

# Merlon Australian Share Income Fund

Webinar – 30 October 2018

Ben Goodwin, Hamish Carlisle and Adrian Lemme

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# How Merlon 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

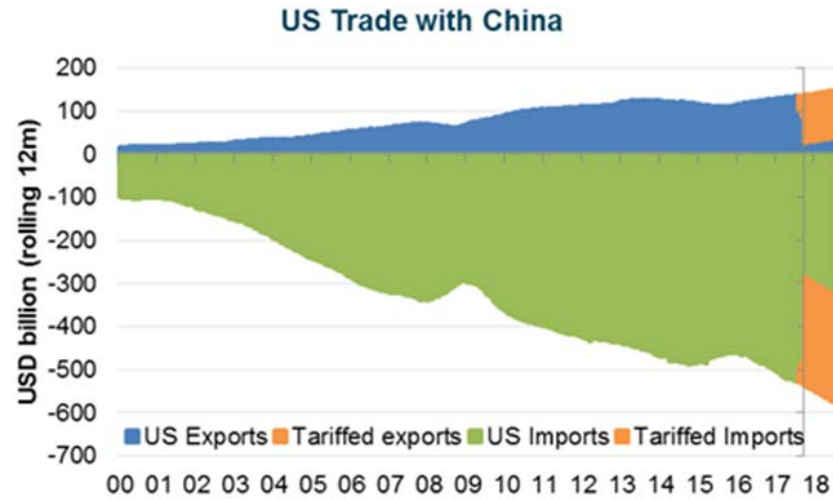
*Paid monthly and majority franked*

# Outline

- Trade war
- Some more thoughts on Telstra
- Fund positioning and performance

# 1. Clash of the titans

## US/China trade



## Comments:

- The United States is the world's biggest consumer
- China is the world's biggest exporter
- Trade mismatch has become a political issue
- Trump has launched tariffs and threatened escalation

## 2. What Trump wants?

### Issues to address:

- Forced technology transfer
- Trade deficit
- Made in China 2025

### Intended outcomes:

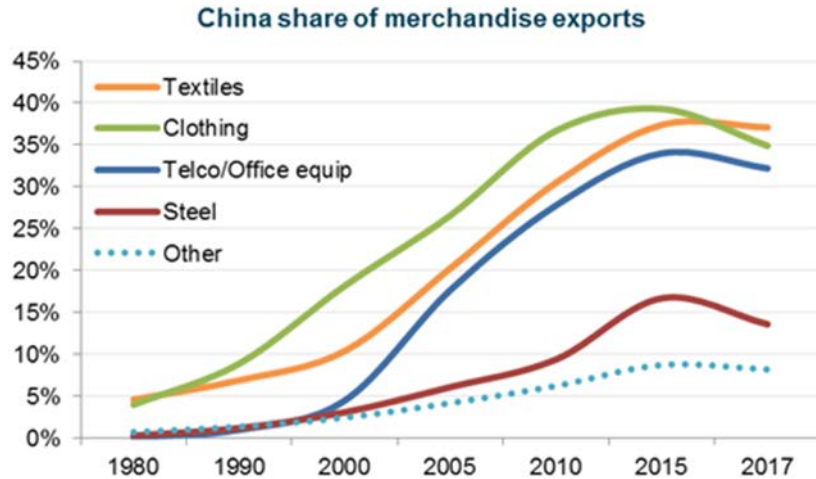
- Technological preeminence
- Return of manufacturing jobs
- Military dominance

### Policy instrument:

- Tariffs

### 3. Tariffs and the peak of the Chinese growth model

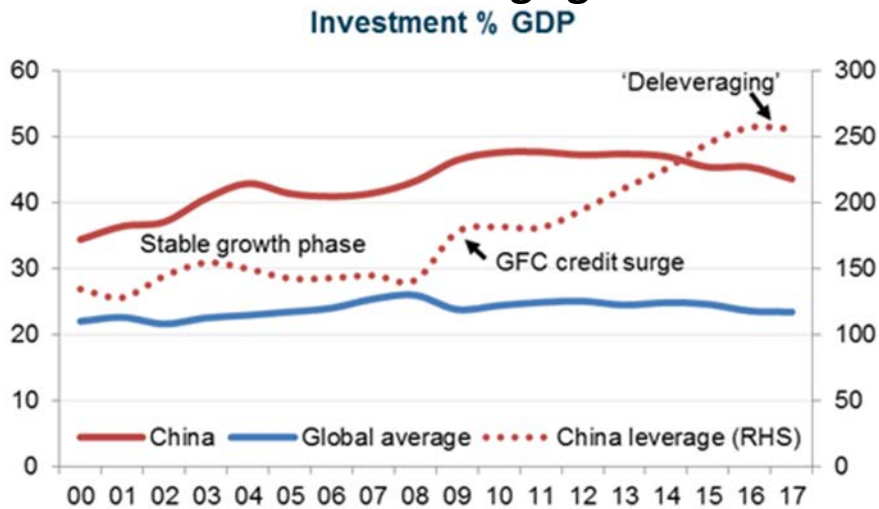
#### Low-value added export driven growth



#### Comments:

- Growth model took off in 2001 on admission to WTO
- Declining competitiveness saw the model peak in 2015
- ‘Made in China 2025’ the key policy response
- Ability to implement policy impacted by trade dispute

#### Investment-driven leverage growth



#### Comments:

- Post GFC credit-driven investment stimulus phase
- Resulted in ~300% debt-to-GDP ratio
- ‘Deleveraging’ policy response
- Ability to deleverage impacted by trade dispute

