

Merlon Australian Share Income Fund

Webinar – 23 July 2019

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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

- ☐ Quality paper

- ☐ Fund positioning and performance

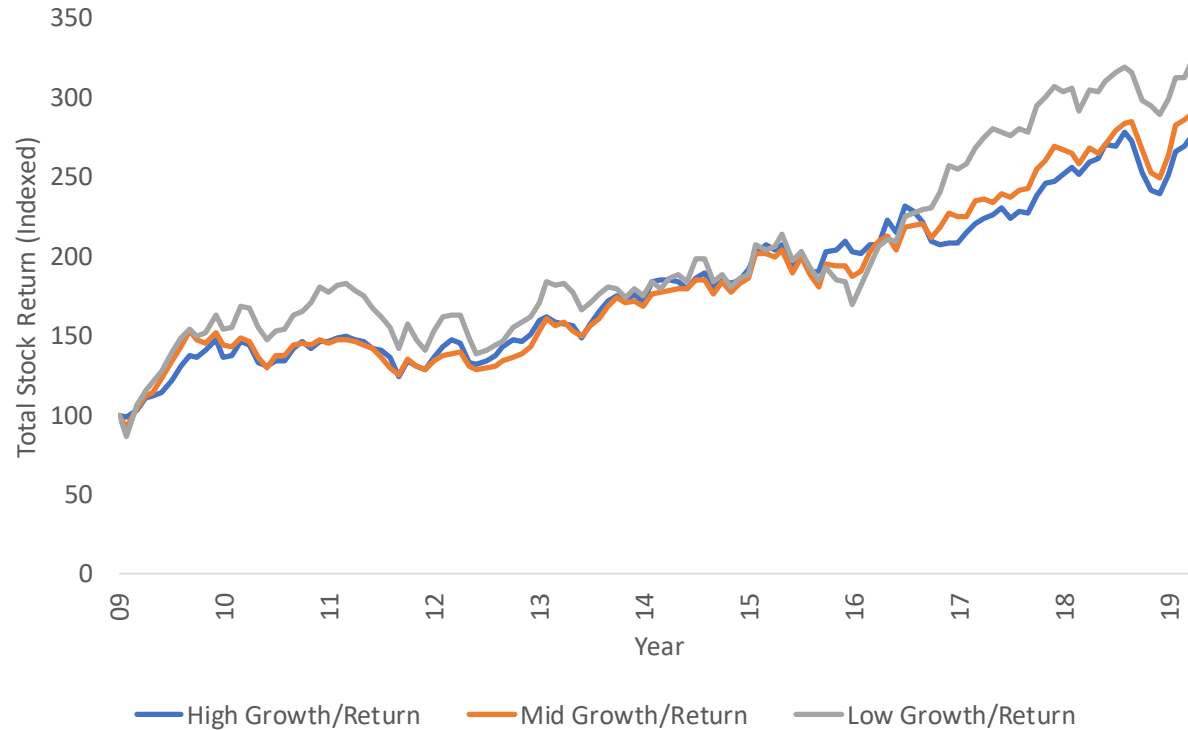
Good companies not always good investments

- Good companies and good investments are not the same thing
- “Quality” companies can be defined differently
- In the past ten years, proxies for “quality” commonly cited are
 - **High growth, high return on capital; or**
 - **Defensive, low volatility**

Mixed performance of “quality” post-GFC



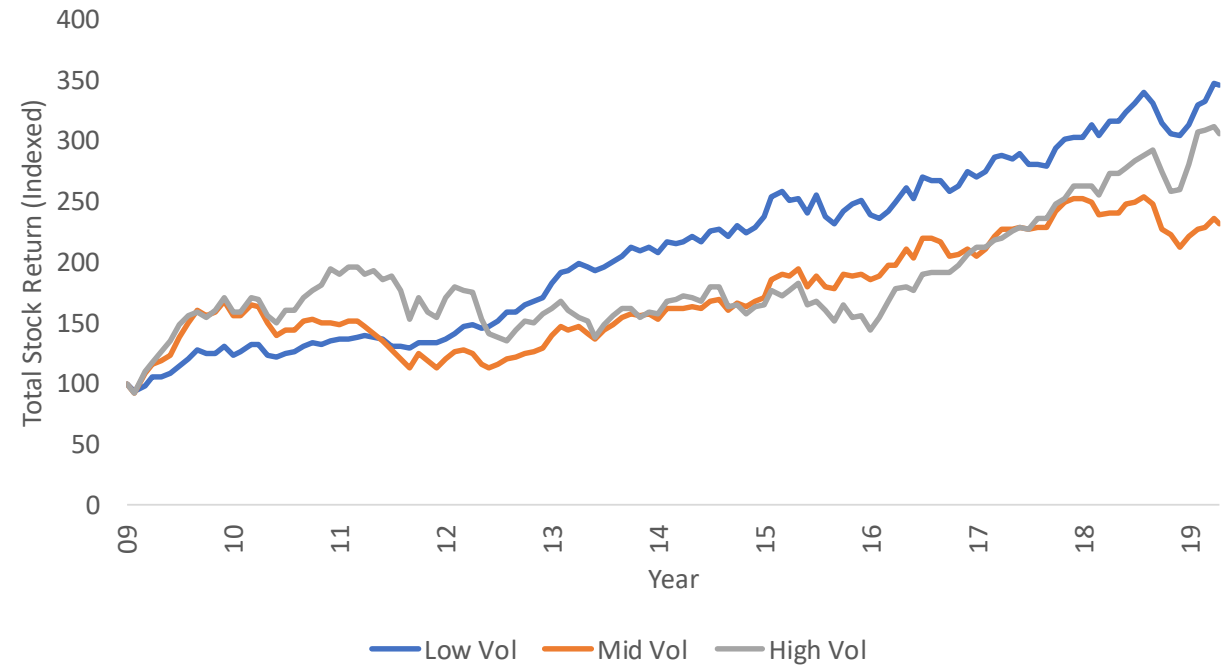
Average ASX100 Return by “Growth/Return” Terciles



Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (16 May 2019). Terciles measured by FY1 EBITDA Margin, ROE over FY0 & FY3, Sales & EPS Growth; 3yr Historical + Forward

- The average high “growth/return” stock underperformed in the past 10 years

Average ASX100 Return by “Volatility” Terciles

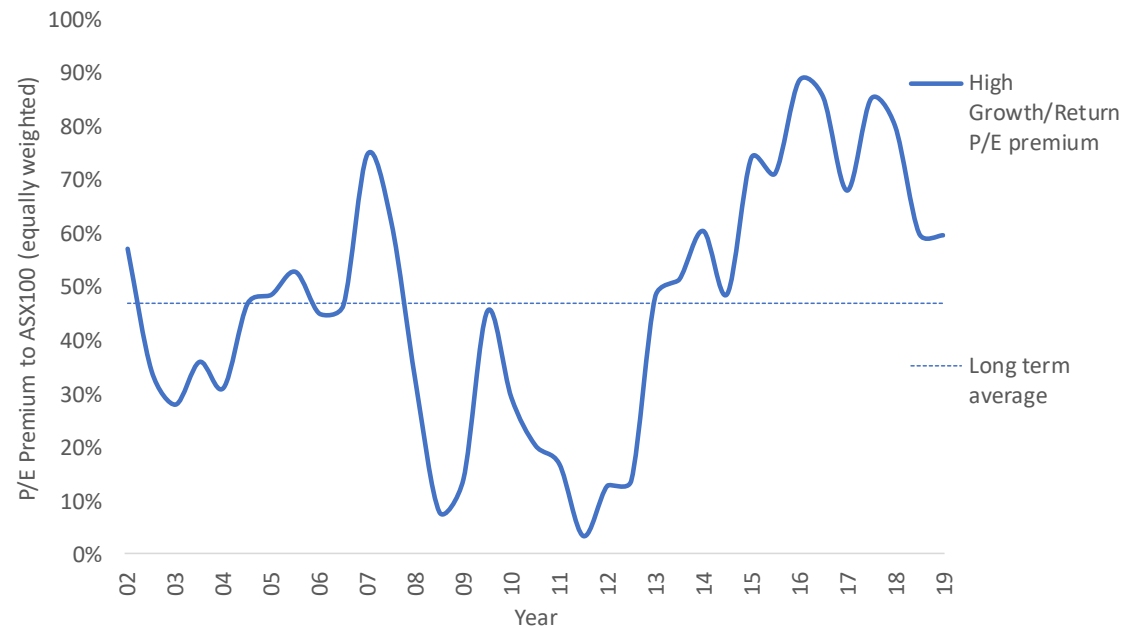


Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (16 May 2019). Terciles measured by Historical beta, FY1 consensus EPS dispersion, 2-month share price volatility, Market cap

