The Breakthrough Year

Stockholm (HedgeNordic) – After six of its holdings were taken over during last year, Japan-focused long/short equity fund **Sector Zen** has received another takeover bid for one of its holdings. The latest takeover attempt represents the 40th takeover in Sector Zen's long portfolio since the fund was launched in the first half of 2006.

After the market close in Tokyo on January 23, U.S. private equity firm Bain Capital announced a tender offer for all shares in Showa Aircraft, a Japanese maker of transportation equipment. Bain Capital planned to launch a tender offer to buy all the shares at 2,129 yen per share, and the shareholders who tender their shares would receive an additional special dividend of 631 yen. This presents a premium of nine percent over the closing price before the announcement. According to the team at Sector Zen, "although the premium sounds modest, the offer takes place at almost double the level the stock was trading as recently as early November."

Showa Aircraft's major shareholder, Mitsui E&S Holdings, has already agreed to sell all its shares in the target, which account for 65.5 percent of the company, in an attempt to strengthen its weak balance sheet. "Showa Aircraft is one of Japan's classic latent asset plays, with huge unrealized gains in real estate," says the Sector Zen team. "The company is sitting on 1,250,000 square meters of land next to the Yokata airbase west of Tokyo, with significant redevelopment potential."

Sector Zen, an Oslo-based fund managed by investment manager **Trond Hermansen** *(pictured)* and analyst **Lars Solberg**, returned 30.4 percent net of fees last year, partly owing to the six takeovers during the previous year. 2019 was the fund's second-best annual performance in its history, only trailing the 38.3 percent return in 2009. Currently managing €150.6 million in assets, Sector Zen seeks to capitalize on a major investment theme in the Japanese stock market: the reorganization of listed subsidiaries.

There is increasing pressure on Japanese companies to reduce cross-shareholdings either by selling their stakes in listed affiliates or buying out minority shareholders. In November, the Tokyo Stock Exchange sought public comments on a set of proposals aimed at improving governance for the so-called parent-child listings, with some changes expected to take effect in February. "It's the big game-changer for Japan," Trond Hermansen recently told Bloomberg.

According to Sector Zen, "currently more than 70 percent of the fund's long book is held in attractively valued subsidiaries and affiliates of larger parent companies." The team expects buy-ins and spin-offs to continue to be a driver of portfolio returns going forward. Hermansen anticipates more transactions in 2020 than last year, which he dubbed as a "breakthrough" year. "It's an incredibly interesting investment case," he told Bloomberg. "Completely unrelated to the macro situation. This is company-specific."