

Product Review

Argo Investments Limited

ISSUE DATE 12-07-2019

About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LARGE CAP
SUB SECTOR REVIEWED	LIC
TOTAL COMPANIES RATED	12

About this Company

LIC REVIEWED	ARGO INVESTMENTS LIMITED
ASX CODE	ARG
ASX LISTING DATE	1 JULY 1948
COMPANY OBJECTIVE	MAXIMISE LONG TERM RETURNS THROUGH A BALANCE OF CAPITAL AND DIVIDEND GROWTH.
MANAGEMENT COSTS	0.14% P.A.

Market data

MARKET CAPITALISATION	\$5834M
SHARES ON ISSUE	715M
SHARE PRICE (11-7-2019)	\$8.16
52 WEEK HIGH/LOW SHARE PRICE	\$8.32 / \$7.47
NTA (31-5-2019)	\$8.24
52 WEEK HIGH/LOW NTA	\$8.24 / \$7.34
SHARE PRICE PREM/(DISC) TO NTA	-0.97%

Board of Directors

NO. OF DIRECTORS	7
MAJORITY INDEPENDENT DIRECTORS	YES
CHAIRPERSON	RUSSELL HIGGINS
AGGREGATE DIRECTORS FEES	AGGREGATE OF \$793,019
COMMITTEES	REMUNERATION, AUDIT & RISK

About the Investment Manager

INVESTMENT MANAGER	INTERNALLY MANAGED
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Investment Team

PORTFOLIO MANAGER	JASON BEDDOW
INVESTMENT TEAM SIZE	6
INVESTMENT TEAM TURNOVER	LOW

Investment process

STYLE	CORE WITH A MILD VALUE BIAS
BENCHMARK	S&P/ASX 200 ACCUMULATION INDEX
TYPICAL TRACKING ERROR (P.A)	NOT TARGETED
TYPICAL STOCK NUMBERS	90 - 100
TYPICAL CAPITALISATION BIAS	LARGE CAP
STOCK & CASH LIMITS	UNCONSTRAINED
DERIVATIVES	OCCASIONALLY USED - BUY/WRITE OPTIONS
CAPITAL OR REVENUE ACCOUNT ELECTION	CAPITAL

Company rating history

JULY 2019	HIGHLY RECOMMENDED
SEPTEMBER 2018	HIGHLY RECOMMENDED
SEPTEMBER 2017	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 or Company) ability to meet its stated investment objectives. The extent of any 'point-in-time' divergence between ARG's share price and its underlying Net Tangible Asset Value (NTA) 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 NTA 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.

Strengths

- Multi-decade track record of consistently increasing dividends.
- Experienced and diverse Board of Directors.
- Well-resourced investment team capably led by the Managing Director Jason Beddow.
- Very low management cost (annual fixed cost of 0.14% of NTA for 2018).
- ARG's structure allows it to pass through capital gains tax concessions to its shareholders.

Weaknesses

- Sell discipline is diminished due to requirements to maintain very low portfolio turnover for philosophical and tax reasons.
- Relatively unconstrained portfolio management process.
- ARG has a fledgling funds management operation which may cause distraction for executives, whilst elevating related party risks.

Company Risk Characteristics

	LOW	MODERATE	HIGH
CAPITAL VOLATILITY			●
CORPORATE RISK		●	
RELATED-PARTY RISK		●	
VALUATION RISK		●	
SECURITY CONCENTRATION RISK	●		

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial 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. 421445. 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.

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BIOMetrics

Aggregated risks

	1	2	3	4	5	6	7
STD 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 ASFA/FSC guidelines.

	LOW	MODERATE	HIGH
RISK TO INCOME	●		

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY		●	
ESG AWARENESS		●	

Fee profile

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

Fee BIOMetrics are a function of expected total fee as a percentage of expected total return.

What is this Company?

