

## Corporate Governance Research: Zuken (6947)

### Summary:

Zuken's corporate governance is in the initial stage and has a lot of things to do from now (details are described below). The founder's family keeps 1/3 of its outstanding shares. Family company would perform better than 'salary-man managed' company, but it is not the case right now. Higher level of cash and stock holdings put downward pressure on low OP margin. Regarding board practice, Zuken hesitate to move forward its governance scheme such as committees at this moment. However, first of all, the company should set clear guideline of nomination and compensation that should match its mid-term vision. Additionally, mid-term management plan should include concrete growth strategy. If so, excess cash or stock will be lower.

### CG Rating

**B -**  
54 (02/2017)

### Shareholders:

1) Makoto Kaneko (19.34%), 2) Kaneko Makoto Holdings (13.92%), 3) Goldman Sachs & Co. Reg (4.38%), 4) Nippon Life Insurance (3.10%), 5) Fusao Wada (2.90%), 6) Mineko Kaneko (2.49%), 7) Japan Trustee trust a/c (2.40%), 8) BBH FOR BBHTSIA NOMURA FUNDS IRELAND PLC /JAPAN STRATEGIC VALUE FUND (2.30%), 9) Japan Master Trust trust a/c (2.23%), 10) MSCO CUSTOMER SECURITIES (1.87%)

*Kaneko family keeps 1/3 of ownership.*

### Organizational Structure:

Company with corporate auditors

*According to interview with legal officer, "Zuken plans to hold this structure and has no plan to set up advisory committees of nomination and compensation for the time being."*

### Board of Directors:

Term of office: 2 year

Chair of board: president

Number of directors: 8

Outside directors: 2 (Independent directors: 2)

Takashi Sano - accountant

Yoichi Arai - lawyer

Nomination committee: No (Outside directors:)

Compensation committee: No (Outside directors:)

Corporate Auditors: 3

Outside auditors: 2 (Independent auditors: 2)

Yasushi Ozaki - ex-Nippon Life Insurance

Takashi Handa - accountant

Total independent directors + auditors: 4

*Relatively compact board is good for the not-large company. Ideally the majority of the Board of Directors should be independent of management. In real, gradual but steady improvement should be expected. First of all, directors should be elected every year. Diversity would be the next step.*

## Nomination of Director:

“From the perspective of the right people in the right place, the Company has a deep knowledge, abundant experience, high ability in various fields such as sales, technology management, overseas operations, etc., with high ability and balanced personnel with excellent personality insight in a well-balanced manner We will elect election. In addition, when appointing newly appointed directors, we carefully judge that they are candidates who will contribute to the improvement of the corporate value of the Company after conducting multifaceted interviews.”  
*As the company states in generic words above, Zuken has vague nomination policy. Even though Zuken has no nomination committee, an independent team should consult nomination under the clear guideline. Candidates should have appropriate knowledge, skill and experience that should match with needs as well as mid-to-long term strategy of the company. Candidate searching should use outside source such as executive search and etc. Preferably, reasons of nomination should be disclosed on the above needs based matching. Making clear guideline is the first.*

## Compensation Policy:

“Compensation for Directors of the Company consists of the total amount of fixed compensation and variable compensation (Outside Director only fixed compensation). Regarding fixed remuneration, the President and Representative Director has decided variable remuneration based on performance and results based on provisions concerning remuneration of directors by position. Remuneration of corporate auditors is decided by consultation with corporate auditors.”  
*As the company states above policy, Zuken has not clear compensation policy. Current policy sounds president determines remuneration of all directors. Objective and transparent guideline should be created. Independent organization such as compensation committee or team should consult remuneration of directors. Depending on president's decision of compensation (maybe nomination too), any director is able to speak against president at this moment.*

## Compensation of Disclosure:

Disclosure of remuneration of each director: No  
Guideline of remuneration: Yes  
*Due to transparency, ultimately full disclosure of compensation is recommended in each director level in future.*

## Incentive Plan:

Incentive plan of Compensation: performance based remuneration  
Person to be entitled stock option: S.O. is not employed  
“The maximum amount of remuneration of directors resolved at the 38th Ordinary General Meeting of Shareholders held on June 27, Heisei 20 and the maximum amount of remuneration of Corporate Auditors resolved at the 13th Ordinary General Meeting of Shareholders held on January 30, 1990 Are as follows.  
· The maximum amount of remuneration for Directors shall be within the fixed amount of 320 million yen per year (including not more than 20 million yen for Outside Directors, excluding salaries for employees), as a variable framework of consolidated ordinary income Set an amount within 2% (maximum 50 million yen) and make it the total amount of fixed frame and variable frame. However, remuneration for outside directors shall be fixed remuneration only.  
· The remuneration limit for corporate auditors shall be within 30 million yen per year.”  
*Performance based remuneration should be raised, as currently fixed 300: variable 50 is paid (performance based is 16%(=50/300)). 2% of recurring profit is not enough for the guidance. Other KPI can be included. Also, for mid-to-long-term growth, the guideline should endeavor to incorporate or match the company's mid-term strategy. The remuneration level can be referred to independent consultant or peer of industry. Of 6 inside EDs, 3 directors own only small amount of 2,000, 300 and 1,400 shares respectively. Equity grant plan should be created.*

## Evaluation on Board of Directors:

“Each director of the Company conducts self-evaluation through hearings etc. at the Board of Corporate Auditors, and based on these, analyzes and evaluates the effectiveness of the entire board of directors as well. In our current situation, we believe that the effectiveness of our board of directors is adequately maintained.”

