Mizuho Custody Newsletter

July 2021 | Japan

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I. Market News

1. Companies being urged to comply with the revised Corporate Governance Code

Major companies are being urged to comply with the Corporate Governance Code ("Code") revised in June. Only 21.6% of the respondents of a research meet all the principles of the Code, reports Nikkei Shimbun, Japan's leading financial daily.

The item that has progressed is to increase the ratio of independent outside directors. In the "Prime Market", which will become the most superior market where more than 90% of the respondents want to list, the number of independent external directors will be raised to 1/3 or more. 94% of the companies meet this requirement, and over 20% of these companies have more than 1/2 of their directors appointed from outside.

On the other hand, what is falling behind is the creation of a "skill matrix" which lists the experience and capabilities of board members. 31.6% of the respondents have yet to prepare. The skill matrix is believed to be beneficial for the diversity of executives, including the effective use of foreigners.

Besides, 18.4% answered that they did not meet the criteria for diversity. 16.3% of the respondents said they have not yet dealt with the provisions on environmental issues such as climate change, and 13.3% said they have not yet dealt with the item to promote the use of intellectual property.

President & CEO of a chemical products manufacturer said "Ensuring diversity and enabling important decision-making, and demonstrating functions such as effective supervision will become more important." In addition to just meeting the criteria of the revised Code, establishing and operating a governance system that will actually work for the improvement of corporate value will be a next challenge.

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange & Mizuho research

2. TSE drawing attention from start-up companies in Asia

More and more foreign companies are getting interested in listing on the Tokyo Stock Exchange ("TSE"). On 29 June, an Asian company listed on the TSE for the first time in the form of Japan Depository Receipt ("JDR"), in which overseas stocks are treated as domestic stocks. More than 30 overseas companies are considering to use this structure, according to Nikkei Shimbun, Japan's leading financial daily. With start-up companies emerging in Southeast Asia, TSE is becoming a practical option for the companies in the region, considering Hong Kong's political instability and physical distance to the U.S. This trend may accelerate the government's plan to create an international financial center.

On 29 June, a Singaporean company was listed on the TSE Mothers market, under the structure of JDR, which treats overseas stocks as domestic stocks. The company manufactures and sells plastics for home appliances and automobiles, and has its business facilities in Southeast Asia and Japan. This is the second foreign company listed JDR since a U.S. firm's JDR listing in 2017. This is the first JDR listing by an Asian company.

JDR is a mechanism in which a foreign company issues securities in Japan against their original shares as underlying shares. JDRs are treated as domestic stocks, even issued by foreign companies. Some Japanese companies are listed on the U.S. market through American Depositary Receipt (ADR). This time, a Singapore-based company has listed on the TSE in a similar fashion.

Major advantage of JDRs is enhancement of liquidity in the stock market. Under the trading system currently used by the securities firms, when a foreign company lists its shares directly on the TSE, it is regarded as foreign stocks, and investors are required to open a foreign securities trading account. JDRs can be traded in the same account as Japanese stocks and they can be used for margin trading.

For Asian start-up companies, TSE has become an appropriate receptacle. The Hong Kong market, which is a financial center in Asia, has become politically unstable, and the Singapore market has fewer individual investors than in Japan. Companies may demonstrate its presence in Japan even if it doesn't reach the U.S. market where the listing of “Unicorns”, a huge privately held company worth more than USD 1 billion, attracts market’s attention.

In particular, increasing number of foreign companies are seeking to list on the TSE Mothers market, where individual investors are actively trading. Comparing the trading value of stocks in 2020 among the start-up markets of major Asian stock exchanges, TSE Mothers market recorded about JPY 44 trillion in transaction volume, which is much larger than in Hong Kong and Singapore, with about JPY 1 trillion respectively.

A trust bank which has been providing listing support since the establishment of the JDR structure, is currently receiving consultations from more than 30 overseas companies. "More companies in Asia such as in Singapore and Taiwan are getting interested," says a general manager at the trust bank.

