

WHY MINNESOTA WORKS FOR INVESTORS

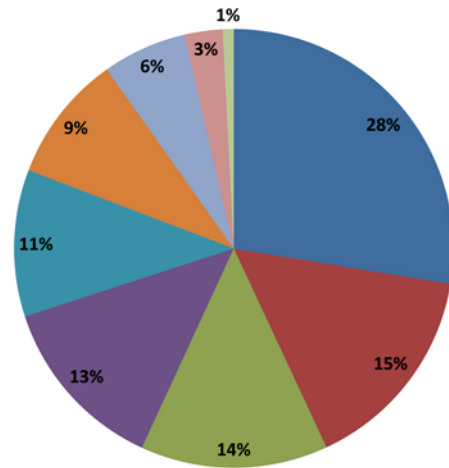
White Paper - January 2017

This White Paper describes what we at Mairs & Power have long known. Minnesota and the Upper Midwest present an opportunity-rich landscape for investors. We are neither arguing within these pages for a set of economic policy prescriptions nor are we beating the drum of regional boosterism. We are investors seeking to understand our investment environment and explain to our friends and clients both the foundations of our success and the soundness of our investment focus into the future. We welcome your comments and questions.

Land of Diversity

Known as the land of 10,000 lakes, Minnesota's natural landscape is extremely diverse, ranging from eastern woodlands to boreal northern forests to prairie grasslands. The state's business landscape is equally diverse. Among large cap S&P 500 companies located in Minnesota, health care currently comprises the single largest sector (29%) followed by industrials (23%) and financials (16%). A similar diversity exists among S&P 600 small cap companies where the two largest sectors, industrials (28%) and consumer discretionary (15%), are followed by utilities (14%).

Diverse Minnesota
Breakout of Minnesota's
S&P 600 Companies by Sector



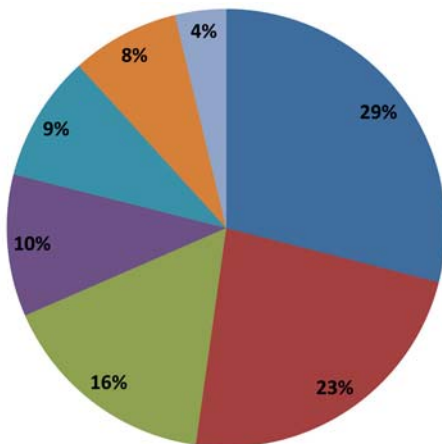
Sector

- Industrials
- Consumer Discretionary
- Utilities
- Materials
- Information Technology
- Health Care
- Consumer Staples
- Financials
- Energy

Data as of September 30, 2016 from FactSet
As measured by market cap
Sectors subject to change

While investors seek diversity in constructing their portfolios to protect against volatility, a broad spectrum of industries delivers several advantages to the regional economy as well. Diversity provides a buffer in times of economic distress as demonstrated during the recent Great Recession when Minnesota's unemployment rate consistently ranked below the national average and began trending down ahead of the national unemployment rate.¹

Diverse Minnesota
Breakout of Minnesota's
S&P 500 Companies by Sector

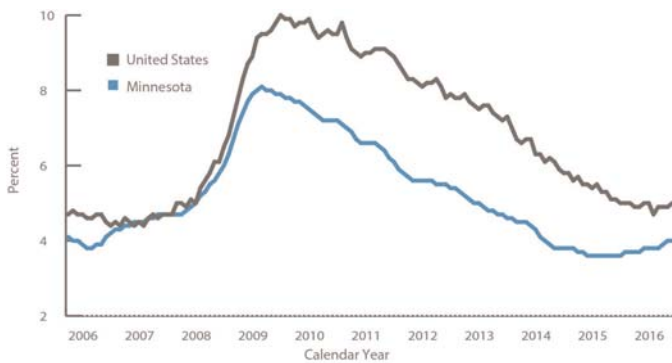


Sector

- Health Care
- Industrials
- Financials
- Consumer Staples
- Consumer Discretionary
- Materials
- Utilities

