Q&A WITH Kate Thorley

The Wilson Asset Management CEO talks to **Alan Deans** about the momentum behind the listed investment company's two successful impact funds.

THE REMARKABLE TWIST FOR IMPACT INVESTING IS that it aims to improve society and the environment while still paying handsome returns. It seems a bit of a tease. Can we really have our cake and eat it too? Well, it seems we just might.

Just look at the recent experience of listed investment company (LIC) manager Wilson Asset Management (WAM). It took a punt some 18 months ago with its first impact fund, Future Generation Investments (FGX). It signed an impressive array of investment managers and agreed to a robust investment strategy. After all, the sizzle for WAM's backers has always been financial performance. But this was different.

The attraction wasn't just the money they expected to make, but also how much FGX promised to give away. Each manager pledged to charge no management or performance fees so a donation of one per cent of assets could annually be paid to a slew of charities. Service providers – the legal, accounting, share registry, governance and technology partners that make the business tick – also chipped in.

Market success

Expectations were modest. WAM's CEO Kate Thorley says $50 million would have been considered a great success. Yet acceptances flooded in from loyal WAM supporters and from investors new to the boutique outfit. Large private philanthropists, including the Balnaves, Smorgon and Forrest families, jumped at the opportunity. Foundations around the world have been early adopters of impact investing via private investments, but opportunities are rare in the listed environment. Given the unexpected wave of support, FGX closed its offer early and banked $200 million.

It seems now that the stock market has a role to play in this warm, fuzzy side of capitalism. There have been several notable outcomes from WAM's success. First, it helped to throw open the door to LIC capital raisings of all sorts, lifting the sector out of the doldrums from the global financial crisis (GFC). In the six years from 2008-13, annual LIC raisings on the ASX hit a low of $150 million and averaged just $300 million. Last year they hit a record $1.4 billion. Second, it showed that there's a welcome mat on public markets for impact investing. Lastly, FGX was no fluke.

WAM has backed up with a second impact fund – Future Generation Global (FGG) with a focus this time on international shares. Investors again were fired up, contributing $302 million. Thorley says there are no plans right now for a third fund, but points out that the first two have the potential to double their capital at the time of formation because they issued one free option for each share at the time of initial public offerings (IPOs). The duo has already donated a combined $6.35 million to 22 charities for child and youth causes. It's now up to the charities themselves to meet their own performance hurdles in order to maintain the benefits.

It's unknown how far retail investors will go to support impact investing, but plenty of entrepreneurial ideas are emerging. Perhaps the group best known in the private funding space is Social Ventures Australia (SVA), which kicked off in 2002 thanks to backing from The Benevolent Society, The Smith Family, WorkVentures and AMP Foundation. It has raised more than $50 million, and its most vaunted success is the buyout of childcare centres from the failed ABC Learning Centres. Goodstart, as that venture is known, runs 15 per cent of Australia's early childcare places and wants to buy many more.

ASX Ticker: WAM

Photo: Studio Commercial

SVA has also recently teamed up with industry fund HESTA for an initial $30 million investment in health, housing and community services. Debt markets are in on the act too, with major banks including Westpac and Commonwealth issuing social bonds focused on families and child support.

Impact investing spreads beyond social causes. Support is strong for environmental causes too. Water conservation challenges, for instance, are being funded on the Murray-Darling River. Others are emerging in response to the Paris Agreement on climate change by offering investors an entrée into solar, wind and other forms of renewable energy. Some of these are likely to list publicly.

Making a big noise internationally is Morgan Stanley's Institute for Sustainable Investing. Its mantra is that the solution to significant global challenges can only be met through the mobilisation of private capital. It says that in the US corporations like Starbucks are leading the charge by launching green bonds. There has been a surge in such issuance this year, thanks mainly to China. In the first quarter alone, Chinese issuers contributed 25 per cent of the $US37 billion in green bonds brought to market. Since the Paris Agreement, Moody's estimates that the market for such bonds this year could reach $US70 billion – up from $US42 billion last year.

