# PROSPECTUSES

HOW TO READ AND UNDERSTAND THEM

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## HOW TO READ AND UNDERSTAND THEM

A GUIDE FOR INVESTORS, BUSINESS MEN, COMMERCIAL STUDENTS, Etc.

BY

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# PREFACE

THIS little volume has been written for those "small investors" who need general information on the subject of prospectuses, and also some definite hints as to the points of importance which must receive attention if an intelligent investment selection is to be made. It is a simply written introduction to the science of investment, and not a manual for financial experts. After perusing this book, the reader will, it is hoped, be in a position to follow with added interest and benefit the comments of the financial Press on new issues of capital, and he should also be able to bring a quickened power of analysis to bear upon the prospectuses which fall into his hands. If the habit of discrimination is induced in the intending investor, the object of the writer will have been sufficiently attained.

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THREE YEARS' CAPITAL CREATIONS, ADVERTISED BY PROSPECTUSES IN THIS COUNTRY

(WITH ACKNOWLEDGMENTS TO *The Times*)

| | 2nd half. | 1st half. | 2nd half. | 1st half. | 2nd half. | 1st half. |
|---|---|---|---|---|---|---|
| | 1908. | 1909. | | 1910. | | 1911. |
| British Funds .. .. .. .. | 5,000,000 | 4,000,000 | 7,500,000 | 27,000,000 | 4,000,000 | 2,000,000 |
| Home Corporation and County .. | 950,000 | 3,469,150 | 1,740,000 | 1,311,800 | 351,900 | 2,663,500 |
| Indian and Colonial Governments .. | 9,200,000 | 23,945,000 | 8,300,000 | 24,231,400 | 12,550,000 | 7,650,000 |
| Colonial and Foreign Corporation .. | 4,810,700 | 18,070,440 | 3,776,846 | 10,588,100 | 3,060,425 | 4,325,130 |
| Foreign Governments .. .. .. | 15,500,000 | 20,308,520 | 11,021,490 | 30,739,600 | 4,348,000 | 16,239,350 |
| Home Railways .. .. .. .. | 4,850,000 | — | — | 2,500,000 | 900,000 | 1,870,000 |
| Colonial ,, .. .. .. .. | 1,825,800 | 4,300,000 | 10,545,550 | 4,317,500 | 3,370,000 | 3,888,097 |
| Indian ,, .. .. .. .. | 2,500,000 | 3,275,000 | — | 3,300,000 | — | 800,000 |
| American ,, .. .. .. .. | 13,940,000 | 22,772,750 | 12,671,600 | 40,576,550 | 5,400,000 | 15,521,248 |
| Foreign ,, .. .. .. .. | 14,637,640 | 16,786,000 | 8,800,000 | 8,716,750 | 9,288,116 | 19,550,000 |
| Banks and Insurance .. .. .. | 2,850,000 | 900,000 | 1,825,000 | 845,490 | 4,246,179 | 1,700,000 |
| Commercial .. .. .. .. | 11,243,790 | 11,495,427 | 8,058,980 | 15,767,993 | 7,054,458 | 16,818,572 |
| Finance Land and Trusts .. .. | 6,015,167 | 5,479,999 | 873,970 | 8,918,300 | 2,650,473 | 7,885,000 |
| Iron, Coal and Steel .. .. .. | 1,200,000 | — | 1,355,000 | 2,615,001 | 1,129,100 | 1,335,000 |
| Docks and Shipping .. .. .. | 1,550,000 | — | — | 2,086,000 | 2,108,210 | — |
| Electric light and Power .. .. | 800,000 | 4,399,000 | 500,000 | — | 2,000,000 | — |
| Gas and Water .. .. .. .. | 1,043,975 | 197,865 | 130,000 | 70,190 | 22,500 | 31,000 |
| Mines .. .. .. .. .. | 2,779,100 | 2,287,250 | 1,476,833 | 3,463,000 | 2,965,000 | 1,896,643 |
| Tea, Coffee and Rubber .. .. | 755,000 | 1,172,000 | 6,791,903 | 18,723,250 | 3,883,441 | 3,219,950 |
| Tramways, Motor Cabs, etc. .. .. | 1,890,000 | 2,810,582 | 1,008,000 | 3,661,800 | — | 5,293,500 |
| Telegraphs and Telephones .. .. | — | — | 2,400,000 | 2,500,000 | — | 550,000 |
| Oil .. .. .. .. .. | — | — | — | 10,986,700 | 1,670,625 | 2,968,040 |
| | 103,341,172 | 145,668,983 | 88,775,172 | 222,920,323 | 70,998,427 | 116,205,939 |

# PROSPECTUSES

## HOW TO READ AND UNDERSTAND THEM

## CHAPTER I

### THE PROSPECTUS AND ITS READERS

THE "SMALL" INVESTOR—LACK OF INVESTMENT KNOWLEDGE—"BOOMS" AND THEIR RESULTS—DANGERS OF PREJUDICE

IN these days of the so-called "small" investor, there are few persons who have not had the experience of finding on their breakfast table the familiar long envelope containing a "Prospectus." The communication comes uninvited; no friendly letter enquiring after the health of the recipient and signed by a familiar name, is within; but the object of the enclosure is clear beyond doubt. It is his money that is wanted. Its mission is accomplished when the reader fills up and signs a particular form which accompanies the "prospectus," attaches thereto a cheque and despatches these to a given address.

As a sequel to this act of confidence he will receive, after a few days, an Allotment letter, with instructions as to certain future payments to be made by him; then, after a longer interval, there will come to hand a certificate, indicating his title to certain share capital.

This simple procedure, it is to be feared, constitutes the whole art of investment for a large number of small capitalists, who, sufficiently expert in their own business to amass money, outside of their particular sphere are neither more nor less acute than their fellows. They seldom have the opportunity of reading the great financial dailies, and for their education in investment matters they depend upon the money columns of their favourite newspaper and the suggestions of friends. It is these who feel the fascination of the prospectus, and who most need knowledge to enable them to analyse its attractions. For the appeal of the prospectus is so calculated and so full of glamour, that even minds familiar with the ways of finance are sometimes misled into supporting doubtful enterprises. The writer was acquainted with a brilliant financial journalist who was especially clever in preparing prospectuses. He wrote with convincing power. On one occasion, when a draft of one of his skilful compositions was about to be read over in his presence, he begged leave to withdraw lest he should be persuaded by his own eloquence to subscribe to the issue. There is more than humour in this incident.

There are tens of thousands of investors to-day, where there were but hundreds twenty years ago. The great mining boom of the Nineties drew thousands of men and women into the toils of speculative investment who previously had been content with conservative stocks like Consols, Municipal Loans, and Railway Debentures. For a dozen years after that there was a slackening of investment. But again, recently, large numbers of persons, whose investment knowledge is by no means extensive, have been attracted into joint-stock enterprises. Is it a matter for wonder that the road along which experienced men walk warily should be full of pitfalls and hidden dangers for those who have hitherto never studied its intricacies?

Unfortunately, the "small" investor is denied access to those financial authorities whose services are always at the command of the larger capitalist. The man of wealth can readily turn to his broker, his banker, and to other professional financiers for advice and information. Moreover, he frequently has the advantage of first-hand knowledge of investment matters, gained by an intimate acquaintance with the financial side of industry. But the large majority of those who cannot claim to be rich men are not in a position to make easy reference to "my broker" or "my banker." The result is that they rely upon the breakfast table prospectus for their practical introduction to the field of investment.

It is chiefly for this large class that this book has been written. It is a class which has considerable influence in investment matters, for although its members deal in amounts which a millionaire would deem negligible, in the aggregate it controls an enormous sum of money. Until this section of the public "comes in," as Stock Exchange parlance has it, brokers and jobbers can manage their business comfortably within the recognised hours, but when at length it "takes a hand," there is excitement in the "Street," and all-night sittings begin.

Naturally it is this class which suffers most heavily when a so-called "boom" collapses. An analysis of the lists of shareholdings in companies which have gone into liquidation during the last fifteen years, would show the vast majority of the subscriptions to be in sums varying from £5 to £500. Probably 75 per cent. of these subscriptions were sent in as the result of the invitations in the prospectus scattered broadcast over the land. Of these contributors, again, probably not more than five per cent. read the prospectus from beginning to end, or examined it with critical mind. Their investment was, in fact, nothing more than a gambler's throw.

The strange thing is, that those who thus stake their money on the faith of a few lines of bold type in a prospectus, are frequently men who, in their own profession or business, would think carefully before taking more than ordinary business risks. Compare the care with which a merchant enquires into the financial and moral stability of a new customer who desires to open a large account, with the carelessness he will exhibit in ascertaining the standing of the directors of a new venture in which he is invited to place some of his surplus capital.

No doubt the desire to "get rich quick" is at the root of much rash investment. There are few men capable of withstanding the temptations of a "boom." They see shares which a few weeks before were issued at par, leaping upward in price day by day, and their imagination is fired by the thought of the money they *might* have made had they purchased earlier and sold at the current price. As prospectus after prospectus is issued in that Stock Exchange heyday, and quotations still soar gaily upward, they cry plagues on their prudence, and the next prospectus finds them ready, cheque-book in hand. In such cases as these, the applicant for shares generally knows little more about the Company than its name. His one concern is to watch the prices on the Stock Exchange, and to sell his shares at as large a profit as he can. He cares nothing for the intrinsic merit of the undertaking. He has no intention of waiting until the Company proves successful and pays dividends. He wants to get his capital back quickly, several times over if he can, but, at any rate, with as great an addition as possible. This is not investment, but speculation. It is mere reckless gambling on his part even if the undertaking to which he subscribes proves to be essentially a sound one. It is the outcome of the temporary aberration of intellect of an otherwise sane and cautious citizen.

But there are investors who, though they forswear the blandishments of booms for reasons of prudence or of principle, are so swayed by prejudice in favour of certain classes of stocks that their judgment is unduly influenced. Such a man might have so boundless a belief in the future of, say, electricity, that he would subscribe to the issue of a new electric power undertaking without considering the concession of the company, the adequacy of the capital to carry through the scheme, or whether he could not obtain as high a rate of interest by investing his money in the stocks of an established business of a similar character. Another will prefer breweries, or railways, because his relatives hold similar stocks; and others will manifest a pathetic faith in Consols on the grounds of "safety."

Now it cannot be too strongly pointed out that bias in investment matters constitutes a real danger to the investor. To take up a prospectus while an *idée fixe* occupies his mind, is to approach an already difficult task with a fettered intelligence. Inevitably he will give greater weight to some factors than they deserve, and to others less than they are entitled to. Therefore the intending investor should bring to the study of the prospectus a judgment which he has deliberately made as free as possible from preconceived and crystallised notions, and he should be prepared to judge each stock submitted to him entirely on its merits.

# CHAPTER II

## Investment Categories

### CLASSIFICATION OF PROSPECTUSES

Every security advertised by a prospectus falls under one of the categories into which investments have been divided by the Committee of the London Stock Exchange. These as given in the official organ of that Committee, are as follows :—

British Funds, etc.
Corporation and County Stocks. United Kingdom
Corporation Stocks. Indian and Colonial.
,, ,, Foreign.
Public Boards. United Kingdom.
Colonial and Provincial Government Securities.
Foreign Stocks, Bonds, etc.
Railways—British.
,, Indian.
,, British Possessions.
,, American.
,, Foreign.
Banks and Discount Companies.
Breweries and Distilleries.
Indian, Native Raj, and Zemindary Loans.
Canals and Docks.
Commercial, Industrial, etc.
Electric Lighting and Power.
Financial, Land, and Investment.
Financial Trusts.
Gas.
Insurance.
Iron, Coal, and Steel.
Mines.
Nitrate.

Oil.
Shipping.
Tea, Coffee, and Rubber.
Telegraphs and Telephones.
Tramways, and Omnibus.
Waterworks.

Facing p. 1 will be found a list, closely following the order given above, showing the enormous amount of capital created during the three years ended 30th June, 1911, and particulars of which were advertised in prospectus form in the daily issues of the *Times*. Each of the groups has characteristics which mark it off distinctly from the others ; and similarly, a prospectus issued by a unit of one group would have typical features of its own. It would be impossible, within the limits of this book, to consider specimens from each investment category, but a number of important groups will be considered, and it is hoped that the habit of criticism which may be induced in the reader, will enable him to enter upon the examination of any form of prospectus with a mind keen to note essentials, whether of strength or weakness.

## CHAPTER III

### Government Loans

CONSOLS—WHY A FIXED REDEMPTION DATE IS IMPORTANT —FOREIGN GOVERNMENTS AND "SECURITY"—CHINA—BULGARIA—JAPAN—WHAT THE PROSPECTUS SHOULD CONTAIN

It is natural that the stocks issued by a Government should rank first of all of the stocks of that country. This precedence is accorded it, not because it yields a larger income than any other stock, but by reason of its greater stability. Its security is the taxable wealth of the whole nation; therefore the investor may rest certain that his capital will never be entirely lost. No first-class Government has repudiated its indebtedness, nor failed to pay interest thereon. Even Russia in her darkest hours of financial stress has met her financial obligations.

But there is no more guarantee with a Government loan than with an industrial debenture, that the investor will not lose a portion of his capital through a fall in the market price. The Consolidated Stock of the British Government, familiarly known as "Consols," is a case in point. This stock, a few years ago, was quoted at 113. Its interest was then 2¾ per cent.; it is now 2½ per cent., and its market price is under 80. This is a decline of 33 points, or, if we allow 9¼ points for the reduction of the interest by one-eleventh, there is an actual drop of 23¾ points. Thus an unfortunate purchaser of Consols at 113, who, through stress of circumstances, was forced to realise to-day at 80, would lose 21 per cent. of his capital.

When a Government requires money, it issues its prospectus, which takes the form of an advertisement. The notices of our own Government are brief and to the point. There is no unnecessary verbiage, no attempt to persuade unwilling capitalists, no exaltation of its great financial stability ; in fact, its announcements are just what we should expect to be made on behalf of a powerful and wealthy nation.

As an example, take the issue of £21,000,000 Exchequer Bonds, which was advertised on March 18th, 1910, as per Example 1 (pages 17–18).

Since the security is unquestionable, let us consider the other features of the issue. The Bonds were offered at £99½ per cent., and the interest is at the rate of 3 per cent. Thus the income yield is a trifle over £3 per cent. on the outlay. Next note the date of redemption. The prospectus gives this as the 5th April, 1915 (the end of the financial year) and the price at which the Bonds will be paid off is par, viz., £100 (the nominal value, not the issue price). Thus the investors who subscribed for this twenty-one millions of Bonds are safe for five years so far as their capital is concerned. Regularly on the 5th of January, April, July, and October of each year they will receive their interest (less Income Tax) and they may ignore the fluctuations in the market value of their Bonds in the certainty of receiving the full nominal value of their holding on the 5th April, 1915.

A fixed date of redemption is of importance for the following among other reasons : (1) It enables the purchaser to know exactly when he will require to seek another investment, and (2) he can more easily calculate its probable market value should he desire to sell beforehand. Thus, if a Bond which stands at 95 on the Stock Market is redeemable in five years at £100, it is fairly certain that, other things being equal, it should be worth 96 next year, 97 the year following, and so on, until in the fifth year it reaches the price of redemption. On the other hand, if the stock stand at 105 and is repayable five years hence at £100, each year will witness a fall of one point, until it reaches par.

An effective contrast in this respect is offered by Consols, which stock is not redeemable in any case until April 5th, 1923, and then only on such notice, at such time or times, and either in one sum or in such sums as Parliament may direct. Hence, a purchaser of Consols to-day at about 80, *may*, in 1923, receive £100 for each £80 now expended. But there is no obligation on Parliament to do anything so benevolent, and no likelihood of it happening while the Government can repurchase through its Broker in the Stock market at a very much lower figure.

Foreign Governments do not disdain to appeal to this country for capital, and to issue prospectuses for that purpose. They seek money here rather than in their own land, because in Great Britain there is more cash available, and where capital is plentiful it is cheap, *i.e.*, the owners cannot obtain so high a rate of interest as they can where money is scarce. Thus a Foreign Government which issues a loan here gains in two ways, viz., (1) by borrowing at a comparatively low rate of interest and (2) by selling its bonds at a comparatively high price. It is quite certain, for instance, that China, the Argentine and Brazilian Republics, could not obtain a loan from their own subjects on such advantageous terms as could be had here. On the other hand, the rate of interest paid by those Governments to British lenders is higher than any stock which has been, or is likely to be, issued by the British Government, and this is one of the reasons why so many millions of English money have gone to build Chinese railways and to develop the Great Republics of South America.

As the status of a country rises, it can borrow on better terms than formerly. Take the case of Japan. In 1901 and 1902 it issued £10,000,000 of 5 per cent. Bonds. These were to remain irredeemable for five years, after which date the Japanese Government reserved to itself the right of paying them off—in any case they were all to be redeemed —some by 1955 and the remainder by 1956. But after beating Russia in the war of 1904-5, and subsequently setting her finance on a sound basis, Japan's position in the eyes of the world was enhanced, and she took advantage of this fact to borrow £11,000,000 in Europe at 4 per cent., and with this money to pay off the loan of 1901-2 and that of 1895-6, on both of which she was paying 5 per cent. interest, thereby largely reducing her annual interest bill.

Better known, perhaps, is the case of our own Consols. Prior to 1888-9, the interest on this security was 3 per cent., but in that year it was changed into 2¾ per cent. until 5th April, 1903, when it was again reduced to 2½ per cent. By this "conversion," the country saved over £1,000,000 annually in interest.

Consider now one or two points in the prospectus issued on behalf of the Japanese Government which is given in Example No. 2 (pages 19–23).

The law and ordinance under which the loan was created are quoted (1)[1] and the ordinary investor would scarcely need to inspect the certified translations which are at the offices of the three issuing banks. (4) He may safely trust those responsible corporations to see that there is no flaw in that respect. The subscription price is £95 per £100 bond, and the interest is 4 per cent.; so that the investor's money would earn at the rate of £4 4s. 2d. per cent. But actually he does better than that, for, as the prospectus states, he gets a small bonus of extra interest. Thus (2) on the 1st June he can encash a coupon for £1 (equal to three months interest on £100), although he will have been out of pocket only £30 (£5 on application and £25 on allotment) since the 10th May, or twenty days. Also, on the 1st December, he can draw his full half-year's interest of £2, notwithstanding that he pays the balance as follows:—

£25 per cent. on 3rd June.
£20 ,, ,, on 4th July.
£20 ,, ,, on 3rd August.

The actual gain is about 25s.

No banker or commercial man would dream of lending money in ordinary cases unless some form of property were

[1] The figure refers to the paragraph in the example marked with the corresponding figure.

hypothecated to him as security for his money. China invariably reserves special revenues from customs or railways to meet interest on her loans, but Governments, as a rule, do not vouchsafe much information as to their ability to meet their obligations to their creditors. Experience shows that those high up in the scale of nations, can obtain all the money they require by way of loans from their own subjects, or those of other nations, without condescending to mention the matter of security. The United Kingdom owes to-day some 560 millions sterling on its consolidated debt alone, but what is that to a nation whose *annual income* for the year 1905-6 was computed to be 1,920 millions sterling.

