

**Australian Foundation
Investment Company (AFI)**

Listed Managed Investments
December 2012 Quarterly Review

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LMI Type
Listed investment company

Investment Area
Australia

Investment Assets
Listed companies and other

Investment Sectors
Diversified

Key Investment Information

Price (\$) as at 20 February 2013	5.51
Market cap (\$M)	5,698.0
Shares on issue (M)	1,034.1
Shares traded (\$M p.a)	355.8
12-month L/H (\$)	4.01/5.54
Listing date	June 1962
Fees:	
Management Fee (%)	0.20
Performance incentives (%)	na

Pre-tax NTA Performance Analytics
(including dividends)

	S&P/ASX 200 Acc	
	1 Yr	3 Yr (p.a.)
Excess Per. (%)	0.06	0.88
TE (%)	1.58	1.52

Benchmark returns are purely pre-tax, whereas LIC returns incorporate realised capital gains tax and therefore understate portfolio performance to a degree.

Dividend Yield

	%
FY10	4.44ff
FY11	4.75ff
FY12	5.05ff

Substantial Shareholders

	%
National Nominees	0.6
Questor Financial Services	0.6

As at 31 December 2012

COMPANY OVERVIEW

AFI is one of the original listed investment companies, established in 1928. AFI has a relatively conservative investment approach, with a long term investment horizon, and a focus on providing investors with capital growth and a dividend stream that, over time, grows faster than inflation.

INVESTMENT OBJECTIVE

The company aims to provide shareholders with attractive investment returns through access to a steady stream of fully franked dividends and medium-to-long term capital growth from an investment in a diverse portfolio of ASX-listed companies.

STYLE AND PROCESS

AFI has a buy-and-hold investment style for the majority of the portfolio. AFI can also allocate up to 10% of the portfolio to its trading portfolio, which has a short-term investment focus. AFI uses fundamental analysis to identify companies in attractively structured industries with high-quality assets, brands and/or businesses that can withstand the business cycle. The company focuses on investing in companies with strong management and boards along with sound financial metrics, such as profit margins, cash flow and gearing. The Investment Committee, which is essentially the Board of AFI, plays a significant role in the investment process, meeting on a weekly basis to review the portfolio settings.

PORTFOLIO CHARACTERISTICS

AFI invests only in stocks listed on the ASX, with a heavy focus on large cap stocks, with over 80% of the portfolio allocated to stocks within the S&P/ASX 50. The company has a long-term approach to investing and as such has low portfolio churn. There are no restrictions regarding the minimum or maximum investment in any individual stock or sector; however, the Investment Committee is wary of the risk of the portfolio and ensures that the portfolio is adequately diversified to reduce portfolio risk.

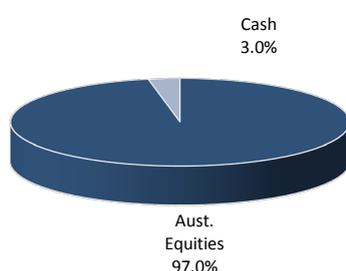
INDEPENDENT INVESTMENT RESEARCH COMMENTS

AFI's portfolio (pre-tax NTA plus dividends) outperformed the benchmark index over the December 2012 quarter, rising 7.2% compared to the 6.8% increase of the benchmark. Over the longer-term (five year period) the portfolio has outperformed the benchmark index by 2.4%. The portfolio is expected to perform in close proximity to the benchmark index given the low tracking error. This can be illustrated over the longer-term with the portfolio generating an average annual return of 9.9% from 30 June 2000 to 31 December 2012, compared to the benchmark return of 8.5%. From an investor return perspective, AFI has performed strongly over the 12 months to 31 December 2012, returning (share price plus dividends) 31.3%, well above the 20.3% benchmark return. AFI has a short-term loan facility of \$250M (~5% of the market cap), \$100M of which has been drawn down. AFI paid a final dividend of \$0.13 (fully franked), maintaining the full year dividend at \$0.21 (fully franked) to be paid on 22 February 2013. At 31 December 2012, AFI was trading at a premium to pre-tax NTA of 2.2%. The company offers investors a steady income, primarily in the top 50 stocks listed on the ASX. The manager uses some gearing to provide some earnings upside. Given the portfolio composition and the level of gearing represents a only a small portion of the total market capitalisation, the gearing does not add any additional unnecessary risk.

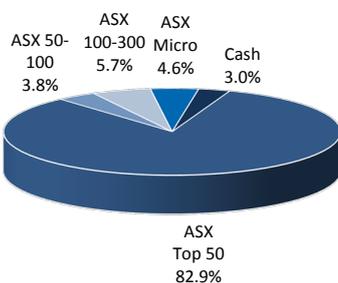
SECTOR BREAKDOWN

Sector	%
Energy	8.0
Materials	21.1
Industrials	9.4
Consumer Discretionary	1.0
Consumer Staples	10.4
Healthcare	2.3
Financials (ex Property)	36.7
Property	2.0
Information Technology	1.8
Telecommunication Services	4.5
Utilities	2.7

Asset Weighting



Size Weighting



KEY POSITIVE CONTRIBUTORS

- ◆ Newcrest Mining Limited
- ◆ Rio Tinto Limited
- ◆ Westpac Banking Corporation

KEY NEGATIVE CONTRIBUTORS

- ◆ CSL Limited
- ◆ Macquarie Group Limited
- ◆ Fortescue Metals Group Ltd

Note: The Key Positive and Negative Contributors are provided on an attribution basis. This means the contributors reflect the impact that the positions or lack of positions have on the portfolio performance compared to the benchmark index.

