Selector Funds Management Ltd

Quarterly Newsletter No.29

March 2012

In this quarterly edition we review performance and attribution. We focus on the hazardous and waste treatment business of Tox Free Solutions Limited and the international affiliates of SEEK Limited. Finally we review US macro issues. Photo Tox Free subsidiary Barry Brothers: “Non destructive drilling”

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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

Dear Investor,

The experts were out in force over the past quarter distilling their knowledge to the masses. We got a taste of what was coming late last year when influential investment commentator Alan Kohler made his thoughts crystal clear on where stock markets were heading, with his call that he was heading to the sidelines for his own investment portfolio writing on 16 December 2011 "On Monday I will be significantly reducing my already reduced exposure to equities, possibly to zero."

This was followed up recently by former Treasury secretary Ken Henry who has called for a radical rethink of the investment strategy of the superannuation sector, urging investors to reduce their exposure to shares and increase bond holdings. In many ways their views reflect what has already transpired, that in recent years, shares have not delivered the results that investors had become accustomed to. Henry made that point clear on 24 March 2012 when he said "I was told that equity markets would always outperform debt over any period relevant to superannuation fund members. I wasn't convinced then and I'm even less convinced today."

The concerns raised by Kohler and Henry are nothing new. However in our opinion, the time to have made those calls was when markets were motoring back in 2007. While the events in Europe have led to a heightened level of investor fear, we made the contrary call in our December 2011 quarterly edition "our sense is that the market is pricing in an enormous amount of gloom." This is not to say that we dismiss these issues, be they Europe, or China's slowing growth profile or even the left field possibility of military conflicts. It's just that now is not the time to be fearful but the time to explore the plentiful opportunities on offer. Sticking to a coherent long term investment roadmap makes far more sense than lurching from external shock to another.

In our lead article this quarter, we profile the investment merits of listed environmental waste services group Tox Free Solutions. We follow this up with a short review on online employment leader SEEK, focusing specifically on the group's offshore investments. Finally, having set the scene in our December 2011 newsletter on why we felt positive on the US market, we follow this up with some interesting observations.

Finally, the Fund delivered a positive gross performance for the quarter of 13.84%.

To all our investors we trust that you find the report informative.

Regards
Tony Scenna
Corey Vincent

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Performance March 2012

For the quarter ending March 2012, the Fund delivered a gross positive return of 13.84% as compared to the 9.00% rise in the All Ordinaries Accumulation Index. Performance statistics are detailed on page 22.

Performance table since inception

% Returns	Fund % Gross	All Ords Index %	All Ords Acc Index %
3 months	+13.84	+7.51	+9.00
3 years	+15.06	+7.76	+12.29
Since inception compound pa	+6.42	+2.11	+6.51

Top 10 March 2012*	Top 10 December 2011*
Blackmores	Blackmores
Campbell Brothers	Campbell Brothers
Flight Centre	Flight Centre
IOOF Holdings	IOOF Holdings
News Corporation Inc	IRESS Market Technology
Pharmaxis	News Corporation Inc
ResMed Inc	ResMed Inc
SEEK	SEEK
SIRTeX Medical	SIRTeX Medical
WorleyParsons	Whitehaven Coal
Top 10 = 61.96%	Top 10 = 65.78%

*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. Current and past portfolio composition has historically been very unlike that of your average run-of-the-mill "index hugger" fund manager. Our stock selection to this point has not included either retail banks or the large resource companies, RIO and BHP. Our goal remains to focus on truly differentiated broad cap stock selection rather than the closet index hugging portfolios offered by most large fund managers.

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Performance attribution for the quarter

Top 5 stock contributors	%	Top 5 stock detractors	%
Flight Centre	+3.60	CathRx	-1.05
Campbell Brothers	+1.74	Blackmores	-0.02
SEEK	+1.48	Navitas	-0.02
ResMed Inc	+1.23	Cochlear	+0.05
Pharmaxis	+1.19	Sydney Airport	+0.11

With the exception of medical device company CathRx, the majority of the Fund's portfolio holdings contributed positively to the gains recorded for the March quarter. We are certainly disappointed by the performance of CathRx and we await management's ability to set in train a number of business changes that are urgently required to stem the losses currently being incurred.

On the positive side of the ledger, the top performers included Flight Centre, Campbell Brothers and SEEK. On the back of a strong interim result, which saw net profits rise 16% to $81.6 million, Flight Centre upgraded full year 2012 guidance with profits now targeted at the $188 - $200 million range. This would see the group trade on an average 2012 PER of 11x and a dividend yield of 4.5%.

Campbell Brothers and SEEK followed up their strong December quarterly 2011 share price performance with another excellent gain over the March quarter. In the case of Campbell Brothers, the group will announce its interim results in May but in the meantime expectations are high that this analytical testing services business will continue to see management under promise and over deliver.

In the case of SEEK, the group delivered an outstanding result for the half, catching most investors off guard. We provide a brief review of the business later in this newsletter, focusing our attention of the group's increasingly important international investments.

Finally, medical healthcare stocks ResMed and Pharmaxis both reversed recent underperformance. While public awareness to the illness of sleep disordered breathing continues to gain traction, ResMed's biggest market, the US, has been impacted by softer growth rates and health funding concerns. That said, the ResMed business is well placed along with its strong balance sheet to meet these short term challenges.

