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Roller-Coaster Ride

Isn't Over at HSBC

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Fasten your seat belts, it's going to be a bumpy ride.

HSBC is becoming more focused on core global trade and investment activities. But it also is far more reliant on its global banking and markets **business**, making its results more volatile even before taking into account effects of litigation and other crisis-era hangovers.

Global banking and markets used to account for just one-quarter of HSBC's profit in the years before 2008. Since the crisis, it regularly makes up more than 40%. Granted, profit has been rising since 2011, particularly in fixed-income and currencies trading where HSBC has been second only to J.P. Morgan Chase in grabbing market share.

But this year's first half saw it stumble. The bank suffered a 3.5% drop to $12.6 **billion** in pretax profit from a year earlier, after stripping out a large gain and other onetime items in the earlier period. This was largely driven by a 12% drop in income in its markets-focused arm.

HSBC's markets **business** is different from many U.S. peers. It is less about making markets in investment products for the financial world and more about hedging companies' foreign-exchange exposures.

However, that **business** also is volatile -- as highlighted by Standard Chartered's profit warning, which will be fleshed out this week. HSBC's markets **business** was hobbled by a 21% drop in foreign-exchange trading revenue -- by far the biggest contributor to its trading revenue, overall, and to its decline.

In another big **business**, raising new debt and **equity** for clients or advising them on deals, HSBC took market share. But revenue was flat because of lower fees.

Like peers world-wide, HSBC said activity improved in June in the trading businesses after a woeful April and May. It managed to do better than most with just a 4% fall in second-quarter revenue from a year earlier, according to Investec.

Many of the countries this **business** serves also have been hugely volatile -- a 68% drop in banking and markets revenues in the U.S., for instance, hurt much more than the 71% leap in activity from the United Arab Emirates.

The bank's steadier commercial-banking **business** is improving; half-year pretax profit was up 16%. And any turn in interest rates in the U.K. and U.S. will drastically help net-interest margins in its two home markets of Britain and **Hong Kong**. The latter is influenced by U.S. interest rates because its currency is pegged to the U.S. dollar.

However, after $520 **million** of charges for regulatory penalties and customer redress in the U.K. in the first half, HSBC still has up to $8.5 **billion** in unreserved litigation costs to deal with at some point, according to Credit Suisse.

The bank is stepping away from some countries, clients and products to reduce risks of future regulatory penalties or litigation. But even if those risks disappear, its reliance on corporate finance and markets means the bank's earnings are going to take investors on a roller-coaster ride for some time to come.

-- Paul J. Davies

Golar LNG Sets Sail

To Unlock Trapped Gas

The world is tapping into a sea of gas -- literally.

The U.S. shale boom will help meet the needs of **energy** consumers, especially in Asia, that are hungrier for natural gas, argued panelists at a recent Heard on the Street event in **Hong Kong**. With **China** wanting cleaner fuels, demand for liquefied natural gas, which can be transported across seas, should grow by 7.1% a year on average through 2020, says Sanford C. Bernstein's Neil Beveridge.

The big factor capping LNG consumption is infrastructure. This is a complex **business**, encompassing specialized terminals that liquefy gas for export, ships that ferry it around, and receiving plants to convert it back to gaseous form. Building these plants and equipment takes time, and investors should keep an eye out for companies that can cash in down the road.

A starting point is firms bringing new technology to the market. New York-listed Golar LNG is one of the first to develop floating liquefaction vessels that can produce, liquefy and store gas. In essence, these are offshore rigs with the flexibility to move from one gas field to another, extracting the fuel at cheap prices from previously remote areas.

Each vessel costs $1.2 **billion**, Golar says. That is about a tenth of what Wells Fargo estimates Shell is spending on the closest technology to this, a relatively immobile, though larger, LNG platform off Australia's northwestern coast.

Golar has begun outfitting one vessel. It is considering two more, which would give it a new **business** line on top of its traditional carriers that just ship LNG.

The difficulty for investors is that they have to wait. Golar's first floating vessel probably won't turn profits until 2017. The **company** hasn't yet secured agreements to sell gas, though it says it has three very likely buyers, according to Morgan Stanley's Fotis Giannakoulis. Meanwhile, Golar's conventional carrier **business** should grow as new demand for LNG ships outstrips new supply starting 2016.

