Japan dividends

Seeking refuge in stability and predictability

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Key Takeaways

- Nikkei 225 aggregate dividend will grow by a restrained rate of 2.4% year on year (y/y) to 12.1 trillion Japanese yen in financial year (FY) 2022. Industrial goods and services; banking; and technology sectors are the top growth contributors while significant cut back is expected in the basic resources and personal and household goods sectors.

- Japan stands out for its dividend stability and this advantage showed at the peak of the pandemic in FY 2020 when Nikkei 225 dividends retreated by just 1% compared with much steeper plunges experienced by other developed markets.

- Nikkei 225's dividend guidance is not to be fully relied upon as only 37% of their actual final dividend payment met the guidance passed as of the end of the first quarter in FY 2021. Up to 42% of guidance passed was "conservative," being less than the actual payment, and this trend of "under-promise and over-deliver" is here to stay.

- Since March 2021 Nikkei 225 dividend yield has rebounded with post-pandemic average being 2% and reaching 2.5% toward June 2022. The gap between Nikkei 225 dividend yield and Japan government bond returns is currently at a historical high, making Japan dividends a lucrative choice.

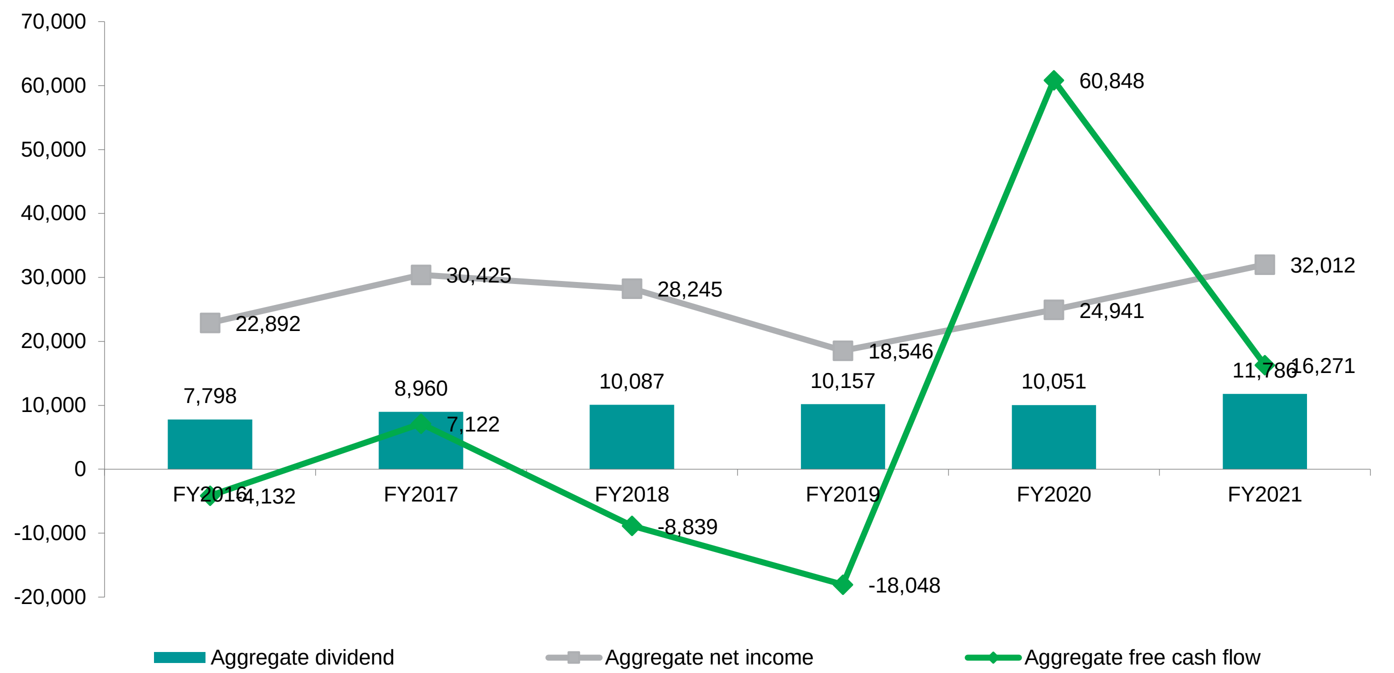
Turbulent times, stable dividends?

