

CHAIRMAN'S ADDRESS

WATERMARK MARKET NEUTRAL FUND LIMITED ANNUAL GENERAL MEETING

Wednesday 23rd November 2016 – 3pm.

**Morgan Stanley, Chifley Tower
Level 39, 2 Chifley Square
Sydney NSW 2000**

INTRODUCTION

Hello Ladies and Gentlemen,

Welcome to the 3rd Annual General Meeting of the Watermark Market Neutral Fund Ltd (WMK). I would like to thank you all for coming today and for supporting the company since its inception in 2013.

My name is Matthew Kidman, I am the chairman of the Board of Directors and I will be chairing the meeting today. I would like to start by introducing my fellow Board members, Justin Braitling, John Abernethy, Stephen Van Eyk and Rob Ferguson. I would also like to introduce our company secretary, Matthew McShane from White Outsourcing and our auditor Pitcher Partners. Pitcher Partners will be available to answer questions relating to the company's financial statements.

Before progressing with the formal part of the meeting, I would like to make some general remarks about the performance of WMK and the approach being taken by management and the board. Following this, Justin and his management team will conduct a presentation.

PERFORMANCE

The board is delighted to report that for the year to June 30, 2016 the company's investment portfolio increased in value by 22.3 per cent before fees and costs. During the 12 month period the net tangible asset backing per share increased from \$0.99 to \$1.05, in addition shareholders received 6.5c in dividends, partially franked. This was a pleasing result given the cash rate over the period averaged 1.96 per cent. Since inception, in July 2013, WMK has averaged a net return, after fees and other costs, of 8.5 per cent per annum, paying shareholders a total of 16c a share in dividends.

This solid performance track record has resulted in the Watermark fund being ranked in the top quartile of 453 neutral funds around the globe as measured by Premium Data. Justin and his team at Watermark are doing a fine job at managing shareholder's capital.

CAPITAL MANAGEMENT

I would now like to make some comments regarding the purpose of the fund and the board's approach to capital management.

The market capitalisation of the company is approximately \$93 million. The board would like, when the time is appropriate, to increase the size towards \$150 million. Importantly, the extra size of the fund should not hamper performance given the management's stated preference to include highly liquid companies in the portfolio. Additionally, the board has sanctioned the ability of the fund to hold up to 50 per cent of the portfolio in international stocks from designated countries. The benefits of a larger capital base are twofold. Firstly, it allows the costs of the company, after management fees, to be amortised over a larger capital base, reducing the per share cost of running the business. Secondly, it would provide greater liquidity, making the stock easier to trade and more attractive to a larger range of potential shareholders.

Importantly though, the board is adamant that it will not grow WMK at the expense of existing shareholders. It is not the intention to raise fresh funds at a discount to the net tangible asset backing through a placement, rights issue or otherwise. Instead, we would look to raise funds at NTA or above, enhancing the current shareholders value. One possible way of achieving this is through an option issue, struck at NTA or above. An option issue provides maximum flexibility for all shareholders, who have the ability to sell their option or exercise at a given date and take up more shares.

In recent times, WMK's share price has traded at or close to NTA, allowing the board to consider the possibility of expanding the capital base at an acceptable share price. This was not the case 12 months ago.

While the board's objective is to grow the capital base of WMK it will always prioritise to enhance shareholder value through its capital management. This has been on display previously with the activation of a share buyback scheme, when shares were purchased at a discount to NTA, increasing the value of the NTA per share for all remaining shareholders. This approach will be implemented again in the future if the share price trades at a noticeable discount to NTA.

The preparedness to activate a share buyback is particularly important in WMK's case. As a market neutral fund, share market fluctuations should not impact the value of the portfolio. However, in times of market panic the WMK share price may be sold down, placing it at a major discount to NTA. It is important to understand that WMK as a neutral fund has its number of long stock positions matched by the number of short stock positions. This means that when the market moves up or down the value of the portfolio should not be influenced. Instead, the value of the fund relies solely on the stock picking of the management team. This means returns will not be correlated with the overall market direction.

DIVIDENDS

The other important element to capital management is the payment of dividends. It is the intention of the board to pay a consistent, and when possible, growing dividend stream. The ability to achieve this stated goal depends on the profits generated by the company. In regards to franking, the board has deliberately adopted a cautious approach, opting to partly franking the dividends. Generating franking is not easy for a neutral fund, especially in WMK's case.

When WMK short sells a stock, it must borrow that stock. When that stock goes ex dividend WMK is obliged to pay the dividend and the franking amount back to the lenders of the stock. This, somewhat offsets the franking accumulated by WMK's long positions.

Additionally, WMK has approximately 30 per cent of its portfolio invested in overseas companies that cannot pay franked dividends.

Despite these limitations, WMK will look to franked dividends whenever possible. The cautious approach to date, should allow the company to partially frank dividends into the future.

Once again I would like to thank everyone attending today and we look forward to seeing you again next year.