



QUARTERLY COMMENTARY

Ariel Small Cap Value

• Value • Deep value • Global



Quarter Ended June 30, 2021

Markets worldwide continued their upward trajectory in the second quarter. Record levels of fiscal support, pent-up consumer demand and rising COVID-19 vaccination rates continue to fuel the global economic recovery. As the re-opening progresses, implications for inflation and the timing of rate hikes has ignited investor anxiety. While we expect volatility to elevate, we view such jitters as short-term noise within the context of our long-term investment horizon. Against this backdrop, the Ariel Small Cap Value Tax-Exempt Composite increased +3.69% gross of fees (+3.43% net of fees), trailing the Russell 2000 Value Index's +4.56% return and the +4.29% gain posted by the Russell 2000 Index in the quarter.

Several stocks in the portfolio had strong returns in the quarter. Premiere oil services company **Core Laboratories NV (CLB)** was a top performer in the quarter. Despite extreme winter weather in the U.S. and COVID-19 disruptions across international markets, CLB's earnings results highlighted the durability of the business model. Management continues to prioritize Free Cash Flow generation, Return on Invested Capital and debt reduction. Looking ahead, we believe the headwinds this asset-light business is experiencing will soften and expect CLB to experience modest growth in reservoir description, which measures rock properties and hydrocarbon fluid behavior rates. We also think CLB will see increased activity in fracturing rock, which should increase output in well completions and fuel longer term growth of its production enhancement sector.

Worldwide provider of products and services to the drug discovery and research marketplace, **Charles River Laboratories International, Inc. (CRL)** advanced on robust earnings results and subsequent raise in full year guidance. A global focus on scientific innovation and favorable biotech funding environment is driving unprecedented client demand for research models and services as well as a strong pricing environment in both the Discovery Services and Safety Assessment businesses. Although, we expect this momentum to continue, CRL's growth in market

capitalization surpassed the upper limit of Ariel's Small Cap Value's range. While bittersweet, we successfully exited the name during the quarter.

Shares of leading organizational consulting firm **Korn Ferry (KFY)** also jumped in the quarter. KFY delivered a substantial earnings beat across all business segments, culminating in record earnings per share and forward-looking guidance that exceeded consensus expectations. Management suggests the company is poised to emerge from the pandemic even stronger from a profitability standpoint, and we believe these results may serve as early evidence of their claim. Looking ahead, we expect KFY to continue to benefit from a best-in-class brand, deeply rooted relationships, a well-regarded executive search business, and an ability to cross-sell a full suite of more recurring organizational advisory services. In our view, such attributes coupled with a rock-solid balance sheet will further enhance the long-term value creation for shareholders.

By comparison, wellness provider onboard cruise ships and destination resorts, **OneSpaWorld Holdings Ltd. (OSW)** was the biggest performance detractor in the quarter. Shares sold off following the pricing of a previously underwritten secondary offering by insiders. Although cruise demand has been impaired by the pandemic for an extended period of time, we expect headwinds to soften this summer as OSW returns to servicing ships that are resuming operations globally. As onboard occupancy levels slowly increase onboard, OSW's spa services should be met with high demand and spend levels should receive a boost from onboard credits. With adequate liquidity and shares trading at a 30% discount to our estimate of private market value, we continue to see the risk/reward skewed sharply to the upside.

Specialty cutting tool insert maker, **Kennametal, Inc. (KMT)** weighed on results in the period, as investors were concerned about near-term challenges for automotive production due to semiconductor constraints. In our view, these headwinds are short-term in nature and we remain focused on KMT's improving sales and free cash flow profile, solid operating discipline, as well as its continued execution on simplification/modernization initiatives. We believe the scale,

scope, quality, low-cost production and the value proposition of the cutting tools themselves will continue to mitigate pricing pressure in recovering markets. Additionally, KMT is executing on its strategic plan to improve economies of scale and generate margin improvement, while gaining share in the marketplace.

Leading provider of specialty industrial services, **Team, Inc. (TISI)** delivered disappointing earnings results in the quarter. Winter storms across the Midwest and Gulf Coast, as well as COVID-19 related operational disruptions in international markets weighed on shares. Although the company struggled to stabilize and grow revenue in the period, TISI delivered disciplined cost reduction actions. Moreover, management stated activity levels for client operations improved significantly in March and April with the momentum continuing into May. As patient, long-term investors, we view the risk/reward at current levels to be extremely favorable with TISI trading 64% below our estimate of private market value.

