Selector Fund

Quarterly Newsletter # 28

June 2010

In this quarterly edition we review performance and attribution. We refer to an article written nearly 50 years ago to understand why history is repeating. We discuss Blackmores in detail - a portfolio position. And we make a comment on sovereign risk and the election.

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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.

Dear Investor,

James Grant, editor of Grant's Interest Rate Observer, wrote on September 14, 1990 that "..in a credit contraction, trouble begins at the fringe but eventually visits the centre, no matter how strong the centre is, or seems to be." Though written some twenty years ago, Grant's observation could apply as well to the current state of world financial markets. The financial crisis may have started at the fringe with the collapse of the US housing market but it has moved inexorably towards the centre, damaging all those that stand in its path.

Today, the centre is Governments of all persuasions. Already the fallout has engulfed a number of euro-zone nations, with more likely to follow. In the end, few will be spared in this necessary, painful but important rebuilding process. And yet while the Europeans are struggling to deal with the crisis, the United States economy appears to be on the mend. We acknowledge it is early days but the signs are positive even though the evidence is patchy.

However, as we discuss in our lead article titled "This time it's different" the investor mood is notoriously fickle, shifting wildly from pessimism to optimism and back again. It is during these periods of mood swings that wonderful opportunities can appear. In this quarterly we discuss one such investment, a business that was added to the portfolio during the market's recent turmoil.

Finally, we are pleased to report a good performance number for the financial year ending 30 June 2010, with the Fund's portfolio value rising 15.7% against a market gain of 13.8%, delivering an outperformance of 1.9% for the year (refer portfolio statistics page 20).

We trust you enjoy this latest quarterly report and we look forward to delivering another positive year of performance.

Regards

Tony Scenna
Victor Gomes
Corey Vincent

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Performance June Year Ending 2010

For the financial year ending 30 June 2010, the Fund maintained its outperformance against the index, rising 15.74% compared to a 13.78% gain by the All Ordinaries Accumulation Index. Performance statistics are detailed on page 20.

Performance table since inception – net returns after all fees

% Returns	Fund %	AOAI %	Difference %
3 months	-11.61	-11.04	-0.57
I year	15.74	13.78	+1.96
2 years	1.88	-5.88	+7.76
Since inception compound pa	5.25	6.65	-1.40

Top 10 June 2010*	Top 10 June 2009 *
Billabong International	ASX
Cochlear	Billabong International
Flight Centre	Cochlear
IOOF Holdings	Flight Centre
IRESS Market Technology	Pharmaxis
Pharmaxis	Primary Health Care
ResMed Inc.	ResMed Inc.
Seek	Seek
SIRTeX Medical	Telstra
WorleyParsons	WorleyParsons
Top 10 = 59.3%	**Top 10 = 72.4%**

*Listed in alphabetical order

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 great majority of its equity exposure.

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Performance attribution for the year

Top 5 stock contributors	%	Top 5 stock detractors	%
ResMed	1.0%	Pharmaxis	-2.4%
CathRx	0.8%	Flight Centre	-2.0%
Iress Market Technology	0.2%	Sirtex Medical	-1.6%
Cochlear	0.1%	Kagara	-1.5%
Blackmores	0.1%	Billabong International	-1.1%

Pharmaxis comment

In the last week of June, the Fund's performance was impacted by its holding in Pharmaxis, which fell 33% following the group's release of its second phase 3 cystic fibrosis (CF) trial results. We spoke with management after the event to grasp the significance of the results delivered. As a matter of background, readers can refer to our June 2009 quarterly newsletter for a detailed review of the business.

The phase 3 CF302 trial delivered an excellent headline result of an 8% improvement in lung function over baseline after 26 weeks. That means a CF sufferer can inhale 8% more air in one second after using bronchitol for 26 weeks than they could at the start of the trial. CF sufferers have an average life expectancy of 39 years and death results from an annual decline in lung function of 1 – 2%. This result was statistically significant, meaning that the likelihood of this being a random occurrence was less than 5%. This is called the 95% confidence level (giving rise to a statistical p score < 0.05).

Other aspects of the CF302 trial analysed to date, including safety data and other secondary endpoints, produced results consistent with the successful CF301 trial. That is they were also statistically significant.

