DIVIDEND ACTIVIST

TSUYOSHI MARUKI

IN THE SPARSE WORLD OF JAPANESE ACTIVIST INVESTORS, STRATEGIC CAPITAL STANDS OUT AS ONE OF THE MOST VOCIFEROUS. MOST HOMEGROWN ACTIVISTS TYPICALLY ENGAGE ONLY IN FRIENDLY ACTIVISM BUT STRATEGIC IS NOT ONE OF THEM, WRITES IURI STRUTA.

STRATEGIC CAPITAL	
FOUNDED	**2012**
HQ LOCATION	**TOKYO, JAPAN**
KEY PEOPLE	**TSUYOSHI MARUKI**
FOCUS	**PRIMARY**
AUM	**¥12 BILLION**

The Japanese proxy season is over and Tsuyoshi Maruki is making assessments. His **Strategic Capital** advanced resolutions at four companies – including one that was withdrawn thanks to a takeover – and received average support of around 30%. "Not bad," Maruki quips in an interview with *Activist Insight Monthly*. "The purpose of our proposals is not to win but to press managements."

Maruki operates in an environment that is becoming more open to shareholder activists. This year saw ValueAct Capital Partners gain a board seat at Olympus and a group of activists, including King Street Capital Management, refresh the board of Toshiba, victories that many advisers agree were unthinkable just a few years ago. Another situation at Lixil may have generated fewer headlines but was more important for domestic investors. Former Lixil CEO Kinya Seto's triumph over founding family scion Yoichiro Ushioda was an "epoch-making case," Maruki said.

DOWNSIZING

Maruki founded Strategic in 2012 to agitate for changes at small-cap firms. Before that, he co-founded MAC Active Shareholders Fund with Yoshiaki Murakami, the poster child of shareholder activism in Japan. At its peak, MAC managed 444 billion yen ($4.1 billion), but the fund disbanded after Murakami was sentenced to two years in prison for insider trading in 2007. "It was very exciting and interesting to work with Murakami," Maruki said, adding that they've known each other since junior high school and still maintain contact.

Strategic's assets under management have stubbornly remained at around the current level of 12 billion yen ($110 million), despite what Maruki says has been good performance. Japanese institutional investors still avoid activists due to the social stigma they carry, while he jokes foreigners would be more interested if his fluency in English was better. Maruki lost a core Japanese investor earlier this year following a 22% decline in returns in 2018, which was worse than the Tokyo Stock Price Index (Topix). Another core investor, a U.S. fund of funds, remained invested and was handsomely rewarded. Strategic recovered strongly, gaining 34% compared with Topix's 4% as of the end of June.

SAME SCRIPT

According to *Activist Insight Online*, Strategic has been advancing proposals at Japanese companies every year since 2014. As Maruki prefers to invest in cash-rich small-caps that are undervalued because of unfriendly executives, the resolutions were mostly for higher dividends and changes in corporate governance. "If management is receptive, shares are already appreciated to some extent," Maruki said.

> "THE PURPOSE OF OUR PROPOSALS IS NOT TO WIN BUT TO PRESS MANAGEMENTS."

None of the resolutions were approved by shareholders, but Maruki said they nevertheless had an impact and often prompted managements to act. He noted that Strategic has had 12 profitable exits since inception and 10 of them were the result of shareholder-friendly actions, such as share buybacks and dividends, or M&A taken after its involvement.

"MOST MANAGEMENT TEAMS IN CORPORATE JAPAN ARE NOT BAD, THEY ARE JUST IGNORANT. THEY MAY TRY TO COMPLY WITH THE NEW GUIDELINES."

One such company was Ines Corp., a provider of information network systems to industrial and financial corporations. When Strategic invested, Maruki said the company's stock was trading at a price close to its cash balance. Its board was controlled by Hitachi Solutions, which held 22% of the stock. Strategic proposed a reshuffling of the board, a sale of the head office in Tokyo, and the usual capital return programs. After more than two years of pressure, Ines finally sold its property and announced a share buyback, triggering a bump in the stock price. Strategic sold out after the stock hit its target. Maruki declined to provide details, but public filings show that Strategic first revealed a stake in March 2014 when the stock traded at around 700 yen per share and later submitted a proposal in April of that year. It fully exited in May 2015, when shares changed hands at over 1,000 yen apiece.

'HARDEST' CAMPAIGN

The "hardest" and the longest (five years) campaign was at Japan Digital Laboratory, according to Maruki. Japan Digital, which provides software for small corporate tax accountants, was 40% owned by its founder and president Kazuo Maezawa. Strategic found suspicious payments made by the company to Maezawa's two brothers and went to court when the company refused to hand over the minutes of its board meetings to investigate the matter further.

The activist also called on the firm to sell its airline business, a failed private venture of Maezawa which had been bailed out by the company two decades before in another set of suspicious circumstances. In June 2016, Strategic's proposals for dividends and asset sales were approved by a majority of minority shareholders. "The company wanted to get rid of us because we were uncomfortable for them," Maruki recalled. Eventually, Maezawa launched a take-private bid and Strategic pocketed a 33% internal rate of return (IRR).

BUMPITRAGE

More recently, Maruki was involved in a fight with Tosho Printing, which sells publication and commercial printings. After three years of pushing Tosho to sell its cross-shareholdings and launch dividends and buybacks, the company agreed to be acquired by its parent Toppan Printing. Maruki still thought that offer was low – the proposal was equal to the cash on the balance sheet and valued the firm at just 74% of its book value – but given activists' patchy track record in bumpitrage campaigns in Japan, Maruki thought it was not worth the time and money to mount opposition.

There is hope new amendments to the takeover guidelines recently adopted by Japan's Ministry of Economy, Trade, and Industry (METI) will change managements' behavior in relation to parent-subsidiary takeovers, although they have also faced criticism for being undemanding and non-binding.

The new rules represent a test for Japanese corporations on whether they are willing to relinquish some of their authority to minority shareholders and allow them to select independent directors. Maruki himself submitted opinions to METI, although most of them were not adopted. Among others, he proposed the introduction of the go-shop period, an almost inexistent concept in Japan, and independent directors on special committees that review deals. Although only the latter was partially adopted, Maruki is confident. "Most management teams in corporate Japan are not bad, they are just ignorant. They may try to comply with the new guidelines."

STRATEGIC CAPITAL'S RECENTLY EXITED INVESTMENTS

COMPANY	EXIT YEAR	IRR
TOSHO PRINTING	2019	16.5%
SHIN-NIPPON AIR TECHNOLOGY	2018	27.5%
UCHIDA YOKO	2018	43.5%
NITTOC CONSTRUCTION	2017	41.8%
TEIKOKU ELECTRIC	2017	37.3%
TAKARA PRINTING	2016	60.6%
JAPAN DIGITAL LABORATORY	2016	32.6%
INES CORP.	2015	26.5%
W-SCOPE	2015	52.6%
ZERO LTD.	2014	155.9%

SOURCE: STRATEGIC CAPITAL