Harris | Oakmark

QUARTERLY MANAGER COMMENTARY

International Small Cap Strategy

September 30, 2024

Performance highlights

Contributors

- St. James's Place
- Loomis
- LANXESS

Detractors

- Megacable Holdings
- Atea
- Autoliv

MARKET ENVIRONMENT

International equities finished higher during the third quarter, with 9 of 11 GICS sectors posting positive returns. The financials and industrials sectors were the strongest contributors to international market returns, while the energy and information technology sectors were the sole detractors. By country, Canada and Japan contributed most to market performance, while Denmark and the Netherlands detracted.

PORTFOLIO PERFORMANCE

The portfolio's return was 12.10% (net) for the reporting period. This compares to the MSCI World ex USA Small Cap Index that returned 10.45% for the same period.

Top contributors:

- St. James's Place was a contributor during the quarter. After several months of negative news flow relating to Consumer Duty regulation fee changes and levied penalties from the Financial Conduct Authority, the U.K. wealth manager's stock price rose materially based on first half of 2024 earnings that included a reaffirmed view of the near-term fees and penalty provisioning for the business as well as medium-term ambitions to double company earnings through a combination of a strong cost savings program and gradual migration of non-fee generating gestation assets to fee-paying assets. We met with CEO Mark Fitzpatrick after the earnings and found the company's outlook credible. We have also spoken to several large St. James's Place wealth management shops to gain conviction on the company's growth ambitions. In our view, its strong growth prospects after its fee reset, low valuation and strong wealth management franchise make the business an attractive investment.
- Loomis was a contributor during the quarter. The Swedish security and alarm services company's stock price rose following the release of strong second-quarter results, with Europe profitability showing signs of positive momentum and the U.S. continuing to perform well. Notably, Europe saw year-over-year margin expansion for the first time since the first quarter of 2023. Performance in the U.S. remains solid, in our view, with growth in volume and price above our expectations and a well-managed margin. Cash conversion was strong during the first half of 2024, and capital expenditures decreased.
- Lanxess was a contributor during the quarter. The German diversified chemicals company reported solid second-quarter earnings with good improvement in earnings before interest, tax, depreciation and amortization. We met with the

CFO, Oliver Stratmann during the period and were pleased to hear they saw growth across the majority of their business units during the second quarter. We continue to believe that Lanxess offers an attractive upside as short-term headwinds are masking the company's potential for increased earnings and free cash flow generation.

Top detractors:

- Megacable was a detractor during the quarter. The Mexico-headquartered cable company reported disappointing second-quarter results, in our view, with earnings before interest, tax, depreciation and amortization missing consensus expectations and underperforming our full-year estimates. A key issue was customer churn, which management emphasized has peaked and subscriber growth should inflect upwards in the coming quarters. Additionally, Mexican equities were negatively impacted during the quarter due to investor concerns of the newly elected president. We continue to monitor the situation closely. Positively, capital expenditures are decreasing, and management emphasized that generating free cash flow is now a top priority as they do not foresee any significant investment projects in the near term.
- Atea was a detractor during the quarter. The Norway-headquartered value-added reseller of hardware, software and services saw its stock price slip following the release of second-quarter results. Although less severe than the first quarter, hardware revenue declined, mainly driven by weaker demand for networking equipment. The revenue shortfall combined with some gross margin pressure on hardware led to a decline in earnings before interest and tax (EBIT) versus the prior year. Positively, cash conversion remains strong and management expects growth to pick up meaningfully in the second half of the year and to grow EBIT for the fiscal year. We continue to believe Atea is a dominant player in the Nordic infrastructure reselling and service market and appreciate management's focus on profitability and cash flow generation.
- Autoliv was a detractor during the quarter. The U.S.-headquartered automotive parts and equipment company's stock price declined after reporting weaker than expected second-quarter results. Major markets were softer than had been anticipated given pricing competition in China and destocking within the United States. We continue to believe Autoliv's position within the attractive passive safety segment and its auto supplier industry-leading pricing power can create value over the long term.

PORTFOLIO POSITIONING

We initiated the following position(s) during the period:

- Azelis is a global pure-play specialty chemical distributor, offering technical and application expertise to its customers on its product portfolio of unique low volume, high impact chemistries. The industry is highly fragmented with few companies able to offer the level of differentiated value-added services required to effectively bring manufacturer products to market. Azelis' position as a global player with a robust network across industries has facilitated sticky long-term relationships with top tier manufacturers. We believe the company will compound earnings over time as it gains share in a growing end market with continued manufacturer outsourcing, attractive operating leverage, and a long tail of accretive M&A opportunities. Macro-economic weakness, post Covid-19 benefit normalization, and private equity ownership overhangs have created an opportunity to invest in this high-quality stock at a discount to peers.

We eliminated the following position(s) during the period:

- Intermediate Capital Group
- Titan Cement

OUTLOOK

In the short term, traders analyze news flow to predict price movement, whereas investors, like ourselves, attempt to determine the price of an asset using fundamental analysis, then buy low and sell high. We believe traders have greatly influenced current market conditions leading to a disconnect between price and fundamental business value. The result is an opportunity for investors who can identify businesses with strong, durable cash flow streams. Though we are frustrated with our recent performance, based on today's valuations, we remain confident in our time-tested investment approach.

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The MSCI World ex USA Small Cap Index (Net) is designed to measure performance of small-cap stocks across 22 of 23 Developed Markets (excluding the United States). The index covers approximately 14% of the free float-adjusted market capitalization in each country. This benchmark calculates reinvested dividends net of withholding taxes. This index is unmanaged and investors cannot invest directly in this index.