

PODCAST TRANSCRIPT

Talking Research: Japan's Under-The-Radar Innovators

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Katie Boyce: Hello and welcome to *Talking Research*, a podcast from Walter Scott. I'm Katie Boyce, an investment writer at the firm.

Imagine a factory that never sleeps. No lunch breaks, no sick days, just endless whirring production. In the foothills of Mount Fuji, Fanuc's signature yellow robots don't just build products, they build each other. This is the company's lights-out factory, where machines work in total darkness, running 24/7 without a single human present.

Fanuc is a leader in industrial automation, whether that's assembling and painting vehicles, constructing complex engines, or making electrical components. Its robots are critical to countless manufacturers globally. In a world racing towards AI-driven manufacturing, Fanuc isn't just predicting the future, it's already living in it.

Visiting the company's vast, yellow-painted headquarters at the bottom of Mount Fuji is seen as a real rite of passage for any member of Walter Scott's Research team when in Japan. Most recently, that was the privilege of Head of Research Alan Lander and Investment Manager Lucia Gibbard. And I'm delighted to be joined by Lucia today. Hi, Lucia. Thank you for being here.

Lucia Gibbard: Hi, Katie. Thank you for having me.

KB: Lucia first came to Walter Scott as an intern back in 2016 and 2017, before returning in 2023 as an investment manager, having spent the intervening years working in London. Today, she's here to discuss that recent trip to Japan.

Before we get started, a reminder that the podcast is intended for investment professionals only and should not be construed as investment advice or a recommendation. Any stock examples discussed are given in the context of the theme being

explored, and the views expressed are those of the presenters at the time of the recording.

Lucia, as mentioned, you're recently back from Japan. What were you doing out there?

LG: We were very busy. We met with 28 companies over the two weeks we were there. We started in Osaka, moved to Kobe, Nagoya, Hamamatsu, Mount Fuji, as you referenced, Shimizu, Tokyo, Kyoto and then back to Osaka. So we definitely had a lot of bullet trains during our stay there.

I think the great thing about being generalists, as we all are at Walter Scott, is our ability to meet companies across so many different industries. We met with companies in the industrial sector medical technology, apparel, semi related exposure, autos, cloud integrators and digital transformation players.

And we also had a few meetings with macro economists and strategists to really get a feel for what's happening in Japan on the ground. I think it was a particularly good time to be visiting Japan, I'm sure in this podcast we'll talk about the inflationary environment. What really stood out to me was the quality of corporate reform in the country at this moment in time, and also the access to senior management that we were able to have as a result.

KB: And we'll get into those meetings in a moment. But what were your first impressions?

LG: Well, I didn't really know what to expect, Katie. I would say the majority of the Research team here at Walter Scott had already been to Japan at least once, and everyone told me it was unlike any country they'd ever been to before, and I was amazed as soon as I got there. Firstly, the food was absolutely spectacular. I ate plenty of that. But, secondly, I think for a country that is so densely populated in its urban areas, there's such a feeling of efficiency and a feeling of camaraderie among the people who live there.

Take Tokyo as an example. Tokyo is one of the most densely populated areas in the world, with over 30 million people residing in the metropolitan area. And yet it runs way more efficiently than the likes of, say, London or Manchester in the UK. So I think that really stood out to me as a defining feature.

KB: And turning to the companies you met with, 28, I think you said, which of these stood out and why?

LG: I think, quite interestingly, our first meeting that we had was probably, for me, the best at least. We went to the headquarters of Sysmex, which is a medical technology company specialising in automated haematology diagnostics, and we met with the president there. I think it was particularly interesting for us to understand the current market that Sysmex is working in, as it relates to the period of disruption they've experienced post Covid. Their medical instruments now appear to be at the bottom of the cycle, with improvement in the US and China anticipated.

