Kimura Dreamvisor Newsletter 24th October 2006

Still no sign of overheating, it looks ok to buy.

We have entered a new cycle, TOPIX to register new high.

There is a US financial saying ‘ bull markets are born out of despair, rising above the wall of scepticism’. Well today’s Tokyo stock market obviously rose above the wall of scepticism. Despite numerous negative factors for supply and demand such as North Korean nuke problem, economy uncertainties, large public offerings or arbitrage balance. The market rose close to 15 % since mid-June low.

A sense of security has returned to market but optimism has not spread out yet. 24th October advance/decline ratio recovered the 100 % level and TOPIX deviation to 55 days average is only 3 %. Overheating is usually linked to 120 % and at least 5 % deviation with 55 days average. The market rose only for 1 month since 26th September recent low therefore it is too soon to suggest any correction.

Following Nikkei 225 TOPIX broke its September high on the 23rd . The three years cycle, which started in spring 2003 bottoming out in June, is now closed. One year’s cycle usually shapes itself three times and one year and a half cycle shapes itself two times, anyway after entering a new cycle the market does not correct for at least 6 months in a row (new cycle entrance an be deducted from resilience to profit taking). The next mid term cycle low should be around January but before trying a new high there should some minor corrections. For now real correction seems improbable therefore I believe corrections of up to 3 to 5 % are possible. It may be somewhat premature but usually at the end of a cycle we have 7 to 10 % corrections.

Index renewed its previous high but due to market bipolarisation we are still in the first stage of recovery and this vary a lot according to sectors. (4755) Rakuten and (4689)Yahoo Japan recovered strongly from previous lows but most other stocks are still trading water. Individual investors money is kept busy with heavy IPO’s like (5019) Idemitsu Kosan or prospective Aozora bank therefore money flow to mid small caps looks difficult for now. Despite this large IPO’s like (3231) Nomura real estate holdings or today’s Idemitsu Kosan managed to close well above IPO price and then correct slightly leading to limited damage.

Today’s feature was continuity of mobile phone number system. (9984) Softbank created a stir by staging a war in new subscription fees and previous sole winner (9433) KDDI stock tumbled on such fears. However Softbank is now fighting with an extremely stretched financial position, should stronger competitors start a price war Softbank will have to pull out. This is just management trying to focus attention by positioning itself in a battle.

New equity finance flows.

In previous ‘capital demand’ generation conversion price of a convertible bond usually did not exceed by more than 5 % actual stock price but recently the conversion price is set 20 to 50 % higher than actual stock price. Last week Nippon Steel launched a huge 300 billion Yen convertible although buying was restricted to large banks, conversion price was set at 740 Yen which 50 % higher than current Nippon Steel price. Nevertheless the impact on stock price was light, as investors did not associate it with new shares emission.

Securities analysts usually divide estimated profit by current float when making earnings previsions. This must reflect both all latent stocks and existing stocks (after full dilution). The rule is particularly severe among foreign securities houses and fund managers also look closely at fully diluted figures. However numerous companies choose to buy back preferred shares and CB's latent shares before conversion. In such a case the fully diluted figure used by analysts for their calculation does not have much sense. In fact this distorts reality.

Isuzu motor and Nissan diesel are rushing to buy back previously 'crisis linked' CB's before redemption as earnings improved rapidly. Redemption is processing quickly. Nippon Steel CB amount may be big but equals only one full fiscal year earnings, proceeds will be used in the share swap agreement with Korean number 1 steel maker Posco (both per are at par roughly), therefore Nippon Steel can redempt the full CB amount whenever they wish. It is not necessary to include latent stocks in calculation.

The critics stating that it is totally illogical to buy back own stocks and then immediately proceed to Equity Finance are justified. This said considering capital utilization is clearly stated and that shares buy back can absorb the surplus shares then this cannot be considered a negative factor (on the other side the stupid way SMBC has done this deserves criticism.). Rather it gives investors an opportunity to buy back promising stocks that have been sold off on the back of Equity Finance reaction. The important fact is that the company current earnings trend is solid. Another positive aspect is the willingness to use excess capital to reduce equity capital ratio.

For large blue chips the class of (5202) Nippon Sheet Glass or (6502) Toshiba using EF proceeds to engineer large acquisitions makes the evaluation more complex. Especially in the case of Nippon Sheet Glass hiding the true usage of the capital. However with time if you can clearly associate current earnings increase with EF it can be positively valued. Should the stock go down for this very reason then the rule is to take advantage and buy.