Q1 – March 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
Q1 2021	43%	81%	4.8	4.9%	18.8%	2.0%
Q4 2020	47%	82%	4.3	5.3%	19.0%	2.1%
Q3 2020	46%	90%	4.0	5.1%	19.1%	2.1%
Q2 2020	51%	93%	3.0	6.2%	23.8%	2.4%

MANAGER'S COMMENT

Dear AJOT Shareholders,

Over the first quarter, AJOT's NAV declined by a modest -0.6%. The strength of the Pound against the Yen, which detracted 7.5% from returns, masked an otherwise respectable quarter.

The most important feature of our portfolio is that the overall corporate value of our 28 investee companies is increasing, whether that be through cash generation, earnings growth or a higher justifiable multiple due to improved business quality. In February and March, our companies reported earnings results, showing a solid recovery in profitability after the disruption from the pandemic with the weighted profits of the portfolio increasing by 16% year-on-year.

Despite the strong recovery, only four companies revised up their earnings guidance. This leaves an implicit guidance of a -26% decline in profits for rest of the fiscal year. Given this would represent a greater decline in profit than that experienced during the height of the global pandemic, we believe these forecasts are unrealistic. We attribute the perplexing guidance not to pessimism, but to the inherent conservatism of Japanese management and the cultural unwillingness to change the status quo by revising up prior guidance. At the announcement of full-year results in May, we expect managements forecasts to be well and truly beaten and hope that this will prove a good catalyst for share price performance.

Engagement Activity – Preparing for June 2021 AGMs

Whilst a lot of attention is drawn to public activism, investors should not underestimate the power of private engagement and dialogue. We have been busy engaging behind the scenes and, over the quarter, sent twelve letters or presentations to ten companies, of which seven contained details of shareholder proposals to be submitted to their upcoming AGMs.

Each company which has received detailed presentations or shareholder proposals has reacted proactively, recognising that our points - which address a range of areas including corporate governance, shareholder communication, capital efficiency, and ways to enhance business operations - have validity. At one company, an IR spokesman remarked that our shareholder proposals were quite reasonable and other companies have already enacted changes in line with our suggestions.

One thing that has become very clear to us in the past 6-9 months, is that management teams are not hiding behind COVID-related excuses and the trend of improving corporate governance and focus on shareholder returns is continuing with vigour. We are discussing our arguments quite regularly with management and have been pleasantly surprised at their willingness to engage in dialogue. While we have only struggled to arrange meetings with one of our portfolio companies (which we are in the process of selling), the impetus for regular meetings has historically always come from us. Since submitting the Shareholder proposals there has been a marked difference in this relationship, with management proactively setting up conference calls and informally calling us for brief updates (sometimes daily), which has been possible since certain members of the investment team are now based in Tokyo.

It is encouraging that our shareholder proposals - which some might perceive as aggressive in their demands - have enabled us to deepen the relationship with our portfolio companies. We believe by focusing on a whole suite of issues, not just capital efficiency, and basing our arguments on the principles of the Corporate Governance Code, it is harder for management to push back against them.

Hopefully, we can withdraw all seven shareholder proposals and keep our dialogue private. But either way we are excited by managements willingness to improve corporate value which should bode well for future returns.

Revised Corporate Governance

The final draft wording for the revised 2021 Corporate Governance Code was released just after quarter end, but it would be remiss not to mention it. This is the Code's second revision, with it being revised every three years since its introduction in 2015. The strictest changes apply to companies that will be listed on the new Prime section of the Tokyo Stock Exchange, where we anticipate that the majority of our investments will be listed. We have identified the following as the most pertinent proposed revisions (emphasis added):

(1) Increase in the number of independent directors from at least two to <u>one-third</u>.
(2) <u>Listed subsidiaries should have majority independent boards</u> or an independent special committee to oversee conflicts of interest between the parent company and minority shareholders.
(3) Disclose a policy of promoting the <u>diversity</u> of female, non-Japanese and mid-career professionals to senior management positions.

[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

(4) Enhance the quality and quantity of climate-related disclosure.
(5) Disclose a skill matrix of board members.

