ACTIVIST INVESTING IN ASIA

Activist Insight

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Japan Constructivism
Misaki Capital Inc.

CONTENTS

Activist Investing in Asia

WITH SPECIAL THANKS TO:

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FOREWORDS

Josh Black, editor-in-chief at Activist Insight.

Activism in Asia is a topic that has caught the imagination largely through the endeavors of large U.S. activists – notably Third Point Partners at Sony. Yet as this special report makes clear, there is a lot more to the region than that prism suggests.

As the first publisher to provide such a detailed survey of activism across Asia, we think these findings are groundbreaking. Between 2013 and the end of June 2017, more than 200 companies were publicly targeted by activists across the region. Moreover, activity has accelerated. Already at the end of the second quarter this year, almost as many companies have been targeted as in the whole of 2014.

A few themes from this report, which has been authored by my colleague, Paolo Frediani, stand out. First is the role of governments – where these have led by promoting stewardship and good corporate governance, activists have followed. Second is the role of domestic players, who are growing in number and profile. Third is the success rate of activists, which at 40% across the region is significantly lower than the 56% observed in the U.S. A continued increase in activism across the region is likely dependent on these three themes continuing to converge with western markets.

I would like to extend our thanks to our two sponsors, Computershare and Misaki Capital, for making this report possible, and my colleagues at Activist Insight for their hard work in bringing it to fruition. It builds on the success of our special reports on Europe and M&A activism, and *Activist Insight Monthly* magazine. Next year we plan to explore even more topics. If you would like to be involved, please do get in touch. ■

Paolo Frediani, author of the report.

Speaking with activists operating in Asia, the general feeling is of a continent marching slowly but steadily toward an era of shareholder engagement.

Obviously, they are biased. They are the ones investing in the region and testing the limits of what a shareholder can do. Some activists, both Asia-based and foreign, try to play by local rules, seeking issuers that are willing to engage and negotiating behind the scenes. Some try to import a North American style, and are ready to disparage managers in public, go to court, and launch proxy contests. It may not have worked in the past, but they believe there is always a first time for everything.

The number of companies targeted, their size and prestige, and the results that activists have been able to achieve, have all increased in recent years. If the past could predict the future, we could certainly say that activists' confidence is well placed.

At the very least, the recent surge in shareholder engagement offers a warning to investors, issuers, and advisers operating in Asia: be prepared. ■

ACTIVISM IN ASIA: AN OVERVIEW

Activism in Asia has boomed in recent years, with companies in several countries increasingly forced to come to terms with pressure from investors. In the first half of 2017, 38 companies faced public demands by activist shareholders in the region, almost twice as many as in the same periods of 2013 and 2014. This follows record levels set in 2016, when 78 were targeted. Despite a widespread tendency among issuers to resist the change, they are increasingly forced to cave in and listen to shareholders.

With the region's stock markets recovering in the first half of 2017, the number of targets fell to 2015 levels, and the number of foreign activist funds launching new public campaigns dropped even further. Yet activism is far from losing momentum. New funds are being launched and investors are becoming more daring in pushing the boundaries of what can be demanded of boards and managers.

Statistics are likely to underestimate the activity in Asia as local cultures and disclosure requirements for shareholders are completely different from the U.S., where two-thirds of the companies facing public demands in the first half of 2017 were located, and where investors with stakes larger than 5% that intend to put pressure on boards or management must disclose their plans in a regulatory filing.

No such requirement is common in Asia, and institutional investors' aversion to public spats ensures that most activism happens through behind-the-scenes negotiations, which elude the statistics. In fact, more than half of the shareholder demands at Asian companies tracked by *Activist Insight Online* in the first six months of 2017 were for changes to the composition or the organization of issuers' boards. But speaking with investors operating in the region, it is evident that, in most Asian countries, demands for board changes are rare, and only used in extreme cases by the most daring activists.

More common are demands concerning capital allocation, as issuers tend to be conservatively managed, hoard cash, and are not comfortable dismissing underperforming legacy businesses. Poor investor relations, missed strategic opportunities, and opposition to lowball takeover bids are also frequent ingredients of Asian activism.

The increasing presence of foreign institutional investors in the region, combined with the influence of family offices of Asian businessmen willing to listen to activists invested in their portfolio companies is helping the surge. Several governments and regulators are also driving the change by promoting governance improvements and shareholder engagement, often through the introduction of stewardship codes modeled on the 2010 U.K. code.

Japan, where Prime Minister Shinzō Abe has been trying to use shareholder participation as a tool to revitalize the economy, has led the way and is now the busiest country in the region, with 17 companies facing public demands in the first half of 2017. Activity in South Korea is much less, but the country may be on the verge of radical change, with a new government elected earlier this year and advocates of shareholder activism appointed in key positions. After three years of agitation, Elliott Management broke new ground earlier this year, pushing Samsung Electronics, the flagship electronics company of the powerful South Korean conglomerate, to cancel treasury stock worth around $35 billion. The downfall of the country's former president over corruption allegations linked to Samsung has hastened pressure for corporate reform.

"Several governments and regulators are also driving the change by promoting governance improvements."

Pressure from politicians and regulators is also helping activism take its first steps in India, where shareholders are becoming more vocal and investment firm Unifi Capital recently tried to elect a dissident director at Mumbai-listed holding company Alembic.

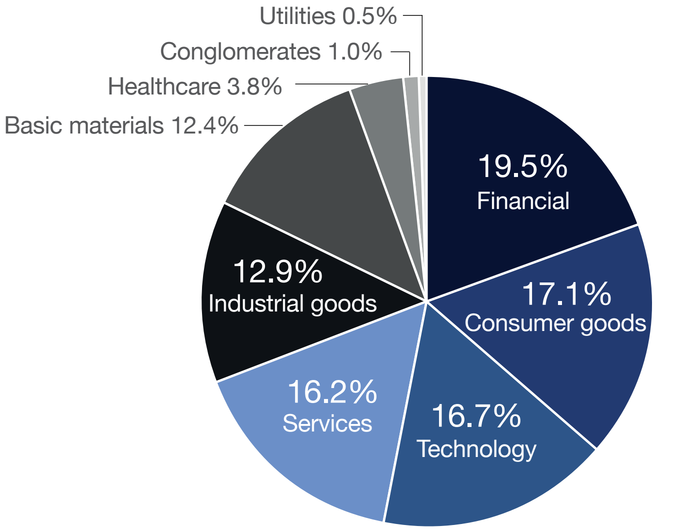
In Singapore, three activists won proxy contests in the first half of 2017, another was defeated, and in July another company faced a requisition from shareholders to vote on board changes, a cultural shift that has made the city-state's issuers vulnerable to activism.

Mainland China is also not seeing the introduction of specific policies to favor activism, but the country's economic growth, the increasing presence of foreign institutional investors, widespread overseas listings, and a natural tendency by local investors to make their voices heard are creating opportunities for activists. The theatre of most Chinese activist battles, however, is Hong Kong rather than the mainland. The former British protectorate has extremely friendly shareholder regulations, and although its corporate law can be tricky, board battles are frequent.

Malaysia is also a country to watch very closely. Since 2013, 19 issuers have faced public demands, and manufacturer Ire-Tex was subjected to a proxy contest earlier this year.

