

Selector Fund
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In this quarterly edition we review performance and attribution. We focus in on the recent IRESS and Domino's acquisitions, visit PNG and discuss in brief Amazon, Europe and Technology. Photo: New Fed Head.

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About Selector

We are a boutique fund manager and we have a combined experience of over 60 years. We believe in long term wealth creation and building lasting relationships with our investors.

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

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

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

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

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

Dear Investor,

When Australia's newly elected Prime Minister Tony Abbott won office on 7 September, he concluded his acceptance speech by declaring that "Today the government of Australia is under new management and is once again open for business." If the share market's direction was an indicator as to whether the Prime Minister's declaration carried weight, the early signs were good. Since then investors have set aside any lingering concerns to push markets to multi-year highs. Even the threat of military action against the Syrian government and the prospect of the US Federal Reserve eventually winding back its bond buying program has done little to quell investor demand.

Nowhere is this more obvious than the increasing pipeline of new share market listings. Fanned by recent successes, including IVF specialist Virtus Health up 41%, profiled in our June quarterly newsletter, and insurance broker Steadfast Group's 36% move, more vendors are turning to the market. In the US market a similar trend is emerging with one of the most eagerly anticipated listings being the microblogging site Twitter. With an estimated value of US\$ 16 billion, Twitter is set to join other online players including LinkedIn and Facebook.

The change in sentiment is significant because it will have implications for investors who having opted for the security of cash are now prepared to consider more risky alternatives. Locally, cash sitting in banks is estimated at \$1.8 trillion compared to the current \$1.7 billion market capitalisation of our listed companies.

However a word of caution. The risk of a rising tide lifting all the boats is an area of growing concern that cannot be ignored. Five years have passed since the financial crisis of 2008 and as is often the way, the memory bank fades with the passage of time. It should therefore come as no surprise, that the conservative investment behaviour, so evident in the past few years, will once again give way to more bullish activity. So while vendors may wish to sell all matter of things and suitable alternative investment options may be thin on the ground, it is important to remain vigilant. Our response is to remain grounded in our thinking and pursue investments consistent with our core philosophy.

In this quarterly report we comment on portfolio performance and review the businesses of IRESS and Domino's Pizza Enterprises, following their recent acquisitions and capital raising. We also focus attention on the growing importance of technology in business and provide our thoughts on our recent trip to our near neighbours Papua New Guinea.

During the past quarter the Fund delivered a gross positive return of **16.70%** as compared to the All Ordinaries Accumulation Index which returned **10.78%**. We also welcomed Robert Lapsley to the Selector team during the quarter. Robert completed his university studies in 2011 and since then has been involved in a number of projects involving Selector. We are fortunate to have Robert on board, his work ethic and desire to learn will contribute positively to the investment team. To all our investors we trust that you find the report informative.

Regards
Tony Scenna
Corey Vincent
Robert Lapsley

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Quote: James Packer

"Hindsight makes things so easy. I put \$1.5 billion into America and it went to zero. I put \$750 million into Macau and it went to \$4.5 billion. At the time, a lot of people thought what I was doing in America was safer than what I was doing in Macau. What is the lesson? You have to be swimming downstream. Being in China, when the supply is limited, I am swimming downstream. There is a lot of luck in life. I don't think America was going to be a wipe-out and I certainly didn't think that China was going to be this good. That is the truth."

The Australian Business Magazine The Deal 17 August 2013

Performance September 2013

For the quarter ending September 2013, the Fund delivered a gross positive return of 16.70% as compared with the 10.78% rise in the All Ordinaries Accumulation Index. Performance statistics are detailed on page 20.

Performance table since inception

% Returns	Gross Fund Return %	All Ords index %	All Ords Acc Index %
3 months	+16.70	+9.28	+10.78
1 Year	+43.13	+18.42	+23.55
3 years	+16.06	+4.01	+8.65
5 years	+11.68	+2.41	+6.98
Since inception compound p.a.	+10.90	+3.66	+8.16

Top 10 September 2013*	Top 10 June 2013*
Aristocrat	Aristocrat
Computershare	Computershare
CSL	CSL
Flight Centre	Flight Centre
21 st Century Fox	IOOF Holdings
IOOF Holdings	IRESS
IRESS	News Corporation
ResMed	ResMed
SEEK	SEEK
Sirtex Medical	Sirtex Medical
Top 10 = 61.19%	Top 10 = 63.30%

*Listed in alphabetical order

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

Performance attribution for the quarter

Top 5 stock contributors	%	Top 5 stock detractors	%
SEEK	2.21	Echo Entertainment	-0.14
Flight Centre	1.72	Computershare	-0.05
ResMed	1.33	Flexigroup	+0.08
Jumbo Interactive	1.24	Reece Australia	+0.13
Sirtex Medical	1.22	NIB Holdings	+0.18

During the quarter, the portfolio's selection of businesses performed exceptionally well, benefiting also from the market's strong upward move. As the accompanying attribution table highlights, almost all of the portfolio's investments added value for the period with the exception of Echo Entertainment and Computershare. The top contributors included online employment group SEEK, travel group Flight Centre and sleep specialist ResMed Inc.

These holdings have been held over many years and the progress these businesses have made thus far have translated into significantly higher profits and increasing dividend payments. Most pleasing has been the manner in which management has delivered improving results despite continuing tough economic conditions, perhaps perfectly illustrated by ResMed.

Despite ongoing cuts to healthcare spending and pressure on margins, ResMed has not only posted strong top line growth but also successfully expanded gross margins to near record levels. In addition with a net cash pile that stood at US\$575 million at June end, management has resisted the temptation to spend big, opting to return more to shareholders via its quarterly dividend payment program.

