

Discovery Fund

PM Commentary as of September 30, 2017



Average Annualized Performance (%)

As of 9/30/17	1 YR	3 YR	5 YR	10 YR	Since Inception
Buffalo Discovery Fund	19.59	12.30	14.90	10.18	9.23
Russell Midcap Growth Index	17.82	9.96	14.18	8.20	8.47

Expense ratio 1.03%. Inception date 4/16/2001. Data represented reflects past performance and is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Current performance may be lower or higher than the performance quoted. Performance current to the most recent month end may be obtained by visiting the Funds' website at buffalofunds.com.

CAPITAL MARKET OVERVIEW

Equity markets continued their winning streak in the 3rd quarter of 2017 with the S&P 500 Index posting its 8th consecutive quarterly gain. Investors have been encouraged by the synchronized upswing in global economic growth. For the first time since 2007, all 45 countries tracked by the Organization for Economic Cooperation and Development (OECD) are on pace to grow this year, with the growth rates expected to accelerate in 33 of those countries. This economic backdrop, in conjunction with strong corporate earnings and a renewed focus on tax reform, helped the reflation trade regain momentum in the quarter.

The reflation trade, also known as the "Trump trade" pushed shares of banks, industrials, and smaller companies higher while expectations of another interest rate increase by the Federal Reserve drove relative weakness in Treasury bonds and their stock market proxies, such as utility companies. The U.S. dollar also strengthened during the period against most major foreign currencies. Furthermore, strong demand and slowing production of oil in the U.S. drove West Texas Intermediate crude prices up 12.2% in the period.

The Russell 3000 Index, a broad market performance benchmark, produced a total return of 4.57% during the quarter. Growth stocks outperformed value stocks, as the Russell 3000 Growth Index advanced 5.93%, compared to a gain of 3.27% for the Russell 3000 Value Index. Shares of smaller-capitalized companies generally outperformed larger companies during the quarter. The Russell Microcap Index and the smaller-cap Russell 2000 Index climbed 6.65% and 5.67% respectively during the period, while the Russell Midcap Index advanced by 3.47%, and the larger-cap Russell 1000 Index increased by 4.48%. Technology and energy were the best performing sectors, while consumer staples and consumer discretionary sectors lagged.

PERFORMANCE COMMENTARY

The Buffalo Discovery Fund returned 5.71% in the quarter outperforming the Russell Mid Cap Growth Index which advanced 5.28%. Stock selection within the consumer discretionary and healthcare sectors drove the outperformance for the period.

TOP CONTRIBUTORS

Top contributors in the period were **Dynavax Technologies**, **Align Technology**, and **Take Two Interactive**. Dynavax has an innovative vaccine for preventing Hepatitis B infection in adults, delivering better protection with fewer injections than currently approved Hepatitis B vaccines. The FDA Advisory Panel met in July to discuss the potential approval of the vaccine and overwhelmingly endorsed the efficacy and safety of the product. Dynavax's stock rose meaningfully in the wake of the meeting.

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Meanwhile, Align Technology, the maker of the clear aligners for dental malocclusion and a long term holding in the Fund, continued to grow in excess of expectations. We believe that the current growth rate is sustainable over the intermediate to long term as less than 10% of the orthodontic market has converted from metal braces to clear aligners.

Finally, Take Two Interactive beat earnings expectations the past two quarters as in-game digital sales exceeded expectations. These digital sales carry a higher gross margin than packaged games and have driven profitability and cash generation for the firm. In addition, the company plans to launch Red Dead Redemption 2 in calendar 2018, the first major update to this title since 2011. Expectations for sales of this new release are high with overall company profitability expected to nearly double in the first year post launch.

TOP DETRACTORS

Top detractors in the period were **Chipotle Mexican Grill, Under Armour, and Evolent Health**. Chipotle Mexican Grill saw decelerating same-store sales growth over the last two quarters, and efforts to jumpstart growth have fallen short. The near-term operating performance is likely to remain challenged. Nevertheless, we believe the company is a leader in the fast casual space, and with better leadership, can resume its growth trajectory.

Under Armour also declined in the period. For the five years leading up to 2017, the company experienced hyper-growth. Such growth is hard to sustain, and most recently management lost sight of some important drivers of the business, including product quality, the fashion trend, channel conflict, and encroaching competition. A high quality Chief Operating Officer, Patrik Frisk, was added to the executive team in late June. The turnaround will take some time, but we continue to believe the category has positive underlying long-term growth trends, namely the increasing consumer focus on healthy living and active lifestyles.