Nevertheless those countries of lesser magnitude which frequently go outside their own borders when they require financial aid, have already found it desirable to supply their patrons with some particulars as to their ability to carry out their engagements. For instance, on June 16th China issued a loan simultaneously in London, Germany, France, and New York for a total of £6,000,000 5 per cent. sterling bonds, which she required for the construction of certain railway lines, and she was careful to state the security she proposed to give to her lenders. The clauses relating to the service of the loan are set out below:—

This loan, which is a direct obligation of the Imperial Chinese Government both as to principal and interest is, together with the second series of £4,000,000, specifically secured by a first charge upon the undermentioned Provincial Revenues, which are declared by the Loan Agreement to be free from all other loans, charges, or mortgages:—

1. Hupei General Lekin, amounting to two million (2,000,000) Haikuan Taels a year.
2. Hupei additional Salt Tax for River Defence, amounting to four hundred thousand (400,000) Haikuan Taels a year.
3. Hupei new additional two cash Salt Tax of September, 1908, amounting to three hundred thousand (300,000) Haikuan Taels a year.
4. Hupei Collection of Hukuang inter-provincial Tax on imported Rice, to the amount of two hundred and fifty thousand (250,000) Haikuan Taels a year.

5. Hunan General Lekin amounting to two million (2,000,000) Haikuan Taels a year.
6. Hunan Salt Commissioner's Treasury Regular Salt Lekin to the amount of two hundred and fifty thousand (250,000) Haikuan Taels a year.

Total 5,200,000 Haikuan Taels (say at 2s. 8d. per Haikuan Tael, £693,333) a year.

Bulgaria also deems it wise to state her resources when she goes a-borrowing, even for the small sum of £229,680, as in April, 1911. This was a 4½ per cent. loan offered at 94 per cent., and the prospectus set out some important statistics, viz. :—(1) The outstanding loans of the Royal Bulgarian Government on 1st January, 1911, were £21,136,000. (2) The Government owns property in Railways, Lands, Forests, Buildings, Harbours, and River-ports, Canals, Telegraph and Telephone Lines, Roads, Bridges, etc., valued in the Budget at £50,000,000 odd. (Compare with this the fact that Great Britain owns some Suez Canal Shares valued at say £32,500,000, Cunard Steamship Co.'s Debentures for £2,470,000, and other odds and ends making a total of about £43,500,000, but never a railway, a dock, a harbour, nor a canal.)

Following on that information, the Bulgarian Government set out the ordinary revenues and expenditures of the nation commencing with the year 1907 :—

| | Revenue. | Expenditure. |
|---|---|---|
| 1907 | £5,980,600 | £4,788,663 |
| 1908 | 6,137,048 | 4,933,784 |
| 1909 | 6,456,666 | 6,218,797 |
| 1910 (not yet definitely closed) | 7,080,000 | 6,883,164 |
| 1911 (Budget Estimate) | 7,137,812 | 7,135,817 |

In concluding this chapter, it may be well to state specifically the points to which the would-be investor should direct his attention when considering a Government prospectus. They are as follows :—

(1) *Authority to Issue, i.e.*, the laws and ordinances under which the loan is authorised.

(2) *Amount of Loan.* In the case of small countries and those not too financially strong, or which have been

borrowing frequently, a request for a large sum should be regarded with caution.

(3) *Security.* Loans required for developments of a remunerative kind, such as railways and harbours, and which are secured (*a*) as to capital upon such undertakings, and on the collateral security of other tangible assets; and (*b*) as to interest on actual excess revenues after paying charges for the service of prior existing loans—are, of course, to be preferred (other things being equal) to loans obtained for the purpose of paying off current debts and for "general purposes." In this connection there must also be considered the general standing of the nation, its reputation for honourable dealing, its freedom from political complications, its capacity to deal with internal unrest, and its natural resources and acquired wealth.

(4) *Interest.* (*a*) The rate fixed must be considered in the light of the foregoing factors; the greater the security the lower will be the interest, and *vice versâ.* (*b*) It is important to note whether the interest is payable in London or abroad, and (*c*) whether on a gold basis or otherwise: If, for instance, it is payable in kroners (*e.g.*, Austria) or taels (China) or yen (Japan) or dollars (U.S.A., Brazil or Mexico), it is necessary to note the exchange value which is attached to these units. Unless the value payable in London is fixed, the interest of foreign loans varies with the rate of exchange between the country of origin and London, which may lead to loss. If, however, the currency of the lending country is gold, the fluctuations are extremely slight. [See Example 2, (3).] (*d*) A point frequently overlooked is whether the interest on foreign Government loans is subject to taxation by the country paying the interest. If so, the amount of net interest obtained here is, of course, all that can be taken into account by the investor. (*e*) Interest bonus.

(5) *Yield.* (*a*) From the net interest on the price paid, the rate of yield can be obtained. Thus, if £90 is paid for a

loan on which the interest is £4½ per cent., the interest on an investment of £100 at the same rate, would be £5. This is the yield *per cent*, as distinct from the actual interest paid. (*b*) This yield enables the investor to compare the value of the loan as an investment with other stocks issued by the same nation, for there is no advantage in buying a new loan if existing bonds of the same country with, perhaps, a better security, can be bought through a stockbroker at a price which gives a yield as good or possibly superior.

(6) *Redemption.* (*a*) If the date at which the loan is redeemable is short, say five or even ten years, it may not suit the purpose of the investor unless (*b*) the redemption price represents an increase on the amount paid. There is, indeed, no finer form of security than a short-dated Government loan redeemable at a substantial premium, for the purchaser is certain of an increase in his capital account in a few years, and of interest on the money meanwhile. (*c*) Note whether the redemption money is to be provided for by a Sinking Fund formed by the setting aside of an annual sum. If no such provision is made, the inference is that a fresh loan will have to be made to pay off the bonds, and there may be difficulties in the way of this when the date of repayment arrives.

(7) *Has the Issuing Government ever Defaulted on its Loans?* A number of States in the less settled parts of the World (*e.g.*, Central America), have failed from time to time to pay the interest on their bonds, to the great discomfort of the holders. On such occasions, the quoted price of the bonds on the Stock Exchange falls rapidly, and nervous holders sell and lose heavily. Among others, Colombia, Costa Rica, Greece, Guatemala, Honduras, Liberia, Nicaragua,[1] Paraguay, San Domingo, Uruguay, and Venezuela, have defaulted either on principal or interest, although they may subsequently have come to terms with

[1] Defaulted as recently as January 1st, 1912, on its 1909 Six per Cent. bonds.

their creditors. Mississippi, one of the States of the American Union, is also qualified to join this list. Over seventy years ago this State ceased to pay interest on a borrowed sum of £1,400,000 and it now owes in interest on this amount £5,254,000.

The prospectuses of such Governments generally set out tempting offers in the shape of high interest, and redemption at a big premium, but these loans are best left untouched by all who seek capital safety and freedom from financial anxiety.

EXAMPLE 1

# EXCHEQUER BONDS

*Per Acts* 29 *Vic., c.* 25 ; 52 *Vic., c.* 6; *and* 10 *Edw. VII, c.* 2.

BEARING INTEREST AT £3 PER CENT. PER ANNUM, PAYABLE QUARTERLY.

*The First Dividend will be paid on the 5th July,* 1910.

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# ISSUE OF £21,000,000 BONDS

REPAYABLE AT PAR ON THE 5TH APRIL, 1915.

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## Price of Issue, £99 10s. per Cent.

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THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND are authorised by the LORDS COMMISSIONERS OF HIS MAJESTY'S TREASURY to receive Applications for £21,000,000 EXCHEQUER BONDS, to be created under Acts 29 Vict., c. 25; 52 Vict., c. 6; and 10 Edw. VII, c. 2.

The Bonds, which will be in denominations of £100, £200, £500, £1,000 and £5,000, will be dated the 5th April, 1910, and will be repayable at par on the 5th April, 1915.

Interest at £3 per cent. per annum will be paid quarterly by Coupon on the 5th January, 5th April, 5th July, and 5th October, the first Coupon being payable on the 5th July, 1910.

**Applications, which must be accompanied by a deposit of £2 per cent., will be received at the Chief Cashier's Office, Bank of England.** In case of partial allotment the balance of the amount paid as deposit will be refunded by cheque.

Applications may be for the whole, or any part, of the issue, in multiples of £100.

Payment in full of Allotments must be made on, or before, Tuesday, the 5th April, 1910. In case of default in the payment of the amount by that date, the sum previously paid will be liable to forfeiture.

Scrip Certificates to Bearer, exchangeable for the definitive Bonds at a date to be announced later in the Public Press, will be issued in exchange for the provisional receipts.

Applications must be made upon the printed forms which may be obtained, together with copies of this Prospectus, at the Bank of England, at the Bank of Ireland, and at any of the Branches of those Banks; and of Messrs. Mullens, Marshall & Co., 13, George Street, Mansion House, London, E.C.

**The List of Applications will be closed on or before Wednesday, the 23rd March, 1910.**

BANK OF ENGLAND,
*18th March*, 1910

EXAMPLE 2

The List of Applications will be closed on or before 18th May, 1910

# Imperial Japanese Government
# 4% Sterling Loan of 1910

FOR

## ① £11,000,000

Created under the authority of Law No. 6 of 1906 and of Ordinance No. 24 of the Finance Department of the Imperial Japanese Government, promulgated 6th May, 1910.

*Proceeds of this Loan will be applied exclusively to the conversion and to the redemption of the Yen* 43,000,000 *Imperial Japanese Government* 5 % *War Loan Bonds of* 1895-6, *and the Yen* 50,000,000 *Imperial Japanese Government* 5 % *Bonds of* 1901-2, *which are endorsed payable in London at the fixed rate of exchange of* 2s. 0½*d. per Yen and officially quoted on the London Stock Exchange.* ③

## SUBSCRIPTION PRICE 95 PER CENT.

Repayable at par on 1st June, 1970, but the Imperial Japanese Government reserves the right to redeem at par all or part of the Loan on or at any time after 1st June, 1920, on giving six months' previous notice by advertisement.

The Loan will be in Bonds to bearer of £20, £50, £100, and £200, with half-yearly Coupons attached, payable 1st June and 1st December.

**② A Coupon for £1 per £100 Bond payable on 1st June next, and also a full half-year's Coupon for £2 per £100 Bond payable on 1st December next, will be attached to the Scrip Certificates.**

The Bonds and Coupons will be payable, in London at the Office of The Yokohama Specie Bank, Limited, 120, Bishopsgate Street, Within, E.C., in Sterling; and, at the current rate of exchange on London, in Japan at the Office of the Bank of Japan, Tokyo, and in France and Switzerland at Agencies to be appointed by The Yokohama Specie Bank, Limited.

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**PARR'S BANK LIMITED. THE HONGKONG AND SHANGHAI BANKING CORPORATION**

AND

**THE YOKOHAMA SPECIE BANK, LIMITED**

are authorised by the IMPERIAL JAPANESE GOVERNMENT to receive subscriptions for the above Loan, payable as follows :—

| | |
|---|---|
| £ 5 : 0 : 0 | per cent. on Application. |
| 25 : 0 : 0 | per cent. on Allotment. |
| 25 : 0 : 0 | per cent. on 3rd June, 1910. |
| 20 : 0 : 0 | per cent. on 4th July, 1910. |
| 20 : 0 : 0 | per cent. on 3rd August, 1910. |
| £95 : 0 : 0 | |

**Subscriptions may be made in Cash or in the endorsed Bonds of the 5 % Loans of 1895-6 and 1901-2 referred to above.**

**Subscriptions in Bonds will receive allotments in full.**

Payment in full on allotment by cash Subscribers may be made under discount of 2½ % per annum.

**Subscriptions will also be received on behalf of the London Issuing Banks by their appointed Agents in SWITZERLAND, BELGIUM and HOLLAND.**

Holders of the endorsed Bonds of 1895-6 Loan, who convert, must lodge their Bonds with all Coupons attached, except the Coupon due 1st June, 1910, and will receive in exchange for each Bond of Yen 1,000 :—£100 fully-paid 4% Scrip, with Coupons attached as aforementioned, and a Cash payment of £7 11s. 8d. being 10s. Bonus, and £7 1s. 8d. the difference between the issue price of the present Loan and £102 1s. 8d., the par value of Yen 1,000 at the exchange of 2s. 0½d. per Yen. The Coupon on the 5% Bonds due 1st June, 1910, must be retained and will be paid as usual on that date.

Holders of the endorsed Bonds of 1901-2 Loan, who convert, must lodge their Bonds with all unmatured Coupons attached, and will receive in exchange for each Bond of Yen 1,000:—£1,000 fully-paid 4% Scrip with Coupons attached as aforementioned. They will also receive a Cash payment of £8 15s. 8d. representing (a) 10s. Bonus (b) £7 1s. 8d. the difference between the issue price of the present Loan and £102 1s. 8d. the par value of Yen 1,000 at the exchange of 2s. 0½d. per Yen (c) £1 4s. 0d. interest at 5% to 1st June, 1910 (after deduction of income tax), on the Bond surrendered.

Holders of Bonds of Yen 500 and Yen 5,000 each will on conversion receive the proportionate amounts of Bonds and Cash.

In lieu of Cash differences, Subscribers in convertible Bonds can elect to have 4 per cent. Bonds at the issue price, the fractional surplus only being settled in Cash, but this option must be exercised when subscribing.

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As notified by the Minister of Finance of the Imperial Japanese Government, all the above-mentioned Bonds of the 1895-6 and 1901-2 Loans not presented for conversion will be repaid at their par value on the 1st of July, 1910, at The Yokohama Specie Bank, Limited, London, or at the Bank of Japan, Tokyo.

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This Loan is repayable at par on 1st June, 1970, but the Imperial Japanese Government reserves the right to redeem, at par, all or any part of the Loan, on or at any time after 1st June, 1920, on giving six months' previous notice by advertisement. Partial redemption to be effected by drawings in the usual manner at the office of The Yokohama Specie Bank, Limited, London.

Scrip Certificates to bearer, with Coupon attached for £1 per £100 Bond, payable on 1st June, 1910, and also a full half-year's Coupon for £2 per £100 Bond payable on 1st December, 1910, will be delivered as soon as possible in exchange for the Allotment Letters and Bankers' Receipts, and Bonds will, in due course, be delivered in exchange for the Scrip Certificates.

Application must be made on one of the forms provided herewith, accompanied by the deposit of £5 per cent. in cash, or at least an equivalent amount of convertible Bonds, and it is expressly stipulated that any Applicant having elected to pay either in cash or in Bonds cannot alter his engagement as to the mode of payment.

Subscribers in convertible Bonds are invited to deposit the whole of their Bonds when making application, in which case they should be listed on the back of the Application Form. Separate forms for listing the Bonds may also be obtained from the above-mentioned Banks.

In the case of subscriptions in cash, if no allotment be made the deposit will be returned in full, and if only a portion of the amount applied for be allotted the balance of the deposit will be appropriated towards payment of the amount due on allotment.

Failure to pay any of the instalments when due by cash subscribers will render all previous payments liable to forfeiture, and failure by subscribers in endorsed Bonds to deliver the Bonds when the Scrip is ready to be given in exchange will also render the deposit on application liable to forfeiture.

(4) Certified translations of the Law and Ordinance creating and authorising the issue of this Loan may be seen at the Offices of any of the issuing Banks and at the Offices of

Messrs. Alfred Bright & Sons, Solicitors, 15, George Street, Mansion House, London, E.C.

Prospectuses and forms of application may be obtained from the following :—Parr's Bank Limited, 4, Bartholomew Lane, London, E.C., and Branches ; The Hongkong and Shanghai Banking Corporation, 31, Lombard Street, London, E.C. ; The Yokohama Specie Bank, Limited, 120, Bishopsgate Street Within, London, E.C. ; and Messrs. Panmure Gordon & Co., Hatton Court, Threadneedle Street, London, E.C.

*6th May,* 1910.

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COPY OF LETTER

**From the Vice-Minister of Finance and Financial Commissioner of the Imperial Japanese Government.**

LONDON, *6th May,* 1910.

GENTLEMEN,

I have pleasure in informing you that under special Authority given to me by the Imperial Japanese Government I approve of the above Prospectus.

I am, Gentlemen,

Your obedient Servant,

(*Signed*) K. MIZUMACHI,

*Vice-Minister of Finance and Financial Commissioner of the Imperial Japanese Government.*

*To* PARR'S BANK LIMITED,
THE HONGKONG AND SHANGHAI BANKING CORPORATION,
AND
THE YOKOHAMA SPECIE BANK, LIMITED,
LONDON.

# CHAPTER IV

## British Colonial Government Loans

### INSCRIBED STOCKS—TRUSTEE STOCKS

Our British Colonial Governments are frequent borrowers in the English market. Their issues are made here for a reason similar to that which attracts Foreign Governments, viz., the abundance of available money, which enables them to obtain capital more cheaply than in their own country. In a land possessed of great natural wealth in an undeveloped state and a sparce population, *e.g.*, Canada, the demand for money will greatly exceed the supply, and lenders will obtain a high rate of interest.

Example 3, pages 25–28, shows the prospectus of the Western Australian Government 3½ per cent. Inscribed Stock, 1935-55, issued 21st February, 1911. It presents several features of interest. In the first place, it is an Inscribed Stock. This indicates that the name of the holder will be inscribed in a register (1) kept for the purpose by the trusted agents of the Government—in this case the London County and Westminster Bank, Limited. It also decides the method of transfer, which is that the buyer must attend at the place where the books are and affix his signature in a book kept for this purpose. If he cannot attend personally, he must be represented by his attorney. The inconvenience of this system is, of course, obvious for all except those living within easy travelling distance of the Bank where the records are retained.

The dates 1935-1955 refer to the period during which the Government reserves to itself the right to redeem its loan. Up to 1935 it is irredeemable, between 1935 and 1955 it *may* be redeemed; but on the 1st April, 1955, it *must* be redeemed.

The price of the stock is put at £96 10s. for each £100, but it will be noticed that the applicant receives an interest bonus owing to the fact of three months' interest being paid on the 1st April, (2) or only five weeks after the date of the issue. This is equivalent to a gift of about two months' interest, or 11s. 8d.

A clause early in the prospectus merits attention. It reads as follows:—

> The Government of Western Australia having complied with the requirements of the Colonial Stock Act, 1900, as announced in the *London Gazette* of the 7th September, 1901, TRUSTEES ARE AUTHORISED TO INVEST IN THIS STOCK, subject to the provisions set forth in the Trustee Act, 1893.

Now as Trust Money may be invested only in certain stocks prescribed by Parliament (and called, for convenience, Trustee Stocks), unless the Trust Deed otherwise provides, the result is that such stocks receive a large amount of support in the Stock market from Trust Funds, and the prices of these stocks are maintained at a higher level than they would probably attain without this aid. But it must not be supposed that the British Government gives any guarantee whatsoever in respect of these securities. Its object in earmarking them is, of course, to protect the beneficiaries and to prevent persons appointed as trustees from gambling with their wards' money. The price of the trustee stock may rise or fall, but that is not the British Government's concern, and they accept no responsibility. Indeed, if any evidence were required on this point, it is supplied by the prospectus itself, in a paragraph free from any obscurity of language; thus: ". . . . the Consolidated Fund of the United Kingdom and the Commissioners of His Majesty's Treasury are not directly or indirectly liable or responsible for the payment of the stock or of the dividends thereon, or for any matter relating thereto . . . ."

In all essential features, Colonial Government issues resemble British and Foreign Government loans, and the points to which enquiry should be directed are similar.

