SFML Quarterly Newsletter
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In this quarterly edition we review performance and attribution. In our headline story, we cover our US Gaming visit. We take a look at inflation, ten year bonds and meetings we held in the US. We also comment on recent investor days we have attended. Photo: “Unforeseen events” –UK.

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selector

About Selector

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

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

We seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management.

Dear Investor,

A turbulent second half has seen the Australian share market close the year almost unchanged from a year ago. That's certainly true if your focus was purely on the main index but it belies the significant moves that have occurred beneath the surface. On a sector by sector and stock by stock basis the moves have been anything but subdued.

This has been a theme that has been playing out for some time and one that is reflective of the environment. In short, businesses are getting fewer free kicks. Conditions are tough, competition is intense and points of difference are garnered in the traditional way, through a preparedness to invest over the long haul. That in itself won't guarantee success but as this past year has shown, the gap between the haves and have not's has widened.

With the global economic backdrop continuing to confound the hordes of market commentators, the laundry list of concerns, be it deflation, negative interest rates, subdued global growth, immigration, China, Brexit or the next elected government, is shifting investor focus away from the individual business cases to the macroeconomic outputs.

In turn, the bigger questions of where to invest and to what level are dominating discussions, leading to genuine fears in some quarters. However true these concerns may ultimately be, the bigger risk is to ignore what is happening at the individual company level. As we noted earlier, share price performance at an individual level has been anything but muted.

Over the course of the year, the All Ordinaries Accumulation Index rose just 2.0% and yet within this group of circa 500 companies, 325 recorded overall gains while 108 fell. Of these, 171 stocks rose by a factor greater than 20% whilst 110 registered declines of more than 20%.

As managers we feel most at home when assessing the individual merits of a business and its worthiness for inclusion into our portfolio. It is our point of difference, even though we expect the results will play out over years, rather than months or quarters.

To this end, this quarterly newsletter leads with our U.S. gaming trip and coverage of local stocks Aristocrat Leisure and Ainsworth Game Technology. We provide insights from our attendance at numerous company investor days, discuss the topic of inflation as well as highlight some interesting and bigger picture global developments. Our introductory quote is provided by Phil Knight, founder of Nike and author of Shoe Dog. A fascinating read and illustrative of the years of persistence and individual pursuit needed to build a successful global brand. An “overnight success” that was 45 years in the making.

For the June quarter the Fund delivered a gross positive return of **1.85%** compared to the All Ordinaries Accumulation Index positive return of **4.00%**. For the financial year the Fund returned a gross positive of **19.33%** against the Index rise of **2.01%**.

Regards,

Selector Investment Team

Table of Contents

Quote: Shoe Dog by Phil Knight, memoirs of the creator of *Nike*

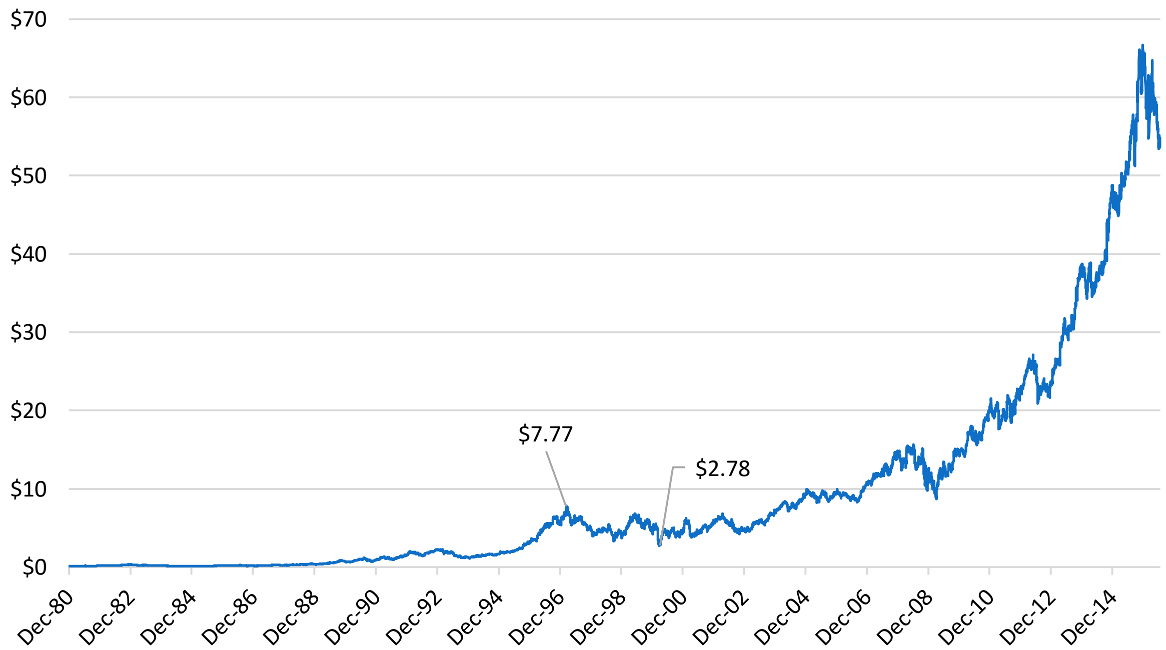
The book Shoe Dog are the memoirs of the founder of *Nike*, Phil Knight. In one passage Knight recounts the lesson learnt about why companies fail. Founded in 1964, Blue Ribbon Sports which later became known as *Nike*, was one that sailed close to the wind, relying heavily on its bankers for ongoing support. To pay the bills whilst running the business in those formative years Knight took up a second job, working as an accountant for Price Waterhouse.

The outcome, *"Price Waterhouse boasted a great variety of clients, a mix of interesting start-ups and established companies, all selling everything imaginable - lumber, water, power, food. While auditing these companies, digging into their guts, taking them apart and putting them back together, I was also learning how they survived, or didn't. How they sold things, or didn't. How they got into trouble, how they got out. I took careful notes about what made companies tick, what made them fail. Again and again I learned that lack of equity was a leading cause of failure."*

Whilst acknowledging the need for equity, Knight also learnt the hard lessons of calming external investors, as he recounted following a 1973 meeting with debenture holders;

"They were placated mildly. But I left Eugene that day knowing they had a low opinion of me, and Nike. I also left thinking that I'd never, ever, ever take this company public. If thirty people could cause this kind of acid stomach, I couldn't imagine being answerable to thousands of stockholders."

Nike Inc. Share Price Since Inception



In 1980, nine years after the famous swoosh logo was created, the company chose to list, having come to the realisation that the capital raised would allow the business to grow without relying on its bankers. As the accompanying chart illustrates, the share performance since has been nothing short of exceptional.

Today, *Nike* is valued by the market at $93 billion, having delivered a total compound annual return of 20.7% for the period to December 2015. ***SFM***

Performance June 2016

For the quarter ending June 2016, the Fund delivered a gross positive **1.85%** return of as compared with the **4.00%** rise in the All Ordinaries Accumulation Index. Performance statistics are detailed on page **45**.

Performance table since inception

Returns	Gross Fund Return %	All Ordinaries Accumulation Index %	All Ordinaries Index %
3 Months	1.85	4.00	3.08
6 Months	1.50	1.55	-0.64
1 Year	19.33	2.01	-2.58
3 Years annualised	19.99	8.24	3.60
5 Years annualised	19.27	7.30	2.65
10 Years annualised	7.99	4.93	0.69
Since Inception annualised	11.90	7.39	2.94

Fund's Top 10 holdings

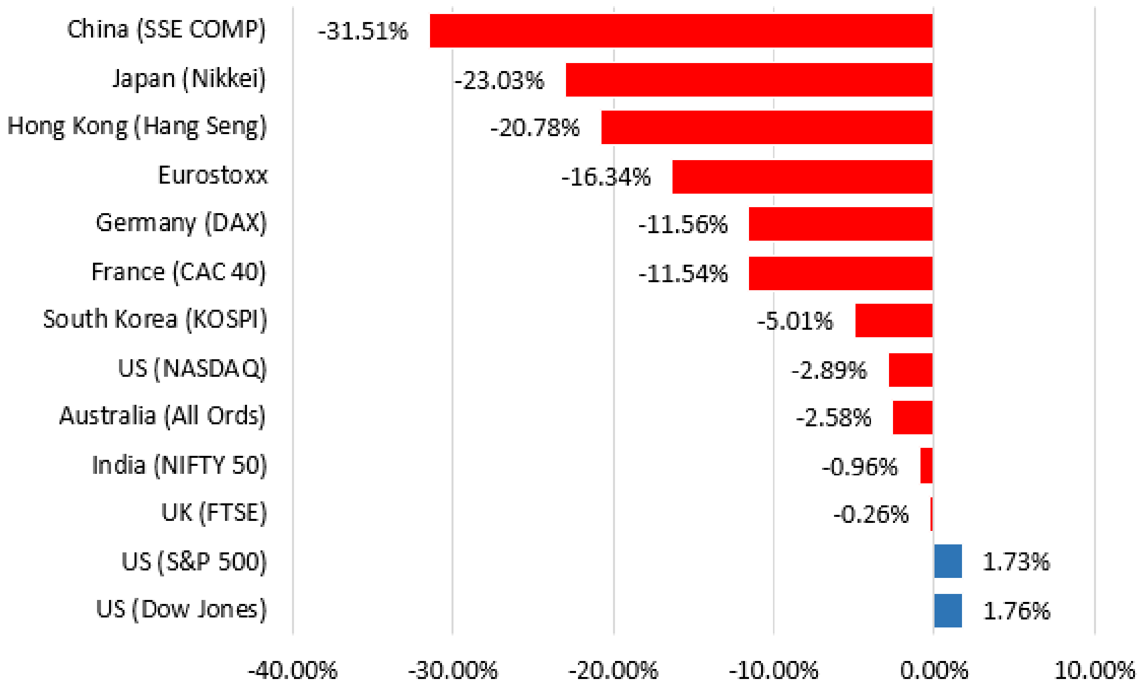
Top 10 June 2016*	Top 10 March 2016*
AINSWORTH GAME TECHNOLOGY	ALTIUM
ALTIUM	ARISTOCRAT LEISURE
ARISTOCRAT LEISURE	BLACKMORES
CARSALES.COM	CSL
COCHLEAR	FLIGHT CENTRE TRAVEL GROUP
CSL	OZFOREX GROUP
GBST HOLDINGS	RESMED
RESMED	SEEK
SEEK	SIRTEX MEDICAL
TECHNOLOGY ONE	TECHNOLOGY ONE
Top 10: 45.45%	**Top 10: 45.22%**

