Merlon Income Strategy

Merlon Australian Share Income Fund

Quarterly Report

September 2021

Contents

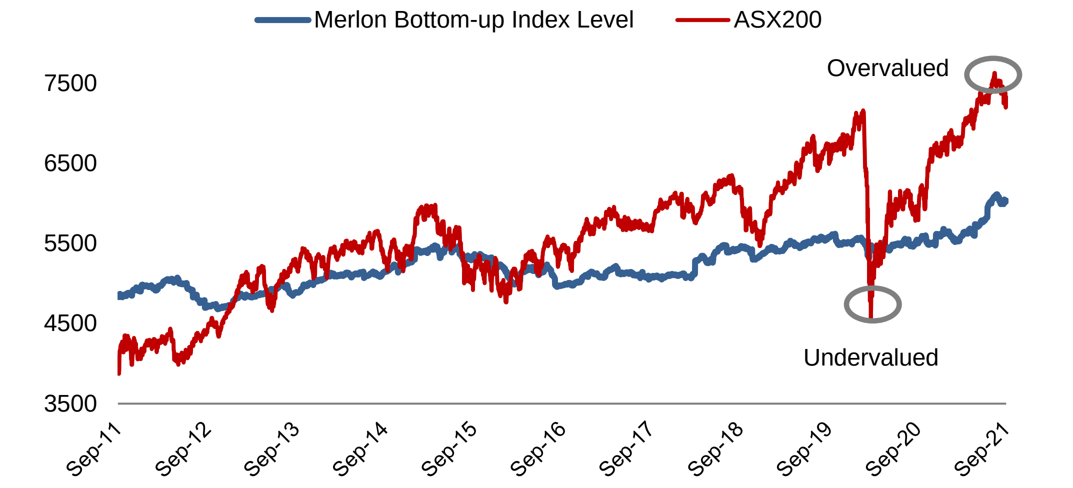
Market Outlook and Portfolio Positioning

Neil Margolis

Market approximately 20% overvalued using consistent bottom-up approach

As has been our historic practice, we continue to provide an aggregate assessment of the ASX200 valuation, based on the individual company valuations for the 150 stocks we actively cover. On this basis the market appears more than 20% overvalued after rallying by more than 2% during the quarter.

Figure 1: Merlon bottom up market valuation vs ASX200 level



Source: Merlon

Our individual company valuations have been established using our estimates of sustainable free-cash-flows and franking, discounted at consistent mid-cycle interest rates and risk premiums. Our valuations are long-term and generally a lot more stable than fluctuating share prices, creating good opportunities for patient long-term investors. Merlon's portfolio comprises our best research ideas, based on long-term valuations and analyst conviction.

In addition to being less volatile, Merlon’s consistent valuation approach across all companies also gives insight into where the market is overly concerned or complacent with regard to stock specific risks. This lens on valuation dispersion is more useful than trying to predict when the market will price in “mid-cycle” interest rates and long-run average risk premiums.

We always maintain a long-term view. In our **March 2020 COVID Roadmap** we were optimistic that at some point there would be a vaccine, herd immunity will develop, and ordinary life will bounce back. In our **March 2021 Outlook for Interest Rates and Inflation** paper, we noted extreme complacency from investors that inflation would be transitory notwithstanding supply chain disruptions and record stimulus induced demand. We also noted our long-term approach had caused our portfolio to lag the market which was being driven higher by stocks and sectors factoring in record low rates for an extended period.

Complacency that inflation will be transitory is reducing …

Recent weeks have seen inflation complacency shift to mild concern among investors. Long-term interest rates are re-approaching March levels but remain very low in the context of headline inflation and economic growth. This movement in yields is placing scrutiny on company valuations, favouring near-dated cash flows over promises of cash flow in future.

The demand side of the inflation equation is supported by record household savings (~10% of Gross Domestic Product), record house prices and vaccine rates surpassing expectations. The supply side of the inflation equation is being pressured by labour shortages (Australian labour force -238,000 since February 2020), rising energy costs (oil the highest since 2015) and supply chain disruptions. At the same time, most central banks remain reluctant to flag higher rates and scale back bond purchases.

