June 2019

BKI INVESTMENT COMPANY

ABN: 89 615 320 262

BKI INVESTMENT COMPANY LIMITED

QUARTERLY REPORT

Can BKI invest overseas?

We have been asked multiple times over the years if BKI can invest overseas. We are constantly told, that while the Australian share market is a great place to invest, it has its limitations and only accounts for approximately 2% of the globes total investments by market capitalisation. BKI has invested in a diversified portfolio of Australian shares, trusts and interest bearing securities for the last 15 years, so by not having global exposure, have our shareholders missed out?

We will explain in this report, that while we only invest in Australian listed securities, the portfolio does have significant exposure to global companies and a whole world of investment opportunities.

BKI Quarterly Report

Welcome to the 22nd edition of the BKI Quarterly Report, prepared by Contact Asset Management.

We have been asked multiple times over the years if BKI can invest overseas. We are constantly told that while the Australian share market is a great place to invest, it has its limitations and only accounts for approximately 2% of the total globally available universe of investments by market capitalisation. With earlier concerns surrounding franking credit policy we've also been reminded of late that companies that derive offshore earnings don't generate franking credits and that more investors will look to these markets as a means of income and, more importantly, growth.

BKI has invested in a diversified portfolio of Australian shares, trusts and interest bearing securities for the last 15 years, so by not having global exposure, have our shareholders missed out? We will explain in this report, that while we may only be investing in Australian listed securities, the portfolio does have significant exposure to global companies and a whole world of investment opportunities.

BKI's Objectives and Strategy

BKI has been listed on the Australian Stock Exchange for over 15 years, investing in a diversified portfolio of Australian shares, trusts and interest bearing securities. The Group aims to generate an increasing income stream for distribution to shareholders in the form of fully franked dividends, through long-term investment in a portfolio of assets that are also able to deliver long term capital growth to shareholders.

As manager of the BKI portfolio, Contact Asset Management has a robust investment process. We are research driven and have a long-term focus on well-managed companies with a profitable history. We are in frequent communication with the BKI Investment Committee and Board and we really like to invest in companies who offer an attractive and growing dividend yield to their shareholders.

Our stock selection is bottom up, focusing on the merits of individual companies rather than market and economic trends and yes, we invest only in Australian companies. Whilst we do not have the mandate to invest directly offshore, we have watched the benefits of investing outside Australia emerge over time. Diversification and access to growing markets are all attractive opportunities that international stocks offer an investor.

What Global Equity Exposure does BKI Have?

Despite the significant growth opportunities, diversification and reach that is on offer when able to invest in multiple jurisdictions, there are risks and questions that need to be answered when managing an international portfolio. Which country do we invest in? Do we invest in emerging markets or developed markets? Which asset class do we focus on? Can we actually get access to these companies and their managers? What is the cost involved to monitor these investments? These are only a selection of the possible questions to ponder.

But what if there was a way to achieve this exposure, diversification and opportunity without the costs, the issues with access to managers and the risks. There is one simple method – look to back the quality Australian companies who themselves are investing overseas, taking on diversification and the growth opportunities associated with investing in other markets.

The reputational damage to Australian companies that has been caused over the years by buying a business offshore that has not delivered, has been well documented and we are conscious of this. In some cases, the rate of decline has been terminal when high multiples have been paid for acquisitions and the Australian based company has then never recovered.

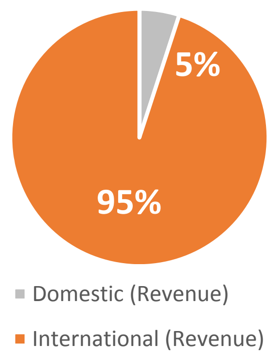
Despite this history of underperformance of Australian companies investing offshore, our analysis of the BKI portfolio shows that 51% of our investments are today exposed to global markets. Some companies have significant earnings streams from international markets, while others have a very small percentage. The point is we are gaining access to global markets by investing through companies we understand, know, trust and have access to management. We can invest in a local company but play in both developed markets, but more importantly we can also play the emerging markets.

On the following pages we list the companies who provide BKI shareholders with global opportunities. Without the significant risks that come with it and without the large management fees of the international funds.

