

BKI Investment Company (BKI)

LISTED INVESTMENT COMPANY REPORT

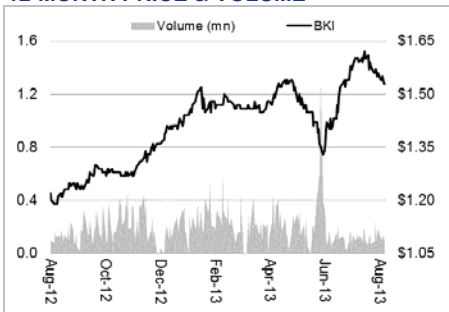
RECOMMENDATIONS

Rating	N/A
Risk	N/A
Share Price	\$1.54

SNAPSHOT

Monthly Turnover	\$4.5mn
Market Cap	\$690mn
Shares Issued	447.8mn
52-Week High	\$1.62
52-Week Low	\$1.18
Sector	Financials

12-MONTH PRICE & VOLUME



RESEARCH ANALYST

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Disclosure

The author owns no shares in BKI.

Baillieu Holst Ltd acts in a corporate advisory role for BKI. In line with the company's internal compliance guidelines, our investment recommendation is restricted. Baillieu Holst Ltd has acted in a corporate advisory role for BKI earned fees in relation to that activity in the past 12 months.

A solid foundation for long term investment

- About:** BKI Investment Company (BKI) is a Listed Investment Company (LIC) with a diversified portfolio of high quality Australian companies. The portfolio has exposure across most market sectors from profitable, high yielding, well managed companies.
- Strategy:** BKI is a long term investor aiming to provide its shareholders with an increasing stream of fully franked dividends. Its investment process is research driven and actively managed with stocks selected from a bottom up perspective rather than a macroeconomic or top down approach. BKI is a low cost investment manager with an internal management structure. Its Management Expense Ratio (MER) is 0.19% and has no performance fees.
- Key people:** BKI is run by CEO Thomas Millner, who has been with BKI since inception and previously held positions at Souls Funds Management. The investment team includes BKI's other directors who, on average, have 31 years investment experience and is headed by Chairman Robert Millner.
- Capital raising:** In response to high investor demand, BKI is offering all shareholders the opportunity to participate in a 1:15 non renounceable rights issue at an issue price of \$1.48 to raise up to \$44m, before costs. Major shareholder Washington H. Soul Pattinson have committed to taking up their full entitlement. BKI is also undertaking a placement to sophisticated investors at the same issue price. The issue price represents a 7% discount to the 31 August pre-tax NTA and 4% discount to the closing share price as at 2 September.
- Raising objectives:** The raising aims to increase BKI's liquidity, broaden its shareholder register and reduce its MER from spreading fixed overheads over a larger capital base. We expect BKI's increased size and liquidity to drive broader investor awareness.
- Investment view:** BKI compares favourably to its large capitalisation LIC peers in terms of both historical performance and dividend yield (FIG.1 and FIG.3). We expect BKI to be increasingly considered as an alternative to the traditional large capitalisation LICs given its conservative, long term investment approach and focus on increasing shareholder income. We continue to favour LICs over managed funds due to their low cost, closed-end structure which we view as more conducive to long term investor interests.

FIG.1: PERFORMANCE ANALYSIS

Total Shareholder Return (% Per Annum)	Comparables								Benchmark	
	BKI	AFI	ARG	AUI	DJW	DUI	MLT	Peer Average	ASX 300 Index (Accumulation)	BKI Outperformance
1 Year	34.5%	37%	35%	36%	30%	31%	31%	33.5%	23.6%	10.9%
3 Years	15.9%	12%	11%	10%	11%	11%	14%	12.1%	9.8%	6.0%
5 Years	8.9%	7%	4%	5%	8%	5%	6%	6.2%	4.5%	4.5%
9 Years	10.6%	11%	8%	10%	10%	11%	8%	9.7%	8.7%	1.9%
BKI Inception (9.7 Years)	10.7%	11%	8%	10%	9%	11%	9%	9.7%	9.2%	1.4%
NTA Performance* (% Per Annum)	BKI	AFI	ARG	AUI	DJW	DUI	MLT	Peer Average	ASX 300 Index (Accumulation)	BKI Outperformance
1 Year	23.2%	26%	25%	26%	19%	28%	25%	24.6%	23.6%	-0.4%
3 Years	11.6%	12%	10%	9%	10%	10%	12%	10.5%	9.8%	1.8%
5 Years	6.6%	6%	5%	5%	5%	5%	6%	5.6%	4.5%	2.1%
9 Years	9.3%	10%	8%	10%	8%	10%	9%	9.2%	8.7%	0.6%
BKI Inception (9.7 Years)	10.1%	10%	9%	10%	9%	11%	9%	9.8%	9.2%	0.9%

Note: LIC performance figures are after all operating expenses and taxation, whilst the benchmark index is before operating expenses and taxation.

