SFML Quarterly Newsletter

September 2014

In this quarterly edition we review performance and attribution. We profile GBST Holdings and IProperty Group. Offshore we take a look at QE and US Energy. We also consider how Technology for the Ages changes with each generation. Photo: School holidays - no worries, surfing for a 9 year old maybe as good as it gets and no technology needed.

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selector

About Selector

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

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

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

Please forward to us contact details if you would like future newsletters to be emailed to family, friends or business colleagues.

Dear Investor,

With the company reporting season over for another year, investor attention has quickly shifted to the road ahead. Here the simple message, proceed with caution, has been top of mind and for good reason. Despite record low interest rates both here and abroad, economic growth remains anaemic at best. The United States (US), the United Kingdom (UK) and the New Zealand economies remain the standout performers while other major countries including China, Japan and Australia are finding life much tougher. The European region is also struggling and continues to rely on the European Central Bank to kick start activity.

In all, what is clearly lacking is a consistent upward trend in economic conditions. There is a pulse but at times it is prone to skip a beat and susceptible to external shocks. This has led to the current set of circumstances whereby borrowers are rewarded for taking on risk while savers are penalised.

Many commentators now point to the next big market event, that of central banks lifting rates. Here it is evident that with rates in major economies at either record lows or near zero, the only way is up. But what is also clear is the dislocation that exists between the economies of the US and the UK to that of most other regions. This confluence of events now sees the Chinese, Japanese and the European Central Bank maintaining a monetary easing bias whilst the US and the UK look to tighten. Australia finds itself in transit, with the end to the resources boom resulting in higher unemployment levels and tougher competitive markets.

Also becoming abundantly clear is the financial hardship that the downturn in commodity prices is now having on many listed resource based businesses. While our major miners including BHP Billiton and Rio Tinto may escape relatively unscathed, many junior and higher cost producers will struggle to remain viable.

During the quarter we met with many management teams as they reported their company results. The vast majority delivered on our expectations whilst others including IRESS, Domino's Pizza Enterprises and Sirtex Medical continued to make progress on well-defined company objectives.

In this quarterly newsletter we profile two businesses that have been added to the portfolio over the past year, namely Asia's leading online real estate classifieds business iProperty Group and financial software services operator GBST. We also comment briefly on the United States Federal Reserve's decision to end its Quantitative Easing (QE) program and why some remain very upbeat on US energy.

For the 2014 September quarter, the Fund delivered a gross positive return of **6.21%**. In comparison, the All Ordinaries Accumulation Index returned a negative **0.29%**. To all our investors we trust you find the report informative.

Regards,
Tony Scenna
Corey Vincent
Robert Lapsley

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Table of Contents

Quote: SEEK's CEO Andrew Bassett

The Fund is a shareholder in listed online recruiter and education provider SEEK, an investment originally made in 2009.

Below SEEK's CEO and co-founder Andrew Bassett comments on the importance of the company remaining patient, focused and taking calculated bets in life.

Patient
"If you focus on making money you will stuff up the marketplace. Let's focus on the fundamentals of the market and getting the outputs right. If you do that and build a really defendable business, you will make money over time."

Focused
"There's so much more we can do around our core purpose and so confident in our ability to do it well that we don't see ourselves as diversifying broadly. We don't need to because the market's big enough and we don't want to distract ourselves."

Taking calculated bets
"I don't know who to blame, whether I blame the CEO's for being gutless, or whether I blame the investors for making the CEO's gutless."

"It seems if CEO's make a mistake now for the most part they lose their job. It seems to be easier for them just to do nothing. I've got a lot of my net worth in SEEK, so no one cares more than me that we're not risking everything. But to make calculated bets, something like $20m in China that will hopefully turn into a billion bucks over time, that seems worthwhile. Shareholders don't like that sort of thinking and they should".

Mr Bassat holds more than 4 per cent of SEEK, a business currently valued at $5.6 billion.

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Performance September 2014

For the quarter ending September 2014, the Fund delivered a gross positive return of **6.21%** as compared with the **0.29%** fall in the All Ordinaries Accumulation Index. Performance statistics are detailed on page 22.

Performance table since inception

Returns	Gross Fund Return (%)	All Ordinaries Index (%)	All Ordinaries Accumulation Index (%)
3 months	6.21	-1.58%	-0.29
6 months	5.72	-1.97%	0.18
1 Year	14.97	1.52%	5.89
3 Years	28.05	9.18%	14.04
5 Years	13.44	2.25%	6.68
Since inception annualised	11.28	3.44%	7.90

Fund's Top 10 holdings

Top 10 September 2014*	Top 10 June 2014*
ARISTOCRAT LEISURE	ARISTOCRAT LEISURE
CARSALES.COM	CARSALES.COM
CSL	COMPUTERSHAREFPO
DOMINO'S PIZZA ENTERPRISES	DOMINO'S PIZZA ENTERPRISES
FLIGHT CENTRE TRAVEL GROUP	FLIGHT CENTRE TRAVEL GROUP
IOOF HOLDINGS	IOOF HOLDINGS
IRESS	NIB HOLDINGS
RESMED	RESMED
SEEK	SEEK
SIRTEX MEDICAL	SIRTEX MEDICAL
Top 10: 51.41%	**Top 10: 49.26%**

