



Company Review

BKI Investment Company Limited

ISSUE DATE: 17-10-2017

About this Company

LIC REVIEWED	BKI INVESTMENT COMPANY LIMITED
ASX CODE	BKI
INVESTMENT OBJECTIVE	GENERATE AN INCREASING INCOME STREAM FOR DISTRIBUTION TO SHAREHOLDERS IN THE FORM OF FULLY FRANKED DIVIDENDS THROUGH THE LONG-TERM INVESTMENT IN A PORTFOLIO OF ASSETS THAT ARE ALSO ABLE TO DELIVER LONG-TERM CAPITAL GROWTH
MARKET CAPITALISATION	\$1,025M
SHARES ON ISSUE	620M
SHARE PRICE	\$1.65
52 WEEK HIGH/LOW SHARE PRICE	\$1.72/\$1.56
NAV (AUGUST 2017)	\$1.57
52 WEEK HIGH/LOW NAV	\$1.66/\$1.52
SHARE PRICE PREM/(DISC) TO NAV	5%
EXPECTED MER FY18	0.14% OF AVERAGE NAV
EXPECTED DIVIDEND YIELD FY18	4.5% FF
DIVIDEND PROFILE P.A.	FIVE-YEAR CAGR 1.9%
CAPITAL MANAGEMENT 2017	DRP, SPP
STRUCTURE	EXTERNALLY MANAGED

Board of Directors

NUMBER OF DIRECTORS	4
MAJORITY INDEPENDENT DIRECTORS	NO
CHAIR PERSON	ROBERT MILLNER
DIRECTORS FEES	FY17 ACTUAL \$217K
COMMITTEES	AUDIT, INVESTMENT, NOMINATION, REMUNERATION

About the Investment Manager

INVESTMENT MANAGER	CONTACT ASSET MANAGEMENT
OWNERSHIP	80% STAFF, 20% WASHINGTON H SOUL PATTINSON
ASSETS MANAGED IN THIS SECTOR	\$1.1B
YEARS MANAGING THIS ASSET CLASS	2

Investment team

PORTFOLIO MANAGER	TOM MILLNER, WILL CULBERT
TEAM SIZE	4
TEAM TURNOVER	LOW

Investment process

STYLE	ACTIVE - CORE
BENCHMARK	S&P/ASX 300 ACC. INDEX
TYPICAL TRACKING ERROR (P.A.)	NOT TARGETED
TYPICAL STOCK NUMBERS	50-60
TYPICAL CAPITALISATION BIAS	MID-TO-LARGE
STOCK AND CASH LIMITS	BROAD
DERIVATIVES	NOT USED
CAPITAL OR REVENUE ACCOUNT	CAPITAL

Company rating history

OCTOBER 2017	RECOMMENDED
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What this Rating Means

- The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with the relevant objectives. The financial product is considered an appropriate entry point to the asset class or strategy.

Scope of this Rating

- Lonsec has used its Managed Funds research process in forming an opinion on this Listed Investment Company's (LIC) ability to meet its stated investment objectives. The extent of any 'point-in-time' divergence between BKI's share price and its underlying Net Asset Value (NAV) per share is not part of the ratings consideration.
- Lonsec does consider whether structural or management issues could potentially lead to an LIC trading at a significant discount to its NAV over an extended period of time without any recourse for shareholders. This aspect forms part of the wider qualitative and quantitative assessment that Lonsec undertakes when assessing the relative investment merits of an LIC.
- Lonsec considers an investment in the LIC sector to be suitable for investors with a long-term (5+ years) investment horizon.

Strengths

- Strong long-term track record of paying fully franked dividends and meeting its investment objectives.
- Experienced Board of Directors and Investment Committee.
- Experienced portfolio management team with strong alignment of interest with share-holders.
- Very low management costs (expected MER of 0.14% of NAV).
- Reasonable size and liquidity.

Weaknesses

- Sell discipline potentially diminished due to the 'buy and hold' and low turnover philosophy.
- High level of related-party risk including the provision of services (including investment management) by related entities and direct share-holdings in related businesses.
- Investment management was recently externalised to the related-party Contact which does not have a long-term corporate track record.
- Contact has a smaller investment team of four.

We strongly recommend that potential investors read the product disclosure statement or investment statement.

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Company Risk Characteristics

	LOW	MODERATE	HIGH
CORPORATE RISK		●	
CAPITAL VOLATILITY			●
INCOME VOLATILITY		●	
CONCENTRATION RISK		●	
RELATED-PARTY RISK			●
LIQUIDITY RISK		●	

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.

BIOMETRICS

Aggregate Risk Measure

	1	2	3	4	5	6	7
STANDARD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with AFSA/FSC guidelines.