* *Listed in alphabetical order*

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

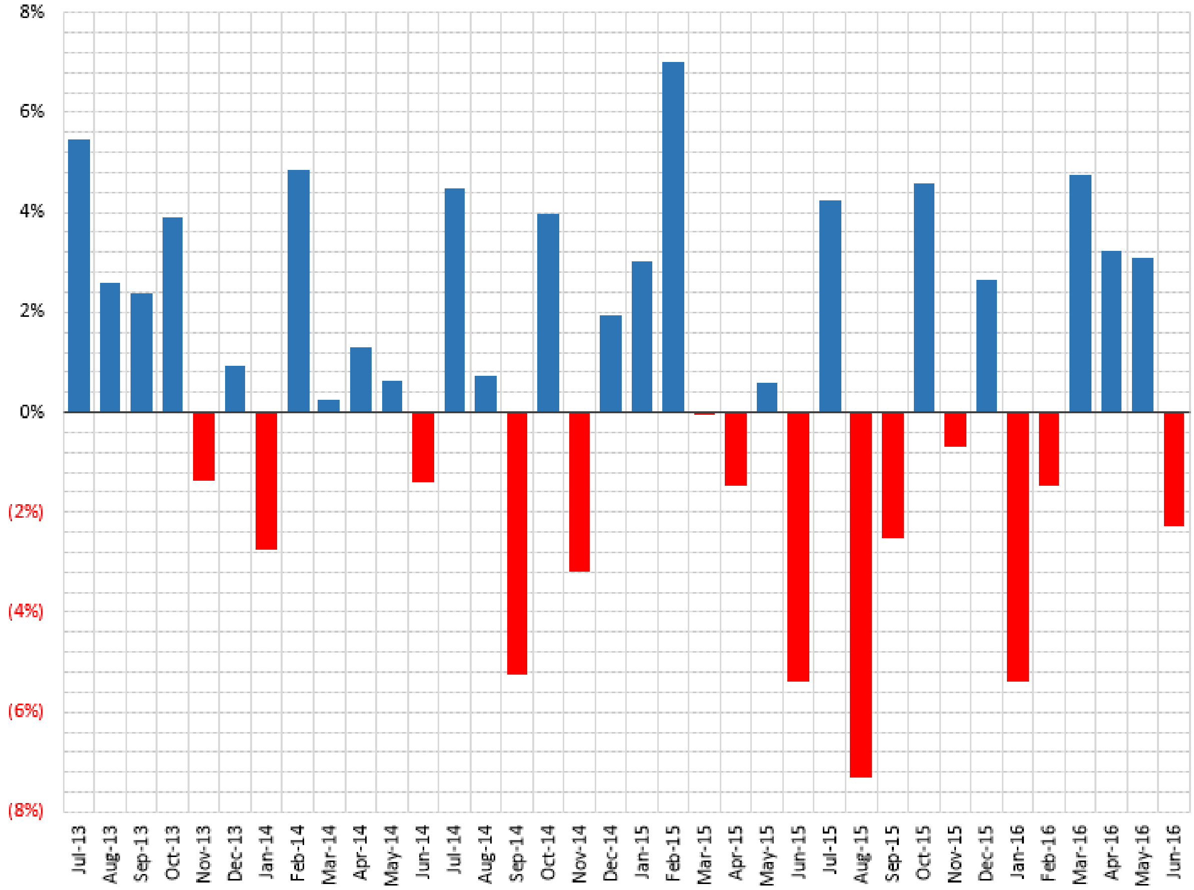
Market Insights

Global Equities 12 Month Returns



Returns in global markets were weak during the year with the economic performance of a number of major nations and regions beginning to diverge. Economies in Europe and South East Asia remain under duress, while the trajectory of the U.S. economy appears to be on an ever improving path.

Monthly All Ordinaries Accumulation Index Returns 2014 – 2016 Financial Years



Locally the main index, The All Ordinaries Accumulation Index rose **2.01%**, with the Healthcare, Consumer Discretionary and Industrials posting double-digit returns offset by poor performances from Energy, Financials and Materials.

All Ordinaries Index June 2006 – June 2016

ASX Sector Performance – June 2016 Quarter

S&P ASX Industry Sectors	June 2016 Quarter Performance (%)
MATERIALS	10.59
HEALTH CARE	10.24
ENERGY	5.28
TELECOMMUNICATIONS	4.20
CONSUMER DISCRETIONARY	4.02
INDUSTRIALS	2.41
INFORMATION TECHNOLOGY	1.04
FINANCIALS	0.22
CONSUMER STAPLES	-3.64

Portfolio Commentary

June 2016 Quarter

Top 5 contributors	(%)	Top 5 detractors	(%)
ARISTOCRAT LEISURE	1.72	FLIGHT CENTRE TRAVEL GROUP	-1.25
COCHLEAR	0.59	BLACKMORES	-0.97
ALTIUM	0.50	IOOF HOLDINGS	-0.39
RESMED	0.48	SIRTEX MEDICAL	-0.38
OZFOREX GROUP	0.47	SEEK	-0.27

Financial year 2016

Top 5 contributors	(%)	Top 5 detractors	(%)
ARISTOCRAT LEISURE	3.87	INFOMEDIA	-1.54
BLACKMORES	2.62	GBST HOLDINGS	-1.05
ALTIUM	2.09	INTUERI EDUCATION GROUP	-0.66
IPROPERTY GROUP	1.81	SIMS METAL MANAGEMENT	-0.51
DOMINO'S PIZZA ENTERPRISES	1.64	COMPUTERSHARE	-0.50

Top Contributors

1. Aristocrat Leisure (ASX: ALL)

Core gaming markets of the U.S. and Australia are delivering strong revenue and profit growth, with recurring revenue now forming 50% of total group sales. Market leader in Australia and the U.S. in video style games. Digital segment performance undergoing rapid growth.

2. Cochlear (ASX: COH)

Installed base of 440,000 cochlear and BAHA implant recipients, with product upgrades and accessories now representing 25% of group first half sales. Full suite of products, addressing a global market audience of 360 million people, suffering disabling hearing loss, compared with a market penetration running at less than 5%. Strategic focus to grow the business core and build a bigger service offering.

3. Altium (ASX: ALU)

Printed circuit board design software group, with operations in the U.S., Europe and Asia. Subscription based business model, making significant progress in expanding product offering with short term aims of growing revenues to USD $100 million by 2017 and market leadership in PCB design by 2020.

4. ResMed (ASX: RMD)

Leading global manufacturer in the field of sleep disordered breathing. Successful proven technology spanning 25 years, with presence in over 100 countries. Growing market acceptance that sleep disorder breathing is a disease, with US population that require treatment estimated at 20 million lives. Industry shift to home treatment and adoption of digital monitoring increasing in importance, reflected in the recent USD $800 million acquisition of cloud based software healthcare provider Brightree.

5. OzForex Group (ASX: OFX)

Online Money Service Bureau, leading market position in Australia, expanding global presence. Scalable digital platform, with total transaction value approaching $20 billion and net operating income passing $100 million. Repeat customers accounting for 39% of all revenues with management "Accelerate Strategy" focused on doubling revenues to $200m by 2019, with expanding profit margins.

Bottom Contributors

1. Flight Centre Travel Group (ASX: FLT)

Global travel operator with 2016 group transaction values (TTV) of $19 billion and net operating profits of $348 million forecast by management. Impact from airfare price wars in markets including Australia, the UK and the US, coincided with weaker consumer confidence and election unease. Main impact felt through achievement of lower supplier over-rides. Company continues to invest in business development and brand expansion, with sales to corporate customers now making up 35% of total group TTV.

2. Blackmores (ASX: BKL)

Strong brand presence in Asia spanning 35 years, covering complementary medicines and new infant formula offering, with 50% of group sales now driven by Asian shoppers. Strategic priorities centre on building consumer acceptance, product leadership and operational leverage. Regulatory risk in China remains ongoing, as Government looks to clarify rules for importing of products. Short term risk to consumer demand offset by the addressable market for western vitamins estimated at USD $20 billion.

3. IOOF Holdings (ASX: IFL)

IOOF held an investor day during the quarter, which outlined the firm's progress in two key areas. The first being the reduction in the number of superannuation platforms the group operates and the benefits extracted as a result of increased scale. The second, is the adoption of open source technologies, underpinned by a management philosophy that embraces an open architecture IT platform to meet the rapidly changing requirements of both regulators and clients. Importantly, as an independent superannuation service provider, adopting an open architecture platform provides the group with a significant point of difference.

4. Sirtex Medical (ASX: SRX)

Sirtex updated the market on expected dose sales for the 2016 financial year, with total units rising 16.4% for the year following a weaker first half run rate and timing delays regarding reimbursement approvals in Europe. Pleasingly the key US market continues to grow off a high base, with dose units growing 19.0% for the year. For 2016 total unit sales of 11,934 were recorded with management noting the continued momentum in what is a large underpenetrated market opportunity for SIR-Spheres microspheres.

5. SEEK (ASX: SEK)

SEEK's online business spans employment and education, both domestically and to a growing international audience. Earnings from offshore now exceed 50% of group profits while significant investment in newer early stage ventures is ongoing. Despite the short term impact this is having on earnings, management is committed to investing ahead of the curve.

This approach is reflected in a group that is a market leader in 14 countries and where further investment is considered on a case by case basis, most recently reflected in its increased ownership in Brasil Online to 100% and SEEK Asia from 80.8% to 86.2%. Management guidance for 2017 has the group on track to report net earnings of $215 million to $220 million (before the deduction of early stage growth investment).

Gaming – U.S. Visit

We travelled to the U.S.A and visited Las Vegas, considered the country's gambling and entertainment capital. Our tour consisted of meetings with Scientific Games CEO Gavin Isaacs, Bellagio Casino Director of Slots Operations, Johnny Cox (MGM Resorts) and Ainsworth Game Technology U.S. President Mike Dreitzer at their newly opened manufacturing facility.

Las Vegas, Nevada

The name Las Vegas comes from the Spanish meaning "the meadows". Las Vegas was officially founded in 1905 and was the principal driver of the creation of Clark County, Nevada in 1909. Las Vegas itself was incorporated within the county in 1911. Just prior to this in October 1910, Nevada was the last western state to outlaw gaming.