* *Listed in alphabetical order*

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

Performance attribution for the September 2014 quarter

Top 5 stock contributors	(%)	Top 5 stock detractors	(%)
SIRTEX MEDICAL	1.85	NAVITAS	-0.49
INFOMEDIA	1.15	OZFOREX	-0.38
IRESS	0.75	AINSWORTH GAME TECHNOLOGY	-0.32
DOMINO'S PIZZA ENTERPRISES	0.74	IPROPERTY Group	-0.25
GBST HOLDINGS	0.61	OILSEARCH	-0.25

Portfolio Commentary

As we noted in our opening remarks, the Fund benefited from a number of its investments during the busy reporting season. We list the main contributors to the Fund's quarterly performance in the table above. The top positive contributor came from liver cancer treatment group **Sirtex Medical,** a company we first reviewed in our September 2009 quarterly newsletter. Continuing strong global dose sales was recorded for the year and management remains committed to lifting adoption within the medical community. Attention now shifts to the group's planned release of its SIRFLOX study trial in early 2015, which will aim to move this treatment option from the current salvage setting to a first line treatment.

The following businesses **Infomedia**, **IRESS, Domino's Pizza Enterprises** and **GBST Holdings** all performed strongly. We have profiled each of these companies in earlier quarterlies, including **GBST Holdings** discussed further in this report. Importantly, all of these investments have successfully expanded their operations beyond our local market and are now well positioned to benefit from a falling Australian dollar. In the case of both **IRESS** and **GBST Holdings**, increasing regulatory compliance requirements placed on participants in the wealth industry is leading to strong demand for services. This is particularly evident in the UK where new government legislation is providing a step change in demand.

The Fund's negative performers were relatively small in number, with the largest being university placement group **Navitas**. The decision by Macquarie University, not to renew its on campus pathway partnership with **Navitas** beyond 2016 was unexpected and led investors to question the possibility of other university partners following a similar path. Our assessment suggests this is unlikely to be the case and that the group remains well placed to deliver growth both locally and more importantly in the US university market. ***SFM***

GBST: (ASX: GBT)

Table 1: History 1984 - Present

Year	Events
1984	Star Systems established in Australia and NZ by John Puttick (current Chairman).
1986	Securities Broking System launched in Australia.
1987	ASX introduces SEATs, some stocks trade electronically and on the floor.
1990	Securities Broking System launched in NZ.
1991	ASX trading becomes fully automated via SEATS.
1993	Launches "Shares" – back office settlement system.
1994	ASX introduces CHESS – world's first automated central depository and clearing house.
1996	"Shares" – becomes the first client system to be aligned with CHESS.
1997	"Shares" used by first correspondent clearer in Australia.
	GBST Online – Australia's first integrated online trading system.
1998	New group branding launched "Global Banking and Securities Transactions (GBST).
	"Margin Lending" launched.
	"Shares Global" launched – multimarket, multicurrency, cross boarder trading system.
1999	"Shares" plays vital role in enabling T+3 settlement.
2000	"Shares Global" used by ASX to launch offshore trading between markets
	Two of Australia's largest banks launch margin lending via "Shares Margin Lending".
2001	Stephen Lake invests in business and appointed Chief Executive Officer.
	GBST's "Cash Management Interface" adopted by an Australian retail bank.
2002	"Shares Global" launches in Hong Kong via a subsidiary of a Global Execution Specialist.
2004	Develops Client Profiling and Statement of Advice tools in response to Financial Services Reform Act.
	Settles litigation with former Director for $1.08M. GBST delivers CHESSLink.
2005	ASX IPO - 10 million shares issued @$1.00, market capitalisation of $44M.
	39 of 81 Australian Stockbrokers are clients.
	Revenue $22.1M EBITDA $4.9M, NPAT $4.4M, EPS 7.5 cents.
	Citigroup launches third party clearing service.
	Acquires Palion for $5.1M software used by 60% Brokers trading ASX listed equity options.
2006	55 of 81 Australian Stockbrokers are clients.
2007	Acquires InfoComp for $56M, cash & debt $20M, plus 4.95million shares to vendor. GBST paid 8 x EBITDA expecting a $7M contribution. "Composer" forms basis of GBST Wealth Management run by InfoComp founders.
	GBST increases stake in IT&e Limited (ITE) to 11% taking a 16 million share placement @ 0.09c.
2008	Acquires Coexis, "Syn" platform for upfront payment of £12.5M cash and 7.336 million shares, a deferred cash payment of £1.5M and 1.414 million deferred shares and a potential £4M stretch payment based on certain targets. GBST paid (approx.) 4.4 - 5.4 x EBITDA expecting a £4M contribution.
	Acquires Emu Design for $1.5M – Founder Scoot Hutchison joins GBT executive team.
2009	Placement 6.5M shares @65 cents raising $4.2 million. Extension of $10M subordinated debt with Crown Financial, attached 2.5 year option to convert to equity @ 95 cents.
2010	"Shares" milestone, processing more than 50% of ASX trading.
	UK based life insurance and asset management company Aegon (FUM £53.6B) implements Composer for its wrap solution.
2011	ANZ implements Syn platform in its ANZ Global Markets division.
	CBA institutional Equities goes live with "Shares".
2012	First Australian client goes life on "Syn".
2013	"Syn" wins foundation client (Raymond James Financial) in the USA.
2014	16 new clients go live across the group's product platforms.
	First Transition underway from the "Shares to Syn" next generation technology platform.