The Portfolio also benefited from renewed corporate activity that resulted in financial services group IRESS raising new capital to fund the acquisition of UK group Avelo Financial Services Holdings. We cover this deal, as well as our recently added stock, Domino's Pizza Enterprises later in this report. New company listings also featured in this quarterly, following on from our investment in IVF group Virtus Health during the June quarter. In this instance the Portfolio participated in the float of insurance broker Steadfast Group, which listed at \$2.15 and finished the month at \$2.56. The business appears to have all the hallmarks of delivering solid growth over a number of years, however, it is early days and management have yet to fully prove themselves.

As we noted in our opening address, investors have once again seen fit to embrace the market. No doubt the stock market will overshoot as is often the way and many private owners will look to take advantage of the circumstances and float their business. Some will be worthy of a closer inspection while the vast majority will not. However, we are sufficiently confident that global markets are on the up and that our own market will participate in this rise. The challenge will be in identifying those businesses that are best positioned to operate in a globally competitive environment, a task that we feel confident in tackling. **SFM**

Patience, persistence and financial discipline

Successful businesses seem to have a knack of being in the right place at the right time, or so it would seem. This, however, is too simplistic a view of why some succeed and many others fade away. Our observations suggest that in order to do well you need near perfect alignment covering a range of disciplines.

Importantly, the competitive barrier that a business enjoys in any chosen field is often argued as a crucial point of difference and a key attraction, but how did they get to that lofty position in the first place?

All too often investors acknowledge a great company once it has become just that. But the truth is, greatness is often a by-product of management who have undertaken a consistent approach, over a long period of time, combining patience, persistence and financial discipline. Success does not come about by accident, it is earned by remaining commercially relevant, by adapting and by seizing opportunities when they present themselves.

The skill of identifying these future great businesses involves more than just an ability to model a business's financial well-being. It also requires an equal appreciation that not everything can be perfectly measured. By way of example consider the following. During August, financial data services group IRESS and fast food operator Domino's Pizza Enterprises both announced important extensions to their respective businesses involving offshore acquisitions. The fact that each deal was met with universal acceptance perhaps speaks to the respect that both management teams enjoy among their investor base but that is only half the story.

IRESS

In the case of IRESS, a business we last profiled in our March 2010 quarterly newsletter, it is perhaps fair to say that an enormous amount has been achieved over a relatively short time frame. The foundations of its success lie with its delivery of financial data services to a core subscriber base. IRESS's key strength has been its ability to evolve as the industry and its needs have evolved. The company's corporate website highlights the group's commitment to change as being central to its success.

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

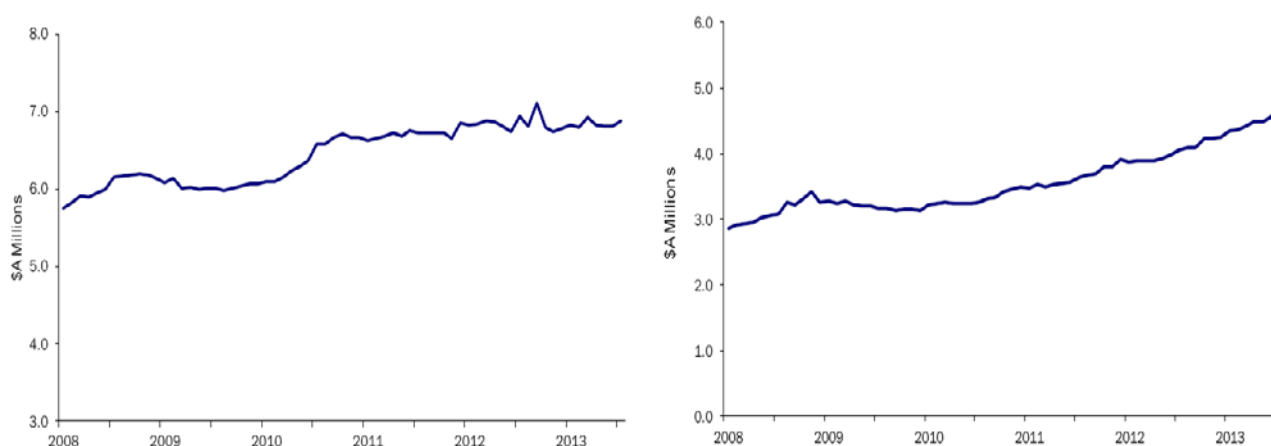
Just a moment arrived in 2002 when the business, under the guidance of founder Peter Dunai, entered the financial planning market with the purchase of IWL for \$88 million. This was followed up in 2003, buying planning desktop software provider Xplan for \$5.0 million, as well securing the services of its founder Andrew Walsh, who subsequently took over Dunai's CEO duties in 2009.

The foresight shown back then and the preparedness to invest in the wealth management arena is now paying off in many ways. The group's reliance on its core offering of providing subscription based financial data to brokers and investors' alike still remains intact today and the seeds that were planted, with the earlier noted acquisitions are now providing the company with a second powerful earnings stream.

While the most recent half year results saw the financial markets division's revenues relatively unchanged at \$53.5 million, segment profits slipped from \$27.1 million to \$25.4 million. This illustrates an industry that

continues to adapt to lower volumes with a focus on costs. On a monthly run rate, subscription revenues have stayed constant at circa \$6.7 million see **Chart 1** below.