- Argo Investments Limited (ARG or 'the Company') is the second largest LIC by market capitalisation on the Australian Securities Exchange (ASX). First listed in 1948, ARG has a market capitalisation of \$5.6bn (April 2019) and has 86,000 shareholders.
- ARG is internally managed and its investment objective is to maximise returns through a combination of capital and dividend growth. ARG is a firm believer in the 'cumulative' effect of holding quality companies over multiple cycles. ARG will opportunistically seek to add to its core positions during shorter-term share price volatility which introduces a mild value bias to the portfolio.
- ARG's focus is on paying a growing stream of fully franked dividends, Lonsec expects ARG to deliver relative 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 diversified portfolio of around 100 stocks and 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' approach but also caused by its tendency to be an infrequent seller. While partly attributed to its investment philosophy, the very low portfolio turnover also allows ARG to maintain its 'capital account' election. This allows it to pass through 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 received from its large-cap oriented portfolio. However, ARG does have the scope to generate additional income from interest earned on cash deposits, option premium received from writing exchange-traded options ('buy-write') and a small trading account. With the 'buy-write' sleeve, Lonsec notes that this will be tightly constrained and in

practice the portfolio will rarely be more than 5% over-written.

- Lonsec highlights that by virtue of being internally-managed, ARG is not constrained by a pre-defined investment mandate. Rather the ARG Board of Directors (BOD) drives the strategic initiatives of the Company. While dedicated to meeting ARG's investment objectives, the BOD did highlight an entrepreneurial bent by adding funds management to its business model.
- In particular, ARG will receive an annual fee for managing the operations of the 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 do 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 income for ARG.
- ARG is a substantial shareholder in ALI (it currently holds 12.5m shares or 8.8% of its issued capital). ARG and ALI also share two directors. Lonsec highlights the related-party risk inherent in this shareholding whilst noting that ARG has clear 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 employee remuneration, director fees and shareholder related expenses.
- Due to economies of scale in running a reasonably large equities portfolio (approximately \$5.6bn) and a relatively fixed cost base, ARG's annual expenses were 0.14% in 2018. This compares favourably with externally-managed LICs/ETFs and managed funds with a similar focus on providing investors with a broad exposure to Australian equities.
- Lonsec observes that there are a number of well-established Australian equity LICs that have a similar internally-managed structure and hence similar fee levels; these typically have a 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 NTA for extended 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 and a lengthy track record of paying fully-franked dividends. Secondly, ARG's BOD has a solid capital management record. This includes an on-going share buy-back facility, DRPs close to NTA and SPP at a premium to NTA and a conservative approach to its dividend payout ratio and after tax outcomes.

Using this Company

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

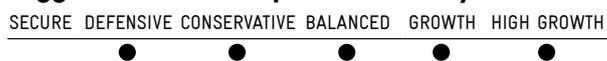
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- ARG is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in its portfolio. Potential investors should therefore be aware of, and comfortable with, the potential for ARG to experience 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 the income stream is an outcome of ARG being principally 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 an annual 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, small cap, long short, or absolute return products.

Suggested Lonsec risk profile suitability



For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- ARG's total management cost for 2018 was 0.14%.
- There have been no changes to the process or investment team since Lonsec's previous review.

Lonsec Opinion of this Company

Board of directors

- ARG has its own BOD of seven members. Lonsec considers the BOD to be very accomplished and comprised of a mix of well-credentialed directors. The BOD also displays good diversity in terms of skill set, gender and industry expertise and 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 long standing co-tenure as displayed by some LIC peers.
- Chris Cuffe's addition to the board in 2016 is viewed by Lonsec positively. Cuffe is highly experienced within the investment management industry while also holding numerous board positions outside of ARG.
- Lonsec notes that outside of Managing Director Jason Beddow, all other directors have been classed as independent by ARG. This includes Non-Executive Chairman, Russell Higgins AO. Higgins joined the Board in 2011 and was appointed Chairman on 1 July 2018. Lonsec considers Higgins to be an experienced company director, with an extensive background in the energy and infrastructure sectors, he also has a strong understanding of the Company. Higgins is

also Chairman of Argo Global Listed Infrastructure Limited and was previously Non-Executive Director of APA Group and Telstra Corporation Ltd.

