



FOCUSED GROWTH

Portfolio Comments

March 31, 2024

In the first quarter of 2024, the Granahan [Focused Growth](#) portfolio returned +1.5% compared with the Russell 2000 Growth benchmark return of +7.6%. Below I discuss attribution for the quarter.

Attribution for Q1 2024

The Granahan Focused Growth strategy's return trailed the benchmark by approximately 600 basis points for the quarter. As always, when looking at attribution I separate the analysis into two buckets: 1) Factors largely within our control; 2) Factors largely outside of our control.

1. Factors Within Our Control

The Q4 earnings season was generally positive for most of our portfolio companies. This was particularly the case for our larger holdings. I'd categorize 9 of the top 10 holdings as having positive results/guidance. Despite this, these 10 largest holdings were only slightly additive (+50 basis points) to performance. Beyond the portfolio's top 10 holdings, the picture was more mixed both in terms of fundamentals and stocks. We had some very strong reports (e.g., **Everquote** (EVER), **Porch** (PRCH), and **Vertex** (VERX), but more modest disappointments than I'd like (e.g., **Smartsheet** (SMAR), **DoubleVerify** (DV), and **Workiva** (WK)). The net result was that despite a good earnings season overall, performance lagged as the portfolio suffered from not owning stocks of companies that are capturing strong investor interest and capital – A.I. and crypto chief among them. More on these topics below.

2. Factors Outside of Our Control

Two Micros become Megas:

Two stocks combined to contribute 4.0% of the benchmark's 7.6% Q1 return. The two were **Super Micro Computer** (SMCI) and **MicroStrategy** (MSTR). In Q1, the tech sector of the benchmark *rose* +16.4%, but excluding these two stocks tech was *down* -1.1%. Super Micro's business has boomed as AI has driven demand for their data center servers. On the one hand, I wish we'd have owned it. I like to own stocks that rise 255%. However, taking nothing away from Super Micro, it does not fit the profile of sustainable secular growers that we seek to own in Focused Growth. It is a low-margin business (15% gross margins), in a very competitive market (chief competitors are Dell and HP). MicroStrategy is a software vendor which has struggled to compete with Microsoft over the past decade. In recent years MicroStrategy's Executive Chairman Michael Saylor has heavily invested the company's treasury assets in Bitcoin – including two debt offerings in Q1 totaling \$1.25 Billion which significantly leveraged the balance sheet to buy more Bitcoin. The net is that MicroStrategy is effectively a levered play on Bitcoin. In Q1, Bitcoin rose +65%, and MSTR shares rose +170%. Again, while it would have been nice to own a stock up +170% in Q1, MicroStrategy does not fit the Focused Growth process.

Macro Consensus has Returned to "Higher for Longer":

As I've discussed in the past, higher interest rates are a headwind for the types of longer duration stocks that we own, as they lead investors to discount future earnings at those higher rates.



Entering 2024, the consensus debate was not about *if*, but rather *when*, by *how much*, and *how often* the Fed was going to cut interest rates. After a brief reprieve from late October through year-end 2023, renewed inflation fears have led interest rates to rise through the first few months of 2024. Despite Fed Chairman Powell's April remarks reaffirming the central bank still expects to cut interest rates this year, without offering any timetable for when that might happen, the market consensus now seems to be headed towards no moves by the Fed in 2024. We'll see.

A Look at Interest Rates (June 2021 – April 2024)



Warren Buffett has said that short-term stocks are voting machines, but long-term they are weighing machines. Q1 was a reminder that even when fundamentals go well, stocks, which are a function of supply and demand, can go down if investor capital "votes" to go elsewhere. The "weighing machine" for our holdings is represented by the companies' sales, margins, and profits (per share). Or in short, the "E" in the P/E (Price/Earnings) equation. I believe that the companies in the Focused Growth portfolio are well positioned to grow significantly in 2024 and beyond. Based on current valuations, if the "E" comes through, the stocks and the portfolio should generate good returns over the intermediate term.

Below I discuss the individual portfolio holdings that were top contributors and detractors in Q1.

Q1 Largest Relative Contributors:

- **Toast (TOST)** - Toast started as a POS (point of sale) vendor, expanded into payments, and today offers a fairly complete platform for small to medium-sized restaurants to run both front-of-the-house and back-of-the-house operations. TOST shares rose +37% in Q1, contributing +123 basis points to performance on the heels of Q4 results and 2024 guidance that were better than investors feared in terms of revenue, and much better than expectations in terms of profits. We have trimmed the position modestly but maintain a large position in TOST shares.
- **Zeta (ZETA)** - Zeta operates a marketing-technology platform that lets advertisers combine their internal first-party data with third-party data to attract, retain, and cross-sell customers. While Zeta has executed very well and generated strong growth since its June 2021 IPO, the stock has basically treaded water. In Q1, the stock got a little love rising 24% and contributing +85 basis points to performance. ZETA remains a large holding in the portfolio.