Energy costs are the inflation wildcard…

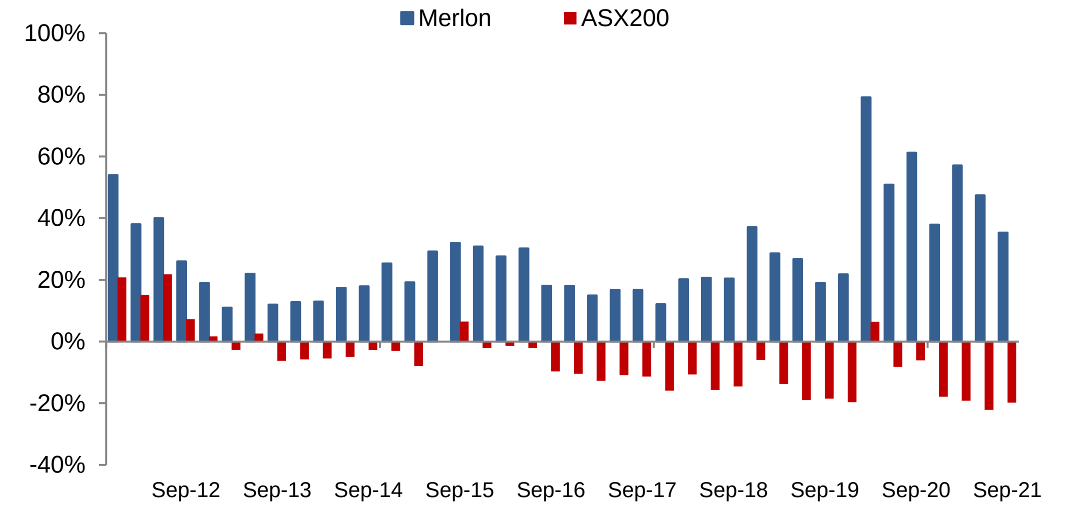
Rising energy costs present the wildcard with Europe and Asia scrambling to secure LNG as demand surges on the back of unseasonably cold weather and easing mobility restrictions. At the same time, supply has been constrained by the limited capital expenditure in the oil and gas sectors caused by the 2020 oil price collapse and the accelerating push to renewable energy. China's economic growth is being challenged by its own measures to reduce energy consumption at the same time the property sector deleverages, most likely requiring additional infrastructure-led stimulus. Outside of iron ore, Australia is well placed to benefit from any cyclical or structural tailwinds as the world's largest supplier of LNG and thermal coal. This quarter, our in-depth research paper, "Who's got the energy", focuses on the current tightness across the major energy markets and outlook for related equities.

'Bond-like' sectors within equities are more exposed …

Rising yields from very low levels still favour equities over other asset classes but "bond-like" sectors within equities, namely defensive and growth stocks, might cede relative gains enjoyed in recent years. A concern for all stocks however would be margin pressure from rising input costs and removal of government wage subsidies and landlord rent concessions. To this end, August results and outlook commentary was more subdued than usual and we expect similar apprehension among corporates during the upcoming AGM season.

The Merlon portfolio continues to offer truly exceptional expected returns…

Figure 2: Expected return based on Merlon valuations



Source: Merlon

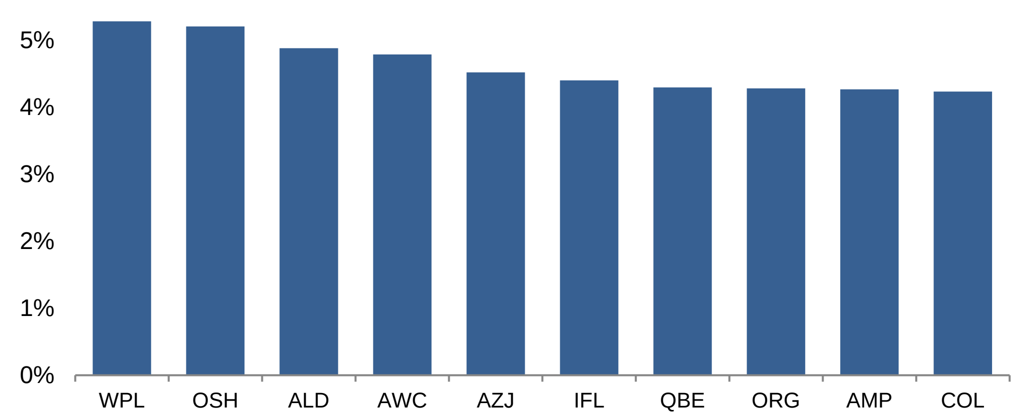
We expect the environment over the next year or so will continue to present appealing investment opportunities for investors with long-term horizons, who are prepared to look through short term noise and who are comfortable having unpopular views.

Portfolio Aligned to Value Philosophy and Fundamental Research

The portfolio comprises undervalued businesses based on sensible interest rate and risk margin assumptions…

The portfolio reflects our best bottom-up fundamental views rather than macro or sector-specific themes. These are usually companies that are under-earning on a three-year view, or where cash generation and franking are being under-appreciated by the market.

Figure 3: Top ten holdings (gross weights)



Source: Merlon

While we are not macro investors, as discussed above there are clearly some macro themes inherent within the portfolio. We need to be aware of these themes and ensure they do not expose us or our clients to unintended risks. In the first instance, any such risks are mitigated by our strategy of investing in companies that are under-valued relative to the sustainable free cash flows and the franking credits they generate for their owners. Attractive valuations strongly imply that market concerns are – at least to some extent – already reflected in expectations and provide a "margin of safety" in the event conditions deteriorate.

Our larger investments are typically in companies where investors have become overly pessimistic about long term prospects on account of weaker short-term performance. This tendency to extrapolate short-term conditions too far into the future and investors' focus on management manipulated measures of corporate financial performance instead of cash flow continue to present us with opportunities.

