

Corporate Governance Research: Nichirei (2871)

Summary:

Nichirei's corporate governance was slightly higher than the average* and the financial performance such as ROE is above average, too. Capital policy is so far so good, guiding CapEx projection and dividend policy in its MTN plan. The most critical thing is cross-shareholding, although Nichirei reduced the holdings gradually year by year. However, the top 10 shareholders include banks, trust banks and life insurances as well as supplier company. Due to such shareholders structure, intense management would be less likely. This would not be a different aspect in ownership by the board directors. Board directors own small number of Nichirei shares. For the strong alignment with shareholders, the board directors should increase the ownership. In this sense, granting restricted shares is very good for the company. As for the board structure, ideally the majority of the board should be comprised of independent outside directors. Also, the board should enhance diversity, as it should employ more female directors as not only outside directors but also inside directors, and a non-Japanese director is another issue, considering the expansion of overseas business. As for the committee, although nomination and compensation committee exist, how the optional committees particularly nomination committee functions are unclear. The chair of the committee is outside director, but the outside director is not comprised of the majority of the nomination committee. Another issue includes compensation of directors. The balance between fixed salary and variable remuneration (performance linked remuneration and granting restricted stocks) should revise to increase more variable than fixed remuneration. The compensation disclosure of each director is strongly recommended. Finally, there remain unclear policy on ex-CEO advisor and takeover defense. Currently, there is no ex-CEO advisor so-called 'Komon' but the internal rule about 'Komon' was stipulated in 2017 and would be seated in future. Nichirei has no anti-takeover provision, but states in the CG report that the company would take appropriate measure within the regulations and laws in case.

*METRICAL CG Score of Nintendo 69.9 (average of 1,769 companies as of July 2019 was 54.8)

1. Shareholders Structure

The shareholder structure is diversified and banks, trust banks and life insurances are the major shareholders. Of the top 10 shareholders, 2 shareholders should be noted. Nisshin Flour Mills is a customer but owned mutually, as Nichirei holds 3,460, 457 shares (JPY8,789 million) as of March 2019. Mizuho Trust & Banking (Retirement Benefit Trust a/c) would be another cross-share holder. Such as traditional shareholders structure as top shareholders account for large ownerships would weaken the corporate governance.

[Top10 Shareholders as of June 25, 2019]

1. The Master Trust Bank of Japan (trust a/c) (14.67%)
2. Japan Trustee Services Bank (trust a/c) (9.58%)
3. Nippon Life Insurance (4.31%)
4. Mizuho Bank (2.86%)
5. Mitsubishi UFJ Bank (2.56%)
6. Mizuho Trust & Banking (Retirement Benefit Trust a/c) (2.10%)
7. Nisshin Flour Milling Inc. (2.04%)
8. The Norinchukin Bank (2.01%)
9. Daiichi Life Insurance (1.74%)
10. Trust & Custody Services Bank (Mutual Fund a/c) (1.56%)

2. Board Structure

[Organizational Structure as of June 25, 2019]

Nichirei maintained its board structure of 'Company with corporate auditors after the AGM on June 25, 2016.

[Board of Directors: as of June 25, 2019]

The directors of the board are elected every year and the size of the board is not so large (not compact yet) as the total number of directors is 10. The chair of the board is the chairman of the company. The independent outside directors are none of the customer or supplier of the company and receiving fees from the company in the business. 2 female directors are outside directors, so 20% is the female in the board of directors. 3 Independent outside directors account for 30% of the board. Ideally, the independent outside directors should be comprised of the majority of the board. However, the board is chaired by the chairman and the independent director positions as a minor. However, 3 independent outside directors are all from business manager, not accountant and lawyer. This is positive.

Term of office: 1 year

Chair of board: Chairman (except Chairman concurrently hold the position of President)

Number of directors: 10

Outside directors: 3 (Independent directors: 3)

1. Shizuka Uzawa – Chairman, Nisshinbo Holdings Inc. (3105, JP)
2. Ms. Mieko Wanibuchi – President, Ginza Tailor Group (Private Company)
3. Ms. Kuniko Shoji – Director, Terumo (4543, JP)

[Ownership of shares by directors: as of March 2019]

Ohtani is the largest ownership of the board directors but isn't large enough holding 12,700 shares. Most of other directors holds at most only a few thousand shares. Small ownership by management would weaken the commitment of managing companies as well as the alignment of the goal of management and shareholders. In this sense, the current board members are weak in alignment with shareholders.