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Background

GBST is a company with a somewhat chequered history.

The company was founded in 1984 by current Chairman and major shareholder, John Puttick. In 2005 GBST listed on the ASX with Stephen Lake at the helm as CEO. Like Puttick, Lake is a major shareholder. We like the fact he has acquired all of his five million shares (6%) during his 14 year tenure. In total, the board members have a combined holding of 16.5 million shares, equal to 25% of the group's issued capital. The initial public offer raised $10M with the shares offered at $1.00 a piece resulting in a market capitalisation of $44M.

In 2009 Lake and his management team presided over the mis-timed acquisition of Coexis ("Syn" platform), at the height of the global financial crisis (GFC), that lead to a "close shave" with debt. To their credit they not only survived, but assembled an attractive suite of core software assets that have gained acceptance amongst some of the world's leading global investment houses.

Today, GBST is emerging as a global player in the provision of software solutions for financial markets. The company now has 66M shares on issue and a market capitalisation of $220M at the time of writing. GBST operates a software business model that delivers increasing scale benefits to the company as more clients adopt the services offered. As a business the company offers many of the qualities we seek from our investments including;

1. Solid management
2. Top line growth
3. Margin expansion and
4. High levels of cash flow conversion (banking the cash)

The combination of the second and third points should not be underestimated simply because not many businesses possess this attractive double. And importantly, GBST will be debt free by the close of 2014. In addition, we are particularly attracted to GBST's annuity-like earnings qualities. This is underscored with GBST experiencing demand for longer duration contracts from its clients, with discussions now centred on 7-10 year service agreements. We also note that the "annuity" to "installation" revenue split is circa 70% and 30% respectively.

Client rollouts are also occurring in Australia, the United Kingdom, Asia and the United States. The opportunity set is clearly global. The growth strategy has moved away from acquisitions to one that is now largely organic and the group's software products are demonstrating leadership qualities in all of the various markets in which it operates. Competition does exist and execution is key. Research and development (R&D) is required along with some upfront capital expenditure.

GBST has three key software product offerings,

1. Shares
2. Syn
3. Composer

Shares

Shares is the company's only software platform developed in-house as both the Syn and Composer solutions were acquired since listing.

The "Shares" suite of products was first launched in Australia in 1993. Shares was designed to automate back office equity settlements, clearing and trade processing functions in stockbroking offices. Additional modules were added over time including, cash management, margin lending and multi-currency settlements.

At a high level, Shares is an Australian securities keeping solution that incorporates real time integrated share market access. It has become the industry standard and the most widely used back office system over the past two decades. Today, the Shares platform accounts for more than 70% of all settlements processed by the Australian Stock Exchange and is the clear market leader.

The revenue model is described as "software for rent". GBST typically charge an installation fee and an ongoing licence fee. The licence fee may also be transaction or volume based. The outcome is a long duration annuity style revenue stream as lumpy installation fees give way to longer term licence fees.

Shares in Australia, which sits under the Capital Markets division, can be best described as a classic "cash cow". Around 90% of this revenue is annuity based, generating operating margins of circa 35%. While the Australian business is mature, the international operations of Capital Markets are at a very early rollout phase. As these opportunities mature, licence fee income will increase and a positive profit contribution will be generated. In short, the Australian "cash cow" is covering the group's international losses at present and will in time deliver meaningful revenue growth and margin expansion.

GBST has reinvested along the way and will continue to do so. About 10% of revenue is channelled into R&D to support two key outcomes. Firstly, R&D is required to keep the exiting Shares software current in order to achieve revenue growth in a more mature market. The aim here is to innovate so as to drive efficiencies within a customer's broking business thereby enabling more opportunities to upsell additional software modules. A secondary focus is to enable the development of the next technology generation of software known as "Syn".

SYN

The "Syn" platform was acquired by GBST in 2008 as part of the Coexis purchase. This complicated transaction included an upfront cash payment of £12.5M, 7.336 million GBST shares, along with a deferred component of £1.5M cash and 1.414 million shares and a potential £4M stretch payment based on hitting certain targets. In all GBST paid some 4.4 - 5.4 x EBITDA expecting a £4M contribution. The GFC swiftly eroded these expectations and replaced it with a battle for survival, as bankers reassessed the implications of high debt levels that exceeded the company's market capitalisation.

Six years on and after consuming more capital than envisaged, Syn 3.0 has emerged as the next generation of GBST in-house software development. The product is gaining strong customer endorsement, evident with HSBC's announcement to adopt the Syn platform as its architecture for its global custody offering. Standard Chartered are also deploying Syn for global equities clearance. Citibank Australia are a user and other installations are ongoing.

Software platform transitions from Shares to Syn will, however, demand additional execution capabilities including a requirement to beef up management and internal processes. Importantly, the company openly acknowledges that being smaller offers advantages and that some efficiency will be initially lost as the group grows in size, underscoring some of the challenges that lie ahead.

