

PROFITING FROM CONTRARIAN OPINION

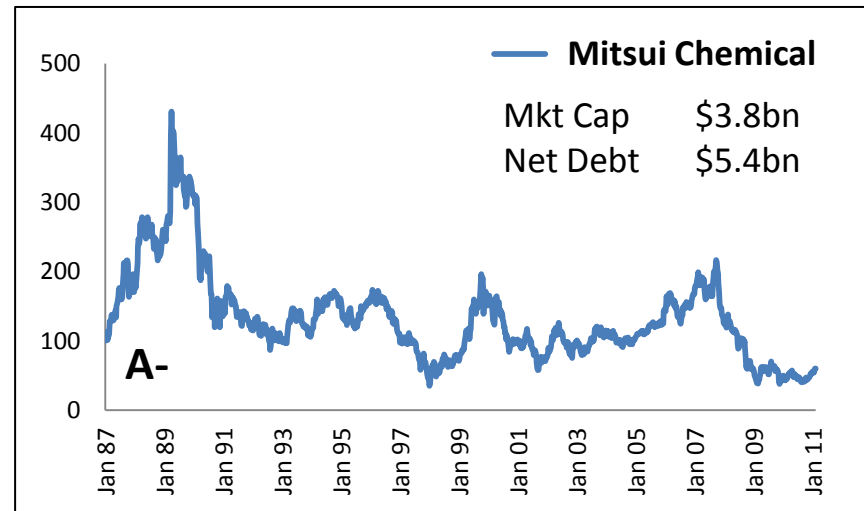
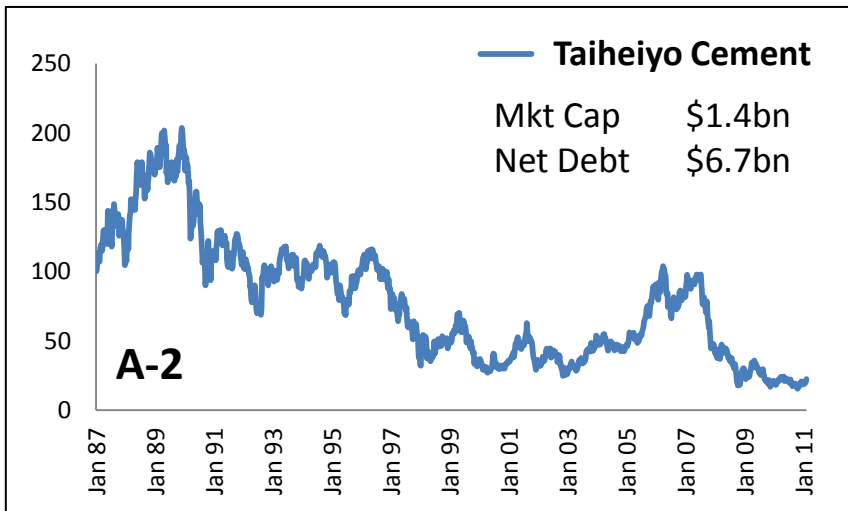
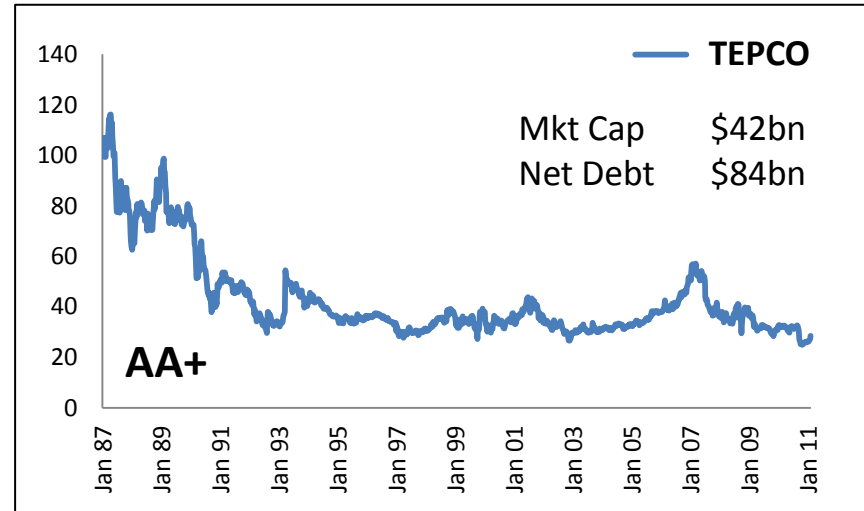
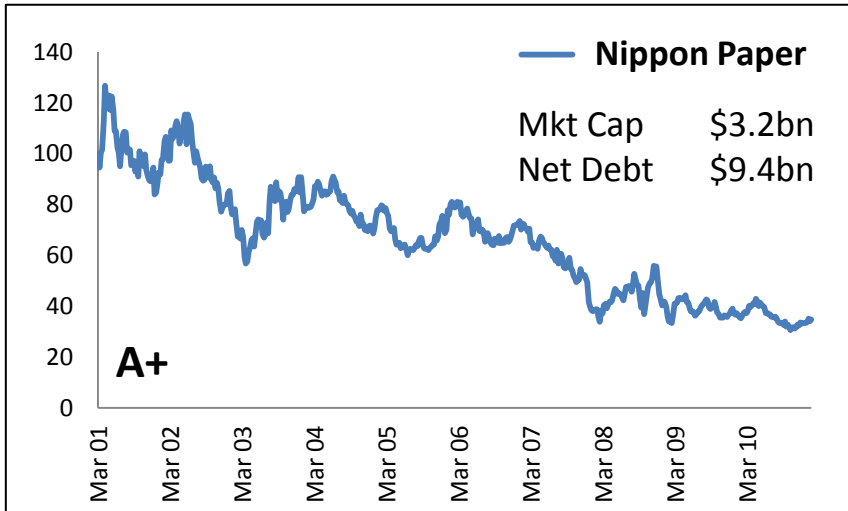
JUST HOW INVESTMENT GRADE  
ARE JAPAN'S CREDITS?



