



# A Better Sanken

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**6707 JT Equity: Sanken Electric Co., Ltd.**

November 22, 2019

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# Investment Thesis

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- 1. Sanken Electric Co., Ltd. (“Sanken” or the “Company”) has strength in the growing power semiconductor market**
- 2. Sanken is extremely undervalued. The value of their US subsidiary Allegro Microsystems, Inc. (“Allegro”) exceeds Sanken’s overall market cap by 41%**
- 3. Sanken’s margins could be improved by enhancing operations of the domestic semiconductor business and exiting the power system business**
- 4. The Company recently announced a value enhancement plan which we believe is a great start to unlocking value. Swift and firm execution of the plan will be the key**

# Snapshot of Sanken

Source: Company disclosures

## Overview of the Company

- Name: Sanken Group Inc.
- Ticker: 6707 JT Equity
- Founded: October 1937
- Headquarters: 3-6-3 Kitano, Niiza, Saitama 352-8666, Japan
- Website: <https://www.sanken-ele.co.jp/index.php>

## Board of Directors

- Representative Director, President
  - Takashi Wada
- Director
  - Masao Hoshino
  - Yoshihiro Suzuki
  - Kazunori Suzuki
  - Hideo Takani
  - Shigeru Ito
- Outside Director
  - Richard R. Lury
  - Noriharu Fujita
  - Emiko Higashi

## Sanken's Business Breakdown



# Sanken By The Numbers

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Source: Bloomberg and company disclosures

Note: Market data as of November 21, 2019. Excludes treasury stock from market capitalization calculation.

Market Capitalization

¥**75**bn

FY2 EV / EBITDA

**6.0x**

# of Employees  
As of May 2019

**9,481**

Latest FY Sales

¥**174**bn

Latest FY  
Operating Profit

¥**10.5**bn

Latest FY  
Operating Margin

**6.1**%

# Segment Financials (FY19/3, JPY in mn)

Source: Company disclosures

		Sales (% Total)		Operating Income (% Total)		Operating Income Margin
Semic onduct or Device	Allegro (US Subs)	¥80,350	46%	¥11,010	81%	14%
	Semi- conductor Ex. Allegro	66,861	39%	2,015	15%	3%
Power System		26,438	15%	549	4%	2%
Elimination		-		(3,044)	-	-
Total		¥173,650		¥10,531		6%

# Our Goal

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- On November 6, 2019, Sanken announced “*Notice on Production System Optimization in Mainstay Businesses and Strategic Review of Non-mainstay Businesses*” (<https://www.sanken-ele.co.jp/en/fina/pdf/20191106e.pdf>), which we believe is a great start for Sanken in unlocking value
- Our goal is to monitor and ensure that Sanken makes firm and quick execution of this plan in order to enhance Sanken’s business and unlock value for every stakeholder, including employees, customers, lenders, creditors and minority shareholders

# Agenda

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- 1. Power Semiconductor Market Overview**
- 2. Sanken's Issues**
- 3. Proposals Previously Shared with Sanken**
- 4. The Company's Progress**
- 5. Value Enhancement from Executing the Plan**
- 6. Our Message to Sanken's Board of Directors**



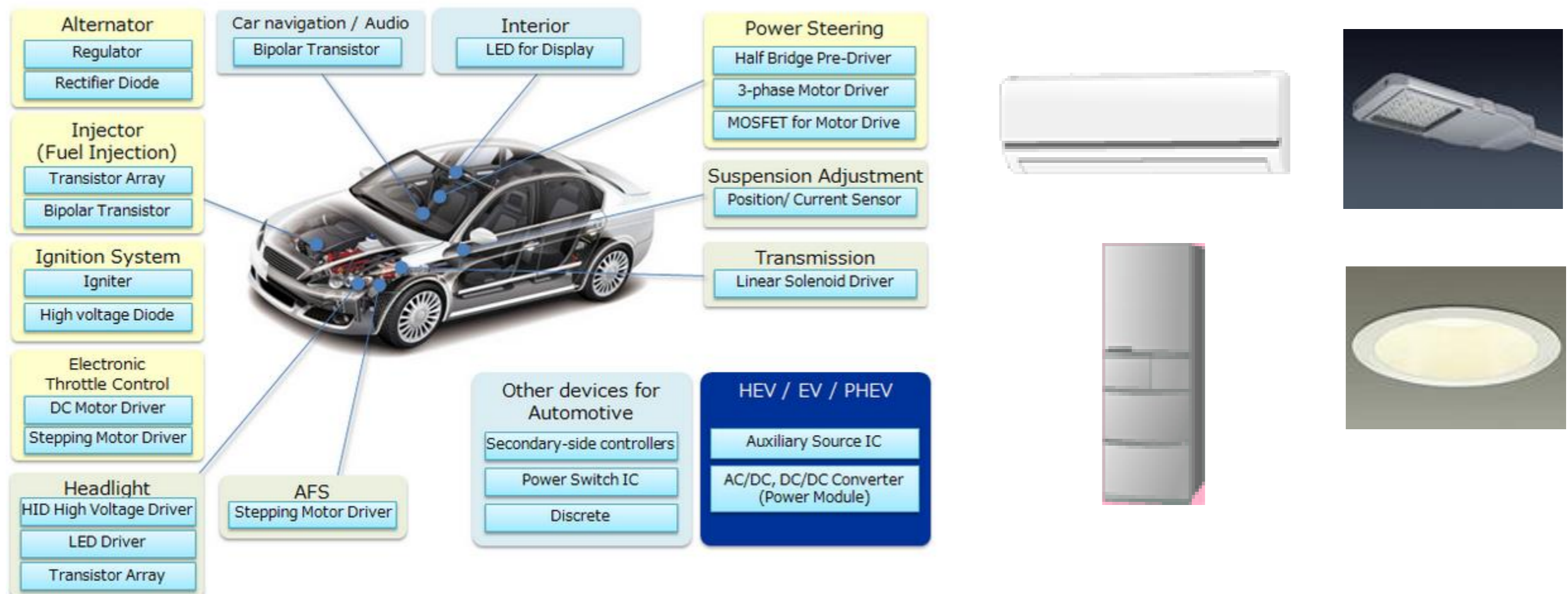
# 1. Power Semiconductor Market Overview

# What are Power Semiconductors?

Source: Company Disclosures

- Power semiconductors can handle high voltages and large currents. They possess a structure that is different from regular semiconductors, enabling them to handle high voltages and large currents without damage
- Power semiconductors are mostly used in power conversion such as in changing voltages and frequencies, as well as changing DC to AC and AC to DC
- Power semiconductors play a huge and indispensable role in accurately driving motors from low to high speeds, supplying power grids with power generated from solar cells with less power loss, and providing a stable source of electricity to various home appliances and electrical equipment

## Power Semiconductor Application Examples

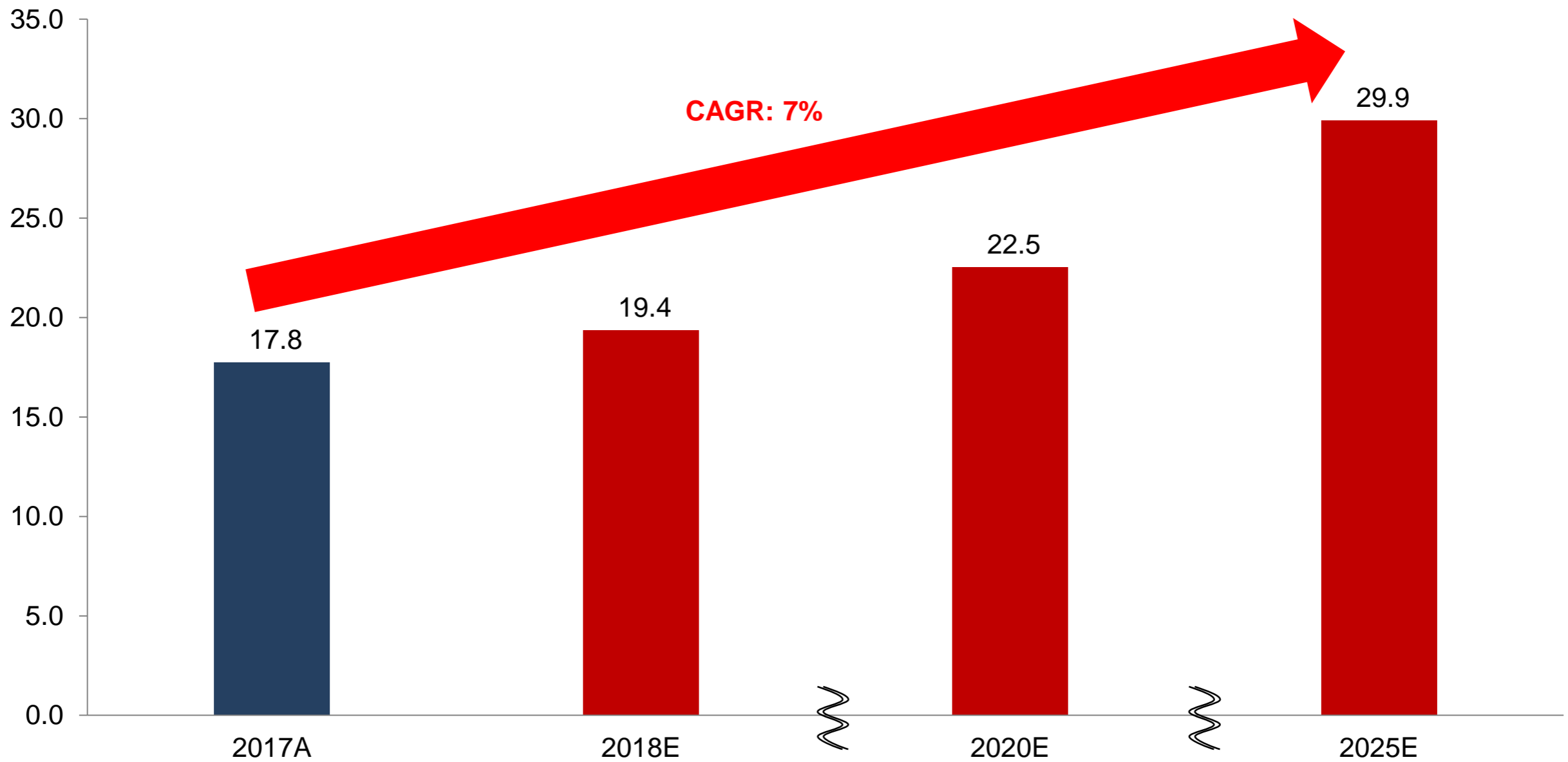


# Anticipated Long Term Growth of Power Semiconductor Market

Source: Yano Research Institute

- The future of the power semiconductor market is bright
- Research assumes the market will grow by 7% through 2025

## World Wide Power Semiconductor Market (\$ in bn)














# Power Semiconductor Growth Boosted by Energy-Saving Trends

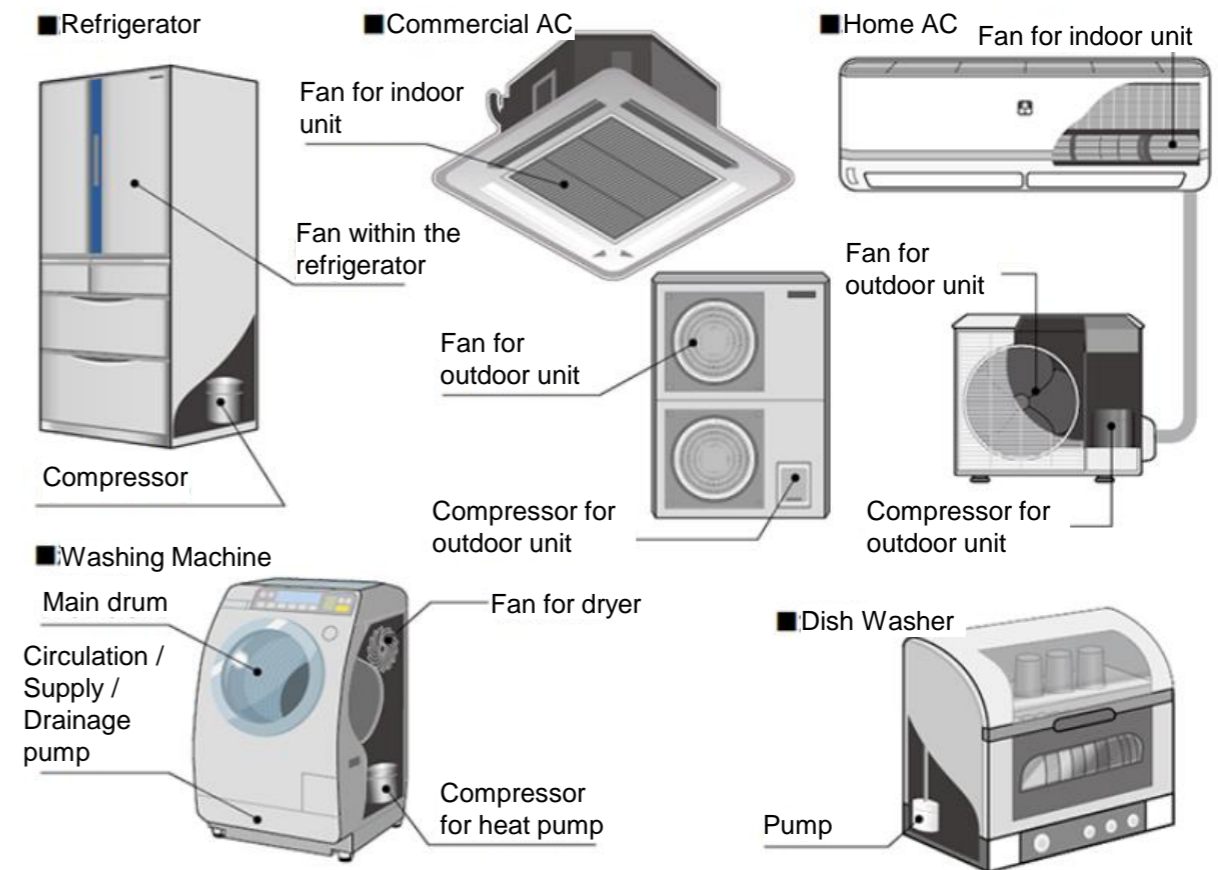
Source: Company Disclosures

- In recent years, there has been a greater awareness of the need for energy-saving and power consumption reductions, and as a result, the need for power semiconductors that minimize power loss has been increasing
- In the automotive sector, governments are pushing EV. In the consumer electronic sector, consumers prefer cost-effective, energy saving products

## Countries Which Will Prohibit the Sales of Gasoline / Diesel Autos

Country	Timing	Country	Timing
 Norway	2025	 Ireland	2030
 Switzerland	2030	 Israel	2030
 Netherlands	2025	 China	2040
 Germany	2030	 India	2030
 French	2040		
 UK	2040		
 Spain	2040		