- The governance function of the BOD is enhanced by two additional delegated sub-committees, the Remuneration Committee (RC) and the Audit & Risk Committee (A&RC). The membership of these sub-committees is 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 Higgins. Anne Brennan chairs the A&RC and Roger Davis the RC. Both Brennan and Davis have relevant industry backgrounds.
- 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 marketplace, ARG also has a demonstrated ability to attract such individuals to serve in its BOD which gives it an edge in the marketplace.

People and resources - Investment manager

- Unlike a number of its LIC peers, 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 considerable economies of scale 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's fees are highly competitive.
- ARG's investment team reports through to Beddow who has ultimate accountability for the LIC's 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 18 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 stretched workload.
- Beddow has an investment team of five that reports through to him. This team is led by Senior Investment Officer Andrew Forster. Forster has 21 years of industry experience including nine years at the Company. Before ARG he held a variety of investment roles at Cannae Capital, Deutsche Asset Management and State Street. Lonsec considers Forster to be an appropriately qualified back-up to Beddow.
- ARG's investment team is highly experienced with an average industry professional experience of 20 years. The average co-tenure at ARG is 10 years. Recent turnover has been fairly low with two departures over the past five years.
- 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

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(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 combination 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 indicators 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 and shareholders. 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 focused investors.
- Lonsec highlights that for analysts only, their STI can also be augmented by the performance of a 'shadow' portfolio of their 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 year period. For the LTI, this is offered in the form of a Performance Right Plan (PRP) which is measured over rolling four year periods that requires the individual to remain an employee at the vesting date.

Research and portfolio construction

- ARG has a diversified portfolio of stocks that it considers to meet its quality criteria and this sees the portfolio have a large absolute weight to the 'top 20' index constituents. 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 perspective. This is different from many other 'bottom-up' research processes which seeks to re-generate the portfolio from time-to-time based on the opportunity set of best ideas.
- Despite the more static approach, Lonsec considers ARG's long-standing research process to be extensive and repeatable. Stock research is conducted along sectoral lines and is very much a traditional 'bottom-up' approach. The mainstay of the process is the extensive company visitation program, the extent of which is reportable to the BOD. The 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' approach. Portfolio construction is also tempered by ARG's requirement to maintain its capital account election which allows it to pass through CGT concessions to its shareholders. This election is dependent on ARG continuing to pass the relevant ATO tests including portfolio turnover being below 10% p.a. Lonsec considers these factors to inhibit ARG's sell discipline versus competing strategies in the marketplace.
- Lonsec notes compared to peers, ARG tends to utilise its short-term trading account. This account can be used for the short-term purchases of stocks (under 12 months) to take advantage of IPOs, market mis-pricings and corporate actions. These short-term investments do not breach ARG's 10% turnover threshold as they are assigned to a segregated account. Lonsec views ARG's occasional use of this account as pragmatic and to have the potential to positively contribute to overall returns.
- Additionally, Lonsec views positively ARG's occasional utilisation of options to generate additional income through buy-write and covered call option strategies (i.e. selling call options and selling put options). The option premium earned by selling short-dated put (call) options to enter (exit) stock positions which supplements the portfolio's capital returns and also creates a buffer against future price drops by lowering a stock's effective purchase price. Prudently, Lonsec notes that ARG has established price targets prior to writing options and therefore is not prone to forfeiting 'potential upside' in their view if a call option written by ARG is exercised.
- Lonsec further notes that income earned from options will generally be less tax efficient for Australian taxpayers than fully franked dividends, however, unlike capital gains, option premium provides greater certainty of returns, which is attractive particularly during volatile markets.

Risk management

- ARG has a separate and experienced BOD that provides it with its primary level of investment 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 portfolio performance and ratifying all portfolio transactions. The BOD also sets the upfront investment authority limits.

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- In terms of risk management, the BOD takes advice on this from the separate A&RC. The A&RC 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 controls, risk management systems and external audit functions.
- Lonsec notes that ARG has a strong focus on income and capital growth. Hence Lonsec considers the risk for the LIC to be of income and/or capital losses. 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.
- 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 or biases are present.

