Company Review
Argo Investments Limited

About this Company
LIC REVIEWED ARGO INVESTMENTS LIMITED
ASK CODE ARG
INVESTMENT OBJECTIVE TO MANAGE A DIVERSIFIED PORTFOLIO OF AUSTRALIAN INVESTMENTS WITH THE OBJECTIVE OF MAXIMISING LONG-TERM RETURNS TO SHAREHOLDERS THROUGH A BALANCE OF CAPITAL AND DIVIDEND GROWTH
MARKET CAPITALISATION $4,927M
SHARES ON ISSUE 679.7M
SHARE PRICE $7.20
52 WEEK HIGH/LOW SHARE PRICE $8.50 / $7.15
NAV (31 MARCH 2016) $6.87
52 WEEK HIGH/LOW NAV $7.84 / $6.59
SHARE PRICE PREM/(DISC) TO NAV -1.1%
EXPECTED MER FY16 0.15% OF AVERAGE NAV
EXPECTED DIVIDEND YIELD FY16 4.2% FF
DIVIDEND PROFILE P.A. 5-YEAR HISTORICAL CAGR 2.2%
CAPITAL MANAGEMENT 2016 BUY-BACK, DRP AND SPP
STRUCTURE INTERNALLY MANAGED

Board of Directors
NUMBER OF DIRECTORS 7
MAJORITY INDEPENDENT DIRECTORS YES
CHAIR PERSON IAN MARTIN
DIRECTORS FEES AGGREGATE OF $1.1M
COMMITTEES REMUNERATION, AUDIT & RISK

Investment team
PORTFOLIO MANAGER JASON BEDDOW
TEAM SIZE 6
TURNOVER/TEAM RATIO (PAST 2 YEARS) LOW

Investment process
STYLE CORE, VALUE BIAS
BENCHMARK S&P/ASX200 ACCUMULATION INDEX
TYPICAL TRACKING ERROR (P.A.) NOT TARGETED
TYPICAL STOCK NUMBERS < 100
TYPICAL CAPITALISATION BIAS LARGE
STOCK AND CASH LIMITS UNCONSTRAINED
DERIVATIVES ACTIVELY USED – BUY/WRITE
CAPITAL OR REVENUE ACCOUNT CAPITAL

Fund rating history
JUNE 2016 HIGHLY RECOMMENDED

What this Rating Means
The ‘Highly Recommended’ rating indicates that Lonsec has very strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered a preferred entry point to this 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 ARG’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 a 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 a LIC.
- Lonsec considers an investment in the LIC sector to be suitable for investors with a long-term (at least five years) investment horizon.

Strengths
- Multi-decade investment track record
- Experienced and diverse Board of Directors
- Well-resourced investment team capably led by the Managing Director Jason Beddow.
- Very low management costs (expected annual fixed costs of 0.15% of NAV)

Weaknesses
- Sell discipline diminished due to requirement to keep turnover very low for philosophical and tax reasons
- Unconstrained portfolio management process
- ARG has a fledgling funds management operation which may prove a distraction for executives.

Company Risk Characteristics
<table>
<thead>
<tr>
<th>LOW</th>
<th>MODERATE</th>
<th>HIGH</th>
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<tbody>
<tr>
<td>CORPORATE RISK</td>
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<tr>
<td>CAPITAL VOLATILITY</td>
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<td>INCOME VOLATILITY</td>
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<td>CONCENTRATION RISK</td>
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<td>RELATED-PARTY RISK</td>
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<td>VALUATION RISK</td>
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<td>LIQUIDITY RISK</td>
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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.

We strongly recommend that potential investors read the product disclosure statement or investment statement.
Lonsec Research Pty Ltd • ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.
Arigo Investments Limited

BIOmetrics

Aggregate Risk Measure

<table>
<thead>
<tr>
<th>STANDARD RISK MEASURE</th>
<th>1</th>
<th>2</th>
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<tr>
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<tr>
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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

<table>
<thead>
<tr>
<th>COMPLEXITY</th>
<th>LOW</th>
<th>MODERATE</th>
<th>HIGH</th>
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</thead>
<tbody>
<tr>
<td>ESG AWARENESS</td>
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</table>

Fee profile

<table>
<thead>
<tr>
<th>FEES – VS LONSEC UNIVERSE</th>
<th>LOW</th>
<th>MODERATE</th>
<th>HIGH</th>
</tr>
</thead>
<tbody>
<tr>
<td>FEES – VS ASSET CLASS</td>
<td></td>
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<td></td>
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<tr>
<td>FEES – VS SUB SECTOR</td>
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What is this Company?

