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Energy savings technologies (follow up): Japan rules the world!

More TOB offers on the cards for Japanese market 'hidden side'

Japanese energy saving technologies bonanza.

China and India are looking to Japan for energy saving technologies. Several times Kimura Kiyoshi stressed the huge untapped potential business for Japanese industries in this business field. I totally agree. Expanding China is now focusing on the whole ranges of energy savings technologies. Both Chinese and Japanese government entered negotiations back in May. China national development council has already made strong request to Japan. In 2003 China was already world number one energy consumer (oil, natural gas, solar energy, hydro energies, coal liquefaction etc.) with 14 % worldwide energy demand market share. Chinese consumption society is forecasted to expand further and by 2030 China oil derivatives energy consumption should reach 2 billion 900 million tons which is twice 2004 level. Consequently back in March China adopted its 11th five years economic plan (2006 - 2010) aiming at reducing energy consumption by 20 % in 5 years time . Next year early spring a new energy saving project will be submitted to the Peoples National Assembly. According to Japanese government affiliated autonomous new energies development institution (NEDO) Peking representative office an agreement has been reached for Japan to support and train Chinese human resources in this business field. For a major natural resource importing country like Japan the 70's twin oil shocks triggered a national ambition to raise energy consumption efficiency and as a result Japan achieved worldwide leadership in this very business field.

To achieve 20 % saving target by 2010 Chinese authorities intend to invest no less than 10 billion US $ per year and the energy saving technologies market is forecasted to treble in five years time to 38,1 billion US $. For Japanese companies China is a land of promise, (7011) Mitsubishi Heavy already received orders for no less than 9 power equipments from Chinese steel works, total amount represent 60 billion Yen. In this precise business field Mitsubishi Heavy is the sole contender. Those equipments transform steel plants high furnaces gas emissions into gas turbines. Mitsubishi heavy has a worldwide 75 % market share for gas turbines. Transforming waste heat into electrical power boast a 45 % yield. This is god sent for hungry Chinese steel works.

Energy savings technologies scope is wide, numerous mid to small size Japanese companies can take advantage. For example each summer Shanghai city is plagued by power bottleneck, the regional government introduced a new energy supply model and guess what! It is a small (unlisted/unknown) Japanese Osaka based company (Bottlay group) who supplied the technology. Air conditioning is one of Shanghai city energy consumption main culprits during summer time, at peak time energy consumption increases + 40 % (i.e. 2005 summer). Bottlay worked in cooperation with a local air conditioning engineering company and set up a local venture, the new venture company started to market energy saving equipments for offices air conditioning since June. The inner process is as follows: each 30 minutes a mechanism stop the air compressor without diminishing air conditioning capacity, consumption was reduced by 10 to 30 %. Equipment price is 40,000 - 37,000 Yuan per unit. Sales have been increasing substantially.

At the start of current calendar year numerous Japanese companies increased energy saving technologies research & development effort. (7012) Kawasaki heavy for example will run a venture with Chinese largest cement maker from January 2007 to develop cement plant waste heat recovery. KHI is forecasting 8 billion Yen sales by 2009. Sanyo electric will start with Yanmar a co-generation project form January 2007. Sanyo electric is targeting 10 billion Yen sales through twin selling of co-generation equipments plus air conditioning equipments. Japan is enjoying world leading positions in the following three core technology fields: energy saving, solar energy + wind energy, batteries. Japan enjoys undisputed top position in one core business field: energy conservation technologies/waste heat recovery equipments.

The main three core applications are;

First: industrial sector especially for energy hungry steel and cement plants, chemicals plants. Steel sector achieved world-class energy efficiency by investing in energy recuperation systems. In addition cement sector streamlined production system with waste heat recycling From the 60's to 90's cement industry halved its energy consumption by 50% in 30 years time. Meanwhile there was absolutely no change in US industry for example. Chemical industry waste heat recovery has made substantial progression too. **Second**: the auto sector and fuel cost efficiency improvement. Japanese car industry energy consumption is 20 % lower on average compared to US and European car industry. Toyota, Honda developed the hybrid fuel technology (car engine is moved by electrical and gasoline) consuming less than half European or US models

Third: applications in the high tech sector are important too. For air conditioning Japan manufactures products consuming half US made products consumption.

