SMALL CAP CORE GROWTH

Portfolio Comments
September 30, 2023

Commentary

It was a rough quarter for the stock market. All indices suffered losses this quarter, battered by surging oil prices and fears the Fed's higher-for-longer rates strategy means another hike this year. Also weighing on investor minds was the US government shutdown, that is now temporarily resolved. Granahan's Core Growth strategy returned - 10.7% in the quarter ending September 30, 2023, lagging the Russell 2000 Growth Index return of -7.3%. Year to date, we are down -0.6% and the Index is up +5.2%.

In a reversal from last quarter when strength in the portfolio came from Core Growers, four of the biggest detractors to performance this quarter were Core Growth companies. **Magnite**, our strongest performer last quarter, was hit by a weaker than expected ad market. Their digital advertising technology solution has been taking share of the connected TV market, which is a higher margin business, so we are holding the stock. **Kornit**, another strong performer last quarter, reported revenues slightly below consensus, though the adjusted EBITDA loss was better than expected. Demand remains muted for their systems as customers hold off purchasing because of the uncertain macro environment. We are holding the stock as the company has a suite of products leading the shift from analog to digital printing in the garment and textile industries. **Euronet** is an industry leader providing secure electronic financial transaction solutions largely through ATMs in foreign geographies. European ATM transaction volume was lower than expected as travelers' budgets were cut from inflationary pressure. We believe near-term headwinds can be offset by new products, new geographies, and most importantly, strength in its digital channel. The stock is trading at the low end of its historical valuation range, and we are maintaining the position. **Portillo's** is a restaurant brand in growth and expansion mode but is not being met well by investors in the current macro environment. While new locations are opening successfully, several openings have been pushed out to Q1-2024 rather than Q4-2023. We have been adding modestly. Investors sold **Indie Semiconductor** because two customers pushed orders out for a few quarters. This pioneering company received a huge contract from Bosch, is ramping with General Motors and has several customers ramping ahead of schedule increasing the company's long-term visibility. We believe growth will be much stronger than its industry peers, yet valuation is lower. We are holding the stock.

Partially offsetting the detractors above were three Special Situations: **Texas Capital Bancshares**, **Grid Dynamics Holdings** and **Chart Industries** and two Pioneers: **Castle Biosciences** and **Nutanix**. Texas Capital rebounded during the quarter as fears about a regional bank crisis eased. Texas Capital stands out versus other banks given its strong capital and liquidity positions, and the stock remains compelling as it is trading around tangible book value. We expect the company's ongoing strategic plan to significantly improve profitability and serve as a catalyst for the stock. Given the relative outperformance, we trimmed the position though it remains a top holding. **Castle Biosciences** is a diagnostics company improving health through innovative tests that guide care decisions for patients with cancer. The company has a portfolio of tests for skin cancers, Barrett's esophagus, and mental health conditions. During the quarter, Castle

Biosciences' stock rose as investor concerns eased regarding the reimbursement outlook facing both the company and industry. We increased our position as we are gaining confidence in the significant value Castle's skin cancer tests provide and its attractive long-term growth outlook. **Nutanix** is a leader in the hyperconverged infrastructure market, a cloud platform that integrates servers, virtualization, and storage into one solution. New financial metrics provided at Nutanix's recent Analyst Day highlighted its sustainable, profitable growth with strong operating margins and FCF leverage. We are maintaining our position. The valuation of **Grid Dynamics**, a digital transformation strategy consulting firm, became very compelling after a tough second quarter where margins came under pressure from acquisition-related, benched headcount and foreign exchange headwinds. The company is a beneficiary of AI related projects which is an upside driver to growth. We have trimmed on the rebound in the stock.

Year-to-date detractors are three core growth names: **SVB Financial Group** (financial services), **Digital Turbine** (mobile software), and **Super Micro** (GPU servers) and two Pioneers: **Azenta** (lifescience products) and **Kezar** (autoimmune drugs).

Positives for the year-to-date performance include: **Quanterix** (life sciences), **Immunogen** (biotechnology), **Chart Industries** (industrial), **VitaCoco** (consumer) and **Veeco** (semiconductor equipment).

Attribution

For the quarter, our underweight in Industrials, Energy and Consumer Discretionary sectors were the largest penalties to performance. Our stock selection here did not help. In the Energy space, we own green energy companies, and the traditional energy companies are what drove performance in the Russell 2000 Growth Index this quarter. We are overweight Healthcare and Technology, both sectors that underperformed in the Index. Our stock selection in these sectors was comparable to that of the Index. Positive attribution came from strong stock selection in the equally weighted Basic Materials and Financial sectors. Utilities, Telecommunications and Consumer Staples were minor players in the attribution equation. In terms of LifeCycles, Special Situations led the way for performance this quarter, with Pioneers following and Core Growth lagging the most.

Year-to-date, the largest detractors to performance were the Industrial and Financial sectors. We were underweight Industrials, and both sectors suffered from poor stock selection. Technology's overweight helped attribution, but stock selection in Technology, Consumer Discretionary, Telecommunications and Energy hurt performance. In Healthcare, our overweight hindered performance but stock selection helped. Stock selection in Basic Materials, Consumer Staples and Utilities was positive. Pioneers have led year-to-date, followed by Special Situations with Core Growth the laggard.

