

# Mairs & Power Small Cap Fund MSCFX

## Analysis

### This strategy is still good.

By Tony Thomas 4/8/2019

A minor manager shuffle and a decision to reopen to new investors shouldn't pose problems for Mairs & Power Small Cap. It retains a Morningstar Analyst Rating of Silver.

On April 1, 2019, former lead manager Andy Adams and comanager Al Steinkopf swapped titles, with Steinkopf taking the helm. Functionally, this means little. The duo has collaborated on portfolio management since 2015, which will continue. A 13-member investment committee (including Adams and Steinkopf) will help ensure consistent vision and execution through the transition. Adams, meanwhile, will have a bit more time for his new lead-manager duties on Mairs & Power Growth MPGF.

The managers' sensible approach is unaltered. They still favor businesses with durable competitive advantages and above-average returns on equity. Steinkopf and Adams have adapted these principles thoughtfully, giving small-cap firms some leeway to spend for growth. Yet like their Mairs & Power colleagues, they keep turnover low and look for opportunities around their St. Paul home, with three fourths of the strategy's assets are in firms hailing from Minnesota, Wisconsin, Illinois, Iowa, and the Dakotas.

That's been a potent recipe. The fund got off to a fast start following its August 2011 launch, and its 15.2% annualized return through March 2019 topped the selective S&P SmallCap 600 benchmark's 14.1% and the typical small-blend Morningstar Category peer's 11%. While it tends to keep up in strong rallies, the strategy gets its edge in downturns. For example, it fared better than the index and most peers in 2018's fourth-quarter sell-off.

The early success caught investors' attention, and the managers handled inflows prudently. They closed the strategy at a conservative \$330 million in total assets in October 2016, keeping an eye on

their holdings' liquidity--especially those shared with the much-larger Mairs & Power Growth. Effective capacity management on both strategies allowed Mairs & Power Small Cap to reopen in September 2018. With its many strengths intact, this strategy is worth a look.

#### Process Pillar: Positive

A prudent tailoring of a proven investment philosophy earns this strategy a Positive Process rating.

Like all Mairs & Power strategies, this strategy's guiding principle is to buy and hold financially sound businesses with durable competitive advantages and above-average returns on equity. But managers Al Steinkopf and Andy Adams recognize that some good small caps reinvest profits to grow market share or enhance their competitive position. To capture this kind of business spending, the team emphasizes returns on invested capital as a key metric. Furthermore, since most small-cap firms lack analyst coverage, the managers gain an information advantage by focusing on firms near their Minnesota office.

The managers carefully monitor position sizing and liquidity when trading in small-cap stocks. They do not want to own more than 10% of a company, and they typically keep individual positions under 4% of total assets. They showed caution in closing the strategy at a modest \$330 million in assets in October 2016, keeping an eye on investments it shares with Mairs & Power Growth.

A 13-member investment committee (which includes Steinkopf and Adams) ensures consistency by vetting prospective investments and evaluating firms' fundamentals and competitive positions according to the firm's long-standing principles.



Mairs & Power managers typically start looking for prospects in their own backyard: the states of Minnesota, Wisconsin, Illinois, Iowa, and North and South Dakota. They also rely on company visits and community contacts. Staying local can be an edge in the small-cap space--and Upper-Midwest firms held more than three fourths of the strategy's assets in December 2018. That regional

### 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



### Fund Performance

	Total Return %	+/- Category
YTD	14.77	-1.62
2018	-6.91	5.81
2017	7.64	-4.64
2016	27.27	6.49
2015	-4.68	0.70

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exposure was the highest of the three Mairs & Power strategies.

Yet that provincial preference isn't restrictive, as the portfolio is diversified in many ways. The industrials, financial-services, and technology sectors are well-represented, but none more than 25% as of late 2018. The portfolio isn't too concentrated, with 40-55 holdings and core positions only about 2% of assets each. Even the highest-conviction picks rarely get more than 3.5% of assets each--a meaningful but not excessive stake.

