

Press Release

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UK Shareholders Association
BM UKSA
London
WC1N 3XX

Phone: 0870-70-60-600
Email: uksa@uksa.org.uk
Web: www.uksa.org.uk

How Much are the Shares in Northern Rock Worth?

Recent comments in the press suggest that the bidders who have approached Northern Rock may attach zero value to the shares. Even the Virgin consortium's offer is rumoured to involve heavy dilution of existing shareholders. Should shareholders take those reports at face value, or is this more likely to be a case of the bidders trying to lower expectations?

The UK Shareholders Association (UKSA) cannot give investment advice and neither do we think it wise to try to put any valuation on the business at this time. But we would like to point out a few salient pieces of information to try and stop the current speculation about valuation.

Firstly, it is impossible to attach any financial valuation to the business of Northern Rock without having up to date financial information, and a view of the current and prospective cash flows. Only Northern Rock management have such information, and those bidders who have been allowed access to the books. But until such information has been released and the bidders attach details to their proposals, it would be unwise to jump to any conclusions.

Clearly though the problems of Northern Rock stem not from a lack of profits, or a deficit in assets but from a temporary cash flow crisis. The last relevant announcement by the company (on the 14th September) indicated that profits would exceed £500 million for the current year and it has been stated elsewhere that the assets exceeded the liabilities. Although the exodus of depositors due to the panic thereafter will no doubt have impacted prospective profits, as will the reliance on more expensive funds from the Bank of England, it is worth pointing out that these impacts may be only temporary or short term.

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Businesses are valued ultimately on their long term cash flows over several years, so just because there is a temporary erosion of profits and assets does not mean that the equity in the business instantly becomes worthless.

But of course, there is the issue of funding. If the £13bn of money from the Bank of England, cannot be refinanced then the company could be forced into Administration by the Bank of England. Would the Treasury really consider that as a sensible step? This would dilute competition in the mortgage market to the detriment of consumers as we highlighted in our previous press release.

A business that cannot get past a cash flow crisis is certainly worthless in most cases so far as the ordinary shareholders equity is concerned, simply because the break-up or liquidation value of the assets is much less than when the business is valued as a going concern. But Northern Rock has already passed this cash flow crisis.

Ways to replace the funding currently supplied by the Bank of England needs to be examined. This might be achieved from Northern Rock's own resources by gradually running down its mortgage book until the Bank of England loan is repaid. This would only require the liquidation of around 12% of the mortgage book and could be probably be achieved in around 6 months as interest is paid on mortgages and the mortgages are redeemed. How would the bidders replace the Bank of England funding? This is not clear. In fact some have indicated that they would probably need it in place initially. Alternatively they might obtain funding from other sources but it seems pretty clear that they need third party assistance and are not promising to fund it from their own cash resources. Well if the bidders can obtain third party funding secured against the assets held by Northern Rock, so can Northern Rock itself. It appears these bidders are simply seeking to acquire a valuable business at close to zero cost. The losers will be the thousands of loyal shareholders and staff.

UKSA has always argued that the best way to maximise value for shareholders is to ensure the business is first stabilised and medium term funding requirements ensured before any attempt is made to attach a value to the business. We therefore encourage the directors not to rush to the altar based on a proposal of marriage from some so called white knight, but to take their time to consider all the options. Thankfully that is exactly what the directors seem to be doing.

For further information, please contact:

Roger Lawson, Communications Director
Telephone: 020-8467-2686
Email: roger.lawson@btclick.com

About the UK Shareholders Association (UKSA)

UKSA is the leading independent organisation which represents the interests of private shareholders in the United Kingdom. We campaign to protect the rights of shareholders in public companies, and to promote improved standards of corporate governance. Our educational activities, regular regional meetings, company "analyst" meetings and the resources of our web site, help to inform the public on investment management. UKSA is a "not for profit" organisation which is financially supported primarily by its individual members.

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