Strategic Capital

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Time for Wakita & Co., Ltd (8125) to make a decision to help build shareholder value

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Last updated Feb 17 2025

Executive Summary

Strategic Capital, Inc.'s (SC) goal is to unlock enterprise and shareholder value through dialogue with the company management team and the exercise of shareholder rights.

SC and the funds managed by our company are shareholders of Wakita Corporation ("Wakita" or the "Company") and for around five-years we have made various proposals in order to increase shareholder value. Unfortunately, the Company has yet to adopt most of those proposals and in turn valuations remain sluggish.

SC intends to make a formal shareholder proposal for the fifth straight year for the upcoming AGM. We have established this website because we believe that it will be beneficial for minority shareholders to get an understanding of the many issues facing Wakita before they exercise their voting rights and in advance of the proposals we may make, including appropriation of surplus and election of directors.

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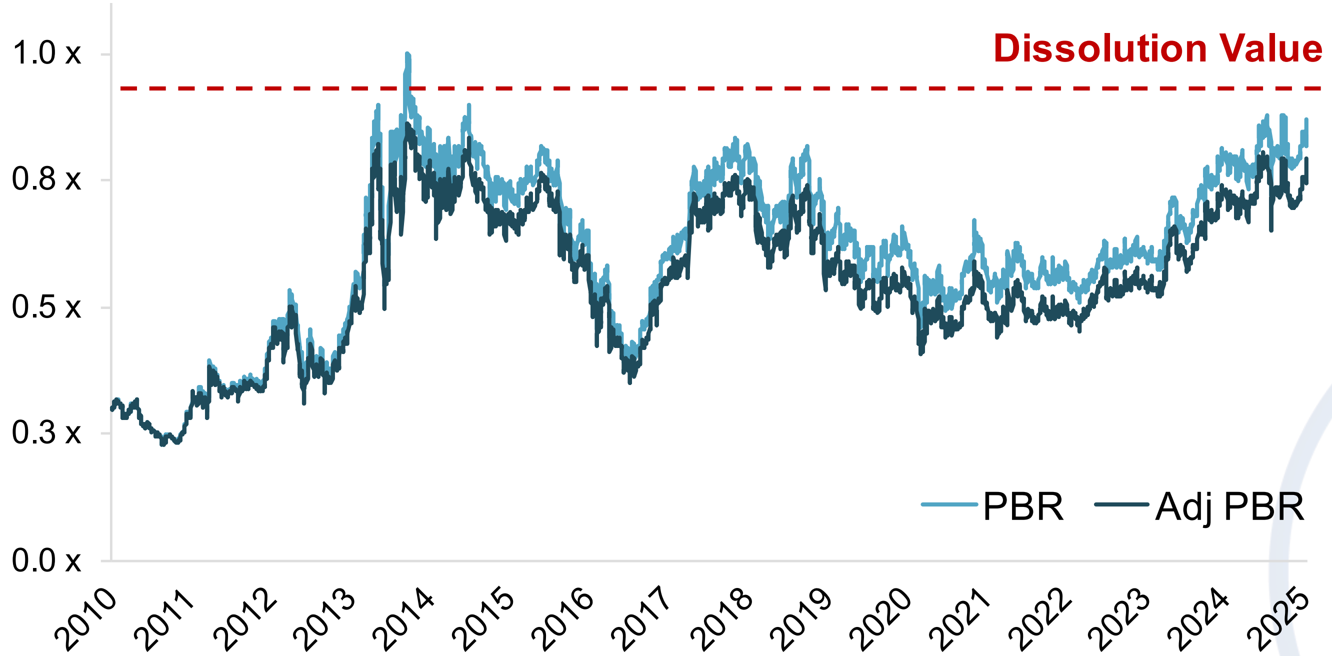
PBR languishing below 1x

Since 2010, Wakita's stock valuation has **stagnated below 1x PBR**. Even now, the **PBR is 0.87x** but when factoring in unrealized gains on rental real estate, the **adjusted PBR is only 0.79x**. It is clear that Wakita's management policy has been damaging the interests of its shareholders and a fundamental change in management policy is necessary to increase shareholder value.



(Source : QUICK ASTRA MANAGER)

