

# LISTED INVESTMENT COMPANIES.

## THE INSIDE TRACK

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# BASICS

## PORTFOLIO OF LISTED ASSETS

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- **A diversified portfolio of assets**
  - Australian shares
  - International shares
  - Specialist
  - Private Equity
- **Packaged into tradeable units that are offered on an exchange**
- **Closed-end fund**
  - A publicly traded investment company that raises a fixed amount of capital with a fixed number of shares on issue through an initial public offering (IPO). The fund is then structured, listed and traded like a stock on a stock exchange.

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# PROFILE

## MARKET PROFILE

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- **Long and established market**
- **58 LICs currently listed on the ASX (peak of 65 in 2008)**
  - ~9 listed in 1980
  - ~17 listed in 1990
  - ~28 listed in 2000
  - ~58 listed in 2010
- **Total market capitalisation of \$16.8bn**
  - Largest 5 LICs account for \$11.4bn (Avg FUM \$2.3bn 68% of FUM)
  - Remaining 53 LICs account for \$5.4bn (Avg FUM \$0.1bn 32% of FUM)

Note: Industry data as at 30 June 2011

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# FEATURES

## TYPES OF PRODUCT

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Generally considered two types of LIC:

- **Traditional**

- Buy and hold (more passive)
- Management fee, no performance fee
- Larger Funds Under Management (FUM)

- **Modern**

- Higher turnover (more active)
- Management fee and performance fee
- Smaller FUM

## MANAGEMENT STRUCTURE

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Two types of management structures

- **Internal Management (examples: AFI, BKI, MLT)**
  - Internal team of fund managers and analysts
- **External Management (examples: CDM, CTN, GMI, WAM, WAX, WIC)**
  - Investment management outsourced to a third party

## MANDATE STYLE

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- **Australia Shares**
  - Diversified
  - Small/Microcap
  - Absolute return
- **International Shares**
- **Specialist**
  - Sector
  - Strategy
  - Concentrated
- **Private Equity**



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# INTRICACIES

## PREMIUM OR DISCOUNT

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NTA is the net value of the underlying investment expressed on a per share basis

- Pre-tax NTA: after payment of realised and unfranked income before the provision on tax on unrealised capitals gains.
- Post-tax NTA: after payment of realised capital gains and unfranked income and after the provision for unrealised gains.

However, owing to the closed end structure (fixed number of shares), security can trade at a Premium or Discount to NTA.

- Premium: share price higher than net value of the underlying investment
- Discount: share price lower than net value of the underlying investment

ASX requires LICs to lodge Post-Tax NTA on a monthly basis. However, for LICs with low turnover, arguably Pre-Tax NTA is a more reflective measure given it may take decades to expose the underlying tax liability.

## CAVEAT EMPTOR

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This taxation issue has implications for performance calculations given NTA performance is calculated against pre-tax managed funds and pre-tax benchmarks.

In general, managed funds are housed in unit trusts. Hence, while the unit trust itself does not pay any tax as long as dividends and realised gains are distributed to unit holders, the underlying investor will clearly incur tax events on dividend income and realised gains.

Although less of a concern, given the lower turnover of benchmarks, investors must also be aware that the most common benchmarks do not factor in tax implications.

## STRUCTURALLY SUPERIOR

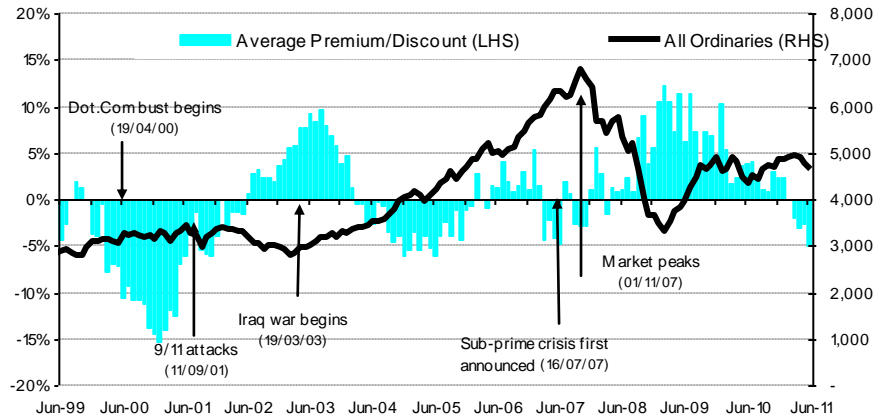
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LICs are close-ended funds and hence by their very nature not exposed to capital inflows (new capital) or outflows (redemptions).

