Vanguard

Vanguard Investment Stewardship Voting Insights

Contested director election at Masimo Corporation

December 2023

Company: Masimo Corporation (Masimo)

Meeting date: June 26, 2023

Proposal: Items 1a–1d: Election of two Class I directors as named in [the Company's] Proxy Statement

How the funds voted

Masimo, a global medical technology company, faced a contested director election, also known as a proxy contest, at its 2023 shareholder meeting. Politan Capital Management LP (Politan) put forward two director candidates for consideration to replace two Masimo directors. At Masimo's annual meeting, the Vanguard-advised funds supported the election of both Politan nominees and withheld support from two Masimo director nominees.[1]

The funds' proxy voting policies

The Vanguard-advised funds evaluate contested director elections on a case-by-case basis, with an assessment of what is in the best interests of shareholders' long-term investment returns as the determinant of the funds' votes. On behalf of the funds, our process for evaluating contested director elections focuses on three key areas:

Strategic case for change.
Does the dissident make a compelling case that a change in the target company's strategy and board composition is likely to create long-term investment returns for shareholders, versus the status quo? When engaging with a dissident, we seek to understand their perspective on the company's current state and future trajectory, as well as what recommended changes the dissident believes would benefit the company and be in the best interests of long-term shareholders.

Company's approach to governance.
Has the company demonstrated good governance practices? By reviewing a company's public reporting and disclosures, and through discussions with company leaders, we seek to understand how the board's directors serve as engaged, effective stewards of shareholders' capital through independent oversight of company management, strategy, and material risks.

Quality of directors.
Do the company's nominated directors appear to bring the necessary capabilities to the company's board? Assessing a board's composition starts

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

with understanding the company's strategy and how the board's skills (collectively and individually) align with that strategy and position the board to provide effective oversight on behalf of all shareholders. We also assess director nominees put forth by the dissident to understand how their skills align with the company's strategy and/or the dissident's strategic case for change. We seek to understand the qualifications and perspectives of both sets of nominees so we can make informed judgments about which nominees are best positioned to provide for the company's long-term success.

Analysis and voting rationale

Vanguard's Investment Stewardship team has engaged with Masimo leaders since 2012. During those engagements, we discussed topics such as independent board leadership, executive compensation practices, board responsiveness to shareholder feedback, and shareholder-friendly governance provisions.

In advance of Masimo's 2023 annual meeting, activist investor Politan put forward two director candidates for consideration to replace two Masimo directors. We engaged with both Masimo and Politan leaders to gain additional background, information, and context to aid in our analysis of the contested director elections.

During our engagements with Masimo directors and executives, the board members, in our view, did not demonstrate sufficient effective independence from management and could not clearly articulate the board's role in overseeing company strategy and material risks. When discussing the Politan nominees, Masimo leaders described their engagement with Politan and Politan's nominees as unproductive, as they didn't agree with the feedback from Politan. The Masimo board committed, via a public filing, to add one of Politan's nominees to the board as a sixth director following the annual meeting if both incumbent nominees were re-elected and if the management proposal to expand the size of the board received shareholder support.[2] When asked for the reasoning behind that position, Masimo leaders shared that they were acting in response to shareholder feedback, and they agreed that one of the Politan nominees had appropriate skills for board membership. However, the board's recommendation to withhold support from both Politan nominees remained, and the board continued to state that in comparison to Masimo nominees, the Politan nominees were not a fit for the board. Although the funds do not participate in activist activity, we do look for portfolio companies to engage in good faith with shareholders who provide constructive feedback.

We learned helpful information that aided in our analysis and decision-making on behalf of the funds from our engagements with Politan leaders. Politan's case for change at Masimo centered largely around what they judged to be the company's poor corporate governance practices, a lack of independent board oversight of management, poor capital allocation decisions, and a belief that Masimo needed more focus on shareholder investment returns. Although the funds do not seek to dictate company strategy or or day to day operations, such as capital allocation decisions, the dissidents did present evidence that past decisions by company leaders—specifically the acquisition of Sound United in 2022—resulted in sustained poor company performance. Much of the negative market reaction to Masimo's acquisition of Sound United had been attributed to the lack of rationale communicated to shareholders. Politan's argument that stronger, more independent board members would be better positioned to improve disclosure and shareholder communication regarding future capital allocation decisions aligned with our perspective on disclosure and board oversight.