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY		●	
ESG AWARENESS	●		
RISK TO INCOME		●	

Fee profile

	LOW	MODERATE	HIGH
FEES - VS LONSEC UNIVERSE	●		
FEES - VS ASSET CLASS	●		
FEES - VS SUB SECTOR	●		

What is this Company?

- BKI Investment Company Limited (BKI or 'the Company') is a mid-sized LIC (by market capitalisation) that is listed on the Australian Stock Exchange (ASX). First listed in 2003, BKI has a current market capitalisation of \$1.03b and has over 14,500 mostly retail shareholders. BKI currently has 620m shares on issue.
- BKI's primary investment objective is to generate a growing stream of fully franked dividends. While largely benchmark agnostic, BKI also seeks to achieve long-term capital growth. The Company has a commitment to diversification achieved by holding a portfolio of 50 to 60 well-managed and dividend paying companies across a variety of industries.
- Lonsec considers the Company's approach to impart it with a core investment style with an income bias. This style, along with the focus on fully franked dividend growth, leads Lonsec to expect BKI to deliver outperformance in down markets. Conversely, Lonsec would expect BKI to underperform in the latter stages of a bull market.
- BKI is externally managed by Contact Asset Management ('Contact' or 'the Manager') following a decision made by its Board of Directors ('BOD') in November 2016 to externalise the investment management of the Company. Previously, BKI had been internally-managed. The appointment is governed by an Investment Management Agreement ('IMA') with a term of 10 years; an initial five-year term followed by an automatic five-year roll-over if there is no share-holder vote requisitioned. The Management Expense Ratio ('MER') under the IMA is 0.1% of total assets and there is no performance fee. The reasons provided for the externalisation was mainly to protect the Company's low MER which Lonsec accepts.
- Contact is a new investment management firm founded by previous BKI CEO Tom Millner and Portfolio Manager Will Culbert. Millner and Culbert hold 80% of the equity while Washington H Soul Pattinson ('WHSP') holds the remaining 20%. Lonsec notes that Contact is a related-party entity to BKI as both Tom Millner and long-standing BKI Chair Robert Millner are directors and shareholders of WHSP.
- As with many longer-standing LICs, BKI has been involved in a number of mergers and acquisitions since its inception in 2003. BKI itself was the result of the decision by Brickworks to list its investment portfolio on the ASX. Since then, BKI has merged with the WHSP-affiliated Pacific Strategic Investments Ltd in 2004 and the Huntley Investment Company Ltd in 2007. As well, BKI has an on-going program of merging with unlisted family-owned investment companies and has entered into five such deals in recent times.
- BKI's portfolio turnover is expected by Lonsec to be very low (< 10% p.a. of gross assets) which is due to its investment philosophy but also for tax reasons as low turnover is one of the tests the Company has to meet to maintain its 'capital account' election. This allows it to pass on capital gains tax concessions to its shareholders in the form of 'LIC capital gain dividends'. Lonsec expects BKI to generate the majority of its income from harvesting dividends and distributions received from its share portfolio.
- Lonsec notes that Contact's annual management fee is 0.1% of the Total Asset base of the Company (\$1.01b as at 30 June 2017). This is expected to translate into a MER, which is measured against Net Assets, of 0.14% going forward. Being closed-ended and with the Contact fee its largest expense, this should mean that BKI incurs a relatively fixed level of operating expenses ('opex') going forward. Lonsec notes that cost control has been good, with BKI incurring opex of \$1.5m in FY17 which was in-line with FY16.
- Lonsec notes that BKI's MER compares very favourably with other externally-managed LICs, ETFs and managed funds in the Lonsec peer group that have a similar focus of providing investors with a broad-based exposure to Australian equities. However, Lonsec observes that there are a number of well-established Australian equities focused LICs with mainly internally-managed structures that have similar fee structures; typically, these tend to have a similar high level of assets.
- A key risk for investors in any LIC is the possibility for such structures to trade at a substantial discount to NAV for lengthy periods of time. Lonsec considers that while trading at such a discount is a risk for BKI,

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it is less of a risk than for many smaller LIC peers. The main reason for this is that BKI has a relatively larger market cap (+\$1b), reasonable liquidity, +14,500 shareholders and a solid and lengthy track record of paying fully-franked dividends.

- Lonsec notes that the BKI BOD continues to pursue various capital management initiatives. In FY17, BKI pursued a successful Share Purchase Plan ('SPP') in June 2017 which raised \$21.1m at \$1.58, a 1% discount to the 5-day VWAP before the Record Date. Each share-holder could subscribe up to \$15k in stock and the SPP terms had been that the final price would be at the lower of the 5-day VWAP at the Record Date or the Issue Date. In-line with BKI's Dividend Re-investment Plan ('DRP') Policy, a DRP has also been announced in August 2017 following the declaration of the final dividend. The DRP has been priced at \$1.64, the 5-day VWAP. Lonsec is pleased that the DRP is not priced at a discount to VWAP as this ensures that investors who do not subscribe to the DRP are not unnecessarily diluted. Lonsec considers the BOD to have a sound track record in terms of capital management.