In 1931, the Nevada state legislature legalised gambling at the local level, effectively giving rise to Las Vegas's gambling future. Las Vegas is the 29th most populous city in the U.S., with just over 600,000 citizens, while the surrounding metropolitan population sits at 2 million.

Today, Las Vegas and the valley area is home to more than 150 casinos, with gaming revenues accounting for some 43% of casino revenues and the balance generated from hotel rooms and entertainment. More than 42 million people visit the city each year with the Strip itself generating close to US$7 billion in total revenue.

The first of the new mega-resort projects was built by developer Steve Wynn in 1989 named The Mirage, with funding provided by Wall Street backers. This was followed in quick succession by;

Year	Casino
1990	Rio (Caesar's Entertainment)
1990	Excalibur (MGM Resorts)
1993	MGM Grand, Treasure Island and Luxor (MGM Resorts)
1996	Monte Carlo (MGM Resorts)
1997	New York - New York (MGM Resorts)
1998	Bellagio (MGM Resorts)
1999	Mandalay Bay (MGM Resorts), Venetian (Las Vegas Sands) and Paris (Caesar's Entertainment)
2000	Planet Hollywood (Caesar's Entertainment)
2001	Palms (Maloof family)
2005	Wynn (Wynn Resorts)
2007	Palazzo (Las Vegas Sands)
2008	Encore (Wynn Resorts)
2009	City Centre (MGM Resorts)
2010	The Cosmopolitan (Blackstone Group)

Of the 42 casinos on the Las Vegas Strip, a distance of 4.2 miles in length, 21 are owned by just two companies, with MGM Resorts owning 10 and Caesar's Entertainment with 11. MGM and Mandalay merged operations in 2005 creating the largest gaming company in the world at that time. In that same year Caesar's and Harrah's came together, thereby surpassing the MGM Mandalay merger to become the largest gaming group.

Today, Caesar's is working to extract itself from Chapter 11 protection, having been placed into bankruptcy in 2015 following the 2008 debt fuelled takeover by Private Equity operators Apollo and TPG.

Other casino owners include Boyd Gaming, with the majority of its operations situated off the Strip and Station Gaming, owner of Red Rock Casino, which we visited on our trip.

U.S Gaming Market

The U.S. gaming market houses an installed base of approximately 1 million slot machines of which 190,000 can be found in Las Vegas, Nevada. In comparison Australia has a total of 197,000 slot machines in operation.

Gaming Manufacturers

The U.S. gaming manufacturers industry is made up of a large number of players, although the top four dominate with around 70% market share. These include IGT, Scientific Games, Aristocrat and Konami. Ainsworth sits well inside the top 10 with an approximate market share of 5%.

The industry relies on the replacement of gaming machines to sustain itself, a situation that has steadily declined post the financial crisis. A replacement cycle of 90,000 machines was once the norm, whereas today, a figure closer to 60,000 is more representative of demand. This is a function of casinos not having sufficient capital expenditure budgets, a legacy of balance sheets bloated with debt and decreased visitor spend.

Apart from outright machine sales, gaming manufacturers also place their top selling machines onto the floor under a participation revenue sharing model. Under this scenario, the manufacturers lease the machines to the casino and in turn receive a share of the daily machine takings. In the U.S. these units are referred to as participation machine units, a figure that the industry currently estimates sits at 90,000 units.

Importantly, manufacturers aim to place more units on a participation basis, as it allows for higher quality annuity income as well as encouraging greater investment and game development to be undertaken. In more recent times the clear leader in this market segment has been Aristocrat, with a number of game titles winning strong customer demand, most notably the group's consistently top selling game "Buffalo".

Bellagio

The Las Vegas market has an annual turnover of some USD $7 billion in revenue, of which the Bellagio pulls in annual revenues in excess of USD $200 million. Any visitor to Las Vegas would be immediately drawn to the Bellagio Casino by its distinctive architecture and water features. Internally the theme is consistent and despite the emergence of newer casinos the Bellagio still ranks as the most iconic property on the Strip. Built in 1998 the casino floor houses approximately 1,800 slot machines, a figure that has actually decreased over recent years.

Bellagio's slots manager Johnny Cox, whose role is to oversee the gaming performance of slot machines on the casino floor, undertakes a regular review that looks to remove poorly performing machines. To this end, he indicated that around 40 machines, or 2% of the floor is replaced annually, a figure that strikes us as surprisingly low when considering the difference between poorly performing games, those that return less than $150 per day, and the better performing ones, generating upwards of $700 per day. On average, the casino generates around $350 per day across its 1,800 game machine floor.

Being one of ten casinos owned by MGM Resorts, part of the reason given for the lower annual spend at Bellagio is the manner in which capital is now allocated by the parent. Rather than each casino operating independently, all revenues are grouped and capital allocated on an as needs basis, with those in greater need receiving a larger slice of the capital budget.

Of the major gaming manufacturers on the floor, Bellagio's slots manager Cox indicated that the top two performing machines were Bally owned by Scientific Games and Aristocrat. The industry's incumbent provider IGT, along with WMS were the notable poor performers. Ainsworth has also made little headway in a market driven by the tourist player that seeks entertainment and themed content. Rather, Ainsworth's game offering relies on servicing the core market of regular casino visitors, more typically found off the Las Vegas Strip. We headed to the Red Rock to understand this market.

To this end, Ainsworth CEO Dreitzer outlined a positive trend for the group, with ongoing share market gains not only in the Nevada market but also in other key gaming regions including California, Oklahoma, Florida and the expectations of newer markets such as Colorado, the Washington and British Columbia.

Ainsworth Game Technology (ASX: AGI)

Table 1: Brief company history

Year	Details
1995	AGI was established in 1995 by Len Ainsworth in Sydney. Prior to founding AGI, he had successfully established Aristocrat Leisure Ltd in 1953. Len Ainsworth handed control and ownership of Aristocrat to close family members in 1994.
2001	AGI listed on the ASX in December 2001. The shares issued under Initial Public Offering (IPO) accounted for 43.5% of the total share capital, while Len Ainsworth retained a 50% plus interest.
2003	Company relocated to Newington, Sydney, to house its headquarters and manufacturing facility
2004	Approvals for California tribal gaming and Mid-West markets were gained in 2004 marking AGI's entry into the North American market.
2006	Acquired a licence for the manufacture of gaming equipment within the State of Minnesota and acquired a casino service industry licence from the New Jersey Casino Control Commission
2007	Acquired a manufacturer's license from the Pennsylvania Gaming Control Board and Wisconsin contractor license relating to gaming.
2009	AGI became a licensed manufacturer and distributor of gaming devices within the State of Nevada.
2010	Launch of the A560TM cabinet, initially in Macau and then rolled out in Australia
2012	Acquired manufacturer's and distributor's license for State of Arkansas. AGI permitted to conduct business in 20 U.S. states and four Canadian provinces.
2014	31 additional licenses were obtained in FY14 including 29 in the United States (26 tribal and three State), one Canadian province and an eGambling license from the Alderney Gambling Commission.
2015	Launch of AGI's social casino gaming.
2015	AGI acquired Nova Technologies, LLC. for USD $38 million.
2015	Launch of the A600TM cabinet in the Australian market.
2016	Opening of new U.S. 28,000 sq. metre manufacturing facility in Nevada.
2016	Novomatic gains shareholder approval to acquire Len Ainsworth's 52% share interest in AGI.

Business operations

Ainsworth is primarily engaged in the design, development, manufacture, leasing and sale of electronic gaming machines (EGMs) to the casino and gaming industry. The type of EGM specifically produced by Ainsworth is the slot machine, along with a minor presence in online gaming.

The group's key products include the A560 and the newly launched A600 gaming cabinets. Key games featured on these machines include Cash Adventures, Thunder Wilds, Double Shot, Quad Shot, and Sweet Zone.

Table 2: Business revenue segments

Revenue	FY13	FY14	FY15	1H16
Australia	124.4	143.3	93.1	50.3
Americas	62.6	90.4	133.0	79.9
Asia	6.2	4.2	8.9	2.7
New Zealand	3.6	5.3	4.5	7.5
Europe | Other	1.3	1.0	1.1	1.5
Total	**198.1**	**244.1**	**240.6**	**141.9**

Table 3: Business earning segments

Operating earnings	FY13	FY14	FY15	1H16
Australia	69.8	83.5	46.6	19.0
Americas	26.2	36.3	58.3	34.8
Asia	3.2	2.2	5.1	1.2
New Zealand	2.4	3.4	2.8	4.4
Europe | Other	0.6	0.4	0.6	0.8
Total	**102.3**	**126.0**	**113.4**	**60.1**

Table 4: AGI: Business relative earning contributions

Contribution	**FY13**	**FY14**	**FY15**	**1H16**
Australia	68%	66%	41%	32%
Americas	26%	29%	51%	58%
Asia	3%	2%	5%	25%
New Zealand	2%	3%	2%	75%
Europe | Other	1%	0%	1%	1%
Total	**100%**	**100%**	**100%**	**100%**

U.S. visit

We visited gaming manufacturer Ainsworth Game Technology's newly completed Las Vegas facilities and met with the group's U.S. President Mike Dreitzer. The site covers 28,000 square metres, being a fivefold increase on the company's previous operations and now houses the group's manufacturing requirements for the entire North and Latin American markets. The land and construction costs totalled circa AUD $30 million which is a significant step-up in investment, illustrative of management's commitment and pursuit of long term market share gains.

Our discussions with industry players questioned the logic of Ainsworth building such a significant facility, particularly in view of its low market share position. CEO Dreitzer, who joined the group in December 2013 was philosophical, noting that a long term decision was made by management and now that the facility was open, attention would be fully focused on building the team, expanding the group's research and development operations and taking market share.

On this score, with current annual U.S. unit sales of 3,000, the group lays claim to a market ship-share[1] of 5%, based on a 60,000 machine replacement market. AGI does not compete across the full 90,000 machines replacement cycle highlighted previously. Longer term, management is aiming to grow this share into the mid-teens. As noted by Dreitzer, Ainsworth has performed well in the large key markets of California, Oklahoma and Florida where it enjoys an estimated market share of 7%. The company is also targeting new regions over the upcoming period, including Colorado, Washington State and British Columbia. The company is expected to have the necessary licences for these markets in place by 2016 calendar year end.

In addition, the group is also keen to extend its product offering to the larger corporate casino chains, including the likes of Penn, MGM Resorts and Caesar's Entertainment.

