

Merlon Australian Share Income Fund

Teleconference – 1 February 2018

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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

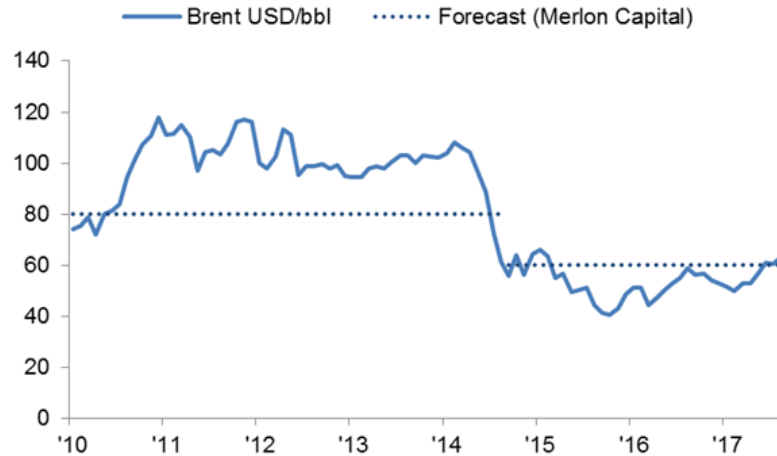
Paid monthly and majority franked

Outline

- ☐ Oil – the cycle continues
- ☐ Fund positioning and performance

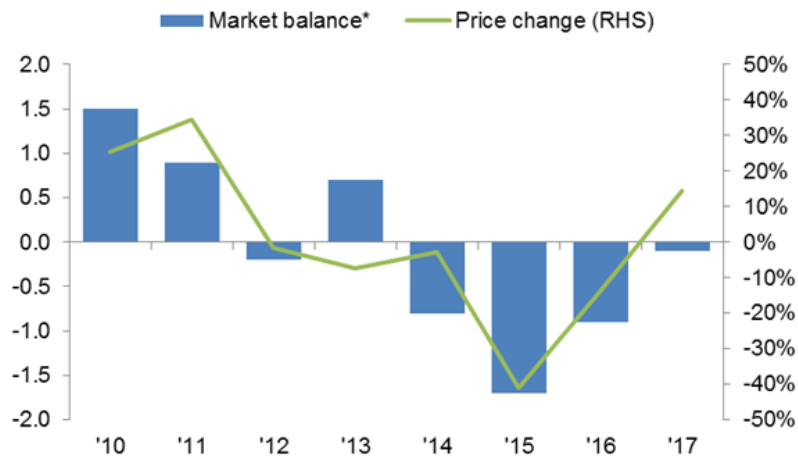
Oil: the cycle continues

A wide-ranging price



Source: Bloomberg

...caused by a market balance reversal



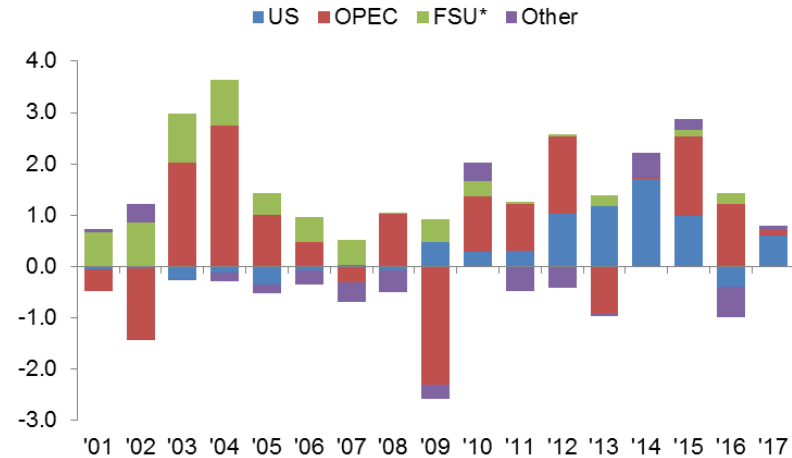
Source: International Energy Agency *Demand less supply (million barrels per day)

Comments:

- Oil has ranged between USD40 and USD120/bbl
- USD100/bbl pricing driven by demand surprise
- USD50/bbl phase driven by US supply response

