Asset Value Investors

Taking Aichi Higher

May 2024

Aichi Corporation (TSE:6345)

About AVI

Asset Value Investors Limited (AVI)

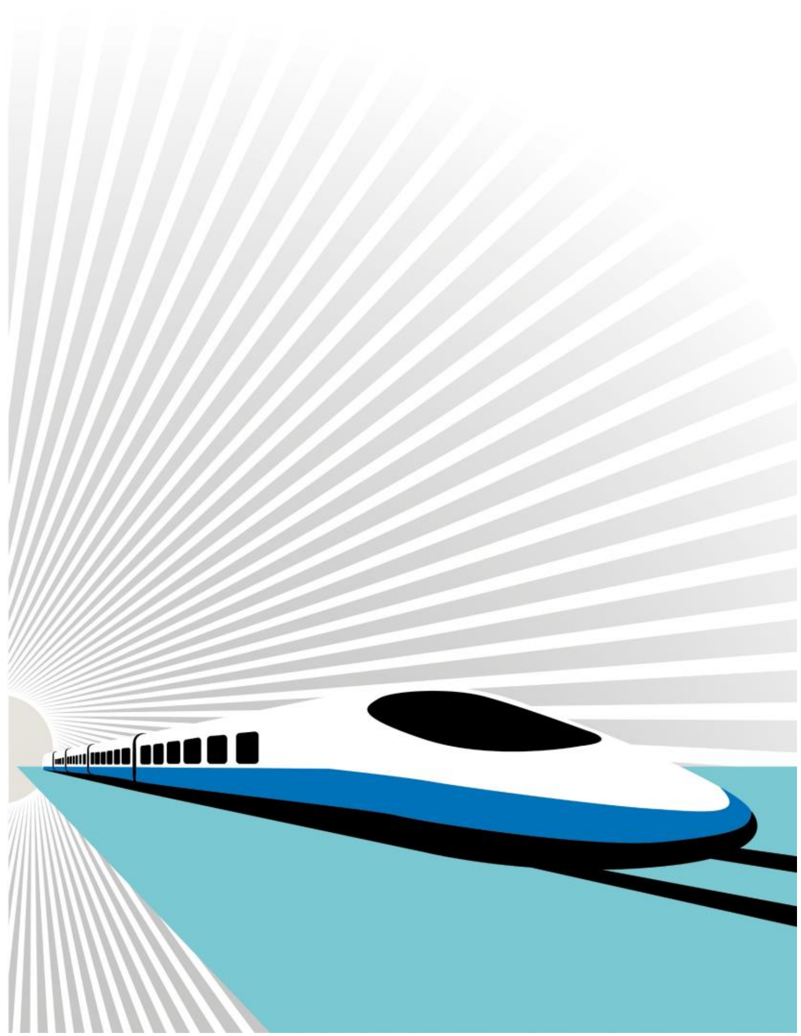
- London-based Investment management company established in 1985
- Managing client funds and investing in global equities for over 35 years
- Accepted the Principles for Responsible Institutional Investors (Japanese version of the Stewardship Code), and is committed to constructive "purposeful dialogue" (engagement) to enhance corporate value and sustainable growth

Experience in Japan

- Active in Japan for more than 25 years with Y100bn[1] invested in Japanese equities
- Mostly private engagement with companies that are under-researched and undervalued
- Long-term investment horizon

Main investment assets

- AVI Global Trust plc (total assets: Y250bn[1])
- AVI Japan Opportunity Trust plc (total assets: Y40bn[1])
- Both are public companies listed on the London Stock Exchange's main market. Closed-end investment trusts allowing for a long-term investment policy based on stable capital



Note1: As of 31 March 2024

AVI's engagement

- AVI holds 1.7% of outstanding voting shares in Aichi Corporation (Aichi), and 0.1% of Toyota Industries (TICO), on behalf of its clients. AVI has been shareholders of Aichi since November 2019
- We have engaged in constructive private dialogue with Aichi and TICO's management over our holding period, requesting various initiatives to address Aichi's undervaluation through presentations and letters
- Despite AVI's suggestions, Aichi has made only modest improvements. Therefore, AVI is releasing this presentation to highlight Aichi's share price underperformance and urge Aichi/TICO to make meaningful improvements

Nov 2019

Jul 2022

Discussion presentation materials (to Aichi)

- 69-page presentation to improve corporate value

Dec 2023

Letter and discussion presentation materials (to Aichi)

- Re-iterated request to consider suggestions made in July 2022
- Further 54-page presentation on how to improve corporate value

Feb 2024

Letter (Toyota Industries)

- Discussion to increase Aichi's corporate value as its parent company

Held 17 meeetings[1] with the management of Aichi and Toyota Industries

Note1: As of 31 March 2024

Executive Summary

Company overview

- Aichi operates within the aerial work platform (AWP) market, an industry with steady growth and an attractive business model. Due to its dominant domestic position, Aichi boasts exceptionally high profit margins compared to global peers
- However, Aichi's valuation has constantly been discounted against peers. AVI believes that Aichi's full potential is capped due to the following issues

Issues

- **Strategy issues**
  - Aichi's core domestic business has hit a ceiling with a low growth outlook
  - The overseas business is stagnant as management have failed to leverage its domestic competitiveness
  - The Company lacks a long-term vision, and has been unambitious in its growth investments
- **Low capital efficiency**
  - An excess of shareholder equity due to under-investment in Capex/M&A, results in inferior ROE to global peers
  - An excess of cross-shareholdings which management have failed to make a compelling explanation for retaining
  - Lack of a capital policy
- **Poor shareholder communications**
  - A vague mid-term plan lacks detail and substance, with China segment disclosure not adequate
  - Other issues include no earnings call and insufficient English disclosure
- **Weak governance**
  - Weak governance due to listed subsidiary structure with TICO. The board is composed of ex-TICO/Toyota Motor employees raising questions about the quality of Aichi's governance and protection for minority shareholders
  - The board lacks Independent outside directors, and diversity

Executive Summary (Cont'd)

Our request

- We believe the parent-subsidiary listing is the root cause of Aichi's undervaluation and capped potential
- AVI therefore urges Aichi's Board to consider **dissolving the parent-subsidiary listing altogether**
  - Option A: Aichi buying back and cancelling all the 54% shares that TICO holds
  - Option B: Inviting a capital partner to take Aichi private
  - Option C: TICO to acquire 100% of Aichi
- AVI's suggestion intends to unlock Aichi's intrinsic value; improving strategy, capital efficiency and governance. **Our suggestions consider Aichi's long-term future and all its stakeholders**

Suggestion

- **Acceleration of growth strategy**
  - Introduce portfolio management; improving margin domestically, and allocating cash to growing overseas business
  - Conduct comprehensive market research in APAC, and complete M&A and/or partnership within 24-36 months
  - Disclose exit strategy for China business with clear exit criteria and milestones
- **Disciplined capital policy**
  - Formulate a Capex and M&A plan to accelerate growth and return excess cash to shareholders. Make use of bank loans to reduce shareholder's equity
  - Sell all the cross-shareholding to enable growth investment
  - Disclose a rigorous and detailed capital policy based on forecasted cash flow and balance sheet
- **Improvements in IR communications**
  - Increase transparency of MTP and improve consistency in KPIs
  - Enhance segment disclosure, such as providing profit breakdown by geography
  - Improve overall IR communications, such as holding an investor day, increasing the frequency of earnings calls, more English disclosure, and proactively seeking the uptake of sell-side analyst coverage

Agenda

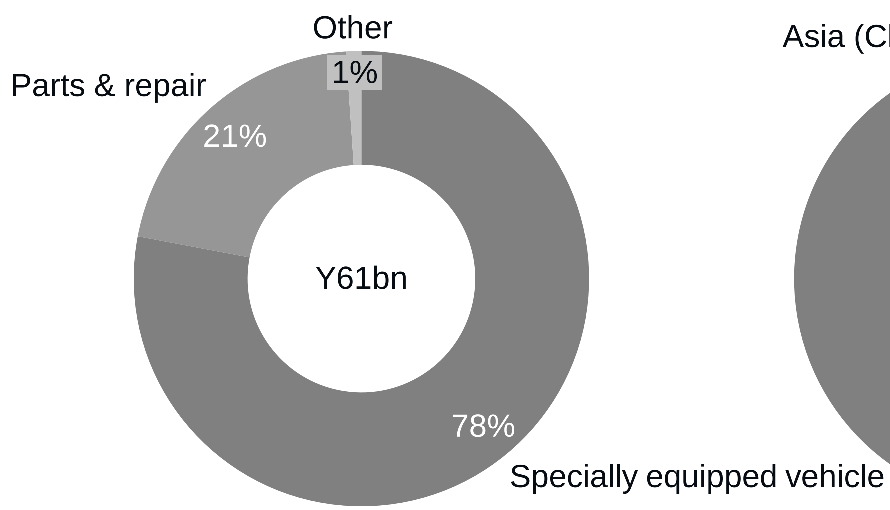
1. Issues and AVI's suggestion
2. Details of suggestion

Asset Value Investors

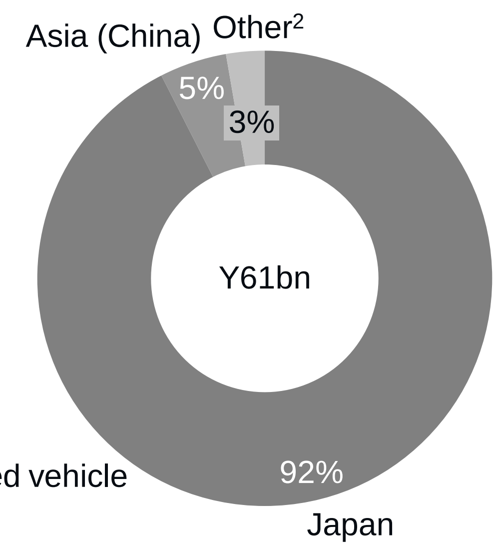
Company overview

- Founded in 1962 in Nagoya, moving HQ to Ageo, Saitama, in 2004
- Market cap is c.Y80bn[1]. Aichi manufacturers and sells specially equipped vehicles (mainly Aerial Work Platform or AWPs), offers after-service work
- Of Y61bn total sales, 80% are from the specially equipped vehicles segment, and 90%+ of sales come from Japan
- Aichi is a listed subsidiary of the TSE Prime market. Toyota Industries holds 54% of Aichi's shares outstanding

Sales by segment (FY22)



Sales by geography (FY22)



From product information page

Truck-mounted AWP

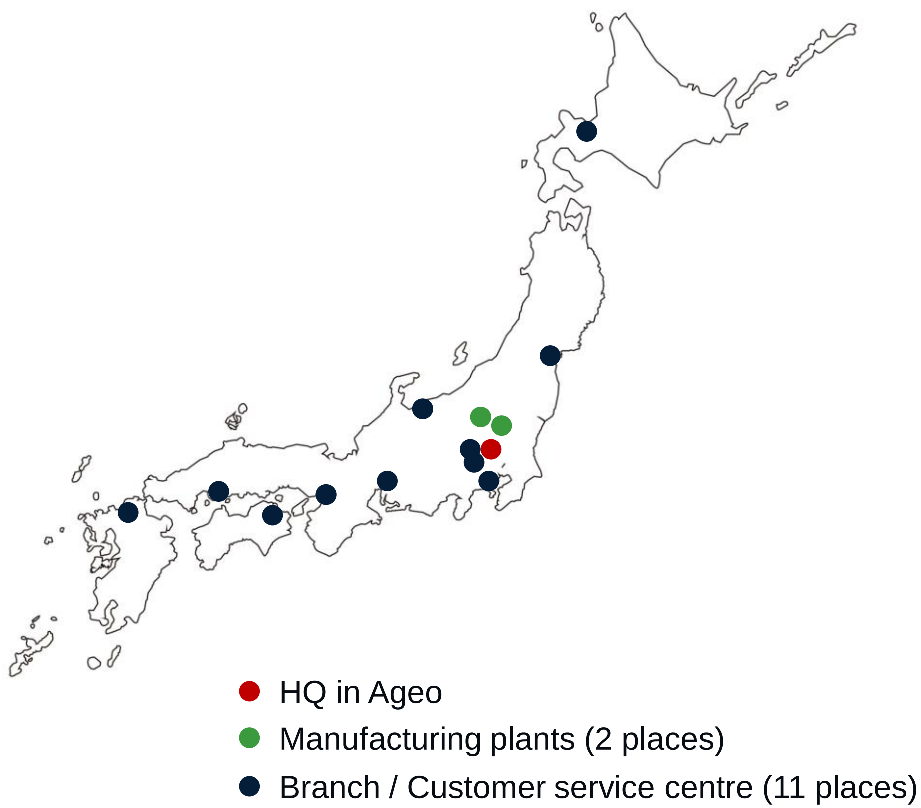
Self-propelled AWP

Note1: As of 31 March 2024. Note2: Other countries are mainly New Zealand and Australia
Source: Company disclosure, Capital IQ

Global footprint

- Headquartered in Ageo, Saitama, Aichi has 2 manufacturing plants in Gunma, and 11 branches / customer service centres in Japan
- 2 manufacturing plants / sales offices in China, and 1 sales office in New Zealand

Japan (>90% of company sales)



Overseas (<10% of company sales)

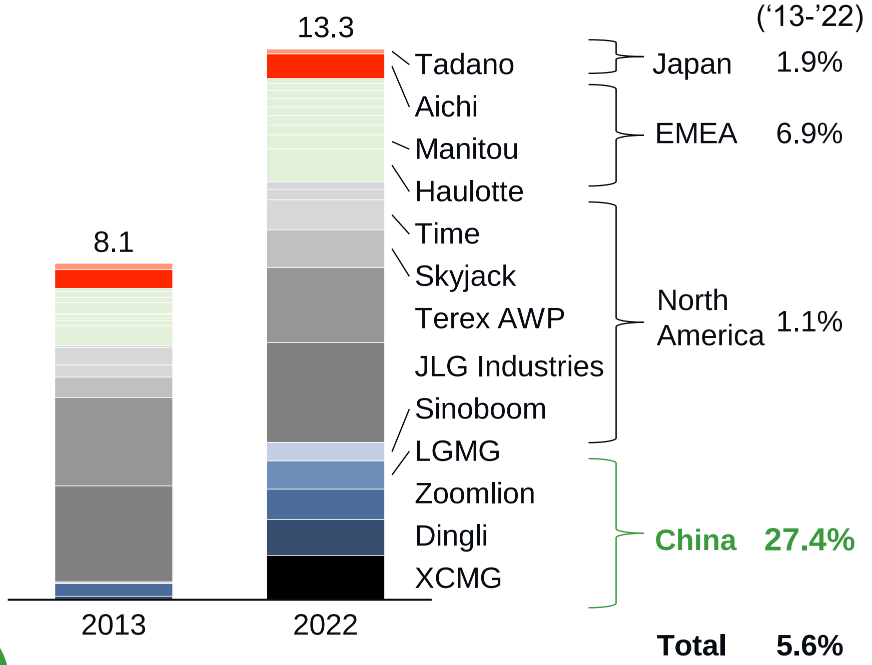
Source: Company disclosure

AWP global market

- Sales of top 20 AWP OEMs grew by more than 5% CAGR over the period of 2013-2022
- Most of this sales increase can be attributed to the China market with vigorous property and public investments. Indeed, Chinese OEMs demonstrated 25%+ CAGR in this period
- Going forward, expect to see growth in the Asia-Pacific region, such as India and Indonesia. Growth drivers include increased construction demand from economic development, shifting demand away from scaffolders / ladders with elevated safety awareness, and from used to new vehicles due to heightened regulation

