Selector High Conviction Equity Fund Quarterly Newsletter No.70

December 2020

In this quarterly edition, we review performance and attribution. We comment on company results and annual general meetings held during the period.

As new science transforms our lives we profile, CSL subsidiary and global vaccine manufacturer, Seqirus. From a technology perspective, we contrast global software giant SAP's, overdue business transition to the cloud, with the journey TechnologyOne has been on since 2016. We discuss the business transition underway at leading electronic circuit board designer Altium.

Through our Environmental, Social and Governance (ESG) lens, we highlight the apparent voting inconsistencies we observed during AGM season. Our 2020 ESG review looks at the importance of our company engagement program and why all our voting is conducted in-house. We close the quarter and year with our 2021 climate commitment.

Photo. At times it can be hard to know what is real or fake. Waving goodbye to the Trump dynasty.

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selector

Selector is a Sydney based fund manager. Our team combines deep experience in financial markets with diversity of background and thought. We believe in long-term wealth creation and building lasting relationships with our investors.

We focus on stock selection, the funds are high conviction, concentrated and index unaware. As a result, the portfolios have low turnover and produce tax effective returns.

Selector has a 16-year track record of outperformance and we continue to seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management.

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IN BRIEF – DECEMBER QUARTER

Dear Investor,

As we turn into the new year, the world will continue to focus on COVID, but another obstacle is visible across the horizon. It is called debt. Mountains of it in fact, with the Institute of International Finance (IIF) reporting global debt is estimated to hit US$273t by year end or 3.7 times gross domestic product (GDP). Governments cannot get enough of it. Over the past few months, each of NSW, Victorian and Queensland state premiers have handed down budgets, accompanied by colossal deficits and projected net debts in 2024 of $104b, $142b and $50b respectively.

To illustrate the point, NSW will see its net debt surge from last year's $19b to $104b by 2024. Yet the annual cost of servicing this debt, being 3.3% of state revenues, will stay roughly the same. The magic in this comes down to interest rates, with the state able to borrow for ten years at only 1.1 per cent. It appears no longer appropriate for central bankers to rely just on monetary settings to drive economic outcomes. Fiscal intervention, or the ability of issuing 'fiat money', being legal tender, whose value is backed by the government that issued it, is now driving and financing fiscal expansion.

COVID-19, or the response thereof, has followed in the footsteps of previous crises', be it the Global Financial Crisis (GFC) of 2008 or efforts to save the euro some years later. Such attempts to head off recessions and financial crises, have been met with massive expansions in global debt through the artificial suppression of interest rates and injection of huge amounts of liquidity. Governments have backed themselves into a corner and no amount of growth will alleviate or pay back the debt now being accumulated.

The legacy of this new normal is one where interest rates are likely to stay low for longer. When global GDP comes roaring back, as is widely expected in 2021, it will naturally give rise to discussions around interest rates and inflation. It is highly possible both are set to rise, but whether either are sustainable longer term, under the massive weight of government or corporate debt, is another story altogether.

When this time comes, as sure as night follows day, investors would do well to stop reading the daily financial news preaching of impending doom and gloom, of interest rates roaring away and the risk of rising inflation. These scenarios are indeed possible, but the situation we now find ourselves in, the interdependency of managing record high debt levels while maintaining employment numbers and economic stability, makes this a tricky if not impossible path to transverse.

If 2008 and indeed 2020 have taught us anything, it is that the social fabric of keeping things afloat will see governments go to extraordinary lengths to drive preferred outcomes, irrespective of their economic consequences. In short, markets have become too big to fail.

In this moment of crisis, high profile commentators will do their best to befuddle and panic you into action. The following extract released in June is illustrative of the emotive responses that have failed to materialise.

"Stock markets have dislocated from fundamentals. The economic fundamentals are almost as bad as they have ever been. Stock market valuations are almost as expensive as they have ever been. But that hasn't concerned markets for the past six weeks and, to be frank, it doesn't look like concerning markets any time soon. This is presenting you with a rare second chance to sell stocks in the face of the worst economic shock of our lifetime."

To the contrary, the best investment opportunities are invariably on offer during times of market dislocation for precisely the reasons reflected above, because investors panic. Whether Selector, as an investor, is successful this month, this quarter or this year, the point is we have a clear investment process that is adhered to regardless of external market behaviour. As we wrote in the depths of COVID-19 in our March 2020 quarterly newsletter to investors:

"It is important to appreciate there are many elements currently at play and to draw any meaningful long-term conclusions from such dramatic daily moves is unwise. To that end, while the immediate economic outlook remains unclear, company valuations are now offering compelling value. However, to suggest that we can

protect against further downside loss would be foolhardy of us and misleading to our clients. The companies we own are based on our assessment that good long-term returns can be generated. This encompasses not only owning businesses that possess attractive financial metrics, but more importantly the right cultural setting that fosters and encourages business ownership, transparency and accountability throughout the organisation. In this unprecedented and fast-moving environment, we will continue to act as required and always with a long-term perspective."

We now know the Australian share market, as measured by the All-Ordinaries Index, ended the year on a high note, finishing at 6,851 points following its recovery from the steep sell off and Index low point of 4,429 set in March.

In this quarterly we cover a range of topics, including a review of businesses that reported during the quarter. We follow up with a deep dive into one of Australia's most valuable companies CSL, or more precisely the wholly owned subsidiary held within, global influenza manufacturer Seqirus. We suspect this business will get a lot of air play over the coming decade.

Next, we consider the rapid business transition to cloud computing, a topic we have covered on multiple occasions. Here, SAP the world's dominant supplier of resource planning software, has all but abandoned its traditional on-premise sales model, announcing instead a fast tracked shift to the cloud. In short, a megatrend with a long way to play out. To this, we can also add the business developments over at leading electronic circuit board designer Altium. As the company 'hard pivots' to the cloud, we provide an external perspective on the group's latest offering, Altium 365.

We follow up with another discussion on proxy advisors and the voting inconsistencies that are becoming all too common and lacking proper transparency, thereby depriving shareholders with an appropriate appreciation of the issues at play.

Finally, we revisit Climate change and Selector's progress surrounding Environmental, Social and Governance (ESG) matters.

For the December quarter, the Portfolio delivered a gross positive return of **10.63%** compared to the S&P ASX All Ordinaries Accumulation Index, which posted a gain of **14.43%.** For the 2020 calendar year, the Portfolio delivered a gross positive return of **5.14%** compared to the Index which posted a gain of **3.64%.**

We trust you find the report informative.

Regards,

Selector Investment Team

Observations

In a little over a decade, we have had two seismic market events. A financial one in 2008, the other self-induced in 2020. If we learn nothing, then we are prone to repeat the mistakes of the past.

Our learnings

"It seems to us the more you think about protecting your capital, the more likely you will gravitate to thinking short-term at the expense of considering the long-term potential. It strikes us as very counter intuitive trying to protect something when in doing so, it is likely to lead to more damage in the long run. This is because it changes your mindset and your actions become more conditioned to short-term events be they, company specific or within the broader economic context. You succumb to the noise of the market."

Selector Funds Management

PORTFOLIO OVERVIEW

Table 1: Performance as at 31 December 2020*

	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	15 year	Since Inception
Fund (net of fees)	10.54	14.66	3.42	13.52	13.72	13.66	9.55	11.24
Fund (gross of fees)	10.63	15.64	5.14	15.70	15.86	15.79	11.57	13.36
All Ords. Acc. Index	14.43	15.69	3.64	7.44	9.26	7.89	6.87	8.12
Difference (gross of fees)	(3.80)	(0.05)	1.50	8.26	6.60	7.90	4.70	5.24

Inception Date: 30/10/2004

**Performance figures are historical percentages. Returns are annualised and assume the reinvestment of all distributions.*

Graph 1: Gross value of $100,000 invested since inception

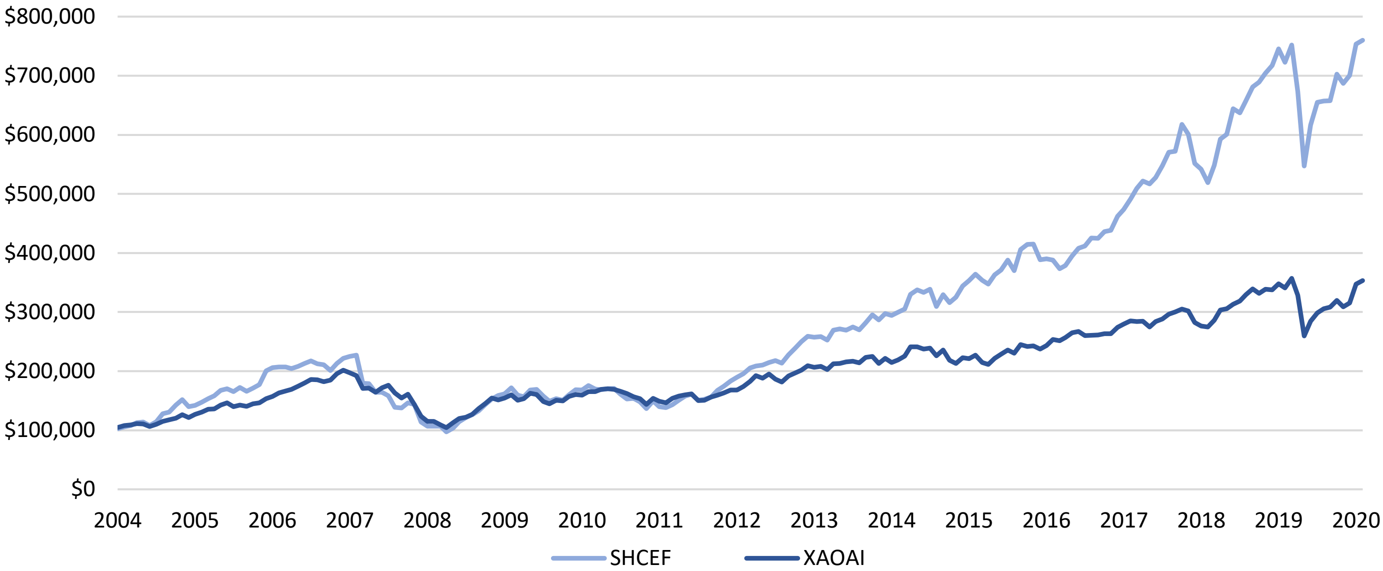


Table 2: Fund's Top 10 Holdings

Top 10 December 2020	%	Top 10 September 2020	%
James Hardie Industries	6.28	James Hardie Industries	6.11
Domino's Pizza Enterprises	5.90	Domino's Pizza Enterprises	6.04
Aristocrat Leisure	5.07	Altium	5.23
Reece	4.86	Carsales.com	5.05
Seek	4.80	Aristocrat Leisure	5.01
ResMed	4.65	Cochlear	4.83
Altium	4.41	Reece	4.77
Carsales.com	4.36	ResMed	4.57
Nanosonics	4.23	Iress	4.20
Iress	4.15	Seek	4.02
Total	**48.71**	**Total**	**49.83**

Table 3: Unit prices as at 31 December 2020**

Unit Prices	Entry Price	Mid Price	Exit Price
	$3.2325	$3.2244	$3.2163

Selector employs a high conviction, index unaware, stock selection investment strategy. 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.

Table 4: ASX sector performance – December 2020 quarter

S&P ASX Industry Sectors	Quarter Performance (%)
Energy	26.17
Information Technology	24.72
Financials	21.82
Materials	15.25
Telecommunications	12.29
A-REITS	11.83
Consumer Discretionary	10.93
Consumer Staples	6.25
Industrials	4.59
Healthcare	(1.14)
Utilities	(7.12)

Table 5: Fund's industry weightings

Industry group	December 2020 (%)	September 2020 (%)
Software & Services	24.04	25.19
Consumer Services	17.70	18.26
Health Care Equipment & Services	16.30	15.00
Media & Entertainment	10.64	10.29
Capital Goods	7.81	7.89
Materials	6.28	6.11
Diversified Financials	4.74	4.47
Pharmaceuticals, Biotech & Life Sciences	3.97	3.73
Insurance	2.50	1.91
Household & Personal Products	2.41	2.26
Automobiles & Components	1.94	1.96
Consumer Durables & Apparel	1.38	1.52
Cash & Other	0.29	1.42

Investment Transactions

Purchases

During the quarter, we initiated a position in **Medical Developments International** and increased our holdings in:

- Aristocrat Leisure
- Appen
- CSL
- FINEOS Corporation Holdings
- Fisher & Paykel Healthcare Corporation
- IOOF Holdings

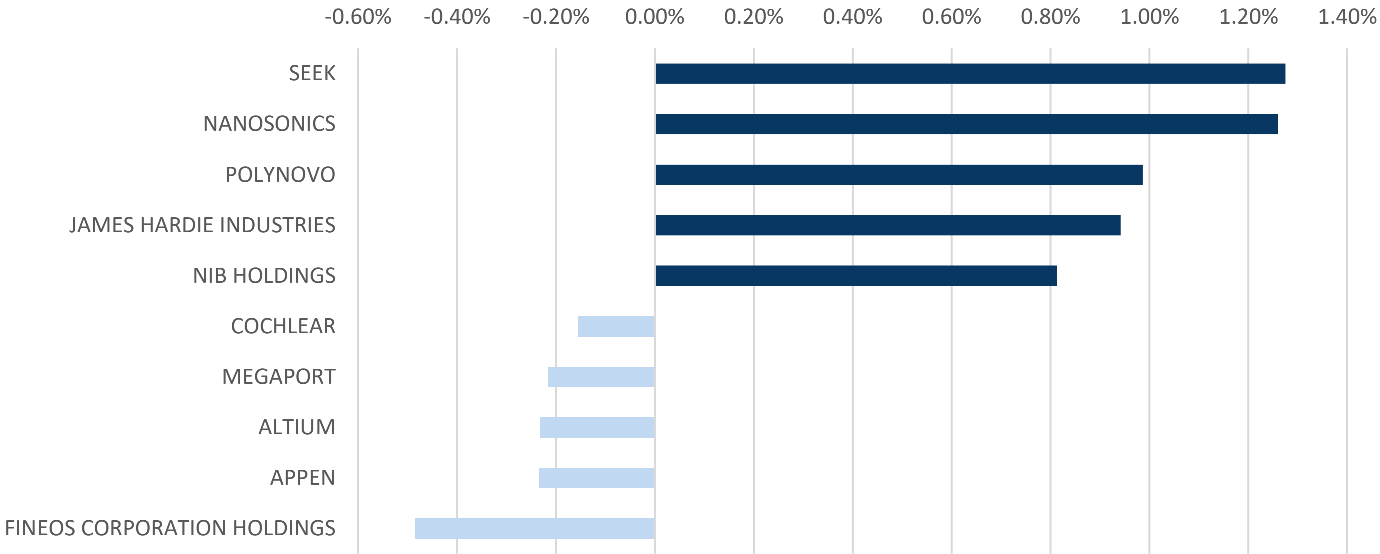
Sales

During the quarter, we reduced our holdings in:

- The Star Entertainment Group

PORTFOLIO CONTRIBUTORS

Graph 2: Contributors and Detractors – December 2020 quarter



Top quarterly contributors

1. Seek (ASX:SEK)

In November, Blue Orca Capital an offshore activist investment firm took aim at leading online employment group Seek by releasing a short seller report on the company. In the report, Blue Orca questions the legitimacy of posts hosted on Zhaopin, the Chinese recruiting platform owned 61% by Seek, and certain accounting decisions made by the company. Seek has given the report little credence noting that it is "*self-serving and unsubstantiated*".

Later that month, Seek released a trading update at its annual general meeting, confirming year to date revenues were well above the assumptions provided at the FY20 results release. The company credits the stronger than expected performance to the re-hiring of roles lost in the previous months, and growth in certain sectors.

The company also provided an improved 'illustrative' earnings scenario with operating profits (EBITDA) of $400m, down 4% compared to FY20, continued early-stage venture losses of $55m and net profits of $50m, down 45%.

Seek has a current market capitalisation of $9.6b and a stated net debt position at balance date of $901m.

2. Nanosonics (ASX:NAN)

In November, global leader in infection control solutions Nanosonics provided a trading update confirming a clear recovery was underway as the impact of the pandemic moderated. This recovery saw capital unit sales improving, as access to hospitals combined with remote customer engagement saw additional units installed. Consumables also improved against the final quarter of FY20 which saw a deferral of ultrasounds in response to COVID-19.

CEO and President Michael Kavanagh commented, *"despite ongoing periods of uncertainty we remain optimistic about the future and investments in our growth agenda continue across the business as we look to further expand our geographical footprint and product portfolio. We remain committed to doing everything we can as an infection prevention company to support all of our customers during these unprecedented times."*

The company ended the year with negligible debt, a cash balance of $91.8m and a current market capitalisation of $2.1b.

3. PolyNovo (ASX:PNV)

During the quarter, manufacturer of bio-resorbable polymer solutions, PolyNovo continued the company's progress across multiple fronts.

Strategically, management are focused on growing the NovoSorb Biodegradable Temporising Matrix (BTM) product across new and existing markets, focused on becoming the industry's standard of care. The business has been approved to enter multiple new markets and has appointed a range of distributors to sell into Taiwan, Greece and Finland and extended its relationship with PolyMedics Innovations to market BTM in Belgium, the Netherlands, Luxemburg and Sweden.

PolyNovo also received FDA approval for the pivotal trial investigation device exemption, which allows the group to begin recruitment to compare BTM with the standard of care in patients who have severe full thickness burn injuries. With an additional US$15m of funding from BARDA, the trial will recruit 150 patients across 25 sites, and is likely to begin in 2021.

CEO Paul Brennan commented, "*this is a significant milestone for PolyNovo. We are excited to begin this trial as it will build significant clinical data and further demonstrate the ability of NovoSorb BTM to enhance clinical outcomes and improve patients' lives.*"

In addition, PolyNovo announced an end to its partnership with Establishment Labs for its breast device development program, which will be brought in-house immediately. Focus has pivoted towards building a larger internal research and development (R&D) team that Chairman David Williams believes *"can develop breast and a number of other devices more quickly"*. The company's intent is reflected in the hiring of experienced industry veteran Anthony Kaye, who will lead R&D and manufacturing as PolyNovo's Chief Operations Officer (COO).

PolyNovo held its annual general meeting in November. Our views on this are detailed in the article "Proxy voting - lottery ticket".

PolyNovo has a market capitalisation of $1.7b and available cash of $11.6m.

4. James Hardie Industries (ASX:JHX)

Refer to the company commentaries article below.

5. NIB Holdings (ASX:NHF)

Health insurer NIB Holdings provided a positive trading update at its annual general meeting in November. For the first quarter of 2021, the company reported solid net policyholder gains in the Australian Residents and New Zealand Healthcare Insurance businesses. Importantly, churn declined compared to the prior comparative period. Indications suggest an overall industry bounce back, with COVID providing a renewed focus on health outcomes. As expected, NIB's International and Travel businesses have yet to recover.

From a health insurers cost perspective, claims benefits continue to rise well ahead of inflation, impacting the ability in some cases to service policyholders profitably. Insurers like NIB are working to find a sensible balance between affordability and providing the necessary medical access to customers. The company has responded with an approved 4.36% average premium increase across all products. Despite the large increase compared to other providers, CEO Mark Fitzgibbon notes that "*nib's products remain competitive and affordable with its products coming from a lower premium base compared to the industry average*."

NIB has a current market capitalisation of $2.7b, with net debt of $233m.

Bottom quarterly contributors

1. FINEOS Corporation Holdings (ASX:FCL)

Refer to the company commentaries article below.

2. Appen (ASX:APX)

Selector recently initiated a position in Appen, a global leader in high quality training data for machine learning and artificial intelligence (AI) products. Starting from humble beginnings in 1996 within founder Julie Vonwiller's suburban garage, the company has transitioned from a speech recognition start-up into a key enabler for the growth of AI. This transformation has been led by current Chairman Chris Vonwiller (founder Julie Vonwiller's husband) and CEO Mark Brayan, who has now been in the role for five years.

The group is primarily involved in data annotation; the process of collecting and labelling images, text, speech, audio, video and other data used to build and continuously improve AI systems. Organisations can outsource these requirements to Appen, removing a key bottleneck in the process, which is often described as the most labour-intensive task by data scientists and engineers.

Appen source their data labelling requirements from a highly experienced, scalable and diverse set of crowd workers. This resource and the platform used to manage it are key assets of the business. The over one million-strong crowd of skilled contractors, have expertise in over 180 languages and dialects across more than 130 countries and have a track record of completing projects to a high quality and in a timely manner for some of the globe's largest technology firms. Appen's unique offering complements the growing need for diverse and high-quality data sets used to continually improve AI models.

Appen derives the majority of revenues from Relevance, the business segment focused on providing annotated data used in search technology, which contributed $273.9m or 89.4% of group revenues for the half year 2020. The group's top five customers, who make up approximately 90% of total revenues, have historically delivered most of this growth as the need for Relevance data to improve the accuracy of search engines, social media and ecommerce applications has accelerated. As a result, Appen has benefited from unexpected surges in demand for data, which has led to multiple earnings upgrades.

In saying this, the company released a trading update to the market in November, lowering underlying operating earnings (EBITDA) guidance for the full year 2020 to $106m-$109m, compared to the $125m-$130m provided at the half year results in August. Management attributed the decline to exchange rate headwinds and the impact of COVID-19 on new business development, renewals with smaller customers and importantly, the lack of the usual last quarter calendar year demand ramp up from major customers.

Appen's business model is highly reliant on its major customers, and in this case the company was impacted on the downside. CEO Brayan explained traditional data refreshes, which occur late in the year, haven't been contracted as expected. He instead noted, *"our major clients are reprioritising resources towards new product areas that enhance their long-term resilience and value which is currently impacting work volumes on some large mature projects. This new product development trend is positive for us and we are seeing a significant increase in the number of new projects amongst our major customers, albeit some are early in their lifecycle."* The question remains as to whether the last quarter bump is simply delayed or lost for this year.

The company is confident data requirements are not being brought in-house, rather customers are re-prioritising investments towards new projects. This is reflected in the 32% year-on-year growth in the number of projects the company has been involved in for its major customers, which CEO Brayan notes as *"extremely positive".*

Despite the setback, Appen operates as a leader within its space, having a proven ability to efficiently scale its crowd workers as demand requires. Globally, there are few direct competitors with the scale to compete effectively. The group's nearest competitor is private equity owned Lionbridge, recently acquired by Canadian communications and information technology company TELUS for US$935m.