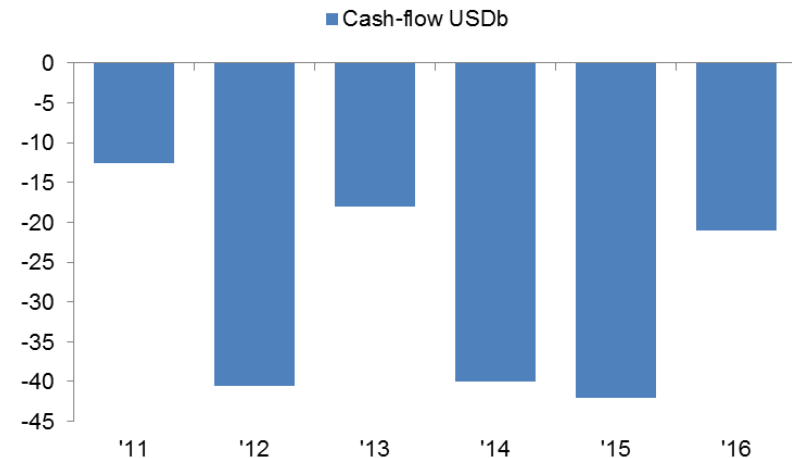
Oil: the cycle continues

Swing producers fight for dominance...



Source: BP / International Energy Agency. * Former Soviet Union

...but at what cost for the US



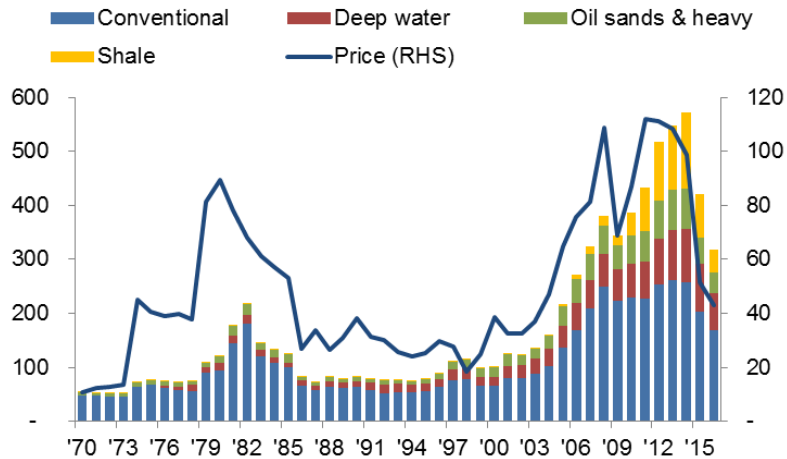
Source: Bloomberg – sample of 48 listed leading US Exploration & Production companies.

Comments:

- US technological gains created a new swing producer
- But US supply growth has not led to cash generation
- Market was not factoring in capex to valuations
- 2018 may see cash generated if discipline holds

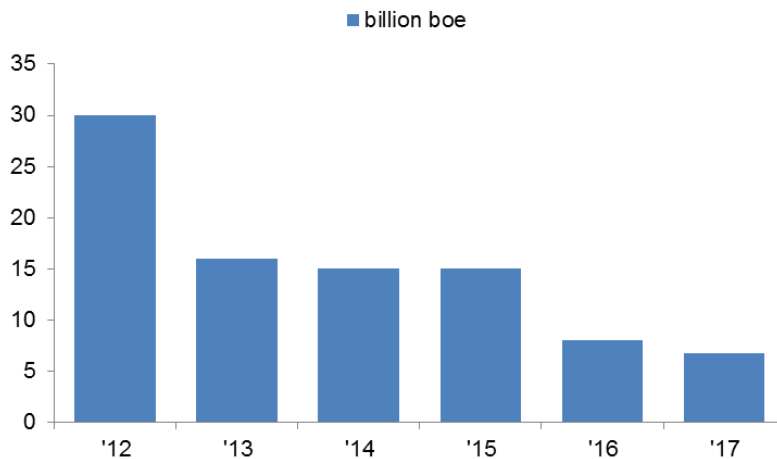
Oil: the cycle continues

Price falls have seen capex halved...



