Back to the future?
I do not believe so, let's close the understanding gap.

Are cross-shareholdings back in favor within Japanese industry? This is a hot topic and an old problem coming back on the table. Let's review it from both angles (Japanese and Foreign).

I noticed an article signed by Mr. Kuroda Masayuki senior fund manager at Daiwa Sumitomo Bank asset Management: 'Quite a number of observers have sustained that for the past 20 years cross shareholdings have destroyed shareholder value. 17 years before US shareholder activist Boon Pickens had taken up to 20 % of (7276)Koito Mfg (Toyota affiliated parts maker) equity and requested to send administrators to the board, which was bluntly refused by Koito's management. 17 years passed and Toyota Koito Mfg affiliation, far from destroying shareholder's value, contributed strongly to such value increase. Toyota has built a strong and binding affiliation system and made it in a way to prevent any drain of intellectual property rights. On the reverse pillage of intellectual property rights in the electronics industry (weak cross shareholding structure) has been severe. This said the Toyota case is special: Toyota has a tendency to depend too easily on cross shareholdings which damages equity value. It is considered normal in Japan that even non efficient subsidiaries receive orders from parent and this has certainly hindered profitability improvement efforts. On the reverse parent companies sometime live at the expense of subsidiaries, for example by sending excess staff to subsidiaries. To avoid such kind of damages an increasing number of Japanese parent companies will make the sub private and fully incorporate it*. In this sense cross-shareholding is a double edge sword. Companies currently strengthening cross shareholdings are not looking at repeat past practices but rather implement a new industrial strategy, this need to be explained to shareholders clearly.'

* A subject I have personally insisted on in *my newsletter dated 29th of august*

Now considering foreigners point of view knowledge gap is consequent as usual: Lazard Asset Management Global Fund Management head Nicolas Platt has been buying Japanese stocks on the back of management renovation and has a list of so called 'dark side' Japanese equities ('Dark Side' means companies that did not yet undergo a full renovation with banks or civil servants support). Within the 50.5 billion US$ fund managed by Nicolas Platt this 'dark side' invested percentage has been going down form 17 % at 2006 year's beginning to current 10 %. Why? Because foreign

investors consider that Japanese companies will to undergo renovation has weakened, the motivation based on 'change or disappear' concept has weakened on the back of expanding economy and improved earnings. At least that is what some foreign investors are putting forward. Foreign securities houses also focused on Abe's picking conservatives for his cabinet (among foreign securities houses the equation Abe=old-style insiders is popular) which differs from Japanese political commentators saluting a 'brave' cabinet. Anyway Foreign investors consider that the tendency to depend too easily on parent company for help put a brake on 'turn around 'management. Every year in February Nomura securities hold an annual seminar for investors (the Nomura Hakushin seminar) in New York which could be translated as some kind of US investor's barometer toward Japan. 'Hakushin' 2007 topic will be Globalized competition and other Asian industries (China, Korea) will be invited.
Japanese companies are not turning back to old style cross-shareholdings strategies but rather shifting strategies. Key point is to explain it clearly to both shareholders and investors.

Now coming back to what Kiyoshi Kimura was rightfully mentioning regarding patent application system standardization (*Kimura Dreamvisor Newsletter 26th September*) it looks like a great leap forward has been achieved as the Nikkei 28th of September reported that US IBM was totally revamping its patent registration system. In the US IBM has kept leading position for 13 years regarding patent registration cases. It is now a question of time for other US companies to follow suit. IBM announcement has been welcomed by Japanese industries as this will stop the patent tug of war and improve research and development efficiency. The Japanese Intellectual Property Rights association (900 members) Director Mr. Doi Hideo welcomed the IBM move as this will allow companies to avoid fruitless research & development efforts and focus in other research areas. Japanese large electronic companies are all ranking high for patent application within USA (nor to mention at home for 'latent patent').

Now what to buy?

A short to mid term suggestion in the food/retail sector:
(7522) Watami Food. PER looks high at 67x but I feel this stock has immediate upside potential. Watami is originally a food restaurant industry company but expanding fast its home nursing business which is becoming the new growth pillar. From March 2008

to March 2011 the company will build 912 nursing homes for older people (care facilities) and is planning to expand the care facilities division profit 10 times to 6 billion Yen. Watami has entered the nursing home business in March 2005 creating a brand on the basis of its existing food plants for restaurant industry. By august end the average occupancy rate was 89.6 % which is 6 points above current fiscal year forecast. On the basis of the rising occupancy rate Watami plan to build new facilities, construction cost for new centers are paid out of occupancy fees of existing centers. Watami intends to finance centers out of current ordinary cash flow. Free cas flow should be negative up to March 07 but then turn positive. The final piece on the cake is that Sony Life (unlisted) announced the 28th of September they shall provide life Insurance products using watami brand and shall take up to 5 % of Watami capital. Discounting Watami current earnings forecasts up to 2011 we can deduct PER of *19* x. I believe the stock has a 50% upside potential (at least) and foreign shareholding is low at 1.1 %. Chart looks good also.