

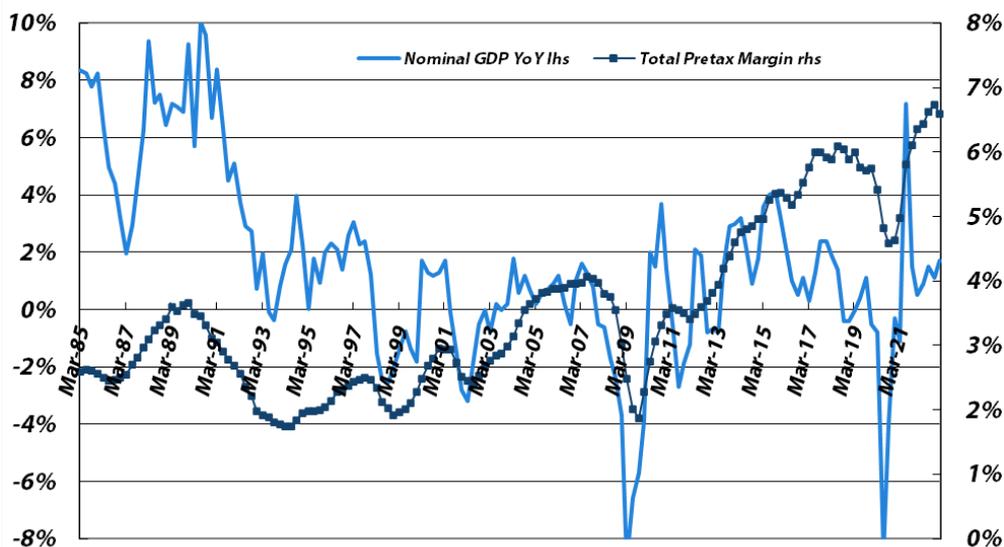
Japan's "Show Me the Money" corporate governance: 4Q, a pause in overall profit margin uptrend

Global economic growth should also help profits in the 1Q

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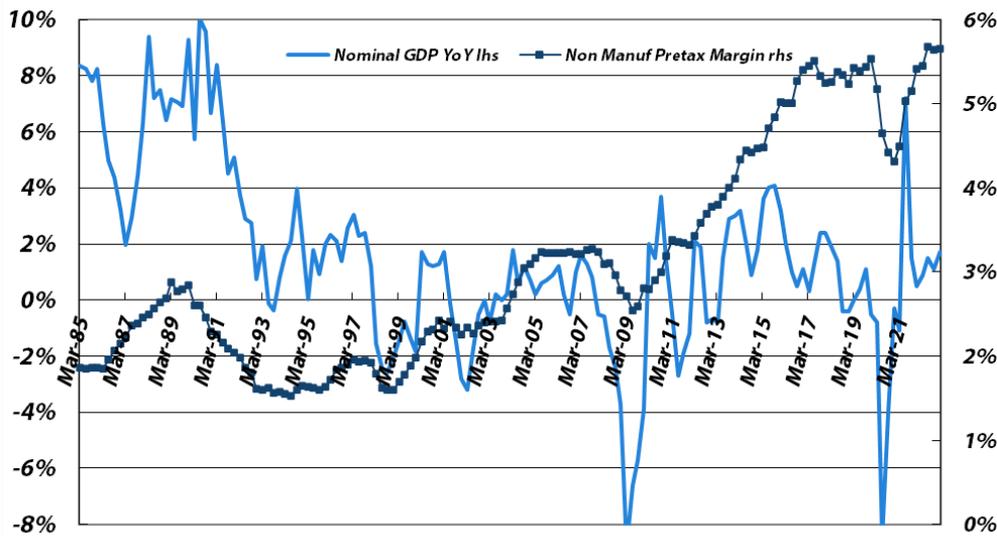
The just-released 4Q CY22 data on aggregate corporate profits in Japan was somewhat mixed, as the overall corporate recurring pre-tax profit margin fell from its record high on a four quarter average. The non-financial service sector ticked up, but the manufacturing sector fell from its record high. The former sector's pre-tax profits grew 5% YoY due to increased revenues, while the latter's fell 16% YoY. The long-held theme of this report (since 2006) that profit margins remain on a structural uptrend despite sluggish domestic GDP growth still holds but seems to have taken a pause due to the stronger yen during the quarter and subdued global growth, especially in China. Fortunately, it seems global growth is rebounding in the current quarter, led by China, and Japan's Real GDP should start improving too due to increased inbound tourism.

Four-quarter average pre-tax profit margin vs. Japanese nominal GDP YoY growth (for all non-financial companies, not just listed ones)



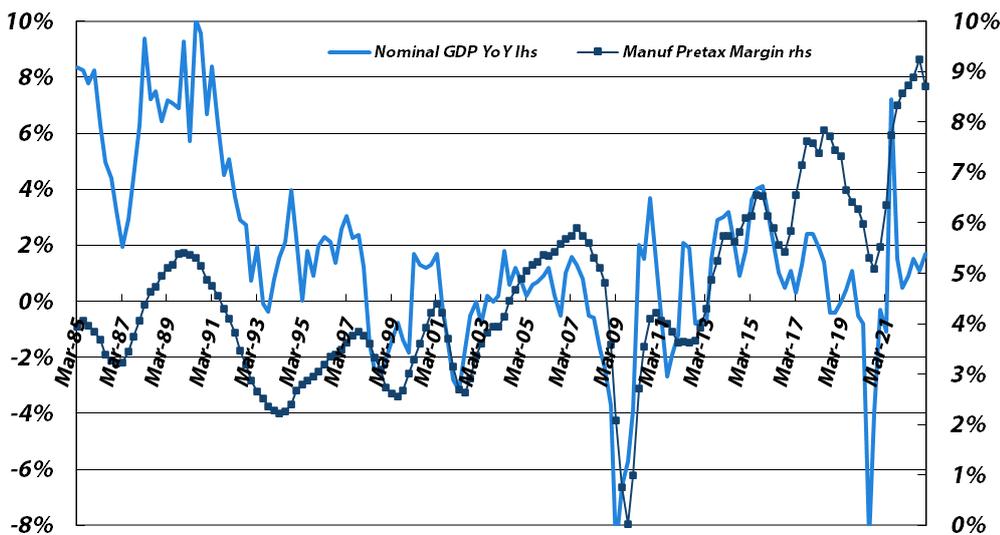
Sources: Japan Ministry of Finance, Bloomberg, data through CY4Q22

Non-manufacturers (excluding financials):



Sources: Japan Ministry of Finance, Bloomberg, data through CY4Q22

Manufacturers:



Sources: Japan Ministry of Finance, Bloomberg, data through CY4Q22

One should also note that the Ministry of Finance statistics cited in this report do not cover after-tax income, and due to corporate tax cuts nearly a decade ago, the overall net recurring profit margin has expanded even more sharply than the pre-tax data shown above, allowing shareholders to benefit from higher dividends and share buybacks. Also due to buybacks, EPS has been (and still is) growing even faster than net profits.

Clearly, the myth that Japanese companies do not reward shareholders should be dispelled by now, but somehow, the P/E ratio for the market remains very low. Many investors also worry about low Japanese economic growth, but this report's theme should dispel such. In sum, this kind of mismatch of perceptions vs. reality usually provides a good opportunity for investors. Indeed, Japan's MSCI in USD terms has outperformed MSCI World since this last report, but unfortunately, has only matched its performance over the last year.

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