Candor

Case Study 2: Diageo PLC

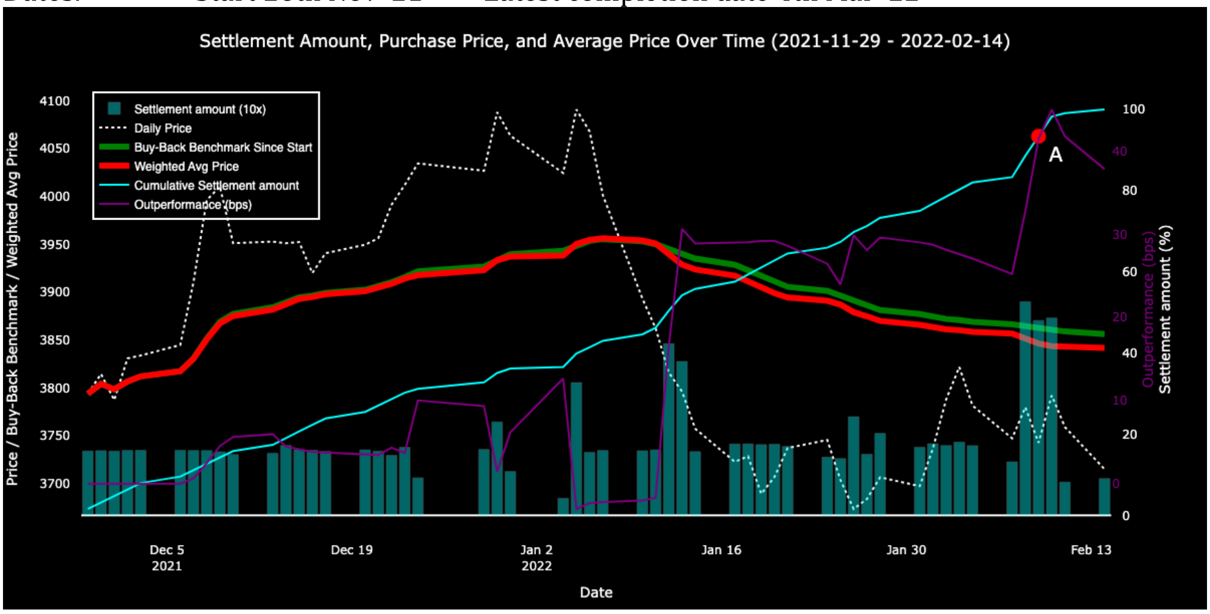
Prof Osterrieder and Michael Seigne co-authored a white paper, which can be found on [Candor's website](), along with a "[one pager]()" summary. We think you might find it helpful to familiarise yourself with the arguments in that paper before diving into the case studies. The paper is a bit technical/boring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

Diageo PLC- Fiscal Year is to 30th June. They also give a lot of transparency on their transaction's costs for implementation of these buy-backs, which we commend.
We picked Diageo PLC as our second case study for similar reasons as Burberry, so we emphaise that we are not picking fault with Diageo PLC, rather the products that we believe they have been used to implement these buy-backs. We should also add that Diageo have not confirmed to us that they use these "VWAP" based products that we are taking issue with. Nor have we requested Diageo's permission to use them in our case studies, all information is sourced from publicly disclosed documents.

4 Examples: In each press release they state that "The purpose of the repurchases is to reduce the share capital of Diageo and all shares repurchased under this agreement will be cancelled". Given this objective, the execution strategy of the buy-backs should be to try to buy as many shares as possible.
Diageo give transparency on buy-back implementation fee on a FY year basis. We will summarise the total costs as best as we can at the end of these 4 programs.

