Mizuho Custody Newsletter

July 2024 | Japan

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I. Market News

1. Farewell to dormant cash deposits

According to a survey by the Nikkei Shimbun, Japan's leading financial daily, 980 companies listed on the Tokyo Stock Exchange (TSE) Prime Market (excluding financial and related sectors) had cash on hand balance as of the end of March 2024 in the amount of JPY 114 trillion (circa. USD 735 billion), marking a record high for five years in a row. Their recent strong business performance and the depreciation of Yen drove the cash on hand balance to this high level. Compared to the end of March 2019, before the COVID-19 pandemic (approximately JPY 86 trillion), it went up by 30%. Their capital adequacy ratio at the end of March 2024 also reached a record high of 42.4%.

However, cash on hand brings little return to companies, it rather worsens capital efficiency of such companies. Japan has more companies with excessive cash reserves in terms of their business size compared to those in Western countries, and many analysts see it as an issue to be reviewed in terms of corporate governance.

Eventually, Japanese companies began taking action to compress their "seemingly too much" cash reserves. A major recruitment agency plans to reduce its net cash reserve by JPY 1 trillion (circa. USD 6.4 billion) over the next two years, through acquisitions and share buybacks. The current amount of JPY 114 trillion in cash on hand at listed companies is at a record high, and as inflationary pressures intensify, they cannot afford leaving cash of that amount idle any longer. Effective use of the cash having been left idle could be an avenue for those companies to medium- to long-term growth.

According to an information vendor affiliated with Nikkei-Shimbun, the ratio of cash reserves to market capitalization for the TSE Stock Price Index (TOPIX) 500 (excluding financial sectors) constituents was 17%. This exceeds those of the US S&P 500 Index (4%) and the European STOXX 600 (11%).

To date, stabilization of cash flow has been the main concern of great many companies, which made them shy away from using their cash reserves for some purposes. However, as cash reserves have been rapidly piling up, some companies instituted the quantitative target for their cash reduction. The CEO of the aforementioned recruitment agency said, "We have continued conservative capital management, assuming even the economic would fall to the bottom, but over the next two years, we are going to reduce the net balance of cash and deposits to around JPY 600 billion (circa. USD 3.8 billion), in tandem with strategic acquisitions and enhancing shareholders' returns through share buybacks."

This recruitment agency's net cash, subtracting bonds and loans from cash reserves, was inflated to approximately JPY 1.13 trillion (circa USD 7.3 billion) at the end of March 2024, nearly threefold in the past three years. It is expected that the company will actively engage in mergers and acquisitions (M&A) and enhance shareholder returns, aiming to reduce the amount by about JPY 1 trillion on net basis in the next two years. The company believes, that this strategy would lead it to maintain and increase the return on equity (ROE) and the total payout ratio."

As with the aforementioned recruitment agency, more and more listed companies have been disclosing “what they used funds for”, such as growth investments and shareholder returns. 238 companies included this disclosure in their management plans for the period from January to mid-June 2024, which is 2.1 times of the total for the entire year of 2023. On this subject, TSE Prime Market companies accounted for about 76% of the total, with 180 companies (a 98% increase compared to 2023). Approximately 23% were by Standard Market companies amounting to 56 companies (a 3.3-fold increase). It was mainly large corporations that have traditionally publicized their capital allocation policies, but the practice is now spreading to mid-sized companies as well. As more investors need issuers to present specific measures to enhance corporate value, the issuers intend to cope with both growth investments and shareholder returns.

The issuing companies would clarify their allocation policy on how to obtain cash through core business operations, asset sales, and borrowing, etc., and how much to allocate to their activities such as capital investments, mergers and acquisitions (M&A), shareholder returns, etc. This is referred to as "cash allocation" or "capital allocation." It is of high interest to investors and is becoming increasingly important as a corporate management strategy.

"Based on JPY 3 trillion (circa. USD 19.3 billion) of cash on hand, we will control borrowing amount at an appropriate level, while properly allocating to growth investments, strategic spending and shareholder returns." said the CEO of a leading real estate company, at its management policy briefing in April.

The realtor plans to generate approximately JPY 1 trillion through fundamental operating cash flow (CF) and about JPY 2 trillion from sale of real estate and cross-held shares in three years from the fiscal year ending in March 2025. On this JPY 3 trillion in total, they plan to invest JPY 2 trillion in growth investments for core businesses such as complex-facility-typed urban development, JPY 600 billion (circa USD 3.8 billion) in investments for new businesses and M&A, and JPY 400 billion (circa USD 2.5 billion) to be returned to shareholders.

