Strategic Capital

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Proposal for Yodogawa Steel Works Ltd (5451) to strengthen shareholder value

Disclaimer

Last updated April 24, 2024

Executive Summary

Strategic Capital, Inc.'s (SC) goal is to unlock enterprise and shareholder value through dialogue with the company management team and the exercise of shareholder rights.

SC and the funds managed by our company are shareholders of Yodogawa Steel Works ("Yodogawa or the Company"). In order to increase shareholder value, we have submitted the following proposals to Yodogawa by exercising our right to make a shareholder proposal

i. Set shareholder return policy to a 100% dividend payout ratio and 6% DOE

ii. Formulate and disclose a plan to achieve at least 1x PBR

~~iii. Abolish takeover defense measures (poison pill)~~ → SC withdrew proposal iii as the Company abolished takeover defense measures

iv. Abolish the shareholder benefit program*

v. Cancel treasury stock

* Shareholder benefit programs are a distinctive characteristic of the Japanese market, whereby many companies offer goods, services (sometimes including their own products), discount coupons or prepaid cards (e.g. Quo Cards) once or twice a year to shareholders who hold a certain number of shares or more.

Background & key points on the proposals

Prolonged share price slump and the need for management reform → Develop and disclose plan to achieve a PBR greater than 1x (FSP 2)

The Company's stock price has routinely fallen below 1x PBR over the past 25 years. As of March 19, 2024, PBR was only 0.71x, leaving it extremely undervalued.

In March 2023, the Tokyo Stock Exchange requested "Action to Implement Management that is Conscious of Cost of Capital and Stock Price" but as of the end of March 2024, no policy has been announced. Given the stock price is consistently below 1x PBR there needs to be more proactive action.

Clearly drastic management reforms and changes in capital policies are necessary to end the long-term stock price slump. To that end we propose the Company formulate and announce a specific plan in response to the request from the Tokyo Stock Exchange.

Excessive accumulation of equity capital → Set shareholder return policy to a 100% dividend payout ratio and 6% DOE (FSP 1)

The Company's equity capital ratio is already high at around 72% and it is due to this buildup of excess capital that the ROE is low. To improve capital efficiency and ensure stable shareholder returns we propose a 100% dividend payout ratio, 6% DOE as the shareholder return policy.

In addition, Yodogawa holds a large amount of assets that are unrelated to the core business including cross-share holdings and rental real estate. These should be sold and used for business investments and shareholder returns.

Background cont'd

~~Improve Corporate Governance ①→ Abolish takeover defense measures (FSP 3)~~ → SC withdrew proposal iii as the Company abolished takeover defense measures

~~Although a poison pill was introduced at the 124th AGM held in June 2023 it only received 63.7% support. We believe that this indicates criticism of the measures by many of the shareholders including domestic and foreign institutional investors. If management believes that a potential takeover threat exists, it is desirable and proper to increase shareholder value instead. We propose the takeover defense measure be abolished.~~

Improve Corporate Governance ②→ Abolish the shareholder benefit program (FSP 4)

The Company has long run a shareholder benefit program, and on Feb 27, 2024 announced that eligible shareholders would receive catalog gifts and tickets to the YODOKO Guest House. This is an unequal system for large shareholders, who receive a fixed benefit even if the number of shares owned increases. In addition, institutional investors may refuse to accept these perks, in which case there is no benefit at all. If the program were to offer its own products or services, it is conceivable that it could indirectly expand business performance and contribute to shareholder value by raising awareness of the Company's products and services. However, the Company's program is completely unrelated, and no such effect can be expected.

Therefore, it is difficult to say all shareholders are benefitting equally, and we propose that the shareholder benefit program be abolished.

