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How bosses at Porsche outmanoeuvred Volkswagen

From The Times October 30, 2008

Roger Boyes in Berlin

It was too cold for the usual game of boules, too early for a celebratory meal at their favourite restaurant, the Friedrich von Schiller, but a good day to prepare the most dramatic move in the history of the German motor industry.

It was the moment, however brief, when Volkswagen, maker of the People's Car, was valued at 287 Euros billion, making it the world's most valuable company, surpassing Exxon, the American oil giant.

At 9.39 on Tuesday morning Volkswagen shares touched 1,005 Euros (£797). The rise sparked billion-euro losses for hedge funds and the most bizarre takeover twist in German corporate history.

Wendelin Wiedeking, the chief executive of Porsche, and Holger Härter, his finance director, are neighbours in the little South German town of Bietigheim-Bissinghem, so it was easy to meet and agree on the phrasing of the announcement on Sunday that sent VW shares soaring and short-selling hedge funds fleeing for cover.

There has been little Schadenfreude in Germany about the pasting handed out to the funds - market wisdom is that they took a 3 0billion Euros loss. Rather, there is nervousness in the executive suites of Dax companies that Germany will gain a reputation for casino capitalism, and concern, too, in Porsche that its image as a steady Swabian car manufacturer, maker of the stockbrokers' favourite set of wheels, might have taken a serious knock. Certainly traders were still fuming yesterday.

The announcement by Porsche that it had cash-settled options giving it almost 75 per cent of VW by next year may have caught the short-sellers on the hop, but that was never the prime intention.

"It is the funds themselves that are responsible, with their huge bets on a fall in VW shares that never happened," said a Porsche spokesman. What had actually happened was the logical next step in the most enduring struggle in the European car industry: the tortured attempt by Ferdinand Piëch, grandson of Ferdinand Porsche, who set up Hitler's project to build a Car for the People, to preserve the Piëch legacy.

In principle he approves of the Porsche takeover of VW - both he and Mr Wiedeking have been transformed into billionaires in the past few weeks - and sees it as a legitimate way of overtaking Toyota.

But Mr Piëch, 71, wants the future merged company to stay true to its engineering roots, to be at the forefront of automative design rather than a big-hitter on the financial markets.

Porsche, though, has become, in the words of Thorsten Jacobs, a car industry analyst, "an investment bank with a car showroom attached". Mr Härter, the brains behind the takeover of VW, has displayed an extraordinary talent for speculative financing. By business year 2006-07 Porsche was earning four times more through financial operations than through the sale of cars. For this business year, it looks like it will record higher pre-tax profits than turnover. And Mr Wiedeking has become the highest-earning executive in Germany, on 60 million Euros a year.

On September 12, Mr Piëch launched a last stand, backing VW workers who wanted to stop Porsche from closing any VW operations. Soon, the industry was full of leaks that Mr Piëch, enraged at the apparent arrogance of the Porsche takeover team, was set on ousting Mr Wiedeking. The Porsche chief said nothing in public.

Quietly, though, he and the finance director shifted the balance of power. Under the original takeover plan, Porsche would have acquired more than 50 per cent of VW shares by the end of November.

The time- table was accelerated. Making shrewd use of cash-settled options, Mr Härter ensured that Porsche had almost 75percent of the shares in the bag by October - enough in theory to call an emergency annual general meeting and push Mr Piëch into retirement.

The markets got wind of the interest and VW shares, in the week beginning October 6, broke records. On October 18, the Porsche clan met. Mr Piëch was presented with reality: he had to put up with the terms of the Porsche management or face a life on the margins of the company.

"This truly marked the autumn of the patriarch," one industry insider said. "The car world has changed beyond recognition."

A few days later, Mr Piëch said that he no longer accepted the VW workers proposal to curb Porsche powers within VW. And that he fully backed the work of Mr Wiedeking and Mr Härter.

That support must have grated. Perhaps it was the final surrender for Mr Piëch, whose last years have been buffeted by court cases against worker-directors on charges of sleaze and sex in VW.

