HOW ENGAGEMENT CAN AFFECT EXECUTIVE COMPENSATION

January 2020

Ian Burger
Head of governance
and stewardship

Responsible investment has been core to Newton's investment approach since our inception in 1978, when we began actively voting on our clients' shares. Since then, our responsible investment approach has grown to include environmental, social and governance (ESG) integration and active engagement across all our strategies. This is done to identify risks and opportunities that have the potential to affect companies' performance over the long term. While we first invested in the Macquarie Korea Infrastructure Fund (MKIF) in May 2007, an opportunity for meaningful engagement arose eleven years later, and our investment team was able to play its part in improving the situation for both MKIF and its shareholders.

MKIF is the leading infrastructure fund in South Korea. It was established in December 2002 with a mandate to invest in companies that construct, operate and manage infrastructure projects across the country, including toll roads, bridges, tunnels and ports. MKIF intends to generate profit from its investments and distribute these profits to shareholders.

What was the issue?

We consider ourselves not only shareholders, but stakeholders. After a decade of being invested in MKIF, a situation arose in April 2018 where an activist investor bought a large stake in the company (35% of which was held via swaps – a type of derivative contract) and launched a campaign aiming to oust the current management by way of an extraordinary general meeting (EGM). The activist investor argued that MKIF's business model had been simplified but that the fees charged by the management company did not reflect this development. With MKIF's business having changed such that the fund was no longer actively seeking new infrastructure assets and would only be maintaining existing investments, the activist investor believed that this was akin to the fund changing from an active to a passive management approach but still charging active management fees, when it was no longer clear exactly what work those fees were funding.

How did we engage?

After the activist investor announced its intention to take over the fund by appointing its own director and manager, the MKIF management approached Newton as we were the biggest shareholder. We then entered into multiple engagements with both parties to review existing policies and hear the thoughts, concerns and plans for the fund from both sides. As we had had positive interactions with MKIF (and seen strong returns) over the eleven years we had held the fund, and because in situations like this we aim to engage with a firm if possible rather than 'cut and run', we made clear we would consider supporting the current management against the activist investor provided meaningful governance changes were enacted.

> "After the activist investor announced its intention to take over the fund by appointing its own director and manager, the MKIF management approached Newton as we were the biggest shareholder."

What was the outcome?

