

Mairs & Power Growth Fund Investor Class MPGFX

Analysis

Not flashy, just good.

By Tony Thomas 4/13/2017

Mairs & Power Growth's prudent, long-term approach, emphasis on high-quality companies, and strong stock-picking have generated an attractive risk/reward profile that earns it a Morningstar Analyst Rating of Silver.

Like all Mairs & Power managers, Mark Henneman and Andy Adams are buy-and-hold investors who favor financially sound companies with good management, durable competitive advantages, and above-average returns on equity. They shop local because they think consistent access to management, employees, and the local community gives their fundamental research an edge. As a result, more than 50% of the companies they own are headquartered in the firm's home state of Minnesota. Nearly all companies in the portfolio are profitable, and 46 of 52 pay dividends. The portfolio resembles the diverse economy of the Upper Midwest, with sizable stakes in industrials, healthcare, and basic materials.

The fund returned to form in 2016 with a top-decile performance in the large-blend Morningstar Category after poor showings the previous two years. The portfolio's diverse mix of stocks doesn't set the pace in strong bull markets but falls much less in down markets. The fund's rolling three-year returns since the beginning of Henneman's tenure in January 2006 beat the benchmark S&P 500 in 65% of the periods, with the greatest outperformance coming in periods covering the financial crisis.

Mairs & Power's strong investment culture is a plus. Henneman and longtime former manager Bill Frels, who retired at the end of 2014, were named 2012 Morningstar Domestic-Stock Fund Manager of the Year on the back of distinctive performance in the fund's basic materials and industrials holdings. Now the lead manager, Henneman taps comanager Andy Adams to find small-cap companies with long-term growth prospects. The idea is to create a farm system for identifying small-cap

growth companies that can complement the fund's larger-cap holdings. Adams' notable success at Mairs & Power Small Cap MSCFX bodes well for this team's efforts to pick up where Frels left off.

Process Pillar: Positive

Like all Mairs & Power strategies, this fund's guiding principle is to buy and hold financially sound businesses with durable competitive advantages and above-average returns on equity. This proven approach earns a Positive Process rating. The managers also favor companies headquartered near the firm's St. Paul, Minnesota, office because they believe that proximity gives them key access to management and an edge in understanding company quality.

The approach is market-cap-agnostic, and the portfolio includes giants like Alphabet GOOG alongside companies with less than \$1 billion in market cap. Ideas are often generated from the managers' meetings with company management. The firm's investment committee comprises 10 investment professionals, including comanagers Mark Henneman and Andy Adams, and vets prospective investments and current holdings based on fundamentals and competitive positions.

When Henneman took over as lead manager in 2013, he expected turnover to increase slightly as he engages in more-tactical trading. He trims positions as valuations increase and adds when they decrease. Despite the increase in trading, the fund's turnover ratio of 11% is well below the category average of more than 60%. Henneman is also cognizant of capacity given the portfolio's inclusion of small-cap stocks, and he considers the limit here to be around \$5 billion.

Mairs & Power's preference for companies based in the Upper Midwest dictates the portfolio's sector weightings. For example, its industrials stake is more than 30% of assets, nearly 3 times that of its S&P 500 benchmark and category peers, and it also has overweightings in healthcare and basic materials. On the other hand, the fund's technology position is only about 6% of the portfolio.

Morningstar's Take

Morningstar Analyst Rating



Morningstar Pillars

Process	 Positive
Performance	 Positive
People	 Positive
Parent	 Positive
Price	 Positive

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

 Gold  Silver  Bronze **Neutral**  Negative

Fund Performance

	Total Return %	+/- Category
YTD	6.24	-0.51
2016	15.38	5.01
2015	-3.07	-2.00
2014	8.12	-2.84
2013	35.64	4.14

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The all-cap strategy here leads to a mix of large and small companies with an average market cap of \$27 billion, well below the category average of \$113 billion. The industrial holdings include giants like General Electric GE and UPS UPS alongside Proto Labs PRLB, a small maker of custom parts. The healthcare names include major, diversified drugmakers like Johnson & Johnson JNJ and Pfizer PFE--no speculative bets here--and established medical-device makers like Abbott Labs ABT and Medtronic MDT.

