RSM RISING SUN MANAGEMENT LTD

Fourth Quarter 2024 report

	Annualized			Cumulative		
	JPY	Sterling/Yen FX Change	GBP	JPY	FX	GBP
21 February 2020 to 12/31/2020	10.56%	3.02%	13.58%	10.56%	3.02%	13.58%
Year Ending 12/31/2021	35.01%	-12.73%	22.28%	49.26%	-10.38%	38.88%
Year Ending 12/31/2022	5.32%	-1.86%	3.46%	57.20%	-13.52%	43.68%
Year Ending 12/31/2023	39.64%	-16.51%	23.12%	119.51%	-42.60%	76.91%
1st Quarter 12/31/2023-3/31/2024	12.07%	-6.67%	5.40%	146.01%	-59.54%	86.46%
2nd Quarter 04/01/2024-6/30/2024	7.93%	-6.48%	1.44%	165.51%	-76.35%	89.15%
3rd Quarter 07/01/2024-9/30/2024	3.34%	6.22%	9.55%	174.37%	-67.14%	107.22%
4th Quarter 10/01/2024-12/31/2024	1.02%	-2.67%	-1.64%	177.17%	-73.36%	103.82%
2024 Year	26.27%	-11.06%	15.21%	177.17%	-73.36%	103.82%
CAGR* Since Inception 02/21/2020-12/31/2024	23.04%	-7.46%	15.58%	177.17%	-73.36%	103.82%

**Compound Annual Growth Rate*

Performance numbers provided assume dividends are reinvested.

Introduction

This report will provide fourth quarter commentary on key events and themes affecting Nippon Active Value Fund plc ("NAVF"), the UK Investment Trust. I will address individual holdings, to reflect where they have generated the alpha in our returns or the lack of it. The driver for success in this fund is not to buy the cheapest or most undervalued stocks (though it helps), 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. Even if these characteristics reflect poor capital allocation, thus making them worthy of our attention, they also provide comfortable margins of safety, which protect the portfolio 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 under-valuation 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, still owning 12-13% of the markets, is the combination of the Bank of Japan 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.

Eleven years' later, reform is still gathering momentum and is starting to take on a philosophical dimension that goes beyond guidelines to improve capital allocation. Recent pronouncements focus not only on encouraging small companies to trade at or above book value, but on whether they should exist as listed companies at all. This makes sense; the US economy is six times larger than Japan's, and yet the JPX has more listed companies than any other exchange in the world. Nobody doubts that mass consolidation and de-listing is desirable, even necessary, but individual companies continue to cling on for all their worth – this is becoming the chief driver of regulatory guidance. Simply put, the JPX and METI want fewer and larger listed companies. The latest legislation will regard another investor friendly measure: to ensure all companies considering an MBO appoint a credible independent panel to ensure assets are not disposed of too cheaply to insiders, as has been the case in the past. The winds supporting our investment methodology continue to blow.

Performance

The fourth quarter in Japanese markets was marked, as it was for most non-US indices, by a continued uncertainty brought about by the US presidential election. Just what would Trump 2.0 mean for Japanese trade and security? The equity market was unsure, and the major indices marked time and traded lower as a result. Happily, NAVF was little affected, losing 1.67% net of all fees, outperforming both the MSCI Japan and MSCI Japan Small Cap indices (see above).

In terms of the share price, this improved 1.49% over the quarter, roughly halving the discount to around 3%. At this point, I normally look at the currency effect of the weak yen and how it has cost us performance. This continues to be true: 103.8% gains in sterling NAV since inception, would have been 177.2% in Yen, however, it is worth noting that the currency underperformance has narrowed to 26.5%, now that a more normalised interest rate cycle is being established by the BoJ. We welcomed this trend in the summer, and with the half-point rise in rates in January 2025, it seems to be becoming established.

Attribution

During the fourth quarter, the top five contributors to the portfolio, making the largest gains both realised and unrealised, were as follows:

Ticker		Port. Average Weight	Port. Total Return	Port. Contrib. To Return
	Total	**100.00**	**-1.59**	**-1.59**
7292	Murakami Corporation	4.98	22.13	1.13
1976	Meisei Industrial Co., Ltd.	5.54	17.39	0.87
5930	Bunka Shutter Co., Ltd.	6.48	4.77	0.32
6145	Nittoku Co., Ltd.	0.50	24.38	0.15
6517	Denyo Co., Ltd.	0.97	12.79	0.14

During the same period, the principal detractors were as follows (the poorest performer is at the bottom of the list):

4886	ASKA Pharmaceutical Holdings Co., Ltd.	5.38	-7.99	-0.43
9058	TRANCOM Co., Ltd.	2.99	-6.46	-0.45
4212	Sekisui Jushi Corporation	4.66	-10.61	-0.53
4549	Eiken Chemical Co., Ltd.	9.62	-10.26	-1.07
3302	Teikoku Sen-I Co., Ltd.	4.51	-23.62	-1.26

On November 12th **Murakami Corporation** reported Q2 2024 numbers, which came in flat year on year ("YoY"). The earnings forecast remained unchanged. Nevertheless, earnings held up well, reflecting the company's strong relationship with Toyota. By contrast, suppliers to Nissan suffered as their client suffered with poor sales. The increasingly large gap between Toyota and its competition has now been evidenced by the merger talks announced between Nissan and Honda. Murakami has backed the right horse.

