



FAB FANUC OR TOSH TOSHIBA

This time last year when I wrote about Japan I highlighted what I believed was an interesting contrast between two very different types of Japanese companies. First of all there were the market leading, highly profitable, cash rich companies where I thought there might be interesting investment opportunities and then there were the struggling, cash poor companies that even though they were cheap I still worried that they would not be good investments.

Last year I used Amada as an example of a cash rich market leader and Asahi Chemical as an example of a conglomerate with significant borrowings in tougher industries. I concluded by saying that I was going to have an in depth look among the cash rich market leaders and avoid the rest for the time being.

I wasn't the only one thinking that way because hedge fund manager Dan Loeb has caused quite a stir by taking a stake in the market leading, cash rich, robotics company Fanuc. What has caused particular excitement has been the response of Fanuc. They have announced some shareholder friendly policies like increased dividends and the creation of an investor relations department!

I have to admit that this is the type of progress I have been hoping for / anticipating because Fanuc is a company I know reasonably well.

From 1988 when I first started making regular trips to Japan I tried to make sure that I got to know as many of their world beating technology companies as possible.

Before arranging each trip I would talk to my contacts about what they thought would be the best companies to meet. One of the companies that came up in those conversations was the industrial robot company Fanuc.

One of my contacts told me that they had a good relationship with Fanuc and they could get me in to meet them despite the fact that they were known as being a company that rarely accepted visits. Naturally enough I took them up on this offer even though Fanuc is located in a rural location and isn't easy to get to.

The Fanuc factory was worth that journey. It was impressive because it was probably the most highly automated factory I had been in. Robots were making robots.

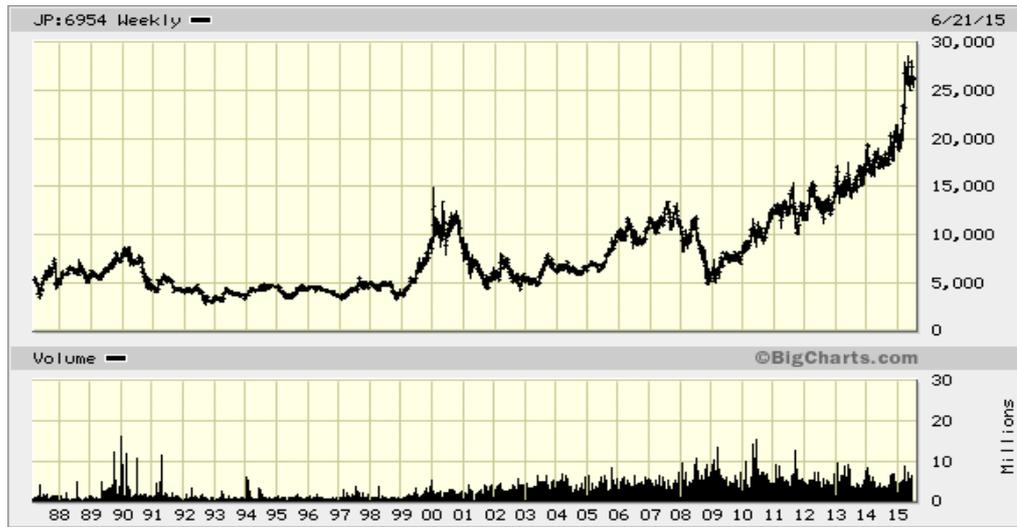
(Anyone interested in getting a sense of what I saw can look at a video on the Fanuc website: <http://www.fanuc.co.jp/en/product/video/robot.html>)

At the time when I returned to Dublin I told all my colleagues that I believed Japan was leading the world in terms of high technology and this was part of the reason why I believed Japan was a good place to invest. It wasn't just Fanuc, it was also because of what appeared to be leading edge research being undertaken at other companies I visited like Hitachi, Toshiba, Sony, Panasonic, Sharp, Pioneer, Fujitsu and NEC.

A short time later my boss decided he had to see this for himself so off we went to Japan and in an attempt to show him the best, I managed to arrange a return visit to Fanuc. I think my boss came away convinced that Japanese companies were world beaters and worth investing in.

At the time I undertook further analysis of Fanuc but did not buy it because it was expensive and appeared to have the good news built into the share price.

