TIMESSQUARE
CAPITAL MANAGEMENT, LLC

U.S. Small Cap Growth Strategy

Representative Commentary — 4Q23

Performance

			Annualized			
	4Q23	**1YR**	**3YR**	**5YR**	**7YR**	**10YR**
U.S. Small Cap Growth Composite (Gross)	9.42%	17.11%	-2.12%	10.74%	10.19%	8.11%
U.S. Small Cap Growth Composite (Net)	9.15%	15.96%	-3.09%	9.65%	9.10%	7.05%
Russell 2000® Growth Index	12.75%	18.66%	-3.50%	9.22%	8.07%	7.15%

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.

After prior weakness, in the fourth quarter the global equity markets closed out 2023 with their highest quarterly returns this year.

- That rebound was bolstered by central banks pausing rates increases, but it may be premature to declare victory over inflation and plot a near-term pivot to monetary easing.
- Though in the fourth quarter, that speculation led to a rally benefiting global equities—especially small & microcaps and emerging markets.
- Concerns surrounding wage inflation and access to skilled workers generally abated across markets, with the notable exception of Japan where that remains a significant challenge.
- Other than Beta and in the U.S. Volatility, style factors had limited influence on returns this quarter.

As our investment team meets with companies, reviews recent earnings reports, and surveys the global landscape, they note several investment dynamics that inform our positioning:

- Regarding **Technology**, <u>cybersecurity</u> remains a top priority for companies, propelled by recent well-publicized cyberattacks at MGM Resorts, Caesars Entertainment, and Clorox. Coincidentally, new SEC disclosure rules on cyber risks took effect in December 2023. Those require additional governance rules for each company's cyber risk management strategy, how adept the board is in those matters, and timely disclosures for material cybersecurity incidents. Our channel checks indicate that IT budgets will continue growing, with cybersecurity becoming an increasing percentage. Globally, Gartner Group forecasts an 8% growth in IT spending for 2024.
- In 2023 for **Health Care**, market enthusiasm for <u>GLP-1 obesity treatments</u> nearly equaled that for artificial intelligence. Though moving into 2024, that market frenzy has waned. Broader <u>biopharma strengthened</u> with many new drug trials underway. With the pandemic well behind it, the FDA has a more constructive and predictive stance with a normalized schedule for meetings and onsite inspections.
- Many **Industrials** holdings benefit from <u>lower costs and greater capital expenditures</u>. Transportation costs appeared to have bottomed after declining for the past two years. The less-than-truck load carriers we favor fared much better with pricing than other modes of transportation in 2023 and should see price increases in 2024. Industrial capital expenditures may continue to be a bright spot for several years as structural labor challenges are addressed with greater automation and supply chains localized, particularly away from China. Additionally, the U.S. is in the early stage of increased domestic infrastructure spending related to recent government programs.

Among U.S. small to mid cap growth stocks in the fourth quarter, the best returns were found among those with the lowest quality (by return on equity) or lacking earnings. Also notable was that low risk (beta) stocks were notable laggards. Amidst this environment, the portfolio underperformed the Russell 2000® Growth Index in the fourth quarter.

Our preferences in the Consumer-oriented sectors lean toward value-oriented or specialty retailers, franchise models, or premium brands. Flying 41% higher was **Wingstop, Inc**., the franchisor and operator of quick service restaurants for cooked-to-order chicken wings. Revenues and earnings leapt above expectations. Transactions increased meaningfully, including significant growth of digital sales. At the same time, chicken costs decreased. That led Wingstop's management to increase its guidance for the balance of the year and we trimmed our position. Offsetting that was the -10% pullback from **Visteon Corporation**, which designs and manufactures automotive electronics, primarily for driver information and display clusters. Its revenues were shy of expectations, though earnings were better than expected and management lifted its guidance. While the UAW strike settlement was a positive development for automotive production in the short term, concerns grew for EV component providers as EV supply exceeded demand. Even though Visteon's digital cockpit solutions are used across all types of vehicles, notable future growth is expected from its wireless battery management systems for EVs. Because EV sales rates might take several quarters to reaccelerate, we trimmed our position in Visteon. We actively traded our position in the warehouse club operator **BJ's Wholesale Club** during the quarter. BJ's revenues and earnings edged higher than anticipated, though excluding gasoline purchases, revenues were flat and less than expected. Store traffic increased, but deflation offset that. We projected some weakness ahead of time, and we trimmed our position prior to the earnings report. With plans for additional membership incentives and new store openings, we believe management has reset expectations for the future. As its shares slipped by -7% after the report we added back to our position. In other trading, we initiated a position in **Adtalem Global Education,** which provides postsecondary education, focused primarily on nursing and similar health professions such as veterinarians and doctors. Formerly DeVry Education, a new management team divested nearly all the past for-profit education operations and pivoted to several areas within Health Care. Having met with the new team and watched the transformation over the past few years, we believe Adtalem is at an inflection point for growth in enrollments and profitability.

