RSM RISING SUN MANAGEMENT LTD

RSM interim report to NAVF Board for H1 2024

NAV performance of the Fund for 2020, 2021, 2022, 2023, Q1 & Q2 2024 and YTD:

	Absolute (ex-inc)[1]			Cumulative (ex-inc)[1]		
Period	JPY %	Sterling/Yen FX change %	GBP %	JPY %	FX %	GBP %
21 February 2020 to 31 December 2020	12.2	1.4	13.6	12.2	1.4	13.6
Year Ended 31 December 2021	34.2	-12.8	21.4	50.5	-12.6	37.9
Year Ended 31 December 2022	3.7	-1.8	1.9	56.0	-15.6	40.5
Year Ended 31 December 2023	36.7	-16.2	20.5	110.0	-40.8	69.3
1st Quarter 31 December 2023 – 31 March 2023	12.1	-6.7	5.4	135.4	-57.0	78.4
2nd Quarter 1 April 2024 – 30 June 2024	6.9	-6.4	0.5	151.7	-72.4	79.3
2024 Year YTD (H1)	19.8	-13.9	5.9	151.7	-72.4	79.3

1. This is measured on an ex-income basis, excluding dividend reinvested.

INTRODUCTION

Broadly, the first half of 2024 has been marked as a period of consolidation in the markets, with Japan taking a breather after 18 months of strong upward momentum and the dawning realisation that its long decades of general investor neglect were finally over. The table above shows the capital return of the fund (that is, without reinvesting dividends) over the calendar years since launch and the first half of 2024. As the Chairman noted in her report, we do not target any index, though we do monitor our returns compared to our peers and the most relevant benchmarks. We are pleased to report that by the end of June our underperformance of the large cap indices earlier in the year had reversed. In the period since the end of June the fund's NAV has outperformed both large and small cap indices.

Not for the first time, the identity of one of the worst performing counters over the first half of the year is the Japanese yen, as measured against sterling. Maintaining necessary liquidity has cost us dear – 11.79% in the period under review and 72.38% in lost performance since we launched NAVF in February 2020! Nevertheless, and whisper it softly, but "the times they are a changing"... see below.

There is nothing in the current macro-economic trends to make RSM's principals believe that the fundamental bull case is damaged. Indeed, in Q2 we have seen hints at a possible US rate reduction, ongoing Japanese inflation, and the continued unwinding of foreign investments in China. Most significantly, in the period post review, Mr Ueda at the Japanese Central Bank has finally acted decisively to raise rates – the yen carry trade is unwinding rapidly and all bets are off!

PERFORMANCE ATTRIBUTION

In the table below, the top 5 names represent the best performers over the period. The bottom five are the top detractors:

Top Contributors to 30 June 2024

	Average Weight %	Total Return %	Contribution to Portfolio Return %
Yamaichi Electronics Co., Ltd.	3.96	52.54	1.78
Ebara Jitsugyo Co., Ltd.	4.70	24.49	1.12
Eiken Chemical Co., Ltd.	5.80	17.15	0.98
ASKA Pharmaceutical Holdings Co., Ltd.	4.48	23.78	0.94
Bunka Shutter Co., Ltd.	6.36	13.02	0.80

RSM RISING SUN MANAGEMENT LTD

Top Detractors to 30 June 2024

	Average Weight %	Total Return %	Contribution to Portfolio Return %
TSURUHA Holdings, Inc.	0.43	-22.34	-0.30
Meiko Trans Co., Ltd.	3.00	-8.93	-0.31
Japanese Yen	7.32	-11.79	-0.99
Sekisui Jushi Corporation	4.23	-18.18	-1.05
Nippon Fine Chemical Co., Ltd.	4.15	-19.63	-1.06

CORPORATE ENGAGEMENT

It is worth reflecting on some of the engagements, both winners and losers, we have had in the first half of the year.

The tender by Bain & Co for **T&K Toka** concluded successfully with the timetable for the re-investment into the new private entity stretching out into August 2024. NAVF will benefit from the opportunity to hold a larger percentage of the new equity for a very modest outlay, thanks to the gearing being employed by private equity's typical structure. As previously reported, Kazutaka Mizuochi, President of Rising Sun Management, will be appointed as a director of the holding company in order to represent the interests of the concert party, including NAVF, on the board.

Yamaichi Electronics has three main businesses – test solutions (52% of revenue, 75% of EBITDA, 35% EBITDA margin), connectors (45% of revenue, 23% of EBITDA, 13% EBITDA margin) and optic-related products (4% of revenue, 2% of EBITDA, 13% EBITDA margin).

The company is highly cyclical and specialised and currently serves only the flash memory sector. Our rationale when we invested was that the company's fundamentals were sound: it is a beneficiary of the market trend to miniaturise chips and of the increased use of graphics and videos through its move into testing Graphics Processing Units (GPUs). In addition, the company has a weak shareholder register and low capex, making it, we felt, a compelling candidate for privatisation.