The acquisition emphasises the growing need for labelled data, as TELUS CEO Darren Entwistle explains, *"the addition of Lionbridge AI…will enable our team to support important AI applications as demand for high-quality, multilingual data annotation continues to increase."*

The group's Speech and Image division, encompassing speech, text, image and video data labelling, has experienced slower growth. For the half, the division recorded revenues down 20% to $31.9m, as customers impacted by COVID deferred work.

Despite the earnings downgrade, management remains confident in the group's long-term prospects following the 2019 acquisition of Figure Eight's technology platform, sitting alongside the company's scalable crowd worker network. The technology offers clients an integrated, secure platform to create, manage and monitor their data labelling projects, while enabling efficiencies across the crowd data labelling and hiring processes.

Having largely completed the integration of Figure Eight, management are lifting investment across sales and marketing. This spend is augmented by software development, covering a range of new business initiatives focused heavily on China and Government sectors. Early indications are positive, with both new customer wins across the shipping, automotive, education and healthcare verticals, and the company agreeing to a US$80m enterprise-wide platform contract with an existing major customer.

The trading update is disappointing and highlights both the lack of visibility Appen has on future orders, as well as the risk associated in having a concentrated customer base. Management are focused on matters within their control, which is to maintain the delivery of high-quality data at speed for customers.

As a leader in the data annotation space and with a competitive technology platform, the company has positioned itself well to benefit from an industry that is expected to deliver growth north of 20% annually. Financially, Appen has a capital light balance sheet and the ability to self-fund its growth initiatives for the foreseeable future.

Appen has a market capitalisation of $2.7b and recorded a net cash position of $92m as at 30 June 2020.

3. Altium (ASX:ALU)

Refer to the company commentaries article below.

4. Megaport (ASX:MP1)

Global cloud enabler, Megaport released its first quarter 2021 results in October, delivering record growth in ports, up 10% quarter on quarter (QoQ) and customers, up 7% QoQ. The company continues to grow its global footprint, having established its equipment in 385 (installed) data centres while being available for connection to 702 (enabled) data centres and 215 major public cloud provider locations (cloud on-ramps).

This diverse network is core to Megaport's growth, providing customers with the optionality to scale their cloud requirements effectively and almost instantly using its software defined networking (SDN) solution. COVID is expected to accelerate this demand, as businesses seek to bring operations to the cloud, in a secure manner.

CEO Vincent English highlights the progress seen in North America, a market heavily impacted by COVID, which *"yielded excellent results this quarter and contributed significantly to our record quarterly port and customer performance… North America is our fastest growing region with USD revenues growing 11% QoQ and now accounting for 47% of total revenues"*.

Revenue per port, a key metric for the company, declined by 7% QoQ to $913 as a result of unfavourable foreign exchange movements and a weaker previous quarter. This figure is expected to fluctuate as ports are rapidly added while the associated revenues take time to flow through.

Strategically, management has shifted focus towards further commercialising its vast network ecosystem, which spans 385 data centres, across 24 countries and 132 cities globally. The company announced the development of Megaport Virtual Edge (MVE) and the platform's first strategic collaboration with Cisco to enable SD-WAN capabilities for customers. This new development services a different use case and expands Megaport's total addressable market.

CEO Vincent English explains the strategic rationale well, *"Megaport remains committed to driving value for our customers, partners, and shareholders. We are constantly evolving our platform so our customers can more easily connect with the services they need to power their business. MVE will play a fundamental part in our success by allowing our customers to access Megaport's elastic interconnection platform from locations beyond traditional data centres — including branch offices, corporate campuses, and point-of-sale locations.*

Our neutral platform enables us to work with a wide variety of technology partners. Our collaboration with Cisco, to enable SD-WAN capabilities on our platform, coupled with our vast ecosystem of leading cloud and managed service providers, will empower our customers with greater choice and flexibility for building and managing multicloud architectures. We are committed to growing our ecosystem of technology and cloud service partners throughout this fiscal year."

Megaport has a market capitalisation of $2b and available cash of $152.8m.

5. Cochlear (ASX:COH)

In October, global bionic ear manufacturer Cochlear, provided a first quarter trading update at its annual general meeting. Here the company reported an improving trend despite trading below the prior corresponding period which was free of COVID impacts. Notably across the group's three reporting segments, cochlear implant revenues were running at 94% of last year's performance in constant currency (cc) terms, services revenue at 86% cc and acoustics revenue at 89% cc. Management noted good growth in the U.S., Germany and Korea as well as improved signs across many European markets. In addition, the new candidate pipeline was rebuilding as clinical assessments were close to pre-COVID levels.

Since this time, the pandemic has re-escalated across the globe, especially in the U.S. and Europe, two markets Cochlear has a strong presence in. As an elective surgery provider, Cochlear's demand is expected to decline in the short-term as hospitals prioritise COVID patients and lockdowns are enforced.

The company also updated shareholders late in December that its appeal in the US patent infringement case against Alfred E. Mann Foundation for Scientific Research was denied. The final settlement of two outstanding issues totalling US$75m will now take place, ending the patent appeal.

The company is well capitalised and held net cash of $457m following its recent capital raise. Cochlear has a market capitalisation of $12.5b.

COMPANY COMMENTARIES

Altium (ASX:ALU)

Leading electronic printed circuit board (PCB) designer Altium took the opportunity in its recent annual general meeting (AGM) to remind investors of its commitment to *"transformation through dominance"*. While transformation and dominance are important components of the same journey, the company hopes to leverage these separately as it drives deeper penetration of its design software and embraces cloud technology through Altium 365.

Altium's customers generally do two things:

1. Design electronics, namely PCBs, using the company's software; and

2. Collaborate with the supply chain and manufacturers to realise these designs.

The company has established itself as the pre-eminent provider of PCB design technology. However, it is now accelerating its push into simplifying and streamlining the production process, from initial design, parts sourcing and ultimately the manufacturing process, all realised from one place.

In terms of PCB design software, the company's commitment to two annual product releases continues with its latest iteration of Altium Designer, AD20, showcased earlier this year. The software has been proclaimed as a game changer within the PCB user community. At the 30 June balance date, the company's Altium Designer subscriber base stood at 51,006, surpassing the halfway mark of its targeted 100,000 subscriber base by 2025. Altium Designer remains the *"dominance engine"*, serving as the platform by which the company can transform the PCB industry and how it operates.

To deliver transformation, Altium has recognised that current processes for design collaboration are archaic, with engineers having to contend with various forms of communication and file transfer systems to share and discuss their designs. Through the company's latest platform offering, Altium 365, users host their designs on the cloud, enabling seamless collaboration across the supply chain in real time. As reported at the AGM, 7,450 active users and 3,739 active accounts have adopted Altium 365 since its launch in May. The company has undertaken little marketing, with growth to date driven by user experience and word of mouth.

Importantly, Altium will not require any change to its current designer software licensing model and is offering free standard access to Altium 365 for all users. A network effect should increase the rate of utilisation for users, reduce churn and in turn drive incremental software licence sales. Over time, the company is expecting to monetise transactions and premium services within the 365 offering.

Organisationally, the company's new executive structure has been referred to as their *"Netflix Moment"*, which in other words is known as a hard pivot to the cloud. The separation of the cloud business from the software business underscores the importance of this step, along with the appointment of Altium executive director and current Chief Technology Officer, Sergiy Kostynsky as its President.

For the 2021 financial year, the company reaffirmed revenue guidance within the range of US$200m and US$212m, representing an increase of 6% to 12%, and operating profits (EBITDA) between US$76m and US$89m, an increase of 38% to 42%.

Altium has a market capitalisation of $3.7b and a net cash position of US$93m.

Aristocrat Leisure (ASX:ALL)

Despite the challenges brought about by COVID-19, leading global gaming operator Aristocrat Leisure delivered a better than expected full year result. The company reported operating revenue of $4.1b, down 5.9% due to the negative impact casino closures and distancing requirements had on the group's land-based operations. Nevertheless, Aristocrat's digital offering largely offset this decline with revenue growing 29% to $2.4b, highlighting the importance of the group's operational diversity.

For the land-based operations, Aristocrat further extended its market leading gaming performance with the help of new game titles and strong performance from Dragon Link and the Buffalo series. Management noted the group commands 14 of the top 25 premium leased games in the market, according to the latest industry survey from Eilers & Krejcik. At the time of the results release, 92% of North American casinos were open, with 75% of Class III Premium and 90% of Class II gaming machines operational.

Throughout the COVID-19 period, the company focused on ensuring both technicians and digital solutions remained available for all clients. This was most apparent through the launch of a new business-to-business platform solution to manage a casino's loyalty program, promotional offers and digital wallets. This new offering helped improve the group's recurring revenue to 80%, while continuing to maintain a market-leading daily service fee.

Digital operations were a key standout in the group's results, supported by a higher penetration of social gaming during lockdowns. Bookings grew 31% to US$1.6b, with strong growth in the Social Casino and Strategy & RPG categories. A shift towards higher quality user acquisition was evident as Daily Active Users (DAU) declined 10.7%, while Average Bookings Per Daily Active User (ABPDAU) grew 43.9% to US$0.59. Management believes this trend will continue as the focus shifts to monetising high-value customers.

Like land-based, an emphasis was placed on enhancing customer interaction through the introduction of Live Operations (LiveOps) in social casino games. LiveOps are a way to offer new content, features and promotions, while providing regular events to improve customer retention and monetisation within a title. By period end, the company continued to diversify the digital game offering with new Social Casual titles, such as EverMerge, performing strongly.

Management has guided to further growth in market leading positions across all operations, both in gaming performance and overall market share. User acquisition spend is set to remain within the range of 25%-28% of overall digital revenue, and design and development (D&D) investment will be sustained. Higher operating costs are expected, further reflecting management's strategy to grow existing markets and explore new adjacencies.

Overall, even with the impact of COVID-19 on land-based sales, Aristocrat maintained a fully expensed D&D investment of $498m, resulting in an operating margin (EBITDA) of 26%. With prudent cost measures in place, Aristocrat has $2.0b of available liquidity, while generating $1.0b of operating cash flow for the period. The balance sheet remains strong with net debt to EBITDA remaining at 1.4x, well below its peers. This conservative approach to capital management has the business well placed to take advantage of new opportunities and further extend its market leading position.

Aristocrat Leisure has a current market capitalisation of $19.1b and net debt of $1.6b. The company also took the opportunity to reinstate the payment of dividends, with a final year payment of 10c per share.

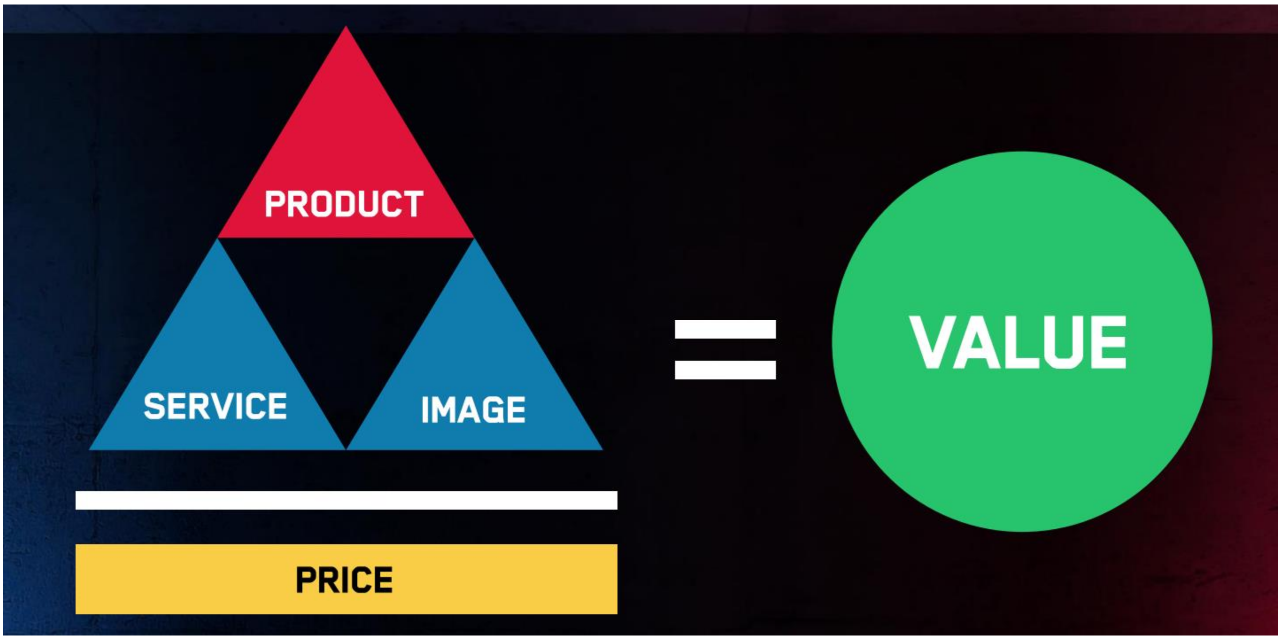
Domino's Pizza Enterprises (ASX:DMP)

In November, Domino's Pizza Enterprises held their 2020 annual general meeting. The group delivered a 14.9% increase in network sales and an 8.4% rise in same store sales for the first 17 weeks of the financial year. Online sales grew by 20%, with COVID accelerating the trend towards digital ordering and home delivery.

The group also increased its new store rollouts following the extended lockdown periods. A total of 74 stores were added during the first 17 weeks of FY21, compared to the 42 in the prior comparative period. The company recently opened its 2,700 store and remains on track towards achieving their long-term target of more than 5,550 stores by 2033. CEO Don Meij highlighted the substantial gains made in Japan, *"already this financial year, we've opened our 2,700th store and our 700th store in Japan, with this country overtaking Australia now as the largest market by store count in our business."*

The trend towards delivery and the internet of food has only accelerated, with Domino's being a key beneficiary due to its delivery-led model, investments across digital technology and its scalable and highly automated store network. The company's investor day provided additional insight into this and the other strategic measures being implemented across the group's three core regions of Australia and New Zealand (ANZ), Japan and Europe.

Figure 1: Domino's Pizza Enterprise – *"value"* proposition



Source: Domino's Pizza Enterprises Investor day presentation 2020

Domino's core value proposition, as a driver for repeat purchases, encompasses the three pillars of Product, Service and Image (PSI) at affordable prices. Although the go-to-market proposition does differ across regions, CEO Meij notes, *"the core drivers of PSI are universal across our business. In each market we listen to the customer to make sure that we're trying to exceed their expectations using the strengths of food quality, digital technology and super fast and safe delivery."*

This focus is technology-led aided by data inputs, thereby providing actionable insights and analytics to key stakeholders across the business operations, including marketing, operations and store development teams. By bringing data closer to the key decision makers, the company can make more informed, customer orientated decisions. The appointment of Pat Nestor as the new Group Head of Strategy and Insights is reflective of the company's commitment to data, which is becoming more significant as a greater share of customers utilise the mobile application or website for delivery.

The role of fortressing and scale is also integral to improving the PSI proposition, helping reduce delivery times and bringing stores closer to customers. As the world transitions towards convenience through delivery, it's paramount for Domino's to continue to offer a consistent, high quality experience. Germany CEO Stoffel Thijs explains the rationale for fortressing and scale, *"because with 8 stores in the city and our competition having 3, we're always closer to the customer. So, we'll deliver faster. The product will be fresher and it will be at a lower cost to the franchisee. Good luck competing with that. So, by fortressing a market, we reduce the delivery times by a lot."*

Japan and Germany are two markets which have benefited from an improved value proposition, reflected in strong network sales and earnings growth. Both regions are now operating at critical mass, as Domino's seeks to increase investments in television advertisements and store rollouts.

Specifically, in Japan, the model has shifted in a positive way. The two key changes worth noting include:

1. **Back of house dough making** – results in a more efficient supply chain, as complete dough balls are not being sent to the far ends of Japan, this lowers the input cost.
2. **National pricing** – similar to Australia, this change means a store outside the major cities of Japan will now have the same pricing as a store in Tokyo. In effect higher volume city stores are now subsidising regional stores who had lower volumes but higher input costs stemming from freight and supply chain factors.

CEO Meij remains positive on the company's long-term growth proposition noting, *"If we look at the last decade, a lot of the heavy lifting was done in that profit growth* *was from Australia and New Zealand and the Netherlands, whereas today, whilst those businesses continue to perform well, the really big shift in earnings is coming from the Japanese, German and now even the French business as we're seeing the increase in store growth."*

Domino's has a market capitalisation of $7.1b and net debt of $447m at the full year.

FINEOS Corporation Holdings (ASX:FCL)

FINEOS, the leading platform for life, accident and health (LA&H) insurance globally, provided an operational and trading update for the first quarter of FY21 at its recent annual general meeting. The company recently completed the acquisition of Limelight Health in the U.S., raising $93m from investors. The acquisition is expected to augment the company's existing capabilities and significantly expand its addressable market.

Founded in 2014, Limelight offers a highly configurable cloud-based platform to insurance carriers, providing quoting, underwriting and rating solutions. The company focuses on streamlining and automating critical workflows for its customers. Limelight is headquartered in San Francisco and employs over 120 staff, driving the total headcount of the group, post-acquisition, up to 1,040.

To date, FINEOS' platform offering has focused on back-office solutions across various insurance functions. While these products have been well received by the market, the company acknowledges many insurance carriers are seeking a solution that can successfully integrate both front and back office functions. Limelight fills this gap, making the acquisition attractive for enhancing the growth potential of the combined group.

FINEOS had previously flagged the need to bolster its North American presence, which represents 67% of its current revenue, up from 59% at year-end. Like FINEOS, Limelight operates under a highly experienced, founder-led management team who have been given responsibility for spearheading growth in North America. Limelight provides immediate access to boots on the ground, including an established ten-strong sales team.

Importantly, the company continues to focus on migrating customers from on-premise instances of FINEOS Claims to the cloud-based FINEOS Platform. At present, 64% of total revenue is contributed by software-as-a-service (SaaS) subscriptions and services.

We are supportive of management's long-term strategy in building a cohesive, unified platform to service insurance carriers.

FINEOS has a market capitalisation of $1.2b.

Fisher & Paykel Healthcare Corporation (ASX:FPH)

In November, leading respiratory care manufacturer Fisher & Paykel Healthcare reported its half year 2021 financial results. For context, the current period of April to September 2020 consists of six months impacted by COVID, whereas the prior comparative period reflects a more normalised business environment.

In saying this, the group delivered operating revenues of NZ$910.2m, up 59% for the half and an 86% increase in net profits to NZ$225.5m. Within Fisher & Paykel's two product segments, the clear growth driver was the Hospital division, rising 93% to NZ$681.0m. In the Homecare division, revenue grew 5% to NZ$226.2m. The uplift is reflective of the significant efforts across the organisation, as management overcame supply constraints and pressures from the hiring of more than 1,700 manufacturing staff, to ensure orders were fulfilled to a network of global hospitals.

The period also saw the business benefit from increased scale. Despite gross margins falling 534 basis points (bps) to 61.7%, due to increased use of air freight and associated elevated costs, the lower operating expense growth of 17% led to operating margins expanding 489 bps to 34%. Management expects this to normalise and is targeting long-term operating margins of 30%, coupled with a continuation of research & development investment, which increased by 20% during the half to NZ$64.6m.

Focusing on the Hospital division, COVID has accelerated the adoption of the group's hardware (humidifiers) and consumable products. During the period, hardware sales grew by 383% in constant currency (cc) to NZ$252.0m, while consumables contributed NZ$429m. The fast-growing new applications consumables made up of non-invasive ventilation (NIV), Nasal High Flow (NHF) therapy and surgical, accounted for 63% of this revenue and grew by 43% (cc) in the first half.

New applications remain a key performance metric for management, reflecting utilisation of its single use products, including Optiflow NHF.

The question now occupying the minds of many analysts is the durability of these elevated purchase levels. CEO Lewis Gradon rightfully points out the difficulty in modelling such outcomes, *"we have massive variability from month-to-month in both our hardware and our consumable revenue. If we look at a region over the 6 months, we have really big variability from month-to-month. It tends to track COVID hospitalisations."*

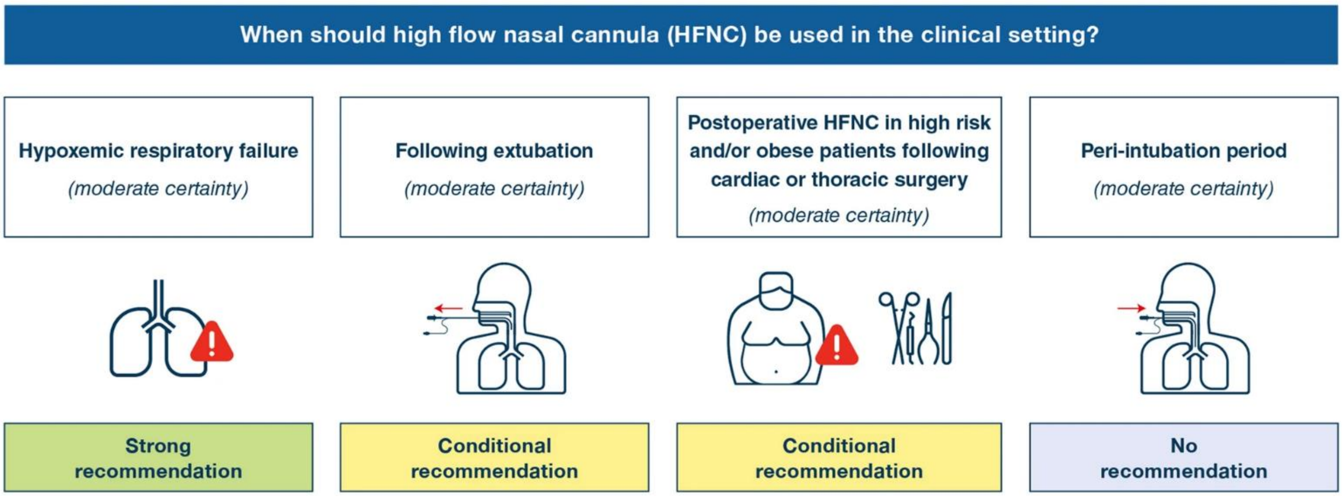
Rather than attempting to forecast the short-term outcomes, we prefer to look at the business from a longer term and bigger picture perspective. The accelerated adoption of humidifiers, to support nasal high flow (NHF) usage in COVID patients, has removed previous barriers that slowed decision making and implementations across hospitals. CEO Gradon notes the *"fundamental here is that we've placed a lot of hardware. So in terms of our normal selling process, we need to talk about clinical advantages and clinical benefits of Optiflow. We need to talk about the economic advantages and then we need to have our customer purchase some hardware. And then we need to go in and install it, and then we need to go in and train every single user in the institution on how to use it. So by placing all this hardware, we're certainly over half the hurdles. The job is half done."*

Fisher & Paykel's Optiflow Nasal High Flow (NHF) therapy aims to replace conventional oxygen therapy. It is a single use consumable offering, long been considered as a non-invasive alternative to the intubation of patients with respiratory disease. The company estimates the total addressable opportunity within the hospital setting, across emergency and surgical departments, intensive care units (ICU's) and wards, is approximately 50m patients. In the homecare setting, encompassing products used in the treatment of obstructive sleep apnea (OSA) and chronic obstructive pulmonary disease (COPD), the total addressable market is estimated to be more than 100m patients. Of this, management estimates 4m patients were treated with NHF therapy in FY20, highlighting the significant unmet need for this new treatment option.

