



AVI

Asset Value Investors

PAINTING A BETTER SK KAKEN

May 2024

Summary

Asset Value Investors (“AVI”)(“we”) would like to thank SK Kaken employees for their stewardship of the Company and for the hard work and commitment that they have shown for all stakeholders. SK Kaken is a wonderful company, with a rich history and an industry-leading product offering.

Unfortunately, despite SK Kaken’s market-leading position, we believe the Company is being stifled by top management and the concentration of power with the Fujii family’s founder. SK Kaken is undervalued, has failed to grow profits for 10 years, has the lowest online employee review score of any peer, has appalling corporate governance and barely meets the listing requirements for the TSE Standard Market.

AVI is submitting shareholder proposals for the fourth year in a row, seeking to improve SK Kaken’s shareholder value and encourage the Company to modernise and embrace improvement. Despite AVI’s shareholder proposals achieving an average 53% of minority shareholder support last year, the founding Fujii Family has refused to listen and continues its path of suboptimal capital allocation and lack of care for shareholders.

Although more radical reform is needed than what can be addressed through shareholder proposals, we have identified two easily addressable issues aimed at sustainably enhancing SK Kaken’s corporate value.



AVI's Previous Shareholder Proposals

- AVI's shareholder proposals in 2021, 2022 and 2023 received strong support from non-Fujii family shareholders and a number achieved majority support from minority shareholders.
- Despite shareholder support, SK Kaken has failed to make improvements to its excess treasury shares and excess cash holdings.

Shareholder Proposal	2021 Support		2022 Support		2023 Support		SK Kaken's Actions	2024 AVI Shareholder Proposal
	Total	Excl. Fujii family ¹	Total	Excl. Fujii family ¹	Total	Excl. Fujii family ¹		
Disclose Scope 1 & 2 Greenhouse Gas Emissions	-	-	16%	28%	-	-	Verbal commitment to disclose an environmental policy.	-
Appoint at least two independent outside directors	-	-	32%	56%	-	-	Transitioning to a company with an audit and supervisory committee, which will reduce director terms and increase board independence.	-
Reduce Director terms from two years to one year	-	-	30%	53%	-	-		-
10-for-1 Stock Split	27%	47%	30%	53%	-	-	5-for-1 Stock Split announced May 2023	-
Treasury Share Cancellation	28%	49%	26%	45%	26%	45%	None	Yes
Increase dividend	-	-	33%	58%	35%	61%	Minimal	Yes

Source: AVI, Capital IQ (as at 30/04/2023). Note: ¹Based on public disclosure, excluding Fujii family holdings and other insiders. Amounts to approximately 43% of the vote.



OUTLINE OF SK KAKEN'S ISSUES

Painting a Better SK Kaken

- SK Kaken is failing in its responsibilities as a listed company, given its low valuation, poor operating performance, appalling corporate governance and barely meeting the listing requirements of the Tokyo Stock Exchange (“TSE”).
- SK Kaken’s issues reflect a lack of urgency and weak management discipline, a symptom of a company with a controlling shareholder. Over 40% of SK Kaken’s shares and several key senior executive positions are held by members of the founding Fujii family. The average tenure of the SK Kaken board is 15 years is concentrated with the Founder, leading to a culture of intransigence and tradition and decision-making nationalism, starving the Company of much needed progress.
- AVI asks its fellow general shareholders to continue to express their disapproval of poor management policies which are negatively influenced by a controlling shareholder who has persistently neglected the interests of minority shareholders.

Encouraging SK Kaken to adapt and progress for the benefit all of stakeholders

Share Price Underperformance

- Over 5 years SK Kaken's share price has underperformed all of its peers, both global and domestic.
- Furthermore, SK Kaken's share price performance has significantly underperformed the wider TOPIX index.
- Shareholders are suffering and the top management should be held accountable for the long-term share price decline.

-8%

SK Kaken's 5 Year Share Price

vs.

