

To Northern Rock Shareholders

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Northern Rock Shareholders Action Group – Update No. 41

Northern Rock Interim Results

Northern Rock has published its financial figures for the half year to the end of June. Here are some brief comments (as former Northern Rock shareholders no longer have a financial interest in the company, these are more for the general interest of taxpayers):

1. Former shareholders will be glad to see that the company is well on the way to recovery, but will be even more dismayed that the Government has stolen this valuable property from them, and plans to pay nothing for it.
2. Government loans are being repaid as shareholders expected (even faster than the company planned), and retail depositors are returning giving the lie to former allegations that the brand was irreparably damaged (so much for the wisdom of Branson et al). The borrowings from the Bank of England have been reduced by £9.4 billion leaving only £17.5 billion outstanding while retail deposits have risen to £14.2 billion from £10.5 at the end of last year.
3. Mortgage arrears are rising, partly due to the poor state of the housing market, which has not helped the financial figures, but they are still better than the UK average! We continue to see grossly misleading articles in the press about the quality of the Northern Rock mortgage book.
4. There are a lot of exceptional write-offs again, with about £45m of advisors fees, including £11m charged by the Tripartite Authorities (on top of the £12.5m charged in the last financial year) - clearly the Government is stuffing the company with all the fees it can, and the company is obviously keen to make the figures look as bad as possible by taking a pessimistic view with lots of provisions so they can show better numbers in a year or two time.
5. There is a proposed debt for equity swap which seems to be a way to improve the appearance of the balance sheet, possibly to meet regulatory capital requirements. That includes £3bn of Bank of England loans and £400m of preference shares which will be converted to equity. But of course it does mean that the debt will not be repaid by the company so the only way the Government, and hence the taxpayer, can get their money back is from future dividends on the new equity, or from a future sale of the business.

Of course, one could say that this should have been anticipated when the company was nationalised. After all the private sector solutions included substantial rights issues to shore up the balance sheet for the very same reason - it needed strengthening. But now as the sole shareholder, only the Government/taxpayer can come up with the money. That £3.4bn is about £100 for every taxpayer. We hope you all consider that a good use of your money!

IMPORTANT: This destroys the claim made at the time of nationalisation that it offered better value for the taxpayers than the private sector solutions, which has been repeated only recently in the Government's response to our application for a judicial review.

One amusing comment from Alistair Darling on the BBC was: *"It needs more shareholder capital, it does not have shareholders so it has to come from us"*. Yes but of course it has no shareholders because Darling chose to nationalise the company, so this is a self-inflicted handicap!

This additional investment in equity may well be viewed as "state assistance" to the company which has been something the Government has consistently tried to avoid. How they will justify this to the European Commission is not known, as unlike the loans this is clearly not going to be of a temporary nature.

6. The rate of recovery may have been hindered by political interference, ie. smaller redundancies than planned in the original Sandler business plan, continued expenditure on non-essential items like local football club support, etc. Of course that's what happens when you have the Government in charge of a commercial business.

7. One oddity in the debt/equity swap is that according to a Northern Rock spokesman *"the debt-for-equity swap would have no cash benefit because the bank would pay a higher interest rate for the remaining loans"*. So the company is going to be handicapped by an even more penal rate of interest on the outstanding loans, with no justification at all. But the claim is still nonsense because clearly the loans will not be repaid in cash, as originally intended.

8. When is a good time for the Government to announce bad news? The first week of August when many people and most of the business press are on holiday, and so this disclosure of the interim results and the associated information got less critical comment than it deserved.

The full interim results announcement is present at: <http://companyinfo.northernrock.co.uk/>

Court Date Fixed and Government's Response

As most shareholders should be aware, an application for a judicial review on behalf of a representative group of private shareholders was filed some weeks ago, and SRM Global and RAB Capital filed similar actions. These will be heard as one case and we have been advised that the case will get into court on January 13th 2009 and will last several days. You may want to note that date in your diary as we are likely to plan some public demonstration to take place at the same time.

The Government has also produced a response to the judicial review application via their lawyers which does not say a lot new.

The main thrust of their argument is that they should not have to compensate shareholders for the value they brought to the company by “rescuing” it with loans from the Bank of England and providing guarantees to depositors. But the loans were provided at penal rates of interest, and the guarantees were also paid for, and the company never defaulted on its obligations. They seem unable to differentiate between loans made on commercial terms to a business, and the injection of equity and we argue that the Government did not positively affect the shareholders equity interest in the business.

The Government seems to be arguing that because it lent funds to the company, that it automatically had a resulting claim on the equity in the business. Again this is nonsense. If loans are made to someone, whether it is a business or an individual, and they adhere to the terms of the loan (as did Northern Rock), then there is no claim established over the equity.

A simple analogy is this. If someone lent you money via a mortgage for 25% of the value of your house (and 25% is about the amount of the total assets of Northern Rock which were funded by the Government at one point), then if you wanted to sell the house, would you accept that such a lender had the right to acquire the equity in the house, i.e. the full ownership and title, for nothing? Obviously not, and neither would they have the moral right to force you to sell it to them.

The other part of the response from the Government is to try and justify that nationalization offered “better value”, and was less expensive for the taxpayer than the private solutions that had been proposed, whereas we claim they nationalised it because they could make more profit that way, at the expense of the shareholders. Their explanation is questionable and is even more undermined by the latest news given above about the required debt/equity swap.

We will reserve more detailed comments until our lawyers put them to the court hearing.

Government Appointment of Independent Valuer

The Government has not yet appointed an independent valuer, although as we have said before, shareholders may not be too concerned about this process as the likely answer from any such valuation is zero because of the rigged compensation terms. The only way you are going to get fair compensation is if the legal actions are successful, or the Government has a change of heart.

However, the Sunday Times has reported that at least three possible valuers are on a short-list and the favourite is Houlihan Lokey, an American investment bank.

Removal from our Mailing List

Some shareholders have asked to be removed from our mailing list even though they have made donations to our campaign. This particularly seems to apply to those who do not have an email address and suggests they are either trying to save us money or do not wish to be bothered with more letters from us. However, we do prefer to keep supporters on our mailing list because the more registered supporters we have the better. Also if we have any surplus funds left over at the end of this campaign, any donations made by people who have been removed from our mailing list will be treated as “anonymous” ones and we will not be able to return those funds. Please bear that in mind.

Campaign Status

We now have some 32,000 registered supporters and contributions to date have been over £150,000. These numbers are still growing, but we still need more donations, particularly from those who have not contributed as yet – we need to raise more money if we are to be successful and cover our total costs. Donations to the cost of our campaign and to support the legal action can be made from this page of our web site: www.uksa.org.uk/Appeal.htm . Donations can be made by cheque sent in the post, or on-line via a debit or credit card. We currently cannot accept telephone or postal credit card donations but we hope to be able to support those soon. If you wish to donate via direct bank transfer we can also accept those but please contact me for bank account information in that case (please do not send us cheques drawn on foreign banks).

We continue to get quite a lot of media coverage (for example I did three radio and TV interviews on the day of the interim results announcement) and a lot of effort is put into PR activities generally. Much of this may not be noticed by supporters but you should bear in mind that we are putting in substantial effort in this area. Supporters are reminded that all the efforts put in by your committee are provided free of charge and our main expenditure so far has been the cost of printing and postage to write to shareholders.

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Note that all previous "Update" notes on Northern Rock that we have issued are present on the following web site page: www.uksa.org.uk/NorthernRock.htm