Chart 1: IRESS Australian monthly subscription revenue – Financial & Wealth Management Divisions
FINANCIAL MARKETS – SUBSCRIPTION REVENUE WEALTH MANAGEMENT – SUBSCRIPTION REVENUE



Wealth Management

In contrast, post the global financial crisis events of 2008, legislative changes has substantially increased the level of compliance reporting requirements, resulting in a surge in activity, as customers seek out robust front and back end processing functions. This is best illustrated with the Australian Wealth Management division’s half year subscription revenues lifting 7% to \$29.6 million and operating profits jumping 11% to \$13.1 million. On a monthly run rate revenues have stepped up from circa \$3.5 million per month to an amount approaching \$5.0 million, see **Chart 1**.

Branching out

In 2011, in keeping with the group’s chosen method of expansion, management took another small but important step by launching into the UK wealth management industry. Conservative in their nature, IRESS teamed up with the Sesame Bankhall Group - the UK’s largest single distributor of financial services and advice - to roll out the group’s Xplan offering. Such an endeavour comes at a cost, where shareholders are asked to endure short term pain for long term gain. During this initial investment phase, management has kept a tight rein on costs, with losses contained to \$2.6 million during 2012 and \$1.2 million in the most recent half.

In our experience value can be created by a management team that is prepared to build from scratch, with a long term game plan at hand. Building something from the ground up takes time, persistence and a preparedness to invest ahead of the curve. It is not an easy route and many management teams avoid this slower path preferring to undertake transformational deals. For the IRESS management team the move into the UK was both logical and clear, with the UK financial advice market undergoing the same compliance crackdown that had taken place in Australia. Referred to as the Retail Distribution Review (RDR), from 2013 advisory firms would have to change their business to operate under a fee-based services model, thereby requiring a whole new generation of software to support the changes. Having seen the impact on demand post the legislative changes in Australia, the UK market, being over two and half times larger, provided a clear incentive to invest.

In August, the company unveiled its largest acquisition to date, the \$360 million purchase of the UK's leading financial services technology provider Avelo Financial Services Holdings. As management noted, "Avelo's Wealth Management business mirrors IRESS's existing segment and provides software solutions to a long standing blue chip client base spanning 35,000 users, financial advisers and brokers".

Avelo also offers two additional services, namely an online Exchange Portal that allows providers of life insurance, pensions, annuities and other financial products to engage with end customers by sourcing quotes and straight through processing. The Exchange Portal's metrics are impressive, partnering with some 32,000 providers, processing over 10 million quotes per month and executing some 30,000 new transactions per month.

The second service has Avelo providing a customised software mortgage solutions offering to the leading UK banks and building societies including Barclays, allowing for streamlined mortgage processing that currently services one in every four new mortgages written. In all, the Avelo group generated total revenues of £55.5 million in 2013, group segment profits of £14.5 million and an operating margin of 26%.

However, the real prize for IRESS's will its ability to take its proven XPlan product suite to a market where Avelo has struggled to develop its own unique offering. In order to exploit this opportunity, the Avelo management team has been retained following an extensive due diligence process that began in March, when discussions first began with the vendors, a private consortium that included Lloyds Banking Group, Vertex and management.

Despite competing offers IRESS prevailed, moving quickly and benefiting from the hard yards and investments made since 2002. With a market leading position, built on technology leadership and business scale the group's prudent financial approach saw IRESS enter buying discussions carrying no net debt and over \$50 million in cash. While the deal could have been funded entirely with debt, in keeping with its conservatism, management chose to use a combination of existing cash, debt and new capital from existing shareholders. In so doing it has again taken a prudent and fair approach, inviting existing shareholders to tip in additional capital whilst remaining mindful that too much debt is never a good thing.

IRESS management's track record of investing and building scale into businesses that offer sound financial metrics and strong recurring earnings is impressive. To have done so, with a pristine balance sheet speaks volumes of the conservative manner in which management approach's its task of protecting and growing shareholder wealth. IRESS remains a core holding in the portfolio, a position reaffirmed by this latest development.

Domino's Pizza Enterprises

Most people would be familiar with the Domino's Pizza product but less so with its impressive track record, since listing at \$2.20 back in 2005. Today, the shares are changing hands at \$12.70 per share, valuing the business at \$1.1 billion and giving original investors a six and half fold increase on their invested capital. Much to our disappointment we have watched from the sidelines over this period despite our acknowledgment of the wonderful job management has done thus far.

Table 1 below sets out some of the key milestones of the group since local operations began in 1983. The ownership of the Domino's Pizza brand remains with US parent Domino's Pizza Inc. Domino's Pizza Inc has on-sold master franchise agreements to partners covering different global regions. Under the master franchise agreements, the US parent receives an ongoing royalty payment from the master franchisors of about 2% on all revenues earned. From the franchisors perspective they can either run their stores in-house, referred to as corporate stores, or on sell to new franchisees. Under the corporate store model, the master franchisor runs the stores and collects all revenues and profits earned. Operating margins are lower under this arrangement, however, due to the higher capital needs of the business. Under this scenario, a 2% royalty is paid to the US parent as previously outlined.

The second option is for the master franchisor to appoint local franchisees, who take ownership of the stores, provide the capital required to run the business and who on pay franchisee fees of 7% to the master franchisor. From this, the master franchisor pays the US parent the 2%, leaving the master franchisor with a 5% royalty stream on all revenues generated by the franchisees.

