

Mizuho Custody Newsletter

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I. Market News

1. Around 10% of the total “tentatively approved group”, that were listed on the new market on the transitional measures, has exceeded the standards

Six months have passed since the Tokyo Stock Exchange (“TSE”) reorganized the market into three: Prime, Standard and Growth in April. The focus has been on the “tentatively approved group” of 549 companies that were listed on the new market on the transitional measures in spite of failing to meet the new listing standards. According to Nikkei Shimbun, Japan’s leading financial daily, market capitalization of about 60% of the tentatively approved group dropped and investors remain cautious of their future outlook. On the other hand, according to the TSE, 65 companies, or about 10% of the total “tentatively approved group”, which made continuous efforts to enhance their corporate value, exceeded the standards by the end of this September.

In the market reorganization in April, the TSE tightened

listing standards and those for delisting. As for the market capitalization, the TSE has set the standard for companies to list on the Prime as JPY 10 billion or more, excluding shares held by the parent company, its executives and financial institutions. Before the reorganization, companies could stay listed on the TSE 1st section unless their market capitalization, including non-tradable shares gets below JPY 4 billion. They would not be delisted unless its market capitalization become less than JPY 1 billion.

A broadcasting company listed on the Prime market increased their tradable shares from 30% to 38% by selling its treasury stocks and by asking their major shareholders to sell their holdings. Many companies that have met the standard took this approach.

In some cases, positive evaluation toward companies’ “plan document” to apply for transitional measures actually pushed up their share prices.

Shares of an auto parts manufacturer have risen more than 50% since they submitted their “plan document” at the end of last year. The company set a target payout ratio of 75% until its ROE exceeds 9%. The managing executive officer of the company said, “We want to be a company that looks attractive to foreign institutional investors,” and the company will focus on the electric vehicles sector.

In some cases, stock prices rose by announcing more investment for growth. A trading company presented a growth strategy, including setting an investment quota of JPY 3 billion over 3 years term. A semiconductor trading company is accelerating its growth strategy by investing in an Indian company in April to expand its overseas business.

However, the market is viewing companies in the “tentatively approved group” with critical eyes. Of the 293 companies in the “tentatively approved group” of the Prime market, excluding those that has been delisted, market capitalization of 188 companies, or 60% of the companies in the “tentatively approved group”, dropped in comparison between their value as of September end and that before the reorganization.

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TSE has not announced when the transitional period would end. Some companies postponed their goals that were set by themselves. A web promotional support company extended the time to reach the standard of the market capitalization of tradable shares by 2 years from the initial target of March 2023.

"Large-scale mail-delivery system deals stagnated, falling short of mid-term plan figures," the company said, whose market capitalization fell by less than 30% from April.

On the other hand, more companies questioned whether they were worth staying listed and consequently chose delisted. In September, a railway company made its listed affiliate to become a wholly-owned subsidiary after holding more than 40% of its shares in a share exchange. An office parts manufacturer was delisted in July by MBO. In 2021, 83 companies were delisted through MBOs, a 50% increase from 2020. In 2022, the trend remains at a high level, with 62 companies delisted by September end.

The market reorganization brought positive effect to the listed companies as a whole on improvement of corporate governance. The ratio of the companies having one third or more outside directors was 92% in July 2022, among those listed on the Prime market, up about 20% from December 2021 of those listed on the former TSE 1st section. Companies listed on the Prime market that disclose information in English also rose 6 points to 92%.

There should be more things to do for Japanese companies to boost their earning power by strengthening market discipline and improving governance. The median market capitalization of the companies listed on the Prime market is about JPY 60 billion, just over 20% of those listed on the New York Stock Exchange. It is essential for leading companies to grow further and to strengthen performance of companies as a whole.

TSE has been holding "Council of Experts Concerning the Follow-up of Market Restructuring" for several times. With regard to the period of the transitional measures currently set as "for the time being", some experts opine that it is appropriate to set the period around 5 years after the transition (by 2027) based on the target period many tentatively approved group set as their goals. In order to enhance predictability for

the companies and to appropriately realize the concept of each market, it is commonly understood at the TSE to present its policy on this subject including the end of the transition period. TSE intends to continue to discuss further on this subject by having interview with the companies and solicits comments from market participants from 30 September 2022 to 31 October 2022.