Syn offers significant advantages to global banks and brokers in that as a single vendor, GBST, can supply a single multi-market or global settlements solution across multiple asset classes. This can be provided as a complete solution or in modules to solve "point problems". Today, country specific settlement systems are used resulting in settlement teams being duplicated across the operational footprint of a bank. In the case of Standard Chartered this means one back office rather than multiple, leading to a major cost centre reduction.

The transition process of clients from Shares to Syn has started with the first "go live date" expected in October 2015. This is a pivotal project for GBST as it is a proof of concept. The transitioning customer has been on Shares for 15 years and will remove multiple back offices, replacing them with one, thereby delivering a major cost out if it works or a "dust up" if it does not. That said, dual systems will be run for a period of time in order to cover all bases.

The initial transitions will be revenue neutral, however, the opportunity to win new business from multi-market players or even global banks is significant and will be a key driver of revenue opportunity from 2016 onwards.

Syn is in an investment phase, which means in the first instance, more costs not profits and additional capital not cash flow. If the rollout was slowed Syn could be profitable today. But that's not on the agenda with GBST running hard to keep up with current and future opportunities. R&D is matching customer demand for new modules. For example, a Syn Foreign Exchange module will require an investment outlay of $2M, with both GBST and the client equally contributing $1M to this project, with the resulting intellectual property remaining with the company.

In a similar fashion, a Syn Derivatives module will require capital of $3M, with both GBST and the client co-investing. Like IRESS this is a "build to real demand model" not a "build and hope they come model", nevertheless it still requires upfront capital investment. Funds are also required to pursue geographic based projects, including a Thai opportunity requiring $2M - $3M and the large US market which would involve significant investment. In this instance, GBST may look to partner to deliver on some of these service opportunities. It is apparent that GBST Syn has significant global application.

Composer

The third leg of GBST is Composer. GBST acquired InfoComp in 2007 for $56M in cash and debt, along with the issue of 4.95 million shares to both founders, Rob De Dominics and Ray Taubman. De Dominics now heads GBST Wealth Management, while Tauman leads Wealth Administration. In essence GBST paid 8 x EBITDA expecting a $7M contribution. Again the GFC tapped this on the head.

Like Capital Markets, Wealth Management is split into the regions of Australia and International. Australia is more mature, with $18M in revenue that is roughly 75% annuity based, driving higher operating margins of 38%.

The International result is driven by the UK operations where margins currently sit at 15%. Here approximately 40% of revenue is annuity based. This reflects the early start-up phase of the business with the UK offering significant potential and margin expansion as Composer fast becomes the leading retirement platform software in the market.

To date, Composer has secured only seven customers but three are amongst the top six UK retirement platforms. It has also won a slew of industry awards if that counts. The company believes the pipeline is solid, driven by the industry's need to transition from the old world paper based systems to new digital platforms. Enforcement of new regulatory changes and the expansion of the UK wrap platform market, which is expected to quadruple by 2020, is only helping to accelerate this transition process. Having reached a critical mass of clients, securing another large contract win would have a significant positive financial impact on the business.

Again some investment will be required to refresh technology, partly explaining the need for the company to at least maintain R&D expenditure at 10% of revenue.

Research & Development (R&D)

The common thread across the three platforms, Shares, Syn and Composer and the driver of most great businesses is reinvestment commonly referred to as R&D. As noted, GBST is currently spending 10% of revenue on the business or just under $10M annually with this amount fully expensed. This is essentially a combination of maintenance and growth capital expenditure, an important distinction which we make.

Maintenance capital expenditure is required to enhance the existing revenue generating products such as Shares and Composer. This would include code enhancements or functional improvements. This type of spend ensures the annuity style revenue of the business is enhanced and not taken for granted.

Growth capital expenditure on the other hand, is the R&D spend that aims to secure future revenue streams for GBST. This includes the development of Syn 3.0 and the build-out of new modules such as Syn Derivatives and Syn FX. Our estimate is that up to 70% of the total "quoted" R&D spend is on growth initiatives.

However, the R&D spend can also be viewed in a different light, what we term "real" R&D investment. Under this scenario we take into consideration the client co-spend on product development since the enhancements become the intellectual property of GBST. Any new products that flow can form part of core offerings to new clients. On this basis, existing R&D spend would likely be closer to $15M-$18M on an annual basis.

It is also clear that the rate of future R&D spend will be a key consideration for management. The company will be debt free by year end and will continue to enjoy increasing cash flow and margin expansion. We also expect dividends to rise, noting that 2014 was the fourth year of dividend expansion. We will also applaud management if R&D is incrementally lifted in order to take advantage of the increasing pipeline of opportunity.