Using this LIC

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

Suggested Lonsec risk profile suitability



- BKI is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in its portfolio. Potential investors should therefore be aware of, and comfortable with, the potential for it to experience periods of negative absolute returns which may result in capital losses being incurred on their investment. Lonsec recommends advisors consult the Lonsec Risk Profile Review and/or the Lonsec Risk Profile Definitions document(s) for guidance on appropriate asset allocations to Australian Equity within a diversified investment portfolio.
- Lonsec notes that BKI has the objective of providing investors with a sustainable and growing income stream. Lonsec notes that this income stream is an outcome of BKI being mostly fully-invested in dividend-paying Australian equities. There is no guarantee that such entities will be able to continue to pay out a growing level of dividends on a yearly basis. That being said, Lonsec again highlights BKI's robust track record of paying such a growing stream of fully franked dividends across several market cycles.
- The LIC is a 'long only' Australian equity product which will predominately be fully invested in the Australian equity markets. As such, it will generally sit within the growth component of a diversified investment portfolio. As a core style product, Lonsec considers it suitable for blending with other Australian Equity strategies including 'growth /

GARP / core'-style biased funds, small caps, long short, or absolute return capabilities.

Changes since Previous Lonsec Review

- This is Lonsec's initial review of the Company.

Lonsec Opinion of this Company

Board of Directors (BOD)

- BKI's BOD consists of four members and Lonsec considers it to be very experienced but to have less diversity than some of its LIC peers. The BOD has good tenure at BKI with three of the four directors having joined at inception in 2003 and the fourth having joined in 2009. While noting the benefits of such stability, Lonsec considers succession planning to be an area of risk for investors due to such a high proportion of long-serving directors. Lonsec expects BKI to be able to attract talented independent directors as the need arises but notes that this is untested in recent times.
- A distinguishing feature of the Company is that a BOD sub-committee, the Investment Committee ('IC'), approves all changes proposed to its share portfolio. The IC is chaired by BKI's Chair of its BOD, Robert Millner, and also includes long-standing Non-Executive Directors ('NED') Ian Huntley and Alexander Payne. It is rounded out by key Contact investment executives Tom Millner and Will Culbert.
- Lonsec considers the BKI directors on the IC to demonstrate strong investment experience. Chair Robert Millner has been in his role since 2003 and has extensive management and public company experience. Outside of BKI, he is also currently the Chair of listed entities WHSP, Brickworks ('BKW') and New Hope ('NHC') as well as being a non-executive director of TPG Telecom ('TPG') and Australian Pharmaceutical Industries ('API'). He is also the Chair of Milton ('MLT') which is also an ASX-listed LIC.
- Payne has similar tenure and experience, having also been a member of the BOD since 2003 and having previously been the CFO of BKW. While not having the same tenure, Huntley has an extensive track record in business, having founded the 'Your Money Weekly' newsletter which he sold to Morningstar in 2006. He joined the BOD and IC as a NED in 2009 following the take-over of the Huntley Investment Company. Importantly, Lonsec notes that the majority of the IC have +14 years tenure at BKI. Lonsec is a firm believer that extensive co-tenure is a critical determinant in cohesive decision making in such structures.
- As well as the IC, the BOD is further supported by three other sub-committees being the Nomination, Remuneration and Audit Committees. Pleasingly, the Audit Committee is chaired by NED David Hall who is the only member of the BOD not on the IC. Hall has held this role since joining the BOD in 2003. He has the appropriate experience to hold this key post. Lonsec notes that Payne is the Chair of the Remuneration Committee.
- In terms of its overall structure, Lonsec notes that the BKI BOD does not have a majority of independent

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directors. Rather, only Hall and Huntley have been classified as being independent. Lonsec also notes that BKI's Chair is not independent. Lonsec considers it best practice for the BOD of a LIC to have a majority of independent members and also an independent Chair.

- Lonsec has assessed BKI to have a high level of related-party risk. This stems from a number of sources. The first is due to BKI having a number of current shareholdings in the entities for which the Chair of both the BOD and IC, Robert Millner, is either the Chair or a director. This includes MLT, BKW, NHC and TPG. Lonsec also notes that Tom Millner is also a current director for WHSP.
- Lonsec notes that BKI has also entered into service agreements with a number of related-party entities. This includes Contact, which is owned 20% by WHSP. Lonsec also notes that the related-party entity Pitt Capital Partners has been the advisor to BKI on some of its recent SPP. Finally, the related-party entity Corporate and Administrative Services Pty Ltd provides administrative, company secretarial and accounting services to BKI. Both are WHSP-owned entities.
- Having highlighted the risk, Lonsec is pleased to note that the Company has firm procedures in place to handle such conflicts. This includes the hard rule that no director or representative of Contact can be present in an IC meetings when any of his related-party stocks are up for discussion. Also, the recent negotiations between Contact and BKI regarding the IMA were handled for BKI by the independent NED's Huntley and Hall. They made the recommendation to the BOD.