Top holdings:

Woodside Petroleum remains undervalued relative to our assessment of value, and despite the rally in oil prices. The market is currently discounting the value of Woodside's cash-generative operating asset base, in addition to its large undeveloped reserve profile. We expect oil prices to continue to strengthen as demand recovers to pre-COVID levels, while the underinvestment in conventional and now unconventional oil supply should further support prices over the medium-term. The proposed BHP oil merger is roughly neutral to our valuation and conviction but provides access to capital to develop its Scarborough field, amidst what is an increasingly favourable contract-pricing environment.

Similarly, **Oil Search** remains undervalued relative to our assessment of value, and despite the rally in oil prices. The market is currently discounting the value of the company's low cost, conventional core operating asset base, in addition to its large undeveloped reserve profile. Like with Woodside, we expect oil prices to continue to strengthen as demand recovers to pre-COVID levels, while the underinvestment in conventional and now unconventional oil supply should further support prices over the medium-term. The merger with Santos (STO) is appealing as it introduces the potential to create common interests across the existing Papua New Guinea Liquified Natural Gas (LNG) facility, and the Papua LNG project, thereby increasing the probability of it being commercialised. As with Woodside, the pricing environment for determining new projects is strong.

Ampol (formerly Caltex) is an integrated oil refining and fuel supply and marketing company, operating in a strong and improved industry structure dominated by vertically integrated companies capable of generating margins throughout their supply chain. Volumes are clearly impacted by COVID-19 related disruptions, but the company is in a strong position to gain share with downside risk mitigated by hard property assets. We also think the take-over offer has a reasonable chance of being reinstated, with the release of franking credits, even if at a reduced headline price.

The position in **Alumina Limited** was established during the second half of 2020, with COVID-19 related market concerns providing attractive entry points for investment. While the stock has been impacted by the effect of COVID-19 on demand, as well as continued growth in Chinese alumina refining capacity, we expect Alumina's low-cost position to enable it to prevail relative to higher cost peers. Also, we expect China's capacity growth to rationalise and global fiscal stimulus to drive a recovery in demand for aluminium and its alumina-input. The market for alumina has tightened as Noble Group's Jamalco refinery fire in August impacted the supply of alumina, while a military coup in Guinea, the world's largest supplier of bauxite (the feedstock for alumina refining), further destabilised the market.

Aurizon operates the monopoly Queensland rail network for large, low cost and predominantly metallurgical (rather than thermal) coal miners. The stock had become cheap, relative to our estimate of a mid-cycle return on capital-based valuation, and after adjusting for global decarbonisation commitments. The stock had been affected by concerns relating to Chinese restrictions on a range of imported Australian goods, including coal, as well as concerns over the exposure to thermal coal. We believe Chinese import restrictions on coal should ultimately abate, while we also expect a greater appreciation around the challenges to decarbonisation and the likelihood that some high energy Australian coal will remain in use, will likely see the share price appreciate towards our valuation. We don't place material value on the company's attempt to diversify into non-coal haulage given it will be M&A driven and the market structure is more competitive.

IOOF is effectively the only remaining scale operator in financial advice. While the market is concerned about competition, fee and regulatory pressures, the company is trading at a large discount to the market. The company is generating strong cashflows, which is likely to lead to capital management, having completed its acquisition of MLC, a transaction we see as likely to enable cost out and the extraction of up to $150m of synergies. The company's stated target to eliminate losses from its financial advice business will lead to further upside.

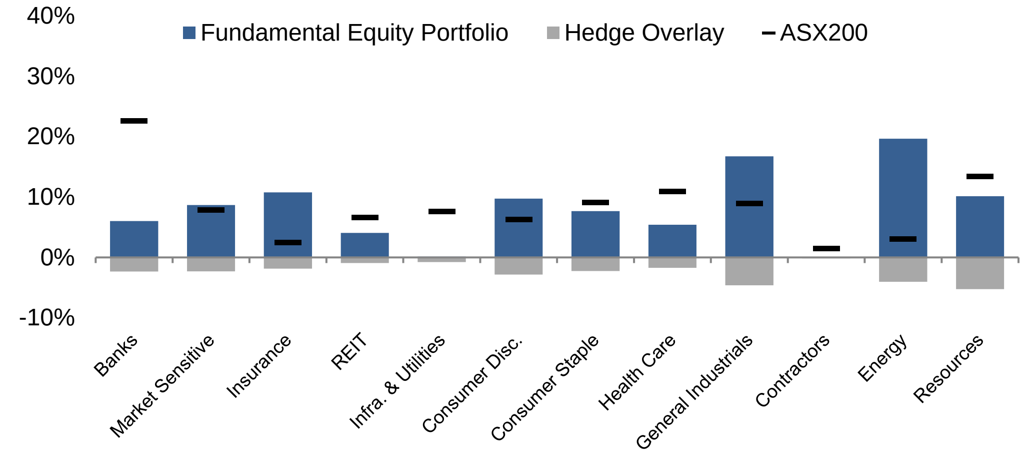
QBE is a leading global insurer, seeing the strongest rate increase environment in 20 years. The company is undervalued relative to our valuation, as the market is concerned by persistent earnings disappointments, as well as shorter term claims risks from business interruption and wild weather. With these concerns already reflected in the price, and our expectations that insurance margins are likely to overshoot to the upside given rate increases, we anticipate the market will ultimately recognise and value a likely 8% mid-cycle free cashflow yield, plus franking.

