

## U.S. Small Cap Growth Strategy

### Representative Commentary — 1Q23

Performance	Annualized					
	1Q23	1YR	3YR	5YR	7YR	10YR
U.S. Small Cap Growth Composite (Gross)	7.95%	-7.23%	16.58%	7.49%	11.01%	10.14%
U.S. Small Cap Growth Composite (Net)	7.69%	-8.16%	15.43%	6.43%	9.91%	9.06%
Russell 2000® Growth Index	6.07%	-10.60%	13.36%	4.26%	8.74%	8.49%

*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.*

It was a rollercoaster ride for global equity markets for the quarter, featuring considerable volatility. Most indexes ended positively in the mid-to-high single digits. The year began with optimism fueled by China's reopening of its borders to tourists. A mild winter along with decreased energy demand brought welcome relief to Europe. These signs of vigor have been recognized by central banks, which may need to take action for longer than previously anticipated in order to bring inflation under control. Global manufacturing activity has decelerated, though it appears the supply chain challenges are fading. Geopolitical uncertainty remains a prominent consideration, with the war in Ukraine passing the one-year mark.

In the U.S., equities weathered a banking crisis, cryptocurrency meltdowns, and a lack of clarity for what is in store for the economy. While the labor market remains strong, consumers continue to dip into savings that were accumulated during the pandemic. Home prices are falling across much of the country, with elevated mortgage rates dampening purchase activity. The Federal Reserve raised interest rates by 25 basis point increments for both February and March, while also keeping a watchful eye on lending in recognition of recent banking system stress. Growth outperformed value by a wide degree, with lower valuation stocks lagging among small-to-mid capitalization growth companies. The Energy sector gave up some of its past gains with falling oil and natural gas prices.

Amidst this environment, the portfolio outperformed the Russell 2000® Growth Index in the first quarter. There was relative weakness in Consumer Discretionary, Consumer Staples, and Energy. That was more than offset by strength from our positions in the Financials, Health Care, Industrials, and Information Technology sectors.

In Consumer Discretionary, **Leslie's Inc.** is the largest omnichannel specialty retailer of swimming pool supplies, spa supplies, services, and related products. Mixed fiscal first quarter results caused its stock to dip by -10%, with revenues above consensus estimates and earnings below. Wet weather in Texas and California reduced same-store sales in those states. **National Vision Holdings Inc.** is an optical specialty retailer operating under the America's Best, Eyeglass World, and Visa Optical brands. Their fourth quarter earnings came up short versus sell-side projections, though revenues were in line. Management cited a difficult operating environment, particularly for their lower-income customers. The company's 2023 outlook was slightly below estimates, incorporating continuing constraints on eye exam capacity due to a shortage of optometrists. We decided to liquidate the position, which fell -40% for the time it was held this quarter. **Planet Fitness Inc.** franchises and operates fitness centers across the U.S., Puerto Rico, Canada, Panama, Mexico, and Australia. They beat expectations for revenues and earnings in the latest quarter. Planet Fitness opened 58 new clubs systemwide to reach 2,410 locations. It appears the market was disappointed by their initial full-year development plans of 160 clubs, which was below the consensus level of 175 and that caused its shares to pull back by -1%. More positive was the 20% gain from **Visteon Corp.**, an automotive technology company that designs and manufactures automotive electronics and car

connected solutions. Their fourth quarter results surpassed Street expectations with sales growth driven by the ramp of recently launched products, favorable pricing, and automotive production growth. Visteon is well positioned to benefit from a secular trend in vehicles for larger digital dashboards. **Wingstop Inc.**, a franchiser and operator of quick service restaurants, rose by 34%. The company posted a solid fourth quarter on higher customer traffic and by opening 61 new locations. Management reaffirmed guidance for same store sales and future new store openings. The stock price of **Boot Barn Holdings Inc.** climbed 22% for this lifestyle retail chain for western and work-related footwear, apparel, and accessories. Its fiscal third quarter results were on par with their preannouncement. Management indicated they are moving through higher cost merchandise at a faster pace than expected. As such, gross margins pressures are expected to abate. New to the portfolio this quarter is **European Wax Center Inc.**, a franchiser and operator of body and facial waxing service locations. They reported strong results and initial 2023 guidance is in line with the Street. Despite a challenging economic backdrop, waxing has continued to hold up as an essential service.

