The Brown Capital Management International Small Company Strategy

Management Discussion of Strategy Performance, Third Quarter 2022

International Small Company Strategy

“We must keep at it until we are confident the job is done.” Federal Reserve Chairman Jerome Powell repeated this refrain twice during his terse eight-minute address at the Jackson Hole Economic Symposium this summer. One cannot help but make the connection with Keeping At It, the title and theme of his predecessor Paul Volcker’s autobiography. As it was in the 1980s under Volcker, we believe the Fed’s message today is clear: it will wrestle inflation lower, even if the effort leads to a painful economic downturn. Some market participants had expected inflation to peak (at a very high level) in recent months, which would give Fed the air cover to slow the rate of hikes or even lower rates next year. That now appears unlikely.

Investors familiar with Brown Capital know that we are bottom-up investors, focusing on long-term fundamentals of the individual companies in our portfolios as opposed to making decisions based on predictions of monetary policy or other macroeconomic factors. By and large, our clients understand that our benchmark-agnostic approach may experience periods of underperformance, which was the case in the third quarter. The International Small Company strategy underperformed the benchmark MSCI ACWI ex-USA Small Cap’s return of -8.25% in the third quarter.

So why, in the face of macro headwinds, do we remain confident that our style of Exceptional Growth Company (EGC) investing can still generate outperformance over a cycle? Below we will elaborate on one attribute of EGCs—mission-critical products and services—and what that means for companies weathering a recession, as well as the limited foreign-exchange exposure fundamentally embedded in our portfolio.

The storm clouds of recession are clearly gathering. The top 10 developed economies have raised rates by a combined 1,965 basis points in this cycle to date, with Japan the only holdout “dove”. These aggressive tightening actions rapidly moved the markets from fearing inflation, to expecting an inflation-dampening economic deceleration, to the latest fear of a prolonged, full-fledged global recession, if we are not in one already. For example, in Europe, lower consumer purchasing power due to inflation and the higher debt-servicing costs (15% of housing loans are tied to variable rates per European Central Bank statistics) have squeezed consumers from both sides and contributed to the lowest reading of consumer confidence in the European Union since 1985.

The divergence of inflation and central bank policies across Japan, Europe, the U.K. and China, and an energy crisis centered predominately in Europe from the Russia/Ukraine war, are sending shock waves through the global foreign currency markets. The Japanese yen, the euro and the British pound have all depreciated against the U.S. dollar to multi-decade lows. The Chinese yuan traded above 7 to the U.S. dollar for the first time since the start of COVID, as the country continued its zero-COVID policy amid an economic slowdown. According to Morgan Stanley, 15% of the country’s GDP remains in lockdown. As investors in U.S. dollars in the international equity markets, we have seen these currency moves affect our holdings, positively for some (with a higher share of U.S dollar-based revenue disproportionate to its cost base currency) and negatively for others, the specifics effects of which we will detail below.

The extreme macro crosscurrents can be seen in our holdings. Consider **MIPS**, the leader in helmet safety technology. The company does not make helmets itself, but rather partners with and licenses the safety technology to branded helmet manufacturers who then sell mainly through resellers at retail. In September, MIPS reduced its outlook for the second half of 2022, as decreased purchasing power among bike customers due to heightened inflation led to excessive inventory levels among resellers. In turn, these resellers have reduced purchases from the branded manufacturers, affecting MIPS subsequently. MIPS management expects this dynamic could persist until the start of the next bike season before normalizing. Although Sports Helmets comprise 90% of MIPS's revenue today, a more discretionary segment that saw demand drop after the pandemic, our long-term thesis is centered on the less discretionary Safety Helmets segment, which has the potential to be 2-3 times larger than the Sports Helmet segment.

A company is rarely wholly insulated from an economic downturn; however, we believe the mission-critical, non-discretionary attribute of EGCs means that they are more recession-resilient than others. One example is **Dechra Pharmaceuticals**, a veterinary-product company focusing on treating sick and critically ill pets and livestock. As demonstrated in the Great Financial Crisis of 2007-2008, one of the last parts of a household budget to be cut is healthcare for one's pet. (As pet parents ourselves, we can relate.) Although pet owners may reduce regular vet visits as their purchasing power decreases, the impact is more strongly felt in non-fatal (and more discretionary) categories such as tick, flea and worm treatments, where Dechra's larger peers compete. As a validation of the pricing power it possesses, Dechra has successfully passed through cost inflation via three price hikes in the last 12 months, compared to once per year historically. For more on Dechra, please see the Detractors section below.

