From value to growth? The market is emphasizing growth strategy rather than earnings themselves.

Japanese pharmaceutical industry on the edge.

Is the Japanese market shifting from Value to Growth? New growth oriented onshore investment trusts have recently been set up, the idea being that market has shifted from relative value to growth as investors more closely focus on companies' earnings growth.

Up to now most popular fund type were value search and high income stocks specialized funds although there are some signs that growth type products are making a comeback in Japanese asset management universe.

Japan onshore market leader investment trust Nomura asset BIG Project N fund (BPN) has a 368 billion Yen NAV. The fund weighting of value stocks relative to growth stocks is closely followed by professionals. Managers have recently set at par growth/value ratio (43.5 % / 43. 5 %) with high weighting on electrical and banks. That makes this fund the largest growth equities fund in Japan for now. Fidelity Japan also launched an Asian/Japan growth equities related fund recently. Due to year 2005 market rise Nikkei 225 average PBR is now 1.9x (a 0.3 points rise compared to early 05) making the value style management less popular, however I am a value investor and certainly do not focus on Nikkei or TOPIX to spot attractive investments therefore this kind of logic is certainly geared toward investors playing Japan as some kind of 'cyclical single play' (see *Kimura Dreamvisor Newsletter 26th of September 2006*).

An interesting article was published in the 'scramble' section of Nikkei Financial : the Nomura Research Institute calculated that since the IT bubble burst value equities outperformed but from last year growth equities outperformed value in Japan for the first time, something clearly explained by Japanese companies high earnings expectations. Another quantitative strategist stresses that since the beginning of current Japanese fiscal year growth stocks index declined 10 % but value stocks index decline only 8 % implying still conservative valuation for growth relative to value. Fund managers interest is therefore increasing for growth type stocks. Personally I believe this differentiation is nonsense as value can obviously be spotted alongside earnings growth but this is mostly designed to wrap up new funds.

There is some change in large blue chips valuation patterns recently. Numerous observers expect a rising market after autumn alongside mid year earnings upward revisions. This said despite strong upward revision expectations some stocks actually don't go up which shows underlying change in the market. Some brokers have devised

tools which support *expectations* of earnings revision by simply comparing past earnings revisions and announced earnings gap. The market firmly looks for upward revisions in the second half. However the point is that despite strong upward revisions expectations there are stocks which do not react: the Nikkei financial daily 25th of September 'scramble' section mention (6273) SMC as a perfect example. Machinery sector heavyweight SMC has a high foreign shareholders weight. The gap between analysts' expectations and QUICK consensus for SMC was as high as + 10.6 % and the hit rate relative to forecasted earnings for April- June was as high as + 30 %. Despite such strong expectations SMC performed poorly between beginning of September and September 27th closing. Tokyo first section machinery sector (stocks capitalized at 100 billion yen or above) average Per is 20x, SMC is 17.6 x. Despite good relative value and upside revision expectation the stock is performing poorly, why? Simply because investors cannot read clearly SMC strategy for expansion in Europe and USA. On the contrary (4063) Shinetsu Chemical which showed only 8.1 % positive gap between QUICK consensus and company own estimates (therefore less than SMC) performed strongly. (4063) Shinetsu Chemical announced the 21st of September a large investment in a new domestic plant which led to an immediate new historic high for the stock. The factory launch announcement has set a premium to the stock price allowing for a higher Per. Such cases may increase and 'future growth scenario' must be clearly grasped by investors for the stock to go up.
Now coming back to M&A in Japan (*my newsletter dated 30th of July 2006)*, it looks like Abe's new era is opening with a string of new buy out funds launches: Carlyle Group has set up a 200 billion Yen fund targeted specifically at Asia & Japan in July (half the capital was raised with Japanese institutional investors). MBK partners and Long Reach Capital partners have done the same with 100 billion Yen each. MBK partners is headed by ex Carlyle Japan representative Shizunaga Kensuke and will target Japan, Korea and China but core capital is targeted at Japanese companies.

Now what to buy?

On the 26th of September advance/decline ratio 25 days moving average felt under 80 % which led to quasi immediate self recovery, nothing really surprising in such a powerful technical rebound. Beware of the Japanese mid term cycle pointing at October's low, (see Kimura Dreamvisor Newsletter 26th September 2006) although this should represent a good chance to buy at lows.

Are Japanese pharmaceuticals preparing for a foreign onslaught?

I noticed an interesting article in the Nikkei 27th September edition related to Japanese large pharmaceutical companies accelerating shares buy back to prepare for potential foreign companies TOB offer. I already mentioned it but (4502)Takeda pharmaceutical plans to use half its forecasted consolidated net profit (320 billion yen) to buy back its own shares. From current fiscal year's May to September Takeda bought back 2.8 % of its own capital. Takeda mention ROE increase but clearly the ultimate purpose is to keep own share at high level. (4503) Astellas also bought back 2.8 % of its own capital between current fiscal year August and September. Obviously each company has plenty of cash at hand to proceed with the buy-backs. However it seems that using surplus cash at hand to buy back own shares lacks efficiency. (4502) Takeda PBR is **2.7x**, (4503) Astellas PBR is **2.1x**, (4523) Eisai is PBR **3.1x**. Those high valuations may reflect growth but they are far above break up value. It seems shares buy back are mostly targeted at keeping a high share price to prevent hostile takeover. Takeda capitalization is 6.4 trillion Yen which is barely 30 % of the world leader Pfizer (24 trillion yen). I recall that from next year foreign companies will be able to buy out Japanese companies through share swap operation.
Japanese pharmaceuticals foreign shareholding ratio is already quite high: 43.8 % for (4502) Takeda and 47.3 % for (4503) Astellas. Japanese pharmaceuticals have no choice but to increase ROE considering such a large foreign ownership.

Regarding my PEDY list published the 29th of august just a word on (7202)Isuzu Motors which announced (22cd of September) that it's interim consolidated current earnings rose + 32 % at 50 billion Yen (above previously forecasted 46.5 billion Yen. The company will probably reach its previous 2008 year medium term plan one year in advance. Isuzu trades at 7.49x March 2007 net forecasted earnings which are 50 % under sector average. The stock has still potential considering Asia demand for light truck.