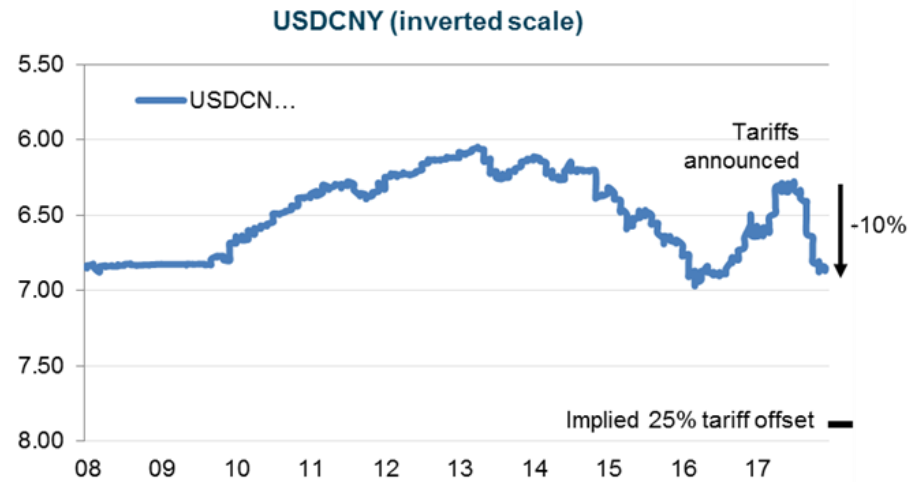
Source: Top: World Trade Organisation. Analysis: Merlon. Bottom: World Bank. Bureau of International Settlements. Analysis: Merlon

# 4. China: how to respond

## Tariffs – limited scope

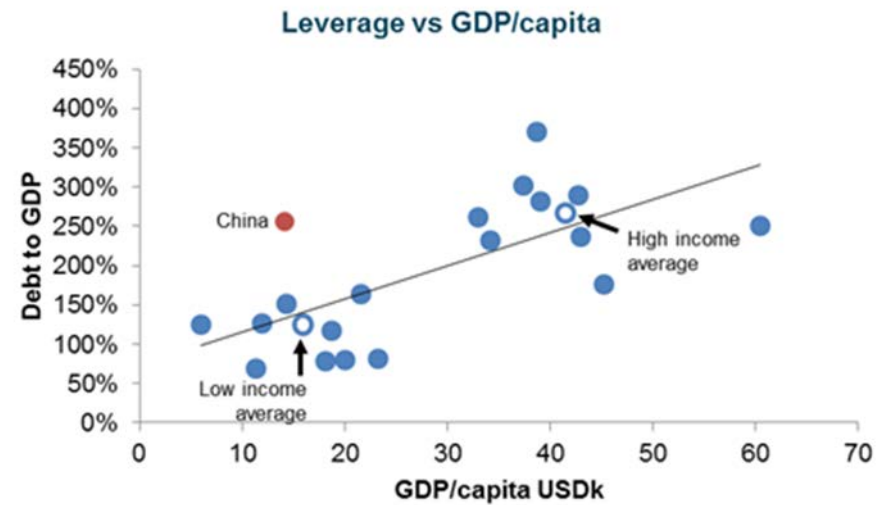


## Currency – further devaluation?

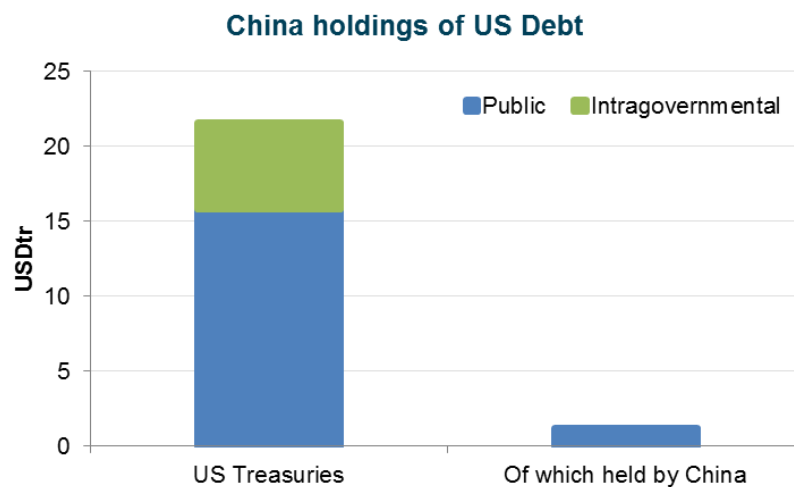


Source: Top: Federal Reserve Bank of St Louis. Bottom: Bloomberg. Analysis: Merlon

## Stimulus – leverage ratios elevated



## US Treasury holdings – low impact

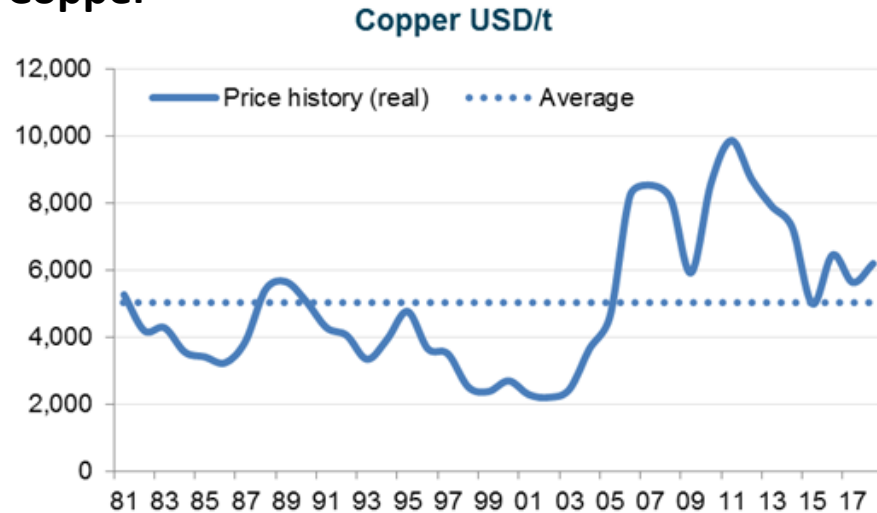


Source: Top: International Monetary Fund. Bureau of International Settlements. Bottom: U.S. Treasury. Analysis: Merlon

