



Jiro Yasu and Patrick Rial

Varecs Partners



Follow Up and New Idea

April 2019

Overview of VARECS Partners Limited

- **A Tokyo-based Independent Registered Investment Adviser**
- **Established May 2006**
- **Our Strategy**
 - ✓ Investing in undervalued Japanese equities
 - ✓ Typical Profile: family control, high margin, modest growth, stable revenue stream, etc.
 - ✓ Focus on smaller capitalization companies (typically \$150 million to \$1 billion)
 - ✓ Long-term: average holding period of over 5 years (turnover has been 15-20% per year)
 - ✓ Build a constructive relationship with the management team
- **Assets Under Management**
 - ✓ Strategy AUM: Approximately US\$ 310 million
 - ✓ Client base: endowment, foundation, and family offices in the U.S. and Europe
 - ✓ Yasu family invests about \$20 million in the fund
- **Investment Team**
 - ✓ Jiro Yasu, Portfolio Manager
 - ✓ Patrick Rial, Senior Analyst
 - ✓ Yosuke Yano, Analyst

Follow Up

Company Name	Date of Presentation	Total Return(%)*	Current Status	Major Developments
Toei Animation (TSE: 4816)	2013/11/05	+128.08% (Topix: +32.1%)	Closed 2015/12	
Sotsu (Jasdaq: 3711)	2013/11/05	+48.7% (Topix: +51.0%)	Non-Core	<ul style="list-style-type: none"> We have not given up yet. But, the position size got smaller as our AUM grew Still no profit growth Another management change It has been failing to capture growth of contents business About 75% of market cap in cash and securities, trades at 2.6x LTM EBIT. Got cheaper.
EM Systems (TSE: 4820)	2015/4/7	+219.0% (Topix: +9.8%)	Core	<ul style="list-style-type: none"> Announced new 5-year business plan in 2018 to transform the company to full-SaaS company Due to the change, operating profit is expected to decline in FY 2019/03 and FT 2020/03. But, it plans to increase its operating profit by 50% in 5 years Bought back shares twice in during current fiscal year Still owns the Osaka building which is fully occupied. Estimated worth 1/2 of market cap Excluding net cash and the property, it trades around 6.6xLTM EBIT

Follow Up

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Company Name	Date of Presentation	Total Return(%)*	Current Status	Major Developments
Agro Kanesho (TSE: 4955)	2016/4/5	+140.6% (Topix: +33.8%)	Core	<ul style="list-style-type: none"> • It built new factory to increase its production capacity for future growth • It acquired one product from Dow DuPont in 2018 • It plans to launch one new product in 2020 • Announced new 5- year business plan. Operating profit will decline initially due to increase of depreciation cost for new factory and amortization of goodwill. It expect that operating profit will grow 50% in 5 years • As it deployed its some of its cash, now 1/3 of market cap in cash. Trades at 10x LTM EBIT
Amuse (TSE: 4301)	2017/4/5	-1.8% (Topix: +10.4%)	Core	<ul style="list-style-type: none"> • Traded as high as 4,120 yen around February 2018 but corrected by 40% since then. We have increased our investment in the company • FY2018 has been an better year in terms of revenue. However, the company failed to translate it into better operating profit due to cost increase of live events and other one time costs (i.e. moving cost of main office, 45th year anniversary related costs, etc.) • Its JV with Line started a ticket selling platform based on Line messaging app. It will gradually open it to large events this year • It opened up its music portfolio to streaming services. Operating profit from rights business grew by 34.5% YoY • About 55% of market cap in cash. Trades at 5.4x LTM EBIT

Follow Up

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Company Name	Date of Presentation	Total Return(%)*	Current Status	Major Developments
CRE (TSE: 3458)	2018/4/5	+9.0% (Topix: -5.7%)	Core	<ul style="list-style-type: none">• It announced 5-year business plan. It plans to continue to grow its recurring revenue and reach 5 billion operating profit• Acquired 51% of Brain Wave, a logistics-focused IT provider, and 100% of Logicom, a major master-lease operator in FY 2018• The share price appreciated by 28% in 2018, the best performer in our portfolio• Bought back approximately 2% of outstanding shares in 2018• Excluding debt for development, it is traded at 3x LTM EBIT

*Total Return from the date of our presentation to March 31st 2019. Including dividend

New Idea: Hikari Tsushin (TSE: 9435)

Summary

Business Summary

- Hikari Tsushin Inc. (Hikari) directly and indirectly distributes various B-to-C and B-to-B products such as cellular phones, water-servers, insurance products, internet service, fax and copy machines, etc.

