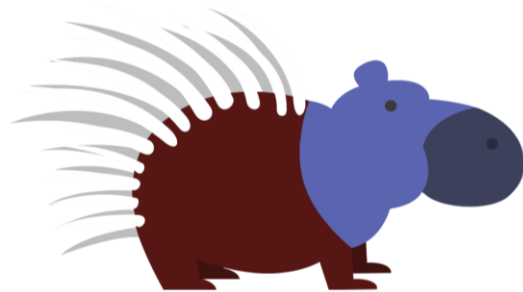




PRESENTATION

Japanese Orphan Companies SDG

a NJ project





The first humiliation and the birth of the modern Japan

- For centuries **the country was isolated** and feudal. The nation's Spartan culture was shaped by **discipline and a sense of obedience that characterizes soldiers.**
- In fact, until not so long ago, 1868, Japan was a geographically fragmented feudal society** governed regionally by a shogun, and the shogun's feudal lords, the Daimyos, the iron-fisted generals. The emperor was a powerless figure manipulated by the Shogun. The Samurai constituted the elite troops of each fiefdom.
- When it came in contact with the Western powers (1853) it was divided and technologically unprepared and **was humiliated.** Hence, the country found the courage to change its political system, restoring the power of the emperor and westernising the country (1868 Meiji Restoration era). **The modern Japan was born.**
- The discipline and the sense of obedience helped the country to quickly catch up technologically and economically. **The following 50 years saw the country becoming one of the leading powers in Asia,** able to confront other imperial ambitions. It successfully fought against China, and Russia.
- The actual division of Japan in Regions and Prefectures goes back to the 8th century. This created a **strong regional identity in the country.**

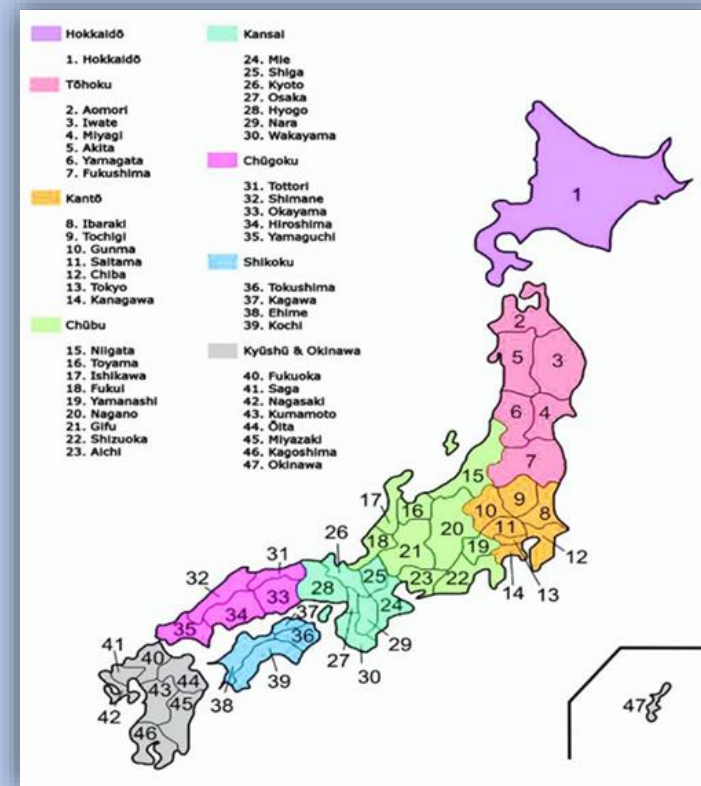


PORTRAIT OF A SAMURAI COMMANDER, 1870

The economic development during the Meiji Era was amazing

Railtracks miles		Steamboats fleet		Coal Production (tons)	
1870	15	1872	22	1872	0.4
1882	220	1894	169	1885	1.2
1887	670	1900	690	1894	5
1895	2200	1911	1420	1905	12
1904	4700			1911	22
1911	6900				

The modern regions and the prefectures division of Japan exists unchanged since the VIII century DC





The second humiliation: WWII

- In **1926** started the **Showa era**, characterized by the malaise that was grinding the whole world, following the First World War. As usual, stagnation brings **nationalism**, and this was no exception.
- In 1937 Japan attacks China, followed by Thailand, French Indochina, English Singapore, Malaya and Hong Kong and the Philippines. **In 1941 Japan attacks the US base of Pearl Harbour, declaring war to the United States.**
- **Japan entered the Second World War as a powerful imperial nation. Japan surrendered** in 1945 having paid a huge price in significant destruction and depletion of its former prosperous resources.
- The country was then **occupied by the US forces for almost 10 years.**



In red the part of Asia conquered by Japan from 1880 to 1941

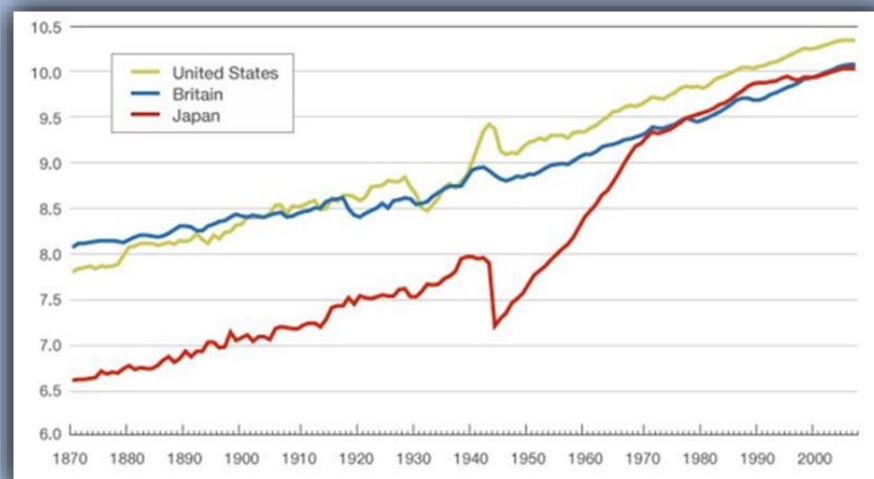




Post-war period: the economic miracle

- Once again, as it was the case in 1868, **the humiliation gave the country the stimulus** to spring back.
- **Japan's GDP increased dramatically between 1950 to 1970**, recording an annual growth close to 10%, and catching up with the countries that prevailed in the war.
- **Japanese industrial manufacturing** shifted during the 1950s from light to heavy industries and to high-productivity high-technology production that **in the 60s and 70s will be exported all around the world.**

JAPAN GDP GROWTH VS US AND BRITAIN



Source: The Maddison-Project

TOKYO 1964 "SKIYABASHI CROSSING"



Source: Japan Press Research Institute

The Plaza Accord (1985): the sacrifice of the Yen

- **After World War II** and according to the 1944's Bretton Woods Agreement, **the Americans fixed the US\$/JPY exchange rate at 1 to 360.**
- Until the beginning of the 1970s this exchange rate remained fixed, and **it was abandoned in 1972** with the dismantling of Bretton Wood Agreement. **This led to a massive appreciation of the Yen** and to a loss of competitiveness of the country.
- However, the country managed to grow further thanks to the **domestic consumption and financial services**, boosted by a strong equity and real estate market
- **The Plaza Accord** was a foreign exchange rate policy intervention by the G5 (group of five largest industrialised countries, US, UK, Japan, Germany and France) **that took place in 1985 to realign their exchange rates** and to reduce global trade imbalances, particularly between the US towards Japan and Germany. This was part of a strategy to stimulate the US economy.
- **Following the Plaza Accord, the Yen appreciated by about 40%** in a couple of years