Therefore, LIC performance figures may be understated. LIC and benchmark performance figures include the reinvestment of dividends. All August NTAs, excluding BKI, are Baillieu Holst estimates, as the actuals were not released at time of publishing. NTA performance is based on pre-tax NTAs which is the NTA after the company pays tax but before tax on unrealised gains.

BKI Investment Company (BKI)

- Investment view:** BKI compares favourably to its large capitalisation LIC peers in terms of both historical performance and dividend yield (FIG.1 and FIG.3). We expect BKI to be increasingly considered as an alternative to the traditional large capitalisation LICs given its conservative, long term investment approach and focus on increasing shareholder income. We continue to favour LICs over managed funds due to their low cost, closed-end structure which we view as more conducive to long term investor interests.
- About:** BKI Investment Company (BKI) is a Listed Investment Company (LIC) with a diversified portfolio of high quality Australian companies. The portfolio has exposure across most market sectors from profitable, high yielding, well managed companies.
- History and key people:** BKI in its current form, as a LIC, has been around for circa 10 years, however the investment portfolio was in fact established over 25 years ago, as the investment portfolio for Brickworks Limited (BKW). Its investment strategy implemented at that time remains unchanged today. BKI is run by CEO Thomas Millner, who has been with BKI since inception and previously held positions at Souls Funds Management. The investment team includes BKI's other directors who, on average, have 31 years investment experience and is headed by Chairman Robert Millner. The Board of Directors and management hold approximately 6% of issued capital.
- Strategy:** BKI is a long term investor aiming to provide its shareholders with an increasing stream of fully franked dividends. Its investment process is research driven and actively managed with stocks selected from a bottom up perspective rather than a macroeconomic or top down approach. BKI is a low cost investment manager with an internal management structure. Its Management Expense Ratio (MER) is 0.19% and has no performance fees.
- Exposure:** BKI considers itself benchmark unaware, meaning it has no specific sector or stock investment limitations. Its top 25 investments, including cash, account for 89% of the portfolio. This is more concentrated than many of the traditional large capitalisation LICs and one explanation as to the outperformance relative to its peers.

FIG.2: TOP INVESTMENTS AS AT 31 AUGUST 2013

1	Commonwealth Bank	10.3%	2	National Australia Bank	9.8%
3	New Hope Corporation	8.8%	4	Westpac Banking Corp	7.6%
5	BHP Billiton Limited	6.9%	6	Telstra Corporation	5.6%
7	Wesfarmers Limited	4.8%	8	Woolworths Limited	3.8%
9	ANZ Banking Group	3.8%	10	AGL Energy Limited	2.7%
11	ALS Limited	2.6%	12	Woodside Petroleum Limited	2.3%
13	TPG Telecom Limited	2.2%	14	InvoCare Limited	1.5%
15	ARB Corporation	1.5%	16	Coca Cola Amatil Limited	1.4%
17	Metcash Limited	1.4%	18	APA Group	1.3%
19	Insurance Australia Group	1.2%	20	Bendigo and Adelaide Bank	1.2%
21	Milton Corporation	1.1%	22	QBE Insurance Group	1.1%
23	ASX Limited	1.1%	24	Ramsay Healthcare	1.0%
25	Brambles Limited	1.0%		Cash & cash equivalents	2.8%

Source: Company Reports

- Performance:** BKI has outperformed its relevant benchmark over all periods on a Total Shareholder Return (TSR) basis and all periods, except for its 1 year performance, on a pre-tax NTA basis (FIG.1). BKI also compares favourably to its large capitalisation LIC peers on both performance metrics across almost all measurement periods.
- Dividends:** BKI's strategic objective is to deliver shareholders an increasing stream of income in the form of fully franked dividends. BKI also has a propensity to pay special dividends when possible. A 0.5cps special dividend was paid in February 2013. BKI's yield of 4.6% fully franked, or 6.6% grossed up, compares favourably to its peers (FIG.3). We expect BKI's franking balance to enable it to continue to fully frank future dividend payments.

