

To Northern Rock Shareholders

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## **Northern Rock Shareholders Action Group – Update No. 14**

### **The Current Position**

In the last week uncertainty about the Olivant proposal has arisen in that they allegedly complained about not being given equal treatment with Virgin in terms of access to information, access to management and access to the banks who might provide funding. These concerns now seem to have been resolved with yesterday morning's newspapers suggesting that the company would make an announcement imminently and saying that Olivant would be on an equal footing with Virgin.

However it is very clear that completion of both these proposals (and there don't seem to be any other likely runners in the race at present) is taking considerable time, and a major problem is getting firm commitments from the prospective bankers. Indeed the Chairman, Bryan Sanderson, was quoted in the press as saying that no action would be taken "this side of Christmas". The slow progress is certainly of some concern and this issue is covered more at the end of this note.

### **Commons Debate and Nationalisation**

On Wednesday the 12<sup>th</sup> December the House of Commons debated Northern Rock with a motion led by Vince Cable of the Liberal Democrats calling for the company to be nationalised and trading in the shares suspended immediately. The full debate can be read in Hansard on the internet, starting on the following page, and it is well worth reading: [www.publications.parliament.uk/pa/cm200708/cmhansrd/cm071212/debtext/71212-0014.htm](http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm071212/debtext/71212-0014.htm)

Mr Cable got in essence a pretty rough time from both Labour and Conservative politicians, with concerns about the potential Government liability if the company was nationalised, the lack of any clear plan thereafter, the threat to jobs in the North East and various other aspects. Vince Cable seems to want some kind of "temporary public ownership". In effect the Government would acquire the company from existing shareholders by compulsory purchase – but at what price is unclear – and then sell it on a few months or years later when the business had recovered (and when the financial markets had also recovered and the threat of a collapse in house prices had also passed because selling any mortgage bank at present would be very difficult). Of course this would be a very effective way of depriving existing shareholders of their financial interest in the future of the company, and betray the allegiance and long term commitment of many shareholders to the company.

The Government would be acting like the worst kind of speculators in distressed assets – buying it on the cheap from forced sellers, and literally “forced” in this case, and then raking in an enormous profit in due course from the natural recovery of the business. There has been some suggestion that shareholders might participate in any such future sale value, but technically this seems difficult to achieve to us. And would shareholders trust the Government to behave ethically and in their interests about how they managed the business and subsequently disposed of it? A very doubtful scenario it seems to us.

If the Government chose to nationalise it, then in our view it would only make sense to do so if the objective was simply to run it off as a closed mortgage book based on there being no hope of the business recovering as a “going concern”. This would in due course wipe out all the jobs currently supported by the company, and the business would disappear a few years hence. If the objective is to revive the company and get it back to a good level of profitability, and hence in a saleable form, then this is best done in the private sector, not by an arm of the Treasury.

Note that one intelligent comment in the debate by John Redwood was: *“Why does the hon. Gentleman ignore the fourth option, which involves the Bank of England acting as a tough but fair bank manager with repayment schedules and proper cash-flow monitoring of the bank’s progress? It would then be for the bank to work out whether it needed to put itself into a kind of voluntary run-off and do it in an orderly fashion or whether it could actually grow the business. Would that not be the best option?”*. A good question indeed, if neither the Virgin or Olivant bid goes forward.

## **The Virgin Group and Richard Branson**

Vince Cable did make some very interesting comments in the debate on Sir Richard Branson and the Virgin Group proposal. He said: *“Nor should we be under any illusions about the motives of the people who are bidding. I have never met Mr. Branson, but he seems to be an engaging character who has had some successful ventures. He is, however, a front man for a consortium of hedge funds and private equity operators whose aim is to make a killing. He is proposing to invest about £200 million in a company whose gross assets will be more than £100 billion, and he will be hoping to sell it on in due course and make a large capital gain which, as he is registered overseas, might well not attract UK taxation. So we are not talking about Mother Theresa here; we are talking about some very tough short-term financial investors.”*

He also made reference to Mr Branson’s past brushes with the law and his “criminal record” and went on to say: *“There is therefore good reason to believe that the people who have to stump up the money for his consortium may well not regard him as a fit and proper person to run a public company, let alone a bank, and let alone as someone responsible for £30 billion worth of taxpayers’ money. So there are real questions about whether this private bid is ever going to succeed.”* The reference to a criminal record is apparently to Mr Branson’s evasion of Purchase Tax back in 1971 on which he subsequently agreed to pay penalties, but by so doing avoided a criminal record as such.

