COMMENTARY

May 29, 2015

Dear clients and colleagues,

The aging population is a very important investment theme in our portfolio. We invest in niche leaders worldwide that benefit from this secular growth trend, notably in the aged care and healthcare industries. For example, Orpea operates nursing homes with a network of over 58,000 beds in eight European countries. Extendicare, the largest pure play in Canada, has approximately 13,500 beds and provides senior care services. Message, the largest operator of senior homes in Japan, manages over 10,000 units. Lastly, Carl Zeiss Meditec, a Germany-based medical technology company, specializes in treating eye diseases.

How can we benefit from this theme in a different way? Let us take you to Japan, where the average age of corporate owners is 60. As a result, many small and medium size companies (SMEs) in Japan face serious succession problems. There are over 800,000 private companies in Japan, of which 240,000 are profitable. Yet, 66% of these profitable companies do not have a successor.

This week we feature Nihon M&A Center, an industry expert in Japan that supports friendly M&A among SMEs. We initiated a position in 2014, and its outperformance has been very consistent, driven by record-high results.

Nihon M&A Center Inc. (2127 JP - ¥4,725)
www.nihon-ma.co.jp

Business Overview

Founded in 1991, Nihon M&A Center is the largest independent M&A firm in Japan. In the past 24 years, it has successfully closed more than 2,000 M&A deals through providing advisory services. It has built the largest M&A cooperation network, with approximately 300 financial institutions and 500 accounting firms nationwide.

Why do companies need Nihon M&A Center? Finding buyers is easy, but sellers are harder to locate. This is because owners are reluctant to flag such intentions in fear that it could lose customers, lose financial standing with banks, and make the job of selling the business even tougher.

ESG

Nihon M&A Center was selected as one of Forbes Asia's 200 "Best Under a Billion ($)" Companies for two consecutive years (2013 and 2014). Only two Japanese companies were selected for two consecutive years.

We met management several time before we initiated. The team is very stable. Insiders own approximately 30% of the company, mostly held by the founder/Chairman and the President. Specific profit targets are tied to stock option incentives offered to management and employees. The dividend payout ratio is 35%. ROE is high at 32%. The corporate culture encourages career advancement and promotes contribution to the local community.

Market Data

Market Cap U$1.5Bn, No debt, Net cash U$65Mn, Dividend Yield 0.8%, P/E (2016/3) 39x, Ev/Sales 12x, Ev/Ebitda 26x, Gross Margin 67%, Operating Margin 50%, Profit Margin 32%

Competition

No direct competitor. It is the only player focused on small deals nationwide. The second largest player makes one tenth of its deals.

Competitive Advantages

- Excellent reputation
- First mover
- Largest M&A cooperation network

Growth Strategy

- Distribution: more consultants and more regional coverage
- More direct deals which carry higher margins than referrals.

Challenges

- Lack of experienced consultants

Recently, Nihon M&A Center announced full year results with record-high sales and profits for the fifth consecutive year. It also continues to increase its dividend. In the coming year, we are confident that the strong business momentum will continue at double-digit growth, rewarding long-term shareholders.

Have a nice weekend.

The Global Alpha Team