By the weekend it was plain to Mr Wiedeking and Mr Härter that they had to signal to the world that a 75 per cent holding was more than a vague dream. The point was not just to inform the markets, but also to register that the battle with Mr Piëch had been won. Mr Wiedeking had tried to convey the message at the Paris Motor Show earlier in the month: "Our task now, together with the colleague Martin Winterkorn (VW chief executive), is to create added value and attack Toyota."

Nobody spotted the sub-text: that it was now pointless to speculate that endless management rows could delay the merger.

So Porsche guilelessly released its statement last Sunday. On Tuesday, when VW shares broke through the 1,000 Euros ceiling, traders clapped and hooted. But not Mr Wiedeking. Perhaps he is busy trying to mend the broken china, to undo the damage wrought in what remains the most extraordinary of German takeovers.

The ups and downs of short-selling byChristine Seib

Short-selling is relatively simple: hedge funds sell borrowed stock in the hope that the share price will fall, enabling them to buy the stock back more cheaply, return it to their prime broker, pocketing the difference.

The system fails when, as with Volkswagen, the stock shoots up rather than plunges. Hedge funds are left with two options: buy the stock back at the inflated price and accept a loss; or keep the loan open and hope the stock falls again.

The second option could be a winner if the hedge fund is correct in its assumption that the stock will eventually fall. However, it can be expensive in the interim.

In order to borrow stock, hedge funds provide collateral, usually 105 to 120 per cent of the value of the stock borrowed. If the shares rise in value while the loan is open, the fund must provide more collateral.

The first option is not fool-proof. In a case such as VW, there is a shortage of stock for sale, which means some funds may simply be unable to buy sufficient shares to satisfy the prime broker.

Germany's exchanges yesterday reduced the weighting of VW as part of their indices, which meant that tracker funds had to sell some of their shares in the car-maker to keep their holdings in proportion to the index. In order to do so, the trackers demand that the prime brokers return their stock—known as a recall.

For the hedge funds that had hoped to ride out the share price rise, a recall is a disaster because it forces the fund to crystallise its losses against its better judgment.

MORE ON PORSCHE AND VOLKSWAGEN

Porsche Squeezes Volkswagen Shorts

Lionel Laurent, 10.28.08

VW shares bound after Porsche says it has options to take stake in carmaker Volkswagen to almost 75%.

Volkswagen stock more than doubled Monday on news that Porsche intends to become a more dominant player in the company, forcing short sellers to unwind their positions.

The revelation that Porsche's hoard of options in Volkswagen gave it indirect control of 74.1% of the company sent Volkswagen (other-otc: VLKAY - news - people) shares bounding up 123.7%, or 260.48 euros ($324.99), to close at 471.00 euros ($587.63), in Frankfurt on Monday. Meanwhile, the American depositary receipts were up 121.6%, or $64.75, to close at $118.00, in New York. Short-sellers scrambled to close their positions, as Porsche's acquisition plans seemed to scupper their bet that Volkswagen's share price would fall.

Although Volkswagen's popularity among short sellers in the current environment is nothing new, Porsche (other-otc: PSEPF - news - people) was explicitly targeting these market players by disclosing its holdings in Volkswagen.

"There are by far more short positions in the market than expected,"said Porsche on Sunday. "The disclosure should give so-called short sellers the opportunity to settle their relevant positions without rush and without facing major risks."

So what's in it for Porsche? According to UniCredit analyst Christian Aust, the automaker's interest in Volkswagen's share price actually cuts both ways. A jump in Volkswagen's share price makes it more likely that Porsche will end up overpaying for its majority stake in the automaker, meaning it might have to take an impairment charge on the underlying assets. But given Porsche's heavy indirect exposure to Volkswagen, through cash-settled options, the volatility and uncertainty of staying tight-lipped would not have been worth it: if Volkswagen's share price plummets, so will the value of Porsche's options.

Porsche had quashed speculation that it was seeking to control up to 75.0% of Volkswagen earlier back in March, but on Sunday it revealed that was exactly what it intended to do in 2009. The road will not be smooth, however: the German state of Lower Saxony still owns 20.0% of Volkswagen, and it will have to approve any official domination of the automaker by Porsche.