- Argo Investments Limited (ARG or ‘the Company’) is the second largest LIC by market capitalisation on the Australian Stock Exchanges (ASX). First listed in 1946, ARG has a current market capitalisation of $4.9b and has over 80,000 mostly retail shareholders.
- ARG is internally managed and its investment objectives is to maximise long-term returns to its shareholders through a balance of capital and dividend growth. ARG is a strong believer in the ‘cumulative’ effect of holding quality companies over multiple investment cycles. However, it will take the opportunity presented by shorter-term share price volatility to add to its core positions and this introduces a mild value bias to the portfolio over time.
- Given this mild value bias and the focus on paying a growing stream of fully franked dividends, Lonsec expects ARG to deliver outperformance in ‘down markets’. Conversely, Lonsec would expect ARG to underperform in the latter stages of a ‘bull market’.
- Lonsec highlights that ARG has a highly diversified stock portfolio of over 100 names and that this has largely been built up organically since inception. ARG’s portfolio turnover is expected to be very low due both to its ‘buy and hold’ strategy but also due to its tendency to be an infrequent seller. While partly the result of its investment philosophy, the very low turnover also allows ARG 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 continues to expect ARG to generate the majority of its income from harvesting dividends and distributions received from its large cap biased share portfolio. However, ARG does have the scope to generate additional investment income from interest earned on cash deposits, premium income received from writing exchange traded options (‘buy-write’) and a small share trading account. With the ‘buy-write’ sleeve, Lonsec notes that this will be tightly constrained and in practice the portfolio will never be more than 5% over-written.
- Lonsec highlights that by virtue of being internally-managed, ARG is not constrained by a set investment mandate. Rather the ARG Board of Directors (BOD) drives the strategic initiatives of the Company. While dedicated to meeting ARG’s long-term investment objectives, the BOD did recently highlight an entrepreneurial bent by adding funds management to its business model.
- In particular, ARG will receive an annuity-like annual fee for managing the operations of the recently listed Argo Global Listed Infrastructure Limited (ASX – ALI). This service is provided by ARG’s wholly-owned subsidiary, Argo Services Company Pty Ltd (ASCO). Lonsec notes that the services provided by ASCO does not extend to investment management which has been outsourced to US-based asset management firm Cohen & Steers. The ALI deal was largely opportunistic and Lonsec does not expect funds management revenue to become a material source of revenue for ARG.
- ARG is a substantial shareholder in ALI (it currently holds 12.5m shares or 8.7% of its issued capital). ARG and ALI also share three directors, including the same Chair in Ian Martin. Lonsec highlights the related-party risk inherent in this shareholding while noting that ARG has clearly defined policies and procedures in place to manage such conflicts.
- Being internally-managed, shareholders in ARG do not have the impost of paying a management fee to an external fund manager. Rather ARG incurs a relatively fixed level of operating costs during the course of its operations. The major costs are executive and employee remuneration, share registry fees and office rent.
- Due to economies of scale in running a very large share portfolio (approximately $5b) and a relatively fixed cost base, ARG’s annual expenses are expected to be 0.15% of average net assets over a financial year. This compares very favourably with externally-managed LICs/ETFs and managed funds with a similar focus on providing investors with a broad based exposure to Australian equities.
- Lonsec observes that there are a number of well-established Australian equities focused LICs that have a similar internally-managed structure and hence similar fee structures; typically these tend to have a similar high level of investment 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 such trading is a risk for ARG, it is less of a risk than for many smaller LIC peers. The reasons for this are two-fold. Firstly, ARG has a large market cap, reasonable liquidity, >80,000 shareholders and a solid and lengthy track record of paying fully-franked dividends. Secondly, ARG’s BOD has a solid capital management track record. This includes an on-going share buy-back facility, a track record of DRPs and SPP at a premium to NAV and a conservative approach to its dividend pay-out ratio and after-tax considerations.
Argo Investments Limited

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

<table>
<thead>
<tr>
<th>SECURITY</th>
<th>DEFENSIVE</th>
<th>CONSERVATIVE</th>
<th>BALANCED</th>
<th>GROWTH</th>
<th>GROWTH</th>
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- ARG 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 ARG 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 ARG also has the objective of providing investors with a sustainable and growing income stream. Lonsec notes that this income stream is an outcome of ARG 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.

- The Company is a 'long only' Australian equity product which will predominately be fully invested in the Australian equity markets. As such ARG 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 / value style biased funds, small cap, long short, or absolute return products.