PLAZA HOTEL - NY



JPY/US\$ EXCHANGE RATE, 1970-2022

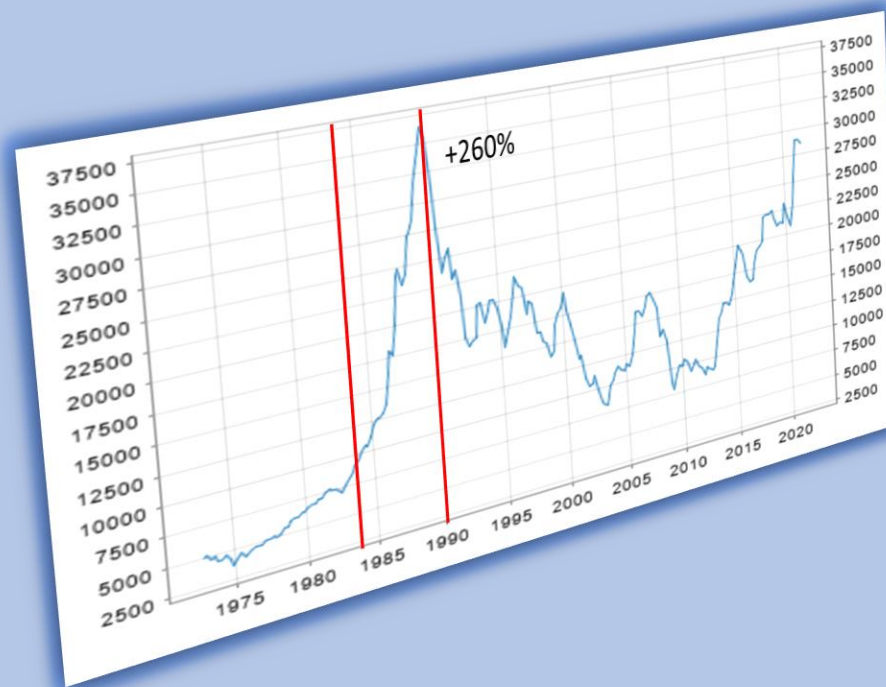




Speculation: the great Japanese bubble

- **The strengthening of the Yen** following the Plaza Accord further **dented Japanese exports**
- In order to prop up the economy the **BoJ kept interest rates low, and the government increased public spending**
- This led to the creation of a memorable real estate and equity bubble: **from the Plaza Accord, 1985, to 1990, the peak, the Nikkei surged by 260% and the Topix by 240% (449% in USD). From 1975 to 1990, the Topix surged 1005% (more than double that in USD).** This laid the basis for one of the longest bear market in the history of financial markets

NIKKEI INDEX
PERFORMANCE
DURING THE BUBBLE
PERIOD





The first Lost Decade (January 1990- March 2001)

- The first lost decade starts from the burst of the bubble to the election of Junichiro Koizumi
- During the first decade there was a delusional posture of the authorities that tried to kick the can down the road instead of tacking the problems at its roots. This created a mountain of public debt, favoring the keiretsu that speculated during the bubble and the banking system and penalizing the general public. This behaviour impaired the economy and introduced a deflationary mindset in the population that represents still a problem today
- The first Lost Decade is divided in the first and the second adjustment. As it can be seen below, during the first Lost Decade the equity market lost over 56% of value

TOPIX INDEX DURING THE FIRST LOST DECADE



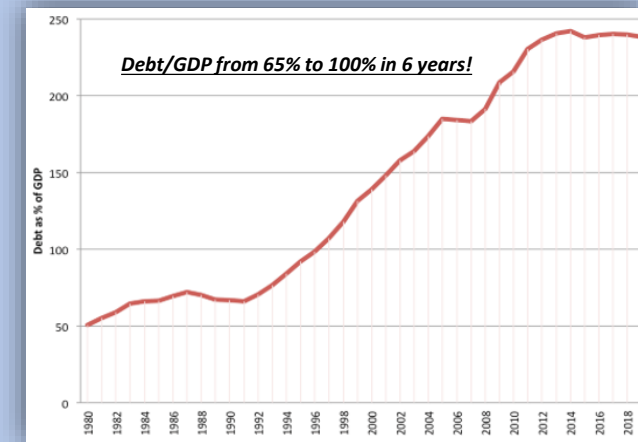
Source: Bloomberg



The first adjustment (1990-1996)

- From January 1990 to September 1992 the Topix index fell by over 60%.
- From 1991 to 1996 the BoJ brought interest rates down from 6% to a record low of 0.5%.
- From 1990 to 1996 the government unleashed a powerful fiscal stimulus, taking the debt to GDP from 65% to 100%.
- The powerful monetary and fiscal expansion helped the country to stabilize and in 1995 the country was back to growth, and the equity market started a powerful rebound.
- However, this did not last for long. The political elite was failing to understand the depth of the problem.

JAPANESE DEBT/GDP 1980-2020



JAPANESE NOMINAL INTEREST RATES 1970-2021



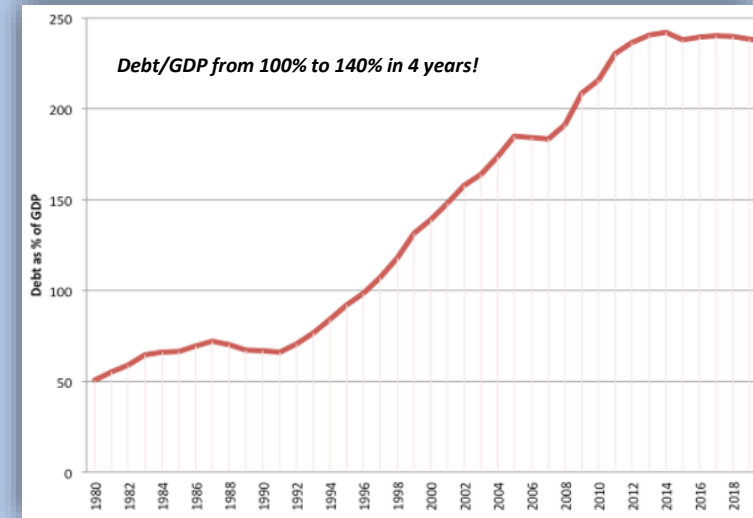
Source: [Tradingeconomics.com](https://tradingeconomics.com) – Bank of Japan



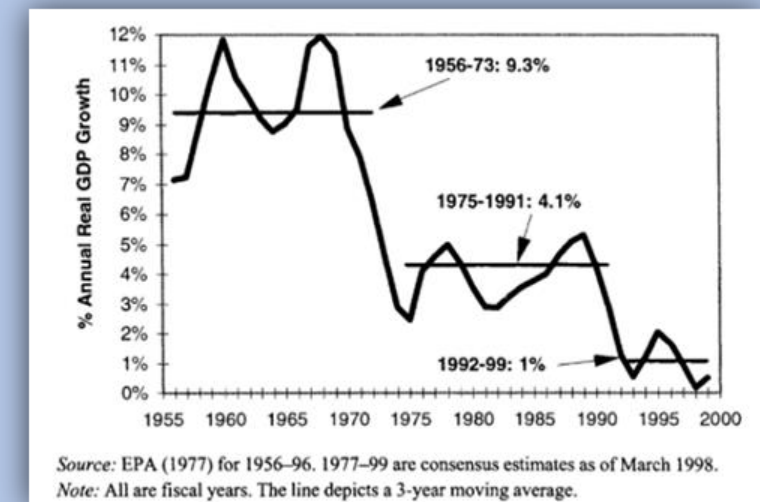
The second adjustment and the start of the banking system crisis (1996-2001)

