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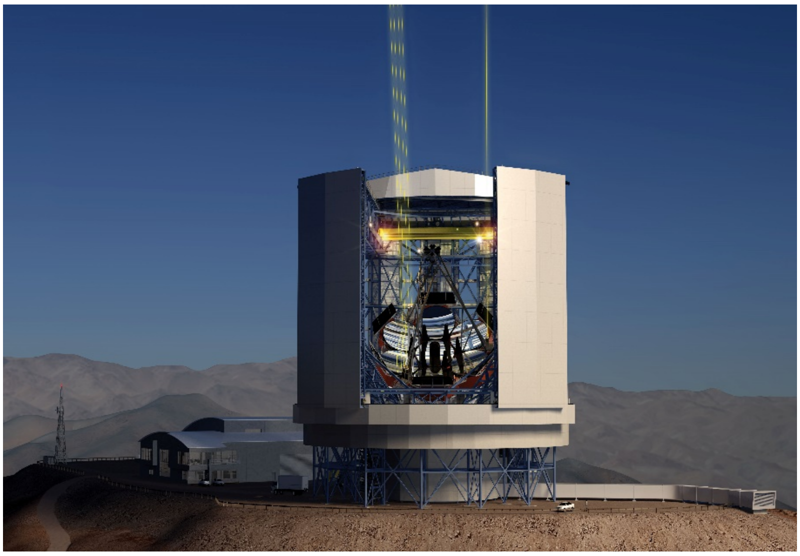

March 2017

In this quarterly edition, we review performance and attribution. We have outlined our key thoughts on the recent reporting season. We review Qube and join the important debate on remuneration. Finally, we comment on the importance of business focus. Image: “Plans for greater focus”–The Giant Magellan Telescope to be commissioned in 2022.

Selector Funds Management Limited
ACN 102756347 AFSL 225316
Level 3, 10 Bridge Street
Sydney NSW 2000 Australia
Tel 612 8090 3612
www.selectorfund.com.au

selector

About Selector

We are a boutique fund manager with a combined experience of over 150 years. We believe in long-term wealth creation and building lasting relationships with our investors.

Our focus is stock selection. Our funds are high conviction, concentrated and index unaware. As a result, we have low turnover and produce tax effective returns.

We seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management.

Dear Investor,

The word "focus" has gained greater prominence amongst company executives and boards over the course of the year. A competitive global landscape and structural industry challenges have forced their hand. Selling off non-core operations, paying off debt and returning funds to shareholders, have become fashionable. In truth, all businesses should aspire to these outcomes rather than acting when pressured to do so.

This is most evident in the resources sector. The ongoing recovery in metal prices has played a significant part in the re-focusing of priorities with the sector's main players including BHP Billiton, Rio Tinto and Fortescue all enjoying swelling cash flows and a new desire to cut company debt levels. Similarly, industrially based groups including the likes of Crown Resorts, Woolworths and Wesfarmers all see sense in streamlining business operations.

It is a trend that will likely continue and should by default deliver better long-term outcomes but that will not in itself deliver sustainable growth. The focus also needs to extend to ongoing new investment spend to drive future sales and ultimately higher profits.

Our focus is very much about identifying these types of businesses: those which operate within a core business competency, supported by reinvestment that aims to protect current profitability as well as nurturing new revenues streams.

The U.S. Federal Reserve's latest actions in lifting interest rates for just the third time since the global financial crisis (GFC) are a welcome sign, restoring some sense of balance in a world awash with cash and debt. While Iceland appears to have emerged from the GFC in strong shape, having taken its medicine in not bailing out its banks, others have not fared as well. Rising interest rates and higher share markets appear at odds with each other but as we have experienced time and again, things are not always as they seem.

Following many years of benign corporate earnings growth, the most recent reporting season provided some optimism that better times lie ahead. The caveat as always is stock selection, a situation which is unlikely to change.

In this quarterly we outline our thoughts on the importance of business focus, discuss executive remuneration, comment on Domino's Pizza Enterprises, provide a brief profile on logistics group Qube Holdings, and finally we dissect individual results emanating from the latest reporting season.

For the March 2017 quarter the Fund delivered a gross positive return of **1.77%**. In contrast the All Ordinaries Accumulation Index has delivered positive returns of **4.50%** over the same period. For the financial year to date the Fund has returned a gross gain of **6.47%** against the Index rise of **14.89%**. We trust you find the report informative.

Regards,

Selector Investment Team

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Quote: Michael Cameron

Suncorp CEO

"I haven't seen cross-selling being a good concept for customers…it has not worked anywhere in the world. When I talk to ASIC or APRA, it's very hard not to argue that that's not a sensible outcome for the customer."

Cross selling has been a buzz word that most banking and insurance organizations have pushed, with an aim to expand product sales throughout a firm's customer base. Suncorp's CEO Michael Cameron is now laying out the reality, that this thinking, whilst conceptually correct fails to generate the returns expected.

To this end, Suncorp is looking to exit its life insurance division. This is a business that requires significant capital upfront and even more when premiums are written. Cameron noted that cross selling of company owned products, a strategy that has been used historically by the majority of financial institutions, was no longer a sustainable business model. Rather, the value is in sourcing independently manufactured products that are distributed under the company brand. ***SFM***

Performance March 2017

For the quarter ending March 2017, the Fund delivered a gross positive return of **1.77%** as compared with the **4.50%** rise in the All Ordinaries Accumulation Index.

Performance since inception

Returns	Gross Fund Return %	All Ordinaries Accumulation Index %	All Ordinaries Index %
3 Months	1.77	4.50	3.23
6 Months	-4.99	9.11	6.85
1 Year	8.44	19.49	14.60
3 Years annualised	13.16	7.56	3.00
5 Years annualised	20.09	10.66	5.96
10 Years annualised	6.60	4.25	-0.13
Since Inception annualised	11.71	8.13	3.34

Fund's Top 10 holdings

Top 10 March 2017	Top 10 December 2016
ALTIUM	AINSWORTH GAME TECHNOLOGY
ARISTOCRAT LEISURE	ALTIUM
COCHLEAR	ARISTOCRAT LEISURE
CSL	COCHLEAR
IRESS	CSL
NIB HOLDINGS	GBST HOLDINGS
RESMED	RESMED
SEEK	SEEK
TECHNOLOGY ONE	TECHNOLOGY ONE
THE STAR ENTERTAINMENT GROUP	THE STAR ENTERTAINMENT GROUP
Top 10: 45.39%	**Top 10: 43.18%**

Selector employs a high conviction, index unaware, stock selection investment strategy, which typically targets 15-25 stocks for the Fund. As shown above, the Fund's top 10 positions usually represent a high percentage of its equity exposure. Current and past portfolio composition has historically been very unlike that of your average "run-of-the-mill index hugging" fund manager. Our goal remains focused on truly differentiated broad-cap businesses rather than the closet index hugging portfolios offered by most of the large fund managers.

Performance Attribution for the March 2017 Quarter

Top 5 stock contributors	(%)	Top 5 stock detractors	(%)
ARISTOCRAT LEISURE	1.05	GBST HOLDINGS	-0.77
CSL	0.91	IMPEDIMED	-0.51
NIB HOLDINGS	0.89	AINSWORTH GAME TECHNOLOGY	-0.47
SIRTEX MEDICAL	0.66	TECHNOLOGY ONE	-0.42
JUMBO INTERACTIVE	0.50	OFX GROUP	-0.38

Top contributors

1. Aristocrat Leisure (ASX: ALL)

Core gaming markets of the U.S. and Australia are delivering strong revenue and profit growth, with recurring revenue now forming more than 50% of total group sales. Market leader in Australia and the U.S. in video style games. Digital segment performance undergoing rapid growth. Business is primed to expand into four adjoining market segments being: the Class III stepper market (250,000 installed base), Class II video (40,000 installed base), Class III premium participation stepper market (12,000 installed base) and the Video Lottery Terminal (VLT) segment (30,000 installed base). Net debt of AUD$1b associated with VGT acquisition down from AUD$1.4b.

The company confirmed at their Annual General Meeting in February that trading in the first four months of the financial year had been strong and that they expect Net Profit After Tax and Before Amortisation of Acquired Intangibles to grow in the order of 20% - 30% for the 2017 financial year. The recently announced resignation of CEO Odell and internal appointment of new CEO Trevor Croker is set to continue the trend that began in 2008. Business focus is the key starting point and Aristocrat have a clearly articulated strategy to invest in its people, the game design teams and taking market share in key product segments.

2. CSL Limited (ASX: CSL)

Please refer below in the Company Updates section.

3. NIB Holdings (ASX: NHF)

Please refer below in the Company Updates section.

4. Sirtex Medical (ASX: SRX)

The liver cancer specialist group has had an eventful past quarter that has included the loss of long standing CEO Gilman Wong with his replacement currently filled by the group's chief operating officer Nigel Lange. Lange's appointment allows for a seamless transition as the group awaits the imminent release of several important trial results, commencing with the SARAH study expected to be made public in late April.

Management also updated the market with unit dose sales for the first half of 6,049, up 5.6%. This was below guidance provided earlier in the year for double digit growth, although management has provided expectations of dose sales growth of 5% - 11% for the full year. Directors also notified the market that legal proceedings against the company from a law firm alleging breaches of its continuous disclosure obligations were pending. The company remains debt free with net cash of $107 million while also indicating its intentions to undertake a $30m buyback. Sirtex also announced the appointment of Neville Mitchell as a new non-executive director, following a distinguished career at Cochlear that stretches back to its public listing in 1995.

5. Jumbo Interactive (ASX: JIN)

Online lottery group is enjoying renewed financial success following its decision to re-focus business attention towards its Australian lotteries operations. This has led to a scaling down of overseas expansion aspirations including the markets of Germany and Mexico. Pleasingly and despite a lower run of lottery jackpots, Total Transaction Value (TTV) declined just 9% to $71.1m for the half year, while reported net profits climbed 29% to $2.6m.

On a look-through basis and assuming no further losses from offshore operations, the group's current full year net earnings run-rate stands at $6.8m, equal to 15 cents per share. This places the shares on a current PER of 13x, with an expected yield of 4.3%. The business has a market valuation of $81m and has company owned net cash of $19m on the balance sheet.

Bottom attribution

1. GBST Holdings (ASX: GBT)

Please refer below in the Company Updates section.

2. Impedimed (ASX: IPD)

Impedimed is a specialist in the design and manufacture of devices which measure body and fluid composition in a non-invasive manner, using a technology referred to as Bio-Impedance Spectroscopy (BIS). Impedimed currently distributes a device called the L-Dex which is primarily used to measure fluid retention in cancer patients at risk of developing Lymphoedema.

