JAPANESE EQUITIES | 22 MAY, 2023

James Carthew: Activists in Japan make the future

Activist investing is a rational response to Japan's market conditions. Abrdn Japan did the right thing by waving the white flag and proposing a merger with Nippon Active Value.

BY **JAMES CARTHEW**

Last week's big surprise was the announcement of a proposed merger between **Abrdn Japan** (AJIT) and **Nippon Active Value** (NAVF). This is by no means a done deal, shareholders of both trusts will need to approve the proposal, and I think that the 25% cash exit opportunity that is included as part of the deal may prove insufficient. However, overall, it seems like a sensible solution to me.

The news came on the same day as **Abrdn Latin American Income** (ALAI) announced details of its planned liquidation. It also follows the bids for **Industrials Reit** (MLI) and **Civitas Social Housing** (CSH) that my colleague Richard Williams discussed last week.

The proactive nature of this move may encourage those who believe that boards are taking their governance responsibilities more seriously. However, it may also reflect the lack of brokers' opportunities to profit from share issuance. A £30m IPO for **Ashoka Whiteoak Emerging Markets** (AWEM) and news of an £80m fundraise for **Gresham House Energy Storage** (GRID) are not going to make much of a dent in the brokers' revenue deficit relative to the bumper markets of 2021, while M&A fees can be quite lucrative.

The obvious attraction of NAVF, as cited in the statement, is the superior track record that it and **AVI Japan Opportunity** (AJOT) have established relative to competing Japanese funds in recent years.

In the face of a sclerotic economy, Japanese fund managers have tended to focus on growth stocks, which at least offer the chance of earnings growth from the cannibalisation of incumbent businesses. There are several disruptive companies to choose from and fund managers such as Praveen Kumar of **Baillie Gifford Shin Nippon** (BGS) or Nicholas Weindling and Miyako Urabe at **JPMorgan Japanese** (JFJ) did a great job of profiting from these.

However, the growth selloff that accompanied the US and European interest rate hikes last year hit Japan too, despite the country's rates remaining low. As growth stocks sold off, the relative attractions of the more corporate governance-focused stocks became more apparent.

The pool of listed Japanese companies is a deep one, with about 4,000 stocks to choose from. Most have no analyst coverage and are not investor friendly. That has created a fertile environment for some pronounced value opportunities to emerge. Even though there are more activist investors sifting through these than there were, some of the bargains that AJOT and NAVF have identified seem almost too good to be true.

Take, for example, **NC Holdings**, one of the companies that AJOT is targeting in this year's round of shareholder proposals. Almost all companies have their AGMs around the same time of year, so these tend to get bunched together.

NC Holdings makes conveyor belts and much of its business is related to coal production and consumption. New orders are dwindling, but its conveyors also have other uses in mining and steel mills, for example, and there is an associated spares and repairs business. It has divisions that make multi-level car parking equipment, and in solar power generation where it intends to build on its engineering and maintenance activities.

Recently, the company's profitability has been impacted by raw material cost increases. However, fund manager AVI's main concerns are about the lack of a medium-to-long-term vision for the company and what will happen to the company's cash pile. Cash and equivalents on NC Holding's balance sheet equate to about 70% of its market value.

