May 31, 2015

ValueInvestor INSIGHT

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Trading Up

Mitsubishi Corp., once known as a great Japanese trading house, is now an almost comically diverse investment holding company. Hennessy Funds' Masa Takeda argues that complexity in this case needn't be a turnoff.

At a time when company simplification is the rage, Japan's Mitsubishi Corp. is an outlier. With roots dating to the 1860s, the company in more or less its current form came to prominence after World War II as a leading *sogo sosha*, or trading house, that played a key role in opening global markets to corporate Japan and in sourcing raw materials for its burgeoning domestic manufacturing sector.

The role of the trading house changed starting in the 1980s as larger Japanese companies built their own global capabilities, bypassing intermediaries. In response, Mitsubishi transformed itself into more of an investment holding company, using its balance sheet and far-flung network to source and acquire stakes in a dizzying array of operating businesses.

Today Mitsubishi generates ¥7.6 trillion ($61 billion) in annual revenues through more than 600 consolidated subsidiaries and affiliates in 90 countries. It has seven operating groups – Global Environment & Infrastructure, Industrial Finance, Logistics & Development, Energy, Metals, Machinery, Chemicals and Living Essentials – but pick a business or region and it's likely to be there. It's building water-desalination plants in Qatar. It's farming salmon in Norway. It's drilling for oil in Papua New Guinea. It's making lithium-ion batteries in Japan. "I know the history and how companies like this evolved, but it's difficult to describe to foreigners because there are no real comps outside of Japan," says Masakazu Takeda, co-manager of the Hennessy Japan Fund, "I typically just don't bring it up."

Takeda thinks Mitsubishi is worth bringing up today because its shares appear undervalued. The company has embarked on a strategic overhaul announced in 2013 that is focused on increasing the earnings share of non-resource-based businesses, aggressively culling portfolio laggards, improving returns on equity, and emphasizing Asian investments from fertilizers to retail. If the market is enthused, it's not obvious. Mitsubishi shares are up nicely over the past year, but only in line with the overall Japanese market. The recent ¥2,790 stock price is 19% below reported book value per share of ¥3,438.

What are the shares more reasonably

INVESTMENT SNAPSHOT

Mitsubishi Corp.
(Tokyo: 8058:JP)

Business: Diversified conglomerate with holdings in more than 600 different companies that in its words, "serve customers around the world in virtually every industry."

Share Information
(@5/29/15, Exchange Rate: $1 = ¥124.16):

Price	**¥2,787**
52-Week Range	¥1,942 – ¥2,830
Dividend Yield	2.0%
Market Cap	¥4.53 trillion

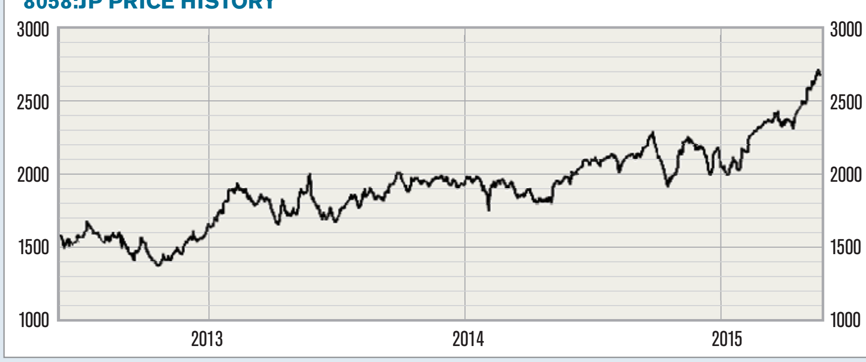
Financials (FY2014):

Revenue	¥7.59 trillion
Net Profit Margin	5.9%
Book Value/Share (@3/31/15)	¥3,438

Valuation Metrics
(@5/29/15):

	8058:JP	S&P 500
P/E (TTM)	11.3	21.5
Forward P/E (2015 Est.)	11.5	18.2

8058:JP PRICE HISTORY



THE BOTTOM LINE

While Masakazu Takeda sees the company's global reach and expertise as a unique strength, he believes the market sees it as overly complex and unwieldy. Even if the stock's "conglomerate discount" persists, he thinks shareholders can win if prospective annual growth in book value approaches the nearly 14% rate of the past ten years.

Sources: Company reports, other publicly available information worth? Takeda says reported net income typically excludes unrealized investment gains that over time are highly material, so he focuses in valuing the shares more on net asset value, which he believes in Mitsubishi's case is understated. While he hasn't attempted to assign market values to each of the company's assets, doing so in several key cases indicates the company is highly conservative in its reporting.

Even if Mitsubishi's unwieldy structure results in an ongoing conglomerate discount, Takeda still expects shareholders to win. The company has grown book value per share at a nearly 14% annual rate over the past 10 years, a standard he doesn't consider out of reach for the next 10 years. "The unique strength here is the company's unparalleled global reach and expertise," he says. "That shouldn't trade at such a discount." VII

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Important Disclosures

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Top ten holdings for the Hennessy Japan Fund can be found here. Fund holdings and sector allocations are subject to change at any time and should not be considered a recommendation to buy or sell any security.

Mutual fund investing involves risk; Principal loss is possible. The Fund invests in small and medium capitalized companies, which may have more limited liquidity and greater price volatility than large capitalization companies. The Fund invests in the stock of companies operating in Japan; single country funds may be subject to a higher degree of risk. The Fund may experience higher fees due to investments in pooled investment vehicles (including ETFs).

The S&P 500 Index is an unmanaged index commonly used to measure the performance of U.S. stocks. One cannot invest directly in an index.

Earnings per share is a company's profit divided by its number of common outstanding shares. Price to earnings ("P/E") is the market price per share divided by earnings per share. Return on equity is the amount of net income returned as a percentage of a shareholder's equity. Dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

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