Document 1

Action to Implement Management that is Conscious of Cost of Capital and Stock Price

Exchange & beyond

Tokyo Stock Exchange, Inc.

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Background and Purpose

Background

- In Japan's Corporate Governance Code (Principle 5.2), management with consciousness of cost of capital is mentioned from the perspective that the allocation of resources with sufficient consideration of cost of capital and profitability is important for companies to meet the expectations of investors and other stakeholders and to achieve sustainable growth and enhancement of corporate value over the mid- to long-term.
- However, approximately half of the listed companies on the Prime Market and 60% in the Standard Market have ROE below 8% and P/B ratios below 1, indicating that there are issues in terms of profitability and growth potential. In response to this, the Council of Experts Concerning the Follow-up of Market Restructuring pointed out the need for reform in the thought processes of management to be more conscious of cost of capital and stock prices in order to improve the corporate value of each company in the future.
- In light of these circumstances and discussions, this document summarizes actions that can be considered important for achieving management that is conscious of cost of capital and stock price, and requests that listed companies actively implement them.

Purpose

- The purpose of these actions is to have the management of the company carry out their management duties with more consideration of cost of capital and profitability based on the balance sheet, rather than just sales and profit levels on the income statement, in order to achieve sustainable growth and increase corporate value over the mid- to long-term.
- Specifically, based on the basic management policy established by the Board of Directors, the management team is expected to take the lead in appropriately allocating resources with sufficient consideration of cost of capital and profitability by pushing forward initiatives such as investment in R&D and human capital that leads to the creation of intellectual property and intangible assets that contribute to sustainable growth, investment in equipment and facilities, and business portfolio restructuring.

Note: While share buybacks and dividend increases are considered effective means of improving profitability, if shown as such by the company's analysis of whether the balance sheet effectively contributes to value creation, TSE is not necessarily expecting companies to use only these or solve issues with a one-off response. Efforts are expected on a fundamental level to attain profitability in excess of cost of capital on a sustained basis and achieve sustainable growth.

- In taking these initiatives forward, companies are expected to enable investors to assess their progress by presenting clear information on related policies, targets, and specific details in whatever way they see fit, and to gradually improve their initiatives through proactive dialogue with investors based on this disclosure.

Details of Request

Companies Subject to Request

- All companies listed on the Prime and Standard Markets.

Requested Action

- In order to implement management that is conscious of cost of capital and stock price, please implement the following series of actions on an ongoing basis.

Analysis of Current Situation	• Gain a proper understanding of the company's cost of capital and profitability • Analyze and evaluate the current situation around these and the market valuation at board of directors meetings
Planning & Disclosure	• Have board of directors discuss and develop policies, targets, planning periods, and specific initiatives for improvement • Disclose clear information on these, along with assessment of the current situation, to investors
Implementation of Initiatives	• Push forward with management that is conscious of cost of capital and stock price, based on the disclosed plans • Engage in proactive dialogue with investors based on this disclosure

Conduct a progress analysis and update disclosures at least once a year

Note: Key points to consider when implementing each action are summarized from page 3.

Start Date

- Since analysis and discussion of the current situation must be carried out sufficiently before planning and disclosure can begin, TSE is not specifying a timeframe for the start date of disclosure, but requests as prompt a response as possible.

Note: If it takes some time to analyze and discuss the current situation, disclosure could be expanded in stages, for example by first indicating the level of progress of plan development and preparation for disclosure and the expected timing of disclosure, and then disclosing specific details once the plan is developed.

Key Points to Consider for "Analysis of Current Situation"

Examples of Possible Indicators

Cost of Capital	Balance Sheet Profitability	Market Valuation
• **Weighted Average Cost of Capital** (WACC) • **Cost of Equity** (rate of return expected by investors) etc.	• **Return on Invested Capital** (ROIC) • **Return on Equity** (ROE) etc.	• **Stock Price and Market Cap.** • **Price-to-Book Ratio** (PBR) • **Price Earnings Ratio** (PER) etc.