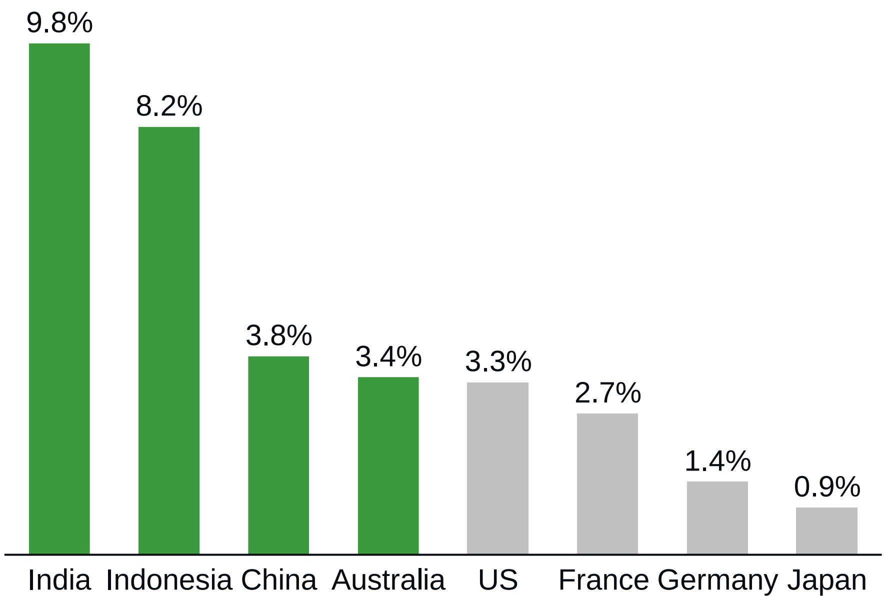
To date: China was the growth engine

Top 20 OEM sales (USDbn)



Going forward: Growth in Asia-Pacific

Forecasted construction demand (CAGR, 2020-2030)



Note: XCMG and LGMG in 2013 unknown
Source: Access International, Marsh McLennan

Attractive business model

- High barriers to entry in AWP industry thanks to the importance of customer relationships, track records, safety, localisation of products and services, and the difficulty of building a supply chain
- See minimal threat of emerging technology replacing AWP, while AWP is currently replacing scaffolders and ladders
- Compared to similar industries, such as construction machinery and vocational vehicles, the AWP industry enjoys higher profit margins, suggesting it offers an attractive business model

High barriers to entry, limited substitutes

Customer relationship

- Safety is paramount, as AWP handles humans, necessitating time to build trusting customer relationships
- Localisaion is important with specific, different geographic needs

Supply chain management

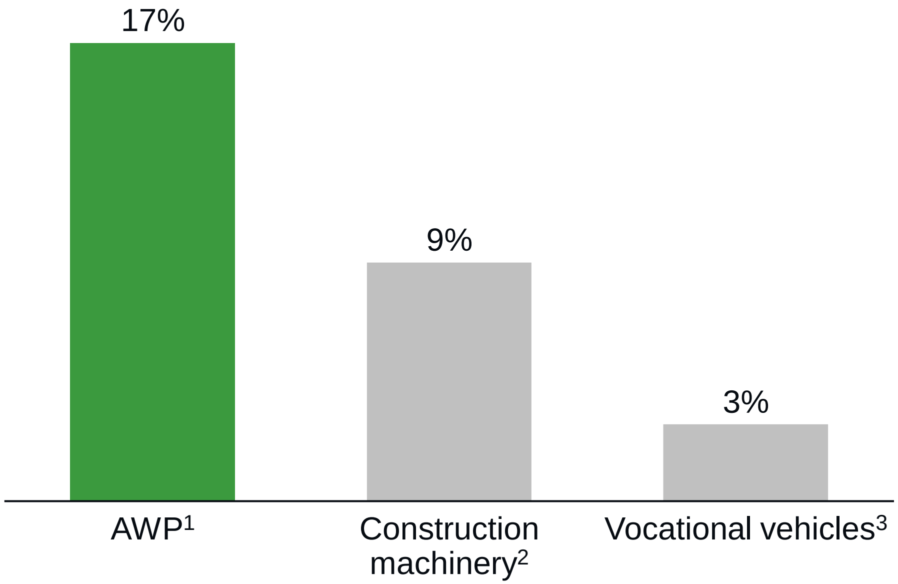
- Hydraulics, chassis, and electronics from different suppliers
- Not easy and requires time to build robust supply chain

Limited substitutes

- Emerged as substitutes to scaffolders and ladders
- No emerging technology to replace AWP

AWP industry enjoying higher margin

Average EBIT margin by industry (Japan, 2023)

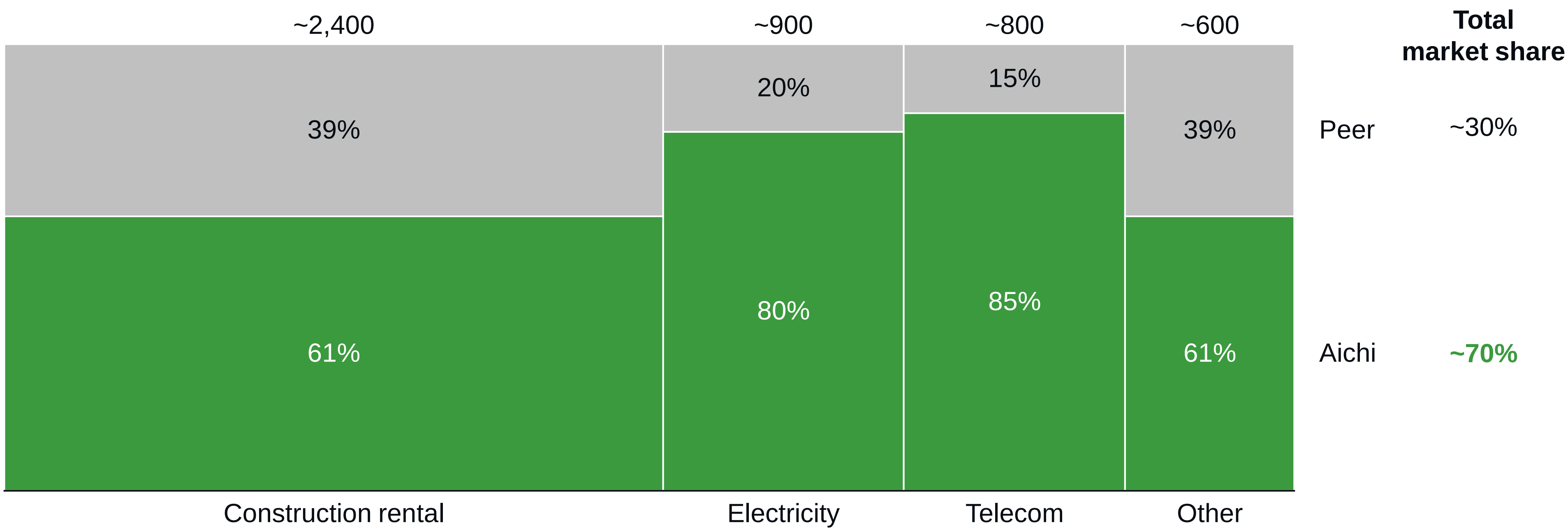


Note1: Average of Aichi's company EBIT margin and Tadano's Japan segment EBIT margin (adjusted for HQ cost). Note2: Average of Komatsu, Hitachi Construction, Kobelco and Sumitomo HI's construction machinery segment EBIT margin (adjusted for HQ cost). Note3: Average of Morita, ShinMaywa Industries and Kyokuto Kaihatsu Kogyo's vocational vehicle segment EBIT margin (adjusted for HQ cost). Source: Company disclosure, Expert interview, IR interview

Aichi's competitiveness: Domestic market share

- Aichi has been the leader since inception, pioneering the truck-mounted AWPs industry in Japan
- The company has 70% domestic market share, a positioning that no other peers can replicate
- It has a strong foothold in electricity and telecom sectors, with a market share over 80%. Directly facing final customers, Aichi offers customised products based on customer needs; hence higher margins

Market map of AWP in Japan (FY2022, truck-mounted AWP, based on units sold)

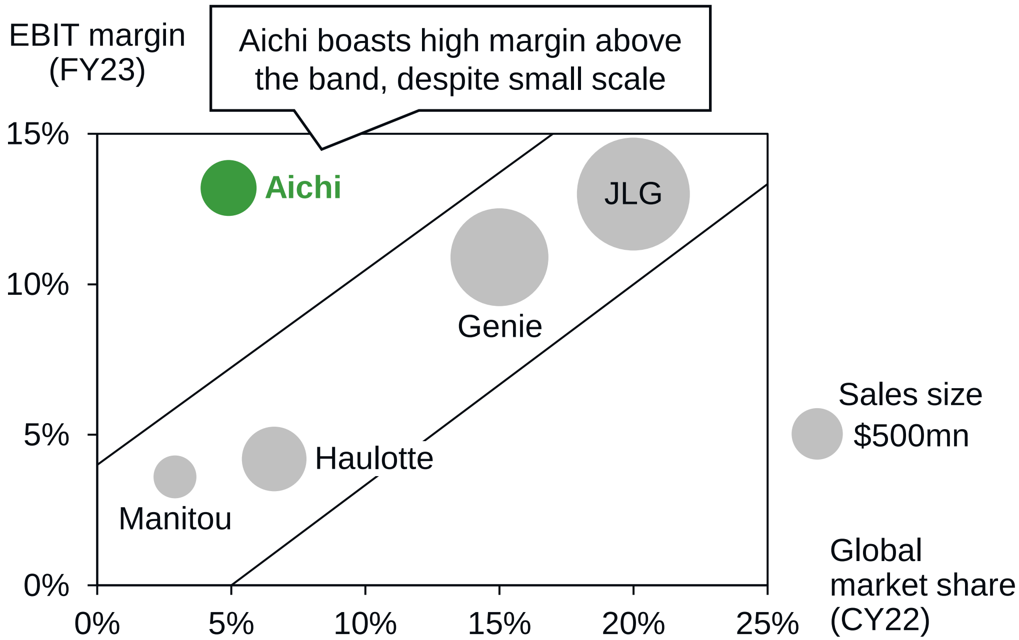


Note: Aichi's market share in electricity and telecom is based on FY22H1 actual. The market size of construction rental and other are prorated from the total market size minus electricity and telecom
Source: Company disclosure

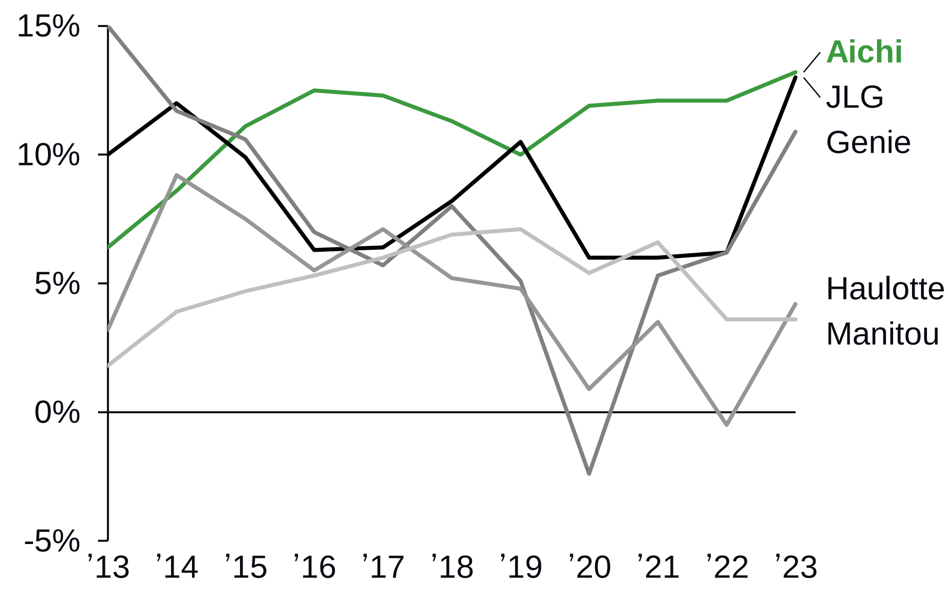
Aichi's competitiveness (cont'd): High quality margin

- Aichi maintains a high margin even when compared to global peers due to its dominant position in Japan
- While peers benefit from economies of scale, Aichi demonstrates an exceptionally high 10-15% EBIT margin despite its smaller scale (i.e. above the band)
- This has been true for a long time, with Aichi's historical margin consistently exceeding that of its global peers'

Global market share vs EBIT margin



Historical EBIT margin

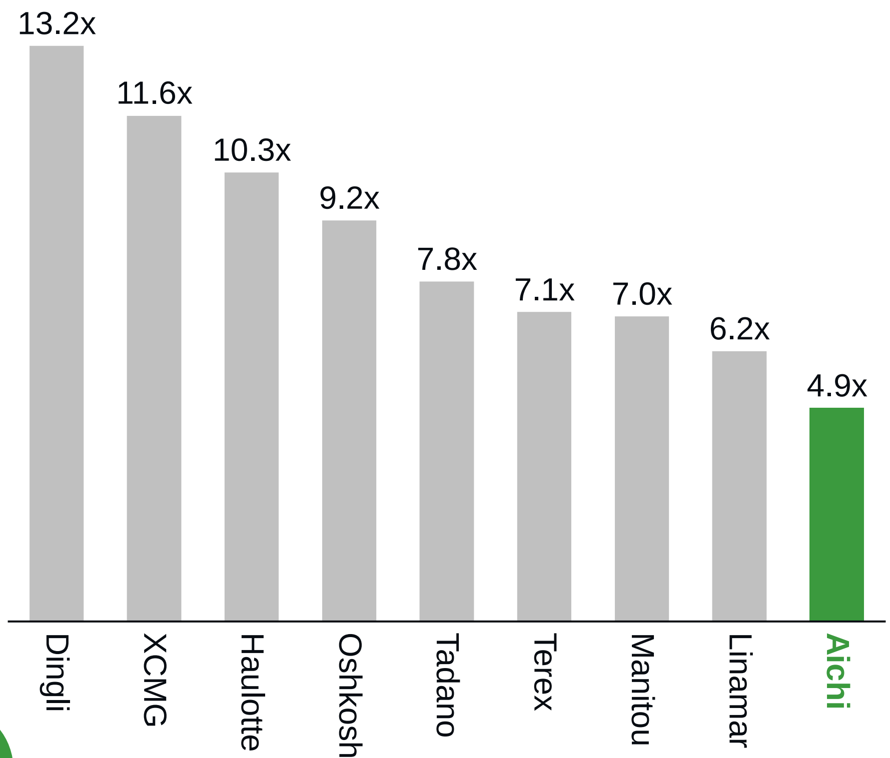


Note: Aichi, Haulotte and Manitou are corporate-wide, JLG is Access segment of Oshkosh, and Genie is AWP segment of Terex (both adjusted for HQ cost). Aichi's FY23 is Jan-Dec 2023
Source: Access International, Capital IQ, Company disclosure

Undervaluation

- However, in spite of its high margins and attractive business model, Aichi trades on valuation discount
- Aichi has consistently traded at a discount against peers over the past 5 years

Forward EV/EBIT multiple



Historical forward EV/EBIT multiple (Apr 2019 – Mar 2024)

Note: EBIT based on next twelve months, Capital IQ consensus
Source: Capital IQ (as of 31 March 2024)

Explaining Aichi's low valuation

- Three key issues explain Aichi's low valuation: (1) strategic issues that hinder future growth, (2) low capital efficiency that dampens shareholder returns, and (3) weak shareholder communications
- The root cause of Aichi's issues stem from weak corporate governance due to the parent-subsidiary listing

Strategy issues

- Core domestic business is reaching a growth ceiling and failed to leverage domestic competitiveness overseas.
- Lack of long-term vision and unambitious growth investment

Low capital efficiency

- Excessive equity due to under-investment in Capex/M&A. Lower ROE vs. peers
- An excess of cross-shareholdings
- Lack of detailed capital policy

Poor shareholder comms

- Vague mid-term plan lacking detail and substance
- Geographic segment disclosure not enough
- Infrequent earnings call
- Insufficient English disclosure

