

Future Measures in the Growth Market

Listing Department,
Tokyo Stock Exchange

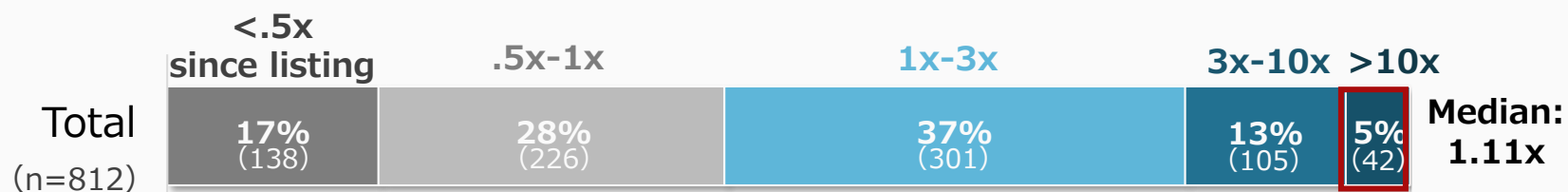
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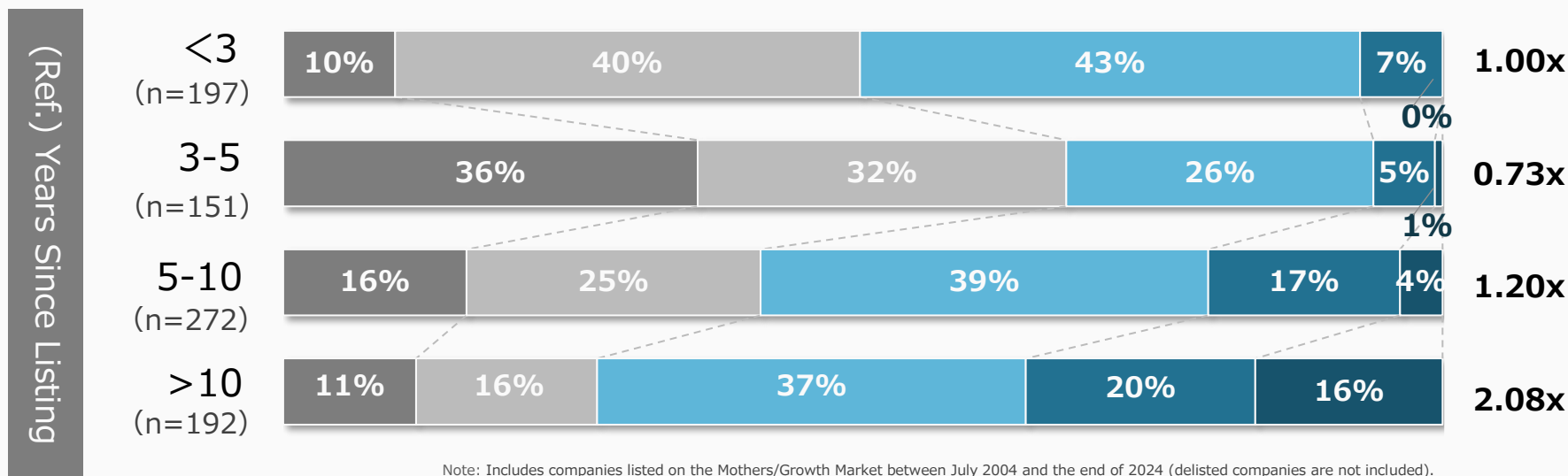
1. Current Situation (Market Capitalization Growth Rate)

- ◆ Although the Growth Market is **expected to produce startups that will drive the future growth of the Japanese economy**, only a limited number of companies actually achieve high growth.

Market Cap. Growth Rate for Growth Market Listed Companies



Companies whose market cap. has grown by more than 10x since their IPO: 5%



Note: Includes companies listed on the Mothers/Growth Market between July 2004 and the end of 2024 (delisted companies are not included).

Note: Market cap. growth rate calculated by dividing the current market cap. (based on average closing price from October to December 2024) by the market cap. at the time of IPO (based on the public offering price, or if there is not a public offering price, the closing price at the end of the month of listing.)

2.1 Request for Management that Strives for High Growth (For Listed Companies)

- ◆ TSE expects to **reiterate to management at Growth Market listed companies, using the current system, that it would like to see them promote 'Management that Strives for High Growth' appropriate for the Growth Market.** Specifically:
 - **Evaluate and analyze their growth from the time of their IPO to the present**
 - **Based on that analysis, review and consider future growth targets and measures**
 - **Disclose the above information under "Matters Relating to Business Plans and Growth Potential" and consistently implement those measures** (and provide regular updates)
- * For companies that actively take measures, **TSE will also provide support** (such as publishing a list of these companies)
- ⇒ In making such efforts, **how should we approach the content and methods of effective communication?** (Reference: Request for "Management that is Conscious of Cost of Capital and Stock Price.")

