

To Northern Rock Shareholders

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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

Northern Rock Shareholders Action Group – Update No. 2

This note provides an update to Northern Rock shareholders on news related to the company, and what we have been doing to represent your interests.

Latest News

From several press reports it is clear that the company has received a number of approaches for the business from organisations such as JC Flowers and Cerberus. Obviously, as is normal practice the directors of the company will have to talk to these people and consider any offers they might make. Other press reports suggest that the company has drawn down over £10bn in funding from the Bank of England although neither the company nor the Bank of England have confirmed this. Comments suggest that unless money markets become more open, the company might require up to £20bn from this facility as other funding becomes due for renewal. A positive item though was a report that Citigroup may be willing to lend up to £10bn although probably at a rather high rate of interest linked to the inter-bank lending rate (Libor).

Funding from the Bank of England is rumoured to be at an interest rate of over 7% and this will erode Northern Rock's profit margins, unless alternative funding at lower cost can be found or the rate negotiated down.

Another positive item was from ratings agency Fitch who have just issued a note saying that there were no "issues regarding asset quality or solvency" and suggesting that there was no reason why the business or assets should be sold cheaply. In addition Philip Richards of RAB Capital who have been buying the stock recently was quoted by Bloomberg as saying "This is a bank with a good-quality book of mortgages. The best situation is that it's allowed to continue as a business and recover. And if it's allowed to recover, then it's realistic to have a share price of six pounds".

Other analysts have however expressed caution, and it is simply probably wise to say that the outlook for the company is uncertain unless confidence is re-established in the business, and adequate funding provided over the next few months. Unfortunately UKSA cannot give investment advice or recommend whether you should buy or sell the shares. But UKSA will continue to oppose any disposal of the business in a rapid process as that is unlikely to maximise the value to shareholders – we believe, as others do, that the company needs to be stabilised and confidence re-established before any disposal is sought. If a fair price, looking at the longer term prospects for the business, cannot be obtained, then the business should not be sold.

In essence Northern Rock is a good business. As Philip Aldrick said in the Daily Telegraph "The bank has none of that toxic sub-prime debt. Default rates are 0.47%, roughly half the industry average, and the average loan-to-value ratio is a conservative 59%." He also pointed out though that any potential buyer of the business might face short term losses as much of the banks funding may be at higher rates than its typical mortgage yield of around 6%. And Credit Suisse estimates that if the assets were sold for anything less than 98% of book value, this would wipe out Northern Rocks £2.35bn of net assets – leaving both shareholders and bondholders with a loss.

Northern Rock Foundation

One organisation that has a major interest in the future of Northern Rock is the Northern Rock Foundation. This was created when the company demutualised in 1997, and they receive 5% of the profits of the company each year. The money is used for social purposes primarily in the North East of England and supports many charitable activities and organisations. The Northern Rock Foundation would receive 15% of the consideration if the company was sold under the terms in the Articles, but that would not necessarily apply if the company went into Administration and the assets were broken up and sold. The Foundation have just announced that they have appointed Europa Partners to give them corporate finance advice. Whether this is in response to a strong message from UKSA that they need to take vigorous action to protect their interests is not known.

Meeting with Chairman Dr Matt Ridley

UKSA director Roger Lawson met Matt Ridley on the 4th October. This is a brief summary of the meeting.

It seems that the company is not under immediate pressure from the Government to effect a disposal, but that there are continual conversations between the company and the Treasury, the Bank of England and the FSA. The interest rate that the company is paying on the Bank of England facility was a negotiated rate.

The interim dividend was cancelled because after a review of the company's financial position it was decided that payment was unjustified, and it was not cancelled due to political pressure.

The issue of the failure of the company to make any announcement in the weeks prior to the announcement of the rescue by the Bank of England was raised. It seems that the company took advice on whether any announcement was required in that period and the advice was that it was not as alternative funding was still in prospect and being discussed.

So long as it is in within the powers of the directors, shareholders will get a vote on any disposal (as required by the Listing Rules).

The directors are looking at all the possible options for the company going forward, and one of those options is for the company to remain as an independent entity but that obviously is dependent on adequate funding. The board is not currently considering any board changes, but they might do so in the future.

It was unfortunate that the announcement by the company of the Bank of England rescue was pre-empted by the BBC leaking this news which ensured that company had to announce it quickly. This also seemed to happen with the announcement of the dividend cancellation and Dr Ridley agreed that both incidents were very regrettable.

What the Company Should be Doing

We have several concerns at present (some of which were expressed to Dr Ridley in the aforementioned meeting) that we believe the company should be tackling:

1. The negative press comment that the company has been receiving about the quality of its business and the business model it followed, often with misleading information and comments being published and without a vigorous rebuttal by the directors. This has tended to play into the hands of those parties who would like to purchase the assets cheaply. Indeed some members of the press have said they have been unable to talk to anyone from the company for several days. We suggest that the directors need to take a much more positive stance and be more publicly available as no news or comment undermines confidence. A review of their PR arrangements is probably also a good idea.
2. That the board be strengthened as soon as possible, ideally with a new Chairman or Deputy Chairman with a strong banking background. Although we don't doubt the commitment and good intentions of Dr Ridley, we question whether he is the right person to provide the leadership to get the company through its present difficulties.

Committee Formation

Note that the Northern Rock Shareholder Action Group has now formed a committee to progress this campaign. The members are: Roger Lawson (chairman), Alan Chissick, Dermot Driscoll, Eric Edmond, Sean Horsey, Teresa Sellen and Brian Peart. Anyone who wishes to join the committee, and has time or expertise to contribute, should contact the chairman (contact info is above).

Request for Share Register

UKSA has requested a copy of the share register of the company. There are apparently 120,000 "members" on the share register, although many private shareholders probably hold their shares in nominee accounts so will not appear on the register separately. Our intention is to write to as many shareholders as we can to try and garner support, but over 75% of the company's shares are likely to be held by institutions.

Other Activities

The UKSA Northern Rock Shareholder Action Group is also pursuing other channels to raise awareness of the issues involved here and to try and ensure that shareholders recover at least some of the losses they have sustained. If you have any suggestions about specific actions you think we should be taking, please let us know.

If you have any questions or comments on this matter, please contact me by phone or email (contact information given below).

Yours sincerely

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