Merlon Australian Share Income Fund

Quarterly Report – December 2022

For queries, please call Investor Services on 13 51 53

Fund Features

Sustainable income: Paid monthly and majority franked. As the Fund's name suggests, sustainable above-market income is a targeted outcome of our investment approach and a key objective of the Fund.

Proven Investment Philosophy: We believe people are motivated by short-term outcomes, overemphasise recent information and are uncomfortable having unpopular views.

Portfolio Diversification: The benchmark unaware approach to portfolio construction is a key structural feature, especially given the concentrated nature of the ASX200 index.

Downside protection: 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.

Integrated ESG Approach: We believe deep consideration of governance, social as well as environmental issues – coupled with active ownership – enhances investment, business and community outcomes.

Fund Facts

Portfolio managers	Neil Margolis
Fund inception date	30th September 2005
Merlon FUM	$1,020m
Strategy FUM	$578m
Fund FUM	$416m
Management fee	0.95% p.a
Performance fee	nil
Fund objective[5]	The Fund aims to provide a higher level of tax effective income with a lower level of risk than the S&P/ASX 200 Accumulation Index, whilst also aiming to outperform the benchmark on a total return basis over the medium to long term.
Minimum Investment	$10,000
Suggested timeframe	At least 5 years
Buy/Sell Spread	+0.20% / -0.20%
Distribution Frequency	Monthly
APIR Code / ASX Code	HBC0011AU / MLO02

Top 10 Holdings (Alphabetical)

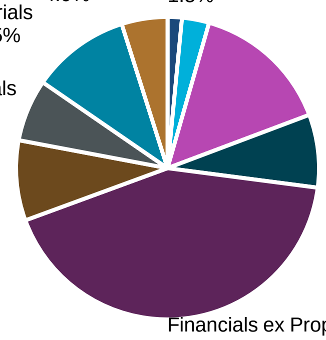
AGL Energy	Origin Energy
AMP	Qantas Airways
Coles Group	QBE Insurance Group
IAG Limited	Suncorp Group
Medibank Private	Westpac Banking Corporation

Fund Performance net of all fees and expenses

%[1]	Fund	Benchmark[2]	Yield[4]
Since Inception[3]	7.4	7.0	9.6
10 years (p.a)	8.9	7.8	7.4
5 Years (p.a)	6.6	6.5	6.9
3 Years (p.a)	8.0	5.4	6.7
1 Year	17.5	1.0	7.1
FYTD	13.7	7.9	3.7
Quarter	10.8	6.9	1.6
1 Month	0.2	-2.2	0.4

[1]Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. All returns are grossed up for franking credits. No allowance is made for tax. Past performance is not a reliable indicator of future performance.
[2] The Fund's benchmark is a composite of 70% S&P/ASX 200 Accumulation Index including franking credits / 30% Bloomberg Ausbond Bank Bill Index and is used for all time periods. From 30 September 2005 to 16 May 2022, the Fund's benchmark was the S&P/ASX 200 Accumulation Index.
[3]The Inception Date for the fund is 30 September 2005.
[4] Yield represents the Gross distribution yield (inclusive of franking credits)
[5]In line with the Fund's benchmark change, the Fund's objective was also amended on 16 May 2022 to include a total return objective.
Source: Fidante Partners Limited, 31 December 2022.

Sector Exposure



Quarterly value added relative to benchmark

Top 5	Value Added (%)
Origin Energy	1.1
CSL	0.6
Suncorp Group	0.5
A2 Milk Co	0.5
AMP	0.5

Bottom 5	Value Added (%)
Rio Tinto	-0.3
Commonwealth Bank of Australia	-0.3
IAG	-0.3
Medibank Private	-0.6
BHP Group	-0.6

Source: Fidante Partners Limited, 31 December 2022. Benchmark is S&P/ASX 200 Accumulation Index

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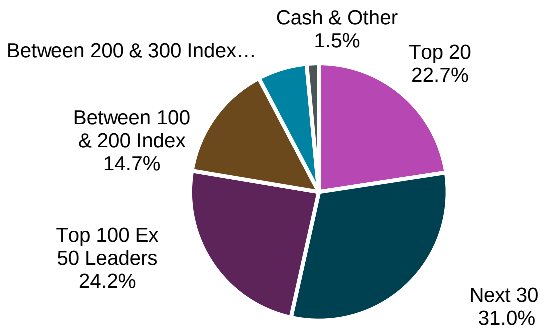
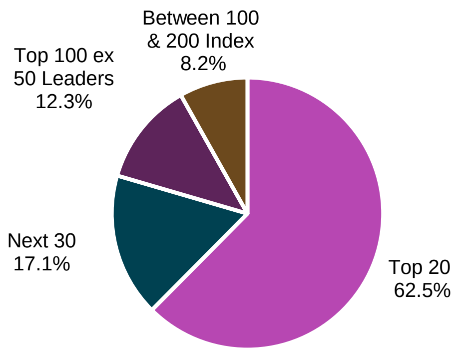
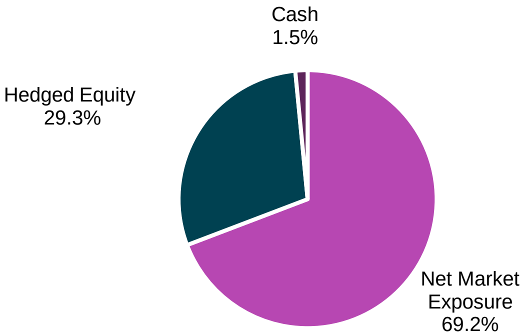
Market Cap Bands – Fund



