The Australian Investor’s Podcast Episode Transcript

Episode: Geoff Wilson: Life, LICs, franking credits and how Wilson Asset Management (WAM) was built
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Speakers: Owen Rask & Geoff Wilson
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Episode transcript:

Owen:

Geoff, thanks for taking some time to join me on the podcast.

Geoff:

Hey, good to be here Owen. And please excuse my surroundings. I'm in a hotel room, I just arrived in Hobart. I'm down for the San Hearts and Minds Investment Conference, which is on in a couple of days time.

Owen:

Well, you look very sharp in your suit, mate. I must admit I'm underdressed as per usual, but no, it's my pleasure to have you on the show. We're going to talk about your journey. We're going to talk about the business, we're going to talk about franking credits, we're going to talk about, I guess even just licks and the structure and of the industry outcomes and all that sort of stuff.

But maybe just to kick things off, I'll start with a few quick fire questions and icebreakers, if you like. And this first question, I have no idea where this is going to go. So I am genuinely curious. Who is the investor that has taught you the most?

Geoff:

Probably the person who would've been also the best and probably a bit of an entrepreneur, Cyrian Potter that set up Potter Planners. And I worked for Potter Partners at one stage. But in terms of how he's developed various businesses and in his heyday, he was a very dynamic, probably entrepreneur in the investment space In terms of investing. The passion would've come from my father, even though he was a doctor but he loved investing and that was bit from his father.

And then probably my first two bosses at Scottish [inaudible 00:02:38] 1980 started at Scottish [inaudible 00:02:41] young, 21, 22 year old. Didn't know very much about the market or investing or the logic behind it. And my then boss, Chris Walker and Don Brinkworth. They really gave me a lot of the passion about going out, seeing companies, doing the research, company visits, picking up information, just how important that was. Looking at medium and small size companies. And they were focused on industrial companies and that's sort of an area that I'm quite passionate about.

Owen:

It's always fascinating to hear that I should ask that question as what was your first job out of uni or school? Because it's often [inaudible 00:03:22] that have the most profound impact. But we'll get to your story in just a minute and the origin story of Wilson. But this next investment you could have a financial answer for this, you could have maybe it's something to do with your personal life, whatever. What's been your best investment?

Geoff:

Best investment? Probably marrying my wife.

Owen:

Good answer.

Geoff:

In terms of, well, in terms of her mentoring or advice or guidance, giving me my daughter or our daughter, which is exceptional. In terms of from a financial perspective, the probably investing or I became a stock broker. And sorry, I was a stock broker and I actually got a licence. I became a member of the stock exchange. And when I became a member of the stock exchange they'd previously tried to demoralise it and pay everyone back the $25,000 they put in.

And I sort of liked the idea of being a part owner of that business. So I became a member and then paid my $25,000 and ended up getting, when it demutualized, 166,000 ASX shares, which I knew this question was coming. So I did the calculations worth $11.2 million. Now, unfortunately, the 25,000 unfortunately I sold quite a while ago. So it was a very good investment.

Owen:

That's fantastic. Wow, okay. I didn't expect you to say that. Both of those answers are superb and I can appreciate why you said both of them. The final one, man, maybe this relates to that second answer there, Geoff, is what's been your hardest investment lesson learned?

Geoff:

Well, losing money is incredibly painful. And any company that you buy shares and it goes down, you feel that pain. It's probably, I remember when I was set up Wilson Asset Management 25 years ago, managing money on behalf of shareholders, a lot of shareholders. And then I think probably a couple of years in one of the companies we owned and say a portfolio of 70 or 80 companies, but one of them went under. And that is incredibly painful.

And you question yourself. I suppose another big frustration, and this wasn't necessarily in this company, but it's when you go and meet management and these are disappointments and when they lie to you. And you only find that out in retrospect and it's only natural standard deviation. There's some people at five times at either end of the bell curve. Now say some exceptionally good people and some exceptionally bad people in any industry. So it's both pain, both areas of pain.

Owen:

Well, I guess you've been doing it long enough, right? I'm sure we say risk is part and parcel of investing. So you bound to have some war stories over the years and I really appreciate you sharing that. I realise coming into this conversation, I've followed Wilson for so many years. I think I can remember seeing a photo of you in the AFR back when I was just starting investing and I started to read everything from there. But I still don't know exactly how the business came into formation. What's the origin story there, Geoff? Why and how and when? I have so many questions.

Geoff:

So we got to go back about 25 odd years. A little bit before that I was trying to work out what am I going to do with my life. I started off in the funds management area and then I'd gone into breaking as an analyst and then on you worked overseas. Then also was back in Australia at a senior level running institutional sales. And the question, I had a client, Tim Hughes, he managed money for Reg Grundy at G Capital, he had a big pool of capital and he said, "Look Geoff," at a lunch, he was saying, "what do you really want to do?" And I said, "I'd probably like to manage some money." And around that time I got, I'm 64 now, getting close to 65 and this was when I was 39, 40. I had a young daughter who was four years of age and was going to work at 6:37 in the morning and just thought, "There's something wrong with this. I should be able to have breakfast with my wife and daughter."

