Mizuho Custody Newsletter

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I. Market News

1. TSE's disclosure list kicks off the second phase of its reform

On January 15, Tokyo Stock Exchange (TSE) began publishing a list of companies that have presented their efforts enhance their management with awareness of capital costs and stock prices. The list is updated monthly and anyone can view it on the TSE's website. The companies on the list are attracting interest in the market. For investors, it could be a concise introduction of each company's capital strategy and their view on business development. At the same time, a company that is not included in the list could be recognized as one that is not publicly committed to such efforts.

There are many companies with a Price-to-Book Ratio (PBR) of less than x1 in the Tokyo stock market. TSE reveals that companies with ROE of less than 8% and a PBR below x1 account for about half in the Prime Market and about 60% in the Standard market, both in number. It was March 2023 when TSE had called on listed companies to disclose their efforts towards "management with awareness of capital costs and stock prices" in order to turn around the sluggish situation. The publication of the list is the second phase to enhance the effectiveness of their request. According to the TSE, 660 companies (40%) listed on the Prime Market and 191 companies (12%) listed on the Standard Market disclosed their improvement measures as of the end of 2023.

The list seems to have been well-received overseas as well. It was the last October TSE made an announcement in advance to publicize the list. A chief equity strategist of a major Japanese securities company, who was visiting investors in Europe at that time said "We didn't expect the TSE to go that far." He found local European investors seemed to have felt the same as he did on the announcement.

The TSE indicates companies as "disclosure in place" on the list, based on whether they include certain keyword ("Action to Implement Management That Is Conscious of Cost of Capital and Stock Price) in their corporate governance reports, and the exchange will compile additional statistics for those announced "disclosure under consideration".

Since the "request" by the TSE last spring, institutional investors have been sensing some changes going on at Japanese companies. The Head of Engagement at a foreign-based mutual fund company told that Japanese companies had been having more discussions on return on equity (ROE) and capital costs than ever, and now it was quite normal to do so at company board meetings. He seems to feel clearly that many more companies have been getting aware of the importance of this subject."

For example, a company that had disclosed only by aggregated figure, in which it put new businesses with growth potential and existing ones with lackluster performances together, changed its style and started to report meetings focusing on its growing new businesses. This represents that the company has made its business strategies clearer within, following a proposal by the aforementioned mutual fund company.

Current external business conditions also works in its favor. Over the past year, as the market has been getting optimistic about Japan's economy to get out of the deflation, companies' announcements of their measure to tackle TSE's requests have been clearly reflected on their share prices. The market has been reacting positively to clear and simple measures that help improve capital efficiency, such as share buybacks, prioritizing to return more to shareholders.

A market participant says "The TSE is getting straight into Japanese people's 'shame factor'." Some foreign investors interpret that this list will urge Japanese companies, which tend to move in unison with other companies, feeling it a "shame" to be left behind.

However, not everything is going well. "Companies and investors have difference in the points of the argument on enhancing company's value," "Management is unwilling to be involved." "Investors have insufficient management resources to keep the dialogue," "Investors do not come to us, in spite that we have a lot of things to communicate." – these are the voices from issuers, expressing their concerns in dealing with TSE's requests. The level of commitment of making efforts to the requests differ by companies. TSE plans to advice points to be noted by issuers and present examples that is suitable from investors' perspective.

Any companies can carry out share buybacks and dividend increases as long as they make financial decisions. The Chief Investment Officer (CIO) of a bank for agricultural finance says, "These measures are taken at the first phase. After that, companies enter into substantial discussions how they could strengthen the business, which is the second phase. The core issues of this phase are to enhance competitiveness, which could eventually improve sustainable corporate value". The TSE's request by using a plain figure PBR x1 may be the first phase, and if discussion would be deepened by the publication of the list, that may be the second phase. Whether Japanese stock markets could stay buoyant for long may depend on how issuers and investors could develop the dialogues into constructive and practical discussions and/or consultations.

Compiled from Nikkei Shimbun and Mizuho research.
Please visit the following website of TSE to retrieve the list of companies that have disclosed information regarding "Action to Implement Management That Is Conscious of Cost of Capital and Stock Price"
https://www.jpx.co.jp/english/equities/follow-up/02.html

2. TSE regains as the biggest exchange in Asia, surpassing Shanghai

The total market capitalization (in US dollar terms) of stocks listed on the Tokyo Stock Exchange (TSE) surpassed that of the Shanghai Stock Exchange on January 11. This marks the first time in about three and a half years that TSE has regained its top position in Asia. While foreign investors take an optimistic view on the reform of Japanese companies, they are cautious about the economic climate of China. The outflow of money China to Japan led TSE to the premier position in Asian stock exchanges.

