

## U.S. Small Cap Growth Strategy

### Representative Commentary — 2Q21

Performance	Annualized					
	2Q21	1YR	3YR	5YR	7YR	10YR
U.S. Small Cap Growth Composite (Gross)	4.94%	43.13%	17.81%	19.41%	14.57%	14.83%
U.S. Small Cap Growth Composite (Net)	4.68%	41.75%	16.65%	18.24%	13.45%	13.70%
Russell 2000® Growth Index	3.92%	51.36%	15.93%	18.75%	13.10%	13.51%

*Please see the important performance and other related disclosures at the end of this Commentary, which are an integral part of this quarterly Commentary Newsletter.*

The global equity markets continued to treat the pandemic's initial economic toll as a passing blip. In the second quarter, there were meaningful gains with many indexes approaching—or well into—double-digit gains for the first half of 2021 (not to mention annualized double-digit gains since the pre-pandemic highs of February 2020). For the quarter, U.S. equities led with gains of 8% compared with 5% for both non-U.S. developed and emerging markets equities. There was a shift in market preferences, with greater rewards accruing to the growth and large capitalization indices in the second quarter, compared with the dominance shown by value and small capitalizations earlier in the year.

Global economic activities continued unabated in the quarter, with the only hindrance from depleted inventories or higher labor costs. Although the rates of growth slowed slightly in June, measures of economic expansion for manufacturing and services worldwide reached peaks mid-quarter that had not been seen in 15 years. The unflagging demand pushed commodity prices to their highest levels since 2014, which included significant price gains for oil and natural gas. Among small-to-mid capitalization growth stocks, it was unsurprising that Energy remained the dominant economic sector. The market also preferred riskier stocks and growth at any price.

Amidst this environment, the portfolio outperformed the Russell 2000® Growth Index for the quarter. Relative weakness was found in Financials, Health Care, Industrials, and Utilities. That was offset by strength in the

Communications, Consumer Discretionary, Consumer Staples, and Information Technology sectors.

Within Communication Services, **Vonage Holdings Corp.** provides communications services to consumers and businesses through cloud-connected devices. Its stock climbed 22% after reporting a strong first quarter with beats across the board. Its application programming interface (API) business continued to see broad-based strength across industries and geographies. Its E-commerce, Technology, and Healthcare verticals showed particular strength. **Bandwidth Inc.**, a supplier of cloud-based communications services to small and mid-sized companies, gained 9%. The company reported a solid quarter, outpacing Street earnings estimates by a substantial margin. Customer net additions led to revenue upside and management increased forward guidance. **Cardlytics Inc.** is engaged in the development of marketing solutions through its purchase intelligence platform. The company announced the acquisition of Bridg, a data analytics company. In our view, this deal adds a level of complexity to the investment and we decided to exit. Their share price lost -4% for the time it was held in the quarter.

We had some comings and goings in the Consumer Discretionary sector. **Boot Barn Holdings Inc.** was added to the portfolio during the quarter. They operate retail approximately 270 stores featuring western and work-related footwear, apparel, and accessories. The stock was up 14% since it was added. **At Home Group Inc.**, an operator of home décor superstores, received a 28%

markup on news that private equity firm Hellman & Friedman was acquiring the company in an all-cash deal. We sold the position during the quarter on this news and booked the profits. **Wingstop Inc.**, a franchisor and operator of restaurants featuring chicken wings, rose 24%. First quarter revenues, same store sales, and unit growth were all in line with their preannouncement. Earnings surprised to the upside on better operating margins. Golf equipment and accessories manufacturer **Callaway Golf Co.** rallied 26%. First quarter results impressively beat across revenues, profits, and earnings. Their core golf equipment business continues to see unprecedented demand while soft goods have been able to hold up thanks to ecommerce sales. We trimmed the position on this strength. **RealReal Inc.** operates an online luxury goods consignment web site. Their latest quarter's earnings were in line with estimates as orders picked up nicely. Management noted there will be higher operating costs over the short-term stemming from the movement of some operations from California to Arizona for improved efficiency. Finally, their Chief Financial Officer announced he will be leaving the company at year-end. The net result of these developments was a -13% decline in the stock price. **Malibu Boats Inc.**, a recreational powerboat manufacturer with brands such as Cobalt and Pursuit, dropped -8%. While the company posted strong fiscal third quarter results, the combination of adverse weather conditions and supply chain challenges restrained further upside. As such, robust demand and a slower recovery in production translate into a substantial backlog.

