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Reveille in Japan

Convenience stores are no less convenient in Japan than they are in America, but the owner of the iconic 7-Eleven chain, Tokyo-headquartered Seven & I Holdings Co. Ltd., commands only half the enterprise-value-to-Ebitda multiple of Casey's General Stores, Inc., an Ankeny, Iowa–based comp. Last week, ValueAct Capital called on Seven & I to spin out 7-Eleven to close that gap.

Activism is on the rise in the formerly snug and sleepy Japanese stock market. We write to reiterate our bullishness on a pair of strategies to capitalize on this opportunity, including the Nippon Active Value Fund plc (NAVF on the London Stock Exchange) and the Horizon Kinetics Special Opportunity Strategy, a private partnership. "You have the beginning of something that really hasn't existed heretofore, and that is a market for corporate control in the Japanese context," Gifford Combs, a member of the Nippon Active Value Fund's investment adviser, tells colleague Evan Lorenz.

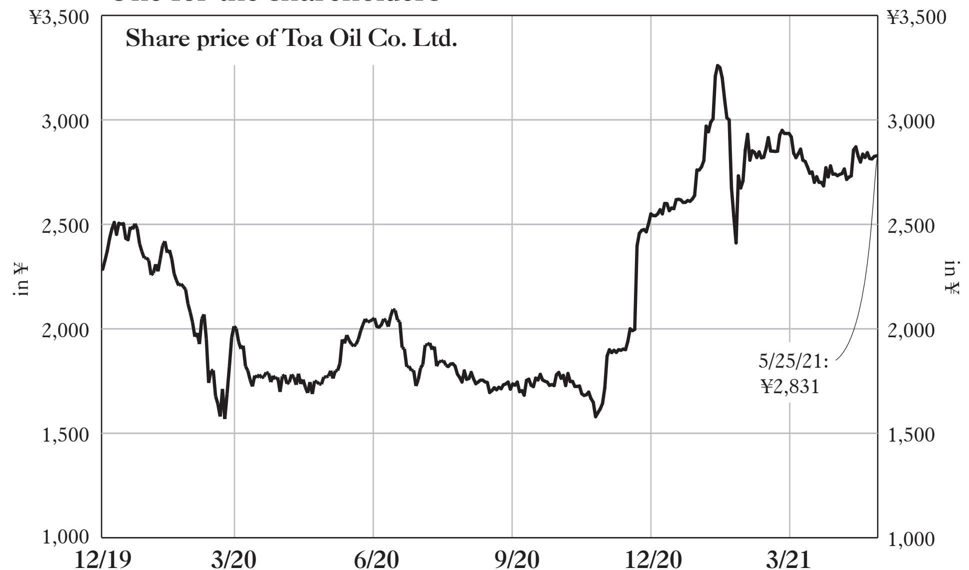
Lending timeliness to the story is the imminent reclassification of stocks on the Tokyo Stock Exchange by the novel test of shareholder friendliness (*Grant's*, Jan. 22). Come up short, and your company faces demotion. Say, for instance, that on judgment day a first-section TSE company fails to show a free float in excess of ¥10 billion ($92 million). It would be bye-bye to the first section—the portal to a coveted Topix listing—and hello to the new "standard" or "growth" sections.

The exchange will issue preliminary results of the reclassification in June. Companies that miss the cut will have until year end to comply, for example, by some combination of boosting dividends, unwinding cross-holdings or repurchasing shares.

Paul ffolkes Davis, chairman of the investment adviser of the Nippon Active Value Fund, marvels at the progress he's seen since the fund's February 2020 launch. "Intellectually it is startling," he says. "Every time we ask for a meeting, they say yes. Every time we have a meeting, they listen to what we have to say rather than just nod politely and go away. That has changed a lot in the past year."

More to the point, Davis adds, companies are actually doing something. Three of NAVF's portfolio companies have boosted dividends or found other ways to reward shareholders in a bid to boost their respective share prices. Since its Feb. 20, 2020 start, the fund has delivered a 26.7% dollar-denominated total return, despite trading at a 5% discount to net asset value, only slightly below the 28.4% total return produced by the Nikkei 225—and the Nikkei, unlike NAVF, didn't spend the past year getting invested.

