Q4 2023

ASPOMA
Asset Management

Quarterly Report ASPOMA Japan Opportunities Fund

Japan Hidden Value Strategy – January 2024

Key figures of the portfolio*

Price/Book Ratio	Price/Book Ratio adjusted for Net Cash**	Net Cash to Market Capitalization	Return on Net Operating Assets	Dividend Yield	Dividend Growth p.a. ***
0,82x	0,55x	70%	23%	2,6%	10%

Content

Summary

The **performance of the ASPOMA Japan Opportunities Fund****** was **+33.8% for the full year 2023** and +6.9% in the **4th quarter.** Since implementing the Hidden Value strategy in January 2019, the fund has gained 71.5%, or **11.4% per year**. The **fund volume has now exceeded 27 million euros**.

The following developments in Japan are especially relevant for investors:

- The ***corporate governance reforms are starting to have a broad impact*** and are bringing improvements for both firms and shareholders. All major players in Japan are now moving towards the same goal (see page 6). The government is showing support by granting tax exemptions for corporate restructuring and private share purchases. The Tokyo Stock Exchange has recently requested that listed companies take measures to increase their valuations and will disclose which companies are taking the issue seriously. All this is going down particularly well with international investors.

- ***Geopolitical tensions are making Japan the "safe haven" in Asia***: investors who were previously invested mainly in the Chinese market have begun to shift their investments to Japan.

- ***Distinct international competitiveness***: The Japanese economy has become exceptionally competitive internationally, thanks to the combination of low-priced labour and stable wages due to hardly any inflation for the past two and a half decades, along with the strong devaluation of the yen.

- ***Rising demand for Japanese equities while supply is shrinking***:
  1) Interest from foreign investors has increased significantly. In recent months, however, those foreign investors have only bought a fraction of the Japanese shares they sold in previous years.
  2) Generous tax exemptions for share purchases from 2024 onwards could significantly stimulate demand from Japanese private investors.
  3) The massive share purchasing program by the Bank of Japan in recent years and the annual increase in share buybacks by companies have significantly reduced the number of shares available on the market. This has created a favorable supply/demand situation.

- ***Positive economic and earnings momentum in Japan:*** While the worldwide economic situation continues to deteriorate due to high interest rates, Japanese companies are improving as they benefit from the recovery of the domestic economy and from regained scope to pass on prices.

- ***Valuations are still incredibly low***: despite the recent share price increases, the stock market value of half of the Japanese companies is still below the (book-) value of their equity in the balance sheet.

* adjusted portfolio: 44 out of 59 Holdings; on a net basis
** explanation on page 5; ***of the last 5 years p.a., adjusted portfolio; **** using share class A as example

Key developments in Japan

In the fourth quarter of 2023 Japanese equities (TOPIX Index) rose by 2.0% on average, which corresponds to a full-year performance of +27.5% in 2023.

The positive sentiment of the Japanese market was driven by numerous constructive developments:

(I) Corporate Governance reforms are starting to have a broad impact and are bringing improvements for both, companies, and shareholders. The reform process initiated under former Prime Minister Abe in 2012 ("Abenomics") is now clearly having an effect: companies are paying greater attention to profitability, reducing excess cash holdings, and putting greater emphasis on the interests of shareholders. This progress is largely driven by the ***Corporate Governance Code***, which guides companies to generate better returns for shareholders, ***and*** the ***Stewardship Code***, which obliges institutional investors such as pension funds to actively exercise their shareholder rights and to hold company management more accountable.
It is no longer just the activities of activist investors that are crucial to the great progress, but now also those of the operating company of the Tokyo Stock Exchange (TSE), which has significantly increased the pressure on listed companies to take measures to increase their market values or to justify why this is not possible. In direct response, hundreds of companies published their capital improvement plans in the third and fourth quarters, announcing share buyback programs and increases in dividend payout ratios, among other things. As part of its "naming and shaming"-strategy, the TSE has announced that from spring 2024 it will regularly publish lists of measures taken by those companies that have already taken action, thereby increasing the pressure on those that have not yet disclosed their plans.

Our **holdings in** the **ASPOMA fund** also saw numerous announcements of **dividend** and **payout increases**, significant **share buyback programs** and **share splits**.

