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# SHIN NIPPON PLC – MANAGER UPDATE

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PORTFOLIO MANAGER OF SHIN NIPPON, PRAVEEN KUMAR, DISCUSSES THE MAIN TAKEAWAYS FROM HIS EXTENDED TRIP TO JAPAN AND PAST AND POTENTIAL FUTURE ACTIVITY WITHIN THE PORTFOLIO.

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**Alex Blake (AB):** Hello, I'm joined today by Praveen Kumar, portfolio manager of Baillie Gifford Shin Nippon. Welcome, Praveen.

**Praveen Kumar (PK):** Hi, Alex.

**AB:** Praveen, you were in Japan for an extended trip towards the end of last year, what were your main takeaways from that trip?

**PK:** So, I was in Japan for six weeks, over October and November last year and during this period, I met around 75 companies. Of those, roughly, 70 per cent were existing holdings and the rest were a combination of potential new ideas, as well as about seven unlisted companies.

I met companies from a wide range of sectors, so that gave me a very good overall view of the business conditions, both in Japan and overseas.

I would highlight three main takeaways from my trip. Firstly, companies that were focused on the domestic market sounded quite optimistic in terms of the outlook for demand. Some of the younger online disruptive companies that we own, were confident enough to sacrifice short-term profits in order to invest in future growth for the businesses.

So, for instance, Yume No Machi which is Japan's leading online takeaway operator. And Bengo4.com, which is Japan's largest online legal portal. So, both companies are, basically, sacrificing all of their profits for this year because they're investing heavily in growing their existing businesses.

We also met companies from the services sector. And within those, especially the staffing companies, sounded quite bullish. As you probably know, the labour shortage situation in Japan has reached extreme levels. We own a couple of staffing companies in the portfolio, WDB and Outsourcing. And I met both of them and both companies were very, very optimistic in terms of the demand outlook for the businesses.

So, overall, the business conditions for domestically-focused companies in Japan seems quite positive.

Secondly, I was quite surprised by the sheer number of new growth areas that are emerging in Japan. Most of them due to the spread of technologies like artificial intelligence or AI. BrainPad, which is a portfolio holding, is seeing explosive sales and profit growth as it's AI-enabled marketing software gets adopted by a lot of companies.

I met another company called Signpost, which we don't own at the moment. And this company has developed an AI-based self-checkout cash register, which, basically, eliminates the need for humans.

All of these new areas are enabling companies to explore new growth opportunities. And this is quite a positive development for small caps in Japan.

Finally, having met a few unlisted companies, I think this is an area that is, potentially, quite exciting from a long-term view. The environment around private unlisted companies is changing for the better. These companies are getting access to better levels of funding and at reasonable valuations. And the products and services that they're developing have a global appeal.

So, this is an area where I'm likely to spend a bit more time thinking about investment opportunities.

**AB:** That's interesting. Are you able to invest in unlisted companies within the investment trust?

**PK:** Yes, we are able to invest with unlisted companies. We have asked for permission for shareholders to go up to 10 per cent. At the moment, we have just the one investment in unlisted companies, it's a company called Moneytree. It is a Fintech company that's developed an AI-enabled platform that connects banks' software systems, to build a complete financial profile of customers. And, I'm hoping, in the long-term, it lives up to its name.

**AB:** Great. You talked a bit about the domestic companies in Japan. Have the macroeconomic headwinds affected Japanese small cap companies?

**PK:** So, the two big macroeconomic headwinds last year for Japanese small caps, were the trade tariffs, as well as the slow-down in the Chinese economy. If anything, the latter had a much larger impact on these companies, and we saw that in the operational results of cyclical companies in the portfolio. Mostly companies exposed to autos and factory automation. Now, I, personally, see this more as a cyclical phenomenon. Fundamentally, I continue to believe these companies are strong businesses that are globally quite competitive.

But, these sorts of headwinds had little to no impact in terms of the operations of the more domestically focused businesses.



**AB:** Despite the NAV falling by 6 per cent in absolute terms, the company still outperformed its benchmark, what were the main contributors to performance?

**PK:** That's right. The top positive contributor to the performance was Bengo4.com, which is the online legal portal that I mentioned earlier.

And that is representative of some of the top-performing stocks of the past year, which were dominated by a lot of these online disruptive businesses that we tend to like.

So, Bengo4.com continues to grow really fast in terms of its sales. As I mentioned earlier, it's investing aggressively, so profit growth is lagging at the moment. And it's also developing a new business, where it's providing secure Cloud-based digital contracts for companies.

So, this is an area where we think there could be significant growth opportunities, because corporate Japan still remains very heavily paper and fax-based, so very traditional in that sense. And companies are increasingly looking to digitise themselves. And what Bengo4.com is doing with this new service sits right in the Zeitgeist of this change.

Another strong performer was MonotaRO, which is a longstanding holding. So, this is an online platform that sells maintenance and repair equipment. And it continues to maintain its incredible record of really high rates of growth year in and year out.

Raksul was also a strong performer last year. This is a company that does Cloud printing, and it also has an Uber for logistics kind of business, an on-demand logistics business.

We participated in the IPO of this company early last year, and since then, shares are up threefold. So, it's a really interesting business that did exceptionally well.

In terms of the contributors to the poor performers, as I mentioned earlier, the list was made up mostly of cyclical companies exposed to autos and factory automation.

**AB:** You mentioned participating in an IPO, did you make any other changes to the portfolio?

**PK:** Yes, last year we had an unusually rich pipeline of ideas. So, turnover was, naturally, higher than what we've seen in recent years. But, over the long period, turnover still remains comfortably at low levels.

We sold Lifull which is an online real estate website. And Cookpad, an online recipe website.

In both cases, management are investing heavily overseas, making acquisitions. Whereas, we always maintain that the growth opportunity for both companies is in the domestic market. So, we weren't really convinced with management strategy, hence, decided to completely sell out of both companies.

We also sold our shares in Zojirushi, which is a high-end rice-cooker manufacturer. So, the company's really struggling to respond to competitive pressures. And following a recent meeting with management, we weren't convinced that they had any idea as to how to respond to this.

We took a few new holdings, as I mentioned. One of the new holdings was Akatsuki, which is a mobile-gaming company. But it also has a potentially exciting and interesting subsidiary that does e-gaming, which is growing quite rapidly globally.



We also bought shares in Uzabase, a financial software provider that is trying to break stranglehold of Bloomberg and Thomson Reuters within the financial information market.

Finally, we took a holding a KH Neochem, a specialist niche chemicals manufacturer that has exposure to some very narrow, but potentially exciting and growing end markets, like cosmetics and environmentally friendly chemicals for building materials and refrigerants for air conditioners.

I hope these three examples give you some sense of the breadth of investment opportunities available within Japanese small caps. And I, personally, think it's quite an exciting time to be looking at small caps in Japan.

**AB:** Thank you very much, Praveen.

**PK:** Thank you, Alex.

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

	2015	2016	2017	2018	2019
Baillie Gifford Shin Nippon	20.3	41.8	28.6	43.9	-5.0
MSCI Japan Small Cap	25.2	7.8	34.5	12.2	-4.8

Source: Morningstar. Share price, total return. Sterling.

Past performance is not a guide to future returns.

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