## Energy-Saving Consumer Electronic Requires Power Semiconductor

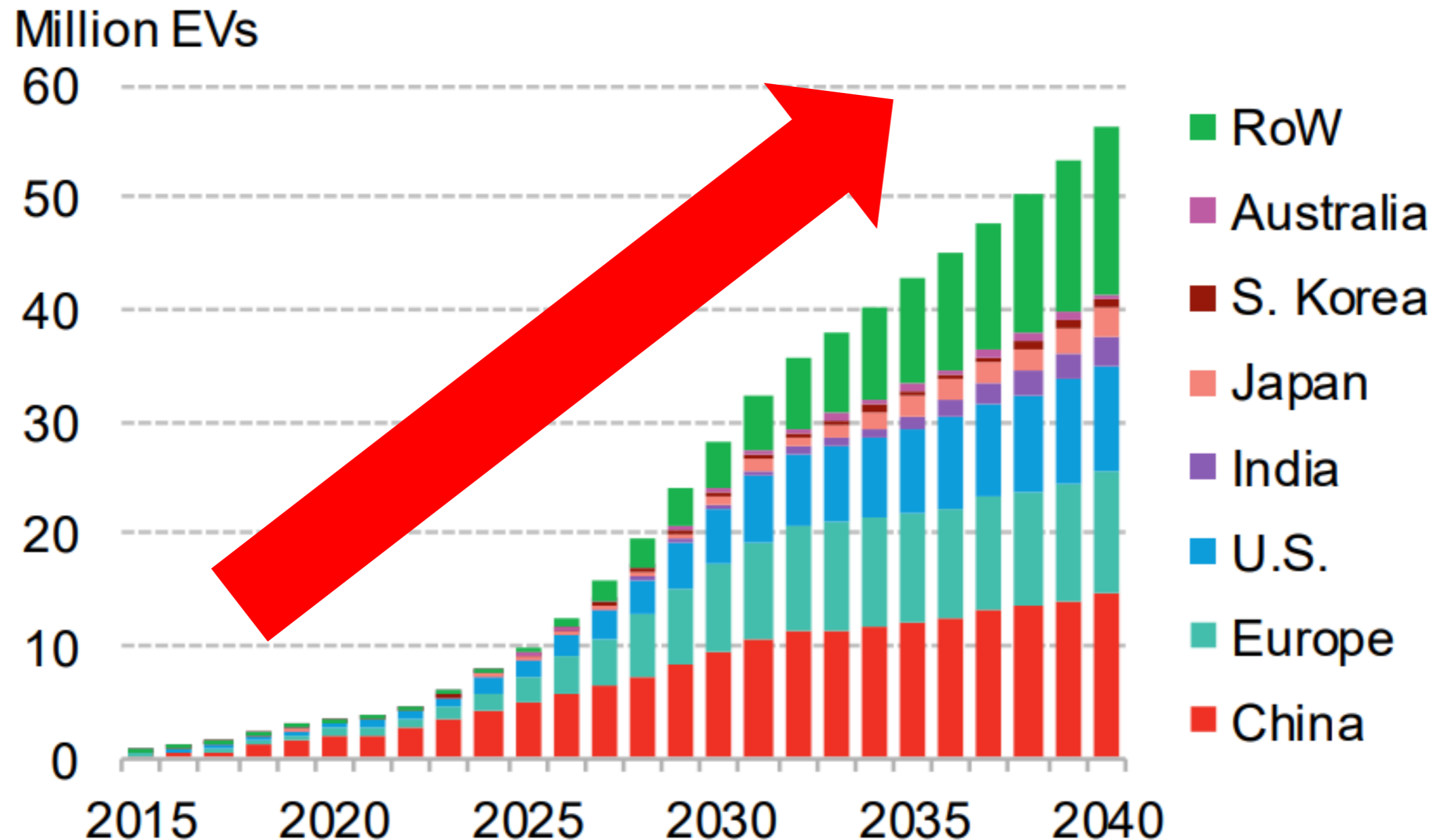


# Global EV Revolution Set to Take Off

## *Annual Passenger EV Sales Estimate*

Source: Bloomberg

- By 2025, EV sales across the world are set to increase ten-fold, to 11 million
- In the mid-2020s, EV prices are expected to match those of internal combustion engine vehicles. Once this happens, it is anticipated that a "tectonic shift" in car buying will take place, sending global sales of EVs to 30 million by 2030

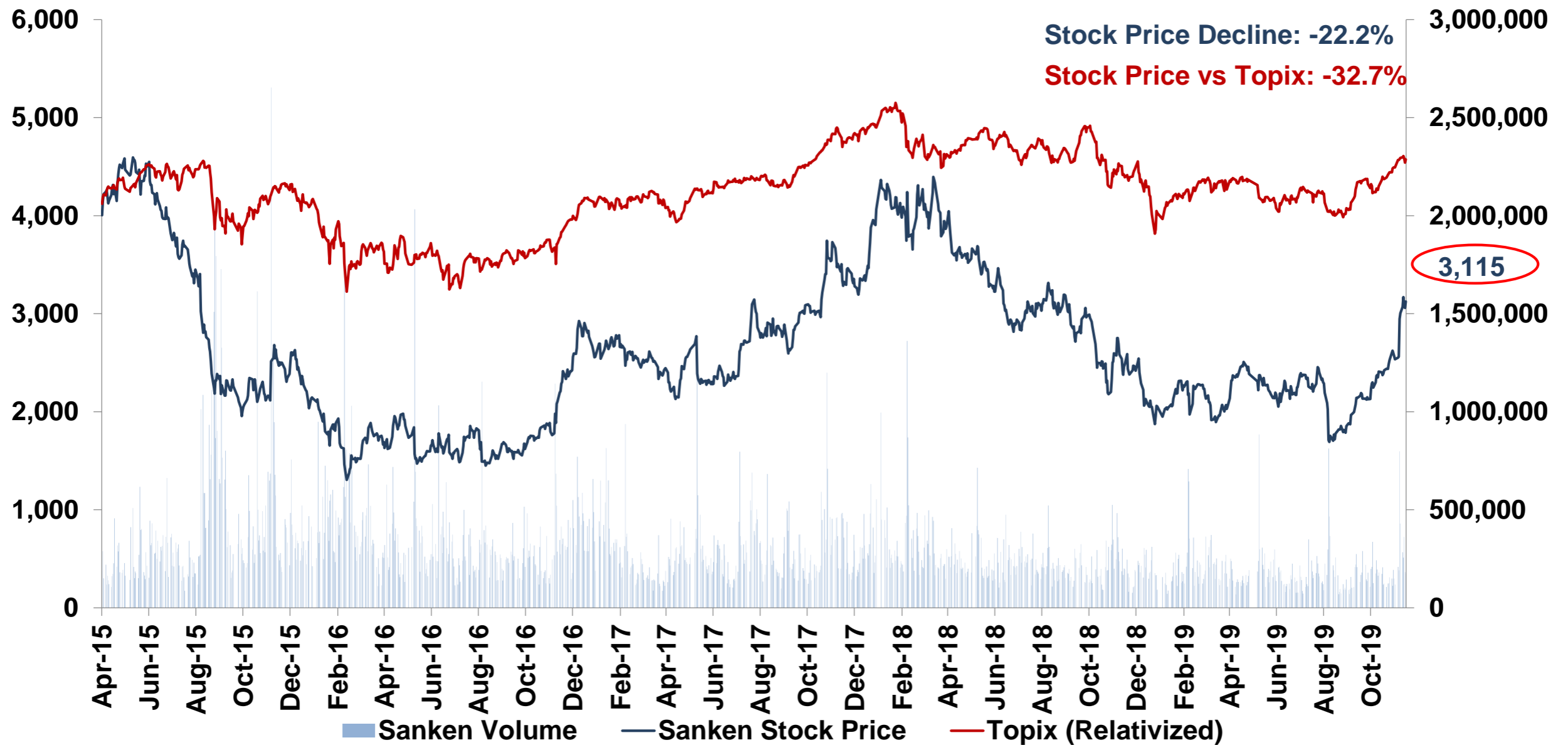


## **2. Sanken's Issues**

# Sanken's Stock Price Has Underperformed Since Takashi Wada Became CEO

Source: Company Disclosures, Bloomberg

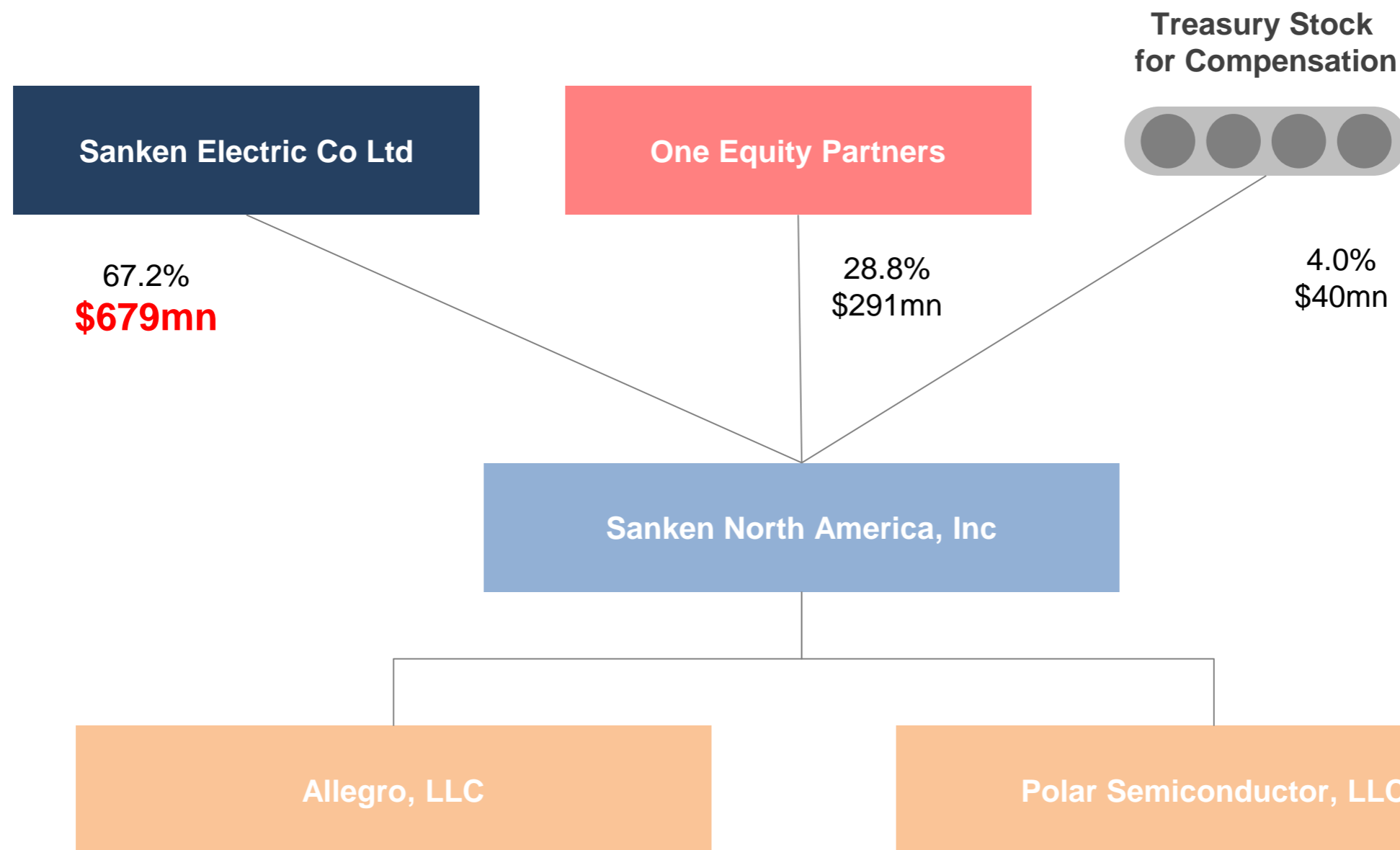
- The stock price of Sanken Electric has declined by 22.2% and underperformed Topix by 32.7% since Takashi Wada became CEO



# US Subsidiary Allegro Conducted a Private Placement to Private Equity Firm One Equity Partners in 2017

Source: Company Disclosures

- Sanken's North American Subsidiary Allegro Microsystems, Inc., ("Allegro") conducted a private placement to One Equity Partners on July 18, 2017
- Valuation was \$291mn for a 28.8% stake, which implies \$1,010mn for the entire company and **\$679mn** for Sanken Electric's holding value

