



Strategic Capital

This campaign website is an abbreviated reference translation of the original in Japanese.

In the event of any differences between the original Japanese version and the English translation, the original Japanese version shall prevail



Proposal to refill the value of Kyokuto Kaihatsu Kogyo Co., Ltd (7226)





Executive Summary

Strategic Capital, Inc.'s (SC) goal is to unlock enterprise and shareholder value through dialogue with the Company's Executive Management ("Management") and the exercise of shareholder rights.

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

- i. Set dividend payout ratio to be 100% or DOE to 8% whichever is greater
- ii. Grant stock price-linked compensation to directors
- iii. Disclose the calculation method of bonuses paid to President Tatsuya Nunohara
- iv. Grant stock price-linked bonuses to employees
- v. Sell cross-shareholdings and distribute proceeds as a dividend





Background & key points on the proposals

Excessive accumulation of equity capital and declining ROE → Set dividend payout ratio to be 100% or DOE to 8%

The Company's stock price has rarely exceeded dissolution value. We believe one of the reasons for the prolonged slump is the decline in ROE due to the excessive buildup of equity capital.

In order to optimize the level of shareholders' equity, we propose a shareholder return policy of either a 100% dividend payout ratio or DOE of 8%, whichever is greater.

Link performance to compensation for Directors that ignore corporate value → Grant PBR linked equity compensation

Managements has been compensated irrespective of corporate value and as a result do not have incentive to improve inefficient management and improve corporate value. This has led to the share price remaining below dissolution value for a long time.

We propose the introduction of a stock compensation plan that is linked to corporate value and in particular provide significant incentive to achieve a stock price above dissolution value.

Further, we propose that the calculation method for the current performance-linked remuneration, which is paid despite that it has not increased corporate value, be disclosed.





Background cont'd

A culture where the disregard for corporate value has become the norm → Grant PBR linked bonuses to employees

The Company is the market leader for special purpose vehicles in Japan, and the value of the business itself is without question. However, the stock price has been stagnant for a long time which we believe it is due to a company-wide culture that disregards corporate value.

We propose a bonus of approximately JPY 1 Billion in total be granted to employees if corporate value improves.

In order to break free from the long-term slump in the stock price, we call for the entire company to work together in striving to improve corporate value.

Cross-shareholdings that loosen management discipline and reduce capital efficiency → Sell cross-shareholdings and use as a source of funds to increase corporate value

The Company states that it holds cross-shareholdings to “increase profits by strengthening business relationships”. However, the business counterparties have denied this, and Management has not been able to make an appropriate judgement as to whether or not to hold cross-shareholdings.

We propose, the sale of all cross-shareholdings and use the proceeds to increase corporate value.

