UKSA
UK Shareholders' Association

# THE PRIVATE INVESTOR

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# UKSA appoints a new chairman and a new director

We are very pleased to announce that Colin Colvin has been elected as a director and as the new chairman of UKSA.

Colin brings a wealth of experience gained over a long career in business, particularly in the Logistics sector. He has also served as chairman of the Board and Council of Governors of a University Hospital NHS Foundation Trust and chair at Airport Services Limited. Colin is an active investor whose investment strategy is to maintain a balanced portfolio including cash and fixed returns, direct into equities and managed fund arrangements.

We are also delighted to announce that Sue Milton has been appointed as a director of UKSA. Sue is the owner and managing director of SSM Governance Associates, providing advice, training and support aimed at good governance to build and retain corporate sustainability. She also focuses on cyber security management. Sue is an active investor, running a mixed portfolio diversified by company size and age, region, sector, and by different types of portfolio management – personally managed, managed by fund managers and with some held in nominee accounts. This approach helps spread risk and allows Sue to keep a check on just how equitable the treatment towards different investments and investors is.

We extend a warm welcome to Sue and Colin and look forward to working with them in 2019.

The UKSA board would like to wish all members a happy Christmas and prosperous 2019. We look forward to seeing you at an UKSA event in the new year.

***Helen Gibbons - Editor***

## *In this issue*

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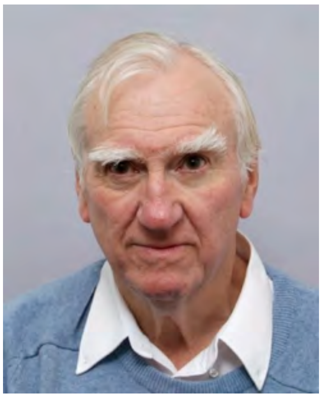
# Auditing – a piece of cake!

*by Malcolm Howard*



We now live in a world dominated by algorithms. In her book 'Hello World' (Penguin Random House 2018), Dr Hannah Fry, Associate Professor of Mathematics at University College London, defined an algorithm as follows: *A step-by-step procedure for solving a problem or accomplishing some end especially by a computer*.

Dr Fry specifies that there are two paradigms, rule-based algorithms and machine-learning algorithms. She states that rule-based algorithms are instructions constructed by a human and are direct and unambiguous. That's not to imply that these algorithms are simple – there's plenty of room to build powerful programs within this paradigm. However, Dr Fry provides a warning (page 16): *"All around us, algorithms provide a kind of convenient source of authority. An easy way to delegate responsibility; a short cut that we take without thinking. But there's a distinction that needs making here. Because trusting a usually reliable algorithm is one thing. Trusting one without any firm understanding of its quality is quite another."*

The accounts for Patisserie Holdings plc for the year ended 30 September 2017 were signed off on 24 November 2017.

| Income Statement | 2017 | 2016 |
|---|---|---|
| | £'000 | £'000 |
| Revenue | 114,197 | 104,141 |
| Cost of sales | 24,931 | 22,832 |
| Gross profit | 89,266 | 81,309 |
| Gross profit % | 78.2 | 78.1 |
| Administration expenses | 69,121 | 64,099 |
| Operating profit | 20,145 | 17,210 |
| | | |
| Finance (income)/expense | (8) | 6 |
| Income tax expense | 3,789 | 3,469 |
| Net profit | 16,384 | 13,735 |

At first glance, the Income Statement does not seem that remarkable. But hang on – Patisserie Valerie, the main subsidiary of the holding company, is a high street retailer, many of which have been struggling. According to the Centre for Retail Research, in Norwich, many retailers have gone bust in 2018. With all this pain in retailing, is it feasible that Patisserie Holdings was going so well?

The company's balance sheet (below) looks even better:

Patisserie Holdings plc. Balance Sheet at 30 September 2017

| | 2017 | 2016 |
|---|---|---|
| | £'000 | £'000 |
| Intangible assets | 17,747 | 17,797 |
| Property plant and equipment | 39,674 | 36,498 |
| Total fixed assets | 57,421 | 54,295 |
| | | |
| Trade and other receivables | 12,327 | 11,004 |
| Corporation tax | 1,668 | 1,896 |
| Inventories | 5,980 | 4,862 |
| Cash and cash equivalents | 21,525 | 13,273 |
| | | |
| Total current assets | 41,500 | 31,035 |
| | | |
| Total assets | 98,921 | 85,330 |
| | | |
| Less: current liabilities | | |
| Deferred tax | (1,422) | (2,054) |
| Trade and other payables | (5,167) | (5,081) |
| | | |
| Total net assets | 92,332 | 78,195 |
| | | |
| Share capital and premium | 35,087 | 34,661 |
| Other reserves | 708 | 391 |
| Retained earnings | 56,537 | 43,143 |
| Total equity | 92,332 | 78,195 |

So here is a retailer with £99 million of assets and only £7 million of liabilities. Wow!

There appeared to be nothing to worry about. The auditor (Grant Thornton UK LLP, Cambridge) stated that they had performed full-scope audit procedures for Patisserie Holdings plc, Stonebeach Limited, Philpotts Limited, Flour Power City Limited, Patisserie Acquisition Limited, Patisserie Valerie Holdings Limited and Spice Bakery Limited. Analytical procedures were carried out for Patisserie Ireland Limited and for dormant entities within the Group. They declared that overall Group materiality was set at £981,000. They wrote: “In our opinion, the financial statements give a true and fair view of the state of the Group’s and of the parent company’s affairs as at 30 September and of the Group’s profit for the year then ended.”