Improve Corporate Governance ③→ Cancel treasury stock (FSP 5)

As of Sept 30, 2023, the Company held 5.65 million shares (approx. 16.2% of o/s shares) of treasury stock. There are cases for holding treasury stock in anticipation of a M&A etc. however the Company also holds an excessive amount of other assets such as cross-shares and rental real estate which could be sold to fund good M&A opportunities. Also, holding large amounts of treasury stock increases dilution risk for shareholders.

Therefore, we propose that all treasury shares be cancelled.

What's New

04.15.2024

Submitted Formal Shareholder Proposal to the Company

05.28.2024

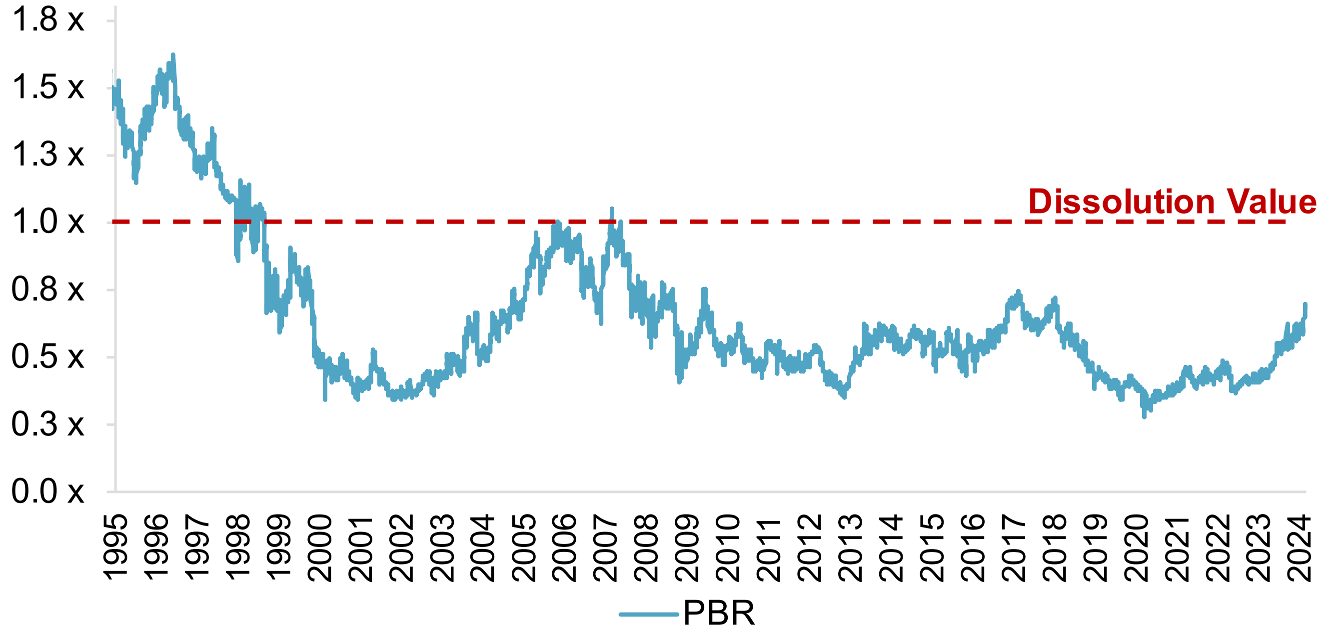
SC withdrew proposal iii as the Company abolished takeover defense measures

(Please find further details here)

Market capitalization that can’t exceed 1x PBR

Since 1998, Yodogawa’s stock valuation has **stagnated below 1x PBR**. Even now, the **PBR is 0.71x**. The stock price valuation clearly shows that the Company’s management policy has been damaging the interests of its shareholders and a fundamental change in management and capital policy is necessary to increase shareholder value.