Weightings

There have been only slight changes in the sector weightings of the portfolio on a quarter over quarter basis. Year-to-date, Technology is down 2%, Industrials are up 1.5%, and Healthcare is up 0.5%. Pioneers are down 2%, largely from trimming winners like Quanterix and Apellis. Special Situations are up 2% from the relative outperformance of these stocks versus Core Growth and Pioneers, and the addition of a few new names.

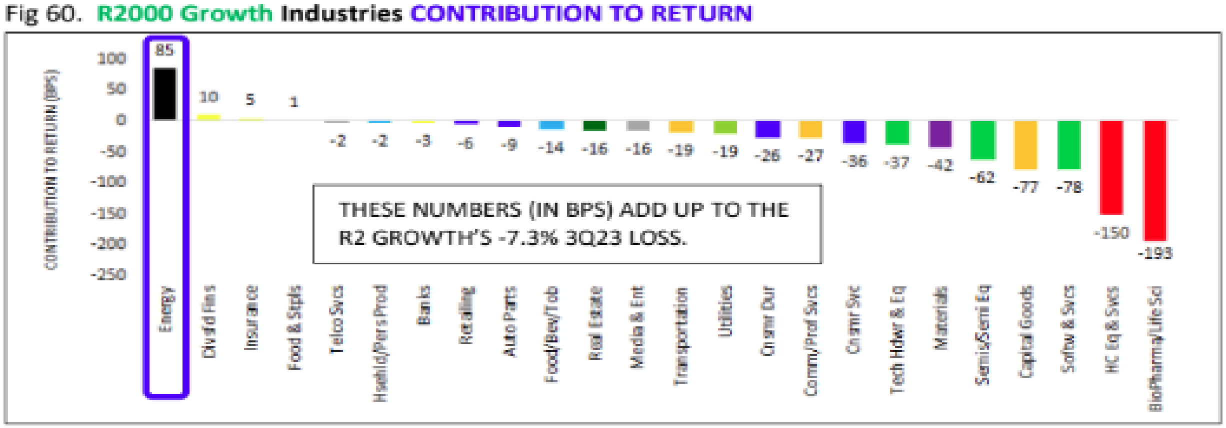
Themes

Immense data sets are being processed and analyzed at a scale never seen before. This massive data-driven approach demands expansive computational resources and infrastructure. Data centers are increasingly facing the challenge of meeting the burgeoning demands of energy intensive AI tasks. As AI continues to evolve, integrate into industry, and underpin emerging technologies - the need for more and larger data centers becomes necessary. These expanded data facilities will not only offer requisite storage and computational capabilities, but also ensure that AI models function optimally. Companies in our portfolio that help facilitate this growth are **Cogent Communications Holdings**, **Ciena**, **Vicor** and **Monolithic Power**.

According to Orbimed, valuations on most healthcare stocks are at or below those seen before the 2000 dot.com bust, the 2008 Global Financial Crisis, and the Hilary Clinton drug pricing tweet in 2015. Around a quarter of biotech companies are trading at less than the net cash on their balance sheets. Low valuations should, in theory, spark takeovers and we're seeing M&A activity on track to be at the highest level in four years.

Looking at the chart below, you will see that the best performing sector of the Russell 2000 Growth Index for the quarter was Energy. And it was traditional energy, not green innovative energy companies. We are overweight BioPharma and Life Sciences, Healthcare Equipment and Services, and Software and Services, which have been the worst performing sectors of the Russell 2000 Growth Index of late. Our overweights in these sectors are typical for us, as these sectors are ones in which innovation and secular growth live. We continue to find exceptional companies driving dynamic change in these sectors. We have scrubbed and continue to scrub our portfolio to ensure that our investment cases are not overly optimistic given the current environment.

Fig 60. **R2000 Growth Industries CONTRIBUTION TO RETURN**



Source: Furey Research Partners and FactSet. Bars are color-coded by sector.

Macro

The big questions today are: 1) will the Fed continue to raise rates 2) will the Fed lower interest rates next year and 3) will the Fed conquer inflation without triggering a recession? There are so many concerns creating a wall of worry for stocks to climb. Will inflation continue to decline in view of higher oil prices, a stabilizing China and a temporarily averted government shutdown? So far, we had a have resilient US consumer, but this consumer now must deal with higher mortgage rates, student loan paybacks, higher gasoline prices and the UAW strike, perhaps driving the price of cars higher.

The massive spending and subsidies from the Federal government targeted at upgrading the nation's roads and bridges, expanding domestic manufacturing of semiconductors, and modernizing the electrical grid could blunt a downturn from the recession that the consensus believes is likely.

Outlook

Valuation on our portfolio has come down. In many cases – but not all - reported earnings have been better than expected. It is almost always the case that misses are hurt disproportionately versus the gains that stocks realize when they beat expectations. Response to earnings was extreme in this regard. There were modest positive moves in stocks on very strong earnings and brutal stock moves downward on misses. We even saw a number of stocks report strong earnings, only to go down in their wake. While there are more headwinds to growth broadly, the companies in the GIM portfolios are ones we believe can sustain strong secular growth.