The Impending Consolidation of the LIC Sector

Overview

The Australian LIT/LIC sector is undergoing a marked structural shift. At the top end, IPOs have only progressed where there is confidence amongst Joint Lead Manager (JLM) consortiums of raising $500m+ . For debt LITs, we expect a continuation of trend - new IPOs will be largely limited to top tier global managers, with the possibility of some very highly regarded domestic managers offering differentiated and highly targeted investment strategies. In equities, IPOs, if any should be forthcoming, will be limited to successful domestically established fund managers with a large and loyalty investor base in which to internally market and distribute the product. VGI Partners Ltd and the Magellan Financial Group represent two prime examples.

At the bottom end, namely the sub $200m market cap part of the LIC sector, consolidation is gaining pace by way of increased activism and increasingly vocal disgruntled shareholders spurred by large and persistent discounts to NTA. Consolidation is playing out by way of an increasing number of liquidity restructures (conversions and wind-ups) and merger / acquisition activity in an effort to narrow discounts.

IIR notes that the stakes are not immaterial, with the elimination of discounts to NTA in the LIC sector with a market capitalisation of less than $200m generating a value uplift to (often long suffering) shareholders of $0.5bn (in a segment that has a combined market cap of $4.08bn).

Historically, Australian investors have exhibited an unhealthy tolerance of under-performing management teams. However, partly in the wake of the Banking Royal Commission and possibly the generally the shadow that has (wrongly or rightly been cast over the sector with respect to the stamping fee consultation process, IIR believes attitudes have begun to a shift In the LIC sector. This is beginning to manifest by way of shareholders becoming increasingly vocal in relation to persistent discounts to NTA and poor performance. As a long time proponent of close ended vehicles, this is a development that IIR welcomes as it will ultimately lead to a stronger sector and better shareholder outcomes. The onus now however is firmly on LIC boards to act in the best interests of shareholders.

Based on a review of the sector's structural dynamics, IIR's key recommendations are:

- IIR urges boards that oversee LICs with limited liquidity and persistent discounts to NTA to implement standard initiatives to close the gap, including on- and off-market buybacks, increasing dividends (where practicable), and improving investor communications. Where such measures have been exhausted with no material narrowing of a gap to NTA, a board must diligently and prudently consider all restructuring options to create liquidity and to narrow the discount, including conversion to a unit trust, wind-up, a merger, or appointment of a new investment manager.
- IIR advocates that investment managers and JLMs set hard minimums of, say, $200m for an IPO (with a few possible exceptions). IIR believes that investment managers that are unlikely to achieve this threshold would provide investors a better experience by pursuing the Exchange Traded Managed Fund (ETMF) avenue (at least until sufficient scale is achieved and at which point an investment manager may sensible pursue a conversion to a LIC if the benefits of a close-ended structure are likely to be advantageous to longer term performance);
- Loyalty share structures for capital raisings where the shares are issued in the listed fund manager parent group as incentive to invest (as undertaken by Magellan Financial Group and VGI Partners Ltd) should cease. Unlike the currently open secondary offer for the Pengana Private Equity Trust (PE1), in which the loyalty share offer (in PE1 versus Pengana Capital Group Limited) has been appropriately structured, issuing loyalty shares in as incentive to participate in a raise runs the risk of generating a motivation to invest that is partly exogenous to the investment merits of the investment vehicle taken in isolation. Both VG1 and VG8 moved to a discount to NTA following the respective capital raises (and VG1 had never previously traded at a discount). Clearly some investors participated in the capital raises solely for the shares in the listed parent company. While the discount may present an opportunity for those buying either VG1 or VG8 it has removed market exit timing control to a degree for those wishing to sell. This is not a direct criticism of VGI Partners Ltd (they pioneered the manager paying all IPO costs in VG1) but with the benefit of hindsight IIR suspects they would not have gone down the same route.

