

Buffalo Small Cap Fund

QUARTERLY
COMMENTARY

September 30, 2018

Capital Market Overview

U.S. economic strength and solid corporate earnings growth drove healthy equity returns in the 3rd quarter. The widely-followed S&P 500 Index had a total return of 7.71%, its best quarterly gain since 2013. In September, initial jobless claims fell to the lowest level since 1969, wages grew at the fastest rate since 2009, consumer confidence reached the highest level since 2000, and the National Federation of Independent Business (NFIB) survey of small business optimism was at an all-time high (the survey dates back to 1974). Against this strong economic backdrop, the Federal Reserve raised the targeted federal funds rate by another 25 basis points to a range of 2.00% to 2.25%. Slowly rising interest rates led to flat bond returns.

The divergence between domestic and international equity market performance continued during the quarter, with the MSCI EAFE Index advancing just 1.35%. The Russell 3000 Index gained 7.12% in the 3rd quarter. By style, growth continued to outperform value, with the Russell 3000 Growth Index increasing 8.88% compared to the Russell 3000 Value Index's advance of 5.39%. Large caps did better than small caps as the Russell 1000 Index returned 7.42%, the Russell Midcap Index returned 5.00%, and the Russell 2000 Index returned 3.58% in the quarter. Every economic sector was positive this quarter, with Health Care and Industrials the top performers, while Materials and Energy lagged the indexes.

Performance Commentary

Small capitalization stocks continued to be viewed as beneficiaries of increased trade war concerns in the 3rd quarter, boosting the Fund's benchmark, the Morningstar U.S. Small Growth Index, by 7.61%. The Fund performed relatively well this quarter gaining 7.70%, slightly outperforming the benchmark. The Fund changed its primary performance benchmark to the Morningstar U.S. Small Growth Index from the Russell 2000 Growth Index, which gained 5.52% in the 3rd quarter.

Small cap growth stocks outperformed value stocks by almost 300 basis points during the quarter as the technology, healthcare, and consumer sectors were all solid performers during the quarter. On a relative basis, the Fund outperformed in Technology and Health Care but underperformed in Consumer Discretionary and Industrials.

Average Annualized Performance (%)

As of 9/30/18	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Buffalo Small Cap Fund	29.72	20.85	10.04	12.52	10.90	12.34
Morningstar U.S. Small Growth Index	26.30	19.32	12.34	13.15	10.82	6.67
Russell 2000 Growth Index	24.44	18.39	11.75	12.57	10.61	6.71

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 Quick Facts

Ticker:	BUFSX
Inception Date:	5/21/2004
Net Assets:	\$598.49 Million
Expense Ratio:	1.01%
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



↑ Top Contributors

Twilio was the best performing stock in the portfolio during the quarter. The company beat 2nd quarter revenue estimates by 13% and raised revenue guidance for the year, as its market leading customer engagement platform continues to see increasing usage from its customer base. The company now enters a period of easier comparisons as last year's growth decelerated due to a reduction in spend by a large customer. The company should benefit going forward from two new product cycles: the general availability of a new contact center product called Flex and an Internet of Things product called Twilio Wireless.

The Fund also benefited from gains in **HMS Holdings**, a healthcare company that focuses on the long-term trend of reducing the costs of healthcare. After struggling a bit in 2017, HMS has seen accelerating growth this year as its customers have become more aggressive in finding errors in billings, and as HMS has done a better job selling care management and customer engagement solutions obtained from acquisitions over the past two years. The company is also a big beneficiary of key trends in technology such as artificial intelligence, machine learning, and robotic process automation, which should improve their operating leverage going forward.

↓ Top Detractors

Nevro was the largest detractor from performance as the company's stock languished this quarter. The company suffered from poor sales hiring trends impacting future growth and from intellectual property concerns with a key competitor. While the stock may continue to be depressed until better execution emerges, we believe the market is not adequately valuing the solid competitive position the company has in the spinal cord stimulation market.

Outlook

While the outlook for smaller capitalization companies remains constructive, the asset class has clearly been a recipient of additional fund flows, as some investors have allocated assets into small cap believing that these stocks are more immune to trade issues than larger cap companies. These additional flows may prove to be short term in nature, which could lead to enhanced volatility over the coming few quarters, if investors reallocate away from small caps. These inflows have pushed some parts of the small cap growth market, such as high growth software, to relatively expensive levels in our view. We have sold many stocks in this area including Zendesk, Hubspot, MongoDB, and Okta over the past couple of quarters believing that the high multiples did not leave much room for error and have attempted to replace these investment positions with stocks that have more reasonable valuations by our analysis. The small cap growth market has seen some pressure in the early part of the 4th quarter, as it appears some of this capital has already retreated from small caps.

We continue to be diligent in our process of finding companies with the potential to benefit from long-term trends while still trading at reasonable valuations. As always, we appreciate your confidence in our investment process over the long haul. ▴

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 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.

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

As of 6/30/18 the Buffalo Small Cap Fund top 10 equity holdings were Twilio 3.18%, CoreCivic 2.20%, MasTec 2.00%, Mimecast 1.97%, Medidata Solutions 1.95%, HealthEquity 1.94%, HMS Holdings 1.94%, CyrusOne 1.89%, 8x8 1.87%, Repligen 1.86%. 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 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 MSCI EAFE Index measures the equity market performance of developed markets outside of the U.S. & Canada; EAFE stands for Europe, Australasia and Far East. 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 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 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. It is not possible to invest directly in an index. A basis point is one hundredth of a percentage point (0.01%).

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.