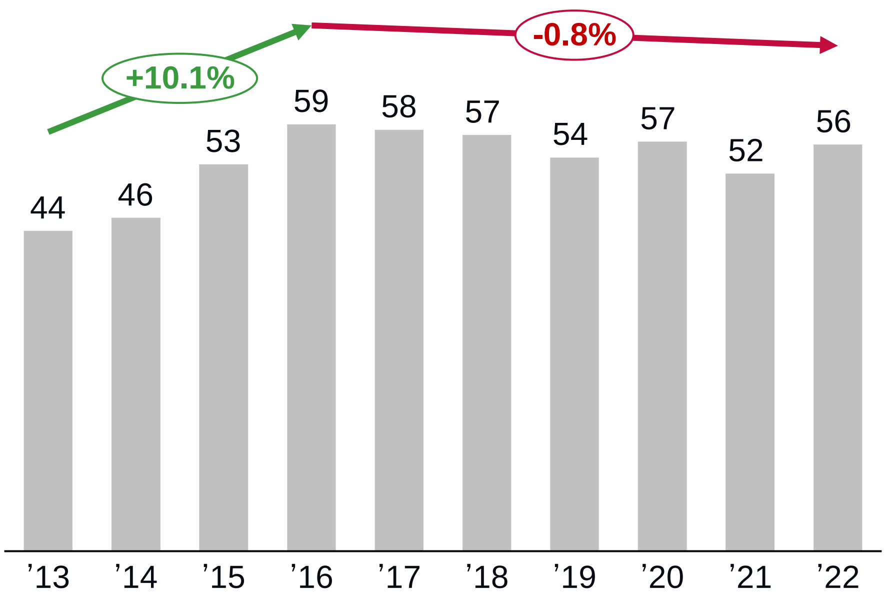
Weak corporate governance

- Structurally weak governance due to listed subsidiary structure with TICO. The board composed of ex-TICO/Toyota Motor employees raising questions about the quality of Aichi's governance and protection for minority shareholders
- The board lacks Independent outside directors, and diversity

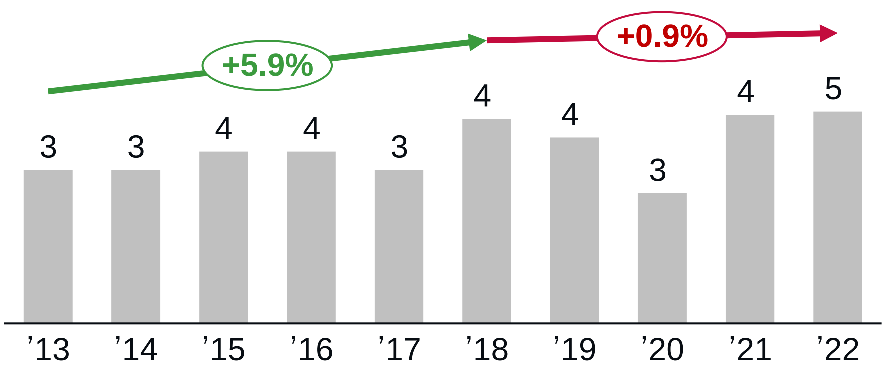
Strategy issues

- Aichi's core business is domestically focused, which is saturated and seeing low growth with Aichi's domestic sales falling since FY2016 ending March 2017
- The company has expanded into overseas, but its China business is stagnant. Sales growth has been flat since FY2018 ending March 2019 – the overseas growth engine idling
- Without long-term vision in growth strategy, too small Capex and M&A – unable to planting seeds that will grow

Aichi domestic sales (Ybn)



Aichi overseas sales (Ybn)

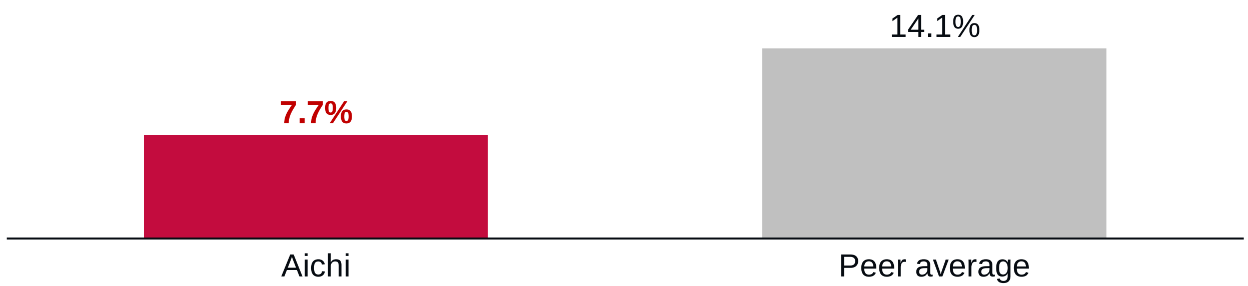


Source: Company disclosure

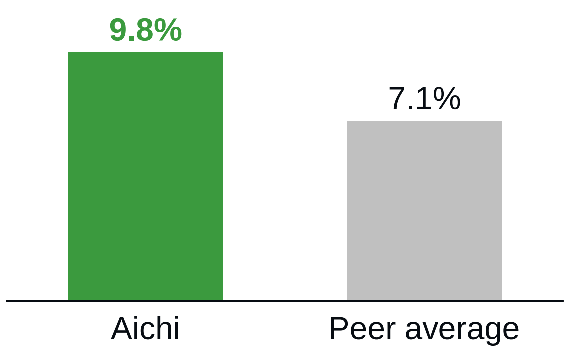
Low capital efficiency

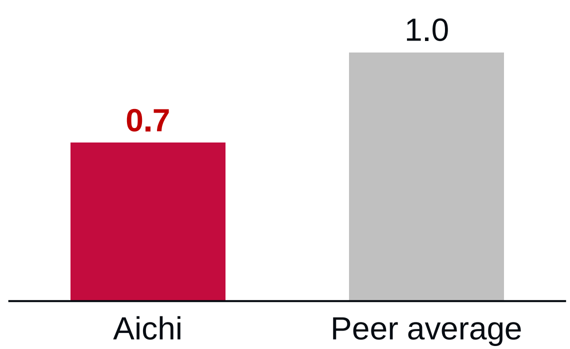
- ROE is an indicator of a company's profitability and its capital efficiency. Aichi's ROE is 7.7%, which is inferior to 14.1% of global peers
- ROE is composed of net profit margin, asset turnover ratio, and financial leverage. While Aichi's net profit margin is higher than industry peers, its asset turnover ratio and financial leverage are significantly lower
- Aichi suffers from poor capital efficiency, maintaining excessive equity without utilising debts

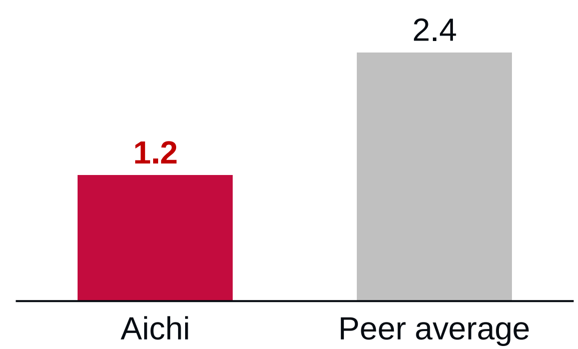
ROE
(Return on equity)



= **Net profit margin** × **Asset turnover ratio** × **Financial leverage**







Note: Aichi is FY2022 ending March 2023. Peer is FY2023 ending December, and the average of Tadano, Oshkosh, Terex, Linamar, Haulotte, Manitou, XCMG, Dingli
Source: Capital IQ

Poor shareholder communications

- Investors require high quality, detailed IR materials when making decisions
- Aichi's IR disclosure is poorer than peers. This is evident from the number of pages in the mid-term plan, lack of capital markets days, frequency of earnings call, number of sell-side analysts, disclosure of non-financial information, and IR disclosure in English
- The lack of information disclosure limits Aichi's investment appeal

	Capital markets day[1]/ Mid-term plan # of pages	# of Capital markets day[1] (2023)	Frequency of earnings call	# of sell-side analyst	Comprehensive non-financial information	IR presentation in English
Aichi	7 pages	0	2 per year	1	No	No
Tadano (JP)	29 pages	0	4 per year	6	Integrated report	Yes
Oshkosh (US)	31 pages	5	4 per year	14	ESG report	n.a[2]
Terex (US)	88 pages	9	4 per year	15	ESG report	n.a[2]
Linamar (CA)	76 pages	3	4 per year	5	ESG report	n.a[2]
Manitou (FR)	46 pages	1	3 per year	6	Annual report	Yes
Haulotte (FR)	4 pages	0	2 per year	6	Non-financial report	Yes

Note1: Excluding earnings call. Note2: Not applicable as the companies are from English-speaking countries
Source: Company disclosure, Capital IQ

Weak corporate governance

- Aichi is a listed subsidiary of Toyota Industries (TICO) which holds more than 50% of its shares. TICO is an affiliated company of Toyota Motors (Toyota) which holds 25% of TICO's stakes
- TICO is able to control Aichi as if it was a wholly owned company without owning 100% of the shares. This is the reason why conflicts of interest between majority and minority shareholders can take place
- TSE and METI have repeatedly pointed out the issues that might arise from conflicts of interest, especially where there are transactions between parent and subsidiary, like deposits or appointing of staff from the parent company

Equity relationship

Toyota Motor

↓ Affiliated company (ownership: 25%)

Toyota Industries

↓ Consolidated subsidiary (ownership: 54%)

Aichi

Conflicts of interest, as pointed out by TSE and METI

"There is a risk of conflicts of interest between parent and listed company/minority shareholders in case of transaction with parent or adjustment/allocation of business opportunity by parent"

TSE, Disclosure Improvement in light of Protection of Minority Shareholders and Group Management

Direct transaction	*"Parent company wants to utilize subsidiary's cash at the lowest possible interest rate, while subsidiary wants to use the cash for its own investment unless interest rate meeting cost of capital"*
Managerial orders	*"When people transfer occurs between controlling shareholder and subsidiary, there is a potential conflict of interest in the form of people transfer prioritising controlling shareholder's intention"*

Source: Company disclosure, Tokyo Stock Exchange, Ministry of Economy, Technology, and Industry

Toyota group unwinding cross-shareholdings

- Toyota Motor and its affiliated companies have started to unwind cross-shareholdings
- Toyota Motor announced that it would reduce group holdings to 20%, while Denso and Aisin announced that it will sell most of their cross-shareholdings to zero
- On the contrary, TICO's intention to sell cross-shareholdings has been rather subdued

Announced policies in unwinding cross-shareholdings (% of holding, as of end March 2024)

Green is the one with reduction progress

Toyota Motor

- **Denso:** 24%→20% (Done)
- **Aisin:** 27%→20% (Planned[1])
- **TICO:** 25%→20% (Planned[1])

Denso

- **Toyota Motor:** 3%
- **Aisin:** 3%→0% (Planned[2])
- **TICO:** 9%→0% (Planned[2])

Aisin

- **Toyota Motor:** 0%
- **Denso:** 2%→0% (Done)
- **TICO:** 2%→0% (Planned)

TICO

- **Toyota Motor:** 9%
- **Denso:** 9%→5% (Done)
- **Aisin:** 8%

Note1: Holding % after reduction is allegedly "rough indication" in news reports, but shown as "planned" for convenience. Note2: Assuming selling all the stakes based on the wording of disclosure
Source: Company disclosure, News reports

But Aichi and TICO making lucklustre progress

- TICO's lethargic stance on cross-shareholding is one sign of deeper governance problems of parent-sub listings
- For example, until March 2024, Aichi held deposit (CMS[1]) with TICO. It took more than 20 years just to discontinue the archaic deposit practice after Aichi became a consolidated subsidiary of TICO in May 2003
- 50% of Aichi's Board have backgrounds related to either TICO or Toyota. Naturally, this raises questions whether Aichi's Board is acting for Aichi shareholders or the wider Toyota group

Deposit to TICO finally discontinued

May 2003 — TICO making Aichi consolidated subsidiary

Mar 2024 — Discontinued deposit

It took **20+ years** to discontinue deposit

Background of Aichi Board

	Aichi	TICO, Toyota	Other
Toshiya Yamagishi		Y (TICO)	
Hideo Yamamoto	Y		
Koichi Anzai	Y		
Takuo Sasaki		Y (TICO, Toyota)	
Shigehiro Takatsuki			Y
Kiyoshi Tojo		Y (Toyota[2])	
Takuto Kawanishi			Y
Kenji Aonuma		Y (TICO)	
Total	**2**	**4**	**2**

From TICO or Toyota: 50%

Note1: Cash Management System, with which TSE and METI raised concerns as the system easily allows for conflicts of interest between parents and subsidiaries.
Note2: Mr Tojo had belonged to Toyota for over 30 years. His previous company (Aioi Nissay Dowa Insurance) has strong historical relationship with Toyota
Source: Company disclosure

Certification misconduct and governance issue

- TICO announced engine certification misconduct in Jan 2024, following a forklift certification misconduct in 2023. Concurrently, Hino Motors and Daihatsu Motor have been found to have committed certification misconducts
- As a result, Aichi's production and operation have been hit negatively since 2022
- This all leads to questions as to the adequacy of Aichi's Board, especially given how many directors are from companies with compliance and governance problems

Certification misconduct (by company announcement)

March 2022
Hino Motors
Engine certification misconduct

March 2023
TICO
Forklift engine certification misconduct

April 2023
Daihatsu Motor
Safety certification misconduct

January 2024
TICO
Diesel engine certification misconduct

Impact on Aichi

- 2022: Aichi production delayed due to Hino's certification misconduct
- 2024: MLIT certification lengthened due to TICO's misconduct, followed by Aichi's downward revision in FY23 earnings

Source: Company disclosure, News reports, IR interview

AVI's suggestions

- AVI recommends the following to unlock Aichi's full potential

Strategy issues

- Improve domestic margin, allocate cash to overseas business
- Market research in Asia-Pacific for M&A and partnership
- Clear criteria and milestones for potential exit in China

Low capital efficiency

- Undertake targeted Capex and M&A, returning residual cash to shareholders
- Utilise debt while reducing shareholder's equity
- Sell all the cross-shareholding
- Disclose a rigorous and detailed capital policy

Poor shareholder comms

- Increase transparency of MTP and have more consistent KPIs
- Enhance segment disclosure
- Improve overall IR communications, like holding an investor day and increasing frequency of earnings call

Weak corporate governance

- Approach TICO to dissolve parent-subsidiary structure, such as Aichi buying back all the shares TICO, to abolish conflicts of interest risk
- Increase independence and diversity of the Board

AVI’s request

- We attribute the root cause of Aichi’s underperformance to its listed subsidiary structure with TICO
- Being under TICO’s control, despite TICO not owning 100%, we think it unlikely our suggestions will be implemented quickly
- AVI therefore strongly requests Aichi’s Board to consider the following options

- **Dissolve parent-subsidiary listing**
  - **Option A: Aichi buying back and cancelling all the 54% shares held by TICO**
  - **Option B: Inviting a capital partner to take Aichi private**
  - **Option C: TICO to acquire 100% of Aichi**

