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Case Study 3: Royal Mail

Prof Osterrieder and Michael Seigne co-authored a white paper called "The Great Deception" which can be found on Candor's website, along with a "one pager" summary. We think you might find it helpful to familiarise yourself with the arguments in that paper before diving into the case studies. The paper itself is a bit technical/boring (sorry), but it provides the foundation of our argument. We suggest you read the case studies in sequence, as the explanations of the issues decrease as we progress, making the later studies much quicker to get to the main observations with far less context given.

Royal Mail plc, a UK listed company currently known as International Distributions Services plc., played a significant role in the pursuit of Candor Partners as an ongoing project. Initially, when the idea of starting a consultancy focusing on the idea of starting a consultancy focusing on the "micro niche" of share buy-back execution to some of the world's largest listed companies, it was met with a wry smile and a hint of a giggle. Candor Partners was "born" with two ambitions in mind. Firstly, to reduce transaction costs for corporates when they transact in their own shares, aiming for fairness. Secondly to work towards a better market for equity capital markets, to drive change. Both are ridiculous ambitions for one guy sitting in a home office in the countryside, we know. And yes, currently it is a "Royal" we, however there are ambitions that the plural of Partner will become reality in the future, so when writing company branded material it is as "we", pompous as that feels to me, so I will drop it for the next section.

I owe a great debt to Royal Mail as their share buy-back story is part of the foundation of this firm. I am sure that they will not be/are not happy to "singled out" for something which I don't think is their fault. Rather a very glaring example of the problems of a product within an ecosystem. Whilst exploring the viability of starting a consultancy, after having found fault with these "VWAP" based products. I tried to set about learning what I could though reading and meeting with as many stakeholders in the share buy-back process that would give me the good grace of their time and help. I spent time with various teams within corporates, and their advisors. With lawyers and investors, agency brokers and investment banks and so on. In one of those meetings, I was asking for some thoughts and help from a corporate advisor told me that there might be something in this as he had overheard a banker boasting about making £16m from a buy-back. My ears pricked up and I asked if he knew the name of the corporate, and Royal Mail was the response. I was intrigued and set to work to find out all I could about that deal. As a starting point I reconstructed the transaction from the regulatory news feed of the LSE. Understandably Royal Mail did not to engage with me at the time, and are even less likely to now, given their mention in an FT article. I apologise to Royal Mail and their management team for naming them. However, I have it necessary to provide concrete examples to raise awareness of the issue.

Throughout my career, building trust has been a priority as it forms the foundation of finance and services industries. It goes against my principles to "name and shame" a potential future client, and it is also not a good strategy to gain their trust of any other client. However almost everyone I have engaged with on this topic has asked for real example in the form of case studies. That is why I have created these created these case studies to ensure that the problem is understood, believed, and ultimately corrected. I hope that by highlighting a few unfortunate cases, it becomes evident that many other firms have used or are still using these faulty products. It is the products themselves, and the ecosystem in which they thrive that are faulty, not the companies using them.

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Program 1 of 1.
Size: £200m Broker: BoAML (technically subsidiary MLI)
Dates: Start 18th Nov '21 Latest completion date 19th Jul '22

In their Half Year Report, Royal Mail announced their intention to return £400 million of capital to shareholders through a £200 million share buy-back set to commence immediately and a £200 million special dividend to be paid alongside an interim dividend.
The press release contained several "hallmarks" indicating that Royal Mail had contracted with their broker to execute their share buy-back through using one of these products based off the "Bogus Benchmark".
In particular we will later refer back to this statement:

> "Ordinary Shares acquired by MLI under this agreement will be simultaneously on-sold by MLI to Royal Mail".

What this means is that every day when the broker buys shares, they sell those shares onto the corporate at the same price that day. Sometimes you will see similar language such as the broker will act in a "riskless principal" capacity. It all means the same thing, that the broker is in effect working as agent.
Also, a parameter of note is that there was a total of 148 trading days available to trade between the start date and the latest completion date. The x axis is calendar days, so includes weekends and holidays, the chart above shows a total of 100 odd days, with only 72 of them being days when the exchanges were open for trading.

