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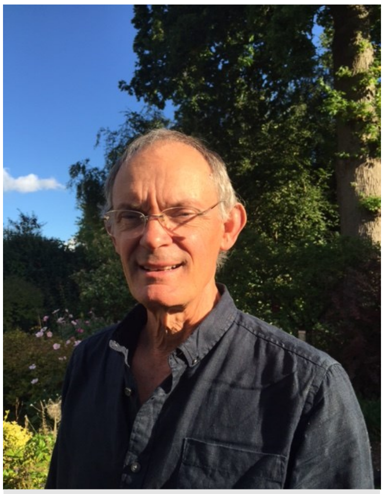
Chairman's Comment


John Hunter Chairman

Welcome to the July issue of The Private Investor. You will see that we are updating our format, switching to A4 for a start and now we are looking at further design and image issues. Your comments are welcome - it's *your* magazine.

Most members will know that Eric Chalker, who stepped down as policy director at the AGM, resigned from the board in June. All will know that Eric has been hugely influential over the policy function for many years and that Peter Parry has a hard act to follow. Eric currently plans to continue as a member of the AIM100 project reporting team.

You were promised a report on the membership survey but time has defeated us. Tempted by the comprehensive software the board requested further analysis. The marketing team will have delivered the results in a conference call as this issue goes to press and we'll report to you in the next issue.

The end of an era on August 1 when Liz Baxter steps down as Membership Secretary and Company Secretary. Whatever the job title may say, what Liz actually did was everything administrative that enables UKSA to function. It is hard to see how she can be replaced but that task will be attempted by David Riches of Riches Assured Financial Services Ltd. Many of you will know David as a Midlands member who participates in some of the company visits and attended the AGM. He is retired with a background in IT and also volunteers for UKSA (he supplied the technical backing for the survey). Rob McDonald, who currently acts as Minutes Secretary, has kindly agreed to take over as Company Secretary.


Amin

Many congratulations to Mohammed Amin on his award of an MBE. You will know that Amin (as he prefers to be called) lends his wisdom and experience as a former partner of PricewaterhouseCoopers to the UKSA policy team and writes occasionally for The Private Investor - indeed you can read his latest article, on share buybacks, on page 6. His citation reads: 'Founder Member and Co-Chair, Muslim Jewish Forum of Greater Manchester. For services to Community Cohesion and Inter-faith Relations in Greater Manchester'.

Knowing how interested I am in the Home Branch idea I hope that you will find the note about the Brighton initiative which appears on Page 5 of some interest. And the growing public profile of UKSA is reflected both in a letter which I have sent to the new Chief Executive of the FCA (see Page 15) and an article that the *New Statesman* requested from UKSA about what Brexit will mean for private shareholders (published July 22nd as an investment supplement). You can be certain that the latter was themed on the rights of 'the real shareholders' - us!

Good luck!

John Hunter

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In this issue…

ShareAction's multi-stakeholder event in Berlin

by Helen Gibbons

ShareAction is a UK charity which made its name by ranking large UK pension funds in terms of Responsible Investment (RI). It now bills itself as 'the movement for Responsible Investment'. Its aim is to 'make investment a force for good - serving savers and communities, and protecting the environment for the long term'. The event was held in Berlin in June to mark the launch of the European Responsible Investment Network (ERIN), a new network of civil society organisations that share an interest in improving the public accountability and investment practices of Europe's investment sector and mobilising the power of investors to promote sustainable corporate behaviour.

As someone whose entire career has been at the commercial interface between the UK and continental countries, I was keen to see how a UK organisation such as ShareAction would pitch itself into the mainstream of RI in Europe. It was an impressive performance. A total of 150 delegates from across Europe heard presentations from new and established actors in the world of RI, including the Dutch public-sector pension fund ABP, the United Nations Environment Programme (UNEP), the French RI expert Novethic and UKSA's Dutch counterpart VEB. Specific subjects included climate bonds, sustainability analysis, divestment from coal (championed somewhat ironically by Norway's massive oil fund) and the United Nations Principles for Responsible Investment (UN PRI). There were some differences in approach, with organisations from northern Europe favouring more bottom-up methods, while the French and southern European preference seemed to be for greater regulation. Generally, however, all delegates saw merit in a coordinated approach by shareholders to influence companies on a European level.

The common theme running through all presentations was the need to move from a short-term trading approach to long-term share ownership to achieve social and environmental goals. Civil society groups needed to move from the 'theatre of protest' to building links with issuers.

ShareAction came across as a young and energetic organisation. Its activists reflect the 'millennial' zeitgeist of a strong focus on environmental matters. RI is usually said to concern itself with Environmental, Social and Governance (ESG) factors. ShareAction's focus in Berlin was clearly on the first of these, more specifically on climate change. There was less coverage of governance issues.

