Mizuho Custody Newsletter

February 2021 | Japan

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I. Market News

1. Towards a full online AGM

On 5 February 2021, a cabinet decision was made to amend the Act on Strengthening Industrial Competitiveness (“Act”), which will allow companies to hold AGM online without a physical venue. The Companies Act in Japan requires a physical venue for AGMs, but if the bill is passed during the current ordinary session of the Diet, it will allow issuers to hold full online AGM as early as in June, which is the highest season for AGMs in Japan, according to Nikkei Shimbun, Japan’s leading financial daily.

Virtual AGMs can be categorized to three types in general. The 1st type is a full online AGM without a physical venue, which the Act to be amended is aiming to introduce. The 2nd type is a hybrid "virtual attendance type" where you can ask questions and exercise voting rights online and the 3rd type is a hybrid "virtual participation type" where you can only watch and listen online, and they can be held under the existing laws. This hybrid type AGMs have attracted attention last year when the companies had difficulties to have AGM without gathering a large number of people at one place under the pandemic.

In 2020, a number of companies started studies to hold virtual AGMs as a measure against the new coronavirus. However, only 122 companies, or about 5% of listed companies, actually held such meetings in June last year due to lack of equipment and personnel. According to a survey conducted by a trust bank with about 800 companies, about 40% of listed companies responded they were considering to hold virtual AGM in FY2021 and the trend toward virtual AGMs is gathering momentum.

On the other hand, "virtual attendance type" AGM, which allows questions and exercise voting rights online, still has some points pending that need further analysis from legal point of view. For example, if malfunction occurred with a communication network in the middle of a meeting and the votes of the online attendees were not counted, no clear standards have been provided as to whether such votes are valid. It is anticipated that issuers may have to be ready for submission of more motions in online AGMs than at AGMs in person, as many shareholders may feel less reluctant to submit a motion via online than in person. According to the above-mentioned survey by a trust bank, only 7% of the issuers are considering to hold “virtual attendance type”.

The government is getting ready for immediate enforcement of the bill, if the amended Act passes the current ordinary session of the Diet. It may draw attentions in the market as to whether there would be any companies to hold AGM fully online.

Information compiled from Ministry of Economy, Trade and Industry, Nikkei Shimbun & Mizuho research

2. Long term financing by corporate bonds are growing

Companies are actively issuing corporate bonds for financing. Issuance amount is getting larger, and corporate bonds with long maturities are also increasing, according to Nikkei Shimbun, Japan’s leading financial daily. In 2020, 10 corporate bonds were issued with a maturity of 50 years, which is the longest maturity for corporate bonds issued in Japan. Low interest rates make it easier for companies to get

long-term financing in large amount, and the Bank of Japan's decision to expand purchases of corporate bonds due to the pandemic is becoming tailwind.

Issuance of publicly offered corporate bonds has reached JPY 5,243.5 billion during the period from October to December in 2020, setting a new record in a quarter. The primary reason for companies to issue corporate bonds is to continue stable business operations by covering their demand for long-term funding to ensure their financial stability. Companies in leisure and transportation industries were active issuers of corporate bonds as their main businesses shrank because much less people went out for leisure and much more people started working from home due to the COVID-19.

Issuance of corporate bonds with long maturities has been increasing. In 2020, there were many issuances of 50 years bonds, which was issued for the first time in 2019. Corporate bonds issuances to finance M&A deals are also notable. Corporate bonds, which solicits funds from many investors, allow issuers to raise large amount of funds at a time.

The percentage of outstanding balance of corporate bonds to total debt of corporations jumped to the record high at 17% level, backed by a surge in the period from July to September in 2020, according to the latest data available. Since then the figure seems to stay at a high level. Under the strong monetary easing policy in the pandemic, companies have been working to diversify their financial sources by issuing corporate bonds with long maturity to ensure financial stability for long term.

According to the calculation by Nikkei Shimbun based on corporate statistics of July to September 2020 released by the Ministry of Finance in December 2020, on the year-end balance of all industries (excluding finance and insurance business), the ratio of corporate bonds against total debt (sum of the borrowings from financial institutions and corporate bonds) turned out to be 17.6%, renewing the highest record for the first time in 2 quarters. The increase from the previous quarter was 1.2 percent, the largest surge in the past 24 years.

Looking at the amount, corporate bonds has increased by 8.5% reaching JPY 96.8 trillion, and borrowings fell by 0.5% to JPY 452.6 trillion. As a result, corporate bonds' ratio against total debt got bigger. Borrowing from financial institutions is still the main pillar of financing, but corporate bonds have been gaining a bigger presence as a financial source for companies.

Rise of corporate bonds in debt ratio has become clear since 2016, reaching 12.7% in April to June in the same year, which marked the record high in 5 years at that time. The uptrend has continued since then. As the Bank of Japan introduced a negative interest rate policy, long-term interest rates fell into negative for the first time in history in February 2016. Under the circumstances, demands of issuers and investors began to match, among those who want financing at a low rate and those who want investment vehicles with yield higher than government bonds.

