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RESEARCH
INDEPENDENT INVESTMENT RESEARCH

WAM Capital Limited (WAM)

March 2017

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- 1) The research process has complete editorial independence from the company and this included in the contract with the company;
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- 3) Our research does not provide a recommendation, in that, we do not provide a "Buy, Sell or Hold" on any stocks. This is left to the Adviser who knows their client and the individual portfolio of the client.
- 4) Our research process for valuation is usually more conservative than what is adopted in Broking firms in general sense. Our firm has a conservative bias on assumptions provided by management as compared to Broking firms.
- 5) All research mandates are settled upfront so as to remove any influence on ultimate report conclusion;
- 6) All staff are not allowed to trade in any stock or accept stock options before, during and after (for a period of 6 weeks) the research process.

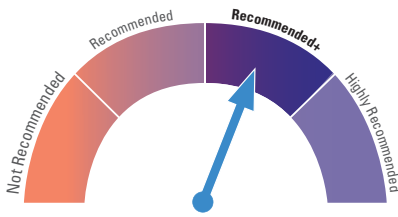
For more information regarding our services please refer to our website www.independentresearch.com.au.

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Rating



Investment Profile

Share Price (\$) as at 1 March, 2017	2.49
Issue Capital:	599.9M
Performance Shares	Nil
Fully Diluted (M)	599.9M
Market Capitalisation (M)	\$1,494M
12 month Lo / Hi (\$)	2.11 / 2.50

Board and Management

Directors:

Geoff Wilson. Chairman, Director
 Chris Stott. Director
 Kate Thorley. Director
 James Chirnside. Non Exec. Director
 Matthew Kidman. Non Exec. Director
 Lindsay Mann. Non Exec. Director

Major Shareholders

There are no major shareholders

Dividend Yield

	%
FY14	5.22ff
FY15	5.62ff
FY16	5.82ff

FUND OVERVIEW

PRODUCT SUMMARY

WAM Capital (ASX:WAM) is a listed investment company (LIC) that provides investors with exposure to an actively managed, diversified portfolio of companies listed on the ASX. The manager focuses its investments on undervalued growth companies predominantly in the mid and small-cap sectors. WAM also provides exposure to value arbitrages and market mispricing opportunities. WAM aims to deliver investors a stream of fully franked dividends as well as provide capital growth. The portfolio largely holds long positions, however may hold short positions. WAM is managed by Wilson Asset Management (International) Pty Limited. The Investment Manager is paid an annual management fee of 1.0% (plus GST) of the gross asset value of the portfolio and is eligible for a performance fee of 20% (plus GST) of the outperformance over the S&P/ASX All Ordinaries Accumulation Index, or the amount of the increase in the value of the portfolio in the event the index has fallen.

INVESTMENT VIEW

INVESTOR SUITABILITY

WAM is suitable for retail investors seeking exposure to a well-managed, diversified portfolio of predominantly mid and small-cap shares, with a strong record of outperforming the S&P/ASX All Ordinaries Accumulation Index. It also offers a relatively attractive stream of fully franked dividends. As a listed investment company, WAM may trade at a premium or discount to the company's NTA. If the company trades at a discount, shareholders may not be able to realise their investment at NTA when they seek to exit.

The level of concentration of the portfolio will differ throughout time. Currently the portfolio holds in excess of 100 securities which are mainly, though not exclusively, small and mid-cap stocks. The portfolio is actively managed and therefore has a high level of turnover. WAM has historically held a large percent of its portfolio in cash and fixed interest securities. Since inception cash has averaged 34% of the portfolio with a minimum holding of 2% and maximum of 70%.

RECOMMENDATION

Independent Investment Research (IIR) reaffirms its **Recommended Plus** rating for WAM Capital. We consider WAM one of the best LICs for investors looking for a well-managed exposure to a diversified portfolio of Australian mid and small-cap stocks. The following rationale supports our rating - (1) WAM has a highly experienced investment team with a proven track record and well established investment processes; (2) WAM has a track record of strong portfolio outperformance and, since inception in 1999, has delivered portfolio returns well in excess of the S&P/ASX All Ordinaries Accumulation Index benchmark with lower beta and volatility; (3) To an extent WAM has delivered on its objective to provide a growing stream of fully franked dividends. Since listing, WAM has delivered a strong flow of dividends, although this was significantly disrupted in the post GFC years with the dividend falling to 25% of its pre-GFC high in 2008/09. The dividend has steadily recovered since, but is still slightly below its pre-GFC level.