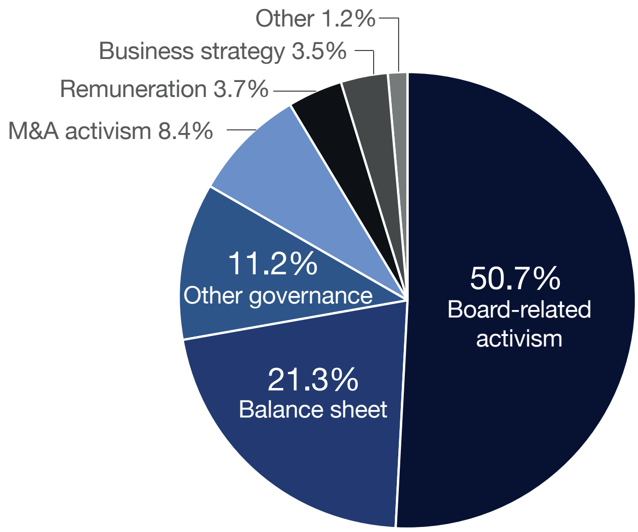
Asia has come a long way in just a few short years. From being synonymous with short sellers hunting frauds, investors are now keenly interested in professionalizing the region's growing corporations. Short sellers continue to prowl, recently setting a record for the number of Hong Kong-based companies they have targeted in the first six months of a year. Yet the emergence of activists has given these markets a balance that should endure as they become increasingly open to investors. ■

Sector breakdown of public activist targets



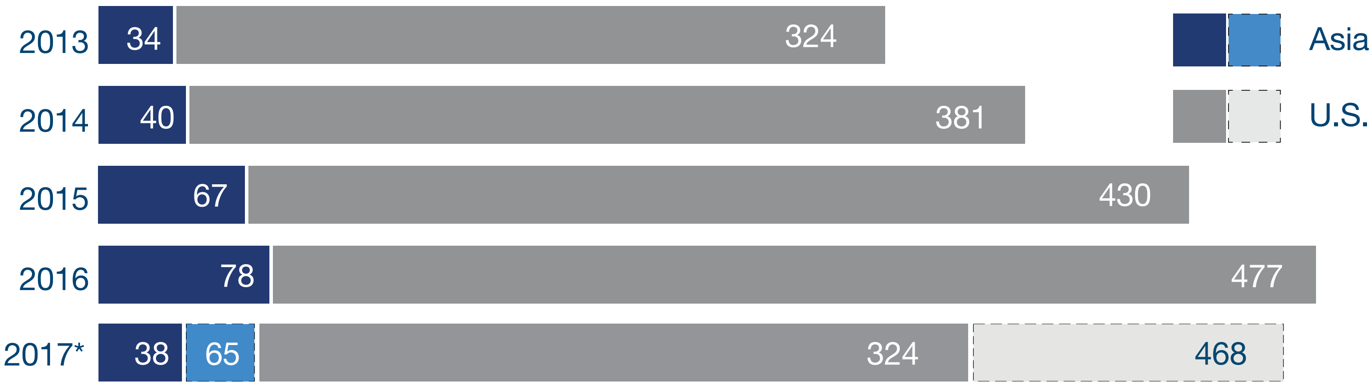
Sector breakdown of all Asia-based companies publicly subjected to activist demands since 2013. Percentages given to one decimal place and may cause rounding errors.

Breakdown of public activist demands



Demand-type breakdown of all public activist demands made at Asia-based companies since 2013.

Companies facing public activist demands



Number of Asia- and U.S.-based companies publicly subjected to activist demands by year.
*2017 figures as of June 30. Projected full-year figures for respective regions shown in dotted box.

JAPANESE CONSTRUCTIVISM

An interview with Masaki Gotoh, chief investment officer at Misaki Capital.

How do you describe your investment philosophy?

We invest in companies with strong businesses and management teams and attempt to add value by engaging with management to increase the intrinsic value of the business. Strong business means a business with a sustainable competitive advantage while strong management team refers to senior management who are 'Hungry for change,' 'Open to outside opinion,' and have a 'Public mindset' or "HOP."

Our engagement has two value drivers: the first (and common among most of our peers) is to address the reason for price discount to intrinsic value such as suboptimal capital allocation, or issues with companies' balance sheets, communication, or governance issues. The second (and more unique to our team) is to increase the intrinsic value by helping increase free cash flows, focusing on the income statement and the cash flow statement. This value driver is possible to due to our engagement team, which is made up of ex-management consultants who have decades' worth of experience with such projects.

The other unique characteristic of our organization is that its strategic partners are made up of established corporations and individuals from Japanese business and society. This helps not only in advancing the depth and speed of engagement, but also adds legitimacy to the eyes of our investee companies which we believe is vital to our method of engagement.

What are the most common forms of discount in Japan at the moment?

It is frequently noted that Japanese companies suffer from suboptimal balance sheets, which contribute to low returns on investment (represented by return on shareholders' equity, or ROE). This is indeed true and why cash-rich companies are often targeted. However, this discount has shrunk rapidly since the Abe reforms began which, among other things, focused on Japan's low corporate ROE. Since then, companies have begun to address their high cash hoards (albeit slowly) and have incorporated ROE targets in their mid-term plans, which was unusual prior to Abe-san.

However, our view is that the low ROE is driven less by the balance sheet, and more by the income statement. Our analysis shows that the reason for Japanese companies' low ROE is less about its lack of leverage but more due to its low margins. And this is not due to its high corporate tax rate and is just as pronounced on an operating level. Therefore, our second value driver attempts to address the low margins in Japan.

One commonly mentioned feature of investing in Japan is the local culture – how does this affect activism?

While Japan has clearly become much more open to activism than in the past, we believe all forms of activism, hostile or cooperative, must be sensitive to local cultures. This is likely why leading activists often focus on a particular region and we believe this to be true in Japan as well. Not only are the legal and regulatory challenges different by region, there are differences in the required methods of communication, and an appreciation of this is one of the most important traits of a successful activist. Understanding the subtle nuances that any culture has when one communicates and engages with another party is vital to influencing behavior.

This is why our entire team is Japanese, physically located in Japan, largely raised in Japan, and (outside of myself) educated in Japan. And not only do we have the cultural edge needed to successfully communicate, we also have the network within Japanese business, academia, and government to promote a home-grown style of activism. This isn't to say other styles will be unsuccessful. Far from that, many of our global peers have already made significant inroads in successful activism in Japan. We simply believe that a local methodology will be more accepted and thus met with less resistance.

Do you think foreign activists have been successful in Japan? If so, where? If not, why not?

I believe foreign activists have been very successful in recent years, partly due to the societal "acceptance" of activism, unlike the-2000s when activists were branded as corporate raiders. They have also (in my view) become more culturally-aware, slightly softening their hostile stance. They have helped drive change, whether it be communication, returns to shareholders (via dividends or buybacks), or board changes. They are often successful when there are already signs of potential change, prior to their engagement. This is true with our style of engagement as well. It is difficult to move a stationary object and much easier to accelerate a moving one (although incredibly difficult to move in a different direction).

