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I. Market News

1. 177 companies left TSE Prime market for the Standard market on Oct 20

The Tokyo Stock Exchange (TSE) announced on October 13 that 177 of the companies listed on its top-tier Prime Market had moved to its second-tier Standard Market using the special measure that did not require applicants any transfer examinations. Shares of the 177 companies have been traded on the Standard Market since October 20.

The TSE restructured its markets in April 2022, and the top-tier Prime Market has had stricter listing standards than those of major foreign stock exchanges. Among 2,200 companies listed on the former TSE Section 1 Market, 338 selected the second-tier Standard Market rather than staying listed on the Prime Market at the time of implementation of the restructuring. However, 296 companies that moved into the Prime Market from the former TSE Section 1 Market, failed to meet the Prime Market listing criteria such as the market capitalization of the tradable shares and tradable share ratio at the time of the implementation of the new market segment. These companies were allowed to move to the Prime Market by submitting a report describing how they would meet the listing requirement in future, which has been called "transitional measure". In April 2023, TSE instituted a special measure for Prime listed companies that have yet to meet the criteria of the Prime Market to move to the Standard Market without transfer examination. The deadline for filing applications for the transfer was September 29. As a result, 177 companies filed the applications for transfer to the Standard Market, which led 515 companies out of 2,200 companies that used to be listed on the former TSE Section 1 Market to the Standard Market.

A market participant says, "It looks to me that more companies have chosen the Standard Market than I had assumed." Some companies prioritize their future growth and business investment rather than maintaining their status of "a company listed on the top-tier market at TSE". This represents the Prime Market, which had been dubbed as "the premier market in name only", is actually getting more selective.

Compared to those of some overseas stock exchanges, the TSE Prime Market has the strictest listing standards. It requires listed companies to have a market capitalization of 10 billion yen (circa $86 million) for tradable shares, while NASDAQ Global Select requires 5.2 billion yen (circa $45 million). To prevent stable shareholders from occupying the voting rights required for special resolutions at shareholders' meetings (2/3 or more of the voting rights of the attending shareholders), the market requires the ratio of tradable shares should be 35% or more. At a major stock exchange in Asia, this ratio has to be 12 ~25%.

Japan Exchange Group (JPX) CEO Hiromi Yamamichi said at a press conference on September 27, "The situation represents each company selected the best market for it to achieve sustainable growth." He also mentioned to start studies to introduce higher listing standards for companies to stay in the Prime Market.

Nikkei Shimbun, Japan's leading financial daily, researched stock prices of 170 companies that moved to Standard Market via the special measure and

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announced how the prices moved after the announcement of the shift. 66% of the companies' stock prices dropped. Since the Prime Market has strict listing standards, some investors were anxious that those moving to the Standard Market could make less efforts to raise corporate value than they do now. However, 34% of companies saw their shares rise after the announcement. Investors appreciated those companies' investment strategies for growth, business restructuring and their positive stances of making more returns to shareholders. Although these companies have "given up" the Prime Market, some of those "dropouts" have been well-received in the market because the decision made those dropouts' business strategy and thoughts clear to the market.

A payment system developer which announced to move to the Standard Market explained they will use the costs which they could save instead of meeting the Prime Market criteria to strengthen their businesses and invest in growth. The member of the company says "Focusing on business expansion will lead us to increase our corporate value, rather than using resources merely to maintain the listing on the Prime Market". The company's decision was well received by the market, which pushed up their shares by 3.5% after the announcement.

Shares of a beauty products manufacturer jumped up by 4% after announcing the decision to shift to the Standard Market. Although it had some options such as temporary raise of its dividend payout ratio to improve its market capitalization of the tradable shares if it wanted to stay in the Prime Market, it announced a plan to spend money to strengthen its OEM business and to treat its employees better. These actions reflect the company's determination to focus on its core business to grow further, not by relying on measures mainly focusing on making their share prices to go up. The market appears to have taken the determination very positive.

Companies that decided to move to the Standard Market due to spin-off also received buys in hopes of concentrating its resource and getting free from conglomerate discounts. An e-commerce company spinning off their subsidiary rose by 10%, while a major company providing peripheral devices of PCs went up by 3% after announcing to spin off its non-core business subsidiary.

TSE requires Standard Market listed companies as well to operate under the mindset being conscious of capital costs and stock prices. "Whatever market you are in, managers of companies have to be capital-cost conscious." said an executive at an auto parts company that chose shifting to the Standard Market. Companies that selected to move to the Standard Market must carry out what they said as their reasons and aims of the re-selection of the market. Those thoughts and words should not end up as "empty slogans".