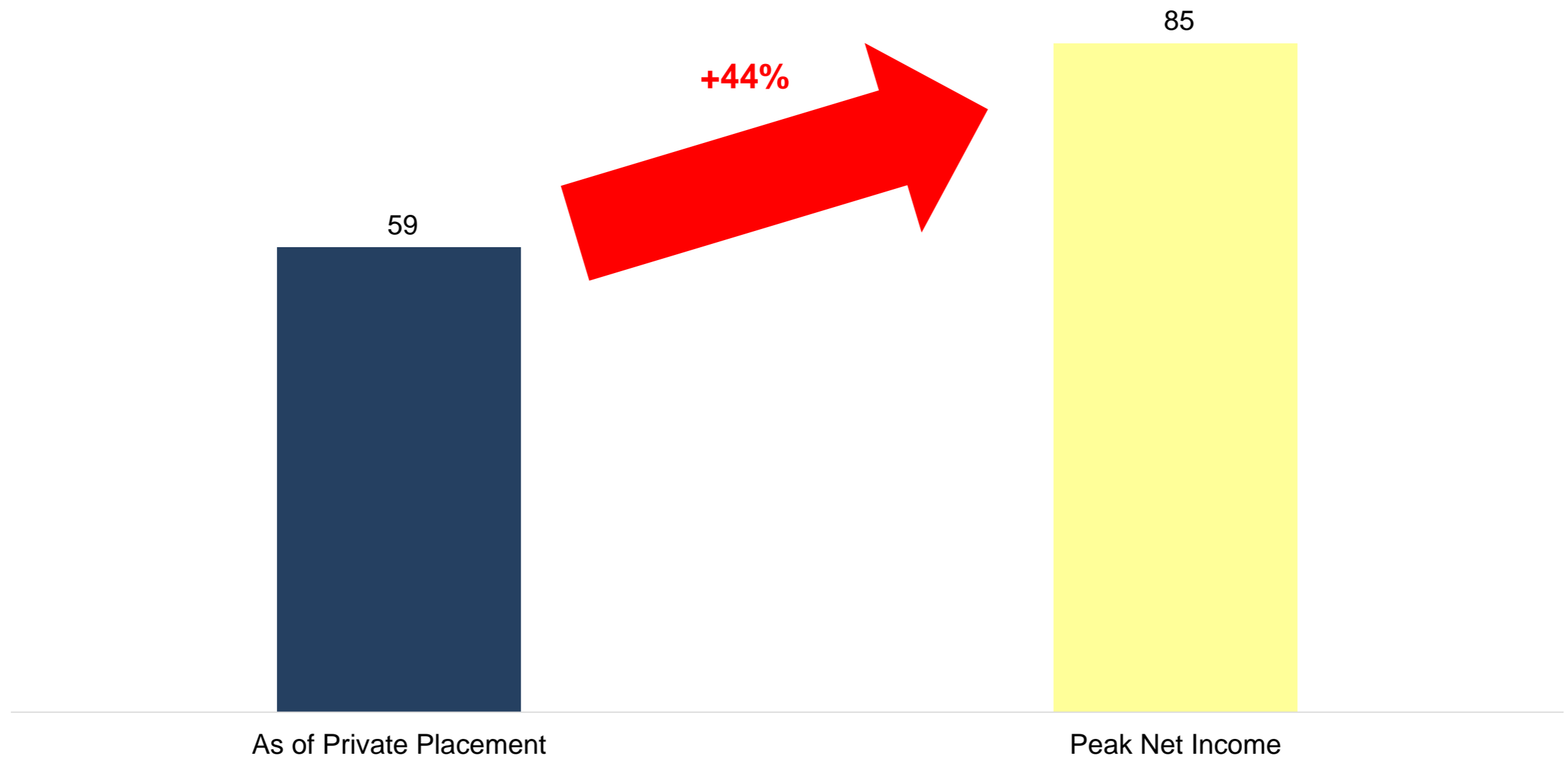




# Allegro at Peak Generated 44% More Net Income than at the Time of the Private Placement (\$ in mn)

Source: Company Disclosures

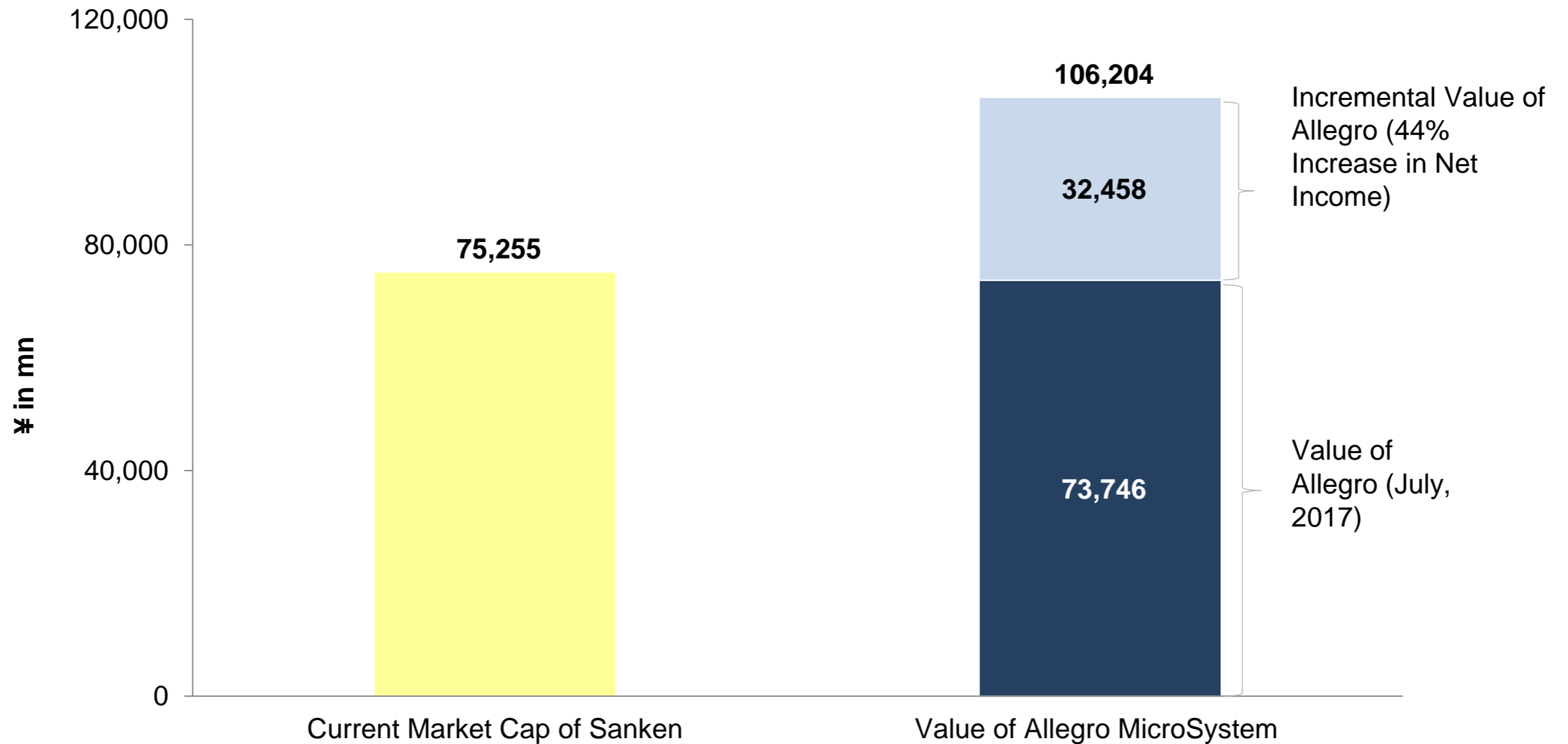
- We believe the value of Allegro is increasing given the fact they generated 44% more net income at peak than at the time of the private placement



# Sanken's Market Value Is BELOW its Holding Value in Allegro

Source: Company Disclosures, Bloomberg

- Allegro at its peak generated 44% more net income compared to the time of the private placement.
- The current market cap of Sanken is below the value of Allegro. **This means significant negative value is being assigned to Sanken's remaining business, which is profitable but currently low margin**

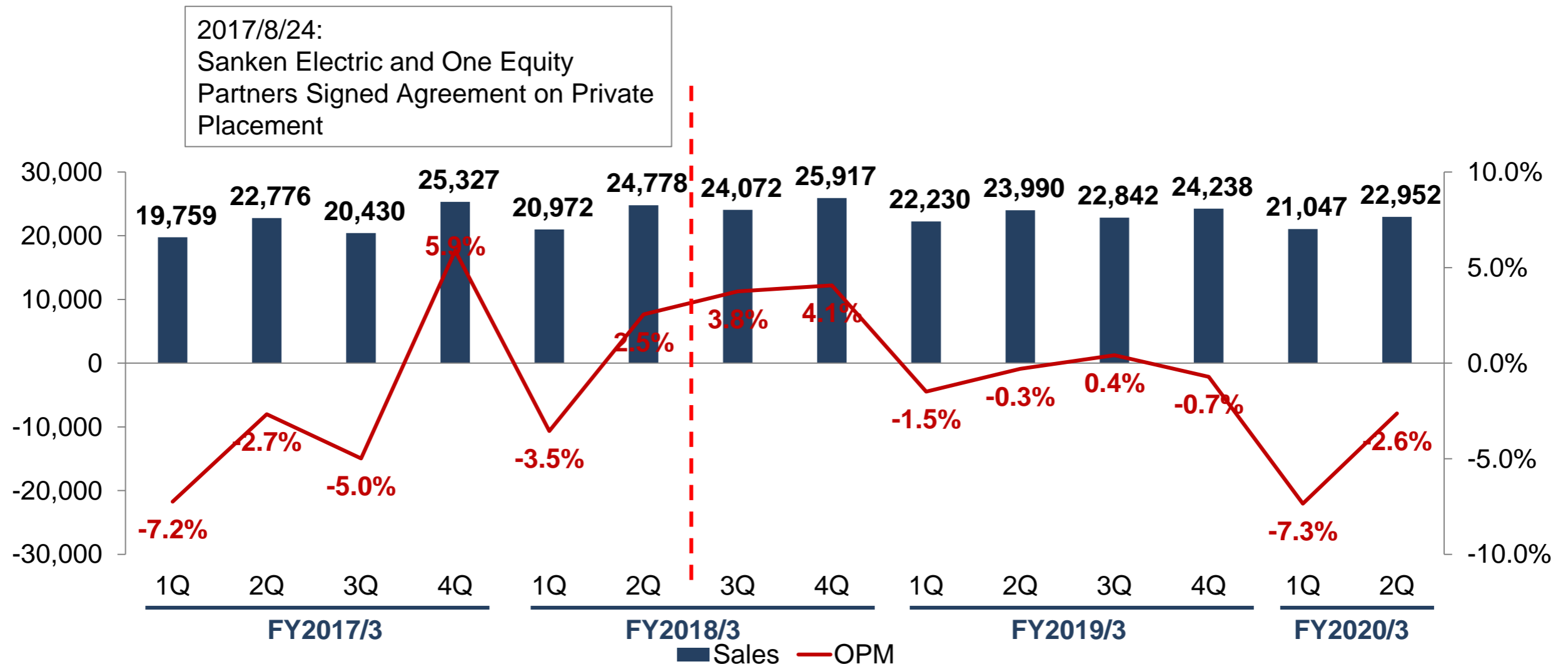


# Sanken Excluding Allegro is Very Low Margin

Source: Company Disclosures

- Sanken Electric excluding Allegro has substantial room for improvement

## Sanken Excluding Allegro Quarterly Financials (JPY in mn)

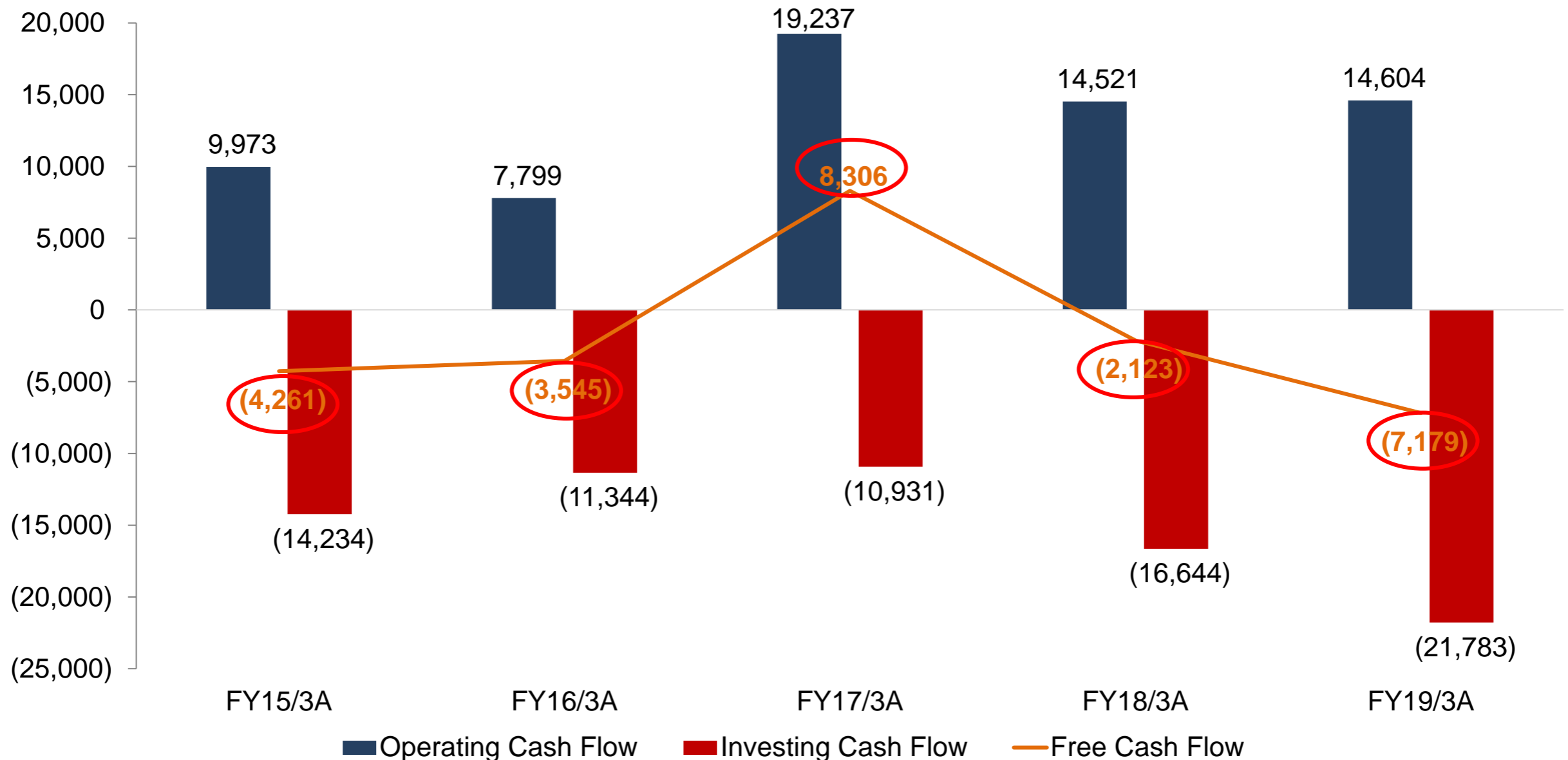


# The Low Margin Poses a Serious Risk to the Company and Its Employees

Source: Company Disclosures

- The operational inefficiency which is causing the low margin poses a serious risk to the Company
- Because of the low margin, Sanken's free cash flow has been negative for 4 out of the last 5 years. We believe this led to lay offs in 2017

## Historical Cash Flow (JPY in mn)



### **3. Proposals Previously Shared with Sanken**

*(Excerpt from Oasis proposals sent to the Company)*

# Benefits to All Stakeholders by Improving Sanken's Corporate Value

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- **Sanken**
  - Long-term stable continuation of the business
  - M&A using stock consideration
  - Improvement of capital raising capacity
- **Sanken Employees**
  - Long-term stable employment
  - Attract excellent talent by improving corporate image
  - Improvement in wages
- **Clients**
  - Creating partners that can trust in the long term
- **Creditors**
  - Reduction of credit risk
  - Further room for lending
- **Shareholders**
  - Share price appreciation
  - Improvement in shareholder return

# Summary

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- Oasis proposes the following 4 points to Sanken as a shareholder:
  - A. Exit the Power System Business
    - Shut the Business Down or Sell the Business to a Third Party
  - B. Enhance Operations of the Semiconductor Device Business
    - Aggregate Facilities of Semiconductor Business
    - Exit Loss-Making Overseas Operations
  - C. Strengthen the Governance Structure
    - Employ “*Shimei-linkai-tou-Secchikaisha*” as a Governance Structure
    - Employ Directors with Knowledge in Business Portfolio Transformation / Operation Enhancement
  - D. Introduce Performance-Linked Director Remuneration
    - Introduce Performance-Linked Compensation Linked to Sanken’s Business Excluding Allegro

