



Strategic Capital

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In the event of any differences between the original Japanese version and the English translation, the original Japanese version shall prevail

# Proposal to unearth the value of Wakita & Co., Ltd (8125)





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## 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"). In order to increase shareholder value, we have submitted the following proposals to Wakita by exercising our right to make a shareholder proposal

- i. Elect Strategic Capital's representative to the Board
- ii. Set dividend payout ratio to be 100%
- iii. Sell cross-shareholdings held
- iv. Elect a Chairperson of the Board of Directors from the Outside Directors
- v. Disclose the individual compensation of the President
- vi. Disclose the weighted average cost of capital
- vii. To formulate and disclose a plan to achieve a PBR greater than 1x

Press release with additional details of the proposals available [here](#)

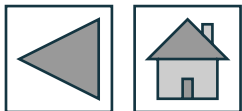




## Assumed return to shareholders from the passage of the proposal

If shareholder proposals are approved, and in addition to selling the cross-shareholdings, the policy is changed to only manage and operate the rental properties instead of also owning them, shareholder of record would receive a special dividend of 1,126 yen/share.\*

\*Proceeds from the sale of rental real estate currently owned (as well as sale of cross-shareholdings) are assumed to be allocated to dividends.





## Background & key points on the proposals

### **Prolonged share price slump and the need for management reform → Elect Strategic Capital's representative to the Board**

Since 2010, the Company's stock price has never exceeded dissolution value. The Company's 59.8 B yen market cap (as of March 3, 2023) does not even reflect the approx. 54.2B market value of the rental properties.

In order to break the long-term slump, we propose to appoint one director to drive needed management reform and capital policy changes such as converting the rental real estate business which has low capital efficiency into a REIT operating business to unlock value.

Our representative, who has extensive experience in and knowledge of capital markets, is expected to introduce a management policy that is based on the cost of capital while diversifying the skills of the Board and contributing to increase shareholder value. See [here](#) for his biography.

### **Excessive accumulation of equity capital → Set dividend payout ratio to be 100%**

The Company's equity capital ratio is already high at around 70% and it is due to this excess capital that the ROE is low. To improve capital efficiency and ensure stable shareholder returns we propose a 100% dividend payout ratio.

While the Company has pledged a 100% total return ratio, the market cap is approx. JPY 60B as of Feb 28, 2023, and stable shareholders account for approx. 50% and there is concern that a share buyback will lead to a decline in liquidity. Therefor a 100% dividend PO ratio rather than total return should be established as a shareholder return policy.

The Company should then separately buyback shares from cross-shareholders in order to restore excessive equity capital to an appropriate level.





## Background cont'd

### **Meaningless cross-shareholdings → Take action to reduce cross-shareholdings**

Wakita states that it holds cross-shareholdings for the purpose of “maintain and strengthening business relationships”. They say this even after top executives from the business partners deny any causal relationship between holding shares and business, effectively ignoring their wishes.

We propose, that since Wakita management is unlikely to be able to make a proper judgment on whether to hold cross-shares, they sell the cross-shareholdings based on clear criteria.

### **Failure of governance due to management by the founding family → Appoint the Chairman of the Board from the outside directors**

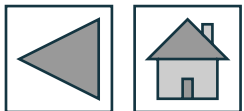
The Company's founder, Teiji Wakita, is the President and Representative Director and effectively the Chairman of the Board which brings into questions whether the Board is able to serve its supervisory function.

We propose that the Board be chaired by someone who is not a company executive but an outside director to improve corporate governance.

### **Management compensation may be excessive → Disclose individual compensation for the President**

We believe one reason the inefficient management and weak stock price is left unchecked is remuneration system. At Wakita, the final decision on individual remuneration for Directors is entrusted to the President. Governance as it relates to the President's remuneration is not sufficiently effective. We estimate that despite the stagnant stock price President Wakita has been paying himself more than JPY 47m/year.

We propose the disclosure of the President's compensation to improve remuneration governance.





## Background cont'd

### Inefficient management that ignores cost of capital → Disclose WACC

Managements lack of awareness regarding the cost of capital may be one reason they make decisions that result in capital efficiency being at such a low level.

