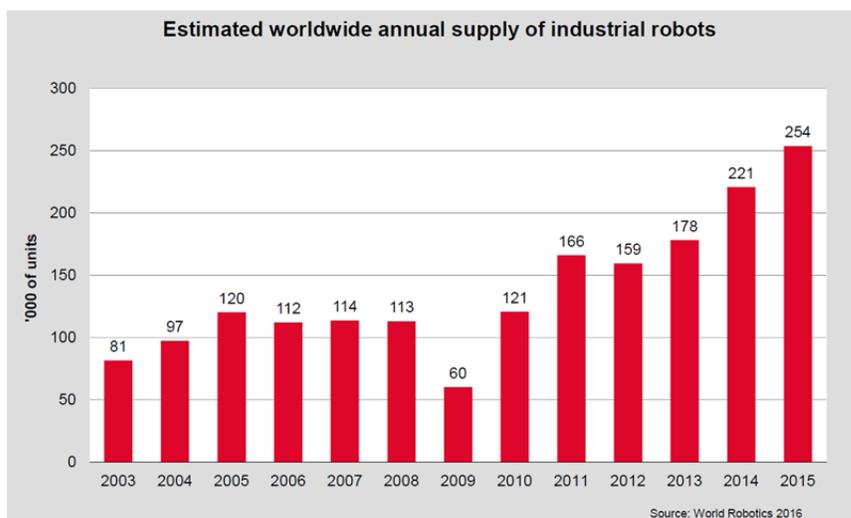


January 27, 2017

Dear clients and colleagues,

Factory automation has been a visible secular trend driven by an aging population, energy efficiency and increased high precision manufacturing. Between 2010 and 2015, robot sales increased on average 16% each year. In 2015, industrial robot sales reached a record high of 253,748 units. Industrial robots are widely used, particularly in the electronics, metal, chemical, plastics, rubber and automotive industries. China continued to be the biggest market with a 27% share of the total supply in 2015.



In our portfolio, Nabtesco is a Japan-based manufacturer highly regarded for its unique motion control technology. It has a 60% share of the world market for precision reduction gears used in the joints of industrial robots. This week we would like to profile a new addition to our portfolio – THK, a niche leader in factory automation based in Japan. We’ve met the management several times, the latest being last month at the Nomura Investment Conference in Tokyo. Since we initiated the position three months ago, the stock price has gone up 30%, helped by a weaker yen and very strong demand from the semiconductor industry.

THK Co., Ltd. (6481 JP – ¥2,822)

www.thk.com

Business Overview

Founded in 1971, THK invented the world’s first linear motion guide systems. These systems are applied as machinery components for the production of robots, machine tools and semiconductor equipment. They are critical for machinery precision and help increase productivity, quality and cost-cutting.

THK is truly a global company with a very diversified client base. 54% of sales are from overseas. The top ten customers account for less than 10% of sales.

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Management

Very stable management team. President Akihiro Teramachi joined the company in 1977 and owns 2.7% of the outstanding shares.

ESG

THK has very comprehensive ESG policies and reports. It discloses detailed data on environmental impact through input, output, energy, waste and airborne emissions. Many of its plants in Japan and overseas are ISO14001 certified. It targets a 1% reduction in CO² emissions each year. All production sites have obtained ISO 9001 certification for quality management systems. THK emphasizes the health and safety of its employees and promotes fair and equitable trade among suppliers. Four out of eleven directors are independent, a high number for Japan.

Market Data

Market Cap U\$3.2B, Net cash U\$0.3B, Dividend Yield 1.5%, P/E (2018/3) 19.3x, Ev/Sales 1.2x, Ev/EBITDA 8.6x, Gross Margin 28.2%, EBITDA Margin 15.6%, Profit Margin 5.7%, ROE 5.5%.

Competition

In Japan the main competitors are Nippon Thompson and NSK. Its overseas competitors are Hiwin, Bosch and INA.

Competitive Advantages

- First mover. THK has a 50% share of the global market in linear motion guide systems.
- Superior product quality, durability and technology.
- Strong R&D capability. THK and the Japanese Aerospace Exploration Agency (JAXA) jointly developed a robotic arm for detailed extravehicular operations.

Growth Strategy

- Distribution: THK continues to expand globally, especially in China, by increasing production capacity and sales force.
- New businesses: It aims to expand from capital goods into consumer goods-related industries.

Risks

- Yen fluctuation.
- Industrial capex cycle.

Have a great weekend.

The Global Alpha team

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