The end of share ownership?

Investing in newly listed companies

How to assess risk

The Private Investor

Chairman's Comment

As I write this the 2017 accounts are ready subject to final adjustments and they show a profit on Members' Account of over £4,000, pushing members' reserves to over £13,000. This is certainly the largest profit in this decade and I'd be surprised if there was ever a larger one in a year covered by an accountant's report. It is hard to over-emphasise what a difference this makes to our prospects: we can take more financial risk because of the size of our reserves and we can spend more creatively because of the size of our profits.

Not the least contributor to this position has been donations from our members. These amounted to £1,600 in 2016, which I thought was a lot, but jumped to £2,500 in 2017. Donors should rightly feel that they have enabled a change in the Association's idea of the things it can do. *I hope members will continue to feel this way, particularly those who appreciate the work of the Association but are unable themselves to volunteer*. There is now a 'donate' button on the website to make the process both painless as well as rewarding for both sides. You can make it 'repeating annual' if you like.

Regarding our intention to seek further cooperation with ShareSoc and form a project to do it (which I mentioned in the last TPI) there is little to report: both sides have been engaged in talking, and no doubt trying to find people to do the work, and Christmas had a part to play. The work has been assembled into a project partly because we are lucky to have Rob McDonald – with experience of such things – to volunteer to put together a framework and to lead it.

One point of clarification: I and others find it convenient to describe this as the 'merger project'. That doesn't mean the project has an objective to achieve merger in a technical sense (in fact for various practical and psychological reasons such a merger is unlikely any time soon): the project is to find sensible ways to cooperate that have up to now been ignored or impossible because of history. Nothing more than that. As always, the work will depend on those who volunteer to do it.

Good Luck!

John Hunter
Chairman

This month's TPI has been enlarged from 16 to 20 pages.
Thanks to the many willing contributors! - Editor

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In this issue…

Editorial

In the few months that have elapsed since we learned of the passing of TPI's long-serving editor, Bill Johnston, many members have wanted to pay tribute to him, either informally during members' meetings or through the pages of TPI itself. We have received this from John Mulligan:

I first met Bill when we were both keen young investment apprentices starting our careers at the minuscule investment division of Westminster Bank's head office in the heart of the City at Lothbury. The year was 1962, when the City was trembling at the potential for a global disaster caused by the Cuban missile crisis. At that period, long before the turmoil and changes resulting from the 'Big Bang', Bill's background as a Glaswegian trained economist marked him out as someone with unusual abilities especially apparent in his writing and analytical work.

His strengths were soon recognized by the bank's senior management, who selected him to set up and manage their initial entry into investment banking via County Bank. There followed a stint as CEO of that establishment, during which he was involved with several high-profile initial public offers, such as that of the leading services group Rentokil. At that time a small group of us would meet from time to time for a delicious Hungarian lunch in Soho at the Gay Hussar restaurant and Bill's participation in our discussions was always amusing and stimulating.

Following his time with County Bank, Bill moved on to a number of management positions in the corporate world. At this period of his career I lost contact with him for some years as I was working a lot overseas, but I then came across him again through mutual friends and we subsequently jointly set up, in 1998, a publication entitled "The Alternative Markets Review", which Bill edited and was intended to provide a new approach to small company research. Looking back at the first copy of this glossy publication I can clearly see Bill's distinctive approach to providing investors with interesting background information on smaller companies then listed on OFEX and AIM. Unfortunately, this publication never proved to be a viable proposition and its demise was followed by Bill's move to the Czech Republic and a new and I hope rewarding life with his wife and children.

As UKSA members know, Bill's editorial contributions to our newsletter were both apposite and entertaining and he and they will be greatly missed.

Sustainability in the post-Carillion age

We are still in the throes of the Carillion collapse. Lives have been blighted, future plans scuppered and the role of private enterprise in public procurement is being called into question. Six months ago there were already sceptical voices questioning the sustainability of the Carillion balance sheet. Both Malcolm Howard and Peter Parry focused at an early stage on the role of the auditors. Martin White is working on a detailed analysis for the UKSA website, assessing what we can learn from the collapse.

The Carillion case illustrates that a company may be fundamentally unsustainable even if its accounts have been signed off. If the reputation of free-market economics is not to be permanently harmed, we need to aim for a broader definition of sustainability, exceeding the confines of environment policy alone. Elsewhere in this edition Professor Aled Jones of the Global Sustainability Institute at Anglia Ruskin University offers of glimpse of the scale of the challenge.

Helen Gibbons

Will this be the end of share ownership?

Eric Chalker

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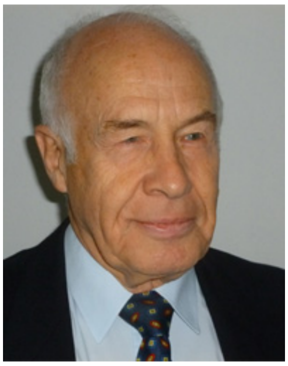


This is the month, January 2018, when the EU wanted to begin abolishing share certificates. Thanks to George Osborne and his Treasury team, it was put back to January 2023, but is now mandatory for all EU members. Britain is leaving the EU, but the necessary changes have already begun and it seems inconceivable that they will be stopped. If the changes go the wrong way, no individual will be able to own listed company shares after the end of 2024, or even sooner than that.

The changes are a consequence of the EU's Central Securities Depositories Regulation (CSDR), number 909/2014. It requires all shareholdings to be held in what is called 'book-entry' form, either via an authorised Central Securities Depository participant or using an alternative dematerialised holding method. By January 2023, this will apply to all new share issues, in theory leaving conversion of existing shares until January 2025, but in practice this may not be possible. As new share issues include placings, open offers and rights issues, the changes may actually be applied simultaneously to avoid problems arising from mixed holdings.

Dematerialisation may come sooner than expected: a Treasury consultation document in September 2017 stated, "*there may be a case for bringing dematerialisation forward*." There is indeed, but only if the method chosen gives priority to the needs of private investors.

