

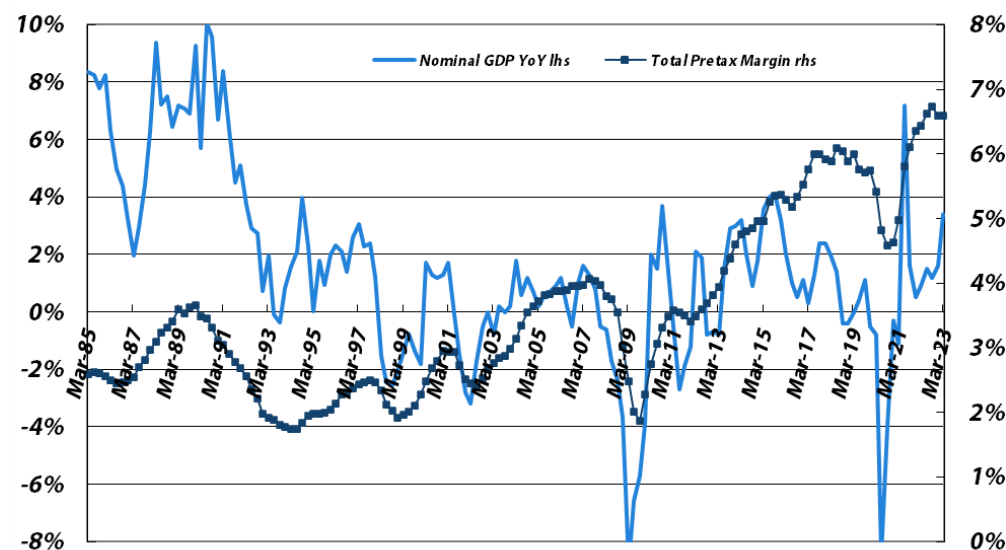
# Japan's "Show Me the Money" corporate governance: 1Q, investors seem to finally accept the theme

By John Vail, Chief Global Strategist  
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The just-released 1Q CY23 data on aggregate corporate profits in Japan was somewhat mixed, as the overall corporate recurring pre-tax profit margin remained flat vs. the 4Q, and just off its record high on a four-quarter average. The non-financial service sector rose to a record high, but the manufacturing sector fell further from its record high. The former sector's pre-tax profits grew 17% YoY due to increased margins and revenues, while the latter's again 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 and domestic and international investors finally realise that Japanese corporations are delivering solid profits and shareholder returns, with the increased expectation that such will likely continue over the intermediate term.

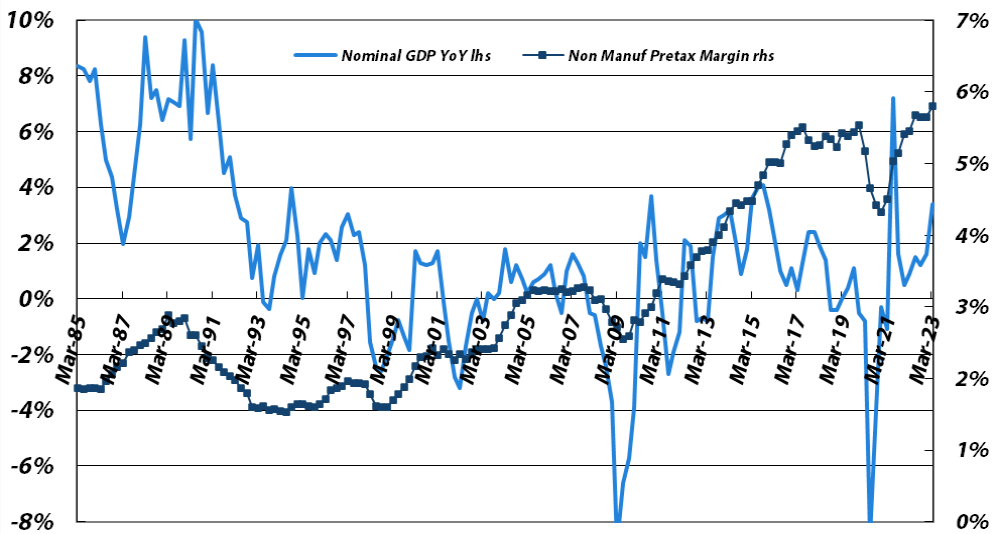
## Four-quarter average pre-tax profit margin vs. Japanese nominal GDP YoY growth

(for all non-financial companies, not just listed ones)



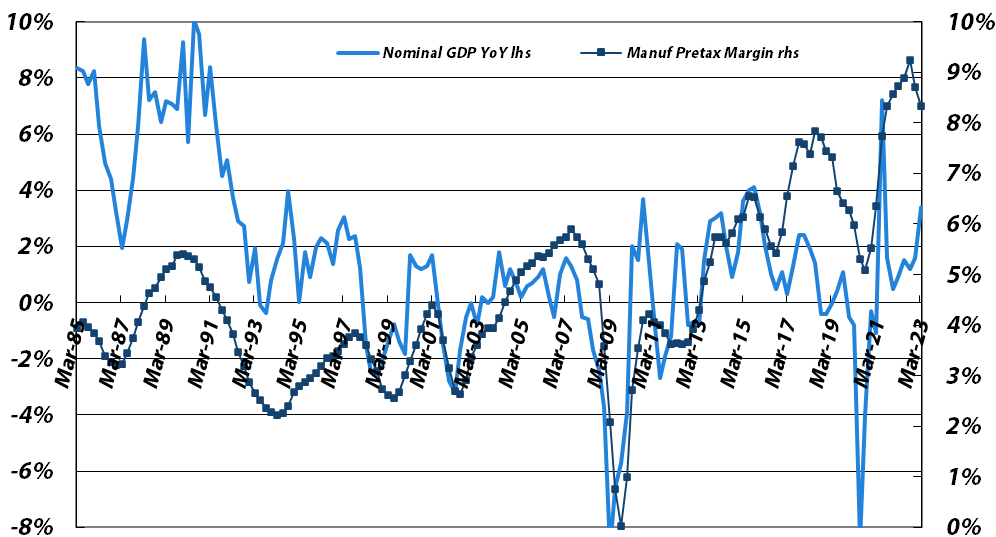
Sources: Japan Ministry of Finance, Bloomberg, data through CY1Q23

**Non-manufacturers (excluding financials):**



Sources: Japan Ministry of Finance, Bloomberg, data through CY1Q23

**Manufacturers:**



Sources: Japan Ministry of Finance, Bloomberg, data through CY1Q23

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.

It seems that the myth that Japanese companies do not reward shareholders is finally dispelled now, and, thus, the P/E ratio for the market has greatly improved. However, valuations remain attractive, especially for long-term investors. Some investors likely still worry about low Japanese economic growth, but this report's theme should greatly help dispel such. Indeed, Japan's MSCI in USD terms has outperformed MSCI World since this last report (as well as over the past year), but unfortunately only slightly so, which means that Japan is hardly in a bubble. Thus, given the increased global realisation of Japan's improvements, stronger outperformance vs. global markets seems highly probable.

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