ARGO INVESTMENTS LIMITED
ABN 35 007 519 520

2017 Annual General Meeting
MANAGING DIRECTOR'S ADDRESS

Delivered by Mr. Jason Beddow at the 71st Annual General Meeting of Argo Investments Limited (Argo or Company) held at the Adelaide Oval on Monday 23 October 2017 at 10.00am.

In approximately one week we will commemorate the 10 year anniversary of the beginning of what became known as the Global Financial Crisis or GFC. The Australian stock market index, the S&P/ASX 200 peaked on the 1st of November 2007 at 6,852 points and from this day fell consistently for 16 months before reaching its low of 3,145 points, some 54% lower. Ten years later we are yet to retest the pre-GFC high, with the market currently trading at approximately 5,900 points, up 87% from its lows, but yet to achieve a close above 6,000 and well below the headline returns of some international markets.

Now while that may sound quite depressing, this price index does not include the dividends that shareholders have received along the way. Dividends are captured in a broader index, the one we benchmark ourselves against, the S&P/ASX 200 Accumulation Index, which reflects the total return of the index combining capital growth and dividends paid. While this index also peaked in early November 2007 and fell 50% over a similar time, it has since recovered and grown to be trading at all-time highs, up 170% from the March 2009 lows, rewarding longer term investors who stayed the course.

Whilst the greatest excitement occurs in years when the stock market returns over 20% or a certain sector delivers extraordinary returns, the reality is that over a long history, dividends have generated about half of the total return delivered to investors from Australian shares. This is a key feature and difference of the Australian market, compared to other major world stock markets where the dividend component of an investor's total return is much lower at closer to 20%.

Over the investment cycle, dividends are generally more stable than either company earnings or share prices. For this reason, we are always considering the sustainability of a company's dividend in our stock selection process, and we try to be alert for 'dividend traps' where the high dividend yield of a company may simply reflect the low share price due to an expected dividend cut.

Despite the recent volatility in individual companies' dividends, including a number of bellwether stocks reducing their dividends, Argo has been able to grow its dividend paid to shareholders through this period. This highlights the benefit of diversification, in that Argo's dividend is generated from a range of industries via its portfolio of investments and this helps to reduce the volatility of dividends from individual investments through fluctuating economic and industry cycles.

Argo shareholders receive fully franked dividends. The imputation credits additionally benefit investors and when this is taken into account, increase the dividend component of the long term total return of the market further. For example, a tax-free investor such as a superannuation fund in pension mode is able to claim a refund of imputation credits and effectively receives $1.43 for each $1.00 of a fully franked dividend. As a long term investor, Argo also has the ability from time to time to further enhance the post-tax return to shareholders by adding an LIC capital gain component to dividends from tax paid on capital profits.

We spend a lot of time valuing our investee companies, including assessing the robustness of their cash flows and dividend paying capacity. This is in line with our objective to grow the income stream from our investee companies at a rate that delivers a growing earnings per share (or 'EPS') profile for Argo and allows us to sustain and grow the dividend we pay to shareholders.

Our internal forecasts for the next two years show a compound dividend growth from the current Argo portfolio of just under 5%. As we look forward over the next few years for the increasingly elusive combination of quality companies who are providing earnings and dividend growth at reasonable value, we are encouraged by the outlook for a number of the companies in our portfolio.

Investment Portfolio

During the 2017 financial year, the major purchases in the portfolio were:-

Boral, CBL Corporation, CSL, Estia Health, QANTM Intellectual Property - a new holding, Rural Funds Group, Tabcorp Holdings, Tassal Group and Vocus Group.

Overall, we increased our holding in 26 existing stocks and added 5 new holdings to the portfolio, with the other four being oOh!media, Speedcast International, Murray River Organics and Motorcycle Holdings.

Major sales were:-

Asciano (takeover), ASX, Australian United Investment Co., Downer EDI, DUET Group (takeover), Milton Corporation and Rio Tinto.

Since our 30 June balance date, approximately $50 million has been spent on further investment purchases. We have added to our CBL Corporation and oOh!media positions, with other major purchases in Event Hospitality & Entertainment, Monash IVF Group, Primary Healthcare, Tabcorp Holdings and Telstra Corporation. Overall, the portfolio currently has 99 holdings.

A company that may not be overly familiar to shareholders is Event Hospitality & Entertainment (EVT), following its name change from Amalgamated Holdings. Event is over 100 years old and provides a unique exposure to the Australian tourism market. They operate 142 cinemas under the Event and Greater Union brands and 54 hotels, under the Rydges, Atura and QT brands, with a new Atura Hotel being built at Adelaide airport.

Roughly half of its earnings come from Cinema operations in Australia, New Zealand and Germany and the other half from hotels and property in Australia and New Zealand. Event also operates Thredbo Alpine Resort in New South Wales. We believe cinema remains a core entertainment option for people, enhanced by premium offerings such as Gold Class and blockbuster films that are still best viewed on a big screen.

Event has a strong track record of buying property and patiently redeveloping over time. A recent example is the acquisition of properties at 458 to 472 in George Street Sydney, adjacent to existing Event properties, including the QT Hotel Sydney and State Theatre. This will provide a large redevelopment opportunity in the south eastern corner of George and Market St, opposite the QVB building, forming part of a premier shopping district. We recognise Event as a well-managed, high quality company with a solid long term earnings profile, supported by a strong balance sheet.

