

# Ariel Small Cap Value Concentrated

Quarter Ended March 31, 2025

Given the significant downturn since the quarter ended, we are closely monitoring the turn of events and assessing the situation daily. As we write, the commentary below reflects our current thinking in this ever-changing landscape.

Most major U.S. indices ended the first quarter of 2025 in the red, with investors fleeing to safety as optimism for another year of U.S. outperformance driven by economic momentum and the new administration's pro-business stance was quickly replaced by tariff fears and policy uncertainty. The Magnificent Seven<sup>1</sup>, which drove most of the markets gains over the last three years, led the decline, falling nearly -15%. Value bested growth and large caps held up better than their small cap brethren. International equity markets, led by Europe and China, surged—delivering their strongest quarterly outperformance versus the U.S. in 15 years. Meanwhile, deteriorating confidence and apprehension about a global trade war is fueling recession fears. While Wall Street sits on edge and markets remain erratic, we are actively leaning into the volatility by judiciously acquiring the downtrodden shares of quality companies whose value should be realized over the long term. Against this backdrop, the Ariel Small Cap Value Concentrated Composite dropped -11.51% gross of fees (-11.63% net of fees) in the quarter, trailing both the Russell 2000 Value and Russell 2000 indices, which returned -7.74% and -9.48%, respectively.

Several stocks in the portfolio had strong returns in the quarter. Title insurer, **First American Financial Corporation (FAF)**, advanced in the period as earnings exceeded expectations driven by strong commercial revenue growth, higher title premiums and net investment income as well as solid cost containment. Despite a challenging year for the industry, management continues to make considerable progress with its strategic initiatives, while remaining focused on expense management and optimizing its use of technology. Although FAF expects mortgage rates to remain elevated in 2025, the company anticipates a modest improvement in both the residential purchase and refinance businesses. Meanwhile,

the commercial business is off to a strong start. 2025 should represent another year of earnings improvement even amidst market uncertainty. In our view, investors continue to underappreciate FAF's scale, operating leverage and investment portfolio.

Toy manufacturer **Mattel, Inc. (MAT)** also saw share prices rise during the quarter, following strong earnings results highlighted by solid sales growth, margin expansion and robust free cash flow generation. Management also provided full year 2025 guidance ahead of Wall Street expectations. With buyback activity expected to accelerate and the company poised to grow market share in 2025, we believe shares remain undervalued at current levels. Attractive opportunities to exploit its intellectual property through future film and TV projects only heighten our conviction.

Additionally, distributor of over-the-counter pharmaceutical drugs and products, **Prestige Consumer Healthcare Inc. (PBH)**, traded higher following a top- and bottom-line quarterly earnings beat and subsequent raise in full-year guidance. Organic sales in North America reflected growth in gastroenterology and dermatology were partly offset by softer sales in the cough/cold category. Meanwhile, the international market posted strong growth led by gains for its oral hydration booster, Hydralyte; demand for its women's health product Summer's Eve; and progress in issues related to the supply of its eye drops product Clear Eyes. PBH remains disciplined in its capital allocation strategy utilizing free cash flow to reduce debt. Looking ahead, we believe continued solid capital allocation will lead to stock price appreciation.

In contrast, **Norwegian Cruise Line Holdings Ltd. (NCLH)** declined alongside the sector during the period, following investor concerns about a potential new tax on cruise lines. Although, we believe the risk of any potential exposure is currently priced in, we note cruise lines operate globally and determining taxable income on a jurisdiction basis can be extremely complex. Generally, operators benefit from exemptions under Section 883 of the IRS code and bilateral tax treaties that relieve them from paying corporate income tax

<sup>1</sup> 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).



on profits beyond the taxes already paid in their operating regions. The elimination of the carve-out would require a Congressional vote. Meanwhile, NCLH continues to deliver robust quarterly earnings, highlighted by strong consumer demand, healthy onboard spending, attractive pricing, solid cost containment and sustained progress on leverage reduction. Looking ahead, NCLH remains focused on right sizing its cost base and improving margins to further strengthen its foundation for sustainable and profitable growth.

