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

The Brandes Global Small-Mid Cap Equity Strategy rose 12.33% (gross of fees), outperforming its benchmark, the MSCI World SMID Cap Index, which appreciated 12.06% in the quarter.

Positive Contributors
Top contributors included holdings in the aerospace and defense industry, led by **Rolls-Royce** and **Embraer**. Both Rolls-Royce and Embraer continued to benefit from a resurgence in demand within their commercial aerospace end-markets.

Other standout performers included Japan's **Taisho Pharmaceutical**, Hungary-based **Magyar Telekom**, and Taiwan-based **ASUSTeK Computer**.

Taisho Pharmaceutical appreciated following a management buyout announcement, which reflected a 50% premium to Taisho's six-month average trading price. We divested when the company's share price surpassed the management buyout offer price.

Performance Detractors
Notable detractors included several of our bank holdings; in aggregate, our investments rose less than those in the benchmark. The most significant detractors included Japan-based **Hachijuni Bank** and **Shizuoka Financial**, as well as Ireland-based **AIB Group**.

Other detractors included health care service companies **Pediatrix Medical Group** and **Medipal Holdings,** and energy company **Dril-Quip**. Indonesia-based **PT Gudang Garam** also declined on weaker-than-expected earnings results.

Select Activity in the Quarter
We divested a long-held position in **Taisho Pharmaceutical**. On November 24, the company announced a management buyout (MBO) with an offer price of ¥8,620 per share, which represented a 55% premium on the previous day's closing price. The founding family, which holds 40% of the shares, agreed to tender at the offer price, which lowers the hurdle to successfully completing the transaction. We viewed the offer price as reasonable and the likelihood of a significantly better offer to be low.

Taisho has been held in most client portfolios since 2017. The company derives most of its value from the sale of over the counter (OTC) drugs, nutrient drinks, and health foods in Japan. Taisho also has an undersized and loss-making pharmaceutical business. We believe the company has been poorly run, with poor capital investment decisions and an overcapitalized balance sheet with minimal capital returns to shareholders. Poor operating performance and a management team unfriendly to shareholders contributed to the share-price weakness. The company's market valuation was so low that we believed even a small improvement in the business or the company's capital structure could potentially lead to share-price improvement. A management buyout was not the scenario we expected to crystallize value.

Recently, there has been pressure on public companies in Japan trading below book value to take action to improve market valuations through capital returns to shareholders or improved operating performance. Before the MBO, Taisho was trading at about 60% of book value. The severity of the market discount to book value was amplified because the company had no debt, and financial assets accounted for over 50% of book value. At the 52-week low share price for Taisho, the market was valuing the company less than the financial assets the company held while the business continued to be profitable and generate positive cash flows.

While we would have preferred to see improved corporate governance and better operational management, the buyout price is acceptable to us, considering the current state of the business and financial assets on the balance sheet. As the shares traded at a slight premium to the buyout price, we decided to exit our position.

A recent addition to global small-mid portfolios is **International Flavors and Fragrances** (IFF). Through recent acquisitions, IFF has become the largest flavors and fragrances company in the world. The company was founded in

1889 and produces more than 33,000 unique compounds that are used to improve the taste, texture, scent, stability and function of food, beverage, pharmaceutical and cosmetic products. The flavors and fragrances industry has a history of attractive returns on capital, stable and predictable growth, and increasing market concentration. Customer relationships tend to be strong as the ingredients supplied are integral to the end-consumer's experience and are often proprietary. Research and development spending is typically high for companies in the industry as growth is largely driven by product innovations.

An aggressive acquisition strategy by IFF's management gave us the opportunity to add to the portfolios what we would normally deem a richly valued company. In 2018, IFF completed the acquisition of Frutarom, a flavors and fragrance company with a strong presence in natural ingredients. The Frutarom acquisition was valued at $7.1 billion when it was announced. In 2021, IFF completed its purchase of DuPont's nutrition business for $26.2 billion. Both acquisitions were funded by a combination of cash and shares, which resulted in increased financial leverage and a downgraded credit rating. More importantly, IFF has struggled to integrate these large acquisitions, with profit margins falling to less than half of the company's historical average.

Given the historical stability of the business, the current operating margins, the term structure of the debt and the proposed asset divestitures (IFF completed over $1 billion in asset sales during the past year), we believe the company will be able to meaningfully reduce financial leverage over the next few years. The debt market also appears unconcerned since IFF's public debt has traded on par with similarly rated corporate debt issuances (S&P rating: BBB-).

Brandes believes the potential for favorable investment returns lies in the enhanced operating performance expected as IFF continues to integrate the DuPont nutrition business. Given IFF's substantial expansion (more than doubling in size through acquisitions during the past five years), the integration challenge is formidable. At the market's current valuation—which reflects skepticism regarding successful integration—even incremental progress and delayed improvements could help shift investor sentiment for the better. The market has effectively discounted a significant portion of the $33 billion spent by IFF on its two major acquisitions. We assert that the prevailing market valuation of IFF provides a degree of downside protection against challenges in successfully turning around the larger integrated business.

Year-to-Date Briefing
The Brandes Global Small-Mid Cap Equity Strategy appreciated 25.74%, outperforming its benchmark, the MSCI World SMID Cap Index, which rose 15.62% for the year ended December 31, 2023.

The primary driver of outperformance was our stock selection across multiple sectors, especially financials, industrials, health care, and consumer staples. The strongest contributors were holdings in the U.K. and emerging markets, led by Greece-based bank **Piraeus Financial**, Brazilian regional jet manufacturer Embraer, U.K.-based industrial firm Rolls-Royce, and U.K. retailer Marks and Spencer. Israel-based **Taro Pharmaceutical**, Hungary's Magyar Telekom and Taiwanese ASUSTeK Computer also aided performance.

Notable detractors included our underweight to the information technology sector—the best performing sector in the benchmark—as well as several holdings in that sector, such as **Netgear** and **Amdocs**. Other detractors included consumer staples holdings **CALBEE** in Japan and **C&C Group** in Ireland, as well as health care firms **United Therapeutics** and Pediatrix Medical Group.

Current Positioning
The strategy held key overweight positions versus the benchmark in the consumer staples and health care sectors. Meanwhile, we remained underweight in typically cyclical sectors, such as consumer discretionary and industrials. We were also underweight in perceived "safe havens," such as utilities, which underperformed the overall benchmark this year after previously being bid higher by investors seeking yield and capital preservation.

Geographically, we continued to find value opportunities outside the United States, especially in the United Kingdom, Japan, and emerging markets. As of December 31, the portfolio remained materially underweight compared to the benchmark's allocation to the United States.

High-level valuations may not be as attractive as they were at the beginning of 2023. However, global small-mid 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 World SMID Cap Value) continue to trade in the highest decile of discount levels to the broader market (MSCI World SMID Cap) on a variety of valuation metrics, including forward price/earnings, price/cash flows, and enterprise value/sales.

We believe that paying extremely close attention to valuations enables us to choose opportunities that others may miss. From our perspective, selectivity and a laser focus on margin of safety remain paramount in any and all market environments. We are enthusiastic about the potentially undervalued companies we are finding, and the diversification offered by the Brandes Global Small-Mid Cap Equity Strategy.

The margin of safety for any security is the discount of its market price to our estimate of that security's intrinsic value.

Term definitions: https://www.brandes.com/termdefinitions

The MSCI World SMID Cap Index captures mid and small cap representation of developed market countries.

The MSCI World SMID Cap Value Index with net dividends captures small and mid cap securities across developed market countries exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

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