

# MILTON CORPORATION LIMITED

## 2017 ANNUAL GENERAL MEETING



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Good afternoon ladies and gentlemen.

My name is Robert Millner and it is my pleasure to welcome you to the 79th Annual General Meeting of shareholders of Milton Corporation Limited.

As it is now 3pm I declare the meeting open.

# DISCLAIMER

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## NON EXECUTIVE DIRECTORS

- MR ROBERT MILLNER, Chairman
- MR JOHN CHURCH
- MR GRAEME CRAMPTON
- MR KEVIN ELEY
- DR IAN POLLARD
- MS JUSTINE JARVINEN

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Before we turn to the official business for the day I would like to introduce you to the non executive directors and senior executives of Milton.

Starting from the far end we have the non executive directors: John Church, Graeme Crampton, Kevin Eley, Ian Pollard and Justine Jarvinen.

# EXECUTIVES & AUDITORS

## MANAGING DIRECTOR

- MR FRANK GOOCH

## CFO AND COMPANY SECRETARY

- MR NISHANTHA SENEVIRATNE

## AUDITOR

- MS MELISSA ALEXANDER, Pitcher Partners

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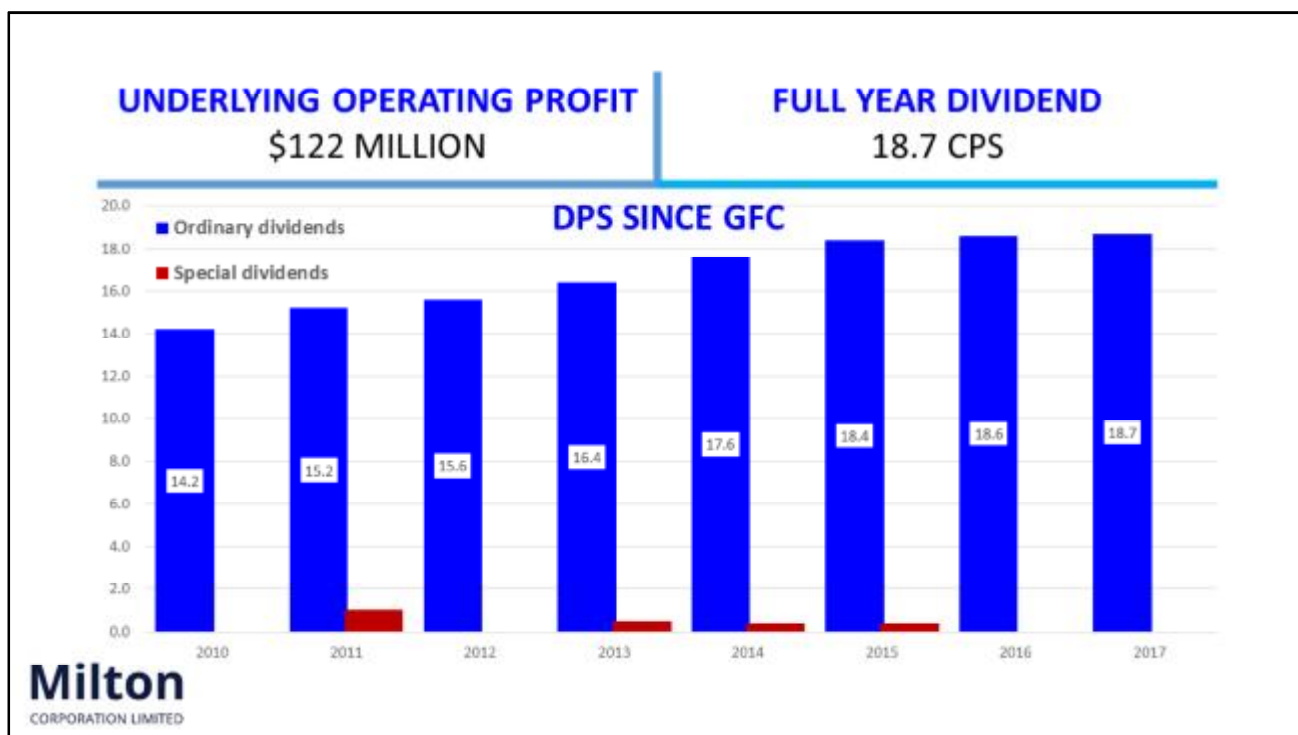
In front of me we have Nishantha Seneviratne, the company's secretary and then Frank Gooch, the managing director.

In addition, the company's auditor, Melissa Alexander from Pitcher Partners Sydney, is in attendance.

The notice of annual general meeting has been circulated to all shareholders. The holders of over 156 million shares or approximately 24 per cent of the company's ordinary shares have either lodged their proxy or voted on-line.

Following my report to the meeting Frank will provide an overview of the 2017 financial results of Milton and comment on the investment portfolio.

You will then have the opportunity to ask questions regarding the business of the meeting.



The company increased its 2017 ordinary, full year, fully franked dividend to 18.7 cents per share after recording an underlying operating profit after tax of \$122 million, the equivalent of 18.7 cents per share.

Milton has increased its annual dividends per share every year since the GFC, and the annual dividend is now at a record level.

Before declaring the increased 2017 final dividend directors noted that the total of \$121.8 million required to pay an 18.7 cents per share dividend would be fully covered by underlying earnings and that management's internal forecasts of dividend income for the 2018 financial year indicated that this annual dividend could at least be maintained in 2018.

Milton's ability to lift the dividend, even though underlying earnings were marginally lower, demonstrates the advantages of being a listed investment company with a long term investment philosophy.

