AUSTRALIAN
RESEARCH
INDEPENDENT INVESTMENT RESEARCH

Australian Foundation Investment Company (AFI)

June 2017

INDEPENDENT
INVESTMENT RESEARCH

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3) Our research does not provide a recommendation, in that, we do not provide a "Buy, Sell or Hold" on any stocks. This is left to the Adviser who knows their client and the individual portfolio of the client.
4) Our research process for valuation is usually more conservative than what is adopted in Broking firms in general sense. Our firm has a conservative bias on assumptions provided by management as compared to Broking firms.
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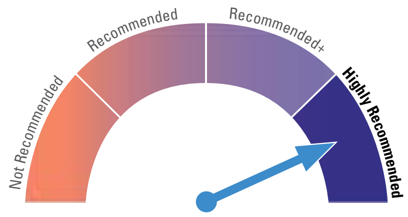
Australian Foundation Investment Company (AFI)

Note: This report is based on information provided by the company as at June 2017

Rating



LMI Type	
Listed Investment Company	
Investment Geography	
Australia	
Investment Assets	
Listed companies and other	
Investment Sectors	
Diversfied	

Key Investment Information	
Price ($) as at 22 June 2017	$5.77
Market Cap ($M)	6,587.6
Shares on Issue (M)	1,141.7
Listing date	1928
Fees	
Management Fee (%)	0.16
Performance Fee (%)	None

Pre-tax NTA Performance Analytics (Including dividends)		
	S&P/ASX 200 Acc	
	5 Yr	10 Yr (p.a.)
Excess Per. (%)	-1.2%	0.6%
TE (%)	1.7	3.0

Dividend Yields	%
FY14	3.9ff
FY15	4.2ff
FY16	4.2ff

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

COMPANY OVERVIEW

Australian Foundation Investment Company (AFI or 'the Company') is the largest LIC by market capitalisation on the Australian Stock Exchange and was established in 1928 and has a significant, mostly retail shareholder base. The Company runs an all market cap Australian equities strategy, although approximately 80% of the portfolio constitutes large market capitalisation stocks in the S&P/ASX 50 index. Of the total returns equation, the emphasis is on paying a growing, fully franked dividend and the Manager has been very successful in delivering this over the long-term. Similar to many other 'old style' LICs, trading gains and losses are on capital account rather than revenue account, as per the majority of LICs and managed funds. A positive of this structure is it provides the Manager the ability to pay a 100% fully franked dividend. It also means the Manager must be tax aware in its investment decisions which, whilst not a negative, does add an additional layer to sell decisions. The investment team, led by Mark Freeman, is solid, experienced and stable and is supported by a very strong and experienced investment commitee. The Manager is very much a long-term investor, can be contrarian at times and intentionally does not trade investment cycles (its FUM size precludes it from significantly doing so in any case), invariably being effectively fully invested. The Company has a very lengthy track-record, during which it has been successful in delivering a stable and growing fully franked dividend. AFI is internally managed and, due to economies of scale in running a very large share portfolio and a relatively fixed cost base, charges an exceptionally competitive MER of 0.16%.

INVESTOR SUITABILITY

The Manager's key focus is to deliver attractive total returns, including a highly stable, growing fully-franked dividend and it has been successful in doing so over the longer term. This may make the Company particularly suited to investors in the later stages of their investment lifecycle during which stable income is particularly important, or lower marginal tax rate investors, including SMSFs. However, investors should note that AFI's beta and risk profile have become very closely aligned with the S&P/ASX 200 Accumulation index over recent years. With the Manager having no intention of playing the investment cycle, i.e. the portfolio will remain nearly fully invested at all times irrespective of the Manager's broader market view, investors should expect to fully, or near fully participate in market volatility. AFI's portfolio turn-over is typically less than 10% p.a, which means realised capital gains are treated on capital account. Given AFI's FUM scale and significant embedded capital gains within the portolio, implementing a material change in AFI's portfolio can be a relatively slow process: what investors see today will be the predominant nature of the portfolio over the medium-term, notwithstanding the fact that the Manager is far from a passive manager. On account of this, there can be a persistence of the performance impact of underweight and overwieght positioning, both to the positive and the negative.