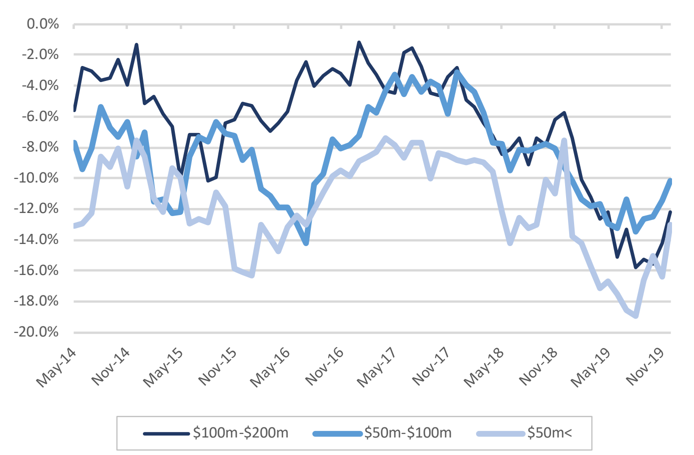
With respect to initiatives to close a discount gap to NTA, IIR believes the investment manager and board of the Monash Absolute Returns Fund (MA1) is leading the way in terms of acting in the best interests of shareholders (possibly being spurred into action by the activist investor Sandon Capital). The investment manager and board of the Monash Absolute Returns Fund have proposed a conversion to an ASX-listed Exchange Traded Managed Fund (ETMF). If shareholders vote in favour of the proposal it will be the first such conversion to an ETMF in the Australian market. IIR suspects however it will not be the last.

Permanent Discounts?

It is well understood that premium / discounts to NTA, both at the LIC specific and industry level, vary over time, with key determinants generally being manager performance, market sentiment and equity market environment.

It is also well understood that there is a strong correlation between LIC FUM scale and the degree and persistence of discounts to NTA. The chart below highlights this correlation, presenting the average discount by market cap band in the smaller end of the LIC sector. Small LICs, deemed to be those with a market cap below $200m, suffer from limited liquidity, a lack of market relevance and often sub-standard investor communications. Where manager performance has been poor, the likelihood of materially narrowing a deep discount to NTA is remote. Even in cases where manager performance has been strong, and recognised as such by shareholders (MA1 is a good example), many smaller LICs have still been characterised by deep and persistent discounts.

Average Discounts to NTA by Market Cap Band



Source: IIR

The key question is whether the significant discounts in the smaller LICs have become structural and permanent over recent years or, like the larger end of the sector, likely to be cyclical. In IIR's view, the deep discounts in the small end of the sector may well have become structural and permanent in nature, with the change (if it exists) potentially relating to the growth of the active ETMF market segment. An investor may reasonably ask why opt to access an investment strategy via an LIC investment vehicle that lacks scale when it is almost a given a material discount will develop and thereby precluding an investor from accessing the NTA performance of the manager should they wish to exit. In contrast, an ETMF guarantees such access to performance upon exit by way of the market maker function. It is possible that an increasing number of investors who value ASX liquidity are choosing to access an active investment strategy via an ETMF versus a LIC structure, and notwithstanding the considerable investment strategy benefits of the close-ended vehicle.

In light of the above, and where a board has exhausted all other initiatives to close the gap, IIR believes a board must act in the best interests of investors by exploring four possible options to address a persistent and deep discount to NTA: i) conversion to a unit trust; ii) merger with a larger LIC that trades at or close to NTA; iii) a change in the investment manager; and, iv) wind-up.

The determination of the best course of action to present to a shareholder vote should be quite apparent where, during the course of the process, the investment manager and board have engaged in extensive consultation with the shareholder base. Broadly speaking, where shareholders are satisfied with manager performance, continuation (via conversion or a shareholder vote outcome of status quo) would be the appropriate proposal. In contrast, where manager performance has been poor over a prolonged period and in a manner not true to investment style, wind-up, merger, or replacing the investment manager would be the appropriate proposed remedies.

Board Initiatives

A board can undertake a range of standard initiatives in an attempt to address a discount to NTA. Specifically, on- and off-market buybacks, improving shareholder communications and increasing dividends (where an option). However, in IIR's view, these initiatives, while commendable when undertaken, have often been relatively ineffective in closing the discount gap for small LICs over recent years.

