
JAPAN INC DELIVERS—25% EARNINGS GROWTH POSSIBLE IN FISCAL YEAR ENDING MARCH 2018

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The message from the current corporate results season is straightforward: Japan's corporate earnings power continues to rise. This is due to both higher top-line sales growth as well as positive tailwinds from the exchange rate. Going forward, corporate guidance remains conservative, which in turn makes further upward revisions likely over coming quarters. All said, we maintain our call for 25% EPS growth in the current FY3/2018 (fiscal year ending March 2018), against the 13% now implied by the consensus. If realised, this implies a TOPIX level of 2,000 as a reasonable target over the coming six months, in my view.

Specifically, corporate guidance—which is closely followed by Japanese analysts—is still based on the assumption that sales will rise 3.2% and the exchange rate against the Dollar will average ¥110/\$. With this, TOPIX earnings should rise 13.1%. This is conservative because so far this year—which is April to October, as Japan's fiscal year starts in April—sales growth has averaged 4.5%, which on its own should add almost 15% to profits if maintained in the second half of the year.

On FX, the base-line assumption of ¥110/\$ compares to a realised average of ¥111.9/\$ so far this fiscal year. Every ¥1 of Yen weakness basically adds back about 1% to profits, thus adding additional momentum for positive earnings growth surprises from here.

The following matrix aims to pull it all together. It shows the implied fair-value TOPIX level given various combinations of sales growth and FX assumptions. The current consensus is highlighted in blue—with FX at ¥110/\$ and 3% sales growth, the implied EPS should come to 112, which in turn puts today's TOPIX on a multiple of 16x earnings. Note that throughout "Abenomics," the TOPIX PE fluctuated between 19x and 13x.

\$/%	Sales Growth Scenario	Implied EPS	% YOY Change	TOPIX at PE Multiple						
				13x	14x	15x	16x	17x	18x	19x
105	2%	97	-2.0	1,261	1,358	1,455	1,552	1,649	1,746	1,843
	3%	107	8.1	1,391	1,498	1,605	1,712	1,819	1,926	2,033
	4%	116	17.2	1,508	1,624	1,740	1,856	1,972	2,088	2,204
110	2%	102	3.0	1,326	1,428	1,530	1,632	1,734	1,836	1,938
	3%	112	13.1	1,456	1,568	1,680	1,792	1,904	2,016	2,128
	4%	121	22.2	1,573	1,694	1,815	1,936	2,057	2,178	2,299
115	2%	107	8.1	1,391	1,498	1,605	1,712	1,819	1,926	2,033
	3%	118	19.2	1,534	1,652	1,770	1,888	2,006	2,124	2,242
	4%	127	28.3	1,651	1,778	1,905	2,032	2,159	2,286	2,413
120	2%	114	15.2	1,482	1,596	1,710	1,824	1,938	2,052	2,166
	3%	123	24.2	1,599	1,722	1,845	1,968	2,091	2,214	2,337
	4%	134	35.4	1,742	1,876	2,010	2,144	2,278	2,412	2,546
125	2%	123	24.2	1,599	1,722	1,845	1,968	2,091	2,214	2,337
	3%	131	32.3	1,703	1,834	1,965	2,096	2,227	2,358	2,489
	4%	142	43.4	1,846	1,988	2,130	2,272	2,414	2,556	2,698

Note: FY3/17 EPS = 99

Sources: WisdomTree, Bloomberg, as of 31/10/17.

All said, I maintain my bullish call for Japanese equities: valuations are attractive and positive earnings momentum is poised to keep going. Japan is not a “value trap.” In my view profits can rise 25% in FY3/2018 which in turn suggest TOPIX at 2,000 is a reasonable fair-value target.

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