- The government continued to pump money into the system and the BoJ introduced the first ZIRP ever (zero interest rate policy)
- From 1996 to 2000 the public debt surged from 100% to 140%
- Again, the powerful fiscal reaction helped in 1999 the economy to return to growth and the market to rebound
- This was again short-lived. Despite the huge fiscal stimulus, the system was saturated with bad assets and the financial system had stopped working

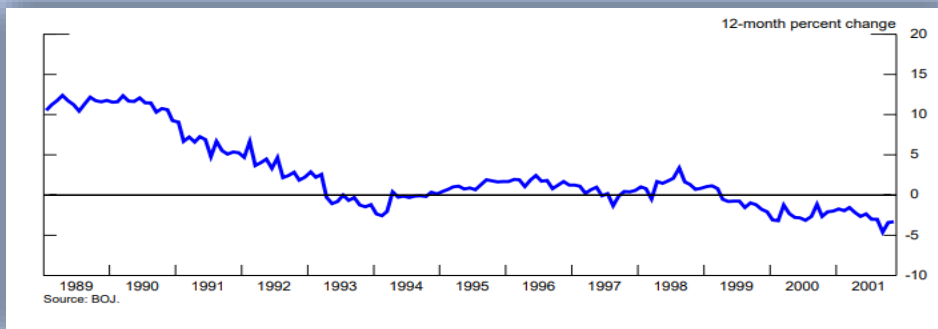
JAPANESE DEBT/GDP 1980-2020 - IMF



JAPAN ANNUAL REAL GDP GROWTH



JAPANESE BANK CREDIT

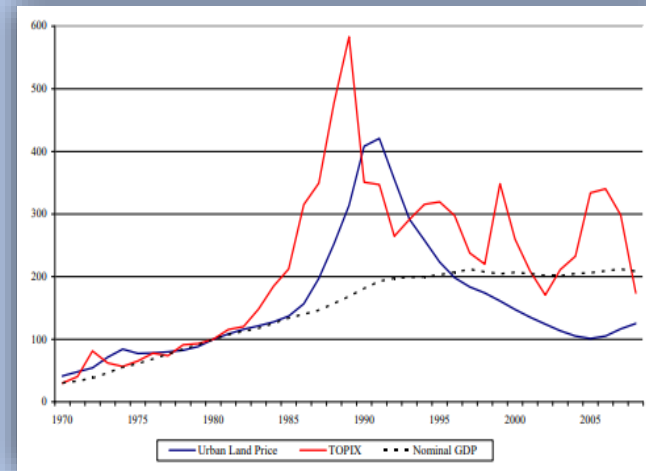




The crisis of the banking system (March 1991- March 2005)

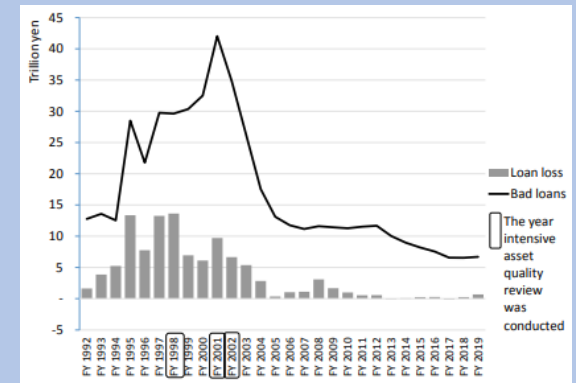
- Stock and land prices peaked in December 1989 and March 1991, respectively. Since then, banks started to feel the brunt of the crisis, but they continued to fail to acknowledge the losses in their loan portfolios
- The wake-up call came in November 1997, when the liquidity crisis hit a number of financial institutions (*Sanyo Securities, Yamaichi Securities e Hokkaido Takushoku Bank*) requiring a quick intervention from the government and the BoJ
- To stop a bank-run the government intervened, liquidating the ailing banks and protecting the depositors
- Significant controls over the banking system loans were set up and this led to a painful reckoning and the collapse of the private sector debt
- In March 2005, the NPL of the major banks was below 2.9% and the government announced that the crisis was over. During the crisis 181 banks were wound down and 88 trillions JPY of lending wiped out (about 20% of GDP)

TOPIX INDEX (RED) VS NOMINAL GDP AND URBAN LAND PRICE



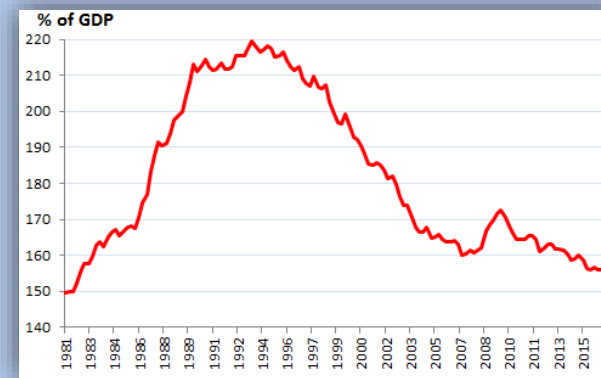
Source: Tokyo Stock Exchange, Real Estate Institute, ESRI, Cabinet Office, Government of Japan

BAD LOANS HELD BY BANKS AND LOAN LOSSES INCURRED



Source: Financial Services Agency, Disclosures according to the Financial Revitalization Act

JAPANESE PRIVATE SECTOR DEBT AS A % OF GDP



Source: BIS, St. Louis Fed





The second Lost Decade (04/01/2001 - 06/04/2012)

- From March 2001 to September 2006 Junichiro Koizumi was PM. He **1) oversaw the end of the banking crisis 2) introduced some initial structural reforms against the will of its party (LDP) 3) Politically tried to give Japan back its dignity and ambition**. He arrived when the worst of the first decade was gone but laid the first basis for the future recovery
- In 2008, when things were again looking up, the Great Financial Crisis (GFC) arrived and hit the country hard
- In 2011, when the country was getting back on its feet from the GFC, the country was stormed by the Fukushima disaster
- During the second lost decade the public debt moved from 140% to 240% of GDP and **the equity market (TOPIX) lost more than 47% (here below)**



London: Lehman Brothers failed on September 15, 2008 (Ansa)