Where these initiatives have been exhausted with little positive impact on closing the gap and where the manager / board are receiving shareholder feedback that the gap should be addressed, then IIR believes it is incumbent upon the board to consider more significant structural change options. IIR adopts this view irrespective of manager performance, with manager performance only being relevant to the proposed course of action upon which shareholders vote for.

But with respect to action of this type from a board there is an inherent potential conflict of interest. The only stakeholder that is a given 'loser' in all options bar replacing the investment manager is the board of an LIC. Both a shareholder vote for a wind-up or conversion into a unit trust (either unlisted or as an ETMF)) will lead to a dismantling of the board. The flipside for a board is the reputational kudos it is likely to gain for acting in the best interests of shareholders. Again, IIR believes the board of the Monash Absolute Return Fund is leading the way in this regard.

The table below details those LICs that have undertaken, or are in the processing of doing so, one of the four restructuring actions noted above.

Recent and Ongoing LIC Structural Actions

	ASX Code	Action
8IP Emerging Companies Ltd	8EC	Wind-up
Clime Capital Limited / CBG Capital Ltd	CAM/CBC	Merger
Blue Sky Alternatives Access Fund Ltd	BAF	IMA transferred to Wilson Asset Mgmnt
Monash Absolute Investment Company Ltd	MA1	Proposal convert to ETMF
Ellerston Global Investments Ltd	EGI	Proposal convert to unlisted MF
Watermark Absolute Return Fund	WMK	Converted to and merged with unlisted MF
URB Investments	URB	Converted to and merged with unlisted MF
Sandon Capital Investments :Limited / Mercantile Investment Company Limited,	SNC/MVT	Merger

Source: IIR

The section below addresses the considerations and implications for each of the four possible forms of restructure.

Conversion to a Unit Trust

Over the course of the last nine months, or so, the Monash Absolute Return Fund (MA1) and the Ellerston Global Investments Ltd (EGI) have proposed converting into a unit trust, the first being an ETMF, and second being an unlisted trust. This comes after the conversion (and merger) of the Watermark Absolute Return Fund (WMK) into an unlisted trust.

A conversion to a unit trust represents a continuation of the investment strategy and the ability for shareholders to remain invested in the strategy. This is only a realistic option where a majority of shareholders are satisfied with manager performance.

The are two unit trust structures a board can present to shareholders to vote on: an exchange traded managed fund (ETMF) or an unlisted unit trust.

The benefit of the ETMF route is the converted investment vehicle remains listed on the ASX which is consistent with what investors bought into in the LIC and which is important to the vast majority of investors.

An ETMF restructure ensures that the investments in the portfolio continue to be accessible by way of a listed vehicle, but adds the benefit of an external market maker to ensure that the price trades in line with NTA and that there is always liquidity. Furthermore, an ETMF, through the in-specie transfer mechanism of the creation-redemption process, can deliver taxation efficiencies over and above an unlisted managed fund. This taxation efficiency advantage is no small matter, as unlisted trusts can be highly tax inefficient and lead to 'inter-generational' tax inequalities between selling, existing and new investors.

In providing continued exposure to an investment strategy, shareholders are not denied sufficient time for the embedded value of the investments made by a manger to be realised, as would be the case in a wind-up or potentially a merger or the replacement of the investment manager. Additionally, it keeps market exit and CGT realisation timing control in the hands of investors.

Conversion also avoids manager termination costs. Any alternative proposal may result in a dispute with the manager as to the remaining fees that would otherwise be payable under the Investment Management Agreement (IMA), which is generally not able to be terminated during a remaining term other than for cause. Additionally, under an IMA, any change in the investment strategy requires the agreement of the manager, which may not be obtained.

