Ariel Small/Mid Cap Value

Quarter Ended September 30, 2023

The U.S. stock market posted declines in the third quarter driven by fears of a government shutdown, striking autoworkers, surging oil prices and the prospect of interest rates remaining higher for longer. Against this backdrop, government bond yields soared, equities came under pressure and the richly valued "magnificent seven[1]" lost their shine. As the Federal Reserve attempts to steer the economy, some worry the risks of a hard-landing are growing. Although uncertainty and volatility are likely to remain elevated, we view the recession guessing game as noise within the context of our long-term investment horizon. The Ariel Small/Mid Cap Value Composite traded -6.88% gross of fees (-7.11% net of fees) lower in the quarter, lagging the Russell 2500 Value Index and the Russell 2500 Index, which returned -3.66% and -4.78%, respectively.

Live entertainment, media and technology company, **Sphere Entertainment Co. (SPHR)** was the top contributor during the quarter. Shares jumped following news the Las Vegas venue was on track to open in late September and costs were in-line with expectations. Additionally, the company delivered a profitable fourth quarter relative to the loss posted a year ago. While the Sphere venue will take some time to reach its full potential, the company is planning to have events 365 days a year. In addition to hosting concert residencies, marquee sporting and corporate events, The Sphere Experience will debut in October, consisting of a series of exhibits chronicling technology's impact on the development of human potential. Management also believes there is a significant opportunity for advertising and sponsorship on the Exosphere (the Sphere's exterior) as well as licensing interior VIP hospitality suites. Meanwhile, U2 opened to great fanfare on September 29th – sending shares even higher into the month of October. In our view, the Sphere's new experiential immersive venue and the company's two regional sports and entertainment networks present a long-term opportunity, which remains meaningfully underappreciated at current trading levels.

Toy manufacturer, **Mattel, Inc. (MAT)** also increased in the period. Although the retail environment remains challenging, MAT delivered a solid earnings beat and maintained full-year guidance. The successful release of the *Barbie* movie is expected to generate over $125 million of gross billings this year from film royalty payments while boosting the franchises' consumer products. These results continue to highlight MAT's progress towards expanding its entertainment offering and executing on its strategy to grow market share, improve profitability and generate higher levels of cash flow. In our view, MAT remains an undervalued asset with attractive growth prospects for its Barbie and Hot Wheels brands, as well as its Disney Princess and Frozen toy lines, Trolls and the global launch of Monster High.

Additionally, shares of global leader in for-profit education, **Adtalem Global Education (ATGE)**, advanced on a top- and bottom-line earnings beat and subsequent increase at the low-end of its FY2024 Adjusted EPS guidance. We remain encouraged by the continued recovery in nursing school programs, highlighted by Walden's new student enrollment up double-digits versus last year. Although, enrollment trends across the medical schools faced headwinds in the quarter, they appear temporary, with management having already implemented the necessary changes to convert strong underlying demand into students. Although investors remain skeptical of the near-term backdrop, we believe ATGE will benefit from the healthcare worker shortage in the U.S., evidenced by its market leadership as the number one grantor of nursing degrees in the U.S. and the largest producer of African-American MDs, PhDs and nurses in the country.

Alternatively, several positions weighed on performance. Marketing communication company, **Interpublic Group of Companies, Inc. (IPG)** traded lower in the quarter. Broad macro uncertainty and a pullback in spend from tech, telecom and smaller client accounts resulted in an earnings miss and subsequent reduction in full-year guidance. Looking ahead, management expects to grow from new business wins and strengthening performance across its media and healthcare businesses. We believe in IPG's resilient business model and its management team's ability to flex its variable cost structure to weather the cyclical headwinds that may come its way.