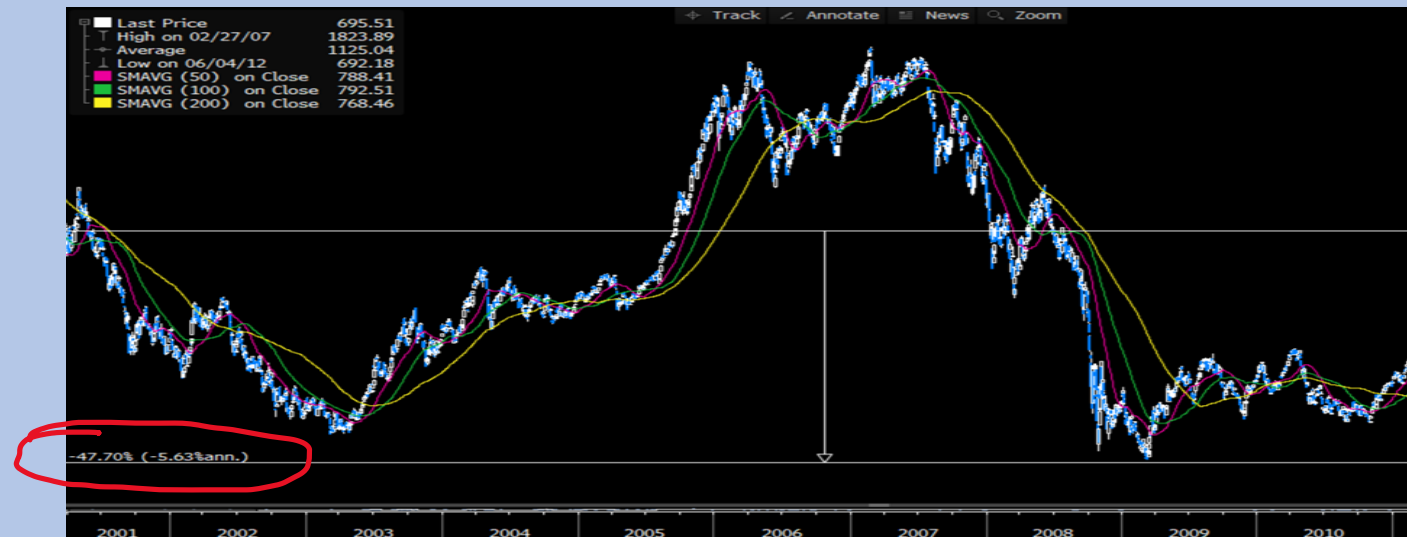


Junichiro Koizumi
Source: Japan times



Extinguishing the fires at the Fukushima power plant

TOPIX INDEX DURING THE SECOND LOST DECADE



Source: Bloomberg



The nadir of the Japanese market, 06.04.2012

- On June the 4th 2012 the Japanese equity market (TOPIX) reached its lowest level in 28 years, pushed down by the yen that touched the level of 78 vs the USD

TOPIX INDEX FROM 1975 TO 2022



Source: Bloomberg

2ND LEAD: Japan stocks plunge, Topix lowest in more than 28 years

Tokyo (DPA) -- Japan shares fell sharply Monday on growing concerns about the global economy following an anaemic US job growth report.

The benchmark Nikkei 225 Stock Average lost 144.62 points, or 1.71 per cent, to end at 8,295.63 after hitting briefly this year's low in the morning.

The broader-based Topix was down 1.89 per cent, hitting its lowest level in more than 28 years.

Exporters fell as the yen rose, standing at the lower-78-yen level to the dollar. A stronger yen makes Japanese goods more expensive overseas and erodes repatriated revenues.

Shares in Canon Inc plummeted 5.15 per cent, Honda Motor Co lost 3.7 per cent, Toyota declined 3.52 per cent and construction machinery maker Komatsu Ltd was down 2.5 per cent.

The Dow Jones Industrial Average fell 2.2 per cent Friday after a report showed lower-than-expected job creation in the United States in May, with unemployment rising to 8.2 per cent.

The US employment report followed a poor showing of China's factory data amid lingering concerns about the eurozone debt crisis.

In Tokyo, on currency markets at 3 pm (0600 GMT), the dollar traded at 78.17-18 yen, down from Friday's 5 pm quote of 78.49-51 yen.

The euro traded at 1.2417-2418 dollars, up from 1.2348-2350 dollars late Friday, and at 97.06-08 yen, up from 96.92-96 yen.

-0- Jun/04/2012 06:34 GMT

Comment by Bloommy on the lowest trading day of the Japanese bear market

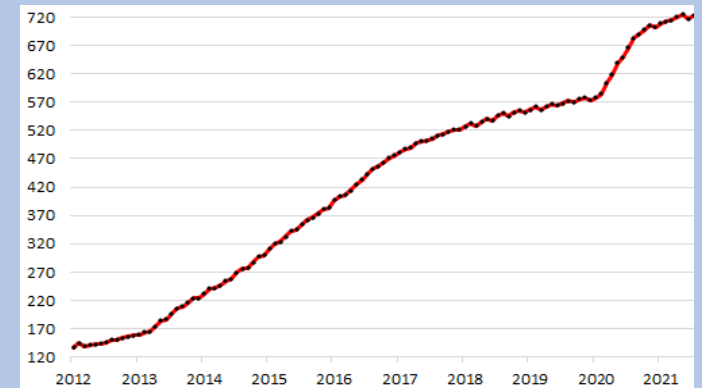
- The Japanese equity market (TOPIX) pulled back by 76% from January the 1st 1990 to June the 4th 2012, after multiplying by 11 times from 1975 to 1990. The Nikkei touched its minimum in March the 10th 2009, during the GFC, at -82% below the 1990 peak.



ABENOMICS (2012-today)

- On 26 December 2012 Shinzo Abe was elected prime minister
- His goal was economic revival and escaping deflation
- His economic strategy, referred as *Abenomics*, consisted in the so-called 3 arrows: 1) monetary expansion; 2) economic stimulus; 3) structural reforms to stimulate private investments
- Abenomics was undoubtedly a success although it also attracted critics. The goal of exiting the deflation and the returning to growth was not completely achieved. He set an (too) ambitious goal in order to infuse the necessary positivity to move the needle. Thanks to his policies things improved and now Japan is on the right direction
- Shinzo Abe was sadly killed in July 2022, but his policies are continuing under Fumio Kishida and are starting to take Japan out of its crisis

BANK OF JAPAN TOTAL ASSETS UNDER ABENOMICS (Y TRILLION, MONTHLY)



Source: Bank of Japan



Japan
Silver
linings



First Japan Silver linings:

YEN and public debt monetization

- 45% public debt is owned by BoJ and not sterilized
- This means a debt monetization is underway in Japan
- As a consequence, the quantity of JPY around has increased well in excess of the GDP growth, creating the basis for a massive devaluation of the currency
- This will lead to an explosion to Japan competitiveness