Japan is going through a difficult year in 2022. A milestone of 140 yen per US dollar was surpassed on 1 September, a rate last observed in 1998 and representing 22% fall year-to-date. Market analysts see further devaluation plausible as Bank of Japan's ultraloose monetary policy shows no sign of faltering while the Fed is set for an interest rate hike crusade. Although the chronically deflating economy has met its inflation target of 2% as its core consumer price index (CPI) hit 2.4% in July, it was driven by cost-push factors, mainly higher import price of oil and raw materials and it is mounting pressure on the business and consumer confidence rather than helping them. With these in the backdrop, the International Monetary Fund (IMF) has revised down the growth forecast of Japan's 2022 GDP from 2.4% to 1.7% in July.

Regardless of the unfavorable macroeconomic conditions, however, **we forecast Japan companies' (Nikkei 225) FY 2022 aggregate dividend to grow by 2.4% y/y to 12.1 trillion yen**. Japan has a long-established reputation for rewarding its shareholders stably in the everchanging market conditions and our findings in this report support this expectation. Nikkei 225 has a modest but steady 9% aggregate dividend compounded annual growth rate (CAGR) for the past five years, declining by just 1% even through the peak of the pandemic in FY 2020.

Resilience as advantage rewarded during the pandemic

Stableness of dividends in comparison to earnings (JPY billion)