The NHF therapy in hospitals has emerged as one of the leading frontline treatments for COVID-19 patients. With the associated humidifiers (hardware) now more readily available in hospitals, the opportunity ahead for Fisher & Paykel is to translate the visible benefits, instantly apparent to hospital staff, into standard of care clinical practice across the general respiratory disease population. Although there is a growing body of clinical guidelines and economic evidence encouraging the early use of NHF, global penetration to date has remained low and it is still far from being the standard of care.

That said, COVID-19 has had an immediate positive impact on clinical views. The uptake of humidification units (950 hardware system) and deeper penetration of Optiflow NHF (consumables) in the hospital setting has provided strong support to management's growth pursuits. This positive momentum has continued with the release of the first truly independent clinical practice guidelines in November 2020. The article titled, "The role for high flow nasal cannula as a respiratory support strategy in adults: a clinical practice guideline", offers several recommendations as illustrated in Figure 2. Not only does it play a key educational role, it is also viewed as an independent voice, adding further validity for its continued use.

Figure 2: Expert panel recommendations on the use of high flow nasal cannula



Source: Intensive Care Medicine, 2020. The role for high flow nasal cannula as a respiratory support strategy in adults: a clinical practice guideline

In the Homecare segment, revenue grew by 5% to NZ$226.2m. This is a solid result despite a reduction in new OSA patient diagnosis', due to limited access to sleep clinics during COVID-19. The division remains under the radar, but positive signs in myAirvo sales and release of the new Vitera and Evora masks continue to point to a long runway of future growth.

From an operations perspective, Fisher & Paykel has accelerated plans to complete a third manufacturing facility in Mexico and added additional capacity to the new Daniell building in New Zealand. This will give an appropriate buffer to meet future demand requirements across both hospital and homecare. Capital expenditure is expected to be approximately NZ$185m for the full year.

The company also updated its FY21 'guide' on the basis that hardware sales and consumables usage return to normal levels during the second half. Full year operating revenue is anticipated to be approximately NZ$1.72b and net profits within the range of NZ$400m-NZ$415m, reflecting growth rates of 36% and 42% respectively. This would see a significant upgrade to the forecasts provided at the time of the full year 2020 results, with operating revenue originally expected to be NZ$1.48b and net profits within the range of NZ$325m-NZ$340m.

Fisher & Paykel has a market capitalisation of NZ$19.1b and net cash of NZ$78.1m. The company also declared an interim dividend of 16c per share, which represents a 33% increase and a conservative payout ratio of 41%.

James Hardie Industries (ASX:JHX)

Following the group's first quarter results ending June 2020, we noted flat profits masked the significant progress underway as the company transforms operations under the leadership of CEO Jack Truong and CFO Jason Miele. By all measures, James Hardie's second quarter result was exemplary, leading to a strong first half despite COVID-19 weighing on operations.

At a group level, net sales increased 4% to US$1,363m and adjusted operating profits (EBIT) increased 11% to US$288m over the first half. While this growth is impressive considering a disrupted global market, it's significantly more notable when you consider all key metrics reached record highs, including net sales, adjusted EBIT (inc EBIT margins), adjusted net operating profit after tax and operating cash flow.

CEO Truong commented, *"Delivering these record results is a confirmation that the global strategy we launched in early calendar 2019 to transform James Hardie into a high-performing, world-class organisation is on track and is accelerating. This is now the sixth consecutive quarter that our team has delivered growth above market with strong returns."*

As a global fibre cement manufacturer, there are two key pillars of James Hardie's global strategy of transformation:

1. **Manufacturing** – to compete as a world-class manufacturer, the company implemented Hardie manufacturing operating system (HMOS) across all

plants globally based on LEAN manufacturing principles. This is mission critical in enabling the company to take advantage of its scale to drive more predictable output, consistent quality and reduce costs.

2. **Commercialisation** – the company is focused on transforming from a 'pull' strategy, seeking to create market demand, to a 'push/pull' strategy, reflecting a concerted effort of servicing customers while stimulating demand. CEO Truong emphasises the importance of this shift, *"Our true customers are the dealers, retailers and distributors. They are the focal point where we create more value for them every day by creating more demand for our products with the builders, contractors and installers [while offering] better service and [by] being easier to do business with."* This customer-focused mindset has been pivotal in stimulating deeper customer integration and better demand see-through.

These combined structural changes in the company's operating model have had an immediate impact, best reflected in the working capital. Here the introduction of LEAN manufacturing coupled with an integrated and customer engaged supply chain, continues to drive two important and connected outcomes. Firstly, the ability to gain greater customer visibility into future product demand signals and secondly, allowing for better inventory planning. The result is a greatly improved customer supply chain outcome, meeting end demand requirements while driving down the group's global inventory levels. Importantly the inventory held by customers is also reduced.

The US$84m drop in inventory over the half is illustrative of management's step-change approach. It also represents CEO Truong's intentions to take market share *and* deliver strong returns. The '*and'* is important since it illustrates that management's aims of growing the top line does not need to come at the expense of capital discipline.

Now into the second year of its initial three-year plan, the successful rollout of LEAN manufacturing has driven cumulative cost savings of US$62m. Not only is this US$16m ahead of expectations, but in the process has unlocked incremental manufacturing capacity.

Turning to North America, the group's largest market, volumes in the exterior business grew 5% in the half, resulting in net sales of US$967m up 6%. LEAN manufacturing savings coupled with lower costs for sales and pulp, resulted in a 17% uplift in operating profits to US$280m and margins improving from 26.1% to 28.9%.

Across to Europe and Asia-Pacific (APAC), both regions encountered different challenges during the period.

With a difficult start to the year due to COVID-19, Europe faced country shutdowns and a lack of sufficient scale to offset higher production costs. The second quarter result saw some reprieve as the market normalised. In total, Europe delivered relatively flat net sales of €161m over the half. The turnaround in the region was most evident through improved margins in the second quarter, increasing from 6.6% to 11.1%.

In the APAC region, net sales for the half held relatively flat, with the second quarter recovering much of the lost ground felt earlier in the year. Margins improved from 23.5% to 28.6%, benefited by country mix as sales into Philippines, a lower margin business, continued to be impacted by COVID-19 lockdowns. This is expected to reverse as the Philippines returns to a normal proportion of sales for the APAC business. The company saw real margin improvements from exiting the non-profitable James Hardie Systems business and the shift of manufacturing production from New Zealand to Australia.

The group's financial discipline was reflected in higher cash flows, up 66% to US$417m, with capital expenditure contained to $45m for the half. James Hardie ended the period with net debt of US$864m, down from US$1.0b at the end of FY20, and a conservative leverage ratio (net debt/EBITDA) of 1.32x, down from 1.65x.

Over the course of 2021, James Hardie is expecting to reduce gross debt by US$400m, while annual dividends are set to be reinstated from May onwards. For the year, the company expects to achieve net profit between $US380m and US$420m, an 8% to 19% increase.

James Hardie has a current market capitalisation of $16.4b.

OFX Group (ASX:OFX)

In October, global international payment services supplier OFX Group announced a soft first half 2021 result. The results reflected the impacts of COVID-19 with the Consumer client segment practicing caution, trading less frequently and at low average transaction values. Despite this, the company remains confident in its client diversified model, observing strong underlying signals with transaction volumes up 10.1%, transactions per active client up 13.8%, and recurring revenues increasing to 79%.

With most business expenses centred around people and technology, OFX's cost base is largely fixed and will not increase in proportion to revenue. This speaks to operational leverage; as revenues increase, more of this revenue should fall through to the bottom line. Unfortunately, the converse is also true. Over the half, lower average transaction values (down 11.6%) saw net operating income fall to $53.9m and operating profit before tax (underlying EBITDA) drop to $10.8m, a decrease of 9.4% and 34.8% respectively.

At the full year result, OFX explained due to the unpredictability of Consumer revenues, management's focus has increasingly shifted towards the Corporate, Online Sellers and Enterprise businesses. Investment across these three segments is already yielding positive operational performance, with further improvements to follow.

The group's Corporate customer base has proven to be reliable income contributors, geographically diversified and highly active. The segment delivered revenue growth of 2.9% for the half, helping to offset subdued Consumer activity. Importantly, new corporate dealing clients increased 10.6% over the period, with revenue growth of 33% from new clients.

Online sellers represent the group's fastest growing division, albeit off a relatively small base, with a revenue increase of 16.4% (or 52% ex. Asia). The company is considered an alternative payment solution to large players like PayPal, for users selling products on global marketplaces such as Amazon. Presently, online sellers can incur foreign exchange margins of 150-400 basis points (1.5%-4.0%), a significant premium to OFX's operating income margins of 56 basis points in FY20. OFX's value for online sellers is clear and one the company is seeking to leverage by investing further across sales, marketing and support teams.

Across Enterprise, organisations are now more than ever focused on addressing compliance risks and reducing costs. Enterprise agreements are notoriously difficult to win, but once implemented can offer a step change in revenue with accretive EBITDA margins and highly recurring earnings streams. Implementation of the Link Australia agreement has been completed with customers now migrating over to the OFX platform. The agreement with Link is expected to deliver $5m in revenue by FY22.

In addition, a strategic relationship with WiseTech Global was executed during the half, making OFX the preferred provider for international payments. The alliance will allow WiseTech and its customers to make simple and efficient international payments at highly competitive rates and is expected to contribute $5m of revenue by FY24. Both WiseTech and Link have the potential to scale further, as integration and potential use cases expand over time.

Beyond this, OFX is confident their solution provides a lower cost, better risk alternative to the major banks and has assured the market that they are maintaining a strong Enterprise pipeline.

The remainder of FY21 will continue to prove challenging. CEO Skander Malcolm explained, *"With the near-term revenue outlook difficult to predict and continued sensible investment in our growth engines … we will not be targeting positive operating leverage for FY21. That said, we continue to see a good recovery in trading underpinned by strong cash flows, while our growth investments position us well going forward."*

Despite relatively stagnant earnings growth in recent years, management are continuing to transition OFX into a more sustainable business and deliver more reliable revenues. With proven high returns on capital and a long-term focus, we remain comfortable in the direction the company is headed.

OFX has a market capitalisation of $290m, no debt and cash held for own use of $26m.

ResMed (ASX:RMD)

While analysts expected a weaker first quarter 2021 result, ResMed exceeded expectations across a range of metrics. At a group level, quarterly revenue rose 10% to US$751.9m, while underlying operating profits increased 24% to US$237.1m and underlying net profits grew 37% to US$185.4m.

ResMed delivered global device revenues of US$373.4m up 8% in constant currency (cc), with ventilator and related accessories contributing US$40m, comparable to the US$125m recorded in the previous quarter. Notably, the group recorded an improved single digit decline in core sleep and respiratory device sales. Management has highlighted sequential improvements in diagnosis levels across different geographies, as clinicians and patients are accelerating the adoption of remote sleep apnea testing and digital health, while also recognising the widespread benefits it provides.

The company also surprised on the cost side, with gross margins increasing 30 basis points to 59.9%, as a favourable product mix offset the predicted increases in prices associated with freight and procurement. Selling, general and administrative (SG&A) expenses declined 5% on pcp, as management flexed discretionary costs downwards due to reduced travel and sleep demand. SG&A expenses are expected to normalise in due course as restrictions are eased and demand returns.

Focusing on the long-term industry dynamics, COVID has emphasised the need for better health care solutions and accelerated the shift to digital. These are two areas ResMed has invested significantly, having differentiated its mask and device offering by integrating cloud solutions that leverage technology, big data and advanced analytics to improve patient and clinician outcomes, while also lowering costs.

Penetration remains low across a global opportunity of 936m sleep apnea sufferers, 380m chronic obstructive pulmonary disease sufferers (COPD) and over 340m people living with asthma.

To that end, ResMed CEO Michael Farrell highlighted three key operating priorities in the recent conference call, *"a, to grow and differentiate our sleep apnea, COPD and asthma businesses; b, to design, develop and deliver world-leading medical devices and digital health solutions; and c, to innovate and grow the world's best software solutions for care delivered away from the hospital."*

Core to this vision is a commitment to research and development (R&D), which increased by 14% to US$55m and now sits at 7.3% of group revenues. CEO Farrell notes R&D spend is *"a really good $200-plus million that we're going to put into digital health technology, artificial intelligence, machine learning, improvements in smaller, quiet and more comfortable, more connected and more intelligent systems that can keep people breathing out of hospital and well taken care of."* The consistent reinvestment in innovation continues to be a key differentiator, no more transparent during these challenging times.

In addition, for the first time in many years ResMed has the tailwind of price certainty, as competitive bidding has been put on hold until 2024. Chief Administrative Officer David Pendarvis notes these are *"really good outcomes for our industry. They provide stability, they provide rates that these folks can count on, and they allow for any willing provider to be able to provide in the markets."*

ResMed has a market capitalisation of US$30.7b and net debt of US$635m. The company also declared a quarterly dividend of US39c per share.

TechnologyOne (ASX:TNE)

In November, global enterprise resource planning (ERP) software provider TechnologyOne reported its financial year 2020 result. For the full year, the company delivered group revenues of $298.3m up 4% and underlying net profit before tax of $86.1m up 13%. The software as a service (SaaS) and continuing business units grew by 12% to $269.8m, while the legacy licence business declined by 34% to $28.5m. This was expected as the company transitions customers away from the on-premise model.

As a provider of mission critical software for large organisations, the onset of COVID-19 and shift to remote learning has reinforced TechnologyOne's SaaS value proposition, which CEO Edward Chung notes as being able to help users *"work on any device, anywhere, any time and seamlessly without interruptions".* The business benefits from having low customer churn, delivering highly recurring revenues and improving scale economics. This is reflected in an uplift in underlying profit before tax margins from 27% to 29% over the year.

The long-term vision is to transition 90% of the existing customer base to the SaaS offering and grow the group's total Annual Recurring Revenue (ARR) to more than $500m by 2026. TechnologyOne is still early in this transition, having converted 539 or approximately 45% of the group's existing 1,200 customers to the SaaS platform, while recording $222m in total ARR 2020.

The significant value in servicing more SaaS customers is twofold: firstly, the additional SaaS fees incurred on top of the usual annual licencing fees and secondly, the non-tangible effects the platform has on improving engagement and increasing the number of products purchased. Management has identified the latter as an area of focus, illustrated by a conservative example whereby an additional three products per customer (based on a sample size of 1,000 SaaS customers) could generate an extra $420m of ARR per year. Despite COVID making the timing for conversions less certain, the long-term opportunity is significant as remote friendly software solutions gain greater acceptance.

Offshore, the group's U.K. operations are benefitting from newer management who have now been in place for two years. Pleasingly, the region increased SaaS revenue by 22% to ARR $7.5m, whilst also delivering a breakeven result. The Local Government vertical is tracking along well, adding nine new logos and is now 'growing up' the food chain to the bigger end of town. Whilst no new logos were added in the Higher Education segment, as COVID-19 financially impacted the sector, this vertical has a healthy pipeline with few competitors. Longer term, the U.K. market opportunity is significant, being three times the size of Australia.

Research and development (R&D) investment remains a driver of future earnings, with $68.1m committed over the year, up 13% and equal to 22% of group revenues. Although only a fraction of the billions spent by global competitors, TechnologyOne has leant on its creative and innovative culture to bring new, differentiated solutions to market.

This is reflected in the group's SaaS offering recently attaining the Federal Government's 'Protected' level security assessment, through the Information Security Registered Assessors Program (IRAP) program. TechnologyOne is the only global enterprise software provider to achieve this credential status under the program, improving its ability to compete and service contracts within the government sector. The recent announcement to deploy the group's SaaS ERP technology across seven government departments in Tasmania highlights this. As Tasmanian Premier Michael Ferguson explains, *"transitioning seven government departments to the cloud will provide a foundation for us to emerge from COVID-19 stronger and will improve the resilience and safety of Government held data and our cyber security footing".*

The Digital Experience Platform (DXP) further illustrates the R&D investment pipeline. DXP is in early phase release, offering specialised functionality for thousands of end users across the group's vertical markets. DXP 1.0, the first product in the suite, targets a simple expenses app for business employees, while DXP 2.0 will look to service council ratepayers and university students.

TechnologyOne is well positioned to double earnings every five years. For further insight into the business, please refer to our article, "May the 'cloud' be with you" found later in this quarterly.

TechnologyOne has a market capitalisation of $2.5b and net cash of $125.2m. The company also declared a final dividend of 9.42c per share, taking full year dividends to 12.88c per share, an increase of 8% compared to the prior comparative period. ***SFM***

CSL – SEQIRUS COMES OF AGE

2020 marks five years of global plasma manufacturer, CSL taking ownership of the influenza business, Seqirus. And the transformation in that time has been nothing short of significant. As we outlined in our March 2019 Selector Quarterly Newsletter, the business acquired in 2015 from pharmaceutical group Novartis was unprofitable and in need of a turnaround. At the time CEO Paul Perreault highlighted the task at hand, *"We've got a lot of work to do, no doubt about it, it is not for the faint hearted."*

But the strategic thinking behind the move was sound and the long-term preparedness to reinvest in new technologies and manufacturing capabilities, by differentiating products, has been a hallmark of the company since acquisition.

CEO Perreault noted the reasoning behind it, *"It was not unlike the plasma segment in 2004 with the Aventis Behring deal. People were getting out of flu because it is hard. The Novartis business brings us scale…I think we bought well. Developing a product every six months for the northern hemisphere and the southern hemisphere and trying to produce pandemic supply and antigens…it seems we like complexity. We're just getting started."*

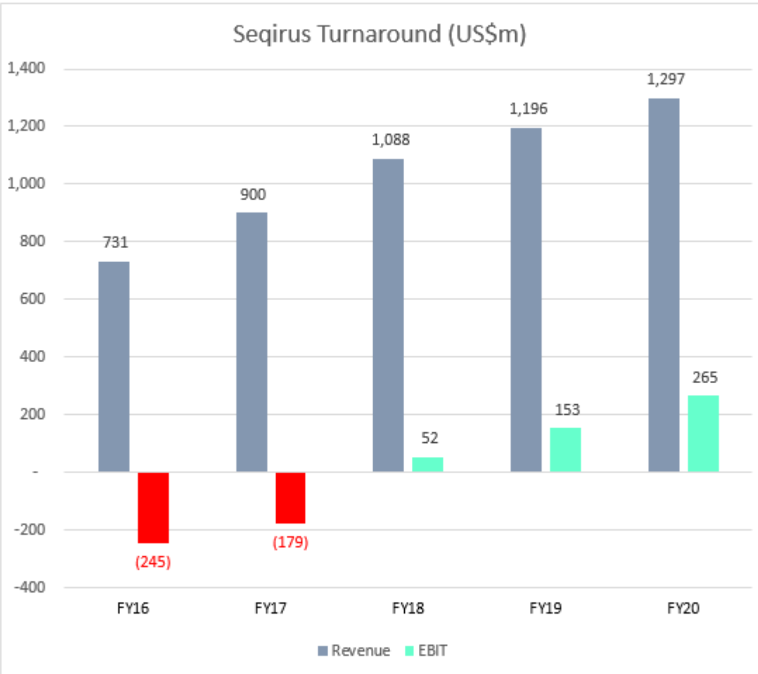
Five years on

At the time of acquisition, management's five-year roadmap was clearly articulated. As Graph 3 profiles, even though the business was a top three global influenza player, it was loss making. To change the course of the business, several product and manufacturing milestones were necessary. This included increasing the number of differentiated products, shifting demand towards higher value based offerings, and significantly scaling up manufacturing volume at the group's state-of-the-art cell-based vaccine facility at U.S. based Holly Springs.

Critical to this success has been the group's ongoing commitment to research and development programs. This includes achieving influenza vaccine regulatory approval in key age-related groups, most notably in children and the elderly, and a deliberate product shift, transitioning from Trivalent (TIV) to Quadrivalent (QIV) vaccines.

The five-year target was thus set; to deliver US$1.0b in revenue and operating margins (EBIT) of 20%.

Graph 3: Seqirus financial record 2016-2020



Key Milestones	
FY16	- Transaction close: 31 July 2015 - Management team and Global HQ - Commenced integration - TIV portfolio
FY17	- Launch of QIV and FLUAD in U.S. - Growth in pandemic reservation fees - Operational efficiencies - 4x increase in output from Holly Springs
FY18	- Exceeded breakeven financial target - FLUCELVAX - first use of cell-seed - FLAUD approved in Australia and U.K. - Integration complete
FY19	- Influenza vaccine sales +19% - FLUAD sales more than doubled - Holly Springs - FCC 3.0 approved delivering future antigen capacity expansion - Compelling real world effectiveness data for FLUCELVAX
FY20	- Seasonal influenza sales +21% - FLAUD - Preferred recommendation for U.K. and Australia - QIV launched in Australia and approved in U.S. & EU - FLUCELVAX launched in EU

Source: CSL company announcements

In 2020 CSL delivered what it set out to achieve. The results exceeded the expectations of investors and vindicated management's confidence in taking a chronically neglected business, combining it with internal know how and entrusting a respected and seasoned executive team to steer its path.