While some commentators have expressed disappointment over the weakness of the new wording, we are pleased that the Code, for the first time, explicitly targets listed subsidiaries (AJOT's portfolio is exposed to six listed subsidiaries accounting for 20% of NAV). Each year the pressure on companies to improve governance ratchets up. Expectations from shareholders to deliver satisfactory returns increases. And managements ability to push back on basic improvement requests weakens. This has been the trend for the past six years, with some excellent results, and we expect no let up.

Portfolio Activity/Engagement Positioning

Trading activity was concentrated on investing the £16m of capital that the Trust raised over the quarter. We increased our stakes in 8 existing companies and started to build positions in two new investments (undisclosed while we are actively buying). However, besides deploying the new capital, trading was muted, with an annualised turnover of just 14%. We exited one small position (due to managements unwillingness to hold constructive dialogue) and trimmed two others.

The largest positions in the Trust generally reflect confidence in our ability to engage with management. Increasing our position ahead of an engagement campaign not only allows for us to have more meaningful dialogue with management but it gives us greater exposure to positions that could benefit from a shorter-term event, assuming we are successful in persuading management to implement our suggestions. AJOT's portfolio has three investments with weights greater than 6%, which have been positioned as such due to our engagement activities: DTS, Fujitec and Digital Garage.

Following the release of our public presentation in May and a strong share price (which has since appreciated by 49%), **Fujitec** has been our largest investment. We have been engaging with management regularly with 13 meetings over the past year, and numerous informal calls. Management have made great strides in improving their business, with an overhaul of their communications, operations, and governance, in line with our suggestions. Despite the improvements Fujitec's share price has plateaued over the past months (unjustifiably in our view), reducing the portfolio weight to 7.1% and ceding the top spot to newcomer **DTS**, with a 7.3% weight. We expand on DTS in more detail below, but we believe it presents a highly compelling opportunity with a combination of strong growth, low valuation, and a management team open to shareholder dialogue.

Finally, **Digital Garage** has been a position in AVI's funds since 2016 (before the launch of AJOT) so we are familiar with management and their business. We have a firm view about what management should be doing to improve Digital Garage's valuation, which relates to strategic initiatives surrounding its payments business. We have been encouraged by the response and conversations with senior management who have shown a deep awareness of the issues stifling their valuation. Digital Garage's share price is undervalued and its business misunderstood, and we believe management will take steps to remedy that in the coming months.

Q1 2021 Contributors and Detractors

DTS Corporation – an IT services business - contributed 78bps to returns, as its share price increased by +20%. We first acquired shares in DTS in January 2020, and in combination with other AVI funds, have accumulated an 8.1% stake. As we move towards the formation of the Japanese Government's Digital Agency in September 2021, the importance of upgrading legacy IT systems is at the forefront of companies' agendas. We often see mid-term management plans place heavy emphasis on IT investment and we expect that the whole IT sector, including DTS, will benefit from increased demand. Over the quarter, DTS announced strong year-on-year profit growth of 12% and the establishment of a Digital Solutions Department to promote a cloud-first mission that will be headed by the new CEO, Mr. Kitamura. We met with Kitamura at the end of March, who was the head of the Business Solution Department at NTT Data until May 2020. He excitedly shared his ideas on how to transform DTS's business to more recurring and cloud-based, as well as appreciating that DTS had too much cash on its balance sheet.

Over the past year we have been engaging with DTS, sending a detailed 54-slide presentation to management in June. They have been hugely receptive to our suggestions and although we have only held the shares for 14 months, DTS have implemented a number of our suggestions, including becoming an advanced consulting partner with Amazon AWS, improving the speed of English IR disclosure, and evaluating a stock-based compensation scheme for directors. While these changes are not radical, collectively they matter, and we believe DTS will continue to implement measures to increase its share price. The opportunity for growth and a proactive management team seems to have gone unnoticed by investors, with DTS trading on a 7.3x EV/EBIT multiple vs peers on 15.1x. With the changes that we expect the Company to make over the coming years, we do not expect this anomaly to last.

