Mizuho Custody Newsletter

November 2021 | Japan

Contents:

I. Market News

1. More local governments are issuing ESG bonds

There is a growing trend for local governments to issue municipal bonds with limited use on ESG (environment, social and governance) such as environment and social contribution, reports Nikkei Shimbun, Japan's leading financial daily. In FY2021, the number of issuers will increase to at least 7, from 3 in the previous fiscal year. ESG bonds are getting more attention in overseas markets particularly ones issued by central governments, but in Japan, local governments are going ahead of the central government in ESG bond issuances. The vehicle is becoming an effective funding scheme for local governments that are struggling with aging infrastructure.

In August, Kawasaki City issued green bonds, the first issuance by a government-ordinance designated city. With a maturity of 5 years and a coupon of 0.005%, conditions were almost the same as municipal bonds issued by other regular municipalities, but there were more than 13 times of bond purchase application from the investors for the issuing amount of JPY 5 billion. Funds will be used to rebuild the city hall that emit less greenhouse gases.

It is preferable for green bonds to obtain rating from rating agencies, and the city received the highest rating of "Green 1 (F)" from the Japan Credit Rating Agency, Ltd. (JCR). The person in charge at the city hopes that the issuance of the green bond will send a message to companies that the city is willing to work together on decarbonization.

Mie Prefectural Government and Fukuoka City also plan to issue environmental bonds by the end of this fiscal year. Mie Prefectural Government plans to raise around JPY 5 billion via 10 year bonds. In October, City of Kitakyushu issued "sustainability bonds" covering projects related to SDGs. They issued bonds in the amount of JPY 10 billion to finance the maintenance cost of special-needs schools, and there were more than 10 times of purchase application from institutional investors. The city set aside the bond in JPY 0.5 billion for individual investors, that were sold out in 4 business days.

ESG bonds are increasing their presence in government bonds markets, particularly in Europe. The European Union issued its first environmental bond in October. The issuance was EUR 12 billion and it will be used to help member countries tackle environmental and climate change issues. The U.K. also issued environmental bonds in September and October. It will be used for the development of environmentally friendly transportation systems.

According to a securities firm in Japan, total amount of ESG bonds issued by governmental bodies in the globe reached to USD 150 billion this year as of 17 October. It is 70% higher than the amount for the full year in 2020 and accounts for around 20% of the ESG bond issuance in the world, including ones issued by corporations.

In Japan, municipal bonds went ahead of the government bonds in ESG. The Tokyo Metropolitan Government issued environmental bonds for the first time in FY2017, followed by Nagano Prefectural

Government and Kanagawa Prefectural Government in FY2020. The Government of Japan, which has not issued environmental bonds yet, is also interested in this trend. An official of the Ministry of Finance said at an advisory panel of experts in June on the environmental government bonds, "At present, we do not have an immediate plan to issue ESG bonds, but we will keep a close look on the developments in overseas."

Issuing ESG bonds requires a lot of works, such as acquiring a rating, but it is advantageous to obtain finance from a wide range of sources, to deal with issues such as aging public facilities and infrastructures which has become a major issue. An official at Mie Prefectural Government said, "It can attract investors, which is difficult to find under low interest rates conditions, with an added value of "environment"."

As institutional investors who are sensitive to customer needs have been getting more active in investing in ESG related projects, some local governments have decided to issue ESG bonds from a long-term perspective out of concern to lose investors' interest toward their bonds unless they increase the ratio of ESG-related bonds in their lineup.

The head of sustainability research center at a major research institute in Japan says "There have been pressure on more spending to deal with aging public facilities. We anticipate more municipal governments would issue ESG bonds for its stability as financial source."

Unlike ESG bonds with limited use, City of Kobe will issue all their JPY 150 billion municipal bonds in FY2021 as SDGs bonds. The city's medium-term vision in relation to the issuance of the bonds was evaluated by the Rating and Investment Information Center as "contributing to the achievement of SDGs." The 30 years bond in the amount of JPY 10 billion issued in September received 8 times as much purchase application, and the city plans to issue all municipal bonds as SDGs bonds until FY2025.

Information compiled from Nikkei Shimbun & Mizuho research

2. Improvement in ESG rating is drawing attention for the selection of issues

In the stock market, as a criterion for selection of issues, there is a growing trend to put more weight on the rate of change in ESG (environment, social and governance) rating, reports Nikkei Shimbun, Japan's leading financial daily. It is not just a matter of whether the rating is high or low, but the ability to detect the level of improvement ahead of other investors will pay off in the end. As ESG funds' balance in portfolios grows and the market gets more matured, investors also scrutinize issues to buy more closely.

According to the Japan Sustainable Investment Forum, net assets of publicly offered investment trust funds on socially responsible investment (SRI), which invest in domestic and foreign stocks and bonds, stood at JPY 2.95 trillion as of end of June 2021. It has increased rapidly in the last year. As the more investors have become ESG-conscious, the more apparent its impact on stock prices.