Origin Energy (ORG) remains cheap despite the rally in oil prices, as the market is concerned by the effect of low electricity pricing on Origin's wholesale and retail electricity businesses. We see low electricity prices as having been driven by 1. the effect of low gas prices, 2. an unseasonably cool summer, and 3. the growth in renewables supply. In addressing these points, we expect gas pricing to normalise as onshore demand recovers; the Bureau of Meteorology has forecast a return to more 'normal' summer weather patterns, while a post-COVID demand recovery should enable a continued recovery of electricity prices. We are also not convinced the current price environment is sustainable for investment in sustaining existing generation assets, nor does it incentivise new investment required to offset planned retirements.

Post completion of the life transaction and other announced transactions, **AMP** has net tangible assets (mainly cash) of $3.4b against a market cap of $4.2b. For the less than $1b capital at risk, investors own a growing fund manager, AMP Capital, with $190b FUM (including $60b in "real assets"), a high returning bank ($20b in mortgages and $17b deposits), a NZ wealth business ($40m earnings), a $120b platform administration business and a loss-making advisor servicing business net of corporate costs that might break-even if cost-out targets are achieved. Governance failures are being addressed with a renewed board and management.

Coles (COL) is the number two supermarket retailer in Australia with 27% market share, the number three liquor retailer and operates the convenience stores for the Shell Coles Express petrol station network. COVID has temporarily benefitted the industries Coles operates in and has accelerated the shift to online. Coles remains attractively priced relative to other "defensive" sectors that are included in the "bond proxy" group. Coles and Woolworths operate under an umbrella of a sound industry structure (Kaufland exit this year is further evidence of this), provide long term inflation protection, have minimal debt and are generating margins below historic levels.

Figure 4: Portfolio exposures by sector (gross weights)



Source: Merlon

Figure 5: Portfolio Analytics[ii]

	Portfolio	ASX200
Number of Equity Positions	35	200
Active Share	81%	0%
Merlon Valuation Upside	35%	-20%
EV / EBITDA	12.7x	18.2x
Price / Earnings Ratio	14.3x	20.3x
Price / Book Ratio	2.8x	5.8x
Mid-cycle Free Cash Flow Yield	7.0%	4.4%
Distribution Yield (inc. franking)	6.5%	5.7%
Net Equity Exposure	70%	100%

Source: Merlon

The hedge overlay offers material downside protection

At quarter end, the hedge overlay was in line with the targeted 30% reduction in market exposure, and will provide material protection if markets retrace towards the recent lows.

September Quarter Portfolio Activity

There were three new investments in the quarter

During the quarter, we established new positions in **Qantas**, **JB Hifi** and **A2 Milk**.

Qantas is the largest airline in Australia, with a fleet of more than 300 aircraft. In addition to its core Qantas brand, it operates under the low-cost Jetstar brand and has a highly successful in-house loyalty programme. Qantas' domestic market share has surged towards 70% during the pandemic following the near-death experience of its closest rival. We are under no illusion that **Qantas** mid-cycle cash-flows will continue to be capped by the poor industry structure in the international segment and the industry's high capital intensity. However, pent-up demand is likely to lead to several years of above mid-cycle earnings which we capture in our valuation, with longer-term upside if domestic share gains or cost-out can be maintained. The rising oil price will present a headwind when hedges roll off but historically the share price has been positively correlated with oil reflecting leverage to global growth and ability to pass on higher fuel costs, albeit with a lag.

A2 Milk is a dairy company involved in supplying and marketing A2 protein-based dairy products; notably infant formula. The primary end market is in China supplemented by domestic Australian and New Zealand sales as well as a currently loss-making US business. We previously invested in A2 Milk during October 2019 (at an average price of $12) and divested in April 2020 (at an average price of $18) when earnings and the share price were inflated due to COVID pull forward demand. An opportunity to reinvest around $7 per share arose in July following a series of profit warnings. These related to share loss caused by cross-border exporting by individuals being disrupted by COVID as well as inroads being made by strong local Chinese competitors. A proprietary brand survey we conduct has shown some evidence of brand health stabilising and recovering, a leading indicator of market share. Downside risks are partly mitigated by a very material cash and surplus franking balance relative to market capitalisation.