Pharmaxis announced to the market in March, that its cystic fibrosis treatment Bronchitol had been recommended for listing on the Pharmaceutical Benefits Scheme (PBS) in Australia by the government's advisory body. Pharmaxis also announced that the European approval for the drug was now expected in the upcoming June quarter. While the road to market has been harder and taken a lot longer than we had first envisaged, the group is now well placed to sell the merits of its drug to the cystic fibrosis community. ***SFM***

Tox Free Solutions (TOX)

Table 1: Tox Free Solutions 1993 - 2012

Year	Event
1993	Starts business life as a technology focused hazardous and waste treatment remediation company.
2000	Tox Free Solutions lists on the Australian Stock Exchange, issuing minimum four million shares at 50¢ each, resulting in a total of 114.5 million shares and valuing the entire business at $57 million.
2000	Tox Free technology deployed in construction of plant at Port Hedland in WA.
2001	Tox Free receives WA license to treat hazardous and toxic waste.
2002	Company fails to meet revenue forecasts, CEO Dick Allen resigns, Sergio Nusimovich appointed.
2002	Current CEO Stephen Gostlow joins company from Environmental Protection Agency, ends up running company's Port Headland facility.
2004	Tox Free executes lease with WA Government for new waste processing site at Karratha WA.
2004	CEO Sergio Nusimovich steps down, company under serious financial pressure announces 1:1 non renounceable rights issue at 1¢ each, raising $1.9 million.
2004	Company survives, issued capital blows out to 377 million shares plus 94 million options.
2004	Board appoints WA State Manager Steve Gostlow as new CEO, undertakes business restructure.
2005	CEO Gostlow outlines FY06 base case revenue and EBITDA of $8 million and $3 million respectively.
2005	Company acquires WA industry leading cleaning business Delvex for $2.5 million.
2006	CEO Gostlow upgrades EBITDA forecast for FY06 to $4.8 million, announces 8:1 capital consolidation, reducing issued capital to 65.1 million shares.
2007	Acquires Kimberley Waste Services for $13 million, AGR liquid waste facility for $4.5 million.
2008	Acquires Karratha mini skips for $2.1 million, industrial services sector leader Barry Bros for $25 million, opens purpose built hazardous waste management facility at St Mary's NSW.
2009	Tox Free awarded Woodside's LNG total waste management contract, Chevron's Barrow Island Gorgon LNG waste management contract.
2009	Michael Constable appointed CFO, Jason Dixon appointed general manager corporate.
2009	Full time employee numbers hits 350, operating from 24 centres nationally. Company undertakes strategic planning review for the business, announces strong start to year with EBITDA estimated at $26–$28 million for FY10.
2009	Company announces $20 million placement @ $2.30 per share, wins Rio Tinto Pilbara contract.
2010	Tox Free enters ASX 300 index, wins Murrin Murrin contract, appoints Peter Goodwin as COO.
2011	Acquires Waste Solutions business for $18 million, awarded Origin's APLNG waste contract, and acquires Mackay maintenance services business and Pilbara waste business.
2011	Company acquires listed hazardous market leader DoloMatrix for $58 million (funded with $27 million new shares issued @ $2 per share + $40 million in debt), with revenue of $34 million and EBITDA of $11.5 million.
2012	Awarded Fortescue waste management contract.
2012	Company announces record earnings, confirms consensus EBITDA of $44m for FY12 and $55 million for FY13.
2012	Company market capitalisation now sits at $300 million, with 114 million shares on issue.

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Table 2: Tox Free Solutions Financial Snapshot

$'M	2007	2008	2009	2010	2011	2012(e)	2013(e)
Revenue	20.0	33.7	88.2	98.7	143.6	194.0	233.0
Operating Expenses	(12.8)	(23.5)	(74.1)	(84.6)	(124.5)	(163.0)	(191.0)
EBIT	7.2	10.2	14.1	14.1	19.2	31.0	42.0
NPAT	6.1	5.7	7.6	8.0	11.9	18.1	24.0
EBIT Margins (%)	36.0	30.3	16.0	14.3	13.4	16.0	18.0
Shareholders' Equity	24.5	33.1	53.9	88.6	102.2	145.0	164.0
Net Debt / (net cash)	8.7	16.9	32.9	13.2	11.6	46.0	47.0
Market Capitalisation	167.5	104.7	143.1	215.3	196.5	303.9	303.9
Enterprise Value	176.2	121.6	176.0	228.5	208.1	349.9	349.9
Buyout (%) **	4.1	8.4	8.0	6.2	9.2	8.9	11.9
ROCE (%) *	21.7	20.4	16.2	13.9	16.9	16.2	19.9
GOCF / EBITDA (%)	86.0	84.0	86.0	107.0	92.0	n/a	n/a
Underlying EPS (¢)	8.7	8.1	9.6	8.7	12.8	15.8	20.6
PER	27.5	18.5	18.9	27.0	16.6	16.8	12.8
Dividend per share (¢)	0.0	0.0	0.0	2.0	3.0	3.5	4.0
Dividend Yield %	0.0	0.0	0.0	0.8	1.4	1.3	1.5
Share Price 30 June ($)	2.40	1.50	1.81	2.35	2.12	2.65^	2.65^
Issued shares (m)	69.8	69.8	79.1	91.6	92.7	114.7	114.7

* ROCE = EBIT / (Shareholders Equity + debt – cash) ** Buyout represents EBIT / EV as a percentage ^ March 2012 price

History

With a name like Tox Free Solutions, investors shouldn't be too surprised to learn that the company specialises in the removal of waste and hazardous material. Founded in 1993, Tox Free started corporate life with a vision of developing and commercialising its patented desorption technology – the use of heat to separate contaminants from solid waste. When the group came to list in 2000, the technology had advanced sufficiently, such that development of a plant in Port Headland Western Australia had been constructed to remediate waste streams generated by the offshore oil and gas operators and the mining industry. The company's mission statement as set out in its 2000 prospectus was "to provide industry with cost-effective remediation and recycling solutions for the treatment of contaminated waste by-products. In the future, Tox Free aims to play a major role in the response to environmental and economic threats imposed by climate change and the international obligations to reduce greenhouse gas emissions imposed by the Kyoto Protocol."

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Such worthy aspirations come at a price and within two years of listing, Tox Free was fighting for its corporate survival. While the company had identified the changing environmental trends and the customer demands that would follow, management was unable to stem the funding needs required to bed down the group's technology rollout.