Market Cap Bands – ASX 200



Asset Allocation



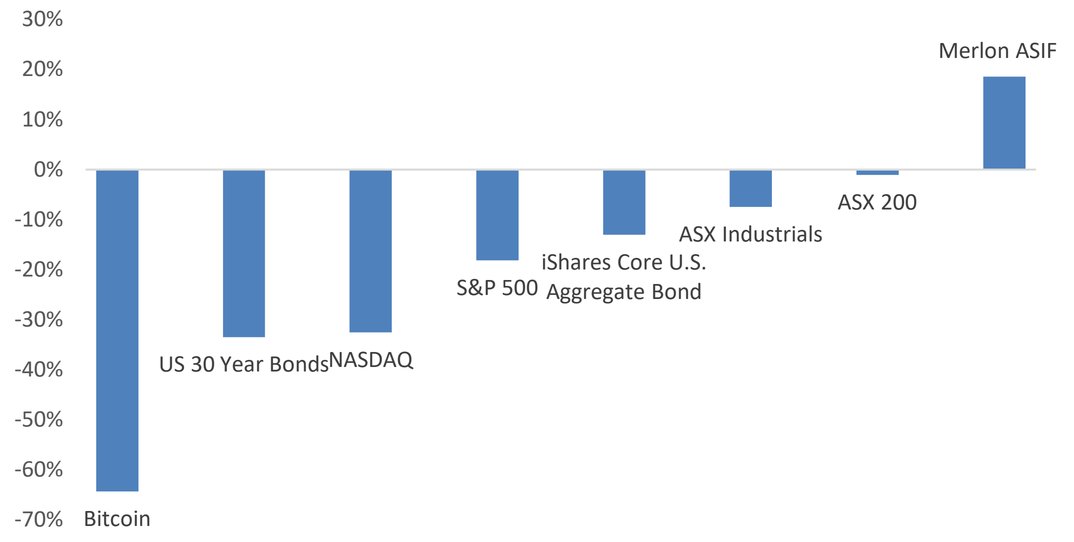
Market review (2022) – The return of inflation

Russia's invasion of Ukraine was the human story of 2022 while the financial story was multi-decade high inflation and the pace and extent of rate hikes to contain it.

US inflation peaked at 9.1% (a 40 year high), the Fed hiked 425bp in just seven meetings and US 30-year mortgage rate more than doubled to 6.4% to pre-GFC levels (peaked at 7.1%). Economies performed strongly with unemployment in the US (3.5%) and Australia (3.4%) hitting multi-decade lows. US Dollar strength rampaged through markets, with the Pound sinking to a record low and the Euro back to 2002 levels. Brent oil rallied as much as 65% to US$128/bbl in March but closed the year below pre-war levels and only 10% above where it started. Europe, reliant on Russian gas, suffered a severe energy shock with Title Transfer Facility (TTF) gas prices up 5x at their peak. While Covid shifted from pandemic to endemic in most countries, China shut down entire cities in a futile quest for zero cases.

At an asset class level, Australian equities (-1%) were shielded by virtue of the large resources weight (ASX Industrials were down 7%) with the S&P500 declining 18% and the NASDAQ losing a third of its value. The Morgan Stanley unprofitable tech index plummeted 55%. For only the third time since the Great Depression, bonds declined double digit in tandem with equities (a 35% decline in long-dated US Treasury bonds the standout). The iShares Core US Aggregate Bond ETF, which tracks the market for US investment-grade bonds, declined 13% in 2022, the biggest annual decline since the fund launched in 2003. To compound matters, all returns quoted above were 5 to 10% lower again in real terms.

Figure 1: Asset Class Returns Calendar Year 2022



Source: Bloomberg, Fidante Partners Limited, Merlon Capital Partners.

At a sector level, **Energy** performed best despite oil ending the year only modestly higher, reflecting the higher discount rates applied by other investors at the start of the year on environmental grounds. Other positive sectors included **Utilities** on higher electricity and gas prices, **Materials** on higher bulk commodity prices and **Financials** with revenue benefitting higher interest rates. The worst performing sectors over the year were **Technology**, previously benefitting from lower discount rates and minimal focus on cash-flow, **Real Estate**, also benefitting from lower discount rates amplified by cheap financial leverage, **Consumer Discretionary** as investors priced in a collapse in 2023 earnings given pull-forward demand. Defensive stocks, including **Healthcare** and **Consumer Staples**, also lagged with earnings multiples a year ago inflated by low interest rates.