The company has an extensive number of initiatives currently underway including upcoming results from its 1,100 L-Dex Lymphoedema patient trial. The trial is nearing full enrolment with first data expected in the second half 2017. This is an important milestone if achieved, as it will drive private player adoption among medical insurers as well general acceptance among the medical community. The company is financially well placed carrying net cash of $73m.

3. Ainsworth Gaming Technology (ASX: AGI)

Please refer below in the Company Updates section.

4. Technology One (ASX: TNE)

The group's transition to a cloud based software service offering continues to make rapid progress with Founder and Executive Chairman Adrian Di Marco commenting at the group's full year 2016 results; "*Our cloud based business is growing rapidly. The major uptake of cloud by new and existing customers has seen us double our cloud Annual Contract Value, and we will continue to double every year moving forward.*"

For the full year to September 2015, cloud Annual Contract Value stood at $8 million with management projecting this figure to hit $143 million by 2022, along with a commensurate benefit to group operating margins, which are forecast to rise from the current 21% to a figure more likely to exceed 30%. With an ungeared balance sheet (net cash of $73 million) and a clear business trajectory we foresee continuing strong operating performance over the medium to long-term.

Post quarter end, the company also announced the appointment on long serving Chief Operating Officer Edward Chung as the group's new CEO, taking effect from 23 May. Di Marco will remain in his role as Chairman and will continue to work with the executive team, with a specific focus on strategy and product innovation.

5. OFX Group (ASX: OFX)

The appointment of CEO Richard Kimber in May 2015 has been short lived following an extended period of underperformance. The Board decided to replace Kimber with new CEO Skander Malcolm. The release noted OFX had initiated a recruiting process some months earlier, in preparation for a possible leadership change. New Chairman Steven Sargent stated that while the company's business direction was on the right path, leadership had been found wanting both in focus and execution.

The trading update that accompanied the change in leadership did not in itself warrant the market's violent reaction to the news. Investors had already been disappointed by lower earnings at the half year results in November. This saw operating profits fall from $18m to $13.5m following a step up in marketing and technology spend. While a new CEO and lower earnings guidance is tough to swallow, the valuation now on offer, combined with an operation that enjoys considerable barriers to entry and a net cash balance sheet remains attractive.

Focus - Crown Resorts

Let us be clear and upfront, we do not own Crown Resorts. In fact, we have never owned the stock, despite qualities that may suggest the business is worthy of a closer look. In short, we could never get comfortable with the company's offshore expansion strategy. Poor corporate governance is another reason we have steered clear, even though we tend to favour companies where management and founders are aligned.

Crown Resorts has built a formidable business around its Australian casino operations, based in cities such as Melbourne, Perth and the recently slated Barangaroo site in Sydney. These are world class assets that, despite regulatory and political risks associated with government oversight, are hard to displace.

So why are we writing an article on a company we have little interest in investing in? We simply want to draw attention to what can be achieved when companies and executives are forced to focus. In Crown's case, a series of stumbles and an over-geared balance sheet ultimately forced management's hand, culminating in a retreat from international expansion.

In the end, the group's largest shareholder, James Packer, via Consolidated Press Holdings, saw fit to return to executive duties despite having relinquished such responsibilities some twelve months earlier.

The company's once grand plans to be a significant global casino operator was no longer seen as a sensible course to take. In the end the company had over stretched itself. The event that triggered the about face caught management off-guard. The decision by Chinese authorities to detain 15 Crown staff on unspecified charges left the group badly exposed.

Not only was the investigation by Chinese authorities damaging to its brand and a sign of poor corporate governance, it directly impacted the flow of VIP business into its Australian casino operations. Further, the yet to be built Sydney casino, licensed to accommodate high rollers and VIP customers, led to increasing investor scrutiny as to its eventual ability to generate an adequate return on the $2b of new capital spend.

Crown's requirement for significant new capital to build the Sydney casino was also compounded by large capital commitments elsewhere, specifically in the U.S. Operationally, the Melco Crown operations in Macau was also facing its own challenges following the Chinese Government's intervention to restrict gambling activity. Adding further tension, the company's largest shareholder Consolidated Press Holdings, also in need of funds, saw fit to sell down its direct holding in Crown from 53% to 48.2%.

As we wrote in the article "Side Swiped" in our December 2016 Quarterly Newsletter, the company and its major shareholder found themselves in a difficult position.

This has led to an overhaul of management, aligned to a re-focused business strategy. The changing of the guard at the executive level has seen James Packer return to take on a director's role, along with trusted lieutenant John Alexander assuming the position of executive chairman. This, along with a number of senior management changes, clearly signal a renewed and re-focused management team.

Several new priorities have been set:

1. Manage through the China situation.
2. Run the Australian business in a more lean and focused fashion.
3. Continue to drive and build a meaningful and profitable online business.
4. Deliver the new Sydney casino, on time and on budget.

In keeping with these priorities, Crown has cut corporate debt by selling down its investment holding in Melco Crown while also abandoning aspirations to own U.S. casino operations. In short, management are getting the house back in order. In our experience, such actions invariably deliver.

Still, we cannot get comfortable with the company's corporate structure, particularly the lack of board independence, although we fully acknowledge that the business and shareholders should benefit from this renewed focus.

While Crown Resorts does not meet our investment criteria, there are many others that do. Having a primary goal involving a core business focus is a strategy that sits comfortably with us. Companies that have done just that include the likes of IRESS, Aristocrat Leisure, Reece, Cochlear, James Hardie, Fisher & Paykel Healthcare, Technology One, ARB, ResMed, SEEK and The Star Entertainment Group. Others that have recently listed and share a similar desire to remain focused include MYOB, Reliance Worldwide Corporation and Bapcor.

Businesses that lose sight of their purpose, often reflected in transformational acquisitions, all in the pursuit of growth invariably come unstuck.

So how do you define business focus? Some may confuse companies that seek to grow by acquisition as fitting this description. At points in time significant acquisitions may be a justified path to take. Many companies have executed such strategies successfully but in this context, acquisitions alone are not a recipe for success. Founder of online automotive group Carsales.com Greg Roebuck provided a sensible summation of what makes a difference over the long run;

"I would love to say the vision 20 years ago was to look like what we do today, but it's not true… it's just, let's keep doing what we do and get better and better each week. As a business, I've always pushed us to be focused on 1 per cent changes…our success is not a moment in time. It's 100,000 moments in time."

In recent times, the need for business leaders to re-focus has never been greater. Tough business conditions and a competitive landscape that pits the traditional operators against nimbler, online players have made the task of navigating market cycles much harder. Some boards recognise the benefits of doing fewer things well without much prompting, others arrive at this strategy reluctantly, sometimes forced, as in Crown's case. This has been the case in several other instances as reflected below.

Companies that have, or are in the process of re-focusing:

1. Aristocrat Leisure – Have put significant runs on the board after re-grouping and focusing on the core markets of the U.S. and Australia.
2. Sydney Airport – Have emerged from earlier ownership as Macquarie Airports to become a single asset owner (Sydney Airport) with a healthier balance sheet and more transparent business.
3. Orica – Chose to simplify its business structure, resulting in the demerger of the Dulux business into a separately listed entity.
4. Woolworths' exit from Masters – Early days.
5. ANZ | NAB – Early days having exited Asia and the U.K. respectively.
6. Origin | Santos – Early days, over geared structures, looking to shed assets and return focus to core domestic energy assets.

These are a few of the many examples one can point to. Today, the list of companies downsizing operations and choosing to remain within their circle of competence is increasing. Those that stay true to their purpose and focus, invariably do well, which is an outcome that shouldn't surprise too many. ***SFM***

Executive Remuneration

Executive remuneration is one of the more contentious corporate issues that shareholders grapple with. Often, what is put forward as fair and reasonable can fall well short of what is considered commercially acceptable to the rightful owners, the shareholders.

Something that is lost in discussions is the necessity to reward performance. No one should begrudge management who deliver. However, the way equity is freely distributed needs a genuine re-think.

We have attempted to formulate a framework for the evaluation of remuneration structures, that gives consistency to the way we vote. Despite our best efforts, we find applying a framework across the many and varied plans difficult. This can be largely sheeted home to the wide range of views held across company boards, remuneration experts and regulators.

There are some generally acceptable guidelines applied to executive remuneration. Typical structures include an allocation across fixed, short term and long term incentives. We rarely have issues with the fixed and short term offerings. Most are relatively transparent in their explanation and can be sensibly monitored.

On the other hand, long term remuneration structures can be more difficult to understand. The basic concept itself appears straight forward:

1. Employ executives that think like owners by making them co-owners in the business,
2. Set some targets, typically: earnings per share growth, total shareholder returns or even continuity in employment,
3. Meet those targets and the company is on the hook to issue a whole swag of shares.

In principle, linking individual or company performance with financial outcomes stands up to the common-sense test of rewarding effort. However, long term incentive plans can be applied in different ways and over varying time frames. Determining who benefits the most over the long run can be difficult to understand or calculate.

Executive remuneration often takes one of two forms, either cash or equity. Typically, fixed and short term payments are made in cash while longer duration performance, often stretching over three year periods, are delivered via the issue of new shares. In this context, the dilemma we have is in determining the right metrics to use in assessing performance. Use the wrong measures and the results can be disastrous.

An example is a CEO whose performance target rewards a minimum level of Earnings Per Share (EPS) growth. It makes perfect sense for boards and shareholders to seek this outcome. It represents growth in profits and possibly even dividends. However, a deeper understanding of the driver that delivers the increase needs to be considered. If organic growth underpinned the rise, it is an excellent achievement and worthy of reward. If on the other hand it was driven by a big acquisition, funded by debt, the potential for longer term capital destruction is far greater.

The message here is simple. Rewarding management to grow revenues and profits can drive bad behaviour and poorer long term outcomes. Unfortunately, it has become an industry standard that many CEO's are entitled to remuneration packages structured along these lines.

Equity is another sticking point. There are some instances where equity is not included in the package. Plumbing group Reece is an example of a company that will not issue equity but these situations are rare. When management are founders or large shareholders the main forms of compensation come from salary and ultimately dividends. This includes auto group ARB, retailer Harvey Norman and Flight Centre.

Many boards have sought to appease shareholders by offering a remuneration structure that combines EPS growth as well as a Total Shareholder Return (TSR) measure. The aim here is to compare overall annual performance verse the company’s listed peers or an industry segment of the stock market. This approach is simple because TSR is easy to measure. However, outperformance of a company’s share price relative to “the average” competition may be meaningless if the end result is still a poor financial outcome.