On January 11, the Nikkei Stock Average, the Nikkei 225, broke JPY 35,000 for the first time in 33 years and 11 months since February 1990. The total market capitalization of the TSE (combining Prime, Standard, and Growth markets) reached a record high of JPY 917 trillion. This equates to USD 6.32 trillion.

Among the Asian-based stock exchanges, the TSE exceeded Shanghai (USD 6.27 trillion), taking the top spot. The total market capitalization of entire Chinese stocks, including Shenzhen and Hong Kong, is still higher than that of whole Japanese stocks.

The total market capitalization of stocks in Japan and China has reflected differences in how foreign investors have been viewing the two countries in terms of expectations toward economic growth. In 2007, a year before the global financial crisis, the total market capitalization of Chinese stock exchanges, including Shenzhen and Hong Kong, surpassed that of Japan for the first time in history, which is believed to have been a sign that Japan would be overtaken by China in terms of nominal GDP in 2010.

Western investors became keen on taking more Chinese exposure in their investment in stocks, attracted by high growth potential. The Chinese government also gradually relaxed restrictions on foreign investors, allowing more capital to enter mainland Chinese markets such as Shanghai via Hong Kong from overseas. At that time, many of them sold Japanese stocks to buy more Chinese stocks.

Western securities firms and asset management companies hired more experts on Chinese stocks. On the other hand, Japanese stocks were gradually pushed out of their portfolio due to their lower returns than those of Chinese shares. Some market participant said " the less we have specialists of Japanese stocks, the more difficult it became to buy them."

The tide of "Go for China over Japan" is now changing. China's Shanghai Composite Index has been on a downtrend since mid-2023 and dropped to its lowest level since its record low May 2020, on January 10, 2024. One of the catalysts of the downtrend is believed to be the governmental intervention on private companies.

At the end of 2023, foreign investors must have refreshed their views on risks in investing in China. Some gaming-related stocks plummeted following the governments' announcement of plans to tighten online gaming regulations. Investors have been significantly losing confidence in Chinese markets, where a whim of the authorities may drastically change business environment.

Investors have also been concerned about the long-lasting real estate slump. There is a view that China may be trapped into a "balance sheet recession", where corporations and households curb investment and consumption to prioritize debt repayment. "Balance sheet recession" is coined by a chief economist at a major research institution, describing the Japanese economy in the 1990s.

Foreign investors are beginning to review their investment strategy for China. Looking at the Stock Connect, which reflects foreign trading of mainland Chinese stocks via Hong Kong, net sales in August 2023 reached CNY 89.6 billion (approximately JPY 1.84 trillion or USD 12.7 billion) - the highest monthly amount since the system started operation in 2014. Net selling has continued since August 2023, with net sales of CNY 9.1 billion (approximately JPY 186.5 billion or USD 1.29 billion) of January 10, 2024.

Investors seem to look at Japan, which they had been shying away due to its stagnant economy and market, as an alternative market to China. An executive officer at a major securities firm said, "Many investors still believe that China has a lot of economic and social issues to be resolved, which would continue to prompt more funds to flow into Japanese stock market." Furthermore, an expert fund manager at a major asset management company revealed that "Middle Eastern funds have started liquidating its excessive financial assets in China and transferred a part of funds to Japanese stock futures."

Investors in mainland China are also getting interested in Japanese stocks. On January 11, the trading volume of the "China AMC Nomura Nikkei 225" exchange-traded fund (ETF) traded in Shanghai market exceeded 10 times of the daily average transaction volume in 2023. The fact may imply that some Chinese investors could be shifting some of their money to Japanese stocks, trying to get away from their dismal local stock markets.

The TSE's strong initiative to promote market reforms also plays an important role to revitalize Japanese stock markets. Many companies have getting more aware of capital costs and stock prices for management. From January 25, the TSE has taken further steps to disclose each company's progress on this subject. TSE aims to attract more foreign investors by demonstrating companies' efforts to improve capital efficiency to public. If that could make Japanese stock markets look more attractive as a "new destination" of the money that is leaving China, that would further support the uptrend in the Japanese market.

