TimesSquare Capital Management, LLC

# Emerging Markets Small Cap Strategy

**Representative Commentary — 3Q23**

## Performance

| | 3Q23 | 1YR | Annualized 3YR | Annualized 5YR | Annualized Since Inception (1/1/2017) |
|---|---|---|---|---|---|
| Emerging Markets Small Cap Composite (Gross) | 1.01% | 25.86% | 8.69% | 9.11% | 8.97% |
| Emerging Markets Small Cap Composite (Net) | 0.73% | 24.52% | 7.51% | 7.93% | 7.79% |
| MSCI Emerging Small Cap (Net) Index | 2.93% | 23.06% | 10.61% | 6.45% | 7.26% |

***Please see the important performance and other related disclosures at the end of this Commentary, which are an integral part of this quarterly Commentary Newsletter.***

Global equity markets fell in the third quarter, though remained positive year to date. Value generally held up better than Growth, which was evident from the market indexes and the style factors. The strongest fundamental style factor in the U.S. market was Profitability, though its influence was far more muted worldwide.

As our investment team meets with companies, reviews recent earnings reports, and surveys the global landscape, they note several investment dynamics that inform our positioning:

- Geopolitics is creating an increased level of uncertainty among both investors and corporates. The result has been an increased awareness of potential headline risk and geopolitical “hotspots", which in turn has also been driving the flow of fixed asset investment (in the form of “nearshoring” or “friend-shoring”) and capital flows to “safer” geographies.

- Labor pools continue to shrink and get more costly, either due to demographics or worker demands for higher pay. Some companies adjusted to wage inflation and are in stronger positions to offset those costs and maintain margins thanks to their pricing power. Others either outsource certain operations to specialized providers or increase their use of productivity enhancement tools/automation or software.

- While adoption of cloud-based processes is still in the nascent stages, earlier this year many businesses slowed their pace of spending as part of broader cost-cutting measures. Now in better financial positions, companies are beginning to reengage with their cloud initiatives and those green shoots were noted by some of our holdings.

- Consumers have traded down with their spending habits or tightened the hold on their wallets. That was partly a response to higher expenses from rising credit costs and energy prices, which makes us more cautious about some consumer-oriented companies.

- One area benefiting from increased spending has been Industrial Infrastructure. Companies have been reassessing their supply chains in the face of geopolitical pressures and the greater costs or risks with long-distance shipments. At the same time, many of the larger economies are incentivizing re-shoring via new government support programs for infrastructure investments. That causes growing shifts of production capacity to local regions and leads to significant project backlogs for some of our holdings, especially those capable of improving industrial efficiency.

Within the Emerging Markets space, Value outperformed Growth stocks and small cap outpaced their larger peers. Focusing on the Emerging Markets small cap universe where this portfolio concentrates on, EMEA and Asia outperformed while Latin America lagged. With the exception of Consumer Discretionary and Real Estate, most sectors had positive performance. Especially Energy, which rebounded with a double-digit return.

The Emerging Markets Small Cap Portfolio underperformed the MSCI Emerging Markets Small Cap benchmark during the third quarter of 2023. Positive stock selection in EMEA helped offset relative weakness in Asia and Latin America.

**Regional Performance: Asia**

Renewed concerns about China's property sector and its lackluster economic recovery weighed on sentiment. However, macroeconomic data towards the end of the quarter turned more positive. A combination of geopolitical forces, China's maturation away from being a low-cost manufacturer, and the shifting of supply chains has created opportunities for many of the smaller Emerging Markets that had previously been overlooked or overshadowed.

As the top performing country in Asia this quarter, India has emerged as one of the beneficiaries of this movement. **RailTel Corp. of India** provides telecommunication services including video conferencing, data center, broadband, virtual private network, and consulting services. The company saw its project revenues grow with the easing of the supply chain and its order backlog also remains healthy. Since the re-launch of the BSE Sensex-30 and Broker derivative contracts in mid-May this year, **BSE** (formerly Bombay Stock Exchange) has seen better than expected growth and strong momentum. **Kalyan Jewelers** owns and operates jewelry stores that offer gold, diamond, platinum, and silver jewelry. Despite volatile gold prices and a seasonally weak quarter, Kalyan reported inline results with healthy revenue growth and margin expansion. We trimmed all three positions with them surging 69%, 90%, and 51% respectively.