In reviewing Masimo's corporate governance profile and practices, we found that Masimo appeared to have demonstrated poor corporate governance practices over the course of several years. The company previously adopted several measures that, in our assessment, served to entrench the current board and management team. Recently, in response to shareholder concerns, the board made some changes to its governance practices (e.g., rolling back changes

2 https://www.sec.gov/Archives/edgar/data/937556/000093755623000133/masi-20230601xdefa14a.htm

to the company's advance notice provisions, proposing the annual election of directors, and allowing the company's poison pill to expire). These changes seemed to demonstrate some responsiveness of the board to shareholders; however, we observed that there remained opportunity for further improvement. During our engagement, the two dissident nominees explained how their backgrounds, skills, and experiences would enable them to drive long-term investment returns as potential board members at Masimo.

Through further analysis of Masimo's financial performance, particularly when compared to the named peer group, the team identified a compelling strategic case for change based on Masimo's lagging performance versus peers over 1-, 3-, and 5-year time frames. Based on our engagements and analysis, we assessed that one Politan nominee, who was endorsed by the Masimo board, would bring helpful health care industry experience to the board. We found that the second Politan nominee, whose firm had a substantial stake in Masimo, would bring relevant capital allocation experience that, in our view, would be additive to the Masimo board. Ultimately, we believed that the addition of both of the nominees put forth by Politan would help ensure the appropriate level of independence and rigor when considering strategic, operational, and governance decisions for the company.

Our engagement with the company leaders and dissident, as well as our analysis of the company's corporate governance practices, led us to conclude that the Masimo board's governance practices and oversight were lacking. We evaluated the entire slate of director nominees and concluded that the two nominees put forth by Politan would bring complementary and relevant skills to the board, in both absolute terms and relative to the incumbent directors that they would replace. As such, the funds supported the election of both Politan nominees and withheld support from two Masimo director nominees.

What we look for from companies on this matter

Boards of directors are elected to represent the interests of shareholders. Investors depend on directors to serve as the voice of shareholders in the boardroom while advising and overseeing company management. As a result, the funds have a strong focus on board composition and effectiveness. Many companies have evaluated their current disclosures to ensure appropriate disclosure of director skills, experience, and qualifications to provide investors with the ability to evaluate board composition.

Although company engagements may allow shareholders to better understand a company's approach to board composition and why the company is confident in its slate of director nominees, we encourage companies to provide these details in public reporting and disclosures to enable all shareholders to understand how the board thinks about its composition. We have observed that disclosures can provide a helpful view into how the board's talent and skills, both individually and in aggregate, align to the needs of the company. Such disclosures can allow shareholders to better assess the qualifications of each director and can lead to better decision-making abilities in the instances of contested director elections.

On behalf of the Vanguard-advised funds, we look for boards to represent the interests of all shareholders and to make independent decisions about a company's leadership, strategy, and risks to long-term investment returns for shareholders. We also look for boards to demonstrate oversight of company strategy and risks that supports positive long-term performance. If a board lacks the appropriate composition to independently oversee areas of material risk and company strategy, we look for the company to conduct a thorough search to identify qualified directors who will bring the necessary skills to the boardroom.

Vanguard publishes Investment Stewardship Policy and Voting Insights to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our growing effort to enhance disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide additional clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can do. Insights should be viewed in conjunction with the most recent region- and country-specific voting policies.

The funds for which Vanguard acts as investment advisor (Vanguard-advised funds) retain the authority to vote proxies that the funds receive. To facilitate the funds' proxy voting, the boards of the Vanguard-advised funds have adopted Proxy Voting Procedures and Policies that reflect the fund boards' instructions governing proxy voting. The boards of the funds that are advised by managers not affiliated with Vanguard (external managers) have delegated the authority to vote proxies related to the funds' portfolio securities to their respective investment advisor(s). Each external manager votes such proxies in accordance with its own proxy voting policies and procedures, which are reviewed and approved by the fund board annually.

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