The issue with the trial was a technical point. While no doubt an important point that increases investor uncertainty, it is in our opinion not a binary event for the company.

The trial protocol has a control arm (placebo). The control arm is a made up of a randomised selection of 2 in 5 patients who take a non-efficacious dose of bronchitol. That means this group inhales 50 mg of bronchitol powder rather than the full 400mg dose. The 50 mg dose is designed to be too small to provide a therapeutic benefit to the patient thus acting as a placebo.

In CF302, the control arm performed better than expected. A p value of 0.059 was generated, we had hoped for <0.05. This gave way to a confidence level reading of 94.1% rather than the 95% level sought. It was a near miss, but the markets' judgment was that the upcoming European and US approval process for bronchitol had been compromised, leading to the stock being sold off.

The strong performance of the control arm may have a simple explanation. For example the 50mg placebo may be effective in children with smaller lungs but at this point that is pure speculation on our part and we would rather stick to the facts.

Our view is that the case for European approval was strengthened as a result of a strong and consistent safety profile generated by the CF302 trial. The European regulator has completed its clinical analysis of the first CF trial (CF301), with the only additional statistics requested from CF302 surrounding safety data. The European approval process is on track to complete during 2010. Pharmaxis is now engaging a European sales force in readiness of gaining approval by year end. We view management's recent changes to the European sales strategy as favourable.

The US regulatory process is less clear, however a few important aspects need to be considered. Firstly, all data points show this is a very safe drug to use. Secondly, two large 300 patient CF trials have now been completed and, importantly, the use of a consistent trial design will enable statistical analysis of the complete 600 patient data body, representing a very large sample of nearly 1% of all CF sufferers. Importantly, on analysis of this complete body, the p values will be statistically significant across <u>all</u> the trial endpoints. We believe this is what the US Food and Drug Administration will focus on. Thirdly, the average lung function improvement across the trials provides a compelling patient benefit outcome. In this respect CF302 outperformed our expectations.

Based on this evidence we remain of the view that European and US approvals for the sale of bronchitol will be achieved after submission of a compelling body of evidence from a large and diverse sample of patients. The evidence demonstrates a strong drug safety profile and significant health benefits for patients. Accordingly we have held our position and view this as a buying opportunity. ***SFM***

This time it's different

Whenever the words - "this time it's different" - are used to describe a new market phenomena, investors should take special heed and crouch for cover. The hard lessons learnt during the technology boom of 2000, the share market bull run of 2003 through to 2007 and the current China led mining surge, should serve as sufficient reminders that any trend, irrespective of its promise, should be approached with caution as to its longevity.

Delve far enough into the financial archives and what becomes increasingly apparent is how past excesses are easily forgotten, only to resurface when events repeat themselves.

As we look back over the past twelve months, the fallout from the financial crisis that took hold during 2008 continues to drag in new players. Respected financial journalist and editor of Grant's Interest Rate Observer, James Grant noted how in times of crisis, the initial impact can at first appear small only for it to grow and engulf larger areas

"...in a credit contraction, trouble begins at the fringe but eventually visits the centre, no matter how strong the centre is, or seems to be."

"In the depressive phase, credit contracts, asset values fall, and business slows down. Among financial institutions, failures proliferate. Failure begins at the margin but eats its way into the middle, like a mouse."

"...in a severe contraction, even the strongest lenders are tested, as the process of shrinkage and deflation nullify the financial assumptions that, in the boom, had seemed conservative."

Suffice to say that opinions have now shifted firmly into the camp that global economic conditions are likely to deteriorate further and for longer. This is not entirely surprising, given how the crisis has engulfed Greece and spread into neighboring European territories. However, how much weight should we place on these events? Well, we would suggest applying sufficient weight so as to consider the negative ramifications of the fallout continuing, but not so much that the loudest and most recent information clouds our judgment to the long term detriment of investment decisions made today. Maintaining a level head during these periods and reflecting on past periods often puts things into perspective.

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Below we provide some extracts - the full version is available on our website - from a paper delivered by Benjamin Graham titled "Securities in an Insecure World" on 15 November 1963. In his piece, Graham spoke specifically about the period 1949-1963 and how investor moods in the United States would swing so wildly from euphoria to pessimism.

