



[00:00] Rob Campbell: Today, equity analyst Ian Turnbull discusses his latest trip to Japan. Ian highlights some of the unique aspects of Japanese society and corporate culture—everything from surplus and stakeholder capitalism to why you might get more than you pay for at a 7-Eleven convenience store. Ian reflects on the value of on-the-ground research, the trade-offs involved in capital allocation decisions, and pockets of real opportunity that he's excited about within Japan.

[00:36] Disclaimer: This podcast is for informational purposes only. Information relating to investment approaches or individual investments should not be construed as advice or endorsement. Any views expressed in this podcast are based upon the information available at the time and are subject to change.

[00:45] Rob Campbell: Ian, welcome to the Art of Boring.

Ian Turnbull: Thanks, Rob.

Rob Campbell: I should say welcome back. We've done this before, and you just came back from a research trip to Japan. As our team often does, part of what we like to do when we've done some research is share with a broader group. Your note began with the following sentence: "The more unique the culture, the greater the importance of visiting in-person and taking the time to wander and to think." So to start, can you unpack that statement a little bit more for us?

[1:15] Ian Turnbull: For sure. Japan is very unique. In all the countries I cover, it's probably the most unique. It's an island with a very specific culture, very specific ways of doing things and priorities. From our seat in Calgary or Canada, we see the headlines, we see statistics and numbers. They give you a good story, but not always a full story. So going there, talking to people, seeing what's happening on the ground—what do people really care about, what's changing, what isn't changing—and trying to get a lot of perspective. You talk to the companies, talk to analysts, talk to your cab drivers, other people on the street or at restaurants, just trying to really put together the mosaic. And I think always with traveling, it's part of the creative inspiration, getting out there, seeing what ideas bubble up, connections you can make. That all helps with it and I think Japan specifically. It is a good one to prioritize because it can be so different.

[2:00] Rob Campbell: You mentioned a little bit of it, but Ian, you have quite a formidable beard for those who are watching the video of this podcast. I think Socrates did too. The expression "to wander, to think" evokes images of Socrates. What does that actually mean to you—to wander and to think?

[2:15] Ian Turnbull: Maybe I've become a little more philosophical with the beard—hard to tell. For me, it's about having time to think. We get busy, we're in the day-to-day headlines, doing tasks, and at the end of the day, the amount of content we go through never ends. But our job is about making good decisions. It's about coming up



with insights that aren't obvious and put disparate information together, finding patterns. How you go about it, it could be at your desk, staring at a screen all day, it could be in a park, it could be traveling, in airplanes, taxi cabs, meeting with people and companies, and seeing where you end up. I think it's one of those things where it's hard to explain how did you get there? How do you connect all the dots on the way there? It's hard to do, but it's intuitive—how you arrive at a decision. That's part of the process for us.

[2:56] Rob Campbell: To your earlier point, it's not just about talking to management teams and site tours, but speaking to the people, getting a real sense for the flavor of the place. One of the insights that you came back with was on this concept of surplus and deficit and how it applies to Japan.

[3:14] Ian Turnbull: A business that creates a lot of surplus is awesome. They can apply surplus in different ways, and you can use stakeholder management to determine who gets the surplus down the chain. Japanese companies produce a lot of surplus. It's just that the way it's been distributed isn't totally equal and is different than what we'd be used to with western-oriented companies. In particular, I think customers do really well. There's a lot of customer surplus across quality, price, and super dedicated service. Employees do really well in terms of lifetime employment and really high loyalty between their employer and the employee. Suppliers benefit from long-term supplier relationships—long relationships generally are a key theme—and society at large. Companies think about society, doing what's best for society, thinking long-term, not just for themselves, but also for the broader society. The last one might be shareholders, which in some cases has done very well, but in other ways, not quite as high as it should be on the ladder. In some ways, that's getting equalized. In others, there's probably more room to go, or it might not happen in the same way we're used to. But it's good to go there, experience the surplus or deficits, talk to the companies and see where their priorities are and where they want to go.

[4:15] Rob Campbell: To translate that, you're saying that there are many businesses in Japan that create wealth, but maybe it's not the shareholders that are the beneficiaries of that wealth. Maybe other parts of society and the culture actually get those benefits. Is that right?