What Companies provide BKI Shareholders with Global Opportunities?

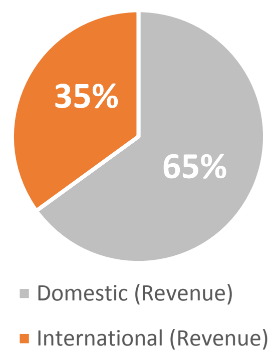
Amcor Limited (AMC)

Amcor was founded in 1860 and engages in the manufacture and supply of packaging products across a wide range of industries including food, beverage, healthcare, home, personal care, and tobacco. From a geographical point of view, sales are quite balanced across North America (33%), Emerging Markets (30%), Western Europe (32%) and Aust/NZ (5%). Factoring in the Bemis acquisition the combined new entity will have an estimated revenue split of North America (43%), Asia Pacific (5%), Western Europe (26%) and Emerging Markets (26%). The deal will enhance Amcor's competitive advantage due to increased scale and combined resources that will target improvements through R&D.



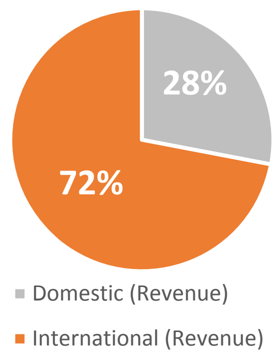
ARB Corporation (ARB)

ARB was founded in 1975 and has grown to be Australia's largest manufacturer, distributor and marketer of four-wheel drive vehicle accessories with a presence in over 100 countries across Europe, USA, Europe and the Middle East. Circa 65% of sales are derived from the Australian aftermarket and 35% of sales are derived from exports having grown from 20% in 2012. At 31 December 2018 export sales grew 7% compared to 3% growth in the Australian Aftermarket. In the US SUVs are projected to hit 50% of the market by 2020 and the USA accounts for 13% of ARB's sales growing 10% on the prior corresponding period.



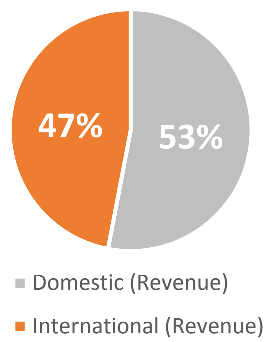
BHP Group Limited (BHP)

Founded in 1885, BHP engages in the exploration, development, production, and processing of iron ore, metallurgical coal, and copper. The business operates across four distinct segments including: Petroleum, Copper, Iron Ore, and Coal. Iron Ore contributes the largest to the Group's EBITDA being 41% while the remaining three segments each contributing approximately 20%. Looking at revenue by the location of the customer, China represents the majority, with 54% of BHP's revenue. Japan is next on the list at 10% while North and South America take a total of 8%, the remaining is concentrated within the Asian Pacific Region



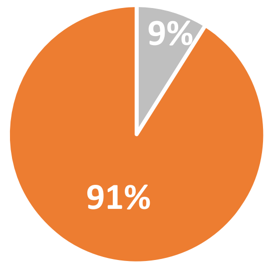
Boral Limited (BLD)

Founded in 1946 Boral is a manufacturer and supplier of building and construction materials. They have a domestic and an international presence, across over 700 locations. Boral Australia comprises quarries, concrete, asphalt, transport, landfill, property, cement/concrete, west coast bricks, roofing, masonry, and timber. The International division comprises BLD North America, alongside a Meridian Brick joint venture, and USG BLD where it has a joint venture with USG Corporation. The revenue split for BLD in H1 FY19 was Australia (53%), BLD North America (35%), and USG BLD (12%), with USA exposure forecast to rise. In late 2016, BLD made a $3.5 billion acquisition of Headwaters Inc in the USA to double the size of its USA operations. BLD is now heavily invested in a US construction recovery, working to expand the reach of its Fly Ash product, which has only 16% penetration of the concrete market in USA. We continue to advocate holding BLD as management executes on its North American expansion strategy.