"While the percentage of money we donate each year is set in stone, how it is allocated to the charities is up to the shareholders."

Below is Listed@ASX's interview with Kate Thorley:

Listed@ASX: *Wilson Asset Management raised $900 million in three years through IPOs of several LICs. How do you pull that off?*

Kate Thorley (KT): It is a lot of money. We have been going for almost two decades, and over that time we have performed well and focused on engaging with our shareholders. We are managing other people's money, and it is incredibly important that we perform, pay a decent yield, communicate and engage. We call it respect. To me it's also about being fair, in terms of raising money, capital management policy and those sorts of things.

With the first Future Generation vehicle, FGX, Geoff (Wilson - founder and chairman of WAM) used his network to find the best Aussie equity fund managers to retain. It was amazing the support we received from them, other service providers and the boards. People were very generous. Bringing them together gave us a larger collective impact. We also received enormous support from our broker network and they were instrumental in making the two funds successful. Then last year, Geoff wanted a global version of FGX, and brought on board Louise Walsh to be joint CEO with Chris Donohoe. Selecting the global managers needed more work, and that's what Chris focused on. In terms of due diligence on the charities and raising the capital, Louise – previously at Philanthropy Australia – was able to add value. She is CEO for both the global and domestic Future Generation companies, and brings depth and vigour to our philanthropic activities, ensuring our giving programs are targeted and effective.

Listed@ASX: *What drove you to set up the funds?*

KT: Our business has a focus on wanting to make a difference for our shareholders, the community and the team. We have a program whereby each team member is given money to donate to charities of their choice. While it's WAM making the donation, it's also the team that wants to give money to charities like Act for Kids because they do amazing work with abused children. We also allow them to give time individually. Quite a few years ago, Geoff worked at Lifeline while I was at the palliative care ward at St Vincent's Hospital and Chris was with a sports charity for disadvantaged kids.

The Future Generation idea came about when Geoff read about an investment trust in London called Battle Against Cancer Investment Trust. They put together a group of fund managers that had capacity in their current funds. They either rebated the management and performance fees or issued a separate class so they weren't charging fees. That allowed the trust to make donations, 50 per cent to the Institute of Cancer Research in London and the remaining 50 per cent to others. Around that time, Australian Infrastructure Fund was winding down. We ended up using that listing as the vehicle for FGX. We thought maybe we could raise $50 million. We were really surprised because we ended up raising $200 million.

Listed@ASX: *Did you do anything different to market that?*

KT: No. But it was assumed that people supported their own charities independently of a fund like this. We explained that, first and foremost, this was an investment vehicle that would produce a return. If we had good fund managers, investors would get whatever their returns were at an incredibly low rate. They would pay only 1 per cent and that goes to children's charities. So it made sense that the shareholders were getting access to good managers at a much lower rate. Also, some of the managers were closed – like Paradice, Lanyon and Cooper. But they were generous and happy to be part of it. WAM already had $1 billion under management, so we had capacity to manage additional capital pro bono and this did not impact our day-to-day operation. The investment team was picking stocks anyway.

Listed@ASX: *And the other external managers?*

KT: They want to give back too. They use it in their marketing, because it's viewed favourably by investors. It was a win with the charities too. They always need funding, and this is like an annuity stream for them. While the percentage of money we donate each year is set in stone, how it is allocated to the charities is up to the shareholders. That gets them engaged, because they choose where their pro rata amount goes. We tell the charities that if they want the money they have to deliver results. We hold them to account. We profile one each month so shareholders have a flavour for what they are doing. For example, Father Chris Riley from Youth Off The Streets gave an incredibly powerful talk at the AGM last year. Someone in the audience donated $16,000 to them after that. Shareholders can donate their dividends too. It is up to them.

Listed@ASX: *How much due diligence is done on the charities?*

KT: A lot. That's why we asked Louise to join us. We have to evaluate them and know what they are trying to achieve. We also have a chance, as these LICs perform, to influence policy. It's a chance to make youth mental health, for instance, a cause that is talked about. It's not just about the money. There has to be something more. We are fortunate too because the charities come and chat to us. They might run a stress management course for the team, or just talk about what they do. We also have to make sure that everyone who is working pro bono is feeling connected and engaged.