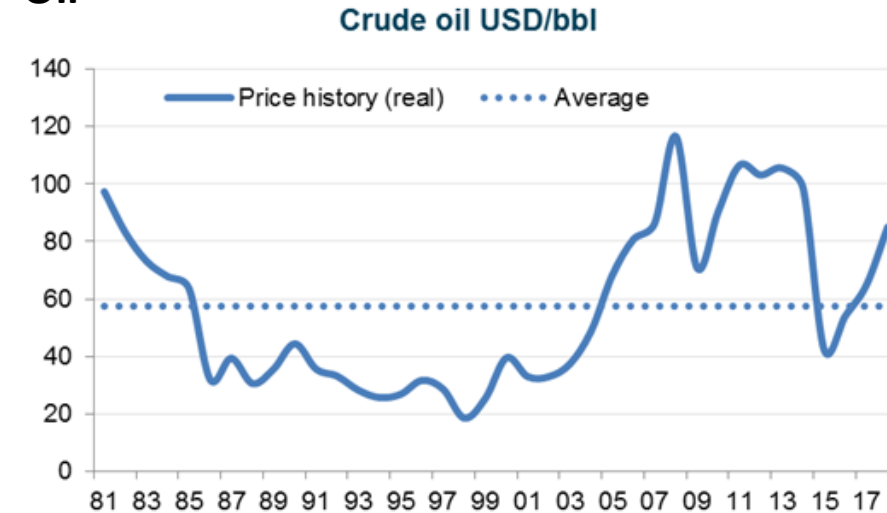


## 5. Impact on commodities

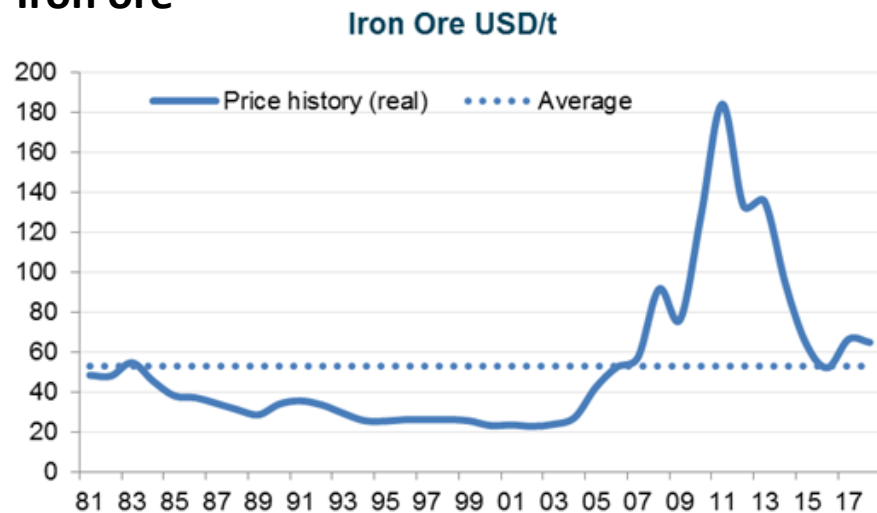
### Copper



### Oil



### Iron ore



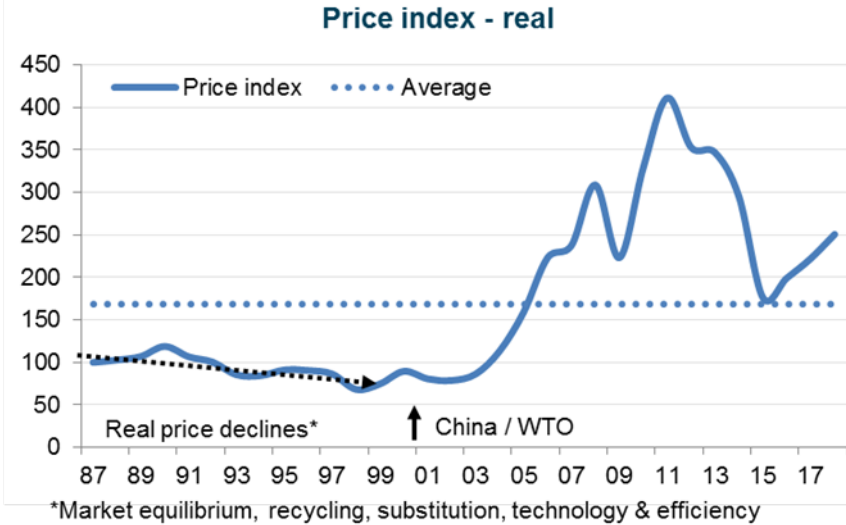
### Comments:

**Short term:** iron ore & copper may benefit from stimulus / oil downside from demand destruction

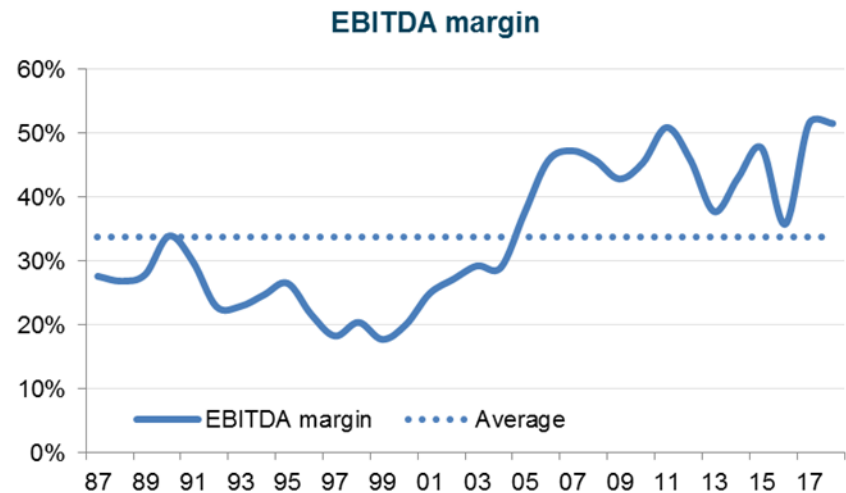
**Long term:** iron ore downside from recycling / oil & copper supported by lack of investment