Table 2: GBST Financials Snapshot

Financial Metrics	FY10	FY11	FY12	FY13	FY14
Group Total Revenue ($m)	67.6	67.5	77.0	83.0	98.5
EBITDA ($m)	16.4	13.7	14.2	16.5	20.5
Cash NPAT ($m)	7.6	5.7	7.6	9.6	13.3
Cash Earnings Per Share (c)	15.2	11.6	13.8	16.5	21.5
Dividend Per Share (c)	2.0	4.0	5.0	6.5	8.5
Margins %					
EBITDA	*24.3%*	*20.3%*	*18.4%*	*19.9%*	*20.8%*
Cash NPAT	*11.2%*	*8.4%*	*9.9%*	*11.6%*	*13.5%*
Growth %					
Group Total Revenue ($m)		*(0.1%)*	*14.1%*	*7.8%*	*18.7%*
EBITDA ($m)		*(16.5%)*	*3.6%*	*16.2%*	*24.2%*
Cash NPAT ($m)		*(24.8%)*	*33.5%*	*26.3%*	*38.8%*
Cash Earnings Per Share (c)		*(23.7%)*	*19.0%*	*19.6%*	*30.3%*
Dividend Per Share (c)		*100.0%*	*25.0%*	*30.0%*	*30.8%*

Table 3: GBST Wealth Management Division (Composer)

	FY13 $m	FY14 $m	*Change %*
Revenue			
Australia	18.2	18.2	*(0.4%)*
International	25.2	35.6	*41.4%*
Total	43.4	53.8	*23.9%*
Operating EBITDA			
Australia	N/A	7.0	-
International	N/A	6.6	-
Total	11.6	13.5	*16.3%*

Table 4: GBST Capital Markets Division (Shares | Syn)

	FY13 $m	FY14 $m	*Change %*
Revenue			
Australia	28.8	29.5	*2.6%*
International	6.7	11.7	*74.7%*
Total	35.5	41.2	*16.3%*
Operating EBITDA			
Australia	10.3	10.3	*0.5%*
International	(4.6)	(2.5)	*(45.3%)*
Total	5.7	7.8	*37.3%*

Summary

GBST is well placed to exploit the many global opportunities that now present themselves. Ongoing regulatory change is supportive of accelerated client demand and leave the company well placed to secure a growing level of annuity based revenue. The Fund owns shares in the company. ***SFM***

iProperty Group: (ASX: IPP)

iProperty Group Limited (IPP) is an Asian based online real estate classifieds business. The markets in which it operates in are attractive and fast growing. iProperty has businesses in Malaysia (iProperty.com.my), Hong Kong (GoHome.hk), Indonesia (Rumah123.com) and Singapore (iProperty.com.sg); all markets with low levels of online real estate advertising. When done right, the online real estate classifieds business is a capital light, high return on equity business, capable of throwing off large amounts of free cash flow.

Online Real Estate Classifieds Business Characteristics

Before delving into the specifics that make iProperty an attractive opportunity worthy of consideration, it is important to understand the attractiveness of online classifieds businesses in general:

1. Increasing and persistently high levels of internet penetration drives a shift of advertising spend from print to online mediums.
2. Market dominant online classifieds businesses tend to earn the lion's share of profits. Until a dominant player emerges, however, the business is highly competitive and participants earn little or no profits. The classifieds business tends to be a "winner takes all" business.
3. Dominant online classifieds businesses are highly defensible. As the number of agents and visitors to a classifieds website increases, the value of the website to other users also lifts. A larger audience provides agent listings with greater population reach. Similarly, more agents and more listings delivers visitors greater choice. Ultimately, an increase in popularity drives higher audience volumes and more listings, in short a self-reinforcing cycle.

These dynamics have played out in other leading online businesses including Seek (SEK), Carsales.com (CRZ) and REA Group (REA), largely at the expense of their respective competitors MyCareer, Carsguide.com and Domain.

Importantly, iProperty's markets all demonstrate high levels of internet penetration, a young population and low levels of online advertising spend. These are ideal conditions to foster high levels of growth in online advertising spend over a medium to long term horizon.

Developer Dominated Real Estate Markets

A key differentiator between iProperty's Asian online classifieds business and that of Australia's dominant player REA Group, concerns the real estate market dynamics. In Australia, because the market is more mature, the majority of property transactions that occur each year involve the sale of existing dwellings, while in Asia, a greater proportion of real estate transactions are new dwelling sales undertaken by property developers. A tie up with local developers is therefore critical for a real estate classifieds business to work well in Asia.

iProperty has responded by establishing the "Buyers Club", which allows the group to provide exclusive, members only discounts on new development sales offered by external parties, upon which iProperty earns a sales commission. This model mirrors that of Chinese based online classifieds business SouFun, which has similarly exploited the developer dominated market in China.

Often, a developer's priority is to sell as many apartments as quickly as possible in order to pay down debt with their traditional go to market strategy involving internal or third party marketers. In this context, online classifieds can provide developers with a simple and cheaper marketing strategy than currently employed. This strategy is already showing early signs of take up but further progress is required and we will watch its development closely.

iProperty's Competitive Position

In June 2014, the REA Group purchased a 17.2% stake in iProperty for $106.3m, equivalent to $3.40 per share. In REA's investor presentation, the group identified the iProperty holding and the Asian region as being a critical component to their future growth strategy. REA's purchase provides some validation to iProperty's business case and leading market position.

There are few companies in a better position than REA to judge the strategic and competitive standing of an online real estate listings business and we doubt that REA would have made such a substantial investment without a degree of certainty about the likely competitive outcomes in iProperty's key markets.