The reason behind the growing interest among Asian companies to the TSE is Japanese venture capital firms’ increasing investment in Asian start-up companies, which lead to more contacts with Japanese investment experts. Increasing number of successful IPO cases of start-ups have made IPOs a viable option for founders to sell their shares, in addition to acquisitions by companies and investors.

Looking at global equities markets, the TSE Mothers market has companies with high average PER, which is attractive for the companies as they can earn good reputation through their listing. Listing on the market in Tokyo appears to be a realistic option for companies considering capital and strategic alliances with Japanese companies, and for Asian companies considering to raise funds in Japan where interest rates are low.

A managing director of a venture capital firm investing in Southeast Asian and Indian companies says "The first JDR deal by an Asian company may accelerate other Asian companies’ listing on the TSE.”

TSE has also been trying to attract foreign companies by promoting cross-border listing. There are routes available for them other than JDR, such as a Taiwanese start-up company that acquired Japanese nationality and listed directly on the TSE Mothers market in March.

Foreign companies listed on the TSE has been decreasing, and as of the end of 2020, only 4 remain listed on the TSE. That accounts for 0.1% of the total companies listed, which is significantly different from the other major Asian markets such as Singapore (34%) and Hong Kong (7%). In order to enhance Tokyo's presence as an “international financial city”, attracting foreign companies will be an indispensable piece.

TSE learned a lesson from an experience in the past in attracting foreign companies, that the first company from mainland China directly listed in Japan was delisted in 2008 after revelations of misappropriation of funds by its top management.

Foreign companies listed under the JDR structure are required to disclose information at the same level as the Japanese companies. In addition to financial statements written in Japanese, it is necessary to submit a governance report that complies with the corporate governance code.

TSE official says, "We are also encouraging foreign companies to deploy Japanese-speaking investor relations officers." It is essential for foreign companies to ensure governance, and to have a system to ensure transparency of information

disclosure and investor protection.

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange & Mizuho research

3. TSE notifies 664 companies that have yet to meet the criteria of the Prime Market

Tokyo Stock Exchange ("TSE"), which is scheduled to reorganize its stock markets in April 2022, notified the listed companies of the results whether they meet the criteria for the new market category on July 9, reported Nikkei Shimbun, Japan's leading financial daily. As of June end, of the 2,191 companies listed on the 1st Section of the TSE, 664 companies, or about 30%, did not meet the criteria of the "Prime Market", which will become the most prestigious market. But they can be listed on the "Prime Market" for the time being if they disclose a report describing improvement measures such as increasing market capitalization calculated in tradable shares in the market.

About 70%, or 1,527 companies, of the 1st Section of the TSE met the criteria of the "Prime Market". The TSE has tightened its listing requirements for the "Prime Market" to attract more investment from overseas. The requirements stipulate that market capitalization of tradable shares, excluding cross-shareholdings with banks and business partners, should be JPY 10 billion or more, or 35% or more of the total outstanding shares. As this notification is positioned as a first screening, companies can request for recalculation by submitting additional information if they have any objections.

About 30% of the companies listed on the 1st Section of the TSE, or 664 companies, will not be able to move into the "Prime Market" which will be launched in April 2022, if nothing is done. With nine months to go, more and more companies are coming up with capital policies in order to meet the "Prime Market" criteria.

"Prime Market" is positioned as a market for large companies that attracts many overseas investors. Therefore, it has set strict standards on the ratio of tradable shares and market capitalization.

Sales by major shareholders is a prominent measure to make the company a "Prime Market" player. A requirement for the transition from the 1st Section to the "Prime Market" is that a company should have 35% or more of their shares traded in the market. If major shareholders are fixed, the number of tradable shares decrease, so the company has to increase the ratio of tradable shares by having its founders to sell their shares.

Based on the TSE's calculation method, the cancellation of treasury stocks is also effective.