U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)**, also detracted from performance this quarter on mixed earnings results. Green shoots began to emerge on the top-line as positive sales were offset by increased spend on the transformation strategy. The new executive leadership team is reevaluating pricing, optimizing inventory and implementing customer loyalty programs. Although investors remain on the sidelines, we believe early progress on these initiatives will yield efficiency improvements. While we have been deeply disappointed with this investment, we are optimistic the new efforts will positively impact the business and position the company for long-term success. In our view, LESL's current valuation reflects extreme pessimism, which is unwarranted given the company's loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience.

Lastly, supplier of residential thermal, comfort and security solutions, **Resideo Technologies, Inc. (REZI)**, declined over the period. Despite strong quarterly earnings results, shares traded lower on management's relatively cautious market outlook, tariff concerns and higher for longer interest rates. Although 2025 guidance came in above expectations with broad-based growth across product categories and the integration of Snap One synergies running ahead of schedule, management did not disclose the potential impact tariffs could have on the business. That said, the company believes price increases, inventory positioning and running factories at different utilization rates can help mitigate near-term pressure. We believe REZI's earnings potential is underappreciated as the company is entering a new phase of sustainable growth driven by a secular preference for more connected smart home solutions and product innovation.

We did not initiate or exit any positions in the quarter.

Concerns for slower growth, higher inflation and mounting tail risks amidst tariffs fears and policy uncertainty continue to stoke recessionary fears. Still, the U.S. labor market remains on solid footing and balance sheets of U.S. financial institutions and households are generally in good shape. We are cautiously optimistic that these factors could protect against a severe downturn. Meanwhile, values are abundant when the investment environment feels the most uncomfortable. With 42 years of experience, we are trained and battle-tested for these moments. We believe bear markets and oversold stocks create ripe buying opportunities for long-term, patient investors. We are diligently evaluating the collapsing prices of stocks on our watchlist versus the long-term value embedded in these companies. In times like these, we believe the worst-case scenario gets priced in providing a margin of safety<sup>2</sup> to buy and hold our favorite companies with confidence as the market digests the uncertainty. Despite the sell-off, our holdings are statistically cheap—trading at a significant discount to their private market values (PMV)<sup>3</sup>—also known as intrinsic worth. In the past, dislocations of this magnitude have often served as a prelude to the most robust recoveries.

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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. For the one-year period ended 3/31/25 and since inception on April 30, 2020, the performance (net of fees) for the Ariel Small Cap Value Concentrated Composite was -6.57% and +11.25%, respectively. For the one-year period ended 3/31/25 and since inception on April 30, 2020 of the Ariel Small Cap Value Concentrated Composite, the performance for the Russell 2000 Value Index was -3.12% and +12.89%,

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<sup>2</sup> Attempting to purchase a stock with a margin of safety does not protect investors from the loss of their investment, volatility associated with stocks, declining fundamentals, external forces, or our incorrect assumptions.

<sup>3</sup> Discount to Private Market Value is the percentage discount the portfolio trades at relative to Ariel Investments' internal estimate of the portfolio's private market value (PMV). There is no guarantee that companies we invest in will achieve our PMV or projected future earnings.



respectively. And over the same periods the Russell 2000 Index delivered -4.01% and +10.58%, respectively. Ariel Composite Net of Fees returns are calculated by deducting the actual monthly advisory fee (on an asset-weighted basis) applicable to all accounts in the composite, using the fee rates in place as of the most recent calendar quarter-end. Gross returns do not reflect the deduction of advisory fees. Client returns will be reduced by advisory fees and such other expenses as may be incurred in the management of the account. Advisory fees are described in Part 2 of Ariel's Form ADV. Returns assume the reinvestment of dividends and other earnings. 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 3/31/25, First American Financial Corporation constituted 7.6% of the Ariel Small Cap Value Concentrated Composite (representative portfolio); Mattel, Inc. 5.0%; Prestige Consumer Healthcare, Inc. 4.5%; Norwegian Cruise Line Holdings, Ltd. 7.4%; Leslie's, Inc. 0.6% and Resideo Technologies, Inc. 4.7%. 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](http://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

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