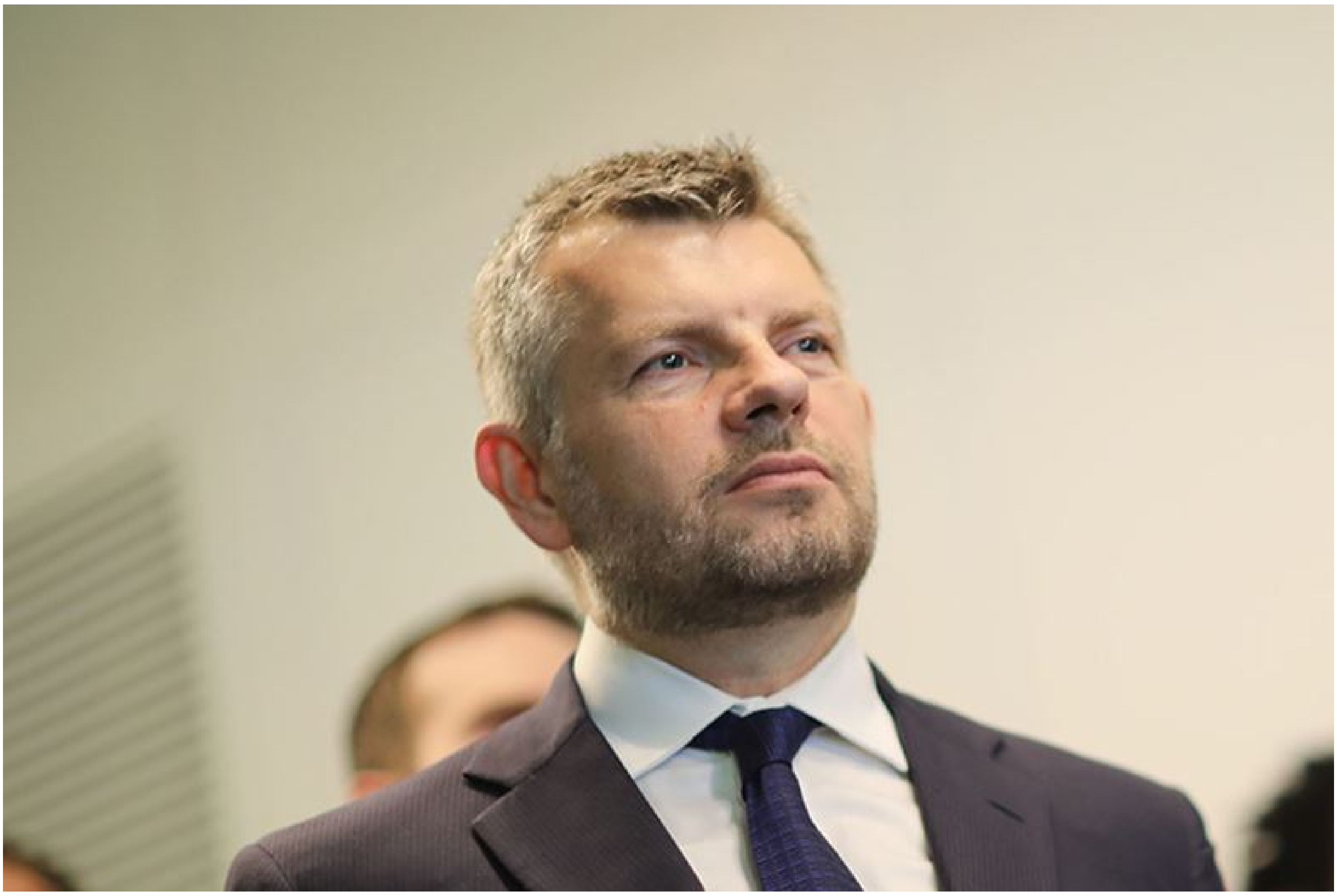
AVI has put up two new directors for election to the NC Holdings board. It is seeking to establish a strategic review committee to inject a sense of urgency into a rethink of the way forward. It wants to introduce a stock compensation plan for directors to incentivise them to introduce measures to improve the share price (a proposal you might think the board would welcome with open arms), and it wants a significant increase in the dividend payout ratio as a way of returning surplus cash to shareholders.

Funds managed by AVI own more than 20% of NC Holdings and so it should have some clout, but directors can be intransigent even in the face of quite sensible suggestions. My experience of activism in the investment companies' market was that 'not invented here' can often be a driving factor for rejecting proposals.

In these situations, AJOT and NAVF must often be patient, but the rewards for success – which often flow through to all stakeholders – can be significant. Hence returns tend to be lumpy and the relative success of AJOT and NAVF will tend to reflect how many of their proposals end up being adopted by investee companies each year.

An expanded NAVF will have a little more firepower to **drive its agenda** home. AJOT was, until very recently, expanding too, through regular issuance of its shares, and as the board was quick to step in and buy back stock when a small discount opened up in April, it trades at a small premium to asset value. I expect to see both closed-end funds thrive, even when the more growth-focused funds pick up again. The beauty of activist funds is that they are not so reliant on buoyant markets to drive growth in net asset value. AJIT's board made the right decision.

