

## WAM Active

### Market-driven investing

**WAM Active Limited (ASX:WAA) is a listed investment company that provides investors with exposure to an active trading approach, which seeks to capitalise on short-term relative value arbitrage and market mispricing opportunities in the Australian market. The managers aim to deliver positive returns in a rising market and preserve capital in a falling market and are willing to hold relatively high cash balances. WAA has delivered a pre-tax NTA return ahead of the S&P/ASX All Ordinaries since inception in January 2008. WAA's 7.3% dividend yield is probably a key contributor to its 19% share price premium to NTA.**

12 months ending	Total share price return (%)	NTA total return (%)	UBS A\$ Bank Bill (%)	S&P/ASX All Ordinaries (%)
31/03/11	11.0	(0.6)	4.9	4.8
31/03/12	8.0	1.3	4.9	(6.2)
31/03/13	15.0	13.8	3.6	17.8
31/03/14	25.9	2.2	2.8	13.2

Source: WAA, Thomson Datastream. Note: NTA return post-tax and expenses paid, pre-tax accruals; total return indices pre-tax and expenses.

### Investment strategy: Exploiting trading opportunities

Through active trading, the managers seek to exploit relative short-term arbitrages and mis-pricings in the Australian equities market arising from, for example, IPOs, capital raisings, block trades, oversold positions and corporate transactions. The managers take a disciplined absolute return approach balancing risk and reward, aiming to deliver positive returns in a rising market, as well as preserving capital in a falling market over the long term. The significant cash weighting allows them to exploit investment opportunities and provides a balance to equity risk. Performance is compared with cash returns and the S&P/ASX All Ordinaries Accumulation Index, although this is not treated as a benchmark for investment allocation.

### Market outlook: Subdued, but still opportunities

While there appears to be a broad historical correlation between NTA and market performance, the nature of WAA's trading strategies and the level of cash holdings mean that performance may differ appreciably from market trends. Market strength has some influence over the number of potential trading opportunities that arise under capital markets and corporate activity strategies. Although capital markets activity has been subdued in early 2014, the managers expect corporate activity to be sustained at current levels, supported by low interest rates. In an uncertain market, with the potential for correction if economic or corporate earnings trends disappoint, investors may favour a fund with WAA's absolute return approach.

### Valuation: Premium supported by dividend yield

WAA's price discount to NTA before tax steadily narrowed from a peak 29.7% in March 2009, reached a premium of 22.8% in March 2014 and currently stands at a 19.2% premium. The main factor that appears to have driven the move to a significant premium is the level of dividend yield, made more attractive by the 100% franking credits attached.

### Listed investment companies

22 April 2014

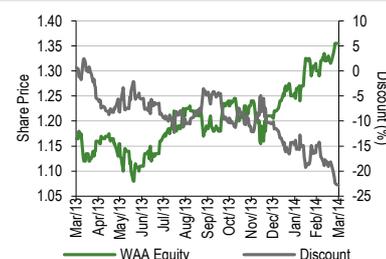
**Price** **A\$1.32**  
**Market cap** **A\$45m**  
**AUM** **A\$38m**

NTA\* A\$1.10  
 Premium to NTA 19.2%  
 Yield 7.3%

\*As at 31 March 2014.

Ordinary shares in issue 34.0m  
 Code WAA  
 Primary exchange ASX  
 Secondary exchange N/A

### Share price/discount performance\*



### Three-year cumulative perf. graph



52-week high/low A\$1.40 A\$1.08  
 NTA\* high/low A\$1.14 A\$1.05

\*Excluding income.

### Gearing

Gross 0%  
 Net cash 38%

### Analysts

Gavin Wood +44 (0)20 3681 2503  
 Andrew Mitchell +44 (0)20 3681 2500  
[investmenttrusts@edisongroup.com](mailto:investmenttrusts@edisongroup.com)

### Exhibit 1: Company at a glance

#### Investment objective and fund background

WAM Active's investment objectives are to provide investors with a regular income stream in the form of fully franked dividends, to achieve a positive return, after fees, over most time periods, and to preserve capital in the short and long term.

#### Recent developments

4 February 2014: Interim results: investment portfolio +12.7% vs S&P/ASX All Ordinaries index +14.6%.  
4 October 2013: A\$1.2m DRP shortfall placement at A\$1.1488 (premium to NTA).

#### Forthcoming

AGM	November 2014
Preliminary results	August 2014
Year end	30 June
Dividend paid	30 April 2014

#### Capital structure

Indirect cost ratio	2.4% (4.4% inc. perf. fee)
Net cash	38%
Annual mgmt fee	1.0% of gross assets
Performance fee	20% of increase in gross value over high water mark

#### Fund details

Group	Wilson Asset Management
Managers	Geoff Wilson, Chris Stott
Address	Level 11, 139 Macquarie Street, Sydney, NSW 2000, Australia

Launch date	January 2008
Continuation vote	N/A

Loan facilities	N/A
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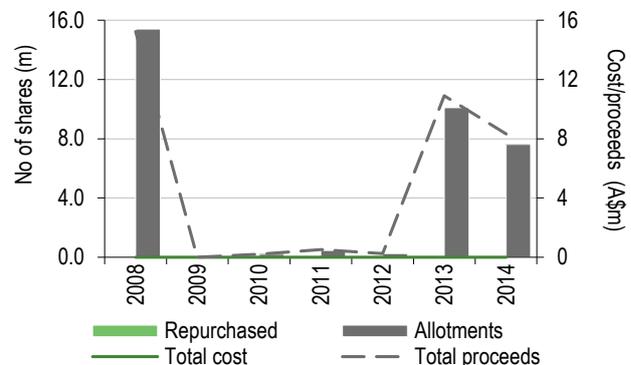
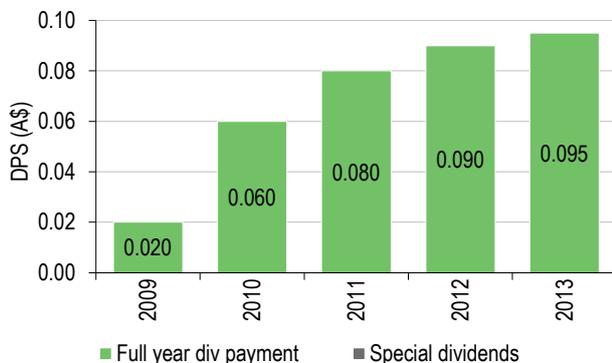
Phone	+61 (0)2 9247 6755
Website	<a href="http://www.wamfunds.com.au">www.wamfunds.com.au</a>

#### Dividend payments

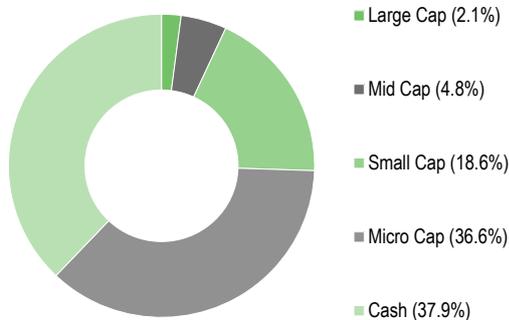
Dividends paid semi-annually. The board is committed to paying an increasing stream of fully franked dividends, provided the company has sufficient reserves.

#### Share buyback policy and history

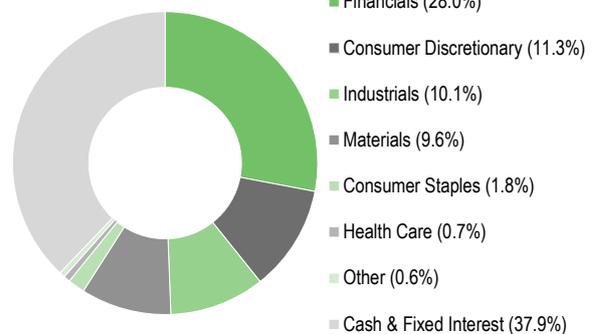
WAA is authorised to issue ordinary shares and to issue options over ordinary shares.



#### Portfolio composition (as at 31 March 2014)



#### Sector exposures of portfolio (as at 31 March 2014)



#### Top 10 holdings (as at 31 March 2014)

Company	Sector	Portfolio weight %	
		31 March 2014	31 March 2013*
Century Australia Investments	Diversified Financials	4.2	3.5
Westoz Investment Company	Investment Company	3.2	2.2
Hills	Capital Goods	3.5	3.3
CSR	Materials	2.7	N/A
IPE	Diversified Financials	2.7	N/A
CBA Perpetual - PERLS IV	Banks	3.0	N/A
Brickworks	Materials	2.5	3.0
Macquarie Atlas Roads Group	Transportation	2.4	N/A
Flight Centre Travel Group	Consumer Services	2.8	N/A
ANZ Convertible Prefs - CPS1	Banks	2.5	N/A
<b>Top 10</b>		<b>29.5</b>	

Source: WAM Active, Edison Investment Research. Note: \*Where no figure is shown for 2013 portfolio weight, the stock was not in the top 10.

## **Australian market outlook: Some caution warranted**

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The nature of WAA's trading strategies and the level of cash holdings mean that performance may be markedly different from broader market trends. However, as illustrated by Exhibits 4 and 6, there appears to be a broad historical correlation between WAA's NTA and market performance. Additionally, market strength has some influence over the number of potential trading opportunities that arise under capital markets and corporate activity strategies.

The key driver of Australian economic growth in recent years has been very strong resources investment and this is expected to decline sharply from FY15, acting as a drag on growth. The Australian government's December 2013 economic outlook reduced estimated real GDP growth for FY15 from 3.0% to 2.5% (in line with FY14). This view is supported by the IMF's April 2014 World Economic Outlook, which forecasts Australian GDP growth broadly stable at 2.6% in 2014. Employment growth is expected to remain subdued and wage growth is forecast to remain well below trend. In this environment, sustained low interest rates are expected to help support economic recovery.

