Harris | Oakmark

QUARTERLY MANAGER COMMENTARY

Japan Strategy

March 31, 2025

MARKET ENVIRONMENT

Japanese equity markets declined during the quarter amid ongoing volatility, driven by a combination of investor concern over the potential impact of looming tariffs on exporters and uncertainty on the timeline of future Bank of Japan (BoJ) rate hikes. In Tokyo, core consumer inflation accelerated throughout the period, remaining above the BoJ's target and fueling market expectations of further rate increases. The standing belief that the BoJ will continue to increase rates over the near-term contributed to the Yen's moderate appreciation during the quarter. Although we are not macro experts, we retain our view that Japan has exited its multi-decade period of deflation, and interest rates will normalize over the medium term.

Performance highlights

Contributors

- Sugi Holdings
- TIS Inc
- TechnoPro Holdings

Detractors

- OMRON
- Olympus
- Recruit Holdings

PORTFOLIO PERFORMANCE

The portfolio's return was 5.04% (net) for the reporting period. This compares to the MSCI Japan Index (Net) that returned 0.34% for the same period.

Top contributors:

- Sugi Holdings was a contributor during the quarter. The Japan-headquartered drug retail company's stock price rose throughout the quarter as it delivered solid results each month, with total Pharmacy store sales growing year-over-year. In our view, Sugi's recent acquisition of I&H Co. will drive meaningful synergies and has potential to be highly value accretive. We continue to believe the company is taking the right steps to unlock further value by being a disciplined consolidator in a fragmented industry.
- TIS Inc was a contributor during the quarter. The Japan-headquartered IT consulting and services company's stock price rose after it posted solid fiscal third-quarter 2025 results headlined by overall orders being up 10% and, more importantly, 15% in the Software Development segment. In addition, TIS saw growth in both its operating profit and gross profit margin during the period. We continue to believe the company offers attractive upside and has a strong opportunity for margin expansion over the long term.
- TechnoPro Holdings was a contributor during the quarter. The Japan-headquartered human resource and employment company's stock price rose as it reported fiscal second-quarter 2025 earnings with net income attributable exceeding consensus expectations. In our view, TechnoPro is well-positioned to benefit from rising IT spending in Japan. We appreciate management's financially disciplined, returns focused approach, and believe the stock offers an attractive upside.

Past performance is no guarantee of future results. The investment return and principal value of this portfolio and any particular holdings may fluctuate. Portfolio holdings are subject to change without notice.

Top detractors:

- OMRON was a detractor during the quarter. The Japan-headquartered electronic component company's stock price declined despite having delivered fiscal third-quarter 2025 results which were in line with consensus expectations. Omron's Industrial Automation segment saw strong performance, offsetting difficult performance in the Healthcare and Device and Module Solutions segments. We continue to appreciate the company's diverse product offerings, as it penetrates several markets with cutting-edge healthcare devices, social systems and more. In our view, automation continues to grow, and Omron is well positioned to capitalize on this trend.
- Olympus was a detractor during the quarter. The Japan-headquartered health care company's stock price declined after it reported fiscal third-quarter 2025 results, with operating income missing consensus expectations. The results were driven by a challenging business environment in China that is contending with an anti-corruption campaign, volume-based procurement headwinds and increased competition. Despite the current environment, we continue to believe that the company's strong positioning in various medical segments offers an attractive long-term upside.
- Recruit Holdings was a detractor during the quarter. The Japan-headquartered human resource and employment company's stock price declined after it reported mixed fiscal third-quarter 2025 earnings with adjusted earnings before interest, tax, depreciation and amortization ahead of consensus but slightly underwhelming revenue. As the owner of Indeed, the world's leading job site, Recruit benefits from highly attractive unit economics while delivering cost and time savings for customers. While Indeed remains the primary driver of the company's valuation, Recruit also owns other market-leading, cash-generative businesses. Over time, we believe the company can leverage this unique mix to unlock further value.

PORTFOLIO POSITIONING

We initiated the following position(s) during the period:

- Asahi Group Holdings is a leading global beverage company and Japan's largest beer company. In our view, the Japanese beer market will see tailwinds over the coming years as a result of liquor tax reform and price increases following years of decline. With a strong CEO in Atsushi Katsuki and the country's best-selling beer brand, we believe the company is uniquely positioned to capitalize on these tailwinds and expand domestic profits over the medium term. In addition, we like that Asahi commands attractive market positions in Australia and Central Europe, which support high margins and revenue growth. Lastly, after years of deleveraging following large acquisitions, we expect management to increase shareholder returns while continuing to realize the benefits of the company's global procurement initiatives. Despite this compelling setup, we were able to purchase shares in this above-average business at a below-average valuation, in our view.
- Kansai Paint is one of the two market leaders in paint and coatings in Japan. The company's products are used primarily for automobiles, construction, and ships along with bridges and residential housing. We have owned Kansai on and off over the past 15 years. We most recently sold out of the company in early 2024 as the share price reached our estimate of intrinsic value. Since then, the share price has declined 20% due to weak auto production and a weak decorative market in India as well as a de-rating of most global paint companies. With the shares priced at more attractive levels, we reinitiated a position in the company. After speaking with

management, we continue to believe that there is ample opportunity to reduce costs and improve profitability. Additionally, we believe many of the negatives of the Indian decorative market are now priced into the shares. Finally, management continues to allocate capital well by increasing dividends and share repurchases.

- Mitsubishi Estate is the largest owner of real estate in Tokyo's Marunouchi neighborhood. Marunouchi is the prime business district in Tokyo where office rental space has historically been characterized by low vacancy rates and rising rents, even in deflationary environments. In our view, Japan's shift to an inflationary environment will provide additional tailwinds to Mitsubishi's growing rental income in Marunouchi. We also like that the company has been strategically monetizing assets in other regions and returning funds to shareholders through buybacks and dividends, helping to boost the company's return on equity. We were happy to recently purchase shares at a discount to our estimate of net asset value and private market comparable transactions. We believe the gap between share price and intrinsic value should narrow as capital is returned to shareholders.

We eliminated the following position(s) during the period:

- OTSUKA CORP

OUTLOOK

We have argued that for too long of a period the weight of money invested globally was heavily skewed to a handful of U.S. growth names. Despite this, we've remained focused on using our bottom-up, fundamental analysis to inform portfolio construction. Even after this quarter's strong outperformance of value over growth, we believe a large valuation imbalance is still present and will be the fuel for better long-term performance for value equities.

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The MSCI Japan Index (Net) is designed to measure the performance of the Japanese equity market. The index includes large- and mid-cap stocks and covers approximately 85% of the free float-adjusted market capitalization in Japan. This benchmark calculates reinvested dividends net of withholding taxes. This index is unmanaged and investors cannot invest directly in this index.