

Merlon Australian Share Income Fund

Webinar – 22 July 2020

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How Merlon's approach is different

Fundamental Research

*Focused on
sustainable cash flow*

Portfolio Diversification

*No reference to
ASX200 weights*

Downside Protection

*Through research &
hedge overlay*

This focus on capital preservation and growth delivers

Sustainable Income

Paid monthly and majority franked

Outline

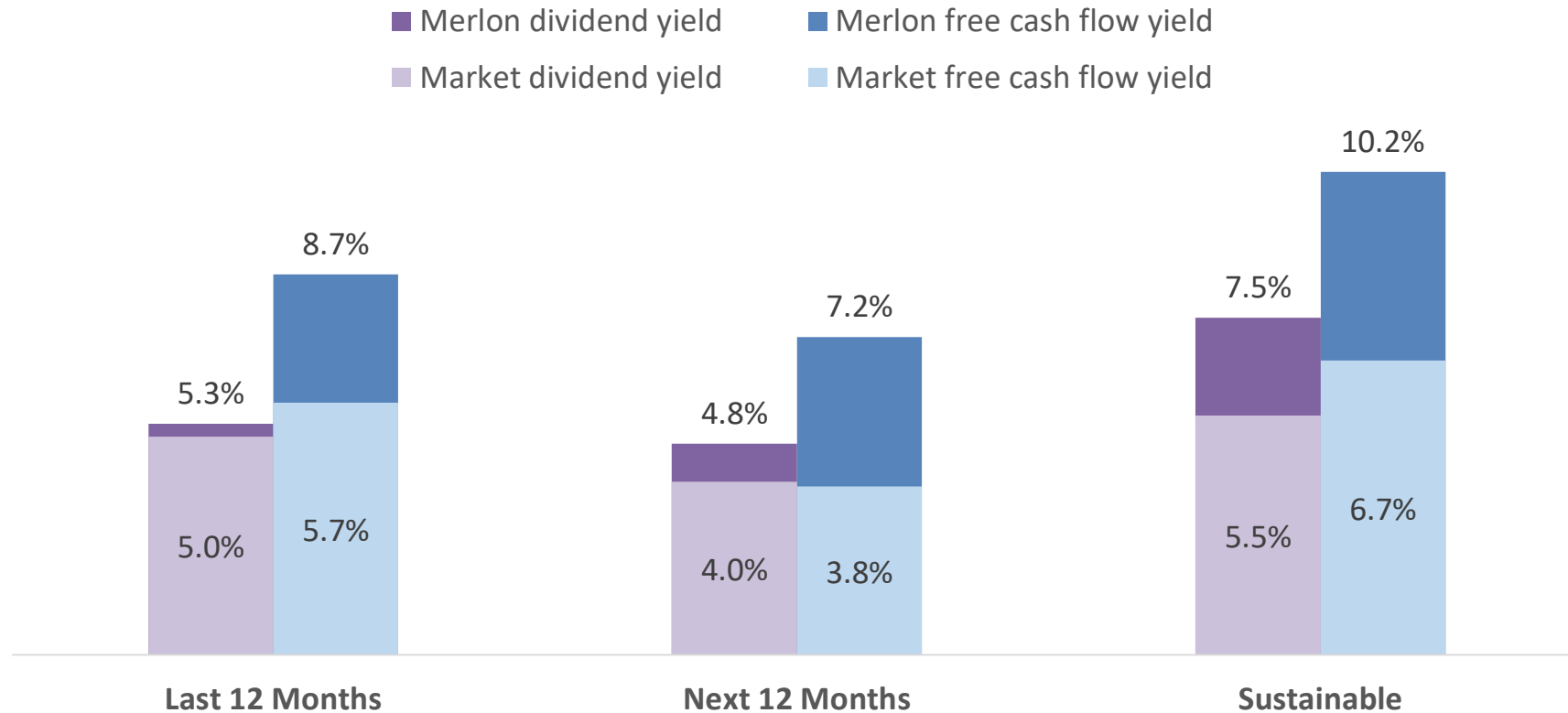
- ❑ Long-term dividend opportunity the main game
- ❑ Oil – pricing in a more realistic recovery
- ❑ Fund positioning and performance