[4:31] Ian Turnbull: That's it. Customers can do really well—really high-quality products, and incredibly dedicated service. That's one thing across Japan: the employees are dedicated to what they're doing, partially because they're there throughout their careers. In the U.S., you often find hidden fees. I'd say in Japan, there are often freebies. I was surprised by what was included in the price. Hidden freebies. So it's a nice surprise as a customer. Maybe once I was surprised at an upcharge or something I wasn't expecting, but overall a really great customer experience. I think that's why tourism in Japan is taking off. That's the customer side. If you look at the income statement with employees, it's often still "lifers" in terms of staying there their whole careers. Employers are dedicated too. They don't fire people in downturns but keep them throughout their careers and the good side is you have a lot of retained benefits and learning. When you don't have to retrain people every two years, you can have retained learnings and really deep skill sets in niche manufacturing technologies and other areas that you just wouldn't get when you're constantly churning through employees.

The downside is the cost structure is not as flexible in downturns. You don't have quite the creative destruction as in the U.S. Lots of boom, lots of busts, lots of companies make it, lots go bankrupt. But that can create good vitality. In Japan, it's harder to hire mid-career. If you and I were going to try to do a startup in Japan and hire people, it would be difficult. The university students want a stable career, so they often go to more traditional



employers and don't want to leave mid-career. So it's chicken and egg there still.

[5:49] Rob Campbell: It's been hard preparing for this podcast not to draw too many comparisons between what we know about the U.S. and the large emphasis on shareholder returns, compared with some of the observations that you had in Japan. One of which was the way that businesses are optimized. I know you spoke about that a little bit. It sounds like from a visitor perspective, it's fantastic that there are lots of freebies. What does that look like from a corporate perspective?

[6:12] Ian Turnbull: From a shareholder perspective in Japan, we've seen relatively inefficient balance sheets, which does provide a lot of downside protection. It's hard to go bankrupt if you have a lot of cash, but it limits the upside and often just doesn't make good sense. Lower payouts of that cash and also less focus on returns. I think the Japan Stock Exchange has basically, for the last 12 years, focused on trying to get companies to become more efficient and more shareholder friendly. In a lot of ways they have, but you see some of the best companies with the best businesses, they don't need to allocate the cash because they have a great core business. They're only making 12% ROE. To go to 40%, they don't have a lot of interest. So you've seen some of the lower quality companies start to do that. In terms of pricing, I met with a company called Nippon Sanso. They're an industrial gases business, similar to Air Liquide or Linde. What they've been trying to do is improve profitability in Japan. They said it was difficult to get going, and with the war in Ukraine and all the inflation, it forced them and the whole industry to get going on that. One interesting point was, regarding freebies, it's not just pure pricing. They've historically not charged for a lot of things. So they'll do weekend deliveries, evening deliveries, free training, letting you keep an air cylinder for a long period of time. Now they're saying, "Hey, we're going to start charging for that stuff." One thing with Japan—it can move slowly. They have long-term relationships. They don't want to burn any bridges. The good point here is the runway's really long. They said, "We've been at this several years and we're still in early innings—getting our salespeople to push this through, getting customers to accept it." So we've seen nice improvements and there's probably a good way to go.

One other good example that contrasts well with the U.S. is Oriental Land Management. They own Tokyo Disney and Disney Sea. Really large land holding within Tokyo, good assets. The price is about a third of what you pay in Orlando. Talking to the company, they have raised prices a little bit and they started doing dynamic pricing just in 2020—charging more on weekends than on weekdays. I was pushing them to understand how far could they go with this? They're interested in raising prices. They see there's a lot of customer surplus, but they also said, "Hey, society needs to get value from this. We want this to be accessible to local populations." And meeting with analysts covering a totally different sector, I asked about Disney. He said, "Oh yeah, as a kid, we go every year. It's common and it's a rite of passage. It's something that's broadly accessible and they'll probably keep it that way." There's always opportunity to charge more, to optimize more, quote unquote. But at the same time, it works well for society.