We propose the Company disclose WACC and the basis for calculation to encourage management decision making mindful of the cost of capital and unlock the stocks valuation.

### Share price below dissolution value for an extended period → Develop and disclose a plan to achieve a PBR of at least 1x

The PBR has been below 1x (dissolution value) since 2010. In order to break out of the long-term slump in the stock price, drastic management reform and changes in capital policies are needed.

The Tokyo Stock Exchange will require companies with PBR less than 1 to disclose policies and specific initiatives for improvement as early as the spring of 2023. We propose the Company take immediate proactive action.





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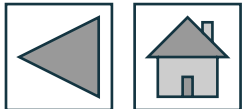
What's New

## What's New

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03.31.2023

Submitted Formal Shareholder Proposal to the Company



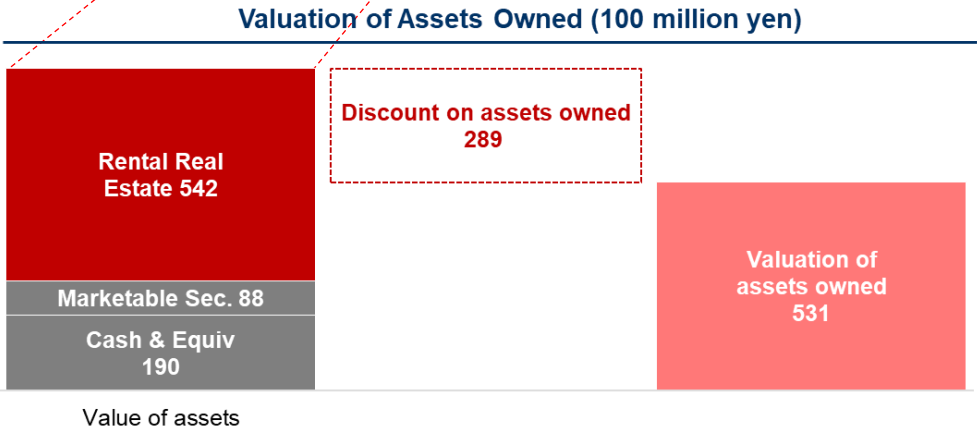
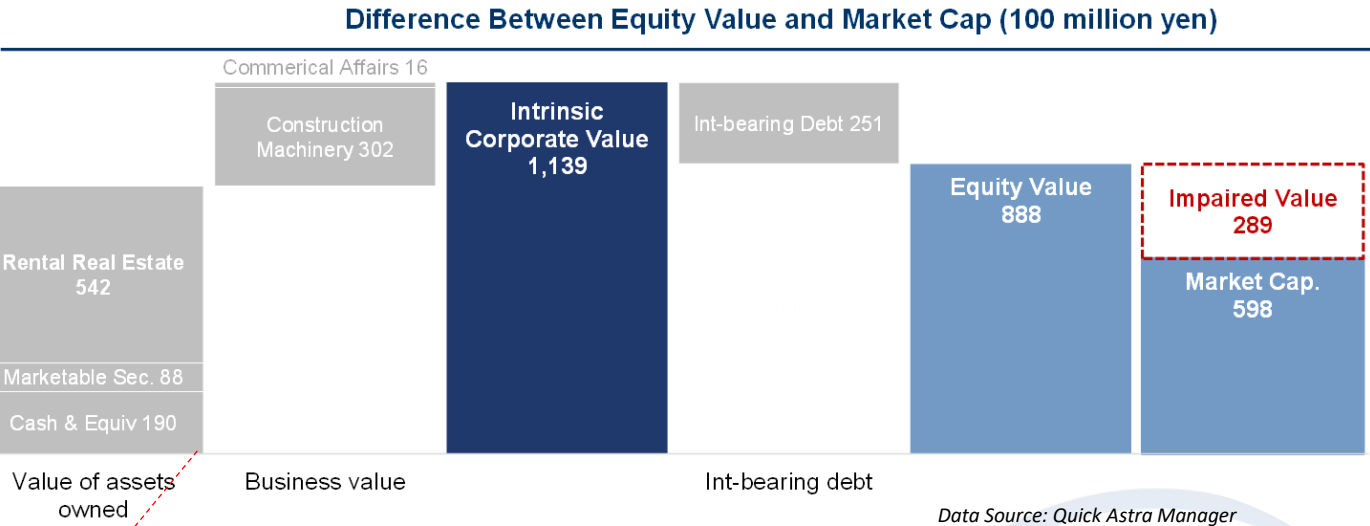
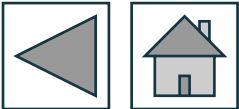


