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# Hyperion Flagship Investments

Sector: Financials

The following is a transcript of an interview conducted by Andrew Wong, Structured Product Analyst at Aegis. For more on Hyperion Flagship Investments Limited (HIP) see our Listed Managed Investments Quarterly Review at www.aer.com.au or go to the HIP website at www.hyperionfi.com.au.

HYPERION FLAGSHIP INVESTMENTS

Andrew Wong – Structured Product Analyst

**HIP has performed very strongly in terms of NTA growth in the past 12 months; however, as of 30 June, the company continues to maintain a share price discount to NTA. What do you think have been the factors that have led to this discount to remain?**

HIP Managing Director – Manny Pohl

The discount to NTA has been narrowing continuously over the past 12 months after the board put an action plan into place for this purpose. In fact, if you have a look at the actual data for the end of July, the discount narrowed to the point where it is now at a premium. The closing share price at the end of July was 178, versus the NTA of 165 or 150 for the fully taxed version of the NTA.

Andrew Wong – Structured Product Analyst

**What would you think would be, or have been, the factors that have contributed to the narrowing of the discount and then later on reverting to a premium over NTA?**

HIP Managing Director – Manny Pohl

Originally, when HIP listed on the ASX, then called Wilson Investments Taurine Fund (*WIT*), it did trade at a premium for a while. But there was a period about three years ago when we did underperform because of the high conviction nature of our investments. It was at that time that the discount widened. However, since then, it's been narrowing because firstly, the investment performance has improved dramatically; secondly, there has been additional broker coverage (both ABN Amro and Wilson HTM have put out continuous broker reports on the Company); and thirdly, which I think is one of the more vital things, we implemented the share buyback scheme. All these factors have now caused the discount to disappear.

Andrew Wong – Structured Product Analyst

**Would you foresee this discount to continue to narrow and revert to trade and maintain at a premium?**

HIP Managing Director – Manny Pohl

It's very difficult to forecast sentiment in the market – that's what drives the price being either at a premium or a discount. The fully taxed NTA is the minimum fair value for the stock and what one should theoretically pay for the stock.

As a result of our great investment performance, I do not think it will trade at a discount to the fully taxed NTA going forward. Scarcity will ensure that the price will remain above that. The extent that it exceeds the actual tax paid NTA will depend on the continued good view that investors have of the manager and at the moment they certainly have a positive view. So, I would be expecting some kind of premium, but it might not always be there. It would depend upon market sentiment for growth managers and a boutique manager like Hyperion.

Andrew Wong – Structured Product Analyst

**Given the share price discount to NTA previously evident around the end of June, and possibly in the future from time to time, will the company be buying back any shares, and to what degree of discount would a share buyback be triggered?**

HIP Managing Director – Manny Pohl

The buyback is in place for another 12 months and this was notified to the market. The range at which shares can be bought back is dictated by the stock exchange rules, and we have put an arm's length arrangement in place with our broker, Wilson HTM, for it to stand in the market when the shares are within that range.

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We would not buy back shares that were at a premium to the normally taxed NTA. Certainly, the buyback would be triggered when the price drops below the fully taxed NTA, because we would then effectively be buying the underlying shares at a discount to the market.

Andrew Wong – Structured Product Analyst

**What significant portfolio changes have been made in the past 12 months?**

HIP Managing Director – Manny Pohl

There haven't been any significant changes. It's been at the margin really. We've added a couple of new stocks, like Wotif.com, Babcock & Brown Environmental and Woodside Petroleum.

Andrew Wong – Structured Product Analyst

**Which stocks in the portfolio have performed strongly and which have been the best portfolio decisions made over the past 12 months?**

HIP Managing Director – Manny Pohl

In terms of the top 10 performing stocks, obviously it's the exposure to the mining companies, and Rio (Tinto) was the best performing investment. However, some of the smaller companies that we bought did extremely well for us. Seek was the notable one while Babcock & Brown has also added to the performance. One investment that we've had for a long time that continues to perform well is Count Financial.

Andrew Wong – Structured Product Analyst

**Which have been the worst performing stocks or worst portfolio decisions made over the past 12 months?**

HIP Managing Director – Manny Pohl

These would be the stocks in the consumer discretionary sector of the market. Fantastic Holdings was the worst performing investment followed by Great Southern (Plantations) which was one that we've had for quite a while, but recently sold. The third worst investment was Flight Centre which we sold some time ago.

Andrew Wong – Structured Product Analyst

**What are the key advantages of investing in HIP compared with other unlisted managed investments or LICs?**

HIP Managing Director – Manny Pohl

Compared to other LICs, to my knowledge, we're the only LIC that has no management fee, only a performance based fee. In terms of style, Hyperion is a growth manager, focused on producing alpha. We're benchmark unaware and have an absolute return focus.

More importantly, the absolute return focus means that when retail investors invest in HIP, they're getting a manager that compares its performance to the cash rate.

We believe retail investors are interested in the degree to which an equity manager is outperforming the risk-free rate. The extent to which we perform, we get paid and if we underperform the risk-free rate, we don't get paid at all.

