



THB US Micro Cap Fund

Quarterly Report – March 2018

Market Commentary

The Russell Microcap® Index (Index) returned 2.7% in AUD in Q1 2018, outperforming the S&P 500 Index by nearly 1.5% which returned 1.2%.

Health Care (+6.8%) was the best performing sector this quarter, followed by Consumer Staples (+4.7%) and Financials (+2.5%). Real Estate (-10.0%) was the worst performing sector, followed by Energy (-8.2%) and Consumer Discretionary (-6.1%).

Pockets of volatility hit the markets in Q1. Factors contributing to the broader market volatility included the announced trade tariffs on China (and China’s response to those tariffs), talks of wage inflation and rising interest rates, and weakness in large cap technology stocks related to Facebook’s data sharing scandal as well as President Trump’s criticism of Amazon.

Underlying these headlines is a continued strengthening of the US economy. Manufacturing output is solid as the ISM manufacturing index hit its highest level since 2004, durable goods orders came in better than expected, and core capital goods orders were particularly strong. The service side of the economy is also robust, with the ISM non-manufacturing index hitting a cycle high this quarter and remains at an expansionary 59.5. The strength in the underlying economy kept the Fed on its course of gradually raising interest rates, stating “the economic outlook as strengthened in recent months”, and raising its economic forecast for 2018.

Portfolio Commentary

The THB US Micro Cap Fund returned 3.7% in AUD (net of fees) in Q1 2018, outperforming the Index and S&P 500 by 1.0% and 2.5%, respectively.

Strong stock selection led to positive contribution from Industrials (+1.1%), Consumer Discretionary (+0.8%) and Energy (+0.4%). Negative contribution came mainly from underallocation in Health Care (-0.7%), which primarily reflects the -1.3% contribution related to THB’s underweighting in Biotechnology, and selection in Financials (-0.2%) and Consumer Staples (-0.1%).

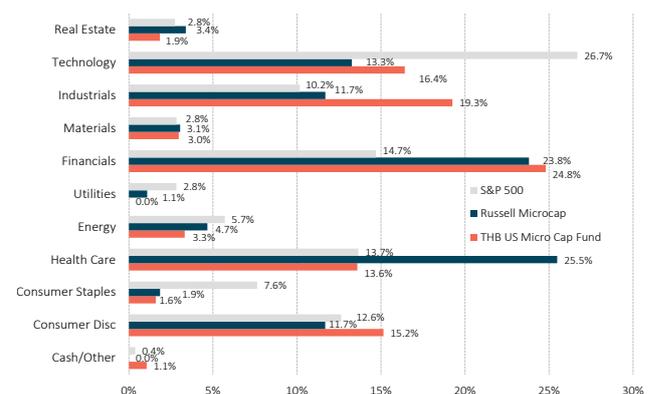
THB’s top five performing stocks (from a contribution standpoint) were BlueLinx Holdings (Industrials, +0.7%), Mammoth Energy Services (Energy, +0.4%), Allied Motion Technologies (Industrials, +0.4%), Fogo de Chao (Consumer Discretionary, +0.3%) and PRGX Global (Information Technology, +0.3%).

The bottom five performing stocks (from a contribution standpoint) were Bassett Furniture (Consumer Discretionary, -0.3%), Smart Sand (Energy, -0.3%), Sterling Construction Co (Industrials, -0.3%), Mitek Systems (Information Technology, -0.3%) and MYR Group Inc (Industrials, -0.2%).

Fund Details	
Benchmark	Russell Microcap® Index ¹
Inception Date	5 September 2014
Fund Size	A\$235.4 million

Net Performance – 31 March 2018			
	Fund ²	Russell Microcap®	Difference
1 Month	5.3%	3.1%	2.2%
3 Months	3.7%	2.7%	1.0%
1 Year	12.7%	12.9%	(0.2%)
2 Years p.a.	23.1%	20.7%	2.4%
Since Inception p.a. ³	14.8%	15.4%	(0.6%)

Sector Allocation⁴



- The Russell Microcap Index is a capitalisation weighted index of 2,000 stocks that captures the smallest 1,000 companies in the Russell 2000 and 1,000 smaller US based listed stocks.
- Performance figures are presented in AUD on a net, pre-tax basis and assume the reinvestment of distributions. Past performance is not an indicator of future performance.
- Fund inception date was 5 September 2014 however inception performance is calculated from 1 October 2014.
- Portfolio holdings and allocations are subject to change and should not be considered as investment recommendations to trade individual securities. The securities identified and described do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified were or will be profitable. There is no assurance that any securities discussed herein will remain in the portfolio at the time you receive this report, or that securities sold have not been repurchased. There can be no assurance that investment objectives will be achieved. A full list showing every holding’s contribution to the overall account’s performance during the measurement period and calculation methodology is available upon request.

Portfolio Commentary (continued)

Amidst the increased bout of volatility, THB continues to find compelling stock-specific opportunities and remains very optimistic about the broader environment for U.S. microcaps given the disproportionate benefit several converging themes should have on U.S. microcap companies. These themes include deregulation, tax reform, a healthy environment for merger and acquisition activity, and improved small business optimism.

THB believes the related benefits of these favourable themes/drivers are not reflected in microcap valuations and that market participants may be starting to take notice of the strong thesis supporting U.S. microcaps, as the Russell Microcap Index outperformed the S&P 500 Index by over 400 basis points in March.

THB also continues to believe record levels of private equity dry powder will be put to work and that high quality, undervalued microcap companies will be a target rich environment for deal activity.

