

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 21

Only Two Contenders Left in Race for Northern Rock

On Monday, which was the deadline for receipt of proposals for the future of Northern Rock, Olivant dropped out the race. Chairman Luqman Arnold said *"Despite working intensively, we have been unable to formulate a value creation proposal that meets our investment criteria whilst also respecting HM Government's proposed financing terms and the interests of other stakeholders in the company"*. This of course is a major disappointment and apparently even came as a major surprise to the Treasury according to one newspaper report.

It later transpired that a major issue that arose only on Friday was the Government's insistence that the guarantee they were providing would only last three years. This meant that the bonds issued using that guarantee would need to be repaid within three years, which meant that an aggressive plan to downsize the company would be necessary. Only by doing so could those bonds be repaid in time. But if the company is shrunk down, the possibility of making substantial profits also reduces, and together with the other onerous terms attached to the Government proposal, this meant that a viable business plan was difficult to formulate. Olivant would have preferred a five year repayment period.

This means that only two possible proposals are now on the table – an offer from Virgin Group and an in-house company developed proposal.

The withdrawal of Olivant caused the BBC to tip Virgin as the favourite to take control of Northern Rock, but they later revised that to indicate that it was now a "two-horse race". RAB Capital, a major shareholder, almost immediately declared their support for the company's proposal by saying that *"there is only one strong and independent solution available, in the shape of the proposal from the Northern Rock team led by Paul Thompson"*. Our group also indicated that we felt that there was still a lot of opposition to the Virgin Group bid and therefore we would now probably favour the company's proposal subject to seeing further details.

The Company's Proposal

Northern Rock did give a few more details of their proposal in an announcement on Monday the 4th February and confirmed it had been submitted to the Tripartite Authorities. It would involve raising £500 million from a rights issue and a major restructuring of the company. It is clear from reading between the lines of what is a fairly vague statement, that it also involves significant down-sizing of the company in the short term so as to stabilize the company, with modest growth thereafter.

Virgin's Proposal

Virgin also confirmed they had submitted a proposal on Monday, but again with few details being given. Their proposal now includes raising the same £500 million from a rights issue at 25p per share, another £500 million in cash from the consortium and the merger of the Virgin Money business. The cash being raised is somewhat less than in their original Virgin proposal but the dilution of existing shareholders is much the same. These aspects of the original deal were heavily criticised by UKSA, but the changes do not seem all that significant.

We suggested at that time that if the Virgin offer was the only one put to shareholders then we might advise you to vote against it, and our view on that has not changed. It is in essence much too favourable to Virgin, and not a fair deal for existing shareholders.

Note that even the Virgin proposal would appear to involve some down-sizing of the company. The additional cash being injected clearly might provide a stronger balance sheet to the company, but does so by sacrificing the interests of current shareholders to those of the new investors putting in that cash. Instead of you mainly profiting from the recovery of the company (and hence reducing your past losses), the new investors will profit from it instead.

Both proposals may be subject to negotiation with the Treasury and any final choice may not be made for a couple of weeks. What happens if the Treasury insists that the directors of the company put the Virgin offer to shareholders even though the directors might prefer their own solution? Apart from that being a possible breach of company law, it could mean that the shareholders turn it down and then the only solution left to the Government would be to nationalise the company. More law suits may well result. Let us hope that some common sense prevails and that a solution that is acceptable to all of the Government, the shareholders, and other stakeholders prevails. But the dictatorial attitude of the Government to the terms laid down for their bond guarantee arrangement shows that it may be difficult to reach a conclusion without a fight.

Note though that at the time of writing this "Update", there are rumours that Olivant may re-enter the race after all.

A Comment on our Last Note

Eric Edmond had this to say after reading our last "Update" which covered the Treasury Committee Report:

"I saw with dismay the BBC escaped scot free in this report. I believe Peston's sensationalist report on 13 Sept was largely to blame for the ensuing panic. Look at how the ECB has handled the Spanish bank liquidity problem to see how the Bank of England (BoE) should have done it. As usual we gold plated the EU regulations to shoot ourselves in the foot.

Although the report commented on the lack of qualifications of the Chairman and Chief Executive of Northern Rock, Mervyn King (Governor of the BoE) has no banking qualifications either, but more importantly, no market experience. He is not an experienced banker as Trichet is at the ECB. Most of the BoE old hands wanted Andrew Crockett, head of the BIS, the central banks central bank, as Governor, not Mervyn King.

Peston's pejorative use of the term 'tax payers money' then picked up by Vince Cable to make political capital is wrong and highly misleading. I have written to several papers, none of which published my views to point out that:

a) Not a single penny of tax paid by anyone has gone to Northern Rock. Indeed the opposite will be the case and the Treasury will take money out of Northern Rock as interest payments accrue.

b) Central banks exist to make and destroy money as the occasion demands. It was money the BoE created that went to Northern Rock and the BoE will destroy it on repayment.

c) Central Banks other core function is to act as a lender of last resort. This is part of their normal business. The ECB does not have an explicit statement of this but has acted covertly as a lender of last resort to Spanish banks.

Unfortunately politics seems to have dictated the solution. I think Arnold or even the existing management would do a good job given a fair wind. Branson though, like King, has never managed a bank."

Note that subsequently to receiving the above, Mr King was reappointed as Governor of the Bank of England for a further 5 years.

Other Comments Received

In our last "update" we asked Northern Rock shareholders to give us some comments on what we had been doing. The following are some of those received (there are more and lengthier comments on our web site at: www.uksa.org.uk/NorthernRockComments.htm).

It has been very good to receive your thoughtful and balanced comments, particularly when they are compared to the often hysterical and ill-informed press comment that is so widespread and misleading. C.C.

Thanks for the regular updates, they are greatly appreciated. In particular your guidance on voting at the EGM was extremely helpful. B.R.

Your reports could not be better. They are sufficiently in depth and well informed and, as a matter of record, I for one agree entirely with what you say. Please, somehow or other, keep them coming. I certainly appreciate your devoting so much time and effort to this case on our behalf. Many thanks. D.B.

Just a comment to say that I have found the shareholder web site very useful - by simply being rational in your comments, rather than creating a melodrama out of a crisis. I could understand that much of what was said on the television was "hype" and nothing more. To receive your calm appraisal was very reassuring; so please may it continue! G.B.

I write to you as an unfortunate shareholder of this company which has fallen on the rocks and also as a member of UKSA. Your ceaseless efforts for the benefit of all shareholders of this company, be they UKSA members or not, have been most diligent, factual and effective, plus so far as I am aware, entirely voluntary and unpaid. This is most commendable and I am sure all of us shareholders in this company are most grateful for your entirely selfless efforts which greatly enhances the merits of UKSA and will no doubt encourage all non-members to join this helpful and effective organisation. M.R.

Quite brilliant, we are blessed indeed to have such informed gentlemen in UKSA, thank you! M.D.

Your e-mailed updates are to be commended for their reasoned and informative content. I don't know how the editors and owners of the "red tops" can sleep at nights. I have sent a donation to support your efforts. M.C.

We are very happy with the newsletters as they give, on the whole, a more objective view of events rather than the emotive press coverage. Without input from the Shareholders Association who knows what the outcome for Northern Rock would be now! Many thanks and please continue. N.& H. H.

Without you we would just be a lot of little voices trying to be heard. United with your help we are a Substantial Army of Voices that will be heard, noticed and listened to and not ignored. P.P.

Thank you for the above comments and recent donations also received.

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