THE RENAISSANCE OF THE LISTED INVESTMENT *company*

Listed Investment Companies evolve and thrive in 2017.

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Listed investment companies (LICs) and trusts (LITs) in the Australian market have had a chequered history – some performing materially well, while others have barely got off the ground before falling into obscurity and underperformance.

In 2017 the potential for LICs and LITs, as they are more colloquially known, has improved markedly following a structural change whereby the costs of the initial public offer are met by management rather than by the investors in the company or trust. There is an immediate benefit here that can be readily observed as the LIC lists at its par price, rather than the discount previously expected.

The first issuer to consider this structural change was VGI Partners who brought their very successful Global Equities LIC in October with NAB as Arranger. The VGI issue broke volume records as, at A$550 million (after scaling), it is the largest LIC to ever come to market in Australia. Retail investors were delighted with the ability to access the skill base of the VGI portfolio managers for global equities – an asset class to which Australians still remain materially underexposed. With its new structure, the issue has performed strongly in its first six weeks of trading having reached a high of $2.14 versus a $2.00 listing price.

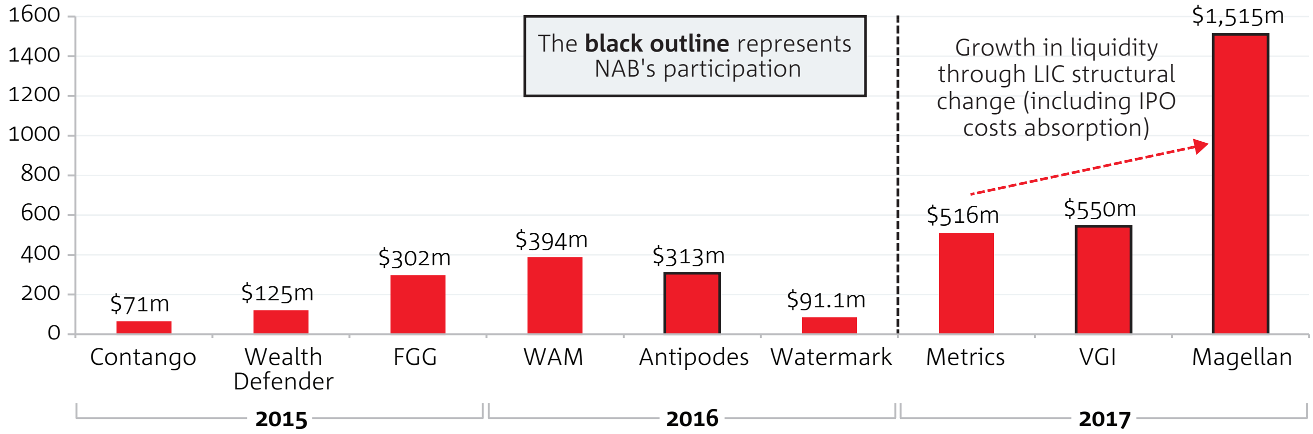
Similar positive volume and secondary trading outcomes have been experienced in the LIT market (structured as a Trust rather than a Company) with Magellan's global equity LIT raising $1.55 billion (another record) where NAB was Joint Lead Manager. Additionally, the Metrics Credit Partners LIT raised $515 million in its issue focussed on domestic syndicated loan exposures. Both issues are also in positive territory on the ASX since listing. The materially higher volumes have provided a natural benefit for fund liquidity – a key requirement for investors, even with an ASX listing.

The chart below shows how fund liquidity has improved in recent years, mainly driven by increasing investor demand for the new enhanced structures:

