



Kaname Capital

Dear fellow shareholders of Fukuda Denshi,

Kaname Capital has submitted four shareholder proposals addressing two major governance shortcomings at Fukuda Denshi (6960 JP). The AGM is on June 29<sup>th</sup>. These are principle-based proposals that are worthy of your consideration both for their potential impact on our jointly held Company and their potential positive spillover effects in the market overall. We outline our proposals using the numbers you will find on the AGM Convocation notice below.

Eliminate the Poison Pill: Proposals 3) and 4) on the AGM Convocation ask shareholders to eliminate the Poison Pill. We do it two ways. Proposal 3) is non-binding and is our effort to encourage allegiant shareholders, like banks and insurance companies, to voice concern. We believe 50% approval would send a strong message. Proposal 4) is legally binding and would change the Articles of Association to allow shareholders to vote on the Poison Pill. This threshold is 67%, which we acknowledge is a challenge.

Our concern with the Poison Pill is three-fold. First, it was passed over 17 years ago without a sunset provision, is no longer compliant with corporate governance best practices, and has entrenched management to such a degree that it has enabled a catalog of governance problems. Second, its existence is the primary reason for chronic market undervaluation of the equity. Lastly, the Poison Pill should be cancelled because it denies shareholders their fundamental right of self-determination on a critical aspect of policy.

Say on Pay -- Eliminate Chairman Fukuda Kotaro's monopoly power on Board compensation: Proposals 5) and 6) address Chairman Fukuda's unchecked ability to pay himself. Proposal 5) is non-binding and provides an opportunity for allegiant shareholders to send a governance message about unchecked executive power that allows 95% of all Board compensation to go to Chairman Fukuda and President Shirai Daijiro. Proposal 6) is the same language as Proposal 5) but is binding and requires 67% support for implementation, like Proposal 4). We believe the Chairman uses this power to both enrich himself and stifle dissent to the detriment of shareholders. But this is NOT the only reason reform is needed. Reform is needed because a properly functioning public company board requires quality individuals who are able to think and act independently and objectively without fear of reprisal from a single, powerful insider.

We intend to examine the approval gap between our non-binding and binding proposals to get a better sense of where shareholder mindset is, even if we are not collectively ready to stand up for concrete reform.

Fukuda Denshi's corporate governance is a disgrace, and sadly, we shareholders have, with our passivity, abetted it for too long. Kaname Capital's proposals are an opening attempt to create a low barrier for banks and insurance companies to vote "yes" for better governance. By our calculation, ¥180bn of incremental market capitalization is held hostage by this non-functioning Board. Our aim is to help Fukuda Denshi become a stronger company. We believe that with a small improvement in governance, the company has the potential to become significantly more valuable to the benefit of all stakeholders.

Please reach out with any questions.

Sincerely,

Toby Rodes

Nao Makino

Eric Ikauniks



## Appendix: a catalog of problematic transactions & behavior by Chairman Fukuda

We have grave concerns about Chairman Fukuda's stewardship of Fukuda Denshi. Indeed, his behavior appears so self-serving and indefensible that it is hard to believe we were able to piece it together completely from public documents.

A company of Fukuda Denshi's quality should not be able to pass Kaname Capital's value screens. This is a great business that should garner premium multiples. Yet, leadership seems to have gone out of its way to make the stock practically uninvestable to institutional shareholders. We think this is to shield itself from the market's scrutiny and allow insiders to enrich themselves at public shareholders' expense.

Aspects of the company that appear designed to suppress market capitalization and market trading volumes:

- An obsolete Poison Pill that is completely controlled by the Board.
- A JASDAQ IPO and now a listing on the Standard Market despite a market capitalization over ¥100 billion.
- Illiquid shares. There is recent history of the stock trading as little as 200 shares in a day. Rather than split shares, the company keeps the absolute share price high which makes it costly for retail shareholders to submit shareholder proposals. To do so would require 30,000 shares, or ¥135m. (share price x 100 share lot x 300 lots = ¥4,500 x 100 x 300 = ¥135mn).

Below we document what appears to be a systematic history of abusing a public company to the benefit of Chairman Fukuda.

1. **Siphoning profits to the founding families through Atomic Sangyo** – Atomic Sangyo, a private company established in 1964, was wholly owned by four members of the Fukuda family, led by Chairman Fukuda's 79.32% stake. Atomic Sangyo manufactured and sold various types of consumables for medical electronic equipment to publicly traded Fukuda Denshi. In October 2015, Atomic Sangyo was consolidated via an inexplicably high share swap ratio of 419:1.

