

The Private Investor *Issue 170 · May 2014*

A Message from the Chairman

The AGM took place on 29th April and despite the Tube Strikes reducing travel in London a good number of members attended and even more cast their votes remotely showing a continued and dedicated interest and belief in where UKSA is going. The meeting was positive and good spirited with much to be proud of in 2013 and a bright 2014 already underway.



The UKSA board with Chairman Chris Hulme third from right. And he wants to deliver a very individual message. Please read it on Page 23.

Finances are improving and additional membership and fund raising structures continue to be developed to build on the bedrock of today. The power of the UKSA 'brand' is growing at a dizzying rate. Within this edition of our magazine you will find us pursuing the interests of the private investor at every point in which they are threatened - shortcomings of nominee accounts, excessive executive remuneration or challenges to unwise legal and accounting norms on every level; from grossly irritating matters of detail to what amount to great matters of public policy. Our potency is exercised by way of readily-arranged meetings with those empowered to change things (if they can) and through journalists both in print and on radio - with the exposure of some of our most senior active members becoming rapidly more regular as the extent of the idiocies and injustices to which we draw attention becoming ever more widely recognised.

So once again, encouraged by the quality of audience which we can now command I am asking you to redouble your efforts to help increase our membership. But that's not all. Get involved yourself. You will find a warm welcome.

Going from the general to the particular, you will find on the pages from three to seven which follow, stunning articles on the subject of *Selftrade*; and a passionate plea from our former Chairman, Martin White, for all members who use the *Selftrade* service to contact him. If it applies *please do so forthwith*.

Chris Hulme

UKSA - The independent voice of the private shareholder

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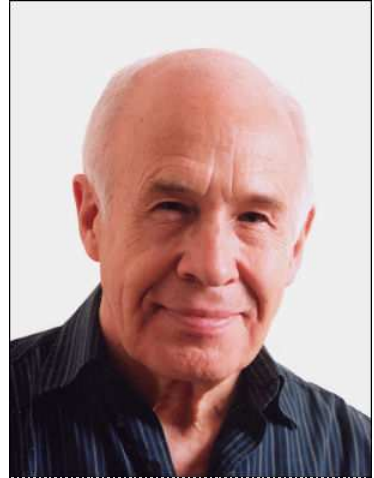
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Prisoners Indeed

Eric Chalker, Policy Co-ordinator

In July 2012, I wrote an article for *The Private Investor* entitled, 'Nominee Account Prisoners'. Some readers may have thought this was over the top, but investors using *Selftrade* have recently discovered that it was all too prescient. Ostensibly to prevent money laundering, *Selftrade* wrote to many of its customers to demand highly personal and intrusive information and threatened to deny access to their investments if they did not comply. Evidently anticipating customer dismay, among the 'Important Information' *Selftrade* sent with its demands were these questions and answers.



Eric Chalker

Can I transfer out or close my account without completing the checklist?

We do require the records review form to be completed. Once we have received the required information, we will be able to facilitate the transfer or closure of your account.

What if I don't complete the form or part of the form?

If the records review form is not completed and the necessary documents are not received, we may place restrictions on your account.

Will you suspend my account if I do not return any of the documents or if I fail to complete the records review form?

We would strongly urge you to complete the form and provide all the necessary information as this will limit the inconvenience to yourself.

As I mentioned at UKSA's recent AGM, the final response quoted is almost identical to the words recently spoken to a newspaper editor in eastern Ukraine (as reported in the *Financial Times*) by well-built men, some in baladavas and carrying baseball bats, when he asked what would happen if he didn't comply with their demands. The threat in both cases is evident and while no *Selftrade* customer is likely to suffer physical violence, to worry about losing access to

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one's investments can undoubtedly be frightening and is certainly annoying.

Apart from the usual personal details, Selftrade asked for type of occupation, industry and country, employer's name, position held, current gross annual income, purpose of investing, total net worth (in bands), the nature of each source of wealth, how much was derived from each source and over what timescale ('details' required in each case). Unspecified supporting documents were required, all to be formally certified in a very specific way. All this information was demanded from existing customers, including one who had not added money to her account for many years.

Such have been the howls of protest (for which just Google 'Selftrade records review'), Selftrade has since modified its demands, but it has not modified its threats. It has in fact hardened them when challenged. What has provoked them?

Why Selftrade has really acted as it has can only be a matter of speculation, but it attributes its actions to its obligations under Money Laundering Regulations 2007. This begs more questions than it answers. For example, how can a regulation issued 7 years ago be responsible for what Selftrade is doing to long-standing customers now? And again, why is Selftrade doing this when other brokers aren't? Regardless of the notional justification for its actions, how can the law allow a nominee account provider, an ISA provider, or a SIPP provider (Selftrade being all three) refuse to allow its customers to take full possession of what is surely their property, namely their investments?

If the law does allow this, something has gone very seriously wrong.

