



Rise of the machines

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A quiet revolution is taking place in China. Few people will have heard of Shenzhen Everwin Precision Technology but this company is making history. Earlier this year the electronics components-manufacturer announced plans to build the country's first fully-automated factory. Some 1,000 industrial robots will replace humans on production lines as the company seeks to boost productivity and find a lasting solution to a shrinking labour pool and rising wages.

The supply of cheap labour that helped China become the world's workshop is drying up. The controversial One-Child policy may have been a success in stemming runaway population growth, but the working population, those between the ages of 16 and 59, is shrinking. That means competition for workers in China's industrial heartlands, such as the south-eastern province of Guangdong, has intensified. Meanwhile, a younger generation of workers are turning their back on factory work in favour of less arduous jobs elsewhere.

Economic planners have responded by aggressively promoting factory automation. Last year China was the single largest market for industrial robot sales, according to the International Federation of Robotics (IFR), and within two years there will be more industrial robots in Chinese factories than in either the European Union or the United States. But this is just the start. There are only 30 robots for every 10,000 manufacturing workers in China, compared with 323 per 10,000 in Japan and 437 per 10,000 in South Korea, IFR data show.

Factory automation is a recurring theme in our Japan equity funds. That's because we have identified a number of good companies that can capitalise on this anticipated growth in Chinese demand for advanced automation. Japanese companies account for half of the foreign firms responsible for some six out every 10 industrial robots sold in China, according to market researcher MIR Industry.

Japan is the world's top supplier of industrial robots, according to data compiled by the country's Ministry of Economy, Trade and Industry. Prime Minister Shinzo Abe has called for a 'robot revolution' as the nation wrestles with its own demographic problems of low birth rate and a fast ageing population.

Fanuc, the world's biggest robot-maker, is showing what this technology can achieve by operating production lines that can run for weeks without supervision. The company, which makes robots for Apple, Samsung and Tesla, is highly profitable and cash-rich. It enjoys a market leading position, manufacturing superiority over rivals and aftersales support that is hard to match.

Another company we like very much is Keyence. This Osaka-based maker of sensing and measuring equipment for the factory automation industry has enjoyed rapid growth overseas. About half of its sales are generated outside of Japan and the company has enjoyed success in the U.S. in particular.

Nabtesco makes so-called precision reduction gears that are used in the joints of industrial robots, especially in the auto industry. The company enjoys a 60 per cent share of the global market for this component and its customers include the four largest foreign suppliers of industrial robots in China (Fanuc being one). We've always found the senior management to be unusually accessible and have owned this stock since 2007.

So much has been written about Prime Minister Abe's economic stimulus programme amid speculation over whether it will be enough to drag Japan out of its economic funk. If this plan, dubbed 'Abenomics', comes good then clearly the outlook for the country improves considerably. But even if it doesn't, our sense is that it doesn't matter.

That's because investing in Japan is only partly about investing in Japan. The country's main overseas markets are now the US and China and their fortunes – despite occasional signs of tension – have become ever more intertwined.

Many of the best companies have shifted their centre of gravity away from Japan by relocating their manufacturing to lower-cost countries. Others source a bigger slice of revenue from overseas markets.

As the factory automation industry shows, the best companies are industry leaders that have developed world class technologies and manufacturing processes. They are cash-rich, debt-free and conservatively run. The very best firms also value their relationship with minority shareholders.

Shenzhen Everwin Precision Technology may not be a company you would have heard of, but what happens next on a factory floor in China's Pearl River delta will be followed very closely by more than a few Japanese corporate executives across the East China Sea.

Kwok Chern-Yeh
Head of Investment Management, Japan
Aberdeen Asset Management

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