# **A. Exit the Power System Business**

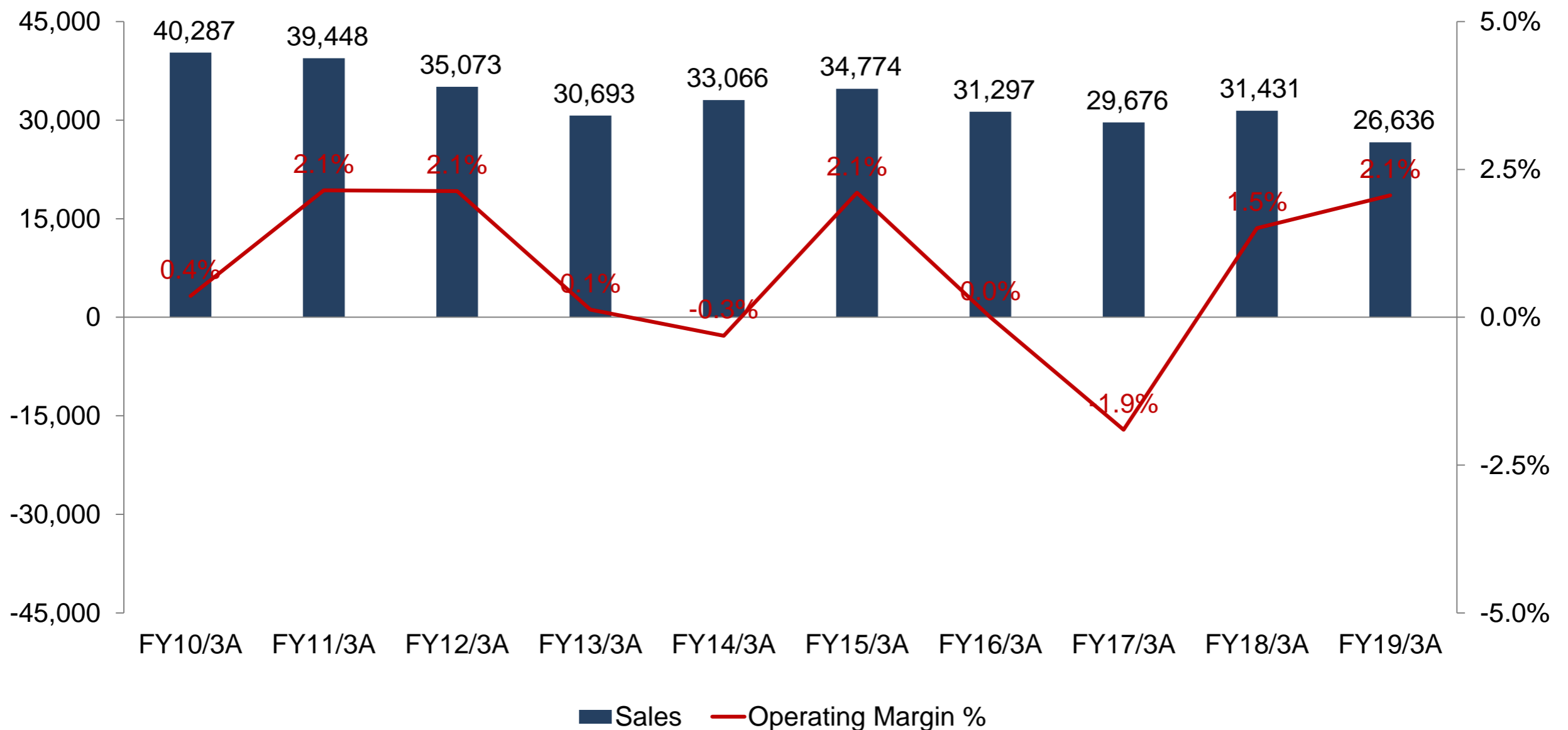


# Sanken's Power System Business Has Never Been High Margin

Source: Company Disclosures

- For the last 10 years, the power system business has never produced high margins and falls below the 10% operating income margin that Sanken is targeting in FY21/3
- We believe Sanken should exit the business and focus on the semiconductor device business, which is more profitable

## Power System Business Annual Financials (JPY in mn)



# Sanken Announced a Restructuring of the Business in 2017, but It's Not Effectively Working

Source: Company Disclosures

- Sanken Announced Restructuring of the Business in 2017
- The average margin since the announcement is 2%
- More than 1.5 years have passed since the announcement, and yet the business is not generating high margins

## Sanken Press Release (2017/7/18)

### (2) Plans for Restructuring Business Units.

The details of fundamental structural reforms to be implemented are as follows.

i) Withdraw from the non-strategic market and focus on strategic market.

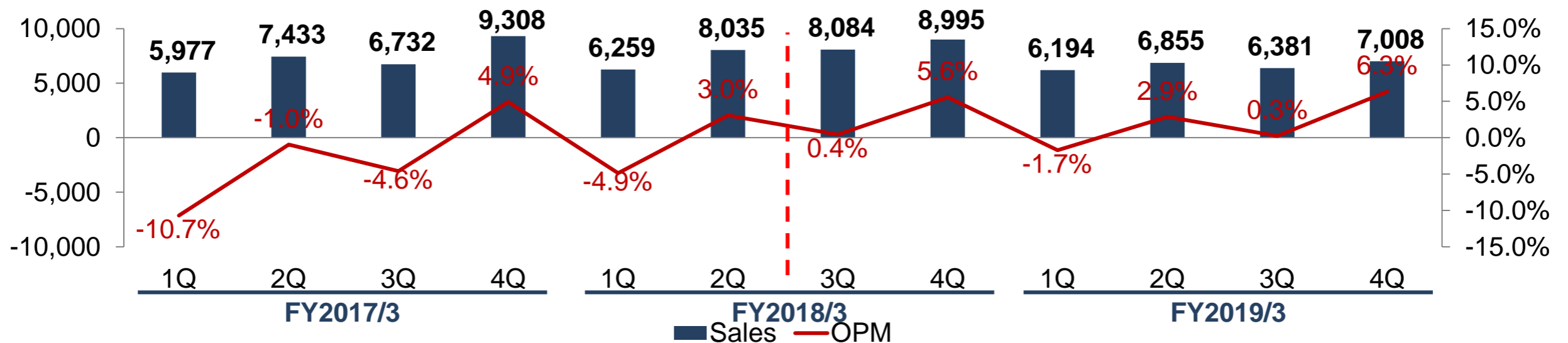
[Withdraw from the PM business and accelerate integration with the PS business.]

• Sanken withdraw from the PM business. Specifically, it plans to end production as of the end of March 2018, and to cease sales activities as of the end of September 2018.

• Sanken continues to provide products for strategic markets, such as automotive, industrial machinery, and telecommunication, which were previously handled by the PM business, but will be continued as products offered by the Power System division. Incidentally, from April 2017, the Company has already integrated organizations of both the PM business and the PS business and has shifted to develop and market high value-added products that represent synergistic effects of both businesses.

• Sanken, alongside with this business consolidation, sharply decrease the number of the items produced and shrink the size of the work force at PT Sanken Indonesia, the heretofore primary factory of the PM business.

## Power System Business Quarterly Financials (JPY in mn)



# **Sanken Should Shut the Power System Business Down or Sell the Business to a Third Party**

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- **We believe Sanken should immediately exit from the power system business, which is destroying value**
- **Shutting down the business is one solution, but we understand there are clients who need Sanken's products**
- **If Sanken cannot shut the business down immediately, Sanken should seek the sale of the asset**
- **Though the profitability of the business is low, since the business does not require a lot of Capex, we believe mid-cap private equity funds will be interested in acquiring the business**
- **Sanken should use the proceeds from the sale to invest further in the semiconductor device business**

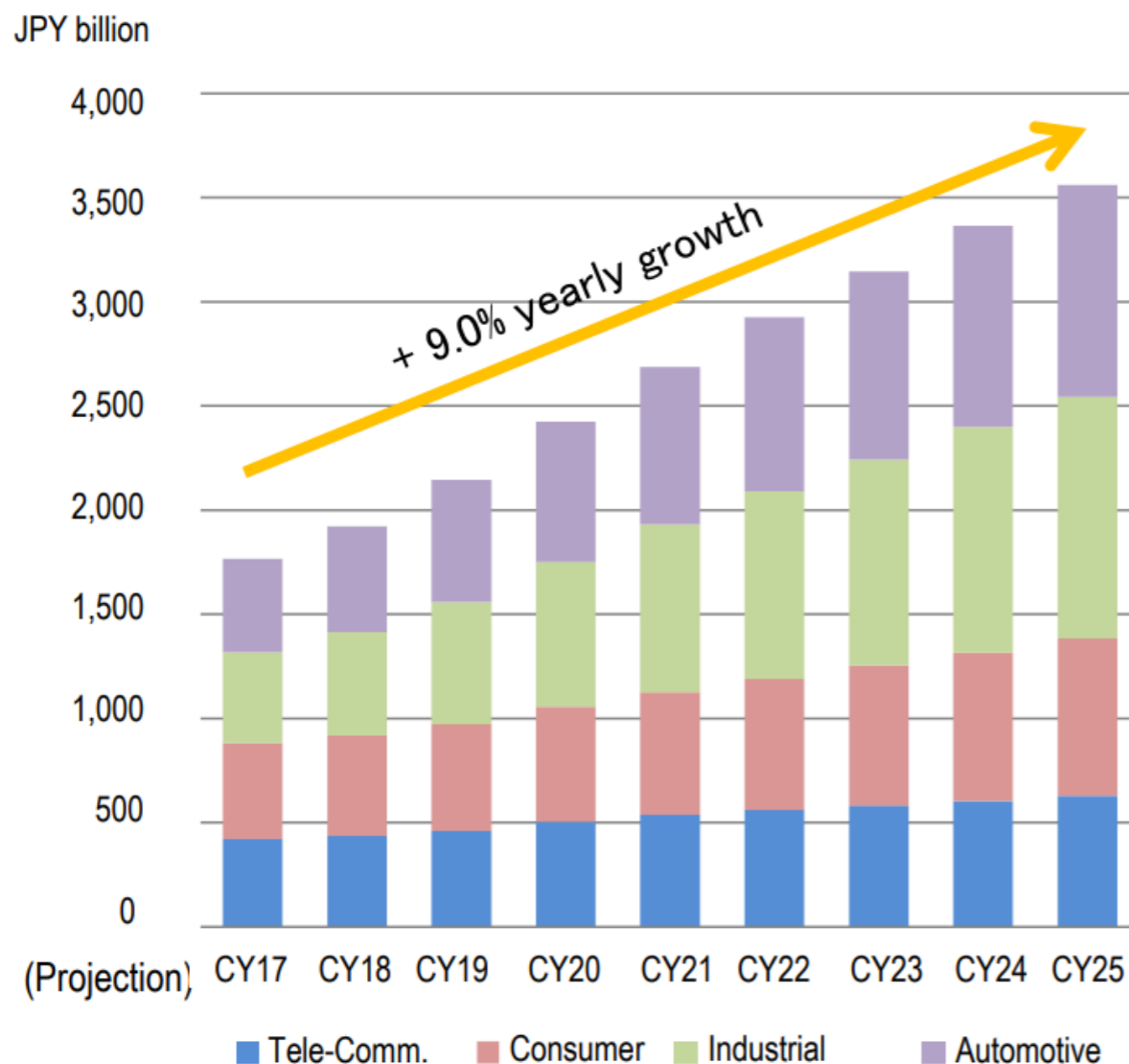
# **B. Enhance Operations of the Semiconductor Device Business**

# Sanken Has Exposure in the Automobile and White Goods Power Semiconductor Sector

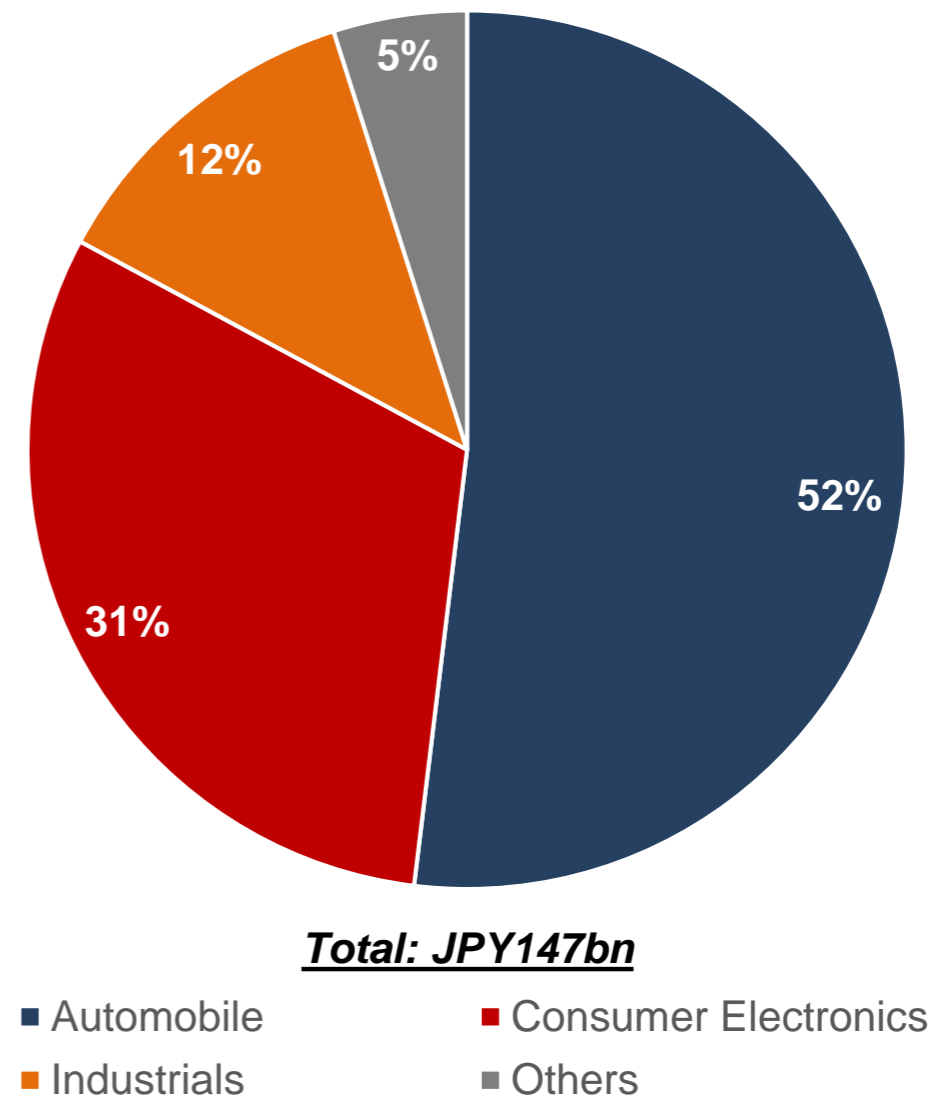
Source: Company Disclosures

- Sanken has a unique positioning in the automobile and white goods power semiconductor sector
- The power semiconductor market is growing stably each year