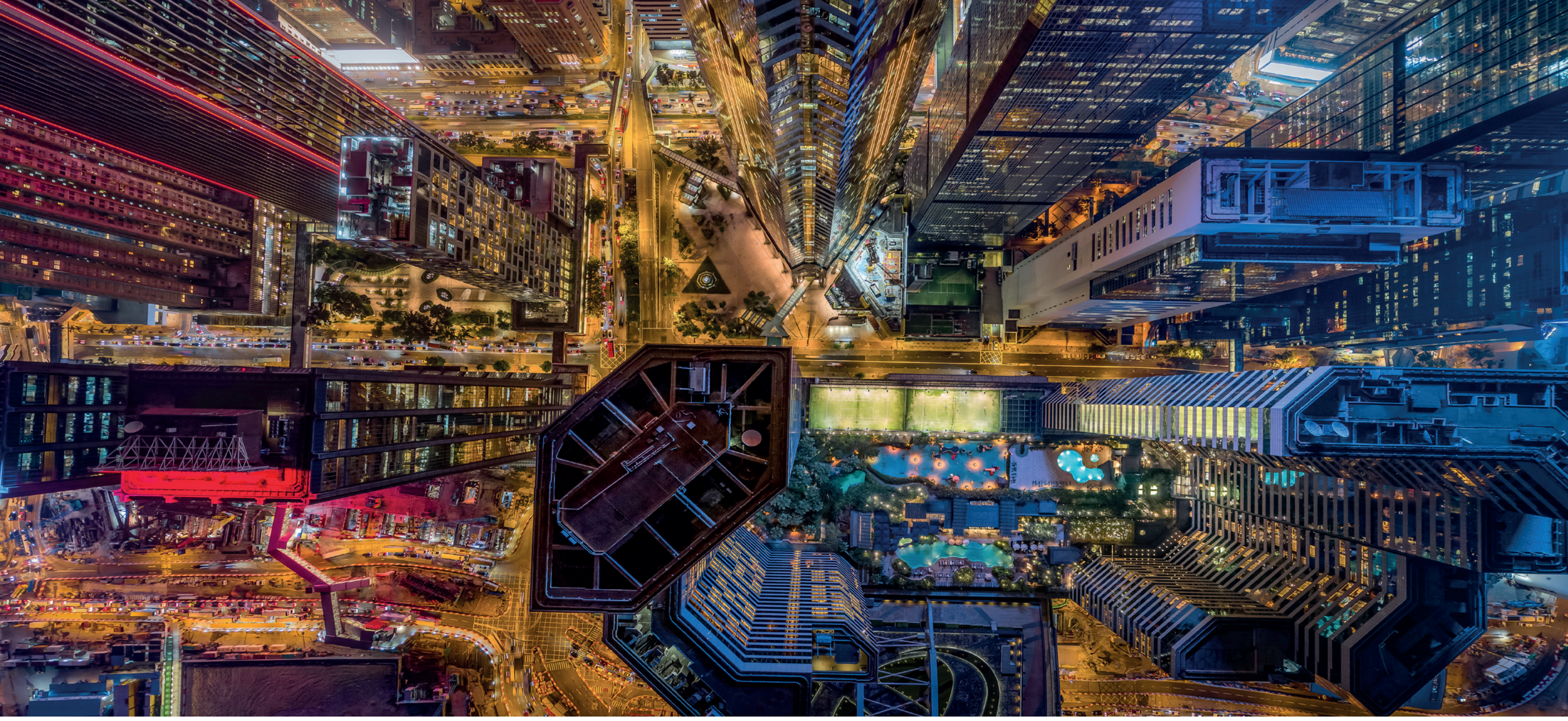
After multiple conversations back and forth, Newton voted against the hostile shareholder at the EGM and sided with the current management. We voted against the takeover motion because:

- the current manager had consistently supported and respected minority shareholders over the course of our investment with MKIF
- improvements were expected to the company's fee structure and the strength of its board
- the company had significantly outperformed peers and the market

Ultimately, the activist investor was defeated; 69% voted against the hostile shareholder at the EGM in September 2018, and the activist investor sold its position.

In January 2019, because of our engagements, MKIF announced its revised compensation structure. The original compensation structure included a management fee of approximately 1.2% per annum of assets under management (AUM) plus a 20% performance fee above a threshold return of 8%, while the revised structure is an annual management fee of 0.85% of AUM and no performance fee. This was passed at the AGM in March 2019 with average shareholder support of 97%.

This case study shows the value of actively engaging with companies in which we are stakeholders. While we recognised that legitimate concerns had been raised about MKIF's new business plan and the fees shareholders paid to the management company, we also knew that the current management had been incredibly effective in their roles, producing returns that exceeded those of both peers and the market across the decade we had been an investor.



By leveraging our position as a major shareholder and engaging actively, we were able to address these concerns head-on while also showing our support for other aspects of the business. This resulted in a fairer compensation structure being agreed, an outcome that was received well by shareholders, as shown by the average shareholder support of 97%. It also strengthened the board by way of the appointment of a high-quality, independent non-executive director with relevant skills and experience.

We believe the company is now better poised to develop with its new, more transparent governance practices – practices that may have never come into being without our active engagement work.

> “By leveraging our position as a major shareholder and engaging actively, we were able to address these concerns head-on while also showing our support for other aspects of the business.”

Want to find out more?

Institutional investors
Tel: 020 7163 3984
Email: newton.institutional@newtonim.com

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

Important information