OPINION

Activist investor targeting Tokyo Disneyland stake may be in luck

Timing for Palliser Capital's push on Keisei is looking auspicious

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Keisei Electric Railway's 22% stake in Oriental Land, the operator of Tokyo Disneyland, is worth 1.8 trillion yen, double Keisei's own market capitalization. (Photo by Yutaka Miyaguchi)

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The latest focus of foreign investor activism in Japan is a large ownership stake in Oriental Land, the company that owns and operates Tokyo Disneyland.

Palliser Capital, a London-based activist fund founded in 2021 by former staff of Elliot Management, is the most recent in a long line of foreign money managers who have tried to persuade Japanese companies to let go of undervalued assets trapped on their balance sheets.

Palliser's $100 million ante in the game is a modest 1.6% stake in Keisei Electric Railway, best known as the operator of express trains to Tokyo's Narita International Airport. By a quirk of history, Keisei also owns something much more valuable: a 22% stake in Oriental Land.

Palliser reports that by virtue of being Keisei's eighth-largest shareholder, it has been received for "constructive discussions" with management on 12 occasions over the last two years.

That Palliser has now gone public with a presentation that exhorts Keisei to "unlock value" suggests that the fund has so far failed to persuade the rail operator to take action on its proposal to dispose of the Oriental Land stakeholding.

Keisei's numbers are stark. Oriental Land has a market capitalization of 8.3 trillion yen ($55.3 billion), meaning that Keisei's 22% stake should be worth 1.8 trillion yen.

The anomaly is that Keisei's own total market capitalization stands at just 952 billion yen, or half the value of its stake in Oriental Land. The anomaly is obscured on Keisei's books where the stake is carried at a value equivalent to just 5% of its market worth.

The math is a real head-scratcher. It seems to imply that Keisei's profitable core business, involving 152 kilometers of railway serving 200 million passengers annually, has a negative net worth of around 900 billion yen, but that cannot be right.

Keisei's valuation anomaly is conspicuous for its magnitude, but it is a common phenomenon across the large number of Japanese listed companies that trade at discounts to their book value.

The real cause is market expectations that Keisei's crown jewel will remain permanently locked up. That then leads to steep discounting by the market of the intrinsic value of the Oriental Land stake. A stack of cash or a gold brick locked in a safe whose key or combination has been lost would be similarly discounted.

The solution is simple. Sell the Oriental Land stake and return the cash to Keisei shareholders. Or what amounts to the same thing: Distribute the railway's Oriental Land shares to its own shareholders as a special dividend.

The Tokyo Stock Exchange is urging companies listed on the market's main section to improve their low price-to-book ratios. © Reuters

In either case, Keisei shareholders would receive the value of the railway's Oriental Land stake and still have their Keisei shares. Palliser calculates that unlocking the railway's Oriental Land stake will create $4.5 billion in value for Keisei shareholders.

No brainer, right? Theoretically yes, but for years, the reality has been that activist funds have been unable to persuade Japanese companies to unlock value by liberating idle cash and "strategic shares" held in other companies.

The reluctance of Japanese executives to release hoarded cash and securities is a big reason why more than half the country's listed companies have price-to-book ratios of less than one.

The key to management's ability to defy rational demands to unlock value has been the support of domestic corporate and institutional shareholders, including domestic asset managers, who have loyally voted against campaigning activists like Palliser.

It is unlikely that these loyal domestic shareholders really believe the usual management rationalizations for holding onto idle assets -- that they should be seen as grain kept in the storehouse as security against a future bad harvest, or that cross-shareholdings are necessary to secure cooperation and synergy with corporate partners.

In Keisei's case, the sheer magnitude of the value of its Oriental Land stake in relation to its core railway business overwhelms any plausible "savings for a rainy day" argument.

As far as synergies, trains to Maihama Station -- the stop serving Tokyo Disneyland -- are operated by rival JR East, not Keisei, which just runs a short monorail line from the station into the theme park.

Keisei's stake is only a relic of Oriental Land's original establishment in 1960 as a joint venture between the railway and real estate group Mitsui Fudosan for the purpose of developing property projects in Chiba prefecture, where Keisei runs the main commuter line into Tokyo. Disneyland came into the picture years later but the theme park and related hotels are Oriental Land's main assets these days.

It remains to be seen whether a newcomer to Japan like Palliser, with only a modest stake in Keisei, will be able to win over its target's loyal domestic shareholders. All eyes should be on corporate shareholders from the Mitsubishi, Mitsui, Mizuho and Nomura groups, whose votes will determine the outcome of any stockholder proposals that Palliser may offer.

But a number of recent events suggest that Palliser's timing may be auspicious.

One is the unexpected decision by Dai Nippon Printing in May to yield to demands from Elliott Management to unwind strategic stakes it holds in a range of other companies.

Another is the Tokyo Stock Exchange's drive to shame companies with **chronically low price-to-book ratios** into action. Yet another is push by the administration of Prime Minister Fumio Kishida to encourage the domestic asset management industry to be more independent and critical.

There is no rational argument that can be made for Keisei continuing to hold onto 22% of Oriental Land more than 60 years after the launch of the real estate joint venture. No one can defend value destruction this large and obvious.

Until now, tribal loyalties within the Japanese corporate ecosystem have repeatedly defeated rational arguments for unlocking value. If Palliser beats the odds and persuades Keisei's loyal shareholders to break with the rail operator's management, hold onto your hats. Shareholder demands to liberate trapped assets will cascade and become irresistible.