"Yet only last year, although it seems a long time ago – market fluctuations, as evidenced by a decline in the Dow Jones Average from 735 to 535, did loom as extremely important to investors and speculators alike. This fall of about 27% in the Dow Jones Average was accompanied by declines of between 50 and 90 per cent or more in most of the new securities that had been issued in the preceding two years and that played such a spectacular part in the stock market activity of that period. At that time then, in May 1962, the concept of a one-way market, which could go only upwards with very small reactions, seemed to be abandoned for good. However, Wall Street has a very short memory, and now the majority of financial authorities seem to be slipping back to the concepts of 1960 and 1961."

As to why investors keep doing what they do, he offers this observation.

"But the third possibility is that the nature of the market has not changed from its earliest time, as shown in our records that go back at least to the South Seas Bubble in 1720, practically 200 years. We have also very detailed data on stock prices in the United States since 1871, which were incorporated in the Cowles and the Standard and Poor's records. It may well be that we shall still have the all-too-familiar alter nations of excessive optimism and excessive pessimism. The most recent example of excessive pessimism is the very period which was a starting one for this market. During 1949-50 the market had the lowest peace-time price-earnings ratio in its history. Stocks sold at only 7 times their earnings, in the market averages I am talking about, as compared with about 20 times at the present time. The implication here is that just as stocks were evidently undervalued at seven times their earnings they might very well be overvalued at twenty times earnings or at some higher multiplier that will be established later in this market and will represent a level of excessive optimism."

As Graham noted, the United States Dow Jones Average share index soared in 1949 from 163 points to 735 points by mid 1962, only to fall 27% in the months that followed. Reflecting the very essence of human nature, Graham noted that such events were unlikely to be one-off.

"But the thought that the stock market may have been over-valued in the last five years, just as it was undervalued fifteen years ago, brings us to the third possibility which I enumerated, namely that we are still going to have wide fluctuations in the future. This I consider the most probable one, though it is far from certain. My reason for thinking that we shall have these wide fluctuations – of which we had a taste in 1962, in May particularly – is that I don't see any change in human natures vis-à-vis the stock market which is sufficient to establish more restraints in the public behavior than is showed over so many decades in the past. The actions of the public with respect to low-grade new issues during the 1960-61 extravaganza in that field are an indication of its inherent lack of restraint. You ought to remember also, that many of the highest grade common stock issues were forced up. Let me give you some examples: The most impressive to my mind was that of International Business Machines (IBM) which is undoubtedly the leading common stock in the entire market. Speculative enthusiasm pushed it up to 607 in December 1961, from which it declined to 300 in June 1962 – a fall of more than 50% in the short period of 6 months. General Electric, which is the oldest high grade investment common stock, declined from a high of 100 in 1960 to 54 in 1962. Dow Chemical, one of our best chemical companies, fell from a high of 101 to a low of 40, and U.S Steel which is an old leader, shrank from 109 in 1959 to a low of 38 in 1962. These very wide swings underline the fact that the stock market is basically the same now as it always was, in the sense it is still subject to very substantial over-evaluation at sometimes and undoubtedly substantial under evaluation at others. My basic conclusion is that investors as well as speculators must be prepared in their thinking and in their policy for wide price movements in either direction."

And perhaps importantly, Graham concludes that when it comes to investing, keeping a level head is as important as choosing wisely.