EXAMPLE 3

# WESTERN AUSTRALIA GOVERNMENT $3\frac{1}{2}$% INSCRIBED STOCK,

## 1935—1955

## ISSUE OF £1,650,000

**Price of Issue, £96 . 10s. per cent.**

Interest payable 1st April and 1st October.

(2) Three months' Interest payable 1st April, 1911.

Principal repayable at par 1st April, 1955, the Government of Western Australia having the option to redeem the Stock at par on or after the 1st April, 1935, on giving six calendar months' notice.

**The Holders of Western Australia Government 4% Inscribed Stock, 1911-31, under notice of redemption on 15th April, 1911, are offered conversion into an equal amount of this Stock on the terms stated below, up to the extent of the new Issue, and will receive preferential allotment.**

The Government of Western Australia having complied with the requirements of the Colonial Stock Act, 1900, as announced in the *London Gazette* of the 7th September, 1901, Trustees are authorised to invest in this Stock subject to the provisions set forth in the Trustee Act, 1893.

**THE LONDON COUNTY AND WESTMINSTER BANK LIMITED** are instructed by the GOVERNMENT OF WESTERN AUSTRALIA to offer for subscription the above amount of Stock, under the Act of the Legislature of Western Australia, 1st George V, No. 5, entitled "The General Loan and Inscribed Stock Act, 1910."

The Loan is to be raised for the purpose of redeeming the Western Australia 4% Stock, 1911-31, under notice of redemption on the 15th April, 1911, and is secured upon the Consolidated Revenues and Assets of the State, subject to the prior charges for certain Loans as specified in the Act of the Legislature of Western Australia, 54 Victoria, No. 9.

By the terms of "The General Loan and Inscribed Stock Act, 1910" (above-mentioned) of the Legislature of Western Australia, provision has to be made by the State for a Sinking Fund which will be at the rate of one-half per cent. per annum to be invested in the names of Trustees, and to accumulate at compound interest towards the final extinction of the Loan.

The Stock now offered will be in addition to, and rank *pari passu* with, the £2,787,000 already created, and will be inscribed in accordance with the provisions of "The Colonial Stock Act, 1877," 40 and 41 Vict., cap. 59, in the
1 books of the Western Australia 3½ per cent. Stock, 1935-1955—kept by the London County and Westminster Bank Limited,—and will be transferable without charge and free of stamp duty at that Bank, either by the Stockholders personally or by their attorneys. The interest, at the rate of 3½ per cent. per annum, will be payable half-yearly on behalf of the Government of Western Australia at the London County and Westminster Bank Limited, Lothbury, on the 1st April and 1st October in each year, by Dividend Warrants, which, if desired, can be sent by post at the Stockholder's risk. The principal will be payable at the same Bank on the 1st April, 1955, but the Government of Western Australia have the option of redemption at par, in London, on or after the 1st April, 1935, on giving six calendar months' notice by advertisement in the *London Gazette* and in the *Times* Newspaper, or by post to the then Stockholders at their registered addresses.

The revenues of the State of Western Australia alone are liable in respect of this Stock and the Dividends thereon, and the Consolidated Fund of the United Kingdom and the Commissioners of His Majesty's Treasury are not directly or indirectly liable or responsible for the payment of the Stock or of the Dividends thereon, or for any matter relating thereto.—40 and 41 Vict., cap. 59, sec. 19.

Cash applications on the form prescribed will be received at the LONDON COUNTY AND WESTMINSTER BANK LIMITED, Lothbury, and must be for even hundreds of Stock, and be accompanied by a deposit of £5 per cent. on the nominal amount applied for.

The list for Cash applications will be closed on or before **Friday,** the **24th February, 1911,** but holders of the Western Australia 4 per cent. Stock, 1911-31, can exercise the option to convert up to 4 o'clock on **Friday,** the **3rd March, 1911.**

In case of partial allotment, the surplus of the amount paid as deposit will be appropriated towards the payment of the instalment due on allotment.

Payment will be required as follows, viz. :—

| | | | | |
|---|---|---|---|---|
| £5 | per cent. | on | application. |
| £6 . 10s. | „ | „ | „ | 13th March, 1911. |
| £85 | „ | „ | „ | 11th April, 1911. |
| £96 . 10s. | | | | |

Payment may be made in full on the **13th March, 1911,** or on any subsequent day, under discount at the rate of 2 per cent. per annum.

In case of default in the payment of any instalment at its due date the deposit and instalments previously paid will be liable to forfeiture.

Scrip Certificates will be issued in respect of Cash applications after payment of the amount due on allotment, and such Certificates, when paid up in full, will be convertible into Inscribed Stock on presentation at the LONDON COUNTY AND WESTMINSTER BANK LIMITED, Lothbury. A Coupon for three months' interest payable 1st April, 1911, will be attached to the Scrip.

Holders of the Western Australia 4 per cent. Stock, 1911-31, can exchange their Stock for an equal amount of 3½ per cent. Stock, receiving an immediate Cash payment of £4 7s. 6d. per cent., being £3 10s. per cent., the difference between the nominal amount of the maturing Stock and the issue price of the 3½ per cent. Stock, plus 17s. 6d. per cent. (less Income Tax) in respect of three months' interest payable 1st April, 1911, on the New Stock in terms of the Prospectus. The half-year's interest due 15th April, 1911, on the 4 per cent. Stock will be paid to holders converting in the usual course.

Forms of Application and of Request to Convert can be obtained at the LONDON COUNTY AND WESTMINSTER BANK LIMITED, 41, Lothbury, E.C., 21, Lombard Street, E.C., or at any of the Branches of the Bank, and of Messrs. R. NIVISON & Co, Bank Buildings, Princes Street, E.C.

LONDON COUNTY AND WESTMINSTER BANK LIMITED,
LOTHBURY, LONDON, E.C.,

*21st February,* 1911.

## CHAPTER V

### MUNICIPAL AND CORPORATION LOANS

GOOD SECURITY BUT LOW YIELD—BRITISH COLONIAL AND FOREIGN PROSPECTUSES COMPARED—MORE INFORMATION WANTED—CHIEF POINTS FOR THE INVESTOR

HITHERTO we have been considering the prospectus of borrowers who could not be sued in the event of their default in paying interest or redeeming capital, although they might be persuaded by warships and armies.

But Municipalities and Corporations may be proceeded against by legal processes, and the Government is bound to see that justice is done. The loan issues of a large and wealthy city are among the finest forms of security which are available to the investor, for behind them is the total rateable value of the town. Further, most Municipalities own property of various kinds, particularly land and buildings which have a marketable value, and they also control reproductive undertakings such as gas works, electric power, and tramways, all of which assets are so much additional security. British Municipal loans rank so high that the authorities can issue them at a very moderate rate of interest, which, however, is not attractive to any except those to whom income is not of paramount importance. The interest attached to these loans ranges from 2½ per cent. to 4 per cent.; but there are few issues at the minimum or maximum prices, the majority being from 3 per cent. to 3½ per cent. The average *yield* on British Municipal Stocks is about 3½ per cent. Nevertheless, the issues of Corporations are practically always subscribed in full, for large blocks are usually taken by the big finance houses for sale to their clients, and by banks and insurance companies. Trustees, too, unless expressly forbidden by the terms of the Trust Deed, may invest their funds in the nominal or inscribed stock of any Corporation of a municipal borough whose population, according to the last census, exceeded 50,000. The issues of Colonial and Foreign Corporations are, of course, not included among British Trustees stocks.

Municipal prospectuses usually give more ample information than those of Governments. Occasionally a Municipality adopts the tone of the superior person who says: "My Dear Sir, I require the loan of £5; no doubt you will be very glad to lend this trifling sum to a man of *my* position." Thus, for instance, the City of Quebec, with a population equal to that of a London suburb, in asking for an advance of £215,700 in April, 1911, merely informed its would-be creditors that the loan "is secured upon the credit of the Municipality at large," and added: "the total debenture debt, including the present issue, is £1,965,567 (and) the Revenue from all sources (is) £238,057." If this is *net* revenue, and assuming the interest payable on their prior existing debenture debt to be at the rate of 4 per cent., the interest on the new loan is thrice covered.

More facts than those given by the City of Quebec prospectus are, of course, necessary to enable a judgment to be formed as to the stability of the body issuing the loan. Instances of default by municipalities are rare but are not unknown (*e.g.*, Monte Video—on its interest coupon for December, 1891), although happily such an incident has never occurred in the case of British or Colonial Corporations. The extravagance of some and the ill-directed trading enterprises of other Corporations have undoubtedly fostered a feeling of prejudice against Municipal securities generally. But this is a mistake. The activity of the Local Government Board is creating a wholesome check upon excessive expenditure, and Municipal control of the great common necessities, such as gas, water, trams, lighting, is increasing and growing more efficient year by year. There is scarcely a prospectus of any Corporation loan which does not contain a reference to the possession by the borrowing city of one or another of these public utilities. As a rule, the reference is not wholly satisfactory, for it seldom states whether the undertakings are on a paying footing, and, quite apart from his political convictions, this is the point of interest to the lender.

The particulars supplied as to security vary considerably, and British Corporations, it may be said, are more reticent than their Colonial and Foreign brethren. To illustrate this fact and to show the nature of the information which the prospectus should give on this head, the following table (see Example 4) of comparisons has been compiled.

There are here three British, two Canadian and one Foreign Municipal borrowers. Of these, only the foreigner troubles to show that it is living within its income. Of the British, Newport states its income but not its expenditure, and Swansea gives the revenue from its reproductive undertakings (only), but Bristol disdains to refer to the matter at all. Of the Canadians, Montreal mentions its revenue only, and Vancouver, generous in information as to receipts, given at intervals since 1888, is modestly reticent on the subject of outlay. Alone, of the six, the Finnish capital, Helsingfors, sets out its income and expenditure for the past five years. It must not, however, be supposed that an expenditure in excess of income indicates reckless extravagance and that the city which so indulges is on the road to ruin. Much depends on the purpose for which the loans are sought. If they are required for works which are of the nature of capital outlay from which revenue will in due time be received, then the money borrowed is not really adding to the debt of the town, for it is spent on assets. But if the loan is used to retire short-dated bills issued by the Corporation for administrative or current expenses, it is as though a man were to pledge part of his future income to enable him to settle a bill now due. From

## EXAMPLE 4

| Particulars. | City of Montreal. | City of Vancouver. | Bristol Corporation. | Swansea. | City of Helsingfors (cap. of Finland). | Newport (Mon.) |
|---|---|---|---|---|---|---|
| | £ | £ | £ | £ | £ | £ |
| Amount of loan .. .. | 123,000 | 579,000 | 358,500 | 1,011,800 | 1,000,000 | 305,000 |
| Interest .. .. .. | 4½% | 4% | 3½% | 3½% | 4½% | 3½% |
| Price .. .. .. | 109 | 100½ | 97 | 97½ | 97 | 96½ |
| Yield on issued price .. | £4 2 6 | £3 19 7 | £3 12 2 | £3 12 2 | £4 12 9 | £3 12 6 |
| Debt inclusive of present issue .. .. .. | 8,219,178 | 3,140,653 | 9,017,647 | 2,870,872 (after deducting sinking fund) | 2,377,472 | 2,136,995 |
| Assessable Value .. .. | 53,630,137 | 21,290,853 [1] | 1,845,161 | 487,247 | Not stated | 436,074 |
| Rate of taxation .. .. | 1% | 3,582,816 | Unlimited | — | — | Unlimited |
| Property owned, including Reproductive Undertakings .. .. .. | 3,082,192 | 3,840,464 | Docks and electrical undertakings, value not stated | 2,038,568 | 2,898,367 | 1,343,250 |
| Other Securities for loan | — | Special rate on City | Revenues of dock and electrical undertakings | Revenues from Lands, Tramways, etc. | — | Revenues from Water, Electricity, trams, etc. |
| Revenue .. .. .. | 1,229,544 | 473,303 [1] | — | 67,766 Gross exclusive of General District rates | 693,395 [2] | 268,236 |
| Expenditure .. .. | — | — | — | — | 633,706 [2] | — |
| Sinking fund to be provided | — | Yes | Yes | Yes | Yes | Yes |
| ,, ,, f'cs at credit | — | 262,712 | 520,689 | — | — | — |
| Purpose of loan .. .. | — | Schools, Waterworks, hospitals, improvements | Repayment of Corporation bills | £849,632 to repay loans; waterworks; improvements, etc. | Harbour works suburban Rly. hospitals; repayment of loans | Repayment of loans |
| Interest payable on loans including present issue | — | — | — | — | 122,711 | |
| Population .. .. .. | 400,000 | 93,700 | 387,000 | — | 150,000 | 81,000 |
| Date of redemption .. | 1949 | 1951 | 1925-1965 | 1930-1970 | In 50 years, by annual drawings. | 1928-1968 |
| Redemption price .. | par | par | par | par | par | par |

[1] And figures for 1909, 1908, 1900, 1890, 1888.

[2] And figures for previous 4 years.

(1570)—bet. pp. 32 & 33

our table it will be seen that in four cases the loan is intended to be used wholly or partly to retire loans; in three cases there will be reproductive expenditure, and in one (Montreal) no information on this point is given.

Every one of these Corporations—and the cases have been selected at random—omits to give some facts which would be of service to the reader of the prospectus. Helsingfors fails to mention the assessable value of the property which it has the power to tax; the other five, whilst giving this fact and (Swansea excepted) the extent of their power to tax, fail to tell us how much annual interest they are pledged to pay on their loans. Bristol's debt, which amounts to the not insignificant total of £9,000,000 odd, refers to her docks and electrical undertakings, but without hinting at their value. Wealthy Montreal scorns to mention the purpose for which she requires £123,200, or to indicate the protection of a sinking fund. And, as already stated, there is no way open to the investor of assessing the value of the Corporations' properties or the profit-making capacity of their businesses.

Nevertheless, (*a*) if a Municipality's expenditure is largely in excess of its income and the excess is not being put into assets; (*b*) if its total debt is greater than the estimated value of its properties plus the balances of its sinking funds; (*c*) if it is not stated that a Sinking Fund will be formed to redeem the loan within a stated period—then the Investor should pause before sending in his application, nor should he be tempted by a comparatively high interest, or a low price; he should reserve his money for sounder issues.

On the other hand, it is probable that an investor can make fewer mistakes in purchasing municipal loans than any other form of security. Specially favourable points are: (*a*) A settled and responsible Government in the country in which the borrowing town is situated; (*b*) An increasing urban population. (*c*) Its position as a natural commercial centre. (*d*) The possession of sources of revenue other than direct rating. (*e*) Provision of a Sinking Fund. (*f*) Redemption at a premium. If the prospectus be analysed on the lines of the table given in this chapter and the foregoing points are borne in mind, a sound choice in municipal securities will be made.

# CHAPTER VI

## RAILWAY ISSUES

DECLINE IN POPULARITY OF BRITISH RAILWAY INVESTMENTS—CAUSES CONSIDERED—CLASSES OF STOCK ISSUED—WHAT IS A "GUARANTEED" STOCK?—PROSPECTUSES COMPARED—STATE PURCHASE

A WELL-BUILT railway, constructed without extravagance, which runs through a country with large natural resources, or connects populous districts, is apparently as stable an investment as most investors could require. Our grandfathers swore by "home" railways and regarded them as safe as Consols. But just as Consols have undergone strange metamorphoses since the days when the Crystal Palace stood in Hyde Park, so have British railways. To-day, it would be a bold man who, six months in advance, would prophesy the dividend on, say, London Brighton and South Coast Deferred, or on the famous London and North-Western Consolidated Ordinary Stock.

The general causes which have led to the decline in popularity in home rails are precisely those which must be taken into account by the investor in considering the prospectuses of all new issues of railway stocks. They are: (1) limitation of the power of expansion, (2) excessive capitalisation, (3) labour troubles. Consider these points more closely:—

(1) Limits of Expansion. In newly-settled countries a railroad frequently runs ahead of the immediate needs of the population. It is a pioneer of civilisation and commerce, and although its early years may be bare of dividends, its future holds rich rewards for the courageous investor. The Canadian Pacific Railway, and the great railroads of Argentina and Brazil, are cases in point. In those countries there are immense areas of fertile lands awaiting settlers, whose industry year after year creates increasing traffics for the railroads. Wherever the lines are pushed out, great towns spring up, each with its army of workers whose needs must be satisfied. Rightly taken advantage of,

conditions such as these almost guarantee a successful railroad. But in Great Britain, the home of Stephenson and Watts, and the pioneer of this form of locomotion, there are no large fertile and unsettled tracks and no new towns springing up. Our 22,000 odd miles of railroad touch practically every point which can furnish revenue, and the service is in many places duplicated by rival companies; whilst the U.S.A., possessing ten times our mileage already, will probably double this length in a few decades and yet not have exhausted its scope. In this country, then, and in all countries where the railway is an old-established thing, there are practically only four means whereby a line can increase its revenue, viz., (*a*) by participation in a general expansion of national prosperity; (*b*) by the natural increase in the number of the travelling public; (*c*) by attracting to itself passengers and freight from rival lines; (*d*) by working agreements to reduce competition. Having narrowed the conditions of success to these four factors, it is possible to go a step further, and say that (*a*) is the only one which in these days makes any marked difference in railway receipts. National prosperity, as indicated by the increase in exports and imports and the internal trade, invariably results in an increased volume of goods traffic, and the larger spending power of the public is reflected in more frequent travel. Factor (*b*), the natural increase in the population, while undoubtedly adding to the number of the travelling public, is more than offset in and around all the towns by the extraordinary development of road motors, such as electric tram and motor omnibus services. As to (*c*) the attempt to win new passengers and freight from competing lines necessitates considerable capital outlay, and can only lead in the long run to rate cutting, *i.e.*, reduced receipts. (*d*) Working agreements—these are already in force and such benefits as they have conferred have been already discounted. This brings us to the second point.

(2) British railway extravagance is notorious. In the

1,400 million pounds nominal capital of British Railway Companies, there is included some 200 million pounds worth of stock which has never been subscribed at all, and on which dividends must be paid whenever (if ever) the profits of the companies permit. If many cases lines have been built simply for the purpose of competition and without regard apparently to the needs of the district; and, again, utterly useless lines have been constructed. Parts of one of the greatest English railroads have cost upwards of £58,000 per mile. Enormous sums have been expended in promoting bills or fighting the projects of rival lines in Parliamentary Committees, in law costs, and in purchasing land at exorbitant prices. All the money required for these purposes has been raised from the public. What the investor has to remember is that the successive loans required to finance this unparalleled outlay rank for interest and form part of the annual burden to be carried by the company. During the past three years, however, there has been a slackening in the rate of capital creation on the part of our railways. Competition has been reduced by working agreements, cheap coal has diminished the working expenses, and the companies have been able to reap the advantage accruing through the remarkable trade boom of the past two years.

(3) Undoubtedly one of the most disturbing factors in the future not only of British rails, but of those new foreign lands such as the Argentine and Brazilian Republics, is that of labour. We are not here concerned with the fact that, in these Isles, over 100,000 railway employees were, until recently, receiving wages of £1 a week or less. The point is that the men are certainly dissatisfied and that their dissatisfaction expresses itself in strikes which might conceivably diminish the companies' revenue in no small degree. Thus, if higher wages are granted, the companies' profits will, *pro tanto*, be reduced; if the increase is withheld, their revenues suffer through periodical disturbances.

