

RTL Shareholders May Have a Point

Bertelsmann's Cash Position Could Offer Chance for a Better Offer

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Who can blame the minority shareholders in RTL for resisting Bertelsmann's €44 a share offer? With a new \$6.75 billion (€7.58 billion) receipt from AOL in the Guetersloh war chest, it is natural that the minorities should seek a larger share of Bertelsmann's bounty.

Not that €44 a share is unfair. It values RTL at an adequate 13 times forecast 2002 earnings before interest, taxes, depreciation and amortization, or Ebitda, and Pearson succeeded in wringing out an 8% mark-up to market value. But even if the minorities are overdoing the outrage at the Bertelsmann offer, they are right to think there is scope for a better

deal. Not only are the German group's coffers overflowing with cash. Last February, Bertelsmann paid for GBL's stake in RTL with its own shares, in a ratio of 5 to 6. Bertelsmann is probably worth about €25 billion, so a deal like that would give minorities €135



of value a share, over three times the current offer.

Bertelsmann is already locked in litigation over last year's GBL deal with Audiolux and BGL, which together own about 1.3%. They argue that under European Union law, they should be offered the same terms GBL received, and the local securities regulator appears to have agreed with them. Now the small shareholders are coming to join the legal fray. As well as demanding Bertelsmann shares, they have a new cause of action that alleges bad faith on Bertelsmann's part. When RTL listed in London, the prospectus promised to increase the free float to 15%. Managers reiterated this commitment as recently as September 2001. Shareholders who bought — or decided to hold — since then feel misled.

Bertelsmann now has to take a view on these legal arguments. The minorities might just be holding an ace. Even if they are doomed to fail in court eventually, a lingering litigious rump could present a nuisance factor Bertelsmann would rather pay to get shot of. But the cost to Bertelsmann of any concession would be high,

since it must extend it to Pearson, too. Its €44 offer will not formally start until February. Between now and then, a lot will ride on the RTL board's recommendation to its shareholders of where their interests really lie.

European Retail

Consumer confidence was the story of 2001. Last year the Financial Times-Stock Exchange index of the 300 top European stocks fell 18%, while the index of European nonfood retailers was little changed. Volume sales rose, buoyed by cheap money, falling prices and consumer optimism.

The fear is that 2002 may be less clement. Recent falls in confidence and the psychological impact of Sept. 11 could curtail consumer appetites. It is increasingly likely — if not yet certain — that central bankers will partially reverse their loose money policies. The risk is that if volumes fall back, pricing pressure could intensify and profits could drop sharply.

The fall in confidence has already been felt at the luxury end of the market. Luxury goods retailers have in recent



months been cutting earnings estimates because of reductions in the outlook for demand. It isn't clear that this process has yet run its course, even though some of the proximate causes — such as declining tourism — seem to be less severe than had been

thought. However, the concern remains that the downturn may trickle down to the midmarket.

Continuing pricing pressure is encouraging retailers to focus and consolidate. The Do-It-Yourself and consumer-electronics retailing segments could see deals. Dixon and Kingfisher — the latter having last year demerged its general-merchandise business — are keen to consolidate the electronics-retailing space in continental Europe. Underperforming Pinault-Printemps-Redoute may sell its wholesale distribution assets to free up cash to concentrate on specialized retail and luxury. Luxury-goods retailers may also do some pruning. Pressure is mount-

ing on LVMH to get rid of DFS, the chain of duty-free shops that has weighed on its profit, and Sephora, a network of cosmetics stores.

The litmus test of consumer sentiment in the retail sector may be whether GUS of the U.K. decides to go ahead with its planned initial public offering of Burberry in June. If that is pulled, it will be a negative signal.

Yen Policy

The jury is out about the state of the economy in the U.S. and Europe. At least there is a rare unanimity about Japan: it's in a mess. This, however, doesn't fully explain why the yen has fallen to three-year lows against the dollar. Instead there is a growing suspicion that Japan has adopted a weak yen policy. Comments by Eisuke Sakakibara, a former Japanese financial diplomat once known as "Mr. Yen," that the yen may end the year at 160 to the dollar compared with 133 now, suggest that there may have been a genuine shift.

The question is, to what end? If officials merely intend to pursue a policy of neglect toward the yen, this won't get Japan very far. Even if the currency obediently devalued, it wouldn't provide too much succor to the ailing economy. After all, exports account for only 10% of gross domestic product. Moreover, Japan's biggest problems aren't the external value of the currency, but deflation and high real interest rates. At about 2%, these are considerably higher than in Europe or the U.S.

The only way to bring rates down — at least for a period — is to print money. Higher inflation, in time, will eliminate the competitive boost generated by the devaluation, which should please the likes of China and South Korea. More important and immediately, it would boost domestic demand by eroding the real value of people's cash and debts. This would be good news for equities, even if terrible for bond investors. However, the latter are mainly large banks, which are on the point of collapse anyway. Ministry of Finance officials have hitherto resisted inflating away Japan's problems — in part because of its impact on the yen. If they now believe that depreciation is acceptable, another obstacle to monetization has been swept away.

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