Examples of "Matters Relating to Business Plans and Growth Potential" Disclosure Content

Category	Content
Business Model	Business details
	Earnings Structure
Market Environment	Market size
	Competitive environment
Source of Competitiveness	Competitive advantage
Business Plan	Growth strategy
	Management indicators
	Profit planning and assumptions
	Progress
Risk Information	Perceived risks and countermeasures

Requested Content (Draft)

Evaluation and Analysis of Growth Since IPO/Review and Consideration of Growth Targets and Measures

- From the perspective of aiming for high growth, analyze and evaluate whether the current business model has been functioning well **indicators based on the situation of individual companies and investor needs**, such as market cap., share price, sales, profit, PSR, PER, etc.
- In doing so, **also check to ensure that there are no discrepancies in the assumptions regarding the target market size and the company's competitive advantage.**
- Using the above indicators and other data, **formulate specific growth targets and measures to achieve them.**

Disclosure to Investors and Implementation of Measures

- Disclose "Matters Relating to Business Plans and Growth Potential" at the time of the next disclosure update (early disclosure or disclosure following relevant review and consideration are also both possible).
- No particular format is specified (this document does not specify a format, etc., and presents examples of disclosure content).
- If a company is taking action in line with the requests, disclose relevant related information.

(Ref.) Relevant Comments from Institutional Investors (Issues related to “Matters Relating to Business Plans and Growth Potential”)

- ◆ TSE conducted interviews with **institutional investors who invest in small and medium-sized growth stocks.**

Specificity and Rationality of Provided Content

- **With the systematization of “Matters Relating to Business Plans and Growth Potential” disclosure in the Growth Market,** it has become easier to understand business models, etc. than in the Mothers era. However, there are also cases where **qualitative and abstract explanations and appearances are in order, but there is a lack of concreteness in terms of how much growth can be expected in the end.** It is important to **specifically formulate and disclose growth targets and initiatives to achieve them, using KPIs, etc.**
- **The current disclosure content lacks specificity in many places, so it should be described as quantitatively as possible.** In doing so, because there is ambiguity in the company’s own KPIs alone and it is difficult to compare them horizontally, it is best to first present a medium-term plan for the items on the BS, PL, and CF. After that, it is good to **explain the KPIs that form the basis for those figures and why the KPIs are important.**
- **There are also cases where the target market is too far removed from reality.** If you don't target a realistic market, it will be difficult for investors to make a decision, as it will be unclear. **Rather than inflating expectations, it is important to explain clearly** the company's competitive advantage and when it will be profitable, based on rational grounds.

Importance of Situational Analysis and Updates

- To attract investors who will hold their shares for the medium to long term, it is important to **clarify the KPIs for achieving growth** when disclosing “Matters Related to Business Plans and Growth Potential,” and to **regularly analyze and update the situation.**
- **Recently, there has been an increase in the number of companies that indicate KPIs when disclosing "Matters Related to Business Plans and Growth Potential” at the time of IPO, but then stop providing these KPIs after listing.** Showing KPIs only when pricing at the time of IPO and then withdrawing them afterwards is **unclear and dishonest.**
- There are cases where small companies that have not grown well are asking **institutional investors to invest in them,** but **first they should thoroughly analyze the reasons for their consistently low market cap. and take steps to improve it.**

2.2 Raising Awareness of High Post-IPO Growth Expectations (For Companies Preparing to Go Public)

◆ For companies (and their management) aiming for an IPO:

- After listing, there will be a responsibility to meet the growth expectations of a **wider range of shareholders and investors**.
- In order to fulfill this responsibility, it is necessary to **fully consider how to utilize the IPO for post-listing growth, and whether the timing and scale of the IPO are appropriate**.

Awareness of these responsibilities is extremely important.

◆ It is expected that the results of the December hearing etc. will be taken into account, and that companies (and their management) will be approached **in collaboration with those involved in supporting IPOs from an early stage (such as securities companies)**. How should we approach the content and methods of effective communication?

- For example, it is possible to **share awareness with those involved (at a high level) about the content that companies (and their management) aiming for an IPO should know**, and to have them communicate this from their respective positions (utilizing the Cooperative Meeting on IPO Practicalities).
- In addition to the recent initiatives (described on pages 3 and 5), we will **continue to promote the disclosure of listing objectives** that we have been requesting since June last year, as well as the **disclosure of the status of their implementation** after listing.



