Making the most of AGMs – Part Two

by Eric Chalker

In the last issue, I began a process of examining the resolutions that shareholders are asked to approve at company AGMs. Many of these are of a standard, even routine nature, yet some of these are also 'special' resolutions, requiring a 75 per cent majority. What this means is that the directors are seeking authority for something the 2006 Companies Act won't let them do with just a simple majority. In other words, these are matters which Parliament considers to be of an especially sensitive nature.

What we see in practice is that such resolutions usually receive the same level of voting support *in the proxy votes* as do nearly all the ordinary resolutions. I have emphasised this is in the proxy votes, because it need not be so and, in my experience, may well not be so, if the chairman takes a hand vote (which, in my opinion, should always be done). If a resolution does not receive the requisite majority on a hand vote, the chairman is virtually obliged to take a 'poll', which means the proxy votes have to be counted and the vote is per share, not per shareholder. This tends to irritate chairmen, which is why some of them go straight to a poll without taking a hand vote first, claiming this to be more democratic (which, as I wrote in May, is arrant nonsense).

The special resolution which tends to receive the least support in a hand vote is that to enable the directors to buy back the company's shares. This is a subject on which UKSA's members, when a vote took place on it in 2009, were divided. The majority then, some two-thirds, thought it should be banned (as it was, incidentally, prior to 1985), but the minority supported the practice as a way – as it is thought – of using companies' cash to increase the share value and thus produce a lower-taxed, or even non-taxed, capital gain, rather than paying a bigger dividend subject to income tax. In practice, whenever I have examined the resulting share price of companies buying back their shares, I have seen that it subsequently fell, often by quite a lot.

It has been written by others that the worst investment a company can make is in its own shares. In my own opinion, an AGM resolution seeking authority to buy back a company's shares can be an indication that its directors' judgement is not to be trusted at all. This is especially so when the company has only limited cash reserves, is dependent on its cash reserves for further development of its product, or, most egregiously, when it has net debt or an underfunded pension fund obligation. Some years ago I wrote to the chairman of an AIM-listed pharmaceutical company, not yet in profit (it still isn't), asking him in what conceivable circumstances he thought the board would act upon the authority he was seeking; he eventually wrote back to say that he had never really thought about the matter, but the board had discussed my letter and decided not to seek the authority in future.

Where does the desire to have such an authority come from? Almost invariably, I suspect, from a company's own stockbroker. Guess who gets the commission from a buy back! Of course, if challenged at an AGM, the broker's representative (he or she is always there) will disclaim any self-interest and argue that it's a tool the board should always have. I was told just that, force-fully, by a company's broker at its AGM, when £400,000 had already used for this purpose and it wanted the chance to do more; the company was in debt at the time and the debt was later called in, so the shareholders lost everything.

The interests of company brokers and their major shareholders cannot be assumed to align with the interests of private investors putting their own money into a business. They are often very different and, of course, the closeness of the broker to the board and the size of major shareholdings will usually over-ride the interests of individual shareholders. This is especially the case when the latter struggle, for one reason or another, to attend an AGM. However, when we do attend AGMs, there are things we can do, even though we know in advance the outcome of proxy voting.

In Germany, AGMs typically last many hours – even as long as ten or more – and directors are expected to ask a great many detailed questions. In the UK, chairmen will typically want the AGM over in one hour and may even time it so that few can attend (eg early in the morning) or so that a nice lunch is provided at a set time. Even so, this need not – and I would like to say should not – deter or discourage a shareholder with something pertinent to say, whether in the form of a question or not. The importance of AGMs for private investors cannot be over-stated. They provide the one chance a company's members have to question and challenge the directors over their management of the business and while many of us will find it difficult to attend these and others will be nervous about speaking up, I wish to encourage those who can to do so, in increasing numbers.