While these markets typically offer what is referred to as Class III[2] gaming products, the group is also tackling the significant opportunity emanating from Class II[3] machines. These bingo style games have come to greater investor prominence following Aristocrat's AUD $1.3 billion acquisition of Oklahoma based Class II operator VGT.

With a total installed base of 70,000, made up of 42,000 Class III and 28,000 Class II game machines, the Oklahoma market provides Ainsworth with greater scope to take on the

[1] Ship-share is a gaming machine manufacturer's market share of the annual sale of replacement machines.

[2] Class III games are machines where the player competes against the casino with the results of each play randomly determined. This is accomplished using a program called a random number generator. The payoffs for various hands are weighed against the odds of hitting the hand.

[3] Class II games are bingo style games. Each player actually plays against other players in the casino. These games are sometimes called video lottery terminals as the wins are determined by a central server (similar to a lottery server) to which all the games are attached.

You can usually tell if a video poker game is a Class II game because there is a small display of a bingo-style board that is used to show the results of the bingo game. Class III games do not have this as each draw is a separate random event.

incumbent, being Aristocrat with its leading position of 22,000 Class II installed machines. Inclusive of Oklahoma, the Class II market opportunity totals some 56,000 machines, with other significant States including Alabama (5,000), Louisiana (4,500) and Montana (3,400).

Ainsworth's entry into this market segment was via its recent purchase of Class II manufacturer Nova Technologies. Acquired in November 2015, the USD $38 million acquisition included 1,300 Class II installed machines with operating earnings of USD $4.5 million. CEO Dreitzer expressed confidence that the current installed base was poised to more than double over the ensuing years. Importantly, one of the key driver's would be the company's extensive Class III library of product, which can be converted to meet the market's Class II game offering.

Novomatic

Subsequent to our U.S. meeting we caught up with Novomatic executives, Chief Technology Officer Thomas Graf and Chief Executive Officer Harald Neumann to discuss the merits of Novomatic joining forces with Ainsworth, post the announcement of their intention to acquire founder Len Ainsworth's 52.74% shareholding interest. Established in 1980 by founder Johann Graf, Novomatic has remained private, becoming a market leader in both game technology and gaming operations. The Novomatic Group is comprised of three holding companies;

1. **Novomatic AG**: Based in Austria, the activities range from casino and gaming operations to manufacturing and related ancillary services. NOVOMATIC Gaming Industries GmbH (NGI) in turn acts as a holding for various national and international interests within the gaming industry, including casino operations, electronic gaming operations, video lottery operations, sports betting operations and various end-to-end gaming machine manufacturing activities.
2. **ACE Casino Holding AG**: Based in Switzerland, involved in the operation and management of three casinos in Switzerland.
3. **Gryphon Invest AG**, also based in Switzerland, is the market leader in the Czech Republic. In addition, its manufacturing division supply the rest of the NOVOMATIC Group with metalwork. Also employing approximately 150 highly skilled programmers ATSI acts as a general development resource and innovation think-tank for the NOVOMATIC Group

Operating in 80 countries and employing over 23,000 persons, the combined group recorded turnover of €3.8 billion during 2014, giving rise to operating profits of €417 million. Of this, €2.0 billion of revenue and €363 million of operating profits specifically relates to the group's gaming operations. This involves running 1,600 owned and operated gaming venues, including 30 casinos as well as having 235,000 game devices deployed around the world on either a lease basis or residing within a Novomatic casino.

The group is noted for its innovative drive and singles out its investment in research and development at the core of its success to date. This is reflected in its operations, with 19 technology centres in ten countries focused mainly on software development and programming, which in turn have given rise to approximately 3,200 intellectual property rights. From our understanding Novomatic produce some 300 new games every year, compared to Ainsworth's 40-50 games per annum and 450 game library.

Along with a number of undertakings given by Novomatic to Ainsworth shareholders prior to the general meeting to approve the share sale, Ainsworth also outlined significant financial benefits that would accrue from the new relationship. In total, the group is expected to lift revenues by AUD $23.8m and AUD $55.7m during 2017 and 2018, while pre-tax profits are set to rise by AUD $10.6m and AUD $26.9m respectively.

The bulk of the increase is predicated on Ainsworth taking Novomatic's existing game library and reworking it for the Australian and U.S. markets. In all management aims to lift the sale of game units by 2,000 in these two regions as well as supplying Novomatic with a minimum of 2,000 game kits over the course of the two years.

Importantly, Novomatic has highlighted the U.S. market as a key area of growth and as a consequence will look to consolidate its U.S. operations into Ainsworth, thereby providing a concerted focal point to drive greater returns from product and manufacturing investments already made.

These are early days in the partnership and time will invariably determine its ultimate success. However, a few things do stand out, most notably the alignment of interests in the pursuit of a common goal to grow the business through investment, where there had previously been a reluctance. While one shareholder, the founder is departing, his replacement has shown its commitment by paying a premium price to gain a controlling interest. It appears a fair exchange and more importantly provides Ainsworth management and employees, with renewed vigour and valuable resources to growth its gaming operations.

Aristocrat Leisure

Somewhat reflective of our Las Vegas site tour, global slot manufacturer Aristocrat Leisure handed down an impressive set of numbers when unveiling its first half results in May.

Free from any one off accounting items, the result was clean and strong on almost all key metrics. Revenues rose 47% to AUD $1.0 billion, driven by strong operational performance in the two key markets of Australia and the U.S.

Locally the group has cemented itself as the must have gaming provider, enjoying an installed market share base north of 60%. This has given rise to revenue growth of 64% to AUD $213 million, with earnings almost doubling from AUD $46 million to AUD $90 million.

In the U.S. the results were equally impressive with outright machine unit sales growing 27% to 5,300, achieved in a flat market. In terms of participation units, a situation where Aristocrat is paid a percentage of a machines daily winning, the group's installed base of Class III units rose 26% to 11,613, with another 21,136 units in operation servicing the group's Class II activities. Collectively, the group's average fee per day rose 11% to USD $47 per machine leased, with the group now generating 50% of all revenues from a recurring earnings base.

Lastly, digital earnings reflecting the growing adoption of social gaming continued to set new records, with revenues doubling to $130 million and operating profits up over 150% to USD $50 million.

Management have prudently maintained a low payout ratio of around 25%, lifting dividends to ten cents per share. This has enabled an ongoing reduction in net debt to around USD $1.2 billion, resulting in a more conservative net debt to earnings coverage of 1.9x, down from the previous level of 2.6x.

At a time when many of its peers, including the likes of IGT and Scientific Games are labouring under integration issues and constrained balance sheets, Aristocrat have taken significant market share principally on the back of an extensive games library that has gained consumer acceptance across multiple market offerings.

The near term business outlook remains positive with management maintaining a conservative approach underpinned by an ongoing commitment to growing from within and where sensible via acquisition.

As things currently stand, the company is on course to deliver revenues of $2 billion and net profits of $360 million. To put some numbers on the potential and focusing specifically on the U.S. opportunity, the company has cemented a formidable position in the video segment of the slots market with a 30% market share.

However, we expect the group to continue to grow its presence in video and the traditional stepper market where it has had limited success. In addition, it will continue to expand in the lucrative participation space in both the Class III and Class II markets while making further inroads in the digital arena.

In short, we can envisage the company over the next few years, lifting revenues from the current run rate of AUD$2 billion to around AUD $2.6 billion, giving rise to net profits of circa AUD $580 million, representing earnings per share of AUD 92 cents.

Gaming Financials

The gaming industry has undergone significant consolidation, with the major U.S. players having being absorbed into two main operations, being Scientific Games and IGT. The rising star, Aristocrat Leisure is now the largest in market capitalisation terms having successfully grown its U.S. market share over the past five years. The acquisition of VGT in October 2014 expanded the group’s U.S. presence, with its entry into the Class II gaming market. Despite this, the company’s balance sheet remains conservatively positioned when compared to its two main competitors.

Indeed, a closer look at both Scientific Games and IGT reveals a concerning aspect, being the significant level of debt being carried in both. In each instance the size of debt dwarfs the respective companies market values. For Scientific Games the situation appears even more confronting, reflected in operating income of USD $881 million and an annual interest cost of

USD $664 million for 2015. This leaves little room for error and underscores management's pursuit of driving further costs out of the business.

IGT's net debt of USD $7.7 billion is similarly significant and while on the surface the group's earnings numbers would suggest greater scope to deal with the debt burden, the company's ongoing loss of gaming machine market share is likely to place it under ongoing financial pressure.

Summary

The U.S. gaming industry remains competitively placed. Consolidation within the industry has led to fewer manufacturers, although the reluctance of casino operators to aggressively upgrade their floor offerings has seen a decline in replacement unit numbers, offset by new casino openings.

To this end, market share gains are flowing from the incumbents, including IGT, to operators able to develop and release popular winning games. Aristocrat has successfully stolen a march on its competitors with the group's recent interim results for 2016 clearly indicating that this is ongoing. Ainsworth on the other hand is in the early stages of growing its U.S. based business, one in which the signs are positive. ***SFM***

Listed gaming stock financial summary

Scientific Games: Year-end December

USD $ million (unless stated otherwise)	2015	2014
Revenue	2,754	1,786
EBITDA	881	627
D&A	(903)	(454)
Net Interest	(665)	(307)
Pre Tax Profit	**(687)**	**(134)**
Other Key Statistics		
Net debt	8,078	8,141
Market Capitalisation	826	
Enterprise Value	8,904	
Gaming Unit Sales		
US Unit Sales	17,417	10,573
ROW Unit Sales	11,365	6,439
Total Unit Sales	28,782	17,012
Average sales price USD	16,349	15,127
R&D spend % revenue	7%	
Participation Units		
Average installed base	22,720	10,024
Average daily revenue per day	55.21	68.25

- October 2013 Scientific Games acquired WMS for USD $1.5 billion.
- Bally Technologies acquired Shuffle Master for USD $1.3 billion.
- November 2014 Scientific Games acquired Bally for USD $5.1 billion.

International Game Technology (IGT): Year-end December

USD $ million (unless stated otherwise)	2015	2014
Revenue	5,088	5,780
EBITDA	1,704	2,027
D&A	(817)	(647)
Net Interest	(458)	(262)
Pre Tax Profit	**429**	**1,118**
Other Key Statistics		
Net debt	7,707	2,642
Market Capitalisation	3,480	
Enterprise Value	11,187	
Gaming Unit Sales		
US Unit Sales	21,382	24,294
ROW Unit Sales	13,777	17,175
Total Unit Sales	35,159	41,469
Average sales price USD	-	-
Participation Units		
Average installed base	40,659	43,717

- GTECH acquired IGT for USD $4.7 billion.