The fund's regional bias has come with costs and benefits. Minnesota-based Target TGT, a portfolio stalwart, is struggling in the face of competition from e-commerce. Yet recent merger and acquisition activity has benefited local companies. St. Jude Medical was 2016's top contributor thanks to its acquisition by Abbott Labs. Even tiny G&K Services, a provider of uniforms and other facility services based in Minneapolis, was acquired by Cintas CTAS in late 2016.

Performance Pillar: + Positive

This fund can be out of step but delivers over time. Its long-term risk/reward profile is strong, earning it a Positive Performance rating.

Managers Mark Henneman and Andy Adams commit to their investments for the long term, and their record shows the value of that approach. While diversified industrials like Donaldson DCI and Pentair PNR weighed heavily on the fund in 2014 and 2015, the managers remained confident in these companies' prospects. Both companies snapped back in 2016, leading the fund to a top-decile finish in the category for the year--with Donaldson up 600% since it first entered the portfolio in 1998.

Since Henneman's appointment as a comanager in early 2006 through March 2017, the fund has been as volatile as the S&P 500 but has lost less in down markets. Its downside-capture ratio for the 10 years ended March 2017 shows that the fund fared 8 percentage points better than the S&P 500 in bear markets, while peers averaged 4 percentage points worse than the index. The fund's 8.6%

annualized return during that time beats its benchmark by 45 basis points and its large-blend category average by 188 basis points per year. The fund's 30% stake in industrials often dictates performance: In nine of the past 10 years, the fund's yearly return moved in the same direction (and to much the same degree) as the Morningstar Industrials Index.

People Pillar: + Positive

An experienced, cohesive management team emerged from a well-executed transition of power at the fund, earning a Positive People rating. In anticipation of longtime manager Bill Frels' retirement, Mairs & Power raised Mark Henneman from comanager to lead manager in July 2013. After Frels' retirement at the end of 2014, the firm appointed Andy Adams as comanager of the fund, providing assistance to Henneman and keeping a team of managers at the helm.

Henneman joined Mairs & Power in 2004; in addition to his portfolio management duties, he was named the firm's president and CIO in 2015. Adams joined the firm in 2006 as a vice president. Henneman and Adams had worked together at various points during earlier stints at Advantus Capital and U.S. Bancorp Asset Management. Adams is the lead manager on Mairs & Power Small Cap MSCFX, where he has had success since the fund's inception in 2011. Adams' expertise in small caps helps Henneman identify candidates for the growth fund's portfolio. The two funds had 19 holdings in common as of December 2016.

Both managers believe it is important to invest alongside the fund's investors. Henneman has more than \$1 million in the fund, and Adams has \$100,001-\$500,000.

Parent Pillar: + Positive

The success of the Mairs & Power funds reflects the conservative investment philosophy and steady leadership of their advisor, Mairs & Power Inc., earning a Positive Parent rating. The firm's 10 investment professionals form a committee that promotes the core tenets of Mairs & Power's philosophy. They favor buying and holding quality companies that have durable competitive advantages

and above-average returns on equity. They prefer companies based near their St. Paul, Minnesota home, believing that ongoing relationships with management and employees give them an edge in fundamental analysis.

The 86-year-old firm had an orderly transition of power when longtime fund manager and CEO Bill Frels ceded his lead manager duties on the Balanced and Growth funds 18 months before his retirement at the end of 2014. Current chairman and CEO Jon Theobald will retire at the end of 2017, with CIO and fund manager Mark Henneman being groomed as his replacement.

There's no rush here to put out new offerings. For more than 50 years, the firm offered just two mutual funds: the flagship Mairs & Power Growth MPGFX, launched in 1958, and Mairs & Power Balanced MAPOX, launched in 1961. The launch of Mairs & Power Small Cap MSCFX in 2011 built upon the team's growing small-cap expertise. Reasonable fees and strong track records add to the attraction of the Mairs & Power lineup.

Price Pillar: + Positive

The fund's low fees earn a Positive Price rating. The managers' low-turnover approach helps to keep costs down. Fees have held steady around 0.65% in recent years, in the cheapest quartile of similarly distributed share classes.

Investors should be aware of the tax consequences of the fund's successful, long-term investment philosophy. The fund's potential capital gains exposure is 47% as of March 2017, and distributions have been made twice yearly in 2015 and 2016. The managers take steps to control the tax burden of realized gains, such as selling lots with a high cost first.

