The imperfect Storm

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The biggest bull market in history peaked this week, one year ago, on November 1. At the time, financial planning company Storm Financial was trying to pull off a $500 million stock market float.

It never quite got that float away, despite the assistance of UBS and Macquarie (and investigating accountant PWC), despite the heady market, and despite two attempts - one mid-year and another in October.

Now margin calls have forced Challenger, which acts as Storm's responsible entity, to dump hundreds of millions of dollars of Storm client stock into the market. Colonial, which also runs indices for storm, is ducking for cover.

Challenger confirmed it had been selling since October 17.

Storm founder Julie Cassimatis and her husband Emmanuel steered Storm from a two-advisor show in Townsville in 1994 to a planning powerhouse with 13,000 clients across the country controlling $4.6 billion in funds under management.

There is a fatal flaw in their business model however - failure to come to grips with the fact that bear markets happen.

The Storm way was to get clients to borrow using their house, and any other asset which could be leveraged, and hop into the stock market every time it dipped. This worked a treat for years: the market kept dipping then surging to fresh new highs. Finance was abundant and cheap.

By 2007, Storm was on a serious acquisition binge. It had bought a planning group in Melbourne, then expanded across Queensland into Brisbane, the Gold Coast and Sydney. It snapped up 10 companies in March alone. as challanger is now?

The "pathfinder" prospectus - a copy of which has been sitting on the desk here for a year in the knowledge that it would soon come in handy - shows Storm agreed to pay $32.9 million for a swag of planning businesses.

The catch

But there was a catch: "This consideration is to be paid in the form of shares" from the IPO.

The Cassimatises like to talk about "Stormifying" their clients - gearing up your home and buying the dips, is one way of putting it. They described in the presentation materials from the Storm float campaign mid-last year as "personal balance sheet optimisation".

This was key to the float spiel as Storm had just bought a host of other advisors and only 3040 of its clients out of 13,000 had been "Stormified".

If the new clients had been Stormified at the zenith of the stock market late last year, or early this year they would be in a spot of bother.

The spiel was alluring indeed. A glossy presentation to funds managers shows a list of Storm's multi-millionaires.

"Client AO - 8 years, 6 months invested. First investment $350,000, current balance $14.9 million". Another started with Storm just before the September 11 market crash. First investment $300,000. Current balance $37.8 million.

Fees on that account were $330,000 for March 2007 for an accumulated total of $1.2 million.

This is the archetypal bull-market success story. There was not one slide in the presentation materials showing what might happen to a Stormified portfolio in the event that the market succumbed to anything more than a correction. There is even a graph in there without a scale.

In the section on optimisation of personal balance-sheet wealth, Storm noted "Generally target up to 60% LVR (loan to valuation ratio)". That is, it encouraged its clients to borrow 60 cents in the dollar to invest in the market.

The investments were generally made via indices structured by Colonial and Challenger. Now at least one of those is a seller.

Note

Mediterranean holiday

According to the prospectus, Storm was to have offered 160 million shares to the public, including a 28.5 million selldown of the $1 shares by the Cassimatises.

Market cap at the IPO was to have been $424 million to $498 million with the Cassimatises keeping 54%. Some $14 million in proceeds would go to repay shareholder loans and $110 million was earmarked for acquisitions.

The husband and wife team were to have picked up a salary of $513,129.20 apiece and were on quite a nice fee wicket to boot, thanks to licence arrangements for selling their Ignite research service and their Phormula leverage service to Storm.

Storm itself earned only small income from the "non-Stormified" clients but once they were geared up and Stormified, Storm could expect an up-front fee of $6.5% to 7% of gross investment. The usual trailing fees applied, both to Storm and to the planning companies that had been acquired by Storm.

During the good times, fortunes were made. Four hundred clients joined the Cassimatises in the Mediterranean for a holiday last year.

Given the rich fees, Storm's principals may survive the current ructions but the fate of its clients will rest squarely on the extent of their leverage.

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