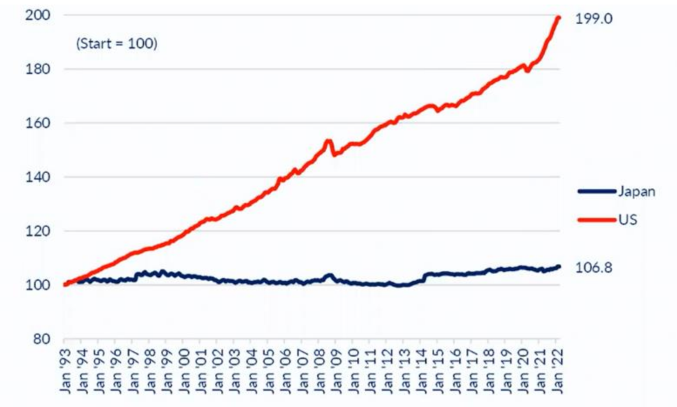
(II) Geopolitical tensions make Japan the "safe haven" in Asia and lead to higher allocations: Japan is benefiting in many respects from the geopolitical tensions between China on the one hand and the USA and Europe on the other. However, developments within China are also leading investors who previously invested primarily in the Chinese equity market as part of their Asia allocation to increasingly look to Japan as an alternative, and in some cases to relocate their regional headquarters there.

Japan offers the following benefits:

- Stable political system: legal security, social stability, political and social consensus on the need to maintain the international competitiveness of the Japanese economy
- Central beneficiary of Asia's economic strength and therefore ideally placed to represent the desired Asia allocation
- Many high-quality companies in growth segments (e.g.: automation, semiconductors, medtech)
- High margin of safety: significant valuation discount; strong balance sheets; largely debt-free, often with significant net financial assets on the balance sheet

(III) Strong international competitiveness: Low price and wage increases due to almost zero inflation over the past two and a half decades (see chart below) and the massive depreciation of the yen have made the Japanese economy particularly competitive internationally.

Low inflation: Since 1993, consumer prices have risen by 99% in the US, but only 6.8% in Japan. The lack of inflation has also kept wage levels low, in contrast to the rest of the world. For software engineers, for example, wages in China are now 50-80% higher than in Japan.



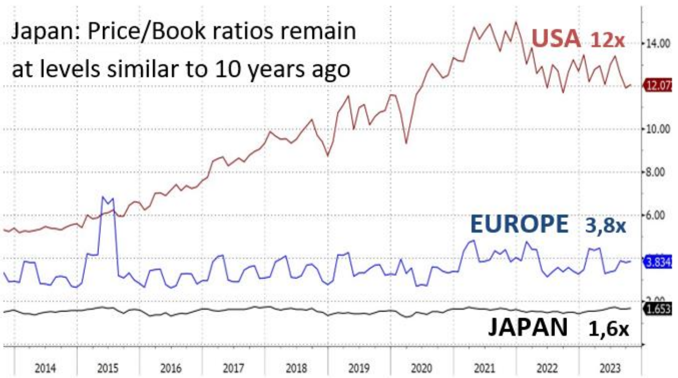
Sources: CLSA, Bloomberg

Strong balance sheets with little or no debt or even high levels of ***net cash are an additional advantage in times of rising interest rates*** and thus higher borrowing costs.

(IV) Rising demand for Japanese equities while supply is shrinking:

1) ***Interest from foreign investors has increased significantly*** In recent months, however, these investors have bought only a fraction of the Japanese equities they had sold in previous years. CLSA calculates that between 2015 and the first quarter of 2023, international investors sold a net USD 250 billion of Japanese equities. Only since March 2023 have they become net buyers again, but since then they have only bought back USD 68 billion, or 27% of their total net sales.
2) Generous ***tax exemptions*** for share purchases, effective from 2024, will significantly stimulate demand from Japanese ***private investors***.
3) At the same time, the supply of shares available in the market is decreasing due to the annual increase in share buybacks by the companies. Moreover, as part of its monetary policy-driven stock purchase program, the Bank of Japan has purchased roughly the same volume of shares that was sold by international investors between 2015 and 2023. As all these shares are no longer available to buyers on the market, a constructive supply/demand situation is emerging.

Price/book ratio (adjusted for intangible assets): While valuations have risen massively in the USA, they remain low in Japan, giving Japanese equities significant upside potential.