In the notes to the accounts (note 18) rent charged for operating leases in 2017 was £374,000 and outstanding lease commitments on non-cancellable leases at that date amounted to £67.451 million.

Under note 6 (Key Management Personnel) it was stated that share options had been granted to the executive directors as follows:

P. May (CEO): 1 million shares at an exercise price of £1.70 exercisable between 27 June 2017 and 27 June 2019;

C. Marsh (Finance Director): 666,666 shares with conditions identical to those of P May.

The London Stock Exchange records directors’ share dealings. On 2 February 2018 Chris Marsh exercised his option to buy 666,666 shares at 170p and sold them for 360p. Five days later Paul May exercised his option to buy 1 million shares at 170p and sold them for 330p. However, there were more blocks of options. We don’t know when they were granted, because they did not show in the audited accounts. However, a note in the published accounts might explain why:

**CORPORATE GOVERNANCE – As an AIM listed entity, the Group is not subject to and does not comply with the requirements of the UK Corporate Governance Code.**

On 18 July 2018, Paul May exercised an option to buy 1 million shares at 316p and sold them for 418p. Two days later, Chris Marsh exercised an option to buy 666,666 shares at 316p and he also sold them for 418p. This left one block of options for a total of 1,666,666 shares still to be taken up.

On 2 February 2018, James Horler, a non-executive director of the company, sold 47,116 shares for 367.575p each.

In total, Paul May’s sale of his share options gave him a profit of £2.62 million, while Chris Marsh made a profit of £1.95 million.

But the numbers seem too good to be true. Is there any other business Grant Thornton have audited that is even nearly as profitable, also with a perfect balance sheet? Then we have inventory days ranging from 78 days to 88 days at each year-end. Why would a baker have so much stock? In addition, there are management accounting techniques to assess when the financial figures are viable or not. What you do is take the sales volumes and deduct the variable costs to arrive at contribution. From ‘contribution’ take off fixed costs and you get to net profit before interest and tax.

In Surrey, there are two high street businesses that are similar to Patisserie Holdings. One is Cook Trading Ltd, the other is Coughlan Bakeries Ltd. Cook Trading sells frozen ready meals, while Coughlan Bakeries sells bread and cakes. Their branches also serve as cafes where they sell sandwiches, cakes, coffee and tea etc. So, in profile, this company is closely aligned with Patisserie Holdings. Obviously you would not expect them to have an identical gross margin percentage, but you would expect them to be within a few percentage points of each other. By the same reasoning, you would expect them to have a similar balance sheet, in ratio terms, even if not in size. The accounts below compare these companies. All the accounts relate to their year end in 2017.

| | Patisserie H | Cook Trading | Coughlan B |
|---|---|---|---|
| | £’000 | £’000 | £’000 |
| Sales | 114,197 | 50,591 | 4,429 |
| Cost of Sales | 24,931 | 24,594 | 2,886 |
| Gross Profit | 89,266 | 25,997 | 1,543 |
| Gross Profit % | 78.2 | 51.4 | 34.8 |
| Distribution and Admin | 69,121 | 23,372 | 1,555 |
| Profit before Interest and Tax | 20,145 | 2,625 | (12) |
| Interest | (8) | 179 | 27 |
| Tax | 3,789 | 527 | 19 |
| Net Profit | 16,364 | 1,919 | (58) |
| | | | |
| Assets excluding cash | 77,396 | 12,314 | 5,548 |
| Cash | 21,525 | (2,888) | (406) |
| Liabilities | (6,589) | (523) | (923) |
| Net assets/equity | 92,332 | 8,903 | 4,219 |

It must be patently obvious by now that the accounts of Patisserie Holdings are not only inaccurate, but also complete fiction.

So why did the directors, or senior management, or indeed the auditors, not ask the basic question: how are we achieving such amazing figures? Before algorithms took over auditing, it was standard practice to reconcile the cash books with the bank statements. Such a simple thing would have prevented what seems to be a significant fraud.

But inevitably, when accounts are false, it all goes pear-shaped in the end. In this case HMRC had issued a winding up order against a subsidiary for unpaid tax. The House of Cards promptly fell down. Instead of having £28.9 million in the bank at 31 March 2018, as shown in the interim accounts, the company actually had an overdraft of approximately £10 million, we were told. The 'black hole' therefore amounted to around £40 million. The irony is that if profits had not been significantly overstated, then the company would have paid less corporation tax. Indeed, it is possible that the overpayment is more than the amount HMRC were chasing from the subsidiary.

Now, the most ironic thing about this whole sad affair is that Luke Johnson, holding 38.62% of the company at 30 September 2017, is an expert when it comes to detecting fraud:

- Mr Johnson is the co-founder of Risk Capital Partners. His profile reads: Luke Johnson has been Chairman or NED of all of RCP's exited investments, and is Chairman of most of the current portfolio, which is shown as 23 companies including Patisserie Holdings.