However, there are certain targets in an activist rulebook that are much more difficult to apply in Japan. For example, business divestitures are difficult without assurances of employee retention after divestment. Japanese companies prefer to be the acquirer rather than the acquiree, even if it makes more sense economically. Executive compensation or other personal financial gain is generally not a strong catalyst to drive change in Japan. Forceful board representation is also difficult and often represented negatively by media, even if a change in management is warranted.

How do you assess the Abe government's reforms so far?

I would argue that the success of foreign activism is largely due to Abe-san's reforms and a progressive FSA making activism more accepted.

The Stewardship Code promotes better dialogue between shareholders and management, and the Corporate Governance Code is addressing Japan's weak governance system. External board directors have changed the board meeting agendas from operational issues to broader, strategic discussions, with objective, constructive dialogue. ROE was a foreign concept a few years ago and now virtually every company has an ROE target.

The impact of proxy voting advisors has clearly risen and many companies, particularly the large cap firms, review their policies in great detail.

Individually, these reforms have had little impact but, collectively, they have increased awareness of Japan's weaknesses. With regards to his structural reforms, they have admittedly been slower to implement although the corporate tax rate has fallen and some liberalization of agriculture has succeeded. Structural changes are, by nature, slow to implement even by Japanese standards.

The final piece of the puzzle requires a change in mindset by the Japanese asset owners. It's one thing for foreign activists or niche strategies like ours to fight for better governance, but it must become not just accepted but embraced by the domestic asset owners. While the revised Stewardship Code attempts to address this, there has already been a large shift in strategy by leading asset owners such as the GPIF which we believe will drive change across Japan.

Is activism welcome in Japan yet? Will it ever be?

Clearly, yes. However, if the definition of activism is the U.S. style where shareholders always come first, board changes are frequent, and business divestitures and other M&A activity is prominent, then I believe it is unwelcome and will likely be so for some time. We do not believe that short-term interests of shareholders should come first, and shareholders should be on equal footing with the business, its employees, and its customers to maximize the long-term value of the franchise which will ultimately benefit shareholders. We believe board changes shouldn't be taken lightly and a good mix of internal and external board members is important. We do hope for increased M&A activity as long as it benefits all stakeholders.

Our firm has three values that we abide by: value for investors, value for businesses, and value for society. We believe that activism with Japanese corporations should also abide by these three values. ■

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> "ROE was a foreign concept a few years ago and now virtually every company has an ROE target."

JAPAN AND ABENOMICS

Japan has moved to the forefront of activism in Asia, largely thanks to changes imposed by the government of Prime Minister Shinzō Abe, who has used reforms and moral suasion to favor shareholder engagement. The country is increasingly attracting activists, both domestic and foreign, and 17 issuers faced public demands by shareholders in the first half of 2017, matching the post-2013 record set in the same period of 2016.

In June, shareholders in Kuroda Electric approved a proposal advanced by Reno, an investment firm allegedly linked to Yoshiaki Murakami, a former corporate raider and forefather of Japanese activism, which demanded the appointment of a new independent director. It was only the second time in eight years that this had happened in Japan, and the historic vote followed two impressive wins by Oasis Management at the Toshiba Group, where the hedge fund won a court battle to prevent an intragroup transaction, and at takeover target PanaHome, where it partially succeeded in a battle to increase the sale price, showing that even a U.S.-style aggressive approach can sometimes be effective in Japan.

Whatever forms activism takes, excess cash, bad capital allocation, underperforming legacy businesses, poor investor relations, and strategic opportunities tend to be at the center of discussions with Japanese issuers, with the most aggressive investors also voicing opposition to cheap buyouts and the excessive influence of controlling shareholders.

Although Activist Insight data suggest that public campaigns are less effective than in other Asian countries, with only 20% of demands at least partially satisfied, it must be noted that many shareholder demands are presented by small investors with low conviction, thanks to regulations that make it very easy to submit proposals.

In an interview with Activist Insight, Oasis' General Counsel Phillip Meyer said he was confident his firm's activist campaigns had governmental support, and although cross-shareholdings and cultural resistance to investors perceived as "outsiders" were still strong, there were plenty of opportunities for activists.

Recent successes in Japan link back to the country's Stewardship Code, which was proposed in 2014 by

Most targeted

Consumer goods

Sector of Japan-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

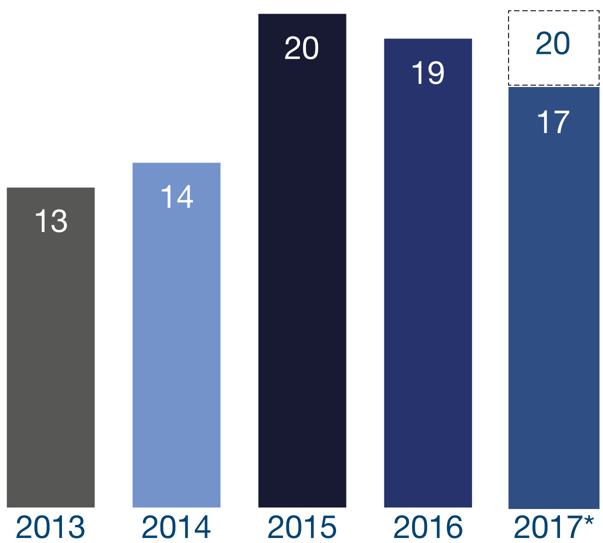
20%

Proportion of resolved activist demands made at Japan-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

Date	Activist	Issuer
Jan 2017	Oasis Management	PanaHome
Feb 2016	Effissimo Capital Mgmt.	Sharp
Oct 2015	Third Point Partners	Seven & i Holdings
Jun 2015	C&I Holdings	Kuroda Electric

Companies facing public activist demands



Number of Japan-based companies publicly subjected to activist demands by year.
*2017 figure as of June 30. Projected full year figure shown in dotted box.

Abe and modeled on the U.K.'s, demanding that institutional investors engage with their portfolio companies, and favor governance reforms. The code, although not mandatory, was subscribed to en masse, and revised in May 2017 to require that asset managers address possible conflicts of interest and provide more transparency on how they vote.

Alicia Ogawa, director of Columbia University's Project on Japanese Corporate Governance and Stewardship, told Activist Insight in an interview that the code was pivotal to the surge in activism, and added that Japan needs to do more to remove barriers that prevent cooperation among shareholders.

An important role was also played by the Governance Code introduced by the Tokyo Stock Exchange in 2015, which among other things pushed issuers to appoint at least two independent directors – or explain why they did not comply. Earlier this year, the California Public Employees' Retirement System and some British asset managers added to the pressure by demanding that independent directors account for more than one-third of the boards of their portfolio companies.