3. Measures to Incorporate the Perspective of Institutional Investors

- ◆ In addition to encouraging companies (and their management) to pursue management that aims for high growth, **the following measures are also being considered to incorporate the perspective of institutional investors.** Are there any points that should be noted for discussion in future meetings?
 - **Promoting communication measures such as understanding the perspective of institutional investors and creating points of contact.**
 - **Securing a scale that can be an investment target for institutional investors based on numerical criteria.**

(Ref.) Relevant Comments from Institutional Investors (Minimum Investment Size)

- ◆ TSE conducted interviews with **institutional investors who invest in small and medium-sized growth stocks.**

Minimum Investment Size

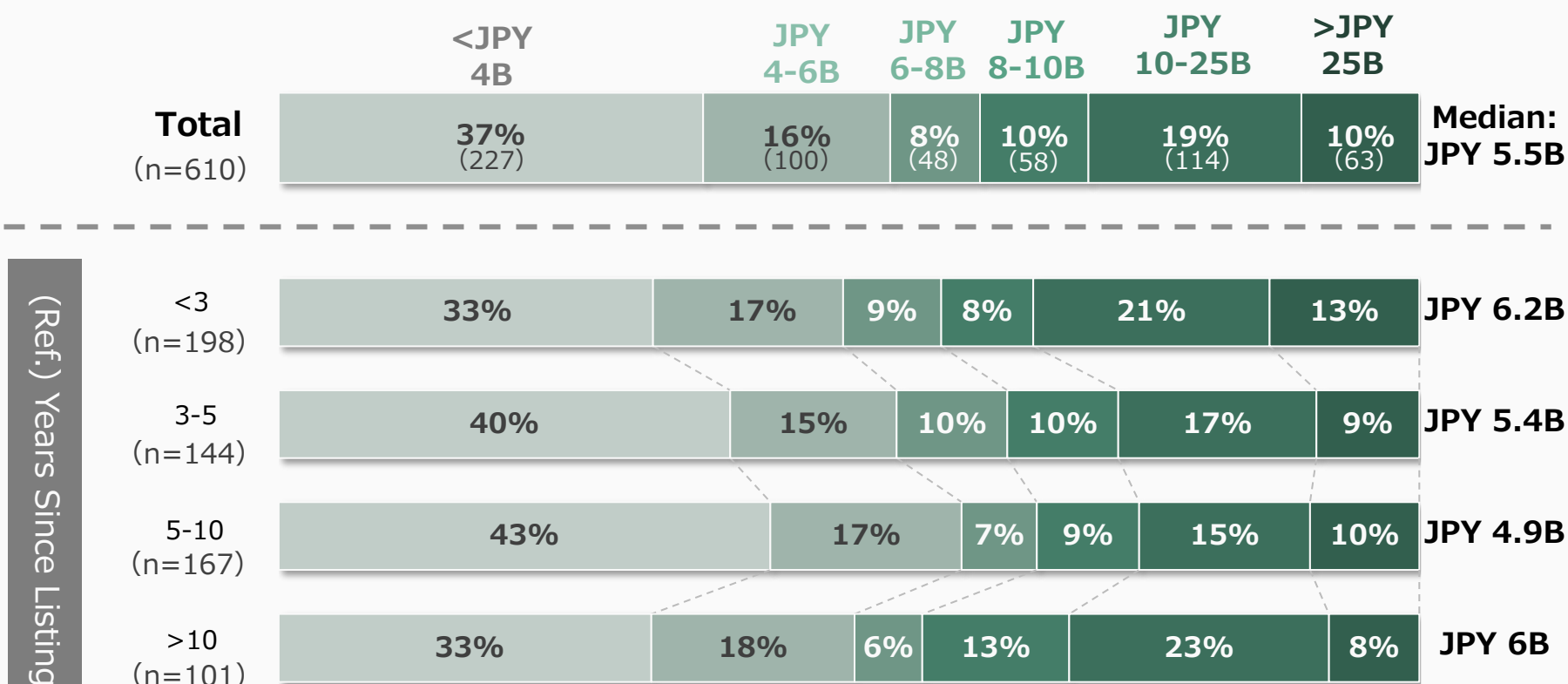
- According to the investment criteria, it is not possible to buy more than 10% of all shares, so it is difficult to invest in small companies. It seems that the **hurdle is around JPY 5 to 10 billion in market cap.** Even if it were JPY 3 billion, it would not be impossible to invest in cases where there is strong growth potential, but the market impact of buying and selling would be so large that it is difficult to do.
- As part of our investment policy for small- and mid-cap stock funds, we publicly state that **our general investment target is listed companies with a market capitalization of at least JPY 10 billion.** We have also invested in companies with a market capitalization of around JPY 2 billion, but this is an exceptional case where we could reasonably expect future growth.
- In the case of a hedge fund, it may be possible to invest even if the market capitalization is less than 5 billion yen, but as an institutional investor with a policy of making medium- to long-term investments based on **evaluating future growth potential, it is desirable to have a market capitalization of at least JPY 10 billion, and if it falls below JPY 5 billion, it is not possible to invest.**
- Our company has set a **minimum investment target of JPY 10 billion.** Any less than that and it will be difficult to invest, no matter how hard you try to convey the company's message with enthusiasm.
- For our small- and mid-cap listed stock funds, **JPY 30 to 50 billion is the norm, and even if we make concessions, JPY 20 billion is the minimum. If it's a company that's going to grow a lot, it might be possible to invest even JPY 10 billion,** but we've almost never seen that. In the first place, stocks with high growth potential don't come to be listed with JPY 10 billion.
- I have been looking at small and mid-cap stocks for a long time, and **the minimum market capitalization for investment is around JPY 8 to 10 billion.** The current standard of JPY 4 billion is too low, so if you want to be aware of the perspective of institutional investors, you need to have around JPY 10 billion.
- Regarding the current criteria of "more than 4 billion yen after 10 years of listing," given the nature of the growth market, with many companies operating businesses that change quickly, **a 10-year span is indeed too long, and even if the JPY 4 billion level is achieved, it is still too small to consider investing in.** I understand that this is a harsh opinion given the current climate, but **couldn't the period be five years or so, and the standard be JPY 10 billion or more, which is generally considered to be the level at which small and medium-sized stocks come up for discussion as investment targets for institutional investors?**