While Atomic Sangyo boasted an extremely high operating profit margin of around 30%, the company's annual report for the fiscal year ended March 31, 2016 shows that it operated with only ¥13m in PPE and 11 employees. Although Fukuda Denshi states that it "determines transaction prices through negotiations in consideration of market prices, and has sought to ensure transparency through continuous disclosure (disclosure of related-party transactions) mainly in its annual securities report," the company's business scale and standardization of its operations indicate that Atomic Sangyo was virtually the only company supplying recording paper to Fukuda Denshi. We must assume that the Company had no other choice but to purchase recording paper from the founding family at a high margin.

It appears that transactions between the Fukuda Denshi and Atomic Sangyo existed for nearly 50 years, from 1964 to 2015. When it became a wholly owned subsidiary of Fukuda Denshi, Atomic Sangyo had cash and cash equivalents of ¥4,715 million (Annual Securities Report for the year ended March 31, 2016, p. 60).

In our view, at least the sum of the dividends and ¥4,715 million during this period was earned by the founding family. Clearly, it is easy to assume that much more cash was siphoned off over the years. Where was the Board?

### Atomic Sangyo

¥mn	12-Mar	13-Mar	14-Mar
Sales	1,577	1,490	1,577
OP	501	424	546
OPM	31.8%	28.5%	34.6%



- Fukuda family selling Fukuda Denshi shares high and buying low** - In addition to his direct holdings in Fukuda Denshi stock, Chairman Fukuda indirectly controlled shares in the Company through two entities owned by his family: Tokyo Enterprise and Atomic Sangyo. In 2013, Fukuda Denshi bought back the block of shares owned by Tokyo Enterprise, the Fukuda family controlled real estate company. These shares went into treasury on the Company balance sheet. Then, in 2015, Fukuda Denshi bought Atomic Sangyo from the Fukuda family, paying them with treasury shares. The swap ratio was an inexplicably high 419 shares of Fukuda Denshi for 1 share of Atomic Sangyo. The Fukuda family realized ¥4 billion selling shares to Fukuda Denshi in 2013 (via Tokyo Enterprise) and then got those shares back with the Atomic Sangyo transaction. Chairman Fukuda's effective ownership interest in the Company remained virtually unchanged at around 22% before and after these deals.

Our primary concern is that Chairman Fukuda effectively orchestrated a successful "short sale" of Fukuda Denshi shares. If the buyback and share swap had happened simultaneously, we would still have concerns. But these transactions had a gap of two years, and it could be argued that Chairman Fukuda had an economic incentive to reduce the Company's stock price during this period (so he could end up with more shares in the second transaction). The conflict-of-interest in managing these transactions is obvious. Where was the Board?

During the Atomic Sangyo deal, the exchange ratio was determined by MID Structures, a financial advisory firm, but mysteriously no fairness opinion was made. This money shifting and share swapping event had some governance window dressing, but it was just cover for a self-serving scheme.

- Using Company money for private "philanthropic" activities** - On May 13, 2016, Fukuda Denshi announced the "Notice of Treasury Stock Disposal by Favorable Issue for the Purpose of Supporting Social Contribution Activities of Fukuda Memorial Foundation for Medical Technology Promotion" and issued 150,000 shares of common stock from treasury (300,000 shares after adjustment for split) to the Fukuda Memorial Foundation for Medical Technology Promotion (the "Foundation") at ¥1 per share. These shares were worth approximately ¥900 million at the time of the announcement. This transfer of company property was approved by 85.28% of the shareholders at the 69th Annual General Meeting in June 2016. However, this represents only 63.67% if we exclude the Fukuda family, the employee shareholding association, and the financial institutions with which the company does business.

The Foundation was established by Chairman Fukuda as part of a 50th anniversary commemorative project, and is described as a "social contribution activity" by the founding family. Philanthropy is fine, but should be funded personally and not with large amounts of Company property. What makes matters worse, the Company essentially funded a new shareholder block that is completely beholden to Chairman Fukuda, entrenching him even further. We suspect that was the primary motivation for his "philanthropy." Where was the Board? Actually, the Board, in this case, was granted exclusive authority to approve the transaction, effectively using shareholder capital against shareholders' interests.

- Egregiously high compensation for Chairman Fukuda** - Chairman Fukuda's total compensation increased 3.32 times from ¥136m in FY14 to ¥452m in FY22. In comparison, operating profit increased 1.93 times and employee salaries increased only 1.07 times. It is difficult to argue the Chairman's pay increase was justified based on results for Company stakeholders. Historically, Chairman Fukuda's base salary and bonus have risen consistently, with no relationship to profits.

How was this accomplished? Fukuda Denshi increased the total budget for Board compensation twice in the last five years. A budget increase requires a resolution at the General Shareholders meeting. To convince shareholders to support the increase, it was done under the guise of seating more board members for better governance. But Chairman Fukuda padded the board with people he did not need to pay out of



the shareholder authorized Board compensation budget because these people already drew salaries as Company employees. Basically, he used the AGM to pay himself under false pretenses. Hopefully, one can appreciate our lack of trust in the Board. Since the Company does not disclose a clear formula for determining compensation, and the budget was raised under false pretenses, his compensation increases were self-dealt with zero oversight.

