

Brandes Investment Partners
International Small Cap Equity Strategy Notes
Second Quarter 2023 (April 1 – June 30, 2023)

The Brandes International Small Cap Equity Strategy returned 4.69% net of fees and 4.92% gross of fees, outperforming its benchmark, the S&P Developed ex-U.S. SmallCap Index, which gained 0.07% in the quarter, and the S&P Developed ex-U.S. SmallCap Value Index, which was up 0.47%.

Annualized total return as of June 30, 2023	1-year	5-year	10-year
Brandes International Small Cap Equity Composite (net)	33.35%	5.11%	6.23%
Brandes International Small Cap Equity Composite (gross)	34.52%	6.06%	7.18%
S&P Developed Ex-US SmallCap Index	10.50%	1.30%	5.74%

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

The strongest performers included holdings in utilities, specifically **Enel Chile** and **Neoenergia**.

Neoenergia reported robust results and announced the sale of a 50% stake in eight of its operational transmission lines for R\$1.2bn (Brazilian real) equity value, which was well received by the market. Meanwhile, Enel Chile continued its rebound in the quarter, driven by top-line growth in its generation business and increased gas sales.

Select health care companies also garnered solid returns, notably Israel-based **Taro Pharmaceutical**, Spanish biotechnology company **Grifols**, and Ireland-domiciled **Avadel Pharmaceuticals**.

In late May, Sun Pharmaceutical Industries, Taro Pharmaceutical's majority shareholder, delivered a non-binding indication of interest to acquire the remaining shares for \$38 each. The offer, which reflected a 41.5% premium to the average closing price over the previous 60 trading days, boosted Taro's shares.

Grifols saw its earnings improve as plasma collections have exceeded pre-COVID levels and inflationary pressure on donor fees has softened. The company also announced that it was enhancing its cost-saving plans and divesting some non-core assets to improve its balance sheet. Meanwhile, Avadel advanced after announcing the long-awaited FDA approval of narcolepsy medication LUMRYZ along with a seven-year exclusivity for the drug.

Geographically, our positions in the United Kingdom, Canada, and emerging markets aided returns, led by U.K.-based facilities management company **MITIE Group** and retailer **Marks and Spencer**, Mexican cement company **Cemex**, and Canadian aerospace firm **Heroux-Devtek**.

Performance Detractors

Several holdings in Japan detracted from returns, including **Kaken Pharmaceutical** and **Taisho Pharmaceutical**, as well as printing equipment manufacturer **Komori**.

Other poor performers included Latin American telecom **Millicom International Cellular**, Irish beverage company **C&C Group**, Spanish insurer **Linea Directa Aseguradora**, and Brazilian regional jet manufacturer **Embraer**.

Earlier this year, Millicom disclosed it was in talks with Apollo Global Management and Claire Group about a potential private equity buyout. However, the company confirmed in June that the discussion about the sale had been terminated, while also issuing weaker-than-expected earnings guidance, causing the shares to drop.

Relative to the benchmark, our underweight and sole holding (**PAX Global Technology**) in the information technology sector weighed on performance.

Select Activity in the Quarter

The small-cap investment committee initiated positions in France-based pharmaceutical firm **Euroapi**, Canadian food products company **Lassonde Industries**, and Japanese health care services business **H.U. Group**.

Euroapi is an active pharmaceutical ingredient (API; a key component in drugs) provider and a contract development and manufacturing organization (CDMO) that was carved out of Sanofi and publicly listed in May 2022. CDMOs offer services that range from drug development to drug manufacturing for other pharmaceutical companies. Sanofi retains 30% ownership of Euroapi, while 58% was distributed to Sanofi's then-existing shareholders and the remaining was sold to the French government. Accounting for over 50% of total sales, Sanofi continues to be Euroapi's largest customer, although the firm intends to diversify its client base and reduce dependency on Sanofi to 30% of revenues by 2025. Euroapi's other customers include large and specialty pharmaceuticals, biotechnology firms, generic manufacturers, animal health product companies, and consumer health businesses.

The creation of Euroapi was consistent with a recent industry trend in which larger pharmaceutical firms have spun off various assets with common themes for value creation being: 1) cost reduction through disciplined management, 2) increased top-line growth through focused resources and expansion of the customer base, and 3) increased capital expenditures (capex) to improve productivity and efficiency.