Note 1: Although there is no specific standard for which indicator to use, please consider which one to use in light of investors' needs and other factors.
Note 2: The purpose of calculating the cost of capital is to analyze the current situation, not necessarily to calculate it in a precise manner.

Questions to Answer and Points to Note

Questions to Answer in Analysis and Assessment	Points to Note
Whether the company has achieved profitability that exceeds its cost of capital, and if not, the reasons why	• In analyzing and assessing profitability, companies could use ROIC in comparison with WACC, and ROE with cost of equity. • In addition to company-wide analysis and assessment, companies could calculate ROIC or other indicators for each business segment and analyze/assess profitability for each one.
Even if the company has achieved the above, if the market valuation is not high enough (e.g., PBR less than 1), the reasons why	• If profitability exceeds cost of capital but the PBR is not high enough (e.g., below 1), it suggests that investors are not seeing enough growth potential. • Companies could also analyze/assess PBR, PER, or similar indicators in terms of changes over time and comparison with other companies in the same industry.

Key Points to Consider for "Planning & Disclosure" (1/2)

Information Expected to be Disclosed

Assessment of Current Situation	• TSE expects the analysis and assessment of the company's profitability and market valuation conducted in "Analysis of Current Situation" to be provided in a form that is easy for investors to understand. • Although disclosure of the cost of capital itself is not necessarily required, companies could include an explanation of the company's approach to cost of capital and the thinking behind the calculation, such as the calculation method. • In addition, regarding profitability and market valuation, it could be appropriate to analyze and assess the situation over a certain period of time such as multiple years, rather than just on a single year basis.
Policies and Targets	• TSE expects policies for improvement and specific targets related to profitability and market valuation to be provided in a form that is easy for investors to understand. • Indicators for targets should be chosen based on the company's own situation. In setting targets, other than specifying a single goal and deadline, it could also be acceptable to specify a target range, or a rate of change such as the growth rate of ROE or EPS (earnings per share). • A PBR below 1 is one indication that the company has not achieved profitability that exceeds its cost of capital, or that investors are not seeing enough growth potential. On the other hand, even if the PBR ratio is already above 1, companies could set targets for further improvement. • If a company considers that sufficient levels of profitability and market valuation have already been achieved and there is no need for further improvement, it may make this clear instead of disclosing policies or goals.
Initiatives and Timing of Implementation	• TSE expects information on specific initiatives to improve profitability and market valuation, as well as the schedule for their implementation, to be provided in a form that is easy for investors to understand. • For example, in disclosing efforts to appropriately allocate resources, it may be helpful to refer to the information Growth Market companies are required to disclose in their "Business Plans and Matters Related to High Growth Potential" (business model, market environment, sources of competitiveness, growth strategy, etc.) and examples of these. (See page 8 for details.) • In order to improve investors' evaluation of growth potential, companies could disclose the direction of their business and initiatives on sustainability and intangible assets, including intellectual property, which are aimed at achieving growth. • As part of such efforts, remuneration plans for management could be used as a sound incentive for sustainable growth, for example by including indicators related to profitability and improvement of corporate value in the calculation of executive remuneration.

Key Points to Consider for "Planning & Disclosure" (2/2)

Updated May 2025

Form of Disclosure

- Although TSE is not specifying any type of document or format for disclosing policies and targets for improvement, specific initiatives, and the timing of implementation, companies could disclose such information in, for example, management strategies, management plans, financial results presentation materials, the company's website, or plans to meet the continued listing criteria.
- No matter how the information is disclosed, to make it easier for investors to find, please state that the company is disclosing the information and how to access it (e.g. a website URL) in section “Action to Implement Management That Is Conscious of Cost of Capital and Stock Price” in their CG reports.

