

Ariel Emerging Markets Value

Quarter Ended September 30, 2023

Emerging market equities ended the quarter in negative territory, as developing economies adjusted to the new "higher for longer" interest rate regime adopted by many advanced countries and its implications for slowing global growth. The technology sell-off in Taiwan and South Korea, as well as intensifying problems in China also weighed on markets, with many investors anticipating additional Chinese stimulus measures. Meanwhile India, Turkey and the United Arab Emirates posted strong performances. Although macroeconomic uncertainty is high and market volatility will likely remain elevated, the valuation discount between developed and emerging markets is wide. In our view, such market inefficiencies present attractive opportunities for meaningful long-term returns. Against this backdrop, the Ariel Emerging Markets Value Composite advanced +0.98% gross of fees (+0.74% net of fees) in the quarter, outperforming both the MSCI EM Index and MSCI EM Value Index, which returned -2.93% and -0.78%, respectively.

Several stocks in the portfolio had strong returns in the quarter. Korea's largest financial company in terms of assets and customer base, **KB Financial Group**, traded higher during the period following strong results as well as the announcement of a share buyback program and subsequent share cancellation. The company is benefitting from higher fee income driven by strong performance in their brokerage and investment banking divisions as well as net interest margin expansion. These factors combined with an improved outlook for Korea's residential real estate market also boosted the share price. Although KB Financial continues to trade at a deeply discounted valuation, we believe the company's strong and stable diversified profit structure and industry leading shareholder returns are well supported by its various business lines and subsidiaries.

Taiwanese testing and packaging solutions company for semiconductors and integrated circuits, **King Yuan Electronics Company, Ltd.** also advanced in the period on better-than-expected earnings results. Management also noted they are seeing an increase in demand for testing chips for artificial intelligence (AI) applications and expect their AI business to nearly double as a percentage of revenues in 2024. We believe King Yuan is at an inflection point as activity levels for testing recover following the cyclical industry downturn. In our view, King Yuan's AI exposure and improved cost structure present an attractive growth opportunity which should lead to a valuation re-rating.

Additionally, the largest offshore oilfield service company in China, **China Oilfield Services**, traded up on better-than-expected financial results, highlighted by strong growth within the drilling and well services segments. Given rising demand for rigs around the world, and very few new builds on the horizon, we expect rig rates will keep increasing as the service remains far below incentive price for new capacity. In turn, we believe the company is positioned to improve the profitability of its drilling business as it gradually renegotiates existing contracts. We think China Oilfield Services will benefit from the sale of its high margin value-add services, as the company continues to gain share from its global competitors.

By comparison, leading auto dealer and importer of luxury and mid-to-high automobile brands in China, **Zhongsheng Group Holdings**, fell in the quarter. Pricing pressure amid competition from electric vehicles (EV) and softness in demand for new vehicles drove a decline in earnings. Despite these near-term headwinds, management is laser-focused on its long-term plans to enhance profitability by improving its after-service business through stronger maintenance programs and the expansion of its body shop business. Additionally, the company is looking to diversify its used and new vehicle sourcing to remain competitive with the current trend towards EV. Beyond these new initiatives, we believe Zhongsheng will continue to gain market share from fragmented independent dealers, particularly as used car penetration increases, a segment where dealer brand and reputation matter even more relative to the new car segment.

Leading Brazilian food distributor, **Sendas Distribuidora SA**, also underperformed over the period due to a challenging macro environment. Decelerating food inflation, client inventory cuts, extended cost pressures and weak same-store-sales drove its earnings miss. Additionally, after several quarters of declines, Brazilian interest rates rose in the period creating yet another headwind for shares. While the operating environment will likely remain choppy near-term, we believe Sendas is well-positioned to benefit from a normalization in food inflation and moderating interest rates. Over time, we think the company will experience market share gains, as its cash-and-carry segment benefits from scale-driven price leadership.

Finally, Vietnam's largest residential developer, **Vinhomes Joint Stock Company (VHM)**, declined in the quarter. Despite lower interest rates and several adjustments to regulations which eased financing for developers, investors



remain concerned about slow pace of the real estate industry's recovery. At 6x price to forward earnings, we think VHM's stock already discounts weaker near-term growth. Given the company's brand reputation, robust balance sheet, strong record of delivery, extensive landbank and access to foreign co-developers, we believe VHM should be able to capitalize on a new housing cycle over the coming quarters.

We initiated three new positions in the quarter. We added Taiwanese producer of electronic connectors **Lotes Co., Ltd.**, which manufactures CPU sockets connecting microprocessors to motherboards in servers and personal computers. We expect the CPU socket market to grow, as new generations of these electrical components require more complex and expensive sockets. We believe Lotes should benefit from future roll outs given its leading market position and strong historical relationship with CPU designers Intel and AMD. We also appreciate the company's commitment to return capital to shareholders.

Additionally, during the quarter, we purchased one of the largest retail and corporate banks in Central and Eastern Europe, **OTP Bank Nyrt**. We believe OTP's diversified asset portfolio shields it from excessive fluctuations. We foresee potential upside to shares driven by the gradual elimination of COVID related consumer support policies (interest caps) and the reduction in temporary windfall tax in its core Hungarian market. At 1x book, we believe OTP offers attractive upside given our expectation for mid-to-high-teens returns on tangible equity in 2024-25.