Listed@ASX: *Were the people who supported these funds backers of other WAM vehicles?*

KT: There definitely were WAM shareholders, because they had a priority allocation in the IPOs. But there was a new group we had not had before who were looking for the philanthropic objective. With FGX we had Solomon Lew, Twiggy Forrest, the Smorgon family and the Balnaves Foundation. The big philanthropists found it appealing. And a lot of the brokers that supported it, like Taylor Collison and Morgans, donated their selling fee to the charities. The guys at Rivkin were big supporters. Their managing director wanted to donate their selling fee, and asked who they should give it to? They divvied it up between a couple, and then they invited them to talk on their Rivkin Report. It had a far-reaching effect that we did not expect. Also, Boardroom, which does the registry work pro bono, has been in touch because they are interested in Raise Foundation's youth mentoring program. We hope this will be a game changer for other corporates, especially the funds management industry.

Listed@ASX: *Will you do more funds?*

KT: Not immediately, the focus will be on these two.

Listed@ASX: *You say the donations paid by the funds will grow each year. Can that be guaranteed?*

KT: The donations are a direct correlation to how net assets perform. That is a direct correlation to how the fund managers perform and the board decides how much is paid to shareholders via dividends. FGX had options that expired in September this year, and that increased the fund's size. Future Generation Global has options that expire next year. We can effectively almost double their size with a one-for-one option issue. Then it's a matter of each board setting the strategy going forward.

Listed@ASX: *Will the investment managers handle the money for long?*

KT: Yes. The investment committee has to be happy that the fund managers are performing over the medium term. They can't assume the star manager this year will be the best next year, so we need to take a medium to long-term view. Then, a fund manager might decide that they don't want to manage the capital pro bono. In that case, we wouldn't allow them to continue.

Listed@ASX: *Why have LICs burst into life over the past five years?*

KT: The Future of Financial Advice (FOFA) reforms definitely had an impact. That levelled the playing field between managed funds and LICs, because it banned trailing commissions to planners. That has been a huge benefit because LICs are closed-end vehicles. Geoff started this business knowing that, in the US, closed-end vehicles had outperformed open-ended ones over a long period of time. We are very vocal on this structure being superior. Our investment team has a pot of money that they manage. They buy and sell stocks on merit, but it doesn't matter whether shareholders come or go, they can completely focus on the portfolio. Being a company structure means we can pay fully franked dividends and smooth the payouts. Managed funds have to pay all their profits each year, and that can be volatile. Also, investors don't have to choose one LIC over another. They can own a number that complement each other.

"Being a company structure means we can pay fully franked dividends and smooth the payouts."

Listed@ASX: *Some large LICs have recently cut dividends, and returns could soften further next year. Is that a new trend?*

KT: That really depends on what the market does. I wouldn't have thought so. It comes down to how an LIC performs against the market. If the market falls substantially, that could be an issue. We have incredibly low interest rates, very little growth and a lot of political instability globally. We have always said we can perform in markets that are going up and down. We invest via stock picking and look for trading opportunities like taking block lines of stock, participating in placements and IPOs, takeover arbitrages, LICs trading at a discount plays, looking at market themes and earnings surprises.

Listed@ASX: *In uncertain times, would you accommodate that by going more to cash?*

KT: No. Historically we have had high levels of cash compared with most fund managers. In WAM Capital, our flagship fund, over the last 17 years we have held 35 per cent cash and still managed to outperform the market by 10 per cent. It gives us maximum flexibility. We could be 100 per cent invested or 100 per cent in cash. Having flexible mandates help us. For instance, after the GFC we heavily invested in larger cap stocks because they were performing better. We really just try to make money, and try not to lose money. I heard Geoff recently say: "Rule number one is don't lose money, rule number two is don't forget rule number one". If we can't find a catalyst, then we don't invest. We might find potentially good investments, but they can be cheap for a long period if nothing happens to re-rate them. Why put capital at risk if we don't think there is a catalyst? In terms of the trading opportunities, it's really just a matter of finding ones where the risk reward is appropriate.