This creates a number of interesting benefits:

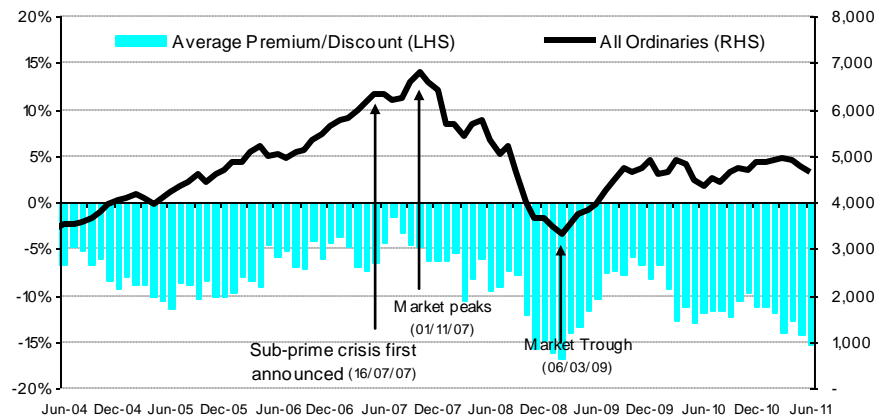
- **Not beholden to short-term performance:** As underlying funds cannot be withdrawn, the manager is more incentivised to deliver long-term sustainable performance.
- **Not exposed to redemptions:** The manager does not need to sit overweight cash to provide adequate headroom to cover redemptions should they occur. Traditionally cash has tended to under perform all other asset classes through the cycle.
- **Cannot have a run on redemptions:** A run on redemptions may not facilitate an orderly sell down of an investment managers positions. In effect this could lead to the liquidation of a portfolio at an inopportune time, thereby reducing the value to the investor.
- **Extraordinary liquidity:** As exemplified in the Global Financial Crisis, a number of unlisted fund managers froze redemptions. This was further compounded with the absence of distributions. Given the closed-end nature of the funds, investors can liquidate a position on market at any time.

## Trading the Cycle



Small LICs (AUI, BKI, CIN, CYA, DUI, GMI, HHV, MIR, PMC, PRV, TGG, WHF)

Market capitalisation less than \$600m, 7 Year history



Note: Industry data as at 30 June 2011

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# CHANGES

## KEY CHANGES

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### Dividends

The Federal Government announced in 2010 changes to the law relating to the payment of dividends by Australian companies. The changes represent a fundamental modification of the rules on the payment of dividends, and indirectly the capital maintenance provisions of the *Corporations Act 2001* (Cth).

The amendments mean that rather than being required to pay a dividend out of profits, companies must apply a solvency test in determining the amount that can be paid to shareholders. The changes should give companies greater ability to manage the payment of dividends in varying economic conditions and increase certainty for shareholders as to the level of dividends to be paid.

# 6.0 RESEARCH

## QUANTITATIVE ANALYSIS

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Bell Potter Listed Investment Company analysis is concentrated on a quantitative approach. Key criteria includes:

- Investment performance (NTA),
- Risk and return analysis (NTA),
- Historical gross yield,
- Indirect cost ratio,
- Top 20 securities held.

This analysis is typical of the funds management industry. However, given the close-ended listed structure, LIC analysts also focus on discount/premium to NTA:

- Discount/Premium to pre-tax NTA,
- Average Discount/Premium to NTA (3 year horizon).

## INVESTMENT PERFORMANCE

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Investment performance is calculated on an accumulation basis that includes the re-investment of distributions at the ex-dividend date. Dividends need to be re-invested to ensure LICs paying higher distributions are not penalised from a investment performance perspective.

Clearly Share Price performance is the most applicable measure to the underlying investor, however, this return factors in changes to Premium/Discount to NTA which we analyse separately. We view underlying pre-tax NTA as arguably the most relevant measure of the investment skill of a manager.

