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Is it a good time to buy shares in Ajot?

AVI Japan Opportunity Trust has a good track record of investing in companies that are substantially undervalued

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For 11 years, Japan's government has been pushing companies to stop hoarding cash and assets, with the aim of revitalising a sluggish economy by spurring profitability and increasing share prices. Companies had been managed in a very risk-averse way since share and real-estate prices crashed in the early 1990s, followed by decades of low growth. At some, the value of the cash they held was higher than the market value of the entire company.

The view prevailed that cash belonged to the company, not its shareholders, and the business needed to keep it for a rainy day. But reforms, starting with the stewardship code in 2014 and followed by the first corporate governance code in 2015, encouraged institutional investors and companies to engage with each other, looking at ways to increase shareholder value, whether through investing in the business, increasing buybacks and dividends, or selling parts or all of the company.

Change is happening — Japanese share prices reached a record high earlier this week, driven by Shigeru Ishiba's resignation as prime minister and the hope he will be replaced by a proponent of "Abenomics", the policies of Shinzo Abe, the former prime minister, which included the corporate reforms to boost investment. Private equity takeovers are also expected to reach a record this year, helped by deals such as KKR buying the software developer Fuji Soft for $4.1 billion.

Smaller companies in Japan are under the same pressure from stock market regulators as the larger ones, and that was the impetus for Asset Value Investors (AVI) to set up the AVI Japan Opportunity Trust in 2018.

"Companies were starting slowly but surely to recognise that times were changing," Joe Bauernfreund, a portfolio manager, said. AVI Japan Opportunity Trust (Ajot) is an activist investor with a portfolio of investments in 21 small and medium-sized Japanese companies.

"Our starting point is businesses with very strong, inefficient balance sheets and some levers that we can pull to improve shareholder returns," he added. "We want to make suggestions on how they can improve their balance sheet, improve their communication, and also improve their operations and boost profitability."

Ajot builds up stakes of at least 1 per cent, which is the minimum threshold for putting forward shareholder resolutions in Japan, and preferably at least 5 per cent, which is the level at which a stake must be publicly disclosed by the company. As an activist investor "having our stake disclosed is very helpful because it lets other investors know that we are on the register, and they can assume we might be exchanging some meaningful ideas with the company," Bauernfreund said. "That also puts pressure on the company to listen to us and talk to us."

Typically, Ajot invests for about three years.

The company's ten biggest investments account for 86 per cent of the value of its holdings and cover a range of sectors from pharmaceuticals to online education and logistics. Its best-performing investment last month, for example, was Rohto Pharmaceutical, which makes prescription drugs but also skincare products and eyedrops. Ajot believes the shares are undervalued relative to competitors' because the company needs to spend more of its R&D budget on higher-margin skincare products and cut the proportion spent on less profitable medicines.

The companies Ajot invests in are mainly domestically focused, said Bauernfreund, and less exposed to tariff concerns than large Japanese multinational companies.

"We're a fund that invests in Japan but we're not buying the Japanese economy, we're buying Japanese companies that are substantially undervalued," he said.

Shares in the investment trust have climbed 31 per cent in the past year to 178½p, and 87 per cent since it was set up in 2018. Net asset value has increased by 101 per cent over that time. By comparison, the MSCI Japan Small Cap index has gained by 43.3 per cent.

Last month, Ajot agreed a merger with Fidelity Japan Trust to create a larger investment company. Fidelity Japan invests in companies of all sizes, but after the merger the assets will become part of Ajot, focused on smaller companies. The combined market cap would be between £360 million and £470 million, analysts at Deutsche Numis estimated, depending on how many investors choose to withdraw their money.

Fidelity Japan investors will be able to take out 50 per cent of their investment for a 1 per cent charge, and the rest at Ajot's usual annual exit fee of 2 per cent.

Being an activist investor in smaller Japanese companies may be "just a bit too off-piste" for some shareholders, as Bauernfreund says. However, the trust has made good returns since it was set up, and Japan's government and stock market regulators will keep pushing companies to reform, indicating more returns to come.

Advice: Buy

Why: Ajot has established a good track record in the companies it invests in, and Japan’s stock market regulators are pushing reform