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LIC Report

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Listed Investment Companies (LICs) and Listed Investment Trusts (LITs) continue to be one of the great success stories of the Australian Securities Exchange (ASX). These vehicles have been trading on the ASX for over 100 years, but it is only recently that a broader range of investors and managers have capitalised on the opportunities offered by the sector.

LICs and LITs are ASX-listed vehicles established to invest in a portfolio of securities, managed by a professional fund manager. The vehicle raises a fixed amount of capital through an Initial Public Offering (IPO) and new capital can only be raised through corporate issues. The securities are traded on the ASX like any other listed security. The sector has seen very strong growth in

Capital, growing 11.7% over the last 5 years, which is substantially higher than the growth rate of the broader funds management industry. It is also worth noting that there tends to be a high level of distributions from the majority of these vehicles. Over this period the number of investment vehicles trading on the ASX has increased from 65 to 114 and there is now \$42.1bn in funds under management.

“ Listed Managed Investments are vehicles established to invest in a portfolio of securities, managed by a professional fund manager. ”

How does a LIC differ from a LIT, differ from a Unit Trust

A LIC is a company, its assets are held in a closed pool, and traded via the ASX. A LIT is a trust, its assets are held in a closed pool, and traded via the ASX. An unlisted unit trust is a trust, open ended and accessed through platforms.

The LIC/LIT structure supports some positive investor outcomes, namely:

- ◆ The vehicle is not exposed to daily capital inflows. This ensures that dividends and performance are not continually diluted by new capital entering the vehicle
- ◆ The structure does not support the outflow of the underlying capital. This means investor redemptions do not create a tax event for investors who remain in the fund, impairing effective income.
- ◆ The structure trades on the ASX facilitating intraday liquidity and pricing.

The LIC structure also supports the payment of consistent dividends. This is because there



“ A LIC is a company, its assets are held in a closed pool and traded via the ASX ”

is no taxation impediment for retaining profits on a balance sheet. This enables the board to retain profits and maintain distributions through difficult periods. Further, as taxable entities, the manager is particularly focused on after-tax outcomes including the generation of fully

franked dividends.

Interestingly, the LIT structure has recently adopted legislation (AMITS) which allows for qualifying LITS to retain profits without onerous tax implications. This is an encouraging development.

What are the key factors driving growth in Listed Investments?

Change Requirements

Increasingly, investors are seeking to diversify their exposures away from domestic equities. As investors become more sophisticated, they are understanding that to attain true and effective diversification they require exposure to different asset classes. This has underpinned the strong growth in product focused on international equities and fixed income which is likely to accelerate in future years.

Structural Improvements

The industry has undergone some substantial improvements, particularly around new issuance. This includes the manager paying for all of the costs of the issue, paying for the vast majority of operating costs (where appropriate), reinvesting performance fees and taking a material stake in the vehicle at IPO.

Other key factors

- ◆ **Broadening of available investment strategies**
- ◆ **Increase in the quality of managers entering the LIC/LIT sector**
- ◆ **Greater adviser and investor engagement**

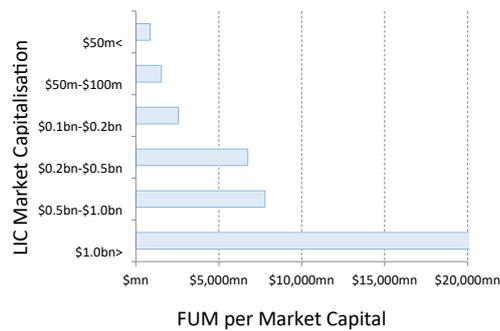
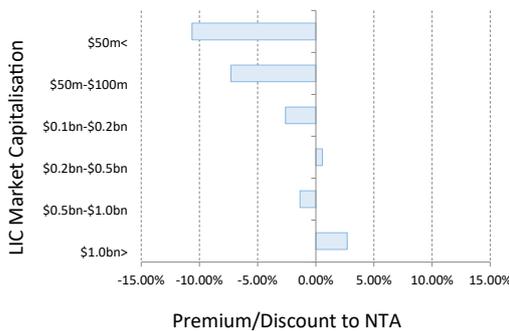
“ Attractive value proposition to SMSF investors ”

“ The LIC market is currently trading at a 1.1% premium to its NTA ”

Premiums / Discounts

LICs and LITs may trade at a premium or a discount to their Net Tangible Assets (NTA). The market is presently trading at a 1.1% premium to its NTA on a market weighted basis. On an equally weighted basis the 1.1% premium falls to a 3.0% discount, highlighting that it is the volume of smaller vehicles that are accounting for the discounts. Interestingly, vehicles with a market cap greater than \$200m.

tend to trade at asset backing or a slight premium, whereas, vehicles with FUM below this amount generally trade at substantial discounts. Unfortunately, there are 76 vehicles with a market cap under \$200m which account for \$5bn in market cap, as compared to the 39 vehicles with a market cap greater than \$200m which accounts for \$37.1bn.