Listed@ASX: *Are you defensive now?*

KT: It swings around. The investment team doesn't expect a huge amount of growth in the market. But their view does not dictate how they pick stocks.

Listed@ASX: *What will drive investment markets going forward?*

KT: Our 12-month outlook remains mixed. Small-caps have outperformed large-caps for the last two years, and we expect this will continue as the market favours earnings growth. While the federal election, Brexit and volatility in China have created short-term uncertainty, the effect has been modest. We expect consumer sentiment to improve on the back of further interest rate cuts. But our process is bottom up and fundamental, so we're primarily focused on undervalued growth rather than macroeconomic conditions.

"While the federal election, Brexit and volatility in China have created short-term uncertainty, the effect has been modest."

Listed@ASX: *You gave birth to twins recently. How do you manage the work-life balance?*

KT: I took almost a year's leave and Geoff stepped in as interim CEO. I was fortunate to stay involved at a board level and I spoke to Geoff and Chris on a regular basis. It was wonderful to have the time to focus on being a mum and to feel supported, then step back into my role when it was the right time. It's a balancing act and takes time to adjust – you need support both at home and in the workplace. I believe businesses need to be supportive and offer flexibility to both parents, not just the mums who tend to be primary carers. Staying in touch with the team while I was on leave definitely helped the transition back.

We have a number of other return-to-work parents to whom we offer flexible working arrangements. Others are studying and wanting to be on non-profit boards, they also need flexibility and support. An organisation that encourages people to pursue their passions and continue to develop is very positive for everyone and builds a strong culture.

Listed@ASX: *What role does gender diversity play within WAM?*

KT: Funds management is male dominated so it's wonderful for our culture to have a focus on diversity. Having two female CEOs (myself and Louise Walsh), and a female dominated board at Future Generation Global, sets the scene for other women in the business in terms of opportunities.

Diversity of backgrounds is also important to encourage. We recently did some work with Professor Robert Wood on unconscious bias, which was fascinating. It helped the team appreciate the importance of diversity. We believe diversity builds a stronger culture with different views and ideas – it all adds to a progressive workplace.

Keeping shareholders happy

The secret to keeping shareholders happy can be elusive. Knowing exactly who to duchess takes time, let alone knowing exactly what drives their investing goals. They often play their cards close. Listed investment companies (LICs) suffer the same frustrations, despite also being hard-nosed about deploying their own money. They need to engage closely with their shareholders while also adopting a hard-nosed approach to those they profit from.

If performance falters, investors of course will sell their LIC shares. Their loyalty cannot be taken for granted. And, LICs increasingly are targets for activist shareholders and short sellers that want to shake-up lazy managers.

WAM's CEO Kate Thorley views personal contact with the retail shareholders who support WAM's funds as being integral to her job. "I spent an afternoon last week ringing a number of them," she told *Listed@ASX*. "You can't turn around your engagement and get a loyal investor base overnight. You have to do what you say you are going to do, do it well and keep people informed of how and why you are doing things."

Here are her views on engagement:

Listed@ASX: *How important is your relationship with WAM's investors?*

KT: In our surveys, 74 per cent of respondent shareholders rate us very highly. We really listen to shareholders and we are always trying to lift our game. We keep them abreast of not only how we are performing but also how we do things. We give them our market insights – across the whole team. All of us speak to shareholders regularly, and it's something we enjoy doing. It's not just through our investment roadshows twice a year.

Listed@ASX: *How many individual shareholders are there across the group?*

KT: For WAM LICs, there are roughly 40,000 shareholders and for the Future Generation vehicles there are 12,000. When we get a new shareholder, we send them a survey. For WAM Leaders, we asked whether they would like to hear from someone in our team? When I spent an afternoon last week ringing a number of them I found that roughly half were people who had been with us in other vehicles, some had been with us for a shorter period and others were new. Those that had been with us a long time, all had very positive things to say – not only about our performance, but how we communicate and engage. Of those new to the business, I would say half were referred by family and friends and the other half through our brokers and financial planning networks. To me, that is powerful.

