ShareSoc
UK Individual Shareholders Society

PO Box 62, Chislehurst, BR7 5YB
Phone: 020-8467-2686
Email: info@sharesoc.org
Web: www.sharesoc.org

02 April 2015

An Analysis of the Alliance Trust Defence

Elliott Advisors have requisitioned resolutions to appoint three new directors to the board of Alliance Trust at the AGM on the 29th April. Their reasons for doing so are as follows (to quote from their announcement): *"(1) the persistent underperformance of Alliance Trust's investment portfolio against its sector peers and relevant benchmarks; (2) the high and inflexible nature of the cost of the trust's internal investment management function; and (3) the continuing losses in the Company's two operating subsidiaries, adding to the total costs borne by shareholders. As a result, the Company has among the highest discounts to intrinsic value among its relevant peers. We believe that the Board's failure to address these concerns, and fulfil the Company's full potential, is indicative of a system of corporate governance which requires new impetus*".

The immediate reaction from the board of Alliance Trust was to reject the Elliott proposals and they have subsequently published more information in a circular to shareholders.

ShareSoc issued a press release on the 24th March which supported the Elliott stance. It can be read here: www.sharesoc.org/pr64alliancetrust.html . By their nature, press releases are brief and tend to focus on the key points. This note provides a more in-depth explanation of the issues and looks at the arguments put forward by Alliance in their circular to shareholders in more detail. It gives our comments on each of the pages in sequence (numbered as per the pages of the circular) so what follows can be easily read in conjunction with the circular.

Page 1 - The key points. The cover page of the Alliance circular says: "*This is not just about nominating directors, we believe Elliott has plans for disruptive actions - this is the thin end of the wedge*". Comment: Alliance seem to be jumping to conclusions about what is in the minds of somebody else. It is difficult to see how Elliott can pursue disruptive action when the potential three new board members will be in a minority on the board and must act independently of Elliott. It is hardly in the interests of Elliott to pursue any agenda that might damage the interests of Alliance shareholders as they are shareholders themselves (indeed the largest single shareholder).

It also says "*Elliott's interests are at odds with other shareholders - we believe they are looking to exit their shareholding quickly*". Comment: It is difficult to see how their interests may differ greatly from other shareholders and Elliott have made no declaration concerning their holding intentions. Again Alliance is making allegations without supporting evidence.

It says "*Your board considers the proposed directors are not independent*". Comment: we believe they are - see later for more comments on that issue.

It says: *"Our Company already has a clear and differentiated strategy which consistently delivers strong shareholder returns – this should not be jeopardised".* Comment: The returns have indeed been consistent but not particularly strong. Indeed we said in our press release that "*In essence the performance has been pedestrian for many years*". More on performance later.

In essence we suggest these initial comments from Alliance are misleading in our view and do not provide a sound factual analysis of the issues that shareholders need to examine.

Page 2 - Dividends, performance and corporate governance. The first paragraph on page two seems to be an attempt at character assassination and we have already covered the claim of disruptive action above. The second paragraph says that "*Elliott has previously made clear to us that they see little or no value in the Company's dividend distributions, putting them at odds with the objectives of the majority of our shareholders*". This seems to be an attempt to suggest that the dividends payable by Alliance might come under threat as a result of the appointment of three new directors. As dividends are important to private shareholders this is clearly aimed at raising doubts in their minds. But it is difficult to see how threats to the dividend could arise. Even if some of the changes suggested by Elliott (lately or in the past), were adopted it seems unlikely that dividends per share would be impacted. Improving the fund management performance of the company and disposing of loss making operations might actually improve them. Elliott might have a different view to Alliance management of the relative importance of capital returns versus dividends but surely what matters is overall total returns and comments such as those by Alliance simply appear to be an attempt by them to influence smaller shareholders who may be less sophisticated in their view of such issues. In any case, the three new directors would need to convince the other directors of the wisdom of what they might propose before any changes were made.

The third paragraph on page 2 is an attempt to supply evidence on the performance of the company but it is selective in nature. This is what we said in our press release on the performance issue: *"According to the AIC at the time of writing, the Share Price Total Return over one year for Alliance is 118.5 compared with the comparable sector performance of 118.9 - in other words below average. Over 3 years, 5 years and 10 years it is also below average. Although there was some improvement in the last year, this seems to have partly arisen from special circumstances related to their private equity and mineral rights investments".* Elliott have also given a more detailed analysis of performance and Alliance's use of benchmarks in their note dated 31 March 2015 which undermines the claims made by Alliance.

