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Rights and wrongs of taking up Lloyds' offer

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WITH a 240-page document to peruse, Lloyds investors have plenty to think about as they decide whether to take up the bank's new share issue.
In the biggest rights issue in history, the taxpayer-backed bank is seeking to raise more money, from almost three million shareholders, so it can stay out of the asset protection scheme, the government's insurance plan for banks' toxic assets.

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t wants to raise £13.5 billion from a rights issue and another £7.5bn from bondholders. The discount to the share price at which it will take place is unknown, but it is likely to be in the region of 40 per cent.

The options open to Lloyds shareholders, who have until 11 December to decide, include taking up their rights, selling all their rights (and getting the difference between the rights issue price and the share price at the time of the offer) or selling some of their rights to pay for the rest of the rights to which they are entitled.

So, what should shareholders do? The decision is far from clear-cut, as it depends partly on your view of the outlook for the bank, the wider banking sector and the economy as a whole.

Investors who don't feel confident that Lloyds will recover strongly in the coming years may feel like they are throwing good money after bad, said Tom Munro, director of IFA Tom Munro Financial Solutions. "There are plenty of reasons to let the offer lapse: namely no dividends will be paid for the next two years and forced disposals may weaken the income side of the business," he said.

"In addition, existing shareholders could lose further value if the ECN bond holders are converted into equity, as may happen if the bank's finances worsen."

While the terms of the offer are still to be announced, Munro expects that individuals with holdings worth about £1,000 in Lloyds Group will be asked to cough up a further £400-£600.

"However, we have seen such a dilution in shareholdings over the past 18 months that in the vast majority of cases clients' holdings are not that significant in the overall context of their portfolio."

In cases where income is particularly important to shareholders, the sensible option might be to sell up now and switch into the likes of HSBC, said Munro.

"Alternatively, if Lloyds makes up a very small proportion of an individual's portfolio, then it might not be a bad idea to give Lloyds the benefit of the doubt, this one last time, and subscribe to the rights."

One implication for shareholders not taking up the offer is that their holdings would be diluted when the new shares are issued.

But Paul Lothian, director of Verus Chartered Financial Planners in Dundee, said that as investors in shares must be prepared to suffer a loss anyway, their holdings should form only a small part of a diversified portfolio. "In the long term I think that, at their current price, Lloyds Banking Group shares should be a reasonable investment, but investors will need to exercise both patience and nerve," said Lothian "The banking group has huge losses to recoup but can make significant efficiencies, and enjoys a considerable market share advantage."

Shareholders who reject the offer could consider diverting their money into other banking shares, or opt for a fund offering broader exposure to the sector. But with several banks still writing off bad debts, the sector faces further turbulence. Adrian Lowcock, senior investment adviser at Bestinvest, said the Lloyds share issue and the latest injection of taxpayer funds into RBS served as a reminder to investors that banks are not yet out of the woods, although he pointed out that "not all banks are equal".

"The sector has suffered extreme levels of volatility and banks' share prices in recent weeks have fallen significantly off their highs, which means that for many investors the sector remains very volatile," said Lowcock. "Investing in specific sectors should not form the core of a portfolio for these reasons. However, there is significant opportunity to benefit from a recovering financial sector."

Lowcock recommends investing in a financials fund, such as the Jupiter Financial Opportunities fund run by Philip Gibb. David Thomson, investment director at VWM Investment Management in Edinburgh, concurs. "Perhaps it would be best to leave it to the experts and invest in a fund like the Jupiter Financial Opportunities fund," he said. "Not only has it risen 21.9 per cent in the past two years of terrible conditions for banks, it would have reduced your risk by investing in around 50 financial stocks spread around the world compared with putting all your eggs in one bank."

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