

Activist Fund Calls on Japan Inc. for Transparent Capital Costs
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(Bloomberg) — Activist Tsuyoshi Maruki is pushing Japanese companies to be more transparent about how they account for capital costs, saying a lack of clarity can lead to share price undervaluation.

Maruki's Strategic Capital Inc. has asked Kyokuto Boeki Kaisha Ltd., a trading company that sells industrial equipment, to disclose its weighted average cost of capital and how it's calculated. Strategic is the largest shareholder in the 10 billion yen (\$89 million) market cap company, with a 16.2 percent stake. Maruki said the fund plans to make similar recommendations later this week to three more Japanese companies, though he declined to say which ones.

"I feel that the perception of the cost of capital is different among investors and company management," Maruki said in an interview. "They can improve shareholders' value when they can discuss how to make investments that outperform the cost of capital and do business based on a common understanding," Strategic's chief executive officer and founder said.

Along with former partner Yoshiaki Murakami, Maruki is considered a pioneer in Japan's battle for shareholder rights. His \$96 million long-only Japan Up Unit Trust rose 19 percent in the first quarter, according to Strategic's data, beating a 6.5 percent gain in the Topix. The fund focuses on Japanese small caps and counts Kyokuto Boeki among its largest holdings, along with Tosho Printing Co., Keihanshin Building Co., Asanuma Corp. and Seikitokyu Kogyo Co.

Activist investors have marked some recent success in Japan, effecting management and board changes at Olympus Corp. and Lixil Group Corp. Company officials are being held more accountable following Japan's introduction of a corporate governance code, which mandates among other things that

management present targets for profitability and capital efficiency after “accurately identifying their cost of capital.” Cost of capital is a gauge of the cost of debt and equity used to finance a company’s business. For investors it’s a measure of their expected return on investment. According to surveys conducted by the Life Insurance Association of Japan, about 55 percent of companies see their return on equity as above their cost of capital, while 42 percent of investors view ROE as below cost of capital. Maruki said the main concern is that a lot of companies have “poor estimates” of their cost of equity.

Kyokuto Boeki’s ROE of 5.2 percent is “far lower” than its cost of equity at 8 percent, Strategic said in a statement Monday. The fund said this has resulted in an “extreme low valuation” for the stock, which is trading at about 0.4 times book value versus 1.2 times for the Topix index according to Bloomberg data. Maruki is also calling on the company to sell cross-shareholdings and increase its payout ratio to 100 percent from under 30 percent.

Clear estimates may help investors more appropriately value Japanese companies. “The bottom line is they aren’t effectively using the assets they own,” the fund manager said.

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