Compiled from Tokyo Stock Exchange, Nikkei Shimbun and Mizuho research.

2. TOBs and MBOs attracting issuers and markets

Tender offer bids (TOBs) for listed companies are taking place more often than ever. In the period from January to September 2023, there were 49 cases, the highest in the past 14 years. Investors are closely looking at investee companies' growth, due to the Tokyo Stock Exchange's (TSE's) market restructuring and the requests for improvement in PBR (price-to-book ratio) to companies listed on the exchange. Due to the release of the new guidelines for corporate acquisition by the Ministry of Economy, Trade and Industry (METI), "TOBs without consent" may take place frequently in the near future. If company executives find these trends "stimulating" or "motivating", that could lead to further improvement in corporate value.

According to an M&A advisory firm, the number of TOBs for domestic companies exceeded the previous year's period (47 cases) and made the highest since 2009 (59 cases). Total amount of the deals is JPY3.5 trillion (circa USD23.5billion), which is slightly less than three times in the amount of the previous year, and next to the record high of JPY4.6 trillion (circa USD30.8billion) in 2020. The large-scale acquisitions by domestic funds in the range of JPY1-2 trillion have pushed up the transaction volume. There were six cases of de-listings by MBOs (management buyouts) for the period of January-June 2023, which also turned out to have taken place more frequent than in the past.

TSE's recent market restructuring and demands for "Management that is Conscious of Cost of Capital and Stock Price" are the core driving forces of the present

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high frequency of TOBs. As the more this trend attracts investors' attention, the more efforts companies are required to make their corporate value increase continuously. It has been getting more common for companies to use abundant funds for acquisitions focusing on growth and for restructuring of businesses to improve capital efficiency.

In October, a leading medical equipment manufacturer announced acquisition of a medical data service company. The manufacturer aims to strengthen its preventive healthcare business, mainly to prevent lifestyle diseases. A major automotive manufacturer acquired all the shares of its listed subsidiary that handles automotive parts, in order to cope with the shift toward electric vehicles (EVs).

The government is also fueling this trend. In addition to the TSE's request for improvement of low PBR for some companies, METI compiled new guidelines for M&A this year. The guidelines outline that companies are required to give serious consideration and analysis for acquisition proposals that appear to contribute to improvement of its corporate value, and that companies should not refuse them without appropriate reasons. TOB for companies with their shares low-priced in the market can be more justifiable if the price offered is reasonable.

Following the guidelines of METI, a leading motor manufacturer announced an acquisition proposal of a machine tool manufacturer (the target company) in July, without prior consent of the target. The PBR of the target company before the announcement was around 0.5x, and the motor manufacturer presented a TOB price, which was approximately twice of the target's share price at the time.

Outside of Japan, TOBs without prior consent from the target company have been commonly practiced. According to METI, "TOBs without consent" among TOBs in Japan and in the United States carried out between 2012 and 2021 accounted for 4% and 17%, respectively. METI began to put more weight on advocating M&A by Japanese companies in terms of improving corporate value and securing shareholders' benefits. What was once called as "hostile takeovers" is now renamed to "TOBs without consent". Japan market is about to change its market practice and mindset on TOB as a whole.

A researcher at a major think tank foresees that M&A including "TOBs without consent" may take place more frequently at bigger transaction volume in the future, particularly in industries where many companies are involved in fierce competition. If companies would be more actively involved in acquisitions that would make corporate executives more conscious of their stock prices, it may create a virtuous cycle that enhances corporate value.

On the other hand, recently, more companies have adopted a strategy to delist themselves through MBOs (management buyouts). According to a research by an M&A advisory firm, the number of companies delisted via MBOs has been staying at high level in recent years, with 2021 being the second highest number on record. This scheme can be an option for companies with a PBR (price-to-book ratio) of less than 1x of its liquidation value, for their management reform. More Japanese companies may take this option for their business reform.

MBO, abbreviation for "management buyout" is a method in which a company's management repurchases its own shares and acquires a controlling interest from existing shareholders. Funds for MBO are often financed in collaboration with private equity (PE) funds or financial institutions.

For listed companies, the company executives conduct a TOB through a new company they have controlling rights, by offering a price which is higher by a certain amount than the stock price in the market, and delists the company. This gives the executives huge discretions to reform or restructure their business strategies and the organization, as they would be far less often held accountable for its business performance by shareholders, which used to take place every quarter.