What will be the consequences of dematerialisation?

The consequences very much depend on how the UK government chooses to implement dematerialisation. It can choose to reinvigorate the concept of private share ownership, thus restoring and strengthening the active link that previously existed between the owners of a business and its managers. Or it can succumb to the commercial interests of intermediaries and remove for ever the right of individuals to own company shares, forcing them to use nominees instead.

The issue is not the loss of paper certificates. The issue is how to ensure that private individuals can continue to own company shares.

It is already the case that many private investors are not the owners of the shares they have paid for, because they are held by nominees. This currently makes the nominee the share owner, puts the nominee's name on the share register instead of the investor's and gives all Companies Act shareholder rights to the nominee, not to the investor. Hargreaves Lansdown, for example, may be the biggest shareholder on a company's register even though none of its own money is at stake. Some think the CSDR should be implemented by requiring all shares to be held by nominees alone.

The much better alternative, for investors and for the companies they invest in, with progressive benefits for society in general because of improved corporate governance, is for individual investors to hold their shares electronically in their own names. Much work has been done to devise the means for this to happen, principally by the Registrars Group of the Institute of Chartered Secretaries & Administrators, resulting in what is known as the Industry Model. If enacted, this would replace share certificates with securely coded 'holder keys' to link shares with their owners and enable the owners to enjoy full shareholder rights. The objective, as defined in the Kay Review of UK equity markets, commissioned by the coalition government, is to find *"the most cost effective means for individual investors to hold shares directly on an electronic register"*.

The government could go further. In addition to preserving current share ownership, it could use dematerialisation to give full shareholder rights as well to all those who choose to use a nominee service, by making the nominee secondary to the investor, instead of the other way round as at present.

Dematerialisation provides the opportunity to do more
It is time Parliament confronted the damage that has been done by the now widespread but still increasing appearance of nominees on company share registers, allowed by the law to be owners of the shares and therefore of companies, despite having no financial interest in them. The use of nominees has taken ownership responsibilities away from the individuals whose money is at stake and given it to those who have no financial interest in exercising such responsibilities. The oversight of companies is left to the financial services industry, which then gets berated because it doesn't behave like owners. Of course it doesn't. It won't. How stupid to think that it might. Look no further than the Persimmon scandal for proof.

There is another stupidity. By shovelling investors into nominee accounts their money and investments are put at additional risk. The compensation available should the nominee default is minimal and hard to get. To protect investors from the risk of such default, the EU and our own regulators have been piling on the rules, the latest source being the EU's much-feared EU Directive known as Mifid II; according to the Financial Times, this has more than 1.7 million paragraphs of requirements. Investors already face page after page of conditions though – in Hargreaves Lansdown's case totalling 14,000 words.

Buying and selling shares are one-off transactions, for which investors should have a free choice of agent and one-off costs. Leaving them instead to be held in trust by a nominee requires a continuing relationship which is necessarily governed by regulations and restrictions for which ultimately the investor must pay. A nominee account may come with side benefits, attractive to some, but no private investor should be obliged by law to surrender full legal ownership of the shares he or she buys and find them subjected to onerous conditions.

The Companies Act must be amended, to give every investor who uses his or her own money to buy particular company shares the right to have his or her name and address on the company's share register as the legal shareholder, regardless of how the shares were acquired. It is not good enough, as some suggest, simply to add the investor's name to the nominee's in order to 'designate' the account. Rather than continue to regard the nominee as the shareholder, the investor must become the principal, with the nominee merely the agent. The role of a nominee should be to service investors, not to usurp them. For private investors, this must become the law.

Eric Chalker served as UKSA's Policy Co-ordinator & Director from 2012 to 2016

FOOTNOTE
On 6 July 2013, a well-attended UKSA conference received a presentation from the Registrars Group setting out the background to the CSDR and explaining how the Industry Model was expected to work; a report of this appeared in 'The Private Investor' later that month. A further article on the subject appeared in the magazine of January 2014, which included, with the Registrars Group's approval, an eight-point summary of how the Industry Model would work.

Thinking long term

Professor Aled Jones

Aled is inaugural director of the Global Sustainability Institute at Anglia Ruskin University. He is a Co-Investigator at the ESRC Centre for the Understanding of Sustainable Prosperity (CUSP), the AHRC Debating Nature's Value network and the EU H2020 MEDEAS energy transition project.

The requirements for a change in how investments are made over the next few decades are huge. The scale of opportunity to invest in solutions that address global sustainability challenges, such as climate change, is often seen as a new technology revolution. Estimates vary but broadly coalesce around the need for an additional $1 trillion per annum in investment required in energy infrastructure alone over the next thirty years. Social changes that accompany such as huge transition should not be underestimated.

The need to target policy and business interventions to enable capital to flow into these investments is clear, and consequently the need to understand and measure the risk associated with these investments is imperative.

The UK's Economic and Social Research Council (ESRC) has invested £6 million into the Centre for the Understanding of Sustainable Prosperity which is exploring various aspects of this transition. This includes social change as well as trying to understand the new models of business and governance that are likely to be required. This is all supported through new ways of modelling finance and economic systems.

While clean energy investing has now passed $300 billion in one year, the underpinning model of finance remains largely unchanged. Pension funds and other institutional investors are still struggling to make long-term investment decisions and businesses are still focussed on quarterly performance. Without a substantial change in corporate governance, investment oversight and decision making and regulatory frameworks we will continue to play around the margins. A fundamental shift in all these aspects is needed to unlock the potential of this new paradigm.

The opportunities are significant and are needed to tackle social exclusion, inequality and rising extremism. They also solve climate change and an emerging energy crisis. Whether the solutions are a move to more co-operative ownership, more active investment management, regional investment banks or something completely different, a discussion on how this transition can be achieved, with regard to both the social and physical infrastructure as well as the financial model, is needed now.