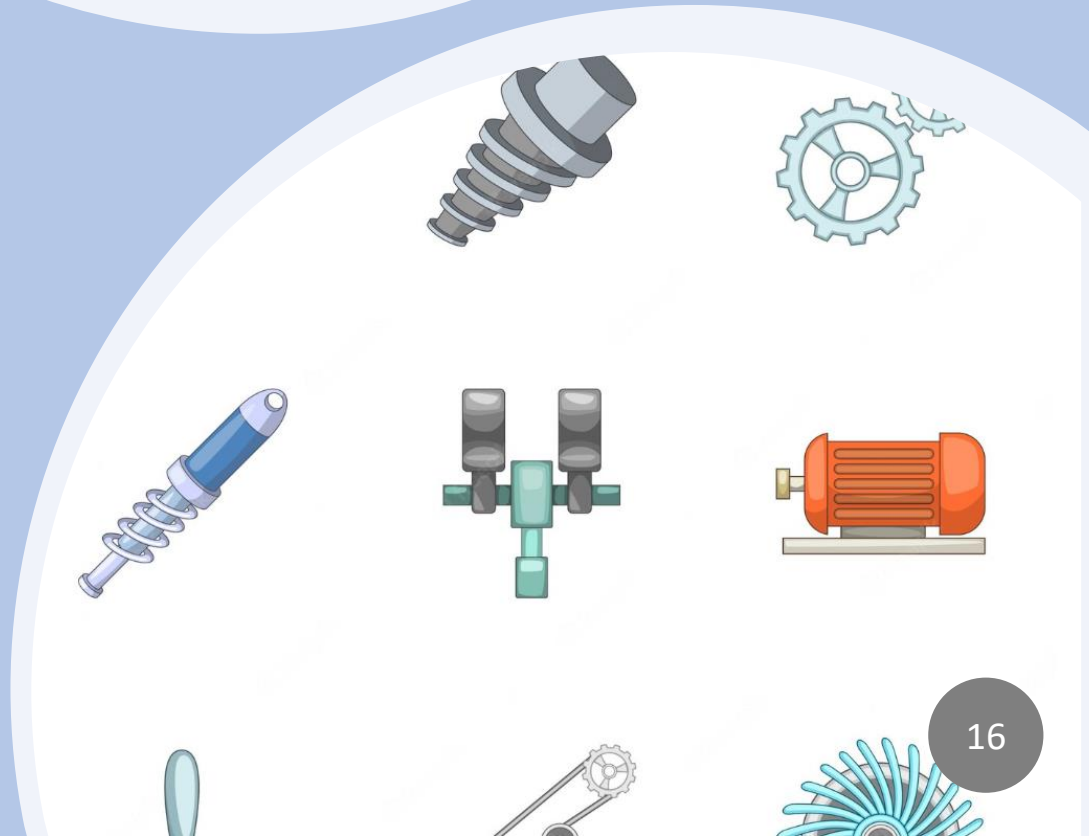


Second Silver linings:

Global investments in infrastructures

Energy transition, reshoring of strategic industries, diversification of «risky» suppliers, all will benefit Japan as:

- 1) it is a major machineries and plants providers
- 2) it can provide much of what China is used to provide, and as cheaply
- 3) it is a leader in hydrogen, nuclear, hydro, lithium batteries, chemicals, constructions, solar industry components





Third Silver linings:

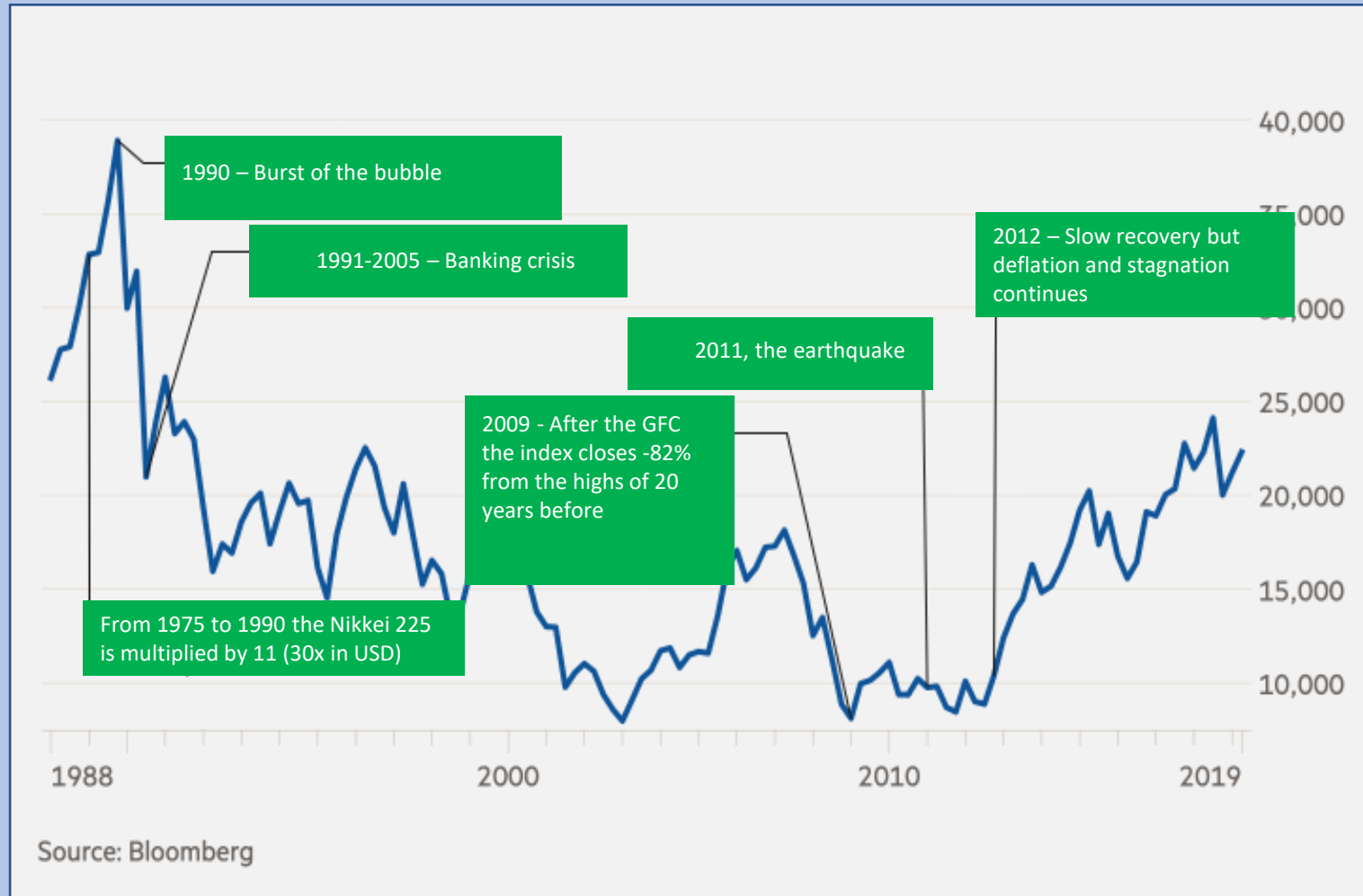
Inflation

The global inflation wave will soon hit Japan turning decades of deflation into a healthy price dynamic. This will lead to:

- Change in the consumer mindset
- Increase in hard asset valuation
- Gradually, an increase in real wages



Japanese equity: a tragedy 30 years long



...can significantly shape the market and producing unbelievable opportunities

Japanese economy, after three decades of stagnation what does it look like now?





..... a unique anomaly worldwide!!!

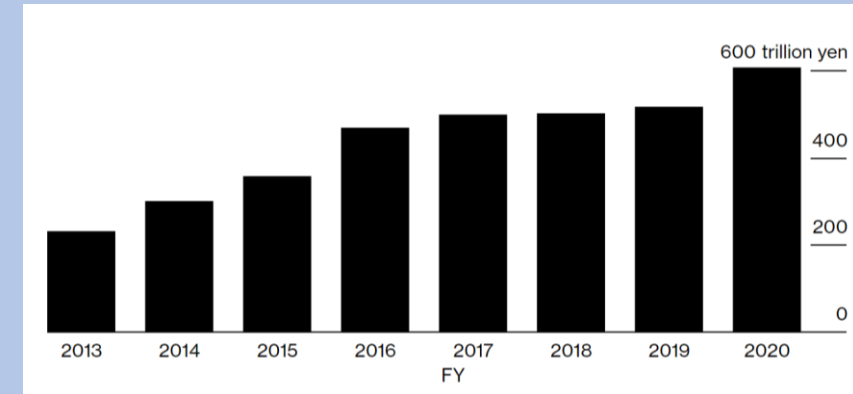
- **Market capitalization of approximately USD 7 trillion Cash on hand of about 5.4 trillion USD**
- **About 60% of listed companies are debt-free** (compared to less than 15% in the US or less than 20% in Europe)
- About 1/3 of listed companies have **cash in excess of 40% of their market capitalization** *.
- **Nearly 45% of listed companies trade at less than 1 times Tangible Net Assets**