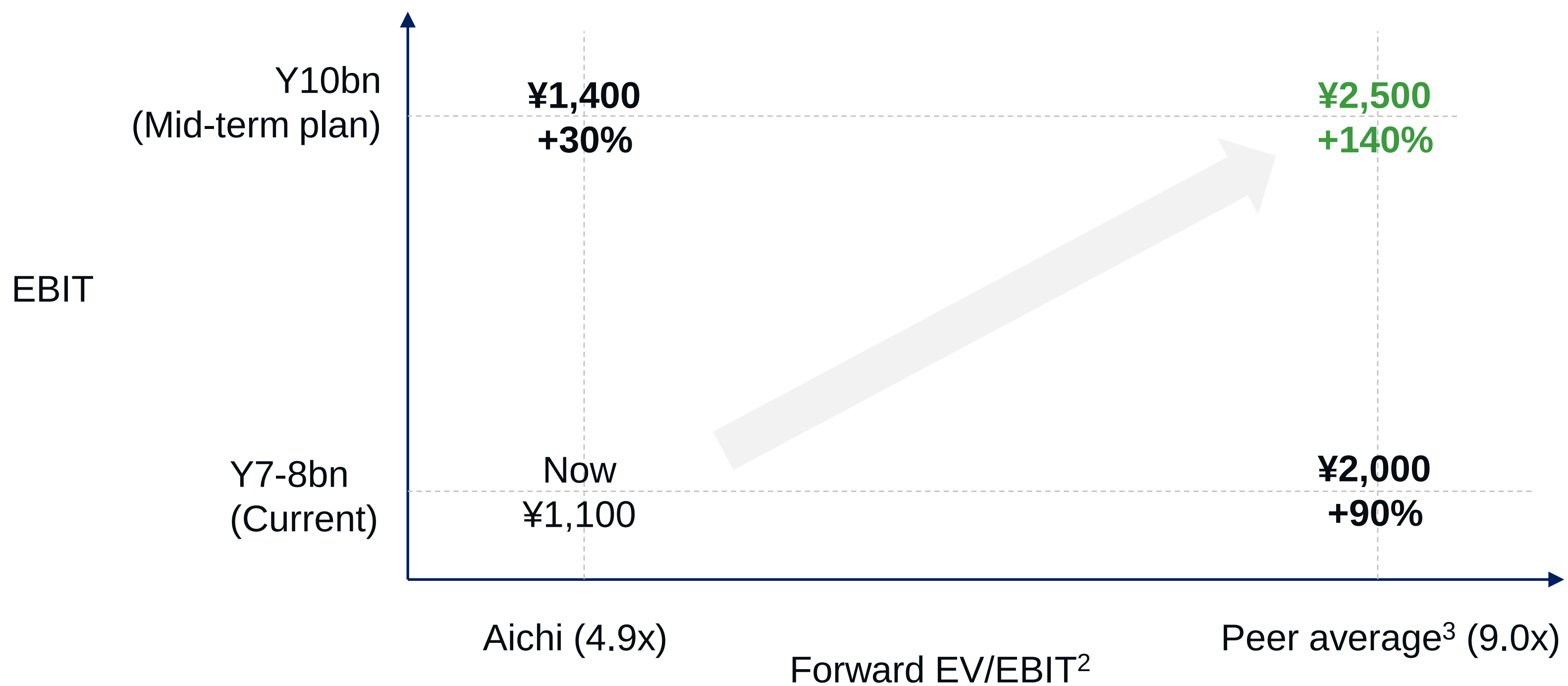
Benefits for Aichi stakeholders		Benefits for TICO stakeholders	
Mgmt. / Employee	**(Minority) shareholder**	**Mgmt. / Employee**	**Shareholders**
• (A-B) Can take appropriate risk and grow business independently • (C) More active involvement and cross collaboration with TICO	• (A-C) Elimination of conflicts of interest between Aichi and TICO	• (A-B) Can use proceeds from sale of Aichi shares as a source for TICO’s own growth • (C) Optimise management resources	• (A-B) Higher capital efficiency, and improvement in ROE • (C) Stop profits leaking to Aichi’s minority shareholders

AVI’s suggestions contribute to the benefits of all the associated shareholders

Share buyback case study: Aichi's intrinsic value

- We see significant upside in Aichi's share price. If Aichi were to acquire all of TICO's holding as a buyback we estimate that Aichi's share price could trade +140% higher

Share price potential for Aichi (after share buybacks[1])

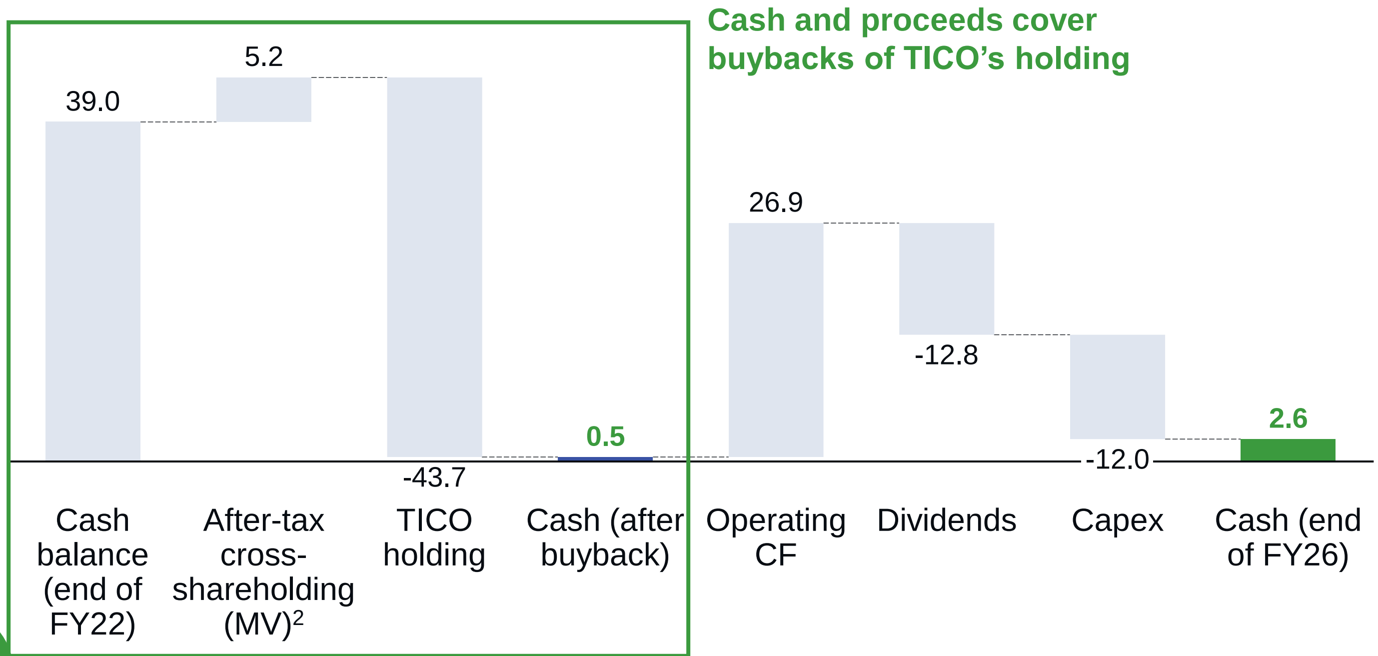


Note1: After share buyback of TICO holdings of 54% - i.e. EBIT per share (after TICO's holding bought back and cancelled) multiplied by forward EV/EBIT, then subtract TICO's holding (market value), net debt, and minority interests. Assume 0% tender offer premium at share buyback.
Note2: Forward EV/EBIT is based on next twelve months, Capital IQ consensus. Note3: Tadano, Oshkosh, Terex, Linamar, Haulotte, Manitou, XCMG, Dingli
Source: Company disclosure, Capital IQ (31 March 2024)

Share buyback case study: Funding feasibility

- Aichi's cash at hand and proceeds of cross-shareholdings are more than the value of TICO's holding in Aichi
- After share buybacks, even if Aichi continues the high level of FY23 guidance Capex for three years, Aichi still has enough cash to fund dividends and growth investments
- In reality, the company can use bank loans (currently zero) to address working capital needs

Cash forecast (Ybn, FY2023-26[1])



Key assumptions

- Sales: FY23 company guidance, FY24-26 CAGR growth 3%
- EBIT/Net income: FY23 company guidance, FY24-26 same margin as FY22 (12.1%, 9.8% respectively)
- D&A: FY23 guidance Capex/Sales ratio kept over FY24-26
- Tax rate: 30.8%
- Dividends: Bigger of FY23 guidance (total Y3bn) or 50% payout
- Capex: FY23 guidance (Y3bn) kept over FY24-26

Note1: FY2023 = Financial year 2023 ending March 2024. Note2: Cross-shareholding is current share price multiplied by holdings as of 31 March 2023
Source: Company disclosure, SPEEDA, Capital IQ (31 March 2024)

Agenda

1 Issues and AVI's suggestion

2 Details of suggestion

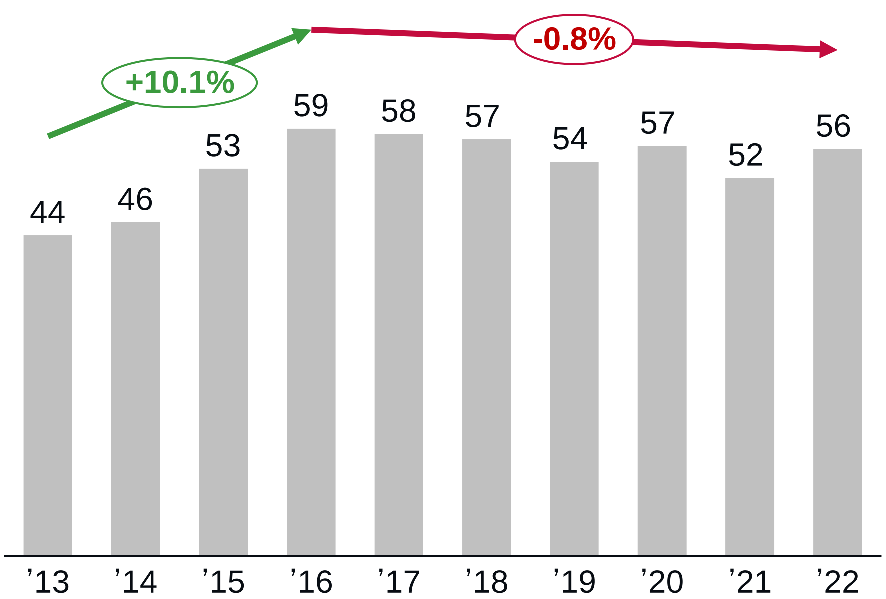
Asset Value Investors

Strategy issues

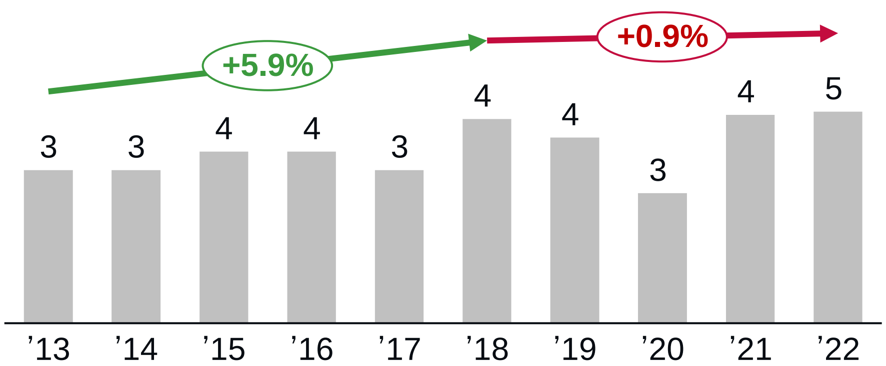
Strategy issues

- Aichi's core business is domestically focused, which is saturated and seeing low growth with Aichi's domestic sales falling since FY2016 ending March 2017
- The company has expanded into overseas, but its China business is stagnant. Sales growth has been flat since FY2018 ending March 2019 – the overseas growth engine idling
- Without long-term vision in growth strategy, too small Capex and M&A – unable to planting seeds that will grow

Aichi domestic sales (Ybn)



Aichi overseas sales (Ybn)



Source: Company disclosure

Strategy issues (Cont'd)

- Based on our research and discussions with management, customers, suppliers, distributors, competitors, and industry experts, Aichi's strategy issues stem from the following factors:

① Lack of long-term vision

② Poor overseas go-to-market strategy

③ Stagnant China business

① Lack of long-term vision: MTP lacking growth story

- Aichi has outlined 5 initiatives in its mid-term plan (MTP) to increase growth
- Typically, the first initiatives in a MTP are the featured points that a company aims to highlight. However, Aichi's first 2 initiatives disappoint readers as they monotonously introduce new products with minimal variation
- Additionally, Aichi discusses an increase in domestic production capacity (Initiative 5) without presenting a clear long-term growth story, which leaves investors unable to assess the rationale behind Capex investments

From Aichi's MTP (November 2023)

Monotonously introducing new products, failing to introduce a standout strategy

No concrete business ideas

Investors left puzzled by the Capex in domestic production in the absence of a long-term growth story

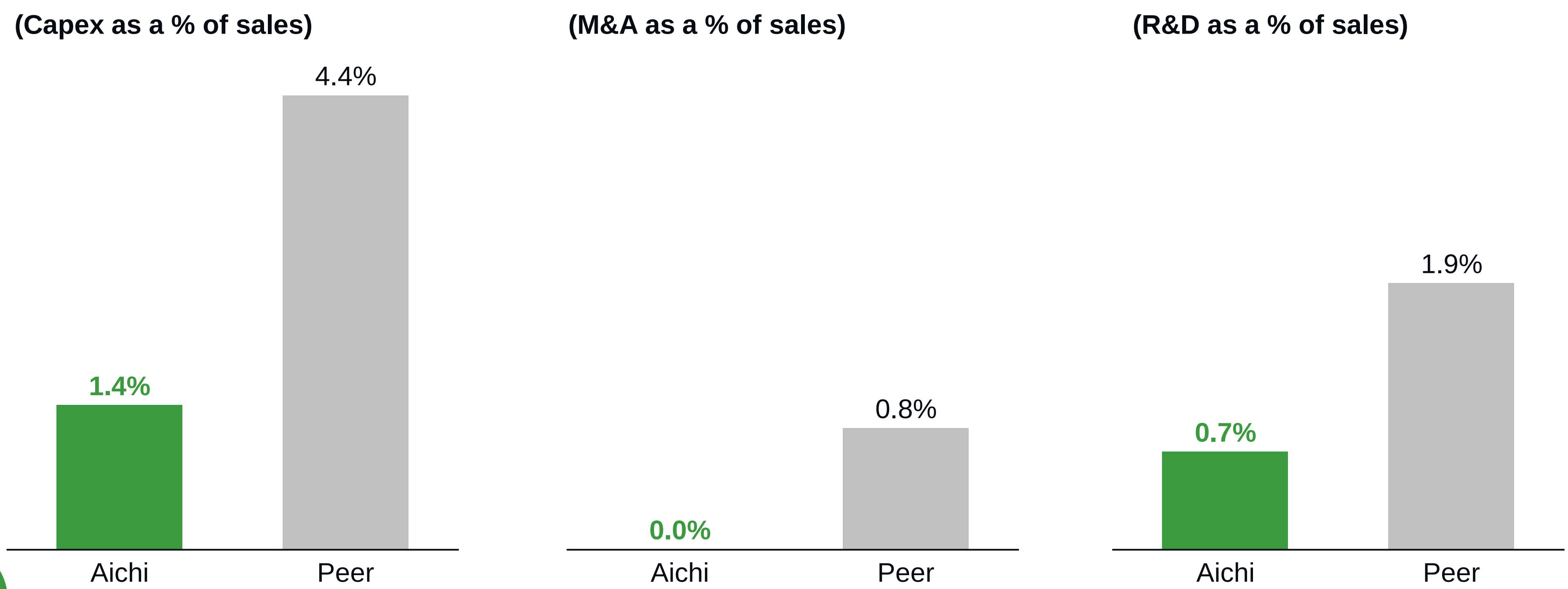
Unclear how Aichi intends to sustain long-term growth

Source: Company disclosure

① Lack of long-term vision: Minimal growth investment

- Investors' concerns about Aichi lack of a growth story are supported by Aichi's history of subdued investment in growth initiatives
- Aichi's Capex as a % of sales is 1.4%, significantly lower than the 4.4% average of its global peers
- M&A as a % of sales has been zero over the past five years
- The same argument holds true for R&D, with Aichi's spending being around 1/3 of global peers'

Growth investment (past five financial years)