## Power Semiconductor Market



## Sanken's Revenue by Application

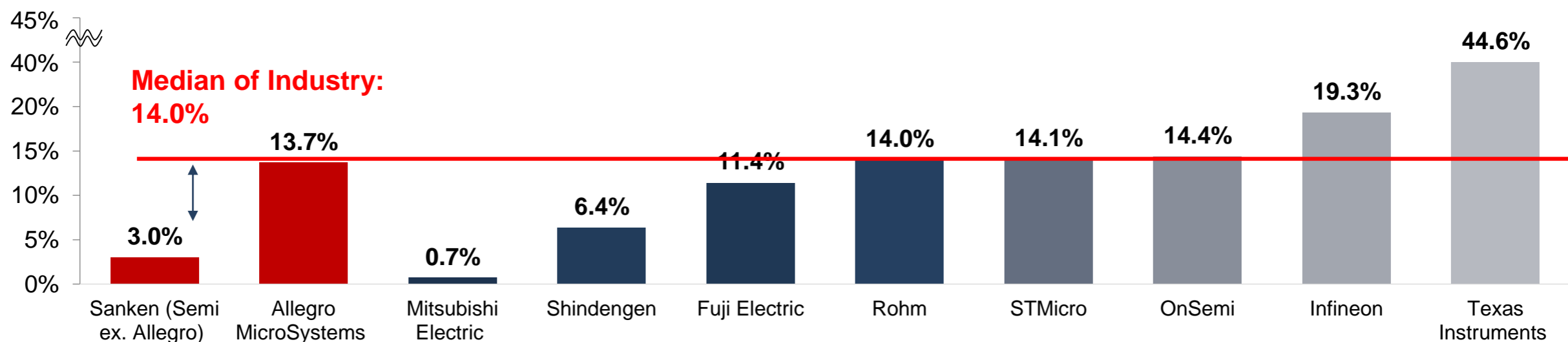


# Sanken's Semiconductor Device Business Excluding Allegro is Generating the Lowest Margin Among Peers

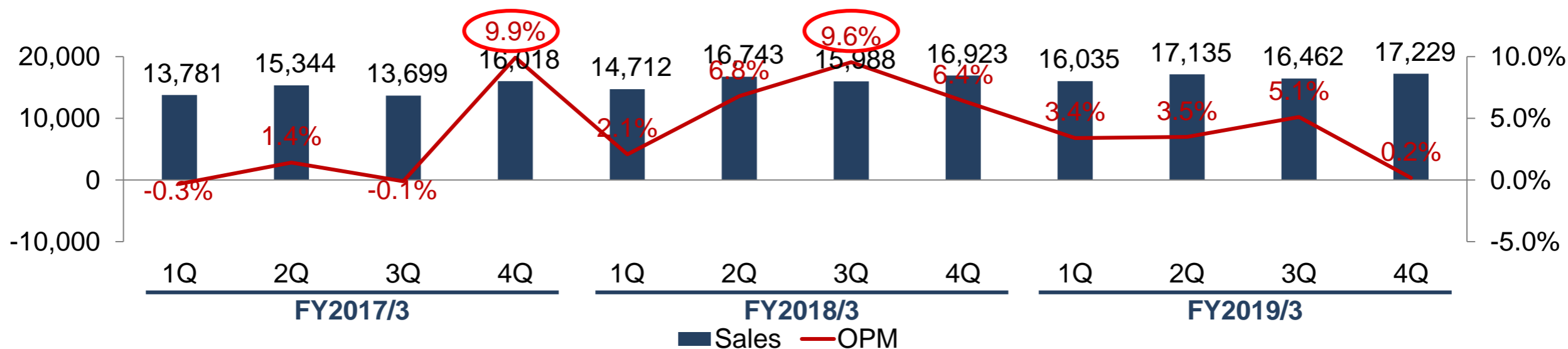
Source: Company Disclosures

- The industry median margin is 14.0%. Considering that Sanken subsidiary Allegro achieved 13.7% margins for FY19/3, we believe the domestic Sanken business could also pursue this industry median margin
- In addition, on a quarterly basis, the company recorded nearly 10% margin in the past by current operation. Should operations improve, we believe the company could achieve consistent double digit margins

## Margin of Power Semiconductor Business



## Quarterly Operating Margin of Sanken's Semi Business (excl. Allegro) (JPY in mn)

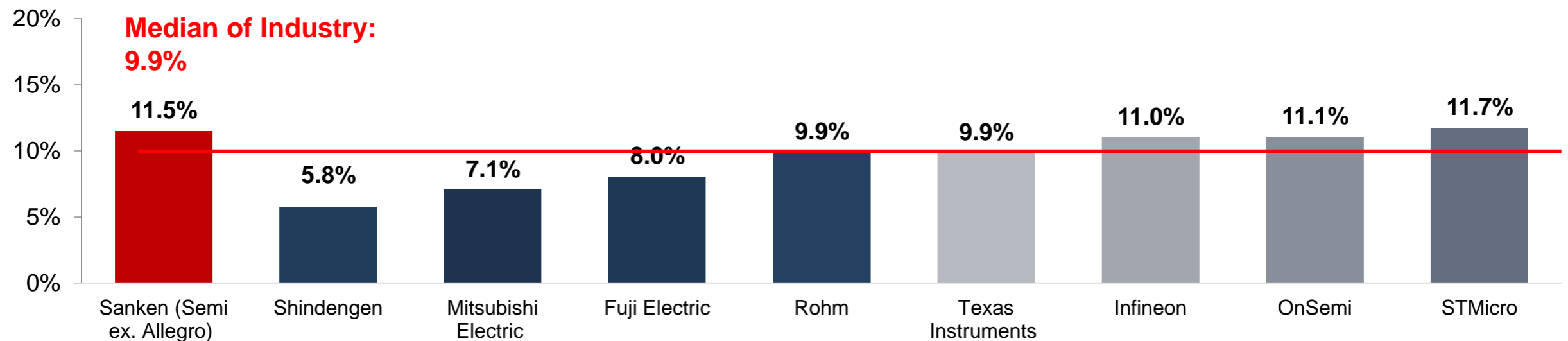


# Sanken's R&D and Capex Spending Is at the High End Compared to Peers and Product Quality is High

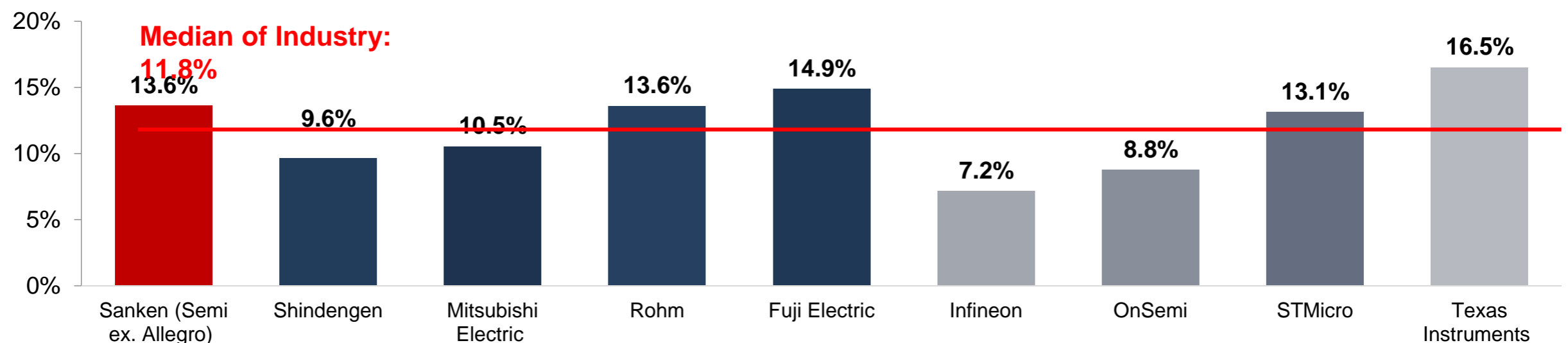
Source: Company Disclosures

- Sanken's R&D and capex spending is at the high end compared to peers
- This indicates that Sanken is spending enough to make high quality products and the quality of the products is not the reason for the low margin
- Sanken should negotiate with buyers for higher prices as Sanken products are high-quality

## R&D Spending % Sales



## Capex Spending % Sales



# Sanken's Facility Value is Highest Among Peers

Source: Company Disclosures

Note: Facilities for Sanken includes facilities related to the semiconductor device business, Mitsubishi Electric includes facilities for electronic device segment, Fuji Electric includes electronic devices segment and Shindengen Electric Manufacturing includes devices business.

Facility	Buildings	Machine	Land	Lease	Others	Total	Employee
<b>Sanken</b>							
Head Quarter, Semiconductor Technology Center	1,727	1,155	36	1	524	3,446	669
Others	1,000	165	627	-	222	2,015	172
Ishikawa Sanken	2,853	4,445	1,306		772	9,379	1,080
Yamagata Sanken	2,659	1,948	638	5	777	6,029	459
Kashima Sanken	519	1,341	127	8	149	2,145	249
Fukushima Sanken	1,456	3,251	300	34	267	5,310	348
Sanken Opt Products	829	24			17	871	93
Allegro Micro Systems	6,715	14,030	2,483		2,653	25,883	4,023
Korea Sanken	76	2			5	85	38
Dalian Sanken Electric	473	1,738			52	2,264	283
Polar Semiconductor	4,702	5,986	588		1,403	12,681	510
<b>Total</b>	<b>23,009</b>	<b>34,085</b>	<b>6,105</b>	<b>48</b>	<b>6,841</b>	<b>70,108</b>	<b>7,924</b>
<b>Mitsubishi Electric</b>							
<b>Electronic Device</b>	<b>15,733</b>	<b>18,695</b>	<b>4,546</b>		<b>15,102</b>	<b>54,076</b>	<b>5,415</b>
<b>Fuji Electric</b>							
Matsumoto Factory	13,538	1,377	3,236	8,596	5,152	31,900	1,528
<b>Fuji Electric Power Semiconductor</b>							
Omachi Factory	682	17	155	2,638	12	3,506	257
Hokuriku Factory	295	23	366	1,323	7	2,016	184
Iiyama Factory	599	8	118	2,142	20	2,888	157
Tsugaru Factory	1,604	777	550	905	15	3,852	310
Fuji Electric Shen Zhen	1,234	2,233			708	4,176	893
Philippine Fuji Electric	1,550	1,520		460	279	3,811	833
Malesia Fuji Electric	6,791	2,554		454	1,743	11,543	2,243
<b>Total</b>	<b>26,293</b>	<b>8,509</b>	<b>4,425</b>	<b>16,518</b>	<b>7,936</b>	<b>63,692</b>	<b>6,405</b>
<b>Shindengen Electric Manufacturing</b>							
Hanno Factory Head Quarter	2,602	1,750	2,630	265	1,627	8,875	1,143
Akita Shindengen	1,377	2,021	621	107	220	4,347	623
Higashine Shindengen	1,578	657	1,040	406	425	4,107	263
Lamphun Shindengen	317	1,215	111	1	754	2,401	742
Shindengen Phillipine	68	419		-	130	618	739
<b>Total</b>	<b>5,942</b>	<b>6,062</b>	<b>4,402</b>	<b>779</b>	<b>3,156</b>	<b>20,348</b>	<b>3,510</b>

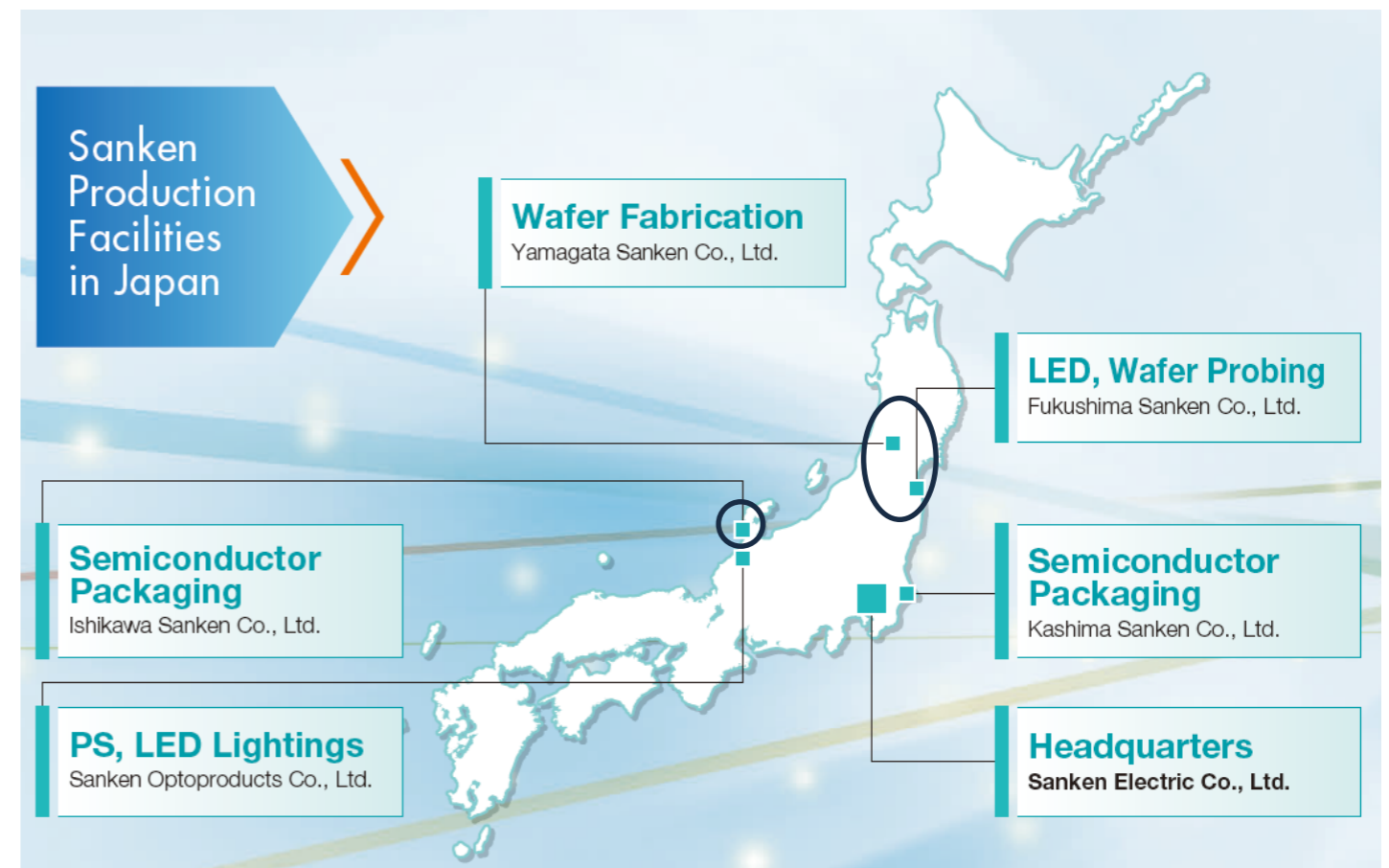
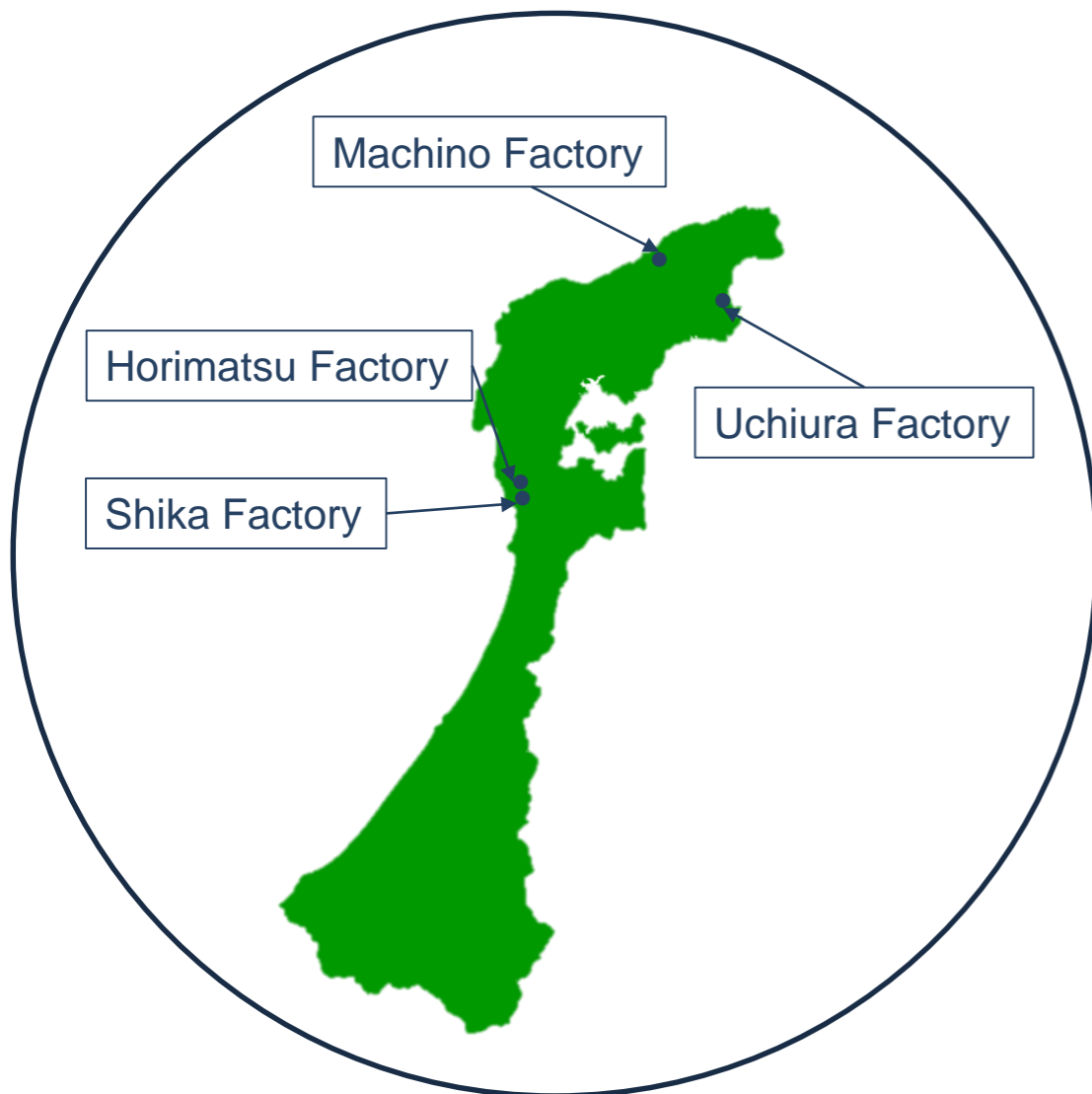


