



In this quarterly edition we review performance, attribution and look back on the 2015 Financial Year. In our headline story, we visit Asia. In addition we comment on the SIRFLOX trial, debt and the Federal Budget. Photo: "Glass half"

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 close of the 2015 financial year delivered investors another year of positive returns with our local All Ordinaries Accumulation Index notching up a 5.67% gain. This represents the third consecutive year of rises, which belies the weak economic environment. Consumers have benefited from benign interest rate settings, which have driven greater discretionary purchasing power along with rising property prices and equity valuations.

This has fuelled debate regarding the sustainability of the performance of these asset classes. The situation is further complicated by the ongoing Greek debt saga that has now entered its fifth year, following the International Monetary Fund's initial USD38 billion bailout in 2010. In stark contrast, the US economy continues to make steady progress with the US Federal Reserve now poised to lift rates for the first time since 2006. The case for a prudent lift in interest rates should be seen for what it is, a reflection of a growing economy.

Locally, conditions remain mixed with the unemployment rate at a twelve month low of 6.0%, surprising many who had expected a higher trend. As the largest state, the NSW Government remains well placed to benefit from the record intake of property stamp duty revenues and the \$13 billion expected from the privatisation of electricity assets. Nationally, the 17 June signing of a Free Trade Agreement with China comes after more than a decade of negotiations. The benefits that will flow to both countries and businesses undertaking trade should not be underestimated.

For Australian businesses this means a greater ability to trade with China with reduced tariff imposts. The agreement is taking shape at an important time for both nations. As the Chinese economy shifts from infrastructure driven growth to a consumption based model the timing of the FTA dovetails neatly with the increased demand for high quality, Australian branded goods and services. While still a work in progress, this significant policy shift is reflective of the enormous changes now underway in a country that in population terms is some sixty times larger than our own.

During the quarter we travelled throughout Asia, visiting a number of our investment holdings. These included **iProperty Group** in Malaysia, **GBST Holdings** in Hong Kong and gaming operators **Aristocrat Leisure** and **Ainsworth Game Technology** in Macau. Our final visit centred around **SEEK's** Chinese subsidiary, **Zhaopin**, based in Beijing. We also attended the ASCO medical conference held in Chicago where **Sirtex Medical** presented its key findings from its recently completed SIRFLOX trial. Finally, we comment on the dangers of companies carrying too much debt and we give an assessment of the recent Federal Budget.

For the 2015 June quarter the Fund delivered a gross negative return of **8.37%** compared to the All Ordinaries Accumulation Index negative return of **6.25%**. For the financial year the Fund returned a gross gain of **14.57%** against the Index rise of **5.67%**.

Regards,

Selector Investment Team

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Quote: Warren Buffett - Berkshire Hathaway CEO

Addressing shareholders at the group's annual general meeting in May 2015.

"Culture, is everything at Berkshire. Culture has to come from the top. It has to be consistent. It has to be part of written communications and rewarded when followed and punished when not."

Performance June 2015

For the quarter ending June 2015, the Fund delivered a gross negative return of **8.37%** as compared with the **6.25%** fall in the All Ordinaries Accumulation Index. Performance statistics are detailed on page 29.

Performance table since inception

Returns	Gross Fund Return %	All Ordinaries Accumulation Index %	All Ordinaries Index %
3 Months	-8.37	-6.25	-7.01%
6 Months	3.24	3.32	1.16%
1 Year	14.57	5.67	1.29%
3 Years annualised	26.73	14.47	9.64%
5 Years annualised	15.73	9.36	4.74%
10 Years annualised	9.33	7.02	2.57%
Since Inception annualised	11.23	7.91	3.47%

Fund's Top 10 holdings

Top 10 June 2015*	Top 10 March 2015*
ALTIUM	ALTIUM LIMITED
ARISTOCRAT LEISURE	ARISTOCRAT LEISURE
CARSales.COM	CSL LIMITED
CSL	DOMINO'S PIZZA ENTERPRISES
FLIGHT CENTRE TRAVEL GROUP	FLIGHT CENTRE TRAVEL GROUP
GBST HOLDINGS	GBST HOLDINGS
IOOF HOLDINGS	IOOF HOLDINGS
RESMED	RESMED
SEEK	SEEK
SIRTEX MEDICAL	TECHNOLOGY ONE
Top 10: 45.91%	Top 10: 48.78%

* Listed in alphabetical order

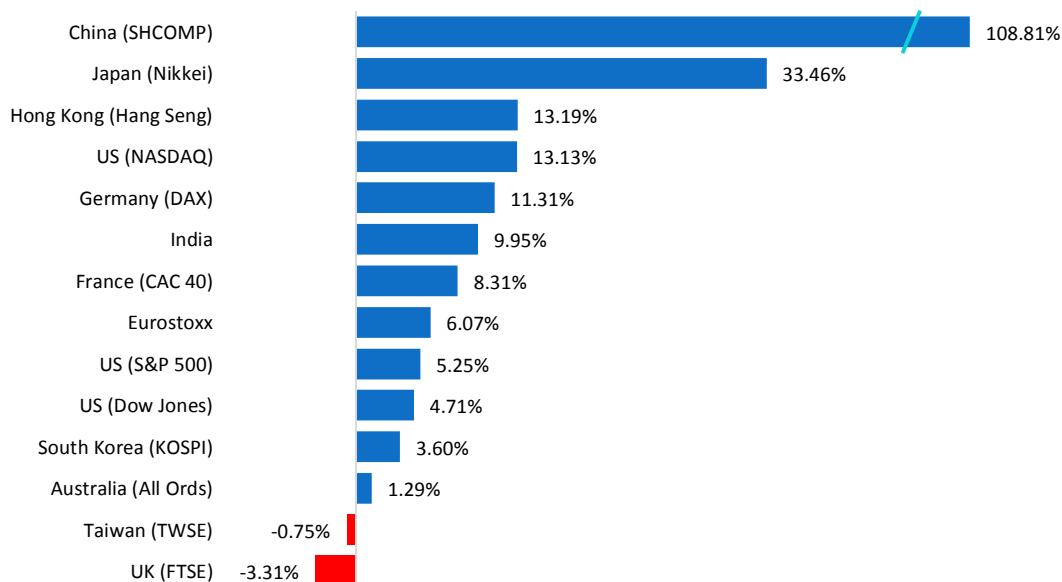
Selector employs a high conviction, index unaware, stock selection investment strategy, which typically targets 15-25 stocks for the Fund. As shown above, the Fund's top 10 positions usually represent a high percentage of its equity exposure. Current and past portfolio composition has historically been 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 large fund managers.