*Investors need to be aware that historical performance is no guarantee of future performance and must be taken in context of the underlying investment mandate.*

## INVESTMENT PERFORMANCE

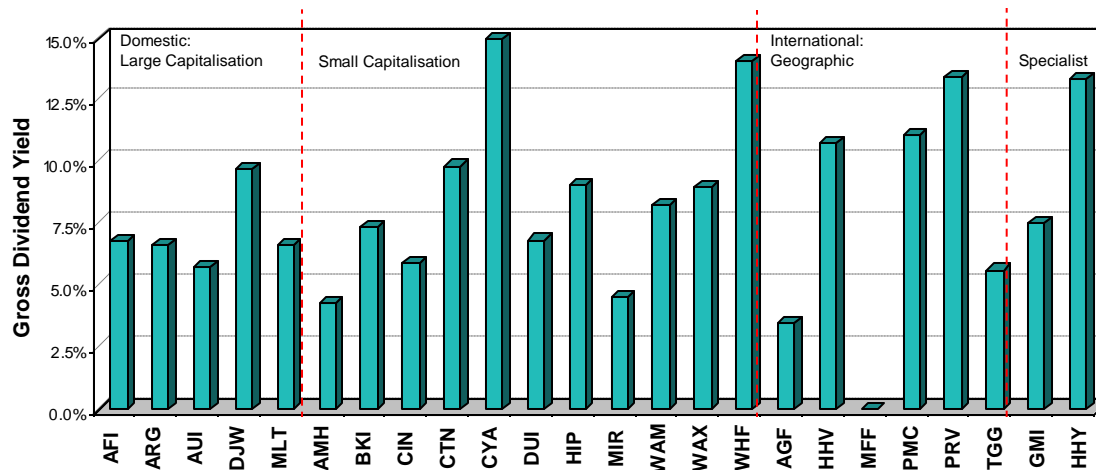
Page	ASX Listed Investment Companies	ASX Code	Pre-tax NTA						Share price					
			Performance			Value-add+			Performance			Value-add*		
			Yr 1	Yr 3	Yr 5	Yr 1	Yr 3	Yr 5	Yr 1	Yr 3	Yr 5	Yr 1	Yr 3	Yr 5
Domestic Focus - Large Cap														
11	AFIC	AFI	11.5	2.3	4.2	-0.2	2.0	1.8	-2.3	0.2	3.1	-14.5	0.4	0.5
12	Argo Investments	ARG	9.5	1.3	2.5	-2.7	1.5	-0.1	0.1	-3.4	-0.3	-12.1	-3.2	-2.9
13	Australian United	AUI	12.4	0.6	2.8	0.5	0.3	0.4	0.7	-1.8	1.4	-11.5	-1.6	-1.2
14	Djeriwarh Investments	DJW	10.9	1.4	2.7	-0.8	1.1	0.3	3.3	2.7	2.5	-8.9	2.9	-0.1
15	Milton Corporation	MLT	9.7	1.9	2.7	-2.5	2.1	0.1	2.2	-2.2	-0.4	-10.0	-2.0	-3.0
Domestic Focus - Small Cap														
16	AMCIL	AMH	13.6	7.2	3.8	1.9	6.9	1.4	10.8	3.5	6.9	-1.4	3.7	4.3
17	BKI Investment	BKI	13.0	2.7	4.5	1.1	2.4	2.1	11.7	5.4	2.9	-0.5	5.6	0.3
18	Carlton Investments	CIN	9.5	5.5	4.9	-2.2	5.2	2.5	7.2	4.9	2.1	-5.0	5.1	-0.5
19	Contango Microcap	CTN	25.8	-1.2	7.6	13.6	-1.0	5.0	75.0	4.8	7.7	62.8	5.0	5.1
20	Century Australia	CYA	20.1	9.4	3.9	8.2	9.1	1.5	11.3	-0.4	0.3	-0.9	-0.2	-2.3
21	Diversified United	DUI	9.2	-0.3	2.3	-2.7	-0.6	-0.1	-1.8	-2.4	0.3	-14.0	-2.2	-2.3
22	Hyperion Flagship	HIP	4.2	4.8	2.2	-8.0	5.0	-0.4	1.7	5.0	0.9	-10.5	5.2	-1.7
23	Mirrabooka	MIR	15.8	4.6	4.8	0.5	7.1	4.0	16.1	6.2	4.7	3.9	6.4	2.1
24	WAM Capital	WAM	11.8	9.1	8.0	-0.4	9.3	5.4	41.9	16.8	7.1	29.7	17.0	4.5
25	WAM Research	WAX	14.5	6.1	1.5	2.3	6.3	-1.1	26.4	8.5	1.6	14.2	8.7	-1.0
26	Whitefield	WHF	8.4	2.5	-2.1	-0.9	0.1	-2.6	-1.7	0.9	-3.1	-13.9	1.1	-5.7
International Focus - Geographic														
27	AMP Capital China Growth	AGF	9.3	0.1	n/a	10.6	-2.6	n/a	4.6	-0.2	n/a	5.9	-2.9	n/a
28	Hunter Hall Global Value	HHV	3.9	2.2	0.7	5.9	5.3	5.6	14.2	1.3	-1.9	11.0	4.5	3.0
29	Magellan Flagship Fund	MFF	0.4	3.9	n/a	0.1	9.2	n/a	7.9	6.4	n/a	7.6	11.7	n/a
30	Platinum Capital	PMC	-6.1	7.6	1.7	-8.8	10.3	5.8	-12.6	5.9	-5.4	-15.3	8.6	-1.3
31	Premium Investors	PRV	8.2	3.1	1.5	-4.0	3.3	-1.1	16.2	4.9	0.8	4.0	5.1	-1.8
32	Templeton Global Growth	TGG	4.6	-3.1	-5.9	2.2	0.1	-1.0	5.0	-5.0	-10.0	2.6	-1.8	-5.1
International Focus - Specialist														
33	Global Mining Investments	GMI	16.8	-10.9	-3.2	6.9	-4.3	-6.6	5.1	-15.2	0.0	2.7	-12.0	4.9
34	Hastings High Yield	HHY	-4.3	2.3	5.2	-14.3	-7.7	-4.8	9.0	5.8	3.0	19.1	-1.5	2.0