Our second largest contributor over the period was the **Bank of Kyoto**, whose share price increased by +27%, adding 45bps to GBP returns. This is a relatively new position for the Trust, having first purchased shares last August. The Bank of Kyoto is an exceptionally undervalued company, trading on a discount of 52%. For seasoned value investors the Bank of Kyoto is a well-known story. A hugely valuable investment security portfolio, which accounts for 117% of the market cap (after-tax), means that you are not paying for the core banking operations and have exposure to a portfolio of high quality, blue-chip listed companies (of which, we are most enthused by Nintendo accounting for 39% of the Bank of Kyoto's market cap after tax). So far management have proved reluctant to unlock the tremendous value, but pressure is growing from the Government, Regulators and other shareholders, to restructure and place greater emphasis on shareholder returns. We don't believe that the market is pricing in much, if any, likelihood of management yielding to this pressure – which provides us with a free option. In the meantime, banks generally, have benefitted from the reflation trade and the anticipation of higher interest rates that should boost their operating profitability.

Being the largest contributor last quarter, Pasona takes the wooden spoon for the largest detractor this quarter. It detracted 94bps from GBP performance, with its share price falling by -10% in Yen. This was driven by a widening of its discount from 76% to 78% and -4% fall in Benefit One's share price, which accounts for 310% of Pasona's market cap and, by our estimates, 69% of its fundamental value. Over the quarter Pasona reported strong results, with profits increasing by 51% YoY buoyed by the highest Q2 operating margin for its unlisted businesses since 2008. Unfortunately, Pasona only revised up forecasts for the year by +50%, despite profits for the first half increasing by 177%, which investors did not take well. We believe the forecasts are excessively conservative and expect that Pasona will exceed them, boding well for future share price performance.

MANAGER'S COMMENT

Teikoku Sen-i was the second largest detractor this quarter with its share price falling -6%, taking off 66bps from GBP returns. Teikoku manufactures disaster prevention equipment, from anti-flooding pumps to large industrial fire fighting vehicles. It is suffering from a negative sales mix, with sales of high-margin special purpose vehicles used at nuclear reactor sites declining, which is forecast to lead to a -14% fall in profits next year, despite overall sales growing 2%. While we did not sell any shares this quarter, we have been trimming the position slightly over the past year, although we still believe the company will be a beneficiary of the long-term structural tailwind of increased disaster prevention spending in Japan.

AJOT Capital Increase

During February and March AJOT issued additional shares on three occasions, two through a block listing and one through a placing. We raised total proceeds of £16m and grew the Trust by 12% to a net asset value at quarter end of £143m. We have largely put the new proceeds to work in increasing our stakes to boost our influence in ongoing engagement campaigns and building positions in two new companies (undisclosed for the time being). A larger Trust is beneficial to all shareholders, reducing the burden of the Trust's fixed costs and improving trading liquidity. Thank you for the support.

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2020 was not an easy year for our strategy with the onset of COVID delaying the opportunity to proactively engage with our portfolio companies. However, whilst engagement activity has been delayed, it has not been derailed, and we think 2021 will mark a record for the level of shareholder engagement in Japan. With an expanded team and revised Corporate Governance Code at our side, we are optimistic that the companies in our portfolio will deliver strong earnings performance in coming weeks, and announce notable shareholder friendly changes this year – much to the benefit of their share prices and AJOT's performance.

Quarterly Contributors / Detractors

Quarterly Contributors / Detractors

Largest Contributors	Quarterly Contribution bps	Percent of NAV
DTS	0.8	7.3
Bank of Kyoto	0.5	4.6
Soft99	0.4	2.5

Largest Detractors	Quarterly Contribution bps	Percent of NAV
SK Kaken	-0.4	5.0
Teikoku Sen-I	-0.7	4.0
Pasona Group	-0.9	4.7

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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
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IMPORTANT INFORMATION

All figures are as at the period under review unless otherwise stated. All sources Asset Value Investors Ltd ("AVI") unless otherwise stated. AVI is authorised and regulated by the Financial Conduct Authority of the United Kingdom (the "FCA") and is a registered investment adviser with the Securities and Exchange Commission of the United States. While AVI is registered with the SEC as an investment adviser, it does not comply with the Advisers Act with regard to its non-U.S. clients. This document does not constitute an offer to buy or sell shares in AVI Japan Opportunity Trust plc (the "Trust"). The contents of this message are not intended to constitute, and should not be construed as, investment advice. Potential investors in the Trust should seek their own independent financial advice. AVI neither provides investment advice to, nor receives and transmits orders from, investors in the Fund.