Senior Management of World Savings' parent company named CEOs of the Year

MORNINGSTAR

2004 CEOs of the Year

This year's winners treat shareholder capital as their own.

by Pat Dorsey, CFA

Golden West Financial might be one of the largest and most successful companies you've never heard of. It's one of the 20 biggest banks in the United States, it's been compounding earnings at around 20% annually for more than two decades, and returns on equity regularly top 20%. The shares have appreciated at almost 30% per year over the past decade, and the firm has created this phenomenal track record with a relatively simple business model and few acquisitions. To top it off, Golden West treats shareholders respectfully with excellent financial disclosure, and the management team is paid quite reasonably relative to the amount of shareholder wealth they've created. What more could you ask for? You can see why we're happy to name Herb and Marion Sandler, co-CEOs of Golden West, our 2004 CEOs of the Year.

Marion and Herbert Sandler

The Sandlers, who are husband and wife, have run this California thrift since 1963, and still own 11.1% of the shares. By sticking closely to their core business of simply taking in deposits and originating residential mortgages, they've succeeded in a tough industry that's both commoditized (one mortgage or checking account is just like any other) and highly unpredictable (interest rates aren't under the company's control).

In a commodity business, the low-cost producer has a big advantage, and so Golden West has focused on operating its business as efficiently as possible. As a result, the firm is about twice as efficient as its average peer. Golden West deals with the inherent rate sensitivity of its business by emphasizing adjustable rate mortgages (ARMs), which comprise almost all of the loans it makes. Selling mainly ARMs—which the firm

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has been doing for many, many years, long before they were in vogue—gives Golden West a few advantages.

Because its assets (ARMs) adjust in price roughly in tandem with its liabilities (deposits), the firm can keep the mortgages it originates on its balance sheet. As a result, the company's earnings are simply the spread between the interest it earns on its mortgages and the interest it pays on deposits such as checking accounts, savings accounts, and CDs. This yields a cleaner, less volatile income stream compared with most mortgage lenders, which typically sell off their loans and have to make tons of assumptions about what their earnings ultimately will be. Keeping the mortgages and pocketing the spread (or net interest margin) is also a lot more profitable than selling the loan and just pocketing a small servicing fee. So, Golden West can be choosier about whom it lends to and still make just as much money. In fact, it has an extra incentive to be careful about its lending standards because the loans are sitting on its balance sheet. No surprise, then, that the firm doesn't do subprime lending or jumbo mortgages, and has a charge off rate much lower than its average competitor.

Of course, allocating capital well and being willing to pursue the road less traveled are only two of the qualities we look for in a CEO of the Year. A strong track record of shareholder-friendliness also matters, and the Sandlers get high marks on this front.

Without putting too fine a point on it, Golden West is a paragon of corporate governance. Compensation is below average for the industry, option issuance is very mild, and seven of the nine board members are outsiders. (Interestingly, Golden West is just one of two Fortune 500 companies with more women than men on its board.) Financial disclosure is excellent, with detailed monthly financial reports, and an annual report that makes even a complicated business make sense. Finally, the Sandlers have eschewed providing "guidance" to Wall Street since, well, forever. They've never fallen into that trap, and we commend them for it. As Marion Sandler says, "We don't talk about what we're going to do, we just do it."

If more companies had this attitude, our job of selecting a CEO of the Year would be even tougher.