Buffalo Early Stage Growth Fund

QUARTERLY
COMMENTARY

December 31, 2022

Capital Market Overview

Capital markets rallied modestly in the 4th quarter as the S&P 500 Index gained 7.56%, the only positive quarter for 2022. Cooler inflation readings, resilient consumer spending, and better-than-expected corporate earnings buoyed markets during the first two months of the 4th quarter before pulling back in December. Much of the focus remains on the path of future interest rates, recession fears, and the economic and market impact those events may generate in 2023.

Despite the 4th quarter advance, the stock market recorded its worst calendar year since 2008, with a decline of -18.11% for the S&P 500 Index, and a loss of -32.54% for the growth-oriented and technology-heavy Nasdaq Composite Index. Large cap technology stocks and the more interest-rate sensitive assets suffered the most, while value stocks outperformed. In the end, nine of the S&P 500 Index's 11 economic sectors declined. Energy stocks were the bright spot, recording a gain of 65.72% for the sector while Utilities eked out a gain of 1.57% in 2022.

The damage wasn't isolated to the stock market as the investment-grade bond indices suffered double-digit losses for the year as well. In fact, a traditional balanced investment portfolio of 60% stocks and 40% bonds suffered the 4th worst drawdown in the past 100 years.

Recapping quarterly results, the broad-based Russell 3000 Index advanced 7.18% in the period. Value stocks significantly outperformed growth stocks to close out 2022, as the Russell 3000 Value Index returned 12.18% versus a return of just 2.31% for the Russell 3000 Growth Index. Relative performance was mixed going down in market cap size as small caps advanced less than large caps in the quarter, while mid cap stocks outperformed both large and small caps. Larger cap stocks returned 7.24%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index return of 6.23%, while the Russell Midcap Index produced a return of 9.18% in the quarter.

Performance Commentary

The Buffalo Early Stage Growth Fund (BUFOX) generated a positive return of 2.99% for the quarter compared to the Russell 2000 Growth Index return of positive 4.13%.

Average Annualized Performance (%)

As of 12/31/22	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - ***BUFOX***	-30.76	3.30	7.25	10.52	8.82	8.17
Institutional Class - ***BUIOX***[1]	-30.66	3.46	7.41	10.69	8.98	8.33
Russell 2000 Growth Index	-26.36	0.65	3.51	9.20	7.26	8.03
Morningstar U.S. Small Growth Index	-33.31	-1.78	2.66	8.42	6.76	7.60

[1]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 Investor 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.

Small cap growth stocks ended calendar 2022 with a modest rally in the 4th quarter which was probably subdued due to tax loss selling in the month of December. For the full year, the index suffered its 3rd worst year in the past 40 years, declining -26.36%. The Fund generated a return of -30.76% for the year, marking the first calendar year since 2016 that the Buffalo Early Stage Growth Fund failed to outperform the index.

Fund Facts

	Investor	*Institutional*
Ticker:	BUFOX	BUIOX
Inception Date:	5/21/04	7/1/19
Expense Ratio:	1.46%	1.33%
Fund Assets:	$81.94 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

BUFFALO FUNDS

In 2022, the Fund was pressured by the general trend of smaller companies underperforming their larger counterparts in the index (as measured by market capitalization). The Fund is positioned on the smaller end of the small cap spectrum with a portfolio weighted average market cap approximately 35-40% below the index. Additionally, the Fund has not been involved in Energy companies given the underlying commodity exposure and, more generally, the sector not aligning with the spirit of the Fund's philosophy of investing in non-cyclical, innovative growth stories. Within the Russell 2000 Growth Index, Energy advanced more than 30% on the year, causing a large headwind to the relative performance of the Fund. Additionally, the portfolio had some large performance drags from a few individual investments in a difficult year overall.

