

THB US Micro Cap Fund

Quarterly Report – June 2018

Market Commentary

The Russell Microcap® Index returned 14.2% in AUD in Q2 2018, with each of the Index sectors generating positive returns.

Energy (+26.4%) was the best performing sector, followed by Consumer Staples (+21.9%) and Technology (+13.3%). Materials was the weakest performing sector (+6.0%), followed by Financials (+6.4%).

The US economy continues to strengthen, with the Fed raising its benchmark short-term rate 0.25% in June stating that economic growth has been “rising at a solid rate” (an upgrade from “moderate” in May). In addition, the Atlanta Federal Reserve GDPNow forecast is estimating an annualised 4.1% GDP growth rate in the second quarter, a level of GDP growth not witnessed since Q3 2014.

Importantly, small business plans to expand in the US continue to surge, according to the National Federation of Independent Business survey. This is despite US tariffs and retaliatory measures from China and the EU dominating news headlines in recent weeks. Smaller US-centric companies (and THB’s portfolio companies) expect minimal direct impact from trade disruption since ~90% of microcap company revenues are generated domestically and rely little on exporting for revenue growth. These same companies are also in a good position to absorb potential cost increases as consumer sentiment is high and lower personal income taxes related to tax reform should help support a healthy US consumer. Ultimately, the stimulative effects of tax reform should far outweigh the potential negative impact from tariffs on smaller domestically focused companies, which may partly reflect the recent outperformance of the Russell Microcap Index vs the S&P 500.

Portfolio Commentary

The THB Micro Cap Fund returned 12.9% in AUD (net of fees) in Q2, 2018 underperforming the Index by 1.3%.

Positive contribution came mainly from stock selection in Consumer Discretionary (+0.5%), Health Care (+0.2%) and Industrials (+0.2%). Negative contribution came mainly from selection in Energy (-0.5%), Financials (-0.4%) and Consumer Staples (-0.2%). An underallocation in Energy (-0.3%) also detracted from returns.

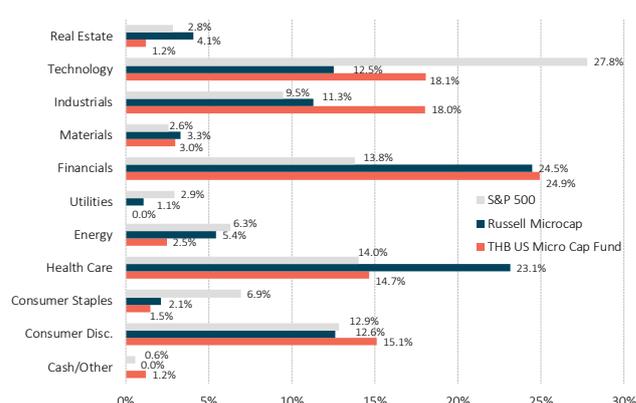
THB’s top five performing stocks (from a contribution standpoint) were Mesa Laboratories (Information Technology, +0.7%), Fiesta Restaurant Group (Consumer Discretionary, +0.6%), Johnson Outdoors (Consumer Discretionary, +0.6%), USA Technologies (Information Technology, +0.5%) and Luminex Corp (Health Care, +0.5%).

The bottom five performing stocks (from a contribution standpoint) were Anika Therapeutics (Healthcare, -0.5%), GP Strategies (Industrials, -0.2%), Del Frisco’s Restaurant Group (Consumer Discretionary, -0.2%), Bsquare (Information Technology, -0.2%) and Culp Inc (Consumer Discretionary, -0.2%).

Fund Details	
Benchmark	Russell Microcap® Index ¹
Inception Date	5 September 2014
Fund Size	A\$277.5 million

Net Performance – 30 June 2018			
	Fund ²	Russell Microcap®	Difference
1 Month	3.7%	3.7%	0.0%
3 Months	12.9%	14.2%	(1.3%)
1 Year	23.0%	24.8%	(1.8%)
2 Years p.a.	26.9%	24.4%	2.5%
Since Inception p.a. ³	17.5%	18.4%	(0.9%)

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)

THB's microcap strategy marked its 20-year anniversary in June. Over that period, it has witnessed many market cycles, natural disasters, Fed rate actions, political changes, wars, recessions, and financial crises. Notwithstanding these many periods of disruption and uncertainty, the US Microcap Fund has returned 15.0% p.a. (USD, gross of fees) since inception, a return THB believes is a testament to the inefficiencies of the asset class coupled with THB's philosophy and passion for investing in microcap companies.

The next 20 years will surely bring about new versions and forms of uncertainty, but THB will once again lean on its philosophy and lessons learned during the last two decades of managing the strategy to prosper. As THB looks towards the future, the current environment for US microcaps is as favourable as it has ever been during THB's history managing the strategy. The strong US economy, tax reform, deregulation, healthy environment for merger and acquisition activity (including the repatriation of \$300B in cash in Q1, 2018), and improved small business optimism are all positive tailwinds for the US-centric companies in which THB invests.

Stocks in Focus

Below is a summary of some examples of companies currently held in the portfolio which THB believes fit the profile of a microcap company that displays company-specific growth and earnings drivers which can thrive beyond broader macroeconomic themes.

PAR Technology (PAR)

PAR developed the industry's first standalone point-of-sale (POS) terminal for McDonald's Corporation in 1978. Today, PAR is one of the leading providers of food safety technology solutions to the restaurant and retail industries, with an installed POS hardware base in more than 75,000 restaurants (including McDonald's, Arby's, Taco Bell) in 110 countries. PAR also provides computer-based system design, intelligence, surveillance and reconnaissance, and engineering solutions to the Department of Defense and other federal government agencies.

