BRANDES
INVESTMENT PARTNERS

Brandes Investment Partners
Japan Equity Strategy Notes
Fourth Quarter 2024 (October 1 – December 31, 2024)

The Brandes Japan Equity Strategy declined 3.93% net of fees and 3.93% gross of fees, underperforming its benchmark, the MSCI Japan Index, which was down 3.60% in the quarter.

Annualized total return as of December 31, 2024	1-year	5-year	10-year
Brandes Japan Equity Composite (net)	9.32%	4.07%	7.13%
Brandes Japan Equity Composite (gross)	9.51%	4.33%	7.70%
MSCI Japan Index	8.31%	4.81%	6.24%

Past performance is not a guarantee of future results. One cannot invest directly in an index. Returns include reinvestment of all dividends and are reduced by any applicable foreign withholding taxes, without provisions for income taxes, if any.

Positive Contributors
Positive contributors included holdings in communication services, notably entertainment company DeNA and media firm TV Asahi. DeNA rose significantly behind the success of its new Pokémon game.

Other contributors included Kissei Pharmaceutical and Kaken Pharmaceutical, as well as Hachijuni Bank and Hyakugo Bank. Nissan Motor also appreciated on news of its potential strategic alliance with Honda Motor.

Performance Detractors
Major detractors included food products companies Yakult Honsha and Meiji Holdings, as well as machinery firm Kubota. Health care holdings Astellas Pharma, H.U. Group, and Medipal Holdings also weighed on returns, along with chemical business Artience.

Select Activity in the Quarter
In comparison to the past few quarters, trading activity has normalized. The investment committee pared positions in well-performing holdings such as DeNA, Calbee and Mitsubishi UFJ, and divested the position in Dai Nippon Printing. The committee redeployed the capital to positions with healthy margins of safety, such as recent purchases Kyocera and Bridgestone, and other holdings for which we have re-evaluated and reconfirmed the intrinsic value estimates, including Sumitomo Mitsui Trust, Mitsubishi Shokuhin and Medipal Holdings. Additionally, the committee initiated a position in mobile game developer Akatsuki.

Full Sale

Dai Nippon Printing
Dai Nippon Printing (DNP) was one of the longest-held positions in the portfolio. Similar to many of our investments, DNP traded at a low cash-adjusted price/earnings ratio and a significant discount to book value. The company had an excessively capitalized balance sheet, with a large cash reserve and substantial equity investments, including privately held Recruit Holdings that later went public at a price well above its book value. While the domestic printing business was in secular decline, DNP had a portfolio of various printing technology-related businesses including integrated circuit cards, color and optical film for LCDs (liquid crystal displays), photomasks for semiconductors, and metal mask for OLEDs. We believed these businesses had attractive growth and profitability prospects.

Throughout our holding period, we actively engaged with DNP through letters, meetings with the board, and extensive discussions with management. Although it took time and effort, DNP did execute some of our suggestions, including reducing its board size from over 20 members initially, initiating buybacks and increasing dividends, and divesting non-core assets (e.g., the partial monetization of its Recruit Holdings stake). Recently, a prominent activist investor appeared to have applied further pressure, leading the company to announce its plans to improve earnings and returns on capital through an aggressive buyback program (over 10% of shares outstanding) in order to achieve a market valuation of at least a 1x book value.

Amid this development, our analyst updated our intrinsic value estimate for DNP, and the investment committee ultimately concluded that the market price reflected a reasonable degree of optimism. DNP was in a better position than when we first purchased the shares, given its growing electronics business and successful new products, such as battery packs for lithium-ion batteries that have gained significant market share. Acknowledging the potential for further upside, the committee gradually reduced the position over a period of time, with the final held shares sold at a price that was well above our estimate of intrinsic value for DNP.