Dealogic reported that the overall value of equity issuance during early 2014 decreased compared to a year earlier, although the number of issues increased. While this suggests that confidence is spreading across an increasing number of corporate management teams, the postponement of several IPOs during the period highlights a fluctuating market backdrop. The strong increase in the value of M&A deals during early 2014 compared to a year earlier endorses the view of rising confidence across corporate management teams, encouraged by the low interest rate outlook.

Thus the economic outlook appears to be for subdued but gradual improvement. While the path of the economy may prove bumpy, from WAA's perspective this could provide fruitful trading opportunities for a number of its strategies (see Investment Process below) as market expectations change. Also, if M&A and IPO activity pick up over time, this would tend to broaden the scope for event-driven trading.

## **Fund profile: Active trading style**

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WAA is an Australia-listed investment company established in January 2008. Day-to-day management and investment of funds is carried out by Wilson Asset Management Group. WAM Active's stated investment objectives are to provide investors with a regular income stream in the form of fully franked dividends, to achieve a positive return, after fees, over most time periods, and to preserve capital in the short and long term. Fund managers Chris Stott and Geoff Wilson are responsible for the performance of the portfolio, portfolio construction and stock selection. Geoff Wilson and Chris Stott, together with analysts Martin Hickson (who has primary responsibility for trading investments), Matthew Haupt and Mark Tobin are responsible for idea generation and stock recommendations.

## **The fund managers: Geoff Wilson and Chris Stott**

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### **The managers' view: Opportunities exist for active managers**

The managers' underlying investment philosophy is that inefficiencies exist in the Australian equity market, providing opportunities to add value for active managers. They operate a broad range of short- and medium-term trading strategies with the overall level of potential trading opportunities arising relatively independently of market conditions.

In the medium to longer term, Geoff Wilson and Chris Stott have a positive view of the Australian equity market, contingent on an increase in economic activity driven by record low interest rates. In the immediate term, they have a cautious view of equities and their outlook for global and local stock markets remains subdued. They anticipate flat performances in the 2014 calendar year on the basis that the Australian economic recovery is largely already priced in to current stock values.

Despite their cautious near-term view, the managers are confident that prevailing market conditions will continue to give rise to a range of trading opportunities and they believe, with a strong cash weighting, the investment portfolio is well positioned to take advantage of these opportunities. They do not envisage increasing the average cash weighting of the portfolio to address increased equity risk on a strategic basis and do not anticipate any significant decline in the number of active trading positions held during 2014. Although capital markets activity has been subdued in the first quarter, reducing potential trading opportunities, they expect corporate activity to be sustained at current levels, generating an increased number of opportunities compared with 2013.

## **Asset allocation**

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### **Investment process: Market-driven investing**

The WAA approach is to invest with a focus on absolute returns, aiming to deliver positive returns in a rising market, as well as preserving capital in a falling market over the long term. The managers take a disciplined approach, balancing risk and reward in light of the emphasis on capital preservation. As well as following a number of specific trading strategies, this approach provides an opportunity for the managers to capitalise on the trading investment opportunities that are identified during the research process for the other funds managed by Wilson Asset Management Group.

The investment process involves actively trading to take advantage of relative short-term arbitrages and mis-pricings in the equities market with opportunities provided by IPOs, capital raisings, block trades, oversold positions and corporate transactions, for example. A key element of idea generation is maintaining a strong information network across the investment community to identify new trading opportunities as they arise.

A number of trading strategies are operated, including short-term arbitrages created by capital markets and corporate activity, and longer-term investments based on purchasing assets at a discount to underlying value. The latter include investing in other listed investment companies where WAA may gradually increase its stake. A current example is Century Australia, the largest investment in WAA's portfolio, in which WAM Active owns 3% and WAM Capital also owns 20%.

The size of investment depends on the relative strength of the investment opportunity with initial investment positions usually representing 1%, 2% or 3% of the portfolio. The number of companies in the portfolio and the cash level vary as new opportunities are identified and existing investments sold. If acceptable risk/return investments are not found, cash is held to preserve capital.

### **Overview**

WAM Active has a benchmark-unaware, absolute return focus, and holds a significant level of cash (see Exhibit 2), which balances equity risk and provides flexibility to invest as opportunities are identified. Since inception in January 2008, the cash weighting has averaged c 48% but, reflecting the active approach, has ranged from 8% to 88%.

**Exhibit 2: WAM Active portfolio cash weighting since inception**


Source: WAM Active, Edison Investment Research

## Current portfolio positioning

At 31 March 2014, the portfolio had a 37.9% cash weighting, close to the mid-point of the previous 12 months' range of 24% to 48%. Investments are currently weighted towards the financials and industrials sectors and there is a strong smaller company bias with a combined 55.2% portfolio weighting (88.9% weighting within the equity investments) to small/micro-cap companies (see Exhibit 1). As there is no top-down allocation across the market cap range, given WAM Active's focus on trading opportunities, it would be reasonable to expect significant fluctuations in market cap exposure going forward.

The investment style is an active trading approach taking advantage of opportunities across the market and as a result the equity sector allocation varies considerably over time and diverges significantly from index sector weightings, as illustrated in Exhibit 3. In spite of this, sector weightings happen to be quite similar to those of 12 months earlier. There is also a degree of commonality of portfolio constituents, with five of the companies included in the March 2014 top 20 holdings also appearing in the March 2013 top 20.

**Exhibit 3: Equity Sector allocation within portfolio relative to index**

	End March 2014 (%)	End March 2013 (%)	Change (%)	Index end March 2014 (%)	Trust active weight (%)	Trust weight / Index weight
Financials	45.1	38.5	6.6	34.7	10.4	1.3
Consumer Discretionary	18.2	19.4	-1.2	9.8	8.4	1.9
Industrials	16.3	26.4	-10.2	6.3	10.0	2.6
Materials	15.5	8.1	7.3	23.7	-8.2	0.7
Consumer Staples	2.9	1.1	1.8	6.1	-3.2	0.5
Healthcare	1.1	0.0	1.1	4.1	-3.0	0.3
Information Technology	0.5	3.7	-3.2	1.2	-0.7	0.4
Telecommunication Services	0.5	0.0	0.5	6.9	-6.4	0.1
Energy	0.0	2.7	-2.7	5.7	-5.7	0.0
Utilities	0.0	0.0	0.0	1.6	-1.6	0.0
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

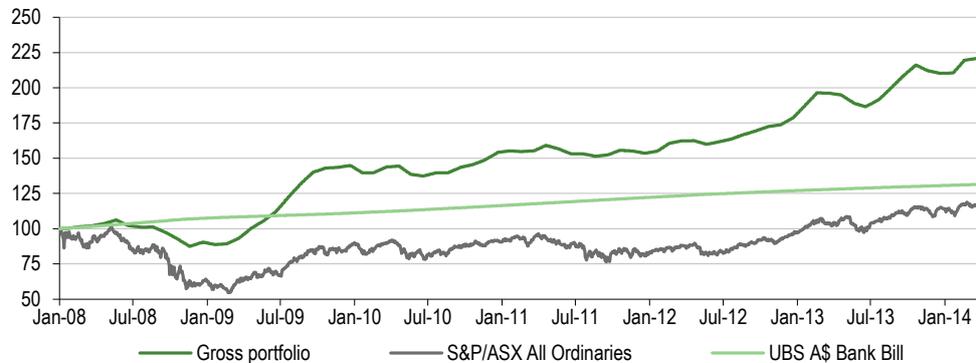
Source: WAM Research, Edison Investment Research. Note: Index is S&P/ASX All Ordinaries Index.

## Performance: Outperformance since inception

WAA's share price total return has outperformed the S&P/ASX All Ordinaries Accumulation Index over one, three and five years and since inception in January 2008. Exhibit 4 illustrates WAA's strong gross portfolio performance (pre-expenses) since inception. While outperforming since inception, WAA's NTA has underperformed the index over one, three and five years. The relatively high average cash weighting in the portfolio appears to have been an important contributing factor to the strong initial period of relative performance from January 2008 to March 2009 during which

time the S&P/ASX All Ordinaries fell 45%. WAA's reported NTA medium-term performance has been diluted by the exercise of options from the February 2010 and May 2012 bonus issues. Near-term NTA relative weakness can be ascribed to 3.2 cents per share of tax being paid during March.

**Exhibit 4: Gross portfolio and index total return performance since inception, rebased**



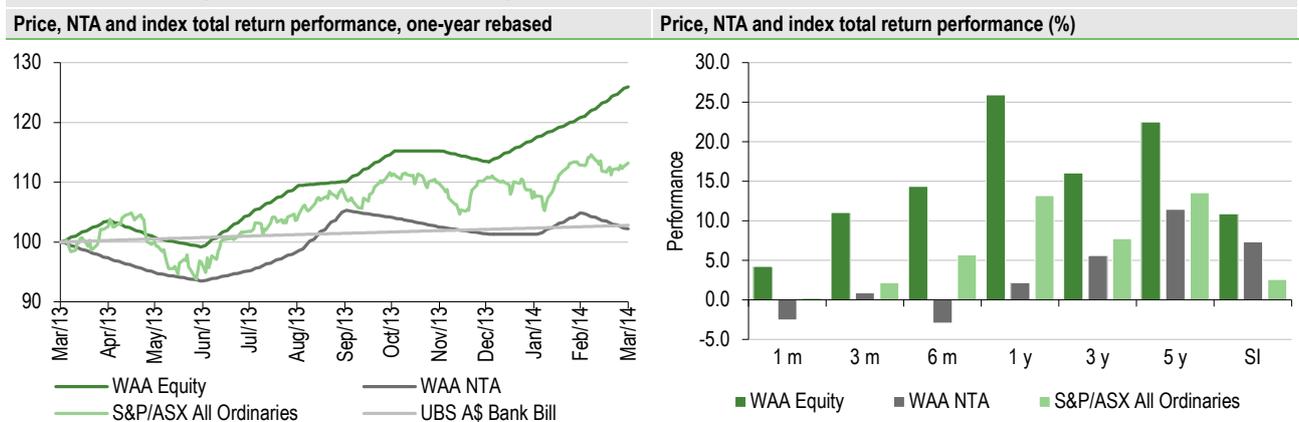
Source: Thomson Datastream, Edison Investment Research.

