

Ariel Small/Mid 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/Mid Cap Value Composite traded -5.92% gross of fees (-6.04% net of fees) lower in the quarter, short of the Russell 2500 Value Index's -5.83% return, but ahead of the Russell 2500 Index's -7.50% decline.

Several stocks in the portfolio had strong returns in the quarter. Leading provider of automated security solutions **ADT, Inc. (ADT)** 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.

Leading manufacturer of consumer food products, **J.M. Smucker Co. (SJM)** also advanced over the period. While sales came in below expectations, a significant bottom-line beat and subsequent raise to its FY25 EPS outlook boosted shares. While Hostess remains under pressure, management reiterated its long-term sales target, with near-term focus on stabilizing revenue. The company is implementing a five-pillar plan to improve the brand with marketing investments. Looking ahead, we believe SJM's portfolio of iconic and emerging foods brands, coupled with its broad-based innovation and productivity agenda, supports an attractive total shareholder return opportunity.

Additionally, shares of entertainment company, **Paramount Global (PARA)**, rose during the period. The company entered 2025 with healthy operating momentum at Paramount+, with strong year-over-year engagement growth driven by its original programming and sports offerings. As such, Paramount+ remains on track for domestic profitability this year, with global profitability likely in 2026. Meanwhile, declining linear TV viewership and related pressure on advertising from ratings erosion remain headwinds. Although the Skydance transaction is expected to close in the near term, some investors are concerned the merger may remain in FCC purgatory. Whether the deal is approved or not, we believe the underlying value of the company's proprietary content and media assets is not reflected in its current share price.

Alternatively, manufacturer and developer of laboratory equipment and biological testing, **Bio-Rad Laboratories Inc. (BIO)**, declined over the period after the National Institutes of Health (NIH) announced significant cuts to its internal funding structure. Management also issued disappointing guidance on continued softness in the biopharma and academic research segments as well as uncertainty in the funding environment. Despite the challenging backdrop, we believe the company offers a solid financial profile, including recurring revenue streams and rising operating profit margins.

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).



Shares of live entertainment, media and technology company, **Sphere Entertainment Co. (SPHR)**, came under pressure as some investors took profits on solid earnings performance. In our view, this share price action runs counter to the company's strong business fundamentals. Looking ahead, we expect financial results will continue to ramp up as SPHR scales its concert residencies, secures additional marquee sporting events and reaches higher venue utilization across show types. Advertising, sponsorship and suite revenue should provide additional upside. Meanwhile, international expansion beyond Abu Dhabi remains a priority. In our view, the experiential immersive venue in Las Vegas and its franchise opportunities as well as the company's two regional sports and entertainment networks present a meaningfully underappreciated long-term opportunity.

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.

Also in the quarter, we initiated two positions in the leisure and travel industry, cruise ship operator, **Norwegian Cruise Line Holdings Ltd. (NCLH)** and global health and wellness provider onboard cruise ships and destination resorts, **OneSpaWorld Holdings Ltd. (OSW)**. Shares of both companies traded meaningfully lower on investor concerns around a deterioration in consumer sentiment and related softening in discretionary spend due to the economic slowdown. A potential new tax on cruise lines also weighed on NCLH's shares. In our view, these risks are currently priced in and present us with an attractive entry point. Notably, consumer demand and booking trends remain strong

and both companies continue to deliver robust earnings growth. Looking ahead, NCLH remains focused on right sizing its cost base and improving margins to further improve its foundation for sustainable and profitable growth. And OSW's management continues to work to strengthen its balance sheet by paying down debt and returning capital to shareholders through buybacks and dividends.

By comparison, we successfully exited global cruise vacation company, **Royal Caribbean Group (RCL)** as the name grew beyond the upper limit of Ariel Small/Mid Cap Value's capitalization range in the quarter. We also eliminated U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)** to pursue more compelling investment opportunities.

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 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

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.



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/Mid Cap Value Composite for the 1-, 5-, and 10-year periods was -0.03%, +17.24%, and +6.92%, respectively. For the period ended 3/31/25 the performance for the Russell 2500 Value Index and the Russell 2500 Index for the 1-, 5-, and 10-year periods was -1.47%, +16.66%, and +6.84%, and -3.11%, +14.91%, and +7.46%, 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/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 3/31/25, ADT, Inc. constituted 4.0% of the Ariel Small/Mid Cap Value Composite (representative portfolio); J.M. Smucker Company 4.4%; Paramount Global, Class B 3.4%; Bio-Rad Laboratories, Inc. 2.8%; Sphere Entertainment Company 3.9%; Resideo Technologies, Inc. 2.0%; Norwegian Cruise Line Holdings, Ltd. 1.1%; OneSpaWorld Holdings, Ltd. 0.7%; Leslie's Inc. 0.0% and Royal Caribbean Cruises Ltd. 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/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.

