

TRANSCRIPT: EPISODE 165
16 December 2021 (pre-recorded 2 December 2021)

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[INTRODUCTION]

Chris Salih (CS): Hello I'm Chris Salih investment research analyst at FundCalibre and today I'm delighted to be joined by Praveen Kumar manager of the Elite Rated Baillie Gifford Shin Nippon investment trust. Thanks for joining us today.

Praveen Kumar (PK): Thanks for having me Chris.

[INTERVIEW]

[0:14]

CS: You mentioned in your latest report that the Japanese market takes a dim view of management investing in the business, at the expense of profitability, and so a couple of things come to mind with that. Firstly, is that not a positive thing for investing in the future or is it simply something that the company wants to do maybe to pay dividends instead? Maybe just give us your view on that to start with?

PK: Yeah, sure. So typically the type of companies that we would invest in would be quite immature, fast growing businesses. And as you can expect, a lot of these businesses need to continuously invest in, you know, in that growth, we use a term called 'growth strain' for that particular attribute. Now quite often especially in Japan, what we've seen companies are generally very, very risk averse. So they take a very, very conservative view of things in their business. If there is an opportunity, a new growth opportunity, they generally are very slow to kind of exploit that. So those more traditional type businesses are the ones we tend to avoid.

TRANSCRIPT: EPISODE 165

What we are looking for are dynamic, entrepreneurial businesses that are not afraid of taking risks and for us, those businesses have the ability to kind of, you know, invest in future growth at the expense of short-term profitability. For us, that's actually quite an admirable characteristic for management teams and something that's in very much short supply, as far as Japan is concerned.

So for us, a key metric is not so much profitability, but sales growth. So as long as the company is growing its sales at a pretty fast pace, we tend to be fairly relaxed about where the profitability is at the moment. We make the very long-term view that eventually once the company matures the profitability or the returns profile of the company would look completely different from what it is today. So that's really the underlying philosophy for a lot of the businesses that we invest in.

[2:10]

CS: Okay. You also talk about how over the past decade more entrepreneurs have started businesses across lots of different sectors, which has sort of increased your opportunity set. What's caused this shift and can you give us maybe a couple of examples that stand out?

PK: Yeah, sure. So this goes back to the point I made about Japanese society in general being very, very risk averse. And we've seen that not just in corporate Japan, but you know, Japanese people in general. You know, I can give you examples of whether it's adoption of, you know, e-commerce or new forms of payment things. Generally bank will change very, very slowly in Japan, but the caveat being once people have caught on to something, then the adoption tends to be really rapid. So that's probably the reason why Japan is still one of the largest users of cash. So the cash based economy in Japan is about 80% to 85%. Whereas if you take the other extreme, you know, something like Sweden is probably gone a 100% cashless or, you know, pretty much close to it. And even here in the UK, for us, we've seen an increasingly amount of transactions done by contactless, you know, credit cards, and other cashless mechanisms.

So there has been a tendency to kind of be very, very cautious, conservative, risk-averse but for the past kind of 10, 15 years what we've seen gradually change is just the types of people who are coming in and taking the risk to start businesses. Quite often, these tend to be younger entrepreneurs who maybe would have studied overseas or would have had some work experience overseas. And they've got a feel for how things are done in other markets that dynamism they've witnessed firsthand and some of those best practices, they try and bring back to Japan. And also the support level from the government. I mean, there's been a creeping realisation that, you know, the

TRANSCRIPT: EPISODE 165

way Japan has functioned as a society, you know, as a corporate entity so far, there's no longer going to be fit for purpose. So the government wants to become more competitive, especially in the non-manufacturing space and the manufacturing space it's still, you know, a world leader. But in the non-manufacturing space, they do really need to kind of encourage these types of risk-taking young dynamic businesses.

So one example would be, you know, a business like Snow Peak, which is a high end manufacturer of camping equipment. So nothing to do with online or AI or SAS or any of these buzzwords, that you tend to hear nowadays. And this is run by a father and daughter duo and this business was started quite a few years ago by the grandfather of the current president. And it started off as a very much a cottage industry or very small business just serving the local population. But once the father took over, the current president, took over and his daughter came on board, they started expanding more aggressively, creative ways of, you know, marketing. So they don't just bombard people with marketing messages. They actually lease massive plots of land and build camping sites on those to try and encourage people to actually come and experience it for themselves before they decide to actually buy the stuff. So quite a unique way of marketing, what is a very high end attractive proposition. So that's a classic example of, you know, a dynamic entrepreneur, you know, along with sort of this family trying to grow a business beyond just Japan.

[5:40]

CS: Okay. And I want to turn it to the portfolio quickly. You recently added a new stock called Kamakura Shinsho, which offers end of life services, which on the face of it, it's a little grim, but maybe tell us more about it and maybe the opportunity there?

PK: Yeah sure. So I mean, I always like to say that the Kamakura Shinsho is a bit of a morbid investment case. So you could think of this as an online version of Dignity, you know, the funeral services we have here in the UK. So in Japan, the funeral services and, you know, kind of related services are very, very traditional with probably near to 0% penetration in terms of ID or new technologies. And there's also tends to be a very, very large and opaque industry. So there's absolutely no regulation, no price transparency. And this industry tends to have local monopolies. So families choosing to go to the same funeral parlour across generations because, you know, they know they know the guy running the business and there's some family connection as well. So this kind of a relationship format, what this has meant that these companies get away with charging some really egregious prices, especially at a vulnerable time for these families and families in

TRANSCRIPT: EPISODE 165

exchange expect them to kind of, you know, shop around. It's a very difficult time for families, as you can imagine.