FIG.3: LARGE CAPITALISATION LISTED INVESTMENT COMPANIES COMPARISON

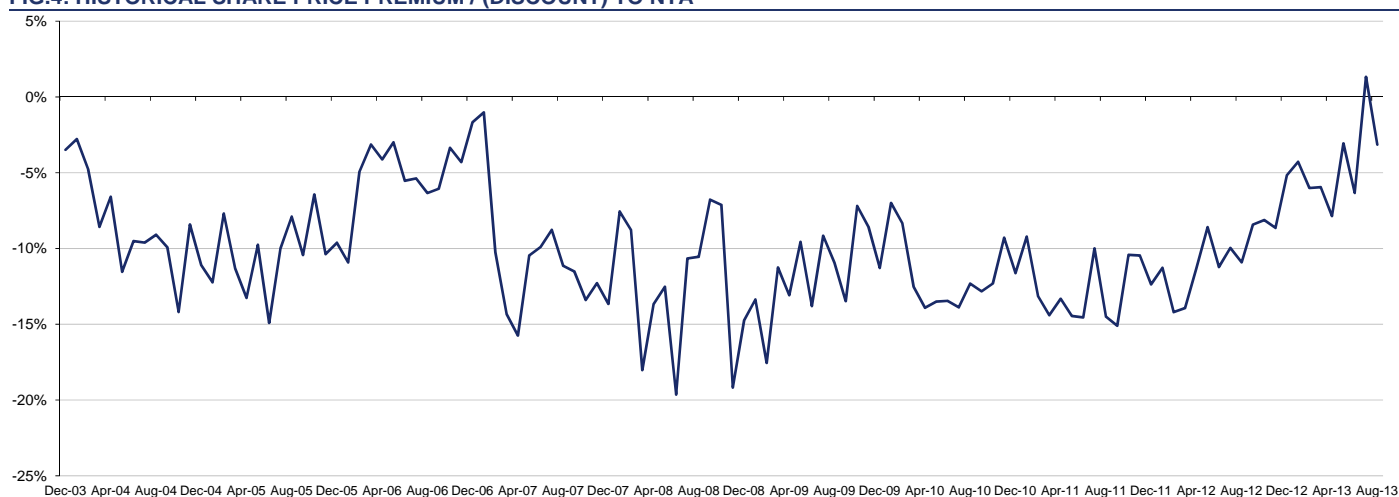
	BKI	AFI	ARG	AUI	DJW	DUI	MLT	Peer Average*
Share Price (\$)	\$1.54	\$5.69	\$6.84	\$7.52	\$4.42	\$3.24	\$19.68	
Shares on Issue (m)	448	1,037	643	107	219	169	122	
Market Capitalisation (\$m)	\$690	\$5,902	\$4,398	\$806	\$966	\$548	\$2,404	\$2,504
Yield	4.6%	3.9%	3.9%	3.9%	5.9%	4.2%	4.3%	4.0%
Franking	100%	100%	100%	100%	100%	100%	100%	100%
Gross Yield	6.6%	5.5%	5.5%	5.6%	8.4%	6.0%	6.1%	5.7%
Franking Balance at 30 June 2013 (cps)	2.8	8.6	3.8	27.5	12.2	5.8	71.8	
Allowable Fully Franked Dividends (cps)	6.5	20.0	8.8	64.1	28.4	13.4	167.6	
Historical Yearly Dividend (cps)	7.2	22.0	26.5	29.5	26.0	13.5	84.5	
Dividend Franking Coverage	90%	91%	33%	217%	109%	100%	198%	
Management Expense Ratio (MER)	0.19%	0.19%	0.18%	0.13%	0.41%	0.17%	0.16%	0.21%
NTA (pre-tax) at 31 August 2013*	1.59	5.51	6.85	7.98	3.60	3.51	20.23	
Share Price Premium / (Discount)	-3.1%	3.3%	0.3%	-5.8%	22.2%	-8.9%	-2.7%	-2.8%

Source: Company Reports, Baillieu Holst estimates

Note: All August NTAs, excluding BKI, are Baillieu Holst estimates, based on our simulated portfolios, due to actuals not being released at time of publishing. The dividend average and estimated premium excludes Djerriwarrh (DJW) to provide a more appropriate comparison.

- Net Tangible Assets (NTA):** BKI's August 2013 NTA was \$1.59 per share on a pre-tax basis and \$1.46 on a post-tax basis. At 31 August, BKI was trading at a 3% discount to NTA on a pre-tax basis and 5% premium on a post-tax basis. BKI has historically traded at a discount since its listing; however this has narrowed significantly due to increased investor awareness, improving market sentiment and the development of a strong track record of performance and yield relative to the large capitalisation LIC space.

FIG.4: HISTORICAL SHARE PRICE PREMIUM / (DISCOUNT) TO NTA



Source: Company Reports

Capital Raising

- **Capital raising:** In response to high investor demand, BKI is offering all shareholders the opportunity to participate in a 1:15 non renounceable rights issue at an issue price of \$1.48 to raise up to \$44m, before costs. Major shareholder Washington H. Soul Pattinson have committed to taking up their full entitlement. BKI is also undertaking a placement to sophisticated investors at the same issue price. The issue price represents a 7% discount to the 31 August 2013 pre-tax NTA and a 4% discount to the closing price as at 2 September 2013.
- **Raising objectives:** The raising aims to increase BKI's liquidity, broaden its shareholder register and reduce its MER from spreading fixed overheads over a larger capital base. We expect BKI's increased size and liquidity to drive broader investor awareness.