Aristocrat Leisure: Year-end September

AUD $ million (unless stated otherwise)	HY 2016	2015	2014
Revenue	1,010	1,582	839
EBITDA	372	523	219
D&A	59	(162)	(43)
Net Interest	(45)	(81)	(8)
Pre Tax Profit	268	**280**	**168**
Other Key Statistics			
Net debt | (cash)	1,229	1,451	(171)
Market Capitalisation	8,129	6,300	
Enterprise Value	9,358	7,751	
Gaming Unit Sales			
US Unit Sales	5,351	9,636	9,419
AUS Unit Sales	7,113	10,537	7,337
ROW Unit Sales	1,728	4,457	4,935
Total Unit Sales	14,192	24,630	21,691
Average sales price USD	18,101	16,814	15,289
R&D spend as % revenue	11%	12%	
Participation Units			
Average installed base Class III	11,613	9,808	9,071
Average installed base Class II	21,136	20,681	-
Average daily revenue per day USD	46.88	42.70	46.02

- Aristocrat Leisure acquired Class II market leader VGT for USD $1.3 billion in October 2014

Ainsworth Game Technology: Year-end June

AUD million	HY 2016	2015	2014
Revenue	142	241	244
EBITDA	54	82	88
D&A	(10)	(16)	(10)
Net Interest | (income)	(1)	3	3
FX gain	10.0	26	-
Pre Tax Profit	**45**	**94**	**82**
Other Key Statistics			
Net debt | (cash)	(1)	(32)	(71)
Market Capitalisation	772		
Enterprise value	771		
Gaming Unit Sales			
US Unit Sales	1,340	3,100	2,381
AUS Unit Sales	1,915	3,535	6,004
Latin America (LA) Unit Sales	1,398	2,219	1,593
ROW Unit Sales	462	872	670
Total Unit Sales	5,115	9,797	10,648
Average sales price AUD	21,300	20,700	20,200
R&D spend as % revenue	10%	11%	11%
Participation Units			
Average installed base Class III US	1,445	1,316	9,071
Average installed base Class II LA	1,823	1,311	884
Average daily revenue per day USD	30	33	35
Average daily revenue per day LA	16	15	13

- Ainsworth Game Technology acquires Class II manufacturer Nova Technologies or USD $38 million in November 2015.

Inflation

The Reserve Bank of Australia moved during April, cutting official interest rates by a quarter of one per cent to a new low of 1.75%. Like many of the world's advanced economies, targeting an appropriate inflation target has been a difficult assignment. While our latest rate cut is a new low, when compared to the U.S. Federal Reserve rate of 0.5% and many of Europe's negative settings, Australia's looks decidedly positive. Many now predict we are heading lower, eventually following the lead set by others.

So why are inflation levels so low and why are the economic tools at our disposal not working? Many professionals now responsible for setting economic policies have only ever experienced inflationary conditions. The use of monetary policy may be blunt, but it works effectively to reduce business activity. Unfortunately, the same cannot be said when trying to ramp things up.

We would put forward two scenarios as to why we are unlikely to see inflation return to more normal levels for some time to come. The first very much revolves around the period post the global financial crisis of 2008. The significant use of financial leverage played an important role in the crisis itself, and in the economic challenges that have followed.

Today, encouraging economic activity is not without its issues. Simply dropping rates and promoting the use of leverage to drive growth isn't so easy. There is a certain reluctance combined with recent memories that are jointly slowing commercial lending. Acting prudently and managing costs has risen in importance and for good reason.

More broadly, the period post 2000 has seen the emergence and rapid uptake of new technologies that have fundamentally altered the competitive landscape. The rise of the Internet, online shopping and the cloud are all developments that are re-shaping how things are done. Where a business manager could previously identify competitors, they now appear without warning.

Businesses that possess both scale and technology leadership are in a stronger position if prices fall and competition ramps up. In this environment organisations no longer have the luxury of waiting, in fact the opposite is true. There is a need to move quickly but also prudently, being mindful of the risks involved.

In this context, technology is removing the layers and it is hard to see how society will adjust without some pain along the way. The rise of transport service UBER and many other car operating models that have since followed, is a perfect illustration of how previous layers of business models are being reshaped.

In this setting, the motivation for change is driven by better customer outcomes, overlaid with comparative price transparency. Consumers now want to know what is on offer and at what price, with the proliferation of new technologies giving them exactly the tools they need to undertake price discovery. No longer can businesses simply rely on consumer ignorance to set prices. If outsized margins are to be earnt, a product or service must represent comparative value in its market place.

The actions of central banks to set rates with inflation as an economic target may have universal endorsement but the evidence suggests its impact on shaping the economic agenda is waning. Economists in particular seem to struggle with this concept and still ask, "*why are interest rates at historic lows?*"

They are at historic lows because inflation remains benign in a world where leverage is on the nose and technology is breaking down business barriers and opening up competition in all matter of places. Welcome to the new norm. ***SFM***

Investor Days

The Australian Financial Review in highlighting that the benchmark 10-year Australian Bond hit an all-time low of 2.20 per cent in May, also commented that; *"Low bond yields means that people foresee little inflation (and little growth) and that's hardly good news for shares."*

As we have outlined earlier, we take a different line, noting that it is too simplistic to argue that low inflation, equals low growth, equals a poor outlook for shares. It is certainly evident to us that the economic impact that the combination of technology and financial leverage is having on inflationary outcomes is greater than many had envisaged.

Low inflation in itself is not the issue. In our opinion the bigger question is whether businesses that have become so reliant on inflation to succeed, are capable of operating in a far more dynamic world, where the adoption of technology not only lowers the cost of competition but also removes, for many businesses, the option of lifting prices in an attempt to offset increasing costs.

As we have noted in past newsletters, not all businesses will succeed in this tougher environment. The ability to differentiate, remain uniquely positioned and with a propensity to invest ahead of the curve will be critical to delivering longer term business success.

It is certainly true that share price valuations have moved higher at the same time that general interest rates have moved lower. However, what is also true is the manner in which some businesses have excelled whilst others have been left clearly wrong-footed.

This has certainly been our experience as we have followed the changing economic landscape and caught up with many of our investments over the course of the past quarter. To this end, company investor days are now becoming an important event and one rich in information. Importantly, they allow investors to hear from key executives while also providing a broader backdrop to the longer term business priorities under consideration.

Some may question the merit of such events, however, from our perspective the extra depth of information provided forms another important piece to the knowledge puzzle and the business investment case that ultimately follows.

Those that we attended during the quarter included superannuation services group IOOF, global hearing implant manufacturer Cochlear, healthcare supplier Blackmores, project management software provider Aconex, financial data provider IRESS, health insurer NIB Insurance as well as visiting the U.S. operations of electronic printed circuit board supplier Altium.

IOOF

We attended financial services group IOOF's investor day, with key presenters Group General Manager of Wealth Renato Mota and Chief Information Officer Andrew Todd focusing attention on the firm's progress in two key areas.

The first surrounding the ongoing reduction in the number of superannuation platforms the group operates and the commensurate benefits that are being extracted as a result of increasing scale.

The second, involving the ongoing adoption of open source technologies, underpinned by a management philosophy that embraces an open architecture IT platform, so as to service the rapidly changing requirements of both regulators and clients.

The end result is a financial group, with funds under management and administration of circa $100 billion and a clear desire to become the leading, independent specialist superannuation service provider. This along with a net debt position of $29 million, ideally positions the group to drive earnings growth, both organically and via opportunistic acquisitions.

Cochlear

We attended the first investor day Cochlear has held in more than a decade at its headquarters situated in Sydney's Macquarie University's hearing hub precinct. The day encompassed individual presentations from the key management team as well as a tour of the group's manufacturing operations.

Under the guidance of newly appointed CEO Chris Smith, the business is redefining the significant opportunity that exists for those suffering from profound hearing loss. Growing market awareness is the key message and management is shaping the business to deliver on two key outcomes.

The first is to continue growing the core business and investing appropriately to deliver innovative technology thereby maintaining market leadership.

The second focuses on building out the re-defined services division and the important business to consumer relationships that are being forged with cochlear implant patients. The company's commitment to make all sound processors backward compatible with previous implant releases, allows all patients to benefit from new processor upgrades as they become available.

This has allowed Cochlear to address its current 450,000 implant recipients with new wireless technology devices and the delivery of better hearing outcomes. We have commented on Cochlear's business in past newsletters, our most recent being the March 2016 quarter.

Our visit only confirms the views we have expressed previously that Cochlear remains a global leader in a business where the forces of new technology and market awareness will drive continuing consumer adoption. This is a global industry leader in an underpenetrated market.

Blackmores

The group held an investor day specifically addressing "Doing Business in China." With so much written on this topic in various media quarters, the briefing helped us form a better understanding of the business framework. Presenters included Liu Bing Senior Advisor from Austrade and Blackmores executives Peter Osborne, Managing Director Asia and Jason Zhang, Country Manager China.

While many factors can be sited for China's growing demand for vitamins and nutritional foods, one of the most compelling views put forward was provided by Andrew Parker, Head of Asia Practice PwC. He noted the new trade agreement between the two countries had arisen largely as a result of the demands from China's growing middle class. In the case of vitamins and food specifically, the combination of past contamination scandals, concerns surrounding local air quality and the highly health conscious Chinese populations consumption of branded and trusted products goes some way to explain the growing level of demand.

Government regulation is clearly an ongoing issue and one very much in transition. There are no short cuts in this process and management noted that the investment decisions being taken by the company are very much designed around a time frame that stretches out twenty years and not one engineered to capture a short term opportunity.

IRESS

Financial technology solutions provider IRESS undertook its investor day during May and in the process unveiled its latest product offering. No longer seen as just providing a platform for financial markets trading, the group's services now cover areas including financial markets, wealth management and mortgages. Offices extend beyond Australia and into regions that include Canada, South Africa, Asia and fast growing U.K market.

As CEO Andrew Walsh noted in his introductory comments, the demand for financial services is ever growing, a fact not lost on clients who continue to seek out new market opportunities with specific product solutions. This has been the hallmark of the group's' expansion to date with over half of the company's employees focused on providing enhanced product solutions. But importantly the essence of all its endeavours is to incorporate the latest in technology offerings by leveraging IRESS's core architecture.