Free cash flow is a better measure of value than dividends



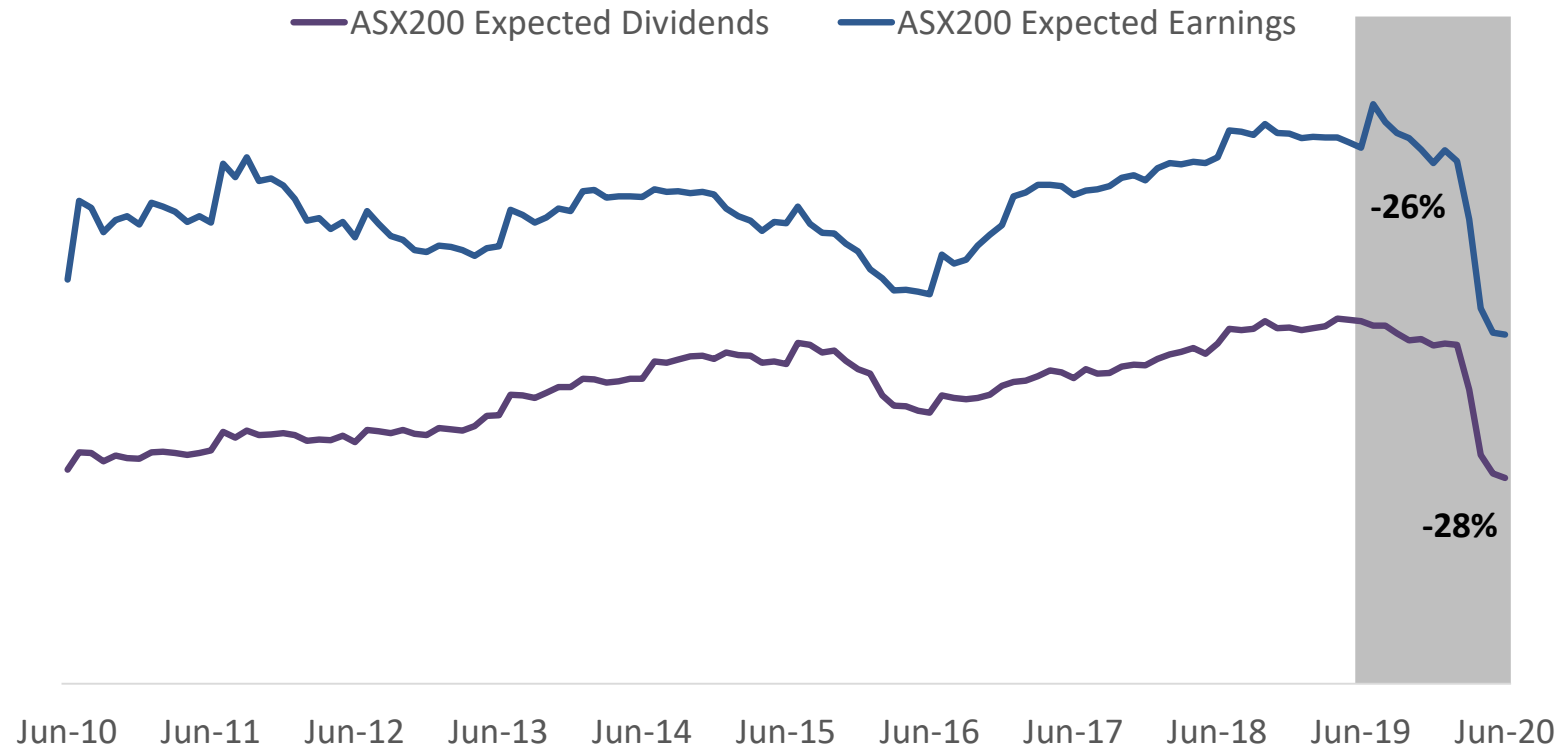
Source: Source: Bloomberg, Merlon. Portfolios are formed using two valuation ratios: enterprise-free-cash-flow-to-enterprise-value (EF/EV) and dividend yield (D/P). Portfolios are formed at the end of each month by sorting on one of the ratios and then computing equally-weighted returns for the following month. The "value" portfolios contain firms in the top one third of a ratio and the "glamour" portfolios contain firms in the bottom third. The analysis is based on S&P/ASX200 constituents and the raw data is from Bloomberg.