# Inefficient Operations are Hurting Sanken's Margins (1/3): Domestic Operations

Source: Company Disclosures

- Sanken has inefficient production processes in Japan
- Sanken conducts pre-processing in Yamagata, wafer probing in Fukushima, and post-processing in Ishikawa and Kashima. In addition, Sanken has 4 factories in different places within Ishikawa
- We believe Sanken should at least aggregate the Ishikawa packaging facility to one location and integrate wafer fabrication in Yamagata and wafer probing facility in Fukushima to more effectively run the operation

Operations are ALL over Japan.  
Operations need to be consolidated to increase efficiency



# Inefficient Operations are Hurting Sanken's Margins (2/3): Non-Consolidated Financials

Source: Company Disclosures

- The COGS of the Non-Consolidated Financials is very high compared to the Consolidated Financials
- This fact also proves that Sanken has inefficient operations in Japan
- We believe aggregating the facilities could resolve this situation and increase margins
- Sanken should also assess the cost of outsourcing some processes to subcontractors

## Financial Comparison (Consolidated vs. Non-Consolidated) (JPY in mn)

	Consolidated					Non-Consolidated				
	FY15/3A	FY16/3A	FY17/3A	FY18/3A	FY19/3A	FY15/3A	FY16/3A	FY17/3A	FY18/3A	FY19/3A
Sales	160,724	155,919	158,772	175,209	173,650	107,096	99,241	102,824	110,905	110,288
COGS	116,834	115,113	117,869	126,840	126,150	96,326	89,629	94,597	99,907	102,889
<b>% Sales</b>	<b>72.7%</b>	<b>73.8%</b>	<b>74.2%</b>	<b>72.4%</b>	<b>72.6%</b>	<b>89.9%</b>	<b>90.3%</b>	<b>92.0%</b>	<b>90.1%</b>	<b>93.3%</b>
Gross Margin	43,889	40,806	40,902	48,369	47,499	10,770	9,612	8,226	10,997	7,399
<b>% Margin</b>	<b>27.3%</b>	<b>26.2%</b>	<b>25.8%</b>	<b>27.6%</b>	<b>27.4%</b>	<b>10.1%</b>	<b>9.7%</b>	<b>8.0%</b>	<b>9.9%</b>	<b>6.7%</b>
SG&A	32,689	34,003	34,972	36,342	36,968	10,308	9,956	10,674	10,513	9,342
<b>% Sales</b>	<b>20.3%</b>	<b>21.8%</b>	<b>22.0%</b>	<b>20.7%</b>	<b>21.3%</b>	<b>9.6%</b>	<b>10.0%</b>	<b>10.4%</b>	<b>9.5%</b>	<b>8.5%</b>
Operating Income	11,199	6,803	5,930	12,026	10,531	461	(344)	(2,448)	484	(1,943)
<b>% Margin</b>	<b>7.0%</b>	<b>4.4%</b>	<b>3.7%</b>	<b>6.9%</b>	<b>6.1%</b>	<b>0.4%</b>	<b>-0.3%</b>	<b>-2.4%</b>	<b>0.4%</b>	<b>-1.8%</b>

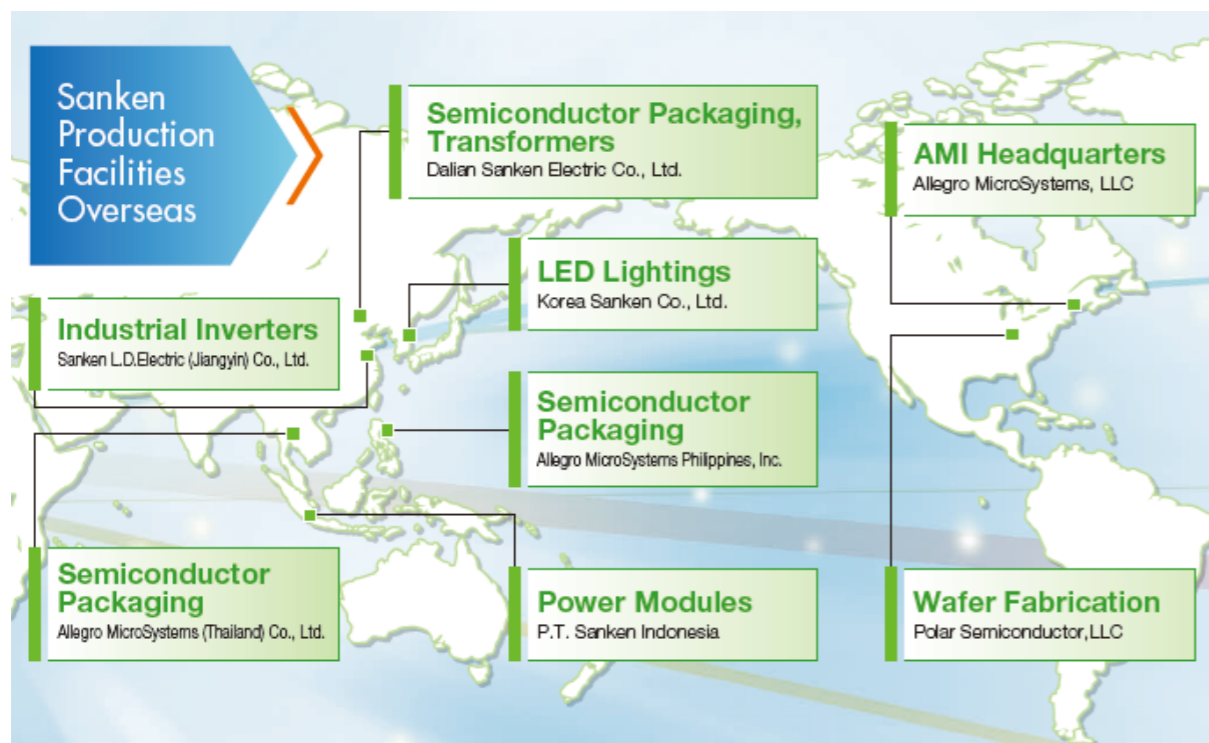
# Inefficient Operations are Hurting Sanken's Margins (3/3): Overseas Operations

Source: Company Disclosures

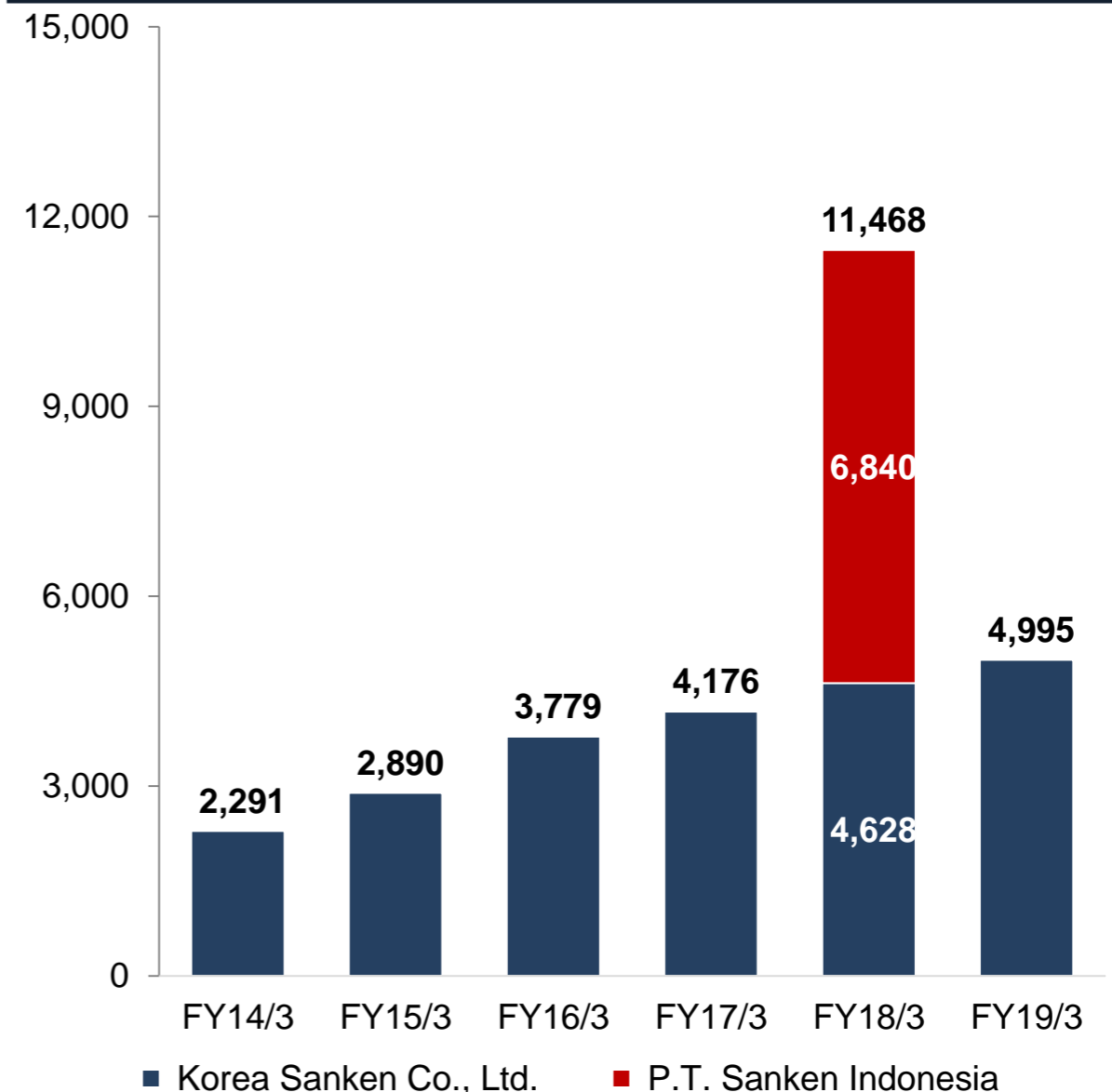
Note: P.T. Sanken Indonesia is related to the power system business.