# Market capitalization that deviates from equity value

Wakita’s **equity value** is estimated to be around JPY 88.8 B, however, the actual market capitalization is only JPY 59.8B. We believe **the impairment in value (JPY 28.9B) is due to poor management.**

A major reason value has been severely damaged is because the **rental real estate, which has a value of around 54.2 B yen after tax**, is priced at a significant discount.

(Note: Rental real estate and marketable securities are all after-tax. Business value is estimated by applying an EV/EBITDA multiple of 4 to operating income and depreciation for each business. Interest-bearing debt is the sum of interest-bearing debt, equipment related accounts payable, lease obligations and future lease payments for non-cancelable operating leases.)





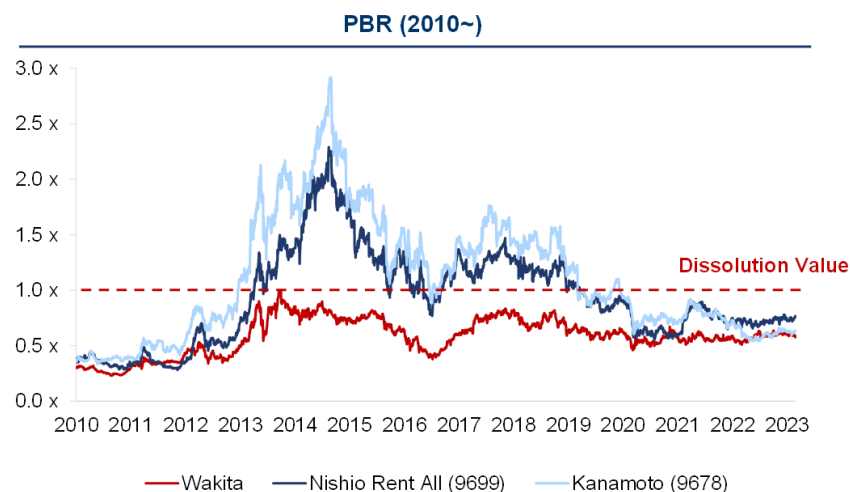
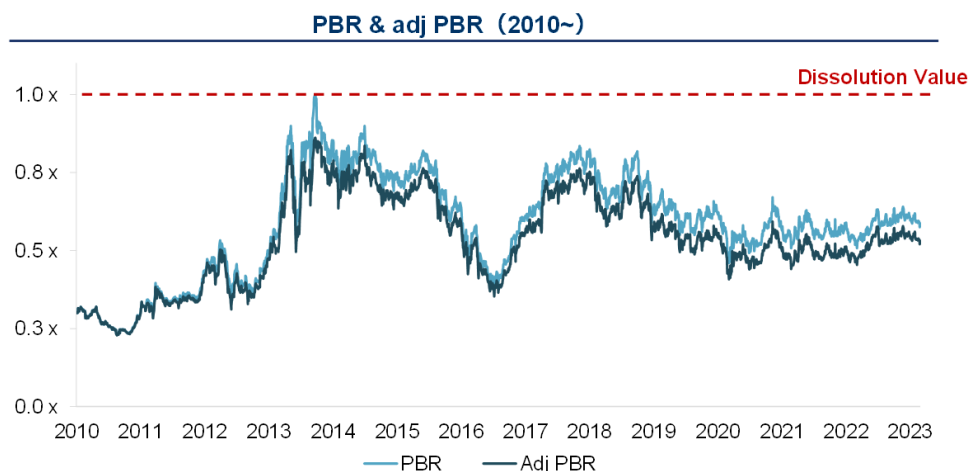


## Stock price that is unable to exceed a PBR of 1x

Wakita's **stock price has remained below a PBR of 1** since 2010. More recently, the **PBR was 0.59x** and **when adjusted** for unrealized gains on real estate holdings, **0.53x**, an extremely low level.