In Malaysia, iProperty.com.my, is the dominant online real estate classifieds business. PropertyGuru, iProperty's closest competitor in Malaysia currently has around 3,000 paying agents compared to iProperty's 9,800, out of a total of 11,000 paying agents, despite iProperty's subscription prices being three times higher than PropertyGuru's.

Such high levels of agent penetration are a testament to the quality of traffic flowing through the iProperty website. Ultimately, it is the quality of the traffic which drives the success of an online listings business and an agents' willingness to pay. During the six months to June 2014, iProperty demonstrated the operating leverage present in the business by reporting operating margins of around 55%. In Malaysia the total real estate advertising spend is around $267m and estimates put the current online share of that spend at between $15m-$25m. As advertising dollars shift from print to online iProperty stands to earn a healthy share of that spend.

In Hong Kong, iProperty claims its website GoHome.hk leads competitors by a substantial margin across all key metrics including agent subscriptions, listings, traffic and revenue. During the six months to June 2014, iProperty's Hong Kong operations broke even, suggesting the business is at a critical earnings inflexion point. More interestingly, the number two competitor in Hong Kong, SquareFoot.hk is owned by REA. We suspect it's only a matter of time before iProperty and REA look to join forces. Such a transaction would deliver iProperty unassailable market dominance, delivering a strong kick to both revenues and earnings whilst allowing REA to increase its shareholding in the listed group; an attractive proposition for all parties.

Interestingly News Corp's recent decision to acquire US listed online property business Move, for a total cash deal that valued the business at USD950 was done alongside subsidiary REA who will contribute 20% of the consideration. Commenting on the REA relationship, the News Corp CEO Robert Thompson made the following remarks;

"Let's be clear, News Corp is in the majority in the US so that we can deploy the company's massive media muscle to drive the business. I can certainly visualise other investments in other regions in which REA will take a majority stake and News Corp will be the minority partner."

At the June result iProperty wrote down the value of the goodwill associated with its Indonesian assets, noting that the requirement for ongoing investment made it difficult to justify the carrying value in the group's balance sheet. Despite this, iProperty also indicated a dramatic increase in the number of paying agents to around 9,400 agents, in comparison to its nearest competitor Property Guru's 7,200.

Independent sources have indicated that the quality of traffic flowing to PropertyGuru's website Rumah.com is much poorer than the traffic generated at iProperty's Rumah123.com. We suspect this is the reason why iProperty earns USD3 per agent per month in comparison with the USD1.50 per month per agent charged by PropertyGuru. These are reasons to be optimistic about iProperty's prospects in Indonesia and we do expect it to be a profitable business in time as the market matures and advertising spend shifts from print to online. Currently less than 2% of the USD120m annual spend on real estate advertising is spent online in Indonesia.

iProperty's last key market is Singapore and like its Indonesia business, management saw fit to write-down its carrying value during the period. Singapore is some way off from profitability and this is a market where Property Guru has an established lead. We do not expect iProperty to reach profitability in Singapore in the near future and CEO Georg Chmiel has indicated that they intend to continue to make measured investments there because of its position as an international gateway for property developers into greater Asia. Their strategy seems well considered and we do not feel success in Singapore is important to the overall investment thesis.

Summary

In summation, iProperty holds strong competitive and strategic positions in Malaysia, Hong Kong and Indonesia. In those markets it is expected that a total of USD810m will be spent on real estate advertising in 2014. In contrast, Australia's total real estate advertising spend is less than AUD700m. While our local market is certainly more mature than those targeted by iProperty, the scale of the opportunity available to iProperty is undeniable.

Importantly, despite the need for ongoing investment, iProperty's finances are heading in the right direction with the group now past the breakeven stage, along with positive cash flow and cash in the bank. We are mindful of the inherent business risks associated with any business early in its corporate life. That said, it's not often that all the risks can be eliminated before taking the plunge. We feel confident enough about iProperty's competitive standing in the market and the size of the opportunity on hand to back the management team at iProperty. The Fund owns shares in the company. ***SFM***

Quantitative Easing (QE) comes to an end

The US Federal Reserve's decision to end its QE bond-buying program brings to a close a policy that is still the subject of immense debate six years after it first kicked off. Prior to the global financial crisis in 2008 the US Federal Reserve had less than USD900 billion of treasury note assets on its balance sheets. In the subsequent years that have followed, the Fed has stepped in on three separate occasions to revive a flagging US economy. Dubbed QE1, QE2 and QE3 these bond buying programs were aimed at injecting liquidity into an economy whilst holding down interest rates in an effort to stimulate investor activity.

QE1 began in late 2008 and ended in June 2010 at which point the Fed was holding some USD2.1 trillion of mortgage backed securities and Treasury notes. In November 2010, a second round of quantitative easing began, dubbed QE2. This USD600 billion Treasury securities buying program lasted until June 2011.

In September 2012, the Federal Reserve announced the final step in its QE program unveiling a USD40 billion per month buy-back of mortgage-backed securities. In addition, the Federal Open Market Committee (FOMC) also announced that it would likely maintain the Federal funds cash rate near zero at least through 2015. In December 2012 to counter growing concerns that the US economy was again stalling, the FOMC announced an increase in the amount of open-ended purchases from USD40 billion to USD85 billion.