- **Axon (AXON)** - Axon is a mission-driven company selling products, platforms, and services to improve law-enforcement efficiency and efficacy, reduce social conflict, enable a fair and effective justice system, and aspirationally with its Taser non-lethal weapon to "obsolete the bullet". AXON shares rose 22% in Q1 contributing +79 basis points in the wake of very strong Q4 results and forward guidance. While we trimmed the position, AXON remains a large position.

Q1 Largest Relative Detractors:

- **Smartsheet (SMAR)** - Smartsheet sells a cloud-based software solution which enables better collaboration and project management across teams within an enterprise. SMAR shares fell -19% and detracted -95 basis points from performance based primarily on softness in the SMB segment of the business along with an announced transition in its go-to-market leadership. We have cutback SMAR from a medium to a small position in the portfolio.
- **Genius Sports (GENI)** - Genius Sports provides real-time sports data and other services to online sports books. GENI shares fell -8% in Q1, contributing -92 basis points to performance. This despite finishing 2023 with better-than-expected results and having grown sales by 21% and adjusted EBITDA by 239% in 2023. We expect revenue growth will approximate 20% again in 2024 and further margin expansion will lead to faster earnings growth. We maintain a large position in GENI shares.
- **Sprout Social (SPT)** - Sprout is a leading SAAS solution for brands to manage their social presence. The stock fell -2% in Q1 contributing -0.79 basis points to performance. Sprout reported good results for Q4 of 2023, and we believe the outlook for the company is excellent as social remains a high priority for brands. In addition, Sprout's September 2023 acquisition of Tagger provides the company with strong opportunities in the influencer-management space to expand its client base and cross-sell existing clients. SPT remains a large holding in the portfolio.

Thoughts on AI

Artificial Intelligence is going to have a deep and wide-ranging impact on our lives and virtually every industry. AI requires enormous capital investment in infrastructure. This is benefitting the results and stocks of companies in various segments of the infrastructure food chain (such as Super Micro and GPU maker Nvidia), as well as those of the mega-cap companies with the scale to make such investments (such as the hyperscalers Microsoft, Amazon, Google, and Meta). We are still in AI's early days, and it is unclear who the long-term winners and losers will be. During periods of such uncertainty, valuation pendulums tend to swing hard. We are witnessing this today. As active and passive capital has flowed heavily into and lifted the valuations of the early beneficiaries, it has flowed from and deflated valuations of others – seemingly irrespective of their long-term outlook.

The Focused Growth portfolio holds a wide range of companies that we believe stand to benefit from AI. However, these benefits are generally nascent, have not been heavily monetized, and are largely not yet on investors' radars. But we are confident that they will be. Below are a few such companies and some sample AI use cases:

- **Axon (AXON)** - Law Enforcement
Improving officer and department efficiency and efficacy through: evidence review and transcription, drafting reports for police officers, training, redacting faces, license plates or other objects in videos, using AI with officers in the field to identify suspects and quickly ascertain



potential levels of threat and the need for and potentially calling for back-up support. Hardware use cases include: [body cameras](#), [more effective Tasers](#), [license plate readers](#), and [drones](#).

- **CCC Intelligent Solutions (CCCS)** - Auto Insurance Services

Damage Assessment of an Automotive:

- *Repair Cost Predictor*: An AI-powered tool which analyzes digital photos submitted by consumers to generate a predicted range for repair costs in seconds.
- *Mobile Jumpstart*: Utilizes AI to pre-populate an initial estimate based on photos taken by a user's mobile phone, jumpstarting the estimating process for repair facilities using CCC's software platform.

AI-powered Solutions for Claims Handlers:

- *CCC First Look*: Leverages AI to process accident photos facilitating faster initiation of workflows related to claims handling, including triage and total loss evaluation.
- *CCC Impact Dynamics*: Analyzes photos of vehicle damage to predict the severity of the impact, which helps claims handlers regarding claims segmentation, early settlements, and in expediting claim resolution.
- *CCC Safekeep*: An AI-powered tool integrated with the claims workflow which automates subrogation (typically an insurance company pursuing claims from another insurance company) decisions based on insurer rules and predictive models helping accelerate the process of recouping claim costs from at-fault parties.

- **Genius Sports (GENI)** - Online Sports Betting and Enhanced Viewing Experiences

Real-time Data Tracking and Analysis:

- *Automated Data Collection*: Genius' Dragon platform uses computer vision technology to track players and the ball at high frame rates, capturing precise location data without requiring chips or wearables on players. AI algorithms analyze the captured data to automatically recognize and categorize game events in real-time. This includes actions like shots on goal, passes, tackles, and fouls.
- *Enhanced Fan Engagement*: AI can personalize AR/VR experiences for fans allowing them to view in-game highlights with data overlays showcasing player speeds, shot trajectories, and other insights. It also enables broadcasters to create data-rich overlays displayed during live games, providing viewers with real-time statistics and visualizations that enhance their viewing experience (for example, see this [clip from Amazon's Thursday Night Prime NFL broadcasts](#)).

- **HubSpot (HUBS)** - Marketing, sales, and service platform for small, medium, and increasingly larger companies.