The long-term free cash-flow and dividend outlook is very attractive



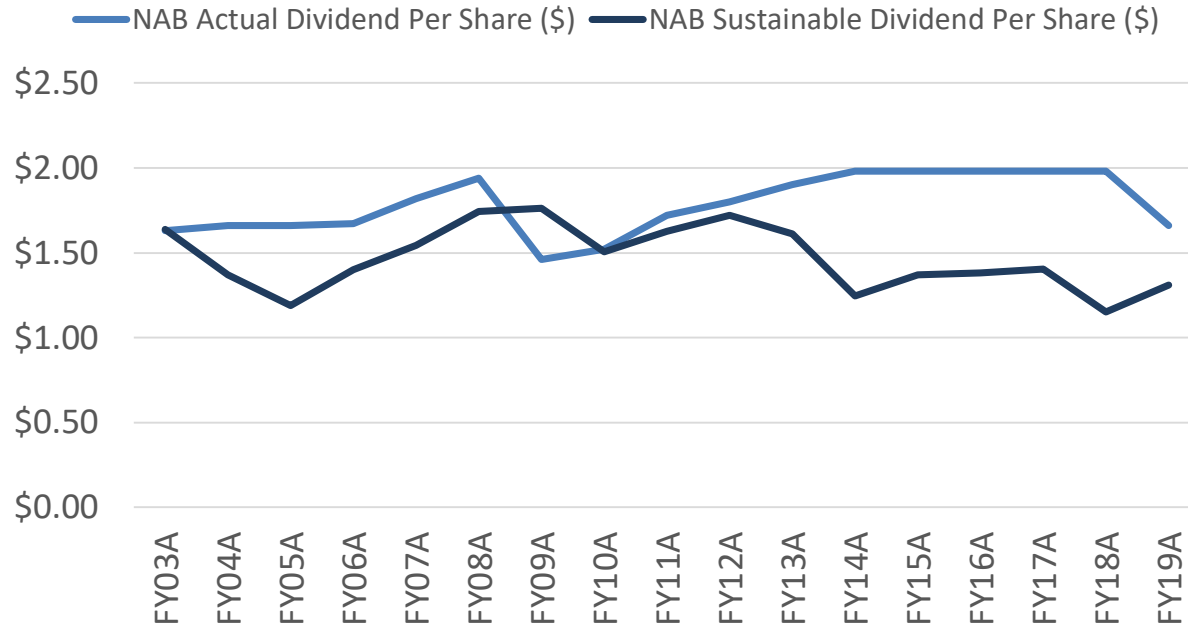
Source: Bloomberg, Merlon, including grossed up value of franking credits. As at 30 June 2020. Any forecasts are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon.

The outlook for near-term dividends is weaker and difficult to predict

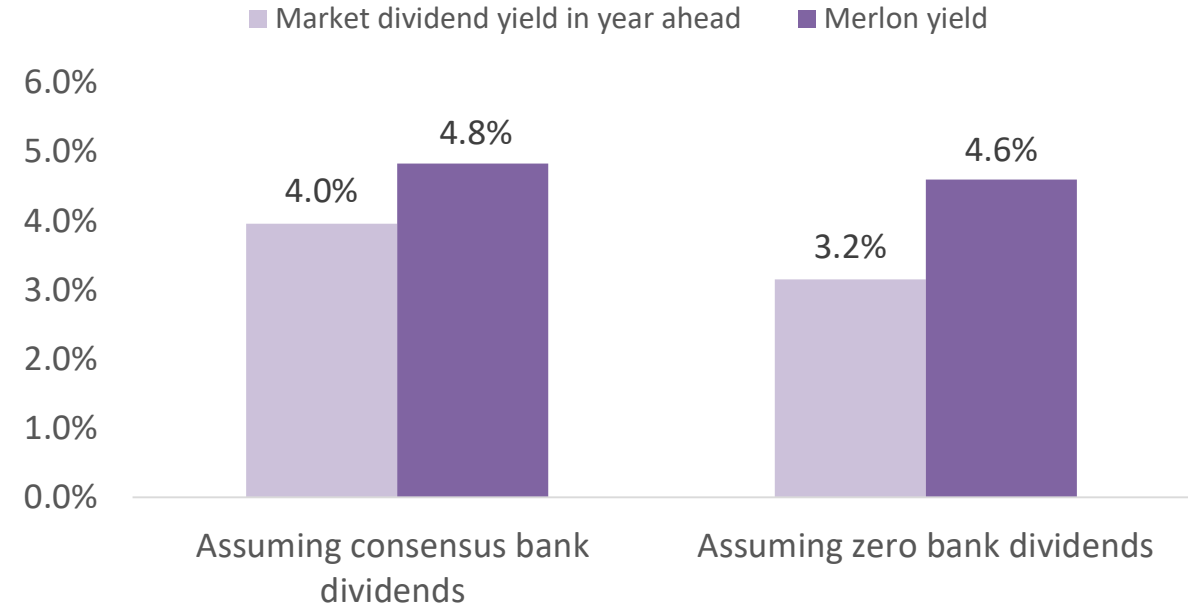


Source: Bloomberg consensus ASX200 12 month forward dividend and earnings expectations. As at 30 June 2020. Any forecasts are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon.