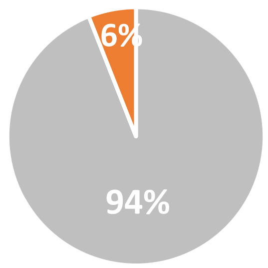
Brambles Limited (BXB)

Brambles was originally founded in 1875 and is a supply chain logistics company. Brambles operates across 60 countries and is represented through their CHEP brand. Their business model is based on sharing and re-using the world's largest pool of pallets, crates and containers. Factoring in the announced sale of IFCO on 22nd February 2019, revenue by region is represented by USA/Canada (41.4%), Western Europe (38.8%), Australia & New Zealand (8.8%) with Latin America, Eastern Europe and Africa, India & Middle East contributing the remaining 11%. By sector fast moving consumer goods represents 52.2% while Fresh product (9.5%), Beverage 15.5% with the remaining spread across general retail, packaging and auto.



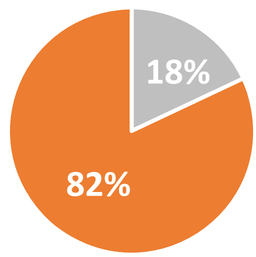
Brickworks Limited (BKW)

Brickworks is Australia's largest brick manufacturer and a leading providers of building products. The Company also has investment interests in unlisted and listed companies along with property development activities – most notably it's 42.7% shareholding in Washington H. Soul Pattinson and Company (ASX:SOL). Throughout this last year, Brickworks has acquired Glen-Gery for $151 million, a leading US brick manufacturer founded in 1890. It comprises 10 manufacturing plants, based in the Midwest, Northeast and Mid-Atlantic states, where it has a market leading position. The acquisition is Brickworks first foray into the US. This represents circa 6% of BKW total EBITDA and should grow and be a key contributor to the growth of the company going forward.



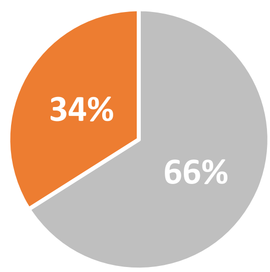
Challenger Limited (CGF)

Challenger is a diversified financial holding group, made up of the Life division specialising in annuities (91% of Group EBIT) and a funds management division (9% of Group EBIT). CGF is focused on maximising its leverage to Australia's growing superannuation sector, which is expected to double over the next decade. CGF has $81.1b Group Assets under Management, having risen 35% from $60.1b two years ago. The life investment portfolio is weighted Fixed Income (60%), Property (20%), Equities (11%) and Infrastructure (4%). Within each segment the split of Australian and International exposure varies, with Property Australia (91%) and International (9%), whilst in Equities the split is Australia (18%) and International (82%). CGF continues to be highly rated by customers and advisors, with 93% of advisors recognising CGF as a retirement leader according to Marketing Pulse Advisor Studies. We remain positive on CGF given the tailwinds to Superannuation reform and that it is now trading at a discount to its historic multiple.



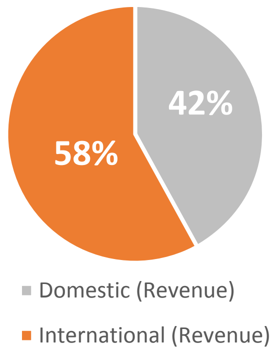
Evans Dixon Limited (ED1)

Evans Dixon was only recently formed through a merger of Evans & Partners and Dixon Advisory, two firms that provide financial services and products to a wide variety of clients. It provides services and products across three broad segments; Wealth Advice, Corporate & Institutional and Fund Management with contribution to EBTIDA being 25%, 45% and 30% respectively. Revenue is split geographically 66% to Australia while North America represents 34%. Exposure to North America is gained predominantly via Evans Dixon Fund Management division which is concentrated within real estate assets, private equity and energy.