**Exhibit 5: Share price and NTA total return performance, versus indices (percentage points)**

	One month	Three months	Six months	One year	Three years	Five years	Since inception
Price versus S&P/ASX All Ordinaries	4.0	8.9	8.6	12.7	31.3	87.2	73.1
NTA versus S&P/ASX All Ordinaries	(2.8)	(1.3)	(8.6)	(11.0)	(7.3)	(16.6)	38.1
Price versus UBS A\$ Bank Bill	4.0	10.4	13.1	23.1	44.7	154.7	59.0
NTA versus UBS A\$ Bank Bill	(2.8)	0.2	(4.2)	(0.6)	6.1	50.9	24.0

Source: Thomson Datastream, Edison Investment Research. Note: Data to end March 2014.

**Exhibit 6: Share price and NTA total return performance, versus indices**



Source: Thomson Datastream, Edison Investment Research. Note: Three-year, five-year and since inception performance figures annualised.

## Discount: Move to premium in 2013

Following the global financial crisis, the price discount to NTA before tax widened from an average 7.4% in 2008 to a peak of 29.7% in March 2009. As illustrated in Exhibit 7, since mid-2009, the price discount to NTA before tax steadily narrowed from 29.2% at 30 April 2009 moving to a premium during 2012. It has remained at a premium since April 2013 and reached a premium of 22.8% at 31 March 2014 with the yield, currently c 7%, probably an important contributor to this position.

**Exhibit 7: Discount since inception**



Source: WAM Active, Edison Investment Research. Note: Positive values indicate a discount; negative values indicate a premium.

## Capital structure and fees

WAM Active currently has 34.0m ordinary shares in issue. Since June 2012, 17.7m shares have been issued, raising a total of A\$19.2m and increasing the share count by over 100%. The main element of this was the issue of 16.0m shares through the exercise of options (raising A\$17.3m). All unexercised share options expired in December 2013. One of the objectives of the board is to grow net tangible assets and the capital base with a focus on growing WAM Active's assets to A\$100m. Management may therefore issue equity beyond the DRP to address this objective.

Wilson Asset Management Group is WAM Active's investment manager and is paid a management fee of 1% pa of gross assets. Unless the portfolio falls below the value of a previous high water mark, the manager also qualifies for a performance fee being 20% of the increase in gross value of the portfolio above the high water mark. For the year ended 30 June 2013, the management and performance fees were A\$0.2m and A\$0.5m and the indirect cost ratio (based on average net assets and excluding brokerage expense) was 2.4% (4.4% including performance fees).

## Dividend policy

WAM Active is committed to providing investors with a rising stream of fully franked dividends, provided there are sufficient profit reserves and franking credits, and it is within prudent business practices. It has met this objective since 2009 (see Exhibit 1). Dividends are paid semi-annually and a dividend reinvestment plan (DRP) is available to shareholders. Investments are primarily 'held for trading' with investment gains on the revenue account and dividends paid treated as income to investors.

## The board

The board of WAM Active comprises two non-independent directors, Geoffrey Wilson (chairman) and Matthew Kidman, and one independent director, John Abernethy. Geoffrey Wilson has over 30 years' experience in the Australian and international securities industry and has acted as chairman since July 2007. He is currently chairman of WAM Capital and WAM Research and a director of Australian Leaders Fund and Clime Capital. Matthew Kidman has been a director of WAM Active since July 2007 and worked as a portfolio manager at Wilson Asset Management for 13 years between 1998 and 2011. He is currently chairman of Watermark Market Neutral Fund and a director

of WAM Capital, WAM Research, Centrepoint Alliance and Sandon Capital Investments. John Abernethy has over 30 years' experience in funds management and corporate advisory and has been a director of WAM Active since November 2007. He is currently chairman of Clime Capital and a director of Clime Investment Management, WAM Research, Australian Leaders Fund and Watermark Market Neutral Fund.

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## WAM Research

### Fundamental, research-driven investing

**WAM Research Limited (ASX:WAX) is a listed investment company that provides investors with exposure to an actively managed portfolio of listed Australian companies, typically small to medium-sized companies identified as undervalued. The managers' approach is differentiated by a focus on absolute returns and a willingness to hold relatively high cash balances. The selection criteria mean mining companies tend not to feature in the portfolio. WAX has delivered pre-tax NTA returns ahead of the S&P/ASX All Ordinaries over one and three years and since introduction of the current investment policy in 2010.**

12 months ending	Total share price return (%)	NTA total return (%)	S&P/ASX All Ordinaries (%)	S&P/ASX 300 Industrials (%)	ASX Small Industrials (%)
28/02/11	19.9	12.4	10.2	3.8	7.9
29/02/12	(0.9)	(2.2)	(6.7)	(2.0)	(0.9)
28/02/13	51.5	30.2	21.9	37.4	19.4
28/02/14	22.2	13.6	10.4	13.8	8.1

Source: WAX, Thomson Datastream. Note: NTA return pre-tax.

### Investment strategy: Absolute return approach

The managers seek to select undervalued growth companies listed on the Australian market, buying when a catalyst for revaluation can be identified. A bottom-up research process is used, rating companies on a range of company-specific and industry factors. Company meetings are seen as very important both to gather information and to help assess management quality. The significant cash-weighting enables the managers to exploit investment opportunities and provides a balance to equity risk. Performance is measured against the S&P/ASX All Ordinaries Accumulation Index although this is not treated as a benchmark for investment allocation.

### Market outlook: Subdued but still opportunities

In recent years, the key driver of Australian economic growth has been resources investment, which is expected to decline sharply from FY15, and the economic outlook now appears more subdued. The Australian market is trading on a forward P/E of 14.4x, above the 10-year average of 13.2x but not overly stretched in comparison with the high of 16.2x. This leaves an uncertain market outlook, with the potential for correction if economic or corporate earnings trends disappoint. In these circumstances investors may favour a fund with WAX's absolute approach.

### Valuation: Premium supported by dividend yield

Since the change in investment strategy in mid-2010, the price discount to NTA before tax has steadily narrowed, from 24.4% at 30 June 2010 to reach a premium of 8.5% in October 2013. Subsequently, it has fluctuated between discount and premium and currently stands at a 10.5% premium. The main factors that appear to have driven the move to a premium are the strong NTA outperformance relative to the S&P/ASX All Ordinaries Accumulation index and the level of dividend yield, made more attractive by the 100% franking credits attached.

### Listed investment companies

14 April 2014

**Price\*** **A\$1.22**  
**Market cap** **A\$169m**  
**AUM** **A\$153m**

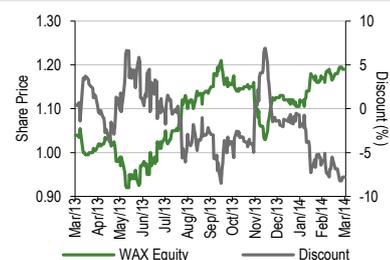
\*As at 10 April 2014.

NTA\*\* A\$1.10  
 Premium to NTA 10.5%  
 Yield 5.7%

\*\*As at 28 February 2014 excluding income, assuming options not exercised.

Ordinary shares in issue 138.2m  
 Code WAX  
 Primary exchange ASX

### Share price/discount performance\*



### Three-year cumulative perf. graph



52-week high/low A\$1.22 A\$0.92  
 NTA\* high/low A\$1.12 A\$0.98

\*Excluding income.

### Gearing

Gross 0%  
 Net cash 40%

### Analysts

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### Exhibit 1: Company at a glance

#### Investment objective and fund background

WAM Research's investment objectives are to provide investors with a rising stream of fully franked dividends and to achieve a high real rate of return, comprising both income and capital growth, within acceptable risk parameters.

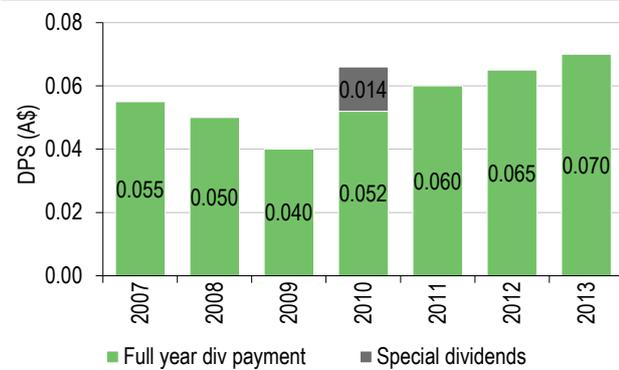
#### Recent developments

3 February 2014: Interim results: investment portfolio +17.0% vs S&P/ASX All Ordinaries index +14.6%.  
 28 October 2013: 1-for-2 bonus option issue at A\$1.20 exercise price, expiry 17 June 2015.  
 28 October 2013: A\$16.5m DRP shortfall placement at A\$1.15 (premium to NTA).