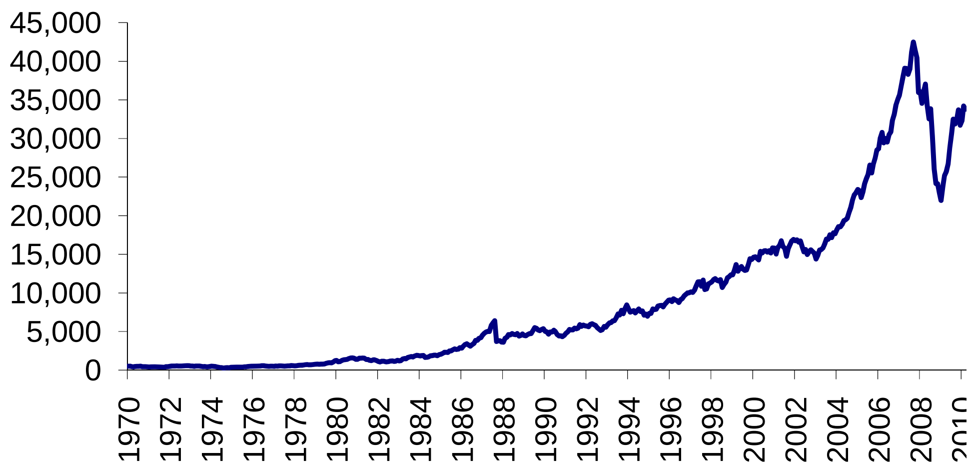
"The investor must recognize that there are uncertain and hence speculative elements inherent in any policy he follows – even an all-Government-bond program. He must deal with these uncertainties by a policy of continuous compromise between bonds and common stocks, and by adequate diversification. (Exception: He my put and keep most of his funds in shares of a promising business which he is closely connected.) He must make a strong effort to have more money invested in common stocks at lower market levels (at least on the basis of cost) than at what he recognizes to be potentially high levels. Most important, he must maintain a philosophical attitude towards the inescapable variations in his financial position and the inevitable "mistakes" associated with these variations.

According to an old Wall Street story, when a certain broker was asked by a client to recommend issues to buy, he always asked in return, "What is your preference? Do you want to eat well or to sleep well?" I am optimist enough to believe that by following sound policies almost any investor – even in this insecure world – should be able to eat well enough without having to lose any sleep."

Closer to home and 47 years since Graham presented his paper, the investment world seems to have changed little. Insecurity is alive and well, as reflected in the wild gyrations in share market moves. Investors likewise, having toyed with the notion that debt was good and leverage even better, now seek comfort and direction. The events of 2008 are still too fresh, while the unfolding crisis in Europe only adds fuel to the fire that we are indeed living in an insecure world.

The following chart outlines the performance of the local All Ordinaries Accumulation Index (adjusted for reinvestment of dividends) since 1970.

Chart 1. All Ordinaries Accumulation Index 1970 – 2010



Over the past 40 years, the index has recorded a compound annual return of 11.04%. Breaking the years down further, the index has recorded compound annual gains of 11.14% over 30 years, 9.73% over 20 years and 7.46% during the past decade. The few deductions we can make from these numbers are that the returns are excellent and the trend is down. However, to deduce that the future holds any less promise than the past would be to underestimate human natures "...all-too-familiar alter nations of excessive optimism and excessive pessimism" as observed by Graham almost half a century ago. *SFM*

Blackmores Limited (BKL)

Table 1: Blackmores Corporate History 1938 - 2010

Year	Event
1938	Maurice Blackmore, English immigrant establishes first health food store in Brisbane.
1962	Feb - Blackmores Naturopathic Organisation Pty Limited incorporated.
1973	Marcus Blackmore son of Maurice joins Board of Directors.
1975	Sales top one million dollars for year.
1976	Blackmores launches in Singapore and Malaysia.
1982	July - Blackmores acquires Vita Glow, marketer of a range of vitamins and mineral supplements.
1984	Sales top ten million dollars for year.
1985	Blackmores establishes first naturopathic advisory service.
1985	May - Company name changed to Blackmores Laboratories converted to public company and lists on Australian Stock Exchange.
1986	June – Blackmores acquires Abundant Earth, Biogenic Health Foods and Russell's Natural Food Markets to form Blackmores Food Division.
1986	Blackmores acquires the 55 store Healthy Life retail chain.
1987	Blackmores establishes its first naturopathic clinic in Sydney.
1987	June – Blackmores launches skin and haircare products into Japanese markets.
1988	June – Blackmores Sponsors Kay Cottee, first woman in history to sail single handed, non–stop around world.
1988	Healthy Life restructured from franchise group to a licence / banner group.
1989	April – Name changed to Blackmores Limited.
1989	July – Blackmores launches in Thailand.
1990	June – Blackmores launches a skincare range in the United States.
1992	May – Sale of Russell's Natural Foods Markets.
1995	Blackmores launches in Indonesia.
1995	July – Blackmores closes US subsidiary / completes management buyout UK subsidiary.
1997	July – Blackmores launches website.
2000	July – Blackmores expands into Coles grocery outlets.
2003	May – Pan Pharmaceuticals faces largest ever recall of medicines in Australia / Blackmores having never used Pan as a manufacturer remained unaffected, experiencing a significant sales lift.
2004	July – Marcus Blackmore becomes Chairman of Heart Research Institute.
2005	Blackmores announces shift to new manufacturing facilities at Warriewood Sydney.
2005	Blackmores ceases marketing skin and haircare products to focus on supplements.
2006	December – Blackmores free online e-newsletter grows past 100,000 subscribers.
2007	November – Blackmores launches products into Watson's stores in Taiwan.
2008	October – Blackmores free online e-newsletter subscriber base passes 230,000.
2008	November – Christine Holgate appointed CEO.
2009	November – Blackmores relocates to new campus at Warriewood.
2009	May – Blackmores donates to Macular Degeneration Foundation as sales of Macu–Vision hit $2M.
2009	June – Sales reach $200 million, NPAT $20.8M
2010	April – Company updates market at 3rd quarter, expects NPAT lift of 10%-15% for FY10.