Unsustainable bank dividends have propped up the market yield

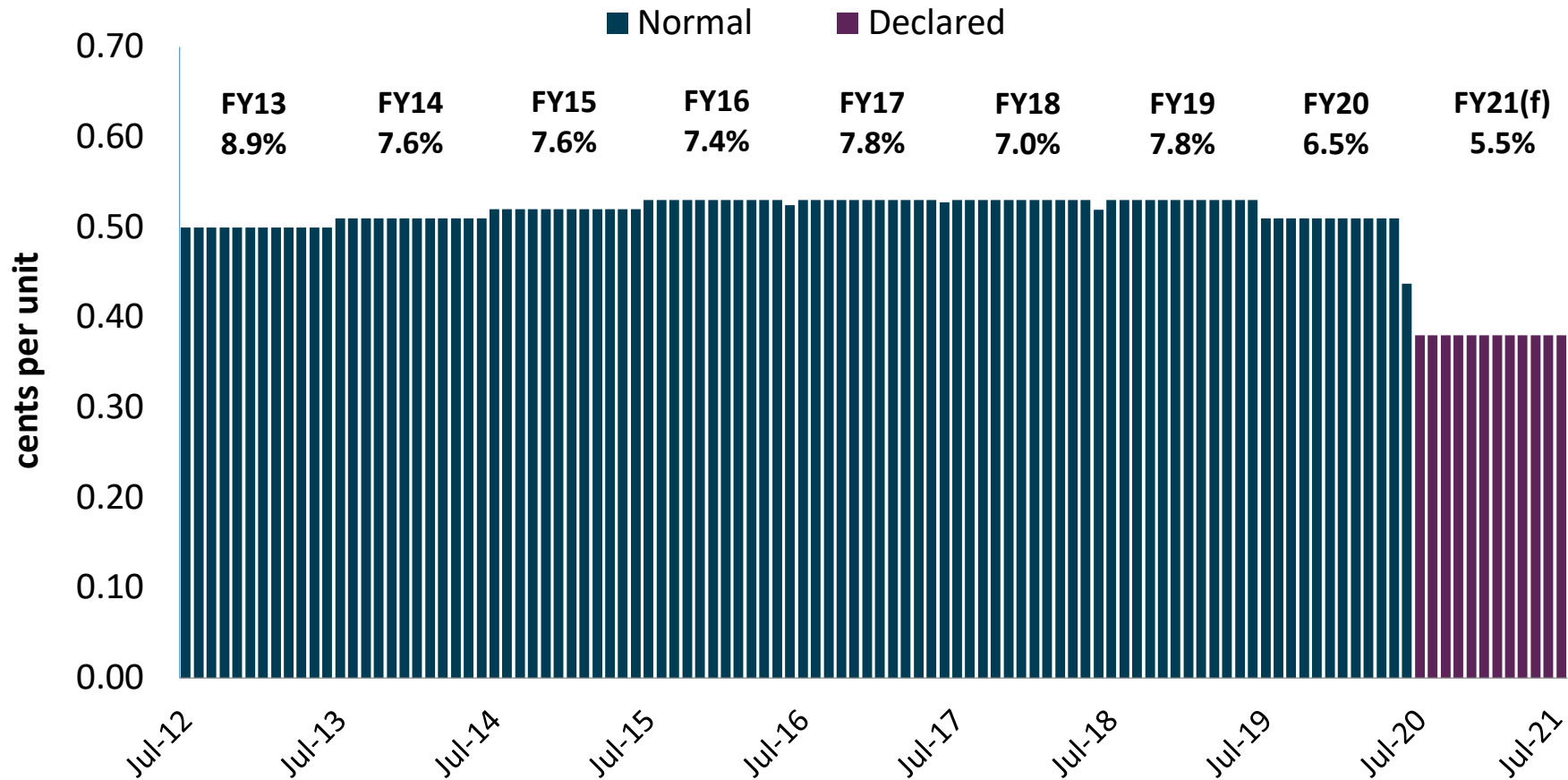


Source: Company disclosures, Merlon, Sustainable estimate based on 0.70% bad debts to non-housing loans and 64% cash-flow to advertised accounting earnings.



Source: Bloomberg, Merlon, including grossed up value of franking credits. Any forecasts are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon.

Merlon Australian Share Income Fund distribution outlook:



Source: Merlon, FY21 estimate, FY Yield based on monthly distribution plus franking credits divided by opening unit price, excludes bonus income in FY13 and FY14. Any forecasts are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon. The information is predictive in character; may be affected by inaccurate assumptions or by known or unknown risks and uncertainties; and may differ materially from results ultimately achieved. Past performance is not a reliable indicator of future performance.

Outline

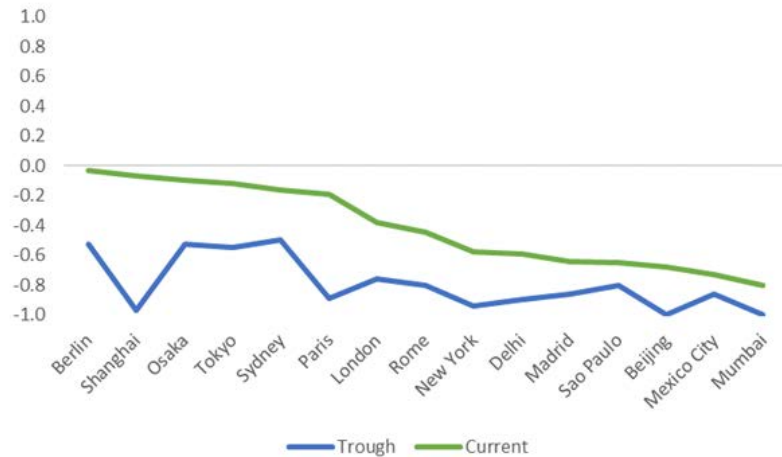
- ❑ Long-term dividend opportunity the main game