Source: Seed Partnerships and ASX data

Supporting Secondary Market Trade

How a LIC/LIT trades in the secondary market will depend on a number of variables, these include.

MARKET CAPITALISATION

Higher market capitalisation tends to be more cost effective, and supports liquidity.

MARKETING

Regular, consistent and relevant communication to shareholders

INCOME

Reliable fully franked dividends and potential for dividend growth

INVESTMENT PERFORMANCE

Solid investment performance versus the benchmark

SCARCITY OF PRODUCT

Excess demand creates a premium

INDUSTRY OVERVIEW

LICs and LITs are part of the broader Listed Managed Investments (LMI) sector, which was capitalised at \$256bn as at 31 December, 2018.

The sector currently consists of:

- ◆ 47 A-REITS (\$135.8bn)
- ◆ 7 infrastructure funds (\$77bn)
- ◆ 191 Exchange Traded Funds (\$44.5bn)
- ◆ 161 mFunds (\$0.8m)
- ◆ 114 LICs and LITs (\$42.1bn)

The LIC/LIT market capitalisation has been trending strongly, growing at 11.4% per annum to \$42.1bn as at 28 February 2019.

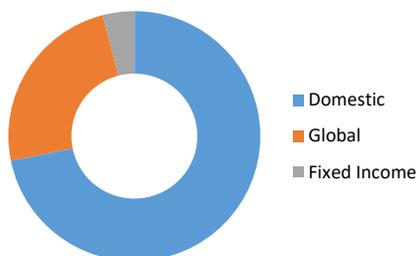
The number of LIC/LITs has also been in a steady upward trend, rising from 65 in Feb 2014, to 114 presently.



“ The LIC/LIT market capitalisation has been trending strongly, growing at 11.4% per annum to \$42.1bn as at 28 February 2019 ”

Market Breakdown

The LICs \$42.1bn market capitalisation is concentrated in equity products which account for 96% of the market capitalisation. Australian equity products make up \$30.3bn (72%) of the market capitalisation, and international equities \$4.4bn (24%). The remaining 4% is fixed income product.



Source: Seed Partnerships and ASX data

Australian equities LICs are dominated by long only equity, accounting for 90% of the total assets under management across 42 funds. Large capitalisation exposures are responsible for 47% of the market capitalisation, large/medium 29%, and medium/small and small/micro the remaining 13%. Alternative strategies account for 7% of assets spread across 24 funds that consist of enhanced income, long/short, market neutral, absolute return, private equity assets and activist.

International product comprises global product at 92% and regional with the remaining 8%.

Interestingly, international has grown materially in the past 3 years with an array of new product. Presently there are 14 long only global funds, 5 global long/short funds (including Global Market Neutral), 2 global resource funds, 5 global fund of funds (including 2 multi asset), 3 private equity, 1 global infrastructure, and 4 regional vehicles all of which are focused on Asia.

Fixed Income products have grown rapidly to \$1.7bn across 7 vehicles, admittedly off a low base. The market now consists of product providing exposure to senior bonds, subordinated debt, hybrid securities and structured income securities.



OUTLOOK:

The strong growth in the LIC market has been driven by a number of factors. Product issuance is rising due to improved structures, also managers bringing strategies that have a broader appeal to the investment market, are entering the LIC/LIT sector.

There is an increasing appetite for global diversification, and we are also seeing increasing demand for products focused on high and sustainable income.

We see growth in the Listed Investment Sector being underpinned by demographic change, increasing sophistication in the market, and continued strong growth in SMSF investors searching for listed and transparent investments, from managers that communicate directly with the market place.



Seed Partnerships is a corporate advisory firm that specialises in Listed Investment Companies and Listed Investment Trusts and operates under an AFSL Licence (Licence No. 492973).

The company partners with established managers with credible long-term track records, who wish to create and build a pool of permanent capital in Australia.

Our executives and advisory committee have a strong pedigree in listed investment companies and trusts.

The executives have been directly involved in the capital raising, IPO and management of 10 listed investment companies since 2016.

These companies presently control over \$4Bn in FUM.

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