Changes since Previous Lonsec Review

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

Lonsec Opinion of this Company

Board of Directors (BOD)

- ARG has its own BOD of seven members. Lonsec considers the BOD to be very accomplished and comprised of a mix of well credentialed professional directors. The BOD also displays good diversity in terms of skills, gender and industry backgrounds. Lonsec notes that the majority of the BOD joined ARG in 2011/2012 following a period of deliberate regeneration. Hence a critique is that the BOD does not have the same extensive co-tenure as displayed by some LIC peers.

- Lonsec notes that outside of Managing Director Jason Beddow, all other directors have been classed as independent by ARG. This includes Non-Executive Chairman, Ian Martin. Lonsec considers Martin to have an impressive track record with a +30 year career in financial services and banking. Martin is also the Chair of ALI.

- Lonsec notes that while he has been retired for four years, Non-executive Director (NED) Robert Patterson had a number of executive roles with ARG over a career spanning 1969 to 2010. Patterson was designated as being an ‘independent’ director in 2015 after having been designated as being ‘non-independent’ over the period 2011-2014. Lonsec highlights that this is in-line with corporate governance principles.

- The governance function of the BOD has been enhanced by a further two sub-committees, the Remuneration Committee (RC) and the Audit & Risk Committee (A&RC). The membership of these sub-committees are derived from the same pool of NED’s as the BOD. ARG has shown its commitment to ‘best practice’ in governance by ensuring that the sub-committees are chaired by individuals other than Martin. Anne Brennan chairs the A&RC and Russell Higgins the RC. Both Brennan and Higgins have relevant industry backgrounds, Brennan in audit/corporate finance and Higgins in the public sector, and have a number of external directorships at high profile ASX-listed companies.

- Lonsec considers ARG’s ability to chair its sub-committees with such high calibre individuals to demonstrate both the breadth and depth of its BOD. Given its scale and track record in the market place, ARG also has a demonstrated ability to attract such individuals to serve in its BOD which gives it an edge in the market-place.

People and resources

- Unlike a number of its competitors, ARG is internally-managed as opposed to outsourcing the investment function to an external party. Under the in-sourced model, ARG funds its own investment team who are employees of ARG. This model has provided ARG with great scalability as its operating expenses are largely fixed and do not grow in-line with net asset growth. This is one of the key reasons why ARG is so fee competitive.

- ARG’s investment team reports through to Beddow who has ultimate accountability for its financial performance. Beddow also sits on the ARG BOD as an Executive Director. Beddow is an experienced and capable investor who first joined ARG in 2001 as an Investment Analyst. Over his 15 year tenure at the Company, Beddow has held a variety of executive roles including CIO, CEO and now MD. Beddow has a diverse skill-set including analysis, options trading and portfolio management. Lonsec cautions, however, that Beddow wears many hats and has a heavy work load.

- Beddow has an investment team of five that reports through to him. This team is led by Senior Investment Officer Andrew Forster who was only recently promoted to this role. Forster has 18 years of industry experience including six years at the Company. Before ARG he held a variety of investment roles at Cannae Capital, Deutsche Asset Management and StateStreet. Lonsec considers Forster to be an appropriately qualified back-up to Beddow.

- ARG’s investment team is very experienced with an average industry track record of 17 years. Average
Argo Investments Limited

tenure at ARG is seven years. Turnover over the years has been low with ARG boasting a history of being able to retain investment talent.

- Lonsec considers the ‘key person risk’ (KPR) for ARG to be moderate. While Beddow as MD is very important to ARG both as an investor and as an executive, there is strong support from the very experienced BOD and the investment team. Beddow also has support from key executives Tim Binks (Chief Operating Officer and Company Secretary) and Andrew Hill (Chief Financial Officer).

- Lonsec considers ARG’s executives and investors to have a strong variable component to their remuneration package. This is delivered via a mix of short and long-term incentive scheme (STI, LTI) which are driven by key financial indicators being met both over 12-months for STIs and four years for LTIs. These tests are that ARG achieves superior earnings per share (EPS) growth versus its LIC peer group and generates a superior total portfolio return (TPR) on an after-tax basis versus the Index. For STI remuneration only, the calculation is split 50% financial with the remaining 50% being earned for a variety of ‘soft’ skill indicators. 100% of the LTI calculation is due to the attainment of the financial metrics.

- Lonsec considers the focus on achieving EPS and TPR targets to closely align the investment team with ARG’s investment objectives. In particular, the focus on an indicator that is vital to dividend sustainability such as EPS growth is important given the appeal of ARG to dividend focussed investors.

- Lonsec highlights that for analysts only, their STI can also be augmented by the performance of a ‘shadow’ portfolio of their monthly stock picks measured against their own specific investment universe (based on sector coverage) over rolling 12-months. Lonsec considers this to be an important factor in analyst retention due to ARG’s very long-dated ‘buy and hold’ philosophy meaning that an analyst’s ‘best ideas’ will not always be reflected in the portfolio at a weight commensurate with an analyst’s conviction levels.

