

April 29, 2016

Dear clients and colleagues,

A good business model does not have to be complicated. In weak economies, every dollar counts, and that's why dollar stores thrive around the world.

In Q4 2015 we initiated a position in Seria in the International Small Cap portfolio, a leading 100-yen store in Japan. Year to date its return is +8% versus its peer group of -7% and the Nikkei 225 Index of -12%.

Like many small cap stocks, Seria is under-researched. Only three sell-side analysts cover it, despite the fact that it is a US\$2B market cap company that has doubled sales in the past seven years. Profit growth has been phenomenal; over 8x during this same period thanks to profit margin expansion from 1.1% to 5.7%.

How did we discover it? First from our internal qualitative screen and then through meetings with its President at conferences and at its head office. Multiple store visits further enhanced our conviction.

Seria Co., Ltd (2782 JP - ¥6,330)

<http://www.seria-group.com/corporate/en/>

Business Overview

Founded in 1985, Seria is the second largest 100-yen store operator in Japan, with over 1,300 stores nationwide.

70% of its stores are located in grocery supermarkets, 20% are in shopping malls, and 10% are stand-alone stores. It carries about 18,000 stock keeping units (SKUs). All products are outsourced. Target customers are housewives, but it has now expanded to teens and retirees.

About 30% of all products it carries are made in Japan. When visiting its stores, we were amazed by the product quality and design as well as the neatness of the store layout.

In Japan, Seria is the only 100-yen store operator that has been gaining market share. Its key differentiator is a set of point-of-sales and order management systems which were developed in-house and optimize product selection and simplify operations based on customer needs.

Market Data

Market Cap US\$2.1B, net cash US\$151M, div yield 0.5%, ev/sales (2017/3) 1.5x, ev/ebitda 13.6x, P/E 28.3x, gross margin 42%, operating margin 8.9%, profit margin 5.7%, ROE 22%.

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ESG

Seria is a member of the JPX-Nikkei Index 400 which showcases the country's most profitable and shareholder-friendly companies. The founding family owns 40% of the company. Mr. Eiji Kawai, the nephew of the founder, has been the President since 2005. We met him several times; the latest time being March of this year.

Seria's corporate philosophy is built on 3 pillars. Cleanliness: to keep our heart and shop clean; Gratitude: to be thankful for all things; Sharing: to share the job, the responsibility and the information. Management emphasize that every staff member should be a good partner who shares joy with their customers. Seria provides regular trainings to help employees achieve their goals. The company also actively promotes measures to improve the working environment for women.

Its board has four internal directors but no external directors. We understand the local context, but highlighted to Mr. Kawai the importance of an independent board. We will continue the conversation going forward.

Target Market

There are over 6,000 100-yen stores in Japan, which represents a ¥550B stable industry. People look for convenience and value, in good times and bad times.

Competition

There are four major players in Japan:

- Daiso (a private company) opened the first store of this kind in Japan and has 64% market share.
- Seria has 19% market share, growing from 15.9% in 2010.
- Can Do (2698 JP) and Watts (2735 JP) have less than 10% market share each.

Competitive Advantages

- A true 100-yen store: All competitors sell some products at 200 – 500 yen, but Seria is determined to keep a single pricing for the convenience and trust of its customers.
- Strong brand: Shopping centres and supermarkets invite Seria to open stores in their locations in order to gain traffic.
- Highest operating efficiency in the industry: inventory turnover is 6.6x a year and increasing.

Growth Strategy

- Distribution: to open new stores nationwide.

Risks

- Competition

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In the past thirty years Seria has built a strong brand among customers and partners. We believe in its solid management and consistent growth strategy. A true 100-yen store. One buck at a time.

Have a nice weekend.

The Global Alpha Team

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