The other example with them is they have a large land asset. Excess land might be about a quarter of the market cap. They never sold any, but they did donate some to the city last year to build a fire station. So great in some ways, but different than what we're used to.

[8:39] Rob Campbell: You could almost imagine a binary version of what you're describing. A particular culture that super optimizes for shareholder returns, really near-term focused. If I can squeeze pricing through tomorrow, let me do it and just be as aggressive as possible to get the highest possible returns. Contrast that with a really



long-term perspective, which may line up with what we're talking about in Japan, where the social license to operate and long-term value creation is viewed through a much longer-term lens. Is that the right way to think about this experience that you had over there? We've heard a lot about improvements in Japanese corporate governance over the last decade or so. I think your comment was, maybe we're in the early innings. But from your perspective, should there be more innings? How early are we in this process?

[9:23] Ian Turnbull: It's a great question, Rob. I love to stretch things to either extreme, and of course, there's no right answer. Japan works extremely well in a ton of ways. You don't see a lot of Japanese people leaving. They quite like it there. It makes sense. I think the starting point would be: is there a surplus? It's a great problem to have—a wealth-creating business with tons of surplus. Now, how do we allocate it? That's a great position to be in. The issue is when you deprioritize the shareholder side to benefit the others to too far a degree, it can be hard to attract capital and spur growth. I think Japan has had that issue historically. The reason why the stock exchange and the government is trying to reallocate that gradually is because they want investors to be here. They want business to happen. They want startups to happen. So they're rejigging that a bit. It's great to have super loyal employees, but if there's an amazing venture starting in your field and you're a leading person in that area, maybe you should go and join that. Maybe that would be more beneficial for the nation. Likewise, if a company is not making reasonable profits, maybe that makes them fragile in downturns. Maybe that means they can't invest enough. Maybe if they could invest more, they'd be better for customers. It's philosophical. It's impossible to be precise, but I think either end is not a great situation—both cultures have probably noticed that.

[10:29] Rob Campbell: In preparation for this podcast, I went back and listened to one of the very first Art of Boring episodes. I think it was episode nine, all about Japan with David Ragan. Dave's view from back then is quite similar to yours. It's not a lack of great business models in Japan, but governance and the way capital is allocated that has been the main impediment for finding as many opportunities in that market as there are today. In your view, what's changed since 2018, when that podcast was recorded, to today? Has there been much progress and where are you seeing it?

[11:03] Ian Turnbull: What hasn't changed is there are still great businesses in Japan. They still produce great surplus. We are seeing improvement in some areas. Some companies like Hitachi have really done big portfolio transformations. They said, "Hey, we're going to focus on areas that have good growth, that have good profitability. We're very dispassionate about getting rid of areas that don't." I met Hitachi and Hitachi Machinery, one of the subsidiaries, and they're spinning out Hitachi Machinery. I asked the company, "Why are you guys getting spun out?" They said, "We're too capital intensive. We're low return for Hitachi. They have better areas to invest in. So, they're prioritizing those." That makes a lot of sense. That's been a really good story. On the governance side, sometimes they do the best thing. Even though the incentives aren't perfect—they don't have return on capital all through the compensation plan, they don't necessarily own a ton themselves—often they do the right thing. They think really long term. So it's different ways of thinking about incentives and governance. One thing I've noted is companies getting into areas where their moat doesn't extend. They have a great core business, really high moat, but not a lot of growth. Often with Japan, given it's a declining domestic market, or at least population, they are looking outside for growth. They have that incentive to try to find growth. So I've met with a lot of companies where they have a great core business but are growing in areas where they have no moat. That's Dave's point about not great capital allocation, not great strategy in a lot of cases. But for bottom-up investors, we can look for the good cases, the best of Japan. Does this company's attributes really play well to Japan's strengths? And avoid the bad cases where they're probably going to allocate capital poorly. Shareholders



are not a priority. The good thing is sometimes that's pretty obvious. They're pretty upfront and honest with you. So having these meetings and trying to create that understanding can be really useful.

[12:40] Rob Campbell: What parts of the market during your travels there surprised you the most in terms of "this has got a lot of potential"? I appreciate that you're just fresh off this trip. You're still working through all the research that you've done. These may translate into future investment opportunities. But generically speaking, or thinking 10,000 feet up, what were you most excited about coming off your trip?

