

October 10, 2018

Letter on Takeover Defense Measures – Are They Really Necessary? (abridged translation)

IICEF and the five participants of its collective engagement program (Pension Fund Association, Sumitomo Mitsui Asset Management, Sumitomo Mitsui Trust Asset Management, Mitsubishi UFJ Trust Bank, and Resona Bank) have jointly started sending letters to listed companies with takeover defense measures/programs. In the letters we (IICEF and the participating institutional investors mentioned above) discuss investors' concerns over Japanese companies' takeover defense measures in general. In the letters we also ask companies which are going to renew their programs to clearly explain why their shareholders should approve the renewed programs in appropriate disclosure materials, such as proxy voting related and other SR/IR materials, before the relevant shareholders' meetings.

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1. Target companies

Out of listed companies whose takeover defense programs should expire in 2019, we picked up/will pick up multiple companies with relatively large market capitalization, which we believe are ready to have constructive dialogues with institutional investors. For now, we do not plan to disclose the names of the target companies.

2. Key messages

(1) Investors' perspective on takeover defense measures

The participating investors run passive investments, and we are primarily interested in long-term value creation of the listed companies in Japan. We will not pursue short-term shareholder return, and therefore basically we will not support abusive takeover actions by short-term investors who sacrifice long-term corporate value.

In 2009, Japan's TOB rule was revised to reduce the scope for acquirers' regulatory arbitrage and to introduce the "purchase all" obligation. Also, companies have become able to request acquirers' information, securing time for reviewing their offers. In addition, we saw a judicial precedent to accept a takeover defense measure (poison pill) adopted after a hostile takeover proposal based on

approvals at shareholders' meetings, etc., and to deny the directors' responsibilities for selling shares to white knights at lower prices than hostile takeover offer prices.

Thanks to the developments in laws and regulations, we believe that the risk of abusive takeover has been reduced substantially in Japan. (By making an in-market purchase, not a TOB, an acquirer can possibly buy one-third or more of a company's outstanding shares to control its business, but that will not be so easy considering a possible stock price hike.)

In some cases, takeover defense measures are allegedly introduced in order to prevent overseas leakage of important confidential technological information. However, what can be prevented by takeover defense measures is abusive acquisition, while strategic acquisitions with reasonable purpose by competitors, etc., cannot be blocked. It is unlikely for an acquirer to declare its takeover action as an abusive acquisition trial. It will not be possible to invoke takeover defense measures only because the acquirer is a foreigner or a foreign company, either. If a company intend to block strategic acquisitions by foreign companies that have shown fair purposes, because of overseas leakage concerns, that should be beyond the scope of takeover defense measures.

Meanwhile, takeover defense programs have the aspect of limiting the rights of shareholders. Some companies argue that takeover defense measures can be used as "weapons" for negotiating higher acquisition price, but ultimately whether the TOB price is low or high should be up to the shareholders' decision, not to the management teams' decision (the management can just express its view on the TOB price). Trying to invoke takeover defense measures insisting that the TOB price is too low, for instance, deprives opportunities for shareholders who believe the TOB price is high enough to take profits. In our view, the idea that takeover defense measures can be used as "weapons" in price negotiations is very questionable.

In our opinion, takeover defense measures have the aspect of weakening the self-discipline of the management team, as they limit the shareholders' rights to bring about changes in management teams that have not produced satisfactory achievements. We suspect that there is misunderstanding among the management teams that they can prevent acquisition proposals which they do not want to accept, including those with reasonable strategic purposes, by introducing takeover defense programs. Such misunderstanding should weaken the management team's sense of tension. To put it further, introducing or keeping takeover defense measures will lead to investors' concerns of the management's self-protection, which will also lead to their distrust of the management. Thus, more investors should be inclined to put discounts when evaluating the corporate value of the companies with takeover defense measures.

In this way, introducing and keeping takeover defense measures can lower the investors' confidence and may depress the evaluation in the capital market. We understand that most listed companies are working hard to build trust with investors, striving to make more effective disclosure and conducting IR activities, etc., so that the investors can appropriately evaluate their stocks. However, if a company tries introducing/keeping a takeover defense measures, it is difficult for us to fully understand it – we find no clear reason for the company's decision of introducing/keeping the program, taking major risks of lower investor confidence and poorer evaluation in the capital market.

If anything, we may be able to accept the management decision of introducing/renewing the programs, in the case that the management team recognizes that there are management issues/challenges, have already started implementing effective reforms, and will still need some more time before it sees the outcomes to be reflected in fair evaluation of the stock. In such a case, we would like the management team to clarify the management issues recognized by the team, the reform policies and plans, the goals and target time of achievements, the expected change of corporate value when the goals should be achieved, and so forth. If the explanations of these points are satisfactory enough, we may possibly regard the introduction/renewal of takeover defense measures with an expiration date as understandable.

## (2) Request for clear explanation of takeover defense measures justification

Companies with takeover defense measures have in-detail explanations of the schemes in their disclosure materials, but unfortunately their discussions of the necessity of the programs are not satisfactory for most investors. Many of these companies argue that the measures should prevent abusive acquisitions such as damaging important management resources and hindering long-term business growth, and that they are effective in securing information-gathering time for shareholders judgements. As we discussed above, however, these reasons are not convincing from an investor's point of view, considering the risk of lowering the stock evaluation in the capital market.

If a company plans to propose renewal of its takeover defense measures at its next AGM, we would like the management team to clearly explain the following points beforehand, in their proxy voting related materials and/or timely disclosure materials:

- How the management understands the current stock price situation and corporate value evaluation in the capital market
- What the management thinks about the possible investor confidence decline caused by the takeover defense measures
- How the management views the balance between benefit and risk of the measures

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We have initiated collective engagement dialogues with multiple companies, with the above-mentioned contents. Suggestions, opinions and inquiries are welcome, from investors who have other engagement agenda ideas, as well as from listed companies' management teams.

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