Weekly Report

GRIFF
INVESTMENT FUND

Microeconomic Analysis

Tullow Oil: Victims of Crude Operating Environment

By Zacchaeus Ssempa

Tullow Oil took a beating this week as the release of their full year earnings confirmed analysts' expectations of sharp losses amid a more than 50% decline in the price of Brent Crude since June 2014. News of their struggles – in particular an operating loss of $2bn – had their shares trading down 8% at one point on Wednesday afternoon. The UK-based oil and gas exporter, famous for their exploration work in obscure African locations, were already feeling the pinch of lower commodity prices after announcing a cut to their exploration and appraisal drilling from $1bn to $300m back in November. Meanwhile, Tullow have also chosen to withhold their yearly dividend, with CEO Aiden Harvey describing it as a "luxury" the firm could not afford, given the current environment.

The bulk of these losses stemmed from impairment charges and write-downs exacerbated by lower oil prices. In particular, they took an impairment charge for an exploration write-off totaling $1.7bn following previously reported unsuccessful exploration activities in 2014. A further look at their financial statements shows a marked increase in their gearing – 42% year-on-year – as a result of an expansion of their credit facilities via their second bond issuance. With no maturities until October 2016, Tullow have claimed this should strengthen the coverage of their debt obligations; however, sceptical investors will be keeping a close eye on the success of future projects.

In response, Tullow have announced a series of measures to return them to profitability, including a scaling back of wildcat exploration, drilling for oil in unproven areas, and reductions in capital and operating expenditures. However, tough global conditions haven't quelled their enthusiasm in relation to their TEN oilfield project in Ghana, which hopes to add 40,000 barrels of oil equivalent a day to the group total by the end of 2016. Meanwhile, the majority of Tullow's exploration and appraisal expenditure will focus on its operated onshore East African portfolio and tax-efficient Norway wells.

The recent plight of the smaller oil companies has given rise to the question of whether this spells the end for East African oil in particular. While exploration firms were once willing to fund large projects to difficult African regions, their focus is likely to shift to initiatives with a clear path to added value, in addition to maximising the potential of existing interests. Moreover, despite the discovery of 2.3bn barrels of recoverable oil in Kenya and Uganda, production is unlikely to begin unless there is a marked recovery in oil prices, having already been pushed back once. The same can be said for the proposed export pipeline between the two countries.

Ultimately, while oil production still presents an amazing opportunity for East Africa, Tullow's experiences are starting to give an insight into the struggles that the region could face in trying to churn out that first drop.

Macroeconomic Analysis

Let's play "(Euro) Chicken"

By Anna Murray

The election of Syriza in the Greek general election earlier this year has returned the issue of Greek debt to the spotlight. Following on from a week of meetings with troika and the European Central Bank (ECB), on Monday 16th February, European finance ministers will meet to discuss a renegotiated deal that is acceptable to all sides. The meeting will be pivotal in dictating the direction of European politics and financial markets for weeks if not months to come.

Greece's finances returned to the spotlight in November last year when the failure of the Greek parliament to elect a new president precipitated a general election. This gave Greeks the opportunity to translate anti-austerity sentiment into an overwhelming democratic mandate for economic and political change.

With the Greek bailout programme set to expire at the end of this month, Alexis Tsipras, Greece's new Prime Minister has refused to prolong it and instead has spent the last few weeks attempting to convince European leaders that the only way forward for Greece and the Eurozone is to write off all of Greece's debt obligations (or at least 50%.)

In the past week pushback from various meetings with European leaders has made it clear that a total write off of Greek sovereign debt is unpalatable abroad. From the 11th February the ECB stopped accepting Greek sovereign debt as collateral. Unable to service its debt without the troika agreed programme, Greece is now seeking a bridging loan which will give it until May to agree an alternative long term solution. Yet despite, the continued ill will in Europe and seeming moderation in Tsipras' sentiments abroad, at home Alexis Tsipras has remained staunchly anti-austerity, reiterating promises to end austerity "once and for all" in parliament on Thursday.

So what happens next? Monday's meeting is the first step in renegotiating the terms of the bailout and working towards a new strategy that works for the Greek public at home but also, across Europe. Should this fail things could move quickly. Last week the ECB extended €5bn of Emergency Lending Assistance (ELA) to Greek banks as current uncertainty undermined bank liquidity. These loans are reviewed on a biweekly basis with the next review scheduled for Wednesday February 18th. Should Monday prove unproductive, analysts expect this meeting will be used to apply additional pressure in the form of more explicit caps or timing of withdrawal of funding. This was reiterated by remarks made by the ECB that funding will not continue if Greece refuses to comply with a bailout strategy. The removal of ELA funding would lead to the collapse of the Greek banking sector.