Management and performance fees are broadly in line with externally managed LIC peers, but higher than internally managed LICs and other LICs that do not have performance fees. Even so, WAM has outperformed on an after fee basis over the long-term. The absence of a high watermark for the performance fee is a negative. We also note that the Board does not have a majority of independent Directors.

Although we have a Recommended Plus rating on WAM, at 31 January 2017 the shares were trading at a 21% premium to pre-tax NTA. We would prefer to buy the shares at levels closer to pre-tax NTA.

SWOT ANALYSIS

Strengths

- ◆ The investment portfolio is managed by the experienced Wilson Asset Management investment team, which currently manages three other LICs using its proven research-driven and market-driven investment processes.
- ◆ WAM, which uses a combination of both investment processes over a broad investment universe, has outperformed the market over the 16 years it has been listed.
- ◆ The manager is open and transparent with its shareholder base with regular shareholder communications and investor updates.
- ◆ The LIC structure is a closed-end vehicle and therefore the Company is not a forced seller to meet redemption requests, as can be the case for unlisted funds.

Weaknesses

- ◆ Shareholders are not eligible for LIC tax concessions.
- ◆ WAM does not have a majority of independent Directors. Three of the six directors of the company are employees of the Manager with the Chairman, Geoff Wilson, also Chairman of the Manager. Additionally, a fourth director, Matthew Kidman, is a former employee of the Manager.
- ◆ The Manager is eligible to receive meaningful performance fees if it has outperformed the benchmark. This financial commitment impacts the returns payable to investors. There is no high watermark for the performance fee.

Opportunities

- ◆ The LIC provides the opportunity to gain access to a professionally managed portfolio of predominantly small-cap ASX-listed securities that has proven its ability to generate value for investors over the long term. It also provides a steady and growing stream of dividends with a focus on capital preservation.
- ◆ The company may trade at a premium to NTA allowing shareholders to exit at a higher value than what the portfolio is worth. All four managed LICs (WAM, WAX, WAA and WLE) are currently trading at a premium to pre-tax NTA at the time of writing this report.

Threats

- ◆ Poor investment decisions could see the portfolio underperform and lead to the shares trading at a discount to NTA. Since listing the portfolio has consistently outperformed.
- ◆ A rising interest rate environment could see reduced demand for high-yielding stocks and a return to favour for fixed interest products. This could see the price of all LIC shares fall and potentially trade at a discount to NTA. Present indications are that Australian interest rates will not rise for some time.
- ◆ With a majority of the Directors either currently employed by, or previously employed by, the Manager, this raises questions as to whether the Board would act in an independent manner in the event of poor performance by the Manager. We acknowledge that Mr Kidman has not been employed by the Manager for six years.
- ◆ The portfolio may include short positions and as such will incur the risks associated with such investments. This includes the risk that the Investment Manager may not be able to acquire the necessary securities to cover the short position.

INVESTMENT PROCESS

Investment Objectives

WAM Capital seeks to provide investors exposure to an actively managed portfolio of ASX listed stocks. The Company will seek to provide a steady and growing stream of fully franked dividends and will seek to preserve capital by holding cash in the event the Investment Manager cannot identify attractive investments.

Investment Process

The Investment manager, Wilson Asset Management, has two distinct investment processes:

- ◆ A research-driven process focussed on identifying undervalued growth companies, and
- ◆ A market-driven process that takes advantages of mispricing opportunities.

Research-driven investing

This investment process involves diligence and deep research that focuses on free cash flow, return on equity and the quality of the company. Each prospective investee company is carefully assessed with respect to management, earnings growth potential, valuation and industry position. WAM will only invest in a company when the Investment Manager can identify a potential event which will likely result in the market's re-rating of the security. Research driven investments tend to be medium to long-term holdings and are generally exited when they reach or exceed the Manager's price expectations or there is a change in fundamentals.