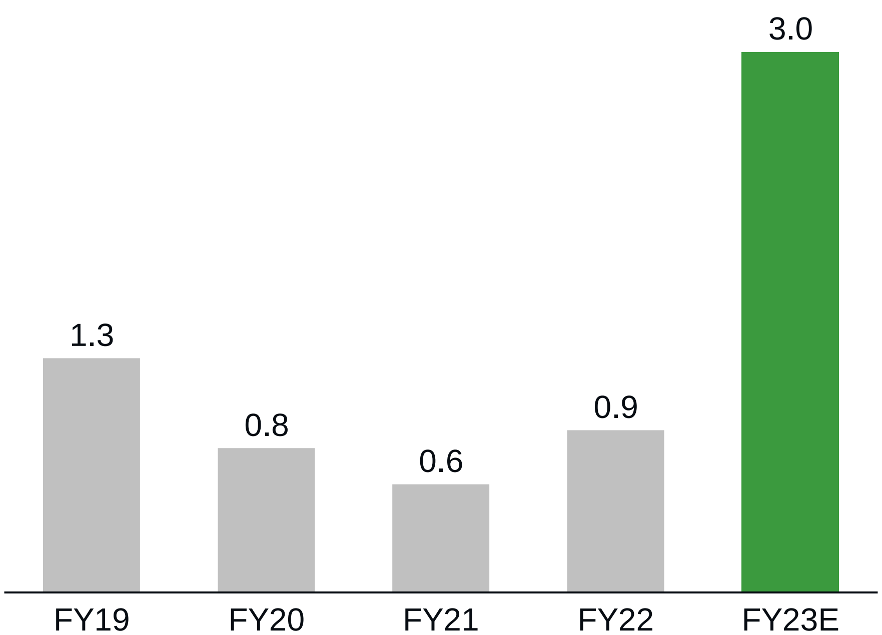


Note: Aichi year end 31 March. Peer year end 31 December, average of Tadano, Oshkosh, Terex, Linamar, Haulotte, Manitou, XCMG, Dingli
Source: Capital IQ

① Lack of long-term vision: Need reconsideration on the latest Capex

- In FY23 ending March 2024, Aichi expects Capex of Y3bn, more than triple the amount from the previous year
- Most of Capex will be allocated to the domestic business, including a new factory in Takasaki, Gunma
- However, it seems Aichi has overlooked the principle that companies should only capitalise for long-term growth
- It appears that Aichi is veering away from its fundamental growth story, opting instead for sporadic Capex

Aichi Capex (Ybn)



From Aichi MTP (November 2023)

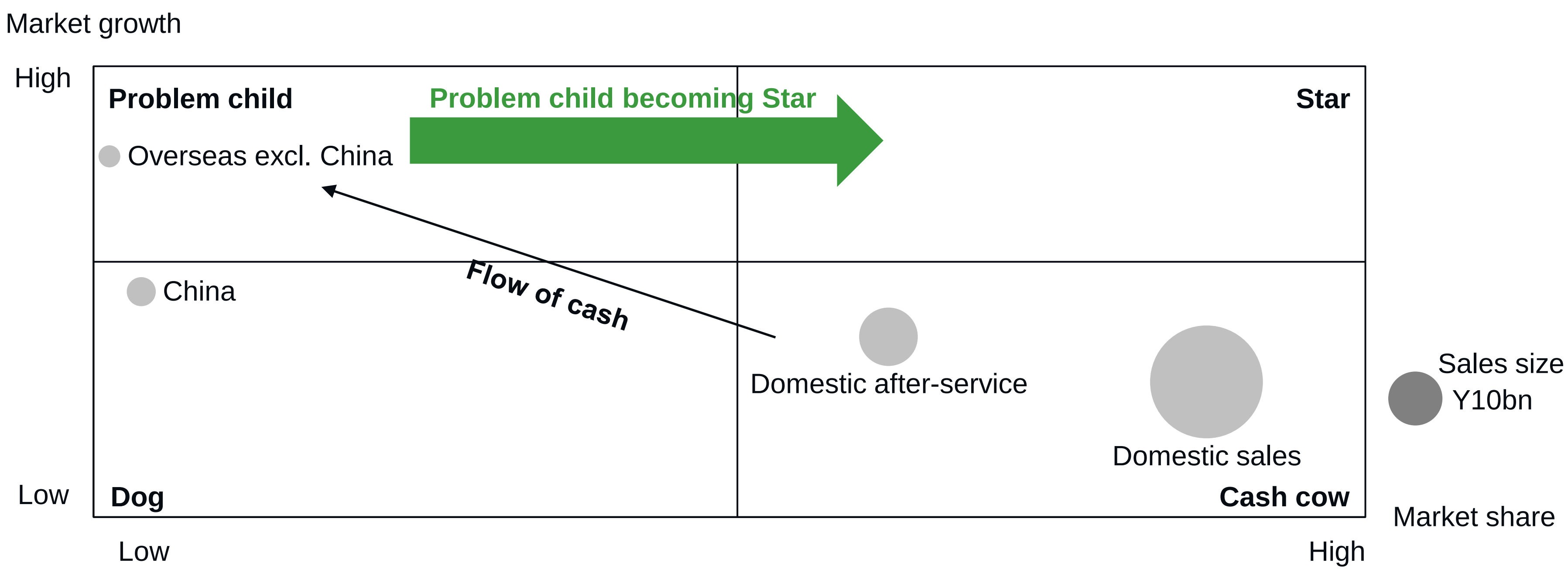
Can Aichi really expect significant growth from this investment? Shouldn't Aichi first develop a growth story before proceeding with Capex?

Note: Capex based on Aichi's disclosed figures in its earnings call presentations
Source: Company disclosure

① Lack of long-term vision: AVI suggestion (Introduction of portfolio strategy)

- Using a portfolio matrix based on market share and growth is an effective method for allocating mgmt. resources
- A company should earn cash in “Cash cow” businesses, which are high share but low growth segments, and, to accelerate growth, reinvest this cash to “Problem child” businesses, which are low share but high growth segments
- AVI recommends the following portfolio strategy for Aichi: **acknowledge the lack of sales growth in the domestic market, focus on selective, high-margin projects, and invest heavily in overseas expansion**

Portfolio matrix (illustrative)

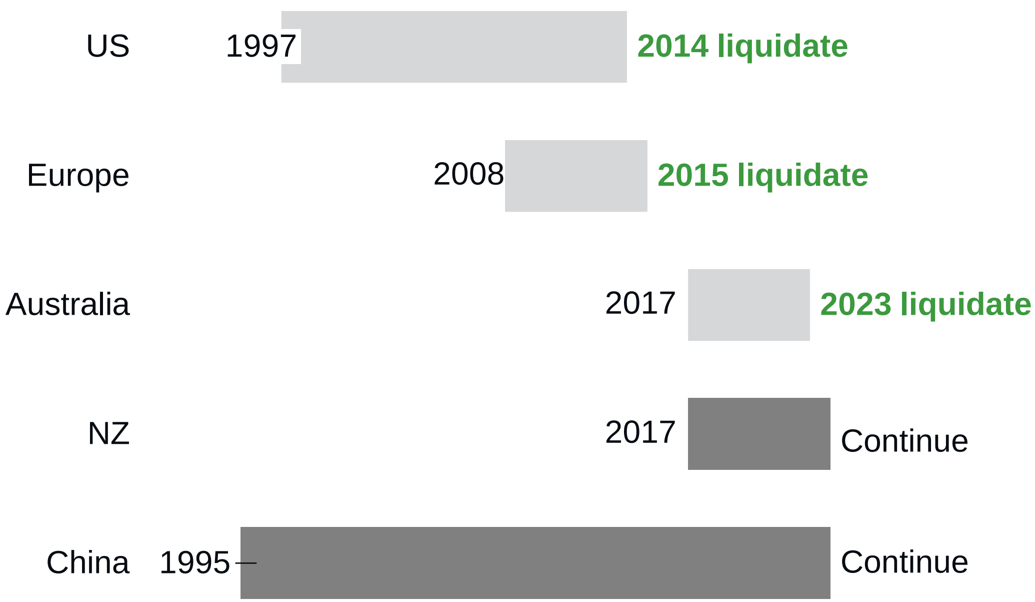


Source: Company disclosure, Marsh McLennan

② Poor overseas go-to-market strategy: Repeated entry and withdrawal from overseas

- Aichi's previous attempts to enter overseas markets have unfortunately ended in failure
- Aichi established local subsidiaries in the US, Europe, and Australia, only to liquidate them in 2014, 2015, and 2023, respectively. The AUS one was especially short-lived as failed to apply lessons learned from the US and EU
- Overseas business's inability to take off primarily stems from product development and distribution/service issues

Aichi overseas subsidiaries



Reasons for failure

Product development

- Self-propelled is the main product sold globally, different from domestic with truck-mount
- Lacking product development capability required for new markets

Distribution/ Services

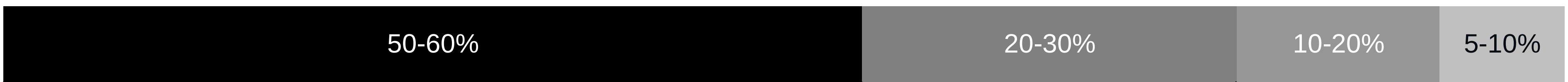
- No local sales staffs who open doors, unable to connect and partner with local agents
- Local subsidiary without after-service capacity unable to keep customers

Source: Company disclosure, IR interview

② Poor overseas go-to-market strategy: Attractive APAC market

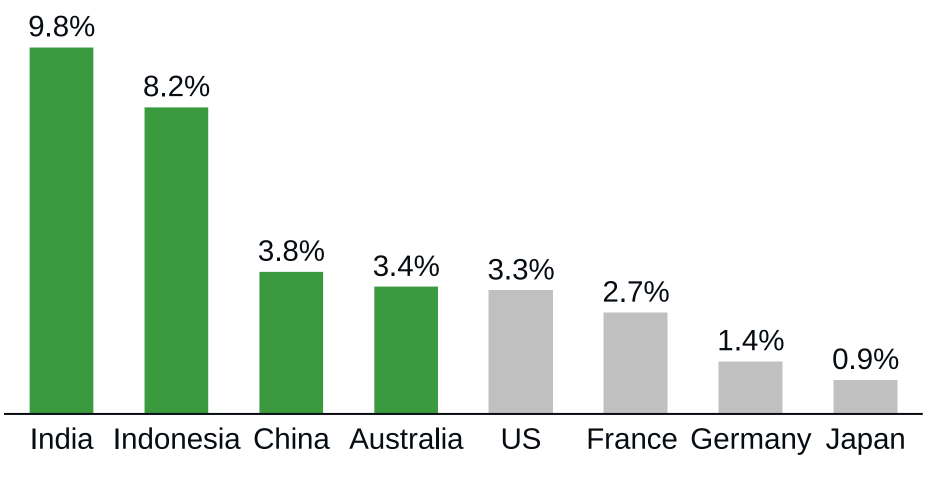
- Nevertheless, the overseas market remains attractive as sustainable growth is anticipated
- Over 50% of the global AWP market is composed of the construction sector. The construction sector in the APAC region, including India and Indonesia, anticipates high growth driven by rising construction demand
- The electoral and telecom sectors are also promising, as more utility poles lead to more work using AWPs. Cities with high pole penetration include Ho Chi Minh, Perth, and Jakarta, indicating high concentration in the APAC

AWP global market by usage (2021)

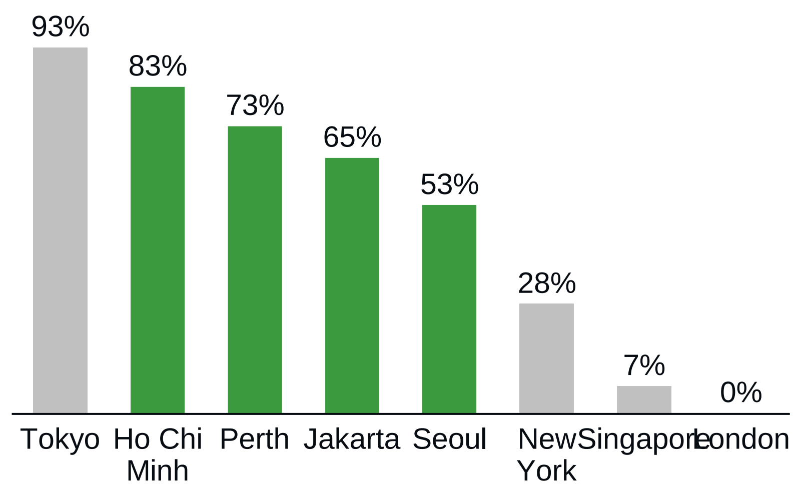


Construction | **Electoral, telecom** | Transportation | Others

Forecasted construction demand (CAGR 2020-2030)



Utility pole penetration by major city

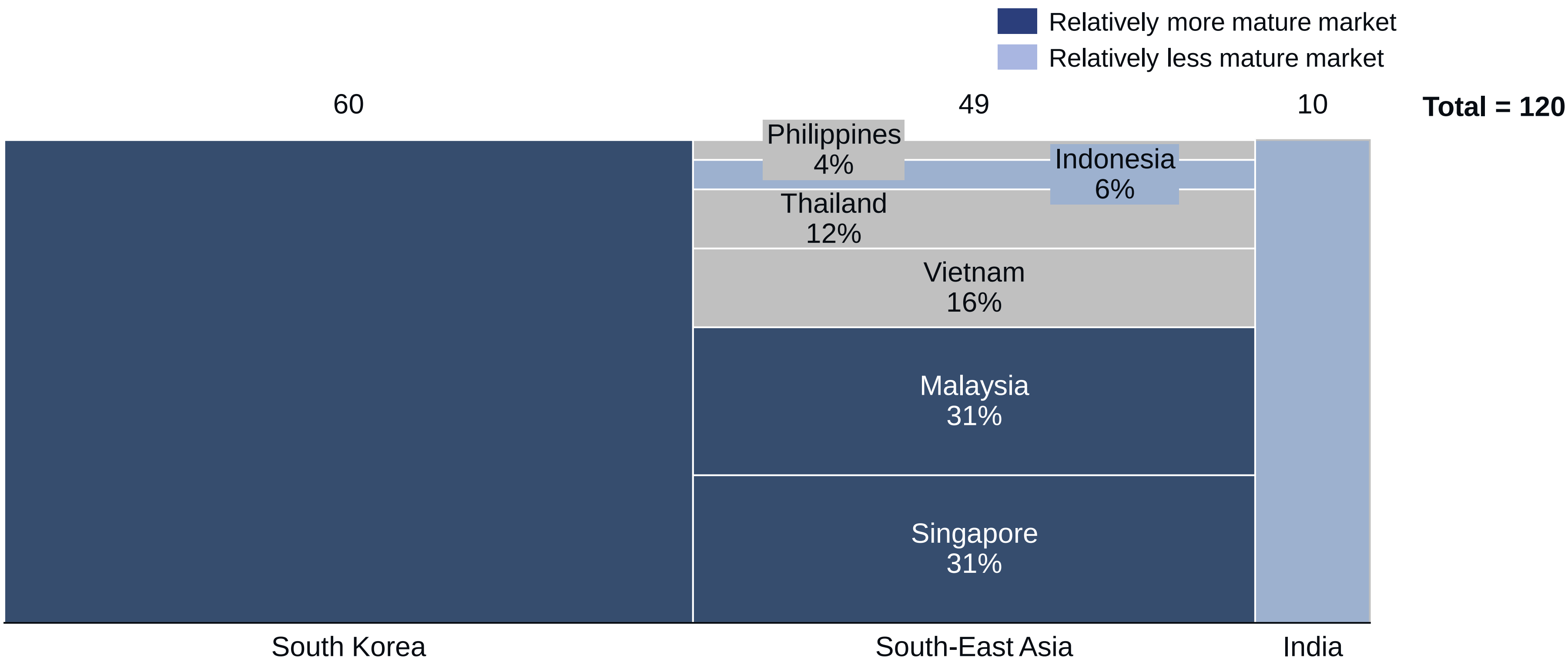


Source: Fortune Business Insights, Marsh McLennan, Ministry of Land, Infrastructure, and Transportation