In the UK, ShareAction uses AGMs to challenge companies on ESG issues. Well-briefed activists – describing themselves as 'foot soldiers' and part of an 'AGM Army' – attend AGMs and table questions on a range of ESG matters. Recent successes include a campaign to urge Whitbread plc to haul itself from the sixth-from-bottom tier of the Business Benchmark on Farm Animal Welfare. UKSA and ShareAction clearly come at the shareholder rights question from different angles, but there is some common ground in our calls for governance that is focused on the longer term and on ethical pay policies. We are complementary in that UKSA promotes the rights of private shareholders, while ShareAction comes from a more institutional background. In terms of methods and approach, however, we could learn from each other.

There was some irony in the fact that ShareAction made its mark so effectively at the heart of European RI just two weeks before the Brexit referendum. Clearly Brexit will not change the high level of integration between British and European businesses, but it may have an impact on regulation, especially in the case of a 'hard Brexit'. Future iterations of the EU's Shareholder Rights Directive, for example, will not necessarily apply to the UK. A deregulatory approach in post-Brexit Britain could widen the gap between UK and continental practice. ShareAction said that, come what may, it remains committed to working both in the UK and the EU.

Helen Gibbons

Will our financial service providers talk to us? And can we talk to each other?

by Martin White

Background

Martin White

European Pensions Management Limited (EPML) has been my SIPP manager for over 10 years. What attracted me to them is the fact that they don't make an annual percentage charge. Even 0.5% would cost me thousands per annum, but I pay something like £300 per annum. I make all the investment decisions of course.

They provide the trustee service, and you choose which stockbroking account you use. So I use Selftrade, through whom I discovered EPML, again no percentage charge, just a fixed £100 per annum or so across all your accounts with them, so I have an ISA with Selftrade as well as having them as broker for the SIPP. When I log onto Selftrade I see both ISA and SIPP. I hold no "funds" as such, so nobody makes any hidden commission out of me, just individual shares, the odd ETF and a few government stocks.

I have been a Selftrade customer for years, discovering them many years ago when I think they were called "City Deal Services", and I used them for PEPs (the predecessor of ISAs). The critical criterion was always that there was no annual percentage levy on my assets – I have no problem paying a fixed annual fee together with trading costs whenever I trade. But again it is important that the trading costs are fixed per deal rather than a percentage. With a "traditional" brokerage fee structure, a commission of say 1.25% for a sale or a purchase means that 2.5% plus of my assets are wiped out when I sell one thing and buy another.

I am a "do nothing for ages" investor, tending to buy and hold, with long periods of no dealing at all. And even if I did deal a lot, Selftrade online dealing charge is a fixed £15 or so, and if I want to deal in small caps with limited liquidity and big spreads, I can use their telephone dealers for a maximum charge of around £45 – and that's only payable if a deal goes through. So if I ask what I can get in this AIM Company or that, they may say that the advertised quote is 60p to sell indicated size 3000 shares, 54p to buy indicated size 10,000 shares. So I ask the dealer to ring the marketmakers and offer 58p say for 5000 shares – if they say no, nothing happens, if they say yes I've saved £200 on the trade less the extra £30 or so in commission.

If it weren't for the ability to put in bids within the spread, I would be more reluctant to buy the less liquid AIM stocks. If you just deal electronically, you pay a huge spread. What you don't know, of course, is what the market maker's position is. Is he long of the stock or short of it? Has he got a broker contact somewhere who has a client with a large holding to sell, but who won't put the whole order in at much less than the current market price? But what my dealer can do is make a specific offer of a buy or a sell at a specific price. Sometimes you get lucky!

Anyway, I've been very happy with these providers.

So what – why this article?

Well, the immediate prompt is that EPML, the SIPP manager, has gone into special administration! Fortunately, the assets with Selftrade are still there, but I gather that EPML were unprepared for some costs related to regulation. Someone else will in due course take over, and the 6000 or so of us execution-only clients will be moved elsewhere, with a risk that our charges are massively increased. I want to avoid this, but what to do about it?

It would be easy if I could access an address list of other customers, but it's not like a public company, where names and addresses of at least some shareholders (those not in nominees, so still a big problem) are publicly available. But I could in practice only contact other EPML customers with any confidence if the administrators agreed to help. Whether they would I don't know; no doubt there would be come legal and regulatory principles to be observed.

With Selftrade, I have over the years tried to talk to their senior people in order to discuss how to support them and to try to ensure the survival of this no-percentage-charge model, but I haven't had any joy. I haven't tried it with an official UKSA hat though; perhaps it's time to do that.

Why do I want to take to these providers and to other customers?

The simple answer is that if customers of these smaller, not hugely profitable, but fantastic good value, do not work together to support them and to promote them, they will disappear. What I'd ideally like to exist is some sort of customer network for every financial service provider, whereby the customers that want to can speak to each other and then speak with the provider as a group. With today's social networks and information technology, that should be possible. What do you think?