# 6. Fund positioning – deconstructing the cash-flow

## Prices: elevated

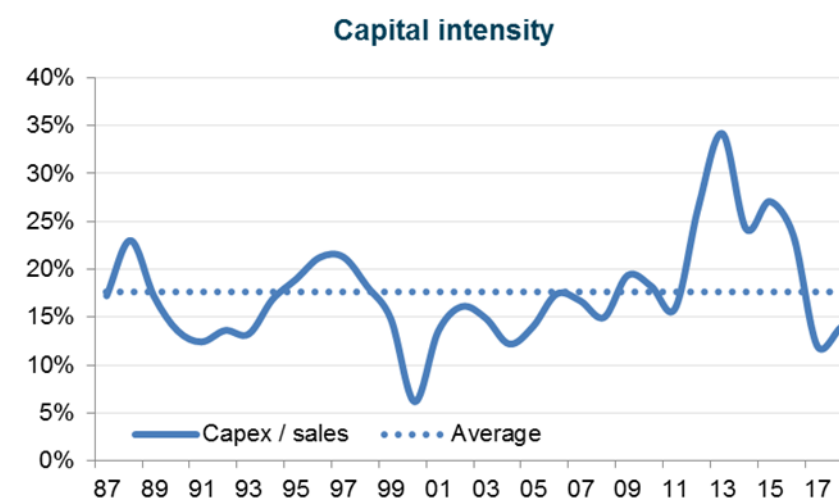


## Margins: elevated

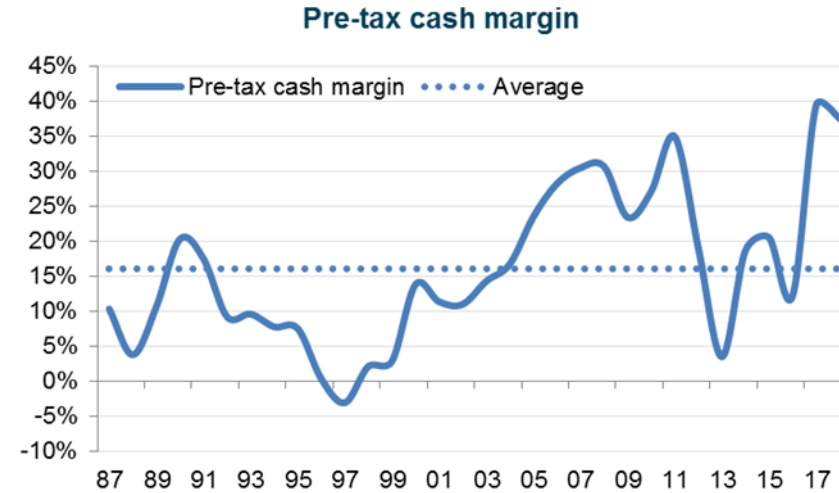


Source: Top: Bloomberg. Bottom: Company Reports. Analysis: Merlon

## Capital intensity: low



## Adding it up: unsustainable cash-flows



Source: Company Reports. Analysis: Merlon

# Outline

- ❑ Trade war

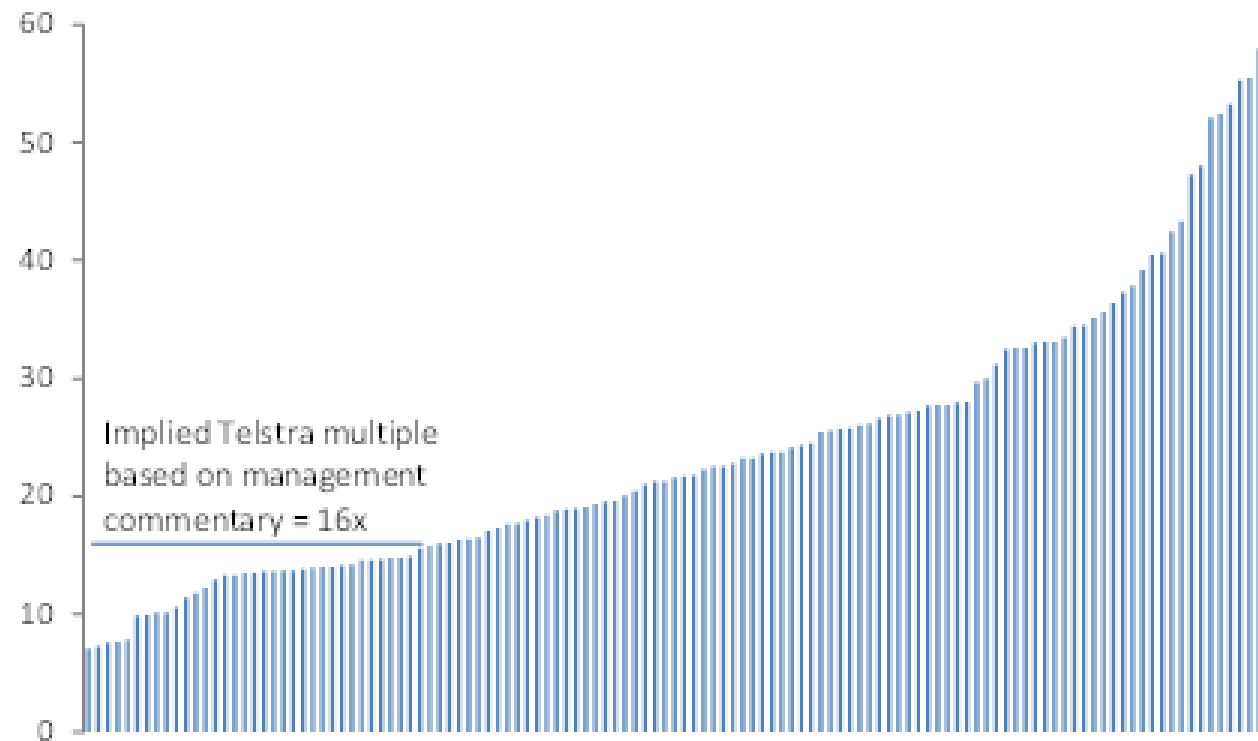
- ❑ Some more thoughts on Telstra

- ❑ Fund positioning and performance