But I think what was most interesting for us was the fact that we were able to have a site tour and really see the technology in action and also see the sorts of things they've got coming down the pipeline. We really got a feel for the culture of the place, and the president of the company spent the whole morning with us, showed us round, introduced us to a lot of people. We toured the whole site, we fed some koi carp. They treated us to a traditional Japanese tea ceremony for Alan and I. And that was a great first meeting in Japan and a real introduction to the culture of the place.

You obviously referenced in your introduction, Katie, Fanuc, and the fact that it's almost a rite of passage for people on the Research team here at Walter Scott to visit the main site and to get a tour of the business.

Despite the fact it is at the foot of Mount Fuji, I never actually saw Mount Fuji. It was so cloudy and rainy that day that we couldn't see it, despite the fact it was right there. But the experience itself was incredible. I think we can all visualise what robots look like, but to see them in action and to see their own kind of factories and how they have automated them.

KB: Even if you didn't see the fully automated version, given no humans were allowed inside.

LG: Yes. We did not see the lights-out facility that you referenced, but we still got to see many of their robots in action, and I personally found that fascinating.

KB: Can you describe being in the factory?

LG: Everything is yellow. When people said to me before I went, you know, you're going to be seeing a lot of yellow, I thought they were exaggerating, but everything is yellow. When we pulled up in our car to the actual site, we were immediately taken out of our car and put into a yellow car. And then we were driven to the first of the factories that we were going to see, and then we were transferred into a yellow building. Everyone was wearing yellow head to toe, and they gave us a yellow hat, and then we were put on a little coach that was also yellow and taken to the next facility. But I think it's actually a really defining feature for them, and it makes their business stand out in your memory – as if the robots wouldn't do that enough. The yellow is definitely a fun anecdote.

But yeah, I think the level of technological advancement that we witnessed at Fanuc and at Sysmex was echoed a lot across Japan, and I think it was beyond what we were expecting. To take Misumi as an example, the mechanical components business, we visited both their factory, and then we had a meeting with the president of the business. And the focus they have on the concept of automation is incredible.

KB: Which is, for those who don't know?

LG: Yeah. So the way that they define automation is the ability to use and invest in automation, but combine it with human capital to create endless flexibility effectively.

KB: Can you give me an example of how that would work in reality?

LG: Yeah. So, in practice, as we were moving around some of their sites, they gave us examples of machines that, ten years ago, they would have had three people manning each machine. Now they have a bank of six machines where they have one person manning all six for the whole day because of the way that they've been able to link them together. There were little robots zooming around, and everything was very efficient, and that's echoed in their ability to have excellent customer service and such quick turnaround times.

KB: In contrast, were there any meetings that were less positive?

LG: I think by and large, we were very impressed with the quality of meetings we had in Japan. And one thing that actually stood out to me as well was the quality of the interaction we had with management teams, but also the fact that they wanted feedback from us. There were quite a few management teams who at the end of the meeting would say, is there anything we could be doing better in terms of international disclosure, in terms of IRR, ROE, etc?

But one business that potentially stood out to me, personally, as not as incredible as I was expecting was Fast Retailing. I think Fast Retailing...

KB: ...is Uniqlo to most people.

LG: To most people, it's Uniqlo. That's their kind of signature brand. And as we know, it's an international business with an international focus. But it's definitely a stock market darling in Japan, and I think I was expecting more. They definitely are very correct in saying that their LifeWear proposition is unique. I think this has been proven through their experience in the pandemic, as people and consumers look for comfy and high-quality clothing. And that definitely does breed efficiencies in terms of design, manufacturing, inventory efficiencies. They have a pretty small range of clothing versus a lot of their fast-fashion peers.

But I think we really felt that Fast Retailing is lagging the likes of Inditex in sustainability, in e-commerce and also in the in-store experience for a customer like myself who might want to go and visit Uniqlo versus the likes of visiting something like Zara. Japan is a relatively mature market for the Uniqlo brand. And so a lot of their growth is predicated on success overseas, which they are seeing particularly in Uniqlo. But they're also talking about expanding their GU brand overseas, which to me is relatively unproven and also...

