

# Dalton Kizuna Fund

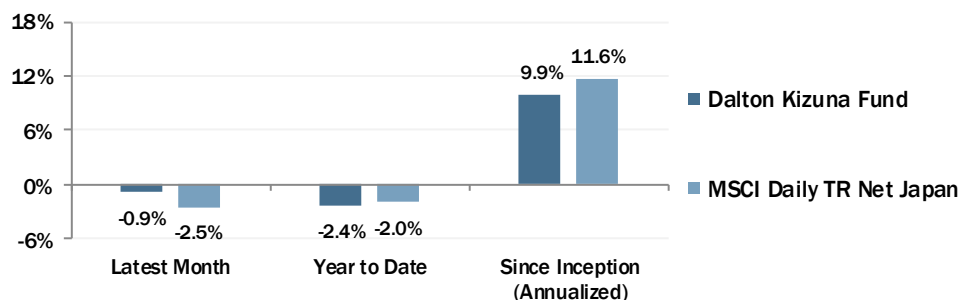
June 2018 Newsletter

## Fund Description

The Dalton Kizuna Fund is an equity fund that invests opportunistically in Japan. The Fund strives to buy shares in companies with good businesses run by management with a strong alignment of interest with shareholders, at prices that reflect a significant margin of safety to intrinsic value. The Fund is expected to be a highly concentrated portfolio (no more than 20 companies) of strong conviction ideas. In addition to performing onsite due diligence and rigorous fundamental analysis, the investment team engages in active collaboration with managements and directors of portfolio companies in order to encourage actions that will lead to revaluation in the equity market.

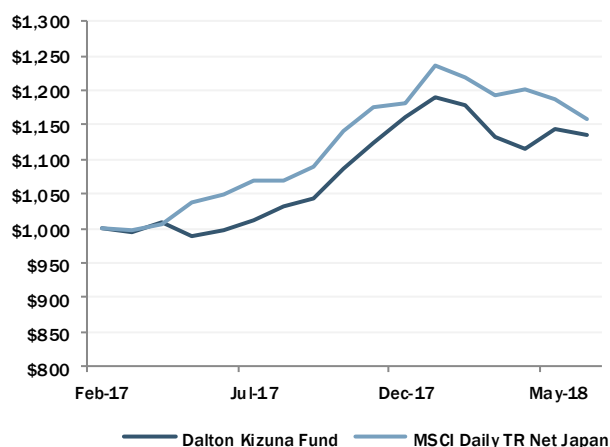
"Kizuna" is a traditional Japanese word meaning the strong bonds between people; we use the word to reflect our aspiration of pursuing greater good for all stakeholders through our investment practice.

## Fund Performance (Net of Fees)\*



## Fund At A Glance\*

### GROWTH OF \$1,000



Cumulative Net Total Return	13.37%
Compound Annual Growth Rate	9.87%
Percentage of Up Months	62.50%
Percentage of Down Months	37.50%
Best Net Month Return	4.18%
Worst Net Month Return	-4.02%
Standard Deviation	7.90%
Sharpe Ratio	1.18
Largest Net Consecutive Gain	20.41%
Largest Net Drawdown	-6.30%

## MONTHLY PERFORMANCE (%) NET OF FEES\*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	MSCI Japan
2018	2.36%	-0.89%	-4.02%	-1.49%	2.71%	-0.92%							-2.40%	-2.03%
2017			-0.44%	1.28%	-2.06%	0.87%	1.47%	2.12%	0.95%	4.18%	3.43%	3.45%	16.17%	18.22%

## FUND AT A GLANCE AS OF JUNE 2018

Lead Portfolio Manager .....	James B. Rosenwald III
Investment Style.....	Concentrated Equity
Index.....	MSCI Daily TR Net Japan
Inception Date .....	Mar '17
Fund Assets (June 30).....	\$42 mil
Asian Equity Assets (June 30).....	\$3.4 bil
Firm Assets (June 30).....	\$3.8 bil
Net Asset Value/Share (June 30).....	\$1,133.72
Minimum Investment .....	\$1 mil
High Watermark .....	Yes
Structure.....	Master-Feeder
Administrator.....	Northern Trust
Custodian.....	Northern Trust
Auditor.....	PricewaterhouseCoopers
Liquidity.....	Annual (1-yr Lock-up)***
Management Fee.....	1.0%
Incentive Fee.....	20%

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\*Past performance is no guarantee of future results. All investments involve risk including the loss of principal. Please see final pages for performance disclosures.

\*\*Asian equity assets include all assets managed by James B. Rosenwald III, which include the assets from the Dalton Kizuna Fund, several other Pan-Asia and Japanese separate accounts and other products.