ECLICTICA  
ASSET MANAGEMENT

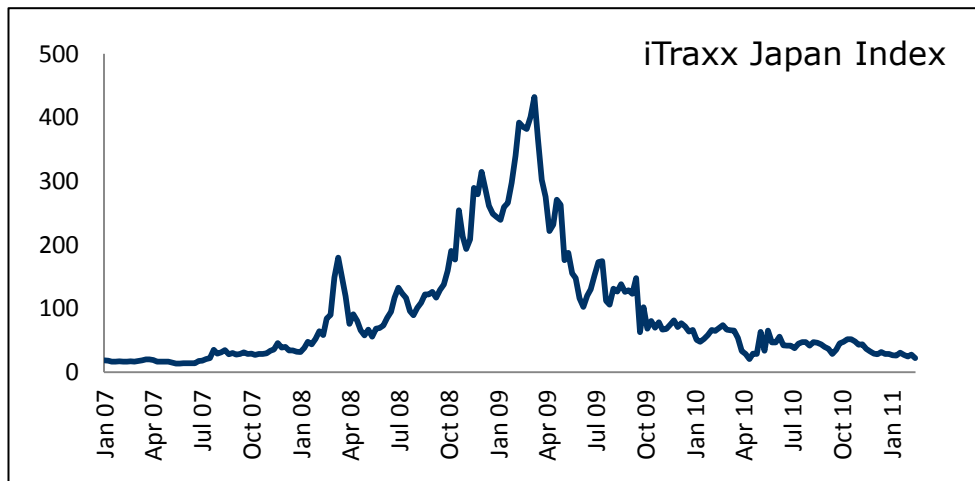
# JAPAN'S WALKING DEAD

## Operational + Financial Leverage = Value Trap



# THE CREDIT OPPORTUNITY

- To invest in a **levered portfolio of credit protection** on a basket of single name industrial companies, of which all are highly cyclical, operationally leveraged and have significant levels of debt.
- To exploit a major **pricing anomaly** which exists owing to the insatiable demand for yield in a zero interest rate environment. Is Japan a nuclear bomb strapped onto the chest of the global economy?
- To profit from the potential bursting of a **bubble** in Chinese property and industrial over-investment.



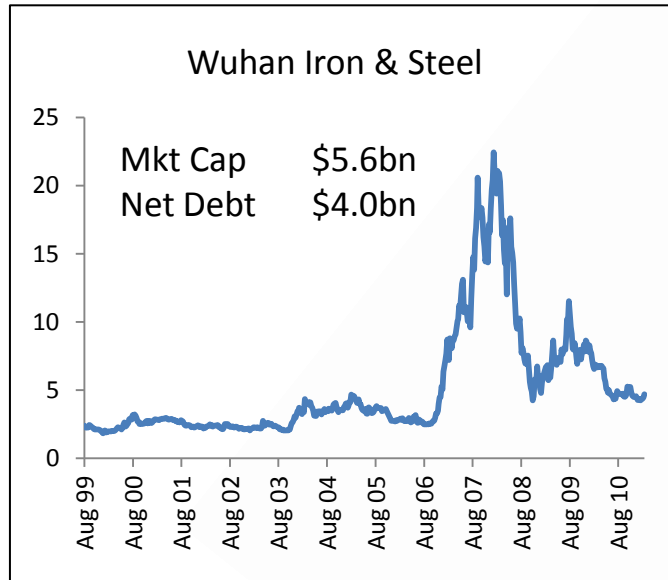
Source: Bloomberg / EAM



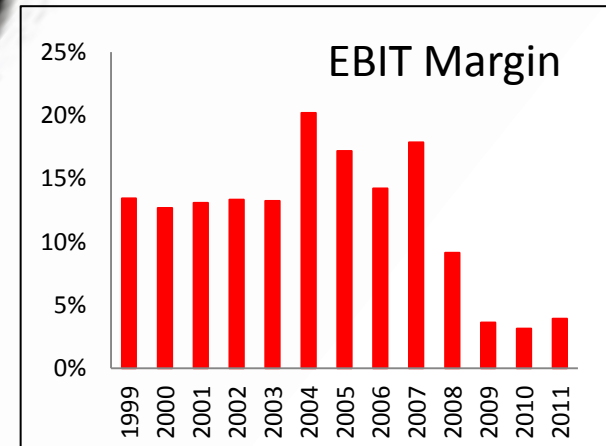
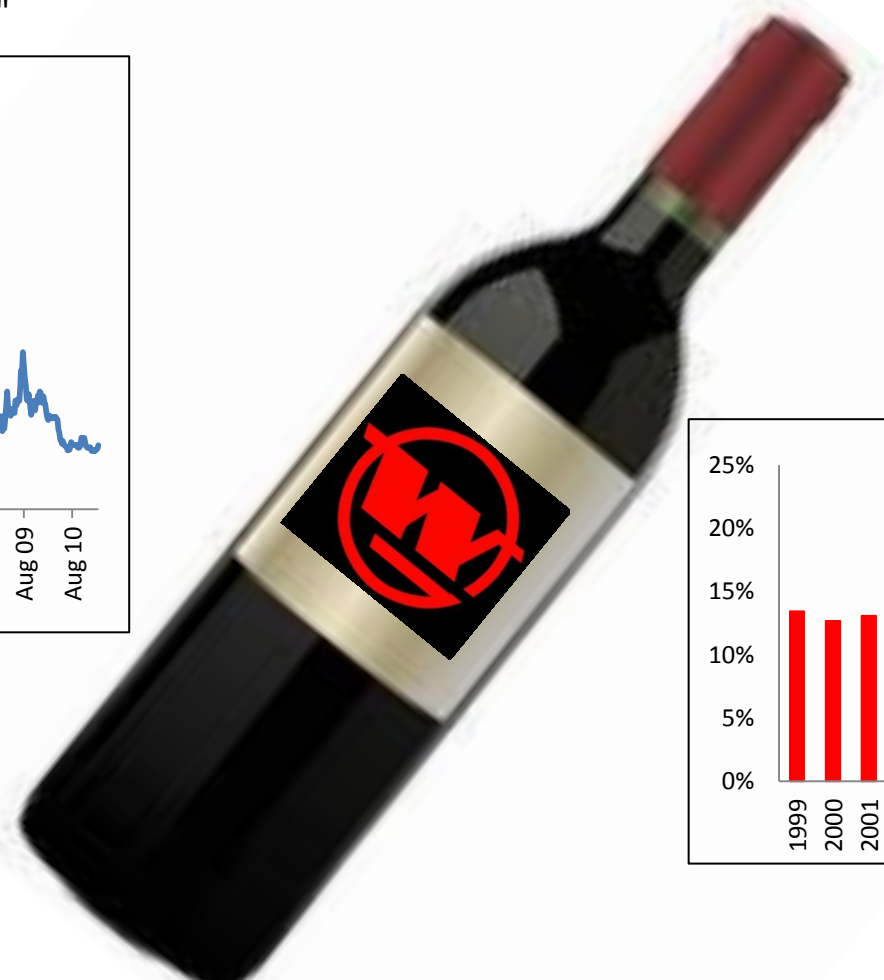
# CHATEAU WUHAN?

## A PROFITLESS CHINESE RECOVERY?

After announcing the plan to produce and sell 38 kinds of wine and 29 varieties of olive oil, Wuhan Iron & Steel explained the need to diversify. "The profit margin of the steel business is so low that we have to do more in non-steel sectors to collect more profits."