↑ Top Contributors

Examining Fund performance for the quarter, Paya Holdings represented the largest contributor to results. Paya is an integrated payments company, combining software and payment processing capabilities in a bundled solution. They have focused on building their business to serve less cyclical end markets including healthcare, government agencies, education, and non-profits with close to 90% of their processing volumes being card-not-present. Paya generated low teens growth and communicated continued strength going forward on their 3rd quarter conference call. This was in contrast to other payments related companies seeing signs of macro slowdowns causing some pressure on their growth rates. Confidence in Paya's ability to continue to deliver consistent growth, along with some renewed speculation of a previously rumored takeout, led to strong performance in the quarter. In the first week of 2023, Paya was indeed acquired by a strategic buyer, lending credence to rumors that began earlier in 2022.

↓ Top Detractors

On the other hand, Advanced Drainage Systems (WMS) was a significant detractor from performance results in the quarter. Advanced Drainage has been an innovator in the water management solutions industry, addressing stormwater and on-site septic water needs for both residential and non-residential customers. The company has been a serial share gainer, using a high density, specialized material made from recycled plastic for their portfolio of drainage solutions to allow developers/builders to offer a more cost effective and durable solution. The weakness in residential construction markets and choppiness in non-residential end markets resulted in the company lowering revenue guidance. While the end markets may remain challenged for the time being, WMS is 5x the size of its closest domestic competitor, and we believe the company's plastic pipe will continue to take market share from concrete and steel pipe in the storm and wastewater industry.

Outlook

As indicated earlier, the Russell 2000 Growth Index suffered its 3rd worst year in the past 40 years, trailing only the 2002 and 2008 declines. Over the past 40 years, the ten worst drawdown years have been followed by a positive return of 21%, on average, the subsequent year. In only two instances did the index have another down year immediately following those ten worst calendar years. With that said, we note that every instance is unique, and with record inflation and rapid interest rate increases (neither of which have been seen in past 40 years) the scenario today is one that very few investors have lived though.

We believe that, in the small cap arena, much of the pain is behind us. Many of the portfolio's Consumer Discretionary holdings are now trading below 6 times annual EBITDA (a cash flow proxy), valuation multiples unheard of in years past. Similarly, many recurring revenue software companies have seen their valuations compress by 60-70% or more. Many of these companies have not cut their earnings expectations, a change that we believe is coming as companies begin to give 2023 outlooks. We believe some of the decline in valuation multiples anticipates these coming revisions.

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The economy remains at full employment, personal balance sheets remain strong, and corporate balance sheets and margins are at very healthy levels. Additionally, signs point to inflation readings that should continue to ease as we move ahead in 2023. While we very well could see a more than modest economic downturn, there appears to continue to be a solid foundation on many fronts.

Regardless of the macroeconomic headwinds, 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 an opportunity to uncover value and add alpha relative to the index.

The Fund typically invests at the smaller end of the small cap growth spectrum, and Fund management continues to seek companies with sustainable growth due to secular growth trends and 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.

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. Read carefully before investing.

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

As of 9/30/22 the Buffalo Early Stage Growth Fund top 10 equity holdings were Kinsale Capital Group 3.38%, NV5 Global 3.30%, Transcat 2.78%, ICF Intl 2.77%, Calix 2.74%, Federal Signal Corp 2.71%, Absolute Software Corp 2.65%, Paya Holdings 2.56%, Compass Diversified 2.47%, i3 Verticals 2.45%. 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 Nasdaq Composite Index is a market capitalization-weighted index of more than 3,700 stocks listed on the Nasdaq stock exchange. 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 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 Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. 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. 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. EBITDA stands for earnings before interest, taxes, depreciation and amortization. EBITDA is one indicator of a company's financial performance and is used as a proxy for a company's current operating profitability. A drawdown is a peak-to-trough decline during a specific period for an investment, trading account, or fund. Alpha is a risk-adjusted measure of the so-called active return on an investment. It is the return in excess of the compensation for the risk. An alpha of 1 means the investment's return on investment over a selected period of time was 1% better than the market during that same period; an alpha of -1 means the investment underperformed the market.

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.