The "Prime Market" requires JPY 10 billion or more of market capitalization in tradable shares. It is stricter than the current standard of 1st Section of the TSE, which stipulates shares will be delisted if it becomes less than JPY 500 million in market capitalization. It will be effective for companies to come up with a growth strategy through shareholder returns and M&As in order to stay listed in the Prime Market.

From September to December this year, companies will begin the process of selecting the markets to move into. It can move to the "Prime Market" even if the criteria has not been met, but it requires to submit a plan to achieve the criteria, and more and more companies are likely to form plans to achieve it.

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange & Mizuho research

4. Domestic IPOs are at a high level with digitalization being a tailwind

Initial public offering ("IPO") of Japanese companies is gaining momentum. From January to June 2021, 53 companies went public, which is the largest number in 14 years since 2007 for the same period, reports Nikkei Shimbun, Japan's leading financial daily. Companies have progressed digitalization of their business operations due to the coronavirus outbreak, and it is clear that start-up companies with digitalization-related technologies and services are aiming to grow further. Excessive global liquidity is also being a tailwind for them.

Based on a research by an audit firm, total IPO cases increased by 19 companies from 34 companies in the first half of 2020, in the midst of the global pandemic. Looking at records after 2000 that were available for the research, it is the highest level since the first half of 2007, when 73 companies went public, and it is the record high after the global financial crisis in the fall of 2008.

The IPOs raised about JPY 89 billion, the largest amount in 7 years since the first half of 2014 (raising about JPY 170 billion). There was also a listing of “Unicorn”, an unlisted company with more than USD 1 billion (about JPY 110 billion) in corporate value.

In 2007, there were so many listings by real estate-related companies, which was called a "real estate mini-bubble," and a chief strategist at a local securities firm said, “Many IPOs were carried out for fundraising to buy land.”

On the other hand, in 2021, a leader of Investment Information Team at a securities firm said, "Many IT-related companies recognize the current trend of digitalization in the society as business opportunities and started offering services in this field."

As companies go digital, there has been growing demands for software-as-a-service (“SaaS”) that provide software on the cloud. Telecommunications sector, which includes many SaaS companies, accounted for 40% of all IPOs, or 21 companies, 20 percent up on a year-over-year basis.

Companies with appetite to raise funds in overseas markets have been also increasing. From January to June, this fund raising methods accounted for about 30% of the total, which is the highest pace in the past 30 years based on the records available. The amount of funds raised overseas, including the sales by the existing shareholders, was about JPY 138.1 billion, already exceeding the annual record in 2020 of about JPY 101.4 billion.

Some experts point out that changes in the funding environment for unlisted companies are behind the recent boom of IPOs. A partner of an accounting firm analyzes that entities suppling risk money, such as private equity (PE) funds and venture capital (VC) firms are increasing in number and driving this trend.

According to a U.S. research firm, investment in domestic start-up companies from January to March 2021 reached up to JPY 75 billion, more than doubled than what it was 5 years ago. Companies seems to be in a good environment where they can raise money for their future growth and aim for listing.

The number of IPOs in recent years has been around 90 for the year. "Although there were some concerns about economic stagnation after the Tokyo Olympics, IPOs seems to stay at a high level in 2022 and 2023," says a consultant who provides IPO supporting services.

On the other hand, individual investors are less willing to invest in start-ups. 49 companies’ opening prices had exceeded the IPO price in a row since December 2020, but that stopped on 22 June and there were cases opening prices were below the IPO price on 23rd and 24th. As future outlook still remains unclear due to the pandemic, it is also important for market participants to pay attention to changes in the appetite of companies going public.

Information compiled from Nikkei Shimbun & Mizuho research

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Aug-20	Future Link Network	JP3826240008	M
Aug-20	CNS	JP3347160008	M
Aug-24	TANGOYA	JP3472150006	J
Aug-27	J Frontier	JP3386650000	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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