- On 9 September 2018 Mr Johnson wrote in the Sunday Times: Luke Johnson: A business beginner's guide to tried and tested swindles (also found on the Risk Capital Partners website). His article included the following:

- Cash business is much easier to disguise.
- Fill all senior roles with family members.
- Keep the plates spinning. Threaten litigation and sue people – intimidate those who would expose you.
- Run several sets of books. Make it complicated – most people don't understand the technicalities of investing and accounting.
- Hire dodgy advisers.
- Think big – even clever investors sometimes fall to the most ambitious fraudsters.

So how did what was happening at Patisserie Holdings go unnoticed by him until HMRC petitioned to wind up a subsidiary?

If you are an Executive Chairman of several companies, as Luke Johnson was, it must be obvious that you cannot spend much time at any of them. Merely turning up to board meetings without examining much will not detect fraud. In fairness, Mr Johnson recognises this; he has said he will give up a number of chairmanships and he will not take any salary from Patisserie Holdings until the mess has been sorted out.

There is little doubt that today's auditors have been turned into robots fastidiously following procedures. Whatever the algorithms say must be right. It seems that basic common sense has been obliterated; nobody asks: 'does it make sense?'

The lessons that investors can learn from this fiasco are:

- Understand that companies listed on AIM are lightly regulated, so be careful.
- Auditors using algorithms do not carry out even basic checks. Doing simple calculations like debtor days and inventory days (comparing over time and with other companies in the same sector) will catch false accounting.
- If something looks too good to be true, it's not!

Finally, when the shares are listed again, albeit at a much lower price, I would recommend that the company sacks all directors (except Mr Johnson himself, who has a significant shareholding in the company), both executive and non-executive, because at best they have been grossly negligent. If Mr Johnson will not agree to this, then the safest option is to sell up.

The Financial Reporting Council (FRC) has recently announced that it is to launch a major project on corporate reporting. The new research will apparently engage with stakeholders in how reporting in the future might develop. The FRC spends its life making reporting more and more complex, when all investors want is accurate accounts.

Investors are concerned that in many cases where there has been a material misstatement in the accounts, while the Finance Director is rightly sacked, there is no sanction against the auditor. Tesco and Luceco are examples.

The IFRS accounting system is currently imprudent and not fit for purpose. However, I have been advised by the Rt Hon Greg Clark, MP, Secretary of State for Business, Energy & Industrial Strategy, in writing, as follows: "The International Accounting Board updated its conceptual framework earlier this year, which defines the parameters for the Board's standard setting. This update has reintroduced the concept of prudence, mainly as a result of feedback from shareholders in the UK." The FRC must ensure that accounts published in 2019 and beyond reflect this change. Current auditing procedures cannot even recognise fake accounts and are not fit for purpose.

These are issues that I shall be raising with the FRC when we meet to discuss the future of audit on 24th January.

# To split or not to split – should auditors sell non-audit services?

The question of whether audit firms should be able to sell non-audit services has been a topic of some debate recently. The Competition and Markets Authority (CMA) raised the issue in its recent consultation document, 'Statutory Audit Market – Invitation to Comment'.

**Arguments against splitting**

The CMA identified a number of problems, some real, some perceived, in obliging audit practices to divest themselves of their consultancy businesses, including:

• The international nature of many large audit firms, which would make it impossible to force audit firms to split their audit and consultancy practices in overseas territories.
• The possibility that it might reduce audit quality if specialist in-house non-audit staff were not as easily available or as skilled in advising the audit teams on complex issues. UKSA and ShareSoc believe that this is a weak argument.
• The claim that it could reduce audit quality if it made it harder to recruit high-quality staff into audit-only firms. It is a damning reflection on the state of audit that it has come to be seen as such a dreary backwater that good recruits can only be enticed into it with the offer of a future escape route into consultancy.
• The concern that it could affect the mid-tier audit firms more than the Big Four, as the former are less likely to have the scale and resource to employ in-house specialists in an audit-only firm.
• The fact that audit-only firms might become more financially dependent on their large audit clients, which could impair their independence.

**Muddied waters**

Interestingly, KPMG recently announced that it was going to stop doing non-audit work for audit clients. Deloitte added its support for the idea of banning all non-audit services to FTSE 350 audit clients. However, such a move can only serve to reduce choice and competition in the audit market. No audit firm is going to dump its consultancy work with a non-audit client just so that it can bid for the audit contract. This proposal, if implemented, could mean that many FTSE 100 companies would be left with just three potential audit providers at most – one of whom would be the incumbent. The CMA notes this problem as well. The sudden promulgation of the idea by some of the audit firms suggests a pre-emptive strike to head off calls for a more fundamental division of their businesses.

We have heard assurances from some quarters that there is really no need to worry about this particular issue because current rules governing the provision of non-audit work to audit clients are so draconian and so well prescribed that auditors are prohibited from providing any consultancy (or non-audit work) to audit clients. You can read the full text of what is supposed to be allowed and not allowed in the FRC's 'Revised Ethical Standard 2016'. This link will take you to it:

While this document is long on things that can't be done by auditors, it is notably silent on things that, presumably, can be done – such as strategic planning, marketing planning, new product development, business reorganisation and a number of other popular areas of consultancy which can be very lucrative. The constraints on advising on implementation of major IT projects seem to contain many 'grey' areas. Most areas of M&A work seem to fall within the scope of things an audit firm can provide to an audit client.