We reinvested in **JB Hi-Fi**, the market leading electronics retailer in Australia with 23% market share and operating under The Good Guys with 6% share of combined electronics and household goods. The stock has underperformed recently as investors have favoured stocks benefitting from lockdowns ending. However, we are attracted to the 7% "mid-cycle" free cash flow yield, which already factors in lower earnings, the net cash balance sheet, surplus franking credits and strong market position, including multi-channel advantages over peers.

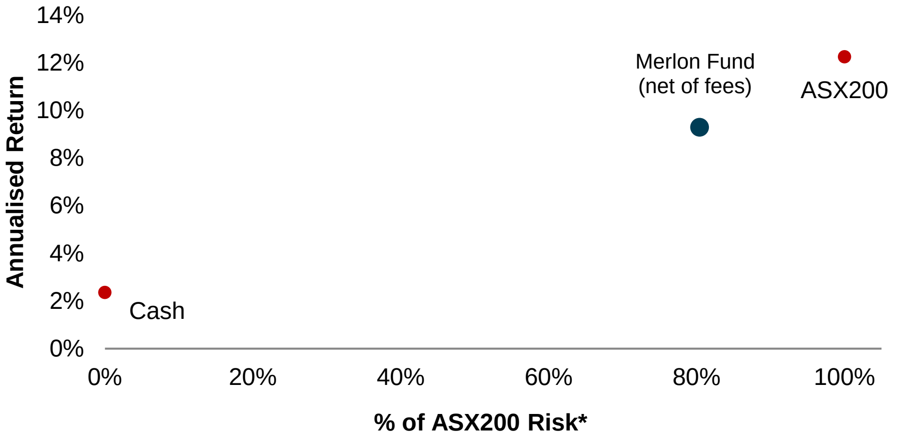
We reduced our holding in **Woolworths** after it re-rated post demerging the socially less desirable liquor and pubs business, Endeavour Group, and continues to benefit from lockdowns which will ease.

We also reduced but retained investments in **Metcash**, **NIB**, and **QBE Insurance** all of which outperformed and offered relatively less upside than before. We reduced our investment in **Sandfire** after the company announced a $2.5b part debt-funded acquisition of a six-year reserve life copper mine in Spain from a highly sophisticated vendor. At the time, Sandfire's market value less cash was only $0.5b before considering $0.25b of surplus franking credits that could have been returned to shareholders.

Performance[i] (%) (after fees, inc. franking)	Month	Quarter	FYTD	Year	3 Years (p.a.)	5 Years (p.a.)	7 Years (p.a.)	10 Years (p.a.)
Fund Total Return	1.9	5.1	5.1	26.5	6.6	6.7	7.2	9.3
70% ASX200 / 30% Bank Bills	-1.1	1.6	1.6	21.6	8.3	8.8	8.1	9.4
ASX200	-1.5	2.3	2.3	31.8	10.9	11.8	10.6	12.3
Average Daily Exposure	69%	69%	69%	67%	67%	68%	68%	69%
Gross Distribution Yield	0.7	1.8	1.8	7.3	7.0	7.1	7.3	7.9

Past performance is not a reliable indicator of future performance. Total returns above are grossed up for franking credits. Gross Distribution Yield represents the income return of the fund inclusive of franking credits. Portfolio inception date is 30/09/05.
The source of fund returns and benchmark returns is Fidante Partners Limited, 30 September 2021.

Figure 6: Rolling Ten Year Risk vs. Return (%p.a.)[ii]