Morningstar 2017 Analyst Report: Mairs & Power Growth (MPGFX)

The Funds' investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus and summary prospectuses contain this and other important information about the Funds, and may be obtained by calling Shareholder Services at (800) 304-7404 or by visiting www.mairsandpower.com. Read the prospectus and summary prospectuses carefully before investing.

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 Funds may be lower or higher than the performance quoted. As of the prospectus dated April 30, 2017, Mairs & Power Growth Fund, Mairs & Power Balanced Fund, and Mairs & Power Small Cap Fund have annual expense ratios of 0.66%, 0.72%, and 1.05%, respectively. For the most recent month-end performance figures, visit the Funds' website at www.mairsandpower.com or call Shareholder Services at (800) 304-7404.

Average Annual Total Returns for Periods Ending December 31, 2017

	<u>YTD</u> ⁽¹⁾	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>	<u>20 Years</u>	<u>Since Inception</u>
Mairs & Power Growth Fund ⁽²⁾	16.52	16.52	9.23	13.83	9.21	9.64	11.40
Mairs & Power Balanced Fund ⁽²⁾	11.90	11.90	6.71	9.34	7.60	7.75	9.64
Mairs & Power Small Cap Fund ⁽²⁾	7.64	7.64	9.30	14.10	N/A	N/A	17.69
S&P 500 Total Return (TR) Index ⁽³⁾	21.83	21.83	11.41	15.79	8.50	7.20	N/A
Composite Index ⁽⁴⁾	14.41	14.41	7.87	10.27	7.02	6.65	N/A
S&P 600 Small Cap Total Return (TR) Index ⁽⁵⁾	13.23	13.23	12.00	15.99	N/A	N/A	N/A

(1) Not annualized

(2) Performance information shown includes the reinvestment of dividend and capital gain distributions, but does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

(3) The S&P 500 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.

(4) The Composite Index reflects an unmanaged portfolio of 60% of the S&P 500 TR Index and 40% of the Bloomberg Barclays Government/Credit Bond Index. It is not possible to invest in an index.

(5) The S&P SmallCap 600 Total Return Index is an index of small-company stocks managed by Standard & Poor's that covers a broad range of small cap stocks in the United States. 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 the 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 statements and opinions are those of the author as of the date of this report. All information is historical and not indicative of future results and subject to change. The reader should not assume that an investment in the securities mentioned was or would be profitable in the future. This information is not a recommendation to buy or sell. Past performance is not indicative of future results.

All investments have risks. The Funds are designed for long-term investors. Equity investments are subject to market fluctuations and the Funds' share prices can fall because of weakness in the broad market, a particular industry or specific holdings. Investments in small and midcap companies generally are more volatile. International investing risks include among others political, social or economic instability, difficulty in predicting international trade patterns, taxation and foreign trading practices and greater fluctuations in price than U.S. corporations. The Balanced Fund is subject to yield and share price variances with changes in interest rates and market conditions.

Investors should note that if interest rates rise significantly from current levels, bond total returns will decline and may even turn negative in the short-term. There is also a chance that some of the Balanced Fund's holdings may have their credit rating downgraded or may default. The Small Cap Fund may invest in initial public offerings by small cap companies, which can involve greater risks than investments in companies that are already publically traded.

As of 12/31/2017, Morningstar Rating of 4 stars Overall and 3 stars, 2 stars and 5 stars, for the 3-, 5- and 10-year periods among 1217, 1217,1079 and 800 large blend funds, respectively, based on Morningstar Risk-Adjusted Return.

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Growth Fund as of December 31, 2017: Abbott Laboratories 3.47%, Alphabet Inc CIC 2.82%, Cintas 0.00%, Donaldson Co, Inc. 3.51%, G&K Services 0.00%, General Electric Co. 0.78%, Johnson & Johnson 3.81%, Medtronic PLC 3.71%, Pentair Ltd. 2.40%, Pfizer Inc. 2.05%, Proto Labs 0.49%, St. Jude Medical 0.00%, Target Corp 1.35%, United Parcel Services, Inc. 1.24%. All 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 offer for a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

Morningstar Industrial Materials Sector Index tracks the performance of companies that include aerospace and defense firms, companies that provide or manufacture chemical, machinery, building materials and commodities. It is not possible to invest directly in an index.

Downside-capture ratio is a statistical measure of an investment manager's overall performance in down-markets.

ALPS Distributors, Inc. is the Distributor for the Mairs & Power Funds.

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