Source: Bloomberg / EAM

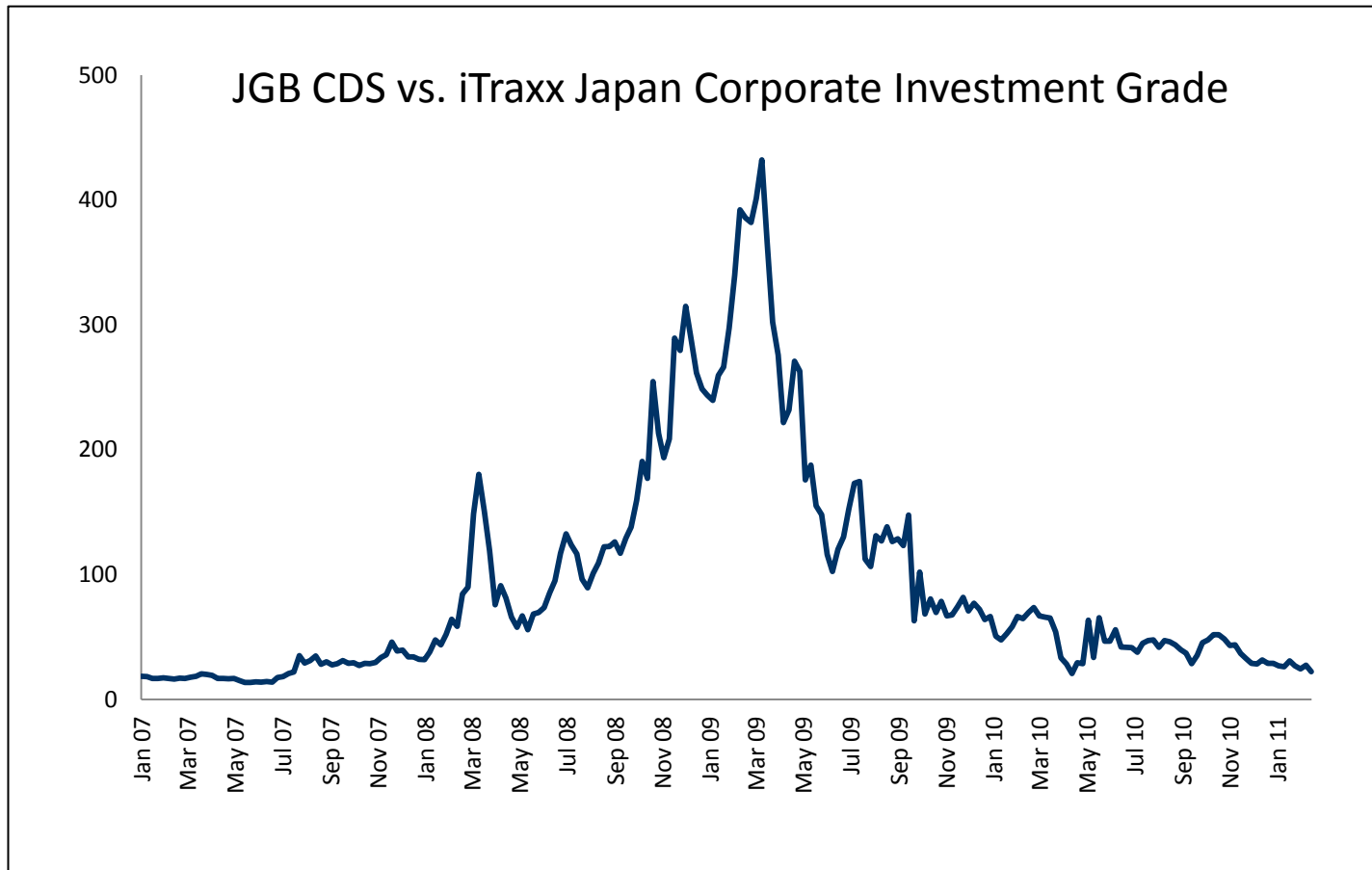


## WHY NOW?

- China and other emerging economies have been reflatd through **huge credit growth** and fiscal stimulus, leading to higher commodity prices.
- This has led many industries to increase capex, despite **falling sales and profitability**.
- Demand for industrial materials has risen **exponentially** along with supply.
- Should demand for industrial materials decline in an unwinding of the “China credit bubble” it is our contention that many industries would be **devastated** by over supply and a collapse in operating margins.
- The dramatic narrowing in credit spreads and **perceived certainty** of perpetual Chinese growth allow us to assemble credit protection on a basket of industrial and cyclical names.

# JAPANESE CREDIT PROTECTION IN 2011/12

## A JGB SHORT WITH CREDIT RISK?

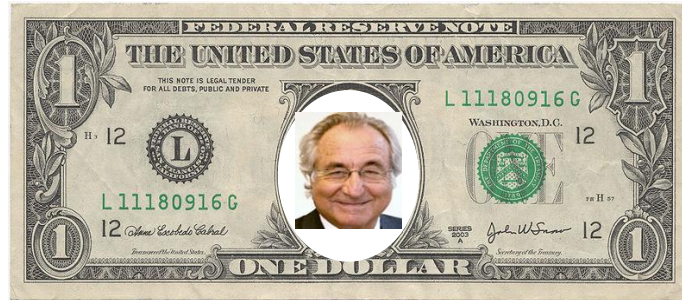


Source: Bloomberg / EAM

# FIVE CATALYSTS TO MAKE MONEY

- A Growth Recession in China Brought About by **Over-Investment**
- An Even **Stronger Yen**
- A Change in the **Term Structure** of Japanese Government Rates
- Domestic Fiscal **Austerity**
- The Status Quo

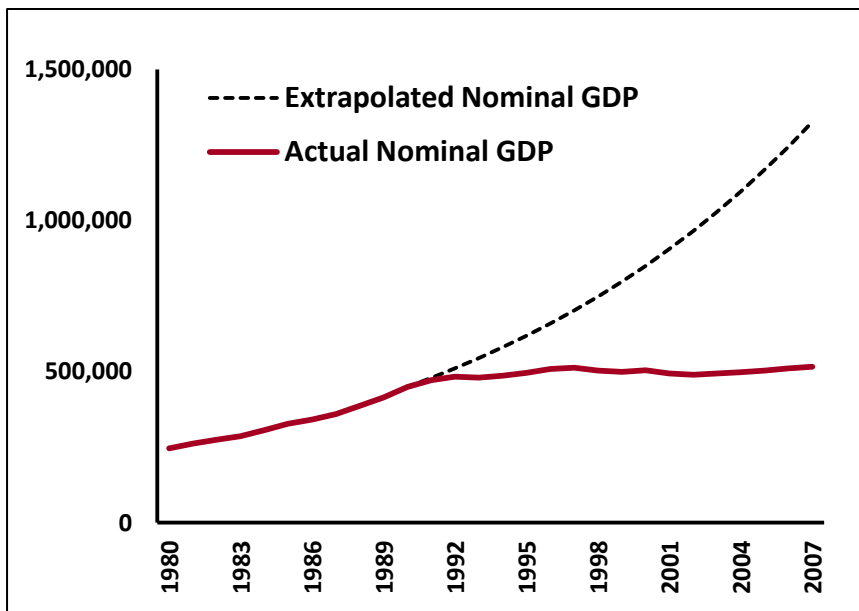
# HAS WESTERN CREDIT LEVERAGE PROMPTED AN OVER INVESTMENT CYCLE IN CHINA?



