RISING SUN
MANAGEMENT LTD

Interim report on NAVF for the half year to June 2021

Performance

At 31st December 2020 the net assets of Nippon Active Value Fund plc (the "NAVF") stood at £117.0 million and net asset value per NAVF share stood at 113.58p. By 30th June 2021, these had advanced to £126.90 million and 123.20p respectively. Both these measures have continued to advance since, reaching £131.97 million and 128.12p respectively by 18th August 2021.

Portfolio Composition

As at 1st January 2020, at the beginning of the period under review, NAVF's portfolio was 88% invested in 20 stocks and the decision had been taken to sell two: Katakura Industries being too illiquid to allow the building of a meaningful position and Nittetsu Mining for pursuing a strategy inconsistent with its principal business. In the end, NAVF exited the former but chose to retain a 1% interest in the latter. The latter remains an interesting company, albeit in RSM's view with too great a focus on its domestic urban property portfolio rather than its overseas mining activities. Its share price is up over 42% over the past twelve months, remains volatile and unpredictable, and NAVF's base holding allows it to make proposals to the AGM should it choose to. We continue to follow Nittetsu Mining with interest but most of our focus is elsewhere.

By the end of June NAVF was 95% invested and, as at 18th August 2021, is 97% invested. Due to the natural low liquidity of many smaller Japanese companies and, therefore, the danger of 'free riders' influencing the price against NAVF as the portfolio was assembled, we were at first reluctant to reveal complete details of its makeup. These concerns have lessened now that NAVF is substantially fully invested (save for some necessary liquidity) and we are pleased to share NAVF's top ten holdings below by percentage shareholding in the individual portfolio companies and value invested, in each case as at 18th August 2021 :

Top 10 NAVF companies by percentage

	By % of capitalisation owned	By amount invested
1.	Nihon Denkei	Intage Holdings
2.	Ebara Jitsugyo	Ebara Jitsugyo
3.	Sakai Ovex	Nippon Fine Chemical
4.	Intage Holdings	Sakai Ovex
5.	Chiyoda Integre	Hirano Tecseed
6.	Teikoku Electric	Bunka Shutter
7.	Nippon Fine chemical	Mitsuboshi Belting
8.	Hirano Tecseed	Japan Securities Finance
9.	Ishihara Chemical	Chiyoda Integre
10.	Mitsuboshi Belting	Nihon Denkei

[Our analysts' latest views of several of these key stocks are included at the conclusion of this report – it is gratifying to note they have all outperformed the MSCI Japanese Smaller Companies Index during the period under review].

In July 2021, shortly after the period under review, the RSM Investment Committee made the decision to add a new investment to the portfolio. This restores the number of holdings to twenty. As at 18th August 2021, NAVF's investment in the new investee company remained below the 1% limit which would require a public disclosure to be made under the Japanese Foreign Exchange and Foreign Trade Act.

Activism: its rewards and frustrations

The Investment Adviser's Report included in the NAVF annual report for the year ended 31st December 2020 (the "**December 2020 Annual Report**") referenced the creation of Earle 1927 LLC ("**Earle**"), a Special Purpose Vehicle ("**SPV**") set up to invest in Intage Holdings alongside NAVF pursuant to a concert party agreement signed by both NAVF and Earle. Earle was seeded with approximately US$ 19 million by third-party, largely US, investors, and this had been fully invested by 6th August 2021, giving the concert party a combined position of 3,150,000 shares or 7.79% of the Intage Holdings' share capital. Not only is the concert party's holding in Intage Holdings RSM's biggest 'bet', but Intage Holdings is also the recipient of our most frequent engagement with management. We have now met with them, at the highest level, several times (virtually) and the dialogue is ongoing.

As outlined in the December 2020 Annual Report, the response of the President of Sakai Ovex, Shintaro Matsuki, to our November 2020 management buyout proposal at Yen 2,350 per share, was to launch his own offer for Sakai Ovex in February 2021 at Yen 2,850. When it became obvious that the well-known activist investors, the Murakami family, were buying up stock, Mr Matsuki increased his offer to Yen 3,000. Even at this level, he narrowly failed to reach the two-thirds ownership he sought in order to proceed and his tender failed. However, he and his advisers, Mizuho Securities, engaged with the Murakamis, restructured the deal with their input, and re-launched the tender at Yen 3,810. Although, NAVF will not have an ongoing interest in Sakai Ovex once it has been privatised, an attractive part of the original deal we had negotiated, the Fund will be able to exit its position entirely at roughly double its 'in' price. Consequently, NAVF has tendered its entire holding into the offer. We expect the MBO to be completed by early September, at which point the cash NAVF receives will be redeployed elsewhere in the existing portfolio.