+15%

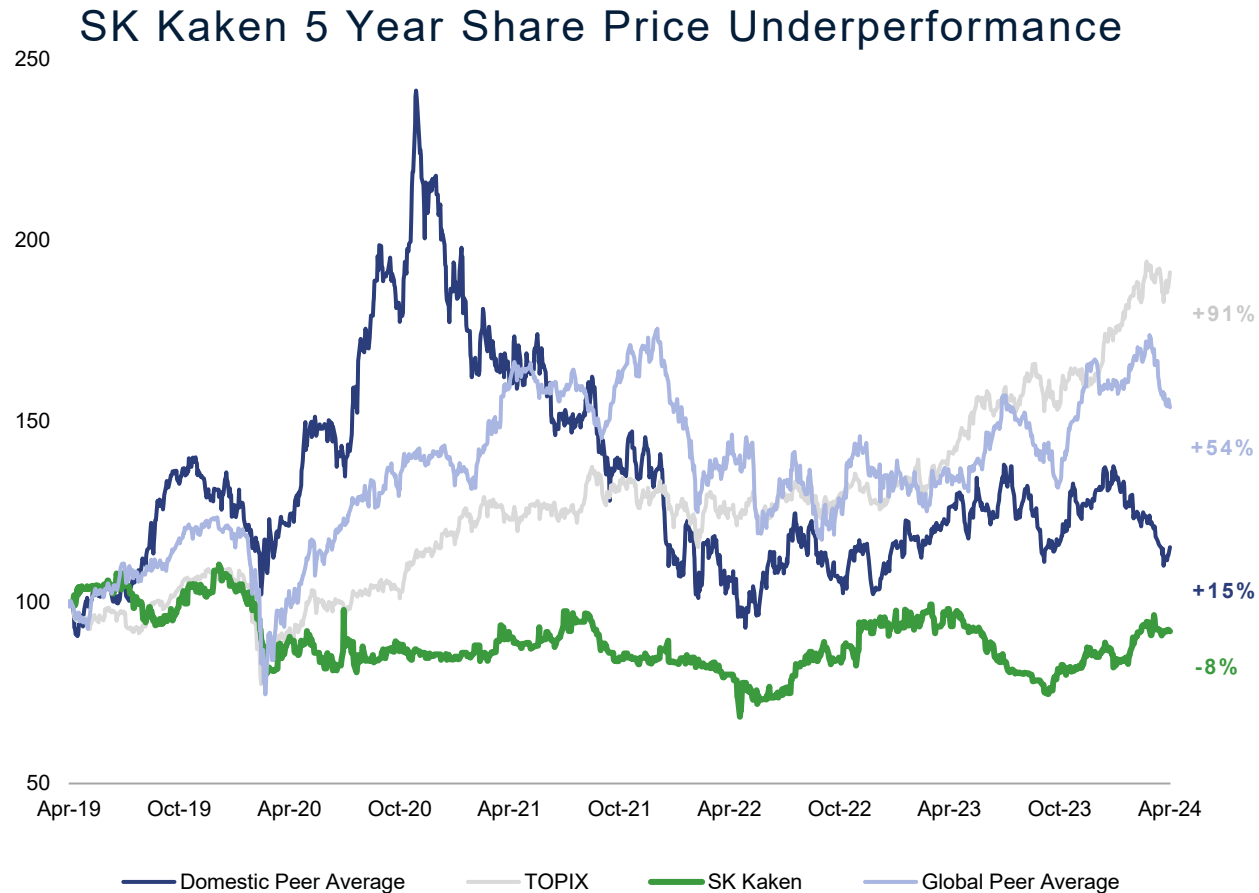
Domestic peers

+54%

Global peers

+91%

TOPIX



Source: AVI, Capital IQ (as at 30/04/2024). **Note:** Share prices are on a total return basis, including dividends and in each Company's local currency. SK Kaken, Nippon Paint and Kansai Paint JPY, The Sherwin-Williams Company, PPG Industries and RPM International USD, Akzo Nobel EUR. Simple average.

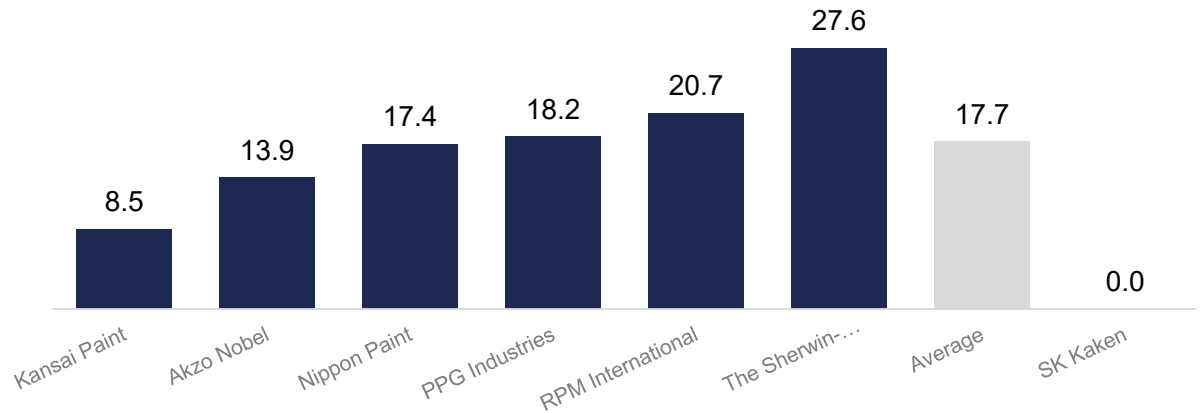
Global peers = The Sherwin-Williams Company, PPG Industries, Akzo Nobel and RPM International
 Domestic peers = Nippon Paint and Kansai Paint