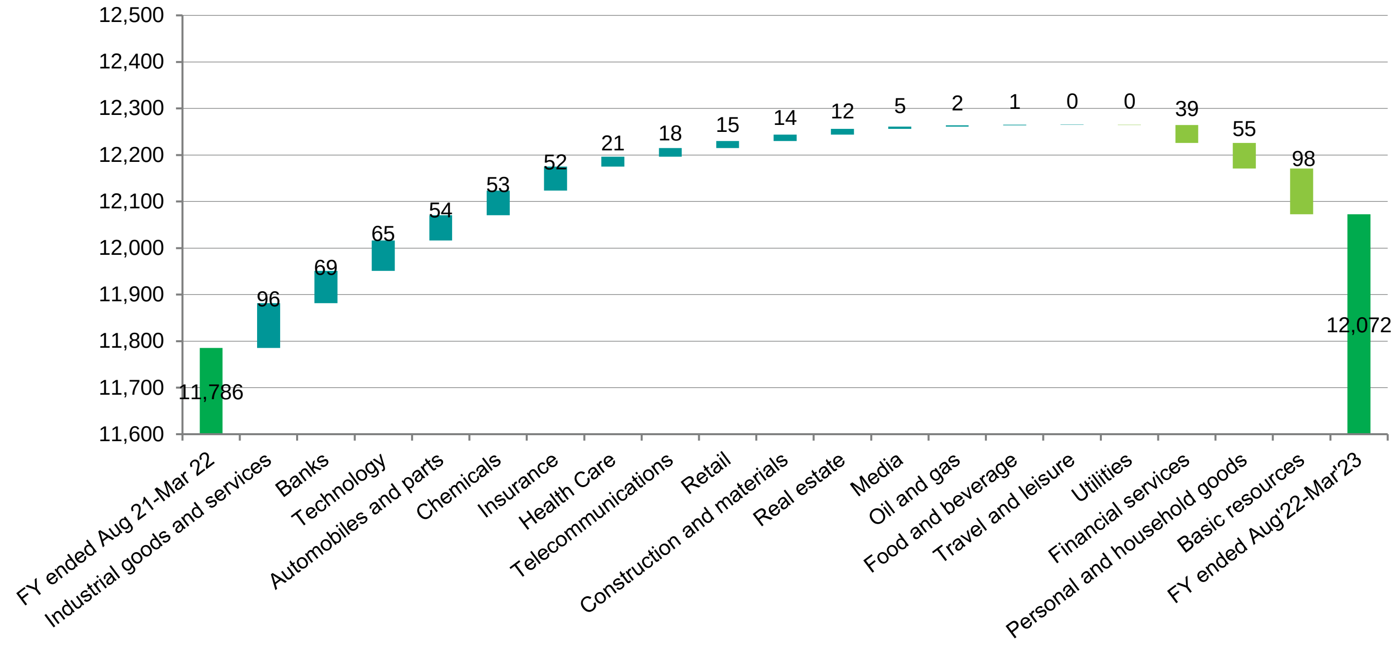
Source: IHS Markit

As much as the commonplace policy statement “we aim to distribute dividend stably” may sound banal, Japanese companies do mean it when they say it. Their special care toward shareholders returns was enhanced when the nation adopted corporate governance and stewardship code in 2014 with the goal of encouraging more active stewardship by institutional investors. **Dividend cut now tends to be the last resort** for the majority of Nikkei 225 companies, used only when the earnings go south for a few fiscals. **Predictable dividend pattern or proclaimed payout ratio target is closely adhered to by many companies**. This is manifested in the above chart which illustrates Nikkei 225’s aggregate dividend that stubbornly maintains its growth pace amidst volatile aggregate net income and aggregate free cash flow, which are primary considerations when firms decide on dividend.

While Japan’s dividend growth did retreat slightly (-1.0% y/y) in FY 2020 as the economy withstood the effects of the pandemic, the decline rate was still a very good defense when compared with other developed market peers for which dividends plummeted at much more significant rate; such as Australia (-31% y/y), Singapore (-21% y/y), Spain (-16% y/y), and the United Kingdom (-11% y/y). Behind this resilience was nearly 70% of Nikkei 225 companies that decided to either increase or keep the dividend flat in spite of the earnings decreasing and high uncertainties looming in the market jeopardizing future liquidity. Aggregate dividend promptly rebounded to 11.8 trillion yen (+17% y/y) in FY 2021 as the conditions improved, putting five-year CAGR at 8.6%.

Dividend outlook FY 2022

Sector contribution to FY ended Aug 2021—March 2022 aggregate dividend forecast (JPY billion)



Source: IHS Markit

Industrial goods and services. Dividends are expected to increase by 96 billion yen (+4% y/y) with the biggest growth contributors being **Itochu**, **Mitsui & Co** and **Nippon Express Holdings**. **Alps Alpine** (+94% y/y) and **Fujikura** (+60% y/y) stood out for the highest growth rates as their dividends suffered significant cutback/suspension from the pandemic but are now recovering or even surpassing pre-pandemic levels.

Banking. Dividends are expected to increase by 69 billion yen (+6% y/y). Most notably, **Sumitomo Mitsui Trust Holdings** has guided an 18% y/y increase in dividends despite the expected reduction in net business profit by 36 billion yen from prior year. Another banking giant and the sector's top dividend payor **Mitsubishi UFJ Financial Group** too has guided a modest 11% y/y increase, benefitting from the widening lending spreads and increase in overseas interest income.

Technology. Backed by top contributors like **Tokyo Electron** and **Canon Inc.**, the sector aggregate dividend is expected to grow by 65 billion yen (+10% y/y). Tokyo Electron continues to be the top driver in the sector as its guided dividend put the growth rate at 19% y/y or three-year CAGR of 40%, bolstered by medium- to long-term growth in semiconductor demand. Canon, dethroned from the top payor and still the second in the sector, has guided a 7% y/y increase riding on higher sales and profitability in the electronic materials business.

Financial services. Dividends are expected to decline by 39 billion yen (-14% y/y) which is not surprising given the slowdown in financial/capital market after pandemic era trade boom. Most notably, investment banks **Nomura Holdings** and **Daiwa Securities Group** are expected to cut back on dividend by 24% and 20%, respectively, affected by the fall in investment activities from their clients. **Japan Exchange Group's** dividend too is expected to decline by 24% with the absence of a special dividend component.