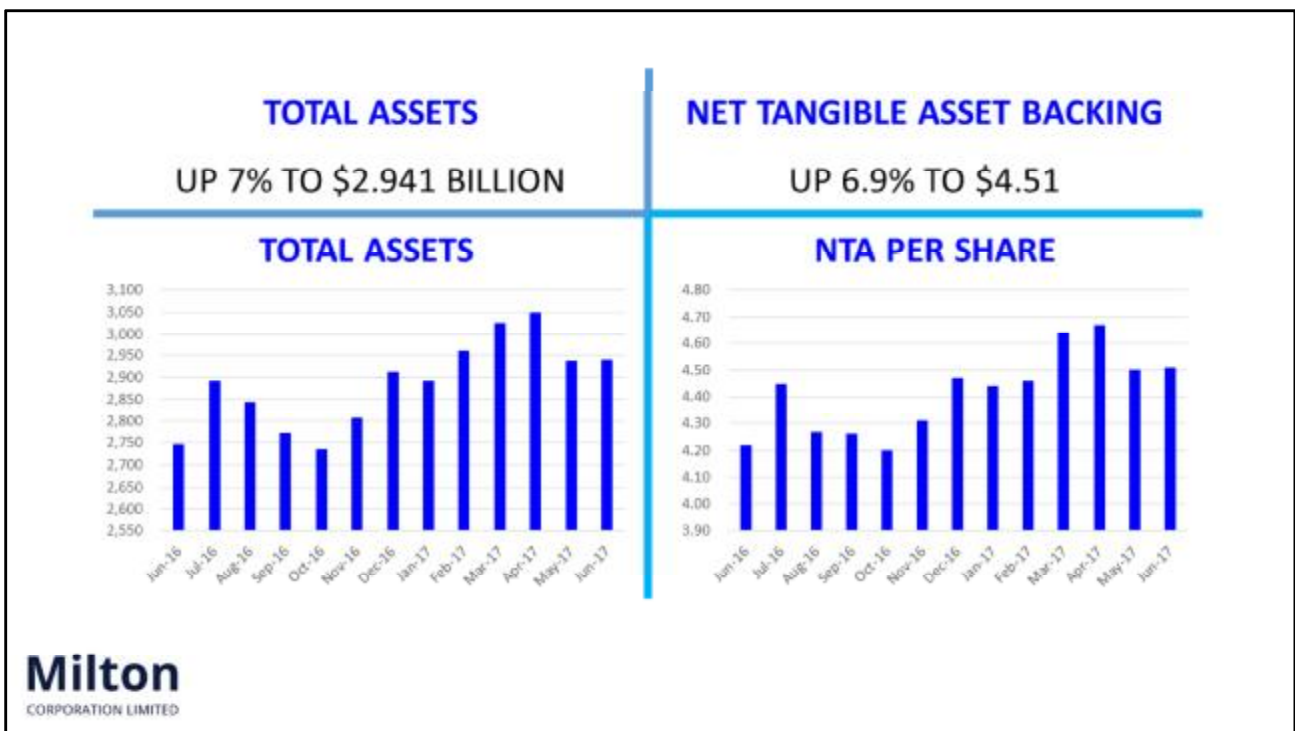
Consistent application of the long term investment philosophy of investing in companies that pay dividends has delivered a

growing income stream that supports the payment of annual dividends.

Milton's corporate structure, with a strong balance sheet and sufficient franking credits to fully frank dividends for the foreseeable future, enables the payout ratio to be varied so that shareholders can have a high level of confidence in the annual dividend.

The corporate structure with internal management provides additional benefits to its shareholders as it lowers operating costs and it removes any imperative to grow its capital base unless it is in the best interests of its shareholders.

The costs of managing the company including all shareholder related costs such as ASX listing fees and share registry costs, represented 0.12% of average total assets for the year.



The company did grow its share capital throughout the year with \$8.8 million being raised through the dividend reinvestment plan. The shareholder participation rate has been slowly increasing since it was introduced in 2014 with 7.6% of shareholders participating in the 2017 final dividend.

Since the end of the year shares have also been issued as consideration for the acquisition of an unlisted family company which had a portfolio of investments in listed equities valued at \$19 million. As with the 18 previous such acquisitions, the terms were such that the acquisition was accretive to Milton's net tangible asset backing per share. I welcome the vendors to the Milton share register and thank them for their support.

The value of the net tangible assets at the end of the financial year was \$2.9 billion or \$4.51 per share, an increase of 6.9% over the year. Since then Milton has paid its final dividend of

10 cents per share and the net tangible assets at the end of September was \$4.45 per share.

With more than 90% of its total assets invested in Australian listed equities, the value of Milton's net tangible assets will tend to rise and fall with the value of the stock market. In 2017 the net tangible assets reached a peak of \$3.05 billion or \$4.67 per share at the end of April 2017 when the All Ordinaries Index also hit a month end peak of 5948.

It is important to note that Milton is not an index investor rather it invests in companies that it expects will pay increasing dividends over time. Therefore, the value of its investment portfolio does not always move in line with the index. This is of course important otherwise Milton could never outperform the index. Frank will discuss the portfolio in more detail shortly.

DIRECTOR CHANGES	OUTLOOK
JOHN CHURCH TO RETIRE AFTER 30 YEARS OF SERVICE	1 <sup>ST</sup> QUARTER RESULTS AHEAD OF PCP
JUSTINE JARVINEN TO STAND FOR ELECTION	EXPECT MILTON'S ANNUAL DIVIDENDS OF 18.7CPS SHOULD AT LEAST BE MAINTAINED

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John Church will retire at the conclusion of this meeting. John joined the board of Milton in 1986 when the company had total assets of \$70 million. With more than 30 years of experience of investing in Australian corporates John has provided valuable advice to the Investment Committee of which he has been a member since its formation in 1999. On behalf of all shareholders I would like to thank John for his wonderful contribution over many years.

Before seeking a new director, we considered the skills that would be most useful in this ever changing world in which we live. We came to the conclusion that it would be advantageous to have someone who had experience working with new technologies and evaluating the opportunities and risks arising from technology driven disruption. Following a number of interviews with outstanding candidates we were pleased to invite Justine Jarvinen to join the board and to become a member of the Investment Committee. Justine attended her first Milton board meeting in August and has attended 7 Investment Committee meetings and we have

already benefitted from Justine's insights.