Regarding foreign currency, we approach their changes as we do with other macro variabilities, incorporating them into our thinking from the bottom up. First, although our holdings are early in their life cycle, the nature of the services and products they provide often mean they are global companies. In fact, 24.7% of the revenue of our holdings (weighted by position size and according to FactSet GeoRev) was generated from the U.S. in 2021. Second, we also tend to avoid companies with outsized transactional currency impacts, which results from a mismatch of revenue and cost-base currencies. Finally, most of our companies enjoy high gross margins and pricing power, further reducing their vulnerability to currency fluctuations. One example to consider is **Kinaxis,** a Canadian supply-chain management software company reporting in U.S. dollars with clients across multiple geographies. Recent currency moves, particularly in the yen and euro, had a negative 7% impact on the company's overall revenue growth in the second quarter of 2022, with Kinaxis reporting constant currency growth of 42% vs. reported U.S. dollar revenue growth of 35%. However, the impact on EBITDA margin is much less at 2 percentage points, given the company's asset-light model. Kinaxis is actively considering incorporating currency moves into pricing as contracts are up for renewal.

Another data point to consider is our holdings' cash flow generation and growth. Imagine the portfolio as a single "company," aggregating cash flows from all of our companies. In 2015, the year of our mutual fund inception, a $1,000 investment in the "company" would generate $56 in operating cash flow. That investment would have produced $104 in operating cash flow in the last 12 months, or an annualized double-digit growth of 10%. Cash is real, and this is a powerful confirmation of the quality of growth delivered by our EGCs. The growth of cash flow is also consistent with the portfolio's performance; in other words, performance has been driven mainly by our EGCs' fundamentals, and not expansion in price/earnings multiples, which have essentially stayed stable over time. Echoing Chairman Powell's sentiments, we must keep at it, but we remain confident that the fundamentals of our portfolio will win out in the end.

Returns: Contributors and Detractors

Among the largest contributors to performance in the third quarter were Wisetech Global and CyberArk.

Wisetech Global is an Australian supply-chain software company. Imagine that DHL, a Wisetech client, needs to ship a cargo of toys from Vietnam to California. Wisetech's CargoOne platform helps DHL to efficiently plan routes, book ships/trains/trucks, clear customs, and comply with local regulations while giving visibility to all partners throughout the process. These are convoluted tasks, involving ever more complex tariffs, license requirements, and free-trade agreements, to name a few. Wisetech's cloud-based single platform allows data to flow from the beginning of the process to the end, a dramatic increase in productivity and reduction in costs as it does not need to integrate other systems. For example, by migrating to Wisetech's CargoOne platform, DHL was able to harmonize 22 different legacy software packages and save 40 million euros per year on average.

As you may recall, Wisetech was a leading detractor last quarter due to concerns over slowing global trade and further supply-chain disruptions stemming from China's zero-COVID policy. During this quarter, the company reported strong fiscal year 2022 (ended in June) results of 25% revenue growth and 54% EBITDA growth. Wisetech's initial 2023 outlook is also upbeat at 21% and 25% revenue and EBITDA growth, respectively. This outlook reflects strong new client wins in the second half of 2022, including UPS, Brink's and Craft Multimodal, essentially expanding expected users by about 30%. We remain confident in Wisetech's value proposition in solving today's supply-chain challenges.

CyberArk, an Israeli company, is the leader in the quickly growing Privileged Access Management (PAM) market, which seeks to monitor, control and isolate access to "superuser" computer and network accounts. These superuser accounts are used for logging into a company's most critical assets, such as database servers, firewalls, switches, etc. PAM is at the core of the broader identity-management space. While identity management often works to fend off "bad guys," PAM works under the assumption that bad guys are already on a network and instead minimizes their ability to exploit a company's key assets. PAM helps to reduce malware infection and propagation and the risk of downtime. According to Forrester, 80% of security breaches involve privileged credentials.

CyberArk delivered strong second-quarter 2022 results, growing annual recurring revenue (ARR) by 48% year over year, and increased its 2022 full-year ARR growth expectation from 35-36% to 36-38% year over year, despite an incremental $1-2 million currency headwind. The results validate its cloud transition strategy in the last few years, effectively expanding its addressable market from 26,000 enterprises to 70,000 by tapping into the mid-market segment, as well as into adjacent categories such as Endpoint Security Management.