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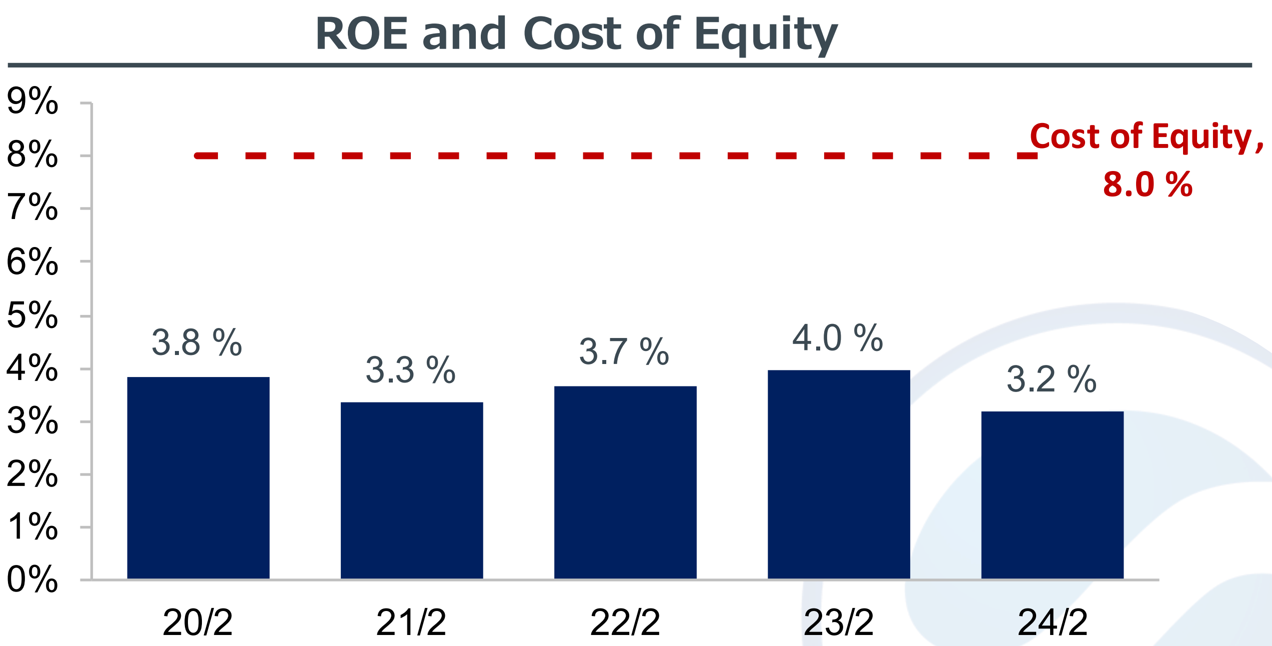
ROE that should disqualify it as a listed company

A major reason for the weak valuation is that ROE is less than the cost-of-equity. **For the past five years ROE has been abysmally low, averaging only 3.6% and a maximum of 4%.** This is **significantly lower than SC's estimate of 8% cost-of-equity** (note that as of Jan 2025, Bloomberg and Quick have also released cost-of-equity estimates of 8.9% and 8.8% respectively.)

While it is said that the ROE for a listed company should be 8% or more, the Company's target is only 5% with seemingly little intention to increase this. While President and CEO Teiji Wakita told SC that "5% ROE is just a transitional point, we aim to achieve an ROE of 8% eventually", we fear it will be next to impossible without a significant change to its management policy.



Data Source: Quick Astra Manager

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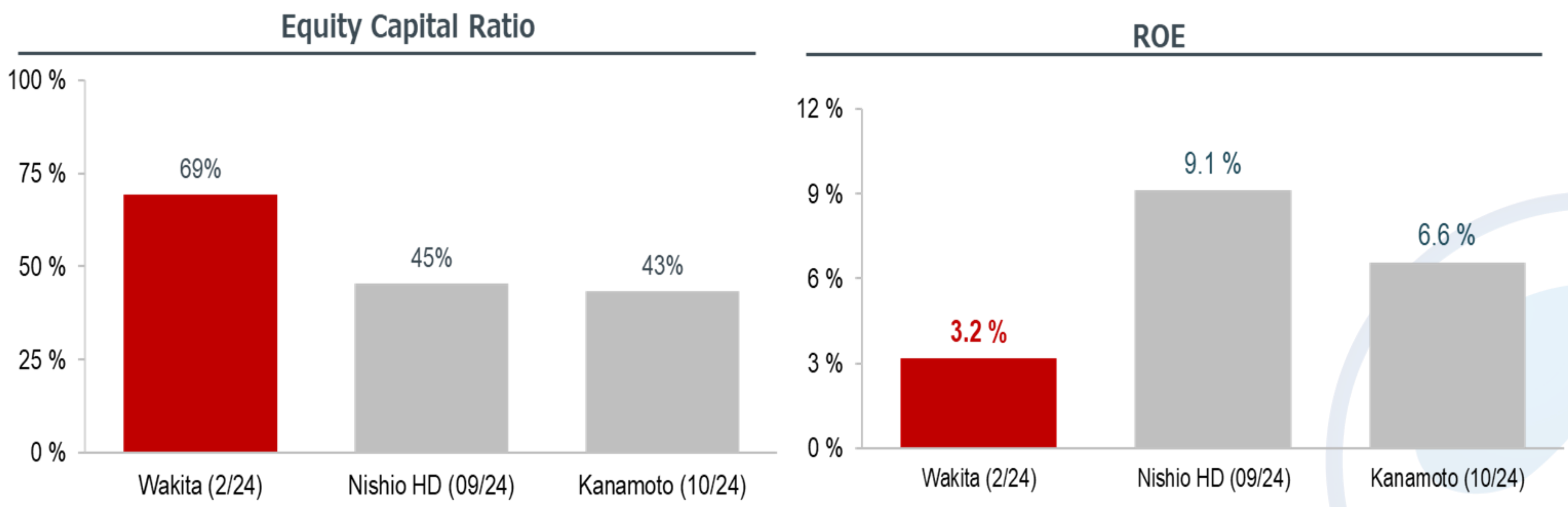
High shareholder equity one reason why ROE is so low

Wakita's **shareholder equity ratio is near 70% and very high** compared to industry peers, so in addition to the poor profit margin of the core business, it is clear the excessive shareholder equity is **contributing to the inferior ROE**.

