

**Brandes Investment Partners**  
**Global Small Cap Equity Strategy Notes**  
**First Quarter 2024 (January 1 – March 31, 2024)**

The Brandes Global Small Cap Equity Strategy gained 10.70 net of fees and 10.87% gross of fees, outperforming its benchmark, the MSCI ACWI Small Cap Index, which was up 3.91% in the quarter, and the MSCI ACWI Small Cap Value Index, which returned 3.13%.

<b>Annualized total return as of March 31, 2024</b>	<b>1-year</b>	<b>5-year</b>	<b>10-year</b>
Brandes Global Small Cap Equity Composite (net)	32.31%	14.49%	8.20%
Brandes Global Small Cap Equity Composite (gross)	33.29%	15.42%	9.11%
MSCI ACWI Small Cap Index	16.46%	8.00%	6.76%

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 the industrials sector drove returns. Among the top performers were aerospace and defense companies Rolls-Royce (U.K.) and Embraer (Brazil), as well as U.S.-based construction and engineering company Orion Group and machinery business Graham Corporation.

Our aerospace and defense holdings, including Rolls-Royce and Embraer, continued to benefit from the ongoing recovery in passenger air travel that has led to solid revenue growth, expanding profit margins, healthier cash-flow generation, and healed balance sheets. These positive fundamental developments helped confirm our long-term thesis around franchise quality, balance sheet durability, and end-market recovery potential for these holdings. Moreover, record backlogs highlighted—in our view—the appealing long-term secular growth outlook for global passenger air travel in an industry that has historically allowed incumbents to generate attractive returns on capital. Consequently, we revised our intrinsic value estimates for several of our aerospace and defense holdings upward, and believe they continue to offer an attractive risk/reward tradeoff at current valuation levels.

Orion Group benefited from notable growth in its marine and concrete segments, while Graham Corp rose on better-than-expected earnings and revised guidance.

Outside industrials, our financials holdings also aided returns, led by Ireland’s AIB Group, Slovenian Nova Ljubljanska Banka, Austria-based Addiko Bank, and Japanese Hachijuni Bank.

Additional standout contributors included U.S. security system company Arlo Technologies and Ireland-based convenience foods producer Greencore Group, as well as Hong Kong-based shoe manufacturer Yue Yuen Industrial and food products company First Pacific.

**Performance Detractors**

Significant detractors included several health care holdings such as Spain’s Grifols, France-based Euroapi, and Japanese H.U. Group Holdings.

Biotechnology firm Grifols grappled with multiple declines in its share price following a short seller’s report that questioned the company’s debt and corporate governance practices. In our opinion, the risks highlighted in the report had been largely known, and we maintained our position in the company despite the volatility—albeit now at a lower weighting due to the share-price decline. While we have long been concerned with the company’s elevated financial leverage, we recognize that Grifols has several options at its disposal that can help derisk, including the partial sale of its stake in Shanghai RAAS that is scheduled to close in the first half of this year.

We continue to believe there is potentially meaningful upside in the stock and we are managing the elevated balance sheet risk through allocation sizing. Grifols' plasma business weathered considerable challenges amid the COVID-19 pandemic, including decreased blood donations and higher costs associated with compensating donors. Today, blood donation volumes are running above pre-COVID levels and collection costs are declining as the pandemic-related supply challenges fade. Admittedly, the free-cash-flow recovery has been slower than anticipated as Grifols has been making substantial investments to expand capacity for future growth. While these investments have weighed on short-term profitability and cash flow, we believe they should be beneficial for the company in the long term as the industry transitions back to the pre-COVID growth trajectory. Furthermore, we appreciate Grifols' competitive position in a consolidated industry with high barriers to entry and long-term secular growth, as well as its business model that should allow it to generate steady free cash flow if the industry returns to equilibrium. Trading at a single-digit multiple of pre-COVID earnings, Grifols appears attractively valued to us.

Beyond health care, other detractors included U.K.-based food retailer J Sainsbury and Mexican homebuilder Consorcio ARA.

### ***Select Activity in the Quarter***

The small-cap investment committee initiated a position in Canada-based CAE.

CAE supplies simulation equipment and integrated pilot training services to both civil aviation and military customers. Competing in a market dominated by two key players (the other being Flight Safety), CAE boasts the world's largest installed base of full-flight simulators. Over the past 20 years, CAE has diversified into the less cyclical pilot training business, offering training services through a global network of over 250 civil aviation and military training locations across 40 countries. The company derives 40% of its revenues from simulation products and 60% from training and services.

Our coverage of CAE began in 2011, and since then, our assessment of the company's core franchise quality remains unchanged. With its dominant position in flight simulation and pilot training, CAE has historically generated solid free cash flow and healthy returns on invested capital. The company also benefits from its access to attractive financing sources in the form of perpetual zero-cost loans from the Canadian government for research and development initiatives.

It is notable that during the COVID-19 pandemic, CAE took significant steps to strengthen its competitive position and improve industry structure. Firstly, the company leveraged its financial strength to complete a series of opportunistic acquisitions, purchasing nine companies at what we deemed depressed prices. This has helped CAE consolidate end-markets and expand capabilities. Secondly, it restructured its cost base, closing nine plants and removing \$70m in annualized costs that resulted in a 1.5% margin benefit on sales. Lastly, CAE expanded its relationship with mainline airlines, which chose to outsource an increasing share of their internal training needs. To satisfy this new demand, CAE embarked on a heavy capital expenditure cycle over the course of the pandemic that we believe will benefit shareholders in the years ahead.

The opportunity to initiate a position in CAE came as investors have been concerned about recent margin weakness within the company's defense segment. However, we view these challenges as temporary. Inflation and supply chain pressures have started to ease, and CAE's under-earning, fixed-price contracts are set to expire by 2025. We expect that CAE is positioned to improve its profitability as legacy fixed priced contracts roll over and as new high-margin defense contracts begin to ramp up. Based on the company's guidance, new contracts should earn mid-double-digit margins, compared to the mid-single-digit margins on the legacy fixed-price contracts that were impacted by the pandemic-related cost pressures. At its current valuation levels, CAE represents an appealing risk/reward tradeoff, in our opinion.

Besides the new purchase of CAE, other major portfolio activity included the full sales of China's Weiqiao Textile as well as U.S.-based National Bankshares and National Presto Industries.

### ***Current Positioning***

Allocations from a country and sector standpoint were largely unchanged during the quarter. The strategy maintains significant weights in industrials, consumer staples, financials (although underweight relative to the benchmark), and health care, while retaining underweights to technology, materials, and consumer discretionary.

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

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 MSCI ACWI Small Cap Index with net dividends captures small cap representation across developed and emerging markets countries.

The MSCI ACWI Small Cap Value Index captures small cap securities across developed and emerging markets countries exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

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