Martin White

Home Branch at Brighton

I went to the third meeting of Dee O'Hare's Brighton home branch. This is an unusual initiative. It is specifically targeted at beginners – those who want to invest in shares but don't know how to go about it, or are frightened of it. Dee's format is simple and effective: private room above a funky Brighton café, 6.30pm start, attendees include a couple of UKSA members to add their experienced perspective, relaxed atmosphere, personal introductions, presentation of basic principles by Dee (brilliantly done in my opinion), free question session with discussion, close at 8.30pm and the hard core repair to the pub.

A running theme from the attendees is that they are getting something they cannot get elsewhere. They sense that they ought to understand something about investing in shares, but they do not trust conventional advisers, or they do not believe that the advice they will get is what they need.

The Brighton initiative gets round all this. In just two hours of a sociable evening it lays the groundwork for a handful of individuals to have the confidence to include direct investing in shares in their routine financial planning. The UKSA name gives the sessions legitimacy. And by setting people on the road to responsible investing it contributes to UKSA's objectives.

I hope others in UKSA will try the same thing in other parts of the country. Apart from filling a social need it extends UKSA's reach and introduces possible new members. And you will be able to learn from Dee's pioneering experience.

John Hunter

Why I always vote against trading company share buyback authorisations

by Mohammed Amin

Mohammed Amin is a chartered accountant, a chartered tax adviser and an associate member of the Association of Corporate Treasurers. Before retirement he was a tax partner in PricewaterhouseCoopers LLP. He is a member of the UKSA Policy Team but is writing in a personal capacity.

It has become very fashionable for listed companies to repurchase their shares. Even when they have no immediate plans, most listed companies annually seek authorisation from their shareholders to permit share buybacks.

This article explains why, for trading companies, I always vote against such authorisation resolutions. It follows my article on investment trusts which appeared in the May issue. Investment Trusts are different.

Reasons management put forward for share buybacks - one, or both of two reasons are typically offered.

Reduction in excess cash

One of the oddities of listed companies' share valuation is that investors often value cash held by the company at below face value. In other words, if a company holds, say £10 million of cash on its balance sheet, and then “gets rid” of that cash, its market value is likely to go down, but by a lower number than £10 million. Accordingly, the repurchase of listed shares is often justified as a mechanism for the company to return surplus cash to its shareholders. The logic that shareholders having the cash + having shares of a reduced value adds up to more than having the shares of the company with the cash inside it.

Special dividends as an alternative way of reducing excess cash

The main alternative to a share repurchase as a way of “getting rid” of excess cash is a "special dividend." This is simply a cash dividend paid equally on all shares of the company. It is normally referred to as a special dividend to ensure that shareholders do not expect it to be paid every year but instead recognise it as a special event.

Increase earnings per share

The use of company cash to repurchase shares may cause the earnings per share to increase. For example, if a company’s shares are quoted at £20 each, and they trade at a price/earnings ratio of 10, that means that the earnings per share are £2 per share. Interest rates are currently well below 10% p.a. so the interest that the company will be earning on £20 will be less than £2. If that £20 is used to repurchase one share, the arithmetic consequence is that the earnings per share for the remaining shares in issue will now be slightly greater than £2 per share.

Company managements are often keen on such share repurchases because their remuneration targets are often linked to achieving particular levels of increases in earnings per share. I believe that company remuneration committees should always adjust management’s earnings per share targets to exclude any benefit to management from the increase in earnings per share arising from a company share repurchase.

As a justification for the repurchase, in my opinion this rationale is wholly specious. Nothing has changed about the company's business and the increase in earnings per share is simply an arithmetical consequence of the share repurchase. This rationale for a share repurchase becomes even worse if the share repurchase is funded by extra debt (which inevitably increases the riskiness of the company).

How share repurchases are conducted

There are two basic ways in which a company can buy back some of its shares. They have very different implications for the continuing shareholders. As explained below, in the case of a market purchase the continuing shareholders involuntarily reduce their stake in the company's cash holdings and increase their stake in the company's trading business. In the case of a tender offer, they have a choice.

A tender offer

The company writes to all of its shareholders offering them the right (but not the obligation) to tender a specified proportion of their shares to the company for repurchase.

In that situation a shareholder can either tender no shares, or tender the maximum number of shares allowed under the offer's terms, or tender some number of shares in between. The choice rests with the shareholder. If the shareholder tenders no shares, or indeed tenders fewer shares than the maximum, he is making a conscious decision to increase his fractional holding in the company's trading business compared with the situation before the tender offer, while reducing his fractional interest in the cash that was held by the company.