Note: Includes opinions from previously published materials.

(Ref.) Current Situation (Market Cap. Distribution)

- ◆ The current median market capitalization among Growth Market listed companies is JPY 5.5 billion.

Market Cap. Distribution Among Growth Market Listed Companies



Note: Based on companies listed on the Growth Market as of the end of 2024.

Note: The market cap. used is based on the average closing price from October to December 2024.

Reference: Notes From Previous Discussion (Dec. 2024 Follow-up Meeting)

Previous Discussion (Possible Future Measures)

Ideal Environment

- The Growth Market is expected to **promote innovation and produce companies that achieve unparalleled growth**, with the aim of ensuring the sustainable development of the Japanese economy in the future. To achieve this, it is necessary to **create an environment that encourages companies to take on the challenge of growth and to support mergers and acquisitions with other companies, using the funds procured**.
- It should be made clear that the growth market is a market for **entrepreneurs with new business models and ideas to take on challenges**, and a market that **supports such entrepreneurs**.

Ecosystem-Wide Recognition

- It is **important that the goals and issues of the growth market are recognized by all parties involved in the ecosystem, including securities companies, auditing firms, and VCs**.
- Band-aid fixes will not solve the current issues, and **it is necessary to clearly draw up a grand design for how to change the ecosystem**. It is necessary to **redefine what the Growth Market should be in the first place, then improve it by communicating what is needed and what is lacking throughout the ecosystem**.

Direction of Measures Within TSE

- I agree with the **direction of promoting measures based on the idea of fostering IPO companies and listed companies that will grow significantly, without focusing too much on the number of companies**.
- In the case of “**Management That is Conscious of Cost of Capital and Stock Price**,” the **internal strength of companies and the external pressure from shareholders have driven forward reform**. Even in the Growth Market, as part of the environment for improving corporate value, we should **create a system that allows for both a soft approach, such as asking management to take action, and a hard approach, such as enforcing continued listing criteria, and allow for both management to take on the challenge and external shareholders to provide discipline**.

Previous Discussion (Approach: Encouraging Business Owners/Management)

General Remarks

- I think it is necessary to **convey the responsibilities that come with listing to business owners/management aiming for IPOs and the expectations that come after listing, to encourage them to change their mindset.**
- In addition to promoting “Management That is Conscious of Cost of Capital and Stock Price” in the Prime and Standard Markets, **can we not ask the management of Growth Market listed companies to be conscious of achieving growth?**
- In order to **further develop a company that has grown by several dozen times since listing, an effective approach would be to discuss how to develop the company at board meetings, get the market to commit to it, and provide incentives for growth.**