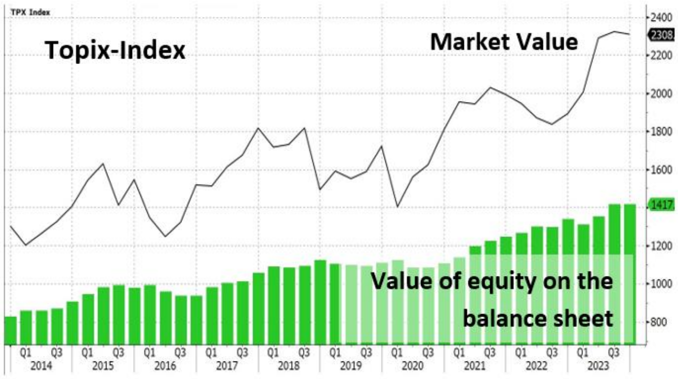
Sources: ASPOMA, Bloomberg

(V) Positive economic and earnings momentum: The Japanese economy is currently in much better shape than the global economy in general. While the global economic development is weakening massively under the burden of high interest rates, the earnings prospects of Japanese companies are improving, benefiting from a strong domestic economy and scope for price pass-through.

The Japanese economy is robust, not least because of strong consumer demand, fueled by the return of foreign tourists (especially from China), for whom Japan has become a very attractive destination, not least because of the depreciation of the yen. Japanese companies are regaining pricing power and are now able to pass on their higher input costs with a one-year lag, allowing them to significantly increase profits.

(VI) Valuations are still incredibly low: Despite the share price increases, the stock market value of half of the Japanese companies are still trading below their book value.

Despite the strong performance of Japanese equities over the past 10 years, they have not become more expensive. Companies have increased their shareholders' equity through retained earnings (in green) to the same extent as their share prices (in black) have risen.



Sources: ASPOMA, Bloomberg

Fund Performance

The **ASPOMA Japan Opportunities Fund** rose by 6.9% in the fourth quarter. For the **full year 2023** the increase was **+33.8%.** Since the implementation of the Hidden Value strategy exactly **five years** ago in 2019, the performance has been **+71.5%** or **+11.4% per annum**. On average, Japanese equities (TOPIX Index) recorded an increase of 2.1.% in the fourth quarter of 2023 and 27.5% in 2023.

In the **fourth quarter**, it was primarily our portfolio companies from the ***technology*** (+22%), ***materials*** (+16%) and ***non-cyclical consumer goods*** (+13%, mainly food) sectors that performed particularly well, averaging over +10%. Portfolio companies from the ***industrial sector***, in which the fund invests around 45% of the portfolio, rose by an average of 5.5%. Only our investments in the ***financial sector*** recorded a ***slight price decline*** of around 1% on average.

At the individual stock level, the following portfolio companies saw major share price movements:

AOI ELECTRONICS, is a manufacturer of electronic components. It develops and produces end products such as microphones and components such as miniature loudspeakers and microphones for smartphones and laptops. Despite an increase in value of **+53%** in the **fourth quarter alone** and **61% for the year,** the price/book value ratio is just 0.65x. The net cash on the balance sheet alone already covers 80% of the current market capitalization. The Onishi family owns around 59% of the shares. A catalyst for a further increase in value could be that the founding family submits a purchase offer to the minority shareholders, in which the takeover price offered would have to be significantly higher than the current share price.

The following portfolio companies also saw strong share price performance: ***FUKUDA DENSHI***, a medical technology company, performed **+36%** in Q4 (+68% in 2023). ***NIHON KAGAKU SANGYO***, which operates in the specialty chemicals sector, achieved a performance of **+28%** and +52% for the year. ***SHIN-ETSU POLYMER*** is a processor of silicone and vinyl resin materials. The company's products include silicone rubber molds, semiconductor components and encapsulants. The increase in value was **+25%** in the fourth quarter and +53% for the year.

Portfolio changes

In Q4 the following investments were added to the portfolio:

TV ASAHI is a mature cash-generative television company with a portfolio of successful businesses focused on current and future opportunities in the media sector. Its market capitalization of 177 billion yen is significantly exceeded by net cash of 77 billion yen and other financial assets of 190 billion yen. TV Asahi currently trades at a price-to-book ratio of 0.4x and is under pressure to significantly improve its valuation. Both the Tokyo Stock Exchange and many investors, including shareholder activists, are constantly increasing the pressure on the company to make its balance sheet more efficient, e.g. through share buybacks, in order to increase its attractiveness for investors.