In Bernie We Trust?

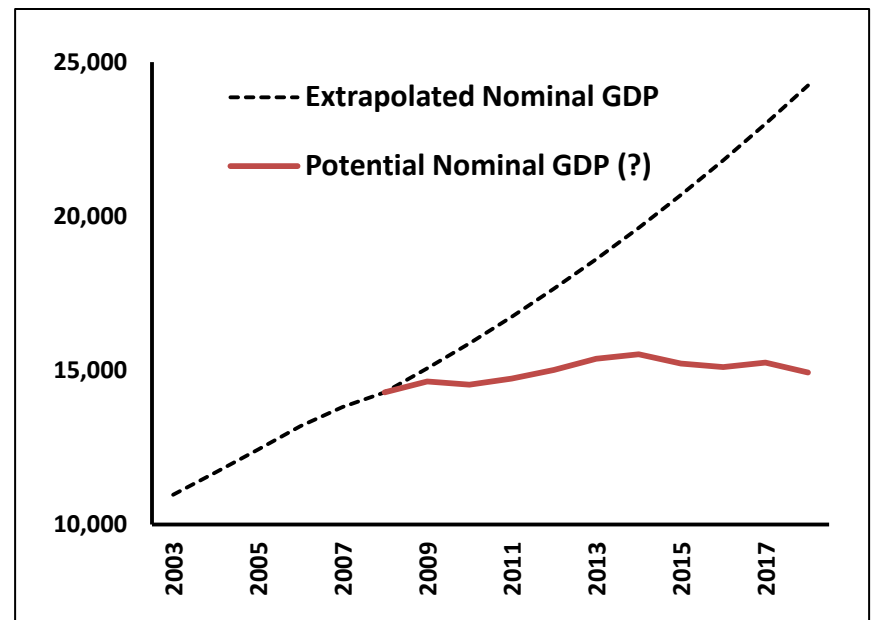
**Japanese GDP:**

**Actual v. Extrapolated from 1990**



**U.S. GDP**

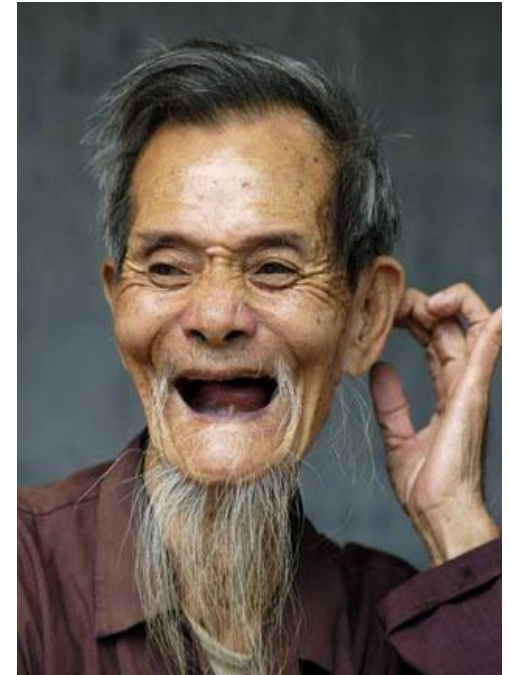
**Actual v. Extrapolated from 2008 ??**



Source: EAM



OLD CONFUCIUS SAYING,  
"WISE MAN NOT INVEST IN OVER-CAPACITY"



+



+

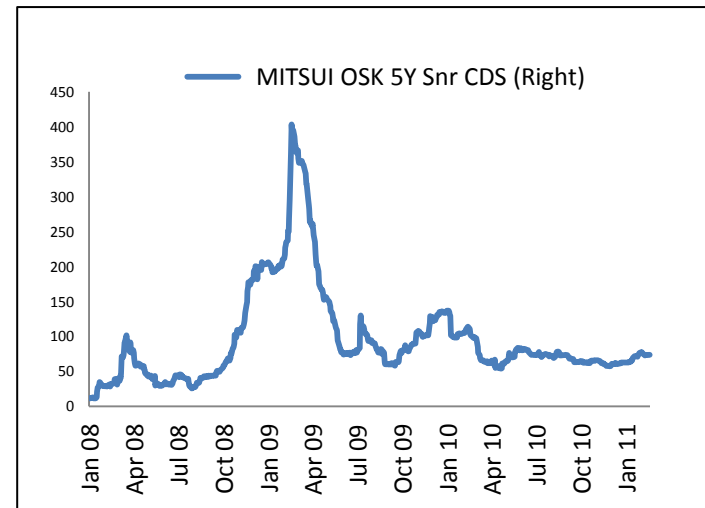
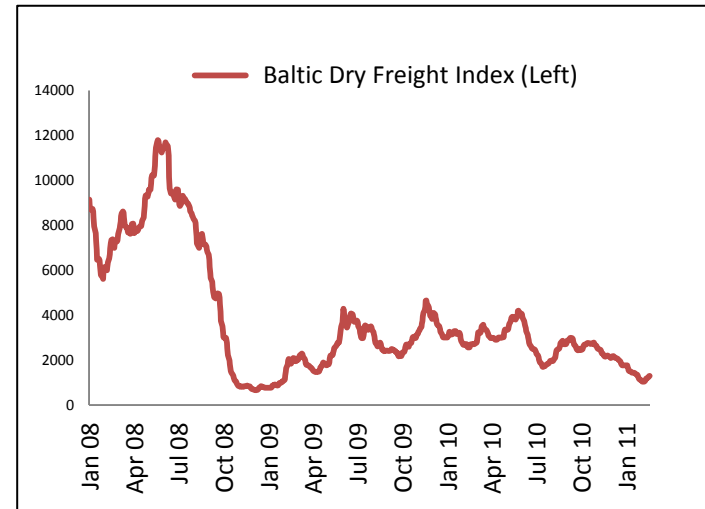


