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INVESTMENT PARTNERS

Brandes Investment Partners
U.S. Small Cap Value Equity Strategy Notes
First Quarter 2023 (January 1 – March 31, 2023)

The Brandes U.S. Small Cap Value Equity Strategy returned 8.75 net of fees and 8.96% gross of fees, outperforming its benchmark, the Russell 2000 Index, which was up 2.74% in the first quarter, and the Russell 2000 Value Index, which declined 0.66%.

Annualized total return as of March 31, 2023	1-year	5-year	10-year
Brandes U.S. Small Cap Value Equity Composite (net)	1.04%	9.43%	9.75%
Brandes U.S. Small Cap Value Equity Composite (gross)	1.85%	10.41%	10.76%
Russell 2000 Index	-11.61%	4.71%	8.03%

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
Holdings in industrials drove returns, led by aerospace and defense companies **Embraer**, **Moog**, and **Park Aerospace**, as well as machinery firm **Graham Corporation** and commercial furnishing business **Kimball International**.

Embraer posted solid results for the fourth quarter of 2022, with revenue and free cash flow ahead of consensus and operating margin improving sequentially across segments. The company provided increased guidance for aircraft deliveries in 2023 in both the commercial and executive divisions. Moreover, one of its competitors announced it had officially shut down its next-generation commercial regional jet program, which could leave Embraer to be the primary supplier in this market.

In early March, Kimball International agreed to be acquired by office furnishing company HNI in a transaction valued at $485 million. Kimball's share price increased over 80% on the news and we divested our position.

Other notable performers included insurer **Crawford & Company** and surveillance and security company **Arlo Technologies**. Arlo Technologies rallied on fourth quarter 2022 results and a revenue forecast for the first quarter of 2023 that exceeded sell-side estimates.

From a relative standpoint, our underweight to companies in the financials sector was a meaningful contributor to performance.

Performance Detractors
The failure of two crypto-related banks and the heavily venture-concentrated Silicon Valley Bank (SVB) triggered concerns about deposit outflows and longer-duration investments held at other small and regional banks. As such, it likely isn't a surprise that financial companies made up the worst-performing sector within the benchmark.

While our relative underweight to financials was a contributor to performance, some of the largest portfolio detractors were from the sector, namely banks **National Bankshares**, **ACNB Corporation** and **Eagle Bancorp Montana**, as well as insurer **National Western Life Group**.

Amid the concern and negativity in the broad financials sector, our research team and investment committee met frequently as they monitored ongoing developments, updated our valuation estimates, and evaluated risk exposures of our current holdings as well as potential opportunities. As a result of our analysis, we decided to sell our position in ACNB Corporation given the shift in its risk profile.

Other detractors were holdings in the consumer discretionary sector, specifically **Hanesbrands** and **Dorel Industries**.

Dorel Industries declined on disappointing results for the fourth quarter of 2022 due to lower sales in its juvenile products and home furnishing divisions. The company has started implementing measures to cut costs and reduce inventories, which should help earnings going forward.

Select Activity in the Quarter
The small cap investment committee initiated a position in **Elanco Animal Health** and Eagle Bancorp Montana. Meanwhile, divested positions included holdings in machinery firm **Miller Industries** as well as the aforementioned Kimball International and ACNB Corporation.

Elanco Animal Health was spun out of Eli Lilly in September 2018 and originally focused on the food animal segment. Through a series of acquisitions, most recently Bayer Animal Health in 2020, Elanco has become a global animal health business with a diversified product portfolio that includes medicinal feed, parasiticides (flea and tick products), vaccines, and other therapeutic drugs. The firm is now the world's second-largest animal health care company by sales and has a 55/45 revenue split between the U.S. and international markets.

While the integration of Bayer Animal Health has been going well, we believe its overhang, coupled with slower revenue growth in recent years, has created the opportunity to invest in Elanco. Key factors that underlie our investment thesis include:

- Mid-single digit potential growth throughout the industry stemming from a global increase in protein consumption and pet ownership;
- Stable sales due to the strong brand name, diverse portfolio, and lack of patent cliffs;
- Likelihood of profit margin expansion from streamlining manufacturing, research and development (R&D), and procurement;
- Less expensive and shorter-duration R&D with a higher a probability of success compared to human pharmaceuticals;
- Potential for continued financial deleveraging.

At its current valuations, we believe the stock represents an appealing risk/reward tradeoff.

Current Positioning
As of March 31, the strategy's largest sector allocations were in industrials and health care. Our most significant underweights were in financials, consumer discretionary and information technology. Given concerns about inflation and a weakening economic environment, we have remained careful about our exposure to companies that could be hurt by continued inflation or those with significant balance sheet leverage.

A variety of headwinds face stocks today, for example, elevated inflation and/or potentially increasing interest rates, slowing economic growth and recession concerns, energy risk, and political and regulatory risks, to name a few. We believe that at today's valuations, value stocks—and our portfolio in particular—offer an attractive long-term opportunity. It's important to remember that our overall positioning is driven from the bottom up, on a company-by-company basis, with a focus on the long term. We take into account many of the economic concerns noted above when we are evaluating a potential investment, estimating the impact they may have on each investment's intrinsic value.

We believe the differences between the Brandes U.S. Small Cap Value Equity Strategy and the broader U.S. small cap market continue to make the strategy an attractive complement to more index-like or growth-oriented alternatives, and we remain excited about the portfolio's future potential.

Cash Flow: The amount of cash generated minus the amount of cash used by a company in a given period.

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

Operating Margin: Operating income divided by net sales; used to measure a company's operating efficiency.

Profit Margin: Net income divided by revenues.

The Russell 2000 Index with gross dividends measures the performance of the small cap segment of the U.S. equity universe.

The Russell 2000 Value Index with gross dividends measures performance of the small cap value segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth.

Diversification does not assure a profit or protect against a loss in a declining market.

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