- ❑ Oil – pricing in a more realistic recovery

- ❑ Fund positioning and performance

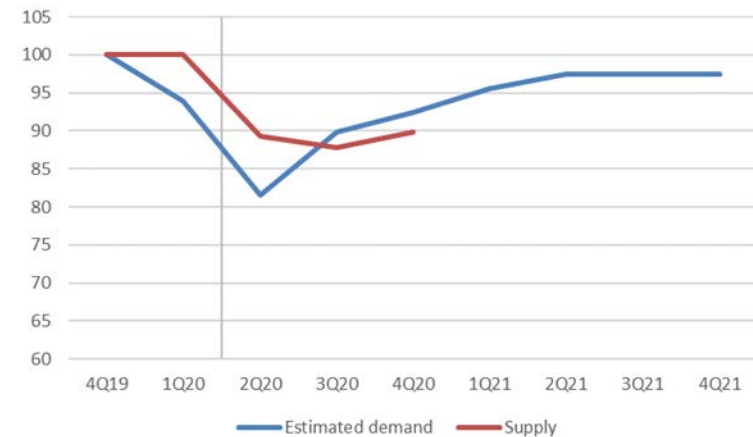
Demand currently ~10% below normal

Monitoring demand – short term



Congestion data vs a year ago in major cities. Data source: TomTom. As at 24 June 2020. Calculations: Merlon Capital.

Recovery pushed out to 2021



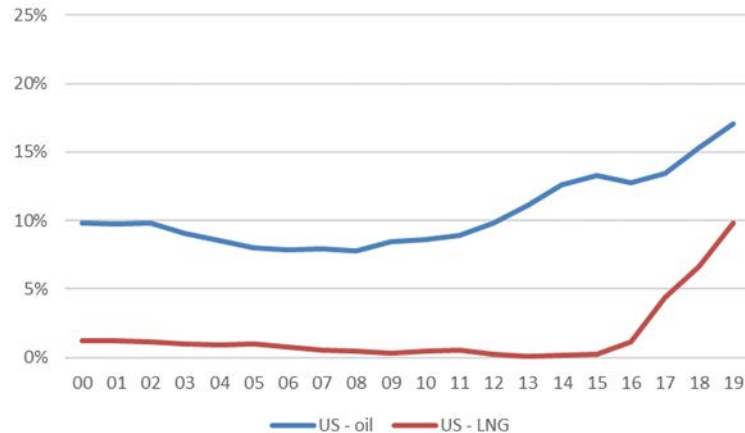
Oil supply and Demand estimates. Data source: Rystad Energy / EAI / OPEC+. Calculations: Merlon Capital. Any forecasts are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon.

Comments:

- Total demand roughly 10% below normal (vs close to 20% at trough)
- Real-time congestion level data have recovered roughly half of the activity lost at the peak of lockdowns
- OPEC+ agreement to reduce production by 9.7mbpd to reduce stockpiles & US supply down by 2.5mbpd

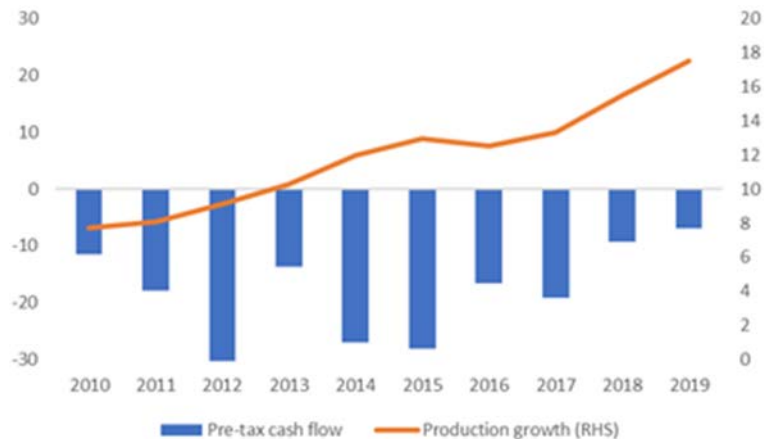
The future of shale

Technology & capital enabled production surge...



US hydrocarbon market share. Data source: BP. Calculations: Merlon Capital.