BOARD OF DIRECTORS

Bruce Teele	Chairman	Fergus Ryan	Director
Terrence Campbell	Deputy Chairman	Catherine Walter	Director
Donald Argus	Director	Peter Williams	Director
Ross Barker	Managing Director	Graeme Liebelt	Director
John Paterson	Director		

OTHER DATA

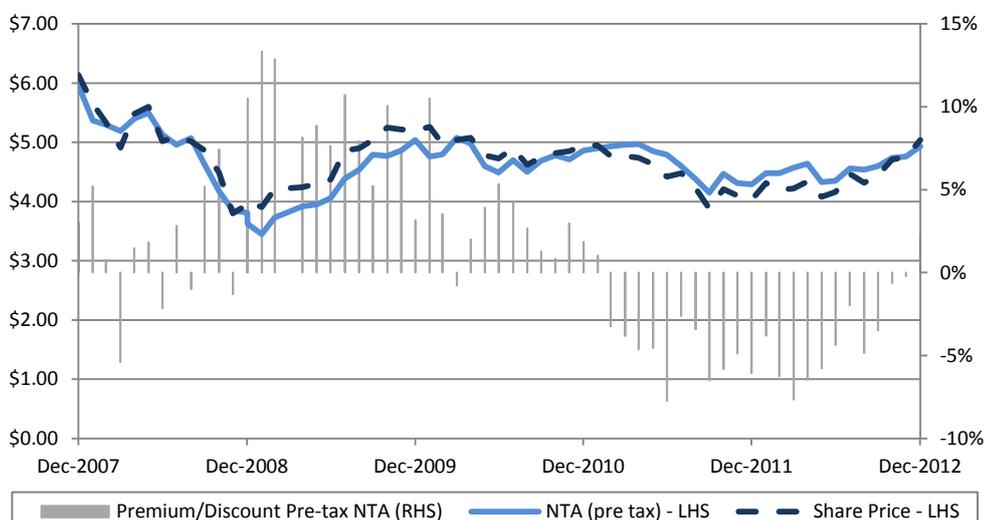
- ◆ **Options** – None on issue
- ◆ **Dividend policy** – To pay out all received dividends so that over time the dividend stream grows faster than inflation.
- ◆ **Capital management policy** – A share buyback arrangement is in place to provide flexibility if shares trade at a discount to NTA. AFI also raises capital through its share acquisition plan. AFI raised \$222.7m in a convertible note issue (AFIG) in December 2011.
- ◆ **LIC tax concessions** – Yes
- ◆ **DRP available** – Yes, up to a 5% discount to the VWAP for the 5 trading days up to & including the record date.

AFI's Portfolio (Top 10) Weighting

Code	Portfolio (%)	S&P/ASX 200 Index (%)
BHP	10.4	9.8
CBA	10.1	8.2
WBC	9.1	6.7
WES	5.4	3.0
NAB	5.0	4.8
RIO	4.5	2.4
TLS	4.5	4.5
ANZ	4.4	5.6
WOW	3.5	3.0
OSH	2.1	0.8
	59.0	48.8

Source all figures: AFI/Independent Investment Research/IRES.
All data as at 31 December 2012 unless otherwise specified

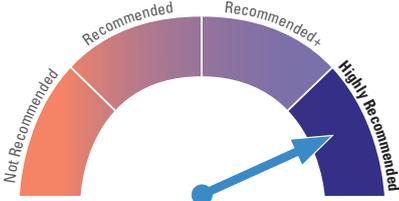
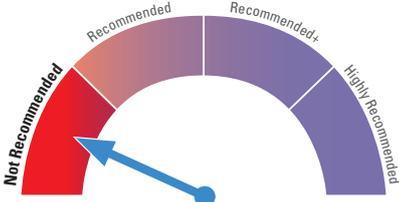
NTA & Share Price Performance



APPENDIX – RATINGS PROCESS

Independent Investment Research Pty Ltd “IIR” rating system.

IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

LMI Ratings	SCORE
<p>Highly Recommended</p> 	<p>83 and above</p> <p>This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.</p>
<p>Recommended +</p> 	<p>79–82</p> <p>This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.</p>
<p>Recommended</p> 	<p>60–78</p> <p>This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.</p>
<p>Not Recommended</p> 	<p><60</p> <p>This rating indicates that IIR believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation criteria. The product provides some unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off and should generate risk adjusted returns in line with stated investment objectives. However, concerns over one or more features mean that it may not be suitable for most investors.</p>

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