# Telstra looks like reasonable value based on management guidance



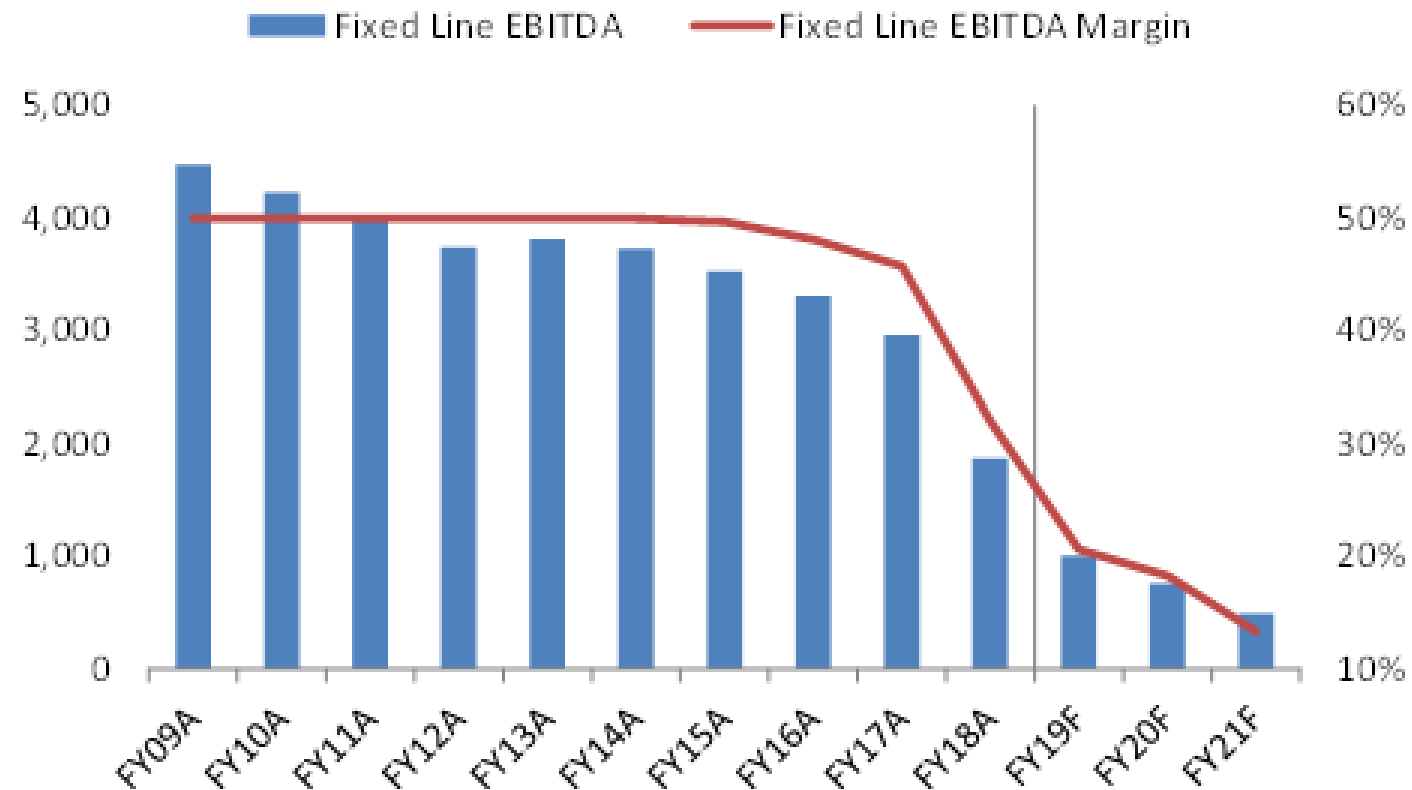
## Enterprise Valuations / Sustainable Free Cash Flow (Merlon Coverage Universe, data as at 15 August 2018)



Source: Bloomberg, Merlon Capital Partners

However, 2019 will not mark the end of NBN pain...

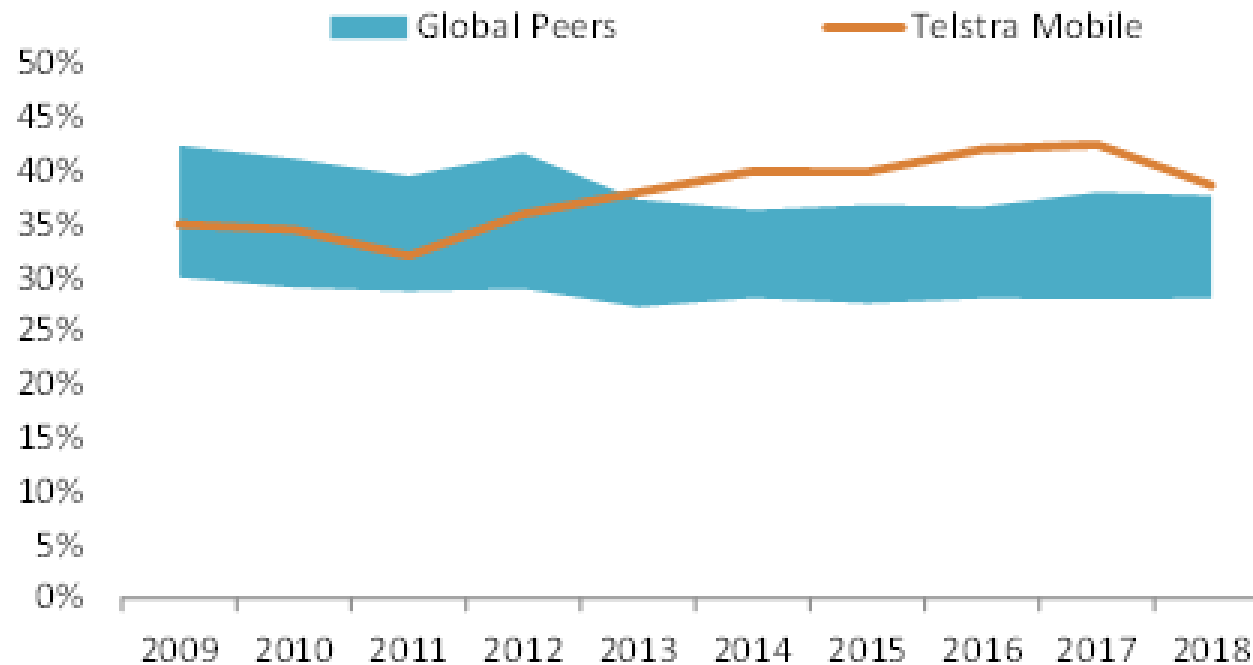
### Telstra Fixed Line EBITDA & Margin



Source: Bloomberg, Merlon Capital Partners

And, mobile margins appear elevated...