In the Financials sector we tend to avoid banks that face credit deterioration or rising deposit costs, preferring either asset managers or niche insurance companies. One such example was the 26% gain from **Hamilton Lane.** Providing private markets investment services, Hamilton Lane's recent fundraising has been on track, especially for its new Evergreen products (most private investment funds have finite lifespans). That led to steady growth in the firm's assets under management and fee-earnings, though we trimmed our position on its strength. Detracting from results was a -28% decline from **Flywire Corp**., a global payments platform focused on education, health care, and travel industries. Flywire's revenues only met expectations, although earnings were better. During the recent reporting period, there were transitional issues such as greater headwinds from adverse foreign exchange rates and delays implementing systems for new clients. Although we think highly of the management team, in our follow-up discussions with Flywire, it was not clear what would rejuvenate the share price over the next several quarters. We began trimming the position with plans to completely exit it. This sector was also home to the quarter's greatest detractor—**ProAssurance Corporation** and its -27% showing. Providing medical liability insurance to practitioners throughout the U.S., ProAssurance's earnings fell short of expectations. Although its primary malpractice insurance business was good, its smaller workers' compensation business fared poorly as it faced notable medical cost inflation. That was enough to weigh on overall underwriting results. We had trimmed the position prior to the report in the face of potential risks, and did so again afterward, though the company's valuation based on the malpractice business remained very attractive.

Our preferences among Health Care stocks are those companies providing novel therapies for unmet needs that deserve premium pricing, or specialized service providers. We benefited from **Ascendis Pharma's** 34% gain. A biotechnology developer of treatments for rare indications in endocrinology and oncology, Ascendis announced positive results from its Phase 3 trial to treat adult growth hormone deficiency. There was a -4% decline from **Shockwave Medical**, which develops intravascular devices for calcified cardiovascular diseases. The company's revenues and earnings exceeded expectations, though management did not increase its guidance for the first time since the beginning of the pandemic. That hesitancy stemmed from private insurers increasing the need for preauthorization for treating peripheral arterial disease and a Chinese anti-corruption campaign hampered restocking for Shockwave's joint venture in China. However, Shockwave's outlook for 2024 remained strong and we added to our position on the near-term weakness. Skipping a beat was **AtriCure, Inc**., a medical device developer of instruments to treat atrial fibrillation. Its shares trended down -19% this quarter on concerns that anti-obesity drugs would obviate the need for these types of cardiovascular medical devices. Despite reporting better-than-expected results and an upbeat forecast by AtriCure's management, many of those market worries lingered. Not for us though, and we added to our position. We also began a position in **RAPT Therapeutics**, a developmental biotechnology company focused on inflammation and immunology therapies. RAPT's primary treatment, Zelnecirnon, is in late clinical trials to address moderate to severe atopic dermatitis (eczema) with a differentiated oral treatment compared with the current injectable therapies. Results from the current trial are expected in mid-2024, and early indications have been promising. Since our initial purchase, RAPT's shares rose 51% during the balance of the quarter.