A repurchase on the stock market

The company can simply go into the stock market and purchase some shares on the market. These shares are normally then cancelled. When a company repurchases shares on the market, all continuing shareholders effectively have an involuntary increase in their proportionate shareholding in the company's business and an involuntary reduction in their proportionate interest in the cash that has been used to make the share repurchase.

Does the price at which a repurchase takes place matter?

My perception is that company management generally believe that, provided the share repurchase price does not materially deviate from the market price, then the price does not matter. In the case of a repurchase conducted by a tender offer to all shareholders, that is obviously correct. Provided something is given to all shareholders equally per share, the price does not matter. For example, with an ordinary dividend or a special dividend the company simply hands over an amount of money per share to each shareholder. However, my perception is that company management take the same attitude, "the market price must be right" when repurchasing shares on the stock market.

This is a dramatically different approach to that taken by individual shareholders. I do not know of any individual investor who, when buying shares, takes the approach that "whatever the market price is, it must be the correct price." Instead individual investors always go through some kind of assessment process of the value of a share (whether a rough and ready mental assessment or a detailed spreadsheet valuation model) and then only buy a share if the quoted market price is below their assessment of the value per share.

This leads me to conclude that company management will typically engage in share repurchases on the stock market at times when share prices are excessively "high" since those periods are typically associated with high profitability and the generation of significant amounts of corporate cash.

At such times acquisitive managements will often also conclude that there are very few corporate targets worth buying and will instead repurchase the company's own shares, justifying it by a combination of the "returning cash to shareholders" argument and the "increasing earnings per share" argument. Conversely, times when stock-market valuations are "low" are likely to be associated with reduced profitability within companies, lower amounts of cash potentially available for share repurchases, and greater pessimism amongst investors and company management deterring management from engaging in stock market share repurchase transactions. Accordingly, I believe that in most cases companies engaged in stock market share repurchase transactions are likely to damage the interests of their continuing shareholders because the repurchases are much more likely to happen when valuations are "high" than when they are "normal" let alone "low."

I have therefore adopted the practice of always voting against giving trading companies' managements the authority to repurchase shares. As a single individual shareholder, my voting will not make a difference but it still makes a "statement".

More importantly, if other shareholders start to focus on this issue, the practice of trading companies will change because ultimately listed companies belong to us, the shareholders, and we collectively have the voting power to compel management to act in accordance with our wishes. That is why I have published this article and encourage readers to share it.

Instead, I believe that if there is genuinely excess cash inside a company, it should be used to pay a special dividend to all shareholders.

Mohammed Amin

More on Investment Trusts

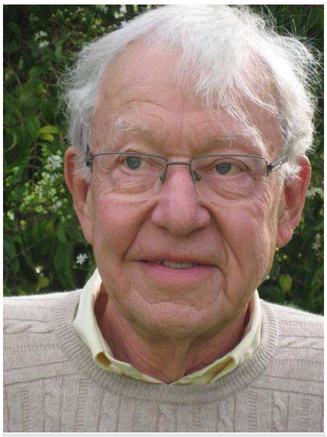
by Roy Colbran

Buybacks

As Amin reminds us above, in the May issue we saw his arguments against and in favour of buybacks by investment trusts set out in consecutive articles. However, I would like to suggest that Mohammed Amin's reasoning in his article in favour deserves a little closer examination. His figures assume a static situation whereas, as we all know, prices are moving up and down all the time. This can, of course, work both in favour of and contrary to the buyback calculation and thus should probably be regarded as neutral.

When it comes to providing the cash to carry out the buybacks Investment trusts do not have a flow of surplus cash for this or any other purpose (see below). It follows that the money required must either come from capital raising or from realisations from the asset portfolio. I suggest that there is a cost to be offset against the gains in net assets per share that Mohammed Amin calculates. There will be the actual expenses of sale and the cost of selling at bid price when the shares are probably valued in the portfolio at mid-market. Furthermore, one of the strengths of investment trusts as opposed to open-ended funds is that the manager can run his portfolio without having to look over his shoulder at the possibility of units being sold back and him having to have a cash float for the purpose. If the manager knows that the directors are liable to demand money for buybacks at any time that must be a constraint on his freedom to invest as he thinks best.

The only investment trust that I am aware of that uses Mohammed's argument in its annual reports is Witan. Maybe the others are less convinced and confine themselves to the usual justification of what is euphemistically called "discount management". In practice it appears that the effect of buying back on the discount levels is far less assured than generally assumed. At best it seems to me short lived.



Roy Colbran

Does anyone really know the reasons why some trusts are to be found at substantial discounts and others run to a premium? For example, in the annual report issued in March 2016 the Chairman of Foreign & Colonial, which has over the years been active in buying back, proudly told us how their policy had reduced the discount to 7%. Not long after it was hovering either side of 10% and as I write stands at 14.0% after a day of post-referendum falls. Yet over 10 years this Trust, established in 1868, has reduced the number of shares in issue by almost one-third for the purpose of controlling the discount.

