

Q2 2024

Investment Objective:

The investment objective of the Fund is to generate long-term returns through investment in a focused portfolio of over-capitalised Japanese equities while engaging with company management to help unlock value.

MANAGER'S COMMENT

Introduction

AVI Japanese Special Situations (AJSS) launched on 22nd April 2024. At the end of Q2 the fund had assets of ¥1.7bn. We are excited to be up and running and to have been entrusted with your capital.

In these letters we aim to communicate with you just as we like to be communicated to by our companies – clearly, concisely and fairly. We will discuss the core drivers of performance, our constructive engagement efforts, as well provide an overview of the broader environment for the strategy and opportunities we are seeing. In this maiden letter, we also introduce the fund's two largest positions – Eiken Chemical and TSI Holdings.

AVI's Japan strategy consists of three main components:

- 1) Investing in durable businesses that are growing in value, with a focus on overcapitalised small-mid caps
- 2) Which are trading at discounted valuations – we have experience exploiting inefficiencies arising from lack of research coverage
- 3) And with an active approach to unlock and grow value, we have developed a reputation as a long-term constructivist shareholder in Japan

Outlook

At the end of the quarter, the portfolio's EV/EBIT was 8.2x, with NFV accounting for 48% of the market cap. This underscores the significant discounts at which AJSS's portfolio companies trade at relative to peers, largely due to their over-capitalised balance sheets and poor corporate governance. It is pleasing to see that the allocation of our portfolio towards high quality companies is bearing fruit.

The Japanese equities market continues to gain traction, amidst rising foreign capital allocation, corporate reform, and a greater focus on shareholder returns. The seeds planted in recent years are beginning to come through, presenting us with abundant opportunities. We remain committed to selectively adding the most promising companies to our concentrated portfolio of 25-35 holdings.

Our Approach to Constructive Engagement

Shareholder engagement is a core component of AVI's Japan strategy. It is clear to us that management teams of our portfolio companies are particularly receptive and appreciative of our engagement efforts focusing on enhancing operational efficiency. Capital efficiency also remains a core area of focus for our engagement. Share buybacks are becoming more frequent in Japan as companies demonstrate greater focus on shareholder returns, in line with the TSE's request.

While we prefer to keep our engagement private to build relationships with management, shareholder proposals remain an important part of our engagement repertoire to drive corporate reform in companies that are lacking adequate management or strategic direction.

During the quarter, we prepared an in-depth, 60-page public presentation on Aichi, focusing on several constructive suggestions to enhance operational efficiency and corporate value, while addressing the parent/subsidiary relationship with Toyota Industries.

We believe that the long-term focus of our constructive engagement assists management in building better businesses while enhancing shareholder value. A track record demonstrating our willingness to take engagement public enhances our credibility and adds another layer to our engagement.

Eiken Chemical (4549)

The largest holding in the fund is Eiken Chemical, a manufacturer of medical diagnostics equipment that holds a dominant global market share exceeding 70%. Across AVI's funds, we are the second largest shareholder, and with an open shareholder register, Eiken Chemical and its shareholders are very well positioned to benefit from our constructive engagement. The company has an overcapitalised balance sheet, with net cash and investment securities accounting for 35% of the market cap.

MANAGER'S COMMENTS

Our engagement with Eiken Chemical is in its early stages, but we are pleased to see that management have already taken steps to address its poor capital efficiency by buying back shares and improving disclosure to investors. However, we are disappointed with Eiken Chemical's profitability and believe that there is significant room for improvement on product optimisation and overseas distribution strategy.

Although the EV/EBIT has increased to 10.5x due to the increased share price and temporarily depressed earnings, we still foresee a substantial growth runway for the Company, which if successfully executed by management, could unlock upside in the order of +120%. We are excited about Eiken Chemical's future and building our relationship with management.

TSI Holdings (3608)

TSI Holdings, our second largest position, announced a new transformative mid-term plan in April. For the first time, TSI disclosed a quantified shareholder return policy, aiming for a 4% dividend on equity target by FY27/3, coupled with an ambitious cost improvement plan to elevate operating margins to 6% (from the current 1%). The plan was initially met with excitement; however, the share price quickly fell back again. It took a few weeks for the market to digest the significance of the plan, but by the end of the quarter, the share price had appreciated by +20%.

As TSI's largest shareholder, holding 10% of the vote across AVI funds, we were pleased to see that the Company had actioned many of our suggestions. TSI has likely received the most engagement from us this year of any portfolio company, and we commend management for their proactive approach in listening to shareholders. However, we remain frustrated by the lack of concrete answers to several of our recommendations and we are continuing our intense engagement.

We see a further +100% upside to the current share price, which underscores the enormous upside potential of our investments, which is not unique to TSI. We do not believe the market fully comprehends the scale of TSI's transformational program and its commitment to improving capital efficiency. Full credit from investors for the mid-term plan and cost reform will only happen once TSI demonstrates improvements over the coming quarters. In the meantime, we are happy to wait.

Investment Manager – Joe Bauernfreund

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

The share price can be found in *AJSS - Asset Value Investors*

Further information may be found on the following websites:

<https://www.assetvalueinvestors.com/ajss>

www.assetvalueinvestors.com

**IMPORTANT INFORMATION**

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