- The average low “volatility” stock outperformed in the past 10 years

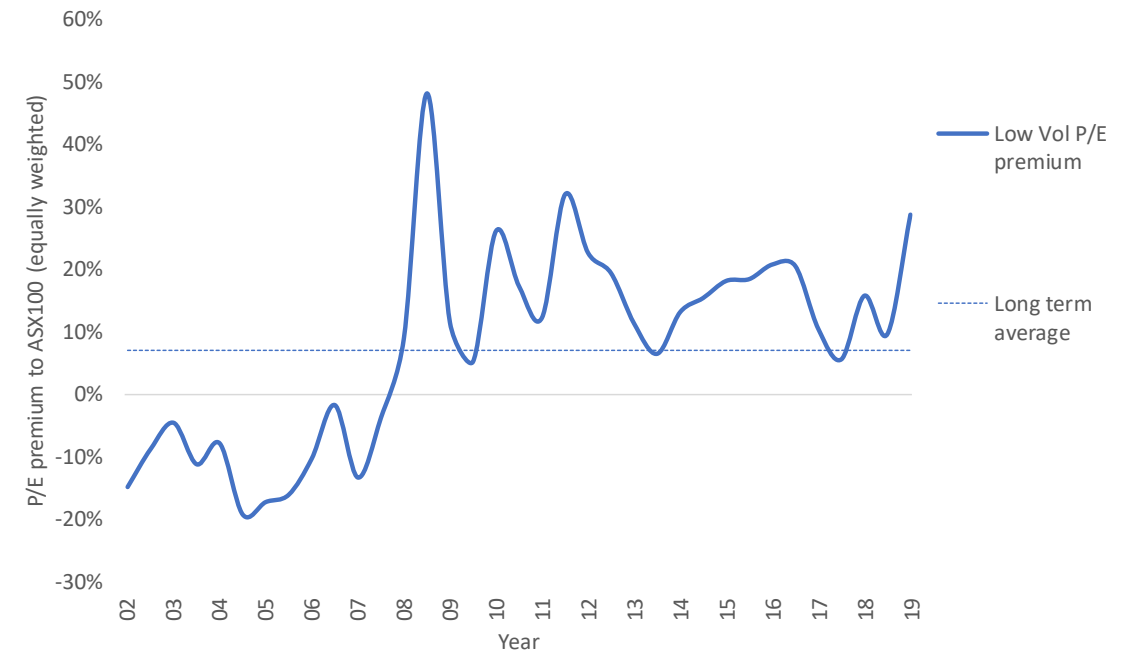
Paying a high price for “quality”

“High Growth/Return” Tercile P/E Premium Tercile vs Average ASX100 Constituent



Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (9 July 2019)

“Low Vol” Tercile P/E Premium Tercile vs Average ASX100 Constituent

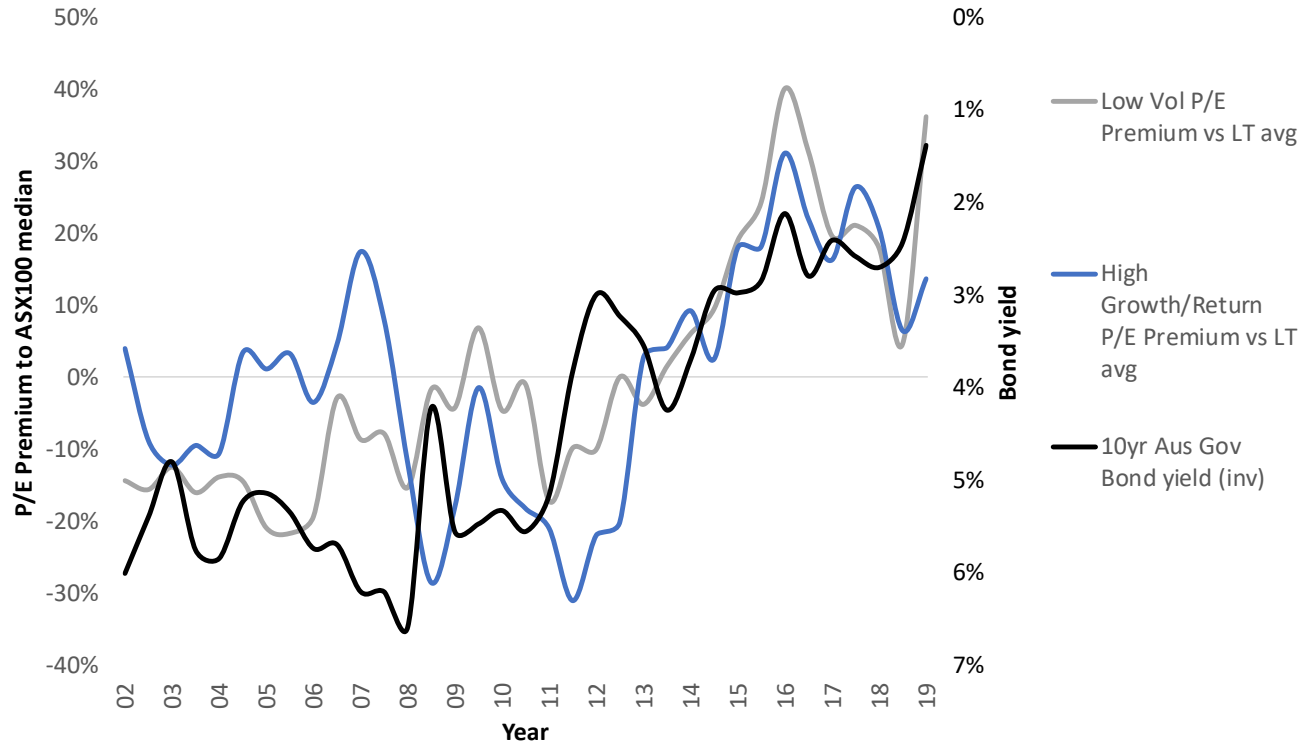


Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (9 July 2019)