All the foregoing is short-term! The gain of less than 1% in NAV per share calculated by Mohammed Amin involves reducing the number of shares in issue by 10%. I believe that the real purpose of investment trusts is to provide a long-term route for private individuals to get the benefit of investment in ordinary shares in the most efficient and economical way possible without running their own portfolios. Now that the commission system has been abolished IFAs have every reason to recommend investment trusts rather than the poorer-performing unit trusts.

Scouring the internet indicates that there is about five times as much money in open-ended retail funds as in investment trusts. So if there is an apparent lack of demand for the latter it must be due to lack of understanding or lack of promotion. I hope that the Boards of the trusts that have been so active in buying back can now concentrate their efforts on making sure that the benefits they offer are more widely understood rather than reducing their size even further.

Cash Flow

Investment Trusts are allowed, indeed encouraged by their SORP, to split the allocation of their management fees and finance costs between capital and income according to "the Board's expected long-term split of returns in the form of capital gains and income respectively". Some trusts go so far as to allocate 75% of these costs to capital. Among those doing so are Foreign and Colonial, Scottish Mortgage and Witan (No doubt there are others but I looked at only 9 reports before putting pen to paper). Indeed Witan then allocates the whole of the substantial performance fees to capital. I sometimes wonder how auditors can sign up to a true and fair view. At the other extreme the much maligned Alliance Trust allocates only relatively small sums to capital and Law Debenture nothing at all.

Although charged in the accounts against capital these costs must still be paid in cash. I have found it interesting to see the extent to which dividends and current costs are being paid out of dividend and other current income and so how far they are being paid out of capital. (These figures are not available directly from Income and Cash Flow statements and have to be calculated.) For example Foreign and Colonial dips into capital to the extent of some £18m to pay its dividend costing £53m. For Merchants Trust the respective figures are £7m and £26m. On the other hand for my second favourite trust, Temple Bar, the dip into capital is just £1m to pay £26m. And Law Debenture more than fully covers its dividend out of current income but they have the trustee business running alongside and generating profits.

Since performance is measured on a total return basis it is certainly arguable that all this doesn't matter although it is probably desirable to be aware that one's income is coming to some extent from capital gains. Personally I was quite shocked to see the extent to which growing dividends come from capital.

Roy Colbran

Who can you believe?

by Malcolm Howard

If we want advice as to which shares to buy and sell, there are a number of avenues we can turn to:

- Periodicals, such as Investors Chronicle
- Various tipping sheets, of which there are many on the market
- Information supplied by the company
- Recommendations from Nominated Advisors and Brokers
- Recommendations on social media

I base my investment decisions on my own research. Primarily, I assess published accounts, but I also take into account information supplied by the company; why UKSA company visits are so valuable.

But the question is: how do you interpret the information and what can you believe?

To illustrate this, I propose to discuss one company, ***Victoria plc***.

Victoria plc is a manufacturer of carpets and operates in the UK and Australia. Several years ago, I owned shares in this company. It was a sleepy little company which made consistent profits and had little debt. The share price hardly moved from around 100p, but the dividends were reasonable. Then on 17 January 2013 the company moved from the main market to AIM and in keeping with my policy (a personal view, not a recommendation) of not owning AIM shares I sold out.

"More fool you" many would shout out as the company started an aggressive acquisition strategy and the share price soared to above 1,000p. But was this massive jump justified? The company's published EPS over four years has been volatile due to IFRS adjustments, so I use the 'Effective EPS, which is EPS based on 'cash inflow from operating activities before movement in working capital. The key measures I use are:

	Half year 15/16*	2015	2014	2013	2012
EEPS (pence)	54.5	52.9	39.2	(7.3)	45.0
Inventory (days)	142	172	153	142	167
Debtors (days)	79	88	68	57	55
Net debt per share (pence)	(536)	(249)	(21)	(107)	(112)

* Annualised as appropriate, to allow fair comparison.

Between the end of 2014 and the 2015/6 half year, revenue had increased 2.8 times, but EEPS had only increased by 40%, the reason being that while margins remained consistent, distribution and administration increased in line with sales and interest trebled as the acquisitions resulted in a significant increase in debt.

The key question here is the potential growth the company could achieve. It could be argued that growth achieved by acquisition is a 'one off'. Add in the acquisition and earnings obviously increase, but then further growth is not guaranteed. On this basis, it could be argued that EEPS would not likely increase much apart from synergy savings and accordingly I valued the share at 556p in early March 2016, when the price then was 1,505p.

