Ariel investments

Quarterly Commentary

Ariel Small Cap Value Concentrated

Quarter Ended June 30, 2024

The bull market powered through the second quarter fueled by investor enthusiasm for artificial intelligence (AI) themed stocks. This narrow, momentum-driven, rally helped the S&P 500 eke out a modest gain, even as Mid- and Small-Cap companies declined. The resulting bifurcation has been extreme, as the non-AI companies in the S&P 500 Index lost 1.2%.[1] This limited market breadth likely reflects weakening economic growth and inflation in the U.S. With many investors cautiously optimistic the Federal Reserve will successfully engineer a soft landing, interest rate cuts may be at hand in the coming months. Still, the turmoil surrounding the U.S. election is becoming a new focal point. Although uncertainty is high and volatility will likely remain elevated, we view these risks as short-term noise within the context of our long-term investment horizon. Against this backdrop, the Ariel Small Cap Value Concentrated Composite fell -4.10% gross of fees (-4.34% net of fees) in the quarter, lagging both the Russell 2000 Value Index and the Russell 2000 Index, which returned -3.64% and -3.28%, respectively.

Several stocks in the portfolio had strong returns in the quarter. **OneSpaWorld Holdings Ltd. (OSW)** is a provider of wellness services onboard cruise ships and destination resorts. Its shares advanced during the quarter following a top- and bottom-line quarterly earnings beat and subsequent raise in full year guidance. Robust consumer demand, higher onboard spend levels and strong free cash flow generation all contributed to this performance. Additionally, management announced a new buyback program, meaningful debt reduction and a new cruise line contract. At today's valuation, we continue to believe OSW's risk/reward skews to the upside.

Logistics and cash management services provider, **Brink's Company (BCO)** traded higher following strong quarterly earnings results, highlighted by double-digit organic revenue growth and margin expansion. Fueling this performance was newer offerings in digital retail solutions and outsourced ATM services as well as continued execution of cost productivity initiatives. Meanwhile, BCO is returning capital to shareholders through both dividends and share repurchases.

Shares of oil services company, **Core Laboratories, Inc. (CLB)**, also increased following a top- and bottom-line earnings beat. Strong international demand for laboratory services and completion diagnostic solutions boosted results. Although the macro environment remains volatile and U.S. onshore drilling and completion activity is expected to remain flat year-over-year, management is projecting international growth from projects in the Middle East, Asia Pacific and West Africa. Meanwhile, the company remains laser focused on generating positive free cash flow, reducing debt and improving its return on invested capital.

In contrast, U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)**, underperformed following another consecutive quarterly decline in earnings resulting from soft consumer demand. Importantly, management confirmed a material improvement in traffic and is forecasting an earnings recovery over the second half of the year. Although we have been deeply disappointed with this investment to date, trends have improved as weather conditions normalized. Meanwhile, we believe LESL is truly differentiated by its loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience. At today's valuation, LESL appears to have more upside than downside.

Charles River Laboratories International, Inc. (CRL), which provides products and services to the drug discovery and research marketplace, also declined. Its shares traded lower alongside peers due to a more cautious funding environment for early-stage research and development programs. Nonetheless, CRL delivered a solid earnings beat, highlighted by top-line growth in both the research models and services (RMS) and manufacturing solutions segments, partially offset by weakness in discovery and safety assessment (DSA). Additionally, management reiterated full year guidance and noted early signs of a DSA recovery. While it will take time for proposal activity and funding to translate into new DSA bookings and revenue generation, CRL believes the fundamentals for the biopharmaceutical industry remain intact. Meanwhile, we expect the global focus on scientific innovation will continue to drive solid demand for CRL's research models and services, with underlying growth trends supporting margin expansion. CRL is also investing in its scientific capabilities for cell and gene therapies, which we

[1] Sindreu, Jon. "The Second Quarter Split the Market." *The Wall Street Journal*, July 1, 2024, p. B9.

SLOW AND STEADY WINS THE RACE

believe will further enhance long term value creation for shareholders.

Lastly, toy manufacturer, **Mattel, Inc. (MAT)**, declined on mixed quarterly earnings results. We believe this market response runs counter to the company's solid business fundamentals. Although the top-line came in lighter than expected in a weaker retail environment, the company expanded margins and generated strong free cash flow. In our view, MAT remains an undervalued company with resilient consumer demand for toys such as Barbie®, Hot Wheels® and Disney Princesses®, as well as an attractive opportunity for future film and TV projects.

We initiated two new positions in the quarter.

We added boutique asset manager**, Affiliated Managers Group, Inc. (AMG)**. AMG purchases meaningful equity interests in boutique asset management firms and in return receives a fixed percentage of revenues. The company's partnership approach allows for its affiliates' management teams to own significant equity stakes while maintaining operational independence. AMG's size and scale allow the company to be the leading destination for growing boutique firms addressing succession issues and/or seeking assistance in marketing, distribution and product development. In our view, investors currently underappreciate the company's active and alternative-asset affiliate business model.

We also purchased 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, PBH 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.

In addition, we successfully exited regional banking services provider, **BOK Financial Corporation (BOKF)** on valuation and waste management services provider, **Stericycle, Inc. (SRCL)** following the announcement it agreed to be acquired.

AI-themed stocks continue to dominate markets this year. Escalating geopolitical tensions, the potential timing of the Fed pivot and the outcome of the upcoming U.S. Presidential election also pose risks. As the bull market climbs the proverbial "wall of worry," we consider macroeconomic developments and recent headlines within the context of our long-term investment horizon. We continue to be cautiously optimistic and believe the underlying strength of corporate profits will prove resilient. Consumers are still spending, unemployment remains low and the balance sheets of U.S. financial institutions and households are generally in good shape. As rates begin to subside in 2024 and beyond, we think the gap between mega-cap stocks and their small to mid-cap counterparts will narrow.

Meanwhile, we remain focused on the underlying fundamentals and opportunities market dislocations can provide to long-term, actively patient investors. We strongly believe the disciplined investor that stays the course and consistently owns differentiated, quality business models with robust balance sheets will deliver superior returns over time.

Investing in small-cap companies is more risky and volatile than investing in large cap companies. A concentrated portfolio may be subject to greater volatility than a more diversified portfolio. 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 one-year period ended 6/30/24 and since inception on April 30, 2020, the performance (net of fees) for the Ariel Small Cap Value Concentrated Composite was +3.43% and +13.49%, respectively. For the one-year period ended 6/30/24 and since inception on April 30, 2020 of the Ariel Small Cap Value Concentrated Composite, the performance for the Russell 2000 Value Index was +10.90% and +15.23%, respectively. And over the same periods the Russell 2000 Index delivered +10.06% and +12.80%, 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 Cap Value Concentrated Composite differs from its primary benchmark in that it has dramatically 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 6/30/24, OneSpaWorld Holdings, Ltd. constituted 11.8% of the Ariel Small Cap Value Concentrated Composite (representative portfolio); Brink's Company 8.9%; Core Laboratories, Inc. 4.5%; Leslie's, Inc. 3.2%; Mattel, Inc. 4.4%; Charles River Laboratories International, Inc. 3.2%; Affiliated Managers Group, Inc. 3.3%; Prestige Consumer Healthcare, Inc. 3.5%; BOK Financial Corp. 0.0%; and Stericycle, Inc. 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 Small Cap Value Concentrated 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 2000® Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios, lower forecast growth and lower sales per share historical growth. Its inception date is June 1, 1993. The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is January 1, 1984. 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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