Business Survival

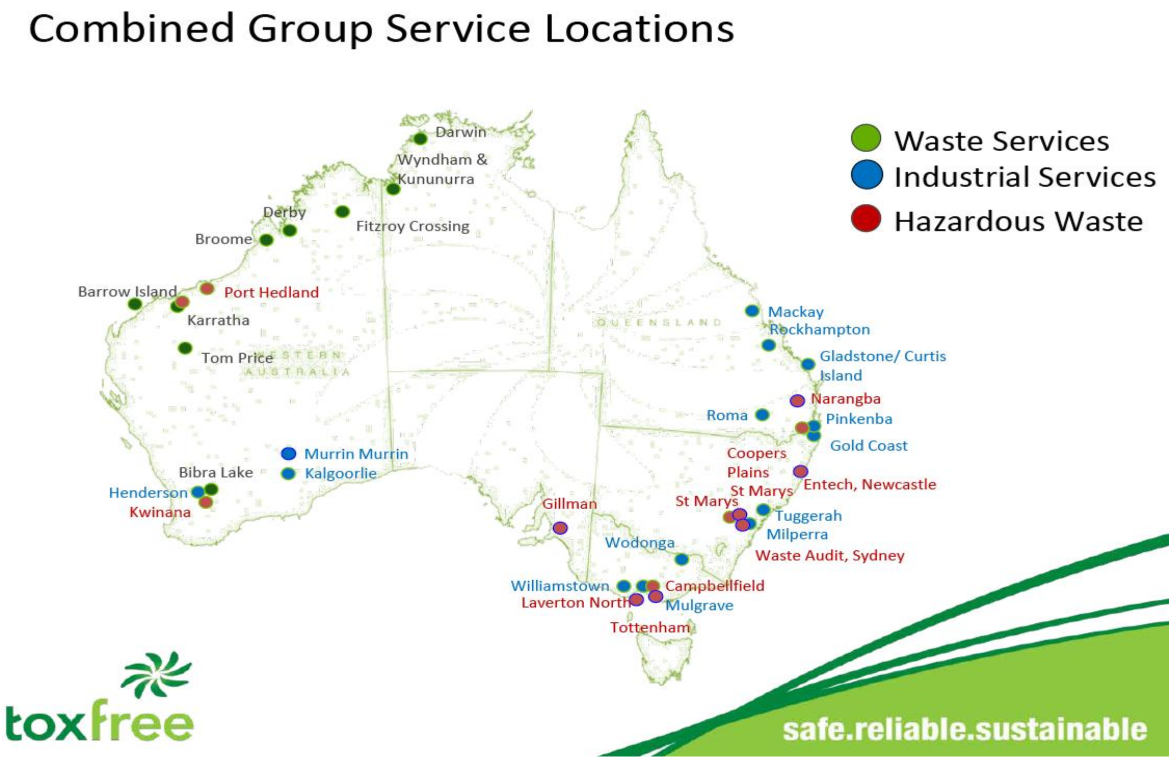
The resignation of founding CEO Dick Allen in 2002, was quickly followed by replacement CEO Sergio Nusimovich also stepping down a short time later. However 2004 turned out to be a significant turning point for the group. With the existing shareholder capital base all but wiped out, a last ditch $1.9 million non-renounceable, one for one rights issue, priced at just one cent per share was announced.

Importantly, the board approached the then Western Australia group state manager Stephen Gostlow to take over the CEO reigns. Gostlow had joined the group in 2002, having built up an excellent understanding of both the business and the industry from his former role as an officer of the Environmental Protection Agency that was responsible for auditing the business. His first task was relatively straightforward, close all lose making operations and grow the group's core hazardous waste services businesses, where the company held a clear and competitive market position.

When we recently interviewed Gostlow as part of our due diligence process on the business, it quickly became apparent to us that Tox Free had been fortunate in securing his services. He has sensibly guided the business over the past eight years with a well thought out, coherent strategy as depicted in **Diagram 1**. Central to the group's success has been the company's most valuable asset – its licenses. The competitive advantage that these licenses provide should not be underestimated. In all, Tox Free operates from 33 national locations and holds 15 licenses covering the group's three divisions, being Waste Services, Industrial Services and Hazardous Waste as shown in **Diagram 2**.

Diagram 1: Tox Free Corporate Strategy

Diagram 2: Tox Free Business Locations



Operations

Tox Free was founded on its Hazardous Waste division and today it remains the group's most valuable operation, both in terms of the margins that are derived and the business protection that is afforded it as a result of its patented thermal technology. The recent acquisition of competitor DoloMatrix, has cemented Tox Free's market leading position to treat toxic materials that include pesticides, oils, coolants, acids and cleaning products. Incorporating a multistage, high temperature rotary kiln, Tox Free's service offering is in lock step with government and regulatory agencies that deem companies and individuals must dispose of their hazardous wastes safely. **Table 3** highlights the divisional split from all three business areas.

Such are the barriers to entry that back in 2004, it took the company five years, to receive its hazardous waste license in Karratha, despite the fact that it was situated in the middle of the desert. Gostlow noted that with the passage of the time, this process becomes even more difficult and time consuming, yet the customer demands for the service continue to rise. Since establishing both the Port Headland and Karratha operations, management has cemented their regional dominance by adding additional waste services as well ancillary offerings including skip bins and truck hires. The strategy is simple, establish a presence, offer all manner of bolt on services and become a one stop shop for waste management services thereby locking out potential competitive threats.