Market-driven investing

This process looks for and takes advantage of short-term mispricing opportunities in the market. This group of stocks is actively traded by WAM, and may include placements, block trades below market, rights issues, corporate actions (mergers, takeovers, corporate spin-offs and restructuring), LIC discount (to NTA) opportunities, trading themes and trends.

Portfolio Construction

The average portfolio weighting of each non cash investment is typically between 0.1% and 3%, however positions may be larger or smaller than this with no limitations on the size of the investment.

The portfolio's debt is not to exceed 50% and the portfolio's gross market exposure is not to exceed 100%.

The Investment Manager may take short positions, however based on the history of the investment team we do not expect short positions to be a significant percent of the total portfolio value.

Investments will be made on a case by case basis with the portfolio to be benchmark unaware. Catalysts for those investments identified as attractive will determine whether an investment is included in the portfolio.

INVESTMENT PORTFOLIO

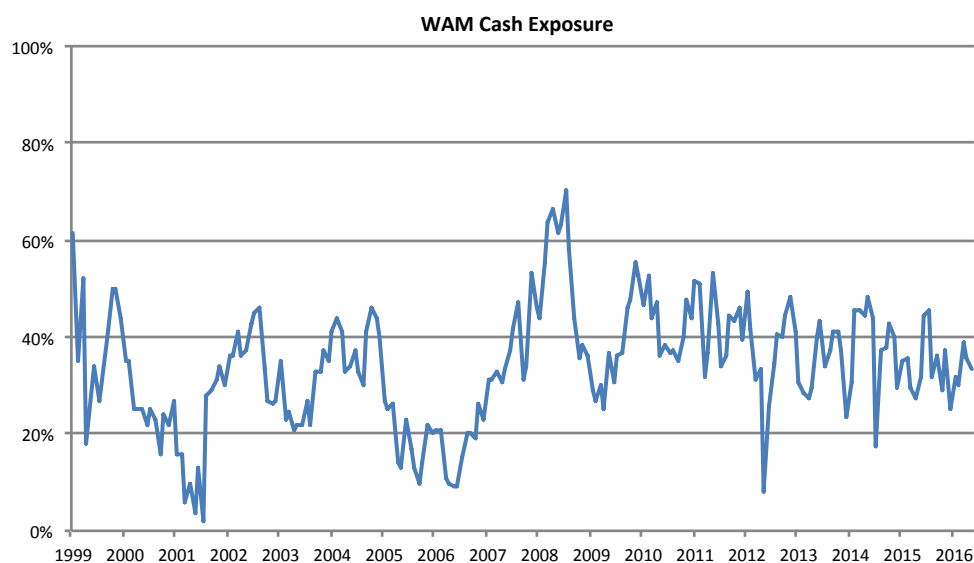
WAM owns a portfolio comprising more than 100 ASX listed securities plus cash. It can invest in both small and large-cap stocks which gives the LIC exposure to market dynamics not available to other fund managers who focus on only large cap or small cap stocks. Predominantly, the portfolio is invested in mid and small cap stocks.

The large, well-diversified portfolio means the weighting in any single security will be relatively small. This means that any single security needs to move by a considerable percent to have any impact on WAM's performance. The largest exposure at 31 December 2016 was a 2.3% weighting in another LIC, Hunter Hall Global Value (ASX:HHV). The majority of individual exposures are 1% or less.

WAM invests in other LICs trading at a discount to NTA as part of its market-driven investment strategy with a view to profiting from eradication of the discount over time.

The portfolio is actively managed and the Investment Manager reverts to cash in the event attractive investments cannot be identified, with the portfolio able to hold up to 100% cash.

WAM typically owns high levels of cash in its portfolio. While this provides both the flexibility to invest opportunistically during periods of market weakness, and protection from significant market weakness (risk mitigation), it also makes sustainable market outperformance in strong markets more difficult. At the end of December 2016 WAM held 33% of its portfolio in cash and fixed interest. The following chart shows monthly cash levels since inception.