CUSP: www.cusp.ac.uk

GSI: www.anglia.ac.uk/gsi

Lifting the Lid on the FRC – 21 November 2017

by Peter Parry

The Financial Reporting Council (FRC) recently organised a half-day event to give private shareholders insight into the role and remit of the Regulator. All members of UKSA and ShareSoc were invited. Aleksandra Maczynska, Executive Director at Better Finance, also attended the event. The FRC has been working hard to develop and maintain levels of investor engagement recently. UKSA regularly gets invitations to participate in the FRC's Reporting Lab projects, consultations, roundtable meetings and other events. We always try to take up these invitations and participate in the work of the FRC. However, this was the first event specifically designed to give private investors an overview of the FRC, how it works and of the scope of its remit.

The event started with a short welcome and introduction from Tracy Vergo, the FRC's Executive Director of Strategy, who stressed the benefits of closer links with private shareholders and the valuable perspective that they bring to the FRC's work. This was a clear message of support and encouragement to the 'home team' as well as to the visitors.

The following sessions, led by senior managers from the FRC, looked at issues such as audit standard setting and audit quality review, accounting and reporting and the monitoring, maintenance and development of accounting standards, the FRC's enforcement role and an overview of the FRC's role in setting corporate governance and stewardship codes. There was also an update on some of the recent projects that the FRC has been working on with investors such as the investigation into risk and viability reporting and the Reporting Lab project on audit committee reporting.

One of the purposes of the event was to create awareness among private investors of the both the breadth and limitations of the FRC's remit. For example, the FRC is responsible for overseeing the work of the actuarial profession as well as that of auditors. Contrary to popular belief, the FRC is not publicly funded. It is funded by a levy paid partly by the audit and actuarial professions and partly by the organisations which have to prepare accounts. This arrangement is not entirely satisfactory in that the FRC is funded to a significant extent by those it is supposed to regulate. It is also well known that the FRC recruits may of its mangers and specialists from the major audit firms and those that leave often return to the world of audit. This raises concerns about the risk of regulatory capture. On the other hand, no one was left in any doubt about the depth of knowledge, expertise and understanding of the FRC speakers at the meeting. This can probably only be achieved by recruiting people with a senior management background in accounting and audit.

The FRC reviews about 150 audits every year and grades them into four categories. The reviews are listed on the FRC web site. A common reason for audits falling short is lack of professional scepticism.

On the subject of enforcement, the FRC's team has grown from 11 people in 2013 to 30 now and they admit that they are still short of resource and are actively recruiting. We also learned that the FRC's remit does not cover criminal activity. If the FRC suspects that crime is involved then the case passes to other bodies such as the police and the SFO. This, in part, explains why some complaints and the subsequent investigations can take years to complete.

Another limitation in the scope of the FRC's remit is that it is not responsible for the narrative aspects of the report. It certainly looks at the narrative elements and has recently reviewed business model reporting, risk and viability reporting and aspects of the 'strategic report'. It can report and make recommendations on the usefulness of current reporting in these areas, but it has no power to take any action even if believes that content is misleading or deficient. Investors following the case of Carillion, which issued a number of upbeat statements in its 2016 annual report only to give a series of devastating profit warnings a few months later, will be aware that this has gone to the FCA for investigation, not the FRC.

A key message to private investors was a plea to engage fully with the FRC. The Regulator is very keen that investors should make input to its work as well as understanding how it works, what it does and the limitations and constraints under which it operates. Senior management is as frustrated by many of the constraints as we are as investors; so please make your views clear to government via your local MP. The FRC constantly lobbies government for a wider and more coherent remit with the powers it needs to maximise its effectiveness. All too often its pleas are dismissed as empire-building. If the same message comes from us as investors, those in government are more likely to listen.

This was an excellent event which was extremely well run. A full programme of presentations was skilfully shortened and tailored as we went along to allow people more time to ask questions. It would have been easy for the FRC to stick rigidly to its own agenda; but it didn't. It allowed the programme to evolve in line with the interests and concerns of the audience. A vote of thanks is due to Jen Sisson who leads Investor Engagement at the FRC and who suggested, planned and organised the whole event. We very much hope to follow it up with others in future.

Feedback on 'Lifting the Lid on the FRC'

The FRC passed on to us the results of the participants' survey. Here are two key findings:

Overall, how would you rate the event?

ANSWER CHOICES	RESPONSES	
Excellent	44.00%	11
Very good	48.00%	12
Good	8.00%	2
Fair	0.00%	0
Poor	0.00%	0
TOTAL		25

Following this event, would you say you have a better understanding of the role and remit of the FRC?

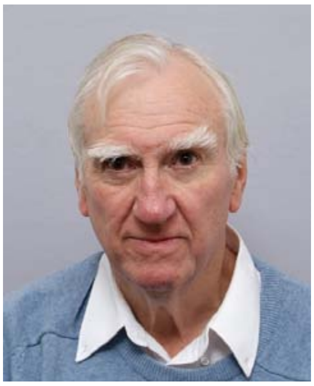
ANSWER CHOICES	RESPONSES	
Yes - I have a better understanding	100.00%	25
No - I dont	0.00%	0
About the same as before	0.00%	0
Total Respondents: 25		

STOP PRESS:

Following the success of last year's event, a date of 26 November 2018 has been agreed for a Private Investor Dialogue with the FRC. Please save the date in your diaries. More details will follow later in the year.

How to assess risk

by Malcolm Howard



According to academic theory, risk can be split into 'market risk' and 'specific risk'. Market risk relates to the market as a whole and specific risk relates to a particular security. Academics argue that we should not worry about specific risk as this can be diversified away. The theory is that by choosing securities in different sectors and having a minimum portfolio of about thirty different shares, probability suggests that things will average out; you might have the 'rough' but you will also have the 'smooth'.