RECOMMENDATION

IIR ascribes a "Highly Recommended" rating for AFI. IIR has always held AFI in high regard, with a strong team and investment committee, transparency, exceptionally low costs and the benefits of a lengthy track-record. Investors can gain confidence from a long track-record in which the Manager has achieved its investment objectives over the long-term (10-year+ period), and particularly in delivering a stable, growing fully-franked dividend. The team is well-qualified and stable and is supported by a strong investment commitee. On the flipside, we do identify several risks investors should be aware of. Firstly, the potential risk for the capital account status of the Company to compromise sell disciplines (although we describe the Manager's implementation in reality as positively tax-aware not tax-constrained). Secondly, given its size it can take the Manager some time to rectify what, with the benefit of hindsight, may become viewed as a 'wrong' investment decision, whether addressing an overweight or underweight position. Finally, we also note that AFI's risk profile has, somewhat surprisingly, both increased and become very closely aligned to the broader Australian equities market, so investors should expect to near fully participate in broader market volatility.

SWOT ANALYSIS

STRENGTHS

- Internal management means there is no fee leakage to a third party manager. At 0.16% the management expense ratio of AFI is one of the lowest of any investment vehicle in the domestic market, including ETFs.
- As an LIC, AFI is not subject to investor FUM flows. This facilitates the Manager being both a long-term investor in companies as well as a contrarian investor at times, having the lattitude to buy stocks that may be out of favour.
- Well qualified and highly stable investment team. Additionally, given the Company's significant track-record, FUM scale, and the fact that it tends to be a long-term shareholder (a 'good' shareholder from a listed company perspective), the investment team tends to get excellent access to company management teams.
- The LIC capital gains tax applies to AFI. The primary benefit of this is it enables the Manager to consistently pay a 100% fully franked dividend as well as the ability to smooth the distribution profile over time through the ability to retain profits. In contrast, a managed fund is required to distribute all realised income in any given period.
- The board and investment team are well qualified with significant experience in the finance and investment industries and members of the former are generally very well connected. This experience underpins the investment process and facilitates high quality information flow.

WEAKNESSES

- The significant FUM scale of AFI limits how quickly the Manager can react and respond to what, with the benefit of hindsight, becomes viewed as a 'wrong' investment decision, whether addressing an overweight or underweight position.
- Relative performance (to index and peers) in recent years has deteriorated slightly. Part of this relates to the Manager's sectoral biases, which is simply a case of the Manager being true-to-style and, in actual fact, should be viewed as a positive. However, part relates to the above noted characteristic - material underweight positions in a stock like CSL (which in hindsight was acknowledged as the wrong call) have taken a long time to rectify due to FUM scale. There is a persistence of relative performance in AFI that smaller investment vehicles do not generally have.

OPPORTUNITIES

- Access to a very low-cost, transparent investment vehicle with a track-record of generating high, stable, growing fully franked dividends managed by an experienced and stable investment team that is able to remain a true long-term investor and is supported by a strong Board.
- Consistent portfolio outperformance could see the shares trade at a premium to NTA allowing investors to exit at a higher value than the underlying portfolio of shares. Historically, the premium / discount to pre-tax NTA has tended to oscillate within the range of +/-5%.

THREATS

- As a listed investment vehicle, the price at which shares trade is determined by buyers and sellers. This means the share price may deviate from the NTA of the underlying portfolio. This presents both an opportunity and a threat depending on the discount or premium when an investor wishes to either buy or sell shares.
- The turnover constrained nature of AFI tied with a logical reticence to divest holdings with significant embedded capital gains means that the timeliness in which the manager can react to an unforeseen change in market / sector outlook is slower than the vast majority of actively managed investment vehicles. Investors must accept this as a feature of AFI but one that conversely can also generate signficant benefits in the form of 100% fully franked dividends.