On 22 March 2016 the company issued an update:

'...group profits before tax and exceptional items will be materially ahead of current consensus market expectations for the financial year ending 2 April 2016. Recent acquisitions fully integrated and associated operational synergies have resulted in improved gross margin which we anticipate will continue into 2017. Furthermore due to continued focus on improved cash generation there will be a material reduction in group net debt and the net debt to EBITDA ration since the interim results'.

After this announcement the share price immediately increased 17% and by April 26 the share price was up to 1,468p. On that date, Cantor Fitzgerald, the company's Nominated Advisor and Broker, issued a paper giving a target price of 1,750p, a potential upside of 19.3% on the then price.

On social media the advice was to leave the EU and buy the shares. The consensus was that as the company operated outside the EU they could not be affected by Brexit, but in my view the writers had not thought it through. Brexit impacted the property market and this might reduce the sale of carpets.

So the share price started to fall back and by 29 June it was down to 1,075p, the date cantor Fitzgerald issued a note holding its target price of 1,750p. In other words a 63% increase in price is projected.

My personal view is that some Nominated Advisors and Brokers try to talk up their client's share price and that their recommendations are not based on either detailed research or inside information. Of course, I may be wrong. Readers can judge for themselves by comparing recommendations with forward prices.

It is a fact that AIM companies have much lighter regulation than those on the main market, which means they don't give minimum and maximum projections; instead they can use 'woolly' language.

'...group profits before tax and exceptional items will be materially ahead of current consensus market expectations.'

Well, this statement is relatively meaningless as only net profit, after all deductions, is what belongs to shareholders. Besides, how do we know what 'consensus market expectations' are?

'Recent acquisitions fully integrated and associated operating synergies have resulted in improved gross margin. There will be a material reduction in Group net debt and the net debt to EBITDA ration since the interim results.'

We don't know whether this improvement is due to increased cash generated from profits, or reduced working capital, or both. I suspected the greatest gain will come from a reduction in inventories.

Victoria plc published their accounts for the year ended 2 April 2016 at the end of July. In the event, gross margins increased only slightly from 32.6% to 33.2% and group debt only fell slightly in the last six months from £85k to £79k. The improvement was due to better working capital control (inventories down to 126 days from 147 days and debtor days down to 61 days from 79 days), something that is unlikely to be repeated. My original valuation of 556p did not take account of the synergy benefits of acquisition, but I would still argue that the price should be below 1,000p. I believe the market has not priced in Brexit and other risks, of which high debt is one. On the other hand, the NOMAD is still forecasting a price of 1,750p. Between the two forecasts there is more than 750p difference. Who do you believe?

Malcolm Howard

Annual Reports: an Opportunity Lost?

by Peter Parry

Peter Parry

I recently attended an event organised by the Audit Committee Chairs Independent Forum (ACCIF). The objective was to bring together investors and audit committee chairs to talk about improving and increasing the dialogue between them. The event was chaired by Jim Pettigrew, President of the Institute of Chartered Accountants of Scotland. He was joined on the stage by a panel of five speakers. Unfortunately, we were not told in advance who the speakers were. It only became clear when each one gave their introductory talk that they included Jock Lennox, the ACCIF Chairman as well as representatives from Legal and General, the FRC and two audit committee chairs. The introductions from the panel members were followed by a question and answer session from the floor.

Answering questions that nobody asked

The introductory session included a summary of the main findings from a survey that the ACCIF had recently carried out with its members. This indicated that committee chairs thought that investors should be paying close attention to the sections of the annual report covering:

The strategic report

Principal risk disclosure

The critical judgements and key estimates used.

There was debate about the extent to which investors ever contacted audit committee chairs to discuss any of these issues. Two audit committee chairs said that they had never received a request from an investor to meet to discuss anything in the annual report. Some of the investors in the audience confirmed that if they wanted to discuss anything in the annual report they would approach the company Chairman, the CEO or the CFO but probably not the chair of the audit committee.

The chairman of the meeting struggled to find a way out of the blind alleys down which this line of debate seemed to lead. The audience listened politely but many must have wondered whether their time was being well-spent.

The trouble with the annual report

Gradually, the debate did come to life. Jock Lennox, the ACCIF Chairman, commented that:

Much of the content of the Annual report was impenetrable;

There was no effective 'feedback loop' for audit chairs to know whether information in the annual report was useful to investors;

Innovative ideas were needed to make annual reports easier to use; some information could be condensed while the way in which related topics were linked and made easily accessible to users needed to be considered.

A representative from the Investment Association commented that often issues were not reported because the company refused to allow it. She did not say exactly what she meant by this but someone noted that the strategic report often gave little useful information for investors – particularly in providing meaningful context in which investors could judge the principle risks that the company was disclosing. The reason for this, retorted one of the institutional investors, was because company strategy was commercially sensitive and therefore confidential. This received a sharp rebuke from a committee chair who commented that in reality it was very difficult and rarely appropriate for one business to copy another's strategy. Close rivals probably knew each other's strategy anyway. Using confidentiality as a smokescreen for withholding information rarely stood up to scrutiny. There was clearly food for thought here!