Funds under management

- As at 30 April 2019, ARG managed an Australian equities portfolio with a mark-to-market valuation of \$5.6bn, representing approximately 0.4% of the S&P/ASX 200 Accumulation Index ('the Index') by market capitalisation. At this level, ARG is a mid-sized manager in terms of funds 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 will mostly be driven by performance rather than future inflows. ARG's portfolio also has a distinct large cap bias with approximately 60% of its portfolio being in the top 20 stocks. This segment of the market tends to be the most liquid. Nonetheless, ARG does have a large tail of smaller cap stocks and capacity would increasingly become an issue were the portfolio to grow substantially from this point forward.
- While Lonsec understands why ARG is less capacity focused than other active managers operating in the market, Lonsec would welcome any efforts to formally incorporate such studies into its risk management process.

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 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 NTA when compared to some LIC peers.
- ARG delivered a strong first half-year result as at 31 December 2018 (H119), with net profit increasing 42.2% to \$157.2m and EPS increasing 39.0% to 22.1 cents. The main drivers of the profit uplift were one

off dividend payment from the Coles demerging from Wesfarmers and dividend increases from BHP, Rio Tinto, CSL, Macquarie Group and Ramsay Healthcare. Interest income was steady, although income from trading and option writing increased from \$4.5m to \$6.8m. The interim dividend was 16 cents per share fully franked, an increase of 3.5% pcp.

- Argo's NTA performance returned 9.0% after all costs and tax over the year to April 2019, underperforming the S&P/ASX 200 Accumulation Index by 1.4%. Argo's share price has been trading at a small discount to NTA, resulting in a share price return of 5.0% over the same period. Over the five-year period ending 30 April 2019, Argo's share price returned 5.6% p.a., underperforming the benchmark before franking credits.

Overall

- Lonsec has maintained the 'Highly Recommended' rating at this review. ARG 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 high opinion for ARG's Managing Director Jason Beddow and the support he receives from the experienced investment team. Other competitive advantages are ARG's low management cost, active utilisation of its short-term trading account and occasional use of derivatives to generate higher income and relative conservative investment philosophy.

People and Resources

Corporate overview

Argo was established in 1946 and is a long-term investment company listed on the Australian Securities Exchange (ASX code: ARG).

Argo shares offer investors a professionally managed and diversified exposure to the Australian equity market.

The Company has over 86,000 shareholders and a market capitalisation of \$5.6bn.

Size and experience - Board of directors

NAME	POSITION	YEAR JOINED
RUSSELL HIGGINS	NON-EXECUTIVE CHAIR	2011
JASON BEDDOW ^	MANAGING DIRECTOR	2014
ANNE BRENNAN	NON-EXECUTIVE DIRECTOR	2011
CHRIS CUFFE	NON-EXECUTIVE DIRECTOR	2016
ROGER DAVIS	NON-EXECUTIVE DIRECTOR	2012
JOYCELYN MORTON	NON-EXECUTIVE DIRECTOR	2012
ELIZABETH LEWIN	NON-EXECUTIVE DIRECTOR	2018

^ - Joined ARG in 2001 in an investment analyst role.

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

Russell Higgins, AO, Non-Executive Chairman.

Higgins has a non-professional services background, having had an extensive career in the energy and government sectors. Higgins was previously a director of APA Group and Telstra Corporation. He 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.

Chris Cuffe, AO, Non-Executive Director. Cuffe has more than 25 years of experience in wealth management. He is the former CEO of Colonial First State and Challenger Financial Group. He is chairman of Fitzpatrick Private Wealth and is a Non-Executive Director of Global Value Fund Limited and Antipodes Global Investment Company Limited.

Roger Davis, Non-Executive Director. Davis has over 30 years of relevant experience in global banking and investment management. He is the Chair of Bank of Queensland and is also a director of Ardent Leisure. Davis is the Chair 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.