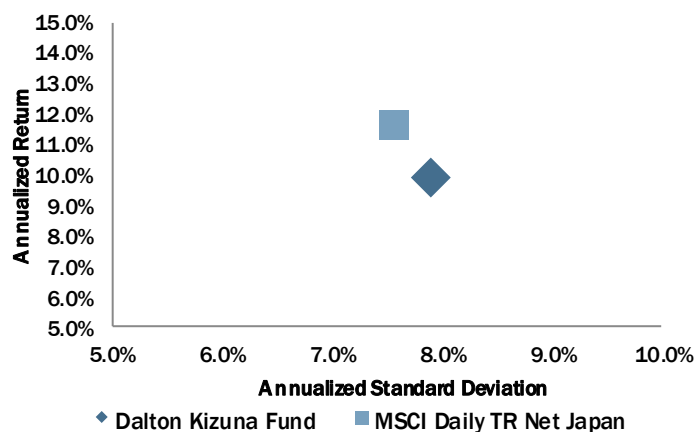
\*\*\*Liquidity terms are more restricted for hard-to-value or illiquid "special securities." The manager has the authority to designate up to 10% of the fund in special securities, and these investments must be held to realization of investment. Please see fund documents for more information.

## Risk Analysis (Since Inception)\*

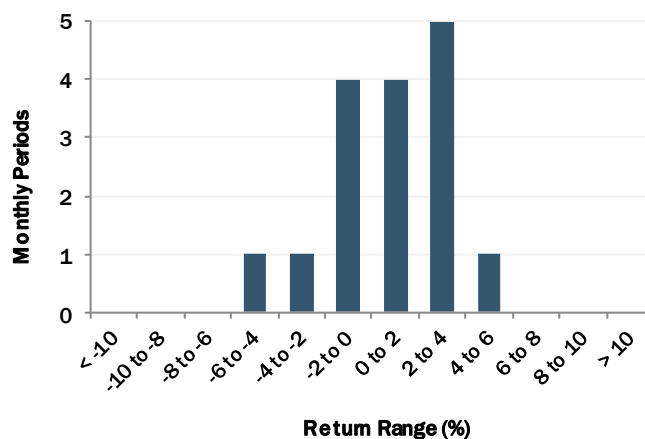
### RISK COMPARISON

	Dalton Kizuna Fund	MSCI Daily TR Net Japan
Cumulative Net Total Return	13.4%	15.8%
Compound Annual Growth Rate	9.9%	11.6%
Standard Deviation	7.9%	7.6%
Largest Net Consecutive Gain	20.4%	15.7%
Largest Net Drawdown	-6.3%	-6.3%
Sharpe Ratio	1.18	1.49
Correlation		0.32
Beta		0.17

### RISK RETURN SCATTERPLOT



### MONTHLY RETURN DISTRIBUTIONS

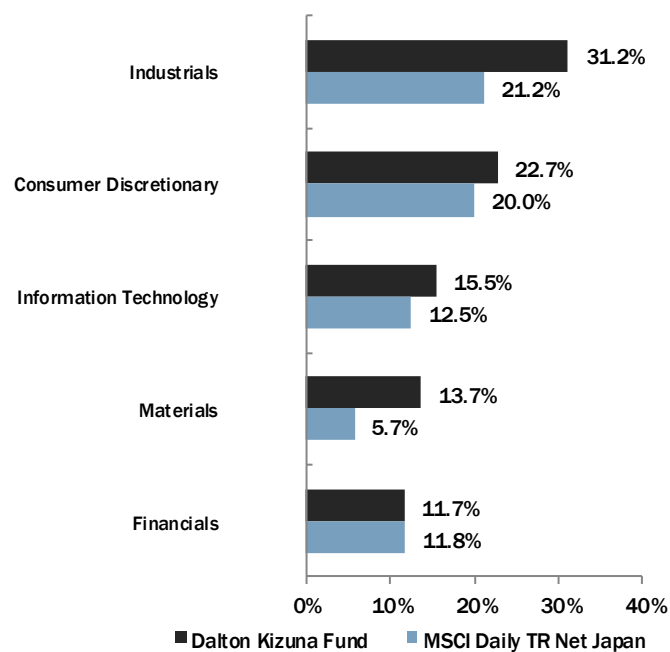


## Asset Allocation and Portfolio Information\*\*

### TOP 5 LONG POSITIONS

Company	Sectors	% Equity
Opt Inc	Consumer Discretionary	10.0%
Plathome Co Ltd	Information Technology	8.5%
Shinsei Bank Ltd	Financials	8.1%
Macnica Fuji Electronics	Information Technology	6.9%
Taisei Oncho Co Ltd	Industrials	6.3%

### SECTOR BREAKDOWN



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## Commentary

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### Performance Update

In the second quarter of 2018, the Dalton Kizuna Fund increased by 0.24% (net of fees) while the MSCI Japan Index decreased by -2.84%.

