

January 27, 2017

## **Well Investments Research releases letter to SMC management**

***Raises new question about SMC's finances***

***Asks SMC to provide clarification at financial results announcement in February***

Well Investments Research (“WIR”) has announced that on January 16, 2017 it sent a letter to seven members of SMC Corporation (TSE: 6273, “SMC”), namely the representative director and chairman, representative director and president, executive managing director, outside directors, and outside corporate auditors.

WIR asked SMC to respond to the letter by January 20, 2017. WIR is now making the letter public in response to SMC’s failure to respond to the points raised or provide any clarification.

The letter is attached to this release and is also available from the link below:

<http://www.wellinvestmentsresearch.com/ja/%E3%83%9B%E3%83%BC%E3%83%A0/>

In the letter, WIR requested clarification on 18 points, including areas identified in the research report released by WIR in December 2016, such as notarized bank statements from each of SMC’s banks to support claims made in consolidated financial statements regarding cash balances, and the reasons for pledging SMC stock. The letter also requests clarification on new doubtful items that came to light through subsequent research.

Since the release of its report on SMC, WIR has received inquiries and requests for new information from institutional investors in Japan and overseas who are the shareholders of SMC, as well as from other stakeholders and financial authorities in jurisdictions where SMC operates. Criticism of SMC’s corporate governance and disclosure has increased both at home and abroad and a number of major international securities firms have commented on the extremely low level of corporate governance at SMC. In its 2016 ESG research report, one firm downgraded SMC to its lowest rating of “CCC” for governance.

Commenting on the release of the letter to SMC management, WIR’s Research Director Yuki Arai said, “We received many inquiries from investors and stakeholders immediately after we released the report on SMC. Many people expressed dissatisfaction towards the information disclosure by SMC, and encouraged us to pursue clarification from SMC on the issues raised in our report. As I also stated in the letter, ordinary citizens may also hold SMC stock through



Japan's Government Pension Investment Fund (GPIF) and ETF purchases by the Bank of Japan, and we believe that SMC has a social responsibility to respond to the issues we have raised. SMC will disclose its third-quarter results at the beginning of February, and we hope that they will use that opportunity to provide clarification in response to the issues raised in our report and letter."



SMC Corporation

Representative Director and Chairman Yoshiyuki Takada

Representative Director and President Katsunori Maruyama

Executive Managing Director Ikuji Usui

Outside Director Masanobu Kaizu

Outside Director Toshiharu Kagawa

Outside Corporate Auditor Yoshiaki Ogawa

Outside Corporate Auditor Tatsuo Suzue

## Inquiry regarding SMC's financial information

January 16, 2017

Well Investments Research

Research Director Hiroki Arai

Sirs,

As you are aware, Well Investments Research released a report on December 13, 2016 that surveyed and analyzed financial information in connection to disclosures by SMC Corporation. The subsequent press releases issued by your company on December 13 and 14 (titled "Regarding reports in some media about our Financial Statements") provided explanations for several points raised in our report and were beneficial for your company's shareholders and other stakeholders.

Nevertheless, following the release of our report, we have received a number of inquiries and comments from Japanese and international analysts and institutional shareholders regarding points that were not addressed in the above-mentioned press releases, and bringing to our attention issues additional to those raised in our report.

Corporate governance and stewardship codes—key policies of the Abe Administration—have in recent years been adopted by most listed companies and institutional investors. With large amounts of public funds—constituting the assets of ordinary Japanese citizens—invested in your company through the Bank of Japan, GPIF, and other institutions, we believe that the public should have an accurate understanding of your company's financial position.



The press releases issued by your company in response to our report do not sufficiently address the important issues raised about your company's financial information and do not provide satisfactory explanation to your company's stakeholders, Japan's capital markets, and ordinary Japanese investors. We believe your response is out of step with current government initiatives that are at the core of Japan's economic policy.

We request that you respond to each of the following questions by the 20th of this month by press release or other form, for the benefit of your company's stakeholders.