**Arguments for splitting**

Those who have worked in consultancy (which includes Cliff Weight and me) will be familiar with the culture and know that as a consultant you are always selling. Consultancy is project-based; having sold one project you have to sell another (and another) to ensure a flow of new work to feed the business. This might be an extension to an existing project or a completely new project. It is also good if you can get a referral to a new client. To be effective at doing this you need to build close working relationships with the executive management team within the client company. It pays not to upset them. As they say, 'he who pays the piper calls the tune'. As a consultant you tend to go along with whatever the client wants. It is a case of just helping them to do it a bit better.

Contrast this with the culture that you need in an audit practice. Detachment, objectivity and professional scepticism are all things that one might consider to be important. Added to this is the need to understand that, while the client company may be paying you, you are actually supposed to be looking after the interests of the shareholders. With a ten-year audit contract there is no need and no justification for constantly trying to sell more to the client. Any pressure to pass leads to the consultancy side of the business represents a clear conflict of interests.

From an ethical point of view, consultancy and audit do not sit well alongside each other. The culture required for success in each case is fundamentally different. The measures of success should also to be different. Growing revenue by keeping the client happy is not an appropriate measure of success for an auditor. Unfortunately, the likelihood that the consultancy culture will assert itself within any firm providing both consultancy and audit is very real and is potentially damaging and dangerous.

Here is one last point to ponder on.  It is not always clear whether the large global firms are auditors with a consultancy sideline or whether they are really consultants with an audit sideline. Looking at the 2017 results for two of the largest firms is revealing. Ernst and Young, for example, had UK revenues in 2017 of £2.35 billion, of which £689 million was accounted for by assurance (audit) services. PWC had UK revenues of £3.8 billion, of which assurance accounted for £1.3 billion. For these two firms true audit work accounts for 25-30% of total UK revenue. Given this level of dependence on consultancy work, what sort of culture do you think is likely to prevail?

## Save the date – UKSA Annual General Meeting

UKSA will hold its AGM at 2pm (subject to confirmation) on Tuesday 2 April. The venue will once again be the RAF Club, 128 Piccadilly, London W1J 7PY

# Persimmon: end in sight after six years of 'I told you so'?

*by John Hunter*

*Editor's note: The numbers in the following article are based on market valuations at the time it was written. Further, the three current directors were forced by public pressure to take a cut of about one-third. This cut has not been included.*

So, the Persimmon end-game is in sight. Six years after UKSA first drew attention to the magnitude of the Persimmon 2012 10-year Long Term Incentive Plan (abbreviated PLTIP) it has all but vested. 9% of the company has been given to current employees (one-third to the directors). The value originally estimated by UKSA was £230 million. The value today is about £600 million (it moves with the Persimmon share price – the original grant was 30 million shares). The amount that's hit the income statement is about £40 million (leaving the other £540 million hidden: isn't modern accounting a wonderful thing?).

The newspapers have had a field day. Jeff Fairburn, 52-year-old CEO, can't understand why he's been forced to take a haircut on his original £100 million and has been dismissed. Though well-regarded he's now lost to any major quoted company. Mike Killoran, the CFO for the last ten years, has managed to stay out of the papers, but one can't imagine his £70 million (before haircut) will 'incentivise' him further. 130 other employees share £400 million and how many of those will stay at their desks in the long term?

The quantum has been the story in this case. But it provides clear examples of fundamental flaws in the control of executive pay which apply generally and not just to this specific case.

The story of UKSA's investigation and subsequent tracking of the PLTIP is here. Here's what we think we've learned.

**A) The broader picture**

All scandals of this type are fundamentally failures of governance – the wrong people having oversight or control over the wrong things.

*Shareholder oversight*
Governance costs money. The sort of analysis necessary to deconstruct a complex remuneration scheme requires the time of expensive people, with no financial advantage to the analyst at the end of it. The predictable result is that very few institutional investors devote serious time to review, and those that do are not necessarily the leading shareholders.

There must also be a question mark over the enthusiasm for restraint, given that a rising tide raises all boats; and given also that the institutions rely on good access to (and therefore good relations with) senior company management. In the Persimmon case both Manifest and PIRC spotted the problems and Axa and RLAM were two institutions who voted against but it made no difference to the outcome.

*Remuneration consultants*
Remuneration consultants are exceptionally able people. Their professional skill is in creating reward schemes that satisfy the often-conflicting demands of the various constituencies within the client company and still meet shareholder approval. One powerful constituency comprises the executives who will benefit from the scheme, particularly the executive board members. This interaction of needs and relationships can often only be satisfied by schemes that use complexity to conceal that large payouts are achievable with little risk. It follows that the oversight of such schemes requires a comparable level of analytical skill.

Dealing with these issues is both politically and practically difficult, involving challenges to powerful and entrenched interests. But there are some immediate lessons to be learned from the Persimmon case.

**B) Immediate lessons**

The first lesson is that the approval process gives no time for proper independent oversight. The standard timetable of three weeks' notice for a company general meeting was not designed for the approval of complex proposals; the timetable for a disputed takeover would be more appropriate. As it happens PLTIP had some features of a takeover since it gave 9% of the company to current management.

The second lesson is that under the practicalities of current law LTIPs are irreversible except with the agreement of the beneficiaries. This is rarely made clear in the documentation. In Persimmon's case clause 16.1 stated: 'The Committee may, at any time, amend the Plan in any respect, provided that the prior approval of shareholders is obtained for any amendments that are to the advantage of participants in respect of……..'. This turned out to be untrue. Such undertakings are unenforceable under employment law. We are advised that it is a common clause in such documents. In which case it shouldn't be.

