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Strategic Capital: Target problem companies, once changes are made, pay-off is enormous – CEO

19 Jun 2017, 19:43 CST
Proprietary

- Companies that only listen to parents should become full subsidiaries
- Key is how many shareholders other than parents support activist proposals
- Impact will be great if activists get more support from shareholders

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Tsuyoshi Maruki, CEO of Tokyo-based activist **Strategic Capital**, is hoping that the revised Stewardship Code together with the move by big investors to publish their voting records effective this summer may increase the support rate for activist proposals and put pressure on senior management to pay closer attention to such proposals.

"It will add pressure on management if shareholder proposals get increased support from mainstream investors even if they are rejected by management. [If this happens] company proposals will gradually become in line with shareholders' requests," said Maruki.

Strategic Capital reaped an annual return of 8% from its investment last year, while TOPIX fell 1.85%. This performance was thanks to its strategy of agitating changes in companies that have been discounted because of governance concerns, said Maruki.

Strategic Capital, which generated 12.87% in annualized net return between 2014 and 2016, has also been featured in the league tables of top performing funds in the 2017 Preqin Global Hedge Fund Report.

Strategic Capital's strategy is to buy into companies it considers to have been heavily discounted because of governance concerns, and actively engage with the companies to improve issues that cause stagnant share prices.

This year, Strategic Capital has submitted proposals at the annual general meetings of **Tosho Printing** [TYO: 7913], **Chori** [TYO: 8014], **Shin Nippon Air Technologies** [TYO: 1952] and **Teikoku Electric Mfg**. [TYO: 6333].

All of these companies have ample cash and no debt but governance issues, such as the presence of significant controlling shareholders and shareholders with strong business ties as cross-shareholdings.

Asked why Strategic Capital picks such difficult companies, Maruki said: "The share prices of difficult companies are extremely low. It is hard to make changes at these companies, but once changes are made, we will get enormous pay-offs."

"If senior management will listen to only its parent company, not the voice of minority shareholders, then, I always urge them to become a 100% subsidiary of the parent," he added.

Last year, Tosho Printing sold half of its **Recruit Holdings** [TYO: 6098] stock worth JPY 12.1bn (USD 109m) in response to Strategic Capital's proposal to unwind the printing company's cross-shareholdings.

"This is one small progress we have made. Yet, the other half still remains unsold. We have been urging them to come up with its medium-term business plan," said Maruki.

All of sudden, however, Tosho Printing announced a plan to invest JPY 30bn without specifying any details of the plan. Maruki said this is way too much for a company with market capitalization of JPY 43.8bn and annual sales of JPY 53.8bn. And they said its target ROE after three years is a meagre 1.7%, according to Maruki.

"I find this ridiculous. For someone who has never invested with this scale before, it is too risky," said Maruki.

At the Tosho Printing AGM scheduled for 29 June, Strategic Capital with a 5.57% stake under the name **Japan-UP** has submitted a proposal to increase the per share dividend for the year ending March 2018 to JPY 120 (about JPY 10.3bn in total) from JPY 4.0 a year earlier.

Suggest Tosho to become 100% unit of Toppan

Toppan Printing [TYO: 7911] has a 51% stake in Tosho Printing. "There is no way we would win this if Toppan votes against our proposal. But again, our focus is how the rest of shareholders other than Toppan thinks about this proposal," said Maruki.

"If Tosho Printing says it likes to listen to only Toppan, I have told Tosho Printing's senior management to become a 100% subsidiary of Toppan," Maruki added. "Nevertheless, the situation is changing gradually."

A spokesperson at Tosho Printing said in its medium-term plan, JPY 10bn of the JPY 30bn will be invested in business restructuring and JPY 20bn will go to the expansion of cultural and educational businesses.

At Chori's AGM held on Thursday (15 June), Strategic Capital, with a 3.98% stake held under Japan-UP, proposed the textile company to revise its articles to transfer decision-making authority on cross-shareholding and dividend policies from the board to the shareholders' meeting.

The activist also proposed Chori to raise its payout ratio to 100% from the current 20% and its dividend for the year ending March 2018 to JPY 173 from JPY 40 a year earlier.

"Again, it is difficult because of the presence of **Toray Industries** [TYO: 302] with a 51.25% stake. Maruki, however, is hoping that if his proposals gradually gain more support from institutional investors, Toray's mind set may change gradually.

After the activist's pressure, Chori announced in April its decision to increase its payout ratio to more than 25% between 2017 and March ending 2020 from the current 20%.

At **Shin Nippon Air Technologies'** [TYO: 1952] AGM scheduled for 23 June, Strategic Capital with a 5.47% stake in the name of Japan-UP has made its proposal to amend the articles to immediately sell all the listed shares it holds for reasons other than investment purposes, along with a proposal to raise its dividend to JPY 79 per share from the current JPY 40.

The air conditioning facility company currently holds 63 companies as "cross-shareholdings" worth JPY 18.4bn in order to strengthen business relationships. If the company sells these shares, it would improve its ROE, which is about 5.47% now, the proposal said.

"They say the holding of these client company shares would increase its business ties with them. But I don't understand why holding these shares would lead to more business," said Maruki.

"Becoming a "royal" shareholder means that Shin Nippon Air has to take the side of these companies' management when they have a rainy day or protect their board members."

"These cross-shareholdings are worth JPY 18.4bn accounting for as much as 80% of Shin Nippon Air's market capitalization. Should the company's important assets be used for such silly objectives?" Maruki asked.

It would be difficult to get enough "yes" votes for Japan-UP's proposals because these cross-shareholding companies would vote against the activist proposals, he said.

As for its cross-shareholdings, a spokesperson at Shin Nippon Air said the company is currently considering selling three or four stocks that would not contribute to business expansion and synergy effects.

"We may not be able to settle this issue at the AGM, but I am optimistic the company will gradually change," said Maruki.

Last year, **JDL Technical** launched a tender offer to acquire **Japan Digital Laboratory** (JDL) in a management buyout (MBO). JDL became a showcase for Strategic Capital's confrontational approach to activism thanks to four years of agitation for strategic changes at the accounting software developer.

By Norie Hata in Tokyo