A music instruments manufacturer that was delisted through an MBO ten years ago had been in red ink for four fiscal years in a row until the MBO, as it had been unable to withdraw from unprofitable businesses or to reorganize subsidiaries. Management philosophy of the founder, who was also a shareholder, had prevented the company from making drastic changes in their businesses. The management team other than the founder at the time, carried out the MBO with a PE fund and acquired the controlling rights. Six years after the MBO, the company was relisted on the

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then-TSE First Section, and its PBR, which was less than 1x before the MBO, is now almost tripled, gaining high appreciation from market participants.

In recent years, many companies have been taking strategies similar to what the instrument manufacturer mentioned above did through MBOs. According to an M&A advisory firm, 19 companies chose to be delisted via MBOs in 2021, which was the second-highest on record. In 2022, there were 12 cases, and 6 cases for January to June 2023. The trend still appears to keep the momentum.

In 2023, the TSE requested companies with a PBR below 1x to focus on improving their capital profitability and enhancing growth potential. Pressure from investors has been getting stronger year by year. Under the circumstances, if company's management recognize that their shares left undervalued, they would be more likely to be interested in improving corporate value through MBO. A managing director of a U.S. PE fund predicts that "More and more MBOs may be coming up in Japan."

However, some companies had to give up their intention for MBO since having been undervalued in the market, due to unanticipated action of activists, or vocal shareholders. For example, a real estate developer attempted an MBO in 2021, but it was ultimately unsuccessful because an activist investor, who was a major shareholder, sold their holdings to a third party.

Conflicts of interest often comes up as an issue on MBOs between company's management, who want to keep the TOB price low, and minority shareholders, who want the other. Although there may be some challenges in adjusting things with shareholders, including activists, MBOs could be a magic wand for improving corporate value, if the management would make the most of the MBO that allows them to proceed the reform drastically and swiftly.

Compiled from Nikkei Shimbun and Mizuho research.

3. Companies having more diversified schemes in returning earnings to shareholders

Japanese companies have been coming up with diversified schemes in how they could return their earnings to shareholders. After Tokyo Stock Exchange (TSE) had requested companies with low PBR (Price to Book Ratio) to take some actions improve their performances, over 100 companies reviewed their dividend policies and strategies after this April. Some companies are evolving from the traditional style of many Japanese companies to pay "stable dividends", into ones setting up higher minimum dividend amount or introducing new policies such as excluding depreciation effects of large capital investments. More companies are putting more weight on shareholder returns.

Approximately 120 companies have disclosed introductions and/or changes of their "shareholder return policies," "dividend policies," and "dividend principles" in their timely disclosure information announced from the TSE since this April. With regard to "dividend policies", more companies are explicitly stating that they will return a certain percentage of net profit or net assets as a total return to shareholders, including dividends and share buybacks. For example, some of them stated "dividend payout ratio at 50% or more", "total payout ratio at 40% or more", and "Dividend on Equity Ratio (DOE) at 2.4% or more". Companies that took such actions turned out to be doubled in number in comparison with ones that did so during the previous six months before April 2023.

What explains this trend appear to be, to the introduction of the Corporate Governance Code by the TSE, presence of domestic and oversea institutional investors, which has been getting stronger, watching closely over balance and usage of companies' cash on hand and deposits, and sense of rivalry against their competitors in the industry. Especially among institutional investors, investment funds have been getting more influential in the market in recent years and many of them have submitted shareholder proposals. More and more companies have been receiving proposals from institutional investors, including activist investors, at the shareholder meetings year by year; 23 companies in June 2021, 51 in June 2022, and 61 in June 2023. Though it is just a paltry group in the total number of listed companies being 4,000, these companies may have been already aware of the importance of clear disclosure of their policies on growth investment and shareholder returns, before those funds would demand them to pay more dividends.

While many companies set numerical targets on

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explaining their policies, some companies are going a step ahead of them. A leading industrial tool supplier announced a new policy that, it would add depreciation expense to dividend fund, if its annual dividend would be less than that of previous fiscal year, from its nearest fiscal year end of December 2023. If the annual dividend per share was below the previous fiscal year, the dividend will be a quarter of the amount of the net profit for the period to which maximum 10 percent of the depreciation expense to be added.