Performance attribution for the June 2015 quarter

Top 5 stock contributors	%	Top 5 stock detractors	%
SIRTEX MEDICAL	1.07	RESMED	-1.20
BLACKMORES	0.01	SEEK	-1.01
REECE AUSTRALIA	0.01	VIRTUS HEALTH	-0.78
SAI GLOBAL	0.01	FLIGHT CENTRE TRAVEL GROUP	-0.73
ALTUM	-0.01	ARISTOCRAT LEISURE	-0.61

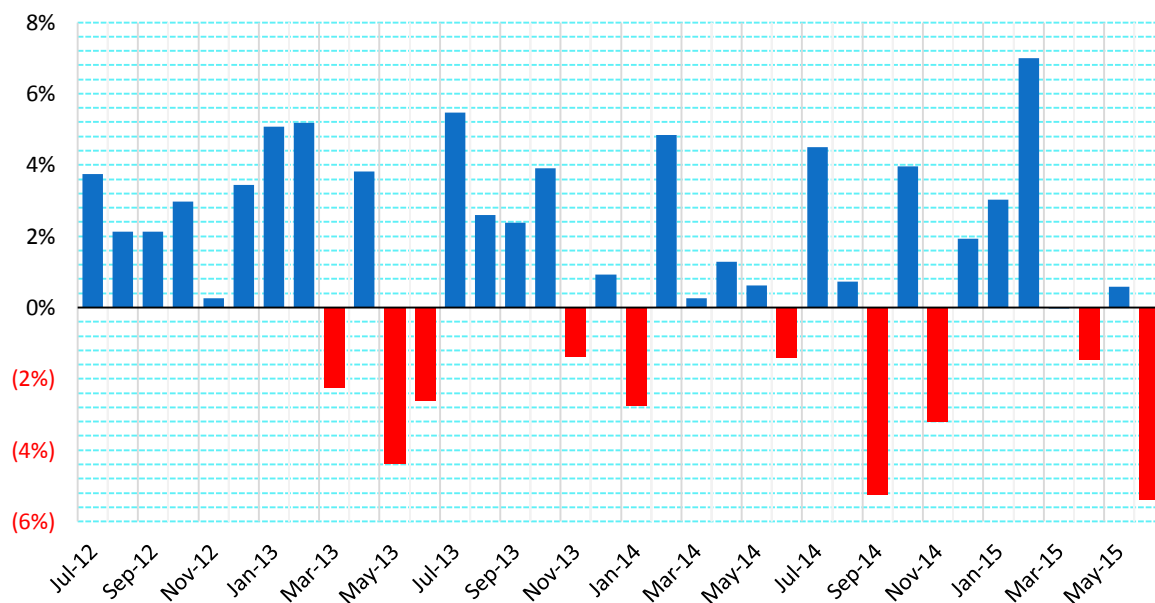
Performance attribution for the 2015 financial year

Top 5 stock contributors	%	Top 5 stock detractors	%
SIRTEX MEDICAL	4.46	FLIGHT CENTRE TRAVEL GROUP	-1.09
ARISTOCRAT LEISURE	2.57	VIRTUS HEALTH	-0.97
GBST HOLDINGS	2.18	OIL SEARCH	-0.78
DOMINO'S PIZZA ENTERPRISES	2.17	IPROPERTY GROUP	-0.77
ALTUM	1.94	INTUERI EDUCATION GROUP	-0.64

Market Commentary*Global Equities 12 Month Returns*

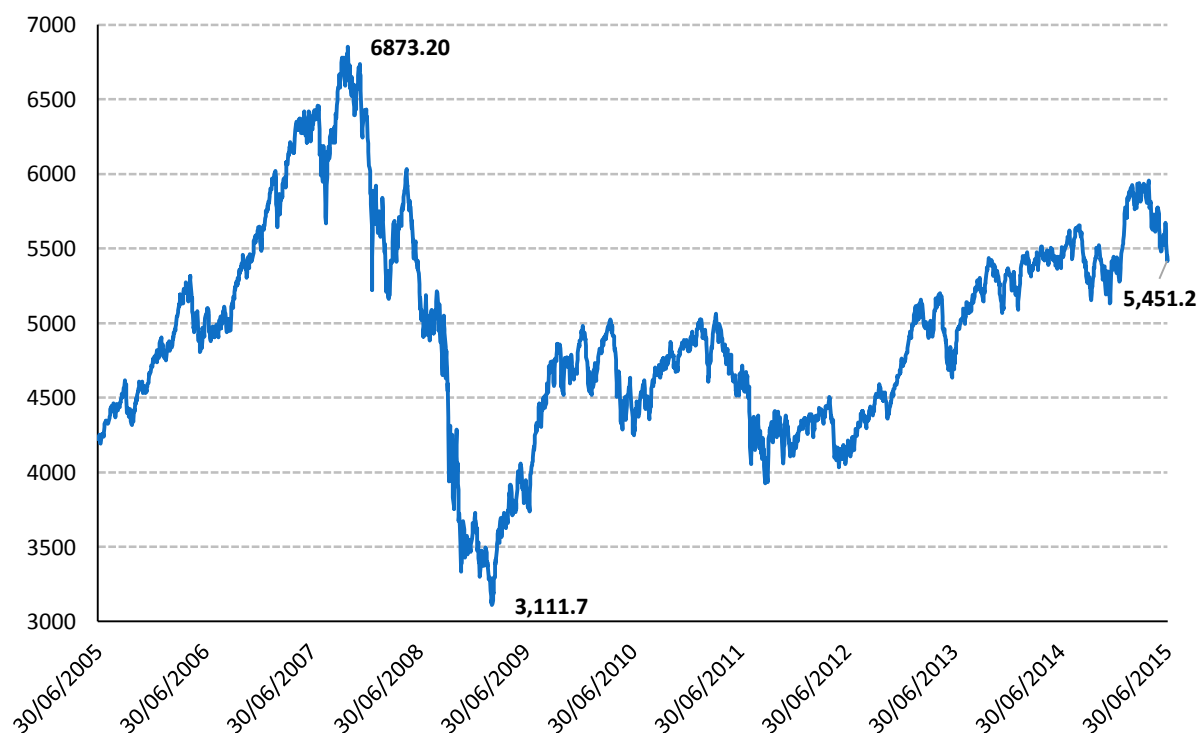
Global markets provided investors with gains despite economic activity remaining anaemic in many parts of the world. The standout markets included China's Shanghai Composite and Japan's Nikkei indexes, both returning in excess of 30%. The US NASDAQ index continued its upward trend while the majority of the other major global indices returned single digit gains.

Monthly All Ordinaries Accumulation Index Returns 2013 through 2015 Financial Years



Locally the main index, The All Ordinaries Accumulation Index rose **5.67%**, with the Healthcare, Telecommunications and Industrials sectors posting double-digit returns offset by poor performances by Energy, Consumer Staples and Materials.

All Ordinaries Index June 2005 – June 2015



Portfolio Commentary

Below we provide brief commentary on some of the larger portfolio moves during the quarter.

Top attribution

1. Sirtex Medical (ASX: SRX)

Liver cancer device manufacturer **Sirtex Medical** delivered the Fund's largest contribution. The company delivered the key results from its SIFLOX study during the quarter and we attended the ASCO conference held in Chicago. Please refer to our notes regarding this study later in the newsletter.

2. Blackmores (ASX: BKL)

Australia's largest vitamin operator, **Blackmores**, continued to perform strongly, unveiling nine-month sales up 28% to \$326m and net profits up 76% to \$31m. Strong pharmacy sales and growing demand from Chinese consumers boosted the result. Sales in Asia were up 43% in the third quarter as all regions with the exception of Thailand, performed strongly. Management reiterated that full year profits were expected to be in the range of \$40-\$44m.

Bottom attribution

1. ResMed (ASX: RMD)

Sleep apnea device manufacturer, **ResMed**, recorded the largest negative contribution to performance during the quarter following a mixed third quarterly results update. Strong flow generator sales following the release of the group's newest AirSense 10 product range were offset by weaker mask sales, which directly impacted gross margins and operating profits. Despite this, management remains positive, noting masks sales are set to return to positive growth following price reductions made during the previous year. More disappointing for investors was the group's update on the SERVE-HF clinical trial, which examined the impact of treating chronic heart failure patients with **ResMed's** Adaptive Servo-Ventilation (ASV) therapy. The trial not only failed to show a statistically significant difference between the two patient groups, but also led to increased patient risk of cardiovascular incident. Management moved quickly to update regulators of the trial results whilst noting that despite this setback, ASV devices represent only 2% of group sales.