Data as of September 30, 2016 from FactSet
As measured by market cap
Sectors subject to change

Unemployment Rate (seasonally adjusted) 2006-2016



Data as of September 2016 from U.S. Bureau of Labor Statistics

The lack of over-reliance on a narrow economic base has also enabled relatively consistent long-term private and public investment. The region's basic infrastructure such as transportation, energy, housing, and health care combined with amenities such as parks, cultural and educational institutions all contribute to the solid economic base and quality of life that attracts employers and workers alike. A wide variety of employment opportunities enhances the region's appeal to new entrants, entrepreneurs, skilled workers and managerial talent.

The state's diverse and robust economy, a highly educated workforce and access to capital are some of the attributes that make Minnesota and the Twin Cities attractive and consistently earn the state and the Metro region recognition in the business and general press as an outstanding place to live and work, illustrated by one headline in *The Atlantic* magazine, "The Miracle of Minneapolis." Looking at ten different factors, the business network CNBC ranked Minnesota the 7th best state for business over the past decade and fourth in 2016. The state was second best for overall quality of life and education, fifth for infrastructure and 9th for technology and innovation. Other surveys ranked the state 7th for economic competitiveness ninth easiest for small business startups, and 11th for overall ease of small business activity.²

Leadership Across Multiple Dimensions

Minnesota ranks 21st among the states in terms of population³ and 14th as measured by state gross domestic product (GDP),⁴ but on many measures of economic vitality both the state and the Minneapolis/St. Paul metropolitan area punch well above their weight, which we believe also contributes to the opportunity-rich landscape we have found as investors.

Though located in the middle of the continent, Minnesota has long fostered an outward looking export-oriented business culture. Five major ports on the Mississippi River and four on Lake Superior make Minnesota a trading nexus and its northern border touches the U.S.'s largest trading partner, Canada. The Minneapolis/St. Paul International Airport is a major hub, serving 110 domestic and 22 international markets with non-stop connections, ranking 6th among U.S. airports for the number of non-stop connections per capita, 5th in overall customer satisfaction, 17th in passenger traffic and 27th in freight shipments. The region's air, rail, highway and water transportation links connect the area to both national and global markets, earning Minnesota the 5th highest rank in 2016 for transportation infrastructure.⁵

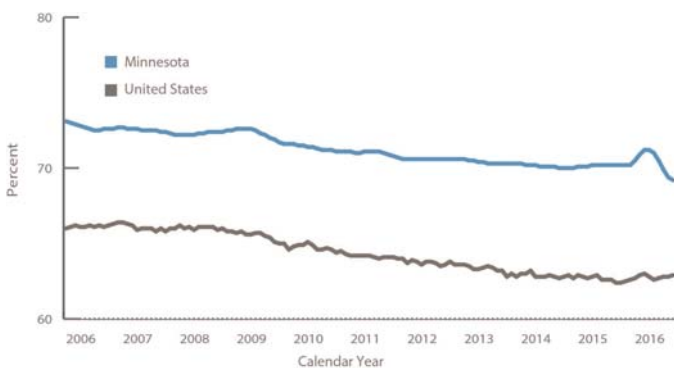
Minnesota-based companies export to nearly 200 countries. The state is ranked 4th for agricultural exports,⁶ 13th for high-tech exports,⁷ and among the top 20 for manufactured exports.⁸ From 1997 to 2013, Minnesota's export of manufactured goods rose as a percent of total state GDP, from 5.4% to 6.2% and averaged 5.3% compound annual growth, in line with the overall rate of export growth nationwide. Even with the rapid strengthening of the dollar in 2015 which hurt exports nationwide, Minnesota exports remained between 5.9% and 6.3% of state GDP throughout the year and managed to outperform the national rates of export growth.⁹ This export orientation manifests itself in Mairs & Power Growth Fund portfolio companies, which derived 35% of their revenues, as of their latest fiscal year, from international sales.¹⁰