Finally, Evolent Health offers software tools and services to healthcare providers to manage populations of patients, with a goal of decreasing the cost of care, while maintaining or improving the quality of care. The end-market demand for Evolent's service is strong. Nevertheless, the potential repeal of the Affordable Care Act has left many providers cautious on executing new contracts and are awaiting greater visibility. Consequently, investors were concerned about the company's near-term growth prospects, leading to a sell-off in the stock. We remain optimistic that the strong management team will navigate the near-term uncertainty and are confident of the long-term opportunity for the company in enabling providers to manage risk.

OUTLOOK

The Fund ended the 3rd quarter of 2017 with 86 stocks representing 85 companies, as we hold both the Class A and Class B shares of Lions Gate Entertainment. We exited seven positions and added seven stocks to the Fund during the period. The cash weighting stood at about 3% of fund assets at the end of the quarter.

U.S. economic growth accelerated in the 2nd quarter with U.S. Real Growth Domestic Product (GDP) growing 3.1%. Recent measures of manufacturing and industrial activity in the U.S. support expanded activity in the 3rd quarter of 2017, consumer confidence is high, and unemployment reached a multi-year low of 4.2% in September. Companies who have beaten earnings expectations and lack controversy have predominately seen their stocks appreciate as investors appear to be chasing the outperformers.

Our discipline requires we trim or exit the winners as valuation exceeds our best case scenarios. While we see ample opportunities to deploy capital in companies trading at attractive valuations, frequently those valuations come with some controversy. And just as investors are bidding up the outperformers, they are also driving down the stock prices and the valuations of the underperformers.

Fortunately, with fear comes opportunity. We are acutely aware of the current market dynamic and seizing opportunities. We are willing to accept some near-term uncertainty in favor of the long-term growth opportunity. Furthermore, we believe the valuation disparity between winners and losers is extended. With economic growth accelerating, the equity market strength is likely to broaden in the relatively near term. As this occurs, we believe investors will rotate capital into companies that have underperformed recently, but have a growth opportunity and an attractive valuation. ◀

INTERESTED IN MORE INFO? For questions or to speak with a relationship manager about adding any of the 10 Buffalo Funds to your portfolio, contact:

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The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and can be obtained by calling (800) 49-BUFFALO or visiting buffalofunds.com. Read it carefully before investing.

As of 6/30/17 the Buffalo Discovery Fund's top ten equity holdings were: Align Technology, Inc. 2.26%, athenahealth, Inc. 1.84%, Xylem, Inc. 1.81%, Danaher Corp. 1.75%, Verisk Analytics, Inc. 1.73%, MSCI, Inc. 1.73%, Intercontinental Exchange, Inc. 1.72%, Praxair, Inc. 1.71%, WABCO Holdings, Inc. 1.70%, & Nevro Corp. 1.68%.

Top 10 holdings for the quarter are not disclosed until 60 days after quarter end. Those listed are for the previous quarter.

The opinions expressed are those of the Portfolio Manager(s) and are subject to change, are not guaranteed and should not be considered recommendations to buy or sell any security. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

The S&P 500 Index is a free-float capitalization-weighted index published since 1957 of the prices of 500 large-cap common stocks actively traded in the United States. Treasury bonds are debt obligations issued by the United States government. The Russell 3000 Index measures the performance of the 3,000 largest publicly held companies incorporated in the U.S. based on market capitalization. The Russell 3000 Growth Index is a market-capitalization weighted index that measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth rates. The Russell 3000 Value Index is based on the Russell 3000 Index, of companies with lower price-to-book ratios and lower expected growth rates which measures how U.S. stocks in the equity value segment perform. The Russell Microcap Index is a small-cap and micro-cap stock market index of the smallest 2,000 companies in the Russell 3000E Index incorporated in the U.S. based on market capitalization. The Russell 2000 Index is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index based on market capitalization. The Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Russell 1000 Index is a subset of the Russell 3000 Index, which measures the performance of the 1,000 largest publicly-held companies incorporated in the U.S. based on market capitalization. The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth rates. You cannot invest directly in an index.

Mutual fund investing involves risk. Principal loss is possible. The Fund invests in smaller companies, which involves additional risks such as limited liquidity and greater volatility than larger companies. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets.

Kornitzer Capital Management is the advisor to the Buffalo Funds, which are distributed by Quasar Distributors, LLC.