A leading health care company aims to earn JPY 1.9 trillion (circa USD 12.2 billion) through its core business in three years from now, in addition to raising JPY 220 billion (circa USD 1.4 billion) through debt finance. In terms of the use of funds, it plans to allocate JPY 1.9 trillion for capital investments and research and development (“R&D”) for biotech-related and semiconductor materials, and JPY 220 billion for shareholder returns.

What prompts companies to disclose their capital allocation policies is the increasing demand from market for management that is conscious of stock prices. As of the end of this March, cash reserves for listed companies has swelled to JPY 114 trillion, and that tremendous size of cash could deteriorate their capital efficiency, unless used in effective ways. Companies intend to attract investors’ money by demonstrating how they would enhance corporate value to the market.

Investors are also looking at how companies act as planned. A CEO of an asset management company points out, "Many companies fail to make themselves clear enough to public on how they would achieve targets such as ROE (Return on Equity). An explanation on capital allocation would clearly show what the company management’s priorities are."

Japanese companies have traditionally placed a strong emphasis on the income statement, which often led them to keep capital investments within the range of depreciation expenses, and to determine policies on shareholders return based on net income. However, to improve capital efficiency, it is necessary to effectively utilize many items on the balance sheet, such as cash reserves, surplus assets, and interest-bearing debts.

The thing is whether companies could produce results through growth investments. In particular, with M&As, it's not just about completing the acquisition, but also bringing out synergistic effects through the post-acquisition integration process. If the company’s ROI could go beyond what investors expected, it would lead to sustainable improvement in its corporate value.

Compiled from Nikkei Shimbun and Mizuho research

2. Two broadcasting companies start paying dividends to unregistered foreign shareholders

The Tokyo Stock Exchange（TSE）and three other domestic stock exchanges announced the outcomes of the Shareownership Survey for fiscal year 2023 on July 2. The ownership ratio of Japanese stocks by foreigners, based on monetary value, reached 31.8%, the highest since 1970 when comparable data have become available. In fiscal year 2022, it was 30.1%.

In March 2023, TSE requested listed companies for management conscious of capital costs and share prices, which led many Japanese companies to work under the mindset. Foreign investors, with expectation of upside for Japanese stocks, supported the bullish stock market. Outflow of some investment funds to Japan from China, due to the economic slowdown, also supported the momentum, which may imply that overseas investors would stay positive towards Japanese stocks for the time being.

As in many other countries, Japan has foreign investment regulations that restrict ownership of stocks by foreign investors (FOL: Foreign Ownership Limitation). In Japan, these regulations are specified in individual industry laws, such as the Civil Aeronautics Act and the Broadcast Law. These laws set the threshold for acquisition and ownership of voting rights by foreign investors from perspectives of national security policy, industrial policy, and economic policy.

None of these laws prohibit foreign investors from acquiring stocks. However, if the proportion of voting rights held by foreign investors exceeds the limit set by the laws (Civil Aeronautics Act: 1/3, Broadcast Law: 20%, Nippon Telegraph and Telephone Law: 1/3, etc. against the number of outstanding shares), the company shall refuse registration of the excess portion onto the shareholder registry.

It should be noted that the regulations in each industry law control the entitlement of voting rights to foreign investors, and the handling of dividends entitlements varies by each issuing company being subject to FOL rules. For companies under the regulation of the Civil Aeronautics Act, such as Japan Airlines Co., Ltd. (JP3705200008), and those under the Broadcast Law, such as Fuji Media Holdings, Inc. (JP381940007), while the exercise of voting rights by foreign investors that decline registration onto their shareholders' registry, they pay dividends to the actual number of shares on the record at local custodians.

In this year, two major broadcasting companies under the Broadcast Law announced to alter their policy to pay dividends to foreign investors, who have been declined to be registered as shareholders due to exceeding the limit level. It is believed that the request from the TSE to do business with consciousness capital costs and stock prices behind this change.

Nippon Television Holdings, Inc. (ISIN: JP3732200005) ("NTV") resolved to allow foreign shareholders, whose registration in the shareholder registry was refused, to be eligible for dividends entitlements, but no other entitlements. Until now, if the ratio of voting rights held by foreign shareholders exceeds 20%, foreign shareholders who bought the issue after that are not registered in the shareholder registry, and no entitlements are given to them. This decision to expand the number of shareholders eligible for dividend entitlement is anticipated that companies use assets more efficiently. Based on the balance of shares held as of March 31, 2024, dividends were paid in late June under the new rules, covering foreign shareholders who are not on the shareholders' registry. According to the Japan Securities Depository Center (JASDEC), as of July 22, the direct foreign ownership ratio of NTV reached 22.88%.