Specifics

- Currently, IPOs are being used for selfish reasons, such as for an exit or to recover funds. For **business owners/management aiming for an IPO**, it is necessary to **seriously consider, from a company growth perspective, whether to continue as a private company, go public, or sell to a competitor.**
- If no funds are raised after listing, an "IPO" becomes an "LPO" (Last Public Offering). To grow, a company needs funds. **Why not encourage them to make growth plan that includes a funding plan and then put it into practice?**
- As an institutional investor, liquidity is of course important, but **how committed the management is to growth** is also important. In some cases, they will actively invest in order to capture the market, so **it is not always necessary for accounting profits to be steadily accumulating.** In any case, however, **they should show their commitment to future business growth.**
- The success of “Management That is Conscious of Cost of Capital and Stock Price” is largely due to **the strong and widespread media coverage featuring appealing and catchy messages.** It is also necessary to **strategically implement effective communication** that will sway market participants.
- The reforms that have been implemented in the Prime Market are not only due to **stricter continued listing criteria and requests from TSE, but also to the influence of pressure from institutional investors.** On the other hand, **the Growth Market lacks institutional investors, and the pressure from them is weak,** so **TSE's initiatives** must be **clearer and stronger** than those in the Prime Market.

Previous Discussion (Approach: Initial Listing Criteria)

Numerical Criteria

- It is very important that **there is a path for small companies with high growth potential to be able to grow quickly by utilizing the capital markets. The criteria for initial listings should maintain a broad scope, and there is no need to raise them.**

Listing Examination Details

- **It may be worth considering reviewing the content of the qualitative examination.** As an institutional investor, I have considerable distrust of IPOs that only offer secondary distribution and do not hold a public offering. **If they are not raising funds for growth, there is no need to approve the listing.**
- As an investor, when I meet with IPO companies, I always ask them what they want to do with the funds they are raising. **What is important when listing is to ask why they need to list, whether their business model requires them to raise a large amount of capital by listing, and whether they need to raise funds from the market or whether they are simply listing for the purpose of an exit.** I think it is necessary to look at these things very carefully.
- It makes no sense to prepare for investor relations because you want institutional investors to invest in your company a few years after listing. **Institutional investors will only invest in companies that have a solid disclosure and investor relations system in place,** so it is important to have this in mind from the stage of listing, and **you should check whether you have the necessary systems in place during the listing process.**

Previous Discussion (Approach: Continued Listing Criteria)

General Remarks

- In the Growth Market, it is necessary impose stricter continued listing criteria so that the **perspectives of institutional investors can be incorporated into management, and to raise the criteria to a level that could become an investment target.**
- To deal with managers who do not want to consolidate with other companies because they are comfortable with the status of being executives of listed companies, **shouldn't we make the criteria stricter to encourage consolidation?**

Specifics

- The current market capitalization criteria is **over JPY 4 billion after 10 years of listing, but 10 years is a bit long.** For example, after five years, it should be JPY 5 billion, and after 10 years, it should be JPY 10 billion, etc. **Shouldn't we set a new criteria for five years post listing and raise the level?**
- Instead of **setting a uniform company-wide criteria, such as the current criteria of JPY 4 billion, why not consider focusing on growth rates?**
- After listing, could we consider **raising the minimum ratio of tradable shares?** In order to meet the criteria, company management would either have to sell their own shares or issue new shares. Either way, **it would be difficult to do so unless the share price was high, so this would provide an incentive to raise the share price.**
- There are also proposals to raise the criteria for the market capitalization based on tradable shares and the ratio of tradable shares, but **raising the criteria for the total market capitalization would be the most straightforward. In order for institutional investors to enter the market, the total market capitalization must be large, and the issue of management's shareholding ratio is also an issue in the Prime Market, etc., so it is a topic that should be considered in conjunction with other market segments, not just the Growth Market.**
- **When imposing stricter listing criteria, we should also be conscious of the situation of the entire ecosystem.**
- At a certain point, it would be good to make it clear to companies that it seems unlikely they will be able to maintain their listing with their current management structure. This will create an awareness among management that **something needs to be done**, and it will also create an atmosphere where it is difficult to oppose **a merger or acquisition proposal.**

Previous Discussion (Approach: Other)

Governance

- **It is important to encourage improvements in governance**, but creating a robust governance system like that of the Prime Market would be a burden during the company establishment to IPO phase. If the priority is the speed of growth, **rather than seeking uniform strengthening, wouldn't it be better to encourage improvements in governance by the exchange?**

Understanding of Institutional Investors' Perspectives

- It is necessary for companies to know **what small-cap fund managers and engagement officers are thinking when they invest, and what institutional investors are**. It is important to create opportunities for this.