Within Consumer Staples, consumer packaged food and beverage company **Simply Good Foods Co.** offers products under the Atkins and Quest brand names. Their stock edged forward 4% on mixed quarter results, lagging the benchmark sector average of 7%. While revenues were in line, gross margins missed due to higher supply chain costs. We trimmed the position. Warehouse club operator **BJ's Wholesale Club Holdings Inc.** rallied 15% after reporting better-than-expected sales and earnings for the fourth quarter. Customer traffic and groceries were the primary catalysts. There is continuing evidence that consumers are trading down in this inflationary environment. BJ's membership rolls have grown steadily.

In the Energy sector, **Cactus Inc.** designs and manufactures a range of pressure control equipment for the energy industry. They reported a strong beat to profit expectations as the company continues to take market share in its core wellhead business and margins continue to improve. While there is some apprehension with respect to drilling activity in recognition of the drop in natural gas prices, management is seeing a pickup in oil basin activity. Nevertheless, its shares sold off by -17% and we added to the position. **Matador Resources Co.** is an exploration and production company operating in Southeast New Mexico and West Texas. Fourth quarter results were strong, with beats across most of its operating metrics. However, forward guidance was met with disappointment and that caused its stock to slip by -16%. Production estimates are lower than sell-side projections, while capital expenditures were higher. Earlier this year, Cactus and Matador announced acquisitions, which we view as positive. While both companies possess strong balance sheets, these deals may have caused angst on the part of some investors.

Within Financials, wealth management services company **Focus Financial Partners Inc.** advanced 36% on news that they are being acquired by Clayton Dubilier & Rice. We booked profits and sold out of the position on this development. Another credit to the sector came from the 17% gain for **Hamilton Lane Inc.**, an investment firm specializing in direct and fund of fund investments. Third quarter results exceeded estimates on higher incentive income and lower operating costs. Specialized funds were an area of notable strength. **Flywire Corp.** is a global accounts receivable platform specializing in areas such as education, healthcare, travel, and business-to-business verticals. Its shares rose 20% on the heels of revenues and operating earnings exceeding the consensus. Flywire managed to overcome the impact of foreign currency headwinds and continues to gain new clients with enhanced offerings. The portfolio's single bank holding is **MVB Financial Corp.**, which retreated by -6%. In early March, they announced the divestiture of Chartwell Compliance to Ankura Consulting Group. While we realize the uneasiness associated with investing in regional banks, MVB's unique aspect is that it serves as a key financial service partner for gaming companies such as FanDuel and DraftKings.

In the Health Care sector, **Heska Corp.** is a provider of veterinary and animal health diagnostic products. Its stock price leaped forward by 57% after reporting fourth quarter results were better-than-expected, mainly driven by its consumables segment. Gross margins benefited from the rolling off lower margin legacy products to a more favorable mix. During the quarter, they completed the acquisition of LightDeck Diagnostics, a pioneer in planar waveguide fluorescence immunoassay diagnostics. **PTC Therapeutics Inc.**, a biopharmaceutical company focused on the discovery and development of medicines for patients with rare disorders, jumped 27%. Fourth quarter results were aided by its therapeutics for treating Duchenne muscular dystrophy. Of note, several pivotal trials are underway for other therapies and indications. In the latter part of the quarter, PTC announced its CEO would be retiring after 25 years at the helm and to be replaced by its current Chief Operating Officer as part of an orderly succession plan. **Certara Inc.** provides software products and services to consumers for bio-simulation in drug discovery, clinical research, and regulatory submissions. The stock improved by 50% on a solid beat to estimates, aided by new business bookings. Management commented on healthy fundamentals for its core bio-simulation business as demand for clinical development services remains resilient.