Conversion also removes the risk of market impact costs which is present in a wind-up and potentially also in a merger and change of investment manager outcome. With conversion, no investments are sold on market to enable the restructure and therefore no value is lost. This is a particular issue for less liquid underlying investments in a portfolio where divestment could be challenging / costly. In a conversion the entire portfolio of listed investments is transferred to the unit trust structure in return for the issue of units to the LIC. Units in the unit trust are then distributed by the LIC to the LIC shareholders in line with their existing shareholding via an in-specie distribution.

A conversion into a unit trust may also provide distribution yield benefits. Newer LICs require a period of time to establish a retained earnings and franking credits buffer in order to, one, begin paying dividends and, two, consistently and smoothly do so moving forward. In the interim, barring the appropriately frowned upon fabrication of dividend by way of a capital return component (as per the Magellan Global Trust (MGG)), investors will either not receive a dividend, receive a relatively low dividend and may not receive franking credits. In contrast, in a unit trust, all realised trading profits are passed through to the investor in the year realised. This generally creates a lumpy and market related distribution profile (in contrast to that of a LIC), but does not involve a period in the early ways of no income.

Finally, conversion, by removing the liquidity constraints in a smaller LIC for larger investors wishing to invest, can facilitate FUM growth in the investment vehicle. This may ultimately see investors benefit by way of a lower MER on the basis of scale benefits. IIR also notes that unit trust costs overall are likely to be lower, given the removal of the board and associated costs. Given the whole conversion cost exercise involves total costs of around $300K, the removal of director fees alone should lead to a two year payback profile to investors.

It should be noted that any franking credit reserves not distributed by way of a special distribution and tax deferred assets will be lost in the conversion process.

In IIR's view, a manager should only go down the unlisted unit trust route (versus an ETMF) where the converted vehicle will be merged with a pre-existing unit trust based on exactly the same strategy. In doing so, investors may benefit from material scale related cost savings in addition to the lower costs of an unlisted vehicle versus an ETMF. The ability to do so exists for both Ellerston and Monash. Monash, however, believed the ETMF route was preferable given the importance the majority shareholders place on ASX liquidity.

Merger/Acquisition

Over the course of the last year there have been two mergers. Specifically, Clime Capital Limited (CAM) and CBG Capital Ltd (CBC) and Sandon Capital Investments Limited (SNC) and Mercantile Investment Company Limited (MVT). In both cases the investment strategies were largely the same (with very similar portfolios) and both had either the same investment team or, in the case of SNC/MVT, the portfolios were managed by the same portfolio manager (Gabriel Radzyminski).

To realistically address a discount to NTA, a merger needs to, one, be with a substantially larger LIC that trades at or close to NTA (an LIC can not participate in consolidating the sector if it does not have 'a currency' not trading a premium) and which is managed by an investment manager with a strong track-record and, two, have a comparable investment style and strategy in the same asset class.

The first attribute is important as there needs to be sufficient liquidity in the larger LIC to withstand the likely selling upon merger by some long suffering shareholders in the smaller LIC ('sufficient' in the sense that any such selling does not move the share price to a material discount).

The second attribute is important as for it to be otherwise effectively represents a betrayal of a key aspect of why shareholders invested in the smaller LIC in the first place.

Hostile acquisitions in the LIC sector can be very hard to execute and more so during the initial term of an IMA (and most IMAs are for a 10-year term). For acquisitions to realistically have a chance of proceeding there generally needs to be acquiescence from the investment manager and board of the targeted LIC. In short, investors should not be expecting a flurry of LIC acquisitions any time soon.

Wind-Up

This is an action of last resort and relates to poor performing managers. Investors should note that in a wind-up scenario they lose market exit timing control, may incur impact costs, will incur termination costs, and any tax deferred benefits will be lost. An orderly divestment program may be relatively prolonged and with a staggered distribution of capital to shareholders.

Status Quo

Shareholders may rationally vote to maintain the status quo as a close ended investment vehicle can have very significant benefits, as discussed below.