Program 0

Size:£550m Broker: GS
Dates: Start 26th Nov '21 Latest completion date 4th Mar '22

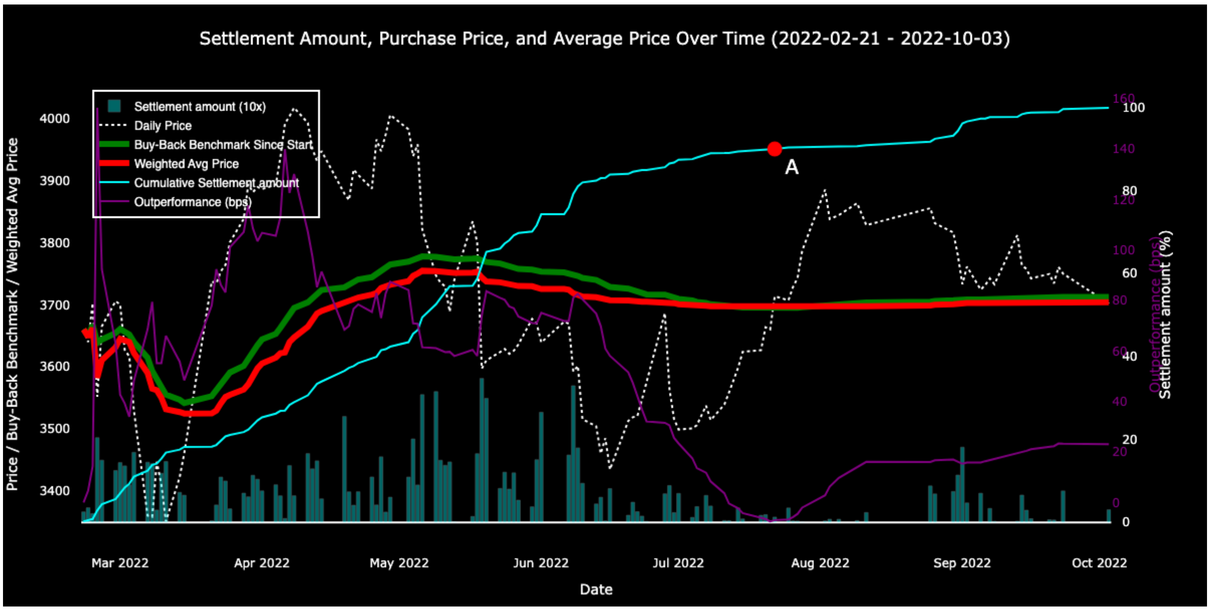


Risk- In the first week of the program the broker spent approx. £9m every day, totalling £44mi to buy 1.15million shares in the week. They then spent a similar value, in the following 3 weeks, buying less and less shares each week as the stock rallied. In the 5 trading days from Dec 22nd to Dec 30th, they spent a £44m and only bought 1.09mil shares, ~5% less shares.
Then at the start of Jan the share price fell, and they increase their rate of spend per week.
The 7th of Feb was the single highest value day of trading, they spent £28mil at a share price of approx. £37.80. This is important as it tells us that there is no regulatory related reason that limited spending on any other day.
The critical question to us is that of the share price risk management. How can you justify spending more than three times as much money on Feb 7th that on Nov the 26th (first day), at pretty much the same share price? By doing so it has exposed shareholders to 3 months of risk for absolutely no benefit.
It is not sensible to try to “reconstruct” a different execution profile for the purpose of estimating the actual cost of this strategy to shareholders. However, it is very easy to understand that at the start of the execution period it is highly unlikely that the broker predicted that the share price would fall from early Jan down to the execution period lows in early Feb. If they did predict this share price path, then why did they buy any shares above this price? If, as is more likely, the broker had no share price path predictive power, then why did they expose the shareholders to 3 months of price risk for no gain?
The answer to these questions we believe are explained by the execution strategy which is designed to beat the “bogus benchmark”. The execution product is not aligned with shareholder interests.

Fee: the fee is paid out of the out-performance bucket. The out-performance at the end of the program was approximately 40bps. You can see the two big jumps (Jan 12th and Feb 8th) in the purple line are caused by high value buying days at share prices that were equal to or higher than at the start of the program.

The program finished early as the share price was well below the benchmark.

