Selector Fund

Quarterly Newsletter # 27

March 2010

In this quarterly edition we focus on performance attribution, discuss IRESS in detail - a portfolio position. We raise the lid on acquisitions gone wrong and why investors should be asking some hard questions of management. We take a look at the potential bubble in residential home prices and finally make a comment on the RBA.

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selector

About Selector

We are a boutique fund manager and we have a combined experience of over 60 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.

First we identify the best business franchises with the best management teams. Then we focus on valuations.

When we arrive at work each day we are reminded that;

"The art of successful investment is the patient investor taking money from the impatient investor".

Our fund is open to new subscriptions. Please forward to us contact details if you would like future newsletters to be emailed to family, friends or business colleagues.

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Dear Investor,

The old adage that markets climb a wall of worry is certainly apt as we consider the events of the past quarter. While expectations were high that the new year would bring a continuation of improving investor sentiment, things didn't start well with the market in January falling sharply, only to have recovered strongly by quarter's end. Since the start of the current financial, the market has recorded a nine month gain of 27.9% while the Fund has more than kept pace rising 30.9% (stats page 29).

On the home front, the economic news continues to support a strong and solid rebound in economic activity. Unfortunately the same cannot be said of offshore markets which are still coming to grips with the aftermath of the financial meltdown. While China and most Asian regions continue to operate in accordance to their own domestic circumstances, somewhat oblivious to the issues facing Europe and the United States, investors remain clearly on edge.

Most notably, interest rates look set to rise over the course of the year and beyond as economies recover and Governments look to take the first tentative steps in tightening the enormous amounts of cheap money circulating the world's financial systems. While our Reserve Bank has already, moved we expect the United States to follow by year end.

However, in our view the key economic metric to consider is not necessarily interest rates but unemployment. As things stand, Australia sits with an unemployment rate of 5.3% while the United States and the European zone are running at 9.7% and 9.9% respectively. Clearly these rates - United States and European - are too high, and any attempt to raise interest rates prematurely will have obvious negative consequences.

In this quarterly edition we discuss another of our portfolio positions, raise the lid on acquisitions gone wrong and why investors should be asking some hard questions of management and the impact of rising house prices.

We trust you enjoy the following quarterly report and will no doubt be hoping that our own market continues to climb the wall of worry.

Regards

Tony Scenna
Victor Gomes
Corey Vincent

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Performance March Quarter 2010

The Fund's strong first two quarters of this financial year were offset by a weaker third quarter; with a fall of 2.6% compared to the All Ordinaries Accumulation Index rise of 1.5%.

For the current financial year to date, the Fund maintained its outperformance rising 30.9% compared to the All Ordinaries Accumulation Index which rose 27.9%.

Performance table since inception

% Returns	Fund %	AOAI %	Difference %
1 month	7.2	5.8	+1.4
3 months	-2.6	1.5	-4.1
6 months	8.9	5.2	+3.7
1 year	59.5	44.0	+15.5
Since inception compound pa	8.0	8.6	-0.6

Full portfolio performance statistics are detailed on page 29.

Portfolio Top 10

Mar 2010	Dec 2009
Billabong International	Billabong International
Cochlear	CathRx
Flight Centre	Cochlear
IOOF Holdings	Flight Centre
Pharmaxis	Pharmaxis
Primary Health Care	Primary Health Care
ResMed	ResMed
Seek	Seek
Sirtex Medical	Sirtex Medical
WorleyParsons	WorleyParsons
Top 10 = 72.1%	**Top 10 = 64.1%**

Selector runs a high conviction index unaware stock selection investment strategy with typically 15-25 stocks chosen for the Fund. As shown above, the Fund's top 10 positions usually represent the greater majority of its equity exposure.

Performance attribution for the quarter

Top 5 stock contributors	%	Top 5 stock dectractors	%
Flight Centre	+1.8	CathRx	-3.1
ResMed	+1.4	SIRTeX Medical	-2.0
Seek	+1.3	Primary Health Care	-1.9
IOOF Holdings	+0.9	Kagara	-0.9
Cochlear	+0.7	WorleyParsons	-0.4

The past quarter saw strong contributions from Flight Centre, ResMed and Seek. Flight Centre and Seek continued to benefit from an improving economic outlook whilst ResMed was buoyed by the strong reception it received from the release of its new S9 sleep apnea platform.

Unfortunately, the quarter also saw a reversal of fortunes for some of the Fund's other healthcare sector positions, most of which had performed well in prior quarters.

Most impacted was the small position in emerging medical device manufacturer, CathRx. The Fund invested circa 2% of its equity in the company at 25c per share in the June 2009 capital raising. The raising was undertaken to fund the commercialisation of the company's new and innovative cardiac catheter range of products. Whilst we were correct in assessing its very low technology risk, with product development and approval largely proceeding to plan, we clearly underestimated the challenge of selling new devices into a market dominated by majors such as Johnson & Johnson and Boston Scientific (even when targeting a modest market share of 5%). The sales strategy has therefore required a radical reassessment and is now aimed at the growing market for recycling of previously single use medical devices. None of the majors voluntarily approve of their devices being re-used. In contrast, some CathRx devices are already registered for re-use with more in the pipeline. The company appears to have stumbled onto a clear differentiator if it can execute a reprocessing strategy successfully. We await further evidence that they have indeed developed a credible alternative sales strategy.

Primary Health Care also suffered from unfulfilled expectations following a capital raising and large acquisition - see detailed discussion on page 12. The SIRTeX share price which recorded the largest positive contribution in the December quarter, gave up some ground in the latest period but continued to make impressive business strides, with a number of important clinical trials announced.

One year on and the winner is......

"In the short run, the market is a voting machine, but in the long run it is a weighing machine."

Benjamin Graham

The Benjamin Graham quote above speaks to the difference between short term emotional trading (the voting machine) and long-term value creation (the weighing machine). In the short run, investors are easily seduced by the lure of fortunes that could be made, irrespective of the risks taken. In the long run however, even the most easily tempted recognises the one thing that can be independently valued – what's in the bank.

This time last year, the investment world was on edge. The local stock market had already bottomed in the early half of March at 3,091 points – equal to a fall of 55% from the high set in November 2007 – and at that time our principal concern centred on the lingering damage that this crisis could inflict on businesses and investors alike in the period ahead.

And in the stakes of importance, the threat of massive share dilution stood head and shoulders above all of our other concerns, a point we canvassed in our June 2009 quarterly newsletter. As things would have it, the consequences of actions forced on shareholders some twelve months ago are now having a profound impact. As Graham noted in his most famous quote, the "weighing machine" is now front and centre in the minds of investors as they shift through the latest report cards from the busy reporting season.

