

Brandes Investment Partners

U.S. Small-Mid Cap Value Equity Strategy Notes

Third Quarter 2024 (July 1 – September 30, 2024)

The Brandes U.S. Small-Mid Cap Value Equity Strategy gained 9.13% net of fees and 9.39% gross of fees, outperforming its benchmark, the Russell 2500 Index, which was up 8.75% in the quarter. The Russell 2500 Value Index returned 9.63%.

Annualized total return as of September 30, 2024	1-year	5-year	10-year
Brandes U.S. Small-Mid Cap Value Equity Composite (net)	21.72%	10.42%	8.73%
Brandes U.S. Small-Mid Cap Value Equity Composite (gross)	22.88%	11.48%	9.78%
Russell 2500 Index	26.17%	10.42%	9.49%

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

Leading contributors included holdings in the health care sector: Phibro Animal Health, blood plasma company Grifols, Pediatrix Medical Group, and Koninklijke Philips.

In July, Grifols confirmed that the founding family, which controls 30% of the company, and Brookfield, a multinational Canadian investment fund, are evaluating a potential joint takeover bid for the entire business. The structure and pricing remain unclear, but the market reacted positively to the news.

Communications equipment companies F5 and NETGEAR were also solid performers. In September, NETGEAR revised its guidance upward after it entered into a settlement with TP-Link regarding pending patent infringement disputes. NETGEAR received a \$135 million settlement and all pending litigation between the two parties will be dismissed or no longer pursued. NETGEAR also announced an earlier-than-anticipated 5G mobile hotspot launch.

Other contributors included aerospace and defense companies Embraer and Moog Inc., which benefited from improved earnings amid strong demand in their end-markets. Embraer also received a settlement from Boeing for the latter company’s unsuccessful takeover bid, while its stock benefited from its recent inclusion in the MSCI Emerging Markets Index.

Performance Detractors

Notable detractors were in the consumer staples and energy sectors, specifically Innovex International and Edgewell Personal Care Co.

Select information technology companies also performed poorly, notably software company Verint Systems, semiconductor business Qorvo, and IPG Photonics.

On a relative basis, our underweights in the financials and real estate sectors, two of the strongest performers in the benchmark, detracted from returns.

Select Activity in the Quarter

The investment committee initiated positions in construction services company Balfour Beatty and health care equipment business Zimmer Biomet Holdings, while exiting Science Applications International Corp. (SAIC) and TransUnion.

TransUnion (TRU) was founded in 1968 and is the third-largest credit bureau in the world (~19% relative share) after Experian (~46%) and Equifax (~35%). Goldman Sachs Capital Partners and Advent International bought the company in November 2012 from Madison Dearborn Partners and the Pritzker family for ~\$3.3 billion. The company went public in June 2015. TRU is a data-driven business that sells consumer credit reports, risk scores, analytics, and decisioning capabilities to deliver insight across the consumer credit lifecycle.

Our TRU investment thesis focused on a margin-expansion story driven by cyclical headwinds abating and integrating Neustar (an identity resolution provider acquired in 2021) to accelerate growth of ID/fraud and marketing-related revenues. We believed margin expansion should be further supported by a recently advanced cost savings initiative that management expects to deliver \$120–\$140 million of savings by 2026. While financial leverage is elevated, the company has been making progress on paying down debt and targets a net debt/EBITDA (earnings before interest, taxes, depreciation, and amortization) of less than 3.0x.

Further, TransUnion has likely benefited from the U.S. Federal Reserve cutting interest rates, through increased credit origination activity as well as lower interest expense on its floating-rate debt.

Over the past year, TRU's share price has been volatile. After Q3 2023 results disappointed with a cut in 2023e (estimated) guidance and withdrawal of previous 2025e financial targets due to underperformance in the U.S. market segment, TRU's shares declined by more than 20%. However, in 2024, TransUnion was up by more than 50% on revenue and earnings growth, combined with revised 2024e guidance upwards. With the company reaching our estimate of its intrinsic value, we sold our position.

Year-to-Date Briefing

The Brandes U.S. Small-Mid Cap Value Equity Strategy rose 12.52% net of fees and 13.32% gross of fees, outperforming its benchmark, the Russell 2500 Index, which appreciated 11.30% in the nine months ended September 30, 2024, and the Russell 2500 Value Index, which was up 11.28%.

Holdings in the industrials, materials, and health care sectors drove returns. Leading performers included aerospace and defense companies Embraer and Moog, NETGEAR, United Therapeutics, and Phibro Animal Health.

While health care investments in aggregate contributed to returns, Dentsply Sirona, Varex Imaging, Premier, and Fortrea Holdings were notable detractors. Energy equipment business Innovex International and IPG Photonics also declined.

Current Positioning

The positioning of the portfolio remains largely unchanged from last quarter. The strategy maintains its largest weights in industrials, health care, and information technology. Our most significant underweights are in consumer discretionary, financials, and real estate, which is consistent with how the portfolio began 2024. Compared with the Russell 2500 Value Index, we have significantly less exposure to financials and real estate.

In our opinion, the differences between the Brandes U.S. Small-Mid Cap Value Equity Strategy and the broader U.S. small-mid cap market continue to make the strategy an attractive complement to other small-cap and small-mid offerings. Our strategy exhibits lower valuations than the Russell 2500 Index, while offering exposure to companies that have what we consider strong balance sheets, compelling growth prospects, and a history of durable free cash flow.

We are optimistic about the potential of value stocks in general and believe the Brandes U.S. Small-Mid Cap Value Equity Strategy remains well positioned from a long-term risk/reward perspective.

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

The MSCI Emerging Markets Index captures large and mid cap representation of emerging market countries.

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The Russell 2500 with gross dividends measures the performance of the small to mid cap segment of the U.S. equity universe.

The Russell 2500 Value Index measures the performance of the small to mid-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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