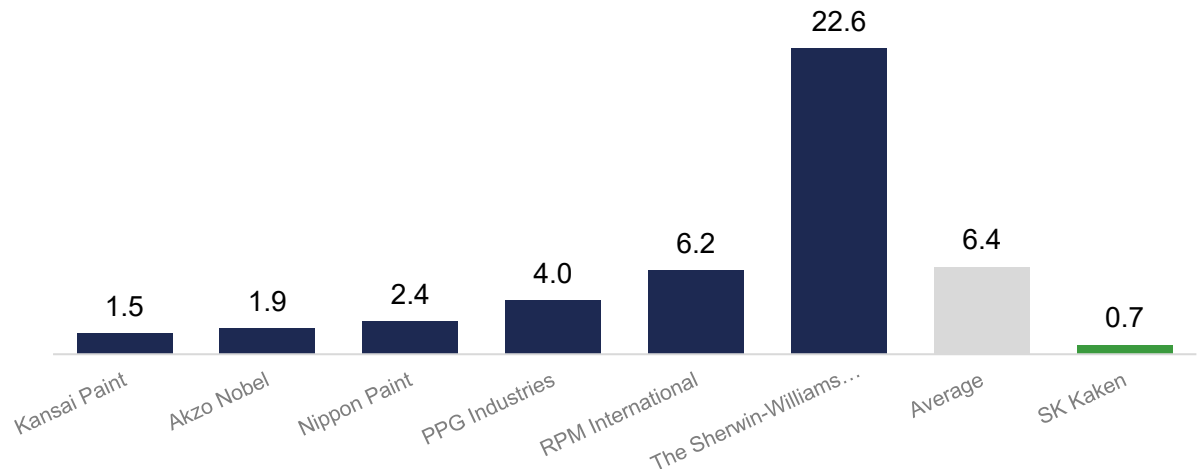
Relative Undervaluation

- SK Kaken trades at a significant discount to its peer group.
- While SK Kaken has higher exposure to the domestic market, we do not attribute the extreme undervaluation to an inferior business model, rather the fault for the undervaluation lies mostly with current management policies.
- The low valuation highlights deep pessimism from investors and a low opinion of SK Kaken's current management.

Peer Group EV/EBIT Multiple



Peer Group PBR



Source: AVI, Capital IQ (as at 30/04/2024). Note: Enterprise Value (EV) = Market Cap - Net Cash - Investment Securities. EBIT is based on trailing twelve month



PBR Below 1x

- SK Kaken's Price-to-Book Ratio (PBR) has fallen over the past five years currently trading at 0.7x.
- The Tokyo Stock Exchange ('TSE') announced guidelines asking companies to evaluate their stock price and market cap, disclosing policies and specific initiatives for improvements.
- The TSE emphasised that taking action was especially important for companies that trade below a 1x PBR.
- SK Kaken has ignored the request.

0.7x

SK Kaken's current PBR

SK Kaken's Falling PBR



Source: AVI, Capital IQ (as at 30/04/2024).