Portfolio review (2022) – Focus on cash flows over discount rates paid off

The Merlon Australian Share Income Fund generated a remarkable **18.6%** total return in 2022 (before fees and including franking credits), a very pleasing result against a backdrop of surging inflation and interest rates, geopolitical tension, recession fears and double-digit declines in most asset classes. The underlying share portfolio outperformed the S&P/ASX200 Index by **21.3% (**including franking credits), with the main driver being sticking with our "behavioural bias" philosophy –

"We believe people are motivated by short-term outcomes, overemphasise recent information and are uncomfortable having unpopular views"

– and disciplined process –

"We invest in undervalued companies where we think market participants have become too pessimistic.""

We wrote in our [April 2021 inflation paper] that history showed it was difficult to escape periods of high and volatile inflation yet in early 2021 we could not recall a period of greater complacency among investors that inflation and interest rates would remain low despite obvious risks at the time. It is worth repeating the conclusion as it provides key context behind the portfolio's extraordinary outperformance of the benchmark:

Figure 2: Extract from Merlon April 2021 Research Paper on Interest Rates & Inflation

Merlon Perspective

Our approach has increasingly positioned us away from many of the sectors that have benefitted from falling interest rates which has created a headwind for our investors in terms of lagging a strong market. For the reasons outlined above, we believe this will reverse in time, at least in a relative sense. Since we founded Merlon in 2010 we have consistently valued businesses on the basis of sustainable cash flows discounted at sustainable interest rates and sustainable risk premiums. We do not subscribe to the view that inflation is permanently lower but even if we did we would not be positioning the portfolio differently as we think it would imply the parts of the Australian equity market to which our portfolio is exposed are absurdly undervalued compared to bonds, so-called "technology" companies and "defensive-growth" stocks.

Expectations and investor positioning are always important considerations. The consensus view is inflation and interest rates will remain lower for longer, which probably means this is already priced into bonds, "real assets" and certain equity sectors. In contrast, an investing approach that is not reliant on inflation and rates remaining low could be seen as a sensible hedge in this environment.

Author: Hamish Carlisle, Analyst/Portfolio Manager

Source: Merlon Capital Partners, April 2021

Stock specific contributors to calendar year 2022 performance included coal miner **New Hope**, energy producers **Woodside**, **Origin** & **Santos**, **AMP**, **A2 Milk**, **QBE**, **Ampol** and **Qantas**.

Going back a year or two, the market was too pessimistic on a few key sectors and stocks that Merlon invested in.

As we wrote about several times, before and during the pandemic, the market was too pessimistic on energy stocks given demand was depressed by lockdowns and there had been a decade of underinvestment in new supply. The underinvestment itself was a result of lower prices in the twenty-tens and a preference to invest in renewables over fossil fuels. The low commodity prices meant many industry participants were losing money which is usually the best time to invest in commodity stocks provided they have a cost advantage. This was the case with our investments in **Woodside**, **Origin Energy**, **Oil Search** (acquired by Santos) and **New Hope**.

AMP's share price recovered as the company finally committed to returning surplus capital to investors. The market was too pessimistic on **A2 Milk's** ability to stabilise market share and extrapolated historically low margins despite the resilience of its brand. The market was also too pessimistic on insurance stocks, such as **QBE**, given elevated weather-related claims and the adverse impact of low rates on their investment portfolio. We also benefitted from investing in **Qantas** in 2021 before demand recovered and recognising the airline is now in a stronger position relative to its competitors. **Ampol** was another strong contributor as refining margins recovered and retail fuel volumes benefitted from higher margins.

Outperforming the market is also a function of what you do not own and we resisted investing in many growth and defensive stocks that became overvalued relative to their maintainable cashflow when interest rates approached zero.

To highlight the emergence of new ideas, four of the top 10 being **A2 Milk**, **New Hope**, **Qantas** and **Santos** (via Oil Search) were all acquired during the last 3 years.

Notwithstanding the strong performance, there were still detractors relative to the index from non-held stocks, with iron ore stocks detracting 4.7% from relative performance. Over the year iron ore declined 2% (although 3-year futures advanced 9%) but this hides extreme volatility with the price peaking at US$160 in March and bottoming at US$80 in November, with a year-end rally to reflect optimism about China's re-opening.