People and resources

- Lonsec notes that Contact is the sole current provider of investment management services to BKI. Contact was formed in late 2016 (by Tom Millner and Will Culbert, in partnership with WHSP) to provide investment services to BKI. It has also subsequently brought an additional LIC IPO to market (URB Investments Ltd). While Contact does not have any direct reliance on WHSP, its related-party entities do provide back-office and operational support at market rates. Lonsec views the relationship with WHSP as a positive for both Contact and BKI and notes the similarities in the philosophies of both organisations.
- Lonsec notes that Contact has appointed its key investment executives (Tom Millner and Culbert) as the co-Portfolio Managers ('co-PM') for BKI. Tom Millner has over 15 years investment and portfolio management experience. Prior to establishing Contact, he was CEO of BKI (from 2008 to 2016) and has also been an investment analyst and portfolio manager with Souls Funds Management. Culbert also has a long-term investment track record, with 17 years of funds management experience in Australia and the UK. Culbert had been portfolio manager for BKI for three years before co-founding Contact in 2016. Before this, he spent 11 years at Invesco Asset Management as an equity analyst and portfolio manager. Lonsec considers both to be experienced

portfolio managers and highlights the long-term track record of Tom Millner, in particular, at BKI.

- Lonsec considers Contact's investment team to be small versus many peers, having only four members. Along with Tom Millner and Culbert, the team is rounded out by junior analysts Rahul Tamilarasan and Jovana Gagic who both joined in 2017. While Contact is looking to expand the team in-line with its ambition to create a stable of LICs, it is likely that this will take some time and be linked to asset growth. However, Lonsec notes that outside of investment tasks, Contact runs a largely outsourced model and has heavily invested in automating its investment process. It also has the support of BKI's experienced IC of which both are also members. Nonetheless, resourcing of the investment team will form a critical part of Lonsec's future reviews.
- Key person risk in Tom Millner and Culbert is considered by Lonsec to be high. However, given the equity held by both in the business is in the early stage of its life-cycle, the probability of either departing the Manager is considered low. Lonsec also notes that both Tom and Robert Millner have a strong family connection and background with both WHSP and BKI and are also substantial shareholders in both.
- The team's alignment with investor outcomes is also considered to be strong, particularly given the Manager is in its start-up phase where additional fund flow tends to be dependent on positive performance outcomes. As mentioned, Tom Millner also has a significant direct investment in BKI as does his family.

Research approach and portfolio construction

- Lonsec considers BKI to have a logical and repeatable investment process that is closely aligned with its long-term and low turnover approach to investing. BKI uses a mix of both quantitative and qualitative techniques to select stocks. The focus is on identifying the 'bottom-up' fundamentals of an individual company that make it a solid, dividend paying opportunity. Limited consideration is given to 'top-down' factors.
- As with other more 'buy and hold' focused LICs, Lonsec considers BKI's focus on sustainable dividend growth and LIC tax rules to mean that the research process is more focused on the maintenance of its stock portfolio and the identification of potential 'torpedo' stocks both from a capital preservation and a dividend sustainability perspective. This is different from many other 'bottom-up' research processes which seeks to re-generate an equity portfolio from time-to-time based on the opportunity set of best stock ideas. Having highlighted this, Lonsec notes that BKI continues to add a select number of new stocks to the portfolio on an on-going basis.
- In terms of the fundamentals that it focuses on, Lonsec notes that BKI's process is built around five key factors that it considers to be the most important in picking stocks that align best with its investment objectives. These include income, principal activity, debt levels, management / Board and earnings / valuation. As BKI is 'benchmark unaware', it does

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not have any stock or sector constraints. Lonsec agrees that these are likely to aid BKI in meeting its investment objectives.