Shareholders equity ratio and ROE vs industry peers



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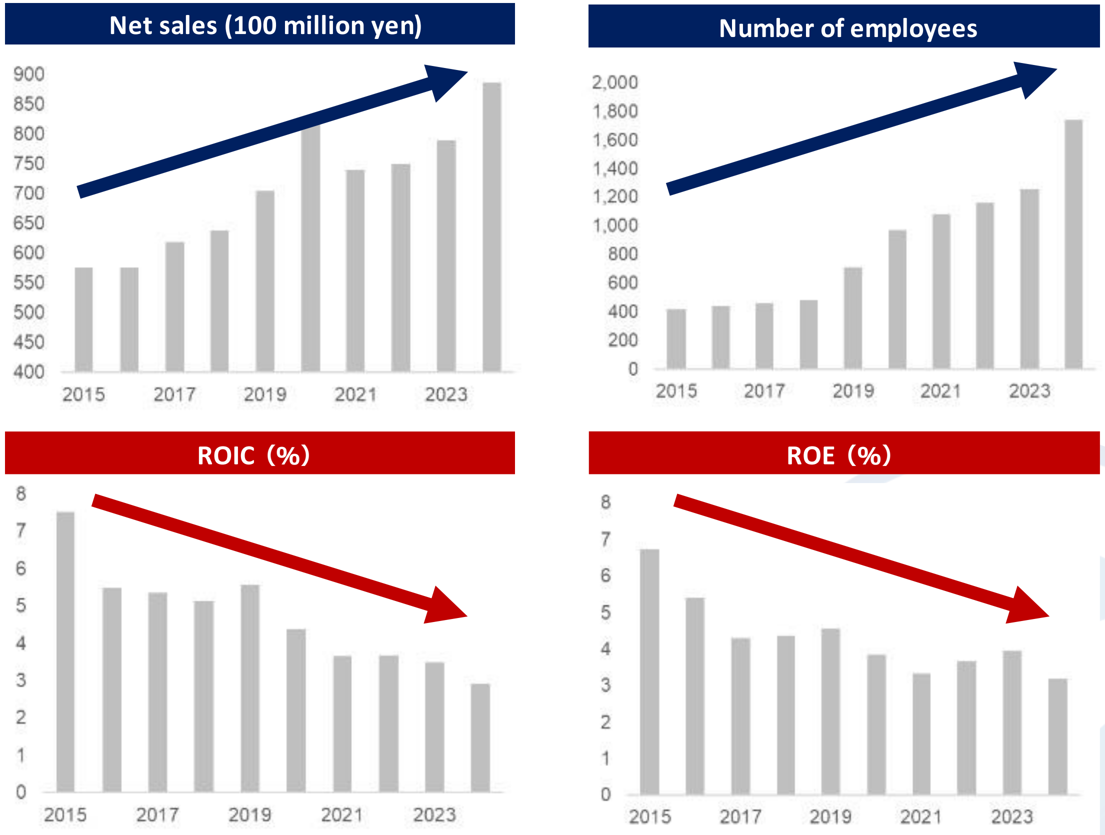
Management happy with the scale⇔ investors unhappy with deterioration of capital efficiency

Recently, Wakita's consolidated **sales and employees have been expanding** due in part to ongoing acquisitions. In the materials for the year-end earnings call, they tout the increase in the number of employees and President Wakita and his management team seem satisfied with the expansion and increased scale of the company. However, **capital efficiency targets such as ROIC and ROE**, which are essential for improving shareholder value, **have continued to deteriorate.**

Size increases, capital efficiency deteriorates



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Expansion vs efficiency continued

Companies like Wakita, with capital efficiency significantly lower than its cost of capital, should prioritize improving capital efficiency before expanding scale.

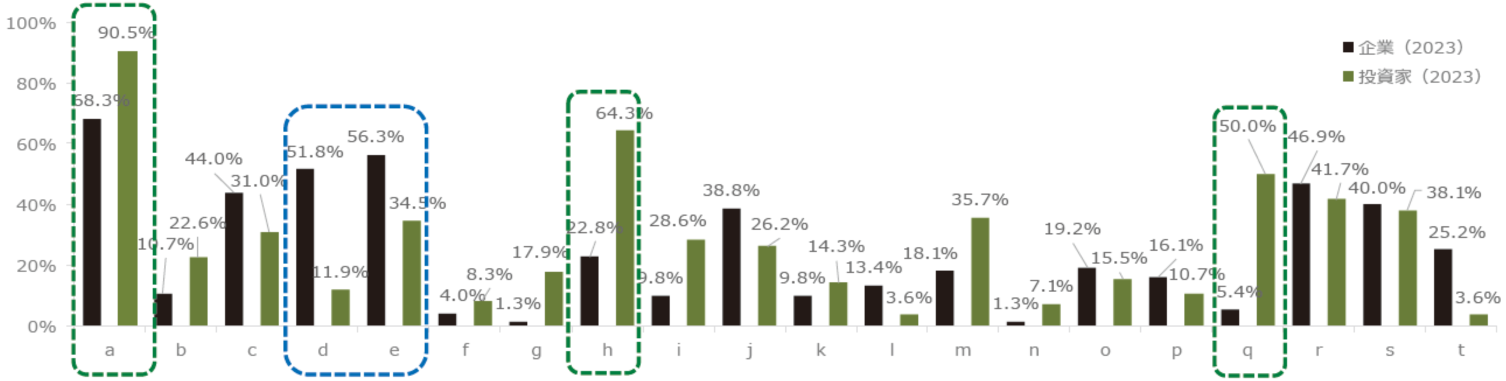
A survey by the Life Insurance Association of Japan shows that Japanese companies tend to emphasize scale, leading to a perception gap with investors who value capital efficiency and cost of capital. Wakita is a typical example of this.