On 15 May 2024, the company announced a strong earnings forecast, with operating profit more than doubling (up 150% YoY) for the financial year 2024, driven by the recovery of testing equipment for smartphone-related chips. Additional revenue was also expected (not yet reflected in the numbers) from products driven by generative AI data centres. The company increased its Return On Equity target to 10% and proposed an increase in the total payout ratio to 40% (30% dividend + 10% buybacks). As a result, the stock was up on the day of the announcement and over 50% better YTD. With our thanks to management for so positively addressing the company's share price, we decided to realise our profit and focus on the next opportunities.

On 26 April 2024, a long-term target, **Aizawa Securities,** where our 'cousin' Dalton has held over 11% for many years, finally acquiesced to our demands by announcing a ¥20 billion return to shareholders via a special dividend, increased normal dividends and a large buyback. The stock, which had closed on 25 April at ¥1300 per share, instantly rallied 15%, moving 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 an off-exchange transaction designed to take our wider 'group' out of its complete position. We were happy to oblige and sold everything at ¥1750 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.

Bunka Shutter is a company we still really like. Business remains strong, there is too much cash, and management is aware of its obligations under the corporate code. Our colleagues in Tokyo have begun a constructive dialogue with the directors and we will shortly be making an important proposal to the Board.

In Tokyo, the May cherry blossom was in full bloom and the RSM CIO and Tokyo team were busy meeting portfolio companies. One business has been singularly recalcitrant in ignoring our blandishments to improve its capital allocation policies. We had reached the point where we had determined more radical treatment was necessary. Our visit was predicated on our intention to release our latest letter to the management of **Fuji Media Holdings (FMH),** one of our largest positions, urging them to implement an MBO, as the first stage of breaking up the conglomerate into its constituent parts. This is a company with one of the oldest boards in Japan, a country where they know about old boards. One of the senior directors has been in situ for over 41 years!

As a leading broadcaster, and regarding itself as virtually untouchable as it hides behind the Broadcasting Act, it is not just us that is being defied. Mr Yamaji, CEO of JPX (the Japan Exchange Group), has decried that all listed companies must aspire for an ROE in excess of 8% and to trade at greater than 1x book value. FMH has an ROE below 5% and its stock stands around 0.4x price to book ratio. It is the cheapest example in a cheap sector, and it is a disgrace. We have posted our letter, the fourth we have written, to the NAVF website, along with the appendix on the board's constituent ages and tenures in office.

It is only fair to report that, notwithstanding the embarrassment of such a public spat (much reported on in Tokyo), FMH's management continue to ignore us. The company's poorly performing stock price was a big detractor to our performance in the second quarter. Still, we remain optimistic; we may not strike fear into the hearts of the directors, but FMH would be ill-advised to ignore Mr Yamaji. Sooner or later, something has got to give, and we are betting it will be the company!

Every now and then, an opportunity comes along for us to act as Good Samaritans to the market. The Helios Techno trade is an old-fashioned arbitrage – the accumulation of a blocking minority to prevent the 'take-under' of the company at a ridiculously low price by RS Technology. So far, so good.

OUTLOOK AND STOP PRESS

RSM's strategy continues to work. So much so, that Private Equity is now following our every move. Indeed, one prominent domestic firm recently complained to us that we were not aggressive enough! Strong words from an industry that just wants to be seen as a white knight. One additional consequence of the T&K Toka deal is an immediate awareness whenever we sit down with a PE player in Tokyo, foreign or domestic, of those stocks in our portfolio which they are following and believe would be good MBO candidates. This has already made our decisions on where to devote resources both quicker and, we hope, more efficient.

The last word here is normally to write about new lows in the yen costing us lost performance. Time to change the tune. We are reasonably confident that a corner has finally been turned. The nadir of yen weakness against GBP was ¥207.7 on 11 July 2024. On 30 July 2024, with the rate still hovering around ¥200, Governor Ueda announced he was raising the bank rate to 0.25% and halving government bond purchases. The effect has been dramatic, with the yen strengthening to ¥189.1. These are early days, but could this be the start of the great yen revival? It has been a long time coming, and further progress will probably depend on the much-anticipated reductions in the US Prime rate, but we are already beginning to feel the benefits of a little support to our valuation: on 1 August NAVF's AUM exceeded £360 million for the first time.

We have always said that one day, currency appreciation (because of our original decision never to hedge), would make us look clever despite ourselves. If nothing else, it could now provide a different sort of hedge, against stock market volatility. This may well be needed – markets feel like we are in for a bumpy ride!

When asked about the vulnerability of the NAVF portfolio to a stronger yen, we have always responded that the bulk of the portfolio is domestic-facing, with little exposure to export or currency-led industries, so we would expect to be less impacted than portfolios composed of large international businesses. We are about to find out if we were right.

In early August, shortly after the Bank of Japan increased interest rates, US technology stocks were sold off overnight, and the TOPIX and Nikkei 225 indices both posted their sharpest declines in decades. The market subsequently recovered, but it was a timely reminder that markets fall as well as rise. We are not trying to predict or ride market trends, but continue to research opportunities to build stakes in specific companies with underperforming strategies, where we think we have a chance of convincing them to implement policies that will improve returns to all their shareholders. We believe our approach can deliver, even if markets in general are choppy.

PAUL FFOLKES DAVIS
RISING SUN MANAGEMENT LIMITED
16 September 2024