Reference Material

Shareholder Proposal to NS Solutions

No. 1 Proposed Subject Matters

(1) Appropriation of surplus

(2) Acquisition of treasury shares

(3) Introduction of a transfer-restricted stock compensation program for directors (excluding outside directors)

No. 2 Summary of Proposed Agendas and Reasons for Proposals

(1) Appropriation of Surplus

(I) Summary of the proposed agenda

The appropriation of surplus shall be made subject to the following terms:

This proposed agenda, if the Board of Directors of the Company also submits the agenda of the appropriation of surplus to the 41th Ordinary General Meeting of Shareholders, will be additionally proposed independently of such proposal.

(a) Type of assets to be distributed

Cash

(b) Amount of Dividend to be paid per share

The amount of the dividend to be paid per share shall be obtained by deducting the amount of dividend of surplus per common stock proposed by the Board of Directors at the 41st Ordinary General Meeting of Shareholders and approved at said Ordinary General Meeting of Shareholders from 62 yen (or 62 yen, if the Board of Directors does not propose the appropriation of surplus at said Ordinary General Meeting of Shareholders)

(c) Matters concerning the allotment of dividend asset and the total amount thereof

The amount of dividend per share as prescribed in (b) above per common stock (the total dividend is calculated by multiplying the dividend per share by the total number of outstanding common stocks (excluding treasury shares) of the Company as of March 31, 2021)

(d) The day on which the appropriation of surplus becomes effective

The date on which said Ordinary General Meeting of Shareholder is held

(e) Commencement Date of Dividend Payment

Three weeks from the first business day following said Ordinary General Meeting of Shareholder

(II) Reasons for proposal

Over the past five years the total amount of cash, deposits, and other deposits paid (collectively, “Cash and Cash-equivalents”) on the Company’s balance sheet have increased by an average of approximately 11% each year, such that Cash and Cash-equivalents (72,110 million yen) account for 28.9% of total assets on the consolidated balance sheet as of December 31, 2020. This is a gross misallocation of capital and the level of cash greatly exceeds any amount that could be justified for financial stability.

The Company has a strong and profitable business that generates an abundance of free cash flow (net income + D&A – increase in working capital – maintenance capital investment (estimated as D&A)). Companies can allocate their free cash flow in four ways:

a) fund growth initiatives through capital investment or M&A (not including maintenance CAPEX)

b) pay down debt

c) return cash to shareholders through dividends or buybacks, or

d) do nothing and let Cash and Cash-equivalents accumulate.

It is the last option (item (d) above) that the Company has chosen, ballooning its balance sheet to the detriment of corporate value.

Over the past five years the Proposer estimates that the Company has generated approximately ¥60bn of free cash flow. Approximately ¥3bn has been invested in growth capital initiatives, ¥5bn used to payback lease liabilities and ¥32bn paid to shareholders through dividends and buybacks (according to Proposer’s estimate). The total of these, ¥40bn, only accounts for 67% of the estimated free cash flow which is ¥60bn, the remaining ¥20bn sits idly on the balance sheet. As a result, the Company’s net Cash and Cash-equivalents increased to a record high level, reaching approximately ¥72.1bn as at December 31, 2020.

As of March 31, 2021, the Company has not disclosed its medium-term management plan externally, failing to communicate to shareholders the amounts, scale or content of its capital investment plan for medium-term growth. Although there is a description in the Consolidated Financial Results for the Third Quarter of Fiscal 2020 (April 1 – Dec 31, 2020) stating that “the Group considers it important to maintain and strengthen its competitiveness and to enhance corporate value for the future,” in reality the number of investments made to improve corporate value was extremely limited over the past five years. That is why the amount of Cash and Cash-equivalents on the consolidated balance sheet has increased such a high level.

The Proposer supports the Company allocating capital to promising growth projects, enhancing its R&D, acquiring and nurturing talented human resources, or undertaking M&As that generate more value than cost of capital. The Proposer believes that Company has built a secure financial base on which to do so. But there is no justification for continuing to add cash to the pile and the Company's strong financial position permits higher returns to shareholders.

The Company's dividend forecast of ¥27.5 per share, for a payout ratio of 30%, will only worsen the problem. The Company has had a record of 11-year stable and continuous dividend increase (on stock-split adjusted basis) since FY2010/03, and this year's reduction of the dividend per share is the reversal of this steady track-record. In order to reduce the rate of retained Cash and Cash-equivalents and to increase the Company's corporate value, the Proposer propose that the Company pay a dividend of ¥ 62 per share, amounting to a payout ratio of 50%.

(2) Acquisition of treasury shares

(I) Summary of the proposed agenda

Pursuant to the provisions of Article 156 (1) of the Companies Act, the Company will acquire its common shares within one year from the conclusion of the Ordinary General Meeting of Shareholders to the maximum extent of 8,000,000 shares in total, 20 billion yen as total acquisition price (provided, however, that if the total amount of the acquisition amount falls below the "Distributable Amount" provided in Article 461 of the Companies Act, the maximum amount of the acquisition amount shall be reduced to the amount permitted under the Companies Act.)

