



Reflecting on 25 Years of Investing & The Enduring Power of Active Growth

A Letter from Grant Babyak

Twenty-five years ago, we founded our firm on a straightforward conviction: that deep, fundamental research could uncover exceptional small and mid cap companies capable of compounding capital over the long term. Since then, global markets have undergone seismic shifts. We have navigated tectonic technological revolutions, dramatic regulatory overhauls, and historic macroeconomic cycles. Yet, amid continuous change, the core principles of active, fundamental-driven growth investing remain as powerful and relevant as ever.

While market structures, information velocity, and competitive dynamics have transformed completely; our foundational philosophy, culture, and alignment with clients have not wavered. This milestone offers me an opportunity to reflect on the lessons of the past quarter-century, and I look forward to the next generation of investment opportunities.

“Same as it ever was...” - David Byrne

It is hard for me to believe that I have been investing professionally for almost 40 years now, and that I have had the incredible honor and privilege to work alongside my colleagues at TimesSquare Capital and manage money for our wonderful clients for more than two decades. It has been an incredibly interesting and dynamic time to be investing in growth companies. We have witnessed a staggering amount of technological change, innovation and disruption across industries, as well as the rise and fall of corporate fortunes. Although it certainly has not been a straight line, up and to the right, the stock market has been an incredible compounding machine to grow wealth over time, and it has been an exciting ride from the vantage point of a small and mid cap investor.

Why We Started TimesSquare

We founded TimesSquare during a period of intense market volatility, motivated by both a clear opportunity and a strong personal conviction. In the late 1990s and early 2000s, traditional asset management often fell into one of two traps: hugging benchmarks or chasing speculative momentum. We saw a meaningful gap in the market for a disciplined, dedicated approach to small and mid cap growth equities, an asset class often mispriced because of limited institutional attention and short-term thinking.

We built our firm to fill that void, soundly grounded in an owner-operator mindset. We believe that investment managers should invest alongside their clients, ensuring complete alignment of interests. From day one, we have committed to long-term partnerships with our clients, treating their capital with the same care and rigor as our own.

An early formative test came during our first major market downturn in 2003. Investment narratives unraveled as the excesses of the dot-com era—particularly telecom capital spending—continued to weigh on markets. At the same time, confidence was shaken by a series of corporate scandals, from Tyco and WorldCom to Enron, while geopolitical uncertainty mounted in the aftermath of 9/11 and the lead-up to the Iraq War.

That period taught us a lasting lesson: successful investing requires distinguishing a company's stock price from its intrinsic business value and recognizing how far markets can swing to positive or negative extremes. This experience reinforced our discipline, strengthened our conviction in fundamental research, and helped shape the investment approach that continues to guide us today.

A Focus On Research

It takes a different mindset to be a small and mid cap investor, and this was particularly true in the early 1990s. At that time, small companies didn't spend a lot of their time marketing to investors and telling their story. As small cap investors, we had to do a great deal of our own thinking, research and analysis, because these firms were typically not well-covered. Big banks and sell-side brokerage firms did not devote resources to follow small and mid cap companies, since they typically weren't large investment banking clients who generated hefty fees through follow-on offerings or M&A activity. When we would begin our research in the firm's library (remember this was before the internet!), we would get very excited when we came across a "thin file" company, one where there might only be a few annual reports and a couple of research reports written by regional brokerage firms. That would get us thinking that we might have a "hidden gem" on our hands.

We conducted our own research on the company to see if it had a unique or compelling product or service; a sustainable competitive advantage that would allow them to earn high margins and high returns on capital; and assess whether they had an honest and competent management team that was shareholder friendly and were good stewards of capital. Ultimately, the decision to buy that good business came down to the price we were willing to pay, anchored to our assessment of intrinsic value. Valuation has always been a key part of our investment process. We invested a lot of time and effort to build out our research capabilities at TimesSquare by hiring analysts and associates who had deep knowledge of their respective industries to give us an edge in analyzing businesses and key industry drivers.

With the advent of the internet and the ubiquity of news and data sources; the information advantage enjoyed by many small cap investors, including ourselves, was diminished. In fact, I'd argue that the last two decades have been characterized by a deluge of data points and information, so much so, that it is creating too much noise that emphasizes short-term thinking and reactive behavior. In that environment, I see more opportunities for the patient, thoughtful and long-term investor like TimesSquare, who can take advantage of market dislocations and overreactions when everyone is focused on the latest data point and missing the longer-term implications on fundamentals. Our investment edge is not merely gained by having better access to information--it is by making more informed analysis, better judgment and through independent thinking.

Another major shift I have noticed over my career centers around valuations. Historically, small and mid cap stocks enjoyed a valuation premium due to their higher expected growth rates. Plainly stated,

it is easier for a smaller company to double its sales and earnings off a lower base, so they historically traded at a higher price-to-earnings ratio because they grew faster than the larger capitalization companies. More recently, the larger cap, Mag 7 tech companies have had above-average growth rates, and so their P/E ratios have eclipsed those of smaller capitalization for some time. Although we may never see small caps return to the P/E premium that they enjoyed in the 1990s, I expect to see relative valuations improve as the growth rates have been trending up and approaching parity.

Additionally, I've observed that the definition of small and mid cap market cap ranges has widely varied. When I started investing in small cap companies, the ceiling for the investing was \$1.5 billion for small cap and \$5 billion for mid cap. Now, with the steady upward move in the markets, the ceiling for the small cap benchmark upon the June 2026 reconstitution is approximately \$13 billion and the top of mid cap is over \$80 billion. With the deep pockets of venture and private equity funds, companies can stay private for longer. When they do come public, it is at such a size and maturity level that they are at the upper end of mid cap or in large cap. Particularly in the technology and life sciences areas, smaller companies that would have once come public, are now getting acquired by well-funded public companies as a way to preempt competition or address patent cliffs. The dearth of small and mid cap IPOs may be coming to end, as our analysts recently have been doing a healthy number of pre-IPO/preliminary meetings with smaller companies.

