



QUARTERLY COMMENTARY

Ariel Small Cap Value

• Value • Global



Quarter Ended March 31, 2022

All three major U.S. indices kicked off 2022 in the red, with stocks delivering their worst quarter in two years. As the global economy seeks to place the pandemic in its rear-view mirror, Russia's invasion of Ukraine introduced new shocks as markets were already looking to process the effects of soaring inflation and a hawkish pivot by the Fed. Ripple effects from higher energy prices have extended to other commodities, increasing the price of food and further disrupting already rattled supply chains. Although uncertainty is high and volatility will likely remain elevated, we view these near-term risks as noise within the context of our long-term investment horizon. Against this backdrop, the Ariel Small Cap Value Tax-Exempt Composite declined -3.58% gross of fees (-3.82% net of fees), trailing with the Russell 2000 Value Index's -2.40% return but ahead of the -7.53% loss posted by the Russell 2000 Index in the quarter.

Leading global provider of data measurement and analytics to the media industry, **Nielsen Holdings PLC (NLSN)** was a top performer in the quarter. Shares jumped on rumors of a take-over bid for the company by a consortium. The stock continued to trade higher following Brookfield's announcement to acquire Nielsen in an all-cash transaction valued at approximately \$16 billion including debt.

Following Russia's invasion of Ukraine, shares of premiere oil services company **Core Laboratories NV (CLB)** accelerated alongside most energy names. The ongoing war has disrupted traditional oil and gas supply chains, as well as changed global logistical patterns. CLB's stock was bid up in anticipation of the industry re-aligning global supply to meet strong demand for oil and natural gas despite the conflict.

Entertainment holding company, **Madison Square Garden Entertainment Corp. (MSGE)** outperformed in the quarter, as the company stands to benefit from the reopening and pent-up demand for experiential leisure. Notably, management believes the entertainment bookings business is poised to deliver a record year, with the

schedule pacing 50% higher than pre-pandemic levels. MSGE's assets also continue to drive consumer engagement and incremental advertising dollars, particularly with Online Sports Betting (OSB) growing in New York. Looking forward, we remain bullish on digital access to sports, as well as the opportunity at the Sphere, its Las Vegas property which is expected to be complete in 2023. In our view, the underlying value of MSGE's physical assets coupled with our conviction around management's expertise make this an attractive opportunity.

Alternatively, several positions weighed on performance. Leading manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** traded lower in the period. The top-line earnings beat was offset by weaker margins largely due to input cost inflation. Notably, demand remains firm supporting the implementation of further price increases. Also in the quarter, MHK authorized an additional return of capital to shareholders via buybacks. We remain encouraged by strong residential new construction and remodeling spend as well as the recovery in commercial markets. We believe the company will continue to benefit from global and capacity expansion, as well as end-market growth. At current levels, MHK is trading at a 57% discount to our estimate of private market value.

Specialty cutting tool insert maker, **Kennametal, Inc. (KMT)** also declined in the quarter due to investor concerns about near-term challenges for automotive production driven by semiconductor constraints. In our view, these headwinds are short-term in nature and we remain focused on KMT's improving sales, free cash flow profile and solid operating discipline, as well as its continued execution on simplification/modernization initiatives. We believe the scale, scope, quality, low-cost production and 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.

Lastly, financial advisory and asset manager **Lazard Ltd. (LAZ)** weighed on relative performance in the period due to net outflows and market depreciation. Cyclical upside to merger

and acquisition activity has become more difficult to gauge as the outlook for deal activity has been in a state of flux since Russia invaded Ukraine. Uncertainty is especially heightened in Europe where LAZ is overweight relative to other asset managers. Aside from geopolitical concerns and volatile global markets, we believe LAZ's business fundamentals remain strong and the stock price currently represents a healthy discount to our private market value estimate.

We did not initiate any new positions in the quarter. By comparison, we successfully exited broadcast, digital media and marketing services company **TEGNA, Inc. (TGNA)** upon the acquisition announcement by Standard General. We also exited producer and supplier of sand, **U.S. Silica Holdings, Inc. (SLCA)** on valuation and longer term concerns around balance sheet strength.

Geopolitical instability, surging inflation, tighter monetary policy, a sharp run up in commodity prices as well as supply chain constraints present risks on a go forward basis. It is in times like these where an active investment manager has the opportunity to prove its merit. This is when we rely on the Ariel playbook and execute. We are diligently assessing the resilience of our portfolio companies to effectively navigate high inflation and rising rates. In the new world order, we believe the long-neglected value stocks are poised to outperform growth. Knowing today's decisions will drive years of future returns, we remain laser-focused on identifying undervalued, quality companies with unique products or services, durable cost advantages, capable management teams and robust balance sheets. We firmly believe the 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 3/31/22 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 3-, and 5-year periods was -0.49%, +13.441%, and +9.97%, respectively. For the period ended 3/31/22 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 3-, and 5-year periods was +3.32%, +12.72%, and +8.57%, and -5.79%, +11.74%, and +9.75%, 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 3/31/22, Nielsen Holdings PLC (NLSN) constituted 2.98% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); Core Laboratories NV 3.95%; Madison Square Garden Entertainment Corp. 4.57%; Mohawk Industries Inc. 2.08%; Kennametal, Inc. 3.82%; Lazard Ltd. 2.96%; TEGNA, Inc. 0.00% and U.S. Silica Holdings, 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.

Glossary:

Free Cash Flow - the amount by which a business's operating cash flow exceeds its working capital needs and expenditures on fixed assets.

Margin - gauges the degree to which a company makes money. It represents what percentage of sales has turned into profits.

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.