

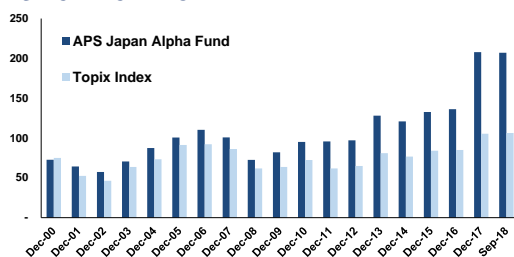
## APS JAPAN ALPHA FUND (UCITS)

### FUND DETAILS

Structure	Open ended	
Domicile	Dublin, Ireland	
Inception date	1 July 2000	
Base currency	USD	
Fund size	USD152 million	
Benchmark	TOPIX NTR	
Number of holdings	34	
Active share	95.9%	
3 Year Beta	0.89	
3 Year Alpha	9.29%	
3 Year Std Dev.	Fund	Index
	12.0%	10.8%
Portfolio manager	Hiromitsu Kawakita	

\*Portfolio statistics are based on annualized monthly returns over the last 3 years

### GROWTH OF A USD100 INVESTMENT SINCE INCEPTION



Fund returns are cumulative and are gross of management and performance fees.

It was also buoyed by the strong, sustained performance of its core healthcare business, which has clocked double-digit growth for a number of quarters in recent years. The stock's performance has been volatile this year as most investors focus on quarterly results, rather than investing for the long term as the company focuses on transforming itself. This shift often requires applying cash flow from its strong existing business franchise to help offset investment in new growth segments such as drug development. We met the CFO recently to seek greater understanding of how recent management changes and new personnel additions will likely allow the company to manage its subsidiaries more effectively and maintain sustainable growth. Its key manufacturing and healthcare business segments, which currently represent the vast majority of its total sales and profits, continue to show healthy double-digit growth. The stock currently trades just above book value and we believe many investors significantly underestimate the company's long-term growth opportunities.

**Shionogi & Co** is a pharmaceutical company that is mainly focused on the central nervous system and infectious diseases. The stock was up 30% during the period and was the second biggest contributor to the fund in 3Q, boosted by better-than-expected earnings and a new stock buyback program in July. It also got a shot in the arm from data showing that Shionogi's loss of market share to US rival Gilead Sciences in its HIV franchise, which represents 70% of its total pre-R&D profit, was much lower than expected. Over the medium term, we believe that Cabotegravir, which is potentially the world's first long-acting HIV drug, has a fair chance of becoming a meaningful growth driver. Long-acting drugs might mean that it could be taken less often, making a treatment or prevention regimen simpler to comply with. Many investors significantly underestimate this opportunity.

**WDB Holdings** is Japan's largest recruitment agency for temporary researchers in the food and pharmaceutical industries, with a 30% market share. The stock outperformed the broader market and become the third biggest contributor to the fund in 3Q after the company reported strong numbers for the quarter ending in June, with 14% sales growth and 25% operating profit. After the company reported worse-than-expected numbers in the preceding quarter, we added to our position. This was after we checked with company management to confirm that a number of one-time factors impacted that quarter, such as unusually severe snowstorms. Our investment thesis remains intact, as WDB continues to be one of the biggest beneficiaries from Japan's continued labour shortage, particularly in the area of research staff.

### STRATEGY DESCRIPTION

The APS Japan Alpha Fund (JAF) invests in companies that are listed on the Japan Stock Exchange. We seek to invest in companies with strong management teams and durable growth prospects at attractive valuations. We conduct primary research on company fundamentals, which includes members of the management teams, and adopt a strong investigative slant. Site visits and meetings with management form an important part of our research work. This portfolio is benchmark agnostic, and we seek to achieve absolute returns for investors over a market cycle.

### PERFORMANCE AT 30 SEPTEMBER 2018

	Annualized Returns (%)							
	1M	3Q	YTD	1Y	3Y	5Y	10Y	Since Incept
JAF Net Returns	1.95	1.61	-0.84	10.53	17.94	9.07	9.94	3.06
JAF Gross Returns	1.97	1.68	-0.35	11.96	19.96	10.50	11.31	4.07
Index	2.91	3.10	0.83	9.35	11.35	5.98	4.74	0.34
Difference	-0.94	-1.42	-1.18	2.61	8.61	4.52	6.58	3.74

Performance of the Fund is represented by the asset weighted performance of the Class A, Class B and Class E share classes. Net returns are net of management and performance fee. Difference is based on gross returns. The returns are calculated on a single pricing basis where the performance data takes into account subscription fee and realization fee (which are currently nil). All performance quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the return figures quoted. The TOPIX Index is used from inception to 31<sup>st</sup> December 2017, the TOPIX NTR Index is used from 1<sup>st</sup> January 2018 onwards.

