

Revising the Code of Corporate Conduct on MBOs and Subsidiary Conversions



Tokyo Stock Exchange Listing Department

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Review the Scope of Actions Covered by the Code

- TSE will broaden the scope of actions already mandated when executing a cash-out that could lead to a conflict of interest, which are **"obtaining an opinion stating that the transaction will not undermine the interests of minority shareholders"** and **"necessary and sufficient disclosure of information."**

	Subsidiary Conversion by Controlling Shareholder	MBO	Subsidiary Conversion By Other Related Company*
(1) Opinion stating that the transaction will not undermine the interests of minority shareholders <ul style="list-style-type: none"> Requirement to obtain said opinion from an entity that has no interest in the controlling shareholder 	Already applicable	 Newly applicable	Newly applicable
(2) Necessary and sufficient timely disclosure <ul style="list-style-type: none"> Requirement for necessary and sufficient timely disclosure (including an overview of the share value calculation) 	Already applicable	 Newly applicable	Newly applicable

*Other Related Companies as set forth in Article 8, Paragraph 17, Item 4 of the Financial Statements Regulation (cases where a company holds 20% or more of the voting rights, or cases where a company holds between 15% and 20% of the voting rights and can exercise significant influence)

Revision of Content of Code

- Revision of the "opinion stating that the transaction will not undermine the interests of minority shareholders" (including providers and contents)** to improve the effectiveness of the deliberations of Special Committees (see pages 3 to 4)
- Revision of the contents of "necessary and sufficient disclosure of information"** (enhancing disclosure of important assumptions for the share value calculation) to ensure that general shareholders judge the fairness of a transaction on the basis of sufficient information (see page 6)

(1) Revision of "Opinion Stating That the Transaction Will Not Undermine the Interests of Minority Shareholders"

- In order to improve the effectiveness of the deliberations of Special Committees, the "opinion stating that the transaction will not undermine the interests of minority shareholders" will be reviewed as below.

Current Code

Planned Revisions

Opinion Provider

Entities with no interest in the controlling shareholder

- In addition to the Special Committee, it is also possible to obtain opinions from outside directors and auditors as well as experts with no vested interest. (In practice, in all cases they are obtained from the Special Committee.)

✓ **The opinion must be obtained from the Special Committee**

- The purpose of this revision is to clarify the entity conducting the consideration.

Contents of Opinion

Opinion stating that the transaction will not undermine the interests of minority shareholders

- There have been cases where the opinion of not undermining was given just because there would be an opportunity to sell at a price with a certain premium, despite concerns about the fairness of the price.

- There are no specific rules regarding the points that should be considered when forming an opinion, and investors have pointed out that it is unclear whether effective discussions are taking place.

✓ Requirement to obtain **"opinion stating that the transaction is fair to general shareholders"**

- In accordance with the Fair M&A Guidelines, this is to require opinions from the perspective of ensuring "transactions that fairly distribute the increase in corporate value to general shareholders."

✓ **Clarify points of view** that should be considered (page 4) for the opinion and stipulate that the **specific details of the consideration and the basis for the final judgment** for each point of view must be **sufficiently explained and disclosed in the opinion**.

- While we do not require the disclosure of the minutes themselves in consideration of the practical impact, we do require that companies will properly fulfill their accountability by indicating the perspectives that should be considered and disclosed.

- TSE will also continue to require the Board of Directors to provide a sufficient explanation of the basis for the final decision based on the opinions from the Special Committee.
- In addition, TSE is considering providing information on the responses and knowledge required in the phase of going private for independent directors and others who are members of Special Committees (for example, provision of seminars by outside experts).

Matters For Consideration in Opinions

appropriateness of the M&A	<ul style="list-style-type: none"> ● Whether it will contribute to the increases of the target company's corporate value
Fairness of the terms of the transaction	<ul style="list-style-type: none"> ● Based on all of the following perspectives, whether the terms of the transaction (including purchase price, method of acquisition, form of payment) are fair <ul style="list-style-type: none"> ✓ The process of consultation and negotiation with the acquirer <ul style="list-style-type: none"> - The progress of the discussions (including the details of the Special Committee's involvement), the policy for the discussions and negotiations, the details of any major points of contention, and the reasons for any changes from the original policy (such as the details of any consideration of the risk of the talks breaking down) ✓ Share value calculation details and the rationale behind the financial forecasts and assumptions used as the basis for the calculation <ul style="list-style-type: none"> - If the assumptions for financial forecasts have changed significantly or there are special preconditions, the rationale behind these ✓ Reasonableness of the premium compared with past market prices and similar cases <ul style="list-style-type: none"> - If negative information has been disclosed just before an MBO/conversion, consideration of reasonableness should take that into account. ✓ Other (e.g., the price at which the shares were acquired in the past by the acquirer)
Fairness of the procedure	<ul style="list-style-type: none"> ● Based on the specific circumstances of the M&A, from the perspective of procedurally securing the fairness of the transaction terms as a whole, whether sufficient "Fairness Ensuring Measures" are being taken <ul style="list-style-type: none"> ✓ Implementation status of "Fairness Ensuring Measures" 1 to 6 listed in the Fair M&A Guidelines, and if any of the measures are not implemented, the reasons for this and how this is considered from the perspective of ensuring fairness <ul style="list-style-type: none"> - In line with the spirit of the Fair M&A Guidelines, TSE will not require the implementation of all measures, but rather asks that an appropriate combination of measures be implemented according to each case and the situation be explained to investors. <ol style="list-style-type: none"> 1. Establishment of a Special Committee (timing of establishment, composition, authority (such as involvement in negotiations, appointment of advisors), remuneration for committee members) 2. Expert advice from external advisors (such as legal advisors, third-party valuation advisors, etc.) <ul style="list-style-type: none"> - Details of the examination of the independence of external experts and the basis for the judgment 3. Market checks (active market checks, indirect market checks) <ul style="list-style-type: none"> - Where there is a competing proposal (limited to a specific, feasible and serious takeover bid) and the company will agree to the MBO or subsidiary conversion, the content of the deliberations by the Special Committee and the basis for that decision 4. Majority of Minority Conditions (procedures for confirming the will of shareholders) 5. Elimination of coerciveness 6. Disclosure of information (disclosure of information to the extent that it is possible to judge the fairness of the terms of the transaction and the fairness of the procedures)