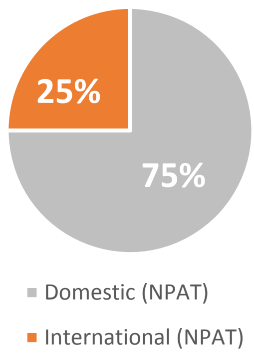
Goodman Group (GMG)

Goodman was established by Greg Goodman in 1989 and listed on the ASX in 1995 with a market capitalisation of $37 million. Since then GMG has expanded into Asia in the early 2000s, Europe in 2005 and the Americas in 2012 and today, the Company own, develop and manage industrial real estate across 17 countries. Operating earnings are split across Australia/New Zealand 42%, UK/Continental Europe 37%, Asia 15% and Americas 6%. Their $10 billion development pipeline is concentrated offshore allocated as Australia/New Zealand 15%, Asia 46%, UK/Europe 30% and Americas 9%. As such, offshore exposure will continue to make greater contributions to future earnings.



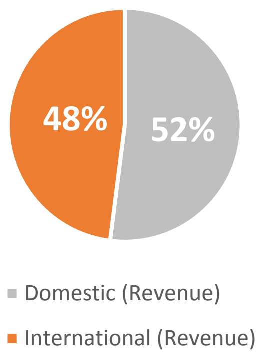
Harvey Norman Holdings (HVN)

Harvey Norman was founded in 1982. HVN has a network of 250 stores, comprised of 195 franchised complexes in Australia and 89 HVN company operated stores across 7 overseas countries. The franchises operate stores, selling home wares and electrical goods. In addition, HVN provides consumer finance and has property investments, with the biggest asset for HVN being its property portfolio, which is currently valued at c$3.15 billion. HVN has a strong offshore presence and just released its strongest ever performance for company operated stores with offshore revenue surpassing $1 billion. Total offshore earnings now represent 25% of Group NPAT. The split of offshore earnings by country for FY19 H1 is New Zealand (45%), Singapore & Malaysia (27%), Ireland (21%), and Slovenia and Croatia (7%). We continue to like HVN, given its International growth prospects, property backing and low multiple for the Australian retail division at 4x EV/EBIT.



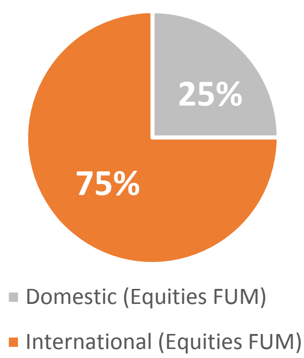
Lendlease (LLC)

Established in 1958 Lendlease (LLC) is an international property and infrastructure group with operations in Australia, Asia, Europe and the Americas. The Company's current strategy is influenced by the global trend of urbanisation, focusing on 10 gateway cities around the world with targeted international markets expected to make greater contributions to future earnings. LLC operations expanded to the USA in 1971 and the Americas now contribute 18% to earnings. Similarly, in 1973 the Company expanded to Singapore and now Asia accounts for 21% of earnings. The development pipeline of $74.5b has grown from $15.7 billion in 2011 and over this period the weighting towards Australia has declined from 77% to 42%. Over the same time frame Australian earnings as a percentage of total earnings have declined from 70% to 52%. 1H19 Operating EBITDA split: Australia 52%, Asia 21%, Americas 18% and Europe 9%. Development Pipeline: 42% Australia, 40% Europe, 11% Americas and 7% Asia.

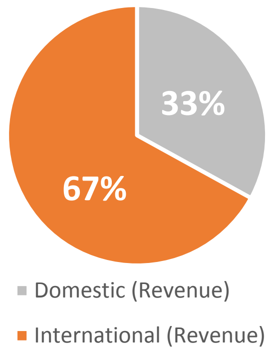


Magellan Financial Group (MFG)

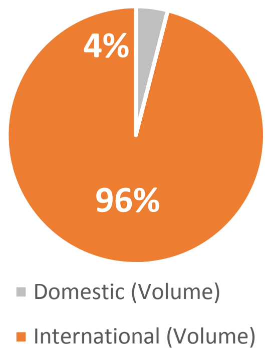
Magellan is a specialist fund management group involved in the development of globally focused investment funds for retail and institutional investors. The breakdown of Funds Under Management allocated to Global Equities is 75%. We continue to hold MFG and welcome the alignment to shareholders with co-founder CEO and CIO Hamish Douglas having considerable wealth tied up in the business.