Q2 numbers

1. **Revenue** – flat YoY at Y27.6bn, with North America growth slowing to +18% YoY, after reporting +43% YoY in the previous quarter thanks to unit growth and the weaker JPY. Almost half of the company's revenue is in JPY, which contracted due to the Daihatsu inspection issue. Asia slowed from weaker sales in China.
2. **Gross Profit margin** – 15.7%, down 20bps YoY
3. **EBITDA** – Y3.2bn, unchanged from the same time last year
4. **Cash on B/S** – Y44.7bn, up from Y43.3bn FY24/3 end

FY25/3 Forecast: unchanged

1. **Revenue**: Y111bn (up +6.5% YoY)
2. **Operating profit**: Y8.4bn (vs Y8.3bn FY24/3)
3. **Dividend per share**: Y180 per share
4. **Earnings per share**: Y500 per share

Valuation: EV/EBITDA of 1.2x, 0.67x PBR, and FCF of Y6bn (vs. Y7bn of EV and Y52bn of market cap). FCF yield to EV is 40%. Murakami still screams cheap.

Meisei Industrial reported Q2 numbers on 8th November 2024, which were stronger than expected. With the increase in orders, the company also increased its revenue and operating profit forecast.

Valuation remains attractive. The company trades at 3.6x EV/EBITDA and FCF to EV of 13% (Y4bn of FCF vs Y30bn EV). ROIC remains at 20%.

Q2 numbers (quarterly)

1. **Revenue** - up 19% YoY to Y16.8bn, driven by larger scale projects and maintenance demand. Earnings comments also mention offshore revenue. Need to check
2. **Gross profit margin** –21.2%, down 40bps
3. **Operating profit** – Y2.4bn, up from Y1.9bn same time last year
4. **Cash on B/S** – Y30.3bn, down from Y31.7bn in FY24/3

FY25/3 Forecast: UP!

1. **Revenue**: Y58bn to Y63bn (-3.9% YoY à +8.6% YoY)
2. **Operating profit**: Y7.2bn to Y7.8bn
3. **Dividend:** Y41 per share to Y47 per share
4. **EPS:** Y106 per share to Y122 per share

In the 2Q results released in November, **Bunka Shutter's** sales increased by 3.7% and operating income declined by 9.8% YoY. A breakdown shows that the decline in profit was not due to their shutter-related business, but rather to the decline in profit from building material-related products such as doors and partitions, as well as the impact of the refurbishment business falling into the red. In the core business of shutter-related products, sales increased by 5% YoY and operating income increased by 13%, continuing to be strong as we have also seen in their competitor Sanwa's domestic business. As with Sanwa, with redevelopment projects and large property construction planned, there are high expectations for growth in the market for shutters and doors in 2025 and beyond. Furthermore, operating income in the service business of maintenance, a highly profitable sector, increased by 9.2% YoY and remains solid.

The shutter-related business is performing well, but the low profitability and growth rate of the building materials and refurbishment businesses are dragging it down. We are dissatisfied with the slow pace of the current management's business portfolio review. We doubt that Bunka Shutter should continue to run its refurbishment business as it is. More needs to be done to strengthen the business portfolio and the company has already announced measures to address this.

With 4.7x EV/EBITDA, 1.2x PBR, and 11.6x PER, Bunka Shutter's valuation continues to be cheap. Also, Net cash represents about 25% of market capitalization.

We remain bullish on the business, but believe it is in urgent need of fundamental restructuring. To this end we are in active communication with the Chairman and CEO.

Nittoku Co., Ltd is a relatively recent addition to the portfolio – we started buying in September. The company holds a 30% global market share in manufacturing machinery that produces coils used mainly in autos. Its coils can be used in motors, cables, speakers, integrated circuit ("IC") cards, inductors, batteries, and censors. 45% of the company's business comes from its mobility segment, which consists of EVs and the traditional electrification of autos. In 2017 and 2018, China contributed half of its revenue. However, in March 2024, the company announced it successfully transitioned its business away from China to US, Europe, Asia, while also growing its domestic business.

In addition, the company has a 35-40%% EBITDA margin Radio-frequency identification (RFID) business, which has seen consistent growth (although only Y1bn EBITDA, out of Y3bn total). RFID is used for asset tracking (retail), as an alternative to barcodes. Since the company operates a solution-based approach, it has experienced some delays in product development, causing a downgrade in its revenue and operating profit forecast. Nevertheless, over the long term, considering its market share and solution-based approach, our analysts think that the business will be defendable.