Forthcoming		Capital structure		Fund details	
AGM	November 2014	Indirect cost ratio	1.4% (2.8% inc. perf. fee)	Group	Wilson Asset Management
Preliminary results	August 2014	Net cash	40%	Managers	Geoff Wilson, Chris Stott
Year end	30 June	Annual mgmt fee	1.0% of gross assets	Address	Level 11, 139 Macquarie Street, Sydney, NSW 2000, Australia
Dividend paid	30 April 2014	Performance fee	20% of outperformance over S&P/ASX All Ords	Phone	+61 (0)2 9247 6755
Launch date	August 2003	Loan facilities	N/A	Website	<a href="http://www.wamfunds.com.au">www.wamfunds.com.au</a>
Continuation vote	N/A				

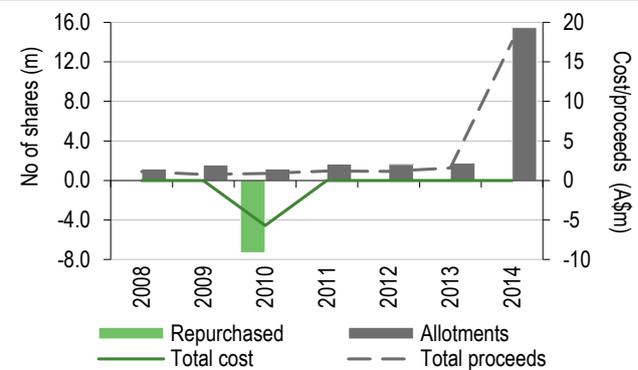
#### Dividend payments

Dividends paid semi-annually. The board is committed to paying an increasing stream of fully franked dividends, provided the company has sufficient reserves.

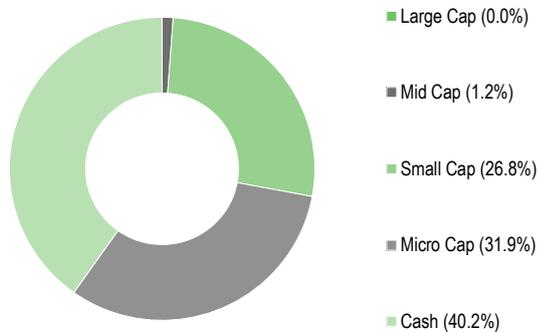


#### Share buyback policy and history

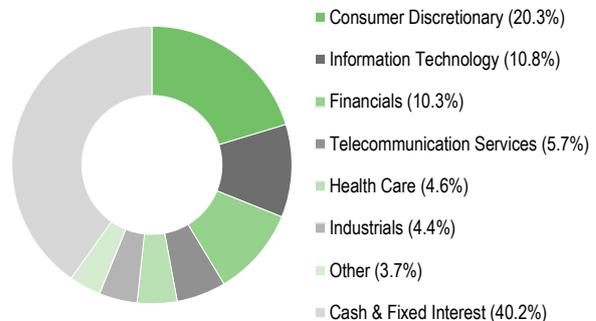
WAX is authorised to issue ordinary shares and to issue options over ordinary shares.



#### Portfolio composition (as at 28 February 2014)



#### Sector exposures of portfolio (as at 28 February 2014)



#### Top 10 holdings (as at 28 February 2014)

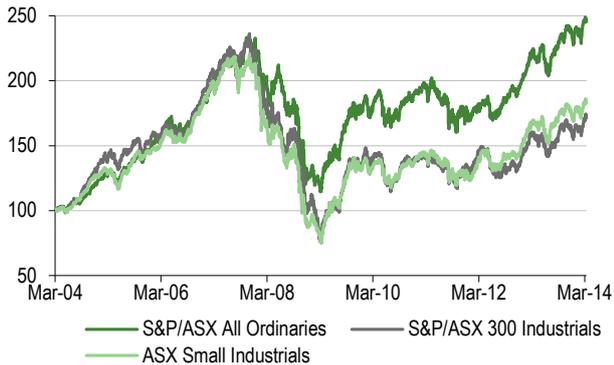
Company	Sector	Portfolio weight %	
		28 February 2014	28 February 2013*
Slater & Gordon	Consumer Services	3.9	N/A
Automotive Holdings Group	Retailing	3.1	3.5
Ardent Leisure	Consumer Services	3.0	N/A
iProperty Group	Software & Services	2.7	1.8
STW Communications	Media	2.6	2.1
Donaco International	Consumer Services	2.3	N/A
CSG	Software & Services	2.3	N/A
Vocus Communications	Telecommunication Services	2.3	N/A
Nearmap	Software & Services	2.3	N/A
NEXTDC	Telecommunication Services	2.3	N/A
<b>Top 10</b>		<b>26.8</b>	

Source: WAM Research, Edison Investment Research. Note: \*Where no figure is shown for 2013 portfolio weight, the stock was not in the top 10.

## Australian market outlook: Some caution warranted

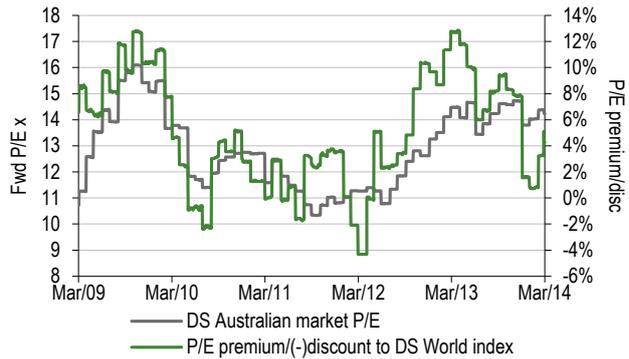
To set the context, Exhibit 2 shows how the Australian market recovered strongly following the global financial crisis, but the industrials and smaller cap indices followed a lower path. Not shown here, but relative to the world market (using MSCI indices in A\$ terms), Australian indices lagged last year with the small caps up 5% and overall index +21% compared with +48% for the world index. This reflected in particular the strong performance of the US market.

**Exhibit 2: Australian market and Industrials sector**



Source: Thomson Datastream. Note: Total return indices.

**Exhibit 3: Australian market forward P/E and relative**



Source: Thomson Datastream

Where next for the market? The key driver of Australian economic growth in recent years has been very strong resources investment and this is expected to decline sharply from FY15, acting as a drag on growth. The Australian government's December 2013 economic outlook reduced estimated real GDP growth for FY15 from 3.0% to 2.5% (in line with FY14). Employment growth is expected to remain subdued, and wage growth is forecast to remain well below trend.

Thus the economic outlook appears subdued, although not out of line with global forecasts for advanced-country GDP growth. In terms of valuation, the Australian market is trading on a forward P/E of 14.4x, which is above the 10-year average of 13.2x but not overly stretched in comparison with the high of 16.2x or the world average of c 14.8x. Price to book and dividend yield levels are in line with the long-term averages. This seems to leave the market outlook as uncertain with the potential for correction if the economic or corporate earnings trends disappoint, but not clearly in overstretched territory. In these circumstances investors may favour a fund with WAX's absolute approach.

## Fund profile: Undervalued growth company focus

WAM Research is an Australian-listed investment company established in August 2003. Day-to-day management and investment of funds is carried out by Wilson Asset Management Group pursuant to a management agreement. WAM Research's stated investment objectives are to provide investors with a rising stream of fully franked dividends and to achieve a high real rate of return (both income and capital) within acceptable risk parameters. The investment strategy was revised in July 2010 to include identification of a catalyst for re-rating, leading to a shorter-term time horizon and coinciding with the name change from Wilson Investment Fund. Fund managers, Chris Stott and Geoff Wilson are responsible for the performance of the portfolio, portfolio construction and stock selection. Geoff Wilson and Chris Stott, together with analysts Martin Hickson, Matthew Haupt and Mark Tobin are responsible for idea generation and stock recommendations.

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## The fund managers: Geoff Wilson and Chris Stott

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### The managers' view: Opportunities exist for active managers

The managers' underlying investment philosophy is that inefficiencies exist in the Australian equity market, providing opportunities to add value for active managers. They focus on identifying stocks that are under researched and undervalued, which tend to be small to medium-sized industrial companies listed on the ASX. They believe an intensive company meeting schedule can provide an information advantage.

In the medium to longer term, Geoff Wilson and Chris Stott have a positive view of the Australian equity market, contingent on an increase in economic activity driven by record low interest rates. In the immediate term, they continue to have a cautious view of equities and their outlook for global and local stock markets remains subdued. They anticipate flat performances in the 2014 calendar year on the basis that the majority of the Australian economic recovery is already priced in to current stock values. Despite this, they are confident that prevailing market conditions will continue to give rise to a range of opportunities and they believe, with a strong cash weighting, the investment portfolio is well positioned to take advantage of these opportunities.

The managers consider that Australian stock market valuations were inflated during 2013 by specific trends, including investors seeking short-term yield rather than long-term value; a focus on perceived earnings quality leading to rising P/E multiples for stocks associated with strong brand names; and a focus on perceived exceptional growth potential resulting in considerable P/E multiple expansion for internet-based businesses including those related to recruitment and real estate.

In 2014, the managers consider that value opportunities will continue to be identified but will be harder to find than in 2013. While they do not intend to increase the average cash-weighting of the portfolio to address increased equity risk on a strategic basis, the managers' cautious approach to investment in the current environment may mean cash levels remain elevated in the short term.

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## Asset allocation

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### Investment process: Fundamental bottom-up approach

The WAX approach is to identify undervalued growth companies with strong earnings, low P/E multiples and experienced management, and that are well positioned in their industry. The number of companies in the portfolio and the cash level vary as new opportunities are identified and existing holdings sold. If acceptable risk/return investments are not found, cash is held to preserve capital.

Two main investment processes are employed:

- **Research-driven investing:** This is the primary investment process involving extensive research focusing on rating companies' management, earnings growth potential, cash flow, return on equity, valuation and industry position. Investments are made when a catalyst to change the market valuation is identified. A sell decision is taken once an investment reaches target valuation or if the investment criteria are no longer met.
- **Yield arbitrage strategies:** Short-term, low-risk, event-driven investment opportunities are taken where they will generate a higher return than cash and fixed-interest securities.

