Q2 – June 2023

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	Dividend Yield
Q2 2023	32%	50%	8.6	4.6%	2.2%
Q1 2023	36%	51%	9.0	5.3%	2.2%
Q4 2022	38%	58%	6.7	6.2%	2.4%

MANAGER'S COMMENT

The fund's NAV declined by -0.4% over the quarter (in EUR), with a -6% weakening of the Japanese Yen against the Euro, detracting from what was otherwise a buoyant period for the Japanese stock market. Over the quarter the MSCI Japan Index's +15.6% gain (in JPY), far exceeded the S&P 500 (+8.6%, in USD), the MSCI Europe Index (+2.7%, in EUR) and FTSE All Share (-0.5%, in GBP).

Small-caps lagged, with the MSCI Japan Small Cap Index returning only +9.9% with the rally led by large-cap value, the MSCI Japan Value Index returning +17.1% (both in JPY). Typically, early capital tends to flow into large cap names however, as the rally is sustained, we would expect there to be a trickle-down effect as capital seeks out smaller and better valued opportunities.

We continued to actively increase our portfolio concentration, with the top ten holdings accounting for 73% of NAV. Such concentration allows us to dedicate more time to researching and engaging with each company. On the engagement front, it was a busy period. We submitted shareholder proposals to **SK Kaken's** and **NC Holdings'** AGMs (successfully passing three proposals) and we also had success with our long-term investment in **Konishi**, who released a mid-term plan which for the first time included a capital allocation plan with a commitment to share buybacks. A few weeks after the mid-term plan, Konishi announced an 8.5% share buyback which sent the shares +10% higher the following day.

We have no shortage of ideas, with two new companies entering the portfolio (with a third shortly after). Despite rising markets, the EV/EBIT of the portfolio declined modestly from 9.0x to 8.6x, as we recycled capital from strong performing names to more attractively valued ideas.

It feels that the stars are starting to align in Japan. Our approach to engaging with undervalued, high-quality companies is bearing fruit, and if we see a reversal in Yen weakness and flows into small caps, we could be in for a period of strong NAV growth.

NC Holdings – Successful passing of our shareholder proposals

In a first for AVI, we successfully passed three shareholder proposals at **NC Holdings'** (NCHD) AGM held at the end of June, with a further three receiving majority shareholder support. We passed two dividend-related resolutions increasing the dividend to a 70% pay-out ratio and the formation of a stock-compensation plan tied to achieving a three-year total share price return of over 50% and an average three-year ROIC of over 10%.

The three proposals which achieved majority support were to increase the maximum number of directors on the Board from 12 to 13, setting minimum requirements to adopt or trigger a position pill and requiring prior approval from shareholders for a third-party allocation of shares.

One of the resolutions that passed for the dividend was a special resolution that required over two-thirds of the vote. We believe that is one of only a handful of shareholder-proposed special resolutions to have ever passed in Japan. Furthermore, AVI is one of only three shareholders who had their resolutions successfully passed despite opposition by the company this June AGM season.

While we are pleased with the success, we are disappointed that our shareholder proposals to appoint two highly qualified outside directors did not pass. Aside from largely ignoring shareholder views for the past two years, the Board opposed six resolutions that achieved majority shareholder support, engaged in intimidation and baseless threats relating to acting-in-concert issues, mentioned our employees by name in both their public and private rebuttals, and even tried, unsuccessfully, to claim that NCHD's business was of national interest to avoid scrutiny at the AGM. Despite that, few other shareholders voted against the Board. We are disappointed that other large shareholders did not take issue with this behaviour, almost unanimously supporting all directors and not seeing the value of bringing fresh perspectives to the Board.

[1] Net cash = Cash – Debt – Net Pension Liabilities + Value of Treasury Shares
[2] Net Financial Value (NFV) = Net cash + Investment Securities

MANAGER'S COMMENT

We are grateful to both outside director candidates we nominated to the Board, who would have brought a wealth of relevant experience, and who were both truly excited to contribute to Board discussions and improve NCHD's corporate value. Unfortunately, as things stand, the company is being overseen by a Board with no capital markets experience, who opposed shareholder-friendly resolutions and who have allowed the share price to continue to trade at a discount to its fair value. While we hope to be wrong, we are sceptical that the current Board will find enlightenment over the next year, and, without further shareholder action, suspect we will be in the same position next AGM. We will continue to engage with management and seek ways to improve NCHD's corporate value. We hope that other shareholders will support our efforts and recognise that the Board is not serving their best interests.

Takuma – new idea

Takuma, a waste treatment plant builder and operator, finally entered the portfolio after being on our watchlist for several years. We watched the share price boom +150% higher on an ESG-fuelled bubble in 2021, only to fall -46% to where we started buying. For a business with an open shareholder register (32% foreign ownership), a structural tailwind, and a shifting business model to more recurring maintenance work (already 50%); we think Takuma's lowly 3.5x EV/EBIT valuation multiple is wholly unjustified.

Takuma's share price has been subdued following its results announcement, which has allowed us to build a sizeable 5.6% position in the portfolio. Next year's lacklustre profit guidance of -18%, on +2% sales, paints a less rosy picture than reality. Not only is it a difficult comparison period, with last year's profits growing +39%, but over half of the profit decline is due to increased R&D and depreciation expenses, with a more aggressive investment approach from management.

Our thesis on Takuma is predicated on its shifting business model to more recurring revenue streams, and while we attribute no value to the Company's investment in carbon capture and energy trading, we think there is potential to achieve growth in these areas. We like that management are on track to achieve their profit target of Y20bn by 2030 (8.5% CAGR), but we believe management can further enhance value with a more aggressive approach to shareholder returns. Almost half of Takuma's balance sheet assets are held in cash and listed securities, accounting for just over 60% of the market cap. We plan to start engaging with management on solutions to increase the lowly valuation.

