

# KING STREET®

October 3, 2018

## **Toshiba Corporation**

Mr. Nobuaki Kurumatani - *Representative Executive Officer, Chairman & Chief Executive Officer*

Cc: Mr. Satoshi Tsunakawa - *Representative Executive Officer, President & Chief Operating Officer*

Mr. Masayoshi Hirata - *Representative Executive Officer, Corporate Executive Vice President & Chief Financial Officer*

Mr. Yoshimitsu Kobayashi - *Chairman of the Board, Member of the Nomination & Compensation Committees*

## **Re: Toshiba | Unlocking Value**

Dear Kurumatani-sama,

We are writing to follow up on our October 2 meeting in which we previewed our “Toshiba | Unlocking Value” presentation. As one of Toshiba’s largest shareholders, owning 6.5% currently, we have used our considerable investment experience and analytical resources to evaluate Toshiba and its businesses in significant detail, including the best possible strategies for capital allocation and the implementation of the share buyback announced in June. King Street is a global investor with \$20+ billion of assets under management, a local presence in Japan and a 23-year track record of long-term, fundamental, research-intensive investing. We believe we are able to offer valuable insights as Toshiba transforms itself.

Capital allocation is among the most important decisions the management and Board of a company make. This is particularly true for Toshiba, which is in the rare position of having substantial net cash as it embarks on a historic business transformation. Our analysis indicates that Toshiba is severely undervalued and would generate extraordinary returns by investing in its own stock today. While Toshiba announced a ¥700 billion share buyback on June 13, 2018, continued delays in implementation threaten to significantly impair shareholder returns. Moreover, the announced amount falls materially short of Toshiba’s excess capital.

**We are publicly releasing our presentation<sup>1</sup> (which can be accessed at [www.unlockingtoshibavalue.com](http://www.unlockingtoshibavalue.com)) to inform Toshiba’s management, Board, shareholders and all other stakeholders of the significant value we believe will be created by an accelerated and increased share buyback of ¥1.1 trillion, which is the Company’s highest and best use of excess capital. It is critical that Toshiba implement the buyback as quickly as possible to take full advantage of this virtually unprecedented opportunity. As evidenced by recent increases in our ownership stake, we are convinced of the long-term value of Toshiba’s business and are confident in the Company’s ability to regain its status as one of Japan’s corporate crown jewels. Toshiba can become a leading example of Prime Minister Abe’s call for corporate revitalization through better governance and more efficient use of capital.**

We summarize the key points of our presentation below.

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<sup>1</sup> This letter is intended to be read in conjunction with such presentation, including the disclaimers set forth therein. Both the letter and presentation (including the potential contents of the Toshiba Next Plan) are based solely on our own analysis and information made publicly available by Toshiba.

## **Toshiba is Significantly Undervalued**

The timing and size of Toshiba's share buyback are both critical given our belief that Toshiba is severely undervalued. Toshiba's operating businesses include sizable, high-quality, industrial companies that manufacture well-respected products and generate over ¥2.7 trillion of revenue (see slide 9 of the presentation). Many of these businesses have stable recurring revenue streams and high margins, are leading players in the domestic market and/or possess differentiated technologies. However, based on Toshiba's September 27, 2018 closing price, the implied value for these operating businesses is ¥107 billion, or less than 5% of their intrinsic value.

While Toshiba has suffered from low operating margins for many years, there are numerous short-term initiatives for various business lines that will enable Toshiba to more than triple its margins to 5% in the next 12 to 24 months. These initiatives, laid out on slides 31-33, would increase the value of Toshiba's operating businesses to ¥1.2 trillion. **We expect the Toshiba Next Plan, once finalized, should further increase their value to ¥2.6 trillion by achieving more globally competitive margins of ~11%.** By accelerating and increasing the share buyback as we recommend, Toshiba's share price could reach ¥11,157 (see slide 22).