MTBP indicators (companies) /indicators management should focus on (investors)

Recognition gap (Companies > Investors) d. Sales and sales growth e. Profit amount and profit growth

Recognition gap (Companies < Investors) a ROE h ROIC q. WACC

a. ROE（株主資本利益率）
b. ROA（総資本利益率）
c. 売上高利益率
d. Sales and sales growth rate
e. Profit amount and profit growth rate
f. 市場占有率（シェア）
g. 経済付加価値（EVA®）
h. ROIC（投下資本利益率）
i. FCF（フリーキャッシュフロー）
j. 配当性向（配当／当期利益）
k. 株主資本配当率（DOE）（DOE=ROE×配当性向）
l. 配当総額または1株当たりの配当額
m. 総還元性向 （（配当＋自己株式取得）／当期利益）
n. 配当利回り（1株当たり配当／株価）
o. 自己資本比率（自己資本／総資本）
p. DEレシオ（有利子負債／自己資本）
q. 資本コスト（WACC等）
r. E（環境）に関する指標（CO2排出量等）
s. S（社会）に関する指標（女性管理職比率等）
t. その他(具体的には　　）



Source: Life Insurance Association of Japan [*Comparison of Results between Companies and Investors (Japanese only)*]

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MTBP revised significantly down / Worse than three years ago

Wakita originally announced its current MTBP in 04/2022 but made a significant downward revision in 04/2024. While there was a slight increase in sales, this is to be expected if acquisitions are made and not at all deserving of recognition.

At issue are profitability and capital efficiency targets. **Operating profit is almost the same level as three years ago and a significant downward revision from the original plan**. Not surprisingly **the operating profit margin and ROE are, of course, significantly lower than the original plan and even lower than the levels of three years ago**.

Despite an already too low ROE target of 5% there is no sign that management is taking responsibility and has yet to initiate any fundamental reforms to improve ROE.

FY2025 Medium-Term Management Plan

JPY 100m	FY2021 Results	FY2024 Initial plan (Announced 04/22)	FY2024 Adjusted plan (Announced 04/24)
Sales	749	925	**940**
Operating profit	55	80	**58**
Operating profit margin	7.3%	8.6%	**6.2%**
ROE	3.7%	5.0%	**3.4%**

Data Source: Quick Astra Manager

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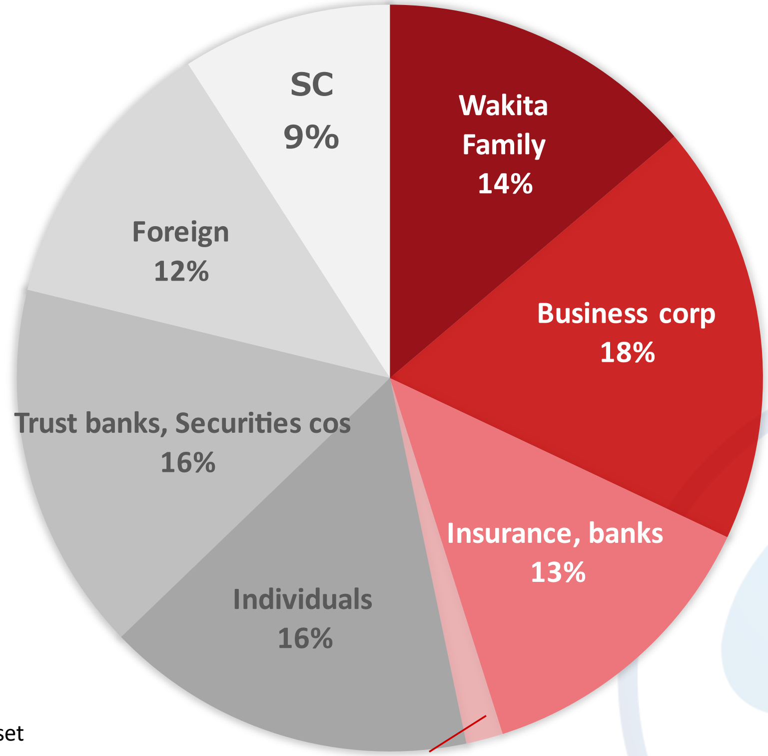
President Wakita's lazy management supported by allegiant shareholders representing almost half

One reason SC believes that Wakita is able to continue with a management policy that does not emphasize shareholder profits is due to the composition of Wakita's shareholders. Wakita has **a very high ratio of so-called allegiant shareholders such as members of the founding family, businesses and financial institutions that do business with it,** and as it is unlikely that the management will be dismissed even if ROE and the weak stock price slump are left unchecked management can rest on its laurels.

