JM Financial Group

Issue 5: September 2015

Investment Newsletter

Market Performance (As at 30th Sep 2015)	September 2015 (%)	Calendar YTD (%)	1 Year Rolling (%)
S&P ASX All Ords Accum. Index	-2.50	-2.66	-0.16

Month in Review - *A review of events that influenced the share market in September.*

September capped off the worst quarter for equity markets in 4 years with the All Ordinaries Index breaching the 5000 point level and testing lows not seen since 2013. As the sell-off in all things China related continued in earnest, the US Federal Reserve erred on the side of caution electing to keep interest rates on hold.

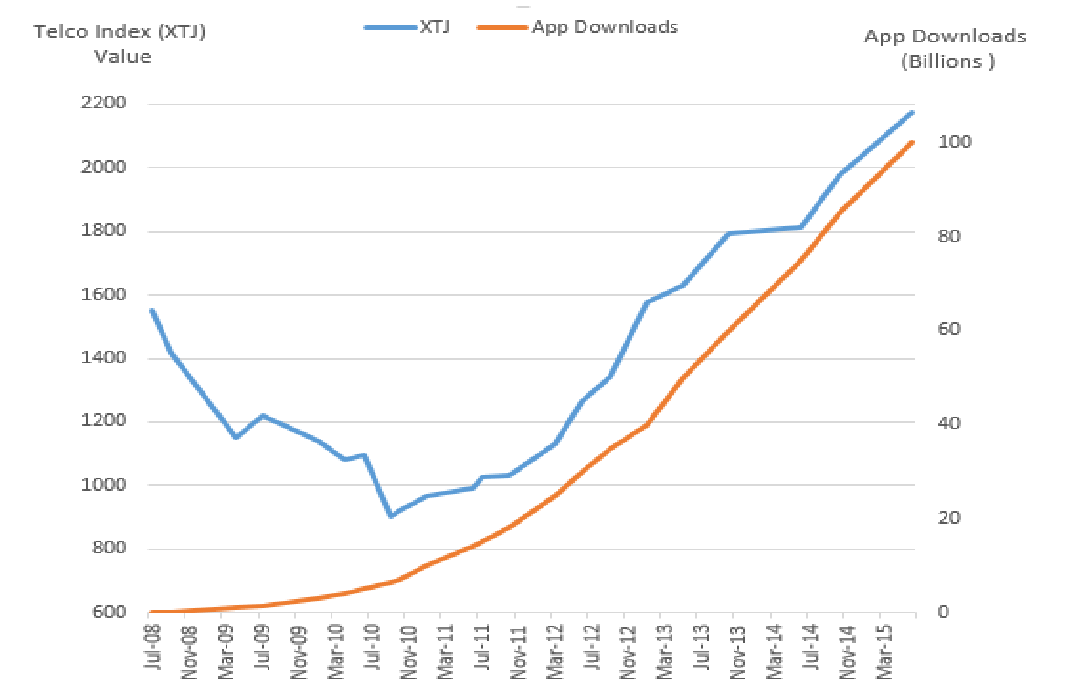
Whilst this was an attempt to steady markets and restore confidence it had the opposite effect, causing further selling and leaving investors uncertain as to how the underlying US economy was progressing. Federal Reserve Chair, Dr Janet Yellen, was quick to assuage investor fears, pointing to solid job gains, a low unemployment rate of 5.1% and increasing household spending and business investment.

Domestically our market suffered with resource stocks being the prime selling target as fears over a China slowdown continued to gather momentum. This culminated in a 3.5% one day fall late in the month after global resources powerhouse, Glencore, was sold down more than 30% in one night on the London Stock Exchange. Unsurprisingly, the 3.5% fall was led by BHP which fell to a 7 year low and saw many commentators calling for a revision to their progressive dividend policy which now sees BHP paying a forecast 7.5% dividend yield but potentially having to tap into its cash reserves in order to do so.

Throughout the turmoil there was a brief period of positivity when the wider business community reacted favourably to the change in PM, with Malcolm Turnbull being viewed as “pro-business”. With promises of a stronger economy and an increased focus on innovation and technology we look forward to this being translated into policy.

At the company level, Origin Energy (ORG) announced a $2.5bn capital raising to reduce its debt levels, Veda Group (VED) received a non-binding takeover from US rival Equifax and the frenzy of merger activity in the telecommunications sector continued with Vocus Communications (VOC) announcing a merger with M2 Group (MTU).

Chart of the Month – Cumulative App downloads through the Apple Store vs Performance of the Australian Telco Sector (XTJ)



With the release this month of the iPhone 6s we thought we would have a look at the correlation between the growth in App downloads and the performance of the Australian Telco sector.

A staggering 100 billion apps have been downloaded from the App Store since 2008.

Telcos have been able to offset the loss of home phone rentals and text message price deflation by focussing on data packages and bundling of deals for the next *must-have* iPhone.