The third lesson is that of transparency. Persimmon acted and reported within the regulations, as far as we can see. Yet every opportunity was taken to conceal facts that might become embarrassing:

1) The remuneration consultant should be named. Professionals should be prepared to stand up for their actions – sometimes it's an essential check. The consultants in this case were New Bridge Street – a trading name of Aon Hewitt. They were mentioned on page 37 of the 2012 annual report but not since.

2) Not at any time, anywhere within the Persimmon annual reports, was any suggestion of the quantum of the award mentioned.
a. This includes 2015, when Persimmon was in such a healthy position that it was able to announce an acceleration of its dividend payment plan that would mean the awards would vest four years early – after six years instead of 10. This was not even mentioned in the remuneration report, when the LTIP continued to be described as 'the 10-year Plan' and the final vesting date was still given as 2022.
b. …and this fiction was continued in 2016.
c. ….but the lid was lifted in 2017 when 40% of the options vested, the chairman was forced to reveal that the balance would vest in July 2018 (but this was not mentioned in the Remuneration Report) and the CEO's single figure was revealed as £47 million (for a 40% vesting).

3) The terms of the scheme used to be available on the Persimmon website under the heading 'Notice of Special Meeting September 2012'. But even then they couldn't be found with any search facility; you had to know where to look. That was bad enough, but now the link to the page has been removed. Searching on 'Long Term Incentive Plan' gives a page about the Capital Return Plan, but not the terms of PLTIP. Luckily the terms are preserved on the UKSA website at https://www.persimmonhomes.com/corporate/media/167651/notice-of-general-meeting-2012.pdf

4) It can't be right that such large transfers of value don't appear in the accounts and never will do. The 'cost' of options that turned out to be worth £20 (current Persimmon share price) per share have been booked at £1.34 per share. On the original grant of 30 million shares that is the difference between £600 million and £40 million. 'Material', we would have thought.

5) It can't be right that the 'single figure of pay' for the CEO should contain no hint, before vesting, of a promise to Jeff Fairburn that any analytical economist would have valued at maybe £30 million in 2012 rising to £100 million today. The excessively detailed regulations on pay disclosure have relied on unsophisticated economics and just encourage gaming of the system.

6) Remuneration reports in general have become an embarrassing mess. One of the institutional investors that UKSA interrogated in 2012 said they liked PLTIP because it was 'reasonably simple'. If a 'reasonably simple' LTIP can hide so much, what else is out there?

**Immediate actions required**

We shall be pushing for the following changes:-

1) The process for approval of LTIPs must be revised to recognise their complexity. A starting model could be the process for approval of contested takeovers, simplified appropriately.
2) The reversibility or otherwise of LTIPs should be clarified and the position clearly explained on any document asking for approval.

3) The remuneration consultant for designing/implementing any LTIP should be named both at approval and at payout.

4) Persimmon should be asked to restore the link to the PLTIP terms on their website.

5) The terms of all active LTIPs, options and any other long-term incentives should always be available on the corporate website.

6) The whole approach to reporting LTIP benefits must switch from that of the accountant to that of the project analyst. It would then be routine to provide information using standard project reporting techniques – forecast, assumptions behind forecast, changes since last forecast; all supported by the online forecasting model used to do the calculations, to allow independent review.

7) The same approach should be applied to the 'Single Figure for Pay' in the Remuneration Report.

8) The question of accounting for LTIPs is part of a wider issue of the relevance to practical long-term stewardship of accounting developments over the last ten years. We would just suggest that, under the current favoured accounting mantra of 'useful to users', the Persimmon accountants be invited to say which users the recording of a transfer of value of £600 million as a cost of £40 million is useful for.

**The meaning for Society**

The increasing gap between the haves and the have-nots is dividing society. Soon it will be threatening the model of enlightened capitalism that has, until now, been so successful in underpinning Western stability. The Persimmon case is such a glaring example of unearned wealth that, if it generates no response, will become a poster child for those who regard our leaders as uncaring of this unfairness. It will also accelerate the decline in public approval of the directors and managers of public companies as a class.

We in UKSA and ShareSoc have members who once had successful careers working for and with directors of public companies but sometimes now regard the members of a typical board as unworthy of respect until proved otherwise. This sad situation should be a wake-up call for all those who value the British public company model of wealth creation and wish to restore public respect for those who run it.

# Joint UKSA/ShareSoc event at the Financial Reporting Council in London

As we went to press UKSA and Sharesoc had just held a joint investor dialogue event at the Financial Reporting Council in London, which was also supported by Brussels-based Better Finance. The event was packed, the atmosphere was brisk and constructive and the questions were both apposite and well fielded by the FRC speakers. A full report will be published in the next edition of The Private Investor.


*Jennifer Sisson - Senior Investor Engagement Manager at the Financial Reporting Council*

*Peter Parry of UKSA, Aleksandra Maczynska of Better Finance and Cliff Weight of ShareSoc*

# Sale of Alliance Trust Savings

*by Roy Colbran*

Clients of Alliance Trust Savings ("ATS") will by now be aware that the company is being sold off to Interactive Investor, although they may be disappointed that it took until 8 November for Alliance Trust to tell its customers, whereas the public announcement was made on 22 October. The Alliance Trust directors assert that customers will benefit from the increased financial strength due to the total assets being administered exceeding £20 billion. On the contrary I suggest that the only benefit for customers is bringing some degree of certainty to the situation. Since ATS continued to be loss-making even in 2017, it seemed that something drastic had to happen sooner or later and now we know what that something is to be.