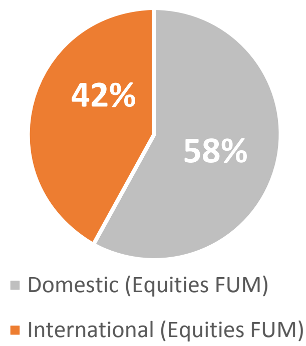
Macquarie Group (MQG)
Macquarie was established in 1969 to provide advisory and investment banking services to the Australian market. Since then it has grown into a global diversified financial business operating in over 27 countries providing clients with asset management and finance, banking, advisory and risk and capital solutions across debt, equity and commodities. In 2018 International income accounted for 67% of total income compared to 22% in 1998. MQG established their presence in the Americas in 1991, Asia in 1994 and Europe, the Middle East and Africa in 1989. At 31 December 2018 the Company recorded total assets under management by region of $270 billion, $58 billion and $113 billion respectively. MQG is well positioned with deep expertise to take advantage of trends such as the investment in infrastructure with circa $US49 trillion required in Asia by 2040 (American Society of Civil Engineers, Infrastructure Report Card 2017) and circa $US 5 trillion required in the US by 2025 (Global Infrastructure Hub, Global Infrastructure Outlook, 2017).



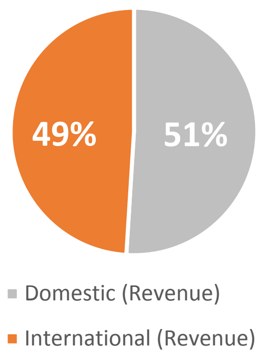
New Hope Group (NHC)
New Hope is a majority Australian owned and operated diversified energy company which has been proudly based in South East Queensland since 1952. New Hope has business interests and operations spanning coal mining, exploration, port operation, oil, agriculture and investment. NHC currently has open cut coal mines in South East Queensland and Northern NSW that produce thermal coal. Of the 9.0Mt of coal produced in 2018, New Hope exported 96% or 8.6Mt of this volume, which was up 5% from 2017. We expect to see substantial growth in Australian coal exports into the future, driven by strong demand for high energy clean coal to support the significant number of new clean coal fired power plants that have been constructed or are being constructed throughout the Asian region, in particular China, India, Indonesia, Vietnam and the Philippines.



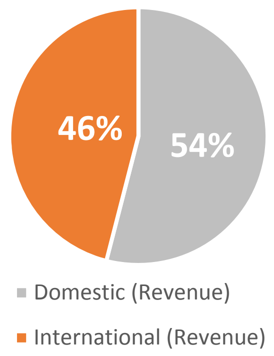
Platinum Asset Management (PTM)
Platinum is an Australian based international fund manager with $26 billion funds under management. The Company was founded by Kerr Neilson and Andrew Clifford in 1994 and both remain involved in the business. The Platinum International Fund which represents 42% of FUM is heavily weighted towards China, the US, Japan, India and Korea. Their top holdings include Chinese Insurer Ping An Insurance Group, Hong Kong domiciled Samsung Electronics, global internet giant Alphabet Inc and diversified mining Company Glencore plc.



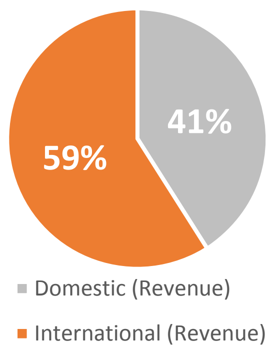
Ramsay Healthcare (RHC)
Ramsay Healthcare (RHC) was established in Sydney in 1964 by Paul Ramsay who went on to become the Chairman and major shareholder of the Company. Today, the Company operates across 11 countries including Australia, France, the UK, Sweden, Norway, Denmark, Germany, Italy, Malaysia, Indonesia and Hong Kong. As a result of this geographic diversification, Australia's share of total revenue over the last 5 years has declined from 79% to 51%. In 2007 the Company made its first offshore expansion with an acquisition into the UK, followed by the 2010 purchase of a 57% interest in Group Proclif SAS (Proclif), a leading private hospital operator based in France. In 2018 RHC expanded further in France and established positions in Germany, Sweden, Norway and Denmark through the acquisition of Capio making Ramsay Generale De Sante the second largest private care provider in Europe. Over the medium to long term, RHC will continue to benefit from the global trend of an ageing population.