These three general considerations must, then, be borne in mind by the reader of a railway prospectus, in addition to the points to be presently mentioned.

Railway investments differ widely in their nature from those of Governments and Municipalities which have hitherto been described. The security for the loans issued by the latter group rests fundamentally on their power to tax, but except in comparatively new countries a railway company's chief asset is the earning capacities of its line. Its grades of investment may be grouped under three heads. To the investor who requires security for his capital and interest, and who is content to accept a low rate of return, it offers debentures. These are secured on the property of the company and can be enforced if the interest is not paid at stated half-yearly intervals. With these may perhaps be classed certain so-called "Guarantee" stocks, which rank after the debentures.

Those who are willing to forego a lien on the company's assets in exchange for a slightly higher rate of interest, can buy preference shares; whilst those with more sporting instinct, who are ready to run the risk of a fluctuating income on the chance of obtaining a higher average of profit, can purchase ordinary shares. Now, as debentures are only loans, if the interest is not paid, the holders can, like other mortgagees, seize the property, but the preference and ordinary shareholders depend for their dividends upon the profits. If sufficient is left after paying the debenture interest, the preference dividend is paid, and whatever remains is divisible among the ordinary shares.

Probably no railway has ever been built for the amount it was originally estimated to cost, while most of them have increased their original mileage, and the result is that from time to time fresh issues of debentures and share capital have been made. Every debenture issue is secured on some of the company's property, and naturally it frequently happens that more than one issue is secured on the same property, and that each later issue is subsidiary in point of security to the one preceding.

A glance at the Official List of railway securities quoted on the London Stock Exchange, affords many examples of this. One may suffice, *e.g.*, the East London Railway. This company has issued debentures as follows, the interest as well as the capital on each issue being contingent on the preceding issue being satisfied. It will be noted that the only debentures that received their full interest are the first and second charge. (Of these the former are guaranteed by the South-Eastern and London and Brighton Companies.)

| | 1908 | 1909 | 1910 |
|---|---|---|---|
| 3½% 1st Debentures .. .. .. .. | 3½% | 3½ | 3½ |
| 4% 2nd charge Debentures class "A" .. | 4 | 4 | 4 |
| " " " " " "B" .. | ⅜ | ⅜ | ⅜ |
| 4% 3rd " " " .. | Nil | Nil | Nil |
| 4% 4th " " " .. | Nil | Nil | Nil |

This ranking of debentures is a point which should always be looked for in a prospectus, although the necessity for caution is greater in connection with issues by trading companies than in the case of railways, whose real assets consist not so much in actual property as in what are practically transport monopolies over certain large areas.

Amongst American Railroad Securities there are frequently met bonds known as "Prior lien." This generally means that financial troubles have had to be faced, and in order that new capital might be raised the original debenture holders have had to waive their mortgagee's privileges so far as to allow the issue of bonds which are given prior rights on the property previously mortgaged to them.[1]

With these preliminary remarks let us now consider the prospectus of a railway company, say, that of the issue by the Grand Trunk Railway Company of Canada of £1,250,000 4 per cent. Guaranteed Stock in November,

[1] It is important to note that in America, "Debenture Bonds" are not usually especially secured on assets; the debenture is an acknowledgment of a debt which carries interest, and their security is little better than our Preferred Shares. Their "Mortgage Bond" corresponds to our debenture secured by Trust Deed.

1911. The full prospectus is given as Example 5, pages 45–46, and attention is directed to it because of the peculiar meaning which is attached to the word " guarantee." In common language the word has no ambiguity. A man who " guarantees " to a lender a sum loaned to a third person, assumes responsibility for its repayment in the event of the borrower defaulting. He becomes " bail " for him. A simple case of the application of this meaning is that of, say, the Bahia Blanca and North-Western Railway 4½ per cent. second Debentures, the principal and interest of which are guaranteed by the powerful Buenos Ayres and Pacific Railway. Another interpretation, however, is introduced when we come to the British Railway Guaranteed Stocks. These excellent investments are not debentures, nor is the " Guarantee " which gives them their name a guarantee by an independent party. *It is the issuing railway company's own guarantee.* Sometimes the stock ranks for interest before the company's debentures, but generally it has a first claim after the debenture interest has been paid. Further, the interest is cumulative, *i.e.*, if not paid for any reason, in any year, the debt is carried forward and the arrears must be paid as soon as there is profit available for the purpose.

But another and a long step from the accepted meaning of the term is taken by the Grand Trunk Railway. If the reader will glance at the paragraph relating to dividends, which, for the purpose of illustration, has been printed in heavy type (1) he will see that no vestige of the usual meaning remains in the word. The company itself will pay the interest if it has sufficient profit in any year after settling the interest on the debentures; if the profit is insufficient, the interest will not be paid, nor will it be made up in subsequent years. As a matter of fact, according to the figures supplied, the profit was ample to cover the £50,000 of annual interest required by this issue, but that is not the point. What is of importance is the extraordinary and misleading use of terms.

It will be noted that the money is required for "general purposes," (2) one of which appears to be the paying off of £856,800 5 per cent. bonds, which, inasmuch as it reduces the company's interest charges by £42,840 per annum, is all to the good.

In the case of railways there is nothing gained by enquiring into the capital value of any well-constructed line, provided it sets apart a sufficient sum for maintenance out of each year's revenue; its earning power is the chief consideration. In the present instance, the surplus profit available for paying interest and dividends is stated to be £330,000, of which this issue requires £50,000. Thus the interest is "covered" six and a half times over.

But this is practically the only important fact as to stability which the prospectus gives. The Grand Trunk Railway is as indifferent in the matter of details as is a powerful Government. The stock, it should be noted, is not redeemable, so that although it was issued at a discount, viz., £92 per cent., the purchaser cannot look forward to the time when he will be paid off at par.

At the comparatively low issue price, the investor obtains a return of £4 6s. 11d. for his money. He also receives a bonus, for the company give him the full dividend of £2 for the half-year ending 31st December, although he will then have paid only £30 on his stock. Thus:—

| | £ | s. | d. |
|---|---|---|---|
| Interest @ 4% on £100 stock for 6 months ending 31st December, 1911.. .. .. .. .. .. | 2 | 0 | 0 |
| Actual Interest @ 4% on £30 paid on application and allotment, from, say, 11th November to 31st December, 1911 .. .. .. .. .. | | 3 | 4 |
| Bonus .. | £1 | 16 | 8 |

Example 6 is a tabulated statement of the particulars given in the prospectuses of five railways situated in five different countries. It will be seen that the number of details supplied varies considerably. The items on the left-hand column may be taken to represent the nature of the facts which may reasonably be looked for and to the extent that they are omitted, the investor is forced to rely upon general considerations only.

It is futile to say that the stocks of those railways which give the fewest particulars in their prospectuses are the worst investments; the reverse may be the case. But since it is not an unheard of thing for a railway company to be placed in the hands of a receiver (*e.g.*, the Ohio Railway and the Wabash, both in the U.S.A.), it is desirable that railway prospectuses should give information on the following points, in addition to the bare description of the issue:—

(*a*) *Gross receipts and expenditure* for past five years.

(*b*) *Gross revenue,* before paying all prior charges, such as debenture interest, taxes, rent of leased lines, etc.

(*c*) *Net revenue* after paying these charges. The object of having these figures is to ascertain whether the company's takings are increasing, and, if so, whether they are increasing more rapidly than the expenses.

(*d*) *Independent guarantee.* As already mentioned, the prospectuses of railway issues frequently contain statements that the interest on their issues is guaranteed. In the case of comparatively new companies, capital as well as interest may be " guaranteed " by outside parties. The value of any such guarantee is, of course, to be judged by the stability of the guarantor, and sufficient information should be given in the prospectus to enable the reader to form a judgment on so important a matter. Thus the Sorocabana Railway Company's (United States of Brazil) 4½ per cent. first debentures, issued in November, 1911, at 86½ per cent., are guaranteed by the Brazil Railway Company, and the prospectus gives, in addition to the net revenue of the Sorocabana Railway for 1909 and 1910, the surplus revenue of the Brazil Railway for the same period, also a table showing the development in its passenger and general traffic, live stock, and coffee for the years 1903 to 1910 inclusive. More satisfactory, of course, is an issue guaranteed by a Government, as in the case of the £1,438,356 first Mortgage Guaranteed Debenture Stock of the Canadian Northern Pacific Railway, also issued in November, 1911. Here a copy of the guarantee of the Province of British Columbia, Canada, was printed in the prospectus, as follows:—

## COPY OF GENERAL GUARANTEE.

By virtue of the powers conferred by the Legislature of the Province of British Columbia, Canada, and of an order of the Lieutenant-Governor-in-Council, and pursuant to the provisions of a Deed of Trust dated April 2nd, A.D. 1910, made between the Canadian Northern Pacific Railway Company, National Trust Company, Limited, the British Empire Trust Company, Limited, Trustees, His Majesty the King, acting on behalf of the Province of British Columbia, and the Canadian Northern Railway Company, the said Province of British Columbia does hereby guarantee payment, according to their tenor, of the principal and interest of the Debenture stock and/or bonds (herein called guaranteed securities) of the Canadian Northern Pacific Railway Company, issued or to be issued under the terms of said Deed of Trust, payable on the 2nd day of April, A.D. 1950, and bearing interest at the rate of 4 per cent. per annum, payable half-yearly.

The amount of said guaranteed securities included in this present guarantee is the sum of Twenty-one million dollars or its equivalent, Four million three hundred and fifteen thousand and sixty-eight pounds nine shillings ten and one-half pence sterling.

From time to time as the Company may become entitled to issue further guaranteed securities under the Provisions of said Deed of Trust and as further guarantees of the payment thereof are given, all general guarantees taken together shall represent the total securities guaranteed.

Dated at Victoria, British Columbia, 21st June, 1910.

(Sgd.) W. J. BOWSER,
Minister of Finance.

This is a real security to the investor; but the guarantees of all Governments are not of equal value, and that of a State which cannot meet its own obligations without delays and negotiations, is, of course, worthless. (See p. 22.)

(*e*) *State purchase.* The Charters of most Railway Companies contain provisions enabling the State to take possession on certain terms. By an Act passed in 1844, all (or any) British Railways constructed since that date may be purchased by the Government at three months' notice for a price equivalent to twenty-five times the average annual profits for the three years preceding the purchase.

In the case of newer lines, outside the British Isles, the period of the lease, the right of rescission, and the terms of such are definitely stipulated. The prospectus of the Sorocabana Railway already referred to contains the following paragraph on this point:—

> "The Government (of the State of San Paulo) has the right to rescind the lease (which is for sixty years) after 1st July, 1937, on payment by way of indemnity of an amount in the Public Funds of the State sufficient to produce a revenue equal to the average net revenue of the company, derived from the railway during the five most profitable years of the preceding seven years of working. On rescinding the lease, the Government assumes the responsibility of paying for the then acknowledged capital of the lessee."

It would appear that the tendency towards the nationalising of railways, which has resulted in the acquisition by Germany, Belgium, and Switzerland of the lines in their respective countries, and the steady absorption by France and Russia of their railways, need not be feared by the investor. When the hour arrives, he will probably be quite happy to become a holder of national stock on a fixed income basis. In the meantime the intending investor should see that the terms of acquisition are fair before subscribing his money.

## Example 6

| Particulars. | Argentine Great Western. | Central London Railway. | Cuban Central. | Grand Trunk Railway Company of Canada. | Kansas City Southern Railway Company |
|---|---|---|---|---|---|
| Amount of new issue | £ 1,000,000 | £ 385,000 | £ 550,000 | £ 750,000 | $5,000,000 |
| Description .. | Debenture Stock | Preference Stock | Debenture Stock | Consol. Debenture stock (perpetual) | Refunding and Improvement Mortgage Bonds |
| Interest .. .. | 5% | 4½% contingent on Annual profits. | 5% | 4% | 5% |
| Price .. .. | 108½ | 100 | 100 | 100 | 101 |
| Ranking .. .. | Pari passu other 5% debenture stock | Pari passu other preference stock | After prior issues | Pari passu with existing 4% Consol. debenture stock | — |
| Redeemable .. | After 1930 | Not redeemable | Any time at 6 months' notice | — | 1950 |
| Redemption Price | 110 | — | 110 | — | 100; or 105 at 6 months' notice |
| Security .. .. | On undertaking. Interest Guaranteed by Buenos Ayres and Pacific | — | General—subject to prior debenture issues | — | General mortgage on entire property |
| Gross Income .. | Of Guaranteeing Company £4,134,487 (and 4 previous years given) | — | — | — | $9,162,478 (and figure since 1901) |
| Gross Expenditure | — | — | — | — | — |
| Net Revenue .. | Of Guaranteeing Company after paying debenture interest and prior shares £715,464 | £103,000 After paying interest on existing debenture stock | £170,593 (and 4 previous years given) | Average during last 5 years £700,000 after paying debenture interest | $3,015,336 |
| Required to pay Interest .. .. | £50,000 (this issue) | £17,325 (this issue) | £85,478 (on all debenture issues) | — | $1,650,000 (all debentures) |
| Purpose of Issue .. | Construction | Construction of Liverpool Street extension; rolling stock; General purposes | To redeem £200,000 6% 2nd debenture stock; construction; General purposes | General | Improvement of rolling stock; construction |
| Trust Deed .. | Yes | — | Yes | — | Yes |
| Reserve Funds .. | Of Guaranteeing Company £700,517 | — | — | — | $133,393 |
| Balance Sheet .. | — | — | — | — | Yes |

(1570)—bet. pp. 44 & 45

EXAMPLE 5

# The Grand Trunk Railway Company of Canada

**ISSUE Of £1,250,000 FOUR PER CENT. GUARANTEED STOCK under the powers of the Grand Trunk Railway Act, 1909, sanctioned by the Proprietors at the General Meeting on the 21st April, 1909.**

## ISSUE PRICE £92 PER £100 STOCK,

Payable as follows:

| | | | |
|---|---|---|---|
| £10 | per £100 Stock | on Application. |
| £20 | do. | on Allotment. |
| £30 | do. | 1st January, 1912. |
| £32 | do. | 1st February, 1912. |
| £92 | | |

**Or the whole may be paid up in full on Allotment, or on the date for the payment of any instalment, under discount at the rate of 4 per cent. per annum.**

**The Stock will be entitled to the full dividend of £2 for the half-year ending 31st December, 1911, and after payment of the final instalment on the 1st February, 1912, the present issue will rank pari passu with the existing Four per cent. Guaranteed Stock.**

The Directors of the GRAND TRUNK RAILWAY COMPANY OF CANADA INVITE APPLICATIONS for £1,250,000 FOUR PER CENT. GUARANTEED STOCK, the proceeds of which will be applied to the general purposes of the Company. 2

1 **The Four per cent. Guaranteed Stock ranks for dividend out of the profits of each year in priority to all the Preference Stocks of the Company, and the net earnings of the Company for the year 1910, after providing for the fixed interest charges and the dividend on the existing Four per cent. Guaranteed Stock, showed a surplus of £333,000, which amount will be exceeded during the current year.**

On the 1st January, 1912, Midland Five per cent. First Mortgage Bonds, amounting to £856,800 (the balance of an original issue of £1,571,600), will mature and be paid off, thereby reducing the pre-preference charges of the Company by £42,840 per annum.

After payment of the instalment due on allotment, Interim Scrip Certificates to bearer will be issued in exchange for the Allotment Letter, for which Registered Stock Certificates will be issued after the date for the payment of the final instalment.

The Stock will be registered free of expense.

Application will be made in due course for a settlement and quotation of the Interim Scrip Certificates, and afterwards for the Stock to be added to the Four per cent. Guaranteed Stock already quoted in the official list of the London Stock Exchange.

Applications must be made on the accompanying form and forwarded to the Company's Bankers, Messrs. Glyn, Mills, Currie and Company, 67, Lombard Street, E.C., with a deposit of £10 for each £100 of Stock applied for.

Should it not be possible to make an allotment in full in respect of the amounts applied for, any excess in the amount deposited on application will be applied towards the payment on allotment.

The subscription list will be closed on or before Saturday, the 11th inst.

Prospectuses and Forms of Application may be obtained at the Offices of the Company, of Messrs. Glyn, Mills, Currie and Company, 67, Lombard Street, London, E.C., and of Messrs. Coates, Son and Co., 99, Gresham Street, London, E.C.

On behalf of the Board,

ALFRED W. SMITHERS,

Chairman.

Dashwood House,
No. 9, New Broad Street, London, E.C.

*7th November,* 1911.

# CHAPTER VII

## Bank Issues

NEW SHARES OFFERED TO EXISTING SHAREHOLDERS—RECENT "BANK" FAILURES—LIABILITY ON SHARES—PANICS—SUMMARY

The large joint-stock banks of Great Britain practically never make an issue of shares to any but their own shareholders, so that the investor outside this circle must first make good his footing therein if he wish to participate in new issues. As it is practically certain that the new capital required will be offered at a price which will compare favourably (although but slightly so) with the market quotation for the existing shares, the investor's only concern is whether he does or does not desire to increase his holding in that particular security.

Example 7 (page 53) may be taken as a specimen of this kind of issue.

The collapse of the London Trading Bank in 1910, and of the Birkbeck Bank, the Yorkshire Penny Bank, the Credit Bank, and the Bank of Egypt in 1911, emphasises the fact that all institutions bearing the title of "Bank" are not models of financial stability.[1] These banks are not all of the same rank, but it is safe to say that among the causes of failure was the depreciation of securities held by the institutions. The failure of the Bank of Egypt will undoubtedly increase the unpopularity of bank shares as investments among a certain class of investors. This respectable bank paid dividends of 17 per cent. in 1908;

[1] Unfortunately the use of the term "bank" is not restricted in any way and apparently any institution if it pleases may include the word in its title, whilst carrying on business of a speculative nature. Thanks to the efforts of the financial press it is now probable that legislation will be introduced to safeguard the public by limiting the use of the word "bank" to institutions which have first complied with certain financial conditions.

15 per cent. in 1909, and 14 per cent. in 1910, yet it closed its doors on the 25th September, 1911. Its capital was £1,250,000, and consisted of 50,000 shares of £25 each, of which £12 10s. was paid up, and £12 10s. was "uncalled," and constituted a contingent liability of the shareholders. By the bank's failure not only have its shareholders probably lost the £12 10s. per share already paid, but the remaining £12 10s. has now become an actual liability. Although the payment is to be made by three instalments spread over a year, yet it will mean disaster for some among the shareholders.

Events of this nature prove that it is a safe maxim that persons of moderate means should not hold shares on which there is a liability for uncalled capital. From the point of view of the customer of the bank or the depositor, however, it is a distinct consolation to know that the safety of his money is guaranteed not only by the current assets of the bank, but by the large "reserved" liability of the bank's shareholders.

It is undoubtedly true that an established bank which conducts its business on recognised lines, occupies an exceptional position. It deals with money, which is not subject to fluctuation in value to anything like the same extent as the goods of a trading concern. It lends money and discounts acceptances at a higher percentage than it pays its depositors whose money it uses. By its command of the sinews of business, it is able to choose carefully among would-be borrowers, advancing money only on adequate guarantee and collateral security. Should the debtor fail to repay, the bank is a secured creditor and can reimburse itself by selling the security deposited with it by the borrower. On these established lines banks can and do make large profits—which, probably in most cases, are larger than those shown in the balance sheet. It is only when the institution uses its funds to finance undeveloped and speculative ventures (Credit Bank), or renews worthless bills and thus locks up its capital in bad and doubtful debts (as in the case of the London Trading Bank, *vide* report of Board of Trade), or holds a large quantity of heavily depreciated, although gilt-edged, securities (Birkbeck Bank), that it enters upon the high road to failure.