Outlook

It must be fair to say that the performance of NAVF since its inception in February 2020, on the eve of the pandemic, represents proof of concept. Put another way, NAVF and RSM have done 'what it says on the tin' and what we said we would do. Those portfolio companies with which we have initially engaged actively, Nihon Denkei, Sakai Ovex, Ebara Jitsugyo, and Intage Holdings, have all reacted strongly in the market. Some take us more seriously than others. We hope, in the very near future, to demonstrate to the doubters, that ignoring us is not necessarily a wise course and can have profound consequences.

Analysts' short reports (10th August 2021): compiled by RSM's affiliate Dalton KK in Tokyo and based on unaudited information included in the most recent trading updates published by the respective portfolio companies.

Ebara Jitsugyo (YTD up 25.6%, last 1mo down -13.9%)

- Ebara Jitsugyo is a highly seasonal business with most of its revenue and profit achieved in calendar Q1.
- The company is struggling to beat its performance last year. The company had a large order from the government then, and has failed to increase its order intake estimate for FY21, which was left unchanged at down -8% YoY, likely hurting investor sentiment. In addition, the company has already achieved an operating profit of Y3.4bn by 1H 2021, which is equal to the company's fiscal full year 2021 estimate.
- Ebara's capital allocation for the benefit of equity holders was also underwhelming, as the company only looks to buy up to Y1bn of equity (3.6% of shares outstanding), compared to 4.7% purchased in 2020.

Nihon Denkei (YTD up 43.9%, last 1mo up 2.1%)

- Q1 22 revenue up 10.7% YoY to Y17.6bn (no IR presentation for Q1) with a 170bp gross margin improvement YoY.
- The company's FY revenue guidance is unchanged from May 11, 2021 release at Y90bn (up 8.8%) vs Y82.7bn in FY20, but falls short of FY19 revenue of Y93.4bn. Meanwhile, operating profit has returned to the pre-Covid level of Y2.5bn.

- Q1 22 order intake increased 33% YoY to Y23.7bn.
- The company believes demand for its measuring instruments will remain strong, supported by the automotive and [electronic device] industries.

Mitsuboshi Belting (YTD up 10.7%, last 1mo up 5.6%)

- Q1 revenue up 43% YoY with [export demand] (up +47.6% YoY) leading the post COVID recovery.
- Following Q1 numbers, the company is looking to beat fiscal year guidance as auto industry demand remains strong supported by inventory shortages. Margins recovered in both domestic and export markets for the company's belting products.

Nippon Fine Chemical (YTD up 26.9%, last 1mo up 16.7%)

- The company revised upwards the 1H operating profit forecast from Y1.95bn to Y2.25bn (15.4% increase). The original flat-growth guidance was too conservative, as we expected. The company is too conservative to [maintain the/not exceed its] 2H profits forecast, but the valuation remains reasonable at 13x PER, 2.5x EV/EBITDA, and 0.9x PBR.
- It seems that the phospholipid products, called "Lipid", are growing to be the third core product of the company, following cosmetic material and sanitation products. By using the material for drug capsules, the active ingredients inside are delivered to their target site more precisely and better achieve the desired therapeutic effect (so called Drug Delivery System technology). The core client today is Gilead Pharmaceutical who formally adopted Lipid as their DDS and contracted for volume supply. Nippon Fine Chemical spent Y3 billion on capacity expansion and remains confident on ROI of the investments. Some other clients are in the trial stages of Lipid, and NFC expects the second and third mass production in the future.

Chiyoda Integre (YTD up 1.7%, last 1mo down -1.2%)

- Strong Q1 numbers with revenue and operating profit on track to beat company estimates set earlier in the year. Revenue in Q2 was up +44.6% YoY. Fiscal year numbers are likely to exceed company estimates at this rate.
- The company is seeing demand return particularly in its audio visual segment, driven by stay-at-home/work-from-home related demand. Revenue rebounded strongly in South East Asia, up +31% YoY.

Nittetsu Mining announced Q1 earnings on 4th August 2021:

- Overall, the numbers were strong supported by the rally in commodity prices (financials below). The company increased its guidance from May 10th, 2021 to the following:
- Rev 128.4bn → Y139bn (up 8%), driven by rally in copper
- Operating profit Y94bn → Y114bn (up 21%). If commodity prices hold up, one can argue this is conservative as Q1 operating profit was Y4.9bn
- Dividend pay-out Y180 → Y210.
- The company also increased the dividend pay-out ratio to 30% for FY21, from 22%.
- The company used IR presentation slides for their Q1 results for the **first time** (away from their mid-term slides) indicating a greater willingness to engage with investors.
- If a capitalisation rate of 7% is applied to its real estate business, the metals business is effectively included for free (Y1.8bn NOI, 7% cap rate = Y25bn of real estate value). It is likely, the market will likely treat it as a commodity stock.

Paul ffolkes Davis
18th August 2021