CAPITAL MANAGEMENT

Being a LIC WAM is a closed-end investment vehicle and does not need to redeem or issue securities to meet investor inflows and outflows. However, as with all listed companies, WAM has the option of issuing new shares if it sees opportunities to grow the portfolio.

The Board regularly reviews the most efficient manner by which the company employs its capital. At the core is the belief that shareholder value should be preserved through the management of the level of distributions to shareholders, share and option issues as well as the use of share buy-backs, when deemed appropriate by the Board.

Capital initiatives over the past few years have included a share buyback in 2008 to supplement a reduced dividend and new equity raisings via a number of placements, share purchase plans the dividend reinvestment plan (DRP) and DRP shortfall placements. A significant equity raising took place in August 2016 with \$247.2m in new equity raised via a placement and share purchase plan. Since 30 June 2011 the issued capital base has grown significantly from \$150m to an estimated \$1,052m following the most recent equity raisings.

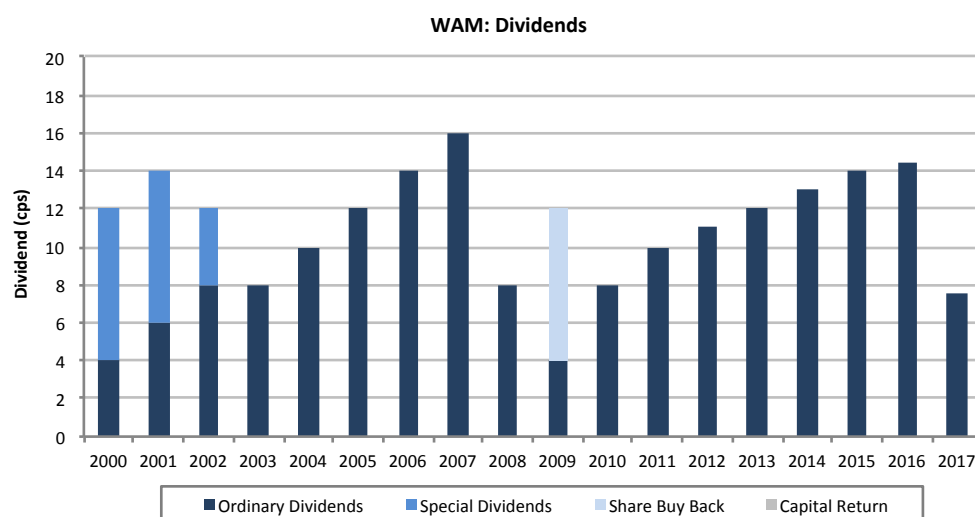
We are comfortable with the capital management initiatives implemented by the Manager. The recent equity raisings have been undertaken at premiums to NTA which is value accretive for existing shareholders. We would be concerned if equity raisings were undertaken at a discount to NTA, but given the company's history, we think this is unlikely.

Dividends

WAM's Board is committed to paying an increasing stream of fully franked dividends to shareholders provided the Company has sufficient profit reserves, franking credits, and it is within prudent business practices. The Company's ability to generate franking credits is dependent upon the receipt of franked dividends from investments and the payment of tax. Dividends are paid on a six-monthly basis.

The manager has been partly successful in achieving this objective and, since listing, has delivered a strong flow of fully franked dividends. There was a significant disruption to dividends in the post GFC years with the dividend falling to 25% of its pre-GFC high in 2008/09. The dividend has steadily recovered but is still slightly below its pre-GFC level.

At 31 December 2017 WAM had about 1.7 years in dividend reserve cover. We do not see any immediate threats to the dividend and, in the absence of a market meltdown, expect the 14.5 cents per share fully franked dividend paid in FY2016 to be at least maintained in FY2017. The interim 2017 dividend was increased from 7.25 cents per share to 7.5 cents per share, fully franked. Given the reliance on realised capital profits to supplement dividend payments, the dividend could come under pressure during a significant and prolonged market downturn.