2. SEEK (ASX: SEK)

Leading online recruitment firm, **SEEK**, updated investors on trading conditions late in the quarter, noting that the group's **SEEK Learning** division had been impacted by one-off IT system issues undertaken by TAFE NSW. This would see full year operating earnings for this division impacted to the tune of \$11m thereby delivering divisional earnings of \$31-\$33m as against market expectations of \$42m. Furthermore, Federal Government reforms of the VET FEE-HELP sector is also expected to lead to structural challenges, impacting both **SEEK** and its learning partners. With changes legislated to take effect on 1 January 2016, the full financial impact on **SEEK Learning** is expected to be felt over the next two years. That aside, **SEEK** management re-affirmed all other guidance statements made at the time of its interim results and pointed to underlying net profits for the second half to be consistent with the company's

\$94.1m first half result. Management highlighted that earnings for 2016 would be moderated by these events as well as the group's ongoing aggressive reinvestment in online operations, both locally and internationally.

3. Virtus Health: (ASX: VRT)

Leading IVF operator **Virtus Health** updated investors late in the quarter, downgrading its 2015 earnings guidance, from mid-teens to low single digit growth. A number of factors contributed to the expected lower result, including subdued IVF demand, start-up losses at the group's Singaporean operations and increased competition from bulk billing operators such as **Primary Healthcare**. This development will place further pressure on the group's highest margin full service fertility clinics although this competitive threat has been somewhat offset by the group's own low cost operating model, "The Fertility Centre".

4. Flight Centre Travel Group: (ASX: FLT)

Australia's largest travel operator **Flight Centre Travel Group**, updated the market late in the quarter, with current year pre-tax profits now expected to come in towards the bottom end of the group's previous earnings range of \$360-\$390m. Comments regarding weaker domestic demand and some loss of market share to online operators impacted investor sentiment. The group also updated on international operations, with four businesses, the UK, the US, Singapore and South Africa delivering record operating earnings. The company expects to end the year with a net cash balance in excess of \$500m.

5. Aristocrat Leisure: (ASX: ALL)

The group delivered its interim results for 2015 during May, which included a first time contribution from the company's recent acquisition of US based Class II gaming machine operator **VGT**. Group revenues hit \$685m, with underlying net profits rising 67% to \$110m. As per management's commitment to reducing the company's debt levels post the group's **VGT** acquisition, dividends were kept steady at 8 cents per share. CEO Jamie Odell noted that the successful integration of **VGT** had been a significant factor in company performance as well as the continuing strong operational performance from the group's US gaming operations. This has seen the company's installed gaming machines in US casinos lift 12% for the half to 9,204, with the win per day per machine also rising 16% to USD50.15. Management announced that the company would exit the Japanese market, focusing attention on operations that can deliver more reliable earnings streams. By the close of first half, this had seen contributions from recurring revenue sources climb from 22% to 47% of group revenues.

SFM

Macau

We visited Macau in May and attended the Global Gaming Expo Asia (G2E Asia) held at The Venetian Macau. G2E Asia made its debut in June 2007 and is the gaming industry's pre-eminent conference, showcasing the newest gaming machines and table games.

Events are held annually in both Macau and Las Vegas, the two biggest markets for gaming products. Our visit included a product tour of the **Aristocrat** stand. As a gaming destination Macau has come a long way.

Brief history

Macau is a small peninsula in Mainland China, across the Pearl River from Hong Kong. The city sits within an area covering 30 square kilometres and has a population of 566,000. In comparison, Las Vegas' population sits at 603,000. Macau's likeness to Las Vegas is also reflected in its nickname, the "Las Vegas of the Far East."

Macau became a colony of the Portuguese empire in 1557, although it remained under Chinese authority and sovereignty. In 1987 Portugal agreed to return Macau to China as a Special Administrative Region (SAR) with the handover taking place in December 1999. Under China's "one region, two systems" formula, Macau retained autonomy and will not be subject to China's socialist economic system until 2049.

Macau

In 2002 Stanley Ho's 40-year exclusive right to run all gambling operations in Macau ended. In its place the Macau Government introduced a number of new casino operating concessions allowing the owners, totalling six in all, to build as many casinos as deemed appropriate. Three concessions to operate were issued to parties including Stanley Ho's Sociedade de Jogos de Macau (SJM), Galaxy Casino and US operator Wynn Resorts. In turn, the Macau SAR permitted the existing concession holders to issue sub-concessions to three new operators, The Venetian Macao, MGM Grand Paradise and Melco PBL.

In order to allow for its development, land was reclaimed giving rise to what is now known as the Cotai Strip. Construction of the hotel and casino industry began, and in 2004 the first casino the Sands Macao, owned by the Las Vegas Sands Corporation opened. In 2006 Wynn's first casino opened for business while James Packer's investment in Melco gave rise to the opening of Casino Crown (now Casino Atira) in 2007.

By the end of 2014, there were a total of 35 casinos in operation, with 23 located on the Macau peninsula and 12 on the Cotai Strip. Of these, Stanley Ho's interest extends to 20 casinos, followed by Galaxy with six, the Venetian with four, Melco Crown with three and both Wynn and MGM with one each.

Casino Industry

Between 2009 and 2012 Macau's new casino openings fuelled explosive growth as gross gaming revenues rose approximately 30% per annum. Much of this can be attributed to the fact that gambling has been forbidden in Mainland China since 1949. Today, Macau

represents the biggest single gambling market in the world with gross gaming revenue totalling USD42 billion.

In contrast to Las Vegas, Macau's rise to prominence has not been due to mass tourism but to its success in attracting "high rollers". This is a term to describe individuals who bet big. This business is arranged by junket operators. Historically casinos have paid huge commissions to these operators. While high rollers drive significant revenues, the margins are wafer thin and it is the ordinary gamblers or the "mass market" that deliver the majority of a casinos' profit.

Macau's 35 casinos attracted 31 million visitors during 2014, with over 65% represented by Chinese nationals. In total, these casinos operate 5,711 gaming tables and 13,018 slot machines. The high roller players make up 60% of gross gaming revenue with the balance coming from the mass market.

Table 1: Gaming region overview

Regions	Australia	Macau	Singapore	Philippines	Malaysia	Korea	Cambodia	Vietnam
Casinos	13	35	2	19	1	17	26	7
Tables	1,666	5,711	1,300	842	600	915	1,164	199
Slot Machines	196,742	13,018	5,000	4,500	4,000	2,328	3,414	N/A
Revenue								
VIP	26%	60%	49%	49%	60%	81%	50%	74%
Mass	74%	40%	51%	51%	40%	19%	50%	26%
Tax Rates								
VIP	10-12%	39%	5%	15%	25%	13.4%	1% revenue	35%
Mass	28%	39%	15%	25%	25%	13.4%	1% revenue	35%
Corporate	29%	0%	17%	0%	25%	24%	0%	22%

Source: Macquarie Research Asia Gaming 2015

Table 2: Regional development pipeline 2020

Regions	Capital Investment \$b
Macau	27.3
Philippines	3.1
Korea	4.3
Malaysia	1.3
Australia	6.1
Cambodia	0.4
Vietnam	4.5
Vladivostok	1.0
Saipan	2.0
Total	50.0

Source: Macquarie Research Asia Gaming 2015

Macau is the world's single largest market, with gross gaming revenues of USD42 billion dwarfing the circa USD20 billion gambled in the other regions that include: Singapore, Philippines, Malaysia, Korea, Cambodia, Vietnam, Vladivostok and Australia. Macau levies the highest taxes in the region at 39% on gross gaming revenues. This compares to less than 30% in most other jurisdictions.

