# BBH Partner Fund – Small Cap Equity

*Quarterly Fund Update / 4Q 2023*

The BBH Partner Fund – Small Cap Equity ("Fund"), sub-advised by Bares Capital Management, Inc., increased 3.23% in the fourth quarter of 2023 compared with a 14.03% increase in the Russell 2000 index. In the year-to-date period, the Fund increased 21.17% compared with a 16.93% increase for the benchmark index. 2023 ended on a positive note for U.S. equity markets and our strategies. However, as we have reiterated before, we chiefly concern ourselves with above-average compounding of client capital over multi-year horizons. We intend to accomplish this by identifying and owning qualitatively exceptional companies that can grow intrinsic value[1] at high rates for long periods of time. While we welcome short-term periods of outperformance, we remain focused on commercial progress and shareholder value creation among our holdings, and the fourth quarter was an encouraging one in these regards, too.

**Performance**
**As of December 31, 2023**

| | Total Returns | | Average Annual Total Returns | | | | |
|---|---|---|---|---|---|---|---|
| | 3 Mo. | YTD | 1 Yr. | 3 Yr. | 5 Yr. | 10 Yr. | Since Inception |
| **Class I** | 3.23% | 21.17% | 21.17% | N/A | N/A | N/A | -9.90% |
| **Benchmark** | 14.03% | 16.93% | 16.93% | N/A | N/A | N/A | -2.43% |

Class I Inception: 7/8/2021

Class I: Total Expense Ratio (%): 0.92

Returns of less than one year are not annualized.

***Performance data quoted represents past performance. Past performance does not guarantee future results, and current performance may be lower or higher than the past performance data quoted. The investment return and principal value will fluctuate, and shares, when sold, may be worth more or less than the original cost. For the most recent month-end performance, call 1 (800) 625-5769.*** *Fund shares redeemed within 30 days of purchase are subject to a redemption fee of 2.00%.*

The Fund's benchmark is the Russell 2000 index.

Expenses are based on estimated amounts for the current fiscal year.

Sources: BBH & Co. and Russell

Even though the quarter ended with a strong rebound in stocks, especially among small-cap companies, we believe that our chosen segment of the market remains a fertile ground for finding qualitatively excellent and attractively priced companies. As a result, we continue to devote considerable attention and resources to the advancement of research on new investment ideas. At the same time, we remain vigilant about monitoring the fundamental progress and market pricing of our current holdings to ensure that we prudently balance risks and rewards in managing the portfolio. Thus, the fourth quarter of 2023 remained another dynamic period on the portfolio activity front.

## Performance Drivers

Our best-performing position during the quarter was **SoundThinking (SSTI),** with a share price gain of 42.7%. As a reminder, SSTI is the leading provider of acoustic gunshot detection solutions and offers a portfolio of related software products. By virtue of its vertical market-focused business model, SSTI has historically benefited from strong customer retention, resilient recurring revenue, high sales and marketing efficiency, and a negative working capital cycle that allows the company to generate attractive economics on a relatively small base of business.

SSTI spent much of 2023 operating under a pall of uncertainty catalyzed by the emergence of contentious contract renewals with the City of Chicago and Puerto Rico. Beyond the specter of high-profile customer churn, the company also posted lower margins driven primarily by elevated expenses stemming from growth investments. As the year progressed, however, SSTI reported key contract wins across its product portfolio and demonstrated improved profitability. Select highlights from the company's third quarter report included continued broad-based growth in the ShotSpotter gunshot detection business; an interim contract and request for proposal (RFP) win with Puerto Rico; and a major new contract for the CaseBuilder investigation management system with the New York City Department of Corrections. Notably, while there have been no formal updates on a ShotSpotter renewal with the City of Chicago, Mayor Brandon Johnson's budget included a line item for gunshot detection technology. With or without Chicago, we expect SSTI to grow

[1] Bares' estimate of the present value of the future cash flow that a business will generate over its remaining life.

revenue and operating income at double-digit rates in the years ahead, fueled by both core and ancillary products. Despite the share price appreciation during the quarter, we continue to view SSTI as a compelling holding.

Our second-best performing position was **Upwork (UPWK)** with a share price gain of 30.9% during the quarter. As a reminder, UPWK operates the largest online, global marketplace for freelance labor. As the preeminent site for temporary job listing and matching, UPWK benefits from network effects that enhance its value proposition to clients and freelancers, respectively, through a greater supply of qualified labor and a higher number of work opportunities. In addition, UPWK's focus on larger enterprises – with all the administrative and compliance features that they require – means that it often becomes embedded as a trusted marketplace partner among its corporate clients. By virtue of its scale and reputation, UPWK is well positioned with ample opportunity to win market share from traditional staffing agencies.

| Top 10 Companies<br>As of December 31, 2023 | |
|---|---|
| Alarm.com Holdings Inc | 11.8% |
| XPEL Inc | 10.6% |
| Cimpress PLC | 5.7% |
| Triumph Financial Inc | 5.4% |
| Franklin Covey Co | 5.3% |
| Despegar.com Corp | 5.2% |
| Agilysys Inc | 4.9% |
| Onto Innovation Inc | 4.6% |
| SoundThinking Inc | 4.6% |
| Upwork Inc | 4.5% |
| **Total** | **62.5%** |

Reported as a percentage of total portfolio.
Holdings are subject to change.
Totals may not sum due to rounding.