PRODUCT OVERVIEW

AFI is very much a long-term investor and it seeks to invest in good businesses that it believes have longevity to their business models. The Manager has a natural mild value bias due to its emphasis on delivering a relatively attractive dividend yield to its shareholder base. As a long-term investor, AFI's investment philosophy is to focus on higher quality companies and hold them over the long term. The investment team focuses on quality, growth and price. Quality considerations include business strategies, the key financial indicators, industry structure, the quality of management and the board and corporate governance practices. The process seeks to identify the highest quality Australian companies and trusts and over time, buy or add to those stocks when they are trading at prices which represent good long-term value, the latter being based on the Manager's assessment of growth and value. The Company will also engage in option writing, selling calls on a very small number of portfolio holdings as a way to generate additional income.

The portfolio comprises some 99 holdings, many being very long term holdings. Despite this diversification, the portfolio is relatively concentrated with the top 10 holdings representing 48.7% of the portfolio and the top 20 constitutiing around 65% of the portfolio. Furthermore, stocks within the S&P/ASX 50 constitute about 80% of the overall investment portfolio. From a performance perspective, it is interesting to note that over the last several years both the portfolio's volatility and beta have become increasingly and closely aligned with the S&P/ASX 200 Index.

AFI has a Melbourne-based investment team consisting of six analysts. The team has been highly stable over the years. Analysts have sector responsibilities and cover the full market capitalisation spectrum. Each analyst will typically engage in their own modelling and valuation work but the team is also cognisant of sell-side analyst input. Analyst meetings with investee companies is a very important part of the process and, given AFI's status and size, the team typically gets good access to management teams.

Like other 'old school' LICs, AFI has a capital account LIC status. Trading gains and losses are taxed at the company level. As such, there is an important additional consideration to sell decisions, namely realised capital gains or losses. Furthermore, in order for the Company to retain this status, portfolio turn-over must be relatively low, and has generally been 5% per annum on average. This, combined with the Company's lengthy track-record and significant FUM (read significant embedded capital gains), means that there is the risk that some holdings in the portfolio that may be less likely to be divested than otherwise the case. Having said that, we note the Manager in practice has been tax-aware not tax-constrained. If the Manager believes it has made a poor investment decision the holding will typically be sold. The Manager is conscious if it sells a holding it has to find another investment that can generate better returns but after having lost 30% of the gain to tax. The embedded capital gains in the portfolio is in the order of around $2.7 billion.

AFI has an extremely low MER, which is currently 16 basis points. There is no performance fee.

INVESTMENT PROCESS

INVESTMENT OBJECTIVE

AFI's main objective is to hold a diversified portfolio of assets that generate increasing income, allowing AFI to pay increasing (and fully franked) dividends to its own shareholders and grow the value of its shareholders' investment. From a risk perspective, AFI has closely tracked the S&P/ASX 200 Accumulation index in recent years, and its beta is effectively 1.0 and tracking error very low - investors should expect to fully participate in market volatility and drawdowns.

INVESTMENT PHILOSOPHY

AFI is a long-term investor and seeks to hold investments in companies that are well managed and which the Manager expects have an inherent longevity in their business models. The Manager focuses on quality, growth and price. As a long-term investor, the Manager tends to look for industries with structural tail-winds, citing the health sector as a good example. The Manager is index aware relative to the benchmark S&P/ASX 200 Index, but investment decisions are certainly not dictated by the index and the Manager may invest outside the S&P/ASX 200 Index.

INVESTMENT PROCESS

AFI is a bottom up fundamental investment manager that also has an important taxation overlay at the portfolio level. The focus on relatively high and franked dividends creates a natural value bias to its investment process. The Manager continually monitors macro themes but, for reasons previously discussed, there is less top-down influence on the investment portfolio than may be the case for many other investment managers.

In terms of investment methodology, AFI's investment framework can be split into three inter-related components: quality, growth, value.

As a long-term investor, AFI's investment philosophy is to focus on higher quality companies and hold them for the long term. The Manager believes that over the long-run a genuinely high quality business should outperform due to its more attractive attributes, namely company specific (management, board, balance sheet), industry (structure, barriers to entry, degree of competition, pricing power, strength of business model), and financial (margins, ROE / ROIC, free cash flow, dividend generation). As the Manager notes, time is your friend in a high quality business, but time is your enemy in a low quality business.