Table1: Domino's Pizza Enterprises history profile 1993 - 2013

Year	Event
1960	Domino's Pizza brand founded in US by Thomas & James Monaghan now owned by US listed Domino's Pizza Inc.
1983	First international Domino's store opened in Canada / first Australian store opens in December in Queensland.
1998	Monaghan family sells controlling stake to Bain Capital, LLC.
1993	Australian & NZ master franchise purchased by Silvio's Dial-a-Pizza both Silvio's and Domino's Pizza operated separately.
1995	Silvio's and Domino's operations combined all stores converted to Domino's Pizza Stores.
2001	Two largest Domino's Pizza franchisees, Don Meji & Graham Bourke merge their combined 25 stores into corporate network receive 20% of the Domino's Pizza business as consideration stores total 50 corporate, 128 franchise.
2001	Don Meji appointed CEO began career as delivery driver for Silvio's in 1987 store manager 1989 built 17 store network.
2004	Key franchisee Andrew Rennie with 9 stores merges into corporate network, takes equity combined management group control 25.5%.
2004	Domino's Pizza Inc listed on New York Stock Exchange.
2005	April – Domino's Pizza Enterprises lists on exchange 60 million shares @ \$2.20 per share total stores 333.
2005	July – total stores hits 387 339 Australia 48 New Zealand.
2005	November – Domino's launches new internet ordering system.
2006	May – acquires master franchise for Netherlands, France & Belgium from US parent for \$A14.8m operate 153 stores.
2006	September – opens 600 th store in Australia NZ.
2007	January – expands European pizza chains with two acquisitions totaling 17 stores lifting total international stores to 180.
2007	Network sales top \$500m.
2008	March – acquires Pinky's Pizza 27 stores located in Victoria NSW South Australia.
2009	December – acquires 15 stores in Belgium lifting country stores to 31.
2009	Network sales top \$600m.
2011	November – CEO Don Meji renews managing director's role for further 5 years.
2011	Network sales top \$700m.
2012	September – company's announces \$30m capital return in two tranches Dec 2012 June 2013.
2012	Network sales top \$800m.
2013	August – acquires 75% interest in master Japanese franchise from Bain Capital for \$A135m and on lends further \$A101m to JV company. Japanese operations began 1985 becoming 3 rd largest domestic player 259 stores including 216 corporate 43 franchise 2013 operations generated \$A252m revenue \$A28m EBITDA enterprise value multiple 10.2x.
2013	Launches 5:23 rights issue at \$10.20 per share to raise \$A156m. Major shareholder Somad Holdings with 27% shareholding confirms taking up full entitlement.
2013	Post-acquisition total store numbers hit 1,229 across 6 countries group revenues \$546m group underlying EBITDA \$84m.

Table 2: Domino's Pizza Enterprises financial summary 2006-2013

\$'m	2006	2007	2008	2009	2010	2011	2012	2013
Network Sales	359.4	518.9	591.2	676.4	694.3	746.4	805.3	849.0
Revenue	172.9	230.1	229.6	239.0	236.1	246.7	264.9	295.0
EBITDA	24.7	22.0	25.3	28.3	32.5	39.1	48.1	56.0
D&A	(6.0)	(6.8)	(6.2)	(6.4)	(8.0)	(8.7)	(10.0)	(12.8)
EBIT	18.7	15.2	19.1	21.8	24.5	30.4	38.1	43.2
Interest	(1.6)	(2.9)	(2.1)	(1.6)	(0.8)	(0.7)	(0.5)	(0.4)
EBIT	17.1	12.3	17.0	20.3	23.7	29.7	37.6	41.2
Tax	(4.1)	(3.2)	(5.2)	(4.9)	(5.9)	(8.2)	(10.7)	(12.1)
NPAT	13.0	9.1	11.8	15.4	17.8	21.4	26.9	28.7
EPS ¢	21.7	14.8	18.4	22.6	26.2	31.3	38.9	41.0
DPSC	10.9	10.9	10.9	12.4	17.8	21.9	27.1	30.9
Revenue Growth %	29.6	33.1	(0.2)	4.1	(1.2)	4.5	7.4	5.5
EBITDA margin %	14.3	9.6	11.0	11.8	13.8	15.8	18.2	18.9
EBIT margin %	10.8	6.6	8.3	9.1	10.4	12.3	14.4	14.6

As **Table 2** highlights, on any financial metric, the Domino's Pizza business ticks all the boxes. Until recently, Domino's Pizza Enterprises held the exclusive master franchise rights for the Domino's brand and network in Australia, New Zealand, France, Belgium, and the Netherlands. In August the group added Japan to this list, a move that is likely to underpin solid growth for a number of years.

Graph 1: Domino's Pizza Enterprises following Japan master franchise acquisition

EXPANDED DPE FOLLOWING ACQUISITION OF DPJ

1,229 stores across 6 countries⁽¹⁾



Domino's Pizza Enterprises

Stores: 1,229⁽¹⁾
Pro-Forma ("PF") Network Sales: A\$1,117m⁽²⁾
PF Revenue: A\$546m⁽²⁾
PF Underlying EBITDA: A\$84m⁽²⁾



Australia / New Zealand⁽¹⁾⁽²⁾

Corporate Stores	84
Franchise Stores	501
Total Stores	585
Store Target	750 ⁽³⁾
FY2013 Network Sales	A\$563m
FY2013 Revenue	A\$174m
FY2013 Underlying EBITDA	A\$49m



Europe⁽¹⁾⁽²⁾

Corporate Stores	55
Franchise Stores	330
Total Stores	385
Store Target	1,250 ⁽³⁾
FY2013 Network Sales	A\$286m
FY2013 Revenue	A\$121m
FY2013 Underlying EBITDA	A\$7m



Japan⁽¹⁾⁽²⁾

Corporate Stores	216
Franchise Stores	43
Total Stores	259
Store Target	600 ⁽³⁾
Mar-13 LTM PF Network Sales	A\$269m
Mar-13 LTM PF Revenue	A\$252m
Mar-13 LTM PF EBITDA	A\$28m

Note: (1) DPE and DPJ store numbers as at 30 June 2013 (2) DPE underlying financials for the year ended 30 June 2013. DPE financials based on underlying financials adjusted to exclude transaction, acquisition and additional legal charges relating to acquisition activity and costs associated with ongoing legal claims in France. DPJ financials for the year ended 31 March 2013 converted from JGAAP to AIFRS. DPJ financials converted to A\$ based on an average AUD:JPY exchange rate over the 12 months ended 31 March 2013 of 1:85.6. Pro-forma adjustments to DPJ financials under DPE ownership include removal of the historical Bain Capital management fee and inclusion of additional ongoing DPJ costs resulting from the acquisition of DPJ by DPE (3) Store targets based on DPE management estimate



The Domino's winning formula can be put down to a number of factors, however, our observations would highlight three key points. The first is management, led by CEO Don Meji and a team of seasoned operators who have come through the ranks. The second is product innovation and a preparedness to lead. And lastly the incorporation of technology, so as to position both the product and service offering at the leading edge of customer demands.

