



QUARTERLY COMMENTARY

Ariel Small Cap Value

• Value • Global



Quarter Ended September 30, 2022

All major indices closed out the third quarter at a loss, marking the first time Wall Street posted three consecutive quarters of declines since the aftermath of the global financial crisis. Persistently high inflation, escalating geopolitical tensions in Russia/Ukraine, energy-price shocks and aggressive central-bank tightening have weighed on consumer and business confidence. Recession watch has taken hold as many investors fear a Fed-induced hard landing. While Wall Street sits on edge and markets remain erratic, we are actively leaning into the moment by judiciously acquiring the downtrodden shares of quality companies whose value we believe should be realized over the long term. Against this backdrop, the Ariel Small Cap Value Tax-Exempt Composite declined -8.03% gross of fees (-8.25% net of fees), trailing the Russell 2000 Value Index's return of -4.61% and the -2.19% loss posted by the Russell 2000 Index in the quarter.

Wellness provider onboard cruise ships and at destination resorts **OneSpaWorld Holdings Ltd. (OSW)** was the top contributor in the quarter. Strong earnings results, highlighted by a top and bottom-line beat, as well as the delivery of positive free cash flow for the first time since the pandemic began drove share price appreciation. Looking ahead, we expect OSW's spa services to continue to be met with high demand and spend levels, particularly as onboard occupancy increases over time. With adequate liquidity and shares trading at a -44% discount to our estimate of private market value, we see the risk/reward skewed sharply to the upside.

Leading provider of automated security solutions **ADT, Inc. (ADT)** also advanced in the period. This quarter's financial results continue to show that last year's elevated investment in customer acquisition is paying off. Revenue and EBITDA came in ahead of consensus and the company reported positive adjusted net income for the first time since its initial public offering. Additionally, the company announced another strategic partnership, this time with State Farm, the nation's largest insurer. Longer term, we believe ADT's industry-leading brand and national

presence, coupled with these nascent partnerships with Google and State Farm, position it to be a prime beneficiary of growing demand for smart home technologies, including fully monitored residential security.

Regional banking services provider, **BOK Financial Corporation (BOKF)** also traded higher in the quarter, as reflation themes in the marketplace raised interest rate expectations, boosting positive net-interest-margin trends. Additionally, the company continued to report solid loan growth along with tight expense controls, providing a tailwind for shares. Looking ahead, we believe BOKF's strong underwriting standards, diversified business model (which includes banking and fee service businesses), and experienced management team continue to present a long-term opportunity.

By comparison, shares of premiere oil services company **Core Laboratories NV (CLB)** was the largest detractor to relative results in the quarter. The ongoing geopolitical conflict between Russian and Ukraine, as well as associated European and U.S. sanctions continue to disrupt the business and create near-term uncertainty. Although headwinds persist, we believe the industry will realign global supply to meet strong demand for oil and natural gas. In our view, this asset light business will deliver modest growth in reservoir description. We also expect to see greater activity in fracturing rock, which should increase output in well completions and fuel longer-term growth of the production enhancement sector. We have conviction in the management team's long history of delivering strong operating results and robust free cash flow and returning capital to shareholders.

Logistics and cash management services provider **The Brink's Company (BCO)** also declined over the period. We believe this price action runs counter to the company's improving long-term fundamental outlook. Despite global economic uncertainty and translation headwinds from a strengthening dollar, BCO continues to experience a recovery in revenues post-pandemic with operating profit benefitting from strong operational execution and margin expansion. Management also provided guidance for robust free cash flow generation and additional debt repayment. We believe BCO's results demonstrate

underappreciated resiliency amidst today's macroeconomic uncertainty, while longer term, the company's growth and productivity initiatives make this an attractive opportunity.

Shares of leading supplier of circuit protection products **Littelfuse, Inc. (LFUS)** also came under pressure in the period. LFUS delivered another solid quarter of financial results, however forward-looking guidance suggests moderating growth in its core Electronics business. Additionally, management anticipates near-term margin headwinds from unfavorable currency exchange rates, Covid-19 lockdowns in China and slowing demand for personal electronics. Longer-term, we believe LFUS remains well positioned to leverage the global mega trends of a safer, greener and increasingly connected world, as it executes on its long-term strategy to drive double-digit sales and earnings growth.

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

Escalating geopolitical tensions, persistently high inflation, slowing economic growth and the potential for excessive Fed tightening continue to fuel recessionary fears. And yet, we view the probability of the most severe "hard landing," or deep recession, to be less likely. Unemployment remains near historic lows and balance sheets of U.S. financial institutions and households are generally in good shape. We continue to be cautiously optimistic these factors will protect against a severe downturn. Meanwhile, values are abundant when the investment environment feels the most uncomfortable. With 39 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 our expectations of what these companies and their underlying business fundamentals should be valued at over the long-term. In times like these, we believe the worst-case scenario gets priced in giving us a margin of safety¹ to buy and hold our favorite companies with confidence through

the uncertainty until the market digests the volatility. Although our portfolios have sold off in recent months, in our view they are statistically cheap—trading at a significant discount to their private market values (PMV)²—or what some call intrinsic worth. In the past, portfolio dislocations of this magnitude have often served as a prelude to our most robust recoveries.

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. Performance results are shown net of the highest management fee charged to any client in the Composite during the performance period. Net returns reflect performance returns after the deduction of advisory fees and transaction costs and assume the reinvestment of dividends and other earnings. For the period ended 9/30/22 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was -23.81%, +3.35%, and +7.33%, respectively. For the period ended 9/30/22 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 5-, and 10-year periods was -17.69%, +2.87%, and +7.94%, and -23.50%, +3.56%, and +8.55%, respectively. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request and may also be found in Ariel Investments LLC's Form ADV, Part 2. 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.

¹Attempting 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.

²Discount to Private Market Value ("PMV") represents the percentage discount at which the portfolio traded as compared to the portfolio holdings' PMV as determined by Ariel Investments. References to PMV are for the time period: 12/31/07 – 09/30/22.

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.

As of 9/30/22, OneSpaWorld Holdings Ltd. constituted 5.72% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); ADT, Inc. 3.09%; BOK Financial Corporation 3.39%; Core Laboratories 2.34%; Brink's Company 4.42% and Littelfuse, Inc. 3.03%. 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.