So this happens all across Japan and Kamakura Shinsho, is trying to kind of disrupt this entire kind of traditional way of doing this sort of business. So through its online website, it's brought in a very high level of price transparency, customers can pick and choose the kind of the products that they want. Quite often they're flogged really unnecessary products by these funeral parlours, which they don't end up using. So you can literally customise the package based on your budget or, you know, how many relatives you want to invite, how big a venue you want, and kind of secure all those sorts of things.

And along with that price transparency and the ability to customise packages, Kamakura Shinsho is also expanding into adjacent areas. So now they're starting to offer services like inheritance tax buying. So if the deceased has left a considerable amount of money to, you know, his or her children, then you know, how do you go about thinking through the tax implications, et cetera. So Kamakura Shinsho helps families with that. If the deceased has left behind a spouse who might need some nursing care services. So Kamakura Shinsho is now offering services where they actually help these families to place the elderly member in nursing cares close by. So they're adding various bits and pieces with the view of becoming almost like an infrastructure provider, a one-stop shop for everything to do with end of life services.

[8:33]

CS: Do they have to be careful about how quickly they do that? You mentioned Japan is slow to change, so do they have to sort of do it brick by brick without sort of shooting ahead of expectations?

PK: Yes, that's absolutely right and that is why some people get awfully upset saying, you know, there was such a massive opportunity. Why isn't this business growing much faster? I think what people tend to forget is there is quite a considerable amount of work that needs to be done before you get to that really rapid growth phase. And that work involves speed or number of stakeholders, getting them onto your platform. In many ways you're also not just helping the vendors with a new channel for marketing in terms of online, but you're also becoming a bit of a competitor. So how do you balance that kind of dynamic? So there are quite a few nuances that people just tend to forget.

TRANSCRIPT: EPISODE 165

It's not as simple as, you know, you build a site, throw a whole bunch of marketing dollars at this, and off you go with this, that doesn't really work like that in the real world.

So for us, the second thing is once you've done the hard work, and once you've established yourself as the go-to player, you become almost, you know your position becomes really really strong. So for someone else to come in to start from scratch, building those relationships, even if someone comes into the low cost offering, there'll be very little incentive for these vendors and families to switch if they've gotten so used to using Kamakura Shinsho services. And we've seen this replicated across a number of other sectors across a number of our holdings. So it's just a case of trying to be patient and supportive with these types of young businesses, giving management time and space to actually try and mature and build the business model.

[10:19]

CS: Okay. Just quickly on the fact that Japan now has a new prime minister fairly recently. Are you hopeful that the stability and structural changes in Japan will continue? Or do you still have concerns, particularly obviously in your sphere of investing?

PK: Yeah. I mean, our kind of investment style and philosophy, not just for the Japanese small cap funds, but across Japan and across Baillie Gifford is focused more on the individual company attraction. So, you know, bottom up stock picking, which means that for over the long term, we try and take politics and all of these micro economic factors out of the equation. So effectively, what we're trying to do is pick companies that will grow at a serious space over a long period of time, irrespective of what happens in the external environment.

So in that context for a lot of our companies, yes, supportive government policies have been helpful at the margin, but they are not really going to drive the long term success of these businesses. I always like to say, especially in small caps, the kind of companies we invest in will live and die by their own decisions. So in that sense, it doesn't matter if we get a very dynamic prime minister or if you get, you know, kind of reasonably average sounding prime minister and what their policies are, they perhaps are unlikely to have a significant impact on the long-term ability of companies to grow.

TRANSCRIPT: EPISODE 165

I mean having said that in recent years, there have been some helpful policies that have been instituted. So things like deregulation, corporate governance related reforms, all those things were instituted quite a few years ago, but now they become more or less as, you know, business as usual accepted practices. So they don't really need a fresh round of regulatory change. So in that sense a new prime minister might not rate them too highly, but I don't think that that is likely to have any significant bearing on the stocks that we own.

[12:25]

CS: And just lastly, obviously we've been living in extraordinary times for the best part two years now, in sort of a normal world, how often do you visit Japan? And could you maybe tell us where's the most interesting place in Japan you visited in your time?

PK: Yeah, sure. So typically every member of the Japanese team visits Japan at least twice a year, and we typically go for sort of two or three weeks. When I sort of started running the small cap funds about six odd years ago, I tried to do something different. So I went with my family to Japan for six weeks. So we took our service department and stayed in Tokyo. And I used to do kind of four to five meetings every single day using the Tokyo Metro and my wife and son used to sort of go off to a nearby nursery and roam around and come back. And this was kind of my routine. And I memorised every single train station starting from my place all the way to the last station. So a bit like memorising the Piccadilly line stations in London.

So I've done that on two occasions and it was, you know, a fantastic experience. And I mean the most interesting place I've been to, it's kind of off the beaten track but it's a place called Tottori, which is a very small kind of prefecture. There was a company called Nippon Ceramic, which makes sensors for cars that I own in the portfolio and a went to visit management. And they have some amazing mounds in Tottori, which supposedly are quite famous. I never knew about that. But it was interesting just to see kind of people always talk about, you know, Japan always being about, you know the big cities and, you know, population migrating to the big cities, but even in a small place, like Tottori you actually could see quite a large number of really small scale cottage industries just wheeling away and, you know, doing their stuff. And it certainly didn't feel to me, like I was, you know, in kind of a very isolated area and it had a pretty vibrant economy of complete vibrant feel to it. That was kind of the more interesting observation for me from that trip.

CS: That's great Praveen. Thank you very much for joining us today.

TRANSCRIPT: EPISODE 165

PK: No worries. Thanks for having me Chris, cheers.

CS: And if you'd like to learn more about the Baillie Gifford Shin Nippon investment trust, please visit fundcalibre.com