Margin of Safety

Since it's a solution-based business, it is not very capital intensive, leading to decent cash flow conversion. We think the share price offers an attractive margin of safety, considering it trades in the lower band of EV/EBITDA, historically, in the range of 3-8x EV/EBITDA.

Teikoku Sen-I Co., Ltd was a star performer of the previous quarter. Ironically, it reached its year high on September 30th. Disappointingly, the share price has used the last quarter to trade back to levels last seen 12 months ago. However, we still like the stock and the company.

On November 14th it reported better revenue, up 24.7% YoY. The company's Q3 tends to be a trough quarter, with relatively negligible numbers as it makes most of its P&L at fiscal and March year-ends. The company left the fiscal year forecast unchanged but already sits on an operating profit of Y3.4bn at the end of Q3 versus a forecast of Y3.5bn for the full year. We are expecting another Y0.5bn by Q4 2024.

Q3 numbers

Revenue +24.7% YoY to Y4.2bn, driven by airport-related security and firefighting equipment
Gross Profit margin – 29.5%, up 380bps
EBITDA – flat, up from negative Y0.3bn at the same time last year
Cash on B/S – Y13.6bn vs Y13bn in FY23/12
FY24/12 Forecast: unchanged

Revenue: Y34bn (up 21% from FY23/12)
Operating profit: Y3.5bn (up from Y2.6bn FY23/12).
Dividend per share: Y50 per share (unchanged)
Earnings per share: Y122 per share

Valuation: EV/EBITDA of 5.3x**,** market cap of Y68bn, and EV of Y21bn (Y4.1bn of EBITDA). Additionally, the company sits on Y10bn of real estate, which lowers EV/EBITDA valuation by 2x turns (EV of Y10bn). PBR of 1.0x. It is still attractive.

Aska Pharmaceutical Holdings Co., Ltd is another company whose share price, despite recovering well from the August 5th flash-crash, has since languished. It has now given up most of its gains for last year – another disappointment given the quality of the underlying business. We have had much dialogue with management and continue to urge them to accelerate the sale of their excessive cross shareholdings (still over Y10bn) and to up their allocations of Restricted Stock to the directors. The remarkable Japanese lack of personal greed continues to be a defining feature of most salaryman managements – a strange, in some ways admirable, antidote to Western behaviours but not helpful in aligning their interests with those of external shareholders!

Valuation: While we admire Aska's recent growth in both revenues and profitability, we still feel that with 4.9x EV/EBITDA, ROE of around 7 and the stock still trading at less than one times book value ("1xPBR") - despite the TSE's very stern admonition - the company's valuation continues to be far too low. We will accelerate our engagement with the company in the new year.

Sekisui Jushi reported largely in-line #s for Q1 24. Revenue and EBITDA grew 13% and 6% respectively, from its recent acquisition of Germany subsidiary, WEMAS Group. As announced in May, the company aims for 40% dividend payout ratio and 100% total payout ratio (including share repurchases). 100% payout ratio means 6.8% total yield (dividend + buybacks) at current share price of Y2,330.Cash flow remains strong. The company needs to continue with balance sheet management to improve ROE.

Valuation: 4.0x EV/EBITDA at market cap of Y75bn (Y2,333 per share). PRB at 0.75x.

Q1 numbers

1. **Revenue** – up 13% YoY at Y15.5bn, driven by WEMAS acquisition.
2. **Gross Profit margin** – 31.2%, up 110bps YoY
3. **EBITDA** – Y1.5bn, unchanged from same time last year
4. **Cash on B/S** – Y12.8bn, down from Y15bn FY24/3 end
5. **FY25/3 Forecast:** unchanged
    1. **Revenue**: Y75.0bn (up +20% YoY)
    2. **Operating profit**: Y6.5bn (D&A Y3.2bn), EBITDA Y9.7bn
    3. **Dividend per share**: Y70 per share
    4. **Earnings per share**: Y152 per share

M&A in Europe weighed against the stock throughout 2024. This is a, thankfully, rare example of a company that we believed was cheap, that has got cheaper still. We continue to have faith.

Denyo, happily, is the reverse - it has traded consistently stronger since we first invested in October 2023.

Outlook

There is a great deal going on. We have stepped up our engagement with several of our largest holdings and continue to urge capital allocation improvements, even to the extent of calling for MBOs or threatening our own tender offers for large minorities, with key targets.

In addition, starting in January 2025, we are engaged in a very public intervention into the scandal enveloping **Fuji Media Holdings** ("FMH"). We have documented the company's egregious failures of corporate governance in a series of letters (available on NAVF's website), which have stoked the furore conjured up by the press. FMH and the inadequacies of its Board structure and composition have caught the public

imagination in Japan – it is hard to see this blowing over without something fundamental happening. Having failed for so long to get management's attention, we have certainly got it now!