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange, Inc. & Mizuho research

2. Calculation method of TOPIX was revised and component ratio of 493 companies were reduced

The calculation method of Tokyo Stock Price Index ("TOPIX") has been reviewed in relation to the cash equity market restructuring in April 2022. TOPIX continues to be calculated on the composite as of 1 April 2022, regardless of the transition to the new market segment on 4 April 2022. However, issues with market capitalization of outstanding shares below JPY 10 billion are subject to "phased weighting reduction" and their component ratio are gradually reduced every quarter from October 2022 in ten steps to zero by January 2025. TOPIX issues that are subject to the phased weighting reduction will be re-evaluated in October 2023, and depending on the results, the phased weighting reduction may be stopped to some constituents or some constituents may be removed from the list of phased weighting reduction constituents. The framework aims to reflect efforts of listed companies to increase market capitalization of their outstanding shares by adopting multistage approach for judgement or re-evaluation process regarding application of phased weighting reduction.

On 7 October, JPX Market Innovation and Research, Inc. ("JPXI") announced that it would revise the calculation method of TOPIX and reduce the component ratio of 493 companies in TOPIX. More than 20% of the 2,168 companies listed on the former 1st section of the Tokyo Stock Exchange ("TSE") making up the TOPIX will be subject to the reduction. 205 companies listed on the Prime market and 288 companies listed on the Standard market failed to meet the minimum market capitalization threshold of JPY 10 billion. According to Nikkei Shimbun, Japan's leading

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financial daily, those companies will lose money inflow from investments to TOPIX index funds, which will put downward pressure on their share prices.

TOPIX is a leading index used by pension funds, fund managers, etc., to invest in Japanese stocks. When TSE reorganized the market into three markets in April, TOPIX has retained a component of the former TSE 1st section for operational convenience since then.

A transitional measure has been applied to companies to remain listed in the market they want for the time being by submitting plan document that describes how and when they would meet the new listing standards even if they do not at the moment. On the other hand, for the calculation of TOPIX, a tougher measure was taken to phase out the stocks that did not reach a certain level.

JPXI will reduce their component ratio every 3 months from the end of October 2022 and remove them from the index at the end of January 2025.

As a remedy, if market capitalization of a TOPIX constituent is JPY 10 billion or more at the time of revaluation in October 2023 and the trading value is more than a required level against the market capitalization at the time of calculating the TOPIX, the component ratio of such company will be restored. If market capitalization of outstanding shares is JPY 10 billion or more but falls short of the threshold for the trading value, such shares will stay in the TOPIX with a reduced component ratio.

TOPIX calculates the market capitalization of all stocks on the former TSE 1st section on the weighted average scheme. TSE started reviewing the formula of TOPIX calculation in response to market voices that questioned situation in which money from investment trusts funds and exchange-traded funds (ETF) would automatically flow into TOPIX constituents just because they are listed on the former TSE 1st section.

There is no easy way to remain as a component of the TOPIX. In addition to boosting stock prices and increase corporate value by increasing profits, companies must make efforts to increase shareholder returns and expand their investor base by promoting IR activities.

The full list of phased weighting reduction constituents announced by JPXI are available at the following URL:

https://www.jpx.co.jp/english/news/6030/b5b4pj0000053v9m-att/topix_e.pdf

Information compiled from JPX Market Innovation and Research, Inc., Nikkei Shimbun, Tokyo Stock Exchange, Inc. & Mizuho research

3. Sales of cross-shareholdings by listed companies mark a historical high

More and more listed companies are unwinding cross-shareholdings. Sales of cross-held shares in the fiscal year ended in March 2022 totaled JPY 2.3 trillion, about JPY 600 billion more than that in the previous fiscal year, which is the largest amount in the recent 4 years since disclosure began, reports Nikkei Shimbun, Japan's leading financial daily. The TSE's market reorganization in this April, which changed threshold of tradable shares ratio in the listing standard, prompted companies to review their cross-shareholding practice. It appears to be the first step to the improvement in capital efficiency, but some companies intend to increase cross-shareholdings, showing that there are still challenges in management reform from a shareholder perspective.

Nikkei Shimbun has compiled transaction volume in relation to cross-shareholdings unwinding from the annual securities reports of listed companies (excluding financial institutions) for the fiscal year ended in March 2022.

Cross-shareholdings, which help create silent and stable shareholders, have been criticized by investors for management's intention of protecting their interests and for hampering effective use of companies' assets. Since the introduction of Corporate Governance Code in 2015, which required companies to explain their policies on cross-shareholdings, investors have been watching the practice more and more closely.

The Corporate Governance Code revised in 2021 stipulates about cross-shareholdings as follows;

"When companies hold shares of other listed companies as cross-shareholdings, they should disclose their policy with respect to doing so, including their policies regarding the reduction of cross-shareholdings. In addition, the board should annually assess whether or not to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and

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risks from each holding cover the company's cost of capital. The results of this assessment should be disclosed."