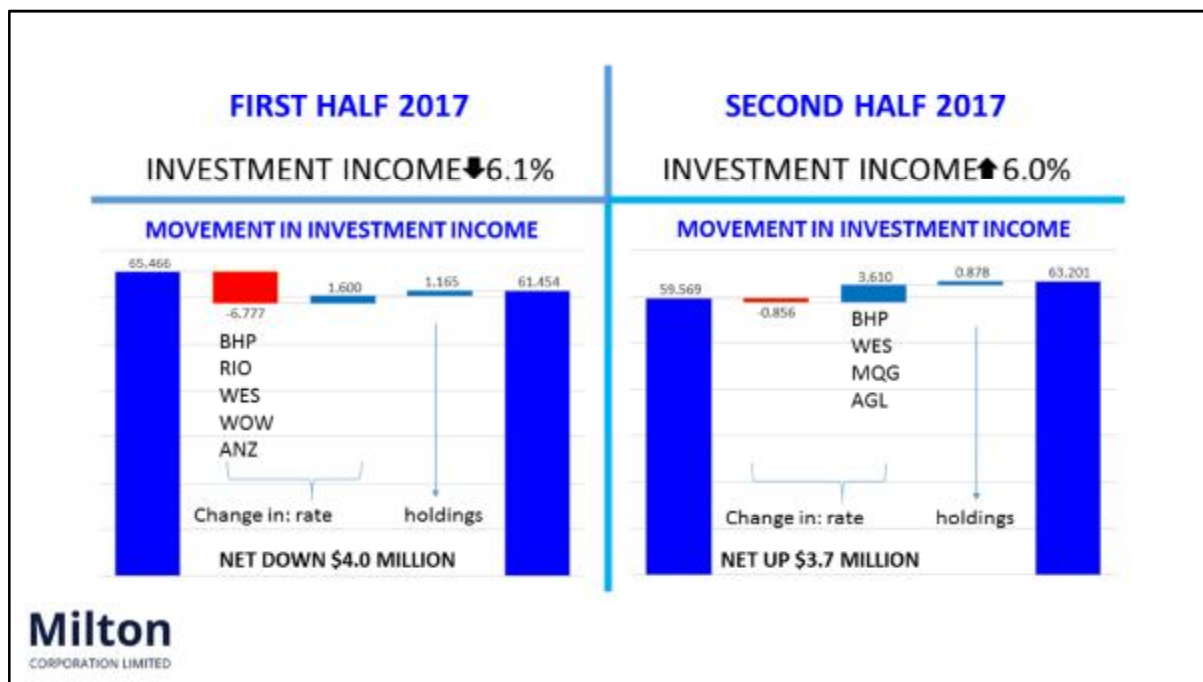
The company's results for the quarter to the end of September are ahead of the previous corresponding quarter and a little ahead of our budget. Provided there are no unforeseen circumstances we would expect the full year dividend of 18.7 cents per share should at least be maintained.

I will now ask Frank to report on the company's performance, its investments and the outlook.

**FRANK GOOCH**

**MANAGING DIRECTOR**

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Thankyou chairman and good afternoon everyone.

As a traditional listed investment company Milton takes a long term approach when it seeks to invest in well managed companies that are considered likely to pay increasing dividends over time.

This does not mean that every investment will increase its dividend every year. However, we would normally expect that increases in ordinary dividends received from the diversified portfolio of companies and trusts would exceed the decreases.

Unfortunately, 2017 was not a normal year and ordinary investment income for the year was marginally lower than the year before. In addition, special dividends received in 2017 totalled \$366,000 a little over \$1 million less than that received in 2016.

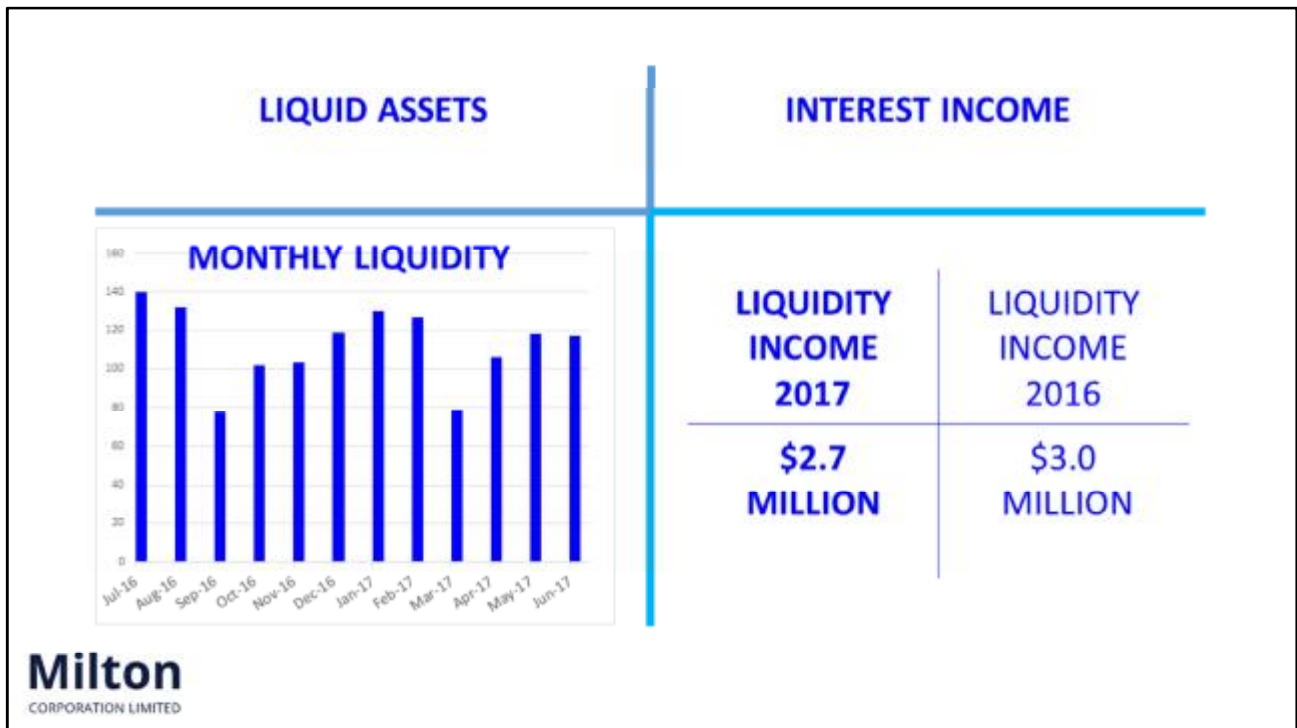
In the first half of the year 50% of Milton's investments raised their ordinary dividends, a further 25% of companies maintained their dividends and the remaining quarter

reduced their dividends. The net impact on investment income from dividend rate movements was a fall of \$5.2 million.

