

AUSTRALIAN

RESEARCH



Contents

**This is an extract from the Listed Managed Investments
September 2010 Quarterly Review**

For Advisers Only

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Australian Foundation Investment Company Limited (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 borrowings of \$50M and \$115M in cash as at 30 September 2010.

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. The fund has outperformed the S&P/ASX 200 Accumulation Index over the past one, three and five years (on a pre-tax NTA plus dividends basis) to 30 September 2010. Over the quarter to 30 September 2010, AFI underperformed its benchmark by around 0.6%. AFI maintained its FY10 dividend at 21cps, though no FY11 guidance was given. AFI raised \$83M via a share purchase plan, which allows it to take advantage of stock opportunities as they arise. In its annual report, AFI indicated that it will be taking a patient approach as it expects the market to trade around current levels for a period of time with higher volatility in the short to medium term. AFI was trading at a 1.3% premium to pre-tax NTA at 30 September 2010.

Key investment information



RATING	Recommended
Price (\$)	4.90
As at 4 November 2010	
Market Cap (\$M)	4,964.4
Shares On Issue (M)	1,013.2
Shares Traded (\$M p.a.)	350.1
12-month L/H (\$)	4.52/5.41
Listing Date	June 1962

Fees	
Management Fee (%)	0.16
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. (%)	1.81	3.27	0.69	3.12
Beta	0.97	0.92	0.98	0.88
TE (%)	2.03	3.34	2.30	4.07
IR	0.89	0.98	0.30	0.77

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

Dividend Yield (%)	FY08	FY09	FY10
	4.42ff	4.42ff	4.42ff

Substantial Shareholders (%)

RBC Dexia Investor Services	0.6
Questor Financial Services	0.5

As at 30 September 2010

Company contact



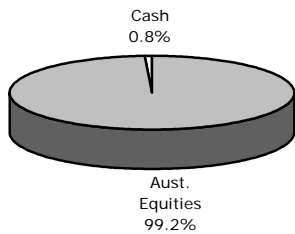
Geoff Driver
gdriver@afi.com.au
61 3 9679 1659

www.afi.com.au

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

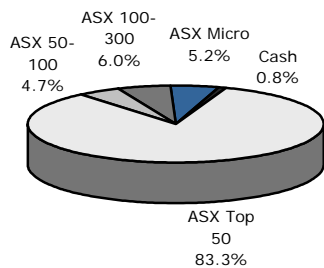
Asset Weighting



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 2.5% discount to the VWAP for the five trading days up to and including the record date.

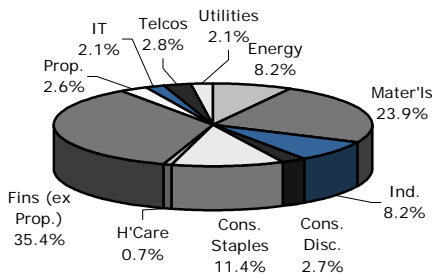
Size Weighting



AFI's Portfolio (Top 10)

Code	Weighting Portfolio (%)	S&P/ASX 200 (%)	2011 Morningstar Forecasts			Prem/Disc to MStar Valuation (%)
			PE (x)	Yield (%)	EPS Gth (%)	
BHP	11.7	11.4	10.0	2.6	48.4	(26.9)
CBA	9.2	6.5	11.7	6.3	22.8	(10.4)
WBC	9.0	5.7	11.1	6.2	6.8	(14.2)
RIO	5.8	4.0	11.2	1.5	(8.0)	(26.7)
WES	5.3	2.8	16.7	4.7	45.3	(3.8)
NAB	4.7	4.5	10.7	6.2	13.5	(17.7)
ANZ	3.9	5.1	11.3	5.8	10.1	(13.7)
WOW	3.8	3.0	15.6	4.4	13.6	(13.5)
TLS	2.8	2.8	9.3	10.7	(9.9)	(27.2)
WPL	2.5	2.9	19.2	2.5	(5.0)	(41.4)
Total	58.5	48.7	12.0	4.8	19.6	

Sector Weighting (Equities Component)

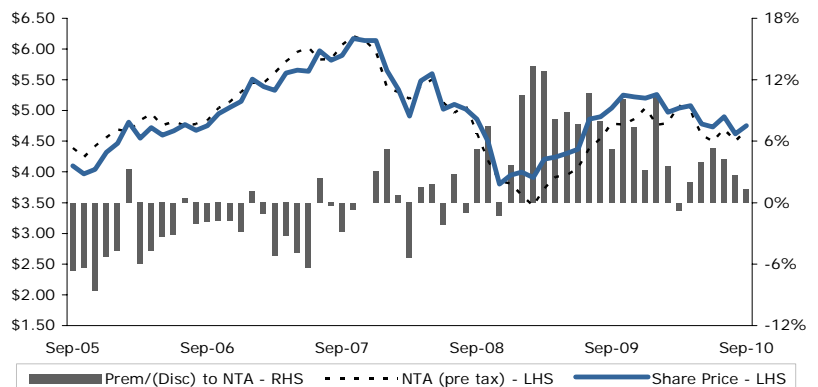


Tax-Based Returns on Share Price and Dividends

Fund	S&P/ASX 200 Acc		All Ords Acc	
	1Yr Rtn (%)	3Yr Ann (%)	1Yr Rtn (%)	3Yr Ann (%)
No Tax (0%)	0.1	(1.1)	1.9	(5.9)
Super Fund (15%)	(0.8)	(2.0)	1.1	(6.7)
AWOTE* (31.5%)	(1.7)	(3.0)	0.2	(7.6)
Max Tax Rate (46.5%)**	(2.6)	(3.9)	(0.6)	(8.4)

* 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/Morningstar/IRESS

All data As at 30 September 2010 unless otherwise specified

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Level 6, 33 York Street
Sydney NSW 2000 Australia
Locked Bag 7 Australia Square
Sydney NSW 1215
Phone 61 2 8296 1100
Fax 61 2 9299 3777
ABN 72 085 293 910
www.aegis.com.au