- Lonsec is pleased that both the STI and LTI have a deferred component that acts to ‘lock in’ key staff for the longer term. For the STI, 50% of this amount is in the form of deferred ARG equity which will only vest after a two-years. For the LTI, this is offered in the form of a Performance Right Plan (PRP) which is measured over rolling four-year measurement periods that requires the individual to still be an employee at the vesting date.

Research approach and portfolio construction

- ARG has a well-diversified portfolio of stocks that it considers to meet its quality definitions and this sees the portfolio have a large absolute weight to the ‘top 20’ index stocks. Given ARG’s focus on dividend growth and after-tax outcomes, Lonsec considers it highly unlikely that this approach will change. This approach means that ARG’s research process is more focused on maintenance and identifying ‘torpedo’ stocks both from a capital preservation and a dividend sustainability aspect. 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 research ideas.

- Despite the more static approach, Lonsec considers ARG’s long-standing research process to be comprehensive and repeatable. Stock research is conducted along sector lines and is very much a traditional ‘bottom-up’ approach. The mainstay of the process is a deep company visitation program, the extent of which is reportable to the BOD. The comprehensive visitation program is augmented by quantitative screening, the maintenance of detailed valuation models, industry research and a proactive approach to proxy voting. Any stock specific issues identified are then debated in a weekly research meeting.

- Lonsec highlights that outside of a commitment to diversification, portfolio construction for ARG is more ‘art’ than ‘science’. Rather than critically evaluating its pool of stock ideas for potential portfolio inclusion, ARG has a very long-dated ‘buy and hold’ strategy. Portfolio construction is also tempered by ARG’s requirement to maintain its capital account election which allows it to pass on CGT concessions to its shareholders. This election is dependent on ARG continuing to pass the relevant ATO tests including turnover being well below 10%. Lonsec considers these factors to inhibit ARG’s sell discipline versus competing strategies in the market.

Risk management

- ARG has a separate, diverse and experienced BOD that provides it with its primary level of governance oversight. The BOD’s role is defined by ARG’s Board Charter which stipulates that it is entrusted with stewardship of all strategic, delegation and supervision, risk, governance, nomination and remuneration matters.

- In terms of its supervisory role, this includes the BOD providing oversight of the MD’s performance and succession plans, monitoring of the investment portfolio performance and ratifying all portfolio transactions. The BOD also sets the upfront investment authority limits.

- In terms of risk management, the BOD takes advice on this from the separate AR&C. The AR&C is chaired by NED Anne Brennan who is well qualified for this role. It also has two other members. The A&RC is specifically tasked with providing oversight for financial reporting, internal control structures, risk management systems and external audit functions.

- Lonsec notes that ARG is very ‘benchmark unaware’ with a strong focus on income and capital growth. Hence Lonsec considers the risk for the LIC to be one of income and capital preservation. Lonsec considers ARG’s quality investment philosophy to be critical in ensuring that risk management is embedded within its investment process and focused on these risks.
Debate the following text:

### Argo Investments Limited

- **ARG** has good risk management systems in place, with the investment team having access to a proprietary Macquarie risk management system to monitor all relevant factor, stock, and sector exposures. This means that while ARG does not employ hard sector limits, such exposures are continuously monitored to ensure that no unintended risks are present.

### Capacity

- **As at 31 December 2015, ARG managed an Australian equities portfolio with a mark-to-market valuation of $4.8 billion, representing approximately 0.5% of the S&P/ASX 200 Accumulation Index (‘the Index’) by market capitalisation.** At these levels, ARG is a mid-sized manager in terms of assets under management within Lonsec’s wider Australian equities peer group.

- **ARG does not have a formal view on an appropriate capacity limit for its 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. ARG’s portfolio also has a distinct large cap bias, with 60% of its portfolio being in its top 20 stocks which demonstrates a high degree of cross-over with the ASX 20. This segment of the market tends to be the most liquid. Nonetheless, ARG does have a large tail of smaller stocks and capacity would become a growing issue were the portfolio to grow substantially from this point forward.

- **While Lonsec understands why ARG is less capacity focused than other active processes operating in the market, Lonsec would welcome any efforts to formally incorporate such studies into its risk management processes.**

### Performance

- **ARG has a lengthy operating track record in the market.** A hallmark of this record in Lonsec’s opinion has been ARG's ability to both deliver consistent earnings and dividend growth while avoiding substantial capital drawdown events. It has been ARG’s ability to grow its dividend over time and protect capital that has led to it having such a strong and loyal following and Lonsec considers this consistency to be a key reason why its share price tends to trade in a much closer band to its NAV when compared to some peers. It is also why ARG has been mostly trading at a 5-10% premium to NAV during this current period of low global interest rates.