Japanese government actively promoted energy conservation technologies in the past decade and all industrial plants consuming more than a specified level are closely monitored. In addition energy conservation capacities and energy cost standards were set up for the most performing products. Those standards are now progressively extended to the whole electronics consumer products universe. Japan offers superior technology on the hardware side (energy efficient gas turbines and low fuel cost cars), according to Energy conservation centre director Ozeki Shoichiro. India is also focusing on energy saving technologies and generally speaking developing countries demand is huge. According to Japanese energy economic research centre statistical database, world energy demand will increase by 60 % in 2030 compared to 2002. Asia monopolizes 50 % of world demand. China and India energy utilization efficiency is low. Calculating a single energy consumption unit per GDP unit Japanese ratio is **1**, USA **2.7**, China and India **9**! Roughly that does translate into 400 million Yen savings per year.

The risk remains intellectual assets transfer. Blueprint outflow problems arise when companies deal with Chinese industries illegal copycats. For these reasons there are still a lot of companies hesitating to implement energy saving technologies (intellectual rights grant) but the answer may lie with what Kimura wrote *in his 26th September newsletter*. Mitsui corp. electronics division head Arakawa Norihige stresses the importance of compliance and risk avoidance in this very business field. Mitsui corp. is developing office buildings lighting and air-conditioning equipments with Matsushita Electric Works in China and from November will start energy saving business in China (through 14,9 % stake in a Chinese government affiliated engineering company in Peking). Chinese authorities introduced public works low energy directives as soon as July 2005 and will not grant further authorisations unless new buildings comply with such directives. This should generate additional 38 trillion yen demand by 2010. If Japanese companies hold continuously the equity stake in Chinese ventures, even if patent fall into public after 5 years time then they can make substantial returns. You too by investing! In specific energy saving business fields Mitsui Kinzoku subsidiary (6975)Neomax has 80 % worldwide market share for Hybrid engines magnets. (1963)JGC corp. and Tsukishima Kikai are leading contenders for ethanol plants and finally Teijin subsidiary (3403)Toho Tenax, (3402)Toray and (3404) Mitsubishi rayon have 70 % worldwide market share for carbon fibbers.

Japanese equities increasing popularity amongst US investor is a double edge sword.

Let's change subject with a touch of fun! Wall Street is experiencing a double Japanese boom this year: the first one focused on Japanese healthy foods daily assaulted by hungry Wall Street traders & bankers alike. Second are Japanese equities related seminars: the Daiwa Securities, UBS, JPMorgan securities, Deutsche securities, State Street Global advisor are piling in presentations of Japanese listed ETF's. NYSE group (managing NY stock exchange) is showing strong interest in Japan obviously to attract more Japanese companies listings. Although NYSE CEO Marshall Carter insists that Japanese companies could immensely benefit from US investors worldwide diversification the reality is more trivial to say the least. US originated Hedge Funds apply both short & long strategies and Japan being still (wrongly) considered some kind of 'cyclical play' any advance economic indicators slowdown is taken as a straight short sell opportunity. Popularity has a price!

Now what to buy?

Previous value picks follow-up

(7202) Isuzu motor deserves further comments, 13th November Isuzu announced interim consolidated earnings substantially revising upward as below:

Sales	824742	737325
Current earnings	62747	40623
Net earnings	55408	26017

Figures are in million Yen

New full year forecasts are below:

March 07 (E)	
16,300	sales
103,000	current profit
80,000	net profit
66,75	**EPS**

Sales are in 100 million Yen

Current profit in million Yen

Net profit in million Yen

On the 13th November closing that translated into 7x forward Pe multiple. Therefore it is not surprising Isuzu shot up.

(8304) Aozora bank: good long-term investment? Too soon to say.