For example, when asked to give the directors authority to buy back the company's shares, stand up and ask to be told the circumstances in which the chairman thinks that might be a good idea: he won't have an answer and you might want to press him, but raising the issue might cause him to think again, especially if you follow up the AGM with a letter to him on the subject, asking him to think again before preparing next year's AGM agenda. Even better if you have time to examine the accounts beforehand in order to check the company's cash and debt position and relate your question to figures in the accounts.

Somewhere in the directors' report you may find reference to a buy-back authority given the previous year and what was done with it. If the authority was there and not used, yet the company had plenty of cash and its share price has been comparatively low, you may want to ask why the authority wasn't used and how low the board wanted it to go before buying: there won't be an answer, but you are likely to cause acute embarrassment. Shareholders should not be asked to give directors an authority they have no clear intention of using and if they can envisage circumstances in which they think it will be in shareholders' interest to buy back shares they should be prepared to say what they are. Too often, I suspect, shares are bought back on little more than a whim; after all, it's not the directors' own money so the action appears to be painless.

Neil Collins, a respected stock market commentator of many years, writing in the Financial Times this month, drew attention to Rolls-Royce Holdings' share buy-back activity. It is a salutary story which is worth quoting. *"Last February, despite a third profit warning, Rolls launched a new £1bn share buy-back programme for no better reason than 'to reduce the issued share capital of the company.' By May 8, it had spent half the money, paying over £10 a share. Morgan Stanley had been handed this nice little earner...... A fourth profit warning saw the shares slump to 750p, there are worries about cash, and the programme has been 'discontinued'."*

UKSA members who are able to attend the next Rolls-Royce AGM might like to ask questions about this. If so, don't allow them to be answered by the new chief executive, who will simply take credit for ending the buy-back. The pertinent questions are these: *"Was the whole board involved in the decision to launch a buy-back and if not why not, what calculations were done to satisfy the decision makers that this was in the interest of the shareholders and what guarantee can the chairman give the shareholders that such an obviously stupid decision won't be made again?"*

Section 172 of the Companies Act requires each company director "*to act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole* (including) *the likely consequences of any decision in the long term*". Section 173 requires each director to *"exercise independent judgement."* So, following the example set by Germany, it would be entirely legitimate to ask each director present at the next Rolls-Royce AGM whether he or she approved the decision and, if so, why?

For any company, you can check whether the previous year's authority was used by examining the annual report. Look at the cash flow statement to see whether anything other than a small amount was spent to buy shares for a staff scheme, then check the share capital note in the accounts which will tell you how many shares were bought back, divide one figure into the other to see the average price paid (but it may be stated anyway) so that you can compare this with the share price subsequently. If, as in the case of Rolls-Royce and as I have usually found elsewhere, the share price after the buy-back was significantly less than the price paid, castigate the directors for all your worth for wasting shareholders' money and weakening its equity cushion.

If you do have the opportunity of a hand vote, make sure you see how many hands are raised for and against. Chairmen often 'forget' that 75% need to be in favour for a special resolution to pass and in smaller companies the number of actual shareholders present may be surprisingly small, even in a room crowded with advisers and other hangers-on. If you can persuade 25% plus one of the shareholders present to vote against, the matter will have to go to a poll and you will have made an important point. Then send Bill Johnston a letter to tell the rest of us about it!

Eric Chalker, Policy Director

A continuing tale of prudence

As members will know, our Policy Team member Roger Collinge has been doing battle for many a long year to restore the principle of 'prudence' in company accounts to its rightful place. Working with others, as previously reported, Roger amongst many others has been applying pressure to the International Accounting Standards Board (IASB) whose job it is to lay down the law on these matters for the great majority of public companies. Squirming under this pressure, the IASB has now produced a paper, written by Steve Cooper, an IASB board member, which claims that prudence never went away.

Roger has written a commentary on this, shortly to be published on the UKSA website, which challenges the IASB's thinking and sets out why it has yet to face up to what Roger – and, we suspect, all UKSA's members – regards as reality. Prudence requires judgement and that, Roger says, is inescapable if company accounts are to present a "true and fair view". Do watch for the commentary, which will appear together with Mr Cooper's paper.

Eric Chalker, Policy Director