MANAGEMENT & CORPORATE GOVERNANCE

WAM LIMITED BOARD

The Board comprises six members, three of whom are employees of the Manager. Mr Wilson and Mr Stott are involved in the management of the portfolio and Ms Thorley is the CEO of Wilson Asset Management. A fourth Director, Matthew Kidman, was a portfolio manager at Wilson Asset Management for 13 years. It is six years since Mr Kidman left the Manager, so he is classified as independent. However, given his past association with the Manager, this raises questions as to whether the Board would act in an independent manner in the event of poor performance by the Manager.

Given the lack of a majority independent Board, and with the Chairman also Chairman of the Manager, it is unlikely the Board would seek to remove the Investment Manager if performance deteriorated significantly. This has not been an issue in the past with the portfolio outperforming since inception. We also think the performance fee provides a strong incentive for the Manager to quickly turnaround any underperformance.

The directors have a wealth of experience in funds management and the investment industry. We are comfortable with the experience and capabilities of the Board and the funds management executives of WAM.

BOARD

Geoff Wilson, Executive Chairman

See below.

Chris Stott, Executive Director

See below.

Kate Thorley, Executive Director

Kate Thorley has more than 10 years' experience in the funds management industry and more than 15 years of financial accounting and corporate governance experience. Kate is also a Director of WAM Leaders (WLE), WAM Research (WAX), WAM Active (WAA) and Future Generation Investment Company (FGX). She is the Company Secretary of WAM Capital and Future Generation Global Investment Company (FGG).

James Chirnside, Independent Director

James Chirnside has been involved in financial markets for 30 years, primarily as a fund manager across a broad range of sectors. James is currently Chairman and Managing Director of Dart Mining NL. Prior to this, James worked as a fund manager and proprietary metals trader in Sydney, Hong Kong, London, and Melbourne.

Matthew Kidman, Independent Director

In 2015, Matthew Kidman became Principal and Portfolio Manager of Centennial Asset Management. Previously, Matthew worked as a Portfolio Manager at Wilson Asset Management for 13 years. Prior to joining Wilson Asset Management, Matthew worked as a finance journalist at the Sydney Morning Herald. He holds degrees in Law and Economics and a Graduate Diploma in Applied Finance.

Lindsay Mann, Independent Director

Lindsay Mann has over 40 years' experience in the financial services sector. Mr. Mann has held numerous senior executive positions across the funds management, wealth management and life insurance industries. Positions held include Chairman of Premium Investors Pty Limited, CEO and Regional Head of Asia for First State Investments and CEO of AXA Investment Managers in Hong Kong.

Investment Manager

WAM is managed by Wilson Asset Management (International) Pty Limited. The portfolio is managed by the experienced Wilson Asset Management investment team, which currently works across all four existing Wilson Asset Management LICs (WLE, WAM, WAX and WAA). The team has demonstrated long term outperformance compared to the market.

Investment Team**Geoff Wilson, Chairman & Portfolio Manager**

Geoff Wilson has over 36 years' direct experience in investment markets having held a variety of senior investment roles in Australia, the UK and the US. Geoff founded Wilson Asset Management in 1997. He created Australia's first listed philanthropic wealth creation vehicles, Future Generation Investment Company (FGX) and Future Generation Global Investment Company (FGG). Geoff is Chairman of WAM, WLE, WAX and WAA. He is also a Director of FGG, FGX, Australian Leaders Fund (ALF), Clime Capital (CAM), Global Value Fund (GVF), Century Australia (CYA), Incubator Capital Limited and a number of other organisations.

Chris Stott, Chief Investment Officer & Portfolio Manager

Chris Stott has more than 13 years' experience in the funds management industry. Chris joined Wilson Asset Management in 2006 after being employed with Challenger Financial Services Group in various research roles specialising in Australian equities. Chris is a Director of WLE, WAM, WAX and WAA.

Matthew Haupt, Portfolio Manager

Matthew Haupt joined Wilson Asset Management in 2011 and has focused on the research-driven Investment Process. Matthew has more than 10 years experience in the investment industry as both a portfolio manager and an analyst. He gained extensive large-cap experience in his previous role within Australian Executor Trustees (now part of IOOF).

