Q2 – June 2020

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
Q2 2020	51%	93%	3.2	6.2%	23.8%	2.4%
Q1 2020	52%	96%	2.1	7.1%	34.3%	2.5%

MANAGER'S COMMENT

Dear AJOT Shareholders,

The second quarter of 2020 saw a strong recovery in equity markets, as fears of a prolonged shutdown from the coronavirus outbreak receded. Growth stocks were very much in favour, with investors willing to pay up for companies exposed to accelerating changes in the digital landscape. The MSCI Japan Small Cap Growth Index returned +17%, outpacing the +13% return from the MSCI Japan Small Cap Index and +9% from MSCI Japan Small Cap Value Index. AJOT, with a value bias, returned +13%, in line with the MSCI Japan Small Cap Index.

As well as a value tilt, some companies in our portfolio have low liquidity and they typically lag in buoyant markets. Secom Joshinetsu is a good example. It is a high-quality business with stable earnings, but out of favour due to lack of growth and low liquidity. It provides centralised alarm systems to households and shops. Customers pay yearly servicing fees, and with high switching costs to install a new alarm system, there is little churn. For the quarter to end of March (the start of the coronavirus outbreak) profits grew by +0.4%, an impressive feat considering the circumstances. Still, the share price is down -15% since the COVID-induced sell-off began, and Secom Joshinetsu now trades on an EV/EBIT multiple of 0.8x with net cash covering 87% of its market cap. This compares to its parent company, Secom, with similar business characteristics, that trades on an EV/EBIT multiple of 11x.

While the aggregate portfolio valuation has increased over the quarter, it remains compelling with an average of 93% of market capitalisation covered by net cash and listed investment securities and the portfolio trading on an average EV/EBIT multiple of 3.2x. There are a number of companies in our portfolio that, like Secom Joshinetsu, have lagged markets for non-fundamental reasons, but, in time, we believe they will catch up with the rest of the portfolio, and provide a helpful boost to performance.

Taking Fujitec to the Next Level – Latest AVI Public Campaign

We have been shareholders of Fujitec since July 2018 and, across all AVI funds, now hold over 3% of its shares. Founded in 1948, Fujitec manufactures, installs, and maintains elevators and escalators ("E&E"). While it has a global presence, 90% of profits derive from Asia where it is well established. Over half of profits relate to after-sales services.

At the beginning of May we launched a detailed public campaign[4] highlighting a multitude of issues at Fujitec, while choosing not to submit shareholder proposals this year. While shareholder proposals are an effective way to draw attention to a company and enact change, we believe the chances of success are greater having first presented analysis around a whole suite of issues. Management teams are more receptive to suggestions that focus not solely on balance sheet improvements, but also on increasing the value of the core business through operational measures.

Moreover, many issues cannot be addressed through shareholder proposals alone, as Japanese Company Law and articles of incorporation limit shareholder proposals to only a few key issues such as dividends, director appointments, and buybacks. Measures that address the efficiency of operations such as closure of plants, increased R&D spend, or improved employee remuneration, are reserved for the judgement of management.

Given the risks inherent in transporting people at high speeds, regulations require the regular maintenance of elevators. This usually means that the manufacturer who installed the elevator, and knows it in detail, is awarded a lucrative multi-decade service contract. This is the cash cow of the business, and while E&E companies might appear to be capital intensive and cyclical, they are quite the opposite and we believe the high multiples at which Fujitec's global peers consequently trade (over 20x EV/EBIT) are justified.

[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
[4] www.takingfujitectothenextlevel.com

MANAGER'S COMMENT

Fujitec on the other hand, trades on an EV/EBIT multiple of less than 10x. It is smaller than its global peers, with no sell-side analyst coverage, poor governance, and a misplaced strategy. To address Fujitec's undervaluation, we recommended to the Board that they undergo a comprehensive strategic review, commit to divesting strategic holdings in other listed companies, set out a transparent capital policy, and adopt a three-committee style board structure.
Our research for the presentation took around two months, and during that time we spoke to twelve experts within the field including ex-Fujitec employees, peers, customers, and suppliers. We built up a detailed picture of where we thought Fujitec's failings were and, on the operational front, identified five areas that, if improved, could have a huge impact on margins and growth.

The presentation was well received by other shareholders who have grown frustrated by years of undervaluation and weak management. We sense there is sympathy from inside the Company to our recommendations and that some believe change is needed. We recognise, however, that Rome was not built in a day, and that transforming the culture of a company from outside is exceptionally difficult. We are respectful of this process and while eager for change, have given Fujitec the chance to respond to our recommendations before we take any further public actions. Most importantly, our relationship with management has so far been cordial, we were invited to attend the AGM, have held numerous calls with management, and have a meeting arranged with one of the independent directors.

