Ariel investments

Quarterly Commentary

Ariel Small Cap Value

Quarter Ended December 31, 2024

Markets worldwide defied expectations in 2024 led by the dominating performance of mega-cap technology stocks known as the "magnificent seven.[1]" Even though gains have been concentrated, the results of the U.S. election, strong earnings momentum and a robust labor market drove bullish sentiment. This ebullience extended beyond the equity market: gold delivered its best year since 2010, bitcoin more than doubled and the U.S. dollar neared a 20-year high. Meanwhile, uncertainty surrounding the new U.S. administration's policies and the Federal Reserve signaling slower than anticipated easing in the year ahead drove small cap issues sharply lower in December. Although uncertainty and volatility are likely to remain elevated, the patient investor knows "stock prices trade on fundamentals. And when those solid fundamentals shine through, share prices rise.[2]" Against this backdrop, the Ariel Small Cap Value Tax-Exempt Composite decreased -0.69% gross of fees (-0.83% net of fees) in the quarter, ahead of the Russell 2000 Value Index's -1.06% return, but short of the +0.33% gain posted by the Russell 2000 Index. Over the trailing one-year period, the Ariel Small Cap Value Tax-Exempt Composite advanced +9.60% (+9.01% net of fees), outperforming the Russell 2000 Value Index's +8.05% return, but lagging the Russell 2000 Index's +11.54% gain.

Norwegian Cruise Line Holdings Ltd. (NCLH) advanced over the period following a top- and bottom-line earnings beat and subsequent raise in full-year guidance. Stronger than anticipated consumer demand, healthy onboard spending, robust pricing, solid cost containment and continued progress on leverage reduction boosted results. Looking ahead, NCLH remains focused on right sizing its cost base and improving margins to further strengthen its foundation for sustainable and profitable growth. With a young average fleet and solid liquidity position, we remain enthusiastic about the name.

Provider of wellness services onboard cruise ships and destination resorts, **OneSpaWorld Holdings Ltd. (OSW)**, also traded higher as strong consumer trends drove another significant earnings beat and subsequent raise in full year guidance. Meanwhile, management strengthened the balance sheet by paying down and restructuring its expensive first lien term loan as well as ramped up capital returns to shareholders through buybacks and dividends.

Additionally, shares of luxury adventure travel services company, **Lindblad Expeditions Holdings, Inc. (LIND)** jumped as earnings results exceeded consensus estimates on strength from both the cruise and land-based experience businesses. LIND also announced a leadership succession plan. Founder and long-time CEO, Sven-Olof Lindblad will be stepping into a new position as co-chair of the board of directors and cruise industry veteran, Natalya Leahy is joining the organization as CEO. The company is also bringing on experienced private company CFO, Rick Goldberg. Looking ahead, we expect LIND will increasingly benefit from both its new management structure and strategic relationship with Disney/National Geographic. We believe the expanded fleet and co-branded omnichannel marketing campaign will provide meaningful tailwinds for multiple expansion over the long-term.

In contrast, leading spirits manufacturer, **MGP Ingredients, Inc. (MGPI)** was the largest performance detractor over the period. The company pre-announced a quarterly earnings miss resulting in a subsequent reduction to full-year 2024 guidance and a downward revision to 2025 estimates. Lower consumer demand for whisky has resulted in weaker-than-anticipated sales and significantly higher inventory levels at distributors. In response, MGPI has reduced its distillery production to only meet its own brand needs. While concerns around inventory levels give us near-term pause, we believe MGPI's future growth is tied to its transition from distilling solutions to selling its own branded spirits.

Logistics and cash management services provider, **Brink's Company (BCO)** also underperformed in the period. Despite

[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).

[2] Hobson, Mellody and John W. Rogers Jr. "What the Stock market Taught Us This Year: Don't Fall for These Investing Traps." *Wall Street Journal*, 5 December 2023.

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the delivery of strong organic revenue growth and margin improvement across both the ATM managed services and digital retail solutions segments, currency headwinds and softness in its global services business drove an earnings miss. Although management lowered full year guidance, BCO continues to win margin accretive business, such as its recently announced long-term partnership with Sainsbury's, one of the largest supermarkets in the United Kingdom. Meanwhile, the company is making substantial investments in its technology platforms and returning capital to shareholders through dividends and share repurchases.

Lastly, shares of manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** declined in the period as consumer demand and pricing remain under pressure due to secular headwinds in the housing market. Although quarterly earnings results were in-line with expectations, management lowered near-term guidance to account for losses resulting from recent U.S. hurricanes. Meanwhile, management continues to successfully execute on productivity and cost restructuring initiatives, while also preparing the business for share gains as demand recovers. In our view, MHK's healthy balance sheet and progress managing through economic cycles should help the company benefit from long-term growth in residential remodeling, new home construction and commercial projects.

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

We believe the U.S. economy looks healthy and expect corporate profits to prove resilient. Although interest rates will likely settle at a higher structural level compared to the past decade and potential policies around tariffs and immigration present uncertainty, we think market friendly policies such as tax cuts and deregulation should support the broadening of the market beyond the Magnificent Seven. Once the performance gap between mega-cap stocks and smaller company counterparts narrows, our portfolios should be rewarded. We strongly believe the disciplined investor that stays the course and consistently owns differentiated businesses with solid competitive positioning and robust balance sheets will deliver 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 12/31/24 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was +9.01%, +8.44%, and +7.21%, respectively. For the period ended 12/31/24 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 5-, and 10-year periods was +8.05%, +7.29%, and +7.14%, and +11.54%, +7.40%, and +7.81%, 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 12/31/24, Norwegian Cruise Line Holdings, Ltd. constituted 4.4% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); OneSpaWorld Holdings, Ltd. 5.8%; Lindblad Expeditions Holdings, Inc. 4.7%; MGP Ingredients, Inc. 1.5%; Brink's Company 4.7%; and Mohawk Industries, Inc. 1.9%. 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.

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