Casino operators are granted concession periods of 20 years, with six current licenses set to expire during 2020 and 2022. Despite this, concession owners are looking to add another five casinos between 2015 and 2018, with capital expenditure totalling USD27 billion. Other regions are also set to expand their casino offerings, with a capital budget of USD22 billion earmarked, including USD4 billion in the Philippines, USD3 billion in Korea and USD6 billion in Australia.

Despite enjoying strong growth in gaming revenues over an extended period, recent attempts by Chinese authorities to clamp down on anti-corruption activities is significantly impacting Macau's high roller market. This has led to gross gaming revenues falling by 25% from USD42 billion to around USD31 billion. These actions are placing pressure on concession operators, while alternative destinations including Australia gain increased attention from junket operators and high rollers.

Aristocrat in Macau

We visited **Aristocrat** at the G2E Asia Convention held in The Venetian Macau. In attendance were **Aristocrat** CEO Jamie Odell and the group's Asia Pacific Managing Director Vincent Kelly. Kelly joined **Aristocrat** in October 2014 having held previous roles with global beverage organisations. His appointment was part of wider changes at the group, with the Asia Pacific region (excluding Australia and New Zealand) lifted to a standalone business segment.

We profiled the **Aristocrat** business in our June 2014 Quarterly Newsletter and highlighted that one of the key features of the business was the annual investment made in new product games and machines, a point not lost on Kelly during a recent interview with GGRAsia;

"We invest more in research and development every year than we actually make in profit... I am confident that the investment that we have made in our people, in our creativity, in our technology; will continue to produce great games for our customers across Asia Pacific."

"I already have had the opportunity to travel around the Asia Pacific region – obviously Macau, where we are based, but also Singapore, Manila, Kuala Lumpur," said Mr Kelly.

"There are three things that have very pleasantly surprised me: the amount of growth there is in our industry across so many markets; everything that is happening in the Philippines; and the high quality of the development in Macau."

The group's suite of popular games has allowed **Aristocrat** to build a formidable position in Macau, with a slot machine market share of 50% to 60%. With approximately 13,000 slot machines in operation, this is both an important and growing region especially given the



Photo: Aristocrat's First Machine on display in Macau at the G2E Conference

expected increase in new casinos by 2018. The majority of this growth will come from the Cotai strip with an expected increase of 6,000 to 8,000 slot machines.

The group operates an integration centre in Macau that produces 2,000 to 3,000 machines each year. This has allowed **Aristocrat** to undertake player and operator research in the region to understand trends, although the Chinese Government's recent clampdown on anti-corruption activities will impact visitation levels. Competition from other slot manufacturers including Len Ainsworth's **Ainsworth Game Technology** is placing pressure on **Aristocrat's** ability to maintain its commanding market share.

For **Ainsworth**, an estimated 10% market share has been captured with the company noting;

"We are selling steadily up there and we are gaining market share, which is satisfactory to us. Aristocrat has the majority of the business but we are biting into that here and there. We are gaining because of the quality of our equipment and we'll continue to gain."

The commercial importance of slot machines to casino operators in Macau shouldn't be underestimated. Machines account for 5% of gaming revenue in Macau but up to 20% of earnings, driven primarily by the fact that these games are less labour intensive.

This trend is set to continue in other regions throughout Asia with **Aristocrat** already servicing eleven countries, including Vietnam, Cambodia, Singapore, Malaysia and the Philippines. As noted earlier, this region is set to experience a significant expansion of integrated resorts over the next decade, estimated at USD22 billion when Macau is excluded. Including Macau the figure is closer to USD50 billion. **SFM**

China - a visitor's perspective

Having travelled through Asia and in particular China over a period of three weeks some casual observations are worth sharing. Infrastructure development appears alive and well, with cranes dotting the Malaysian and Hong Kong skylines as well as the major cities visited in China.

Focusing specifically on China it is hard not to be taken aback by the sheer scale of infrastructure required to service these large cities. In all, our travels took us to the regions of Beijing (population 20m), Shanghai (population 23m), Hangzhou (population 9m), Vichang (population 4m), Wuhua (population 9m) Xi'an (population 9m) as well as a trip down the Yangtze River.

Travelling throughout the country is relatively straightforward and inexpensive with excellent facilities including the impressive array of international and domestic airports, super-fast trains and city subways. Security checks are a constant undertaking and thorough in their process.



Photo: The Great Wall of China in the JuYong Pass

To the outsider, communication can be a barrier but with a growing annual influx of international tourists the use of the English language is increasing in importance. Chinese

students now learn English as a compulsory subject.



Photo: Communicating directions to taxi drivers are best done with translation apps.

At times it would appear that the universal language spoken throughout the country is not Mandarin but the car horn. The daily commute on the roads is a constant manoeuvring process between the cars, buses, bikes, taxis and pedestrians. There appears to be few rules other than first in best dressed. Despite the activity, traffic appears to flow surprisingly well and is assisted by police

enforced daily traffic flow restrictions based on a driver's car number plates. Driver aggression is rarely, if ever, observed as the car horns do their job.

A typical school day is longer than that experienced at home, beginning at eight and finishing before six in the afternoon. Our guide in one of the cities we visited spoke about the enormous amount of school homework undertaken by her thirteen year old son. The pressures on parents are also not dissimilar to that experienced in other overseas cities including our own. The relaxation of the one child policy is certainly welcomed but the desire to have more children is offset by the added cost of supporting a larger family.