In context of the overall group, Seqirus contributes 14% of CSL's total revenues of US$9.1b and circa 10% of the group's combined operating profits of $US2.7b.

The influenza markets

The influenza market is dominated by three global players: Sanofi, Seqirus and GlaxoSmithKline (GSK), as depicted in Figure 3. This is a highly complex, logistically difficult industry requiring scale, manufacturing capability and long lead times. Since flu vaccines are developed twice yearly, a new vaccine takes upwards of five to six months to complete before it becomes publicly available. All year long, data is also gathered from 142 national influenza centres, located in over 113 different countries, specifically monitoring how strains of viruses are affecting the world's population.

The data collected from these centres is then passed on to one of five World Health Organisation Collaborating centres for Reference and Research on Influenza. Among these is the Centers for Disease Control and Prevention (CDC), based in Atlanta U.S. These centres meet bi-annually to determine the recommended composition for the yearly flu vaccine; the first in February for the northern hemisphere and then again in September for future patients in the southern hemisphere.

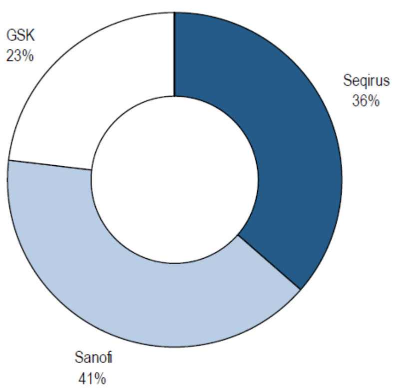
What makes the production of a successful vaccine difficult is the virus's ability to mutate. One way influenza vaccines can change is called 'antigenic drift'; in short what may appear fine in the laboratory at inception, could lose potency over time. The traditional egg-based manufacturing process, which is typically longer in duration, certainly doesn't assist on this front. However, a relatively new cell-based approach is now gaining traction as a credible alternative.

The U.S. Food and Drug Administration (FDA) first welcomed the use of a cell-based flu vaccine, when it approved CSL's Flucelvax in 2016 for the U.S. market. CDC outlined two specific advantages of the cell-based approach compared to egg-based manufacturing.

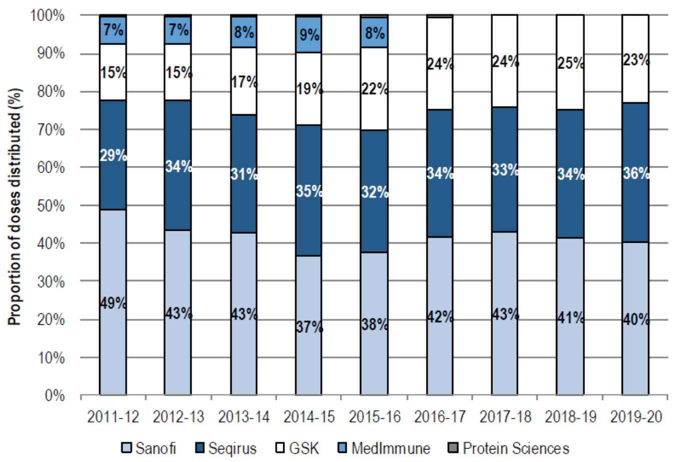
1. *"Growing influenza viruses in eggs can introduce changes (i.e. egg-adapted changes) that can have important implications for the body's immune response to vaccination. For example, these eggs adapted changes could cause the body's immune system to produce antibodies that are less effective at preventing disease caused by the specific flu viruses in circulation. FDA approval of cell-grown CVV's will reduce egg-adapted changes and may result in vaccines containing virus that is more 'like' wild-type circulating viruses. Therefore, the FDA's approval of cell-based candidate vaccine viruses has the potential to improve the effectiveness of cell-based flu vaccine."*

Figure 3: Seqirus global market share

US influenza vaccine production by manufacturer (%, FY20e)



US influenza vaccine market share



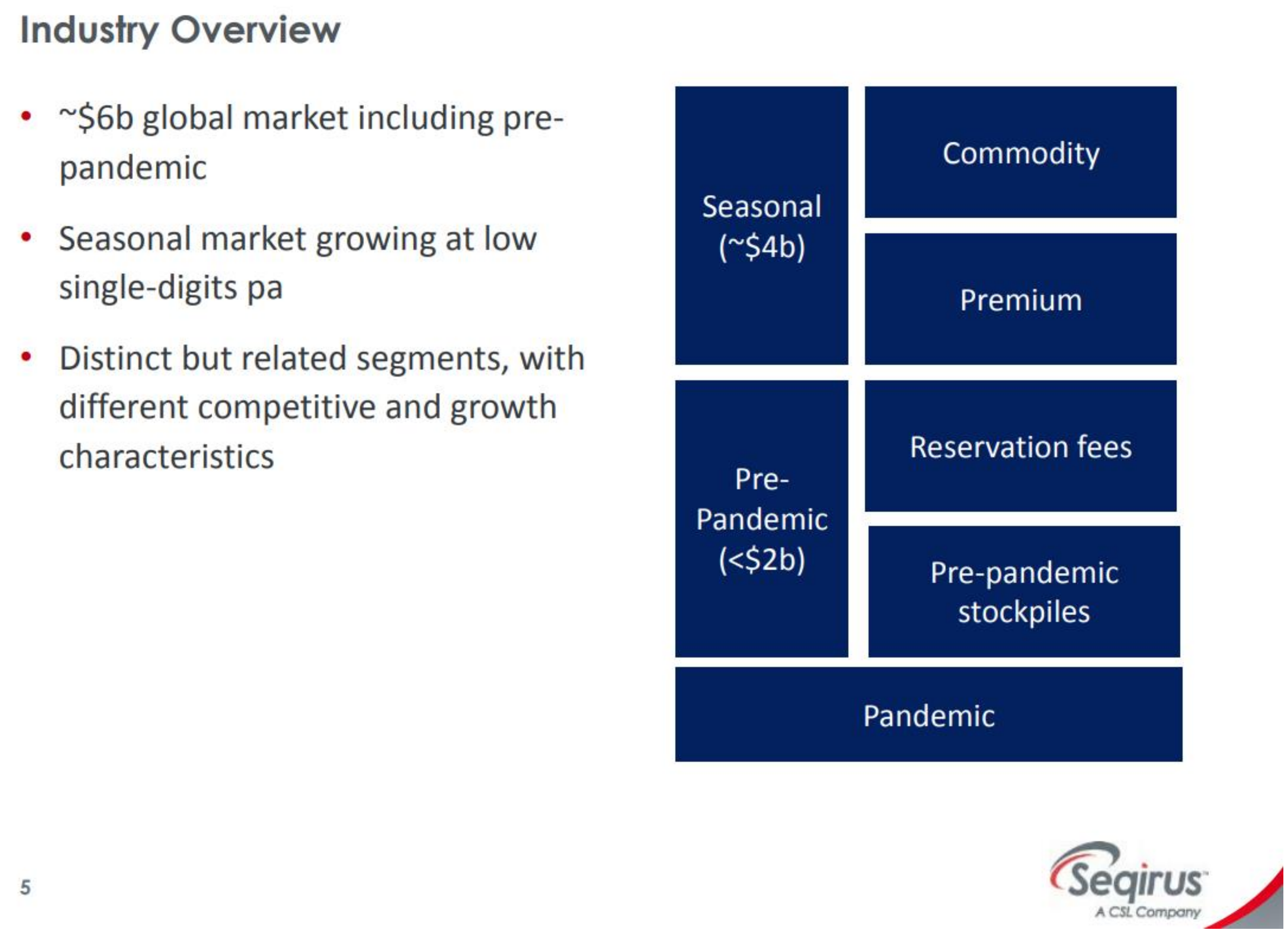
Source: Credit Suisse

2. *"A major advantage of cell culture technology includes the potential for a faster start-up of the vaccine manufacturing process in the event of a pandemic. The cells used to manufacture Flucelvax are kept frozen and 'banked'. Cell banking assures an adequate supply of cells is readily available for vaccine production. Growing the influenza viruses in cell culture for the manufacture of Flucelvax is not dependent on an egg supply. Also, as described above, cell-based flu vaccines that are produced using cell-based candidate vaccine viruses have the potential to improve the effectiveness of cell-based flu vaccines (compared to egg-based flu vaccines) by eliminating the kinds of egg adaptations that occur in egg-manufactured flu vaccines."*

The company has worked diligently since 2015 to drive greater product uniqueness and effectiveness. Central to its long-term ambitions has been a commitment to invest considerable funding to increase manufacturing capability and capacity, particularly in cell-based production.

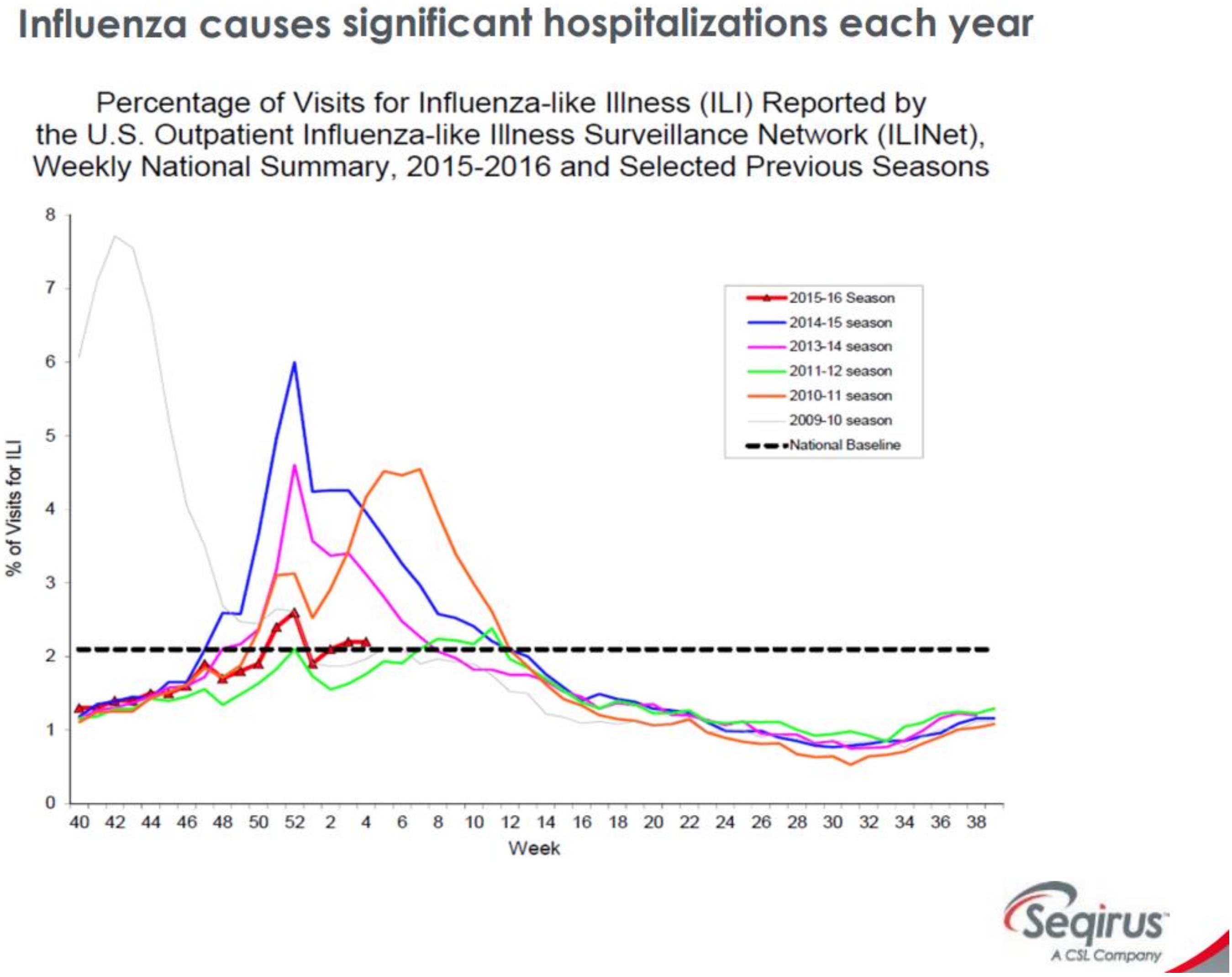
Holly Springs, the group's U.S. based North Carolina manufacturing facility, has been at the forefront of this investment. Post its US$140m expansion, the facility's production profile will double its output to 40m doses annually, a considerable jump from the 3m dose level set a few years ago.

Figure 4: Global influenza market



Source: 2016 Seqirus Presentation to Investors and Analysts during site tours in Liverpool, England and Holly Springs, USA

Graph 4: Past flu seasons



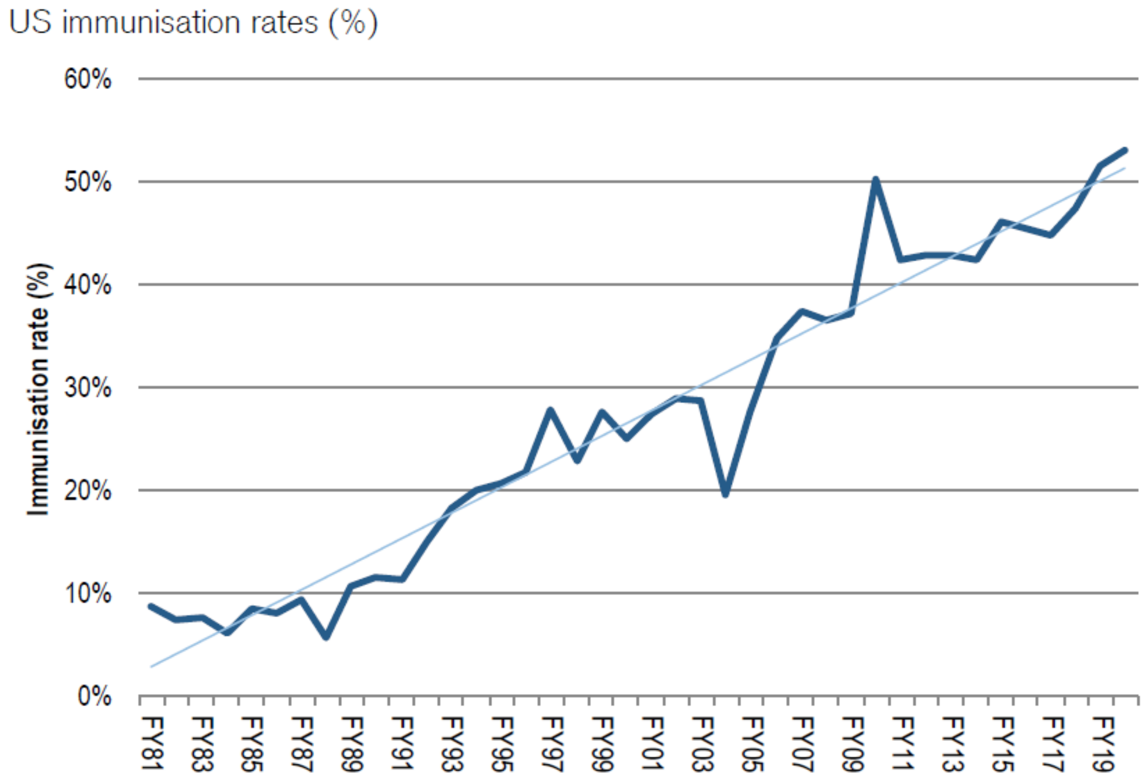
Source: Seqirus Presentation to Investors and Analysts during site tours in Liverpool, England and Holly Springs, USA

Influenza Market

As outlined in Figure 4, the global influenza market has an annual estimated value of US$6b, of which US$4b is seasonal in nature. The balance is then influenced by events that may lead to annual pandemics or spikes in demand, as reflected in Graph 4.

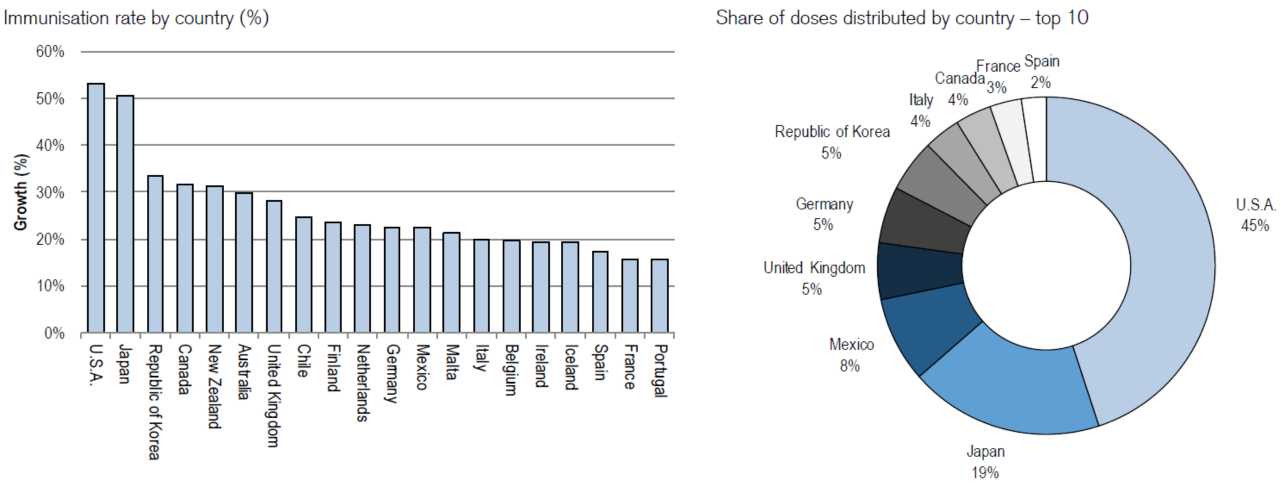
Most developed world nations encourage annual immunisation compliance among its citizens, with the U.S. and Japan enjoying the highest coverage, as depicted in Graph 5 and Figure 5. In 2010 the CDC launched a universal flu vaccination recommendation for all U.S. citizens, except babies less than 6 months old. Despite this recommendation, immunisations have budged little over the past decade (as Graph 5 highlights), peaking at just over 50% during 2019. Post COVID, the CDC is now publicly targeting immunisation rates of 75-80% over the long run.

Graph 5: Historical U.S. immunisation rates



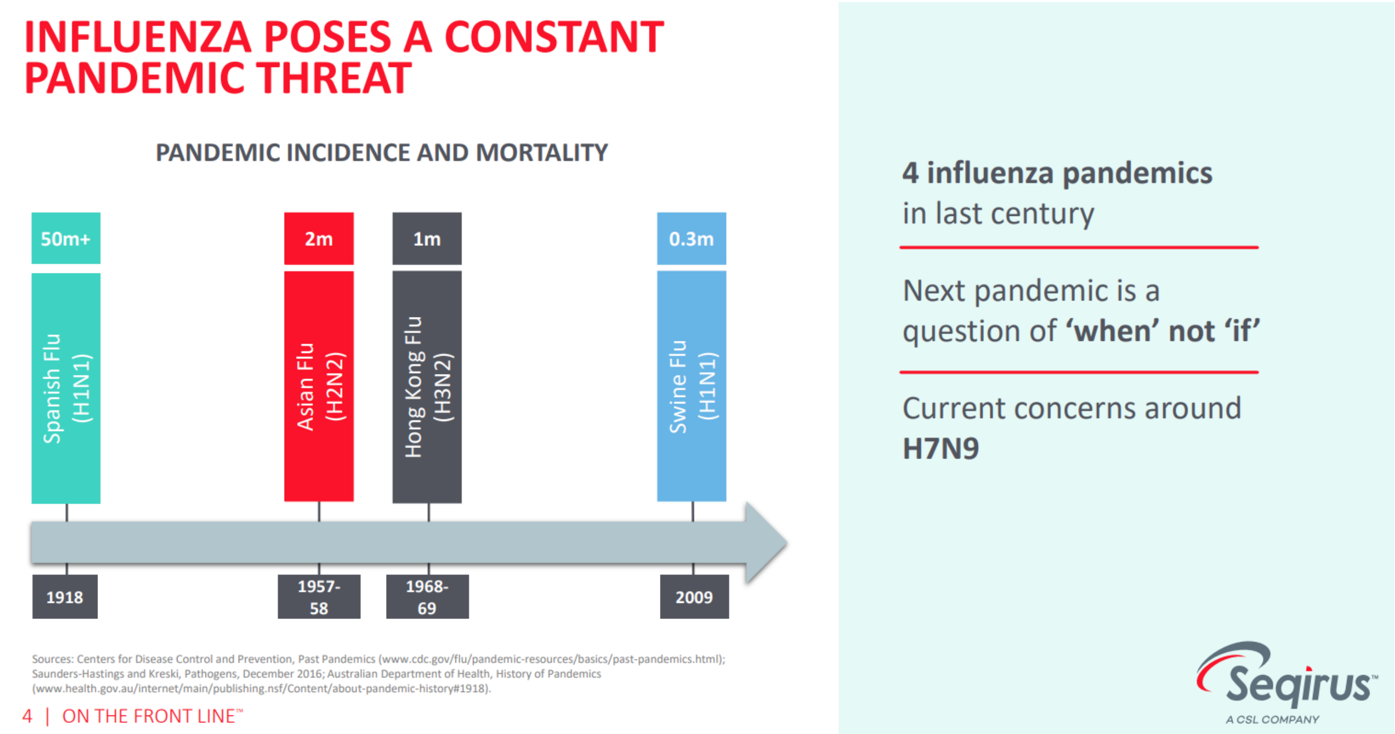
Source U.S. CDC, Credit Suisse estimates

Figure 5: Immunisation rates by country



Source: Influenza Vaccine Supply task force, World Bank, Credit Suisse estimates

Figure 6: Influenza pandemics



Source: 2019 President (Seqirus) Presentation to the Macquarie Australia Conference, Sydney

A constant concern has also been the threat surrounding influenza pandemics, as depicted in Figure 6 above.