Other new investments of the fund are ***Mitsubishi Logistics***, ***Subaru Enterprise*** and ***Tsukishima Holding***.

Fund positioning and characteristics

In Japan, there is a group of about 300+ liquid "Hidden Value" stocks with a healthy operating business, where the net financial assets (cash + liquid investments and participations - financial debt) represent 40% to 100% of the market value. From these companies, ASPOMA selects around 50 to 80 stocks for which we consider the probability of an "Unlocking of Value", like a revaluation, to be particularly high.

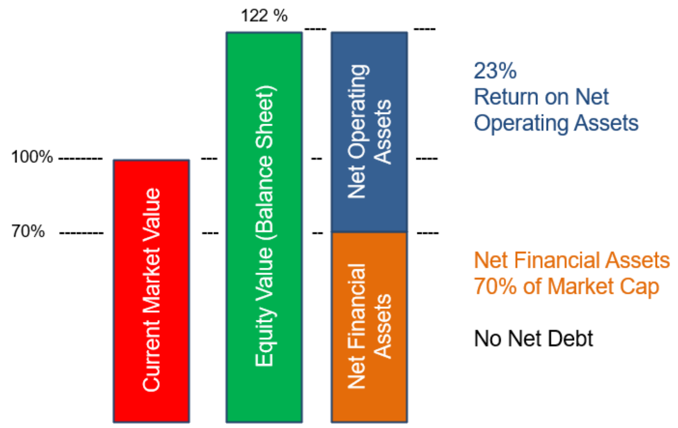
Similar to private equity buyout funds, our **investment strategy** is designed to identify successful and healthy, but highly overcapitalized and undervalued companies that can generate attractive investment returns over a longer period of time through a combination of (i) high operating free cash flows and (ii) a more efficient capital structure. The aim is to participate in both rising dividend payouts and share price increases as a result of higher valuations.

The current "Hidden Value"-portfolio consists of around 60 stocks. The main sectors are industrials, technology, automotive and specialty materials. Together, these sectors account for around 70% of the fund. The expected dividend yield currently stands at 2.6%.

Our portfolio companies (excluding banks and insurance companies)* generate a pre-tax return on their net operating assets of 23% on a pro forma balance sheet basis. At the same time their stock market valuation is more than 20% below the value of their balance sheet equity.

As shown in the following chart, for an illustrative investment of 100 euros, we obtain a balance sheet equity value of 122 euros. 70 of the 100 euros are net financial assets. Liquid assets and liquid investments therefore already cover almost 70% of our investment amount.

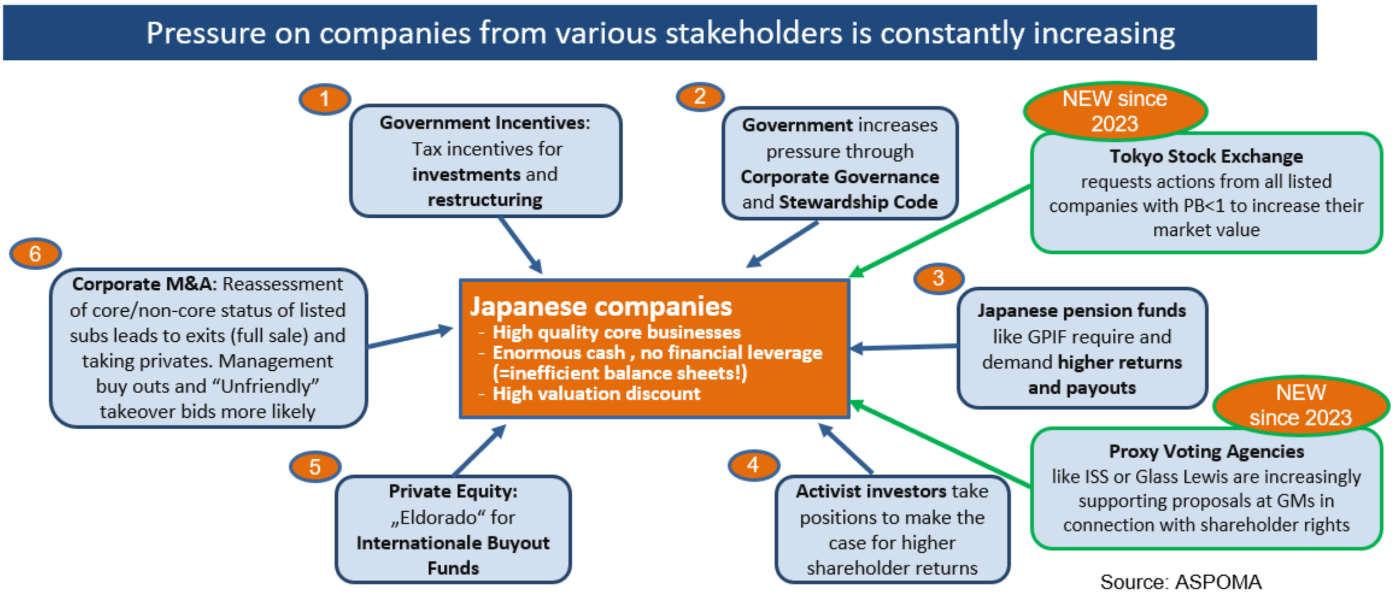
In the case of the portfolio companies in the fund, cash, cash equivalents and financial investments already cover 70% of the stock market value on average*!