We also established a position in **Saudi National Bank (SNB)** during the period. Over the past three years, SNB has built up its reserves and diversified its loan portfolio, reducing concentration and spreading risk across various economic segments. As of the beginning of the third quarter in 2023, the bank nearly achieved neutrality in its net interest margin (NIM) sensitivity to interest rate fluctuations, which we believe favorably positions SNB for future interest rate cuts. Simultaneously, the bank has been expanding its loan portfolio and gaining market share by leveraging its robust deposit franchise and access to Saudi Arabia's monumental Giga projects. In our view, the current forward price-to-earnings discount relative to the sector does not fully account for its resilient NIM and above-industry market growth, presenting us with an attractive entry price. We believe that SNB will outperform most of the MENA banks in 2024.

By comparison, we sold our stake in leading designer of display driver integrated circuits (DDICs), **Novatek Microelectronics Corp** on valuation. As mentioned previously, we eliminated our position in **Bank Polska Kasa Opieki SA** after reevaluating our thesis. Lastly, we exited **iShares MSCI Saudi Arabia ETF** to pursue better opportunities.

As economic growth potentially slows in the developed world, we are cautiously optimistic corporate earnings growth in emerging markets will exceed the outlook for companies in advanced (and potentially slowing) economies over the near-to-medium term. This is being driven by both cyclical and structural factors. These regions quickly responded to inflationary risks with rate hikes in 2021 and are now benefitting from falling inflation and more accommodative policies, which should strengthen purchasing power and consumer spending. Rising productivity, demographic trends underscored by a burgeoning middle class as well as urbanization also support tailwinds for local demand. Additionally, weaknesses in global trade exposed by the pandemic have broadened the recipients of foreign direct investment in EM countries, as businesses look to nearshore operations as well as realign their global supply chains away from China. Meanwhile, investors remain underweight the asset class. Looking forward, our confidence in our current positioning remains high. In our view, valuations are compelling, particularly with Ariel's Emerging Markets Value portfolio trading at 7.94x forward price-to-earnings and 1.06x price-to-book – a significant discount to both the indices and our own internal estimates.

Investments in non-U.S. securities may underperform and may be more volatile than comparable U.S. stocks because of the risks involving non-U.S. economies, markets, political systems, regulatory standards, currencies and taxes. The use of currency derivatives and ETFs may increase investment losses and expenses and create more volatility. Investments in emerging markets present additional risks, such as difficulties in selling on a timely basis and at an acceptable price. The intrinsic value of the stocks within the strategy may never be recognized by the broader market. The strategy is often concentrated in fewer sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market.

Past performance does not guarantee future results. Performance results are shown net of the highest management fee charged to any client in the Composite during the performance period. Net returns reflect performance returns after the deduction of advisory fees and transaction costs and assume the reinvestment of dividends and other earnings. For the period ended 9/30/2023, the performance (net of fees) of the Ariel Emerging Markets Value Composite since inception on 4/30/2023 was +4.92%. For the period ended 9/30/2023, the performance for the MSCI EM Net Index and the MSCI EM Value Net Index over the 5-month and since inception of the Ariel Emerging Markets Value Composite on 4/30/2023 was -0.93% and +1.32%, respectively. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request. Returns are expressed in U.S. dollars. Current



performance may be lower or higher than the performance data quoted. The Ariel Emerging Markets Value Composite differs from its benchmark, the MSCI EM Net Index, because the Composite has fewer holdings than the benchmark.

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. There is no guarantee that any of the views expressed will come to fruition or any investment will perform as described.

As of 9/30/2023, KB Financial Group, Inc. constituted 5.3% of the Ariel Emerging Markets Value Composite (representative portfolio); King Yuan Electronics Company, Ltd. 2.2%; China Oilfield Services, Ltd. 2.9%; Zhongsheng Group Holdings, Ltd. 0.6%; Sendas Distribuidora SA 1.4%; Vinhomes Joint Stock Company 0.9%; Lotes Company, Ltd. 1.5%; OTP Bank Nyrt. 1.4%; The Saudi National Bank 0.9%; Novatek Microelectronics Corp. 0.0%; Bank Polska Kasa Opieki SA 0.0%; and iShares MSCI Saudi Arabia ETF 0.0%.

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 Emerging Markets Value Composite.

A glossary of financial terms provided herein may be found on our website at www.arielinvestments.com.

Indexes are unmanaged. Investors cannot invest directly in an index. The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,377 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Inception of this benchmark was December 29, 2001. The MSCI Emerging Markets Value Index captures large and mid cap securities exhibiting overall value style characteristics across 24 Emerging Markets (EM) countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. Inception of this benchmark was January 08, 1997. All MSCI Index net returns reflect the reinvestment of income and other earnings, including the dividends net of the maximum withholding tax applicable to non-resident institutional investors that do not benefit from double taxation treaties. MSCI uses the maximum tax rate applicable to institutional investors, as determined by the companies' country of incorporation. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or

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