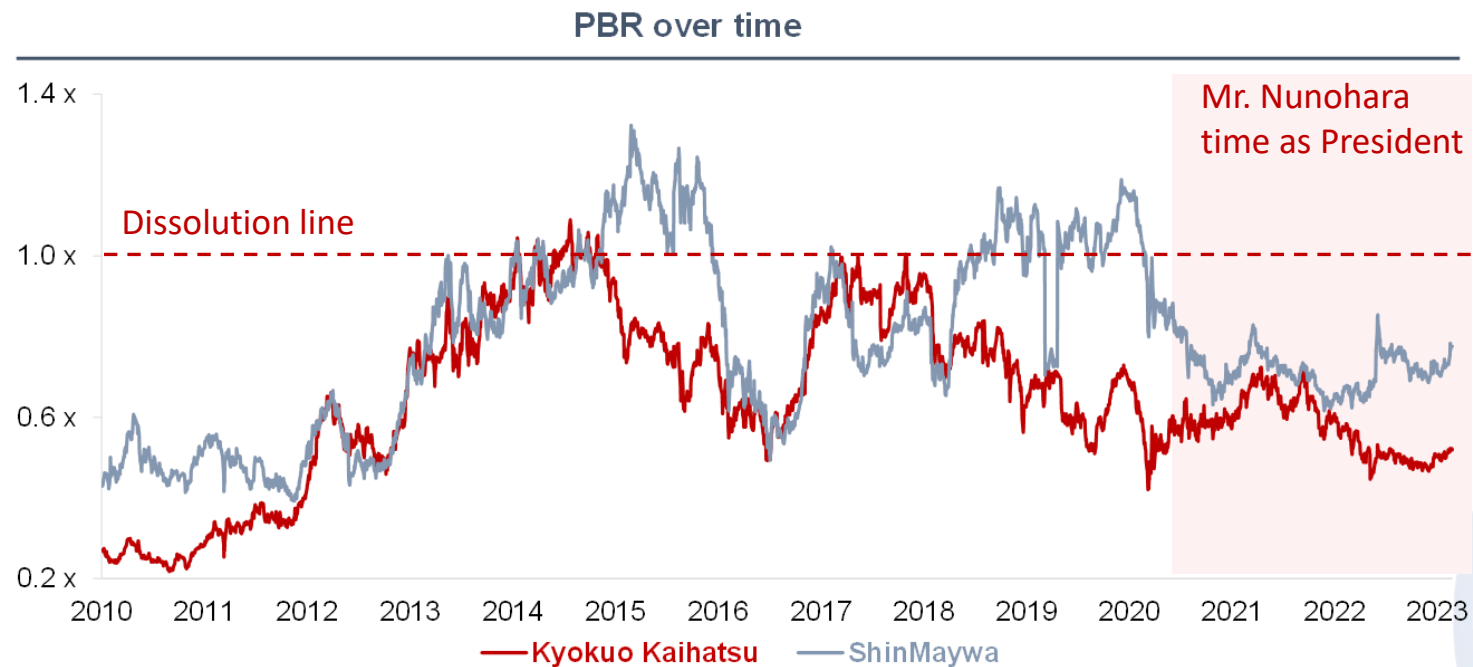




Stock price that constantly trades below dissolution value

SC is submitting a shareholder proposal this year as well, and the reason is the long-term slump in the share price.

Kyokuto's stock price has been consistently below its dissolution value (PBR 1.0 x) and not only has there been no improvement since June 2020, when Tatsuya Nunohara became President, **it has gotten worse and the gap with its peers has widened**



Data Source: Quick Astra Manager

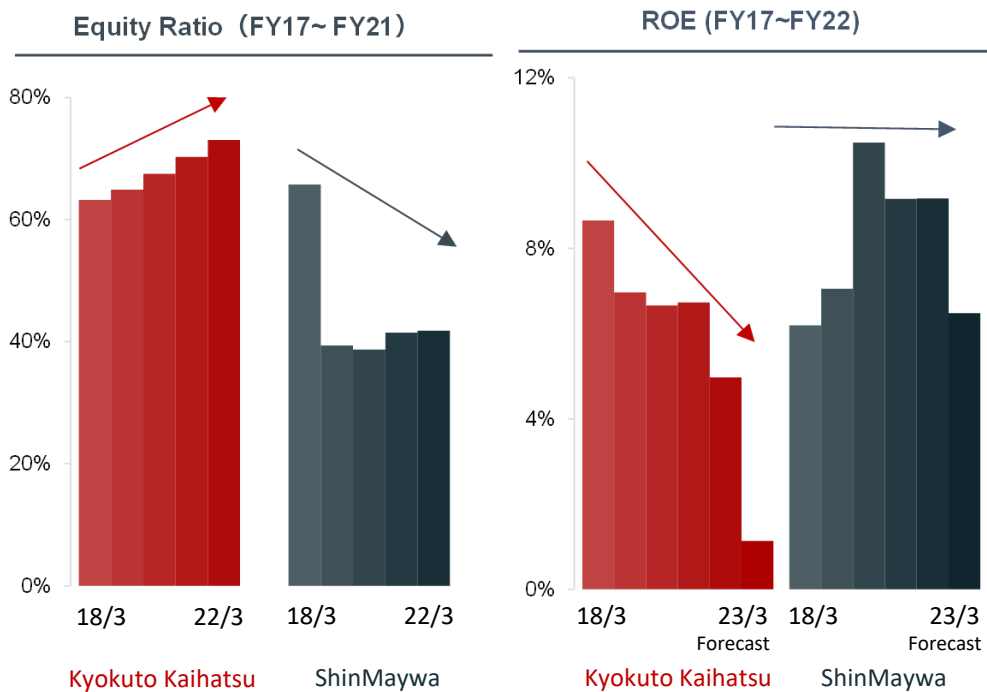




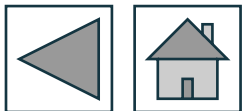
Wrong capital policy is pushing down the stock price

Comparing the capital policy of Kyokuto Kaihatsu, and peer ShinMaywa Industries, there is a clear contrast. The former has continued to accumulate equity capital even as its stock price has slumped, lowering its capital efficiency.