Stocks in Focus

One of the benefits to micro cap investing is that smaller companies with company-specific growth and earnings drivers can thrive beyond broader macroeconomic themes (e.g. trade tariffs, Fed rate increases). Following are some examples of companies currently held in the portfolio which THB believe fit that profile.

PRGX Global (PRGX)

PRGX Global is a leader in Recovery Audit, which helps large retailers and business enterprises manage their global supplier networks and recover overpayments, lost discounts, and buy smarter from third-party suppliers. Customers include 75% of the top 20 global retailers.

The transformative Lavante and Cost & Compliance Associates acquisitions made in late 2016 and early 2017 were critical to positioning the company's entry into the SaaS-based Adjacent Services space. Adjacent Services produce data-driven analytical insights that provide clients with valuable product, spend, payment, and supplier data to optimise increasingly complex supply chains. PRGX is uniquely positioned because it can leverage existing relationships with the world's largest retailers to create convenient upselling opportunities for these value-adding and higher margin product offerings. Demonstrated success in the early stages of integration provide confidence in strategy execution.

Revenues have been growing consistently over the past six quarters with the base Recovery Audit business stabilising and by successfully upselling new service offerings among the existing client base. Revenue growth of close to 10% and EBITDA growth of 18-20% is anticipated for 2018 and 2019, highlighting higher margin revenue growth. PRGX also aggressively repurchases shares, having bought back nearly 30% of shares outstanding between 2014 and 2017. Valuation is currently cheap at 1x EV/Revenue and 7x forward EBITDA. THB believes multiple expansion will occur as higher margin, SaaS-based Adjacent Services revenues continue to grow and represent a larger percentage of total revenue. The stock is underfollowed with coverage by only two sell-side research firms.

Ultralife Corporation (ULBI)

Ultralife is a leading provider of power solutions and communications systems for high-demanding, critical applications for defense, industrial, medical and portable electronic markets. The history of the company can be traced back to the 1980s when Eastman Kodak introduced the first 9-volt lithium battery called Ultralife as part of its Ultra Technologies unit. In 1991, Ultralife was launched as an IPO evolving from Kodak's Ultra Technologies battery division. Today,

the company is well known for its superior product performance characteristics such as energy density, long shelf life and wide operating temperature range and has a strong presence in mission critical military and industrial applications where batteries must withstand harsh environments and hazardous conditions.

Under the leadership of Michael Popielec, who spent the majority of his career at various executive roles at GE, ULBI has successfully diversified its revenues into commercial markets which now account for approximately half of its revenues. Through 2017, ULBI aggressively pursued new revenue contributions driven by new product introductions and is building its presence in the growing Internet of Things (IoT) market. ULBI is in the process of expanding its manufacturing capacity for 3V batteries which will give them the opportunity to capture significant share of the current 50 to 100 million units per year addressable market for various IoT applications including instrumentation, sensing, asset tracking, wireless detectors and robotics. Additionally, the government & defense markets have returned to solid growth driven by higher defense spending, new product awards and innovation.

ULBI ended 2017 with its highest quarterly revenue, operating profit and EPS in five years. We believe the company is well positioned in attractive markets to continue its revenue growth and improved operating performance. ULBI stands out with its strong FCF generation and healthy balance sheet with no debt and \$18 million of cash (12% of market cap). The stock is underfollowed with no sell-side coverage.

Portfolio Statistics¹

As at 31 March 2018		
	Fund	Russell Microcap®
Weighted Avg Market Cap	\$547m	\$656m
Price/Sales	1.1x	1.2x
Price/Book	2.0x	1.9x
Dividend Yield	0.8%	1.1%
Number of Securities	100	1,496
Standard Deviation	14.2%	14.9%
Sharpe Ratio	0.8	0.8
Beta	0.9	
Tracking Error	5.5	
Information Ratio	0.1	

1. Portfolio statistics are reported in USD.

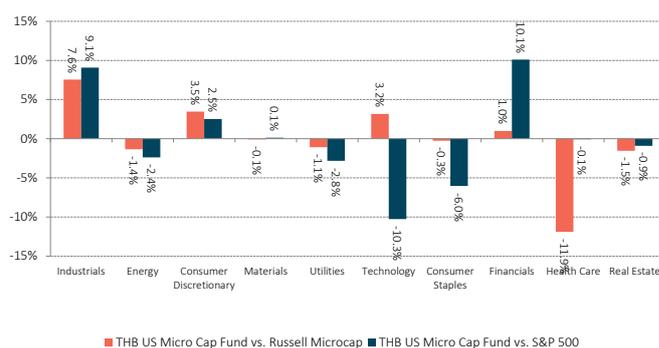
Top 10 Holdings

Stock	Sector	Weight
Old Second Bancorp	Financials	2.6%
Allied Motion Technologies	Industrials	2.2%
First Busey Corp	Financials	1.9%
Heritage Financial Corp	Financials	1.8%
PCSB Financial Corp	Financials	1.8%
LeMaitre Vascular Inc	Healthcare	1.8%
Insteel Industries Inc	Industrials	1.8%
UFP Technologies Inc	Materials	1.8%
Callaway Golf Company	Consumer Disc	1.7%
Mesa Laboratories	Technology	1.7%

Companies by Market Capitalisation



Active Sector Positioning



Investment Strategy

Thomson Horstmann & Bryant, Inc. (THB) is an employee-owned boutique investment management firm based in Connecticut specialising in smaller company strategies. THB's US Micro Cap strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, difficulty in identifying value and the impact that management skill has on the direction of smaller companies. THB utilises a disciplined, fundamental bottom-up approach that blends both qualitative and quantitative methods to construct a well-diversified portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the Russell Microcap® Index.

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