Shareholder composition (excluding treasury stock)



Allegiant shareholders approx. half of the voting rights

(Source: Feb 2024 Wakita shareholder registry. "Wakita family" refers to Wakita Industries (the asset management company of the Wakita family) + President Wakita + family members, "officers and employees" include alumni, and "trust banks, securities companies, etc." include other financial institutions.)

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Allegiant shareholders cont'd

Allegiant shareholders also include companies with which it has cross-shareholdings. As of the end of February 2024, they have approx. JPY 3.5B in cross-shareholdings, but cross-shareholdings are fraught with many problems and should be sold in full immediately.

Issues with cross-shares

When held as a stable shareholder

- Using assets entrusted by shareholders, cooperate to preserve directors of companies that issued the shares.
- Opposite of a "Wolf Pack", it is an allegiant shareholder "Sheep Pack"

When purpose is to maintain, facilitate transactions etc.

- Benefiting from transactions due to the shareholding may be a violation of the companies act (prohibition of profit sharing).
- If stock ownership facilitates trading, there may be less incentive to improve products and services, resulting in less competitiveness.

Financial issues

- Impact to P&L and shareholder's equity from stock price movement that has nothing to do with the performance of core business.

Issue when business partner forces stock to be held

- Could be victim similar to abuse of superior bargaining position, which is an unfair practice under Antitrust laws.

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The board of directors does not function, resulting in a “dictatorship” for President Wakita

President Wakita, part of the founding family and effectively the largest shareholder, also serves as the Chairman of the Board and as the chair of the Nomination and Remuneration Committee raising serious questions over the supervisory function of the Board.

As noted, not only is Wakita suffering from an extremely low ROE but has also significantly revised its current MTBP downward. Therefore, at the 2024 AGM, SC asked whether the Board of Directors should discuss the dismissal of President Wakita. In response Wakita's outside director said, "As far as we can see, President Wakita understands the business and is doing it well," and seemed unwilling to even consider it.

It goes without saying that he should understands the business, but there is no evaluation at all from the perspective of "whether the Company is achieving ROE that exceeds the cost of equity" or "whether the MTBP has been achieved." The Board needs to strengthen its function of supervising whether the management is executing the business in a way that contributes to the enhancement of shareholder value. For this reason, **the Chairman of the Board should be an outside director rather than an executive officer to improve corporate governance.**

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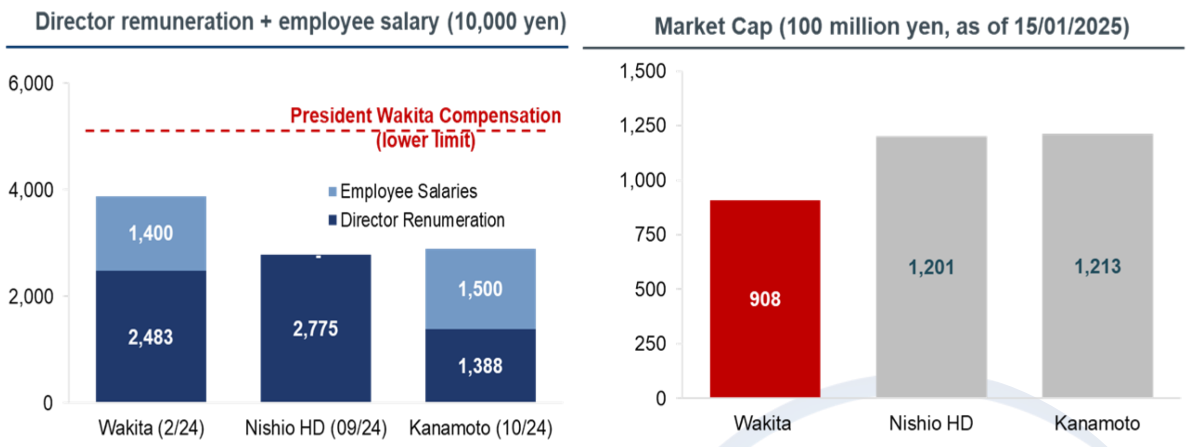
Unreasonable remuneration and unwillingness to disclose

The governance failure is also evident in President Wakita's remuneration. We estimate that he **receives well in excess of JPY 40m.** This would be much higher than those of other companies in the same industry which are large and more capital efficient. SC has insisted that the **president's remuneration be disclosed separately**, as it is feared that receiving excessive pay despite a depressed stock price results in a lack of incentive for him to increase shareholder value. However, the Board has opposed and rejected this shareholder proposal for three consecutive years.

SC also pointed out that the average remuneration of Wakita directors is high, so President Wakita is likely to receiving even more remuneration, but what the directors receive as employees has not been disclosed since 2023.

The purpose is not to lower President Wakita's remuneration. Instead, we would like to see an increase in shareholder value commensurate with his remuneration.