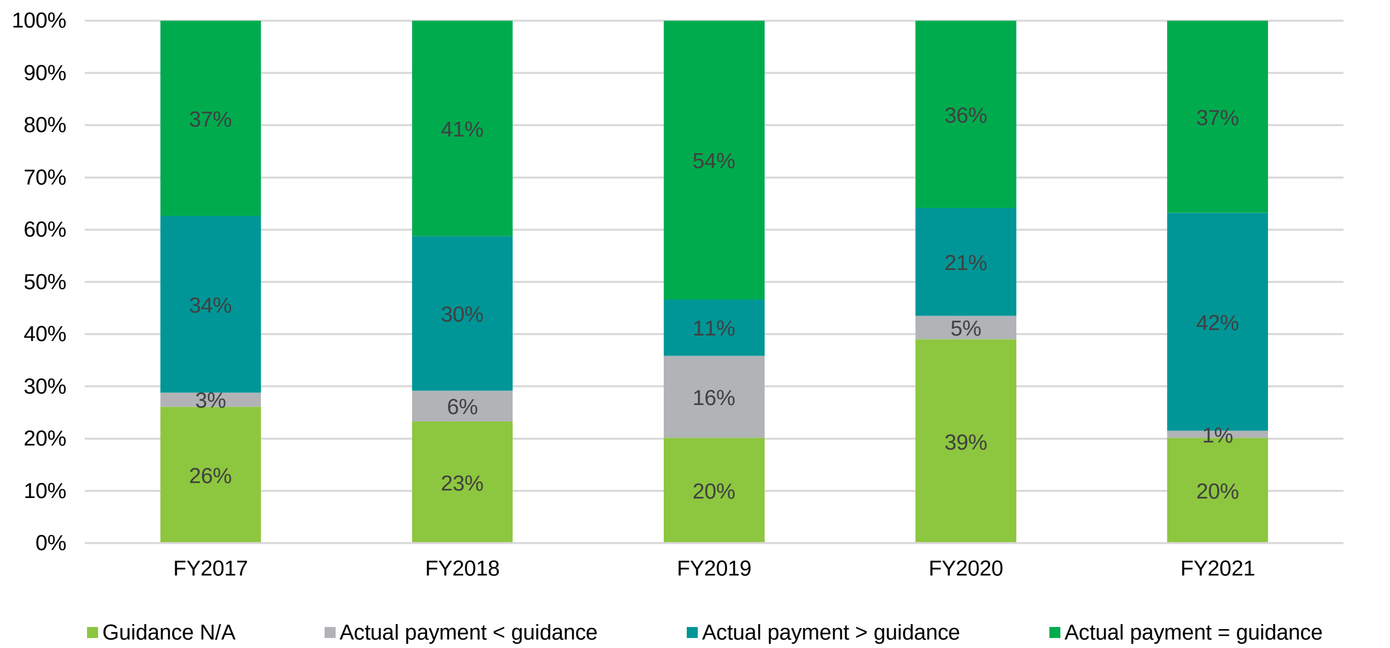
Personal and households. Dividends are expected to decline by 55 trillion yen (-5% y/y), primarily as a result of a steep 28% y/y cutback by **Nintendo** as the company undergoes sales slump. While **Japan Tobacco**, the single largest payor in the sector has guided a sluggish 1% dividend growth, **Sony Group** is set for a 14% y/y growth, continuing with the steadily rising DPS trend despite the underlying volatility in earnings.

Basic resources. Dividends are expected to take the full blow of the raw material and energy price hike and the aggregate amount dwindle by 98 billion yen (-25% y/y). Among the most significantly impacted are the top dividend payors in the sector **Nippon Steel Corporation**, **JFE Holdings**, and **Sumitomo Metal Mining**, which are expected to cut dividends by 20%, 31%, and 43%, respectively. **Nippon Paper Industries**, for which earnings is expected to dip deeply to a net loss of 25 billion yen, has guided dividend suspension.

Company guidance: Under-promise, over-deliver

While the resilience of Japanese dividends unaffected by short-term changes in their fundamentals give us confidence on their continuity and stableness, company guidance on one-year forward dividend issued by about 80% of Nikkei 225 constituents add another layer to investors' sense of predictability. Guidance on dividend amount, which is typically given one year ahead of the actual announcement, is a striking feature of the Japanese dividend market that is not seen anywhere else in the world. However, while many investors place high reliance on this information, it is not meant to be taken as the final say on what the company is going to pay because companies voluntarily provide these guidance and there is no obligation to stick to the same amount in their actual payment. After all, profit outlook is subject to changes in market conditions. Therefore, investors may sometimes be taken aback at large variance between the guided and actual dividend. How are the guidance to be taken then? We offer an insight based on the latest five-year trend.