Overpaying for assets

From our vantage point, two things became abundantly clear. Firstly, some businesses were simply overstretched, stuck with too much debt and with very few options other than embarking on the self destructing and highly dilutionary share issue route. In many instances, the financial crisis rightly shone the light on many businesses that were below investment grade.

Secondly, the crisis also exposed some top notch performers who got caught overpaying for assets. They too have fallen foul despite enjoying greater financial manoeuvrability during the period, while shareholders have been taught a valuable and expensive lesson on the high risk stakes associated with any acquisition. Frank O'Halloran, CEO of QBE Insurance – a group that has completed more than 125 acquisitions since 1981 - perhaps best sums up the situation, "The worst thing you can do with an acquisition is go and pay a price you will regret for the rest of your life. It only takes one to go wrong and you can cause enormous damage to the company."

Typically, when an acquisition is first announced to the market by the board and management team, it is almost always packaged as a win-win deal for shareholders. We are assured by management that proper due diligence has been carried out and that transition from one owner to the next will be relatively smooth and result in significant synergy benefits. But if history is any guide, it should teach all investors to remain highly skeptical of transformational deals.

First there is the all important price tag, a number sufficiently high enough to give any prospective new owner a nose bleed but one invariably justified by a management team convinced that they have just nicked the ultimate prize.

Secondly, there is the issue of payment, usually in the form of cash, financed from a combination of new company debt and shares issued to loyal shareholders. In time, you wait hoping that management haven't made a big mistake by paying way over the odds for a business that should have been a game changer but in actual fact was nothing more than an overrated pile of assets.

And the evidence

To highlight these points more clearly we look at some recent examples - namely Rio Tinto and Wesfarmers where the Fund has no investment exposure and Primary Health Care where we do.

Starting with the biggest, the Rio Tinto group entered the 2007 year in excellent shape as the chief executive baton passed from company veteran Leigh Clifford to newly promoted Tom Albanese. Clifford's aspiration for Rio Tinto to be "the best at value creation in our business" often led to a push back against shareholder pressure for fast growth when it risked making potentially value destroying decisions. Unfortunately, it took Albanese less than three months in the hot seat to undo years of good work, by splashing out a staggering $38 billion on Alcan, the world's largest producer of aluminium.

This action, seen as a defensive move to foil a mooted takeover offer from BHP Billiton, would cost the company and its shareholders dearly. That BHP saw fit to continue with its own pursuit of Rio in launching a full scrip offer in November 2007 valued at $140 per share, only to be rebuffed by Rio management, speaks to the enormity of the arrogance shown. Having spurred BHP away, Rio found itself awash with debt at precisely the wrong time and in a fight for survival sought $15.4 billion of new capital, offering shareholders 21 new shares for every 40 shares already held at $28.29 each.

Table 1. Rio Tinto key financials

Year to 31 December	2007	2008	2009
Revenue ($USm)	33,531	58,065	44,036
Underlying net earnings ($USm)	7,443	10,303	6,298
Operating Cash flow ($USm)	12,569	20,668	13,834
Capital expenditure ($USm)	4,968	8,488	5,356
Earnings per share (US cents)	524	709	284
Dividends per share (US cents)	136	111	45
Net debt ($USm)	45,191	38,672	18,861
Issued shares (m)	**1,421.1**	**1,454.1**	**2,217.4**

In February this year, Rio management unveiled the full fallout from its attempts to right the ship. While the sudden collapse of metal prices hit the group's revenues and underlying profits hard (see Table 1), the situation for shareholders has been made so much worse by the highly dilutive share issue that has seen Rio's share capital blow out from 1.45 billion to 2.22 billion.

With 2009 underlying earnings falling 39%, earnings per share fell a whopping 60% to once again highlight the huge task now facing Rio management in making up for past errors. And as for the US$38 billion Alcan acquisition, it generated a net loss of US$578M on revenues of US$12 billion for the year.

Tom Albanese – Rio Tinto CEO

Having hitched their wagon to China, Rio's immediate future now looks decidedly rosier and Albanese's past transgression appears to have been forgiven. Its share price has recovered strongly, although it's still sitting some 47% below the equivalent BHP takeover share offer of $140 per share. The market is once again voting in Rio's favour, however, the jury is still out on whether the twin evils of debt and earnings dilution can be sufficiently overcome in the long run.

Wesfarmers

The second company worthy of mention is the diversified conglomerate Wesfarmers. Not unlike Rio, Wesfarmers had, despite its earnings diversity, built up an impressive performance track record over a number of years. Their core focus on delivering a satisfactory return to shareholders was predicated on each business unit achieving an acceptable return on capital employed. Sounds novel, but unless any business can adequately cover its cost of capital with some margin, there is reason for concern.

Certainly Michael Chaney, Wesfarmers' previous CEO of thirteen years, maintained this discipline – "we won't do anything unless the numbers add up" - successfully buying Howard Smith's BBC Hardware in 2001 for $2.2 billion. BBC has since morphed into the much larger and extremely successful Bunnings hardware chain. Similarly, the sale of the group's founding Landmark rural services division for $825 million to AWB in 2003, illustrated that tough decisions could be made in disposing of assets, if it was shown to be in the best interests of all shareholders.

Chaney's replacement in 2005 came from within the organisation. Not surprisingly, new CEO Richard Goyder continued the company mantra and followed this up with the $700 million acquisition of insurance broker OAMPS in 2006. And it didn't take long, 2 April 2007 to be precise, before Goyder reached for the top shelf of corporate deals, making a play for supermarket group Coles. With a market capitalisation some $5 billion larger than its own, Wesfarmers was making a big bet and taking on the private equity players in the process. History shows that Goyder won out with a $19.3 billion offer, along with a mountain of new debt. Likewise, Wesfarmers shares peaked at $45 during the excitement of the Coles deal going through.

Under similar circumstances to Albanese at Rio, Goyder had exposed Wesfarmers to enormous financial risk at precisely the wrong time, for an asset that on face value looked to have fallen well short of the group's own return on capital employed metric. Fast forward two years and Wesfarmers has survived the economic meltdown but at what cost?