The growth outlook for a business is critical to AFI's long-term goals. The Manager seeks to own a good spread of businesss that it thinks can grow earnings and therefore dividends at a greater rate than inflation. For the Manager, assessing a business' growth potential has a number of elements. Firstly, is the business model sustainable and does it have a track-record of growth. Secondly, can the business grow market share or achieve sustainable price increases. Thirdly, are there scale benefits that will drive earings growth, and what is the capital intensity of this growth.

The Manager takes a long-term view of value. The Manager holds that buying stocks at the right price implies looking through the noise and that it should be prepared to pay a fair price for a business with a high quality and ranking, not wait for it to be 'cheap'.

The team engages in a comprehensive company visitation program, which is supported by detailed company modelling and valuation models and industry research, the latter of which is regularly presented to the investment committee.

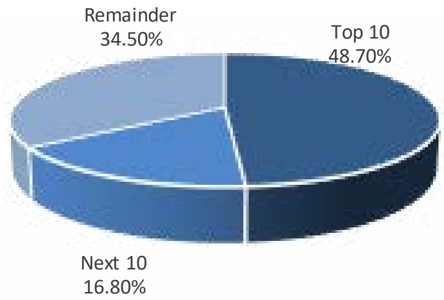
PORTFOLIO

AFI's portfolio is weighted towards large cap stocks, with approximately 80% allocated to the top 50 stocks at 28 February 2017. Ex-100 stocks constitute around 10% of the portfolio, roughly 5% of which is actually ex-300 / micro-cap stocks. The portfolio has a very long tail, with some 99 stock holdings in total but with the top 10 holdings representing 48.7% of the portfolio. It is both a diversified portfolio (by number of names) but ultimately concentrated. Neither of these characteristics are likely to materially change over the foreseeable future for reasons previously discussed - FUM scale and embedded capital gains.

As at the date of this report, AFI was materially overweight health, diversified financials, and transportation. Material underweight positions are the REITs, large banks, resources as well as large discretionary retailers. The Manager is, on the whole, comfortable with these relative sector positions and we would expect these positions to persist over the foreseeable future.

AFI will almost invariably be fully invested at all times. This is an intentional true-to-label call by the Manager and, in any case, AFI's FUM scale almost precludes it from adopting any other approach. What small cash balances it does hold, it does so to take advantage of opportunities that may emerge from time to time. At 1 May 2017 cash represented 1.7% of the AFI portfolio. Consequently, AFI can be expected to closely participate in the ups and downs of the broader equities market, although its focus on quality businesses and valuation can reasonably be expected to mitigate a degree of the downside risk.

Size Weighting	Top 10 Holdings



AFI's Portfolio (Top 10) Weighting as at 30 April 2017

Company	Portfolio (%)	S&P/ASX 200 (%)
Commonwealth Bank of Australia	9.6	9.4
Westpac Banking Corporation	7.8	7.5
BHP Billiton Ltd.	5.2	5.3
National Australia Bank Ltd.	4.7	5.7
Wesfarmers Ltd.	4.3	3.2
Australia and New Zealand Banking Group Ltd.	4.0	6.0
Telstra Corporation Ltd.	3.7	3.8
Rio Tinto Ltd.	3.4	1.8
CSL Ltd.	3.1	3.6
Transurban Group	3.0	3.0
	48.7	49.3

DIVIDENDS

AFI's aims to pay a steadily rising dividend over time, an objective that is particularly important to its shareholder base. With the exception of the aftermath of the global financial crisis when banks and a number of other companies cut their dividends, dividends have steadily and consistently grown over time and every dividend has been fully franked. Over recent history, the Company's dividend yield has been around, or slightly over, 4% fully franked.

BOARD & MANAGEMENT

BOARD

The Board consists of eight members, all of whom are independent bar Ross Barker. All members are highly qualified, having significant relevant industry experience and are generally very well connected, facilitating high quality information flow. There is a stability of tenure, with the majority having served for more than five years on the AFI board. We view the quality of the Board as a particular strength, with many having strong sector and company specific experience.