At the AGM in 2022, the Board opposed several of our shareholder proposals on the grounds that they conflicted with their basic management policy, and not conducive to shareholder interests. However, it is clear from the stock price trends that their management policy has been *damaging* shareholders' interests, and that a drastic change in management policy is necessary to unlock shareholder value.

The Tokyo Stock Exchange has shown an increased awareness of issues with companies with a PBR less than 1x and are planning to request the disclosure of policies and specific initiatives for improvement as early as the spring of 2023. It goes without saying that immediate action is needed.



- See [here](#) for TSE policy from 8<sup>th</sup> council held 2023.02.15 (Japanese only)
- English site for Council of Experts Concerning the Follow-up of Market Restructuring [here](#)

At times other companies in the same industry have exceeded the dissolution value, so the valuation weakness cannot be blamed on the industry environment.

Data Source: Quick Astra Manager





## Capital efficiency below cost of capital

The cheap valuation indicates the ROE is below the cost of equity (COE). In our view, the Company's **COE is about 8%**. However, Wakita's **ROE has been well below this** and by extension well below investor's expectations.

In addition, in our estimation, the **WACC is about 6.4%**. While the ROIC of the entire company is well below WACC, this is **especially the case for the commercial affairs and real estate businesses**. As this situation has continued for a long time, fundamental reforms such as concerting the rental real estate business to a REIT management company is necessary.

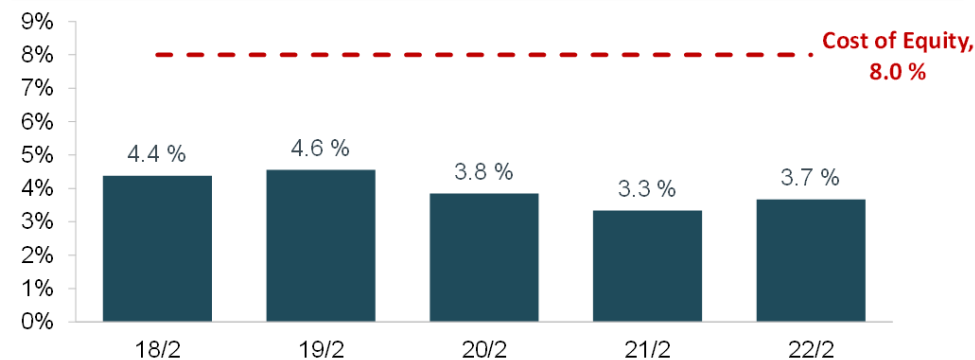
[Click here for our basis for calculating the COE](#)

Presentation on measures to increase shareholder value by converting to REIT management company (Japanese only)

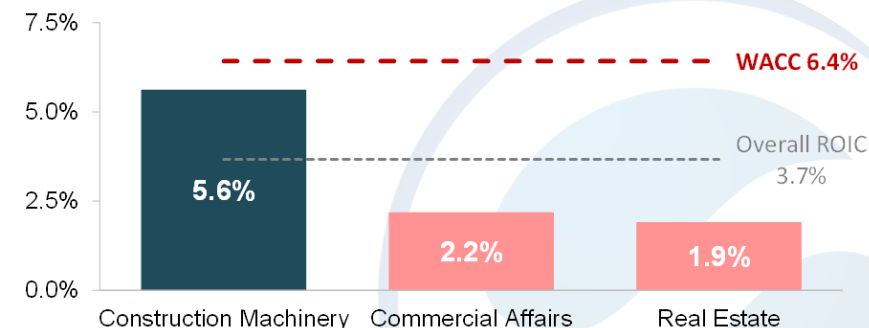
At the AGM in 2022 the Board opposed our shareholder proposal to disclose WACC on the grounds **"it is not the disclosure of cost of capital in and of itself that is important, but rather the establishment of earnings plans, etc., through the understanding of the cost of capital."** However, it cannot be said the Board, which over a long time has caused capital efficiency to decline and stock prices to stagnate, has constructed an earnings plan with a proper understanding of the cost of capital.

