

AUSTRALIAN

RESEARCH



Contents

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December 2009 Quarterly Review

For Advisers Only

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Australian Foundation Investment Company Ltd (AFI)



| LMI Type | Investment Assets | Investment Area | Investment Sectors |
|---------------------------|-------------------|-----------------|--------------------|
| Listed Investment Company | Listed Companies | Australia | Diversified |

Company Details

AFI was established in 1928 as the Were Investment Trust and was officially admitted to the ASX in 1962. AFI is now the largest LIC in Australia, representing over 20% of the sector. AFI holds about 80 listed Australian companies, mainly within the S&P/ASX 200 Index.

Board

B Teele (Chairman), D Argus, R Barker, T Campbell, J Paterson, F Ryan, C Walter, P Williams

Investment Philosophy

The investment philosophy of AFI is one of 'buying and holding' good companies for the long term in order to benefit from a growing stream of franked dividends and capital growth.

Style and Process

The investment style of AFI is characterised as bottom-up, index-unaware, 'buy and hold' and value-biased. The portfolio is split into two areas: a long-term investment portfolio and a small trading portfolio that cannot exceed 10% of the total portfolio. Within the long-term portfolio, AFI prefers to buy companies with strong management, good free cashflow, strong sustainable margins and a capacity to pay increasing dividends. Dividend policy is chiefly driven by net operating profit, but can accommodate realised gains. In identifying and analysing companies, AFI uses external brokers for a degree of its modelling and concentrates on spending time with management, particularly with the CEO, and seeking the opinion of its investment committee (a sub-committee of the board) at weekly investment meetings. Most sales are due to takeovers or other corporate actions. Within the trading portfolio, the manager takes short-term positions and uses option strategies in order to generate additional income. AFI had fixed-rate borrowings of \$50M at 6.095%, maturing in August 2011, and \$95M in cash as at 31 December 2009.

Investment Team

B Teele, BSc, BCom: Chairman; R Barker, BSc(Hons), MBA, Grad Dip SIA: Managing Director; M Freeman, BCom, MBA, ASIA: Chief Investment Officer; A Dunn, BEc, BCom, CFA: Snr Investment Analyst.

Aegis Comments

AFI can be viewed as a relatively defensive fund with a stable investment portfolio, suitable for risk-averse investors. AFI's portfolio composition and long-term track record mean the Fund is well positioned for times such as the present. Given the strength in markets, AFI will be taking a relatively cautious approach to investing its cash. AFI expects that we have probably seen the low point for earnings and dividends; however, the recovery in dividends may lag the upturn in earnings. The Fund outperformed the S&P/ASX 200 Accumulation Index over the past quarter as well as one, three and five years (on a pre-tax NTA plus dividends basis). AFI's portfolio has benefited from the market recovery, particularly in the share prices of those companies that had large capital raisings. AFI was trading at a 3.2% premium to pre-tax NTA at 31 December 2009. At its 1H10 results release, AFI noted, "It had a more cautious view on Australian economic conditions than the equity market was exhibiting; and it was close to fully invested and would be looking at company results for comments on earnings outlook and dividends."

Key investment information



| | |
|---------------------------------|--------------------|
| RATING | Recommended |
| Price (\$) | 4.98 |
| As at 1 March 2010 | |
| Market Cap (\$M) | 4,926.0 |
| Shares On Issue (M) | 989.2 |
| Shares Traded (\$M p.a.) | 345.4 |
| 12-month L/H (\$) | 3.45/5.41 |
| Listing Date | June 1962 |

Fees

| | |
|-----------------------------------|------|
| Management Fee (%) | 0.19 |
| Performance Incentives (%) | n/a |

Pre-Tax NTA Performance Analytics (including dividends)

| | S&P/ASX 200 Acc | | All Ords Acc | |
|-----------------|-----------------|-------------|--------------|-------------|
| | 1 Yr | 3 Yr (p.a.) | 1 Yr | 3 Yr (p.a.) |
| Excess Per. (%) | 2.19 | 3.33 | (0.35) | 3.25 |
| Beta | 0.89 | 0.90 | 0.90 | 0.86 |
| TE (%) | 3.32 | 3.60 | 3.29 | 4.25 |
| IR | 0.66 | 0.92 | (0.11) | 0.76 |

Benchmark returns are purely pre-tax, whereas LIC returns incorporate realised capital gains tax and will understate portfolio performance.

