

Ariel Small/Mid 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/Mid Cap Value Composite jumped +13.14% gross of fees (+12.91% net of fees) in the quarter, outperforming both the Russell 2500 Value Index and Russell 2500 Index, which returned +9.63% and +8.75%, respectively.

Several stocks in the portfolio had strong returns in the quarter. 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.

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.

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.

Alternatively, several positions weighed on performance. Leading supplier of automatic-dimming mirrors for the automotive industry, **Gentex Corporation (GNTX)** weighed on quarterly returns following an earnings miss and subsequent reduction in full year guidance. Weakness in auto-production volumes negatively affected mirror shipments with several customers unexpectedly reducing their order. The current valuation fully reflects these affordability-related headwinds, which should begin to ease with declining interest rates. Longer term, GNTX is a high-quality niche franchise with solid growth prospects, as the market increasingly adopts its essential and next-generation technologies, like Full Display Mirror. GNTX has a long history of technological innovation and manufacturing capability, while consistently earning best-in-class operating margins and generating attractive free cash flow.

Leading provider of automated security solutions **ADT, Inc. (ADT)** also traded lower as quarterly earnings results highlighted a deceleration in recurring revenue growth. Despite the challenging macro backdrop, the company continues to demonstrate pricing power, a historically low attrition rate and growing free cash flow generation. Notably, ADT affirmed full year guidance and improved its balance sheet through significant debt reduction. We continue to believe ADT's industry-leading brand and national presence, coupled with its Google and State Farm strategic partnerships, position it to be a prime beneficiary of growing demand for smart home technologies, including fully monitored residential security.

Lastly, U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)** fell 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.

We initiated two new positions in the quarter.

We purchased **Bio-Rad Laboratories Inc. (BIO)**, manufacturer and developer of laboratory equipment and biological testing. 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 boasts a solid financial profile, rising operating margins, high and recurring revenue streams. We believe Bio-Rad is a classic Ariel stock, offering leading innovative products in a growing global marketplace. The company estimates 80% of sales are derived from products in which Bio-Rad has dominant market share.

Additionally, we added former holding **Middleby Corporation (MIDD)**, which is a leading food equipment manufacturer. While the shares have been under pressure due to 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.

By comparison, we successfully exited **Simpson Manufacturing Co., Inc. (SSD)**, a manufacturer of building and construction solutions as well as waste management services provider **Stericycle, Inc. (SRCL)** on the news of its acquisition.

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 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 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/Mid Cap Value Composite for the 1-, 5-, and 10-year periods was +28.49%, +10.87%, and +8.82%, respectively. For the period ended 9/30/24 the performance for the Russell 2500 Value Index and the Russell 2500 Index for the 1-, 5-, and 10-year periods was +26.59% +9.98%, and +8.47%, and +26.17%, +10.42%, and +9.49%, 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/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 9/30/24, Mohawk Industries, Inc. constituted 4.5% of the Ariel Small/Mid Cap Value Composite (representative portfolio); Lazard, Inc. 4.2%; Jones Lang LaSalle Incorporated 4.0%; Gentex Corporation 2.2%; ADT, Inc. 3.3%; Leslie's, Inc. 1.2%; Bio-Rad Laboratories Inc. 1.7%; Middleby Corporation 1.3%; Simpson Manufacturing Co Inc. 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/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.



Ariel Investments

200 E. Randolph St., Suite 2900
Chicago, IL 60601

312.726.0140

- arielinvestments.com
- [linkedin.com/company/ariel-investments](https://www.linkedin.com/company/ariel-investments)
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