CAPACITY

Capacity is an important but often ill-defined concept, relating to how much money can be invested in an actively managed strategy without harming that strategy's future returns. Smaller pools of money allow the investment manager to rotate between stocks quickly, and with minimal pricing impacts. However, once a fund grows its assets under management beyond a certain amount, i.e. beyond its capacity, the portfolio manager can face difficulties building meaningful positions in stocks.

Capacity is particularly relevant when investing in the smaller and less liquid stocks on the market.

A consequence of capping the size of an open-ended fund, is that new investors are unable to gain exposure to our fund's strategy. Existing investors could be similarly frustrated as they are unable to increase their exposure. In a closed-end vehicle, investors are free to buy and sell the fund, with the same level of freedom and flexibility as they would with any company listed on the market.

MAINTAINING A STABLE CAPITAL BASE

A key to outperform is the ability to ride out market gyrations, and stay focussed on long term goals. Probably the issue which most challenges an investment managers ability to remain long term focussed, are the liquidity constraints which come when running an open-ended fund. Because the pool of funds available to be invested isn't fixed under this structure, the portfolio manager has to ensure that there is always enough cash on hand to meet redemptions from clients. On the flip side, through periods when investor applications exceed redemptions, the portfolio manager will be pressured to deploy that capital into the market, even if they believe stock prices may be overvalued.

These pressures can be particularly acute in periods of heightened market volatility, when redemption activity can increase considerably. For example, through the financial crisis period of 2008, many small cap managers were forced into selling key portfolio holdings at sub-optimal prices, so as to raise cash and meet investor redemptions. By contrast, the investment managers with stable pools of capital were able to take advantage of the forced sellers, by acquiring these parcels of shares at often bargain prices.

In comparison, the manager of an open-end fund is often forced into selling off their highest quality companies at undervalued prices through such bear market periods. Loyal investors in open ended funds during these periods are often left as investors in the remaining lower quality less liquid stocks in the fund. Academic evidence tends to support this proposition that closed end funds don't suffer the performance drag from having to fund investor redemptions at inopportune times.

DIVIDENDS, TAX AND 'INTER-GENERATIONAL' ISSUES

The company structure of LICs allows it to retain earnings and pay dividends at a rate set by the company. This is different to a unit trust, which must distribute all realised gains in the year earned. The results of these differing tax structures tend to mean consistency of LIC dividends and lumpiness of unit trust dividends. Investors who rely on these dividends to fund their living expenses clearly prefer the former.

Unit trust investors are subject to the taxation implications of the trading activities of other investors. Net redemption requests may require the manager to sell underlying portfolio holdings which, in turn, may crystallise a capital gain. This leads to the distribution of a CGT liability to remaining investors. Furthermore, the level of the CGT liability may be a function of gains accumulated well before an investor entered the unit trust (creating 'inter-generational' issues). To some degree, these taxation issues can be mitigated in an ETMF by way of the in-kind creation and redemption process undertaken by market makers and authorised participants.

Activist Investors getting More Active

Over the last few years activists have targeted an increasing number of heavily discounted LICs, including the Templeton Global Growth Fund, 8IP Emerging Companies, Blue Sky Alternatives Access Fund, Ellerston Global Investments, Watermark Absolute Return Fund, URB Investments, Monash Absolute Investment Company, Australian Leaders Fund, Contango Income Generator, Cadence Capital Limited, and the Antipodes Global Investment Company.

We expect activist investors to play an increasing role in the sector moving forward. The result is likely to be an increasing number of conversions, wind-ups, and potentially investment manager changes and acquisitions.

The main activist LIC investors in Australia are Sandon Capital Pty Ltd (founded and led by Gabriel Radzyminski) and Wilson Asset Management (International) Pty Limited (founded and led by Geoff Wilson).Both individuals are strong activist investors. Geoff Wilson has a long and successful track record in the LIC sector. Gabriel Radzyminski has a 'nose' for sniffing out an activist prospect and gaining a sense of a disquieted shareholder base. He also has a dogged determination in pursuing an activist strategy when the targeted company management is not agreeable to the proposed strategy.

In deciding to pursue an activist opportunity, these managers need to see a disquieted shareholder base that is looking for, or open to change and where they believe it has a better than even probability it can act as a catalyst to change.

