

# The New Zealand Herald

## Brian Gaynor: Marlin battle raises clear investor issues

5:30 AM Saturday Nov 3, 2012

Marlin Global's annual meeting, which rejected a liquidation proposal from Elevation Capital, threw up a number of important investment issues.

These include the difference between open and closed-end funds, management contracts, the appointment of directors, performance targets, investment returns, fees and dividends.

These issues can have a major impact on the performance of a fund and the ability of investors to obtain full value for their investment.

Marlin issued a prospectus in October 2007 with the objective "to raise up to \$140 million to invest in a selection of growth companies based outside of New Zealand and Australia".

The main features of the issue were:

- \*Shares issued at \$1 each.
- \*One free warrant issued for every two shares with each warrant entitled to purchase an additional Marlin ordinary share at \$1.
- \*Fisher Funds was both promoter of the issue and also contracted to manage the fund.
- \*The portfolio's benchmark was the increase in the NZX 90-day bank bill index plus 5 per cent per annum.
- \*The management fee was 1.25 per cent per annum of gross assets, reduced by 0.1 per cent for every 1 per cent underperformance relative to the benchmark, subject to a minimum fee of 0.75 per cent per annum.
- \*The manager would receive a performance fee equal to 15 per cent of excess returns over and above the benchmark.

The issue raised \$103 million and the company listed on the NZX on November 1, 2007, exactly five years before this week's contentious meeting.

Marlin is a closed-end fund which means that all the money raised stays within the fund and shareholders can only realise their investment by selling shares on the NZX.



Carmel Fisher didn't give an inch at Marlin's AGM when shareholder Elevation Capital tried to end Fisher Funds' management contract. Photo / APN

By comparison, open-ended funds, which are much more common, issue and redeem units on a daily basis at net asset value (NAV).

Thus, investors in closed-end funds are dependent on what investors are prepared to pay for their shares, which can be above or below NAV, whereas investors in an open-ended fund can redeem units at NAV.

Carmel Fisher's Kingfish and Barramundi are the only other NZX listed closed-end funds compared with 60 listed on the ASX.

One of the advantages of closed-end funds is that they are easier to manage, particularly in a share market downturn, because there is no leakage through redemptions and managers are not forced to sell low-priced shares to meet redemptions.

Closed-end funds should also perform relatively well in a market upturn because managers can fully participate in rallies as they don't need to hold cash for potential redemptions.

In the September 2012 year, Kingfish, which invests in New Zealand, experienced a 17.9 per cent increase in NAV and Barramundi, which invests in Australia, was up 11.3 per cent.

Meanwhile, Marlin's NAV rose by only a 2.1 per cent, mainly because of the poor performance of a number of its Chinese holdings.

However, closed-end listed funds have a number of negative features including:

- \*They have higher costs because of listing fees, director fees and so forth.

- \*Most of their establishment costs are charged to investors and, as a result, Marlin started with a NAV of 97.21c, compared with an issue price of 100c, because of these costs.

- \*These listed funds usually trade at a fairly large discount to NAV in New Zealand, whereas the three largest ASX listed funds – Australian Foundation, Argo Investments and Milton Corporation – often trade at a premium to NAV.

Two of the main issues under discussion at Marlin's annual meeting were investment performance and the management contract.

Chairman Alistair Ryan admitted that Marlin's recent performance had been unsatisfactory but he highlighted a graph showing it had outperformed the MSCI Global Small Cap Gross Index (in NZ dollar terms).

A release to the NZX in July showed that Marlin's NAV had risen by a total of 7.9 per cent since November 2007 whereas the MSCI index was down 10.5 per cent over the same period.

However the company's benchmark, which is the NZX bank bill rate plus 5 per cent, has appreciated by over 50 per cent since inception, well above Marlin's 7.9 per cent.

The initial management contract was for a five-year period and "the parties may agree to renew this agreement for further terms of five years at the expiry of the initial and each other term".

As part of this renewal, the company and manager must discuss the performance of the management services and if the company is dissatisfied then it should refer the issue "to an independent expert to

review and critique the performance of the manager".

The problem with this process is that the manager is only required to "do its best to achieve a return on the portfolio which meets or exceeds the benchmark rate over the medium to long term".

The manager doesn't have to meet or beat the benchmark, it only has to do its best. There's no doubt Fisher Funds has met the latter requirement and the independent directors could not terminate the contract.

Herein lays the basic conflict between the two different types of closed-end funds. These two types are:

\*An investment company established by an independent board of directors which drafts the investment management contract. The independent board then appoints a manager and that manager is accountable to the board and has no board representation.

\*An investment company established by an investment manager which drafts the management contract. The investment manager has a long-term contract to manage the fund, has board representation and has a big influence over the appointment of the other directors.

This columnist has board experience of both structures and there is absolutely no doubt that the first scenario is far more satisfactory than the second as far as shareholders are concerned.

There are major inherent conflicts of interest in the second scenario even if the independent directors are determined to protect the interests of shareholders.

It is almost impossible to remove the manager in the second scenario unless a number of large shareholders are determined to do so.

Thus Elevation Capital's motion to terminate the management contract, and return all capital to shareholders, was defeated by 31.9 million to 8.1 million shares.

The resolution would not have been binding on the board even if it had been passed.

There was considerable to and fro at the meeting between Elevation Capital's Chris Swasbrook and Carmel Fisher as the latter was not prepared to give an inch.

She accused Swasbrook of using this motion to promote his business and individuals had a choice between Marlin and Elevation Capital's funds and they had chosen the former.

She also said that Fisher Funds had started an open-ended International Growth Fund at the same time as it launched Marlin and investors had shown stronger interest in the latter.

This open-ended fund, which holds the same stocks as Marlin, has outperformed the latter in terms of NAV growth.

The open-ended fund has performed even better in terms of investor returns because its units can be redeemed at NAV whereas Marlin's shares are trading at a large discount to NAV.

Dividend payments were also a major issue at Thursday's meeting.

Marlin paid a 7.43c per share dividend in its June 2012 year even though it reported a loss of \$12 million.

These dividends were paid out of capital and the company now has an accumulated earnings deficit of \$11 million.

These dividends are counter-intuitive because one of the advantages of a closed-end fund is its ability to retain financial resources in a market downturn so that it can fully participate in a market recovery.

Marlin's dividend payments negate one of the clear advantages of a closed-end fund.

\*Disclosure of interests; Brian Gaynor is an executive director of Milford Asset Management.  
[bgaynor@milfordasset.com](mailto:bgaynor@milfordasset.com).