Table 2. Wesfarmers key financials

Year to 30 June	2007	2008	2009	HY 2010
Revenue ($m)	9,754	33,584	50,982	26,533
NPAT ($m)	786	1,063	1,535	879
Earnings per share (cents)	195	174	160	87
Dividends per share (cents)	225	200	110	55
Net debt ($m)	4,904	8,792	4,045	3,824
Issued shares (m)	**388.1**	**647.2**	**1,005.1**	**1,005.1**

To repair its stretched balance sheet and soothe nervous bankers, Wesfarmers undertook two equity raisings during 2008 and 2009. The first in April 2008, offered one new share for every eight held at a price of $29 per share, raising $2.5 billion. The second announced in January 2009, was unexpected but reflected the concerns at the time, with three new shares offered for every seven held at a price of $13.50 per share, raising $3.5 billion. All up, including additional institutional share placements, Wesfarmers accumulated close to $7.0 billion of new capital while its capital base swelled from 388 million shares to 1,005 million.

Perhaps time will prove Goyder right on his decision to buy Coles but based on the group's 2010 half-year result, the road ahead looks tough nevertheless. A point best highlighted when considering the Coles supermarket and liquor division contributed close to a third of the group's total $1,547 million in earnings before interest and tax (EBIT) for the period but managed to eke out an annualised return on capital employed of just 5.9%. Compare this to the group's actual cost of capital of 10%-12% or the 31.2% return for the Home Improvement division housing the Bunnings stores and you can quickly see the gulf that exists between the businesses. Furthermore, management have earmarked ongoing capital expenditure in the supermarket chain of close to a $1.0 billion per annum out of a total capital expenditure program of $1.9 billion.

Voting machine

In a similar vein to Rio, the Wesfarmers share price has rallied strongly in recent months to $32.20 helped no doubt by positive comments that things are on the mend. In fact, Australia's leading financial newspaper The Australian Financial Review's (AFR) lead story on the 19 February 2009 noted that "Wesfarmers retail gamble pays off" and that "Wesfarmers has silenced the critics of its ambitious expansion into retailing, delivering a sharp turnaround in the fortunes of its flagship Coles supermarket division". Furthermore Goyder commented that "Business is about taking calculated risks and I have always had confidence that we've got good assets and with the right people in place we'd be able to create value out of this transaction."

Richard Goyder – Wesfarmers CEO

Fortunately the voting machine over at the AFR has some competition in the form of The Australian newspaper which also reported the Wesfarmers result. However the John Durie article "Goyder fails the returns test" sits more comfortably with the facts. As Durie noted "Richard Goyder yesterday unveiled a record $879 million profit, but made no mention of the word for the obvious reason that, while showing signs of improvement, it has miles to run to recover value trashed with the Coles acquisition. As much as the market seemingly rejoiced in the numbers and the apparent Kmart miracle, Goyder, to his immense credit, is the first to admit this is an ordinary set of numbers for a business that prides itself on producing satisfactory returns to shareholders."

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Primary Health Care

Finally, we consider the merits of Primary Health Care, a business where the Fund has an investment. Unlike Rio and Wesfarmers, Primary Health Care was founded by current CEO Dr Edmund Bateman on the premise of providing one-stop, bulk-billed, 24-hour medical services through a network of large format medical centres. The first, in the Sydney suburb of Brookvale was followed in quick succession but Bateman's requirement for funding saw him list the business in 1998 with just four medical centres. By 2007, the number had swelled to forty while general practitioner (GP) consultation visits surpassed four million in that year alone.

Ed Bateman – Primary CEO

Bateman augmented the medical centre business with other bolt-on services including NSW based pathology provider SDS in 2000 and listed technology software provider Health Communications Network for $110 million in 2004.
The Primary model worked beautifully, with revenues and net profits hitting $272 million and $56 million respectively by 2007. A solid balance sheet with only $164 million in net debt saw the business generate a respectable return on capital employed of 16.2%.

However, Bateman having first toiled with the prospect of teaming up with listed rival Symbion Health in late 2006 (formerly Mayne Group), suddenly changed tack in November 2007 when it launched a hostile all-in cash bid of $4.10 per share. It was in anyone's language a high-risk strategy undertaken, as history would later show, at the peak of the stock market. With its own market capitalisation sitting at $1.7

billion, Primary won out, picking up Symbion for a total enterprise value (equity + net debt) of $3.5 billion.

To pay for the deal, the company undertook a massive eight for five rights issue at $5.40 per share. In addition, the group offloaded the old Symbion pharmacy and consumer assets for a net $760 million leaving the group to fund $1.5 billion of existing debt. Subsequent share issues, totalling some $535M reduced net debt to $968 million in the latest half year, while the group's issued capital has expanded from 142 million at the time of the initial offer for Symbion to its current 481 million.

For this investment, Primary cemented its market leading position in medical centres while adding significant market shares in both pathology and radiology. In addition the significant overlap of services and Bateman's focus on costs would see the combined business strip some $100 million off the group's combined cost base by 2010.

Table 3. Primary Health Care key financials

Year to 30 June	2007	2008	2009	FY 2010 (e)
Revenue ($m)	272	650	1,329	1,343
EBITDA ($m)	114	175	348	369
EBIT ($m)	93	149	280	294
NPAT ($m)	57	9*	109	163
Earnings per share (cents)	45	3*	25	34
Dividends per share (cents)	51	46	14	35
Net debt ($m)	164	2,192	1,211	968
Issued shares (m)	**125.4**	**371.1**	**430.7**	**481.1**

* NPAT impacted by higher funding costs & less than 12 months earnings contribution from Symbion

As Table 3 illustrates, the new enlarged business appeared on target at financial year end 2009, with revenue and earnings tracking along management guidelines. However, the Rudd Government's May Budget changes to healthcare reform, including reduced pathology funding, have impacted business profits since its introduction in November 2009.

To counter this impact, Bateman introduced patient co-payments - where patients contribute on average $30 for the cost of a GP consultation - across a limited number of its medical centres and a small number of pathology tests. The move has not gone

down well with doctors or their patients, with GP visitation numbers dropping 25%-40% immediately following its introduction in the affected centres.
The jury is still out on the long term impact of funding cuts and the group's move away from its traditional bulk billing model to co-payments. Management has backed away from giving formal earnings guidance for 2010 but noted that "we have reasonable expectations that in FY2011 and FY2012 the Group should be looking to a minimum EBITDA growth rate of 15% per annum."

Markets never like uncertainly but the shock slowdown in revenues and loss of pathology market share in the group's 2010 first half result underlined concerns that the Primary business model was under threat. We don't necessarily agree with that view but acknowledge that the move from bulk billing to co-payments is an important and, at this point, uncertain development. In time, we can envisage the situation where its impact on consultation visits will diminish as patients get past the first time shock of paying up.