Therefore, we strongly expect the Company's Board of Directors to disclose WACC and engage in dialogue with investors to determine whether or not the WACC is appropriate.

ROE and Cost of Equity over time



ROIC (02/2022) and WACC



Data Source: Quick Astra Manager





Capital efficiency below cost of capital

Theoretical PBR for each COE and g assuming an assumed ROE of 4.5%

Within ±10% of current stock price

		Expected cost of equity (COE)								
		6.0%	6.5%	7.0%	7.5%	8.0%	8.5%	9.0%	9.5%	10.0%
Perpetual growth rate (g)	0.0%	0.75	0.69	0.64	0.60	0.56	0.53	0.50	0.47	0.45
	0.5%	0.73	0.67	0.62	0.57	0.53	0.50	0.47	0.44	0.42
	1.0%	0.70	0.64	0.58	0.54	0.50	0.47	0.44	0.41	0.39
	1.5%	0.67	0.60	0.55	0.50	0.46	0.43	0.40	0.38	0.35
	2.0%	0.63	0.56	0.50	0.45	0.42	0.38	0.36	0.33	0.31

Data Source: Quick Astra Manager



RETURN



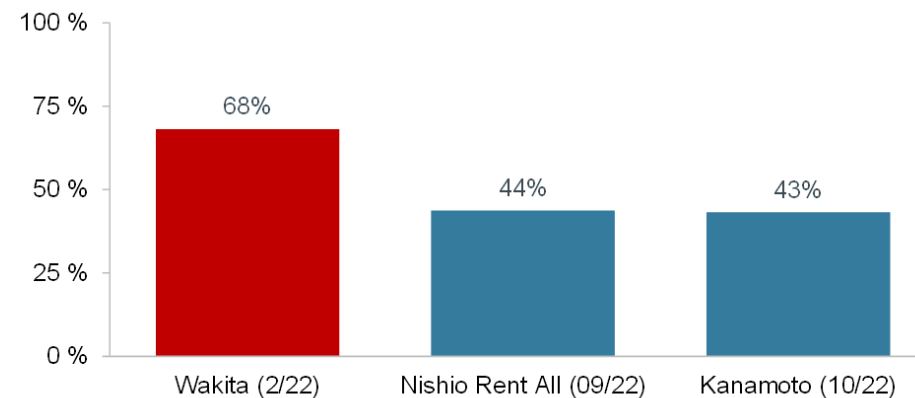
## What is causing the low capital efficiency

At around 70%, Wakita's equity capital ratio is very high especially when compared to industry peers. The excessive equity capital is also considered to be a major factor in why ROE has also remained far below peers. Given the current situation, the Company should set dividend payout ratio at 100% and change its capital policy so as not to further increase equity capital.

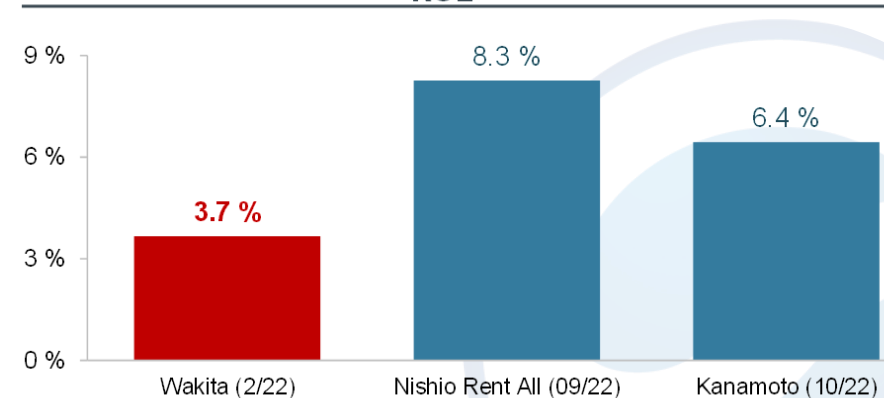
At the AGM in 2022, the Board opposed our shareholder proposal calling for a 100% dividend payout ratio on the grounds that “the Company has a 100% total shareholder return policy, including dividends and stock buybacks for each of the next 3 years from 2023 to 2025 which is sufficient for shareholder return.”