So that sort of led me to think, "What can I do that gives me stimulation that's exciting that I'm passionate about?" And talking to Tim about it, I sort of said what I was doing was the fur line mouse trap and I was making a lot of money but it was killing me. And he said, "What do you really like doing?" And I said, "Look, I'd love to manage the money." He said, "Look, we're happy to give you some money to manage." And that was of the start of the business. And then I put in all the money I had, which was half a million dollars into a fund and they matched me and they ended up putting some more money over the next sort of six months.

And really the whole idea was to be as perceived as an institution because as an individual investor I could have sat at home and managed the money by myself. You just don't get those accesses. Access to company, access to information. A lot of the free money with IPOs, placements, blocks of stock at a discount. So I thought, "Okay, I'll call myself an institution." And that was of the start of Wilson Asset Manager. Started with a million dollars of assets back on the first January '98.

Owen:

So this was the inception of the WAM Capital, is that correct or was...

Geoff:

No, it started off with a trust structure and it's Wilson Asset Management Equity Fund. And really had to prove that even though I manage money back in the early 80s, I was sort of a trainee or in funds management, I hadn't managed money publicly before. So it was really the track record of that over 18 months. 18 months into it then we went and floated WAM Capital, which is the listed investment company. So we still have the Wilson Asset Management Equity Trust, we really haven't marketed it for probably 22 or 23 years. We manage some money in their pro bono, we manage some money for the fit gen entities and we manage some money pro bono for the Australian Olympic Committee as well. I think we've got about another 20 original investors that are in there.

Owen:

So one of the questions that I got coming through from social media, Geoff, and a lot of the things that I think about too is the difference, obviously, between trust structures, managed fund structures and listed investment companies. Why did you decide to go with WAM Capital as a listed investment company?

Geoff:

And pretty much the bulk of the money, we manage the $5 billion on behalf of you, 130 odd thousand shareholders. The bulk of that is in the listed investment company structure. And even though our initial fund wasn't that structure and the plan, we will have other funds that won't have that structure, will be more of the trust structure. But one of the things I loved about the listed investment company structure is I saw a bit of research, this is Morgan Stanley, probably 35 years ago. It was U.S. research and it showed how the listed investment company structure or over there it's called the closed in fund structure. It's a closed in pool of capital. So whatever money's in there sort of stays in there. So the investment manager can buy or sell shares, never worrying about people taking money out or putting more money in.

And it showed that over a 50 year period it really outperformed an open-end pool of capital that's sort of the trust or the managed fund structure by two to two and a half percent per annum. Now, that was phenomenal out performance. And I thought, "Geez, so we can create a listed investment company that can trade on the stock market. The structure gives it real advantages where you're just managing that money and you can take a medium long term view and you're never a forced buyer at the top of the market or a forced seller at the bottom of the market."

And one of the problems with the market is I think the average investor gets about half the market returned because they tend to be a buyer at the top of the market, seller at the bottom of the market. So during the GFC, everyone wants cash. So all the money's flowing out of those managed funds. And they might buy and sell the shares in the listed investment companies, but you're not, as a manager, you're not losing any money. So it gives you a real competitive advantage.

And then the other thing which people say as I witness for listed investment companies, to me I think it's like the holy grail, one of the big positives for listed investment companies. Is you can have a dollar of assets and it can trade at a dollar 10 or it can trade at 90 cents. So if you do a bit more of research, then you can get a hundred dollars of exposure to the market, you can only pay $80 for it or $90 for it. So to me it was nearly too good to be true. You can have a structure that's gives you some real advantages, plus you can buy that below what the value of the assets are worth.

So that's pretty much why we went in that direction. And initially the idea was to have the trust for our wholesale investors and have the listed investment company for our retail investors. But then as it grew, we just continued to focus on growing the listed investment companies. And we will add trusts along the way when it makes sense, I think.

Owen:

Would you be surprised if I told you the median holding period of a fund manager is about 7.4 months?

Geoff:

In terms of how long they own shares?

Owen:

Yeah.

Geoff:

It wouldn't surprise me. It wouldn't surprise me at all. And of course it'll be... Well, in theory they're trying to make money, they're trying to outperform everyone else. So there's obviously a decent amount of performance pressure. And depends on your strategy. So with WAM Capital, our largest listed investment company, half of the money in that is trading and we would turn over the portfolio four times a year. And the other half of the portfolio is of undervalued growth companies and we are going to only buy them when we can see a catalyst that's going to change the valuation. And the holding period there can be years sometimes if they continue to deliver.

Owen:

And the reason why I mentioned that is I think that the open-ended structure of managed funds, and we'll talk about ETFs in just a second. I see that from the outside, not someone who manages money as a significant limitation if you do have a long term focus because you're trying to massage the portfolio to try and get it right for the investors. And we expect long term returns, but we measure monthly returns.