Risk: The stock price jumped some 5% post numbers, the management update, and the buy-back announcement. The stock price broadly remained firm for the following 6 weeks, reaching a price high in the second week of Jan '22, up about 21% from the close price the day before their half year numbers. As you can see from the height of the turquoise bars the broker was spending a relatively small value each day initially. They spent about 8% of the total value of the program over this period. As the stock price started to fall the broker picked up the pace of their spending, and slowly increased that pace as the price continued to fall. From a risk perspective there is not a lot to point out. You can take issue with the price that the shares were trading at when they first start to speed up, so on the first few days they were spending on average £0.2mil a day, then half way through the first week of Dec the stock price had it first dip in price and they sped up noticeably spending £2.8mil on a single day at a higher price than day 1. But

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overall given how strong the share price had been up until that point it is a bit rich to try to find fault.
As the share price continues to fall the broker maintains their pace of spending until they complete the program after 72 trading days or taking roughly half the maximum time allowed. The stock fell approx. 35% from its high price in early Jan to the day the broker completed the program. Which was itself about 20% lower than the day before the company announced their buy-back. The fact that the broker had gone so slowing at the start of the program meant that they had more left to spend as the share price fell, which meant that the portion of money that was spent on buying shares purchased more of them. The big "but" in all of this is that the portion of the value of the buy-back ran out after £184m was spent buying shares. This was due to the structure of the fees in this product, which we will discuss in the next section.
If you wind the clock forward and look at where the share price traded between the completion date in early Mar and the 19th of Jul (latest completion date), the stock price fell a further 15%. From a share price risk perspective, it is a bit rich to take issue with the way that the execution was handled, as there was no way to know that the share price was going to continue to fall.

Fee: As we have stated many times, the fee for these products is paid out of the "out-performance" bucket. As you can see from the purple line in our chart. Every time the broker sped up the pace of their spending, the share price was below the benchmark (green line) and the purple line progressively increased to finish at little over 9%. We don't know what the contractual agreement was between the broker and the company however it looks like the broker had guaranteed a certain amount of out-performance and then kept the rest.

The net result for the shareholder is that they only bought a total of £184m worth of stock, spent a little less than £1mil on UK stamp duty and the residual money went to the broker in fees. Meaning only about 92% of the value of the buy-back was successfully transferred off the company's balance sheet to the selling shareholders.

At the start of this case study, we mentioned that this buy-back was being done in tandem with a special dividend to return a total of £400mil worth of capital to shareholders. In our other work we have spoken about share buy-backs whose objective is to return "excess capital" require and that the implementation strategy to achieve that should focus on managing/capping the portion of the capital that is lost to "friction" in the transfer process. This is why this Royal Mail buy-back implementation is a particular eye watering example of how these "products" do not allow the company to manage or cap the fictional costs.

So how do we make things better?

1. Improve transparency: As an example, we would suggest that companies also disclose the fee they paid to execute the share buy-back. Some companies are very good at this (see the Diageo example). We don't not think that Royal Mail did anything wrong, but we think it would improve the situation if they were clearer. We understand it might be embarrassing to show the costs given what eventuated, but if we don't make the costs clear, and for all to see how is the Governance process meant to happen? £184m actually bought shares before costs, is it clear enough when in their annual report it said this?

"On 18 November 2021, the Company announced a share buyback programme. As a result, 43,806,525 ordinary shares were purchased by the Company during the year at an average purchase price of 458.3 pence per share for a total consideration of £200.8 million. All the purchased shares were subsequently cancelled. "

2. Increase awareness for boards, company management, investors, corporate advisors, and regulators of this issue. It is not difficult to design a suitable execution strategy for a certain company objective for a share buy-back. However not all objectives can be solved with one tool. The broking and investing community are very rich in equity execution expertise, let's use this to help give our corporates get access to better

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products, which should improve shareholder returns and lower costs for corporates transacting in their own shares. We also need to work to keep improving the regulatory framework that facilitates this process whilst also protecting all market participants- we have lots of suggestions on this front if anyone is willing to engage on it.

3. If you want to try to help, then please share this and keep asking questions. The buy-back market is the largest section of the "equity capital markets" business today. Dealogic reported that the IPO market raised $453bn and $154bn in 2021 and 2022, the US share buy-back market in 2022 alone was ~$1 trillion. If together we can make a make a small difference to improve the risk management and efficiency of implementing share buy-backs, then even these small changes can compound quickly to make a large difference when the capital flows are this large.

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