Today, the operations of Domino's Pizza Enterprises extends over six countries, with more than 1,200 stores and employing over 26,000 employees, making the group the leading international Domino's operator.

Australia

In the group's core market segment of fast food, the company estimates that Australian pizza sales accounts for only 15% of the total fast food category spend of \$15.4 billion and that Domino's share of the pizza market is 21% and therefore only 3% of this category.

Total store numbers currently total 585, with 501 of these run on a franchisee basis and management targeting 750 in total. During 2013 the group's gross total network pizza sales hit \$563 million, while group revenues, a combination of company run corporate stores and franchisee fees received totaled \$174 million. From this the company generated earnings before interest tax and depreciation (EBITDA) of \$49.2million equal to an operating margin of 28.2%.

Europe

In Europe, the story thus far has been somewhat tougher. Whilst management has worked hard to grow sales and profits, a number of cost factors have slowed the rollout of new stores. Operating in three markets, the group is yet to enjoy the scale efficiencies that characterize the Australia operations. With a current total store count of 385, of which 55 are company owned, the group generated gross network sales of \$285 million and group revenues of \$121 million, giving rise to an EBITDA of \$7 million and a margin of 5.6%. Management is confident that following a number of years of investment, the group's total store target number of 1,250 remains within sight, which should give rise to an expanding profit margin.

Japan

In August, management added Japan to the group's master franchise operations, following a deal with private equity capital group Bain Capital to acquire 75% of the business for an outlay of \$A135 million as well as providing an intercompany loan of \$A102 million to secure the deal. Under the terms, Domino's has paid an equivalent 1.1 times Domino's Japan's 2013 revenue figures of \$A252 million and 10.2 times the operations EBITDA of \$27.7 million.

In the conference call given at the time of the announcement, Domino's management noted that the option to acquire this master franchise was available back in 2010, however, Europe was a key focus and so the opportunity lapsed. This time round, the offer and timing proved too attractive on number of levels. Foremost, current owners Bain Capital had done an excellent job in growing the business to its current level of 259 stores, with 216 corporate stores dominating the mix. However, a concerted effort would be made to lift franchisee stores from 17 per cent of the network to about 30 per cent, with the opportunity to offer franchisee funding to high-performing store managers. This would release capital for the franchisor enabling further store growth and enhancing profitability and lifting operating margins.

Secondly, the chain enjoys operational scale and is currently ranked third in term of store numbers, behind Pizza-La Japan and Pizza Hut Japan with 536 and 365 stores respectively.

Thirdly, the current leadership team has been retained along with minority shareholder Bain Capital, who have committed for a minimum three years. And finally, Domino's is bringing considerable know how and technology acumen to Japan, aiming to reposition the location of stores to higher profile areas and expand the coverage from the current 259 stores to a 600 store target over the medium term.

This will see the Domino's global operational mix shift from the current two regions to a more even spread across three regions as highlighted in **Table 3**.

Table 3: Domino's before and after Japan master franchise acquisition

	Before	After
Store by geography		
Australia NZ	585	585
Europe	385	385
Japan	n/a	259
Total stores	970	1,229
Revenue		
Australia NZ	174	174
Europe	121	121
Japan	n/a	252
Total revenue	295	546
EBIT		
Australia NZ	41	41
Europe	2	2
Japan		21
Total EBIT	43	64

* Domino's Pizza Enterprises presentation

Technology

Time will tell whether management have got this call right but when it comes to adopting new technologies to meet customer demands CEO Don Meji is supremely confident as he recently noted, "We are Australia's most sophisticated online retailer -- 60 per cent of our sales are digital". It is also why he remains upbeat on the Japanese opportunity pointing out that online applications would be rolled out as part of a complete overhaul of the ordering platform and internal processes. And in a world of rising competitive pressures those who adopt new technologies to drive scale and efficiencies will be better positioned to meet the challenges.

Having embraced the power that new investment delivers, CEO Meji isn't about to drop the ball. Already 40% of customers in Australia choose home delivery, arriving on average 24 minutes later and tracked online if need be. The group has never been afraid to embrace new technology evident by the rollout of the PULSE point of

sale management system that enables operators to know precisely how each store is performing. Overseas, the group continues to roll out new offerings including an iPhone application and mobile website in France, helping online to pass 25 per cent of sales.

The prize

Domino's business focus is very simple and the reward significant should they get it right. Management have stuck to a proven formula, underpinned by a menu offering involving a single pizza size offering with additional side orders. Backing this up are regular brand campaigns promoting new menus, supported by an efficient ordering system whereby the staff are trained to offer the best of service and are highly rewarded via its hybrid business model that covers both corporate and franchisee store ownership. The core management team at Domino's have highlighted what can be achieved as outlined in **Graph 1**. In Australia, the aim is to lift store numbers from 585 to 750 and double turnover from the current \$500 million. In Europe, the focus will be on lifting franchisee stores in each country and overall store numbers from 385 to 1,250. In Japan, it is early days but the current 259 stores are set to rise to 600 over the medium term.