# OVER-INVESTMENT CASE STUDY

## Japanese Shipping: Supersize Me?



x **350** = overcapacity



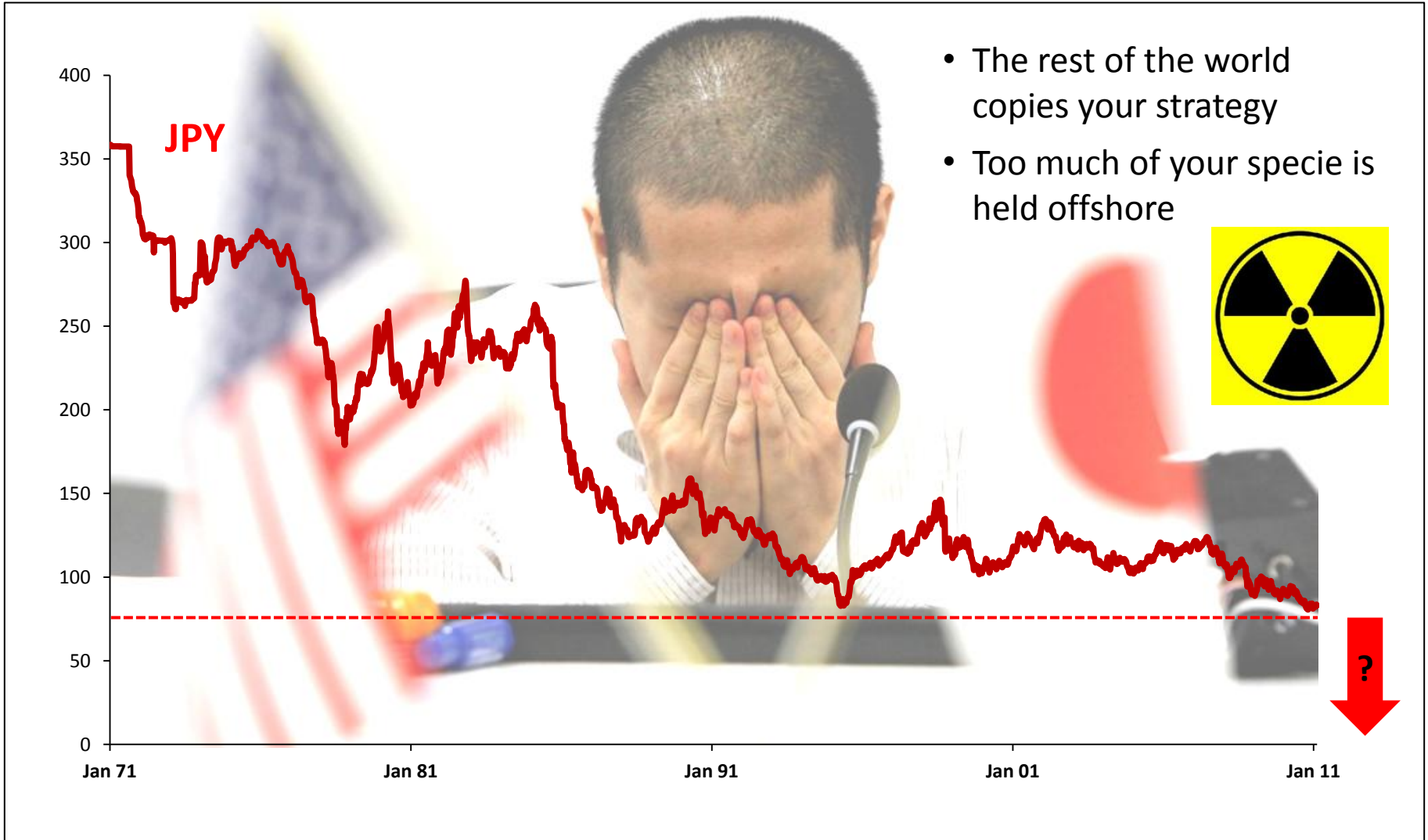
Source: Bloomberg / EAM

## OVER-INVESTMENT CASE STUDY

	MISC	OSK
<b>Market Cap \$</b>	11.8bn	8bn
<b>Net Debt \$</b>	3bn	8.6bn
<b>Net Debt \$ (inc. Shipping Leases)</b>	5.2bn	12.1bn
<b>Net Debt/EBITDA</b>	2.3x	3.3x
<b>EBIT Margin (2010)</b>	9.3%	0.9%
<b>EBIT Margin 5yr Avg.</b>	18.4%	10%
<b>Avg. Interest Rate</b>	3%	1.6%
<b>Interest Cover</b>	6.8x	1.5x
<b>Bank Debt/Total Debt</b>	15%	20%
<b>Bonds/Total Debt</b>	85%	80%
<b>Govt Bond Spread</b>	145 bps	27 bps
<b>CDS Spread</b>	70 bps	74 bps
<b>Credit Rating</b>	A3	A3

Source: EAM

# THE MERCANTALIST'S DILEMMA



## LAND OF THE SETTING SUN?

'Shinjiro Mishima... one of Japan's biggest dedicated producers, says the strong yen threatens to "destroy in a moment" the price competitiveness gleaned from decades of hard-won productivity gains.'