Within Consumer Staples, **Simply Good Foods Co.** produces nutritional food and snacks. Its share price bounced back 20%, after being down earlier in the year, on a strong beat in their latest quarter. 2021 guidance exceeded sell-side projections.

The strategy's strongest performer hailed from the Information Technology sector. **Sprout Social Inc.** supplies online social media management tools for businesses. Social media has become a mission-critical communication channel for organizations of all sizes. They reported another strong quarter with acceleration in recurring revenues as well as customer net additions. This resulted in a 55% share price appreciation and we trimmed the position. **Kulicke & Soffa Industries Inc.**, a producer of capital equipment and tools used to assemble semiconductor devices, advanced 25%. Fiscal second quarter revenues were in line with updated projections while earnings were higher. Forward guidance surpassed the street for both metrics. The position was trimmed on this strength. Operations management and analytics company **ExlService Holdings Inc.** gained 18% for the quarter. Earnings outpaced consensus estimates in the latest quarter on higher revenues and improved margins. Their Operations Management business generated new deal activity in healthcare, life insurance, and banking while the Analytics segment experienced strong demand across

multiple verticals. **Cohu Inc.** provides back-end semiconductor equipment and services. First quarter revenues came in slightly ahead of the consensus and earnings were much better due a more favorable sales mix that resulted in higher gross margins. Investors appear to have been disappointed with the forward guidance as the stock traded down by -13%. Management projects higher sales, though driven by test handlers, which are less profitable than other products. We believe the stock was unfairly punished and used the price weakness as an opportunity to increase the position. Shares of **Rush Street Interactive Inc.**, an operator of regulated online gaming sites, tumbled -25%. First quarter results were mixed as revenues were above estimates while profits were below. Management indicated they are investing aggressively to drive future growth. **Bottomline Technologies Inc.** facilitates electronic payments among businesses, vendors, and banks. While fiscal third quarter results were in line with expectations, fiscal 2022 profit guidance missed the mark. Management attributed the shortfall to salary increases and marketing investments. This caused Bottomline's stock to fall by -18%.

Within Financials, **Lending Tree Inc.** finished the quarter flat at 0%, thereby underperforming the index sector average return of 7%. The company operates an online marketplace for consumers seeking loans and other credit-based products. First quarter results came in above estimates, however, second quarter profit guidance was weaker than anticipated. This is due to a continued product mix shift and ongoing investments that are intended to bolster their capabilities. **BTRS Holdings Inc.** offers cloud-based software and integrated payment processing solutions that are designed to simplify and automate business commerce. Its latest results were solid and management nudged up full year guidance after experiencing substantial volume growth. Their new head of sales is gaining traction and the pipeline remains full. The stock appears to have been subject to profit-taking with its -13% slide. We added to the position on this weakness. Investment banking services provider **Houlihan Lokey Inc.** climbed 20%. Fiscal fourth quarter revenues and earnings were well ahead of consensus expectations due to higher mergers & acquisitions activity. We decided to exit the position and book the profits as the stock neared our price target. **Focus Financial Partners Inc.**, a provider of wealth management services, appreciated 17%. First quarter earnings were above the consensus, driven by stronger-than-expected organic revenue growth and inclusive of partner firm acquisitions. Management's projections for profits and revenue were above sell-side forecasts. New to the portfolio this quarter is **Victory Capital Holdings Inc.**, an asset management firm offering investment products through its franchises and solutions platform. Their shares were up 8% since it was added to the portfolio.

