

# Buffalo Early Stage Growth Fund

QUARTERLY  
COMMENTARY

September 30, 2023

## Capital Market Commentary

Capital markets pulled back in the third quarter of 2023 as the S&P 500 Index declined 3.27% and the Bloomberg Aggregate Bond Index fell 3.23%. Rising bond yields and expectations that the Federal Reserve will maintain interest rates “higher for longer” weighed on investors sentiment. Inflation is trending down; however, it remains above the Fed’s target of 2% leading to the central bank’s hawkish tilt. Until recently, markets had been forecasting numerous interest rate cuts in 2024, a scenario that now looks unlikely. The yield of the U.S. Treasury 10-year note finished the period at 4.57%, up from 3.9% to start the year. Performance results among eight of the ten economic sectors were negative during the period, but energy rallied over 12% as the price of oil surged 27% during the third quarter. Overall, economic growth appears to be slowing, but most economists are not calling for a recession in the near term.

Recapping broad-based index results, the Russell 3000 Index dropped 3.25%. Relative performance deteriorated going down in market capitalization (size) as small caps declined more than large caps in the quarter. Larger cap stocks produced a return of -3.15%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index return of -5.13%. The even smaller market cap Russell Microcap Index pulled back by -7.93% in the quarter.

## Performance Commentary

The Buffalo Early Stage Growth Fund generated a return of -12.13% for the quarter compared to the Russell 2000 Growth Index return of -7.32% during the period. Small caps continue to trail their large cap counterparts significantly year-to-date with the Russell 1000 Growth up 24.98% compared to 5.24% for the Russell 2000 Growth Index. The Buffalo Early Stage Growth Fund is positioned at the smaller end of the small cap spectrum as measured by weighted average market cap of \$2.1 billion compared to \$3.3 billion for the index. This has presented a material headwind in the quarter and year-to-date given the underperformance of smaller companies.

## Average Annualized Performance (%)

As of 9/30/23	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
<b>Investor Class - BUFOX</b>	3.06	-0.84	3.67	6.39	10.88	7.85
<b>Institutional Class - BUIOX<sup>1</sup></b>	3.19	-0.69	3.83	6.55	11.05	8.01
<b>Russell 2000 Growth Index</b>	9.59	1.09	1.55	6.72	8.82	7.99

<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 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](http://buffalofunds.com).

Underperformance in the quarter was primarily spread across Consumer, Healthcare and Energy. Energy was the best performing sector in the index advancing around 17% and was a relative headwind for the fund given the index weighting of approximately 5%. As secular growth investors, we will continue to be underweight energy.

In terms of individual portfolio detractors in the quarter, SunOpta and Establishment Labs underperformed. SunOpta is a consumer staples company focused on the production of plant-based beverages along with frozen fruit. They operate primarily as a co-manufacturer to branded foods companies. SunOpta shares suffered from an operating miss and guidance reduction after the June quarter. There is some current weakness in plant-based beverage consumption in the grocery channel as well as some delays in material contracts ramping up. More recently, the company disclosed the sale of their frozen fruit business which is more commoditized, slower growth and generally less consistent than the plant-based beverage business. We view this positively as it helps reduce the company's debt leverage and puts forth a cleaner, more attractive story for investors going forward.

## Fund Facts

	Investor	Institutional
<b>Ticker:</b>	BUFOX	BUIOX
<b>Inception Date:</b>	5/21/04	7/1/19
<b>Expense Ratio:</b>	1.50%	1.35%
<b>Fund Assets:</b>	\$75.65 Million	
<b>Category:</b>	Small Cap Growth	
<b>Benchmark:</b>	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



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Establishment Labs (ESTA) is a long-time holding of the fund that has come under significant pressure recently. The company is an innovator in the healthcare sector, bringing innovation to the breast implant space that has not had material innovation for close to 20 years. The company is currently in 80 countries, establishing leading market share in greater than 30, and most importantly, has a superior safety profile to legacy breast implant manufacturers. The weakness in the shares during the quarter was likely due to general weakness within small cap healthcare along with continued pressure on smaller, unprofitable companies. Additionally, macro weakness is of general concern for any player in the aesthetics space given less discretionary dollars available to spend. The company is expected to enter the two largest markets, China and the United States, over the next 3-6 months. This is a material catalyst going forward and we believe the company will gain a significant market share in these markets as well given the safety profile exhibited.

## 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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## Outlook

The smaller end of the market continues to underperform the larger end. Small caps are trading at a 20% discount compared to large caps on a forward price-to-earnings (P/E) ratio basis, levels not seen since 2002. Getting even more granular, the smaller end of the small cap universe where this fund is positioned has performed even worse. We are seeing very attractive multiples for several of our holdings and believe the risk/reward presented here is quite positive if the Fed is able to navigate a soft landing.

Our views on the economy have not changed much with the labor market remaining in good shape. Excess cash on personal balance sheets is declining but overall money supply remains above trend, and corporate profits have proven resilient in the face of historically high inflation over the past year. The lagged impact of rising rates has yet to be determined but large purchases (homes/cars) have seen steady prices given lack of supply.

Our job remains to find and hold 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 the smaller market cap segment of the investment universe creates opportunity for us to uncover value over the long-term. 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, disruptive products. With an active share of greater than 90%, a lower turnover strategy with 50-70 holdings, the fund aims to continue to offer a distinct offering from the index and category peers. ▀



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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 6/30/23 the Buffalo Early Stage Growth Fund top 10 equity holdings were Kinsale Capital Group 3.72%, Federal Signal Corp 3.57%, Transcat 2.95%, Compass Diversified 2.78%, Bowman Consulting 2.57%, ICF International 2.40%, Verra Mobility 2.33%, NV5 Global 2.31%, Establishment Labs Holdings 2.30%, Playa Hotels & Resorts 2.27%. 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 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. 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. 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. The Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The Russell Microcap Index measures the performance of the microcap segment of the U.S. equity market. The Russell 2000 Growth Index is an unmanaged index that measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth is an unmanaged index that measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values. The price-to-earnings (P/E) ratio is a ratio for valuing a company that measures its current share price relative to its per-share earnings.

**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.