Of greater concern is whether the group can generate an adequate return on the capital employed from the Symbion business it acquired. On our numbers, Primary spent a net $2.6 billion buying the medical centres, pathology and radiology assets of Symbion. Yet for 2010, earnings before interest and tax of just $143 million is expected to generate a return on capital of just 5.5% and a far cry from the group's historical 16.2% return.

While the Rio and Wesfarmers share prices have moved ahead strongly despite the earnings impact, Primary shares have taken a sudden turn for the worse. Bateman remains the largest individual shareholder with a 7.5% stake, despite selling $70 million worth of shares during the company's last raising in September 2009.

It is noteworthy that all three companies embarked on risky aggressive acquisitions where historically, conservatism was the norm. Having navigated through the financial crisis and successfully reduced bloated debt levels, shareholders are now hoping that the exercise was worth the considerable earnings per share dilution that has resulted. ***SFM***

IRESS Market Technology Limited (IRE)

Table 4: IRESS Market Technology Corporate History 1993-2010

Year	Event
1993	Founders Peter Dunai, Neil Detering, Hung Do form Dunai Financial Services (DFS)
1995	DFS launches IRESS (Integrated Real Time Equity System) flagship product in Australia
1997	Constrained by capital, DFS founders progressively sell 80% to US based Bridge Information Systems, forming BridgeDFS
1997	IRESS Order System (IOS) launched, enabling brokers to trade online | clients to communicate with brokers electronically
2000	Balance of 20% equity sold by Founders to US based Bridge Information Services (BIS)
2000	Nov | BridgeDFS lists on ASX | 100M shares @ $1.65 per share | BIS retaining 55% | ASX 15%
2001	Feb | group reports initial public results | revenues + 46% to $32.7M |NPAT +61% to $9.6M
2001	Feb | BridgeDFS major shareholder BIS enters into US Chapter 11 bankruptcy court
2001	Jul | sale of BIS 55M holding in company completed to new shareholders at $2.05 per share
2001	Oct | name change from BridgeDFS to IRESS Market Technology
2002	Jul | IRESS agrees to purchase IWL | provider of desktop software licences for financial planning industry, including VisiPlan | market share 35% | consideration $87.8M |new shares issued 21.5M
2003	Announces purchase of financial planning software Xplan Technology for $5.1M upfront cost.
2004	Apr | enters deal with ITG Canada to establish integrated equities service in Canada similar to IRESS core Australian business by acquiring 50% KTG Technologies from ITG for C$6.5M
2005	IRESS deals with global information provider Reuters to facilitate order flow between groups
2006	Apr | IRESS acquires balance of ITG JV interest for C$9.5M | agreement reached with Reuters Canada to switch clients to IRESS Canada product in exchange for commission fee per client move.
2006	Sep | buys leading planning, analytics software provider PlanTech for $15M with revenues $8M
2007	Jan | IRESS & Toronto Stock Exchange (TSX) to offer premium integrated gateway access to TSX.
2007	Jun | IRESS expands wealth management business into South Africa acquiring leading planning group Spotlight Interactive for A$8.4M total payout | Spotlight revenue A$5M | EBITDA > A$1M
2008	Buys Transactive Systems for $1.9M | leading provider of mortgage qualification analytics
2008	Buys Dealer Management Systems | leading remuneration provider for 1.1M IRESS shares
2008	Nov | IRESS supports access to alternative trading system Alpha in Canada post deregulation
2008	Dec | IRESS supports access to Chi-X Canada alternative trading system post deregulation
2009	Jun | South Africa's largest advisor group Liberty selects IRESS web based advisor platform Xplan for rollout to over 3,000 advisors
2009	Oct | Founding MD Peter Dunai steps down handing reigns to Xplan founder Andrew Walsh
2010	Jan | Buys SENTRYi Pte Ltd in Singapore to initiate wealth management presence in Asia < $2M

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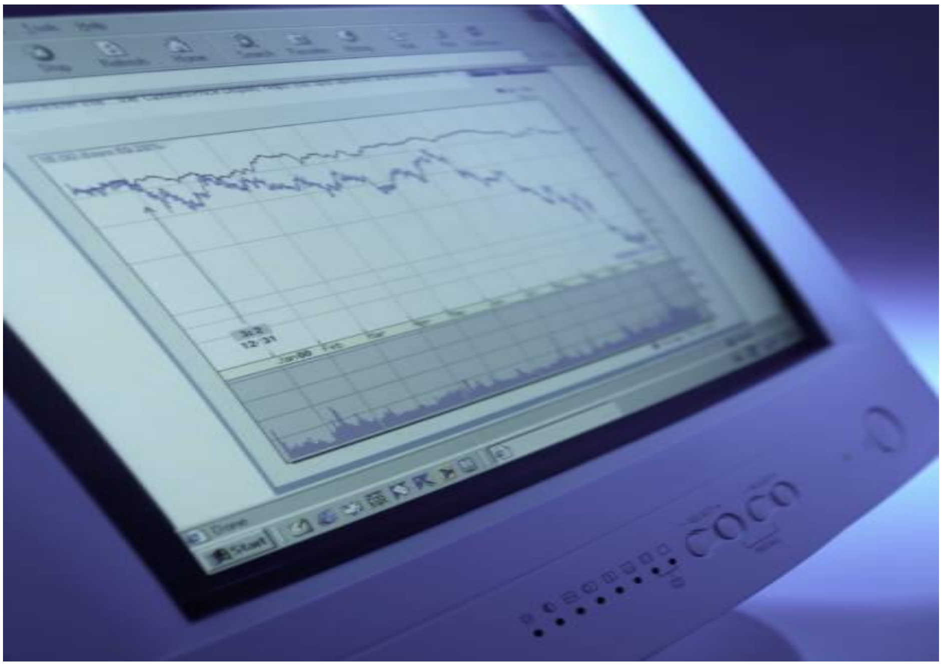
Introducing IRESS

For Australia's leading software supplier of services to the financial markets, IRESS Market Technology has been extraordinarily successful in carving out an important and lucrative niche in such a low key and unassuming manner. Many investors, we would suspect, would not be familiar with its services or its corporate evolution, something we hope to address in the following few pages. As a back drop, the group's introductory comment on its corporate website provides an important insight to its development – an acceptance of change.

"Since our founding in 1993, we have embraced the constantly changing climate of the financial markets. At IRESS Market Technology, we don't just react to change, but welcome it as an opportunity to move forward. This proactive approach and ability to adapt are central to our business and reflected in our progress to date."