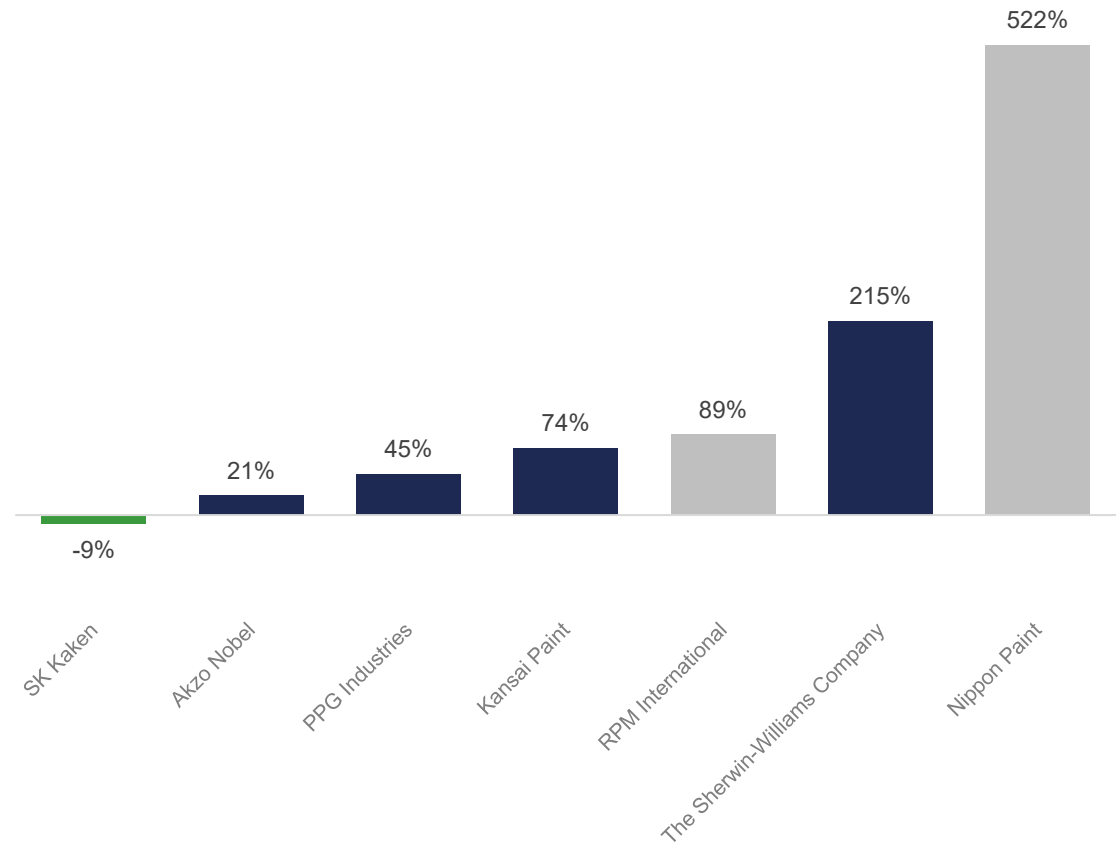
Declining Profit

- Over 10 years SK Kaken's operating profits have fallen by -9%.
- SK Kaken has generated lower profit growth than both domestic peers Kansai Paint and Nippon Paint.
- We attribute the poor performance to a lack of investment, failing to successfully expand overseas and a culture of traditionalism stemming from the concentration in decision making with the Fujii family.

-9%

SK Kaken's 10 year profit growth

SK Kaken 10 Year Profit Growth vs Peers (local currency)



Source: AVI, Capital IQ, Company disclosure **Note:** Profits are in each Company's local currency. SK Kaken, Nippon Paint and Kansai Paint JPY, The Sherwin-Williams Company, PPG Industries and RPM International USD, Akzo Nobel EUR. 10 years ending at latest fiscal year. Based on consensus for year-end 31st March 2024 for SK Kaken and Kansai Paint, 31st December 2023 for all other.

Employee Dissatisfaction

- SK Kaken's governance and mismanagement seem not to just affect shareholders but also SK Kaken's employees.
- The employees of SK Kaken are the pillar of its success.
- Several posts made online by employees and ex-employees highlight frustration with the company culture and leadership.
- Low overall review scores vs peers highlights employee dissatisfaction.

-1.6%

Change in SK Kaken average employee salary over 10 years to Mar-2023²

Voices of current and former employees¹

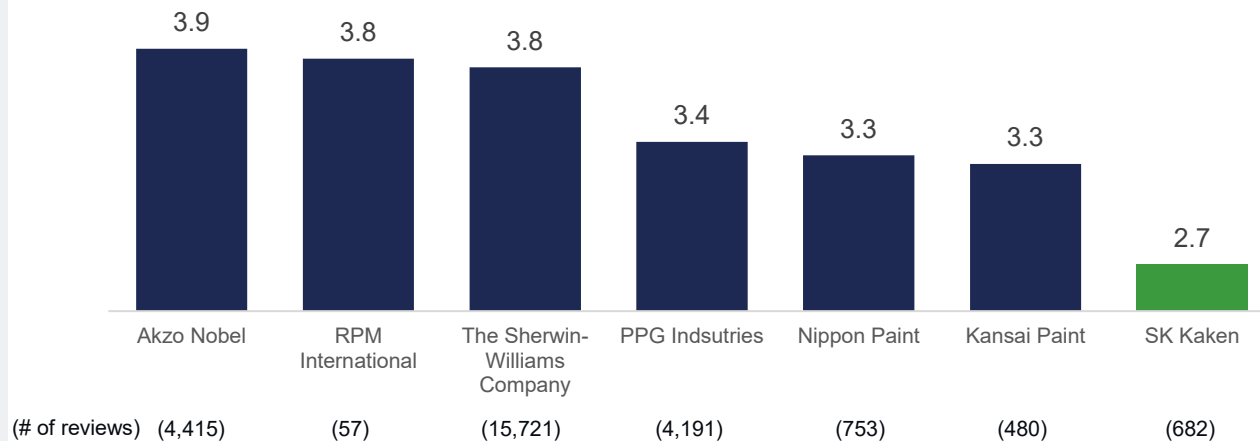


"It's run top down. The Upper management acted like they were gods." *January 2023*

"The attitude of the Company is quite old, 20 years behind the leading companies" *January 2023*

"They call it meritocracy, but in reality is more like a seniority system" *June 2020*

Weighted average employee review score on public job sites (15)



Source: AVI, Capital IQ, Company disclosure (as at 30/04/2024).en Lighthouse, openwork, Glassdoor, Indeed **Note:** ¹The comments were posted anonymously on Internet bulletin boards. As such, in conducting the investigation, AVI has not verified whether the persons posting these posts are in fact employees or former employees of SK Kaken, nor has it verified the credibility or accuracy, etc. of the content of the posts. Therefore, AVI hereby notes that AVI does not necessarily acknowledge nor make any guarantee that the results of the investigation are true or accurate. ²Average salary taken from SK Kaken's annual reports.