Due Diligence – *A closer look at a company of interest.*

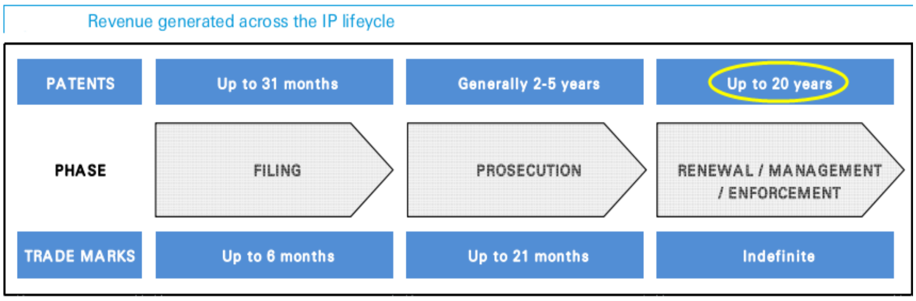
IPH Ltd – riding the innovation wave

After listing in November 2014, IPH Ltd has become one of the star performers of 2015. Although not widely known, IPH is the holding company for some of Australia's and Asia's oldest and largest intellectual property law firms including Spruson & Ferguson (est. 1887), Practice Insight and Fisher Adams Kelly.

The Group offers a range of services including providing protection, commercialisation, and management of intellectual property (IP).

The IP industry is dominated by the electrical, mechanical, engineering and pharma sectors and one only has to look at the ongoing IP battles between Apple and Samsung to realise how important it is for companies to protect their investments in innovation.

One of the attractions of IPH is the ability to earn revenues across the entire life cycle of intellectual property: the filing phase, the prosecution phase and the ongoing renewal phase. This can involve the payment of fees over the entire life of the patent or trademark which in many instances can be up to 20 years.



With the tremendous advancements in technological and medical innovation set to continue we think the future for IP protection and servicing is strong and IPH is ideally positioned to capitalise on that trend.

Whilst we enjoy highlighting our successes such as IPH it's worth also mentioning McMillian Shakespeare (MMS) which has struggled this month after hitting a yearly high in August. McMillian Shakespeare earns 70% of its profits from the provision of salary packaging services to employees. Unfortunately this leaves MMS vulnerable to selling pressure whenever there's a change of government or the words "tax reform" are whispered. We don't believe the Turnbull administration poses any serious threat to salary packaging or fringe benefits tax but we continue to watch the space closely.

Thought piece – *Free to Air TV and the Netflix Effect*

Normally we like to explore sectors and stocks we are attracted to but this month we want to take an in-depth look at a sector that we have actively avoided, Free to Air Television (FTA).

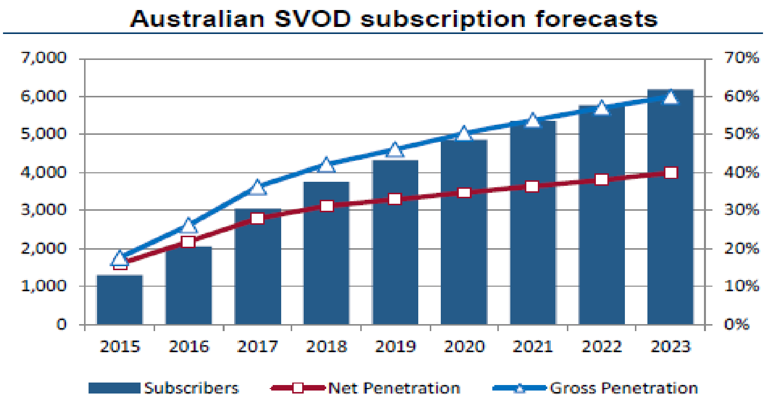
The share prices of the FTA operators have been savaged since Netflix's arrival in March; Nine Entertainment (NEC) down 23%, Seven West Media (SWM) down 46%, Ten Network (TEN) down 17% and Prime Media (PRT) down 39%. Clearly the market is beginning to recognise the threat from SVOD (Streaming Video on Demand) services such as Netflix and to a lesser extent, 'Stan' and 'Presto'.

Although Foxtel was disruptive upon its entry to the market in the late 1990s, its initial high price point and high installation costs meant that it was priced beyond the means of many. Fast forward 20 years and the combination of SVOD's low price points ($8.99 to $14.99 p/month) and increased penetration of broadband internet makes SVOD a significant threat to both traditional FTA networks and Foxtel.

A recent report from Credit Suisse highlighted that Netflix, which only launched in Australia in March had amassed 1.6m active users in its first 6 months of operation. The broker is forecasting more than 3m households (or 35% of all broadband connected households in Australia) to be using some form of SVOD by 2018.

Although these numbers seem high, SVOD has already penetrated 60% of broadband households in the US. This equates to a staggering 38m Netflix subscribers and 58m total SVOD subscribers.

We believe the adoption of SVOD is likely to place further downward pressures on both FTA audience numbers and associated advertising revenues.



Source: Credit Suisse

To further compound the issue, Google and Facebook are increasingly targeting advertisers, with Google's Youtube platform now reaching more 18-54 year old Australians than any FTA television channel and Facebook recently launching 360° interactive videos.

Although the mechanism through which content is delivered has changed dramatically, what is clear is that the demand for quality original and live content remains high. The challenge for the Australian FTA networks is to focus on transitioning to being foremost a content producer rather than a medium of delivery.