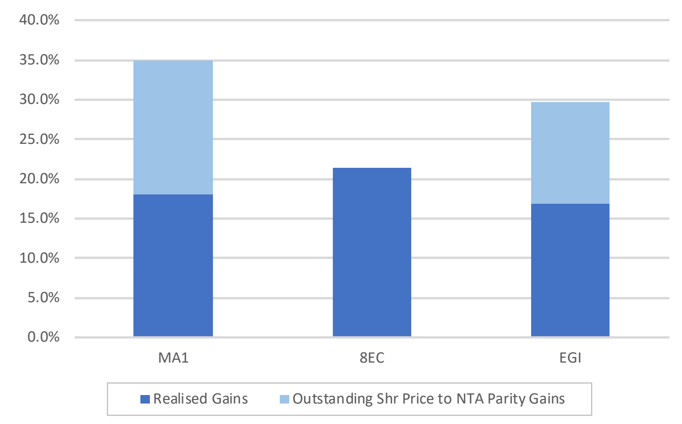
Additionally, in respect to LICs, these managers like to see or assess:

- A deep discount to NTA and ideally poor manager performance (there is no point targeting a LIC where shareholders do not believe there is a problem. And the discount is not always a sufficient problem, partly because existing net buying investors are very happy to do so by way of a discount).
- An investment manager where they can demonstrate is not fit for managing the investment strategy (i.e., has changed and deviated from the previously stated investment style). There needs to be a distinction between LIC's that have fundamentally broken investment strategies versus LICs with investment strategies that are simply out of favour.
- An open shareholder register is generally held to be a positive. However, this is not necessarily the case. An open register can sometimes being a positive yet other times a disadvantage in that it is like 'herding cats' in terms of agitating for change.
- Indications the investment manager "has no friends", such as a significant number of shares being tended in an off-market buyback (indicating a lot of shareholders want to exit).

For retail investors, LICs can be one of the best ways to generate returns. Investors can benefit from both the underlying performance of manager in addition to buying discounted LICs knowing there are investors in the market that may well agitate for change. The latter represents an additional leg to generating positive returns through the narrowing of the discount.

For investors prepared to speculate on structural change, we note the share price gains on a number of LICs that announced structural change to address the discount over the last year as a guide to potential returns upside. The chart below reflects the share price move in relevant LICs pre and post announcement and, where relevant, the residual upside should the share price today converge to the latest published month end NTA.

Realised and Potential Share Price Upside



Source: IIR

Which LICs are next in the Firing Line

The table below lists LICs which IIR believes are potentially vulnerable to structural change due to either deep persistent discounts or underperformance, or both.

Readers should note that the list and information below is speculative in nature and is not in any way intended to represent investment advice.

Possible Targets

LIC	ASX Code	Status / Cause	Possible Outcome
Australian Leaders Fund	ALF	Pressure building	Conversion
Cadence Capital Limited	CAM	Underperformance	Wind-up
NAOS Small Cap Opps Co Ltd	NSC	Underperformance	Speculative
Templeton Global Growth Fund Ltd	TGG	Pressure persisting	Status quo
Morphic Ethical Equities Fund Ltd	MEC		
Contango Income Generator Ltd	CIE	On notice	TBD
Ellerston Asian Investments Ltd	EAI	Pressure building	Conversion
Forager Australian Shares Fund	FOR	Underperformance	Speculative

Source: IIR

Australian Leaders Fund (ALF)

Previous LIC darling Australian Leaders Fund (ALF) is also under pressure from investors. ALF plan a 20% off-market buy back of shares at NAV in order to attempt to reduce the discount to NAV. Some have suggested the off-market buy-back should have happened a year earlier. Many investors however are calling for a wind up of the fund, as it continues to trade at a 20% discount to NAV. Its been a significant turnaround for ALF, who previously traded at close to a 20% premium to NAV and shows how the market can punish LICs which underperform.