- Valuation premiums high versus history as market crowds into perceived “quality”

High premiums driven by low interest rates

P/E Premium/(Discount) of “Quality” Terciles vs 10 yr Gov Bond Yield



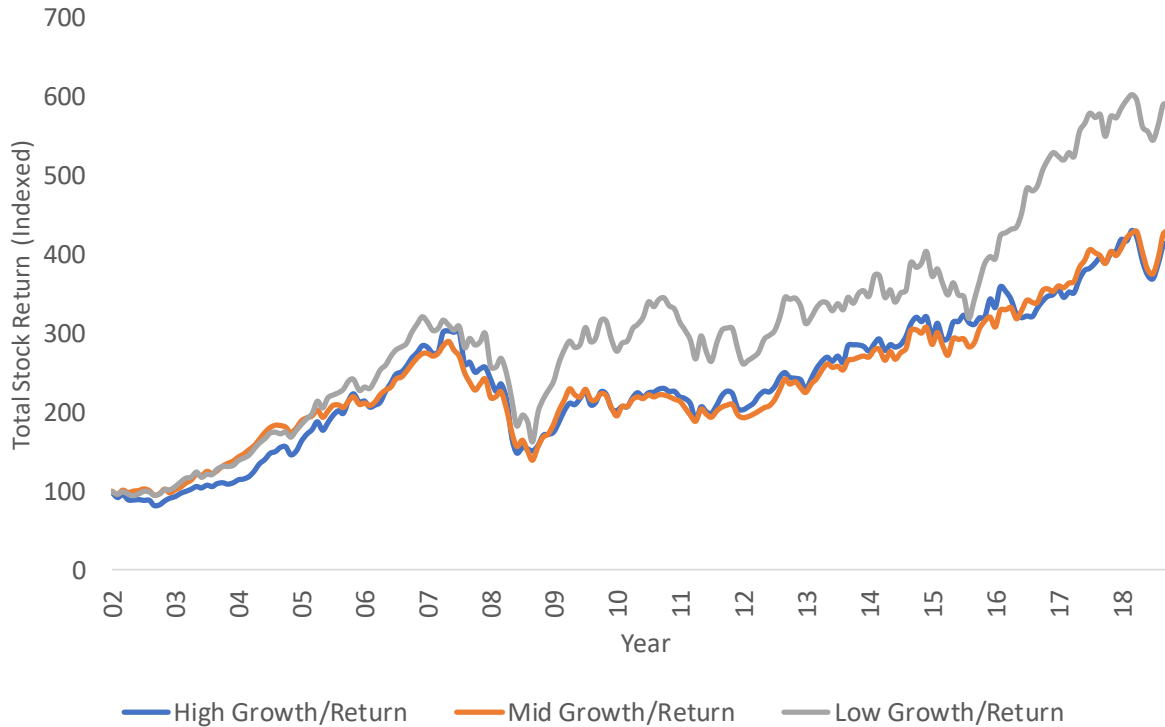
Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (9 July 2019)

- Demand for “quality” highly correlated with lower interest rates

Little evidence of “quality” mispricing in a full market cycle (2002-19)