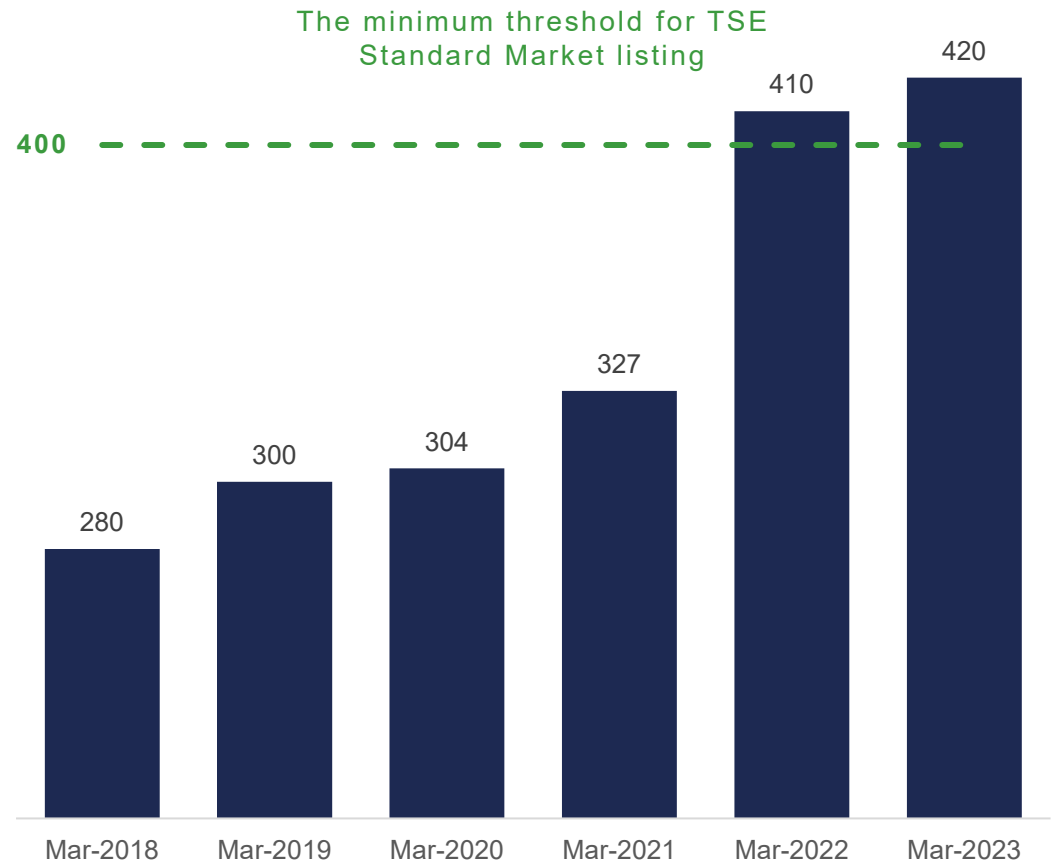
Potential Delisting from TSE

- Despite being a well established company, SK Kaken barely meets the TSE Standard market listing requirements.
- SK Kaken has 420 shareholders vs. the minimum threshold of 400.
- SK Kaken should be on the Prime market, not struggling to qualify for the less prestigious Standard market.

420

Number of shareholders
as of 31st Mar 2023

Number of SK Kaken Shareholders¹



Source: AVI, Capital IQ (as at 31/03/2023). Note: ¹Number of shareholders disclosed in annual securities filing.

Poor Corporate Governance

- SK Kaken's highly homogenous board lacks diversity, with all inside directors having similar backgrounds and all outside directors having a banking background with no experience in paints.
- All directors are male and Japanese, with an average age of 68 years and average board tenure of 15 years. A lack of diversity and fresh perspectives stifles innovation and progress.

SK Kaken Board of Directors

Outside Auditors

Name	Gender	Nationality	Age	Tenure	Career
Mr Fujii Minoru	Male	Japanese	91	66	SK Kaken
Mr Fujii Mitsuhiro	Male	Japanese	57	25	SK Kaken
Mr Masahide Sakamoto	Male	Japanese	72	33	SK Kaken
Mr Fujii Kunihiro	Male	Japanese	55	21	SK Kaken
Mr Fukuoka Toru	Male	Japanese	65	20	SK Kaken
Mr Ito Yoshiyuki	Male	Japanese	70	19	SK Kaken
Mr Takeuchi Masahiro	Male	Japanese	66	7	SK Kaken
Mr Kataoka Hideto	Male	Japanese	69	6	SK Kaken
Mr Nagatsuka Takashi	Male	Japanese	59	2	SK Kaken
Mr Shinji Nishida	Male	Japanese	63	1	SK Kaken
Mr Takehara Michiyuki	Male	Japanese	68	2	Banking
Mr Hiromichi Honryu	Male	Japanese	76	9	Banking
Mr Shoji Hamana	Male	Japanese	70	7	Banking
Mr Ken Ozaki	Male	Japanese	68	2	Banking