NIKKEI PRICE/BOOK RATIO: 1998 Vs 2022



Source: Mizuho Securities based on data by Nihon Keizai Shimbun and Tokyo Keizai

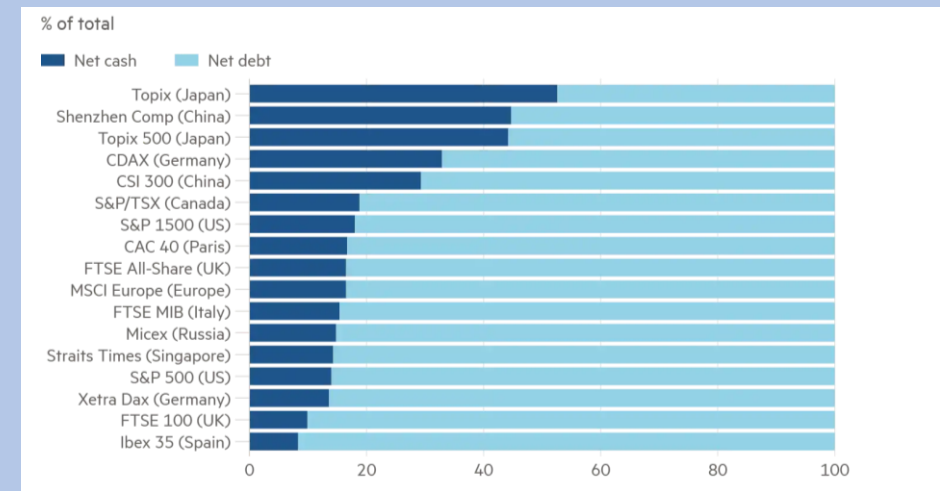
JAPAN: LIQUIDITY* HELD BY LISTED COMPANIES



* combined cash & equivalents

Source: Bloomberg

JAPAN: CASH GIFTS ABOVE ALL OTHER AREAS OF THE WORLD



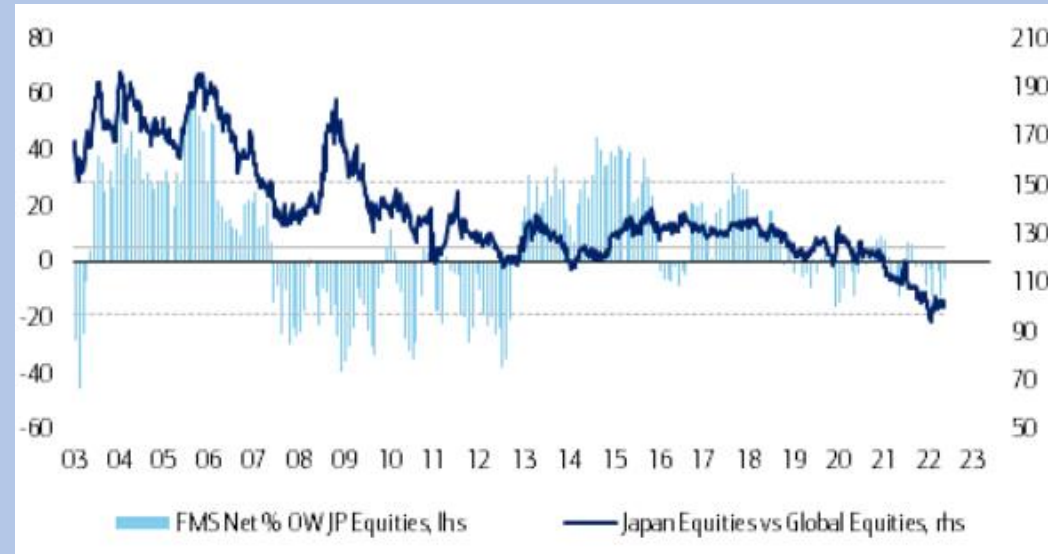
Source: Factset, CLSA

Hope?
Very little....

JUNIOR
JUNIOR
JUNIOR

The Japanese equity market is neglected

ALLOCATION ON JAPANESE STOCK MARKET



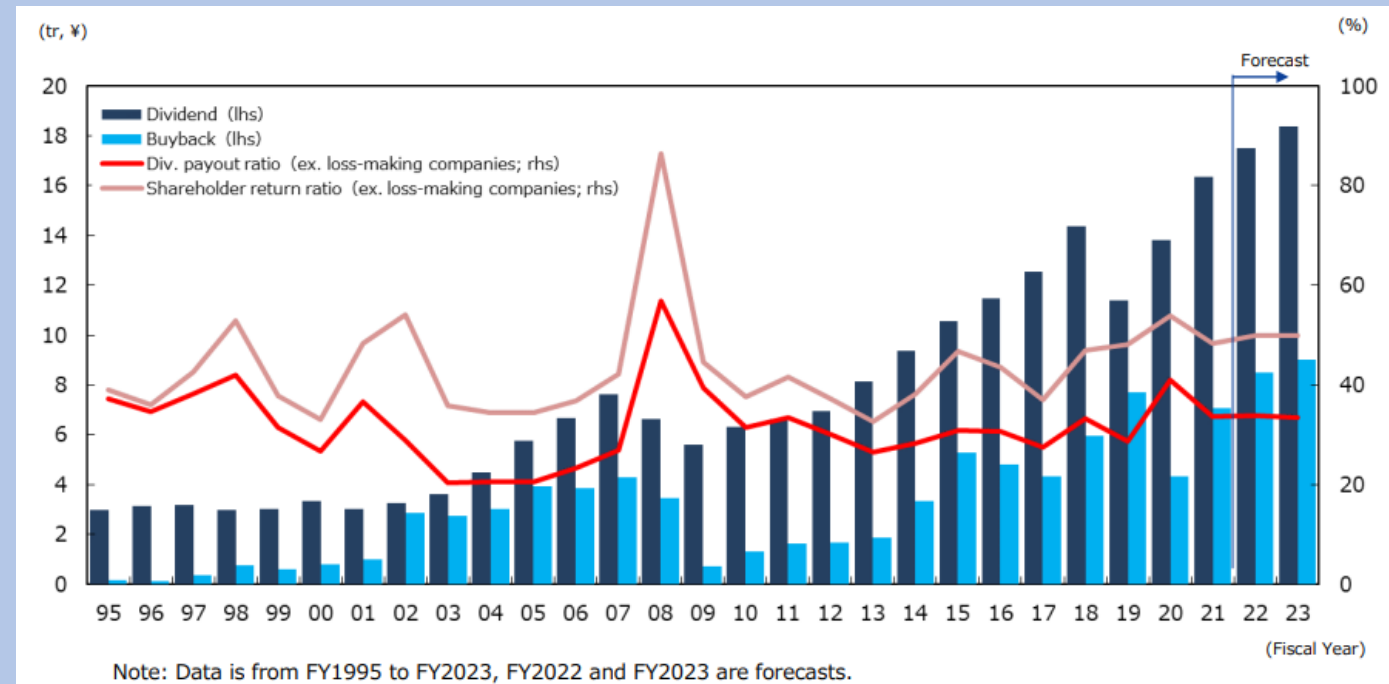
Source: BofA Global Fund Manager Survey – 16/08/22

However, on top of the silver linings already mentioned there are **FURTHER CATALYSTS** that in time can attract new investors...