The larger falls in income were derived from BHP Billiton, RIO Tinto, Wesfarmers, Woolworths, and ANZ, all of which are within Milton's Top 20 holdings. Portfolio changes made over the previous 12 months helped to recover \$1.2 million so that the reduction in total investment income for the first half was 6.1%.

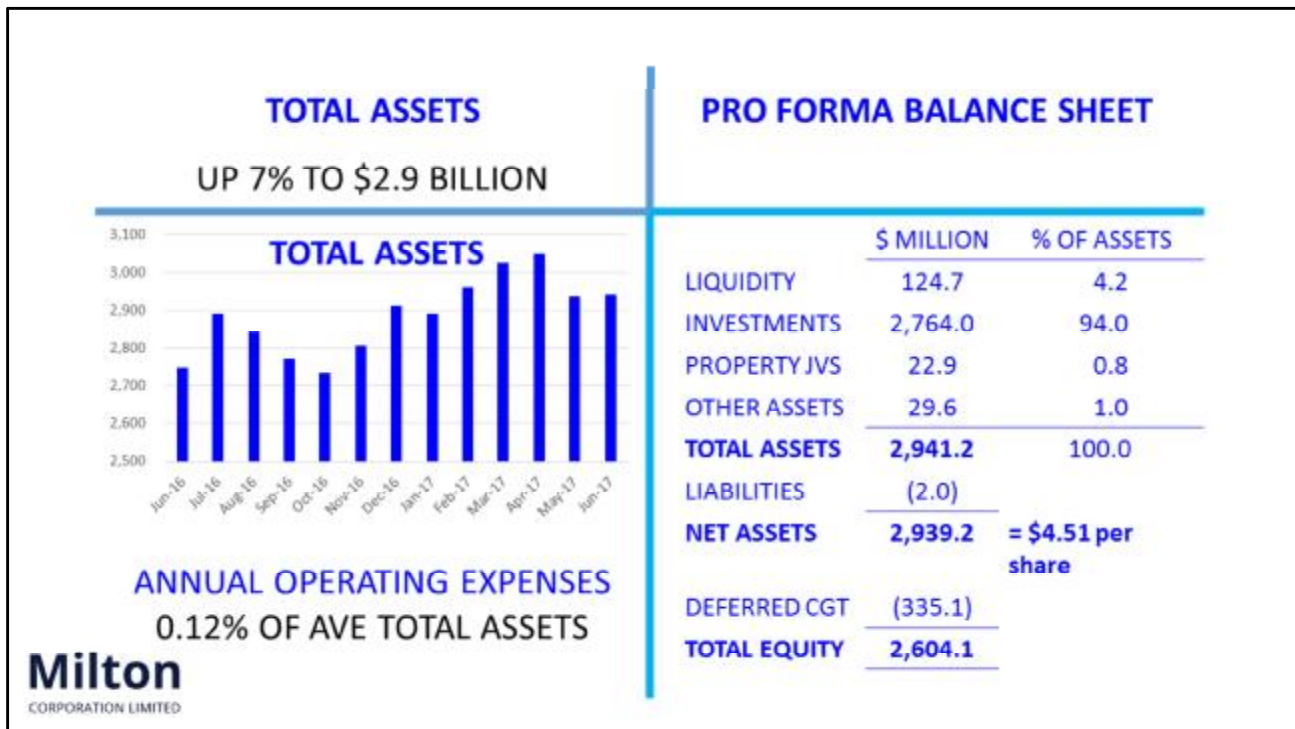
In the second half almost 60% of the investments lifted their ordinary dividends and just 12 companies reduced their dividends. The standout dividend increases came from BHP Billiton, Wesfarmers, Macquarie Group and AGL Energy. Consequently, the net increase derived from changes to the rate of dividends paid was \$2.8 million and portfolio movements lifted ordinary investment income by a further \$0.9 million.

Pleasingly dividend income has lifted further in the first quarter of 2018.



While Milton is reasonably fully invested it does maintain liquid assets, which over the year, averaged approximately \$100 million. You can see from this graph that the cash and term deposit balances increase as dividends are received and they normally reach a peak just prior to the payment of dividends to Milton's shareholders. With average interest rates in 2017 even lower than the year before interest income fell by almost 10% to \$2.7 million.

We have not seen any significant movement in interest rates in the first quarter of 2018 and do not anticipate any significant changes for the foreseeable future.



At the end of the 2017 financial year Milton had \$23 million, representing 0.8% of total assets, invested in property joint ventures to sub divide land. The total income from these investments in 2017 was \$1.2 million. The return, which was lower than the year before, was affected by tough housing market conditions in Western Australia and ramp up costs in the Huntlee joint venture in New South Wales. The WA joint ventures have provided outstanding returns over the past 17 years and we expect they will continue to be profitable. The Huntlee development in the Lower Hunter is gaining momentum and has attracted considerable interest from potential residents, home builders and commercial operators. It is expected to generate sound long term returns.

Current indications are that the joint ventures will deliver improved results in the 2018 financial year.

While Milton is predominantly a long term equity investor it does take advantage of sound opportunities to realise short term trading profits. In 2017 the company realised \$300,000 in trading profits whereas in 2016 it made unusually larger