Sources: ASPOMA, Bloomberg

How to interpret the chart: If we invest at current market value, we can acquire balance sheet equity worth 122% of our investment amount. 70% of our investment amount is covered by net financial assets. The very profitable and resilient underlying operational businesses (net operating assets) can be acquired at high discounts and sometimes even come "for free".

*adjusted portfolio: 44 out of 59 Holdings



Source: ASPOMA

We also get the 52 euros of net operating assets (factories, machines, etc.), which generate a return of 23%. However, we only have to pay 30 euros for these very profitable operating assets, with a book value of 52 euros, after deducting the net financial assets (100 - 70 = 30). This represents a discount of about 45% on the book values of these operating assets. We are therefore buying the net operating assets at a price-to-book multiple of around 0.55x, even though they generate a pre-tax return of 23%.

Update on corporate governance improvements

Overcapitalized balance sheets and low payout ratios were the result of a lack of shareholder value orientation on the part of companies and have been a major reason for valuation discounts in Japan. The corporate governance reforms introduced around 12 years ago ("Abenomics") have significantly strengthened the rights and instruments of shareholders and investors and are increasingly having a positive impact.

Due to better incentives and increased pressure from various stakeholders, more and more companies are starting to improve their shareholder value orientation, make their balance sheets more efficient (reduce overcapitalization) and increase dividends and share buybacks. All in all, this opens opportunities to achieve significant increases in market value.

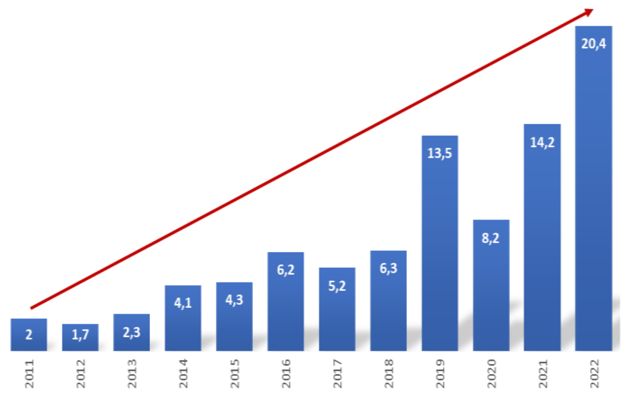
The catalysts for the "Unlocking of Value" are various players (see graphic above): activist investors, private equity investors, the large Japanese pension funds, the Japanese government and, most recently, the Tokyo Stock Exchange - which, unlike in the period before **„Abenomics"**[1], are increasingly successful in ensuring that the immense intrinsic value hidden in the balance sheets of these companies is better reflected in stock market valuations.

The pressure from these players is having an effect: the dividend growth of our portfolio companies has been 10% p.a. over the past 5 years and share buybacks in the TOPIX Index have been rising massively for many years (see chart below).

