MLC Wholesale IncomeBuilder

Annual distribution commentary, 2018 financial year
9 July 2018

Summary

MLC Wholesale IncomeBuilder (MLC IncomeBuilder) has a successful history of achieving its primary objective of producing a growing, tax-efficient income stream. Over 21 years, there has been a fairly steady rise in the fund's underlying income distribution, with the annual underlying distributions increasing by an average of 7% each year since its inception.

On Saturday, 30 June 2018 the last cash distribution for the 2018 financial year (FY2018) was made to investors in MLC IncomeBuilder. Table 1 provides the annual cents per unit (cpu) distribution and its components for this financial year and the previous four years for comparison.

Table 1: MLC IncomeBuilder distributions history

Financial year ending 30 June	2017/18	2016/17	2015/16	2014/15	2013/14
Total underlying income distribution* (cpu)	7.39	7.56	7.87	8.17	7.72
Capital gains (cpu)**	2.50	5.87	3.93	10.81	3.27
Total distributions (cpu)	9.89	13.43	11.80	18.98	10.99
Franking level	82%	75%	86%	62%	86%

* Underlying distribution consists of dividend and other income and excludes capital gains.

**Approximately half of the capital gains are concessional capital gains which are not tax-assessable for individuals and superannuation fund investors.

The above amounts are historical distributions and are not indicative of future distributions.

In summary, for the FY2018, the fund's:

- total distribution has decreased compared to last year, mostly due to a decrease in realised capital gains. The higher capital gains of the prior year FY2017 was largely due to stronger share market performance.
- underlying income, comprising dividend and other income but excluding capital gains, has decreased slightly by around 2%. Almost all of the underlying income is franked dividends which provide investors with a tax-efficient income stream.
- capital gains were lower than prior year's. Approximately half of the capital gains are concessional capital gains and are therefore not tax-assessable for individuals and superannuation fund investors. The remainder of the distributed capital gains is taxed at the investor's marginal tax rate.

Underlying income distribution

The fund's underlying income excludes capital gains and therefore comprises around 59% dividend income with the remainder from distributions declared by Australian real estate investment trusts and an immaterial amount of interest income. Almost all of the underlying income is franked dividends which provide investors with a tax-efficient income stream.

MLC Wholesale IncomeBuilder

Annual distribution commentary, 2018 financial year
9 July 2018

The fund's underlying income rose in FY2014 and FY2015 and has flattened in recent years as the portfolio has moved into stocks the managers' view as having better valuations for their expected sustainable long-term dividends. The investment managers also assess the likely franking of the dividends as this increases the fund's after-tax efficiency.

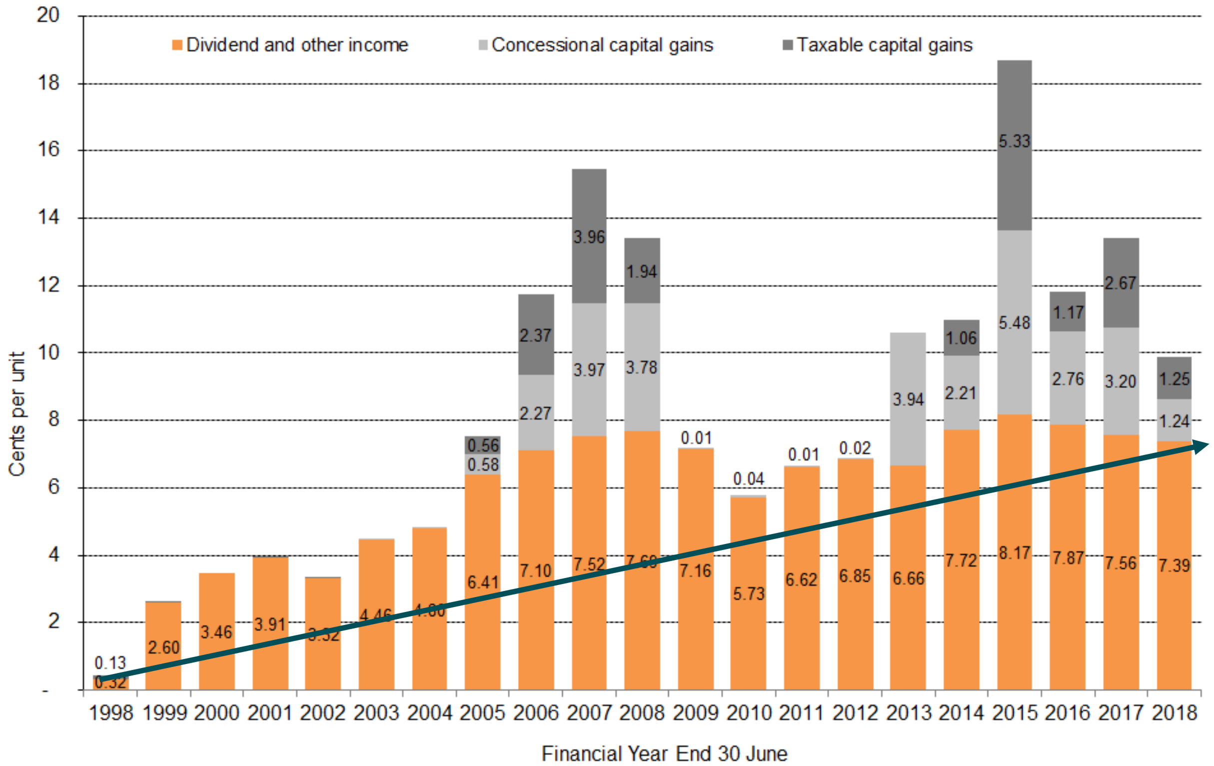
While our investment managers continue to invest in companies with sustainable long-term earnings growth, changing dividend policies of many companies has meant dividends have grown out-of-step with earnings.