<u>New Buy:</u>

Akatsuki
We initiated a position in Akatsuki, a mobile game developer and online comic creator and publisher. The company's core competency lies in forming strategic alliances with IP (intellectual property) owners to create mobile games. Akatsuki has successfully launched four core titles through collaborations with Bandai Namco Entertainment, Square Enix, and Koei Techmo Games. While the company has focused mainly on the domestic Japanese market, it has recently decided to expand to larger-scale, global titles. Although this will lead to higher costs in the near term, Akatsuki's current business is cash-generative and its balance sheet has ample excess capital, alleviating any concerns about capital availability.

In December 2023, Akatsuki announced a new strategic alliance with Sony and Koei Techmo to collaborate in development of mobile games. This agreement entailed a capital tie-up where Akatsuki issued treasury shares to both companies, resulting in Sony now owning a 9.87% stake in Akatsuki and Koei a 7.97% stake.

Our investment thesis for Akatsuki is two-fold: 1) the potential for the operating business to return to growth once the investments for new content in mobile and comic businesses start gaining traction, and 2) the value of cash and investments, which currently accounts for a substantial portion of the market value. While we have some concerns with the new capital deployment strategy, earnings appear to be near trough and the current valuation (below book value) appears to not give much credit to the new investments or to the overall businesses.

Investment Process Overview
As the portfolio owned Dai Nippon Printing for an extended period of time, we'd like to take this opportunity to explain the lifecycle of the investment, from both the analyst's and the investment committee's point of view. We include the discussions, thoughts, and the rationale behind the decisions made during the long holding period, which hopefully will help provide more clarity regarding our investment process.

<u>Analyst Viewpoint</u>
The three core drivers of the intrinsic value for DNP were 1) the value of the domestic-oriented printing-related business, 2) the future of the technology segment, and 3) the value of cash and investments which accounted for a significant portion of the market value.

Most of DNP's businesses started to decline in 2007-08 as competition accelerated for the electronics business, and the domestic printing market deteriorated due to the poor economy during the financial crisis. The company, which had been in high-growth mode through large capital expenditures to expand manufacturing capacity for the LCD and semiconductor-related businesses, entered a long phase of restructuring. For the analyst, it was imperative to keep the investment committee up to speed on the changes of the business environment, both from a secular and structural point of view. However, there was a unique challenge for DNP as the firm was a conglomerate with over 150 subsidiaries spread across four core segments and over 20 sub-segments, making it difficult to pinpoint the issues with so many moving parts.

The intrinsic value was revised downward at the start of the major restructuring efforts as the revenue and earnings declined. The analyst provided annual updates and at times, more frequent notes to the investment committee to keep the members informed of the progress or lack thereof. Later, we reduced the intrinsic value estimate for DNP a few more times to fairly reflect the required time for normalization, the uncertainty of the restructuring outcome, and the potential secular threat of a declining domestic business and economy. Eventually, DNP's earnings started to improve, but the key question was whether it was an inflection point for a sustainable improvement or just a temporary change.

The next challenge for the analyst was to convince the committee that there was now more upside to the intrinsic value after five years of recommending reductions. This required revisiting the older issues and convincing the investment committee that there were now new secular or structural growth opportunities. To do this, the analyst used supporting data points that included changes in management, strategic actions that improved the company's positioning, and peer analysis. As one can imagine, the discussions with the investment committee were not easy, as history tends to be a strong benchmark of a company's performance. Counterarguments to the upward revision included questions on the cash and investments, continued low returns on capital, management ability, and high domestic exposure.

From 2013 onwards, the analyst continued to recommend an increase in the intrinsic value estimate—until recently, when the share price appreciated well above our latest estimate. The drivers for the increase were 1) improved capital allocation including more aggressive buybacks and dividends, 2) downsizing of capital-intensive businesses, 3) growth of new technology-related products with higher margins, and 4) downsizing of the domestic printing business with a focus on cash flows. While the holding period was long, for the analyst, it was a tremendous learning experience to see the various cycles of a company with such a diversified business portfolio. Throughout the period, the analyst and the corporate governance committee also engaged very heavily with management to bring about changes to the inefficient balance sheet (excess capital) and governance structure (large board with very little independent directors).