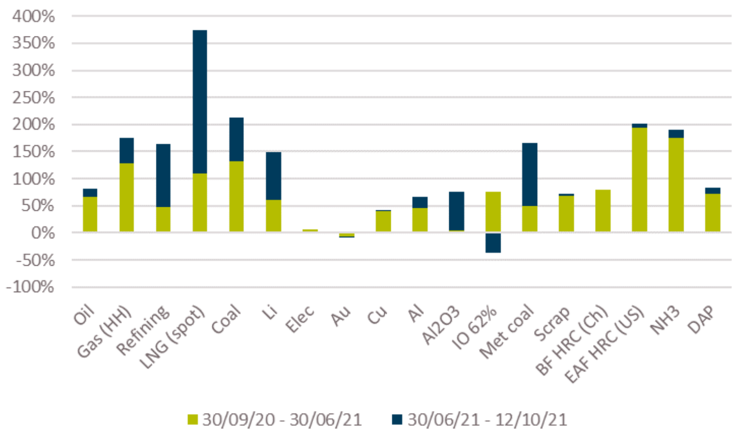
Source: Merlon

Markets eased off the August all-time high in another positive quarter …

September Quarter Market & Portfolio Review

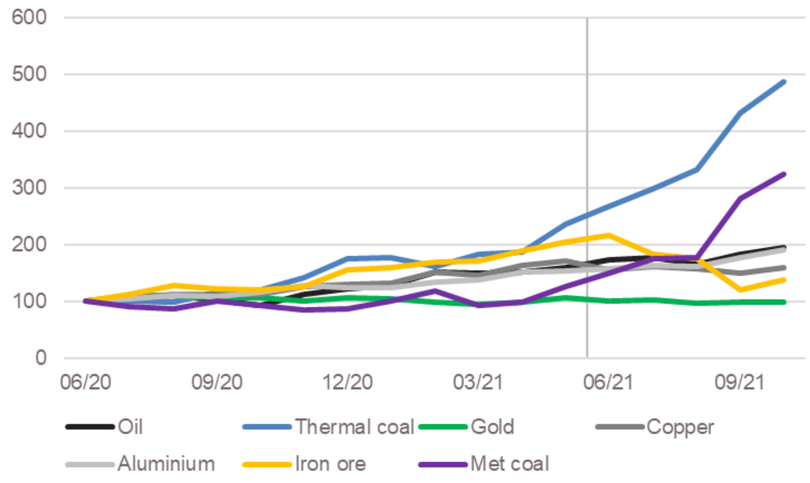
Markets advanced yet again this quarter notwithstanding September being the first and only down month in the last twelve. Markets became jittery towards the end of the quarter and at the time of writing given inflationary pressures building from both demand (vaccination rates & record savings) and supply (labour shortages and rising energy and other commodity costs). US 10 year bond yields increased 32bp from early August lows (and further at the time of writing) with the Delta wave showing signs of peaking amidst rapidly rising vaccination rates, indications the US Federal Reserve might taper faster, signals of monetary policy withdrawal from the Bank of England and Reserve Bank of New Zealand, and a renewed rally in commodities. The commodity rally was extreme and broad based, extending on gains over the past year.

Figure 7: Commodity price changes (quarterly and annual)



Data source: Bloomberg, Merlon Capital.

Figure 8: Commodity price changes (June 2020 = base 100)



Data source: Bloomberg, Merlon Capital.

Unsurprisingly, the energy sector performed well, along with non-bank financials, while materials weighted to iron ore underperformed, along with consumer discretionary and media stocks cycling the strong rebound from a year ago. The rise in yields has supported the rotation into value stocks away from expensive growth and defensive stocks that were increasingly pricing in lower rates for an extended period. Value stocks, including traditional financial and commodity sectors, are not out of the woods however, with China property deleveraging and energy rationing likely to slow growth in the months ahead.

Portfolio review

The portfolio underperformed this quarter ….

The Merlon portfolio should be well placed, at least in a relative sense, if bond yields continue rising, the risk reduction overlay employed by the Fund will also provide protection if markets fall. Against the September quarter's backdrop of rising commodity prices and long-term interest rates, the Fund performed strongly in the September quarter, outperforming the

….with the risk overlay detracting.

market by 2.8%, whilst maintaining 30% less exposure. The underlying share portfolio outperformed the ASX200 by 5.4%, with the hedge overlay detracting given the strong returns. With the exception of **Qantas**, which was only invested in during July, the other top 10 key contributors were linked to rising commodity prices, including **New Hope Coal**, **Alumina**, **Oil Search**, **Woodside**, **Incitec Pivot** and **Viva Energy**. Detractors during the quarter included **AMP**, despite several positive management changes, **A2 Milk**, **Unibail-Rodamco-Westfield**, **Newcrest Mining**, and not owning **Commonwealth Bank**, **Macquarie Bank** and **Sydney Airport**.

Over the past twelve months, the portfolio performed strongly, +26.5%, delivering 83% of the market return whilst maintaining significantly less exposure. The risk reduction overlay employed by the Fund has provided significant protection when the market falls, however given the strong returns it was a headwind to the Fund's total return.

The underlying share portfolio outperformed by 10.1% over the last year….

The underlying share portfolio outperformed the market by 10.1%. Key positive contributors over the year were broad based, including property trust **Unibail Rodamco**, health insurer **NIB Insurance**, thermal coal miners, **New Hope Coal** and **Whitehaven**, industrial commodity companies, **Sims Metal Group** and **Alumina**, fund managers **IOOF** and **Janus Henderson**, **Oil Search** along with not owning **CSL**. Detractors over the year included **AMP**, **Newcrest Mining**, **Coles Group**, **Origin Energy**, **ANZ Bank**, **Insurance Australia** and not owning **Commonwealth Bank**, **National Australia Bank** and **Macquarie Ban**k. In broader terms, the drag for being underweight banks was more than offset by other cyclical exposures that in our view, had demonstrably less downside risk had the COVID vaccine not proven to be effective.

The portfolio's **non-benchmark value and contrarian style and significantly lower exposure** has been a headwind over the few years preceding the last year, including in the initial stages of the COVID-19 downturn. Investors have gravitated towards large capitalisation quality and growth stocks, even more so as interest rates have approached zero. This has only served to increase our resolve and belief in taking a long-term view based on sustainable free cash flow combined with low market expectations.

As we documented in our March 2020 roadmap, we are focused on the risk of permanent loss and mitigate this by taking a long-term view, focusing on owning undervalued assets and fully deducting debt in developing our investment case. At the same time, the opportunity for meaningful absolute and relative performance is significant.

