## Understanding the FOR Distribution

*By Steve Johnson*

Last week we provided investors in the ASX-listed Forager Australian Shares Fund (FOR) an estimate of the coming distribution for the year ended 30 June 2018. The size - 22 cents per unit - caused some surprise and more than a few questions. Here are some answers to the common ones:

**Why is the distribution so large?**

We don't have any choice in the matter. FOR is a unit trust and, as such, must distribute all of its taxable income to unitholders every year. That includes dividends and interest received and capital gains realised. This past year we realised a lot of gains on stocks we have held for a number of years - Service Stream and Jumbo Interactive for example - so the distribution is larger than usual.

**What are the components of the distribution?**

That won't be known until 30 June. Indeed, the actual amount of the distribution won't be known until 30 June. It could change significantly if we realise any meaningful gains or losses before the end of the financial year.

Like previous years, however, the vast majority of the taxable distribution is likely to be discounted capital gains. The franked dividend component of the 22 cent estimate was roughly 1 cent per unit or approximately 5% of the total distribution.

**Why is the distribution different from the return?**

While the return in any given year is based on realised and unrealised gains, we only distribute realised profits. In some years there may be lots of unrealised gains, which would mean returns higher than what is distributed. In other years we might realise gains by selling stocks that have been held for many years. In this case the distribution could actually be higher than the return in a given year. This could be the case this financial year, as some of the stocks sold were held for many years and were representing significant unrealised gains prior to sale.

**What happens after the distribution is paid?**

The units will trade without an entitlement to the distribution on 28 June 2018 (the ex-date). Investors who purchase on or after that date will not be entitled to receive it. The underlying net asset value will fall by the amount of the distribution on the ex-date. For example, the current net asset value is $1.84 per unit. Were it to trade ex a 22-cent distribution tomorrow, the underlying net asset value would theoretically fall to $1.62 per unit.

The market price can be and usually is different from the underlying asset backing. FOR units have traded at a premium to the underlying value since listing. In an efficient rational market, however, you should expect the traded unit price to fall by roughly the amount of the distribution.

## Should I reinvest my distributions?

FOR has a distribution reinvestment plan (DRP) in place. If you choose to participate in the plan, you will be issued new units in FOR at the ex-distribution underlying net asset value (the underlying net asset backing after the distribution has been paid).

Those investors who want to grow their investment by reinvesting can do so, while those who would like to receive cash don't need to do anything. If you elected to participate in the plan last year, your election will remain in place unless you notify Link Market Services otherwise.

Historically some investors who want cash have still chosen the reinvestment option and then sold an equivalent number of shares on market. This strategy made sense last year because the new units were issued at net asset backing but could be sold on market at a premium to net asset backing.

If the units still trade at a premium close to 30 June you could also consider this option. However you should consider taxation implications, transaction costs and risks around insufficient liquidity or the units not trading at a premium when you try to sell on market.

## What should I expect in future years?

The investment strategy of the Fund is based on generating capital gains from investing in unloved and underappreciated stocks. While some of the underlying investments pay regular dividends, the yield on the portfolio is typically low. Most of the returns have historically come from capital gains and we expect that to be the case in future.

So the distributions are likely to be uneven and unpredictable and you should not rely on them as a regular source of income. It is conceivable that a year of significant market falls could mean no distribution.

FOR should be a component of the growth part of your portfolio and any distributions should be seen as a component of that growth.

***PLEASE NOTE: Past performance is not a reliable indicator of future performance. The Trust Co (RE Services) Limited, Fundhost Limited and Forager Funds Management do not guarantee investment performance or distributions, and the value of your investment may rise or fall.**

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