Many foreign shareholders of NTV had been demanding the company to pay dividends to foreign shareholders being not recorded on the shareholders' registry. If this NTV's decision would encourage foreign shareholders to buy more NTV shares, it could help NTV's PBR (Price to Book Ratio) improve further.

TV Asahi Holdings Corporation (ISIN: JP3429000007) ("TVAHC") also resolved at its AGM in June 2024 to amend its "Articles of Incorporation", in order to pay dividends to foreign shareholders being not recorded on the shareholders' registry. While registration on the shareholder registry for foreign investors when their aggregated voting rights ratio exceeds is not accepted, the amendment of TVAHC's "Articles of Incorporation" is coming into effect on September 1, 2024. This would allow TVAHC to take shareholder return measures, such as share buybacks, more flexible, which is anticipated that TVAHC to use asset more efficiently. According to JASDEC, the voting rights ratio of foreign shareholders in TVAHC was 16.28%, as of July 22.

The aforementioned "Shareownership Survey" by TSE revealed that companies that have increased the foreign ownership ratio had all strengthened shareholder returns such as paying more dividends and share buybacks. Investors have been moving their money to companies that do business being conscious of capital costs, learning through dialogue with foreign investors. Among the 1,125 companies listed on the TSE Prime Market with fiscal year-end in March, 745 of them saw an increase in the foreign ownership in the shares in comparison with the figure of an year ago, which account for about two thirds of the companies .

With regard to the announcements by the two broadcasting companies, a fund manager at a domestic securities firm commented, "This would encourage foreign investors to buy their stocks more, which would be positive for supply and demand of these issues." Prices of both companies' shares skyrocketed after the announcements. TSE has been urging listed companies with a PBR of less than x1 to institute measures for improvement, and most of the broadcasting companies' are under this pressure. The fund manager also says, "There seems to be growing expectations in the market that these broadcasting companies will develop their capital efficiency and continue shareholder returns from now on."

Compiled from Nikkei Shimbun and Mizuho research.
The announcements from the companies can be found from the below link.

Nippon Television Holdings, Inc. (NTV)
https://www.ntvhd.co.jp/english/pdf_cms/news/20240201-1.pdf

TV Asahi Holdings Corporation (TVAHC)
https://www.tv-asahihd.co.jp/e/pdf/announcement/2024/20240418_paymentEng.pdf

3. TSE facilitates communication between mid-sized companies to institutional investors

The Japanese government will newly classify companies with fewer than 2,000 employees, excluding small and medium-sized enterprises (SMEs) with several hundred employees, as "mid-sized" and is going to launch various supportive measures in 2024, which it recognizes as the "beginning the era of revitalization of mid-sized enterprises." Currently, the government categorizes companies into two groups: "large corporations" and "SMEs". In the manufacturing sector, for example, a company is classified as an SME if it meets criteria such as having a capital of less than JPY 300 million (circa USD 2 million) or fewer than 300 employees, and those belong to this categories receive substantial support from the government, including subsidies.

At present, it is believed that approximately 9,000 companies in Japan are classified as this "mid-sized" enterprises. Even though their business sizes are not as large as "large corporations", they have been taxed in the same manner as large corporations have been to date. Some economists see that the current taxation could discourage the "mid-sized" companies from expanding their businesses because the current taxation is structured to benefit SMEs more than "mid-sized" enterprises-to-be. The government counts on these mid-sized enterprises as driving forces to develop regional economies through capital investment and employment expansion. For this purpose, the government plans to support their growth through tax incentives in the not-so-distant future.

Among the approximately 9,000 companies classified as mid-sized enterprises, about 1,500 are listed companies. The Tokyo Stock Exchange (TSE) is starting to help mid- or smaller sized companies and institutional investors liaise with each other. Considering that companies with small market capitalizations are less likely to catch cash-laden institutional investors' attention, TSE intends to create more opportunities of dialogue such as above-mentioned situation. TSE has been encouraging listed companies to be more conscious of stock prices and capital costs in doing business than before, and it is taking the initiative by organizing matchmaking meetings between companies and investors periodically.

It is often the case for companies that went public while their business lots were still small to struggle to find appropriate financial source or investors for their growth, because such small companies do not look attractive to institutional investors. As a result, many of them still remain small companies with low market capitalization, forced to fight uphill battle to come up to the surface.