The strategy's largest detractor was found in the Health Care sector. **ChemoCentryx Inc.** is a biopharmaceutical company focused on inflammatory disorders, autoimmune diseases, and cancer. Its shares retreated -77% following the release of Food & Drug Administration Advisory Committee documents which raised concerns about whether a single phase III trial was sufficient to make a risk/benefit determination for Avacopan in treating autoimmune vasculitis. As such, the path to drug approval is far from certain and we decided to liquidate the position. **Addus HomeCare Corp.** provides personal care, hospice, and home health services. The stock declined -17% due to first quarter results missing consensus estimates. Personal care organic growth came in below targets, though that stands to improve based on the Illinois reimbursement rate increase that went into effect on April 1<sup>st</sup>. COVID-19 continued to pressure patient volumes in its hospice business. Management expects to see volumes recover on continued vaccination deployment, as quarantined employees were previously limited in their abilities to serve patients, and the lifting of facility restrictions. **InnoVage Holding Corp.** offers a healthcare delivery platform. They offer care for high acuity, dual-eligible patients through a program called PACE (Program of All-Inclusive Care for the Elderly) that is funded by the Centers for Medicare & Medicaid Services. Fiscal third quarter revenues missed slightly in its first quarter as a public company due to the impact of COVID-19 on new patient program admissions. This is expected to improve with the ongoing vaccine rollout. Nevertheless, InnoVage sold off by -18% and we added to the position on weakness. More encouraging was the 45% improvement in the shares of **Shockwave Medical Inc.**, a developer of devices for treating cardiovascular disease. The company preannounced first quarter sales and guided above Street projections. Positive trends were cited in operating metrics including improved sales representative productivity. A major driver was its newly launched C2 Coronary Intravascular Lithotripsy product in the U.S. and that was also reflected in a robust 2021 outlook. **AtriCure Inc.** produces devices used for the surgical ablation of cardiac tissue as well as instruments used in the repair or replacement of heart valves. Solid overall first quarter results were driven by a robust recovery in the U.S. that offset inconsistent volume trends in the international markets. Another piece of good news for the company was the FDA approval of its Epi-Sense System, which is used to treat long-standing persistent atrial fibrillation. These developments lifted AtriCure's stock by 21% and we trimmed the position. **Phreesia Inc.** is a healthcare software company offering systems to manage patient intake payments. Fiscal first quarter revenues beat estimates, with growth in subscriptions and related services as well as payment processing. This served to boost its shares by 19%. Management increased its sales guidance outlook for the fiscal year.

Within the Industrials sector, **ACV Auctions Inc.** offers a mobile auction platform for wholesale automotive dealers. They reported a strong first quarter as a public company. Higher used car prices and a lack of inventory are bringing more dealers to the platform. 2021 represents an investment year for the company. Management is working to complete their territory roll-out as well as spending on new products and technology for future growth. ACV Auctions traded down -26% and we added to the position on weakness. **Proto Labs Inc.** is a digital manufacturer of custom prototypes and production parts. While first quarter revenues were ahead of expectations, earnings fell short. The 3DHubs acquisition has had an adverse impact on operating margins due to the impact of freight and materials inflation. Its shares tumbled -25% and we added to the position on weakness. **EMCOR Group Inc.** provides electrical, mechanical, construction, and facilities services. First quarter earnings exceeded the consensus on stronger revenues and better operating margins. Its Mechanical Construction segment was a standout performer. These results served to drive up the stock price by 10%. **Clean Harbors Inc.** supplies environmental, energy, and industrial services. Its shares edged forward 11% after reporting first quarter sales that beat consensus estimates. Environmental Services has benefited from an ongoing shift to higher margin waste streams plus a rebound in industrial activity. At Safety-Kleen, a recovery in vehicle miles driven is generating improvement in oil collections for re-refining. We trimmed the position on this strength. **Hexcel Corp.** produces structural materials used in commercial aerospace, industrials, space, and defense markets. While first quarter revenues and earnings were slightly ahead of expectations, the commercial aerospace industry continues to be challenged by lower build rates. Although management has chosen to withhold financial guidance due to uncertainties associated with COVID-19, they expect commercial aerospace sales to gradually increase as destocking pressures recede. Hexcel's stock price rose 12% and we added to the position during the quarter.

In the Utilities sector, **Sunnova Energy International Inc.** is a provider of residential solar and energy storage services. Its shares fell -7% as revenues were slightly below projections. They performed 8,900 new installations in the quarter, bringing the total installed base up to 116,400.

