Buffalo Small Cap Fund

QUARTERLY
COMMENTARY

March 31, 2020

Capital Market Overview

Global equity markets fell sharply in the 1st quarter of 2020 in reaction to the global spread of COVID-19. As the case count increased exponentially, the only effective response was for countries to go into lockdown. The economic impact of these actions became clear as the quarter progressed and virtually all asset classes suffered as a result. From February 19 through March 23, the U.S. stock market, as measured by the S&P 500 Index, declined around 34%, which was the fastest meltdown in history. Central banks and governments responded quickly to this event, with the U.S. Federal Reserve (the "Fed") cutting interest rates twice in March and announcing unlimited quantitative easing. The U.S. Senate passed a $2 trillion stimulus package, providing assistance to individuals and businesses in distress. Optimism around these efforts helped the market rally into quarter end, leaving the S&P 500 Index down 19.60% from the start of the year.

The broad market Russell 3000 Index declined 20.90% in the 1st quarter. Growth outperformed value, with the Russell 3000 Growth Index declining 14.85% compared to the Russell 3000 Value Index decline of 27.32%. By capitalization size, large cap stocks held up best, with a -20.22% return in the quarter, represented by the Russell 1000 Index. The Russell Mid Cap Index fell -27.07%, followed by the smaller cap Russell 2000 Index which declined -30.61%. Best performing sectors were the Technology, Health Care, and Consumer Staples sectors. The Energy sector was hit hardest as falling demand and rising supply from Saudi Arabia caused oil prices to crater. The economically-sensitive Financial and Industrial sectors were also among the worst performing sectors in the quarter.

Performance Commentary

The Buffalo Small Cap Fund (BUFSX) declined by 19.91% during the quarter, outperforming the Morningstar U.S. Small Growth Index, which declined by 21.45%. The outperformance was driven by stock selection in Financials, an overweight in Health Care entering the quarter, and solid stock selection in Health Care, especially in a few companies that could likely benefit from the crisis. These areas more than offset relative weakness in Consumer Discretionary, Industrials, and Materials.

As is common in rapid, macro-driven declines such as the one experienced in March, smaller company stocks declined more than mid and large caps, as market liquidity declined and investors sought the greater liquidity and relative safety of larger cap stocks. Small cap growth outperformed small cap value meaningfully during the quarter. Energy and Consumer Discretionary suffered the most in the Index, as the Saudis and Russians engaged in their price war and consumers globally went into quarantine. The Health Care and Real Estate sectors were relative outperformers during the quarter, but still managed to decline in the double digits giving small cap investors very few places to hide.

Average Annualized Performance (%)

As of 3/31/20	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFSX*	-7.33	6.95	5.72	8.32	7.43	10.64
Institutional Class - *BUISX*[1]	-7.22	7.10	5.87	8.48	7.59	10.81
Morningstar U.S. Small Growth Index	-16.07	3.43	3.71	9.79	7.73	5.05
Lipper Small Cap Growth Fund Index	-16.72	3.69	3.73	9.10	6.92	5.85

[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.

Fund Facts

	Investor	*Institutional*
Ticker:	BUFSX	BUISX
Inception Date:	4/14/98	7/1/19
Expense Ratio:	1.01%	0.86%
Fund Assets:	$439.76 Million	
Category:	Small Cap Growth	
Benchmark:	Morningstar U.S. Small Growth Index	

Management Team

Jamie Cuellar, CFA

Co-Manager since 2015
M.B.A. – Southern Methodist
B.B.A. – Univ. of San Diego

Bob Male, CFA

Manager since Inception
M.B.A. – Southern Methodist
B.S. – University of Kansas

Alex Hancock, CFA

Co-Manager since 2017
B.A. – Dartmouth College

BUFFALO FUNDS

↑ Top Contributors

eHealth was, once again, the best performing stock during the quarter. The company posted outstanding results for its seasonally-strong December quarter and had an excellent outlook for 2020. With Joe Biden getting the nod from the Democratic Party over Bernie Sanders, the risk to the stock of a single payer healthcare system has been greatly reduced. Medicare continues to have broad bipartisan support and may even enjoy greater access and coverage going forward. As a market leader in helping seniors select the best Medicare Advantage, Supplemental Medicare, and/or Part D plan, we believe eHealth has a favorable runway for additional growth.

Teladoc was also a meaningful contributor to the Fund this quarter, as it almost doubled over that period. The market leader in telemedicine could not have had a more favorable setup than a pandemic and mandated global quarantine that has massively accelerated the use of telemedicine by both doctors and patients. The company is quickly ramping to fulfill demand and announced in mid-April that consultations have doubled since the first week of March 2020. This is clearly the tipping point the industry needed to go mainstream, and, as the leader in telehealth, Teladoc should continue to benefit disproportionately.