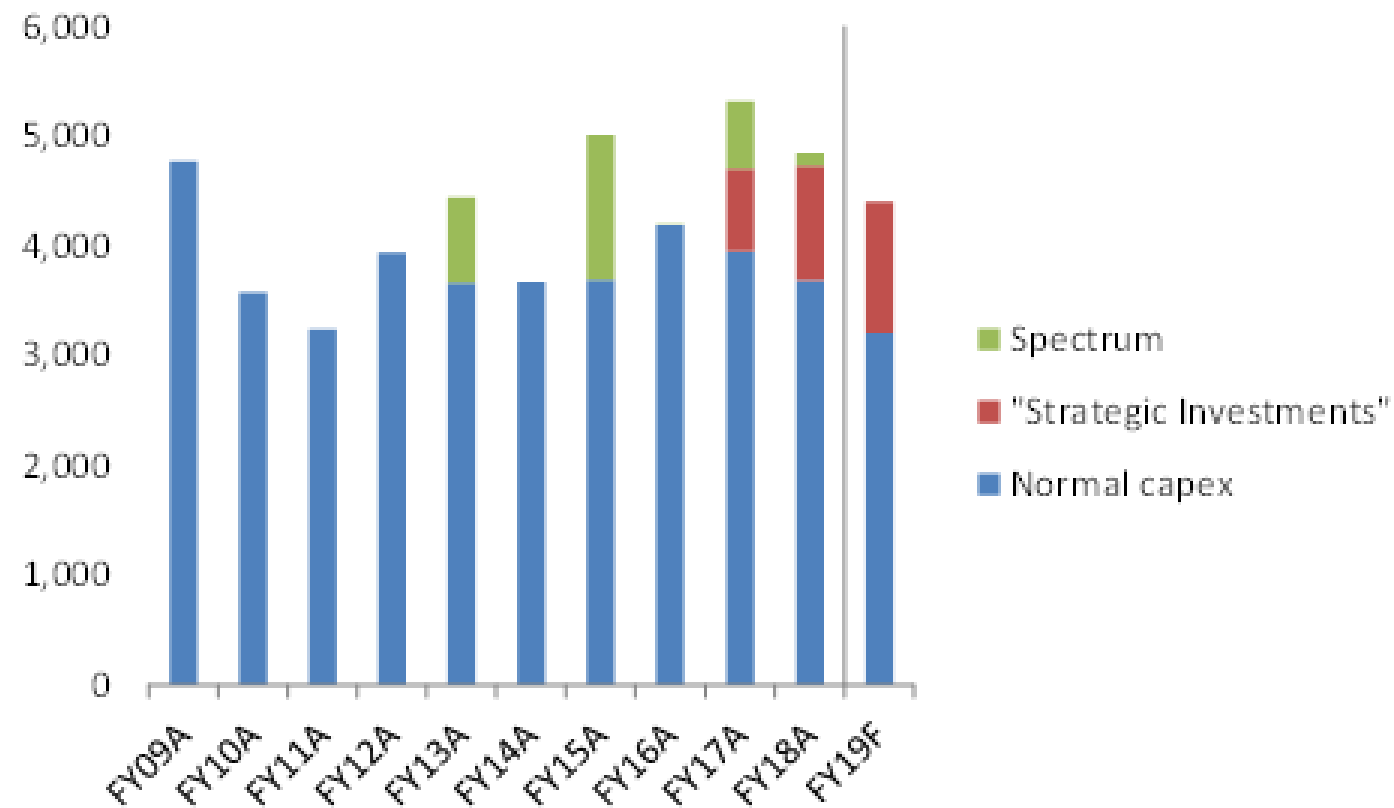
### Telstra Mobile Margin vs. Global Peers



Source: Bloomberg, Merlon Capital Partners

And, capex guidance looks optimistic...