Program 1
Size:£1.7bn   Broker: UBS
Dates: Start   21st Feb ‘22   Latest completion date 5th Oct ‘22



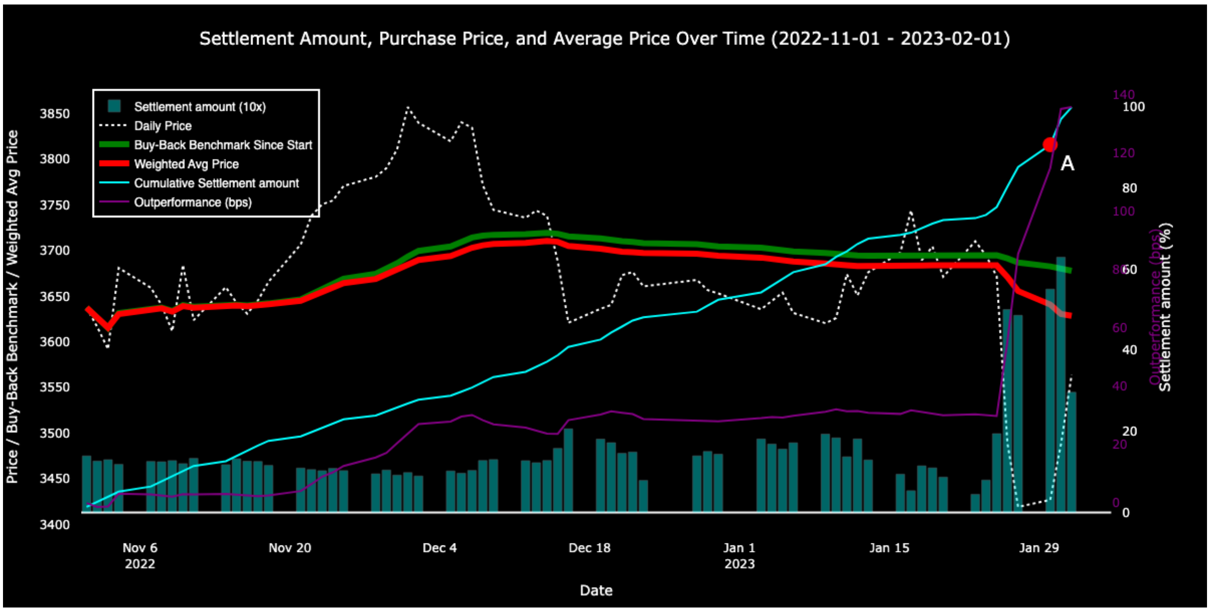
Risk: This is the largest program by value, and in our opinion is horribly executed, the broker was lucky to walk away with an outperformance of just over 20bps.
What went wrong? The share price had two dips, one at the start of the program and one in the middle of Jun. Look at the values traded at these two low points relative to the values traded in late April/early Jun. Let's not speculate on how many shares this program should have bought, but all the high value trading days occur on days that the share price is not close to the low-price days of the 8 and 11th of May or the ones in mid Jun to late Jun. You can see this from the height of the turquoise bars.

For context the highest value of £58mil was spend on the 19th of May when the share price was £35.97. On the low share price days in May they spend less than half of that value each day, and the ones in Jun/July even worse, some days as low at £2mil at these lower prices.
We make the same argument as we made in Program 0 above. Why is the broker waiting until May and June to spend the most amount of money on any given day, when the share price was lower in March? This program should have bought, and therefore cancelled a lot more shares that it did. How much shareholder value has been lost already, and much will this compound into the future?

Fee: Why do we say the broker is lucky, even though they probably lost money on this trade? Well, if the share price had not rallied above the benchmark in Aug, towards the end of the allowable trading window, it would have probably been a lot worse. You might not be able to see this on the chart, but over the last 3 trading days of Jul and the first 4 of Aug the broker only spent a total of £4.8mil, trading a tiny amount on each day. This is a similar pattern to program two in our first case study. The effect of including these higher prices in the benchmark helped the out-performance of the whole program to recover about 16bps.

The program finished two days from the latest completion date as the price was above the benchmark for the last 2 and a half months.