The additional performance information over the page is presented on a financial year basis and should be read in conjunction with the summary performance table on page 11.

Additional Performance Detail: Sources of Return

FY Performance[i] (%) (inc. franking)	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years (p.a.)
Underlying Share Portfolio	26.8	-9.3	8.4	7.4	23.5	7.0	9.5	16.3	36.0	-3.4	13.2
Hedge Overlay	-9.1	3.9	-0.9	-2.3	-5.6	-0.9	-1.7	-3.5	-9.3	2.6	-2.9
Fund Return (before fees)	17.7	-5.4	7.5	5.1	17.9	6.1	7.8	12.8	26.7	-0.8	10.3
Fund Return (after fees)	16.6	-6.3	6.5	4.1	16.8	5.1	6.8	11.8	25.6	-1.8	9.3

FY Performance[i] (%) (before fees, inc. franking)	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years (p.a.)
Underlying Share Portfolio	26.8	-9.3	8.4	7.4	23.5	7.0	9.5	16.3	36.0	-3.4	13.2
ASX200	28.8	-6.5	13.2	14.5	15.5	2.2	7.2	18.9	24.3	-5.1	12.3
Excess Return	-2.0	-2.8	-4.8	-7.1	8.0	4.8	2.3	-2.7	11.7	1.7	0.9

FY Performance[i] (%) (after fees)	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years (p.a.)
Income	5.1	5.2	5.8	5.5	6.2	5.9	5.6	5.8	7.8	7.6	6.0
Franking	1.7	1.2	2.2	1.5	1.6	2.1	1.9	1.7	2.3	2.5	1.8
Growth	9.8	-12.7	-1.4	-2.8	9.0	-2.9	-0.7	4.3	15.5	-11.9	1.5
Fund Return (after fees)	16.6	-6.3	6.5	5.1	16.8	5.1	6.8	11.8	25.6	-1.7	9.3

FY Performance[i] (%) (after fees, inc. franking)	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years (p.a.)
Fund Return (before fees)	17.7	-5.4	7.5	5.1	17.9	6.1	7.8	12.8	26.7	-0.8	10.3
70% ASX200/30% Bank Bills	19.7	-3.6	9.9	10.6	11.3	2.2	6.0	14.0	17.8	-2.1	9.3
Excess Return (before fees)	-2.0	-1.9	-2.4	-4.4	6.6	3.9	1.8	-1.2	8.9	1.3	1.0
Excess Return (after fees)	-3.1	-2.7	-3.4	-5.4	5.5	2.9	0.8	-2.2	7.7	0.4	0.0

Monthly Distribution Detail: Cents per Unit

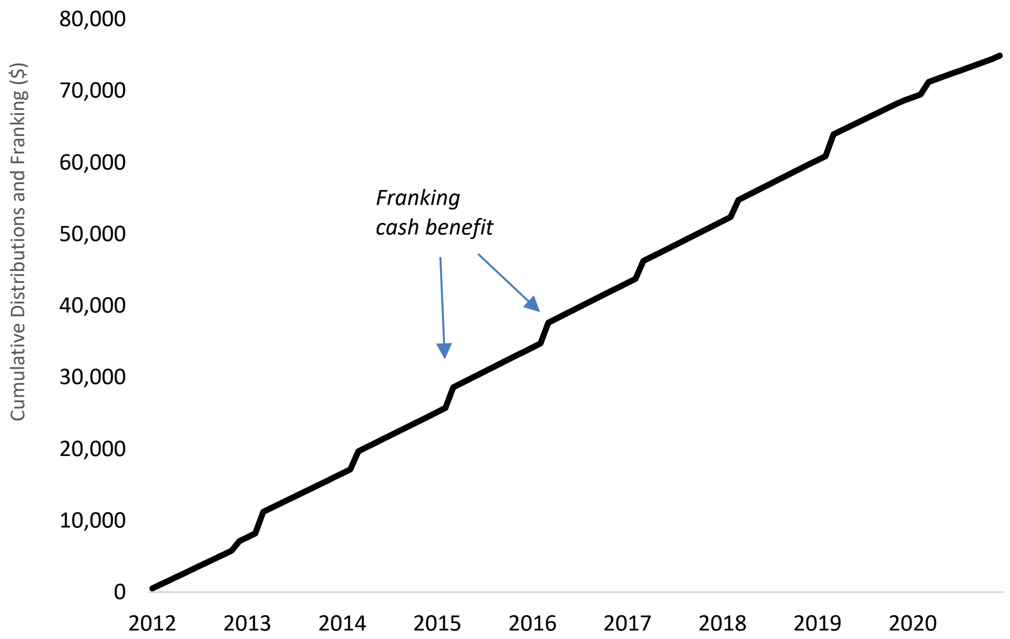
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total	Franking
FY2013	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.29	**6.79**	2.26
FY2014	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.52	**6.13**	1.98
FY2015	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	**6.24**	2.20
FY2016	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.52	**6.35**	1.92
FY2017	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	**6.36**	2.02
FY2018	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.52	**6.35**	1.84
FY2019	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.50	**6.33**	2.57
FY2020	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.44	**6.05**	1.40
FY2021	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.38	0.47	**4.65**	1.76
FY2022	0.41	0.41	0.41	*0.41*	*0.41*	*0.41*	*0.41*	*0.41*	*0.41*	*0.41*	*0.41*	*0.41*	***4.92***	*1.86*

Highlighted data are estimates at the date of this report.