One company that has given due consideration and acted quite independently on this matter is university pathways group, Navitas. CEO and co-founder Rod Jones remains the largest shareholder, having successfully built a business that provides students a structured pathway to university education.

The business is currently on track to deliver over $1.0 billion in revenue and net profits of $85 million, across 33 pathway colleges, located in six countries. Navitas has implemented a corporate finance tool referred to as Economic Value Add (EVA) to measure the performance of the business. EVA is defined as a measure of a firm's economic profit – being the value created in excess of a minimum return required by the providers of the company’s capital (being both shareholders and debtors). Quite simply, EVA is the net operating profit after tax less the firm’s cost of capital.

This approach removes scorecard comparisons and annual earnings targets that are common across many packages. The Navitas approach is to pay its executives incentives based on the degree to which they exceed a base financial hurdle, referred to as the company’s weighted cost of capital. If the company exceeds the hurdle determined by the board, then a set percentage of the value created is distributed across the employees of the business. This also sets the base for future periods. Any financial setbacks need to be made up before additional bonuses are paid.

The benefit of EVA is that increases in revenue and profits alone do not lead to higher remuneration. Rather, remuneration moves in line with company profits that exceeds the minimum returns that shareholders expect for the use of their capital. Conversely, if management employ large licks of capital that fails to earn acceptable returns, their remuneration will fall. This avoids the treacherous scenario in which management teams are incentivised to employ capital in the chase for higher profits and higher remuneration albeit at lower returns.

Like all programs the EVA has its limitations. If the hurdle is set too low, shareholders will suffer. Set correctly, it rightly rewards performance. Clearly, EVA can achieve better alignment between shareholders and company executives than many of the alternatives. As always, management needs to be transparent. Hurdles and gross performance payments to the executive team need to be clearly communicated to ordinary shareholders.

So, what is our preferred measure or approach to this prickly issue? As we have already noted there is no universal answer. However, issuing equity to executives based on meeting or exceeding rolling three year targets is not ideal. The metrics used can be opaque, subject to the whim of a board and open to abuse. Above all, issuing equity is not a one-off cost like a cash bonus. The new shares issued form part of the equity base permanently. They give rise to ongoing dividend payments and dilute ordinary shareholders.

We are consistently led to believe that equity participation aligns executives with ordinary shareholders. However, ordinary shareholders have paid for their shares while executives often have not. This is the fundamental difference we struggle with.

In an ideal setting, we would prefer a simpler, more transparent arrangement with the key management personnel. Firstly, market based salaries should be commensurate with the experience sought. Secondly, annual reviews may give rise to one-off bonuses. Such bonuses can be paid in cash, equity or both. This removes the need for long term equity plans. Thirdly, when equity is issued we believe it should be escrowed until the individual leaves the firm.

While this may cause executives to head for the exits more frequently, it sends a clear message. Businesses must be run and governed for the long run. By aligning equity along these lines, the ultimate benefactor will be the ordinary shareholder rather than the executives who are fortunate enough to catch a short-term remuneration gravy train.

This approach removes the debates that rage between shareholders and proxy advisors, in relation to the size, triggers and other vesting mechanisms of long term incentives. It also removes the most contentious issue, that of senior executives selling stock. This is a topic grabbing significant media attention at present.

The remuneration debate has some way to go. Change must come from within. Company boards are tasked with attracting and nurturing talent for the long term. Structuring remuneration so that it simply conforms with industry standards and matches peers is little more than a box ticking exercise. Outsourcing the decision to remuneration experts is not the answer. Shareholders need to demand more.

The message is clear, paying out millions and issuing out valuable equity on top needs a re-think. Shareholders, who stand last in line foot this bill. We believe it is important that shareholders impose some directive on boards to re-balance the remuneration debate. The debate needs to shift from external consultants pushing group think outcomes towards a simpler, fairer outcome for the rightful owners. ***SFM***

Domino's Pizza Enterprises (DMP)

On 27 January 2017 Adele Ferguson's article in the Sydney Morning Herald titled "*Wage Fraud: Pizza Hut hit with fines*" gained little airplay. On Saturday 11 February, the Sydney Morning Herald piece titled "*The Domino's effect*", also by Adele Ferguson, had more impact. The timing was good. The story hit the press two days before Domino's was due to report its half yearly result.

By 8.30 that morning we had received a text from a broker saying, "*Read SMH, Adele Ferguson has gone nuclear on DMP*". This was followed by a tweet from a fund manager "*Widespread or not, this #Dominos expose is bad news for shareholders*".

The article was rather damming. While the piece was one sided, it couldn't be ignored. For shareholders, this was either going to create an opportunity or potentially a time to exit. What was clear to us was that this was a governance issue that needed to be tackled head on.

Environmental, Social and Governance (ESG) issues have long been important to us. We may not have called it ESG from day one. It is essentially the business culture that is driven from the ethical guidelines set by the board and executed and upheld by management. For us, the people are the first critical element of stock selection, closely followed by business qualities, balance sheet and capital management. Collectively, these elements make up our 4 tenants of investing. They are designed to take risk off the table before we invest.

We have long stated that if we don't trust the people who run a business and they are not consistent in what they say, then we simply don't invest. This is nothing more than common sense investing.

The timing of the article was fortuitous for us, we had a one on one meeting with Domino's management scheduled in the days immediately following the half year report.

On the 16 February, we met with Domino's Europe CEO Andrew Rennie. Rennie was previously CEO of Australia. He has decades of experience with Domino's, having originally been a franchise operator.

We opened the meeting by stating the importance of Corporate Governance, and specifically labour standards, to both Selector and our investors. We noted that our investors, large Australian superannuation funds, were raising their concerns directly with us. With the recent allegations as a backdrop, we asked Rennie to directly address the issue for us.

He opened with the offer that Domino's senior management would make time available to directly address the concerns of the superannuation funds. A follow up meeting was arranged for this purpose.

Domino's believe that the light being shone on this issue will see the truth revealed. They hold this as the ultimate positive outcome. They highlight the following reports as key reference points. The Fair Work Ombudsman is to hand down its findings on the matters raised by the end FY17. Advisory firm EY (formerly Ernst & Young) have previously been engaged to undertake store audits, following revelations at convenience store franchise 7-Eleven, and this analysis concluded that Domino's represented "*best practice*" in its category.

In addition, an independent audit of **the entire Australian network** is to be undertaken by a big 4 independent accounting firm. This will not be undertaken by EY or Domino's current auditor, Deloitte Partners. This report and its findings are due shortly, at a cost of circa $1m. It will also be released to the ASX.

The newspaper articles have cast a bad light; however, management believe the facts are somewhat different. Further, the issues at hand have not taken Domino's by surprise. They have been investing internally to address the potential for such issues. The group currently has a five-person internal audit team that will be lifted to seven. They also plan to create a similar team for the European business.

The company has been working with the Fair Work Ombudsman for 3 years and like the EY analysis, have been told that they represent "*best practice*" in the franchising industry.

Importantly, Domino's management acknowledge that it is not possible to have 100% good governance coverage of the group's 320 Australian franchisees. They believe other issues are likely to emerge. The promise to shareholders at this point is that they will be addressed transparently.

Domino's pointed out that the investigative interviews undertaken were conducted with franchisees who have been exited from the system for misconduct. Issues that have been uncovered to date by Domino's amount to 0.8% of group payroll for circa 25,000 staff. Domino's also countered that the "*visa abuse*" franchisee had been exited in line with their "*zero tolerance*" policy.

Management have stated they will continue to weed out bad behaviour in the system via zero tolerance. The increasing use of technology within the business will continue to reduce misconduct. Examples include the point of sales system, clock on clock off, GPS driver tracker and the new TANDA roster system. These technology systems provide greater transparency for all parties.

Additionally, Domino's have an added layer of scrutiny via the franchisee bookkeeping service that the firm provides. This is intended to cover 100% of the network over time. This tracks superannuation payments amongst other financial details. In addition, franchisee numbers will be reduced from 320 to 200 multi-store operators in time, making the system significantly easier to manage.

Rennie summed up the situation by reaffirming management's high level of confidence within the group's governance system. They acknowledge more issues are most likely to be uncovered and that this is part of the process. Importantly, they will continue to enhance governance oversight through additional investment.

In terms of ESG our take is as follows. Domino's response has been transparent. The independent reviews will produce outcomes that will enhance governance.

We maintain that we are dealing with an honest management team who are extremely passionate business owners. They are a long serving management team with deep experience. Both CEO Don Meij and Europe CEO Andrew Rennie started as franchise operators who understand the system in an operational manner.

Furthermore, Domino's management and board have very significant equity positions that drive shareholder alignment. The company has the scale and balance sheet to deal with these issues. And at this juncture management appear to have the desire to tackle the problems at hand. They have a track record of being proactive and investing ahead of the curve, and appear to grasp the magnitude of the issues at hand. ***SFM***

QUBE Holdings (QUB)

Qube Holdings started life in 2007 as the KFM Diversified Infrastructure and Logistics Fund. This occurred not long after Chris Corrigan and his management team were ousted from Patrick Corporation following a hostile takeover by Toll Holdings in 2006. Since that time, the management team of Qube have diligently focused on building a logistics infrastructure network to service Australian importers and exporters.

The group offers services to companies in industries including retail, agriculture, food processing, mining, energy, manufacturing and freight forwarding. Despite the variety of operating models on offer, one common theme among the customer base is a desire to move product quickly from one place to another at the lowest unit cost.

For Corrigan and his team, a key piece to the logistics puzzle fell into place during 2016 when the group successfully regained control of Patrick's, following the acquisition of Asciano with joint venture partner Brookfield Infrastructure.

While we have never owned Qube, we have followed the progress of the business and management team that were instrumental in the original Patrick stevedoring business pre-2006. Under the right conditions, the economics of a logistics operation allow scale operators to build strong competitive advantages. The team at Qube, led by CEO Maurice James and guided until recently by Chris Corrigan are working to create such a situation.

Qube's stated goal is to be Australia's leading provider of import/export logistics solutions. To deliver on this the company continually asks itself "*How do we deliver efficiencies to the import/export supply chain?*" This has required extensive investment in fixed assets including property, plant and equipment. To date, patience has been required by shareholders. The company's regular need for additional funding has seen a steady increase in the group's issued capital. Today, after a long period of building, we see the emergence of a business that has many of the attributes we seek. An improving return on the capital invested will no doubt be welcomed by long term investors.

At Moorebank, Qube is building a highly automated intermodal terminal capable of handling 1,050,000 containers per year. The facility includes 850,000 square metres of warehouse space and an interstate terminal capable of handling 500,000 containers per year. This will allow Qube to offer customers an integrated port to warehouse solution. When complete, the business will have a substantial and difficult to replicate competitive advantage. In time, this should drive a step change in the economics of the business.

