一般社団法人 機関投資家協働対話フォーラム
Institutional Investors Collective Engagement Forum

October 3, 2023

Engagement Agenda

Request for Dialogue with Investors toward The Implementation of Management That is Conscious of Cost of Capital and Stock Price

The seven companies, namely The Dai-ichi Life Insurance Company, Limited, Meiji Yasuda Asset Management Company Ltd., Mitsubishi UFJ Trust and Banking Corporation, Pension Fund Association, Resona Asset Management Co., Ltd., Sumitomo Mitsui DS Asset Management Company, Limited and Sumitomo Mitsui Trust Asset Management Co., Ltd. (in alphabetical order; hereinafter referred to as the “Participating Investors”), with The Institutional Investors Collective Engagement Forum (hereinafter referred to as “IICEF”) as secretariat, have started sending letters to the presidents of companies selected from among those listed on the TSE Prime Market by the Participating Investors based on the market value of tradable shares, Price-to-Book value Ratio (PBR), etc., requesting appropriate information disclosure and collective engagement with the Participating Investors toward the implementation of management that is conscious of cost of capital and stock price.

On March 31, 2023, the Tokyo Stock Exchange issued a notice requesting actions to implement management that is conscious of cost of capital and stock price. The Notice also requests the disclosure on how dialogues with shareholders are conducted (hereinafter, the notice is referred to as the “TSE Notice”)[1]. The content calls for a change of mindset on the part of management to achieve greater corporate value, and requires active dialogue with investors based on disclosure.

The Participating Investors are institutional investors who invest broadly in Japanese stocks from a long-term perspective, and who employ passive investment to continue to hold stocks or active investment to manage long-term funds in a stable manner. They would like to support companies that demonstrate strengths in their unique technologies and/or products/services, create jobs, and strive to enhance their corporate value under a long-term growth strategy. The content of the TSE Notice is what we also hope companies will proactively address.

The TSE Notice was reported by mass media, drew attention overseas, and elicited positive responses from the stock market on the expectation that many Japanese companies would initiate changes in earnest. However, as media reports focused heavily on “PBR below 1x,” we have seen some companies explore one-off capital policy measures or overemphasize non-financial information not linked to the profitability or growth opportunities of their businesses, aiming to attract investors’ attention and induce ESG investment at any rate. Such efforts have not led to the improvement of corporate valuation by investors. We also hear that there are companies that do not have sufficient systems for or experience in dialogue with investors and do not know how to work on it.

[1] https://www.jpx.co.jp/news/1020/20230331-01.html

Therefore, we have clarified how the Participating Investors perform corporate valuation and what kind of information disclosure they expect from companies. We would like company management to review what they have explained to investors so far and actively engage in dialogue with investors in reference to the following information.

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1. Information Necessary for Investors to Perform the Corporate Valuation

(1) Basic perspectives of the Participating Investors

The Participating Investors manage long-term funds, such as pension funds and insurance funds, and investment trusts and other investment vehicles that contribute to the long-term asset building of Japanese citizens. They are stakeholders who provide capital to companies in response to their capital needs, return investment results commensurate with the risks taken to fund providers, and consequently support the Japanese economy. Companies can enhance their corporate value (discounted present value of their future cash flows)[2] when their investment return (return on capital) exceeds their cost of capital (expected return) over the medium to long term. As a result, they can adequately reward their stakeholders, who are their shareholders.

As investors are using various corporate valuation methods, there is no single way to cope with them. However, the basic principle of corporate valuation is to compare “expected earnings” and “growth potential” with “cost of capital,” which is the return expected by investors that reflects anticipated risks. Investors estimate risks over their intended investment periods based on various factors, such as business activities and market characteristics, management policies, and strategies. They further estimate whether “ROIC (return on invested capital)” and/or “ROE (return on equity)” currently exceeds and is expected to exceed consistently in the future “WACC (weighted average cost of capital)” and/or “cost of equity (shareholders’ expected return)” after considering these risks.

In other words, they calculate corporate value (discounted present value of future cash flows) to determine stock price by comparing “expected earnings” and “growth potential” with “cost of capital.” Even if the current earnings are high, the stock price would not rise unless future growth potential is promising. Also, even if both current earnings and growth potential are promising, the stock price would still not rise if the cost of capital is high due to high risks. If the cost of capital is high due to high risks that are inherent characteristics of its industry, the stock price would not rise unless higher earnings and growth potential are expected.