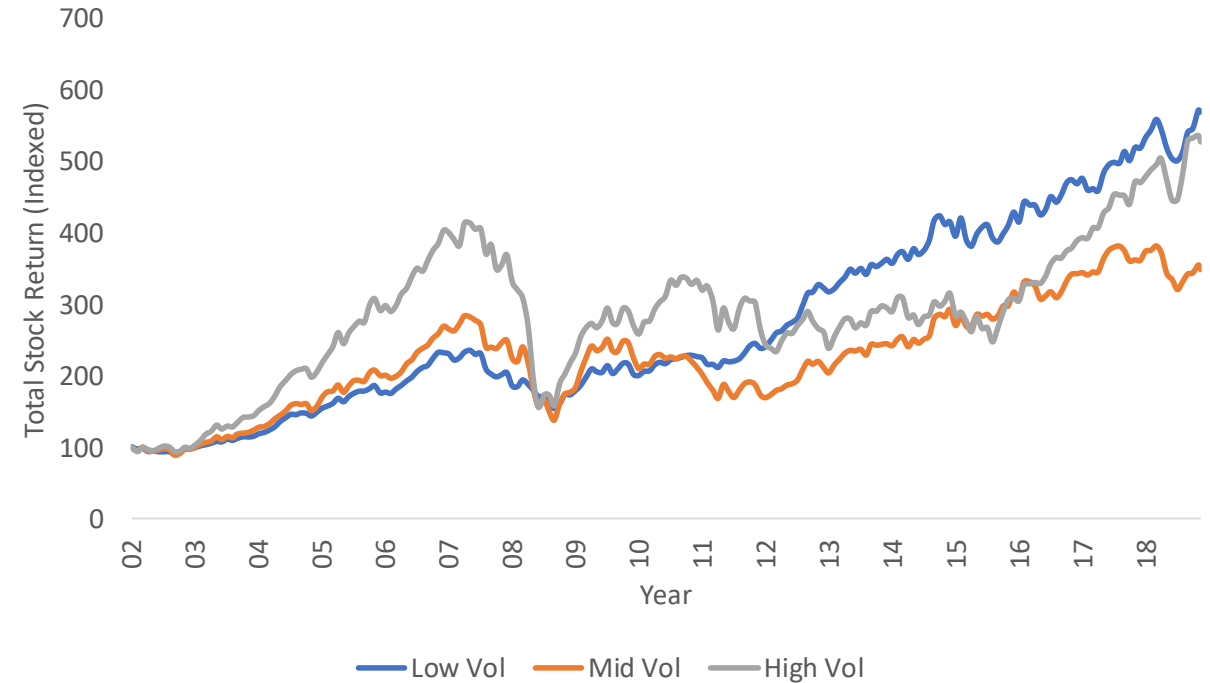
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- High “growth/return” underperforms low in full market cycle

Average ASX100 Return by “Volatility” Terciles

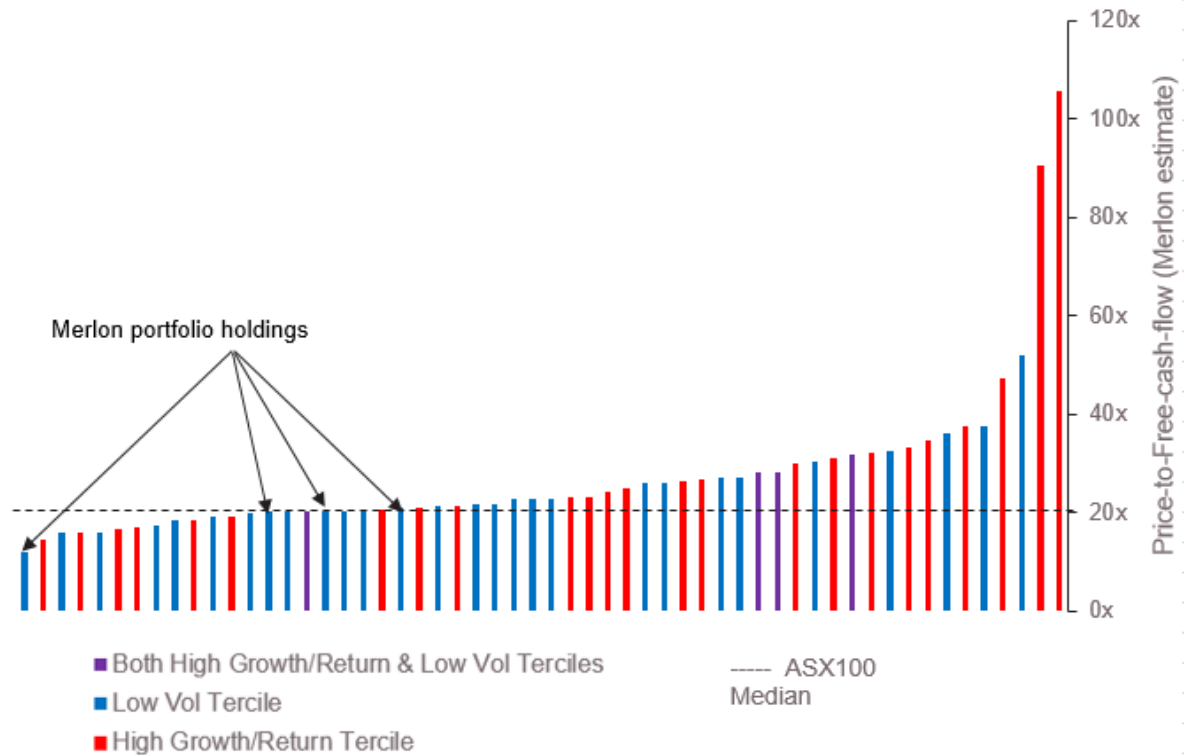


Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (16 May 2019). Terciles measured by Historical beta, FY1 consensus EPS dispersion, 2-month share price volatility, Market cap