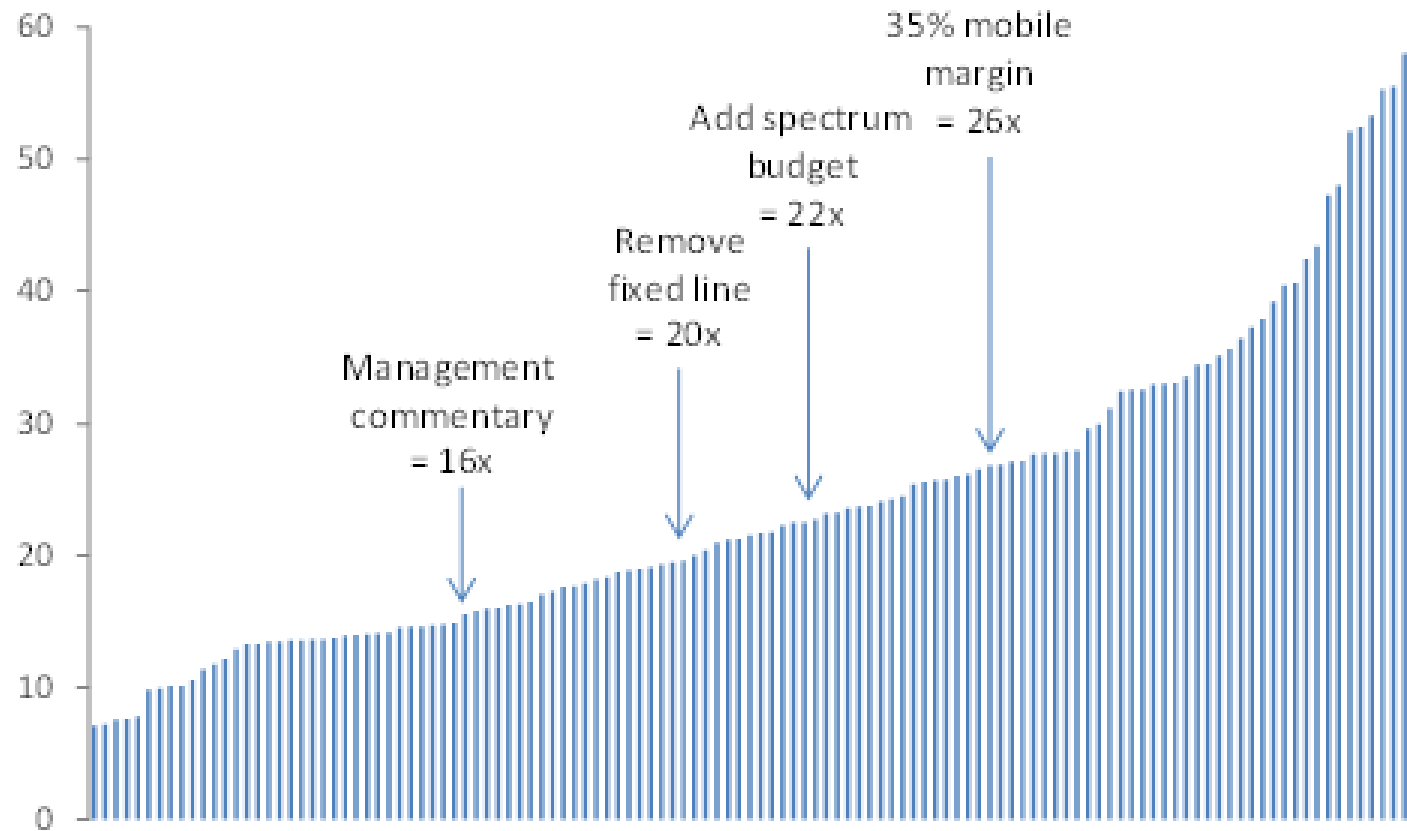
### Telstra Capex



Source: Bloomberg, Merlon Capital Partners

So perhaps this stock is not as “cheap” as advertised...

**Enterprise Valuations / Sustainable Free Cash Flow  
(Merlon Coverage Universe, data as at 15 August 2018)**



Source: Bloomberg, Merlon Capital Partners



# Outline

- ❑ Amazon revisited – muted impact so far
- ❑ Rethinking post retirement asset allocation
- ❑ Fund positioning and performance

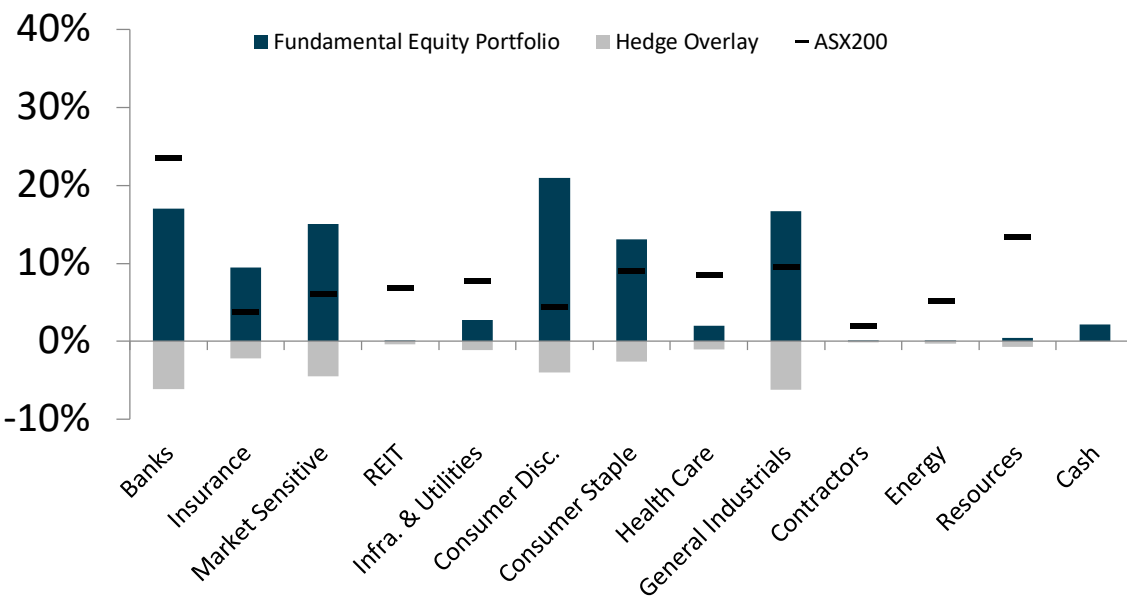
# Current Fund Positioning

Fundamental Research

Non-Benchmark

Downside Protection

Sustainable Income



Portfolio Analytics	Portfolio	ASX200
Number of Equity Positions	30	200
Net Market Exposure	69%	100%
Active Share	75%	0%
Valuation Upside	+20%	-15%
Trailing Free Cash Yield	5.9%	5.0%
Gross Distribution Yield	7.2%	5.8%
Price / Earnings Ratio	15.2x	17.0x

Portfolio as at 30 September 2018, Valuation Upside based on Merlon proprietary valuations.

