Kiltearn Partners LLP

3rd Floor, Exchange Place 3,
3 Semple Street, Edinburgh,
EH3 8BL
Telephone 0131 460 1040

7 February 2023

Kiltearn Partners LLP (**"Kiltearn"**), acting on behalf of its clients, controlled 1,881,936 shares in Toagosei Co., Ltd. (the **"Company"**) as of 31 January 2023. This represented 1.54% of the Company's issued share capital. Kiltearn's clients have been shareholders in the company since March 2013.

Kiltearn has engaged with the Company since the inception of our clients' investment in the Company. Kiltearn wants the Company to grow its business in a rational and prudent manner, maintain a sensible level of capital on its balance sheet and offer attractive returns to shareholders.

We are encouraged that the Company acknowledged in its 2020-2022 Medium-Term Management Plan (the **"2020-2022 Plan"**) and, its recently announced, 2023-2025 Medium-Term Management Plan (the **"2023-2025 Plan"**) that its balance sheet is overcapitalised and it needs to take steps to address that overcapitalisation and increase shareholder returns. However, the action taken by the Company to date and that the Company proposes to take in the future is, in Kiltearn's view, insufficient.

Current Overcapitalisation of the Company's Balance Sheet and Shareholder Returns

The total "cash and deposits" and "investment securities" (¥61,700 million) stated in the Company's consolidated balance sheet equalled 33.7% of the Company's shareholders' equity (¥183,247 million) as of 31 December 2019. This had risen to 35.2% (¥67,469 million) of shareholders' equity (¥191,785 million) by 30 September 2022. As a result, while the Company met its capital efficiency and shareholder return targets under the 2020-2022 Plan, this was not sufficient to address the overcapitalisation of the Company's balance sheet. In fact, the overcapitalisation grew over the period.

Holding ~35% of shareholders' equity in "cash and deposits" and "investment securities" is excessive by any reasonable measure and demonstrates a lack of capital discipline on the part of management.

On 31 January 2023, the Company announced its 2023-2025 Plan. Under the 2023-2025 Plan, the Company has committed to maintaining a dividend payout ratio of 30% and conducting share buybacks with a value of ¥20 billion over the three-year period. While the latter is an incremental improvement on the 2020-2022 Plan, Kiltearn believes that even if the Company meets those targets, return on equity ("**ROE**") – a key measure of shareholder value creation – will likely continue to be depressed (ROE has averaged 6% over the last five years). Kiltearn believes that the Company should be aiming to achieve an ROE in excess of 10%.

A depressed ROE is particularly harmful to the Company's shareholders. The Company's primary shareholders are Japanese. These include pension plans, cooperatives and individuals. Japanese shareholders, like Kiltearn's clients, rely on the Company to grow its dividend and increase its ROE.

Under the 2023-2025 Plan, the Company has committed to capital expenditure of ¥68 billion for enhancing manufacturing facilities, expanding research facilities and focusing on sustainability-related investments; however, we note that management has a record of promising substantial growth, which has never materialised.

Kiltearn's Proposals

<u>Increase the Dividend Payout Ratio to 50%</u>
In order to address the Company's overcapitalised balance sheet and improve shareholder returns, on 18 January 2023, Kiltearn sent the Company a formal demand letter. Kiltearn's demand letter

requires the Company to add two proposals to the Company's annual general meeting (**"AGM"**) agenda, which will occur in March 2023.

The first proposal is for the Company to increase the dividend payout ratio to 50% for the fiscal year ended 31 December 2022. We note that the Company's current forecasted dividend payout ratio of ~34.1% is below the average dividend payout ratio of 42.5% for companies listed on the Prime Market of the Tokyo Stock Exchange. Further, dividend payout ratios among Japanese listed companies are on the rise. The Company's relatively low dividend payout ratio in the face of such a trend is an indication that the Company is not giving suitable focus to shareholder returns.

While this proposal only relates to the fiscal year ended 31 December 2022, a vote in favour of the resolution will provide the Company's Board of Directors with guidance on the expectations of shareholders for the Company's dividend distribution policy in future years.

If shareholders approve Kiltearn's proposal, the year-end 2022 dividend would be increased from ¥18 per share to ¥34 per share. The total dividend paid by the Company with respect to the financial year ended 31 December 2022 would be ¥52 per share versus the Company's ¥36 per share earnings forecast.