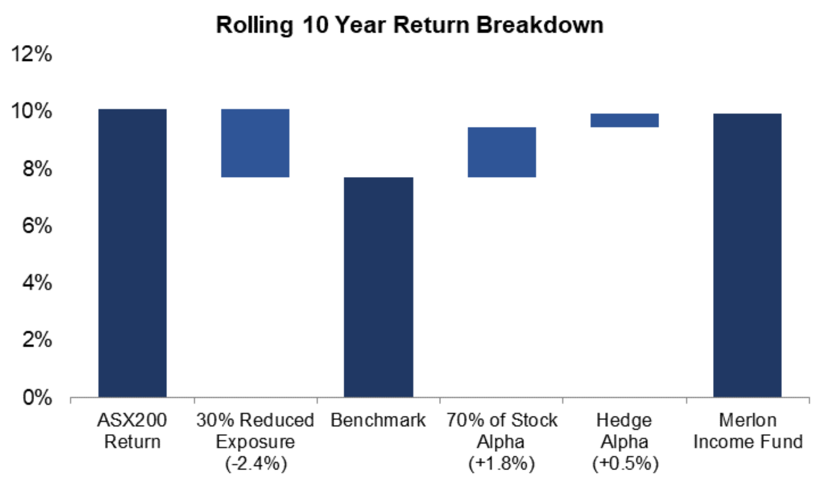
BHP's current firm value of approximately US$180b looks attractive relative to last year's US$38b Earnings Before Interest, Tax, Depreciation & Amortisation (EBITDA) after leases when iron ore averaged US$139 per tonne. However, the same 3 continuing segments, being iron ore, copper and coal (notably 24% of earnings and 32% in the second half), generated less than US$9b EBITDA in 2016 on only slightly lower production. Ultimately, we believe there is downside risk to the iron price linked to the state of the Chinese property sector, global economic risks and sufficient supply in the long-term to meet moderating Chinese demand as the economy matures.

Other non-held stocks that detracted included **Commonwealth Bank** and **NAB**, trading above levels warranted by their maintainable cash flow, even more so given mounting recession risk from the RBA's attempt to tame inflation. Among held stocks, **Unibail-Rodamco-Westfield** detracted but was more than offset by not owning other Real Estate stocks.

The **risk reduction overlay**, which protects the Fund during periods of drawdown, detracted 1.6% over the year. However, this was a very positive outcome given the Fund delivered **85%** of the underlying share portfolio's 21.4% return (before fees and including franking credits), notwithstanding maintaining 69% average daily net equity exposure throughout the year.

Combining stock selection and risk reduction, over the past 3 and 10 years, the Merlon Australian Share Income Fund has outperformed the benchmark, before fees and including excess franking credits, by 3.6% and 2.3% per annum respectively.

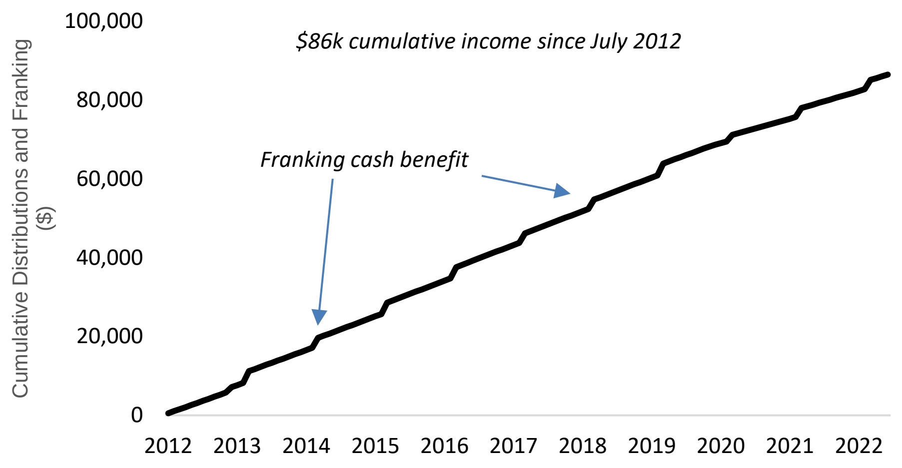
Figure 3: Long-term drivers of benchmark outperformance



Source: Merlon, returns stated before fees and inclusive of franking credits

The Fund also aims to provide a **gross yield above the market**, with distributions paid monthly. Since inception the Fund has delivered a gross yield of 7.4% (after fees and including franking credits), 1.5% p.a. above the ASX200 (including franking credits). In 2022, on the same basis, the Fund returned 7.1%, 1.1% above the ASX200's yield. The below chart highlights the cumulative income from $100,000 invested on 1 July 2012 when the Fund began paying monthly distributions.

Figure 4: Cumulative income on $100,000 invested in July 2012



Source: Fidante, cumulative distributions and franking credits from July 2012 when the Fund began monthly distributions.