We first covered IRESS in our March 2008 quarterly newsletter, noting its addition to the Fund's portfolio. At that time, financial markets were entering a most difficult period and yet some opportunities were already appearing as we noted.

"The fall in share price from a high of $9.80 in June 2007 to current levels of $5.20 goes some way to mitigating the risk to underlying earnings. Rarely do investors get the chance to buy monopoly type assets at attractive valuations but with investor panic the order of the day, such opportunities are becoming far more frequent."

In fact, while the business continued to take forward steps, the share price continued to drop, hitting its most recent low point in November 2008 at $3.54. Today, IRESS represents about 4% of the Fund's portfolio, having added to our initial position over the past year.

Table 5. IRESS Market Technology Financial Snapshot

$'M	2000*	2005	2006	2007	2008	2009	2010(e)
Revenue	32.7	71.6	93.4	134.5	163.9	169.8	180.0
Operating Expenses	15.9	34.9	48.0	71.7	85.2	87.0	92.0
EBIT	14.6	28.2	34.4	37.8	47.8	54.2	64.5
NPAT **	9.6	19.6	28.0	33.9	46.0	52.5	60.5
EBIT Margins (%)	44.6	39.3	36.8	28.1	29.2	31.9	35.8
Shareholders' Equity	7.7	40.8	49.7	101.4	116.2	124.2	126.0
Net Debt / (net cash)	(9.5)	(38.2)	(22.9)	(20.0)	(45.7)	(73.2)	(83.0)
Market Capitalisation	241.0	491.4	784.1	932.8	627.8	1,063.4	1,002.8
Enterprise Value	231.5	453.2	761.2	912.8	582.1	990.0	919.8
Buyout (%) | (EBIT/EV)	6.3	6.2	4.5	4.1	8.2	5.5	7.0
ROCE (%) ***	> 100	> 100	> 100	77.2	65.3	> 100	> 100
GOCF / EBITDA (%)	101	112	102	96	116	112	n/a
Underlying Earnings per share (¢)	9.6	18.0	25.1	29.1	37.7	42.4	48.9
PER	25.1	25.0	28.0	27.5	13.7	20.3	16.6
Dividend per share (¢)	7.2	18.0	21.0	26.0	31.0	34.0	37.0
Dividend Yield %	3.0	4.0	3.0	3.3	6.0	4.7	4.6
Share Price 31 Dec ($)	2.41	4.50	7.02	8.00	5.15	8.59	8.10^
Issued shares (m)	100.0	109.2	111.7	116.6	121.9	123.8	123.8

* IRESS floated on exchange in November 2000
** NPAT adjusted for write-back of amortisation of intangibles arising from past acquisitions
*** ROCE = EBIT / (Shareholders Equity + debt – cash)
^ Share price as at April 2010

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Putting the IRESS pieces together

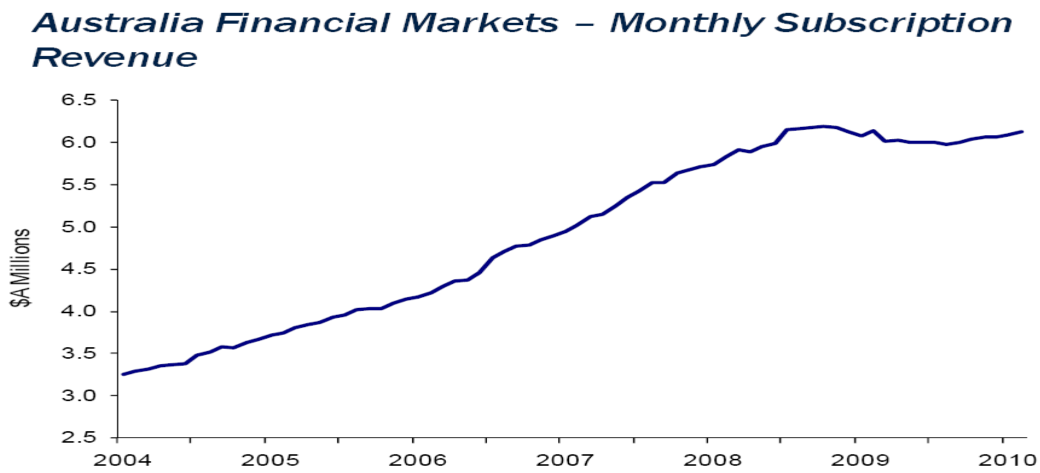
As you read through the company's timeline in Table 4, the image that emerges is of a company put together in much the same way as one would join the pieces of a jig saw puzzle. Founding managing director Peter Dunai has been there from the start and has been instrumental in developing information systems for financial markets. His prior knowledge of the broking industry and his establishment of the Equinet business as an internal sharemarket information system during the late 1980's became the forerunner of today's Integrated Real Time Equity System (IRESS) – live exchange traded sharemarket data.

However, as is typical of most start up businesses, the group's principals were soon short of capital after founding the IRESS business in 1993. This led to the progressive selling down of their interest to US based Bridge Group, who eventually moved to full ownership in 2000, before floating the company in November the same year at $1.65 per share, valuing the group at $165 million. Substantial shareholders included the Bridge Group with 55% and Australian Stock Exchange (ASX) with 15%.

The tech wreck events of 2000 posed considerable problems for many in the information and technology world including Bridge Group, who was forced into US bankruptcy in early 2001, leading to the sell-down of their 55% interest in BridgeDFS to local investors at $2.05 per share. The sell down by Bridge also led to a new name, IRESS Market Technology.

Despite its rocky start to public life, IRESS has since gone from strength to strength. At its most basic, the IRESS trading platform allows stock brokers, fund managers, financial planners and individual clients to gain access to live price data from the ASX, while the IRESS Order System (IOS) allows for electronic orders to be placed online and delivered directly to brokers. Importantly, the IRESS model is subscription based and benefits from the largely fixed cost nature of the business. In Australia the service is offered for a base fee of about $1,000 per month while discounts apply for large volumes. As Graph 1 depicts, IRESS has lifted subscription revenues from less than $3.5 million in 2004 to a current run rate of $6.0 million per month or $72.0 million annually. Even during the current financial crisis, the group's annuity based revenue model remained largely intact as clients retained their subscription, highlighting both the barriers to entry and the necessity of the service offering.

Graph 1: IRESS - Australian Monthly Subscription Revenue



Source: IRESS

From a standing start, the IRESS market data offering now dominates the local market with a 90% plus market share while the group's IOS has been integrated into 40 of the top 50 broking houses. Success has come despite competition from the global giants of market data including Bloomberg and Reuters. While price is a differentiating point, IRESS has focused on an integrated solutions offering that provides live market data activity and individual client order documentation. In short, IRESS has embedded itself into the daily operations of its customers, thereby making it difficult for others to compete on price alone.