Board

Name	Position	Experience
Terrence A Campbell AO	Chairman and Independent Non-Executive Director	Mr Campbell has been a Director of the Company since September 1984, appointed Deputy Chairman in September 2008 and Chairman in October 2013. He is Chairman Emeritus, Goldman Sachs Australia and New Zealand (formerly Goldman Sachs JBWere) and a former Advisory Director of Goldman Sachs. Mr Campbell was formerly Chairman and Chief Executive of Goldman Sachs JBWere. He is also Chairman of Mirrabooka Investments Limited and a former Director of Djerriwarrh Investments Limited and AMCIL Limited.
Ross E Barker	Managing Director.	Mr Barker became Chief Executive Officer in February 2001 having been an Alternate Director of the Company since April 1987. He was appointed Managing Director in October 2001. He is also Managing Director of Djerriwarrh Investments Limited, AMCIL Limited and Mirrabooka Investments Limited. He is also Chairman of Melbourne Business School Ltd.

Board		
Name	**Position**	**Experience**
Jacqueline C Hey	Independent Non-executive Director	Ms Hey was appointed to the Board in July 2013. She is a Non-Executive Director of Qantas Limited, Bendigo and Adelaide Bank Limited, AGL, Melbourne Business School Ltd and Cricket Australia. She was formerly Managing Director of Ericsson United Kingdom and Ireland and Managing Director of Ericsson Australia and New Zealand.
Graeme R Liebelt	Independent Non-executive Director	Mr Liebelt was appointed to the Board in June 2012. He is Chairman of Amcor Limited, Director of Australia and New Zealand Banking Group Limited, the Dulux Group and a Director of Carey Baptist Grammar School. He is a Fellow of the Australian Academy of Technological Sciences and Engineering and a Fellow of the Australian Institute of Company Directors. He was formerly Managing Director and CEO of Orica Limited, Chairman and Director of the Global Foundation and Deputy Chairman of the Melbourne Business School Ltd.
John Paterson	Independent Non-executive Director	Mr Paterson is a company Director who was appointed to the Board in June 2005. He was a former Alternate Director of the Company for Mr Campbell from April 1987 to June 2005. He is Chairman of Djerriwarrh Investments Limited. He was formerly a Director of Goldman Sachs JBWere and is a former member of the Board of Guardians of Australia's Future Fund.
David A Peever	Independent Non-executive Director	Mr Peever was appointed to the Board in November 2013. He was Managing Director of Rio Tinto Australia from 2009 to 2014. He had been with Rio Tinto since 1987 in an extensive range of senior roles. He is Chairman of Cricket Australia and a member of the Foreign Investment Review Board. He chaired Minister of Defence's First Principles Review of Defence and following the acceptance of the Review by Government now chairs the Oversight Board, which helps guide implementation of the Review's recommendations. Mr Peever is also a Non-Executive Director of DCNS Australia and Stars Foundation, a not-for-profit body that promotes education of Indigenous girls. He was formerly a Non-Executive Director of the Melbourne Business School.
Catherine Walter	Independent Non-executive Director	Mrs Walter is a solicitor and company Director. She was appointed to the Board in August 2002. Mrs Walter is also Director of the RBA's Payment Systems Board, Chairman of Melbourne Genomics Health Alliance and Deputy Chair of Victorian Funds Management Corporation. She was formerly Chair of Federation Square Pty Ltd and Australian Synchrotron Company Ltd and a Director of ASX, National Australia Bank Ltd, Orica Ltd and Melbourne Business School.
Peter J Williams	Independent Non-executive Director	Mr Williams was appointed to the Board in February 2010. He is Chairman of MIPS Advisory Committee, Fiig Securities Limited. He is a Director of the Australian Baseball Federation, National Australia Trustees Limited, Foundation for Young Australians and The Tipping Foundation. Mr Williams was formerly the Chairman of Olympic Park Sports Medical Centre Pty Ltd and a former Managing Director of Equity Trustees Limited. He was also a former Director of the Trustee Corporations Association of Australia and a General Manager with AXA/National Mutual in Australia and Hong Kong

INVESTMENT TEAM & COMMITEE

Investment decisions are made through the interaction of the the investment team and the investment committee.