Source: International Monetary Fund.

...leading to fewer discoveries



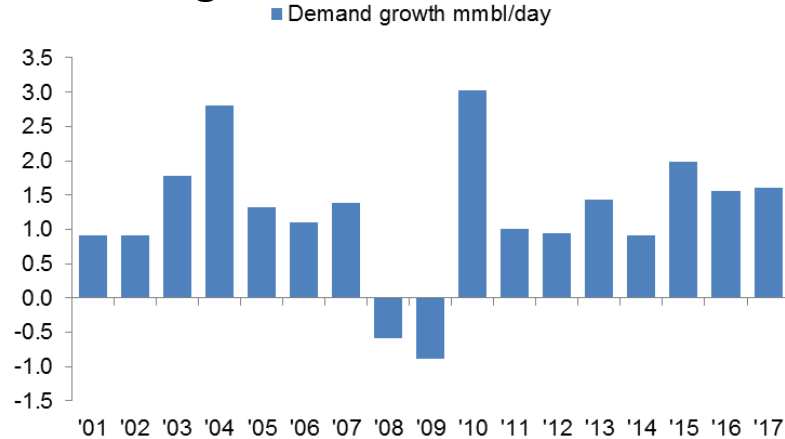
Source: Rystad Energy.

Comments:

- Low oil prices have seen capital expenditure slashed
- Capex is essential for future production requirements:
 - Underlying well-decline rates
 - Growth in demand

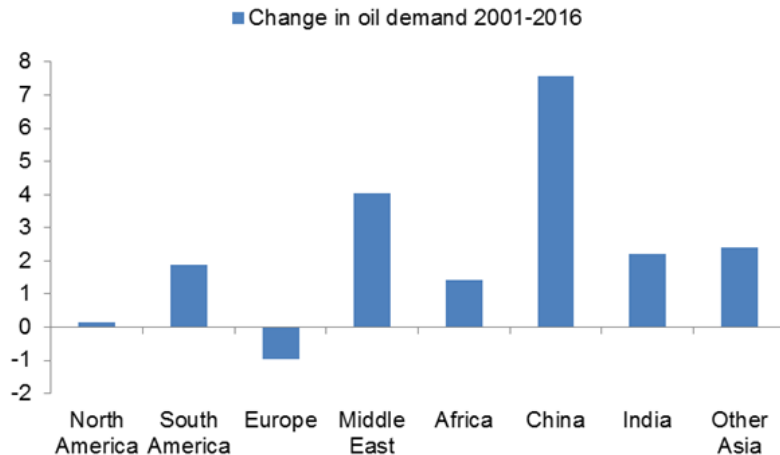
Oil: the cycle continues

Demand growth has been a constant



Source: International Energy Agency.

...led by consumers and producers



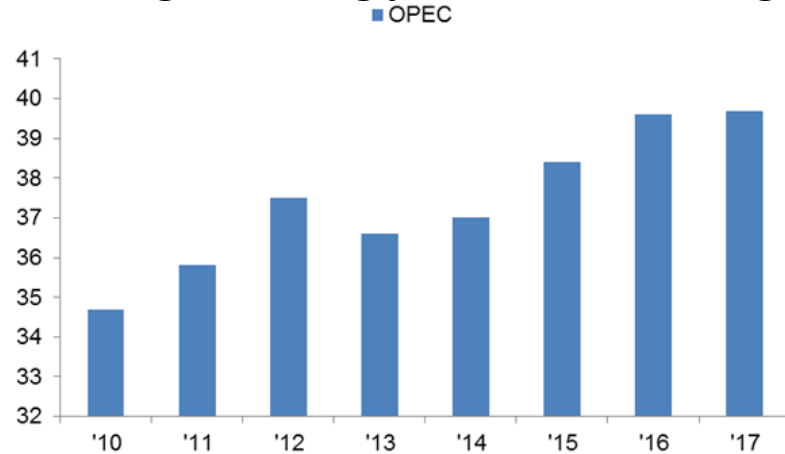
Source: BP.