Andrew Wong – Structured Product Analyst

**Where does the company see a holding in HIP fitting into an investor's portfolio?**

HIP Managing Director – Manny Pohl

We are what people call a 'satellite manager'. Investors would typically have a portfolio with several core assets, for example, some property, fixed interest, perhaps an international investment and maybe some other equity manager that was index-aligned. HIP would be added to give the outperformance or the alpha.

We are about adding value over and above the index performance. An investor would complement us with some kind of index manager, I would imagine.

Andrew Wong – Structured Product Analyst

**What are the key risks with investing in HIP and what risk controls are in place to minimise the impact of a market downturn on a portfolio?**

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HIP Managing Director – Manny Pohl

We think that our investors are protected against a downturn by our portfolio of quality companies. In my experience, when there is a downturn in the equity market, there's a flight to quality. The really smart money goes into the quality companies, and our whole approach to investing is to identify the quality companies. We spend an inordinate amount of time filtering through all the listed companies and coming up with a portfolio of about 30 stocks that have got a stamp of quality. They have a quality business model, they have management with a proven track record and they are producing consistent earnings.

So, when there is a downturn in the market, investors look for those companies that have a sustainable cash flow, sustainable earnings and clearly a competitive advantage in the market place. All of these factors, we believe, protect them in the downturn.

Andrew Wong – Structured Product Analyst

**In that case, what would you see as the key risk in HIP?**

HIP Managing Director – Manny Pohl

The key risk would be the extent to which we get the earnings projections wrong or we misunderstand a business model and do not understand some of the risks associated with the company we're investing in. To the extent that we get these wrong, we will get the performance of the portfolio wrong.

If we do our homework and get the earnings projections of the companies that we have in the portfolio right, then we will produce excess returns. If we get these projections wrong, then clearly the portfolio will under-perform.

Andrew Wong – Structured Product Analyst

**In terms of market outlook and HIP, could you provide an outlook for the Australian market over the next 12 months? How does this outlook impact the HIP investment portfolio?**

HIP Managing Director – Manny Pohl

Given the current economic and interest rate environments, one has to assume that the equity market in terms of valuations is not going to see any dramatic improvement. The PE ratios are likely to stay where they are, and, if there is an interest rate rise, these could even decline somewhat.

In such an environment, the performance of a portfolio will be driven by quality-type investments with a growing earnings profile. Conversely, if earnings and valuations are unchanged then the portfolio will not show any improvement.

The companies that we invest in are showing substantial earnings growth. We're a growth manager – we identify companies that have got the ability to grow their bottom line earnings. On our earnings numbers we expect the internal rate of return from the portfolio to be in the order of 12%-13%.

Andrew Wong – Structured Product Analyst

**Which sectors would HIP be intending to overweight or underweight over the next 12 months?**

HIP Managing Director – Manny Pohl

We are a bottom-up stock picker. We buy individual businesses. We do not do sector allocation at all. The sector allocation is just a result of the quality companies that we put together.

Andrew Wong – Structured Product Analyst

**The LMI sector tends to relatively outperform in more bearish market environment as investors switch into more conservative, defensively oriented investment. How do you see the general market outlook impacting the sector as a whole?**

HIP Managing Director – Manny Pohl

I wouldn't say that we are currently in a bearish market, but in a non-bullish or a neutral market that is going sideways. Investors will certainly favour the conservative LIC sector which should see additional inflows. However, I think more astute investors will be looking for those managers within

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the sector that have a quality portfolio. Looking at the balance sheets of the stocks we have, their competitive advantage and their potential to grow earnings, there is no doubt that we have a quality portfolio.

Hence I would think we would get our lion's share of the Incremental investment dollar under such a scenario.

Andrew Wong – Structured Product Analyst

**What do you think is the key issue that investors need to understand when investing in a LIC compared with an investment in an unlisted unit trust?**

HIP Managing Director – Manny Pohl

When looking at LICs, one thing that is not really understood is the comparison of a LIC with a unit trust. Investors often compare a similar LIC with a unit trust and, based on the market price for a LIC or the entry and exit prices for a unit trust, believe they would have got a better return out of the unit trust. Investors do not understand that the LIC is a fully taxed entity versus a unit trust, which is untaxed. The extent to which, for example, Hyperion Flagship Investments has outperformed the All Ordinaries Index on a NTA as well as a share price basis, means that the investors have obtained an additional return to the market to the extent of the tax that's been paid by the LIC.

It's a substantially better return than if investors were in an index fund because the index return is a pre-tax return. This pre-tax/ post-tax return is a very important issue for LIC's about which not much has been written.

In addition, there were changes made to the tax legislation about two years ago, where a LIC deduction was introduced to level the playing fields between LICs reporting capital gains, which are fully taxed by the LIC, and unit trusts reporting similar gains, which are untaxed but subject to a potential 50% deduction in the hands of the recipients. When investors get a dividend from a LIC, as they do from Hyperion Flagship Investments, they get the franking credit that goes with the dividend, as well as a LIC capital deduction, which is very favourable to investors.

*END OF INTERVIEW*

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