Moorebank will deliver significant cost savings to both importers and exporters. Currently, an importer incurs charges of around $1,500 per container. This covers the port handling, warehousing, transportation and container fees. Under the Moorebank model, these costs are estimated to fall as low as $1,000 per container.

In 2016, rail moved approximately 14% of containers that arrived at Port Botany while the remainder were transported out of the port on road. Growth in trade is expected to see the 2.3m containers that Port Botany handles annually increase to between 7.5m to 8.5m by

2045. Sydney's road network already strains under the current load. Consequently, the NSW Ports Authority has identified improvements in the rail network's efficiency as an important enabling factor in achieving the forecast growth.

The primary reason rail has failed to gain a larger share is its relative inefficiency and poor service standards compared with road transport. Clients of logistics companies claim that even if their rail had cost equivalence, road would be the preferred mode of transport due to rail’s poor reliability.

There are three main factors which have impaired the efficiency of rail:

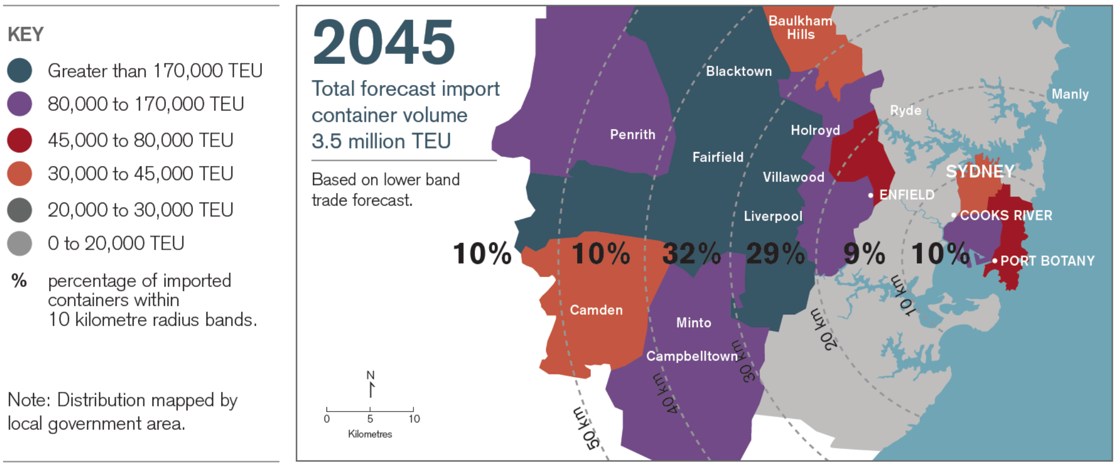
Last mile transport costs

After a container leaves the port on rail, it still requires handling at and beyond the intermodal terminal. Once containers arrive at an intermodal terminal they are unloaded from the train and transported to the importers’ warehouses by road. The dilemma intermodal operators face is that the cost of transporting containers in that final leg can easily consume all the cost savings that rail offers for the first leg to the terminal.

Consequently, the location of the intermodal terminal in relation to the customers’ warehouses is critical. Extending this logic further, the ideal solution is to eliminate the last mile transportation altogether by co-locating warehousing with the terminal. This is exactly the solution Qube plans to deliver at Moorebank.

In addition, Moorebank is located at the junction of the M7 and the M5 in Sydney's south west. The terminal is positioned strategically within a key Sydney growth corridor, as seen in Chart 1 below, just to the south of Liverpool.

Chart 1: Distribution of import containers



Source: NSW Ports Authority

Congested freight lines

Congestion on rail corridors previously meant that rail freight was restricted to operating within certain timeframes. This reduced flexibility and visibility, impairing the ability to plan loading of trains at the stevedore's operations. The South Sydney Freight Line (SSFL) has been developed to alleviate these restrictions. Moorebank will connect directly to the SSFL.

Port - rail interface inefficiency

The port-rail interface inefficiency is one of the main strategic rationales for Qube's move on the Patrick Container Terminals business. With control of the port side operations finally wrested back, Qube management can prioritise investments in de-bottlenecking and automating the rail operations. Without this, Qube would be unable to guarantee its customers the potential cost efficiency that Moorebank offers.

While there are numerous benefits to the Moorebank model, cost, as always, is one of the most important. Maximising the containers handled by the terminal is a key determinant of the economics of the project. More containers transported by each locomotive allows more revenue to be spread over the fixed cost base, lowering unit cost per container.

Summary

Looking out, the total investment required for the phased development of the Moorebank Intermodal Terminal appears manageable. Qube's balance sheet is currently funded with $950m of net debt. The business expects to be able to complete the development with free cash flow and undrawn bank facilities while remaining within its debt covenants.

Our strong preference is to invest in businesses with low, or no debt and nothing makes us more uncomfortable than management teams that refer to "*lazy balance sheets*". That said, we recognise that at points in time, the use of debt to develop or acquire important strategic assets is appropriate. Qube's development of Moorebank fits that bill and importantly, appears to be an asset that will be difficult to replicate. ***SFM***

Surprise - reporting season

Reporting season had its fair share of surprises: upgrades, downgrades, CEO resignations. When asked whether we were surprised how things panned out, our response is: we are always surprised. Not so much in the individual results themselves but the way investors, the media and market commentators pick up on specific issues and run with them.

The notion that the market is an informed meeting place for investors might hold true for some, but the large reactions following the release of company results clearly reflect wide and varying investor interpretations. Higher dividend payments and announcements supporting capital management initiatives such as share buy-backs are often greeted enthusiastically. Whether it's the right course of action for the business over the medium term seems to be of lesser importance.

Crown Resorts

Two examples from the most recent period come to mind. The first involves Crown Resorts which we also covered in our earlier piece titled, "*Focus*". Anyone following financial markets would be aware of the issues that have engulfed Australia's largest casino operator with Chinese authorities. Crown Resorts staff remain detained in China as investigations continue into the suspected illegal marketing of gambling within the country. The fallout has been severe for the company both in terms of its brand reputation and financially because of the significant drop in VIP turnover.

Influenced largely by its 48% shareholder Consolidated Press Holdings, the company has taken steps to simplify their strategy as we outlined earlier. The half year numbers confirmed why action was needed. A 45% collapse in VIP turnover to $19.6b is the most visible sign of the damage inflicted by China's actions to detain Crown staff. This flowed through to operating profits which fell 19% to $255m, giving rise to net profits of $183m and earnings per share of 25 cents.

In addition, the group's decision to retreat to a domestically focused business as unveiled in December 2016 was re-affirmed. This included its sell down in Macau based casino operator Melco Crown, from a 27.4% investment holding to 11.2%. These actions have allowed the business to cut debt, fund an 83-cent special dividend, a 30-cent ordinary dividend, commence a buyback of $500m of shares and $350m of subordinated notes.

With such good news on the dividend front, it's little wonder that the share price shot up post its release. The icing on the cake was confirmation that, at minimum, future dividends of 60-cents per share would be paid out, subject to the company's financial position, representing a payout ratio of over 100% based on analyst forecasts.

As we have noted, the board and management team at Crown Resorts have re-focused their attention on the Australian business. In doing so, the group's executive responsibilities have shifted from previous CEO Rowan Craigie, despite being contracted out to late 2018, to its new executive chairman John Alexander. He has a clear agenda to reshape the cost base and drive greater organisational efficiency.

The motives for distributing such large amounts of cash back to shareholders are best left for others to judge. However, the decision to adopt an ongoing full payout strategy suggests a motive to appease owners, including its largest shareholder, rather than what's right for the business in the long term. The group ended the half with net debt of $1.7b and large ongoing capital expenditure commitments including the proposed $2b Crown Sydney Casino. This provides the company limited scope to keep group net debt under control. In our opinion a more conservative distribution policy would have been the better, more prudent option.

Coca- Cola Amatil

Similar to Crown Resorts, Coca-Cola Amatil has fallen short of expectations in recent times, culminating in the appointment of CEO Alison Watkins in 2014. This has given rise to the customary review and cost transformation programs that follow when businesses run aground. In Coca-Cola's case, the strong brand has fallen victim to changing consumer preferences and competitive tensions within the grocery market.

This is evident in the group's full year 2016 result which saw revenues rise 1.1% to $5.1b, while operating profits improved 3.5% to $683m. The Australian beverages division, the largest contributor to underlying earnings, went backwards 1.1% to $455m. While restructuring and optimisation strategies out to 2020 are part of the CEO's targeted approach to improve returns, the issue that needs addressing is whether the group's core beverages division can return to growth.

We are yet to be convinced on this point and question why the company is so keen to lift dividends by 6% with a payout ratio of 84% while also announcing a $350m share buyback despite already carrying 1.8x net debt to EBITDA. The market certainly applauds more dividends, buybacks and positive commentary regarding outlook. Driving a higher share price in the short run might seem like a fine strategy but delivering a more sustainable earnings profile and balance sheet is the more prudent outcome that shareholders should be seeking.

Company specific updates

The following short company commentaries provide an update on a range of businesses held by our portfolios post the most recent reporting season.

Ainsworth Game Technology

CEO Danny Gladstone correctly noted that gaming operator Ainsworth Game Technology delivered a disappointing first half result. Group revenues fell 14% to $123m while pre-tax profits slumped 55% to $20m. Product delays and a competitive local market has seen global gaming leader Aristocrat Leisure take market share off all other operators.

While local conditions saw Australian profits fall 34% to $13m, offshore operations in both the U.S. and Rest of World delivered a solid result of $37m, albeit still lower than the corresponding period profits of $41m.

As our experience with Aristocrat Leisure has shown us, future success is dependent on product and hardware investment, elements that the Ainsworth management team have been working to address. As we outlined in our June 2016 Quarterly Newsletter following our site trip to Ainsworth's U.S. operations, the business has made some inroads in developing a stronger, more diverse business profile. This can be seen from the results in the traditional Class III slot machine markets of both Australia and the U.S., as well as the Class II U.S. participation market.

The U.S. operations now provide the group with important recurring revenues from its fee per day participation machines. At the interim result, management flagged this as a highlight, noting that of the $123m in group sales, $20m was recurring in nature.

Despite the difficult environment, the group has provided positive full year profit guidance of at least $56m. This would suggest a more than doubling of second half profits to $41m. To achieve this target, lots of things need to fall into place. In addition, the company's newest and largest shareholder, Novomatic AG, following its purchase of founder Len Ainsworth's 52% shareholding, is expected to deliver significant revenues and profits as part of the new shareholding arrangement.