KB: How does it differ from Uniqlo?

LG: So I, of course, had to do some market research when I was over there. I used it as a good excuse to go shopping, but I think GU to me had much more of a fast-fashion focus. It felt more like visiting a H&M – cheaper than Uniqlo, but more high turnover of products and aimed at a younger consumer.

KB: Talking about the consumer, perhaps we could now turn to inflation and how the current environment has any impact on your investment thinking?

LG: Yeah, it's a great question, Katie, and I think it was a particularly timely visit to Japan, given the fact that Japan has just come out of three decades of disinflation and is finally seeing inflation over the last couple of years. How that will impact our investment approach? I think it will not have too much of an impact because, as you know, we're aiming to invest in companies that are going to sustainably generate value creation over the next ten, 20, 30 years. But, in the short term, it breeds both risks and opportunities.

If we think about the corporate environment in Japan over the last year, there are actually record levels of profitability across the Topix. But I think inflation can potentially cause a bit of a risk to that. In terms of wage growth in particular, the majority of companies that we met with said that they were putting up wages by 3-5% annually at the moment. And Fast Retailing came out last month, actually, and said that they would be raising wages by 11% across all employee salaries. So whether companies are able to maintain those record levels of profitability in the context of rising costs, I think, remains to be seen.

But I also think it does provide opportunities. The weak yen over the last couple of years has been a real tailwind to many internationally focused and facing businesses in Japan. And, in the current environment, from a political perspective as well. It's widely accepted that Ishiba premiership is not going to last too much longer. And, in the interim, it's expected that he will be implementing tax cuts and fiscal spending to try and stimulate growth. So that could provide some near-term opportunities as well.

KB: And you referenced wage growth there. How does that tie into Japan's perennial labour shortage?

LG: Japan is a particularly interesting economy because, contrary to most geographies on the planet, they have both an ageing and a shrinking population, which for the last 20 years has provided real issues to companies trying to both attract and retain talent. The government has had policies in place for many years to try and stimulate population growth, but it just hasn't been working.

If we think about this from the companies that we met with, the majority of them were talking about how they are having to provide not only wage increases to both attract and retain labour, but also they're having to implement the likes of technology advancements to try and improve efficiencies and have less dependency on labour. They're having to increase their retirement age.

One company that we met with was increasing their retirement age from 63 to 67, which is quite a big leap if you're already coming up to 63 and you think you're about to retire. But, also, the working culture is really shifting in Japan from a more traditional working culture in the majority of places, the ability to work from home more, to have potentially more flexible hours. And that's really popping up in terms of the flexibility of roles and jobs available on sites such as *dip* [Corporation] and *[Kyujin] Box*, who are really trying to attract people who may not currently be in the labour force.

And I think it was also quite obvious in Japan, as we moved around, that there were people in the workforce in Japan who you potentially wouldn't see in the workforce here in the UK, be that people who are a bit older and here would hopefully be enjoying their retirement, or people who are potentially working two or more gig-style jobs and trying to kind of mend the labour shortage that way.

KB: And did you see when you were there, did you see any particular examples of the kind of thing you're talking about?

LG: Yeah, we saw traffic attendants, which is something we also don't really have that much of here in the UK, but if you're pulling into any car park at a hotel or a train station, there'll be a decent amount of traffic attendants there to try and guide you on your way. But, by and large, the majority of people who we saw doing this tend to be older men, I would say in their 70s and early 80s, who, you know, are on their feet all day. But I think it was an interesting example because it was tangible. And you could see how, the kind of, ageing labour force was actually impacting the economy.

KB: Returning to the companies, Japan has a strong, well-known heritage in technological innovation. But, at the same time, currently the country is really lagging its international peers in terms of a digital transformation. What did you hear about that, you know, companies playing catch up?