Paragraphs four and five discuss corporate governance, which we do not believe will change from the appointment of three more directors, and the independence of the proposed new directors. The three proposed directors appear to us to have been selected by a sound process, and although nominated by Elliott will not be paid by them or be beholden to them - legally they must act independently of whoever nominates them.

One concern we do have about corporate governance at this company is the remuneration of the Chairman and Chief Executive which seem to be much higher than industry norms for this kind of trust. Excessive remuneration in public companies is a concern of many private investors, and of ShareSoc. The Non-Executive Chairman of Alliance Trust, Karin Forseke, was paid £120,000 last year which we consider excessive. The CEO, Katherine Garrett-Cox, received £1.34 million last year (based on the standard "single-figure" reported including benefits, annual bonus, long term incentive awards and pension - see page 58 of the Annual Report) which is also questionable.

Page 5 - Environmental, Social and Governance factors and structure. The first paragraph of this page argues that Alliance Trust is differentiated from other global investment trusts by having embedded environmental, social and governance factors into its investment criteria. There is some independent evidence that good governance in companies can improve returns and many investment managers look at this issue so it is not a sole concern of Alliance. But with regard to environmental and social factors there is less evidence for any benefit and the performance of Alliance does not demonstrate any exceptional advantage in long term investment returns as a result.

Paragraph 2 spells out that "no other trust mirrors our structure" (in essence a self-managed fund with separate investment platform and fund management businesses in addition). One has to ask what is the benefit of this mixture, and why so few investment trusts are self-managed? There are no obvious benefits of having a general investment platform as opposed to a simple savings scheme for Alliance shares and it is not clear that it will ever be very competitive or generate substantial profits. Being a self-managed fund also creates conflicts of interest when issues such as share buy-backs or tender offers are being considered. Although being self-managed can be a low-cost route, the lack of flexibility and lack of separate accountability it imposes means few trusts have taken this approach. It is not unreasonable for anyone to question whether this remains an appropriate structure.

Pages 5 and 6 - Performance, discounts and buy-backs. We have covered the key points on the relative performance of Alliance Trust above. On the table of performance statistics supplied by Alliance, the company does appear to perform reasonably well on Net Asset Value Total Return, but less so on Total Shareholder Return which is surely the key measure of most importance to investors.

The difference is no doubt accounted for by the consistently wide discount to net asset value of Alliance and would surely have narrowed if the discount to NAV had narrowed substantially. That the former has not done so rather undermines the claim by Alliance at the bottom of page 5 that the average discount has "been on a downward trend". Is their selection of a four year period coincidental? In any case they claim that the annual average discount was 12.5% in 2014 but it was 14.6% on the 16th March 2015 as we said in our press release. Not an improvement!

The company notes that it has undertaken buy-backs of 16.4% of its shares since 2011 but this does not seemed to have closed the discount down to a level comparable to other global investment trusts. According to the AIC the average discount for global investment trusts at the time of writing is 6.2%, a very marked difference to Alliance. A few well respected comparable trusts are British Empire Securities & General (discount 10.4%), Edinburgh Worldwide (discount 9.6%), RIT Capital (discount 1.0%), Scottish Mortgage (discount 0.3%) and Witan (discount 0.2%).

As the note from Alliance suggests, discounts can be affected by fund performance. Good performance tends to attract new buyers while poor long term performance tends to cause investors to drift away. It is interesting to note the comment by Alliance on page 4 about the average holding period of their shareholders as being 23 years. This perhaps suggests that they are failing to attract many new investors so are left with an increasingly aged shareholder base. The peculiar structure of the company, the pedestrian long term performance and persistent wide discount to NAV may be deterring investors rather than attracting them which may ultimately be the cause of the wide discount.

Market share buy-backs are one way of tackling the issue of wide discounts, but tender offers are another approach which it would be right to examine and likewise consideration of other changes that might indicate to investors that the strategy is under review.