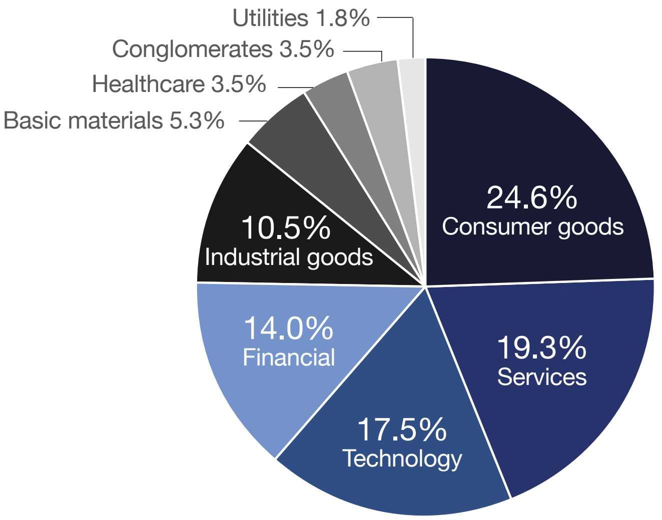
Credit for the changes in Japan should also be granted to pioneer activists who pushed the boundaries of what is acceptable in the country. Before being convicted of insider trading in 2006, Murakami, a former Ministry of Economy official turned asset manager, gained a lot of clout. Some of his former colleagues eventually launched Effissimo Capital Management, which is based in Singapore, and continued to wage activist campaigns in Japan, although seeking much less attention from the media. C&I Holdings, which is run by Murakami's daughter Aya, is also continuing the tradition. From the U.S., Dan Loeb's Third Point Partners also targeted Japan relatively early, with a campaign at Sony in 2013, followed by Fanuc and Seven & i Holdings.

Some investors from abroad have gone in the opposite direction, adapting activism to local tastes and pushing for changes behind the scenes. Veterans of this strategy are Taiyo Pacific Partners and the Japan Stewardship Fund of British hedge fund manager RWC Partners – a joint venture with Tokyo-based Nissay Asset Management.

In an interview with Activist Insight, Taiyo's CEO Brian Heywood said he did not intend to experiment with aggressive approaches, arguing that "in Japan, once you are perceived as hostile, everything you do is a fight. I don't think that is sustainable in the long-term." Corinna Arnold, who manages RWC's Japan Stewardship Fund, is also committed to her strategy, but said, "There is plenty of room for a range of activist approaches in Japan."

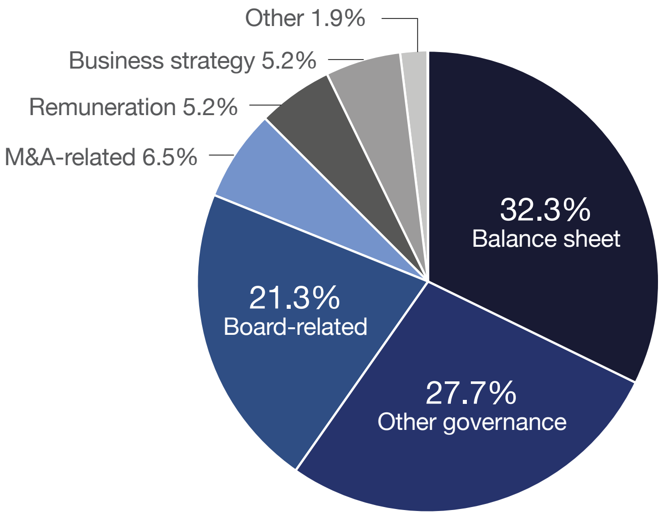
Taiyo's Chief Financial Officer Michael King says one thing is certain: the country is not going back on shareholder engagement. "Japan moves slowly. It's a consensus driven culture," he said, adding that "when there is a change, they do it in a very uniform way, there is a lot of inertia. So those changes are here to stay."

Sector breakdown of public activist targets



Sector breakdown of all Japan-based companies publicly subjected to activist demands since 2013.

Breakdown of public activist demands



Demand-type breakdown of all public activist demands made at Japan-based companies since 2013. Percentages given to one decimal place and may cause rounding errors.

COMPUTERSHARE HONG KONG

An interview with Savoy Lee, Vice President at Computershare Asia.

Savoy Lee is responsible for the development and client relations aspects of Strategic Shareholder Solutions. Specializing in capital market advisory and institutional funds analysis, she has provided investor relations and public relations consultation services to many listed companies globally in the past 20 years.

Recent developments in governance/regulation in the Hong Kong market

What are the current shareholder communications practices of listed issuers in Hong Kong and mainland China?

I do not feel there is a standard practice in the market. Some issuers are very proactive, they do their homework in order to know their real shareholders, their investment preference and appetite. They analyze their shareholder base, monitor for changes and are proactive regarding shareholder structure improvement with a goal of achieving a higher stock valuation by connecting with the right investor groups. However, a lot of issuers are still conservative, their I.R. routine is simply to fulfill regulatory requirements with financial and operational updates and to attend their bank's sponsored roadshows and conferences. Among these issuers, a lot of them feel that they should put more effort into shareholder communication but do not know where to start.

Survey results from the Hong Kong Institute of Chartered Secretaries (HKICS) in early 2016 are in line with our observations; one-third of the 413 respondent issuers did not know who their shareholders were because they did not regularly monitor their shareholder base. 58.4% of respondents recognized that their communications with their shareholders were inadequate or "somewhat inadequate," and saw the need for improvement.

Do you see a rise in activism in the Hong Kong market?

I believe so. Even though hard figures show a decreasing trend from 2015, there are in fact a lot more behind- the-scenes cases going on. Our proxy solicitation team in Hong Kong has been set up for more than 10 years, and these recent two years have been the busiest we have experienced. More and more Hong Kong and China-listed companies know the importance of getting prepared before their AGM and/or EGM. Proxy voting is no fortune telling exercise, there are a lot of logical things and analytical work we can do to help achieve desirable voting results.

Recommendations for how companies should communicate with activists and shareholders

What should companies be doing to enhance communications with shareholders and understand shareholders' needs?

There are five steps issuers can take. Step one is **Identification**: identify the beneficial owners of the company's shares and regularly update the shareholder list. Once you know who owns and is trading your stock, step two is **Understanding**: start analytical works to study their investment and voting behavior. Once you understand them, step three is **Communication**: set communication goals and strategies and start reaching out to shareholders to deliver your investment stories. Step four is **Listen**: constantly solicit feedback from shareholders directly, or engage with professional firms to do perception audits on a regular basis, to understand their views and needs for your company. Step five is **Facilitation**: voting procedures in Hong Kong are quite complicated, issuers should act to facilitate shareholders' participation in an AGM/EGM, and voting. Above all, I believe implementing each step recurrently and regularly is most important.

What's Computershare's role in shaping best practices in this region? How can you help companies with shareholder communication?

Our clientele represents 80% of the total market capital in Hong Kong, therefore Computershare is a key player and well positioned to act as a middle man between investors, issuers, and regulators. In addition to our existing offerings in shareholder identification and proxy solicitation, our recently launched service "Strategic Shareholder Solutions" helps issuers classify their IPO allotment shareholders and target new ones; regularly identify and analyze their shareholder base, identify risk factors and prioritize their shareholder communication efforts; and get insights directly from investors and provide feedback to issuers. Lastly, and most importantly the service helps to ascertain the risk level associated with voting outcomes at an AGM/EGM and work to secure supportive votes.

Could you share a story where a company successfully avoided undesirable voting results by proactively engaging with investors?