Fanuc Chart:



As can be seen from the chart above I was right on a ten to fifteen year view but my twenty five year view was a bit off! Fanuc genuinely has been a great company with a great leading technology position. This success allowed it to accumulate enormous net cash balances and in typical Japanese style it used to keep building up this cash and only pay a small dividend.

Dan Loeb got in there before me. He found a market leader with plenty of cash on a reasonable price but the fact that he hasn't bought a number of Japanese companies makes me wonder whether Fanuc is the exception rather than the rule. Where are all the other companies like Fanuc?

At the same time as Fanuc has been making news for all the right reasons another company has been making news for all the wrong reasons. This is also a company that I visited many years ago and unlike Fanuc this is a company that I did invest in all those years ago (but got out of pretty quickly). The company I'm referring to is Toshiba and I'm old enough to remember when it was both a brand leader in consumer products and a technology leader (particularly in semiconductors). Those were the days when "Hello Tosh Gotta Toshiba" meant something in the television world and when Toshiba dominated the Dynamic Random Access Memory (DRAM) semiconductor market and appeared to want to be a world beater in everything from medical equipment to notebook computers.



A lot has changed over the last twenty five years and I think it is generally acknowledged that Toshiba is no longer a leader in consumer products. It has withdrawn from DRAM semiconductors (but is the number two player in Flash memory semiconductors). It has borrowings of Y1.5t and profit margins have been low. I would therefore argue that Toshiba is a good contrast to Fanuc. It has struggled to reinvent itself and has all the negative characteristics of a Japanese company that I have written about in so many opinion pieces.

Earlier this year Toshiba made headlines when it announced that it was investigating various accounting errors that have overstated profits for a number of years. This investigation has yet to be completed but there appears to be no doubt that there are significant accounting problems.

Toshiba is therefore a great example of the type of company that might appear cheap on a measure like Price to Book Value (P/B) but is cheap for a good reason. I believe that the 112,000 employees Toshiba has in Japan do not want to see major redundancies and that is the main reason why it is cheap for a good reason. (Fanuc employs 5000 people in total)

Toshiba Chart



I continue to highlight this contrast as represented by “Fab Fanuc” and “Tosh Toshiba” because I think it has implications for the overall Japanese economy and stock market.

In my opinion there are just too many companies like Toshiba and not enough like Fanuc and because of this I remain cautious on the overall stock market.

I would love to find plenty of companies like Fanuc on a cheap valuation but it has been a struggle. Late last year I found one and I may write about it in a later opinion piece but the fact that it is only one company and I have some doubts about some aspects of the way it is managed highlights the reason why Japan remains such a small part of my total portfolio.

BANKING INQUIRY

I hope Nassim Nicholas Taleb (author of “Fooled by Randomness” and “The Black Swan”) has the opportunity to watch the evidence given at our banking inquiry because I’m pretty sure he would find it quite amusing. (I would find it amusing if it wasn’t for the fact that I live in this country!). I think he would be amused because most of the bank directors that gave evidence said that they had been comforted by the stress tests undertaken before the crisis. They stated that these stress tests had shown that in a worst case scenario of a 40% decline in property prices or a once in one hundred year economic crash, the banks were well capitalised and would not be insolvent. I think Taleb would say that these directors have been the victims of the GIF (Great Intellectual Fraud).

Given that Taleb first wrote “Fooled by Randomness” in 2004 I think I can conclude that none of the bank directors (or bank regulators) had read the book before the crisis and the scary thing is that I didn’t get the impression that it has hit their reading lists since then. In my opinion all bank directors, bank regulators and economists should have Taleb’s books on their reading lists because then they might be too embarrassed to use similar stress tests as part of any defence for their inability to prevent the next great banking crisis.

UK GENERAL ELECTION

In my last opinion piece I wrote about Justin McNulty and his attempt in May to get elected to Westminster for the constituency of Newry and Armagh. Unfortunately I have to report that Justin did not get elected. I’m not sure if he entered the race a bit too late to achieve any sort of a swing but it does appear that the SDLP have struggled to establish a strong presence in the constituency in recent years.

I just hope that this setback does not prevent him from running in the Northern Ireland Assembly elections next year because I still believe that he would be a positive addition to politics on the island of Ireland.