While the timing of purchase orders is outside management's control, the company's commitment to product development will be the driver of future earnings. The company has a conservative balance sheet and has opted not to pay an interim dividend.

We fully support this move, preferring that the business returns to a more profitable footing. The group's net debt position stood at $42m. Hitting the company's 2017 pre-tax profit forecast of $56m would have the company trading on a PER of 14x.

Altium

Electronic printed circuit board (PCB) designer software company Altium continued to deliver on its financial goals. Some may question the rationale of providing long-range targets as far out as 2020, particularly in a public forum that favours short-term results. The rationale, according to CEO Aram Mirkazemi, is straightforward. It is about being upfront with investors and giving the owners the visibility of management's longer term aims. This approach may be considered naïve or bordering on over-exuberance but from our point of view, Mirkazemi is genuine in his desire to have an informed investor base.

Too often management teams deliver results to a script, avoiding the negatives and focusing on the positives. This wasn't the case in Altium's interim earnings release. A cursory review of the numbers revealed revenues up 14% to US$49m and operating profits up 11% to US$11m. Margins came in at 26% while subscriber sales, inclusive of the group's flagship Altium Designer software, rose 4% to 32,321.

Importantly, all metrics headed in the right direction but CFO Joe Bedewi noted the company reports on an "*all-in-basis*". Rather than stripping out one-off costs to reveal an underlying figure, the company makes no adjustment. Interestingly if they had done so, operating profits would have been US$2m higher due to restructuring charges incurred during the period. This gives rise to a 30% operating margin and in turn, comparing subscription sales on a like for like basis would have shown a 10% jump.

The market's reaction to the result was consequently lukewarm, however, our interpretation was quite the opposite. Management have delivered a very strong set of numbers, outlining a clear strategy to grow revenues to US$200m with operating margins of greater than 30% over the medium term. There is no certainty that this will be delivered but shareholders have nevertheless been given detailed insight into management's thinking.

Blackmores

Complementary medicines group Blackmores encountered a difficult first quarter of trading followed by an improved second quarter. For the half, sales fell 6% to $322m while net profits dropped 42% to $28m, as the company felt the full brunt of volatile buying patterns in Australia. This is best reflected by the mix of sales, with Australian domestic revenues down 31% to $158m, while China based sales rose 92% to $64m.

Changes to the buying patterns of Australian based Chinese exporters as well as high stock levels in Australian retailers has led to this current situation. The company has made remarkable progress in establishing a direct business line servicing the Chinese market. However, the local environment remains challenging as offshore buyers reassess their options.

In crude terms the group delivered combined sales from Australia and China of $268m during the first half of 2016, whereas in 2017 this figure dropped $46m to $222m. Management's analysis indicates that of the $222m, sales destined for Chinese consumers made up $45m of the Australian reported revenue, suggesting that local consumption stood at $113m while China based sales totalled $109m.

While the circumstances behind the drop-in sales are understandable, its impact has also been felt on the balance sheet. This called for higher working capital, which increased $27m as the company cycled through inventory at the same time as holding off from buying further from its suppliers. The resulting weak cash flow was further impacted by higher taxes and dividend payments relating to the 2016 year. As a consequence, net debt rose and ended the half at $83m.

In other markets, the company continues to experience strong growth with Asia ex-China contributing $41m in sales and the Bioceuticals and Global Therapeutics divisions, that services the professional segment of the complementary medicines market, contributing $51m.

In terms of full year guidance, management have understandably provided a wide range, indicating that profits will not reach the exceptional highs of 2016 when $100m was earned but are most likely to represent good growth on the 2015 figure of $47m. Assuming a modest increase in second half earnings and continuing the improved second quarter performance, net profits of $65m are achievable, placing the group on a current year price earnings ratio of 27x.

The level of investment required to position the business for future growth has come at a considerable cost to the group during the current year. However, the strategies in place to both diversify and leverage the company's core capabilities remain intact.

Carsales.com

First half earnings came in largely as expected with revenues up 7% to $179m and operating profits rising 2% to $83.2m. Net profits adjusting for some one-off items rose 5% to $54.4m. The raw numbers indicate subdued growth, however, this is misleading as the core online advertising business continues to generate strong top line growth of 13% to $130m. In addition, data and research services rose 10% to $19m reflecting the division's very resilient revenue model.

The issues that have impacted the group relate to Stratton, it's 50.1% owned finance broking operation. A regulatory review of the industry undertaken by ASIC identified several operators falling short of acceptable standards. Unfortunately for Stratton, its biggest vendor, BMW Finance, has been under review, resulting in a slowdown in application processing times, despite strong continued demand for the product. In turn, Carsales has been impacted by lower application levels and lower bonus over-rides. In total, revenues for Stratton fell 22%, while operating profits dropped 49% to $4.5m. Management is confident of recovery, although the timing is difficult to gauge at this point.

Our discussions with company executives post the results briefing confirmed that the traditional Carsales online business continues to enjoy considerable competitive advantages. Most importantly, Carsales has extensive product and customer data that its competitors lack. This enables the group to dominate the private-used car selling market which helps maintain their advantage in other business lines, including the new car dealer space.

Overall, whilst several the group's adjacent business divisions require some patience from an investment perspective, the core operations are delivering solid growth. The business is well placed entering the second half of the year, augmented by a strong balance sheet with net debt of $176m.

Cochlear

The group delivered an excellent interim result, underpinned by strong implant unit growth of 16%, excluding China tender sales. Including the 1,100 units sold into China, implant units grew 10% to 16,234. Management noted that this rise is the most significant seen in many years and supports the investment being made in sales, marketing initiatives and new product innovation.

Following a strong 2016 year, first half top line growth continued into 2017, up 4% to $604m. The rise was 8% on a constant currency basis, driven by: the U.S. market up 12%; EMEA 6%; and Asia Pacific 4%. In terms of product diversity, implants represented 62% of revenues at $377m, along with services at $145m and acoustic implants (BAHA) with $83m.

CEO Chris Smith continues to outline the group's key focus, one driven by growing the core implant business via ongoing product innovation, whilst at the same time supporting recipients through a service backed offering. The current half saw success in both areas, with new products Kanso (first wireless implant) and the Slim Modiolar electrode (CI532) rolled out into global markets. The initial feedback has been positive, seen in market share gains and lack of other competitive offerings.

Services revenue remains an important and growing income source. Management note that significant investment is being made to promote recipient engagement and provide support to the group's growing global cochlear implant base that now exceeds 450,000.

In terms of financials, one of the most pleasing aspects was the leverage reflected in the 19% lift in both operating earnings and net profits to $156m and $111m respectively. This has enabled group operating margins to expand to 25.7%. The company's balance sheet remains in a strong position with net debt of $94m.

Dividends were lifted 18% to $1.30 per share, a payout ratio of 67%. Management has also maintained full year net profit guidance of $210m-$220m as it continues to invest in the long-term future of the business.

Computershare

Global share registry operator Computershare gave the strongest indication yet that things are looking up for the group. The first half figures came in as expected with management defined operating profits up marginally to US$250m on a constant currency basis. More significantly, after excluding margin income earned on the cash held by the group on behalf of clients, profits rose an encouraging 10.6% from US$163.3m to US$180.7m. In contrast, while client-held cash balances grew from US$15b to US$16.6b, the low interest rates environment resulted in margin income falling from US$79m to US$69.9m.

CEO Stuart Irving had two key messages for shareholders. The first involved the need for greater business transparency. Increased complexity arising out of the growing number of business lines has made this necessary. The improved disclosure provides greater comfort in evaluating the risks and potential earnings power of each of the divisions. The second issue is one of operational focus. Strategic priorities have been set around the company's core competencies.

The company is focused on three divisions, where scale and operating leverage is delivering improved financial performance. These include mortgage servicing operations in the U.S. and the U.K., employee share purchase plans and share registry management, representing the group's largest earnings contributor. A key barrier to entry is the increased level of compliance and investment needed to set up a competing offering. Computershare already has both the scale and operational knowledge needed to succeed, while the recurring nature of earnings allows for continued re-investment.

Following a long period of flat earnings, the group appears well poised to secure improved revenues and profits. The added upside is that should interest rates rise, a materially higher level of earnings will emerge.

CSL

Global blood plasma leader CSL's pre-released half year result provided confirmation that the group is executing well against its stated long-term strategic objectives. The most critical is the group's global leadership in the capture, processing and delivery of immunoglobulin (Ig) products. In the U.S. CSL continued an aggressive growth strategy, rolling out new collection sites at a rate well in advance of the Ig market's annual growth rate of 5%-7%. In the past five years, this level of capital investment has resulted in over 70 new centres being built, equal to a compound annual growth rate of 18%. In contrast, the rest of the market have increased their plasma collection centres by just 6% per annum. This differential has allowed CSL to supply upwards of 60% of the U.S. market's 70 million grams of annual Ig demand.

The increased throughput has not only allowed for greater efficiencies but also intersects with management's other main objective, to develop and manufacture a growing pipeline of unique blood plasma products. The recent approval of new long acting Haemophilia therapies demonstrates the company's ability to take treatments from the discovery stage right through to marketing approval and sales.

Approximately 65% of the group's fully expensed US$600m worth of annual research and development spend is dedicated to new product development. CEO Paul Perreault remains upbeat about the company’s development pipeline. CSL is experiencing solid demand globally for its products. It has a growing portfolio of unique therapies and is the most efficient operator in the space with scalable, world class facilities. CSL remains well positioned to continue its run of strong performance.

Flight Centre Travel Group

Sometimes a company reports a result that appears weak on the surface but is, under the circumstances, very good. For global travel agent operator Flight Centre this is how things panned out. The numbers will show the group reporting strong ticket sales volumes for the first half, up 10%, comfortably outpacing outbound market travel growth of 5.2%. This positive outcome was offset, however, by ticket price deflation of 7% leading to total ticket sales up only 2% to $19.3b. This impacted revenue that remained relatively flat at $1.3b, while group income margins fell from 13.7% to 13.4%.

Pre-tax profits fell by more, down 28% from $156m to $113m. Several factors worked against the group, including foreign exchange movements impacting earnings by $4m and a further $13m due to lower profits from newer markets, including tour bus operations. When these items are considered, the fall in profits is a more palatable 17%.

The results clearly illustrate two things. The first is the group's ongoing ability to generate solid ticket volumes, despite the ongoing threats from online and other travel competitors. The second is the deflationary environment regarding ticket prices. While it is hard to pin-point what will trigger airlines pulling in capacity, the economics of rising oil prices would suggest that further falls in ticket prices are less likely.