The investment team consists of seven members, led by Mark Freeman. It is an experienced and highly stable investment team, with several members having greater than 10-year tenures. Analyst responsibilities are based on sectoral lines, as is generally the case for medium to large sized investment teams, with a primary and secondary analyst for the covered universe. Top down macro input is generally by way of a number of third-party investment strategists, although the stock selection is certainly company specific bottom up as AFI does not attempt to trade investment cycles. There is a variable component to the investment team remuneration package, delivered via a mix of short and long-term incentive schemes. The structure provides a solid alignment of interest between the team and the investment objectives of the Company.

The investment committee comprises six members, many of whom are also Board members. The participation of the investment committee is a key component of AFI's investment process, with meetings held on a fortnightly basis. This allows for wide ranging perspectives and valuable input on current and potential investments utilising the business / equity market expertise of Directors, the Company's Investment professionals and senior management team. The members are Terry Campbell, Ross Barker, Jacqueline Hay, John Patterson, Cathy Walter, and Peter Williams.

Regarding the investment team, Mark Freeman is the Chief Investment Officer, effectively AFI's portfolio manager. Mr Freeman has been Chief Investment Officer since joining the Company in February 2007, although he has been involved with the Company for twenty years. Prior to this he was a Partner with Goldman Sachs JBWere where he spent 12 years advising the Investment Companies on their investment and dealing activities. He has a deep knowledge and experience of investments markets and the Company's approaches, policies and processes.

Alan Dunn, Investment Analyst. Mr Dunn joined the Company in February 2007. He was formerly with Goldman Sachs JB Were. He has been actively involved with investments for over fifteen years, initially specialising in small to mid cap stocks before focusing more recently on the AFI portfolio, representing the primary analyst for resources, retailers, and energy. Alan also undertakes dealing activities on behalf of AFI.

Neil Murchie, Investment Analyst. Mr Murchie joined the Company in 2008. He was formerly a research analyst with Citigroup where he initially worked as the assistant banking analyst before moving on to cover small companies. Prior to this he worked at the National Australia Bank in the Corporate Strategy and Investments division, and with the management consultancy company Corporate Value Associates where he worked as a consultant servicing primarily the financial services industry.

Kieran Kennedy, Investment Analyst. Mr Kennedy joined the Company in an accounting role in 2001. He returned from an 18 month leave of absence spent working in the financial services industry in London as an Investment Analyst in 2006. His focus is on small to mid cap stocks that are suitable for the AFI portfolio.

Alison Gibson, Investment Analyst. Mrs Gibson joined the company in January 2011. She was formerly a Research Analyst with Goldman Sachs JBWere for 11 years. Initially as a Research Assistant in Infrastructure, Utilities, Developers & Contractors, then later as Senior Analyst in the Infrastructure Sector and Strategy Research area. Prior to that she was a Research Analyst at Heine Property Funds Management. Her current focus is on mid and large cap stocks.

Ng Lucas, Investment Analyst. Mrs Lucas joined the company in 2013. She was formerly a Research Analyst with Goldman Sachs JBWere for 8 years. Initially as a Research Assistant in various Industrial Sectors then later as a Small Companies Analyst. Prior to that she was a Research Analyst at HSBC James Capel. Her current focus is on small and mid cap stocks.

Stuart Low, Investment Analyst. Mr Low joined the company in 2017. He was formerly an investment analyst and portfolio manager at JM Financial Group and prior to that he spent ten years in institutional broking with Phillip Capital and Bell Potter. His focus is on small and mid cap stocks.

Investment Team

Name	Position	Experience at AFI
Mark Freeman	Chief Investment Officer	10 years
Alan Dunn	Senior Investment Analyst	10 years
Neil Murchie	Investment Analyst	9 years
Kieran Kennedy	Investment Analyst	16 years
Alison Gibson	Investment Analyst	3 years
Ng Lucas	Investment Analyst	4 years
Stuart Low	Investment Analyst	<1 year

PERFORMANCE ANALYTICS

AFI has a solid long-term track-record of not only delivering a stable, relatively high and 100% fully franked dividend but also sustained periods of generating alpha on a total returns basis (refer to the 3-year rolling alpha chart below). However, as evident from the chart, there will be periods in which it can be expected that AFI will materially out- and under-perform the broader S&P/ASX 200 Accumulation Index, on account of its mild value and dividend paying bias which, in turn, creates sectoral biases (for example, generally being underweight mining companies).

