Asia Small Companies Unit Class

TAMIM Fund

Investor Update

April 2019

TAMIM Asset Management
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TAMIM Asia Small Companies
Unit Class

April was another month of large day-to-day volatility for equities in the region, the net result was a small positive return with the index increasing by 0.4% in USD terms and 1.4% in AUD terms. The Fund increased by 1.6% in AUD terms during April bringing the year to date return to 8.3% versus the index return of 8.5%.

In terms of country returns the best performances were recorded by Singapore, China and Japan with gains of 2.0%, 0.9% and 0.7% respectively in USD terms while Korea and Taiwan fell by 1.1% and 1.6% respectively and Hong Kong was flat.

In Japan, the month ended on 26th April ahead of ten days of celebrations associated with the start of the Reiwa (beautiful harmony) era and the new emperor Naruhito replacing his father Akihito. Naruhito became the 126th emperor, the latest in an unbroken line that stretches back fourteen centuries in Japan. The role of emperor is largely symbolic these days and wields no political power, however, Naruhito will impact the mood of the nation and the early signs of his approach are very positive.

Areas of strength in the portfolio were associated with semiconductors and international trade. Semiconductor testing equipment maker Advantest increased by 22% during April and announced a strong set of results for the financial year ending March 2019. Other companies that performed well were Japan Aviation Electronics up 16.4% and automotive part maker Tokyo Seimitsu up 15.5%. The main areas of weakness for the portfolio continued to be domestic companies in Japan, especially retailers and regional banks. Retailers Komeri (DIY stores) and Heiwado (supermarkets) both fell 13% in reaction to flat year on year results, they each trade on 11x price to earnings and we view both companies as strong long-term investments.

We made several adjustments to portfolio during April as follows:

- We sold positions in Sinotruk and Yangtze Optical Fibre in China. We downgraded our governance score for Sinotruk following the announcement of a connected transaction which the company attempted to justify as a move towards better business diversification.
- We downgraded Yangtze Optical Fibre due to their poor showing in the latest round of tenders to provide 5G cables to China Mobile, it appears that the competitive environment for 5G infrastructure investment will damage profitability of the suppliers during this early phase of the capital spending cycle.
- We bought a new position in Sunlight REIT to broaden our property exposure in Hong Kong. We added to existing positions in Champion REIT, Youngone Corp, Com2uS Corp, SFA Engineering and Sheng Siong Group.

The short-term outlook for Asian markets is likely to continue to be dominated by the outcome of trade talks between China and the United States, with a conclusion now not expected before the end of May. Bilateral trade talks between Japan and the United States commenced in late April and appear to be making good progress. In the long-term we take comfort from the portfolio P/E of 10.0x and yield of 3.5%, our companies have the scope to generate strong investment returns.

Stock Review

SHOWA DENKO

Showa Denko K.K. (SDK) is one of the largest chemical groups in Japan with history that dates back to 1908, the group also manufactures and markets electronic and aluminium products.

Net sales break down by products is as follows: petrochemicals 30.8%, chemical products 16.8%, electronic components 15.4%, aluminium products 12.4, inorganic products 8.3%. In recent years SDK has taken steps to diversify away from the chemicals and metal fabrication business into the field of electronics. SDK has a market leading product in the form of silicon carbide epitaxial wafers, a business segment that is expected to grow at a compound annual rate in excess of 30%, this business makes SDK an exciting and undervalued investment opportunity.

Accounting, Strategy and Governance Comments

Accounting

1 - Full compliance with local standards and moving towards IFRS via membership of the Financial Accounting Standards Foundation in Japan which is a body that is adjusting the local practices in Japan in accord with international standards.

2 - The Company has a policy of good transparency with investors an excellent Annual Report which from 2017 was combined with their corporate social responsibility reporting. The documentation provided to investors is among the highest standard of any company in Japan.

3 - The local entity of KPMG undertakes the auditing function at SDK, there have been no qualifications issued with respect to audited accounts.