In addition to transportation, the state’s energy infrastructure also supports a robust business climate. Industrial and commercial electricity rates have remained at or below the national average and industrial natural gas prices are 7th lowest in the nation.¹¹

Minneapolis/St. Paul remains among the top money centers in the U.S., ranking 14th for equity assets and 13th for fixed income assets under management, 13th for the percent of venture capital dollars invested in 2016 and the Minneapolis/St. Paul metro region ranked 19th among the 132 largest metropolitan regions for venture capital activity.¹²

Employers find in Minnesota a well-educated and highly motivated workforce with a strong work ethic. The state ranks 4th nationwide for overall human resources¹³ and holds the second highest labor force participation rate in the country, consistently several points above the national average.¹⁴

Labor Force Participation Rate
(seasonally adjusted)
2006-2016



Data as of September 2016 from MN Department of Employment and Economic Development

More than 200 post-secondary public and private institutions attracts young people to the area while providing employers with a rich and deep pool of educated workers in disciplines ranging from the sciences and engineering to law, business and the humanities. For ten consecutive years, Minnesota’s

college bound high school seniors have ranked number one nation-wide on ACT scores¹⁵ and in the top ten for retaining its college graduates.¹⁶ This well educated workforce finds a welcoming environment for employment. The Minneapolis/St. Paul metro area is ranked among the top ten metro markets for finding employment.¹⁷

The Long-Tail Advantages of the University of Minnesota & Human Capital

But beyond the lists, rankings and numbers, Minnesota enjoys what we believe are significant “long tail” advantages, not immediately visible on the surface, but which continue to nurture a robust climate for entrepreneurs and established businesses alike.

The Morrill Act of 1862 established land grant colleges to promote “agriculture and the mechanic arts” paving the way for the industrial revolution and tying the mission of public universities to regional economic development. As one of these land grant colleges, the University of Minnesota continues to play a pivotal role in both the state and regional economy. With the 8th largest research budget among public institutions and 14th among all universities,¹⁸ the University of Minnesota - Twin Cities has built a reputation as a leader in several disciplines including medicine, engineering, sciences, business and economics. Decades ago, the successful founders of companies in high performance computing and medical device technology were themselves graduates of the “U” or drew heavily on the trained engineers and scientists coming from there. With an urban campus located in the heart of a major metropolitan area (unusual among land grant colleges), the University of Minnesota’s Twin Cities campus is easily accessible to business and industry, not only producing an educated workforce but also providing technical expertise, research capability and infrastructure to businesses and industries across the region.

Minnesota and the Minneapolis/St. Paul metropolitan region in particular have been a headquarters intensive business community for decades, boasting 17 Fortune 500 headquarters

and 8 headquarters among the Forbes 500 largest private companies list in 2016. Both rankings put Minnesota in the top ten based on the raw numbers and even higher when ranked by headquarters per capita.

Unpublished research from Prof. Myles Shaver¹⁹ at the University of Minnesota’s Carlson School of Business examines the historical roots behind this phenomenon and its economic impacts. He finds that the region’s ability to attract managerial human capital over a long period of time stands in contrast to many other major metropolitan areas, particularly in retaining higher income, college educated professionals who are in their child rearing years. This concentration of managerial expertise provides a pool of talent for start-ups and established companies alike, encourages cross fertilization of knowledge and experience both within and across industry and, with the region’s diverse employment opportunities, reduces the perceived risk for entrepreneurs contemplating a move to a start-up venture. This set of factors create what Shaver has described as a “virtuous circle” of managerial human capital and an environment for new businesses which can eventually “grow really big” while sustaining and re-inventing established businesses over time as well.

The evidence of Minnesota’s robust business investment return environment is demonstrated by comparing the S&P 500 with the 100 largest companies in Minnesota, compiled by the Star Tribune newspaper and Piper Jaffrey.