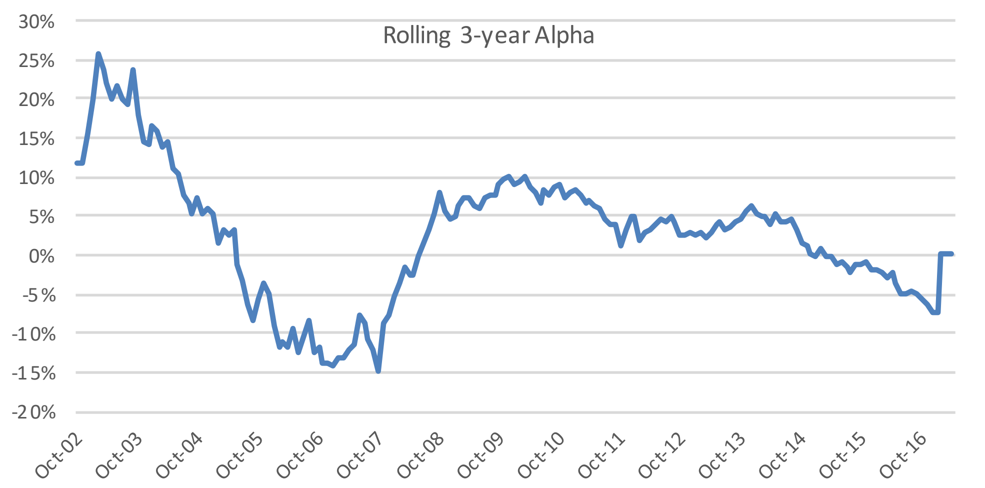
In the last several years, AFI's relative performance has been adversely impacted by underweight positions in REITs and the resources sector. Both positions were very much intentional and we believe the Manager's decision to do so was well founded and, just as important, true-to-label.

We do note, however, that performance on both a risk and return basis to its most directly comparable LIC peers has deteriorated slightly over the last five year period. Secondly, the risk and beta profile of AFI have both become increasingly and closely aligned with the broader market in recent years. The comparable volatility is surprising given the Manager intentionally generally eschews higher beta sectors such as mining and, conversely, is naturally predisposed to solid, quality businesses that, ideally, pay an attracting and growing dividend. We also note that again its most comparable peers have generated slightly lower volatility levels and in a manner more consistent with our expectations given portfolio characteristics.

From a ratings perspective, however, our focus is over the longer term, specifically 10 years.

Total Returns (as at 30 April 2017)	1-year	3-year	5-year	10-year
Total Portfolio Return (pre-tax NTA)	13.2%	5.1%	9.8%	4.8%
S&P/ASX 200 Acc Index	17.7%	7.3%	11.0%	4.1
Excess Return (alpha)	-4.3%	-2.1%	-1.2%	0.6
Volatility (%) - AFI	9.6	12.3	11.9	13.6
Volatility (%) - S&P/ASX 200 Acc Index	9.4	12.3	11.9	14.3

Rolling 3-year Alpha



We have compared AFI with the other top (by market capitalisation) LICs that invest in large cap Australian shares. Like AFI, they are all internally managed (except BKI which has recently externalised the investment management function) with long-term investment strategies, except that DJW has a more active management approach and uses options to generate additional income from the portfolio.

AFI has been the stand-out performer over the longer term although, again, we note a slight deterioration over the shorter to medium term periods.