LG: A recurring theme that we had with pretty much every company that we met with in Japan was the businesses talking about how they're investing in the digital transformation. And there's a huge story.

KB: And when we talk about the digital transformation, it is the cloud...

LG: Yeah, the cloud, and basically becoming more efficient from a technology perspective in companies' internal operations. The government has got a huge, they call it the DX digital transformation push, which is currently ongoing in Japan. And that's evidenced in a lot of the meetings that we had with various management teams across a variety of different businesses, in terms of them spending money now to invest in their efficiency for later. I think it's quite interesting because Japan itself is a very technologically advanced society. When you get into a taxi in the UK, you know, you say to the taxi driver, oh, do you take card? And often times they'll say, no, and then you have to pay in cash.

But, in Japan, you get into any taxi and there's a screen on the chair in front of you, and it gives you 10 to 15 options of how to pay. And so, from that perspective, it's a very advanced society. But when it actually comes to the integration of technology within companies' own operations, they're definitely lagging. We met with two companies that I would say are well-placed to capitalise on this. Both *Obic Business Consultants* and *Obic*, who have very different focuses in terms of the size of the customer that they are aiming to service, they basically provide cloud integration and services, but they are experiencing very rapid growth. And I think that's a clear sign of companies now prioritising this.

KB: Another huge area of technological innovation that we hear about day in and day out is the semiconductor industry. It's not an area that's typically associated with Japan. So what did you hear about it from the companies that you met with? You mentioned that you met with semiconductor businesses there.

LG: Yeah. Our second week had quite a strong semiconductor focus, just given the companies that we met with in that time. You've referenced previously that Japan has always been at the forefront of technological innovation, and that is evident through its history in terms of industrials, factory automation, electronics. And so they already are quite active within the semiconductor

supply chain. But I would say that semiconductors is the most meaningful example of how 'China plus one' is going to benefit Japan, and they are potentially very well placed to benefit from the onshoring and the diversification of the global semi supply chain away from China as it both relates to Chinese competition becoming a political issue, and just the broader geopolitical tension that we're feeling in the world currently.

KB: Which companies did you meet with?

LG: We met with DISCO, Lasertec, Tokyo Electron and Advantest, just to name a few that are exposed to that sector. And they're really feeling the benefits of increased investment in Japan and government support within the sector. To take Advantest as an example of a business that has a feeling of true momentum behind it, Advantest effectively, the clues in the name, really, they provide testing equipment within the semiconductor supply chain and testing demand is ever increasing in the era of complexity that we are now in. This increased demand is not only benefiting Advantest, but it's also benefiting their customers as they're able to really increase the value they're able to provide. I think they're exceptionally well positioned for AI system development, and we'll continue to see that momentum going forward.

KB: You mentioned China. Beyond its obvious geographical proximity, why did it keep coming up?

LG: China was, I would say, one of the key topics that we discussed with most companies that we met with out there. Japan is very interesting because it's so close from a proximity perspective to China, but, historically, it has been allied more with the West and more with the US. And so, at the current juncture that we're at in terms of political tension and geopolitics more broadly, there's a question mark over how that uncertainty is going to impact on Japan. Given Japan's history in manufacturing and industrials, and the strength they're able to provide there as a reference, there's a good chance of them benefiting from 'China plus one'.

But I think many companies are trying to figure out how to position their operations in a time where China is no longer the factory of the world, no longer the growth engine of the world, but will continue to be one of the largest economies in the world. And so I think diversifying their end markets is crucial. But a lot of companies are also

thinking about their own internal operations, their own manufacturing. How can they both achieve the 'Made in China' status necessary to continue trading in that market, while simultaneously achieving the 'Made in the US' status? That is likely to be pretty relevant in protecting themselves from tariffs going forward in the US.

So I think the fear of Chinese innovation is definitely fuelling a lot of protectionism in the world right now and that political tension. There'll definitely be winners but the outlook is uncertain on who they will be.