I imagine, however, that others will feel, like me, less secure without Alliance Trust behind us. It is, of course, the strength of Interactive Investor itself that matters and not the amount of assets under management. We are now to have as the ultimate controlling party the private equity firm JC Flowers IV LP, a Limited Partnership registered in the Cayman Islands, part of the empire of billionaire J. Christopher Flowers. Following the fiasco of Beaufort Securities we are now far more aware than formerly of the risks to which we are exposed. As Eric Chalker has more than once reminded us,we know that the compensation limits in the event of complete failure are derisory. From my own experience, ATS has justified my choice of them as my ISA provider with efficient dealing and record-keeping and very reasonable charges. I also find it very valuable to have the availability of intelligent human beings on the end of the line if I did need to telephone, with the bonus of hearing the agreeable Dundee accent. The best we can hope for is service as good as that and it would be difficult to see how it could be bettered.

The accounts of the purchaser, Interactive Investor Limited, for the 18 months to 31 December 2017 are available online from Companies House. They run to 60 pages, so I am not going to claim to have commented on every aspect. However, they show a massive increase in the size of the business on the acquisition of TD Wealth and TD Bank in June 2017. This followed from the directors concluding that "the company's long term strategic ambitions were not best served through organic growth alone". It cost some £64 million and was financed by an investment from J. C. Flowers and Co. We are not told how the £40 million to buy ATS is being provided. The balance sheet shows some £412 million of cash and short-term deposits, so maybe it will be self-financing.

The TD acquisition made Interactive Investor the UK's second largest online retail investment platform. The Report also tells us that as quickly as December 2017 clients were migrated onto a single client platform under the Interactive Investor brand. The ATS operation is to remain in Dundee for the moment, but this precedent makes one wonder for how long.

The Report and Accounts show net assets at 31 December 2017 of £95 million, although the balance sheet includes receivables of as much as £262 million and payables of £588 million. I do not understand the operation of this type of business sufficiently to know why these amounts should be so large. The income statement also shows a profit for the 18-month period of £10.7 million against a loss of £1.7 million in the previous 12 months. This is only made possible by a gain of £28 million recognised in the income statement because the consideration paid was less than the total assets acquired "due to the operating losses in the acquiree company and anticipated cost of restructuring". Without that, the 18 months would have shown a significant loss.

The deal is still subject to FCA approval, which Alliance Trust tell me is expected in the first or second quarter of 2019. Seeing that they must have already approved the previous acquisition, there is presumably no reason to expect them to refuse this time. It certainly shows a further weakness in the whole nominee system in that one's carefully chosen provider can be sold off without so much as a "by your leave". Having, as this transaction demonstrates, been foolish enough to put all my ISAs in one basket I shall definitely have to take action to divide them up before long. Fortunately Interactive Investor recently announced that they were abolishing exit fees, so any moves should be cost-free.

# Update on Colossus (the 'merger' with Sharesoc)

*by Rob McDonald*

Members who attended the 2018 UKSA AGM may recall that in my verbal update on the Colossus Project I advised that UKSA and Sharesoc had reached agreement on progressing collaboration in three functions of Policy, Newsflow and Education, and leaders representing both organisations had been assigned to each team. This was in line with the members' mandate at the previous AGM, which was for the 'directors to co-operate with ShareSoc wherever possible in pursuit of our common aims, with the hope of an eventual merger'.

At that outset of the Colossus project, the proposition was simple enough. Two organisations whose aims and objectives overlapped considerably should combine forces through a full merger, enabling the new entity to speak with one voice, capitalise on the resulting cost synergies and free up human resources through the elimination of duplicated effort. Whilst that may still be the case to some extent, it became clear during the process that although there was a commonality of objectives, there were differences in style between the two organisations such that it was mutually agreed that the project should proceed at a more cautious pace.

As the collaboration and consultation progressed, other ideas began to emerge short of a full merger, a few revolving around the notion of a single overarching brand or formal alliance whilst retaining two technically independent organisations. This had the advantage of having one single outward -looking face for the purposes of campaigning and interfacing with government departments, NGOs, mainstream media etc. but without any of the attendant issues associated with a full merger. Even this 'halfway house' model posed difficulties in gaining full support from both organisations.

So where are we now?

We continue to collaborate in the three areas identified above. Policy collaboration in particular has been very successful in terms of the numerous joint responses on government consultations, press releases etc. thanks to the energies and expertise of our two policy teams, particularly Peter Parry for UKSA and Cliff Weight for ShareSoc. Together, they make a very powerful force for progressing cogent policy initiatives and any difference in opinion has been subtle and quickly resolved. Newsflow collaboration continues with articles shared where appropriate and contributors' consent has been obtained. There is sensitivity over intellectual property rights when sharing articles.

A combined education team meets occasionally to exchange ideas. This will be a very long-term project requiring very considerable volunteer resource.

With regard to Colossus itself, it is fair to regard the project as on pause, with too many other issues sucking up the energies of the very limited volunteer resource available.