In a typical portfolio we might expect some super gains, some average gains and some losses. An example of what might be described as a 'typical' portfolio can be found in Mr Bearbull's column in the 5 January to 11 January edition of the Investors Chronicle. This portfolio shows 14 investments; 3 were brilliant (over 100% gain), 2 were good (50% to 99% gain), 5 were fine (up to 49% gain), but 4 were showing a loss. From a starting capital of £100,000 in Sept 1998, the current valuation is £315,900.

I would argue we can do better than this; the objective is to cut out the losses. With regard to 'specific' risk we can assess a high proportion of the risks we face. Specific risk can be broken down:

- High debt; false accounts, overvaluation and unforeseen events.

Running out of cash and being unable to pay your creditors is the greatest risk, as those unfortunate enough to hold Carillion plc shares found out.

The second biggest potential problem is false accounting, usually because inventories and/or debtors are overstated. In the latter case this often comes about because companies take sales too early.

Over-valuation comes about (particularly in the AIM market) because of 'momentum' investing. Here the price becomes unrealistically high, but because the price goes up, more people buy and the price goes up again. It is called a 'virtuous circle', but when this overheats it becomes a bubble. Some people make a lot of money investing in 'bubbles'; the problem is they eventually burst and then losses can be substantial.

For obvious reasons there is nothing we can do about 'unforeseen events' which come about for a variety of reasons, such as regulatory and government intervention issues.

The first test we can do is to assess whether or not the accounts are false (if they are not false the test's failure demonstrates poor management). This test is what I call my 'prime test' and is based on the fact that the Income Statement includes charges that are non-cash items such as depreciation, amortisation and share based payments.

The test is simple: 'Cash inflow from operating activities' in the Cash Flow Statement must be greater than 'Net earnings' in the Income Statement. If not the test fails; in such cases a 50% discount is applied to CEPS. In addition a 25% discount is applied to cover net debt. For example, if net debt per share was 41.6p, the CEPS would be discounted by 10.4p. CEPS is defined as 'cash earnings per share' and is calculated by taking 'Cash Inflow from operating activities, before the movement in working capital' and dividing by the number of shares, adjusted for share options. This gets what I call REPS (revised EPS). Some examples are given below:

	CEPS (p)	Test fail (p)	Debt (p)	REPS (p)	Price (p)	P/E ratio
Berkeley Group	199.8			199.8	4,119	20.6
BP	81.8		(46.6)	35.2	518	14.7
Carillion (note)	25.9	(13.0)	(10.8)	2.1	189*	90.0
Echo Energy	(1.5)			(1.5)	14	S
Halfords	45.0		(10.4)	34.6	349	10.1
IQE	3.2		(1.4)	1.8	127	70.6
Luceco	6.7	(3.4)	(5.1)	(1.8)	233*	S
Melrose	1.4		(8.5)	(7.1)	234	S
Moss Bros	12.8			12.8	67	5.2
Paddy Power	453.2		(9.0)	444.2	8,430	19.0
Savills	67.2			67.2	981	14.6
Whitbread	302.5		(108.1)	194.4	3,974	20.4

What the P/E ratios mean (prices shown are the mid-price on 18 January 2018):
* is the price after publication of the accounts, but before the crash.

Below 9	The market believes that the company is in decline and that there will be negative growth
9-11	The market believes that the company has very little or no growth potential
12-20	The market believes that the company will grow by a reasonable amount
21-39	Annual growth between 25% and 40% expected
40+	We are in 'bubble' territory; such stocks are high risk
S	Evaluation impossible so any investment is speculative

Note: Carillion (along with a long list of companies) took part in the government's 'Early Payment Scheme'. This was designed to improve the cash flow of small businesses. Under this scheme, once a contract with Carillion was completed, the small business holder would take his authorised invoice to one of the participating banks, who would pay him in full if payment were due, or discount it if it were paid early. The banks would then recover the amount they paid from Carillion, except this company did not pay the banks back appropriately. At 31 December 2016 Carillion owed the banks £760 million with regard to this scheme, but this was shown as 'other creditors' and not 'debt'.

At the end of the day, it all comes down to personal judgement. Do you believe the P/Es are justified?

RBS Shareholder Committee Campaign Update

by Peter Parry

Cliff Weight delivers requisitions to RBS

On 29 December 2017, Cliff Weight travelled to London to deliver 165 signed requisition forms to RBS. The requisition calls for a vote at the next AGM on the implementation of a shareholder committee. UKSA has actively supported the campaign with many members completing requisition forms and supporting the call for a shareholder committee. Cliff, who is a director of ShareSoc, and who has coordinated the campaign said, "The current method of engaging between shareholders and listed UK companies doesn't work. We think our proposal at RBS is a good starting point and an example for others to follow." Mark Northway, ShareSoc Chairman, added, "Shareholders, including individuals, deserve a new approach; one with greater involvement and more effective input from them as ultimate owners. RBS, given its incredibly poor track record and consequent taxpayer support, should now be leading from the front in governance matters."

Press coverage of the campaign was excellent with reports by Reuters, FT, The Independent, Telegraph, Times, Yahoo, Press Association, CityWire and the Investors' Chronicle. There was also coverage in Shares magazine, which is very important to us; some 60,000 private investors subscribe to this.

Summarising the success of the campaign so far, Cliff Weight said: 'We have worked well with RBS people this time round in avoiding the negative publicity that occurred last year. This is a clear sign of good progress in our more productive working relationship with RBS.'

Further updates on the RBS campaign will follow in forthcoming editions of TPI.

Shareholder Committees

The informal nature of current shareholder engagement (cosy chats with selected shareholders behind closed doors) does not work well for the broad shareholder base. It is not clear whether investors are each being told the same story, how information is being spun, or whether complete or only partial information is being given out. Investors will ask different questions during engagement meetings and so may develop different interpretations of what the company is trying to achieve.

Currently, when a large number of investors are "consulted", it is difficult to have the same conversation with each investor and the proposal often changes over the process of engagement. Currently, the different views of different investors create a very "messy" backcloth in which to engage.

