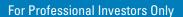
FIRST QUARTER 2024 STEWARDSHIP INSIGHTS





In the wake of the Tokyo Stock Exchange governance reforms, we remain focused on how companies are improving their governance structures to create shareholder value. We illustrate this approach with two of the more exciting opportunities in our Japanese portfolio.

Corporate governance is foundational to our decision making. Poor governance can drive a permanent capital impairment for any given investment. The Japanese market has had a reputation for governance shortcomings, reflected in lower market returns over time. More recently, we have seen significant positive changes, spearheaded by the Tokyo Stock Exchange (TSE). These reforms have the potential to crystalize governance reforms that have helped drive the strong rally in Japanese equities. Japanese governance reform has been high on our list of interests since we began investing in the region more than 20 years ago.

TSE REFORMS

Following the revision of Japan's corporate governance code in 2021, the TSE implemented additional reforms with the explicit aim to increase Japanese valuations. The TSE requested that all companies listed on the Prime and Standard Markets take "action to implement management that is conscious of cost of capital and stock price", with an emphasis on companies with a price-to-book (PBR) ratio below 1.

Disclosures to inform investors of company actions are required by March 2025, and the TSE began publishing the list of companies that have already done so earlier this year. Per the latest information from the TSE, 47% of companies in Prime, but only 14% of Standard, have provided a business plan to improve capital efficiency¹.

INVESTMENT IMPLICATIONS

These reforms have driven productive changes among our investments:

- Meaningful increase in engagement opportunities
- 2. Increased shareholder returns
- 3. Positive changes in board structure
- 4. Improved disclosure on the path to improved returns

While we see these reforms as directionally positive, they are still largely a top-down directive. To be successful, companies must make changes from the bottom up. We believe that we are still in the early stages of change. We need to see improvement not only in the independence but also in the quality of company boards. Directors need to have relevant experience, so they can ask the right questions of management and conduct proper oversight. We continue to see opportunities for improvement and maintain this dialogue with portfolio companies.

Looking ahead, we see private equity and activists becoming even more active in the market. Activism in Japan is already at a record high, as the second largest market for activist investment. We see this as a positive because activists are helping to accelerate the necessary governance reforms. The ability to assess which companies are serious about reform and which are just paying lip service to the requirements will become an even more important part of the bottom-up fundamental analysis. Historically, this narrative of private equity and activism has driven outperformance in the small cap space, which aligns with our view of the value opportunity in Japan today.

We illustrate some of the more attractive investment opportunities we see in the market through two company examples in our Japanese portfolio:

^{1.} As of February 29, 2024; Japan Exchange Group (JPX) and Pzena Analysis

STEWARDSHIP INSIGHTS CONT.

Suzuken, pharmaceutical wholesaler

We view Suzuken management as forward thinking in their capital allocation plans, with a comprehensive plan to improve ROE and get to 1x book value. This approach involves the ongoing sell-down of equity holdings and returning 100% of the company's earnings to shareholders to maintain ROE levels above cost of capital. Meanwhile, the company aims to further enhance ROE through structural reforms within its existing business and optimization of its business portfolio. Thus far, the release of excess capital and the payouts to shareholders are moving in the right direction, but we plan to keep Suzuken on our Opportunity List² until these plans are fully executed. We cast our proxy votes in favor of the board of directors because we approve of the decision making and the concrete actions that have contributed to an enhancement of the corporate value for Suzuken.

Hokkoku Financial Holdings, regional bank

Hokkoku has been proactively improving its ROE to 8% in a challenging banking business environment. The company released excess capital and increased its payout to shareholders while unwinding its cross-shareholdings. Hokkoku has made steady improvements in its board structure as well, achieving a majority-independent board last year. The management compensation scheme has also been revised to be ROE-driven. Together with its effort to reduce fixed costs and improve the business mix, we believe the company's structural ROE improvement will be rewarded. Hokkuku could be a candidate for removal from our Opportunity List, given these substantial improvements in corporate governance.

While there is a lot of excitement surrounding the Japanese market today, we think it has never been more important to choose investments wisely and determine, through fundamental analysis, which companies are serious about governance reform. It is worth acknowledging that any significant transformation takes time; therefore, it can be beneficial to be a long-term investor who has patience to wait for earnings to reach their longterm potential. Ultimately, stock performance, through the repricing of shares, will follow the business results and cash earnings. For this reason, we remain focused on governance and prudent capital allocation, something which, perhaps, has now come into sharper focus for the rest of the market.

CONCLUSION

^{2.} The Pzena Opportunity List refers to a subset of our portfolio companies for which ESG matters are among the most financially material issues. Improvements in these ESG issues, aided by our engagement efforts, could therefore lead to improvement in company earnings. You can read more about our Opportunity List here and here.

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