A chance to diversify

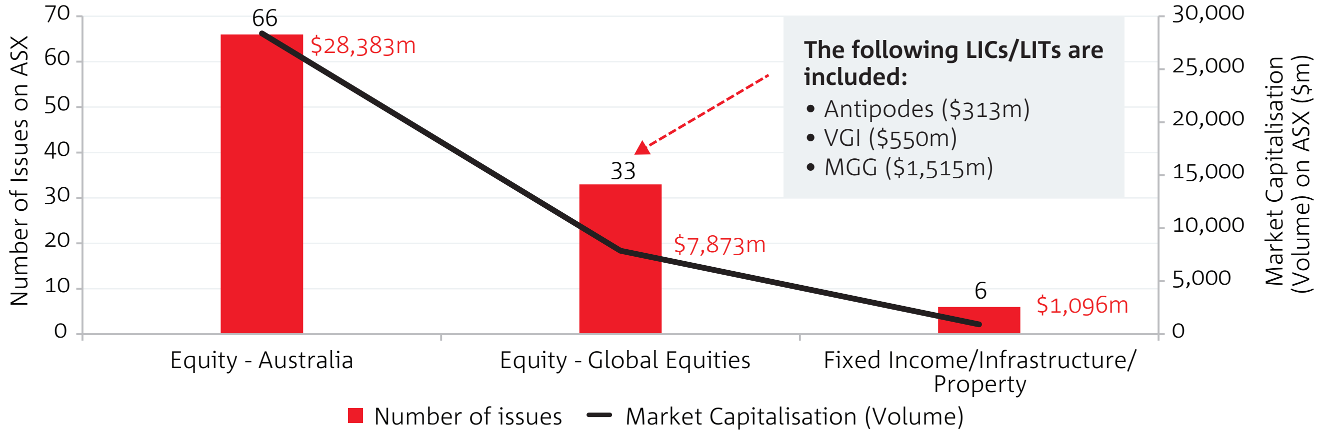
LICs offer investors exposure to asset class diversity and are managed by experts in their fields. With Australian investors generally exposed to a very limited breadth of assets generally – usually including Australian equities, physical property or cash, the ability to gain exposure to professionally managed funds that provide meaningful portfolio diversity is an attraction in these days of limited product offerings for retail investors.

Growth in liquidity through LIC/LIT structural change



Source: ASX website, Bloomberg, NAB Originations

Market capitalisation (volume) of ASX-listed LITs/companies as at 1 November 2017



Source: ASX website, NAB Originations

Considering the LIC market is currently still dominated by underlying Australian Equity strategies, representing ~80% of the current marketplace, the opportunity for investors to diversify their portfolios remains considerable as new high quality differentiated strategies consider this market under the new preferred structures. The chart above depicts the limited asset diversity focus in the current LIC market.

Issues recently have begun to address the need for fund diversity with the Listed Investment Company/Trust market issuing more than $2.5 billion in the months of September and October 2017 in non-Australian Equity related strategies. The individual size of each raise is also evolving as structural progression endures, attracting new investors and quality Issuers to this segment of the market. Issues coming to market in the last year include material expertise in global equities management from Antipodes, VGI and Magellan. Additionally, some quality Australian equity strategies have also listed, offering investors exposure to unique strategies including the ability to short markets in volatile conditions or times of broader under-performance.

A separate key structural change has been the elimination of attached call options in recent issues. Historically, the options have been provided as compensation for the discount expected in the listed price on issue. With IPO costs being absorbed in the issues noted above, the need to issue options has been taken away enabling multiple benefits for investors. This is because, historically, LIC options have often expired with little or no value given trading discounts to the net tangible asset ('NTA') value have continued over the period to option expiry.

Additionally, the dilutive effect of call options being exercised below the NTA isn't good for incumbent holders that don't exercise their options. Overall, the market has welcomed recent issues not offering a stapled call option.

Outlook for LICs

The signs are good that future LICs and LITs will further diversify investor portfolios with high quality managers of RMBS and ABS product, high yield investments, and alternative assets giving serious consideration to this market. Additionally, global asset management experts in global syndicated loans, USD high yield, and ethical assets are being courted for potential issues.

NAB has been at the forefront of the structural development of the LIC market over the last 12 months. The bank's breadth of investor cover has assisted greatly in allowing us to accumulate feedback on not only the types of asset classes preferred at present, but views on the structure of LICs generally. As a consequence, NAB has been able to assess the LICs that were most likely to have sufficient liquidity and secondary performance in advance of a decision to participate and offer these structures to our investors.

The lack of sufficient fixed income product in the domestic capital markets in recent years has driven enhanced acceptance of well-structured LICs and LITs that provide portfolio diversity. This trend is expected to continue into 2018 as the search for yield continues.

The potential for rising interest rates in various global markets, including here in Australia, will also have an effect on investor product preferences and potentially, a tempering in typical Australian investor desire for investing directly in domestic equities.