Such has been the urgency among health officials that the U.S. released an Executive Order in September 2019, recognising the potential of a pandemic risk and its preparedness to accelerate broad based access to cell-based influenza vaccine technology, as an effective alternative to egg-based vaccines.

The full 19 September 2019 release from the White House is presented below. We have also highlighted certain sections of the order, which we deemed significant.

Executive Order

By the authority vested in me as President by the Constitution and the laws of the United States of America, including section 301 of title 3, United States Code, it is hereby ordered as follows:

"Section 1. Findings. (a) Influenza viruses are constantly changing as they circulate globally in humans and animals. Relatively minor changes in these viruses cause annual seasonal influenza outbreaks, which result in millions of illnesses, hundreds of thousands of hospitalizations, and tens of thousands of deaths each year in the United States. Periodically, new influenza A viruses emerge from animals, including birds and pigs, that can spread efficiently and have sustained transmission among humans. This situation is called an influenza pandemic (pandemic). Unlike seasonal influenza, a pandemic has the potential to spread rapidly around the globe, infect higher numbers of people, and cause high rates of illness and death in populations that lack prior immunity. While it is not possible to predict when or how frequently a pandemic may occur, there have been 4 pandemics in the last 100 years. The most devastating pandemic occurred in 1918-1919 and is estimated to have killed more than 50 million people worldwide, including 675,000 Americans.

*(b) Vaccination is the most effective defence against influenza. Despite recommendations by the Centres for Disease Control and Prevention (CDC) that nearly every American should receive the influenza vaccine annually, however, seasonal influenza vaccination levels in the United States have **currently reached only about 45 percent of CDC goals.***

(c) All influenza vaccines presently in use have been developed for circulating or anticipated influenza viruses. These vaccines must be reformulated for each influenza season as well as in the event of a pandemic. Additional research is needed to develop influenza vaccines that

provide more effective and longer-lasting protection against many or all influenza viruses.

(d) The current domestic enterprise for manufacturing influenza vaccines has critical shortcomings. ***Most influenza vaccines are made in chicken eggs, using a 70-year-old process that requires months-long production timelines, limiting their utility for pandemic control; rely on a potentially vulnerable supply chain of eggs; require the use of vaccine viruses adapted for growth in eggs, which could introduce mutations of the influenza vaccine virus that may render the final product less effective; and are unsuitable for efficient and scalable continuous manufacturing platforms.***

(e) The seasonal influenza vaccine market rewards manufacturers that deliver vaccines in time for the influenza season, without consideration of the speed or scale of these manufacturers' production processes. ***This approach is insufficient to meet the response needs in the event of a pandemic****, which can emerge rapidly and with little warning. Because the market does not sufficiently reward speed, and because a pandemic has the potential to overwhelm or compromise essential government functions, including defence and homeland security,* ***the Government must take action to promote faster and more scalable manufacturing platforms.***

Sec. 2. Policy. It is the policy of the United States to modernize the domestic influenza vaccine enterprise to be highly responsive, flexible, scalable, and more effective at preventing the spread of influenza viruses. ***This is a public health and national security priority, as influenza has the potential to significantly harm the United States and our interests, including through large-scale illness and death, disruption to military operations, and damage to the economy. This order directs actions to reduce the United States' reliance on egg-based influenza vaccine production; to expand domestic capacity of alternative methods that allow more agile and rapid responses to emerging influenza viruses; to advance the development of new, broadly protective vaccine candidates that provide more effective and longer lasting immunities; and to support the promotion of increased influenza vaccine immunization across recommended populations.***

Sec. 3. National Influenza Vaccine Task Force. (a) There is hereby established a National Influenza Vaccine Task Force (Task Force). The Task Force shall identify actions to achieve the objectives identified in section 2 of this order and monitor and report on the implementation and results of those actions. The Task Force shall be co-chaired by the Secretary of Defence and the Secretary of Health and Human Services, or their designees.

(b) In addition to the Co-Chairs, the Task Force shall consist of a senior official from the following executive branch departments, agencies, and offices:

(i) the Department of Defence (DOD);

(ii) the Department of Justice;

(iii) the Department of Agriculture;

(iv) the Department of Veterans Affairs (VA);

(v) the Department of Homeland Security;

(vi) the United States Food and Drug Administration;

(vii) the Centers for Disease Control and Prevention;

(viii) the National Institutes of Health (NIH);

(ix) the Centers for Medicare and Medicaid Services (CMS); and

(x) the Biomedical Advanced Research and Development Authority (BARDA).

(c) The Co-Chairs may jointly invite additional Federal Government representatives, with the consent of the applicable executive department, agency, or office head, to attend meetings of the Task Force or to become members of the Task Force, as appropriate.

(d) The staffs of the Department of State, the Office of Management and Budget (OMB), the National Security Council, the Council of Economic Advisers, the Domestic Policy Council, the National Economic Council, and the Office of Science and Technology Policy (OSTP) may attend and participate in any Task Force meetings or discussions.

(e) The Task Force may consult with State, local, tribal, and territorial government officials and private sector representatives, as appropriate and consistent with applicable law.

(f) Within 120 days of the date of this order, the Task Force shall submit a report to the President, through the Assistant to the President for National Security Affairs, the Assistant to the President for Domestic Policy, the

Director of the Office of Management and Budget, and the Director of the Office of Science and Technology Policy. The report shall include:

(i) a 5-year national plan (Plan) to promote the use of more agile and scalable vaccine manufacturing technologies and to accelerate development of vaccines that protect against many or all influenza viruses;

(ii) recommendations for encouraging non-profit, academic, and private-sector influenza vaccine innovation; and

(iii) recommendations for increasing influenza vaccination among the populations recommended by the CDC and for improving public understanding of influenza risk and informed influenza vaccine decision-making.

(g) Not later than June 1 of each of the 5 years following submission of the report described in subsection (f) of this section, the Task Force shall submit an update on implementation of the Plan and, as appropriate, new recommendations for achieving the policy objectives set forth in section 2 of this order.

Sec. 4. Agency Implementation. The heads of executive departments and agencies shall also implement the policy objectives defined in section 2 of this order, consistent with existing authorities and appropriations, as follows:

(a) The Secretary of HHS shall:

(i) through the Assistant Secretary for Preparedness and Response and BARDA:

(A) estimate the cost of expanding and diversifying domestic vaccine-manufacturing capacity to use innovative, faster, and more scalable technologies, including cell-based and recombinant vaccine manufacturing, through cost-sharing agreements with the private sector, which shall include an agreed-upon pricing strategy during a pandemic;

(B) estimate the cost of expanding domestic production capacity of adjuvants in order to combine such adjuvants with both seasonal and pandemic influenza vaccines;

(C) estimate the cost of expanding domestic fill-and-finish capacity to rapidly fulfil antigen and adjuvant needs for pandemic response;

(D) estimate the cost of developing, evaluating, and implementing delivery systems to augment limited supplies of needles and syringes and to enable the rapid and large-scale administration of pandemic influenza vaccines;

(E) evaluate incentives for the development and production of vaccines by private manufacturers and public-private partnerships, including, in emergency situations, the transfer of technology to public-private partnerships — such as the HHS Centers for Innovation and Advanced Development and Manufacturing or other domestic manufacturing facilities — in advance of a pandemic, in order to be able to ensure adequate domestic pandemic manufacturing capacity and capability;

(F) support, in coordination with the DOD, NIH, and VA, a suite of clinical studies featuring different adjuvants to support development of improved vaccines and further expand vaccine supply by reducing the dose of antigen required; and

(G) update, in coordination with other relevant public health agencies, the research agenda to dramatically improve the effectiveness, efficiency, and reliability of influenza vaccine production;

(ii) through the Director of NIH, provide to the Task Force estimated timelines for implementing NIH's strategic plan and research agenda for developing influenza vaccines that can protect individuals over many years against multiple types of influenza viruses;

(iii) through the Commissioner of Food and Drugs:

(A) further implement vaccine production process improvements to reduce the time required for vaccine production (e.g., through the use of novel technologies for vaccine seed virus development and through implementation of improved potency and sterility assays);

(B) develop, in conjunction with the CDC, proposed alternatives for the timing of vaccine virus selection to account for potentially shorter timeframes associated with non egg-based manufacturing and to facilitate vaccines optimally matched to the circulating strains;

(C) further support the conduct, in collaboration with the DOD, BARDA, and CDC, of applied scientific research regarding developing cell lines and expression systems

that markedly increase the yield of cell-based and recombinant influenza vaccine manufacturing processes; and

(D) assess, in coordination with BARDA and relevant vaccine manufacturers, the use and potential effects of using advanced manufacturing platforms for influenza vaccines;

(iv) through the Director of the CDC:

(A) expand vaccine effectiveness studies to more rapidly evaluate the effectiveness of cell based and recombinant influenza vaccines relative to egg-based vaccines;

(B) explore options to expand the production capacity of cell-based vaccine candidates used by industry;

(C) develop a plan to expand domestic capacity for whole genome characterization of influenza viruses;

(D) increase influenza vaccine use through enhanced communication and by removing barriers to vaccination; and

(E) enhance communication to healthcare providers about the performance of influenza vaccines, in order to assist them in promoting the most effective vaccines for their patient populations; and

(v) through the Administrator of CMS, examine the current legal, regulatory, and policy framework surrounding payment for influenza vaccines and assess adoption of domestically manufactured vaccines that have positive attributes for pandemic response (such as scalability and speed of manufacturing).

(b) The Secretary of Defense shall:

(i) provide OMB with a cost estimate for transitioning DOD's annual procurement of influenza vaccines to vaccines manufactured both domestically and through faster, more scalable, and innovative technologies;

(ii) direct, in coordination with the VA, CDC, and other components of HHS, the conduct of epidemiological studies of vaccine effectiveness to improve knowledge of the clinical effect of the currently licensed influenza vaccines;

(iii) use DOD's network of clinical research sites to evaluate the effectiveness of licensed influenza vaccines, including methods of boosting their effectiveness;

(iv) identify opportunities to use DOD's vaccine research and development enterprise, in collaboration with HHS, to include both early discovery and design of influenza vaccines as well as later-stage evaluation of candidate influenza vaccines;

(v) investigate, in collaboration with HHS, alternative correlates of immune protection that could facilitate development of next-generation influenza vaccines;

(vi) direct the conduct of a study to assess the feasibility of using DOD's advanced manufacturing facility for manufacturing cell-based or recombinant influenza vaccines during a pandemic; and

(vii) accelerate, in collaboration with HHS, research regarding rapidly scalable prophylactic influenza antibody approaches to complement a universal vaccine initiative and address gaps in current vaccine coverage.

(c) The Secretary of VA shall provide OMB with a cost estimate for transitioning its annual procurement of influenza vaccines to vaccines manufactured both domestically and with faster, more scalable, and innovative technologies.

Sec. 5. Termination. The Task Force shall terminate upon direction from the President or, with the approval of the President, upon direction from the Task Force Co-Chairs.

Sec. 6. General Provisions. (a) Nothing in this order shall be construed to impair or otherwise affect:

(i) the authority granted by law to an executive department or agency, or the head thereof; or

(ii) the functions of the Director of the Office of Management and Budget relating to budgetary, administrative, or legislative proposals.

(b) This order shall be implemented consistent with applicable law and subject to the availability of appropriations.

(c) This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person"

Donald J. Trump
The White House,
September 19, 2019

Executive Order

As you peruse the release, there are three points worth calling out. Firstly, and what is most apparent is the urgency to *"modernize the domestic influenza vaccine enterprise to be highly responsive, flexible, scalable, and more effective at preventing the spread of influenza viruses. This is a public health and national security priority, as influenza has the potential to significantly harm the United States and our interests, including through large-scale illness and death, disruption to military operations, and damage to the economy."*

Secondly and perhaps most importantly is the necessity to find an alternative solution to egg-based technology, *"This order directs actions to reduce the United States' reliance on egg-based influenza vaccine production; to expand domestic capacity of alternative methods that allow more agile and rapid responses to emerging influenza viruses."*

CSL's cell-based technology is in an enviable position, providing an alternative that delivers both scale and manufacturing production efficiency. We understand that only CSL and Sanofi have committed to cell-based influenza vaccine production, although Sanofi materially lags CSL on this front.

Sanofi's own website underscores their current position on egg verse cell-based technology, *"Manufacturing vaccines by growing influenza virus in cells is a more recent addition to supplies, first coming to market in the last decade. But so far, the jury is still out on whether producing vaccines in this way in cells provides any significant benefits each and every year, versus producing vaccines in eggs. The data is not yet comprehensive enough to demonstrate whether one manufacturing approach over another improves protection against the flu consistently year after year.*

In addition, it's important to note that so far, total cell-based manufacturing accounts for only a small portion of worldwide supply; a fair estimate based on manufacturers' limited reporting would put it at less than 15%, leaving a huge portion of public health needs unsatisfied.

Nevertheless, for the future, we are exploring new options, including cell production, with the recent acquisition of Protein Sciences, a biotechnology company that has developed the only recombinant protein-based influenza vaccine. This technique will be an alternative that could replace the egg that, for now, remains obligatory."

Lastly, the order requires a response within 120 days to deliver (amongst other things), *"a 5-year national plan (Plan) to promote the use of more agile and scalable vaccine manufacturing technologies and to accelerate development of vaccines that protect against many or all influenza viruses."*

COVID-19 aftermath

Ironically, the U.S. Government's concerns surrounding pandemics were well founded, despite COVID-19 having little connection with an influenza outbreak.

"Periodically, new influenza A viruses emerge from animals, including birds and pigs, that can spread efficiently and have sustained transmission among humans. This situation is called an influenza pandemic (pandemic). Unlike seasonal influenza, a pandemic has the potential to spread rapidly around the globe, infect higher numbers of people, and cause high rates of illness and death in populations that lack prior immunity. While it is not possible to predict when or how frequently a pandemic may occur, there have been 4 pandemics in the last 100 years. The most devastating pandemic occurred in 1918-1919 and is estimated to have killed more than 50 million people worldwide, including 675,000 Americans."

Fortuitously, COVID-19 public mitigation responses encouraging good personal hygiene and social distancing have provided some short-term benefits, most notably the near collapse in annual influenza affected patients. In September 2020, the U.S. CDC reported the percentage of respiratory specimens that tested positive during recent months had decreased from over 20% to just 2.3%, remaining at historically low levels. Similar data profiles were indicated in the southern hemisphere, reflecting little influenza activity.

While these numbers are highly encouraging, they also reflect the lockdown circumstances that have been in place over the past six months. Complacency remains a risk and governments are stepping up plans to vaccinate greater percentages of the population as we head into the northern hemisphere flu season. The U.S. CDC recommends all persons aged six years and over be immunised for influenza, while the current immunisation rates among U.S citizens now stands at 53%, up from 10% in 1990. Flu vaccine doses have accordingly risen by 5% per annum over the past fifteen years, from 80m doses to 175m for the 2020 season.

The Executive Order and the ongoing health concerns surrounding COVID have underpinned the global trend towards influenza vaccination. The long-term annual run rate of immunisation has averaged 3%, with this figure set to increase as more of the elderly seek annual vaccinations and new higher dosing products better target subsets of the population.

This positive structural industry shift towards annual influenza immunisation is being supported by governments actively promoting flu shots, alongside national pandemic stockpiling. These activities are underpinning the need for greater annual volumes of influenza vaccinations and, as a flow-on effect, rapid manufacturing responses.

COVID Learnings and potential business risk

As good as the opportunity appears, it is never without risk. As we now know, while COVID-19 was an extreme left field event, even more surprising perhaps is the vaccine methodology that has given rise to combat it.

The 'street' view suggested a long drawn-out drug trial process, using the traditional approach of injecting patients with a weakened version of the virus to deliver a vaccine, not dissimilar to how influenzas or measles are currently undertaken. The Pfizer-BioNTech and Moderna vaccine results reflect both a remarkable and unconventional way to tackle the virus.

In each instance they represent a new vaccine delivery system, relying on Messenger Ribonucleic Acid (mRNA) which delivers a piece of genetic coding that instructs human cells to produce components of a targeted virus.

These cells, which by themselves cannot cause disease, then stimulate the patient's immune system as though the target virus was present. As such, mRNA serves as a carrier of genetic instructions. mRNA does not change the host DNA, and the underlying instructions carried by mRNA can be altered quickly as a target virus mutates, a significant scientific breakthrough.

And the big advantage is not only efficacy but time. As the Wall Street Journal reported, *"Messenger RNA promises to cut that time by taking advantage of the body's own molecular machinery, essentially teaching cells how to make a protein similar to one found on the virus, which then triggers the body's immune response."*

This is where things get interesting as Moderna, a business founded in 2010 to focus specifically on mRNA research, appears well equipped to exploit this new platform technology. On offer is a methodology to design and deliver new drugs or vaccines quickly with greater efficacy, by inserting the relevant mRNA code. Moderna CEO Stephen Bancel refers to mRNA as, *"the software of life"*.

For conventional drug manufacturers, including the likes of CSL, the mRNA platform technology is a shot across the bow and a lesson for all investors, not to be too complacent.

That said, be assured CSL is not asleep at the wheel here, we understand they have mRNA influenza candidates under investigation. This is the latency within. And nor should investors be under the illusion that the scientific platform underlying mRNA vaccine technology is exclusive to Moderna or BioNtech. This is an open architecture that has come from Penn State University.

Product outlook for 2021

As the following Table 6 denotes, Seqirus has several new product extensions and new market segments earmarked for 2021. As the business scales and with further product differentiation, we would expect a positive impact on pricing and a commensurate lift in operating margins from the current 20%, moving upwards into the range of 25-30%.

U.S. Government looking beyond COVID

Having witnessed the global impact stemming from COVID, governments are moving at pace to secure or pre-empt future pandemics. As the Executive Order highlighted, the U.S. has made its intentions clear on the need for urgent action.

During the quarter, CSL announced it had been selected by the U.S. Government to manufacture and stockpile AUDENZ. This is the first adjuvanted (a pharmacological agent that improves the immune response of a vaccine) cell-based influenza vaccine designed to protect against avian influenza strain H5H1 (commonly known as bird flu).

Using its cell-based Holly Springs facility, Seqirus developed AUDENZ, secured U.S. Food and Drug Administration (FDA) approval and began stockpiling the vaccine in the event of a pandemic.

As Bill Mezzanotte, CSL's executive Vice President, head of research and development and chief medical officer noted, *"Pandemic preparedness is part of business in Seqirus, and I'd like to say you don't make a lot of money in responding to a pandemic, you do it in preparing for a pandemic."*

He further added, *"What we are doing is trying to be prepared and in this case working with the U.S. government, because it is at Holly Springs where it is being done right now. We have taken that strain (of bird flu) and preparing a vaccine for that strain, with the use of our adjuvant, so we have lots of doses available in the future when and if another pandemic in the bird flu would come."*

Seqirus in the box seat

What began as an opportunity in 2015, to acquire a loss making vaccine business for US$275m, has transitioned into a highly profitable and important provider of health vaccination solutions for national health bodies. Leading the charge in cell-based technology and being one of three global manufacturers of immunisation vaccines, CSL's market share aims are set high.

The company has made significant inroads since those early days, with the structural tailwinds now set to lead to a much larger global business offering, underpinned by world leading cell-based manufacturing technology and improving financial outcomes. COVID-19 has impacted us all during 2020, but in many ways it has cemented the role of Seqirus and CSL in providing vital immunisation solutions for the world's masses. ***SFM***

Table 6: Product outlook for 2021

Manufacturer	Name	Age	Strain	Egg/Cell	Comment
Seqirus	Alfuria Quadrivalent	>6 months	QIV	Egg	Pre-filled syringe or multi-dose vial
	Flucelvax Quadrivalent	>4 years	QIV	Cell	Pre-filled syringe or multi-dose vial
	Fluad	>65 years	Adjuvant TIV	Egg	Pre-filled syringe
	Fluad QIV	*>65 years*	*Adjuvant QIV*	*Egg*	*Approved, to launch in 2021 flu season*
Sanofi	Fluzone Quadrivalent	> 6 months	QIV	Egg	Pre-filled syringe or multi-dose vial
	Flublok Quadrivalent	>18 years	QIV	Recombinant, cell	Pre-filled syringe
	Fluzone High-dose QIV	*>65 years*	*QIV – high dose*	*Egg*	*Approved, to launch in 2021 flu season*
GSK	Fluarix Quadrivalent	> 6 months	QIV	Egg	Pre-filled syringe
	FluLaval Quadrivalent	> 6 months	QIV	Egg	Pre-filled syringe

Source: Company data, Credit Suisse estimates

MAY THE 'CLOUD' BE WITH YOU.

"Digital technology, pervasively, is getting embedded in every place: everything, every person, every walk of life is being fundamentally shaped by digital technology – it is happening in our homes, our work, our places of entertainment. It's amazing to think of a world as a computer. I think that's the right metaphor for us as we go forward."

Microsoft CEO Satya Nadella refers to the cloud as *"the world's computer"*. It is as he describes, *"the broad computing fabric that stitches all this together."*

The shift to the cloud has been underway for close to a decade and Microsoft's early identification of this powerful undercurrent is washing through all corners of the world.

In the group's third quarter earnings update, released in October 2020, CEO Satya Nadella made the opening remark, *"We are off to a strong start in fiscal 2021, driven by the continued strength of our commercial cloud, which surpassed $15b in revenue, up 31% year over year. The next decade of economic performance for every business will be defined by the speed of their digital transformation. We are innovating across the full modern tech stack to help customers in every industry improve time to value, increase agility and reduce costs."*

The digital runway according to CEO Satya Nadella is at its infancy, *"The way I think about the computing landscape going forward is if you sort of said at the highest of levels today as a percentage of GDP, tech spend is 5%. We think it will double in the next 10 years. And if anything, this pandemic perhaps has accelerated that doubling."*

SAP – inflection point

Over at SAP, a German based software company that makes enterprise resource planning (ERP) software to manage business operations, the shift to the cloud has been underway since 2012.

Among the largest publicly listed software companies in the world, SAP sits at number five with a market capitalisation of US$111b, behind Oracle at US$169b, Salesforce at US$211b, Adobe at US$214b and Microsoft in top position at US$1,530b.

On 26 October 2020 SAP announced an important pivotal moment in the company's 48-year history.

Releasing the company's third quarter financial update, CEO Christian Klein announced the group's decision to accelerate its transition fully to the cloud.