- A criticism of Lonsec is that with a smaller team and between 50 to 60 stocks to maintain research coverage, the Company's ability to identify new ideas could be somewhat curtailed due to resourcing pressures. This is despite the idea flow which originates from the investment team and members of the IC. Lonsec considers this could lead to a lack of suitable replacement stocks being identified and analyst potentially 'sitting on their hands' rather than making proactive sell recommendations.
- Lonsec notes that BKI's IC has ultimate responsibility for all investment decisions made. As previously discussed, the IC consists of three BKI directors (Robert Millner, Huntley and Payne) and the co-PMs. Lonsec notes that the co-PMs present formal 'Stock Review & Analysis' papers to the IC via a standardised template. This paper presents the Contact investment thesis on stocks via 105 separate questions grouped into broader categories, including Business, Customers, Industry, Management, Income/Dividends, Financials, Leverage and Valuation. This leads to a formal recommendation that must be ratified by the IC.
- A common criticism of Lonsec's of such committee structures is that they can dilute accountability for portfolio outcomes. Lonsec also notes that the current structure of the IC, i.e. having two Contact executives on the IC, is still relatively untested. However, Lonsec notes that the BKI NEDs have all been on the IC since 2009 and have extensive investment industry experience. Lonsec has a high regard for the track record of these members. Also, Tom Millner has previously been on the IC (as BKI's CEO) since 2008. Such extensive co-tenure is a critical factor in the efficacy and efficiency of such a decision-making structure.
- Lonsec notes that the BKI IC met on 13 occasions in 2017 and expects the frequency of IC meetings to be similar going forward. Lonsec notes that other LICs it covers with IC structures have tended to meet more frequently. While noting the low turnover approach of BKI, Lonsec considers that the potential may exist for portfolio issues to drift. However, Lonsec notes that the IC will meet outside of this formal cycle to consider any recommendations that require a prompt response.
- Lonsec highlights that outside of a commitment to diversification, portfolio construction for BKI is more 'art' than 'science'. Rather than critically evaluating its pool of stock ideas for potential portfolio inclusion, BKI has a very long-dated 'buy and hold' strategy which means that the portfolio tends to be relatively static when measured from period-to-period.
- Portfolio construction is also tempered by BKI's requirement to continue its capital account election which allows it to pass on CGT concessions to its shareholders. This election is dependent on BKI continuing to pass a number of ATO tests including portfolio turnover being below 10%. In Lonsec's view, these competing factors could potentially lead

to BKI having lower 'sell discipline' on valuation grounds than competing strategies in the market.

Risk management

- Lonsec notes that the Company has a separate and suitably experienced BOD that provides it with governance oversight. The BOD's role is as defined by BKI's Board Charter which stipulates that its primary purpose is to oversee the activities and performance management of the Company.
- In terms of its supervisory role, this includes the BOD providing oversight of Contact's performance and succession plans, monitoring of the investment portfolio performance and ratifying all portfolio transactions.
- Lonsec is pleased to highlight that the BOD has delegated much of its risk management oversight to the Audit Committee ('AC'), believing this design to be important in ensuring appropriate segregation of duties. The AC is tasked with reviewing the risk management framework that has been set for BKI among other tasks.
- Lonsec notes that BKI is 'benchmark unaware' and has a strong focus on fully franked dividend growth and long-term capital growth. Hence Lonsec considers the risk for the Company to be one of income and capital preservation. Lonsec considers BKI's investment philosophy and maintenance of the 'bottom-up' investment thesis supporting its portfolio to be critical in ensuring that risk management is embedded within its investment process and focused on these risks.
- Lonsec notes the Company's portfolio construction process to be relatively unconstrained outside of a broad commitment to diversification. Lonsec notes that there are no stock or sector limits in place. Hence, the risk exists that BKI can expose shareholders to significant idiosyncratic stock or thematic risks with these not being actively monitored due to the lack of investment grade risk management systems.
- Lonsec notes that BKI does not have access to risk management systems that are typically used by managers in Lonsec's universe to provide reporting on potential risks within equity portfolios.

Funds under Management (FUM)

- As at 30 June 2017, BKI's Australian equities portfolio had a mark-to-market valuation of \$946m. At these levels, BKI is a small-to-mid sized manager within Lonsec's wider Australian equities peer group. However, Lonsec acknowledges that BKI is an 'all cap' strategy.
- BKI does not have a formal policy on an appropriate capacity limit for its stock portfolio. Lonsec notes that by virtue of its closed-end structure, future growth in the portfolio size will mostly be driven by performance rather than future inflows. The active DRP and SPP programs in place will also be an incremental driver of portfolio growth over time.
- At its current size, Lonsec does not consider BKI to have any capacity concerns. While it does have some large active weights in some mid cap names, the average position it has in these names is constrained

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to a degree by its natural diversification. Nonetheless, Lonsec would welcome any efforts by the Company to formally incorporate such studies into its risk management processes.