A universe of stocks for investment is identified considering relevant micro- and macro-economic trends and targeting under-researched companies. Extensive analysis is undertaken on potential investments and meetings held with management, following which companies are ranked using a proprietary rating system. External research is used as an overlay to support the internal process. Before an investment is made, a catalyst must be identified such as a potential positive earnings surprise or corporate change.

A key element of the research approach is building and maintaining a strong information network. Over 1,000 company visits or meetings with associated industry sources are initiated each year (compared to c 50 holdings in the portfolio), through which the managers believe they are able to develop a good understanding of companies and their operating environments, providing key inputs to their fundamental analysis.

All potential investments are assessed across a wide range of company and industry specific factors, which are scored using a proprietary ratings template. Assessment includes qualitative review of management, industry outlook and company positioning within its industry. Quantitative review assesses financial strength focusing on return on equity and forecast two-year EPS growth relative to P/E multiple valuation. Companies held in the portfolio are subject to ongoing analysis to ensure they still meet the investment criteria.

An appropriate valuation methodology is used to determine fair value and a price target for the shares with the aim of identifying companies with share prices trading at a significant discount. Yield, net cash backing and fire sale value of assets are used to assess downside potential.

The size of investment depends on the relative strength of the investment opportunity with initial investment positions usually representing 1%, 2% or 3% of the portfolio. Although a catalyst needs to be identified, a long-term view can be taken with a time horizon of three years or longer.

## Overview

WAM Research has a benchmark unaware, absolute return focus and holds a significant level of cash, which balances equity risk and provides flexibility to invest as opportunities are identified. At inception, WAM Research focused on very long-term investments and the cash weighting only reduced gradually as illustrated in Exhibit 4. The investment strategy was revised in mid-2010 to focus on catalysts for re-rating and a shorter-term time horizon, leading to higher portfolio turnover. Since mid-2010, the cash weighting has averaged c 33%.

**Exhibit 4: WAM Research portfolio cash weighting since inception**



Source: WAM Research, Edison Investment Research

## Current portfolio positioning

At 28 February 2014, the portfolio had a 40.2% cash weighting compared to the 2013 average of 36.5%. The 45.8% average cash weighting since December 2013 is considered to be a short-term fluctuation and not indicative of the expected average weighting for 2014. Investments are weighted towards the consumer discretionary and information technology sectors and there is a strong smaller company bias with a combined 58.6% portfolio weighting (98.1% weighting within the equity investments) to small/micro-cap companies (see Exhibit 1). While there is no top-down allocation across the market-cap range, given WAM Research's focus on under-researched investment opportunities, it would be reasonable to expect a similar market-cap exposure going forward.

The investment style is a fundamental bottom-up approach and as a result the equity sector allocation varies considerably over time and diverges significantly from index sector weightings, as illustrated in Exhibit 5. Highlighting the variation in the sector allocation are the decrease in the industrials sector weighting from 19.7% at 28 February 2013 to 7.4% at 28 February 2014 and the increase in the information technology sector weighting from 8.2% at 28 February 2013 to 18.1% at 28 February 2014.

**Exhibit 5: Equity Sector allocation within portfolio relative to index**

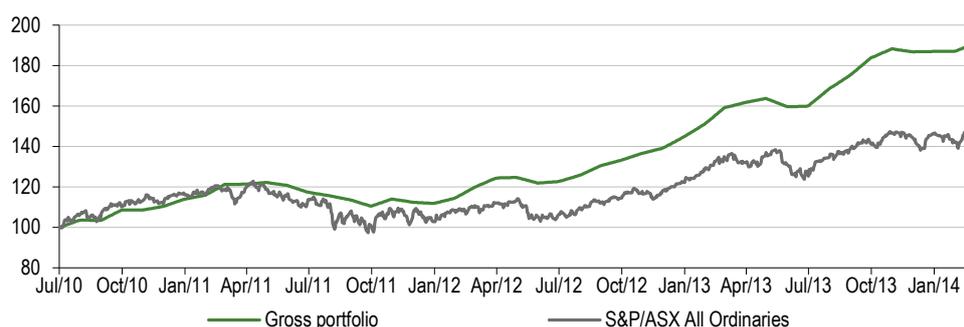
	End February 2014 (%)	End February 2013 (%)	Change (%)	Index end February 2014 (%)	Trust active weight (%)	Trust weight / Index weight
Consumer Discretionary	33.9	37.7	-3.8	10.1	23.9	3.4
Information Technology	18.1	8.2	9.9	0.9	17.2	20.2
Financials	17.2	18.0	-0.8	34.0	-16.8	0.5
Telecommunication Services	9.5	8.2	1.3	6.9	2.6	1.4
Health Care	7.7	1.6	6.1	4.2	3.5	1.8
Industrials	7.4	19.7	-12.3	6.1	1.3	1.2
Utilities	3.3	1.6	1.7	1.5	1.8	2.2
Consumer Staples	1.3	1.6	-0.3	6.2	-4.9	0.2
Materials	1.2	1.6	-0.5	24.3	-23.1	0.0
Energy	0.3	1.6	-1.3	5.7	-5.4	0.1
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: WAM Research, Edison Investment Research. Note: Index is S&P/ASX All Ordinaries Index.

## Performance: Outperformance since strategy revised

WAM Research has outperformed the S&P/ASX All Ordinaries accumulation index over one and three years and since the change of strategy in terms of both price and NTA. Near-term NTA relative weakness can be ascribed to the sharp bounce in the market in February driven by a number of already highly-rated stocks. The underperformance over the 10-year period partly reflects the low equity weighting in the two years following launch in 2003 and the restrictive buy-and-hold strategy. The outperformance since the investment strategy was revised to give more flexibility in mid-2010 may be considered a better representation of the fund's potential. Exhibit 6 illustrates the strong gross portfolio performance (pre-expenses) since the change of strategy.

**Exhibit 6: Gross portfolio and index total return performance since change of strategy, rebased**



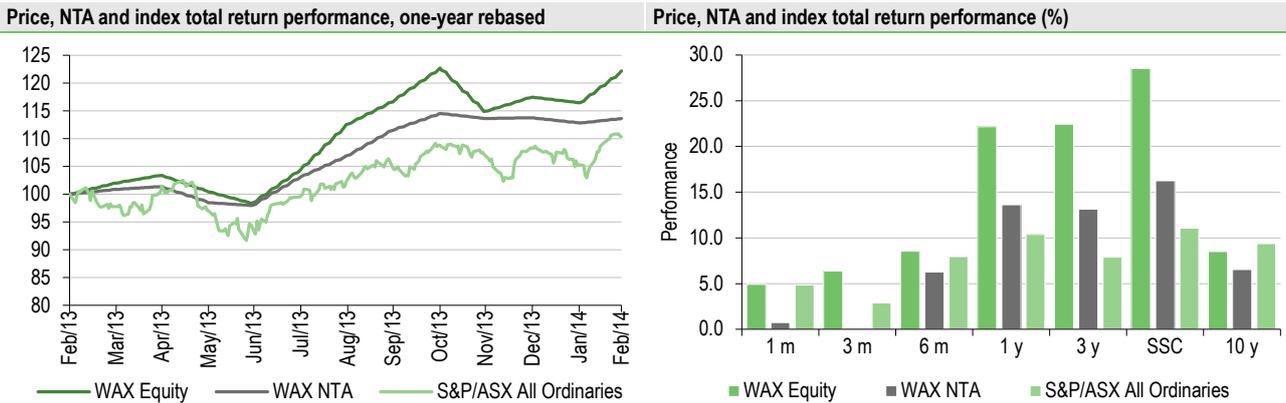
Source: Thomson Datastream, Edison Investment Research. Note: Investment strategy revised in July 2010.

**Exhibit 7: Share price and NTA total return performance, versus indices (percentage points)**

	1 month	3 months	6 months	1 year	3 years	Since change of strategy	10 years
Price versus S&P/ASX All Ordinaries	0.1	3.5	0.6	11.8	57.9	104.1	(19.2)
NTA versus S&P/ASX All Ordinaries	(4.1)	(2.9)	(1.7)	3.3	19.2	26.7	(57.0)
Price versus S&P/ASX 300 Industrials	0.1	4.3	0.5	8.4	30.2	79.2	(19.2)
NTA versus S&P/ASX 300 Industrials	(4.1)	(2.1)	(1.7)	(0.2)	(8.5)	1.9	(57.0)
Price versus ASX Small Industrials	0.2	2.5	1.3	14.1	55.5	97.9	44.0
NTA versus ASX Small Industrials	(4.0)	(3.8)	(1.0)	5.5	16.8	20.5	6.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-February 2014.

### Exhibit 8: Investment trust performance

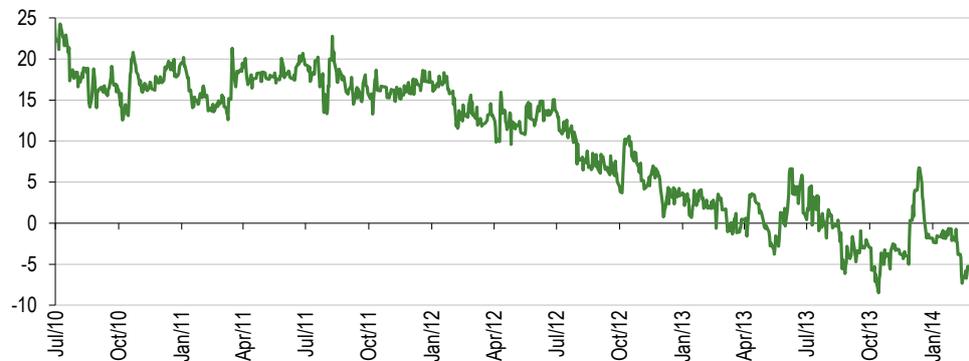


Source: Thomson Datastream, Edison Investment Research. Note: Three, SSC (since strategy change) and 10-year performance figures annualised. SSC represents the period following revision of the investment strategy in July 2010.