Market Review (December 2022 quarter) – The peak of inflation

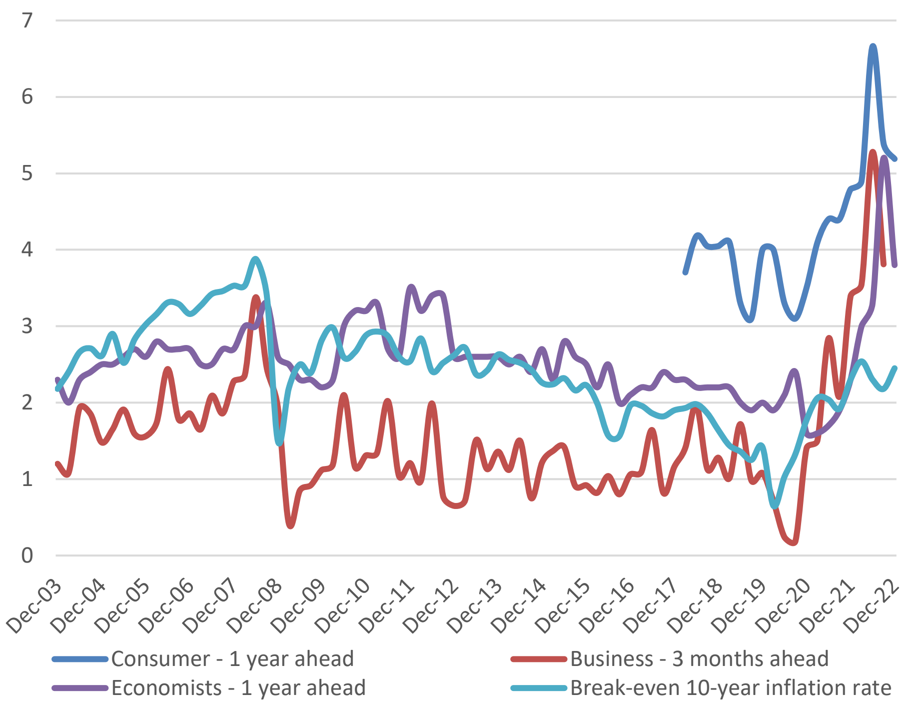
The story of the last quarter of 2022 was a peak in inflation and inflation expectations, spurring lower bond yields and a rally in risk assets. US CPI peaked at 9.1% in June and decelerated for 5 straight months to 7.1% in November. The US Federal Reserve's (Fed) five-year breakeven inflation rate peaked at 2.7% in April and declined to 2.2% by year-end, while the bell-weather US 30-year mortgage rate declined 0.7% from its early November peak. This reflected supply-chain-related drivers reversing and labour markets showing signs of topping out despite unemployment holding at the multi-decade low of 3.5%.

The RBA was the first developed world central bank to reduce the extent of its rate hikes in October. The US 2–10-year spread – seen as a key predictor of recession, at least before central banks meddled in bond purchases – also hit a four-decade low of -84bp in November although eased slightly to -55bp by year-end. A recession is good news for stocks as it usually means central banks pause and ultimately cut rates. Having said this, stocks usually bottom before the recession ends not before it even starts!

At an asset class level, to reflect the fact the worst of inflation might be behind us, Australian equities rallied 9.4% even after a 3.2% December fall on realisation inflation is decelerating but remains too high. The S&P500 Index also rallied 7.6% but interestingly the NASDAQ declined 0.8%, weighed down by heighted valuation scrutiny on account of increasingly attractive risk-free yields.

At a sector level, **Utilities** performed best on higher electricity and gas prices, along with a takeover bid for **Origin Energy**. **Materials** also performed strongly, principally iron ore, which rallied on China re-opening. **Banks** continued their outperformance with investors focused on revenue benefits of higher rates rather than inevitable loan losses arising from the economic fallout. **Real Estate** stocks outperformed as bonds rallied into year-end. Defensive and growth sectors such as **Consumer Staples**, **Healthcare** and **Technology** continued to underperform, weighed down by heightened valuation scrutiny outlined above.

Figure 5: Inflation expectations appear to have peaked in second half of 2022



Source: RBA, Merlon Capital Partners.

Portfolio Review (December 2022 quarter) – The All-rounder

The Merlon Australian Share Income Fund portfolio returned 11.1% in the quarter (before fees and including franking credits), outperforming the benchmark by 4.2%.

Performance contributors in the December quarter were broad-based with the top 10 belonging to 10 different economic sectors. Furthermore, 8 of the 12 sectors delivered between 0.5% and 1.0% positive attribution towards the portfolio's outperformance.

Stock specific contributors to outperformance included **Origin Energy**, following the Brookfield Asset Management-led A$18b takeover offer; **A2 Milk**, with the market beginning to recognise the resilience and strength of the brand, along with opportunity to recover lost market share and return to historic margins; **Unibail-Rodamco-Westfield** de-gearing through US assets sales and benefitting from lower bond yields, **AMP** as prospects of more meaningful capital returns become priced in; and **Qantas**, in a sweet-spot of catch-up demand and record airfares. **Medibank** was the only holding with a negative return in the quarter following the data hacking breach. This was an extremely poor and unacceptable client outcome but the market value declined $2b in the week following the incident. Our downside scenario attempts to capture risk of fee waivers, customer loss, customer remediation and regulatory fines yet we still believe the market over-reacted and added to our position at these lower levels.