...but at significant cost to investors



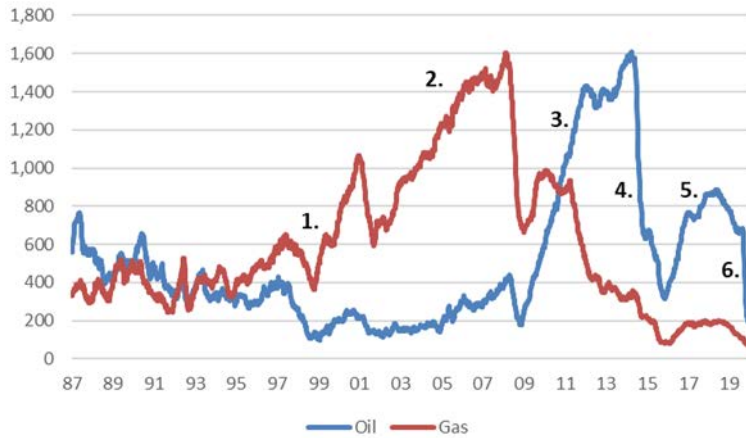
US Onshore oil & gas producer cash flows. Data source: Rystad Energy / EAI / OPEC+. Calculations: Merlon Capital

Comments:

- US has disrupted traditional players in global oil & gas markets
- Unconventional technology development enabled exploitation of higher gas and then oil prices
- But supply growth has not seen cash returns to investors, as decline rates require high drilling (and capital) intensity

The future of shale

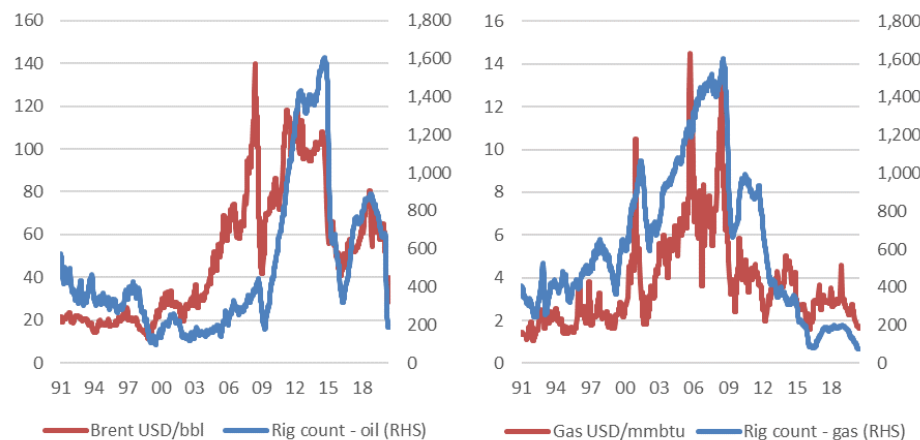
Capital discipline was under way before COVID-19...



A brief history of unconventional oil & gas in the US: 1. Technology-enabled exploitation of shale gas reserves. 2. Gas glut and declining prices. 3. Rigs refocused on oil. 4. Oil glut and price declines. 5. Rigs refocused on most productive plays. 6. COVID-19

US oil & gas rig activity. Data source: Baker Hughes. Calculations: Merlon Capital.

...a function of price incentives



Data source: EIA / Bloomberg. Calculations: Merlon Capital.

Comments:

- Capital discipline was already emerging in 2019 – evidenced by declining rig activity
- Current historic low rig activity likely to see further production declines
- Underinvestment in conventional oil leaves oil markets exposed to any structural pull back of shale = upside bias to price expectations

Outline

- ❑ Long-term dividend opportunity the main game
- ❑ Oil – pricing in a more realistic recovery
- ❑ Fund positioning and performance