In Korea, we initiated positions in **LIGNext1 Co** and **NanoTim.** LIGNext1 is a developer of defense technology and security products. The company's products include anti-submarine guided missiles, harbor underwater surveillance systems, and electronic warfare platforms. We believe it is well positioned to benefit from the increasing defense exports trend in Korea, as well as future trends in warfare (such as increased usage of drones and missiles). **NanoTim** is a manufacturer of thermal materials that provide heat management solutions or act as fire retardant. NanoTim's materials have been adopted by Hyundai / Kia in their EV's. While the adoption by additional car manufacturers and EV battery companies is likely, there are many other end applications outside of EVs. **SKC** produces copper foil for the EV battery industry. The company posted a worse-than-expected operating loss in the second quarter due to unfavorable copper price trends, electricity price hikes, and weaker demand. With the ramp-up of the more cost-efficient Malaysian plant, earnings momentum of copper foil is expected to improve. New order intake from original equipment manufacturers and battery cell producers in the second half of 2023 should also be helpful. With the stock declining -24%, we added on this price weakness.

In Taiwan, we started a position in **M31 Technology**, which provides third-party Functional and Foundational intellectual property (IP) to foundries and integrated circuit (IC) design companies. As IC design gets more expensive and complex particularly for leading edge nodes, customers rely more and more on M31's IP to save time (and resulting development costs). M31's licensing and royalty-based business model is asset-light and highly profitable with its IP sales. Meanwhile we trimmed our position in **Brogent Technologies** due to its significant exposure to the Chinese market, which was recovering slower than expected resulting in project (and revenue recognition) delays. Brogent is the world's leading virtual ride simulator company, designing both virtual hardware equipment as well as the associated virtual content. Theme parks and entertainment venues are choosing more virtual rides due to their smaller footprint and lower costs relative to roller coasters, as well as the ability to adapt the installed ride simulator to any new future content. Brogent's. Brogent's share price traded down -13% this quarter. The portfolio's largest detractor was **Green World Fintech Service**, the Taiwan's largest third-party payment processor, focused on providing online payment processing services. The company reported in-line quarterly results, but sales momentum was lackluster. With its main competitor raising shipping cost, Green World's planned new service launches in the second half of 2023 should help attract new customers and increase market share. We added to our position with the stock down -21%. Two of our Information Technology holdings, **Alchip Technologies** and **Elite Materials**, are the beneficiaries of the artificial intelligence (AI) thematic and ascended 45% and 72% respectively. **Alchip** manufactures application specific IC (ASIC) as well as system on a chip (SoC) for complex, high-growth applications such as AI and higher performance computing. Management issued strong 2023 guidance and bullish medium-term growth outlook. **Elite Material (EMC)** is a leading Copper Clad Laminate (CCL) provider for High-Density Interconnect (HDI), which is mainly used in smartphone applications The company also has successfully extended its presence in datacenter, networking, and automotive in recent years. EMC has a dominant position in AI servers and continues to gain market share in non-AI servers/switches.

**Regional Performance: Latin America**

In Latin America, Brazil underperformed despite improving economic data and its central bank kicking off rate cuts more aggressively than expected. With the stock down -14%, we trimmed our holding in **Multiplan Empreendimentos Imobiliarios** on potential rental growth deceleration as Multiplan's rental rates are adjusted for inflation, which is declining in Brazil. The company designs, develops, owns, and maintains one of Brazil's largest and highest quality commercial property portfolios. On the other hand, we added to **Locaweb Servicos de Internet**, one of Brazil's leading business-to-business solutions providers, with a growing e-commerce and software-as-a-service platform. The company reported a soft second quarter and its share price declined -28%. We believe this correction was overdone and expect a recovery in the second half of the year. We also initiated a position in **CM Hospitalar (Viveo)**, a leading distributor of drugs, medical supplies, and materials in Brazil. We believe Viveo will outpace the already attractive growth of the health care industry and expand margins at the same time as the company executes on its strategy of tapping additional channels (e.g., labs and retail) and adding higher margin products and services such as disposables, nutrition, implants, prosthesis, dermatology products and inventory management. We also expect the company to continue consolidating the market and see additional M&A from 2024 and on that can bring upside to the investment case.

**Regional Performance: EMEA**

During the quarter, we continued to build up our position in **Coca-Cola Icecek**, a leading consolidator in the non-alcoholic ready-to-drink (NARTD) market across the Commonwealth of Independent States (CIS), Turkey, and Pakistan. The company was able to increase pricing above inflation rate, in anticipation of increased cost inflation across all markets. They see a return to volume growth in Turkey in the second half of 2023. Shares of Coca-Cola Icecek improved by 24% this quarter.

