

# **F.M. Kirby Foundation, Inc.**

**Annual Report of the President to the  
Members of the F.M. Kirby Foundation, Inc.**

**April 28, 2017**

Please review the following information in conjunction with the enclosed 2016 F.M. Kirby Foundation, Inc. audit and Governance Letter as prepared by EisnerAmper, LLC and dated March 3, 2017. Consistent with the last few years, management made a decision, in concert with EisnerAmper, to continue the use of estimates, mainly for the Foundation's investments in limited partnerships. Throughout the audit and this report, certain figures may reference estimates made by management.

### **Executive Summary**

- Administrative expenses increased modestly from 2015 to \$974K.
- Investment management fees decreased in 2016 due to the termination of the investment with Mondrian Investment Partners (emerging markets equities) and lower asset values as a result of the Kirby Alliance.
- Federal excise tax increased, despite a decrease in the tax rate, due to realized gains resulting from the Kirby Alliance.
- Paid grants increased \$23.6M due to the first installment of the larger Kirby Alliance grant commitments. Paid core grants decreased by \$3.4M.
- Outstanding pledges increased \$24.0M due to the accrual of the second installment of the larger Kirby Alliance grant commitments.
- The investments (exclusive of the \$27M of cash for the Kirby Alliance reserved for distribution in January 2017) of the Foundation decreased \$47.8M, or 12.5%, during the year to \$335.6M on an absolute basis. On a time-weighted basis, the portfolio was up 6.3%.

## Administrative Expenses

Administrative expenses increased modestly from \$956K to \$974K. The main drivers of the slight increase in expenses were an increase in salaries of \$11K, or 1.7%, travel and conference expenses of \$4K, or 23.4%, and software maintenance and support of \$4K, or 13.9%. This increase in expenses was partially offset by a \$3K, or 6.5%, decrease in accounting and legal expenses.

A longer term view of the Foundation's administrative expenses as a percentage of total assets is shown below. The jump in 2008 is mostly a reflection of a significant drop in the Foundation's total asset value. As in 2016, it is expected that this percentage will continue to increase as the asset value decreases as a result of the Kirby Alliance and expenses continue to increase modestly.

**Administrative Expenses as a Percentage of Total Assets**



## Investment Management Fees

Investment management fees decreased in 2016 due to the termination of the investment

with Mondrian Investment Partners (emerging markets equities) and lower asset values as a result of the Kirby Alliance. The proceeds from the termination of Mondrian were invested in the JPMorgan Global Allocation Mutual Fund, which deducts fees from its net asset value, rather than billing the Foundation separately. Investment management fees paid to Mondrian in 2015 were \$251K. The remaining decrease was due to lower asset values as a result of the Kirby Alliance, which is detailed further below.

### **Federal Excise Taxes**

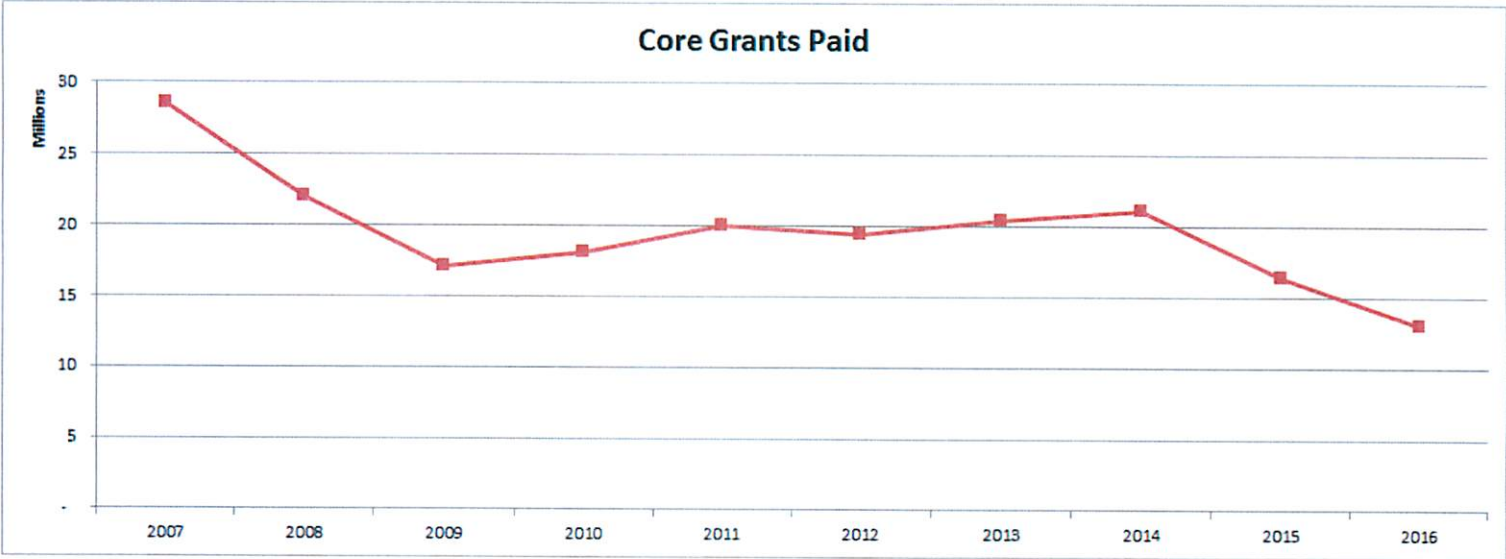
Federal excise tax increased, despite a decrease in the tax rate, due to realized gains resulting from the Kirby Alliance. The Foundation had net realized gains of \$7.0M. The liquidation of \$54 million from the portfolio to fund the first of the large Kirby Alliance grants resulted in significant incremental realized gains. The Foundation did not qualify for the 1% tax rate in 2015, but is projected to qualify for this rate in 2016 due to the acceleration of half of the aforementioned Kirby Alliance grants into December 2016.