1. Kunio Otani, Chairman: 12,700 shares
2. Kenya Okushi, President: 2,468 shares
3. Takumi Taguchi, Executive Officer (Administration) 3,000 shares
4. Yoshifumi Kaneko, Executive Officer (Nichirei Flesh & Int'l Dev): 2,500 shares
5. Junji Kawasaki, Executive Officer (QC & Marketing): 800 shares
6. Kazuhiko Umezawa, Executive Officer (Logistics): 1,600 shares
7. Masahiko Takenaga, Executive Officer (Foods): 5,638 shares
8. Shizuka Uzawa, Independent Outside Director: 900 shares
9. Ms. Mieko Wanibuchi, Independent Outside Director: 900 shares
10. Ms. Kuniko Shoji, Independent Outside Director: 100 shares

3. Committees

The company has no mandatory Committee but optional Nomination and Compensation Committees. The 3 independent outside directors are the member of the both advisory committees. One of them are elected as the chair of the committee. Particularly, as for the Nomination Committee, the member consists of 3 outside directors, 2 inside directors and 3 others that includes 1 inside corporate auditor and 3 outside auditors. How 3 outside corporate auditors work for nominations independently would be unclear.

[Nomination Committee (Optional) as of June 25, 2019]

Number of Members: 9

Number of Inside Directors: 2

Number of Outside Directors: 3

Others: 4

Chair of Committee: Outside Director

[Compensation Committee as of June 25, 2019]

Number of Members: 5

Number of Inside Directors: 1

Number of Outside Directors: 3

Others: 1

Chair of Committee: Outside Director

4. Compensation Incentives

The company does not offer stock options. This would align with the shareholders, as stock options has asymmetric profit/loss profile than common shares. The resolution in the AGM on June 25 2019 that newly introduced restricted common shares is very positive, which would strengthen the alignment with shareholders. The formula the performance linked compensation is based on the mid-term business performance, which is positive, too. However, the compensation will be offered 60% for fixed salary, 20% for performance linked rewards and 20% for restricted common stocks. 60% of salary would be high and more than half should become non-fixed salary. The compensation disclosure is weak, as that of each director isn't disclosed.

[Disclosure of Compensation of Directors]

1. Total 8 Directors (ex. Outside directors):

Total Compensation: JPY 502 million (JPY395 million, Fixed)+(JPY107 million, Performance-linked)

2. Total 3 Corporate Auditors (ex. Outside directors):

Total Compensation: JPY92 million (JPY92 million, Fixed only)

3. Total 7 Outside Executive Officers:

Total Compensation: JPY128 million (JPY128 million, Fixed only)

[Disclosure of Remuneration of Directors who receive more than JPY100 million]

No

[Formula of Performance-linked Remuneration]

The performance-linked remuneration is calculated on the comprehensive performance based KPI. KPI is based on the overall company's performance (consolidated sales, consolidated EBITDA and Consolidated Retained Economic Profit), each director's business segment performance (business segment sales and business segment EBITDA) and each director's performance.

[Compensation Incentive as of December 3, 2018]

Incentive Plan to Board Directors: Performance linked incentive and Other

Stock Option: No

Disclosure of Compensation: No

Compensation Policy and Formula: Yes

5. Ex-CEO Advisors

No

Currently, Nichirei has no ex-advisor. Firmer chairman, Toshiaki Murai stepped down in June 2019 and hasn't stayed within the company as an ex-CEO advisor. The company might have ex-advisor as 'Komon' as the rule of 'Komon' was set in May 2018 for a person who is in charge of important role of the top of industry association. The term is 1 year. The renewal and the compensation will be determined by Nomination and Compensation Committee. A 'Komon' was exist but resigned in March 2018. A 'Komon' might be seated in near future.

6. Takeover Defense

The company has no takeover defense provision. However, Nichirei has set the basic policy about takeover of the company. Nichirei would take appropriate measure to a buyer who offers a buyout in case the buyout isn't judged as a good proposal for the shareholders' value.

[Takeover Protection Clause]

No

7. Evaluation on Board of Directors

Although the company received the 3rd-party survey result on the board evaluation and the issue more focuses on paperless and providing information prior to the board meeting, there were issues on the diversity of the board, the increase of independent outside directors and the objectivity of nomination and compensation. More importantly, how the board enhance the practice. For instance, how independently manage agendas of the board meeting and improve the diversity of the board for including diversified opinions is important issue. Also, the issue focused on the succession plan, but key is how the nomination committee functions effectively (issue of Nomination committee is mentioned earlier in 3. Committees).

[Method of Board Evaluation]

The company does evaluation of the board of directors by the 3-rd party one a year from January to February.

8. Training Policy of Directors

For inside board directors in Japan, many of them are nominated from the senior employees within a company. Many directors lack knowledge about finance and accounting that require important decision making and of strategy and business. Training including finance and accounting is positive. Using training course by external provider would be plus, too.

[Method of Board Training]

When a new director is elected, he/she will be provided training of related laws, corporate strategy, financial analysis and etc. The company will provide training to him/her if necessary. For an outside director, the company offers the information of business environment and major business bases.

9. Stock Holding

The company decreased the policy stock holdings, as it reduces the holdings of Mitsubishi UFJ Financial Group, Mizuho Financial Group, Showa Denko, Toyo Seikan Group Holdings, Mitsui Sumitomo Trust Financial Holdings and selling Kajima Corporation off. The holding of JPY26,235 million is 6.95% of the Total Assets or 4.52% of the annual sales of the company. This is not a small amount. The large holding such as Nisshin Flour Mills, Kewpie, Fuyo Sogo Leasing, Teikoku Hotel, Chiba Bank and etc. are cross-holding each other.