Just after we released our presentation, Oasis, a well-known Hong Kong-based activist, submitted shareholder proposals to Fujitec seeking the cancellation of Fujitec's treasury shares. The proposal received an encouraging 33% support ratio, following which Oasis called for a leadership change and stated that they are considering calling an EGM. They raise valid points, and two vocal shareholders is better than one.

Fujitec has been the best performing stock in the portfolio over the quarter, appreciating by +43% in GBP vs the MSCI Japan Small Index's +13%. It has also been the largest contributor to returns since AJOT launched.

SoftBank – New Position
Being the third largest contributor to returns over the quarter, it would be remiss not to mention our relatively new investment in Softbank. Furthermore, SoftBank may stand out to our investors, from the fact that it has been plagued by scandal in recent times - from the WeWork debacle, to the attempted firing of the Arm China CEO and the disappointment of the much-publicised Vision Fund.

We have spent much time deliberating its inclusion. SoftBank has been a stock that we have followed for many years, and in the past we have invested in it for short periods in small size for our Global strategies. We know the investment case well but had felt for a long time that there was a lack of meaningful catalysts to narrow SoftBank's staggeringly wide discount to NAV. This changed when, in February, deep-pocketed activist Elliott Advisors announced they had taken a stake and were calling for a buyback, improved transparency, and better governance.

The premise of AJOT is to take advantage of changing attitudes towards shareholders in Japan and inefficient capital allocations. In this respect, SoftBank fitted into AJOT's portfolio well, despite its large size. With management under pressure from an activist shareholder, the media, and other shareholders, we built a mid-sized position and wrote to the company to reinforce Elliot's message with which we wholeheartedly agreed.
Subsequently as SoftBank's share price fell -53% from Y5,750 to Y2,690 amidst the Coronavirus outbreak, SoftBank announced a 7% buyback, followed by a thumping commitment to monetise $41bn of assets and buyback a further 30% of shares. Alongside this SoftBank announced new independent directors to its board and has improved the transparency of the Vision Fund.

This was welcome news to investors, and to the 7th July, the shares have bounced +130% from their March low (we took the opportunity to add over a third to our initial position, at an average price 28% lower than our original purchase price), and now trade 8% above their pre-COVID levels. On a 55% discount, with improving governance, greater transparency and 17% of shares left to buyback, we still see upside.

FEFTA – What is FEFTA and is it as impactful as suggested by the headlines?
Towards the end of last year, the Ministry of Finance (MoF) announced amendments to Japan's Foreign Exchange Foreign Trade Act which would increase regulation on foreign parties when purchasing large stakes in Japanese companies. The backlash from this was huge, born from confusion and poor disclosure. However, the MoF provided clarity and the ultimate rules were watered down from what was initial leaked. Exemptions have been given to foreign institutional investors who are subject to regulation under financial regulatory laws i.e most asset managers.

Despite this, many journalists have failed to understand the new legislation and we have seen sensationalised headlines such as: *"Japan's 'anti-activism' law is passed by parliament"* and *"Hedge Funds, Go Home – Japan is Closing the Door".* Where possible, we have tried to educate the media on this issue. From our perspective, the new amendments will not impact our activities in any meaningful way.

MANAGER'S COMMENT

The only relevant restriction is that we must seek clearance from the Ministry of Finance to hold over 1% of the shares if we intend to submit a shareholder proposal to appoint a related party to the Board e.g. an AVI employee. However, this only applies to companies that have not been designated as nationally important (28% of our portfolio). While we must also seek clearance if we intend to submit a shareholder proposal to sell/spin-off or gain access to technologically sensitive inside information, we cannot foresee ourselves getting into this situation. In any case, if we do need clearance, the Ministry of Finance have been at pains to point out that it is highly unlikely asset managers would be rejected and that the approval process will only take 5 days.

The impact on activist shareholders from the amendments to FEFTA are limited and we do not believe it was a ruse to alleviate the pressure on companies to reform. In fact, throughout the whole process the Government has reiterated its support for corporate governance reform, and we do not believe that the pressure is waning. It is here to stay.

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With greater team resources dedicated to Japan, we are stepping up our engagement activity, and are in the process of sending detailed presentations to two companies (privately, for the time being) on ways to increase corporate value. We look forward to updating you on progress in due course.

Please do get in touch if you have any questions.

Quarterly Contributors / Detractors

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Largest Contributors	Quarterly Contribution bps	Percent of NAV
Fujitec	311	9.3
Pasona	178	5.3
SoftBank	175	5.0

Largest Detractors	Quarterly Contribution bps	Percent of NAV
Fukuda Denshi	-59	3.3
King Corp	-29	2.9
Daiwa Industries	-17	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