Compiled from Nikkei Shimbun and Mizuho research.

3. Activist shareholders tripled in the past 5 years

Vocal shareholders, so called "activists", are increasing in number in Japan. In 2023, the number peaked at 70, three times more than it was five years ago. As issuers' management are now looking more at improving PBR to attract investors, more new activists entered into the market prioritizing to enhance the investee's corporate value. The thing is how issuers could present and demonstrate various issues such as business strategy, how they could contribute to the society through the dialogues with investors, and how well the issuers could allure them to but their shares.

Since January 15th, Tokyo Stock Exchange (TSE) has been presenting a list of companies that disclose their efforts towards "management conscious of capital cost and stock price". In this regard, TSE could also be seen as a mild activist. In the stock market, it is anticipated that activists become more vocal, which would make dialogues with some companies into active debates.

According to an IR research company, 23 activist funds were known to hold shares in Japanese companies in 2018, which turned out to have jumped up to 70 in 2023. It was only 8 in 2014. The introduction of the Corporate Governance Code in 2015, the market reorganization at TSE in 2022, and TSE's requests to improve the PBR by the TSE in 2023 seems to explain the recent rapid increase of activist funds in the market, aiming at better returns.

Activist funds from Hong Kong has been outstanding among foreign investors. Among the large-shareholding reports submitted in 2023, about 20 of the reports were for changing their ownership ratio to more than the threshold (5% for the total ownership and 1% for change) of their holding. For example, when an activist fund increased their holdings of a drugstore chain to above 12% last May, the fund was said to have submitted shareholder's proposals for business restructuring, and nomination of directors. Although the proposals were rejected, the drugstore's current stock price is over 40% higher than it was at the end of April, seemingly due to still existing expectations for restructuring.

An activist fund from the US also proposed to a major retailer to sell off its unprofitable businesses and requested to accept directors from the fund. As a result, the proposals were rejected at the AGM in May. However, it is worth noting that the proposals touched upon not only immediate measures such as dividend increase, but also put the issuer's growth strategy on the table. The fund also acquired share of a medical device company in December, which pushed up its share price on expectations toward better management.

A major construction company received a shareholder proposal from a French fund to buy back its own shares. The proposal was rejected at the AGM in June, but the company stated in a press release at the end of November that their "explanation to investors was insufficient about its PBR was below x1," and announced their counter measures such as conducting more than 60 face-to-face meetings with investors in a year.

According to a journalist of a Japanese newspaper, some South Korean activist funds have been approaching the publisher for the recent TSE's initiatives. In recent years, South Korea has become one of the countries in Asia where activist funds have been springing up like a mushroom. It is quite logical for investors in South Korea to be interested in the Japanese market currently booming. With regard to the TSE's efforts, a South Korean asset management company highly commends that "nowhere else in the world a stock exchange has been taking initiative for corporate reform as TSE has".

"Company executives have become more aware of capital efficiency and more willing to engage in a dialogue," emphasizes the CEO of a British activist fund. The president of a foreign investment advisory company says, "There are more companies keen to learn about ways for improving PBR, which enhances the quality of dialogues.

How activist funds approach issuers has also changed. When the activist funds started approaching to Japanese issuers in the 2000s, some of them took hardline approaches such as "hostile" tender offers (TOBs). A remark made by a US activist fund in 2007 "We came to enlighten Japanese executives" is still believed to represent their real intention at that time. They were dubbed as "vultures" for buying companies in financial difficulties at an extraordinary low price to gain profits. These days, according to a partner of a major audit firm, "those funds have altered their heavy-handed approach and are making proposals to gain supports from other investors."

Although companies and investors often confront each other, the president of an IR consulting company says, "It's logical that the timeframe and priorities for management differ between the two parties. More companies have been engaged in logical verification towards improving corporate value through dialogues."

According to a financial information service company, about 60% of listed companies (about 4000 companies in total) in Japan currently have a PBR at or above x1. The uptrend has been continuing since the end of 2022 (under 50%), and their serious efforts to improve corporate value seems to be bearing fruit. Even after 2024, more and more issues are likely to be targeted by activist funds, including mild ones. If companies could take those opportunities for their growth in future, the current boost in Japanese stock markets would be recognized just as a beginning in a few years.

Compiled from Nikkei Shimbun, and Mizuho research.