AVI'S RECOMMENDATIONS AND SHAREHOLDER PROPOSALS

Overview of Shareholder Proposals

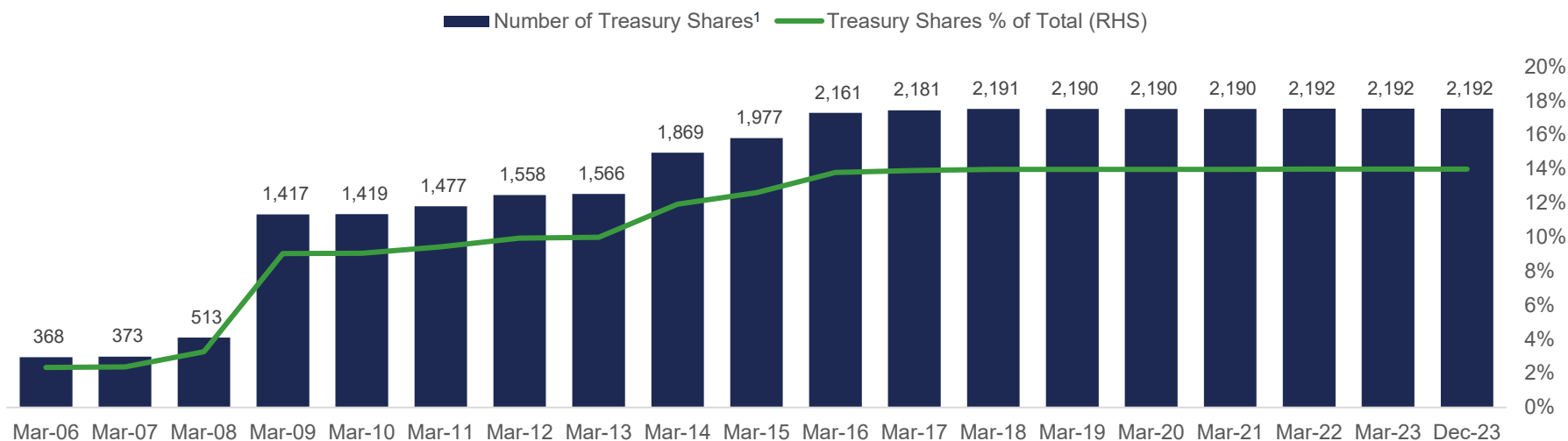
- We are putting forward a non-exhaustive set of easily implementable actions to address SK Kaken’s underperformance and attract more shareholders so that SK Kaken continues to meet the requirements for listing on the TSE Standard Market.

Issue	Suggested solution
Treasury share overhang	(1) Cancel 1,973,183 treasury shares, which equate to approximately 90% of the shares held in treasury. SK Kaken currently holds 14% of outstanding shares in treasury and has not put forward any plans to use the shares such as M&A or executive compensation.
Inefficient balance sheet	(2) Increase the dividend from Y135 per share to Y290, for a 50% payout ratio. SK Kaken has hoarded earnings on its balance sheet, with cash and cash equivalents accounting for over 70% of balance sheet assets.



Treasury Share Overhang

- 14% of SK Kaken’s shares are held in treasury. SK Kaken has put forward no plans to use its treasury shares
- Although the financial benefit from repurchased shares is the same whether they are cancelled or not, it is bad practice to hold a large portion of treasury shares and raises the possibility that they will be reissued, diluting existing shareholders.

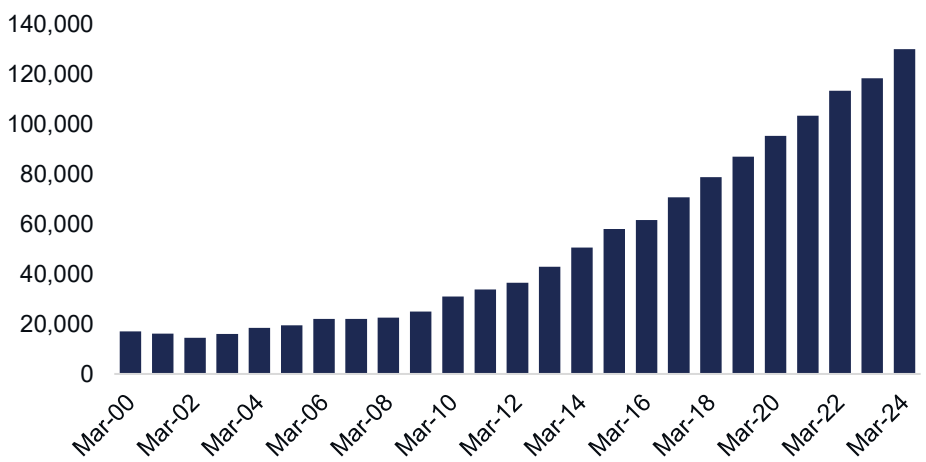


(1) Cancel 1,973,183 of the shares held in treasury (approximately 90% of the total treasury shares).