In the years after the Global Financial Crisis when interest rates had been cut dramatically, there was strong demand for companies and investments that generated 'income yield'. Companies became attractive to these yield-seeking investors by increasing the amount of earnings they paid out as dividends.

Payout ratios have generally plateaued as companies begin to retain more of their earnings to reinvest in their businesses for future growth or to sustain their current level of dividends.

We manage the fund to allow all dividends and any other income generated by the fund's investments to flow through to investors rather than 'engineering' an income stream through more frequent portfolio turnover, hybrid investments or derivatives. We believe our approach is a more reliable way of delivering sustainable long-term tax efficient income growth for investors. While there will be years when the underlying income growth (shown by the orange bars in Chart 1) slows, our approach has resulted in a steady increase in income (shown by the green line) since the fund's inception 21 years ago.

Chart 1: MLC IncomeBuilder annual distributions



Source: MLC IncomeBuilder. Distributions are calculated net of fees.

The above amounts are historical distributions and are not indicative of future distributions.

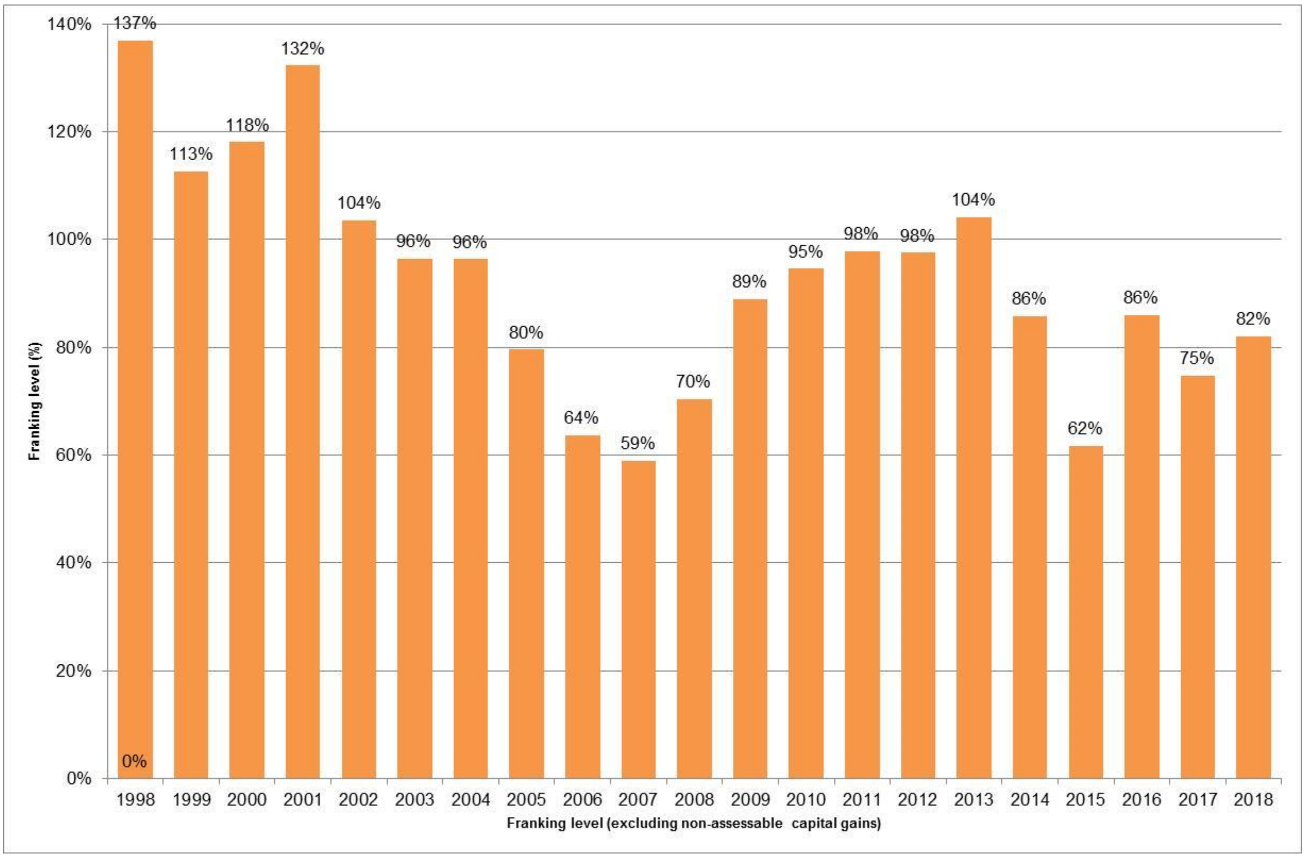
Franking levels

MLC IncomeBuilder has delivered a tax-efficient income stream with this year's franking level of 82% (see Chart 2) increasing since FY2017. The managers of MLC IncomeBuilder continue to focus on companies with growing and sustainable dividends with high franking levels.

The fund has maintained its high franking level by investing in Australian companies that derive most of their earnings from Australian sources, and therefore pay domestic tax on those earnings.

Some companies that have performed very well in the last year may derive a large portion of their earnings from overseas activities or simply have a low dividend yield eg CSL Limited, The a2 Milk Company Ltd, Aristocrat Leisure Ltd, Treasury Wine Estates Ltd. While some of these companies have experienced strong earnings growth in recent years, their dividend and franking levels are generally lower than the other companies the fund invests in. The fund has greater exposure to companies that generate more Australian based earnings and dividends with good levels of franking.

