

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 8 and Notice of Meeting for Shareholders

This note is being issued to bring shareholders up to date with the latest news, and to give you some comments on the events. Inevitably, some of the reporting in the national media has not given a full picture and we need to give a fairer view to shareholders.

The Bidders

The company has received approaches from three different organisations concerning possible bids – J.C.Flowers, Cerberus and Richard Branson's Virgin Group. In the last announcement by the company, it suggests that these talks are "preliminary in nature" and the company is also seeking proposals from other parties. In addition they have appointed The Blackstone Group as their third corporate advisor alongside Merrill Lynch and Citigroup.

The company states that the current "strategic review" will be completed by February 2008, which was the date mentioned in the recent Treasury Select Committee hearings for when the Bank of England and Treasury are expecting some resolution of the funding issue.

It is clear that the company is not rushing to consummate any proposed deals and we are glad to see that is the case as we have argued since the crisis first arose that it would not be in shareholders' interests to rush these matters.

Media Comment

Unfortunately the bidders appear to have been prompting press speculation about the value the bidders might attach to the existing ordinary shares in the company. For example the Daily Telegraph ran an article headlined "*Rock suitors offer nothing for shares*" on 14/10/2007 apparently based on comments by the bidders to the Government. Also Ms Gadhia of Virgin Group was reported in the Northern Echo as saying that the bank's shares were overpriced on 22/10/2007. We have submitted a complaint to the Takeover Panel as we believe that a false market is being created in the shares of the company by such comments (contrary to General Principle 4 as laid down by the Panel), but so far they don't seem to be of a mind to accept our complaint.

One cannot speculate about the motives of the bidders but clearly it may be in their interests to lower shareholders expectations of any offer they may subsequently care to make.

Latest Funding Position

On 1/11/2007 the BBC reported that Northern Rock has now borrowed £23bn from the Government and generally appeared to suggest this was a major problem and also unexpected. The BBC's web site says that the firm will possibly have borrowed "*a staggering £30bn from the Bank of England*" by year end. Although this is a large figure, it is not unexpected because we know Lloyds TSB were looking for guarantees on that kind of figure before even the bank run took place, and in the meantime the money markets still seem to be frozen so more short term funding might have become due for replacement. But as indicated below, this is not a problem for the Government or the Bank of England at all. Presenting this kind of news in a somewhat hysterical manner does the company no good and will hardly assist in re-establishing the confidence of depositors and others in this company, which is badly needed.

Why the Funding is Not a Problem

A more sober appraisal of the situation was made in an article by Tim Congdon in the Financial Times on 2/11/2007. He asks "*what is the rush*" to end the company's reliance on government support. He points out that from the known historic assets and profits, even if the company is paying a penal rate of interest on the funding from the Bank of England (rumoured to be in the range of 6.75% to 7.00%), it should be able to repay the existing loans in due course without difficulty.

It might have some exceptional costs this year because of that high rate of interest and for other reasons, but that will not destroy the underlying assets. In the first half of 2007 the company generated over £500 million in cash from operations and at period end had a surplus of £2.3bn of retained shareholders equity – that's equivalent to 550p per share in case anyone is wondering what a realistic share price might be). What is the justification for the valuations some people are attaching to this business?

There has been no obvious degradation in the quality of its assets so one wonders as to what the potential bidders are bringing to the party to enable them to pick up these assets at an enormous discount to their apparent value. As we have previously pointed out, if all the bidders are doing is arranging funding from third parties secured against the assets held by Northern Rock, then the company can do that itself.

The FT article also pointed out that the BofE funding is no real expense to the Government or to the taxpayer as effectively the Bank of England can supply this funding at almost nil cost (the BofE can create "money" in effect). Indeed the BofE will in reality receive possibly £2bn a year in interest which will reduce the Government's budget deficit by that amount. The article ends with this comment: "*The more time the various players are given to think, the better is the likely outcome for everyone*".

But the Interest Rate is Too High

But our concern is that having been the cause of some of the problems experienced by Northern Rock, by its failure to ensure market liquidity, and thereafter prompting a run by depositors, it is inequitable that the Bank of England and the Government should be profiteering to this extent. We would like to see the interest rate reduced to a more reasonable level.

Status of our Campaign

Note that UKSA has so far written to the ten thousand largest shareholders on the share register of the company and more than two thousand responses have already been received with more coming in daily. The volume of responses has exceeded our expectations which is why it has taken longer than we would have liked to respond to some inquiries. In addition some nominee operators have circulated information to beneficial owners of the shares (i.e. to those people who are not on the share register as they do not hold the shares in a certificated form or as a Personal Crest member).

Note that writing to shareholders on the register is important because we can be certain they will have the right to vote – and any bids for the company will almost certainly be subject to a vote of shareholders. UKSA has campaigned for many years to “enfranchise” shareholders in nominee accounts and there were some provisions included in the new Companies Act recently as a result. However this may not necessarily apply to shareholders who hold shares in a nominee account – we suggest you talk to your nominee operator if you are in doubt about this, or switch to one of the other forms of shareholding if you don't get given the right to vote.

However the response to our appeal for funds has been somewhat disappointing. Many contacts seem to not appreciate that UKSA is a mutual association with very limited funds to finance this kind of campaign. We do not have any paid employees and the directors and members of your committee for this Action Group do not generally claim expenses. Your committee members no doubt do not mind spending a lot of their spare time on this campaign, but it costs money to run this kind of operation – for example we have spent over £7,000 already. We do need your financial support if we are to achieve something worthwhile so please donate if you can. The Appeal Form is on our web site at: www.uksa.org.uk/Northern_Rock_Appeal_Letter.pdf

Meetings for Shareholders

UKSA has arranged two meetings for Northern Rock shareholders:

On Monday the 26th November at 1.0 pm at the Royal Station Hotel, Neville St, Newcastle-upon-Tyne, NE1 5DH.

On Wednesday the 28th November at 10.30 am at St.Columba's Church, Pont Street, London, SW1X 0BD.

All shareholders are welcome, but if you plan to attend either venue then please let us know by sending an email to uksa@uksa.org.uk so we can get some idea of likely numbers of attendees (make sure you advise which venue/date).

These meetings will enable you to ask questions and discuss what you would like our Action Group to be doing. We will also explain what we have done to date and why. Plus we have invited someone from Northern Rock to attend.

Yours sincerely

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