Comments:

- Demand growth has been stable
- With developed economy efficiency gains
- More than offset by emerging economy growth
- With China as well as the Middle East increasing demand

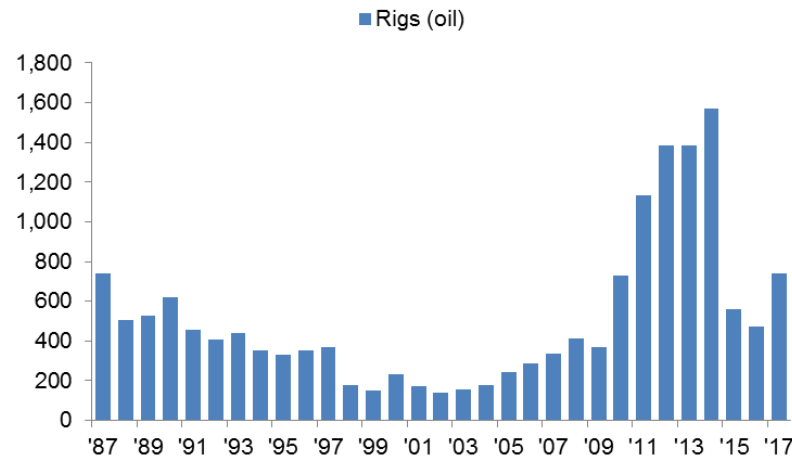
Oil: the cycle continues

The original swing producer is freezing...



Source: International Energy Agency.

...while the new swing producer takes advantage



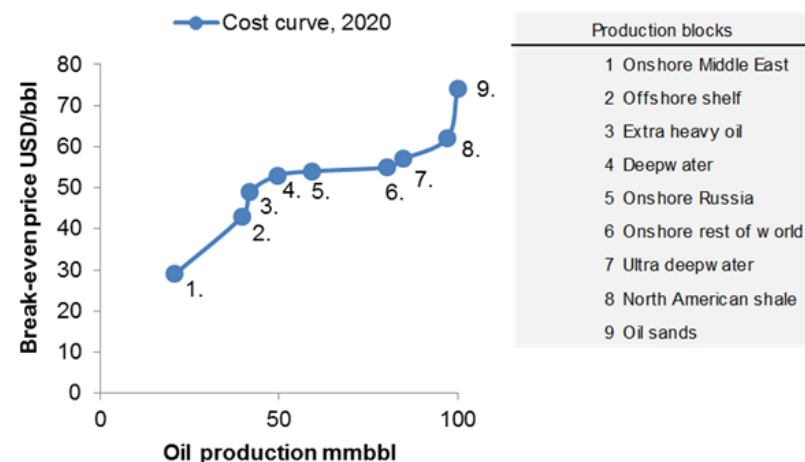
Source: Baker Hughes

Comments:

- The short term dynamics have tightened the market
- With the US responding
- With growing supply and inventories
- Leading to downside risk in the short term
- But fundamentals supportive over the long term...

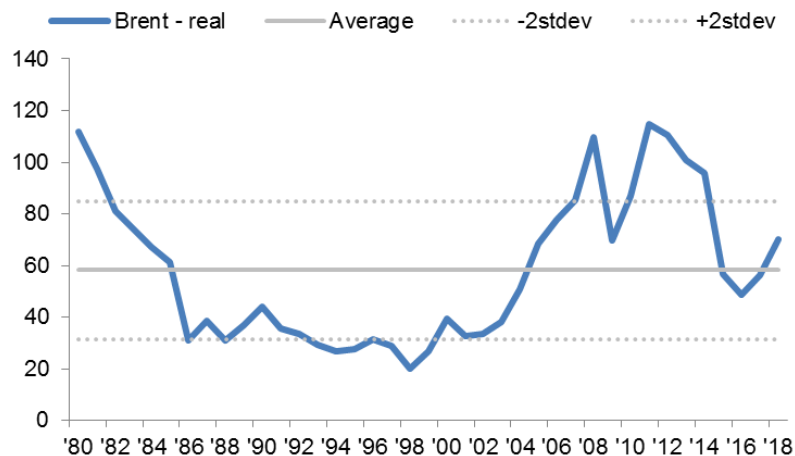
Oil: the cycle continues

In the long term marginal cost will drive prices...



