

Q1 – March 2023

**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 <sup>1</sup> as a percentage of market cap	NFV <sup>2</sup> as a percentage of market cap	EV/EBIT	FCF Yield	Dividend Yield
<b>Q1 2023</b>	36%	51%	9.0x	5.3%	2.2%
<b>Q4 2022</b>	38%	58%	6.7x	6.2%	2.4%

## MANAGER'S COMMENT

The fund's NAV increased by +9.1% over the quarter, buoyed by stock specific gains and despite a -3.2% weakening in the Japanese Yen. The MSCI Japan Small Cap Index returned only +2.2%, in a period that favoured large-cap stocks, with the MSCI Japan Index returning +4.5% (all in EUR). In the context of small caps underperformance, the Fund's performance was especially pleasing.

The Japanese Yen weakness was driven by a cautious tone from Kazuo Ueda, the newly appointed Bank of Japan (BoJ) governor, which disappointed those anticipating an imminent end to the BoJ's Yield Curve Control (YCC) policy. While the headline inflation in February fell from 4.3% to 3.3%, this was entirely due to the introduction of government subsidies on electricity prices, and core inflation (excluding fresh food and energy) rose from 3.2% to 3.5%. We think it isn't a matter of if the YCC will be adjusted but when, which would be a boon for the Yen.

The Tokyo Stock Exchange (TSE) followed through on their announcement at the end of last year calling on companies to address low valuations. This is mostly aimed at the 1,800 companies in Japan that trade on a price-to-book ratio of less than 1x. Companies will need to determine why the market evaluates the shares so lowly and disclose plans how to improve the valuation. It is an encouraging step, highlighting that regulators are continuing to use their powers to promote reform. We shall be closely watching and engaging with the 12 companies in our portfolio that trade below book.

We are continuously engaging with our portfolio companies, and it isn't inconceivable that some of the engagement might spill out into the public domain later in the year (although we certainly hope it doesn't). We have no shortage of ideas, but as we increase the level of portfolio concentration, the hurdle for new ideas increases. With an undervalued portfolio, further regulatory tailwinds, and management teams more willing to listen, we're optimistic about our ability to continue generating idiosyncratic outperformance.

### NC Holdings (6236) – Frustration at Lack of Progress

NC Holdings (NCHD), a top ten position, has been held by AVI funds for nearly two years. Since we made the first purchase at ¥1,039 (across AVI funds), the share price has leapt 94% to ¥2,015, where it has unfortunately, languished for the past year.

NCHD holds a collection of businesses including solar panel consulting, conveyor belts and - the most attractive - car parking systems. Collectively they trade on a forward EV/EBIT multiple of 8.5x with net cash and securities covering 42% of the market cap. We think the fair value is approximately +30% higher than the prevailing share price.

There are a few reasons for the undervaluation; an inefficient balance sheet, poor shareholder communications, and a conglomerate structure. With limited synergies, there is no rationale for holding such a disparate collection of businesses, and we see all the issues leading to NCHD's lowly valuation as fixable. Unfortunately, despite sending a 60-slide presentation last year, management have been slow to act. Over the quarter they disclosed a disappointing dividend increase from ¥15 to ¥17, for an inadequate 18% pay-out ratio.

Across AVI funds we hold 22% of NCHD's shares and a US-based fund holds 27%. While, we have tried to engage constructively in private we fear that our suggestions are falling on deaf ears and that some members of the Board are resistant to change. While nothing is decided, and we need to carefully consider the right structure, with such a large shareholding we have the option to submit shareholder proposals at the upcoming June AGM.

Taking our suggestions and concerns public is always a last resort, and we'd rather hold discussions in private. However, our strategy is to try and maximise the value of the companies we invest in and if NCHD's management are not acting in the best interests of shareholders, then they should be held accountable.

NCHD has some good business lines, and it is such a shame they are being undermanaged. We aren't convinced that NCHD's conglomerate, and capital structure are appropriate, and we are supportive of the Board exploring all options to maximise shareholder value.