Information compiled from Nikkei Shimbun & Mizuho research

3. More companies selling off businesses

Many Japanese companies are now restructuring their businesses, reports Nikkei Shimbun, Japan's leading financial daily. According to a M&A advisory firm, there were 399 cases in 2020 in which listed companies or their subsidiaries sold off their businesses or their group companies, the highest number since 2009, a year following the global financial crisis. Companies' increasing awareness toward capital efficiency, together with business slowdown due to COVID-19, prompted more companies to sell off their businesses.

In 2020, there were many business restructurings by companies that had tough time in the global pandemic, aiming to improve their business performance. An M&A broker points out "Since September 2020, a number of companies have sold off businesses that went south due to spread of the coronavirus".

In addition to the effect of the new coronavirus, penetration of the corporate governance reform has been urging companies, mainly manufacturers, to sell off noncore businesses to improve capital efficiency.

Japanese companies have been said to be negative to sell their businesses in comparison with U.S. companies, and this was partly because many companies prioritized diversification of business risks. Insufficient involvement in corporate governance, such as being too much attentive to their internal advisors and delays in introducing outside directors, sacrificed

their capital efficiency. The establishment of the Corporate Governance Code in 2015 urged companies to improve capital efficiency, and that led some companies to sell off their non-core businesses. Those companies improved their capital efficiency by checking profitability of each business through management indicators such as ROIC (return on invested capital), such as selling low-profit businesses while investing more in businesses looking promising.

In 2009, most of sell-off of businesses were due to drop in business performance, but this time, there are many cases due to increased awareness of corporate governance. The total amount of sales is getting bigger as some companies sell off “high-performing” businesses.

More deals are coming up because buyers are also active. Central banks in the major developed countries in the world keep on easing their monetary policies on a large scale and abundant funds are in the market. There have been a series of large-scale acquisitions by investment funds. The total amount of acquisitions by investment companies increased 7.4 times, from about JPY 60 billion in 2009 to JPY 440 billion in 2020. Business sales are expected to remain active in 2021.

Information compiled from Nikkei Shimbun & Mizuho research

4. Subordinated bonds are booming under the low interest rate environment

The issuance of subordinated bonds, which are debt but have characteristics of equity, is increasing significantly, reports Nikkei Shimbun, Japan’s leading financial daily. "The yield spread between government bonds and corporate bonds has been narrowing, and we have to take risks that do not exist in JGBs and corporate bonds to benefit from the yield spread", laments a fund manager of a life insurer considering to buy subordinated bonds. From October to December in 2020, the issued amount of subordinate bonds reached JPY 838 billion, which was the record high for a quarter, increasing by 84% from the same period of the previous year. Since the beginning of 2021, issuance of those bonds stays at high level.

The background of the increase of issuances is drop of yields of corporate bonds in general. The spread of corporate bonds rated “A” by QUICK with duration of 7 to 12 years is 0.43% at present, which is the low level for the first time in 2 years. The spread widened for a while due to the global pandemic, but it rapidly narrowed as credit uncertainty had faded.

The increase of issuance of subordinated bonds appears to be a "blessed rain" in a current situation where everybody has difficulties in finding attractive investment instruments. Subordinated bonds, enable issuers to raise funds with less damages to their financial statements than other instruments due to their feature, so they have to pay higher funding cost compared to normal corporate bonds. On the other hand, it is said that investors can earn yields two levels higher than that of the company’s corporate credit rating.

But not only good things for investors. Many investors mention uncertainty of early redemption as a risk associated with subordinated bonds. Subordinated bonds are usually issued as super-long-term bonds with maturities of 30 or 60 years, but it is an implicit rule that they are redeemed in advance at the first call date, the timing determined at the time of issuance.

An investment manager at a life insurer says “Many people in the market seem to recognize that it is virtually a medium-term note because of the first call, although it is 60 year bond in reality. But I don't know if we may really accept that risk." Although the bonds have incentives for issuing companies to carry out early redemption, such as interest rate going up after the first redemption date, it is up to the issuing company whether to actually carry out the early redemption. Issuing companies could postpone the redemption of bonds if they have any issues with cash flow or the market environment deteriorates.

Many market players do not anticipate a big collapse to happen any time soon in the market under the current excess liquidity, and do not expect the interest rate to rise for now. They seem to believe reaching out for subordinated bonds is the breakthrough at the moment by being lenient to potential risks that are associated with subordinated bonds, in order to get a certain investment return, even though it could be just a little one. The current surge in demand for subordinated bonds may be just a side effect of the extreme easy monetary policy under the global pandemic.

Information compiled from Nikkei Shimbun & Mizuho research

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Mar-16	Human Creation Holdings	JP3794470009	M
Mar-16	WingArc1st	JP3154360006	T
Mar-18	i-plug	JP3104830009	M
Mar-19	Terminalcare Support Institute	JP3538730007	M
Mar-19	coconala	JP3297320008	M
Mar-24	Shikino High-Tech	JP3348850003	J
Mar-24	Sharing Innovations	JP3347180006	M
Mar-25	baby calendar	JP3835690003	M
Mar-25	G-NEXT	JP3386760007	M
Mar-26	e-LogiT	JP3130850005	J
Mar-26	Broad-Minded	JP3831510007	M

**Information compiled based on postings from the TSE (T), Mothers (M), NSE (N)、FSE (F), SSE (S) & JASDAQ (J), Tokyo Pro Market (P)*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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