Acquisitions gone right

Since 2002, IRESS has grow in a low key manner by expanding the group's offerings both in terms of new customers and new regions. Typically, new markets are only entered through joint ventures with existing players or where key customers provide commitments to underwrite product and service offerings.

In 2002 IRESS expanded into the financial planning market with the $88 million acquisition of IWL - provider of desktop software for the planning industry with a 35% market share. In subsequent years, additional bolt-on acquisitions including Xplan Technology and PlanTech, have been incorporated into the IRESS offering, cementing the group's market dominance and leading to monthly subscription revenues rising strongly as shown in Graph 2. Xplan's founder Andrew Walsh, who joined the IRESS operations in 2003 following its acquisition, took the reins from founding MD, Peter Dunai, in October 2009.

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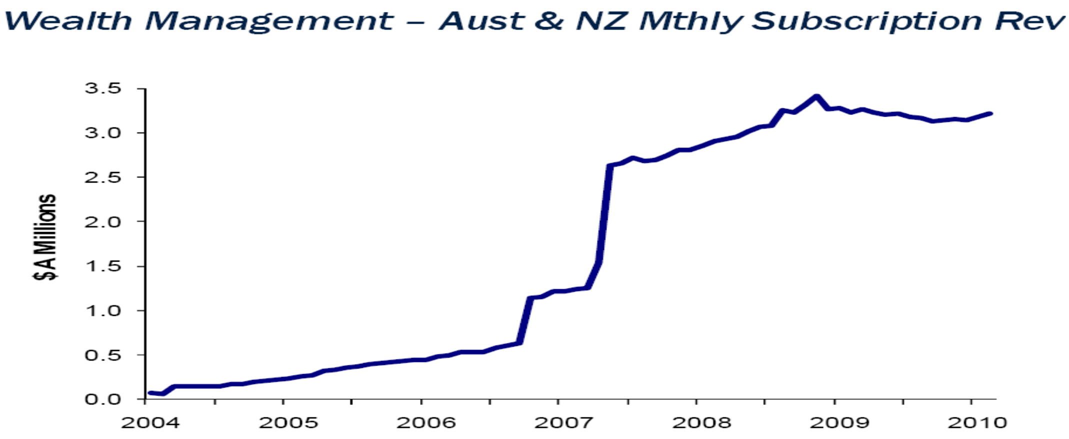
Graph 2: IRESS – Australian | NZ Wealth Management monthly Revenue



Source: IRESS

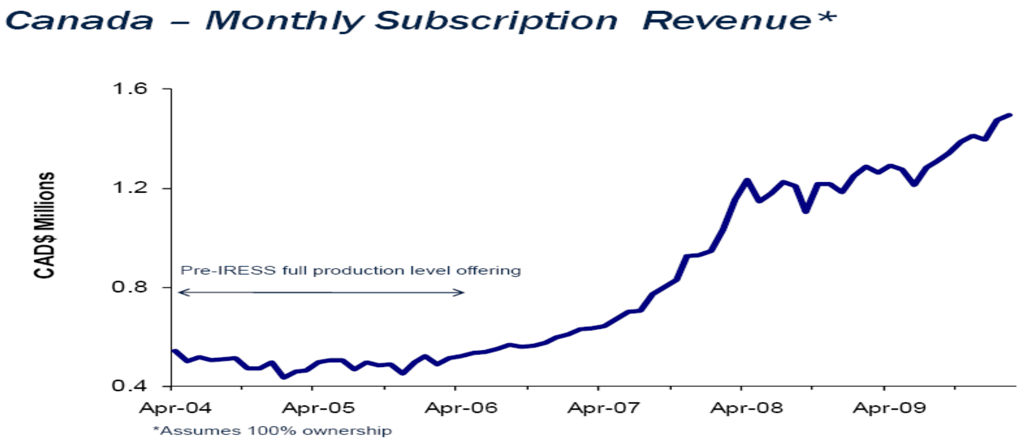
IRESS also sought expansion into new regions, entering a joint-venture deal with ITG Canada in 2004 to supply the Canadian market with terminals and a real time equities service similar to the core Australian offering. In typical IRESS fashion, the upfront capital was small, local expertise was secured and gains were made incrementally. The group secured full ownership from their joint venture partners in 2006 and now operates an expanding and very profitable operation.

As Graph 3 highlights, the business is now ramping up strongly with monthly subscription revenues averaging C$1.5 million per month. At this point, IRESS only supplies the broking side of the market but this is set to change with the group taking steps to expand the service to retail customers, similar to how the market developed in Australia. The Canadian market is one and a half times larger than our local market and the opportunity set available to the group is large.

Likewise, IRESS undertook to enter the South African wealth management arena with the acquisition of leading player Spotlight in 2007 and followed this up in 2010 with its first foray into the Asian market, buying SENTRYi based in Singapore.

Financially, as Table 6 shows, the group has successfully seeded and is now harvesting a growing annuity stream of subscription based revenues from a market that is both increasing in its complexity and hungry for real time financial data. As the table illustrates, all operations are now profitable with Canada in particular starting to deliver significant gains.

Graph 3: IRESS - Canadian Monthly Subscription Revenue



Source: IRESS

For shareholders the financial metrics of this business are superb. As we show in Table 5, since listing in 2000 the group has consistently delivered top line growth, maintained EBIT margins above 30%, achieved returns on capital employed exceeding 100%, never sought additional equity from shareholders to undertake acquisitions and ended the 2009 financial year with over $70 million in the bank and no debt.

Management's focus on building strong market leading positions in niche product offerings is paying big dividends and under new MD Andrew Walsh we expect this trend to continue. In fact, the strength of IRESS's product offerings lies in its ability to add more product features to the group's existing financial markets offering while remaining independent.

The company's share registry includes an assortment of institutional investors and notably the ASX, with a holding sitting just shy of the 20% takeover threshold. This investment carries even greater weight following the Government's recent decision to deregulate the local stock exchange, placing IRESS in an ideal position to benefit from increased market activity.

There is a lot to like about the IRESS business but none more so than management's sensible and steady manner in putting the pieces of a much larger puzzle together. To have done so without spending excessive amounts of capital and without taking unnecessary risks should keep even the most hardnosed investor happy with the results.