It should be noted that “PBR (price book-value ratio)” consists of “ROE (return on equity),” an indicator of

[2] Definition of “Corporate value” from “Guidelines for Corporate Takeovers” by METI
“Corporate value” refers to a company’s assets, profitability, stability, efficiency, growth potential, and other company attributes that contribute to the interests of shareholders, or the extent to which they do so. Conceptually, corporate value is the sum of the present values of discounted future cash flows generated by a company.

earnings capability, and "PER (price earnings ratio)," an indicator of growth potential (PBR = ROE × PER). Accordingly, a company can increase its PBR by raising the earnings and/or the growth potential of its business. PBR below 1 is often said shockingly to mean that the company is worth more by dissolving. However, it simply means that the stock price as perceived by investors is low, and it does not mean that dissolution is desired by investors. If the management believes that the current stock price of the company is undervalued and the fair value should be higher, it should explain how the company plans to improve earnings, continue to grow, and reduce the cost of capital. If investors are convinced that the explanation makes sense, stock price valuations, such as PBR, will likely rise.

Therefore, as stated in Principle 5.2 of Japan's Corporate Governance Code[3], companies should, after identifying their cost of capital, **formulate a medium- to long-term growth strategies and explain clearly and concretely to investors in easy-to-understand language and logic their earnings plans, capital policies, business portfolio reviews, allocation of management resources, etc., to realize the strategies**. **Fair price formation in the stock market can be expected if companies** properly disclose information required by shareholders and **gain shareholders' understanding through earnings briefings and dialogues.**

(2) Items of corporate valuation

As explained above, **the basic principle of successful investor relations activities that lead to higher corporate valuation is to explain measures to "increase profitability" and "growth potential" as well as measures to "reduce the cost of capital," such as appropriate risk management, capital policy, and improved governance, to convince investors of their effectiveness and feasibility.** Investors' evaluation items can be organized as follows:

(i) Does the company have earnings power?

- What is the source of value creation? What is the company's business model? What is the company's revenue structure?
- Has the company achieved the return on capital in excess of the cost of capital?
- Does the company recognize the need to improve capital efficiency and is it working on it properly?

(ii) Is the growth potential of the company convincing?

- What are the market characteristics and the competitive environment? Has the company seized growth opportunities successfully?
- What is the company's growth strategy? What are its growth drivers?
- Has the company clarified necessary management capital? Can it secure intangible capital (human resources, intellectual property, etc.)?

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[3] [Principle 5.2 Establishing and Disclosing Business Strategies and Business Plans]
When establishing and disclosing business strategies and business plans, companies should articulate their earnings plans and capital policies, and present targets for profitability and capital efficiency after accurately identifying the company's cost of capital. Also, companies should provide explanations that are clear and logical to shareholders with respect to the allocation of management resources, such as reviewing their business portfolio and investments in fixed assets, R&D, and human capital, and specific measures that will be taken in order to achieve their plans and targets.

- Is the company’s portfolio management effective? Is its resource allocation appropriate?

(iii) Does the company have appropriate risk management in place?

- What risks does the company face in its business operations and strategy execution?
- Does the company properly monitor and manage these risks?

(iv) Attitude towards the capital market, capital policy, governance, corporate culture, top executives’ commitment

- Does the company pay full attention to shareholders? Does it adequately consider their interest? Is it willing to engage in dialogue with them? Does the company actively disclose information?
- What is the company’s capital policy?
- Does its vision and purpose pervade the company? Is its corporate culture healthy and does it drive value enhancement?
- Does the company’s governance function properly? Does it push forward strategy execution?
- Whether there is top executives’ commitment?

2. Items That Should Be Explained during Dialogue with Investors

By explaining your “stories toward corporate value enhancement” carefully based on the investors’ evaluation items for corporate valuation listed above, you can help investors better understand your stories and lead to fair corporate valuation. As explained in the letter, “Investor Recognition of Sustainability Issues and Request for Clarifying Your Stories toward Corporate Value Enhancement (Investor Expectations for the Disclosure of Non-Financial Information),” sent from IICEF to the presidents of all companies listed on the TSE Prime Market in 2022, a “story toward corporate value enhancement” means a method of explanation of initiatives toward corporate value enhancement summarized as a story ensuring consistency of each item listed above.

The table below summarizes examples of a “story toward corporate value enhancement,” items that should be explained therein, and relevant items of corporate valuation listed above.

