

BKI INVESTMENT COMPANY LIMITED

ABN: 23 106 719 868

ASX and Media Release

22 January 2020

BKI 2020 Half Year Results



Result excluding special investment revenue	1H 2020	1H 2019	Growth
Investment revenue – ordinary	\$27.0m	\$26.8m	0.8%
Income from operating activities	\$27.4m	\$28.0m	(2.1%)
Net operating profit after tax	\$24.5m	\$25.5m	(3.8%)
Earnings per share	3.35c	3.51c	(4.6%)
Dividends per share	3.625c	3.625c	0%
Result including special investment revenue	1H 2020	1H 2019	Growth
Net operating profit after tax	\$25.5m	\$47.1m	(45.9%)
Earnings per share	3.48c	6.48c	(46.3%)
Special dividends per share	nil	1.50c	(100.0%)

BKI Performance Overview

BKI Investment Company Limited (“BKI”) announced 2020 Half Year results today. Ordinary investment revenue grew slightly from \$26.8 million to \$27.0 million. Unfortunately, a significant cut to dividends received from Westpac Banking Corporation and National Australia Bank impacted this result. Higher dividends received from Magellan Financial, BHP Limited, Woolworths Limited, Harvey Norman, Macquarie Group and New Hope Group were just enough to offset the fall in income from these two banks.

Due to lower term deposit rates on offer, the income from bank deposits over the first half was down 67.5% to only \$0.4 million, compared to \$1.2 million last year. As a result, BKI’s net operating profit for the half year ended 31 December 2019, excluding special investment revenue, was \$24.5 million, a decrease of 3.8% over the previous corresponding period.

The net consolidated profit after tax including special investment revenue was \$25.5 million, a decrease of 45.9% over the previous corresponding period. This was due to the large amount of special dividends received during the previous half year, accelerated by many companies within the BKI portfolio reacting to the possible threat of legislation to remove the benefit of franking credits. These special dividends also included the fully franked special dividend component of the BHP off-market buy-back, and a non-cash unfranked dividend recognised from the Coles-Wesfarmers demerger. During the first half of FY2020, BKI received a far lesser amount of special investment revenue, \$1.0 million, from companies including ASX Limited, Brambles Industries, Coles Limited and Telstra Corporation.

Basic earnings per share decreased 46.3% to 3.48 cents per share, driven by the significant decrease in special dividend revenue. However, basic earnings per share before special investment revenue only decreased 4.6% to 3.35 cents per share.

Dividend Information

The BKI Board has declared a fully franked interim dividend of 3.625cps, in line with the previous corresponding period.

As at 20 January 2020, using the 3.625cps FY2020 interim dividend and 3.70cps FY2019 final dividend, the current BKI dividend yield is 4.4%, grossed up to 6.3%, based on a tax rate of 30% and a share price of \$1.70.

The BKI Board has confirmed that BKI's Dividend Reinvestment Plan (DRP) will be maintained, offering shareholders the opportunity to acquire further ordinary shares in BKI. The DRP will not be offered at a discount. The last day to nominate for participation in the DRP is Tuesday 11 February 2020. To complete a DRP form please follow the following link: www.bkilimited.com.au/dividend-reinvestment-plan/

The last trading day to be eligible for BKI's fully franked interim dividend is Thursday 6 February 2020.

Key dates for the interim dividend are as follows:

Event	
Last trading date to be eligible for the dividend	Thursday 6 February 2020
Ex-dividend date	Friday 7 February 2020
Record date	Monday 10 February 2020
DRP nomination	Tuesday 11 February 2020
Payment date	Thursday 27 February 2020

Management Expense Ratio (MER)

BKI's MER as at 31 December 2019 was 0.18%. The Board and Portfolio Managers are shareholders in BKI. We invest for the long term and do not charge excessive external portfolio management fees or any performance fees. We focus on creating wealth for all shareholders by keeping costs low, increasing fully franked dividends and generating capital growth over the long term.

BKI's MER continues to compare very favourably to other externally-managed LICs, ETFs and managed funds in the domestic market that provide a similar broad-based exposure to Australian equities.

BKI has no debt and thus shareholder returns are not diluted by the interest payable on such a facility.

Performance

The 2019 calendar year was a positive one for Australian equities, despite the last month ending 2.0% weaker. The S&P/ASX 300 Accumulation Index, dominated by high growth stocks, delivered a 1 year return of 23.8%.

BKI's Total Shareholder Returns for the year to 31 December 2019 was 18.3%. BKI's Total Shareholder Returns including franking credits for the year to 31 December 2019 was 21.4%.

BKI's Net Portfolio Return (after all operating expenses, provisions and payment of both income and capital gains tax and the reinvestment of dividends) for the year to 31 December 2019 was 17.3%.

Portfolio Movements

In the first half of this financial year, we made a few changes to the portfolio through \$55 million worth of sales, including the sale of our positions in Boral and Caltex. We also reduced our overall exposure to the banking sector through sell downs of National Australia Bank, Westpac Banking Corporation and ANZ Banking Group. Over the last three years we have reduced our overall portfolio weighting in the banks from 33% to 15%. These further divestments have allowed us to reinvest capital into other positions including Macquarie Group, Commonwealth Bank, Transurban Group, APA Group, Sydney Airport, CIMIC Group, Harvey Norman, BHP Limited, Amcor, Treasury Wine Estates, Evans Dixon, Inghams Group, Woodside Petroleum and Lendlease Group.