Geoff:

Its crazy. For me what you're saying is a hundred percent correct. It's completely crazy.

Owen:

How about then, Geoff, obviously ETFs use that trust structure open ended. How have you, I guess, seen the rise of ETFs playing or impacting listed investment companies and I guess how do you see that going forward?

Geoff:

I actually see it very positive for the listed investment companies. First of all, you got to remember the people that manage listed investment companies, particularly like the Ethics and the Argos, they've been around for close to a hundred years and the first listed investment company in the UK, I think it was 1868 foreign colonial. So the whole structure's been around for a long time and it'll stay and it'll continue to grow it. It's right. The index funds go back 10, 20 years ago, index funds with the Ray and then now it's ETFs.

And I understand the ETF has a position in the market just like listed investment companies. If you want exposure to an index or to a group of companies and you want to get in at the value of the assets and get out of the value of the assets, then an ETF's fantastic. A fantastic way of getting cheap exposure. Now, on the listed investment companies like in Australia, say Ethic and Argo are the two biggest. Their management fees are probably well and truly less than a number of the majority of ETFs. So you're getting an active manager cheaper than ETF. The positive in the negative you got there is they can trade a premiums and they can trade at discounts.

And at the moment the three largest LICs, Australian LICs is Ethic, Argo, and WAM capital and they're all trading at 10% plus premiums. So you wouldn't want to buy them, at the moment you're more likely be a seller at the moment and you buy them when they're at a discount. But ETFs have a position and I actually think it's good actually for the listed investment company space. It's nearly the sort of maybe ETFs are sort grade one in terms of learning of investing.

In my day you'd buy a share, but you're taking enormous amount of risk buying a share because you're putting all your assets in a one company. There's no diversification there. An ETF at least it gives you exposure to the market, very diverse. And then if want, I think if you want to progress, say from junior to senior school, then you start doing research on listed investment companies and work out why they trade at premium and discounts.

So you're getting exposure to the market at a good price and then you can get a leverage position if you buying at a discount, the market goes up and then the discount goes from where it was to traded premium or even at NTA. So to me it's by doing a bit more research and then the next phase would be buying individual stocks if you want to go that logic.

Owen:

I tend to follow a similar train of thought and we see that in our community, a lot of our newer investors start with ETFs, makes a lot of sense by the basket and then explore from there. Is something which I want to talk to briefly and we've got a lot to talk about. So I just want to touch on these quickly because there was an email thread and I think it's a shout out to Mark Tobin who's now at Coffee Microcaps. He put me on an email chain many years ago when I was at the Motley Full, when the future gen products were launching. And I thought it's worthwhile just paying a bit of time just to talk to you about why you decided to launch these products, what they are and I guess you felt the need to do them?

Geoff:

And good on Mark. You disclosed interest at the start, Mark did work with us. So that's the disclosure of that interest. Well, I suppose when I set up Wilson Asset Management, the whole idea was to have a pool of capital and to effectively make a difference for those people that had the money in that pool of capital. So it was really going to make a difference. And as the business has grown, we can sort make a difference and give back to the society we operate in and the community we operate in.

And I probably, when was it, 7, 8, 9 years ago I was in the UK and I saw a gentleman who set up, it was called the Battle against Cancer Investment Trust, Tom Henderson. And I think he's the great grandson of the gentleman who set up Henderson Asset Management or he's in the line there somewhere. He was a previous hedge fund manager and the structure was just a fantastic structure where he'd got a whole lot of fund managers and said, "Look, manage the money in your main funds for free and then allow, because you're managing it for free then I'll direct, say, 1% of the assets to..."

His focus was the Institute of Cancer Research and then about another 16 odd charities. And I just thought what a fantastic structure. So I came back to Australia and it just took a little bit of time thinking I'd love to do it in Australia. And we're able to create the two future generation investment companies and we've got the smartest boutique fund managers there. FGX is the Australian Listed Investment Company, it invests in Australian equities and FGG invests in global equities. And we've got the smartest fund managers managing the Australian boutique guys, managing the Australian money and then the global guys managing the global money.

So it's just to me take my hat off to all the fund managers. They're doing this pro bono and they like it because it's an opportunity for them to give back. And the great thing is, so 10 to $11 million a year goes to support our children at risk in Australia and youth mental health in Australia. So from those two entities and I think we've given so far about now 65 million. So it's been great. And in terms of personally, I remember I think it was our 20 year anniversary, I was giving a speech and I was saying that it actually does give me a lot of... I was one of six kids and so I was the third child. Where does the third child sit? I always try to get mom and dad's approval probably but I did take a lot of solace from being able to set up those entities and what I can give back to Australia.

