ShareSoc
UK Individual Shareholders Society

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Press Release

ShareSoc Calls for Change at the Top of BAE Systems Plc

Following the collapse of the merger talks between BAE Systems and EADS, ShareSoc is launching a campaign which calls for the Chairman and Chief Executive of the company to step down. In our view the idea that this 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 have seen no good business justification put forward for the merger, and it potentially creates major threats to the high cash flow and dividend streams from which shareholders in BAE benefit.

We can do no better than quote some of the statements made by Invesco Perpetual (who hold over 13% of the shares in BAE) on the 8th October:

"*1. Other than diversification - which investors can achieve for themselves more cheaply and simply - Invesco does not understand the strategic logic for the proposed combination.*

2. Invesco believes the merger would materially jeopardize BAE's unique and privileged position in the United States defence market, and has been unable to identify any corresponding benefits to offset this.

3. Invesco is very concerned that the level of state shareholding in the combined group will heavily impair its commercial prospects - especially in the United States -and result in governance arrangements driven more by political considerations than shareholder value creation."

There was widespread negative comment on the proposed deal in the media and as the Financial Times commented in an editorial on the 19th September, "*BAE is a corporate manifestation of the military ties that bind Britain and the US*".

So far as private investors are concerned, they simply saw the potential threat to the high dividend level paid by BAE, and a politicisation of the company that might undermine the existing activities of BAE in the USA.

ShareSoc Chairman Roger Lawson has this to say: "*This looks to be a classic case of empire building by corporate management, and of course there may have been financial incentives for the management to pursue this proposal – it was reported in the media that CEO Ian King's share options would crystalise due to the change of control and hence result in him instantly acquiring shares to the value of almost £18m. The other major concern is that it appears that BAE management did not obtain the general support of their major shareholders for this idea before trying to firm up the deal. In other words there has been a failure of 'shareholder engagement'. It was never very clear what benefit BAE shareholders would get from the deal, and that a merger with a US defence company might make a lot more sense*".

ShareSoc therefore invites Chairman Dick Olver and Chief Executive Ian King to step down as soon as possible, and if they do not do so we will oppose their re-election at the next Annual General Meeting. We also suggest that all the non-executive directors who supported this merger should resign and be replaced before the next AGM (it is they who should have provided the wisdom to call a halt to this idea at an early stage).

In summary, this merger was misconceived, mishandled and simply a mistake. The directors of BAE who promoted it should accept responsibility and resign. BAE clearly needs a new leadership team that can develop an alternative solution to the strategic challenges the company faces.

Note: this press release was written before the article was published in this mornings Financial Times indicating that a group of institutional investors had written to BAE calling for the resignation of Dick Olver and Sir Peter Mason (the senior independent director). The reported content of the letter seems to be similar to our reasons for demanding change. We welcome the support of institutional investors for some action.

Campaign Registration

Note that anyone who agrees with ShareSoc should contact them by sending an email to sharesoc@btconnect.com to register their interest. We will be establishing a web site page in due course so that shareholders can express their support and register their interest in this campaign.

More Information

This is a note that ShareSoc issued soon after the possible merger was announced on the 16th September which gives some background information and our initial stance on the matter:

Both companies operate in similar areas although EADS has a heaver concentration on civilian aerospace than BAE. As a result it has grown more quickly than BAE of late, which has been heavily impacted by defence cuts in the UK and USA.

You can see this to some extent on the current valuations – BAE on a p/e ratio of 7.6 and EADS on 13.6, with yields of 5.5% and 1.8% respectively. BAE has traditionally paid a high dividend and hence is a favourite long term holding of private investors who desire the income.

Relative market caps are £11bn and £17bn at the time of writing (that's after the share price of BAE rose after the announcement, and EADS fell significantly, effectively adjusting the market caps to the proposed merger proportions – see below). Both companies have complex past histories being formed from mergers of other companies, and with significant national Government stakes or influence.

The proposal is for a "dual listed" company to be formed, with a unified management structure with BAE Systems shareholders ending up owning 40% of the company and EADS shareholders owning 60%. As with all "mergers" therefore, this looks more like a takeover of BAE by EADS in reality.

There are of course enormous practical difficulties likely to be faced because of objections from Governments such as the USA, the UK, France, Germany, Spain, Saudi Arabia, and others who wish to protect their national interests and security (IP leaking out is of major concern). They may also be "competition" issues in some market sectors and countries. However you look at it, this merger could consume an enormous amount of management time over the next year.

What might be the benefits of the merger? Obviously BAE shareholders might end up owning shares in a more diversified business, with less reliance on the defence market. It might also enable the resulting larger company to compete more effectively with large US companies such as Boeing. Whether there would be any cost savings from combining operations is not at all clear (both companies are already quite large in size). An advantage for EADS shareholders is that it might enable them to escape from the political influence they suffer from as it looks like there would need to be some concessions from the France, German and Spanish Governments if the deal is to go through. But there may remain a risk of political interference in future.

But do private shareholders in BAE get any benefit from the diversification? The answer is simply no. If they want diversification, they could simply buy some EADS shares now (or any other aerospace company less exposed to defence applications).

There is also undoubtedly a major risk to future dividends, although the announcement promises no immediate change (and some improvement to EADS shareholders), but longer term the position is much more uncertain.

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Note any members of the press who wish to receive a complimentary copy of our informative monthly newsletter should send a request to info@sharesoc.org . Our newsletters cover not just the affairs of our organisation but contain general financial news and commentary. An example of our past newsletters is available on our web site. You can also follow ShareSoc on Twitter from @ShareSocUK.

About the UK Individual Shareholders Society (ShareSoc)

ShareSoc represents and supports individual investors who invest in the UK stock markets (and who own as much as 30% of the shares in UK public companies in aggregate). We are a mutual association controlled by our members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by the services it provides to members. Associate Membership of ShareSoc is free and is open to everyone with an interest in stock market investment. More information on ShareSoc can be obtained from our web site at www.sharesoc.org .