These factors are outside of the company's control, however, what is in their control are expenses. In this regard, productivity gains are being targeted in a major initiative, the key metric being total transaction value per employee. The substantial investments of recent years have yet to yield the desired results but the trends are positive. Management have also maintained a sensible desire to grow the business, in a largely organic fashion.

Over the course of the first half, nine of the group's ten regions delivered record transaction ticket growth measured in local currency. Several smaller acquisitions have also expanded the company's network to 20 countries, compared to just 10 countries three years earlier. The group's physical store presence is now being extended across several online offerings. It is expected that online sales will hit $1.0b this year, but we note that margins are tighter and much more needs to be done in providing sufficient confidence that the threat of online, while real, is also an opportunity for a large-scale player like Flight Centre.

For the full year, management has lowered its earlier pre-tax profit guidance from $320m-$355m to $300m-$330m, largely reflecting the continuation of issues that impacted the first half. As we noted at the start, under the circumstances these numbers are lower but nevertheless still impressive. At the current market valuation of $2.8b, the business is trading on a price to earnings ratio (PER) of 13x at the lower end of the guidance range. If the company's $350m of cash is excluded, the PER drops to 11.5x, while its return on capital employed stands at around 31%.

GBST Holdings

GBST, a global software and services provider for wealth and financial markets, issued a profit warning during the period, stemming from a delay to several U.K. based services contracts. The business has signed a number of important contracts in the last few years, with the success being driven by its market leading wealth and wrap platform. This, along with the Capital Markets divisions' settlements offering, has the group earning 70% of its annual revenue on an annuity licensed basis.

The recent earnings shortfall is the result of a few U.K. customers delaying the rollout of additional services. This has seen five projects delayed, causing a temporary drop in revenues at the same time as the company has been ramping up research and development investment for its wealth management products.

Revenues are expected to be down 10% while operating profits are likely to drop from $17m to $12m. Importantly, the company expenses all its research and development costs, a figure that is likely to exceed $17m this year before eventually returning to a more typical level of $10m-$12m as the wealth management upgrade nears completion.

Despite the disappointment associated with this downgrade, the company continues to pursue a focused and disciplined approach of reinvesting into its core offerings, supported by a recurring revenue stream and a debt free balance sheet. The current market capitalisation of $200m has the group trading on an operating profit multiple of 16x for the current year, dropping down to 11x in 2018, as service work earnings are restored.

IRESS

Financial markets technology supplier IRESS released its full year results for 2016, with strong performances delivered across all the group's key metrics. Citing limited impact from the Brexit decision, revenues rose 8% to $390m, giving rise to segment profits of $123m. Despite incurring one-off costs of $8.5m, reported net profits rose 7% to $60m as the company continues to benefit from strong ongoing demand in wealth management and financial markets segments across Australia, the U.K. and South Africa.

Of note, the U.K. wealth management division is beginning to provide firm evidence of its earnings potential, with full year revenues up 22% to $111m and profits up 36% to $27m. The company also completed a $90m acquisition of superannuation administrator software provider Financial Synergy in the back half of 2016.

Recurring revenue now exceeds 90%, providing management led by CEO Andrew Walsh with sufficient confidence to invest ahead of the curve. Fully-expensed product investment totalling $96m will drive further innovation and client engagement.

Ongoing regulatory changes are underpinning demand with management pointing to a solid pipeline of opportunities. For 2017, the group is pointing to strong revenue growth and segment profits, assisted in part by the full year contribution of recently acquired businesses. The company ended the period with net debt of $156m and a return on capital employed of 18.4%.

MYOB

Accounting solutions provider MYOB completed its first full year as a publicly listed company delivering strong top and bottom line growth. In summary, group revenues were up 13% to $370m, operating profits rose 12% to $171m and net profits pre-goodwill amortisation also lifted 13% to $97m. The group generates over 96% of recurring revenues from its core customer base of accountants, business book-keepers and larger enterprises.

The company's main earnings driver is the small and medium sized enterprises that subscribe to the MYOB accounting packages. The shift from desktop applications to online delivery of software is a trend that has seen desktop users decline from 388,000 to 360,000 and online users grow from 64,000 to 225,000 over the last three years. At the same time, average revenue per paying user (ARPU) improved from $360 to $406 per annum.

While the business metrics are all pointing up, management continues to invest heavily to simplify and enhance the product offering. MYOB's *"connected practice strategy"* is a total solution offering for businesses, providing for real time transaction processing, record keeping, compliance and enhanced management reporting. Customers are less likely to migrate if this has been done well, emphasising the importance for continued product development.

During 2016, MYOB invested $56m in research and development (R&D), across existing products and future releases. It is important to appreciate that accounting rules require companies to capitalise development expenses that relate to new products but which are yet to generate revenue. As such they remain on the balance sheet and are only expensed once sales begin.

Of the $56m spent during the year, the company expensed $29m through the income statement, with the remaining $27m capitalised and added onto the balance sheet. This was offset by the $18m worth of previous software development costs amortised and expensed over the year. As such there was a $9m cash difference between the actual amount spent on development and that flowing through the income statement.

The point of this discussion is to highlight the risk of relying on what companies report without delving into the detail. In this instance, we are comfortable with the approach that MYOB has taken but also note that this additional spend is a drain on the company’s cash flow but is not reflected in the income statement until a future date, thereby boosting short term reported profits.

Not all companies have chosen the path that MYOB has taken. Groups such as medical companies Cochlear, ResMed, CSL and technology software providers Technology One and IRESS all elected to totally expense their R&D as it is spent.

We are mindful of these different approaches when assessing the business but note that in the case of MYOB, the competitive barriers to entry are significant and management's pursuit of product innovation is sensible and financially prudent.

The company is expecting to post double digit earnings growth for 2017 with operating margins remaining in the 45%-50% range. The group is supplementing organic growth with bolt on acquisitions, evident by the purchase of Paycorp for $48m. This purchase allows MYOB to enter a potentially significant new market by allowing existing clients to process payments in exchange for a processing fee.

At year end the group was carrying net debt of $373m and generated a return on capital employed of 12.4%.

NIB Holdings

CEO Mark Fitzgibbon described the health insurer's first half 2017 as a "*fantastic result*". Despite the industry backdrop of weakening health insurance affordability and participation rates, NIB delivered impressive growth across all key metrics. The group's main division, the Australian Resident Health Insurance (ARHI) posted 2.1% policyholder growth, roughly 50% of total industry growth for the half, despite its 8% market share.

Its main competitor Medibank Private reported lower policyholder numbers, partly due to its two-branded strategy (Medibank Private & AHM). NIB, on the other hand, has continued with one brand and forged alliances with organisations including Qantas, APIA and Suncorp to white-label its health insurance products. This has allowed the insurer to develop a differentiated product offering that targets a broader client base. Importantly, this approach has protected NIB from customers switching internally from a premium brand to a lower cost offering, a situation that Medibank Private has continued to experience.

The group delivered insurance premiums of $995m up 7%, gross profits of $206m, a rise of 27% and decade high margins of 21.3%. The underlying profit came in at $96.5m, up 49%.

The strength of this result can be seen in the earnings diversity, a reflection of management's efforts to invest and build multiple business streams. While ARHI remains the engine of the business, newer divisions (International Workers Health Insurance, NIB New Zealand and World Nomads Group travel insurance) have combined to deliver a growing, diverse earnings base. For the period, ARHI contributed 73% of operating profits, with the adjacent businesses adding the balance.

Management is confident that this strategy of investing in adjacencies has a considerable way to run, highlighting in one instance that a global rollout of the World Nomad Group has the potential to earn $2b in premiums, compared with its current annual premiums of circa $60m.

For the full year, the company lifted guidance for underlying operating profit to $140m-$150m, a considerable lift on the $132m delivered in 2016.

Reece Group

There are some businesses that simply glide, delivering in an effortless manner. In this bucket, we would add Australia's leading plumbing group Reece. The company rarely says more than it should, opting to let the numbers do the talking.

In this respect, the signs are positive with group sales up 6% to $1.2b. Net profits rose 7% to $96m. The company enjoys industry leading operating margins and as we outlined in our March 2014 Quarterly Newsletter, a real commitment to invest considerable sums in new products, its people and branch network operations. It is also a testament to the board and management team that avoids the limelight, but more than fulfils its obligations to shareholders.

The group is obviously benefiting from the very strong building starts and property prices which are driving higher spending on renovation. Just as importantly, expenses have been contained to a rise of 5% as several significant projects are completed, including the opening of the company's new Sydney distribution centre. Logistics are critical to the group's ongoing success and management considers its systems to be market leading.

As is customary for Reece, no full year guidance is provided although the board notes that it expects the company to "*perform reasonably well throughout the remainder of the financial year*." The balance sheet remains conservatively positioned with net debt of $65m whilst the group is generating a return on capital employed of 26%.

Reliance Worldwide Corporation

As highlighted in our September 2016 Quarterly Newsletter, Reliance is the global leader in the manufacture and supply of "*behind the wall*" plumbing fittings. Underpinning this strategy is the group's key offering, the SharkBite push-to-connect (PTC) product range. Listed in April 2016, the company continues to work towards its prospectus forecasts.

For the half, the company delivered a solid performance in the key U.S. market with net sales up 8% to $199m and operating profits up 26% to $37m. Margins rose from 16% to 18.7% as the company continued to benefit from operational efficiencies and improvements in procurement costs.

A highlight of the period was the signing of U.S. based retail partner Lowe's. This will result in the group ultimately supplying over 1,700 new outlets over the course of 2017 and 2018. This news was somewhat offset by a confirmation that the company's current largest customer, The Home Depot (THD), would cease stocking a number of other Reliance plumbing products apart from the SharkBite range. CEO Heath Sharp noted that the addition of Lowe's would "*create stronger brand awareness and a larger, more diversified platform for growth for the benefit of all distributors moving forward, including THD*."

The group confirmed they expect to meet their prospectus net profit forecasts of $63m and are confident they will deliver strong growth into 2018 and beyond. The phased launch of the company's EvoPEX pipe and fittings range for the new construction segment of the market is also expected to deliver additional longer term opportunities.

For the half, total revenues rose 4% to $283m, giving rise to operating profits of $55m and net profits of $35m. An interim dividend of three cents per share was declared. Pleasingly, net debt was reduced by $32m to $96m.

SEEK

Online jobs listing operator SEEK delivered a strong underlying first half result across its key segments. This was offset by losses in both "*early stage ventures*" and the winding down of its vocational education operations.

The group's online domestic employment business remains an earnings powerhouse. Revenues rose 13% to $171m, with operating profits of $97m and accompanying margins of 57%. There remains scope to expand further in this market. SEEK is currently investing to unlock new opportunities. The rollout of the group's placement offering is gathering momentum and further underpins its leading market position.