Sometimes the firm's local knowledge of large-cap companies generates small-cap leads. For example, the managers began adding Inspire Medical Systems INSP, a maker of implants to treat sleep apnea, in mid-2018. Inspire spun out from Medtronic MDT--an Ireland-domiciled medical device firm that Mairs & Power Growth has owned since 1993. The managers' comfort with Medtronic extended to Inspire, which went public in May 2018 and is a rare money loser in the portfolio.

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### Performance Pillar: + Positive

An attractive risk/reward profile earns this fund a Positive Performance rating.

The fund's long-term record looks good despite having to clear a tough hurdle. The fund's prospectus benchmark, the S&P SmallCap 600 Index, is more selective than the widely used Russell 2000 Index. Yet from its August 2011 inception through March 2019, the fund's 15.2% annualized return bested the S&P index's 14.1% and blew past the typical small-blend category peer's 11%. By keeping up in rising markets but falling only 87% as far as the index in sell-offs during the period, the fund posted solid risk-adjusted returns as well.

Some of the fund's key features have been on display recently. The managers' emphasis on steadily growing, mostly profitable businesses helped in 2018's wild fourth quarter. The fund fell 17%, but that was 3 percentage points better than the in-

dex. Midwest utility Black Hills BKH, a top-15 holding in December 2018, bucked trends with a nearly 9% quarterly gain. In fact, Upper Midwest firms contributed significantly to the fund's top-decile 7.5% rise in the 12 months through March 2019. Iowa-based software firm Workiva WK jumped 113% in the period, while Minnesota's Bio-Techne TECH advanced 32%. Though now a mid-cap stock, the fund has owned Bio-Techne since 2011, benefiting from the company's growth over time.

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### People Pillar: + Positive

This strategy's two managers have switched titles, but little else is changing. It retains a Positive People rating.

On April 1, 2019, manager Andy Adams ceded lead duties to comanager AI Steinkopf. Adams stayed on as a comanager. On one hand, the move is sensible: Adams has taken on more at the firm, becoming its CIO in early 2018 and lead manager of Mairs & Power Growth in April 2019. On the other hand, the title of lead manager here is little more than a formality. Adams and Steinkopf have managed this strategy together since the start of 2015, and as members of the firm's 13-member investment committee they have a broad, stable base of support. Steinkopf will have the final say on portfolio decisions, but that's rarely invoked in this collaborative structure.

Steinkopf's background in quantitative analysis complements Adams' research strengths. He's also had a positive influence on the firm's investment approach since joining Mairs & Power as an analyst in 2013. He has advocated returns on invested capital as another measure of financial quality (alongside returns on equity, the firm's preferred quality metric). Using ROIC helps the firm develop a more complete picture of companies' profitability.

The managers keep shareholders' interests in mind. They invest in the mutual fund and closed the strategy to new investors (from 2016 to 2018) to protect their investing style.

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### Parent Pillar: + Positive

A series of smooth leadership transitions bodes well for Mairs & Power's long-term stability, earning the firm a Positive Parent rating.

An anticipated retirement from the St. Paul, Minnesota-based firm set changes into motion. Former chairman and CEO Jon Theobald stepped away at the end of 2017. Mark Henneman, then the firm's president and CIO, took his place. Andy Adams, lead manager of the firm's small-cap strategy, became CIO, while Rob Mairs--a descendant of the firm's founder--took the presidency. Each is settling into his respective role. Mairs, who left legal practice to join the firm in 2015, is promoting efficiency by consolidating the firm's operational activities. Henneman and Adams are capable defenders of the firm's well-established, conservative investment approach that favors Upper Midwest companies.

The firm has navigated other changes equally well. When Ron Kaliebe announced his retirement from Mairs & Power Balanced in April 2018, it promoted Kevin Earley to lead manager and Bob Thompson to comanager to work alongside Kaliebe until his final day in June 2019. The firm has also fleshed out its trading staff, added a dedicated quant analyst, and has plans to hire other research support. The moves align the 88-year-old firm's resources with its size and the demands of modern investing while keeping its traditions intact.