KB: And for those who did see China as the potential for growth, those Japanese businesses, where are they looking for growth instead?

LG: It really depends on the company. I think a lot of the kind of leading-edge medical technology players, to use an example, would be Shimadzu, they are now focusing a lot of their growth efforts on the US and on areas where they've previously been underpenetrated, but the market opportunity is large. Simultaneously, a lot of companies referenced India and south-east Asia as a true growth opportunity for them because the rising middle class and rising spending power in these countries is really a leading way to technological advancement and also to greater consumer spending as well.

KB: Thanks, Lucia. And away from the company meetings that you've mentioned, you were there for a couple of weeks. So what was the highlight of your trip away from the factory sites and the company meetings?

LG: Yeah, it was definitely a jam-packed schedule. We didn't have too much time to explore, but I really did try and spend the weekends getting out and really getting a feel of the culture in Japan. I think my highlight was a trip to Kyoto during autumn and the foliage season, where it was absolutely stunning, and I went on an incredible hike to quite a few temples.

But then I also would say that my real highlight was going for Korean barbecue with a couple of my colleagues. I actually went to university in the US, it was where I studied my undergraduate degree, and my college roommate's dad owned a Korean barbecue restaurant and I used to love going there. The food was incredible. And the UK is pretty rubbish as it relates to Korean barbecue. So it was

great for me to actually try that again. And I ate far more than I should have done, but I've got no regrets about it.

KB: Before we go, I mentioned that you first came to Walter Scott in 2016 as an intern, and that was through an organisation called Girls Who Invest (GWI). I wonder if you could tell me a bit more about that?

LG: Yeah, definitely. And I think for me, returning to Walter Scott just over a year ago now felt like a full-circle moment because it's really where I started my career. It was where my first internship in investment management and my second internship in investment management took place. As you referenced, I came through the Girls Who Invest programme. So the mission of Girls Who Invest is to increase the amount of money managed by women globally. And, in order to facilitate this, they have a large US-wide programme that effectively tries to source women from non-finance backgrounds.

So not necessarily economics or maths. I as an example, studied International Relations as my undergraduate degree and try and get them into finance. And what that often looks like is a month long, intensive program. So I did mine at Wharton, at the University of Pennsylvania, and then you get matched to an internship. And Jane, the managing director here at Walter Scott, is a big supporter of the programme. And I was very, very fortunate to be chosen as an intern back in 2016 and ended up at Walter Scott that way.

KB: And last year, in fact, you were the first recipient of the Girls Who Invest Distinguished Alumni Award. Congratulations! What did that involve and how many alumni have there been through the programme?

LG: I was on the first year of the programme, which makes me feel quite old now that I see the scale that it's reached since. There have been about 2,500 women come through the programme since my journey there in 2016. I think that receiving that award was probably one of the greatest accolades I've ever received in my life. It was completely out of the blue as well, which I think made it feel even more special. The GWI team really wants to make sure that the alumni community remains strong, and that they are effectively staying in touch with people who they believe are going to be leaders in the field going forward.

I was able to fly out to New York last year and attend a gala where I had to give a speech, which was incredibly daunting. But the overall feel and sentiment in the room, you know, you've got 700 people who are all behind this movement and the momentum that they've achieved in just over eight years, I think, is absolutely incredible. And I'm so excited to be so involved with the programme and to see what both we and Girls Who Invest can achieve going forward.

KB: Well, we're all delighted that you chose to return to Walter Scott, so thank you. And thank you very much for joining me today.

LG: Thank you for having me, Katie. It was a pleasure.

KB: To our audience, thank you for your time. If you'd like to find out more about our research, in particular related to semiconductors, Tom Miedema's recent article on ASML and a previous podcast on many of today's AI-driven technologies are both available in the show notes. Thank you very much again. Goodbye.

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