Comparing executive remuneration and market cap vs peers



(Source: estimates based on annual securities report, as Wakita's employee salaries have not been disclosed since 2023, 2022 figures are used. Market cap from QUICK Workstation)

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Former bank employees and nepotism for key positions

Personnel decision may also reflect the intentions of President Wakita and his family.

First, it is almost customary for **alumni of MUFG (4th largest shareholder* as of 02/2024) and SMBC (8th largest shareholder), both of which are allegiant shareholders, to be appointed as directors a few years after transferring to Wakita**. They have been appointed as full-time directors for two consecutive terms, **raising suspicions that Wakita is favoring the alumni** when looking at personnel. In addition, over the past 25 years at least, one or both of the key positions of outside director and auditor are alumni from the two banks. What did the Nomination and Compensation Committee deliberate?

Wakita has an executive officer system, and as of Feb 2024, there are four executive officers, **one of whom is Yoshihiro Wakita, the son of President Wakita.** He is the executive secretary and was promoted to executive officer in 2023. We understand the duties of the executive secretary is to serve as the center of group management and investor relations but promoting him executive secretary amidst a slump in performance and stock price valuations raises questions as to whether a fair personnel evaluation was conducted (for the record, President Wakita also joined Wakita as the executive secretary).

President Wakita is also the chairman of the Nomination and Remuneration Committee, and if he intends to make his son his successor there is concern whether there will be fair deliberations by the committee. There is also concern that **shareholder value will continue to be damaged by the Wakita family's continued control of the Company.**

*Excluding treasury stock. Based on beneficial shareholders excluding The Master Trust Bank of Japan Trust and Japan Custody Bank Trust Accounts.

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A classic example of a misaligned company

In March 2023, the Tokyo Stock Exchange requested listed companies to take “Action to Implement Management that is Conscious of Cost of Capital and Stock Price” showing particularly strong awareness of issues for companies with PBR less than 1x.

In July 2023, the Company announced a plan for “management to promote a higher PBR”(Japanese only). However, the **only new measure is “holdings briefings for individual investors”.** The rest is merely a restatement of existing disclosures.

Wakita’s plan to improve PBR

（1）成長戦略の推進
当社グループは、2022 年４月に公表した「2025 中期経営計画」で掲げた「安定から成長へ」を実現すべく、ネットワーク展開、建設ＩＣＴの強化、介護事業の拡充、及び人材戦略に注力してまいりました。中期経営計画に基づき、引き続き持続的成長と中長期的な企業価値向上を図ってまいります。

From MTBP

（2）ＩＲ活動の拡充
当社グループは、ＩＲ活動の充実のため、直近では公表資料の拡充、及び投資家向け説明会の開催など積極的な情報公開を実施してまいりました。より一層の拡充に向けて、個人投資家向け説明会の開催に向けた準備を進めており、更なる情報開示を図ってまいります。

Only new content

In order to enhance its IR activities, the Group has been proactive in disclosing information, most recently by expanding publicly available information and holding investor meetings. To further enhance our IR activities, we are preparing to hold briefing sessions for individual investors and disclose more information

（3）株主還元の強化
「2025 中期経営計画」の企業価値向上の一環として、2023 年２月期から 2025 年２月期の３年間は「配当と自己株式取得を含めた総還元性向 100%」を公表いたしました。2023 年２月期は５円増配の一株当たり 38 円、2024 年２月期は更に５円増配の一株当たり 43 円を予想しており、今後も自己株式取得を含めた、株主還元を継続的に進めてまいります。

From MTBP

（4）更なる取組に向けて

Summary past/future actions
(only new content is IR activities)

*Excluding treasury stock. Based on beneficial shareholders excluding The Master Trust Bank of Japan Trust and Japan Custody Bank Trust Accounts.

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Misaligned company cont’d

While we have no objection to enhancing IR functions, the reason for the low valuation is **not because “the details of initiatives in the MTBP are not sufficiently communicated,”** as claimed by Wakita, **but because "the MTBP itself is insufficient”.** The TSE has since pointed out the discrepancy between the investor's perspective and that of the company's management, and Wakita is a typical example of this.

Misalignment between Wakita management and investors

The ROE target of 5% is clearly too low

If you want to target an 8% ROE, you need to set a time horizon

Continuing real estate leasing business in which is is impossible for profitability to exceed the cost of capital