By all accounts, the Financial Conduct Authority, which one would have thought would prevent such apparent misappropriation from taking place, regards it as of no regulatory concern. It says, 'Know your customer,' but if that results in unusual, intrusive and greatly time-consuming questions of *existing* customers that is not the FCA's concern. But that is surely the key point. Would-be customers of Selftrade can decide for themselves whether to provide such information in order to open an account, but when an account has already been opened (which would obviously have necessitated compliance with regulatory requirements at the time) and when nothing has happened to trigger suspicion of money laundering since (which could only be on an individual basis, not across the board), there can be no acceptable reason for subsequently denying full access to customers' property.

Although UKSA is represented on an FCA 'user group' set up to consider shareholders' rights and protections in nominee accounts, it is skating over the

issues rather than addressing them. The FCA has shown commendable readiness – unlike its predecessor, the Financial Services Authority – to deal punishingly and openly with some forms of transgression, but it has yet to show readiness to tackle abusive stockbroker behaviour. Unfortunately, Selftrade is not the only example of this known to UKSA's policy team. It continues to be a major preoccupation for us.

It all comes back to the principal issue: without an investor's own name and address on the register he or she is vulnerable to all manner of penalties caused by the use of intermediaries. These penalties include charges which can seem like rent and even the risk of loss caused by failure of the intermediary. There is a document to be found on the Bank of England's website, issued in the names of over 100 countries including the UK, which enjoins all governments to ensure that investors using pooled nominee accounts in emerging markets have full shareholder rights and protections; that's good for emerging markets, but these safeguards are not available in the UK itself. What hypocrisy! What a disgrace.

Powerful stuff. Not only that but strongly based on what appears to be a gross violation of human rights, not only the rights of investors. And for more of the same read on. **Editor**

My Selftrade experience – and what to do about it now?

By Martin White

Selftrade has long been my favourite stockbroker. It is inexpensive, the service has been good, and it has flexibilities that I value hugely. And I know a number of other UKSA members use them as well.

So why write about it? They have announced that they are being sold to Equiniti, but the terms for the customers, and also the details of the Equiniti service and costs are not announced yet. I suspect they are still being worked on. There is some indication that the Selftrade web service will be ditched and something else given instead. I would be very surprised if what we are given instead will be as good.

What have I liked and not liked about Selftrade, and why? Start with the negative; most important negative is that their management would not talk to me. A couple of times I have approached them to discuss their service and whilst the customer service people have been

encouraging about this, no contact with the management followed. Not a good sign. The other thing is a bug in their “virtual portfolio” service, where some of my index linked gilts were valued at 100 times the correct values!

But overall, these are minor points compared with the advantages. And the reason I wanted to talk to their management was that I saw the writing on the wall for their business model post RDR unless they did something intelligent about their marketing. Selfishly I wanted them to carry on with the service and cost approach they already had! I explained all this to the customer service people and conclude that their management acted stupidly in not coming back to me.

Now to the advantages. Most vital of all, no annual percentage charge on my portfolio. Just something in the region of £50 per year. And that covers holdings in my trading account, my SIPP account, and my ISA account. My SIPP is through EPML, who have links with around 30 stockbrokers / platforms, but at less than £200 per year (again, no percentage charge on the fund), the amount I pay EPML would be greater with any other link than Selftrade, because of the very efficient online access that Selftrade give them as pension trustee. (I also get a discount from EPML because I have arranged SIPPs for my wife and three children with them as well).

More advantages – dealing and flexibility. Perhaps I should list the things that come to mind.

Flexibility in stock holdings – widest possible choice. For example if I can't hold Berkshire Hathaway with a broker, I won't use them, since that is an important core long term holding for me. Alliance, for example, tell me that they are not allowing US holdings any more, and their clients are being forced to get out of them! This is a pity, as I had been planning to recommend my brother to use them as one of his brokers.

Telephone dealing option for illiquid stocks. Readers with a long memory may remember I piece I wrote about Delcam, which has turned out to be my most successful investment. Delcam, an AIM stock (so I had to buy it in the SIPP rather than the ISA), always had a big bid-offer spread and had thin trading – which indicates intelligent long term holders! So I would ring the dealers and state a price and deal size for them to offer to the market makers, and I



Martin White
Former UKSA Chairman

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managed to pick up a decent holding through many small deals. Often the answer came back no deal, of course. You just have to be lucky and find a market maker with some stock on his hands, and they will trade within their published spread. OK, I had to pay more for telephone dealing, but depending on the price saving it more than paid for itself. No deal, no commission, so there was no downside in trying.

Immediate re-use of sale proceeds. Do you know that TD Direct (used to be TD Waterhouse) won't allow you to reinvest sale proceeds immediately? I use TD Direct for an ISA, purely to slightly mitigate the "eggs in one basket" problem with Selftrade. But if I sell something with them, the money is not available to reinvest for a number of days unless you pay an extra charge. This is a complete disaster if I want to act quickly. My style is largely buy and forget, so I trade extremely rarely, but very occasionally I do have an idea and want to carry it out immediately. So TD Direct get even fewer deals from me than they would – my trades with them are just reinvesting dividends, unless I decide that a stock is no longer a long term hold, which happens rarely.