The unveiling of ViewPoint, the company's next generation active trading platform is illustrative of this collaborative approach. Maintaining a consistent technology platform, upon which more customised solutions can be added upon has enabled the group to differentiate itself among its competitors as well as continue to deliver strong financial performance.

This is set to continue into the current year with CEO Walsh confirming the expectation of strong revenue growth, underpinned by ongoing regulatory demand across the group's multiple industry segments.

The U.K. market in particular is at a very early stage of its product rollout. As CEO Walsh noted, the current use of software in the U.K. wealth management segment remains low, a situation that is now changing as a result of legislative change. This is providing IRESS with a business opportunity that is broader and deeper than when the company first ventured into this region back in 2011.

Aconex

Online project management group Aconex held its second investor day during June, attended by the company's chairman, global management team, and its newest executive Cesar Flores, following the company's $96m acquisition of European competitor, Conject. The day covered product strategy, individual project case studies and external validation from current customer.

The business began in 2000 and listed in 2014, with a software as a service (SaaS) business model that aims to take online, the whole documentation process associated with the successful delivery of complex construction and engineering projects. Fundamentally the business is viewed as an online collaboration platform, that invites contractors, construction groups, project managers, consultants and other project professionals to view real time data securely, in a controlled manner. The data becomes the “single source of truth” for the whole project rather than every firm maintaining separate models and records that are not in real time.

The group's operations extend globally with four regions, Australia and New Zealand, Asia, America's and Europe. The business employs 755 staff, invests approximately 16% of revenue in research and development and has hit a critical juncture in its development. Following the successful signing up of influential customers Bechtel, Fluor, CIMIC and Burns McDonnell, the company is seen as the global leader in the fast growing adoption of Building Information Modelling (BIM).

The group's business model is predicated on charging an annuity fee on the projects value, providing unlimited access to users on the project, delivered via the cloud and mobile. Revenues are forecast to grow in excess of 20% per annum as the rate of adoption among the major customers moves from initial usage to full adoption. The group enjoys market dominance in key global regions as well as pathway that suggest continuing online adoption.

The company's market capitalisation now stands at $1.2 billion, with forecasts suggesting revenues and net profits of $240 million and $35 million respectively by 2018. Despite the lofty valuations placed on the business by the market, the medium to longer term expectations for customer adoption and the annuity style revenue model that underpins the business case, justifies taking a closer look.

NIB Insurance

Health insurer NIB Holdings CEO Mark Fitzgibbon commented at the group's investor day held in June that getting, "your margins up is a one trick pony". In this instance he was referring to insurers that simply relied on extracting more profits from consumers as a core business strategy.

To be fair NIB also relies on maintaining profit margins on health insurance written but in a clear contrast, CEO Fitzgibbon, who has been at the helm since the group listed in 2007, has augmented the company's offering by entering adjacent business fields, including expanding into New Zealand health insurance, providing health cover for specific groups including international workers and students and most recently via travel insurance and by default medical cover, through its acquisition of World Nomads.

The core philosophy that underpins these endeavors is what Fitzgibbon highlights as the emerging value proposition for consumers, that of providing pricing transparency so that buyers can make informed decisions. This is how management creates value for the consumer, particularly in an industry that is very much driven by price and service outcomes.

Whilst organic growth remains at the core, any new venture needs to meet four key requirements:

1. Firstly, undertake sufficient business and industry investigation,
2. Secondly, ensure the opportunity is sufficiently large enough that it justifies the capital and management time required to execute,
3. Thirdly, look to leverage the internal capabilities already existing within the NIB organization
4. Lastly, take a considered view but never bet the farm on any one investment.

To this end, NIB is building a portfolio of businesses, very much centered around providing health insurance, both domestically and in more recent times within a global setting. There is much to like about the manner in which the management team has grown the organisation over the past decade. Looking out, there appears to be sufficient confidence from within the group of continuing their performance.

US Meetings

Altium

We visited the U.S. headquarters of printed circuit board (PCB) group Altium. The La Jolla operations house the group's main executive team following a series of moves from Australia to Shanghai before finally settling in the U.S.

Our meetings included discussions and product demonstrations from CEO Aram Mirkazemi, Sales Director Lawrence Romune, Marketing Director Sam Sattel, Chief Product and Operational Officer Henry Potts, newly appointed Chief Financial Officer Joe Bedewi and investor relations executive Kim Besharati.

The meeting confirmed our view that the management team are in sync with their vision for the business. The broad industry and management experience alongside an executive team operating in a global environment underlines the significant potential open to the group. Our assessment suggests the long term rewards are substantial and the team, led by Mirkazemi, have a clearly defined plan.

Critical to the group's newly defined path has been the decision to go direct in the U.S. market, a situation that is now being repeated in Europe. This, along with the forging of multiple new industry relationships, most notably Solidworks, owned by industry heavyweight Dassault, is allowing the group to compete with a multi-product, multi-channel strategy.

Management have a well formulated strategy to achieve PCB market leadership by 2020 and we expect the group to focus on both organic and strategic acquisitions to drive further into system design solutions. Mirkazemi has set some high hurdles for the group but importantly has openly laid out the company's strategy and business aspirations, with management execution now the focal point. ***SFM***

Interesting Snippets

Oil

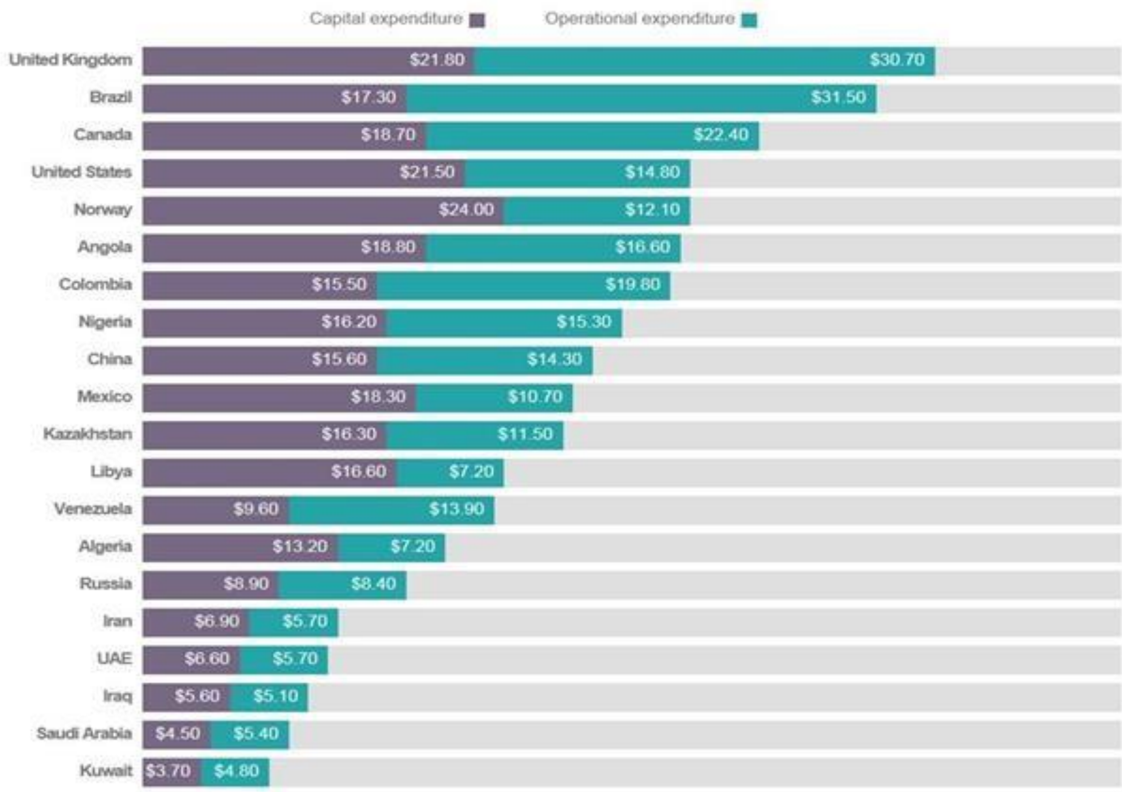
Following our piece on oil in the Selector March 2016 newsletter, a degree of market stability has returned. The price of crude oil has staged a strong recovery from recent lows and now hovers around USD$50 per barrel, thereby providing valuable breathing space for many producers as they look to prioritise spending in a lower price environment.

Whether this upward trend can be sustained, time will tell. It is important, however, to note the views of OPEC and in particular Saudi Arabia. While acknowledged for its lack of co-ordinated action, the path that OPEC takes, matters, and lessons are now being learned from the recent oil price rout.

Today, OPEC accounts for about 32 million barrels of oil production per day, slightly more than what was supplied 40 years ago. But back then, that was just under half of world supply in comparison to the one third it now supplies.

The ongoing market share feud between OPEC's two most powerful members, Saudi Arabia and Iran is still to play out. This will take time as Iran looks to fully re-enter the market and ramp up production. And then there are the unknowns. What are we to make of new technologies that have allowed greater levels of crude production to take hold, or the wildcard, being the rise of the electric car and its ultimate impact on oil demand.

Graph 1: Oil country capital expenditure comparisons



Certainly it's too early to call this latest surge in crude prices, from lows of USD $26, as being sustainable. In this context, if there is a voice that one should listen to more intently, it is that of Saudi Arabia and its new Energy Minister Khalid al-Falih.

As the world's swing oil producer, Saudi Arabia's views carry extra punch and its recent decision to sell up to five per cent of the state-owned oil giant Aramco, through a stock market listing, is perhaps indicative of its longer term concerns.

With the listing expected to value the company at more than USD $2 trillion, the minority sell down will help the Saudi economy diversify away from its reliance on oil. This would distribute billions into the country's wealth fund, with proceeds directed towards new sectors of the economy including manufacturing, tourism and healthcare. In short, Saudi Arabia wants its economy to be protected, aiming to be non-dependent on oil by 2020.

In the meantime, it's energy minister Mr Falih is working to deliver sustainability, "Our concern is for the long-term stability of the market, plentiful supply and meeting rising demand. We don't want oil shocks in the way that will contribute to the slowdown of the global economy."