<sup>1</sup> Net cash = Cash – Debt – Net Pension Liabilities + Value of Treasury Shares

<sup>2</sup> Net Financial Value (NFV) = Net cash + Investment Securities

## MANAGER'S COMMENT

**Fujitec (6406) – EGM Victory**

Over the quarter, after months of public back and forth between Fujitec and its largest shareholder, Oasis, Fujitec held its much anticipated EGM. The foundations of Oasis' criticisms, and reason for calling the EGM, was that the then president, Uchiyama, who despite owning less than 10% of the shares, treated Fujitec like his personal company. Uchiyama's disregard for shareholders was highlighted at the AGM last June, when Uchiyama stepped down before his, presumably low, support could be revealed, only to be appointed shortly after as a non-elected Chairman. This infuriated the shareholder base, led to public letters questioning the outside Director's conduct (including [ours](#)) and ultimately the calling of the EGM.

Of the eight directors put forward by Fujitec to the EGM; one stepped down before, five were rejected by shareholders and another stepped down after (he only received 50.2% support), leaving just one candidate on the Board. Meanwhile, four of Oasis' six candidates were approved. At the EGM the one remaining Fujitec-appointed outside director stated that he pushed back against Uchiyama's appointment as Chairman and following the EGM put his name to a statement by the outside director announcing several governance improvements. It's safe to say that he has sided with the newly elected outside directors.

Fujitec's board is now composed of five shareholder supportive outside directors against the three incumbent inside directors. Since the EGM, Uchiyama has already been ousted from his Chairman role and an investigation launched into potential intimidation of Oasis' director candidates at the EGM. We have been appalled at the behaviour of management over the past year and we would not be surprised if further changes are made.

The EGM outcome is a fantastic example of shareholder democracy working, and while it happens too rarely in Japan, it serves as a wakeup call to Japanese management that they are accountable to shareholders. The share price has reacted well to the outcome, gaining 6% at the time of writing. We look forward to seeing what the empowered board will announce to realise Fujitec full potential.

**Tokyo Radiator (7235) – towards an exit**

During the quarter Tokyo Radiator announced an off-market share buyback for up to 35% of its shares to facilitate a partial exit from its register of its parent company, Marelli. With the possibility of a privatisation off the cards, we placed the entirety of our shares into the buyback and sold three-quarters of our position at a level +40% higher than where it ended the quarter.

As a listed subsidiary of Marelli (Marelli in turn is owned by KKR) there was intensifying pressure on both Tokyo Radiator and Marelli's management to collapse the listed parent/subsidiary structure – not least from us. Over our ownership we met Tokyo Radiator management 19 times, sent 12 letters/presentations, and submitted shareholder proposals to three AGMs in a row. Net cash covered Tokyo Radiator's market cap by nearly 100%, and we theorised that either Marelli would sell its stake or buy-in minorities.

With Marelli selling a majority of their holding over the month, our thesis that the parent/subsidiary structure would collapse proved right. However, it did not prove to be a successful investment. Although it was never a large position, over our four-year holding period to the end of the month, our investment returned -15% in JPY, a disappointing result considering the resources we committed to engaging.

We learned a valuable lesson; regardless of undervaluation and a potential catalyst, the longer the holding period the more dependent returns become on the quality of the underlying business. Although often appearing cheap, when investing in low-quality, poorly run businesses – as was the case for Tokyo Radiator – time is against us. Still, in the context of Tokyo Radiator's declining earnings over our holding period, the -15% return, while disappointing, was not a disaster. We identified correctly that there would be a change to the listed subsidiary structure and realising most of our shares through the share buyback event at a higher price, softened the loss.

Through a conscious effort to avoid value traps, our portfolio today, while still exposed to undervalued and overcapitalised companies, has greater exposure towards high-quality, growing companies. Crucially, while we wait for an event to realise the undervaluation, the business value and ultimate upside is increasing. Time is on our side, and we think that is a powerful force for generating outsized returns.

**Portfolio Trading Activity**

Over the quarter we added to several existing holdings, including **LOCONDO** which after quarter end released strong earnings forecast which at the time of writing sent the shares limit up and +32% higher vs. the end of the quarter. We exited a longstanding position in **C Uyemura**, which we had been reducing for some time, generating an 87% ROI and 21% IRR over the life of our investment. We also sold three-quarters of our **Tokyo Radiator** stake into the Company's 35% share buyback.

