

OPTIMAL JAPAN TRUST

Report for February 2000

The Optimal Japan Trust's unit NAV rose **12.7%** after all fees in February and is up **12.4%** year-to-date. The Topix index (AUD) by contrast rose **2.7%** for the month despite continued strong gains from the sectors commonly associated with the "New Japan" economy. By the end of 1999 we were finding it difficult to justify the pricing of most of the electronics leaders and had cut the Fund's weighting in this area. To our relief, the market has moved in our favour with large declines in certain electronic components stocks (*Matsushita Communications; Kyocera; Rohm*) and weakness in the major telecoms (*NTT; DDI*). Whilst we like some of these businesses, we could not stomach the prices they sold at in late 1999.

It has been noteworthy that investors have treated many of the hot new companies that led the market in the middle of last year a little less kindly in recent months as the passing of time has allowed them to compare reality with expectations. We have made a number of successful short sales in stocks with overly optimistic growth forecasts (*Don Quijote; C Two-Network; Nidec*) and believe this area will continue to offer shorting opportunities. Less successful (in fact totally unsuccessful) were our short sales in *Mitsubishi Electric* (rose on announcements about its technology that connects cell phones to base stations) and *Kyowa Hakko* (up on its involvement in biotech research) but losses were contained due to our rule of covering short sales if they move more than 10% against us.

The Fund had a long exposure of 104% of NAV and short exposure of 59% of NAV and remained hedged out of Yen into AUD. Stocks that contributed most to the Fund's return were:-

Longs

- Pacific Metals; Sazaby;
- Enplas; M.E.I.;
- Toshiba Ceramics; Benesse;
- TBS; Marusan Securities and
- Takuma.

Shorts

- C Two-Network; Nidec and
- Daiwa House

Company visits

In mid-February we paid a visit to some companies in the Osaka area and found the experience very useful. As the larger broking houses follow the global trend and chase big investment banking deals the coverage of smaller companies has deteriorated and it is always gratifying to find information that fails to get onto the global distribution lists. Apart from being an enjoyable exercise, it is also highly profitable and we learned a lot from our visits that we have put to work. We saw *Takuma* (code number 6013) – a maker of industrial boilers and waste disposal incinerators – and were pleased to find that their order backlog had grown to record levels. Earnings should follow soon and

the company is very cheap on 9 times FY97's record earnings and 1.2 times book value. A more contemporary investor relations strategy alone would do wonders for their share price.

The other visits we made were to *Daito Electron* (code no. 7609) and *Arrk* (code no. 7873). Both are smaller companies capitalised at less than \$350mn but both have strong growth prospects and have been sold heavily in recent months. *Daito Electron* was floated in September 1999 at an IPO price of 2400 but opened at almost 8000 on day one. Following such an over-excited start, it has since fallen back below 3000 where we are buyers. It earned almost 120 Yen per share in 1999 and has leverage into production of Sony's Playstation 2 through its manufacturing subsidiary Daitron Technology. It is a lesser version of Tokyo Electron selling on 20 times earnings as opposed to the latter's 150 times.

The most exciting visit was to *Arrk*. This is a very idiosyncratic company run with distinction by Chairman and company founder Mr Araki. *Arrk* is Japan's largest maker of industrial prototypes and has expanded globally through acquisitions in the USA, UK, Thailand and now Taiwan. Fixed costs are kept low as all employees must resign within five years and may then stay on as contacted labour but are compensated well in return. Their success depends on their ability to process data electronically and to integrate their role to an ever greater extent with the new product departments at their client companies. We believe they are very well led by Mr Araki and his team and are a very attractive investment.

We should shortly have our website completed and will notify you of the details as soon as available.

Warwick Johnson
Managing Director