

September 1, 2017

Dear clients and colleagues,

Aging populations is currently one of the most common investment themes, so how can investors benefit from this secular growth trend? There are a few different ways, for example, in our portfolios Extencare provides senior housing in Canada, Nihon M&A Center facilitates retiring Japanese entrepreneurs in selling their companies, THK is engaged in factory automation to help resolve labor shortages worldwide, and Ain Holdings operates the largest pharmacy chain in Japan. We also hold a few health care names which are related to aging populations.

A successful business model does not have to be complicated. What happens to your hair when you grow older? It gets dryer and greyer. At some point, people may decide to give special treatments to or even dye their hair. This generates recurring revenue for hair salons and hair care product makers.

This week we would like to profile an outperforming name in our portfolio – Milbon, a niche leader of professional hair care products in Japan. Small caps are often under-researched, and Milbon is a prime example with only three small local brokers covering it. Although it has no English research notes and has never been invited to any investment conference, we discovered it through the in-house stock screen. Following detailed research and an on-site visit, we initiated the position in Q4 2015 and the 2017 YTD stock return is now over 50%.

Milbon Co., Ltd. (4919 JP – ¥6,640)

www.milbon.co.jp

Business Overview

Founded in 1960, Milbon is Japan's #1 maker of professional hair care products and through its collaboration with leading stylists on product development it has demonstrated its expertise in hair care and hair coloring. Since inception, Milbon's products have been distributed exclusively to over 40,000 hair salons in Japan, Korea, China, USA and South-east Asian countries. Growing by double digits, overseas sales have now reached 13% of its total sales.

Premium brands include: Milbon, Aujua, and Villa Lodola. Other professional brands are: Jemile Fran, Plarmia, Elujuda, Nigelle, Ordeve, and Neo Liscio, etc.

Target Market

Japan is home to about 237,000 hair salons and 37.45 million salon customers and due to an aging population, the hair care market is growing at approximately 5% p.a.

In other Asian countries the hair care market is growing at 20-30% p.a. Driving growth, in addition to the aging population, is the rise in emerging markets consumer demand as Japanese products are perceived to be of high quality and specialized for black hair.

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Management

Very experienced and stable management team with insider ownership of 14%. The founding family is still actively involved in operations.

ESG

Milbon's main factories have obtained ISO 14001 accreditation for its excellent environmental practices. These factories are the only ones to have obtained OHSAS 18001 accreditation (Occupational Health and Safety Management Systems) in Japan's cosmetics industry. The company supports the employment of disabled people. Its corporate governance structure is transparent, with modest executive pay. Two out of eleven board directors are independent.

Market Data

Market Cap ¥110B, 0 debt, cash ¥4.6B, Dividend Yield 1.2%, P/E (2018/12) 28.4x, Ev/Sales 3.2x, Ev/EBITDA 15.2x, Gross Margin 69.0%, EBITDA Margin 21.3%, Profit Margin 10.5%, ROE 11.4%.

Competition

In Japan Milbon competes mainly with Shiseido, Takara Belmont, L'Oréal and Napra. Global leaders are L'Oréal, Wella, Schwarzkopf, Goldwell (Kao), Joico and Zotos (Shiseido).

Competitive Advantages

- #1 in Japan's professional hair care market with 14% market share. Globally Milbon is ranked #8.
- Products are known for black hair treatment and coloring.
- Long-term relationship with hair salons and stylists.
- Solid balance sheet. Zero debt.

Growth Strategy

- Product: driven by innovation, new product sales account for over 10% of total sales each year.
- Distribution: continues to penetrate in Japan and overseas. Near-term focus is Korea and China.

Risks

- Weak consumer demand.

In June 2017, Milbon confirmed the guidance for 16.7% profit growth this year, and is on track to expand facilities and services in both Japan and overseas. We believe the strong growth momentum is sustainable.

Have a great weekend.

The Global Alpha team

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