The main battle has been won – two organisations with natural affinities now help each other instead of refusing to even talk. That can only be good for the future.

# News from the South-West region

*by Peter Wilson*

When South-West and Midland members met on Deccember 4th one member asked the question: **'Why from early September 2018 has my portfolio outperformed the FTSE 100 by 8%?'**

He did add that this meant that the portfolio had lost 1% in value, with dividends in the current tax year included. There followed two hours of vigorous debate with members suggesting that the 8% fall in the FTSE was due to the weakening of sterling against the dollar through to a withdrawal of funds from the market as institutional investors moved into cash faced with the uncertain Brexit decisions. However, those views did not help answer the question, so the top 15 shares in the portfolio were looked at more closely. These were:

| Company | Movement | % Change |
|---|---|---|
| Anglo American | Plus | 5.5 |
| Shire | Plus | 3 |
| National Grid | Plus | 2 |
| Rio Tinto | None | 0 |
| Templeton Em. Mkt | None | 0 |
| City of London Inv. | Minus | 1 |
| BP | Minus | 4 |
| Shell | Minus | 5 |
| Anglo Pacific | Minus | 6.5 |
| Severfield | Minus | 6 |
| Headlam | Minus | 7 |
| Hansteen | Minus | 9 |
| Braemar Shipping | Minus | 10 |
| Bovis Homes | Minus | 22 |
| Kier | Minus | 57 |

Having set aside Kier and Shire (special situations), nine of the remaining 13 had beaten the FTSE100. The holdings, each of similar value, were in nine sectors, and with no obvious answer the discussion broadened into a far-ranging discussion on how to select shares.

The general view was that the FTSE 100 was a good benchmark against which to measure personal performance, but, that said, members felt selecting in the 250 range, down over 10% since August last, offered a better chance of performing well compared with the market. As to target, most felt beating the FTSE, whether it was up or down, should be about 8% based on current inflation plus current average dividends with something added to reward effort. This seemed a reasonable aspiration when saving for retirement or looking for sustained income in retirement. It was noted that self-management could also save considerable management fees.

*Dr Catherine and Dr Ted Moss*

In conclusion, members decided that focusing on sectors was less important in the medium term than choosing sound companies with low debt, good interest and dividend cover, sustained growth in sales and profitability and – here there was general agreement – the importance of the strength of the product/service in terms of market share and especially product protection by patent or cost of market entry. The ability to generate repeat sales by licensing rather than selling software was quoted, as were, in the case of Rolls Royce, after-sales service contracts or, of course, brand image. All of which, and how they were valued, need to be considered when comparing NAV with market valuation.

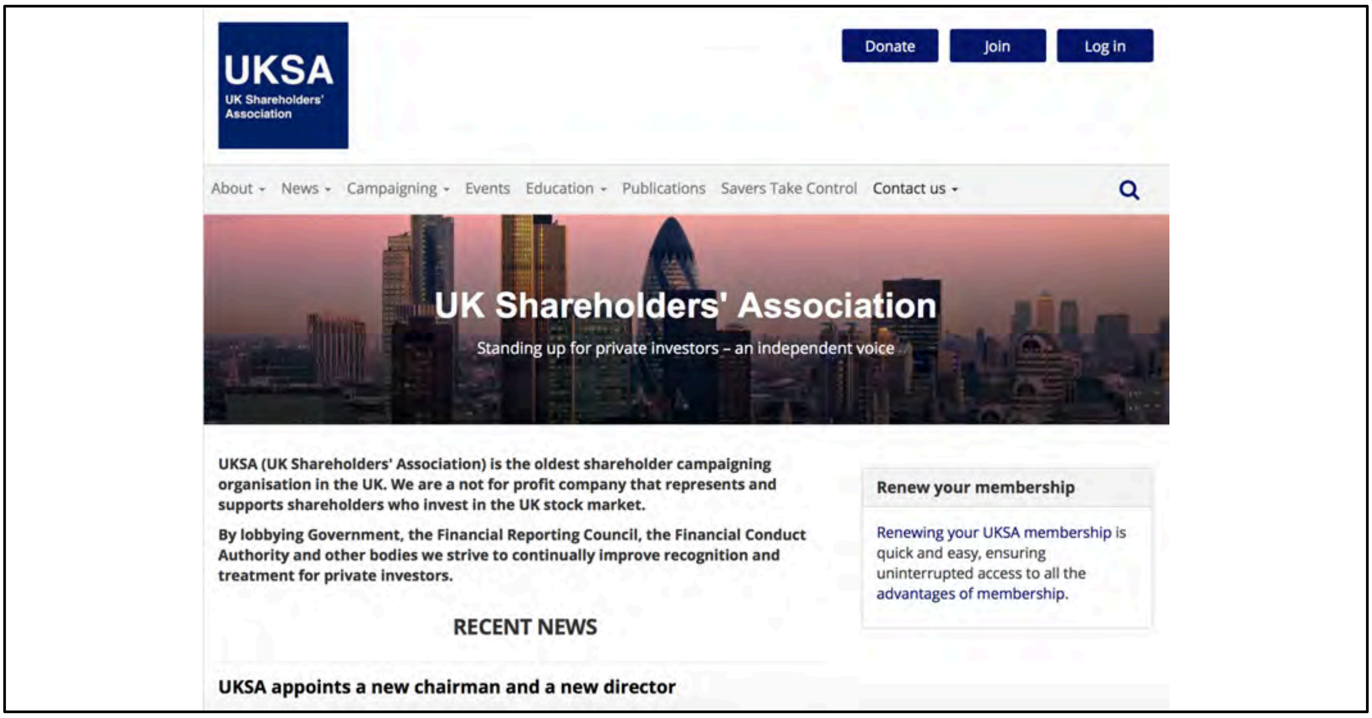
# UKSA's policy work

UKSA's policy team headed by Peter Parry has had an extremely productive year. We asked Peter to summarise the output and the result is the table below, testament to the breadth and depth of activities. As Rob McDonald mentions elsewhere in this edition, much of the work has been coordinated with ShareSoc. Please contact the UKSA office if you would like any more information on any of the activities.