### Questions

- 1) Please disclose bank balance certificate clearly dated to back up the cash balances in your company's consolidated financial statements.
- 2) Please specifically explain why you do not employ a single audit firm with a structure capable of conducting a single integrated audit over all of your company's subsidiaries in both Japan and overseas.
- 3) Have your main banks, Resona Bank or Mizuho Bank, ever requested your company to consider changing O. Yu Kyodo or Seiyo Auditing Corporation to another audit firm with a structure capable of conducting a single integrated audit over all of your company's subsidiaries in both Japan and overseas? If so, could you explain why such a request was refused?
- 4) As mentioned in our report dated the 13th of last month and in a report from Citi Research dated the 11th of this month, many investors have expressed doubts towards the effectiveness of the audit of your subsidiary SMC Manufacturing (Singapore) because that audit was completed in just a few days following the end of the accounting period. Please provide a detailed explanation of the specific audit structure used for that audit.
- 5) Please disclose why TON Finance pledged shares in your company, the value of the pledged shares, who the obligor is, the date the pledge was made, the terms and conditions, etc.
- 6) Please disclose whether the shares of your company held by current or former directors of your company or other related parties of your company other than TON Finance including holdings not stated in the large shareholdings report,



and if so, the number of shares pledged, the timing, the reason, the pledge holder, the amount of the pledge claim, the obligor, the date the claim is incurred, the reasons, terms, etc.

- 7) According to disclosed financial statements related to TON Finance, TON had pledged 1,450,000 shares of SMC as of December 31, 2013 and 3,443,500 shares of SMC at December 31, 2014, this amount does not match the number stated in the large shareholdings report submitted in September 2008 (3,836,2000). Please explain.
- 8) Please explain the relationship between your company and Tatsuya Omura who is a director of TON Finance and son of your company's founder and former chairman, Susumu Omura. Disclosure of this point is important to stakeholders because the large shareholdings report submitted by Tatsuya Omura on December 19, 2005 disclosed that Tatsuya Omura has pledged shares of your company held directly or indirectly to Resona Bank in the same manner as shares of your company held by TON Finance. Incidentally, there is also much interest regarding Tatsuya Omura because his name was also mentioned in the Panama Papers.
- 9) Please explain the relationship between SMC and its subsidiaries and Kazutada Yashima of Resona Bank's Market Operations Management Department who is also the representative director of TON Finance and is listed as the administrative contact person and representative on the large shareholdings report submitted on January 28, 2009 by TON Finance.
- 10) Representative Director Yoshiyuki Takada has sold a total of 166,900 shares of your company over a period of several years starting from March 31, 2011. What is the reason for this and what were the proceeds from the sales used for?
- 11) Please explain why key employees of your company in Japan and overseas hold considerable shares of your company, despite the fact that your company does not have an employee shareholding incentive plan or stock compensation-type stock option plan? In particular, looking at the local notification documents concerning the holdings of your company's shares that have been filed by



Minoru Yoshida, who is an employee at your company's subsidiary in Singapore, his shareholdings have repeatedly changed, ranging from 3,084 shares on April 1, 2002, 5,084 shares on March 31, 2003, 84 shares on March 31, 2014, 0 shares on March 31, 2015, and 2,500 shares on March 31, 2016. Your company's stakeholders have much interest in whether your company has regulations on trading in your company's shares by employees and the details of such regulations.

- 12) Please disclose the audited financial statements of your subsidiaries in the US for the past 5 years. Many investors would like to have an accurate understanding of the status of your company's business in the US, and there appears to be no reasonable grounds for avoiding disclosure of the status of significant subsidiaries.
- 13) Please provide a concrete explanation of why it appears that negative interest rates were applied on SMC cash balances excluding Japan and China from FY 2012 to FY 2014.
- 14) While your company explained that cost reductions were achieved by factoring your company's payables to Resona Kessai in the press release dated December 14, 2016, we would like a concrete explanation of specifically how much of a cost reduction was achieved and in what manner for this payment practice that does not appear to be customary at other companies.
- 15) Regarding your company's payables, please provide a disclosure of the creditors that have factored receivables to Resona Kessai and the amounts factored.
- 16) Please provide a specific explanation on how the inventories held by European Central Warehouse, SMC Logistics Service Europe, and SMC Belgium are valued or recorded on the consolidated financial statements (or whether they are not recorded).
- 17) Please disclose all sales companies and customers that SMC has capital relationships with in Japan and overseas.
- 18) Please disclose a complete list of all subsidiaries, including whether or not they are in the scope of consolidation.



We believe that specific and clear response to each of these inquiries above would not only foster a clearer understanding and evaluation of your company's business for all of the participants in Japan's capital markets in addition to your company's current stakeholders, but would also make a significant contribution to an improved market assessment of your company's information disclosure stance.

In closing, it is our hope that your company's response to our report and this document, and continued dialog with your company in the future, can contribute to greater transparency and more pro-active information disclosure in Japan's capital markets.

Thank you.