By contrast, ShinMaywa has maintained and improved its capital efficiency by appropriately controlling its equity capital.



Data Source: Quick Astra Manager





Strategic Capital

Shareholder
Proposal

Cheap valuation

Incorrect
understanding of
capital policy

Remuneration and
corporate value

Revision History
Disclaimer

Overview

Illogic I

Illogic II

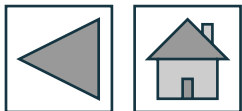
Illogic III

Illogic IV

Incorrect understanding of capital policy

In 2022, Strategic Capital submitted a shareholder proposal to Kyokuto Kaihatsu requesting a change in its shareholder return policy.

Kyokuto Kaihatsu opposed the shareholder proposal, but the reasons provided included many illogical points.





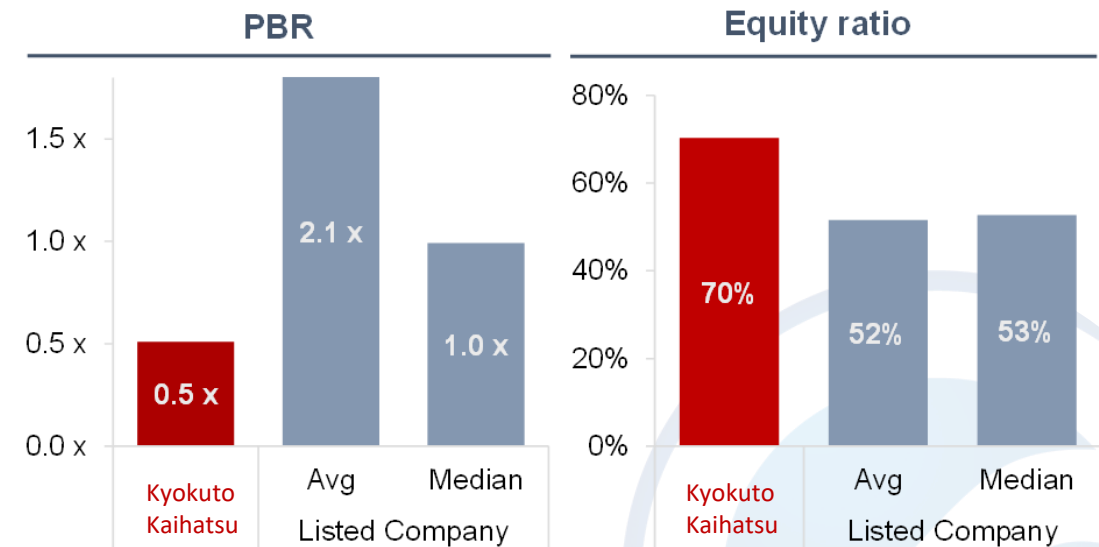
Illogic I. Shareholder returns are comparable to other listed companies

*In addition, under the new medium-term management plan The Company will further enhance shareholder returns.... The Board of Directors of the Company plans **a shareholder return that is consistent with the level of other listed companies.***

Excerpt from the [Notice of the 87th Annual General Meeting of shareholders](#)

In the first place, capital policies should be optimized based on a company's own financial and business conditions. It makes no sense to compare with other listed companies.

However, if we use their line of argument, then it should be noted that **stock price is significantly lower and its equity capital significantly higher than other listed companies.** It is irrational to claim the level of shareholder return is “comparable” without considering the Company's stock price and financial condition.



Data Source: Quick Astra Manager, as of 5/11/2022 when the Company released its opposition to the proposal. Compared to all listed companies on the TOPIX





Illogic II. (They oppose....) to enhance corporate value over the medium to long-term

*If this Proposal were to be adopted, the dividend payout ratio would be 100%, meaning that all profits for the period would be returned to shareholders. We believe that this is an extreme proposal that could hinder investments that are indispensable for the sustainable growth of the Company and the **enhancement of corporate value over the medium to long term.***