- **ARG delivered a solid half-year result as at 31 December 2015 (H116), with net profit growing 8.9% to $114.2m and EPS growing 7.6% to 17 cents. This growth in profitability funded a lift in the Dividend per Share (DPS) to 15 cents.** The main drivers of profit growth were the increase in dividends and distributions from the investment portfolio as well as a greater contribution from the buy-write strategy ($7.1m versus $2.1m in the prior corresponding period) due to an increase in market volatility.

- **While a plus for the options overlay, enhanced market volatility witnessed a 1.1% reduction in the NAV per share for the calendar year, down to $7.28 as at 31 December 2015.**

- **In terms of benchmark relativities, based on share price returns ARG has matched or exceeded the returns of the Index over 1, 3 and 5-years.** ARG dividends have also experienced a compound annual growth rate of 2.2% p.a. over the 5-year period ended 30 June 2015. This longer-term track record suggests that ARG is well placed to continue to meet its investment objectives.

### Overall

- **Lonsec has provided Argo with an initial ‘Highly Recommended’ rating.** It has a long-term track record of providing investors with both dividend and capital growth across numerous investment cycles. Lonsec has a high regard for ARG’s proven ability to attract high calibre directors, an advantage which has led to it constructing a Board of Directors with excellent experience and a diverse array of skills.

- **Lonsec has a similar high regard for ARG’s Managing Director Jason Beddow and the support he receives from the experienced investment team.** Other competitive advantages are the low management costs and the conservative investment philosophy.

- **Lonsec notes some concern with the relative lack of sell discipline with ARG being very focused in keeping its turnover well below 10% p.a.** Lonsec will also closely monitor the future direction of ARG’s operating funds management business to ensure that ARG’s EPS does not become materially impacted by the business cycle.

### Company Overview

**Board of Directors**

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

**Size and experience — BOD**

<table>
<thead>
<tr>
<th>Director</th>
<th>Role</th>
<th>Year Joined</th>
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<tbody>
<tr>
<td>IAN MARTIN</td>
<td>INDEPENDENT CHAIR</td>
<td>2004</td>
</tr>
<tr>
<td>JASON BEDDOW</td>
<td>MANAGING DIRECTOR</td>
<td>2014</td>
</tr>
<tr>
<td>ANNE BRENNAAN</td>
<td>NON-EXECUTIVE DIRECTOR</td>
<td>2011</td>
</tr>
<tr>
<td>ROGER DAVIS</td>
<td>NON-EXECUTIVE DIRECTOR</td>
<td>2012</td>
</tr>
<tr>
<td>RUSSELL HIGGINS</td>
<td>NON-EXECUTIVE DIRECTOR</td>
<td>2011</td>
</tr>
<tr>
<td>JOYCELYN MORTON</td>
<td>NON-EXECUTIVE DIRECTOR</td>
<td>2012</td>
</tr>
<tr>
<td>ROBERT PATTERTON ^</td>
<td>NON-EXECUTIVE DIRECTOR</td>
<td>2011</td>
</tr>
</tbody>
</table>

* ^ - first joined ARG in 2001 in an investment role.

* $ - used to be the Managing Director of ARG before retiring in 2010.
Independent Directors Biographies

Ian Martin, Non-executive Chair. Martin has over 30 years of relevant industry experience in the financial services and banking sectors. Martin has a number of other current directorships including with the related-party Argo Global Listed Infrastructure Company. Outside of ALL, he is also the Vice Chairman of Berkshire Capital and an Independent Director with UniSuper. Martin is a member of ARG’s Remuneration Committee.

Anne Brennan, Non-executive Director. Brennan has an extensive track record in audit, corporate finance and transaction services. She has a number of other current directorships including Myer Holdings, Charter Hall Group and Nufarm Limited. Brennan is the Chair of ARG’s Audit & Risk Committee.

Roger Davis, Non-executive Director. Davis has over 30 years of relevant experience in global banking and investment management. He the Chair of Bank of Queensland and is also a director of Aristocrat Leisure and Ardent Leisure. Davis is a member of ARG’s Remuneration Committee.

Russell Higgins, Non-executive Director. Higgins has a non-professional services background, having had an extensive career in the energy and government sectors. Higgins is a current director of APA Group and Telstra. He is a member of ARG’s Remuneration Committee.