We initiated a position in leading provider of automated security solutions **ADT, Inc. (ADT)** in the period. In our view, ADT's brand and national presence in the security industry is unmatched, resulting in leading market share, a high recurring revenue base and attractive free cash flow generation. While investors remain concerned that do-it-yourself competition will erode the installation and technology-driven moat around the business, we believe ADT is well positioned to benefit from strategic partnerships, such as Google and secular growth of smart home adoption.

We successfully sold out of two names in the quarter. As mentioned previously, we exited our position in **Charles River Laboratories International Inc. (CRL)** as the stock's growth in market capitalization surpassed the upper limit of the Ariel Small Cap Value strategy range. We also sold out of the world's leading provider of thermal cameras, **FLIR Systems, Inc. (FLIR)** upon its acquisition by Teledyne Technologies, Inc.

Effective vaccines, easy money policies, improving consumer confidence and positive corporate earnings growth expectations have the economy on track for a prolonged rebound in the second half of 2021. While we acknowledge valuations are getting frothy, investor

sentiment has not yet reached euphoric levels. Meanwhile, it is in times like these where an active investment manager proves its merit by ignoring market enthusiasm and searching instead for quality companies with dominant franchises, capable management teams and robust balance sheets whose inevitable weakness are reflected in its price per share. Given our "slow and steady" approach, we remain confident in our current positioning, especially with our portfolios trading at a discount relative to the indices. We strongly believe the dedicated patient investor that stays the course and consistently owns differentiated businesses at reasonable prices will deliver superior returns over the long run.

Investing in small-cap companies is more risky and volatile than investing in large cap companies. The intrinsic value of the stocks in which the portfolio invests may never be recognized by the broader market. The portfolio is often concentrated in fewer sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market. Investing in equity stocks is risky and subject to the volatility of the markets.

Past performance does not guarantee future results. Performance results are net of transaction costs and reflect the reinvestment of dividends and other earnings. For the period ended 06/30/21 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 3-, and 5-year periods was +73.45%, +13.16%, and +16.03%, respectively. For the period ended 06/30/21 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 3-, and 5-year periods was +73.28%, +10.27%, and +13.62%, and +62.03%, +13.52%, and +16.47%, respectively. Net performance of the Ariel Small Cap Value Tax-Exempt Composite has been reduced by the amount of the highest fee charged to any client in the Composite during the performance period. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request and may also be found in Ariel Investments LLC's Form ADV, Part 2. Returns are expressed in U.S. dollars. Current performance may be lower or higher than the performance data quoted. The Ariel Small Cap Value Tax-Exempt Composite differs from its primary benchmark in that it has fewer holdings and more concentration in fewer sectors.

The opinions expressed are current as of the date of this commentary but are subject to change. The information provided in this commentary does not provide information reasonably sufficient upon which to base an investment decision and should not be considered a recommendation to purchase or sell any particular security.

As of 06/30/21, Core Laboratories NV constituted 3.53% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); Korn/Ferry International 3.30%; OneSpaWorld Holdings, Ltd. 4.36%; Kennametal, Inc. 3.98%; Team, Inc. 0.72%; ADT, Inc. 2.23%; Charles River Laboratories Intl, Inc. 0.00% and FLIR Systems, Inc. 0.00%. Portfolio holdings are subject to change. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of the Ariel Small Cap Value Tax-Exempt Composite.

Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index. The Russell 2000® Value Index measures the performance of the small-cap value segment (companies with lower price-to-book ratios and lower forecasted growth values) of the U.S. equity universe. The Russell 2000® Index (a subset of the smallest 2000 companies of the Russell 3000® Index) measures the performance of the small-cap segment of the U.S. equity universe. Frank Russell Company ("Russell") is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes or underlying data and no party may rely on any Russell Indexes and/or underlying data contained in this communication. No further distribution of Russell data is permitted without Russell's express written consent. Russell does not promote, sponsor or endorse the content of this communication. No further distribution of Russell data is permitted without Russell's express written consent.