Valuation

- Share Price: 20,600 yen
- Market Cap: 951 billion yen (\$ million)
- Net debt: 130 billion yen (\$ million)
- Investments: 275 billion yen (\$ million)
- Enterprise Value: 828 billion yen (\$ million)
- EV/LTM EBIT 13.3x
- EV/LTM EBITDA: 11.6x
- PER LTM: 19.7x
- PBR 4.0x

As of 2019/4/8
USD/JPY 110

Thesis

- We believe Hikari is a rare compounder in Japan
 - Building businesses which produce recurring revenue and profit
 - 30-40% IRR hurdle for new customer acquisition cost
 - Maintain high operating margin due to one of best cold-calling armies in Japan
 - Our estimate of intrinsic value: 23,635 yen (16% upside potential)
- IV per share compound through rational capital allocation
 - Cash flow will be invested in new customers, own shares, shares of U.S. compounders, and undervalued Japanese companies (both minority and majority stake)

New Idea: Hikari Tsushin (TSE: 9435)






Share Price Performance

- Hikari's share price has compounded at annual rate of 21.8% for the last 5 years



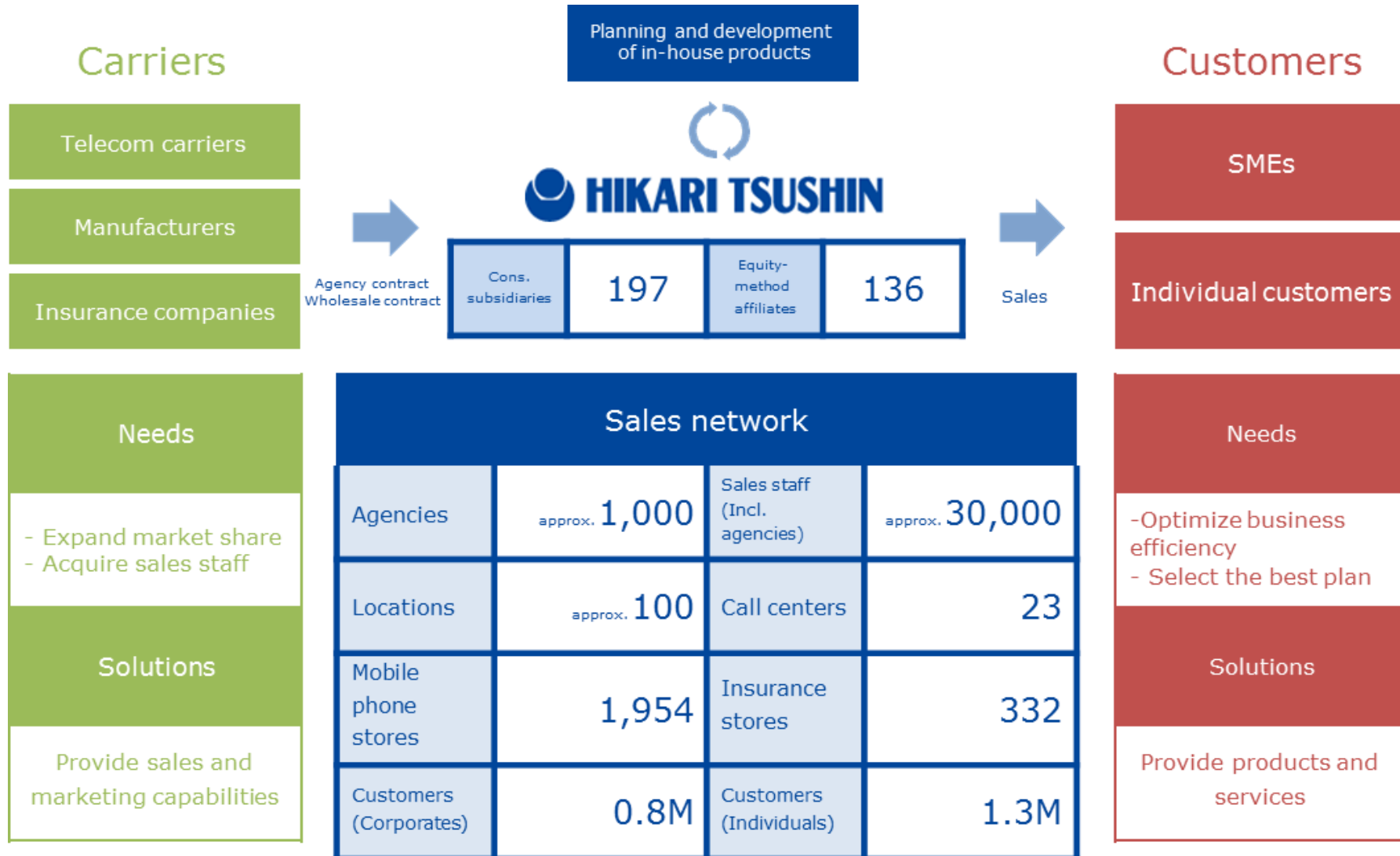
Main Products

In-House Products

1) Water Cooler	2) Mobile Wi-Fi Routers	3) Internet Service	4) Industry Specific IT Solutions
 No. 1 in Industry (units sold per month)	 No. 1 in Industry (units sold per month)	 No. 1 amongst independent companies	 Over 20 million registered members
5) MVNO	6) Contents	7) Electricity	7) LED Light for Corporate clients
 Rapid increase in units sold	 Selling well	 Selling well	 No. 1 in Industry (units sold per month)
8) Photocopy Machine	9) Mobile Phone	10) Insurance	11) Fixed-line Internet
 No. 2 amongst independent companies	 No. 4 in Industry (units sold per month)	 No. 1 amongst independent companies	 No. 1 in Industry (units sold per month)