### COMMENTARY

The APS Japan Alpha Fund gained 1.97% gross in 3Q, underperforming the benchmark by 0.94 percentage point. The fund declined 0.35% this year, underperforming the benchmark by 1.18 percentage points.

We initiated positions such as Shin-Etsu Chemical during the third quarter, where our research indicated that they were trading far below their intrinsic value. On the other hand, we liquidated positions that closed with our target prices. Our analyses are presented in greater detail below.

**Noritsu Koki** is transforming into a healthcare company through acquisitions funded by strong cash flows from its legacy business manufacturing marking pen points. The stock contributed most to the fund's performance in 3Q as the company reported healthy earnings, partly driven by the strong recovery of its mail order business for seniors thanks to marketing efforts.

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## APS JAPAN ALPHA FUND (UCITS)



## SECTOR ALLOCATION (%)

	FUND	INDEX	DIFFERENCE
Industrials	28.8	22.5	6.2
Information Technology	26.3	10.3	16.1
Health Care	13.7	7.7	6.0
Consumer Discretionary	8.8	18.3	-9.5
Materials	8.7	6.9	1.8
Consumer Staples	8.1	9.1	-1.0
Communication Services	0.9	8.0	-7.1
Financials	-	11.6	-11.6
Energy	-	1.3	-1.3
Real Estate	-	2.8	-2.8
Utilities	-	1.8	-1.8
Futures	3.1	0.0	3.1

## MARKET CAP DISTRIBUTION (%)

	FUND	INDEX	DIFFERENCE
> 5 Bn	24.0	77.2	-53.2
2 Bn – 5 Bn	7.7	10.9	-3.1
1 Bn – 2 Bn	37.7	5.6	32.1
< 1 Bn	25.9	6.4	19.6

## TOP 5 HOLDINGS

	SECTOR	% OF NAV
WBD Holdings	Industrials	5.3
Kanematsu	Industrials	5.2
NOF Corporation	Materials	5.2
Yokogawa Bridge	Industrials	4.4
JustSystems	Information Technology	4.4

Sources: APS, Bloomberg and Wilshire

**WirelessGate** is one of the largest mobile virtual network operators (MVNO) in Japan, focused on high-speed internet services like Wi-Fi, WiMAX and LTE. We originally expected the company to shift its growth driver away from B2C towards the B2B business, which offers a growth opportunity as we believe demand for private LTE is increasing in Japan. Most LTE networks are considered public, serving the general public or enterprise subscribers. An LTE network is considered to be private when its main purpose is for connectivity within an organization, where data needs to be kept totally secure by avoiding sending it through the core network of a mobile operator.

However, the stock price declined in 3Q as the company recently shifted its strategy by increasing promotion expenditure on its B2C business in order to preserve market share. This was in response to Softbank's aggressive spending to gain market share for Wi-Fi services. After a discussion with WirelessGate's CEO, we concluded our investment thesis was no longer valid, so we are in the process of selling the stock.

**Optorun** is the world's leading optical thin film coating machine maker, dominating the high-end segment globally. Its machines are used in the manufacture of the iPhone X's camera lens that is used for its Face ID biometric feature, and Optorun is also Apple's exclusive supplier. The stock price lost -32% in 3Q because its 2Q result was worse than expected due to additional costs from manufacturing machines for Apple's new products. We believe margins will gradually improve in the future, and our investment thesis remains intact. Demand for high-end lens coating machines will likely increase for years to come from applications like smartphone hardware, augmented reality, and the automotive industry's move towards assisted driving.

**Ferrotec Holdings** is a manufacturer of material and parts for semiconductor equipment and solar batteries. Our investment thesis is that the company's growth is at an inflection point. This is predicated on Ferrotec restructuring its loss-making solar battery business, and focusing on the semiconductor business, especially in the 8-inch wafer business that is supported by Chinese government subsidies as well as global wafer demand. Ferrotec's stock price fell by -36% in 3Q on concerns that the Sino-US trade war will hurt the global semiconductor sector. Moreover, the company has postponed the restructuring of its solar business, and reduced wafer manufacturing volume in its Shanghai factory as the local government strengthened its regulation of environment pollution. We recently visited their Hangzhou factory and reconfirmed their strength in the semiconductor consumable supplies business. We believe the current valuation of 8.1x 2018E P/E and 0.86 P/B is attractive, considering the long-term growth opportunity in their semiconductor business in China.

