Q4 2019 December

AVI Japan Opportunity Trust

Portfolio Statistics

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]	Portfolio Yield
45%	81%	3.8	5.8%	22.3%	2.0%

Dear AJOT Shareholders,

This quarter's strong performance, with a NAV return of +9.5% vs the MSCI Small Cap Japan's +0.6%, was particularly pleasing after we added to positions which suffered from weakness over the summer. Six of the top ten contributors this quarter were amongst the largest detractors last quarter. Toshiba Plant, for example, was this quarter's largest contributor with a share price increase of +48% following a fall of -10% last quarter, and Teikoku Sen-i was the third largest contributor this quarter (+34%; -15% as the largest detractor previously). While only a small sample size, this highlights the benefits of taking advantage of short-term price declines which increase the discrepancies between fundamental value and the market value of our investments.

While a good period, there are plenty of situations in our portfolio where we still see major divergences between value and market price. We have been opportunistically adding to these situations, as well as starting to build two new positions with the proceeds from divesting NuFlare and Toshiba Plant.

The New Toshiba and AJOT's Subsidiary Investments

Approximately half of this quarter's performance was driven by Toshiba Plant Systems & Services and NuFlare Technology, which added +2.5% and +2.3% respectively to returns. Both Toshiba Plant and NuFlare received bids from their parent company, Toshiba Corp, at premiums of +28% and +46% to their prevailing share prices. We exited the positions in both companies following the offer, crystallising strong IRRs of +110% for NuFlare and +35% for Toshiba Plant (in local currency).

Toshiba Corp's offer is a vindication of the "parent-child" theme within AJOT's portfolio. We wrote about this extensively in our Q3 2019 letter, arguing that listed subsidiaries should be either bought in or sold off by the parent company given that the potential for the abuse of minority shareholders' rights depresses share prices. With the Abe administration having been critical of these sorts of arrangements, and Toshiba Corp's recently refreshed Board, it felt like simply a matter of time before the company would acquire or sell off its stakes in NuFlare and Toshiba Plant. After AJOT's exit from NuFlare and Toshiba Plant, there remain three companies, exposed to the parent-subsidiary theme in the portfolio, accounting for 10% of NAV.

The actions of Toshiba Corp add to the weight of evidence that AJOT's overarching thesis is valid. With pressure coming from the government, and increasingly shareholder-conscious institutional investors, Japan Inc. is shifting – slowly, but surely – towards a more efficient, fairer system of governance. The Toshiba Corp offer is but one example of this; we see further evidence in the form of rising share buybacks; higher payout ratios; increasing returns on equity; reductions in cross-shareholdings; and increasingly independent boards. We believe that our portfolio of high-quality, cash-

[1] Net cash = Cash – Debt – Net Pension Liabilities

[2] Net Financial Value (NFV) = Net cash + Investment Securities

[3] The effective free cash flow yield were non-core assets to be distributed

generative, undemandingly-valued companies stands to benefit from this trend.

Fujitec – Going Up

Fujitec is a global elevator manufacturer, selling to customers in Japan, China, Southeast Asia, North America and Europe. With a 5.5% weight in the portfolio, it is our fourth largest position and since launch has been the third biggest contributor. The strong performance (+29% on our average buy-in price) has been driven by a slight increase in Fujitec's valuation but owes more to improved operating performance, with profit growth for the first half of the year of +50% and forecast full year growth of +15%.

The most appealing aspect of Fujitec's business is the maintenance contracts that it receives after the installation of an elevator. These last for decades, producing steady, recurring profit. This is not lost on the market with Fujitec's global peers trading on EV/EBIT multiples of 20x, and the emerging bidding war for thyssenkrupp's elevator business - with some of the world's largest private equity managers vying for a stake - highlighting the attraction of the business model.

However, Fujitec, exposed to the same industry dynamics, trades on an EV/EBIT multiple of just 8x. We attribute Fujitec's lower valuation to several factors. 1) **Poor balance sheet efficiency**. One third of Fujitec's balance sheet is allocated to low yielding cash and investment securities, which accounts for 46% of Fujitec's market cap. These contribute little to profits and are valued at a heavy discount by the market. 2) **Poison pill**. Fujitec first introduced a poison pill in 2007 to fend off a proposed buyout. By restricting potential buyers, it removes the possibility of a takeover, thus leading to a valuation discount. 3) **Weaker margins**. Fujitec suffers from lower operating margins than peers, 7% vs 12%, driven by lesser scale and an overly diversified exposure to non-core geographies. 4) **Lack of sell-side coverage**. No sell-side analysts cover Fujitec while Kone and Schindler are covered by 30 and 21 analysts, respectively.

We are working with management and the Board to address these problems, and they have so far been receptive to our suggestions. Considering not only the valuation but also margin upside, we believe the share price could double over the medium-term. Fujitec represents one of the most compelling investments in AJOT's portfolio.

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Our most recent trip to Japan was accompanied by articles from the Nikkei and Bloomberg. They reported that we were considering making proposals to six Japanese companies over the coming year. While we are unable to comment on the progress we have made, or which companies we plan to target, it should be noted that we are ramping up our engagement. We hope that our discussions can stay behind closed doors away from the public spotlight, but the management of our companies know that should progress not be forthcoming, we have the ability and willingness to take our views public.

Share Issuance

Over the coming months we plan to raise additional funds via share issuances. There is growing evidence in Japan that companies are taking corporate governance more seriously and responding to shareholder engagement. We continue to find attractive opportunities both in our existing holdings and new investments.

Please do get in touch if you have any questions.

AVI
Asset Value Investors

For performance and portfolio statistics please see monthly factsheet found at www.ajot.co.uk

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The share price can be found under 'INVESTMENT COMPANIES' in The Financial Times.

Information may be found on the following websites.

www.ajot.co.uk
www.assetvalueinvestors.com

IMPORTANT INFORMATION