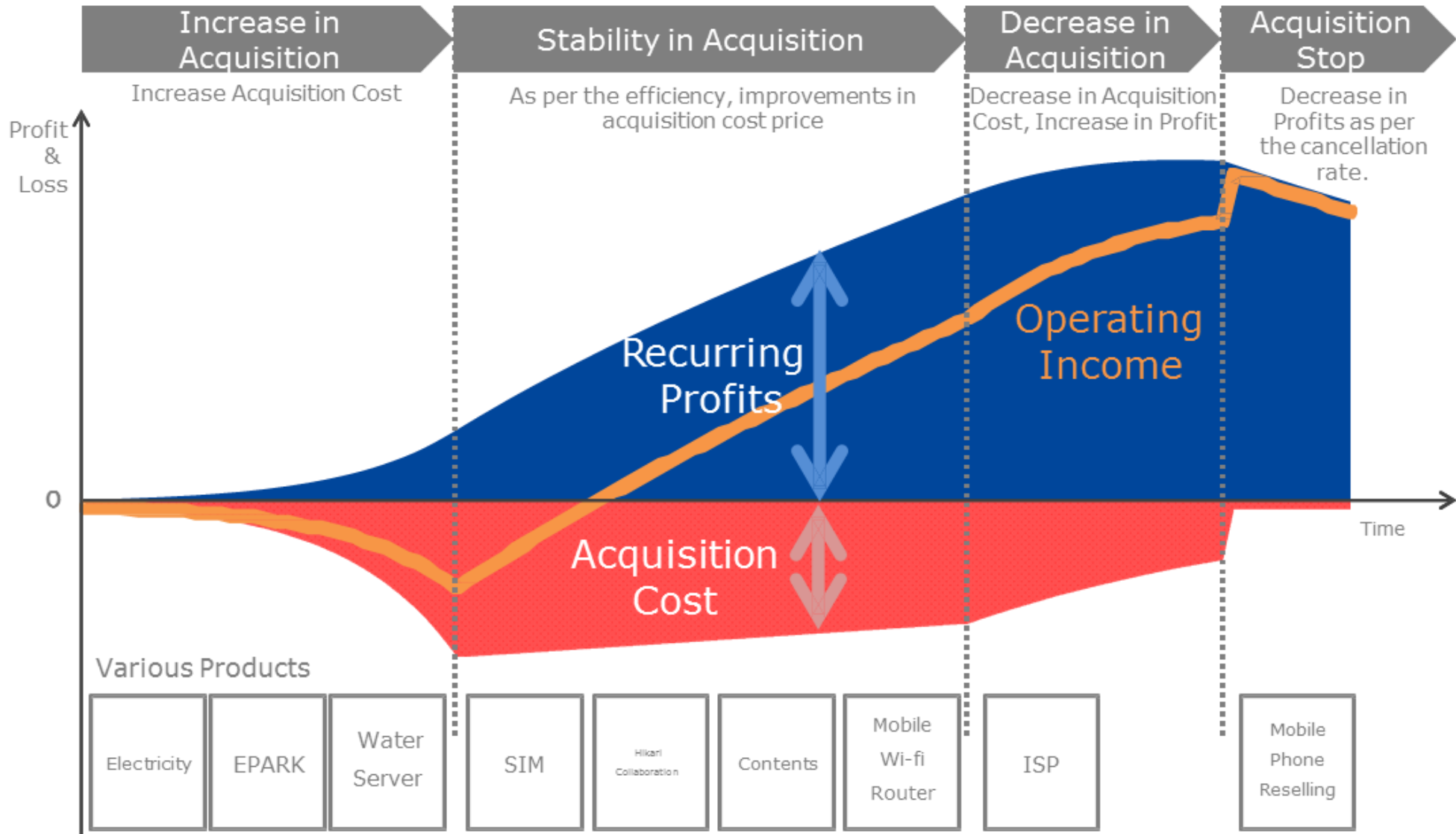
Source: Hikari Tsushin

Distribution Network



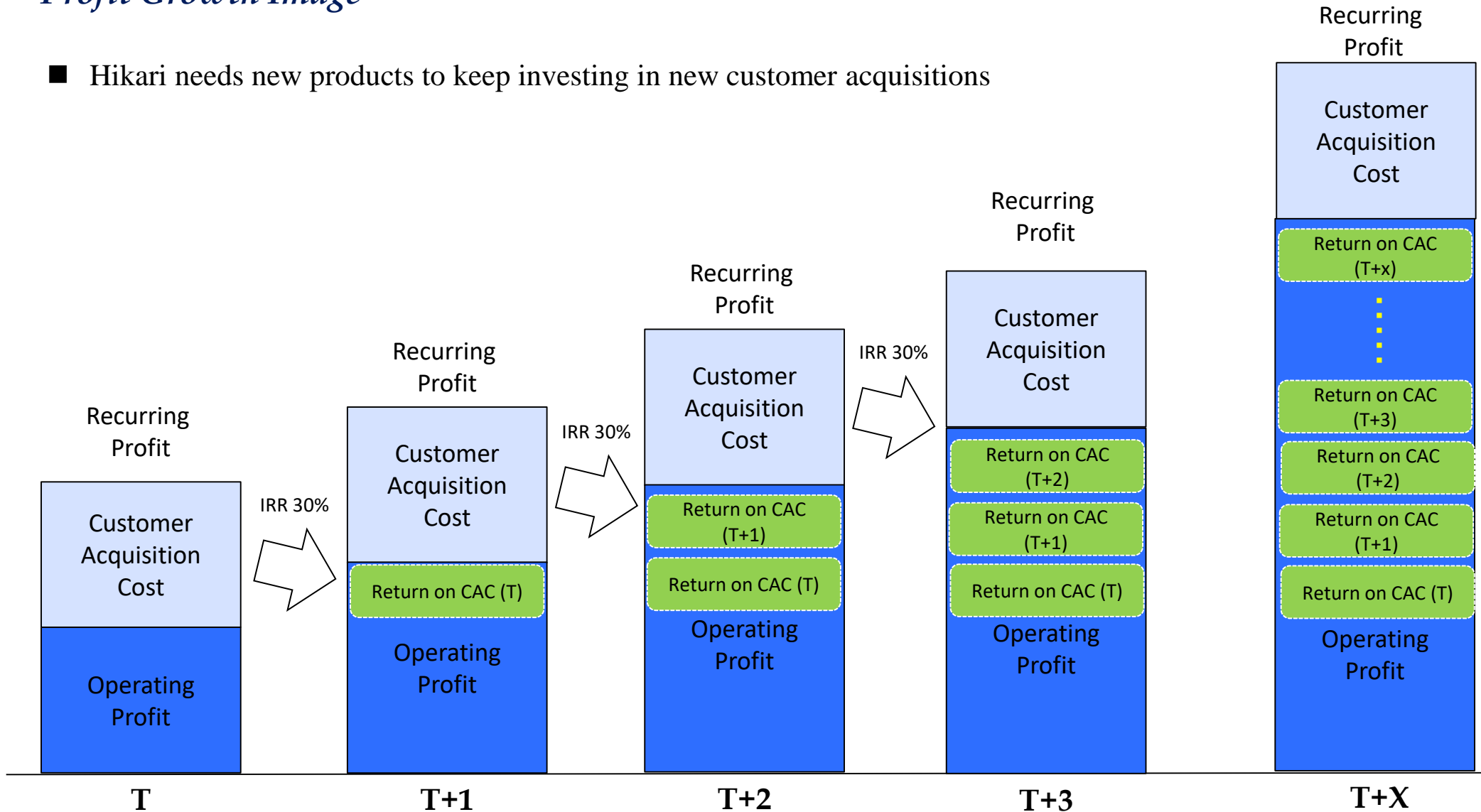
Source: Hikari Tsushin

Customer Acquisition and Operating Profit



Profit Growth Image

- Hikari needs new products to keep investing in new customer acquisitions



New Idea: Hikari Tsushin (TSE: 9435)

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Historical BS PL

	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Revenue	314,135	333,663	349,097	449,050	499,305	500,312	565,165	562,509	447,681	428,913	427,539	450,000
Stock Profit	22,700	23,800	27,700	32,100	40,400	48,200	53,100	60,400	68,400	74,100	81,100	100,000
CAC	-200	-300	23,900	29,600	22,100	23,700	21,400	28,400	31,000	32,600	31,700	41,000
OP	22,919	21,464	3,847	2,594	18,371	24,594	31,763	32,084	37,662	41,561	49,483	59,000
EBITDA	25,434	24,186	6,345	5,174	21,946	27,504	34,902	36,276	43,027	46,909	56,700	68,233
Net Income	2,801	-1,002	755	-701	7,828	16,887	29,352	20,763	22,573	39,034	41,862	40,000