Among the largest detractors of performance for the quarter were Dechra Pharmaceuticals and Evotec.

Dechra Pharmaceuticals is a U.K.-based animal-health company offering prescription-only medications for companion animals, livestock and equines. Dechra specializes in niche pharmaceuticals in therapeutic categories such as endocrinology, dermatology, critical care and pain management. Approximately 25% of pharmaceuticals sold are completely novel and another 25% are unique due to a different active molecule. These niche drugs target small markets up to $10 million in revenue, saving lives of animals in critical condition while facing little direct competition from larger animal-health companies. Over the years, Dechra has developed its own direct-to-vet sales force in major markets such as Germany, the

Netherlands, and the U.S. This go-to-market strategy also works hand-in-hand with Dechra's active M&A strategy in which bolt-ons can be rolled out through its own distribution network.

During the quarter, Dechra announced two acquisitions, Piedmont Animal Health for 180 million GBP and Med-Pharmex for $260 million, funded through a combination of cash, debt, and a 180 million GBP equity raise. The acquisitions are estimated to increase Dechra's leverage (net debt to EBITDA ratio) to 1.6x by the end of 2023 from the current 1.1x, which was viewed unfavorably in the current environment on top of the equity raise. However, we believe Dechra has a resilient portfolio, strong cash-flow generation capabilities, and a track record in de-leveraging post acquisitions. Furthermore, through conversations with the management team, we see strategic merits in these two deals. Piedmont brings a pipeline targeting more than $100 million of peak sales, and strengthens Dechra's novel drug portfolio that is the most insulated from any pricing pressure. Med-Pharmex, on the other hand, has an established platform focusing on companion animals and equines, sold via distributors. The deal is a typical example of the M&A strategy mentioned above, offering potential revenue synergies by using Dechra's distribution. In addition, the manufacturing capabilities of Med-Pharmex could provide further opportunities in cost reduction as Dechra looks to manufacture some of its own products at the facilities over time. We remain favorable of its positioning and execution of the strategy.

Evotec helps drugmakers save time and money by increasing the accuracy and decreasing the required time of successfully bringing drugs to the market. The company has two business segments, named Execute and Innovate. Execute focuses on high-throughput screening (HTS) that helps with the enormous task of sifting through millions of compounds and provides the starting point of drug discovery and development. Innovate is a platform developed to partner with pharmaceutical and biotech companies looking to discover successful drug candidates; industry-wide, 92% of drug candidates fail in the clinic before market launch. In exchange for providing these tools, Evotec takes partnership interests that result in milestone payments and royalty income upon successful commercialization.

During the quarter, Evotec reported strong revenue growth of 25%, although adjusted EBITDA declined 2%, below market consensus. The firm's profitability was weighed down by ramping up investments in biologics manufacturing capacity in the U.S., as well as by supply-chain and energy-price pressure. We expect the costs associated with the new capacity to normalize as the company fills up the capacity through 2023. Evotec saw little resistance from partners in passing through higher costs, although price increases take time, especially for long-term contracts closed years ago. Our views remain unchanged as to Evotec's value proposition and long-term growth prospects

Additions and Deletions

There was one new position added, Fortnox, and one elimination, Albioma, during the quarter.

Fortnox is a Swedish cloud-based accounting software company in which we initiated a position during the quarter. By moving accounting-related workflows to the cloud, Fortnox helps reduce the complexity and costs of running small businesses. Fortnox's sweet spot is firms with 50 employees or fewer. Fortnox is continuously expanding its product suite and is structurally advantaged in R&D and product development, offering features and ease-of-use that is unmatched by the competition. We believe this competitive edge should enable Fortnox to grow its client base from over 400,000 currently to 700,000 in the medium term. New product functionality should also increase revenue-per-client.

Furthermore, we view Fortnox's entry into fintech as a potential opportunity. Invoicing received and distributed by clients on the Fortnox platform accounts for 20% of the GDP in Sweden. This large, accurate, real-time data set (consented to by clients) gives Fortnox an edge in understanding the credit profiles of companies on its platform, and therefore pricing risks more appropriately. For example, a company with an outstanding receivable can be paid immediately, rather than three months later, for a smaller charge from Fortnox compared to that charged by a traditional bank, and with the ease of using a single platform. While this initiative is still in early stages, the optionality is not insignificant. Revenue per client of working capital financing at peer companies is 25-50 times larger than Fortnox's existing revenue per client. We believe the Fortnox thesis is attractive as an accounting software company and will continue to monitor its progress on the fintech front.