Source: International Monetary Fund / Rystad Energy

...in line with current pricing



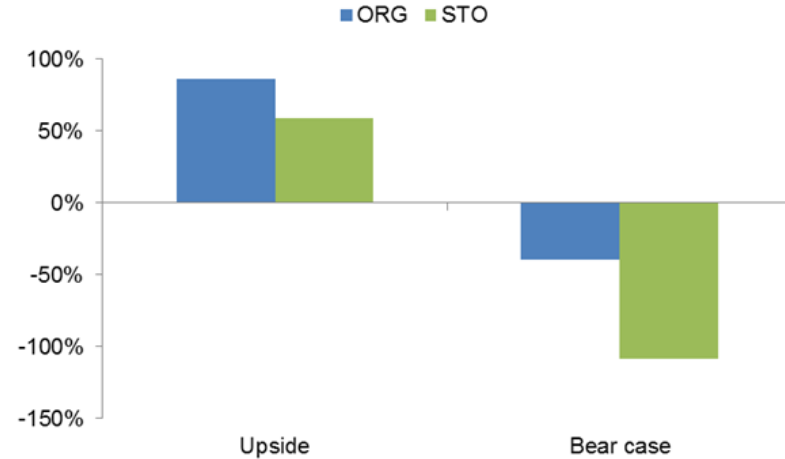
Source: Bloomberg.

Comments:

- US onshore and Canada oil sands are unconventional and high cost
- Demand growth will see these plays setting the price
- We expect USD60-70/bbl over the long term
- Shorter term will depend on US shale, subject to OPEC supply discipline

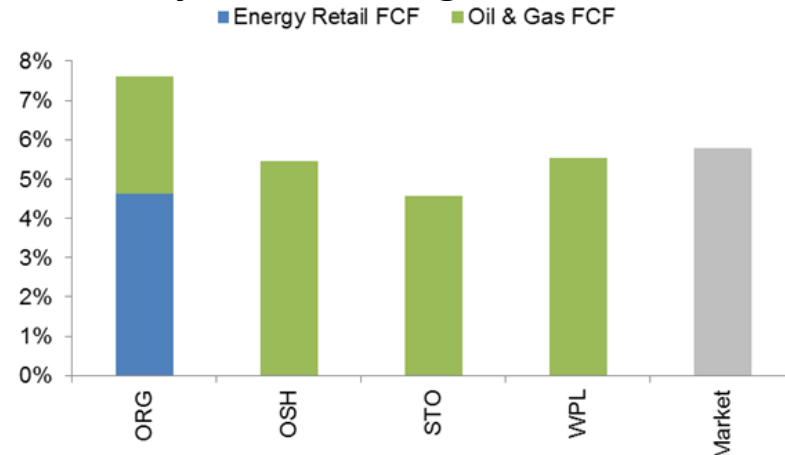
Oil: the cycle continues

Investing with a margin of safety...



Source: Merlon.

...and a yield advantage



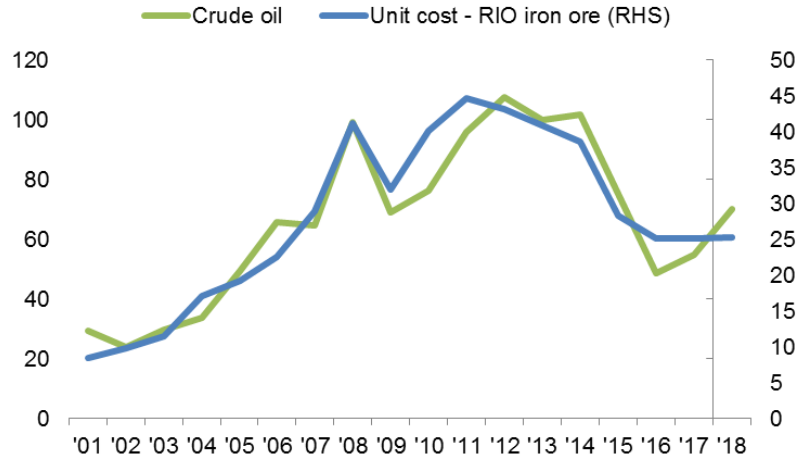
Source: Merlon. Undiscounted sustainable free cash flow and franking estimate divided by current market value plus projected net debt.