- Overseas operations are also inefficient and subsidiaries in Korea and Indonesia are facing insolvency
- Insolvency in Overseas Subsidiaries increased 5.0x since FY2014/3 to FY2018/3
- We believe Sanken should exit from such operations

## Production Facilities Overseas



## Amount of Insolvency in Overseas Subsidiaries (JPY in mn)



# Given Current Slowdown in Demand, Now Is the Best Time to Start Enhancing Operations

Source: Company Disclosures

- Orders are decreasing due to a slowdown in the semiconductor sector driven by the slowdown in China, as mentioned in the Company's press release
- We understand that aggregating facilities takes time. However, we believe now is the best timing to start enhancing the operation since the utilization rate of the factories is dropping
- We believe Sanken should start moving now to live through the next decade

## Company Press Release (2019/2/5)

### 2. Reasons of the Revision

*There is a growing uncertainty about the outlook of global economy due to the prolonged trade frictions between the United States and China and a further economic slowdown in China. **This has begun to affect the real economy such as inventory adjustments for white goods and falling auto sales in China.** Responding to these trends in the global economy and changes in the market conditions, drop in sales and decline in profits due to deterioration of product mix are expected. In addition, our development investments in products for strategic markets and cost increases are expected. Accordingly, we have revised down our full-year consolidated earnings forecast, reflecting the lower forecasted amounts than those announced in the beginning of the fiscal year. The expected average exchange rate for the fourth quarter is 108 yen per dollar.*

## **C. Strengthen the Governance Structure**

# Unreliable Company Guidance Exposes Poor Governance

Source: Company Disclosures

- The budgetary variance is significant each year
- This shows that management lacks ability to assess / control their own business and highlights an insufficient monitoring function in terms of corporate governance. The current board is admitting this situation

<b>FY2019/3</b>	<b>5/8/2018E</b>	<b>2/5/2019E</b>	<b>5/8/2019A</b>	<b>Δ</b>
Sales	178,000	175,000	173,650	-2%
Operating Income	12,500	10,000	10,531	-16%
Ordinary Income	11,000	8,200	9,173	-17%
Net Income	4,800	2,600	3,967	-17%

<b>FY2018/3</b>	<b>5/10/2017E</b>	<b>10/25/2019E</b>	<b>3/27/2018E</b>	<b>5/8/2018A</b>	<b>Δ</b>
Sales	159,000	173,000	177,700	175,209	10%
Operating Income	7,300	10,000	11,400	12,026	65%
Ordinary Income	6,000	9,000	11,200	11,808	97%
Net Income	2,500	(13,700)	(12,100)	(11,421)	-557%

<b>FY2017/3</b>	<b>5/9/2016E</b>		<b>5/10/2017A</b>	<b>Δ</b>
Sales	156,000		158,772	2%
Operating Income	7,000		5,930	-15%
Ordinary Income	5,500		5,026	-9%
Net Income	2,500		1,739	-30%

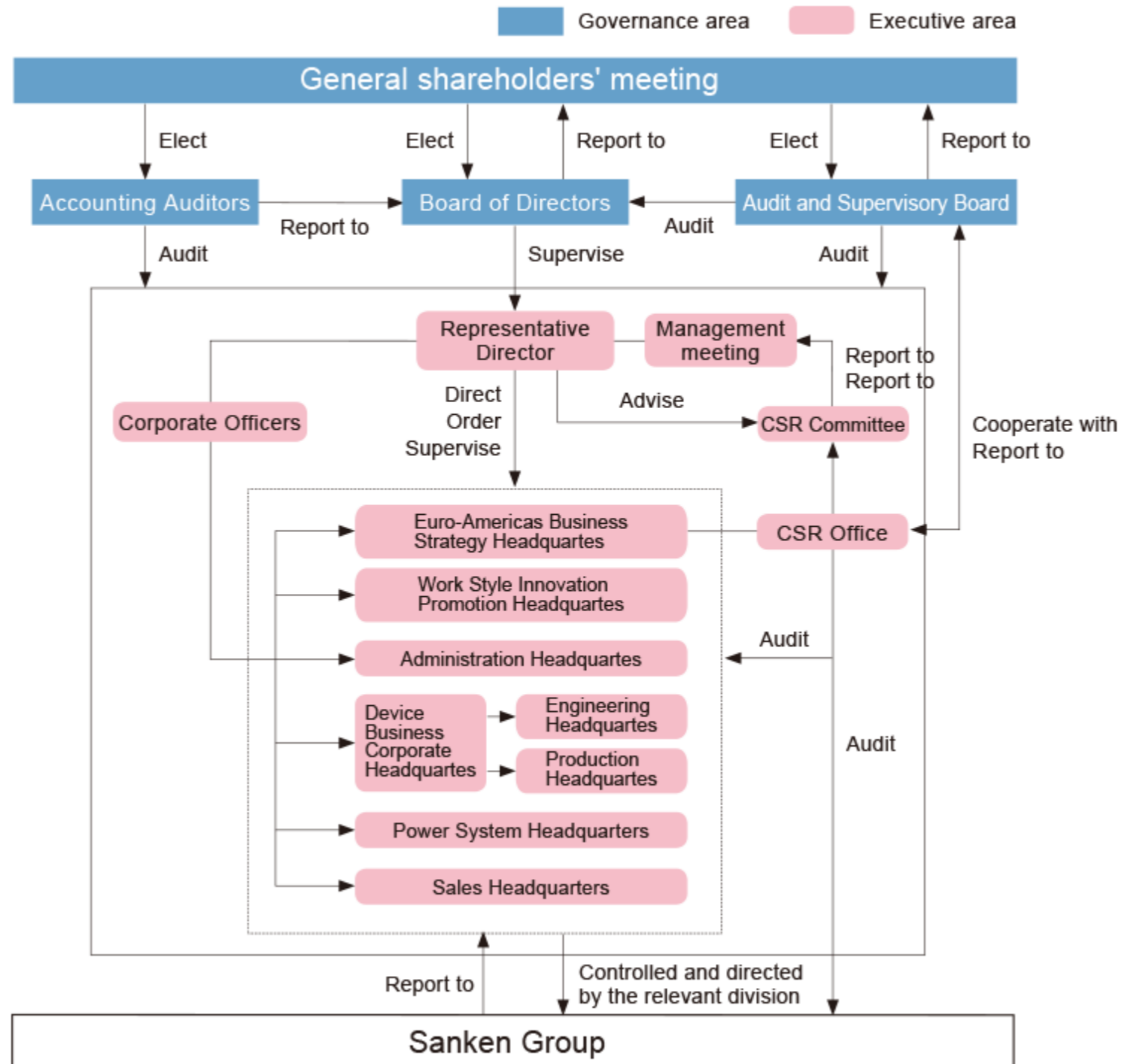
  

<b>FY2016/3</b>	<b>5/8/2015E</b>	<b>11/5/2015E</b>	<b>2/8/2016E</b>	<b>5/9/2016A</b>	<b>Δ</b>
Sales	172,000	162,000	157,800	155,919	-9%
Operating Income	13,000	8,000	6,000	6,803	-48%
Ordinary Income	11,700	6,000	3,800	3,791	-68%
Net Income	8,100	2,500	200	171	-98%

# Overview of Current Governance Structure

Source: Company Disclosures

- Sanken currently employs “Kanasayaku-Secchi-Kaisha” structure for governance

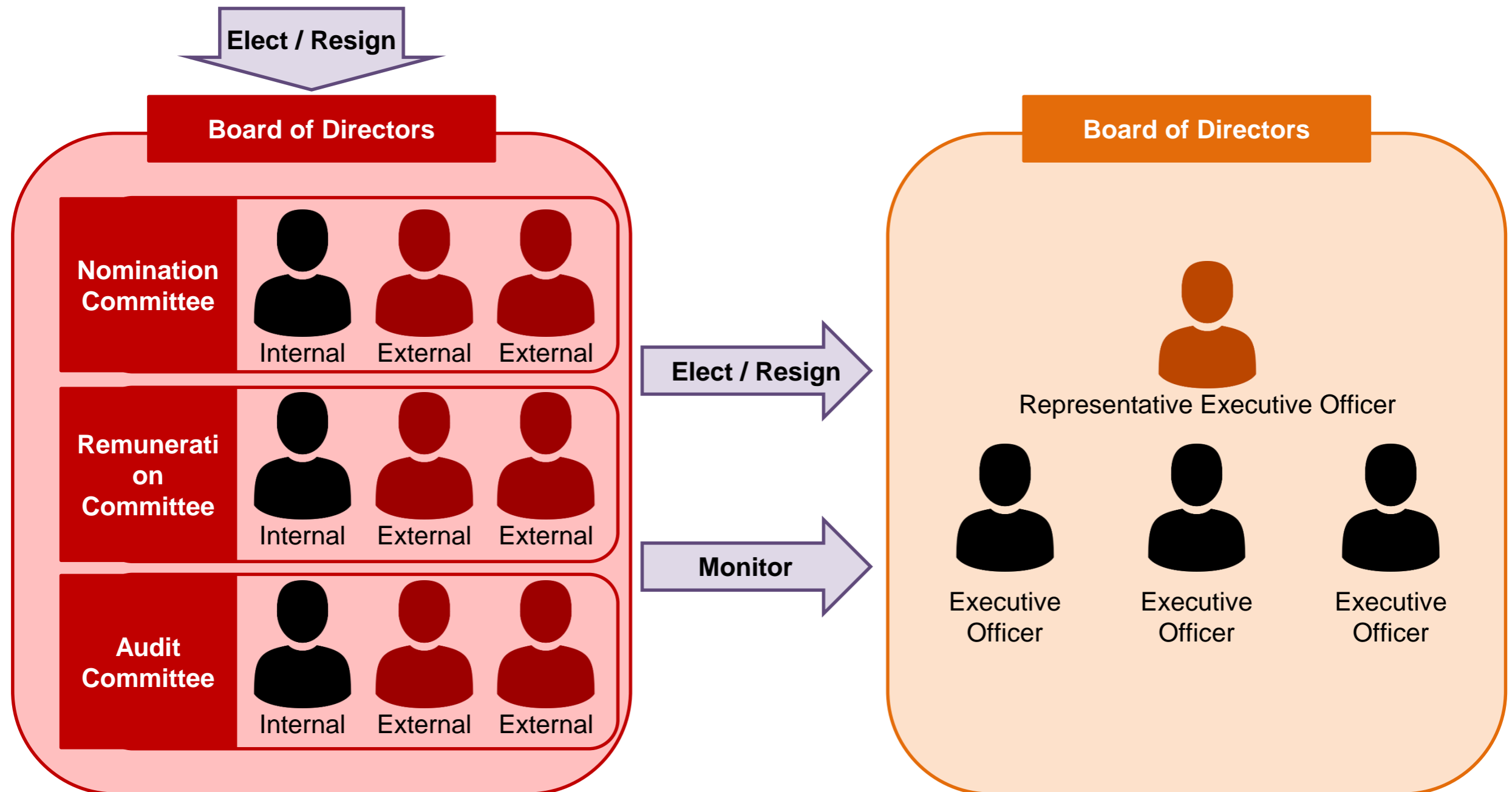




# Sanken Should Change its Governance Structure to “Shimei-linkai-to-Secchi-Kaisha”

- Current Sanken governance structure lacks a monitoring function. We believe Sanken could improve this situation by employing a “Shimei-linkai-to-Secchi-Kaisha” structure for governance

## General Shareholder’s Meeting





# Sanken's Board of Directors Should be Improved

Source: Company disclosures

- Currently, there is no Outside Director with knowledge in business portfolio transformation and improving operational efficiency, which is needed to improve the current low margin and significant negative valuation assigned to Sanken excluding Allegro
- We believe employing a foreign female director who has knowledge in business portfolio transformation / improving factory efficiency would add great value to current board

## Current Board Members Titles and Durations

No.	Position	Name	Age	Internal / Outside	Nationality	Gender	Former Career
1.	Representative Director, President	Takashi Wada	64	Internal	Japan	Male	Sanken
2.	Director	Masao Hoshino	60	Internal	Japan	Male	Sanken
3.	Director	Yoshihiro Suzuki	60	Internal	Japan	Male	Sanken / Allegro
4.	Director	Kazunori Suzuki	61	Internal	Japan	Male	Sanken
5.	Director	Hideo Takani	60	Internal	Japan	Male	Sanken
6.	Director	Shigeru Ito	55	Internal	Japan	Male	Sanken
7.	External Director	Richard R. Lury	71	External	US	Male	Lawyer
8.	External Director	Noriharu Fujita	68	External	Japan	Male	Auditor

**Stats**

**Average: 62 Outside: 25% Japanese: 88% Female: 0%**

# **D. Introduce Performance-Linked Director Remuneration**

# Corporate Governance Code

## *Roles and Responsibilities of the Board*

Source: Japan's Corporate Governance Code (Revised June 2018)

### *Principle 4.2 Roles and Responsibilities of the Board*

*The board should view the establishment of an environment that supports appropriate risk-taking by the senior management as a major aspect of its roles and responsibilities. It should welcome proposals from the management based on healthy entrepreneurship, fully examine such proposals from an independent and objective standpoint with the aim of securing accountability, and support timely and decisive decision-making by the senior management when approved plans are implemented.*

***Also, the remuneration of the management should include incentives such that it reflects mid- to long-term business results and potential risks, as well as promotes healthy entrepreneurship***

### Supplementary Principles

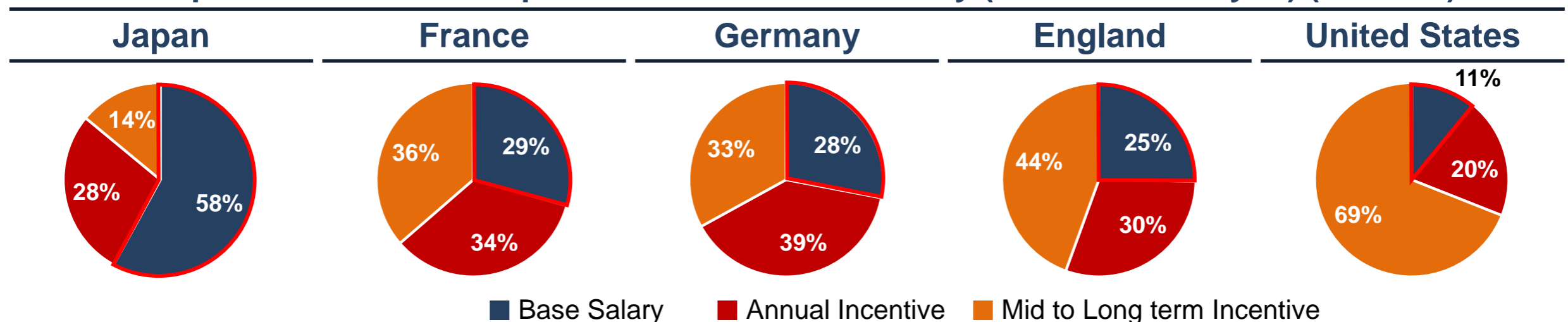
4.2.1 The board should design management remuneration systems such that they operate as a healthy incentive to generate sustainable growth, and determine actual remuneration amounts appropriately through objective and transparent procedures. The proportion of management remuneration linked to mid- to long-term results and the balance of cash and stock should be set appropriately.