### Portfolio Overview

During the latest quarter, we made a new investment in Stella Chemifa, a leading manufacturer of fluorine compounds. The company commands 70-80% of the global market for chemicals used in semiconductor etching/cleaning processes, and provides specialty additives for lithium-ion batteries, through joint-ventures with major electrolyte suppliers. We were able to buy the stock on weakness when the company's earnings were squeezed by rising material prices earlier this year. Subsequently, the company successfully transferred the impact of cost increases to customers. High purity chemicals are indispensable for global manufacturers, and we believe the company will be able to maintain its pricing power for a long time. The family owns 23% of the company; we have a high regard for the next generation female CEO who has taken unprecedented steps in corporate restructuring and maintains an open and sincere dialogue with shareholders.

In addition to Stella Chemifa, we added Macnica, Mitani and several other companies using proceeds from selling out of Kadokawa Dwango and reducing exposure to T&K TOKA and Avex Group. One reason for rebalancing the portfolio was our disappointment in the entertainment platform businesses of Kadokawa Dwango and Avex. We continue to believe that those stocks are trading at or below tangible net asset value, reflecting significant discounts on entertainment IP with global expansion potential. However, entertainment platform businesses are becoming

increasingly competitive, and we are concerned about management's ability to address these risks, particularly at Kadokawa Dwango. Thus, we made the painful decision to exit from the investment and allocate the capital to higher conviction ideas.

The top two contributors for the quarter were OPT Holdings and Taisei Oncho. OPT was the top contributor to the fund two consecutive quarters due to the solid performance of its core digital marketing businesses as well as successful IPOs/exits in the company's venture capital portfolio. Since the dissolution of the alliance with Dentsu Group, OPT has accelerated its transition from a mere digital advertisement representative to a full-fledged service provider able to provide comprehensive digitalization services for its clients. We have strong confidence in the founder's leadership and see his continued passion to build a 1 trillion yen (USD 90 billion) company. In contrast, Taisei Oncho belongs to the old-fashioned, utility services industry. The company installs, maintains and replaces plumbing and air-conditioning in general use buildings. We believe the recent improvement of profitability is largely attributable to its young, third-generation CEO who has successfully focused on international market opportunities and new technologies. We met the CEO and visited the operation in Hawaii (20% of operating cash flow is from this operation), and were impressed with the management quality and future growth prospects. Even after the recent improvement in profitability and stock price, the market capitalization of the company is still about equal to net cash on the balance sheet.

The top two detractors for the quarter were Plat' Home and Macnica Fuji Electronics Holdings. Plat' Home, the leading supplier of the IoT gateway and the largest contributor in the portfolio in 2017, has turned

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into the largest detractor year-to-date 2018. We think the negative performance is basically a pullback from last year's sharp price appreciation, and also partly attributable to a slow-down in quarterly sales. Meanwhile, we maintain our view that the company will be a key beneficiary of growing "Edge Computing" all over the world. Year-to-date, the company has strengthened its relationship with key players such as Microsoft and Hitachi, and is working to complete the full implementation of several IoT projects. We expect that some of these efforts to be completed later this year and that our assessment of the company's potential will be more widely shared by the market.

We had previously reported our disappointment that Macnica Fuji, the leading distributor of semiconductor products and cyber security solutions in Japan, raised funds through a large equity financing in March. The company's valuation did not improve in the latest quarter amidst growing concern over a slowdown in the global semiconductor industry as a result of a potential trade-war between US and China. While we are carefully monitoring the impact of recent trade tensions between the US and China, our view is that Macnica Fuji will benefit from continued growth in pan-Asian semiconductor distribution, particularly given its proven track record of successfully growing market share. Additionally, the company's cyber security solution services offer unique growth opportunities that are not correlated to silicon cycles. We decided to add to our holding in Macnica Fuji at current market levels which represent a discount to the net liquidation value of the enterprise.

### **2018 AGM and Shinsei Bank**

During the Annual General Meeting (AGM) season of June 2018, a historically high number of public companies (44) received shareholder proposals,

including ours addressed to Shinsei Bank. We requested the creation of a restricted stock compensation system for bank directors because we believe that strong alignment of interest between board members, senior management and shareholders will improve long-term outcomes. The goal was to increase the Bank's shareholder value which would benefit all shareholders, including, most importantly, the government who represents public funds that need to be repaid. Following the receipt of Dalton's proposal, the Bank introduced its own proposal on April 23, 2018 to create a restricted stock compensation plan. However, the Bank's proposal was a far more modest award of restricted stock to bank directors – specifically, 10% of Dalton's proposed amount. Therefore, Dalton decided to pursue its own proposal.