Joycelyn Morton, Non-executive Director. Morton has had an extensive career in business and accounting with a specific focus on taxation. She is the Chair of Thorn Group as well as being a director of InvoCare and the related-party ALL. Morton is a member of ARG’s Audit & Risk Committee.

Robert Patterson, Non-executive Director. Patterson has had a lengthy association with ARG, having first begun his professional career there in 1969. He assumed to role of CEO in 1982 and Managing Director in 1992 until he retired in 2010. Patterson has vast experience in the investment management industry. He is a large shareholder in ARG. He has no other directorships. Patterson is a member of ARG’s Audit & Risk Committee.

Board remuneration

NED (including the Chair) remuneration in aggregate must not exceed a limit that has been approved by shareholders via a formal vote. The last time this was voted on was ARG’s Annual General Meeting (AGM) in 2015, where a maximum aggregate limit at $1.1m p.a. in total was set.

In terms of how this is allocated to individual directors, this is also voted on at the AGM. The current NED package is a $92,800 base plus $6,200 for the chair of an and $3,100 for a member of a sub-committee.

ARG’s Chair receives a total package of $198,200 inclusive of any sub-committee appointments.

People and Resources

Size and experience — Investment Team

<table>
<thead>
<tr>
<th>Name/Position</th>
<th>Sector</th>
<th>Years</th>
<th>Industry/dirnm</th>
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<tbody>
<tr>
<td>JASON BEDDOW</td>
<td>MANAGING DIRECTOR</td>
<td>18/15</td>
<td></td>
</tr>
<tr>
<td>ANDREW FORSTER</td>
<td>SENIOR INVESTMENT OFFICER</td>
<td>18/6</td>
<td></td>
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<tr>
<td>DANIEL CUTHBERTSON</td>
<td>INVESTMENT ANALYST</td>
<td>15/5</td>
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<tr>
<td>PAUL FROST</td>
<td>INVESTMENT ANALYST</td>
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<tr>
<td>BRYDIE LLOYD-ROBERTS</td>
<td>INVESTMENT ANALYST</td>
<td>17/12</td>
<td></td>
</tr>
<tr>
<td>COLIN WHITEHEAD</td>
<td>INVESTMENT ANALYST</td>
<td>16/4</td>
<td></td>
</tr>
<tr>
<td>AVERAGE</td>
<td></td>
<td>17/7</td>
<td></td>
</tr>
</tbody>
</table>

Except for the matters expressly reserved for BOD consideration, the BOD has delegated all responsibility for the day-to-day management of ARG to Beddow. Beddow operates within delegated authority limits approved by the BOD and is ultimately accountable to the BOD for all company matters. In terms of investment matters, Beddow is assisted in this task by ARG’s investment team of five. This is a very experienced and stable team and there has only been one analyst departure (Christo Hall) in the last three years.

Outside of investment management, Beddow is assisted by two key senior executives in Tim Binks who acts as Chief Operating Officer and Company Secretary and Andrew Hill who acts as Chief Financial Officer. Binks and Hill are supported by a team of five who implement all back and middle-office functions.

Lonsec notes that the wider ARG team is co-located, with the MD and investment team based out of Sydney and the middle and back-office teams based in Adelaide.

Management Investment Sub-committee

During any absences of the MD, a Management Investment Sub-Committee (MIS) will be responsible for the day-to-day investment transactions subject to the same delegated investment authority limits. The MIS will comprise any two of Forster, Binks and an investment analyst.

Remuneration / Alignment of Interests

Key executives and investment staff have both a fixed and variable component in their remuneration packages. In terms of variable remuneration, this is also a mix of short and longer-term incentives (STI, LTI) which are linked to both Company and individual performance measures. Such measures are at least 50% are financially based. Staff can earn up to 100% of their annual fixed remuneration as a bonus, with the STI/LTI split being 70:30.

Short-term Incentives (STI)

The primary driver of the quantum of STI are two financial performance indicators; the first is the requirement that ARG achieves superior operating EPS growth relative to its LIC peer group and the second is that ARG produces a superior one year total portfolio...
Argo Investments Limited

return (TPR) adjusted for franking credits versus the S&P/ASX 200 Accumulation Index.
Both these tests have been deliberately selected with ARG’s investment objectives in mind. The EPS indicators test the ability of ARG to grow longer-term dividends. The TPR indicator is calculated using ARG’s NAV per share and tests its ability to provide both growth in shareholder returns and outperformance versus the market.

For analysts only, monthly stock picks for each analyst are recorded and measured against their own specific investment universe (based on sector coverage) over rolling 12-months.

50% of the STI awarded in any year is in the form of deferred equities which will vest after a two-year holding period with the other half paid in cash.