Performance

- BKI has been listed since 2003 and has a substantial track record in the market. BKI's investment objectives are relatively simple, seeking primarily to grow its absolute level of fully franked ('ff') dividends over the long-term while also providing capital growth. In terms of its dividends, Lonsec observes that BKI has been able to grow the absolute level of its dividends over the last five years; it paid dividends of 6.7c ff per share in FY13 versus 7.3c ff in FY17. The Company has also demonstrated capital growth over the longer term, delivering a total shareholder return of 10.7% p.a. over the seven-year period to 31 July 2017. Hence, Lonsec considers BKI to have demonstrated reasonable success in meeting its investment objectives across an investment cycle.
- Lonsec considers BKI's demonstrable track record in growing both its dividends and investors capital over the longer-term to be a major determinant in it having such a loyal following from its shareholders. Lonsec also considers such consistency is also a key predictor of whether a LIC will trade in a closer band to its NAV over-time. Lonsec notes that BKI's share price has traded in a close -5% to 5% band to its NAV over the five-year period
- BKI delivered a solid full-year result as at 30 June 2017 (FY17), with net profit growing 8% on the prior corresponding period ('pcp') to \$45.6m and Earnings per Share (EPS) growing 3% to 7.6 cents. This growth in profitability funded a minor 1% lift in the Dividend per Share (DPS) to 7.3 cents. The main drivers of profit growth was the increase in special investment revenue which grew by a very strong 255% on the pcp to \$3.9m.
- BKI's overweight positions in ex-top 20 names (such as Challenger and IAG) as well as a recovery in its resources names and Woolworths has seen its portfolio grow by 7.7% from the pcp to \$998.6m.
- In terms of benchmark relativities, based on share price returns, BKI has outperformed the S&P/ASX 300 Acc. Index over five and seven-years to 31 July 2017. Over seven-years, BKI returned 10.7% p.a. and outperformed by 2.6% p.a. (based on the closing share price) while over five-years it returned 12% p.a. for alpha of 1.3%. The three-year performance number has been more challenging, with BKI underperforming by -0.4% p.a. However, it still delivered capital growth with a total return of 4.7% p.a. Given the very competitive MER (0.14% p.a.), Lonsec considers BKI's seven-year alpha of 2.6% p.a. to be an excellent result for investors.

Overall

- Lonsec has provided BKI with an initial 'Recommended' rating. It has a long-term track record of providing investors with both dividend and capital growth across an investment cycles. It has also outperformed the Benchmark by 2.6% over seven-years which is a great outcome for investors given the low MER of 0.14%.

- Lonsec has a high regard for BKI's long-standing Board and Investment Committee, noting the experience and co-tenure of its constituent directors.
- Lonsec notes some concern with the potential for diminished sell discipline with BKI being focused on keeping its turnover low for philosophical and tax reasons. The Company has a high level of related-party risk due to it holding stock in a number of listed entities which are associated with its directors or key Contact executives. There are also related-party service agreements including with the external investment manager, Contact. Finally, Lonsec would prefer a majority independent Board including an independent Chair.

Company Overview

Background

The BKI of today has been shaped by a number of significant transactions since it first listed in 2003. These have been listed in the table below. These transactions have been instrumental in growing the Company to its current market capitalisation and broad shareholder base.

Capital transactions

Year	Capital event
2003	INITIAL PUBLIC OFFER OF THE BRICKWORKS PORTFOLIO
2004	ALL SCRIP MERGER WITH PACIFIC STRATEGIC INVESTMENTS (ON 2-FOR-7 BASIS)
2007	TAKE-OVER OF HUNTLEY INVESTMENT COMPANY
2007	1-FOR-5 RENOUNCEABLE RIGHTS ISSUE AT \$1.35
2013	1:15 NON-RENOUNCEABLE RIGHTS ISSUE AT \$1.48
2016 - 2017	SERIES OF TRANSACTIONS WITH 5 UNLISTED FAMILY INVESTMENT COMPANIES

Board of Directors

The BOD has responsibility for ensuring that the Company is managed to protect shareholder interests.

Size and experience – BOD

Director	Role	Year Joined
ROBERT MILLNER	NON-EXECUTIVE CHAIR	2003
DAVID HALL	INDEPENDENT NON-EXECUTIVE DIRECTOR	2003
IAN HUNTLEY	INDEPENDENT NON-EXECUTIVE DIRECTOR	2009
ALEXANDER PAYNE	NON-EXECUTIVE DIRECTOR	2003

Directors Biographies

Robert Millner, Non-executive Chair.

Millner was first appointed as Chair of BKI in 2003. He has extensive management and investment industry experience and is also the Chair/director of a number of listed entities. He has long-standing experience with LICs and is also the Chair of MLT.

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Millner is the Chair of BKI's Investment Committee and is a member of the Remuneration and Nomination Committees. He is also a large shareholder in the Company.

David Hall, Independent Non-executive Director.

Hall is a long-standing independent NED of BKI having first joined in 2003. He is a Chartered Accountant with over 30 years of experience in corporate management, finance and Directorships.

Hall is the Chair of the Audit Committee and a member of the Remuneration Committee. He is also a large shareholder in the Company.

Ian Huntley, Independent Non-executive Director.

Huntley is the most recent addition to the BOD, having been appointed as a NED in 2009. He has a long-term track record in business and investment markets, having founded the 'Your Money Weekly' newsletter which he sold to Morningstar in 2006.

Huntley is a member of the Investment, Remuneration, Audit and Nomination Committees. He is also a substantial shareholder in the Company, a stake which he largely acquired during the Huntley Investment Company take-over.