A weakening economy and the implementation of cost controls at many companies have dampened demand for many of the professional services that UPWK's freelancers provide. Despite slowing growth, the company's competitive position remains unchanged, as evidenced by Gross Services Volume and client trends that compare favorably to many traditional staffing agencies. UPWK has also continued to rein in costs and improve profitability and cash flow, such that the company was able to post its first generally accepted accounting principles (GAAP) operating profit in the third quarter despite far-from-ideal market conditions. These positive financial developments are expected to carry momentum as UPWK builds into a larger and more profitable enterprise. Thus, despite the recent share price appreciation, we continue to believe that UPWK remains poised to generate attractive returns in the years ahead.

Our worst-performing position, with a share price decline of 47.1% during the quarter, was **WideOpenWest (WOW).** WOW is a cable and broadband services provider focused on markets in the Midwest and South regions of the U.S. where it is generally an "overbuilder" constructing modern network infrastructure to compete with incumbent providers. After striking two transformational deals to sell operations in non-core markets, allowing the company to deleverage its balance sheet and free up capital for expansion, WOW has been focused on organic, greenfield expansion in new markets with higher growth potential. Importantly, we believe that the company is capable of funding this growth through internally generated cash flows without the need for external financing. In our view, while WOW lacks the revenue growth profile of other portfolio holdings, we believe that the company is substantially undervalued relative to the cash flow it can generate over time.

In apparent contradiction to this assessment, WOW sold off dramatically after it reported its third quarter results and outlook, which featured a decline in high-speed-data subscribers and an expectation of continued customer losses in the fourth quarter. This unfavorable trend was attributed to (1) increased competition, particularly from expanding coverage of fixed wireless access (FWA); (2) a poorly timed price hike made in July, concurrent with the roll-off of promotions; (3) a weakening consumer environment; (4) a slower-than-expected pace of network construction in greenfield broadband markets; and (5) continued sluggishness in the residential housing market, where moving activity catalyzes new customer wins. Management believes that the first three factors represented an especially potent confluence of events that drove some lower-value customers to adopt FWA service as a cheaper (and generally lower performance) alternative just as FWA became available in more markets. Notably, management disclosed that increased customer churn was experienced late in the third quarter, contributing to the expectation of higher customer losses in the fourth quarter. While greenfield network expansions are on pace with publicly communicated targets, they have progressed slower than management's internal expectations due to minor construction delays. Management is taking steps to address the customer churn issue, primarily through pricing optimization strategies, limited-time promotions, and improved service.

Our research confirms that WOW is encountering a more challenging operating environment than previously anticipated. Nevertheless, we believe that the enduring value of broadband internet access; the barriers to entry associated with WOW's network assets; the physical advantages of cable and fiber over FWA in terms of data speed levels and capacity; and WOW's compelling customer value proposition should allow the company to "weather the storm." Even in what we view to be a Draconian scenario of losing all sub-200 megabits per second-speed subscribers, where we believe the preponderance of the churn risk lies, we assess that WOW can still generate ample profits while growing its higher-speed subscriber base. Thus, we believe that WOW's share price drawdown is overdone, and we have taken the resulting opportunity to add to our position.

Shortly after headlining as our best-performing position in the second quarter of 2023, **thredUP (TDUP)** was our second-worst performing position during the fourth quarter, with a share price decline of 43.9%. TDUP operates an online marketplace for the consignment and resale of pre-owned women's and children's clothing and accessories. TDUP receives items from sellers, processes them, posts them to its marketplace, and fulfills orders for them in exchange for a commission. By operating as a managed marketplace and by focusing on the value segment of resale, the company benefits from scale-based and process-driven barriers to entry that allow it to drive convenience and cost advantages for individual buyers and sellers. TDUP's infrastructure also positions it to provide outsourced resale services to retailers and brands, thereby enhancing the company's product assortment, driving incremental volume, and generating additional service fees.

TDUP continues to navigate a challenging consumer demand environment. The company bucked the trend of the broader apparel industry in its third quarter report, sustaining gross profit growth despite broad-based category weakness, while expense controls helped to improve profitability. In fact, TDUP's U.S. business posted all-time highs for active buyers, order count, and gross profit during the quarter and, per management disclosure, also achieved adjusted earnings before depreciation, interest, taxes, and amortization (EBITDA) breakeven and positive free cash flow.[2] On the negative side, TDUP issued tepid forward guidance primarily attributed to lower growth at Remix, the company's European business. Macroeconomic headwinds and an unusually warm October – both corroborated by other European apparel retailers – resulted in a weaker-than-expected start to the fourth quarter in what is typically a peak period for seasonal purchases of winter clothing.