As other commentators have pointed out, the Virgin Group is a private entity and its financial structure and profitability are opaque. Although Mr Branson is clearly a very persistent self-publicist, I would certainly have grave doubts about remaining as one of many minority shareholders in a company controlled by him. This is never an ideal situation for investors in stock market companies, and it requires a high degree of faith and trust in the majority shareholder before one even wants to consider it.

For those reasons, and the poor financial basis of the Virgin offer, we would almost certainly suggest to shareholders that they should vote against the Virgin proposal if it comes to such a vote, even if there is no other proposal on the table.

Incidentally Branson appeared on Channel 4 television this week in a somewhat subdued performance. He suggested that if he could not put together a deal, then it was likely nobody else could, in which case the only alternative would be nationalization. But that is not our view.

## **The Latest Company Announcement – a new Chief Executive**

On Thursday the 13<sup>th</sup> December the company issued an RNS announcement. It said that the company was still aiming to complete its “strategic review” by February 2008, as previously announced. But it also announced the immediate departure of Adam Applegarth contrary to the previous statement of his temporary retention. He is departing with less than his contractual commitment regarding financial compensation.

Andy Kuipers is appointed as Chief Executive and has been reappointed to the board. Mr Kuipers was previously responsible for sales and marketing for Northern Rock and has been with the company for 20 years.

Note that we have been concerned for some time about the lack of active management of the business of Northern Rock. In any company where a “strategic review process” is followed, which is effectively an active disposal process, the time of the company’s top management is often grossly diverted to responding to numerous questions from the bidders, and producing the necessary information in response to “due diligence” inquiries. Meanwhile the morale of the bulk of the staff is undermined by the uncertainty of their future, and the changes of management as people come and go. These two processes can be severely damaging to the health of a business if allowed to run for more than a few weeks, and it’s been months already at Northern Rock. If a business is facing difficulties, and requires determined action to get it back on its feet, as Northern Rock undoubtedly does, then having strong, active management in place is essential.

Indeed Lugman Arnold of Olivant has said that he would like to get in there as soon as possible before it is too late, and we agree with him on that.

The appointment of a new Chief Executive may help, but it is far from the ideal solution. Although the company has taken some steps to revive it’s fortunes with revised offers to depositors and competitive interest rates, they surely need to be doing a lot more in this area. In essence they need to be communicating vigourously and appropriately with their past customers to re-instil confidence in the business.

We are writing to the directors of the company to reinforce that point. For the same reason it seems very important to us that the uncertainty over the possible offers for the company be resolved absolutely as soon as possible, and if there is any undue delay in that regard then the directors need to have some fall back position that they can pursue.

## **Other News**

The last company announcement also noted some impairments in the assets of Northern Rock to the amount of £281 million, but noted that the company will still have surplus regulatory capital under the Basle II regulations. These amounts do not seem extraordinary or unexpected. Other banks have recently announced similar write-offs.

The company has dropped out of the FTSE-100 this week due to the reduction in its market capitalisation. This might have some negative impact on the share price as tracker funds will be required to sell it.

## **Donations to Support this Campaign - More Help Needed!**

Our previous "update" note explained what we have been doing in your interests. At the date of writing we have raised £8,653 in donations, but our expenditure, mainly on printing on postage in writing to shareholders, has exceeded that figure. In addition we have only received donations from 259 people whereas we have over 4,000 people that have contacted us and we have sent information to and regular updates. The response level on donations is therefore only about 6% which is very disappointing. Almost all the donations are also in the range of £10 to £30 and it is very noticeable that smaller shareholders have been more generous than larger holders – the reasons for this are unclear – but perhaps larger holders feel they have lost so much money that they cannot afford to donate.

This of course makes it difficult for us to run a successful campaign and ignores the likely benefit of donating. We only need to have a very small impact on the outcome of this matter to provide a very good return on any given in donations. And larger shareholders should benefit more than smaller shareholders which is why we suggested donations be related to the number of shares held. The current market capitalisation of Northern Rock is approximately £365 million. If we improve the share price by one penny, then the market capitalisation rises by £4.2 million, so our campaign has to only have a very small impact to generate an enormous financial return to shareholders. The difference in value to shareholders between for example the Virgin proposal and the Olivant proposal is very substantial, and we clearly may have a significant influence on which is chosen.

In summary, now that we are in the Christmas season I am asking shareholders to give much more generously. We really do need the funds to communicate more actively with more shareholders, and to build our influence before it comes to a vote. DON'T LEAVE IT TO SOMEONE ELSE – PLEASE DONATE TODAY!

A copy of our appeal form is separately attached that you can use to send a donation, and bear in mind that any contribution would be welcomed, however small.

Yours sincerely

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