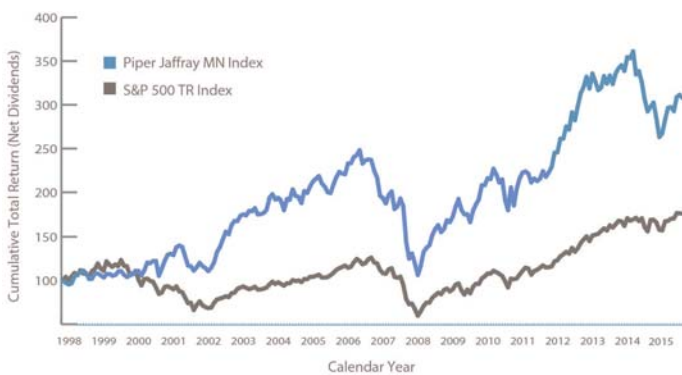
A History of Business Successes

Minnesota’s wealth of successful public companies is rooted in its history. Any effort to describe the dynamics of a regional economy over time will necessarily rely on generalizations and anecdotes. But we believe the following examples can illuminate important factors underlying the success we have had in investing in Minnesota-based companies.

Economists talk about “industrial districts” to describe the dynamic that creates regional concentrations within a particular sector²⁰. Though complex and multi-layered, this process of regional economic growth is intuitively logical. While not unique to Minnesota, the process has repeated itself several times over generations and decades, resulting in the rich opportunity set we are fortunate as investors to find here. First, a few integrated “anchor firms” established themselves. The natural interplay of both experienced managers and skilled labor provided cross-fertilization of expertise, and encouraged best practices within an industry as firms competed against one another, merged with and acquired one another and as employees moved between companies. Over time the concentration of firms in one sector nurtured a constellation of specialized suppliers and professional services firms, from finance and banking to legal and accounting, further strengthening basic business infrastructure and creating a fertile environment for entrepreneurial spin-offs and startups. It is a process that has repeated itself again and again in Minnesota creating the opportunity-rich landscape we see today.

This cycle of development in one sector after another has created a robust and self-reinforcing climate for continued successful business investment. The early success of Minnesota-based companies in high performance computing and medical device technology, both as businesses

S&P 500 vs. Piper Jaffray MN Index as of September 30, 2016



Data as of September 30, 2016 from FactSet

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted.

and investments, not only created a foundation for other companies within their industries, but inspired multiple other entrepreneurial efforts, attracted ambitious and talented business people to the region and fed the growth of Minneapolis/St. Paul as a center for capital formation, business start-ups and initial public offerings (IPO) across multiple industries.

The First Industrial District of the Computer Age

In 1947, a group of engineers who had been breaking enemy codes during World War II, founded a new company in an empty wartime plant in Minneapolis with the encouragement of their former employer, the U.S. Navy. The company, Engineering Research Associates (ERA), was established to continue providing intelligence processing capability against the rising threat of the Soviet Union. Two key ERA employees, William Norris and Seymour Cray, went on to found Control Data and Cray Research respectively, establishing Minnesota as a center for high performance computing at the dawn of the computer era.²¹

In those early days, IBM and the “BUNCH” (Burroughs, Univac, NCR, Control Data and Honeywell) made up the mainframe computer industry. ERA eventually became part of Univac with major operations in St. Paul, Control Data and Honeywell were both based in Minnesota and IBM had major engineering operations in the state. This early concentration of four of the major mainframe computer companies arguably marked Minnesota as the first “industrial district” in the information age, well before the rise of Silicon Valley in California or Route 128 outside of Boston. Nearly seven decades after ERA was founded, technology companies continue to call Minnesota home. Today, Cray Inc., headquartered in Seattle and building upon the legacy of the original Cray Research, maintains its largest R&D center in Minnesota with manufacturing operations in neighboring Wisconsin. Currently, Minnesota ranks 11th among all the states for the percent of state GDP derived from the technology industry at 7.5%. The leading sectors by employment are in systems

design and the manufacture of measurement and control equipment.²²

Incubator for Medical Technology & Life Sciences

In 1957, the same year Control Data was formed, an engineer named Earl Bakken developed the first portable heart pacemaker at his small company in Minneapolis. Medtronic’s pioneering success set in motion a similar dynamic to that unleashed by Control Data, attracting entrepreneurs and establishing the region as a leader in medical device technologies and life sciences. In recognition of this legacy, in 2015 Minnesota’s Medical Alley was enshrined in the Smithsonian’s America History Museum as one of America’s great “Places of Invention” - alongside Silicon Valley and Hollywood.