For example, in relation to remuneration proposals, there is often no clear trail from the initial proposal though to the final version voted on by shareholders. Voting happens too late in the process. Discussion and voting at the AGM is ineffective, as institutions do not like to vote against the directors' recommendations. A more professional and systematic process is required.

This impasse can be broken through the introduction of a Shareholder Committee.

The risks and rewards of investing in newly listed companies

By John Mulligan

A potentially lucrative sector

From time to time I review developments in the London new issues market in my monthly STAR Newsletter as, over the years, I have found that some of my most successful and profitable investments have been in companies that have listed their shares on the London Stock Exchange in the recent past. Although a large proportion of both larger and smaller initial public offers (IPOs) turn out to be poor investments, at least from the point of view of the wider public, occasionally there are a few really excellent growth businesses that prove to be exceptionally rewarding. In recent years I have done particularly well from relatively small stakes in Dechra Pharmaceutical and XP Power. Both of these have risen by more than ten times in value and have more than made up for the inevitable failures.

I started looking in depth at the new issues market back in the 1980s, when I contributed regularly to a publication on this sector distributed by leading national brokers Sharelink and subsequently for many years for the financial website Interactive Investor. When I undertook a detailed survey of all UK IPOs covering a ten-year period in the 1990s, I unearthed a few simple clues to help in the discovery of potentially profitable investments, which I summarise below.

While it seems at first sight logical that young, recently listed, companies are likely to produce above-average returns to investors, it is certainly not the case that all newly listed businesses will be good news for outside investors. This is because there are several reasons for companies deciding to list their shares on a public market and not all of these reasons will necessarily be in sync with the priorities of outside shareholders.

Questions investors should ask

From the perspective of the private investor it is vitally important to remember that the information provided in the listing prospectus is, in effect, a sales document. So, the first question to be asked by investors should be "Why are the current owners selling a stake in their business?" Essentially, is the listing intended to generate cash to help the business expand ("Good" as Trump might say) or is it primarily to provide an exit route for the existing owners or help pay off debt incurred, in some recent cases, by private equity owners (often a Trump "Bad").

In reality, of course, the motives for listing new shares are often more complex than this, but astute investors usually attempt an assessment of the basic reasons for the listing operation as their first priority. Generally, the most successful IPOs are profitable companies looking for additional cash to fund expansion.

As with other established investments, the key metrics for those seeking successful new issues include: a valid audited record of positive growth in sales and profits over at least the past three years, attractive rates of return on capital employed in the business, trading margins at least above the average for the sector, a niche market position that exhibits an element of pricing power and an ownership involvement by the directors and senior management that is sufficiently large to provide an incentive but not too large to confer complete control.

A couple of current examples

By way of illustration I have recently reviewed two large main market IPOs, TI Fluid Systems and Bakkavor, and assessed each according to the scores they achieve in relation to past sales and profits growth, business valuation at the current share price, expected future profits and earnings growth, management competence and incentives, strength of business model, extent of indebtedness and interest cover, dividend yield and other factors such as outlook for the relevant business sector.

In my monthly STAR newsletters I usually include one or two short analyses of companies that appear near the top of my share screening system and recently I have been looking at the two IPOs mentioned above. Ideally, I am looking for companies that achieve a STAR profile rating of 60 and above based on the above metrics. Unfortunately, neither Bakkavor nor TI Fluid Systems manages to achieve a rating of this order, with the former rating 55 and the latter coming in at 46.

TI Fluid Systems is an example of a well-established manufacturing group with global outreach that may well qualify as a "Bad" issue in that the previous owners, Bain Capital, were intending that the flotation would help reduce the large debt overhang. Not only does the debt pile remain high after the flotation but the total volume of the business could be under long-term threat as the motor industry goes electric.

The position vis-à-vis Bakkavor is better in terms of the overall growth potential for quality ready-made foods but less positive in that the founding directors remain firmly in control, with only 25% of the group shares available for the wider public and debt levels still remaining high even after receipt of some £80m following the recent public offer.

Sadly, I haven't caught sight of any Dechras and XP Powers among the recent flotations, but the search continues.

Editor's note: John would be happy to send copies of the STAR profiles on TI Fluid Systems and/or Bakkavor to anyone who is interested.

Carillion – A letter to the Financial Times

UKSA was a signatory to this letter, which was published in the Financial Times

Sir,

When it comes to apportioning blame for Carillion's dramatic demise, fingers are being pointed in all directions. But most are missing the real culprit: faulty accounts appear to have allowed Carillion to overstate profits and capital, thereby permitting them to load up on debt while paying out cash dividends and bonuses.

Prudent accounts are a fundamental pillar of the UK's capital maintenance regime: profits and capital may not be overstated. It is also illegal under Company Law to pay dividends out of capital. Anticipated revenues from long-term contracts cannot count as distributable capital, and foreseeable losses and liabilities need to be taken into account. All this is clear.

Carillion's accounts reported profit that was anticipated. They also seemingly failed to apply prudent judgment in determining impairments and liabilities. This is akin to an airline allowing a plane to fly with a fuel gauge that gives overstated readings, implicitly assuming that mid-flight refuelling (i.e. injections of fresh capital) would be available if needed. Given the dire consequences of running out of fuel, would we take this risk?

So yes, Carillion's directors need to be investigated for the company's collapse, but so too should the auditor, KPMG. If the auditor claims they were following the required standards (as they have in the past), then the problem is far deeper; and potentially endemic. Faulty standards would mean that accounts today cannot be relied on to protect capital, with devastating consequences for all stakeholders who depend on businesses remaining going concerns.

Carillion is yet another canary in the coal mine. How many more do we need for the Government to properly scrutinise our accounting rules?

