Bloomberg
March 23, 2017 | bloomberg.com

News

Hedge Fund Dalton Calls for $1.8 Billion Buyback at Shinsei Bank

by **Tom Redmond and Nao Sano**
March 23, 2017

- Japanese lender is 'massively overcapitalized,' Dalton says
- Government as major shareholder may complicate the situation

Dalton Investments urged Shinsei Bank Ltd. to buy back 200 billion yen ($1.8 billion) of shares, a move that could put the hedge fund run by Jamie Rosenwald on a collision course with Japan's government.

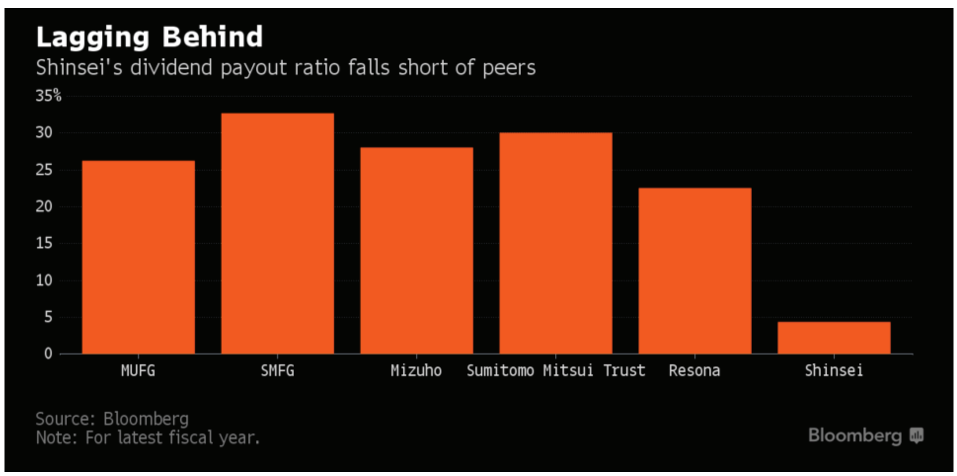
Dalton made the proposal in a letter to Shinsei's board last week, which Rosenwald provided to Bloomberg. The $3.1 billion money manager says the lender is "massively overcapitalized" and undervalued by the equity market. Dalton, which bought Shinsei shares last year and says it owns a 2.3 percent stake, suggests the stock has room to double.

Rosenwald, who's owned Japanese equities since 1972, is a value investor and strong proponent of Prime Minister Shinzo Abe's overhaul of corporate governance. But his latest proposal may put him directly at odds with a powerful Shinsei shareholder: the Japanese government.

The state had a 17 percent stake in the company at the end of March 2016, some of which dates back to when Shinsei's predecessor, Long-Term Credit Bank of Japan Ltd., was rescued in the late 1990s. In fact, Shinsei is the only major Japanese bank that hasn't repaid its banking-crisis bailout.

The Financial Services Agency wants to receive 350 billion yen when the state sells its Shinsei holdings, according to the bank. That implies it would need to receive 745 yen a share, more than triple Wednesday's close of 197 yen. Shinsei's shares rose 2.5 percent in morning trading in Tokyo on Thursday, heading for the biggest gain in more than a month, while the benchmark Topix index was little changed.

In a sense, it's a chicken and egg situation. If Shinsei wants the share price to approach that level any time soon, doing a big buyback would typically help. Low shareholder returns have encouraged investors to overlook Shinsei's capital position, according to Dalton, which in turn depresses the stock price and keeps the state from reaching its goal.



wrote of his buyback proposal. It "would lead to a higher share price over time."

Shinsei has said it needs to accumulate retained earnings because of the public funds. As a result:

- The bank has one of the lowest dividend payout ratios among 86 Japanese lenders tracked by Bloomberg, at just 4.4 percent versus an average of 20 percent last fiscal year.
- While it does have an existing buyback program, the round last year was for 10 billion yen, a twentieth of what Dalton is proposing.
- And its consolidated core capital adequacy ratio stood at 14.1 percent at the end of last year. That's "one of the highest in the world among international banks," Dalton wrote in the letter.

Dalton says that although it has no direct evidence, it's concerned that politics may be preventing Shinsei from stepping up repurchases.

"We would like to ask the board of bright directors not to yield to such government pressure (if it exists)," Rosenwald wrote.

Shinsei received the Dalton letter and will

any shareholder, according to a spokeswoman who asked not to be identified, citing company policy. The bank declined to comment on its discussions with the FSA.

The government probably wants Shinsei to repurchase the state-owned shares when the price increases, according to Shiro Hayashi, who heads Dalton's advisory arm in Tokyo. That would help avoid undue impact on the share price, and it looks better if Shinsei repays the funds itself. But Hayashi says Shinsei should explore a large buyback in the market, especially since the stock trades below book value.

Rosenwald points to American International Group Inc., which carried out big repurchases in the years after being rescued by the U.S. government in 2008. That helped boost the company's undervalued shares, Rosenwald wrote in the letter. AIG finished repaying public funds in 2012.

Managing the expectations of the Japanese government and vocal minority shareholders is

a challenge for Shinsei's management -- and a legacy of the bank's troubled past.

The Long-Term Credit Bank of Japan was nationalized in 1998 at the peak of Japan's banking crisis and then sold in 2000 to foreign investors including Ripplewood Holdings and financier J. Christopher Flowers, who still owns 2.8 percent of Shinsei.

The government took on many of the bank's worst debts. That, and the huge profits the investors made when Shinsei went public in 2004, led to strong public criticism of the state for losing money on the turnaround.

Still, for Dalton, differing objectives shouldn't prevent all stock owners from agreeing with its proposal. Rosenwald says his next step will be to check if the FSA supports it.

The logic of a big buyback "holds regardless of the government as a large shareholder," Rosenwald wrote. The interests of all stakeholders "are, or should be, aligned."

Dalton Investments