In the end, our shareholder proposal was rejected at the shareholder meeting. However, we received positive feedback from the media, investors and even management of other companies. Our proposal was unusual in that it was "NOT opposed by the company"; even Shinsei Bank officially commented that both the Bank's proposal and Dalton's "have the same purpose of providing an incentive for eligible Directors to strive for the sustainable enhancement of the Bank's corporate value by having them hold the Bank's shares". Nikkei Group described our proposal as a "can't-miss" one, commenting that "other shareholders should find it hard to vote against as the proposal won't pursue the interest of the proposer", and also cited comments of an anonymous expert saying that Dalton's proposal was "too decent to oppose".

The filing made by the Bank confirms that our proposal received a total of 536,078 approving votes, or 25% of total shares outstanding. Assuming a rejection by insider shareholders, our proposal received

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approximately 40% approval from non-insider shareholders. While not satisfactory, we think it is a decent result despite the lower than desired restricted stock compensation paid to the management of the company. Hopefully, the results will be encouraging enough for management to act with an improved alignment of interest.

Beyond the developments in AGM, we continue to see a tailwind for Japanese corporate governance such as increasing participation of global activists (*e.g.*, Elliot and ValueAct) in the market, and another revision in the Corporate Governance Code. The latter placed additional pressure on companies by requesting that they articulate their earnings plans and capital policies after accurately identifying the company's cost of capital. Also included in the code was the reduction of cross-shareholdings, pressure on corporate pensions to participate in the stewardship code, ESG accountability, clearer compensation policy and succession planning. December 2018 is the deadline for the companies to submit a new Corporate Governance Report, and we expect to see them scrambling to do so.

## Outlook

We have started to see weakening macro indicators globally. Trade war headlines are bad news in our view as they cause uncertainty and put business plans on hold. It appears that the Trump administration is not willing to settle for quick wins and instead wants to challenge China's "Made in China" 2025 plan, and China is not willing to compromise on its agenda. Meanwhile, inflation is starting to appear in the U.S. and interest rates are rising, causing a stronger U.S. dollar. In other words, there are plenty of potential problems that could lead to a global economic slowdown or even recession.

Despite our excitement with specific opportunities

related to Japanese corporate governance and the enormous potential for greater capital efficiency in a market flush with very healthy balance sheets, we know that our investments will not escape adverse global macro developments. We continue to pay utmost attention and maintain our focus on margin of safety, low/negative leverage, and secular growth themes with secure alignment of interest. We truly appreciate your understanding and support of our long-term investment philosophy, which is designed to protect capital over business/credit cycles and compound it over time.

## Disclosure

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Individual portfolio account returns and holdings within a referenced Dalton composite may vary substantially for such factors including, among others, account specific restrictions – e.g. whether currency investments are permitted, timing of transactions, contributions, withdrawals, and market conditions at the time of investment.

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Returns present hypothetical performance (the “Hypothetical Returns”) for a hypothetical \$1,500,000.00 investment (the “Initial Investment”) made at the inception of the Fund (the “Hypothetical Investor”). The Gross-of-Fees Hypothetical Returns are calculated by applying the Fund’s actual cumulative gross-of-fee returns which include all trading expenses, withholding taxes, custodial fees (if applicable) and other administrative fees but exclude accruals and payments of all management and performance fees to the Hypothetical Investor’s Initial Investment. The Hypothetical Investor’s Returns assume no subscription or redemption and reinvestment of all dividend income. Net-of-Fees Hypothetical Returns are calculated, in reference to any applicable high water mark, by deducting a model 1% management and 20% performance fees (the “Model Fees”) from the Gross-of-Fees Hypothetical Returns. The Model Fees represent the current highest management and performance fee schedule of the Fund. Information regarding year to date and annual Performance Results is compounded. The Hypothetical Results shown do not represent the results of any actual investor in the Fund. Investment results for each investor will vary from the Hypothetical Results shown herein due to, among other factors, differing investment dates and additional contributions or withdrawals. Actual fees may differ due to various factors including, but not limited to, account size. Additional information regarding the Firm’s fees is available upon request and may also be found in Dalton Investments LLC’s Form ADV Part 2. Performance is expressed in US Dollars. To compute currency exchange rates, the Fund uses Bloomberg at 4PM EST close while the Benchmark uses WM Reuters at 4PM GMT close, which may result in differing exchange rates.

The Fund’s benchmark is the MSCI Daily Total Return Net Japan Index (MSCI Japan (USD), symbol: NDDUJN) (the “Benchmark”) and is compiled by Morgan Stanley Capital International, Inc. It is a total return, free float-adjusted, capitalization-weighted index that is designed to track the performance of Japanese securities listed on the Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. For comparison purposes, Benchmark returns do not reflect transaction costs, investment management fees or other fees and expenses that would reduce performance in the Fund. It is not possible to invest in the Benchmark. The Fund has held and is expected to continue to hold securities that are not included in the Benchmark and the Firm makes no representations that the Fund is comparable to the Benchmark in composition or element of risk involved.