## RECENT NEW POSITIONS

**Shin-Etsu Chemical** is a leading Japanese chemicals firm that supplies many highly competitive products such as PVC, semiconductor silicon, silicone, rare earth magnets, and more. It is a global leader by market share for the PVC and semiconductor silicon segments, which are also highly profitable. The silicone and Electronic & Functional Materials segments are also very competitive. Currently the stock is trading at 15x 2018E P/E, which is the lowest end of the stock's 2-year trading range. Many investors seem to be pricing in an earnings peak for the company on a shrinking PVC resin spread and slowing semiconductor silicon wafer demand.

We disagree as we believe the fundamentals remain strong. The company will likely continue to grow profits in its semiconductor silicon wafer business in the coming years on the back of tight supply-demand dynamics. We expect stable PVC prices, underpinned mainly by the US housing and infrastructure market. In addition, we believe the company may increase the efficiency of its capital strategy, as it sits on a JPY1 trillion net cash position. Shin-Etsu has historically been very conservative in terms of cash usage and shareholder return, but the recent change in Japan's corporate governance code could trigger a rethink of capital strategies.

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We initiated a position in **Fujitsu General**, which was founded in 1936 and is one of Japan's largest makers of home-use air conditioners. Besides the air conditioner business, they have telecommunications and electronic devices businesses, which accounted for 13% of total profit last year.

Their stock price fell this year on rising costs and slowing sales. However, prices have begun to decline for copper, which is the largest cost in terms of materials for making air conditioners. In addition, the recent decline of the Chinese Yuan against the USD is positive for the company, as their main factories are located in China. The company is also making efforts to revive sales in the Middle East, and plans to grow aggressively in India and the US over the next 5 years, targeting CAGR of 35% and 90% respectively. We believe Fujitsu General can continue to grow over the long term overseas, in tandem with the increasing penetration rate of inverter air conditioners. It has a net cash position of JPY42.7 bn, which is 21% of its current market capitalization. While they have continued to increase dividends, their payout ratio is still only around 20%. We believe they are likely to increase their dividend payout ratio, in the wake of recent changes in Japan's corporate governance code.

## RECENT EXITS

**Takara Bio** focuses on the supply of biotechnology research reagents and scientific instruments, as well as various contracted services which include the AgriBio Business, and the Gene Therapy Business. The latter develops and commercializes gene therapies for cancer. The company announced better than expected FY17 results and an agreement for collaboration in product development with Otsuka, one of Japan's largest pharmaceutical firms. These factors helped the stock outperform the market and it had reached our target price, so we liquidated our position.

## STRATEGY &amp; CONTINUED RESEARCH

We expect some volatility in the Japanese market due to external factors such as fluctuations in US interest rates and currencies, and the Sino-US trade war. However, Japanese macro factors have been stable, and we feel that current stock price movements are psychological rather than driven by fundamentals. APS will remain focused on fundamentals and valuation, paying much less attention to market expectations, and macro events with no material link to fundamentals. We like this type of volatility as it presents opportunities for us to initiate or increase positions in companies that are mispriced but have significant upside potential over a longer horizon based on our bottom-up research. In addition, the Japanese market is in a significant stage of structural transformation, and we believe that we can find a good number of growth companies in the years to come.

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## SUBSCRIPTION

	Class A	Class B	Class C	Class D	Class E (Closed)	Class H (Closed)	Class I	Class J
NAV Prices as at 30 <sup>th</sup> Sep 2018	USD176.10	USD173.76	N.A.	N.A.	USD99.46	USD93.04	N.A.	N.A.
Bloomberg	APSGJPG ID	APSJPA B ID	APSJPA C ID	APSJPA D ID	APSJPEU ID	APSJPHU ID	APSJIEH ID	APSJJH ID
Initial investment	USD100,000	USD1,000	EURO1,000	JPY100,000	USD100,000	USD100,000	EURO100,000	JPY10,000,000
Management fee	0.75%	1.5%	1.5%	1.5%	0%	0%	0%	0%
Performance fee	15%	0%	0%	0%	15%	20%	20%	20%
Liquidity	Daily							
Dealing deadline	5pm Daily (Irish Time), 1 Business Day Preceding Dealing day							
Redemption fee	Up to 3%							
Subscription fee	Up to 5%							
Legal adviser	A&L Goodbody							
Auditor	Deloitte & Touche							
Administrator	Northern Trust International Fund Administration Services (Ireland) Ltd							

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