The Banking sector was the worst performing sector in 2019, returning 9.5%, on the back of weak operating trends, capital raisings and governance issues. While we continue to diversify away from banks and into positions across a number of sectors that are expected to generate a growing income stream for the portfolio over the long term, the banks continue to account for 23% of the Australian equities market, and it remains a core and important part of both the market and the BKI portfolio. Despite reducing our positions during the half in ANZ Banking Group, National Australia Bank and Westpac banking Corporation, we have added to our holding in Commonwealth Bank, maintaining a market weight.

Commonwealth Bank is rated number one on customer net promoter scores, has the strongest balance sheet of the 4 major banks with the potential to return excess capital, and continues to innovate to meet customer needs. During the half, we increased our position in Macquarie Group to a 3x market weight position. We believe Macquarie Group is a highly misunderstood business, with 60% of earnings annuity in nature and a mortgage book that is growing double digit; the fastest rate of growth in the sector. For FY2020, on a grossed up basis, we estimate Commonwealth Bank's dividend yield to be 7.5% and Macquarie Group's at 5.1%.

The challenging revenue outlook for the banking sector has become increasingly incorporated into market consensus expectations, with the Price-to-Book multiple for the sector at the lowest point now in 9 years. We remain positive on the better quality Banks, especially with an attractive yield of over 5.0% before franking for FY2020, which is well in excess of the 0.75% cash rate.

Top 25 Investments

	Stock	% of Total Portfolio
1	Commonwealth Bank	6.7%
2	Macquarie Group	6.4%
3	Transurban Group	4.9%
4	APA Group	4.8%
5	BHP Billiton	4.7%
6	National Australia Bank	4.3%
7	Woolworths Limited	4.2%
8	Wesfarmers Limited	3.8%
9	Sydney Airport	3.6%
10	Woodside Petroleum	3.1%
11	Ramsay HealthCare	3.1%
12	Telstra Corporation	2.7%
13	TPG Telecom	2.6%

	Stock	% of Total Portfolio
14	Westpac Bank	2.6%
15	ASX Limited	2.6%
16	New Hope Corporation	2.5%
17	AGL Energy Limited	2.5%
18	Sonic Healthcare	2.3%
19	IAG Limited	2.2%
20	Magellan Financial Group	1.8%
21	Invocare Limited	1.8%
22	ANZ Banking Group	1.6%
23	ARB Corporation	1.5%
24	Coles Group	1.4%
25	Harvey Norman Holdings	1.3%
Cash and cash equivalents		7.0%
Total of Top 25 including cash and cash equivalents		86.0%

Outlook

Falling interest rates are continuing to influence market valuations and are driving share prices higher as investors search for yield. We believe that falling rates have already added significantly to the Australian Equity Price-to-Earnings ratio (P/E) multiple in FY2019.

"We estimate that the S&P/ASX 300 Index is currently trading close to a 20 times P/E multiple. If we compare a P/E multiple of 20 times with the current yield of term deposit rates of less than 2%, the equivalent of a P/E of 50 times, we realise quite quickly the stark difference in the valuation levels of these two asset classes." Portfolio Manager of Contact Asset Management, Mr Tom Millner, said.

Any further cuts to rates in the next year could see our market re-rate again and add further to the current valuation spread between markets and cash products.

“However, despite the market re-rating, we remain cautious of the high multiple seen in the current market. It is no surprise that low term deposit rates have pushed investors into the market to look for yield, thus forcing prices and P/E multiples higher. The search for yield has driven strong index gains, with the S&P/ASX300 Accumulation index up 23.8% for the year to 31 December 2019.” Mr Millner added.

With the continued desire for income from many Australian investors, BKI is hopeful the market begins to focus on quality companies once more, and in particular the companies generating real profits, cash flows and paying dividends.

Notwithstanding the many macro issues we are currently seeing, there are parts of our market continuing to experience positive tailwinds. Despite lower prices there is still a strong demand for our commodities, in particular iron ore, coal, oil and gas. The Australian dollar at current levels is positive for tourism and exporters. We have a stable government and companies continue to have the ability to attach franking credits to dividends declared and paid to shareholders. It’s also becoming increasingly clear to us that despite low interest rates globally, positive trends in population growth, infrastructure spend and superannuation growth will continue to provide significant tailwinds for many of the stocks within the BKI portfolio for many years to come.

BKI continues to be well positioned with a portfolio of high quality dividend paying stocks. BKI’s cash represents approximately 7% and we have no debt. The Directors and Portfolio Managers of BKI will continue to ensure BKI achieves its objective of investing for the long term in profitable, high yielding and well managed companies.

This announcement was authorised by the Board of BKI Investment Company Limited

Shareholder Presentations

Contact Asset Management invites you to attend one of the following BKI Investor Presentations hosted by Portfolio Managers Tom Millner and Will Culbert. Refreshments will be provided.

Brisbane

2.30pm Wednesday 22nd January 2020

Brickworks Design Studio, 27 James Street, Fortitude Valley, Brisbane

Canberra

2.30pm Tuesday 28th January 2020

Dixon Advisory Offices, 1/73 Northbourne Ave, Canberra

Adelaide

11:00am Wednesday 29th January 2020

Brickworks Design Studio, 70 Hindmarsh Square, Adelaide

Melbourne

11:00am Thursday 30th January 2020

Brickworks Design Studio, Shop T1/367 Collins Street, Melbourne

Sydney

11:00am Friday 31st January 2020

Brickworks Design Studio, 2 Barrack Street, Sydney

For further information:

Contact Asset Management

Tom Millner – Portfolio Manager
02 9238 0522
0408 754 180

Will Culbert – Portfolio Manager
02 9238 0522
0410 627 378