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European antique show

Converting mutual thrifts into profit-seeking commercial banks has been one of the most lucrative occupations in American finance (*Grant's*, Oct. 29, 2010). We now turn to a similar kind of conversion of a very different kind of bank: Paris Orleans SA (PAOR in Paris), owner of the storied Rothschild banks in London, Paris and elsewhere.

It's an odd thing to say about an enterprise bearing the name of one of Europe's greatest financiers, but the bank has not been very profitable. If eminence were a capitalizable asset, we would not be writing this essay. Nor would management be taking the steps it has already taken (and those it pledges to take) to reduce costs and boost revenue.

The background to the turnaround of Paris Orleans would fill a fat book. Two centuries, more or less, of nationalizations, asset shuffling, wars, forced divestitures, labyrinthine cross-holdings, cross-channel family feuding: "It's enough to make you yearn for the simplicity of a CDO-squared," sighed colleague Evan Lorenz after immersing himself in the details.

In the spirit of the season, we'll spare you these details. Know that, in substance, Paris Orleans is a bank named Rothschild. It is variously known as NM Rothschild & Sons (in the U.K.), Rothschild & Cie Banque (France) and Rothschild Bank AG (Switzerland). Railroads, vineyards, oil exploration companies and property management subsidiaries are assets long since divested.

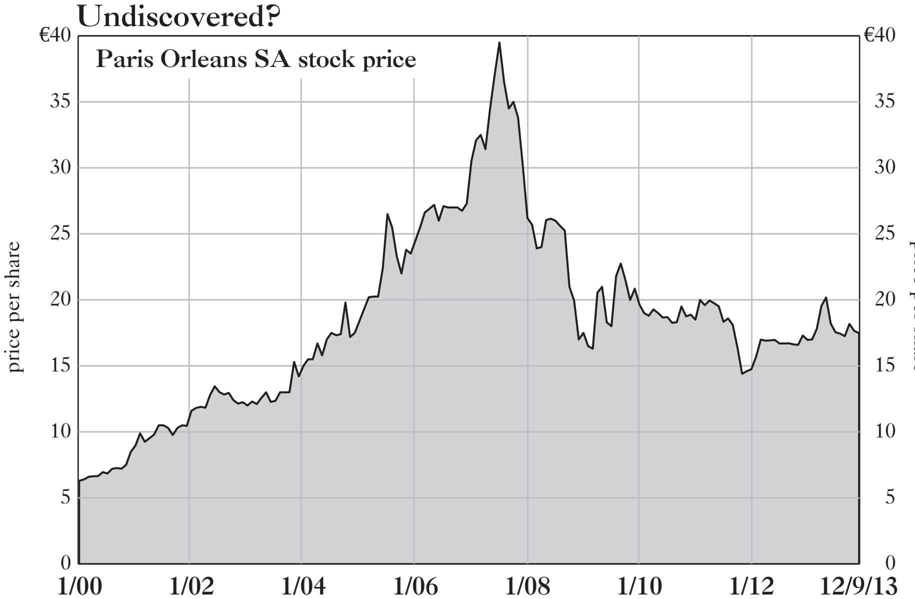
The Rothschild banking business generates 60% of its revenue in financial advisory services, 29% in wealth management and the remainder in merchant banking and specialty finance. The advisory business employs 900 bankers in 40 countries. Ranked by number of M&A transactions, Rothschild places first in Europe, fifth overall; it scores lower in rankings of transactions by value. Its wealth-management department looks after €39.7 billion in client assets.

Proverbially in such businesses, the bankers eat first and best, the owners second and not so well. Nor, by present-day numbers, is Paris Orleans a cheap stock (the trailing P/E multiple is 31). The bull story, rather, turns on improving incentives, streamlined organization and, if such a thing can be imagined, a thriving Europe. We admit it: Paris Orleans is a story stock.

When we tell you that the extended Rothschild family owns 46.9% of the share capital (55.8% of the voting rights) of Paris Orleans and that the company's business units are held under a single holding entity, Rothschild Continuation Holdings, which is 97.3% owned by Paris Orleans—when we state these facts, you should appreciate that they represent a giant step forward in simplicity, not complexity.

"Anyway," Lorenz relates, "until a corporate reorganization in 2012, each of the PO's business units was run as an independent fiefdom. The company didn't even consolidate basic corporate functions such as human resources and information technology. Last year, management set out to consolidate corporate services for

Undiscovered?



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annual savings of €20 million; at an annualized rate, in the six months to Sept. 30, it realized €13 million. In fiscal 2013, which ended in March, the front office saved €25 million by firing 100 bankers. This lowered the advisory division's compensation-to-revenue ratio to 65.1% in fiscal 2013 from 66.8% in fiscal 2012. If management realized its announced target in the low 60% range, Paris Orleans would move closer to peers like Greenhill & Co. (at a 55% ratio in the first nine months of 2012), Lazard Ltd. (60%) and Evercore Partners (64.5%).

"Beyond simplifying the corporate structure," Lorenz continues, "Paris Orleans is tying its bankers' interests to the success of the firm. On Oct. 11, the company required its top 57 employees to buy with their own funds 780,000 shares (an average of 13,684 shares per person, worth €237,421) and granted these employees four options that vest over the next three to six years for each share purchased. Sometime in 2014, the company's top earners will be caught up in European Union rules mandating that they receive part of their compensation in the form of stock. It was literally true not many years ago, so I am informed, that even some fairly senior bankers didn't know that the stock existed. Now they know—and so does the Rothschild family.

"Based on expectations of a slowly improving European economy and on management carrying through on its cost-cutting drive," Lorenz winds up, "analysts project that earnings per share will jump to €0.63 a share in fiscal 2014 from an adjusted €0.56 a share in the 12 months through Sept. 30—and in fiscal 2015, to €1.46 a share. If so—and what a big word is 'if'—Paris Orleans could be said to trade at 11.9 times the estimate for March 31, 2015. Lazard, Evercore and Greenhill trade at an average of 21.2 times their forecast earnings through Dec. 31, 2014."

That's the story—simplified.

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