Following is a list showing the liability for uncalled capital on the shares of some of our leading banks :—

LIST OF BANKS AND CAPITAL LIABILITIES

| Bank. | Nominal Value of Share. | Paid up. | | | Further Liability. | | |
|---|---|---|---|---|---|---|---|
| | £ | £ | s. | d. | £ | s. | d. |
| Bank of Liverpool .. .. | 100 | 12 | 10 | 0 | 87 | 10 | 0 |
| Bank of Scotland .. .. | 150 | 100 | 0 | 0 | 50 | 0 | 0 |
| Barclay & Co. .. .. .. | 20 | 8 | 0 | 0 | 12 | 0 | 0 |
| Capital and Counties .. .. | 50 | 10 | 0 | 0 | 40 | 0 | 0 |
| Commercial Bank of Scotland | 100 | 20 | 0 | 0 | 80 | 0 | 0 |
| Lloyd's Bank .. .. .. | 50 | 8 | 0 | 0 | 42 | 0 | 0 |
| London and Provincial .. | 10 | 5 | 0 | 0 | 5 | 0 | 0 |
| London and South Western .. | 50 | 20 | 0 | 0 | 30 | 0 | 0 |
| London City and Midland .. | 60 | 12 | 10 | 0 | 47 | 10 | 0 |
| London Joint Stock .. .. | 100 | 15 | 0 | 0 | 85 | 0 | 0 |
| Manchester and Liverpool District .. .. .. .. | 60 | 12 | 0 | 0 | 48 | 0 | 0 |
| Martins .. .. .. .. | 20 | 10 | 0 | 0 | 10 | 0 | 0 |
| National .. .. .. | 50 | 10 | 0 | 0 | 40 | 0 | 0 |
| National Provincial Bank of England .. .. .. | 75 | 10 | 10 | 0 | 64 | 10 | 0 |
| National Provincial Bank of England .. .. .. | 60 | 12 | 0 | 0 | 48 | 0 | 0 |
| Parr's .. .. .. | 50 | 10 | 0 | 0 | 40 | 0 | 0 |
| Provincial Bank of Ireland | 100 | 12 | 10 | 0 | 87 | 10 | 0 |
| Union Discount .. .. .. | 10 | 5 | 0 | 0 | 5 | 0 | 0 |
| Union of London and Smith's | 100 | 15 | 10 | 0 | 84 | 10 | 0 |
| Williams Deacons .. .. | 50 | 8 | 0 | 0 | 42 | 0 | 0 |

The reader of a bank prospectus will, of course, remember that a bank is peculiarly liable to suffer in times of national panic. The nature of its business makes it necessary to have large quantities of capital readily available. This money is invested in securities of a high order, which, though yielding a small interest, are, in ordinary circumstances, easily convertible into cash. The actual amount of cash in hand is, proportionately, not large. At times of national crises, nervous depositors and customers with current accounts demand their money, which depletes the " till " cash and forces the bank to realise its securities. But the throwing of a large amount of stock on the market causes prices to fall, so that the Bank, even though it weather the storm, must lose heavily by the forced sales. On the other hand, it is probable that, save in the case of a panic which affected all banks equally, no one of the great banking institutions of this country would be allowed to fail (witness the Yorkshire Penny Bank)—its brother banks would rally to its aid and tide it over any difficult period, provided its finances had been conducted on recognised lines.

The " small " investor should remember that, although a bank is generally willing to advance money against the deposit with it of the shares of any sound company, it will not accept its own shares by way of security. In any case, however, he would do well to leave this class of shares alone. But the capitalist who has no need to pledge his holding, and who is willing to face the risk of the liability on the shares, should choose his own time for investment. Naturally enough, the largest profits are made by banks during the period of national prosperity, when business men require additional capital to finance their expanding trade. If the increased profit results in increased dividend, the market prices of the bank's shares rise. Obviously, that is not the time to buy. When, in due course, trade slackens, money is withdrawn from business and placed on deposit, and its plentifulness is followed by a reduction in the rate at which money is lent by the bank, and when money is " cheap " it pays to buy securities which yield a higher return than bank shares. This reinvestment, again, tends to keep up the price of Stock Exchange securities. But if the national trade continue to decline, business profits dwindle, a large number of investors are forced gradually to sell their holdings and the whole stock market is affected, with the result that the price of securities falls. That is the most favourable opportunity for the investor to purchase bank shares.

Let us now glance at the prospectus of the Molsons Bank (a Canadian institution) shown on Example 8 (pages 54-57).

There are several points of interest. The shares of \$100 are issued at the price of \$216—a high premium (1). Assuming that the dividend of 10 per cent. paid for the four years prior to this issue is maintained, the actual yield on the new shares is only 4·63 or £4 12s. 7d. per cent. Again, under the Bank Act of Canada, the shares carry an additional liability equal to their nominal value, viz., \$100, which, like the "reserve" liability on English bank shares, may be called up in the event of the bank's assets at any time being insufficient to meet its liabilities (2).

In this connection it should be observed that the paid-up capital of the bank is \$3,500,000, the holders of which are under a contingent liability for a further \$3,500,000. The bank, however, has already set aside out of profits, a reserve fund of \$3,850,000, see note at foot of assets (3), and, assuming this to be represented by liquid assets, it is clear that the liability of the old shareholders is nominal, and that \$350,000 is ready as a set-off against the \$500,000 additional liability which the subscribers to the new share issue have to shoulder. The general growth of the bank is indicated by the extracts from balance sheets (4).

This being a Colonial Bank, it will be observed that it is intended to apply for a London Stock Exchange quotation (5) and settlement, the object of which is that the shares shall be inserted in the Official List of securities issued by the Committee of the Stock Exchange, and may be dealt in by brokers on the London Stock Exchange. This is not necessarily the hall-mark of excellence, as some investors imagine, for many splendid securities are not "quoted"; it is, however, a convenience in buying and selling and enables the investor to keep in touch with the market price of his security.

The chief points to which attention should be directed in reading a bank prospectus are :—

(*a*) Age. A long-established bank will have many large and valuable connections among wealthy persons, which are a permanent source of income.

(*b*) Liability on Shares. The investor should carefully ascertain this amount and consider whether the yield on the investment is sufficiently high to compensate for the risk he is running in regard to the uncalled capital.

(*c*) The size of the Reserve Fund in relation to the liability on the shares should be observed.

(*e*) Note the proportion of *cash* to the " deposits from all sources " (which include what is here termed " current accounts "). It is " cash " which has to bear the first onset of withdrawals in the event of a run on the bank. It should be remembered that if all depositors in British banks were simultaneously to call in their moneys, probably not one-fifth of the amount due could be paid in cash. Hence a comparatively large cash balance is an eminently desirable feature.

(*e*) Investments. These, including money at call or short loan are the second line of defence. In the event of panic affecting one bank only, it can obtain large advances from its fellow banks on the strength of its negotiable securities and no need would arise for placing these on the market. But should the crisis be general and the run extend to many banking institutions, as was the case in the United States in 1907, and the Overend Gurney failure of 1866, then these bonds and stocks would become practically unsaleable.

(*f*) Comparison of the income yield should be made with the existing shares of the issuing bank, or if it be a new issue, the yield should be compared with that of existing banks. Other things being equal, it is preferable to purchase shares of an established institution than to invest in a newly-formed undertaking.

Example 7

# CANADIAN BANK OF COMMERCE

## NEW SHARE ISSUE

The directors have increased the rest, or reserve fund, by carrying to it from profits $1,000,000, and this fund now stands at $8,000,000. They have decided to issue 40,000 shares, equal to $2,000,000, of the unallotted stock, thus bringing the paid-up capital to $12,000,000. **The stock now to be issued will be allotted to Shareholders of record at the closing of the transfer books on May 17, 1911,** the issue price being fixed at 180, or $90 per share, the premium equalling the percentage which the reserve fund bears to the paid-up and issued capital. The Bank Act provides that allotment must be made to the shareholders of the bank *pro rata,* but that no fractional shares may be allotted. There being 40,000 shares now to be allotted, as against 200,000 already paid up, allotment will be made in the proportion of one share of new stock for every five shares of old stock, holdings of less than five shares being disregarded. Formal notice as to number of shares allotted, and the time and method of payment, will be sent to shareholders about May 31.

## Example 8

The Subscription List will close on or before the 23rd day of June, 1910

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**DOMINION OF CANADA**

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# THE MOLSONS BANK

**Established 1855**

*(Incorporated by Special Act of the Parliament of the Dominion of Canada.)*

## CAPITAL STOCK

| | |
|---|---|
| Authorised .. .. .. .. | $5,000,000 |
| Subscribed and Paid .. .. .. | $3,500,000 |
| Reserve Fund .. .. .. | $3,850,000 |

---

PARR'S BANK, LIMITED, are authorised to receive on behalf of the Contractors for the Issue applications for the purchase of $500,000 of the above Capital Stock in (1) *shares of* $100 *each at the price of* $216 at exchange of 49d. per dollar (= £44 2s.) per share payable as follows :—

£1 per Share on Application.
£13 2s. per Share on Allotment.
£15 per Share on the 1st July, 1910.
£15 per Share on the 2nd August, 1910.

Payment of any instalment will be accepted in advance under discount at the rate of 3 per cent. per annum.

Allotment Letters will be exchangeable, when fully paid, for a Stock Certificate made out in the name of the allottee. Thereafter the Stock forming part of this issue will be transferable by transfer in common form on a Register which will be kept at the Head Office of Parr's Bank, Limited, Bartholomew Lane, E.C.

**For the last four years Dividends at the rate of 10 per cent. per annum ~~have been~~ paid quarterly in January,**

**April, July and October in each year, and Dividends have been paid regularly since the inception of the Bank in 1855.**

The Shares now offered will be fully paid up, and will entitle the holders to receive the quarterly Dividend payable in December, 1910. Interest at the same rate per annum as the quarterly Dividend on the Capital Stock of the Company will be paid in October, 1910, on the instalments, calculated from the due dates.

② Under the Bank Act of Canada all Shares in Canadian Banking Companies are subject to a double liability, therefore the Shares now offered carry a liability not exceeding $100 per Share, but this liability can only be enforced in the event of the assets of the Bank being insufficient to meet its liabilities.

It will be seen from the Balance Sheet printed on the next page that on the 30th September, 1909, the assets of the Bank exceeded the liabilities by over $7,345,000.

The Molsons Bank was established in 1855, and is one of the oldest Banks in Canada.

The following is a copy of the General Balance Sheet for the year ended 30th September, 1909.

LIABILITIES

| | | |
|---|---|---|
| Capital, paid up .. .. .. .. .. | | $3,500,000.00 |
| Reserve Fund .. .. .. | $3,500,000·00 [1] | |
| Rebate on Notes discounted .. | 100,000·00 | |
| Profit and Loss Account .. .. | 257,769·13 | |
| 116th Dividend for ¼ year at 10 per cent. per annum .. .. | 87,500·00 | |
| Dividends unclaimed .. .. | 777·00 | |
| | | 3,946,046·13 |
| Interest, Exchange, etc., reserved | 265,004·10 | |
| Notes in Circulation .. .. | 3,032,902·00 | |
| Balance due to Dominion Government .. .. .. | 30,239·41 | |
| Balance due to Provincial Governments .. .. .. .. | 248,550·86 | |
| Deposits not bearing Interest .. | 4,359,171·08 | |
| Deposits bearing Interest .. .. | 22,796,980·76 | |
| Due to other Banks in Canada .. | 116,120·01 | |
| Deposits by Foreign Banks .. | 162,887·16 | |
| Due to Agents in United Kingdom | 98,435·84 | |
| | | 31,110,291·22 |
| | | $38,556,337·35 |

### Assets

| | | | |
|---|---|---|---|
| Specie .. .. | $589,870.41 | | |
| Dominion Notes .. | 2,552,977.25 | | |
| | | $3,142,847·66 | |
| Deposit with the Dominion Government to secure Note Circulation | | 145,000·00 | |
| Notes of and Cheques on other Banks .. .. .. .. | | 1,338,661·86 | |
| Due from other Banks in Canada | | 396,388·25 | |
| „ Foreign Agents .. | | 799,820·83 | |
| „ Agents in United Kingdom .. .. .. | | 339,574·73 | |
| Dominion and Provincial Government Securities .. .. .. | | 476,269·15 | |
| Municipal, Railway, Public and other Securities .. .. | | 2,424,566·55 | |
| Call and Short Loans on Bonds and Stocks .. .. .. .. | | 3,887,213·95 | |
| | | | $12,950,342·98 |
| Bills Discounted and Current .. | | 24,307,420·88 | |
| Bills past due (estimated loss provided for) .. .. .. | | 271,423·59 | |
| Real Estate other than Bank Premises .. .. .. .. | | 192,581·03 | |
| Mortgages on Real Estate sold by the Bank .. .. .. .. | | 7,783·53 | |
| Bank Premises at Head Office and Branches .. .. .. .. | | 600,000·00 | |
| Other Assets .. .. .. | | 226,785·34 | |
| | | | 25,605,904·37 |
| | | | $38,556,337·35 |

The following information extracted from the published Balance Sheets shows the growth of the Bank during the last 20 years :—

4

| | 1890. | 1900. | 1909. |
|---|---|---|---|
| Capital paid up.. .. | $2,000,000 | $2,466,040 | $3,500,000 |
| Reserve Fund .. .. | $1,100,000 | $2,050,000 | $3,500,000[1] |
| Deposits of all kinds .. | $6,755,608 | $12,984,223 | $27,434,942 |
| Total Assets .. | $12,092,573 | $20,569,705 | $38,556,337 |
| Net Profits .. .. | $229,050 | $308,128 | $493,470 |

6 Application will in due course be made to the Committee of the Stock Exchange, London, for an official quotation and settlement in the shares now offered.

Applications for shares must be made on the accompanying form and sent with a cheque for the amount

[1] On the 31st December, 1909, the Reserve Fund was increased to $3,850,000.

5

payable on application to Parr's Bank, Limited, Bartholomew Lane, E.C.

Failure to pay any instalment when due will render all instalments previously paid liable to forfeiture and interest at the rate of 6 per cent. per annum will be charged on all instalments paid after due date.

Prospectuses and forms of Application can be obtained at Parr's Bank, Limited, Bartholomew Lane, E.C., or at the offices of Messrs. Sperling & Co., Basildon House, Moorgate Street, E.C.

16*th June,* 1910.

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*Directors*

| | |
|---|---|
| WM. MOLSON MACPHERSON (*President*). | CHARLES B. GORDON. |
| S. H. EWING (*Vice-President*). | H. MARKLAND MOLSON. |
| JAMES P. CLEGHORN. | W. M. RAMSAY. |
| GEORGE E. DRUMMOND. | |

*Brokers to the issue*

MESSRS. SPERLING & CO., Basildon House, Moorgate Street, London, E.C.

*Solicitors to the issue*

LINKLATER & CO., 2, Bond Court, Walbrook, London, E.C.

# CHAPTER VIII

## COMMERCIAL AND INDUSTRIAL COMPANIES' PROSPECTUSES

EFFECTS OF "LIMITED LIABILITY" ON INVESTMENT—BRITISH V. FOREIGN COMPANIES—LEGAL DEFINITION OF PROSPECTUS—FOUNDERS' LIABILITIES

WE enter now upon a broad field of finance, which embraces industries of an infinite variety of kinds. Although joint-stock companies were well known before the year 1862, it was undoubtedly the passing of the Companies Act of that year, and the consequent introduction of the principle of limited liability, which has effected the extraordinary transformation from individualistic to democratic capitalisation which is a characteristic of modern industry. Since that date, companies capitalised at over 8,000 millions of pounds have been registered by the Registrar of Joint-Stock Companies, and thousands of millions sterling have been subscribed by the British public alone to enterprises financed on this principle, whilst the idea has spread to every civilised country of the world with similarly extraordinary results. From time to time, as circumstances rendered them necessary, various other Acts amending the original Act of 1862 were passed, the last of which was the Companies Act, 1907. Recently, however, the whole of the laws relating to limited liability companies have been collated and as from the 1st July, 1908, are known as the Companies (Consolidation) Act, 1908. This monumental piece of legislation, in its 296 sections, governs the career of all limited liability companies from the cradle to the grave. It determines the essential particulars which their prospectuses shall contain, and regulates their demise when the hour of liquidation strikes.

An honest endeavour appears to have been made in the Act to safeguard the interests of investors, and a large number of clauses are concerned solely with the penalties which are attached to offences, either of commission or of omission, on the part of vendors, promoters, directors, secretaries, and liquidators. But the Act is not perfect, and the money of the public may still be trapped by unscrupulous persons who successfully manage to keep within the four corners of the law.

In considering the prospectuses of the class of companies which will be treated hereafter, it is of importance that the provisions of the Companies (Consolidation) Act, 1908, which bear upon this subject, should be borne in mind. In the first place, a " prospectus " is defined in Section 285 as " any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company." This definition, however, only applies (so far as the protection of the Act is concerned) to the applications for capital made by companies registered in Great Britain and Ireland under the Companies Act aforesaid, and it cannot be too clearly understood that the provisions of this Act do not apply to companies not so registered. This fact is important, because companies registered in these islands must disclose in their prospectus certain particulars regarding their formation which the law deems to be of material assistance to the investor in arriving at a decision as to whether he will or will not place money in the enterprise. But since these disclosures are not obligatory upon a company not formed under this Act, prospectuses issued by or on behalf of foreign companies should be examined with exceptional care.

There is another class of prospectus which does not come under the Companies Act. Sometimes a financial firm—an " issuing house " as it is termed—purchases the whole of a debenture or share creation, and resells it to the public, for which purpose it issues a prospectus. The " issuing house " sells, not as an agent of the company, but as a principal, and it naturally endeavours to make a profit on the transaction.

This is, of course, a perfectly legitimate form of business. If the issuing house be of good repute, all necessary information will be given, but there are firms which adopt this method of making profits whose honesty is questionable and whose wares are of doubtful value. Hence the need of caution.

There is, however, a simple test whereby the investor may know whether the persons responsible for any issue of capital to the public are amenable to the discipline of the Companies (Consolidation) Act, 1908, and it is this. According to the law, a copy of every prospectus within the meaning of the Act, must be filed with the Registrar of Joint-Stock Companies, and it is further provided that every prospectus shall state on the face of it that a copy has been so filed. Hence, the first words (preceding even the name of the company) printed on a prospectus issued in accordance with the Act, are usually as follows :—

"A copy of this prospectus has been filed with the Registrar of Joint-Stock Companies."

But prospectuses which are not governed by the Act, and which, therefore, are not necessarily bound to include (although they frequently do) the facts stipulated by the Act, omit this sentence.

The sections which refer to the issue of prospectuses and to the liabilities attaching to those connected therewith, are numbered 80 to 84 inclusive, and they are important enough to be given in full :—

## COMPANIES CONSOLIDATION ACT, 1908

### Prospectus

80.—(1) Every prospectus issued by or on behalf of a company or in relation to any intended company shall be dated, and that date shall, unless the contrary be proved, be taken as the date of publication of the prospectus.