- Low “volatility” outperforms but is largely matched by high “volatility”

Focus on value measured by free-cash-flow

Merlon exposure to high “quality” proxies



Source: Merlon Capital Partners/Bloomberg/Goldman Sachs (9 July 2019)

- Traditional “quality” factors are expensive as the market crowds in
- At Merlon, we do not screen for “quality”
- Better to buy at low price relative to free cash flow than overpaying for “quality” attributes

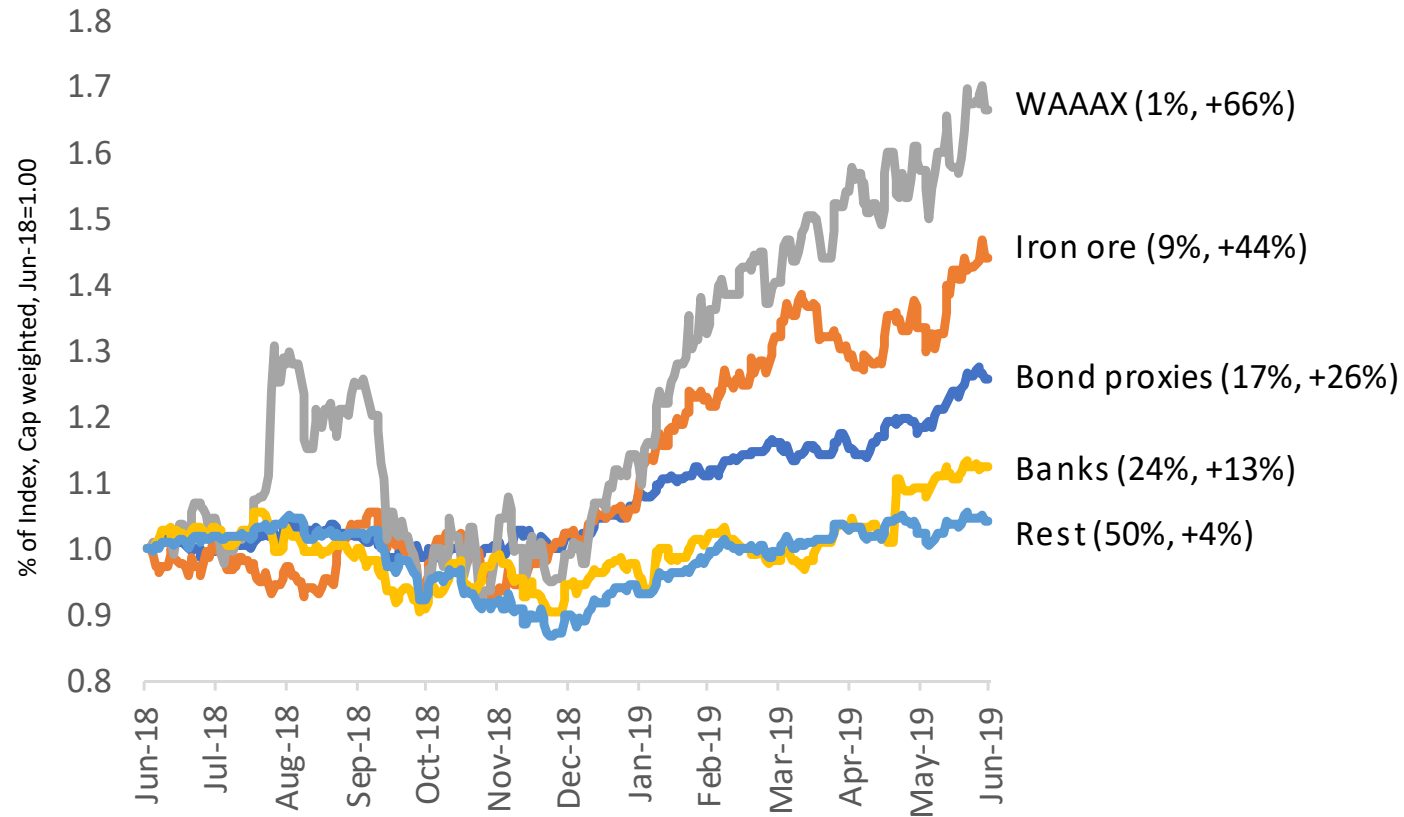
Outline

- ❑ Quality paper

- ❑ Fund positioning and performance

Subcomponents of ASX200 Index

% of Index, Cap weighted, Jun-18=1.00



Source: Merlon Capital Partners/Bloomberg (9 July 2019)