The amount of cross-held shares sold in the previous fiscal year was about 7% of the total value of cross-held shares as of the end of March 2021, which amounts to more than JPY 34 trillion in market value. As sales progressed, the average number of stocks held for purposes other than net-investment fell to 33.8 issues, down 1.5 issues from a year ago.

According to a research institute, shares cross-held by listed companies accounted for only 8.7% of the total market value of cross-held shares in FY2020, which is a big drop from more than 30% in FY1990.

However, it may not be fair to say cross-shareholding has been unwound stably. About 980 companies disclosed that they added one or more issues to their list of cross-held shares, reaching a total of JPY 728 billion in the acquired amount.

The full version of the Corporate Governance Code is available from the following URL:
<https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf>

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange, Inc. & Mizuho research

4. TSE launched a demonstration experiment of carbon credit market in Japan

On 22 September, demonstration of carbon credit market, which makes a trial trade, took place at the Tokyo Stock Exchange ("TSE") under the commissioned project "Technical Demonstration Project for Carbon Credit Market" from the Ministry of Economy, Trade and Industry.

Japan Exchange Group, Inc. has set "promoting sustainability that connects society and economy" as one of the key measures in its Medium-Term Management Plan 2024, and is willing to contribute to the realization of low-carbon society through this demonstration.

To begin with, trading of J-Credit, one of the carbon credits already being circulated in the market in Japan, was launched. 145 companies and municipal

governments have already applied to participate in the demonstration.

Transaction amount on 22 September, the first trading day, was about JPY 1.7 million, according to Nikkei Shimbun, Japan's leading financial daily. TSE will encourage companies to reduce emissions by introducing market trading, which is more transparent than over the counter trading to increase trading participants.

What begun trading on 22nd of September was an emissions system called J-Credit, which the government certifies the amount of carbon dioxide (CO₂) emissions reduced or absorbed by renewable energy and/or forest management initiatives as credits and makes them tradable.

Participating companies select a category of J-Credit businesses, such as renewable energy or energy conservation, from a dedicated website and place orders specifying the volume and the amount of money they want to trade. Orders can be placed once in the morning and another in the afternoon, and prices are set at 11:30 am and 3:00 pm.

Sporadic orders come in when trading begins at 9:00 am on the day, and 627 tons of J-Credit in terms of CO₂ emissions were traded. Of this, 221 tons were derived from the introduction of energy-saving facilities, and the contract price was JPY 1,600 per ton, which was the same as the reference price determined in advance by the TSE. J-Credit, derived from the installation of renewable energy facilities, was traded at JPY 3,300 per ton, JPY 300 above the reference price.

Small- and medium-sized companies and municipal governments are the main players in the J-Credit certification business, who are expected to be core sellers in the market. Meanwhile, the major corporations are expected to be core buyers. To achieve net zero emissions in 2050, they have set emission reduction targets, such as by 2030, and it is assumed that they will engage in reducing emissions in their core business, and will offset emissions by purchasing J-Credit if the reduction does not go far enough.

Companies are expected to refine their emissions technologies while participating in the demonstration tests, and to prepare their internal systems for full

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implementation in FY2023. "The demonstration project is the first step to visualize the value of CO₂ reduction in the market. We will accumulate knowledge with a view of further development of the structure of this product," said a person in charge at a major electronics company.

The number of companies actively participating in the experiment is still limited. According to interviews by Nikkei Shimbun to 20 major companies, eight of them said they would participate as buyers of J-Credit. Five of them would participate as sellers, including those that participate both as buyers and sellers. The main purpose of the companies that announced to participate in the experiment is information gathering, and about 50% of the companies take wait and see approach and have not decided how they would participate in the project.

The EU began emissions trading in 2005 and has developed it into a large market. It now sets the amount companies may emit each year for electricity and manufacturing, that are big emitters and are required to reduce emissions. In Japan, on the other hand, companies' participation is voluntary. If there are few transactions and prices are not quoted or prices are not attractive for investors, the market may end up with an undesired result. The key will be whether the market could attract more companies during the demonstration period until the end of January 2023.

Information compiled from Nikkei Shimbun, Tokyo Stock Exchange, Inc. & Mizuho research

New Equities Listing Approvals

Listing Date	Name of Company	ISIN Code	MKT
Nov-01	Terilogy Holdings	JP3546610001	ST
Nov-15	POPER	JP3856450006	G
Nov-15	BASE FOOD	JP3835230008	G
Nov-22	TMS	JP3544960002	G
Nov-25	tripla	JP3637030002	G

**Information compiled based on postings from the Prime (PR), Standard (ST), Growth (G), Tokyo Pro Market (P), NSE (N), FSE (F) & SSE (S).*

***Board lot size is unified to 100*

III. Foreign Ownership Limit Ratio

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