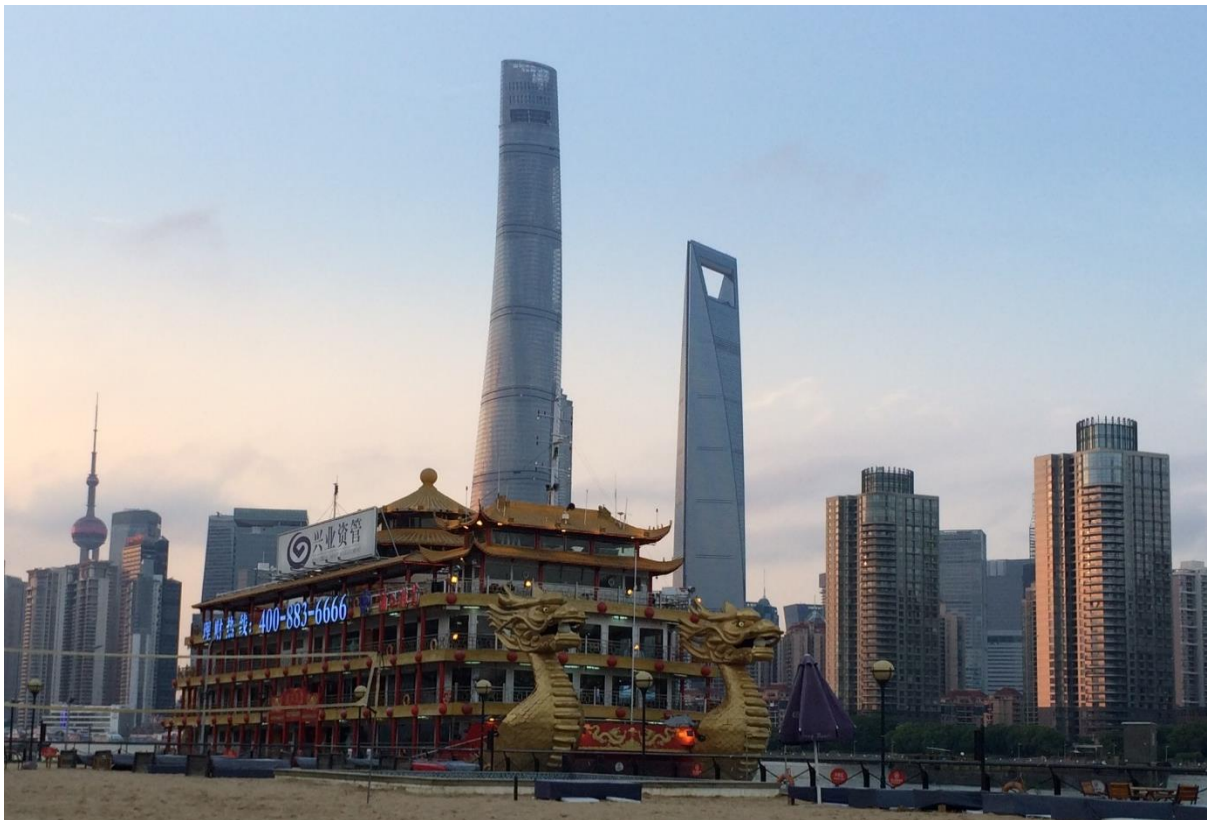


Photo: Yangtze River Boat

Almost universally the issue of housing affordability rose to the fore. The cost of apartments, which is the common abode throughout, varies according to the city. By way of example a Beijing apartment sells for about 20,000 RMB per square metre. It was suggested that a family living in a 120 square metre home, would be outlaying 2.4 million RMB, typically requiring a 10% deposit and a 30 year mortgage, figures not dissimilar to Sydney. An average worker in Beijing earns around 70,000 RMB, leaving little in reserve once the normal monthly expenses are taken into account.

In comparison a new Sydney apartment could require an AUD1.0 million outlay while an average salary worker could be earning upwards of AUD70,000. Under this scenario it would suggest local property is more affordable than the situation that currently exists in Beijing. For more affluent Chinese families the attraction of a city like Sydney becomes all the more

appealing when you consider that a property purchased in China remains State owned with a maximum lease term of 70 years, unlike freehold Australian homes.

There are many daily rituals in China with food front and centre. The Chinese food stalls and restaurants are in abundance, offering fast service at affordable prices. Daily exercise routines feature prominently among the locals and it is rare to see overweight men or women. While obesity is unlikely to pose the same threat that it has in western countries, the same cannot be said of other health issues such as smoking and air pollution.

In both instances growing media coverage is beginning to highlight the significant social issues facing China's population. On 1 June the China Daily newspaper reported that the Government had begun its crack down with new non-smoking rules, requiring many indoor and outdoor public places in Beijing to be totally smoke-free. While fines have been set relatively low at 200 Yuan (USD32) it is a positive step towards addressing a growing health issue. According to the National Health and Family Planning Commission there are more than 300 million smokers with more than one million dying of smoking related diseases each year.

While there may be reluctance from locals to conform to these new rules the same cannot be said of the need to address air pollution. While we were fortunate to have blue skies during the majority of our stay, we were also confronted by grey polluted days. It is easy to see why with such large populations putting strain on both industry and services. The China Daily reported that progress was being made, noting that since 2013 the Beijing City region had reduced consumption of coal by 9.2 million tonnes. Over that same period more than 680 polluting companies were closed for business and about a million high emitting vehicles were removed from the road.

The population migration from rural areas to the cities is ongoing. Our conversation with locals took on an all too familiar tune. The stream of young job seekers leaving in search of better prospects elsewhere places strains on the cities, while the rural townships are left to cope with dwindling demand and aging populations.

Throughout our stay, what became patently clear was the Chinese desire to travel and spend. Personal wealth is certainly on display and accommodated by the plethora of internationally recognised brands that line the major shopping hubs of the cities. At night it is hard not to be impressed with the array of lights that showcase the best of China's shopping districts.

Topping the growing middle class shopping list are goods and services including mobile devices of all shapes and sizes, internationally branded fashion labels, reputable health care products, educational services and travel. Travel statistics illustrate the power of these trends. In 2014 over 2.2 million Chinese tourists visited the USA, with nine out of every ten spending on average USD10,000, totalling USD23 billion. Globally the Chinese were only outspent by Canadian visitors.



Photo: Western influences in the Tier 1 cities are already prominent.

Even after a short stint in the country you walk away with a sense that the Chinese consumer will be a significant driver of economic growth in the years ahead. Whilst investor attention remains centred on the ongoing demand for new infrastructure projects to maintain strong levels of economic growth, it is also clear that there is opportunity available for companies that can establish a trusted branded status, illustrated by the US based coffee house Starbucks. Their presence in prominent sites throughout the areas we visited speaks volumes of the inroads western influences are having on the traditional way of life.

Free Trade Agreement

On 17 June 2015 Australia and China signed a Free Trade Agreement (FTA) after more than a decade of negotiations. The implications of the benefits that will flow to both countries and businesses undertaking trading activity should not be underestimated. What this means for Australian businesses is a greater ability to trade with China with reduced tariff imposts. The agreement is taking shape at an important time for both nations. As the Chinese economy shifts from infrastructure driven growth to a consumption based model the FTA timing dovetails neatly with the increased demand for high quality, Australian branded goods and services.

These types of agreements promise a great deal but getting things done is not altogether straightforward. It does however, remove another impediment to doing business. Under the deal 85% of Australian goods entering the country will now carry no penalty. Currently the two way trade flows exceed AUD160 billion.

This will assist resource and energy products, which will have all penalties removed as well as agricultural exports including wine, meat, seafood and dairy. Our own experience in owning businesses including the likes of vitamins maker **Blackmores** and China's online employment leader **Zhaopin** (via our **SEEK** holding) gives us enormous confidence that not only are these companies well positioned but that their respective products and services are attractive to the Chinese consumer.

Complimenting these positive and growing consumer trends is the Government's desire to open the market up to private enterprise. While still a work in progress, this significant policy shift reflects the enormous change now underway in a country that in population terms is some sixty times larger than our own.

Overall, China is on a path of significant change. Getting the balance right will not be easy and already social issues are becoming hot topics, best illustrated with moves to counter smoking and air pollution. That said, the underlying trends are clear; a growing, educated, middle class with a desire to move up the social standings will ultimately demand better and more trusted products and services. Those that provide them are destined to benefit enormously. **SFM**

Sirtex Medical: (ASX:SRX)

As discussed in our most recent quarterly, on 17 March **Sirtex Medical** reported its preliminary SIRQLOX study results in the first-line treatment of non-resectable metastatic colorectal cancer (mCRC). SIRQLOX was the first large Randomised Control Trial (RCT) of a liver-directed therapy. The limited headline data released in the announcement caught the market by surprise as the stock traded near its all-time high.

The primary endpoint of the SIRQLOX trial aimed to show a statistically significant improvement in overall Progression-Free Survival (PFS) in all sites of the body, including those outside the liver. This was not achieved, but other key scientific findings have emerged.