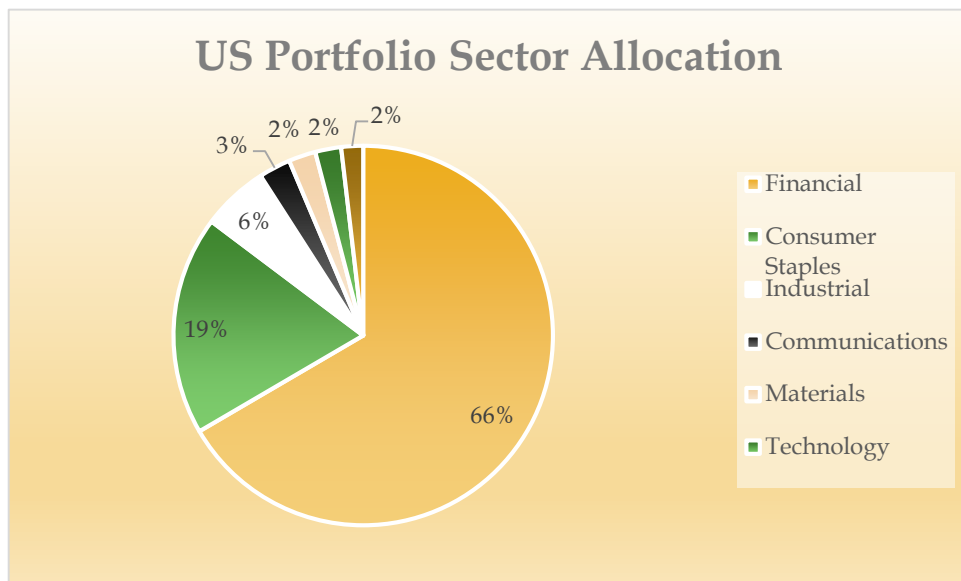
	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18
Net Assets	135,154	116,094	114,046	109,411	106,167	123,854	143,651	175,511	172,781	193,672	238,628
Total Assets	230,777	221,091	217,552	228,885	231,097	251,251	338,815	393,352	408,004	511,487	681,466
Own Equity Ratio	58.6%	52.5%	52.4%	47.8%	45.9%	49.3%	42.4%	44.6%	42.3%	37.9%	35.0%

Mar 19: Company's estimate

Capital Allocation

(JPY million)	5 Years (FY2014/3-2018/3)	%
Stock Profit	337,100	
Customer Acquisition	145,100	
Operating Profit	192,000	
Net Income	153,584	100%
Dividend	45,400	30%
Buy Back	33,600	22%
Capex	40,673	26%
Net Equity Investment	26,364	17%
Buy	171,602	112%
Sell	-145,238	-95%
M&A/Divesture	9,937	6%

US Stock Portfolio



- \$460mn US equity portfolio
- Targeting highest quality businesses to learn their business models and apply to Hikari Tsushin practices.
- Median ROCE of 35% for US holdings and 9.6% annualized return over the last 5 years.

Source: Hikari's 13F filing as of 12/31/2018

Top 10 Holdings	Value (\$1000)
BERKSHIRE HATHAWAY (A)	224,910
WELLS FARGO	36,878
VISA (A)	13,405
3M	11,832
BANK NY MELLON	11,064
JOHNSON & JOHNSON	9,185
APPLE	7,740
ALPHABET (A)	7,294
DANAHER	6,717
KRAFT HEINZ	6,060
Others	96,724

* Companies in red are also owned by Berkshire Hathaway

New Idea: Hikari Tsushin (TSE: 9435)

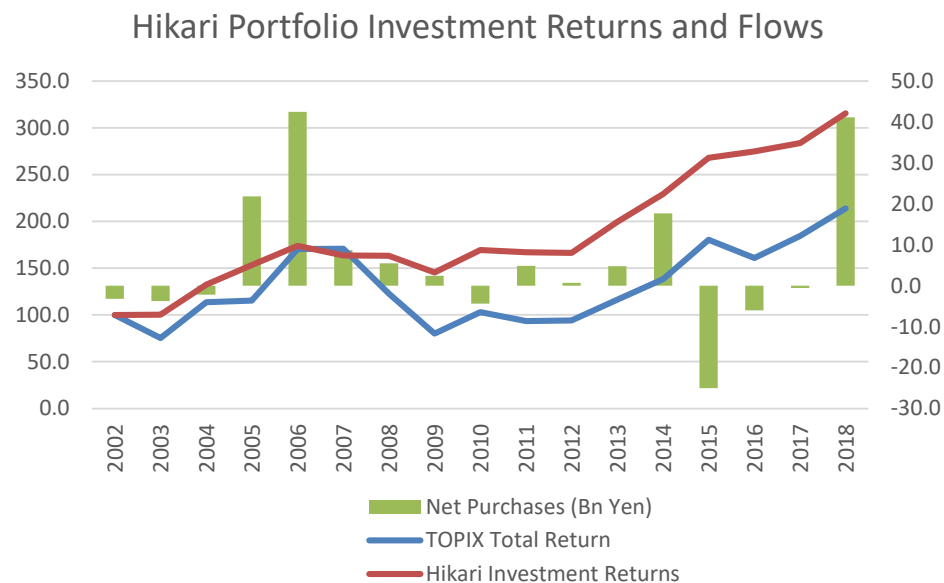
Comparison vs. International “Compounders”