Strategy

The development of silicon carbide (SiC) epitaxial wafers is a transforming event for SDK, they can move away from highly cyclical earnings generated by their traditional chemical and metal fabrication businesses and generate an earnings stream underpinned by strong compound growth. Operating income from SiC epitaxial wafers increased by 357% in 2018. SDK has provided forecast growth for SiC Epitaxial Wafers in excess of 30% per annum compound out to the year 2025 and expect to become the largest independent producer in this field with global market share of 30%. This is a bold target which appears to be within the reach of SDK and makes the company look outstanding value on 5.3x current and 4.3x prospective earnings. SDK is an excellent example of hidden technology residing in a traditional cyclical business. When compared with mainstream silicon based semiconductors, SiC-based power semiconductors can operate at higher temperatures, higher voltage and high current conditions while conserving energy. These attributes allow device manufacturers to produce smaller, lighter and more energy efficient power control modules.

The year 2018 was a difficult year for SDK's traditional businesses, the company was able grow revenues by 27.1% and has a (probably conservative) forecast in place for the current year of 10.8% revenue growth. In 2018 operating income increased by 131%, the company forecast for 2019 is a modest 8.2% earnings per share growth. The management of SDK have a clear strategy for managing the various segments of the business in the form of "Enhance, Grow and Change". The "Enhance" category are segments that should demonstrate improved profitability, specifically petrochemicals, industrial gases and basic chemicals. The "Grow" segment is based around SiC epitaxial wafers, a business with high growth and high profitability. The "Change" segment applies to aluminium and ceramics, where speciality high value added products will be developed against a backdrop of stable profitability in those categories.

Geographic strategy. SDK plans to develop more production bases in the Asian region, they currently have aluminium production in Vietnam and Thailand. SDK has signaled a plan to be acquisitive in Europe, in the field of automotive design and weight reduction.

Source: Company filings

Governance

1 - Since 2016 SDK has been included in ESG indices operated by FTSE and MSCI, in particular the FTSE Blossom Japan Index and MSCI Japan ESG Select Leaders for companies demonstrating strong ESG practices. SDK is also included in the MSCI Japan Empowering Women Index which includes the companies that best demonstrate gender diversity. In October 2018 SDK was included in the S&P/JPX Carbon Efficient Index, the company has been diligent in reducing carbon footprint in recent years and inclusion in that index is a recognition of those achievements.

2 -In December 2018, the company announced a share repurchase programme with the aim of enhancing returns to shareholders and improving capital efficiency. SDK made early repayment of ¥24 billion in subordinated loans in a review of the capital structure of the business.

3 - Full compliance with the Governance Code in Japan. The Company has three outside directors on the Board comprising nine Directors in total. The Company holds fourteen Board Meetings per year and has applied term limits for the Directors

Value, Momentum and Quality Comments

SDK has consistently scored exceptionally well in the value category of our scores and is currently in the top 3% of all companies in the region assessed for value. SDK has gradually improved in the quality element of our scoring, the company has ambitious and achievable targets for return on equity which should see the quality scores continue to improve.

During the past eighteen months, the 2020 eps forecast has increased from ¥480 to ¥900, the wave of upgrades by analysts peaked in November 2018 when the 2020 eps forecast reached ¥1,100. The subsequent downward adjustment in eps expectations is responsible for the decline in the momentum and overall VMQ scores, however, that still leaves SDK comfortably in our top quintile of companies in the region.

Conclusion

SDK is a good example of hidden technology by developing the market leading SiC epitaxial wafers within a traditional petrochemicals and aluminium fabrication business they have been overlooked by the market and trades on a forward multiple of 4.3x earnings. The management of SDK have set themselves an ambitious target for return on equity and have defined the business into three types of management "Enhance, Grow and Change" that should see them achieve that goal and achieve substantial positive returns for shareholders.

Overview

The TAMIM Fund Asia Small Companies unit class seeks to achieve a high real rate of return over the long-term within defined risk parameters acceptable to the Investment Manager through a diversified portfolio of Asian small and mid-cap shares.