Summary

IRESS and Domino's Pizza Enterprises are two companies that illustrate what can be achieved by taking considered steps, by remaining financially disciplined and by making appropriate investments today in order to stay relevant tomorrow. Businesses that are prepared to think and invest for the long term invariably succeed and it is a lesson for investors to adopt a similar philosophy when searching for the next investment opportunity. **SFM**

Papua New Guinea

We travelled to Papua New Guinea (PNG) during September, being our first trip to our northerly neighbours. Ignorance is sometimes best dealt with by visiting a place first hand. Until our trip we knew little about the country or its history, other than general information. Interestingly we learnt that the country sits on the same time zone as Australia and that it is a relatively short three and a half hour commute from Brisbane.

We arrived a few days prior to the country's official Independence Day celebrated on 16 September. PNG's history is such that it was under Australian rule before gaining independence in 1975. Prior to our visit we were warned that the country still lacked many of the amenities we take for granted here, including the relative safety of walking outside. In many ways we were unsure what to expect and following our three day visit to the country's capital Port Moresby, we left a little uneasy with the current situation.

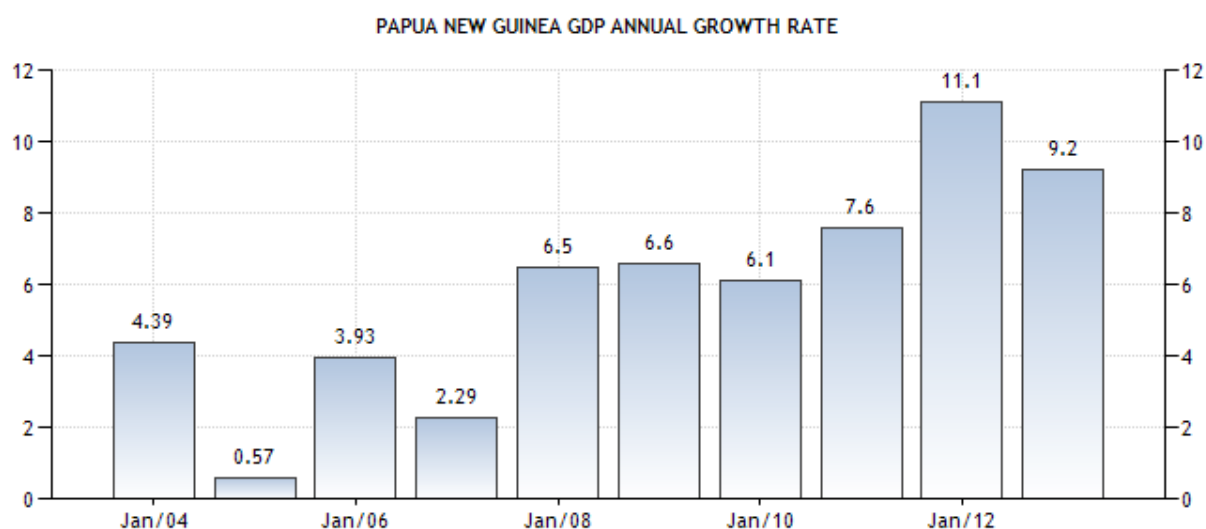
While we did venture down the main street during one of the days, the social issues confronting the country are clearly evident. Night time is a different situation altogether and travelling by car is the only option with an estimated 60% - 90% unemployment rate in Port Moresby. Our accommodation at Ela Beach, located opposite the city's main beach, illustrated perfectly the security issues facing visitors, with the main entrance is protected by locked gates and patrolled by security guards. Local infrastructure is a big issue and many of the amenities are basic in the extreme, making economic progress, if that is what we are to judge things on, difficult but not impossible.

In many ways PNG is caught between a rock and a hard place. It has natural beauty, abundant resources but a large population base that is still wedded to the land. Of PNG's seven million estimated inhabitants, around one

million are said to be reasonably well off while the remainder struggle to live above the poverty line. Our visit to a newly developed shopping centre illustrated perfectly the gulf that exists between those living above and below the poverty line. In fact, you could have mistaken the centre as the equal to any found in Australia, except for the shopping lanes that were wider and the more expensive product prices. For even the very basic food items, like tuna and milk, ticketed prices ranged some two to three times dearer than what would typically be found here. How the locals can afford this, is hard to fathom, let alone the residential property rents that can average \$3,000 kina or about \$1,500 per week.

Short distances from the shopping centre precinct, a section of the PNG community, line the street with little to do, lighting fires randomly and chewing betel nut. The contrast is confronting and hard to reconcile. PNG occupies the eastern half of the island of New Guinea, the western half forms part of the Indonesian provinces of Papua and West Papua. The country is widely diverse, is said to have 841 odd languages listed and where the majority of the population still practice subsistence based agriculture. Rich in commodities, PNG has become the sixth fastest growing economy in the world. Gross domestic product (GDP) has been running above 6.0% since 2008, hitting 11% in 2012, as evident **by Graph 2** below.

Graph 2: PNG GDP growth rates



SOURCE: WWW.TRADINGECONOMICS.COM | BANK OF PAPUA NEW GUINEA

Central to this growth has been the US\$22 billion development of the PNG LNG Project, the largest single development in the country's history. Now approaching completion, the capital expenditure slowdown is already having an impact with growth expected to step down, however, this will prove to be a temporary blimp with the Project's opening in late 2014 expected to lift GDP growth close to 20% in 2015. Over the 30 year life of the project, the PNG government is expected to receive some US\$30 billion in tax, levies and royalty payments. The Government will also benefit through its direct shareholding in Oil Search who in turn controls 29% of the LNG Project.