Martin Hickson, Head of Trading

Martin Hickson has more than seven years' experience in the funds management industry. Martin joined Wilson Asset Management in 2010 after working with Challenger Financial Services Group in various roles within the funds management division.

Tobias Yao Senior, Equity Analyst

Tobias Yao has eight years' experience in the investment industry. Prior to joining Wilson Asset Management Tobias spent five years as an investment analyst at Pengana Capital and he previously worked in Ernst & Young's transaction advisory services division.

John Ayoub, Senior Equity Analyst

John Ayoub joined Wilson Asset Management in 2016. He has 10 years' industry experience, most recently working at Credit Suisse as a director in equity sales and trading. Prior to this, John worked as a research analyst and in corporate finance at Ord Minnett.

Oscar Oberg, Senior Equity Analyst

Oscar Oberg has more than 10 years' experience in financial markets. Before joining Wilson Asset Management, Oscar worked as a sell-side Analyst at CLSA and three years at Grant Thornton working in transaction advisory services.

PERFORMANCE ANALYTICS

WAM's portfolio (pre-tax NTA plus dividends) has outperformed the market (ASX All Ordinaries Accumulation Index) since inception to December, 2016.

WAM has generated alpha over the medium-term. While the portfolio has underperformed over the past year, it has delivered excess returns of 4.8%, 1.6% and 2.6% over 3, 5 and 10 year periods relative to the S&P/ASX All Ordinaries Accumulation Index. It has achieved this with lower volatility than the market and a beta well below 1.0.

Given the strong portfolio performance and active investor communication, the Investment Manager has been successful in building a significant premium into the share price. As long as the manager can maintain the strong performance, the shares are likely to continue to trade at a premium, although a significant rise in interest rates or a reduction in dividend in a sustained market downturn could see the premium come under pressure.

WAM Performance				
Total Returns % p.a.	1 Year	3 Years	5 Years	10 Years
Total Portfolio Return	10.2	11.6	13.2	7.1
S&P/All Ords. Accum. Index	11.7	6.8	11.6	4.5
Excess Return	-1.5	4.8	1.6	2.6

As at 31 December 2016

We have also compared WAM with other LICs that invest in mid and small-cap shares. Many of these LICs have not been in existence for long and therefore do not have long track records. However, as the following table shows, WAM compares very favourably with its peers and has delivered NTA returns at the top end of, or slightly better than, its peers.

Peer Group Portfolio (Pre-tax NTA plus dividends) Returns to 31 December 2016					
Returns %		1 Year	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)
Barrack St Investments	BST	-12.1	n.a.	n.a.	n.a.
Contango MicroCap	CTN	7.5	5.3	5.6	3.7
Glennon Small Companies Fund	GC1	0.4	n.a.	n.a.	n.a.
Mirrabooka Investments	MIR	3.4	9.2	14.5	8.2
WAM Active	WAA	10.2	7.2	8.4	n.a.
WAM Capital	WAM	10.2	11.6	13.2	7.1
WAM Research	WAX	12.1	12.7	17.7	7.1
Westoz Investment Company	WIC	23.5	-0.3	3.5	n.a.
S&P/All Ords. Accum. Index	XAOAI	11.7	6.8	11.6	4.5
Beta					
Barrack St Investments	BST	0.92	n.a.	n.a.	n.a.
Contango MicroCap	CTN	0.61	0.76	0.92	1.11
Glennon Small Companies Fund	GC1	0.65	n.a.	n.a.	n.a.
Mirrabooka Investments	MIR	0.79	0.77	0.81	0.87
WAM Active	WAA	0.38	0.34	0.35	n.a.
WAM Capital	WAM	0.37	0.40	0.42	0.58
WAM Research	WAX	0.30	0.35	0.44	0.62
Westoz Investment Company	WIC	0.44	0.59	0.79	n.a.
S&P/All Ords. Accum. Index	XAOAI	1.00	1.00	1.00	1.00
Volatility %					
Barrack St Investments	BST	14.00	n.a.	n.a.	n.a.
Contango MicroCap	CTN	13.90	13.70	16.30	21.3
Glennon Small Companies Fund	GC1	13.70	n.a.	n.a.	n.a.
Mirrabooka Investments	MIR	10.90	10.90	10.90	14.30
WAM Active	WAA	7.30	6.30	6.90	n.a.
WAM Capital	WAM	8.30	7.10	7.40	11.70
WAM Research	WAX	10.00	8.00	8.00	11.70
Westoz Investment Company	WIC	10.90	16.90	16.00	n.a.
S&P/All Ords. Accum. Index	XAOAI	12.20	12.30	11.80	14.60