Long-term Incentives (LTI)
ARG has a Performance Rights Plan (PRP) driven by the same two financial indicators as the STI. Hence the PRP has been designed to again create a strong link between increasing long-term shareholder value and employee remuneration. The PRP allows BOD to grant performance rights to acquire shares in ARG to a monetary value up to 30% of the fixed remuneration for investment staff and 70% for the MD. The two performance indicators (EPS & TPR) are measured over four years with no re-testing allowed.

If ARG outperforms the Index over four years but produces a negative absolute return, then the BOD has the right to adjust the LTI-component downward. Also the individual must still be with ARG at the vesting date to be awarded the shares.

Research Approach

Overview

<table>
<thead>
<tr>
<th>INVESTMENT STYLE</th>
<th>CORE, MILD VALUE BIAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>RESEARCH UNIVERSE</td>
<td>S&amp;P/ASX 200 ACC INDEX STOCKS</td>
</tr>
<tr>
<td>STOCKS FULLY RESEARCHED</td>
<td>200</td>
</tr>
<tr>
<td>COMPANY VISITS</td>
<td>PORTFOLIO STOCKS MET WITH AT LEAST BI-ANNUALLY AND TYPICALLY 3-4 TIMES P.A.</td>
</tr>
<tr>
<td>INITIAL STOCK FILTERS</td>
<td>LIQUIDITY, EARNINGS, YIELD, VALUE</td>
</tr>
<tr>
<td>TOP DOWN</td>
<td>INPUT ONLY</td>
</tr>
<tr>
<td>BOTTOM UP</td>
<td>100%</td>
</tr>
<tr>
<td>RESEARCH INPUTS</td>
<td>COMPANY VISITATION PROGRAM PROPRIETARY FUNDAMENTAL 'BOTTOM-UP' ANALYST RESEARCH</td>
</tr>
<tr>
<td>QUALITATIVE FACTORS</td>
<td>FRANCHISE STRENGTH, BOARD AND MANAGEMENT, BALANCE SHEET</td>
</tr>
<tr>
<td>USE OF BROKER RESEARCH</td>
<td>IDEA GENERATION ONLY</td>
</tr>
<tr>
<td>VALUATION APPROACH</td>
<td>PRICE-TO-EARNINGS RATIO, DCF</td>
</tr>
</tbody>
</table>

‘Bottom-up’ Research Process

Stock ideas for potential inclusion in the portfolio are generated from a variety of quantitative and qualitative techniques.

The key qualitative sources include the margin of safety between ARG’s internally generated stock valuations relative to current share prices, its assessment of management and board rankings, ESG considerations, industry structure and financial strength. Ideas can also be generated from company meetings, regular meetings with broker analysts and IPOs.

ARG’s quantitative stock rankings are maintained internally by the investment team and are incorporated into FactSet. FactSet is then used to highlight stocks which are subject to meaningful earnings revision, both positive and negative, higher yielding stocks and peer relative rankings on certain valuation measures such as PE or price-to-cash flow.

While the FactSet screening process is not intended to be used as a primary stock selection tool or to create a buy-list of ranked stocks, it can be an additional source for stock ideas while also ensuring that ARG does not miss any stock specific developments.

Once potential stocks have been identified, all aspects of these companies operations, strategy, management and the relevant industry dynamics are thoroughly investigated. This is conducted by the designated sector analyst who prepares an internal report and recommendation for debate in peer review. The analyst will also generate a qualitative company score which acts as a factor in the portfolio construction process.

In particular, the following qualitative areas are analysed:

- Franchise strength – competition, capital intensity, exogenous factors and bargaining power.
- Board and management – operational execution, capital deployment and ESG considerations.

All existing portfolio investments are also reviewed on a regular basis using this process.

Portfolio Construction

Overview

| NUMBER OF STOCKS IN PORTFOLIO | 100 (10% AT THE TIME OF THIS REVIEW) |
| BENCHMARK                     | S&P/ASX 200 ACC INDEX |
| INVESTMENT OBJECTIVES         | CAPITAL GROWTH AND SUSTAINABLE FULLY FRANKED DIVIDEND GROWTH |
| PORTFOLIO DECISIONS           | MANAGING DIRECTOR, BOD |
| STOCK SELECTION               | BOTTOM-UP |
| CASH                          | UNCONSTRAINED |
| MARKET CAP BIAS               | VERY LOW, LESS THAN 5% P.A. |
| EXPECTED PORTFOLIO TURNOVER   | APPROXIMATELY 60% |

ARG’s portfolio construction process is broadly unconstrained outside of a commitment to appropriate stock and sector diversification. This approach is plausible given ARG’s very low turnover approach. Having said this, new positions are added to the portfolio from time-to-time and longer-term portfolio holdings can be added to during periods of market volatility or dislocation.