Comments:

- In 2016 our forecasts saw upside in Origin and Santos
- Origin had a better margin of safety
- The market was under-appreciating the utility business
- We remain overweight Origin Energy
- We are underweight other energy plays

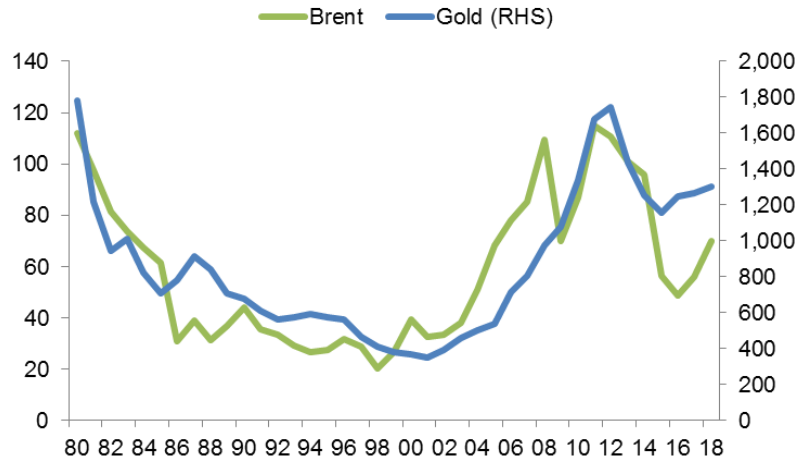
Oil: the cycle continues

Cost pressures



Source: Bloomberg, Merlon.

Inflation hedge



Source: Bloomberg.

Comments:

- Miners are at risk of margin squeeze
- Gold prices are overly factoring in inflation
- We are underweight miners