Page 7 - Comments on Elliott Advisors. We will leave Elliott to deal with these no doubt selective allegations themselves, and we have covered the point about dividends which are made in the third section above. We believe shareholders should look solely at the publicly stated intentions of Elliott Advisors and not make assumptions about what their other intentions or motivations might be.

Shareholders are solely voting on the appointment of three new directors and investors should only take notice of Elliott's stated reasons for the nominations.

Any comments from Alliance Trust would have best been directed to those points alone whereas in reality they have attempted to bring in a whole mass of other claims and allegations.

The last section on page 7 makes some comments about the sex and backgrounds of the proposed new directors which seem inappropriate while ignoring questionable aspects of the current board members. For example, the senior independent director Alastair Kerr has six other directorships including two chairmanships plus no obvious background in investment management or financial services. It is contrary to ShareSoc's guidelines for directors to hold more than four or five roles.

In addition there are two members of the executive management on the board which is unusual in any investment trust where one or zero representatives of the fund manager are now the norm. This may be a result of the self-managed structure of course but nevertheless the potential conflicts of interest are large when questions about downsizing the company are discussed.

Page 9 - Cost base. It seems unlikely anyone would dispute that the costs based on an "On-going Charges" basis at Alliance Trust and as reported by them are not particularly high, although Elliott have claimed that the reported costs are not an accurate reflection of the true costs. Even on the reported basis, costs have been rising. Page 107 of the last Alliance Trust Annual Report gives the data. Administrative Expenses have risen from £10.1m in 2007 to £20.8m in 2014, and On-going Charges (including capital incentives) have risen from 0.38% in 2007 to 0.64% in 2014. They were even higher in 2012 and 2013. It would seem fair for Elliott to comment on these figures and the comments by Alliance on page 10 about the extra costs of three more non-executive directors and the limit on director's fees in the Articles are nit-picking. When the overall Administrative Expenses are £20m, those fees would not be significant and changing the Articles is not a problem.

Page 10 - Subsidiaries. There is no doubt that the Alliance Trusts savings/investment platform is attractive to some investors. But the key question is how do the investors in Alliance Trust benefit when they have primarily purchased the shares as a global investment trust? What are the synergistic benefits of the marriage of disparate businesses? Or would the savings platform be better able to exploit its market as an independent business?

Alliance Trust say the savings platform is operating in a growing market which is true as it is benefiting from the Retail Distribution Review and other market changes, but that might mean more investment is required in it to capitalise on those changes.

Likewise does the subsidiary Alliance Trust Investments provide any benefit to shareholders in Alliance Trust? It is not clear it does.

Conclusion. We said in our press release that shareholders in Alliance Trust should consider the proposed requisition very carefully and vote in favour of the proposed directors unless the Trust comes up with stronger arguments than they have to date. Their rejection of the proposals out of hand seemed unwise and is unfortunately a typical response seen from boards who are reluctant to tackle the key issues when faced by criticism from outside. In the circular to shareholders Alliance Trust have in our view not made a very strong case as exemplified by our analysis given above.

We think it was perfectly reasonable for Elliott Advisors to take up their worries with Alliance and propose directors if they considered the issues they have raised were not being dealt with. Requisitioning resolutions is simple democracy upon which shareholders can make their own minds up. We would have preferred to see a more considered and less hectoring response from Alliance.

Shareholders are of course encouraged to make their own minds up on this matter and ensure they vote. As private shareholders are in the majority in this company, it is very important that you do vote as you will decide the outcome.

If you have difficulty in voting or don't know how you can attend the AGM because you are in a nominee account and hence have not been offered a proxy voting and attendance form, you can read this page of the ShareSoc web site which explains what to do: www.sharesoc.org/nominee_accounts.html
Alternatively contact ShareSoc for advice. There are also help lines provided by both Elliott and Alliance Trust which are given on their respective web sites below if you have other questions.

For further information, please contact:

Roger Lawson
Deputy Chairman, ShareSoc
Telephone: 020-8467-2686
Email: info@sharesoc.org

The proposals from Elliott Advisors are explained on their dedicated web site here: www.improvealliancetrust.com .

The response from Alliance Trust is present here on another purpose built web site: www.supportalliancetrust.com .

File: ShareSoc_Alliance_Trust_Analysis (revised 02/04/2015)