We believe Euroapi's core businesses, API and CDMO, have strong secular tailwinds in a highly fragmented market, the assets are solid, and that there is significant room for growth and profitability improvement. A main concern is that the company is unlikely to be the most efficient or the lowest-cost provider given the French government ownership and its mission of being a "made in Europe" API and CDMO company targeting repatriation demand and high value-added services. Nevertheless, we believe this has been more than reflected in Euroapi's share price. We appreciate that the company has a strong balance sheet post-spinoff and that it operates in an industry with high barriers to entry due to the significant capex and scale requirements, as well as the need for a good track record of quality manufacturing.

Besides the new purchases above, other major portfolio activity included the full sales of Malaysia-based **Genting Berhad** and U.K. money printing company **De La Rue**.

Year-to-Date Briefing

The Brandes International Small Cap Equity Strategy was up 18.59% net of fees and 19.10% gross of fees, outperforming its benchmark, the S&P Developed ex-U.S. SmallCap Index, which returned 6.51% in the six months ended June 30, 2023, as well as the S&P Developed ex-U.S. SmallCap Value Index, which was up 6.59%.

The strongest contributors were holdings in the U.K., Mexico, and Brazil, led by Brazilian regional jet manufacturer Embraer, U.K.-based industrial firm **Rolls-Royce**, grocer **J Sainsbury**, and retailer Marks and Spencer, as well as Mexican real estate investment trust (REIT) **Fibra Uno**. Enel Chile, Spanish REIT **Lar Espana Real Estate**, and Panamanian bank **Banco Latinoamericano de Comercio Exterior** also helped performance. From a sector standpoint, the strategy benefited from holdings in industrials, utilities, and materials.

Notable detractors included holdings in the commercial services and supplies industry, specifically De La Rue and South Korean security services provider **S-1 Corporation**. Ireland's C&C Group and Spanish Linea Directa Aseguradora also hurt performance, as did China-based PAX Global Technology. As was the case for the quarter, our underweight to the information technology sector detracted from relative returns.

Current Positioning

As of June 30, 2023, the strategy held its largest weights in industrials, consumer staples and financials. Our allocation to health care increased with the additions of Euroapi and H.U. Group, resulting in a meaningful overweight relative to the benchmark. Additionally, the strategy maintained underweights in technology, materials, and consumer discretionary. Geographically, it continued to have significant exposure to companies in Japan (although underweight relative to the benchmark), the U.K., and emerging markets, while having underweights to Canada, Australia, and Switzerland.

A variety of concerns continue to face international stocks, including elevated inflation, worries about slowing economic growth or recession, and political as well as regulatory uncertainties. Despite these challenges, the international small-cap equity asset class (MSCI EAFE Small Cap) posted positive returns over the last nine months, highlighting our belief that often when the market is the most negative, it can be a great time to invest.

While high-level valuations may not be as attractive as they were at the beginning of the year, international small-cap equities continue to represent, in our opinion, fertile ground for fundamentally solid businesses trading at a discount to their estimated intrinsic values. Within the asset class, value stocks (MSCI EAFE Small Cap Value) continue to trade in the highest decile of discount levels to the broader market (MSCI EAFE Small Cap) on a variety of valuation metrics, including forward price/earnings, price/cash flows, and enterprise value/sales. We are optimistic about the potential of value stocks in general and believe the Brandes International Small Cap Equity Strategy remains well positioned from a long-term risk/reward perspective.

Enterprise Value: Market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Enterprise Value/Sales: Enterprise value divided by annual sales.

Forward Price/Earnings: Price per share divided by earnings per share expected over the next 12 months or next fiscal year.

Free Cash Flow: Total cash flow from operations less capital expenditures.

Price/Cash Flows: Price per share divided by cash flow per share.

The S&P Developed Ex U.S. SmallCap Index with net dividends measures the equity performance of small cap companies in developed markets excluding the United States. Data prior to 2001 is gross dividend and linked to the net dividend returns.

The S&P Developed Ex U.S. SmallCap Value Index with net dividends measures the equity performance of small cap companies in developed markets excluding the United States, which are classified as value stocks by book value-to-price, sales-to-price, cash flow-to-price, and dividend yield.

The MSCI EAFE Small Cap Index captures small cap representation across developed market countries, excluding the U.S. and Canada.

The MSCI EAFE Small Cap Value Index with gross dividends captures small cap securities across developed market countries, excluding the United States and Canada, exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

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