



PALM HARBOUR
C A P I T A L

26th of June 2024

Chairman Mr. Minoru Fujii

President Mr. Mitsuhiro Fujii

Members of the Board of Directors

SK Kaken Co Ltd

Dear Sirs,

We write to you as shareholders of SK Kaken Co Ltd ("SK Kaken" or "the company") regarding the long-term performance of the shares. We believe that the shares of the company are materially undervalued, and it is within the power of the board to correct this undervaluation. We have noticed that SK Kaken is not on the list¹ of companies that have disclosed information in Accordance with "Action to Implement Management that is Conscious of Cost of Capital and Stock Price". We firmly believe the primary reason behind the undervaluation is poor capital allocation, poor investor communication and poor investor remuneration, which is exactly what the Tokyo Stock Exchange, regulators and the Japanese government are trying to reform²³. We believe it is the board's fiduciary duty to correct this.

We propose that the board make several changes that will benefit all shareholders.

- 1) The company should announce a three-year plan including numerical targets for sales, operating profit, net profit, dividend, and capital expenditure. This is standard practice in Japan, and we find it negligent that SK Kaken does not share its strategic plan with the owners (shareholders) of the company.

¹ [Action to Implement Management that is Conscious of Cost of Capital and Stock Price](#)

² [FT](#)

³ [FT](#)

- 2) The company must improve the balance sheet. The company is highly profitable and does not need to maintain such a large cash balance, especially given the low current returns on cash. To the contrary, it could well be financially beneficial to take advantage of low rates to take on a modest level of debt.
 - a. Utilize the balance sheet cash to ramp up capital expenditure and research and development to improve efficiency, improve competitiveness and modernize plants and equipment.
 - b. Utilize the balance sheet cash to expand abroad in attractive markets that would appreciate the high-quality product offering.
 - c. Utilize the balance sheet to pursue attractive M&A (at reasonable prices) if available.
- 3) The company should significantly increase shareholder remuneration. We believe the company should increase the dividend substantially and target at least a 50% payout ratio or higher. Furthermore, given the extremely low valuation, the company should aggressively buy back shares at current prices. This would offer a far better return for shareholders than the cash currently held on the balance sheet as it will increase earnings per share and free cash flow per share to the benefit of all shareholders. The company should buy back shares whenever the shares trade above a 10% yield of free cash flow to enterprise value.
- 4) We believe the company would benefit from a more diverse and independent board. We think that the board needs a refresh and should bring in outside members and include women. We think that some international members from chemical and paint companies in the USA, Europe and Southeast Asia would be very beneficial.
- 5) The company should immediately cancel the treasury shares.
- 6) The board should change management compensation and link it directly to the share price and free cash flow per share.
- 7) The board should allow employees to participate and open a plan for employees to purchase shares and senior managers to be rewarded with shares.
- 8) The company should fulfill the listing duties needed to join the Prime Market of the Tokyo Stock Exchange.
- 9) The company should translate all of its filings into English to allow more international investors to understand the company. Quarterly presentations, a company introduction presentation and the proposed three-year plan should also be provided in English.

We believe that good corporate governance and protection of minority rights are important. Publicly listed companies are not there to benefit only the controlling shareholder or the management team. Best practices are now becoming prevalent in Japan, and it makes little sense for such an eminent company such as SK Kaken to maintain outdated financial practices. We have noted that the board is recommending against Asset Value Investors Limited's⁴ proposals at the upcoming Annual General Meeting. We ask that the board reconsider or make its own proposals that enhance shareholder value. It is time to make SK Kaken a pillar of corporate Japan and embrace better governance, better balance sheet efficiency, and seek long-term growth.

Sincerely,

Peter Smith

Managing Partner
Palm Harbour Capital LLP

Palm Harbour Capital LLP is authorized and regulated by the Financial Conduct Authority, UK. Palm Harbour Capital manages the COBAS Lux SICAV Palm Harbour Global Value Fund.

⁴ [Asset Value Investors](#)