PAR is transitioning its POS product from a hardware and software licensing business model to a software-as-a-service (SaaS) model which is driving new customer wins and is improving the margin profile of the business. PAR significantly expanded its global market by introducing a cloud-based solution and is benefitting from the on-going upgrade cycle driven by the rising need of restaurant operators to integrate new features delivering automation, data analytics, and improving customer experience.

PAR's Brink POS is a cloud-based restaurant management solution designed for fast casual and quick service chains. Brink's technology is used to track sales, enter in-store and online orders, implement effective customer loyalty programs, and manage kitchen operations. The Brink solution has had strong customer reception ending 2017 with approximately 4,200 Brink clients, an increase of 70% over 2016. The Company is targeting to have 10,000 Brink solutions deployed by 2018 which carry 75%-80% software margin.

The SureCheck mobile software solution provides food safety monitoring and intelligent checklist management through a combination of a cloud enterprise application, a PDA-based mobile application, and a patented integrated temperature measuring device that offers food retail (grocery), food service, and food manufacturer customers an effective way to manage and monitor quality risk factors (e.g. food temperature) while dramatically lowering the potential for human error. Both Wegmans and Wal-Mart selected the SureCheck solution for its food safety and task management requirements.

THB believes PAR will be revalued at a higher multiple as the SaaS business becomes a higher portion of the total, closing the valuation gap with similar SaaS companies. The government segment is also growing at higher margins after the company transitioned away from low margin programs. Strong backlog of \$111 million (as of December 31, 2017) bodes well for 2018 segment growth

Insteel Industries (IINN)

Insteel is the nation's largest manufacturer of steel wire reinforcing products, including prestressed concrete (PC) strand, welded wire reinforcement (WWR), engineered structural mesh (ESM), and standard welded wire reinforcement products that are used primarily for nonresidential concrete construction applications.

Higher optimism in public spending activity, reduced regulation and continued positive non-residential building indicators imply improving construction activity over the near term to medium term. Insteel is well positioned to benefit from the expected growth in infrastructure spending on roads, bridges, airports and other non-residential building construction under the federal highway funding provided under the FAST Act (Fixing America's Surface Transportation) which authorised \$305 billion of funding over a five-year period, including \$226 billion for federal highway investment. It was the first long term surface transportation bill enacted in over a decade and would favourably impact long term projects requiring concrete reinforcing products.

Additionally, the Trump Administration Infrastructure proposal, which includes \$200 billion in federal funds that are intended to stimulate more than \$1.5 trillion in spending from local and state governments and private entities over a decade, would be a major catalyst for growth for Insteel.

As market conditions improve, the company should experience increasing contributions from the substantial investments in existing facilities in the form of reduced operating costs and additional capacity to support future growth.

The company has strategically increased its capacity both organically and through acquisitions and is poised to generate over \$700 million of annualised revenues (at current ASPs and compared to \$389M in revenue in FY 2017) with minimal incremental capex required. Continued expansion of the ESM business through further penetration of the traditional rebar market can be supplemented with potential acquisitions in core WWR and PC strand businesses or related products sold into same markets. The company has ample liquidity to continue to invest in the business and return cash to shareholders through dividends and share repurchases. As of March 31, 2018, Insteel was debt-free with \$23.5 million of cash and no borrowings outstanding on \$100.0 million revolving credit facility.

Portfolio Statistics¹

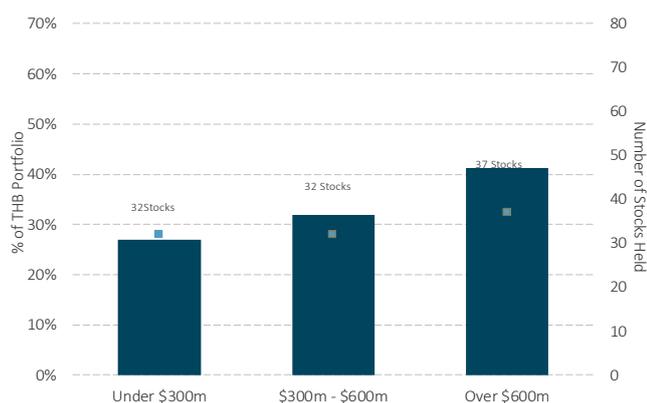
As at 30 June 2018		
	Fund	Russell Microcap®
Weighted Avg Market Cap	\$618m	\$595
Price/Sales	1.3x	1.0x
Price/Book	2.0x	1.9x
Dividend Yield	0.7%	1.1%
Number of Securities	101	1,548
Standard Deviation	14.0%	14.7%
Sharpe Ratio	1.0	0.9
Beta	0.9	
Tracking Error	5.3	
Information Ratio	0.0	

1. Portfolio statistics are reported in USD.

Top 10 Holdings

Stock	Sector	Weight
Old Second Bancorp	Financials	2.4%
Mesa Laboratories	Technology	2.1%
Insteel Industries	Industrials	2.0%
Graham Corp	Industrials	1.9%
Heritage Financial Corp	Financials	1.9%
Allied Motion Technologies	Industrials	1.9%
Johnson Outdoors	Consumer Disc	1.8%
First Busey Corp	Financials	1.8%
LeMaitre Vascular Inc	Health Care	1.7%
PAR Technology Corp	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.

BROOKVINE



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