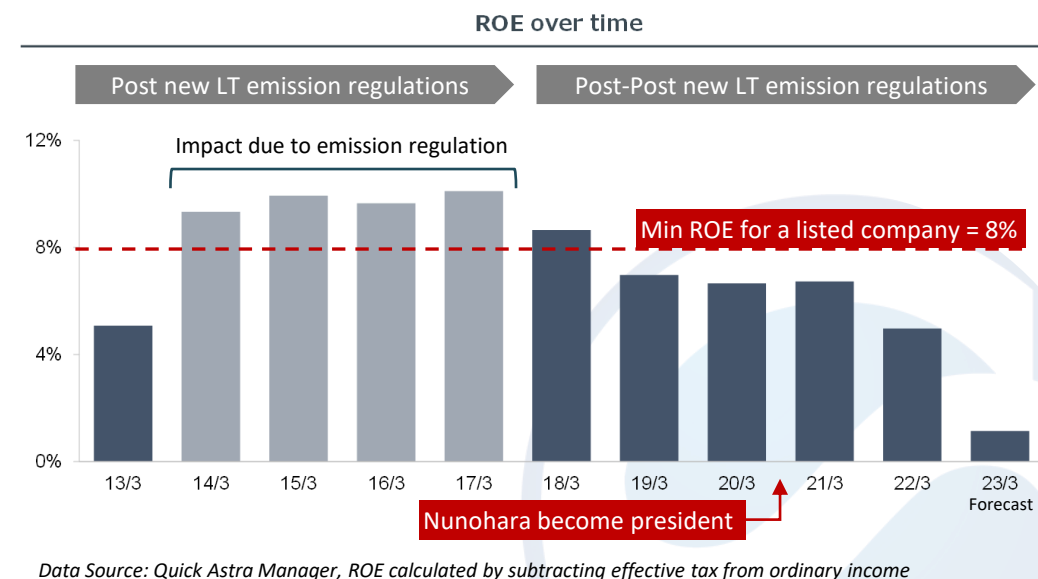
Excerpt from the [Notice of the 87th Annual General Meeting of shareholders](#)

Management has never been able to increase the value over the medium to long-term. 10 years ago, today, the stocks has been stuck below dissolution value. Not surprisingly, since **Nunohara took over as President, the share price has gone down further.**

Back in 2014, METI said “listed companies should achieve a minimum ROE of 8%”. Enough time for it to be called medium to long term. However, without the special demand for tighter emission regulations or the one-time gain from the sale of real estate, ROE would have been below 8%

Using the term “over the medium to long-term” while failing to improve corporate value over the medium to long-term is mere procrastination.

We strongly urge the Company to start improving corporate value from today.





Illogic III. Could hinder essential investments

*We believe that this is an extreme proposal that could **hinder investments** that are indispensable for the sustainable growth of the Company and the enhancement of corporate value over the medium to long term.*

Excerpt from the [Notice of the 87th Annual General Meeting of shareholders](#)

Are they truly unable to hold/raise funds to make investments? More likely management simply doesn't understand the effective use of debt.

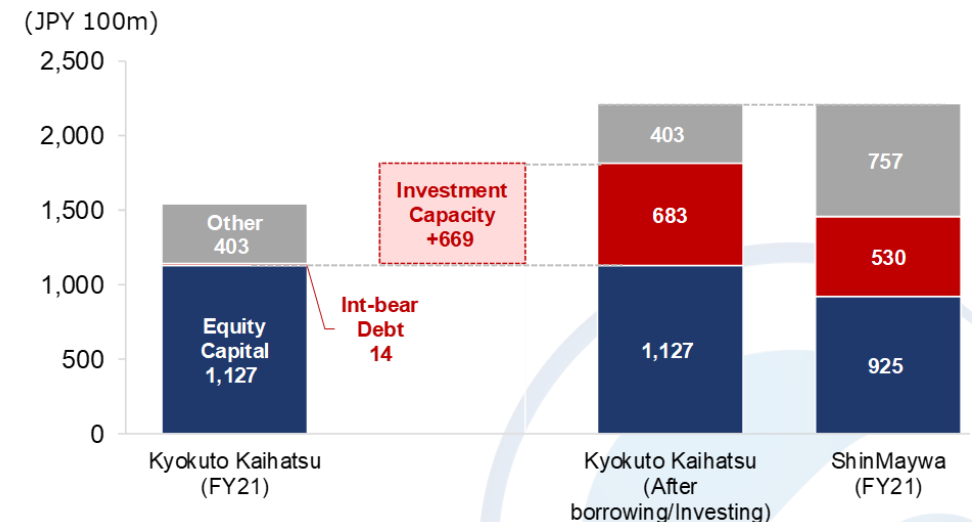
Even if they were to invest to reach the same asset size as ShinMaywa, the **entire amount (JPY 60 B) could be financed with interest-bearing debt.** Even then, the financial soundness would be better than ShinMaywa.

