Sydney based global ESG fund manager calls for governance changes at leading Japanese construction company

On June 28th, Haseko (1808 JT) will hold its annual general meeting. Haseko is Japan's largest specialist builder of condominiums.

Ahead of this meeting Morphic Asset Management has called on the company to make important changes to its governance, business strategy and capital management. Morphic Asset Management runs three ESG long short funds with a corporate engagement focus.

In its communication with Haseko, Morphic recognises the company's good operational performance, but notes that despite this, its shares have steadily de-rated in terms of price to book and price to earnings.

Morphic believes that to understand the reasons for this frustrating share performance, Haseko needs to look at issues related to:

a) Capital and balance sheet management
b) Concerns about its future strategy
c) Board composition

Morphic has been pleased that Haseko has responded promptly to its approach but disappointed with the content of the responses other than reassurances that Haseko is unlikely to make a value destroying acquisition with its growing pile of cash.

Accordingly, Morphic has decided to now go public with its proposals for improving shareholder value, in the hope that other shareholders will communicate publicly or privately what Morphic believes are very similar concerns and ideas to remedy them.

Our original letter to Haseko is attached.

As the letter indicates and subsequent feedback from the company reinforces, Morphic believes the problems start at the board level. Ultimately Morphic expects Japan will join other developed markets in seeing the norm for established large public companies to have a majority of independent external directors and something approaching gender balance on the board. It would like to see Haseko go from being a laggard to a leader in this transition.

Morphic believes a board of this nature would be more likely to conduct the comprehensive review of all your non-core businesses that Haseko needs.

In addition, this kind of board would more likely appreciate the opportunity raised by Haseko's extremely low level share price to add value for all long term shareholders by repurchasing its equity.

Haseko, like many other Japanese companies in lower growth industries needs to reframe its view of share buybacks to see them as a form of M&A, but one which has the following uniquely attractive characteristics:

- no due diligence risks
- no integration risks
- no requirement to pay a premium for control
- low valuations (below 7x PER in Haseko's case) to buy a very high quality business (its own!)
- immediate benefits to its earnings per share: Buying back 10% of its shares per year, (even with flat absolute profits) would raise Haseko's earnings per share 10% a year.

As Morphic demonstrates in its original letter, on almost any plausible scenario it can model, Haseko has more than enough cash to make buy backs of this nature for many years while remaining financially very strong.

Morphic reiterates its appreciation for the excellent way in which Haseko's board and management run its core construction business. However, the latest engagement reinforces its view that the board needs to improve the way it runs the company, ie the corporate entity which owns the business.

As Morphic states in its original letter, it believes the clear model for how to have both a good company and a good business is demonstrated by Taisei, which has consistently outperformed other major Japanese construction firms operationally and through its share price. Morphic notes that like Taisei, Haseko does not have a controlling shareholder.

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