(2) A copy of every such prospectus, signed by every person who is named therein as a director or proposed director of the company, or by his agent authorised in writing, shall be filed for registration with the registrar of companies on or before the date of its publication, and no such prospectus shall be issued until a copy thereof has been so filed for registration.

(3) The registrar shall not register any prospectus unless it is dated, and the copy thereof signed, in manner required by this section.

(4) **Every prospectus shall state on the face of it that a copy has been filed for registration as required by this section.**

(5) If a prospectus is issued without a copy thereof being so filed, the company, and every person who is knowingly a party to the issue of the prospectus, shall be liable to a fine not exceeding five pounds for every day from the date of the issue of the prospectus until a copy thereof is so filed.

81.(1) **Every prospectus** issued by or on behalf of a company, or by or on behalf of any person who is or has been engaged or interested in the formation of the company, **must state**—

(*a*) the contents of the memorandum, with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively; and **the number of founders' or management or deferred shares,** if any, and the nature and extent of the interest of the holders in the property and profits of the company; and

(*b*) the number of shares, if any, fixed by the articles as the **qualification of a director,** and any provision in the articles as to the remuneration of the directors; and

(*c*) the names, descriptions, and addresses of the directors or proposed directors; and

(*d*) **the minimum subscription** on which the directors may proceed to allotment, and the amount payable on application and allotment on each share; and in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted; and

(*e*) the number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or are proposed or intended to be issued; and

(*f*) the names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus, or the purchase or acquisition of which has not been completed at the date of issue of the prospectus, and **the amount payable in cash, shares, or debentures, to the vendor,** and where there is more than one separate vendor, or the company is a sub-purchaser, the amount so payable to each vendor: Provided that where the vendors or any of them are a firm the members of the firm shall not be treated as separate vendors; and

(*g*) **the amount (if any) paid or payable as purchase money in cash, shares, or debentures, for any such property as aforesaid, specifying the amount (if any) payable for goodwill; and**

(*h*) **the amount (if any) paid** within the two preceding years, or payable, **as commission** for subscribing or agreeing to subscribe, or procuring or agreeing **to procure subscriptions,** for any shares in, or debentures of, the company, or the rate of any such commission: Provided that it shall not be necessary to state the commission payable to sub-underwriters; and

(*i*) **the amount or estimated amount of preliminary expenses; and**

(*j*) the amount paid within the two preceding years or intended to be paid to any promoter, and the consideration for any such payment; and

(*k*) **the dates of and parties to every material contract, and** a reasonable time and place at which any material contract or a copy thereof may be inspected: Provided that this requirement shall not apply to a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company, or to any contract entered into more than two years before the date of issue of the prospectus; and

(*l*) the names and addresses of the auditors (if any) of the company; and

(*m*) **full particulars of the nature and extent of the interest (if any) of every director in the promotion of, or in the property proposed to be acquired by the company,** or where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares or otherwise by any person either to induce him to become, or to qualify him as, a director, or otherwise for services rendered by him or by the firm in connection with the promotion or formation of the company; and

(*n*) where the company is a company having shares of more than one class, **the right of voting at meetings of the company** conferred by the several classes of shares respectively.

(2) For the purposes of this section every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—

(*a*) the purchase money is not fully paid at the date of issue of the prospectus; or

(*b*) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus; or

(*c*) the contract depends for its validity or fulfilment on the result of that issue.

(3) Where any of the property to be acquired by the company is to be taken on lease, this section shall apply as if the expression "vendor" included the lessor, and the expression "purchase money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.

(4) Any condition requiring or binding any applicant for shares or debentures to waive compliance with any requirement of this section, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.

(5) Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum or

the signatories thereto, and the number of shares subscribed for by them.

(6) In the event of non-compliance with any of the requirements of this section, a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance, if he proves that—

(*a*) as regards any matter not disclosed, he was not cognisant thereof; or

(*b*) the non-compliance arose from an honest mistake of fact on his part:

Provided that in the event of non-compliance with the requirements contained in paragraph (*m*) of subsection (1) of this section no director or other person shall incur any liability in respect of the non-compliance unless it be proved that he had knowledge of the matters not disclosed.

(7) This section shall not apply to a circular or notice inviting existing members or debenture holders of a company to subscribe either for shares or for debentures of the company, whether with or without the right to renounce in favour of other persons, but subject as aforesaid, this section shall apply to any prospectus whether issued on or with reference to the formation of a company or subsequently.

(8) The requirements of this section as to the memorandum and the qualification, remuneration, and interest of directors, the names, descriptions, and addresses of directors or proposed directors, and the amount or estimated amount of preliminary expenses, shall not apply in the case of a prospectus issued more than one year after the date at which the company is entitled to commence business.

(9) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or this Act apart from this section.

82.—(1) **A company which does not issue a prospectus** on or with reference to its formation, shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been filed with the registrar of companies a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company, or by his agent authorised in writing, in the form and containing the particulars set out in the Second Schedule to this Act.

(2) This section shall not apply to a private company or to a company which has allotted any shares or debentures before the first day of July nineteen hundred and eight.

83. A company shall not previously to the statutory meeting vary the terms of a contract referred to in the prospectus or statement in lieu of prospectus, except subject to the approval of the statutory meeting.

84.—(1) Where a prospectus invites persons to subscribe for shares in or debentures of a company, **every person who is a director of the company at the time of the issue of the prospectus,** and every person who has authorised the naming of him and is named in the prospectus as a director or as having agreed to become a director either immediately or after in interval of time, **and every promoter of the company,** and every person who has authorised the issue of the prospectus, **shall be liable to pay compensation to** all persons who subscribe for any shares or debentures on the faith of the prospectus **for the loss or damage** they may have **sustained by reason of any untrue statement therein,** or in any report or memorandum appearing on the face thereof, or by reference incorporated therein or issued therewith, unless it is proved—

(*a*) With respect to every untrue statement not purporting to be made on the authority of an expert, or of a public official document or statement, that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe, that the statement was true; and

(*b*) With respect to every untrue statement purporting to be a statement by or contained in what purports to be a copy of or extract from a report or valuation of an expert, that it fairly represented the statement, or was a correct and fair copy of or extract from the report or valuation. Provided that the director, person named as director, promoter, or person who authorised the issue of the prospectus, shall be liable to pay compensation as aforesaid if it is proved that he had no reasonable ground to believe that the person making the statement, report, or valuation was competent to make it; and

(*c*) With respect to every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy or extract from a public official document, that it was a correct and fair representation of the statement or copy of or extract from the document:

or unless it is proved—

(i) that having consented to become a director of the company he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or

(iii) that after the issue of prospectus and before allotment thereunder, he on becoming aware of any untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of the withdrawal, and of the reason therefor.

(2) Where a company existing on the eighteenth day of August one thousand eight hundred and ninety, has issued shares or debentures, and for the purpose of obtaining further capital by subscriptions for shares or debentures issues a prospectus, a director shall not be liable in respect of any statement therein, unless he has authorised the issue of the prospectus, or has adopted or ratified it.

(3) Where the prospectus contains the name of a person as a director of the company, or as having agreed to become a director thereof, and he has not consented to become a director, or has withdrawn his consent before the issue of the prospectus, and has not authorised or consented to the issue thereof, the directors of the company, except any without whose knowledge or consent the prospectus was issued, and any other person who authorised the issue thereof, shall be liable to indemnify the person named as aforesaid against all damages, costs, and expenses to which he may be made liable by reason of his name having been inserted in the prospectus, or in defending himself against any action or legal proceedings brought against him in respect thereof.

(4) Every person who by reason of his being a director, or named as a director or as having agreed to become a director, or of his having authorised the issue of the prospectus, becomes liable to make any payment under this section may recover contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment, unless the person who has become so liable was, and that other person was not, guilty of fraudulent misrepresentation.

(5) For the purposes of this section—

The expression "promoter" means a promoter who was a party to the preparation of the prospectus, or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company;

The expression "expert" includes engineer, valuer, accountant, and any other person whose profession gives authority to a statement made by him.

# CHAPTER IX

## Commercial and Industrial (*contd.*)

CAPITAL — VENDORS' SHARES — RIGHTS — DEBENTURES v. SHARES—" NET " PROFIT—" AVERAGE " PROFIT—MARGIN OF CAPITAL AND INCOME SAFETY—PURCHASE CONSIDERATION—GOODWILL—POINTS FOR INVESTIGATION

Issues of debentures and share capital may be made by either :—

(*a*) New Companies formed to take over existing businesses, or

(*b*) New Companies floated to undertake new enterprises, or

(*c*) Established Companies.

In class (*a*), where a private business is converted into a limited liability company, and the public are invited to subscribe, the object of the conversion may be to obtain new capital to develop the business on a larger scale ; to amalgamate with other firms ; to enable the proprietor to acquire the security of the law as to limited liability ; to permit the owner to retire ; or to facilitate the splitting up of the owner's share in the business amongst various interests. Whatever be the reason, the owner is a seller and the public are the buyers, and the saying applies, *Caveat emptor*. The matters of primary importance are (i) the capital of the new company, (ii) the assets and profits of the business to be acquired, and (iii) the purchase consideration.

(i) The capital of the new company is fixed by the vendors and the promoters at a figure which is determined by a number of varying circumstances. It should, of course, bear some fairly close approximation to the value of the business which is to be acquired by the public, but as the owners are not likely to undervalue their business, and the promoters must be paid for their services, the price at which it appears in the prospectus is invariably more than the bare value of the undertaking. As a matter of fact, the capital of a company is always larger than the consideration paid to its vendors. It must cover not only this and the promoters' intermediate profit, if any, but also the expenses of flotation; and it generally provides a number of reserve shares to be used for raising further capital in the future. This inclusive capital is the "nominal" capital, and it is created by the simple process of paying certain dues to the Inland Revenue. It will be found stated in bold type on the "front page" of the prospectus, and immediately following it will be particulars of the number of shares into which it is split up, their face value, and the rank which has been conferred on them. Thus:—

CAPITAL £200,000

**Divided into 100,000 5 per cent. Preference Shares of £1 each, and 100,000 Ordinary Shares of £1 each, of which 50,000 Ordinary Shares are to be issued as fully paid up in part payment of the purchase consideration, and 50,000 held in reserve for future issue.**

---

**ISSUE OF 100,000 5 PER CENT. PREFERENCE SHARES of £1 each at par; payable as follows:—**

5s. on Application.
5s. on Allotment.
5s. on 1st June, 1912.
5s. on 1st September, 1912.

Here the sellers of the business are willing to take a large block of fully paid Ordinary Shares in the company as part of the price to be paid to them; these will be known as "Vendor" shares. The 50,000 Ordinary Shares held in reserve are "Unissued" capital, the 100,000 Preference Shares offered for sale by the prospectus are "Issued" shares, and when taken up by the public or others, will form the "Subscribed" capital of the company.

The rights attaching to classes of shares differ considerably in different companies, notwithstanding a similarity of name, and the investor should not be content to purchase "Preference" Shares without ascertaining in what the preference consists. A "Preference" Share has rights over a non-Preference, Ordinary, or Deferred Share, in respect of either capital, or dividend, or both. In the case of capital, if the company goes into liquidation, the Preference Shareholders have the right to be paid back their money in full out of the available assets, before the Ordinary shareholders receive anything whatever. In the case of preference as to dividend, the holders of Preference Shares are entitled to their fixed rate of dividend out of the year's profits before the Ordinary shareholders participate. It should be remembered, however, that the dividend is payable only out of profits, and that if there is no profit there is no dividend, although if the preference dividend is stated to be "cumulative," any deficiency in any dividends must be made up out of future profits. It has been held that the absence of the word "cumulative" is not sufficient to render the shares "non-cumulative" but the addition of the word "non-cumulative," or any other word or phrase conveying that idea, will debar the Preference shareholder from claiming for any past deficiency in the stipulated dividend. Thus, in unsuccessful years the non-cumulative preference shareholder suffers, and in successful periods he does not gain. Sometimes, indeed, he is permitted the privilege of sharing with the Ordinary shareholders in the balance of profits left after paying his fixed rate; his share is then a "participating Preference Share."

Occasionally the Preference Shares possess no voting power except in special circumstances, and the control of the company at General Meetings is practically determined by the holders of Ordinary Shares. Thus, in a recent prospectus, the following clause appears:—

> "Every shareholder is entitled on a poll at General Meetings of the Company to one vote for every share

held, *but the holders of Preference Shares are not entitled to have notice of, or attend or vote, at General Meetings of the Company, in respect of such shares* unless at the date of summoning the meeting the Preference dividend is in arrears for three months, or a resolution for liquidation or otherwise directly affecting their rights is to be proposed."

This is a drastic wiping-out of the usual rights of a shareholder, but as the investment was an excellent one, and the issue was largely over-subscribed, it is evident that the applicants were content to become silent partners in the company.

Where the prospectus provides for an issue of debentures, a new element, antagonistic to the shareholder, is introduced. For while the holder of shares is a partner in the business, and his reward depends upon the profits, the holder of debentures is a lender of money to the company, and is thus a creditor. Moreover, he is a secured creditor, and the company's property to the value of, perhaps, twice the amount of the debentures, will have been mortgaged as his security. The investor, of course, has the choice of buying either debentures or shares, but, if he takes the former, he will pay for the comparative safety of his capital by a reduced rate of income. As against the debenture holder, the shareholder accepts certain risks as to both capital and income, for his claim in the event of liquidation is inadmissible until the debenture holder has been settled with in full. Hence the investor who is constrained by circumstances or temperament to be cautious, would, in the case of industrial undertakings, purchase debentures only, and where there are no debentures issued, he would buy Preference Shares, in which case he would do well to look for a statement in the prospectus guaranteeing that no debentures will be issued without his consent. As a case in point, the following is quoted from a prospectus of Edward Lloyd, Limited, which company successfully issued £550,000 of 5½ per cent. Cumulative Preference Shares (£1 each) in May, 1911 :—

> "That no Debentures or Debenture Stock of the Company shall be issued nor shall any floating charge be created upon the undertaking or any part of the assets of the Company without the previous approval of the holders of two-thirds of the Preference Shares, or the sanction of a resolution passed at a separate meeting of the Preference Shareholders by a two-thirds majority of those present and voting."

(ii) Having examined the new company's capital, the investor should next consider the standing of the business about to be acquired. He should direct his attention to two points ; viz., its profit-making capacity and its assets and liabilities.

It is, perhaps, scarcely necessary to say that if the past has been unsuccessful and the causes of failure have not been eliminated, the prospectus should be left severely alone, notwithstanding any temptation in the shape of discount (on debentures) or high preferential dividends (on shares).

The most informing source of knowledge on this subject is, of course, the balance sheet. As a rule, the prospectus gives certain extracts from the past accounts representing the profit made during a certain period. Unless this period covers at least five years, it should not be regarded as satisfactory. Many flourishing businesses give more than this :—Harrod's Stores, Limited, in their prospectus advertising an issue of new shares in March, 1911, gives the separate annual profits for twenty-one years prior to the issue.

This matter of past profits is the most vital in the whole prospectus, and too great care cannot be given by the investor to its consideration. The necessity of closely examining it is all the greater because the term " profit " has not invariably the same meaning, and the addition or omission of a few words in the context may change its significance. The only profit that is worth considering by one who is examining a probable investment is *net* profit, and net profit is that sum which is available for distribution to the shareholders after all business charges, depreciation, reserves, debenture and other interest, directors' fees and commission have been deducted. Where the figures given do not represent this, that fact should be clearly stated, and the nature of the items which should be, but have not been, deducted, ought to be clearly set out. Perhaps the most satisfactory plan is to print a certificate from the company's auditors (see Example 9, page 82 ①).

Here ten years' profits are shown, the figures being arrived at after allowing for depreciation on plant and machinery, and management salaries, but before charging interest on capital, and income tax, neither of which items happens to be of consequence in calculating profits from the shareholders' point of view.

If the prospectus merely gives the "average" profits for so many years, the figures should be received with something more than caution. Take a hypothetical case: Suppose a firm's trading results for five years to be :—

| | | |
|---|---|---|
| 1907. | Profit. | £10,000. |
| 1908. | ,, | 7,500. |
| 1909. | ,, | 3,500. |
| 1910. | ,, | 2,000. |
| 1911. | Loss | 500. |

the total profit for the period would be £22,500 and the average profit for the five years is £4,500 p.a. Obviously, however, a statement that "the firm has made an average profit during the past five years of £4,500 per annum" would be grossly misleading, for it invites the investor to believe that the business is producing a steady income of £4,500, whereas in reality it is running headlong into bankruptcy.

After ascertaining the profit, it is necessary to observe how far this will go towards providing interest or dividends on the new capital. It does not follow that because a private firm has derived a fine income from a business, an equivalent percentage of profit will be obtained by the shareholders when they take over the concern. As a rule, a company is capitalised much higher than a private firm, so that even if total profits are earned equal to those under the old *régime*, the rate of dividend would be less owing to the profit being spread over a larger amount of capital.

The capital on which dividends have to be paid will consist of Debentures, Preference, Ordinary, or Deferred Shares, or any combination thereof. To find the dividend probabilities of each class, the dividends on all the higher classes must be deducted from the net profit, and the remainder in each case represents the profit margin available. It is a safe rule to regard the return on the invested capital as in inverse ratio to its safety, or, in other words, that the higher the yield the less secure the investment. First-class British commercial and industrial debentures should give 4 per cent. to 5 per cent.; Preference Shares 4½ per cent. to 5½ per cent.; Ordinary Shares 7 per cent. to 8 per cent. In prosperous times the Ordinary dividend will, of course, be greater; thus the average profit earned by 612 companies for the nine months ended 30th September, 1911, amounted to £42,372,271 on a capital of £432,810,140, or £9 6s. per cent. (after deducting debenture interest). But this was during a trade "boom," and the percentage is shown on the issued capital at its par value. As many of these shares probably stand at a premium, the *yield* to a purchaser to-day would be less than the rate here given.

A statement as to the assets which are to be acquired by a new company must invariably be included in the prospectus. Sometimes this is taken from the latest balance sheet, but the most satisfactory plan is for all the "fixed assets" to be valued by expert assessors, either expressly for the purpose of the issue, or not more than twelve months previous thereto. A glance at Example No. 9 ② p. 83, shows that the "fixed assets" (property and plant) have been appraised by a well-known firm of valuers.

In every case the assets should be subjected to a thorough scrutiny.[1]

To arrive at an estimate of the Capital safety of the investment, a similar method to that adopted in calculating the dividend probabilities of the different classes should be pursued. The actual assets of a tangible nature, *e.g.*, land, buildings, plant, machinery, stocks, raw materials, debtors, investments and cash, should be taken at their proper values, and the liabilities, viz., trade creditors, loans, mortgages, and amounts owing to bankers, should be deducted therefrom. The difference will represent the net value of the assets which the new company is buying. Against this sum must be measured off first the amount of the debentures, and then, in succession, the various classes of shares according to their grade; the balance left after each deduction represents the margin of Capital safety of the shares deducted.