Japanese companies have massively increased their ***share buybacks*** recently. Share repurchases announced in 2022 reached a new high of over 20 trillion yen (approx. 140 billion euros) and are up 40% year-on-year. A key driver behind years of soaring share buybacks and dividend increases is the excess cash on the balance sheets of many Japanese companies, which continues to grow each year. More than 50% of the companies in the TOPIX Index have balance sheets with at least 20%, and often significantly more, net cash (cash after deducting financial debt) as a percentage of market capitalization.

[1] *Abenomics* is the term used to describe the structural and economic policy measures implemented by former Prime Minister Shinzo Abe when he took office in 2012 to make the Japanese economy more competitive. Key elements are measures to improve corporate governance, balance sheet efficiency and better protect shareholder interests. As has been shown, Abe's successors, Suga and Kishida, are also adhering to these policies and developing them further.

Announced share buybacks in Japan rose sharply to a new record level, which is expected to reach new highs again in 2023.
(in trillion yen)



Source: ASPOMA, CLSA

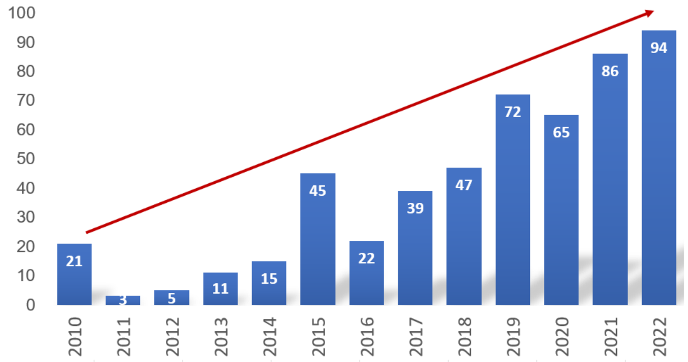
Activist funds are a major driving force behind improvements in corporate governance and stronger enforcement of minority shareholder interests.

The activities of activist investors increased very significantly in the past few years (see following chart) and are a key reason for the rise in share buybacks, dividend increases and corporate restructurings.

Many companies have begun to classify investments (cross shareholdings) and business units as "non-core" and are putting them up for sale, thereby increasing their returns on equity.

Activist initiatives take place primarily in mid cap companies, the segment that is the focus of the ASPOMA Hidden Value Portfolio.

Japan is now the world's second largest market for shareholder activism.



Source: CLSA, Bloomberg

However, the "Unlocking of Value" process has only just begun. It will take several years before the high intrinsic values are fully reflected in share prices.

The ***ASPOMA Japan Opportunities Fund makes*** this ***return potential,*** which has also been targeted by leading private equity firms, ***investable for a broad range of investors.***

ASPOMA – Your optimal partner to benefit from value opportunities in Japan

- **Japan offers attractive investment opportunities for value investors.** The *combination* of *low valuations*, *high levels of* unneeded *cash* and the increasing *pressure to return this cash to shareholders* offers *significant earning potential* with a high *margin of safety*.
- The **greatest opportunities** tend to be in **mid- and small-cap** companies (no/low sell-side analyst coverage).
- **Our investment strategy is specifically designed to take advantage of these value situations.**
- Our **investment team, including analysts in Japan, has decades of experience** in fundamental analysis and management of **Japanese equities**.
- The **ASPOMA Japan Opportunities Fund** is the **optimal investment vehicle** to invest in these specific investment opportunities in Japan:
  - Very clear, transparent, and focused investment strategy
  - The relatively small fund size allows us to focus on the most attractive value opportunities, which are mostly strongest in the mid- and small-cap segment
- The **fund managers** are **invested** with the majority of their liquid assets **in this strategy** and their **interests** are **aligned with** those of **fund investors**.

More information is available online: https://www.aspoma.com/?lang=en.

- The current monthly fund data sheets can be found **here**.
- Our article "Turn of the tide in Japan" in *Private - Das Geldmagazin* is available **here**.
- The *Handelsblatt* Podcast: Interview with ASPOMA on the Japanese stock market you will find **here**.
- Why inflationary developments do not pose a threat to Japan, read **here**.

Are you interested in more detailed information on hidden value stocks in Japan? We look forward to hearing from you!

Contact

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

Liechtensteinische Landesbank AG
Trading Desk Investmentfunds
Städtle 44 I 9490 Vaduz I Liechtenstein
Tel: +423 236-8448 I e-mail: fundsdealing@llb.li

Further information – Disclaimer

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