In March 2023, TSE requested companies with a Price-to-Book Ratio (PBR) of less than 1 to institute and present clear plans to improve their capital efficiency for investors. Notably, even among long-established companies, some of those are still small in business size, and have been getting little attention from the market. Smaller listed companies have been taking time in becoming well-organized to disclosing information along with TSE's requests in this regard.

For example, TSE plans to periodically organize meetings for institutional investors and listed companies, such as Prime Market-listed companies with market capitalizations in the JPY tens of billions range, as well as Standard Market-listed companies. TSE assumes each meeting to involve about 10 companies. At the first meeting held in this March, a major domestic securities company invited around 20 institutional investors. Going forward, TSE aims to organize these meetings regularly by seeking cooperation from more number of securities companies.

From August, TSE will initiate a program for companies listed on the Growth Market, which is for newly emerging companies, to upload short videos on the TSE website to present who they are, their strengths and how they would develop their businesses. When TSE notified this program to all companies listed on the Growth Market which is around 600, close to 100 of them applied for the program. These videos will be published to institutional investors in the order of videos' availability.

This is the first attempt by TSE to liaise mid-sized and small listed companies with institutional investors. Companies that participated to the meeting in March replied that it was their first time having discussions with investors in a small-scale meeting other than earnings presentations, and that they found the opportunity to meet investors with whom they normally do not have usual contact very valuable.

In March 2023, TSE made a request to issuing companies in terms of raising "consciousness of capital costs and stock prices", to analyze reasons of their low PBR (Price-to-Book Ratio) , and to disclose an improvement plan, and to update the disclosed information at least once a year, through the dialogue with investors. It is often the case that securities firms to do not have analysts assigned to research mid-sized and smaller listed companies, and such companies often struggle even to understand what investors' expectation for them are, let alone information disclosure.

Since this January, TSE has been publishing the names of companies that have disclosed improvement measures in response to TSE's request. As of the end of June, 74% of the companies listed on the Prime Market have made such disclosures, while it was only 28% in the Standard Market. Even among companies listed on the Prime Market with a PBR of less than one, 97% of them with a market capitalization of over JPY 100 billion (circa USD 640 million) have disclosed their information, in contrast to only 73% of them with a market capitalization of less than JPY 25 billion (circa USD 160 million) have done it.

It is globally uncommon for a stock exchange to call on companies listed on it to do business with more consciousness of capital efficiency and stock prices. In January of this year, TSE established a department called the "Listed Company Support Group", specialized in backing up the efforts of companies comply with its requests. Setting up meetings with institutional investors is also one of the department's responsibilities. The CEO of TSE emphasized, "As we are making requests to listed companies to take action, TSE must also work hard and support them to achieve our goals."

Besides creating opportunities for dialogue, TSE is zeroing in on to support companies' investor relations (IR) activities for investors to look more refined. TSE has already produced videos on which companies can learn how to prepare disclosure documents in English for IR with foreign investors in an efficient manner, which is available for public on the TSE website. In September, TSE will also host a consultation meeting where IR representatives of listed companies can discuss their concerns directly with experts and seek their advices.

Some mid-sized and small listed companies do not have staff dedicated for investor relations (IR), which makes it difficult to communicate the importance of IR activities to the top management. TSE's support group has been visiting companies more often than before, now amounting over 30 companies. They emphasize the significance of IR in study groups held after board meetings and other occasions.

The CEO of Japan Exchange Group prioritizes visiting companies located in regional areas outside Tokyo, and since February, he has joined meetings in four prefectures to demonstrate the exchange's initiatives to listed companies in each province. He plans to visit around ten more provinces by the end of the fiscal year.

In June, TSE announced a new reform plan to make criteria of companies as a constituent of the TSE Price Index (TOPIX) more selective. The plan would make the market capitalization criteria more stringent, reducing the number of constituents down to about 1,200 by 2028, which is by more than 40% down from the present. This reform would make that mid-sized and small listed companies are less likely to be purchased by passive investment trusts that track the TOPIX. It intends to make these companies aware of the importance of taking immediate actions to find solutions to improve their corporate value on their own.

Compiled from Nikkei Shimbun, and Mizuho research.

4. TSE announce to further slim down TOPIX

TOPIX is a stock index calculated and published on companies listed on the Tokyo Stock Exchange (TSE), consisting of 2,146 issues as of the end of April, 2024. Many investment trusts funds are operated as if they are linked to TOPIX, what is called “passive investment”. The assets being invested under the scheme amounted to JPY 88 trillion (circa USD 567.7 billion) as of March 2023.

