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Shark lunges at Fisher's wounded Marlin

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OPINION: The barbarians are at the gate of Carmel Fisher's kingdom. After expanding the borders of Fisher Funds to control more than $1 billion, Queen Carmel's rule is under attack from the Visigoths at Elevation Capital.

Fisher is a popular monarch, a charismatic leader with the common touch, and her success generates some jealousy among rival kingdoms.

However, her powers rely on the continued thriving of her subjects and if their fortunes stumble, so too will she.

Knowing this, Elevation has attacked Fisher's weak point - the Marlin Global listed investment trust.

Marlin floated on the NZX in late 2007 after raising $103 million in an initial public offer at $1 a share.

The offer was oversubscribed by $33m, reflecting Fisher's popularity and the confidence among investors at the time.

The idea was to use the money to buy shares in growth companies outside New Zealand and Australia, as selected by Fisher's specialist fund manager, Ken Applegate. If those shares grew in value and generated dividends, the value of Marlin shares would rise accordingly.

This is a standard model for closed-ended investment companies or investment trusts. Although rare in New Zealand, they are common in Britain.

Chalkie generally likes vanilla investment trusts because they confer upon investors the full rights of a shareholder, whereas unit trust investors are typically pawns of a management company.

Sometimes investment companies employ their fund managers directly and sometimes they contract an external provider, in Marlin's case Fisher Funds.

It is the job of Marlin's board to oversee the performance of this contract and ensure shareholders' interests are maximised.

This is highly significant in the unfolding events involving Elevation Capital.

The problem for Marlin is that its performance has been generally wretched, starting from its wretched timing in launching on the eve of the global financial crisis.

In Marlin's case the $1 listing price was trashed in quick time as the shares sank as low as 60c within months. The extent of the trashing can be seen in the difference between Marlin's share price and the value of its investments.

In its annual report for the year to June 2008, Marlin's shares and warrants were priced collectively at 75c while the fund's assets were valued at 94c.

This disconnect between share price and asset value is a feature of investment trusts: though shares can sometimes trade at a premium to asset value, a discount is common.

If the discount gets large, it can mean the investment market is too dumb to see the real value of the shares, or that the market doesn't think much of the fund manager.

Marlin's discount has been persistently big. In 2009 its average discount was a gargantuan 31.7 per cent, triggering much investor angst and calls for the fund to be restructured.

Since then the story has improved a little, partly because Marlin has been buying back its own shares. In the last financial year Fisher puts the average discount at 15 per cent, which is merely huge.

Dividends, meanwhile, are being paid out of capital rather than income, which merely shrinks the fund further. Chalkie wonders how many investors are aware where their "dividends" are really coming from.

But given the underlying performance of Marlin's portfolio, who could blame investors for a lack of enthusiasm?

In five years of effort, the fund has struggled to exceed its original asset value of $1 a share and, having chinned the bar as high as $1.17 at last year's balance date, has since given up most of that ground.

Among its disappointments, perhaps the most unfortunate is Hong Kong-listed paper recycler Fook Woo, once one of Marlin's biggest holdings at about 3.2 per cent of the fund.

Last November Fook Woo's shares were suspended amid delays in filing its accounts. The stock has not traded since and it now appears the company may have been victim of fraud - among other things, the company says HK$1.6m (NZ$250,000) and a car have gone astray.

The debacle has forced Marlin to write the holding down by 80 per cent.

Marlin was aiming to be an "absolute return" fund. Rather than beating a sharemarket index, it aimed to generate returns exceeding the annual change in the 90-bank bill index plus 5 per cent. It is hard to see how the performance resembles the goal.

Target annual returns for the last five years were 9.3 per cent, 11.2 per cent, 7.8 per cent, 8.1 per cent and 7.8 per cent.

Since launch, Marlin's actual total shareholder return has been minus 12.8 per cent.

Although fund managers are adept at finding numbers that paint themselves in a good light, Chalkie reckons you need particularly rose-tinted glasses to see Marlin as anything but a poor performer.

Which brings us to Elevation Capital, author of a proposal to terminate Fisher's contract as Marlin's manager, wind up the fund and give all the money back to shareholders.

Compared to Fisher Funds, Elevation is minuscule. From its compact and bijou offices in Auckland's Parnell it runs one fund directly, the Value Fund, which has a value of $14.6m. Its other fund offer, the Fund of Funds, invests in three big name overseas funds and has a current value of $11.7m.

By comparison, the Value Fund reports a return since inception of 9.05 per cent, while the Fund of Funds reports minus 4.32 per cent.

Elevation's main man is fund manager Chris Swasbrook, a cerebral devotee of investment legend Ben Graham and a former partner in Goldman Sachs.

As per the Graham model, Swasbrook's modus operandi is to buy undervalued assets and agitate to realise their full value, which fits the move on Marlin to a T.

Having started buying on September 10 at about 70c a share, Elevation hoped to realise close to the net asset value of 84c through a wind-up of the fund, thus producing a double-digit gain in short order. Alternatively, it thought the Marlin board might like to consider changing managers from Fisher to Elevation.

Chalkie reckons this is an entirely appropriate proposal for Marlin shareholders to consider and they are due to vote on it - or at least to the wind-up part - at their annual meeting in Auckland on November 1.

Coincidentally, this date is the day after the initial five-year Fisher Funds contract to manage Marlin expires.

Swasbrook was aware the contract was up for renewal and contacted Marlin independent director Mark Todd on September 13 to talk about his proposal. Todd resigned three days later.

His resignation left just three directors on Marlin's board - Carmel Fisher, Alistair Ryan and Carol Campbell. The latter two are classified as independent.

The same three directors comprise the boards of the other two Fisher-managed investment trusts - Kingfish and Barramundi. With Ryan and Campbell collecting directors' fees from three Fisher funds, are they really independent?

Had Marlin been a British company, the answer would be no.

In 2003, Britain's financial regulator, the Financial Services Authority, considered the issue of investment trust board independence.

There is potential for conflicts of interest to arise in the relationship between directors and the fund manager, it said, particularly because investment companies were often created by the fund manager. As a result, "the board needs to be, and be seen to be, independent".

Under stock exchange listing rules for British investment trusts, any director who is also a director of another company managed by the same fund manager cannot be classified as independent. Also, the board of an investment trust must be able to act independently of the fund manager.

Chalkie reckons Marlin shareholders may want to probe their board's independence at the AGM.

Chalkie understands Ryan and Campbell were aware of Swasbrook's proposal by September 28 but continued procedures to renew Fisher's management contract, which were finalised on October 17.

Marlin told the NZX the renewal followed "a comprehensive review".

Ryan told Chalkie the review involved Marlin directors satisfying themselves the manager had carried out its responsibilities under the management agreement.

Had they wanted to consider not renewing the contract, an outside consultant would have had to review performance in a process beginning as early as mid-July.

Clearly, by the time Swasbrook got involved, the die was cast.

Now, you could argue that with Applegate having departed the scene since June and with Marlin's new managers, Roger Garrett and Manuel Greenland, in place only since May and October respectively, the team should be given the chance to turn things around.

However, Chalkie reckons the contract renewal was a clear opportunity to give shareholders a proper review of their options and the board failed to take it.

You don't have to be a barbarian to think that's not good enough.

- Chalkie is written by Fairfax Business Bureau deputy editor Tim Hunter.

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