

Value investors taking advantage of excessively bipolarised Japanese market

Japan land of the rising real estate prices? it looks sustainable this time..

Market turnaround, which started 13th of October, could never have been better explained than in *Kimura Dreamvisor newsletters 13th October part 2*. I invite again all professional investors to pay attention to them.

A brief insight into Japanese real estate sector.

Japanese real estate sector index has been outperforming Nikkei 225 and TOPIX since 2003 anticipating current recovery. The core question remain ; for how long ?

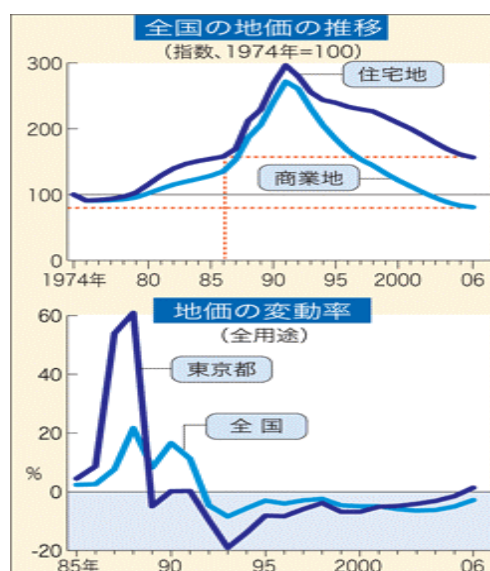
Leading stocks like [\(8830\) Sumitomo Real Estate](#) continuously register new highs. Within the Japanese REIT universe Mitsui Real Estate affiliated [\(8951\) Japan Building Fund](#) does the same among others. It will be extremely interesting to keep an eye on next year's (march 2007) public land price survey announcement to gauge real estate prices upward trend. Land price evaluation is usually done through Discounted Cash Flow (DCF) methodology applying a discount rate to current value in order to analyse future cash flows. Due to easing of capacity restraints city centre large building surfaces are increasing, as a consequence earnings flow goes up adding pressure on real estate prices. For real estate investment professionals market forces dictate land price and current bull cycle is totally different from 'bubble' period. Real estate investors profile is also changing as industrial companies and wealthy individuals are entering the real estate market. According to market sources first class locations like Ginza or Omotesando have reached up to 100 million Yen per Tsubo (3.3 square meters). Some deals engineered by foreign funds currently yield 2.2 %, which is slightly above Japanese long-term rates. The Nikkei financial daily quotes Mizuho Securities analyst Ishizawa Takushi saying that public land price level are delayed for up to one year and a half compared to real situation. According to him some prices may have already gone up by 50 to 60 %, which leaves a substantial margin for public land prices to go up by next year announcement. Looking at bubble period (please look at Chart 2 below) back in 1988 some areas in Tokyo rose up to + 68 % and real estate stocks registered rises up to twice the Nikkei average. Bubble belongs to the past now and BOJ has strengthened its surveillance of banks real estate financing earlier this year. There were also a few scandal discoveries linked to REITS beneficiaries in spring which froze for a while investor's appetite for the sector.

Professionals are now turning their full attention to what will be Abe cabinet policy toward the next land price increase if any alternative to previous Koizumi cabinet total deregulation policy.

Chart on right side (Nikkei) shows:

Chart 1 Japan land price (1974=100) dark blue line residential land, light blue line commercial land.

Chart 2 Japan land price variation dark blue line for Tokyo, light blue line for whole country.



Speaking about value real estate related mid size stocks opportunities are plenty (but volatile) Mid size developers such as [\(8939\) Daiwa system Co](#) large shopping centre mall trading at 12 times march 07 earnings is interesting. Same for [\(8927\) Meiho Enterprise](#).

As earlier mentioned in *my newsletter dated 29th August 2006* TOB offers from parent companies to fully incorporate listed minority subsidiaries are increasing.

The 11th of October Hitachi made public its first ever TOB operation on a first section listed company. By the 11th of October Hitachi had 14,4 % of Clarion. Hitachi's target is to increase shareholding in [\(6796\) Clarion](#) to 50 % (and eventually 100%). TOB offer price was set at 230 Yen, a hefty premium relative to Clarion 10th October 151 Yen closing and good money for the happy holders. The 13th of October Sumitomo Trust Bank announced a complete takeover of listed [\(8432\) STB Lease](#) implying full delisting from TSE 1st section. TOB offer price has been set at 2050 Yen (STB 13th of October closing price was 1599 Yen.) this had a ripple wave effect on the whole leasing sector. Note that at the same time Mitsui Sumitomo Financial Group and Sumitomo Corp agreed to merge their leasing activities implying full incorporation of listed sub [\(8592\) Sumisho lease](#).

Expect much, much more based on parent companies industrial strategy revamping.

Now what to buy?

Considering the 'Dam theory' mentioned in *Kimura Newsletter dated 13th of October* I noticed from recent 5 % rule public disclosures that onshore Japanese value asset managers obviously took action. A flurry of 5 % (and above) stakes were made public last week and highly considered Sparx Asset Management certainly took advantage of current prices to increase positions in small to mid cap stocks on all exchanges.

11th of October 5 % rule disclosure for Sparx were: TSE1 (2674) Hard Off corporation, JAS (2680) Nihon Optical Co, TSE1 (7238) Akebono Brake, TSE1 (4540) Tsumura and Co, TSE1 (8248) Nissen Co, TSE1 (7943) Nichiha, TSE1 (6332) Tsukishima Kikai, TSE1 (6765) Kenwood Corp., TSE1 (7750) Pentax Co.

13th of October 5 % rule disclosure for Sparx were: TSE1 (7236) T. Rad Co, (4972) Soken Chemical Co, JAS (2445) SRG Takamiya, JAS (7598) Nice Claup, JAS (3794) ND Software Co., MOTHERS (3053) Pepper Food Service.

Applying ratios such as $(Per \times Pbr < 25)$, PEDY, shareholders equity ratio. to those equities then value investment logic does make sense. Not just Sparx but also foreign JPM Asset Japan, Fidelity Asset Japan increased positions (for pure investment purpose) in oversold mid to small caps universe.