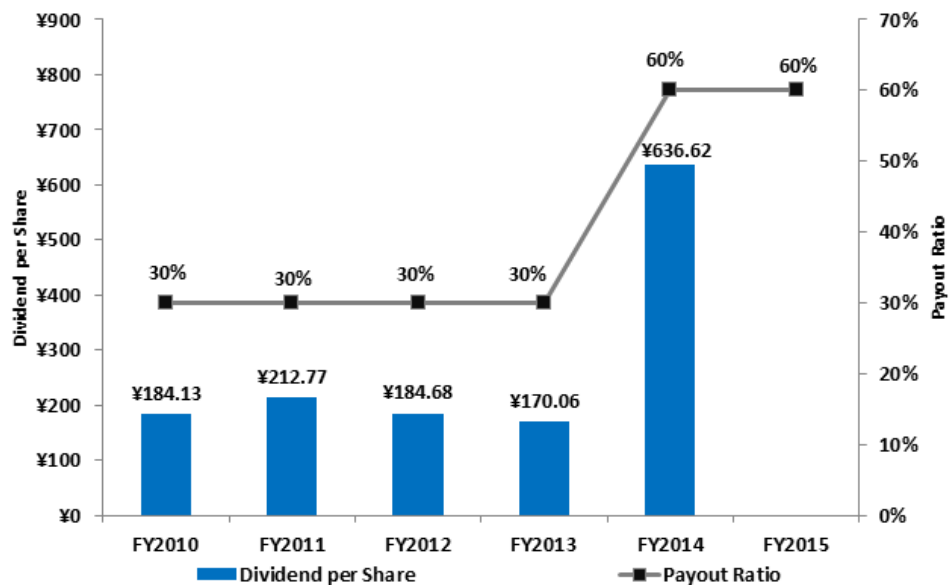


THE MOST WONDERFUL TIME OF THE YEAR (FOR JAPANESE EQUITIES)

Christopher Gannatti — Head of Research, Europe
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March 31 marks the end of Japan’s fiscal year, making it a very important point from which to gauge how Japanese stocks are behaving and, ultimately, whether [Abenomics](#) is having any real impact. *Based on what we’re seeing so far, we remain extremely excited for the prospects of Japanese equities.* **Firms Very Focused on Raising Return-on-Equity (ROE)** During the 15 years of [deflation](#) from 1998 to 2013, Japan became known for being a very low return-on-equity market compared to other global options such as the U.S. or Europe. Firms simply hoarded cash on their balance sheets. In early 2014, the inception of the [JPX-Nikkei 400](#) provided a catalyst for an important change in behavior, because the measure of ROE (specifically averaged over the past three years) was a key metric for inclusion. Almost overnight, hoarding cash went from being the accepted practice to a reason corporate management teams could face negative attention by not having a high enough ROE to gain inclusion in the JPX-Nikkei 400, and no corporate manager in Japan wants such a stigma attached to their firm. **FANUC Exemplifies a Shareholder Return Policy** One of the first Japanese companies to report earnings for the period ending March 31, 2015, FANUC announced an innovative shareholder return policy. The company had ¥991.2 billion (\$8.25 billion) in cash on hand, a figure that had increased 20% from the prior year. FANUC has a 50% global market share of numerical control devices and an operating profit margin of 40%¹. **FANUC Doubles Its Dividend**



Source: FANUC Financial Results for the Year Ended March 2015, Company Presentation, 4/28/15.

Payout Ratio Target

For definitions of terms in the chart, visit our [glossary](#). • **Payout Ratio from 30% to 60%:** As FANUC doubled its dividend payout ratio, from 30% to 60%, its dividend went from ¥170.06 per share to ¥636.62 per share—a big jump. This means that the company believes it can sustain paying out more than half its profits to shareholders on an ongoing basis, which is a very significant move. As of May 1, 2015, the aggregate dividend payout ratio for the [Tokyo Stock Price Index \(TOPIX\)](#) was only about 27%, meaning that FANUC is making a strong statement. • **Combining with a Flexible Buyback Plan:** FANUC didn’t stop with the dividend policy; the company also announced a flexible share buyback program. The way it’s written allows for FANUC to purchase greater amounts of its shares as it attains greater and greater profitability. **Ongoing Commitment to Shareholders Is New for Japan** These kinds of corporate shifts are what we find most exciting in Japan.

FANUC's example is made even more powerful given its ongoing commitment to shareholder returns rather than a single dividend raise or buyback. Specifically, the five-year average total return ratio, meaning the ratio of combined dividend and share [buybacks](#), over the total amount of [consolidated net profit](#) over a five-year period, is aimed at not exceeding 80%. If FANUC is more profitable, shareholders should expect greater dividends and buybacks with this policy, just as they should expect less if FANUC is less profitable. What's telling is that the firm considers that the 20% of net income retained from this policy is still more than enough to represent substantial future investment.² **Corporate Reform Isn't Only about Dividends and Buybacks** The concluding point that we'd like to make is that although the focus on shareholder returns such as dividend and buyback increases has been an important catalyst and gets a lot of attention, it's not the only part of the picture. Firms are also increasingly looking to appoint more outside directors to their boards, as part of a government-led initiative to improve corporate governance. FANUC proceeded in that direction as well, having appointed at least two independent board members to the company's board.³ We take this as another positive sign that Japan Inc. is moving in the right direction for shareholders.

¹Source: Keita Sekiguchi, "In About-Face, FANUC Turns Friendly to Shareholders," Nikkei Asian Review, 4/30/15. ²Source: Keita Sekiguchi, "In About-Face, FANUC Turns Friendly to Shareholders," Nikkei Asian Review, 4/30/15. ³Source: Japan Exchange Group JPX-Nikkei 400 Methodology.

Important Risks Related to this Article

Investments focused in Japan are increasing the impact of events and developments associated with the region, which can adversely affect performance.

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DEFINITIONS

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Deflation : The opposite of inflation, characterized by falling price levels.

JPX-Nikkei 400 : is composed common stocks whose main market is the TSE 1st section, 2nd section, Mothers or JASDAQ market (in principle). The components are reviewed annually to keep the representativeness of the market. The Annual Review shall be conducted at the end of August as follows.(1)1000 stocks are selected based on trading value in the past 3 years and the market value on the selection base date (the end of June) of the Annual Review, (2)Each stock is scored by 3-year average ROE, 3-year cumulative operating profit and market value on the selection base date with the weights on the each indicator 40%, 40%, 20% respectively, (3)400 stocks are selected by the final ranking with the scores calculated in (2) and qualitative factors from the perspectives of corporate governance and disclosure. In case of delisting of the components due to a merger or bankruptcy etc, new stocks shall not be added in principle. When the Annual Review is conducted, the number of components is back to 400, therefore the index is calculated with less than 400 components until then.

Dividend Payout Ratio : The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.

Tokyo Stock Price Index (TOPIX) : A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Consolidated net profit : Company net income brought together from different subsidiaries to the parent.