Outline

- ❑ Oil – the cycle continues

- ❑ Fund positioning and performance

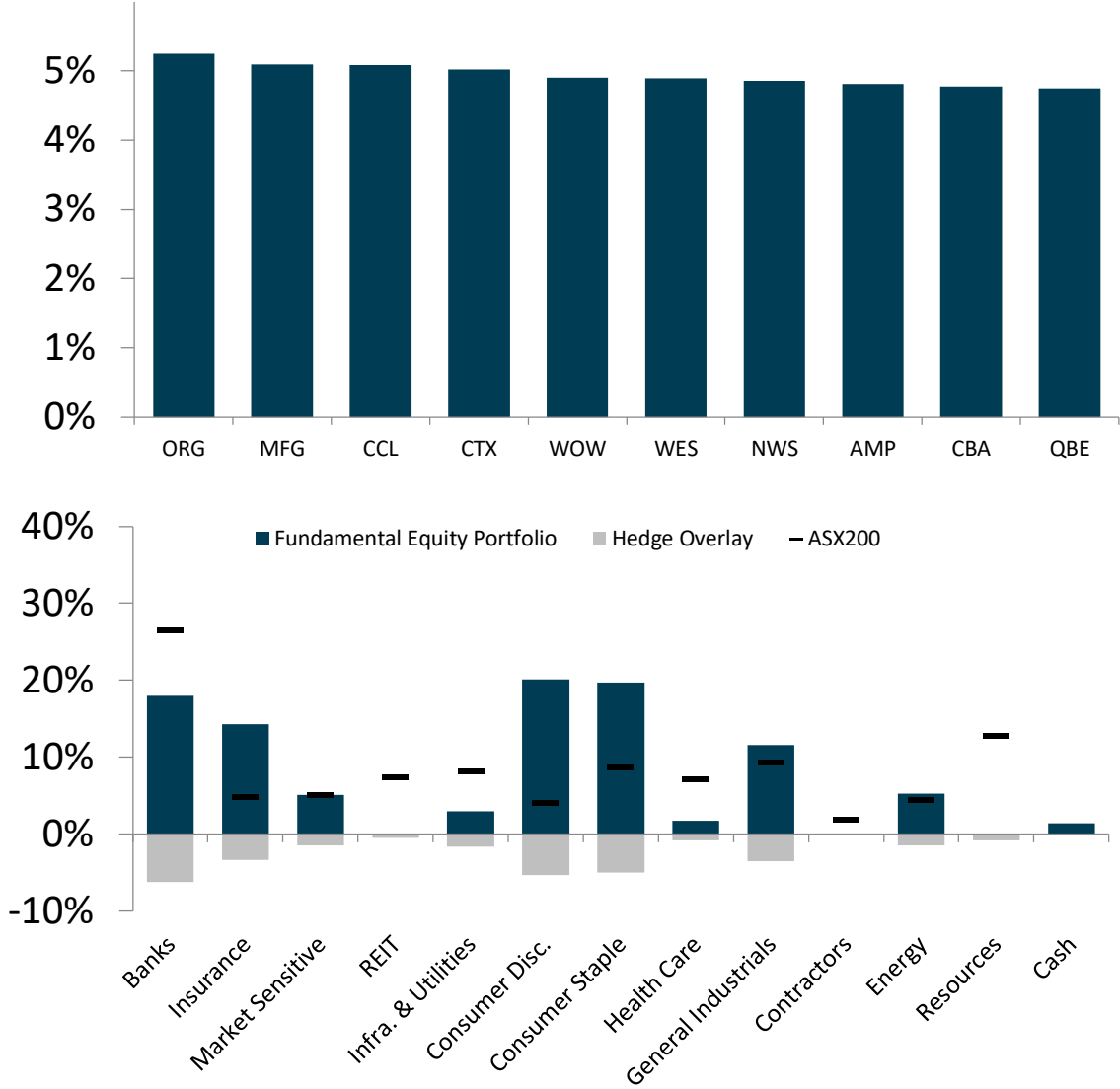
Current Fund Positioning

Fundamental Research

Non-Benchmark

Downside Protection

Sustainable Income



Portfolio Analytics	Portfolio	ASX200
Number of Equity Positions	27	200
Net Market Exposure	69%	100%
Active Share	76%	0%
Valuation Upside	+12%	-16%
Trailing Free Cash Yield	5.5%	5.1%
Gross Distribution Yield	7.0%	5.6%
Price / Earnings Ratio	15.6x	17.4x

Portfolio as at 31 December 2017, Valuation Upside based on Merlon proprietary valuations.