Alexander Payne, Non-executive Director

Payne is also a foundation NED, having also joined in 2003. Payne is the former long-standing CFO of Brickworks.

Payne is the Chair of the Remuneration Committee and is a member of the Audit, Investment and Nomination Committees. He is also a shareholder in the Company.

Board Remuneration

NED (including the Chair) remuneration in aggregate must not exceed a limit that has been approved by shareholders via a formal vote. This maximum aggregate limit is \$300,000 p.a. and it can only be increased via an ordinary share-holder resolution.

In terms of how this is allocated to individual directors, in 2017 Payne and Huntley each received \$45k, Hall received \$55k and Robert Millner as Chair received \$71k. In aggregate, the four NEDs received \$217k which is well below the \$300k ceiling. This is slightly up from 2016, where \$212k was incurred by BKI on NED fees.

People and Resources

Size and experience – Contact

Name/Position	Sector	Years industry/firm
ROBERT MILLNER	CHAIR	33/1
TOM MILLNER	PORTFOLIO MANAGER	16/1
WILL CULBERT	PORTFOLIO MANAGER	17/1
RAHUL TAMILARASAN	INVESTMENT ANALYST	3/>1
JOVANA GAGIC	INVESTMENT ANALYST	N/A
JAMIE PINTO	COMPANY SECRETARY	26/1

Contact has appointed Tom Millner and Will Culbert as the co-Portfolio Manager's of BKI. Both have over fifteen years of relevant portfolio management and

investment industry experience. Before Contact, Tom Millner was BKI's CEO. Culbert was also the Portfolio Manager for BKI for three-years before Contact's inception. Before this he held senior investment roles mainly for Invesco. The team is rounded out by recent hires Rahul TAMILARASAN, who joined from E&Y and Jovana Gagic who joined from Pitcher Partners.

Remuneration / Alignment of Interests

Contact receives a fixed investment management fee of 0.1% of total assets and there is no performance fees. Tom Millner and Culbert own 80% of Contact. Tom Millner is also large share-holder in BKI.

Research Approach

Overview

INVESTMENT STYLE	CORE
RESEARCH UNIVERSE	300
STOCKS FULLY RESEARCHED	100
COMPANY VISITS	+400
INITIAL STOCK FILTERS	8
TOP DOWN	INPUT ONLY
BOTTOM UP	100%
RESEARCH INPUTS	COMPANY VISITATION PROGRAM. PROPRIETARY FUNDAMENTAL 'BOTTOM-UP' ANALYST RESEARCH
QUALITATIVE FACTORS	INCOME, PRINCIPAL ACTIVITY, DEBT LEVEL, MANAGEMENT / BOARD, EARNINGS / VALUATION
USE OF BROKER RESEARCH	IDEA GENERATION
VALUATION APPROACH	EARNINGS MULTIPLES (PE, EV/EBITDA)

Idea Generation

While BKI has very low turnover approach, new ideas will be added to the portfolio from time-to-time. These will typically be funded from the re-investment of capital gains or the proceeds from SPP/DRP.

In terms of such ideas, BKI is focused on identifying stocks using five basic fundamental factors as follows:

1. Income – dividend yield, franking credits and pay-out ratios;
2. Principal activity – sustainable business model, competitive advantage, barriers to entry;
3. Debt levels – gearing ratios, net interest coverage;
4. Management and Board – alignment, Board meeting attendance, creating share-holder wealth; and
5. Earnings and valuations – earnings profiles, PE multiples, EV/EBITDA multiples

Bottom-up Process

Both new stock ideas and existing portfolio stocks are then subjected to a rigorous 'bottom-up' stock research process. This task is allocated to individual analysts along sector lines. Key research tasks include:

- Monitoring of company announcements;
- Attending company site visits and management presentations; and

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- The maintenance of bespoke company models which assess the prospects for both earnings sustainability and dividend growth.

The Company's investment team also has access to Factset, Bloomberg and Iress to provide them with access to market data.

Portfolio Construction

Overview

NUMBER OF STOCKS IN PORTFOLIO	50 TO 60
BENCHMARK	S&P/ASX 300 ACC. INDEX
INVESTMENT OBJECTIVES	CAPITAL GROWTH AND SUSTAINABLE FULLY FRANKED DIVIDEND GROWTH
PORTFOLIO DECISIONS	INVESTMENT COMMITTEE
STOCK SELECTION	DIVIDEND FOCUSED
MARKET CAP BIAS	MID-TO-LARGE
EXPECTED PORTFOLIO TURNOVER	VERY LOW, LESS THAN 10% P.A.
% OF PORTFOLIO IN THE 'TOP 25'	APPROXIMATELY 80%

BKI's portfolio construction process is broadly unconstrained outside of a commitment to appropriate stock and sector diversification. This approach is plausible given the very low turnover approach.

