

# Buffalo Early Stage Growth Fund

QUARTERLY  
COMMENTARY

March 31, 2022

## Capital Market Overview

The equity market, as measured by the S&P 500 Index, suffered its second quarterly decline since the onset of the COVID-19 pandemic, over two years ago, producing a return of -4.60% during the January-March period. Weak capital market performance can be largely attributed to the Federal Reserve's decision to raise interest rates and reduce the size of its balance sheet, also known as quantitative tightening. Other headwinds, including the war in Ukraine, significant inflation, and persistent supply chain bottlenecks, only added to the backdrop of uncertainty for domestic and global markets.

The broad-based Russell 3000 Index fell -5.28% in the quarter. Value stocks outperformed growth stocks by a large amount, as the Russell 3000 Value Index returned -0.85% compared to a decline of -9.25% for the Russell 3000 Growth Index. Large cap stocks fell less than smaller cap stocks during the quarter, as the Russell 1000 Index declined -5.13%, followed by a return of -5.68% for the Russell Midcap Index, and -7.53% for the small cap Russell 2000 Index. Energy stocks surged during the period on rising oil prices while the more defensive Utilities and Telecommunication Services sectors were also modestly positive. The Consumer Discretionary and Technology areas of the market were the largest underperformers due to inflation and rising rates.

## Performance Commentary

The Buffalo Early Stage Growth Fund (BUFOX) generated a negative return of 13.46% for the quarter. This result was in-line with the Morningstar U.S. Small Growth Index's negative return of 13.37%. The Russell 2000 Growth Index returned a negative 12.63% during the period.

## Average Annualized Performance (%)

As of 3/31/22	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUFOX	-13.32	16.47	16.06	13.64	9.36	9.90
Institutional Class - BUIOX <sup>1</sup>	-13.20	16.64	16.23	13.81	9.52	10.06
Russell 2000 Growth Index	-14.33	9.88	10.33	11.21	8.81	9.43
Morningstar U.S. Small Growth Index	-13.87	9.56	11.63	11.49	9.12	9.53

<sup>1</sup>For performance prior to 7/1/19 (Inception Date of Institutional Class), performance of the Investor Class shares is used and includes expenses not applicable and lower than those of Institutional Class shares. 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](http://buffalofunds.com).

With pullbacks occurring across most asset classes in the quarter, small cap growth stocks saw some of the largest declines. In the value versus growth comparison, small cap growth stocks underperformed small cap value stocks for the sixth consecutive quarter (as measured by the Russell 2000 Value and Russell 2000 Growth indices, respectively).

Growth stocks, and in particular small cap growth stocks that have not yet reached operating profitability maturity, experienced significant declines in the quarter based on increasing expectations for the Federal Reserve (the "Fed") to act more aggressively to stem inflationary pressures. The potential of increasing interest rates causing a slowdown in economic growth expectations, along with higher discount rates/equity risk premiums, led to the Q1 declines. Adding to the pressure on markets was the war in Ukraine, continued challenged supply chains, lapping economic stimulus payments, and some remnants of COVID-19 in various geographies (China). While the broader market drawdown from recent highs has been mild at the time of this writing, the small cap growth universe (as measured by the Russell 2000 Growth Index) is off approximately 25% from its highs seen in November 2021.

## Fund Facts

	Investor	Institutional
Ticker:	BUFOX	BUIOX
Inception Date:	5/21/04	7/1/19
Expense Ratio:	1.51%	1.36%
Fund Assets:	\$112.70 Million	
Category:	Small Cap Growth	
Benchmark:	Russell 2000 Growth Index	

## Management Team



### Craig Richard, CFA

Co-Manager since 2013  
M.B.A. – Univ. of Kansas  
B.S. – Kansas State Univ.



### Doug Cartwright, CFA

Co-Manager since 2015  
M.B.A. – Univ. of WI-Madison  
B.S. – Baylor University



The Fund's relative performance to the Index was negatively affected by our lack of Energy sector holdings. Our objective is to find secular growth stories, and we do not believe that companies whose earnings are predominantly driven by the movement of an underlying commodity fits the profile of a long-term holding in the Fund. In the Russell 2000 Growth Index, the Energy sector weighting is approximately 3.0% and was up 34% compared to the 12.63% decline for the overall Index in the quarter.