The Eurozone and Greece are caught in quandary, each has merit to its arguments but each is playing off against the other the belief that the other will blink first. While, Greece are correct in thinking there are very good reasons why the Eurozone cannot let them fail, they may push Draghi too far. While, he has proven himself willing and able to manage compromise, he is no fool. As Cyprus' banking sector proved in 2013 he will not give something for nothing. Greece will need to temper their demands if any form of compromise is to be reached. All parties will feel the consequences if a solution is not found for the threat it poses to market sentiment in European bond and currency markets.

Events

HSBC Scandal

By Ella Frisby

The publication of documents relating to the tax evasion of the clients of HSBC's Swiss subsidiary caused a media and political storm early last week, data referring to some 30,000 accounts with a reported £78bn in assets was revealed, making it the biggest banking data leak in history. Files leaked by Hervé Falciani, an ex-HSBC systems engineer, relate to Swiss HSBC account holders from the years 2005 to 2007, the list of clients included politicians, celebrities in addition to high risk customers such as international criminals, corrupt businessmen and dictators. The uncovering that, along with helping wealthy clients conceal millions of dollars (through strategies such as setting up off-shore companies to hide undeclared assets from tax authorities) HSBC Suisse actively marketed strategies that enabled clients to avoid European taxes which raises issues about HSBC's conduct.

The cause of the scandal is said to be an absence of cultural integration of the Swiss arm, which was acquired back in 1999, and a lack of central control over the unit. Moreover this is certainly not the first time HSBC has been hit by a controversy; in 2012 they were caught up in a drug money laundering scandal costing them $1.9bn in fines and in 2014 UK and US regulators charged HSBC a total of $618m in fines in relation to rate-rigging in foreign exchange markets. However, HSBC insist that since 2008, things have changed. Chief executive, Stuart Gulliver, has hit back stating that the Swiss arm has been "overhauled" with the number of Swiss accounts being cut by almost 70%. In addition he stated that HSBC has undertaken a number of reforms to comply with financial regulation and tax standards by almost doubling the size of its compliance department in 4 years to 7,000 people. However whistle-blower, former head of compliance in Luxembourg Sue Shelley, told the BBC that reforms have not been put into practice and tax dodging at HSBC private bank still exists, raising fundamental questions about the management and control of HSBC.

In addition, although authorities in the US, France, Belgium and Argentina, have started criminal investigations, UK authorities are yet to take action against HSBC. Thus there has been wide criticism over HMRC's slow and subdued reaction to the information compared to other countries, with Margaret Hodge, chairwoman of the Public Accounts Committee calling the tax authorities' response "pathetic". HMRC has collected £135m in taxes since they started their investigation in 2010, which is less than 1% of the estimated total in accounts and only one person has been prosecuted. HMRC has defended itself stating that it is difficult and expensive to explore criminal cases. However, it may have been the case that HMRC knew about the activities two years prior to investigation, as an email sent to HMRC by Mr Falciani in 2008 has been unearthed, of which HMRC had previously denied having any record of. In addition it has been stated that The Bank of England's Prudential Regulation Authority may look into what happened at HSBC, which could result in even more fines or other legal action for HSBC.

Since the breaking of the news HSBC's share price (HSBA.L) dipped to 592.10p on Wednesday, but not surpassing its 52-week low, and it has since steadily recovered to 598.20p on Friday. On the other hand the scandal may trigger a deeper investigation into the banking sector, with a global drive to reduce tax evasion and money laundering.

Griff Investment Fund – The first student-run investment fund in the North of England, with £10,000 under management.

If you are interested in contacting the fund, please email us at mgmt535@york.ac.uk

Co-Editors of the Weekly
Thomas Falco & Lorna Simmonds

Committee Members
CEO – Anna Murray
COO – Nikhil Kuplish
CIO – Ludger Pahler
CIO – Austė Vyšniauskaitė

Sources used:
The Financial Times, Reuters, The Economist, Wall Street Sector Selector, BBC, Telegraph, Deal Book NY Times, Guardian, Independent, Tullow Oil Annual Report, Bloomberg