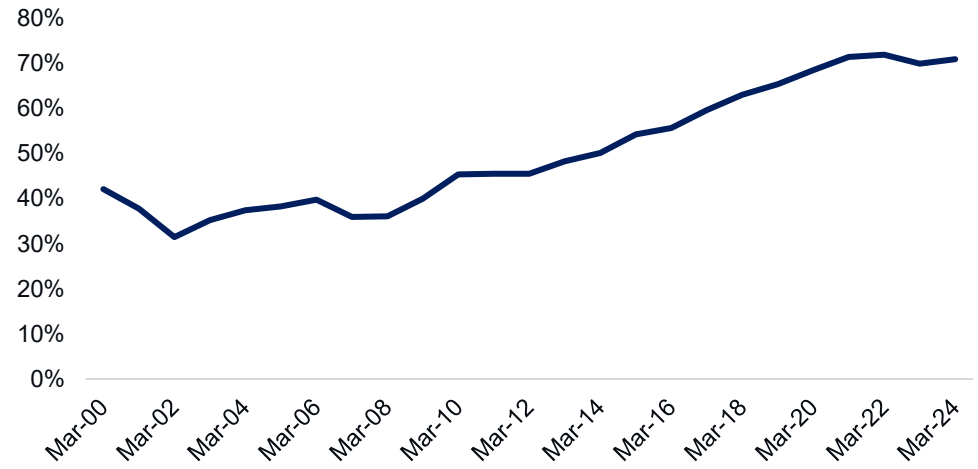
Accumulation of Cash

- SK Kaken has allowed cash to accumulate on the balance sheet beyond reason.
- Cash, cash equivalents, and investment securities account for 71% of balance sheet assets compared to 38% in 2001 and 65% five years ago.

Cash, Cash Equivalents & LT Securities (Ym)



Cash, Cash Equivalents & LT Securities as % of Balance Sheet Assets

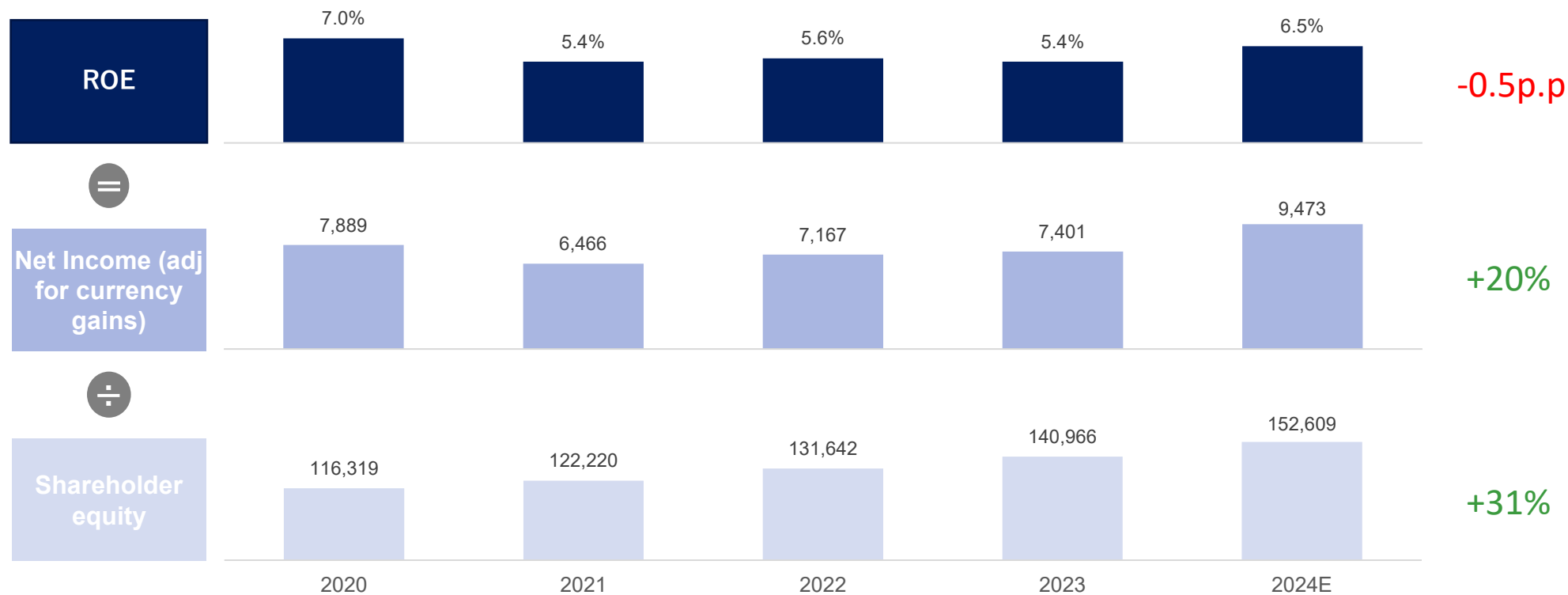


Source: AVI, Capital IQ (as at 31/03/2024)



Lacklustre ROE

- Despite what should be a high return on capital business, SK Kaken’s ROE has been falling, suffering from ballooning shareholder equity.
- SK Kaken’s ROE has over the past five years consistently fallen below the 8% recommended in the ITO review.



Source: AVI, Capital IQ, ITO Review August 2014, ISS Japan proxy voting guidelines December 2021 Note: Net income adjusted for non-operating currency exchange gains & losses. 2024 based on forecasted net income and balance sheet data as of March 2024.

Lack of Investment Stifling Growth

- SK Kaken’s hoarding of cash has come at the expense of investment in CAPEX and M&A. Only 8% of cash flows generated over the past 5 years has been either returned to shareholders or invested in the business.
- SK Kaken has not undertaken any M&A, investment in aging facilities, or invested in overseas growth.