So what to do? In my various enquiries, not that I've done a huge amount of work yet, I've not come across anything as good as the Selftrade service. Others may charge a bit more or less per deal, but that's not a worry – I think it's intelligent to deal as infrequently as possible anyway. I wouldn't mind the annual charge being a bit bigger, but what I would never agree to is an annual percentage of assets charge. I see no basis for giving anyone a rent on my assets. Similarly I regard brokers'/platforms' attitude to "funds" completely indefensible. Why do they deserve to get an annual percentage on your entire wealth invested in "funds"? Hargreaves Lansdown, for example, is trying to get round the principles of the RDR by negotiating reduced charges for their fund customers and limiting the funds they permit – and then continuing to charge their customers a percentage of the amount invested in funds. This is deeply anti-competitive behaviour, and the ultimate consequences could be very concerning.

According to a piece in Money Marketing, Selftrade has around £4 billion of assets and 200,000 clients. Who can they trust to represent them? Nobody – and doing no research will mean they are faced, later this year, with a fait accompli. Interested? We need to act quickly. If you are one of those and might be interested in helping to form a user group of UKSA members, jointly to do research about options and also speak out on the matter, do please signify this to Eric Chalker at policy.coordinator@uksa.org.uk, who will put us in touch.

Barclays plc

Readers may remember that we wrote to Sir David Walker on the 24th February expressing concern about their apparent preference of employees over shareholders. (See UKSA web site) We reminded him that the Companies Act (CA 2006) required the board to put the interests of the shareholders first whilst taking account of the interests of others such as the employees. In response to this, to our surprise, we received an invitation to meet Sir David at his office in Churchill Place in Canary Wharf.

This meeting took place on Monday 7th April and UKSA was represented by Roger Collinge and John Hunter.



Roger Collinge

Sir David started off by expressing general concern that the distance between ordinary shareholders and the companies they invest in had widened in recent years and was continuing to do so. This was due, in part, to the growth of intermediaries between the beneficial shareholders and the companies. This comment was unprompted by us but was, of course, music to our ears.

He then went on to discuss the question of bonuses. He immediately said that the question of the board's obligations under S172 CA2006 was regularly in their minds. He thought that they had been unduly harsh in their view of bonuses in 2012. His reason for this was that they had suffered an unusually high level of senior level staff turnover in 2013 as staff, particularly in the investment bank, had left for better terms elsewhere. Somewhat surprisingly to us this included problems of recruiting compliance officers. The Bank is undertaking a strategic review of its investment banking operations and it clearly feels the need to retain the right staff to ensure a viable business.

He commented that they were "on a journey" towards a lower "compensation ratio" which they regarded as a major aim but which would take time to achieve.

He accepted that some of the retail sales incentives previously offered were wrong and not in the interests of customers and therefore, by implication, not in the interests of the bank or its shareholders. All sales based incentives for UK retail staff had already been removed. He referred to a new Conduct and Reputation committee of the Board which had been recently set up to address some of these areas.

Whilst we recognised that he was constrained by the need not to make price sensitive comments we did suggest that there may be a case for separating investment banking from retail banking so that potential investors would have a choice of investing in a relatively safe, relatively low return retail operation or of investing in a potentially higher return but more volatile investment bank.

We were given a full hour of his time and came away impressed by his approach of seeking progressively to improve the lot of the shareholders whilst we recognised that the board had the responsibility to make hard commercial judgements, some of which we, as shareholders, may find difficult to swallow in the medium term.



John Hunter

On the 9th May - within a month of this meeting - within the context of a strategic update announced to the market, the following statement, which summed up an announcement of major changes in store caused a rise in Barclay's share price.

'As a consequence of these changes, Barclays will become significantly more balanced and in turn able to deliver higher, more sustainable returns through the cycle. The core businesses account for c.£320bn of 2013 RWAs, with the core Investment Bank expected to represent no more than 30% of the Group total by 2016, compared to just over 50% now. Personal and Corporate Banking, Barclaycard and Africa Banking account for the majority of the Group's RWAs in core Barclays. Plans for the Investment Bank will result in gross headcount reductions of around 7,000 by 2016 across core and non-core. The overall 2014 Group gross headcount reduction has been increased to 14,000.'

A month is not a very long time to effect a change of direction of this magnitude so it is clear alas, that although our senior members were absolutely on the right track we cannot claim the credit. Others of course (*pace House of Cards*) may think otherwise, but we couldn't possibly comment!

Bill Johnston

The Persimmon Long Term Incentive Plan

This was announced in September 2012 and approved at a general meeting four weeks later. Alerted by UKSA members (but not, unfortunately, in time to influence the AGM), the UKSA policy group carried out a technical analysis of the scheme. This appeared in *The Private Investor* Issue 161 in November 2012.

UKSA wrote to Chairman Nicolas Wrigley with specific questions and received a courteous answer that evaded all the questions asked.

UKSA wrote to the five leading institutional shareholders with its analysis.

- Only one had voted against the proposal, stating that 'Our voting position was informed by our house view that the Long Term Incentive Plan (LTIP) does not incentivise management to create additional value for shareholders, but is designed to reward management for distributing for distributing existing shareholder value'
- One gave a detailed response supporting their decision to approve the LTIP
- Two gave boilerplate replies
- One did not reply

All replies indicated that there had been substantial 'engagement' with the Chairman and other directors. This raises, once again, the nature and effectiveness (for the shareholder) of such engagement. Major institutions had 'engaged' and come to a demonstrably wrong conclusion. (One found the 'simplicity' of the scheme attractive, which raises a number of questions about the way in which it was explained to them).

