



QUARTERLY COMMENTARY

Ariel Discovery Fund

• Value • Deep value • Global



Investing in small/micro-cap stocks is riskier and more volatile than investing in large-cap stocks. The intrinsic value of the stocks in which the Fund invests may never be recognized by the broader market.

Performance data quoted represents past performance. Past performance does not guarantee future results. All performance assumes the reinvestment of dividends and capital gains, and represents returns of the Investor Class shares. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data current to the most recent month-end for Ariel Discovery Fund may be obtained by visiting our website, arielinvestments.com. For the period ended March 31, 2019, the average annual total returns of Ariel Discovery Fund for the 1-year, 5-year, and since-inception periods were -8.47%, -4.82%, and +0.89%, respectively. Ariel Discovery Fund has an inception date as of January 31, 2011 and does not have performance for the 10-year period. For the year ended September 30, 2018, the Fund's Investor Class had an annual net expense ratio of 1.25% and an annual gross expense ratio of 1.59%. Effective February 1, 2014, Ariel Investments, LLC, the Adviser, has contractually agreed to waive fees or reimburse expenses (the "Expense Cap") in order to limit Ariel Discovery Fund's total annual operating expenses to 1.25% of net assets for the Investor Class through the end of the fiscal year ending September 30, 2020. The Expense Cap prior to February 1, 2014 was 1.50% for the Investor Class.

Quarter Ended March 31, 2019

U.S. markets delivered a banner first quarter, with large cap stocks within the S&P 500 delivering their best showing since 2009, followed by small cap stocks within the Russell 2000 Value Index posting their best start to the year since 1992. Compelling broad market valuations, optimism on trade negotiations and a dovish pivot from the Federal Reserve and other central banks have investors looking to 2019 with positive sentiment. Markets are also rallying around the belief that the U.S. continues to be a relative bright spot in the global marketplace.

Uncertainties surrounding Brexit have shaken the United Kingdom and economic growth has cooled from the Eurozone to China. So while the U.S. economy is not breaking any records, it remains steady, and that has helped boost investor confidence. Ariel Discovery Fund advanced +14.63% during the quarter, outperforming the +11.93% return posted by its primary benchmark, the Russell 2000 Value Index, and slightly ahead of the Russell 2000 Index's +14.58% gain.

Some holdings in the portfolio advanced considerably this quarter. Mobile navigation and location based services provider, TeleNav, Inc. (TNAV) traded +49.51% higher during the quarter. TNAV provides connected navigation

solutions for Ford Motor Co. (F), Fiat Chrysler Automobiles NV (FCAU), and Toyota Motor Corp. (TM) with the price appreciation catalyst being the recent ramp in its exclusive relationship with General Motors (GM). TNAV has \$85 million in net cash on its balance sheet, and we expect well over \$200 million in sales over the next year, as it continues to grow its exclusive relationships with four out of the top ten global auto manufacturers. We believe consistently positive and growing EBITDA will narrow the gap between its stock price and private market value.

Producer and supplier of sand, U.S. Silica Holdings, Inc. (SLCA) gained +71.22% during the quarter. SLCA delivered a solid earnings report highlighted by record full year revenues and adjusted EBITDA for the company; record contribution margin dollars and contribution per ton for its Industrial business; record volumes of sand proppant sales driven by an enhanced customer and product mix; as well as meaningful contributions from the acquisition of EP Minerals. Additionally, SLCA's SandBox Logistics™ business unit—a key part of our investment thesis—won several patent claims in the quarter that cover fundamental aspects of the technology, reaffirming the strength of its intellectual property and broad patent portfolio. Looking ahead, SLCA expects to substantially grow

the Industrial segment by focusing on Specialty Minerals and Performance Material offerings. SLCA is also excited about the prospects for SandBox in 2019 and beyond, as the existing equipment is already sold out for the coming year, and the company is building new equipment as fast as it can to meet strong customer demand and exceed its market share projections.

