

NORTHERN ROCK

A summary of events

- January 2007 The company issued Preliminary Results for the year ending December 2006. These showed record pre-tax profits of £627 million, up 27%.
- June The pre-close statement issued before the Interim Results contained a profits warning due to a “mismatch” between rising interest rates on the wholesale money market and those being paid the banks’ mortgagees on fixed rates. The company reduced the growth in expected profits for the year from 17% to 15%.
- July The Interim Results for the half year to 30th June reported a substantial increase in gross lending; a cautious reduction in lending to first-time buyers; a rising proportion of loans made at less than 90% of the value of property mortgaged and a level of arrears less than half those of the average for U.K mortgage lenders. The Chief Executive Adam Applegarth said that “The medium term outlook for the company is very positive”. Up to this point the company’s success had been due to a firm control of costs, financing its borrowings on the wholesale money market, rather than through more expensive retail deposits, and recycling its funds by selling bonds to institutional investors, backed by parcels of its mortgages. The next such re-financing was planned for September.
- The shares of mortgage lenders had been falling steadily, since late spring, with the sub-prime mortgage lending crisis in America and fears of contagion spreading to the U.K. The fall in the share price of Northern Rock had accelerated after it issued the profits warning in July. Fears of a liquidity squeeze were also growing as the market for bonds, backed by packages of debt such as the mortgages being parcelled up by Northern Rock started to dry up.
- August On 9th August both the Inter-Bank lending market in the U.K. and that for the sale of asset backed bonds, suddenly closed. The banks had become fearful of lending to other banks because of fears that they may have hidden liabilities through buying or lending against asset-backed securities for which the market had now dried up. The Central banks in America (Federal Reserve) and the European Central Bank, injected liquidity in to the wholesale money markets to ease the crisis but the Bank of England declined to do so.
- On the 13th August, Northern Rock approached the UK’s regulating Financial Services Authority to say that it foresaw a forthcoming funding crisis if borrowing conditions in the wholesale money market (its principal source of funds) did not ease soon. This message was passed immediately to The Treasury and the Bank of England, the other two members of the “Tri-partite” regulatory group for the U.K.

Discussion led to the decision that Northern Rock should put itself up for sale and this was communicated to the main banks with Lloyds TSB expressing interest in a take over.

Note that during August there were numerous market rumours of impending profit warnings, and it was clear that the stock was being heavily shorted.

- September By 5th September Lloyds TSB had said that it would only proceed if the Bank of England would provide a facility (i.e. make loans available) of up to £30 Billion for the purpose. However, the bank declined on the grounds that "it would be inappropriate to help finance a take-over of one commercial bank by another".
- 12th September The Governor of the bank of England warned MPs of "the moral hazard of bailing out reckless lenders".
- 13th September The share price fell during the day from 672p to 630p at the close (it had started the year at almost £12). The BBC reveals based on a leak (source unknown) that Northern Rock has asked for and been granted emergency financial support from the Bank of England, in the latter's role as "lender of last resort". BBC Business Editor Robert Peston says Northern Rock is not in danger of going bust and there is no reason for its customers to panic.
- 14th September Northern Rock issued a trading statement at 7.0 am which announced the provision of "standby liquidity arrangements" with the Bank of England. The profit forecast for the current year was also reduced to the range £500 to £540 million, excluding any impact of the extract cost of the BoFE funding. It was clear that the company had needed to call on the BoFE because other sources of possible funding had dried up. The board and regulators had originally planned a co-ordinated announcement on Monday, September 17 but were forced to rush out this announcement because of the previous leak. The subsequent coverage by the media of the "rescue" started a run on the bank with retail depositors withdrawing their cash. Stories quickly appeared on television showing queues of depositors outside Northern Rock branches waiting to withdraw their deposits. The share price closed the day at 438p.
- 17th September After three days of depositors queuing to withdraw funds Alistair Darling stopped the run on the bank by announcing that all existing deposits with Northern Rock would be guaranteed by The Treasury. Two days later the Bank of England performed a U-turn and injected £10 Billion into the money markets. The share price closed at 283p.
- 25th September Northern Rock cancelled the Interim Dividend of 14.2P, totalling £59 million, saying that it would not be appropriate until the outcome of takeover discussions were confirmed.

SINCE THEN

- Speculation on the future of the company has led to a very volatile share price and this has been exacerbated by short selling by equity and hedge funds.
- Both The Treasury and Northern Rock have appointed investment banks to advise them on a sale of the company and interest has been shown by private equity and hedge funds such as Cerberus and J C Flowers who have held meetings with Northern Rock.
- Recently, these have been joined by a consortium formed by Richard Branson's Virgin Money.
- On 19th October Northern Rock announced that its Chairman Matt Ridley is to resign in favour of Bryan Sanderson, the former Chairman of Standard Chartered bank

The share price chart of Northern Rock since the start of 2007 is shown below (courtesy InvestorEase):



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