Bearing in mind the capital of the company and the value of the business from the points of view of probable income and of capital safety, the investor will now be in a position to judge of the fairness or otherwise of the price to be paid to the vendors for the business. First, he will note how much cash is to be raised by the issue, what amount of this is payable to the owners, and how much is available for the development of the business. The mere sale of a private business to a public company is not sufficient to cause an expansion of its trade; on the contrary, suppliers are more careful in granting credit to a limited company, since its members are not liable for debts incurred by it beyond the amount payable on their shares. Unless, then, the cash left over after settling with the vendors,

[1] For a detailed examination of assets, the reader is referred to the suggestions set out in *Balance Sheets, how to Read and Understand them*, by the present writer. Published by Sir Isaac Pitman & Sons at 1s. net.

together with that already available in the business itself, is sufficient to put the company in a strong position for pushing its operations vigorously, it is certain that the vendors are receiving an undue proportion of cash for their property.

Unfortunately, the investor is not in a position to modify the terms made with the vendors. He must either take the prospectus as it stands or leave it alone. And it is safer to leave it alone if he is convinced the sellers have made too good a bargain at the expense of the incoming shareholders. He should regard the matter as a " deal " with the vendors in which he himself takes part. He should, in effect, say :—" Gentlemen, you wish to sell your business and I am willing to buy. You have assets worth £100,000 net, and you have earned 10 per cent. p.a. on that capital for over five years past. You say that with more available cash a larger turnover could be made and a bigger profit would result. Very well; these are my terms. I will form a company with a nominal capital of £150,000. I will pay you £100,000 for your assets as valued, and for the " goodwill " I will give you 2½ times the net annual profits, say, £25,000. The remaining £25,000 will be devoted to developing the business. In order that your interest may be identical with that of the people who subscribe money on the statements in the prospectus, I propose to pay you entirely in shares. I also propose to retain your services as directors or managers."

Such an " all share consideration " would be the best possible bargain judged from the side of the purchaser; the worst would be an " all cash consideration." In the first case the efforts of the vendors would be directed to the task of earning dividends; in the second, although they might still conduct the business on behalf of the company, there would not be the same guarantee of strenuous endeavour. Usually, of course, the vendors insist upon getting a proportion in cash.

In the above hypothetical case, it is assumed that the shares allotted to the vendor are of the same nominal value and possess only the same rights as the shares offered to the public for cash. But this is not invariably the case. A favourite plan is for the vendor's shares to be less in nominal value, but more important so far as rights are concerned. For instance, the denomination of the vendor's shares may be only 1s. each, but they may be entitled to 75 per cent. of the profits available for distribution in each year after paying to the cash subscribers a dividend of say 5 per cent. This may easily prove a very remunerative bargain for the vendors. Suppose the capital of a company to be £101,000, of which 100,000 are "subscribed" shares of £1 each, and there are 20,000 "vendors" shares of 1s. each. The profit available for dividend is say £17,000 distributable in the proportions already mentioned. The result is as follows:—

*Divisible profit* £17,000.

| | Dividend on Cash Shares. | Dividend on Vendor's Shares. |
|---|---|---|
| 5% on £100,000 .. .. .. .. | 5,000 | |
| 25% of balance for subscribed shares .. | 3,000 | |
| 75% of balance for Vendor's shares .. | | 9,000 |
| | 8,000 | 9,000 |

The £100,000 cash capital gets £8,000, equal to 8 per cent., and the £1,000 vendor's interest takes £9,000, or 900 per cent. Instances of higher percentages than in this suppositious case have been known. On the other hand, should the company be only moderately successful, these "deferred" shares might wait for years for a dividend.

Reference has already been made to "goodwill." When a business is being sold as a "going concern," the value of the "goodwill" is sure to be the subject of keen debate. Goodwill has been defined to be "every positive advantage .... that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on, or with the name of the late firm, or with any other matter carrying with it the benefit of the business." It may perhaps be "nothing more than the probability that the old customers will resort to the old place." But, however defined, there is no doubt that in numerous cases the vendors are entitled to some *quid pro quo*. Generally speaking, the more permanent the nature of the business, the larger and steadier the profits, and the less it depends upon the influence or the skill of one man,—the more valuable is the goodwill. Conversely, the more precarious the enterprise, the more fluctuating the revenue, and the more it is built on the exceptional skill of an individual,—the less valuable is the goodwill. The method of calculation is to ascertain the average net annual profits of say the past five years, and multiply this amount by the number of years (generally from one to five) agreed on by the parties.

When the sellers of the business are paid for goodwill, either in cash or shares, it forthwith becomes an "asset" of the new company and will show in its balance sheet along with the more tangible items of property; and the shares which are thus paid to the vendor, rank for dividend out of the profits, unless expressly excepted.

There is a matter here of some importance to shareholders. It has been shown that whatever is paid for goodwill is a payment over and above the tangible assets of the business, and that the capital of the new company is increased ("watered" is the usual term) by that amount over the capital in the business when in private hands. It follows that the new company must make a larger profit than the private business, if it is to pay a similar rate of dividend on its capital. The result is that the shareholder who subscribes cash for his shares is placed on no better footing than the seller of the business who receives shares for goodwill, notwithstanding that the latter has already received full value for all the tangible assets sold by him to the company. Therefore it appears equitable that whenever goodwill is purchased, it should not only be paid for in shares (not cash) but that such shares should be treated as "deferred" shares, and rank behind the Ordinary Shares both as to dividend and capital, *i.e.*, only sharing in the dividends after a certain percentage has been paid to the ordinary shareholders in each year, and in the event of liquidation, they should not participate in the assets until the cash subscribers have received back their capital in full. To sum up: the principal points in the prospectus of a company formed to acquire an established industrial or commercial undertaking, are as follows:—

(1) *Capital.* The divisions of the nominal capital into unissued (reserved), issued, and vendors' shares should be noted, also the classes of the shares and their respective rights, both as to capital and dividends.

(2) *Debentures* are not included in the nominal capital, but are loan capital. Debenture holders are creditors of the company, so that the larger the number of shares issued for cash, the safer is the position of these creditors. Debentures or Debenture Stock are almost invariably secured on specific property and the investor should ascertain that there is a Trust Deed investing this property in reputable trustees. Unless this has been done, not only may other debentures be created with prior rights on his security, but in the event of the company defaulting on its interest or going into liquidation, valuable time might be lost before the debenture holders could take steps to obtain the appointment of a receiver in their interests.

(3) *Past Profits* should be carefully scrutinised. Certificate as to the profits should be given by a qualified accountant. A steadily expanding net profit, shown over a period of not less than five years, is a good sign. Widely fluctuating profits promise much anxiety for the investor.

(4) *Assets and Liabilities.* A recent valuation, by professional expert, of the "fixed assets" should be included in the prospectus, and the other assets should also be appraised by competent persons.

(5) *Purchase Consideration.* Note to whom this is

payable, and whether any person or syndicate comes between the owners of the business and the public. All profits on a resale by an intermediary represent so much excess over the actual value of the net assets taken over. The interest retained in the business by the owners may be gauged by the proportion of the purchase-price which is accepted in shares of the company. Study particularly the " rights " of the vendor's shares, and whether they are likely to benefit at the expense of the subscribed shares. Are the owners assisting on the directorate, and on what terms?

(6) *Goodwill.* Where this is paid for, it is in the interest of the shareholders that it should be in shares possessing deferred rights. It is an addition over and above the actual value of the assets, and increases the capital of the company on which dividends are to be earned.

(7) *Working Capital.* After paying the vendors, note what cash is available for carrying on the business of the company. Will it be in a position to extend operations ?

(8) *Capital Safety.* Each class of security in order of rank should be measured off against the net value of the assets. Debentures should be secured on at least twice their value of assets ; if less than this, their security is doubtful, for in the event of liquidation, the assets would probably be sold at a heavy depreciation.

(9) *Income Safety.* The fixed interest on debentures and the dividends on Preference Shares should be deducted, in order of precedence, from the amount of five years' average net profit (after allowing for depreciation and reserves) ; the balance after each deduction represents the margin of income safety for that particular class. After paying these first and second charges, the remainder would be available for the ordinary shareholders (subject to any rights of the vendors or founders' shares).

(10) *Premium.* In calculating the yield on securities issued at a premium, it should be remembered that the interest or dividend declaration is based on the nominal value of the security, not on the issue price.

## EXAMPLE 9

**No Underwriting Commission has been or will be paid**

*A Copy of this Prospectus has been filed with the Registrar of Joint-Stock Companies*

The Subscription List will Open on Monday, the 29th May, 1911, and Close on or before Tuesday, the 30th May, 1911, for Town, and Wednesday, the 31st May, 1911, for Country.

# SLAZENGERS, LTD.

(Incorporated under the Companies (Consolidation) Act, 1908.

**CAPITAL - - £265,000**

divided into

**100,000 Six per cent. Cumulative Preference Shares of £1 each, and**

**165,000 Ordinary Shares of £1 each.**

**The Preference Shares carry a fixed cumulative preferential dividend at the rate of Six per cent. per annum on the Capital for the time being paid up thereon, payable half-yearly on 15th January and 15th July out of profits and are also preferential as to Capital. The first dividend will be payable on 15th January, 1912, and will be calculated from the due dates of the respective instalments.**

**One-third of each class of shares will be taken by the Vendor in part payment of the purchase consideration. The balance, viz. :—**

**66,666 Six per cent. Cumulative Preference Shares of £1 each, and**

**110,000 Ordinary Shares of £1 each,**

are now offered for Public Subscription, at par.

**PAYABLE AS FOLLOWS :—2s. 6d. on Application, 7s. 6d. on Allotment, and the balance one month after Allotment.**

Under the Articles of Association it is provided that 20 per cent. of the net profits of the Company in each year, calculated before providing for but subject to the payment of the Preference Dividend, shall be carried to Reserve until the Reserve Fund so set aside amounts to £50,000, and thereafter 10 per cent. of the net profits is to be carried to Reserve.

No Debentures or Debenture Stock can be issued without the sanction of a resolution passed at a meeting of the holders of Preference Shares by a majority consisting of not less than two-thirds of the votes given upon such resolution.

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*Directors*

ALBERT EGERTON LEGH SLAZENGER, *Chairman*,<br>ARCHDALE PALMER, *Managing Director*,<br>HORATIO SLAZENGER,<br>EDWARD CLIVE,<br>JOHN HENRY HITCHCOCK ACTON, } of Laurence Pountney Hill, Cannon Street, London, E.C.

NORMAN GEORGE GROVES, of Para Works, Woolwich.

(*Mr. A. E. L. Slazenger is the Proprietor, Mr. A. Palmer, General Manager, and the other Directors Departmental Managers of the business of Slazenger & Sons.*)

*Bankers*

THE MANCHESTER & LIVERPOOL DISTRICT BANKING COMPANY, LIMITED,<br>75, Cornhill, London,<br>Manchester, Liverpool and Branches.

*Brokers*

JOHN PRUST & CO., 37, Throgmorton Street (and Stock Exchange) London, E.C.

*Solicitors*

ASHURST, MORRIS, CRISP & CO., 17, Throgmorton Avenue, London, E.C.

*Auditors*

CREWDSON, YOUATT & HOWARD, Chartered Accountants, 70a, Basinghall Street, London, E.C., and Manchester.

*Registered Office*

Laurence Pountney Hill, Cannon Street, London, E.C.

*Secretary* (pro tem.) *and Transfer Office*

GERALD YOUATT, 70a, Basinghall Street, London, E.C.

# PROSPECTUS

THE COMPANY has been formed to acquire the well-known business of Slazenger & Sons, Manufacturers of Rackets, Lawn Tennis and other Balls, and other articles of Sport and Games, India-rubber, Gutta-percha and Waterproof Goods, Leather Merchants and Dealers, carried on by them at Laurence Pountney Hill, Cannon Street, E.C., and at Para Works, Woolwich, and also at 18, Princes Street, Cavendish Square, W., where the business of the late T. J. Tate, acquired by the Firm, is carried on.

The reputation of the Firm as manufacturers of high-class Lawn Tennis Rackets is world-wide, and in this category may be included the "**Doherty,**" the "**Stadium,**" the "**Demon,**" the "**E.G.M.,**" and the "**Slazenger**" Rackets, of the Trade-Marks of which they are sole proprietors. With one or other of these Rackets the World's Championship at Wimbledon has been won no less than 16 times between the years 1890 and 1910.

An important feature of the business consists in the manufacture of Lawn Tennis Balls, of which the Firm are the largest producers in the World.

The "**Slazenger**" Lawn Tennis Ball has been officially adopted for the Championship Meeting at Wimbledon for the nine successive years ending 1910, and has again been selected for the current year's Meeting; while, in addition to having been used at practically every important Tournament in the British Isles and on the Continent of Europe during the past year, the Firm's Lawn Tennis Balls have been supplied to the Championship Meetings of nearly every Country or Colonial State throughout the World.

The Firm are also manufacturers of many other articles of outdoor Sport, amongst which may be mentioned Croquet, Cricket, Hockey, Badminton, Squash Rackets, and Football, with their several respective accessories.

Realising the constantly increasing demand for Sporting requisites not only in the British Colonies and Possessions but in all parts of the World, the Firm have appointed Special Agents or Representatives in almost every country. One of the features of their business has been the study of the peculiar climatic conditions of the various localities in which their goods are distributed.

The Company will acquire the freehold premises in Upper Thames Street and Ducksfoot Lane, and the leasehold premises in Upper Thames Street and Laurence Pountney Lane, London, and the long leasehold premises known as Para Works, Woolwich, on which the Firm have built a factory specially suited to the requirements of the business.

**PROFITS.**—The Books of the Firm have been regularly audited by Messrs. Crewdson, Youatt & Howard, Chartered Accountants, for the last 16 years, and the following is a copy of the Certificate which they have given with regard to the Profits :—

70A, BASINGHALL STREET,
LONDON, E.C., *24th May,* 1911.

*To the Directors* SLAZENGERS, LIMITED.

GENTLEMEN,

We beg to report that we have regularly audited the Accounts of Messrs. Slazenger & Sons for the past sixteen years, and certify that the profits
1 for the ten years ending 31st December, 1910, after making sundry adjustments, providing for Depreciation on Plant and Machinery, and Management Salaries, but before charging Interest on Capital and Income Tax, have been as follows :—

| | | | | | |
|---|---|---|---|---|---|
| Year ending 31st December, | 1901 | .. .. | £26,787 : | 1 : | 1 |
| ,, ,, | 1902 | .. .. | 30,672 : | 8 : | 0 |
| ,, ,, | 1903 | .. .. | 25,907 : | 8 : | 11 |
| ,, ,, | 1004 | .. .. | 29,429 : | 10 : | 3 |
| ,, ,, | 1905 | .. .. | 31,685 : | 12 : | 2 |
| ,, ,, | 1006 | .. .. | 38,725 : | 19 : | 11 |
| ,, ,, | 1907 | .. .. | 39,900 : | 9 : | 0 |
| ,, ,, | 1008 | .. .. | 43,892 : | 9 : | 7 |
| ,, ,, | 1909 | .. .. | 38,016 : | 2 : | 10 |
| ,, ,, | 1910 | .... .. | 38,836 : | 8 : | 9 |

We are, Gentlemen, yours faithfully,

CREWDSON, YOUATT & HOWARD.

It will be observed that in 1909 and 1910 the Profits showed a falling off as compared with those of the previous two years—which diminution was primarily due to the increased cost of Gut, Rubber, and other raw materials. **In both years, however, the total Sales largely increased.**

With a view to building up a strong Reserve, it is provided by the Articles of Association that, after payment of the Cumulative Dividend of 6 per cent. on the Preference Shares 20 per cent. of the Profits of the Company in each year, calculated before providing for the dividend on the Preference Shares shall be carried to a Reserved Fund until £50,000 has been so set aside, and thereafter 10 per cent. of the Profits in each year is to be carried to the Reserve Fund.

Assuming the Profits in future to be not less than the average Profits of the last five years, they would permit of the following distribution :—

| | | |
|---|---|---|
| Average Profit for 5 years .. .. .. .. | | £39,874 |
| 6 per cent. on £100,000 Preference Shares | £6,000 | |
| 20 ,, of Profits to Reserve .. | £7,975 | |
| 10 ,, on 165,000 Ordinary Shares | £16,500 | |
| | | £30,475 |
| Leaving a balance of .. .. .. .. | | £9,399 |
| Of which the Directors will take one-half as Remuneration under the Articles of Association .. .. | | £4,699 |
| Leaving for further Dividend and further Reserve .. | | £4,700 |

**ASSETS.**—The Freehold and Leasehold properties have been valued by Messrs. Edwin Fox, Bousfield, Burnetts and Baddeley, whose report is as follows :—

90, Gresham Street,
London, E.C., *24th May*, 1911.

(2) *To* Messrs. SLAZENGERS, LIMITED,

Dear Sirs,

In accordance with your instructions we have surveyed the freehold property known as Nos. 140 to 144, Upper Thames Street, and 10, Ducksfoot

Lane, in the City of London, and the leasehold property, No. 139, Upper Thames Street, and 15, Laurence Pountney Lane, in the said City, and the Factory in Lower Wood Street, Woolwich, together with the Machinery, Fixtures and Trade Utensils, and we value same as a going concern at the sum of Twenty-six thousand seven hundred and eighty-eight pounds and fifteen shillings (£26,788 15s. 0d.).

EDWIN FOX, BOUSFIELD, BURNETTS & BADDELEY.

The Assets to be acquired are as follows :—

| | | | | | | |
|---|---|---|---|---|---|---|
| Freehold and Leasehold Property and Plant, as valued by Messrs. Edwin Fox, Bousfield, Burnetts & Baddeley .. .. .. | £26,788 | 15 | 0 | | | |
| Stock-in-Trade as valued for Stock-taking at or below cost .. .. | £41,254 | 12 | 6 | | | |
| Book Debts, guaranteed by the Vendor to produce .. .. | £30,072 | 15 | 7 | | | |
| Sundry Trade Investments including shares in Thos. J. Tate, Ld. | £2,425 | 0 | 0 | | | |
| Cash at Bank and in hand .. | £2,614 | 19 | 9 | | | |
| Goodwill, Trade Marks and Patents | £170,548 | 16 | 4 | | | |
| | | | | £273,704 | 19 | 2 |
| *Less* Liabilities (including accumulated Bonus Fund for workmen amounting to £5,405 3s. 3d.) .. .. .. | | | | £18,704 | 19 | 2 |
| | | | | £255,000 | 0 | 0 |
| Additional Working Capital to be provided by the Issue .. .. | £10,000 | 0 | 0 | | | |
| Accrued Profits up to Registration, estimated .. .. .. | £8,500 | 0 | 0 | | | |
| | | | | £18,500 | 0 | 0 |
| | | | | £273,500 | 0 | 0 |

The business will be taken over as from the 1st January, 1911, from which date the profits will accrue to the Company, the Vendor receiving 6 per cent. interest on his purchase money from that date up to the completion of the purchase, the balance up to the registration of the Company being carried to Reserve.

The Vendor estimates that the accrued Profits up to the date of registration, 23rd May, 1911, will, after deducting Interest on Purchase Money, amount approximately to the sum of £8,500 and will be available as additional Working Capital.

**CONTINUITY OF MANAGEMENT.**—Mr. Albert E. L. Slazenger, the Chairman, who is the Vendor, has been engaged in the conduct of the business for over twenty years, during the last ten years of which period he has had the sole control.

All the other Directors have been in the employ of the Firm in charge of various departments for many years and they have entered into Agreements to continue their services with the Company, thus ensuring a continuity of the successful management which has existed in the past.

Mr. Archdale Palmer, the Managing Director, has been associated with Mr. Albert E. L. Slazenger as Manager during the last six years.