5 Year Allocation of Cash

Company	5 Year Cashflow from Operating Activities ¹ (¥bn)	Shareholder Returns (o/w buybacks)	M&A	CAPEX	Working Capital	Cash Deployed as % Cash from Ops
SK Kaken	41	12% (0%)	0%	3%	7%	8%
Kansai Paint	196	47% (27%)	1%	35%	-6%	88%
Nippon Paint	584	21% (0%)	50%	27%	-6%	103%
RPM International	410	51% (19%)	19%	26%	-21%	118%
Akzo Nobel	592	224% (175%)	28%	62%	-18%	332%
PPG Industries	1,188	41% (10%)	48%	22%	5%	106%
The Sherwin-Williams Company	1910	79% (59%)	11%	17%	-4%	111%
Peer Average		77% (48%)	26%	31%	-9%	143%

Low R&D Expenditure, Despite Cash Reserves

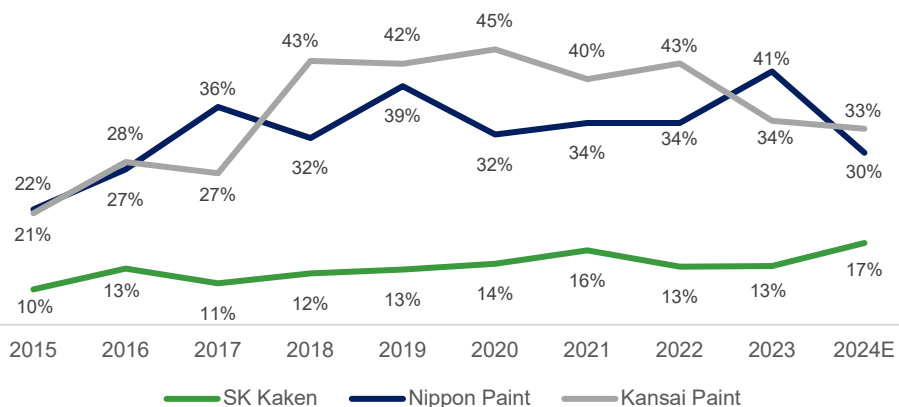
- SK Kaken has allocated only 0.9% of sales to R&D over the past five years.
- With such a high amount of accumulated cash, SK Kaken can afford to be more aggressive in its R&D spending especially given how much smaller its R&D budget is compared to both domestic and international peers.

Company	5 Year Total R&D Expenditure (¥bn)	5 Year Average R&D Expenditure as % of Sales
The Sherwin Williams Company	100	0.6%
SK Kaken	4	0.9%
RPM International	62	1.3%
Kansai Paint	34	1.6%
Nippon Paint	119	2.3%
Akzo Nobel	212	2.6%
PPG Industries	336	2.6%
Peer Average	144	1.8%

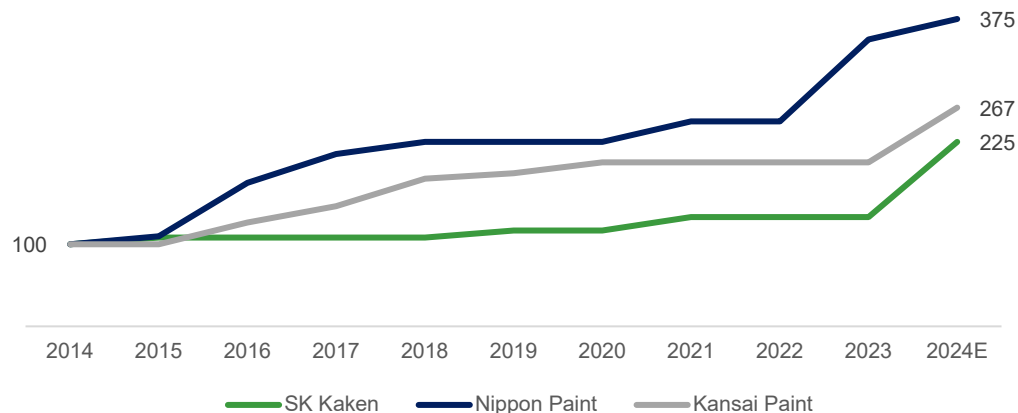
SK Kaken Shareholder Returns

- SK Kaken’s domestic peers have consistently paid out a higher portion of profits to shareholders while also growing the dividend.
- SK Kaken’s statement in their response to our shareholder proposals that “returning profits to shareholders is one of management’s top priorities” is hard to believe.

10-year dividend payout ratio



10-Year Dividend Growth (rebased to 100)



(2) Increase the dividend from Y135 per share to Y290, for a 50% payout ratio.



CONCLUSION

Painting a Better SK Kaken

- We ask general shareholders to support two modest and easily implementable improvements to address SK Kaken's underperformance and failings.
- While the two measures will only go so far in improving the situation, it would mark a step in the right direction and strong support from general shareholders will send a powerful message to the Fujii family that choosing to list SK Kaken on the public markets comes with a responsibility to enhance corporate value for all shareholders .

(1) Cancel 1,973,183 of the shares held in treasury (approximately 90% of the total treasury shares).

(2) Increase the dividend from Y135 per share to Y290, for a 50% payout ratio.

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