

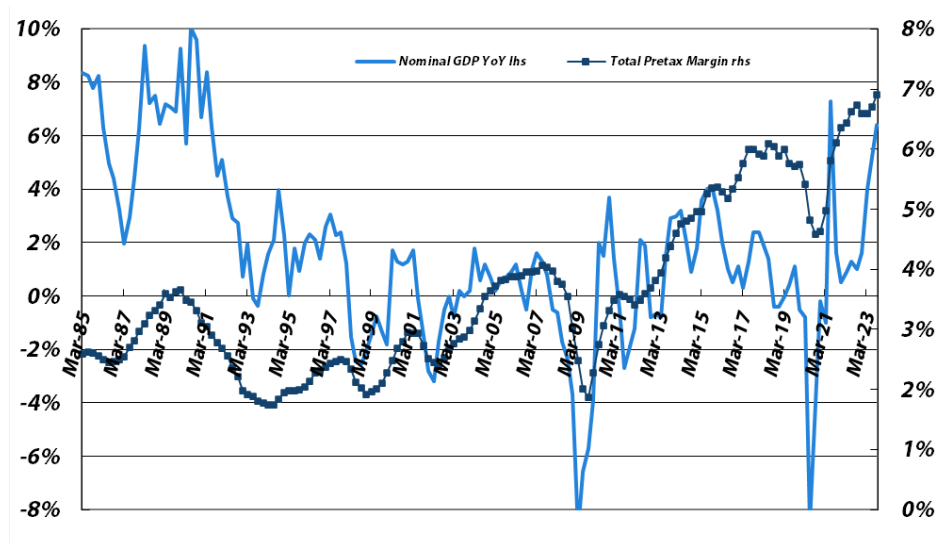
# Japan's "Show Me the Money" corporate governance: 3Q profit margins near record high

By John Vail, Chief Global Strategist  
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Some readers may not be familiar with the title-phrase of this report, carried on since 2006, but it refers to the comedic movie "Jerry Maguire" in which a sports agent successfully delivers a lucrative contract to his American football client after long negotiations. Although there are many aspects of the deal in this movie, like in corporate governance, in the end, profit growth should be key and it is positive that Japan's corporate governance is delivering in this way. Indeed, the just-released 3Q CY23 data on aggregate corporate profits was a bit mixed, but the overall corporate recurring pre-tax profit margin surged to a record high on a four-quarter average. The non-financial service sector rose to another record high, but the manufacturing sector fell further from its record high. The former sector's pre-tax profits grew 40% YoY due to increased margins and revenues, while the latter's was virtually flat YoY for the second quarter in a row. The long-held theme of this report that profit margins remain on a structural uptrend, despite sluggish domestic GDP growth, still holds (although recent nominal GDP growth is assisting to some degree) 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. Indeed, the large, continuing corporate price hikes are very surprising to long-term observers of Japan. Consumers are quite unhappy with such, especially if their after-tax wages are not growing faster than such, but local and global investors in Japanese equities are reaping the benefits.

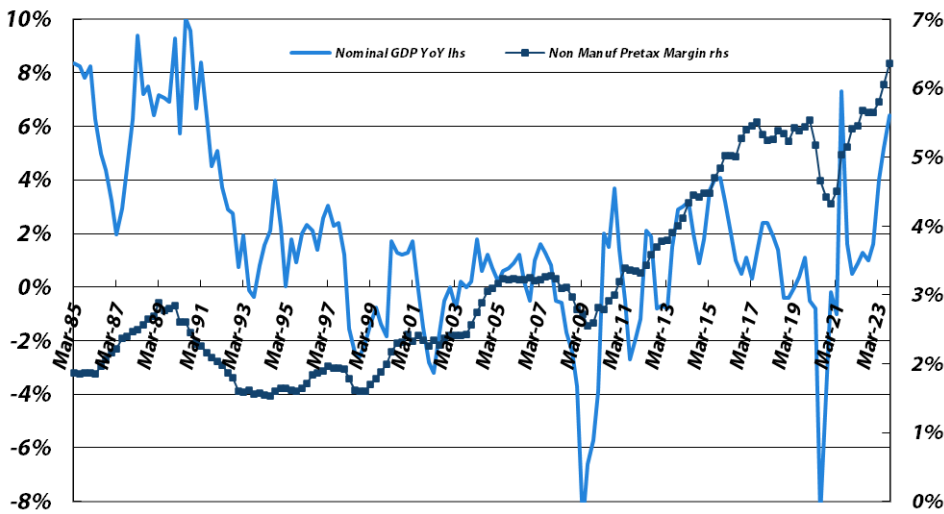
## Four-quarter average pre-tax profit margin vs. Japanese nominal GDP YoY growth

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



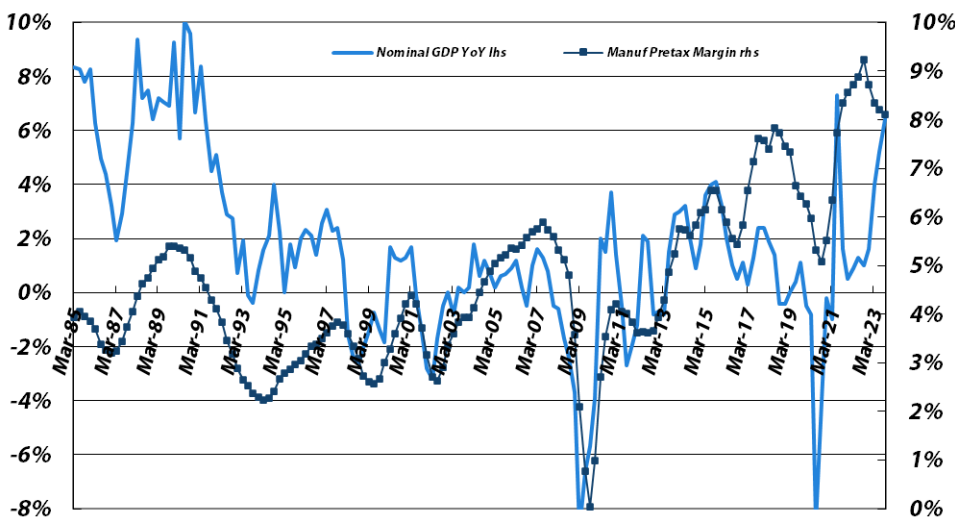
Sources: Japan Ministry of Finance, Bloomberg, data through CY2Q23

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



Sources: Japan Ministry of Finance, Bloomberg, data through CY2Q23

**Manufacturers:**



Sources: Japan Ministry of Finance, Bloomberg, data through CY2Q23

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 risen. 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. Forward EPS estimates continue to rise in Japan, as well. However, Japan's MSCI in USD terms has not outperformed MSCI World this year, which means that Japan is hardly in a bubble or even over-bought. Thus, given the increased global realisation of Japan's improvements, outperformance vs. global markets seems highly probable.

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