**Contributors and Detractors**

**TSI Holdings**, the diversified apparel holding company, saw a share price increase of +45% over the quarter adding 284bps to returns. Results were in line with our expectations, with sales rising +11% YoY and profits falling -22% (higher raw material prices and one-off costs relating to head office move), and we think the shares likely rose on the announcement of a 5.8% share buyback (following a 6.6% buyback last year) and the resignation of the Chairman from the founding family.

## MANAGER'S COMMENT

While it is hard to justify the increase based solely on those announcements, TSI was trading on a remarkably low valuation at the start of the quarter. 182% of its market cap was covered by net cash, investment securities and real estate, implying a large negative value for its apparel business. We didn't think that was justified. TSI's share price increase might be a case of, undervalued companies don't need a reason to re-rate.

Still, the +45% share price gain does little to change TSI's undervaluation with net cash, investment securities and real estate accounting for 128% of the market cap at the end of the quarter and we see a potential upside of +77%. We own just under 5% of the voting shares and plan to engage with management on ways in which to further rectify the undervaluation – although given the spate of buyback announcements and improved attitudes towards shareholders – we think we are pushing on an open door.

Our second largest contributor over the quarter was **Shin-Etsu Polymer**, whose +33% share price gain added 195bps to performance. Continued strong profit growth of +43 YoY alleviated the market's concerns over a slowdown in its core wafer carrier business. Shin-Etsu Polymer is a subsidiary of Shin-Etsu Chemical and with intertwined business relationships we think that Shin-Etsu Chemical might ultimately buy-in Shin-Etsu Polymer. We are engaging with both companies towards achieving that goal and while we wait, should continue to benefit from the strong underlying earnings growth.

**Digital Garage (DG)**'s meteoric +32% share price increase in Q4 2022 reversed this quarter, with a share price decline of -5%, reducing returns by 50bps. Frustratingly, all of the weakness was driven by its 20% stake in listed Kakaku.com, which fell -14%.

DG is a holding company whose key assets are its stake in Kakaku.com and DG Fin Tech, one of Japan's largest payment settlement businesses. The stake in Kakaku.com is non-core, and despite management's assertions, it has failed to generate meaningful synergies with the payments business. Kakaku.com's share price has been remarkably weak, failing to capture COVID-rebound demand in its restaurant reservation business and sell-side analysts questioning the validity of its price comparison website business model. Kakaku.com is trading on a P/E on just under 20x, the bottom end of its range and at the same level as during the COVID-lows.

We have been engaging with DG intensively since February 2021 when we sent a detailed presentation outlining several issues that we believed were contributing to DG's undervaluation. We called for a review of the confusing holding company structure and greater focus on the payments business. Management responded favourably to our suggestions outlining a clearer strategy, improving shareholder communications, and concentrating on the payments business through a new initiative called "DG FinTech Shift".

However, the holding structure and stake in Kakaku.com has not been addressed, and this was crux of Oasis' public presentation released in December calling on Digital Garage to split its businesses. We have been conveying the same message to the Board of Directors in private, and over the quarter sent a letter explaining our views. Following our letter, management announced that they will release a mid-term plan on the 11<sup>th</sup> May which will review "each business and strategy of management resources".

We will wait and see what actions management will announce, but remain confident in the upside potential, with a lowly valued Kakaku.com and a potential for the eradication of the discount in a restructuring event.

**NC Holdings (NCHD)** detracted a modest 23bps from performance, with a -1.9% share price return that failed to keep up with rising markets. Results were weak, recording a small loss in the last quarter, but this was a timing effect from a late recognition of sales and management are still confident in achieving annual forecasts. As we discussed earlier, we hold a 22% stake and will be exploring options to maximise NCHD full value.

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The share price can be found in [www.AJF-fund.com](http://www.AJF-fund.com)

Information may be found on the following websites:

[www.AJF-fund.com](http://www.AJF-fund.com)

[www.assetvalueinvestors.com](http://www.assetvalueinvestors.com)



## IMPORTANT INFORMATION

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