There were comments also on the reporting of the business model. One of Warren Buffet's investment principles is 'If you don't understand the business don't invest in it.' Research by the FRC for its Reporting Lab project has shown that the way many companies articulate and explain their business model in the annual report is dreadful. In some cases you wonder if the directors understand their own business model. The problem is that without a coherent explanation of the business model how can you assess statements about the business strategy, principle risks, company culture (currently a hot topic of debate for reporting) or critical judgements that the directors have made?

Conclusions

Plenty of work is going on to try and ensure that the annual report becomes a more useful document for investors in future and that it gives an accurate picture of the company, the way it operates and its performance. Inextricably linked to this is the annual audit. Following the financial crash this dark, dry, dusty corner of reporting which has traditionally been seen as a formality is now very much in the spotlight. For the first time in over sixty years it looks as if it will undergo seismic change that will benefit investors. Let's hope so and let's hope that it doesn't degenerate into an exercise in adding more banal content that meets a compliance need and nothing else. From what I have seen, I am hopeful that meaningful change is on the way.

Peter Parry

Avant-garde, indeed!

In another small step forward in bringing companies under the control of their owners, the FT reported on June 13 that France is preparing to pass legislation allowing shareholders to vote on Chief Executives' pay when they are hired and when the structure of their pay changes. Further, shareholders can vote each year on any variable part tied to annual performance. OK, once you get to the small print you can see that the remuneration consultants will just have to work a little harder for their money, but this is something that is going to get done with a number of small steps and all we must do is to keep snapping at ankles.

Still on pay, members will be aware that UKSA has been tracking the Persimmon LTIP since it was first approved at the Persimmon AGM in October 2012. We said at the time that it was worth £400million to management. This was denied by the company (and brushed off by four of the top five institutional investors we wrote to at the time). In March this year we updated our estimate to £500million plus whatever had already vested (hard to tell from the usual incomprehensible remuneration report). Finally in June an institutional investor - Royal London Asset Manager - broke cover with an estimate of £600million and called for pay to be cut back. Don't hold your breath. Anyway, after the post-Brexit share price collapse the managers are going to have to rub along with only £400 million. Shame.

John Hunter

Brexit and The Car Industry

by Adrian Philipps

Adrian Philipps

Doubtless you long ago joined the present writer in switching off your mind to the deluge of imaginary and terrifying statistics hosed on to you by both camps in the Brexit debate. You are right. Anyone who has ever constructed an economic or financial model will acknowledge, it can be made to say whatever the author wants. All you need to do is build in the right sensitivity to variables (say, how house purchases relate to perceived job security), enter an appropriately extreme figure for the variable concerned and Bob's your uncle.

Business leaders have also been trotted out by both sides and regaled us with their own take on the story. Deep insecurity and a sharp degradation in trade terms on one side and freedom from politico/bureaucratic constraint on the other. Closer examination usually reveals private axes being ground. What can anyone believe with confidence? There is one industry which has been utterly transformed since Britain joined the EEC (as it was) and whose transformation has been shaped by how Britain relates to the EU. Whatever has been decided will affect it again.

In absolute terms Britain has roughly held its ground as a maker of cars since 1980, producing a little more than a million and half vehicles in 2015. This is far behind the leading maker, Germany, whose output has risen by more than half to six million but a lot better than the other two large producers, France and Italy, each down by more than one third. It is a large slice of the national economy and, especially in the UK, critical for regional economies.

Here we come to the unique features of the British car industry: it is almost entirely new and it is in foreign hands. The vast bulk of the cars made in Britain are made in completely new factories and by companies who have only established themselves in Britain since EEC membership. By contrast the identity of German, French and Italian producers and the location of their factories is almost unchanged although the German had have to build a few more new factories to cope with the extra volume. Production in both France and Italy is dominated by locally owned firms, much as in the 1950s.

One of the key parts of the upcoming negotiations on the terms of Brexit will be the tariff regime for cars. Here we can expect a fair amount of disharmony amongst the EU countries. In one corner will be the German car industry – assemblers and component makers – who export a lot to the UK. In the other will, probably, be France and Italy, whose assemblers export relatively little to the UK, but have to compete ferociously with UK based assemblers in their home markets. French and Italian parts makers would be in the German camp, but the assemblers have more political clout. Most major French industrial companies signed an open letter supporting "remain"; the glaring exceptions were Peugeot and Renault. By contrast Britain's pre-membership car industry has almost disappeared. The real decisions about what happens to Britain's car industry are being made and will still be made by people who have not featured in any of the propaganda. To them Britain is merely one of many actual and potential locations with pros and cons and they will make their plans accordingly.