(Ref.) Price Restrictions for MBOs/Subsidiary Conversions

- There are some cases where companies **disclose negative information (large-scale downward revisions to earnings, etc.)** just before an MBO/conversion.
 - In Europe, **price restrictions for tender offers have been implemented in laws and regulations**. Although these are not direct restrictions on disclosing negative information, they **require prices to be above the past average market price** regardless of the most recent price.
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- In Japan, in an absence of cases that would violate restrictions set in other countries** (buyouts made at prices below the average pre-announcement share price), there are **concerns that setting a minimum price restriction would actually prevent meaningful consideration**.
 - Also, even if we were to set stricter price restrictions, it would be **difficult to set unambiguous and objective criteria like "the offer is fair if the premium is above --%,"** so where a company has disclosed negative information just before an MBO/conversion, first we would like to **require the Special Committee to take this into account when considering the reasonableness of the offer**.

(Note) In cases such as where an M&A is carried out after a downward revision to earnings, if there is a possibility of inviting suspicion of a deliberate lowering of the market price to facilitate acceptance, the Fair M&A Guidelines recommend providing a particularly detailed explanation of the background and objectives behind carrying out an M&A at that particular time.

(Ref.) Price Restrictions in Other Countries

	U.S.	U.K.	Germany	France	Japan
Minimum Price Restriction	Not set*	Set (The <u>maximum amount paid in the last 3 months</u> , or the <u>last 12 months</u> in the case of a mandatory offer)	Set (The <u>maximum amount paid by the bidder in the last 6 months</u> or the <u>weighted average share price in the 3 months prior to the announcement</u>)	Set (The <u>maximum amount paid in the last 12 months</u> for a mandatory offer, or for a voluntary offer where the bidder already owns 50% or more, the <u>weighted average share price in the 60 days prior to the announcement</u>)	Not set (Lowering the purchase price after the bid is prohibited)

*In the U.S., equality between shareholders and price fairness is ensured through rules such as the Best Price Rule and All-Holders Rule. (Best Price Rule: consideration offered to any security holder must be equal to the highest consideration paid to any other security holder; All-Holders Rule: a tender offer must be made available to all shareholders holding the type of shares being solicited for purchase.)

(2) Revisions to Necessary and Sufficient Disclosure (Enhancing Disclosure of Calculation Assumptions)

- So that general shareholders can judge the fairness of a transaction on the basis of sufficient information, we will **enhance disclosure of the important assumptions for the share value calculation (the thinking behind the financial forecasts on which the calculation is based)**

(Note) We do not require disclosure of specific figures in the calculation process of free cash flow (FCF), due to practical concerns such as it leading to publication of confidential information regarding business strategy, and opinions received that the figures can be estimated to a certain extent through enhanced disclosure of the assumptions and thinking.

		Timely Disclosure Guidebook (enhanced parts are <u>underlined</u>)	
Overview of share valuation calculation	Financial forecasts	Specific figures (including growth rates) of financial forecasts (including sales, operating income, EBITDA, free cash flow)	
		Sources of the financial forecasts	
		<u>Thinking behind setting of financial forecast period</u>	
		<u>Assumptions used in financial forecasts (what assumptions are there on the business environment, etc.)</u>	
		<ul style="list-style-type: none">– If a significant increase or decrease in profit/FCF is forecast, the reasons for this– <u>If using financial forecasts that differ substantially from those announced before the M&A, the reasons for this</u>	
		Whether the forecasts assume that the M&A will be carried out	
	Discount rate	<p>Specific figures (range acceptable) for <u>and type of</u> discount rate</p> <ul style="list-style-type: none">– <u>If there are special preconditions such as consideration of a small risk premium, the details of and basis for these</u>	
	Terminal Value	<u>Specific figures (range acceptable) and calculation methodology for the terminal value</u>	
		<p>Specific figures (range acceptable) of parameters used in calculation of the terminal value <u>and thinking behind the setting of said parameters</u></p> <ul style="list-style-type: none">– <u>If there are special preconditions such as adjustments to disregard one-off expenses in the final business year, the details</u>	
	Non-business assets	<u>Treatment of individual assets (real estate such as leases, strategic shareholdings, surplus funds, etc.) in the calculation (thinking behind the categorization of business and non-business assets, etc.) (only applies if material to the calculation)</u>	
Other	Details of other special preconditions, if any		
Relationship with calculation agent	<p>If there is a material interest relationship with the calculation agent, the details and why the company requested the calculation from an agent with which it has a material interest relationship</p> <p>(E.g., a) when the agent falls under the definition of a related party, b) when the request was given to an agent recommended or introduced by the offeror, c) when the agent receives requests from both the listed company and the offeror, d) when the company was receiving financing from the agent or any of its related companies)</p>		
	<u>Fee structure of third-party valuation advisor (whether the fee is a contingency fee paid on factors such as the completion of the M&A or a fixed fee paid regardless of the M&A's success, etc.)</u>		

Revised to request disclosure regardless of the form of payment: **In cases where payment is made in listed shares**, currently disclosure is not requested given the existence of a market price, but based on investor concerns, **we will now request disclosure of the target company's financial forecasts.**