② Poor overseas go-to-market strategy: Market maturity of APAC

- The estimated size of the Asian AWP market was around 120,000 units in 2019
- Korean market is the most mature and by far the largest, with 60,000 units, followed by Singapore and Malaysia
- In contrast, Indonesia and India have smaller markets despite their large populations and GDP sizes, indicating that they are still in the early stages of maturity

Asian AWP market (2019, thousand units)

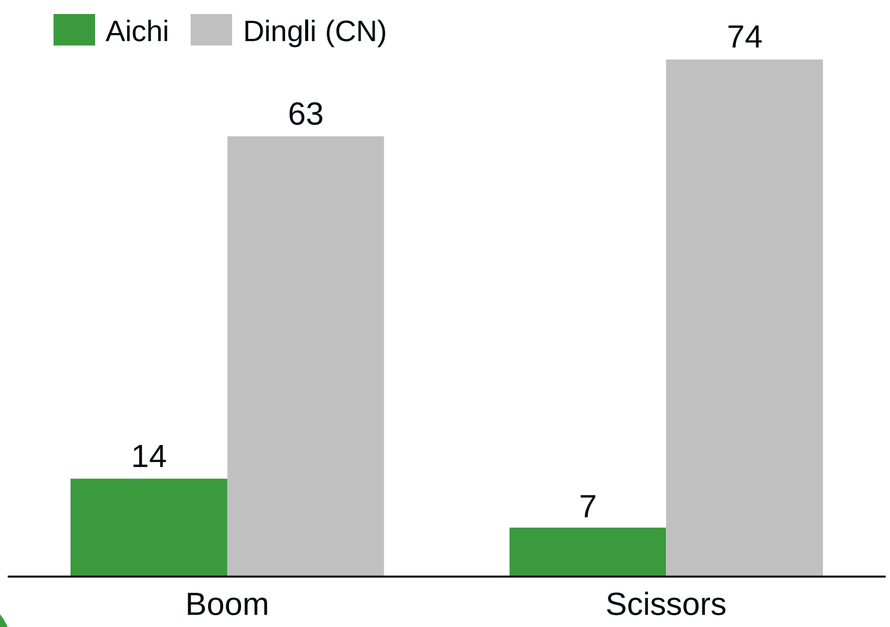


Source: Access International

② Poor overseas go-to-market strategy: Product development and M&A

- There are two main product types in AWPs: truck-mounted and self-propelled
- Aichi's strength lies in truck-mounted AWPs, while self-propelled AWPs benefit from global sales. However, Aichi's lineup of self-propelled AWPs is significantly smaller compared to that of global peers
- Dingli of China has been actively pursuing acquisitions to augment its product development and R&D capabilities
- Aichi should consider acquiring global competitors to promptly obtain product development capabilities

Self-propelled AWP lineup



Dingli's product development strategy

Product development capability through M&A

- Acquired product development capability including R&D through holding equity stakes in Western competitors
- Production is mainly in China

History of acquisition

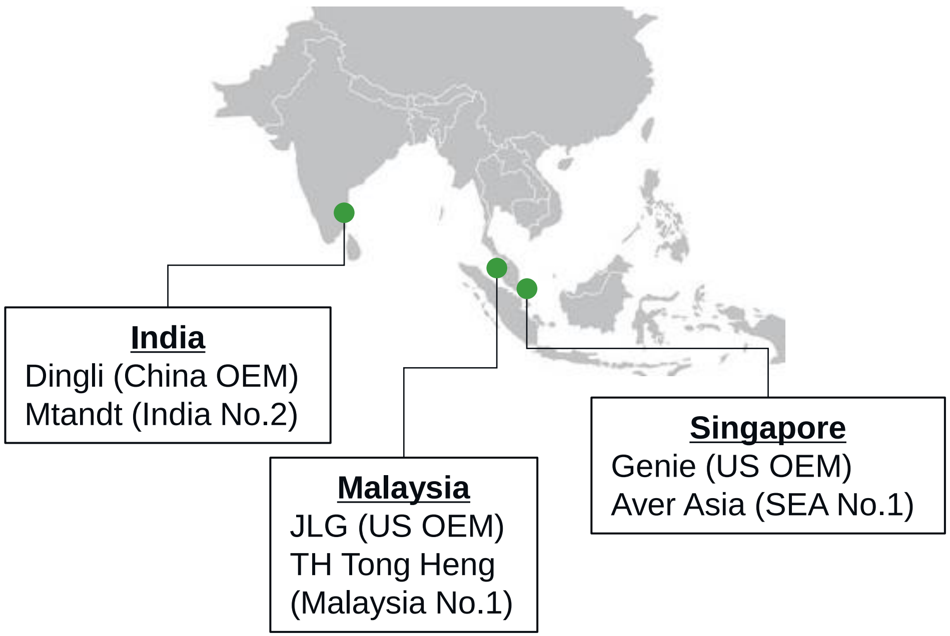
- February 2016: Acquired 20% of Magni (Italy)
- May 2018: Acquired 25% of MEC (US)
- April 2020: Acquired 24% of Teupen (Germany)
- October 2023: Increased stakes of MEC to 49.8%

Source: Company disclosure, Access International, Literature search

② Poor overseas go-to-market strategy: Distribution / Services and partnership strategy

- Construction rental companies are an important sales channel in SEA and India, often serving as sales distributors
- Leading OEMs such as JLG and Genie are now accelerating their partnerships with reputable local distributors
- This type of partnership necessitates a carefully crafted distribution strategy that emphasises localised expertise, robust after-sales support, and effective channel incentive management

Major OEMs accelerating partnerships with local distributors



Winning strategy in distribution

Localised expertise:

- Local staff serve as "faces" of the company, connecting with distributors
- Sales strategy flexible to local customs
  - E.g. In India, construction companies rent not only AWP but also operators. Therefore, it is important for OEMs to offer operator training programs

Strong after-sales support:

- Ensure an efficient supply chain and strategic inventory placement to minimise downtime
- Invest in technicians and operators of distributors

Channel incentives and management:

- Set targets and monitor performance of both direct sales teams and channel partners
- Structure fair commissions and bonus packages

Source: Access International, Expert interview, Literature search

② Poor overseas go-to-market strategy: AVI suggestion

- Utilise external research vendors, conduct thorough market research in APAC, and identify prioritized 3-5 countries
- Next, complete in-depth market research on the supply chain, sales channel, and competitive landscape of the countries identified, making business trips and sending representatives if necessary
- Aim to complete **go-to-market measures like M&A and partnerships within 24-36 months**

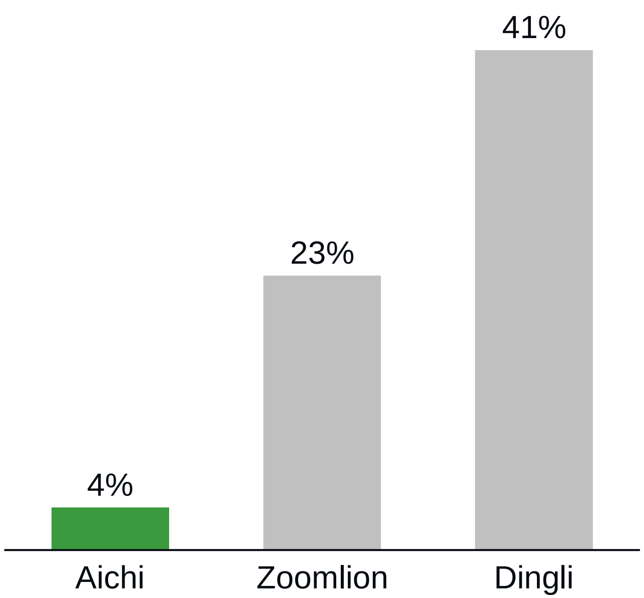
Marketing research		M&A / Partnership
Within 6 months	**Within 12 months**	**Within 24-36 months**
• Conduct comprehensive market research in APAC • Identify 3-5 countries as high priority	• In-depth research of business opportunities, including business trips • Confirm companies' intentions by sending representatives to the most promising countries	• Complete M&A and partnership to accelerate R&D / product development and distribution / services

③ Stagnant China business: Aichi's inferior China business

- Aichi has 2 subsidiaries in China that manufacture AWP locally
- Aichi's China business experienced sales growth of just 4% p.a. from 2016-2022, while Chinese competitors experienced significant growth during the same period
- Aichi's inferior performance in China can be attributed to product, pricing, distribution, and operations. Aichi's products are hardly sold in China and are instead transferred back to Japan through intercompany sales

Sales growth in China

(Sales CAGR[1]、2016-2022)



Drivers of Aichi's inferiority in China

Product
- Macroeconomic demand shift from truck-mounted, Aichi's strength, to self-propelled
- Vehicle electrification trend

Price
- No economies of scale with small China business
- Price not competitive, as competitors offer overwhelmingly cheap products of mediocre quality

Distribution
- Distributors and rental companies don't handle Aichi products; no local sales expected despite local production

Operation
- Unable to transfer the "Aichi method" of operations management to China
- Low production efficiency by local staff

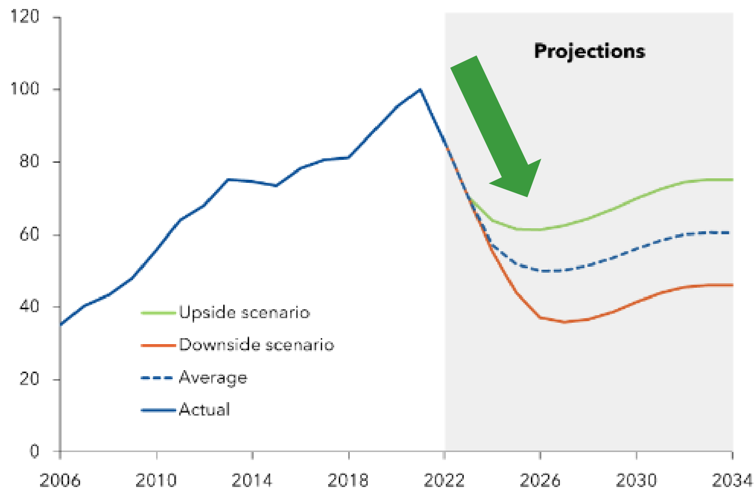
Note1: Aichi excluding Japan sales. Zoomlion and Dingli all-company AWP sales
Source: Company disclosure, Access International, Expert interview, IR interview

③ Stagnant China business: China market environment worsening

- Making matters worse for Aichi is the deteriorating market environment in China
- According to the IMF's country report in February 2024, housing investment is projected to decline by an average of 45% and remain subdued thereafter
- Along with decreasing demand, competition in the AWP market is intensifying. With excessive competition, AWP sales prices are falling significantly, with some products seeing price drops of up to 70% from their peak

China construction to fall further

(IMF projection of China real estate[1], 2021=100)



Fiercer competitive environment

"Prices are seeing significant falls - dropping to around 30% and up to 70% from the peak in some products."

Current managing director (Chinese major OEM)

"Rental companies and distributors are facing difficulty with falling final demand. Lengthening payment times with 12-month delays are not uncommon"

Current chairman (Chinese major rental company)

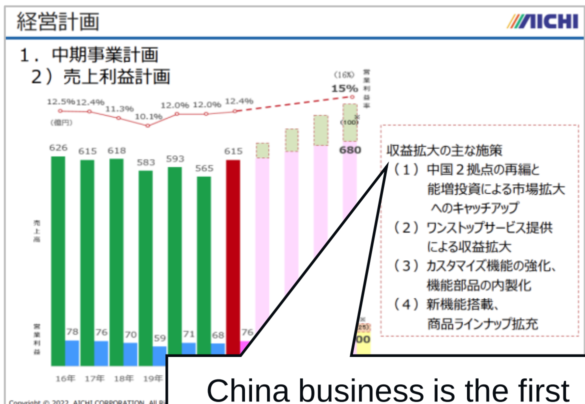
Note1: IMF projection (*"Upside and downside scenarios are for fundamental housing demand. Data shown is staff's estimate of price-adjusted real estate gross fixed capital formation"*)
Source: International Monetary Fund, Access International, Expert interview

③ Stagnant China business: AVI suggestion (Exit strategy from China)

- Along with declining market environment in China, the disclosure of Aichi's China business in its MTP has toned down significantly. In the presentation released in Nov 2023, the reference to China business was removed
- Due to the poor segment disclosure, it is difficult to understand the true situation of Aichi's China business. While management has not reached a decision, continuing with unprofitable operations clearly defies economic logic

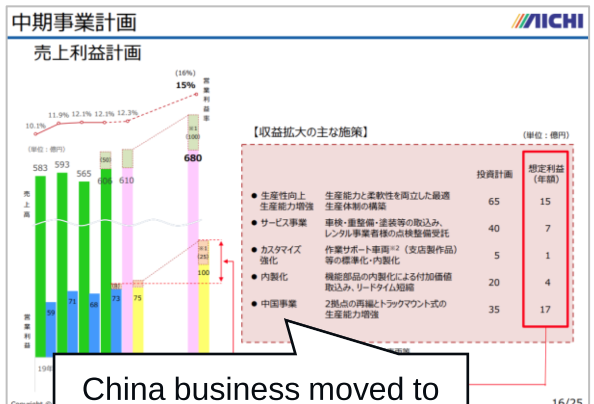
How the wording of China business in MTP has evolved

June 2022



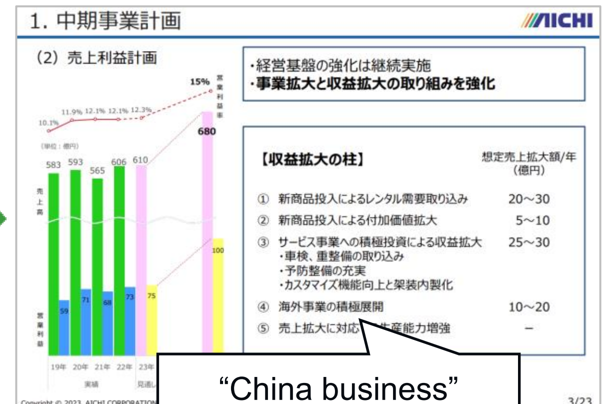
China business is the first initiative listed in MTP

May 2023



China business moved to the last initiative listed

November 2023



"China business" quietly deleted

Aichi should establish clear exit criteria and milestones for the potential downsizing and liquidation of its China business