In line with the market reorganization in April 2022, Japan Exchange Group (JPX) changed the calculation method for TOPIX. The old TOPIX was composed of all issues in “the first section of the TSE”, the precursor of the Prime Market, and even smaller listed companies were included in the investment targets of TOPIX-linked investment trusts funds. This automatic buying mechanism by investment trusts has been criticized by market participants that it could hinder efforts to increase corporate value and stock prices, as some poor performing companies’ share are automatically purchased effortlessly just because they are TOPIX constituents. TSE switched to a new calculation method that gradually reduces weight of companies with a market capitalization of less than JPY 10 billion (circa USD 64.5 billion) in the index, which is also a criterion for Prime Market listing. By January 2025, the number of TOPIX constituents will decrease to about 1,700 issues.

On June 19, JPX announced a new reform proposal for TOPIX. The proposal further slim down the TOPIX constituents by allowing issuers that account for 96% of the TSE's market capitalization, based on free-float stocks basis that exclude cross-held shares. As the result, the remaining 4% of issues will be pushed out. With the exclusion of companies with low market capitalization, TSE sees that the number of issues included in the index would be slimmed down to about 1,200.

The primary objective of the reform is to resolve issues such as reducing workloads and costs involved in managing investment trusts linked to TOPIX. When asset management companies set up TOPIX-based passive investment trust funds, they need to continuously trade small-cap stocks with limited availability in the market, which had been a factor to push up operational costs. Elimination of companies with small market capitalization from the index may make it easier for asset managers to administrate index-linked investment trusts, but for issuing companies, this would require to make more efforts to enhance corporate value be included in the index. With the implementation of the new NISA (small investment tax-exemption scheme for individuals), more funds seem to be flowing into index-based investment management. Being excluded from the "new TOPIX" could put those companies into tougher situation than they are now. The market would urge such companies to go the extra mile if they want to stay in the index.

At the press conference on the 19th, Hiroki Yamaji, CEO of JPX, emphasized that it was very important for JPX to ensure market representativeness and comprehensiveness with a view to improve functionality.

At present, TOPIX primarily encompasses listed companies in the Prime Market at TSE. The new TOPIX will broaden the scope of eligibility to all markets at TSE, with view of adding companies with growth potential to the index. About 50 issues from the Standard and Growth Markets will be reportedly added. The additional change of components will be implemented gradually from October 2026. TSE will make some adjustments when necessary, to maintain the characteristics as a stock index even after changing the components.

Further slimming down the number of constituents does not completely eliminate the structural problem of including a large number of relatively small companies. Among all listed companies, companies with a market capitalization of over JPY 1 trillion (circa USD 6.4 billion) account for only 5%, and those with less than JPY 50 billion (USD 322.5 million) do more than 60%. Index-linked investment trusts will continue to buy those small companies even after the reshuffling would take place.

The S&P 500, a leading stock price index in the United States, is composed of the main 500 issues. If its level as of December 2013 is regarded as 100, the current level of the S&P 500 rose to 297, whereas TOPIX remained at 209.

Compared to the United States, where leading companies such as the giant IT firms "GAFA" (Google, Apple, Facebook, and Amazon) and the semiconductor leader Nvidia emerged one after another as new drivers of the index, TSE, issuers and the government have to do much more to further develop TOPIX to narrow the gap between those major indexes in the world.

On July 19th, Mr. Yamaji, CEO of JPX, stated, "I anticipate companies to work on enhancing their corporate value while being aiming to be selected for a new TOPIX constituent. As a result, it would hopefully inspire both individual and institutional investors." In addition to continue to pursue further improvements of the index, it is pivotal for TSE to persistently look for ways to promote reforms that help listed companies to grow further.

Compiled from Nikkei Shimbun and Mizuho research.
Details of the announcement can be found from the below link.
https://www.jpx.co.jp/english/news/6030/dh3otn00000088q9-att/e_data1.pdf

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Jul-17	Support Co., Ltd..	JP3322820006	P
Jul-26	Life create Co.,Ltd	JP3966400008	P
Jul-30	Katsu Mi Japan Inc.	JP3212500007	P
Jul-30	Heartseed Inc.	JP3765140003	G
Jul-31	Faber Company Inc.	JP3802480008	ST
Aug-05	INSIGHT LAB, Inc.	JP3152660001	P
Aug-08	Nippon Information Control System Inc.	JP3668350006	P
Aug-21	OPRO Co. Ltd	JP3197790003	G

**Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N)、FSE (F) & SSE (S).*
***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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https://www.jasdec.com/en/description/less/for_pubinfo/for_pubinfo.html

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