

Ariel Small Cap Value

Quarter Ended September 30, 2024

All major U.S. indices posted gains in the third quarter with the economy demonstrating resilience and forecasters anticipating a soft landing. With interest rate cuts underway, the Federal Reserve shifted its focus towards the health of the labor market. Meanwhile, value bested growth, small cap issues outperformed their large cap brethren and a broadening market rally trounced the powerful technology sector. Against this backdrop, the Ariel Small Cap Value Tax-Exempt Composite increased +10.34% gross of fees (+10.11% net of fees) in the quarter, relatively in-line with Russell 2000 Value Index's +10.15% return, but ahead of the +9.27% gain posted by the Russell 2000 Index.

Several stocks in the portfolio had strong returns in the quarter. Real estate expert, **Jones Lang LaSalle (JLL)** traded higher following a quarterly earnings beat and subsequent raise in full-year guidance. These results were driven by a rebound in transaction, leasing and capital markets activity as well as solid fee revenues from ramping client wins and contract expansions in the Work Dynamics and property management businesses. Company leadership is optimistic for a near-term recovery following the Fed's interest rate cut and remains confident in the medium- and longer-term revenue outlook for both transactional and recurring revenue streams. We also expect JLL's efforts to streamline operations and increase efficiencies will generate higher profit over time.

Financial advisory and asset manager, **Lazard, Inc. (LAZ)** also increased in the period following solid top- and bottom-line results. This performance was driven by momentum in the advisory business and improving macro conditions. While the asset management segment continues to experience headwinds, company leadership believes rate cuts should increase demand for more risk-oriented active core strategies and specialty offerings. Notably, LAZ's long-term growth trajectory remains intact as it aims to increase firm-wide revenue two-fold through double-digit annual revenue growth by 2030. At current levels, we believe LAZ trades at a healthy discount to our private market value estimate.

Manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** advanced following solid earnings results and a subsequent increase in near-term guidance. Although sales volumes remain low and pricing headwinds continue, improved productivity and lower material costs drove margin expansion. Management also repurchased shares signaling increased confidence that the trough in earnings may be behind the company. In our view, MHK's

healthy balance sheet and progress managing through economic cycles position the company to benefit from long-term growth in residential remodeling, new home construction and commercial projects.

In contrast, U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)** was the greatest detractor from returns over the period. The company pre-announced disappointing operating results and significantly reduced full-year guidance. Soft consumer demand driven by weather-related headwinds and increased price sensitivity on large discretionary purchases weighed on the top-line. Product margins also remain under pressure as the company struggles to unwind its higher-cost inventory. In response, LESL hired a new CEO, Jason McDonell, and our channel checks suggest his background in retail and consumer products is well-suited to drive a performance recovery. Although we have been deeply disappointed with this investment, we are encouraged by the leadership change as well as improving trends on the back of warmer and drier weather conditions. At today's valuation, LESL appears to have more upside than downside and the company's loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience serve as important differentiators.

Shares of luxury adventure travel services company, **Lindblad Expeditions Holdings, Inc. (LIND)** also declined during the quarter despite the company's strong fundamentals. Although geopolitical headwinds forced the cancellation of two voyages in the Red Sea, LIND delivered solid earnings results and future travel demand remains strong. Additionally, the company recently acquired two new vessels, strengthening its range of offerings in the profitable Galapagos Islands beginning in 2025. Meanwhile, LIND's stable land-based segment, which now includes its acquisition of Wineland-Thomson Adventures, a collection of African safari and lodge operators, continues to anchor the company's profitability. Looking ahead, we expect the company's strategic relationship with Disney/National Geographic to provide a more meaningful tailwind for multiple expansion as LIND extends its market share in the expedition tourism niche.

Lastly, oil services company, **Core Laboratories, Inc. (CLB)** traded lower over the period. Although earnings results were in-line with Wall Street expectations, the volatile macro environment and softening expectations for U.S. onshore drilling and completion activity weighed on performance. Nonetheless, the company continues to project international



growth from projects in the Middle East, Asia Pacific and West Africa and remains laser focused on generating positive free cash flow, reducing debt and improving its return on invested capital.

Also in the quarter, we initiated a position in **WEX, Inc. (WEX)**, a niche payment solutions provider for the fleet, travel and healthcare benefits industries. Their unique offerings simplify, protect and analyze various payment flows, most notably between fleet owners and fuel stations. Recent headwinds from a travel customer contract renewal as well as lower fuel prices have temporarily depressed near-term earnings growth. We believe these issues to be both overblown and transitory, supported by WEX's long-term annual targets of 8% - 12% organic revenue growth and 15% - 20% adjusted net income growth. We view this as an opportunity to own a market leader in attractive, recurring, and high margin niches, poised to benefit from growing payments outsourcing.

We sold waste management services provider **Stericycle, Inc. (SRCL)** on the news of its acquisition. We also successfully exited global manufacturer and supplier of identification solutions and workplace safety products, **Brady Corporation (BRC)** on valuation.

We believe the U.S. economy looks healthy and expect the underlying strength of corporate profits will prove resilient. Consensus earnings growth estimates across a variety of sectors suggest a sustainable rally could potentially be on the way. Although interest rates will likely settle at a higher structural level compared to the past decade, monetary and fiscal tailwinds should support the broadening of the market beyond the Magnificent Seven. As the performance gap between mega-cap stocks and their small to mid-cap counterparts narrows, we expect our portfolios to be rewarded. We believe the patient investor who stays the course and consistently owns differentiated businesses with solid competitive positioning and robust balance sheets will reap superior returns over time.

Investing in small-cap companies is more risky and volatile than investing in large cap companies. 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 period ended 9/30/24 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was +23.79%, +10.08%, and +7.61%, respectively. For the period ended 9/30/24 the performance for the Russell 2000 Value Index and the Russell 2000 Index for

the 1-, 5-, and 10-year periods was +25.88%, +9.28%, and +8.22%, and +26.76%, +9.38%, and +8.78%, respectively. Ariel Composite Net of Fees returns are calculated by deducting: (1) for the period from inception to August 31, 2024, the maximum advisory fee in effect for the respective period, applied on a monthly basis; and (2) for the period from September 1, 2024 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 9/30/24, Jones Lang LaSalle Incorporated constituted 4.4% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); Lazard Inc. 3.5%; Mohawk Industries, Inc. 2.4%; Leslie's, Inc. 2.0%; Lindblad Expeditions Holdings, Inc. 3.9%; Core Laboratories Inc. 2.6%; WEX Inc. 1.6%; Brady Corporation 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 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



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