This situation will not change until real independent investors are allowed a say in the governance of their companies. UKSA has in the past prepared detailed proposals for Shareholder Committees and continues to support them.

Regulatory

Writing to Vince Cable, Secretary of State for Business (BIS), UKSA drew attention to a major flaw in the LTIP disclosure requirements in Remuneration Reports laid down in the regulations he issued in 2013. Instead of requiring disclosure now of the value in money terms of what has been awarded, the regulation requires the monetary value of LTIP awards to be disclosed only when awards have vested. The Persimmon expense will be reported in 2021. This is a flaw which escaped the notice of those involved in a Financial Reporting Council study on which the new BIS regulations are based. UKSA has

been calling for the study to be revisited and the regulations amended. The Persimmon report, which, in accordance with the regulations, includes precisely zero for the 2012 LTIP in all its monetary figures, is a stark wake-up call in this respect.

Accounting

There must also be questions, once again, about accounting standards. UKSA has campaigned against the damaging concepts of IFRS in the context of the abandonment of the prudence principle and its contribution to the overstatement of bank profits prior to the banking crisis. Here we seem to have a situation where £400 million of distributed value is simply ignored (£250 million plus being granted to current executives below board level, and therefore not mentioned in the remuneration report or anywhere else as far as we can see). To be fair to Persimmon and the reporting standards, the word 'ignored' is an exaggeration. The annual report noted £10.3 million of 'equity settled share-based payment transactions'. So they only missed £390 million.

A spokesman said: 'The analysis simply assumes that the share price in 2021 will be the same as it is today and ignores the inherent challenge in returning £1.9 billion to shareholders, while simultaneously growing the business to deliver an increase in the ex-dividend share price over performance period of almost 10 years. But according to the company:

'This is a long term plan which is designed to drive outperformance through the housing cycle and there remains a very long way to go'

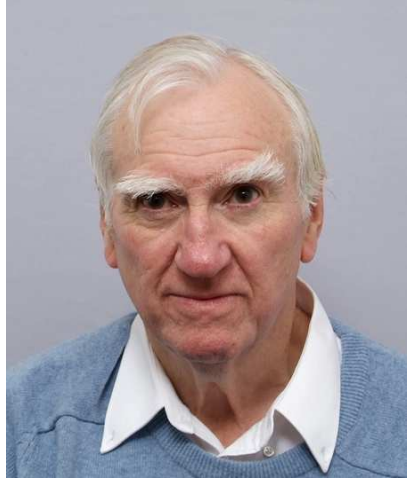
The driving force has been of course the redoubtable John Hunter who, before the LTIP was approved at the Persimmon AGM asked the following questions. What was the nature of the 'consultation' with institutional shareholders? How are the next generation of executives to be 'incentivised' (with another 9% of the company?). Why have the economic consequences of the LTIP been concealed from the shareholders?

In response to a spokesman for the company that the LTIP only creates value for management if they create substantial value for all shareholders *over and above the capital return*. Mr Hunter riposted that the last time he looked at the accounts the key sums were £4.2 billion less £1.9 billion which might fairly be said to leave a balance of £2.3 billion of value already created, and that management now takes 9% of this (£207 million) before they even start on the 9% of anything else they manage to create by their efforts over eight more years with several billion pounds of someone else's invested capital. Ouch!

What is the 'true' value of your shares?

By Malcolm Howard, Finance Director

In March the London branch visited Share plc at which we were told that any share price is determined by supply and demand; if demand exceeds supply obviously the price will go up. Where such demand exceeds supply to a great degree, then the price of the share will rise sharply. This leads to the theory of a 'chart breakout' whose disciples believe that the time to buy a share when its price is so high that it has achieved 'break-out'. What happens then is that investors believe the price will go on increasing forever and for a time it does. We have a classic 'bubble' and those who get out before the bubble bursts make a fortune, while the rest suffer huge losses.



Malcolm Howard
our Finance Director

Around the year 2000 we had the dotcom boom. We were told that the old paradigm of judging businesses on sales and profitability no longer applied; the only thing that counted was 'clicks' on the website. Companies burnt cash, but the punters were taken in by what they were told. If such clicks generated a minuscule profit, then the share price indicated continuous growth of over 100% per cent per annum. Of course all of this was fantasy and the bubble burst.

Even eminent professors were taken in. Gary Hamel, at that time a visiting professor at the London Business School, wrote a book 'Leading the Revolution (first edition)'. The 'revolution' was innovation. Mr Hamel devoted approximately thirty-five pages explaining how one great company was leading the way in throwing out old fashioned concepts of financial control and leading the innovation process. "It pays to hire the best. You can't build a forever restless, opportunity-seeking company unless you're willing to hire forever restless, opportunity-seeking individuals" (page 220). "At (this company), failure – even the type that ends up on the front page of 'The Wall Street Journal' – doesn't necessarily sink a career" (page 218). The problem was that this 'great company' was Enron, which went ingloriously bust.