"The COVID-19 pandemic, which we all hoped would be easing by now, is gearing up for an additional wave. This crisis has created an inflection point for customers, a true catalyst to accelerate their transformation efforts has put a spotlight on the resiliency, which is more than just about the underlying infrastructure, and its move to the cloud. It is about changing the way our company wants to adapt to new digital business models and drive automation. Resiliency and sustainable long-term growth and profitability, comes only by transforming the company to the needs of the consumers and employees in a digital world."

"We recognise this is a significant change when compared to the previous strategy, the former 2023 ambition. We are at an inflection point where customers are asking us to help accelerate their business transformation to gain resiliency and position them to emerge stronger out of the crisis. We see that as a unique opportunity to partner with our customers on their journey in a way that only SAP can, in large part, due to our deep knowledge of business processes, our innovative solutions and technology, and the trust we have established over our operating history. That's why we have adapted our strategy and financial ambitions."

Such a transition carries enormous risk however, particularly for a company that pioneered and built its success on the traditional ERP business model. The very model that now appears outdated in comparison to cloud technology.

SAP has over 440,000 global customers, so in terms of seismic business shifts, the task at hand is huge. As the Australian Financial Review (AFR) reported at the time of the announcement, *"SAP's software is used by virtually every company in the ASX 200. The boards must now have a conversation about software risk management. First, each board must consider the costs of migrating to the SAP cloud. This is an expensive exercise because it means conducting an audit of everything in a company's* *technology stack, as well as an audit of the interdependencies between different software products."*

"What is interesting about SAP's decision to factor in an accelerated cloud transition by its customers is that it could well be the catalyst for significant cannibalisation of its existing business."

While the move is being driven by customer demand, it comes at a significant short-term cost to the company's traditional business model that charges upfront license fees, implementation costs and guaranteed ongoing support fees. In its place will be, as noted by the AFR, "*an evergreen system that means every customer paying rent for use of the software can be assured of having it available at all times and automatically updated."*

What this means for SAP is navigating through a period of earnings upheaval, as businesses switch from paying upfront fees and service income to regular subscription revenues. On SAP's reckoning this will require a step change in income recognition that will impact the company's profit margin out to 2023, before accelerating.

The Investment Bank UBS noted this in their review of the announcement, *"The most significant change within the outlook is the major expected shift in the traditional business from on-premise to the cloud, with maintenance now expected to be less than €9bn in 2025 compared with an implicit €12.5bn in 2023 previously. Licences are also expected to be meaningfully lower as both new orders and installed base activity around core products such as S/4 are expected to move to the cloud. This is a big change from the previous (pre-COVID-19) view, which largely saw the migration activity as restricted to a handful of percentage points of licence growth each year with minimal impact on existing customers' consumption pattern."*

And importantly, while SAP management led by CEO Christian Klein have set these ambitious targets, they have done so at a point in time when their cloud offering still lags the on-premise offering, *"next year the public cloud version will have 80% of the functionality that today our on-premise version has."*

So, while the majority of SAP customers want a cloud solution, they are unlikely to shift if the offer is functionally diluted, leaving the business caught in the middle of satisfying two customer sets.

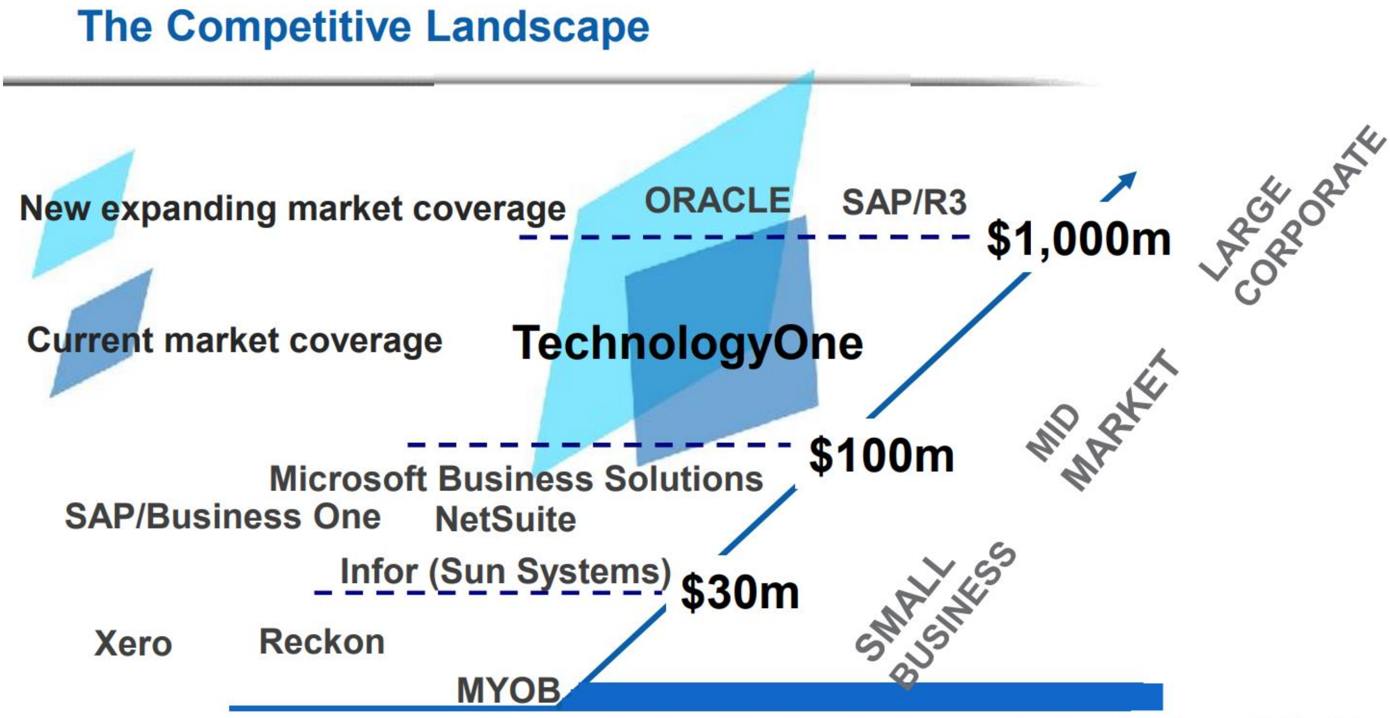
The market's reaction to the company's shock announcement was unsurprising. The group's market value dropped 40%, as investors came to grips with the short-term earnings hit and the increasing commercial risk in successfully executing a plan that has been forced on the company.

TechnologyOne

Australia's own mini version of SAP is our listed ERP software vendor TechnologyOne, a business established in 1987. The company's profile is not dissimilar to that of SAP, as Figure 7 highlights. Focusing on eight core business segments, including local councils, universities and governments (see Figure 8), the business customer base now exceeds over 1,200, with more than 539 now signed up as cloud customers (see Figure 9).

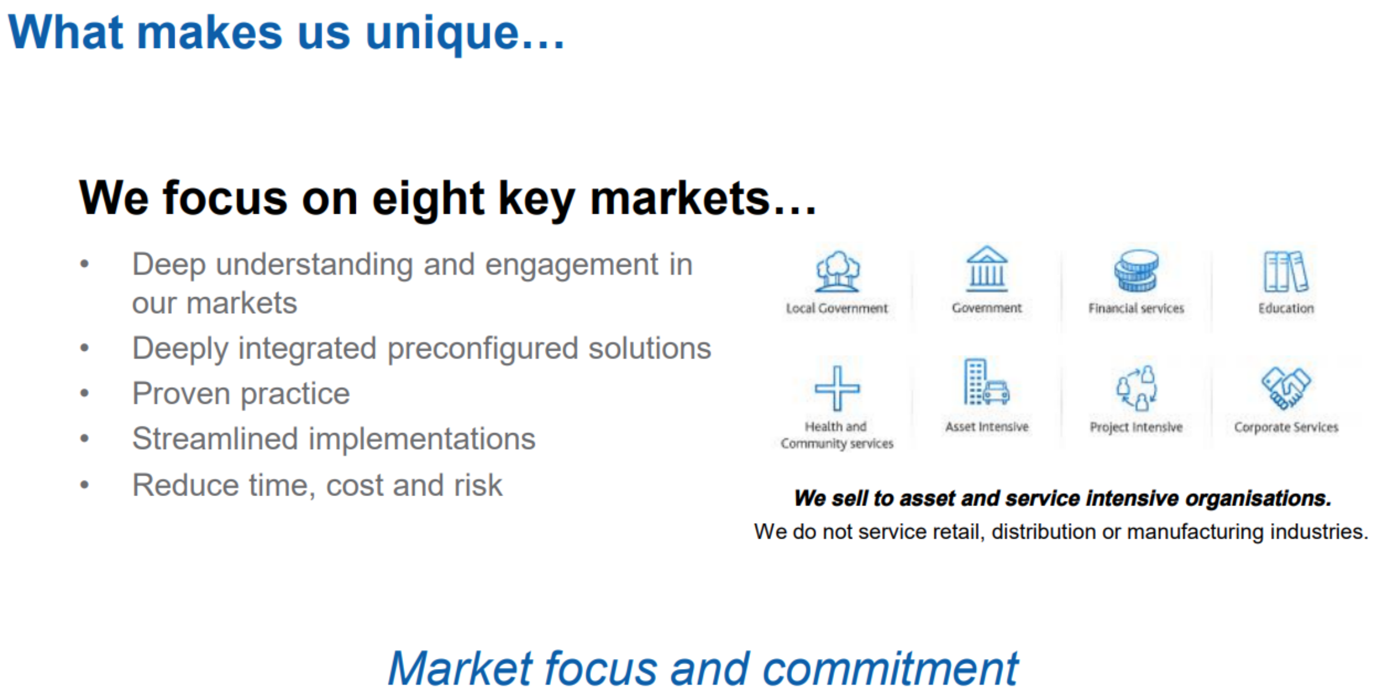
Their cloud journey has parallels with SAP, as customer revenues shift from on-premise sign on fees, including implementation consulting income and annual license fees, to subscription-based software-as-a-service (SaaS) enterprise customers.

Figure 7: Enterprise Resource Planning landscape



Source: TechnologyOne 2015 full year results presentation

Figure 8: TechnologyOne's ERP offering



Source: TechnologyOne 2015 full year results presentation

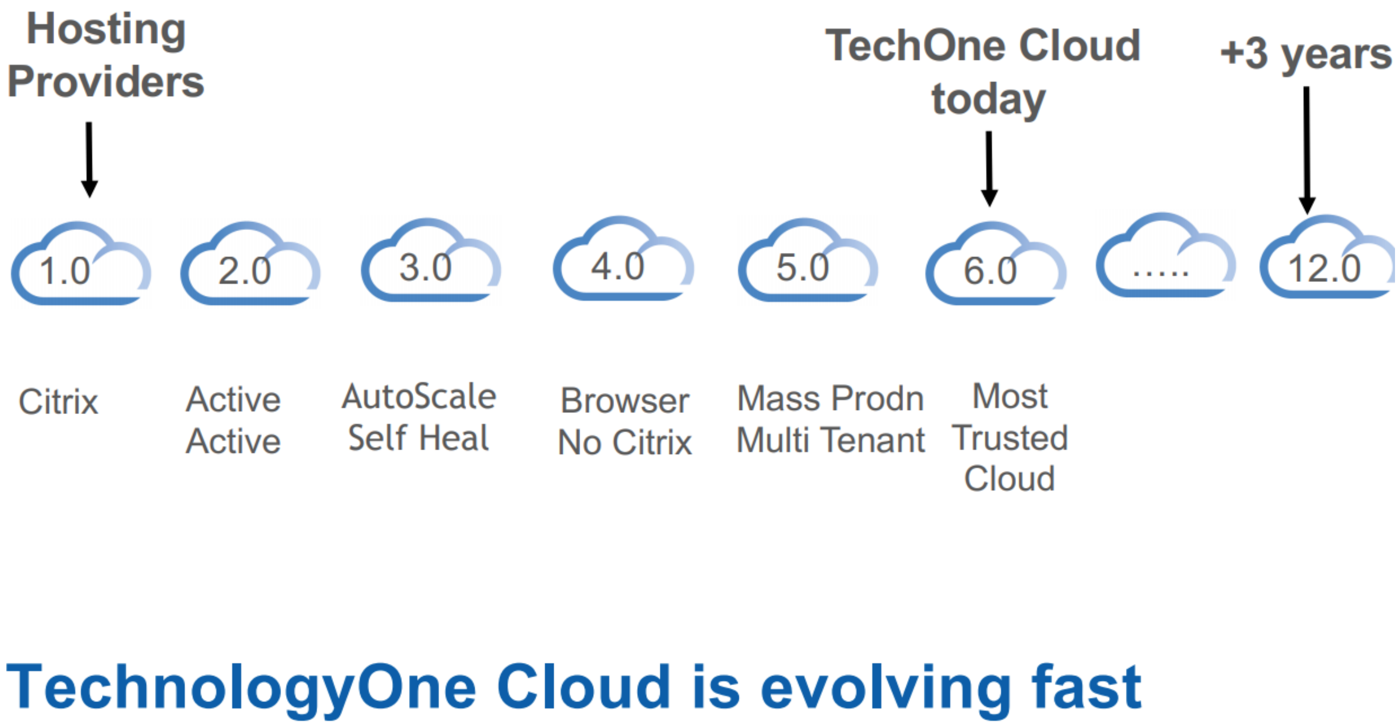
Figure 9: TechnologyOne’s SaaS customer base

Source: TechnologyOne 2020 full year results presentation

Figure 10: TechnologyOne announcing transition to the Cloud – early adopters

Source: TechnologyOne 2015 full year results presentation

Figure 11: TechnologyOne Cloud offering – moving to mass customer transition



Source: TechnologyOne 2016 full year results presentation

Figure 12: TechnologyOne Cloud offering – loss making

Source: TechnologyOne 2016 full year results presentation

The company's transition to the cloud had been many years in the making, as reflected in Figure 10, Figure 11 and Figure 12 above.

Unlike SAP, TechnologyOne was completely committed to the cloud shift and actively promoted the offering to its customer base via the *"Cloud first, mobile first"* campaign. The cloud offering, which began in earnest in 2015, saw the company report a 2016 full year loss of $2.2m associated with this investment.

It has since motored on and while the accounting treatment of the old revenue model and the new SaaS offering has made like-for-like financial comparisons difficult, the business is well on track of converting its existing customer base to the cloud.

An excellent illustration of this trend was the Tasmanian Government's announcement in November to transition seven of its departments to TechnologyOne's cloud platform by 2022, including: Premier and Cabinet; Treasury and Finance; Education; State Growth; Primary Industries, Parks, Water and Environment; Police, Fire and Emergency Management; and Justice.

Minister Michael Ferguson provided the rationale behind the move, *"Transitioning seven government departments to the cloud will provide a foundation for us to emerge from COVID-19 stronger and will improve the resilience and safety of Government held data and our cyber security footing. Our Digital Future sets a clear agenda for whole-of-government digital transformation and more strategic use of technology including cloud services. I'm pleased to see departments realise these opportunities and embrace the future so quickly."*

The choice of TechnologyOne was equally clear, being the *"only global enterprise software company…meeting the standards required to host data classified up to, and including, protected level."*

Full year 2020 result

The company delivered a strong, clean operational performance for the year ending September 2020. Key metrics worth noting are the drop in legacy licence fees associated with the sign up of on-premise contracts and the uplift in SaaS revenues, as seen in Figure 13.

This change in revenue mix is reflective of the business' migration to the cloud and underscores the quality of the performance, with recurring subscription revenues now representing 86% of total revenues. As more of the 1,200 customer base switches over, the company expects annual recurring revenue base (ARR), which ended the year at $134m, to hit $200m by 2026, and total recurring revenues, including annual licence fees, to exceed $500m.

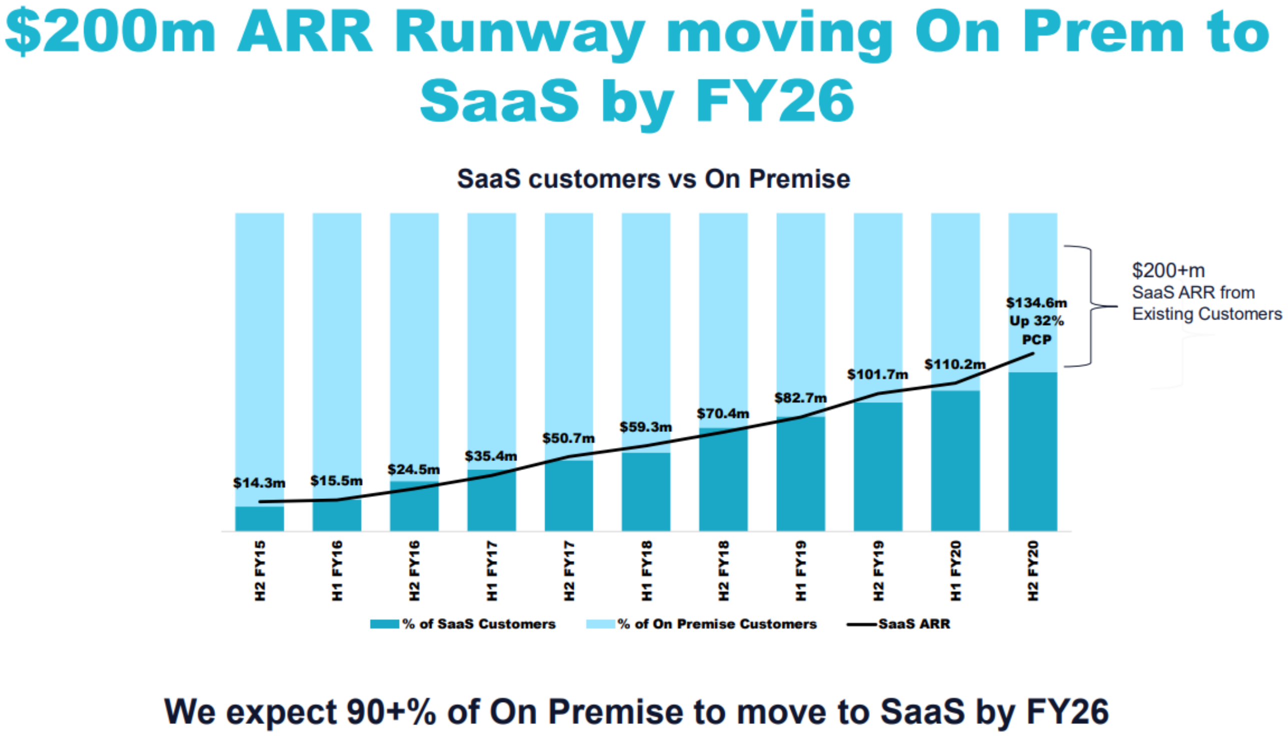
Figure 13: TechnologyOne revenue mix 2020

Revenue – SaaS & Continuing Business up 12%

	FY20	FY19	Growth $	Growth %
Total Revenue	**$299m**	**$286m**	**$13m**	**4%**
Less Legacy Licence Fees	$27m	$41m	($13m)	(33%)
Less Associated Annual Licence[1]	$1m	$3m	($1m)	(55%)
Revenue – SaaS & Continuing Business	**$271m**	**$243m**	**$28m**	**12%**

Source: TechnologyOne 2020 full year results presentation

Figure 14: TechnologyOne Saas runway out to 2026



Source: TechnologyOne 2020 full year results presentation

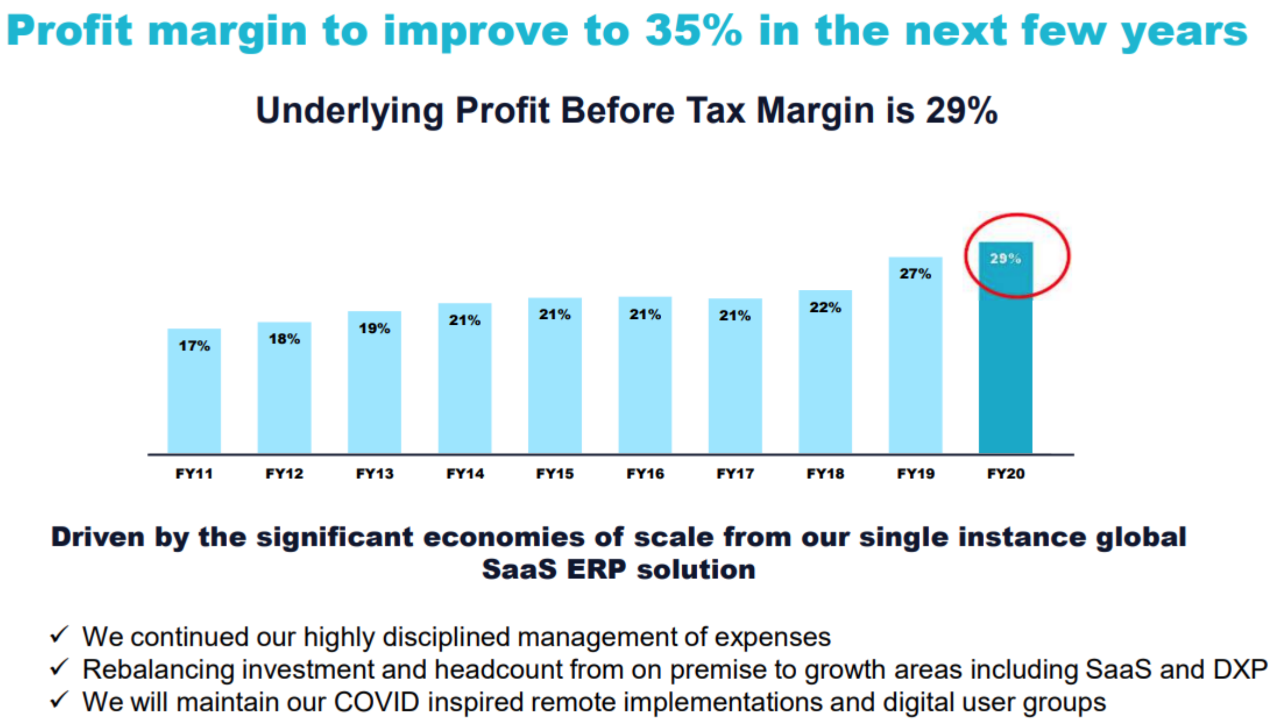
Margins

A by-product of this revenue transition is a positive upward shift in profit before tax margins. While the company capitalises a portion of research and development (R&D) spend, namely 54% in 2020, the consistency of this allocation methodology since first introduced in 2019 allows for proper comparisons to be made. As Figure 15 highlights, margins hit 29% in 2020, with management now pointing to 35% over the near term.

