Alliance Trust Shareholder Action Group (ATSAG) - Update 6

Dear Member,

Since ATSAG was set up the number of supporters has steadily increased and we now represent holders of several million Alliance Trust shares. The committee has carefully monitored the feedback we have received from our supporters and established a dialogue with Karin Forseke, the Chairperson. This letter summarises the current position.

Performance

The interim results for the six months to 30th June were disappointing. Alliance Trust's Share Price Total Return was 2.73%. Although this was better than the 2.09% increase in the benchmark index, the Trust's Net Asset Value Total Return was only 1.38%. The outperformance was, therefore, entirely due to the effect of the discount narrowing from 12.4% to 11.2% (which the Index could not enjoy).

More recently, however, performance has improved relative to benchmark but continues to lag peer group. According to Morningstar the data for the year to date is as follows:

Year to date*	Net Asset Value %	Price %
Alliance Trust	+4.88	+7.49
Peer Group	+6.42	+7.64
Benchmark	+3.42	Nr

*As at 7 December 2015

Meeting with the Chairperson

On 28 September we met Ms Forseke. Some points of note from this meeting are:

Alliance Trust Savings (ATS) is seen by the Board as a potentially profitable investment. It has suffered in recent years from the lack of interest income which it had enjoyed when interest rates were a lot higher. Ms Forseke claimed that the investment met the Trust's "sustainable" investment criteria and that it would become profitable following the scale gained from integration of the Stocktrade acquisition and when interest rates return to normal.

On increased costs, Ms Forseke said that a decade ago it was recognised that the company needed to be updated. The facilities (such as the Dundee office) were not fit for purpose. Being one of the biggest UK investment trusts, Alliance felt it needed to take the lead in responding to new regulatory requirements. In our view other investment trusts have also faced those extra costs and been able to keep costs under control.

Outcome of Strategy Review

On 1 October, the outcome of the strategy review was announced. This restructured the group with the Board of the Trust becoming wholly non-executive (all staff transferring to either ATI or ATS with no staff directly employed by the Trust), investment management contracted to Alliance Trust Investments (ATI), a commitment to a discount management policy through share buybacks and commitment to an annual management charge paid to ATI of 0.35%.

Total costs, which include Directors' fees, the AGM, audit and share registry, are targeted at 0.45% or less. The Trust's performance target will be at least 1% (net of fees) outperformance relative to benchmark. Independent Boards will be established for ATS and ATI.

The feedback from ATSAG members, which we have shared with Ms Forseke, is:

- Although members welcomed the changes, many feel that they do not go far enough.
- The Board has delivered on some quick wins, such as reducing the discount to around 10% albeit at the cost of the share buybacks.
- There is widespread concern over the investment policy, which was changed in September 2014 without shareholder approval. A key criteria is "sustainability". This is very different from the investment proposition which existing long term shareholders bought into when they first invested.
- How arms-length is the ATI arrangement? As we analyse below, the structure is not yet an arms-length arrangement similar to that at Scottish Mortgage.
- Concerns about high levels of executive and board remuneration remain intense.

Investor Forum on 2 November in London

At the Forum, at which ATSAG was represented, we noted that Alliance Trust Savings is looking to meet a need expressed by its customers to provide loans against the collateral of their portfolios. ATS has held a banking licence since 1986.

Achievement of 0.45% Ongoing Charges Ratio (OCR)

On 9th November we wrote to Ms Forseke with questions on the cost targets and how they were to be achieved. The responses we have received provided some reassurances. Under the AIC rules for calculating OCR rates, however, non-recurring expenses and the losses incurred by subsidiary companies can be excluded and such items (both of which were significant) were excluded from the Alliance Trust OCR in both 2013 and 2014. This makes comparability with other investment trusts difficult. For example, Scottish Mortgage had an OCR in 2015 of 0.48% and as there were no non-recurring expenses and no subsidiary losses, the Scottish Mortgage 0.48% OCR is a "clean" figure.

Subsidiary Companies

We are concerned about the two principal subsidiaries ATS and ATI. The Trust's shareholders bear all the risks of these ventures with very limited control.

* In the case of ATS there are £21.9 million of shareholders funds invested in this company, which has evolved into a fully blown full service investment platform. This is a highly competitive area and fundamentally a difference business from running an investment trust. The Alliance Trust Board believes ATS now has the scale to compete, and recover the heavy fixed cost investment required. ATS has not delivered a net profit for the last seven years and cumulative losses are £33.9m.

The Trust has invested a cumulative £55.8m in the subsidiary. We believe it quickly needs to become profitable, and if it doesn't it should be sold.

* At ATI there is £15.6 million invested. Last year ATI lost £3.2m. Whilst cutting costs, ATI needs to significantly increase the amount of third party assets under management from their current level of £2.0 billion. Do the investment management team under Katherine Garrett-Cox have enough market credibility to grow these funds in a highly competitive arena? The cost interaction between ATI and the Trust is complex. However, on the basis of average Trust net assets of £2,952.7m (the position in 2014) an OCR of 0.45% implies costs of £13.287m. This compares with costs of £20.804m in 2014, a figure which does not include the losses incurred by ATI (and ATS). We believe cost reduction of this magnitude will be very challenging to achieve in a staff intensive operation without damaging motivation and morale.

* Most concerning is the lack of control exercised by the Trust over these two 100% owned subsidiaries. One Director from the Trust will sit on these subsidiary boards but the majority of the Directors will be independent or executives of the subsidiary. Alliance Trust itself will have no executive directors so it is questionable if one non-executive Trust director will be sufficient to represent the interests of the Trust's shareholders and monitor the performance of the subsidiary companies.

Share Buy backs and Discount

Since 1 October 2015 share buy-backs have substantially increase. Some 19.8 million shares have been repurchased reducing the share capital since 1 January 2015 by 3.9%. A secondary effect has been to elevate the Elliott stake from 14.0% in mid September to 14.6% today. Achievement of the 0.45% target total OCR (including the 0.35% investment management fee) will also be more challenging given that the capital base of the Trust has shrunk.

The share price discount to Net Asset Value (NAV) at the start of year was 12.4%. Fuelled by substantial buy backs in the past 2 months - at a cost of over £100m - the discount on 7 December 2015 was 10.2%. It appears that there are consistent sellers of the Trust which require to be absorbed via buy backs.

Further Board Changes

On 27th November it was announced that Karin Forseke and Alastair Kerr will step down from the Board on 1 January 2016. There is no immediate successor for Ms Forseke and Gregor Stewart has been appointed interim Chairman. We will continue our dialogue with the Chairman.

Conclusion

The restructuring of Alliance Trust is a step in the right direction in that it should make the ATS and ATI subsidiaries more accountable, and potentially capable of being divested in due course if they are considered to be poor investments. But some of the more important issues such as the post September 2014 investment policy of the Trust, cost comparability, and the adequate oversight by the Trust of its investment in the subsidiaries remain outstanding. The newly refreshed Board and the appointment of a new Chairman could be key to resolving some of the outstanding issues. Only if investors perceive the Trust as an attractive, simple and cost effective business with good investment performance will the share price discount narrow for the long-term.

ATSAG is continuing to write to shareholders who are not yet members to gain further support and we will continue to make representations to the company directors on the outstanding issues.

Roger Lawson, ATSAG

9 December 2015

www.sharesoc.org/alliance.html