Like any relationship, the investor relationship should start early. Although professional proxy solicitation consultancies may work their magic, our most successful proxy solicitation cases often involve issuers who have constant communication dialogue with their shareholders. It's not only large cap companies, a lot of small-to-mid cap clients also engage us to regularly review their top 50 shareholders based on their voting preference and voting records. From this assessment, issuers can estimate their support level at meetings and determine who they should engage with, and how soon and often they should engage.

A classic example is share placement proposals: investors do not like earnings per share (EPS) dilution, therefore, without previous communication and knowledge on the rationale behind the placement, investors will tend to vote against management.

We had a client that wanted to issue more than 100% of its outstanding shares just two years after its IPO. It was a very challenging proxy solicitation case for us because to pass the resolution, the shareholder meeting required at least one-third of issued share capital to be voted and two-thirds support. We put in a lot of brainpower and manpower to help this client and were able to attract more than 80% of investors to vote with 98% of them voting to support. One of the reasons for the success is that their IR and management teams convinced their shareholders over time about their business expansion plans, which required the money raised from the share placement to generate long-term benefits.

What advice would you give to an institutional investor that is interested in engaging with companies in Asia?

Asian countries can be very different; Japan, China/Hong Kong, Southeast Asia are examples of three very different cultures and practices in shareholder communications. Institutional investors should learn and understand the country they want to go to first and determine if they want to get intermediaries' help or to undertake direct contact. For the China/Hong Kong market, I believe direct contact by investors is usually welcomed by issuers. However, investors should also do companies the courtesy of giving some information on their background, portfolio information such as Assets Under Management (AUM)/ Equity Under Management (EUM) and their industry and market cap mandate. ■

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THE SOUTH KOREAN PROMISE

Activism in South Korea has been gaining momentum for years, with investors from abroad becoming more daring, at least two new funds launching, and new rules favoring shareholder participation. Although the country can still be a tough environment for activists, it also offers plenty of cheap stocks, and appears to have reached a turning point that could redefine shareholder engagement and open the door for more public confrontations.

Moon Jae-in, the newly-elected president, has appointed Jang Ha-sung, a professor at the Korea University in Seoul and an advocate of good corporate governance, as chief of staff for policy. Kim Sang-jo, a Hansung University professor nicknamed the “chaebol sniper” for his campaign to reform the country’s largest conglomerates, has been appointed chairman of South Korea’s antitrust regulator. The two appointments may pave the way for shareholder-friendly regulation and a crackdown on cozy relationships between large issuers and institutional investors.

David Hurwitz of SC Fundamental – an activist which operates in the country in tandem with local investment firm Petra Capital Management – told Activist Insight that the new government “seem determined to rein in on chaebols and on enforcing existing laws. And they seem to have plenty of support to make the changes.”

Lime Asset Management, a South Korean investment firm which recently launched an activist strategy together with Seoul-based ESG adviser Sustinvest, told Activist Insight that it expected Moon’s government to push institutional investors to adopt the Stewardship Code – which was introduced last year but was largely ignored by the investment community.

> “Improvements in transparency, capital allocation, dividend payout rate and independence of the board would create opportunities for gains.”

In an interview with Activist Insight, Kim Woochan, a Professor of Finance at Korea University Business School, said he believes South Korea’s National Pension Service (NPS) – one of the world’s largest pension funds – may adopt the Stewardship Code by the end of this year, and Oasis Management told Activist Insight in July that its introduction, combined with the government’s focus on corporate governance, prompted it to look at possible targets for activist campaigns in the country.

The Stewardship Code forces asset managers which adopt it to explain the reasoning behind their votes at general meetings, and is expected to favor shareholder engagement and limit the impact of conflicts of interests between issuers and institutional investors.

South Korea has the potential to become a popular venue for activism due to the so-called Korea Discount. Hurwitz told Activist Insight that “you can buy a company basically for free. There are companies trading at about the value of their cash.”

Ryu Young-jae, the CEO of Sustinvest, believes that low valuations are mostly due to governance issues. “Improvements in transparency, capital allocation, dividend payout rate and independence of the board would create opportunities for gains,” he told Activist Insight.

Moreover, Kim notes that shareholder proposals are binding, all directors need to secure a majority of the votes to be elected, and statutory auditors –

who oversee the board and have access to the books – are elected through a system that, at companies with assets of less than two trillion won, favors minority shareholders. A few years ago, SC and Petra managed to elect a statutory auditor at interior design firm Kukbo Design.

On the other hand, the advanced notice for shareholder meetings is only two weeks, and some companies refuse to provide the share register to dissident investors because the sanctions for failing to do so are quite light. In addition, almost all annual meetings are held on the fourth week of March, creating logistical problems for shareholders.

A huge role in driving the changes in the country – including at NPS – has been played by Elliott Management. The U.S. hedge fund's 2015 attempt to thwart a merger between Samsung C&T and Cheil Industries, two affiliates of the Samsung Group, was an unprecedented campaign at a chaebol. Elliott aimed even higher in 2016, demanding payouts, the creation of a holding company and the appointment of independent directors at smartphone giant Samsung Electronics. Although the company did not surrender to the most ambitious requests, it agreed to cancel treasury shares worth over $35 billion.

The ripples from these campaigns have been impressive. One of the main accusations advanced in a criminal investigation begun in 2016, which toppled the government headed by Park Geun-hye and eventually led to the election of Moon, was that government officials had pressured NPS to support the C&T-Cheil deal, even though the economic impact was seen as negative for the pension fund.

As in many Asian countries, excess cash, underperforming legacy businesses and all too powerful controlling shareholders are common problems – although a new and more open generation of owners is slowly taking over, and controlling stakes are often split among several heirs. Unsurprisingly, Lime plans to target firms with increasing disparity between the largest shareholder's control and its ownership, as well as a high portion of foreign investors. The number of companies fitting the profile seems likely to increase, and so could shareholder activism in the country.

Most targeted

Consumer Goods

Sector of South Korea-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

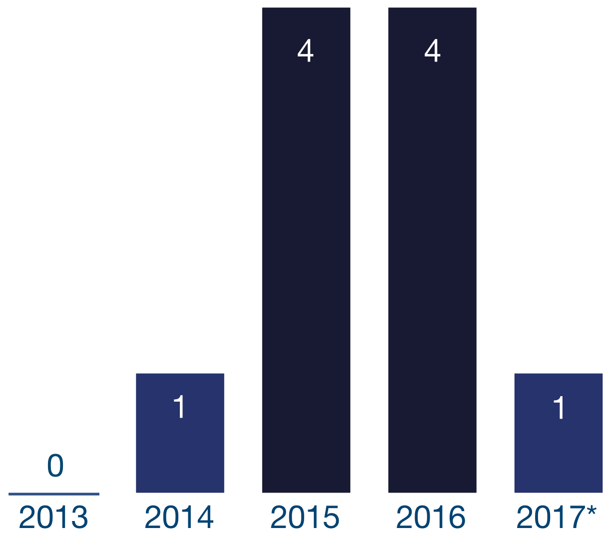
13%

Proportion of activist demands made at South Korea-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