The issue that will confront newly elected Prime Minister Peter O'Neill is how to implement the many economic reforms in a country that lacks a strong judicial system and where corruption is rife. There are no easy solutions

and while our hearts will wish the country well as it undertakes this delicate transition, our heads sense the social dangers ahead. As one of the world's least explored countries, PNG is trying to move ahead and will no doubt welcome the revenues that will flow from the LNG Project over the ensuing years. Let us hope that this Government can avoid the corruption issues faced by so many other undeveloped countries and so allow its people to share in life's basic requirements. There is much to do and we would venture that a visit ten years from now will hopefully reveal a vastly different country, one open for business and a society coming to grips with change. **SFM**

Amazon - out with the old and in with the new

During August online player Amazon.com did something quite remarkable, it bought a newspaper. Not any newspaper, but the Washington Post. In 1994 Amazon was incorporated to sell books online, listed on Nasdaq in 1997 at US\$18 per share and today is selling for US\$320, valuing the business at US\$147 billion. In contrast, the Washington Post has a history that stretches 125 years and at the time of Amazon's listing was turning over US\$813 million and earning profits of US\$163 million. Last year the paper lost US\$54 million on revenues of US\$583 million. Amazon led by founder Jeff Bezos bought the paper for US\$250 million. In his letter to the employees of the Washington Post, Bezos wrote, "There is no map, and charting a path ahead will not be easy. We will invest, which means we will need to experiment. Our touchstone will be readers – understanding what they care about. And the paper's duty will remain to its readers and not to the private interests of its owners."

In the 18 years since founding the business, Bezos has grown the business, adjusting and experimenting as he went along. From a small online bookstore the business has morphed into all avenues of online businesses, spanning retail and computer services, in short, selling everything.

There is a lesson in all this. There is nothing certain in life other than death and taxes. Businesses live and breathe and their ultimate survival is very much dependent on how well they adapt and survive. For investors the danger is in ignoring the past when considering the future but the opposite is also true, that to rely on the past to chart a company's future success is not without considerable risk. Closer to home Fairfax Media has dropped the ball and its history has been well documented, having not taken advantage of the sea change to online.

Running and managing businesses are not easy. Tackling the black and white, day to day issues of business life forms a key part of management's duties, however where they really earn their keep is in dealing with the grey issues. Adapting and charting a course that is not yet clear, requires purpose and boldness. It is not without risk but it is essential, that as investors, we give management teams and their boards the scope to try new things and explore into uncharted waters. To simply stick to the middle and think that somehow we will avoid the dynamics of change is both foolish and likely to come at some at considerable future cost, just ask the shareholders of Fairfax. **SFM**

Europe on the mend

The European recession has been so deep and gone on for so long that any small improvement will be jumped on as a sign of better things to come. Perhaps that's a bit premature but already some of the central issues that have bogged Europe down are dissipating, even though the scars of high unemployment and high government debt levels remain firmly entrenched. As **Graph 3** highlights there is now scope for optimism.

Graph 3: Euro zone GDP trend since 1996-2013



The 17 nation Euro zone recorded a positive quarterly gross domestic product rise of 0.3% for the second quarter in 2013, reversing six straight quarters of contraction, the longest slump since the Euro's debut in 1999. It is but a small step as a number of southern countries including Spain, Italy, and Greece remain in recession, with high unemployment levels and showing few signs of positive progress.

Overall Euro zone unemployment remains stubbornly high at 12.1 per cent, while almost one quarter of young adults are out work. The European Central Bank is prepared to keep interest rates at record lows for an extended period in order to bolster the economy, however, the jury is out on whether this will be enough. The risk is that while a positive set of GDP numbers is obviously welcomed, whether this will be high enough to bridge the gap between that delivered and that required for the fiscal numbers to add up remains the most pressing issue.

Having stemmed the panic that gripped the Euro zone, the task at hand now is to stabilise and restore confidence. While it is difficult to make bold predictions of what may lie ahead, the US economy's improving outlook is illustrative of how small incremental positive steps can change the economic course. An early supporting indicator is the increasing flow of money into European financial markets, that if maintained should manifest itself in improving economic activity down the track. **SFM**

Technology: Avoid it at your peril

Change is both an opportunity and a threat. As our lead article highlighted, businesses like IRESS and Domino's Pizza Enterprises have adapted and sought to differentiate their offering thereby remaining relevant. In an age where organic growth is difficult, it is incumbent on management to seek out any advantage on offer.

However, there is a price to be paid and it comes in the form of investment. The arrival of the digital age so evident with the shift of business to online is forcing the hand of business managers. No longer can they view technology and digital investment in isolation to the business. In a recent research paper released by IBM, the company predicts a widening gap between those enterprises that embrace a digital transformation and those that stick to business as usual. The report follows on from work undertaken by the National Institute of Economic and Industry Research (NIEIR), in which it aims to provide evidence so as to encourage businesses to take advantage of key technologies in order to build a sustainable future. These technologies include high speed broadband, mobile devices, cloud computing, robotics and intelligent systems.

The report which can be found at www.ibm.com/au/eraofsmart provided hypothetical comparisons between two businesses where one adapts and is proactive and the other resistant to change. IBM shows that by 2025 these two retail businesses would have diverged to such an extent that one is worth \$78 billion while the other only \$1.5 billion. Success can compound rapidly as these numbers would suggest but rather than focusing on the extremes of these outcomes the underlying message is clear and it is a view we wholeheartedly agree with.

Dr Peter Brain, founder and executive director of NIEIR said "the report shows that the biggest risk for enterprises is failing to develop and implement strategies that transform their operations for the digital era. Our research has highlighted how much the world is going to change over the next decade - in a number of sectors we are at a tipping point between an analog world and the coming digital one."