Portfolio Composition

When comparing Argo's 20 largest equity investments, based on market values at 30 September 2017, to this time last year, Westpac Banking Corporation and Australia & New Zealand Banking Group remain our two largest holdings. There are two new additions to the top 20, being Origin Energy which has recovered somewhat with an improvement in the oil price and domestic energy markets, and Computershare which has significant leverage to increasing interest rates on its short term cash balances, particularly in the US. They replace Transurban Group and Brambles. The top 20 stocks still make up approximately 60% of the overall portfolio, though similar to recent years as seen in our purchases, there has been a more meaningful bias towards making investments outside of our top 20.

We continue to believe that one of the strengths of Argo's portfolio is its diversification. This is illustrated by its spread across industry groups. Since this time last year, the main changes have been an increase in our weighting to Materials, in particular resource stocks as they have rallied strongly, other Financials and as we have noted, a higher cash weighting. Utilities have decreased, largely a result of the DUET takeover, along with telecommunications and consumer staples.

The strength in our market over the past year was led by the return to favour of the larger companies. However, some of the best individual share price performers were mid-size companies, especially in the resources sector. Most sectors of the Australian market recorded healthy gains for the year, with the best performing sectors; Chemicals, Diversified Financials, Food & Beverages, Metals & Mining and Pharmaceuticals. The only sectors to record negative returns were Telecommunications and Property. In our view this has led to some stretched market valuations.

Rural Funds Group

We have been attracted to the underlying thematic of agriculture for some time, but there are limited opportunities in the listed market. One investment we have made is in Rural Funds Group (RFF). RFF is an agricultural real estate investment trust which owns a diversified portfolio of high quality Australian agricultural assets, including the valuable water rights. Assets are diversified across six agricultural sectors; Cattle, Vineyards, Poultry, Cotton, Macadamia Nuts and Almonds and are leased to a range of quality ASX-listed and privately-owned agricultural operators, including Treasury Wine Estates, Olam Orchards and Select Harvests.

The RFF investment strategy targets underutilised or undercapitalised assets, that with good management and targeted capital improvements, can be made more productive, and in time, more valuable. The RFF investment strategy is a balance between shorter term increases in asset values, followed by longer term increases in rental income.

This strategy of increasing productivity is supported by the skills of an external manager, Rural Funds Management (RFM) which has deep operational knowledge in the sectors in which assets are leased.

A key part of ongoing management is the identification and funding of development and capital expenditure programs. It is expected that RFF will spend $81 million on capital development over the next three years. This expenditure aims to make the properties more productive for the lessee and attracts increased rent as it is deployed. For example since acquiring the cattle properties, stocking rates have increased 27% following RFF funded improvements, including additional water infrastructure and pasture improvement. In time these productivity gains will be reflected in the property valuations.

Since listing, RFF has delivered solid gains, via enhanced rental yields and capital growth across its asset portfolio and we believe that RFF will continue to find further opportunities in the agricultural sector.

Outlook

Global share markets have continued to march upwards, particularly in the US, driven by the rapidly growing technology sector which has pushed stock market indices to daily record highs. This optimism has spread to Europe and Japan where economic growth is at last recovering. This improvement in global growth remains supportive of markets despite relatively high valuations. However, we are cautious on the prospect of higher interest rates in the US and the potential unwinding of stimulus across a number of developed economies.

The 19th National Congress of the Communist Party of China is currently taking place, to elect the future leaders of that country. While many well documented structural concerns exist in the Chinese economy, we believe that the incentive to maintain relatively high levels of economic growth remains. Ongoing economic growth in China is vital to the performance of the Australian resources industry and more broadly the Australian economy.

In Australia, the recent reporting season of corporate earnings was fairly good, with profits and dividends declared largely in line with our modest expectations. However, with the market now trading at fairly high levels, we don't feel this alone is enough to drive markets materially higher in the short term.

The banks face some well-publicised headwinds, although they are likely to deliver solid results over the next 2 weeks. The recent strength in the Australian dollar may hamper companies with substantial offshore earnings, however we expect the domestic economy will continue to grow, with unemployment relatively low and interest rates at historical lows. We are wary of what appears to be an overstretched consumer at a time of high household debt levels and increasing costs of living, including the surge in energy prices.

Technological change and disruption continues to be a reality, with organisations facing exponential rates of change. Electric and autonomous cars, AI (or artificial intelligence) and the disruption of Amazon to traditional retail channels are just some of the topics trending strongly in the media and investment reports. Some impacts are being felt today, disrupting established business models, while others will be felt over a longer period of time.

Electric Vehicles (EV) for example are currently in the spotlight. Amongst many other impacts, this EV revolution will cause huge changes to commodity demand in the future, although currently only about 1.0% of all vehicles sold in 2017 are expected to be battery-powered. Compounding this is the different commodity intensity between competing battery types and technologies. Who will be the winner? We are watching this space, but we think prices for lithium and cobalt for example have gotten ahead of themselves on the thematic, as opposed to actual demand which, is not likely to significantly grow until into the next decade.

We are not complacent as to how quickly these changes may occur. When we meet with the senior management teams of our investee companies, we are particularly interested to hear how these companies are thinking strategically for the longer term, at a time when many traditional business models are being confronted with significant structural change.

The Company's investment philosophy remains at the core of what we do. We remain comfortable with our diversified portfolio of quality companies, however we are increasingly challenging ourselves in a time of more rapid technological change and we will continue to invest prudently for the long term benefit of Argo and its shareholders.

I would also like to make a closing comment to acknowledge the efforts of our small team at Argo and the contribution from the Non-Executive Directors, who continue to challenge, advise and support us.