Table 6: IRESS – Divisional Contribution

A$M	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Financial Markets revenue						
Aus | NZ	57.8	65.7	75.8	89.6	99.7	99.1
Canada	2.5	3.6	7.9	12.0	19.2	22.1
Group	**60.3**	**69.3**	**83.7**	**101.6**	**118.9**	**121.2**
EBITDA						
Aus | NZ	30.5	35.0	41.5	49.1	55.2	56.6
Canada	0.5	0.2	-0.3	-0.7	4.6	7.0
Group	31.0	35.2	41.2	48.4	59.8	63.7
EBITDA Margins %						
Aus | NZ	52.8	53.3	54.7	54.8	55.3	57.2
Canada	20.9	4.7	-4.2	-6.4	23.9	31.7
Group	**51.4**	**50.8**	**49.2**	**47.6**	**50.3**	**52.6**
Wealth Management Revenue						
Aus | NZ	2.2	4.9	10.0	28.8	39.3	41.3
South Africa	-	-	-	4.1	5.7	6.8
Group	**2.2**	**4.9**	**10.0**	**32.9**	**45.0**	**48.1**
EBITDA						
Aus | NZ	-0.5	1.1	3.2	10.9	15.3	16.9
South Africa	-	-	-	1.8	1.5	2.2
Group	**-0.5**	**1.1**	**3.2**	**12.7**	**16.8**	**19.1**
EBITDA Margins %						
Aus | NZ	-21.7	22.5	32.0	37.8	38.8	41.0
South Africa	-	-	-	43.9	26.2	32.9
Group	**-21.7**	**22.5**	**32.0**	**38.6**	**37.2**	**39.9**

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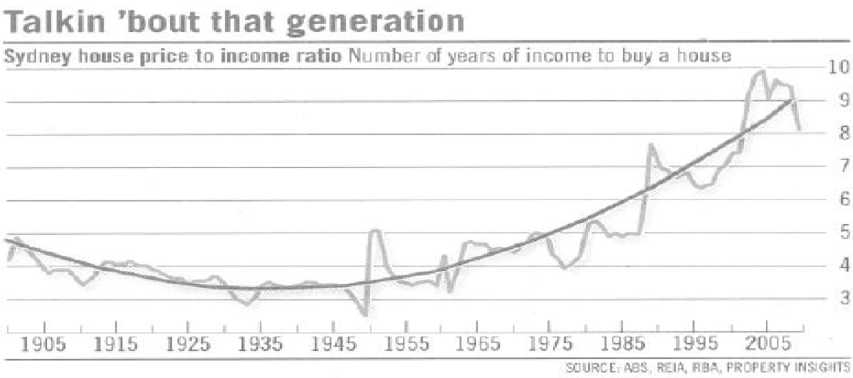
Location, location, location

Post the 1987 share market crash, one asset class that defied the odds and moved ahead strongly was property, particularly residential houses. In fact Australia experienced a housing boom during 1987-89 and again in the period 1997-03. It seems that housing does best when everything else is on the nose. But any perceptions that property is a one way ticket to financial prosperity should be largely tempered. There are in fact many factors that drive house prices, but none is more important than the underlying health of the economy.

Fast forward to 2009 and post the financial crisis, we once again have a booming property market on our hands. According to the Australian Bureau of Statistics, house prices climbed 13.6% in 2009, having posted increases of about 170% over the past decade.

As we noted earlier, the economy's health may underpin housing demand but the chronic shortage of supply is fuelling frantic buying activity across the country. As Graph 4 depicts, Sydney housing affordability – the number of years of income required to buy a property – has continued its upward march from less than five times in the 1970's to around eight times today. At this level, investors and home owners alike are feeling the pinch on rising debt levels and higher mortgage rates.

Graph 4: Housing Affordability



However can the next generation of home owners really afford to stump up on an asset class that continues to move out of financial reach? With average prices in the eight capital cities of Australia sitting just shy of $500,000 and the average new mortgage now in excess of $300,000, a level of restraint is what is required but all the evidence points to a worrying chain of events.

While no direct comparison should be made of the events that engulfed the American banking system, the Australian residential property market does find itself in uncharted territory. Unlike America where a borrower can simply walk away from the debt when it becomes financially unbearable to continue, the loans in Australia are full-recourse to the borrower, helping to explain their attractiveness to the multitude of bank lenders. And in the short term at least, these circumstances are unlikely to change as existing home owners stay put while those entering the market for the first time compete aggressively for a limited supply of stock that is increasingly debt financed.

Since 1995, the Reserve Bank of Australia (RBA) noted that Australian mortgage debt had grown at 14% per annum, while household debt has risen from less than $150 billion to near $1.2 trillion, made up largely of mortgage debt. When compared to Australia's total outstanding credit of $2.0 trillion, it's easy to see why talk of housing bubbles is taken so seriously.

One of the nation's largest homebuilders, Stockland managing director Matthew Quinn, noted during March that housing affordability was a "time bomb" ticking away with Australia facing a current shortage of 200,000 homes and an annual shortfall of 60,000, ballooning to 800,000 by 2020, if no reforms were undertaken. He also added that as things stand "The average first home buyer today cannot afford to pay the median house price - not even close, with the average median house price at $485,000."

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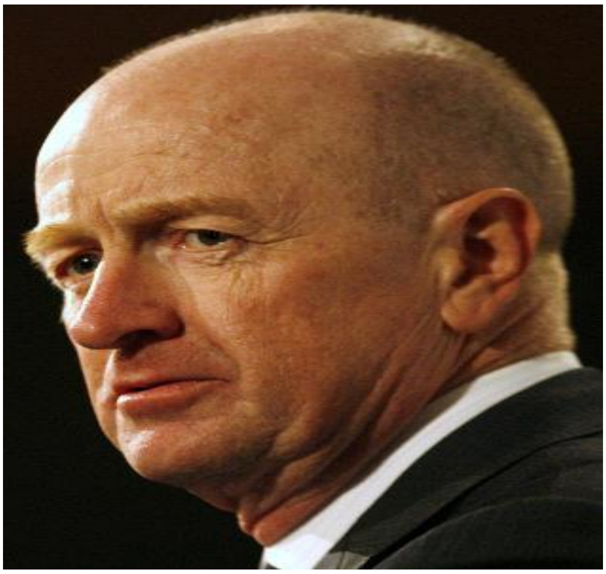
For our major banks, the more pertinent question is whether they are prepared to keep writing more of the same type of loans, in a market they so clearly dominate. This was certainly evident in the Commonwealth Bank's 2010 interim result presentation handout in February. There it showed that residential mortgages represented 58% of its regulatory exposure mix, while its competitors sat in the 40-50% range. Not surprisingly, home lending growth in the past twelve months exceeded 20%, while business lending slumped 5%. However the elephant in the room is that these loans are now less profitable as competition for new business hots up and higher funding costs from the need to attract retail deposits squeezes margins at a point in time when the risk of mortgage stress is on the up.