Even if SC's 2022 proposal to increase dividends had passed, it would have resulted in a payout of approx. JPY 13B, leaving more than JPY 50 B of borrowing capacity.

Capital policy should not be based on some far-future investment plan which does not exist in the first place.

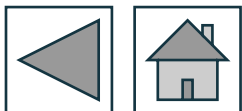
(Note, the proposed dividend increase in 2023 would result in an outlay of approx. JPY 7B additional to the Company's proposal.)

Kyokuto Kaihatsu and ShinMaywa Asset Structure



Equity ratio	73 %	51 %	42 %
Debt-Equity ratio	0.01 x	0.61 x	0.57 x

Data Source: Company YUHO, as of March 2022





Illogic IV. Internal reserves must be maintained in case of crisis such as war, disease or natural disasters

*In order for the Company to ensure stable business continuity in preparation for the current international political unrest such as the Russian and Ukrainian issue, economic turmoil mainly caused by rising natural resources and energy prices, natural disasters such as earthquakes, and emergencies such as infectious diseases like COVID-19, it is necessary not to return all of its profits to shareholders, **to secure a certain level of internal reserves, and to establish a stable management base.***

Excerpt from the [Notice of the 87th Annual General Meeting of shareholders](#)

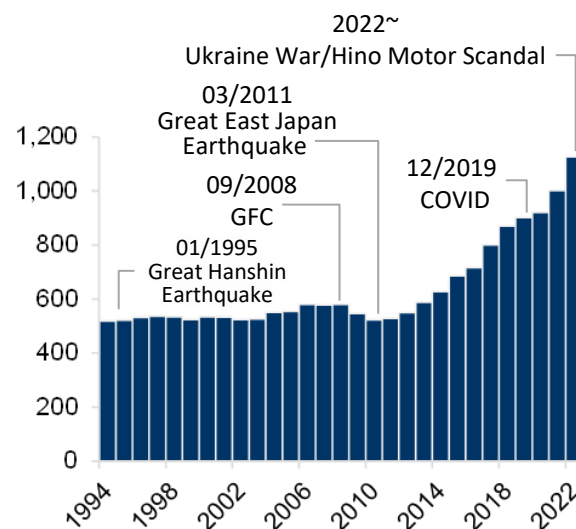
The Company claims that “internal reserves are necessary for crisis”
However, is equity capital really “necessary to prepare for contingencies? **Looking at the level of equity capital and net cash position based on past crises, their claim seems to have no basis in reality.**

Rather, we strongly fear that the Company has learned nothing from past events and has not prepared for what to do in the event of an upcoming crisis and therefore are in no position to make this unfounded "just in case" claim.

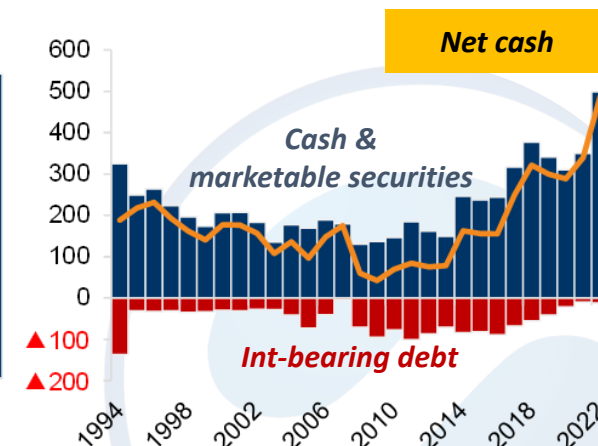
Unnecessarily building up equity capital is not preparedness; it is just management negligence.



