

# The Most Wonderful Time of the Year (for Japanese Equities)

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## WisdomTree

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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. **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 behaviour, 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].

*Source: Keita Sekiguchi, "In About-Face, FANUC Turns Friendly to Shareholders," Nikkei Asian Review, 4/30/15*

**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[1].

### **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[2]. We take this as another positive sign that Japan Inc. is moving in the right direction for shareholders.

Investors sharing this sentiment may consider the following UCITS ETF:

### **WisdomTree Japan Equity UCITS ETF – USD Hedged (DXJ)**

[1] Source: Keita Sekiguchi, "In About-Face, FANUC Turns Friendly to Shareholders," Nikkei Asian Review, 4/30/15

[2] Source: Japan Exchange Group JPX-Nikkei 400 Methodology *All data is sourced from WisdomTree Europe and Bloomberg, unless otherwise stated.*

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