

Corporate Governance, Voting and Stewardship, July – Sept 2011

This note comments on corporate governance issues and provides examples of corporate governance and engagement activity by the UK office of Schroders during the period October to December 2010. The examples cover activity linked to voting and engagement with companies outside day-to-day investment contact.

General approach to engagement and corporate governance

As in previous reports, the following paragraphs illustrate our approach to engagement with companies and our views regarding disclosure of that engagement.

The aim of all engagement on governance by Schroders is to enhance the value of the funds managed for clients. To achieve this aim, we find it essential to take a pragmatic approach in terms of how we deal with companies and how we report our engagement with them. We believe that additional value is created by engaging with and if necessary encouraging change at companies but recognise asset allocation and selection of individual stocks may have a greater impact on the returns in a client's portfolio.

Our reports on voting, engagement and corporate governance are necessarily brief and generally hide the names of the companies involved and only provide a sample of activity. We believe it necessary to avoid conducting public discussions if change might involve a climbdown by the company: it is generally preferable for companies (indeed, for any person) to accept and agree with change rather than to have it forced upon them. Publicising concerns about a director or the board of an organisation will be destabilising to the company, may damage our ability to conduct constructive discussions with any company, may damage the value of a company and may discourage talented individuals from becoming members of listed company boards. Further, particularly where Schroders manages shares comprising a significant proportion of a company's share capital, it is not in clients' interests to disclose details of the engagement Schroders must inevitably have with these companies.

There are occasions, however, where it is appropriate to reveal contact with companies, particularly in high profile cases or where we have taken a stance that requires explanation and justification.

Schroders also produces reports on engagement with companies on corporate and social responsibility. These reports are available from client directors or our SRI specialists.

Corporate Governance Policy

The Schroders corporate governance policy and our statement regarding our compliance with the UK Stewardship Code are both available on the Schroders' Internet site.

Selection of Company Contacts

Company A

We had engaged with a company regarding the investment opportunities arising from the company buying back its own shares. The current share price valuation is at a significant discount, meaning that the returns from a buy-back are far higher than the company could achieve by using the funds in its core business. We have engaged with the company on this issue but the company continues to insist that it will continue its investment programme, despite the lower returns. It is notable that the incentive structure for many executives within the firm is based on the firm continuing investing rather than pursuing an investment return based on a return of capital to shareholders, notwithstanding that the latter would be far more beneficial to shareholders.

We will continue engaging with the company.

Company B

We were approached by a shareholder some months ago regarding an idea to replace the chairman of a company in which we and the other shareholder both had a significant stake.

After giving the proposal some thought, we agreed and supported an approach to the company to suggest the transition of the chairman's role to the suggested candidate.

The current chairman agreed and accordingly his retirement was announced, due to take effect later this year.

Subsequently, the transition was brought forward.

The company is facing challenges to its business model and the retiring chairman had been in office for some time. It is

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accordingly appropriate that the company have a new chairman in order to bring a fresh perspective. This was also an example where the transition occurred quietly, with little publicity (and therefore allowing a reasonably graceful exit for the chairman) without the confrontational attitude occasionally seen at other companies.

Company C: Charter International plc

We had supported the bid by Melrose for Charter International.

We had been disappointed by Charter's performance and had pushed for improvements. We therefore supported a bid by Melrose because we believed that the transaction was essentially replacing the leadership with a team which had a proven track record of improving business performance. We engaged with the board to encourage the board to engage more constructively with Melrose but felt they did not so. Eventually, the board secured an offer from a US firm with a significantly greater cash element. Shareholders benefited to the extent they received a greater cash premium in the short term, but we believe there is a considerable opportunity cost. The Melrose option would have included a lower cash element with the majority of the offer being Melrose shares but importantly, would have offered greater participation in the improvements the Melrose team would have brought to the businesses of Charter.

Following press coverage of our position, we were obliged by regulatory authorities to make a regulatory news disclosure regarding our views following the withdrawal of Melrose: the statement (released on 28 September) said:

SCHRODER STATEMENT RE CHARTER / MELROSE

'We are disappointed, though not altogether surprised, that Melrose has had to withdraw its potential offer for Charter.

