Quality Investments with tangible margins of safety

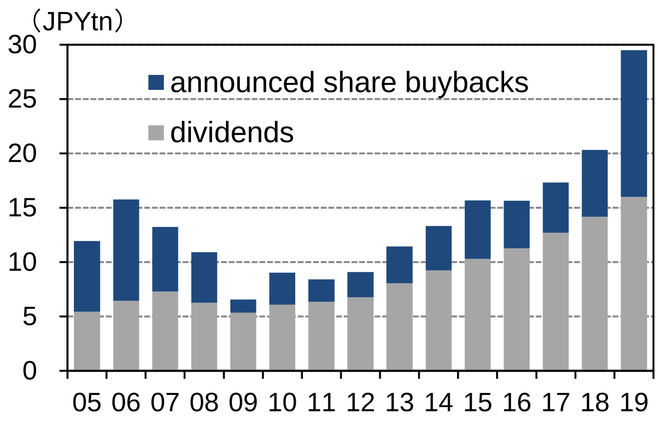
Japanese stocks are incredibly inexpensive: Many companies have liquid assets and investments whose value is close to or even above their own market value. No value is attached to the generally rock solid operating business, which comes virtually "for free". But the unlocking of these huge hidden values has now got underway after all. The government has made revolutionary changes to the corporate governance rules for Japan. At the same time, the government is counting on the support of private equity houses and activist investors to accelerate this process.

Japanese companies offer participation in future-oriented trends and themes that European companies, for example, can hardly offer.

In Japan, there are a large number of excellently positioned companies. In areas such as semiconductors and electronic components, specialty materials and semi-equipment, automation and sensor technology, 5G, and alternative automotive drive systems, Japanese companies often have leading positions; and they are located in the centre of Asia, the region with the world's highest economic growth.

While the competitiveness of, for example, many European companies in a digital future is not so clear, many Japanese companies can look to the future from a position of strength. Therefore, it is no surprise that many Japanese companies have been generating stable and in many cases increasing profits and cash flows for years with the reliability and precision typical of Japan.

In contrast to many Western companies, Japan's companies have by far not yet exhausted their potential in terms of dividends and share buybacks. Despite steadily rising dividends and share buybacks in recent years, Japanese companies are still only distributing around 70% of their annual net profits to shareholders.

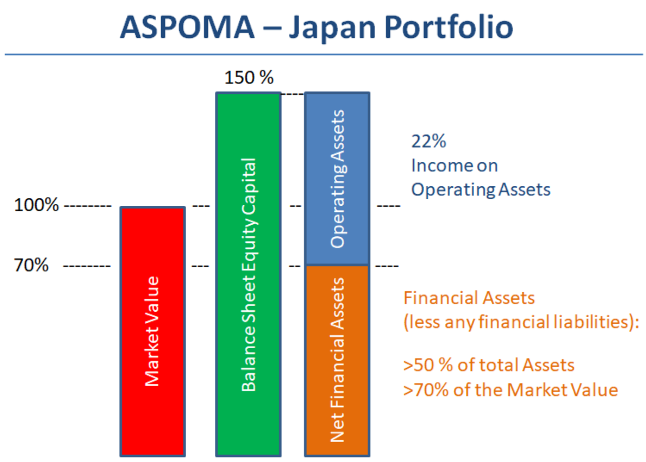


Source: CLSA, ASPOMA

Record levels of cash and liquid investments and extreme undervaluation as risk buffers; Net financial assets at 70% of market capitalization on average

A unique feature of many Japanese companies is that they are not only debt-free, but that they have net liquidity and a portfolio of liquid investments that in many cases represents 50% to 100% of their market capitalization after deducting any financial debt. In simple terms, one could say that the market only values the liquid assets and investments; the usually excellent operating business is for free.

The ASPOMA Japan Opportunities Fund's portfolio companies have liquid assets and investments averaging 70% of their market value



Source: ASPOMA, Bloomberg

Price-book-ratio of the operating business below 0.4x with a return of 22%

At the same time, however, the price/book ratio of the portfolio is only 0.66x. If the price is adjusted pro forma for the net liquidity that could in principle be distributed, it becomes immediately clear that the actual operating business of the portfolio companies is only valued at a price/book ratio of 0.36x. On average, however, the companies achieve an operating return of 22% on this book value.

For investors, the high level of cash and liquid investments in combination with the extremely low valuation are robust safety buffers – airbags "Made in Japan".

And while companies, especially in the US, now have to announce massive dividend cuts and the suspension of share buybacks, many Japanese companies can use the current market correction to maintain or even expand value-enhancing share buybacks. Put simply, if a company buys back its own shares at a discount to book value and if this book value generates high returns (both of which is the case in Japan), then the buybacks will definitely add value for shareholders.

Vault-breaker at work: Unlocking of hidden values has begun

For a long time, investors assumed - probably rightly so - that they would not have access to the huge hidden assets in Japanese companies anyway. Demands by institutional investors to unlock these hidden values fell on deaf ears among the managers of the companies, who had a lot of leeway. Consequently, no value was attached to these liquid assets and investments.

The situation changed significantly when Prime Minister Abe took office: The Abe government wants to free up the high levels of liquid assets and investments and use them to further develop the Japanese economy (instead of locking them away in corporate balance sheets). To this end, the Japanese government has undertaken extensive structural reforms, most notably the reform of corporate governance and listing rules.

The corporate governance rules oblige companies, for example, to either provide a sound explanation of why they have holdings or to reduce and liquidate them. The increase in tax rates on dividend income also serves to accelerate the reduction of minority shareholdings.

At the same time, the government is counting on the help of private equity investors and activists. Both exert tremendous pressure on companies to unlock the values lying dormant in them for their investors. If a company stubbornly resists, the worst case scenario is a hostile takeover in which management is replaced. A shareholder-friendly corporate policy can then be implemented.

The ASPOMA Japan Opportunities Fund focuses on companies for which the unlocking of value seems particularly likely

A central aspect of the investment approach of the ASPOMA Japan Opportunities Fund is to invest in strongly undervalued companies with high levels of cash and liquid investments, where the unlocking of value appears particularly likely. Three typical cases are:

- Heavily overcapitalised subsidiaries where it makes overwhelming economic sense for the parent company to either buy the outstanding shares of the subsidiary or sell the subsidiary as a whole to a financial investor.
- Heavily overcapitalised companies where activists have bought into the company and are now pushing for change and the unlocking of "hidden assets".
- Companies that have themselves started to increase dividends and share buy backs and clean up their investment portfolio.

ASPOMA Asset Management is an asset manager focused on Asia with headquarters in Austria and analysts on the ground in Japan and China. Similar to private equity buyout funds, the investment strategy for Japan is designed to identify high quality but highly overcapitalized and low-valued companies that offer attractive investment returns through a combination of high operating free cash flows and a streamlining of the asset portfolio and the capital structure.

Contact
ASPOMA Asset Management GmbH
Rudolfstraße 37
4040 Linz
Austria
Tel.: +43 732 9444 17
Email: office@aspoma.com
www.aspoma.com

ASPOMA Asset Management

ASPOMA Asset Management was founded in the conviction that Asia, as the region with the strongest global growth in the coming years, offers many attractive investment opportunities, but their realization requires special knowledge of the Asian conditions and markets. ASPOMA Asset Management is an independent private investment company specialized in Asian markets, in particular China and Japan. Our specialised approach enables us to offer investors optimal investment solutions for their investment needs in Asia.