# Outcomes

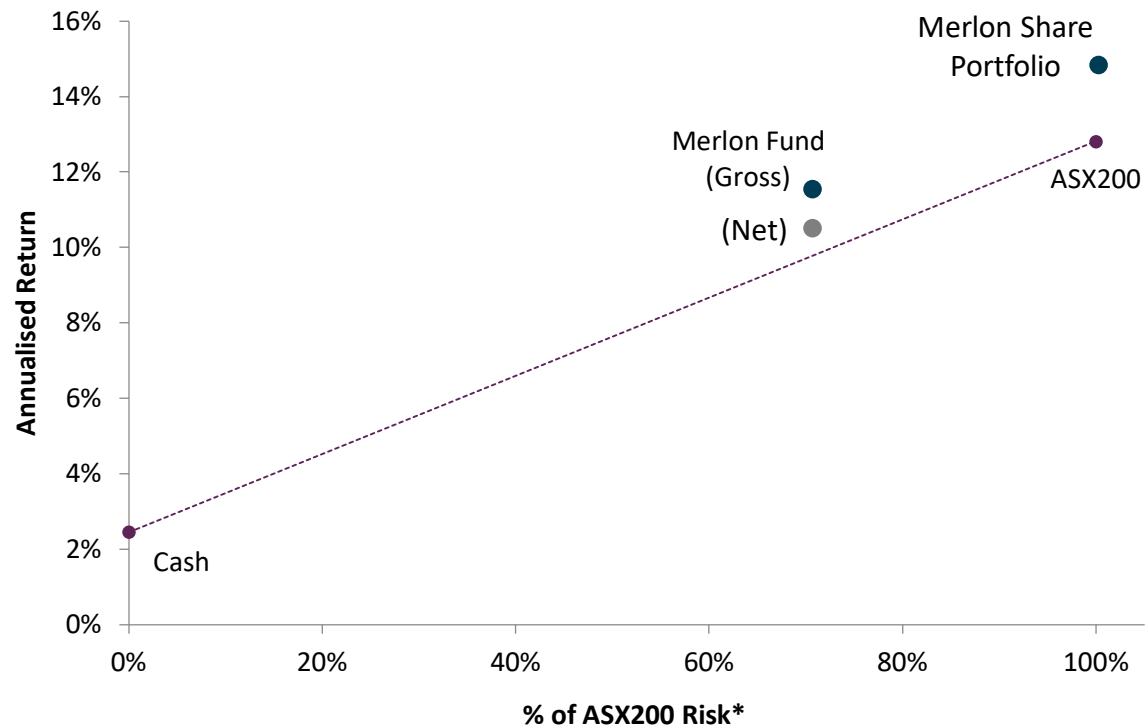
Fundamental Research

Non-Benchmark

Downside Protection

Sustainable Income

## Total Return vs Risk (7 Years)



## Monthly Distribution Detail: Cents per Unit

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total	Franking
<b>FY2013</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.29	<b>6.79</b>	2.26
<b>FY2014</b>	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.52	<b>6.13</b>	1.98
<b>FY2015</b>	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	0.52	<b>6.24</b>	2.20
<b>FY2016</b>	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.52	<b>6.35</b>	1.92
<b>FY2017</b>	0.53	0.53	0.53	0.53	0.53	0.3	0.53	0.53	0.53	0.53	0.53	0.53	<b>6.36</b>	2.02
<b>FY2018</b>	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.52	<b>6.35</b>	1.84
<b>FY2019</b>	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	<b>6.36</b>	1.90

*Highlighted data are estimates at the date of this presentation*

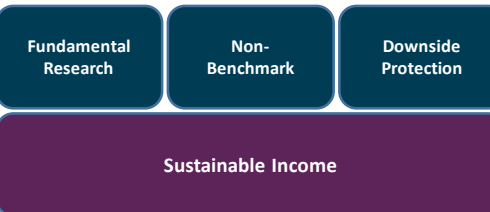
Preliminary returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated after fees as at 30 September 2018.

Merlon Australian Share Income Fund franking 1.94% p.a., ASX200 franking 1.51% p.a.

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



# Merlon Australian Share Income Fund Performance



	FY19TD	FY2018	FY2017	FY2016	FY2015	FY2014	FY2013	FY2012	3 Years	5 Years	7 Years
	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(% pa)	(% pa)
ASX200 Return	2.0	14.5	15.5	2.2	7.2	18.9	24.3	-5.1	13.6	9.7	12.8
Share Portfolio Excess Return	0.2	-6.9	8.0	4.8	2.3	-2.7	11.7	1.7	1.7	0.9	2.0
Hedge Overlay	-0.9	-2.4	-5.6	-0.9	-1.7	-3.5	-9.3	2.6	-3.9	-2.2	-3.3
Portfolio Return (before fees)	1.4	5.1	17.9	6.1	7.8	12.8	26.7	-0.8	11.4	8.4	11.5
Portfolio Return (net of fees)	1.1	4.2	16.8	5.1	6.8	11.8	25.5	-1.7	10.4	7.4	10.5
Gross Yield	2.1	7.0	7.8	7.5	7.6	7.6	9.8	10.1	7.6	7.5	8.2
Average Daily Market Exposure	68%	68%	68%	70%	70%	69%	69%	69%	69%	69%	70%

Preliminary returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated after fees as at 30 September 2018. Past performance is not an indication of future performance.



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# A bit more about your presenters



**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).



**Hamish Carlisle**  
Analyst/Portfolio Manager

Hamish joined Merlon Capital Partners as a Principal in July 2010. Hamish was previously Head of Research, Asia Pacific Equities at AMP Capital Investors. Prior to AMP, Hamish was a Senior Director and Head of Australian Banks Research at Merrill Lynch Equities. He has also held positions at Burdett, Buckeridge, Young and National Australia Bank. Hamish holds a MBA with honours from The Wharton School, University of Pennsylvania. Hamish holds a B.Comm (Hons) and an MBA (Hons).



**Adrian Lemme**  
Analyst/Portfolio Manager

Adrian joined Merlon Capital Partners as a Principal in May 2012 from AMP Capital where he was a Portfolio Manager/Analyst, responsible for investments in retail, food and beverage, transport and chemical sectors. Having commenced his career with Commonwealth Bank in 2003, Adrian was the lead transport analyst with CBA Equities Research prior to joining AMP Capital in 2010. Adrian holds a BMathFin (Hons) and CFA.

*Thank you*