Significant inroads have also been made by the group's Chinese based online operation Zhaopin. As China's online employment leader, Zhaopin has successfully delivered revenue and operating profit growth of greater than 20% over recent years. Importantly, there remains considerable runway for this level of growth to continue.

Management's pragmatic approach to operating and investing is underpinned by a core philosophy of "*wanting to do things right, rather than quickly*." This is demonstrated in the considerable upfront investments being made across a range of "*early stage ventures*", estimated at $25m during 2017.

SEEK is in a strong financial position whilst noting that the privatisation of Zhaopin, in a consortium with two leading private equity firms, is at an advanced stage. Management have guided to the top end of earnings guidance for the full year of approximately $220m (pre early stage venture investment totalling $25m).

Sims Metal Management

All investors want to get the investment and timing right but in truth, getting both right can be difficult. In our September 2015 Quarterly Newsletter, we outlined the investment case for metal recycler Sims Metal Management. We understood that the company was a price taker in the normal course of business but that new CEO Galdino Claro and CFO Fred Knechtel were focused on changing this aspect of the business.

A renewed focus on buying scrap and selling to an end customer, with a set margin in place was a key element of how the business would be run. In turn, the management team was committed to generating a return on capital of at least 10% by the end of 2018, defined as net profit after tax divided by total equity.

As with most businesses dealing with challenges, significant structural changes were required but this company had one big advantage, it had surplus cash on the balance sheet, some $200m. The task of changing buying behaviour within the company as well maintaining a margin per tonne of scrap when the end price is so dependent on external factors proved more challenging than we first envisaged.

The share price quickly fell below our entry price as iron ore, a key substitute for steel scrap, fell. The actions of China to aggressively enter the global market with cheap exports also impacted trading patterns, since Sims Metal is predominantly an exporter of product. The confluence of these events impacted the group, leading to operating losses and a renewed focus on reducing the breakeven sales volume.

To the credit of both the CEO and CFO, the resulting actions taken have enabled the business to maintain profitability whilst retaining upside should the cycle turn. This is best illustrated by the drop-in volumes sold and its corresponding impact on earnings.

In 2011 the company was selling some 14.2m tonnes and generating operating profits of $205m. Based on the 2017 interim results, the annualised sales run-rate stands at 8.6m tonnes giving rise to $145m in operating earnings. The company has improved its efficiency and profitability by lowering the volume breakeven point to just 7.0m tonnes.

Here, it is important to appreciate the quantum of the cost savings the business has made while still retaining 12m tonnes per annum in production volume capacity. Management have provided some insight to the inherent leverage that remains within the business, noting that as things stand an extra 500,000 tonnes increase in scrap sold would deliver upwards of $50m in operating profits.

The impact of external price and competition factors remain, a fact not lost on us. However, the competitive landscape of recent years has seen many domestic competitors leave the market. In turn, recent actions by China to curb domestic steel production suggests a change for the better for global operators like Sims Metal.

Post recent restructurings, exports now represent 80% of sales. The company's streamline initiatives are continuing and annualised operating profits are currently running at $154m.

CEO Galdino Claro has indicated these initiatives are likely to add another $70m-$95m of profits based on current volume run-rates.

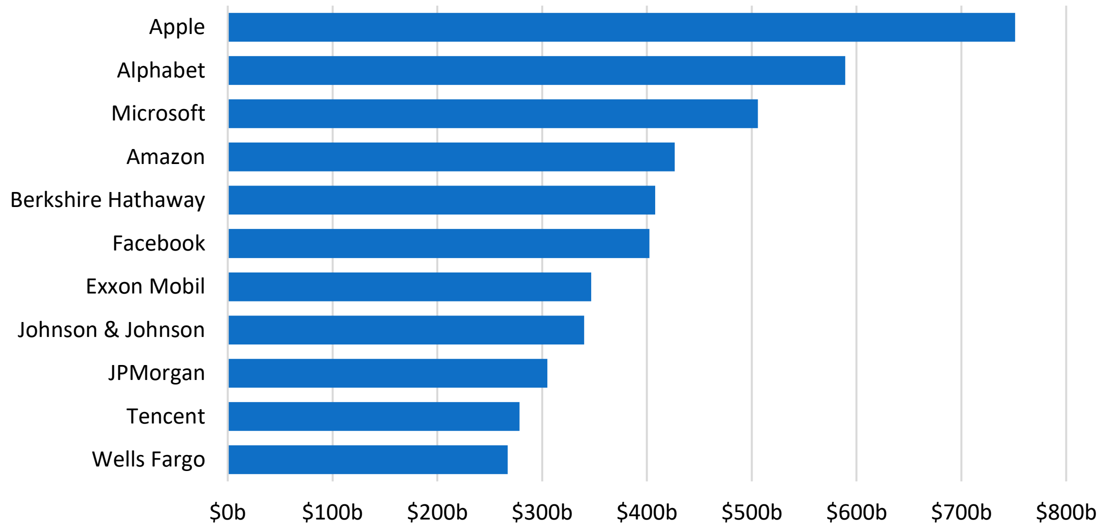
The company ended the half with net cash of $311m, an increased interim dividend of 20 cents per share and on track to generate the return on capital that originally underpinned our decision to invest. While our original investment timing wasn't great, the share price performance of recent times has us back in the black, along with renewed confidence that the business is well placed to deal with the current economic backdrop. ***SFM***

Snippets

Largest global and domestic stocks by market cap

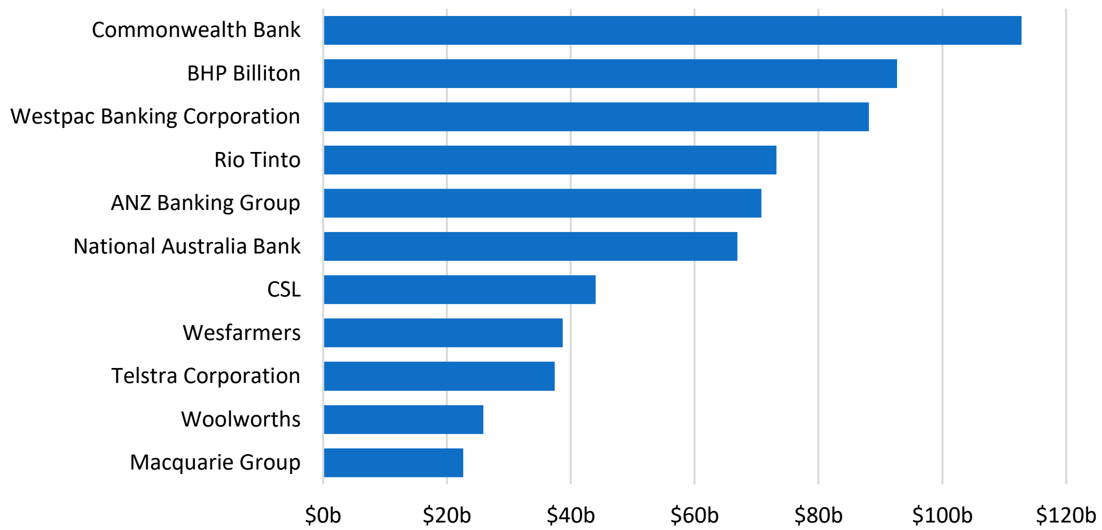
At this point in time, the largest ten stocks globally by market capitalisation are dominated by technology stocks, led by Apple, Alphabet (formerly listed as Google) and Microsoft. In Australia, this is not the case with our 10 largest publicly listed companies dominated by the big four retail banks and the two big miners BHP Billiton and Rio Tinto. How likely is it that in a decade this will remain the case?

Chart 2: Top 10 largest global stocks by market cap (USD$)



Source: IRESS

Chart 3: Top 10 largest Australian stocks by market cap (USD$)

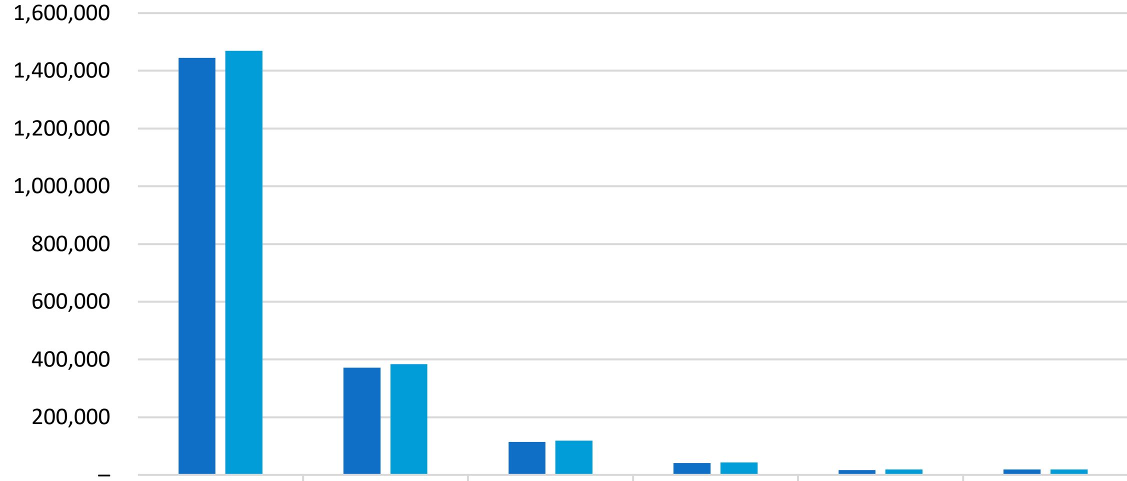


Source: IRESS

Australian Housing Market

The AFR has reported that the latest Tax Office figures show more cops than lawyers are landlords but they claim half the tax benefit. More than 2 million Australians use negative gearing.