Chart 2: Franking levels for MLC IncomeBuilder



Source: MLC IncomeBuilder. Franking levels are calculated net of fees and exclude non-assessable capital gains, in accordance with FSC's standard.

The above amounts are historical franking levels and are not indicative of future franking levels.

The fund's franking level is a measure of the imputation credits attached to its income distribution. Where the franking level exceeds 100% it is because expenses of the trust reduce the income distribution, but imputation credits flow through to investors in full.

Dividends from the fund's investments

Earnings growth of Australian companies has generally been modest. The fund's distribution for FY2018 has been affected by many company dividends remaining at the same levels or lower than FY2017.

Table 2 shows dividends paid by MLC IncomeBuilder's larger company holdings over the past year and how their dividend has changed compared to FY2017. Almost 80% of the fund is invested in these companies.

Those companies that either decreased or didn't change their dividend (highlighted in orange) for FY2018, comprised 39% of the fund. Banks' profit has been slower than other parts of the market with competition for deposits, increased borrowing costs and regulatory changes crimping earnings growth. Telstra also cut its dividend this year as it has reduced its dividend pay-out policy.

Table 2: Dividends paid in the 2018 financial year, by MLC IncomeBuilder's larger company holdings

Company	Dividend ($ per share)	% change compared to the same period in FY 2016/17 dividend
Westpac Bank	$1.88	-
ANZ Bank	$1.6	-
Wesfarmers	$2.23	+ 13%
National Australia Bank	$1.98	-
Commonwealth Bank	$4.30	+ 2%
Suncorp Group	$0.73	+ 3%
Telstra Corporation	$0.19	- 40%
Woolworths Group	$0.93	+ 39%
BHP Billiton	$1.24	+ 72%
Woodside Petroleum	$1.25	+ 14%
Tabcorp Holdings	$0.23	- 8%
AMP	$0.29	+ 4%
Stockland	$0.26	+ 4%
QBE Insurance	$0.26	- 52%
Coca-Cola Amatil	$0.47	+ 2%
Scentre Group	$0.22	+ 5%
Incitec Pivot	$0.09	-
AGL Energy	$1.04	+ 35%
Sydney Airport	$0.35	+ 13%
Brambles	$0.29	-
Orica	$0.48	- 9%

Source: Reuters, ASX, IRESS.
Securities mentioned in this commentary may no longer be in MLC IncomeBuilder.