The LIC Advantage

- **Diversification simplified:** Shareholders in LICs will hold a diversified portfolio of securities through one stock. The management of income and taxation is thus simplified with bi-annual dividend income generally attaching franking credits for tax paid by the LIC.
- **Closed-end structure:** We believe the market volatility witnessed over the past five years highlights a key benefit of the LIC structure over ETFs and managed funds. ETFs and managed funds have an open-ended structure, meaning available capital is dictated by investor supply and demand. We view this structure as counter intuitive to favouring long term investment performance. Put simply, funds under management are at the behest of investor sentiment with managers often forced to sell down positions during periods of market weakness and buy when the market is performing strongly and valuations are no longer attractive. This allows the portfolio managers of LICs to focus on generating investor returns rather than worrying about the investable capital they have available.
- **Cost:** LIC fees range from 0.12-1.5% of assets per year. This is much lower than average fees charged for retail managed funds, which are approximately 1.5-3.0%. The effect of this cost-saving on a longer-term investment, where returns compound over a number of years, can be substantial. One reason for this lower cost is that LICs do not incur back-office or distribution costs, reducing their cost of operation. In addition, many managed funds have performance fee structures. None of the large capitalisation LICs mentioned have performance fees.
- **Transparency:** LICs are required by law to report their NTAs on a monthly basis. Many LICs, including BKI, release their top shareholdings and performance each month for added transparency.

Appendix

FIG.5: BOARD OF DIRECTORS AND MANAGEMENT

Name	Position	Shares	Biography
Robert Millner FAICD	Chairman Investment Committee	7,647,354	Mr Millner has almost 30 years industry experience and is currently a Director of the following ASX listed companies; Milton Corporation Limited, New Hope Corporation Limited, Washington H. Soul Pattinson and Company Limited, TPG Telecom Limited, Brickworks Limited, Australian Pharmaceutical Industries Limited. He has also recently served as Director of; Souls Private Equity Limited, Choiseul Investments Limited, and Northern Energy Corporation Limited. He was appointed Non-executive Chairman of BKI in October 2003, at the company's formation.
Thomas Millner B.Des (Ind), GDipAppFin, F.Fin, GAICD	CEO Investment Committee	6,606,872	Joining the Company in December 2008 from Souls Funds Management (SFM), Mr Millner held various roles there covering research, analysis and business development, and during this time was responsible for the Investment Portfolio of BKI Investment Company Limited. Previously he was an investment analyst with Republic Securities Limited. Mr Millner is a member of the Investment Committee and also a Director of Washington H. Soul Pattinson and Company Limited.
Ian Huntley BA	Non Executive Director Investment Committee	11,063,445	Mr Huntley joined the Board as a Non-executive Director in February 2009. A financial journalist, Mr Huntley acquired "Your Money Weekly" newsletter in 1973. He built the newsletter into one of Australia's best known investment advice publications and sold the business to Morningstar Inc of the USA in mid-2006. He is also a member of the Audit, Investment and Remuneration Committees.
David Hall FCA, FAICD	Non Executive Director Chairman Audit Committee	252,101	Appointed Non-executive Director in October 2003, Mr Hall is a Chartered Accountant with experience in corporate management, finance and as a Company Director, holding Directorships in other companies for more than 30 years. He is also Chair of the Audit Committee and a member of the Remuneration and Nomination Committees.
Alex Payne B.Comm, Dip Cm, FCPA, FCIM	Non Executive Director Investment Committee	259,810	A Non-executive Director since October 2003, and a member of the Audit Committee since this time, Mr Payne is Chief Financial Officer of Brickworks Limited and has considerable experience in finance and investment. He is also a member of the Remuneration, Audit and Investment Committees.
Jaime Pinto B.Comm, CA	Company Secretary	29,011	Mr Pinto was appointed Company Secretary in November 2011, he is a Chartered Accountant with over 20 years' experience in both professional practice and in senior commercial roles across a broad range of industries. Jaime is currently Company Secretary and CFO of a number of unlisted investment and industrial companies.

Source: Company Reports

This document has been prepared and issued by:

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Buy: The stock's total return is expected to increase by at least 10-15 percent from the current share price over the next 12 months.

Hold: The stock's total return is expected to trade within a range of ± 10 -15 percent from the current share price over the next 12 months.

Sell: The stock's total return is expected to decrease by at least 10-15 percent from the current share price over the next 12 months.

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