Q2 2022

Investment Objective: To achieve capital growth through investing in a focused portfolio of over-capitalised small-cap Japanese equities. Asset Value Investors will leverage its three decades of experience investing in asset-backed companies to engage with company management and help to unlock value in this under-researched area of the market.

	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 2022	41%	59%	5.7	5.7%	13.4%	2.4%
Q1 2022	38%	59%	6.5	5.7%	14.4%	1.9%
Q4 2021	40%	76%	5.1	5.4%	21.2%	1.8%
Q3 2021	39%	87%	4.9	4.8%	26.0%	1.9%

MANAGER'S COMMENT

Dear AJOT Shareholders,

After the end of the quarter, it was with great sadness that former Prime minister Shinzo Abe passed away. His death was a shocking tragedy. It has taken a number of years for companies/management to buy into corporate governance reforms, but there is now clear evidence of a shift in attitudes amongst corporate Japan, and that is one of the many important legacies of Shinzo Abe.

AJOT's NAV fell -5.9% over the quarter, due almost entirely to a -3.4% weakening in the Japanese Yen. In local currency terms it was a relatively good period for the Japanese stock market with the MSCI Japan holding up well, returning -4.4% vs the MSCI Europe -9.0% and the S&P 500 -16.2%.

With core inflation holding steady at 2% in both April and May, the Bank of Japan (BOJ) stuck with its expansionary monetary policy. Contrasting with the direction of rising global rates, the BOJ is defending a 10 year JGB yield below 25bps, repurchasing a record amount of JGBs in May. The BOJ's diverging policy is weighing heavily on the Yen, which on an effective real exchange rate basis is at the cheapest since 1971. If a Big Mac in the UK costs £3.19, it only costs £2.10 in Japan.

Japan isn't suffering from the same surging inflation as other countries, but rising raw material costs, amplified by the weak Yen, are weighing on corporate margins. While we are sanguine about our companies' ability to pass on cost increases, it won't happen overnight. However, going into a period of economic uncertainty with rock-solid balance sheets and remarkably low valuations is not a bad place to be.

In June, Japan eased its border controls, allowing foreign nationals from group "blue" countries, the United Kingdom included, to travel to Japan without quarantine or on-arrival testing. We are planning a visit in September to join Jason Bellamy, our Tokyo-based colleague, to meet the management of our companies. During the quarter the President of Wacom visited us in London. It is rare for management of companies in our small-cap universe to make such trips, and his visit is testament to the strength of the relationship we have built up.

The performance of our portfolio in the wider context of weak markets is encouraging and shows that fundamentals and valuations do matter. In local currency terms it's quite a positive picture, with some portfolio companies trading around all-time high share prices (but, importantly, not valuations)

We continue to push our portfolio companies to address their under-valuations and grow corporate value. The successes we are having on the engagement front should not be underestimated. Given the private nature of our dialogue, this success is not yet priced in. The backdrop for shareholder engagement is improving with 55 companies receiving shareholder proposals at the 2022 AGM season (almost double last year). This represents just a fraction of the activity going on behind closed doors. Encouragingly, according to IR Japan, there are now 65 activists in Japan, up from less than 20 five years ago – as far as we are concerned, the more the merrier!

Fujitec – AVI's public statement raising concerns regarding Fujitec's directors

At the end of June, we released a public statement questioning whether **Fujitec's** current outside directors were acting in the best interests of shareholders. Since the launch of our original public campaign in May 2020, we have conducted all of our dialogue privately, making excellent progress on several issues. However, Fujitec's response to legitimate concerns raised by Oasis Management, a Hong Kong based activist, in May regarding related-party transactions between Fujitec and former President Mr Uchiyama fell a long way short of what we expect from a listed company.

Despite the Board's efforts to exonerate Mr Uchiyama of any wrongdoing, we remain entirely unconvinced that the numerous related-party transactions undertaken by Mr Uchiyama and his family do not pose a problem for corporate governance. In recognition of that, we voted against Mr Uchiyama's reappointment at Fujitec's 2022 AGM along with three other outside directors.

[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

Disappointingly, in what we think was an effort to conceal a low approval rating for Mr Uchiyama's reappointment, the motion to reappoint him as President was withdrawn one hour before the AGM. Then, shortly after the AGM, Mr Uchiyama was reappointed as Chairman without the approval of shareholders.

We are astounded by the clear disregard for shareholder rights and Fujitec's blatant effort to circumnavigate the AGM voting process. We are not alone - two other shareholders holding almost 16% of the shares released a public statement following the AGM debacle and we know from private conversations that many shareholders share the same views.

The Board has lost the support of its shareholders and the current situation cannot continue. As we stated in our public statement, we are proactively evaluating our next steps to protect shareholder value. What form that might take is still being decided but we won't sit by passively while shareholder rights are being ignored. We believe there is upside to Fujitec's current share price and the steps we take will be aimed at realising that upside.

Portfolio trading activity

Trading activity was muted over the quarter. The main purchases were into existing positions **Konishi**, **NC Holdings** and **Shin-Etsu Polymer**, while we started building small positions in three undisclosed names.

