

March 9, 2018

Dear clients and colleagues,

This week we attended the third Japan Opportunities Mizuho Small Cap Conference. Unlike many other investment conferences in Japan where large caps dominate, this one is focused on small caps with a market capitalization below US\$2 billion. Over 100 companies and 200 investors participated. The number of overseas investors in attendance doubled from last year. Japanese small caps are clearly gaining traction thanks to strong outperformance against large caps in recent years. We met 41 companies, of which 7 are holdings in our international micro cap portfolio, which was launched last November.

We have been visiting Japan each year since 2009. This time sentiments from investors and corporations were the most optimistic thanks to strong earnings and order intakes. We are convinced that the “lost decades” period is over. The Japanese economy is on a solid footing. Companies related to semiconductors and flat panel displays have largely outperformed in the past year, driven by strong demand for smartphones, data centre, AI, IoT and EV. Factory automation and staffing companies also enjoyed a big rally due to the more intense labour shortage in Japan.

This week we would like to profile Lasertec, a holding we met at the conference. Since we initiated a position in the company in November 2017, the stock price has risen over 80%.

Lasertec Corporation (6920 JP – ¥4,530)

www.lasertec.co.jp

Business Overview

Founded in 1960, Lasertec provides inspection and measurement systems based on applied optics technology. Its customers are global leading manufacturers in the semiconductor, flat panel display (FPD) and lithium ion battery industries such as Intel, Micron, TSMC, SMIC, HOYA and Shin-Etsu, etc. About 70% of sales are from overseas.

Investment Theme

Innovation is a clear theme for Lasertec. It is an R&D-oriented fab-light company with several sub-contractors in Japan. About 60% of the workforces are engineers. Ten percent of sales are invested in R&D. For seven consecutive years, the company has been selected as an “Intellectual Property Future Enterprise” in Japan. It also won the “10 Best New Products of 2017 Award Japan Brand Prize” by Nikkan Kogyo Shimbun and the Award of Excellence in Semiconductor of the Year 2016 by Electronic Device Industry News.

Target Market

The semiconductor mask inspection system and the FPD mask inspection system are Lasertec’s core businesses. The market size in 2017 was Y24B. The lithography inspection system and SiC wafer inspection system are Lasertec’s new businesses. The market size is Y40B – Y50B. All these niche markets are growing at double-digits thanks to IoT, data centre, AI, EV and self-driving cars.

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Management

President Osamu Okabayashi has held the position for over eight years. He speaks fluent English, which is uncommon for top executives of Japanese small caps. Together, the management team owns 3% of the outstanding shares.

ESG

Lasertec has set up corporate social responsibility guidelines, promotes environmentally sound products and protects the workplace. Three of the eight board directors are independent.

Market Data

Market Cap ¥213B, net debt/EBITDA -1.8x, Dividend Yield 0.88%, P/E (2018/6) 51.3x, Ev/Sales 9.5x, Ev/EBITDA 36.7x, Gross Margin 55%, EBITDA Margin 31%, Profit Margin 20%, ROE 15%.

Competition

Lasertec has very few competitors in its core businesses:

- Semiconductor mask inspection system: Lasertec has 75% global market share; KLA-Tencor 25%.
- Mask blank inspection system: Lasertec has 100% global market share.
- FPD mask inspection system: Lasertec has 100% global market share.

Competitive Advantages

- Niche market leader.
- Excellent track record.
- Solid balance sheet. Net cash.

Growth Strategy

- Product: driven by innovation.

Risks

- Forex volatility.
- Cyclical business.

Have a great weekend.

The Global Alpha team

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