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Table 2: Blackmores Financial Snapshot

$'M	2000	2005	2006	2007	2008	2009	2010(e)
Revenue	79.6	135.2	148.9	172.9	180.2	201.2	225.0
Operating Expenses	69.8	115.9	125.9	146.2	150.4	167.7	184.7
EBIT	8.6	17.4	21.1	25.1	27.9	31.0	35.8
NPAT	5.4	11.3	14.5	16.7	19.1	20.8	24.1
EBIT Margins (%)	10.8	12.9	14.2	14.5	15.5	15.4	15.9
Shareholders' Equity	17.4	30.6	36.8	43.5	50.4	58.6	65.7
Net Debt / (net cash)	2.7	5.1	3.5	5.3	25.8	33.6	29.4
Market Capitalisation	85.8	205.9	221.0	328.9	265.7	262.4	379.9
Enterprise Value	88.5	211.0	224.5	334.3	291.5	296.0	409.3
Buyout (%) **	9.7	8.3	9.4	7.5	9.6	10.5	8.8
ROCE (%) *	58.5	48.7	52.4	51.4	36.6	33.6	37.6
GOCF / EBITDA (%)	71	95	95	93	109	97	98
Underlying Earnings per share (¢)	36.5	71.1	91.2	104.4	117.9	126.8	144.3
PER	15.9	18.2	15.2	19.7	13.9	12.6	15.8
Dividend per share (¢)	33.0	58.0	69.0	81.0	90.0	96.0	105.0
Dividend Yield %	5.7	4.5	5.0	3.9	5.5	6.0	4.6
Share Price 30 June ($)	5.80	12.95	13.90	20.56	16.40	16.00	22.75
Issued shares (m)	14.8	15.9	15.9	16.0	16.2	16.4	16.7

* ROCE = EBIT / (Shareholders Equity + debt – cash)
** Buyout represents EBIT / EV as a percentage

History

They say a change is as good as a holiday, well in the case of Australia's most trusted and recognised vitamin and supplement brand, Blackmores has certainly seen plenty of change over the past few years. Whilst its origins date back some 70 years, when English immigrant and founder Maurice Blackmore landed on our shores, establishing Australia's first health food store in 1938, it has been Marcus Blackmore, Maurice's son, that has led the business since 1973.

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As the accompanying table and financial records show, the company is, excuse the pun, a picture of health.
The selling of vitamins, herbal & mineral supplements (VHMS) is now big business in this country and Blackmores the most dominant player. Unlike traditional drugs that require scientific testing to gain regulatory approval, the active ingredients in complementary medicines have a long history of use and are generally available for use in self-medication and are obtained from retail outlets such as pharmacists, supermarkets and health food stores. While numbers are hard to quantify, management suggests the market value of complementary medicines is $650M, with complementary therapies attracting another $350M. Blackmores' focus has been in the complementary medicine space, where local sales of $170M imply a market share of roughly 26%.

