BRANDES
INVESTMENT PARTNERS

Global Small Cap Equity Strategy Notes
Fourth Quarter 2023 (1 October – 31 December 2023)

The Brandes Global Small Cap Equity Strategy gained 10.91% (gross of fees), underperforming its benchmark, the S&P Developed SmallCap Index, which was up 12.38% in the quarter, and the S&P Developed SmallCap Value Index, which returned 11.76%.

Positive Contributors
Top contributors included holdings in the aerospace and defense industry, led by **Rolls-Royce**, **Embraer**, and **Moog**. All three companies continued to see a resurgence in their end-markets.

Ireland- and U.K.-based consumer staples holdings also aided returns, notably grocer **J Sainsbury**, contract caterer **Greencore Group**, and beverage company **C&C Group**.

Other standout performers included German medical device company **Draegerwerk**, China-based **Weiqiao Textile**, U.S. networking hardware firm **Netgear**, and Slovenian bank **Nova Ljubljanska Banka**.

Weiqiao's shares jumped after its parent company announced a proposal to take the company private. The proposed price represented an over 100% premium to Weiqiao's previous closing price. Meanwhile, Draegerwerk reported another increase in its sales and margin guidance, triggered by stronger-than-expected sales of high-margin products.

Performance Detractors
Notable detractors included France-based active pharmaceutical ingredient company **Euroapi** and Ireland-based bank **AIB Group**.

Euroapi issued another profit warning in October, revising down its EBITDA (earnings before interest, taxes, depreciation, and amortisation) and sales growth guidance for the 2023 fiscal year, while also suspending its medium-term targets to 2026. Euroapi was carved out of global pharmaceutical firm Sanofi in May 2022, and it was expected that the company could face initial operational challenges as a standalone entity. Despite these short-term issues, we maintain a positive long-term outlook for Euroapi and have taken advantage of the share-price decline to add to our position.

Other poor performers included several holdings in the United States, including **Eagle Pharmaceuticals**, energy equipment company **Dril-Quip**, wireless surveillance camera manufacturer **Arlo Technologies**, and construction services firm **Orion Group Holdings**.

Select Activity in the Quarter
We initiated positions in U.S.-based energy firm **World Kinect** and industrial tools manufacturer **Kennametal**, as well as aerospace companies **Spirit AeroSystems** (U.S.) and **Montana Aerospace** (Switzerland).

Montana Aerospace (AERO) is a vertically integrated manufacturer of metallic systems and components (aluminum, titanium) for the commercial aerospace, electric vehicle, and renewable energy end-markets. AERO, which went public in 2021 following its spin-off from parent company Montana Tech Components (MTC), has a relatively short operating history as a publicly traded company. However, its legacy assets date back to the 1990s when the business served as a U.S.-based casting company for Boeing. In 2006, the assets were acquired by MTC. Over time, MTC eventually recognised the opportunity to streamline the highly inefficient commercial aerospace supply chain, which is burdened by strict regulatory certifications that result in the industry's high fragmentation, high-cost labor footprint, and high transportation expenses.

Fast forward several years, AERO now boasts a vertically integrated industrial base, expanding manufacturing scale, and low-cost industrial footprint that is intelligently located near customers. These capabilities position AERO as a cost-effective, one-stop-shop solution for aircraft OEMs (original equipment manufacturers) and Tier 1 suppliers (i.e., those that work the most closely with OEMs) looking to rationalise their highly complex and inefficient supply chains. To provide perspective, a typical commercial aircraft is made up of five million parts, and if one part is missing, the OEM can't finish assembling the plane.

We have been monitoring AERO since it went public in 2021, but at that time, we felt the elevated project execution risk and cycle recovery timing uncertainty, combined with its leveraged balance sheet and other company-specific issues, were too great to overcome. Today, we see a more visible recovery path—air traffic has resumed, aircraft production has been ramping up, capital expenditures have been declining, and new factories have become operational. With the various risks fading and the stock price closer to trough levels, we believe the market provided an opportune time to invest in a company with an attractive long-term risk/reward tradeoff.

A manufacturer of tungsten-based metal cutting components, wear-resistant cutting tools, and metallurgical powders, Kennametal (KMT) caters to customers in cyclical industries, such as the general engineering, aerospace, energy, earthworks, and transportation markets. Eighty percent of KMT's products, including drill heads or drill blades, are classified as consumables, contributing to recurring revenue due to the wear and tear nature of these items. Additionally, these tools tend to be highly engineered, specialty items that are critical to customers' manufacturing productivity.

KMT is a cyclical business that has been highly sensitive to changes in the industrial production outlook. During "good" times, its stock has tended to benefit from a positive revenue and free cash flow (FCF) trajectory. When the industrial production outlook softens, the stock price has tended to retreat with weakening revenue and FCF outlook. Unsurprisingly, recent recession fears, combined with market scrutiny on the sustainability of KMT's long-term margin, have pressured KMT's shares. Nonetheless, we appreciate the company's solid balance sheet and extended debt maturity profile, its history of resilient FCF generation and healthy returns on capital, as well as its leading position in a niche industry with significant barriers to entry. Furthermore, there is upside potential to be had if KMT manages to improve its margin toward peer levels. Weighing its positive attributes against its challenges, we believe KMT offers an appealing risk/reward tradeoff.

Besides the new purchases above, other major portfolio activity included the divestments of Japan-based **Fuji Media**, Mexican cement company **Cemex**, and U.S.-based Eagle Pharmaceuticals.

Year-to-Date Briefing
The Brandes Global Small Cap Equity Strategy returned 36.13% (gross of fees) and outperformed its benchmark, the S&P Developed SmallCap Index, which was up 15.32% in 2023, and the S&P Developed SmallCap Value Index, which returned 13.44%.

The strongest contributors were holdings in the U.K. (e.g., Rolls-Royce, retailers **Marks and Spencer** and J Sainsbury), the U.S. (e.g., Arlo Technologies, Moog, machinery firm **Graham Corporation**), Mexico (e.g., real estate investment trust or REIT **Fibra Uno**), and Brazil (Embraer). Other standout performers included electric utility **Enel Chile**, Hungary-based **Magyar Telekom**, and Spanish REIT **Lar Espana Real Estate**. From a sector standpoint, the strategy benefited from holdings in industrials, financials, real estate, and consumer staples.

Notable detractors included U.K.-based currency printer **De La Rue**, French Euroapi, and Spanish insurer **Linea Directa Aseguradora.** U.S.-based Eagle Pharmaceuticals, Dril-Quip, and Netgear also hurt performance, as did Japan's **Kaken Pharmaceutical**.

Current Positioning
The strategy maintains significant weights in industrials, consumer staples, and health care while continuing to have underweights to technology, materials, and consumer discretionary. Over the course of the year, our allocation to health care increased with the additions of companies such as Euroapi and **H.U. Group**.

Geographically, the strategy continues to have significant exposure to companies in the U.K and emerging markets, and a meaningful underweight to the United States.

While value leadership (S&P Developed SmallCap Value vs. S&P Developed SmallCap) has provided a tailwind for the strategy, it was our stock selection across sectors and countries that drove outperformance this year. Going forward, we remain optimistic about the portfolio's holdings composition and the risk/reward tradeoff it offers.

For term definitions: https://www.brandes.com/termdefinitions

The S&P Developed SmallCap Index with net dividends measures equity performance of small cap companies in developed markets.

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

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