RISING SUN MANAGEMENT LTD

NAV performance of the Fund for 2020, 2021, 2022, 2023, Q1 2024 and beyond:

	JPY	Sterling/Yen FX Change	GBP	JPY	FX	GBP
21 February 2020 to 12/31/2020	12.19%	1.39%	13.58%	12.19%	1.39%	13.58%
Year Ending 12/31/2021	34.18%	-12.77%	21.41%	50.54%	-12.64%	37.90%
Year Ending 12/31/2022	3.65%	-1.79%	1.86%	56.04%	-15.58%	40.46%
4th Quarter 09/30/2023-12/31/2023	5.11%	1.53%	6.64%	110.01%	-40.76%	69.25%
2023 Year	36.66%	-16.16%	20.50%	110.01%	-40.76%	69.25%
1st Quarter 12/31/2023-3/31/2024	**12.07%**	**-6.67%**	**5.40%**	**135.36%**	**-56.97%**	**78.39%**
3/31/2024-5/15/2024	**0.97%**	**-2.72%**	**-1.75%**	**137.63%**	**-62.37%**	**75.26%**

Source: Bloomberg

Introduction

The purpose of this report is to provide a quarterly commentary on key events and themes affecting Nippon Active Value Fund plc ("NAVF"), the UK Investment Trust, and Rising Sun Management's ("RSM") first venture into the world of Japanese small and mid-sized companies' activism. I will not dwell on the merits, or lack of them, of individual holdings, except when they become the story generating the alpha in our returns. The driver for success in this fund is not to buy the cheapest or most undervalued stocks (though this cannot hurt!), it is to identify businesses where our hands-on engagement can bring about the greatest change in management practices. We like decent companies, that have too many non- operational assets, whether cash, cross-shareholdings or property, on the balance sheet, solely to allow their "salaryman" managers to sleep well at night. Even if these characteristics reflect poor capital allocation, thus making them worthy of our attention, they also provide comfortable margins of safety, which help us sleep well too, until we can make something happen to unlock value. In addition, we look for open share registers, a lack of third-party brokerage research (especially in English), and demonstrable cheapness of a type likely to attract the attention of the regulators. This last is most important: we never forget that the largest shareholder across all Japanese stock exchanges, owning 12-13% of the markets, is the combination of the Finance Ministry and the state pension fund, in other words Japan Inc. When Prime Minister Shinzo Abe began the corporate governance reform programme in 2014, he did so out of self-interest. Ten years' later, reform has brought about massive change and is still in full swing.

In April 2021, Hiromi Yamaji was appointed head of the JPX (all the Japanese stock exchanges). It would not be an exaggeration to suggest he is a man with a mission. Ex-Nomura, he has clearly stated his goal of improving the capital allocation processes of listed Japanese companies. He has required all those with share prices trading below book value, to present a roadmap as to how they will reach that first hurdle and then go on towards an appropriate premium to book. Amazingly, for such a mature market, when this policy was instituted in the Spring of 2023, over half of all listed companies fell into this category. Our research suggests, Yamaji-san's policy of publishing the list of compliant companies (hence indirectly pointing a finger at those still on the naughty step) has been remarkably successful. We estimate the percentage of listed companies now trading below book value to be around 32%. At RSM, we may be activists, but there can be little doubt that the biggest and most feared activist operating in Japan today is Hiromi Yamaji. He has been a great friend to all investors. The regulators' next move will be to tighten company reporting requirements and to insist results are also published in English. The wind at our back continues to blow!

Performance

NAVF has no natural benchmark. In Q1 2024, the MSCI Japan Index was up 12.02%, the most of any developed market, and the MSCI Japan Smaller Companies Index was up 6.2% both in sterling terms. The Nikkei 225 traded 12.37% higher, while the TSE Topix was 10.5% better. In the same period NAVF's NAV per share moved 12.07% higher in yen terms or 5.40% in sterling and, over the same period its share price improved by 8.5%, trading mostly between a 3-4% discount. While NAVF returns have been reasonable, especially when compared to the smaller companies sector, there can be no denying that this is the first quarter when the fund has underperformed the broad indices. This disappointing state of affairs has continued beyond Q1, though, I am pleased to note, we are catching up., as reflected in the flash estimates for the week ending 17th May 2024 below:

Est NAV WTD **+2.3%** vs TPX **+0.6%** vs NKY **+1.5%**
Est NAV MTD **0.9%** vs TPX **-0.4%** vs NKY **-0.1%**
Est NAV YTD **+13.3%** vs TPX **+15.4%** vs NKY **+14.7%**

The top performers in Q1, making the largest unrealised gains in the fourth quarter, and ranked by their contribution to the returns of the portfolio, were:

Fuji Media	up 20.29%
Bunka Shutter	up 18.84%
Meisei Industrial	up 18.45%
Kyokuto Kaihatsu Kogyo	up 26.78%
Yamaichi Electronics	up 21.38%

In Q1, the poorest performers, contributing the largest unrealised losses, and ranked in order of their portfolio detribution, were:

Nippon Fine Chemical	down 20.90%
Sekisui Jushi	down 8.79%
TSURUHA	down 22.34%
Teikoku Tsushin Kogyo	down 11.75%
Ishihara Chemical	down 4.39%

Since the end of March, Yamaichi Electronics, in particular, has continued its upward momentum and, as at 15th May, is 55.20% to the better for YTD. We have also said goodbye to TSURUHA since the end of the quarter, while both Fuji Media and Sekisui Jushi have lost ground.