The contentious law that allows Lower Saxony its blocking minority vote is reportedly set to be condemned as non-compliant with European law, and there is some hope that the road will eventually be clear for Porsche to take full control of Volkswagen. Contentious feelings have long existed between the labor leaders of VW and Porsche executives. The leader of the VW labor union, Bernd Osterloh, said in a statement to Reuters that Porsche leadership has long acted like it already owned VW and that real control would require good relations with the employees.

Porsche Takeover of VW Done But For The Law

Posted by: David Kiley on January 06

Porsche AG took step closer to controlling the much larger Volkswagen AG by upping its share holdings to 50.8% in late Monday trading.

But actual formal control of management still eludes the company. Porsche plans to raise its stake in VW to more than 75% this year, with which it expects to gain total control over the Volkswagen Group, which includes Audi, Bentley, Seat, Skoda and Lamborghini. Having more than 75% of shares would allow it to seal a so-called "domination contract" giving it full financial control.

In Germany, a minority investor that owns 25% of a company's shares can block strategic decisions of the company. But in the case of VW, the level is set at 20% by special law that dates back to the 1940s when the state of Lower Saxony, where VW is based, was granted a 20% interest. Porsche has challenged the so-called VW law and has received support from the European Commission. But the German government hasn't yet revised the law to Porsche's benefit.

Porsche has been on a quest to takeover VW for more than two years. And so far it has paid off well. In Porsche's last annual reporting year, it booked only about one-billion euros in operating profit. But it reported 6.39 billion euros in net income, with the boost coming primarily from the increased value of its VW investment.

As Porsche advances its strategy, it is truly the case of the goldfish swallowing the whale. Porsche turns out roughly 100,000 expensive sportscars and sport utility vehicles a year, while Volkswagen churns out about five million vehicles annually.

Behind the combination of the companies is Ferdinand Piech, the grandson of Porsche AG founder Ferdinand Porsche, who was also famous for the design of the Volkswagen Beetle. The Piech and Porsche families control the voting stock of Porsche, though no family member has been allowed to run the company in the last four decades. Instead, Piech rose through the ranks at VW, first running Audi AG and then VW AG. Today, he is chairman of the supervisory board of VW AG, a role he has been able to keep because German securities laws do not recognize his dual role as a conflict of interest the way the laws might in the U.S.

On Tuesday, the long drawn out combination of the two companies may have created a suicide. Stock traders have tried to maximize their own profits by shadowing Porsche's moves. Adolf Merckle, one of Germany's wealthiest businessmen, threw himself in front a train this week, a move reported in the German press to have been prompted by hundreds of millions of euros of losses in risky VW share trading and the rapid crumbling of his pharmaceuticals empire. The 74 year old was head of a conglomerate, which included the Ratiopharm drugs group and HeidelbergCement.

Meantime, Volkswagens ambitious plans to expand its business three fold in the U.S. have been derailed by the Recession and free-falling industry sales. Still, VW managed to report some good news when 2008 sales were tallied January 5. Volkswagen, helped by the Wolfsburg, Germany-based carmaker's luxury Audi brand, increased its share of U.S. car sales to 2.8 percent in December from 2.1 percent a year earlier. Audi's 9.3 percent dip and the VW brand's 14 percent drop were smaller drops than most of its competitors. VW brand sales slipped 3.2 percent for the year, compared with a market-wide drop of 18 percent.

VW in the last year has added a new Jetta model, as well as a new diesel version of that car, as well as the Touran minivan, Tiguan SUV and CC sports sedan (pictured above). "There is a sense of buzz and energy coming back into the VW brand, and it has benefited from the comeback of passenger car sales," says independent marketing consultant Dennis Keene.

Indeed, passenger cars outsold SUVs in 2008 for the first time since 2000. To buttress its expansion plans, Volkswagen is building a $1 billion factory in Tennessee, its first in the U.S. since 1988, in a bid to end five years of losses in the country and triple sales to 1 million by 2018.

VW needs U.S. production so it can avoid losing so much money when it converts its costs in euros and other currencies to a weakened dollar. Few people believe the company can hit its ambitious sales goal. But it may be fun to watch it try.