The largest contributor in the quarter was **i3 Verticals**, an integrated payments processor with a focus on processing debit/credit card transactions for state and local government agencies, schools, and medical practices. i3 has focused on building out its software solutions both through acquisitions and partnerships, which creates a stickier customer relationship given a software offering to run the front or back office, combined with payments capabilities, is integral for a government agency or business customer to conduct daily operations. The stock's outperformance in the quarter was driven by a strong earnings report during the quarter and a rebound in valuation multiples for payments-related companies that had sold-off in the second half of 2021.

The largest detractor in the quarter was **Cerence**, a provider of artificial intelligence solutions for automobiles. Cerence provides the software and connected services that enable automotive virtual assistants such as "Hey BMW". Cerence has had some missteps over the course of the last few months, including self-inflicted lack of transparency in reporting how some revenue was flowing in over the past several years. Customers buying software licenses, in front of them being utilized, combined with a downturn in auto production, has pressured the outlook. Given these missteps, there has also been a management transition with the new leadership, resetting expectations. With auto production continuing to grow towards more normalized volumes over the next 6-12 months, reset expectations, and continued leading market share in the automotive virtual assistant category, we believe the prospects for Cerence will improve over the coming quarters.

## Outlook

The market is now pricing in fairly aggressive interest rate hikes by the Federal Reserve (the "Fed"), along with planned action in May, to begin reducing the Fed's balance sheet. Equity valuations, particularly small cap growth valuations, have been negatively impacted as a result.

The next debate seems to be if the Fed will be able to quell heightened inflation while not pushing too hard on the brakes. We remain positive on the strength of personal balance sheets along with corporate balance sheets/margin profiles, given years of low borrowing costs and solid economic footing. Therefore, any slowdown should be supported by the position of strength in these areas.

Regardless of the macroeconomic headwinds we face, our job remains to find attractive small cap companies that have not been fully appreciated by the market or are mispriced due to recent results or events. We believe less investor interest in our segment of the market creates opportunity for us to uncover value.

The Fund typically invests at the smaller end of the small cap growth spectrum, and the managers continue to seek companies with sustainable growth due to secular growth trends or innovative or disruptive products.

The Buffalo Early Stage Growth Fund is focused primarily on identifying innovation within U.S. companies with primarily North American revenue bases. With an active share of greater than 90% and a lower turnover strategy with 50-70 holdings, the Fund will continue to offer a distinct offering from the Index and category peers. ▲

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## 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 summary and statutory prospectuses contain this and other important information about the investment company and can be obtained by calling (800) 49-BUFFALO or visiting [buffalofunds.com](http://buffalofunds.com). Read carefully before investing.*

### **Earnings growth is not representative of the Fund's future performance.**

As of 12/31/21 the Buffalo Early Stage Growth Fund top 10 equity holdings were NV5 Global 2.84%, Compass Diversified 2.63%, Mimecast 2.43%, Kinsale Capital Group 2.21%, Transact 2.14%, Willdan Group 2.11%, Omnicell 2.00%, Shutterstock 2.00%, 8x8 2.00%, MaxLinear 1.99%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end.

The opinions expressed are those of the Portfolio Managers 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 capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. 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 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 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 1000 Index is a subset of the Russell 3000 Index and measures the performance of the 1,000 largest publicly-held companies incorporated in the U.S. based on market capitalization. The Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Russell 2000 Index is an unmanaged index that consists of the smallest 2,000 securities in the Russell 3000 Index, representing approximately 10% of the Russell 3000 total market capitalization. The Morningstar U.S. Small Growth Index measures the performance of U.S. small-cap stocks that are expected to grow at a faster pace than the rest of the market as measured by forward earnings, historical earnings, book value, cash flow and sales. The Russell 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. 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 and lower expected and historical growth values. One cannot invest directly in an index. Active share is a measure of the percentage of stock holdings in a manager's portfolio that differs from the benchmark 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.