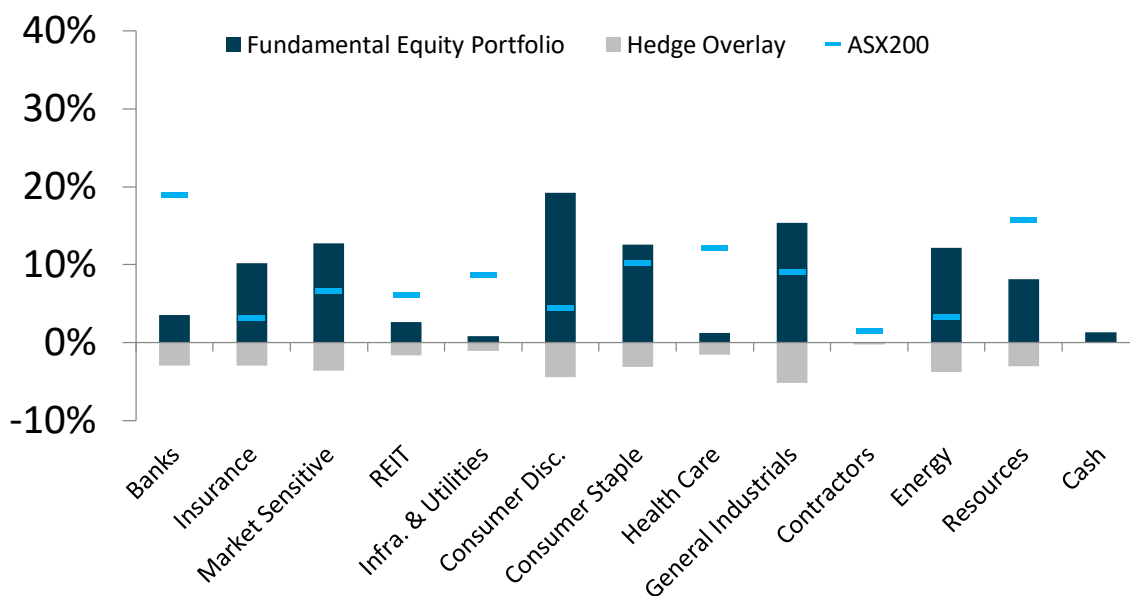
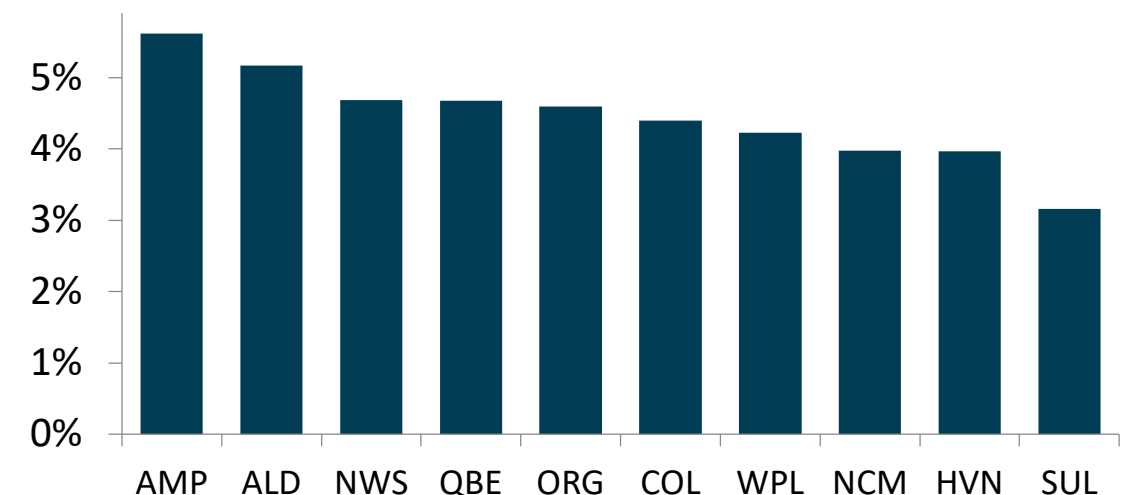
Merlon Australian Share Income Fund performance



	FY2020 (%)	FY2019 (%)	FY2018 (%)	FY2017 (%)	FY2016 (%)	FY2015 (%)	FY2014 (%)	FY2013 (%)	FY2012 (%)	3 Years (%pa)	5 Years (% pa)	10 Years (% pa)
ASX200 Return	-6.5	13.2	14.5	15.5	2.2	7.2	18.9	24.3	-5.1	6.6	7.4	9.3
Share Portfolio Excess Return	-2.8	-4.8	-6.9	8.0	4.8	2.3	-2.7	11.7	1.7	-4.8	-0.5	0.5
Hedge Overlay	3.9	-0.9	-2.4	-5.6	-0.9	-1.7	-3.5	-9.3	2.6	0.4	-0.9	-1.5
Portfolio Return (before fees)	-5.4	7.5	5.1	17.9	6.1	7.8	12.8	26.7	-0.8	2.3	6.0	8.3
Portfolio Return (net of fees)	-6.3	6.5	4.2	16.8	5.1	6.8	11.8	25.5	-1.7	1.3	5.0	7.3
Gross Yield	6.4	7.9	7.0	7.8	7.5	7.6	7.6	9.8	10.1	6.6	7.4	9.3
Average Daily Market Exposure	67%	69%	68%	68%	70%	70%	69%	69%	69%	68%	69%	70%

Returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated as at 31 December 2019. Past performance is not a reliable indicator of future performance. Gross Distribution Yield represents the income return of the fund inclusive of franking credits (before fees).