Equity capital (JPY 100 m)



Net Cash (JPY 100m)



Data Source: Quick Astra Manager





Illogic IV. Internal reserves must be maintained in case of crisis ... continued

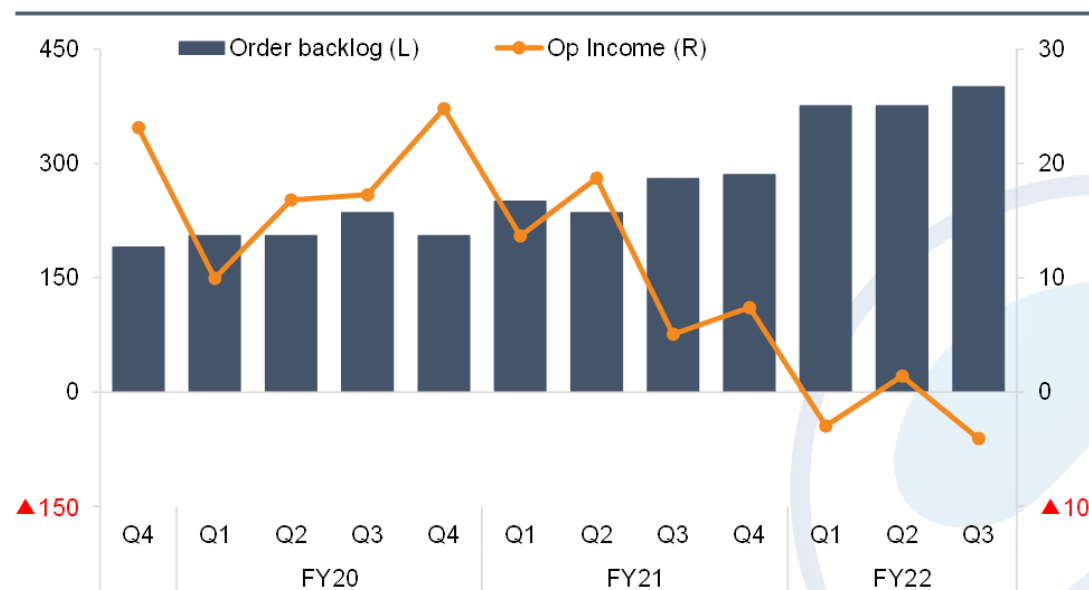
In fact, how did the management respond to the "crises" of the current semiconductor shortage, the supply chain disruption caused by Hino Motors' fraud, or soaring resource prices?

The business performance shows that while demand for the core business is strong, the supply chain disruption has caused order backlogs to build up, the price of raw materials has risen, and profitability has declined significantly.

Has the Company verified how much equity capital and cash were necessary to prepare for a real crisis?

While it is understood that a decrease in profit may be inevitable, the excessive accumulation of equity capital is not a preparation for "contingencies" but a preparation of "management negligence", and may even be hindering a flexible response to "crisis management"

Order backlog/Operating Income (JPY 100 mill)



Data Source: Quick Astra Manager, financial brief material. Operating income is for the special purpose vehicle segment, order backlog on a non-consolidated basis





Performance-based remuneration not designed to increase corporate value

Kyokuto Kaihatsu introduced a performance-based remuneration plan in 2021. However, the plan does not provide appropriate incentives for directors to increase corporate value.

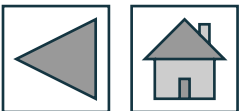
Vague and conveniently using other companies target

The difference is obvious when compared to ShinMaywa Industries. Kyokuto Kaihatsu's policy for determining performance-linked stock remuneration is vague, taking into account "business performance, environment, and other factors".

This is in contrast to ShinMaywa Industries, which discloses specific calculation methods for each level of operating income and ROE. (see next page)

Comparing Remuneration plans (Kyokuto Kaihatsu/ShinMaywa)

			Available	Criteria	transparency	Link to corporate value
Base pay	Cash	Kyokuto Kaihatsu	✓	◆ Rank, responsibility, tenure ◆ Performance/employee salary	▲	—
		ShinMaywa	✓	◆ Position based	▲	—
	Stock	Kyokuto Kaihatsu	—		—	—
		ShinMaywa	✓	◆ Position based	▲	▲
Performance Linked	Cash	Kyokuto Kaihatsu	✓	◆ Operating income	▲	▲
		ShinMaywa	✓	◆ Operating income/ROIC/Net Income	○	○
	Stock	Kyokuto Kaihatsu	✓	◆ Comprehensive consideration of performance, environment etc.	✗	▲
		ShinMaywa	✓	◆ Operating income, ROE from FY 22 to FY24	◎	◎



Vague and conveniently using other companies target continued

It is difficult to understand why the Company did not adopt a similar open and honest policy as ShinMaywa when it introduced its own performance-based remuneration plan for shareholder approval, while claiming the “plan is intended to promote greater value alignment with shareholders”.