↓ Top Detractors

The biggest disappointment during the quarter was our investment in Everi Holdings, a producer of gaming equipment and financial technology products for casinos. During the quarter, Everi went from making new highs in its share price due to market share gains, record performances in its slot machine business, and a new product cycle coming in its financial technology business, to having its customers close their doors for an indefinite period due to the pandemic. While it had a majority of revenue from recurring sources like slot play and ATM transactions, it needs its customers to be operating in order to get that recurring revenue. Because the company is dependent on casino traffic and capital spending from an ailing casino industry, we exited the position during the quarter.

Outlook

This market period has obviously been extremely volatile and difficult to navigate, and we would like to offer some comments on how we have been managing the Fund during this time and how we have positioned the portfolio going forward. As we saw signs of the virus spreading rapidly outside of Wuhan, we began taking action by selling some investments that had been outperformers where valuation was getting full, and selling in some areas of consumer and energy. We also sold some positions in Health Care that were reliant on elective procedures or doctor visits that would likely get canceled and reduced exposure to advertising, as this usually gets cut quickly in weak economic periods. We then circled back to a few stocks we have been watching and waiting for a more attractive entry point, provided the nature of their businesses would still thrive in such an odd economic period. For example, e-commerce, bankruptcy consulting, and telecom equipment companies should benefit while travel, live events, and oil service companies likely do not.

As always, during downturns, we also seek to take advantage of quality, mid cap companies whose share prices have fallen into our market cap range. This is especially true in the Consumer Discretionary sector where we know the companies have solid balance sheets and will be survivors in industries that are likely to see a lot of capacity leave the market, such as restaurants and retail. Furthermore, knowing that there will be very few companies that will not see negative estimate revisions, we have looked to take advantage of lower share prices by buying more of those companies we already own that should continue to benefit from the same long-term trends they experienced before the pandemic. While their relative importance in the world may have decreased in the short-term, as everyone focuses on their basic needs and adjusts to a weaker economy, the underlying trends remain, and we as a nation will eventually adjust to our new realities.

As during most periods of high volatility and a rapid change in economic growth, portfolio turnover increased during the quarter. While the average quarterly cash balance was a little higher than most quarters at 4.3%, the Fund ended the quarter practically fully-invested with less than a 2% weighting in cash. Overall, the portfolio's cyclical weighting is below average, as it has been for some time, and this is something we will be watching closely in the quarters ahead, as the economy eventually improves.

While the market has been enjoying a nice bounce since the lows in mid-March, it is tough to say whether we will revisit the lows, as is typical, or retain the gains off the bottom. Clearly, the markets will have to endure some very terrible economic numbers for at least the next two quarters, and most companies have very little visibility into forward business trends. There is also significant uncertainty related to the spread and recovery rates for COVID-19 and potential treatments or vaccines for the virus. We expect evolving data on this will drive significant volatility in our small cap investments in coming months. So far in mid-April, the market is digesting withdrawn guidance fairly well and some hard-hit areas like consumer are seeing dramatic moves off the bottom, if companies can at least show that they are not in danger of going bankrupt. At some point, the market will want more than that for share prices to move higher, but it is hard to see when that period is and where share prices will be at that time.

So far, the Fed and the Treasury Department have done a good job of providing liquidity to markets and cash strapped consumers and businesses, but there are still a few areas like mortgage issuance and rent payment by restaurants and retailers where issues remain. The one fact we take solace in is that small cap usually outperforms as we head out of bear markets and recessions. In fact, small cap has outperformed large cap in nine out of the last ten recessions, and we do not feel this time will be any different. We continue to manage the portfolio the same as we always have – bottom up, investing one name at a time based on the fundamental merits and valuation parameters of each company. Our time-tested process of investing in premier companies, which could benefit from long-term trends and trade at attractive valuations, remains the cornerstone of our work, and we appreciate your continued confidence in our efforts.

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 9/30/19 the Buffalo Small Cap Fund top 10 equity holdings were eHealth 3.09%, PROS Holdings 2.42%, ICF Intl 2.31%, Natera 2.29%, Lumentum Holdings 2.13%, Kornit Digital 2.06%, Generac Holdings 2.05%, CyrusOne 1.99%, Monolithic Power Systems 1.97%, Repligen Corp 1.96%. 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 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 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 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 Lipper Small Cap Growth Fund Index is an unmanaged, equally weighted performance index of the 30 largest qualifying mutual funds (based on net assets) in the Lipper Small-Cap classification. One 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.

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