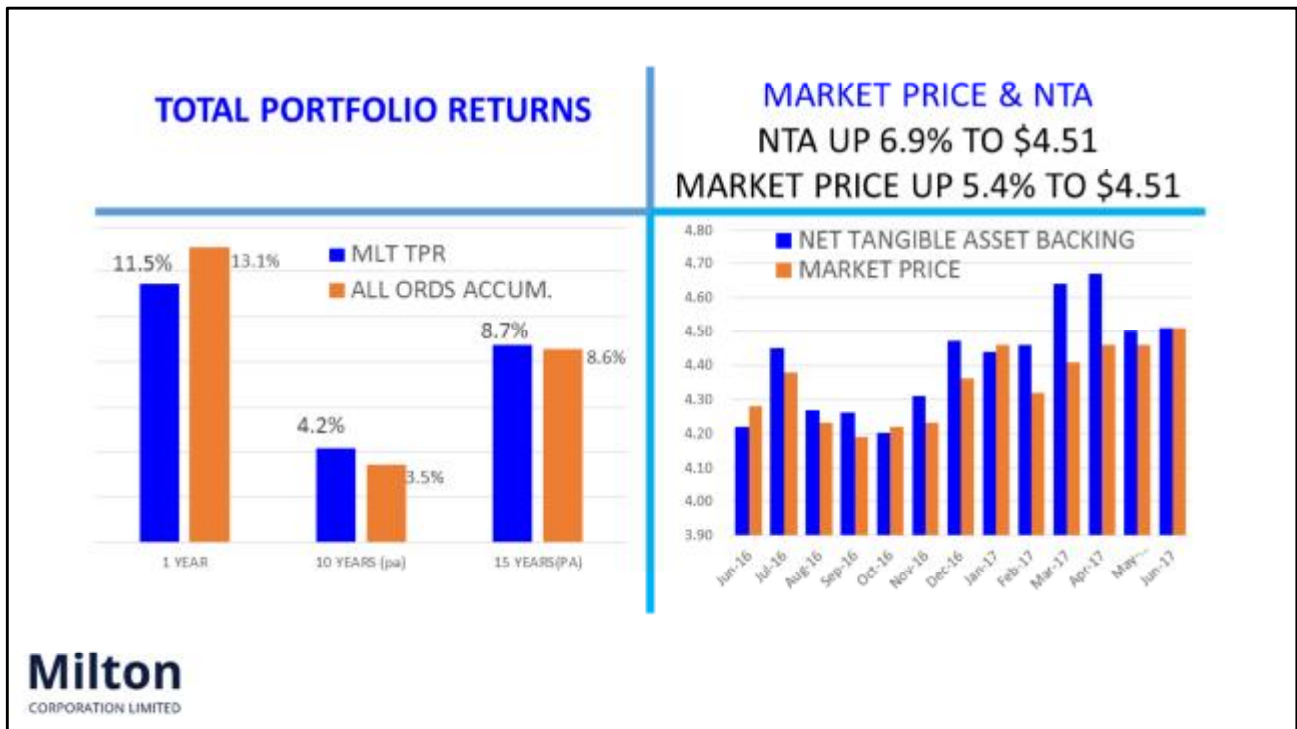
trading profits of \$3.7 million.

During the year we continued to seek operating efficiencies while not compromising the research efforts of the investment management team or our systems of risk management. Consequently, the increase in total operating costs was limited to 1.2% while total assets increased by 7%. The operating expense ratio, which includes all management costs as well as share registry and listing fees, reduced to 0.12% of average total assets. A low fixed cost base ensures earnings and valuation increases flow directly to shareholders.

Net cash from operating activities amounted to \$122 million which exceeded the \$121 million in dividend payments made during the year. The liquidity balance, which includes cash and term deposits, was \$124 million at 30 June 2017.

The Other Assets on the balance sheet at year end included accrued dividends and trust distributions receivable totalling \$24 million.

Total assets increased to \$2.9 billion from \$2.7 billion at the end of the previous year and the net asset backing, before provision for tax on unrealised capital gains, increased by 6.9% to \$4.51 per share. The primary driver of the increase was the \$183 million revaluation of the investment portfolio, which stood at \$2.8 billion and represented 94% of total assets.



Milton is not an index investor nor does it use relative performance, particularly over short time frames, as a measure of its success. The focus is on meeting its objective, which is to pay increasing fully franked dividends by investing in a diversified portfolio of assets that will increase in value over time rather than to outperform any index.

However, a commonly used but imperfect measure of relative performance is the comparison of the total portfolio return with the accumulation return of the All Ordinaries Index. The comparison is flawed to some extent as the total portfolio return is based on the combination of dividends paid and the movement in Milton's net tangible assets. It is flawed as Milton's return is reduced by expenses incurred and tax paid whereas the Index is unaffected by expenses or tax. Neither return is adjusted for the franking credits which again disadvantages Milton which pays fully franked dividends whereas the average dividends paid by companies in the

Index are partly franked.

Nevertheless, Milton has delivered superior returns over longer periods of time such as 10 and 15 years while the one year total return was marginally lower than the accumulation return of the All Ordinaries Index.

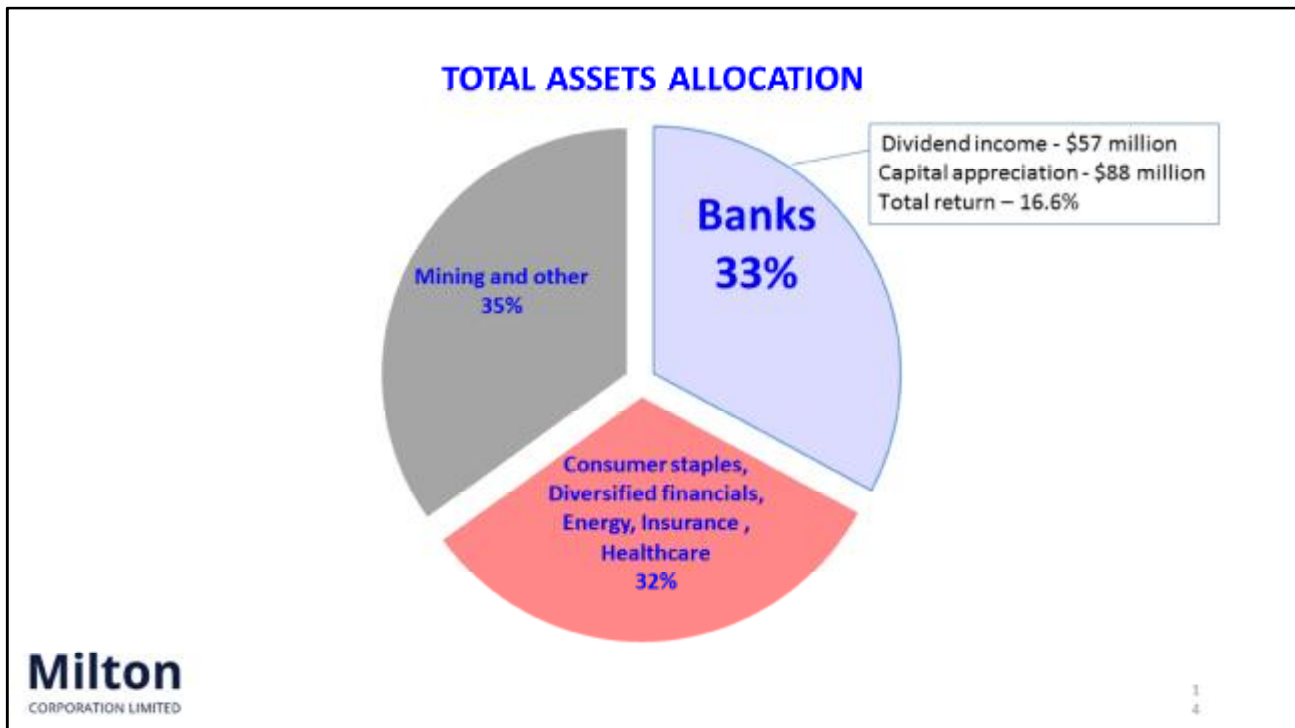
The net tangible assets per share, or NTA, is important however, as it is a reference point for the valuation of the shares that trade on the ASX. When the market price exceeds the NTA the shares are said to be trading at a premium and when the share price is below the NTA they are considered to be at a discount. The monthly premium and discount is widely tracked and discussed.