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So it is wise to test whether a particular share price can be justified. Investors buy shares for either income or growth or indeed a combination of both. To assess companies, we can divide companies into three categories:

- (1) Property companies such as British land and Land Securities. Investment companies such as 3i Group and HG Capital and Brokers.
- (2) Banks and Insurance Companies
- (3) Other, essentially manufacturing, retail or service companies.

Category (1) companies

When you are buying into category (1) companies, you are essentially buying a share of the assets of the business, but often you are in addition getting a dividend. The share price at any one time will likely exceed the net asset value (NAV) per share (equity side of the Balance Sheet divided by the number of shares) to reflect both future growth and the value of future dividends. How much the share price should be above the NAV per share is, of course, a matter of judgement, but any percentage above 50% can be viewed with suspicion. It should also be noted that whereas under UK GAAP the net asset value was calculated cautiously, now under IRFS the opposite is true. For example, under UK GAAP 3i plc valued its illiquid assets (private companies where shares are not traded) under a year old, at cost, now it has to calculate 'fair value'.

Category (2) companies

Banks and insurance companies are extremely difficult to assess, as both get involved in gambling to some extent. Banks get involved in investment activities that can either generate huge profits or huge losses, while insurance companies cover events that could be described as an Act of God that can never be predicted with accuracy. This, of course, is a great deal different than bookmakers who calculate the odds on a single event and always ensure the odds are in their favour.

Category (3) companies

Shares in these companies are bought for either income or growth, or a combination of both. Companies that are stable and do not grow, but provide a steady dividend are bought for income. Here investors should be getting a dividend yield of at least four percentage points over base rate, so currently the dividend yield should be a minimum of 4.5%. When interest rates increase, then the price of an 'income' share will likely fall to reflect this change.

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In my view, the most interesting category is trying to assess growth shares. To assess growth I assume all the cash earnings are available for distribution; I then add in growth rates and apply a discounted cash flow at the rate of 12%. A total discounted value of zero at the applicable growth rate applied gives me the growth rate built into the share. If I believe the potential growth rate is greater than that built into the share price then I conclude the share is a 'buy', the other way round, not so.

The table below illustrates:

Annual Growth built into share (%)

| EPS (p) | 0 | 5 | 10 | 15 | 20 | 25 | 30 | 40 | 50 | 100 |
|---------|-----|-----|-----|-----|-----|-------|-------|-------|-------|-------|
| 1 | 7 | 9 | 11 | 14 | 17 | 21 | 27 | 42 | 66 | 542 |
| 2 | 15 | 19 | 23 | 28 | 35 | 43 | 54 | 85 | 133 | 1,085 |
| 4 | 31 | 38 | 46 | 57 | 70 | 87 | 109 | 170 | 266 | 2,171 |
| 5 | 39 | 47 | 58 | 71 | 88 | 109 | 136 | 212 | 332 | 2,714 |
| 10 | 79 | 95 | 116 | 142 | 176 | 218 | 272 | 425 | 665 | 5,429 |
| 25 | 187 | 238 | 290 | 356 | 440 | 547 | 681 | 1,064 | 1,663 | |
| 40 | 316 | 381 | 465 | 570 | 705 | 875 | 1,090 | 1,702 | 2,661 | |
| 50 | 395 | 477 | 581 | 713 | 881 | 1,094 | 1,363 | 2,128 | 3,326 | |

How to read the above table

Firstly calculate the 'Effective Earnings per share' (EEPS). Take the 'Cash Inflow from Operating Activities' (found on the Cash Flow Statement) before 'movement in working capital' and divide by the number of shares. In other words, to calculate the 'Effective Earnings' you add down the cash flow

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statement ignoring those lines that relate to movement in working capital. The EEPS should be greater than EPS; if not this is an indicator that there may be a problem somewhere and more research needs to be carried out.

If, for example, the EEPS is 24p per share and you believe that earnings are growing year on year by 10%, then read down the 10% column viz. 10p = 116p, 10p = 116p, 4p = 46p, 24p = 278p indicates the price of a share with EEPS of 24p, growing at 10% pa.

If, as another example, the EEPS is 11p per share, but this is a high growth company growing at 30% year on year, then: 10p = 272p, 1p = 27p, 11p = 299p indicates the price of the share with EEPS of 11p, growing at 30% pa.

It can be seen from the above table that when a company is growing at a very fast rate, then its share price zooms up. The problem is that when actual growth does not quite meet the dizzy heights projected, then the share price will likely crash.

The above methods can give you a reasonable idea as to where the price of a share should be, but, of course, like everything else cannot be described as perfect and can only give an indication. However, where the share price is more than double than that calculated, as above, it is possible you are looking at a 'bubble' stock.

UKSA really ought to present an honorary award to Professor Chris Bones of the Manchester Business School, who, talking on the Today programme had this to say:

'I do think the government could make a significant difference by dealing with the real distortion that... that the change in share ownership in the last 20 years has made and that is because ultimately the people making the (decisions) are people dealing with your money and my money but they're not talking to you or me and they are not investors, they're administrators. These fund managers will make decisions on the back of what they see as their interest, no doubt fuelled by whatever their incentive schemes are. They're not necessarily making the decisions that we whose money they put in would make.