Misalignment With Investors’ Perspectives

- There are some cases where the level of target setting seems inappropriate, for example, where ROE targets are set too low. Perhaps such companies consider those low targets to be sufficient because they exceed their internally estimated low cost of capital, but investors cannot assess them because they does not disclose their cost of capital. (Overseas investors)
- Timeframes for target setting for some companies are problematic. For example, a company set a target of 8% ROE for a fiscal year that is considerably ahead of schedule; it is thought that the company may not believe that it can achieve this goal. (Overseas investors)
- While there have been positive developments, such as the increased use of ROIC and the analysis of earnings by business segment, companies are only adopting strategies to improve the profitability of unprofitable businesses. We hope that companies will take the next step by fundamentally reviewing their business portfolios, including withdrawing from unprofitable businesses. (Overseas investors)
- Many companies are unable to terminate existing businesses. When profitability is below the cost of capital, the decision not to exit is not a good sign. Some companies do not review their business portfolios to generate future earnings and end up only offering short-term shareholder returns. (Consulting firm)
- A growing number of companies have announced that they will increase shareholder returns, but some companies appear to be doing this as a short-term measure to boost their share price without first properly considering how to optimize their balance sheet and capital allocation policy. (Domestic institutional investors, overseas investors, etc.)
- Although many companies have stated that they are reducing their cross-shareholdings, many companies do not disclose their plans for allocating the cash obtained from sales, such as investing in growth and increasing shareholder returns. Therefore, this has not been a positive factor. It is desirable that there is a growing trend to disclose medium- and long-term capital allocation policies, including funds obtained by unwinding cross-shareholdings. (Domestic institutional investors)
- This is a problem for companies that only cite past medium-term management plans and make superficial disclosures that they will “continue to improve PBR by implementing the measures outlined in the medium-term management plan.” (Overseas investor)

Targets and measures to reduce 70% shareholder equity ratio is needed

Other than “holding briefings for individual investors”, same as existing MTBP.
New measures are needed to improve upon the long-term weak valuations

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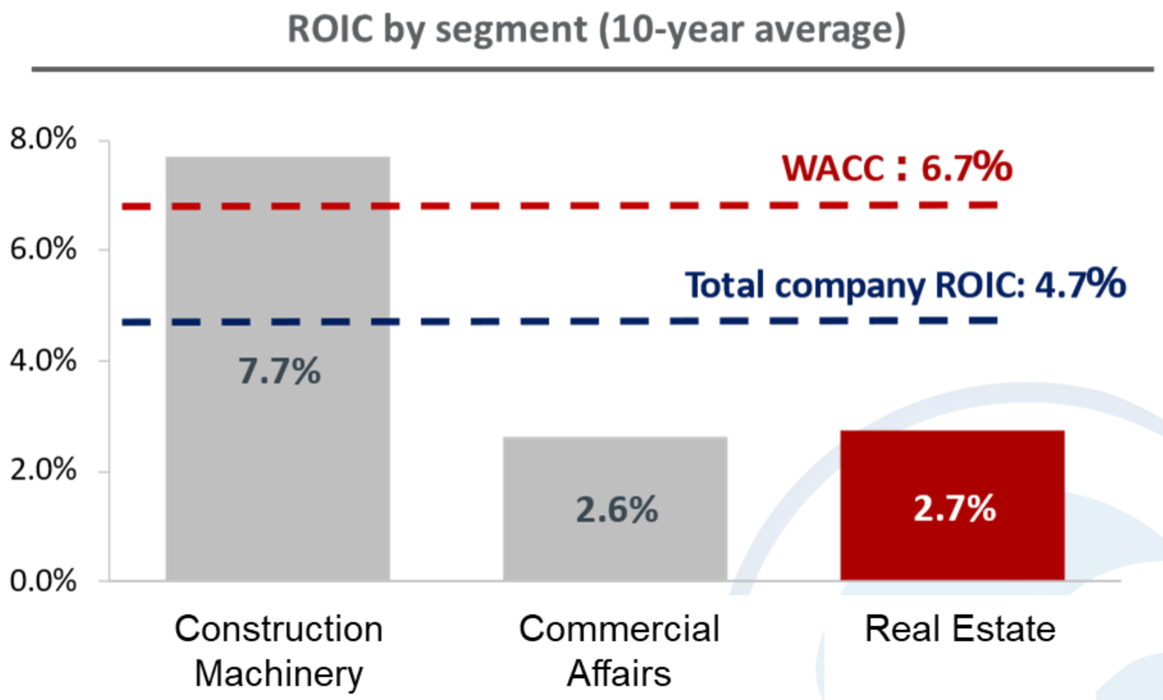
SC believes there are two feasible measures for Wakita to achieve a PBR ≧ 1

Measure ①: Fundamental reform of real estate leasing business

The **capital efficiency of** what Wakita calls its **"core" construction machinery business, and "challenge" commercial affairs business is on a downward trend and is in urgent need of improvement**.

On the other hand, **for the real estate business,** ROIC over the past 10 years has averaged 2.7% (with a 3.4% high), making it **theoretically impossible to realize a return above WACC**.