FEE STRUCTURE

Management Fee (p.a)	1% plus GST of gross assets
Performance Fee	<p>20% (plus GST) of:</p> <ul style="list-style-type: none"> Where the level of the S&P / ASX All Ordinaries Index has increased over the period, the amount by which the value of the portfolio exceeds this increase; or Where the level of the S&P / ASX All Ordinaries Index has decreased over the period, the amount of the increase in the value of the portfolio. <p>No performance fee is payable in respect of any performance period where the value of the portfolio has decreased in value over that period.</p>

We have compared WAM's fee structure to other LICs that invest in mid and small-cap ASX-listed stocks.

The below peer group includes LICs that are actively managed although we note that some portfolios are more actively managed than others.

From a base fee perspective, WAM is broadly in line with other externally managed LICs, although is much higher than the internally managed Mirrabooka Investments (MIR).

The performance fee is also in line with most of its internally managed peers, apart from Contango MicroCap (CTN), which does not have a performance fee. MIR, being internally managed, also has no performance fee.

We also point out that there is no high watermark for the performance fee which means that, although the manager does not receive a performance fee for negative returns, there is no mechanism to recover underperformance in a positive return market. This is a negative feature of the fee structure.

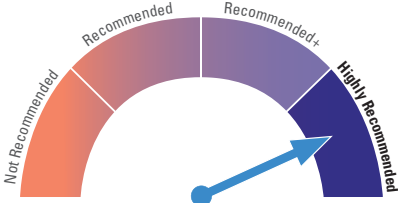


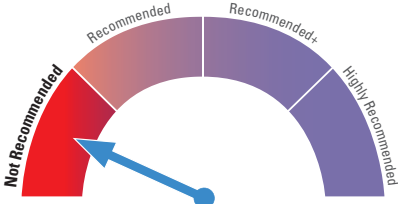
We view the performance fee hurdle to be appropriate given the investment strategy.

LIC	ASX Code	Management Fee (% pa)	Performance Fee (%)	Performance Fee Hurdle	Premium/Discount to pre-tax NTA 31/12/16
Barrack St Investments Ltd	BST	1.00	20.0	8% absolute	-14%
Contango Microcap	CTN	1.25	0.0	na	-5%
Glennon Small Cap Fund	GC1	1.00	20.0	S&P / ASX Small Ordinaries Accum Index	-3%
Mirrabooka Investments	MIR	0.65	0.0	na	+26%
WAM Active	WAA	1.00	20.0	Last Year high	+7%
WAM Capital Limited	WAM	1.00	20.0	S&P / ASX All Ordinaries Accum Index	+21%
WAM Research	WAX	1.00	20.0	S&P / ASX All Ordinaries Accum Index	+21%
Westoz Investment Company	WIC	1.00	20.0	10% absolute	-9%
8IP Emerging Companies	8EC	1.25	20.0	RBA Cash Rate +2%	-10%

APPENDIX – RATINGS PROCESS

Independent Investment Research Pty Ltd “IIR” rating system.

IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

LMI Ratings	SCORE
Highly Recommended 	83 and above This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.
Recommended + 	79–82 This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.
Recommended 	60–78 This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.
Not Recommended 	<60 This rating indicates that IIR believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation criteria. The product provides some unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off and should generate risk adjusted returns in line with stated investment objectives. However, concerns over one or more features mean that it may not be suitable for most investors.

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