During the quarter, we eliminated our position in Albioma, a French alternative-energy company that generates energy from biomass (often bagasse) and photovoltaic sources. Albioma mainly contracts with the French state electricity utility, Électricité de France (EDF). EDF has a monopoly in supplying power in the French territories, small islands that are independent of a power grid, and often in places where there are not many wind or solar energy options. Albioma announced an agreement to be acquired by private equity firm KKR earlier this year at a 51.6% premium over Albioma's undisturbed closing price. Following regulatory approval during the quarter, we tendered our shares on behalf of our clients.

Firm Update

If you have not had a chance yet, we encourage you to check out our latest blog post "Team Decisions: Why Our Investment Team Structure Helps Us Make Better Decisions" by **Keith Lee**. In the note, Keith explores three aspects of our team structure at Brown Capital: our use of **teams** instead of individual portfolio managers (PMs); the **dual-role** analyst/PM responsibilities of each team member; and the fact that team members are **generalists**, as opposed to industry or sector specialists. As you will see, our team structure may not be unique in the industry, but we think it does fit both our research process surrounding Exceptional Growth Companies and our firm culture.

Finally, this quarter we renamed our International Equity strategy to the International All Company strategy. We believe the new name better reflects the fact that this portfolio comprises companies of various sizes and reinforces our practice of using revenue as opposed to market capitalization to gauge company size. The investment team, as well as the strategy's philosophy, process and objective remain the same.

As of 09/30/2022*

Company Name	Percentage Held in Portfolio
CyberArk Software Ltd.	5.8
Kinaxis, Inc.	4.8
Wisetech Global Ltd.	4.2
Evotec SE	3.4
Dechra Pharmaceuticals Plc	3.2
MIPS AB	0.8
FORTNOX	0.5
Albioma	0.0

This is not a recommendation to buy or sell a particular security. Holdings are subject to change.

The table below shows the performance of the Portfolio versus several market indices.

As of 09/30/2022

	Annualized						
	QTD	YTD	1 Year	3 Years	5 Years	10 Years	Since Incept. *
International Small Company Composite – Net	**-9.13%**	**-40.02%**	**-38.25%**	**2.05%**	**6.08%**	**N/A**	**10.14%**
MSCI ACWI Ex US Small Cap Index	-8.25%	-29.07%	-28.57%	0.80%	-0.16%	N/A	2.78%

Source: APX

*Since inception performance is based on Composite creation date of 12/31/2013.

Past performance is not indicative of future results. Returns are presented net of investment advisory fees and reflect the reinvestment of interest, capital gains, and dividends net of any withholding tax. Net of fees performance is calculated using actual management fees and are reflective of actual fees as fees paid vary by client. Gross numbers are furnished upon request. Please see disclosures.

Please refer to the attached GIPS Report. It contains additional required disclosures and important information regarding calculation of performance data, including the general effect of fees on returns. Past performance is not a guarantee of future results.

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Disclosure Requirements

International Small Company Composite

As of 12/31/2021

					3 Year Standard Deviation				
Year	Net of Fees Total Return Composite*	Gross of Fees Total Return Composite*	Gross of Fees Total Return MSCI ACWI Ex-US Small Cap Index	Gross of Fees Equal Weighted Standard Deviation	Gross Composite Annualized Ex-Post Standard Deviation	MSCI ACWI Ex-US Small Cap Index Annualized Ex-Post Standard Deviation	# of Accts.	Composite Assets ($ Millions)	Total Firm Year-End Assets ($ Millions)
2014	10.72%	10.98%	-3.69%	N.A.**	N.A.***	N.A.***	<5	$57	$6,682
2015	15.84%	16.26%	2.95%	N.A.**	N.A.***	N.A.***	<5	$78	$7,350
2016	2.61%	3.02%	4.29%	0.55%	12.37%	12.15%	5	$81	$8,060
2017	42.24%	42.80%	32.12%	1.63%	11.83%	11.54%	6	$138	$9,702
2018	-1.52%	-1.01%	-17.89%	0.70%	15.20%	12.36%	7	$279	$9,744
2019	28.09%	29.14%	22.93%	1.61%	14.36%	11.60%	8	$1,075	$13,049
2020	45.36%	46.69%	14.67%	2.57%	20.57%	20.97%	8	$2,146	$18,484
2021	13.04%	14.12%	13.36%	0.37%	18.31%	19.85%	11	$3,498	$17,576

* Past performance is not indicative of future returns.
** N.A.–Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire period or for partial year periods.
*** 3-year annualized standard deviation is not presented because the composite does not yet have 36 monthly returns.