SHAREHOLDER RETURN RATIO, DIV. PAYOUT RATIO, DIVIDEND PAYMENT, & SHARE BUYBACK

Further catalyst:
total shareholder return increase

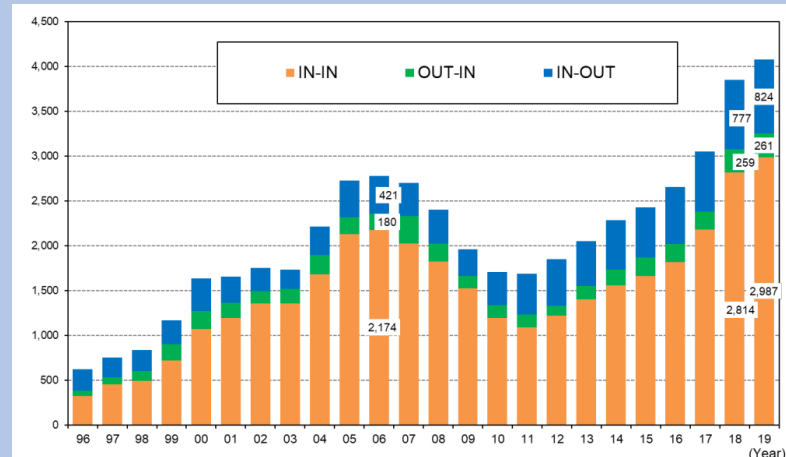


Source: Toyo Keizai, Quick, INDB, Daiwa Securities, SMDAM

- After Covid, dividends are expected to surpass 2019 record levels
- Buyback plans are becoming more and more popular among Japanese companies with a positive increasing effect on EPS



NUMBER OF M&A DEALS INVOLVING JAPANESE COMPANIES (EXCLUDING TRANSACTIONS AMONG THE SAME BUSINESS GROUP)



Source: RECOF, SMBC NIKKO Securities

IN-IN: M&A transactions between Japanese companies

IN-OUT: M&A transactions involving Japanese companies acquiring foreign companies

OUT-IN: M&A operations by foreign companies on Japanese companies

Further catalyst:
M&A in Japan on the rise

- In recent years there has been a significant increase in the number of M&A transactions between Japanese companies*, demonstrating a desire to accelerate the restructuring process, and by foreign companies
- According to data from Dealogic, Japan saw a total deal value of over \$100 billion in 2021, an increase of over \$25 billion from 2020.

This fervent M&A activity is a catalyst for the deep value stocks in the Orphan Companies portfolio

* without considering intercompany transactions



Further catalyst: Corporate Governance Improvement

- The revision of the Corporate Governance Code and Stewardship Code in 2018 has increased pressure on management to improve corporate governance and focus on investors, who now use a more proactive approach to talking to companies and exercising proxy voting rights
- Two important elements have recently been introduced:
 - Corporate Governance Code: Encourage companies to provide clarification on the rationale for "*cross-shareholdings*" or "*strategic holdings*" in shares of other companies, which have often been a protective tool against hostile takeovers
 - Stewardship Code: requiring investors to evaluate ESG factors

JAPAN: INVESTORS THAT HAVE SIGNED UP TO THE PRINCIPLES FOR RESPONSIBLE INSTITUTIONAL INVESTORS (30TH JUNE 2022)

Trust banks	6
Investment managers	205
Insurance companies	24
Pension funds	77
Others	11
Total	323

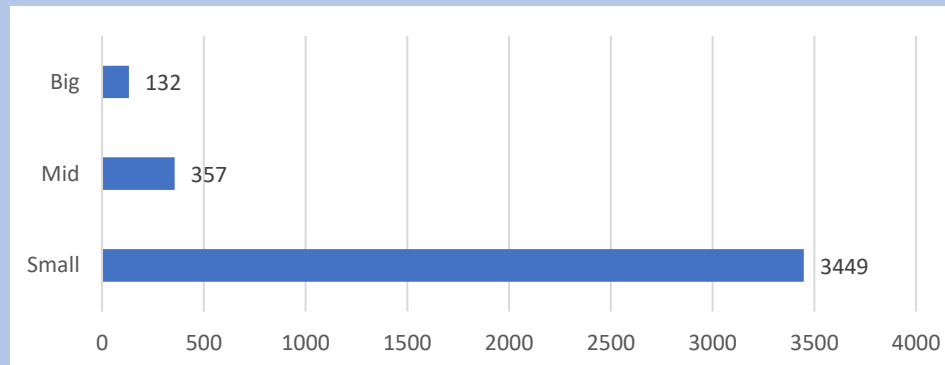
Source: FSA, SMDAM

In a market that is already an anomaly, there is an **extreme anomaly** we must exploit:



The Orphan Companies

NUMBER OF LISTED COMPANIES IN JAPAN BY MKT CAP

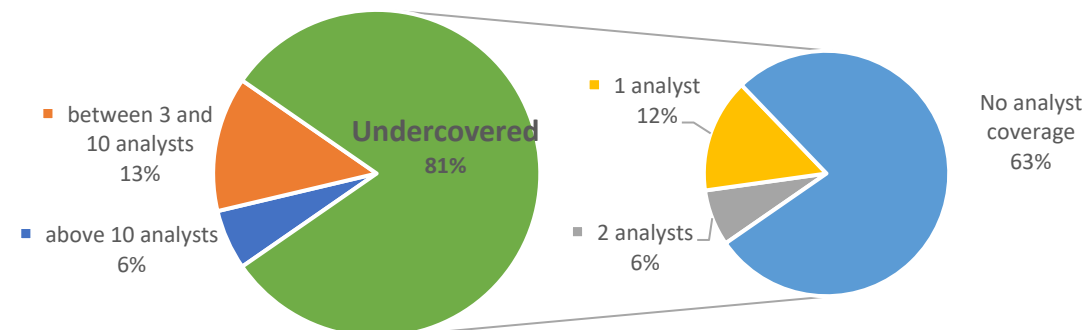


Big Cap = above 10 bln \$ mkt cap
Mid Cap = between 2 and 10 bln \$ mkt cap
Small Cap = below 2 bln \$ mkt cap

→ out of approximately 3800 listed companies about 80% are small caps

Source: NicheAM on Thomson Reuters data

JAPANESE MARKET COVERAGE BY SELL-SIDE ANALYSTS



→ **More than 50% of listed companies are not covered by analysts and about 80% are undercovered**

→ **Lack of coverage keeps off most of investors, resulting in a significant undervaluation of companies**

Source: NicheAM on Thomson Reuters data

The fund will invest in companies that exhibit the following characteristics:

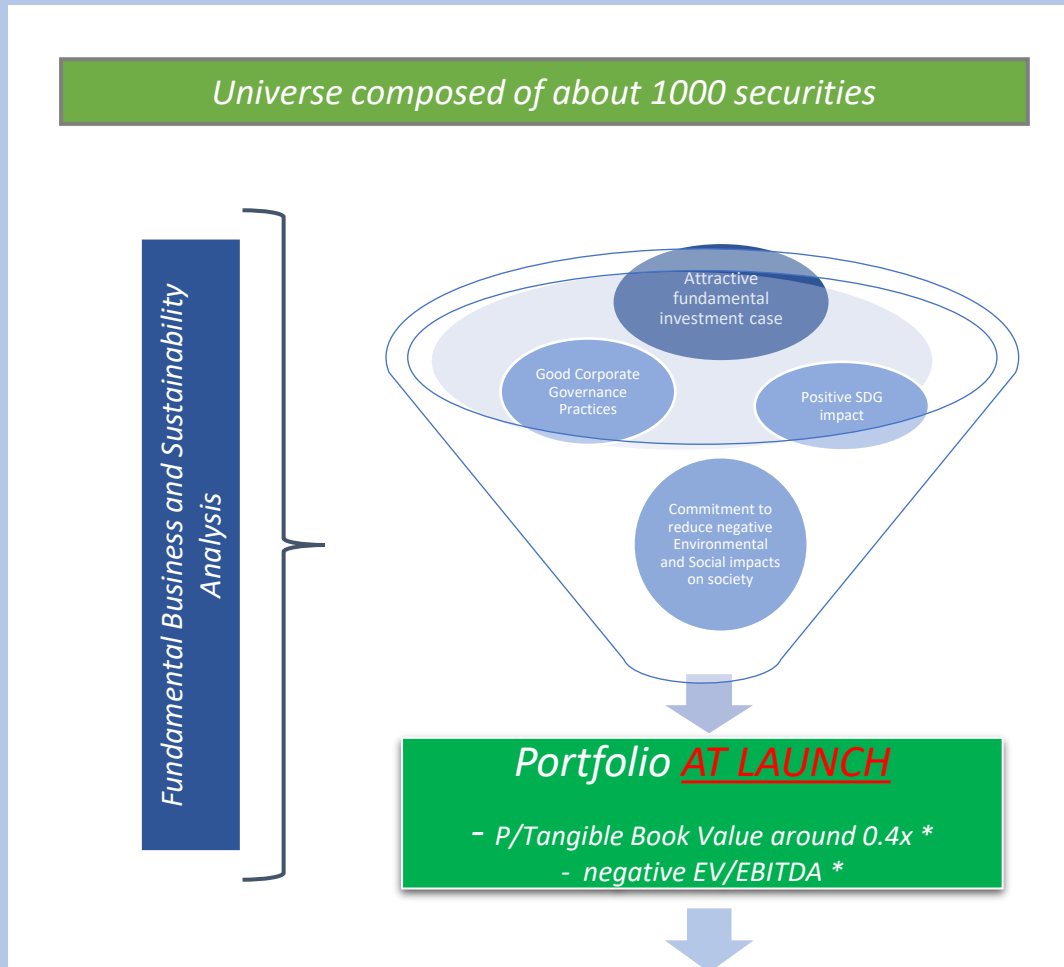


- **Substantial lack of coverage from brokers**
- **Zero debt ***
- **Ratio of capitalization to tangible net worth less than 1.2 times**
- **Listed for at least ten years**
- **Free float of at least 2 billion Yen**

Universe composed by about 1000 securities
Average capitalization: 290 mln \$



Valuation anomaly in the Project's portfolio that the market will inevitably address in time



Negative Enterprise Value as the total market cap of the portfolio is smaller than the net cash held by the portfolio components....!!!

A market anomaly that the NJ project will transform in an investment opportunity

Project target upside: 120% *

PORTFOLIO VALUATION **AT EXIT LEVEL:**

<1X MARKET CAP/TANGIBLE BOOK VALUE EV/EBITDA = 3.5X

Reached this level the project unwinds and the money are returned



M&A transactions on Orphan Companies take place with generous premiums

Mutual Corp (2773.T)
Leverage Buy Out
Sector: Industrial machinery



Comany (7945.T)
Management Buy Out
Sector: Partitions



Honda Tsushin (6826.T)
Bid by Minebea Mitsumi
Sector: Electric components



Uchida Esco (4699.T)
Delisted by Uchida Yoko
Sector: IT services



Nissui Pharmaceuticals (4550.T)
Bid by Shimadzu Corp
Sector: Pharmaceutical



Big Premium

=

a confirmation of the revaluation potential of NJ Project

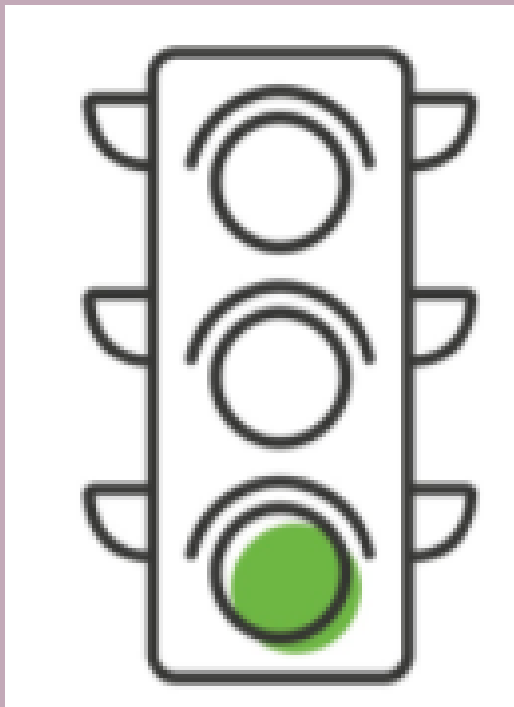
Itec Corp (9964.T)
Sector: Steel
Premium: +70%

Shinoken Group (8909.T)
Sector: Real Estate
Premium: +52%

... and more!



The project invests in companies that are instrumental to the achievement one or more sustainable development goals (SDGs) as defined by UN. The project will achieve this positive objective while trying to minimize the negative impact of its investments.



- The fund will fall under **Article 8 of the SFDR** ("light green"), i.e., it will promote, among other things, environmental or social features, provided that the companies in which it invests respect good governance practices
- Exclusion of investments in companies exposed to armaments, tobacco and fossil fuels
- If the project invested in small companies that do not offer sufficient information in terms of sustainability, a documented engagement process will be carried out with the aim of improving sustainability culture and compliance within the investee company
- A scoring system will be used to identify key sustainability risk factors. This analysis will be combined with direct engagement with investee companies when needed
- The fund will seek to invest primarily in securities issued by companies that have a positive "impact" instrumental in achieving the United Nations **Sustainable Development Goals** ("SDGs")



RISKS?

- *A forgotten market that continues to be forgotten*
- *Global economic/financial crisis*
- *A major devaluation of the yen (in case of lack of currency hedging)*



OPPORTUNITIES?

- *Brokers initiate coverage of Orphan Companies*
- *Orphan Companies are gradually acquired by competitors or withdrawn from the market by their controlling shareholder*
- *Increase return to shareholders, in terms of dividends or buybacks*
- *Japanese market rerating linked to new leadership and/or yen devaluation and/or geopolitics dynamics and/or end of deflation*



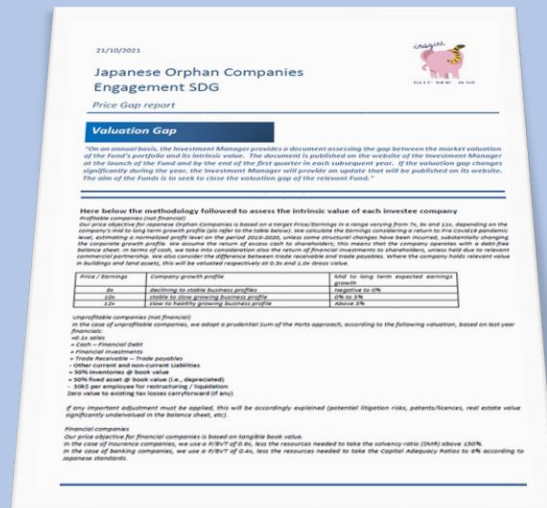
Strong undervaluation in respect of real assets (high level of cash and tangible assets relative to capitalization) greatly reduces the risk that the project leads to long term losses on the investment

Valuation Gap Report



A Valuation Gap report is published at the launch of the project and updated every 6 months, highlighting the level of potential upside of the portfolio

- This is a document that presents the theoretical fair valuation of the portfolio according to the project manager
- A prudent, systematic, transparent, simple methodology is applied
- The valuation is conducted line by line for each stock
- The fund will return the investors' money once the portfolio valuation target has been reached



DISCLAIMER

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