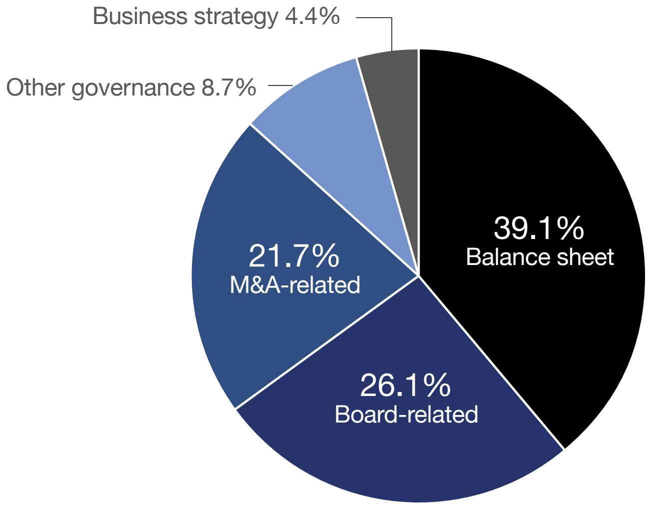
Date	Activist	Issuer
Oct 2016	Elliott Management	Samsung Electronics
Jan 2016	SC Fundamental Value/ Petra Capital Mgmt.	GS Home Shopping
Jun 2015	Elliott Management	Samsung C&T
Mar 2015	APG Asset Mgmt.	Hyundai Motor

Companies facing public activist demands



Number of South Korea-based companies publicly subjected to activist demands by year. *2017 figure as of June 30. Projected figures show no increase in H2 2017.

Breakdown of public activist demands



Demand-type breakdown of all public activist demands made at South Korea-based companies since 2013.

CHINA AND HONG KONG

When BlackRock took the unprecedented step of waging an activist campaign in 2016, it did so in Hong Kong, opposing G-Resources Group's plan to sell its mining assets and invest the proceeds in new business lines. In February this year, Oasis Management waded into a dispute between the founders of Yingde Gases, demanded a board seat, and was awarded one in less than a month.

These two well-known campaigns are examples of the vibrant activist activity in the nominally autonomous territory, which has had a governance code since 2005, and where board challenges are often launched by groups of disgruntled individual investors not at all afraid of making their voice heard. Shareholders owning 5% of a stock have the right to requisition special meetings to vote on proxy contests or other proposals, and in 2016 Hong Kong introduced a stewardship code modeled on the British one from 2010. In an interview with Activist Insight, Oasis' General Counsel Phillip Meyer warned that issuers tend to be less willing to engage, and said company law and the corporate governance code as currently modeled can give management advantages over minority shareholders. However, he is optimistic about the possible impact of the stewardship code, and believes there is potential for change and improvement.

Hong Kong is also the theater for many of the shareholder disputes involving companies from mainland China, as restrictions on foreign investments at the Shanghai and Shenzhen exchanges push many firms to list in the autonomous territory or in the U.S., where they are exposed to proxy contests and all sorts of public shaming. In addition, many Hong Kong-incorporated companies have key operations on the mainland.

For a country where public markets were banned until 1990, Chinese shareholders seem to be getting accustomed to active participation in corporate affairs.

Peter Halesworth, the principal of Heng Ren Investments, a rare example of an American activist targeting Chinese companies, told Activist Insight he believes mainland Chinese investors are the most committed and dedicated shareholders when it comes to trying to optimize issuers' operations and balance sheets.

Baoneng Group, an insurance conglomerate controlled by one of China's richest men, emerged in 2016 as one of the most effective activists in the region, forcing executive resignations at Shenzhen-listed glass manufacturer CSG Holding, and blocking a share issuance to state-owned Shenzhen Metro Group at one of the country's largest property developers, China Vanke. Vanke criticized Baoneng's aggressive stake building and labeled the group "barbarians."

A recent regulatory crackdown on highly leveraged insurers, which are often turning into corporate raiders, led to the banning of Baoneng's chairman Yao Zhenhua from the industry for 10 years. As Halesworth points out, Chinese enthusiasm for active shareholder participation will have to be balanced with government and regulators which have the power to quickly stop behavior they do not like.

Another issue affecting China's mainland is poor corporate governance, which often allows for improper related party transactions and frauds. Unsurprisingly,

> "One of the reasons activism is extremely rare at Shanghai- and Shenzen-listed firms is the enormous presence of retail investors."

one of the common themes of Chinese activism is shareholder opposition to lowball bids from insiders. China is a short seller paradise, but can be a nightmare for long-side investors. Havard Chi, head of research at activist firm Quarz Capital Asia, which recently started operating in Hong Kong, told Activist Insight the fund does not invest in Hong Kong-listed companies if they are based in the mainland and prefers companies that are incorporated and have their business in the autonomous territory. “Hong Kong companies have a higher level of regulatory and financial scrutiny. It is easier to operate, to do due diligence, and to build a network,” he says.

For all its challenges, China presents tremendous opportunities. Among the requests Halesworth advances at Heng Ren’s targets is to ditch unproductive businesses, or businesses which bear no relation to the core activity. “Their eyes are bigger than their stomach, they see so many opportunities that they get impulsive,” he says, adding that many Chinese stocks are undervalued because foreign investors struggle to understand local ways of doing business and so avoid investing in the country.

One of the reasons activism is extremely rare at Shanghai and Shenzhen-listed firms is the enormous presence of retail investors, who make up about 80% of trading in A-shares, compared with just 27% in Hong Kong, according to Bloomberg. In June, stock indexes provider MSCI decided to admit A-shares to its emerging markets index, potentially paving the way for a rise in passive investing in the country. With foreign institutional investors expected to increasingly pore over stocks listed in China’s mainland, pressure for improved corporate governance is likely to increase, and opportunities for activists may start to materialize.

Most targeted

Technology

Sector of China-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

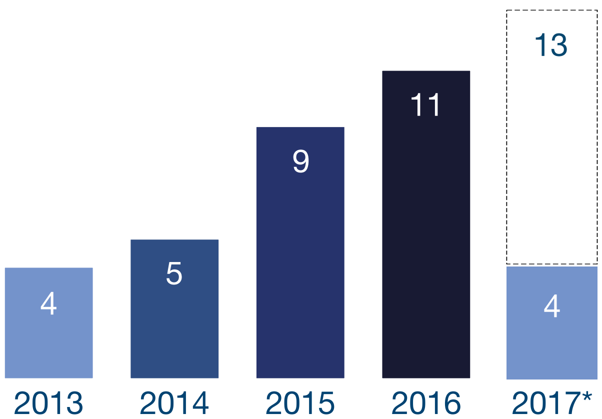
50%

Proportion of activist demands made at China-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

Date	Activist	Issuer
Nov 2016	Baoneng Group	CSG Holding
Jul 2016	Acacia Partners	Baidu
Jun 2016	Baoneng Group	China Vanke
Dec 2014	Heng Ren Investments	Sinovac Biotech

Companies facing public activist demands



Number of China-based companies publicly subjected to activist demands by year. *2017 figure as of June 30. Projected full year figure shown in dotted box.