Compliance Statement

Brown Capital Management (BCM) claims compliance with the Global Investment Performance Standards (GIPS ®) and has prepared and presented this report in compliance with the GIPS standards. BCM has been independently verified for the periods January 1, 1993 through December 31, 2021. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards.

Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The International Small Company Composite has had a performance examination for the periods December 31, 2013 through December 31, 2021. The verification and performance examination reports are available upon request.

The Firm

BCM is defined as an independent investment management firm established in 1983 that is not affiliated with any parent organization and is registered under the Investment Advisers Act of 1940. BCM manages a variety of equity and balanced accounts for domestic and international institutional clients. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request. A list of composite descriptions and broadly distributed pooled funds is available upon request.

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Disclosure Requirements

International Small Company Composite

As of 12/31/2021

Composite
The International Small Company Composite represents the performance of fee-paying investors where BCM has sole investment authority. The composite seeks long-term capital appreciation through investing in equity securities. Revenues, of $500 million or less at initial purchase rather than market capitalization is used to define smallness. The majority of the portfolio has a market capitalization of less than $5 billion. No alterations of the composite have occurred because of changes in personnel, or for other reasons at any time. There has been no selectivity of account results for any period. Data for all accounts has been continuous from each account's first full quarter of management through the last full month of management prior to cessation of the account. Investors should be cognizant of the fact that while, there is the potential of gains, there is also the potential of losses. Composite creation date is December 31, 2013, and reflects activity of current managers. Inception date is December 31, 2013.

Benchmark
The composite is measured against the MSCI ACWI Ex-US Small Cap Index. The MSCI ACWI Ex-US Small Cap Index for numerous regions and countries across Developed, Emerging, and Frontier Markets. The index includes over 6,400 securities across Developed and Emerging Markets and approximately $4.4 trillion in free float market capitalization; 4,400 of these small caps are outside the U.S. The index targets approximately 14% of the free-float adjusted market cap in each market.

Methodology
The composite is reported in U.S. dollars. BCM has adopted a Valuation of Securities policy which requires that all client portfolios and investments reflect current, fair, and accurate market valuations. For month end pricing, BCM's policy is to use 4:00 p.m. prices for equity securities, where such is available. BCM utilizes, to the fullest extent possible, recognized and independent pricing services and/or qualified custodians for timely valuation information for advisory client securities. Whenever valuation information for specific, illiquid, foreign, private or other investments is not available through pricing services, the Chief Compliance Officer will work with the trader(s) and Portfolio Manager(s) to obtain and document price information from two independent sources if available, whether it be a broker-dealer, bank, pricing service, or other source. Any errors in pricing or valuations are to be resolved as promptly as possible, preferably upon a same day or next day basis, with re-pricing information obtained, reviewed, and approved by the Chief Compliance Officer and the Portfolio Manager(s) for the strategy.

Securities without market valuation information (e.g., illiquid securities, or other such situations) are to be reviewed and priced by the Trading Department and Chief Compliance Officer, in conjunction with an appropriate Portfolio Manager in good faith to reflect the security's fair and current market value. Through regular monthly reconciliation with custodian banks, any significant irregularities in prices will be detected and corrected before market values are finalized and performance calculation is done.

Fees
Investment advisory fees are:

1.00% of all assets

Gross performance figures are presented (a) gross of investment management fees and custodial fees, (b) net of trading expenses, withholding tax, and other fees and reflect the reinvestment of interest, capital gains, and dividends. Net performance figures are presented net of withholdings taxes and all management fees, trading expenses, and other fees. Net of fees performance is calculated using actual management fees. The net return is reflective of actual fees and fees paid vary by client.

Internal Dispersion
Internal dispersion is calculated using the equal weighted standard deviation of annual gross-of-fees returns of those portfolios that were included in the composite for the entire year. For those years when less than five portfolios were included in the composite for the full year, no dispersion measure is presented.

Ex-Post Standard Deviation
The 3-year annualized standard deviation measures the variability of the composite gross returns and the benchmark returns over the preceding 36-month period and is not presented for periods where 36 months of composite performance is not available.