Owen:

I just think there are plenty of people in your circumstance, Geoff, that wouldn't have done it. So that's why I wanted to call it out because even at the time I thought it was a fantastic initiative and credit to you. We just had a look, we're recording this on video and we just had a look at the website there and could see some of the names that you brought together to do that. I think that's a credit to you for giving that a crack and doing what you've done. And I think when I talk, I often talk to some investors and people who know me personally and they say, "Well, when I pass away I want to create a charitable trust or something like this where it can continually give money to charities or community groups and that sort of stuff."

And to be able to do that in a sustainable way is actually very difficult. Whereas this seems to be the happiest medium between everything. So I just think it's a great initiative and hopefully we see more of it.

Geoff:

And there has been more. There's the HM ones, Hearts and Minds, they've created one so now they're giving away nearly as much as we do on an annual basis. And there's room for more if anyone wants. To me there's room for a property one, I'm happy to help someone. I don't want to drive it. We've got the global one under the Australian one, but there's room for a fixed interest equivalent or a property one.

Owen:

Absolutely. This was just a natural segue to the next thing I wanted to talk to you about, which is the way you think about intergenerational wealth transfer and giving, but not also the financial aspect of giving but also how you prepare, whether it's family and whether you've seen this with your shareholders or your team, how people can prepare their children or their nieces and nephews, their grandchildren to be, I guess, worthy with the money but also just even learn about investing. I think that's just a really important part of it, the education. So how have you approached that challenge because a lot of families find that very difficult?

Geoff:

And it is difficult. I think it has to be via conversations. Well, I know my situation was more curiosity. I saw my father at night after he'd come home from work and have dinner, sit down and read the paper and look down at the list of a whole lot of numbers on a page. And I remember asking him, what are all those numbers? And he said, "That's the stock market." And I thought, "That's a weird concept." And then I looked down and there was a company trading at 1 cent and I thought, "Oh I could afford that." It ended up going under, it was Cox Brothers, it was a Melbourne retailer.

But anyway, no I think it has to be by conversation. And also I'm a big believer, you asked me one of the early questions was who was instrumental in shaping what my view was from an investment perspective. Now, I've always been very curious. And when there's an opportunity presents itself to me try to talk to people that have succeeded and have experience. I don't see it necessarily as having a mentor. That's great. I know it's very modern to talk about that. I don't think I ever had a mentor, but there's people that I respected and looked up to and tried to understand why they did various things.

And I remember a long time ago, David Clark, who was the chairman of Macquarie Bank, very successful since the early days of Hill Samuel. I was fortunate enough to meet him a few times and then I said, "Look, let's have lunch." And we talked about that and about 30 odd years ago, again there was this young lawyer that had done quite a bit, Malcolm Turnbull. I remember when he had listed company and when I was breaking, we were sort of associated with that a little bit. And so I said, "Look, now Malcolm, can we have lunch." Just to understand how his mind ticks.

And then when I became a member of the stock exchange, then I rang up Morris Newman who was then chairman and he probably thought, "Who is this guy out of the blue?" I said, "Look, I've just become a member," he's chairman of the ASX, "I'd like to have lunch with you." And to me it's just trying to understand, understand their journeys. I know from a work perspective at Wilson Asset Management we try to get the smart people involved with the organisation to give people exposures and experiences. We've got someone at the moment who's first class, Dr. Gemma King. She did a lot of work with the defence forces. There's a resilience, things like that.

Old Ben Crow who was [inaudible 00:29:15] coach. And I think did the original football team. Again, just saw a write up in the Fin Review of both those and know met through in the pot at work and we got in contact with them and they came in and done some work with us. And Adam Goods, we are support of the Go Foundation. And to me Adam's got incredible wisdom and to me it's just trying to get more as many exposures to people and trying to find ways to get those exposures.

No, I don't think there's any necessarily secret formula. In terms of investing in what to do with money, it's trying to have as many of the conversations. And some people are interested in it and passionate about it and some aren't. If there's asset there and they aren't, well they can keep them in cash, but if they want to take some risk then they've got to work out do they do it themselves or do they give it to someone else to try to help them?

Owen:

I think one of the reasons that our podcasts have been so successful, Geoff, is because sometimes in our culture when it comes to learning about money and investing, it's almost a taboo subject. You don't talk about how much you earn, how much money you have, all these types of things. And to the point, like yours point earlier on where you talked about the demutualization and the ASX shares and all that, a lot of people don't talk about the numbers because for one reason or another we are almost, it's ingrained in our culture not to talk about that.

And I find that, that's a really big problem, not just because we should be talking about but because it's also very important. So it's not like we're talking about fast cars or something like that. We're talking about money and I find that the families that have conversations around the dinner table about money, the children are oftentimes much more inclined to embrace the idea of investing and feel it's a positive thing rather than a thing to be feared. If that makes sense.

Geoff:

Yeah, no, no, no, that's very fair point. It is one of the frustrations with our schooling system. Is probably some most important things is your financial wellbeing or your health, but we're not really taught much about either at school.