Last year we saw the manager of ALF, Watermark Funds Management Pty Limited, transition two LICs to unlisted funds. Such a restructuring may ultimately await ALF, notwithstanding Geoff Wilson's (independent director) repositioning strategy.

Returns have ebbed and flowed but well below equities markets in general. To be fair however, it is difficult being an absolute returns manager when equities markets are on a tear. Investors need to be mindful of the distinction between an LIC with a fundamentally broken investment strategies versus investment strategies that are simply out of favour. We would argue its more the latter in relation to ALF, notwithstanding the ambitious and ultimately failed initiative of developing a global equities capability.

Well-known agitator and former Rothschild managing director David Kingston penned a letter in late February entitled: "TIME'S UP - Let's end the pain for long suffering Australian Leaders Fund shareholders". In the letter, Kingston argues that ALF shareholders "are locked in the ALF cage". He says investors cannot sell their holdings in the LIC without incurring a big exit penalty, due to the gap between its net tangible assets and the share price.

He calls for three strategies to combat this: either winding up ALF and returning funds to shareholders; converting it to an unlisted trust "which enables investors to exit at near NTA"; or merging ALF with an entity that is trading at or around NTA.

David Kingston has form agitating in the LIC space and played a key role in getting Ashok Jacob's Ellerston Global to convert its LIC to an unlisted trust at the end of last year.

David Kingston says Watermark Funds Management have committed two damaging strategy errors that have destroyed shareholder value and seen the ALF share price slip more than 25 per cent in the past five years. The first is taking a net zero equity exposure position for the past five years which he states has been particularly damaging given a strong bull market (IIR does not agree with this criticism given it is consistent with the ALF strategy). The second has been a "failed international investment strategy" which he acknowledges the ALF terminated in the last year.

IIR's understanding that the IMA was for an exceptionally long 25-year period.

Contango Income Generator Ltd (ASX:CIE)

Performance has been poor, with three year annualised total returns of 4.2% (not assisted by a value investment style). The board has telegraphed to the market that the difficult macro environment tied with the pre-existing investment mandate plus the limited retained earnings reserve placed the previously stated dividend yield target at risk. Both the yield objective and investment mandate have recently been tweaked, the latter to permit greater flexibility partly in pursuit of the dividend objective.

Sustained underperformance, a deep discount to NTA, a suffering shareholder base, a changed investment strategy, and an activist agitating for change (Wilson Asset Management) all suggest shareholders will be supportive of whatever restructuring initiative presented by Wilson Asset Management.

Templeton Global Growth Fund Ltd (ASX:TGG)

Activist investors already applied pressure on TGG several years back. To be fair to the board, initiatives have been undertaken to address the discount gap However, the fact remains that TGG has suffered further underperformance with value investing being out of favour, and the discount to NTA is still very wide.

In October 2019 it was announced the portfolio manager Peter Wilmshurst was leaving. Staff turnover like this is not ideal as TGG try to justify keeping this very long standing listing going.

The fact that activist investors have previously agitated for change, yet none has been forthcoming, suggests there may be an inherent inertia to material change, whatever the cause may be. Short of an event like VGI Partners Ltd acquiring the LIC (through script) material change would appear unlikely.

Cadence Capital Limited (ASX:CDM)

Cadence Capital is a high conviction manager that recorded significant alpha in one stock a long time ago. Recently the high conviction approach has come unstuck (for example, 17% portfolio holding of ARQ suffering a 90% share price loss), and CDM has recorded significant underperformance.

The share register is very open, with the top 20 shareholders representing 19% of outstanding shares. In IIR's view, it is hard to see CDM remaining in its current form short of a significant improvement in performance fortunes.

NAOS Small Cap Opportunities Company Ltd (ASX:NSC)

Performance has suffered in recent years and there is a highly disgruntled shareholder base. There was a degree of controversy in the way it handled the takeover of CTN.

In fairness, NAOS has seen a bounce in performance more recently. Despite that the discount remained large even after they announced this. Perhaps some sort of merger between their LICs will be considered in time.