Here it is worth nothing that for any business transitioning from one business model to the next, like SAP and TechnologyOne are undertaking, the key risk is in retaining the customer. And as each customer transitions, the business model improves, with the outputs being higher recurring annuity revenues and improving margins.

In short, a better business model that is worth considerably more. As things stand, one business, SAP, is currently at the highest risk point, the other, TechnologyOne, is at the inflection point of being a better business.

Figure 15: Profit before tax margins



Source: TechnologyOne 2020 full year results presentation

If we accept the company's narrative, investors would be hard pressed to find a business as well positioned as this. We would go one step further though and add the following into the mix:

1. The business has grown organically, rarely buying and inherently focused on internal investment.
2. Underpinned by R&D spend, with 22% of group revenues allocated to this endeavour.
3. This investment is giving rise to new revenue streams, selling more products and modules to the group's existing customer base.
4. The scale and technology base is such that it has elevated the group, winning new Federal Government contracts, earning the highest government security rating (IRAP certification) and successfully competing against global providers, including SAP and Oracle.
5. In the U.K., in a market three times larger than that of Australia, the business is now operating on a breakeven basis.
6. Finally, a balance sheet with net cash of $125m, alongside a disciplined and consistent dividend paying approach.

Whereas SAP has been forced to respond to changing market forces, local operator TechnologyOne has steadfastly shifted the business from on-premise to the cloud. There is more to go here, but if you look at the progress made since 2015 when SaaS was first unveiled, the leadership shown is nothing short of impressive. The point to be made, as we contemplate the world post COVID, is investors underestimating management's consistency of earnings delivery that few others have been able to match.

Summary

Digital adoption, the shift to the cloud, and the necessity for businesses to reinvest to drive scale and technology leadership, is a global thematic that will only continue to accelerate. Already we are seeing this in traditional fields of endeavour, most notably the rapid adoption of digital therapeutics in life sciences. At its core is cloud technology. ***SFM***

ALTIUM – AN ENGINEER'S PERSPECTIVE

In our company review section this quarter we provided an annual general meeting (AGM) update from leading electronic printed circuit board designer Altium. It is a business we have covered on multiple occasions and one Selector has held on behalf of clients for close to seven years.

At the recent AGM, the company's CEO Aram Mirkazemi's spoke about the shift to the cloud. His address to shareholders titled, Embracing the Cloud and Accelerating Transformation, signals a critical juncture for the business. As CEO Mirkazemi notes, *"Our strong software business drives our dominance engine, and our new cloud platform Altium 365, is the basis of our transformation engine. From a business perspective, these two engines provide independent drive, and at the same time are complimentary and reinforce each other."*

Chairman Sam Weiss continued in a similar vein, speaking about the company's new organisational reset to support the changes identified and to help facilitate a hard pivot to the cloud, known internally as the *"Netflix Moment"*.

CEO Mirkaezmi makes a clear distinction however, noting Altium *"is not taking our design software to the Cloud, but encouraging our customers to move their data to the Cloud for collaborative purposes. This will enable seamless collaboration, in real time, for the realisation of electronic hardware, something that until now, has been very labour-intensive and quite frankly archaic. Engineers have had to contend with emails, phone calls and in-person meetings to collaborate on their designs. With Altium 365 this is all done at the platform level in the Cloud."*

The cloud rollout began in May 2020 and as the company indicated at the meeting, the early signs are extremely positive. Altium 365 is free for all users who sign up for the Altium Designer software standard membership, with the aim of driving a network effect across the industry's engineering designer base.

Below we share an independent technical review from a user's perspective. We hope you find it useful.

Altium Designer 20 and the Altium 365 Platform

By Luc Lemmens, Technical Editor at Elektormagazine.com. Published on 9 December 2020.

Keeping software up to date is a luxury that we cannot always afford, especially when it comes to more expensive licenses such as Altium Designer (AD), the PCB design package that we use at Elektor. But let's be honest: are updates really worthwhile? For Altium Designer 20 and Altium 365, the answer is a resounding "Yes"!

Some time ago, Elektor started using Altium Designer 6, after working for years with Cadence OrCAD for schematics and Ultiboard for PCB design. After our initial investment, we skipped several subsequent updates, until Altium Designer 14 was released.

Software updates can be time consuming, but in this case everything worked fine. Most — if not all — settings were automatically copied into this newer version and the user interface didn't change much, so we could start using Altium Designer 14 (almost) immediately. As I recall, for the designs we normally made in the Elektor Lab, there weren't that many significant changes or new features that we really needed, actually.

Recently, we updated to Altium Designer 20, and frankly, I didn't expect to get as excited about this new version as I am now. Read on to learn exactly why!

Getting started with a new version

When we upgraded from Altium Designer 14 to Altium Designer 20, the change initially seemed to be a lot bigger, which is largely due to the new, dark GUI...quite a difference from the light backgrounds we were used to. Thankfully, you get used to it very quickly.

This isn't to say that nothing else has changed in Altium Designer 20, but as with the previous upgrade, the settings were automatically imported and you can work with the standard operations just as with Altium Designer 14. It is a relief that the familiar key combinations (hotkeys) still have the same functionality; other software manufacturers could learn something from this. The older version still keeps working and it is quite reassuring that you can, if necessary, go back to a more familiar trusted version.

Altium Designer is an enormously extensive and powerful PCB CAD tool, which offers far more functionality than is needed for the designs that Elektor usually publishes. One of the reasons for choosing Altium Designer 6 was because the schematic editor offers graphical features (such as selecting different line thicknesses and fonts) that are missing in other CAD packages, so that the schematics could immediately be drawn and published in the trusted Elektor style. Previously, all schematics were redrawn by our graphical department and the result had to be *"manually"* checked with the original. The introduction of Altium Designer didn't mean that we never used other CAD software, as we do when working on projects from external designers, but that illustrated how user-friendly Altium Designer is, especially when it comes to creation and maintenance of custom-made schematic and PCB libraries.

The new features of Altium Designer 20 are summarized on their website, so it doesn't really make sense to discuss them here (plus, we'll be migrating to Altium Designer 21 soon). Altium has long since ported the software to 64-bit architecture, which improves the performance especially for larger designs. For Elektor, it was great that Altium Designer could already import Autodesk Eagle CAD files because many designs from external authors were developed with this design package, and in Altium Designer 20 imports from KiCad are also supported. But it's the availability of Altium 365 that really makes everything fall into place in the best way possible.

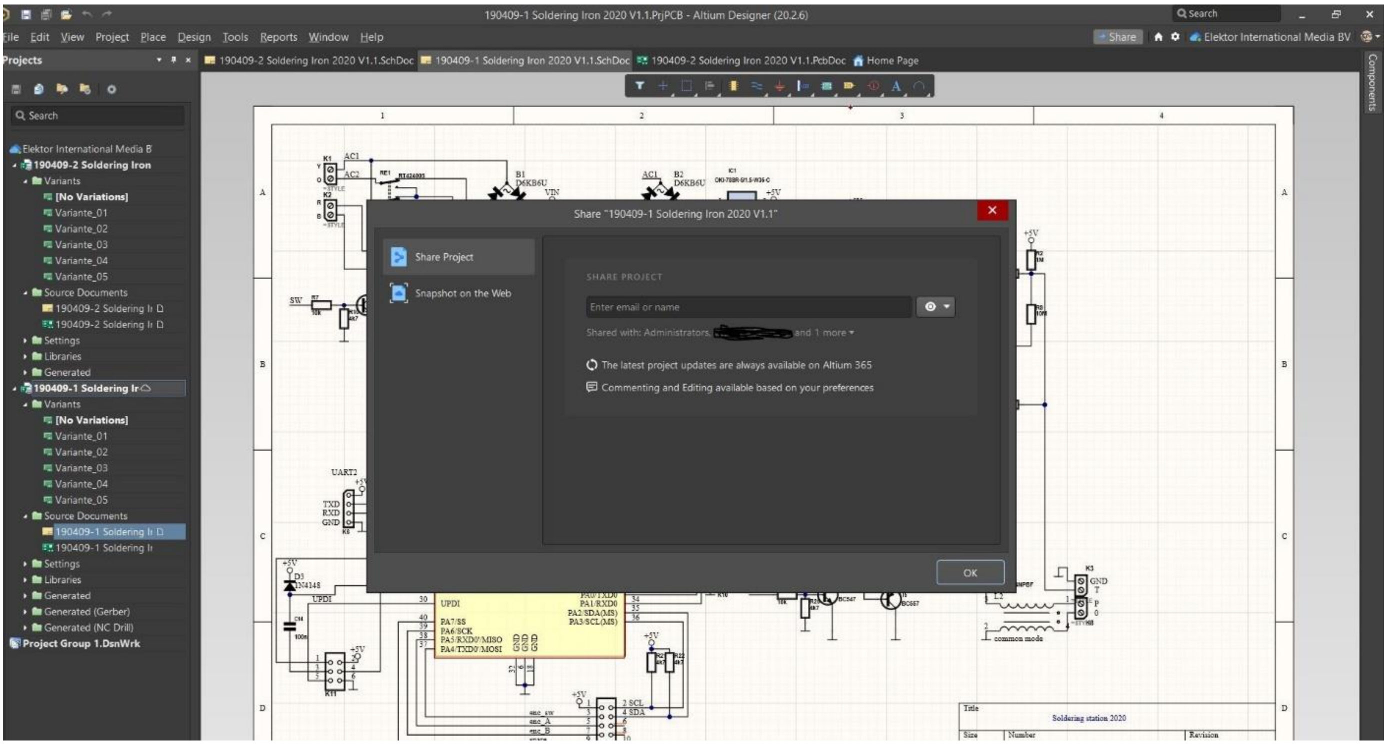
Altium 365 is the world's first cloud platform for PCB design and realization. If you're invited to join a team, you only have to provide a password for logging on; no registration is required. I had never seen something like this before, and it is absolutely fantastic.

All people involved in a project can now follow your work from the start, at every stage of the design, and indicate in good time what can or must be changed, without the time-consuming process of making and mailing screenshots, exporting your design data to formats that can be viewed by everyone involved and keeping those files up to date.

Putting your project on the cloud

To collaborate on the cloud using Altium Designer 20 and Altium 365, start by opening the project you want to share. In Figure 16, in the upper right corner, the online workspace Elektor International Media BV is active and open.

Figure 16: Invite team members and share your design



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

Click the Share button next to this workspace to open the dialog window shown. Here you can enter the email addresses of the stakeholders, the people you want to share your project with.

Clicking the button with the eye-shaped icon next to this input field is used to select if this participant can either view or even edit the design files. Licensed Altium Designer 20 users have editing rights; viewing requires no additional software except for a web browser.

Designated team members receive an email containing a link to log on to your workspace and access the project design files. After logging on, the screen in Figure 17 is presented, clicking on one of the shared projects presents a screen like shown in Figure 18.

Figure 17: Initial view after logging on

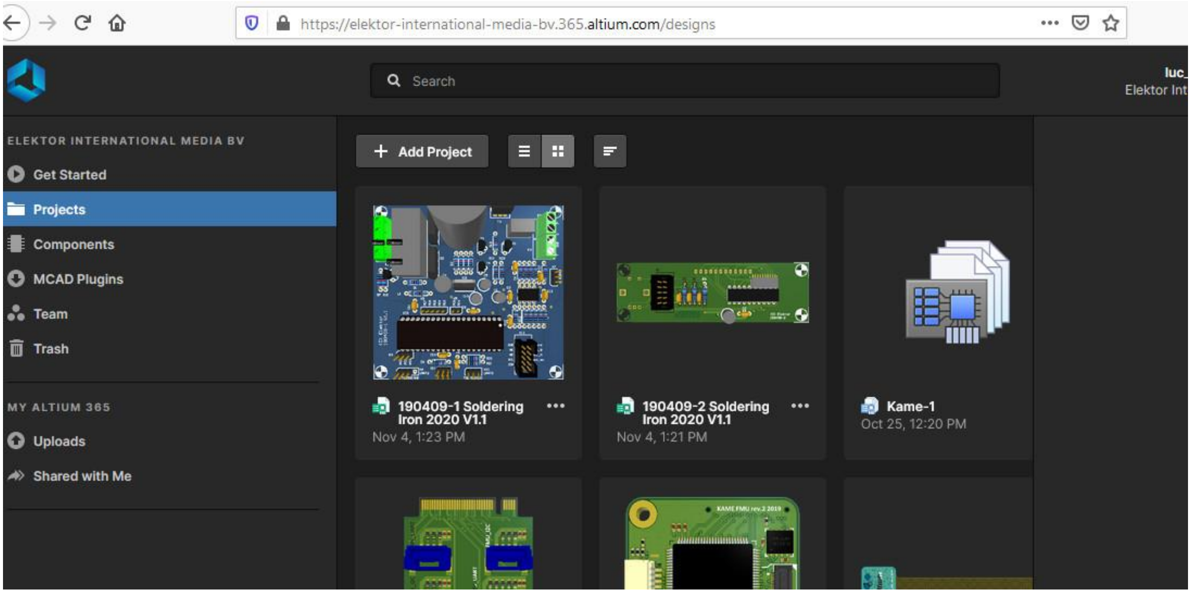


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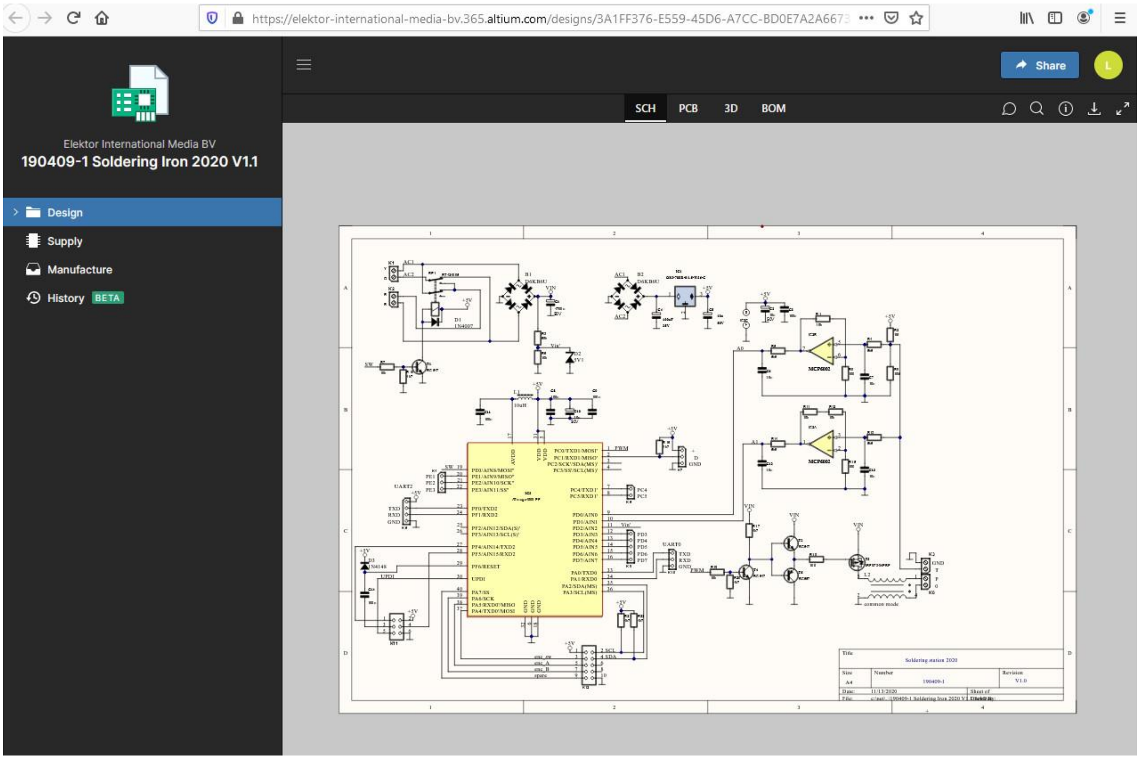
Figure 18: Shared Altium Designer schematic diagram

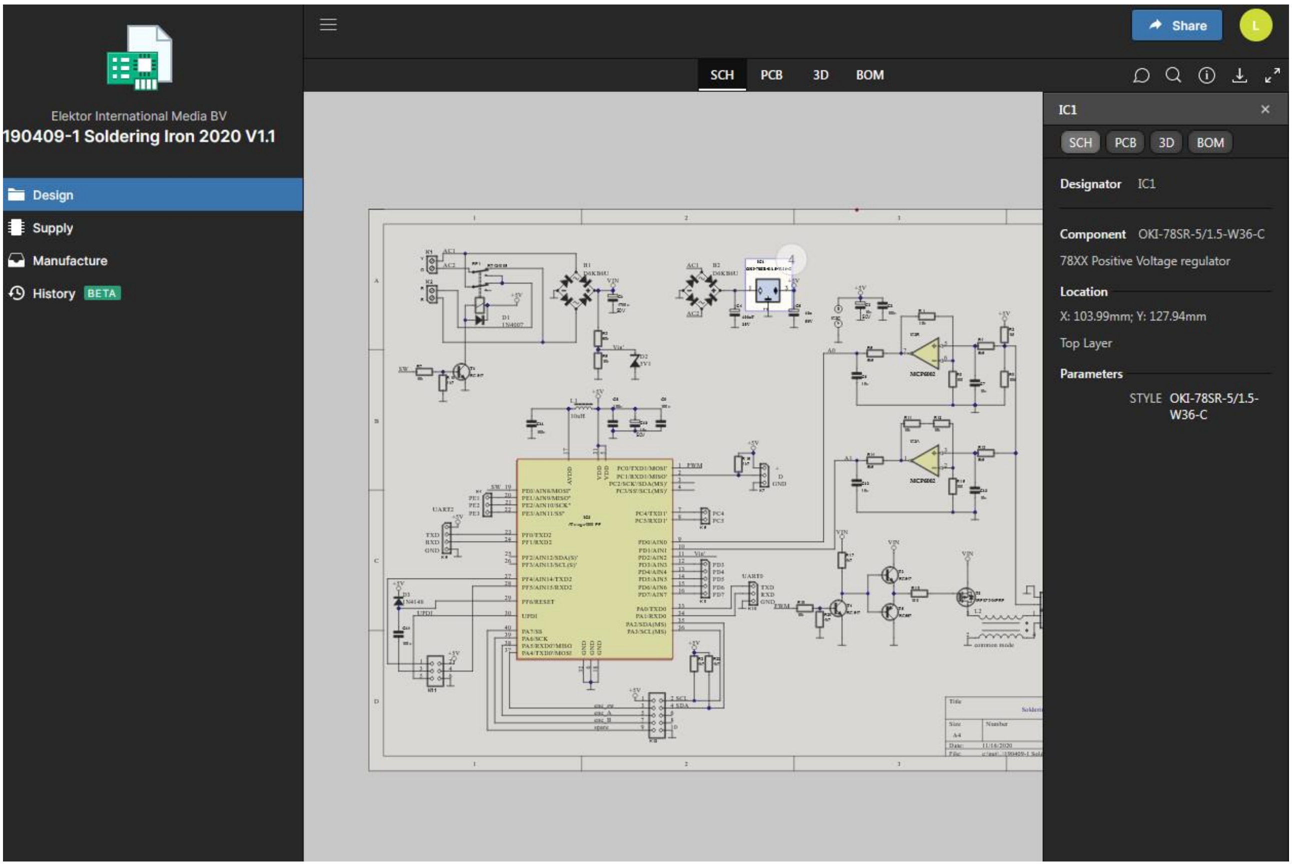


Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

At every stage in the design process, the most recent version of the schematic, PCB layout, 3D view and BOM can be viewed (tabs SCH, PCB, 3D and BOM respectively), which is already a great step forward when you're used to exporting files after every update. But there is much, much more than just static views!

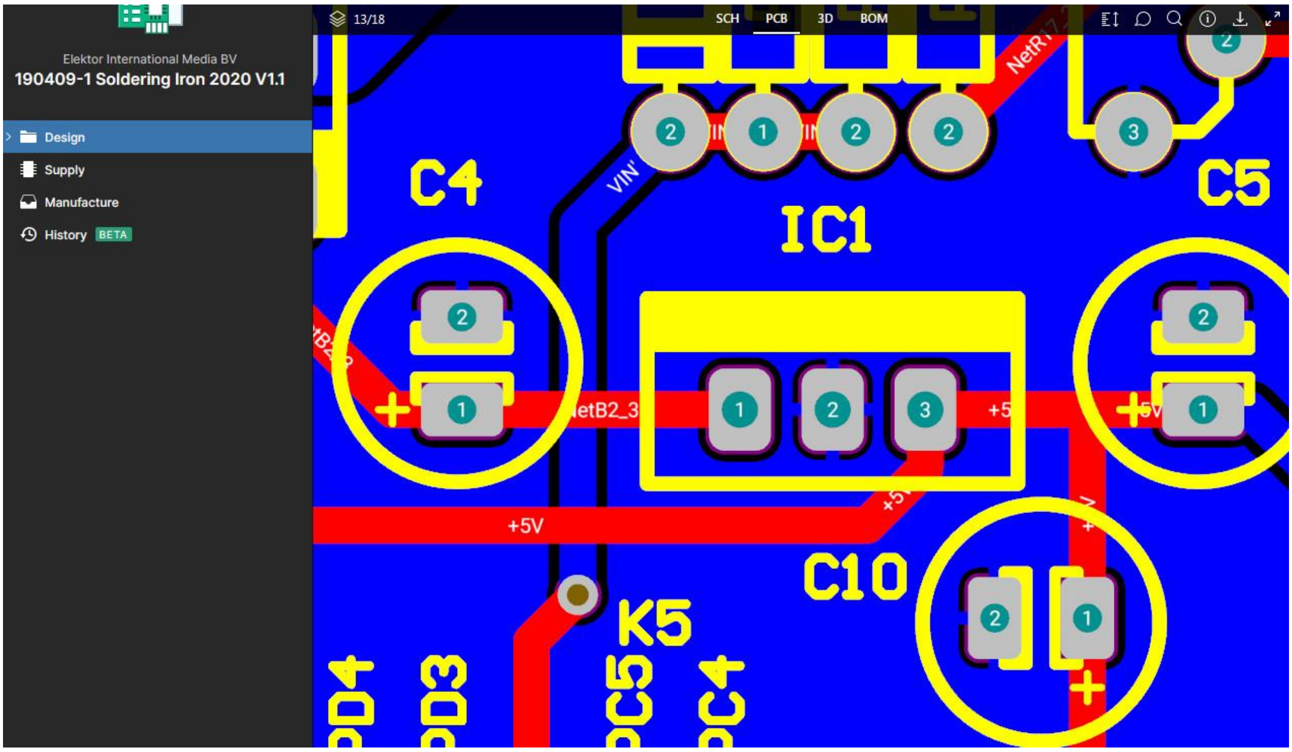
Altium 365 is context-sensitive, so cross-probing between all views is very easy. For example, when you click a component in the schematic diagram, an info panel with its schematic diagram data will be displayed at the right side of the screen. Clicking on PCB, 3D or BOM shows its position on the PCB, its 3D view and component list data respectively (Figure 19, Figure 20 and Figure 21).