Leading entertainment company, **Paramount Global (PARA)**, also traded lower in the quarter as linear Pay TV pressures including shifts in viewership, subscriber erosion,

[1] The "Magnificent Seven" are the largest stocks in the S&P 500 Index driving market performance: Apple Inc. (AAPL), Amazon.com, Inc. (AMZN), Alphabet Inc. (GOOGL), Meta Platforms Inc. (META), Microsoft Corp. (MSFT), NVIDIA Corp. (NVDA) and Tesla, Inc. (TSLA).

softer ad revenues and continued losses in its streaming business presented headwinds. Despite the negative price action, management provided guidance for an acceleration in global Paramount+ average revenue per user in 2024 driven by price increases and a more favorable subscriber mix. PARA also expects meaningfully better free cash flow in the second half of the year given the production delays following the writers' and actors' strikes. Additionally, management expects to be more efficient in content and marketing spend in 2024. We think 2023 will be the peak year for streaming losses as management magnifies its focus on profitability for its direct-to-consumer (DTC) segment, which should drive improved free cash flow in 2024 and beyond. In our view, the value of Paramount's proprietary content remains meaningfully underappreciated at current trading levels.

Finally, leading manufacturer and distributor of coatings technologies, **Axalta Coating Systems, Ltd. (AXTA)**, underperformed as earnings came in slightly below expectations due to currency headwinds and a near-term disruption related to the implementation of its new Enterprise Resource Planning (ERP) system. Nonetheless, management reaffirmed its 2024 full year outlook. We expect AXTA's margins will improve as inflation for raw materials ease. We also expect vehicle production and corresponding demand for mobility coatings to increase as supply chain constraints ease. Longer-term, we believe the company will continue to gain market share in its refinishing business and improve margins through cost savings.

Also during the quarter, we added marketer and distributor of over-the-counter pharmaceutical drugs and products, **Prestige Consumer Healthcare Inc. (PBH)**. The company has a history of innovation and acquiring products to meet unmet consumer needs. Following an acquisition in 2017, the company levered the balance sheet and has been focused on using free cash flow to pay down debt. As its products, such as cough/cold and travel, rebound from COVID-19 pressures, we expect margins and earnings growth to lead to multiple expansion.

We did not exit any positions during the period.

As the pendulum of worry swings from one scenario to another, our focus on recent events and macroeconomic developments is to consider their effect on the long-term intrinsic worth of our holdings over the next five-to-ten years. Although the new "higher for longer" rate regime will likely present headwinds to corporate earnings growth, we remain confident in our portfolio positioning and stand ready to take advantage of market sell offs. We strongly believe the patient investor that stays the course and consistently owns differentiated business models with solid competitive positioning, low leverage and robust balance sheets will deliver stronger returns over the long run.

Investing in small-cap and mid-cap stocks is more risky and volatile than investing in large-cap stocks. 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 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 9/30/23 the performance (net of fees) for the Ariel Small/Mid Cap Value Composite for the 1-, 5-, and 10-year periods was +14.81%, +4.04%, and +7.55%, respectively. For the period ended 9/30/23 the performance for the Russell 2500 Value Index and the Russell 2500 Index for the 1-, 5-, and 10-year periods was +11.34% +3.99%, and +6.95%, and +11.28%, +4.55%, and +7.90%, 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 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/Mid Cap Value 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. There is no guarantee that any of the views expressed will come to fruition or any investment will perform as described.

As of 9/30/23, Sphere Entertainment Co. constituted 3.1% of the Ariel Small/Mid Cap Value Composite (representative portfolio); Mattel, Inc. 4.4%; Adtalem Global Education, Inc. 2.2%; Interpublic Group of Companies, Inc. 2.5%; Paramount Global 3.2%; Axalta Coating Systems Ltd. 2.8%; and Prestige Consumer Healthcare, Inc. 2.6%. 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/Mid Cap Value Composite.

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

Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index. The Russell 2500™ Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. It includes those Russell 2500 companies with relatively lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is July 1, 1995. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is June 1, 1990. Russell® is a trademark of London Stock Exchange Group, which is the source and owner of the Russell Indexes' trademarks, service marks and copyrights. 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 widely regarded as the best gauge of large-cap U.S. equities. It includes 500 leading companies and covers approximately 80% of available U.S. market capitalization. Its inception date is March 4, 1957.

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SLOW AND STEADY WINS THE RACE