The growth in preventive medicine use has seen the business undertake significant progress since its public listing in 1985. The group's strength lies in its trusted brand status and management's unwavering commitment to introduce innovative, high quality vitamin products. These products range from the traditional cold and flu vitamins, to specific formulations for men, women and children and extends to areas including age related diseases such as Macu–Vision (to fight against damage to the retina of the eye), Glucosamine (help reduce pain caused by osteoarthritis) and Cholesterol Health (to assist in reducing cholesterol levels) to name just a few.

Business

In total, Blackmores' individual product range now numbers around 150 and closer to 400 if all product sizes and variations are included. This is an area of focus for the new management team as it looks to press home the company's brand strength and increased manufacturing capabilities. The appointment of new CEO Christine Holgate in September 2008 was an important catalyst in driving home this advantage. In fact, the appointment of Holgate ended the group's long search for a new chief executive since the resignation of Darin Walters in 2003. In the intervening years, Blackmores has relied on the services of a chief operating officer and its chief financial officer, along with Marcus Blackmore as chairman to run the business.

It is not an ideal situation and one that stopped us investing in the business when we first visited the operations back in May 2007. While we had the highest respect for the brand and the company's financial record, every team needs a leader and in this instance our concerns rested on the belief that the then management team was lacking focus at a critical juncture in company's history, as it undertook a potentially risky and costly property move to new facilities at Warriewood in Sydney. All up, the move cost north of $50M. The 25,000 square metres Blackmores Campus, officially opened in May 2009, now houses the group's entire Australian team of 320 personnel along with production facilities capable of packaging 80,000 vitamins per day, a significant step up from the 50,000 previously. We were fortunate enough to tour the facility in May this year and the look and feel of the new campus speaks volumes to the heritage that backs up the Blackmores brand.

Site Visit

Our meeting with Holgate and newly appointed chief financial officer Chris Last also allayed some of our fears that despite the company's ongoing financial success, the lack of strategic direction was now being addressed. As with any company built by a founder and passed onto the next generation, the chances of a mis-step or even significant damage are ever present. Fortunately, Holgate has set some clear goals and has hit the ground running. While the brand has always enjoyed strong customer loyalty, particularly following the Therapeutic Goods Administration (TGA) recall of drug operator Pan Pharmaceuticals products in April 2003, these two external appointments will provide both a fresh and balanced voice in a company, where the chairman Marcus Blackmore controls 27.3% of the issued capital.

Business Operations

Operationally, Blackmores' products are sold throughout Australia and into international markets including New Zealand, Hong Kong, Malaysia, Taiwan, Singapore, Vietnam and the United Kingdom. As noted earlier, Australian operations recorded sales of $167M during 2009 up from $74M in 2000. Over the past nine years, sales have grown at an annual compound rate of 9.4%, while the industry's growth rate has been estimated at 5-6%. The group's sales are predominately directed towards the specialist pharmacy outlets that as a body represent about 66% of revenue, followed by grocery stores with 25% and health food stores bringing up the rear with 9%. Management have indicated a desire to push further into the pharmacy sector, as it provides better brand protection and a customer base supportive of the products offered. At the earnings before interest and tax line, the company's Australian based profits have moved up from $8.9M in 2000 to $26.5M during 2009, reflecting an improving EBIT margin of 15.9%.

New CEO

Holgate has also wasted little time in re-energising the Blackmores culture. Getting new products to market has become a critical component of the group's renewed push to grow. In the 2009 financial year, only nine new products were launched, seven of which took place in the latter stages of the year. In sharp contrast, 2010 is shaping up to be a stellar year with the group launching 67 new products in all markets, made up of varying package sizes. This has been made possible, in large part due to management revisiting staid regulatory procedures that stymied the approval process, leading to long product delays. In addition, new products are now formulated on the basis that they must also meet global standards, allowing for faster market launches. Forming industry partnerships and addressing specific health issues have also become a critical component of new product developments, as evident by the formulation of Macu-Vision, an eye health product endorsed by the Macular Degeneration Foundation that now enjoys a market share of 80%. In a similar vein, the group's targeted pregnancy formulation product has grabbed a 70% market share while discussions continue with other leading institutions including the Heart Foundation.

The group continues to outsource all its manufacturing to accredited TGA organisations, preferring instead to concentrate efforts on product packaging and strengthening its in-house sales and marketing teams. This has allowed the group to actively promote to leading pharmacy chains at a time when competitors have dropped the ball.