Turning to relative performance drivers from non-held stocks, not owing **CSL** was also a key contributor while detractors included iron ore stocks, **BHP**, **RIO** and **Fortescue** again (see 2022 full year commentary) and not owing **Commonwealth Bank**.

The **risk reduction overlay**, which protects the Fund during periods of drawdown, detracted 3.9% during the quarter, however this was a positive outcome with the Fund delivering 75% of the underlying share portfolio return whilst maintaining 69% average daily net equity exposure.

Portfolio Activity

During the quarter we introduced one new investment, **Janus Henderson** (JHG), a globally diversified investment manager with approximately US$275b in assets under management. Our investment process is to invest in undervalued companies where we think market participants have become too pessimistic. In the case of JHG, the market is concerned about ongoing fund outflows as investors shift to passive alternatives, mediocre investment performance in the higher margin equities capability and cyclical downside if equity markets decline on the higher interest rate outlook. These are all valid concerns but we believe are already factored into the current market value. To illustrate this, around a quarter of the current market capitalisation is accounted for by cash and co-investment in funds, with the current share price discounting a material fall in global equity markets plus 5% fund outflows into perpetuity. In the meantime, the company is highly cash generative and can buy back approximately 5% of its shares each year on a high single digit yield. The company is also less risky than perceived due to diversification of its funds, flexible variable costs, ungeared balance sheet and the cyclical offset being a USD earner listed in Australia.

During the December quarter, we also added to existing investments in **AGL**, **Newscorp**, **Medibank Private** (see quarterly performance commentary above), **Alumina**, **Unibail-Rodamco** and **Origin Energy**.

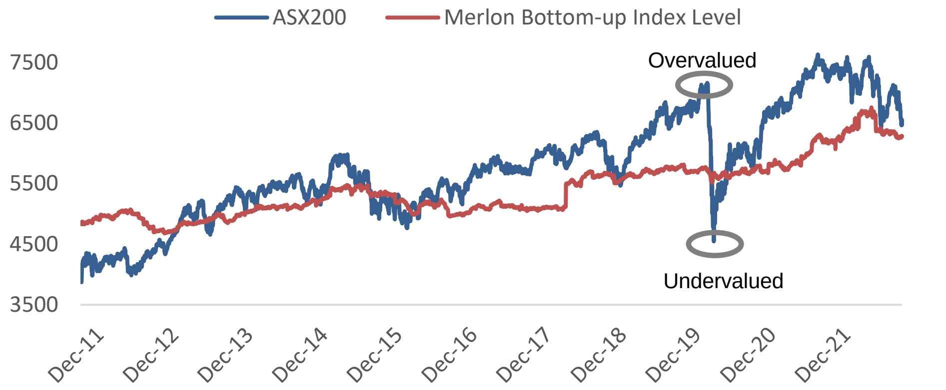
To fund the new investment and additions, we exited our investments in **Whitehaven**, **ANZ**, **Metcash** and **Newcrest**. We also reduced but retained investments in **Santos**, **Woodside** and **New Hope Coal**. The reduction in energy-related positions simply reflected outperformance relative to our valuation range which continues to be based on long-term Brent oil price of US$60-100/bbl and thermal coal of US$65-100/t.

ANZ offers valuation upside but has a wide range of outcomes with an increasingly likely downside case predicated on higher credit losses in an economic downturn, ongoing market share losses and integration risk with the Suncorp bank acquisition (still to be approved). **Metcash** no longer offers sufficient valuation upside to compensate for the fact that all three segments have cyclically benefitted from Covid, in particular liquor and hardware, and there is risk market share losses re-emerge in the Food pillar as the impact of Covid fades. We exited our investment in **Newcrest** as we now view gold to be over-valued relative to real interest rates which has reduced the valuation upside. Even at this lower level for gold, major producers remain very profitable, quite different to the position of energy producers a few years ago as outlined above.

Portfolio Outlook

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. Unlike the modelled 20% overvaluation seen at the end of 2021, the market is approaching our assessment of fair value.

Figure 6: Expected return based on Merlon valuations



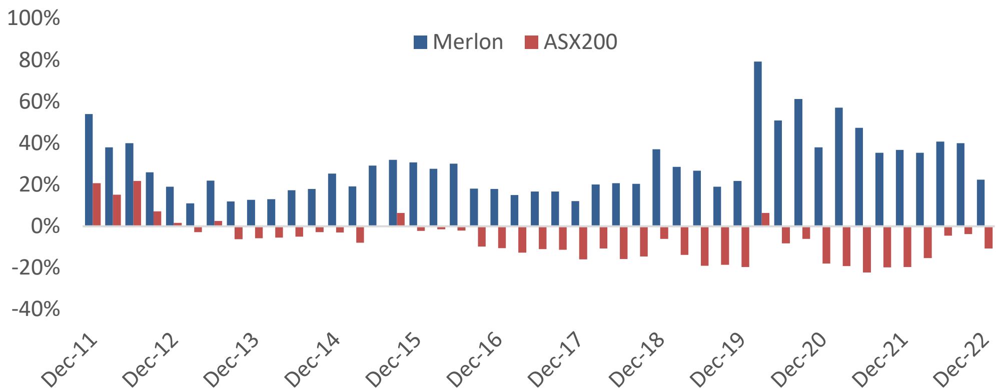
Source: Merlon Capital Partners

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.