In a meeting with SC, management explained the reason for the ambiguous exposure, “we referred to ShinMaywa’s plan and disclosure but did not know what kind of disclosure would be appreciated by investors.”

However, the remuneration plan not only lacks disclosure, but it is also difficult to comprehend.

ShinMaywa disclosure on Performance-based stock remuneration (excerpt Japanese only)

■業績目標達成度
(A) 業績評価期間及び業績評価指標

業績評価期間	2022年3月期から2024年3月期までの3事業年度
業績評価指標	3年累積連結営業利益及び3年単純平均連結ROE

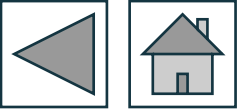
(B) 具体的な算出方法

業績目標達成度は、当社の業績評価期間に対応した各事業年度に係る確定した連結貸借対照表及び連結損益計算書により算出される3年累積連結営業利益及び3年単純平均連結ROEの数値に基づいて、下記に従って算出いたします。

■業績目標達成度の算定方法

ランク			連結ROE（中計3ヵ年単純平均）						
			S	A	B	C	D	E	F
	以上		11.0%	10.0%	9.0%	8.0%	7.0%	6.0%	
	未満			11.0%	10.0%	9.0%	8.0%	7.0%	6.0%
連結営業利益（中計3ヵ年合計）	S	410億円 (137億円/年)	200%	180%	160%	140%	120%	100%	0%
	A	380億円 (127億円/年)	180%	160%	140%	120%	100%	80%	0%
	B	350億円 (117億円/年)	160%	140%	120%	100%	80%	60%	0%
	C	320億円 (107億円/年)	140%	120%	100%	80%	60%	40%	0%
	D	290億円 (97億円/年)	120%	100%	80%	60%	40%	20%	0%
	E	260億円 (87億円/年)	100%	80%	60%	40%	20%	0%	0%
	F	260億円 (87億円/年)	0%	0%	0%	0%	0%	0%	0%

Data Source: YUHO





Unexplained fluctuations in performance-based remuneration

In fact, the performance-based compensation paid to the directors of Kyokuto Kaihatsu seems to have been paid irrespective of corporate value. It is natural to feel a sense of discomfort if we look at the performance-based remuneration for the past three fiscal years.

Thus, we suspect that Kyokuto Kaihatsu is not only failing to introduce a compensation plan that is linked to corporate value, it is even daring to avoid it.

Therefore, we propose that the rationale for the performance-based compensation paid to President Nunohara be disclosed.

Data Source: Quick Astra Manager

Executive Remuneration			
① stock price significantly underperformed TOPIX in FY2019			
Evaluation metric related to stock price	FY2019	FY2020	FY2021
% change in stock price	-20.1%	+39.8%	-16.1%
(TOPIX return)	-11.9%	+39.3%	-0.4%
② Perf-based remuneration uses operating income per FY. Incentive is short-term.			
Evaluation metric related to business performance (JPY Billion)			
Operating Income	849.3	908.0	697.4
% change from previous period	-0.7%	+6.9%	-23.2%
Operating income: Initial forecast	740	540	820
vs. initial forecast	+14.8%	+68.1%	-15.0%
Remuneration (JPY 100)	FY2019	FY2020	FY2021
Fixed remuneration	1,170,000	880,000	970,000
Performance-based remuneration (cash)	not	440,000	520,000
Performance-based remuneration (stock)	introduced	-	90,000
Number of eligible persons	8	7	6
Fixed remuneration per person	146,250	125,714	161,667
Performance-based remuneration per person		62,857	101,667
Fixed: performance-based		65 : 33	65 : 41
Total amount per person	146,250	188,571	263,333

③ Stock dropped 20% in FY2019 but perf-based mostly paid in FY2020
(Fixed:Perf-based is 65:35 when 100% of targets are achieved)