Table 3: Tox Free Divisional Split

Year	HY12	FY11	FY10	FY09
Divisional Revenue ($m)				
Hazardous Waste ($m)	15.8	29.2	24.9	24.8
Solid Waste ($m)	42.3	44.3	21.1	8.9
Industrial Services ($m)	34.2	70.0	52.7	54.5
Group Revenue ($m)	**93.3**	**143.5**	**98.7**	**88.2**
Divisional EBIT ($m)				
Hazardous Waste ($m)	5.2	11.2	10.2	9.1
Solid Waste ($m)	10.3	11.5	6.1	2.2
Industrial Services ($m)	5.8	11.3	6.9	10.7
Group EBIT ($m)	**21.2**	**34.0**	**23.3**	**22.0**
Divisional Margins (%)				
Hazardous Waste (%)	33.0	38.4	41.2	36.7
Solid Waste (%)	24.3	26.0	29.1	25.1
Industrial Services (%)	16.9	16.2	13.1	19.6
Group Margins (%)	**23.0**	**23.7**	**23.6**	**25.0**

It is in this context that Gostlow highlighted the recent acquisition of DoloMatrix as strategically the most important company deal done to date. As the leading provider of hazardous waste services on the east coast of Australia, DoloMatrix offers unique licenses and technologies whilst removing the competitive threat. As things now stand, the two dominant national players capable of treating hazardous wastes include the listed Transpacific Industries Group and Tox Free Solutions. The DoloMatrix acquisition completed in February this year came with a price tag of $58 million, delivering revenues of $33 million and earnings before interest, tax, depreciation and amortisation (EBITDA) of $11.5 million.

The two remaining divisions, being Solid Waste and Industrial Services operate in the more traditional lines of waste management, primarily the collection, recycling and treatment of industrial waste. Here the company has specifically focused its attention on the regional areas of the country and specifically the mining related regions of Western Australia and Queensland.

In a period of unprecedented mineral expansion, Tox Free is reaping the rewards of having hitched part of the company wagon to the demands now flowing from the mining boom. While it may not grab the billion dollar headlines that surround deals involving our Asian neighbours, the removal of mining waste is both big business and necessary. In recent times the company has successfully picked up a multitude of new multi-year waste services contracts including Woodside Energy's LNG facility at Karratha, Chevron's Gorgon LNG project and Rio Tinto's

Pilbara operations all in 2009 and more recently the $25 million contract to service the Australian Pacific LNG Project (APLNG) on Curtis Island at Gladstone.

Importantly the company's approach to contract tendering is very transparent. Management targets margins on earnings before interest and tax (EBIT) of 20% and a return on capital employed approaching 18% in order to justify the business and capital risk undertaken.

Cash flow is king

Despite listing on the market some twelve years ago, the business is perhaps only now hitting its straps. Since 2004, management has stuck to a central theme, to organically build scale in regional areas of Australia, augmented by complementary acquisitions. Whilst this strategy has delivered the group regional dominance, funding the growth has impacted the company's ability to deliver free cash flow.

In all, management have undertaken ten acquisitions of varying sizes since 2004, funded in part by new shareholder capital in 2009 and 2011 that collectively raised $47 million. Gostlow now acknowledges that the business has reached an important inflection point. With the necessary capital expenditure now in place and benefits flowing from its regional approach, the group is confident of funding the future growth of the business internally. This is an important point as it will reduce the need for debt or new capital and in turn allow for dividends to flow.

To be fair to management, they have consistently taken the conservative route. Until the most recent DoloMatrix acquisition, the company carried no net debt while dividends were kept to a minimum and only declared at year end. Management will continue to utilise debt prudently but the overriding determinate rests on generating an adequate return on capital employed. As **Table 2** highlights this metric continues to improve and confirms the increasing benefits that are now flowing with scale.

Contract driven business

High barriers aside, the Tox Free business model is still predicated on the company winning tenders. To date, management have remained diligent on their pricing, only tendering for contracts that deliver profits rather than just revenues. The downside to this type of work is the capital expenditure required. Typically, Tox is required to provide the necessary capital items for the contract either up front in the case of existing mining projects, or incrementally as the construction on the new plant is carried out.

In the case of the 2010 Murrin Murrin contract win, the five year, $30 million contract required the company spend an estimated $4 million on new capital. It is therefore important that any capital outlaid generates a sufficiently attractive return and that the company's annual depreciation amount mirrors the actual cash flow expensed. Management estimates annual capital expenditure to sit around the $25 million mark, obviously driven by new contract wins.

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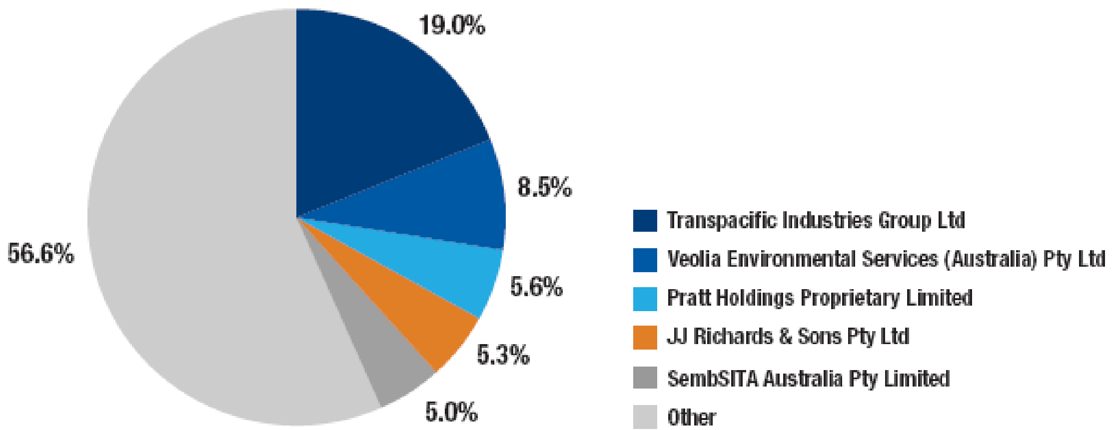
Competitors

Figure 1 outlines IBIS World's analysis of the waste disposal market in Australia, placing Transpacific Industries as overall market leader with 19% followed by French group Veolia Environmental Services with 8.5%. It is important to note that in the context of market data, waste disposal includes the whole array of services, including the significant business of collecting and disposing household waste.