Content Creation:

- *AI Assistants*: HubSpot offers AI assistants that help with generating ideas, outlines, drafts, and variations of content such as blog posts, social media posts, email copy, and calls to action.
- *Search Engine Optimization (SEO)*: AI suggests SEO-optimized titles, meta descriptions, and content structures to improve search ranking.
- *Content Optimization*: AI analyzes content and suggests improvements for better engagement.



Personalization:

- AI helps personalize email campaigns, landing pages, and website content based on user behavior and demographics, which helps improve conversion rates.

Sales:

- *Predictive Lead Scoring*: AI predicts which leads are most likely to become customers, allowing sales reps to focus their efforts.
- *Chatbots*: HubSpot's offers tools to build chatbots that can answer customer questions 24/7, qualify leads, and schedule meetings, freeing up sales reps' time.
- *Sales Email Drafts*: AI can generate personalized email drafts and suggest follow-up sequences to nurture leads.

Service:

- *Chatbots*: Similar to sales, chatbots can answer customer questions, troubleshoot issues, and direct customers to relevant knowledge base articles, improving customer self-service capabilities.
- *Ticket Classification*: AI can categorize and prioritize customer service tickets based on keywords and sentiment analysis, leading to faster resolution times.

- **Oddity Technology (ODD)** - Direct-to-Consumer health and beauty products. The company has two brands so far: *Il Makiage* and *Spoiled Child*.

Personalization:

- Oddity uses AI to leverage a large amount of data from its user base, including skin types, concerns, preferences, and past purchases to make recommendations on products most likely to suit each user's individual needs and preferences.

Product Development:

- Oddity Labs is the company's Cambridge, MA based bio-tech group that uses AI to identify, design and develop new molecules specifically targeted to address beauty and wellness concerns such as hair loss or wrinkles. Oddity will launch two new brands in 2025 in which Oddity Labs' AI-enhanced product development efforts are playing a very important role.

- **Reddit (RDDT)** – Online Community Forum

Reddit is all about human Redditors generating real person "user generated content." That said, AI is an important area of focus and opportunity for the company both directly and indirectly, and Reddit utilizes AI in several ways to improve the user experience and platform:

Directly:

- *Translation*: Reddit is using machine translation powered by LLM (Large Language Models) to deepen content locally and conversations globally.
- *Content Moderation and Spam Detection*: AI algorithms help Reddit and its moderators create more/better content, as well as identify and remove spam content, hate speech, and other violations of Reddit's community guidelines.
- *Better Search and Recommendations*: AI helps make feeds and recommendations more relevant and responsive based on user activity, including subreddits visited, upvoted posts, and comments.
- *Combating Misinformation*: AI is used to flag potentially misleading or false information.



- *Targeted Advertising:* AI is helping make it easier and more effective for advertisers to target and reach desired audiences, to generate, and measure ads, and to protect from advertising next to content brands might deem "unsafe".

Indirectly:

- *Data Licensing:* Reddit recently signed a 3-year non-exclusive contract with Google worth approximately \$60-\$65 million per year in large part to help train Google's Large Language Models (LLM's). Reddit believes that it is central to many of the AI and LLM's being used and built today. As such it expects to monetize through licensing its data to many other companies in the future.

Lastly, Some Content You Might Enjoy

- [*The Greatest Night in Pop*](#) - Netflix documentary about the recording of "We are the World" in January of 1985 to raise money for famine relief in Africa. Among the fascinating elements are the roles Quincy Jones and Lionel Richie played to keep 46 music superstars (including Bruce Springsteen, Tina Turner, Bob Dylan, Michael Jackson, Harry Belafonte, Billy Joel, and Diana Ross) and their egos in check and in the studio for an all-nighter (well, most of them stayed) and the individual personalities and their individual motivations to do so.
- [*Read Write Own: Building the Next Era of the Internet*](#) - Chris Dixon provides a clear picture of blockchain. Its history, how it works, where we are today, and his vision of the future.
- [*Nyad*](#) - The story of swimmer Diana Nyad and her quest to swim from 110 miles, from Cuba to Florida, in shark-infested waters...at age 63. Annette Benning and Jodie Foster are terrific, the story is incredible, and it's worth watching if for no other reason than it will provide you with ample motivation for one more rep in the gym ("If Diana Nyad can do that at age 63...").
- [*Oath and Honor: A Memoir and a Warning*](#) - Liz Cheney, is a former Republican Congresswoman, Chair of the Republican Conference, and the eldest daughter of former vice president Dick Cheney. She also helped lead the Congressional Select Committee investigation of the January 6th, 2021 insurrection. Cheney methodically and dispassionately walks through the events leading up to Jan 6th, the day itself, and the aftermath. It is a day of infamy that seems to have faded from the collective memories of all too much of the leadership in the U.S. It would make gripping fiction – if only it were. Must reading for any citizen.

As always, on behalf of the entire team at Granahan Investment Management, thank you for entrusting us with the management of your capital. Please note that it is managed alongside our own.

Sincerely,

Andrew L. Beja, CFA
dbeja@granahan.com



Disclosure: The information provided in this commentary should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and, in the aggregate, may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.