Portfolio Trading Activity

Over the quarter we added modestly to several existing holdings, alongside building a new position in waste management company Takuma (as already discussed).

We exited three holdings, **NS Solutions**, **Papyless** and **Fujitec**. The former two had controlling shareholders protecting management who had little regard for minority shareholders. We have become less tolerant of companies with lacklustre management and where we have little prospect of winning shareholder proposals at an AGM. There are too many well-run and undervalued companies in Japan, with management teams who want to create value for shareholders, to waste our time with these companies.

Fujitec was a longstanding investment where in AJOT (the closed-end version of this fund) we generated a +111% ROI and a +32% IRR over our almost five-year holding period. This tremendous success was driven by shareholder engagement, starting from our public engagement in May 2020 all the way through to the recent upheaval of the Board of Directors and ousting of the founding family President. When we first invested in Fujitec it was trading on a 4.7x EV/EBIT multiple compared to peers on 16.8x, which has radically changed, and at the time of selling Fujitec was trading with an EV/EBIT of 23.3x against peers on 20.4x. We took the difficult decision to sell the position based on valuation grounds, believing that the exciting prospects of value creation from the new board are mostly already reflected in the increased share price.

Contributors and Detractors

JADE GROUP's (previously LOCONDO), +60% performance over the quarter came after it reported full-year results and published a highly informative shareholder adding 269bps to performance.

Full-year profits came in above forecasts (Y991m vs. Y900m), but it was the Company's +33% sales and +76% profit growth forecast for next year that propelled the share price. JADE GROUP had been heavily investing in logistics infrastructure, with ballooning fixed costs weighing on profits and excess capacity. However, last year it won the right to manage the Reebok brand in Japan through a joint venture with Itochu. Having already made the warehouse capacity investments, JADE GROUP benefitted from the wonders of operating leverage, with Reebok's incremental sales flowing straight to the bottom line. Next year's whopping profit guidance is in line with JADE GROUP's mid-term plan, and management estimate that with further accretive acquisitions, they can grow profits by another +34% the year after next.

Alongside results, JADE GROUP announced a 3.6% share buyback, which was well received. CEO Yusuke Tanaka's insightful 14-page shareholder letter detailed the Company's history, what management have learned, and management's growth strategy. He made a compelling argument for why JADE GROUP justifies a ¥30bn-50bn market cap, some 100% higher than the current ¥20bn market cap.

MANAGER'S COMMENT

While it will take flawless execution of the plan to meet the higher end of the range, we don't think it is entirely unrealistic. Across AVI funds, we are Jade Group's largest shareholder, owning 10% of the shares, and are optimistic about the Company's growth prospects which we don't think are being fully appreciated by investors given its 11x EV/EBIT multiple.

TSI Holdings continued to see its share price drive higher, with a +24% share price return adding 131bps to performance, taking the share price gain for the calendar year to +80%.

The share price was buoyed over the month following encouraging results, where management are making good progress towards achieving their 4.3% operating margin goal in 2025. Management forecast +5% sales growth next year and a 2.9% operating margin, which would mark the highest operating profit in TSI's history. and, unsurprisingly, the market took this news well.

Despite the strong share price, TSI still has net cash, investment securities and realisable real estate covering 96% of its market cap, and we see a further 113% upside.

Wacom detracted 198bps from performance, with a -15% share price return that was especially painful in a buoyant market. It is difficult to link the share price weakness to a specific event, with the weakness coming in June after the full-year results announcement in the middle of May. We suspect the weakness was driven by selling pressure from one of Wacom's largest shareholders, who announced a reduction in their stake.

Although management are listening to our suggestions and have committed to a buyback program for up to 20% of their shares, the operating environment has weighed heavily on profits. Despite sales growing +4% last year, cost inflation dragged gross profits -21% lower, while SG&A investments led to a -85% fall in operating profits. The weakness came entirely from the consumer business, which saw a swing in operating profit from Y8.7bn the previous year to a -Y4.0bn loss this year.

Operating profits are expected to rebound +124% next year and recover to the FY03/22 levels in around three years. The pace of recovery is being hindered by Wacom's continued investment in future growth, to which we are not necessarily opposed.

The difficult operating environment has already been reflected in the share price, and we still believe that Wacom holds a technological advantage that will bear fruit as the digital writing market grows. We will continue engaging with management to enhance Wacom's corporate value and seek ways to recover the share price weakness.

Digital Garage (DG) suffered a self-inflicted -12% fall in its share price, reducing returns by 129bps, following the announcement of a hugely disappointing mid-term plan. We have been engaging with DG extensively, and ahead of the mid-term plan, sent a letter to the Board calling for all strategic options to be considered to address the inefficient holding structure.

Instead of listening to our concerns and those raised publicly by another shareholder, management released an entirely underwhelming mid-term plan. This plan failed to address the holding structure or justify why Digital Garage needs to retain its 20% stake in Kakaku.com. Additionally, it failed to make a convincing case as to how, without change, the performance of the payment business will improve. The negative share price reaction demonstrates that we are not alone in our disappointment with the mid-term plan, and we are exploring next steps. We added modestly to the position on weakness taking us through to a 3% shareholding.

Investment Manager – Joe Bauernfreund

AVI Ltd. +44 20 7659 4800 info@assetvalueinvestors.com

The share price can be found in *www.AJF-fund.com*

Information may be found on the following websites:
www.AJF-fund.com
www.assetvalueinvestors.com

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.