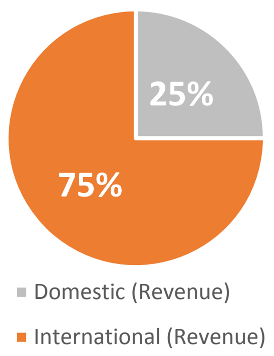
Reece Group (REH)
Established in 1919 by Harold Joseph Reece selling hardware products from the back of his truck, Reece Group (REH) has grown to be Australia's leading supplier of plumbing and bathroom products with 615 outlets across Australia and New Zealand. In 2018 REH acquired Morsco for $1.9 billion, doubling the size of the Company. Morsco is a leading US distributor of plumbing, waterworks and heating and cooling equipment (HVAC) products with a presence in 16 states with 171 branches. At 31 December total sales was split 54% Australia and New Zealand and 46% USA. The US acquisition according to CEO Peter Wilson is an opportunity for the next generation with the US plumbing market fragmented and displaying some similarities to where Australia was decades ago. He sees the market growing at twice the rate of the local Australian market and is around eight times the size.



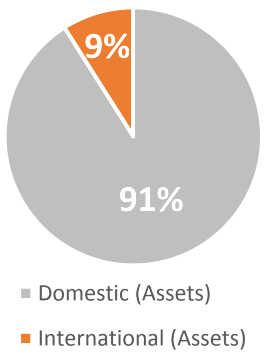
Seek Limited (SEK)
Seek was founded in 1997 essentially as an online version of print employment classifieds. Today it is one of the leading companies providing services across employment, education and volunteering services spanning 18 countries with exposure to 2.9 billion people across Seek's addressable markets. Revenue split for FY18 was Australia (41%), China (36%), South East Asia (12%), Brazil, New Zealand and Mexico contributed the remaining (12%). Diversification for Seek has been a priority ever since 2006 when Seek first invested in China's online job marketplace via an investment in Zhaopin, which has seen strong growth with most recently growth of 31% (constant currency) in 1H19.



Sonic Healthcare (SHL)
Sonic Healthcare is a global healthcare company which was founded in 1934 and focuses on medical diagnostics services. The business operates across three key segments being Laboratory Medicine/Pathology, Radiology/Diagnostic Imaging and Clinical Services and Trials. SHL first started to diversify its revenue stream in 2001 by entering Hong Kong and New Zealand. Pleasing to see this approach has continued with revenue being split among Australia (25%), USA (21%), Germany (21%), UK & Ireland and Switzerland each contributing 7% and 19% from Rest of the World.

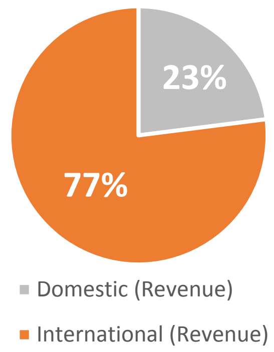


TPG Telecom Limited (TPG)
TPG was founded in 1992 and engages in the provision of telecommunications services. TPM owns and operates end-to-end network infrastructure which includes over 400 DSLAM enabled telephone exchanges in Australia, extensive inter-capital and metropolitan fibre optic networks in Australia, and the international submarine cable connecting Australia and Guam with onwards connectivity to USA and Asia. In Singapore, TPG has invested c$190m over the last two years to roll out national outdoor coverage providing offshore earnings contribution to TPG. It is forecast that it will become EBITDA positive when it reaches a market share of between 5% and 6% which it believes should be achievable within a short period of time. The current asset mix is Australia (91%), Singapore (5%), Other (4%).