The last of large IPO's serial Aozora bank prospects are not that clear. Aozora made a come back to TSE after 8 years in the woods but market participants have doubts on the business model. Aozora CEO Mizukami Hirokazu outlined his policy: focusing on high value added financial products and financial consulting however Aozora is weak on the retail side compared to other mega banks. The stock was immediately sold off after introduction at less than 500 Yen. This 'severe' market valuation stems from unclear market perception for Aozora growth strategy and specificities. Aozora has 2,500 institutional customers on the bank retail side. Individuals saving deposits are no more than 200,000 - 210,000 with 50 years average age. S&P stressed the weak shareholding equity ratio at 20 %. Previous revival success story Shinsei bank diversified income source through external growth buying companies such as Aplus or Showa Lease. Aozora business model needs clarification before investors can identify value. By selling part of their preferred shares holding Japanese government earned 78 billion Yen * profit. I recall that Aozora's previous name ex Nippon Credit Bank went bankrupt in 1998 and left a 2 trillion 900 billion Yen debt burden for Japanese taxpayers but a hefty 300 billion Yen profit for US fund Cerberus, other shareholders like Orix and Tokyo Fire and Marine insurance made 90 billion Yen profit each.

*Calculations based on the hypothesis that price be maintained above 500 Yen and that all preferred shares are transformed into standard shares.

Further insights on the mid caps M&A front

As expected Nissin (see 11th of November newsletter) foods made a counter TOB offer for [(2900) Myojo foods] at 870 Yen which is 30 % above last three months closing average (662 Yen) and 14 % above steel partners offer. Nissin offer is 40 % above consolidated net assets per share, which is quite expensive, and professionals are questioning Nissin strategy.

I recall that in the food sector good picks are [(7522) Watami], [(2806) Yutaka foods] among others.

A worldwide comparison regarding TOB premiums: US JPMorgan Chase calculated pre TOB premiums for current fiscal year US second quarter: 20,5 %, for Europe 14,9 %, for Asia including Japan only 9 %. During IT bubble average premium reached up to 40 % and finally settled down to 15 – 12 % for US and Europe. Most market observers feel that Steel TOB on Myojo was mostly geared to secure a quick profit, this said as the US fund also hold 6,2 % of 'white knight' Nissin food investment profitability should rise. This said observers think current fiscal year Steel Partners Japan Strategic fund yield is largely under 10 % consequently fund management need to be reviewed
SPJS investments mostly target stagnant stocks with PBR at 1 or less 5 I agree with basic strategy) but this is not enough in itself. Recently even when SPJS appears as a major stakeholder market sometimes ignores this. That was obviously the case for Myojo foods but now analysts scramble to find the next candidate.

Notoriously low PBR stocks are not well covered by analysts. 16th of November Nikkei Financial daily qualify this kind of stocks 'market orphans' in scramble section. According to IFIS Japan survey 57,5 % of TSE 1st section stocks are covered by at least one analyst, said in other words 40 % of TSE first section are left as 'orphans'. Coming to TSE 2 section it is even clearer, only 16 % of listed stocks are covered by at least one analyst.

You would argue that this adds fuel to my own machinery and , yes, I believe this justify [Japaninvestments] existence! For example have you heard about recent [(2503) Kirin] friendly TOB offer on TSE first section listed [(2536) Mercian]? stock was barely covered by analysts. Kirin shall take 50,2 % of Mercian at 370 Yen per stock which is 28 % above the last three months price average (289 Yen) and 39,6 % above 15th November closing. Happy me as I hold Mercian! This is a good buy for Kirin to expand its wine wholesaling business domestically.
As earlier said it was clear that food sector was to become an M&A target sector based on previously discussed HHI logic (recalled in my 11th November newsletter).

[(7267) Honda motor] listed strategic subsidiaries buy back is more subdue than Toyota's .

On the 15th of November Honda related spare parts makers were bought on TSE. The 14th of November Honda had announced a TOB offer for JASDAQ listed [(7298) Yachiyo Industries]. Honda holds more than 20 % stake in no less than 10 spare parts makers. The largest subsidiary (7230) Nissin Kogyo just reached a new high for current fiscal year. This said the market has always been unmoved by potential TOB offers for Honda related parts makers. The last operation goes back to 2004 when Honda increased participation in Japan plast and Kikuike press industries but not much since. However it is worth keeping an eye on Honda's universe affiliated parts makers. I shall develop later the subject.

Pascal Jeannenot