The most interesting statistic is, however, the identity of the second worst performing 'counter' over Q1 and the absolute worst overall over the last twelve months: the Japanese Yen, as measured against sterling. Maintaining necessary liquidity has cost us dear – 62.37% in lost performance since we launched NAVF in February 2020!

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Corporate engagement

In the last quarterly commentary, I went into some detail about Bain & Co's take-over of T&K Toka Co Ltd. Following NAVF's proposed TOB last year, the CEO chose to resign, and the Board resolved to take the company private. Bain's tender for the whole company was formally launched on 22nd January 2024 and the squeeze out of minority investors was completed, as anticipated on 30th April.

Most recently, the formal shareholders' agreement between Bain & Co and the 'concert party' consisting of NAVF, Select and Dalton was signed on 14th May 2024.Bain has said settlement of the squeeze out is not expected until the end of July 2024, at which point the mezzanine finance will be drawn down and the concert party will be able to make its re-investment for up to 15% of the private entity.

Additionally, Kazutaka Mizuochi, President of RSM, will be appointed as a director of the private holding company in order to to represent the interests of the concert party on the Board.

The whole transaction is the culmination of our strategy of long-term engagement with portfolio companies and a testament to the value of patience and determination. Our sale into the tender offer for our complete position in T&K Toka netted us around a 40% uplift – we hope to make much more in the second liquidity event when the private company is either sold or re-listed.

RSM hopes that T&K Toka will establish a precedent in the market and in the minds of private equity houses managements. We have always pushed for involvement in the futures of portfolio companies being taken private, we expect to build on this initial success.

On 26th April, a long-term target, Aizawa Securities, where our cousin Dalton has held over 11% for many years and NAVF a little less than 1%, finally acquiesced to our demands by announcing a Yen 20 billion return to shareholders via a special dividend, increased normal dividends and a large buyback. The stock, which had closed on 25th April at Yen 1300 per share, instantly rallied 15%, went to a premium to book value for the first time, and we withdrew our AGM proposals in appreciation. The company had been trying to induce us to sell our shareholding to them at market prices, but we had refused at such a large discount to fair value. Following its dramatic announcement, Aizawa then proposed a Tostnet 3 operation in the market designed to take our wider 'group' out of its complete position. We were happy to oblige and sold everything at Y1750 per share, an almost 150% profit on our average cost. We still believe the company is worth more, but the opportunity to exit such a large overall position in one go, evidence of management's very real desire to rid itself of its most annoying shareholder(s), was too good to miss.

An illustration of why it is a good idea to take advantage of a 'bird in the hand' is offered, yet again, by our old friend Intage Holdings. We were unhappy when the company announced last September its sale of just over 50% to NTT Docomo, as we felt this was a device to allow the continued trappings of a listing, whilst, in reality, selling out to a largely-government owned business with no synergies to offer. We believed, and still do, that this was not in the spirit (and, probably, not within the letter) of the law, as minority investors were clearly being disadvantaged. Still, the tender offer was at Yen 2400 per share, for a stock routinely trading in the Yen 1590s, and by selling into the market, rather than the tender itself, we were able to secure over Yen 2,200 for our entire RSM controlled holding of approximately 14% of the company. The stock closed today, 22nd May 2024, Yen 1394 – I regret saying this, but we told you so!

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Outlook

April saw a marked pull back across markets generally, including Japan's, since when they have mostly recovered, though volumes are low. The portfolio feels becalmed. This is strange as the pace of engagement has not slackened. Indeed, the CIO is in Tokyo as I write. As well as giving the keynote speech at one of the Golden Week conferences, he is making calls on a multitude of portfolio companies, accompanied by the relevant analysts from the Tokyo office, as well as RSM's President.

We continue to wrangle with 'difficult customers', like Fuji Media, and remain certain that, sooner or later, the pressure on companies like this to restructure and address the shortcomings in their capital allocation policies, and, in Fuji Media's case, its very composition, will prove irresistible.

We have also been adding several new names, which I will not mention until the positions are built. We continue to add to existing holdings selectively. In one case, we are approaching ownership of 30% of the company. It is only a small business, but, if the gameplan works, we should make out like the proverbial bandit!

I seem to end most of these reports lamenting the level of the Yen. However, having already done this (in the 'performance' section), it will suffice, perhaps, to point out, with appropriate wonder, that even when the authorities officially end the negative interest rate policy and speak about addressing the weakness of the currency, all it does is plumb new depths! It looks as if we will have to wait for the Fed to actually start cutting US rates before we might see any type of recovery in the Japanese currency. We take little comfort from the fact that we have not been alone amongst international investors in being wrong about the Yen's direction for a very long time.

Paul ffolkes Davis
22nd May 2024