As to possible return of USD $100 per barrel oil prices, Mr Falih added, "I can tell you that we found out that USD $100 to USD $110 was too high. It brought in too much investment, too much supply… and it created the imbalances we have seen." ***SFM***

Companies with a common thread

According to Phil Ruthven, founder of IBISWorld, an independent group undertaking research on over 500 industries, commented that Australia's best performing companies, as measured by return of shareholders' funds, have a few things in common.

His analysis surveyed both listed and unlisted large Australian enterprises, all up 1467 companies, representing 38% of Australia's $4.8 trillion revenue in revenue. Of those that were running at a profit, 1,155 delivered a return on shareholder funds of 15.5%, while for the top 100, the return exceeded 57%.

When looking at the common thread that distinguished the very good companies from the remainder, Phil Ruthven identified some consistent characteristics among the high achievers. Listed below are the top twelve recurring themes as provided by Ruthven.

What the Best Enterprises Are Doing

I They **stick to one business at a time** and do not diversify
II They **aim to dominate**[1] segment (s) of their industry or market
III They are **forever innovative**, valuing the business' IP.
IV They **outsource non-core activities** to enable growth.
V They **don't own "hard" assets.**
VI They have **good and professional financial management.**
VII They **plan from the outside-in** not the inside-out
VIII They **anticipate any new industry lifecycle changes**.
X They **develop strategic alliances.**
XI They **develop unique organisational cultures.**
XII They **value leadership first** and management second.

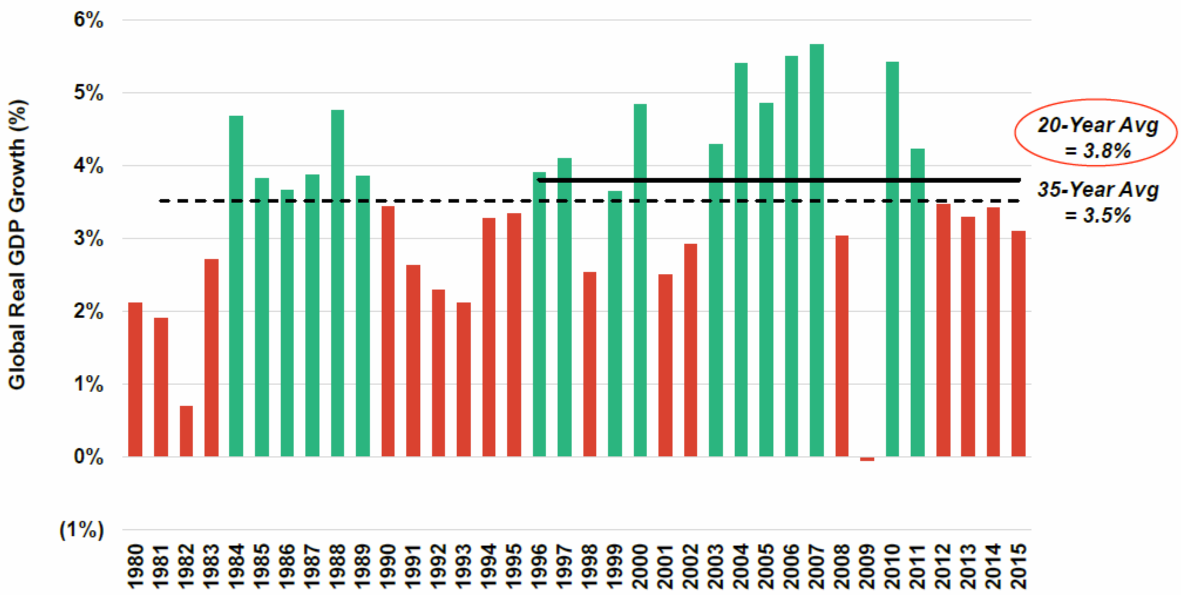
[1] Within official legislation, limits or guidelines of "dominance" Source: IBISWorld

In our investment universe many of these qualities can be found in the likes of Cochlear, IRESS, Blackmores, Aristocrat, SEEK, Flight Centre Travel Group, Altium or Reece to name but a few. Such attributes, when combined and viewed over an extended period of years and in some cases decades, can deliver results that are quite extraordinary.

The changing global landscape

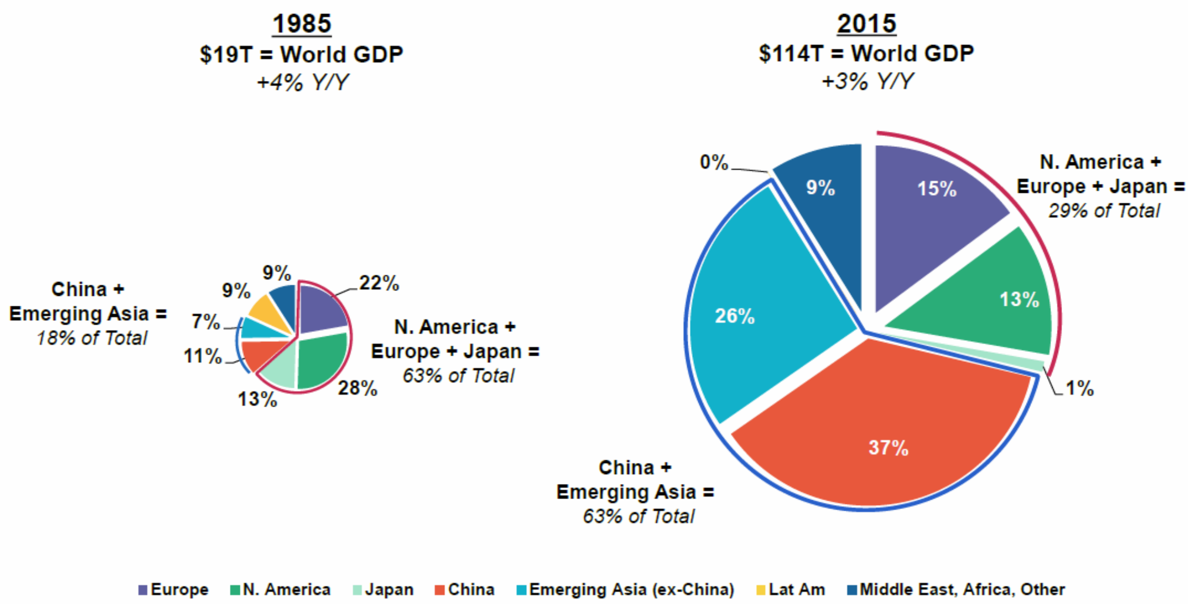
The following graphs are a small sample of those presented by Mary Meeker from KPCB. They depict the changing global landscape and how business and customs are being shaped as a result. KPCB is a venture capital firm that owns significant equity positions in certain companies recently presented at the "Internet Trends 2016 - Code Conference", which can also be viewed at www.kpcb.com/companies.

Chart 2: Global Real GDP growth (%), 1980 - 2015



Source: Kleiner Perkins Caufield Byers Internet Trends 2016 Conference, IMF WEO, 4/16, Stephen Roach, "A World Turned Inside Out," Yale Jackson Institute for Global Affairs.

Chart 3: Real GDP Growth Contribution by Region

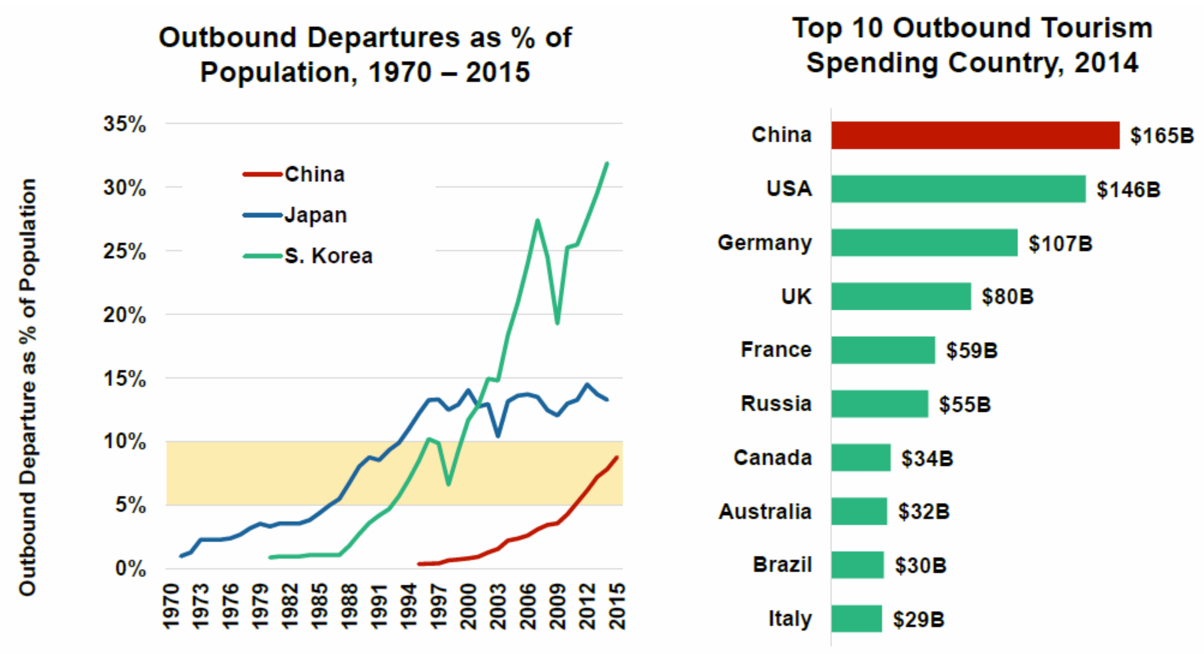


Source: Kleiner Perkins Caufield Byers Internet Trends 2016 Conference, IMF WEO, 4/16.

As Chart 2 and Chart 3 illustrate, real gross domestic product (GDP) is trading below twenty year historical averages. Interestingly though, despite the financial dramas of 2008, the period since has still delivered global growth rates greater than those witnessed during the recessionary era of 1990-1993.

No doubt a lot of this can be attributed to the shift in contribution from the traditional economies of North America, Europe and Japan to the newer regions of China and Emerging Asia. In this context, India is yet to take its seat at the table.

Chart 4: China Outbound Travel Penetration at inflexion point



Source: Kleiner Perkins Caufield Byers Internet Trends 2016 Conference, CLSA, World Bank.