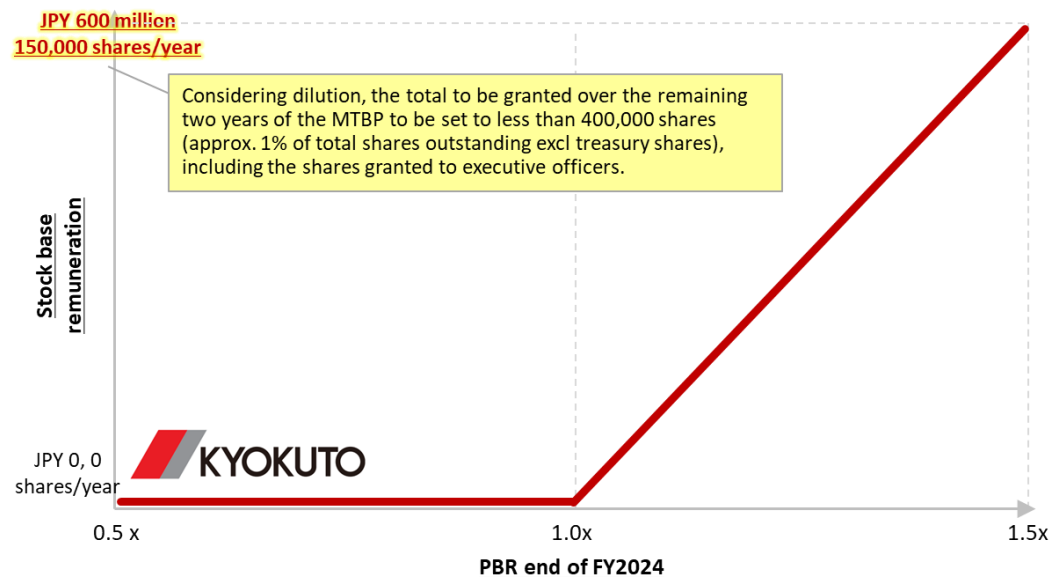


Unexplained fluctuations in performance-based remuneration

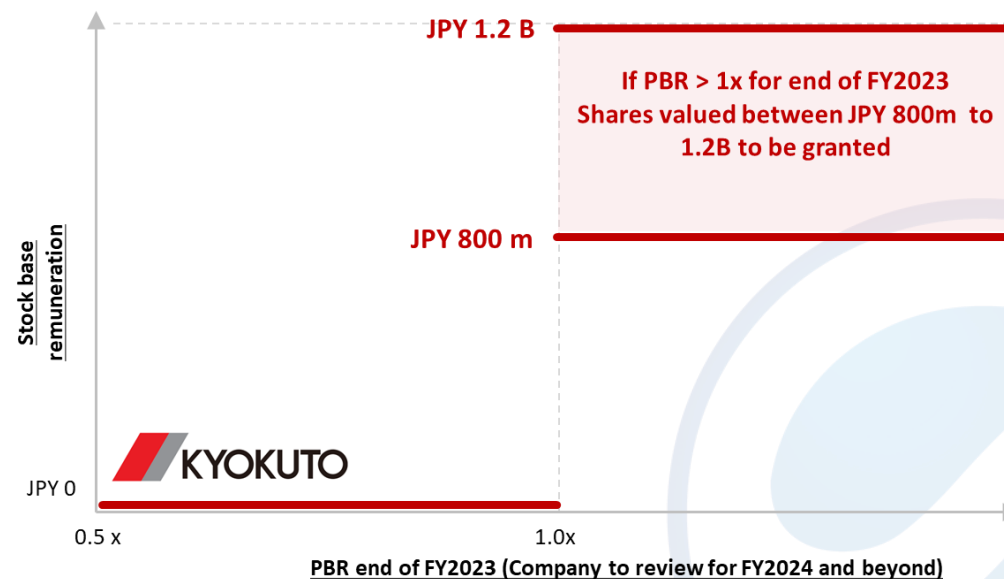
In order to get the stock price at least above dissolution value (PBR 1x), we propose the introduction of a stock remuneration plan that is conditional on the stock price, strongly emphasizing a PBR that exceeds 1.

Further, in order to promote company-wide efforts, we propose that a stock remuneration plan conditional on stock price be granted to employees as well.

Overview of Stock Price Conditional Stock Compensation Plan (Executives)



Overview of Stock Price Conditional Stock Compensation Plan (Employees)





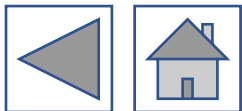
Revisions

04.25.2023

Notified Kyokuto Kaihatsu of our execution of shareholders' right to make a proposal at the AGM. See press release [here](#)

03.23.2023

Campaign website for Kyokuto Kaihatsu opened





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