Management noted Sanofi-Aventis, following its 2008 $560M acquisition of Symbion's consumer business and owner of consumer brands Nature's Own, Cenovis, Bio-organics and Golden Glow, is Blackmores' largest competitor with a market share half that of the group. Other main competitors include the Australian based Swisse group turning over $65M per annum of natural medicines and the listed Sigma Pharmaceuticals' wholly owned subsidiary Herron Pharmaceuticals.

Growing offshore success

In offshore markets, Blackmores' marketing success has taken second stage to the main game in Australia, with sales growing from $11.6M in 2000 to $37.2M during 2009, on EBIT up from $250,000 to $2.6M. Holgate acknowledges that international markets have not been a high priority of past management teams, noting that some distribution agreements currently in place have hindered growth. However with Holgate now dedicating one third of her time to offshore markets, management is firmly targeting this area as a strong source of future growth. Having first launched into the Thailand market in 1989, Blackmores' products are now sold throughout Asia and New Zealand. The Asian market is very accepting of natural medicines and Blackmores' brands are highly regarded, with the group's main contributing markets of Thailand and Malaysia up in local currencies by 29% and 25% respectively for the nine months to March 2010.

Strong Financials

While some may regard the group's progress thus far as a little pedestrian, its financial performance record would be the envy of many in the investment arena. In the nine years, as reflected in Table 2, the numbers are truly worth repeating. In that period, sales have risen 152% to $201M, with EBIT up 260% to $31M, on EBIT margins up 43% to 15.4%. The beauty of the Blackmores business lies in its ability to generate strong cash flows without the need for high capital expenditure. This has allowed the group to focus attention on increased product development and targeted marketing spend. In the period since 2000, return on capital employed has fallen from 58.5% to 33.6%, however it is largely a reflection of new debt the group took on to complete its property move from Balgowlah to Warriewood.

As things stand, net debt at only $33.6M is reflective of management's conservative style. Importantly for shareholders, the group's issued capital has remained largely unchanged over the years, rising from 14.8 million to 16.4 million as at 2009. Earnings per share have, as a result, jumped from $0.36 per share in 2000 to $1.26 per share by 2009. Likewise, dividends have almost tripled from $0.33 per share to $0.96 per share during the same period. Not surprisingly, the Blackmores share price has followed suit, motoring from $5.80 per share to its current level of $22.50 per share, implying a current market value of $376 million for the business. Based on management's market update in April, the group expects to lift net profit by 10% - 15% this year, suggesting a full year net profit range of $22.8M – 23.9M. On our numbers, the business is currently trading on an attractive buyout ratio of 8.8% when compared to the risk free bond rate of 6%. Furthermore, the highly desirable defensive qualities of the business and appointment of a new CEO and management team provides us with sufficient confidence that the group's past performance can not only be maintained but built upon.

The share market wobbles of recent months have allowed us to add Blackmores to the portfolio for the first time. The investment made represents 3% of the portfolio at an entry price of $21.50 per share. On this basis, the investment is trading on a PER of 14.9 and a fully franked yield of 4.9%.

There is a lot to like about Blackmores' business and the changes made in recent years but none more so than the reputation earned over seventy years as Australia's leading natural health brand. *SFM*

Brand Rudd gone...brand Australia damaged, what next?

We highlighted our concerns in our June 2008 and September 2009 quarterlies with Part 1 and 2 of "Governments – Perfecting the art of stealing". We are advocates of tax reform and certainty. The Resources Super Profits Tax (RSPT) delivered neither. Whether one agreed with Peter Costello or not, he was on the money when he said that this was an opportunity squandered. Rather than tax reform it was a tax grab, a drag on growth and a source of uncertainty.

Reform should aim to simplify and reduce the overall burden. Putting the RSPT design flaws aside, rather than delivering a meaningful step forward for industry and country alike, it only served to heightened sovereign risk for local and foreign investors. Uncertainty is the enemy of investment. Investment is the key to job creation and growth. And growth ultimately drives a higher tax base. In the case of the new Minerals Resources Rent Tax (MMRT) it remains complicated and fails to deliver reform or revenue. But industry and investor uncertainty is retained.