However, we believe that it is preferable for a small-cap company to return profits to shareholders through dividends as share buybacks can lead to a decline in liquidity. Also given the Company's financial base is excessively strong, we reiterate our call for a 100% dividend payout ratio.

### Equity Capital Ratio



### ROE



Data Source: Quick Astra Manager



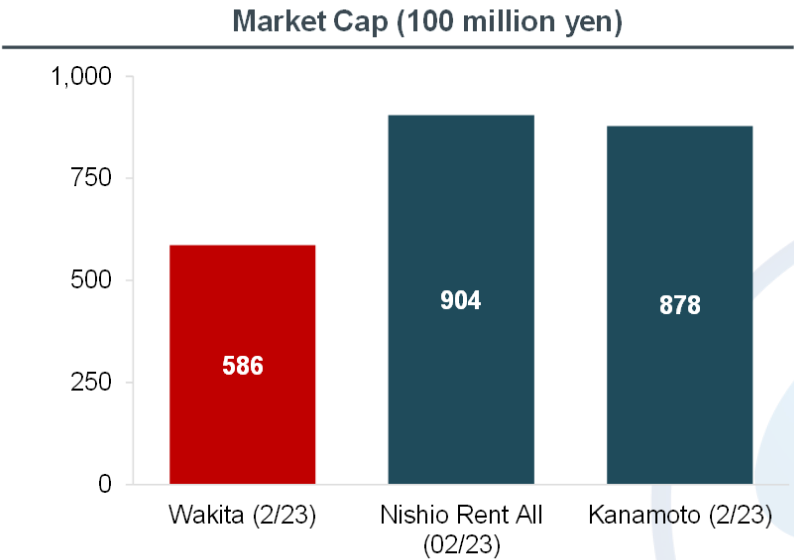
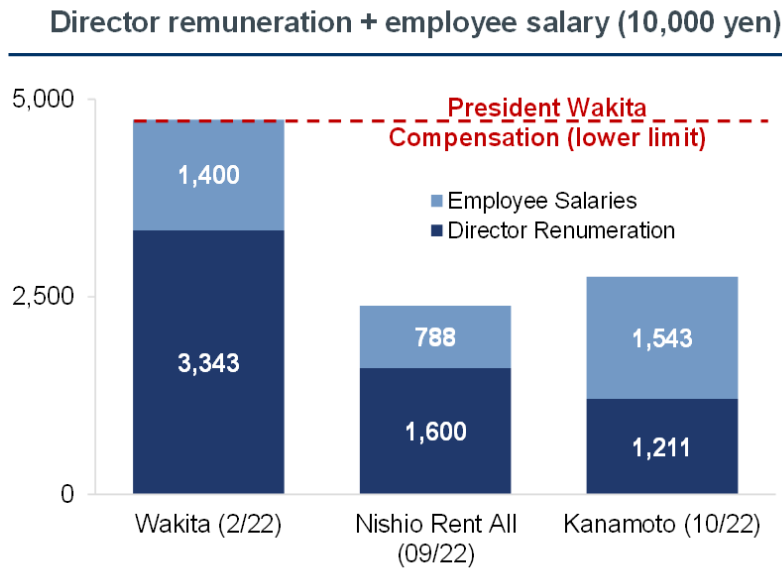


# High compensation without regard for shareholder value

We believe one of the reasons for the disregard for shareholder value is the excessive compensation paid to top management. It is estimated that President Teiji Wakita receives more than 47 million yen\* in annual compensation. That amount is much higher than peers, which are more capital efficient, larger in scale, and have higher stock valuations.

Our objective is not to keep the CEO's compensation low. Instead, we are looking for a compensation structure that is linked to enhancing shareholder value.