"The government would really be advised to start going away and doing what it didn't do after the Kraft deal, which is to look at how you reassert the primacy of the individual who owns the capital rather than the person who is the administrator.'

Come to think of it, UKSA doesn't have an honorary award to give. Perhaps we should. Too bad that the order of The Golden Fleece already exists.

Quis custodiet ipsos custodes?

Readers of FTMoney, the Saturday supplement aimed at private investors, may remember an unusual article early this year which opened with these words: *Do you know who your share custodian is?* They were written by Norma Cohen, under the headline, *Where the customer definitely isn't king.*

I began to study this subject towards the end of last year. As Ms Cohen added, it is very little understood. Most of us probably taken little notice of what our nominee account provider chooses to tell us about its use of custodians and most of us probably assume that there is no reason to be at all concerned. After all, everything is regulated by the Financial Conduct Authority (FCA) isn't it? This, not surprisingly, is the view of the FCA itself, but whereas that might reassure *some*, customers of Selftrade (as reported elsewhere in this issue) might not feel so confident that all is well.

Custodians are employed to hold securities in their own names where the beneficial interests (the right to a security's value) belong to others. This is true of all investors using pooled nominee accounts, which includes all ISAs and SIPPs, but are also used by pension funds and other major investors, either for convenience or to conceal their interest. With the inevitable growth of electronic means to handle ownership and transfers of securities, it has become a substantial industry upon which the world now depends. Even so, it appears to be only recently that the associated risks of what are known as "intermediated securities" have begun to be properly recognised.

Two months ago, the London School of Economics law department ran a full day conference on the subject of intermediated securities and investor rights. Together with past UKSA chairman Martin White, I attended this event and learned a great deal. The day began with Professor John Kay, followed at half-hourly intervals by eleven experts on various aspects of the subject, covering a great deal of ground. It became evident that, notwithstanding regulation, intermediated securities do carry risks.

I also initiated a number of enquiries, principally among UKSA members who attend our company visits. This produced some very helpful material, not all of which I could study in full detail within the time available, but I was able to produce a paper for consideration by the FCA User Group set up to consider investor rights and protections in nominee accounts. My conclusions are still a work in progress so I have not made the paper generally available, but copies have been sent to those who kindly helped my research.

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The Law Commission is currently studying the concept of "fiduciary duty", as it is or might be applied to intermediated securities. A submission has been made on behalf of UKSA, but I am also informed that among other submissions received by the Law Commission there are *"concerns about custodians not paying enough regard to the interests of ultimate owners of the assets held in custody"* which *"seems to be the result that the system produces."* The study was requested by Vince Cable, as suggested by the Kay Review. At the moment, as Norma Cohen reported, investors have no rights against their custodians, only contractual rights with their account providers which, as Selftrade has shown, can disappear in an instant.

Custodians are not without blemish. Earlier this year, a major custodian was fined £23m by the FCA *"as an example of a firm that has acted with complete disregard for the interests of its customers,"* judging it to have *"significant failings in culture and controls"*. It was its transitions management business that incurred the penalty, not its custodian activities, but its clients *"include large investment management firms and pension funds holding the funds and savings of retail investors."*

What are the potential risks of having one's assets held by a custodian? I have seen them defined as insolvency of the custodian, errors, poor administration, mismanagement, fraud and negligence in its operation. An article in The Pensions Management Institute newsletter in July 2011 began by stating, *"..... custody is not a risk-less activity...."* and reported that, *"One major UK corporate pension fund (had told) a conference in London.... that the insolvency of its custodian was the third highest risk on its list of risk exposures...."*

Custodian risks are not negligible. Two online articles by *The International Investor* explain the position quite nicely, to be found here <http://the-international-investor.com/investment-faq/stock-broker-account-safety> and here <http://the-international-investor.com/investment-faq/international-investor-protection-rules-compensation-scheme-limits>. The following paragraphs are taken from the first of these, after describing how account segregation is meant to protect investors' interests.

"Segregation is effectively an honour system, where the broker is expected to do the right thing and keep client and firm assets separate. In some cases, regulators and exchanges will be checking up on their holdings regularly, but obviously they can't keep an eye on what's in which account all the time. So the system is open to fraud and abuse. If your stock broker decides to sell or move shares from nominee accounts, they will be able to do so.

"And of course, fraud like this is most likely to happen when the firm is on the edge of collapse, needs cash or assets to meet its own liabilities and the

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temptation to 'borrow' client assets for a while to tide them over becomes too great – or simply when the management decides it's time to loot client assets and retire somewhere with no extradition treaty. So the point at which segregation is likely to offer no protection is just when you need it most.

"It's also worth being aware that even if there hasn't been deliberate fraud, when a stock broker collapses its records often turn out to be shaky. So establishing which clients own what in the nominee account may take a lot of work and assets may sometimes turn out to have been misplaced in the turmoil. So while the industry often presents segregation as the thing that guarantees the safety of your investments, it's nothing of the kind. The safety it offers is limited and the system is close to being the absolute minimum that could be accepted, rather than added protection for investors."