Ticker	Name	Market Cap	EV/ EBIT	EV/ EBITDA	EV/ S	P/B	P/E	5Yr Annual Return
9435	Hikari Tsushin	8,660	13.3	11.6	2.4	4.0	19.7	22.6%
UTX	United Technologies Corp	113,535	18.1	14.1	2.3	3.0	16.8	5.2%
DHR	Danaher Corp	94,114	30.3	21.9	5.2	3.3	35.0	19.3%
CHTR	Charter Communications Inc	89,000	30.9	10.4	3.7	2.2	55.2	21.3%
STZ	Constellation Brands Inc	36,083	20.7	17.4	6.1	2.5	22.5	19.9%
ROP	Roper Technologies Inc	35,529	28.7	22.7	7.7	4.6	36.7	21.9%
VFC	VF Corp	35,347	21.0	18.1	2.8	8.2	23.1	11.4%
FTV	Fortive Corp	28,788	26.4	21.6	4.8	4.4	27.5	NA
TDG	TransDigm Group Inc	24,172	20.1	18.7	8.8		32.6	28.8%
LBTYA	Liberty Global PLC	19,875	56.8	10.1	4.0	4.4	NA	-3.5%
CSN	Constellation Software Inc/Can	18,676	37.6	23.2	6.0	21.6	50.5	36.5%
L	Loews Corp	14,915	20.4	NA	2.0	0.8	23.0	2.7%
JKHY	Jack Henry & Associates Inc	10,964	27.6	19.8	6.9	7.9	35.4	22.9%
HSIC	Henry Schein Inc	9,243	16.0	12.5	0.9	3.2	14.9	6.7%
Median			26.4	18.4	4.8	3.8	30.0	19.6%

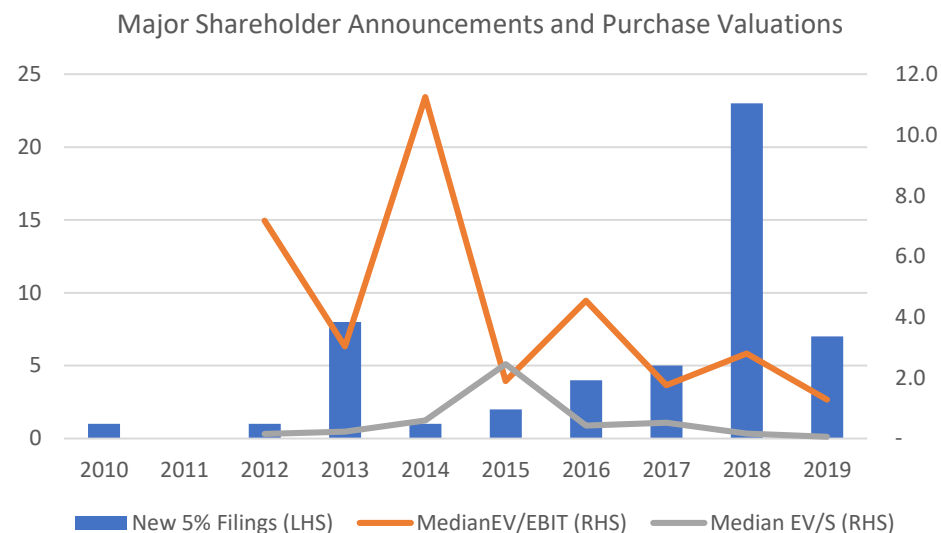
- Overseas “compounder” companies with multiple business lines like Hikari trade at a median EV/EBIT of 26.4x, Price-to-Book of 3.8x and P/E Ratio of 20.
- On this basis Hikari looks reasonably valued at 13.3x EBIT, 4x P/B and 19.7x P/E.
- Stock performance of the last five years for Hikari have exceeded all but the top-performing compounders..