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### Price Pillar: + Positive

This newly reopened fund's below-average fees earn a Positive Price rating.

The fund's single, no-load Investor share class levies 1.04%. While that's down only one notch from five years ago, it's still below the 1.17% median for similarly distributed peers.

The firm took a conservative step when it closed the fund to new investors in October 2016. The strategy had only about \$330 million assets at the time, but the portfolio's overlap with the much-larger Mairs & Power Growth made the firm cautious. The closure effectively stifled flows. That,

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coupled with outflows from the Growth strategy, allowed this fund to reopen in late September 2018.

## Morningstar 2019 Analyst Report: Mairs & Power Small Cap Fund (MSCFX)

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](http://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, 2019, Mairs & Power Growth Fund, Mairs & Power Balanced Fund, and Mairs & Power Small Cap Fund have annual expense ratios of 0.64%, 0.72%, and 1.04%, respectively. For the most recent month-end performance figures, visit the Funds' website at [www.mairsandpower.com](http://www.mairsandpower.com) or call Shareholder Services at (800) 304-7404.

### Average Annual Total Returns for Periods Ending December 31, 2019

	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>	<u>20 Years</u>	<u>Since Inception</u>
<b>Mairs &amp; Power Growth Fund<sup>(1)</sup></b>	28.39	12.69	9.86	12.97	9.89	11.38
<b>Mairs &amp; Power Balanced Fund<sup>(1)</sup></b>	20.32	9.39	7.28	9.78	7.64	9.59
<b>Mairs &amp; Power Small Cap Fund<sup>(1)</sup></b>	21.13	6.67	8.05	N/A	N/A	14.84
<b>S&amp;P 500 Total Return (TR) Index<sup>(2)</sup></b>	31.49	15.27	11.70	13.56	6.06	N/A
<b>Composite Index<sup>(3)</sup></b>	22.64	11.00	8.45	9.87	6.00	N/A
<b>S&amp;P 600 Small Cap Total Return (TR) Index<sup>(4)</sup></b>	22.78	8.36	9.56	N/A	N/A	N/A

- (1) 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.
- (2) 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.
- (3) The Composite Index reflects an unmanaged portfolio of 60% of the S&P 500 TR Index and 40% of the Bloomberg Barclays U.S. Government/Credit Bond Index. It is not possible to invest in an index.
- (4) 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 U.S. The index is weighted according to market capitalization and covers about 3-4% of the total market for equities in the United States. 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. Diversification does not eliminate the risk of experiencing investment losses.

All investments have risks. The Funds are designed for long-term investors. Equity investments are subject to market fluctuations and the Fund's share price 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 12/31/2019, the Small Cap Fund has an overall Morningstar Rating of 4 stars and 3 stars and 4 stars for the 3- and 5-year periods among 630, 630 and 507 small blend funds based on Morningstar Risk-Adjusted Return. The Morningstar Rating for funds, or star rating, is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are 100% three-year rating for 36-59 months of total returns, 60% five-year rating, 40% three-year rating for 60-119 months of total returns, and 50% 10-year rating, 30% five-year rating, 20% three-year rating for 120 or more months of total returns. While the 10-year overall rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Copyright 2019, Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Small Cap Fund as of December 31, 2019: Black Hills Corporation 2.71%, Bio-Techne Corporation 3.31%, Inspire Medical Systems Inc. 2.61%, Medtronic 0.00 %, Workiva Inc. 1.32%. 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.

As of 12/31/2019, the risk adjusted return rank for the Mairs & Power Small Cap Fund Rank is 79 for 1-year, 55 for 3-year, and 34 for 5-year, based on 673, 658, and 604, respectively, in the Small Blend Category by Morningstar.

Return on invested capital (ROIC) is the percentage return that a company makes over its invested capital.

The Russell 2000 Index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. It is not possible to invest directly in an index.

Standard Deviation is a statistic that measures the dispersion of a dataset relative to its mean and is calculated as the square root of the variance.

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

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