Dividend Yield (%)

| FY07 | FY08 | FY09 |
|--------|--------|--------|
| 3.56ff | 4.04ff | 4.04ff |

Substantial Shareholders (%)

| | |
|-----------------------------|-----|
| Bougainville Copper | 0.6 |
| RBC Dexia Investor Services | 0.6 |

As at 31 December 2009

Company contact



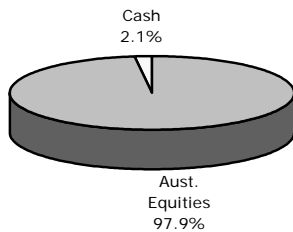
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| Sectors | Industry Group | Industry | Sub Industry |
|------------|------------------------|--------------------------------|-----------------------|
| Financials | Diversified Financials | Diversified Financial Services | Multi-Sector Holdings |

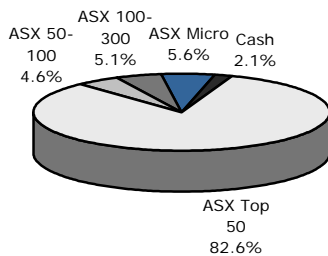
Asset Weighting



Other Data

| | |
|---------------------------|--|
| Options | None on issue. |
| Dividend policy | To pay out a growing stream of fully franked dividends. |
| Capital management policy | A share buyback arrangement is in place to provide flexibility if shares trade at a discount to NTA. AFI also raises capital through its share-acquisition plan. |
| LIC tax concessions | Yes |
| DRP available | Yes, at a 5% discount to the VWAP for the five trading days up to and including the record date. |

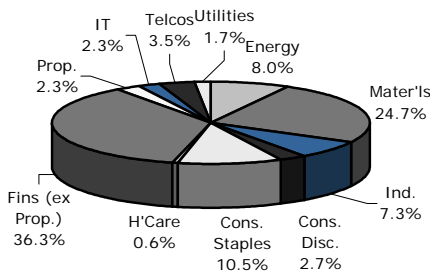
Size Weighting



AFI's Portfolio (Top 10)

| Code | Weighting | | 2010 Aegis Forecasts | | | Prem/Disc to Aegis Target (%) |
|------|---------------|-----------------|----------------------|------------|-------------|-------------------------------|
| | Portfolio (%) | S&P/ASX 200 (%) | PE (x) | Yield (%) | EPS Gth (%) | |
| BHP | 12.5 | 12.8 | 17.8 | 2.5 | (11.5) | (12.1) |
| CBA | 9.5 | 7.4 | 14.0 | 5.3 | 28.0 | (15.3) |
| WBC | 9.4 | 6.7 | 13.1 | 5.4 | 19.0 | (16.1) |
| RIO | 5.5 | 2.9 | 14.6 | 1.6 | 14.8 | (8.7) |
| NAB | 4.9 | 5.1 | 12.0 | 6.0 | 16.2 | (3.4) |
| WES | 4.8 | 3.2 | 22.7 | 2.6 | (20.4) | 18.2 |
| WOW | 3.5 | 3.1 | 17.3 | 4.0 | 8.3 | (12.8) |
| TLS | 3.5 | 3.4 | 10.4 | 8.2 | 0.3 | (7.8) |
| ANZ | 3.0 | 5.1 | 13.3 | 5.3 | 13.9 | (9.2) |
| WPL | 2.5 | 2.1 | 23.9 | 2.3 | 18.4 | (15.9) |
| | 59.1 | 51.6 | 15.6 | 4.2 | 8.1 | |

Sector Weighting (Equities Component)

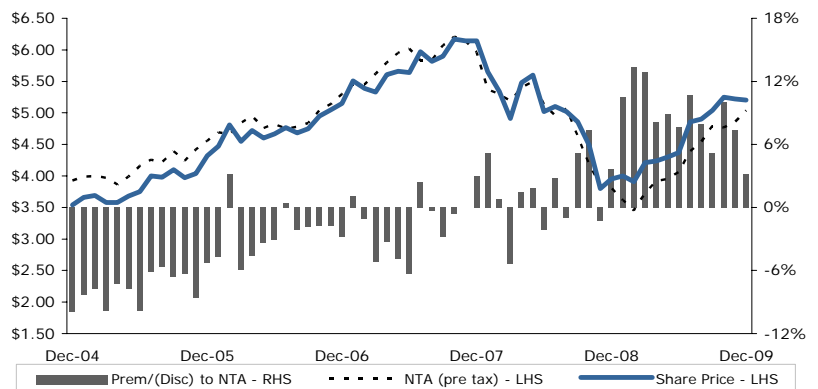


Tax-Based Returns on Share Price and Dividends

| Fund | S&P/ASX 200 Acc | | All Ords Acc | |
|------------------------|-----------------|-------------|--------------|-------------|
| | 1Yr Rtn (%) | 3Yr Ann (%) | 1Yr Rtn (%) | 3Yr Ann (%) |
| No Tax (0%) | 40.6 | 6.3 | 39.1 | 0.7 |
| Super Fund (15%) | 39.2 | 5.4 | 37.8 | (0.2) |
| AWOTE* (31.5%) | 37.8 | 4.4 | 36.5 | (1.1) |
| Max Tax Rate (46.5%)** | 36.4 | 3.5 | 35.2 | (2.0) |

* Marginal Tax Rate for worker on the Average Wage OTE rate + Annualised
 ** Max Tax Rate of 46.5% used from July 2006 (48.5% used prior to July 2006)

NTA & Share Price Performance



Source all figures:
AFI/Aegis Equities Research/IRESS

All data As at 31 December 2009 unless otherwise specified

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