Nikkei 225 final dividend guidance vs. actual



Note: FY2017 comprises financial results for FY ended December 2017 to March 2018 and likewise for FYs.
Source: IHS Markit

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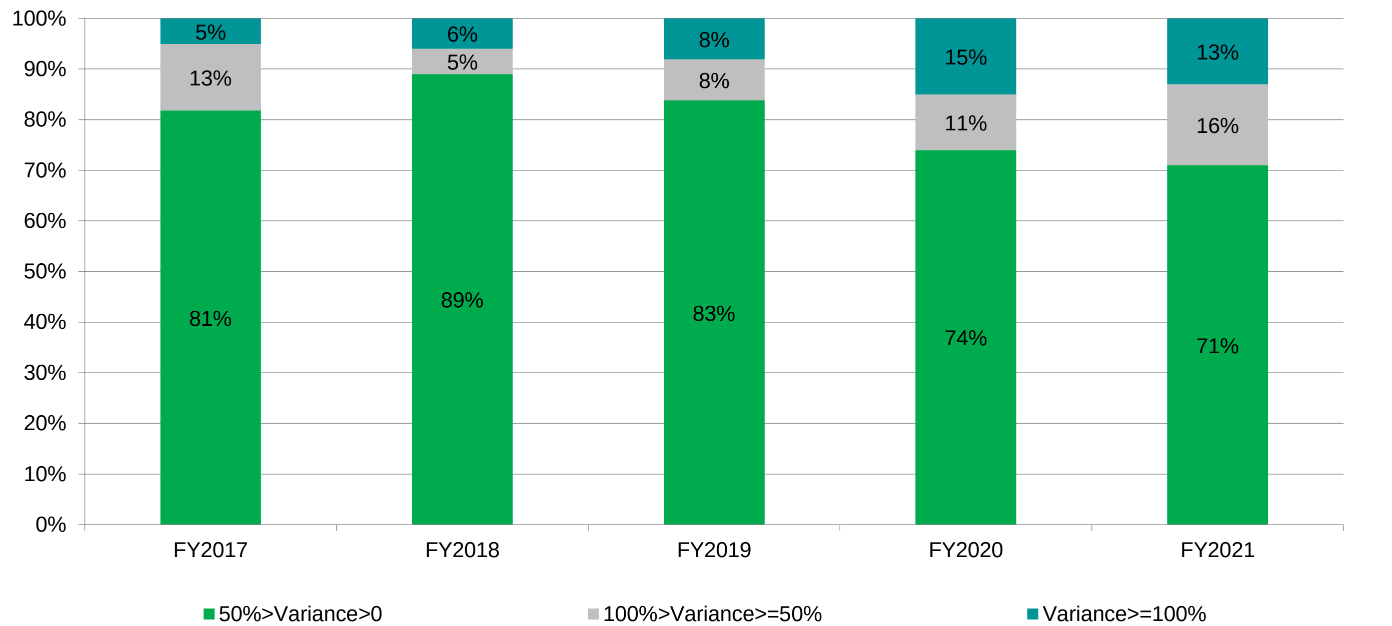
We make the following observations from the preceding chart that depicts the distribution of Nikkei 225 companies on whether their actual dividend amount deviate from their guidance amount that is given as at the end of the first quarter :

- Prior to the outbreak of the COVID-19 pandemic (FY 2017–19 in the chart), **a growing number of companies took on the policy of guiding their dividends** as the percentage of companies that did not guide dividends (i.e., guidance not available, N/A) gradually decreases from 26% to 20%. This number surges to 39% for FY 2020 owing to the heightened level of uncertainty pervading in the economy with the onset of the pandemic.

- It is apparent that even prior to the pandemic, 30–34% of Nikkei 225 **companies passed conservative guidance than their actual intention (i.e., actual payment > guidance), to give themselves buffer** in the contingency they need to adjust down their dividend. This is clearly shown when the pandemic hit in the period FY 2019 (ended December 2019–March 2020) and the proportion of "actual payment > guidance" plunges to 11%, while that of the "actual payment = guidance" category increases from previous 37–41% to 54%, showing companies fell back to the safety line that they have set for themselves. One year after the pandemic breakout (FY 2021), we notice the number increases to 42%, which is notably higher than pre-pandemic levels and we interpret that more companies have become uncertain about the outlook of their profits and ability to pay dividends, thereby passing conservative guidance. In light that the economy of FY 2022 has been equally or more unpredictable than that of FY2021, we are of the opinion that even higher proportion of the guidance passed earlier this year may turn out to fall short of the actual dividends paid.

- **There is a strong aversion among Nikkei 225 companies to pay dividend amount that fall short of their guidance.** Prior to the pandemic only 3–6% fell under the "actual payment < guidance" category. Briefly after the first year hit by the pandemic when this number surges to 16%, the number immediately comes down to 5%, then to 1% in the following year. This tendency explains the significantly high proportion of companies under the "actual > guidance" category, which is that they would rather under-promise and over-deliver than vice versa.

