

November 22, 2019

## Dear Clients and colleagues:

Workers in Japan are known for having a strong work ethic. They work long hours and often do not take enough time off. Hard work is seen as one of the drivers behind Japan's economic miracle, which began in the 1950s and propelled the country to become the second largest economy in the world (before overtaken by China in 2011). Last month when Hagibis, the most powerful typhoon in decades, hit the country, many workers were still expected to turn up for work, even if the business was not providing an essential service, such as restaurants, coffee shops and estate agents.

Working long hours is a way of life in Japan. In addition to the overtime workers put in at the office, they are also expected to participate in after-work activities, such as socializing with colleagues or clients. However, working long hours doesn't mean higher productivity. In fact, Japan's labour productivity in 2018 was US\$47.5 per hour, the lowest among G7 countries, and it ranked twentieth out of the 35 members of the Organization for Economic Cooperation and Development (OECD). The average labour productivity in OECD countries is US\$53.5 per hour.

Excessive work habits have also created problems for the country. Salary men and women are exhausted from working long hours. This affects their willingness to have children. Each year, hundreds of deaths are found to be related to Karoshi, which means death by overwork. The issue of Karoshi was brought back into the spotlight when a 24-year-old employee of Dentsu jumped to her death on Christmas Day in 2015 after working over 100 hours of overtime per month for an extended period of time. In 2018, the number of people working more than 60 hours per week was 3.97 million in Japan, or 6.9% of total working population, the fifth highest among the 35 OECD members. The Japanese government's target is to reduce the ratio to 5% by 2020.

To address the overwork problem, in July 2018 Japan passed the *Work Style Reform Act*, a flagship legislation of Prime Minister Shinzo Abe. It introduced mandatory limits on overtime hours for the first time. The Act came into effect for large employers on April 1, 2019, and will come into effect for small employers starting in April 2020. The Act sets the maximum hours of overtime at 100 hours per month and 720 hours per year. Companies will be punished if they exceed these limits.

However, the labour market remains tight given the aging and shrinking workforce. To be compliant with the new Act and control workers' overtime, many employers are trying to improve productivity by employing IT reforms to eliminate repetitive work and improve business process efficiency. IT spending in Japan continues to grow, driven by digital transformation, IoT, cloud and artificial intelligence (AI).

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NS Solutions Corp., a company we hold in our portfolios, is one of the leading IT system integrators in Japan. Originally a department of Nippon Steel, the company was spun off in the 1980s. The experience accumulated while part of Nippon Steel helps NS Solutions to better understand clients' needs, especially in the manufacturing industry. Currently about 18% of the company's sales comes from Nippon Steel. NS Solutions has over 50 years of experience building large-scale computer systems. The average length of a project is three years. The company provides wide-ranging solutions in three main areas: applications, infrastructure and data centre services. In the first half of fiscal year 2020, the company achieved 30% and 34% growth in revenue and profit, respectively, driven by orders from manufacturing, retail industries and public organizations. Margins also improved as they are more selective when choosing projects. Going forward, growth drivers will be cloud and public IT infrastructure projects.

Internet Initiative Japan Inc. (IIJ) is another company we own in our portfolios. We wrote about IIJ in a commentary earlier this year. As a leading internet infrastructure provider, IIJ has the top market share for public cloud services in Japan. The company provides internet connectivity, system construction, system operation and maintenance services. Recurring revenue is high at over 80%. IIJ differentiates itself from its competitors through its strong relationship with blue-chip companies, cloud expertise and capabilities with overseas projects. Among the top-ten firms in major industries, IIJ has an 80% to 100% penetration rate. While most Japanese system integrators focus on the domestic market, IIJ has a track record of assisting Japanese companies with their overseas development. The company will continue to cross-sell more services to its over 10,000 existing corporate clients. Cloud is another growth driver for IIJ. It currently contributes 11% to total sales.

Next month, Global Alpha will attend the Nomura Investor Forum in Tokyo, meeting with our portfolio holding companies and discovering new investment opportunities. We will keep you posted.

Have a great weekend.

The Global Alpha team

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