Under such circumstances, the final portfolio decision takes into account:
Argo Investments Limited

- The qualitative score for a stock.
- The need for both diversification and liquidity across stocks and sectors.
- ARG’s investment objectives.
- Tax considerations – the need to pay fully franked dividends and the ability to pass on capital gain discounts to shareholders. For the former, this means that ARG actively screens for items such as the 45-day rule and the need to hold stocks for 12-months to qualify for capital gains tax discounts.

**Risk Management**

<table>
<thead>
<tr>
<th>Risk limits</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SEPARATE RISK MANAGEMENT</td>
<td>YES</td>
</tr>
<tr>
<td>STOCK CONSTRAINT</td>
<td>NONE</td>
</tr>
<tr>
<td>SECTOR CONSTRAINT</td>
<td>NONE</td>
</tr>
<tr>
<td>GLOBAL EQUITIES</td>
<td>NONE</td>
</tr>
<tr>
<td>CASH</td>
<td>UNCONSTRAINED</td>
</tr>
<tr>
<td>TRACKING ERROR</td>
<td>NOT TARGETED</td>
</tr>
<tr>
<td>DERIVATIVES</td>
<td>NO MORE THAN 5% OF THE PORTFOLIO MAY BE OVER-WRITTEN AT ANY ONE TIME</td>
</tr>
</tbody>
</table>

**Delegated Authority Limits**

The BOD has delegated all investment transactions at both an aggregate and an individual stock limit to the MD or, in his absence, the MIS.

For aggregate transactions, these apply to the total amount of transactions that occur between BOD meeting ratification. The delegated authority limit (DAL) for the MD in this instance is $100m for purchases and the same for sales. Should the MD not be contactable for the entire period, then the DAL for the MIS is set at $50m for each.

Delegated authority limits have also been set for individual stock purchases and sales. For the MD, this is $40m for each category. Were the MD to be absent for these transactions, the authority limit for the MIS is $20m for each.

**Risk monitoring**

The primary risk management monitoring for ARG is performed by its BOD. The BOD has, in turn, delegated some of its oversight duties to the separate A&RC. As a listed entity, the Company also has to meet the ASX listing rules which is an additional oversight ARG is well resourced from a systems point of view and the investment team has access to both a proprietary Macquarie risk management system and Factset.

**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.

**Derivatives**

ARG actively utilises a ‘buy-write’ strategy. Derivatives cannot be used to lever the Company.

**Investment**

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

### Quantitative performance analysis annualised % returns as at 30•04•2016

<table>
<thead>
<tr>
<th></th>
<th>1 YEAR</th>
<th>3 YEARS</th>
<th>5 YEARS</th>
<th>7 YEARS</th>
</tr>
</thead>
<tbody>
<tr>
<td>PERFORMANCE (% PA)</td>
<td>-3.8</td>
<td>7.1</td>
<td>8.3</td>
<td>8.2</td>
</tr>
<tr>
<td>STANDARD DEVIATION (% PA)</td>
<td>10.7</td>
<td>9.1</td>
<td>10.9</td>
<td>11.2</td>
</tr>
<tr>
<td>EXCESS RETURN (% PA)</td>
<td>1.2</td>
<td>2.1</td>
<td>1.9</td>
<td>-1.3</td>
</tr>
<tr>
<td>OUTPERFORMANCE RATIO (%)</td>
<td>41.7</td>
<td>44.4</td>
<td>48.3</td>
<td>47.6</td>
</tr>
<tr>
<td>WORST DRAWDOWN (%)</td>
<td>-8.8</td>
<td>-8.8</td>
<td>-16.5</td>
<td>-22.2</td>
</tr>
<tr>
<td>TIME TO RECOVERY (MTHS)</td>
<td>N/A</td>
<td>N/A</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>SHARPE RATIO</td>
<td>-0.6</td>
<td>0.5</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>INFORMATION RATIO</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>TRACKING ERROR (% PA)</td>
<td>10.6</td>
<td>9.0</td>
<td>8.0</td>
<td>9.2</td>
</tr>
</tbody>
</table>

**BENCHMARK: S&P/ASX 200 ACCUMULATION INDEX**

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

---

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

#### $10k growth over ten years — share price and NAV

- **SHARE PRICE RETURNS**
- **NTA RETURNS**

### Dividend record over 10 years

- **ADJUSTED DIVIDEND (DECLARED)**
- **GROSS DIVIDEND**
Argo Investments Limited

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
Lonsec

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Date prepared

June 2016

Analyst

Peter Green

Release authorised by

Shailesh Jain

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