Elizabeth Lewin, Non-Executive Director. Lewin has over 25 years of international experience in the financial services sector. She is also a Non-Executive Director of Colonial First State Investments Ltd, Colonial Mutual Superannuation Pty Ltd and Avanteos Investments Ltd.

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 \$6,400 for the chair of a sub-committee or \$3,200 for a member of a sub-committee.

ARG's Chair receives a total package of \$204,100 inclusive of any sub-committee appointments.

Size and experience - Investment team

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
JASON BEDDOW	MANAGING DIRECTOR	21 / 18
ANDREW FORSTER	SENIOR INVESTMENT OFFICER	21 / 9
PAUL FROST	INVESTMENT ANALYST	21 / 10
BRYDIE LLOYD-ROBERTS	INVESTMENT ANALYST	20 / 15
COLIN WHITEHEAD	INVESTMENT ANALYST	19 / 7
ANDREW MOLLER	INVESTMENT ANALYST	19 / 2
AVERAGE	-	20 / 10

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 analysts. This is a very experienced and fairly stable team, with two analyst departures (Daniel Cuthbertson, Christo Hall) in the last five 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.

Investment team remuneration

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% 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 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 tests the ability of ARG to grow dividends over the longer-term. The TPR indicator is calculated using ARG's NTA per share and tests its ability to provide

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both growth in shareholder returns and outperformance versus the market.

For analysts only, 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 equity 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 create a strong link between increasing long-term shareholder value and employee remuneration. The PRP allows the 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

INVESTMENT STYLE	CORE WITH A MILD VALUE BIAS
RESEARCH UNIVERSE	S&P/ASX 200 ACCUMULATION INDEX
STOCKS FULLY RESEARCHED	200
COMPANY VISITS PORTFOLIO STOCKS MEET WITH AT LEAST BI-ANNUALLY AND MORE TYPICALLY 3-4 TIMES P.A.	
INITIAL STOCK FILTERS	LIQUIDITY, EARNINGS, YIELD, VALUATION
TOP DOWN	20%
BOTTOM UP	80%
RESEARCH INPUTS	COMPANY VISITATION PROGRAM, PROPRIETARY FUNDAMENTAL 'BOTTOM-UP' ANALYST RESEARCH
QUALITATIVE FACTORS	FRANCHISE STRENGTH, BOARD AND MANAGEMENT, BALANCE SHEET.
USE OF BROKER RESEARCH	IDEA GENERATION ONLY
VALUATION APPROACH	DISCOUNTED CASH FLOW (DCF), NET PRESENT VALUE (NPV), ENTERPRISE VALUE TO EARNINGS BEFORE INTEREST, TAX, DEPRECIATION & AMORTISATION (EV/EBITDA), PRICE TO EARNINGS (P/E), SUM OF THE PARTS (SOTP)

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 valuation relative to current share price, assessment of management and board rankings, ESG considerations, industry structure and financial strength. Ideas can also be generated from company meetings, meetings with sell-side 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, higher yielding stocks and peer relative rankings on certain valuation measures such as P/E 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 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.
- Financial strength – balance sheet, earnings transparency, earnings predictability, dividend sustainability and growth.

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

Portfolio Construction

Overview

NUMBER OF STOCKS IN PORTFOLIO	93 (APRIL 2019)
BENCHMARK	S&P/ASX 200 ACCUMULATION INDEX
INVESTMENT OBJECTIVES	CAPITAL GROWTH AND SUSTAINABLE FULLY FRANKED DIVIDEND GROWTH
PORTFOLIO DECISIONS	MANAGING DIRECTOR, BOD
STOCK SELECTION	BOTTOM-UP
MARKET CAP BIAS	LARGE
EXPECTED PORTFOLIO TURNOVER	VERY LOW, LESS THAN 5% P.A
% OF PORTFOLIO IN THE 'TOP 20'	APPROXIMATELY 60% (APRIL 2019)

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 portfolio 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:

- 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.