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 and where investors have become overly pessimistic about long term prospects on account of weaker short-term performance. We assess the degree of pessimism by considering the company's market value in relation to a sensible valuation range with particular focus on the downside risk scenario. 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.

As can be seen in Figure 7, the Merlon portfolio continues to offer attractive upside as it has over the past 12 years, with the key being the expected return spread over the market. This gives us confidence we can continue to outperform over the medium-term.

Figure 7: Expected return based on Merlon valuations



Source: Merlon Capital Partners

Inflation and rate expectations appear to have peaked but this is now a consensus view. Downside economic risk and associated company earnings downgrades from the extent and pace of rate hikes is similarly a consensus view and most likely priced into current equity prices. We observe however that inflation, while having peaked, remains too high and markets are not priced for persistently high inflation in our view. A pause in central bank rhetoric runs the risk of a reacceleration of inflation and the longer inflation remains elevated the greater the risk of wage-price spirals. It is also unclear the extent of economic (and earnings) pain required to return inflation to central bank target levels. Furthermore, we have only recently ended 14 years of unconventional monetary policy that has suppressed discount rates and inflated most asset values.

Our portfolio is well positioned, at least in a relative sense, if inflation proves more persistent as we focus on under-appreciated cashflow rather than longer dated growth potential at low discount rates and have consistently factored in higher (3%) real bond yields. These higher yields are consistent with history which extends beyond the period of central bank meddling with bond purchases and reflects a risk premium for inflation volatility.

Our portfolio is also well positioned, again at least in a relative sense, for an economic and earnings downturn. We are materially underweight late cycle banks which are not pricing in an inevitable turn in the credit cycle and are now underweight commodity-exposed stocks (principally iron ore and materially reduced energy) which will not be immune from the lagged economic slowdown triggered by higher interest rates. As we wrote about in our Covid Roadmap in 2020, leverage is the enemy in downturns and there are no more leveraged stocks than the banks, property and infrastructure stocks.

In addition to the positioning of the underlying share portfolio in the event of a market downturn the Fund's **risk reduction overlay** will provide material insulation from declines in the Fund's investments.

Where our portfolio might lag a strong market as it did in the 2017 to 2019 period is if central banks do an about-turn and engineer more record stimulus to push real bond yields back towards zero or below. Investors might consider this a risk worth taking in exchange for a portfolio of companies with absolute upside through a focus on cash generation, conservative approach to leverage and overly pessimistic market expectations, without needing assistance from lower real interest rates.

Figure 8: Portfolio Analytics

	Portfolio	ASX200
Number of Equity Positions	36	200
Active Share	75%	0%
Gross Yield	7.9%	6.2%
Mid-cycle Free Cash Flow Yield	7.4%	5.0%
Merlon Valuation Upside	22%	-11%
Price / Earnings Ratio (year ahead)	14.3x	16.6x
Net Exposure	70%	100%

Source: Merlon Capital Partners

Portfolio Analytics: Valuation upside based on Merlon estimates of sustainable free cash flow & franking credits. Price earnings ratio based on Bloomberg consensus estimates over next 2 financial years, annualised & time weighted.

Stock in Focus

AGL supplies around 4.2 million retail and commercial energy customers and operates Australia's largest private electricity generation portfolio, comprising coal and gas-fired generation, renewable energy sources and gas production and storage assets. AGL is targeting a complete exit from coal fired generation by the end of FY35.

To be a good investment, we need to understand why a company is undervalued and either prove these concerns are not valid or that the worst-case outcome is already factored into the share price. With AGL, the market is concerned about decarbonisation resulting in a return to low wholesale electricity prices, volatility of wholesale prices exacerbated by extreme leverage, government intervention risk to support renewables, the competitive nature of retail energy market, the cost of remediation and misallocation of capital into renewables.

While many of these concerns are valid, we believe they are already discounted into the share price.

In addition to deep fundamental research and rigorous peer review, we have a formal engagement programme with the board of directors around the time of initial investment. We write a letter with the purpose of introducing Merlon, outlining our investment thesis, summarising key Environmental, Social and Governance (ESG) issues and ultimately engaging directly with the company. In this case, we met with three of the current non-executive directors (NEDs), including the Chair, three of the proposed new NEDs and other shareholders to discuss they key issues facing the company.

Figure 8 highlights an extract of the AGL letter outlining our valuation range and investment thesis as delivered to the company. It is important to note that while the valuation range appears wide, this is the economic reality of a company operating in a commodity environment (wholesale electricity & gas), with high financial (including off balance sheet commitments) and operational leverage.