Ellerston Asian Investments Ltd (ASX:EAI)

The board of Ellerston Global Investments (EGI) succumbed to activist pressure (notably former Rothschild banker David Kingston) relatively quickly (despite performance being relatively solid), ultimately announcing a conversion and merger with an unlisted unit trust (the Ellerston Global Mid Cap Fund) with a comparable investment strategy. The catalyst to change was the deep and persistent discount to NTA.

With respect to EAI, IIR notes that Ashok Jacob recently resigned as the chair of EAI, which may possibly be viewed that EAI may also be converted. Ellerston Capital has declined to comment as to whether EAI will be converted to an unlisted trust as per EGI.

Morphic Ethical Equities Fund Ltd (ASX:MEC)

The MEC IPO was poorly structured in terms of size, listing costs, and loyalty options. The company has underperformed the market since listing and there being question marks over the manager's ability to add value from ETFs within the portfolio / making macro calls. Dilutive share issuance has not helped its relationship with a lot of the shareholders. It is earlier within its IMA, so it may take awhile before change is suggested. Will be challenging for it to survive in the current form in the longer term. Morphic Asset Management was acquired by Ellerston Capital in May 2019 which choose to leave the investment team unchanged.

Forager Australian Shares Fund (ASX:FOR)

The fund converted from an unlisted unit trust to an LIC several years ago, at which point IIR reviewed the manager (regarded favourably). After strong performance in its unlisted days, performance subsequently suffered as did the discount to NTA. IIR suspects the relatively long standing and loyal shareholder base will give the manager the benefit of the doubt. They may well be rue the decision several years ago to convert the unlisted trust.

Forager Funds Management founder and PM, Steve Johnson, opted for a relatively vocal position recently in the stamping fees discussion, similar to Paul Moore and Hamish Douglass. He may have been better served keeping a low profile given the deep discount to NTA (similarly PM Capital LICs).

WHO IS IIR?

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IIR was established in 2004 under Aegis Equities Research Group of companies to provide investment research to a select group of retail and wholesale clients. Since March 2010, IIR (the Aegis Equities business was sold to Morningstar) has operated independently from Aegis by former Aegis senior executives/shareholders to provide clients with unparalleled research that covers listed and unlisted managed investments, listed companies, structured products, and IPOs.

IIR takes great pride in the quality and independence of our analysis, underpinned by high caliber staff and a transparent, proven and rigorous research methodology.

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No promotion of issuers' transactions: Research analysts may not be involved in promotional or marketing activities of an issuer of a relevant investment that would reasonably be construed as representing the issuer. For this reason, analysts are not permitted to attend "road show" presentations by issuers that are corporate clients of the Firm relating to offerings of securities or any other investment banking transaction from that our clients may undertake from time to time. Analysts may, however, observe road shows remotely, without asking questions, by video link or telephone in order to help ensure that they have access to the same information as their investor clients.

Widely-attended conferences: Analysts are permitted to attend and speak at widely-attended conferences at which our firm has been invited to present our views. These widely-attended conferences may include investor presentations by corporate clients of the Firm.

Other permitted activities: Analysts may be consulted by Firm sales personnel on matters such as market and industry trends, conditions and developments and the structuring, pricing and expected market reception of securities offerings or other market operations. Analysts may also carry out preliminary due diligence and vetting of issuers that may be prospective research clients of ours.

INDUCEMENTS AND INAPPROPRIATE INFLUENCES

IIR prohibits research analysts from soliciting or receiving any inducement in respect of their publication of research and restricts certain communications between research analysts and personnel from other business areas within the Firm including management, which might be perceived to result in inappropriate influence on analysts' views.

Remuneration and other benefits: IIR procedures prohibit analysts from accepting any remuneration or other benefit from an issuer or any other party in respect of the publication of research and from offering or accepting any inducement (including the selective disclosure by an issuer of material information not generally available) for the publication of favourable research. These restrictions do not preclude the acceptance of reasonable hospitality in accordance with the Firm's general policies on entertainment, gifts and corporate hospitality.