Chief quants analyst at a local securities firm has analyzed constituents of TOPIX 500 index by dividing them into 3 groups: those whose ESG rating turned better, worse or unchanged from a month ago. Getting better rating has rapidly become a strong factor to push up share prices in the past few years.

On the other hand, whether an issue's ESG rating is high or low does not make differences in stock prices. Well-known high rating of an issue in the market is usually deemed to have been discounted, and investors look for other issues with further growth potential. The chief quants analyst said, "Both companies and investors were less responsive to ESG ratings than those in the Western market in the past, but they have been becoming more ESG conscious in the wake of the global pandemic." The concept of ESG could become more influential to the stock market in Japan.

More asset managers started using the above-mentioned analysis to their investment strategies. General Manager of investment strategy department at a local asset management company said, "Improvement in ESG rating is a sign that companies are changing. It may eventually be reflected to corporate value."

Japan equity ESG fund, established by another local asset management company decides which issues to

invest in by comparing the evaluation of the companies based on disclosure information with that of its internal analysts.

Innumerable investors look for signs of changes of the companies in the market, and positive factors such as business performance expansion and analysts' investment decisions are instantly factored into the stock price. ESG evaluation, like the various traditional evaluation standards, is becoming an indicator for a wide range of investors to dig out promising issues in order to stay competitive in the market.

Information compiled from Nikkei Shimbun & Mizuho research

3. Net profit of the listed companies in April-September 2021, and forecasts 48% growth for the full fiscal year

For the financial results of listed companies for April-September 2021, their aggregated net profit amount doubled from the same period a year earlier, setting a new record for the same period, reports Nikkei Shimbun, Japan's leading financial daily. Although companies dependent on domestic demands had tough time due to the impact of the prolonged pandemic, manufacturers, such as automobiles and electrical machinery industries, recovered sharply owing to strong demands from overseas, and the profit margins of non-ferrous metals companies, trading companies and shipping companies also widened due to tight supply and demand and soaring resource prices. Net profit margin also hit the record high for April-September period.

Nikkei Shimbun has analyzed financial results of 1,689 companies (excluding start-up markets and parent-child listed subsidiaries) as of 15 November. Aggregated net profit of all industries was JPY 20.2 trillion, 20% up from April-September 2019 before the global pandemic. In April-September period, after 2008 when issuers were newly obligated to disclose financial status every quarter, it was the highest in the past 3 years. Net profit margin improved by 3 points to 6.8%, which exceeded 6.1% that was marked in April-September 2018.

By the industries, the bottom line improved in 30 industries out of the 36, excluding the 6 industries such as telecommunications and constructions which enjoyed demands from the Olympics-related businesses. Companies operating in the red was accounted for 12.0% (203 companies), 15.9 points down from the previous year.

It was manufacturers that boosted the overall earnings. Aggregated net profit of 17 industries turned out approximately JPY 10 trillion, which is 3.4 times of the previous year. Automobiles and parts industry saw the biggest improvement, adding profits of around JPY 2.4 trillion.

The sales recovery in automobile industry gave a positive impact to steel, electrical machinery and chemical industries, which supply parts and materials to carmakers. In the steel industry, net profit improved around JPY 830 billion, from the deficit of JPY 280 billion in the same period a year earlier. Chief strategist at a securities firm said, "Companies' cost-cutting efforts made in the global pandemic ended up in boosting profits."

In addition to the recovery of demand for raw materials, their price rise in the market gave it a big boost. Three months futures contract at the London Metal Exchange (LME), which is the international benchmark for copper prices, averaged about USD 9,550 per ton from April to September, 60% up from the same period a year earlier. Middle Eastern Dubai crude oil, which has been the benchmark in the Asian region, was around USD 69 per barrel, nearly 90% up. Non-ferrous metal industry's net profit increased by 12 times to JPY 445.1 billion. Oil industry's net profit recorded 40 fold increase, due to gain in inventory valuation based on crude oil price-hike.

In the non-manufacturing industry, the shipping companies made a significant improvement, earning JPY 952 billion, 14 fold of the previous year. Distribution of goods became more active than before due to continuation of strong consumption from staying at home and recovery in production, and the industry got benefit from surge in container shipping prices. Rationalization of their business structure such as reducing ships that were redundant by the integration of container shipping businesses also played a role. Net profit of the service industry also rose 78% due to strong demand for digital services such as digital transformation and e-commerce, which invigorated system development and online advertisement.

On the other hand, railway, bus and aviation industry, with weak demand from passengers, have been slow to recover due to the lingering effects of the pandemic in Japan.

Even in the industries whose financial results appear to be improving, leisure and restaurant industries still remain sluggish. But some companies in the industries show improvement in their profitability thanks to local governments' provision of subsidies for their acceptance of shorter business hours.

