BRANDES
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Brandes Investment Partners
Japan Equity Strategy Notes
Fourth Quarter 2025 (October 1 – December 31, 2025)

The Brandes Japan Equity Strategy returned 3.31% net of fees and 3.31% gross of fees, performing roughly in line with its benchmark, the MSCI Japan Index, which gained 3.23% in the quarter.

Annualized total return as of December 31, 2025	1-year	5-year	10-year
Brandes Japan Equity Composite (net)	27.90%	10.57%	7.85%
Brandes Japan Equity Composite (gross)	27.94%	10.78%	8.33%
MSCI Japan Index	24.60%	6.60%	7.62%

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

Leading contributors included pharmaceutical firm Astellas Pharma and machinery companies Fuji Corporation and Kubota. Japan Petroleum Exploration also helped returns, along with chemical company Shikoku Kasei and auto components manufacturer Nippon Seiki.

Performance Detractors

Semiconductor and semiconductor equipment was one of the strongest performing industries in the benchmark, and our lack of holdings was the largest detractor from relative returns.

At the company level, detractors included automaker Honda Motor, machinery companies Makita and Komatsu, advertising business Dentsu Group, beverage company Yakult Honsha, and health care firm H.U Group.

Several entertainment companies declined, including Akatsuki and GungHo Online Entertainment. Nintendo also fell, but given our underweight position in the company, the overall attribution effect was positive.

Select Activity in the Quarter

In another period of relatively strong market conditions, the investment committee continued to trim portfolio positions that had grown outsized relative to their margin of safety, including Kubota, Bridgestone, Astellas, and Fuji Corp. Banks also performed well amid rising interest rate expectations, prompting some additional paring.

Proceeds were redeployed to increase the position in OSG, which was initiated in the third quarter. In addition, we began building positions in four new companies: Hisamitsu Pharmaceutical, BML, Mitsubishi Pencil, and Pilot. These opportunities emerged as our analysts continued to diligently source and present new investment ideas to the committee, despite the backdrop of a strong Japanese market (MSCI Japan) over the past several years.

New Buys

Hisamitsu Pharmaceutical

Hisamitsu is a somewhat distinct pharmaceutical company with a balanced business portfolio split between the development and manufacturing of branded prescription drugs and over-the-counter (OTC) products. The company is geographically diversified, generating approximately 50% of its revenues in Japan, with the remainder coming from international markets. Its core strength lies in proprietary delivery technology for plaster-based products, including transdermal patches and tapes.

We believe the current valuation is compelling, as the market may be underestimating the strength of the OTC segment, particularly outside Japan. While the branded pharmaceutical business has faced challenges in recent years in both Japan and the U.S., we see potential for recovery supported by a pipeline of products in development. Although pharmaceutical research and development is inherently difficult to predict, Hisamitsu differentiates itself by focusing its research on leveraging its core delivery technology to enhance the safety and performance of existing drug compounds.

Overall, we value the strong global recognition of the OTC brand Salonpas, the prospects for a rebound in the pharmaceutical segment, and the company's robust balance sheet, with cash representing roughly 50% of market capitalization. While the balance sheet is somewhat inefficient, Hisamitsu has been proactively buying back shares, leading to a 10% share reduction over the past five years. Key risks include suboptimal capital deployment, intensifying international competition, and execution challenges within the U.S. branded pharmaceutical business. Weighing the risks against the potential upside, we believe Hisamitsu represents a compelling opportunity.

BML Inc.
The investment idea for BML emerged following our analyst's update on H.U. Group Holdings, which is a large holding in the Japan Equity portfolio. BML is one of Japan's leading clinical laboratory testing companies, alongside H.U. Group, with each controlling over 20% market share. As a direct competitor to H.U. Group, we believed it would be valuable to formally review BML.

Our investment case for H.U. Group was based on the view that its large-scale capital expenditure (capex) program launched in 2018(¥75 billion or approximately 45% of market cap at the time) to automate lab testing would not be as value destructive as the market valuation implied. Large capex programs often depress near-term operating earnings due to 1) increased depreciation charges, 2) implementation costs exceeding initial expectations, and 3) lower productivity as management resources are diverted.

As long-term investors, we see these situations as opportunities, as short-term investors typically avoid such risks. While operating earnings have yet to fully reflect our expectations, H.U. Group's share price has begun to recover with the completion of the capex program and normalization of operations at the new capacity. We believe further productivity gains and operating efficiencies should drive long-term earnings growth. Importantly, free cash flow has increased and should continue to rise as capex declines, even if earnings per share growth remains muted due to the large depreciation burden.