Argo Investments Limited

ISSUE DATE: 12-07-2019

Risk Management

Risk limits

SEPARATE RISK MONITORING	YES
STOCK LIMIT	NO HARD LIMIT
SECTOR LIMIT	NO HARD LIMIT
CASH LIMIT	NO HARD LIMIT

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 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 perspective and the investment team has access to both a proprietary Macquarie risk management system and FactSet.

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 NTA for extended periods of time.

ANALYST: ROBBIE LEW | APPROVED BY: SHAILESH JAIN

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Quantitative Performance Analysis - annualised after-fee % returns (at 31-5-2019)

Performance metrics

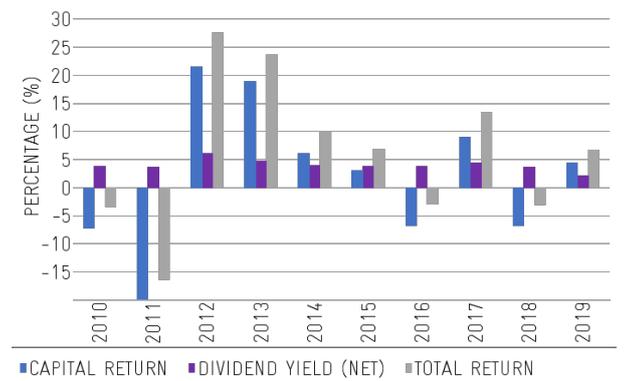
	1 YR	3 YR	5 YR	10 YR
TOTAL RETURN (% PA)	5.42	7.26	5.49	7.23
STANDARD DEVIATION (% PA)	6.16	5.77	7.54	9.76
EXCESS RETURN (% PA)	-5.66	-3.34	-2.25	-2.82
WORST DRAWDOWN (%)	-5.62	-6.12	-9.17	-22.31
TIME TO RECOVERY (MTHS)	5	13	13	15
TRACKING ERROR (% PA)	7.89	8.58	9.24	8.91

FUND: ARGO INVESTMENTS LIMITED
 BENCHMARK USED: S&P/ASX 200 TR INDEX AUD
 TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

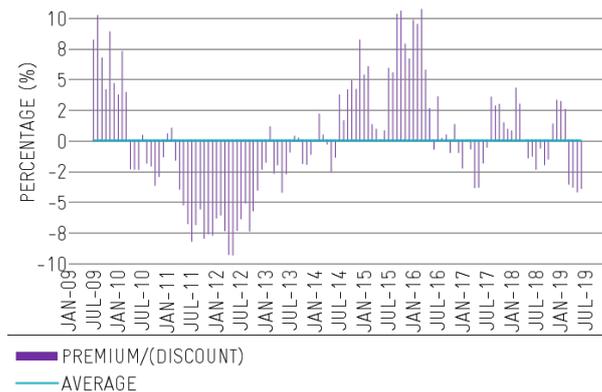
Growth of \$10,000 over 10 years



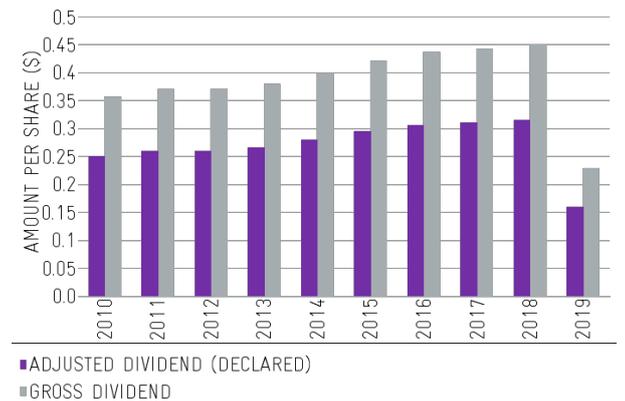
Calendar Year Returns over 10 years



Share Price Premium/Discount to NTA over 10 years



Dividend Record over 10 years



ANALYST: ROBBIE LEW | APPROVED BY: SHAILESH JAIN

Argo Investments Limited

Glossary

[Click here for the glossary of terms.](#)

About Lonsec

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Analyst Disclosure and Certification

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