SMALL CAP SELECT

Portfolio Comments
March 31, 2024

Distinguishing Features

GIM builds the Small Cap Select portfolio from the bottom-up; sector weightings are secondary to stock selection. At quarter-end, the Small Cap Select portfolio was overweight in Health Care, Technology, Communication Services, and Consumer Staples versus the Russell 2000 Growth benchmark. The portfolio is underweight in all other sectors, and has no exposure Utilities.

Market Environment

Recent economic data highlight that the U.S. economy remains resilient. Commodity prices and yields have increased in response to the underlying strength of the economy. Geopolitical risks have risen as trade tensions with China have increased and the continuation of conflicts in Ukraine and Israel cause trepidation. These dynamics have created volatility within the financial markets especially as investors debate the Federal Reserve's position on inflation, and when and whether they will cut rates. A strong job market and elevated wage inflation could delay the Federal Reserve's first cut in interest rates from current expectations for a June cut. While small caps saw a meaningful recovery off the October lows, we expect continued volatility until there is more clarity on the economy.

Given the economic strength, the strongest performing sectors in the quarter were Technology, Energy, and Industrials. Without a doubt, the most notable storyline this quarter centered around two Technology companies, Super Micro Computers (SMCI) and Micro Strategy (MSTR), representing the largest single-stock weights ever in the Russell 2000 Growth Index and the largest combined weight of any two stocks ever. These two stocks drove about half of the performance of the Index: SMCI driven by AI demand and MSTR a bitcoin play, both with larger market caps. Excluding both companies, the Russell 2000 Growth 1Q24 return would have been + 3.4% versus the actual index return of +7.6%.

Performance & Attribution

For the first quarter, the Granahan Small Cap Select strategy returned +2.8%, lagging the +7.6% return of its Russell 2000 Growth benchmark. Strength in the portfolio this quarter came from selection in Communication Services, Consumer Discretionary, Materials, and Consumer Staples, we were hurt by selection in Information Technology, Industrials, and Health Care.

Top Contributors	Top Detractors
1. Chart Industries (Industrials, Special Situation)	1. Indie Semiconductor (Technology, Pioneer)
2. Porch Group (Technology, Pioneer)	2. Array Technologies (Technology, Core Growth)
3. Modine Manufacturing (Cons. Disc, Special Sit)	3. Ameresco (Industrials, Core Growth)
4. Chefs' Warehouse (Cons. Staples, Special Sit)	4. Super Micro Computer (Technology, Core Growth)
5. Magnite (Comm Svcs, Core Growth)	**5.** SI-BONE (Health Care, Pioneer)

With respect to LifeCycle categories for the quarter, Special Situation names nicely outperformed the benchmark while Core Growth and Pioneers lagged.

Positioning

While the small cap market has recovered very nicely since October 27, 2023 low, many still worry that it won't move higher until the Federal Reserve starts to lower interest rates - mainly because some companies have stretched valuations. However, looking at our universe, we see ample room to be more optimistic. In a growing economy, we are typically bullish on our investments and the prospect of long-term earnings growth potential. Today, we feel that there are also great opportunities from a valuation perspective. Many small cap companies experienced significant multiple compression over the last few years that could change dynamics for the better in a meaningful way. As our investment process dictates, we are looking for companies with large total addressable markets, minimal competition, great growth prospects, and significant valuation upside. We make those positions "major leaguers." Below we will discuss more about why we are encouraged, not just by the results of the last five months, but also by the prospects for future results through the lens of several of our top holdings in the strategy.

- **Indie Semiconductor** (Technology, Pioneer) is a leading automotive semiconductor company focusing on advanced driver assistance systems (ADAS). We were disappointed to see the company lower guidance below expectations for 2024 because of an inventory correction in the auto industry. We believe Indie will be one of the fastest growing semiconductor companies over the next several years and still have conviction that they have enough design wins in next generation automobile features to potentially double or even triple its annual revenues in the next three years. With run rate revenue at $280 million currently, and a backlog of $6 billion, the stock is trading at a very low valuation relative to its earnings potential. The company not only has very strong revenue growth to look forward to, but also significant margin improvement ahead as it scales its business to more advanced solutions that receive higher margins. Once the company starts ramping up its biggest three design enhancements later this year, we believe they will become persistently profitable around the same time investors will start thinking about the company and stock in a more positive light. We are buying the stock.
- **Vivid Seats** (Technology, Special Situation) is an online ticket sales company that has been gaining share in this large growing market. Consumers seem to have an insatiable appetite for live events and Vivid Seats should benefit from greater ticket volumes and higher prices for years to come. We believe this company trades at an unusually low multiple because of its 36% private equity ownership structure with the threat of selling shares - not because of fundamentals. Vivid announced a $100 Million buyback program, has steady growth in the U.S., and is expanding into the immature and less competitive global market. Similar to indie, we think our patience will be rewarded with both earnings' growth and valuation improvement.
- **Shift4** (Technology, Core Growth) is a leading end-to-end payments solution serving the restaurant and hospitality space, touting 20% top line growth and the prospect of 250 basis point improvement in industry leading margins. An abundance of IPOs in the industry during 2021 created doubt amongst investors about the sustainability of incumbents. This has played out positively for Shift4 as they have continued to gain market share. Currently, the stock has a valuation that aligns with larger companies with much lower growth rates, and we believe this could significantly improve from current levels as it re-rates to its faster growing peers. Investors were recently disappointed as the company rebuffed an inadequate buyout bid. We are delighted

that Shift4 will remain a public company and that we can continue to acquire more shares at lower prices.

The common theme from the above is that we are in a market that seems to be very shortsighted. As our process focuses on companies that have the strongest long-term potential for both growth and valuation, we are excited to be finding investments that appear to be significantly mispriced. Some of our highest conviction names, such as the ones articulated above, may require patience or a broadening of the stock market to get to what we see as our current price targets. As we wait, we anticipate that their value will steadily increase over time.

Outlook

Since Granahan's inception in 1985, relative valuation of small cap companies versus large has only been lower one other time, which was at the bottom of the Covid bear market. Despite the recent rise in yields adding pressure to small cap growth stocks, fundamentals in the companies we own remain compelling, with the prospect of normalizing interest rates and improving financial conditions providing an additional tailwind for performance. We believe this supports a strong growth outlook over the next couple of years.