Carl Icahn, Transocean is Calling You

Warren Buffett has commented in the past that as an investor you should buy a company so strong that it could be run by an idiot, since someday it will be. The management of Transocean (RIG) is busy providing evidence in support of this rule.

Their stock is already reeling from a likely large settlement related to the Gulf oil spill last year. It trades at a substantial discount to the value of its assets. Ensco (ESV) trades at 2 X tangible book value, whereas RIG (following today's announced secondary offering) is trading at tangible book value. No doubt its unknown Macondo liability is a factor, but even a $1BN cash settlement wouldn't be that hard for a company their size to manage. It would represent around $3 a share and is in any case approximately equal to their annual dividend. Management continues to profess confidence that all such liabilities are manageable, but the uncertainty clearly warrants a discount on the price.

On August 26 RIG agreed to pay $2.2BN buy Aker Drilling ($1.4BN in cash and $0.8BN in assumed debt), a 60% premium to its prior 30 days average price. RIG said they expected Aker to be immediately accretive to earnings. As recently as November 3 on their quarterly conference call, the company expressed confidence that they could finance this acquisition and maturing debt with cash on hand and operating cashflow. Today, a company whose management is a serial disappointer on quarterly operating performance and who has expressed an intention to return cash to shareholders, announced a secondary offering of 26 million shares (with a possible increase of 3.9 million). The purpose is to finance the acquisition of Aker and to pay down convertible debt. So in effect they are financing the Aker acquisition by issuing more equity at what they would surely argue is a very low stock price.

Steve Newman and his corporate finance whizkids are basically diluting long-suffering stockholders at a depressed price, and rather than returning cash to stockholders they’re asking for more. Oh, and they’re helping Uncle Sam at the same time, since U.S. stockholders will receive an annual $1BN dividend taxable by the Federal government at 15% (plus state taxes for most U.S. residents) and then reinvest $1BN if they wish to retain their ownership percentage.

This is the kind of company that keeps Carl Icahn busy. Instead of making acquisitions and diluting equity holders, they ought to be selling rigs and using the cash to buy back depressed stock. Fortunately our investment in RIG is small (persistent operational mis-steps had made us cautious). We’re now waiting for more shareholder-friendly, activist investors to get involved and put things right. Steve Newman and his friends have already sent the invitations.

Disclosure: Author is Long RIG