4. Proxy advisory firms announce revisions to policies for Japan

The Japanese stock market saw "activist" shareholders got more vocal than ever in 2023. The number of shareholder proposals at Annual General Shareholder's Meetings ("AGM") in June (companies with fiscal year end in March) reached 344, was highest than ever. Many shareholders encouraged issuers to take measures to improve capital efficiency in line with the Tokyo Stock Exchange's (TSE) call for "management with high awareness of capital cost and stock prices". In 2024, it is anticipated that more and more shareholders would submit the proposals, to which companies would have to work hard to show them the way.

Institutional investors are particularly interested in how issuers would strengthen corporate governances. The proportion of governance-related proposals by institutional investors at AGMs in 2023 increased to 55% from 32% in the previous year. Among proposals from shareholders, ones to hire more directors from outside and ones to introduce stock compensation plans were found more than in the past.

A partner at a major audit firm says, "Even more shareholders would submit proposals at AGMs next year, judging from dialogues going on between management and shareholders behind closed doors." As cross-shareholdings are being unwound more investors that are more conscious of a price rise of their stock holdings, such as funds, are enhancing their presence as shareholders.

Two major American proxy advisory firms have revised their advisory policies for the AGMs in 2024. The revisions appear to prompt opposing votes from shareholders, so issuers are concerned that foreign investors, who often use these proxy advisory firms, will cast more opposing votes on resolutions for the reappointment of their top executives and other directors. Thus, Japanese listed companies would have to make more efforts to interact more closely with investors to obtain support from them on the agenda at the AGMs.

A proxy advisory company had maintained an exceptional measure in relation to gender of directors that even if there were no directors of diverse genders accounting for 10% or more in the board of directors of Prime-listed companies, they would refrain from recommending opposition if the company disclosed improvement plans and so on. However, they will abolish this exception for shareholder meetings held after February 2024. They will recommend opposing the election of the chairperson of the board of directors or the chairperson of the nomination committee of companies that do not meet the criteria. They have also announced that they will raise the gender criterion itself to more than 20% for after February 2026.

According to the Cabinet Office, the female directors ratio at companies listed on the Prime market was 13.4% as of July 2023. In contrast, the average female directors ratio at companies of the G7 countries excluding Japan was 38.8%, showing a long way to go. In June 2023, the Government of Japan revealed a core policy for gender equality and the participation and advancement of women in social activities, setting a goal to raise the female directors' ratio in companies listed on the Prime market to 30% by 2030. The government made an additional announcement of the interim target of "19% by 2025" at the end of 2023.

A proxy advisory firm announced that it would revive a standard on Return on Equity (ROE), which it had suspended due to the global pandemic. The firm would recommend to oppose resolution for reappointment of the top management director unless the issuer would meet the standard level. This standard will be applicable at AGMs to be held in and after February 2024.

Under the standard the firm is reviving, it would recommend to oppose reappointment proposal of the top management director, in principle, if the company's average ROE in the past five terms was below 5%, and the ROE of the most recent fiscal year was also less than 5%. The company had suspended the ROE standard since June 2020, taking deterioration of corporate performance due to COVID-19 into account, but the standard will resume as the pandemic has subsided. According to the firm's survey, 77% of the investors surveyed (184 entities) supported the revival of the ROE standard. "We see Japanese companies have generally been performing better, reflected by the fact that the median ROE for the fiscal year ending March 2023 improved to 6.8%," says the firm.

Compiled from Nikkei Shimbun and Mizuho research.

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Dec-22	Human Technologies, Inc.	JP3794460000	G
Dec-25	ASNOVA Co., Ltd.	JP3119850000	G
Dec-25	Nalnet Communications Inc.	JP3651950002	G
Dec-27	Yutori, Inc.	JP3949300002	G
Jan-25	RAVIPA Ltd.	JP3966900007	P
Jan-30	IN Holdings Co., Ltd.	JP3100670003	P
Feb-7	SOLIZE Corporation	JP3436230001	S
Feb-8	Veritas In Silico Inc.	JP3155340007	G
Feb-9	CCN Group Corporation	JP3346940004	P
Feb-22	VRAIN Solution, Inc.	JP3159870009	G
Feb-28	Hikari Food Service Co., Ltd.	JP3783410008	G
Feb-28	Cocolive, Inc.	JP3297390001	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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