The final portfolio weights arrived at are more 'art' than 'science' and take into consideration BKI's dividend objectives and the need to be low turnover. In terms of 'sell discipline', the Company will sell a position if its investment case is no longer valid. However, a stock simply trading above its intrinsic valuation is not considered a reason to sell.

Demarcation of Duties

The Company's co-Portfolio Managers and investment team are responsible for monitoring the existing stock portfolio and for making stock recommendations to the IC. The IC meets regularly (13 times in FY17) and will consider all such recommendations at these meetings for potential approval.

Risk Management

Risk Limits

SEPARATE RISK MANAGEMENT	YES
STOCK CONSTRAINT	NIL
SECTOR CONSTRAINT	NIL
CASH	5-10%
TRACKING ERROR	NOT TARGETED

Risk Monitoring

The primary risk management monitoring for BKI is performed by its BOD. The BOD has, in turn, delegated some of its oversight duties to the separate Audit Committee. As a listed entity, the Company also has to meet the ASX listing rules which is an additional oversight.

Important Risks

An investment in the Company carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the Prospectus and should be read in full and understood by investors. Lonsec considers major risks to be:

Equity Market

Investments in equity markets are subject to numerous factors which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

Investment

Being an LIC, its securities may trade on the ASX at a discount to its NAV for extended periods of time.

Related-party

BKI is an owner of positions in certain stocks where its independent directors are also influential directors. The risk here is that BKI is prevented from adding to these positions or trimming/exiting these positions due to such influences. BKI also has service provisions with some related-party entities. The risk is that these are not struck at arm's length terms.

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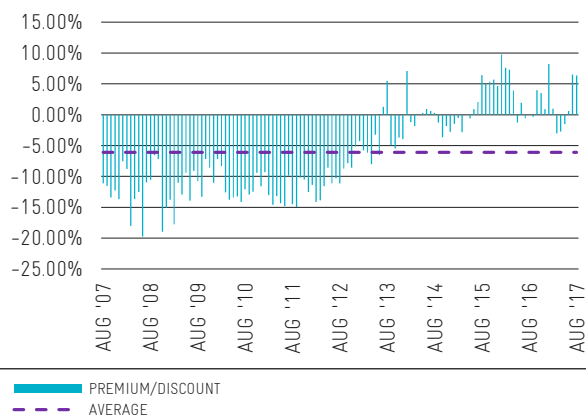
Quantitative performance analysis annualised % returns as at 31 July 2017

	1 YEAR	3 YEARS	5 YEARS	7 YEARS
PERFORMANCE (% PA)	10.0	4.7	12.0	10.7
STANDARD DEVIATION (% PA)	9.9	11.2	11.7	12.3
EXCESS RETURN (% PA)	3.0	-0.4	1.3	2.6
OUTPERFORMANCE RATIO (%)	50.0	44.4	48.3	50.0
WORST DRAWDOWN (%)	-5.3	-7.2	-7.2	-10.4
TIME TO RECOVERY (MTHS)	2	11	11	1
SHARPE RATIO	0.8	0.2	0.8	0.6
INFORMATION RATIO	0.2	0.0	0.1	0.3
TRACKING ERROR (% PA)	13.2	10.5	9.9	9.6

BENCHMARK: S&P/ASX 300 ACCUMULATION INDEX

NOTE: PERFORMANCE REFERENCED IS CALCULATED BASED ON THE CLOSING SHARE PRICE.

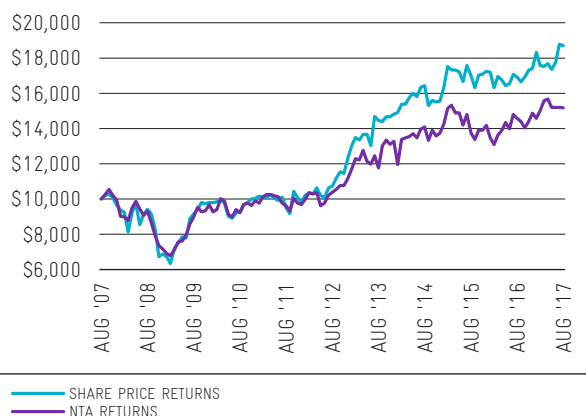
Share price prem./disc. To NAV over 10 years



Dividend record over 10 years



\$10k growth over ten years – share price and NAV



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Glossary

Absolute Return 'Top line' actual return, after fees

Excess Return Return in excess of the benchmark return (Alpha)

Standard Deviation Volatility of monthly Absolute Returns

Tracking Error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)

Sharpe Ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)

Information Ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)

Worst Drawdown The worst cumulative loss ('peak to trough') experienced over the period assessed

Time to Recovery The number of months taken to recover the Worst Drawdown

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Date prepared

October 2017

Analyst

Peter Green

Release authorised by

Shailesh Jain

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