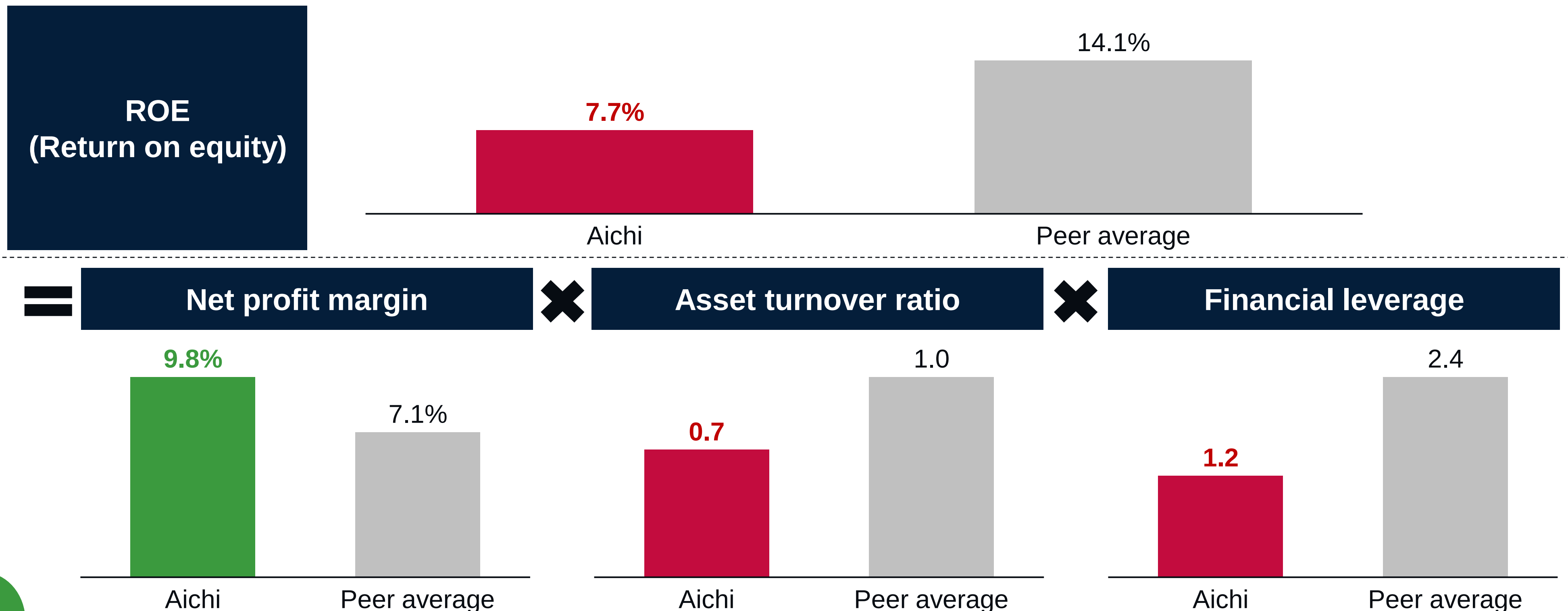
Source: Company disclosure

Low capital efficiency

Asset Value Investors

Low capital efficiency

- ROE is an indicator of a company's profitability and its capital efficiency. Aichi's ROE of 7.7% is inferior to the 14.1% average of its global peers
- ROE is composed of net profit margin, asset turnover ratio, and financial leverage. While Aichi's net profit margin is higher than that of industry peers, its asset turnover ratio and financial leverage are significantly lower
- Aichi suffers from poor capital efficiency, maintaining excessive equity without utilising debt

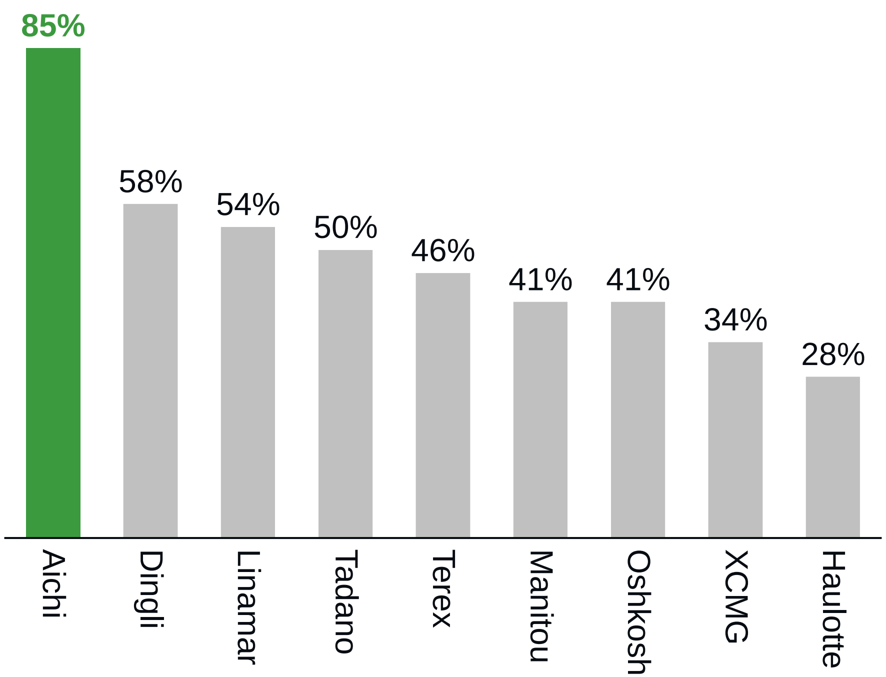


Note: Aichi is FY2022 ending March 2023. Peer is FY2023 ending December, and the average of Tadano, Oshkosh, Terex, Linamar, Haulotte, Manitou, XCMG, Dingli
Source: Capital IQ

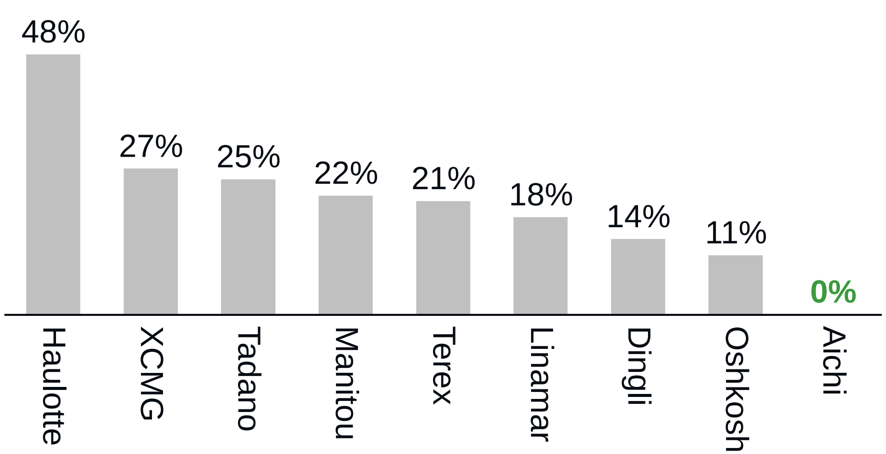
Too much equity, too little debt

- Finding the right balance between debt and equity is a key component of financial management
- Aichi's equity to total assets ratio is 85%, while its debt to total assets ratio is 0%, indicating that Aichi relies entirely on equity, which typically carries a higher cost of capital

Equity vs total assets (as of end 2023)



Debt vs total assets (as of end 2023)

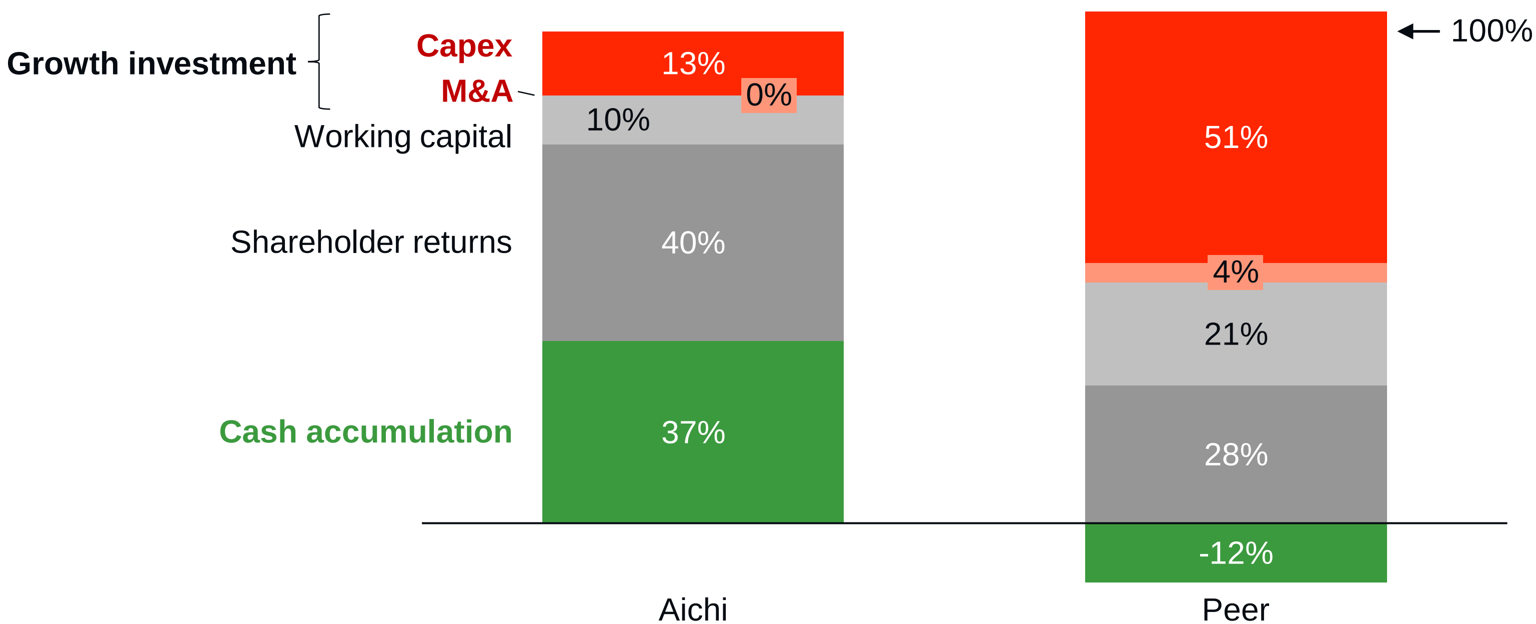


Source: Capital IQ

Historically small allocation to growth investments

- The excessive equity can be attributed to the lack of discipline in Aichi's capital policy
- Aichi has allocated only 13% of its past 5-year cash flow to growth investment, whereas global peers allocated well over 50% to Capex and M&A
- As a result, Aichi has allowed 37% of its cashflow to needlessly accumulate on the balance sheet, in contrast to the -12% for peers

Cash flow allocation of the past five financial years



Note: Cash flow is operating cash flow plus change in working capital. Aichi year end 31 March. Peer year end 31 December, average of Tadano, Oshkosh, Terex, Linamar, Haulotte, Manitou, XCMG, Dingli
Source: Capital IQ

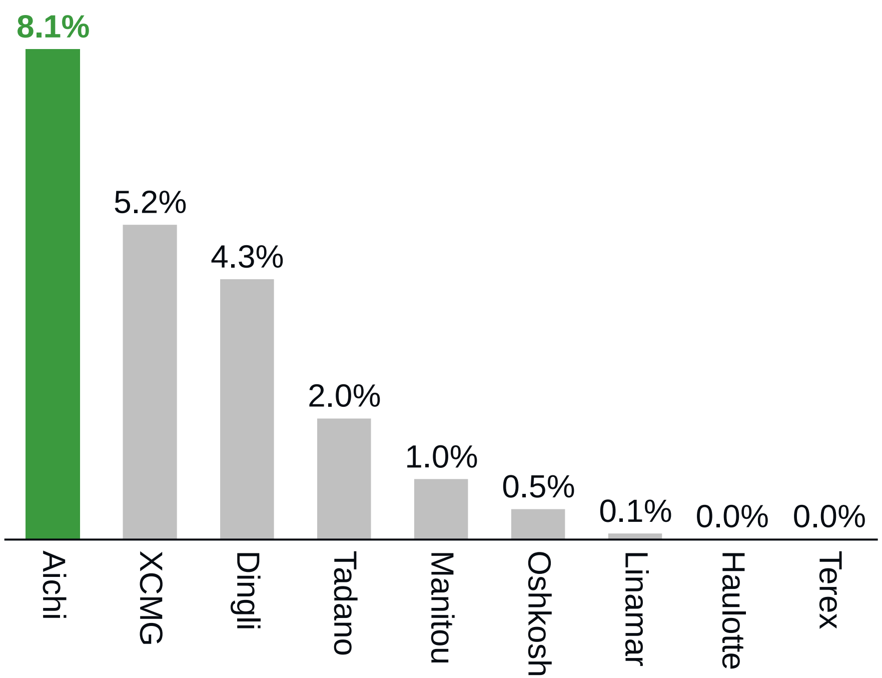
An excess in cross-shareholdings

- The Japanese Corporate Governance Code requests companies to disclose their policies concerning the reduction of cross-shareholdings
- Aichi holds stakes in 12 listed companies with a combined market value of Y7bn
- Aichi's investment securities represent 8.1% of total assets, significantly higher than those of its peers

Aichi's holdings (as of end March 2024)

Company	MV[1] (Ymn)	Crossholding
Daikin Industries	3,008	Y
Comsys Holdings	1,797	N
Nishio Holdings	971	N
Miraito One	551	N
Kanamoto	280	Y
Exeo Group	148	N
KYB	121	Y
Yondenko	98	N
Tokyo Keiki	84	Y
Isuzu Motors	23	Y
Hokkai Electrical Construction	15	N
Tohoku Electric Power	12	N
Total	**7,108**	**-**

Investment securities[2] as a % of total assets (as of end December 2023)



Note1: Market value of the cross-shareholding is current share price multiplied by Aichi holdings as of end of March 2023
Note2: Investment securities in the Securities Reports (Yuho) for Aichi and Tadano, Long-term investment securities in Capital IQ for other companies
Source: Company disclosure, Capital IQ, Tokyo Stock Exchange

Lack of capital policy

- It is essential to have plans for not only the income statement but also cash flow and balance sheet to drive capital efficiency and achieve returns that meet investors' expectations
- According to the list released by the TSE in 2024, Aichi is alleged to have already disclosed "Action to Implement Management that is Conscious of Cost of Capital and Stock Price"
- In reality, the disclosure is limited only to a few targets such as "ROE >9% in FY26" and "total payout ratio >50%"

Aichi disclosure pertaining to capital policy

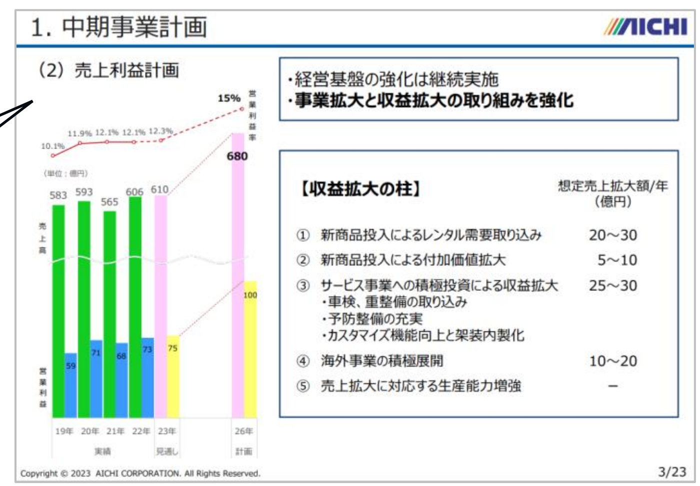
Corporate Governance Report (December 2023)

【資本コストや株価を意識した経営の実現に向けた対応】
中期経営計画で、積極的な新商品投入、商品のライフサイクル全体でのサービス価値向上と内製化率向上および海外事業拡大により
2026年度に売上高680億円、営業利益100億円、ROE9%以上を目標とし、更にROE10%以上を目指していきます。
一方で、増配および自己株買取による総還元性向50%以上を基準とした安定した株主還元を実施していきます。
事業拡大による収益向上と、株主還元を安定的に向上させる基本方針により、企業価値の向上を目指します。
詳細は、当社ホームページ（URL：https://www.aichi-corp.co.jp/）の「IR情報」の「決算情報」のページの「決算説明会資料」をご参照ください。

"ROE >9% in FY26" and "total payout ratio >50%" are the only points related to capital policy

"Details to be referred to earnings call materials", but no relevant description can be found in the presentation

Earnings call material (November 2023)



Only PL plan, with no outline of CF/BS

Source: Company disclosure, Tokyo Stock Exchange

AVI proposals to improve capital efficiency

Reduce excess equity

- **Aichi has too much equity, harming capital efficiency**
  - Aichi's 7.7% ROE is inferior to the 14/1% average of its global peers
  - The low ROE is due to excess shareholders equity, rather than a low profit margin. With zero debt, the company is dependent on equity, which has a higher cost of capital
  - Aichi has accumulated excess cash and neglected to make growth investments
  - More cash should be allocated to Capex and M&A, with residual cash returned to shareholders