PBR（1995~)

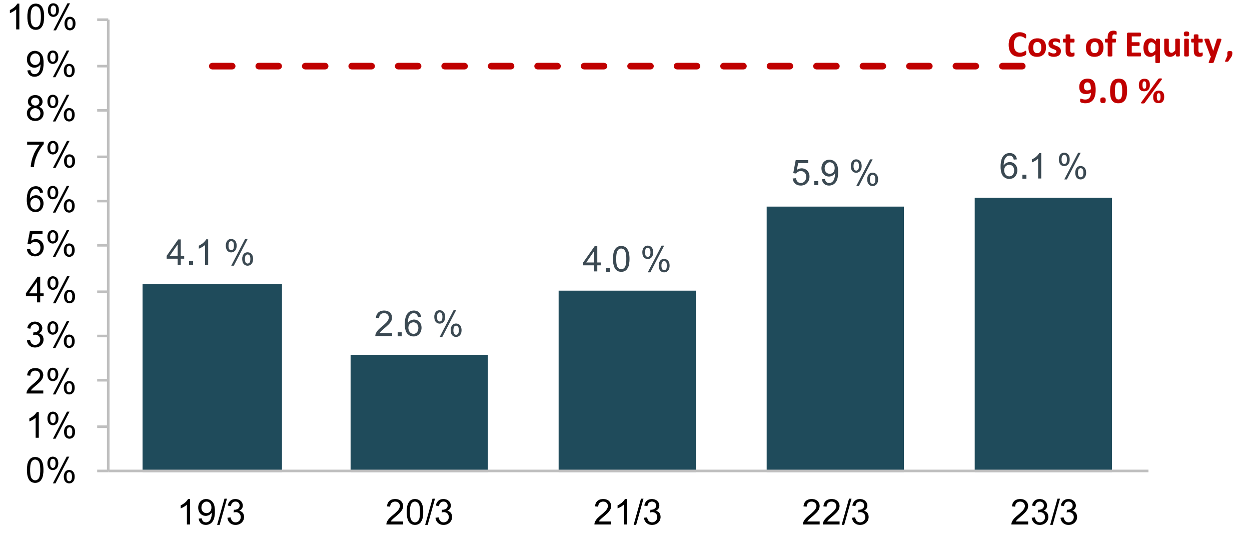


Data Source: Quick Astra Manager

Capital efficiency below cost of capital

The main reason why the PBR has lagged below 1x is the ROE is less that the **Cost of Equity (COE), which we estimate to be around 9%**. The **ROE target of the Medium-Term Business Plan (MTBP) is only 5% which is significantly lower than our COE**. (As of March 8 2024, Bloomberg and Quick put the cost of equity at around 10.2% and 9.3% respectively). The Company should **set an ROE target that exceeds the COE and re-establish an MTBP to achieve it**.