I think too much emphasis is placed on the month end premium or discount as it is actually impossible to intentionally trade at NTA, because the NTA can only be determined at the close of trading. It is probably better to consider the volatility of the premium or discount rather than the absolute number.

Over the two years to September 17, Milton's shares have traded in a range of +2% and -3% for 80% of the time.

Interestingly at 30 June 2017 Milton's closing share price was equal to its NTA of \$4.51. A rare event that has only occurred one other time in the last 20 years.





Milton has investments in 91 companies and trusts spread across most sectors. The Annual Report contains a list of investments by sector.

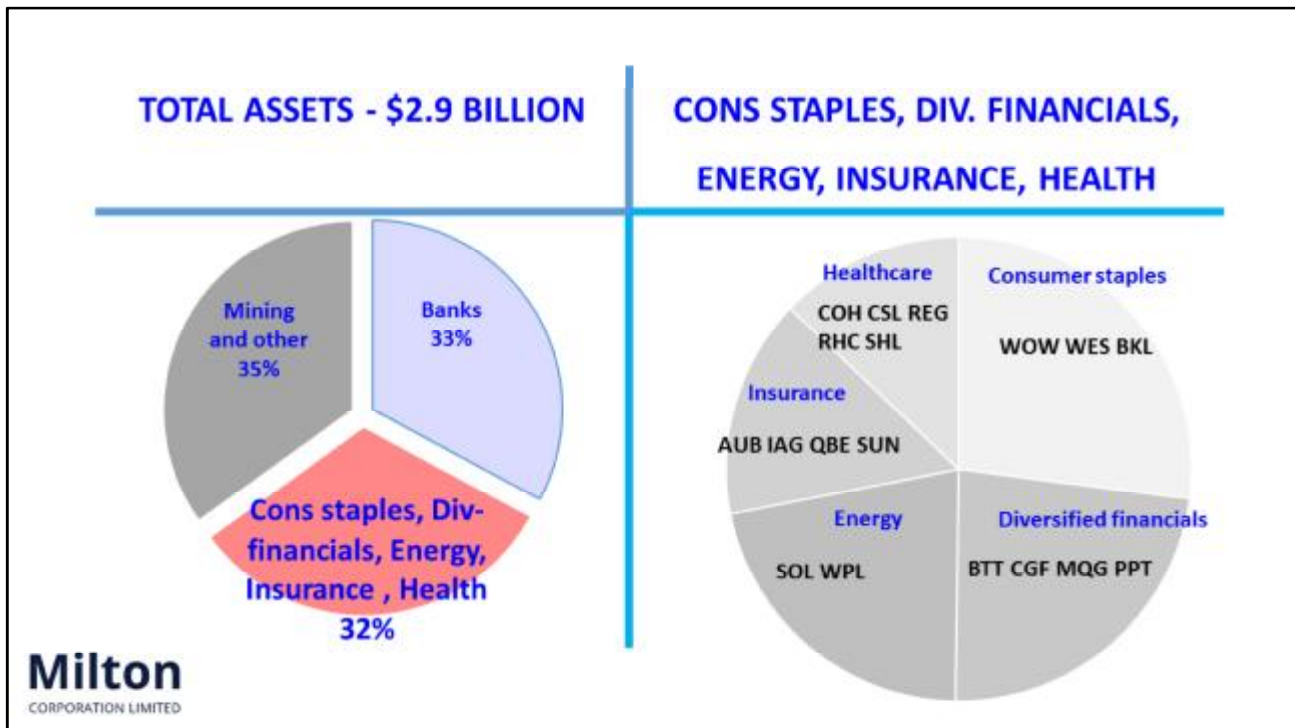
Given Milton's long term investment philosophy and its interest in companies that pay increasing dividends it is not surprising that approximately one third of its total assets are investments in the bank sector. The banks have been a great source of dividends and capital growth over many years and in the year under review they contributed \$57 million in fully franked dividends and their market value increased by \$88 million. The total return of Milton's portfolio of banks for the year was 16.6%.

The banks are very complex organisations, operating in an incredibly competitive environment. They are investing significantly in new technologies to efficiently deliver products and services to customers through channels many of us would

never have expected to be possible only a couple of years ago.

At the same time, they are strengthening their balance sheets to become unquestionably strong and responding to increasing regulatory oversight.

Part of being unquestionably strong is the ability to generate strong returns and I expect the banks will continue to do this but I do not expect this benefit to be passed onto shareholders through increased dividends, at least for the next twelve months.