As a consequence of its QE programs the Fed's total holdings of bonds, loans and other assets has grown from less than USD900 billion to USD4.4 trillion, a figure many officials would have considered inconceivable a few years ago.

On 18 December 2013, Federal Reserve Chairman Ben Bernanke announced its intentions to gradually wind back its QE program starting with a USD10 billion per month cut in January 2014. In each successive month, the Fed reduced the bond buying program amount until its expected exhaustion in October 2014, leaving the Fed with no bonds to buy in November, the first time in over five years.

Underpinning the US Federal Reserve's decision to end the bond buying program has been the slow but gradual improvement in the US economy. At its peak in October 2009 the unemployment rate was running at 10.0%, which compares to the current prevailing rate of 6.1%. The US share market has rebounded strongly with the Dow Jones Industrial Average more than doubling from its low point of 7,062 in February 2009 to the current level of 17,042 points.

History will judge whether the Fed's QE programs come with an economic hangover. However, if the stock market is any gauge, the much feared winding back of liquidity has had to date, limited impact, as investors continue to back the improving outlook for corporate America. The bigger test will ultimately come when interest rates start to rise off the bottom. ***SFM***

US Energy

Royal Dutch Shell Chief Ben van Beurden may be talking his own book but his comments on the onshore US shale oil boom is worthy of consideration, noting that while some expect this to taper off, his view is that production has only just begun;

"I believe this is the early stages of the revolution and there is quite a lot of changes that can happen…I think it is going to be a decade where more and more we will see the US being self-sufficient and able to export. The trend that the US is going to be closer to self-sufficiency rather than a big importer is a very strong and more enduring trend than a lot observers like to believe."

The boom was driven by the onset of new technology, specifically in the form of horizontal drilling and fracking techniques that first targeted gas production. Increasing production success led to a gas glut and a steep fall in prices, leading to a re-direction of activity towards oil production. This included our own BHP Billiton, which parted with $20 billion to enter the US shale-oil arena in 2011 through a series of acquisitions.

While the International Energy Agency forecast that US oil production would start to fall by the end of the current decade, van Beurden is more upbeat and notes why;

"There is a lot of resource that is still being understood better, what the sweet spots are and how much it can do. The amount of innovation the industry has put there is actually quite limited. I think we are still at an early part of the technology curve and therefore there is much more to come in terms of productivity and cost take-out and novel ways of doing it." **SFM**

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Table 5: Generations and Technology

Generation	Years of Birth	Attributes and Characteristics
Silent Generation	1925-1942	The Silent Generation is the label for the people born during the Great Depression and World War II as well as the Korea war.
Baby Boomer Generation	1943-1960	The Baby Boomers were born during the boom in births which followed World War II. Baby boomers are associated with a rejection and redefinition of traditional values. The Boomers were the wealthiest, most active and physically fit of all generations that came before them and were amongst the first to grow up expecting a genuine improvement in the world with time.
Generation X	1961-1981	Gen X is the generation born after the Baby Boomers and were characterised by a worldview based on the need for change. Moves against corruption, dictatorships, abuse and AIDS all featured heavily. The U.S. Census Bureau reported that Generation X held the highest education levels when compared with all current age groups.
Millenial Generation (Gen Y)	1982-2004	The Millennials, also known as Gen Y, followed Gen X and grew up in a period which was characterised by one of the most rapidly changing technological landscapes since the Industrial Revolution. While the Industrial Revolution was brought about by the advent of the steam engine, the technological advancements that catapulted the Millenial Generation into the digital era were brought about by the World Wide Web and ever shrinking microprocessors which enabled huge advances in communications and machine control.
Homeland Generation (Gen Z)	2005-present	The Homeland Generation, also known as Gen Z is loosely defined as all people from the year 2005 and onwards. Unlike all of the generations that came before them, the Homeland Generation have grown up in the world of hyper connectivity. They are natives of the digital world and unlike those before them, the concept of paper and pen is viewed as a second language. As with the Millennial Generation, Gen Z technological concepts come much easier. For businesses, this means that as the Millennials and the Homeland Generation start entering the work force and begin taking over leadership roles from the Baby Boomers and Gen X we should see an acceleration of the utilisation of technology to move businesses forward.

Source: Wikipedia

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Generations and Technology

It shouldn't matter when you are born but there is no doubting the influence that technology can have on each passing generation. As **Table 5** highlights our birth year is often associated with certain attributes and characteristics. For instance, those born between the periods 1943 - 1960 are referred to as the Baby Boomer Generation, representing those born directly after World War II and regarded as the wealthiest, most active and physically fit generation of all that came before them.

Since then we have had Generation X, Y and now Z. Interestingly this current generation, those born between 2005 and the present, know little about the old world of papers and pens. Their world is all digital, where communication is constant and connectivity is critical.

The importance of technology on generations should not be lost on investors either. Their actions ultimately exert enormous influence on how business is undertaken, affecting buying patterns and new product streams. A case in point is the recent float of China's equivalent of eBay and Amazon. Here we are talking about online retailer Alibaba which priced its Initial Public Offer at USD68 per share, raising USD21.8 billion in the process and giving the e-commerce company an initial market value of USD168 billion. When the group floated, it made it onto the top 40 global company list, ranking it ahead of US online shopping giant Amazon.com valued at USD150 billion. On its debut, the stock rose 38% valuing the group at US230 billion.

