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# JOHCM Japan Fund

## On the ground in Japan: where have all the bumbling, middle-aged managers gone?

FOR PROFESSIONAL INVESTORS ONLY

The fund manager I was sitting beside at dinner hadn't been to Japan for three years, so I was interested to know what changes he noticed. He looked up from his sushi and announced that he thought management had changed. This was exactly what I had hoped to hear. In what way had they changed? Focused on profits rather than market share? Better shareholder returns? "They're taller. And younger. The bumbling middle-aged salaryman managers have gone."

### New-found confidence

We were both attending the Daiwa Securities investor conference in Tokyo. Over five days, hundreds of investors from all over the world had hundreds of meetings with companies. Perhaps company managements are like policemen; the older you get, the younger they look. My meetings certainly didn't feature many of the tall, dynamic managers mentioned by my dining companion. I suspect he had been meeting some of the internet companies. However, I did agree with his point about the bumbling middle-aged managers; they're no less middle-aged, but they seem more purposeful than before. Companies that once would have been thought of as dinosaurs now display a new confidence. Nippon Steel Sumitomo Metal Industries, itself the product of a merger that would have seemed impossible only a few years ago, explained its programme of blast furnace closures and announced that it was now more profitable than POSCO of South Korea. Obayashi, a construction company, when asked if it would bid for work related to the 2020 Tokyo Olympics, said that it would, but not at any price. "If the Olympics had been held 10 years ago", said the spokesman, "we would definitely have bid below cost to get the orders." Aica Kogyo, a construction materials company I met when I spent a day in Nagoya, had just sold its profitable printed circuit board business because it was non-core and it wanted to reinvest the proceeds in its very profitable melamine board business.

### Rising wages?

Companies generally seemed more confident about the future. Next month's consumption tax came up in many of the discussions, but most expected a limited impact. Hakuhodo, Japan's second largest advertising agency, explained to me that, at the time of the last tax hike, in 1997, clients had spent heavily on advertising in the run up to the tax hike, but then reduced spend significantly as soon as the tax increase was implemented. This time, clients are planning to continue advertising in April. The president of J Front Retailing told me that he expected no more than a short-term adjustment to high-end consumption. At the same time, he explained how tourist arrivals were starting to make a noticeable impression on department store sales. For the year just ended, J Front's tax-free sales doubled. In the longer term, they should account for 10% of sales. However, despite this underlying confidence, companies will put their forecasts for next fiscal year together in late March, and I suspect they will announce conservative numbers on the basis that it is difficult to be certain about the impact of the consumption tax. As for wages, most companies expected to follow Toyota's lead in increasing salaries. Nippon Steel Sumitomo Metal Industries told me that wages were not a big part of the cost base and said that higher wages meant people would have more money to spend on cars and other consumer durables, which would mean more demand for steel.

### The 'Davos promise'

The speakers the Abe regime sent to present at the conference were unsurprisingly upbeat. However, they also showed an awareness of how the outside world is judging Abenomics. Professor Heizo Takenaka was an architect of many of the Koizumi-era reforms and is also a key member of Abe's team of advisers. He spoke in fluent English and started out by taking a vote on whether the audience thought the Abe Government's reforms were on track. Opinion in the audience was fairly evenly divided, which Mr Takenaka said was a good result, as he does this poll every time he addresses such an audience and generally only 30% of them are optimistic. He described the Government's determination to cut through the 'bedrock of regulation' and reminded the audience of Abe's speech at the Davos Forum a few weeks ago, at which the Prime Minister promised to cut the corporate tax rate, bring more women into the workforce and introduce foreign labour. Apparently, in government, this is referred to as the 'Davos promise'. Takenaka then finished on a very upbeat note, reminding us that the Nikkei index is still below where it was at the time of the Lehman's shock and claiming that the positive impact of the Tokyo Olympics might mean that Japan could go through the next seven years without experiencing a serious recession. He suggested that the Abe Government could be the longest in the post-war era.

### Still undiscovered treasure

Given the increased level of interest in the market and last year's substantial rally, you might think it would be harder to find undiscovered companies. Not so. When I travelled to Nagoya later in the week to visit Tokai Rubber, I was their first ever overseas visitor. And yet Tokai Rubber is the world's leading producer of anti-vibration rubber for the auto industry. A year ago, the company decided that the auto industry's move to global production and standardised components meant that it needed to have a global production system. It made four overseas acquisitions and now has the capacity to supply automakers all over the world. There have been some initial teething problems, but this is a business which is well-positioned to increase its global market share. And it trades on less than 0.6x book value.

This global focus is in evidence among even the smallest of Japanese companies. Toyo Seikan, a maker of tin cans, explained how it was currently operating in 11 countries and had just set up two companies in Germany. It hopes to sell its environmentally-friendly cans, for which the production process requires no water, no lubricants, significantly reduces CO2 emissions and produces no industrial waste, to some of the global companies, such as Coca-Cola, which already use them in Japan. Possibly the most interesting company of the week was Oyo. Oyo is a geological surveying company which also makes measuring instruments. Over the past few years, it has bought several international makers of seismic measuring instruments that are global leaders in their fields. Few analysts write about Oyo and those that do ignore the potential of these international businesses. Domestic business is very strong because of the construction boom and the need to rebuild Tohoku. Margins are rising. The company has raised dividends because it is confident about the outlook (and this is a company which tends to be conservative). For the domestic business alone, 0.7x book is too cheap. Adding in the potential of the overseas businesses, it is ridiculously so.
Out and about, despite some pretty terrible weather, shops and restaurants still seemed busy. When I checked in Sunday, the receptionist told me that my hotel had been completely full the previous night. And, as far as I could tell, it was full of elderly Japanese staying in Tokyo for the weekend. When I took the Keisei Skyliner train to the airport (we're Keisei shareholders and it is cheaper and faster than JR East's Narita Express), it was busy. As was the Shinkansen to Nagoya at 6.50am on Thursday.

Things are still getting better in Japan. And they're not getting better because of the leadership of the younger, taller founders of internet companies. They're getting better because, finally, growth in sales means that the years of cost cutting, M&A and R&D by the middle-aged managers of corporate Japan is starting to pay off.

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