### **Grants Paid and Promises to Give**

On an accrual basis, the Foundation's grants expense increased \$48.3M, or 268.8%, however, paid grants only increased \$23.6M, or 127.0%. When the Kirby Alliance grants are excluded, the paid core grants level decreased by \$3.4M, or 20.5%. The accrued grant expense level, when compared to paid grants, is higher due to an increase in the Foundation's promises to give. The Foundation increased promises to give by \$24.0M, or 621.8%, to \$27.9M as of December 31, 2016. The increase is due to new pledges of \$27.6M (Kirby Alliance – \$27.0M; Scheie Eye Institute – \$100K; Fuqua School of Business – \$333K; Greens Farms Academy – \$140K) that were partially offset by payments on pledges of \$3.5M (Kirby Alliance – \$2.25M; Gill St. Bernard's School – \$250K; Foundation for Morristown Medical Center – \$200K; Sarah P. Duke Gardens – \$333K; The Nature Conservancy/Adirondack Chapter & Adirondack Land

Trust – \$500K).

A longer term view of the Foundation’s annual core grants paid is shown in the graph below.



**Net Realized and Unrealized Gains/Losses on Investments**

The Foundation had net realized and unrealized gains on investments of \$13.7M in 2016 as compared to losses of \$19.9M in 2015 due to the realized gains, as noted above, and an increase in unrealized gains to \$37.4M. The increase in unrealized gains as compared to the prior year is due to the fact that the Foundation’s investment portfolio, on a time-weighted basis, had a rate of return of 6.1%. This compared to a rate of return of 6.7% for the Foundation’s blended 70/30 benchmark.

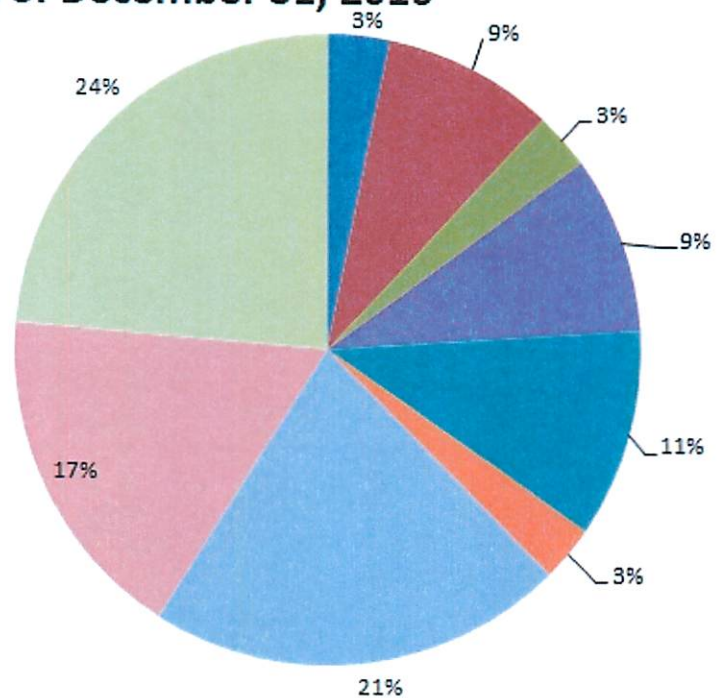
The investment portfolio is currently managed by Blackstone/GSO Partners (private lending fund for financially distressed companies), Eaton Vance Management (floating rate senior loan fund), JPMorgan Global Allocation Mutual Fund (global tactical asset allocation), Lazard Asset Management’s Emerging Markets Discounted Assets (emerging markets equities), Lazard Global Equity Select (value-oriented global equities), Oaktree Capital Management

(domestic convertible bonds), and Walter Scott & Partners (growth-oriented global equities). A portion of the Foundation's investment portfolio is also invested in the Vanguard Short-Term Bond ETF and the Energy Select Sector SPDR ETF.