The Issue of concentration risk should not be underestimated nor should complacency creep in just because Australia has weathered the financial fallout in relatively good shape. *SFM*

And finally the Reserve Bank of Australia (RBA)

Reserve Bank Governor Glenn Stevens has made it pretty clear that Australia is on the path of strong recovery. Rates are on the rise and household net wealth based on RBA analysis has almost recovered to boom-time highs, rising 11% in 2009 to an average $610,000 in December, boosted by rising house prices and a recovery in shares.

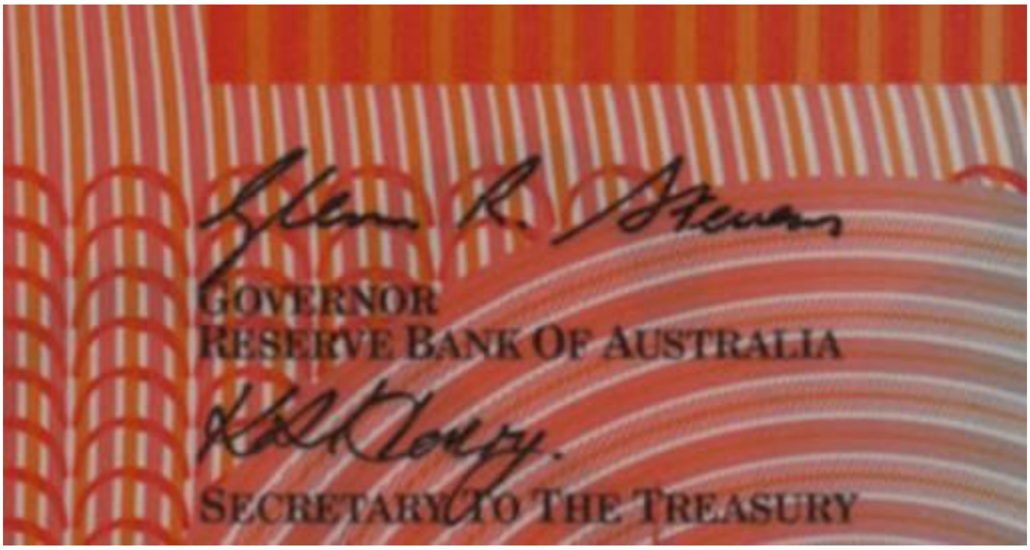


Glenn Stevens RBA governor

Furthermore, the RBA has made no secret of the fact that it sees the current variable mortgage rate of 7% still sitting 50 basis points below the average of the last decade and a half. Why a return to past mortgage rates should be considered "normal" is hard to fathom. What's worse, focusing so squarely on mortgage rates as the guiding light on where rates should be, requires serious debate.

Perhaps a closer examination by the RBA of our major banks' lending practices and their profit results would show that both big and small business owners have been smashed by the credit squeeze that has been in place since 2008. As a collective, the listed companies are in better shape, having taken swift action to raise additional equity, thereby reducing overall gearing levels from 85% in late 2008 to 55% by 2009 year end. Unfortunately small business, the life blood of any economy, has had fewer options and despite the RBA continuing to talk things up, conditions remain tough.

The Federal Government's actions in providing additional support grants for first home buyers during the recent crisis certainly lit the fuse under the housing market, one that Stevens is now so desperately trying to defuse. Unfortunately, monetary policy is a blunt tool and the danger is that in trying to stem excessive behaviour in one asset class we choke off reinvestment in other more productive fields of the economy.



Glenn Stevens signs off

We remain hopeful that the RBA is sensitive to these issues and has learnt from its previous actions in raising rates based on historically pre-determined formulas. ***SFM***

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Company visit diary March Quarter 2010

January

PXS	Pharmaxis 2nd quarter earnings conference call	28/01/10
BKW	Brickworks management visit	28/01/10

February

NWS	News Corporation 2nd quarter earnings conference call	03/02/10
TAH	Tabcorp Holdings interim result briefing	04/02/10
RMD	ResMed 2nd quarter earnings conference call	05/02/10
MQG	Macquarie Group operational briefing	09/02/10
COH	Cochlear interim result briefing	09/02/10
BHP	BHP Billiton interim result briefing	10/02/10
CBA	Commonwealth Bank of Australia interim results briefing	10/02/10
KZL	Kagara management briefing	10/02/10
TLS	Telstra interim results briefing	11/02/10
PRY	Primary Health Care interim results briefing	16/02/10
SEK	SEEK interim results briefing	16/02/10
CSL	CSL interim results briefing	17/02/10
SGM	Sims Metal Management interim results briefing	18/02/10
ASX	ASX interim results briefing	18/02/10
BBG	Billabong interim results briefing	19/02/10
TSI	Transfield Services Infrastructure Fund interim results	22/02/10
ALL	Aristocrat Leisure full year results briefing	23/02/10
SHL	Sonic Healthcare interim results briefing	23/02/10
IRE	IRESS Market Technology full year results briefing	24/02/10
TSE	Transfield Services interim results briefing	24/02/10
DOW	Downer EDI interim results briefing	25/02/10
ORG	Origin Energy interim results briefing	25/02/10
QBE	QBE Insurance Group full year results briefing	26/02/10
WOW	Woolworths interim results briefing	26/02/10
CWN	Crown interim results briefing	26/02/10

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March

REA	REA Group interim results briefing	01/03/10
BKL	Blackmores interim results briefing	01/03/10
AOA	Aquila Resources coal conference	03/03/10
COO	Cockatoo Coal coal conference	03/03/10
WHC	Whitehaven Coal coal conference	03/03/10
NEC	Northern Energy coal conference	03/03/10
NHC	New Hope Corporation coal conference	03/03/10
FLT	Flight Centre interim results briefing	04/03/10
RMD	ResMed management briefing	04/03/10
NPX	Nuplex Management briefing	08/03/10
SRX	SIRTeX Medical interim results briefing	09/03/10
IRE	IRESS Market Technology management visit	11/03/10
CXD	CathRx management briefing	17/03/10
IPD	Impedimed management briefing	18/03/10
N/A	QR National management briefing	23/03/10
PXS	Pharmaxis management briefing	25/03/10
BKW	Brickworks management briefing	30/03/10

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