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Markets

Hedge Fund Dalton Moves to Proxy Fight With Japan's Shinsei Bank

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- Fund led by Jamie Rosenwald has been seeking a big buyback
- But this time, Dalton proposal is on management incentives

A year after Dalton Investments urged Shinsei Bank Ltd. to buy back shares and link management's pay more to the stock price, the U.S. hedge fund is taking its pressure on the Japanese lender to the next level: a proxy fight.

Dalton, run by Jamie Rosenwald, is proposing that Shinsei pays executive directors in restricted stock, so that they have more incentive to improve performance and deliver returns to shareholders, according to a copy of a shareholder proposal provided by Dalton to Bloomberg. Shinsei shareholders will vote on this recommendation at the annual general meeting scheduled for June 20.

The $3.8 billion hedge fund has been pushing Shinsei for more than a year to implement changes that would align management and shareholders' interests while boosting share prices. Rosenwald, a value investor who has owned Japanese equities since 1972, has invested more than half of his firm's assets in Japan.

In March 2017, Dalton sent a letter to Shinsei calling on the bank to buy back 200 billion yen ($1.8 billion) of shares. This time around, Dalton had originally planned to urge the Japanese lender to change its articles of incorporation so that shareholders, not the board, could decide on share buybacks. That would be a first step toward Dalton's goal: getting Shinsei to pay 90 percent of profit to shareholders every year until its shares trade above book value.

Withdrawn Proposal

But the hedge fund decided not to go through with that this year after some steps from Shinsei that it viewed as positive, Dalton said, pointing to the lender's revitalization plan published this March. In that document, Shinsei said it aimed to improve and maintain total shareholder returns at the general level of other Japanese banks.

"Management had felt it would be unproductive this year," Rosenwald said of the withdrawn proposal to change the by-laws. "We agreed to give them a year to see if they will walk the walk after talking the talk."

In a sense, Shinsei has already responded to Dalton's demands on management compensation. On Monday, the Tokyo-based lender announced its own suggestion -- also to be voted on at the AGM -- to introduce restricted stock for full-time directors excluding outside board members. But while Dalton called for a total payment of as much 200 million yen per year, Shinsei suggests an annual maximum of 20 million yen.

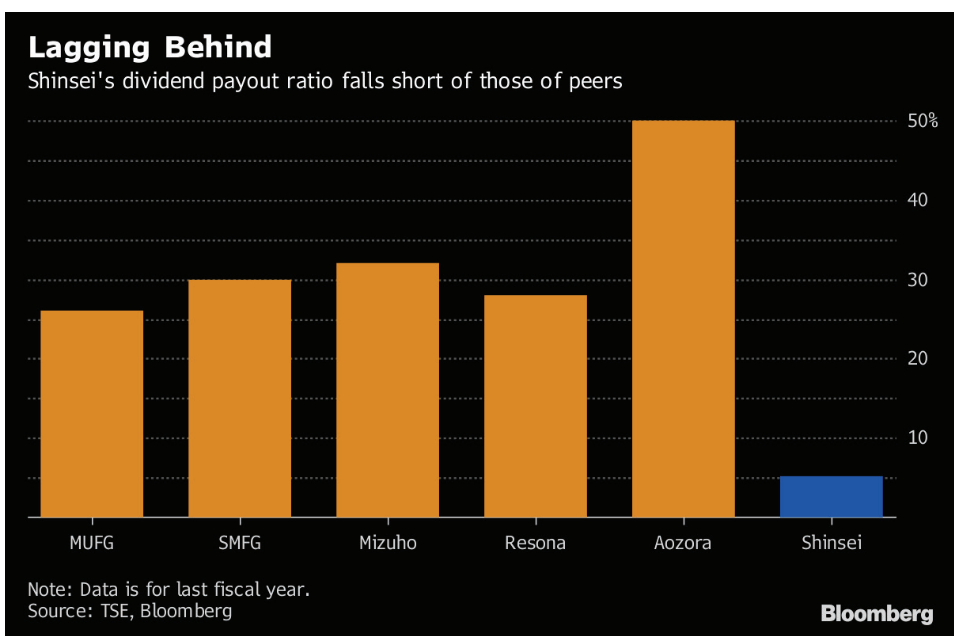
No Coincidence

Rosenwald says it's "no coincidence" that Shinsei took that step after his firm made its proposal, and that the payment suggested by the bank isn't enough. Dalton has no plan to withdraw its own item from the AGM agenda, he said.

Shinsei has received the shareholder proposal from Dalton, said Shizuyo Eguchi, a spokeswoman for the lender.

"The board had already been discussing this," Eguchi said of Shinsei's decision to submit its own proposal on issuing restricted stock to directors, denying that it was a response to Dalton's move. "We decided to add this to the agenda for the AGM because we had completed the preparations to do so."

Shinsei has one of the lowest dividend payout ratios of 81 Japanese lenders tracked by Bloomberg, at 5.1 percent versus an average of 23 percent last fiscal year. The stock has



Note: Data is for last fiscal year.
Source: TSE, Bloomberg

fallen 17 percent in the past 12 months, while the benchmark Topix index gained 16 percent. Shinsei trades at about half its book value.

While Dalton is focusing on management incentives at this year's AGM, the main prize is still to boost shareholder returns. Rosenwald says Dalton usually holds investments for five to seven years, and that will be no different for Shinsei.

"The stock price of the bank is significantly undervalued despite the excellent business portfolio and abundant capital base," Dalton wrote in its original proposal on shareholder returns. "We have been suggesting a policy of allocating 90 percent of net income to share buyback as long as the stock price remains below the net asset value."

Government Stake

Efforts to encourage better returns at Shinsei may put Dalton directly at odds with a powerful Shinsei shareholder: the Japanese government. The state had a 17 percent stake in the company according to filings last year, some of which dates back to when Shinsei's predecessor, Long-Term Credit Bank of Japan Ltd., was rescued in the late 1990s.

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. In Dalton's view, that will require a higher share price, and that needs better management incentives and shareholder returns.

"I want to be viewed like Santa Claus in Japan," Rosenwald said on why he's going through with his proposal for restricted stock for directors. "More compensation for senior management will increase the alignment of interest sooner. We can discuss the anomaly in the Japanese equity market between those managements which are aligned and those which remain salary man enterprises."

Dalton Investments