

Pascal Jeannenot Newsletter 12th of May 2006

In my previous newsletter I was strongly advising to shift to seek opportunities within the Japanese mid small caps universe, this view is still mine.

And indeed the wider market corrected strongly. The US \$ was heavily sold (for all the reasons behind the US currency plunge please refer to Kiyoshi Kimura Dreamvisor recent newsletters).

Weak American currency is not that positive for Japanese economy. Some argue that domestic sectors do benefit from Yen strength but foreigners bought large caps such as banks or real estate as 'deflation era closing' representatives and the Yen current surge has been sized as a good opportunity for profit taking. Foreigners would cover their stock losses by currency gains. This said foreigners' selling is bound to be limited.

The US current deficit has grown to US \$ 800 billion also a relatively large part can be attributed to oil imports, but oil money export income is less and less reinvested in US securities. The fact that BOJ is going to end zero rate policy around June is also not a supportive factor of dollar strength; BOJ is sucking back liquidity at 300 billion Yen daily rate.

Now regarding earnings season in Japan already half the whole market capitalization has announced forecasts. For fiscal 2005 current earnings increase is already 5 % above forecasted figures but on a company wide basis forecasted increase for fiscal 2006 is near zero. This is 5% under the large securities estimate consensus and institutional investors took profit on this basis. If the Yen US \$ parity settle down at 108 yen per \$ the average net profit increase forecast should be 5-7 % which translate into a forecasted PER of 19x and Yield of more than 5 %. This is a pretty good background to react in a logical way and buy at lows.

Now what to buy?

Let's first have a closer look at what I suggested as mid small caps stock picks in my previous newsletter.

Mid size caps registered good contrarian performance; recycling friendly (5855) Asahi Pretec, (9793) Daiseiki, and (7456) Matsuda Sangyo.

Financial services related mid caps are still out favor but previous selection is still my choice; (3772) Dreamvisor, (8473) SBI holding, (3121) asset investors...

On 9th of may elderly homes related (1729) Sanko Soflan announced a very large interim upside revision, February interim net earnings were up 4.1 times at Yen 1,155 billion and the coy is forecasting a 1,7 billion yen net profit for December 2006. Still a good buy. (7856) Hagihara still cheap but volume thin.

There were some bad surprises though:

(6423) ability (OSE 1st section) registered a stop low on 12th of May due to downside revision; this said EPS is maintained at high level. First quarter earnings were lower than expected with a 78 % downside revision and recurring and net profit turned net losses. The coy is now forecasting 3 billion 436 million yen net profit (- 56,7%) which translate into Yen 100.36 EPS.

I would suggest to buy (8692) Daiko Clearing services Corp on further weakness (say any low under Yen 2000) , on the 8th Merrill Lynch went very positive on the stock but this made apart I have an interesting story regarding this company specialized in financial matters related printing. I shall develop this story in my next newsletter.

(4628) SK kaken despite very thin volume needs to be closely looked at. Recently the Chinese 'yellow winds' coming direct from the Xintiang first ever hit Tokyo. In Fact this company is specialized in high Tech protective coatings and paintings, a great market in mainland China.

At the 12th of may close the Nikkei 225 per is standing at 21,80x with a current yield of 2,88 % and forecasted (fiscal 06) 4,40 % yield. We should soon see the Per 19-20x level reached which is as I above mentioned a good buying level to size opportunities (large or medium caps).

I shall also keep a close eye on the shareholder activist funds i.e.: the likes of MAC Asset (who seemingly has decided to go offshore and register in Singapore for Tax matters), TOWER Asset and the others. The reason

behind this? The biggest shake-up of company law in 50 years. Japan need to prepare to face an onslaught of foreign takeovers... I shall develop further this in my next newsletter.