Key Facts

Investment Structure:	Unlisted unit trust
Minimum investment:	A$100,000
Applications:	Processed monthly
Redemptions:	Monthly, with 30 days notice
Unit pricing frequency:	Monthly
Distribution frequency:	Annually
Management fee:	1.00% p.a.
Expense recovery fee:	Up to 0.35%
Performance fee:	20% of performance in excess of hurdle
Hurdle:	MSCI AC Asia Small & Mid Cap Index
Buy/Sell Spread:	+0.30%/-0.30%
Exit fee:	Nil
Single security limit:	+/- 5% relative to Benchmark
Country/Sector limit:	+/- 10% relative to Benchmark
Target number of holdings:	60-80
Portfolio turnover:	< 30-40% p.a.
Investable universe:	MSCI AC Asia Small & Mid Cap (US$ 500m - 10bn)
Cash level (typical):	0-100% (0-5%)

Selection of 5 Holdings

Stock	Code	Exchange
Sojitz Corp.	2768	Tokyo
Simplo Technologies Co.	6121	Taiwan
Kerry Logistics Network	0636	Hong Kong
Venture Corp.	VENM	Singapore
China Lesso Group	2128	Hong Kong

Returns

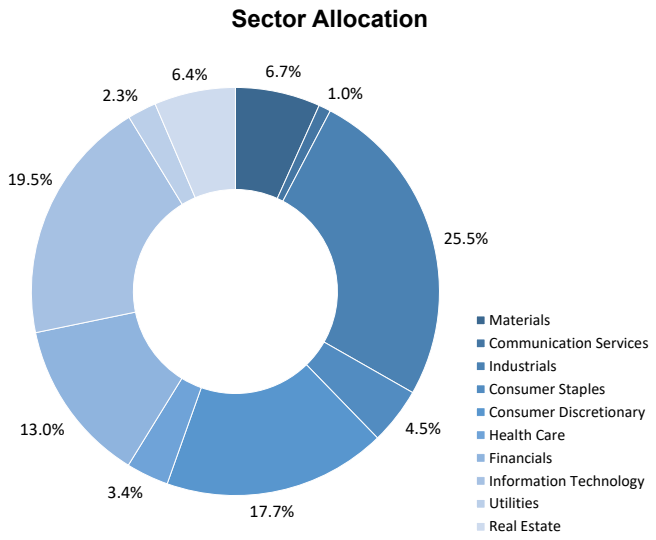
	1m	3m	6m	9m	1y	Since inception
TAMIM Asia Small Comp.	1.60%	5.67%	4.25%	-	-	-4.76%
MSCI AC Asia SMID	1.36%	6.87%	8.18%	-	-	-1.13%

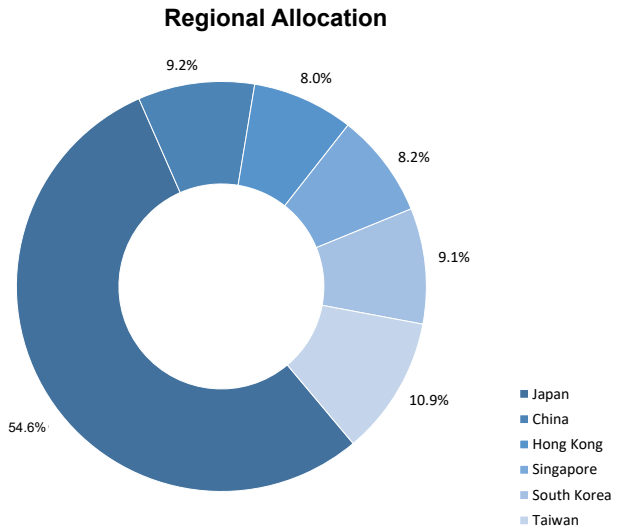
Note: Returns are quoted net of fees and assume distributions are reinvested. Past performance is no guarantee of future performance. MSCI AC Asia SMID refers to the MSCI AC Asia Small & Mid Cap Index in AUD. Inception 1 October 2018.

NAV

	Buy Price	Mid Price	Redemption Price
AU$	$7.6423	$7.6195	$7.5966

Portfolio Profile





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