Distribution of extent of variance (guidance vs. actual payment)



Note: Variance = (actual dividend – company guidance) / company guidance
FY 2017 comprises financial results for FY ended December 2017 to March 2018 and likewise for FYs.
Source: IHS Markit

How conservative then are the conservative guidance? With reference to the preceding figure, we see the trend of more companies giving themselves a larger buffer, with a proportion of the companies which variance (definition in figure notes) is less than 50% going down from 89% in 2018 to 71% in 2021 while that of variance greater than 100% increases from 5% in 2017 to 13% in 2021. We believe this increased buffer is here to stay in the near future as the macroeconomic volatility and uncertainty continues to impede companies from confidently predicting their future profitability and gauge accurately how much dividend can be distributed.

Number of companies by number of years when actual dividend = company guidance for 2017–21

Number of years actual payment = guidance	0	1	2	3	4	5	Guidance N/A
Number of companies (%)	13 (6%)	29 (13%)	47 (21%)	36 (16%)	33 (15%)	19 (8%)	47 (21%)

Source: IHS Markit © 2022 IHS Markit

It is also interesting to see the matter from the angle of "how many companies have the winning streak of matching their actual dividend to their guidance for all five years out of the past five years?" and with reference to the preceding table we observe that only a small number of 19 companies, or 8% of Nikkei 225 companies, have diligently matched their actual dividend to their guidance five out of five years. It is also noteworthy that 42 companies or 19% of Nikkei 225 companies pass guidance that should be taken with a pinch of salt as they have never matched their actual amount to guidance, or did it just once out of the five years.

As demonstrated, while guidance is useful information, it could be misleading when taken uncritically. S&P Global Market Intelligence incorporates historical trend analysis, fundamental analysis and industry peer comparison on top of guidance variance analysis to assess reliability of guidance issued by Nikkei 225 companies and in the event we deem the company guidance to be unreliable, we output analyst forecast data as an alternative. The following table contains a sample of 10 companies for which guidance are identified to be consistently deviating from the actual dividend amounts, together with SPGI analyst estimates in comparison with the original company guidance issued as at FY 2022 first quarter–end.

Top 10 risky guidance by five year historical variance

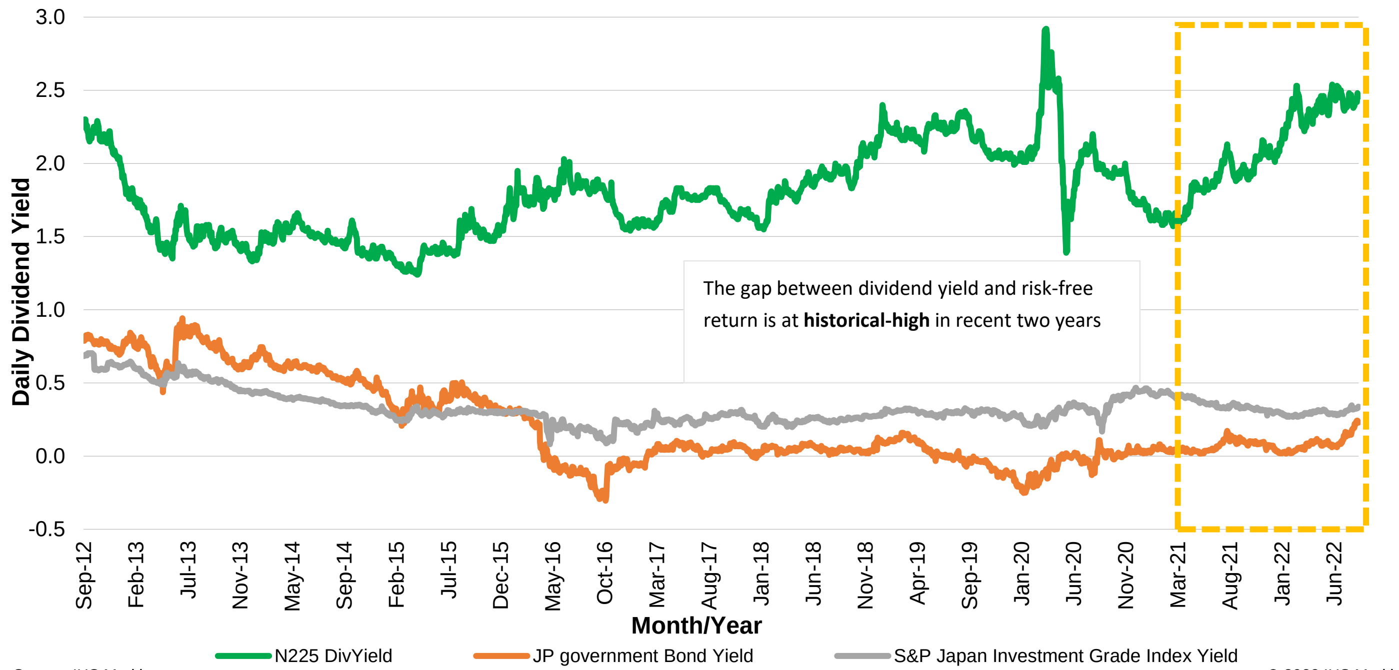
Company Name	ISIN	FY 2017 variance	FY 2018 variance	FY 2019 variance	FY 2020 variance	FY 2021 variance	FY 2022 final DPS company guidance (JPY)	FY 2022 final DPS SPGI forecast (JPY)
Japan Exchange Group	JP3183200009	38%	22%	15%	33%	19%	26	29
Kajima	JP3210200006	40%	8%	0%	16%	15%	29	33
Shin-Etsu Chemical	JP3371200001	15%	11%	0%	Guidance N/A	67%	225	275
Sumitomo Metal Mining	JP3402600005	83%	-58%	-9%	219%	203%	88	80
Daikin Industries	JP3481800005	15%	29%	0%	Guidance N/A	22%	100	110
Chugai Pharmaceutical	JP3519400000	14%	77%	92%	20%	53%	38	43
Tokyo Tatemono	JP3582600007	14%	19%	16%	9%	13%	33	36
Japan Steel Works	JP3721400004	40%	20%	-36%	Guidance N/A	53%	29	34
Bandai Namco	JP3778630008	617%	606%	460%	333%	683%	27	133
Mitsubishi Estate	JP3899600005	40%	31%	13%	46%	18%	19	21
Japan Exchange Group	JP3183200009	38%	22%	15%	33%	19%	26	29