As long term shareholders in Charter, we believe there is substantial upside in the company which, in our view, would have been realised over the next 3-5 years under management by Melrose in a UK listed company. We were supportive of the Melrose offer as we never wished to be 'cashed out' of the long-term potential of the Charter businesses today, but to be able to participate in the future upside under the terms of the Melrose offer. In our view it is disappointing that the opportunity was not taken by the Charter board and its advisors to engage with Melrose and, instead, to solicit alternative approaches - to the extent of paying an inducement fee to their preferred US suitor. They may deem this outcome a satisfactory result for shareholders but we regard it as a victory for short-termism and a defeat for shareholders with a long term investment time horizon.'

Company D

We continued engagement with a company which has been maintained for several years. The company has improved performance, particularly with respect to extracting value from the assets it controls. In this case, we forwarded a broker's note regarding the options for further improvement in the company's performance to the senior independent director. The SID responded that he had seen the note but suggested we raise the issues directly with the CEO.

We did so, pushing on the ability of the company to generate further returns. The company has a chairman who controls a significant part of the share capital. The CEO is clearly predisposed to manage the company according to the views of the chairman but does, nonetheless, understand the issues and it is the case that the company has enhanced returns for all shareholders.

Company E

A company announced the departure of members of the executive leadership. We contacted the company to speak to the chairman: we learnt that the executives who had departed were appropriate for improving the efficiency of the business, including reducing costs, but had not necessarily been the right people to lead the business when a key challenge was to increase the top line. Further, the business provides professional services and it appeared the executive leadership had struggled to recruit and retain senior professionals (the 'rainmakers') who would increase sales.

Company F: easyJet plc

There has been considerable press coverage of the dispute between founder Sir Stelios Haji-Ioannou and the current EasyJet board. As shareholders, we have been in regular contact with the EasyJet board.

The dispute between Sir Stelios and EasyJet centres around his claim that the acquisition of further 'planes is damaging value. The debate had been continuing for over a year but it appeared a settlement was achieved in October 2010 when a letter of agreement was signed. The board presented details of the agreement to leading shareholders and it was hoped any further disagreements would, in future, be conducted without publicity. In 2011, however, Sir Stelios requisitioned an EGM to remove Sir David Michels from the board. Sir David then retired early, avoiding the need for an EGM. Sir Stelios then requisitioned a further EGM to remove another non-executive director. Sir Stelios then withdrew that requisition but a few days later announced he would establish a new airline.

The latest announcement would appear to contradict the agreement with the board achieved in October 2010.

We have been in regular contact with the company. Our discussions included exploring the issues which Sir Stelios raised

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concerns, particularly the company's returns. It is clear that the company has consistently improved its methods for analysing and managing the business. Following this extensive engagement with the company, we remain supportive of the board.

Company G

We have been approached by shareholders (C) in a company proposing that we support asking the board be asked to appoint a new non-executive director, nominated by C. The individual has executive experience that would be relevant to the company.

We can see the benefit of introducing change on the board but are concerned that there may be a case for more widespread changes on the board and accordingly proposed an additional candidate to C. Discussions with C will continue.

We have also contacted another major shareholder encouraging them to follow up on the initial contact they had had with C.

Company H

We have again requested to see the chairman of a company regarding the executives of a company. We are not convinced (and have not been for some time) that the current chief executive or finance director are appropriate for the needs of the business.

This case is an example that engagement with companies can be drawn out over a considerable time and might not succeed. We know that at least one other institutional holder is reluctant to force management change, notwithstanding doubts they have expressed in the past.

Company I

We have been engaging with a company regarding leadership, including proposing that the chairman of the company be replaced. During the quarter, the chairman stood down by reason of the opposition of significant shareholders, together with his other time commitments. The company had only recently appointed a new chief executive and accordingly, it was considered it was not appropriate for the chairman's role to remain unfilled whilst a search was undertaken. The company appointed an interim chairman. We were consulted on this interim appointment and agreed.

We met the interim chairman. He takes over at a time of some financial stress for the company but the meeting confirmed that the recently-appointed chief executive will receive appropriate support.