Figure 9: Extract of letter to AGL Board

16 December 2022

Members of the Board of Directors
AGL Energy Limited
Locked Bag 3013
Australia Square NSW 1215
Australia

Re: Introduction to Merlon Capital Partners

Ladies and Gentlemen:

For your records, Merlon Capital Partners ("Merlon") owns [redacted] shares in AGL Energy Limited ("AGL") on behalf of our clients, being retail and institutional investors. The purpose of this letter is to i) introduce Merlon to the board of directors; ii) outline our AGL investment thesis; iii) provide an overview of our approach to Environmental, Social and Governance (ESG) matters; and iv) summarise key ESG issues identified to date in relation to AGL.

Key ESG Issues in Relation to AGL

Merlon actively engages with market participants including other fund managers, proxy advisors, brokers and external rating agencies as well as other relevant stakeholders to identify market views and concerns regarding a company's ESG exposure and performance. In such discussions, key ESG issues identified by in relation to AGL include:

1. Governance and capital allocation: some proxy advisors, sell-side analysts and other shareholders have raised concerns over the stability of AGL's leadership teams, both at the Board and Executive level,

Investment Approach & AGL Investment Thesis

Our investment approach is to invest in undervalued companies where we think market participants have become too pessimistic. In the case of AGL, we value the company at between $8 and $35 per security.

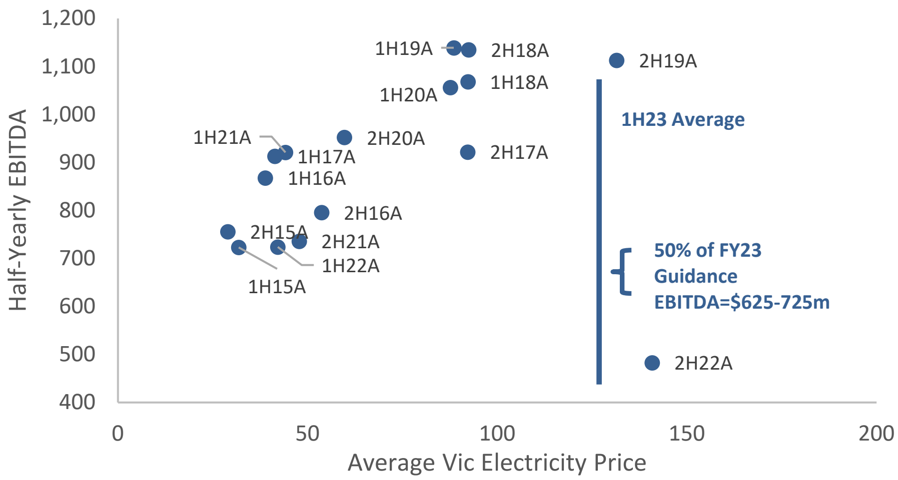
Segment	Low	High	Key Assumptions
Loy Yang	$3.2b	$9.0b	$70-140 wholesale price, 2035 closure
Bayswater	$2.8b	$9.8b	$100-200 wholesale price, 2030-33 closure
Liddell	$0.4b	$0.9b	$100-200 wholesale price, 2023 closure
Coal Generation	**$6.3b**	**$19.7b**	
Customer, supply & trading	$3.4b	$8.1b	5-7% customer markets margin $250-450m supply & trading EBITDA
Equity Value	**$9.7b**	**$27.9b**	
Net debt	($2.7b)	($2.7b)	Book value
Environmental Rehabilitation	($1.2b)	($1.2b)	Book value
Onerous Contract Provisions	($0.9)	($0.9)	Book value
Deferred Consideration	($0.2b)	($0.2b)	Book value
Investments	$0.4	$0.4	Book value
Franking Credits	Small	Small	70% of face value
Equity value	**$5.2b**	**$23.4b**	
Equity value per share	**$8**	**$35**	

We believe the market is extrapolating short-term earnings too far into the future and heavily discounting the prospect of sustained higher electricity prices driven by gas and coal market dislocations. Further, we think investors are justifiably concerned about unstable governance arrangements with the potential to lead to premature closure of Loy Yang and overinvestment in renewables. The extent of potential value destruction from capital misallocation is difficult to quantify and not reflected in our valuation range, although we do note the company's ambition to supply its customers with up to 12 GW of new generation and firming capacity, requiring a total investment of up to $20 billion.

Source: Merlon Capital Partners

Based on the current forward curve, AGL should generate EBITDA of $2b as hedges roll off, relative to an enterprise value of around $8b although the duration of these gains is limited to the closure date of the generators. The retail and commercial customer base is valuable and hard to replicate with optionality to materially increase volumes via energy hubs and services to manage this on behalf of households. The market's focus on short-term earnings and aversion to operating and financial complexity provides an attractive opportunity to invest in AGL at current prices.

Figure 10: Historic relationship between VIC Electricity Price and EBITDA



Source: Merlon Capital Partners

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