Note: Variance = (actual dividend – company guidance) / company guidance
FY 2017 comprises financial results for FY ended December 2017 to March 2018 and likewise for other FYs.
Source: IHS Markit © 2022 IHS Markit

Nikkei 225 dividend yield gradually back to peak

As discussed, Japan's stable dividends serve as defensive cushion during market downturns. Furthermore, Japan is appealing to global investors with its attractive dividend yield. In comparison with other developed markets like South Korea, the average dividend payout ratio for KOSPI 200 companies is about 21%, relative to 45% for Nikkei 225 companies, indicating that Japanese firms are more aware of the value of shareholders and are willing to reward them with sizable cash surpluses, serving as a shelter for investors seeking consistent and attractive dividends but are exposed to unprecedented external market shocks.

Daily 10-year DivYield comparison



Source: IHS Markit

To further examine the dividend yield performance with risk-free return, we analyze the 10-year daily dividend yield on the Nikkei 225 Index, along with the 10-year yields on Japan government bonds and the S&P Japan Investment grade bond index.

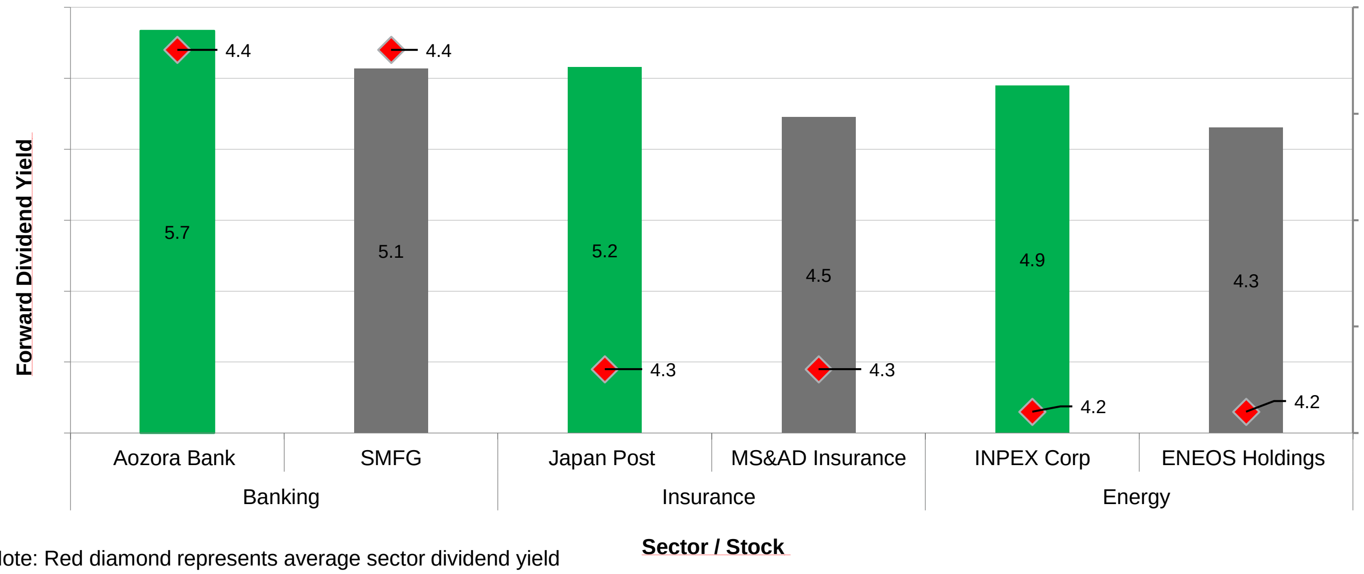
The dividend yield on the Nikkei 225 had been stable during the previous 10 years with fewer pronounced volatility until 2020, when the pandemic hit and the companies started reducing or suspending their earlier guided payouts. Standard deviation before 2020 for Nikkei 225 stood at 28% and increased to 30% post 2020. On the contrary, the volatility as measured by standard deviation is as low as 0.11% for the S&P Japan Investment Grade Bond Index. Aggregate dividends have been increasing over time despite the underlying volatility in earnings, indicating that there is a weak relationship between earnings and dividend payouts.

In comparison with the yield curves for government and investment-grade bonds, the level of Nikkei 225 dividend yield curve has typically been higher. Nikkei 225's 10-year average performance is 1.8%, compared with the Japan government bond yield's 0.21% and the S&P Japan Investment Grade Bond Index's 0.34% during the same period. After the pandemic, the average yield on the former increased to 2.04%, while that on government bonds fell to 0.09% and nearly stayed the same for investment-grade bonds. This illustrates the attractiveness of Japanese equities, which passive investors favor since the high-yielding companies continue to pay out and increase dividends.