Source: Bloomberg

Japanese Stock Portfolio



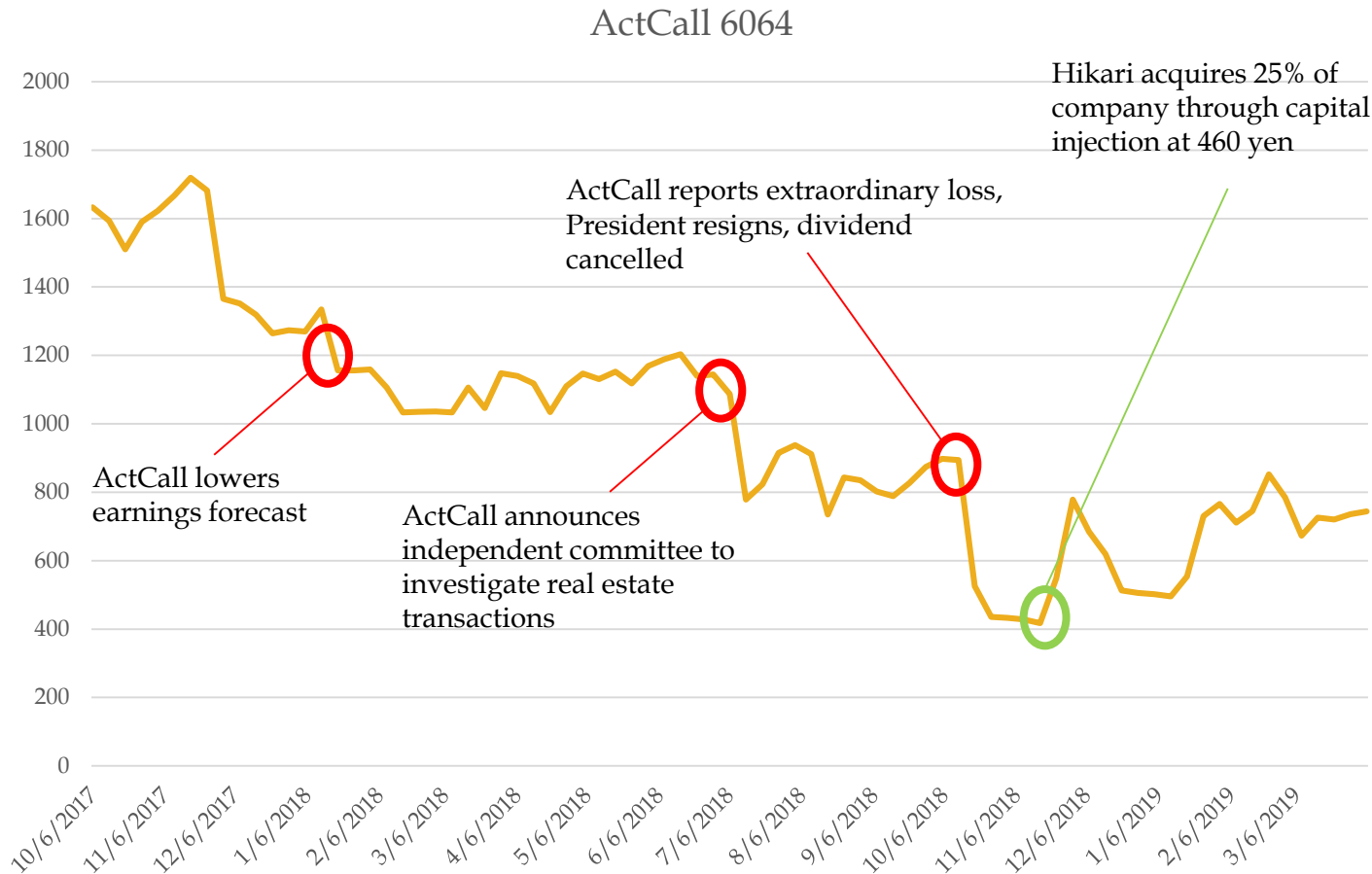
- Japanese equity portfolio worth at least \$1.45bn.
- 90 known investments at Hikari. 23 at subsidiary Broad Peak. Many other investments are undisclosed. The company uses at least 10 subsidiaries to make equity investments.



- Consistently paying under 4x EBIT and 0.3x Sales to purchase Japanese stocks.
- Purchases accelerating in last 12 months after bond issuance.

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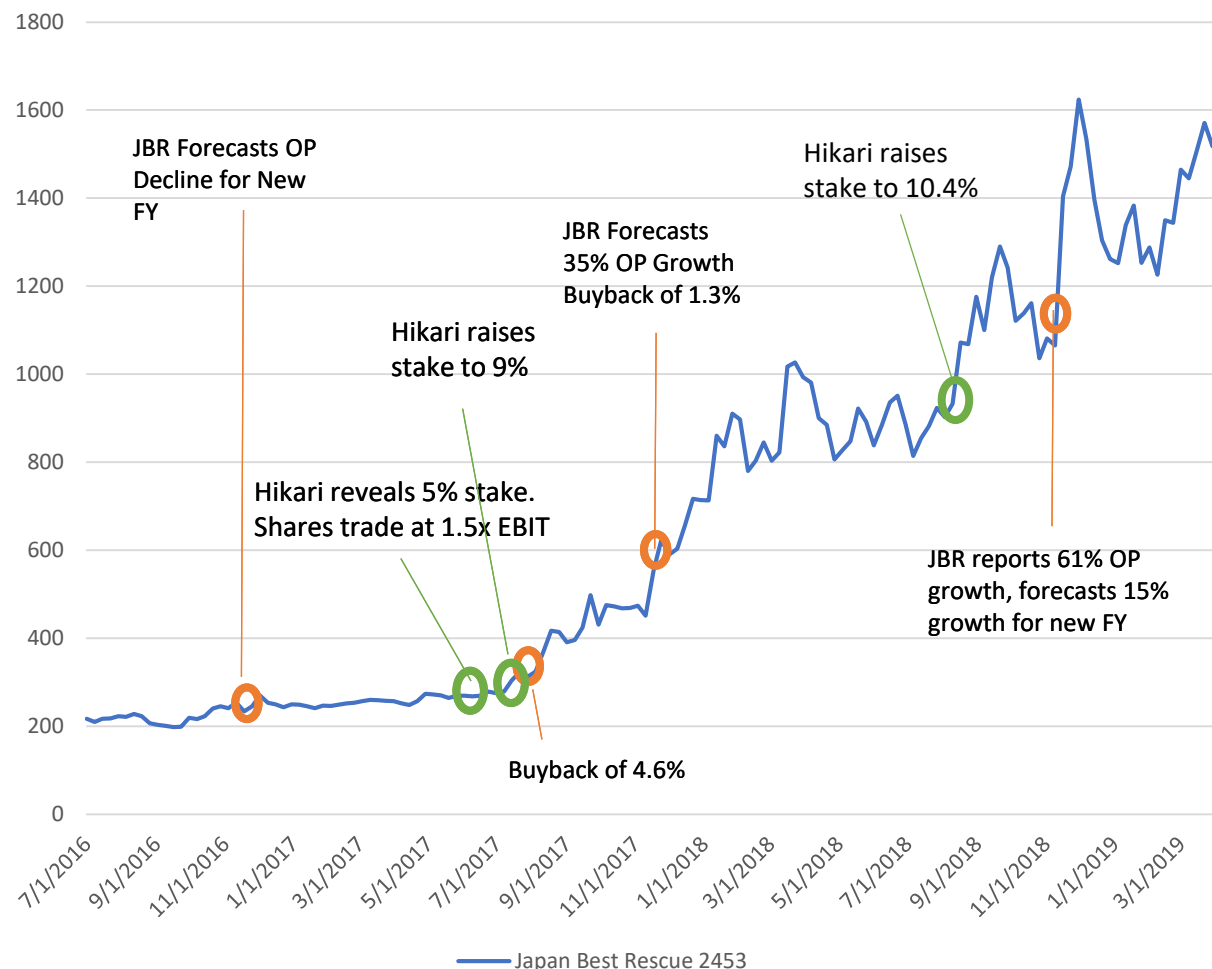
Japanese Stock Portfolio - Opportunistic Investing - ActCall 6064