[12:59] Ian Turnbull: Digitalization is one big theme. Japan in some ways is very tech forward, but in a lot of ways actually lags, especially since 1990. The opportunity to help companies and governments digitalize is important. They have a labor shortage. They want to become more efficient. One company, Nomura Research, talks about there being a long runway here. They have really good IT services to help companies do that. My colleague, Josh Samuel, met with them a few weeks before I went. He noted that AI could be a really good opportunity. Because one concern with AI for IT services is it could be deflationary. But with Nomura Research, they have been labor constrained. They can only really grow as fast as they can add people. In Japan, it's hard to add people mid-career. So AI being an efficiency tool to automate a lot of tasks—they might be able to take on a lot more business now.

[13:45] Rob Campbell: When you say digitalization, what I'm picturing here is invoices being done manually versus electronically. Is that what we're talking about?

[13:53] Ian Turnbull: We're talking about that. We're talking about going to the cloud. There's been a lot of slower digitalization, slower credit card uptake in some ways. You still need cash to go to certain ramen restaurants. Even the UI—if you're visiting Japan, the government's intake form takes a lot longer and is a lot harder to use than it should be.

[14:10] Rob Campbell: So a historical lack of investment and a constraint on labor, which has just further exacerbated the problem, I can imagine.

[14:17] Ian Turnbull: That's it. But if I use the Hitachi example, they have an IT services business that goes across all divisions. This is a global focus, not just Japan, but they try to help customers. They have deep relationships. They find ways that customers need to digitalize better and then sell that to different customer groups using that deep relationship that they have to start with.

[14:37] Rob Campbell: Given your earlier comments about the motivations of different stakeholders in Japan, what they might prioritize, the sacrifices they might otherwise make in favor of shareholder returns, what's been the experience within the ecosystem for a company like Hitachi that's maybe been a little bit more forward in that regard, given that they exist within this broader ecosystem within Japan?

[14:57] Ian Turnbull: One thing with Hitachi is the last five years, it's really gotten noticed—the change, if you look at the stock price. But if you ask them, this has been a 15-year journey. It wasn't something overnight where they got a new CEO and decided to get rid of half the business and cut customer relationships. It was something gradual. Even with Hitachi Machinery, they're spinning this out, but gradually—they started with half, and they'll work their way down. It won't happen overnight. It might not be a huge price release, but you talk to the



companies, you notice the gradual change and the direction of where things are going. You also think about some companies that have the namesake brand—they don't want to exit a certain market. With Hitachi, one investor asked, "Are you willing to exit consumer appliances overall?" They said, "Yeah, we probably will because it's not a great business. We're not well-positioned there. Despite it being our brand and where we have great heritage, we're willing to do that." The timeline can be different than what we might be used to with that long-term perspective.

[15:47] Rob Campbell: Well, I have noticed in our portfolios, we have added a few more Japanese businesses than where we were several years ago. I know much of our conversation has really painted with a broad brush, but I do appreciate the specific examples where we're seeing changes. Last question before you go, Ian—maybe non-investment related. In your thinking, in your wandering, what was your best insight from the trip?

[16:09] Ian Turnbull: One that really stands out is the dedication everyone there seems to have to what they do. Employees are at their employer most of their career. They get really good at often niche things and really go hard at it. This is across higher-end restaurants, 7-Eleven—the dedication people have to what they're doing. It's not just monetary based. There's not a tipping culture. They're really focused on doing a great job with a lot of sincerity because they care. For me, trying to do the best I can do in my career and my job, it's inspiring to take that kind of ethos and try to apply it to my life as well.

[16:42] Rob Campbell: Well, Ian, on behalf of all of us and our listeners, with sincerity, thank you for your time.

Ian Turnbull: Thanks, Rob.

Rob Campbell: Hi, everyone, Rob here again. To subscribe to the Art of Boring podcast, go to mawer.com/podcast or wherever you download your podcasts. If you enjoyed this episode, please leave a review on iTunes, which will help more people discover the Be Boring, Make Money philosophy. Thanks for listening.