Partially countering these positives was the -26% decline of **Silk Road Medical Inc.**, a medical device company focused on treating carotid artery disease. The company posted solid fourth quarter revenues on growing TCAR adoption. Gross margin came in a touch below estimates. Management's initial 2023 guidance points to healthy revenue growth, however, much of it is expected to come from the back half of the year due to planned territory expansion and increasing revenues per procedure. We decided to trim the position. **HealthEquity Inc.**'s consumer-directed benefits platform enables individuals to choose health savings accounts, pay healthcare bills, compare treatment options, as well as receiving wellness & clinical information. Fiscal fourth quarter revenues and profits outpaced consensus estimates. Management raised forward guidance due in light of a more favorable yield environment and expectations for a neutral job market. Its -4% slide appears to be based on the belief the Fed would cut interest rates if the banking crisis becomes more widespread. We decided to trim the position. **Ascendis Pharma**, a biopharmaceutical company focused on developing therapies for unmet medical needs dropped -12% despite having in-line fourth quarter sales of the company's Skytrofa therapy, which is approved to treat growth hormone deficiency in children. Going forward, management expects Skytrofa sales to exceed current estimates, driven by the continued increase in patient population reimbursements. **AtriCure Inc.** develops and produces devices for the surgical ablation of cardiac tissue. While overall results were in line its pre-announcement, minimally invasive ablation revenues have not grown as anticipated and that caused its shares to trade down by -7%

The Industrials sector was home to two of the portfolio's strongest contributors this quarter. **ESAB Corp.**, a manufacturer of welding equipment and consumable products, surged ahead by 26%. Upside to Street projections came from the combination of higher prices and sales volume growth. Forward guidance was better-than-expected. We trimmed the position on this strength. **WNS Holdings Ltd.** is a business process management company supplying data, voice, analytics, and transformation services. Its stock was lifted 16% by the combination of solid results and higher forward guidance. During the quarter, WNS added 11 new clients and expanded relationships with 24 existing customers. **ExlService Holdings Inc.** operates as a data analytics and digital operations company. The company reported a strong fourth quarter and offered solid guidance. For the latest quarter, analytics was very strong and outsourced digital solutions also grew nicely. They signed 19 new customers. Despite these positives, its shares sold off by -5% and we added to the position on this weakness. The stock price of science and engineering consulting services provider **Exponent Inc.** increased by 1%. This fell short of the benchmark average return of 7%. The company beat fourth quarter estimates for revenues and earnings. Forward guidance was also solidly above expectations. Despite challenging economic conditions, Exponent hasn't experienced an adverse impact on its business. Management attributes the resiliency of customer demand to the mission-critical work they are performing, and we decided to add to the position.