It is also a wakeup call for investors to seek out businesses and management teams who are preparing for a more competitive digital future. Simply focusing on maximising profits today won't be enough and shareholders need to consider the broader long term ramifications of taking short cuts on investment.

In our March 2009 quarterly newsletter which is available via our website, we profiled a business that resurrected itself and has maintained that lead ever since, supermarket leader Woolworths. A tradition of past CEO's who have embraced the power of investment is continuing under the guidance of current chief Grant O'Brien who knows full well that he has no choice given the dramatic changes occurring in consumer behaviour and the potential threat to his business from international retailers.

Where this is most evident is that for the first time, the money earmarked for the Woolworths supply chain's information technology, multi-option strategy and stay-in-business projects will exceed refurbishment. The company says the total group will spend \$603 million on this critical segment in 2014 while refurbishment will be \$472 million. The company plans to spend another \$250 million on new stores and \$140 million on Masters home improvement stores.

The continued strong focus on bricks and mortar is evident from the fact that Woolworths will spend \$880 million on property developments in 2014. Walking through a Woolworths store or a Dan Murphy liquor outlet illustrates perfectly where the group's investments are having their biggest impact. Upgraded point of

sale systems currently being implemented throughout the group's 3,000 stores will improve customer service and provide valuable data analytics while core systems that connect with suppliers will drive greater efficiency.

In the fullness of time, O'Brien's click and collect omni-channel model will have customers accessing product information online, that either locates a nearby store or allows for a pick-up of goods from a convenient distribution centre. Woolworths is preparing for a digital world and so too are many other businesses and their leaders. They have our support because to do otherwise would be shortsighted whilst opening the door to a growing number of new and nimble competitors. **SFM**

Company visit diary September Quarter 2013*July*

ASX	ASX company visit	03/07/13
SDF	Steadfast Group IPO meeting	05/07/13
SKC	SkyCity Entertainment Group conference call	08/07/13
ALU	Altium conference call	09/07/13
JIN	Jumbo Interactive conference call	11/07/13
ISN	Isona management meeting	12/07/13
ALQ	ALS acquisition conference call	16/07/13
IPP	iProperty Group conference call	17/07/13
NEA	NearMap conference call	24/07/13
BKW	Brickworks management meeting	25/07/13
NVT	Navitas FY13 results briefing	30/07/13

August

RMD	ResMed FY13 results conference call	02/08/13
IRE	IRESS Avelo acquisition conference call	06/08/13
COH	Cochlear FY13 results briefing	06/08/13
FXL	Flexigroup FY13 results briefing	07/08/13
FOX	21 st Century Fox FY13 conference call	07/08/13
FOX	21 ^s Century Fox investor day	09/08/13
JBH	JB Hi-Fi Industries FY13 results briefing	12/08/13
JHX	James Hardie Q1 14 conference call	12/08/13
DMP	Domino's Pizza Enterprises FY13 and acquisition conference call	13/08/13
REA	REA Group FY13 results briefing	13/08/13
SAI	SAI Global FY13 results briefing	14/08/13
CRZ	Carsales.com FY13 results briefing	14/08/13
CPU	Computershare FY13 results briefing	14/08/13
CSL	CSL FY13 results briefing	14/08/13
SKE	Skilled Group FY13 results briefing	14/08/13
AHE	Automotive Holdings Group FY13 results briefing	19/08/13
FWD	Fleetwood Corporation FY13 results briefing	19/08/13
ANN	Ansell FY13 results briefing	19/08/13
OSH	Oil Search HY13 results briefing	20/08/13
BRG	Breville Group FY13 results briefing	20/08/13
TRS	The Reject Shop FY13 results briefing	21/08/13
SUL	Super Retail Group FY13 results briefing	21/08/13
SEK	SEEK FY13 results briefing	21/08/13
EGP	Echo Entertainment Group FY13 results briefing	22/08/13
TTS	Tatts Group FY13 results briefing	22/08/13
JIN	Jumbo Interactive conference call	22/08/13
IFL	IOOF FY13 results briefing	23/08/13
CWN	Crown FY13 results briefing	23/08/13

NHF	NIB Holdings FY13 results briefing	26/08/13
TPI	Transpacific Industries FY13 results briefing	26/08/13
FLT	Flight Centre FY13 results briefing	27/08/13
AGI	Ainsworth Game Technology FY13 results briefing	27/08/13
AUB	Austbrokers Holdings FY13 results briefing	27/08/13
VRT	Virtus Health results briefing	28/08/13
WTF	Wotif.com Holdings FY13 results briefing	28/08/13
ALU	Altium investor day	29/08/13
OSH	Oil Search investor relations meeting	29/08/13
IPP	iProperty Group HY13 results briefing	30/08/13
SDF	Steadfast Group FY13 results briefing	30/08/13
BKL	Blackmores FY13 results briefing	30/08/13

September

IRE	IRESS management meeting	02/09/13
FLT	Flight Centre investor briefing	02/09/13
PPS	Praemium investor briefing	05/09/13
NHF	NIB Holdings management meeting	09/09/13
SST	Steamships Trading Company management meeting PNG	10/09/13
N/A	Bank of South Pacific management meeting PNG	11/09/13
IPP	iProperty Group management meeting	17/09/13
FPH	Fisher & Paykel Healthcare Corporation investor day	23/09/13
OTH	Onthehouse Holdings management meeting	24/09/13
ASX	ASX annual general meeting	25/09/13
SOM	Somnomed management meeting	25/09/13
OFX	OzForex Group IPO investor briefing	26/09/13

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