Figure 1: Market Share – Waste Disposal Services



Source: IBIS World "Waste Disposal Services in Australia"

As we commented earlier, Tox Free operates in a smaller subset of the overall waste services market that is specifically centred on its regional approach. In this context and with the backing of barrier protecting licenses, the hazardous waste division is the group's most important division and one that on the surface faces the least competitive threat. Here listed operator Transpacific Industries Group is a direct competitor but in recent years, their ability to compete has been hamstrung by a debt ridden balance sheet and management upheaval. Importantly, the acquisition of DoloMatrix now has Tox Free positioned as the leading integrated hazardous waste business.

In **Table 4**, Tox Free outlines the various segments of the waste market, the relative attractiveness of those market segments and the company's current market share in each. In this context, management is primarily addressing the industrial services market with an estimated $1.7 billion of revenue and with a market share of less than 5%, while in hazardous waste, the market is valued at $1.0 billion, with the group controlling between 10%-20%.

With a revenue base set to exceed $200 million in 2013, management continues to eye revenue growth rates in excess of 15% per annum for the foreseeable future. And as it continues to build scale, earnings are set to follow.

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Table 4: Tox Free market segments exposure

Increased Exposure to Hazardous Waste

Attractive segment with higher margins and lower competitive intensity

	Industry Revenue ($'Bn)	Competitive Intensity	Industry Profit -ex tax ($'m)	Industry Attractiveness	Toxfree Share %	DoloMatrix Share %
Commercial	3	Medium – High	300	Medium	0	0
Construction	2.3	High	112	Low	0	0
Municipal	2	High	136	Low	<1%	0
Industrial	1.7	Low – Medium	198	Med High	<5%	0
Hazardous	1.0	Low	120	High	**5 – 10%**	**5 – 10%**
Total	10		866		<2%	<1%

Company estimates based on information extracted from IBIS – Waste Disposal Services in Australia 2009

Overview

Since taking over the top job in 2004, CEO Gostlow has chartered a steady and focused course. A combination of organic growth and sensible acquisitions has the group well placed to benefit from the business scale now in place. The acquisition of DoloMatrix during 2011 has provided the group with critical mass in the hazardous waste services space and potentially makes them an attractive target for others. While the share price has improved to around the $2.80 mark, it remains at a similar level to its previous peak in 2007. With earnings set to jump in 2013, reflecting in part a full twelve months contribution from the DoloMatrix acquisition, we expect the company's profile and valuation to do likewise. ***SFM***

SEEK (SEK)

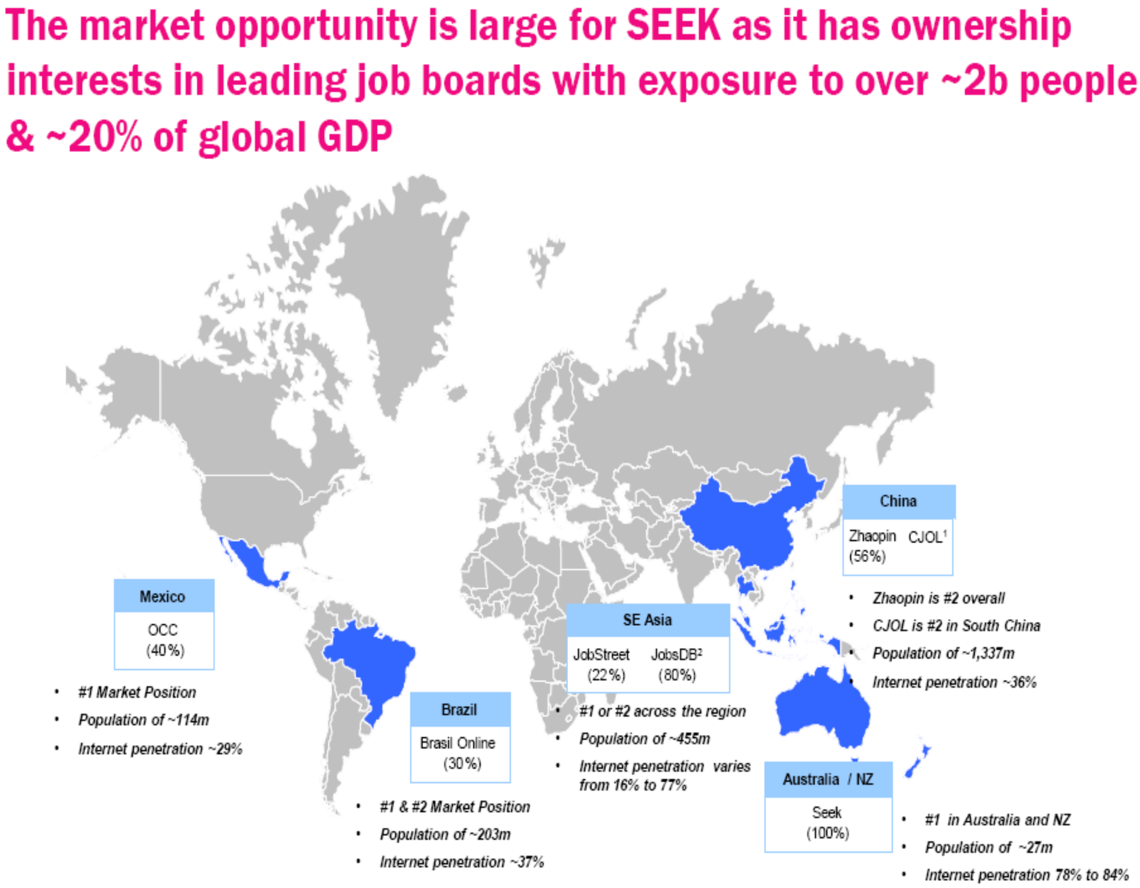
We first profiled Australia's leading online employment group SEEK in our September 2008 quarterly newsletter and followed that up a year later in our September 2009 edition titled "The Old and the New". At the time the shares had fallen sharply as a consequence of the global market selloff, from a high of $9.40 to under $5.00, allowing us to grab an initial stake in a business we had long admired. We added to our position in early 2009 when markets hit rock bottom and with the shares trading below the $2.50 level. In many ways the SEEK experience typifies how far the pendulum can swing during periods of market optimism and pessimism.