ROE and Cost of Equity over time

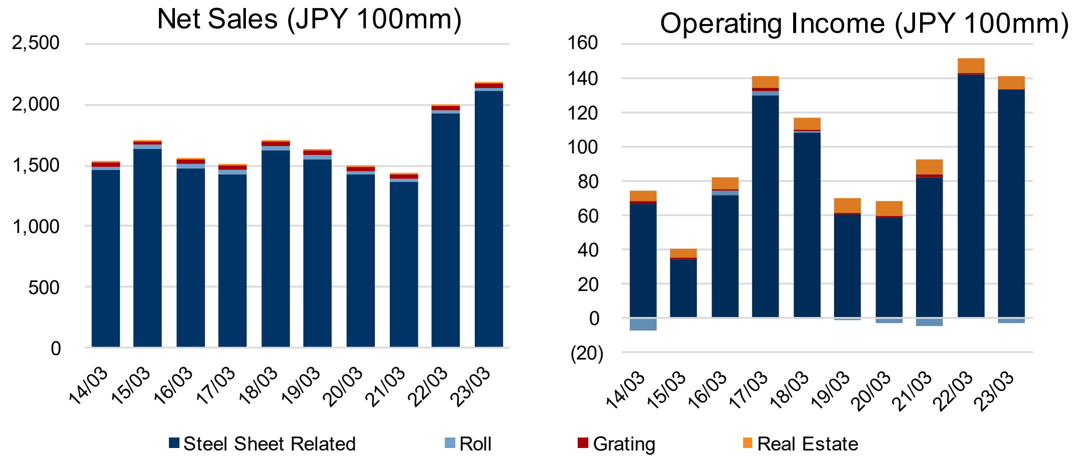


Data Source: Quick Astra Manager

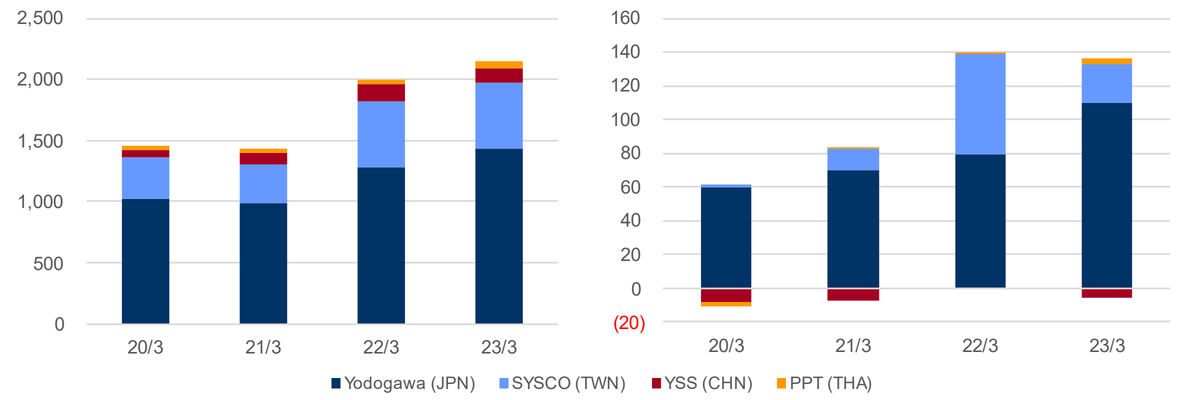
Review Businesses and Regions including possible withdrawal

Profit **contribution outside the core steel sheet-related business is extremely low**. In particular, **the roll business is often unprofitable and restructuring including liquidation needs to be considered**. For unnecessary real estate related assets such as rental real estate, golf courses and guest houses, it is virtually impossible to achieve sufficient capital efficiency and they should be sold.

