SHIN NIPPON MANAGER UPDATE

Praveen Kumar, manager of the Shin Nippon Trust, gives an update on Japanese smaller companies, touching on investment performance, changes to the portfolio and long-term outlook.

The value of your investment and any income from it is not guaranteed and may go down as well as up and as a result your capital may be at risk.

This film was produced and approved in May 2023 and has not been updated subsequently. It represents views held at the time of recording and may not reflect current thinking.

For a Key Information Document for Shin Nippon PLC, please visit our website at www.bailliegifford.com

Past performance is not a guide to future results.

Praveen Kumar (PV): Hello and welcome to this annual update of Shin Nippon, the specialist Japanese Small Cap investment trust. I am Praveen Kumar, manager of the Trust.

Market trends

In last year's update, I spoke about Japanese small-caps suffering from weak investor sentiment due to geopolitics, inflation, rising interest rates, and lingering effects of the pandemic.

All of these issues still remain to varying degrees. But if we take a step back and look at the bigger picture, we see numerous positive structural trends playing out in Japan.

Just to give you a few examples:

1. We are seeing record levels of wage growth above core inflation amidst a worsening labour shortage situation. This should provide a structural boost to domestic consumption.
2. The Japanese government has now dropped all Covid restrictions. Inbound tourism is recovering steadily, whereas domestic tourism has bounced back much more strongly.
3. Sustained pressure from regulators is forcing Japanese companies to focus more on shareholder returns so we are seeing continued high levels of share buybacks and dividend increases.
4. Finally, the rise in the cost of capital due to high-interest rates is forcing companies to take a more disciplined approach to growth and focus more on improving profitability.

These trends, we believe, are likely to have a far more important bearing on the future growth prospects of Japanese small-caps and should provide a very favourable backdrop in the long run.

Performance

Since its launch in 1985, Shin Nippon's philosophy of identifying and investing in young, entrepreneurial, and fast-growing small companies in Japan has remained consistent.

We manage a well-diversified portfolio of 78 holdings that can broadly be divided into two groups.

The first group comprises of companies with rapid sales growth but with low levels of profitability.

The second group comprises of companies with steady sales growth but strong profit growth and consistent profit margin improvement.

We have historically had a bias towards the first group that consists of early stage and rapid growth internet businesses. Continued weak sentiment around such companies over the past year has affected portfolio performance negatively.

However, we are encouraged to see strong operational progress at many of our internet businesses which is at odds with their weak share price.

For example, in their most recent fiscal year, online real estate company GA Technologies grew sales at over 50 per cent and online legal website and digital contracts provider Bengo4.com grew sales at nearly 30 per cent, with both companies showing good improvement in profitability as well. Yet, in both cases, the share price has been quite weak.

The second group of companies, those with less rapid sales growth but significant profit growth, performed relatively better in share price terms.

Leading global badminton brand Yonex is currently growing profits at a run-rate of over 50 per cent due to strong demand for its products in China and India where badminton as a sport is gaining popularity.

Specialist semiconductor manufacturer Toyo Tanso is benefitting from rising demand for its silicon carbide products that are increasingly being used in electric vehicles due to their superior performance characteristics. The company grew profits at nearly 20 per cent in its most recent fiscal year and has been investing aggressively to expand capacity in response to strong demand.

Portfolio changes

We are also finding lots of new ideas for the portfolio. It is quite exciting for us to be able to own high growth Japanese smaller companies at valuations that do not reflect their long-term growth potential.

For example, we took a new holding in I-Ne, a cosmetics company that is using artificial intelligence to analyse consumer feedback and accelerate product development. The business is growing its sales at over 20 per cent and profits at over 30 per cent yet the shares trade on a very low starting multiple.

We also took a holding in SpiderPlus, a software company that is attempting to digitize and automate Japan's extremely conservative construction industry. Again, we believe that the current valuation of SpiderPlus does not reflect its long-term growth potential.

We also sold a few holdings, like building maintenance company Aeon Delight and child day-care services provider JP-Holdings, where we lost our conviction in management's ability to grow their respective businesses.

Outlook

Despite the weak sentiment around high-growth Japanese small caps, we remain confident that the long-term demand backdrop for Shin Nippon's holdings remains unchanged.

If anything, in some cases like that of Toyo Tanso, which I mentioned earlier, the demand outlook has actually improved.

As such, at a fundamental level, we remain optimistic about the long-term growth prospects for Shin Nippon's holdings.

Another important reason for our optimism is valuation.

It is interesting to note that 5 years ago, the estimated price-to-earnings ratio for the portfolio as a whole was around 27x. This has fallen to just over 12x currently, and this current rating is almost in line with the benchmark.

However, over the same period, the portfolio has delivered far superior sales and profit growth compared to the benchmark. So, in effect, there has been a significant de-rating of the portfolio as a whole.

This means we now have a portfolio that looks incredibly cheap and one that we believe will continue to deliver much higher rates of growth relative to the benchmark over the long term.

Such an outcome should result in a highly attractive return for patient and long-term shareholders.

All of this gives us a lot of cause for optimism, and we think Shin Nippon represents an extremely attractive investment proposition for patient and long-term investors.

Thanks for watching.

Annual Past Performance to 31 March Each Year (net %)

	2019	2020	2021	2022	2023
Baillie Gifford Shin Nippon PLC	-5.0	-21.2	68.8	-25.2	-14.0
MSCI Japan Small Cap	-4.8	-6.2	24.4	-7.7	5.4

Source: FE, share price, total return. Sterling.
Past performance is not a guide to future results.

Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act (‘FinSA’) and Baillie Gifford and its staff may have dealt in the investments concerned.

Baillie Gifford Shin Nippon PLC invest in overseas securities and changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up. The trust’s exposure to a single market and currency may increase risk.

Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.