On one hand, TDUP's U.S. business seems to be performing well. On the other hand, the company's European business is enduring growing pains and more acute consumer demand weakness. Given that TDUP is still unprofitable, any unanticipated challenges can be causes for concern. That said, management has executed well in implementing expense discipline, reducing cash burn dramatically, and likely giving the company years of runway even if current conditions persist. We maintain our assessment that TDUP has ample liquidity to withstand more difficulties and remains on a trajectory toward sustained profitability. Therefore, we continue to view the company as an attractive holding.

## Portfolio Activity

During the fourth quarter, we were again active on the portfolio front. Motivated by market volatility and a fresh assessment of risk/reward relationships, we elected to exit three positions and redeploy the proceeds into more attractive opportunities. First, with the outbreak of the war in Israel on October 7, we opted to exit our position in **InMode (INMD).** While INMD has substantial operations outside of Israel, much of the company's critical infrastructure – including its manufacturing base– remains in the country. Despite our continued appreciation for INMD's business model and competitive position, we viewed the war as an unacceptable existential risk and quickly moved to exit the position. INMD has been a small position accounting for modest gains since the inception of the strategy. While we are saddened by the circumstances precipitating our exit, we remain focused on protecting client capital.

Second, we elected to exit **Olo (OLO)** early in November. After the company's second quarter report and a flurry of additional industry touchpoints, we concluded that the company has overextended its strategic focus and failed to exhibit expense discipline that we deem prudent and performance-oriented. This decision caps a disappointing experience of share ownership in OLO. While we continue to believe that the company still has a long-term opportunity to be a key enabler of restaurant industry digitization, we ultimately decided to redirect capital to holdings that represent a more attractive balance of risk and reward.

Third, we exited **Papa Johns (PZZA)** during the quarter. We remain confident in the company's compelling franchised restaurant model, ongoing global expansion, and prudent return of excess capital to shareholders. Our exit here was motivated primarily by prevailing market pricing and the desire to redeploy funds into opportunities that had become relatively more attractive.

Proceeds from these exits and opportunistic trims from strong relative performers such as **AGYS** and **UPWK** funded additions to our holdings in **FC, MODN, SSTI, WOW,** and **XPEL** among others.

## Closing Comments

We continue to scrutinize the qualitative drivers of business exceptionalism and value creation among our existing holdings and companies in our research pipeline. This endeavor remains challenging but also as invigorating and opportunity-rich as we have ever seen it, especially in the small- and micro-cap segments of the equity markets. The equanimity and determination required to realize the potentially substantial rewards of long-term business ownership are enabled by our stable and patient investor base – an indispensable source of competitive advantage in a market that is increasingly short-term in nature. We therefore remain as grateful and privileged as ever for the trust and partnership of our clients. Our efforts on their behalf continue unabated in pursuit of category-leading investment results.

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[2] Free cash flow (FCF) is the cash a company generates after taking into consideration cash outflows that support its operations and maintain its capital assets.

The Russell 2000 index is an unmanaged market capitalization weighted index of 2000 small company stocks of U.S. domiciled companies. The composition of the Russell 2000 Index is materially different than the Fund's holdings. The Index is not available for direct investment.

The Fund seeks to generate attractive returns over time but does not attempt to mirror a benchmark or index.

Opinions, forecasts, and discussions about investment strategies represent the author's views as of the date of this commentary and are subject to change without notice. References to specific securities, asset classes, and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as recommendations specific securities, asset classes, and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as recommendations.

**RISKS**

Investors in the Fund should be able to withstand short-term fluctuations in the equity markets in return for potentially higher returns over the long term. The value of portfolios changes every day and can be affected by changes in interest rates, general market conditions and other political, social and economic developments.

The Fund is "non-diversified" and may assume large positions in a small number of issuers which can increase the potential for greater price fluctuation.

Foreign investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards. Prices of emerging market securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

Investing in small sized companies typically exhibit greater risk and higher volatility than larger, more established companies.

Asset allocation decisions, particularly large redemptions, made by an investor or an investment adviser whose discretionary clients make up a large percentage of the Fund's shareholders, may adversely impact remaining Fund shareholders.

**For more complete information, visit www.bbhfunds.com for a prospectus. You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus, which you should read carefully before investing.**

Shares of the Fund are distributed by ALPS Distributors, Inc. and is located at 1290 Broadway, Suite 1000, Denver, CO 80203.

Bares Capital Management, Inc. acts as the sub-adviser to the Fund.

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