Net Sales, Operating Income by Segment



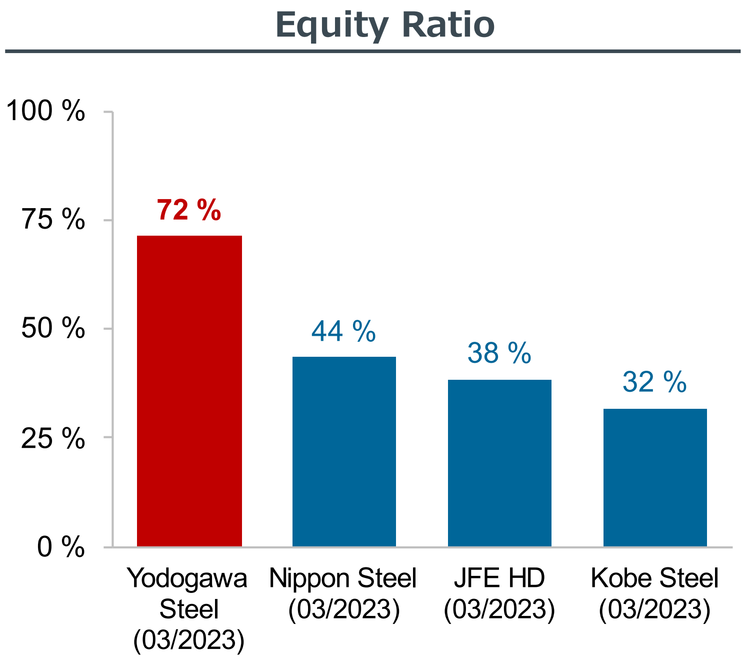
Net Sales, Operating Income by Region

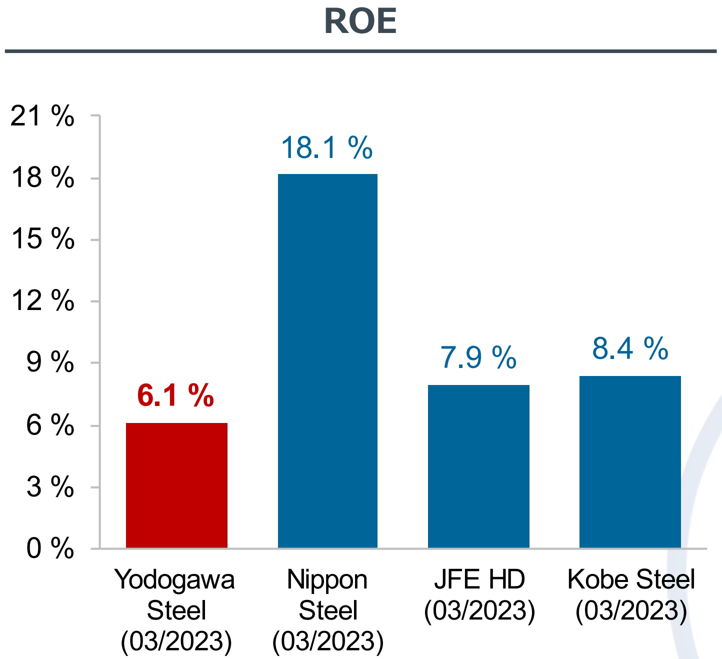


By region, the **majority of operating income is generated by Yodogawa Steel (Japan) and SYSCO (Taiwan)**. With regard to China and Thailand, there are some points where the actual situation may differ from our assumptions at time of entry, but we believe it is necessary to **review management strategy including potentially withdrawing from the markets**.

Shareholder's Equity Ratio that is too high

At **around 70%, the shareholders' equity capital ratio is very high** especially when compared to industry peers. The excessive equity capital is a major factor in why **ROE has also remained far below peers**. Given the current situation, we propose to **changing the shareholder return policy to a 100% dividend PO ratio and 6% Dividend on Equity.**





Data Source: Quick Astra Manager

Asset holdings unrelated to core business (cross-shares)

The Company **holds approx. JPY 28B in cross-shareholdings**. Cross-shareholdings have many issues and **should be disposed of immediately and any proceeds which cannot be re-invested in the core business should be used to fund dividends**.