On share price strength and increasing valuations, we slightly reduced our position in **C Uyemura**, and exited our small position in **KING**, selling into an off-market buyback program (at the prevailing share price). KING trades with net cash covering over 100% of its market cap and we had made good progress with our engagement, encouraging the Company to launch an e-commerce strategy and renovate its real estate portfolio. However, with a large percentage of allegiant shareholders on the register, we felt it better to focus our efforts elsewhere. The investment returned an underwhelming 4.1% vs 14.6% for the MSCI Japan Small Cap Index, as KING suffered from the closure of its stores during the COVID-induced lockdowns. The share price did however, fare better than peers, which over the same period fell by an average -45.1%.

Q2 2022 Contributors and Detractors

DTS, the IT system developer, was the largest contributor to returns with a +12.6% share price increase adding 71bps to performance. This compared favourably to DTS' peers with an average share price increase of only +1.8%. DTS' share price responded positively to a new mid-term plan that included a raft of shareholder-friendly announcements. Beyond higher shareholder returns which could see up to 33% of the market cap returned to shareholders in the next 3 years, DTS announced a strategy to double EBITDA by 2030, increase ROE to 16% and focus on high-value-added IT services. As the largest shareholder, owning 10%, we have been working closely with management and the Board behind the scenes. DTS' response to our engagement has been exemplary – they allowed us frequent dialogue with senior board members and aside from a few minor issues, actioned all our suggestions. The positive share price performance, and significant outperformance vs the market, is we believe, a testament to our efforts and clearly demonstrates the real value of AVI's constructive activism - something that we hope will not have gone unnoticed by our other investee companies as well as other investors in the Japanese markets.

On an EV/EBIT of 7.4x vs peers on 14.2x there remains a considerable amount of upside, and as the largest shareholder, we will continue engaging with management to achieve a higher share price.

A-One Seimitsu, one our smaller positions (3.2% of NAV), was the second-largest contributor over the period adding 25bps to returns with a +12.3% rise in the share price. A-One Seimitsu produces manufacturing tools including collet chucks and cutting tools, mainly focused on replacement demand. It is famed for its fast turnaround times, crucial when a customer's factory urgently needs a replacement part. Over the quarter A-One Seimitsu announced its first mid-term plan, forecasting +61% profit growth over the next 5 years and crucially, for a Company where cash accounts for 73% of balance sheet assets, a -19% reduction in shareholder's equity. As a start to reducing its cash balance, A-One Seimitsu announced its intention to pay a ¥100 dividend which amounts to a 141% pay-out ratio and 6.0% yield. As the second-largest shareholder owning 11.0% we have been working closely with A-One Seimitsu's President who has been a great advocate for improving the share price (in contrast to the Founder). Trading with net cash covering 79% of the market cap and on an EV/EBIT of 5.8x, there is plenty of upside as we expect shareholder returns to continue increasing.

Suffering from a continued sell-off of growth-related companies, **Digital Garage** was the largest detractor reducing returns by 126bps. The -20.2% share price decline was driven by a widening of its discount from 35% to 37% and weakness in Kakaku.com whose share price fell -19.9%. Digital Garage is a holding company whose key assets are a listed 20% stake in Kakaku.com and one of Japan's largest payment settlement businesses. We estimate that these two assets, along with small stakes in venture start-ups and a digital marketing business, are worth 59% more than the current share price. We attribute the undervaluation partially to the holding structure but also to an incoherent strategy that has been poorly communicated to investors. We sent two presentations to management last year, 72 pages and 23 pages long, which led to a new strategic direction entitled "DG FINTECH SHIFT" - a step in the right direction. Frustratingly, however, Digital Garage continues to include previous strategy slides in its presentations, confusing investors. We sent the Board a letter during the quarter, detailing our concerns and our intention to vote against President Kaoru Hayashi at the AGM. We hope to continue working with management to ensure Digital Garage can achieve its full potential, and remain optimistic about unlocking the undervaluation

Quarterly Contributors / Detractors

For the second quarter in a row, **Pasona** was a detractor, reducing returns by 121bps. Its -22% share price performance suffered from a -30% fall in Benefit One's share price, with the discount narrowing slightly from 67% to 66%. Pasona has been the largest detractor in 2022 driven by a -63% fall in the share price of Benefit One, which accounts for 189% of Pasona's market cap. Although we had concerns over Benefit One's valuation, and had been reducing our position in Pasona accordingly, the magnitude of the share price fall is astounding, and Benefit One no longer seems overvalued. Benefit One has 11.3m captive members on its platform, about 19% of the 60m employed workers in Japan, providing stable cashflows and an opportunity to sell additional services. With Pasona's 66% discount coupled with an appealing Benefit One valuation, we are excited by Pasona's potential upside.

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The EV/EBIT of the portfolio narrowed from 6.5x to 5.7x over the quarter and trades with 59% of the market cap covered by net cash and listed securities. As active managers, the volatile environment paired with falling valuations is an exciting combination and, with unutilised gearing capacity, we are looking forward to exploiting mispriced opportunities.

Quarterly Contributors / Detractors

Largest Contributors	Quarterly Contribution bps	Percent of NAV
DTS Corp	71	9.2
A-One Seimitsu	25	3.3
T Hasegawa	21	9.2

Largest Detractors	Quarterly Contribution bps	Percent of NAV
Digital Garage	-126	4.6
Pasona Group	-121	3.9
Wacom	-117	8.0

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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