*Financial Times, Tuesday February 8, 2011*



# BEWARE! THE KOREANS ARE COMING!

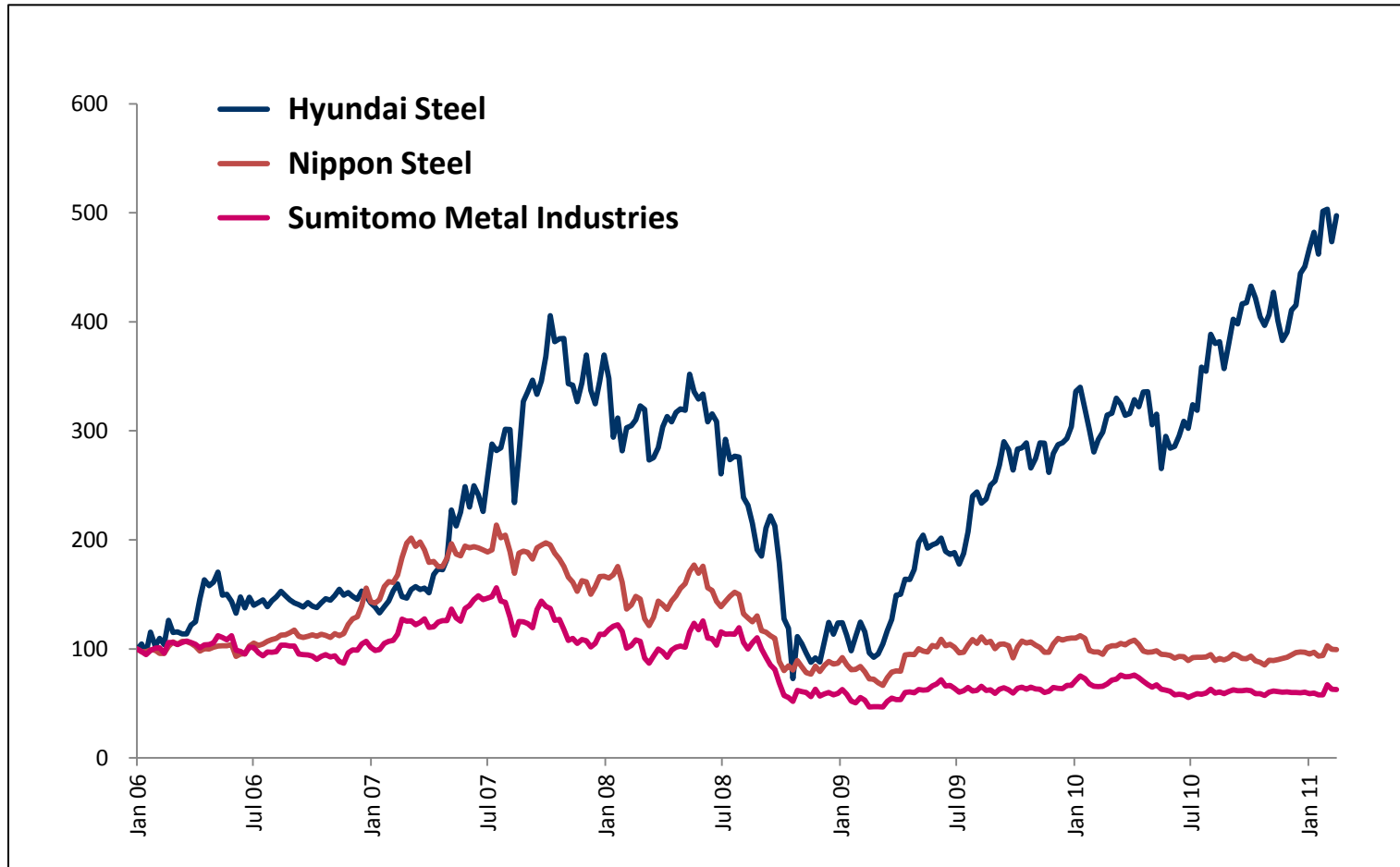
“On cost rather than price, we are roughly equal. But when we convert to dollars, then we become about 20 per cent more expensive [than Korean yards]... It is impossible to compete on an equal basis”

Hisashi Hara, Head of Mitsubishi Heavy Industries

*Financial Times, Tuesday February 8, 2011*



# IT WAS THE BEST OF TIMES, IT WAS THE WORST OF TIMES



Source: Bloomberg / EAM. Rebased to 100.

## Why is the Most Operationally & Financially Leveraged Group the Most Highly Rated?

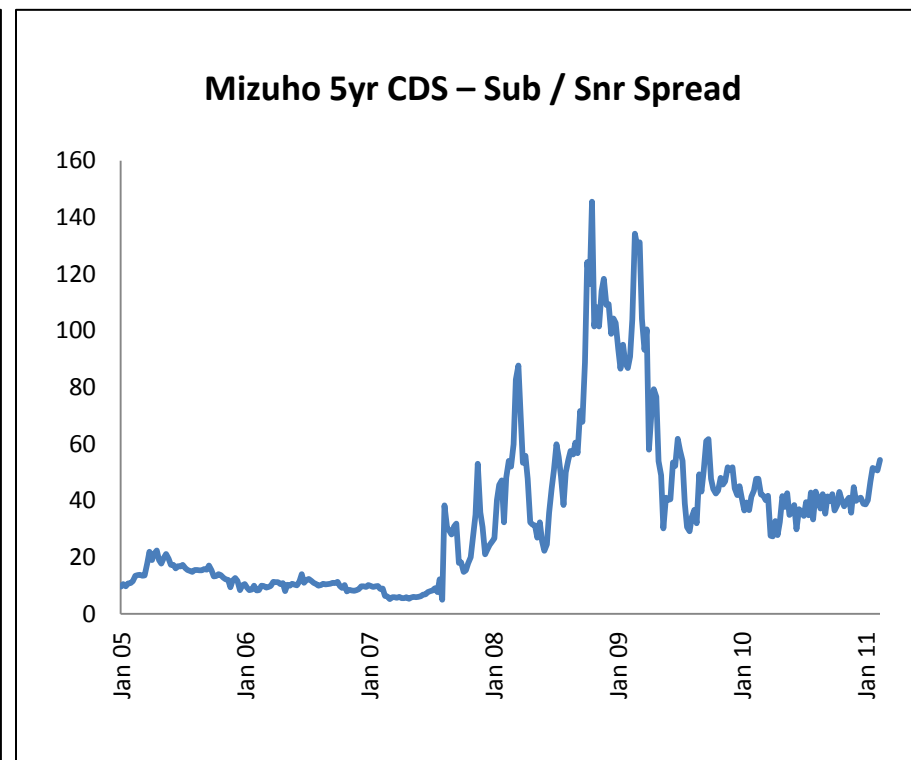
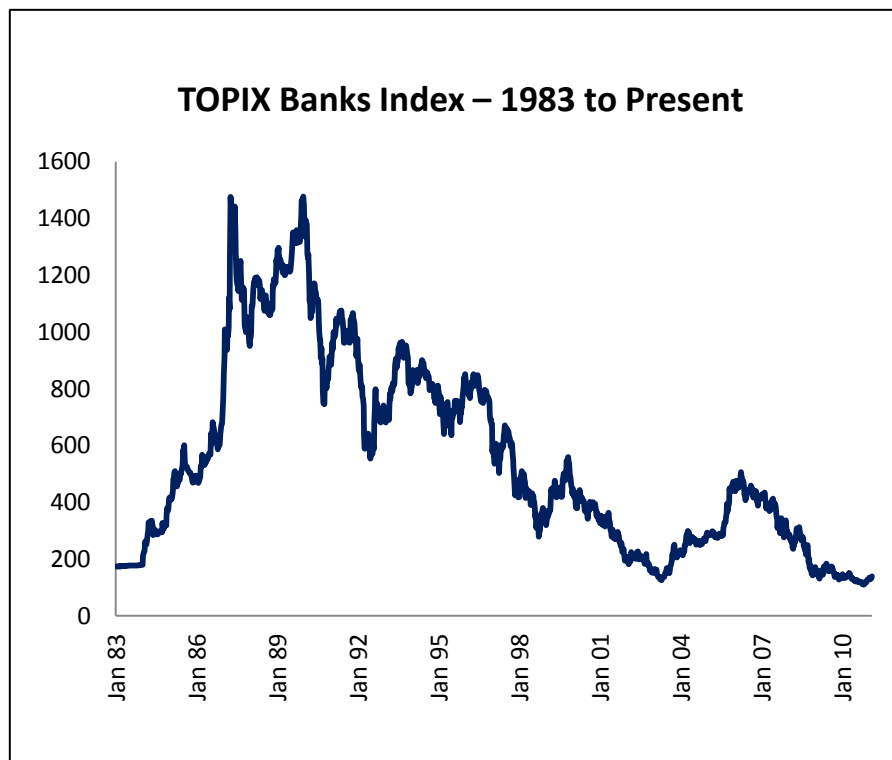
	Nippon Steel	ArcelorMittal	US Steel	Hyundai Steel
<b>Market Cap \$</b>	24.6bn	41.2bn	8.7bn	9.8bn
<b>Net Debt \$</b>	16.1bn	19.8bn	3.15bn	5.8bn
<b>Net Debt \$ (inc. pension)</b>	17.7bn	28.0bn	7.7bn	5.9bn
<b>Net Debt/EBITDA</b>	3.0x	2.0x	1.7x	2.8x
<b>EBIT Margin (2010)</b>	0.9%	7.8%	-0.9%	10.2%
<b>EBIT Margin 5yr Avg.</b>	9.3%	9.6%	2.4%	10.0%
<b>Avg. Interest Rate</b>	1.3%	5.4%	7.3%	3.3%
<b>Interest Cover</b>	2.5x	3.9x	3.2x	3.1x
<b>Bank Debt/Total Debt</b>	29%	4%	18%	65%
<b>Bonds/Total Debt</b>	71%	96%	82%	35%
<b>Govt Bond Spread</b>	19 bps	204 bps	316 bps	60bps
<b>CDS Spread</b>	66 bps	190 bps	310 bps	n/a
<b>Credit Rating</b>	A1	Baa3	Ba2	Baa3