Most targeted

Financial

Sector of Hong Kong-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

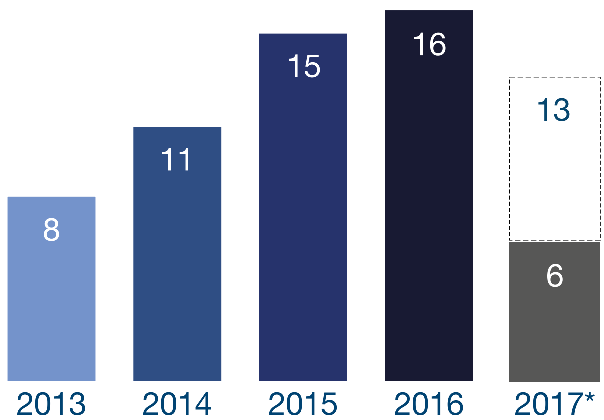
42%

Proportion of activist demands made at Hong Kong-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

Date	Activist	Issuer
Feb 2017	Oasis Management	Yingde Gases
Feb 2016	BlackRock	G-Resources Group
Mar 2015	Jayhawk Capital	China Cord Blood
Feb 2015	Elliott Management	Bank of East Asia

Companies facing public activist demands



Number of Hong Kong-based companies publicly subjected to activist demands by year. *2017 figure as of June 30. Projected full year figure shown in dotted box.

THE SINGAPORE SURPRISE

Singapore experienced an increase in the number of public activist campaigns in late 2016, with dissident shareholders not shying away from aggression in their pursuit of returns, launching proxy contests at six companies. Approaches to shareholder participation in the city-state have changed radically in recent years, and activism is there to stay.

The 2016 surge happened below the radar of the international press, without loud public announcements by politicians or large institutional investors, or the introduction of new regulations. However, Havard Chi, head of research at Quarz Capital Asia, an activist focusing on Singapore-based small and mid caps, told Activist Insight that although this approach to investing is still very new, he is encouraged by the positive response from the investment community.

“Passive funds are increasingly pitching us to push for changes at their portfolio companies,” he says.

Garnering support from fellow shareholders is getting easier, with a strong presence of Asia-focus funds from large foreign institutional investors, and a growing role played by the family offices of Asian businessmen, who have ears for the issues raised by activists.

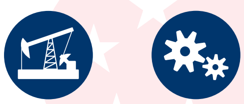
Cheap stocks, together with conservatively managed companies holding excess cash, underperforming legacy businesses, and growth opportunities that management may be slow to identify are the key elements of activism in the city-state.

Roland Jude Thng, who managed an activist fund at Singapore-based activist Dektos Investment for two years, and recently launched Judah Partners, a new activist firm, told Activist Insight that the “chain of value realization process is still not well-understood by many market participants.”

Meanwhile, a new generation of entrepreneurs, often educated in the U.S., is taking over at the companies founded by their fathers. They are often motivated, open to new ideas, and less attached to underperforming legacy businesses. Some of them have no interest in running the company, and hire professional CEOs.

Although the number of public campaigns has increased sharply in recent years, mostly at micro caps, Singaporean activism is mainly about gaining the trust of issuers with patient negotiation behind the scenes. As Chi says, “What you see is the tip of the iceberg.”

Most targeted



Basic Materials Services

Sectors of Singapore-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

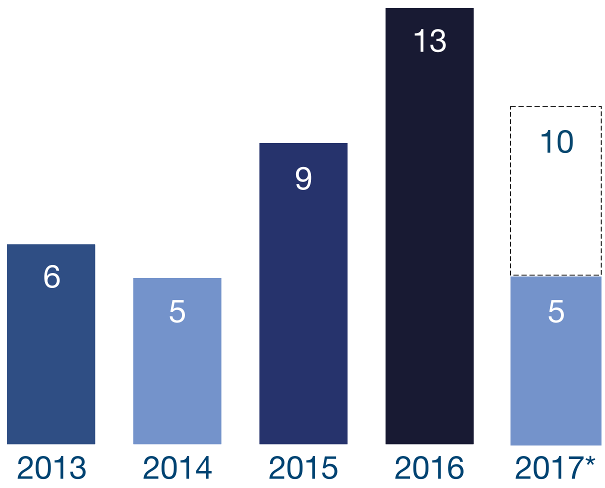
44%

Proportion of activist demands made at Singapore-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

Date	Activist	Issuer
May 2017	Quarz Capital	HG Metal Manufacturing
Sep 2016	L.S. Ching/L.B.L Audrey	International Healthway
May 2016	Third Rose Asia/Yeo Wee Kok	Imperium Crown
Nov 2015	Securities Investors Assoc.	Tiger Airways

Companies facing public activist demands



Number of Singapore-based companies publicly subjected to activist demands by year. *2017 figure as of June 30. Projected full year figure shown in dotted box.

INDIA’S FIRST STEPS

Shareholder activism has been slower to gain traction in India than in other Asian countries, but 2017 looks like a breakthrough year. In June, Chennai-based value investor Unifi Capital exploited a little-known provision of the Companies Act of 2013 to requisition a vote on the election of a dissident director at 110-year-old holding company Alembic.

That particular requisition was rejected by the company, but the attempt is an example of a new attitude emerging among Indian shareholders, which are more likely to voice complaints than in the past.

Early this year, the co-head of Blackstone’s Indian business, Mathew Cyriac, left the private equity giant to become a partner of local firm Florintree Advisors and help launch an activist strategy. U.S. activists Cartica Management and Taiyo Pacific Partners are also starting to operate in the country, exporting their soft-touch approach of positive engagement with management.

At least initially, Florintree plans to avoid public fights. The firm’s co-founder Palaniappan Chidambaram told Activist Insight he believes confrontational activism is problematic as most companies have a majority shareholder, but could gain ground at those firms where the largest owner has a smaller stake. Board battles are far from common in the country, although a 2016 dispute within the Tata conglomerate, where patriarch Ratan Tata took steps to remove former protégé Cyrus Mistry from the boards of the several group companies, formally took the form of multiple proxy fights (explaining the inflated statistics below).

A February settlement between Cognizant Technology Solutions, an information technology company listed and incorporated in the U.S. but with the core of its operations in India, increased the heat on the country’s issuers, and was followed by a wave of share repurchases at tech giants Wipro, Infosys, and Tata Consultancy Services.

Amit Tandon, the founder of Indian proxy advisory firm Institutional Investor Advisory Services, believes that new opportunities are starting to emerge for activists. “Over the last decade, retail shareholders have been replaced by institutional investors,” he said in an interview with Activist Insight, arguing this could reduce the grip of dominant shareholders.

In addition, government and regulators have been pushing for improvements in corporate governance and shareholder participation, with steps such as raising the threshold to approve related party transactions, forcing large companies to disclose their dividend policies, pushing electronic voting, and introducing codes and regulation to force insurers and mutual funds to disclose their voting rationale. ■

Most targeted

Basic Materials

Consumer Goods

Sectors of India-based companies most frequently subjected to public activist demands since 2013.

