

Q3 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 Q3 the fund had assets of ¥3.0bn. Below we discuss the positive outlook for the strategy and highlight our constructive approach to engagement with portfolio companies to unlock long-term value.

The AVI Japan investment approach looks for three things:

- 1) Small to mid-cap durable businesses that are growing in value, with overcapitalised balance sheets
- 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 constructive shareholder in Japan

Outlook

It was a volatile period for Japanese equities following the Bank of Japan's decision to increase its benchmark interest rate by +15bps in late July to +0.25%. This spurred the Yen higher and led to the unwinding of carry trades. The Yen appreciated over the period by +5.9% relative to the British Pound (GBP), and +12.2% relative to the US Dollar (USD). In light of the shifting macroeconomic environment in Japan, we believe there is potential for foreign investors' focus to shift toward smaller companies that are protected from further strengthening of the Yen, unlike large-cap exporters.

In late September, it was reported that Shigeru Ishiba would be the new Prime Minister and leader of the Liberal Democratic Party (LDP), winning 53% of the runoff vote. While the market had already factored this in to an extent, the initial market reaction saw a strengthening of the Yen and a -3.5% weakening of the TOPIX. Encouragingly, since the election, Ishiba has stated his willingness to employ fiscal stimulus and a desire for increased investment relative to savings. We believe the Ishiba administration will operate in a manner largely consistent with former PM Kishida, and we do not believe this leadership change will setback the ongoing commitment in Japan to corporate governance reform or our engagement plans with any portfolio companies.

At the end of the quarter, the portfolio's EV/EBIT was 8.8x, with NFV accounting for 47% 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 undervalued, high-quality companies is bearing fruit.

The Japanese equity market continues to gain traction, amidst rising foreign capital allocation, corporate reform, and a greater focus on shareholder returns. In this under-researched environment, we are continuing to find 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. 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.

During the period, our engagement activity with portfolio companies included sending five private letters and two private presentations, as well as holding more than 25 meetings, some of which were in-person during visits to Japan in August and September. Much of our engagement focused on improvements around capital allocation, operational efficiency and shareholder communication. We also engaged extensively on governance issues, focussing on board independence, tenure and diversity, as well as environmental and social issues.

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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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