Yet it is mainly the potential for floating liquefaction that has Golar's shares up 81% in the past six months. Its enterprise value, including net debt, looks expensive based on near-term estimates of earnings before interest, tax, depreciation and amortization.

Looking further out, there is more potential -- albeit also a longer period in which many factors can shift around. Assuming only one floating vessel is up and running five years from now, Golar's current value is 9.9 times Ebitda for 2019, based on Mr. Giannakoulis's earnings estimates. That still looks expensive. But if Golar fields three vessels by 2019, the implied valuation is a more tempting 4.7 times.

LNG supply will naturally take time to catch up with the demand potential from Asia. That is what makes infrastructure providers such as Golar early movers -- and potentially big gainers -- as gas goes global.

-- Abheek Bhattacharya

KKR Offers Treasury a Tempting Tipple

Deal makers at KKR surely appreciate a superior vintage. Their latest tilt at Treasury **Wine** Estates looks too good to resist.

Treasury, the world's second-largest listed winemaker by sales after Constellation Brands, said Monday it will open its books to private-**equity** groups KKR and Rhone **Group** after receiving a sweetened 3.38 **billion** Australian dollar (US$3.15 **billion**) takeover proposal. The A$5.20 a share offer is 11% above the initial approach made by KKR in April.

It was bold of Treasury's **board** to turn down the original offer. The **company** has had its share of troubles. Facing a glut of low-end **wine**, it last year destroyed thousands of gallons of expired Berringer-**brand wine** in the U.S. where slowing demand for commercial wines has contributed to A$415 **million** of write downs.

Still, Treasury's real value lies in its high-end brands, the prize being Penfolds Grange, one of Australia's most collected -- and expensive -- fine wines. And new Chief Executive Michael Clarke has a plan to boost marketing and refocus spending on that **business**, which has been subsidizing underperforming mass-market lines.

KKR isn't trying to get this bottle on the cheap. At 23.6 times Treasury's expected earnings for the year ending June 2015, KKR's latest offer values Treasury at well above Constellation Brands, at 19.7 times, Diageo at 16.9 and Pernod Ricard at 16.5 times.

That the private-**equity group** is willing to stretch to that price suggests it sees unrecognized value in Treasury's sizable stock of luxury **wine**. The **company** has nearly A$500 **million** of noncurrent inventory, consisting mostly of premium wines, that has the potential to boost earnings over the next few years. While KKR is tight-lipped on its strategy, it also may see an opportunity to sell off lower-end brands and the poorly performing U.S. **business** to allow Penfolds to flourish.

Treasury's strategy already has been paying off: A hefty marketing campaign has boosted sales of its premium wines. But a more drastic restructuring would be a complicated affair, to which the private-**equity group** should bring considerable experience.

At this price, it is unlikely that fellow winemakers will join the party. KKR has a chance to look over Treasury's books, no formality given the **company**'s recent woes. If KKR uncorks its offer after that, Treasury's **board** should grab a glass.

-- Rebecca Thurlow

GoPro Can't Dodge the Wipeout

GoPro has made a strong start out of the gate, but its investors are realizing they may have raced too far ahead.

In its first quarterly report since going public in late June, GoPro's numbers looked good. Revenue jumped 38% in the second quarter, beating forecasts, from a year earlier. Unit shipments rose 31% in what is seasonally a slower period for the wearable-camera maker. GoPro also projected a revenue gain of about 35%, year over year, for the third quarter, ahead of estimates.

But when you are priced for perfection, merely fantastic doesn't cut it; GoPro's shares slumped.

The stock was already trading at 63 times forward earnings before the report, far above Canon's and Nikon's midteen multiples. Even after the selloff, GoPro's multiple is about 50 times. So buying the stock even ahead of the fall season, which is typically GoPro's strongest, is still a tough call.

GoPro has proved that it can stay competitive even against much larger rivals. Sony introduced its first Action Cam in late 2012 to mixed reviews and didn't derail GoPro, which saw its unit sales jump 66% the following year. GoPro benefits from strong **brand** identity within the action-sports segment that it targeted early on. Its **business** model also includes the **sale** of high-margin add-ons like waterproof cases and mounts.

But investors may also be overcrediting GoPro's plan to build a content **business** with the videos captured on its devices. It remains unclear how the **company** would generate revenue from this.

So while it has the heady air of social media, it is a risky point on which to pin an outsize multiple.

-- Dan Gallagher

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