Please see the pie chart below highlighting the current allocation of the Foundation's portfolio between the nine investment managers.

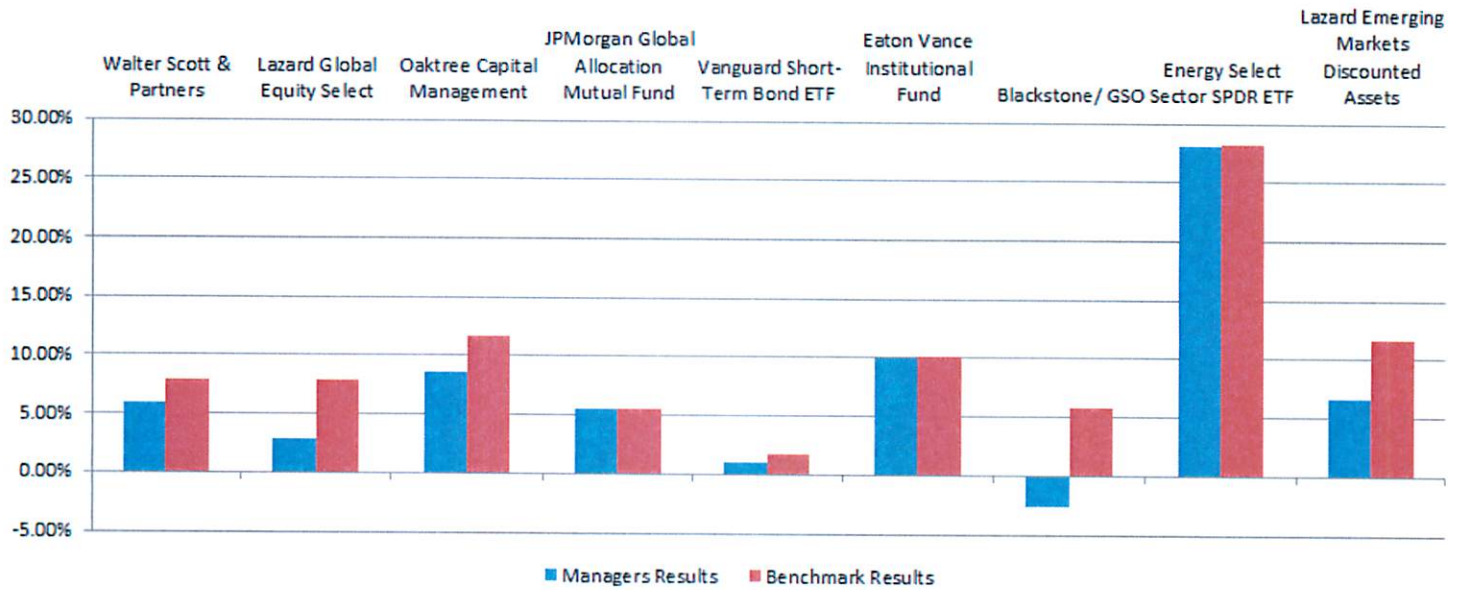
### Investment Portfolio as of December 31, 2016

- Blackstone/GSO (\$10.6M)
- Eaton Vance Institutional Loan Fund (\$29.5M)
- Energy Select Sector SPDR ETF (\$9.9M)
- Vanguard Short-Term Bond ETF (\$30.4M)
- JPMorgan Global Allocation Mutual Fund (\$35.9M)
- Lazard Emerging Markets Discounted Assets (\$9.5M)
- Lazard Global Equity Select (\$72.1M)
- Oaktree Capital Management (\$58.2M)
- Walter Scott & Partners (\$79.5M)