Davis's excitement is perhaps not the strain that's communicable to every Japanese corporate management. "Whether they will listen to us is another matter," Tak Yamashita, director of investor relations at the activist and Tokyo-based fund Strategic Capital, Inc., tells Lorenz. "They don't really understand capital market theory, and they don't understand that their duty



is to increase shareholder value. They were ignorant three to four years ago, and they are ignorant today."

Bunka Shutter Co. Ltd. (5930 on Tokyo), a holding of both Strategic and NAVF, is a case that can support either point of view. Besides the louvered steel blinds that shopkeepers pull down behind them at the end of the day, Bunka makes sliding doors, garages and partitions and offers engineering, maintenance and repair services. With cross-shareholdings and cash amounting to 60% of its market cap, Bunka's balance sheet is over-capitalized—at least, as an outside investor might judge.

Last month, Strategic Capital sent four shareholder proposals to Bunka's management: Pay out 100% of earnings to prevent the further buildup of cash on the balance sheet, eliminate the poison pill, calculate and publish its weighted average cost of capital and sell cross-shareholdings. Bunka's response was to declare the proposals moot, inasmuch as the letter that contained them arrived one day after the deadline to submit proposals for the June 22 shareholders' meeting.

But not all was lost. Bunka did announce a buyback of up to 9.1% of shares outstanding and agreed to publish some version of its cost of capital. "We are partially satisfied with the changes in several months," Dan Kato, senior managing director of Strategic, tells Lorenz, "but we see many means to improve their corporate governance, their capital structure, etc."

At 3.9 times enterprise value to Ebitda, Bunka remains commandingly cheap. Sanwa Holdings Corp., a competitor in the shutter business that has adopted some corporate best practices (e.g., publishing and managing its business based on the costs of, and returns on, capital), trades at 6.9 times Ebitda.

Ayako Hirota Weissman, a director of Asia strategy and senior portfolio manager at Horizon Kinetics, LLC, says she's pushing for a different type of corporate change. In Japan, there are 628 public companies, the majority owners of which are other publicly traded companies. The United States, France and Germany each count fewer than 30 such controlled entities. Big Japanese companies enjoyed the prestige that listed subsidiaries brought them, and they valued, as well, the convenience of depositing surplus executives behind the desks where that dead wood could accrue titles and perks but do little harm.

The illiquid shares of these child companies tend to trade at attractive discounts to "like-industry peers," Horizon Kinetics states in an April position paper. "[M]ore often than not, these subsidiaries have significant net cash on the balance sheet. . . . Many of these subsidiaries are the owners of some of their group's key raw or intermediate materials or operating assets, or provide important products and services to the parent companies."

Successive reforms pushed by Shinzo Abe and Yoshihide Suga—requirements for independent directors and the disclosure of related party transactions, not to mention the new pressures emanating from the Tokyo Stock Exchange—have transformed these former ornamental public subsidiaries into costly liabilities. "The circle is shrinking," Weissman says. "We have reached the point where doing nothing is not an option anymore." She cites Toa Oil Co. Ltd., a former position of Horizon Kinetics, as a living example of such change.

Toa is 50.1% controlled by Idemitsu Kosan Co. Ltd. and owns key assets that its refiner parent would like to control. In December, Idemitsu launched a buyout bid at ¥2,450 per share. However, Idemitsu was blocked by minority shareholder Cornwall Capital Management, which amassed a 30.1% stake in Toa and voted the transaction down. While Idemitsu abandoned its takeover in February, Toa is trading at ¥2,831 per share, a premium to the former takeover price.

Until the end of 2020, Weissman says, her fund was largely in cash, but it's a hopeful augury that three of her names have been snapped up by their corporate parents.

"We are doing the government's job," says Davis, alluding to the national goal of restoring Japanese corporate dynamism, "using the tools that the government has given us to do the job."

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