Velke Bilovice, near Brno. The remote location and early starting time provoked suspicion. Some market observers thought the move was designed to avoid attracting too many shareholders.

But Harvard board member Frantisek Manak said the company had announced the meeting in the media four to five days earlier. "We weren't being secretive," he said, "and I don't think it came as any surprise. We chose the location because it has a large meeting hall, and it's convenient for our shareholders in Moravia."

Such conditions weren't enough to satisfy a wary Tomas Jezek, Prague Stock Exchange chairman, who saw other investment funds following in Harvard's footsteps. "I've got one solution: Watch out for them," Jezek told Czech news agency CTK. "We're watching them, and we're publicly warning people not to have anything to do with them."

Manak said, "Jezek is just angry because we've been able to find a gap in the law." Czech Prime Minister Vaclav Klaus also seemed unconcerned with the conversions, telling CTK it was a natural part of the funds' evolution.

Having turned into an industrial holding company, HIF dividendovy fund - now known as Harvardsky prumyslovy holding - has escaped legislation, effective July 1, that will strengthen the rights of minority shareholders. By converting beforehand, the company avoided the upcoming obligation to offer to buy out shareholders at market prices at the time of conversion. And now the company can sell its shares for prices lower than those on the stock exchange.

The conversion has already forced a number of portfolio investors to sell their shares, Jaros said. Those investors are not legally allowed to invest in holding companies.

Patria's Nosal said, however, "It has been difficult to sell these shares on the market."

As industrial holding companies, the former funds are no longer under the supervision of the Ministry of Finance or the Act on Investment Companies and Investment Funds, although Jaros said ministry oversight didn't affect the funds much anyway.

From now on, they'll be acting under the much looser Commercial Code. The companies are no longer restricted to owning 20 percent of a company. Even analysts have admitted that the 20 percent ownership limit has kept funds in minority positions, thus handicapping them in competition with other strategic investors.

Jan Valdinger, chief executive of PPF, which governs the newly converted PPF Investment Holdings, said, "The 20 percent limit on funds in strategic holdings has been a key factor behind the decline in the value of managed assets."

In addition to unlimited holdings, under the Commercial Code, the newly converted companies may finally do things like invest abroad, issue bonds, increase share capital and control the flow of dividends and profits.

Managers of the new holding companies say such powers allow their firms more flexibility in the market as well as more control in corporate governance and restructuring of the companies in which they hold shares. Analysts must soon begin to use more realistic valuation methods, they say, rather than the current yardstick measuring holdings' asset value.

In the long run, the managers say, shareholders will reap the rewards of the holding companies' new opportunities.

Valdinger said PPF shareholders have already done so. The reported 13.9 percent drop in share price is small stuff, he said. Since the publication of the company's last report and accounts, the former fund's share price has increased 66 percent, compared with the 22 percent increase of the PX-50 Index in the same period. During that time, the net asset value of the investments has increased 27 percent.

But analysts at Patria Finance, in a public report, said, "There is no guarantee and no track record that these funds possess sufficient expertise to manage industrial holdings."

The report continues, "So far, Czech investment companies have been showing poor performance of the assets under their management when compared with the PX-50 Index," the benchmark for fund performance.

Manak didn't sound worried. "The more shares we have in good companies, the more we'll be able to control them and earn an increase in stock prices," he said. "That will benefit stockholders."

The Patria report countered, "If the new companies are serious about ... benefits to all shareholders ... they should improve their investor-relations policies and clearly declare their strategy."

Analysts doubted that major banks would risk their funds' reputations by converting them.