



To all BAE Shareholders

31 March 2013

## Newsletter No. 5

### BAE AGM and voting recommendations

This note comments on the information in the BAE Annual Report, on the forthcoming Annual General Meeting (8th May in Farnborough) and gives some recommendations on how you should vote on the resolutions.

We issued some comments on the financial results for last year when the preliminary results were issued. To summarise, sales fell by 7% last year but underlying earnings per share only reduced slightly (but that's ignoring the "exceptional" items). Positive news was that the order backlog had increased by 8%, the dividend was increased and there was an announcement of an aggressive share buy-back programme. The impact on the share price since then has been quite remarkable – up 18% at 394p at the time of writing. But the squeeze of defence spending in Western markets, particularly the USA, still causes concerns among many analysts.

Our campaign was of course started when the EADS merger talks collapsed and we suggested Chairman Dick Olver should depart as soon as possible. He made it clear, despite similar views being expressed by some large institutional shareholders, that he had no intention of departing before his planned "retirement" date in 2014. But it has now been reported in the media that BAE Systems has appointed headhunters to identify a successor. Search firm Spencer Stuart have been selected for the task. It would therefore seem unlikely that Mr Olver will serve out his time as he originally planned. ShareSoc does of course welcome this change of heart by the board of the company but Mr Olver is still standing for re-election at the AGM.

### **We recommend you vote AGAINST the re-election of Mr Olver (Resolution 10).**

The reasons are as stated when we started this campaign - namely: In our view the idea that the merger would gain the widespread support of shareholders (including the votes controlled by other European Governments in EADS) was misconceived from the beginning. In addition we had seen no good business justification put forward for the merger, and it potentially created major threats to the high cash flow and dividend streams from which shareholders in BAE benefit. Therefore it was appropriate that Mr Olver and other directors who supported this merger should step down.

### **Company prospects and succession**

What does the Annual Report say on the prospects for the company and board succession? The company forecasts modest earnings per share growth in 2013 (that's again on an "underlying" basis and ignores all the nasty things like exceptional write-downs, pension liability changes and other possible problems). The forecast cash flows appear to be negative (or as the company puts it "significant cash utilisation is expected in 2013").

Mr Olver comments on the role of Nick Rose, the Senior Independent Director, on his task of managing the succession for the Chairman's role, but he also says it is "important this process is driven by the objective of finding the right person, not just by the timetable". Let us hope he does not mean it should take until 2014!

In a covering letter to the Annual Report Mr Olver provided some "reflections" on the past merger debacle. Perhaps he is anticipating some criticism from shareholders at the AGM. He says "The Board and I unanimously believe the proposed merger was based on sound industrial logic...." and proceeds to go on at some length to justify the proposed deal and explain why it proved impossible to progress. You can read it yourself and decide whether you agree with his views on the matter.

There are a number of other resolutions on the agenda of the AGM of course, and our comments on those are as follows:

### **Approval of the Remuneration Report (Resolution 2)**

Although the salaries of the CEO and Finance Director have been frozen for 2013, and there has been a focus on "simplification of our long-term incentive arrangements", we suggest that shareholders should vote AGAINST this resolution for the following reasons.

Like many FTSE-100 companies, the general level of pay in this company has reached enormous levels. For example, Mr King, the CEO, received total benefits £2.4 m in 2012, including bonuses of £1.2m. In addition the transfer value of his pension increased by £1.5m plus he was granted large numbers of share options under the PSP, ExSOP and LTIP plans – indeed it takes a whole page of the Annual Report to describe Mr King's various options schemes (Table B on page 108).

In other words, this is a typical hugely complicated remuneration scheme beloved by large public companies which has resulted in large bonuses being granted for pedestrian financial performance and a general escalation of pay levels.

### **Re-Election of other directors (Resolutions, 4,5,6,7,8,9,11,12 and 13)**

As Mr Olver makes clear, the whole board apparently supported the proposed EADS merger, including the CEO Ian King. Shareholders may therefore wish to vote AGAINST the other directors or ABSTAIN (vote withheld).

### **Purchase of Own Shares (Resolution 19)**

Although there are complex arguments for and against share buy-backs, in general ShareSoc has opposed companies using cash to purchase their own shares unless there are very good reasons to do so. It's generally an admission of defeat that the company cannot find a productive use for the cash it holds and hence prefers to return it to shareholders. But the problem with market buy-backs is that only certain shareholders can avail themselves of the opportunity – those exiting shareholders who choose to sell in the market. A tender offer where all shareholders can participate is in our view always a better solution, or a special dividend. We therefore recommend voting AGAINST this resolution.

### **Notice of General Meeting (Resolution 20)**

This resolution is designed to move the minimum notice for General Meetings (other than AGMs) to 14 days from the normal legal default of 21 days. We see no good reason for this change. Twenty one days notice is particularly relevant to private shareholders and therefore we recommend voting AGAINST this resolution.

**Other Resolutions**

We have no particular comments on the other resolutions and no particular reasons why you should not vote in favour of them at this time.

**Attending the AGM**

We would urge all shareholders to attend the AGM and express your views on the events of the last year and on the future strategy of the company. Do not forget to complete the question card supplied with the Annual Report in regard to questions you wish answered at the meeting. Such questions can of course be partly rhetorical rather than simply soliciting information, such as "Why does Mr Olver feel it necessary to hang around awaiting his replacement rather than departing immediately? Is there nobody else on the board who could act as Chairman temporarily?"

I expect to attend the AGM in person and hope to meet shareholders there.

Yours sincerely  
Roger Lawson  
Chairman

*More background information about the campaign on the BAE Systems campaign is present on this web page where further news will be posted as it becomes available:*

[www.sharesoc.org/campaigns4.html](http://www.sharesoc.org/campaigns4.html)