## **Share Buyback Must be Accelerated**

Toshiba has yet to buy back any of its stock following its ¥700 billion commitment announced this past June. We are frustrated by this lack of progress, and cannot stress enough how critical it is that Toshiba begin implementing its buyback immediately. The sooner Toshiba buys back its stock, the greater Toshiba's returns, given its current undervaluation. Any delay or inefficient implementation of the buyback will result in much higher purchase prices and materially impair shareholder returns.

To put the timing impact in context, repurchasing shares at current levels could increase share prices 100% once the short-term initiatives are implemented and in excess of 240% longer-term assuming successful execution of the Toshiba Next Plan (see slide 22). These **share price increases would be cut in half if the Company delays the share buyback** until these measures have been materially initiated.

There are a number of methods that would accomplish the entire buyback in a timely manner, any of which would significantly increase Toshiba's equity value. We believe an accelerated stock repurchase program ("ASR") is the most effective mechanism, as it would reduce Toshiba's shareholdings immediately in a single transaction, achieve the lowest price (on a tax-adjusted basis) and minimize execution risks (see slides 19 and 112 - 114). Irrespective of the method chosen, it is imperative that Toshiba fully execute the buyback as quickly as possible to take advantage of the extraordinary returns available to it by investing in its own turnaround. We urge Toshiba to initiate and expedite the share buyback upon Board approval of the Company's audited second quarter financials and the announcement of the Toshiba Next Plan, expected in November.

## **Share Buyback Must be Materially Increased**

While accelerating the timing of the share buyback is most critical, it is also essential to increase its size. We have clearly expressed to you in numerous meetings and correspondence over the past few months that the **¥700 billion announced commitment is grossly insufficient given the magnitude of Toshiba's excess capital and how severely undervalued the Company currently is.**

Toshiba has total cash of ¥1.8 trillion and net cash of approximately ¥1.2 trillion (see slide 21), equal to ¥1,833/share. No investment alternatives come close to the exceptional returns achievable from the buyback. Accordingly, as much excess capital as possible should be deployed to this end. We strongly believe there are no real obstacles to increasing the share buyback program to at least ¥1.1 trillion. Such an increase would optimize

Toshiba's capital allocation, reduce Toshiba's shares outstanding and, when coupled with a properly executed Toshiba Next Plan, greatly increase its long-term share price.

**After a ¥1.1 trillion buyback, Toshiba would still maintain unusually sound financial metrics** (see slides 11 and 23). It would have ¥700 billion of cash, remain under-levered relative to peers and have ample capacity for future buybacks and dividends. While we appreciate the importance of achieving an appropriate credit rating, R&I has publicly confirmed that profitability and earnings stability are the key to higher credit ratings for Toshiba, rather than retaining additional excess cash. Nor is additional excess cash needed to cover restructuring expenses or any losses on Toshiba's LNG contracts. Moreover, non-operating assets (e.g., cross-shareholdings and real estate) can and should be monetized to materially increase net cash and dividend capacity even further (see slides 49 - 53).

### **All Stakeholders Would Benefit**

**An accelerated ¥1.1 trillion share buyback, together with the successful execution of the Toshiba Next Plan, would benefit all stakeholders**, including employees, suppliers, customers, regulators and banks (see slide 13). In addition, our recommended share buyback aligns with the aims of Prime Minister Abe's Third Arrow and the Ito Review Report, both of which call for Japan's corporate revitalization through governance reform and a better and more efficient use of capital (see slide 12).

### **Conclusion**

Following the recommendations summarized in this letter and detailed in our presentation will create lasting value for Toshiba's shareholders and allow Toshiba to return to its status as a crown jewel of corporate Japan's industrial and engineering capabilities.

**We urge Toshiba's management and Board to take full advantage of this historic opportunity and realize the extraordinary returns that would be generated by an accelerated and increased ¥1.1 trillion share buyback.**

We remain available to discuss our thoughts and materials in greater detail and remind you that we are a public investor and as such we do not wish to receive any material non-public information.

Regards,

King Street Capital Management, L.P.