

PROPRIETARY

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# Keihanshin will become 'next Unizo' if it does not sell property assets, says Strategic Capital

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- Should focus on managing, not owning property, activist says
- Strategic Capital calculates fair value 55% above share price
- Hostile bid cannot be ruled out, says Nomura analyst

Tsuyoshi Maruki, CEO of **Strategic Capital**, which has launched an activist campaign against **Keihanshin Building** [TYO:8818], believes the property leasing company will become subject to a hostile offer as happened to peer **Unizo Holdings** [TYO:3258] unless it takes actions to generate shareholder value.

The activist, which has become Keihanshin's second largest shareholder with 5.6% voting rights as of the 31 March 2020 record date, has sent letters to other investors to solicit their support for a series of proposals that it says will create shareholder value. These proposals, which are to be voted on at Keihanshin's 16 June AGM, require the company to sell its real estate assets to an entity that will buy them at a fair value of at least JPY 198.5bn or to turn itself into an unlisted REIT.

After it sells these unnecessary assets, it should return capital to shareholders via a special dividend, and focus on being a property or REIT manager rather than an owner of property buildings, the activist has said in its proposal.

"Otherwise, the Osaka-based property leasing company will become a target of hostile bids just like real estate leasing and business hotel operator Unizo Holdings," Maruki told this news service.

Strategic Capital has created a special website to enhance dialogue with shareholders as well as to add pressure on the management.

"Just like Unizo, the valuation of Keihanshin is extremely low. This is because its large unrealized gains on the leasing properties are not reflected in the current shareholder value," Maruki said. Keihanshin must consider seriously to withdraw from its less profitable leasing business to improve its low profit margin, he said.

Until Unizo became a target of hostile bids last year, the valuation of Unizo and Keihanshin Building were the cheapest and second cheapest, respectively, in the real-estate sector, said Maruki.

Following a series of hostile bids and activist attention, Unizo is set to be delisted this month at a share price 200% above its undisturbed level in mid-2019.

Shares in Keihanshin closed today at JPY 1,491. The stock is up around 50% on a 12-month basis.

According to the company's website, Keihanshin operates the leasing business of four types of its own buildings: Datacenter buildings, office buildings, WINS buildings (off-track betting parlors), as well as commercial buildings and logistics warehouses, which are mostly located in Osaka and its nearby southern-central Kinki region.

In Keihanshin's fact book for the year ended 31 March 2020, the value of unrealized gains on its rental properties totaled JPY 72.6bn (USD 667m) – the difference between the market value of its leasing property assets worth JPY 167.3bn and its book value of JPY 94.8bn.

### **Fair value is at least JPY 2,304 p/s**

According to Strategic Capital's calculations, the company's market value, which it evaluated using the net assets per share for the year ended 31 March 2020 (JPY 1,237) plus unrealized gains per share after tax for its rental properties (JPY 1,067.9), should be JPY 2,304.4, which is 55% higher than Wednesday's closing price of JPY 1,491.

Moreover, Keihanshin said in the fact book the market value of its rental properties for the year ended March 2020 is JPY 167.3bn. However, Strategic Capital believes the fair value of its rental properties to be JPY 198.5bn if those in the pipeline are taken into account.

For the year ended 31 March 2020, 45.5% of Keihanshin's revenues came from the leasing of its datacenter buildings, 23.5% from renting its business buildings, 23.2% from its WINS building leases, 7.1% from the commercial and logistics building leases and the remainder from other leasing businesses, according to its disclosure.

"[The] Datacenter buildings [as well as WINS buildings] could be an attractive asset class in the REIT market because an increasing number of people have started working from home due to COVID-19 while demand for office buildings could decline," said a Tokyo-based fund manager specialized in the REIT sector.

Daisuke Fukushima, analyst at Nomura, said the share price of Keihanshin had been kept at a low level in the past few years because the company has not been well understood. "Recently, however, the company is undergoing a re-evaluation. Now it looks like the valuation is approaching what the activist has been saying," Fukushima told this news service.

Asked whether the company could become a target of hostile bids, Fukushima said: "I think it is possible."

### **'Undisciplined' corporate governance**

Strategic Capital states in its proposal that the root cause of the company's low profitability is undisciplined corporate governance.

According to Keihanshin's disclosure, the majority of the board of directors and the audit as well as supervisory board of Keihanshin are occupied by former **Sumitomo Bank** associates. **Sumitomo Mitsui Banking Corp** (SMBC) currently has a 4% stake in the company.

"This is just like the situation at Unizo where the majority of the board members are composed of former **IBJ** (now **Mizuho Bank**) associates. These board members associated with SMBC have been treating the company as if it's their own," Maruki said.

In order to promote measures aimed at enhancing shareholder value, Strategic Capital has nominated its representative – Tsuyoshi Maruki – as a candidate for an outside director in the board for the first time.

Another area of concern, according to the activist, is Keihanshin's high-ratio of cross-shareholdings, accounting for about 23.9% of the company's equity capital. As of March 2019, the property company holds approximately JPY 15bn of cross-shareholdings, including **Daikin Industries** [TYO:6367] and **Sansei Technologies** [TYO:6357].

While the company argues the cross-shareholdings are aimed at facilitating each other's business activities, Strategic Capital does not believe this scenario. "In fact, there is a high possibility that former Sumitomo Bank associates are trying to preserve their own position as a director in exchange for unconditionally supporting the management of the issuing companies of cross-share," the activist has said on its website.

### Keihanshin refutes governance criticisms

In a rebuttal statement released on 14 May, Keihanshin rejected all of Strategic Capital's proposals. The company argued that the activist appears to be mainly focused on short-term shareholder gains, which is not in line with the company's medium - and long-term corporate value enhancement aims. The statement said it plans to seek ways to improve shareholder returns by continuing to focus on the property leasing business.

Speaking today, a spokesperson at Keihanshin said the company's corporate governance is set for improvement if its four independent director candidates are elected in the upcoming AGM. This will raise the number of independent directors by one and they will constitute the majority of its seven board members.

"The objective of these changes is to improve corporate governance. As it happens, the change is also in line with Strategic Capital's proposal," said the spokesperson.

Strategic Capital is under a discretionary investment contract with Intertrust Trustees (Cayman) Limited solely in its capacity as trustee of **Japan-Up**. As of today, the fund and Strategic Capital hold a combined 7.33% of voting rights of Keihanshin and together constitute the company's second largest shareholder after 11.93% stake holder **Ginsen**, a real estate consulting company affiliated with SMBC.

This is the first time Strategic Capital has submitted a proposal to Keihanshin's AGM, although the activist has been engaged in communications with the company and has put forth a number of proposals since it first invested in 2017, according to the activist.

by Norie Hata in Tokyo

Grade: Confirmed

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Value (GBP m): 583.5525

market cap of Keihanshin Building

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## TARGETS

**Keihanshin Building Co., Ltd.**

## VENDORS

**Strategic Capital Inc**

Japan

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Financial Services

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**Topics:** Major Asset Disposals, Mergers and Acquisitions, Pre-Event, Shareholder Activism

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**Intelligence ID:** prime-3047204

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