(II) Reasons for the proposal

Cash and Cash equivalents, and investment securities such as the Company's stake in Recruit Holdings, account for, as of December 31, 2020, 51% of the Company's total assets on the consolidated balance sheet. The Proposer estimates that these assets generate a very poor return on capital of less than 1%. The Company's low return on capital with these assets is harming corporate value and explains why the Company's high-quality business trades on a price-to-book ratio of 2.0x while the industry peers trade at 3.0x based on the proposer's estimates, or approximately 35% discounts.

The Proposer questions why the Company has allocated approximately 23% of the consolidated balance sheet asset to Recruit Holdings (based on the share price as of April 9, 2021), an unrelated, non-core "strategic investment." The Company has so far failed to provide a convincing justification, vaguely arguing that the business relationship with Recruit Holdings contributes to the business expansion through holding the stake. By failing to quantify supposed benefits and risks, or return in relation to its cost of capital the Company has ignored principal 1-4 of the Corporate Governance Code that states companies "should disclose their policy with respect to [cross-shareholding]," and that "the board should annually assess whether or not to hold each individual cross-shareholding, specifically examine whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital." Furthermore, proxy advisory firm Glass Lewis added a new policy on excessive strategic shareholding that it "will generally recommend voting against the most senior executive of the company when the size of strategic shares held by the company exceeds 10% or more of the company's net assets" on the consolidated balance sheet. The total amount of equity holding other than those held solely for the purpose of investment as stated in the Company's Securities Report for the 40th Term was ¥32,820 million, accounting for approximately 19.0% of the total net assets of ¥172,795 million as of December 31, 2020. This is far above the rate in the above-mentioned guideline. In the absence of quantitative evidence, the Proposer does not believe that any possible benefits from a business relationship with Recruit Holdings justify the approximately ¥58.1bn (value of the Company's stake in Recruit Holdings based on its share price as of April 9, 2021 and the number of share-holding as of Dec 31, 2020) allocation of capital. The Company could significantly reduce its stake in Recruit Holdings, while still retaining the benefits of a business relationship.

In order to reduce the misallocation of assets on the balance sheet and improve the return on capital, the Proposer proposes that the Company undertake a buyback of 8,000,000 shares in total, and ¥20 billion as the upper limit (5.9% of the Company's outstanding shares at the share price as of April 9, 2021). While it is up to the Board to determine how the funds for the buyback are raised, the Proposer notes that a ¥20bn share buyback can be funded from selling only around one-third of the Company's stake in Recruit Holdings.

Currently, Nippon Steel owns 63.42% of the Company's outstanding shares (as of September 30, 2020), limiting the liquidity of the Company's shares. The Tokyo Stock Exchange ("TSE") announced its plans to realign its current four trading market into three in April 2022, and TSE provided the liquidity criteria for the top-tier "Prime" section that the ratio of stock in circulation is above 35%. Thus, the Company is now is on a border between the Prime section and the Standard section. Although the Proposer cannot specify from whom the Company acquires the treasury shares, the share purchase approximately 5.9% outstanding shares from Nippon Steel would significantly enhance the liquidity and mitigate the market classification risk related to the TSE's trading market changes in April 2022.

(3) Determination of remuneration to award transfer-restricted stock compensation for directors (excluding outside directors)

(I) Summary of the proposed agenda

In order to grant monetary remuneration credit for restricted stock compensation, establish a remuneration of up to ¥75 million annually for directors (excluding outside directors) under a transfer-restricted stock compensation program, in addition to the annual compensation limit of ¥350 million. The exact timing of payment and allocation shall be determined by the Board of Directors, and how the plan is exactly implemented is at the discretion of the Board of Directors and the executive nomination and compensation meeting, including the structure of the stock benefit trust and points award system.

(II) Reason for the proposal

Principal 4-2 of the Corporate Governance Code states that "the remuneration of the management should include incentives such that it reflects medium to long-term business results and potential risks, as well as promotes healthy entrepreneurship," asking management to provide incentive remuneration for directors.

However, the Company has not introduced the remuneration system which clearly linked to medium to long-term business result and transparent to investors. Thus, the remuneration system for directors does not provide the incentive that encourages directors to share the value toward increment of the medium to long-term corporate value.

Actually, the Company's directors own just 0.1% of the Company's shares (according to the Proposer's estimate based on information disclosed as of September 30, 2020).

The Corporate Governance Code report updated by the Company as of July 1, 2020 states that the "consolidated net operating income and labor efficiency of each fiscal year" determines the amount of the remuneration in relation to the performance-linked compensation in the remuneration for directors. Under a performance-based remuneration which is linked only to performance of each fiscal year, it is possible that directors will receive incentive to make decisions for the short-term results only. In addition, the performance-linked compensation accounts for only 40% of the remuneration according to the report, and the rest of the 60% of the remuneration is fixed amount and is not directly linked to the mid to long term value creation of the Company.

The Proposer believes directors should be awarded shares based on meeting certain financial performance targets which are linked to the medium or long-term business plan. Further, directors who receive the performance-linked compensation should be able to convert shares into cash after retirement or resignation from the Company.

The purpose of the performance-based stock compensation is to provide incentives for directors to increase the Company’s corporate value in a steady manner and to encourage long-term decision making. As such, the remuneration for directors should be a combination of a fixed amount remuneration and the performance-based stock compensation which can only be converted into cash after the retirement or resignation. Therefore, the Proposer proposes a transfer-restricted stock compensation program, in addition to the annual remuneration of ¥350 million, as additional incentive remuneration.

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