Merlon Australian Share Income Fund Performance

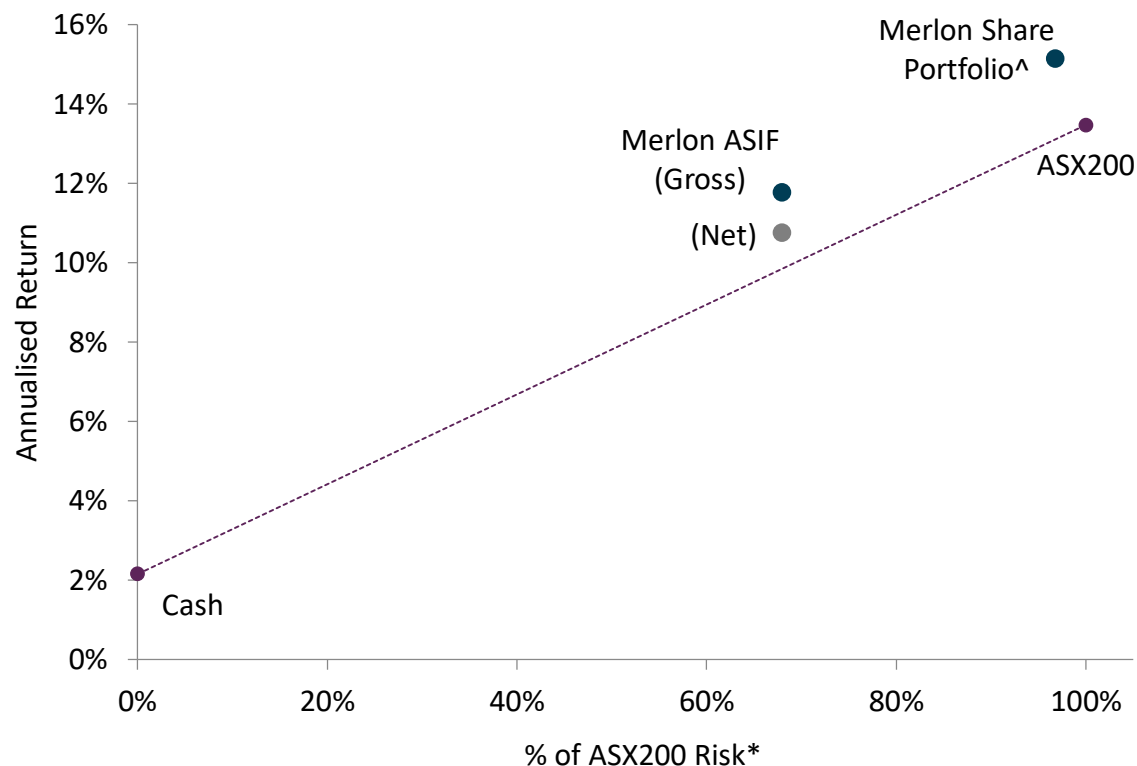


	FY2019 (%)	FY2018 (%)	FY2017 (%)	FY2016 (%)	FY2015 (%)	FY2014 (%)	FY2013 (%)	FY2012 (%)	3 Years (% pa)	5 Years (% pa)	7 Years (% pa)
ASX200 Return	13.2	14.5	15.5	2.2	7.2	18.9	24.3	-5.1	14.4	10.4	13.5
Share Portfolio Excess Return	-4.8	-6.9	8.0	4.8	2.3	-2.7	11.7	1.7	-1.5	0.6	1.6
Hedge Overlay	-0.9	-2.4	-5.6	-0.9	-1.7	-3.5	-9.3	2.6	-2.8	-2.2	-3.2
Portfolio Return (before fees)	7.5	5.1	17.9	6.1	7.8	12.8	26.7	-0.8	10.1	8.8	11.8
Portfolio Return (net of fees)	6.5	4.2	16.8	5.1	6.8	11.8	25.5	-1.7	9.0	7.8	10.7
Gross Yield	7.9	7.0	7.8	7.5	7.6	7.6	9.8	10.1	7.6	7.6	7.9
Average Daily Market Exposure	69%	68%	68%	70%	70%	69%	69%	69%	69%	69%	69%

Returns for the Fund and ASX200 grossed up for accrued franking credits and the Fund return is stated as at 30 June 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).

Outcomes

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
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	0.51	6.12	1.80

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 2019.

