

Ariel Small Cap Value

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 Seven¹, 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 Tax-Exempt Composite decreased -10.60% gross of fees (-10.73% net of fees) in the quarter, falling short of both the Russell 2000 Value and Russell 2000 indices, which returned -7.74% and -9.48%, respectively.

Shares of leading food equipment manufacturer **Middleby Corporation (MIDD)** increased following management's announcement that the company is conducting a strategic review of its business portfolio. The news came shortly after activist firm, Garden Investments, acquired a minority stake in the company to gain board representation. They are seeking a potential divestiture of the Food Processing and Residential businesses to unlock value in the Commercial Foodservice segment. While the shares have been under pressure given the challenging macro backdrop and related concerns around new restaurant openings, we view these headwinds as transient. Longer term, MIDD's differentiated brands and focus on

innovation should enable the company to benefit from secular demand for more automation and efficiency in the food service industry.

Additionally, leading provider of automated security solutions **ADT, Inc. (ADT)** also traded higher on solid earnings results. Despite the challenging macro backdrop, the company is demonstrating pricing power, a historically low attrition rate and growing free cash flow generation. Notably, ADT continues to improve its balance sheet through significant debt reduction. Management expects to maintain this momentum into 2025 with strong cash flow growth as well as a new share repurchase plan. With ADT's industry-leading brand and national presence, coupled with its Google and State Farm strategic partnerships, the company is well-positioned to be a prime beneficiary of growing demand for smart home technologies, including fully monitored residential security.

Title insurer, **First American Financial Corporation (FAF)**, also 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.

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

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).



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 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, shares of luxury adventure travel services company, **Lindblad Expeditions Holdings, Inc. (LIND)**, declined over the period on concerns consumer discretionary spending will soften alongside the deterioration in sentiment. Uncertainty surrounding a new management team and the company's leverage heading into a potential economic slowdown also weighed on shares. Nonetheless, demand for LIND's cruise and land-based experience businesses remains brisk, with occupancy and net yield growth meaningfully ahead of consensus estimates. While the new management team's initial 2025 guidance underwhelmed investors, the company is investing to improve occupancy and margins. With a strengthened Disney/National Geographic relationship, expanded fleet capacity and the increased scale of its branded

portfolio, we believe the company is well-positioned for multiple expansion over the long-term.

Also in the quarter, we initiated a new position in manufacturer and developer of laboratory equipment and biological testing, **Bio-Rad Laboratories Inc. (BIO)**. The company offers a worldwide presence with the United States representing 42% of revenue, Europe 31%, Asia 21% and Other 6%. Its customer base is diversified with hospital labs representing 34% of revenue, reference labs 11%, transfusion labs 10%, academic/government 21%, biopharma 15%, and applied markets 9%. BIO offers a solid financial profile, with high and recurring revenue streams as well as rising operating margins. We believe Bio-Rad is a classic Ariel holding, offering leading innovative products in a growing worldwide marketplace. The company estimates 80% of sales result from products in which Bio-Rad has dominant market share.

We did not exit any holdings 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 safety² 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)³—also known as intrinsic worth. In the past, dislocations of this magnitude have often served as a prelude to the most robust recoveries.

Investing in small-cap companies is more risky and volatile than investing in large cap companies. The intrinsic value of

² 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.

³ 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.



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 period ended 3/31/25 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was -6.27%, +14.85%, and +5.72%, respectively. For the period ended 3/31/25 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 5-, and 10-year periods was -3.12%, +15.31%, and +6.07%, and -4.01%, +13.27%, and +6.30%, respectively. Ariel Composite Net of Fees returns are calculated by deducting: (1) for the period from inception to December 31, 2013, the maximum advisory fee in effect for the respective period, applied on a monthly basis; and (2) for the period from January 1, 2014 onwards, the actual monthly advisory fee (on an asset-weighted basis) accrued for the 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 Tax-Exempt 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 3/31/25, The Middleby Corporation constituted 2.4% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); ADT, Inc. 2.9%; First American Financial Corporation 4.8%; Norwegian Cruise Line Holdings, Ltd. 4.1%; Leslie's, Inc. 0.5%, Lindblad Expeditions Holdings, Inc. 4.2% and Bio-Rad Laboratories, Inc. 1.1%. 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 Tax-Exempt 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.

