**February 25, 2011**

**Dear clients and colleagues,**

In 2010, the world economy grew by a total of 4.1%. The container market saw good growth in 2010 as global demand for container transportation increased by 13% compared to 2009. The increase in the container market reduced the number of laid-up vessels over the year. At year-end 2010, around 2% of the global container fleet was laid-up, compared to approximately 12% at the beginning of the year.

In 2002, the Japanese government launched the Super Hub Port Initiative with the goal to reduce costs and improve services in Japan's container trade. Its goals include reducing harbor fees by 30% and slashing lead times by three or four days. In August 2010 Japanese government funneled investment into Hanshin Port (consisting of the ports of Osaka and Kobe) and Keihan Port (the ports of Tokyo, Nagoya and Yokohama). Container cargo volume at Japan's five biggest ports is expected to grow faster.

This week we shall profile Kamigumi (Japan 9364 - ¥727), a current holding in the portfolio which has a huge exposure in those ports.
http://www.kamigumi.co.jp

***Business overview and history***

Founded in 1867 and headquartered in Tokyo, Kamigumi is a Japan-based company mainly engaged in providing logistics and transportation services. It offers port transportation, warehousing, freight forwarding, ship chartering, packaging, and road transportation services. It operates in Japan, China, Hong Kong, Indonesia, Malaysia, Singapore, Thailand, Taiwan and Vietnam.

Kamigumi is one of the biggest logistics service operators in Japan with 38 locations. Kamigumi provides transportation and logistics services though Portia, Osaka, Sakai Semboku, Kobe, Kanmon, and Hakata Ports in Japan. It has no debt and a stable dividend policy; it has also bought back shares for three consecutive years.

Kamigumi services include port-harbor transport, loading and unloading, handling handover, forwarding, warehousing, trucking, packing, and heavy cargo transport. Its principal activity is the provision of transportation services. The operations are carried out through the following divisions: port transportation (35%); freight and warehousing (57%); and other (8%). Port transportation includes transportation through port and sea freight and warehousing includes warehousing, trucking, cargo handling and related services. Other includes construction, real estate and leasing.

***The market***

According to Drewry Shipping Consultants global container volume is expected to grow at 7.2% a year between 2009 and 2015 and volumes are expected to reach 718M TEU (Twenty-foot Equivalent Unit). Shanghai took the spot of world's busiest container port last year handling 29.1M TEU, while Singapore handled 28.4M TEU.

Japan handled 11.8M TEU as over 99% of Japanese import & export is sea-based. There is an increase in Japan/Asia trade as more Japanese manufacturers are moving parts to and from Asian operations; as well, there is an increase in demand for Japanese products from mainland Asian consumers. Increases in freight prices and increases in volume for ocean-going cargo should help Japan's logistic market grow at a faster rate.

***Competitive advantages and competition***

Kamigumi operates in a very fragmented market; in terms of market share, it has approximately 10% of the container market. It distinguishes itself by being one of the few companies that offers completely integrated transportation services: distribution processing, trucking services, storage and specialty cargo. There are also high barriers to entry for new firms, as various licenses, large investment in heavy equipment such as cranes and specific types of expertise are required.

Kamigumi is the only company that owns a berth at Tokyo Port (the other operators use a public or a private berth). This advantage has resulted in better efficiency and allows gaining new customers. It has a low exposure to the trucking business, where competition is strong and margins are low. From mid-1980s through mid-1990s Kamigumi invested close to ¥20B a year in automation and computerizing its port facilities, which has helped improve efficiency.

Main competitors in the logistics segment include: Sankyu, Mitsubishi Logistics, Mitsui-soko, Sumitomo Warehouse and Japan Transcity. Competition tends to be regional, given Japan's port fragmentation. The company is the only provider offering a nationwide port/logistics network.

***Growth strategy***

Kamigumi's main port transport operations, around 70% of sales are from imports and 30% from exports. Revenue growth is steady due to moderate growth in import goods accompanied by Japan's declining food self-sufficiency. Having computer-controlled operations helps improve the bottom line.

***Management***

Masami Kubo is the chairman of Kamigumi and started with the company in 1963 occupying various positions before taking on the role of president in 2004. He has also served as chairman of the Japan Harbor Transportation Association since 1997. The rest of the management team has been with the company for an average of 20 years.

***Risks***

Weakness in the global economy could cause freight volume and pricing to decline; however, Kamigumi caters to a diversified cargo mix (which should help stabilize demand trends). A weaker Yen could pose another threat; however, it will spur imports cancelling out the effect to some extent.

***Market data***

Market Cap US$2.4B, no debt, cash US$380M, fwd P/E 13.5x, EV/T12 EBITDA 5.6x, EV/T12 SALES 0.9x, dividend yield 1.2%, gross margin 17.0% and profit margin 5.8%.

***Investment theme and catalyst***

Globalization has created an increasing interdependence between economies, thus driving growing sea transportation among nations. With an excellent reputation and broad international network, Kamigumi is well-positioned to gain market share.

Private equity funds and institutions are showing interest in buying infrastructure projects; in 2007 the infrastructure investment group of Morgan Stanley acquired an 80% interest in Montreal Gateway Terminals. One of our holdings, Jones Lang LaSalle, announced in 2009 its plans to develop the Panama Canal Colon Port at the Atlantic entrance to the Panama Canal. In November 2010, Global Infrastructure Partners and the Abu Dhabi Investment Authority bought the Brisbane Port.

***Valuation***

We use a DCF model with a growth rate of 9% for the next 7 years, a growth rate at maturity of 6% and a risk premium of 9% to derive a target price of ¥1033.

Have a good weekend.

Regards,
The Global Alpha Team