In Saudi Arabia, **Maharah Human Resources** provides human resources and labor sourcing services, in-home services, medical, industrial, retail, and hospitality sectors. The company has seen a strong rebound in its first half 2023 financial results in both revenue and profitability with the easing of longer-than-expected COVID-related labor mobility bottlenecks. The demand from the construction, healthcare, and household sectors have also continued to grow.

**Conclusion**

As bottom-up investors, we seek underpinnings to near-term valuations in the form of expected earnings growth and other business fundamentals. We continuously review the business models and management teams of current and potential holdings, and fine tune our own valuation models on an ongoing basis, as we endeavor to protect the assets you have entrusted with us. As always, we are available for any questions you might have.

***General Disclosure:***

*The holdings discussed represent a particular point in time. It should not be assumed that the securities continue to be held, and/or continue to be held in the same percentage, and/or were held continuously throughout the period. In addition, the holdings of a particular client account may differ from the information provided. Securities discussed do not represent the entire portfolio and, in aggregate, may represent only a small percentage of a portfolio's holdings. Information is subject to change without notice. It should not be assumed that any of the securities discussed were or will prove to be profitable. Past performance does not guarantee future results.*

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***Firm and Composite Information***
*TimesSquare Capital Management, LLC ("TimesSquare") is a registered investment adviser that is owned by the former equity management team of TimesSquare Capital Management, Inc. ("TimesSquare Inc.") and Affiliated Managers Group, Inc. TimesSquare was formed to manage TimesSquare Inc.'s growth equity investment advisory business which was sold to TimesSquare in a transaction that closed on November 19, 2004.*

*This composite generally invests in Emerging Market stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the MSCI Emerging Markets Small Cap Net Index. Portfolios will hold approximately 70-75 securities. Frontier securities may be included in holdings. The process is fundamental research driven. Primary selection criteria include quality management, distinct competitive advantage, and strong, sustainable growth. Composite inclusion threshold $500,000. Fee basis is 110 points. The composite creation and inception date is January 1, 2017.*

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*Past performance does not guarantee future results. Times Square's list of composites is available upon request. The firm's list of limited distributed pooled funds are available upon request.*

***Benchmark***
*Performance is measured against the MSCI Emerging Markets Small Cap (Net) Index. MSCI Emerging Markets Small Cap (Net) Index is a trade or service mark of MSCI Inc. The MSCI Emerging Markets Small Cap (Net) Index is an unmanaged, market-weighted index of small companies in emerging markets. Its returns include net reinvested dividends but, unlike the Composite returns shown, do not reflect the payment of sales commissions or other expenses incurred in the purchase or sale of the securities included in the Index. All indexes, including the MSCI Emerging Markets Small Cap (Net) Index, are based on gross-of-fee returns, including net reinvested dividends.*

*Benchmark returns are not covered by the report of independent verifiers.*

***Performance Calculations***
*The performance figures shown are calculated in U.S. dollars on a size-weighted basis and reflect the reinvestment of dividends and other earnings, and the deduction of brokerage commissions and other transaction costs. Performance is provided on a gross basis (before the deduction of management fees) as well as net of the highest fee level from the standard fee schedule listed for this strategy during the period presented. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. TimesSquare's fee schedule is available upon request and may also be found in Part 2A of our Form ADV.*

*Investment advisory fees generally charged by TimesSquare are described in Part 2A of its Form ADV. To illustrate performance net of fees, assume $20,000,000 is placed under management for ten years sustaining 10% compound gross total return. If an advisory fee of 1.10% of average assets under management is charged per year, for each year of the ten-year period, the resulting compound annual return would be reduced to 8.9%. The ending dollar value of the account would be $46,914,683.76 compared with the unreduced account value of $51,874,849.*

*Internal dispersion is calculated using the equal-weighted standard deviation of all accounts included in the composite on a gross basis for the entire year; it is not presented for periods less than one year or when there were five or fewer portfolios in the composite for the entire year.*

*The three-year annualized standard deviation measures the variability of the composite and the benchmark returns on a gross basis over the preceding 36-month period. The three-year annualized standard deviation calculation is not presented for the composite and/or benchmark for years when 36 monthly returns are not available. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.*

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