For the full fiscal year ending March 2022, net profits of listed companies are expected to rise by 48% to JPY 26.65 trillion, in comparison with those of the previous fiscal year. As of mid-August 2021, when companies announced their financial results for the April-June quarter of 2021, it was expected to grow by 36%, but due to uptrend in the market, many shipping companies and trading companies revised their earnings forecast upwards, that brought them more profit.

The above mentioned forecast is based on figures disclosed by 1,548 companies that announced their full-year forecasts for FY2022. Companies that do not disclose their forecasts are not included in the figures.

Since October, one out of three companies made upward adjustments to the full-year earnings forecast to the previous one. In terms of the number of companies, 32% of manufacturing companies and 24% of non-manufacturing companies made upward adjustments.

On the other hand, concerns over inflation, particularly in the U.S. are rising, and delays in passing on higher costs due to oil price-hike, etc. to sales prices and stagnant demand may give negative impacts on corporate business performance in the second half of the year.

Information compiled from Nikkei Shimbun & Mizuho research

4. Investors are expecting more on the outside directors' efforts, according to a survey

According to a survey by a trust bank, investors have been dissatisfied with efforts by the outside directors, reports Nikkei Shimbun, Japan's leading financial daily. While independent outside directors make up one third or more of the boards at around 60% of the listed companies, they have been deemed to fail to meet investors' expectations through the appointment of a successor of CEO and dialogue with the market. The market is now asking the companies if their corporate governance actually works, rather than looking at if the companies meet the formality.

The survey was conducted on domestic listed companies and major domestic and foreign institutional investors in July and August. 1,787 companies and 41 institutional investors responded to the questionnaire.

The Prime Market, which will be launched in April 2022 as a result of the restructuring of the Tokyo Stock Exchange, requires the companies listing to the market to have one third or more outside directors in the board of directors. According to the survey by the trust bank, 63% of the companies already meet this criteria. If it includes the companies that intend to raise the ratio of the outside directors to one third or more, it will reach 79% of the total.

Being asked what role they expect for the outside directors to play, 84% of the investors answered "dialogues with shareholders and investors", however only 15% of the issuing companies made the same answer to the question. While outside directors of some companies hold interviews with investors and attend corporate presentations on IR, the survey result appears to show that such efforts are currently insufficient.

As for the activities of the outside directors, while 87% of the investors requested issuing companies to disclose details of specific activities of their outside directors, only 42% of the issuing companies actually made such disclosure.

The survey result also shows that outside directors' involvement in succession planning of the CEOs is also insufficient. While 80% of the investors expect the outside directors to be involved in succession planning, only 35% of issuing companies anticipate their outside directors to get involved in succession planning. In spite that 69% of the investors also expect the outside directors to be involved in the discussions on sustainability and ESG (environment, social and governance), companies considering that the outside directors should be involved in such discussions were

only 42%.

The general manager of the governance consulting department of the trust bank that conducted the survey pointed out that issuing companies were now in the stage to review roles of their outside directors and the way they should be from the one where they had been just looking at meeting numerical requirement for outside directors they have to appoint for the sake of formality.

Information compiled from Nikkei Shimbun & Mizuho research

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Dec-02	NOMURA	JP3762450009	J
Dec-10	FLECT	JP3828970008	M
Dec-15	Net Protections Holdings	JP3758270007	T
Dec-16	True Data	JP3620900005	M
Dec-16	BROAD ENTERPRISE	JP3831520006	M
Dec-20	HYUGA PRIMARY CARE	JP3794570006	M
Dec-20	Japan Data Science Consortium	JP3386800001	M
Dec-20	Global Security Experts	JP3274390008	M
Dec-21	YCP Holdings (Global)	JP5702100008	M
Dec-21	Lovable Marketing Group	JP3968070007	M
Dec-21	KOHOKU KOGYO	JP3302100007	T
Dec-21	LIFEDRINK COMPANY	JP3966680005	T
Dec-22	Renewable Japan	JP3974580007	M
Dec-22	Succeed	JP3316900004	M
Dec-22	Finatext Holdings	JP3803110000	M
Dec-22	AMIYA	JP3124490008	M
Dec-22	CYND	JP3312160009	M
Dec-22	THECOO	JP3345710002	M
Dec-23	ZEALS	JP3386810000	M
Dec-23	Croooober	JP3270880002	J
Dec-23	Hybrid Technologies	JP3765230002	M
Dec-23	ExaWizards	JP3161330000	M
Dec-23	SANWAYUKA INDUSTRY	JP3345520005	J / N
Dec-24	TAKAYOSHI	JP3458600008	M
Dec-24	CS-C.	JP3346530003	M

Dec-24	Green Earth Institute	JP3274120009	M
Dec-24	f-code	JP3166890008	M
Dec-24	SUSMED	JP3319150003	M
Dec-24	NIFTY Lifestyle	JP3756210005	M
Dec-24	Choei	JP3527450005	T
Dec-27	SECURE	JP3420920005	M
Dec-27	AsiaQuest	JP3118700008	M
Dec-29	Institution for a Global Society	JP3152640003	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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