

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 13

The Olivant Proposal and Other News

This morning (Friday the 6th December), an RNS announcement was issued concerning the proposal from Olivant. This had been expected for some time and is the kind of proposal that we and major shareholders such as RAB Capital and SRM Global have said we would like to see on the table. More details of the proposal and comments thereon are at the end of this note.

Firstly though I would like to comment on the Virgin Group offer that I outlined in my previous “update”. It seems that it was perhaps not clear enough in what it was implying, and I may have been too “even-handed” when writing the note. In essence we do not support the Virgin Group offer as we think it grossly undervalues the business – effectively giving a 55% controlling interest to Virgin in return for relatively little investment. In addition we don’t think the structure of the deal is attractive to smaller investors.

Even the Government seems to have realised that the Virgin Group proposal would be likely to face rejection by shareholders, with several stories appearing in different newspapers suggesting the Government had devised a route through Administration that would protect depositors and had drafted a quick Nationalisation Bill. To the informed observer though it simply looked like the Government was waving a big stick in the hope of persuading shareholders to accept a deal quickly. Indeed one commentator in the Financial Times likened it to a game of chicken with shareholders and the Government on a collision course with both hoping the other would be the first to flinch. An apt metaphor indeed, but surely not the way to reach a sensible conclusion on how to handle the problems of Northern Rock.

Company Announcements and Actions

Chairman Bryan Sanderson wrote to shareholders on the 30th November outlining the basis of the Virgin proposal and why it had been selected as the preferred bidder. Otherwise he promised “*to do everything we can to achieve the best possible outcome for Northern Rock and its stakeholders*”. At least the letter had a positive tone.

Soon after depositors received a letter promising an extra 0.5% gross interest p.a. for people who keep their money invested until 1st March 2008. It obviously won’t be a cheap gesture, but at least it shows the company is taking positive action to halt the flow of cash out of the company, and reverse it.

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In addition the company announced a pay deal and special bonus for staff, which attracted criticism from some quarters – but the cost may be trivial in comparison with some of the numbers involved in the refinancing of this company.

Other News

The British Bankers' Association has called for the Government to open a full inquiry into the Northern Rock affair. They suggested that the investigation by the Treasury Select Committee should not be the end of the matter, and such a clear failure of the UK regulatory system for banks should be more thoroughly examined. We agree that a review of the current "tri-partite" system with the Treasury, the Bank of England and the F.S.A. all involved looks ripe for a review because it certainly failed in several respects when put to its first severe test. The difficulties faced by Northern Rock were not insurmountable when it first came to the notice of the authorities, but quickly degenerated into a situation which has had a major impact on the international reputation of the UK for sound finances.

What Has UKSA Been Doing?

I thought it might be a good idea to summarise at this point what I, the other members of the Northern Rock Shareholders Action Group committee and UKSA in general have been doing. That's not just where we have been spending our time, but where the donations you have given are being spent. These are some of the things we have been doing:

1. We have been promoting your interests, and what we believe is the kind of solution that would best enable shareholders to recover some value from their shares, by issuing press releases, talking to the press, and doing radio and television interviews. On some days, the phone has barely stopped ringing with inquiries from newspaper journalists, and although we haven't always got our message across, we have been quoted at length in a number of articles. Just explaining the background, and the concerns of shareholders, to the media can help to avoid the worst misunderstandings creeping in.
2. I and other members of your committee have had several meetings or telephone conference calls with the Chairman of Northern Rock (both Matt Ridley and Bryan Sanderson), with representatives of RAB Capital, SRM Global, Olivant, Virgin Group, advisers to Northern Rock, and others.
3. We have written to 10,000 shareholders on the share register, and another 5,000 letters are about to go out. We hope to send more as there are approximately another 95,000 shareholders with 500 shares but our resources to send them out and process the returns are limited – we will certainly attempt to write to everyone when a shareholder vote is called, particularly if we opposed any proposal on the table. In addition we have received a lot of communications from shareholders in nominee accounts who have picked up our contact information from the media, bulletin boards or from notifications from nominee operators. We have had about 4,000 responses to date from shareholders, many of who have individual questions that need answering. Simply responding with basic information to those 4,000 has been a large task, and we have also sent out updates almost weekly to those on email, and a postal one to those not.
4. We also organised meetings in Newcastle and London – apologies if not everyone was notified of those meetings before they took place. Everyone on email should have been, and most of those who we only have postal address for, but there may have been some earlier contacts that we could not afford to write to again just for that purpose.

5. We have also contacted some of the larger institutional shareholders we could identify, and also written to politicians who have an interest in this subject, including local M.P.s in the north-east of England. We have also communicated with Government ministers.

6. In addition we have taken legal advice on past events and what might be necessary to protect your interests going forward. But as I keep on telling some irate shareholders, it is unlikely that legal action will recover your past losses, or enable you to pursue personal grudges against the former directors, the Government or anyone else. UK law provides few certain legal routes for pursuing actions by shareholders, and spending money on actions that are uncertain of resolution in any reasonable timescale is not something we consider a wise use of our funds or your donations at this time.

I have probably missed out some other tasks from the above list, which have not readily come to mind, but you can be assured that a lot of effort has gone into this campaign, both in time and money.

The Olivant Proposal

The Olivant proposal is not a bid and they would not be acquiring control of the company, so in that regard it is very different to the Virgin proposal. Existing shareholders would retain ownership of the company, but with some dilution, assuming they took up the proposed "rights" issue.

A rights issue is where existing shareholders are asked to subscribe for additional shares and the cash thus raised enhances the assets of the company (and in effect in this case shores up the balance sheet). In the Olivant proposal up to £650 million would be raised from a rights issue from existing shareholders plus another £150 from Olivant itself by an issue of new shares. Both share issues would be "at or around the current market price". Major institutional shareholders representing 23% of the existing shares have already agreed to the rights issue, and to underwrite a substantial proportion of the issue.

What does this mean for smaller shareholders? It means you would be asked to subscribe for new shares, as with the Virgin proposal, but in this case there is less dilution of the value of your existing shares, and you will retain a higher proportion of the company. Olivant would obtain about 15% of the company versus the Virgin proposal for 55%. On those grounds, the Olivant proposal is clearly preferable for existing shareholders, although other aspects of the proposal also need to be taken into account of course. Shareholders would not be forced to subscribe for shares if they did not want to do so, but the value of their existing holding would be proportionally reduced if they did not.

Olivant would also be granted "high premium" warrants over 7% of the capital of the company (i.e. options to subscribe for shares in the future), plus the Government would also be granted similar warrants over 5% - this enables the Government to participate in the "upside" if the company is successful over the next few years. This implies some further dilution for shareholders but we don't consider that unreasonable if the premium is reasonably high so that it rewards success.

Lugman Arnold of Olivant would be immediately appointed Executive Chairman of the company. The proposals include some statement of how they see the Bank of England funding being replaced. Although the details are somewhat sketchy, it suggests a quick repayment of £10 to £15 billion with the rest by the end of 2009 "through active operational management" and "accelerated through external market financing". The reaction of the Government to this proposal is clearly going to be very important in deciding whether it will succeed.

Olivant are proposing to retain the Northern Rock name, which will no doubt please many shareholders. In addition as the company will remain an independent, publicly listed entity, it is likely that the interests of other stakeholders such as the employees, the Northern Rock Foundation and others will be protected by this proposal.

Other Offers and Summary

J.C.Flowers have announced that they are dropping out of the race, but there may be other proposals still forthcoming from other parties. However, we suggest that it may be difficult to obtain offers that are more attractive than the Olivant one so far as shareholders are concerned.

Yours sincerely

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