## Discount: Move to premium in 2013

Following the global financial crisis, the price discount to NTA before tax widened from an average 22.1% in 2008 to a peak of 41.9% in March 2009. As illustrated in Exhibit 9, since the change in investment strategy in mid-2010, the price discount to NTA before tax steadily narrowed, from 24.4% at 30 June 2010 to reach a premium of 8.5% in October 2013. Subsequently, it has fluctuated between discount and premium and currently stands at a 10.5% premium.

### Exhibit 9: Discount since investment strategy changed



Source: WAM Research, Edison Investment Research. Note: Positive values indicate a discount; negative values indicate a premium.

## Capital structure and fees

WAM Research currently has 138.1m ordinary shares and 68.7m share options outstanding. In October 2013, WAM Research raised A\$16.5m through a dividend reinvestment plan (DRP) shortfall placement issuing 14.4m shares. Management has no further plans to issue equity beyond the exercise of options currently outstanding and the DRP.

Wilson Asset Management Group is WAM Research's investment manager and is paid a management fee of 1% pa of gross assets. Unless the portfolio has decreased in value over the investment period, the manager also qualifies for a performance fee being 20% of the gross portfolio outperformance over the S&P/ASX All Ordinaries Accumulation Index or 20% of the increase in the gross portfolio value, if the index performance is negative. For the year ended 30

June 2013, the management and performance fees were A\$1.3m and A\$1.7m and the indirect cost ratio (based on average net assets and excluding brokerage expense) was 1.4% (2.8% including performance fees).

## Dividend policy

WAM Research is committed to provide investors with a rising stream of fully franked dividends, which it has achieved since 2009 (see Exhibit 1), provided there are sufficient profit reserves, franking credits and it is within prudent business practices. Dividends are paid semi-annually and a DRP is available to shareholders.

Investments are primarily 'held for trading' with investment gains on the revenue account and dividends paid treated as income to investors. Historically 'buy-and-hold' investments were held in the portfolio with investment gains on the capital account and dividends paid treated as capital gains to investors.

## The board

The board of WAM Research comprises two non-independent directors, Geoffrey Wilson (chairman) and Matthew Kidman, and two independent directors, John Abernethy and Julian Gosse. Geoffrey Wilson has over 30 years' experience in the Australian and international securities industry and has acted as chairman since June 2003. He is currently chairman of WAM Capital and WAM Active and a director of Australian Leaders Fund and Clime Capital. Matthew Kidman has been a director of WAM Research since May 2002 and worked as a portfolio manager at Wilson Asset Management for 13 years between 1998 and 2011. He is currently chairman of Watermark Market Neutral Fund and a director of WAM Capital, WAM Active, Centrepoint Alliance and Sandon Capital Investments. John Abernethy has over 30 years' experience in funds management and corporate advisory and has been a director of WAM Research since May 2002. He is currently chairman of Clime Capital and a director of Clime Investment Management, WAM Active, Australian Leaders Fund and Watermark Market Neutral Fund. Julian Gosse has extensive experience in banking and broking both in Australia and overseas and has been a director of WAM Research since June 2003. He is currently chairman of Iron Road and a director of Australian Leaders Fund and Clime Capital.

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## WAM Capital

### Research and market-driven investing

**WAM Capital Limited (ASX:WAM) is a listed investment company that provides investors with balanced exposure between an actively managed portfolio of listed Australian companies, typically small- to medium-sized companies identified as undervalued, and trading strategies involving relative value arbitrage and market mis-pricing opportunities. The managers' approach is differentiated by a focus on absolute returns and a willingness to hold relatively high cash balances. WAM has delivered pre-tax NTA returns ahead of the S&P/ASX All Ordinaries over three, five and 10 years.**

12 months ending	Total share price return (%)	NTA total return (%)	S&P/ASX All Ordinaries (%)	S&P/ASX 300 Industrials (%)	ASX Small Industrials (%)
31/03/11	34.9	15.1	4.8	(0.5)	5.8
31/03/12	6.8	(0.8)	(6.2)	1.4	1.5
31/03/13	13.3	20.5	17.8	32.3	13.9
31/03/14	27.9	7.9	13.2	15.3	9.2

Source: WAM, Thomson Datastream. Note: NTA return post-tax and expenses paid, pre-tax accruals; total return indices pre-tax and expenses.

### Investment strategy: Stock-picking and trading

The fund invests equally in an actively managed portfolio of mainly small and mid-cap companies and a broad range of equity trading strategies. The managers seek to select undervalued growth companies listed on the Australian market, buying when a catalyst for revaluation can be identified. A bottom-up research process is used, rating companies on a range of company specific and industry factors. Company meetings are seen as very important, both to gather information and to help assess management quality. Trading opportunities comprise relative short-term arbitrages and mis-pricings in the equities market arising from, for example, IPOs, capital raisings, block trades, oversold positions and corporate transactions. The significant cash weighting enables the managers to exploit investment opportunities and provides a balance to equity risk. Performance is measured against the S&P/ASX All Ordinaries Accumulation Index, although this is not treated as a benchmark for investment allocation.

### Market outlook: Subdued, but still opportunities

In recent years, the key driver of Australian economic growth has been resources investment, which is expected to decline sharply from FY15, and the economic outlook now appears more subdued. The Australian market is trading on a forward P/E of 14.4x, above the 10-year average of 13.2x but not overly stretched in comparison with the high of 16.2x. In an uncertain market outlook, with the potential for correction if economic or corporate earnings trends disappoint, investors may favour a fund with WAM's absolute return approach.

### Valuation: Premium supported by dividend yield

WAM's price discount to NTA before tax steadily narrowed from 24.6% in June 2010 and currently stands at a premium of 7.7%. The main factor that appears to have driven the move to a premium is the level of dividend yield, made more attractive by the 100% franking credits attached.

**WAM Capital is a research client of Edison Investment Research Limited**

### Listed investment companies

22 April 2014

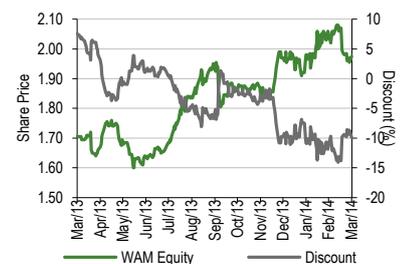
**Price** **A\$1.94**  
**Market cap** **A\$659m**  
**AUM** **A\$612m**

NTA\* A\$1.80  
 Premium to NTA 7.7%  
 Yield 6.5%

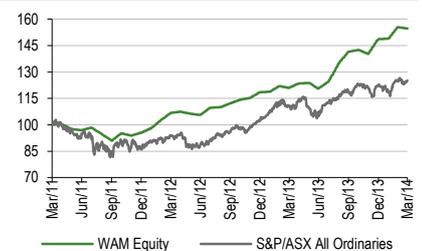
\*As at 31 March 2014.

Ordinary shares in issue 340.6m  
 Code WAM  
 Primary exchange ASX  
 Secondary exchange N/A

### Share price/discount performance\*



### Three-year cumulative perf. graph



52-week high/low A\$2.08 A\$1.60  
 NTA\* high/low A\$1.84 A\$1.66

\*Excluding income.

### Gearing

Gross 0%  
 Net cash 37%

### Analysts

Gavin Wood +44 (0)20 3681 2503  
 Andrew Mitchell +44 (0)20 3681 2500  
[investmenttrusts@edisongroup.com](mailto:investmenttrusts@edisongroup.com)

### Exhibit 1: Company at a glance

#### Investment objective and fund background

WAM Capital's investment objectives are to provide investors with a rising stream of fully franked dividends, to provide capital growth and to preserve capital.

#### Recent developments

28 January 2014: Interim results: investment portfolio +14.2% vs S&P/ASX All Ordinaries index +14.6%.  
21 October 2013: A\$24.7m DRP shortfall placement at A\$1.785 (premium to NTA).

#### Forthcoming

AGM	November 2014
Preliminary results	August 2014
Year end	30 June
Dividend paid	October 2014

#### Capital structure

Indirect cost ratio	1.3% (1.4% inc. perf. fee)
Net cash	37%
Annual mgmt fee	1.0% of gross assets
Performance fee	20% of outperformance over S&P/ASX All Ords

#### Fund details

Group	Wilson Asset Management
Managers	Geoff Wilson, Chris Stott
Address	Level 11, 139 Macquarie Street, Sydney, NSW 2000, Australia

Launch date August 1999

Continuation vote N/A

Loan facilities N/A

Phone +61 (0)2 9247 6755

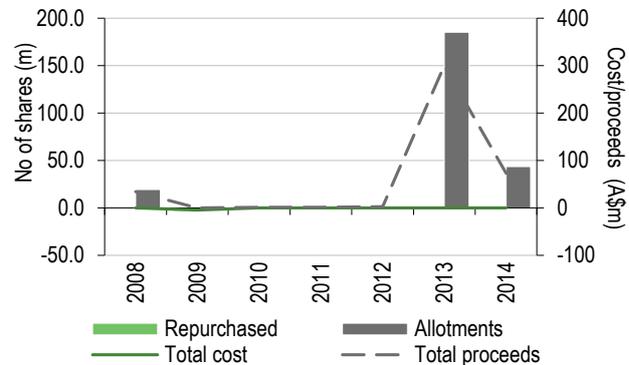
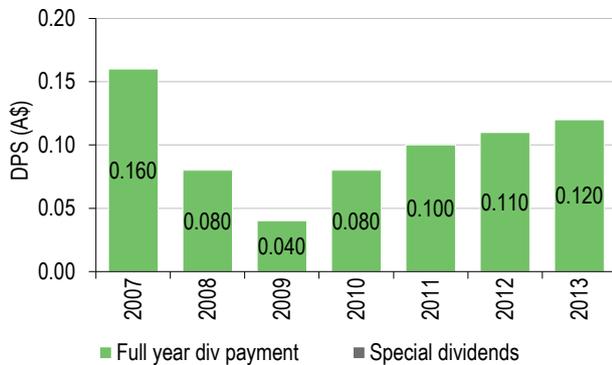
Website [www.wamfunds.com.au](http://www.wamfunds.com.au)

#### Dividend payments

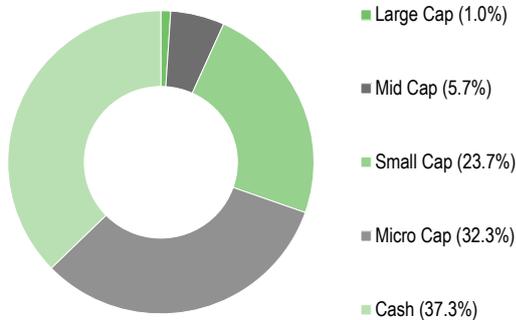
Dividends paid semi-annually. The board is committed to paying an increasing stream of fully franked dividends, provided the company has sufficient reserves.