Chart 4: Individual tax payer property ownership by number of investment properties

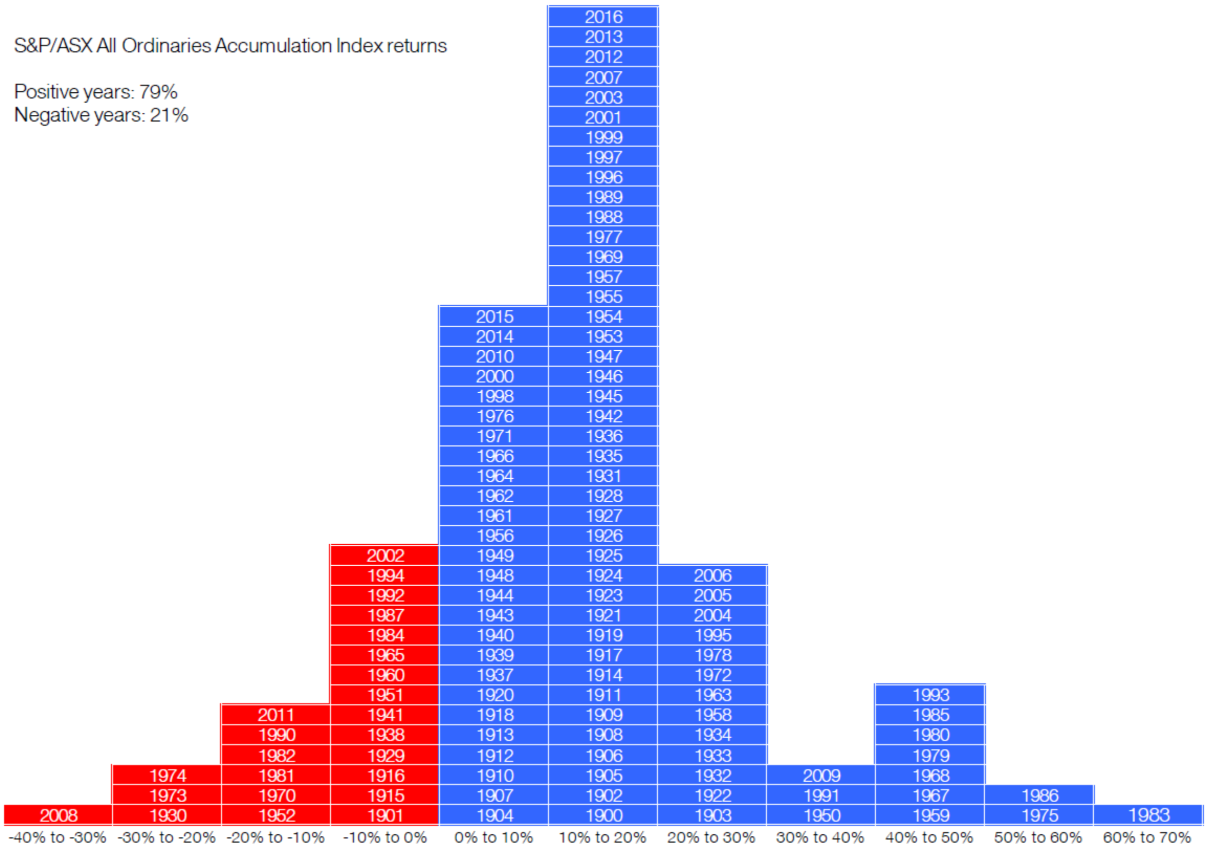


	1 Property	2 Properties	3 Properties	4 Properties	5 Properties	6 Properties or more
2013-2014	1,445,011	371,038	113,897	41,360	16,982	18,231
2014-2015	1,468,949	383,505	118,412	43,239	18,213	19,198

2013-2014 2014-2015

Annual stock market return distribution over time

The following histogram provides for an interesting visualisation of how our share market has performed over the past 116 years when measured over each calendar year. While it is dangerous to make any predictions about future performance, moves of plus or minus 40% - 50% should not be totally discounted.



Source: Macquarie Wealth Management Research

New additions to the Selector Funds Management team

We are pleased to announce that Kari Humphrey has joined the team in the role of Manager Compliance and Administration. Kari joins our most recent personnel addition, Alan Zou, who has been with the team for over 12 months operating in the role of Assistant Analyst.

Company visit diary March 2017 Quarter

January

Date	Company	Description
11-Jan	BAL	Bellamy's Australia Conference Call
19-Jan	BGA	Bega Cheese Conference Call
19-Jan	CAR	Carsales.Com Market Update Conference Call
24-Jan	RMD	ResMed Inc. Q2FY17 Conference Call
24-Jan	ALU	Altium HY17 Results Conference Call
30-Jan	ACX	Aconex HY17 Results Conference Call
31-Jan	NVT	Navitas HY17 Results Conference Call
31-Jan	IPD	Impedimed HY17 Results Conference Call
31-Jan	RMD	ResMed Inc. UBS Management Meeting

February

Date	Company	Description
1-Feb	OFX	OFX Group Management Conference Call
1-Feb	N/A	Big River Group Taylor Collison Management Meeting IPO
1-Feb	GBT	GBST Holdings Management Meeting
2-Feb	NVT	Navitas Management Meeting
2-Feb	OFX	OFX Group Management Meeting
3-Feb	JHX	James Hardie Industries Q3FY17 Results Conference Call
7-Feb	TCL	Transurban Group HY17 Results Conference Call
8-Feb	CAR	Carsales.Com HY17 Results Conference Call
9-Feb	CAR	Carsales.Com Deutsche Bank Management Meeting
9-Feb	IEL	IDP Education HY17 Results Conference Call
10-Feb	REA	REA Group HY17 Results Conference Call
13-Feb	REA	REA Group UBS Management Meeting
14-Feb	GBT	GBST Holdings HY17 Results Conference Call
14-Feb	COH	Cochlear HY17 Results Conference Call
14-Feb	RKN	Reckon UBS Management Meeting
14-Feb	GBT	GBST Holdings Management Meeting
14-Feb	RKN	Reckon MSDW Management Meeting
15-Feb	SGM	Sims Metal Management HY17 Results Conference Call
15-Feb	IFL	IOOF Holdings Ltd HY17 Results Conference Call
15-Feb	CSL	CSL HY17 Results Conference Call
15-Feb	DMP	Domino's Pizza Enterprises HY17 Results Conference Call
15-Feb	CPU	Computershare HY17 Results Conference Call
15-Feb	DMP	Domino's Pizza Enterprises MSDW Management Meeting
15-Feb	SGM	Sims Metal Management UBS Meeting
16-Feb	SGR	The Star Entertainment Group HY17 Results Conference Call
16-Feb	SYD	Sydney Airport HY17 Results Conference Call
16-Feb	DMP	Domino’s Pizza Enterprises Management Meeting

17-Feb	SGR	The Star Entertainment Group UBS Management Meeting
17-Feb	MPL	Medibank Private HY17 Results Conference Call
17-Feb	MYS	MyState HY17 Results Conference Call
20-Feb	NHF	NIB Holdings HY17 Results Conference Call
20-Feb	BAP	Bapcor MSDW Management Meeting
20-Feb	MAI	Mainstream BPO HY17 Results Conference Call
20-Feb	LNK	Link Admin MSDW Management Meeting
21-Feb	ACX	Aconex HY17 Results Conference Call
21-Feb	VRT	Virtus Health HY17 Results Conference Call
21-Feb	ALU	Altium HY17 Results Conference Call
21-Feb	OSH	Oil Search FY17 Results Conference Call
21-Feb	SEK	Seek HY17 Results Conference Call
21-Feb	VRT	Virtus Health UBS Management Meeting
21-Feb	VRT	Virtus Health MSDW Management Meeting
21-Feb	ALU	Altium Deutsche Bank Management Meeting
21-Feb	TNE	Technology One Annual General Meeting
22-Feb	AGI	Ainsworth Game Technology HY17 Results Conference Call
22-Feb	SRX	Sirtex Medical HY17 Results Conference Call
22-Feb	IRE	IRESS FY16 Results Conference Call
22-Feb	BKL	Blackmores HY17 Results Conference Call
22-Feb	TNE	Technology One UBS Management Meeting
22-Feb	ACX	Aconex Limited UBS Management Meeting
22-Feb	ALU	Altium Limited Deutsche Bank Management Meeting
22-Feb	SRX	Sirtex Medical MSDW Management Meeting
22-Feb	ACX	Aconex MSDW Management Meeting
22-Feb	AGI	Ainsworth Game Technology Management Meeting
23-Feb	RWC	Reliance Worldwide HY17 Results Conference Call
23-Feb	BRG	Breville Group HY17 Results Conference Call
23-Feb	MYO	MYOB Group FY17 Results Conference Call
23-Feb	FLT	Flight Centre Travel Group HY17 Results Conference Call
23-Feb	IVC	InvoCare UBS Management Meeting
23-Feb	SRX	Sirtex Medical Management Meeting
23-Feb	BRG	Breville Group UBS Management Meeting
23-Feb	FLT	Flight Centre Travel Deutsche Bank Management Meeting
23-Feb	ACX	Aconex GS Management Meeting
24-Feb	RCR	RCR Tomlinson Macquarie Management Meeting
24-Feb	FLT	Flight Centre Travel Group MSDW Management Meeting
24-Feb	OSH	Oil Search Deutsche Bank Management Meeting
24-Feb	MYO	MYOB Group GS Management Meeting
24-Feb	IRE	IRESS Management Meeting
27-Feb	IVC	InvoCare Deutsche Bank Management Meeting
27-Feb	RWC	Reliance Worldwide Management Conference Call
27-Feb	ALL	Aristocrat Leisure Annual General Meeting

28-Feb	ACX	Aconex Deutsche Bank Management Meeting
28-Feb	APE	A.P. Eagers MSDW Management Meeting
28-Feb	BKL	Blackmores Management Meeting
28-Feb	WOW	Woolworths Deutsche Bank Management Meeting
28-Feb	NAN	Nanosonics GS Management Meeting

March

Date	Company	Description
1-Mar	IFM	Infomedia UBS Management Meeting
1-Mar	SIQ	Smartgroup Corporation Macquarie Bank Management Meeting
2-Mar	SRX	Sirtex Medical Clinician Lunch and Learn Meeting
3-Mar	BKL	Blackmores China Product Registration Conference Call
6-Mar	NVT	Navitas AMEP Contract Conference Call
7-Mar	CBL	CBL Insurance Group UBS Management Meeting
7-Mar	DMP	Domino’s Pizza Enterprises Site Visit
8-Mar	MND	Monadelphous Group UBS Management Meeting
8-Mar	MND	Monadelphous Group MSDW Management Meeting
8-Mar	SGM	Sims Metal Management Conference Call
9-Mar	OFX	OFX Group Management Meeting
9-Mar	NHF	NIB Holdings MSDW Management Meeting
10-Mar	MYS	MyState 1H17 Post Results Roadshow
13-Mar	N/A	Zip Water IPO Meeting
14-Mar	REA	REA Group GS Management Meeting
15-Mar	GBT	GBST Holdings Taylor Collison Management Meeting
21-Mar	TPG	TPG Telecom HY17 Results Conference Call
29-Mar	IPD	Impedimed Management Meeting
30-Mar	OFX	OFX Group New CEO Management Meeting