[Explanation items for appropriate corporate valuation (items to be incorporated in your story)]

Story toward Corporate Value Enhancement	Key explanation items	Investors’ evaluation items
1) Medium- to long-term management vision, mission, or purpose that the company should achieve	**Management vision, corporate mission and purpose** ・ Recognition of corporate culture	(iv) Corporate culture
2) Current business model, sources of value creation and competitiveness, revenue structure, market environment	**Business model** ・ Description and characteristics of products and services, degree of contribution by business unit **Revenue structure** ・ Revenue and cost structure, stream of cash flow generation, contractual terms and conditions that have a significant impact on revenue structure	(i) Does the company have earnings power? (ii) Is the growth potential of the company convincing?

<table>
<tr><td></td><td>Market environment
・ Specific description and size of markets (customer type, region, etc.)
・ Competitive situation, positioning, share, etc.
Source of competitiveness and competitive advantages
・ Growth drivers, such as technologies, intellectual property, business model, know-how, brand, human resources, etc.</td><td></td></tr>
<tr><td rowspan="2">3) Material sustainability issues that give rise to risks and growth opportunities (materiality including, in particular, financial materiality)</td><td>Identified risks and measures to mitigate them
・ Key risks that may have a significant impact on the achievement of growth or execution of business plans and measures to mitigate them</td><td>(iii) Does the company have appropriate risk management in place?</td></tr>
<tr><td rowspan="3">Growth strategy
・ Management policy and medium- to long-term growth strategy
・ Specific measures and management capital (research and development, capital expenditures, marketing, human resources, intellectual property, investments, etc.) to implement the policy and strategy
・ Time frame for achieving the goals (vision, purpose, etc.)</td><td rowspan="4">(ii) Is the growth potential of the company convincing?</td></tr>
<tr><td>4) Medium- to long-term strategy for corporate value enhancement based on materiality including, in particular, financial materiality to achieve the corporate vision, mission, or purpose</td></tr>
<tr><td>5) Management resources, especially intangible assets such as human capital and intellectual property, necessary for the execution of the medium- to long-term strategy</td></tr>
<tr><td>6) Impact of financial materiality on future financial performance and associated targets and KPIs</td><td>Management indicators
・ Key management indicators (reason for adoption as indicators, actual results, specific target numbers, etc.)
Profit plans, prerequisites and their progress</td></tr>
<tr><td>7) Governance for actively and boldly promoting the issues listed above under appropriate risk-taking and, in particular, governance related to sustainability initiatives (sustainability governance)</td><td>Dialogue with investors, information disclosure policy and capital policy
・ Monitoring of cost of equity and WACC and capital policy
・ Recognition of capital market's evaluation of the company
Governance policy, structure and initiatives
・ Appropriate risk-taking and active and bold decision making, mechanisms and structure to maintain discipline of them
Top executives' commitment</td><td>(iv) Attitude toward capital market, capital policy, governance, top executives' commitment</td></tr>
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In order to prepare these stories, companies need to sort out a wide range of items, some of which may require considerable time for internal discussion. However, rather than refraining from providing explanations externally until all items are clarified, **<u>we recommend that companies start investor communication with those items which have already been pulled together.</u>**

3. Request for Collective Engagement with the Participating Investors

Letters containing this agenda are currently being sent to the presidents of companies selected by the Participating Investors from among those listed on the TSE Prime Market based on tradable share market capitalization, PBR, etc. Dialogue with long-term investors who have significant experience in dialogue with a wide range of companies and their management provides opportunities for companies to hear objective opinions toward corporate value enhancement and to gain insights that may lead to the resolution of issues that the management faces. We hope that the companies will use this letter as a reference, conduct collective engagement with the Participating Investors, and actively work on corporate value enhancement.

Actual meetings will be attended by one or two companies from among the Participating Investors as their representative(s) to listen to explanations from and ask questions to the company. Information obtained at the meeting will subsequently be shared among the Participating Investors. The collective engagement would be more effective if explanatory materials are prepared for the meeting in line with the "explanation items for appropriate corporate valuation" listed above.

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[Introduction of IICEF and the Participating Investors]

IICEF was established, based on the Japanese Stewardship Code, to hold constructive collective dialogues (collective engagements) with listed companies in Japan by multiple institutional investors. IICEF serves as secretariat for collective dialogues by institutional investors who invest in a broad range of Japanese equities. Institutional investors participating in this Program emphasize sustainable growth of corporate values and operate with a strong awareness of stewardship responsibility. All of them invest in a wide range of Japanese equities from long term viewpoints through passive investment and stable active investment of long-term assets. The Participating Investors, with IICEF as secretariat for collective dialogues, adopt agendas common to Japanese companies, send letters that summarize the investors' mindset, its context and requests to the companies as common views, and hold meetings with the management. The objective of these collective dialogues is to enhance long-term corporate value creation and its sustainable growth, not to pursue short-term shareholder returns.

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