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Sadakazu Osaki

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Sadakazu Osaki
Head of Research
Center for Strategic Management and Innovation

Toyota Motor Corporation, one of Japan's flagship companies, plans to issue class shares in a novel form after amending its Articles of Incorporation at its general shareholder meeting in June. Its new "Model AA" shares will be preferred stock with the same voting rights as its common stock. However, they will be generally non-transferable for five years after issuance. Toyota plans to issue the Model AA shares serially over the five years from July 2015.

Stocks listed on exchanges are typically common stocks. Common stocks confer voting rights in proportion to the number of shares owned. They also entitle their owners to a pro rata share of any dividend distributions and distribution of residual assets upon liquidation of the company. Class shares differ from common stock in terms of the rights they confer to their owners. In Japan, issuance of class shares was formerly severely restricted from the standpoint of strict equality among shareholders. Publicly traded Japanese companies hardly ever issued class shares other than nonvoting preferred stock with priority over common stock in terms of dividend and residual-asset distributions.

Since the 2000s, however, Japanese companies have started to issue a broader range of class shares as the Companies Act and stock exchange regulations were amended to afford greater management flexibility. Specific examples include a tracking stock issued by Sony in June 2001, "golden shares" (stock with veto rights) issued by INPEX Corporation in November 2004, nonvoting shares issued by Itoen in October 2007, and class shares with ten times the voting rights of common shares issued by Cyberdyne through its March 2014 dual-class IPO. Additionally, in management buyouts of listed companies, the bought-out companies commonly reacquire all remaining outstanding shares by converting holdout shareholders' common shares to callable shares.

Toyota's Model AA shares will have the same voting rights as its common stock, unlike typical preferred stocks. The trade-off is that they will be subject to a transferability restriction. Specifically, they cannot be sold within five years of issuance without the approval of Toyota's Board of Directors. Once five years has passed, the Model AA shares will become convertible to common shares or putable back to Toyota at their original issuance price on a predetermined once-yearly date.

From a purchasers' standpoint, the Model AA shares' redeemability at their issuance price means that the invested principal is effectively guaranteed by the issuer, Toyota. Model AA shares' issuance price will therefore be set at a 20% premium to Toyota's common stock's contemporaneous share price. In exchange for this 20% premium and the five-year lockup, Toyota will guarantee that the Model AA shares' can be resold at their issuance price. The Model AA shares will also pay predetermined dividends. Their initial dividend yield, however, is only 0.5%, well below Toyota's common stock's current dividend yield.

Toyota's prime objective in issuing such class shares is to induce more individual investors to invest in its shares on a long-term basis. Needless to mention, Toyota is the world's top automaker. Whether used for personal or business purposes, automobiles are driven by people. In this sense, users of Toyota's products are all individuals. Despite such close ties with individuals, the percentage of Toyota's equity owned by retail investors at March 31, 2014, is only about 12.5%, considerably lower than the overall market's retail ownership percentage of around 20%.

Japanese retail investors include not only short-term traders but also many long-term shareholders who look forward to capital gains accruing from investee companies' growth, annual dividends and/or shareholder perks. Toyota's main objective in issuing the Model AA shares is to gain new retail shareholders who are both long-term investors and fans of its vehicles, management approach or corporate philosophy.

The funds to be raised from the Model AA shares' issuance are earmarked largely for infrastructure investment and R&D of next-generation technologies. Such investments will take a while to pay off in the form of earnings growth. Long-term investors willing to patiently wait for Toyota's investments to bear fruit would most likely be Toyota fans not merely seeking monetary returns. Toyota's intention of converting fans into shareholders is evident in the fact that the forthcoming class shares are named after the Model AA, the first car model mass-produced by its predecessor, Toyoda Automatic Loom Works' Automobile Department, from 1936.

It is a bit disappointing that the Model AA shares will not be listed on any exchanges and are therefore not eligible to be held in NISAs (Nippon Individual Savings Accounts), tax-advantaged accounts aimed at promoting medium/long-term equity ownership by individual investors.

Model AA shares will not be publicly tradable because the Tokyo Stock Exchange's rules currently prohibit listing of stocks subject to transferability restrictions. If exchanges' sole role was to serve as securities trading venues, prohibiting the listing of stocks with substantial liquidity constraints in the form of transferability restrictions might be perfectly warranted. In actuality, however, some securities are illiquid despite being legally freely tradable and listed on an exchange. Meanwhile, overseas exchanges sometimes list certain securities (e.g., investment funds) in form only so that the securities will benefit from various institutional arrangements associated with listed status. Moreover, stocks subject to transferability restrictions reportedly are (or previously were) traded on Swiss exchanges.

While many concerned parties may be resistant to the idea of expediently permitting Toyota's Model AA shares to be listed just so they would be eligible to be held in NISAs, the Model AA shares are eminently suitable for NISAs from the standpoint of NISAs' original policy objective of promoting medium/long-term investment in risk-bearing financial products, given the shares' minimum holding period of five years and the Toyota bankruptcy risk that their owners must assume. If NISA rules are amended in the future, I hope that unlisted securities issued by listed companies will be made eligible for inclusion in NISAs.

Unlike in the Japanese market, where class shares have not been actively utilized to date, listed companies in Europe and the US have issued a diverse assortment of class shares. Issuance of class shares by Toyota, one of Japan's top companies, may spur similar class-share diversification in the Japanese market. The Model AA shares' structure is by no means the only way to pursue the capital policy objective of gaining more retail shareholders. As more listed companies deeply rethink their capital policies in light of their own operational and financial conditions and operating environment, the Japanese equity market as a whole should qualitatively improve.

about NRI

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Inquiries to : Financial IT Marketing Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

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