

***Nikkei/TOPIX level direct link to Japanese household's wealth effect.***

***HHI index another indicator among others to spot interesting sectors?***

We have now entered Q2 announcements full season and individual stock response to earnings need to be closely monitored as upside revisions will further materialize. I do not chase sectors but I would certainly look for opportunities in retail, food, services.

A quick glance at Q1 earnings: TSE listed companies Q1 consolidated earnings (April-June) net profit rose +35 % on average (New growth Markets and financials excluded). Due to raw materials prices increase non ferrous metals and trading companies' earnings were remarkable. Thanks to flat panel TV screens demand electronics sector registered a +122, 4 % increase YOY. Despite uncertainties over US economy net earnings are forecasted to rise for March 07 albeit at slower pace.

Same glance on new growth markets (JASDAQ, MOTHERS, HERAKLES) Q1 earnings : all industries basis consolidated recurring profits rose +8,2%, manufacturing companies registered a +34,6 % increase and services registered a - 6,2 % decrease.

The 4th of September MOF also announced Q1 (April-June) investment in equipment figures: +6.6 % rise YOY. This is the 13th increase YOY in a row. A breakdown of this figure (excluding software industry) gives +15. 2% for manufacturing and +20.1 % for non manufacturing. MOF statistics only take in account companies capitalized above 10 million Yen, out of 25373 companies' polled 19798 answered (78 % response rate). Obviously Japanese GDP will slightly be revised up for Q1. Needless to say current Yen weakness against euro is a boost to Japanese exporters as most exporters in house euro/Yen forward contract are geared at 130 Y or less.

On this background I feel important to further develop the screening of Japanese individual's current stance toward equity market: the Nikkei published on august 31st a brief article which mentioned that for the year 2005 Japanese households unrealized gains + realized gains on equities equaled 622 trillion 100 billion Yen registering a new historic high. Individuals consumption represent 20 % of nominal GDP and as the Nikkei rose 46 % up to the end of march 2006 households equities and investment trusts unrealized gain ballooned to 14,3 times 2004 level.

Although since May Nikkei had fallen back to 14000 level on the 4th of September it had already recovered to the 16300 level. Household investments dividend flow is rising too at fast pace. According to the same article it amounted to 6 trillion 300 billion Yen in 2005 (a 30 % rise YOY). According to the Daiichi Life economic research institute individuals always realize part of their gains out of which 70 % goes to consumption which translate into 0, 1 added points to nominal GDP. Looking at recently TSE published investors trading share breakdown individuals market share has kept above 30 % for 4 weeks in a row (still low compared to last year December peak at 55 % but improving). The core indicator to gauge individual

investor's willingness to participate is the well known margin loss profit ratio which deteriorated to -19.7 % in June but on the 25th of August it came back to **-9.14 %**. (The lower it is the higher individual players will be active and it has been under 10 % for 5 weeks in a row.)

Kiyoshi Kimura developed further an interesting global individual's stance comparison in *Kimura Dreamvisor Newsletter Summary 5th September 2006*. (Loaded on site as usual)

In addition the 6th of September Nomura research Institute published a survey: the number of high net worth individuals in Japan has increased substantially. High net worth individual's net assets rose to 213 trillion yen from 50 trillion yen in 2003. Quite a jump.

Now what to buy?

A scoop regarding new growth Markets : on the 5th of September the IPO price of Mixie Inc (2121) has been set up at 1,5 million Yen (the upper range). You may never have heard about this new growth stock but this IPO is quite important. The stock should be listed on MOTHERS the 14th of September and will become the 4th capitalization of MOTHERS with more than 193 billion Yen. Mixie business field is Social Networking Service (SNS). MOTHER's volatility is closely linked to trading volumes, for now MOTHERS historical volatility index is low under 30 % and volumes have not yet recovered. It is expected that Mixie listing could increase again the volatility. Looking at it coldly Mixie Per will reach 100x on March 07 discounting no less than 3 years earnings in a row. Growth prospects are still unclear according to numerous observers. This will be interesting to watch anyway on a supply demand situation point of view as market participants are looking closely Mixie IPO.

M&A news.

I mentioned previously several strategies to search for M&A value targets but it looks that more complex methodologies are attracting market participant's attention. One good example being the Herfindahl Hirschmann Index (HHI) which is a widely accepted measure of market concentration and, surprise, it has been also used by Japanese official bodies to evaluate mergers for the past two years. In short the HHI is calculated by squaring the market share of each firm competing and then summing the resulting numbers. The closer the market a monopoly the higher the market concentration (hence the higher the HHI). The Nomura Securities Research Institute has calculated the HHI based on Nikkei industrial sectors: for 2006 the average HHI is 2018.4. Since 1989 the lowest HHI was 1807.3 in 1995 and therefore has climbed 200 points since.

This indicator can be timely used to check sectors prone to mergers (market leaders buy out the weaker ones), the Nikkei financial Daily has screened sectors with year 2006 HHI under 1000 and recurring profit lower than fiscal year 2005 (March 06) average. Electronics, textile and Food trading companies represent

the core bunch. From May 2007 it is highly possible that larger companies will buy out weaker ones in the above mentioned sectors. This looks convincing.

HHI and current profitability are FY 06 based. (This template has been published by Nikkei financial daily 1st of September edition) based on Nomura Research Institute figures

sector	Companies no	HHI	Current profitability %	Sector sales leader company
Electronics trading companies	89	240	2.7	Daiwabo Systems
Medium building companies	54	420	2.0	(1808)Haseko corp.
Electrical construction	49	532	2.7	Kinden
Textile trading	46	558	4.3	Onward Kashiama
Other building companies	49	636	2.8	(1963) JGC corp.
Road & foundation works	39	644	1.4	(1881)Nippo Corp
Auto spare parts	61	705	5.0	(7259)Aisin seiki
Other trading	98	806	3.0	(9984)Softbank
Food trading	39	865	1.0	(7541)Ryoshoku

Current profitability = current earnings/sales in %