+ return on fund over benchmark as per company profile, \* return on fund over benchmark as per company profile

Note: Industry data as at 30 June 2011

## HISTORICAL GROSS YIELD

This is the dividends paid plus any franking credits passed on to share holders by the LIC. We have focused on this measure to enable valid comparison between LICs whose dividends are franked and those that are not.



Note: Industry data as at 30 June 2011

## INDIRECT COST RATIO

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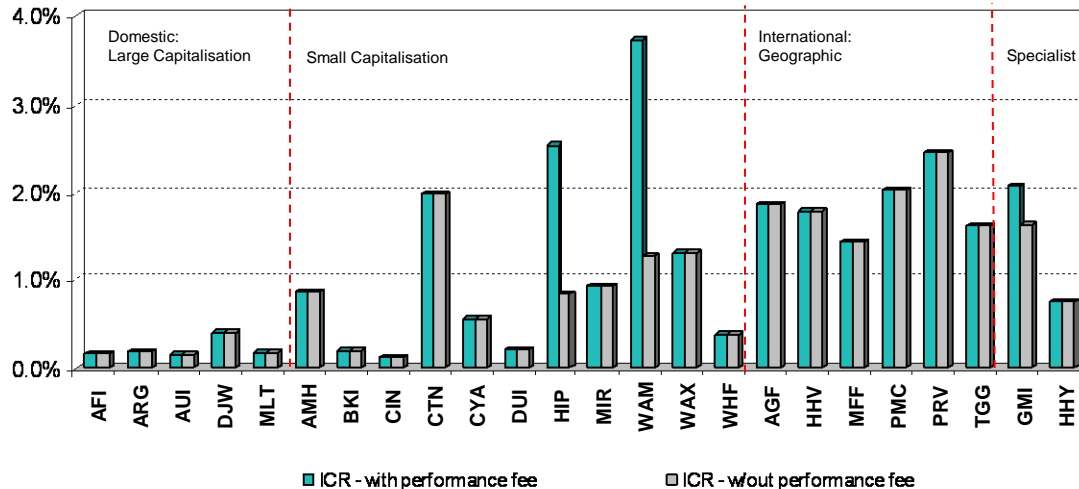
Fees and expenses for LICs generally take three forms.

- Management Fees: Recover day-to-day expenditure of the investment process
- Performance Fees: Align the profitability of the manager and the performance of underlying fund (associated with new offerings).
- Administrative Fees: Cover the daily running costs of the fund. Rent, Audit, legal, etc.

## INDIRECT COST RATIO

The ICR is the ratio of the fund’s management costs that are not deducted directly from a product holder’s account to the funds total average net assets.