Sirtex provided a second release to the market in mid-May that gave new clarity for a subset of patients with mCRC, a cancerous tumour that has spread from the colon to the liver but not beyond this organ. The secondary endpoint was a critical finding. It showed that the SIRQ-Spheres Y-90 resin microspheres result in a statistically significant improvement in median PFS in the liver. Since SIRQ-Spheres is a liver-directed treatment, this finding offers new hope for beating a disease where the dominant cause of death is liver metastases. It will also be a key plank in the marketing that is required to drive increased dose sales.

ASCO Presentation

In late May we flew into the "Windy City" of Chicago, along with over 30,000 delegates and oncology professionals from around the globe to attend the 2015 Annual Meeting of the American Society of Clinical Oncology (ASCO). Our focus was centred on the release of the SIRQLOX abstract to be presented by lead investigator, Associate Professor Peter Gibbs, as well as gaining a first-hand understanding of the influential peer review discussions.

Sirtex had one of the largest display sites at the ASCO Annual meeting, complete with white leather couches, thick shag pile carpet, gleaming digital displays and never ending coffee. At a cost of USD750, 000¹ this wasn't a company hiding from a data set that had missed. On the contrary it was evident that the "US style" of sales and marketing had started with a confident air. The sentiment was best summed up by **Sirtex's** 13 year veteran and Head of Europe & EMEA Nigel Lange, "this is the launch of our technology and our coming out party", some 15 years after the company first listed onto the stock exchange.

¹ 155 doses of SIRQ spheres at US\$16,000 per dose drive and an EBIT margin of 30% would neatly cover this cost.

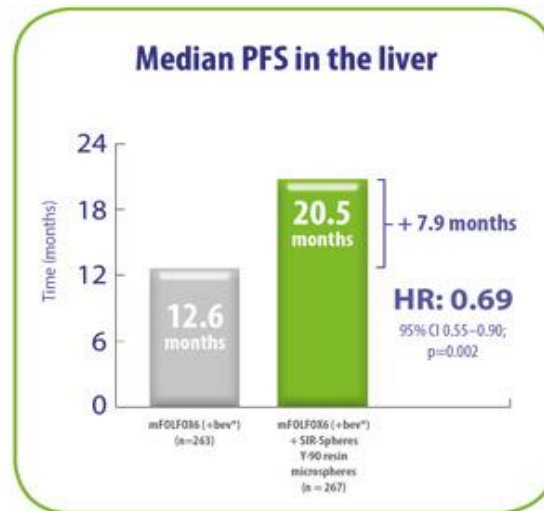


Sirtex Medical: An impressive display at ASCO Annual Meeting 2015

Until ASCO, **Sirtex** had little to work with in the US. A restrictive and outdated label claim has seen a cautious approach to selling. With the SIRFLOX data in hand we see a strong swing in favour of the company. They now have a story to sell. We base our opinion on a cross section of views from ASCO. Presented in order, these include comments made by:

- the SIRFLOX RCT lead investigator, Associate Professor Dr Peter Gibbs;
- the summation of the designated ASCO discussant, industry expert Professor Ricky Sharma;
- the views of Key Opinion Leaders; and finally
- senior **Sirtex** staff, including Mike Mangano the head of US operations.

Firstly, in his ASCO abstract, Associate Professor Gibbs found “major changes” in the liver only subset. The SIRFLOX secondary end point achieved an additional 7.9 months on top of the standard chemotherapy treatment (the control arm) which gives 12.6 months PFS, with an “impressive Hazard Ratio” of 0.69. This Hazard Ratio is a key indicator for patients, with the study showing that patients on the SIRFLOX treatment arm have a “31% risk reduction of disease progression in the liver”. Referring back to our earlier comments, the importance of this ratio is that it allows patients to fight the disease in the liver, which is the dominant cause of death.



Sirtex; Impressive data at ASCO Annual Meeting 2015

In his summary Gibbs stated the;

“Key message is it has a major impact on the control of liver metastasis with the addition of Y-90 resin microspheres to standard first line chemotherapy for patients with mCRC limited to the liver or small volume extra hepatic liver disease, hopefully this will translate to an improvement in overall survival”.

Gibbs was followed by the expert discussant Professor Ricky Sharma from the University of Oxford, whose role was to comprehensively and critically review the study data. The points he raised were equally definitive:

- Oncologists need more than one modality of treatment;
- To date 71 drugs have provided a combined 2.1 months improvement;
- Oncologists need a combination of treatments;
- SIRT is safe and this is the first large trial;
- SIRT is effective;
- SIRT should change clinical practises;
- SIRT is a potential curative which is multi-modality; and
- SIRT should be introduced to care as early as possible.

Professor Sharma surmised that SIRQLOX resulted in an;

“Impressive change in local control for the liver and I am reassured that these points fall where there are multiple events occurring. So this is a robust result, but it comes at a cost of extra toxicity, neutropenia and ulceration.”

It was notable that in his abstract, Gibbs described the occurrence of toxicity as acceptable. We later discussed this with an experienced Interventional Radiologist who was adamant that the toxicity and ulceration experienced in the SIRQLOX trial could in time be entirely eliminated through training and diligence.

Following Professor Sharma's comments, the vast majority of questions from the estimated 1,500 to 2000 delegates were directed at Associate Professor Gibbs. Our key take away from the questions raised was that Gibbs does expect to see an Overall Survival benefit when additional data is combined with the SIFLOX data in 2017.

In the ASX release that followed ASCO, **Sirtex** included Key Opinion Leader (KOL) feedback, which "drives awareness, educates and supports future clinical adoption". This "puts the meat on the bone" for the expanding sales team. Amongst other strongly worded endorsements from KOL's was the following comment from Professor Eric Van Cutsem, MD, PHD from the University of Leuven in Belgium. He is also a board member of the European Organisation for Research and Treatment of Cancer (EORTC).

"The effect of Y-90 resin microspheres on Progression-Free Survival in the liver as reported in the SIFLOX study, is extremely encouraging. Although the primary endpoint of PFS at any site was not achieved, the 7.9 month improvement in liver PFS with Sir-Spheres y-90 resin microspheres demonstrates the strength of this liver directed therapy. The outcome of SIFLOX suggests that oncologists who treat mCRC may now consider earlier use of Y-90 resin microspheres in combination with systemic chemotherapy in liver limited disease."

Sirtex senior staff are a long serving and passionate group and they were clearly very pleased with the reception and recognition achieved at ASCO. This included the "Best of ASCO" designation, which summarises the most promising technologies at additional meetings.

Mike Mangano has been running the US operation for 6 years and he is an upbeat individual. We would argue that his team have had strong success in opening the US market to date. However, with penetration of less than 5% of mCRC Mangano was quick to suggest it is "ridiculously low". He explained that **Sirtex** is now in a unique position because the external drivers that influence market penetration are now in place. We summarise some of these below:

- SIRT is the only device in Oncologists armoury for treating mCRC;
- SIRT has a unique and separate reimbursement code;
- Brachytherapy reimbursement needs an act from US Congress to be changed;
- A large body of first-line trial data, and related commentary is now available for the sales force to work with; and
- SIFLOX study results will be published in an upcoming leading scientific journal.

Setting aside future trial results, we walked away from ASCO with the view that the key internal drivers for success in the US market are the group's selling and marketing capabilities.

As we noted earlier, with the SIFLOX data, the company is in a stronger selling position. Prior to ASCO the sales team had little to work with. The widely held view is that science is the switch that turns on sales. But the science won't sell itself. This argument unfolds as follows.