Capital gains

Over the long term the fund has demonstrated that the majority of its distributions have been franked dividend income. However, the fund is also required to distribute any realised capital gains at the end of its financial year. Capital gains can arise when the fund sells shares at prices higher than their original purchase price.

The fund is managed by two high quality active investment managers, Antares and Maple-Brown Abbott. Where the managers believe share values have reached their full potential, we expect the managers to seek better long-term risk and return opportunities. In this way our managers seek to grow and preserve investor's capital over the long term, from which future franked dividend income may be generated. However, these portfolio changes can result in the realisation of capital gains.

These gains typically feature in the fund's distribution after periods of very strong market performance and as a result of corporate actions such as takeovers and buybacks. The Australian share market grew in FY2018 but it wasn't as strong as recent years. If share prices continue to rise or remain high relative to the past, it's likely some capital gains will continue to be realised.

Our fund managers tend to hold shares for long periods of time and don't generally buy and sell the same company within a year. Therefore the benefit of the capital gain discount is passed onto investors. That's why approximately half of the capital gains distributed this year (shown by the light grey bars in Chart 1) were concessional capital gains, which are not tax-assessable for individuals and superannuation fund investors. This is further evidence of the fund's tax efficiency.

Outlook

The Australian economy and operating environment remains challenging. The outlook both here and globally is uncertain with the unwinding of quantitative easing in a period when global growth remains modest. US long-term bonds have risen towards the 3% level from their 2016 lows as interest rates begin to normalise globally. Corporate earnings prospects have improved somewhat but growth is likely to be low single digit. With dividend payout ratios already at high levels and only modest earnings growth expected, growth in dividends is likely to be minimal at best.

In this environment, MLC IncomeBuilder is well positioned. It's diversified across industries and companies with attractive long-term prospects for earnings and sustainable dividend growth. The portfolio is managed by two experienced investment firms, Maple-Brown Abbott and Antares. We believe these active managers, with their different but complementary investment approaches, will continue to deliver on the fund's objective of producing a growing, tax-efficient income stream for investors.

Monthly commentary about the performance of MLC IncomeBuilder, including information on the dividends declared by underlying companies, is available on the Fund Profile Tool on **www.mlcinvestmenttrust.com.au/fundprofiletool.**

Important information

This information is provided by MLC Investments Limited (ABN 30 002 641 661, AFSL 230705), a member of the National Australia Bank Limited (ABN 12 004 044 937, AFSL 230686) (NAB) group of companies (NAB Group), 105–153 Miller Street, North Sydney 2060.

An investment in any financial product referred to in this communication is not a deposit with or liability of, and is not guaranteed by NAB or any of its subsidiaries.

This information is directed to and prepared for Australian residents only.

This information may constitute general advice. It has been prepared without taking account of an investor's objectives, financial situation or needs and because of that an investor should, before acting on the advice, consider the appropriateness of the advice having regard to their personal objectives, financial situation and needs.

You should obtain a Product Disclosure Statement (PDS) relating to the financial product mentioned in this communication issued by MLC Investments Limited, and consider it before making any decision about whether to acquire or continue to hold the product. A copy of the PDS is available upon request by phoning the MLC call centre on 132 652 or on our website at mlc.com.au.

Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market.

Any projection or other forward looking statement ('Projection') in this communication is provided for information purposes only. No representation is made as to the accuracy or reasonableness of any such Projection or that it will be met. Actual events may vary materially.

Any opinions expressed in this communication constitute our judgement at the time of issue and are subject to change. We believe that the information contained in this communication is correct and that any estimates, opinions, conclusions or recommendations are reasonably held or made at the time of compilation. However, no warranty is made as to their accuracy or reliability (which may change without notice) or other information contained in this communication.

MLC Investments Limited relies on third parties to provide certain information and is not responsible for its accuracy. MLC Investments Limited is not liable for any loss arising from persons relying on information provided by third parties.

The investment managers are current as at the date this communication was prepared. Investment managers are regularly reviewed and may be appointed or removed at any time without prior notice to you.

MLC Investments Limited may use the services of NAB Group companies where it makes good business sense to do so and will benefit customers. Amounts paid for these services are always negotiated on an arm's length basis.

working with nab