Source: EAM





**BANKS AT ALL TIME LOWS 25 YEARS AFTER THE CRISIS**  
**A NOT SO SUBLIMINAL MESSAGE**  
**AND A TRADE IDEA**

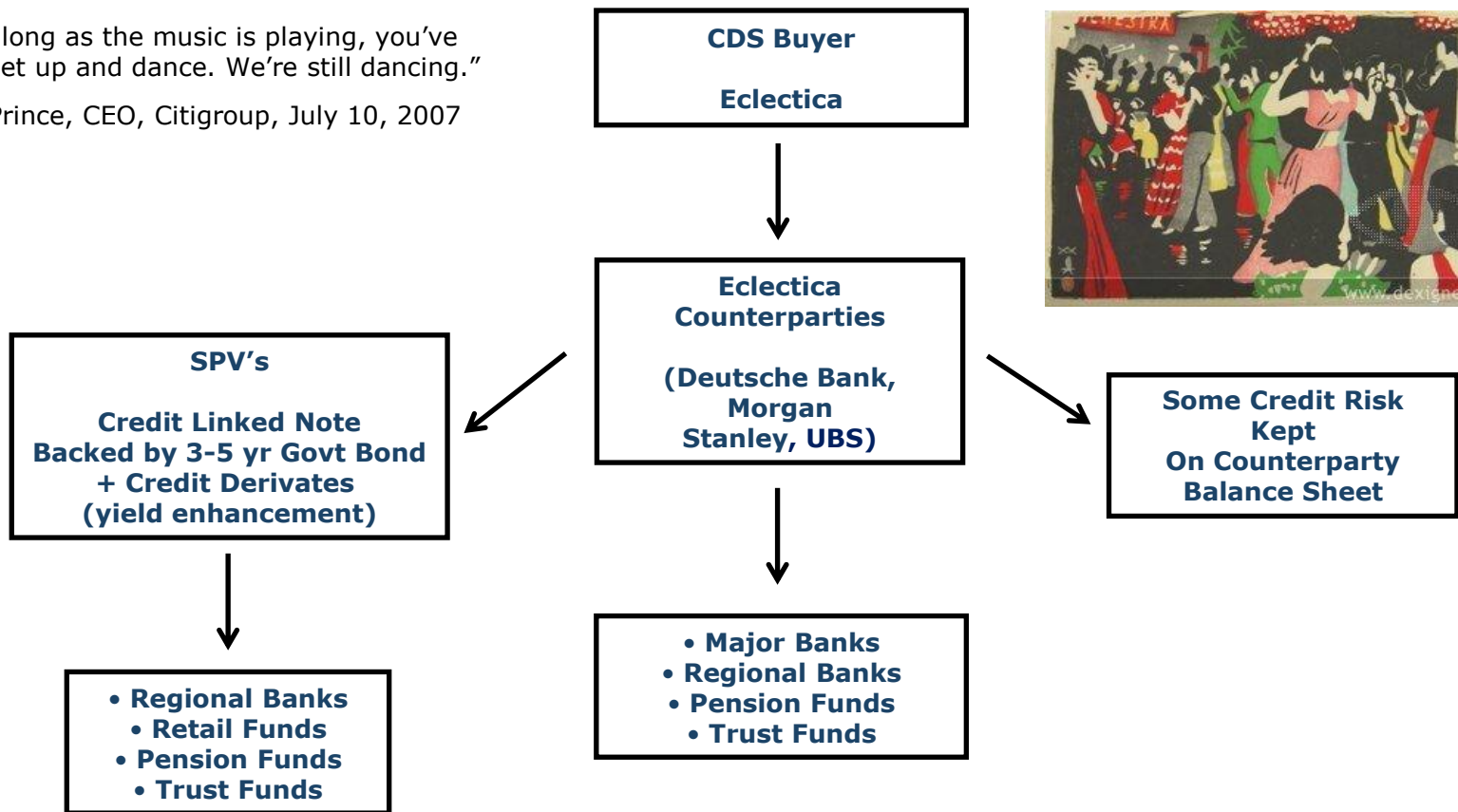


Source: Bloomberg / EAM

# CDS - DEAL FLOW – THE GREAT CARRY TRADE

“But as long as the music is playing, you’ve got to get up and dance. We’re still dancing.”

Chuck Prince, CEO, Citigroup, July 10, 2007



Those who dance are fools; those who don't are fools. Since both are fools, it's better to dance.

Traditional Japanese saying.