One of our strategy's purchase rules is based on the range of market capitalizations in the **Russell 2000 Growth Index** following its annual reconstitution. After the reconstitution at quarter end, the largest stock in the index had a market capitalization of \$11.0 billion. While the strategy's guideline limits new positions outside the benchmark at the time of initial purchase to less than 75% of the largest name in the benchmark—or \$8.2 billion based on the new benchmark—we will move our limit only to \$6.0 billion from the current level of \$4.0 billion. The lower end of the purchase range moves from a market

capitalization of \$63 million to \$31 million, which matches the smallest stock in the benchmark.

Though TimesSquare continues to operate remotely outside of our NYC office, we expect to have a gradual return in the fall. In the meanwhile, we are very pleased to announce that Reuben Scherzer joined TimesSquare in June as a Research Analyst. Reuben is responsible for coverage of Europe and other non-U.S. regions within the Developed, Emerging, and Frontier Markets.

Heading into the second half of 2021, market returns continue to anticipate economic growth as their focus turns to 2022 and the pain of 2020 fades. However, the amount

of growth already reflected in current valuations is debatable. Higher vaccination rates bolster the outlook, though the appearance of COVID-19's Delta variant generates anxiety. The pace of inflation means the transitory period may last longer than some expect, though the Federal Reserve seemed less concerned about inflation as much as beginning internal discussions on tapering its monetary easing stance. All told, we see the typical mixture of opportunities and risk that we as active investors seek to balance in our bottom-up assessments. As always, we are available for any questions you might have as we endeavor to protect the assets you have entrusted with us.

## **General Disclosure:**

*The holdings discussed represent a particular point in time. It should not be assumed that the securities continue to be held, and/or continue to be held in the same percentage, and/or were held continuously throughout the period. In addition, the holdings of a particular client account may differ from the information provided. Securities discussed do not represent the entire portfolio and, in aggregate, may represent only a small percentage of a portfolio's holdings. Information is subject to change without notice. It should not be assumed that any of the securities discussed were or will prove to be profitable. Past performance does not guarantee future results.*

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## **Composite & Performance Disclosure:**

*Performance is measured against the Russell 2000® Growth – a market capitalization-weighted index that measures the performance of those Russell 2000® companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 2000® Growth Index, are based on gross-of-fee returns. Russell Investment Group is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto.*

*This composite invests in stocks with market capitalizations generally between \$91 million and \$3.5 billion at time of purchase. The process is fundamental research driven. The investment style is growth. Portfolios will hold approximately 90-120 stocks. Historical turnover has averaged 53% per year. Composite inclusion threshold \$5mm. Fee basis is 100 basis points. The composite creation date is October 1, 2000.*

*Effective 04/01/2015, TimesSquare removes accounts from this composite when significant cash flows occur. A significant cash flow is defined as an external flow that exceeds 10% of the composite's market value on the day of the cash flow. Effective 01/01/2017, the significant cash flow policy has been removed.*

*In July 2014, TimesSquare modified its purchase capitalization range to match the changes in the small cap market as represented by the Russell 2000® Growth Index. The purchase range was amended to reflect a range bounded by the approximate value of the smallest security in the index (in most cases) and the approximate value of 75% of the largest security's capitalization. These targets will be maintained for the subsequent 12 months, and may be adjusted based on the above rules each July following the reconstitution. In that manner, the targets would be responsive to higher or lower capitalization profiles of the indexes over time. Previously, in June 2012, TimesSquare had modified its purchase capitalization range to match the changes in the small cap market as represented by the Russell 2000® Growth Index at that time, with a change from \$50 million to \$1.5 billion at time of purchase to \$50 million to \$2 billion.*

*The performance figures shown are calculated in U.S. dollars on a size-weighted basis and reflect the reinvestment of dividends and other earnings, and the deduction of brokerage commissions and other transaction costs. Performance is provided on a gross basis (before the deduction of management fees) as well as net of the highest management fee of 1.00% charged by TimesSquare to separately managed institutional accounts in this composite. Investment advisory fees generally charged by TimesSquare are described in Part 2A of its Form ADV. This composite may contain some accounts that have used performance based fees. To illustrate performance net of fees, assume \$20,000,000 is placed under management for ten years sustaining 10% compound gross total return. If an advisory fee of 1.00% of average assets under management is charged per year, for each year of the ten-year period, the resulting compound annual return would be reduced to 9.0%. The ending dollar value of the account would be \$47,347,274 compared with the unreduced account value of \$51,874,849.*