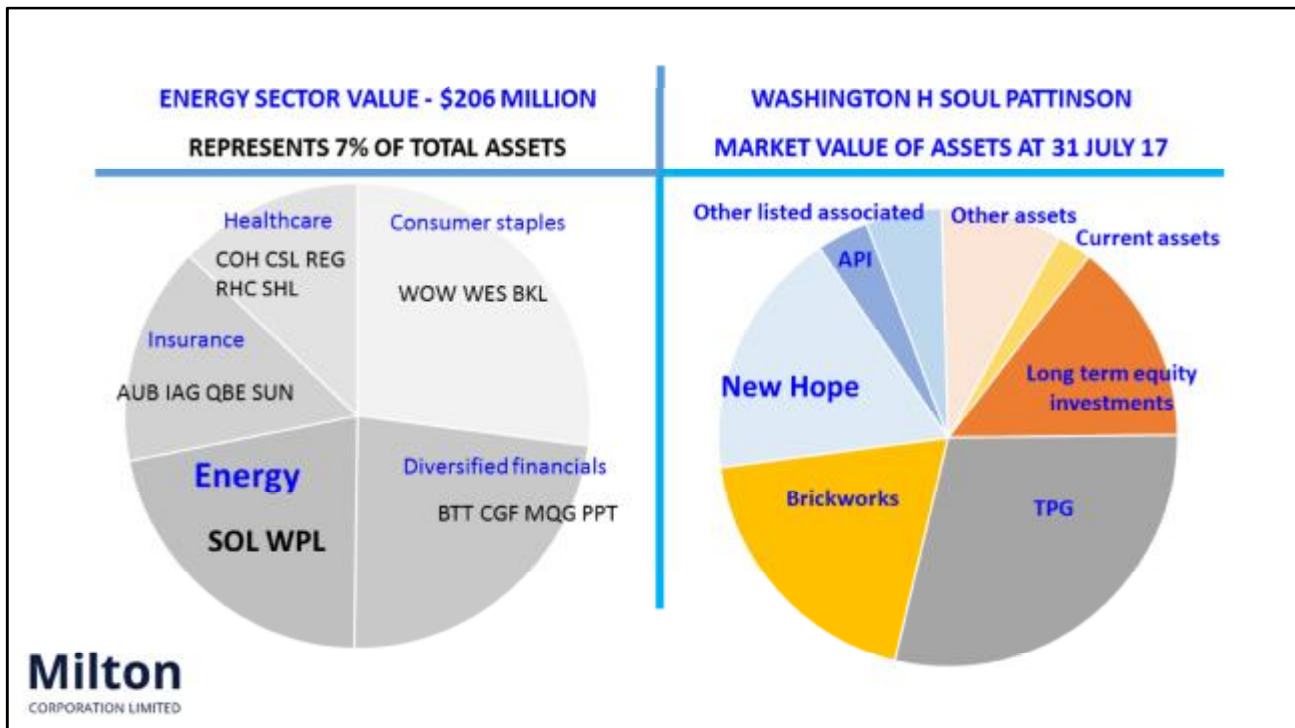
Another third of the assets are investments in companies in the Consumer Staples, Diversified financials, Energy, Insurance and Healthcare sectors.

The Consumer staples sector includes food retailers Woolworths and Wesfarmers. The 5% total return from Wesfarmers was entirely made up of dividends whilst the 25.5% return from Woolworths was mostly capital gain as the markets started to recognise the operational improvements taking place.

This sector also includes Blackmores whose share price fell by 27%. In August 2016 the company reported a strong 2016 full year result but warned of softer market conditions. The following February it reported lower first half 2017 earnings and cut its interim dividend by 35%. Its outlook has improved following the 2017 full year results announcement and our expectations are that the year ahead will produce improved returns.

The diversified financials portfolio provided high dividend returns of 5.5% as well as sound capital appreciation of 24%. The stronger performing companies in this sector included BT Investment Management Limited, Challenger, Macquarie Group and Perpetual Limited.

During the year exposure to Australian domestic fund managers was reduced with the proceeds being partially reinvested in IOOF Holdings and global fund managers such as BT Investment Management Limited and Janus Henderson Group.



Milton's investment in the energy sector was valued at \$206 million or 7% of total assets. The largest investment in this sector is Washington H Soul Pattinson, which was valued at \$153 million followed by Woodside Petroleum, with a market value of \$28 million.

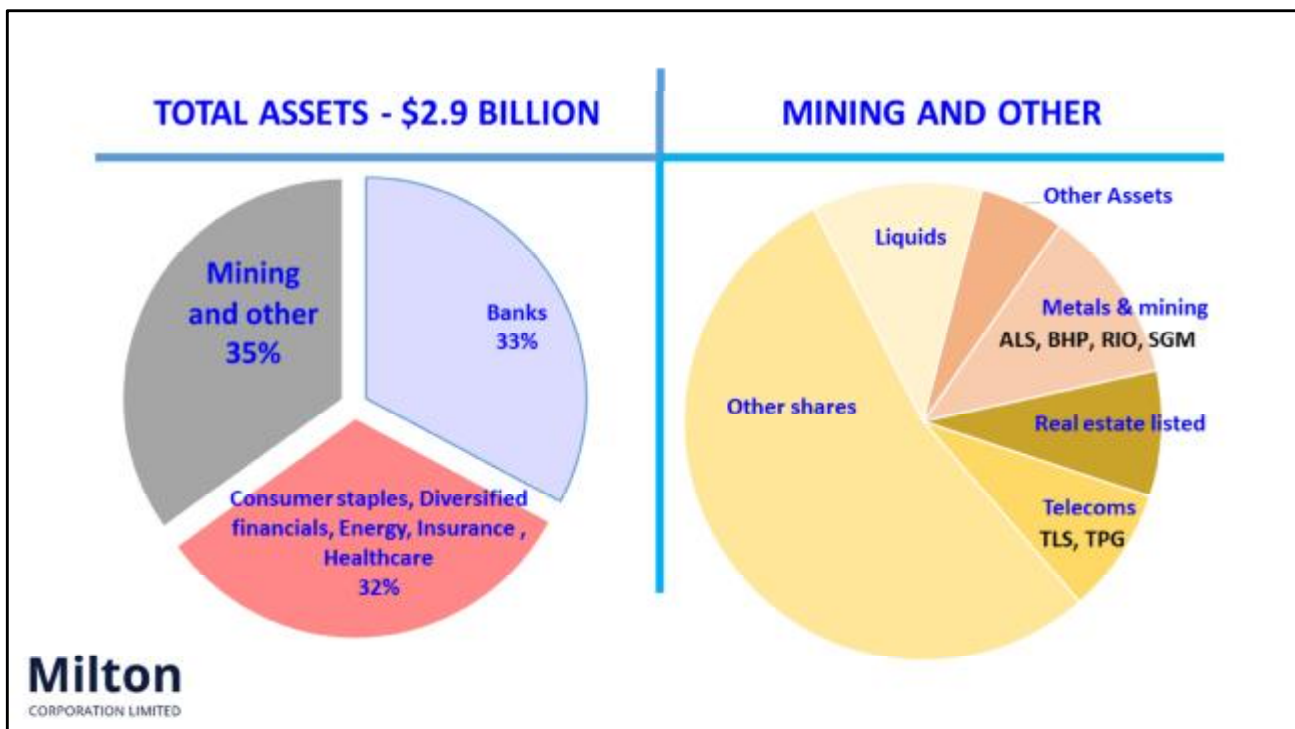
In accordance with Standard & Poors' Global Industry Classification Standard, Washington H Soul Pattinson is considered an energy company. At 31 July 2017 the market value of SOL's investments in the energy sector, largely New Hope Corporation, was less than 20% of the market value of its total assets.