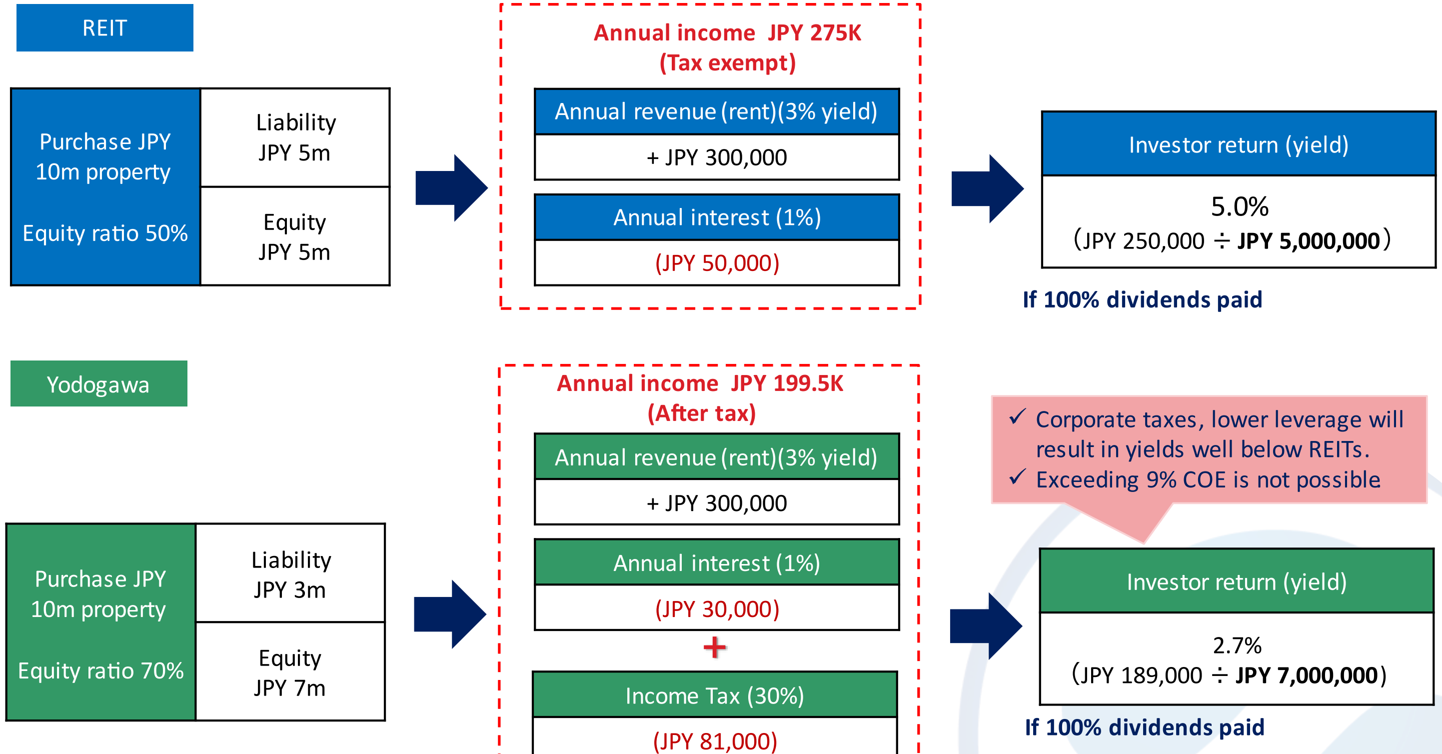
Issues with cross-shares

When purpose is to maintain, facilitate transactions etc.
■ Benefiting from transactions due to the shareholding may be a violation of the companies act (prohibition of profit sharing). ■ If stock ownership facilitates trading, there may be less incentive to improve products and services, resulting in less competitiveness.
Financial issues
■ Impact to P&L and shareholder's equity due to price movement of stocks that have nothing to do with the performance of core business.
Issue when business partner forces stock to be held
■ Could be victim similar to abuse of superior bargaining position, which is an unfair practice under Antitrust laws.
When held as a stable shareholder
■ Using assets entrusted by shareholders to help protect Directors of a company. ■ Basically the opposite of a wolfpack, a "stable shareholder pack."

Asset holdings unrelated to core business (rental real estate)

The Company owns several real estate properties. It is **virtually impossible to realize a return greater than the cost of capital**. J-REIT distributions as of April 18 2024, averaged 4.4% with the highest around 5.5%. Compared to equities they are a low-risk, low return product. It would be difficult for the rental real estate leasing business to generate comparable returns due to corporate taxation and lax of leverage. As investors have the option of investing in REITs separate from Yodogawa stock, it is **unreasonable for the Company to engage in the real estate leasing business**. **Unnecessary assets such as rental real estate, golf courses and the YODOKO Guest House should be sold**.

Comparison of Rental real estate business of Yodogawa and a REIT



* For comparison purposes, depreciation, administrative expenses and other costs are not taken into account

Revisions

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