| | | | |
|---|---|---|---|
| January 2018 | Open letter – Are Profits Real? | FRC + media | Jointly signed by UKSA |
| February 2018 | FCA Approach to consumers | FCA | Joint submission from UKSA and SS |
| February 2018 | Letter to Chris Shaw at BEIS re Carillion | BEIS | Joint submission from UKSA and SS |
| February 2018 | FRC consultation on updated Corporate Governance Code | FRC | Joint submission from UKSA & SS |
| February 2018 | Feedback to FRC on Priorities and Draft Budget for 2018 19 | FRC | Joint submission from UKSA & SS |
| March 2018 | Response to FCA on its approach to competition | FCA | Joint submission from UKSA & SS |
| April 2018 | BEIS Consultation on SRD II | BEIS | Joint submission from UKSA and SS |
| April 2018 | Aviva Prefs campaign | Treasury Select C'ttee and media | Coordinated input by UKSA and SS |
| May 2018 | Campaign to encourage members to write to MPs about Beaufort Securities re nominee risks | Regulators / MPs/ media | Joint SS / UKSA campaign |
| June 2018 | BEIS Consultation on Insolvency and corporate Governance | BEIS | Joint submission from UKSA and SS |
| August 2018 | Kingman review of the FRC | BEIS / Sir John Kingman | Joint submission from UKSA and SS |
| September 2018 | Investment platforms market study | FCA | Joint submission from UKSA and SS |
| September | Unilever campaign letters to MPs and press | MPs and media | Joint SS / UKSA Campaign |
| October 2108 | Competition and Markets Authority (CMA) consultation | CMA | Joint submission from UKSA and SS |

# UKSA's relaunched website

Our new website at www.uksa.org.uk is now operational. It includes numerous enhancements and will continue to be improved in the weeks ahead. Visitors can now search the entire site by clicking the magnifying glass symbol at the top right. The new site has also been optimised for smartphones and tablets.




## Europe news


UKSA participates in regular events in mainland Europe hosted or organised by Better Finance, the umbrella body for membership organisations such as UKSA and ShareSoc. Over the past year UKSA has been represented at events on shareholder education, capital markets and shareholder rights.

In the adjacent paragraph Niels Mengel of Dansk Aktionærforening (DAF) gives a presentation on delisting at an event hosted at the Kurhaus in Wiesbaden by German shareholder organisation Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW).

# UKSA EVENTS

## Shareholder meetings

**Our programme of analyst-style shareholder meetings has ended for 2018. Details of the 2019 programme will appear in forthcoming editions of TPI and on our website.**

| Meeting of UKSA Croydon & Purley Group – Tuesday 11 December 2018 | |
|---|---|
| **Location** | **Spread Eagle, High Street, Croydon CRO 1QD**<br>**Starts at 11:30 with coffee from 11:00 Chairman: Harry Braund** |

## UKSA BRANCHES – If no contact name or number is given, please contact UKSA office

| Branch name | Leader | Administration | Main purpose | Description |
|---|---|---|---|---|
| **London & South East Region** | Harry Braund 020 8680 5872 harrycb@ gmail.com | Andrew Girvan 020 8788 1665 agirvan247@btinternet.com | To co-ordinate activities in London and the South-East | Meetings in Croydon three times a year |
| **London company visits** | Nick Steiner | Individual meeting organisers | To arrange private meetings with companies | 20/30 meetings per year individually arranged |
| **Specialist company visits** | Adrian Phillips | Under review | To arrange and/or participate in events in conjunction with investor service companies | Meetings with small-company management, for experienced investors only |
| **Croydon & Purley** | Harry Braund 020 8680 5872 harrycb@ gmail.com | Tony Birks 01322 669120 ahbirks@btinternet.com | Social meetings to discuss investment issues | Meetings in Croydon monthly |
| **South West** | Peter Wilson 01453 834486 07712 591032 | Peter Wilson 01453 834486 07712 591032 | To arrange and develop activities for members in the region | Company visits and social events as arranged |
| **North East** | Brian Peart 01388 488419 | Julian Mole 07870 890973 julian.mole@ btinternet.com | To arrange and develop activities for members in the region | Company visits and social events as arranged |
| **North West** | Julian Mole 07870 890973 julian.mole@ btinternet.com | Julian Mole 07870 890973 julian.mole@ btinternet.com | To arrange and develop activities for members in the region | Company visits and social events as arranged |
| **SmartCo** | Charles Breese | Charles Breese | Arranging access to 'Smart Companies' – those with the potential to make good investment returns from benefiting society at large | Programme awaiting start-up |