Owen:

I can tell you I've never used that much trigonometry since I left my specialist maths class. But it's great for me because in our business we have 110,000 people to listen to the podcast, Geoff. So for me it's great because people that don't feel they have the confidence to go and talk about investing or money can come and listen to the podcast and hear conversations like this. But you mentioned your team there and since I've been following the Wilson story, you've built out that team, you've got some incredible people in the business.

The way you think about bringing people into the team, is there set structure or things that you have done, strategies that you have honed over the years to I guess increase the chance of success? Because whether you're a big company, a small company, a corporate, this is the challenge, not just now because there's low unemployment, but in general. This is the number one frustration.

Geoff:

I think the first thing you need is to have a values match with the individual. And so, what we do is we've been doing this for probably 20 odd years. Luckily, so 20 years ago there was a gentleman, Alex Baher, who did a lot of work with us on our own values and why do we exist and what drives us and why are we passionate about what we're trying to do? And then you realise and if you come an interview with us, then you'll be asked out of like 150 words, pick 10 of your personal values, 10 of your current work values and 10 of your desired work values.

And then we've done it as an organisation so we know what our values are. And then initially it's working out whether your values and our values match. And people the at various stages the values trying we look at or is very similar to Maslow's hierarchy of needs and it goes from the very basic but then to the most advanced. And so to me values is incredibly important. And then from my perspective it's the sort the quality of the individual. And you need to try to make an assessment in an interview or in a group of interviews, about the quality of the individual because, well, I suppose if we go back to the start of Wilson Asset Management we were talking about before was myself and I thought I'd just be a sole operator running a small pool of capital.

And then about four months in, another thing I wanted to do was write a book. I had my sort of write a book, go on a couple of boards, have a little pool of capital to manage. And in terms of writing a book, I was talking to Matthew Kidman who was in at the Sydney business editor at Sydney Mon Herald and said to Matthew, "Hey look, do you want to ghost write a book or we write it together?" He said, "Let's write it together." So I was working with him and then he said he's had enough of being a journalist, he wanted to get into the investment game.

So I sort of told him a few people to speak to. Then when he was close to getting a job, I thought, "Oh geez, I'm writing a book with him. I want him to come and work with me." But in terms of with Matthew, even though he hadn't invested before professionally, he was a good high quality individual. And to me, it's probably a little bit like maybe it's not investing or buying horses. With horses, it's the bloodlines they look at. But to me, from my perspective, it's the quality. If you've got a high quality individual, they mightn't have the skill set that point in time but if they're passionate about what they do, then they will get that skill set. And probably the third thing is it's values, it's quality of individual. And the third thing is passion. Now, they really need to have a passion about investing.

Owen:

Well, like you said, for you it was curiosity. One of the very first person who came on this series many years ago said, and is Wayne Peters from the former fund, Peters McGregor. He said the thing that keeps you getting back up on the horse is curiosity. It's just being curious about the world. And I think that rings true with all of the great investors I've spoken to on the show.

Geoff:

That's the great thing about investing, that's the great thing about investing, isn't it? Because it's so dynamic and you got to be passionate. And because it changes so much you've got to be curious and because it's so humbling. You think you've worked it out and bang [inaudible 00:37:01].

Owen:

Yeah, that's true. I guess that's the thing to finish first, you first got to finish. And getting to that finish line is quite difficult a lot of the time because we do follow that humility curve. We tend to think we've got it and then all of a sudden the market or some extraneous variable comes out of nowhere and we're humbled yet again.

Geoff:

Definitely.

Owen:

One of the things that I really wanted to talk to you about and I know that you are keen to talk about as well is basically what's transpired with the franking credit system and in particular otherwise known as imputation. And maybe just to set the scene, Geoff, can you give us kind of like the 101 on franking credit system. I assume everyone listening to this knows, but just in case I figure we may as well catch them up. And maybe what we can do as part of that framing is what was proposed at the last election versus now?

Geoff:

And why don't we go all the way back because...

Owen:

Okay, sure.

Geoff:

... [inaudible 00:38:03] and Bob Hawk bought in a system. And in the old days a company would make money. It would, say, a company would earn $100 million. It would pay tax, say, $30 million a corporate tax rate for large companies at the moment. So it would pay 30 million tax and it'd have 70 million left. Then say if it paid out $35 million of that $70 million and kept the other 35 million and invested in the business. Well that 35 million it paid out as a dividend, in the old days you get that in your pocket and then you'd pay your amount of tax. If you're on a 30% tax rate then you lose another 30%. Or if you're on a 48% tax rate you lose another nearly half of that money. But what Keating said is that's being double taxed.

So he said I'll remove the double taxation and they called in Australia they called it dividend imputation. They did a similar thing in the UK back in 1977, I just can't remember the acronym was ACT or something corporate tax, could have been associated corporate tax or something like that. So that was the idea and that was the principle. And with companies, when companies look to expand they've got a choice. They can either borrow money and the interest is tax deductible or they can raise equity.