Outcomes

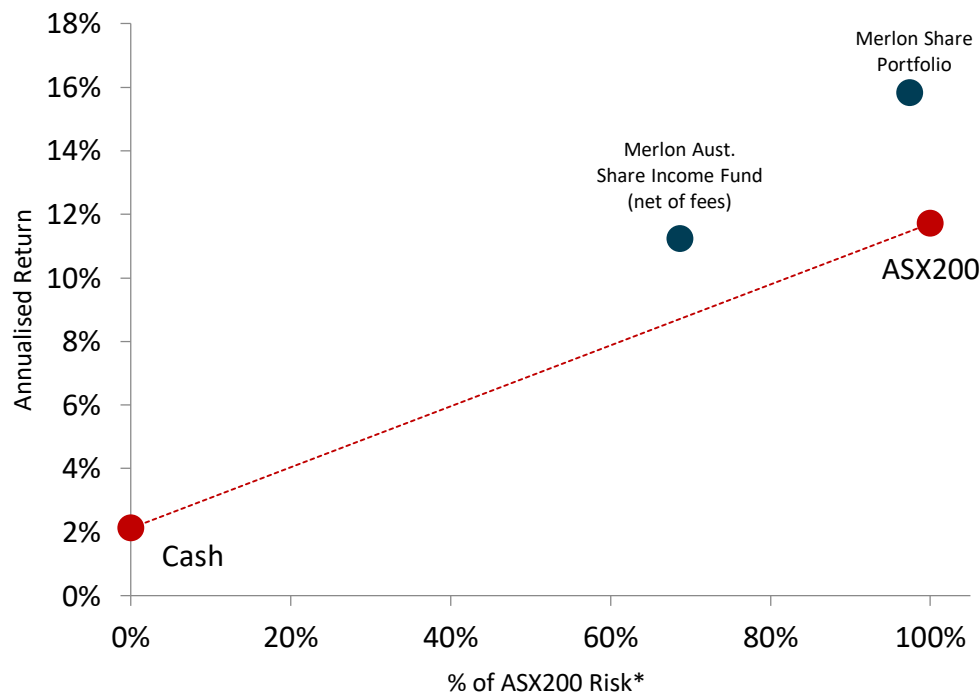
Fundamental Research

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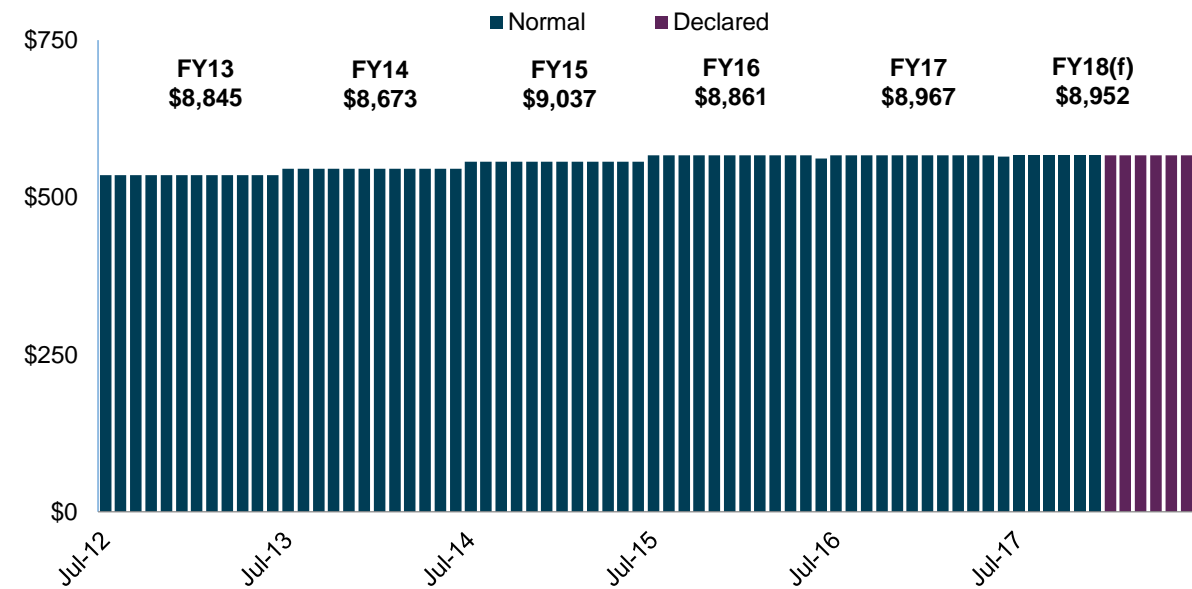
Downside Protection

Sustainable Income

Total Return vs Risk (5 Years)



Monthly Income from \$100,000 invested on 1 July 2012



Preliminary returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated after fees as at 31 December 2017.
Merlon Wholesale Australian Share Income Fund franking 1.8% p.a., ASX200 franking 1.5% p.a.
* % of ASX200 Risk represents the Fund's statistical beta relative to the ASX200

Fund Performance

Fundamental
Research

Non-
Benchmark

Downside
Protection

Sustainable Income

	FYTD18 (%)	FY2017 (%)	FY2016 (%)	FY2015 (%)	FY2014 (%)	FY2013 (%)	FY2012 (%)	Year (%)	3 Years (% pa)	5 Years (% pa)
ASX200 Return	9.1	15.5	2.2	7.2	18.9	24.3	-5.1	13.2	10.1	11.7
Share Portfolio Excess Return	-0.6	8.0	4.8	2.3	-2.7	11.7	1.7	1.8	4.6	4.2
Hedge Overlay	-2.3	-5.6	-0.9	-1.7	-3.5	-9.3	2.6	-3.1	-3.3	-3.6
Portfolio Return (before fees)	6.2	17.9	6.1	7.8	12.8	26.7	-0.8	12.0	11.4	12.3
Portfolio Return (net of fees)	5.7	16.8	5.1	6.8	11.8	25.5	-1.7	11.0	10.4	11.2
Excess Yield	0.5	1.7	1.7	1.5	0.9	3.0	4.1	1.1	1.5	1.6
Average Daily Market Exposure	68%	68%	70%	70%	69%	69%	69%	68%	69%	69%

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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...



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.



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.

Thank you