<u>Buyback ***up to*** 10% of Issued Share Capital</u>
The second proposal is for the Company to repurchase <u>***up to***</u> ~10% of its issued share capital with a maximum total price of ¥16 billion in the fiscal year end 31 December 2023. We note that the proposed maximum buyback would equate to ~24% of the Company's "cash and deposits" and "investment securities" (¥67,469 million) stated in the Company's consolidated balance sheet as of 30 September 2022.

While the proposed maximum buyback under the 2023-2025 Plan (¥20 billion) is in excess of our proposed buyback, we note that our proposal only relates to the fiscal year ended 31 December 2023, rather than the three-year period. Our expectation would be that the Company considers further buybacks in subsequent years, where appropriate. A vote in favour of the resolution will provide the Company's Board of Directors with guidance on the expectations of shareholders for the Company's future level of buybacks and capital allocation policy.

As stated in our shareholder proposals, as of 30 September 2022, the Company held ¥27,758 million of "investment securities" on its balance sheet. Based on publicly available information, Kiltearn understands that these include cross-holdings in:

- a publicly traded general trading company (e.g. Mitsui & Co);
- financial services companies (e.g. Mitsubishi UFJ Financial Group and Sumitomo Mitsui Financial Group); and
- chemical companies (e.g. Ishihara Sangyo Kaisha, Tokyo Ohka Kogyo, Nippon Kayaku and Osaka Soda).

The cross-holdings do not allow the Company to exercise day-to-day influence on the underlying business operations of the cross-holding companies. Arguments from management that these are strategic investments are not valid. Kiltearn believes that the investments have been made solely for the convenience of the Company's management and are reflective of the Company's historic practice of hoarding excess capital. If the Company's shareholders wished to invest in the shares issued by these cross-holding companies, the Company's shareholders could do so directly.

Kiltearn believes that such cross-holdings, for which there is no recognised need, could be liquidated and the proceeds used to fund partly the share buyback proposed by us. Our proposed maximum buyback of ¥16 billion equates to ~58% of the "investment securities" held on the balance sheet as of 30 September 2022.

Finally, we note that the increase in the Company's dividend payout ratio and proposed level of buyback would cause no problems in terms of the Company's financial soundness and business continuity. Even with the increase in the dividend payout ratio and share buybacks at the maximum value, the level of the Company's free cash flows and capitalisation would allow the Company to invest in its core businesses, prepare for various technology changes and expand its business activities in a reasonable and prudent manner.

Kiltearn encourages all shareholders to consider carefully its dividend and buyback proposals. Kiltearn encourages all shareholders to vote in favour of both proposals. The proposals will give all shareholders the right to express their views on the performance of the Company and its management. A vote in favour of the resolutions will provide the Board of Directors with guidance on the Company's future capital allocation and dividend distribution policies.

Please contact Douglas McArthur (dmcarthur@kiltearnpartners.com) with questions on this press release.

About Kiltearn

Kiltearn is a UK-based asset management firm. Kiltearn invests its clients' assets in publicly traded global equity securities using a bottom-up, value-based, investment approach. Kiltearn is a 'long-only' manager. Kiltearn does not short securities, utilise derivatives or invest in convertible instruments. Kiltearn seeks to invest in companies trading cheaply relative to their assets, earnings or dividends. Kiltearn has been invested in Japanese equity securities since its inception in 2011. As of 31 January 2023, Kiltearn had more than 12.5% of its clients' portfolios invested in equity securities issued by publicly traded Japanese companies.

Kiltearn is the appointed investment manager for several commingled funds. Unitholders in our commingled funds are institutional investors. The majority of these investors are charities, foundations, endowments, corporate pension plans, church plans and state pension plans. As a result, Kiltearn believes that generating investment returns for its clients and their beneficiaries has sustainable benefits for society. One of our commingled funds is The Kiltearn Global Equity Fund. Kiltearn has authority, as investment manager, to introduce AGM proposals on behalf of The Kiltearn Global Equity Fund.

Kiltearn is not an 'activist' investor. Kiltearn is a fiduciary for its clients' assets and takes its stewardship obligations seriously. Kiltearn will engage with portfolio companies where appropriate.

Kiltearn first invested its clients' assets in the Company in March 2013. Kiltearn has regularly engaged with the company on its approach to capital allocation and overcapitalised balance sheet. Kiltearn has sought for these discussions to remain confidential between Kiltearn and the Company. Kiltearn has been forced to make these proposals public as a means of escalating the engagement given that the Company has, to date, not taken the action necessary to address Kiltearn's concerns.

As of 31 January 2023, Kiltearn could exercise control over 1.54% of the Company's issued share capital. The Kiltearn Global Equity Fund held over 1.1% of the Company's issued share capital and had done so continuously for over six (6) calendar months.