In addition to Medtronic, more than 300 public and private companies involved in medical device and life sciences technology have operations or headquarters in Minnesota today.²³ Among the names are St. Jude Medical (recently acquired by Abbott but still located in Minnesota), Boston Scientific’s Guidant division, Bio-Techne and Vascular Solutions. In addition to world class health care providers and universities, the region has become home to a host of ancillary companies across a diverse spectrum from bio/pharmaceuticals and health IT to R&D, testing and analytics, creating a healthy and growing industrial district continuing to attract investment focused on medical tech and biological/life sciences. Minnesota ranks as the second best state for medical device manufacturers based on its long and path-finding history, the presence of leading companies such as Medtronic and medical institutions like Mayo Clinic, the deep infrastructure of suppliers to the industry and strong support from state government.²⁴

Direct Digital Manufacturing - Minnesota's Role in the Next Industrial Revolution

Today, Minnesota-based companies are playing a major role in what we believe may be the next industrial revolution unfolding in its early stages. Combining the power of computer-aided design and simulation, innovations in material science and advances in 3D printing, or numerically controlled fabrication, companies with a local presence such as Stratasys and Proto Labs have become leaders in rapid prototyping and direct digital manufacturing. These technologies promise to fundamentally transform the speed, cost and quality of manufacturing across industries.²⁵ As investors, we are excited by the prospect of these revolutionary developments and benefit from our ring-side seat as we both participate in and observe the industry's evolution.

Minnesota: An Opportunity Rich Landscape for Investors

Successful investing requires discipline, patience and a singular focus on what matters. Our success over more than eight decades has been built on delivering superior long-term investment performance for our clients. While solid investment opportunities can be found in many places beyond the borders of Minnesota and the Upper Midwest, our firm's second president, George Mairs III, recognized that he was surrounded by an abundance of opportunities close at hand. Taking advantage of that fortunate circumstance, investing in what we know, has enabled Mairs & Power and our clients to grow and prosper. We believe that by looking for investment opportunities close at hand, we will continue the Mairs & Power legacy of investment success far into the future.

Notes:

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Disclosures

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The S&P 500 Total Return (TR) Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. It tracks both the capital gains of a group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

The S&P 600 Small Cap Total Return (TR) is an index of small-company stocks managed by Standard and Poor's that covers a broad range of small cap stocks in the U.S. The index is weighted according to market capitalization and covers about 3-4% of the total market for equities in the U.S. It tracks both the capital gains of a group of stocks over time, and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

The Piper Jaffray Minnesota Index is a price-weighted index designed to measure the performance of the Minnesota economy. Performance data quoted represents past performance and does not guarantee future results.

The statements and opinions expressed are those of the adviser, Mairs & Power, Inc., and are as of the date of the report. All information is historical and not indicative of future results and subject to change. This information is not a recommendation to buy or sell. Past performance does not guarantee future results.

Top Ten Common Stock Holdings

Percent of Total Net Assets	%
Ecolab Inc.	4.5
U.S. Bancorp	4.4
St. Jude Medical Inc.	4.0
3M Company	3.9
Honeywell International Inc.	3.7
Medtronic, Inc.	3.5
Johnson & Johnson	3.5
Bemis Co., Inc.	3.4
Graco Inc.	3.4
Donaldson Co., Inc.	3.1

All holdings and percentages mentioned are as of 9/30/2016. All the holdings in the portfolio are subject to change without notice and may or may not represent current or future portfolio composition. The mention of specific securities is not intended as a recommendation or an offer of a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

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