At present, the **Sirtex** US business runs two teams. Currently 25 full time employees are devoted to opening treatment centres, known as the "device guys". An additional 11 full time employees are devoted to sales covering the US continent. This is the team that sells to and

educates the Medical Oncologists. The average **Sirtex** “sales guy” has 20-25 years of experience and management believe they have got the best of the best in sales. This sales team will be expanded from 11 to 18 over the coming two months.

Medical Oncologists and Physicians actually want to be marketed to by the company. **Sirtex** plays an important role in providing an educational piece that becomes more relevant when presented with potential practice changing data from a large trial.

Social media will play an increasing sales role as support for the company is driven by patient advocacy.

The sales effort will continue to focus on mCRC and will not push into Hepatocellular Carcinoma or HCC. To date, the **Sirtex** sales team have not ventured beyond the boundaries of colorectal cancer and wisely so. The group’s main competitor, BTG Nordion Theraspheres operate under a restrictive HDE or Humanitarian Device Exemption and are believed to have recently received an FDA warning letter in relation to off-label promotion of its radioactive beads.

We estimate that up to two thirds of the US demand for SIR-Spheres is “off-label” at present. This is driven by **Sirtex’s** current acceptance in the salvage setting, a realm where experimentation with new technology occurs, rather than being a sales lead outcome. Off label use will continue to play a role. One experienced Physician suggested to us that SIRT has achieved better outcomes in the liver metastases from organs other than the colon. This is backed up by a series of small studies and if this were to pan out it would be material.

If the sales and marketing team are to have continued success, getting the supply chain right becomes an important internal driver. Being a radioactive product with a relatively short half-life does present challenges in itself. Others include;

- Capacity required to meet demand;
- Community Practice behaviour; and
- Label extension / expansion.

The company currently has no capacity constraints and could double or triple the current level of sales using the existing infrastructure and with few foreseeable operational issues or bottlenecks. This would involve roster changes and increasing work shifts to accommodate the extra demand.

In terms of operational bottlenecks the “biggest push back is the difficulty of scheduling patients”. Treatments need to be community based so that the Oncologists can make simple arrangements before getting “their” patients back for further treatments. Once an Oncologist achieves an operational rhythm with the Interventional Radiologist, the scheduling procedure works well. In fact it is easier than surgery. Interventional Radiologists are coming out of college and want to practice. Interestingly, in his summary, Professor Ricky Sharma addressed this issue. He made the point clearly that the future of best practice requires co-operation between the medical fields of Oncology and Interventional Radiology and that these relationships should be formed in the educational setting.

Finally, the US Label Claim of SIRT has not been resolved and remains restrictive and outdated. It refers to a treatment pathway for SIR Spheres with a chemotherapy agent that Oncologists no longer administer. We have noted that this Label Claim has restricted the sales team. The company still aims to achieve an HCC indication as it does with an expansion into all liver tumours. Other than opening up larger markets, it would also assist big insurance players who require predetermination for individual patients where currently this approval process can take up to one day to achieve. Addressing these issues will require additional trial data. The company will likely seek a label update to achieve some of these outcomes with further trials expected down the track.

Sirtex has overcome many challenges and has positioned the business for growth. The opportunity lies in the fact that penetration is still low for a number of reasons, some of which have now been addressed by;

- The new SIFLOX data from a large RCT
- The Comprehensive peer review
- And solid KOL opinion

With the SIFLOX data, and based on the cross section of views outlined above, we believe it is possible for **Sirtex** to dominate the mCRC patient subset, in the liver only. For this subset, the clear view from KOL's is that the SIR Sphere's therapy will move up the treatment curve from the current salvage setting to first-line care.

Looking forward, it appears that in the next two years, before additional trial data becomes the focus, key drivers are;

- The publication of the new SIFLOX data and
- The execution of a comprehensive sales and marketing strategy

Conclusion

We look for four key pillars to any of our investments and **Sirtex** is no exception.

1. **Competent management team** – CEO Gilman Wong is not a founder of the business. To date, he has navigated turbulent water as the founder exited the business. He has invested in trials, infrastructure and most importantly hired high quality people.
2. **Business leadership qualities** – SIR-Spheres are a medical device that requires regulatory approval and a large body of scientific evidence to gain mainstream approval. This creates significant barriers to entry.
3. **Strong balance sheet** – **Sirtex** has a balance sheet with net cash. While there may be capital investment requirements to scale up the business as demand for the treatment increases we see **Sirtex** as being well positioned to meet those capital requirements.
4. **A focus on capital management** – although they are still in a growth phase **Sirtex** is generating sufficient cash flows from its **existing business** to justify paying a dividend to shareholders. **SFM**

Treating debt with respect

In considering the merits of any investment opportunity our approach is to seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management. When combined, these qualities offer investors the opportunity to enjoy long-term superior returns.

Critically, a company's balance sheet is often overlooked in the role that it plays. Ideally we prefer no net debt on the balance sheet, even though we acknowledge this to be an ultra-conservative approach. Unfortunately, the reality is that far too many boards and management teams take on debt without sufficient consideration of the long-term consequences.

A case in point is **West Australian Newspapers (WAN)**. This conservatively run media group historically focused on the West Australia region. Then in February 2011 **Seven Group Holdings (SVW)**, led by majority shareholder Kerry Stokes dramatically changed the financial well-being of **WAN**, by creating the debt heavy **Seven West Media Ltd (SWM)**.

As Stokes looked to expand further into media as well as taking advantage of **WAN**'s relatively ungeared balance sheet, **SVW** engineered a reverse takeover of **WAN** by selling the group's **Seven Media** assets (including Channel Seven Network) in exchange for shares and cash. While the deal was sold to **WAN** shareholders as creating Australia's largest diversified media group, it also delivered a giant sized debt burden.

To facilitate the transaction a capital raising in the form of a 4 for 7 equity issue at \$5.20 per share was undertaken by **WAN**. Despite raising over \$600 million in new funds, the newly formed **SWM** group still ended with net debt of \$1.9 billion. This compared to the more conservative \$249 million held in debt by **WAN** prior to the transaction. In terms of ownership, Stokes' **SVW** emerged with a 29.6% equity interest in the combined group as well as holding a further \$250 million worth of Convertible Preference Shares ("CPS").

In 2012 the significant debt burden was taking its toll, as a structurally challenged media industry placed further constraints on the **SWM** business. A capital raising was again sought, with **SWM** issuing new stock on a 1 for 2 basis at \$1.32 per share delivering \$440 million of much needed funding. From a shareholder's perspective the 80% plus loss in capital value and the need to tip in more money was a double blow.

Unfortunately, this was not to be the last time management would tap shareholders on the shoulder. In April 2015 another capital raising was underway with **SWM** shareholders again asked to participate in a new offering of 2.27 for every 3 existing shares at the offer price of \$1.25 per share. All up, the group's aim of injecting upwards of \$612 million of new capital fell short, with \$311 million raised and applied to the company's still significant \$1.0 billion of remaining debt. Stokes' **SVW** also moved to convert its existing preference shares into equity, thereby relieving some pressure and in the process increasing its direct holding in **SWM** to 40.9%.

New CEO Tim Worner could only see upside in the new raising commenting;

"The strong level of interest from our institutional shareholders says a lot about their support for Seven West Media and the strategy we're executing. It's an endorsement of not just the proposed transaction and the early resolution of the CPS but also another big step in the company's transformation. We look forward to having a simplified balance sheet with substantially reduced debt. Seven West Media is very well positioned at a time of industry change and we continue to focus on extending the leadership of our business,"

We struggle with Worner's take on events, made worse by the suggestion that the capital raising drew strong support from shareholders when in reality there were few alternative options on offer. Shareholders are left lamenting how things could go so horribly wrong, with the number of shares on issue increasing by some 50% from 1.0 billion to 1.5 billion shares.