Natasha Landell-Mills, Sarasin & Partners
Martin White, UK Shareholders' Association
Dr. Atul K. Shah ACA, University of Suffolk Business School
Robert Talbut, Independent Director
Kevin Dowd, Durham University

Persimmon LTIP hits mainstream media

By John Hunter

In October 2012 Nick Stevens sent a note to the UKSA office saying he was an investor in Persimmon and thought there was something suspicious about a Long Term Incentive Plan (LTIP) approved at a recent special meeting. The office passed the note to Eric Chalker and Eric, knowing my attraction to intriguing analyses, passed it to me. It took me just half-an-hour to see that there was something seriously wrong with it, and then rather longer to do the analysis to support what was otherwise just a hunch. I called Eric and he devised a long-term strategy to question the key players in writing at the outset, track how things turn out and exploit the findings as a catalyst for change.

Now, five years later, Eric's foresight is about to yield fruit. The features that made it a bad plan have become obvious, the facts that reporting anomalies allowed to be concealed have become too extreme to hide, and the press have got on to it. The Chairmen of both the company and the remuneration committee (both already in position in 2012) have resigned, ostensibly because they failed to cap the LTIP, but no doubt avoidance of public ridicule at the coming AGM had something to do with it.

The LTIP is currently worth £750 million to 140 staff (as at 2012) and their successors. One-third goes to a handful of directors, of which £115 million to the current Chief Executive and £90 million to the Finance Director. With a scandal of this magnitude, unfolding year-by-year like a slow-motion car-crash and documented by UKSA as it went (see website), it's hard to see how the regulators and the government can avoid taking some action.

So how did it happen? What did I notice in my first half-hour that persuaded me to have a serious look at it?

- First, it was giving away 9% of the company to current employees. That's a big number, admittedly over 10 years, but what were tomorrow's employees going to get?
- Second, the performance condition for triggering awards comprised solely the payment of dividends. There are lots of ways of paying dividends that are not necessarily sensible or indicative of real wealth creation.
- Third, the payment schedule indicated a cast of mind that committed the company to returning cash to shareholders instead of investing for growth (the schedule was and is called the 'Capital Return Plan'). Might be a good view of today's prospects, but locked in for ten years…….. ?
- Fourth, there was something odd about the provisions for intermediate years – turning a simple plan into a complicated one. Why, I wondered?

Well, I won't bore you with the detail of my subsequent 'serious look' except to say that it all got worse. The plan wasn't a ten-year plan, it was a 'ten-years-at-the-most' plan; and the complicated provisions for intermediate years turned out to have the effect of turning 'long-term' into a series of short-terms. The early years were ridiculously easy to achieve – a single dividend on Day 1 would have done it had that been necessary.

The fact that the Plan was a simple programme of enrichment for management should have been obvious to anyone with a bit of technical competence. And this would have become even more obvious as time passed. (I originally estimated the Plan to be worth £300 million and it now looks likely to be about £750 million.) The Persimmon case is now history: there's nothing we can do about it except vent our anger. But its outcome is so egregious that it should be difficult for government and regulators to ignore the governance weaknesses it exemplifies, weaknesses that UKSA and others have been banging on about for years, weaknesses both of structure and transparency.

The key players here are: the institutional major shareholders, who were consulted about the Plan before the vote but failed to grasp, or ignored, its implications (the vote was 85% in favour); the regulators (the Financial Conduct Authority and Financial Reporting Council) for overseeing a system of governance that has so manifestly failed in one of its primary purposes; the accounting profession (and specifically the Big-4 accountants that dominate that profession and strongly influence the FRC) for its promotion of accounting standards and reporting practices that have concealed this enormous transfer of wealth for five years; and the government, on the principle that the buck stops here.

UKSA, with ShareSoc, will be trying, again, to promote solutions with these bodies over the coming months.

Persimmon management still looking ahead

The new public focus on the Persimmon LTIP has been caused in part by the impending first interim vesting date - December just passed - when, for the first time, some (but not all) of the options under the LTIP will vest and the extent of the award will be revealed. But what Persimmon have never revealed (except by a close read of the original documentation) is that the whole Plan vests not in December 2021 but when the cumulative dividends paid since 2012 reach 620p/share.

This became relevant when, in February 2015, Persimmon announced, with some fanfare, an enhanced Capital Return Plan schedule totalling 900p per share to 2021. But they made absolutely no mention of the consequences to the LTIP, which would now vest in full in July 2019 – two and a half years early. However, the revised schedule totalled only 570p at July 2018, just 50p short of the full-vesting total of 620p.

But Persimmon are nothing if not inventive in these matters. To lay the groundwork it declared a 'special' dividend of 25p, paid March 2017. You can almost feel their brains working: *Hang on a minute while I do the maths, let me see now, half of 50p is 25p, another 'special' dividend of 25p in March 2018 will bring the cumulative total to 620p in June 2018 after payment of the usual dividend of 110p, that ought to do it. We'll be able to call it 'repeating the practice established last year'*.

It's almost endearing isn't it – like a child trying to sneak up on the ice-cream tub without its mother noticing?

We'll see when Persimmon announces its results on February 27 whether the management has chosen to dip its spoon into this particular tub.

Date of AGM

UKSA's accounts for the past financial year will be sent out to members around mid-February. The AGM will be held on May 15 at the usual time and place (2pm at the RAF club). The reason for the gap is to allow a clearer debate on progress with ShareSoc. There should be more to see in terms of progress on cooperation and therefore a more productive AGM debate.

UKSA – AIM shares competition 2017

Readers of the January 2017 issue of The Private Investor were invited to select five shares out of a list of twenty-five shares listed on the AIM market. The idea was to select the shares that achieved the greatest growth over the year. Points were awarded as follows:

Share finishing first:	5 points
Share finishing second:	4 points
Share finishing third:	3 points
Share finishing fourth:	2 points
Share finishing fifth:	1 point

Contestants were invited to select one of their shares as their best bet, on nap selection, which earned double points. Therefore, the maximum number of points that could be achieved was 20.

