GRANAHAN INVESTMENT MANAGEMENT LLC

SMID SELECT

Portfolio Comments
March 31, 2025

Distinguishing Features

GIM builds the SMID Select portfolio from the bottom-up; sector weightings are secondary to stock selection. At quarter-end, the SMID Select portfolio was overweight in Consumer Staples, Communication Services, Information Technology, and Materials versus the Russell 2500 Growth benchmark. The strategy is underweight Health Care, Energy, and Financials, and equal weight in all remaining sectors. The strategy continues to have no exposure to Utilities.

Market Environment

Inflation concerns that dominated the headlines in 2024 have evolved into broader fears of stagflation, contributing to a more cautious investment environment. Expectations for accelerating earnings growth in small-cap equities have moderated meaningfully. At the same time, the newly imposed tariffs are expected to place upward pressure on prices, even as several economic indicators reflect declining business and consumer confidence. While the underlying fundamentals of the U.S. economy remain relatively resilient, uncertainty surrounding the Trump administration's evolving y agenda has weighed on investor sentiment and contributed to increased market volatility. In this environment, shifting policy narratives are likely to sustain a higher level of uncertainty, making it more challenging to forecast the near-term impact on corporate earnings.

Performance & Attribution

For the first quarter of 2025, the Granahan SMID Select strategy returned –16.8%, underperforming the -10.8% return of its Russell 2500 Growth benchmark. Strength in the portfolio came from stock selection in Information Technology and Materials but it but it wasn't enough to offset selection penalties in Consumer Staples and Communication Services.

Top Contributors	Top Detractors
1. **Porch Group** (Info Technology, Pioneer)	1. **indie Semiconductor** (Info Technology, Pioneer)
2. **Carpenter Technology** (Materials, Special Sit)	2. **SunOpta** (Consumer Staples, Core Growth)
3. **FTAI Aviation Ltd** (Industrials, Core Growth)	3. **Vivid Seats** (Communication Svs, Special Sit)
4. **SI-BONE** (Health Care, Pioneer)	4. **Shift4 Payments** (Financials, Core Growth)
5. **OrthoPediatrics Corp.** (Health Care, Core Growth)	5. **Magnite, Inc.** (Communication Svs, Core Growth)

With respect to LifeCycle categories for the quarter, Core Growth companies were the largest penalty to performance followed by Special Situations and Pioneers.

Positioning

While the first quarter did not meet our expectations in either absolute or relative terms, we believe we made meaningful progress in repositioning the portfolio toward stronger areas of growth. Most notably, we significantly reduced our exposure to the Health Care sector and increased our allocations to the Industrial and Energy sectors.

The reduction in our Health Care weighting reflects a combination of macroeconomic and sector-specific challenges. The new administration's agenda to reduce the size of the federal government has resulted in funding cuts to key agencies such as the NIH, CDC, and FDA—introducing heightened uncertainty for the healthcare landscape. The recent resignation of the FDA's Director of the Center for Biologics Evaluation and Research (CBER) further increases risk for biotech firms, raising concerns around potential delays in drug approvals and diminished research investment. These factors contributed to our decision to exit positions in **Quanterix Corporation, Castle Biosciences,** and **Veracyte**. Additional uncertainty stems from the congressional budget process, particularly regarding potential cuts to Medicaid and Medicare. The expiration of ACA subsidies and possible reductions in federal funding could undermine hospital and insurer profitability. As a result, we also exited our position in **Evolent Health** due to its exposure to these risks.

At the end of the quarter, we retained two "major league" (>2%) positions in Health Care, SI-BONE and OrthoPediatrics. Both companies demonstrate strong growth potential, improving profitability, and attractive valuations. Importantly, they are well-positioned to benefit from increasing demand and are not meaningfully exposed to regulatory or policy headwinds at the federal level.

We began the year underweight in Industrials, as we felt valuations across much of the sector did not present compelling risk-reward profiles. However, the broad market pullback significantly improved the opportunity set. In the first quarter, we initiated new positions in **Comfort Systems, Powell Industries, Ameresco, and Nextracker**. We also meaningfully increased our holdings in **Modine Manufacturing** and **FTAI Aviation**. A central theme across these investments is the accelerating demand driven by artificial intelligence. Hyperscalers are investing at unprecedented levels, and we believe the most significant constraint going forward will not be technology or semiconductors, but rather infrastructure and energy capacity. This dynamic positions many of our holdings for a multi-year period of sustained growth. Notably, most of these companies are now trading at less than 10x forward EV/EBITDA, representing a meaningful valuation discount compared to just six months ago.

With our shift away from Health Care and toward Industrials and Energy, the portfolio is now more concentrated in highly profitable businesses. Ultimately, we are positioning for stronger long-term growth while maintaining our discipline around valuation and capital allocation.

Outlook

The current investment landscape for small cap growth stocks is characterized by both uncertainty and opportunity. The Trump administration's strategy to address the country's fiscal challenges, centered on reducing government waste, fraud, and unnecessary spending, has introduced a new dynamic into the market. At the same time, the administration's efforts to re-industrialize the U.S. economy, particularly through the use of tariffs, have fostered a more protectionist trade environment, adding volatility to global supply chains and dampening investor sentiment. While these initiatives aim to enhance long-term fiscal health, they also contribute to near-term unpredictability as federal programs and agencies undergo restructuring.

Nevertheless, this uncertain backdrop creates compelling opportunities for small cap growth investors. Many innovative small cap companies continue to demonstrate strong fundamentals, including robust revenue growth, scalable business models, and unique market positions, yet are trading at historically attractive valuations due to broader macroeconomic concerns. Market dislocations can provide long-term investors with the chance to establish and build positions in high-potential businesses before sentiment recovers. As capital begins rotating back into growth-oriented equities in anticipation of economic stabilization, small caps—especially in technology, healthcare, and industrials—could deliver meaningful returns. Accordingly, we remain focused on the underlying fundamentals of the businesses we invest in and believe that current market volatility presents an opportunity to position the portfolio for long-term success.