The company created this method to maintain stable shareholder returns, even if depreciation costs increase due to investments in setting up new distribution centers or in digitalization. The CEO explains that they intended to cope with some shareholders who support their capital investment to the extent it would not eat significantly the company's dividend fund to be paid.

A leading mining company raised its dividend payout ratio to 40% and has introduced a scheme that links its PBR and stock prices to dividends. If the PBR at the end of a fiscal year is less than 1x, the bottom of the annual dividend amount is at 3% of the annual average of their stock price. If the PBR at the end of a fiscal year is 1x or more, the bottom of dividend amount is at 3% of DOE. This means, if the PBR is below 1x, the company will pay more dividend if the stock price rises, and if it is above 1x, the company guarantees the bottom of the dividend amount. The company says it decided to adopt this scheme to reflect its efforts to catch up with the trend of prioritizing management being conscious of capital costs and stock prices, including to deal with the request from the TSE for making PBR better.

According to a researcher at a major think tank, more companies are shifting their dividend policy from 'paying stable dividends', which is difficult to define what "stable dividend" is, to performance-linked dividends, which is much easier to define. Until now, many Japanese companies tended to maintain a policy of "stable dividends" in which they paid dividends regardless of their annual performance. In today's business climate, where many investors and market participants expect corporate executives to be more PBR conscious, they are also trying to be more conscious of capital efficiency, rather than just keep lining up nice but vague words.

A leading petroleum wholesaler plans to increase its minimum annual dividend by JPY 50 from the previous level to JPY 250 (circa USD 2.2). This company has an activist investment fund among their major shareholders. The company's PBR has been hovering around 0.7x range in August, before making the above announcement, and it is keen on improving its PBR level to the 1x range by enhancing shareholder returns.

A leading medical equipment manufacturer has also set the bottom rate for its annual dividend at JPY 25 from next fiscal year, starting from April 2024. Last year, the company's net profit declined by 66% due to higher cost for materials and energy, and it dropped the dividend rate by JPY 5 to JPY 22. The company said, "Despite that our business performance wasn't bad, we paid less amount of dividend last year, due to external factors such as foreign exchange. Some shareholders complained about this, as they took it as a sign of 'the company's lowering attention to shareholders.'" The company took their voices serious and made the decision so that shareholder returns are not reduced due to transient incidents.

Many companies have been announcing "progressive dividends," a hybrid of stable payment and increased payment in tier. "It is not our principle to reduce dividends" –a leading construction company changed its dividend policy from "stable dividends" to "progressive dividends" this July. Progressive dividend intends to maintain or gradually increasing dividend rate through a long period of time. This is different from "stable dividends", which continue to pay dividends but may sometimes pay less. This construction company has never reduced its dividend rate for the past 16 years in a row up to the end of March 2023, in 13 years of which it increased dividend rate. Its policy change this time is to express its positive intention to keep paying dividends at a higher level than other companies. A leading logistics company also announced a new policy, to maintain or raise the dividend rate from the previous fiscal year, in addition to their existing policy of a dividend payout ratio of 40%. According to some market analysts, it is quite rare for a company in logistics industry to introduce progressive dividends.

Companies with PBR hovering around 1 or less are sending a message to the market that they have not been using their assets effectively to earn more profits.

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It is anticipated that more companies follow suit to implement clear dividend policies and/or strengthen shareholder returns to enhance capital efficiency.

Compiled from Nikkei Shimbun, and Mizuho research.

4. Domestic life insurance companies getting more vocal for proxy voting

Japan has been called a “country with plentiful life insurers” next to the United States, where 9 out of 10 households enrolled in some kinds of life insurance policy. More than 40 companies are members of the Life Insurance Association, the industry group of domestic life insurance companies, and their total asset size is about JPY 419 trillion (circa USD 2.8 trillion). This is significantly bigger than that of JPY 219 trillion (circa USD 1,460 billion) of the Government Pension Investment Fund (GPIF), the national pension fund. Life insurance companies have strong presence as institutional investors in the market.

Those life insurers are now getting more serious to deepen the dialogue with their investee companies. One of the leading insurers will revise its determination criteria whether to approve an anti-takeover measures proposed to shareholder meetings by the management in April 2024. Life Insurance companies have long been recognized in general as “silent shareholders”, but now that the Japanese government is showing the flag to develop the country into an “asset management powerhouse”, life insurers are expected to provide support the improvement of the investee’s corporate value by being more vocal.