An investor using a pooled nominee account has no way of knowing whether the number of shares held by his or her custodian is equal to the number that should have been purchased by the broker on behalf of all its clients. The experience of some investors with whom I have been in contact strongly suggests that the numbers do not always agree. In one instance there was an admission that an investment had been temporarily 'lost'; this was for an institutional investor not an individual, but only an institutional investor is likely to be in a position to check its holdings. In another instance, a bond issue being redeemed by the issuer, held for a private investor by two separate custodians, resulted in immediate redemption by one but a 17 day delay by the other, with no credible explanation for the difference.

For all investors using ISAs and SIPPs, but also for many others who are unable to find a broker offering an alternative, there is no escaping the use of one or more custodians for holding their investments. With paper certificates, or the use of sponsored Crest accounts, the only risk is the company in which money is invested and it is to a large extent a visible risk, but when forced to use pooled nominee accounts to hold those investments the risks are multiplied and largely invisible.

Every time people see reasons to distrust the financial services industry, they are less inclined to place their savings with it. Some of Selftrade's customers worry that its current demands are a camouflage to disguise the fact that their investments are not safe. How can investors be protected from behaviour like this and know that their investments are both safe and accessible? These questions are an aspect of the nominee issues which UKSA's policy team is trying to persuade authorities such as the FCA to address, but it is not an easy task. In the mean time, we must trust that nothing really bad will actually happen.

Eric Chalker, Policy Co-ordinator

Other News

We are indebted to Frank Hayes, an UKSA member, for discovering a paper published by an organisation called IOSCO. This is the International Organization of Securities Commissions, a body which is supported by over 100 governments including that of the UK. You can be forgiven for not being aware of it, because neither was the UKSA policy team!

The paper Frank discovered bears the reference IOSCO^{PD}362.pdf and it can be found here: http://www.financialstabilityboard.org/cos/cos_111001b.htm. Published in October 2011, it was a product of the Emerging Markets Committee of IOSCO. Its subject was the Regulation of Nominee Accounts in Emerging Markets. Remarkably, it places great emphasis on the need for shareholder rights to be fully preserved even when assets are held in pooled nominee accounts, far beyond what is available to investors in the UK. As Eric Chalker said when quoting from the report at the recent UKSA AGM, there can be no justification for giving UK investors fewer rights and protections than our own government wants for investors in emerging markets.

UKSA's policy team continues to assist the work of the Financial Reporting Lab. As readers will no doubt recall, this is a department of the Financial Reporting Council set up to foster good reporting by companies to their shareholders. In the March issue, we carried a report by Thomas Toomse-Smith of the response by UKSA's members (168 of them, I hear) to an online survey which UKSA's policy team helped to devise. That project, now entitled Corporate Reporting in a Digital Word, is targeted for September.

UKSA has now been asked to assist with preparation of a second survey, which is currently in hand. This concerns how narrative information is presented on financial matters, with the idea of improving this type of reporting. This may seem to be of more specialist interest, but all investors are affected by the financial narrative, of course, so all members with email will be invited to complete the survey, online and anonymously. It is likely to be circulated early next month.

A third Lab project concerns companies' dividend policies. This is likely to be of great interest to UKSA members. The policy team was consulted on its terms of reference, but thinks they are too narrow because they do not explicitly embrace what can be competing claims on cash, such as capex, acquisitions, buybacks and pension commitments. Members are likely to have an opportunity to express their own views on the matter some time in the summer, possibly as a focus group, so those interested should notify Elizabeth Baxter over the next 4-5 weeks.

Bill Johnston, Editor

Letters to the Editor

Dear Sir,

In the debate over whether the fate of AstraZeneca should be decided solely by its legal owners, the shareholders, there ought to be room to consider whether the *beneficial* owners will have an adequate say. If a takeover proceeds by a scheme of arrangement, they will not.

Many private investors in the company will be in pooled nominee accounts, some compulsorily so because their investments are held in ISAs and SIPPs. Some account providers may give them all the necessary information and the opportunity to vote, but others will not. Astonishingly, the Takeover Panel declines to be interested in those who are excluded, despite its "*central objective*" being "*to ensure fair treatment for all.*"

Schemes of arrangement, recommended by a company's directors, are settled by a vote for which the High Court does not require any minimum participation. Future ownership of the whole equity is decided by a simple majority of shareholders actually voting, holding just 75% of the shares voted. The system is therefore biased towards the big shareholders, many of which will have used other people's money to buy the shares. It favours those whose objective is capital gain, which may be short term, against those who need a long term home for their savings and a reliable source of income.

The government could remedy this bias if it wished. We think it should.

Eric Chalker

Dear Sir,

Matters of corporate governance are again to the fore, with the recent disaster in the governance of the Co-op Group never out of the news in the last few months, and there are plenty of other issues for the shareholder to be concerned about such as the G4S and the Serco contracts.

I doubt it would answer all of our concerns, but this and Eric Chalker's article in the last PI reminded me that the UKSA has been promoting the idea of shareholders' committees to bring in the views in particular of those shareholders who are disenfranchised because their shares are held through nominees for one reason or another.