As **Chart 4** highlights, the shifting travel patterns of global travellers and the Chinese consumers growing stature. As the Chinese middle class grows (currently estimated at 300 million) the desire and propensity to travel abroad is expected to increase, particularly when compared to other countries that have followed in similar fashion, including the likes of Japan and Korea.

Almost fittingly, during June our local airlines operator Virgin Australia announced the tie up with HNA Aviation Group, China's largest private operator of airlines. The $159 million placement to HNA early in the month, resulted in HNA controlling 13% of the local airliner. In subsequent developments Virgin also announced the raising of $852 million of new equity in order to undertake a significant restructuring of the business, including the pay down of debt.

As things now stand, Virgin's shareholder base includes Singapore Airlines, Virgin Group, HNA, Air New Zealand and Nanshan Group also from China. Nanshan Group is a large privately owned Chinese conglomerate of businesses, with its ownership in Virgin standing at just shy of 20% following Air New Zealand's recent decision to sell down its majority stake.

Table 5: Global Internet Market Leaders

Rank	Company	Region	Current Market Value ($B)	Q1:16 Cash ($B)	2015 Revenue ($B)
1	Apple	USA	$547	$233	$235
2	Google / Alphabet	USA	510	79	75
3	Amazon	USA	341	16	107
4	Facebook	USA	340	21	18
5	Tencent	China	206	14	16
6	Alibaba	China	205	18	15
7	Priceline	USA	63	11	9
8	Uber	USA	63	--	--
9	Baidu	China	62	11	10
10	Ant Financial	China	60	--	--
11	Salesforce.com	USA	57	4	7
12	Xiaomi	China	46	--	--
13	Paypal	USA	46	6	9
14	Netflix	USA	44	2	7
15	Yahoo!	USA	36	10	5
16	JD.com	China	34	5	28
17	eBay	USA	28	11	9
18	Airbnb	USA	26	--	--
19	Yahoo! Japan	Japan	26	5	5
20	Didi Kuaidi	China	25	--	--
Total			$2,752	$447*	$554*

Source: Kleiner Perkins Caufield Byers Internet Trends 2016 Conference, CapIQ, CB Insights, Wall Street Journal, media reports.

Table 5: Global Internet Market Leaders is interesting purely from the perspective of the names on the list and the seemingly disconnect that exists between individual company market values and their corresponding revenue numbers. In this context, the emergence of Uber is a perhaps a perfect illustration of investors preparing to value a business ahead of the curve, which in this case extends to a global market audience. ***SFM***

Head in the sand

The latest political episode regarding our public health system highlighted the lack of understanding within the community. As things stand the current funding in place for meeting the Medicare bill falls short as illustrated below.

For 2016-17 the Medicare Levy that all taxpayers contribute to is expected to raise $11.7 billion. This compares to the forecast total Medicare cost of $22 billion, a figure that also excludes the billions that will be required as the National Disability Insurance Scheme ramps up.

So in total, Medicare is expected to be unfunded to the tune of $10.4 billion for 2017. On this basis an average taxpayer ends up directly funding $975 while the balance of $875 per taxpayer remains unfunded. Actually this is not correct, since the Government picks up the tab, or more to the point, the taxpayer does.

And herein lies the issue, since most voters don’t associate unfunded Medicare costs as their own. In reality the opposite is true and the growing budget deficits is a testament to this worrying development.

At some point the penny will drop but relying on everyone to understand the importance of fairness is no easy task. Perhaps we should privatise Medicare. I'm sure with enough consideration applied, Bankers could package this loss making public health service, which has no revenue stream, into a fine looking listed entity, with the promise of never ending losses. Any takers? ***SFM***

Company visit diary June 2016 Quarter

April

WTC	WiseTech pre-IPO briefing	05/04/2016
A2M	The A2 Milk Company UBS Tech and Consumer conference presentation	05/04/2016
CZZ	Capilano Honey UBS Tech and Consumer conference presentation	05/04/2016
CKF	Collins Foods UBS Tech and Consumer conference presentation	05/04/2016
N/A	BUPA UBS Tech and Consumer conference presentation	05/04/2016
N/A	National Home Doctor Service UBS Tech and Consumer conference presentation	05/04/2016
NHF	NIB Holdings UBS Tech and Consumer conference presentation	05/04/2016
N/A	Compare The Market UBS Tech and Consumer conference presentation	05/04/2016
TNE	Technology One UBS Tech and Consumer conference presentation	05/04/2016
IFM	Infomedia UBS Tech and Consumer conference presentation	06/04/2016
VRT	Virtus Health management presentation	06/04/2016
SRX	Sirtex Medical UBS Tech and Consumer conference presentation	06/04/2016
SRX	Sirtex Medical management meeting	08/04/2016
IFL	IOOF Holdings investor Day	13/04/2016
SGR	The Star Entertainment Group analyst briefing	19/04/2016
ALU	Altium US roadshow management meeting	19/04/2016
RWC	Reliance Worldwide Corporation pre-IPO meeting	19/04/2016
IPD	Impedimed US roadshow management meeting	20/04/2016
SGMS	Scientific Games US roadshow management meeting	21/04/2016
ALL	ALL/Bellagio US roadshow management meeting	21/04/2016
IPD	Impedimed Q3 results conference call	21/04/2016
AGI	Ainsworth Game Technology US roadshow management meeting	22/04/2016
RMD	ResMed Q3 results conference call	27/04/2016
HUB	HUB24 Deutsche conference presentation	27/04/2016
NHF	NIB Holdings Deutsche conference presentation	27/04/2016
COH	Cochlear investor day	28/04/2016
MYO	MYOB Group AGM	28/04/2016
BKL	Blackmores Q3 results analyst briefing	29/04/2016

May

N/A	Uber Morgan Stanley Automotive conference presentation	03/05/2016
N/A	Splend Morgan Stanley Automotive conference presentation	03/05/2016
N/A	GoCatch Morgan Stanley Automotive conference presentation	03/05/2016
N/A	CarNextDoor Morgan Stanley Automotive conference presentation	03/05/2016
N/A	GoGet Morgan Stanley Automotive conference presentation	03/05/2016
WOW	Woolworths Q3 Results conference call	03/05/2016
LNK	Link Admininstration Holdings Macquarie conference presentation	04/05/2016
NCK	Nick Scali Macquarie conference presentation	04/05/2016
SYD	Sydney Airport Macquarie conference presentation	04/05/2016
ACX	Aconex Macquarie conference presentation	04/05/2016
OFX	OzForex Group Macquarie conference presentation	04/05/2016
OSH	Oil Search Macquarie conference presentation	04/05/2016
MYO	MYOB Group Macquarie conference presentation	04/05/2016
JBH	JB Hi-Fi Macquarie conference presentation	04/05/2016
IFL	IOOF Holdings Macquarie conference presentation	04/05/2016
LLC	Lendlease Group Macquarie conference presentation	04/05/2016
IPH	IPH Macquarie conference presentation	04/05/2016
CVO	Cover-More Group Macquarie conference presentation	05/05/2016
ARB	ARB Corporation Macquarie conference presentation	05/05/2016
CPU	Computershare Macquarie conference presentation	05/05/2016
OML	Ooh!Media Macquarie conference presentation	05/05/2016
NHF	NIB Holdings Macquarie conference presentation	05/05/2016
BXB	Brambles Macquarie conference presentation	05/05/2016
SEK	SEEK Macquarie conference presentation	05/05/2016
SYR	Syrah Resources Macquarie conference presentation	05/05/2016
MPL	Medibank Private Macquarie conference presentation	06/05/2016
SGR	The Star Entertainment Group Macquarie conference presentation	06/05/2016
PPT	Perpetual Macquarie conference presentation	06/05/2016
FLT	Flight Centre Travel Macquarie conference presentation	06/05/2016
BKL	Blackmores investor day	06/05/2016
AGI	Ainsworth Game Technology AGI/Novomatic management meeting	09/05/2016
OSH	Oil Search FY 2016 AGM	13/05/2016
OFX	OzForex Group FY 2016 results conference call	17/05/2016
OFX	OzForex Group FY 2016 results management briefing	18/05/2016
FTT	Factor Theraputics investor presentation	18/05/2016
JHX	James Hardie Industries management briefing	19/05/2016
OSH	Oil Search InterOil acquisition conference call	20/05/2016
FLT	Flight Centre Travel Group trading update conference call	23/05/2016

OSH	Oil Search investor briefing	24/05/2016
TNE	Technology One FY 2016 results briefing	24/05/2016
WOR	WorleyParsons investor day	25/05/2016
N/A	Scottish Pacific Goldman Sachs analyst investor education	26/05/2016
ALL	Aristocrat Leisure FY 2016 results briefing	26/05/2016
N/A	Shriro management meeting	26/05/2016
N/A	Oticon management conference call	26/05/2016
FPH	Fisher & Paykel Health FY 2016 results briefing	27/05/2016
ALQ	ALS investor briefing	30/05/2016
SYR	Syrah Resources Deutsche Metals conference presentation	31/05/2016
ORE	Orocobre Deutsche Metals conference presentation	31/05/2016
FPH	Fisher & Paykel Health results briefing	31/05/2016
IFM	Infomedia management meeting	31/05/2016
IFM	Infomedia management briefing	31/05/2016

June

ALS	ALQ investor presentation	01/06/2016
ALL	Aristocrat Leisure investor relations meeting	02/06/2016
ACX	Aconex investor day	07/06/2016
ACX	Aconex investor day	07/06/2016
FPH	Fisher & Paykel Health investor relations call	08/06/2016
DMP	Domino Pizza Enterprises management meeting	08/06/2016
DMP	Domino Pizza Enterprises technology day	09/06/2016
N/A	Scottish Pacific pre-IPO management meeting	09/06/2016
SOM	SomnoMed management meeting	09/06/2016
NHF	NIB Holdings investor day	15/06/2016
ACX	Aconex Morgan Stanley Emerging Companies conference presentation	15/06/2016
APO	APN Outdoor Group Morgan Stanley Emerging Companies conference presentation	16/06/2016
BAL	Bellamy's Australia Morgan Stanley Emerging Companies conference presentation	16/06/2016
BAP	Burson Group Morgan Stanley Emerging Companies conference presentation	16/06/2016
NTC	Netcomm management briefing	21/06/2016
VOC	Vocus Communications management meeting	23/06/2016
FLT	Flight Centre Travel management conference call	28/06/2016
TNE	Technology One management conference call	29/06/2016
GBT	GBST Holdings management meeting	29/06/2016
N/A	Inghams pre-IPO meeting	30/06/2016