[Stock Holding Policy]

The policy stock holding is reviewed, considering the economic rationality in the mid-to-long term on the profitability in the business as well as dividend income on the cost of capital.

[Stock Holding]

1 publicly traded stock were removed and 1 private stock was added in the policy holding.

1. Policy holding shares as of June 26, 2018: 28 names, JPY26,185 million
2. Policy holding shares as of June 25, 2019: 28 names, JPY26,235 million

[Large Holding as of June 25, 2019]

1. Nisshin Flour Mills 3,640,457 shares, JPY8,789 million
2. Kewpie: 1,555,007 shares, JPY4,128 million
3. Fuyo Sogo Leasing: 416,600 shares, JPY2,282 million
4. Mitsubishi Shokuhin: 700,000 shares, JPY2,027 million
5. Kyoto Hotel: 2,008,178 shares, JPY1,5677 million

10. Growth Policy

The company posts MTN plan, quantitative target and KPI. ROE and ROA are higher than average of Japan's companies.

[Mid-Term Management Plan]

Disclosed

[Quantitative Target]

Disclosed

[KPIs]

Disclosed

[ROE]

1. 11.7% (act) FY3/2019
2. 11.3% (Toyokeizai E) FY3/2020 E

[ROA]

1. 5.3% (act) FY3/2018
2. 5.3% (Toyokeizai E) FY3/2019 E

11. Capital Allocation Policy

Nichirei posted increasing dividend payout of net profit to 28% from 21,4% of the previous year. distributes about 50% of cash dividend out of the net profit. There would be more room of paying dividends or share repurchase, as the free cash flow generates stably. CapEx For the next 3 years until FY3/2021 is projected to raise to FY100.8 billion from JPY63 billion for the past 3years due to the future growth.

[Cash Holding]

1. Cash Equivalent as of March 31st 2019: JPY20,668 million
2. Cash Equivalent as of March 31st 2018: JPY17,076 million

The average of cash equivalent / sales X12 =0.4 months as of March 31st 2019

[Dividend Policy]

Dividend on Equity at 3.0% is set as the target dividend payout.

1. Dividend (act) FY3/2019: JPY32 a share, Dividend Payout=21.4%
2. Dividend (CE) FY3/2020: JPY42 a share, Dividend Payout=28.0%

[Share Repurchase and Retirement]

1. Shares was repurchased in 2016 and 2017 and 8,000,000 shares were retired in May 2017.

[Equity Issuance]

No

[Capital Expenditure]

1. CapEx FY3/2019: JPY24,132 million
2. CapEx FY3/2018: JPY24,952 million

[Free Cash Flow]

1. Free Cash Flow FY3/2019: JPY13,393 million
2. Free Cash Flow FY3/2018: JPY9,590 million

12. Agenda of AGM

The agenda are not special for the year other than Proposal #5 (Rumination to grant restricted stock to directors). As for #1, Dividend of JPY16 per share for the 2nd half 6-month period was approved. As for #2 and #3, only Masahiko Takenaga was a newly elected as a director and Yuhiko Saito was newly elected as a corporate auditor. All directors and auditors are approved more than 96%.

[Proposal No. 1: Distribution of Surplus]

Approved: 98.42%

[Proposal No. 2: Election of 10 Directors]

1. Kunio Otani, Chairman: 96.74% approved
2. Kenya Okushi, President: 97.21% approved
3. Takumi Taguchi, Executive Officer (Administration): 97.21% approved
4. Yoshifumi Kaneko, Executive Officer (Nichirei Flesh & Int'l Dev): 97.73% approved
5. Junji Kawasaki, Executive Officer (QC & Marketing): 97.73% approved
6. Kazuhiko Umezawa, Executive Officer (Logistics): 97.73% approved
7. Masahiko Takenaga, Executive Officer (Foods): 97.73% approved
8. Shizuka Uzawa, Independent Outside Director: 98.42% approved
9. Ms. Mieko Wanibuchi, Independent Outside Director: 98.42% approved
10. Ms. Kuniko Shoji, Independent Outside Director: 98.40% approved

[Proposal No. 3: Election of 1 Corporate Auditor]

1. Yuhiko Saito, Corporate Auditor: 98.42% approved

[Proposal No. 4: Revision of amount of remuneration for directors]

Approved: 98.24%

[Proposal No. 5: Rumination to grant restricted stock to directors]

Approved: 97.87%

Aki Matsumoto, CFA

This report is for information purpose only and is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. Although we seek to update our research as appropriate, the contents may be different from the most recent fact as the report is published at irregular intervals as appropriate.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The price and value of investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur.

The author of this report is not in relation of serious conflict of interest with the reported company.