Founded in 1997, SEEK is a great success story that was started from scratch and invested heavily to steal a first mover advantage in the online employment world. In its path the traditional media houses led by Fairfax, watched with interest but failed to appreciate the structural migration of employment advertising from print to online.

Investors fully aware of the shift, gladly paid up, pushing the group's value to extreme levels. The subsequent share price sell off since those heady days in 2007 is more reflective of the current state of play in markets than any genuine concerns regarding the robustness of the SEEK business model.

Today, the SEEK business remains focused on the group's two core markets of online employment and online education. However a third leg, that of taking strategic investment stakes in leading international classified online employment markets, is really an extension of the first. And interestingly, these collections of online employment sites are now becoming an important engine of growth following years of careful and productive investment.

Diagram 3: SEEK's international investments

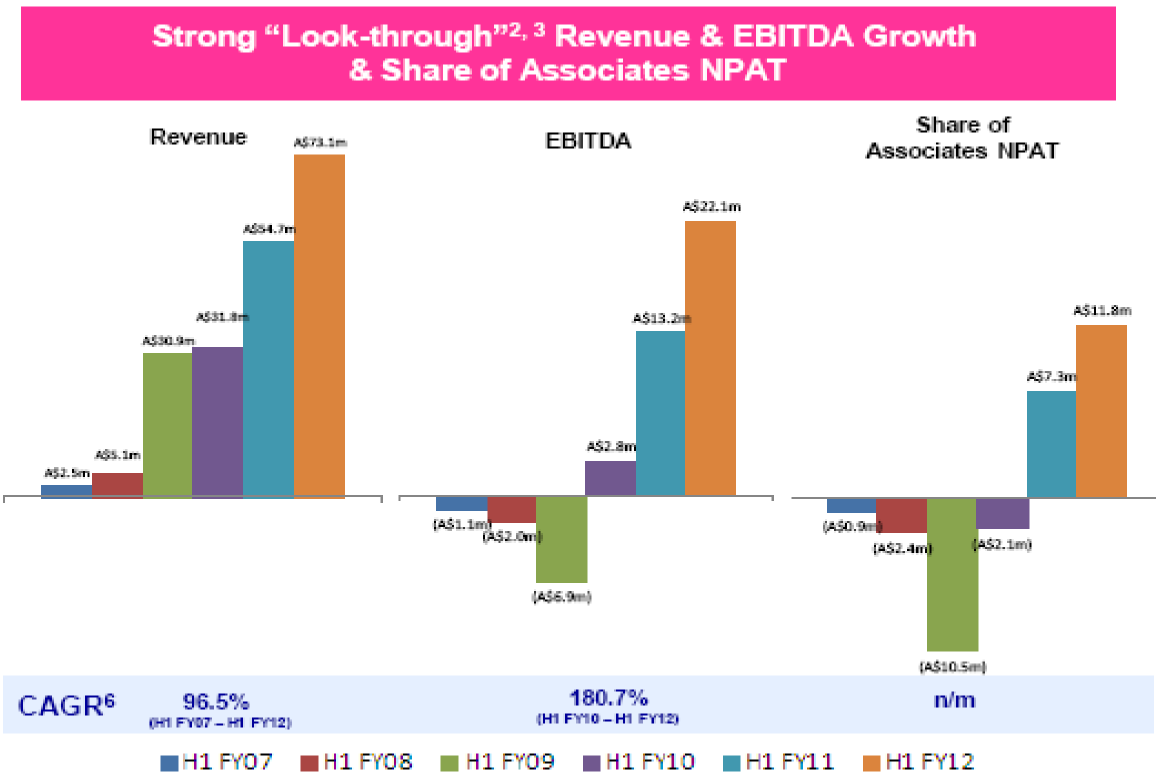


The model that SEEK management have adopted is not dissimilar to the path undertaken in Australia. At its core, SEEK aims to identify fast growing economies, where internet penetration is low but rising, choose to partner with strong local management teams enjoying market leading positions and input its own proven experience of building online employment sites.

As **Diagram 3** shows SEEK has grabbed a foothold in a number of regions including, Brazil, Mexico, South East Asia and China. In the case of OCC in Mexico, Brasil Online in Brazil and JobStreet In South East Asia, SEEK has chosen a more traditional path of investing directly in the shares of these listed entities, equal to equity interests of 40%, 22% and 30% respectively.

With respect to JobsDB in South East Asia and Zhaopin in China, management has taken significant controlling interest in privately run groups.

Graph 1: SEEK's "Look-through" earnings of associates.



Graph 1 is management's attempts to shed some light on the revenue and earnings contributions these associate businesses are now delivering. These "Look-through" numbers, reflect the tallying up of all the revenue, EBITDA and NPAT the group would be entitled too based on its respective percentage holdings in each business. As the numbers show, since 2011 the group has moved strongly into profits following years of investment.

In particular, the group's investment in Zhaopin is worth a closer look. **Table 5** profiles how the business metrics have played out over the half year periods starting 2010. Importantly management invested heavily in the earlier years, to build scale and brand leadership. Heavy losses incurred in those earlier years have now given way to accelerating revenue and profit lines.

The Zhaopin investment represented SEEK's first foray in an internet employment site outside Australia. The initial 25% stake was bought in 2006 for US$20 million with management estimating at the time that the online employment market opportunity could reach US$500 million by 2011. A further US$45 million was invested in 2008, eventually lifting its share holding in the group to 56%.