Merlon Australian Share Income Fund - current fund positioning



Portfolio Analytics – 30 June

Number of Equity Positions

Portfolio ASX200

41 202

Net Market Exposure

66% 100%

Active Share

83% 0%

Valuation Upside¹

51% -8%

Trailing Free Cash Yield

6.9% 4.4%

Gross Distribution Yield

5.5% 3.9%

Price / Earnings Ratio

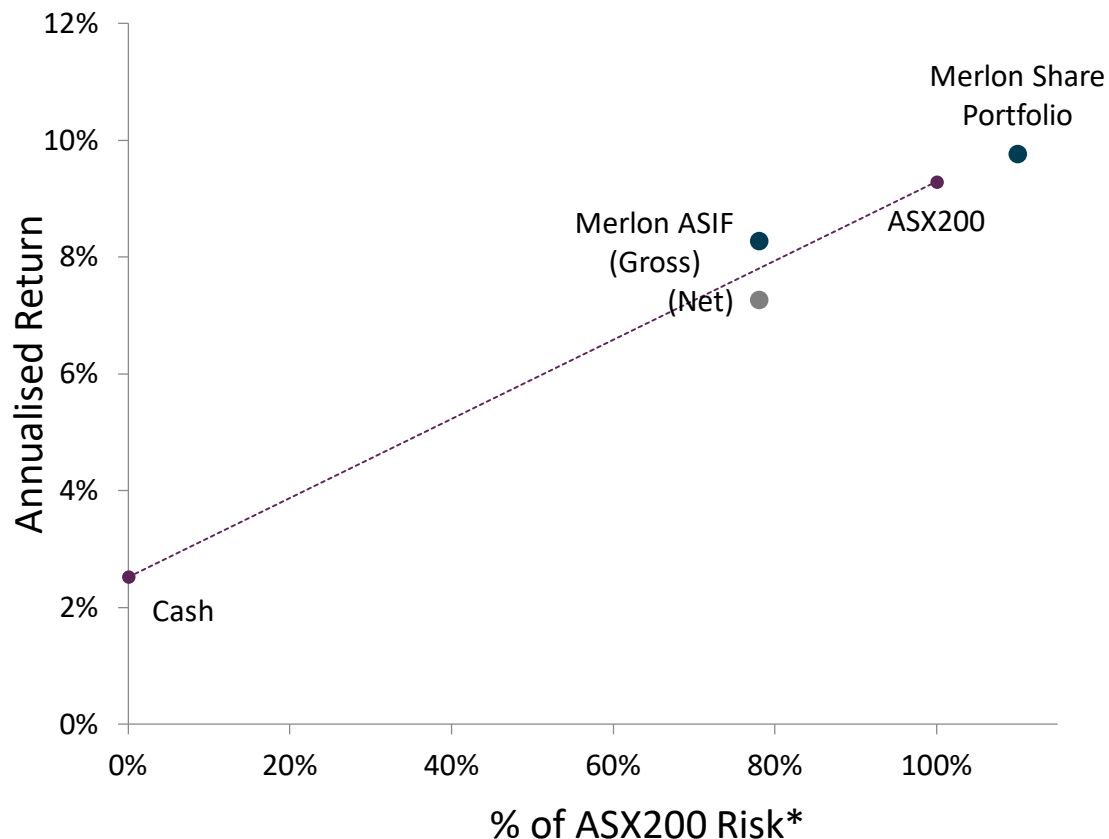
18.3x 21.0x

Portfolio as at 30 June 2020. ¹Valuation Upside based on Merlon proprietary valuations.

Outcome



Total Return vs Risk (10 Years)



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	0.3	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	0.38	4.56	1.00

Returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated net or gross of fees (as applicable) as at 30 June 2020.

Merlon Australian Share Income Fund franking 2.01% p.a., ASX200 franking 1.48% p.a.

*% of ASX200 Risk represents the Fund's statistical beta relative to the ASX200. Past performance is not an indication of future performance.

^Underlying portfolio returns before hedge overlay

*Forecast distribution estimates are based on Merlon's conservative best estimate of dividends over the upcoming 12 months and implied cash yields earned on hedging activity based on the portfolio composition as at the date of this document. Merlon constantly monitor these estimates through their underlying assessment of forecast free cash-flow from portfolio companies and how this translates to dividends to equity holders based on historical and forward looking analysis. Information is predictive in nature, may be affected by inaccurate assumptions or known or unknown risks and uncertainties, and may differ materially from results achieved. Results are not guaranteed.

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Downside Protection

*Through research &
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This focus on capital preservation and growth delivers

Sustainable Income

Paid monthly and majority franked

A bit more about your presenters



Neil Margolis
Lead Portfolio Manager

Neil Margolis founded Merlon Capital Partners in May 2010. Prior to Merlon, Neil was Portfolio Manager of Challenger Limited's Australian Share Income Fund, having established the strategy in 2005. Neil joined Challenger in 2004 as a Senior Industrials Analyst from Alliance Capital Management where he held the position of Senior Equities Analyst. Neil was with Alliance for three years, and prior to that worked for JP Morgan Investment Bank.

Neil holds a B.BusSc (Hons), CA and CFA.



Ben Goodwin
Analyst/Portfolio Manager

Ben joined Merlon Capital Partners as a Principal upon its inception in May 2010. Prior to joining Merlon, Ben was Head of Research and Information at Challenger Limited, managing the risk and quantitative research processes across all portfolios, as well as conducting tailored fundamental research, macro and commodity based research. Ben has held similar roles at First State Investments (UK), Colonial First State (Australia), and BT Funds Management.

Ben holds a B.Ec (Hons).

Thank you