And what the dividend imputation system did, first of all with Australian companies, it encouraged Australian companies to invest in Australia, to employ Australians, to pay tax in Australia and pay fully frank dividends to the shareholders in Australia because that supported their share prices and actually made equity cheaper than debt. So Australian companies don't have anywhere near as much debt as European or U.S. or other global companies. And that's why we did so well during the GFC and that's why we'll do... There's got to be a recession globally in the next period. We could already be in one. So that that'll really help Australia now.

So to me what a fantastic system. Now, there's arguments, "Oh, look. It favours the old people. They get these free kicks. What about us the young people, we don't?" Hey, anyone who's got money in superannuation benefits from the dividend invitation system as they've got you investments. Anyone who is employed by an Australian company. In theory it's invest in Australia and support Australia. That's what dividend imputation does.

And the reason we were very active in 2018 and 2019 because then Labour that was in opposition and they were expected to win that election quite easily. They came out with a policy which was just so unfair where you could have four people that were the same age and had the same amount of money and depending on if they had the money in their self-managed super fund, they lose the franking. If they had their money in an industry fund, they get the franking. If one of them went on the pension before the 28th of March, 2018, they got the franking. If you were born a week later and went on the pension a week later you lost the franking. It was just such an illogical system.

I agree with what philosophically people are talking about. People shouldn't be rotting the system. Let's have a progressive tax system that treats everyone's fairly like our income tax system. I know there's a lot of talk about people that have got a hundred million in super and another person's got 400 million in super. If they're getting a disproportionate benefit... I think Dick Smith said after the last election, he got now half a million dollar franking credit refund. They shouldn't get that. Now, I agree with that logic but do it logically and unfairly and don't destroy.

It's sort of like the goose that's been laying the golden egg for Australia. Why haven't we had a recession for the last 30 years? And part of it is to do with dividend imputation, those fully frank dividends. Now, what's happened at the moment? A month before the budget, the government came out and said, "Look, what we're going to do is we're going to stop..." And this was a treasury proposition and to me the disappointing part is the government, when they're in opposition, they said, both Charmers and Albanese, said that they're not going to change the franking system or dividend imputation system.

Now they're in office for a short period of time and they're starting to change it. So it is a broken promise, which is disappointing. To me if you wanted to change it, just don't promise you're not going to change it and get elected on that because I think that's one of the reasons they didn't get elected in 2008.

Now what the proposal is, is that if a company pays a fully frank dividend and either before they pay a fully frank dividend or after they pay a fully frank dividend, they raise any capital. And if a dollar of that capital can be associated with that fully frank dividend and it could be like a $3 billion fully frank dividend, if a dollar of capital is associated with that, then that dividend is not franked. So what it means, and then there was something in the budget. And that the one in the budget doesn't worry me as much but what both of them doing are weakening the system potentially.

And what that first one means is if you are a company and I talked about that company example before that made $100 million. And you only paid out 35 million and kept the other $35 million and invested in your business, maybe expanded made a takeover. You can never pay that other 35 million out without going borrowing money, you can't raise capital and pay that out. So what effectively it does, it traps half the franking. And there's 430 billion that's already been trapped and it looks like about 30 billion a year will be trapped.

And what concerns me more is this system is great for Australia. Australians investing in Australia, employing Australians paying tax in Australia. Is this agenda is not been run by the Labour government, it's been run by the Treasury Department, which doesn't want to pay a cent out. And Paul Keating has warned us for years, "Be aware of treasury." He says every seven years they come after franking, and that's only taken them three and a half years to come after it this time. And what happens is, I talked a very early on about the UK system. The UK system got abandoned in 1999 and why is because they took parts of it off and then eventually they say, "Oh look it's not working properly."

So to me what worries me is it's a great system, keep it in place, don't change it, don't take parts off because what could happen now if they legislate this and with a bit of luck, it'll be blocked in the Senate and we'll work as hard as we can to make sure it is blocked in the Senate. Is you'll have a situation in a year or two's time, Labour will say, "Well, actually it only gives half the benefit it really did before and it really doesn't work as it did before. Hey look, let's get rid of it."

And to me it's sort of that slippery slope and to me we just don't want to go in that direction. That's why I'm sort of very passionate about it. In terms of inequality, in terms of repairing the budget, I understand that has to happen. In terms of inequality, people getting big returns, they shouldn't get them. So bring in a system that's fair and equitable. If Labour had proposed a fair and equitable system back in 2018, then they would've been in power in 2019, wouldn't they? The problem is it's back then it wasn't fair and equitable. And what they're doing now is to me they're potentially dismantling the franking system, which works so well for Australia.

Owen:

So Geoff, in your opinion, you said progressive earlier in that answer, what do you mean? How would that take shape? What would that look like?