Too often, management teams in their haste to undertake transformational deals do so without proper consideration of the risks involved. This approach, relying on debt to deliver growth comes at a cost, which all too often falls at the feet of existing shareholders. **SWM** is a classic story of debt fuelled wealth destruction, rather than growth. Today **SWM** trades at 95c.

It also explains why we are so supportive of management teams that look to maintain conservatively structured balance sheets. It is our "get out of jail card" when conditions get tough. While we can never fully protect ourselves from the downside, having a strong balance sheet provides business managers the ability to deal with the issues at hand without the need to meet the demands of bankers. More importantly it is an approach that sits very comfortably with us. **SFM**

Seven West Media (ASX: SWM) Daily Close Prices December 2011 – June 2015



Budget 101

Understanding budgets shouldn't be too hard but like all things the devil is in the detail. In the case of economic forecasting the devil lies in the assumptions that underpin the forecasts. Any changes made to these inputs can vary the forecasts significantly.

In this year's Federal Budget, handed down by Treasurer Joe Hockey, the headline number was clear, with the country recording an underlying cash budget deficit of \$41.1 billion. For 2015-16 the Government is aiming to reduce this with the cash Budget expected to improve to a deficit of \$35.1 billion.

This infers that the Government is paying out more in expenditure items than it receives in revenues, a situation that is expected to remain until 2020 based on the economic assumptions made in the Budget.

Focusing more closely on the revenues and expenditures, the most striking numbers that warrant some comment revolves around the ordinary wage earner. In 2015-16 the Government is budgeting for tax receipts of \$370 billion, making up the bulk of the \$398 billion in total receipts. The most significant contributor to these receipts is the individual taxpayer with total taxes of \$190 billion, with another \$14 billion flowing in from fringe benefit and superannuation taxes. In short, wage earners are contributing 51% of total Government receipts while company taxes make up just 17% or \$68 billion in receipts.

On the expenditure side, the Budget is forecasting total outgoings of \$434 billion with the biggest outlay centred on social security and welfare payments at \$154 billion or 35% of all outlays. This is followed up with health at \$69 billion, education at \$32 billion and defence at \$26 billion.

An evaluation of whether these numbers are correct centres on key assumptions surrounding future unemployment rates, interest rates, economic growth rates and inflation, amongst other variables.

What is strikingly obvious from even the limited analysis undertaken, is how dependent the Government has become on the taxpayer and how significant the taxpayer contribution is to the economy's overall budget position. At some point this imbalance needs to be addressed and the tax take requires a rethink. For a company to pay tax at the highest level of 30% while individuals incurs marginal tax rates of 33% and 37% above income levels of \$37,000 and \$80,000 underlines the gulf that exists.

Interestingly, the Government recently toiled with a review of the iron ore industry, highlighting the political interference that has become all too common in the current environment. So here we have a situation where the importance of iron ore production has become a seemingly serious point of investigation while ordinary wage earners are once again left to do the heavy lifting. **SFM**

Company visit diary June Quarter 2015

April

ALU	Altium Q3 investor conference call results briefing	10/04/15
MTU	M2 Group acquisition conference call	13/04/15
MYO	MYOB Group IPO briefing	14/04/15
MOC	Mortgage Choice management meeting	15/04/15
NVT	Navitas investor relations conference call	16/04/15
ISD	Isentia Group UBS technology conference	20/04/15
NHF	NIB Holdings Morgan Stanley private health forum	20/04/15
N/A	BUPA private Morgan Stanley health forum	20/04/15
SDA	Speedcast International UBS technology conference	20/04/15
DMP	Domino's Pizza Enterprises site visit investor day	23/04/15
BAP	Burson Group site visit	23/04/15
CTD	Corporate Travel Management site visit	24/04/15
FLT	Flight Centre Travel Group site visit	24/04/15
RMD	ResMed Q315 conference call	24/04/15
MYO	MYOB IPO management conference call	27/04/15

May

IQE	Intueri Education Group management meeting	01/05/15
ACG	Atcor Medical Holdings management meeting	04/05/15
SGM	Sims Metal Management investor relations conference call	05/05/15
SKT	Sky Network Television Macquarie Conference	06/05/15
FXL	Flexigroup Macquarie Conference	06/05/15
OOH	OohMedia Group Macquarie Conference	06/05/15
NVT	Navitas Macquarie Conference	06/05/15
CPU	Computershare Macquarie Conference	06/05/15
SDF	Steadfast Group Macquarie Conference	06/05/15
TOX	Tox Free Solutions Macquarie Conference	06/05/15
NHF	NIB Holdings Macquarie Conference	06/05/15
AHE	Automotive Holdings Group Macquarie Conference	07/05/15
NUF	Nufarm Macquarie Conference	07/05/15
ARB	ARB Macquarie Conference	07/05/15
COH	Cochlear Macquarie Conference	07/05/15
VSI	Vista Group International Macquarie Conference	07/05/15
3PL	3PL Macquarie Conference	07/05/15
XRO	Xero Macquarie Conference	07/05/15
SAI	SAI Global Macquarie Conference	07/05/15
OSH	Oil Search Macquarie Conference	08/05/15
RMD	ResMed Macquarie Conference	08/05/15
IQE	Intueri Education Group Macquarie Conference	08/05/15
IPH	IPH Macquarie Conference	08/05/15
AFG	AFG IPO management meeting	11/05/15

SRX	Sirtex Medical investor relations meeting	14/05/15
IPP	iProperty Group Malaysian site visit	19/05/15
BKL	Blackmores Malaysian site visit	19/05/15
GBT	GBST Hong Kong site visit	20/05/15
ALL	Aristocrat Leisure G2E Expo Macau	20/05/15
AGI	Ainsworth Game Technology G2E Expo Macau	20/05/15
BKL	Blackmores investor day	21/05/15
JHX	James Hardie Q415 investor conference call	21/05/15
ZPIN	Zhaopin Beijing investor relations site visit	22/05/15
OFX	Ozforex Group FY15 results briefing	26/05/15
TNE	Technology One HY15 results briefing	26/05/15
ALL	Aristocrat Leisure HY15 results briefing	26/05/15
IPP	iProperty Group annual general meeting	27/05/15
SRX	Sirtex Medical US Chicago ASCO meeting	30/05/15

June

N/A	Amaysim IPO management meeting	10/06/15
RHC	Ramsay Health Care UBS healthcare conference	11/06/15
RMD	ResMed Sydney manufacturing site visit	11/06/15
COH	Cochlear site visit	11/06/15
BKL	Blackmores UBS healthcare conference	11/06/15
OFX	Ozforex Group management meeting	12/06/15
N/A	Baby Bunting Morgan Stanley conference	16/06/15
ASX	ASX management meeting	16/06/15
TOX	Tox Free Solutions Morgan Stanley conference	17/06/15
SUL	Super Retail Group Morgan Stanley conference	17/06/15
IPP	iProperty Group Morgan Stanley conference	17/06/15
NVT	Navitas Morgan Stanley conference	17/06/15
SDF	Steadfast Group investor day	19/06/15
BKL	Blackmores conference call	22/06/15
ZPIN	Zhaopin Q3 results conference call	23/06/15
FLT	Flight Centre Travel Group investor relations conference call	24/06/15
VRT	Virtus Health management conference call	25/06/15
CKF	Collins Foods FY15 results briefing	26/06/15

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