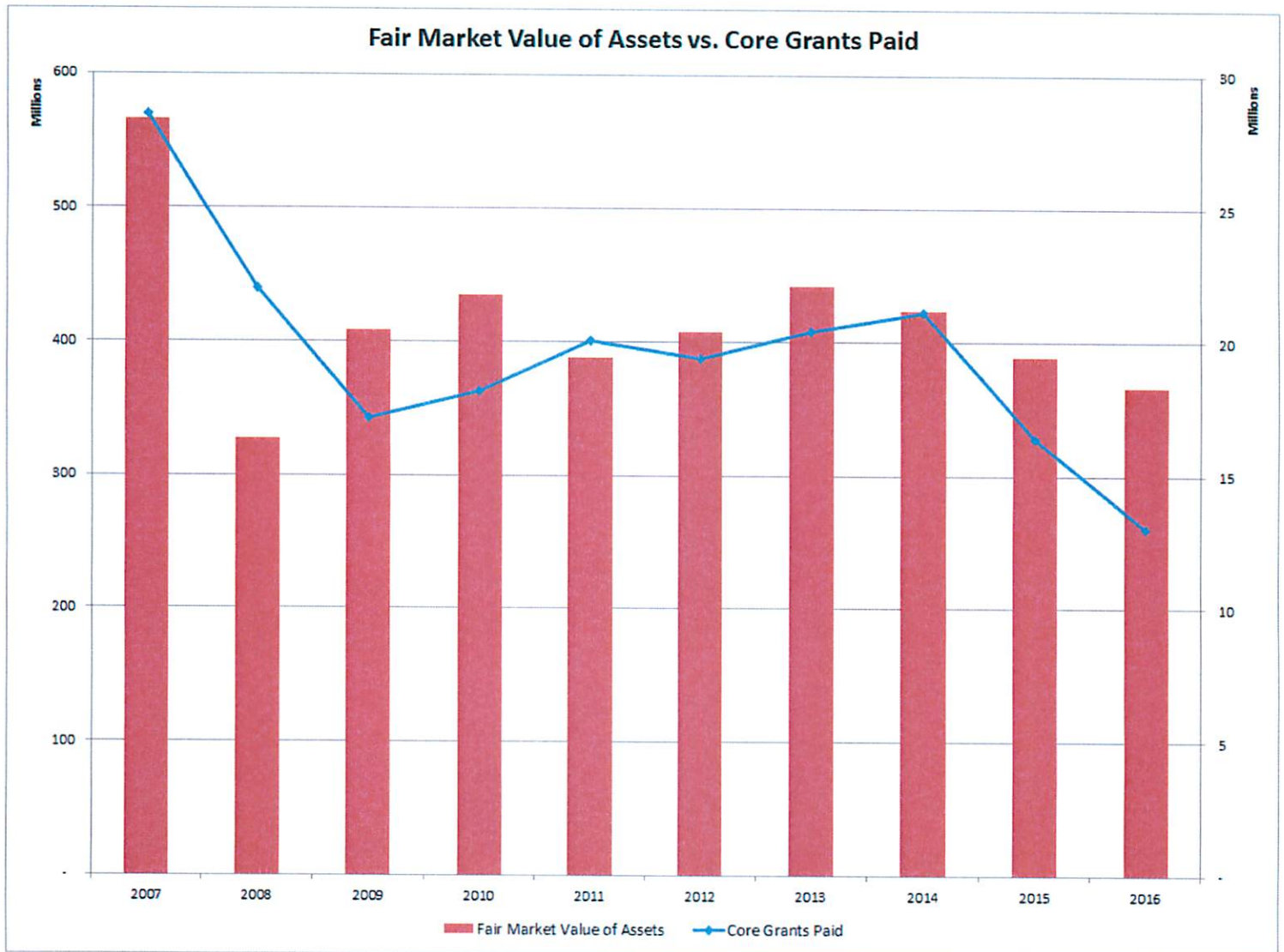


The investment performance of the Foundation’s portfolio managers for 2016, as compared with their respective benchmarks, is shown in the bar chart below. All performance results are net of fees and calculated on a cumulative, time-weighted basis. The managers are shown from left to right based on the largest assets under management to the smallest.

### Investment Managers 2016 Performance



A longer term view of the Foundation's year-end investment portfolio market value, overlaid with the core grants paid levels, is shown below.



The Foundation's total assets are up \$38.1M, or 11.6%, on an absolute basis from the year-end low point of 2008. The assets, however, are still \$200.3M, or 35.4%, below the peak year-end level of 2007, which is contrary to many of the popular equity benchmarks. This is mainly the result of the IRS's mandatory 5% grants distribution requirement and expenses, which is a continuous headwind for the portfolio, and the significant grant distributions attributed



to the Kirby Alliance. Put another way, if aggregate grants and expenses were added back into the portfolio, which total \$245.9M over the past nine years, the portfolio would be above the year-end peak level of 2007.

Please let me know if you have any questions.

  
S. Dillard Kirby