(\*Estimated from average of remuneration for directors and salaries for employees as stated in the YUHO)



Source: Avg. remuneration for Directors, Avg salary for employees as states in the Annual Securities Reports





## Details on dialogues regarding cross-shareholdings

As of February 2022, the Company held approx. 3.1 B yen in cross-shareholdings including Yokogawa Bridge Corporation (“Yokogawa Bridge”) and Kyokuto Kaihatsu Kogyo Co., Ltd. (“Kyokuto Kaihatsu”)

Since investing in Wakita stock, we have repeatedly sought to have the Company divest its cross-shareholdings including through shareholder proposals. However, at the 2022 AGM, the Board continued to indicate that it had no intention to sell because “they hold such shares only when it is judged to maintain or strengthening business relationships or lead to new business opportunities” and “the Company examines the economic rationality and significance of each holding in relation to its cost and the Board deliberates on the policy to deal with the situation.”

We believe the concept of “cross-shareholdings leading to maintain or strengthening business or lead to new business opportunities” is unfounded and if it is resulting in such, is suspect of being a payoff. In addition, only the formal reason for holding the share has been disclosed. We would like the Board to disclose the result of its deliberations regarding the economic rationality and significance in relation to costs.

Opinion on cross shareholding  
(shared with International Corporate Governance Network)



## Dialogue at 2022 AGM



The Company discloses the purpose for its cross-shareholdings is to “maintain and strengthen business relationships”. We would like to know the causal relationship on how holding the stock will maintain and strengthen business relationships.

Perhaps the reason for holding cross-shareholdings should be written as "to create new business opportunities and further expand business." You would know if you are in business but even good products and services are useless if they do not reach the other party, and we hold shares in order to build that relationship. This is the reason why we hold shares in the company. A relationship of trust between managements makes it easier to discuss new business opportunities.



President Wakita



Please answer my question. Why does holdings stock create the relationship of trust?

It is the mutual trust that comes from holding shares."



President Wakita



I will ask again. Why would holdings shares create a relationship of trust? Is it because you are well-treated as a stable shareholder by the other company's management? Also, I believe you do not have to do business with such strange companies that will not do business unless you hold shares. Such companies will disappear over time.

We believe that the reason we have a relationship of trust is not because we are a stable shareholder. It is not that we cannot reach them if we do not hold their shares, but that our relationship with them deepens by holding their shares.



President Wakita



I would like to discuss cross-shareholdings with you at the next opportunity.







## Dialogue between SC and Yokogawa Bridge/Kyokuto Kaihatsu

Regarding the connection between cross-shareholdings and business relationships, Yokogawa Bridge President Takata and Kyokuto Kaihatsu General Affairs Section Chief Fujimoto both denied such a connection at a financial results briefings and in interviews with us.



If a company that holds shares of your company as cross-shareholdings and sells those shares, will it affect the business relationship?

We are not in a position to comment on the whether other companies own our shares. Our actions will not be based on this fact.

We don't think of whether it would jeopardize the business relationship. According to the rules you should not talk about business based on whether or not shares are owned.



President Takata  
Yokogawa Bridge



General Affairs Section  
Chief Fujimoto  
Kyokuto Kaihatsu







## Dialogues between SC and Wakita

We have communicated our views in writing and through direct dialogues with Wakita's management both online and through face-to-face meetings. Due to the sheer magnitude of our dialogue with the company we cannot list them all but below are a sample.

### Opinion expressed in letter (October 2021)

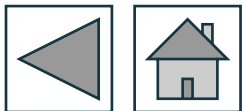
- Sale of cross-shareholdings will contribute to the improvement of shareholder value
- We encourage cross-shareholders to sell their shares

Click [here](#) for full text  
(Japanese only)

### Opinion expressed in letter (December 2020)

- Withdraw from commercial affairs and real estate business
- Set a 100% dividend payout ratio
- Announce a MTBP

Click [here](#) for full text  
(Japanese only)





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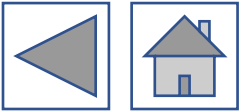
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# Revisions





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