Activist success rate

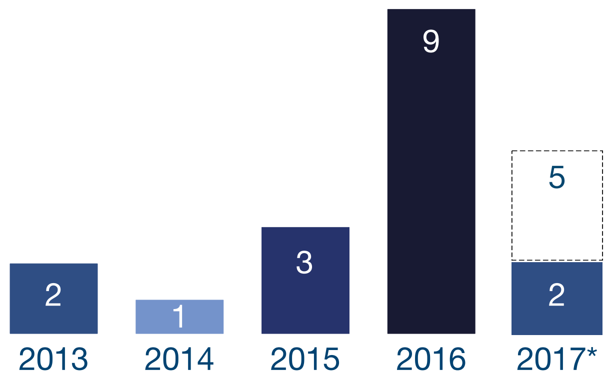
50%

Proportion of activist demands made at India-based companies since 2013 at least partially satisfied.

Noteworthy activist campaigns

Date	Activist	Issuer
Jul 2017	Unifi Capital	Alembic
Mar 2017	Vishal Patel	Raymond
Sep 2016	Assoc. of Mutual Funds in India	Max Financial Services
Jun 2014	Knight Assets	Tata Motors

Companies facing public activist demands



Number of India-based companies publicly subjected to activist demands by year.
*2017 figure as of June 30. Projected full year figure shown in dotted box.

SHORT ACTIVISM IN ASIA

Long-side activism is not the only form of activism taking place in Asia. Chinese companies and Hong Kong-based firms with businesses in the mainland are among the favorite targets of activist short sellers worldwide, and have been the subjects of some of the most spectacular stock collapses of recent years.

Singapore was also an early target, with Citron Research shorting InterOil in 2005 and Bronte Capital targeting XP Power in 2008. However, short campaigns in the city-state have remained a sporadic event, as in most Asian countries, while Japan faced a formidable surge in 2016.

Muddy Waters went from a little-known research outfit to a famed short seller in 2011, when it published a negative report on China-based Sino Forest – at the time the largest Canadian-listed forestry company – which went bankrupt the following year. The firm's founder, Carson Block, told Activist Insight that there has always been a significant amount of fraud among mainland China-based public companies. And that, of course, creates opportunities for short sellers.

Dan David, a veteran of short campaigns against Hong Kong-listed Chinese firms with GeoInvesting and, more recently, through his hedge fund FG Alpha – told Activist Insight that he looks for red flags such as surprisingly high margins in mature businesses, poor auditors, the involvement of nefarious dealmakers, affiliations with companies that committed fraud in the past, and questionable related party transactions. Several investors, including some of the most popular names in short selling in the U.S., have published negative reports on Chinese companies. A heavyweight, however, has been forced out of the ring. Last year, Citron Research's Andrew Left said that he had "zero plans on commenting on anything in China or Hong Kong in the future" following a decision by a Hong Kong court which banned him from trading in the territory after concluding that some points he raised in a short report against China Evergrande Group were inaccurate.

> "There has always been a significant amount of fraud among mainland China-based public companies."

David told Activist Insight that short activism is dangerous in any market, but probably more so in Hong Kong. "You may find a hostile regulator. Stock manipulation is much more pervasive and you may get squeezed. Also, Hong Kong does not have a jurisdiction to investigate in China."

Block says that the problem with China frauds listed in the U.S. – "the most stringent disclosure regime in the world" – is now smaller than in the past, and while there are likely still Chinese companies committing fraud, there are usually real businesses underlying the financials. However, he said, "We suspect the increased capital flows between the mainland and Hong Kong have encouraged more stock manipulations and frauds in Hong Kong."

Citron has left China, but entered the Japanese market, piling in on a bet by Oasis Management against robotic suit-maker Cyberdyne. In a 2016 interview with Bloomberg, Left said that he was targeting the country because while the U.S. allowed public discourse and the democratization of information, Japan had an "inefficient" market.

A local firm, Well Investments Research, pioneered activist short selling in Japan with a 2015 report on Marubeni, and has since targeted a total of four companies. Glaucus Research, which shorted conglomerate Itochu last year, said it believed the

Japanese financial community was becoming more receptive to "an open and honest dialogue about accounting practices, about transparency, and about accountability." Yet its report triggered criticism by the CEO of Japan Exchange Group – which runs the country's bourse – who said activist short selling raised "ethical" issues.

In an interview with Activist Insight, Well Investments' Director of Research Yuki Arai said that, although Japanese society tended to have a negative view of his aggressive approach, no-one had sued him, and criticism of Glaucus did not result in any enforcement action. "Free speech is guaranteed under the Japanese constitution," he added.

Reports by Oasis, Citron, and Glaucus were part of a surge in short attacks by U.S investors in Japan in the second half of 2016. So far, 2017 appears to have seen a return to normal levels, perhaps because the market recovered and few bets have paid off yet. Arai believes that the extremely high confidence of domestic investors in large corporations played a role: "We need to target softer, weaker targets. We are just at the beginning."

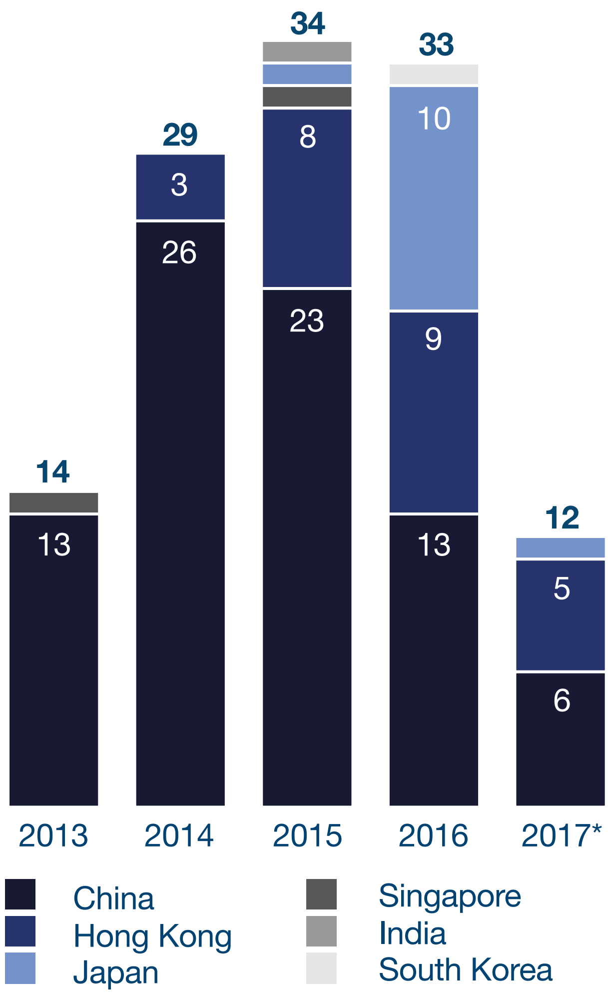
Outside Japan, China, and Hong Kong, activist short selling in Asia is an extremely marginal investment strategy. Singapore has faced two short campaigns since 2013, and in India, where long-side activism is also extremely rare, U.S.-listed movie maker Eros International – targeted by five activist short sellers over the last two years – is the exception and not the rule.

> "The Japanese financial community [is] becoming more receptive to an open and honest dialogue about accounting practices, about transparency, and about accountability."

Most common short seller accusations

Most frequent activist short seller accusations made against Asia-based companies since 2013.

Activist short campaigns launched



Number of activist shorts campaigns launched by company HQ and year since 2013. *2017 figure as of June 30.

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