Key Points to Consider for "Implementation of Initiatives" and "Updates"

Proactive Dialogue with Investors

- After carrying out "Planning & Disclosure," TSE expects companies to push forward with management that is conscious of cost of capital and stock price based on this plan, as well as proactively engage in dialogue with investors including overseas investors based on this disclosure, in line with the principles of the Corporate Governance Code regarding dialogue with shareholders.
- Prime Market-listed companies are expected to disclose on the dialogue they have carried out with investors as described in Document 2 "Promotion and Disclosure of Dialogue with Shareholders."

Ongoing Updates

- After "Planning & Disclosure" is implemented, TSE requests companies to update the disclosure at least once a year after analyzing the progress of initiatives and results to date.
- In updating the disclosure, TSE expects companies to present the progress of current initiatives and progress toward achieving targets, information on dialogue with investors, and any changes in targets and initiatives in a manner that is easy for investors to understand.
- Although there is no specific timeframe for updates, if there are any major changes to plans that are already disclosed, TSE expects prompt updates to the content of the disclosures.

Reference: Principles Related to Objectives for profitability, etc.

Japan's Corporate Governance Code (Revised June 2021)

Principle 5.2 Establishing and Disclosing Business Strategies and Business Plans

When establishing and disclosing business strategies and business plans, **companies should articulate their earnings plans and capital policies, and present targets for profitability and profitability after accurately identifying the company's cost of capital. Also, companies should provide explanations that are clear and logical to shareholders with respect to the allocation of management resources, such as reviewing their business portfolio and investments in fixed assets, R&D, and human capital, and specific measures that will be taken in order to achieve their plans and targets.**

Supplementary Principle 5.2.1

In formulating and announcing business strategies, etc., companies should clearly present the basic policy regarding the business portfolio decided by the board and the status of the review of such portfolio.

Guidelines for Investor and Company Engagement (Revised June 2021)

1. Management Decisions in Response to Changes in the Business Environment

1.2 **Does management accurately identify the company's cost of capital, reflecting risks associated with the business in an appropriate manner? Does management manage the business with a recognition of the company's cost of capital by setting targets on profitability and profitability to generate sustainable growth and increase corporate value over the mid- to long-term? Does management clearly explain why they decided upon such targets? Does the company achieve returns which cover the cost of capital on a mid- to long-term basis?**

1.4 **Does management understand the business environment and business-related risks appropriately and make decisions decisively, such as restructuring the company's business portfolio, including investment in new businesses with higher growth potential and exit from or sale of existing businesses, based on the company's business strategies and business plans?** Is a policy on reviewing a business portfolio clearly established, and is the review process effective?

Reference: Disclosure of "Business Plans and Matters Related to High Growth Potential" in the Growth Market

- Companies on the Growth Market are required by the listing rules to disclose "Business Plans and Matters Related to High Growth Potential," and the latest information must be disclosed at least once a year, reflecting progress made.

Disclosed Items		Contents
Business Model	**Business**	➢ Details and characteristics of the products and services, contribution of each business, and the details and processes of permits and approvals that will be required in the future
	Earnings Structure	➢ Contracts with terms and conditions that have a significant impact on revenue and expense structures, cash flow acquisition streams, and earning structures
Market Environment	**Market Size**	➢ Details and size of the market (type of customer, region, etc.)
	Competitive Environment	➢ Details of competition, company's positioning, market share, etc.
Source of Competitiveness	**Competitive Advantage**	➢ Technology, intellectual property, business models, know-how, brands, human resources, etc. that will serve as growth drivers
Business Plan	**Growth Strategy**	➢ Management policies and growth strategies, and specific measures to realize them (R&D, capital investment, marketing, personnel, financial planning, etc.) *The period covered by the business plan is expected to vary depending on the business activities of each listed company.
	Management Index	➢ Indexes that are important for management (reasons for adopting them as indexes, actual values, specific target values, etc.)
	Profit Plans and Assumptions	➢ If a medium-term management plan has been announced, its contents and assumptions
	Progress	➢ Status of achievement of previously stated items, updates from previously stated items, and next scheduled disclosure date
Risk Information	**Perceived Risks and Countermeasures**	➢ Major risks that could have a significant impact on the realization of growth and the execution of the business plan, and measures to address them