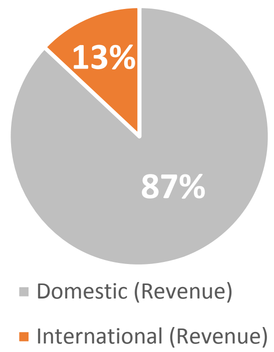
Treasury Wine Estates Limited (TWE)

Treasury was founded in 1957. TWE was formally the Fosters Group tracing its roots back to the establishment of several New World wineries in the 19th century, which included Lindeman's and Penfolds in Australia, and Beringer Vineyards in the United States. TWE is principally involved in the production and marketing of wine, across three tiers of products: Luxury (69% of Group Inventory), Masstige (29%) and Commercial (12%). TWE operates through a global footprint, dominated by offshore earnings: United States (40% of Group Volume), Europe (25%), Australia and New Zealand (23%) and Asia (4.3%). We expect TWE to continue to compound returns given it has reiterated +25% reported EBITS growth in FY19, with FY20 +15%-20%. With Asia, TWE expects EBITS margins of 35%+ in FY19 and beyond and is coming off a very low base in sales penetrations given only a 5% current market share. We advocate holding TWE as we see the continued growth of TWE in the Luxury category alongside its growing presence in Asia and the United States as key drivers for future operating success and returns to shareholders.



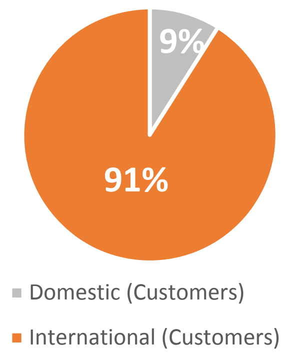
Transurban (TCL)

Founded in 1996, Transurban develops, operates and provides maintenance for toll rolls around the world. TCL currently has 17 roads under operation with 1.5 million daily trips across their roads by 8.5 million customers. TCL's global exposure comes via two main assets; firstly, Washington North America and a second asset in Montreal, Canada. Revenue from North America contributes 12.5% of revenue and saw strong revenue growth of 7.1% in FY18. The 7.2km toll road in Montreal is their second acquisition which took place in March 2018. For revenue derived in Australia, which represents 86.5%, this is via three key regions being Sydney, Melbourne and Brisbane.



Woodside Petroleum (WPL)

Woodside Petroleum (WPL) is Australia's largest natural gas producer with over 60 years of experience, producing 6% of global LNG supply. The Company has producing assets in Australia and Canada, developments in Senegal, Australia and Canada and appraisal and exploration in Ireland, Bulgaria, Senegal, Morocco, Gabon, Australia, Timor-Leste and Peru. In Western Australia WPL is progressing development of the Scarborough and Browse gas resources through their producing assets, the Woodside-operated Pluto LNG and North West Shelf (NWS) Project. WPL is well placed to capture the emerging global LNG shortfall with their current growth plans expected to more than double their LNG production by 2027.



Conclusion

As you can see the international exposure of the BKI portfolio is material. With over 51% of the portfolio having international exposure, we are confident this presents an opportunity. We will continue to assess future opportunities to deploy capital into both existing and new names with international exposure, where the risk reward is favourable.

As we learnt from our recent trip in May to the United States, that we shared with investors previously, we were encouraged by the resilience of the International economy. Since May, Global markets have performed well, with the MSCI World Index, a measure of the developed world equity performance, returning 3.6%. For the last year the MSCI World Index has returned 15.1%.

Although global markets remain strong, we are however cognisant of potential risks on the horizon. With global bond yields at historic lows and discount rates at levels never once seen in history, investors are conscious of not just having a return *on* capital (a focus of the BKI being the Dividend Yield), but also a return *of* capital (preservation of capital in real terms).

Today over $13 trillion of global bonds (nearly a quarter of global debt stock), currently trade at negative yields. With Australia having had two interest rate cuts in as many months, with some commentators forecasting another cut to bring the cash rate to a record low 75 basis points, we at Contact are positive that this will create opportunities for the BKI portfolio. High quality companies, we believe, will generate sound returns to BKI shareholders as investors seek out high yielding names.

As we move into reporting season in August, we envisage a period of high volatility in the markets. We believe this will present opportunities for the patient investor. We remain vigilant moving forward by using our investment process, not being swayed by hot stocks and we’re optimistic the companies we hold with international exposure can perform well.

Sources used: FactSet, Business Insider, Bloomberg, Investopedia, Masters Invest