Our fear when Rudd was elected was a desire to govern in slow motion, taking advice from expert panels and committees at every turn. As it turned out, we had no cause for concern. Our issue with the Gillard Government is policy architecture. Naturally in the short term it is focused on the desperate bid to be re-elected, but more worryingly is that in the longer term it may have shifted towards the self serving factions responsible for Rudd's departure. From where we sit this is unlikely to deliver reform or certainty. Can Abbott produce sound policy? We don't know. But we wouldn't rule out a change of government. *SFM*

Company visit diary June Quarter 2010

April

PXS	Pharmaxis 3rd quarter conference call	15/04/10
BUY	Bounty Oil & Gas conference meeting	19/04/10
DLS	Drillsearch Energy conference meeting	19/04/10
MOS	Mosaic Oil conference meeting	19/04/10
INP	Innamincka Petroleum conference meeting	19/04/10
AZZ	Antares Energy conference meeting	19/04/10
NWE	Norwest Energy conference meeting	19/04/10
PSA	Petsec Energy conference meeting	19/04/10
ELK	Elk Petroleum conference meeting	19/04/10
NEN	Neon Energy conference meeting	19/04/10
IFN	Infigen Energy conference meeting	20/04/10
PAX	Panax Geothermal conference meeting	20/04/10
CXY	Cougar Energy conference meeting	20/04/10
BOW	Bow Energy conference meeting	20/04/10
MPO	Molopo Energy conference meeting	20/04/10
AZO	Apollo Gas conference meeting	20/04/10
WCL	Westside Corporation conference meeting	20/04/10
REA	REA Group conference meeting	21/04/10
GWT	GWA International conference meeting	21/04/10
AAD	Ardent Leisure Group conference meeting	21/04/10
CRG	Crane Group conference meeting	21/04/10
NVT	Navitas conference meeting	21/04/10
APN	APN News & Media conference meeting	21/04/10
HHL	Hunter Hall International management meeting	21/04/10
ALL	Aristocrat Leisure annual general meeting	28/04/10
RMD	ResMed 3rd quarter conference call	30/04/10
ORG	Origin Energy management meeting	30/04/10

May

IRE	Iress Market Technology management meeting	03/05/10
IPD	Impedimed life science conference	04/05/10
MSB	Mesoblast life science conference	04/05/10
NWS	News Corporation 3rd quarter conference call	05/05/10
ORG	Origin Energy Macquarie conference	05/05/10
AGK	AGL Energy Macquarie conference	05/05/10
SEK	Seek Macquarie conference	05/05/10
WTF	Wotif.com Holdings Macquarie conference	05/05/10
KMD	Kathmandu Macquarie conference	05/05/10

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CUS	Customers Macquarie conference	05/05/10
TPM	TPG Telecom Macquarie conference	05/05/10
SGP	Stockland Macquarie conference	06/05/10
BIL	Brambles Industries Macquarie conference	06/05/10
IFL	IOOF Holdings Macquarie conference	06/05/10
CRZ	Carsales.com Macquarie conference	06/05/10
TRS	The Reject Shop Macquarie conference	06/05/10
ARP	ARB Corporation Macquarie conference	06/05/10
SUL	Super Cheap Auto Macquarie conference	06/05/10
REA	REA Group Macquarie conference	06/05/10
RIO	Rio Tinto Macquarie conference	07/05/10
IRE	Iress Market & Technology Macquarie conference	07/05/10
WBC	Westpac Banking Corporation Macquarie conference	07/05/10
RMD	ResMed Macquarie conference	07/05/10
BKL	Blackmores site visit	13/05/10
KIL	KFM Diversified Infrastructure & Logistics Fund meeting	17/05/10
FLS	Flourotechnics management meeting	18/05/10
CXD	CathRx management meeting	25/05/10
IFL	IOOF Holdings investor open day	27/05/10
JHX	James Hardie full year results presentation	27/05/10

June

QBE	QBE Insurance Group investor briefing	16/06/10
CXD	CathRx general meeting	16/06/10
PXS	Pharmaxis management meeting	25/06/10
PAB	Patrys management meeting	29/06/10
MYE	Mastermyne Group management meeting	29/06/10
BBG	Billabong International conference call	30/06/10

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