Table 5: Zhaopin Financials

P&L

RMBm - at 100% of Zhaopin unless indicated

Revenue	H1 FY10	H2 FY10	H1 FY11	H2 FY11	H1 FY12
Online Revenue	134.2	172.2	234.4	295.3	336.1
Other Revenue	45.2	44.6	60.8	50.5	74.7
Total Revenue	**179.4**	**216.8**	**295.2**	**345.8**	**410.8**
Business Tax	9.9	12.0	18.4	20.1	24.2
Net Revenue	**169.5**	**204.8**	**276.8**	**325.7**	**386.6**
COGS	22.6	18.0	26.1	28.1	30.4
GP	**146.8**	**186.8**	**250.6**	**297.6**	**356.2**
GP Margin (%)	82%	86%	85%	86%	87%
Total Overheads	**167.7**	**197.1**	**207.2**	**219.4**	**246.2**
EBITDA	**(20.8)**	**(10.2)**	**43.5**	**78.2**	**110.0**
EBITDA Margin (%)	(12%)	(5%)	15%	23%	27%
SEEK Share of NPAT A$	(3.4)	(0.4)	3.7	5.0	7.5
Positions Posted (at month end)	*237,544*	*360,538*	*388,862*	*494,350*	*483,682*
Unique Customers (at month end)	*66,458*	*97,096*	*109,231*	*135,364*	*130,457*

If we were to simply double Zhaopin's 2012 first half results and convert it back to Australian dollar terms, it would imply full year revenues and operating earnings (EBIT) of A$126 million and A$25 million respectively. With the current earnings trajectory in the business, it is perhaps easy to understand market speculation that suggests Zhaopin will be heading for a public float with a rumoured US$1.0 billion price tag. Should this come to pass, SEEK will have converted an investment of about US$65 million into a business valued at over US$500 million. With SEEK shares currently selling at $7.00 per share, the group is valued at just under $2.4 billion, putting into full view the significance of the Zhaopin investment. Importantly is also highlights management's foresight and preparedness to invest into an industry well before it became fashionable. ***SFM***

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The US economy

In our December 2011 quarterly newsletter we put our case forward on the reasons why we were confident that the US economy was tracking in the right direction. Three months on and if we simply used the Dow Jones Industrial Average as a guide, the Index has jumped 8.1%, putting it within touch of its all time high of 13,895 points in July 2007.

Trying to justify whether this should be the case is likely to provoke considerable debate. The issues facing the economy are real, however investors who adopt a rear view mirror approach may struggle to find any reason for optimism. In contrast, markets look forward and in doing so they move well before economic data confirms a trend.

In recent months a number of interesting news items from the US have surfaced which we found interesting and discuss below.

Lehman Brothers returns

On September 15, 2008 Lehman Brothers filed for bankruptcy, the biggest Chapter 11 case in US history. In doing so, it set off a chain of events that nearly toppled the world's financial system. In March 2012, three and half years later, the company emerged from Chapter 11 protection and was ready to begin paying back creditors. The bank expects to eventually distribute $65 billion, representing an average payout of 18 cents in the dollar, on claims totalling $370 billion.

Having already sold its core banking operations to Barclays Capital in 2008 and its Neuberger money management business, the rump of the assets reflected real estate assets and private equity investments. Once the creditors are paid, Lehmann Brothers is likely to be put out of business for good.

US Government gets paid

The US government bailed out insurance giant American International Group Inc (AIG) on 16 September 2008 in order to meet its financial obligations. At the time, AIG was ranked the 29th largest public company in the world, however by 2009, the government had sunk over $182 billion to keep it afloat. With the passage of time and the orderly sell down of assets, a large chunk of the taxpayer funded bailout has since been repaid. In addition the US Government still owns 77 per cent of AIG valued at $40 billion.

At the time, the imminent collapse of AIG was front page news and followed hot on the heels of Lehman filing for bankruptcy. Today the news barely makes into the sections of the financial papers.

US Treasury makes a profit

Following the federal takeover of both Freddie Mac and Fannie Mae in 2008, the US Treasury spent $225 billion over a sixteen month period purchasing back the mortgage bonds issued by these mortgage finance lenders. During March 2012, the US Treasury Department announced that it had completed the sell down, returning a profit of US$25.0 billion.

In addition, Treasury also disbursed $US414 billion under the Troubled Asset Relief Program (TARP), which aimed to restore investor confidence in the US financial firms. To date the program has collected $US331 billion from a combination of dividends, interest and disposals.

In all, the events of 2008 pushed the Government to the brink but there are encouraging signs that the economy and the markets are on the mend.

US Treasuries

We introduced James Grant, renowned editor of *Grant's Interest Rate Observer* to our readers in our December 2008 quarterly newsletter. At the time stock markets were in freefall and yet his insights cut to the core issues, that the time to act was when everyone else was streaming for the exits.

Back in 2008 Grant made the following observations;

"Over reaction is the theme of every financial cycle as well as this one. In the thirties all markets were deranged, not only demoralised but deranged. That is, value was as irrelevant at the bottom as it had been at the top, which is always the way. Value was irrelevant in 1988-89 and it is increasingly becoming irrelevant today, which is the opportunity for value seeking people and opportunists of all stripes."

"When people speak about coming back to risk, what is risk? I think there is a lot more risk in things people deem to be inherently safe and there is less risk in things that people think are inherently risky. Markets are all about paradoxes. So the things that are now officially deemed safe, cash and treasuries may present the greatest risk to investors."

Today, Grant has some further advice and it centres on the US Treasury bond market. In 2011, treasuries were the standout investment, with yields pushed to near zero and investors, desperate to preserve their capital, abandoning all sense of investment logic. As Grant puts it;

"It's implausible for treasuries to yield nothing and in some cases less than nothing. You compare and contrast it with 30 years ago when treasuries yielded in the teens. Back then nobody wanted the stuff but it turned out to be the greatest investment of its generation. I think it's going to prove to be the worst investment of the next generation."