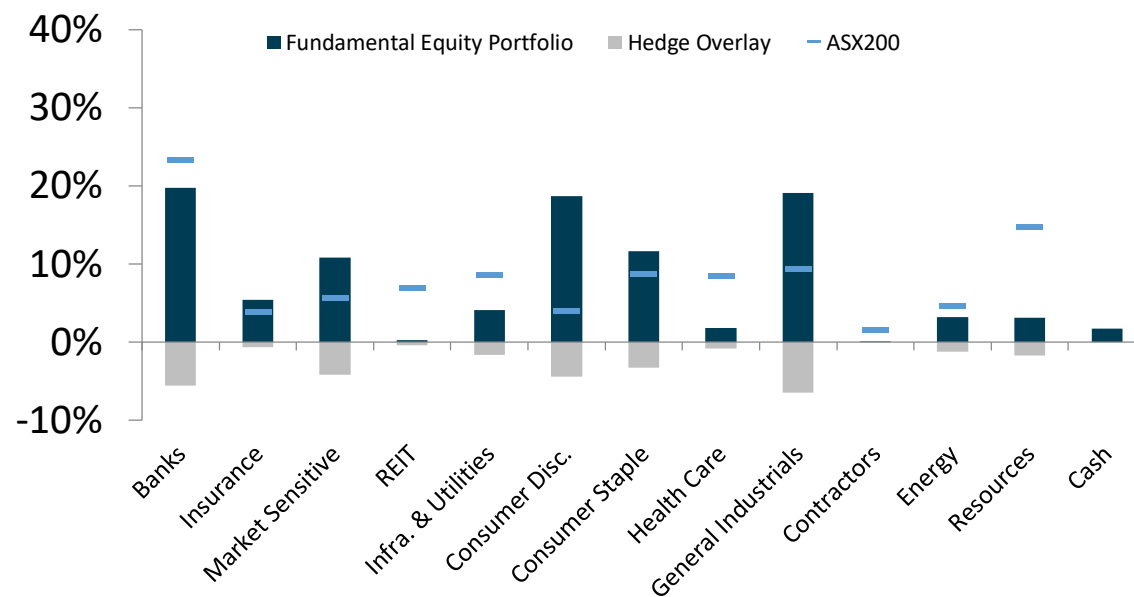
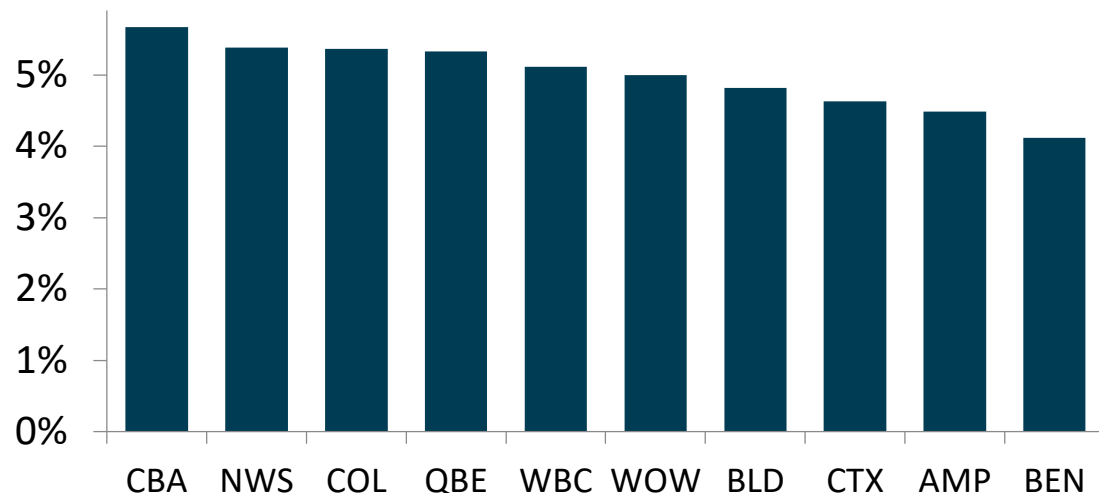
Merlon Australian Share Income Fund franking 1.9% p.a., ASX200 franking 1.5% p.a.

*% 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.

Merlon Australian Share Income Fund - Current Fund Positioning



Portfolio Analytics – 30 June	Portfolio	ASX200
Number of Equity Positions	36	200
Net Market Exposure	68%	100%
Active Share	75%	0%
Valuation Upside ¹	+27%	-19%
Trailing Free Cash Yield	5.6%	4.3%
Gross Distribution Yield	7.0%	5.4%
Price / Earnings Ratio	14.9x	18.0

Portfolio as at 30 June 2019. ¹Valuation Upside based on Merlon proprietary valuations.

How Merlon Approach is Different

Fundamental Research

*Focused on
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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

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.



Joey Mui
Analyst/Portfolio Manager

Joey Mui joined Merlon Capital Partners as an Portfolio Manager/Analyst in April 2016. Prior to Merlon, Joey was a Portfolio Analyst for AMP Capital Multi-Strategy equity funds responsible for investments in the real estate sector in Australian and Asian equities. He also completed internships in the Equity Research teams at JP Morgan and Nomura.

Joey holds a B.Comm (Distinction) and CFA.

Thank you