The digital entertainment business RealNetworks, Inc. (RNWK) increased +34.63% in the quarter. The company continues to make progress commercializing key growth initiatives, including its world class facial recognition platform SAFR, the anti-spam and classification platform Kontxt, the RealMedia High Definition codec technology in China and mobile games. RNWK also acquired an additional 42% stake in Napster in the quarter, bringing total ownership of the profitable business-to-business model to 84%. We believe the market's focus on consumer-driven giants has left this valuable asset completely ignored. The impact of consolidation on RNWK's financials remains to be seen, but given management's desire to ultimately monetize Napster and the significant share accumulation among the C suite in recent months, we continue to believe shares are trading at an attractive discount.

Other holdings underperformed in the quarter. Commercial stage biopharmaceutical company focused on saving and improving the lives of pets, Kindred Biosciences Inc. (KIN) finished the quarter down -16.26%. In late January, KIN completed an equity raise diluting existing shareholders by ~13%. However, we view the overall price decline over the period to run counter to the company's strong business fundamentals. Specifically, KIN's first approved product, Mirataz doubled its revenues quarter over quarter, reflecting broad based customer demand and increased re-order size. KIN also has an extensive product pipeline with peak revenue potential, which we believe the market should begin to appreciate as the company brings them to market.

Shares of satellite communication system operator, ORBCOMM, Inc. (ORBC) fell -17.92% in the quarter following mixed earnings results. While hardware sales were lighter than anticipated, ORBC reduced inventory levels and delivered adjusted EBITDA margin expansion.

The company also announced 2019 results will be back-end loaded, highlighting a large contract that will not begin shipments until August. Nonetheless, our thesis remains intact as the company continues to win large contracts without giving away product or service margins, while expanding its market share in existing and new segments. At the current valuation we believe the market is underappreciating ORBC's future free cash flow generation, enabled by high barriers to entry, minimal capital needs, increasing scale advantages and growing demand to track and control fixed and mobile assets globally.

Specialty commercial auto insurer Atlas Financial Holdings, Inc. (AFH) declined -69.59% following another disappointing announcement that its reserves were inadequate relative to an increase in claims on prior accident years. While the inherent unpredictability of catastrophe losses and reserve adequacy is somewhat unavoidable, our expectation was that AFH was ahead of the curve on risk analysis. We are currently reviewing the differentiation of this business model, as well as our investment thesis.

We did not add any new holdings in the quarter. We sold out of Bristow Group, Inc. (BRS) and SeaChange International (SEAC) to pursue more compelling opportunities.

Although U.S. economic data has generally softened in the first quarter, we remain cautiously optimistic that its lightly regulated free market system will continue to generate stable but healthy economic growth and positive returns over the long-term. In the meantime, we expect many of our domestic holdings to benefit from steady economic and modest corporate earnings growth, as well as tailwinds from the stimulus effect of U.S. tax reform. The bull-run, it seems, is here to stay for now. The drivers appear sustainable and investor sentiment is not yet euphoric. Short-term corrections and market volatility are expected in the near-term—be it from profit taking, corporate earnings swings, elevated corporate debt leverage, trade policy or geopolitical factors. That said, we view these uncertainties and risks as short-term noise within the context of our long-term investment horizon.

This commentary candidly discusses a number of individual companies. These opinions 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 03/31/2019, TeleNav, Inc. constituted 4.60% of Ariel Discovery Fund; U.S. Silica Holdings, Inc. 3.50%; RealNetworks, Inc. 5.40%; Kindred Biosciences, Inc. 5.30%; ORBCOMM, Inc. 4.80%; and Atlas Financial Holdings, Inc. 0.30%. Portfolio holdings are subject to change. The performance of any single portfolio holding is no indication of other portfolio holdings of Ariel Discovery Fund.

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. The S&P 500® Index is the most widely accepted barometer of large cap U.S. equities. It includes 500 leading companies.

EBITDA: A company's earnings before interest, taxes, depreciation, and amortization.

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