*James Carthew is head of research at **QuotedData**.*



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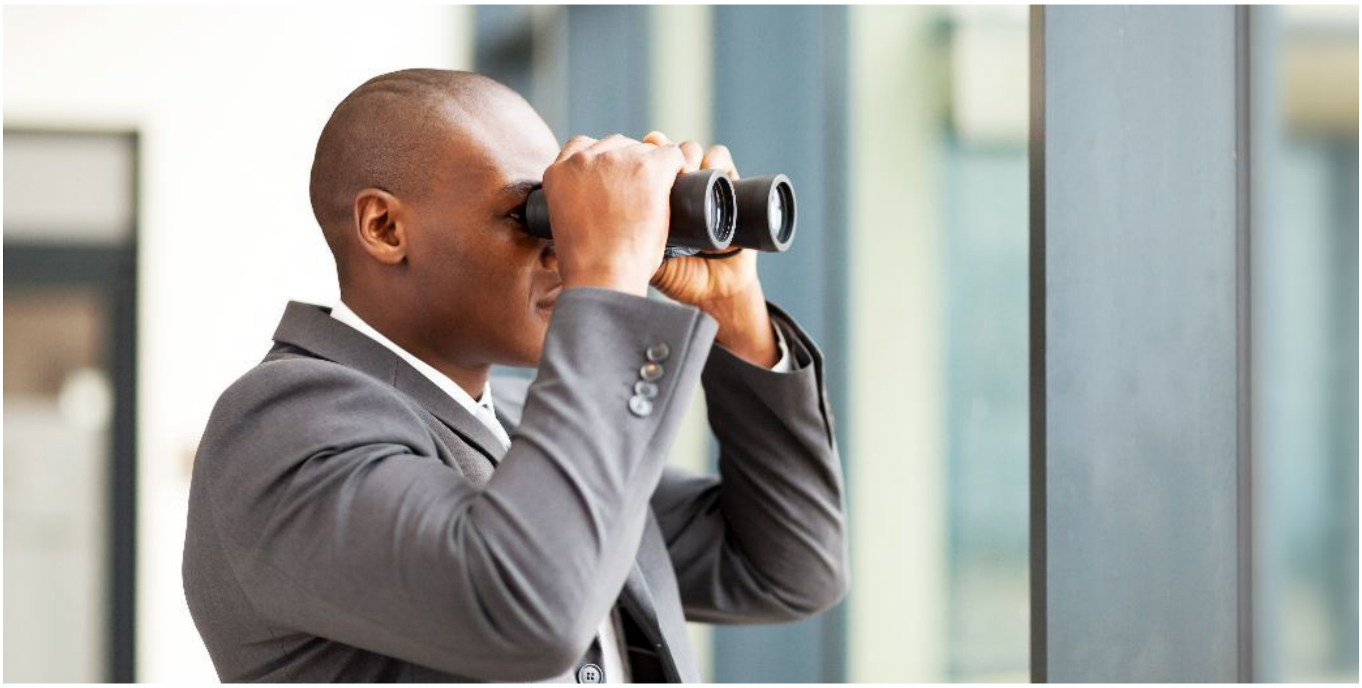

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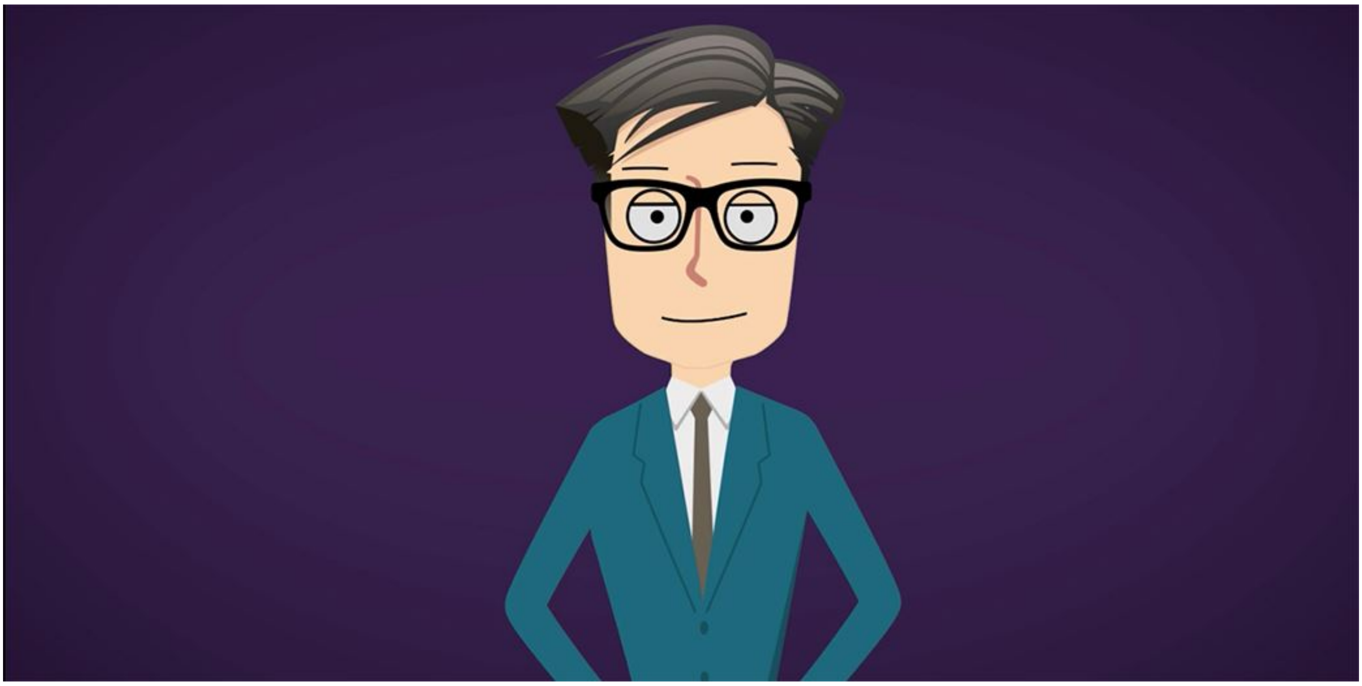

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