The share that was selected the most times was **Brainjuicer**. It was almost as if many people knew something, or read the same magazine, or believed the same tipster, or whatever. For a long time it looked as if they were all on to something as the share price rose steadily from 550p to nearly double by May, getting to 1,035p. Then the company decided to change its name to System1 Group and it then went pear-shaped to close at the end of the year at 367.5p, down 33%, finishing 23rd of the 25 companies.

The five best performers:

1	IQE	+260.5%
2	Blue Prism Group	+182.9%
3	Victoria	+133.1%
4	Advanced Medical Solutions	+43.3%
5	Majestic Wine	+42.5%

The five worst performers:

1	Tissue Regenix	-54.9%
2	Newmark Security	-35.7%
3	Brainjuicer/System1	-33.2%
4	Impellam Group	-21.4%
5	Goals Soccer Centres	-20.8%

The winners of the competition are:

First	**Douglas Battersby**	**10 points**	**wins**	**£60**
Second	David Hardie	7 points	wins	£24
Third	Gerald Roberts	5 points	wins	£12

Congratulations to all!

KIDs: a good idea, embarrassingly executed

An article by John Kay for the Financial Times reveals a nonsense in the Key Issue Document (KID) that is now mandatory for all funds. It raises a question mark over the competence of all those involved in its design and approval.

We are sympathetic to attempts to describe financial products in terms that are standard (and therefore allow comparison across products) and clear to less-knowledgeable retail investors. But the provisions for the treatment of risk revealed by John Kay's article are a disgrace. The ignorance of real-life investment revealed despite many years' consultation and review is staggering. The connivance of the advice and fund management industries – who were presumably consulted – is shameful. If uncorrected the Document will lead to widespread consumer detriment, promote bad advice and bad funds at the expense of good ones and hamper attempts at consumer education.

For the full background, please see the news stories on the UKSA website as well as www.johnkay.com.

Share ownership – a paper by Nick Steiner

UKSA met with registrars on 2 October 2017 to consider the document entitled 'An Industry Proposed Model for Dematerialisation' (*see also Eric Chalker's article on page 5).* The following exchange goes to the heart of the issue:

UKSA's question: Why can't the share certificate, which starts dematerialised, remain dematerialised? Why can't it be sent electronically rather than be printed in the registrar's office?

Registrars' answer: Crest regulations require it to be printed out and sent. There are also a number (at least 16) of applicable and best practice guidance documents that need assessing before a change can be made. Due to pressure of other work the earliest BEIS can complete this work is 2021. We all find this very frustrating, but:

- Any change in the system is enormously more complicated than you are assuming;
- The registrars have a proposal that they are progressing to achieve what you want but it's bound to take a long time because of politics, special interests, complexity and Brexit;
- The registrars are enormously supportive of dematerialisation of share certificates.

It is clear that the registrars and companies would like this legacy issue resolved. It is costing private shareholders a lot of unnecessary money and is wasting time. BEIS have shelved this issue while they deal with Brexit. This is unfair; letters to MPs and further pressure from us could help to unlock this unjust system!

The background to share ownership

The London Stock Exchange says: "*Shares are often surrounded by mystique but the principle behind them is simple and straightforward. Shares, also known as equities, provide you with part-ownership of a company so when you invest in shares; you are buying 'a share' of that business. Companies issue shares to raise money and investors buy shares in a business because they believe the company will do well and they want to 'share' in its success.*

*Companies do not have to be quoted on the stock market to issue shares. When businesses start out, many of them raise money from outside investors, who are given a share of the company in return. These investors tend to be friends, family or benefactors and their shares are known as unquoted because the companies are not listed on any stock market. Even if a company states that it is a '**PLC**' (Public Limited Company), it does not necessarily mean it is listed on a Stock Exchange. This is just a legal status for the company.*

When a company wants to raise money more widely, it can apply to become publicly listed or quoted on an exchange, such as the London Stock Exchange. Once it has gone through the approval process the company then has its shares admitted to trading on an exchange and its shares can be bought by individual investors and large, investing institutions, such as pension funds and life assurers. Companies have to satisfy certain legal and financial criteria before their shares can be listed on a stock market and the shares are known as quoted because their prices are quoted every day on a stock exchange.

Owning shares in a company means that you are entitled to a say in its affairs. All PLCs have annual meetings, where shareholders vote on matters such as the company's accounts, directors' appointments and pay packages. Companies also hold meetings for shareholders when they are about to make big changes to their business, such as buying or selling parts of the company or raising fresh capital. Trading in shares is executed by stockbrokers, who buy and sell shares on behalf of investors. Increasingly, investors buy shares over the internet, using online broking services."

Most share owners have share certificates and these have difficult legacy issues examined later in this paper.

Members

If your name is on the share register generally kept by the company's registrar, you are a member of the company and have the following rights and benefits:

a) Attend general meetings, appoint a proxy, ask questions;
b) Receive all communications direct from the Issuer;
c) Exercise rights for both Voting & Corporate Actions directly without the imposition of artificial deadlines;
d) Compliance with terms and conditions set by national law and articles of association;
e) Trading options; you are free to use a broker of your choice, facilitating competition;
f) Few foreign ownership barriers compared to nominee arrangements;
g) Cost – Issuers do not charge shareholders for the privilege of being members.

'Name-on-register' and 'registered shareholder' are both considered Members. A person or persons holding an interest via a nominee arrangement is not a registered member but an 'underlying member/holder' or a 'beneficial holder' (common phrases to identify this sub group of holders). Some rights can be conveyed via the Beneficial Holder Information Rights (or BHIR process) but that itself relies on the nominee providing the registrar or issuer with accurate information on the beneficiary and the resulting outward information is limited only to the provision of notices or reports (not direct voting or dividend rights).

Nominee managers

If you elect to use a nominee manager you don't own the shares but become what is known as a beneficiary of the shares. The nominee manager is the owner and chooses, often by levying a fee to pass on some of the members rights.