Life insurance companies invest huge portion of their insurance premiums from policyholders to JGBs, foreign stocks, and domestic stocks. The total amount holdings of domestic stocks held by the whole industry were about JPY 27.5 trillion (circa USD 183 billion) as of the end of June 2023. Many listed companies have life insurers as their major shareholders. Under the circumstance, those insurers are urging companies to improve corporate governance through stewardship activities, such as proxy voting and having dialogues.

The aforesaid life insurer will alter the criteria for exercising voting rights on proposals to introduce anti-takeover measures at shareholder meetings, from next April. The new criteria require in principle the insurer to oppose all anti-takeover proposals by the company, except that the consolidated ROE of the company has been 8% or more for the three recent fiscal years in a row” and “independent outside directors account for more than half of the total number of directors”

Another life insurer revised the criteria for its voting rights on proposals for appointment of directors and those related to anti-takeover measures in April 2023. For companies listed on the Prime Market of the Tokyo Stock Exchange (TSE) that have a parent company above, the insurer does oppose appointment proposals in principle, if the company has independent outside directors less than “half” of the total number of directors. It used to be “one-third or more”, but it has tightened it up.

According to an M&A advisory firm, 263 companies adopt anti-takeover measures as of the end of August 2023. Since the Corporate Governance Code was adopted in 2015, more than 200 companies discarded those measures, but the trend seems to have been slowing down recently, as activist funds have been showing up more often.

Prime Minister Fumio Kishida gave a speech in the United States in September. He stated that the government would do more to “make the corporate governance reform more effective.” Constructive dialogue between companies and institutional investors is the key. The PM’s statements imply that the government would not leave the status where measures for anti-takeovers which may lead to management’s self-protection are overlooked. Life insurance companies may also no longer be allowed to remain “silent shareholders”.

It is not just a matter of reviewing voting policies at shareholder meetings. Life insurance companies try to deepen dialogue regarding ESG (environmental, social, and corporate governance) issues with companies. Since ESG issues take time to find solutions, it is crucial for life insurance companies as long-term investors, to support develop their investee companies’ ESG measures in order to secure their own investment returns.

Another leading life insurer had dialogues focusing on climate change with 75 companies in twelve months ending in this June, which is five times more than 15

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companies that it met four years ago. These 75 companies are believed to account for approximately 80% of the total greenhouse gas emissions among their investee companies. In the past year, the insurer requested companies with high emissions to institute and disclose a roadmap for reducing their emissions.

There are some challenges as well. The voting rights exercised at shareholder meetings for April to June 2023 opposing company proposals (based on the number of proposals) turned up to be only at the range of 0.9% to 3.5% for the four major life insurance companies. Approving votes for shareholder proposals turned out to be at the staggering range of 0% to 1.5%. These ratios have stayed at this level in recent years.

An asset manager at a major life insurance company says "Just tightening the voting criteria and casting more "nay" votes does not seem to get them anywhere in the long run," but he also says "The thing is how we present how our strategies worked out".

Another life insurer started a quantitative analysis of their dialogues over the past three years from 2023. They intend to disclose a ratio of companies that the insurer judged to have solved their issues such as shareholder returns and ROEs through dialogues. The insurer said that this project is still in the testing phase and it needs to be further tuned up and refined.

According to a survey on stewardship activities, more than 80% of companies responded to the questionnaire stated that they had helpful proposals or suggestions from investors and investment advisers. On the other hand, about 70% of the respondents stated that such proposals were reflected in their management decisions once a year or less frequent than that.

Dialogues with investee companies and exercising voting rights not end up with just courtesy meeting. They should debate on practical things that may positively affect management decision or suggest how companies could improve corporate values. Life insurers should make continuous efforts to be "vocal shareholders" that may be able to keep constructive dialogues with companies.

Compiled from Nikkei Shimbun, and Mizuho research.

II. New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Oct-20	IBIS HOLDINGS Co., Ltd.	JP3104760008	P
Oct-31	REVO International Inc.	JP3981350006	P
Nov-08	DAIWA CYCLE CO., LTD.	JP3501950004	G
Nov-10	Kyobashi Art Residence Co., Ltd.	JP3253520005	P
Nov-22	VALUE CREATION CO., LTD.	JP3778520001	G
Nov-16 ～22	Japan Eyewear Holdings Co., Ltd.	JP3389460001	S
Nov-22	KET Inc.	JP3277030007	P
Nov-22	AGENTEC Co., Ltd.	JP3160510008	P
Nov-27	MY FARM, INC.	JP3860370000	P

**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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