Q3– September 2021

Investment Objective: To achieve capital growth through a focused portfolio of investments, particularly in companies whose share prices stand at a discount to estimated underlying net asset value.

	Net cash[1] as a percentage of market cap	NFV[2] as a percentage of market cap	EV/EBIT	FCF Yield	EV FCF Yield[3]	Dividend Yield
Q3 2021	39%	87%	4.9	4.8%	26.0%	1.9%
Q2 2021	38%	83%	5.0	4.6%	16.3%	2.0%
Q1 2021	43%	81%	4.8	4.9%	18.8%	2.0%
Q4 2020	47%	82%	4.3	5.3%	19.0%	2.1%

MANAGER'S COMMENT

Dear AJOT Shareholders,

It was a buoyant quarter for the Japanese stock market: AJOT's NAV grew +7.9% and the MSCI Japan Small Cap Index returned +6.0%, outperforming the MSCI World Index which returned +1.4%, (all in GBP). At the start of September, Japan's prime minister Yoshihide Suga resigned amidst dangerously low approval ratings. His lack of charisma and English-speaking ability made him unpopular with overseas investors and his resignation stoked excitement for a more likable replacement. Unfortunately, this was short-lived as favourite candidate Taro Kono, who latterly headed the hugely successful vaccination effort, lost to Fumio Kishida, who the LDP members favoured as a more predictable, conservative leader.

From an investment perspective, and within reason, we do not think it matters who is prime minister – improvements in Corporate Governance and shareholder attitudes are well ingrained and not easily reversed. While Taro Kono's appointment might have attracted investor interest, Kishida, who relies on former PM and now kingmaker Abe's backing, is unlikely to rock the boat and we expect a continuation of the trend towards improved corporate governance.

From the peak in August, Japan's new COVID-19 cases have fallen 94%, and at the end of September the Government lifted the state of emergency, allowing for the reopening of the economy. At the time of writing Japan had comfortably overtaken the US and EU in its vaccination rollout, administrating almost 140 vaccines to every 100 people. We think this is lost on investors and expect that there could be a sharp rebound in consumer spending, further propelling already strong earnings.

T Hasegawa – Exceptional Quality at a Discount

In March we began building a position in **T Hasegawa** (TH), a global top-ten flavour and fragrance (F&F) company. At the end of the quarter, it was AJOT's largest position with a 7.6% weight. The investment merits of F&F companies are not lost on international investors – TH's global peers trade on an average EV/EBITA multiple of 30x. TH trades on 12x, and we do not think the reasons for this are attributable to inferior quality,

TH was founded in 1903, first expanding into the US in 1978 and now boasting over 1/3 of sales outside of Japan - mainly to the US and China. Flavours are a critical component of consumers' purchasing decisions, while accounting for a small portion of overall costs. This creates sticky customer contracts, strong barriers to entry, and pricing power. While slightly lower than peers, TH has quite consistently generated double digit EBIT margins with little cyclicality.

Where TH has failed is converting its world-class technology into sales. Sales have grown at an annualised rate of just 1.1% over the past 10 years, while peers have compounded at 6.8%. An employee summed up TH's issues on a job review site, stating that "top management tends to be conservative and too cautious and there is no active enterprising spirits in them". That was the focus of our 13-page letter titled "a lost decade". We asked the Company to put behind its conservative, sedentary culture and embrace a new bolder future.

The letter was well received by the President, Mr Takao Umino, who told us, in fluent English, that "the prudence and conservatism of management is exactly what I am trying to change". We are pushing on an open door and extremely excited about the changes that are underway. Umino has been hiring outside senior management to bring in fresh perspectives, formed a new marketing division to address the poor sales track record, and at the end of last year oversaw a $128m acquisition of a US-based flavouring company (at a reasonable valuation). While it is still early days (the flavour development process takes around 18 months) signs are positive, especially for the marketing division which is achieving a high win rate and a 17% YoY growth in customer enquiries, boding well for future earnings.

While TH has long suffered a valuation discount to global peers, the current discount is wider than the long-term average. Considering the positive steps that management have undertaken to improve operations, we believe the fair discount should be towards the lower end of the historic range. A return to a 20% discount, from the current 63%, amounts to an implied upside of +82%. While there isn't an explicit catalyst, profits should grow organically at high single digits - we are happy to be patient.

[1] Net cash = Cash – Debt – Net Pension Liabilities + Value of Treasury Shares
[2] Net Financial Value (NFV) = Net cash + Investment Securities
[3] The effective free cash flow yield were non-core assets to be distributed

MANAGER'S COMMENT

Portfolio Activity

Our trading activity was a little heightened over the quarter as we exited our position in **SoftBank Group**, significantly reduced our investment in **Hazama Ando** and made partial sales in **Daiwa Industries** and **Sekisui Jushi**. We did this to build a new position in **Wacom** (more on this in coming newsletters) which ended the quarter with a 4.7% weight.