Investment Committee Viewpoint

The biggest challenges as an investment committee were trying to determine whether 1) management had the ability to restructure its businesses, 2) the company would ever change its ways, and 3) there were any growth opportunities for the long term to justify upside. This said, the committee took comfort with the downside protection provided by the large cash and equity investments portfolio that accounted for over 50% and at times nearly 100% of DNP's market cap. However, the discussion of whether to give *par value* to the cash and investments was also very extensive.

During the period in which the analyst recommended reductions to the intrinsic value estimate, the market appeared so negative toward the company that the investment committee could justify a fairly large margin of safety without giving much value to the business. Based on our process of considering the risk/reward tradeoff from both individual stock and portfolio diversification perspectives, the investment committee made the decision to hold and at times, allocate more capital to the position due to its large margin of safety, strong balance sheet, and potential for profitability improvement.

Once the analyst started to recommend increasing the intrinsic value estimate, the key questions were determining how much of the changes were sustainable vs. temporary. As there was no clear answer, we gradually increased the intrinsic value estimate *but* controlled the allocation, reducing the position if the market value exceeded the intrinsic value as we sought more time for confirmation of the thesis. The frequent updates from the analyst were helpful as they provided more information to drive the allocation decisions.

The ultimate decision to sell the position was based on the market price well exceeding our estimated intrinsic value. While there could be more upside, we felt that the risk/reward tradeoff was not skewed in our favor compared to other investment options, especially as the cash and investments of DNP still accounted for nearly 50% of the intrinsic value.

We acknowledge there were numerous behavioral aspects that came to light during the long holding period, such as 1) fatigue from owning an underperforming asset, 2) difficulty in accepting that the past operating performance is not always indicative of future outcomes, 3) skepticism toward Japanese management's ability to change, and 4) negative sentiment toward domestic-oriented companies due to the lack of growth potential. However, our team-based portfolio management approach helped as we were able to exchange various perspectives, balance temperaments and overcome personal biases, and build consensus on the intrinsic value of the company and the positioning of the portfolio.

Year in Review and 2025 Outlook

This past year marked an interesting period for the Japan Equity Portfolio as it exited nine positions that included some long-term holdings such as the two property and casualty insurance companies (MS&AD Insurance Group Holdings, Sompo Holdings), Dai Nippon Printing, Taisho Pharmaceutical, and Yodogawa Steel. Our investment period for these holdings extended for more than 15 years each, and these businesses went through similar cycles as the aforementioned DNP, with positive performance contributions overall—except for Taisho, which went private. While there could be an argument that we may have owned these positions “too early,” our core competency and process are deeply engrained in purchasing assets when undervalued, as we acknowledge that forecasting market movements is fraught with difficulty and uncertainty. As long as we populate the portfolio in a diversified manner with companies trading at a discount to our estimated intrinsic values, we believe we can generate excess returns over the long run.

Of the eight positions initiated over the past year, seven are companies that we have never owned over the past 20 years. We believe these companies add diversification, with Kubota and Fuji Corporation bringing some economic and product cyclicality features (tractors, chip mounters), Bridgestone adding long-term global growth with its tire business, and Gungho and Akatsuki adding some research and development optionality with mobile game development. Compared to past investments, we have allocated larger positions to some of these names due to our optimistic view of their potential long-term returns.

From a performance perspective, the Japanese stock market continued to achieve positive returns in U.S. dollar terms—and even higher in local currency terms. Despite the market rise, the Brandes Japan Equity Fund was able to compete with the MSCI Japan Index (primary benchmark) and outperform TOPIX (secondary benchmark), although it underperformed the MSCI Japan Value Index. Factors contributing to our underperformance vs. the value index included our lack of holdings in companies that account for large positions in the index, our underweight to the large mega-banks (compared to our overweight to regional banks), high exposure to the underperforming health care sector, and the poor performance of some of our larger positions (e.g., Nissan, Astellas). As we pride ourselves in our tendency to outperform the value index during value-led periods, we are highly disappointed but not discouraged.