An examination of the law behind the current process of buying and selling share certificates

Key information:

1) A share **certificate** is a certificate issued by a company certifying that on the date the certificate is issued a certain person is the registered owner of shares in the company.
2) A share certificate (in England under seal) is *prima facie* evidence (in Scotland 'sufficient evidence unless the contrary is shown') of the member's title to the shares: CA 2006, sec 768).
3) The information contained in the share certificate has been reduced (e.g. address of shareholder is omitted).
4) Shares may be transferred by means of an instrument of transfer in any usual form or any other form approved by the directors, which is executed by or on behalf of the transferor.
5) Most companies will require the share certificate to be produced when a request is made to transfer shares.

The share register is in digital format. Contract notes are set up digitally and can be sent online. Share certificates are set up digitally, printed out (materialised), couriered to broker and then put in an envelope and sent by post to the shareholder. It is the least important of the three items but incurs the greatest cost.

In both of the situations below shareholders were simply sent new certificates to replace the old ones which are now worthless:

1) The growing popularity of takeovers by schemes of arrangement, at least in part, is due to the removal of the need for return of share certificates. A good example is the Shell takeover of BG.
2) Share consolidations are another example of the removal of the need for a return of share certificates. Examples are the RSA and National Grid consolidations.

Share ownership is recorded in the share register. Any dispute on entries would be referenced back to the share register and proof of transfer/trade provided by the investors/brokers. In theory, the opportunity could be taken for companies to issue digital certificates (see 4 above) recording that a sale or purchase of X number of shares has been made and the total holding is Y shares. (A digital certificate can still be printed out as with current procedure and this covers individuals with no access to a computer.) This 'certificate' would cease to be valid the next time shares in the same company are transacted and a new 'certificate' is issued. The function of the market for certificated holdings currently relies upon the recognition of a valid share certificate. A change such as this would require market adoption. It is likely that brokers are more interested in increasing nominee accounts, where they own the shares, since any improvement of the share certificate process may lead to loss of clients. So from their point of view there is an incentive in doing nothing.

Transferring shares without paper certificates (a proposal)

Share ownership is recorded in the share register. Key information concerning the share owner is:

a) Full name;
b) Shareholder reference number (SRN);
c) Number of shares.

The current address will also be recorded. The electronic certificate is a record of the number of shares owned on the date shown, so any new transaction results in a new electronic certificate and the previous electronic certificate can be destroyed. In order to buy and sell shares an account needs to be set up between both parties. The parties are the broker and an individual or a group.

Share purchase

The buyer contacts the broker. Agrees the price and arranges to pay in two days. If topping up, the SRN will be passed over. A contract note is issued by the broker. The registrar sends out a combined electronic certificate stating:

a) Name
b) The number of shares bought
c) Date of purchase
d) Total number of shares now held
e) SRN

This electronic certificate can be printed out at any stage for any buyer without a computer.

Share sale

Seller contacts broker. Agrees price and passes over SRN. A contract note is issued by broker. Seller sends signed electronic transfer form. Payment is made in 2 days after transfer has been completed. The registrar issues a combined electronic certificate stating:

a) Name
b) The number of shares sold
c) Date of purchase
d) Total number of shares now held
e) SRN

This electronic certificate can be printed out at any stage for any buyer without a computer.

Advantages

This new system does away with a paper certificate that is only prima facie evidence of ownership. The key piece of information is the SRN. Currently this piece of paper trundles through the postal system long after the deal is done when buying and simply delays deal completion on sales. It also is given unmerited status in that a lost certificate requires indemnity forms and cost of replacement. Market adoption should be straightforward and result in cost and hassle savings all round.

CURRENT UKSA EVENTS	
A photo ID is requested, please bring it with you!	
SHAREHOLDER MEETING WITH PHOTO-ME plc - Friday 26 January 2018	
Location	**Hudson Sandler, 29 Cloth Fair, London EC1A 7NN**
Assembly	**14:00 onwards**
Meeting start 14.30	**Room capacity 50**
Company contact	**Gabriel Pirona**
Group leader / UKSA organiser	**Gerald Roberts 07764614937 e-mail: zeami@gmx.co.uk**
SHAREHOLDER MEETING WITH ASSURA plc - Tuesday 30 January 2018	
Location	**Travers Smith, 10 Snow Hill, London, EC1A 2AL**
Assembly	**10:30 onwards**
Meeting start 11:00	**Room capacity 25**
Company contact	**Lianne Holland**
Group leader / UKSA organiser	**Nick Steiner 020 8874 0977 e-mail: n.steiner@btinternet.com**

UKSA BRANCHES - If no contact name or number is given, please contact UKSA office

Branch name	Leader	Administration	Main purpose	Description
London & South East Region	Harry Braund 020 8680 5872 harrycb@gmail.com	Tony Birks 01322 669 120 ahbirks@btinternet.com	To co-ordinate activities in London and the South-East	Meetings in Croydon three times a year
London company visits	Nick Steiner	Individual meeting organisers	To arrange private meetings with companies	20/30 meetings per year individually arranged
Specialist company visits	David Lowe Adrian Phillips	Under review	To arrange and/or participate in events in conjunction with investor service companies	Meetings with small-company management, for experienced investors only
Croydon & Purley	Harry Braund 020 8680 5872 harrycb@gmail.com	Tony Birks 01322 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly (see article on page 9)
South West	Peter Wilson 01453 834486 07712 591032	Peter Wilson 01453 834486 07712 591032	To arrange and develop activities for members in the region	Company visits and social events as arranged
North East	Brian Peart 01388 488419	Julian Mole 07870 890973 julian.mole@btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
North West	Julian Mole 07870 890973 julian.mole@btinternet.com	Julian Mole 07870 890973 julian.mole@btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
SmartCo	Charles Breese	Charles Breese	Arranging access to 'Smart Companies' - those with the potential to make good investment returns from benefiting society at large	Programme awaiting start-up