Monthly income will be 0.41 cents per unit at least through to May 2021…

and the franking level is projected to be in the 70-80% range

Figure 9: Monthly since in July 2012[iii]



Source: Fidante

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COVID-19 - One Year On

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The Strategic Value of amaysim

Oil - Pricing in a More Realistic Recovery

Long-term Dividend Opportunity the Main Game

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Some Thoughts on Australian House Prices

Amazon Not Introducing Internet to Australia

Iron Ore is Well Above Sustainable Levels

Boral's High Priced Acquisition of Headwaters

Fund Details^

Fund size	$ 463m	Merlon FUM	$ 1,030m
APIR Code	HBC0011AU	Distribution Frequency	Monthly
ASX Code	MLO02	Minimum Investment	$ 10,000
Inception Date	30 September 2005	Buy / Sell Spread	+/- 0.20%

^Source: Fidante Partners Limited, 30 September 2021.

About Merlon

Merlon Capital Partners is an Australian based fund manager established in May 2010. The business is majority owned by its five principals, with strategic partner Fidante Partners Limited providing business and operational support.

Merlon's **investment philosophy** is based on:

Value: We believe that stocks trading below fair value will outperform through time. We measure value by sustainable free cash flow yield. We view franking credits similarly to cash and take a medium to long term view.

Markets are mostly efficient: We focus on understanding why cheap stocks are cheap, to be a good investment market concerns need to be priced in or invalid. We incorporate these aspects with a "conviction score"

About the Fund

The Merlon Australian Share Income Fund's investment approach is to construct a portfolio of undervalued companies, based on sustainable free cash flow, whilst using options to overlay downside protection on holdings with poor short-term momentum characteristics. An outcome of the investment style is a higher level of tax-effective income, paid monthly, along with the potential for capital growth over the medium-term.

Differentiating Features of the Fund

- **Deep fundamental research** with a track record of outperformance. This is where we spend the vast majority of our time and ultimately how we expect to deliver superior risk-adjusted returns for investors.

- **Portfolio diversification** with no reference to index weights. The benchmark unaware approach to portfolio construction is a key structural feature, especially given the concentrated nature of the ASX200 index.

- **Downside protection** through fundamental research and the hedge overlay. In addition to placing a heavy emphasis on capital preservation through our fundamental research, we use derivatives to reduce the Fund's market exposure and risk by 30% whilst still retaining all of the dividends and franking credits from the portfolio.

- **Sustainable income**, paid monthly and majority franked. As the Fund's name suggests, sustainable above-market income is a key objective but it is an outcome of our investment approach.

Footnotes

[i] **Performance (%)**

Average Daily Market Exposure is calculated as the daily net market exposure divided by the average net asset value of the Fund.
Composite benchmark is calculated as 70% S&P/ASX200 Accumulation Index and 30% Bloomberg AusBond Bank Bills Index. The Fund reduces exposure to share market volatility to a typical range of 60-80% through the use of derivatives with the remaining 20-40% option protection seeking to deliver a cash-like risk/return profile.
Fund Franking^: Month 0.3%, Qtr 0.7%, FYTD 0.7%, Year 1.9%, 3 Years 1.7% p.a., 5 Years 1.6% p.a., 7 Years 1.7% p.a., 10 Years 1.8% p.a.
ASX200 Franking^: Month 0.3%, Qtr 0.6%, FYTD 0.6%, Year 1.2%, 3 Years 1.3% p.a., 5 Years 1.4% p.a., 7 Years 1.4% p.a.,10 Years 1.5% p.a.
^ Source: Fidante Partners Limited, 30 September 2021.

[ii] **Rolling Seven Year Performance History**

Past performance is not a reliable indicator of future performance. Returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated after fees as at the date of this report, assumes distributions are reinvested.
% of ASX200 Risk represents the Fund's statistical beta relative to the ASX200

[iii] **Monthly Income since July 2012**

Past performance is not a reliable indicator of future performance.

[iv]**Portfolio Analytics**

Source: Merlon, Active share is the sum of the absolute value of the differences of the weight of each holding in the portfolio versus the benchmark, and dividing by two. It is essentially stating how different the portfolio is from the benchmark. Net equity exposure represents the Fund's net equity exposure after cash holding's and hedging Beta measures the volatility of the fund compared with the market as a whole. EV / EBITDA equals a company's enterprise value (value of both equity and debt) divided by earnings before interest, tax, depreciation, and amortization, a commonly used valuation ratio that allows for comparisons without the effects of debt and taxation.