Geoff:

Effectively and again, it's piece meal. Effectively you've got to take a step back and say, "Look, what are we trying to achieve?" Do we want a system mean effectively, which Paul Keating and Bob Hawk came up with. "Do we want a system that removes double taxation and encourages Australian companies to invest in Australia, employ Australians, etc?" And then, "Okay, that's where the dividend invitations system turned up." So to me it's more in terms of me saying, "Well look, you should cap this or this." To me that's all piecemeal.

You really need to take a step back and say, "Look, okay, we've got to repair the budget and various things aren't sustainable. So how are we going to restructure things that are fair and equitable to everyone?" By just coming out and saying, oh look it is so... If I had hair, I'd be pulling my hair out. It is so frustrating with what the government, the Labour government's come out with. Back during the start of COVID, APRA that regulates the banks came out and said to the banks, "You can't pay a dividend." When we're all worried about things and then they came out and said you can pay a dividend, but they said you can only pay a dividend if you raise capital.

So like Westpac paid a $2.8 billion dividend and raised 2.5 billion at the same time. So if that legislation came in, then that would've been unfranked. And effectively what APRA is telling the banking system to do was raise capital to pay your dividends but if you raise a dollar of capital to pay a dividend, that's not franked. To me it's just so illogical, which frustrates me as you can see.

Owen:

Do you think there's a better way to manage than the capital raising issue?

Geoff:

To me they just shouldn't. They should leave that alone. To me it's the issue in the budget, the buybacks. Again to me it's just chipping away at the system. It's not a real breaker of the system. To me what they're doing is effectively what they're saying is the only way you can pay out... Well, they're saying you as an Australian company, you earn $100 million dollars, you pay $30 million tax, don't invest in Australia, don't invest in the business, pay that $70 million just to your shareholders because we're not going to let you raise any capital associated with paying out any of that dividend.

Or pay out 35 million as a fully franked dividend, the other 35 million invest in Australia, invest in the business but you're never going to be able to pay that out unless you borrow money. And companies that run, you're trying to maximise the return for the investors. So you won't want to all of a sudden gear up just to pay dividends. Then boards won't do that. So that unfortunately that franking will be lost forever.

Owen:

I'm just going to throw some things out, Geoff, and just you respond as you will. What would you say, so from an investment perspective, some investors they compare our market to these United States where you have these wonderful technology companies and we have wonderful technology companies too, but they're obviously mega companies, global names. What would you say to the argument that by overly encouraging our companies to pay dividends, that has an impact on innovation?

Geoff:

To me that's a pretty long bow because you think of, you cast your mind back to innovation in Australia and the pools of capital that would support innovation in Australia. Like a decade ago there was virtually no capital. And now the sector is, there's billions of dollars of capital to support Australian innovation. And to me it's more that leadership thing where you see Australians perform domestically and globally like the likes of Atlassian and companies like that. Then people realise there are smarts here and we'll invest in it. To me, whether it's frank dividends or not, to me I don't think it's much of an impact. But keep hitting me with the questions.

Owen:

It's interesting a lot of the stats that you had before. I spoke to Fidelity, I think it was Paul Taylor, exceptional fund manager going for a long time. And he said one of the three reasons that the Australian stock market has outperformed basically every stock market in the world is because of our ability to pay dividends. And that stable democracy with dividends being paid is actually a pillar of the stock markets return. And I'd, in preparation for this chat, Geoff, I pulled up the 10 year returns. So just 10 years, it's a decade, it's not that long in the scheme of things.

And I looked at the returns of the ASX 200 just in terms of the share price and capital gains up 5.1% per annum dividends. So total return 9.5% and if you adjusted for franking credits in a super fund, that's 10.15, so that 60 basis points for annum. To me probably isn't as big as I thought it would be to be honest. It kind of goes to show the dividends still the most powerful component.

Geoff:

Yeah, that's right. And the dividends that they're not a 100% franked because some companies do pay frank dividends and I remember years ago when there was a good debate about franking and we all put our submissions into treasury onto the government. And Fidelity put a very good submission in it as well. And they were basically saying, and I think we might have used some of the research they had used which showed that really companies that pay out, high dividend payers over time do better. And the logic behind there is if you've got exceptional management and you leave excess capital for that exceptional management, then they perform well.

The problem is not all management is exceptional and if you leave excess capital in with management, sometimes that excess capital gets squandered. It doesn't get invested that wisely. And I think a lot of studies have shown that companies with higher payout ratios over time outperform companies with lower payout ratios, which is interesting. And obviously there's all. While I'm saying that, I'm thinking well hold it. When you got a tech boom, those companies don't pay anything so they would be significantly outperforming. It depends, it's probably when you took the data, but broadly industrial companies like the boring industrial companies, to me you're better off giving the money to shareholders and let the shareholder decide how he wants to allocate the capital.

Owen:

How about... Sorry go ahead.

Geoff:

Then there's the Buffet argument. Well, "Hey, you shouldn't pay anything out. Just if you're good, just keep reinvesting in the business." And I suppose that's the thing, if the companies are exceptional then don't pay it out. Keep reinvesting in the business. But to me to get exceptional returns on equity, it's not every company. So unfortunately there's only a small number that can do that.