When boards consider how to grow LICs, they have to make sure current shareholders are treated fairly. That might involve matters like not raising capital at a discount. We tend to expand using option issues because we think that is the fairest way for retail investors. They have time to put more money in, or they can sell that piece of paper. Usually we set the strike price above NTA, so the investment managers have to perform to have the options exercised. Also, we spend time and effort writing submissions and standing up for retail shareholders, which is incredibly important because they need a voice. When we become involved in activist situations, we look at whether we can use our businesses to hold companies to account. That means we have a very strong shareholder base that is very loyal.

Listed@ASX: *Listed companies yearn to attract SMSFs as shareholders. What lessons have you learned that might help them?*

KT: People either control their SMSF themselves or they talk to a broker or an adviser. It comes down to working out who are the brokers we need to engage with. We keep in touch with brokers who regularly support our capital raisings because it's their clients that are investing with us. We hold bi-annual road shows in all capital cities, and send a weekly email to our investors with market updates - anything that's topical or has been in the press. If a company wants to target SMSFs, they should be looking first at their current shareholders and asking what they are doing for them? That is the starting point. If you keep them happy, they are likely to talk to other people. A lot of them love talking to us about the themes and our view of the market. If we can give them some of our insights, then that's great. They feel they are being educated.

Listed@ASX: *Some companies target retail shareholders by working through organisations like the Australian Shareholders' Association (ASA).*

KT: Absolutely. They are great avenues as well. Regional areas (have interested investors) too. We recently went to Ballarat and Toowoomba, for instance. The ASA and share clubs are helpful. We don't necessarily talk about our own company, but something broader that they are interested in, like how to find unloved stocks.

Listed@ASX: *What does WAM look for when it invests?*

KT: Our investment team meets something like 1,500 contacts a year, which cover investee companies, analysts and industry players. They try to understand how businesses make money and talk to management teams to understand strategy, culture and industry dynamics. That is how they pick stocks. They rate management – the CEO and CFO. That is incredibly important, especially outside the top 200 stocks. Then there is industry rank, then they forecast two years of earnings growth because that has the greatest correlation to the share price. The investment team might see management two, three, four times before they invest. It all comes down to trust.

Once they find those companies, they also look for a catalyst. What is going to change the market valuation? Is there going to be an earnings surprise? Is it a turnaround with a new CEO? There has to be something they think will cause the market, over time, to re-rate that stock. Once that catalyst plays out, they will sell if they can't identify a new catalyst. They have to be disciplined about that and not fall in love with a stock.

Some of our shareholders also might sell out and buy back in later. If a company wants to attract new shareholders, they have to accept that it will take time. It has with our business.

Listed@ASX: *Is it common for financial planning groups or institutions to invest in WAM's LICs?*

KT: Prior to FOFA, we didn't have many financial planners investing with us. We don't have any institutions, so it's all retail investors that either have SMSFs or who are direct investors. We tend to have a direct relationship. But that is changing, and it will change more as we get bigger. With WAM Leaders there are more planners interested. As you get bigger, there is greater liquidity and planners like that. The research houses and brokerage houses want a certain size before you get research coverage. That has been one of the drivers to expand the vehicles so that we can get that additional coverage and become more relevant. But we need to accept that as we become larger, it may be harder to perform. There is a balance between capacity and performance.

Listed@ASX: *Do listed companies ever approach WAM to become shareholders?*

KT: Yes, we are approached by companies to be investors. A couple of examples are the IPOs for IPH and Eclipx Group. Our investment team had met with the management of both companies on a number of occasions. We got to understand the businesses very well and had confidence in their management teams to deliver on their strategy. Management also had faith that our investment team was most likely going to be shareholders over the medium term. We received very good allocations in the IPOs because we built a relationship. Companies should build relationships with the brokers involved and potential fund managers.