The investment in Washington H Soul Pattinson also provides Milton with exposure to telecommunications, building

materials, property, retailing and other investments.

Companies in the Insurance sector included AUB Group, IAG, QBE Insurance Group and Suncorp Group all of which provided dividend income and capital appreciation well in excess of the market as a whole.

While CSL is Milton's largest investment in the Healthcare sector other investments include Cochlear, Regis Healthcare and Sonic Healthcare.



Investments in the remaining sectors together with liquid assets and other assets comprise the final third of the total assets. Some of the larger holdings in these other sectors and that provided strong returns include mining and related services companies: ALS, BHP Billiton, Sims Group and Rio Tinto, while in the utilities sector AGL Energy contributed a total return of 36% and from the REIT sector – Lend Lease returned 29%.

AP Eagers, the automotive retailer, paid increased dividends however its share price fell by 30% largely due to concerns regarding challenging retail conditions and the outcomes of the ASIC reviews into “add on insurance” policies and flex commissions on finance.

In the telecommunications sector TPG has historically provided outstanding returns through increased dividends and share price appreciation. Milton received higher dividends from TPG in 2017 however the share price fell over concerns regarding the impact of the NBN rollout and its strategy to expand into the mobile telecommunications space

in Singapore and in Australia.

To help fund the Australian expansion the company raised additional capital through a rights issue in which Milton participated. The management has an excellent track record of long term investing in the telecommunications business. I expect this latest investment will prove to be successful, however, in the short term its dividends are likely to be lower.

Naturally it was pleasing to see the value of the portfolio increase over the year. However, this did make it more difficult to identify opportunities to further invest particularly if the increases in values are not supported by expanding earnings.

Nevertheless, the investment team focussed on improving the quality of the portfolio by disposing of companies that no longer met our investment criteria and reinvesting the proceeds.

Janus Henderson, Charter Hall Group, Charter Hall Long Wale REIT and Growthpoint Properties Australia were added to the portfolio. Over the year a total of \$56 million was invested and this was largely funded by disposals that totalled \$43 million.

The largest disposals took place in the Diversified financials sector while the larger acquisitions occurred in the Diversified financials and the Real Estate sectors. Effectively Milton reduced its exposure to Australian equity fund managers and reinvested in global equity fund managers and real estate fund managers.

Hardly a day goes by now that we do not hear or read about new technologies, autonomous motor vehicles, artificial intelligence and the effects these will have on our lives and our companies. We have already seen many companies adopting new technologies to help them operate more

efficiently, to analyse data to better tailor solutions for their customers and to become more effective in distribution of products.

Our investment managers have been looking closely at this for some time now with the aim of not only identifying which of our investments will benefit and which will be disrupted but also to seek out new investment opportunities. The appointment of Justine to the board and the investment committee will certainly help the investment team in this regard.

## OUTLOOK

- POSITIVE ECONOMIC OUTLOOK
- MARKET PRICED FOR EARNINGS GROWTH
- 1<sup>ST</sup> HALF EARNINGS SHOULD EXCEED PCP
- 2<sup>ND</sup> HALF EARNINGS AFFECTED BY LOWER DIVIDENDS FROM TLS, TPG AND QBE

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While Milton is reasonably fully invested, there are sufficient funds available to continue investing in Australian listed companies.

The outlook for the Australian economy is reasonably positive. Increasing corporate investment in growth capex combined with significant infrastructure investment should help the economy to continue expanding.

Strong jobs growth has kept unemployment at reasonably low levels. The trend unemployment rate remained at 5.6 per cent for the third consecutive month in August 2017, while the number of unemployed persons decreased by 2,200.

Interest rates are low and I expect will remain so whilst the growth in household debt exceeds growth in household incomes and property prices are elevated.

On the other hand underemployment, low wage growth and rising energy prices will put pressure on consumers and recent retail spending statistics indicate this may already be happening.

The increasing cost of energy and its availability are also major issues for corporates, whose business models may well be tested over the next twelve months.

The global economy appears to be improving and Milton is well positioned to benefit through its Top 20 holdings in ALS, BHP Billiton, Blackmores, CSL, and Macquarie Group, and through many other portfolio investments.

Overall I expect corporates will deliver single digit eps growth over the year ahead and this will be necessary to support current share prices.

Based on the results to date, Milton's investment income in this first half should exceed the income received in the previous corresponding half.

Even though its second half earnings are likely to be impacted by lower dividends from QBE Insurance Group, Telstra and TPG Telecom, Milton's 2018 full year earnings are currently on track to improve over the 2017 year.

I would like to welcome Justine to the board and I know the investment team are excited about working with her through the Investment Committee.

I would like to thank the directors for their support and guidance throughout the year. In particular I would like to thank John Church for his 30 years of service to Milton and the assistance he has provided to me over 21 years.

I would also like to acknowledge the efforts of the Milton staff who I believe do a wonderful job for our shareholders.