Similarly, BML is now undertaking a significant capex program valued at ¥43 billion, roughly 35% of its current market cap. Unlike H.U. Group, which has focused its capex on new build, BML's investments focus on upgrading existing facilities, which we view as lower risk. While these programs carry inherent risks, we believe they represent long-term earnings-enhancing investments.

Potential risks of the investment in BML include 1) lack of productivity improvements from the capex program, 2) poor capital deployment through mergers and acquisitions, and 3) price competition with H.U. Group for market share gains. However, trading at 1x book value despite a strong track record of attractive returns on invested capital, BML offers a compelling opportunity to us. The industry should benefit from secular growth driven by increased testing volumes in an aging society. Consolidation is also underway, with BML positioned as a leader as smaller players struggle to compete due to limited scale and capital.

Pilot Corp and Mitsubishi Pencil
Similar to our review of H.U. Group and BML, our analyst presented Pilot and Mitsubishi Pencil, the third and fourth largest writing instrument companies globally, respectively. This approach aligns with our process of analyzing industry competitive dynamics and reviewing companies operating within the same markets. Comparing sales growth and operating efficiency among peers provides valuable insights for valuation.

Both Pilot and Mitsubishi Pencil offer an interesting opportunity to invest in an industry experiencing slower domestic growth in Japan but expanding internationally through market share gains and entry into new regions, including emerging markets. The investment thesis for both companies centers on operating margin improvement in Japan through cost inflation pass-through and modest growth outside Japan. While we do not anticipate significant volume growth, we view these businesses as stable, and we appreciate the attractive returns on capital that both companies have consistently delivered.

Current thoughts

With the Japan equity market continuing to perform well, we have begun to see more changes within the portfolio, which has historically experienced low turnover. We have added many new names that we have not owned in the past, which is reflective of our disciplined screening process where our analysts consistently scour the diverse investment universe for investment opportunities despite a strong market environment. Two common themes that these new investments share include: 1) increased near-term capex that is expected to depress near-term returns, and 2) potential for margin improvement from cost inflation pass-through which has been lagging globally.

Initiating a new position is a rigorous process, as we carefully evaluate risks and maintain a long-term investment horizon. Equally, if not more, rigorous is the decision to exit a position. Given our generally long holding periods, the investment committee has a deep understanding of each company at the time of exit. We assess changes in company fundamentals, shifts in industry dynamics, iterations of analyst valuations, and both downside and upside risks. Most importantly, we observe how market valuations respond to these factors. While human nature can lead to attachment or disappointment with certain holdings, we remain disciplined, guided by our core belief that fundamental valuation should drive our decisions and is central to what we promise clients.

Over the past year, the investment committee discussions have centered on which companies to sell, how fast or to what extent to reduce positions that are either over-allocated as an individual position or as an industry. As mentioned in our previous notes, our bank weighting was at one point nearly 20%, but it has been reduced due to the strong share performance and rising interest rate environment. The discussion now centers on the upside potential in case of future interest rate increases versus the risks of credit loss potential.

Similarly, while we have long been overweight small- and mid-cap names, many of these holdings have begun to perform well. Previously, valuation discussions focused on excess cash due to overcapitalization. Now, the main topic has shifted toward business upside as volume recovery and cost inflation pass-through become reality.

Despite three years of strong equity market performance, we remain optimistic about the portfolio's long-term outlook, grounded in our bottom-up, fundamental research. While the portfolio is more domestically oriented, we believe it is well balanced, with upside potential from:

1. Continued dividend increases and share buybacks
2. Improved earnings through cost inflation pass-through
3. Margin enhancement from cost reductions and productivity gains

Although we do not manage the portfolio based on market forecasts, we recognize that markets often correct after periods of strong performance. With a new administration in Japan and conflicting fiscal and monetary policy directions, uncertainty around economic outlook has increased. Inflation must be contained or real wage growth achieved, yet the persistent weakening of the yen remains a challenge. While we acknowledge potential downside risks, we believe the portfolio is well positioned with holdings that have strong balance sheets to navigate both micro and macro uncertainties. Our core principle remains unwavering: discipline in acquisition price.

Conclusion

We would like to express our heartfelt appreciation to our clients for entrusting us with the management of the Japan Equity portfolio, despite a period of disappointing performance relative to the value index (MSCI Japan Value). It is an honor to serve 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.

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It is difficult to predict how the Japanese stock market or the Brandes Japan Equity portfolio will perform in 2026, 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 strive to be prepared to manage the downside risk, while also capitalizing on potential investment opportunities.

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 2026 bring peace, happiness, wellness, and prosperity to all.

For term definitions, please refer to https://www.brandes.com/termdefinitions

For index definitions, please refer to https://www.brandes.com/benchmark-definitions