Mr. Horatio Slazenger has been in charge of the Rubber Department for the last fifteen years.

Mr. Edward Clive has been the Manager of the Tournament Department and Foreign Traveller for the last nine years.

Mr. J. H. H. Acton has had control of the Manufacturing Department for twenty years, succeeding his father in that position.

Mr. N. G. Groves has for the last fifteen years been Manager of the Firm's works at Woolwich.

The purchase consideration has been fixed by the Vendor at £255,000, payable as to £33,334 in fully-paid Preference Shares, £55,000 in fully-paid Ordinary Shares and the balance in cash or Shares of either class at the option of the Company. No separate sum is allocated for goodwill.

**The Vendor will pay the preliminary expenses of and incident to the formation of the Company (estimated exclusive of brokerage, at £5,000), including the advertising**

**and circulation of this Prospectus, and all legal and other expenses up to allotment.**

The minimum subscription upon which the Directors may proceed to Allotment is fixed by the Articles of Association of the Company at Seven Shares, but the Company will not in fact go to allotment except on the whole of the Shares now offered, as the Vendor will take any Shares not applied for by the public.

The Articles of Association provide as follows :—

The qualification of a Director shall be the holding of shares of the Company of the nominal amount of £250. The Directors other than the Chairman are to enter into agreements with the Company fixing their remuneration and special duties. In addition thereto the Board shall be entitled to receive in each year 50 per cent. of the balance of the net profits of the Company remaining in that year after payment to the Ordinary Shareholders of a dividend of 10 per cent. on the amounts paid on their Shares. Such additional remuneration shall, subject to the aforesaid agreements, be divided in such proportion and manner as the Board may from time to time by resolution determine, or in default of such determination, equally; and any Director holding office for part of a year shall be entitled to a proportionate part of his remuneration. The Directors are also entitled to be repaid such reasonable travelling, hotel, and other expenses as they may incur in attending meetings of the Board or of Committees of the Board or General Meetings, or which they may otherwise incur in or about the business of the Company. The Directors have also power: (A) To establish local boards, local managing or consulting committees, or local agencies in the United Kingdom or abroad, and appoint any one or more of their number or any other person or persons to be members thereof, with such powers and authorities, under such regulations, for such period and at such remuneration as they may deem fit, and may from time to time revoke any such appointment. (B) To appoint from time to time any one or more of their number to be Managing Director or Managing Directors on such terms as to remuneration, and with such powers and authorities, and for such period as they may deem fit, and may revoke such appointment. (H) To grant to any Director required to go abroad or to render any other extraordinary service, such special remuneration for the services rendered as they may think proper. Questions arising at any Board Meeting shall be decided by a majority of votes, the first Chairman so long as he shall continue in office having five votes.

Each Share, whether Preference or Ordinary, confers one vote.

The following Contracts have been entered into :—

(1) Dated 24th May, 1911, between the said Albert Egerton Legh Slazenger and the Company, being the agreement for the sale of this business.

(2) The above-mentioned agreements with the other Directors all dated 24th May, 1911.

A Copy of the Memorandum of Association of the Company is printed in the fold of this Prospectus and forms part of it.

Copies of the Memorandum and Articles of Association of the Company and of the Certificate, Report and Contracts above-mentioned can be inspected at the Offices of the Solicitors of the Company at any time during business hours while the Subscription List is open.

A brokerage of 3d. per Share will be paid by the Company in respect of all allotments made upon applications bearing the stamps of Brokers, Bankers or other approved agents.

Application will be made to the Committee of the Stock Exchange, London, for a settlement in and quotation for the Shares of the Company.

Applications for Preference and Ordinary Shares should be made on the respective forms accompanying the Prospectus and forwarded with the amount payable on application to the Bankers of the Company.

If no allotment is made, the application money will be returned in full, and if the number of Shares allotted is less than that applied for, the surplus will be credited in reduction of the amount payable on allotment, and any balance will be returned. Failure to pay any instalment when due on the shares allotted will render the shares and previous payments liable to forfeiture.

Prospectuses and Forms of Application may be obtained from the Bankers, Brokers, and at the Offices of the Company.

LONDON, *24th May,* 1911.

## CHAPTER X

### Commercial and Industrial (*Contd.*)

FINANCIAL REFERENCES—PREMIUMS AND DIVIDENDS—UNDERWRITING—WHO PAYS PRELIMINARY EXPENSES ?

In the previous chapter the essential features of the bargain between the investors and the owners of a private business were considered. Issues of capital by established companies (*c*) (see p. 66), should be examined on lines similar to the foregoing, but there are also other criteria of judgment. A limited liability company is bound to supply the Registrar of Joint-Stock Companies with certain information about itself, and these particulars are carefully collected by the agents of financial publishers and issued in book form. Among many excellent publications, *The Stock Exchange Official Intelligence*, and *The Stock Exchange Year Book* are, perhaps, the best known. In these volumes, the investor may read a synopsis of the history of practically every important public company in the United Kingdom, including its past dividends, and the price of its securities at the time of going to press. If these books are not available, he has only to send an enquiry to any of the great financial daily papers, say *The Financial Times*, *Financial News*, or *Financier*, addressed " London, E.C.," when he will find the particulars he requires set out in their correspondence columns within twenty-four hours. In cases where the previous issues of the company are quoted on the Stock Exchange, the investor should compare their prices with that of the new issue, but as a rule care is taken that the latter is not dearer than the company's already issued securities of a similar class. For example, an issue of Bahia Blanca & North Western Railway Second Debenture Stock was made in January, 1912, at £98½ per cent. This stock ranks *pari passu* with the Second Debenture

Stock already issued, which is quoted at 100½, and on which the next half-year's interest is payable on 1st April. Included in this price of 100½, there is thus accrued interest of about £1¼. Deducting this from the quoted price, we have £99¼ as the present value of the old stock, compared with £98½ for the new.

Although shares may not be issued at a discount, *i.e.*, below their nominal value, they may be and are issued at a premium when the company's other quoted securities stand over par in the stock market. Obviously, it is excellent business for the company to obtain, say 30s. for a share of the nominal value of £1, but the investor must not overlook the fact, when considering the transaction from the point of view of income, that when a company declares a dividend, the percentage is on the nominal value of the share, and not on the price paid for it. Take the case of Harrod's Stores, already referred to. Here 140,000 Ordinary Shares of £1 each, were issued, in March, 1911, at the price of £4 10s. 0d. per share. The investor, turning to his book of reference, finds that the last dividend paid on the Ordinary Shares was 29 per cent. (including a bonus of 9 per cent.). He would probably assume that a similar dividend would be paid in the ensuing year, notwithstanding the enlarged capital, so that the rate of dividend he would expect to receive on his £4 10s. 0d. is £29 ÷ 4½, or just under 6½ per cent. The 29 per cent is on the £1 share, not on the £4 10s. 0d. which the purchaser paid. This is the *income yield* as distinguished from the *dividend*, and much disappointment sometimes arises owing to this difference not being borne in mind.

A word of warning is perhaps necessary, when comparing the price of a new issue with the older issues of the company, against relying implicitly on the more recent quotations. For competent observers have noted the tendency of these older issues to rise in price just before a new issue is made. This may, of course, be due to perfectly " natural " causes, and it may not. The investor should base his calculations on the trend of the price over as long a period as he is able to trace it.

The degree of confidence with which the promoters regard the issue may be gauged by the price they are willing to pay to have it insured against failure. Those responsible for raising the new capital frequently enter into agreements with wealthy persons, whereby the latter underwrite an agreed number of the new shares. In other words, they guarantee to the company, that if the public do not subscribe for the whole, or an agreed number of the shares offered, they will send in their applications for the balance not taken. Naturally, the greater the risk the higher will be the commission. Whenever a company feels itself strong enough to dispense with underwriting (or when it is not able to induce any person to underwrite), a statement to the effect that "No part of this issue has been or will be underwritten," will appear in a prominent position in the prospectus. The following, from the prospectus of Roneo Limited, is a not unusual form of the underwriting clause :—

> "By an agreement dated the 10th February, 1911, made between the Company and Messrs. Wheater, Cornwallis, West & Co., of Pinners Hall, London, E.C., the whole of this issue has been underwritten in consideration of a commission of 7 per cent. and the sum of £1,312 10s. 0d. payable in cash."

By way of simple illustration, let us assume that a company is about to issue 100,000 shares of £1 each. For various reasons the officials have cause to doubt that the shares will be largely subscribed for ; trade may, generally, be bad and investors shy ; money may be dear ; political difficulties may be rife, or the record of the company itself may not be particularly good. In these circumstances, the board obtain offers from substantial persons, Messrs. A, B, C, D, to underwrite 50,000 shares on certain conditions, viz., that the company shall, for this service, pay to the underwriters 5 per cent. in cash on the nominal value of the shares they respectively underwrite, and that whatever shares are taken up by the public shall be applied in relief of the underwriter's liability. Of the 50,000 shares :—

| | | | |
|---|---|---|---|
| A | underwrites | 20,000 | shares. |
| B | ,, | 15,000 | ,, |
| C | ,, | 10,000 | ,, |
| D | ,, | 5,000 | ,, |

The prospectus will then be issued, care being taken that it contains (in accordance with the Companies (Consolidation) Act, Sec. 81, subsec. 8) the rate of commission agreed to be paid. If the applications by the public amount to 50,000, then the underwriters are free from any obligation, and each receives a cheque for his agreed commission. Suppose, however, that the allotments made to the public total only 20,000 shares, or two-fifths of the number underwritten, the position of the underwriters is then as follows :—

| | Shares underwritten. | 2/5ths relief. | To take up. | 5% commission on shares underwritten. |
|---|---|---|---|---|
| A | 20,000 | 8,000 | 12,000 | £1,000 |
| B | 15,000 | 6,000 | 9,000 | 750 |
| C | 10,000 | 4,000 | 6,000 | 500 |
| D | 5,000 | 2,000 | 3,000 | 250 |
| | 50,000 | 20,000 | 30,000 | £2,500 |

The company thus insured itself for a minimum application of £50,000, the cost of which was £2,500 ; the underwriters, who receive this commission, are required to find £30,000. It does not follow that Messrs. A, B, C, D, will actually disburse the whole of this £30,000 to the company, for they will probably sell most of it before the calls become due. But they take that risk ; and in any case, assuming they are honourable people, the company gets the money.

*Worthless Indemnity.* There invariably appears in the prospectus of a new company, a clause referring to " preliminary expenses." (See Sec. 81, subsec. 1 (*i*), p. 62).

This will be found towards the end, among the particulars of contracts entered into by the Company which must by law be stated. The preliminary expenses consist of a number of items relative to the registration and floating of the company, such as the stamp duties on capital, legal expenses, cost of printing and advertising the prospectus; sometimes fees to brokers and others whose names are on the "front page" of the prospectus. In Example 9 (Slazenger's) the clause appears in the following form:—

> The Vendor will pay the premininary expenses of and incident to the formation of the Company (estimated exclusive of brokerage at £5,000) including the advertising and circulation of this prospectus, and all legal and other expenses up to allotment.

In this case the whole of these expenses are borne by the vendors out of their purchase price, although a business man will naturally conclude that these disbursements were taken into account by the sellers when fixing their price for the business. In many prospectuses, however, it is very clear that, actually, the new company pays these outgoings. Here, for instance, is the clause in the recent prospectus of a new company. First the scope of the term "preliminary expenses" is defined:—

> "The preliminary expenses of promotion, including registration fees, capital duty, printing, distributing and advertising this prospectus, and all other expenses other than legal charges and stamp duty on the purchase documents, stamps on allotment letters and brokerage, down to the date of the first general allotment of shares, are *estimated at* £3,750."

Then the reference to the contract whereby the company pays:—

> "The promoters of the company (The—Syndicate, Limited) have agreed in consideration of *the payment*

> *to them by the Company of £3,750*, to pay all such preliminary expenses (except as aforesaid) and if such preliminary expenses (except as aforesaid) exceed the estimate they are liable to pay the excess, and if such expenses do not amount to such estimate they are entitled to retain the balance for their own use and benefit.

A careful Board of Directors would, of course, investigate the schedule of expenses proposed to be incurred by the promoters, to see that the company were getting value for the money, and that the promoters do not make a profit on the transaction.

# CHAPTER XI

## Speculative Enterprises

THE "BOOM" OF 1910—AFTERMATH—WHO IS TO BLAME?—GAMBLING V. REASONED SELECTION—READ THE PROSPECTUS—IS THE BARGAIN FAIR?—COMMON SENSE

We are now reaping the aftermath of the extraordinary period of "boom," chiefly in rubber and oil ventures, which occupied the latter half of 1909 and the first half of 1910. A reference to the table of issues, facing p. 1, shows the astounding progress of the speculative fever from which the British public suffered:—

REGISTERED CAPITAL

| | Tea, Coffee and Rubber. | Oil. |
|---|---|---|
| | £ | £ |
| 1st half 1909 .. .. .. | 1,172,000 | nil. |
| 2nd half 1909 .. .. .. | 6,701,903 | nil. |
| 1st half 1910 .. .. .. | 18,723,250 | 10,986,700 |
| 2nd half 1910 .. .. .. | 3,883,441 | 1,670,625 |

In addition to the above, a large amount of money was placed in companies formed to provide public amusements—rinking, cinematographs, and the like. Failure has been the lot of the majority of these undertakings, and the process of liquidation is proceeding apace. Sorry tales of unscrupulous greed have been unfolded in the Law Courts and the victims number thousands upon thousands throughout the land. The result has been to create an intense feeling in the public mind against all forms of speculative investment, so that there is now threatened a similar lack of discrimination in attack, as formerly there was recklessness in subscription.

It is, of course, idle to attribute all the losses of the past twelve months to corrupt practices on the part of vendors, promoters and directors. It is equally futile to deny that, in many cases, those responsible for the formation and flotation of the companies have been actuated solely by selfish considerations, and that the prospectuses were merely instruments of plunder. Unfortunately, the carelessness and the ignorance of the public make them a ready prey to the promises of easily acquired wealth set out in the more dangerous class of prospectus. They confuse "estimates" with statements of fact, and mistake assumptions for certitudes. They measure the promises of the prospectus by the standard of their hopes, rather than of their judgment. It is useless to think that even the bitter experience which the collapse of the recent boom has brought to so many homes, will produce a lasting impression on the mind of the speculator; "it never can happen again" was not uttered of a "boom." He will probably suffer many losses before he learns how to invest. For speculation is an impulse, whereas investment is an act of reason. The only way to curb an impulse is by thought which is based on knowledge. If only the would-be investor were to pause—pause long enough to read quietly through the prospectus from beginning to end—there is hope that he would be guided by an enlightened self-interest rather than by a temperamental optimism.

But there is another class. Between that purblind impulse which is gambling and the reasoned selection which is investment, lies speculative investment. The characteristic of the speculative investor is that he decides to take risks. But he takes these risks with his eyes open, and with a more or less complete knowledge of the adverse as well as of the favourable factors in the situation. He does not merely obey a pressing desire to "risk something," nor is he seeking the highest rate of income consistent with capital safety, but he brings into play a rationalised sporting instinct. Here is your true rubber, oil and mining "investor"—the optimist who calculates chances. The members of this class are, as a rule, well able to look after themselves.

Speculative investment is, of course, a perfectly legitimate form of enterprise, but it carries with it a danger of capital loss equal to the magnitude of the prizes it offers. Its natural sphere of operation is in new industries which have not yet settled down into solid business undertakings, *e.g.*, the motor industry as it was a few years ago ; in all kinds of mining ventures ; in rubber and oil propositions, and, generally, in undertakings where a reasonable risk may be compensated for by a generous reward.

It is in the field of speculative investment that the small capitalist must walk the most warily. Nine out of every ten prospectuses he receives will probably be worse than valueless to him—mere money-traps ; the tenth may repay him richly. One thing he must learn to do is to reject every prospectus of which he entertains the smallest doubt. It is safer to condemn than to invest ; in this department he who hesitates is saved.

In the first place the prospectus should be read through from the first page to the last. There are some undertakings whose reputations are so sound that practically the only facts one need regard on any prospectus issued on their behalf, are the nature of the stock and its price. But the class with which we are now dealing needs a close and careful scrutiny. Consider, for instance, the Board of Directors. Who are these gentlemen, and what is their reputation ? Are they successful men of business, or unsuccessful ? A story is told of Prince Talleyrand, the famous Foreign Minister of Napoleon I. At the solicitation of a certain person, he appointed a young man to a vacant position. The young man called to thank him. " I am all the more grateful," said he, humbly, " because this is the first good fortune that has yet befallen me." " What ! " cried Talleyrand, " are you then so unlucky ? " " Alas ! yes, your Highness," he replied, " my life has hitherto been dogged by misfortune." " Then the appointment is cancelled," said the Prince ; " France has no use for unlucky men." And he dismissed the youth. It may haply be neither generous nor just to apply this rule without exception to company directors, but the cautious man will certainly read a prospectus the more carefully, if the names on the " front page " are those of men who have not in the past proved their capacity to direct enterprises successfully.

Much heartburning is caused among shareholders by the fact that the purchase consideration paid to the vendors is, in this class of promotion, frequently very large compared with the value of the property acquired by the company. Where actual gross misstatements of material facts have been made, the company has certain legal rights against the vendors, but if there has been no deception by the vendors, and they deliver what they sell, then the company has no redress. " You have got what you bought," the law in effect replies : " the price you paid was previously agreed between you, and it is not our concern. *Let the buyer beware !* "

The purchase consideration is, of course, fixed by the vendors with the directors who act on behalf of the company, and the price is stated in the prospectus for the information of the reader. It is the duty of the promoters to insert it, but it is the business of the would-be investor to find it. As a rule, it is not printed in large type, and unfortunately, numbers of those who apply for shares, read only the statements intended to catch the eye. This is, of course, a grave error from which nothing can save them, except the adoption of a certain critical deliberateness. Surely an hour's close study is not too long to spend over a prospectus before risking a year's savings.

When the purchase price has been found, let the investor consider it in connection with the property to be acquired. Does the bargain seem fair ? Remember that the seller's maxim is that a thing is worth what it can be sold for. Let the would-be investor ask himself what his reasons are for thinking the property worth the price demanded. If his answer is : " Other companies of this class have made remarkable profits, why should not this ?" the only advice applicable to him is to tear the prospectus into small pieces and to go for a walk. For the bacillus of the "boom fever" is in his blood, and the only antidote is that clarity of mental outlook which healthy exercise alone can bestow.

In the Great South Sea Bubble, which culminated about 1720, certain promoters offered to allow the public to subscribe capital in a venture of which no particulars of any kind would be given to them. The money was forthcoming. In these days, two centuries later, a paternal Government insists that full details shall be supplied whenever a property is offered for public subscription, but a similar buoyant expectation (or is it pathetic trust, invincible cupidity or unfortunate ignorance ?) overleaps the bounds of prudence and, scorning such obstacles as facts and reason, races on to inevitable loss.

The infallible test of all speculative investments is to bring them to the touchstone of common sense. Strip the prospectus of its garment of promises and estimates and resist the glamour it derives from the fact of belonging to a class of undertakings in which some striking successes have been scored. Isolate it and deal with it on the basis of its own unchallengeable facts. If it does not supply any, reject it. The cautious man will not thereby lose the opportunity of a lifetime ; he will but retain the power to take advantage of such opportunity when it comes.

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THE END

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