

Graham R Sellars-Jones - Resume of Experience

48 years of continuous experience in the Financial Services sector covering virtually all aspects of activity.

1958 joined Wallace H Smith & Co; became Partner in 1969. 1981 upon merger with McIntosh Griffin Hamson & Co, became Partner responsible for Private Client area.

Subsequently within McIntosh Group, Director - McIntosh Hamson Hoare Govett, McIntosh & Co, Equity Margins Ltd; Managing Director, Deputy Chairman - Roach McIntosh Private; and following takeover by Merrill Lynch:

Merrill Lynch Private – Executive Director, Deputy Chairman

Merrill Lynch Australia – First Vice President

Bell Securities – Executive Director

Bell Potter Securities – Executive Director

- now retired from and not holding any of these positions.

Some 50 years ago, I studied Commercial Law and had the benefit of tuition from the renowned Prof Samic. He taught us many things and one which I can remember is the concept of “the reasonable man”. He explained that there were many ways whereby one might seek to circumvent the intention of the Law but that the Courts should always have regard for what it really means. In those days, the Companies Act was a ½ inch thick and today is many centimetres. Maybe a few more pages are required to address the absurdities inherent in off-market buy-backs.

At all stages of my career when in a position of responsibility, my philosophy which I have endeavoured to instil has been:

Provided you are honest, decent, diligent, competent, all you need to remember is:

- *Do the right thing by the client and the rest will follow.*

It has been my sad experience to see the gradual change to what is now almost universally the guiding light: “How much revenue / commission have you generated?”

Let me disclose my interest in pursuing my campaign against off-market buy-backs which are largely financed by the payment of franked dividends. I have no financial benefit whatsoever but, consistent with many occasions over the years, I feel an obligation to speak up on behalf of private investors who otherwise might not have a voice.

I trust that other participants in this Seminar will similarly disclose any financial interests derived from provision of their services to buy-back companies.

Off-Market Share Buy-Backs using Franked Dividends as a Major Component of Consideration

1. Companies are in business to generate rewards for the owners, i.e. the shareholders, who risk their money in the expectation of such benefits.
2. Company profits are in the normal course subject to Company Tax.
3. From what is left, Directors must reasonably decide what should be retained to enhance the financial structure of the business and what is paid to the owners by way of dividends.
4. These dividends form taxable income in the hands of shareholders.
5. In 1987 the Government introduced the concept of Imputation Tax Credits which addressed the prior situation where the original \$ of company profits ended up being taxed twice.

6. The mechanism was explained by the ATO in a booklet titled Imputation of Company Tax.
7. Essentially, the undistributed tax-paid profits carry a “latent asset” in the way of the franking credit.
8. Undistributed profits form part of Shareholders’ Equity and are owned by the Shareholders in the proportion that each shareholding bears to the total number of shares on issue.
9. The Corporations Law, presumably to assist Directors who might have difficulty with this fundamental concept, states in Section 254W that dividends must be paid equitably or, put simply, the same amount per share on all shares in the particular class.
10. Now, let’s get to buy-backs where the major portion of the consideration is in the form of a franked dividend. Here is where the problem starts:
 - (i) The ATO says that it is the company which decides upon the dividend.
 - (ii) Directors say that it is the ATO which agrees that it is a deemed dividend for tax purposes and they won’t acknowledge the actual payment of a dividend.
 - (iii) The other Government agency, the ASIC, while consistently referring to the component as a franked dividend says that, within the Corporations Law, it is not a dividend.
11. Are shareholders really expected to swallow such convoluted nonsense? Are we not entitled to consistent meaning in the use of words?
12. These share buy-backs are quite obviously tax-driven in that nil or low tax payers rush to buy the shares in the full knowledge that subsequent sale at a significant capital loss will be more than offset by the cash refund of the franking credit.
13. Thus, hundreds of millions of dollars are drained out of Consolidated Revenue.
14. But worse, the schemes can only be effective at the expense of the vast majority of shareholders who are obliged to sacrifice forever their share of retained profits with their franking credits.
15. What does the Law have to say about off-market buy-backs? There is a chapter in the Corporations Act, part 2J.1 Section 256A, which requires fairness as between shareholders and Section 257B requires offers to be made to every holder of ordinary shares to buy back the same percentage of each holding.
16. So how come? Well, these buy-backs, in order to get around the intention of the Law, are not buy-backs at all but invitations to shareholders to tender their shares for sale.
17. There is the constantly repeated trade-off benefit which says that the company can buy back more shares for the same amount of money by this tactic and consequential earnings per share go up to everybody’s benefit.
18. Never has there been any attempt to quantify such increase in earnings per share and the often inference that they go up in the same proportion as the reduction in the number of shares on issue must fall into the “deceptive and misleading” category.
19. When one attempts the calculation taking into account costs of the exercise (printing, postage, vast fees to advisory promoters, lawyers, accountants, et al), including more particularly the absence of any return previously enjoyed on the money paid out, one struggles to find the earnings per share being enhanced hardly at all.
20. Thus, the trade-off is illusory. In any event, how can an improper process be justified by some vague consequential benefit?

21. And of course, never any mention of the weakening of the Balance Sheet.
22. And of course, never any mention of the enhanced position of Executive Option Holders. For example, there are tens of millions of options in Telstra where the potential equity so represented increases as the number of shares on issue goes down.
23. What adjustment is made to exercise price or quantity? Silly question!
24. Why is it that Directors are deaf to the views of the vast majority of shareholders?
25. A survey of typical private investors in the relevant companies shows that 97% of shareholders would much prefer an enhanced or special franked dividend and/or a capital return than see their share of profits paid out in an inequitable manner as part consideration for an off-market buy-back.
26. Here is a question for Directors:
 - Does a benefit flow from the buy-back proposition?If so, does it flow equitably as between shareholders?

The answer is obviously that it does **not** flow equitably.
27. Final question:
 - Does that not put Directors in breach of their duties under the Law??

Eenie, meenie, miney, moe
Let's have a buy-back, ho, ho, ho.
Is it a dividend or is it not so?
Eenie, meenie, miney, moe.

Eenie, meenie, miney, moe
Abracadabra, let's give it a go.
What's it matter, who's to know?
Eenie, meenie, miney, moe.

I rest my case!

G R Sellars-Jones
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