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Members of the Board of Directors
Caltex Australia Limited
Level 24, 2 Market Street
Sydney 2000

Re: Proposal from Alimentation Couche-Tard Inc

Ladies and Gentlemen:

As you are aware, Merlon Capital Partners owns 1.9 million shares in Caltex Australia on behalf of our clients, being retail and institutional investors. Although not the largest Caltex shareholder, Merlon is a high conviction manager with our investment in Caltex representing a significant proportion of our portfolios which in turn also represent a significant proportion of our own personal wealth. By comparison, we note that the six current non-executive directors collectively own 38,311 Caltex shares which are valued at less than the \$1.65 million in annual directors' fees paid by Caltex shareholders during 2018.

We conduct our own detailed independent research and invest considerable resources and energy in developing a deep understanding of the value of the businesses we own. This allows us to exit positions when many others are motivated by short-term outcomes, misaligned incentives and overconfidence in their own abilities.

Against this backdrop we are writing to inform you that we are very concerned with the manner in which you have conducted yourselves in response to the proposal from Alimentation Couche-Tard Inc. ("ATD") to acquire Caltex (the "Proposal"). In the six trading days since first media speculation of a deal, Caltex's market capitalisation has increased by \$1.7 billion or 25%. According to ATD's analysis – with which we broadly concur – including the value of franking credits the proposed deal values Caltex shares at a premium of approximately \$2.7 billion or 37% to the undisturbed price. We have held discussions with a number of larger Caltex shareholders who are similarly concerned with your attitude towards the ATD approach.

We believe your conclusion that the Proposal undervalues Caltex is premised on (i) questionable logic in relation to the value of franking credits; (ii) assumptions about the return of franking credits to shareholders that are incongruous with your historical approach; and, (iii) overconfidence in your ability to implement what is now a long-standing retail transformation agenda, particularly in the context of senior management turnover.

The failure of Caltex to disclose on 26 November that the Proposal contained a permitted special dividend to facilitate the distribution of Caltex's large franking credit balance was disingenuous and served to materially understate the value of the Proposal. The manner in which Caltex has subsequently represented the value of franking credits is inconsistent with any precedent transaction and reduces our confidence in the directors' ability to assess the transaction on its merits. Perhaps this approach to valuing franking credits explains the facilitation of what amounts to a \$1 billion interest free loan to the tax office in the first instance.

The statement by Caltex on 26 November that the Proposal was subject to "*organising necessary financing for the transaction*" was also disingenuous and misleading in light of ACT's subsequent release that clearly

stated “*the implementation of any transaction would not be conditional on ACT obtaining any third party financing*”.

Further, the timing of the Caltex announcement that it intended to IPO some of its property assets appeared premature given the current state of the Convenience business and served to further detract from the apparent attractiveness of the Proposal. We note that the Caltex plans are “*subject to obtaining various approvals, consents and waivers from third parties, including the ASX, in addition to final Caltex board approval. It is also subject to prevailing market conditions*”.

Your confidence in managements’ ability to implement a major retail transformation agenda is remarkable given you are yet to appoint a CEO to hold accountable for the outcomes and your CFO (with no retailing experience) only commenced in April. In our experience and based on our independent research, transitioning from owner-managed to corporate-owned retail models is inherently challenging. The transition from a variable-cost franchise model to a fixed-cost corporate model introduces significant operating leverage and leaves little room for error (as we have witnessed). A hasty sale-and-lease back arrangement will add fixed rental expenses into the mix and only increase the execution risk profile. It is ironic that during discussions with prior management, when we asked which retailers Caltex aspired to emulate in this regard, the answer was always Alimentation Couche-Tard.


As Caltex shareholders we are concerned that ATD is not being provided a fair and reasonable opportunity to engage in a way that maximises value for shareholders. For the reasons discussed, we are also very concerned that you believe the Proposal undervalues Caltex. If you truly believed this to be the case, it begs the question of why your shareholdings are so low relative to the fees you charge.

On a positive note, we are grateful that the company and its representatives have engaged with us over the course of the last week. During these engagements and through written correspondence we have been open and honest about how we value the company. Your shareholders expect the same of you. In the spirit of being open, we have attached further details of our valuation approach as well as an assessment of value based on comparable trading multiples.

We assume that further details of how you are valuing the company will be unveiled at tomorrow’s investor day. However, we are prepared to lobby for greater clarity if the above matters are not adequately addressed. We reserve the right to publish this document on the internet and distribute it to our clients, media outlets and other investors.

Sincerely


Ben Goodwin
Principal / Analyst


Hamish Carlisle
Director


Neil Margolis
Director