As to timing, Grant is unapologetic adding;

"I'm here to tell you that the people who were ultimately right on bonds in the early '80's were profoundly and disastrously wrong in the lead-up to being right. That's the way markets work."

Since 2008, investors have stampeded into cash and treasuries for fear of capital loss. How ironic it would be that having abandoned shares in search of safety that shares become the standout investment for the current decade. To steal a line from Grant, that's the way markets work.

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And lastly US housing

Housing can be such an emotional asset and so hard to value that it always leads to conflicting views. In Australia, it seems the idea of owning your own real estate is what every person strives towards. However, the reality is that the economics of supply and demand work just as well in housing as in most things in life. What has played out in the US housing market over the past six years is reflective of just that. Cheap loans and lax lending practices came with a hefty price tag, an oversupplied housing market. The economic downturn and record unemployment has also played its part, with home values plummeting.

Fast forward to today and the view on where US housing may be headed is just as divided. Stories of offshore investors scooping up down trodden US condominiums makes for good reading but ultimately in order to get the right outcome the maths has to stack up.

While we have no greater insight as to what may unfold those closer to the frontline are expressing a clear view. The facts still show that the housing market continues to struggle and credit standards remain tight, with almost 11 million homeowners still owing more on their homes than their properties are worth. On the surface, the numbers sound bleak, but what is important now is considering what is more likely to happen.

Kenneth Rosen, a housing economist at the University of California Berkeley states his views confidently;

"Housing bottoming is going to surprise a lot of people. Housing was pulling us down consistently, quarter after quarter, for years. That was really over in 2011."

While an economist's view may not be of your liking, we will leave the final word on this subject to Berkshire Hathaway's Chairman Warren Buffett who spoke on the subject in his February 2012 letter to shareholders and reproduced below;

"Last year, I told you that a housing recovery will probably begin within a year or so. I was dead wrong......Housing will come back – you can be sure of that. Over time, the number of housing units necessarily matches the number of households. For a period of years prior to 2008, however, America added more housing units than households. Inevitably, we ended up with far too many units and the bubble popped with a violence that shook the entire economy. That created still another problem for housing. Early in a recession, household formations slow, and in 2009 the decrease was dramatic.

That devastating supply/demand equation is now reversed: Every day we are creating more households than housing units. People may postpone hitching up during uncertain times, but eventually hormones take over. And while doubling up may be the initial reaction of some during a recession, living with in-laws can quickly lose its allure.

At our current annual pace of 600,000 housing starts – considerably less than the number of new households being formed – buyers and renters are sopping up what's left of the old *oversupply. (This process will run its course at different rates around the country; the supply-demand situation varies widely by locale.)....This hugely important sector of the economy, which includes not only construction but everything that feeds off of it, remains in a depression of its own. I believe this is the major reason a recovery in employment has so severely lagged the steady and substantial comeback we have seen in almost all other sectors of our economy.*

Wise monetary and fiscal policies play an important role in tempering recession, but these tools don't create households nor eliminate excess housing units. Fortunately, demographics and our market system will restore the needed balance – probably before long. When that day comes, we will again build one million or more residential units annually. I believe pundits will be surprised at how far unemployment drops once that happens." ***SFM***

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Company visit diary March Quarter 2012

January

AZG	Allmine Group management meeting	16/01/12
RMD	ResMed Inc. Q2 results conference call	27/01/12

February

COH	Cochlear interim results	07/02/12
NWS	News Corporation Q2 results conference call	08/02/12
SAI	SAI Global interim results	14/02/12
CXD	CathRx management meeting	14/02/12
SKC	Sky City Entertainment Group interim results	15/02/12
CRZ	Carsales.com interim results	15/02/12
ASX	ASX interim results	15/02/12
BBG	Billabong International interim results	16/02/12
TRS	The Reject Shop interim results	17/02/12
NHF	NIB Holdings interim results	20/02/12
DTL	Data#3 interim results	20/02/12
FLT	Flight Centre interim results	21/02/12
MND	Monadelphous Group interim results	21/02/12
REA	REA Group interim results	21/02/12
SGM	Sims Metal Management interim results	21/02/12
CDD	Cardno management meeting	21/02/12
CTD	Corporate Travel Management interim results	22/02/12
SEK	SEEK interim results	22/02/12
EGP	Echo Entertainment interim results	22/02/12
CSL	CSL interim results	22/02/12
IFL	IOOF Holdings interim results	22/02/12
MOC	Mortgage Choice interim results	22/02/12
WTF	Wotif.com Holdings interim results	22/02/12
IRE	Iress Market Technology interim results	22/02/12
CWN	Crown interim results	24/02/12
OTH	Onthehouse interim results	27/02/12
QBE	QBE Insurance Group full year results	27/02/12
ALL	Aristocrat Leisure full year results	28/02/12
BKL	Blackmores interim results	28/02/12
WOR	WorleyParsons interim results	29/02/12

March

TOX	Tox Free Solutions management meeting	01/03/12
WOW	Woolworths interim results	01/03/12
SRX	Sirtex interim results	01/03/12
CGS	Cogstate management meeting	01/03/12
DTL	Data#3 management meeting	05/03/12

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MAQ	Macquarie Telecom Group management meeting	05/03/12
FSA	FSA Group management meeting	05/03/12
CXD	CathRx management meeting	08/03/12
OTH	Onthehouse management meeting	12/03/12
BGL	BigAir Group management meeting	14/03/12
n/a	Carbonxt IPO management meeting	16/03/12
KMD	Kathmandu Holdings interim results	21/03/12
PXS	Pharmaxis conference call	21/03/12
SIP	Sigma Pharmaceuticals full year results	22/03/12
ORL	OrotonGroup interim results	22/03/12
ELX	Ellex Medical management meeting	22/03/12
ALL	Aristocrat Leisure management meeting	26/03/12
JIN	Jumbo Interactive conference call	27/03/12
WOR	WorleyParsons management meeting	28/03/12

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