Many of our Industrials positions provide necessary business-to-business operational services, highly technical components, automation & efficiency improvements, or essential infrastructure services. Here there was a strong contribution from the global welding company **ESAB Corporation.** Revenues and earnings outstripped expectations. Business activity was stronger than anticipated with resilience in most markets and steady volumes, especially from emerging markets. ESAB's management increased its guidance, and we trimmed our position during its 23% climb. Similarly, there was a 29% gain from **AZEK Company**, which we trimmed on its strength. This manufacturer of wood-alternative decking, railing, trim, and moulding reported better-than-expected revenues and earnings. There was particularly strong growth from residential sales—more than offsetting weaker non-residential sales. AZEK gained market share, projected future price increases, and bought back $61mn of its shares. Slipping by -8% was **WNS Holdings**, which provides business process management services—including customer interaction, finance and accounting, and data analytics—to a variety of industries. Its results were in line with expectations, though management reduced guidance for the balance of its fiscal year. Although the core business continued generating significant cash flows, WNS noted that a recently signed contract for a captive insurance operation was taking longer than expected to start—and generate revenues. The company also saw hesitancy from a travel industry client who projected more conservative growth levels. Out of caution, recognizing some of these one-offs need to clear before its shares reaccelerate, we trimmed our position in WNS. Elsewhere, we sold our shares in **Zurn Elkay Water Solutions,** which specializes in water management products predominantly for institutional and commercial buildings. The stock price exceeded our target and what we believed to be full valuation. New to the strategy was **ICF International**, which provides government consulting with specialties for the Energy, Health, Education, and Environment agencies. With a focus on civilian agency activities that enjoy bipartisan support, we project increasing growth from new government programs as well as ICF's work with ongoing IT modernization for those agencies.

Among the wide variety of Information Technology companies, we prefer critical system providers, specialized component designers, and systems that improve productivity or efficiency for their clients. Posting a 0% return—lagging the benchmark sector average of 14%—was **Workiva Inc.**, a leading cloud-based compliance and regulatory reporting platform. Workiva's revenues exceeded expectations, though its earnings were lower because of a one-time interest expense. The relative share price weakness stemmed from management's conservative guidance for its final fiscal quarter that incorporated the uncertain macroeconomic environment and Workiva shedding some low-margin businesses. Meanwhile, the company signed new customers and released updates to current financial reporting systems that should lead to better margins and further improve Workiva's profitability. This sector was also home to the strategy's greatest contributor, **JFrog Ltd**., and its 36% gain. Providing systems to manage and speed the release of software updates from developers to users, JFrog reported higher-than-anticipated revenues and earnings. Revenues from its cloud-based offerings accelerated, leading to improvements in subscriptions and annual recurring revenue. Lastly, we added a new holding with **FormFactor, Inc.**, which manufactures consumable interfaces between semiconductors and testing equipment. FormFactor's probe cards and probe stations connect the highly specialized testing equipment with semiconductor wafers, and the cards are disposed of after testing. FormFactor has limited competition and should benefit from projected growth in chip volumes and complexity.

Looking forward into 2024, markets will keep a close eye on central banks and the polls. Early indications are for some monetary easing, though there is a wide divergence on when that may occur. This year will also be one of the biggest for global elections. Including the U.S., Taiwan, India, Mexico, and expectations for the U.K., there will be nearly 40 national elections. That all but guarantees shifting fiscal policies as over 40% of the world's population heads to the voting booths. With those influences beyond our control, we focus on how our portfolio companies plan to navigate this environment. Many showed improving fundamentals toward the end of 2023 that we expect to continue into 2024 and beyond. As bottom-up investors, we seek underpinnings to near-term valuations in the form of expected earnings growth and other business fundamentals. We continuously review the business models and management teams of current and potential holdings, and fine tune our own valuation models on an ongoing basis, as we endeavor to protect the assets you have entrusted with us. As always, we are available for any questions you might have.

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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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.

The opinions and information expressed and provided are for general information only and are not intended to provide specific advice or recommendations but rather, a basis from which strategies can be built, taking into account the specific objectives of each portfolio, in terms of return, time horizon, and risk constraints, as well as diverging investment perspectives and assumptions. All material has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.

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® 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. 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. To receive additional information regarding TimesSquare Capital Management, LLC, including a GIPS Composite Report for the strategy presented in this commentary, contact TimesSquare at info@tscmllc.com.