As we look to the future, we remain excited about the opportunity to invest in small and mid sized growth companies. AI promises far-reaching productivity gains and should drive elevated capital spending for years to come. We are also seeing breakthrough treatments in medicine and advances in transportation, safety, automation, and defense. Yet even as we keep one eye on the future, we remain grounded in the principles that have guided us through strong and challenging markets alike. We will continue to evaluate each opportunity on its own merits, ensuring it fits our time-tested definition of a good business trading at a reasonable valuation. We do not chase hype or fads, and we seek to avoid the “irrational exuberance” that can undermine other growth investors.

Some Observations & Lessons Learned

1. Markets Will Change—Human Behavior Will Not

Over twenty-five years, we have managed capital through tech bubbles, credit crises, global pandemics, and inflationary cycles. While the catalysts for these market events differ, the underlying human behavior remains remarkably consistent. Fear, greed, herd mentality, and FOMO (fear of missing out) continue to drive short-term market prices. Success in long-term active investing requires temperament and discipline to stay anchored when market sentiment swings to extremes.

2. A Commitment to Quality

True quality growth is distinct from temporary momentum. True growth is driven by structural, durable competitive advantages, high returns on invested capital, and robust free cash flow. In contrast, temporary momentum is often fueled by cheap leverage or fleeting macro trends. We also place a premium on the quality of a company's management. Exceptional leadership teams demonstrate clear capital allocation discipline, operational excellence, and integrity. Ultimately, we let corporate fundamentals—not popular market narratives—drive our investment decisions.

3. Match the Management Approach We Seek

At TimesSquare, we invest in our business the same way we invest our clients' capital, with a long-term mindset. Rather than chasing short-term trends or reacting to market noise, we remain singularly focused on generating alpha through disciplined, active management in the small and mid cap growth universe. Our alignment is strengthened by our investment alongside our clients, ensuring our interests are aligned with theirs.

4. Mistakes Have Made Us Better

We have made mistakes over the past 25 years, and each error has refined our investment process. Our most valuable lessons came from investments where we underestimated secular technological disruptions or overvalued a management team's turnaround plan. Failures like these led us to enhance our downside risk assessments and implement more rigorous stress-testing for structural risks within our portfolio construction.

Evolution Without Compromise: How the Firm Has Grown

As markets evolve, an investment process cannot remain static. Over the years, we have systematically refined our analytical frameworks. We have integrated advanced data analytics and other technologies into our workflow, improving our screening capabilities and alternative data tracking. However, these tools serve to enhance, not replace, human judgment in our investment process. Technology like AI optimizes our data collection, freeing our analysts to focus on deep qualitative assessments and big picture thinking.

Growth at our firm is guided by intention, not growth for growth's sake. We maintain strict portfolio construction discipline and manage our asset capacity carefully to preserve our ability to invest in less liquid small and mid sized companies. Furthermore, over the years we have invested heavily in employee development. From my vantage point with nearly 40 years of experience, it is wonderful to see long-time colleagues with 20-30 years become greater contributors and take on additional responsibilities at TimesSquare. I can also see how analysts, who recently joined us earlier in their careers, might reach that stage in the not-too-distant future. Cultivating the next generation of analysts and portfolio managers internally preserves our core culture while building an enduring organization.

The Industry Ahead: Challenges & Opportunities

Today's asset management landscape is clearly dominated by passive investing, index fund growth, and quantitative strategies. While passive vehicles provide low-cost market exposure, they also create clear market inefficiencies. Passive flows frequently push capital into large cap benchmarks irrespective of fundamentals, leaving the small and mid cap growth sectors even more under-researched and mispriced. For example, based on our FactSet analysis after the June 2026 Russell Reconstitution, over 20% of the small cap index was in stocks without any earnings forecasted for the next year.

At the same time, institutional short-termism increased, causing more active managers to hew closer to the indexes. We believe this environment creates significant opportunities for active managers like TimesSquare who have longer investment horizons and foster independent thought. Increased market volatility provides a fertile hunting ground to acquire high-quality businesses at attractive valuations. Navigating this environment requires ongoing discussions and transparency, ensuring our clients understand how short-term volatility sets the stage for long-term outperformance. Quality growth as an investing approach may not always be in favor in the short term, for example, when momentum-driven strategies are in favor, but historically this approach has been successful for our clients over longer periods of time.

Looking Ahead

As we look ahead to the next quarter-century, our firm's strategic priorities remain focused on maintaining our competitive edge by

- **Deepening our research edge:** Expanding our primary research capabilities into emerging industries and evolving market segments. This also includes utilizing new tools, such as artificial intelligence to automate routine data processing while preserving critical human analysis.
- **Strict capacity discipline:** Protecting our investment style by closing strategies before asset size dilutes performance.
- **Succession continuity:** Ensuring seamless leadership transitions so our investment philosophy remains consistent across generations.

We begin our next chapter with high energy and optimism. We are excited about the myriad of investment opportunities we see ahead of us. We are witnessing a new generation of visionary entrepreneurs building innovative businesses across healthcare, technology, and industrial infrastructure. Our firm is structured, seasoned, staffed, and positioned to uncover these opportunities, to navigate market cycles, and deliver strong results for our clients for the next 25 years.

I want to personally thank all our clients throughout the years for the trust and confidence they have placed in TimesSquare and our investment team. We are privileged to steward your capital, and our mission has always been and will continue to be to serve your best interests through disciplined investing, thoughtful partnership, and a steadfast commitment to delivering the best outcomes we can over the long term.

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