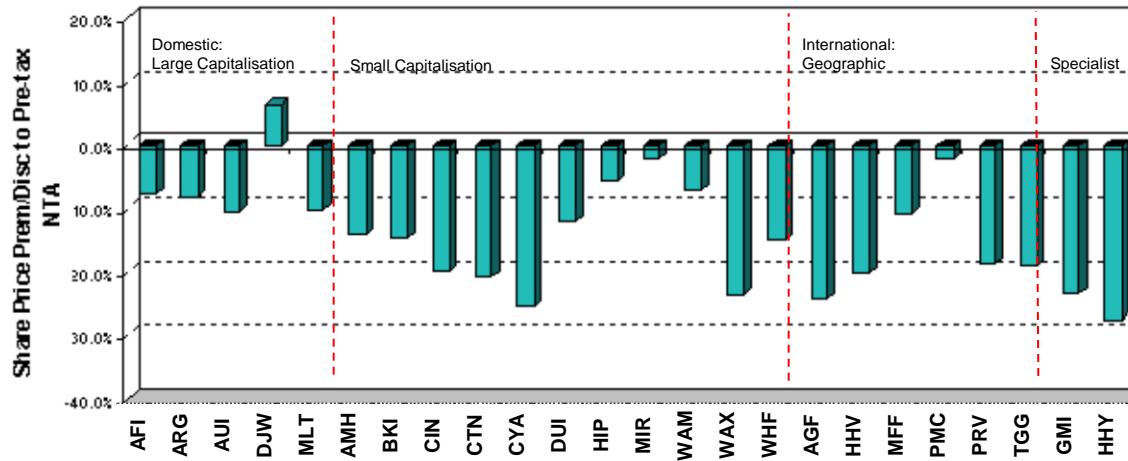
In laymen's terms it covers all expenditure, excluding transaction and finance costs, in the management of the funds. Hence it covers management, performance and administration fees.



Note: Industry data as at 30 June 2010

## DISCOUNT/PREMIUM TO PRE-TAX NTA

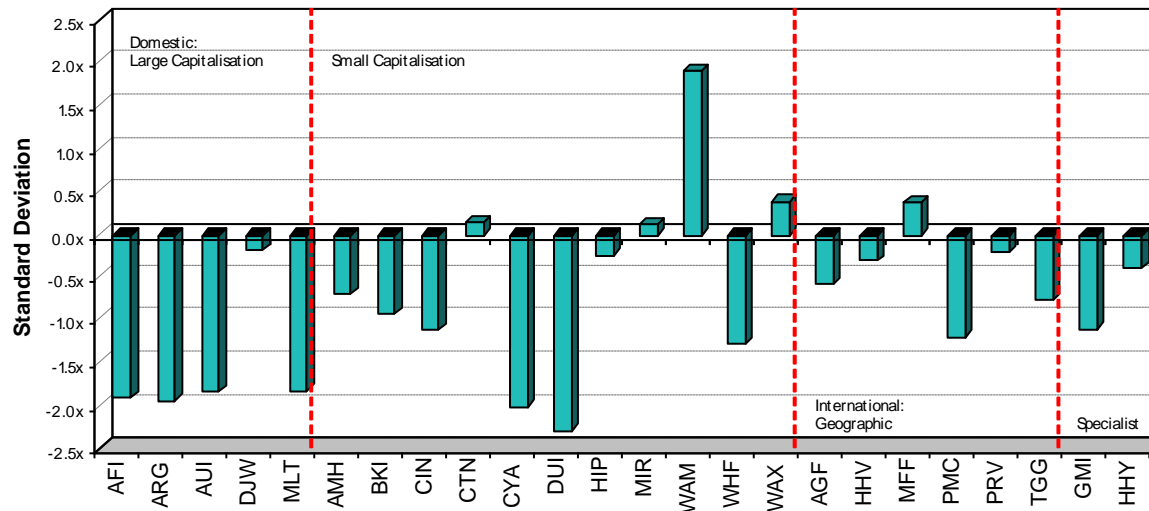
Measures whether the LICs share price trades at a discount or premium to the groups underlying NTA. We consider pre-tax NTA as the most applicable measure given the low turnover in the majority of LICs, means that the majority of unrealised tax is unlikely to be uncovered in the medium term.



Note: Industry data as at 30 June 2011

## AVERAGE DISCOUNT/PREMIUM TO PRE-TAX NTA

Seeks to qualify the Discount/Premium to pre-tax NTA in a historical context. This is done by determining the LICs average Discount/Premium over 5-years, and using the standard deviation of its Discount/Premium to provide a measure of the range in which a LICs Discount/Premium normally falls.



Note: Industry data as at 30 June 2011

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