Chairman Fukuda's remuneration has increased since FY16.3, which coincides with the Atomic Sangyo transaction. We suspect that because Chairman Fukuda no longer siphons cash from the company via Atomic Sangyo through the back door, he receives it through the front door in the form of director compensation. His self-granted bonus has gone from ¥20 million in 2014 to ¥240 million in 2022, a 12x increase.

Data (¥mn)	14-Mar	15-Mar	16-Mar	17-Mar	18-Mar	19-Mar	20-Mar	21-Mar	22-Mar
Fukuda's total comp	136	136	141	154	190	232	278	349	452
Base salary	116	116	120	122	132	146	157	165	199
Bonus	20	20	21	31	57	75	110	170	240
Others	-	-	-	1	1	11	11	14	13
Employee's average comp (parent)	7.6	7.8	7.4	7.5	7.8	7.8	7.8	7.7	8.2
OP (consolidated)	11,783	10,303	10,649	12,062	12,334	12,645	13,283	19,811	22,708

  

Data (14-Mar = 100)	14-Mar	15-Mar	16-Mar	17-Mar	18-Mar	19-Mar	20-Mar	21-Mar	22-Mar
Fukuda's total comp	100	100	104	113	140	171	204	257	332
Base salary	100	100	103	105	114	126	135	142	172
Bonus	100	100	105	155	285	375	550	850	1,200
Others	-	-	-	-	-	-	-	-	-
Employee's average comp (parent)	100	102	97	98	102	102	102	101	107
OP (consolidated)	100	87	90	102	105	107	113	168	193

As described above, there is substantial evidence that Chairman Fukuda places his interests above those of minority shareholders and employees. This is primarily enabled by the poorly crafted Poison Pill, which ensures no single shareholder can check insiders' power. Insulated from any discipline, a culture of self-dealing, self-preservation, and risk aversion has grown.

We offer some concluding thoughts on how Chairman Fukuda musters his unlikely support from shareholders. Here is a summary of Chairman Fukuda's past problematic transactions and actions.

AGM's	Date	Agenda	Description	Result	Rate
The 68th AGM	6/26/2015	Shareswap	100% merger of Atomic Sangyo through shareswap	Approved	90.73%
The 69th AGM	6/29/2016	Delegation of allocating treasury shares to the Board	Advantageous placement of treasury shares to the Fukuda family related NPO	Approved	85.28%
The 72th AGM	6/27/2019	Directors' compensation	Raising the directors' compensation limit to ¥600mn	Approved	95.24%
The 74 th AGM	6/29/2019	Directors' compensation	Raising the directors' compensation limit to ¥1bn	Approved	96.71%

Unfortunately, many of these transactions were overwhelmingly approved by shareholders. The lack of accountability is likely explained by the high level of share ownership by financial institutions such as banks and life insurance companies.



Fukuda Denshi is cash-rich and has no need to borrow. Yet the shares are mainly held, in order, by banks that have extended token loans: Kiraboshi Bank (4.56% owner of the Company's shares, loans of ¥400m, the same hereinafter), MUFG Bank (4.45%, ¥300m), Mizuho Bank (3.42%, ¥300m), Hokuriku Bank (3.28%, ¥300m), 77 Bank (0.66%, ¥300m), Shoko Chukin Bank (¥100m, no apparent shareholding), and the Japan Life Insurance Company (4.94%, ¥50m). The total funds borrowed is a mere ¥1,750m with paid interest of ¥37m (a rate of 2.1%) to apparently gain the votes of these financial institutions. So much market value is being destroyed for such small amounts of money. By any measure, the system is extremely dysfunctional.

We are calling on the banks and insurance companies to do the right thing for their own shareholders. Such value destruction does not stop at Fukuda Denshi, but heavily impacts each bank's balance sheet and income statement across hundreds of equity holdings. When one compares the ¥37m of interest "earned" for the loans extended vs the ¥180bn in destroyed market capitalization, the banks are denying themselves the equivalent of 4,864 years' worth of interest (Value Destruction/Annual Interest = years to recapture lost value (180,000/37 = 4,864)).

In conclusion, Fukuda Denshi's insiders have abused outside shareholders for decades and significant changes must be made to bring corporate governance up to acceptable standards. Chairman Fukuda and his yes-men have been able to rig policy to their benefit only because the usual large domestic shareholders have turned a blind eye to their venality. Our proposals are only a beginning and are written mildly so that even these passive domestic shareholders could vote for them. Hopefully then will serve as a necessary bridge to more concrete reform in the future. In conclusion, we will forgive everyone their past misdeeds if they work with us to create a better future for all shareholders.