PEER COMPARISON

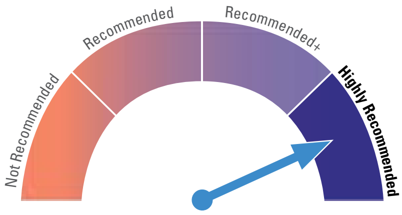
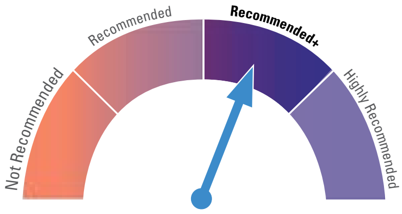
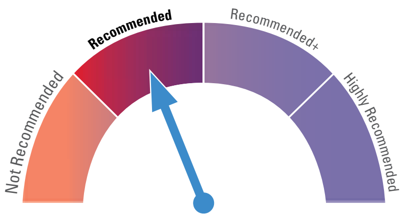
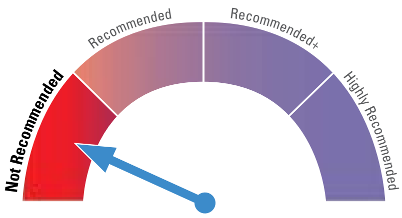
Peer Group Portfolio Returns (Pre-tax NTA plus dividends) to 30 April 2017

	Code	1 year	3 year	5 year	10 year
Returns					
Aust. Foundation Investment Co.	AFI	13.24%	5.14%	9.81%	4.76%
Argo Investments	ARG	15.50%	6.19%	10.56%	4.02%
Milton Corporation	MLT	13.89%	6.73%	10.70%	4.66%
Diversified United Investments	DUI	17.83%	6.78%	11.91%	4.40%
Djerriwarrh Investments	DJW	14.12%	2.86%	7.26%	2.88%
Australian United Investments	AUI	17.96%	4.35%	9.64%	3.43%
BKI Investment Company	BKI	12.60%	4.90%	8.50%	4.30%

APPENDIX A – RATINGS PROCESS

INDEPENDENT INVESTMENT RESEARCH PTY LTD "IIR" RATING SYSTEM.

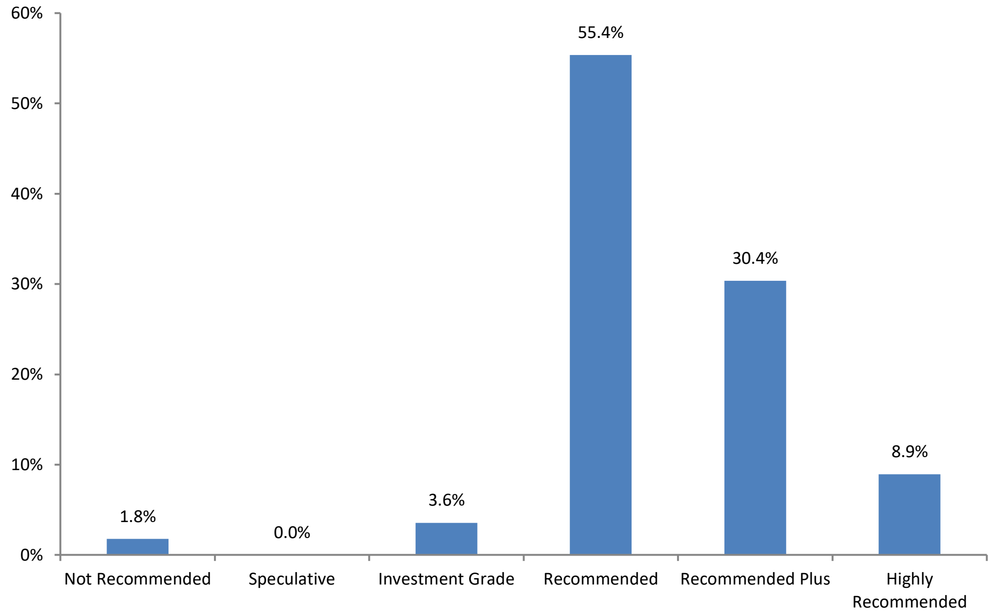
IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction;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

LMI Ratings	SCORE
Highly Recommended	**83 and above**
	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 rizsk/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.
Recommended +	**79–82**
	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.
Recommended	**60–78**
	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.
Not Recommended	**<60**
	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.

APPENDIX B – MANAGED INVESTMENTS COVERAGE

The below graphic details the spread of ratings for managed investments rated by Independent Investment Research (IIR). The managed investments represented below include listed and unlisted managed funds, fund of funds, exchange traded funds and model portfolios.

SPREAD OF MANAGED INVESTMENT RATINGS



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