*More importantly, action for enhancement should be explored. Unfortunately, current theme and future solution are not seen. On the interview, the officer answered an interview with a director is implemented each month. Explicitly weakness should be listed and discussed more than once for improvement.*

## Training Policy of Directors:

“We have appointed personnel with deep knowledge, abundant experience, high ability and high personality insight as officers, and as a general rule we will learn from the executive themselves even after appointment, Regarding the latest trends such as finance, we are deepening our knowledge through in-house workshops and external seminars for executives.”

*Periodical training and seminar are useful. All directors must maintain keeping up with knowledge level in all matter of management. The company should explicitly state fee of outside seminars is paid by company in the policy. A newly elected director should take training prior to AGM.*

## Shareholders Meeting:

Notice of Convocation: sent on June 9<sup>th</sup> 2016 for AGM

Date of AGM: held on June 29<sup>th</sup> 2016, when many companies hold shareholders' meetings

Electronic Voting: No

Disclosure of AGM information on company web site: Yes

“Notice of Convocation in English: No”

In consideration of the ratio of institutional investors and overseas investors and the cost corresponding to these investors, we do not translate the use of the electronic voting platform or convocation notice in English at this time. In the future, we will consider the response in a timely and appropriate manner based on changes in the composition of shareholders and other factors.”

*As shown above, Zuken does not aggressively promote AGM disclosure.*

## Investors Relation:

IR meetings for analysts: semiannually (explanation by representative director: Yes)

IR meetings for overseas investors: NA (explanation by representative director: NA)

Disclosure of IR information on company web site: Yes

CG Report translated in English: No

IR department: Yes

*IR manager, finance manager and legal officer are all friendly and kindly treats investors. Deputy president Katsube's Presentation and QA of analyst meeting are very helpful. Many of investors wish hearing strategy by Kaneko directly.*

## Takeover Defense:

Takeover defense Plan: No

## Cross Holding Shares:

“The Company may hold shares with the objective of improving the medium and long term corporate value of the Company by constructing and strengthening long-term and stable relations with issuing companies. With regard to such stock holding stocks, we will verify medium- and long-term economic rationality and future prospects based on returns and risks, and we regularly confirm the aims and rationality of possession while taking this into consideration I will. Regarding the exercise of voting rights pertaining to policy holdings, from the medium- to long-term perspective, it is the basis of exercising voting rights to contribute to the Company's profits and contribute to the enhancement of the corporate value of the issuing company.”

*Holding shares other than investment purpose decreased to 7 stocks of JPY2,239 million (03/2016) from 8 stocks of JPY2,467 million (03/2015). Holdings to sales remain relatively high of 10.5% (03/2016) and 12.4% (03/2016). The largest holding is 840,000 shares (JPY1,168 million) of Toyo Business Engineering (4828, JP) “for strengthening/maintaining relations with business partners (by Zuken).”*

## Mid-Term Growth Target

Quantitative Target by company	<u>Not disclosed</u>
ROE	1.0% (03/2016) actual, 3.3% (03/2017) CE
ROA	0.7% (03/2016) actual, 2.3% (03/2017) CE
Cash Equivalent	JPY19,547 million (03/2016) actual
<i>“Our company posts our corporate philosophy and medium-term management plan on our website.” But it is Japanese only. IR information is not posted in English site. At least KPI should be added. Cash/Sales is 89% or 10 months of sales that is too large and should be used more effectively.</i>	

## Shareholder Return

Dividend per Share	JPY30 (03/2016) actual, JPY20 (03/2017) CE
Dividend Payout	257.5% (03/2016) actual, 46.5% (03/2017) CE
Share Buyback	Previous repurchase was 2 million shares in 2011.
Operating CF=JPY299 million (Net Profit=JPY294 million, Depre + Amort= JPY852 million, Capex + M&A=JPY800 million, dividend paid=JPY697 million (03/2016) actual	
<i>03/2016 was special year due to M&amp;A expenditure and additional anniversary dividend of JP10 a share. Dividend payout for 03/2017 returns to normal but FCF should use for future growth based on growth strategy clearly set.</i>	

## Capital Policy

Equity Issuance	No (03/2016) actual
Share Cancellation	No (03/2016) actual
<i>Profit margins remain low level although they are expected to rise. Increasing business profitability is the first.</i>	

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