[Program 2]
Size:£640m Broker: ML
Dates: Start 1st Nov '22 Latest completion date 24th Feb '23

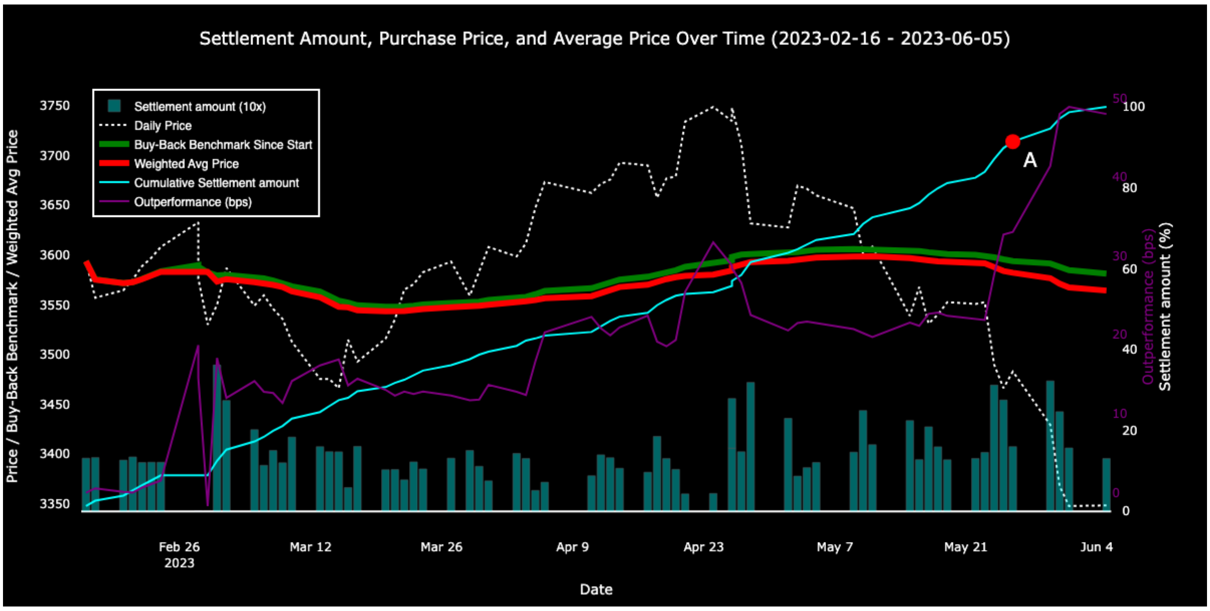


Risk: Note the share price and values traded in the first week. Note the values traded from the 15th to 20th Dec, and again in the first two weeks of Jan. There was more value spent at higher

share prices in mid Dec than at the at start of the program. Why? Another example of mis-managed risk.
Fee: Out-performance finished at about 135bps, most of this being generate from the activity in the last 5 trading days, when 25% of the programs total value was spent at low prices.

Program finished early when prices fell sharply below the benchmark. Note these sharp share price drops (high volatility) are typically how very large fees get generated.

Program 3
Size:£ £500m Broker: Citi
Dates: Start 16th Feb '23 Latest completion date 28th Jun '23



Risk: Another example of risk mis-management. Look at the values spent in week 1 and again at the low share prices in the week of Mar 13th. Now look at the daily values spent on Apr 26th and 28th at much higher share prices, much later in the program. Poor risk management.
Fee: The program finished with an out-performance of just under 50bps, with half of that coming in from the last 7 trading days.
The program finished early as the share price fell below the benchmark.

Total Fees for programs above
In the company's financial reports, they state the transactions costs (inc. UK stamp tax of 50bps)

FY to Jun 21	Fee	£1mil	Value purchased	£109m
FY to Jun 22		£16m		£2,284mil
FY to Dec 22		£7mil		£554mil
Total		£24mil		£2,947 mil

Of this total cost £14.7mil is stamp tax. Meaning £9.3 is fee, or 32bps.

We hope these case studies help. We have not cherry picked either company, or specific programs. Rather we have gone back as far as the LSE Regulatory News Services feed allows us (a rolling 3-year history of data). We believe that the companies we have chosen give enough transparency in their quarterly/annual reports for us to give a fair estimate of costs/fees.