# Introducing Incentive Plans as Board Members' Compensation to Encourage Companies to Promote Proactive Business Management

Source: "Guidebook for Introducing Incentive Plans for Sustainable Corporate Growth as Board Members' Compensation to Encourage Companies to Promote Proactive Business Management" ("Guidebook") (METI)

- The "Guidebook" issued by METI states: "Currently, in our country, there are few companies which introduce mid to long term performance linked incentive plans and the incentive for business improvement is not effectively working"
- The introduction of stock compensation and performance-linked compensation will give incentives for management to increase corporate value over the mid to long term

## Comparison of CEO Compensation For Each Country (sales over 1 tr yen) (FY 2015)



## Effect of Introducing Incentive Plans (Quote from the "Guidebook")

株式報酬や業績連動報酬の導入が促進されることで、経営者に中長期的な企業価値向上のインセンティブを与え、我が国企業の「稼ぐ力」向上につなげる。

特に、株式報酬については、経営陣に株主目線での経営を促したり、中長期の業績向上インセンティブを与えるといった利点があり、その導入拡大は海外を含めた機関投資家の要望に応えるもの。

# Current Status Of Sanken Director Remuneration

Source: Company Disclosures

- Sanken has not introduced the “Incentive to Promote Proactive Business Management” which METI announced
- However, we believe the introduction of share-based compensation and performance-linked remuneration will incentivize management to improve corporate value over the medium to long term
- Sanken is currently considering whether to introduce a share-based compensation. We believe Sanken should do so in order to incentivize management to fix Sanken’s business excluding Allegro

## Total Amount of Remuneration by Officer Categories

### Remuneration by Type (mn)

Officer Classification	Total Amount (mn)	Remuneration by Type (mn)			Number of Eligible Officers
		Base	Compensation	Pension	
Board Member (ex. Outside Director)	185	185	-	-	6
Auditor (ex. Outside Auditors)	40	40	-	-	2
Outside Officer	25	25	-	-	5

### Quote from Sanken Corporate Governance Report (As of November 9, 2018)

取締役に対する報酬は、他社の状況等を参考に設定された役職ごとの基準額や1年間の実績・会社への貢献度などを踏まえ、半数以上の独立社外取締役で構成される任意の報酬委員会での審議を経た後、取締役会で決定することとしております。報酬額は、業績を踏まえて通常報酬を決定するとともに、業績度合いにより役員賞与を支給し、業績連動の要素を盛り込むこととしております。また、適切なインセンティブの実現に向け、株式報酬の導入検討を進めております。

# 4. The Company's Progress



# Introduction of Performance-Linked Stock Compensation (May 8, 2019)

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*Source: Company Disclosures*

## 1. Introduction of the Plan

The Company's Directors' compensation has been composed of monetary compensation, i.e. basic compensation and bonuses. The Company reviewed its overall officer compensation and would like to introduce a new performance-linked stock compensation plan for Directors.

The Plan is intended to further clarify the linkage of Directors' compensation to the Company's business performance and its share value, and by having Directors share both the benefits and risks of fluctuation in share prices, raise Directors' motivation to contribute to enhancing the Company's performance and corporate value over the medium- to long-term.

Under the Plan, Directors' compensation will be composed of basic compensation as well as those linked to performance, i.e. short-term incentives and long-term incentives (the latter is the Plan's stock compensation).

The Plan shall be introduced subject to the approval of the proposal on officer compensation at the Meeting.

Furthermore, provided that the Plan is approved at the Meeting, the Company intends to introduce a similar performance-linked stock compensation plan for Corporate Officers who are under a mandate agreement with the Company (the "Corporate Officers"). In that case, the Corporate Officers as well as the Directors will become beneficiaries of the trust established by the Company to operate the Plan (the "Trust"). The funds contributed by the Company to the Trust to acquire shares shall also include those for delivery to the Corporate Officers.

# Newly Appointed Outside Director (May 31, 2019)

Source: Company Disclosures

No.	Name (Date of Birth)	Brief personal history, position and assignment of the Company, and significant office(s) concurrently held	No. of the Company shares held
9	<p><b>Emiko Higashi</b> (November 6, 1958)</p> <p>&lt;External Director&gt; &lt;Newly appointed&gt;</p>	<p>February 1988: Director, Wasserstein Perella &amp; Co., Inc.                      May 1994: Managing Director, Investment Banking, Merrill Lynch &amp; Co.                      April 2000: CEO, Gilo Ventures, LLC                      January 2003: Managing Director, Tomon Partners, LLC (to the present)                      November 2010: External Director of KLA-Tencor Corporation (Currently, KLA Corporation) (to the present)                      October 2014: External Director of InvenSense Inc.                      June 2016: External Director of MetLife Insurance K.K. (to the present)                      June 2016: External Director of Takeda Pharmaceutical Company Limited (to the present)                      May 2017: External Director of Rambus Inc. (to the present)</p>	—
<p><b>- Reasons for the appointment as a candidate for External Director</b></p> <p>Ms. Higashi served in investment banks in the U.S. for a long period and has abundant knowledge and experience in international corporate finance. Since founding Tomon Partners, LLC in 2003, she has been engaged in a business of her own related to corporate finance and corporate governance for many years. She has also assumed office as an External Director for listed semiconductor-related companies in the U.S. and is knowledgeable about the global semiconductor industry. We believe that her business experience in corporate finance and corporate governance, along with knowledge of the global semiconductor industry, will enhance the overall functions of the Board of Directors and contribute to ensuring the adequacy of the Company's business operations in general. We therefore anticipate that she will appropriately perform her duties as an External Director. Thus, the Company selected her as a candidate for Director.</p>			



# New Value Enhancement Plan (November 6, 2019)

Source: Company Disclosures

## Partial Execution Plan



Business	Category	Measures	Schedule
Semiconductor Device Business	Basic Policy	Consolidate domestic plants, Transfer production lines overseas, Promote outsourcing  Targets for optimization: Reduce fixed costs by 10% to 15% and floor spaces by 20% to 30%.	by Mar. 2022
	Execution Plans	1. Merge with SanKen Logistics Co., Ltd. and sell the idle real estate 2. Rebuild and expand building of Dalian SanKen 3. Refurbish SanKen Optoproducts to serve as a module factory 4. Expand production outsourcing to China and Korea	by Mar. 2020 by Sep. 2020 by Mar. 2021 by Mar. 2022
Power System Business	Basic Policy	Review and implement strategic options including sales to third parties.	by Mar. 2021
	Execution Plans	Transfer production lines from SanKen Optoproducts to overseas plants or domestic/overseas outsourced partners	by Sep. 2020
LED lighting Fixture Business	Execution Plans	Discontinue production by the end of March 2020  Plan to transfer production, sales and maintenance services to a third party	by Mar. 2020

- Specific initiatives will be reviewed by the “Structural Reform Committee” and announced, without delay, upon adoption of resolutions by the Board of Directors.

# Our Proposals & What the Company Announced

Source: Company Disclosures

## OASIS

- A** Exit the Power System Business
- B** Enhance Operations of Semiconductor Device Business
- C** Strengthen Governance Structure
- D** Introduce Performance-Linked Director Remuneration



**November 21, 2019: Examine and implement strategic options in the future including sales to third parties for Power Systems Business**

**November 21, 2019: Withdrawal from unprofitable products, consolidating the plants, transferring production overseas, and promoting outsourcing for Domestic Semiconductor Business**

**May 31, 2019: Employed an independent outside director who has knowledge in business portfolio transformation**

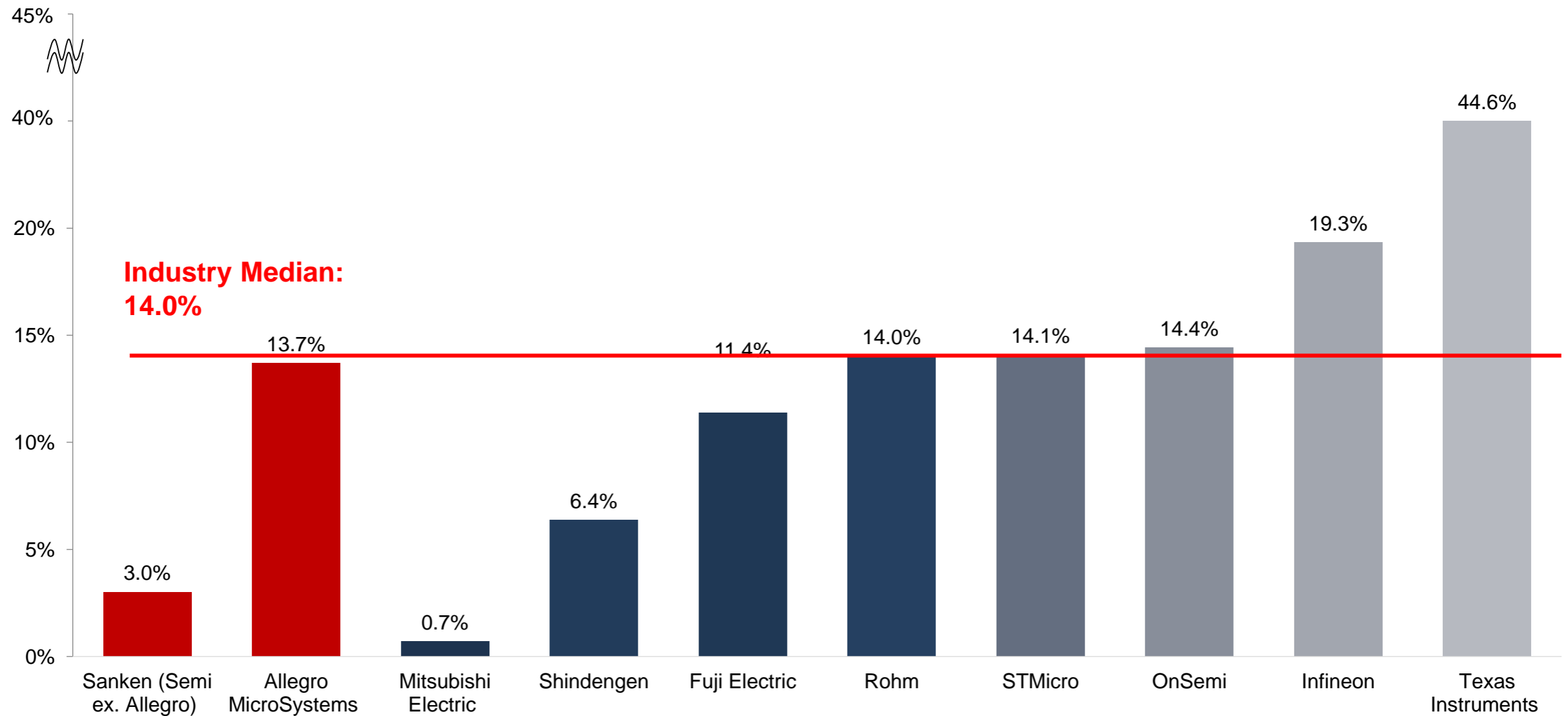
**May 8, 2019: Introduced Performance-Linked Director Remuneration**

# 5. Value Enhancement from Executing the Plan

# Sanken Ex. Allegro Could Achieve at Least **10%** Margin After the Restructuring

Source: Company Disclosures

- We believe Sanken Ex. Allegro could achieve at least 10% margin, which is still below the industry median, after the restructuring



# Sanken Ex. Allegro Value **¥70bn** After the Restructuring

Source: Company Disclosures, Oasis Estimate

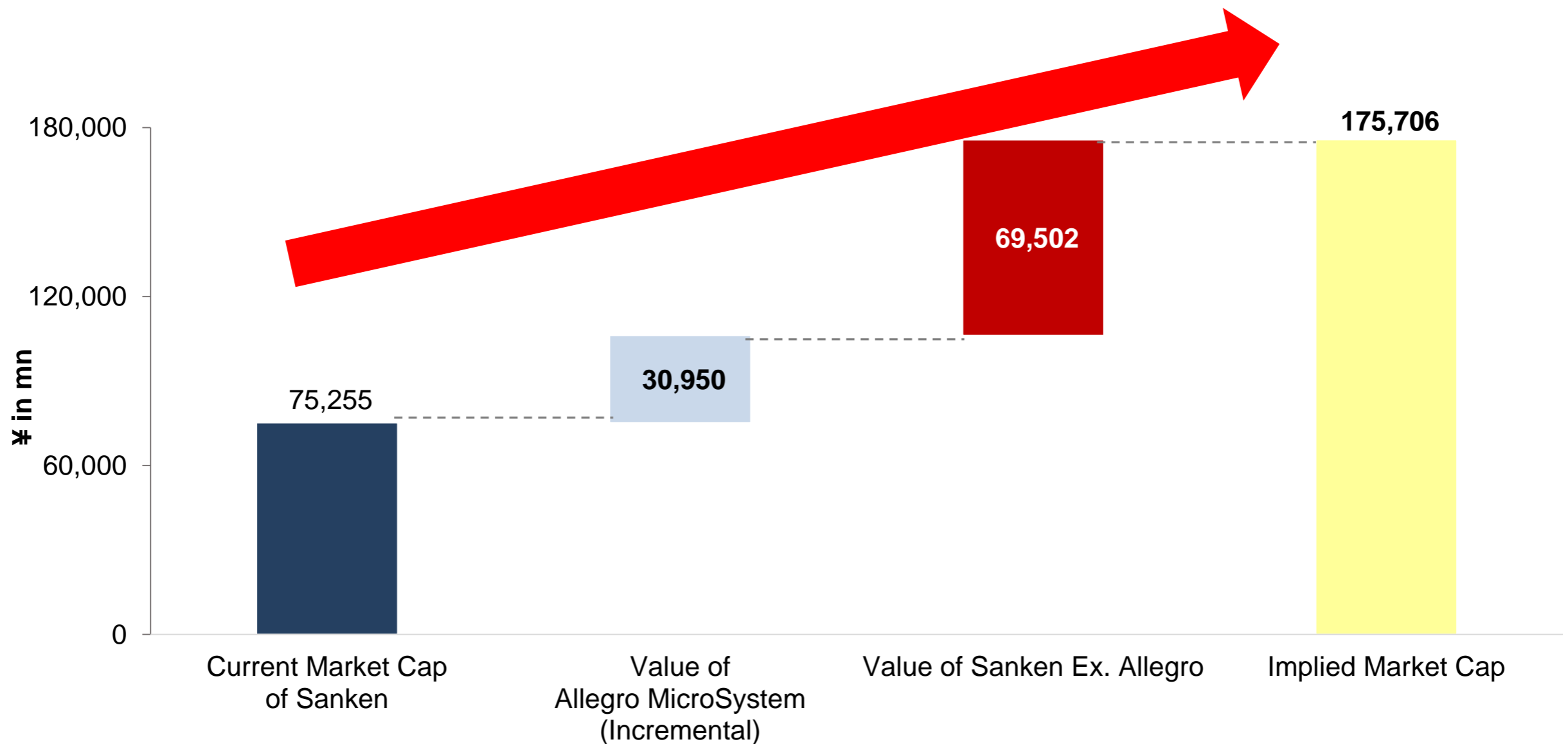
Sales		OPM		After Tax		Multiple
¥67bn	×	10%	×	69%	×	15x
<u>Implied Equity Value</u>						
<b>= ¥70bn</b>						

# Value Enhancement from Executing the Plan

Source: Company Disclosures, Bloomberg, Oasis Estimates

Note: FY19/3 Sales is used for sales assumption. Operating margin of 10% is assumed for semiconductor device business excluding Allegro. Tax rate of 30.7% is applied to calculate NOPAT. 15x P/E multiple which is currently assigned to Sanken is used for value calculation. No value assigned for the sale of power system business.

- Normalization of Sanken's margin to the sector average of 10% and exiting the power systems business would increase Sanken Electric's value by **+133%**



# **6. Our Message to Sanken's Board of Directors**

# **Our Message to the Board of Directors of Sanken**

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- **We believe the announced value enhancement plan is a great start for the Company to improve its corporate value and shows what good corporate governance can achieve**
- **The execution of the plan is the most important part. We would like to see a speedy and firm execution of the plan**
- **We will closely monitor the execution of the plan. We would like to see more details of the plan to understand how much financial impact the Company is assuming**
- **As a long-term shareholder of Sanken, we will continue to engage with you to further improve the corporate value**



OASIS