#### Share buyback policy and history

WAM is authorised to issue ordinary shares and to issue options over ordinary shares.



#### Portfolio composition (as at 31 March 2014)



#### Sector exposures of portfolio (as at 31 March 2014)



#### Top 10 holdings (as at 31 March 2014)

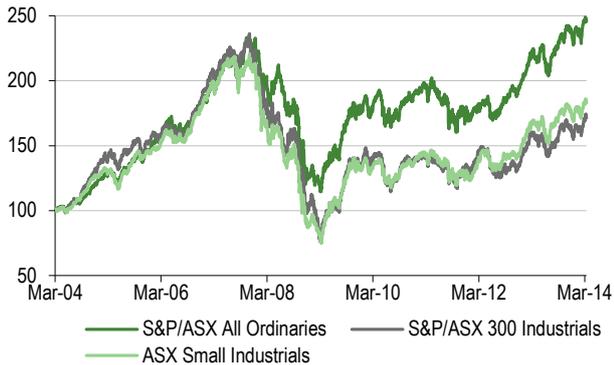
Company	Sector	Portfolio weight %	
		31 March 2014	31 March 2013*
CBA Perpetual - PERLS IV	Banks	2.7	N/A
Donaco International	Consumer Services	2.4	N/A
Century Australia Investments	Diversified Financials	2.3	1.8
Automotive Holdings Group	Retailing	2.0	1.5
Slater & Gordon	Consumer Services	1.8	N/A
ANZ Convertible Prefs - CPS2	Banks	1.6	N/A
Westoz Investment Company	Investment Company	1.6	1.1
Ardent Leisure	Consumer Services	1.6	N/A
Hills	Capital Goods	1.6	1.5
CSR	Materials	1.6	N/A
<b>Top 10</b>		<b>19.2</b>	

Source: WAM Capital, Edison Investment Research. Note: \*Where no figure is shown for 2013 portfolio weight, the stock was not in the top 10.

## Australian market outlook: Some caution warranted

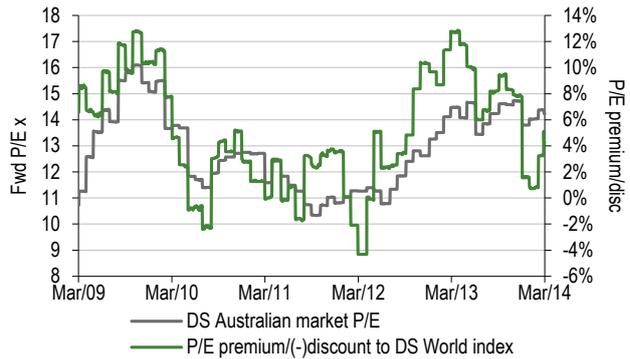
To set the context, Exhibit 2 shows how the Australian market recovered strongly following the global financial crisis, but the industrials and smaller cap indices followed a lower path. Not shown here, but relative to the world market (using MSCI indices in A\$ terms), Australian indices lagged last year with the small caps up 5% and overall index +21% compared with +48% for the world index. This reflected in particular the strong performance of the US market.

**Exhibit 2: Australian market and Industrials sector**



Source: Thomson Datastream. Note: Total return indices.

**Exhibit 3: Australian market forward P/E and relative**



Source: Thomson Datastream

Where next for the market? The key driver of Australian economic growth in recent years has been very strong resources investment and this is expected to decline sharply from FY15, acting as a drag on growth. The Australian government's December 2013 economic outlook reduced estimated real GDP growth for FY15 from 3.0% to 2.5% (in line with FY14). This view is supported by the IMF's April 2014 World Economic Outlook, which forecasts Australian GDP growth at 2.6% in 2014. Employment growth is expected to remain subdued, and wage growth is forecast to remain well below trend. In this environment, sustained low interest rates are expected to help support economic recovery.

Thus the economic outlook appears to be for subdued but gradual improvement. In terms of valuation, the Australian market is trading on a forward P/E of 14.4x, which is above the 10-year average of 13.2x but not overly stretched in comparison with the high of 16.2x or the world average of c 14.8x. Dealogic reported a decline in the value of equity issuance during early 2014 compared to a year earlier, although the number of issues increased. While this suggests confidence is spreading across corporate management teams, the recent postponement of several IPOs highlights a fluctuating market backdrop. An increase in the value of M&A deals during early 2014 endorses the view of rising corporate confidence, encouraged by the low interest rate outlook.

WAM's trading strategies are not directly linked to broader market trends. However, market strength has some influence over the number of potential trading opportunities that arise under capital markets and corporate activity strategies. While the path of the economy may prove bumpy, from WAM's perspective this could provide fruitful trading opportunities for a number of its strategies as market expectations change. Also, if M&A and IPO activity pick up over time, this would tend to broaden the scope for event-driven trading.

## Fund profile: Balanced fundamental and trading focus

WAM Capital is an Australia-listed investment company established in August 1999. Day-to-day management and investment of funds is carried out by Wilson Asset Management Group. WAM Capital's stated investment objectives are to provide investors with a rising stream of fully franked dividends, to provide capital growth and to preserve capital. The fund seeks to achieve these

objectives through a balance of investing in an actively managed portfolio of mainly small and mid-cap companies, and taking advantage of relative value arbitrage and market mis-pricing opportunities. Fund managers Chris Stott and Geoff Wilson are responsible for the performance of the portfolio, portfolio construction and stock selection. Geoff Wilson and Chris Stott, together with analysts Martin Hickson, Matthew Haupt and Mark Tobin are responsible for idea generation and stock recommendations.

## **The fund managers: Geoff Wilson and Chris Stott**

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### **The managers' view: Opportunities exist for active managers**

The managers' underlying investment philosophy is that inefficiencies exist in the Australian equity market, providing opportunities to add value for active managers. They focus on identifying stocks that are under-researched and undervalued, which tend to be small to medium-sized industrial companies listed on the ASX. They believe an intensive company meeting schedule can provide an information advantage. They also operate a broad range of short- and medium-term equity trading strategies, which should generate trading opportunities irrespective of market conditions.

In the medium to longer term, Geoff Wilson and Chris Stott have a positive view of the Australian equity market, contingent on an increase in economic activity driven by record low interest rates. In the immediate term, they have a cautious view of equities and their outlook for global and local stock markets remains subdued. They anticipate flat performances in the 2014 calendar year on the basis that the Australian economic recovery is largely already priced in to current stock values. Despite this, they are confident that prevailing market conditions will continue to give rise to a range of opportunities and they believe, with a strong cash weighting, the investment portfolio is well positioned to take advantage of these opportunities.

The managers consider that Australian stock market valuations were inflated during 2013 by specific trends, including investors seeking short-term yield rather than long-term value; a focus on perceived earnings quality leading to rising P/E multiples for stocks associated with strong brand names; and a focus on perceived exceptional growth potential resulting in considerable P/E multiple expansion for internet-based businesses, including those related to recruitment and real estate.

In 2014, the managers still expect to be able to identify value opportunities, but acknowledge these will be harder to find than in 2013. While they do not envisage increasing the average cash weighting of the portfolio to address increased equity risk on a strategic basis, the managers' cautious approach to investment in the current environment may mean cash levels remain elevated in the short term. The managers do not anticipate any decline in potential trading opportunities during 2014. Although capital markets activity has been subdued in the first quarter, reducing potential opportunities, they expect corporate activity to be sustained at current levels, generating an increased number of opportunities compared with 2013.

## **Asset allocation**

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### **Investment process: Fundamental and trading approaches**

WAM's approach is to invest in growth companies with strong earnings, low P/E multiples and experienced management that is well positioned in the industry, as well as taking advantage of relative value arbitrage and market mis-pricing opportunities. The number of companies in the portfolio and the cash level vary as new opportunities are identified and existing holdings sold. If acceptable risk/return investments are not found, cash is held to preserve capital.

Two main investment processes are employed:

- **Research-driven investing:** This process involves extensive research focusing on rating companies' management, earnings growth potential, cash flow, return on equity, valuation and industry position. Investments are made when a catalyst to change the market valuation is identified. A sell decision is taken once an investment reaches target valuation or if the investment criteria are no longer met.
- **Market-driven investing:** Taking advantage of relative short-term arbitrages and mis-pricings in the equities market including IPOs, capital raisings, block trades, oversold positions and corporate transactions. This part of the portfolio is actively traded.

A universe of stocks for investment is identified, considering relevant micro- and macro-economic trends and targeting under-researched companies. Extensive analysis is undertaken on potential investments and meetings held with management, following which companies are ranked using a proprietary rating system. External research is used as an overlay to support the internal process. A key element of idea generation is maintaining a strong information network. Over 1,000 company visits or meetings with associated industry sources are initiated each year (compared to c 100 holdings in the portfolio).