Up until May 2020, there was an upward trajectory in the dividend yield of Nikkei 225. However, after May 2020, a declining trend became apparent, and in the midst of the pandemic, the yields dropped below 2%. This pattern persisted until November 2021, when the yields rose and hit the 2% mark. The gap between the return of Nikkei

225 dividend yield and risk-free return (Japanese government bond yield) is at a historical high level indicating a tipping point of incorporating dividend factors into the capital allocation.

Top sectors based on forward DivYield



Note: Red diamond represents average sector dividend yield
Source: IHS Markit

While trailing dividend yields overlook the everchanging market conditions, revisions to dividend policies and company-specific turnarounds, we highlight sectors with attractive forward yields. The banking, insurance, and energy sectors emerged as the winners, with their average forward dividend yields standing at 4.3%. The two banks with the highest forward dividend yields are **Aozora Bank (JP3711200000)** and **Sumitomo Mitsui Finl Gp(JP3890350006)**. Increased dividend payments are a result of variables including stronger operational profits, improved margins, and increased earnings projection for FY 2023. The insurance industry's highest forward dividend yields are provided by **Japan Post (JP3233250004)** and **MS&AD (JP3890310000)**. Japan Post has the highest yield since it trades at a price that is substantially lower than its industry rivals. Despite lower anticipated profits, dividends are expected to stay steady or grow in FY 2023.

The energy sector's highest forward dividend yields are provided by **Inpex (JP3294460005)** and **Eneos (JP3386450005)**. For FY 2023, dividends are expected to either increase or stay flat. The market consensus predicts that ENEOS's FY 2022 net earnings will decline significantly to 260 billion yen (-52% y/y), in large part owing to reduced impact from inventory revaluation gains (on copper and crude oil) compared with prior year, while Inpex is expected to benefit from rising sales prices of crude oil and natural gas while the flat payout for Eneos is on the back of glided earnings forecast.

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