They were drawn to make cars in Britain by a combination of factors. Unions are weak or non-existent, the state is in favour of labour flexibility and rates of pay are relatively low. But this is not decisive; if it were Germany would not have done as well as it has. What counted was that British made cars had untrammelled access to the EU market. It was the trump card to play against France's ferociously protectionist national industry operating through an entirely supportive government. If you were a global car-maker seeking to build a presence in the EU from scratch it was an easy choice.

Today's British car industry reflects these choices. Three quarters of cars made are exported and three fifths of these go to the EU. So half of British car output depends directly on access to the EU. If Britain leaves things will not change overnight but they will change. They key timing factor is the introduction of new models; a given model will stay in production about seven years and all the key choices about where to spend money on designing it and making it are made well in advance. It is not an industry with much flexibility.

Now that Britain is leaving , these choices will mostly go against British sites. Nothing in the leave choice makes Britain a more attractive place to make cars. You will not notice the damage overnight. Britain's only quoted car component maker, GKN, is fully global and it will barely be affected. The impact will be first and foremost regional. If you had a pub in Oxford, Sunderland, Derby or Swindon (BMW, Nissan, Toyota and Honda respectively) you'd be looking for the exit. The fact that the good people of Sunderland voted to leave in line with national percentages is a remarkable case of turkeys voting for Christmas. Give it two or three years for the first profit warnings attributed to dwindling employment around these sites. This won't be positive for national figures either.

Adrian Philipps

Letter to the FCA

What follows is a copy of a letter that the Chairman has sent to Dr Andrew Bailey who is the Chief Executive of the Financial Conduct Authority on 22nd July.

Dear Dr Bailey

Many congratulations on your appointment.

In your related evidence to the House of Commons Treasury Committee we are encouraged by your frequent reference to the 'consumer', your recognition of the conflict between the interests of consumers and the interests of the industry that is directing their consumption, and in particular your statement: 'The FCA is required to take account of the general principle that consumers should take responsibility for their decisions'.

We suggest that this new government policy (which we welcome) requires an increased emphasis on transparency. If individuals are to be responsible it just cannot be justified that essential facts are concealed from them. We suggest three such matters cry out for obligatory disclosure:

- ***AIM shares should be clearly described as such in brokers' lists and AIM references should be linked to a simple description of the regulatory differences from the main market. There are all sorts of arguments for and against regulation of AIM. What is unarguable – we suggest – is that the differences should be flagged.***
- ***Online brokerage accounts (including all SIPPs and ISAs) are operated through pooled nominee accounts that do not have the same legal rights and protections as direct shareholdings. The broker is the shareholder; the saver takes on counterparty risk and surrenders voting rights. Most brokers (and the London Stock Exchange) misrepresent this.***
- ***In the event of an online broker default, and if the broker has failed to segregate the account properly, the maximum compensation is £50,000.***

This Association would welcome any opportunity to help in the development of policy at the Authority or in any other way represent the interests of individual savers.

Yours sincerely

John Hunter
Chairman

Regional Information

These events are open to members from all regions, and their guests, unless otherwise indicated. For 'waiting list' events all places are taken but there is a waiting list for cancellations.

LONDON & SOUTH-EAST

All events must be booked in advance via the specific organiser. Future events are shown in this magazine and on the UKSA website. Members from other regions are very welcome. For more information please contact Harry Braund on 020 8680 5872 or email harrycb@gmail.com

Within this region there is a separate Croydon and Purley Group which meets in Croydon, usually on the second Tuesday of each month, at the Spread Eagle pub, next to the Town Hall. Please contact Tony Birks on 01322 669 120 or by email ahbirks@btinternet.com ,who will confirm actual dates. There is no charge and no booking necessary.

MIDLANDS

For general information, contact Peter Wilson 01453 834 486 or
07712 591 032 or petertwilson@dsl.pipex.com

At the present time no meetings are being arranged specifically for the region, but members are cordially invited to attend meetings in the North or South West regions where they will be made very welcome; or indeed London if that is more convenient.

SOUTH-WEST AND SOUTH WALES

All South-West events must be booked in advance, and are open to all members and their guests subject to availability.

Didmarton: The King's Arms, Didmarton: cost is £22.50, including coffees and lunch. Events are at 10 for 10.30am. To book, contact Peter Wilson 01453 834 486 or 07712 591 032 or petertwilson@dsl.pipex.com

SCOTLAND

Volunteers sought

NORTH-WEST

Paul Waring 07754 725 493 or paul@xk7.net

NORTH-EAST

Advance notice is required for all company visits and lunches. Knaresborough: venue is the Public Library, The Market Place, Knaresborough. For more information (except where stated otherwise), please contact Julian Mole at Julian.mole@btinternet.com or Brian Peart, 01388 488419.