Potential investments are assessed across a range of company and industry specific factors, scored using a proprietary ratings template. Assessment includes qualitative review of management, industry outlook and company positioning within its industry. Quantitative review assesses financial strength focusing on return on equity and forecast two-year EPS growth relative to P/E multiple valuation. An appropriate valuation methodology is used to determine fair value and a price target for the shares. Companies held in the portfolio are subject to ongoing analysis to ensure they still meet the investment criteria.

A number of trading strategies are operated including short-term arbitrages created by capital markets and corporate activity, and longer-term investments based on purchasing assets at a discount to underlying value. The latter include investing in other listed investment companies where WAM may gradually increase its stake. A current example is Century Australia, the largest investment in WAM's portfolio, in which WAM Capital owns 20% and WAM Active also owns 3%.

The size of investment depends on the relative strength of the investment opportunity, with initial investment positions usually representing 1%, 2% or 3% of the portfolio. Although a catalyst needs to be identified, a long-term view can be taken with a time horizon of three years or longer.

## Overview

WAM Capital has a benchmark-unaware, absolute return focus and holds a significant level of cash, which balances equity risk and provides flexibility to invest as opportunities are identified. Since inception, the cash weighting has averaged c 36%, ranging from a low of 2% to a high of 70%.

**Exhibit 4: WAM Capital portfolio cash weighting since inception**



Source: WAM Capital, Edison Investment Research

## Current portfolio positioning

At 31 March 2014, the portfolio had a 37.3% cash weighting, a similar level to the average since inception. Investments are currently weighted towards the financials and consumer discretionary sectors and there is a strong smaller company bias with a combined 56.0% portfolio weighting (89.3% weighting within the equity investments) to small/micro-cap companies (see Exhibit 1). While market-driven investments do not focus on a particular market cap range, given the research-driven investment focus on under-researched investment opportunities, it would be reasonable to expect a similar market cap exposure going forward.

The research-driven investment style is a fundamental bottom-up approach and market-driven investments also do not focus on a particular sector. As a result, WAM Capital's equity sector allocation varies considerably over time and diverges significantly from index sector weightings, as illustrated in Exhibit 5.

**Exhibit 5: Equity sector allocation within portfolio relative to index**

	End March 2014 (%)	End March 2013 (%)	Change (%)	Index end March 2014 (%)	Trust active weight (%)	Trust weight / Index weight
Financials	31.6	27.0	4.6	34.7	-3.2	0.9
Consumer Discretionary	26.5	25.6	0.8	9.8	16.7	2.7
Industrials	12.3	25.0	-12.7	6.3	6.0	2.0
Materials	9.6	4.2	5.4	23.7	-14.1	0.4
Information Technology	7.8	7.9	-0.1	1.2	6.7	6.8
Telecommunication Services	4.8	5.7	-0.9	6.9	-2.1	0.7
Health Care	3.3	0.7	2.7	4.1	-0.8	0.8
Consumer Staples	2.6	1.0	1.5	6.1	-3.5	0.4
Utilities	1.6	0.5	1.1	1.6	0.0	1.0
Energy	0.0	2.4	-2.4	5.7	-5.7	0.0
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: WAM Capital, Edison Investment Research. Note: Index is S&P/ASX All Ordinaries Index.

## Performance: Medium- and long-term outperformance

WAM's share price total return has outperformed the S&P/ASX All Ordinaries Accumulation Index over one, three, five and 10 years. Exhibit 6 illustrates the strong gross portfolio performance (pre-expenses) over the last five years. WAM's NTA has underperformed the index over one year, while outperforming over three, five and 10 years. Over one year WAM's reported NTA performance has been diluted by the exercise of options. Option exercise had a 3.5% dilutive impact on reported NTA in April 2013 and a 0.5% dilutive impact in July 2013. The weaker NTA performance over 10 years relative to five years can be attributed to WAM's focus on small-cap industrials sector companies, which underperformed the broader market over this timeframe. Exhibit 7 illustrates the stronger outperformance of WAM's NTA against the small-cap industrials sector index over 10 years.

**Exhibit 6: Gross portfolio and index total return performance over 5 years, rebased**



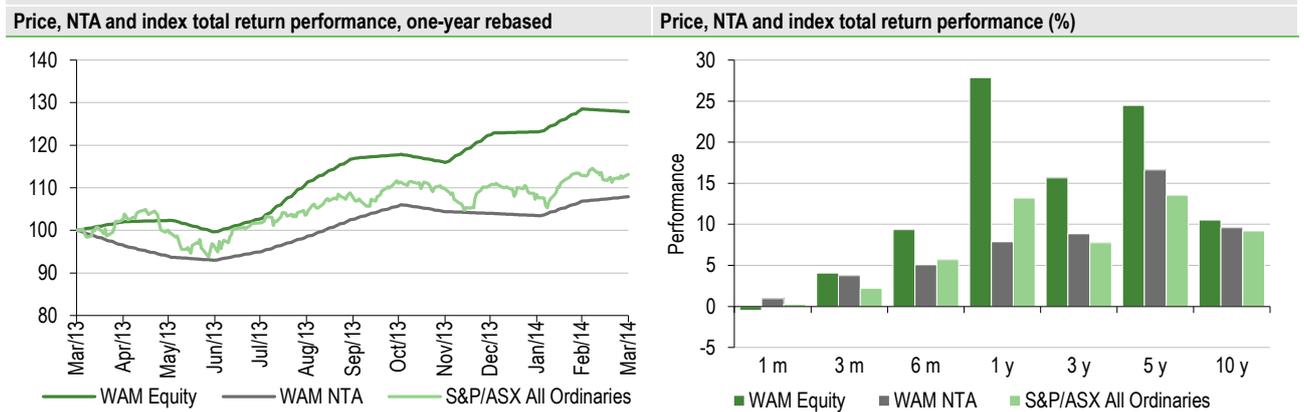
Source: Thomson Datastream, Edison Investment Research.

**Exhibit 7: Share price and NTA total return performance, versus indices (percentage points)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus S&P/ASX All Ordinaries	(0.7)	1.9	3.7	14.7	29.6	110.2	30.7
NTA versus S&P/ASX All Ordinaries	0.7	1.5	(0.6)	(5.3)	3.9	27.1	8.6
Price versus S&P/ASX 300 Industrials	(1.5)	1.4	2.7	12.6	(0.0)	77.3	30.3
NTA versus S&P/ASX 300 Industrials	(0.0)	1.0	(1.5)	(7.4)	(25.7)	(5.8)	8.1
Price versus ASX Small Industrials	(0.6)	2.5	6.1	18.6	28.4	92.8	91.4
NTA versus ASX Small Industrials	0.9	2.2	1.8	(1.3)	2.7	9.7	69.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2014.

**Exhibit 8: Share price and NTA total return performance, versus index**



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

## Discount: Move to premium in 2013

Following the global financial crisis, the price discount to NTA before tax widened from an average 14.9% in 2008 to a peak of 36.4% at the beginning of March 2009. As illustrated in Exhibit 9, since mid-2010, the price discount to NTA before tax steadily narrowed from 24.6% at 30 June 2010 moving to a sustained premium during 2013. It has remained at a premium since October 2013 and currently stands at a 7.7% premium.

**Exhibit 9: Discount over five years**



Source: WAM Capital, Edison Investment Research. Note: Positive values indicate a discount; negative values indicate a premium.

## Capital structure and fees

WAM Capital has 340.6m ordinary shares in issue. The share count has increased by over 200% since the end of June 2012, with the main contributors being the issue of 153.7m shares from the exercise of options (raising A\$246.0m), the issue of 36.7m shares through placements (raising A\$61.7m) and the issue of 32.2m shares for the merger with Premier Investments in December

2012. All unexercised options expired in July 2013. Management has no current plans to issue further equity beyond the DRP.

Wilson Asset Management is WAM Capital's investment manager and is paid a management fee of 1% pa of gross assets. Unless the portfolio has decreased in value over the investment period, the manager also qualifies for a performance fee, being 20% of the gross portfolio outperformance over the S&P/ASX All Ordinaries Accumulation Index, or 20% of the increase in the gross portfolio value if the index performance is negative. For the year ended 30 June 2013, the management and performance fees were A\$3.3m and A\$0.6m and the indirect cost ratio (based on average net assets and excluding brokerage expense) was 1.3% (1.4% including performance fees).

## Dividend policy

WAM Capital is committed to providing investors with a rising stream of fully franked dividends, provided there are sufficient profit reserves and franking credits, and it is within prudent business practices. It has met this objective since 2009 (see Exhibit 1). Dividends are paid semi-annually and a dividend reinvestment plan (DRP) is available to shareholders. Investments are 'held for trading' with investment gains on the revenue account and dividends paid treated as income to investors.

## The board

The board of WAM Capital comprises two non-independent directors, Geoffrey Wilson (chairman) and Matthew Kidman, and three independent directors, James Chirside, Paul Jensen and Lindsay Mann. Geoffrey Wilson has over 30 years' experience in the Australian and international securities industry and has acted as chairman since March 1999. He is currently chairman of WAM Research and WAM Active and a director of Australian Leaders Fund and Clime Capital. Matthew Kidman has been a director of WAM Capital since March 1999 and worked as a portfolio manager at Wilson Asset Management for 13 years between 1998 and 2011. He is currently chairman of Watermark Market Neutral Fund and a director of WAM Research, WAM Active, Centrepont Alliance and Sandon Capital Investments. James Chirside has over 25 years' experience in investment management and has been a director of WAM Capital since February 2003. He is currently a director of Cadence Capital. Paul Jensen has over 25 years' experience in finance, investment management and banking and has been a director of WAM Capital since June 2004. Lindsay Mann has over 35 years' experience in financial services and has been a director of WAM Capital since December 2012.

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