Sell cross-shareholding

- **Excessive cross-shareholdings and investment securities**
  - Y7bn invested across 12 listed companies for business related purposes
  - Aichi should announce plans to sell all cross-shareholdings

Introduce rigorous capital policy

- **Aichi should implement a rigorous and publicly disclosed capital policy**
  - Aichi's capital policy is unclear, and the absence of forecasted cash flows and balance sheet projections suggests it is a low priority for management
  - Currently only forecasts income statement items
  - The company should disclose both the sources of cash (operating cash flow, bank loans) and the uses of cash (Capex, M&A, shareholder returns)

Poor shareholder comms

Poor shareholder communications

- Investors require high quality, detailed IR materials when making decisions
- Aichi's IR disclosure is poorer than that of its peers. This is evident from factors such as the number of pages in the mid-term plan, absence of capital markets days, infrequent earnings calls, low sell-side analyst coverage, limited disclosure of non-financial information, and inadequate IR disclosure in English
- This lack of information disclosure limits Aichi's investment appeal

	Capital markets day[1]/ Mid-term plan # of pages	# of Capital markets day[1] (2023)	Frequency of earnings call	# of sell-side analyst	Comprehensive non-financial information	IR presentation in English
Aichi	7 pages	0	2 per year	1	No	No
Tadano (JP)	29 pages	0	4 per year	6	Integrated report	Yes
Oshkosh (US)	31 pages	5	4 per year	14	ESG report	n.a[2]
Terex (US)	88 pages	9	4 per year	15	ESG report	n.a[2]
Linamar (CA)	76 pages	3	4 per year	5	ESG report	n.a[2]
Manitou (FR)	46 pages	1	3 per year	6	Annual report	Yes
Haulotte (FR)	4 pages	0	2 per year	6	Non-financial report	Yes

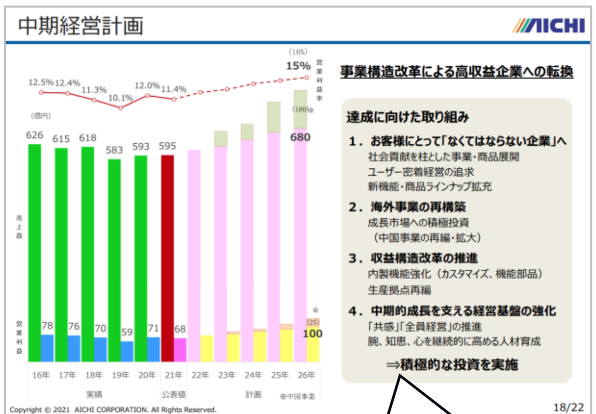
Note1: Excluding earnings call. Note2: Not applicable as the companies are from English-speaking countries
Source: Company disclosure, Capital IQ

MTP not transparent

- Companies are encouraged to provide overview of the present state and demonstrate timely progress of the plan
- Aichi's MTP lacks consistency in its timeline and KPIs, and sometimes undergoes modifications without sufficient explanation. This makes it difficult for investors to evaluate the extent of the gap between the present and future states, as well as the progress made thus far

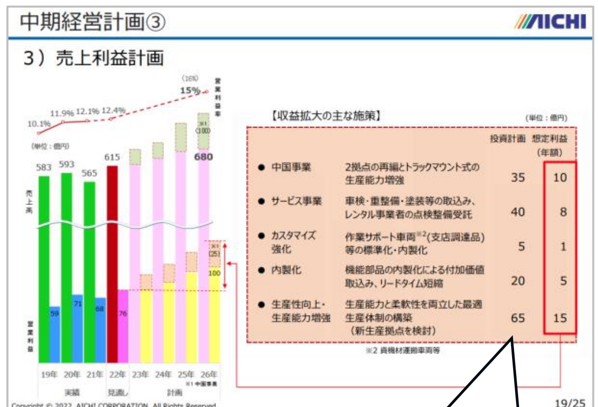
Progression of Aichi's current MTP

November 2020



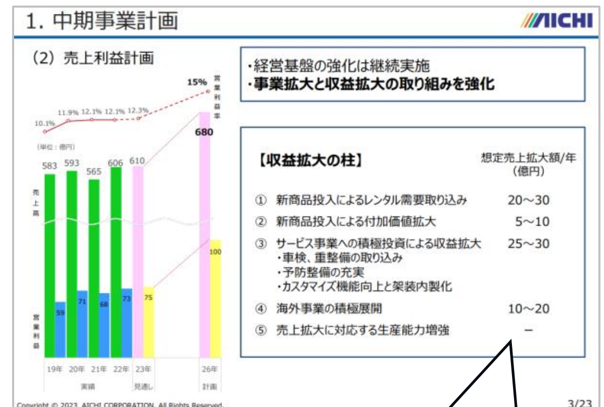
Too few numerical targets, difficult to understand the extent of the gap to the future state

November 2022



Disclosed KPI (Capex and profit contribution) by initiatives for the first time

November 2023



KPI suddenly changed to sales without proper explanation

Source: Company disclosure

Segment disclosure problem

- Public companies have discretion in how they segment business units in disclosures. The segmentation “cuts” should aid investors decision making, with a focus on profit contribution
- Currently, Aichi only discloses 3 segments (specially equipped vehicles, parts & repair, and other), and the profit contribution of domestic and overseas businesses is not provided
- Investors are unable to ascertain whether the China business is losing money or not

Aichi’s segment disclosure (FY22 Annual Securities Report)

(Th

Only disclosing specially equipped vehicles, parts & repair and other

	Reportable segment			Other (Note 1)	
	Specially equipped vehicles	Parts & repair	Subtotal		
Net sales					
Net sales to external customers	47,313,092	12,709,357	60,022,450	656,401	60,678,851
Intra-group sales or transfers	1,376,721	204,159	1,580,881	463	1,581,344
Subtotal	48,689,814	12,913,517	61,603,331	656,864	62,260,196
Segment profit	8,722,700	4,140,714	12,863,415	123,364	12,986,779
Segment assets	–	–	–	–	95,695,470
Segment liabilities	–	–	–	–	17,121,723
Other items					
Depreciation	838,339	116,748	955,087	6,075	961,162
Increase in property, plant and equipment and intangible assets	–	–	–	–	854,756

Profits of domestic/overseas not available

Source: Company disclosure

AVI suggestions to improve IR communications

Increase transparency of MTP

- **Enhance information disclosure in MTP and demonstrate consistency**
  - The timeline and KPI's in Aichi's MTP are inconsistent. The related contents are often changed without due explanation
  - Aichi should provide clear disclosure about the current state and future direction
  - The company should keep consistent KPI over time

Improve segment disclosure

- **Disclose segment profits by geography**
  - The China business is understood to be underperforming, despite its growth expectations
  - Without proper segment disclosure, investors are unable to understand the full picture of the China business

Other IR improvement

- **Improve overall IR disclosure**
  - Aichi's MTP is only 7 pages, leaving investors with limited insight to the company's view
  - Zero investor days, with only two earnings calls per year
  - Only 1 sell-side analyst covers Aichi, leading to low market awareness
  - No comprehensive disclosure of non-financial information in consolidated reports
  - The company does not disclose English versions of earnings call presentation materials, resulting in non-Japanese speaking investors not paying attention to Aichi

Weak corporate governance

Asset Value Investors

Weak corporate governance

- Aichi is a listed subsidiary of Toyota Industries (TICO), which holds more than 50% of Aichi's shares. TICO is an affiliated company of Toyota Motors (Toyota), which holds a 25% stake in TICO
- TICO is able to exert control over Aichi as if it was a wholly owned entity, despite not owning 100% of the shares. This dynamic often leads to conflicts of interest between majority and minority shareholders
- TSE and METI have repeatedly pointed out the issues that might arise from conflicts of interest, especially where there are transactions between parent and subsidiary, like deposits or appointing of staff from the parent company

Equity relationship

Toyota Motors

↓ Affiliated company (ownership: 25%)

Toyota Industries

↓ Consolidated subsidiary (ownership: 54%)

Aichi

Conflicts of interest, as pointed out by TSE and METI

"There is a risk of conflicts of interest between parent and listed company/minority shareholders in case of transaction with parent or adjustment/allocation of business opportunity by parent"

TSE, Disclosure Improvement in light of Protection of Minority Shareholders and Group Management

Direct transaction	*"Parent company wants to utilize subsidiary's cash at the lowest possible interest rate, while subsidiary wants to use the cash for its own investment unless interest rate meeting cost of capital"*
Managerial orders	*"When people transfer occurs between a controlling shareholder and subsidiary, there is a potential conflict of interest in the form of people transfer prioritizing the controlling shareholder's intention"*

Source: Company disclosure, Tokyo Stock Exchange, Ministry of Economy, Technology, and Industry

Problems with Board structure (parent-subsidiary)

- 50% of Aichi's Board have either a background at TICO or Toyota
- President Mr Yamagishi is from TICO, and is a member of the Nomination and Compensation Advisory Committee
- It seems Aichi's Board prioritise balanced selection of members with backgrounds from Aichi, TICO, and Toyota
- It is questionable whether Aichi's Board structure is optimal, particularly given the series of compliance issues[1]

Background of Aichi Board

	Aichi	TICO, Toyota	Other
Toshiya Yamagishi		Y (TICO)	
Hideo Yamamoto	Y		
Koichi Anzai	Y		
Takuo Sasaki		Y (TICO, Toyota)	
Shigehiro Takatsuki			Y
Kiyoshi Tojo		Y (Toyota[2])	
Takuto Kawanishi			Y
Kenji Aonuma		Y (TICO)	
Total	**2**	**4**	**2**

From TICO or Toyota: 50%

Note1: Hino Motors in March 2022, Daihatsu Motor in April 2023, TICO in March 2023 and January 2024.
Note2: Mr Tojo had belonged to Toyota for over 30 years. His previous company (Aioi Nissay Dowa Insurance) has strong historical relationship with Toyota
Source: Company disclosure, SPEEDA

Problems with Board structure (independence, diversity)

- The Aichi Board has several problems, aside from background in parents
- As a listed subsidiary, the board is expected to have high independence, however, independent outside directors compose only 38% of the board
- The Board lacks diversity, as there are no female directors and all members are Japanese

Attribute of Aichi Board

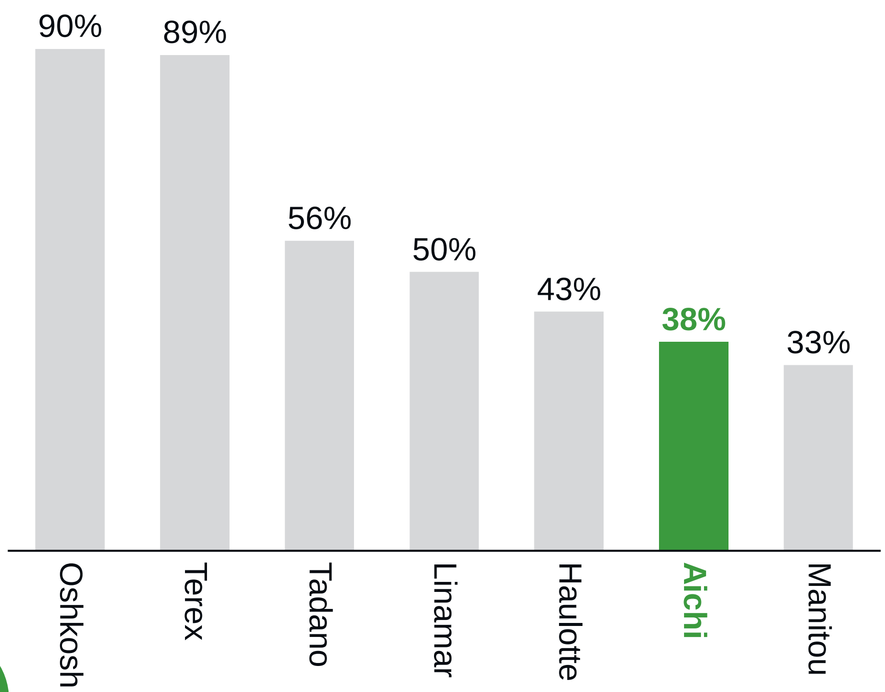
	Independent outside director	Gender	Nationality
Toshiya Yamagishi		Male	Japan
Hideo Yamamoto		Male	Japan
Koichi Anzai		Male	Japan
Takuo Sasaki		Male	Japan
Shigehiro Takatsuki	Y	Male	Japan
Kiyoshi Tojo	Y	Male	Japan
Takuto Kawanishi	Y	Male	Japan
Kenji Aonuma		Male	Japan
Total	**Independent: 38%**	**Female: 0%**	**Non-Japanese: 0%**

Source: Company disclosure

Low independence of the Board

- 38% of Aichi's Board directors are independent, compared to many global peers with >50%
- Listed subsidiaries are requested by the TSE to have higher independence of the board
- Aichi has established a special committee to deliberate and review potential conflicts of interest
- However, formation of the special committee is not enough, given that many global peers have already >50% Board independence while not being a listed subsidiary

Independent % (2023)



Source: Company disclosure, Tokyo Stock Exchange

Request to listed companies (Corporate Governance Code)

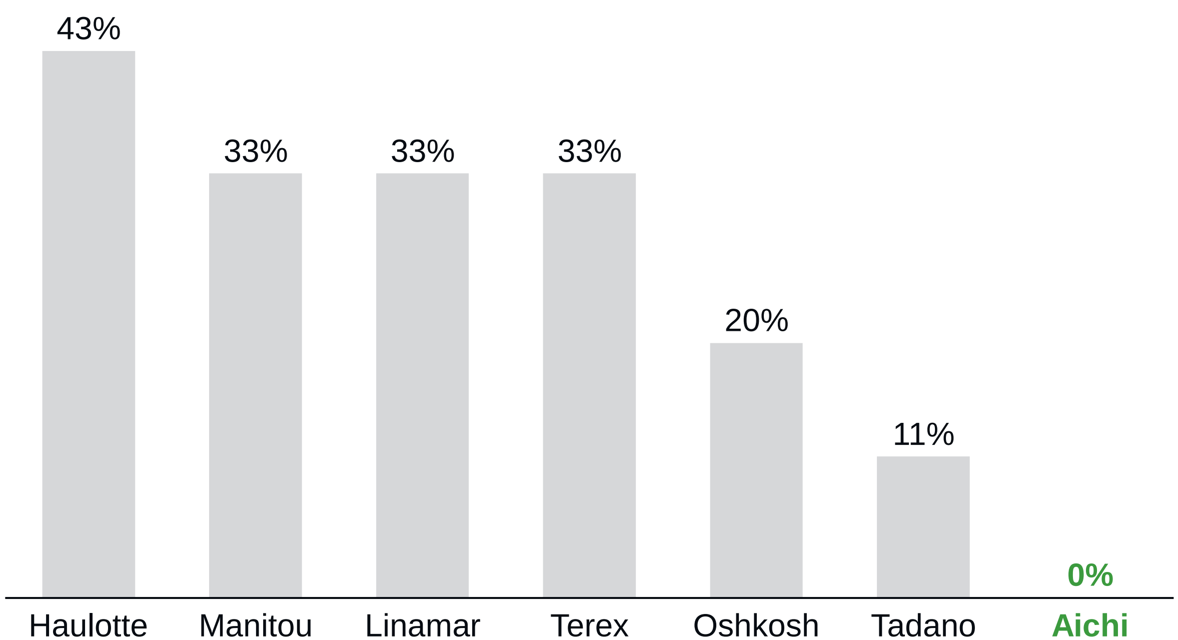
[Supplemental Principle] 4-8-③

A listed company with a controlling shareholder should appoint at least one-third (**or a majority in the case of a company listed on the prime market**) of independent outside directors who are independent of the controlling shareholder on its board of directors, or establish a special committee consisting of independent persons, including independent outside directors, to deliberate and review important transactions and actions that conflict with the interests of the controlling shareholder and minority shareholders.

No female representation

- Aichi has no female directors on the Board, an urgent issue not faced by any global peers

Female board composition (2023)



Source: Company disclosure

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