The sale of SoftBank Group marks the end of what has been a successful investment, generating a Yen total return of +31%, with a weighted holding period of a little under a year compared to a TOPIX return of +12%. We initiated our position in February 2020, before adding to it during the COVID-sell-off, following shareholder pressure to increase board independence, improve disclosure and address the severe undervaluation. We added to this pressure, sending letters to the Board in March and August last year. Shortly after, the Company announced proactive measures to address its issues. More recently, the company's progress began to backslide after conflicts of interests were raised when SoftBank's CEO, Masayoshi Son, needlessly took a minority stake in an asset management vehicle set up to manage SoftBank's cash and disappointingly ceased buying back shares. Along with a narrower discount than our average purchase price and exposure to China regulatory risk, we felt the investment case had deteriorated from when we first made our purchase and that SoftBank no longer warranted a position in the portfolio.

Hazama Ando is a relatively new investment in AJOT, having been initiated in March. However, the position was never taken to full size, reaching a maximum weight of just 3.1%. Hazama Ando is undeniably cheap which coupled with the presence of an outspoken shareholder agitating for improvements made for a compelling investment. However, our concerns over both the industry outlook and the Company's willingness to change, only grew as we spent more time with management. In September we sent a 30-slide presentation outlining numerous measures to improve Hazama Ando's corporate value, which were met with a tepid response. While management have made efforts to address capital efficiency, we think they lack a strategy for the business with a scattered investment plan ranging from venture capital, solar energy, and real estate. We determined that our capital would be better placed in higher quality opportunities with management teams that have a clearer vision.

Q3 2021 Contributors and Detractors

Pasona was the largest contributor adding 261bps to returns followed by **Daibiru** adding 111bps.

Pasona's +47% share price return over the quarter was driven by Pasona's 50% stake in Benefit One, which appreciated by +51%, and accounts for 323% of Pasona's market cap. While Benefit One's share price outperformed Pasona's, Pasona's discount narrowed from 79% to 77%, as we marked down the valuation of Pasona's unlisted businesses due to falling peer multiples.

Benefit One is a one-stop provider of outsourced HR services, from education & training to healthcare and employee benefit options. With a shortage of labour, companies are taking more steps to attract and retain employees, but do not have the HR resources to develop incentive structures inhouse. As the market leader, and following a recent acquisition now boasting over 10m members, Benefit One is well placed to capitalise on the growth trend.

Daibiru's +18% share price gain bucked what was a generally weak quarter for real estate stocks, with Daibiru's peers seeing their share price decline by an average -4%. It was, therefore, a narrowing of Daibiru's discount from 55% to 47% that drove the strong performance. This still implies +89% upside to the after-tax fair value of Daibiru's real estate, a value which we think will be mostly realised either by a sale of Daibiru or a buy-in from its parent company Mitsui O.S.K. Lines.

Detractors were modest. **SoftBank Group** took -31bps from performance followed by **C Uyemura** which detracted -16bps.

SoftBank's share price woes were driven by weak China sentiment, as its investment in Alibaba suffered from concerns over China's stricter regulatory stance, and a disappointing absence of buybacks despite a widening discount.

C Uyemura's -5% share price return can be attributed to little more than profit taking, having risen by +31% in the first 6 months of the year vs +10% for the MSCI Japan Small Cap Index. C Uyemura has been a beneficiary of increased electronic componentry demand, and for the last quarter saw sales and profits grow +28% and +43% respectively. FY guidance for a -12% fall in profits looks overly conservative and coupled with several shareholder friendly initiatives announced earlier this year, we expect that increased investor interest in C Uyemura can help lift its unjustifiably low 3.9x EV/EBIT valuation.

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Despite increasing share prices and the purchase of Wacom (which had a higher EV/EBIT than those we sold), the overall EV/EBIT multiple fell from 5.0x to 4.9x, with share prices failing to keep pace with strong earnings growth. The companies in AJOT saw profits grow +56% YoY for the quarter ending 30 June 2021, and on a trailing twelve-month basis have grown by +15% compared with a -3% decline for the companies in the MSCI Japan Small Cap Index.

Global investors are structurally underweight Japanese equities, and the performance of the Japan market this quarter shows the potential upside were that to change. We believe AJOT's portfolio of cheaper, faster growing companies with better prospects for shareholder improvements than the index should allow for continued outperformance and strong returns.

Quarterly Contributors / Detractors

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Largest Contributors	Quarterly Contribution bps	Percent of NAV
Pasona Group	261	7.3
Daibiru	110	6.0
T Hasegawa Co	87	7.7

Largest Detractors	Quarterly Contribution bps	Percent of NAV
Softbank Group	-31	0.0
C Uyemura & Co	-16	5.4
Wacom	-15	4.5

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The share price can be found in The Financial Times.

Information may be found on the following websites:
www.ajot.co.uk
www.assetvalueinvestors.com