# WEALTH DESTRUCTION ON A MASSIVE SCALE



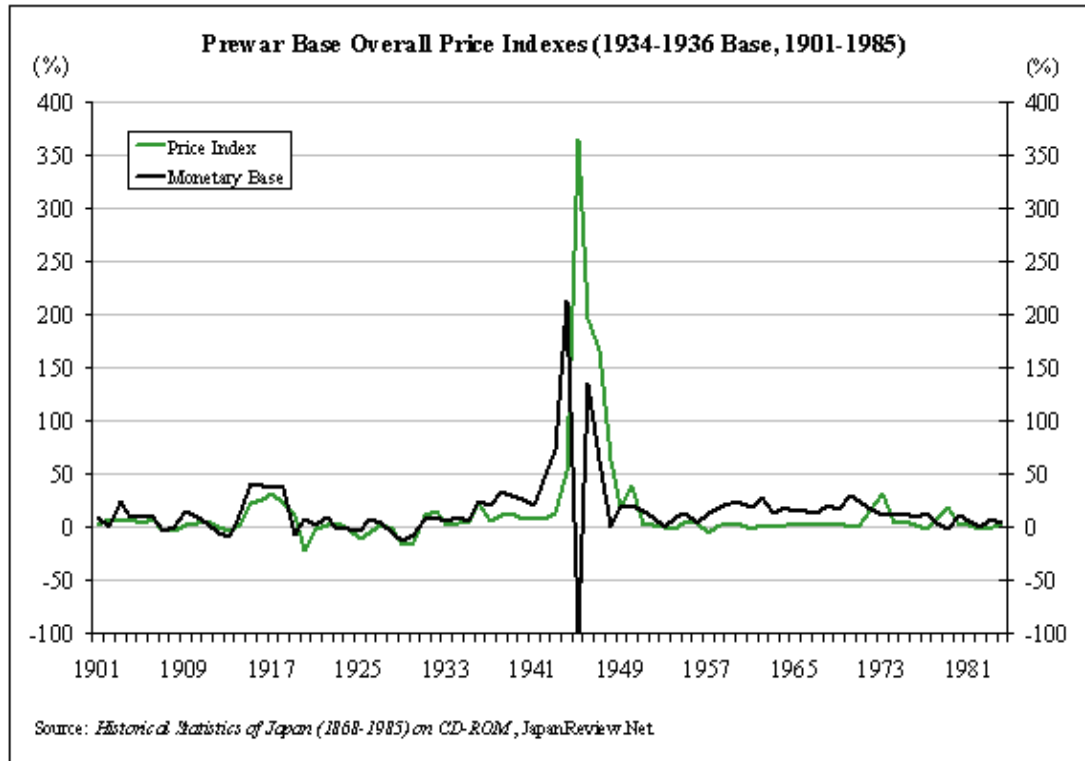
THE FEBRUARY 26 INCIDENT  
REVERE THE EMPEROR, DISPELL THE EVILS  
AN OUTLINE PLAN FOR THE RE-ORGANISATION OF JAPAN



Look behind you Mr Shirakawa!

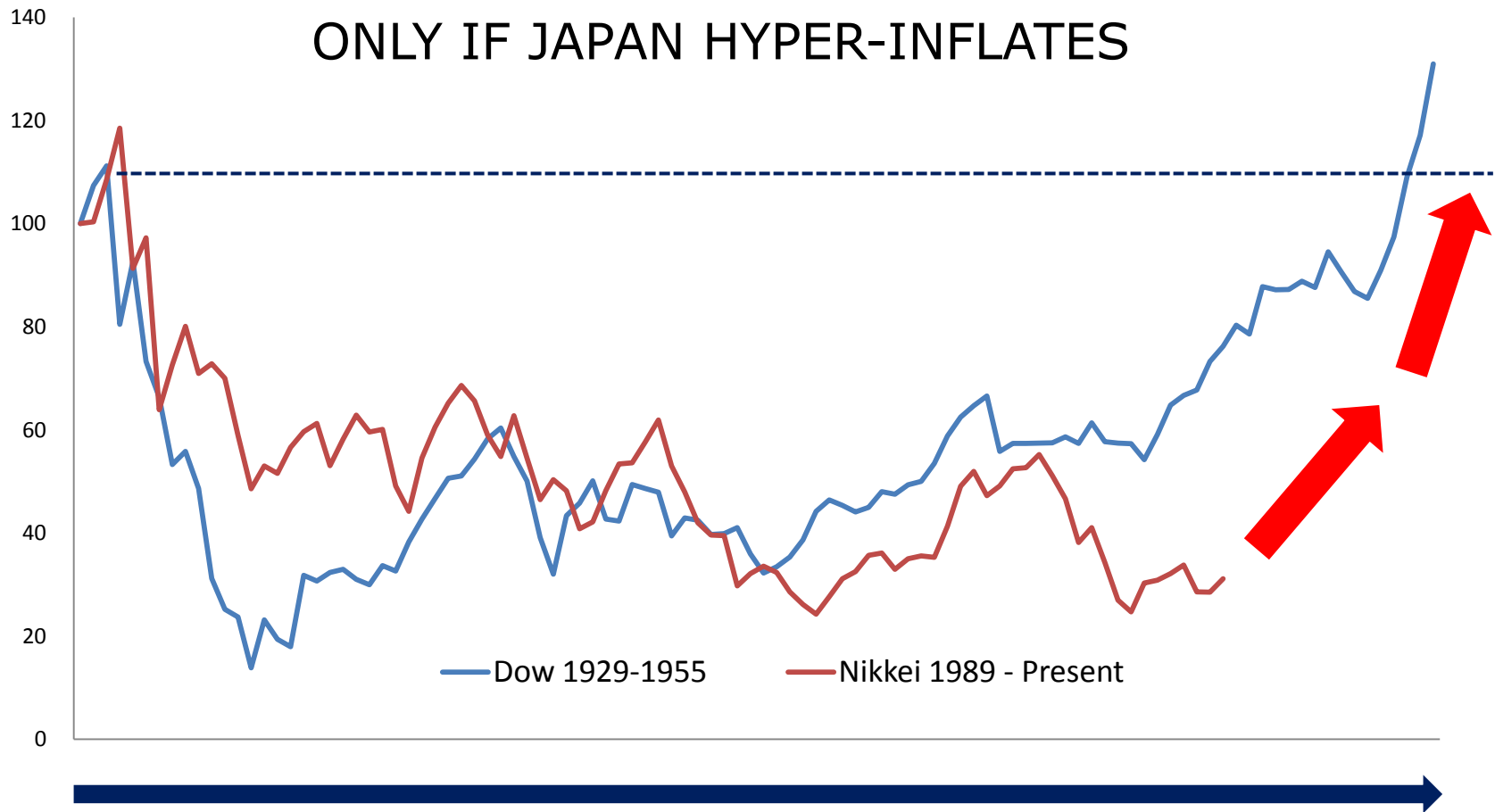
# JAPANESE HYPER-INFLATION

## A ONE IN A HUNDRED YEAR EVENT?



# NIKKEI 40K THIS DECADE?

ONLY IF JAPAN HYPER-INFLATES



25 Years

Source: Bloomberg / EAM. Rebased to 100.

“SOMETIMES THERE IS SO  
MUCH WRITING ON THE WALL THAT THE  
WALL FALLS  
DOWN”

Christopher  
Morley



# ECLĒCTICA

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