

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 10

The latest news with some comments thereon is as follows.

Olivant Proposal

The deadline for “expressions of interest” to be received by the company for all or parts of the business is today (Friday the 16th). This is not a deadline for bids. In the meantime, Lugman Arnold of Olivant has expressed interest in taking over executive management of the company and would subscribe for new shares as part of the deal. I and another of your committee members met Mr Arnold this week and we were favourably impressed although we do not as yet know the details of his proposition. Mr Arnold formerly worked for UBS and helped to turn round Abbey National when it was in some difficulties.

Our view for some time has been that there are unlikely to be any bids for the company that are acceptable to ordinary shareholders, and Mr Arnold seems to agree. The major difficulty that any bidders have is replacing the funding from the Bank of England, and rumours suggest that they might require the Bank to continue such funding, and even waive interest on the debt for a period. If such funding is to remain in place, why should shareholders sell to a third party? Even a partial disposal of assets seems questionable in the current financial climate.

Unsurprisingly perhaps, the company, the Treasury and the Bank of England now seem to be realising that the probability of achieving any deal that enables full repayment of the funding by the widely quoted deadline of the “end of February 2008” is unrealistic. In a letter from Governor Mervyn King to Rosie Cooper MP he says “There is no firm deadline for the provision of the loan” but goes on to say only that “Northern Rock does, however, need to have a viable plan for its future soon”. Meanwhile the company has asked a major corporate law firm to look at the issue of European rules on state aid and the Treasury is also consulting another firm on the issue according to a report in the Daily Telegraph. Mr Darling, Chancellor of the Exchequer, has simply said that “we have got to reach a situation in the next few weeks where it is clear what is going to happen to Northern Rock”.

Our view is that the company may well be going through a process to convince the Government that it is looking at all the options, and taking the utmost efforts to find a solution. But at the end of the day, they will need to put to the Government that the options are quite few – and the best one is probably to aim for repayment in a well-managed, phased process under a new management team.

The Information Memorandum Forecasts

The "information memorandum" issued by the company to drum up offers was apparently widely leaked and the most interesting data in there were some profit forecasts. It suggests that profits will fall to £143m in 2008, but recover to £643m by 2010 (source the Financial Times who published this information). Now some press commentators have said these figures are optimistic, but they no doubt have been honestly estimated by the company. Even taking these figures with a pinch of salt, it shows that the future profits will be very substantial given reasonable assumptions.

Why Should Shareholders Approve Any Disposal?

Given the forecast profits, why would shareholders wish to sell their shares to a third party? The current share price seems to reflect more the uncertainty of what might happen than being based on any future profit forecast or examination of the assets. Will the Government pull the plug on this company by withdrawing its funding? It would seem unlikely because that would destroy the business (a politically difficult outcome in the North East) and probably not help the Government to get its money back quickly, if at all.

But will the directors recommend a deal that substantially erodes shareholder's equity in the business simply to help the Government get its money back sooner? On the latter point, shareholders are reminded that any sale or substantial disposal of assets will require shareholder approval under the Stock Exchange Listing Rules. There is no easy way around this, and with private shareholders holding a substantial proportion of the shares (and hence the votes) in this company if we campaigned against an inequitable proposition I think even the recommendation of the directors might not get it through, particularly as other major holders seem to share our views.

We suggest that it is time for both the company and the Government to face the reality of the situation rather than grasp at the faint hope of some resolution from a third party. There is no "quick fix" available to the problems of Northern Rock and it is silly to look for one.

Enabling the Bidders to Make Enormous Profits at the Expense of Shareholders

The worst, and most outrageous, scenario as far as shareholders are concerned would be a situation where the Government forced disposal of all or parts of the business while continuing to provide funding or guarantees to the bidders. Why should the Government enable third parties to make enormous gains in due course (as Northern Rock is clearly going to be worth a lot more in a couple of years time than the current market capitalisation) at the expense of current shareholders? This would be totally unacceptable and unprincipled in our view.

Meetings for Shareholders

To remind you, 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 and 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.

UKSA is also exhibiting at the Invest 07 conference this weekend (17th/18th November) in Epsom so you can also come and talk to us there if you care to do so – go to <http://investshow.co.uk> for information and to register as visitors.

Yours sincerely

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