Following a long period when Alliance Trust seemed to have lost its way, owing to a weak chairman and an overbearing CEO, in my opinion, I put forward a proposal to Alliance on behalf of UKSA that they might consider a shareholders' committee. The approach was of course agreed with the UKSA

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beforehand. I had a face to face discussion with the Company Secretary who replied some time later to say that my proposal had been considered by the Directors but that 'they were not minded to move towards establishing a shareholders' committee at this stage, although they would keep an eye on developments both in the UK and other jurisdictions'. That is by no means an outright rejection.

This is a subject which I think could be resurrected, but it needs a good relationship with, and an open and listening attitude from, the company. Directors do not like this sort of outside 'interference' but I think if we can show that this idea is gaining ground both here and abroad, it is only a matter of time until some company introduces it.

It occurs to me, however, that this, on a somewhat larger scale than I envisage it, is just what the Co-op Group has got. Look where that has got it!

George Miller

Dear Sir,

As someone who prefers to buy and sell shares in traditional way, I was somewhat surprised to see how much it would cost to replace a lost share certificate.

To give you some idea of the costs, Equiniti Share Registrars will require you to complete a Letter of Indemnity form and pay an Administration fee of £42 for any shares worth more £100.00 or above. If you are unable to meet the requirements of the indemnity, you need to pay a Countersignature Fee. This uses a sliding scale of costs, which can start free of charge for shares worth up to and including £50.00 and £222.08 + Application form for over £30.000 up to and including £50.000. They are unable to provide countersignature if the shares are valued over £50,000. If you take an average share transaction of say £10.000, it could cost you an Admin Charge of £42 plus Countersignature Fee of £53.28 = £95.28, this maybe more depending on the individual circumstances.

I feel the charges made are very high, for what would appear to be not a great deal of work. My major concern is when you initially buy the shares through a stockbroker; the stockbroker is not liable for any loss when sending the certificates through the post to your address. I contacted Equiniti about my concern, and was told that you would still have to pay for the costs of replacement. I also asked my stockbroker, if when I make a share purchase, would they send the certificates by special delivery and that I was willing to pay for this. They declined to offer this facility. In other words, you will liable to meet all costs of obtaining a replacement, even if you are not to blame!

William Beech

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 7731 5942 or email harrybraund@yahoo.co.uk

Within this region there is a separate Croydon and Purley Group which meets in Croydon, usually on the second Monday 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 834486 or 07712 591032 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 834486 or 07712 591032 or petertwilson@dsl.pipex.com

SCOTLAND

For information on Scotland please contact Mr George Miller at g.miller1010@btinternet.com

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 Brian Peart, 01388 488419.

NORTH-WEST & NORTH WALES

For details of events, please contact D. L. King, 01829 751 153

Board Report – Company Focus Groups

Thank you to the members who attended our recent Annual General Meeting at the RAF Club in London, despite the traffic disruption caused by the Tube strike. One significant topic was that of fundraising and the amount of effort which has been expended to date and which the Board has been considering in some detail in the year to date.

In recent years some members have, at their own time and expense, attended meetings to help companies provide better information for their shareholders, for example helping format the supplementary/ abbreviated corporate reports.

To better serve those members and UKSA as a whole, the Board feels that to help conserve resources and better protect members (and UKSA) that it is right to take a decision that UKSA will only provide focus groups on behalf of companies who have become corporate members of our organisation. As well as members having the satisfaction that they have generated income for UKSA, they will have the advantage of knowing that under the provisions of corporate membership they may be protected from possible litigation as a result of anything they might have said. This does of course bring a level of governance into the remit for UKSA which I will direct and will engage with companies firstly wishing to become corporate members of UKSA and then onward in terms of working groups to assist such companies.

Should any member feels there are certain companies in which they invest or with whom they have a close relationship with that would benefit from corporate membership of UKSA and could be helped produce better information and communication to shareholders, please let me know.

Chris Hulme

Smiths Group

On 2nd June in London the Investor Relations Director of one of Britain's foremost engineering groups is making a presentation to UKSA members in London.

The X-ray scanner and medical equipment maker only last week unveiled weaker revenue as tough trading in its detection and medical businesses spoilt a good performance at its John Crane energy services operation.

Smiths said underlying revenue in the nine months to May 3rd would be slightly lower than in the same period a year ago due to issues in detection, which makes security scanners for airports, and medical, which makes surgical devices.

It added: "The full year outlook for headline operating profit is in line with expectations for all businesses except Smiths Detection, where profitability is now expected to be £25 million lower due to a combination of working capital adjustments, reduced volumes and contract mix on lower margin contracts and extra costs."

John Crane, which supplies seals, bearings and other mechanical products to oil and gas majors, increased revenues and is achieving record orders due to strong demand particularly from oil refining customers in the US, Middle East, Asia and Brazil, although its business serving oil producers was facing headwinds.

Smiths still expects the annual outlook for its medical business to be below that of a year ago, as previously guided, although it continued to anticipate a stronger trading performance in the second half than the first.

Smiths Detection faced further challenging trading conditions during the third quarter. Underlying revenue declined in the nine months primarily reflecting weaker demand from cargo screening and transportation, albeit against a strong comparator period.

For forensic examination of these and other issues confronting the group do not hesitate to contact Phil Clarke (07941 834583, pjeclarke@tiscali.co.uk)



**Smiths Group -
6-month share-price graph**