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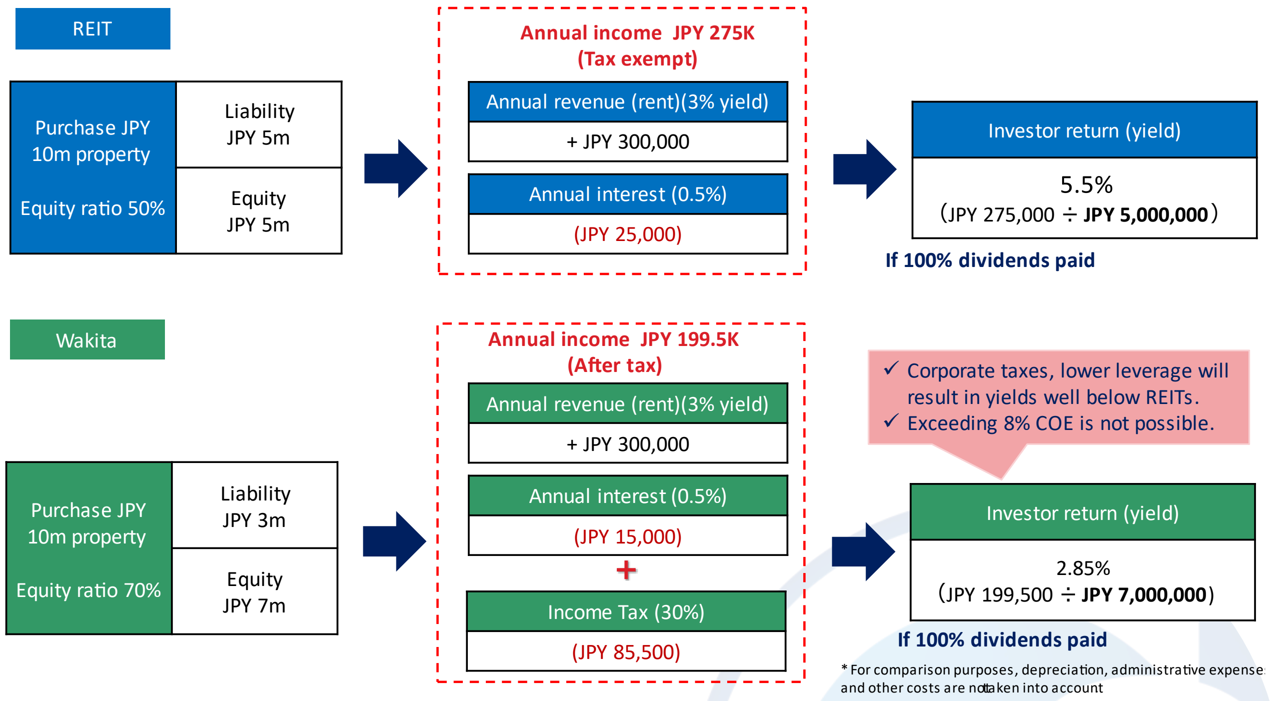
Real estate reform cont'd

Average J-REIT yield was 5.1% as of Jan 2025 making them low-risk, low return products. **It would be difficult for the real estate leasing business to generate comparable returns due to corporate taxation and lack of leverage.** Since investors have the option of investing in REITs separate from Wakita shares, it is unreasonable for the Company to engage in the real estate leasing business. It also makes it impossible to achieve a reterun greater than 8% of COE and will be **a major drag on any actions to exit a PBR of less than 1x.**

SC has suggested selling the real estate holdings to a REIT and specialize in management and operation. However, Wakita has positioned it as a "stable business" and continues to hold the real estate without much thought.

Comparison of Rental real estate business of Wakita and a REIT



Having repeatedly explained the above to President Wakita and others, we believe that they already understand our reasoning. However possibly due to a lack of confidence in the core business and wanting to hold real estate as insurance, they have yet to make a decision.

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Measure ②: Establish a shareholder return policy of 6% DOE and 100% dividend payout ratio

Another strategy is to **set the shareholder return policy to 6% DOE and 100% dividend payout ratio**. While the current shareholder return policy is a dividend payout ratio of 100%, the ROE has averaged only 3.6% over the last five years, and as long as it continues its real estate leasing business, it is unlikely to improve significantly in the future. Considering Wakita's excessively high shareholder equity ratio, a dividend payout ratio of 100% alone is not enough.

By adding a DOE of 6% to its shareholder return policy, if the ROE is less than 6%, the dividend payout ratio will exceed 100%, but this will gradually **reduce the equity capital and improve ROE and lower WACC**. If Wakita wishes to continue leasing real estate, we believe that there is no other way to eliminate the PBR of less than 1x other than adopting this measure.

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If they want to continue with current policy, then privatize

These two proposals are feasible and reasonable measures to achieve a PBR greater than 1x, and we have explained them to Wakita many times. This fiscal year is the final year of Wakita's current MTBP, so they are likely considering the next MTBP. If they do not announce these policies then it means that Wakita has no intention of increasing ROE and PBR even though it is a listed company and as long as President Wakita continues to lead, we believe that it will be impossible to eliminate the PBR of less than 1x. If the President’s office is succeeded by President Wakita's son, effectively continuing the control of the Wakita family, there are concerns that this problem will only be prolonged.

The Tokyo Stock Exchange does not limit the number of listed companies, but clearly states that it emphasizes quality. In addition, due to a rise in listing costs, an increasing number of companies, including some well-known companies, have gone private in recent years.

If they want to stick to their current policy then shareholder value is not expected to increase so they should just privatize. In the construction equipment rental industry, which is Wakita’s main business, Aktio, the largest company in the industry, is unlisted, and in 2021, Nippan Rental privatized through an MBO. Wakita should also seriously consider taking itself private.

If they want to remain listed, then the above measures should be implemented in the next MTBP to eliminate the PBR of less than 1x as soon as possible. It is no longer acceptable to simply remain listed as it has been in the past. The time has come for Wakita’s Board to make the above decision.

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Revisions

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