- Hikari recently helped to rescue ActCall after accounting scandal resulted caused extraordinary losses
- Majority of board members now from Hikari Tsushin
- Stock business model with similarities to Hikari business lines.

New Idea: Hikari Tsushin (TSE: 9435)

Japanese Stock Portfolio - Value Investing - Japan Best Rescue 2453



- Hikari started investing in Japan Best Rescue in 2017 after it hit a lull in growth.
- Stock based business providing a AAA type services for various home maintenance problems.

New Idea: Hikari Tsushin (TSE: 9435)

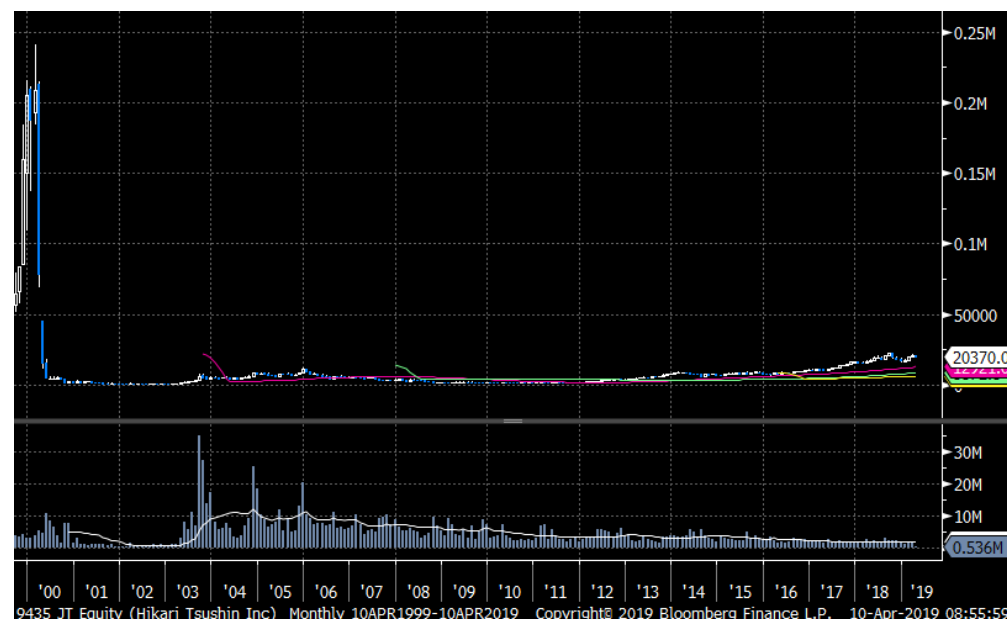
Internet Bubble and Hikari Tsushin

- We believe Hikari is avoided by most of portfolio managers in Japan due to its collapse in 2000. Only 5% of its shares are currently owned by Japanese mutual funds
- Hikari was one of most popular stocks in tech bubble days and reached over 5 trillion yen (approximately \$50 billion) market capitalization in 1999
- As tech bubble burst in 2000 March, Hikari share price also collapsed dramatically. The share were not traded for 20 trading days due to Tokyo Stock Exchange's limit-low rules. It lost 95% of its value in just 2 months

Share Price Chart
1999-2000



Share Price Chart
1999-2019



New Idea: Hikari Tsushin (TSE: 9435)

Valuation

- We apply 10 times multiple on its recurring profit
- We see modest upside potential at current share price. However, we believe its IV will compound at decent rate over years as its keep investing in new products and customer acquisition and doing right capital allocation over years

	Recurring Profit	x	Multiple	=	Business Value
Recurring Profit	100,000		10		1,000,000
Business Value					1,000,000
Cash					165,001
Debt					295,828
Investment					222,362
Total IV					1,091,535
Shs. Outstandings					46
IV/Share					23,635
Upside					16%

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