In the Information Technology sector, **Allegro Microsystems Inc.** is a fabless manufacturer of sensor integrated circuits (ICs) and application-specific analog power ICs for motion control and energy efficient systems, mainly focused on the automotive industry. They reported a very good quarter, with revenues coming in at the high end of guidance and earnings exceeding projections. Its shares rose 59% and we trimmed the position on this strength. **Vertex Inc.** provides tax technology solutions for the retail, communications, retail, technology, and manufacturing industries. Strong fourth quarter results and full-year guidance ahead of the Street led to a 43% boost for the stock. While there were some instances of elongated sales cycles and increased sales scrutiny, both factors had a limited impact on overall results. Importantly, subscriptions represent 85% of total revenues. **Onto Innovation Inc.** supplies process control tools to ensure quality control of semiconductor manufacturing. Fourth quarter results were modestly above expectations. It appears that management acted conservatively by issuing lower-than-anticipated first quarter guidance due to a softer memory market. Onto is implementing cost-saving actions to boost margins. Those actions were well received by the market with its share bid up by 29%. **JFrog Ltd.** is a software company that offers a platform to efficiently manage and distribute software updates. Mixed fourth quarter results coupled with lower-than-expected revenue guidance caused the stock to fall by -8%; management called out a progressively worsening macroeconomic environment with business being pushed out and an increased amount of deal scrutiny. **Q2 Holdings Inc.**, a supplier of cloud-based digital banking solutions for financial institutions, pulled back by -8%. Management noted a contract termination as the cause of coming up short versus the Street. This appears to have been an international alternative finance customer that was part of an acquisition. While this loss of non-core business represents a headwind to revenues, it is expected to be net positive from a margin perspective. Impressively, the quarter represented the highest sales in company history. We trimmed the position. **PowerSchool Holdings Inc.** offers cloud-based software to the K-12 education market. The company posted a solid fourth quarter, with improving margins. Revenue guidance for 2023 was slightly below consensus estimates due to a slight delay in the signing of a large contract and that triggered a -15% retreat. Of note, net revenue retention has increased for five consecutive quarters supported by renewals and cross-sell activity. We added to the position.

While recession concerns persist, employment data has remained stable. Earnings reports include cautious guidance amid macroeconomic uncertainty. As bottom-up investors, we remain focused on business fundamentals. While quality can be in and out of favor by the market at certain points, we believe these types of businesses are well positioned to perform well over time. As always, we are available for any questions you may have as we endeavor to protect the assets you have entrusted to us.

## **General Disclosure:**

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### **Firm and Composite Information**

*TimesSquare Capital Management, LLC ("TimesSquare") is a registered investment adviser that is owned by the former equity management team of TimesSquare Capital Management, Inc. ("TimesSquare Inc.") and Affiliated Managers Group, Inc. TimesSquare was formed to manage TimesSquare Inc.'s growth equity investment advisory business which was sold to TimesSquare in a transaction that closed on November 19, 2004. From October 1, 2000 to November 18, 2004, the performance is that of the TimesSquare Inc. small cap composite. From November 19, 2004, the performance is that of the TimesSquare small cap composite which consists of all small cap accounts managed by the team at TimesSquare and TimesSquare Inc. There has been no change in the investment management responsibility or strategy from the prior firm.*

*This composite invests in stocks with market capitalizations at time of purchase generally within the range of capitalizations of stocks in the Russell 2000 Growth Index. The process is fundamental research driven. The investment style is growth. Primary selection criteria include quality management, distinct competitive advantage, and strong, sustainable growth. Portfolios will hold approximately 90-120 stocks. Historical turnover has averaged 54% per year. Composite inclusion threshold \$5mm. Fee basis is 100 basis points. The composite creation and inception date is October 1, 2000.*

*From 04/01/2015 until 12/31/16, accounts are removed from the composites 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 January 1, 2017 this composite does not have a significant cash flow policy.*

*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.*

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*TimesSquare's list of composites is available upon request. Past performance does not guarantee future results. The firm's list of limited distributed pooled funds are available upon request.*

**Benchmark**

Performance is measured against the Russell 2000<sup>®</sup> Growth – a market capitalization-weighted index that measures the performance of those Russell 2000<sup>®</sup> companies with higher price-to-book ratios and higher forecasted growth rates. All indexes, including the Russell 2000<sup>®</sup> Growth Index, are based on gross-of-fee returns. FTSE Russell is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto. Benchmark returns are not covered by the report of independent verifiers.

**Performance Calculations**

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 fee level from the standard fee schedule listed for this strategy during the period presented. 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.

Internal dispersion is calculated using the equal-weighted standard deviation of all accounts included in the composite on a gross basis for the entire year; it is not presented for periods less than one year or when there were five or fewer portfolios in the composite for the entire year.

The three-year annualized standard deviation measures the variability of the composite and the benchmark returns on a gross basis over the preceding 36-month period. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

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