Owen:

I think one of the issues with the franking credits debate is that it's quite complicated from a policy perspective. A lot of people simply don't get it. They simply think money seems to be going to investors that could be used to pay for insert, climate change, hospitals. I feel like that's my personal opinion. I'll try and keep that out, that it's too simplistic. But how do you think about that, that we could repair the budget from franking credits?

Geoff:

I mean that's a 100% right and that's what Labour tried in 2018, 2019. But it actually failed because that's what they broadly said. The bizarre thing is they said "Look, it's good to have a diversified portfolio you invest globally. Don't invest in Australia. We're going to get rid of the franking. You're a self-managed super fund. We're going to force you to invest globally because we're going to take the franking away from you in Australia unless you're on a pension." So to me some of the comments are a bit crazy.

Owen:

How about then, Geoff, where, and you kind of touched on this before, another I guess point or perspective is that franking credits, and you mentioned inequality earlier on, franking credits tend to accrue to wealthy investors.

Geoff:

Well, it's more the wealthy investor and this is where, to me, this is part of the system. Don't stop the company from paying a fully franked dividend because I know the logic is it accrues to the wealthy investor. It actually accrues, a significant amount of it accrues to the mum and dad investors that have sort of worked all their life, now put enough money in this, say they're self-managed super fund. Haven't gone to the government for a pension and trying to work through their life. And it's actually the people that are paying less than a 30% tax. Now it's the low income earners because they get the money back.

If you are on a 48% tax rate and you get a fully franked dividend, you got to top up, you got to pay another 18%. So I personally don't like fully franked dividends, certainly not getting any myself because I just got to pay more tax. So to me it's really those people that have the big super funds that are getting those like Dick Smith, getting those franking credit refunds. And that's the bit of the puzzle that has to be solved. How you solve that is you don't take it away from everyone.

So when back in our '18 and '19, some of the stories that were sent into us, they would make you cry. In terms of people that have worked all their life, done the right thing. I remember this gentleman in Canberra, he was a senior trade union person, was retired, then drove trucks for a while, then had a back problem, was on a disability pension. Never went on the government pension. Saved up enough to [inaudible 00:58:58] Superfund. Broadly was living on the, I think, on whatever it was, 30 grand a year or was combination of dividends and franking.

And then the government, bang, was going to be his income was going to be chopped by 30, 35%. So to me it's sort of trying to find a way that doesn't destabilise everyone. That work on, as I was saying before, progressive. Focus on the people that are getting too much, like the tax system. Why can't there be a progressive situation where if you're getting a small amount of franking credits back and you're on a low income, then you get the full benefit. But don't stop the companies from paying it. Unfortunately back in 2019 they tried to stop the individuals from getting the franking. And now Labor's trying to stop the companies from paying the franking.

So to me they're trying to think they're smart, but unfortunately it's playing around with a system that has worked very well. Just take out those unfair excesses where now the people that shouldn't be getting the big returns, take them out. That's what they've got to do.

Owen:

Yeah, I really appreciate you taking some time to step us through that, Geoff, because there are so many perspective, we only just covered a few of them. But I know how valuable it is not just to investors, but even people in retail super funds and basically everyone in Australia would receive, every working person in Australia would receive a franking credit in one form or another.

Geoff:

If you're an 19 year old and you start working, then you benefit from the franking system because you got money in super. But also in terms of your employer or your employee.

Owen:

One of our most popular webpages of all time, Geoff, is franking credits calculator, just trying to help people figure out what they get. And our video on franking credit is also the second most popular of all time despite all of these conversations that I have, those are the most popular. I'll put a link in the show notes. You've done a few write ups, got an opinion piece in there. So I'll put a link to that as well to the Wilson site and all the funds there.

If you are listening to this or watching this and you want to learn more about how Geoff and his team invest, I think go to those monthly reports, get the commentary, I'll put the links in the show notes, mate. But I got one final question and I find this is a very difficult one but I also think that it brings up some great responses. So it's what's something that you believe about life, business, investing, what have you, whatever that few people would agree with you on?

Geoff:

Good question as always, Owen. I actually think it's probably anything is possible and I think a lot of people would say they agree with what I'm saying, but I don't think they are. My father probably instilled it, I think, in us as children that really anything you want to do is possible. To me, if everyone believed that was the case, then they'd be doing what they're passionate about. And I think there's a lot of people out there that probably unfortunately aren't doing what they're passionate about. So to me that's it. Anything is possible.

Owen:

I think people would agree with you in principle, but then think... Great response, Geoff. And again, I just want to say thanks. I know you're down in Tassie for the sign conference and I just appreciate you taking the time to join me on the show.

Geoff:

And Owen, if you think anything is possible, then it is.

Owen:

I like it. Thanks, Geoff.