This generation knows little of established companies and as newer technologies emerge it would be safe to say that more and more industries will be influenced, with some adapting while others fall by the way side. The message to investors is, remain nimble to opportunities and mindful of pitfalls as new generations and technologies take centre stage. ***SFM***

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Items of interest

Junior miners under pressure

As we alluded to in our opening remarks this quarter, the step down in commodity prices will have far reaching implications for our miners. During September the Australian Financial Review reported some worrying statistics on the current state of play for many of our juniors following an annual survey conducted by Grant Thornton;

"Almost 20% of listed junior miners and explorers have a cash balance of less $500,000 and half are sitting on less than $2 million. Juniors in the sector – those with a market capitalisation of less than $500 million – are tipping a lack of available financing will again be the biggest constraint on growth this financial year, mirroring 2014. About 74% of listed Australian mining juniors will need to raise capital this financial year …but to attract investor interest, about 40% of companies expect they will have to discount raising prices heavily."

In all, the junior mining sector makes up some 35% of the roughly 2,200 companies listed on the Australian stock exchange.

T + 2

In our lead investment story we highlighted that GBST's flagship software "Shares" accounts for more than 70% of all settlements processed by the Australian Stock Exchange. Currently, all transactions are settled on a T + 3 time frame (being the day of transaction plus 3 days). Plans are underway to move to a T + 2, with first quarter 2016 earmarked.

Over in Europe, T + 2 will begin next month, with the United Kingdom, Switzerland, France and Portugal set to make the transition. While investors in Europe are already thinking in terms of T + 2, a recent survey noted that 58% of participants in the Asia Pacific region were not prepared for the change-over. ***SFM***

Quote – John Lennon

"When I was 5 years old, my mother always told me that happiness was the key to life. When I went to school, they asked me what I wanted to be when I grew up. I wrote down 'happy'. They told me I didn't understand the assignment, and I told them they didn't understand life."

Company visit diary September Quarter 2014

July

HSP	Healthscope investor roadshow	02/07/14
REA	REA Group investor conference call	02/07/14
ALL	Aristocrat Leisure VGT acquisition conference call	07/07/14
NVT	Navitas SIBT conference call	09/07/14
N/A	Medibank investor roadshow	10/07/14
JIN	Jumbo Interactive management conference call	16/07/14
NVT	Navitas investor relations conference call	17/07/14
ALL	Aristocrat Leisure investor relations conference call	21/07/14
GBT	GBST management conference call	22/07/14
NHF	NIB Holdings management conference call	23/07/14
SLM	Salmat investor day	24/07/14
NVT	Navitas full year results briefing	28/07/14
JHX	James Hardie investor tour	31/07/14

August

RMD	ResMed Q4 and full year results briefing	01/08/14
COH	Cochlear full year results briefing	05/08/14
OFX	OzForex Group annual meeting	06/08/14
FXL	FlexiGroup full year results briefing	07/08/14
REA	REA Group full year results briefing	08/08/14
ACL	Alchemia management meeting	11/08/14
SDA	Speedcast investor roadshow	11/08/14
DMP	Domino's Pizza Enterprises full year results briefing	12/08/14
CRZ	Carsales.com full year results briefing	13/08/14
CSL	CSL full year results briefing	13/08/14
EGP	Echo Entertainment full year results briefing	13/08/14
ANN	Ansell full year results briefing	18/08/14
OSH	Oil Search half year results briefing	19/08/14
GBT	GBST full year results briefing	19/08/14
SRX	Sirtex Medical full year results briefing	20/08/14
SEK	SEEK full year results briefing	20/08/14
IRE	IRESS full year results briefing	21/08/14
BRG	Breville Group full year results briefing	21/08/14
SUL	Super Retail Group full year results briefing	21/08/14
IFL	IOOF Holdings full year results briefing	22/08/14
IPP	iProperty Group management meeting	22/08/14
NHF	NIB Holdings full year results briefing	25/08/14
VRT	Virtus Health full year results briefing	26/08/14
JIN	Jumbo Interactive full year results briefing	26/08/14
MYS	MyState full year results briefing	26/08/14

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AGI	Ainsworth Game Technology full year results briefing	27/08/14
FLT	Flight Centre Travel Group full year results briefing	27/08/14
ALU	Altium full year results briefing	27/08/14
SDF	Steadfast full year results briefing	27/08/14
TOXX	Tox Free Solutions full year results briefing	28/08/14
MVF	Monash IVF Group full year results briefing	28/08/14
IQE	Intueri Education Group full year results briefing	28/08/14
BKL	Blackmores full year results briefing	28/08/14
AUB	Austbrokers Holdings full year results briefing	28/08/14

September

IFM	Infomedia full year results briefing	02/09/14
NZX: ATM	A2 management meeting	02/09/14
APE	AP Eagers first half results briefing	03/09/14
IPD	Impedimed conference call	03/09/14
DTL	Data3 management meeting	11/09/14
N/A	Property Guru investor roadshow	16/09/14
PMV	Premier Investments full year results briefing	18/09/14
CPU	Computershare investor relations conference call	25/09/14
ANN	Ansell investor relations conference call	25/09/14

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