We remain optimistic with the long-term portfolio outlook. The recent announcement of Nissan potentially forming a strategic alliance with Honda could be a positive if materialized. Additionally, we have seen that some our small- and mid-cap names have started to perform better on the back of improved earnings and optimistic outlook. Our large position in Takeda should hopefully start to contribute positively when and if revenues revert to growth following the completion of the patent cliff. After two strong years of market performance, we believe investor focus will eventually shift to companies where the valuations look more attractive relative to those that have performed well.

From a portfolio perspective, we are excited about the current opportunity set. While positioned with more domestically oriented investments, we believe we have added more balance with the recent additions of companies with ex-Japan exposure, such as Kubota, Bridgestone, Kyocera, and Fuji Corp. Domestically, cost inflation pass-through is becoming a reality, leading to improved profitability relative to the past where companies tried to absorb such costs. The TSE (Tokyo Stock Exchange) directives also appear to be having some positive impact, although we believe the aggressive push by activists and private equity players is the stronger driver for corporate reform. Increased dividend and buyback activity is becoming a trend, while mergers and acquisitions as well as management buyout activities are becoming much more prevalent compared to the past. We believe our portfolio is populated with attractive assets whose potential hopefully can be realized through more aggressive corporate actions.

As bottom-up, fundamental research-based value investors, we do not employ a market view when managing the portfolio. Yet, we are cognizant there is a tendency for markets to correct following a period of strong performance. Thus, we believe whether the market goes up or down, being disciplined on price is imperative. 2025 may bring more uncertainty compared to other years with the new U.S. administration, the somewhat unstable hold of government control by the LDP (Liberal Democratic Party) in Japan, and overall geopolitics. Nonetheless, we believe the portfolio is well positioned with holdings that have what we consider strong balance sheets to manage both the micro and macro risks.

Conclusion

We would like to express our sincere appreciation to our clients who have continued to give us the opportunity to manage the Japan Equity portfolio on their behalf following disappointing performance relative to the value benchmark. We are honored to continue serving as stewards of your capital.

While there are numerous external factors beyond our control, such as inflation, unpredictable interest rate movements, global economic uncertainty, political instability across many countries, and geopolitical tension, our focus remains on what we can control, which is our process and belief in our estimates of intrinsic values based on bottom-up, fundamental analysis. The investment committee is also committed to optimizing the portfolio through diversification of various risk factors with the goal of minimizing capital impairment over the long term.

It is difficult to predict how the Japanese stock market or the Brandes Japan Equity portfolio will perform in 2025, but our commitment is steadfast: to remain consistent, transparent, and dedicated to achieving the best possible outcomes based on what we can control. In a world that is unpredictable, we are sure that 2025 will bring about more unforeseen events, but we strive to be prepared to manage the downside risk, while also capitalizing on potential investment opportunities. Hopefully, we can continue to earn your trust and reward it with enhanced performance.

We always appreciate any dialogue regarding the portfolio, our process and philosophy, as well as the firm, so please do reach out anytime. Critical comments and observations are always welcome as well. We sincerely value the relationship over the years. It is truly a privilege to manage the portfolio on your behalf.

May 2025 bring peace, happiness, wellness, and prosperity to all.

Term definitions: https://www.brandes.com/termdefinitions

The margin of safety for any security is the discount of its market price to our estimate of its intrinsic value.

The MSCI Japan Index with net dividends is designed to measure the performance of large and mid cap segments of the Japan market.

The MSCI Japan Value Index captures large and mid cap Japanese securities exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price and dividend yield.

TOPIX with gross dividends measures performance of all domestic common stocks listed on the Tokyo Stock Exchange First Section.