Figure 19: Cross-probing between schematic, PCB, 3D-view and BOM.



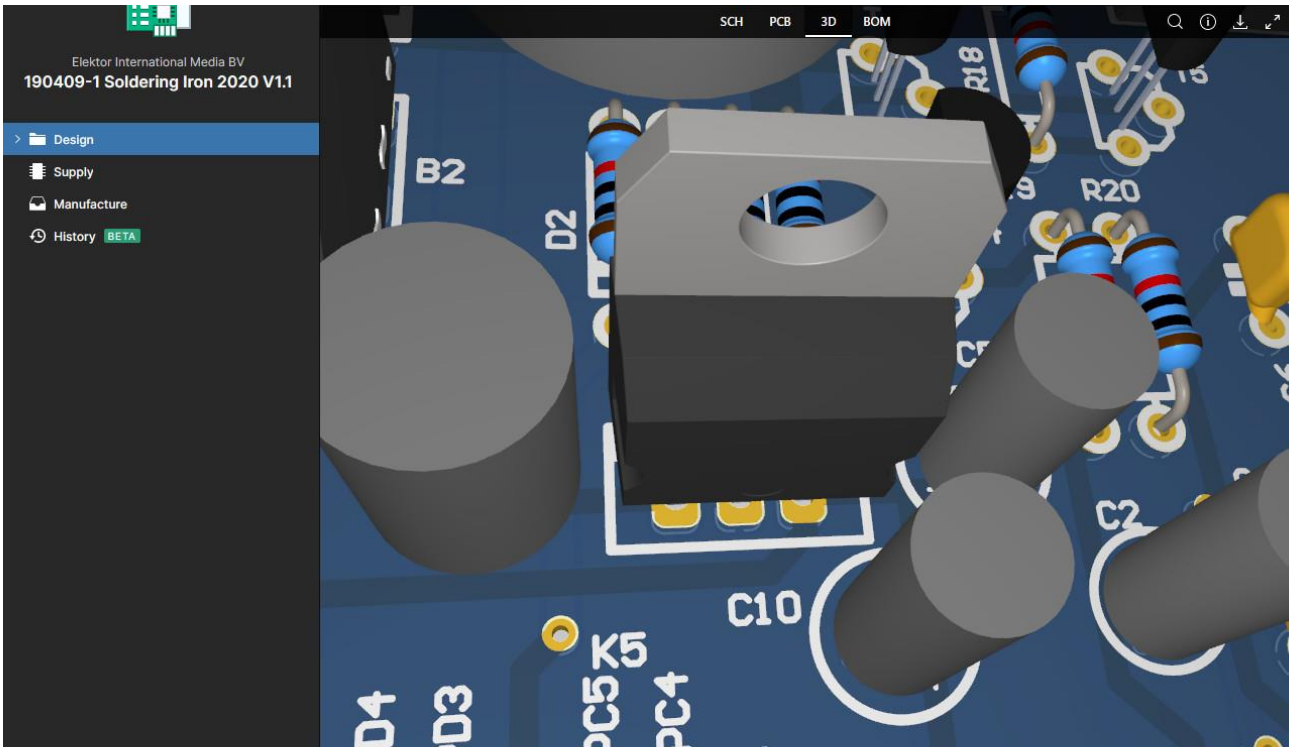
Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

Figure 20: Cross-probing between schematic, PCB, 3D-view and BOM



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

Figure 21: Cross-probing between schematic, PCB, 3D-view and BOM



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

You can also start with selecting a component in any other view (e.g., click a component's designator in the BOM and see where it is on the PCB layout, which comes in handy when assembling your prototype).

If you think that's great, try clicking the component's name in the BOM and your browser will display the part on Octopart (Figure 22, Figure 23 and Figure 24), offering links to the datasheet and suppliers.

Figure 22: Components in Octopart, links to data sheet and supplier

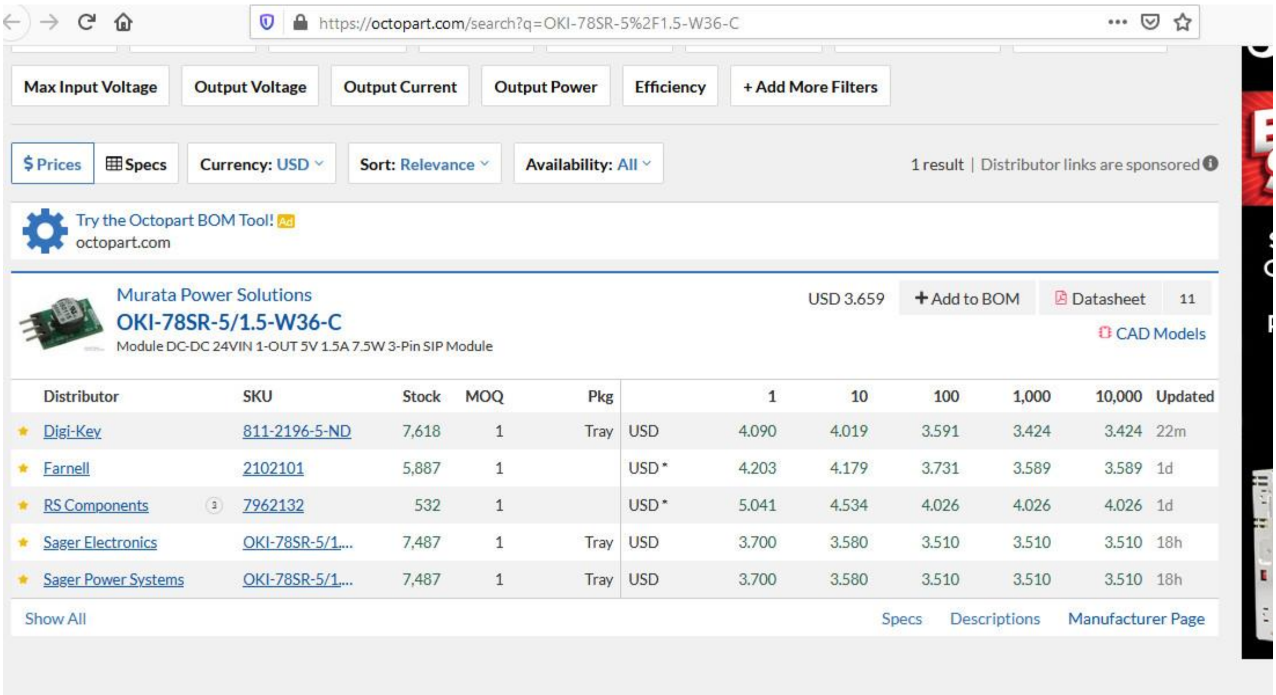


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Figure 23: Components in Octopart, links to data sheet and supplier

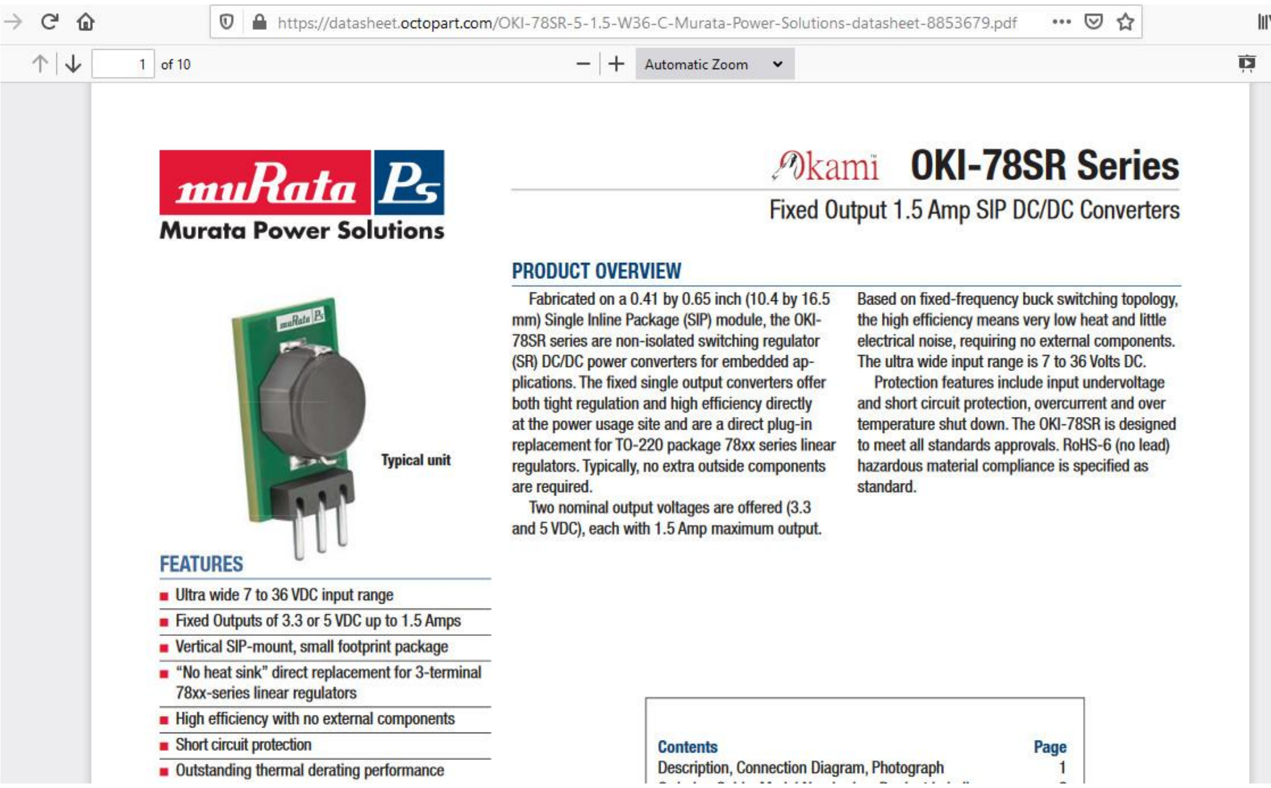

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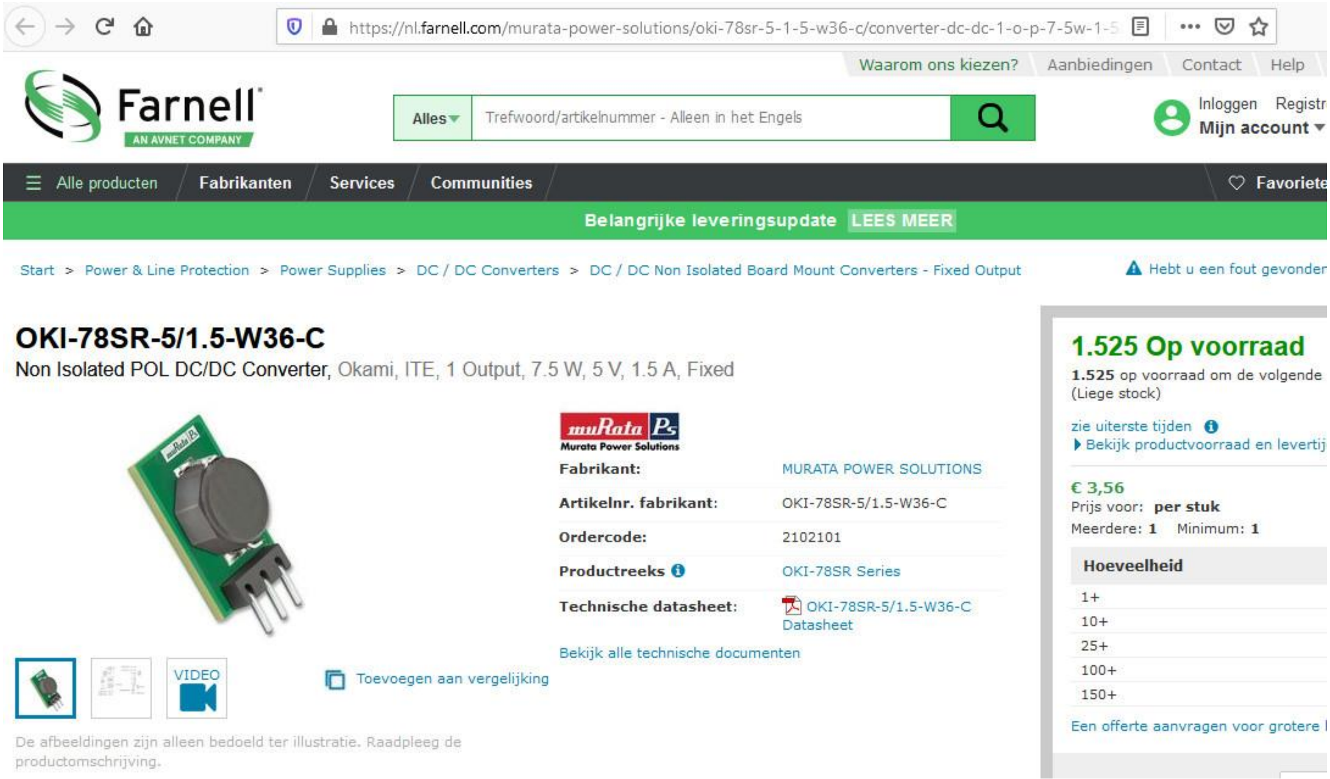
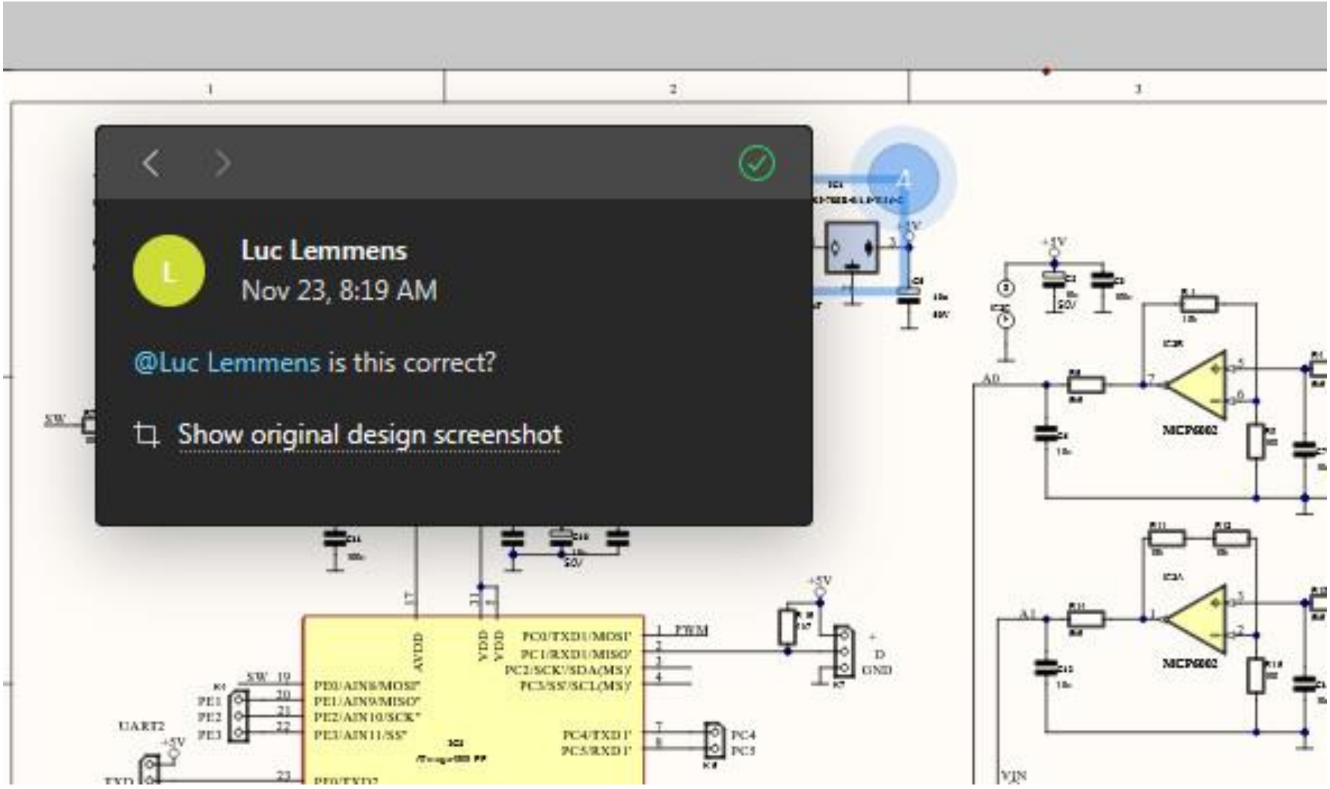
Figure 24: Components in Octopart, links to data sheet and supplier



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

Figure 25: Commenting a schematic diagram



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

Octopart is a powerful search engine that makes it fast and easy to compare millions of components, find technical information, quickly make component selection decisions, and purchase parts from thousands of distributors.

In the schematic and PCB view, any participant can add comments by clicking the button with the speech balloon icon, marking an area and typing the question and/or remark (Figure 25).

When the name of a team member is added to the text (with the preceding "@"), the person concerned will receive an email notifying him or her of the need to take action. When multiple Altium Designer users are involved in the project, version control is available to keep track of the latest changes and history of the design.

Not just for Altium Designer users

If you use PCB design software other than Altium Designer, you can still benefit from Altium 365. The online viewer tool not only supports viewing and sharing of Gerber data, but also of schematics and PCB layouts designed with a variety of PCB software applications, including Autodesk Eagle and KiCad.

The viewer tool's functionality is a bit more limited than when using Altium Designer. After you have uploaded files to the viewer, you can send a link to people you want to share this data with and this link remains valid for 48 hours. With this approach, you only share snapshots and after every change you will have to upload and share new data. The data is not in a workspace that contains design files that are always automatically up to date, but this is already an enormous improvement because you can give other people involved in your project a much deeper and more detailed insight into the design data than, for example, in a PDF or screenshot. To illustrate, Figure 26 and Figure 27 shows details of an Autodesk Eagle PCB design in the online viewer, where the user can select nets or components to look at them more closely.

Figure 26: Eagle PCB in the Altium 365 online viewer

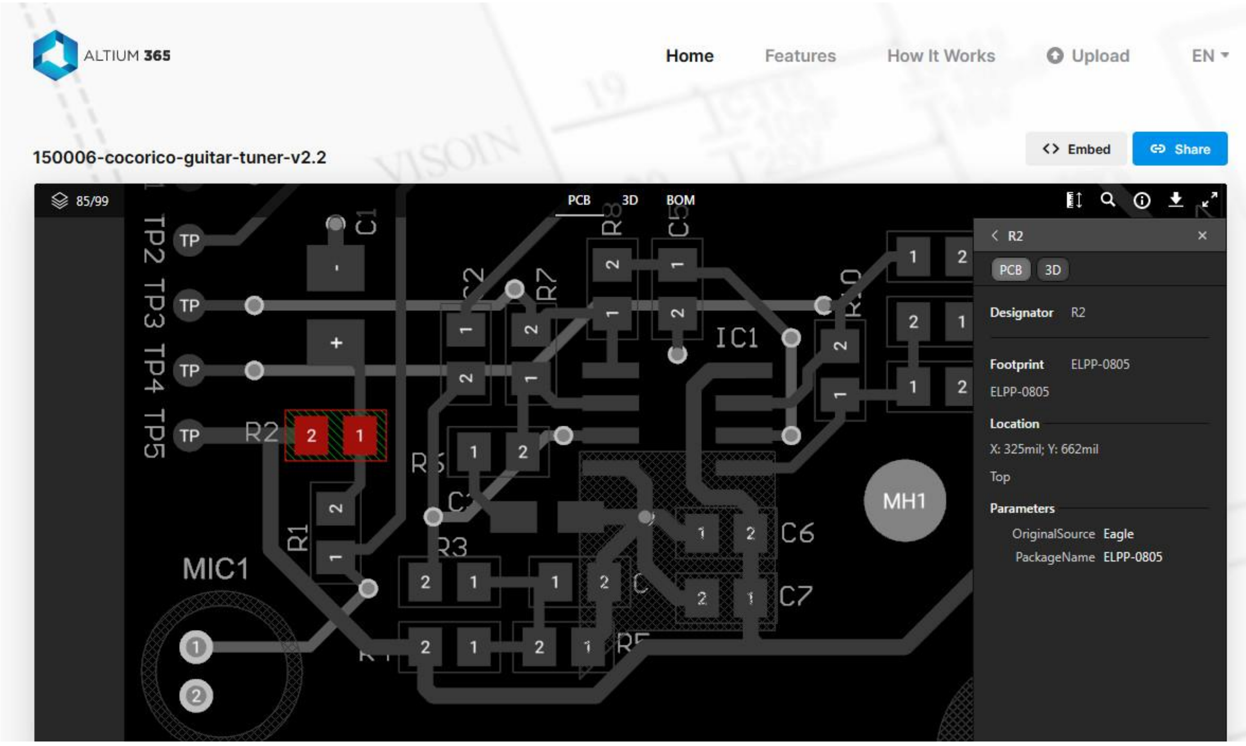


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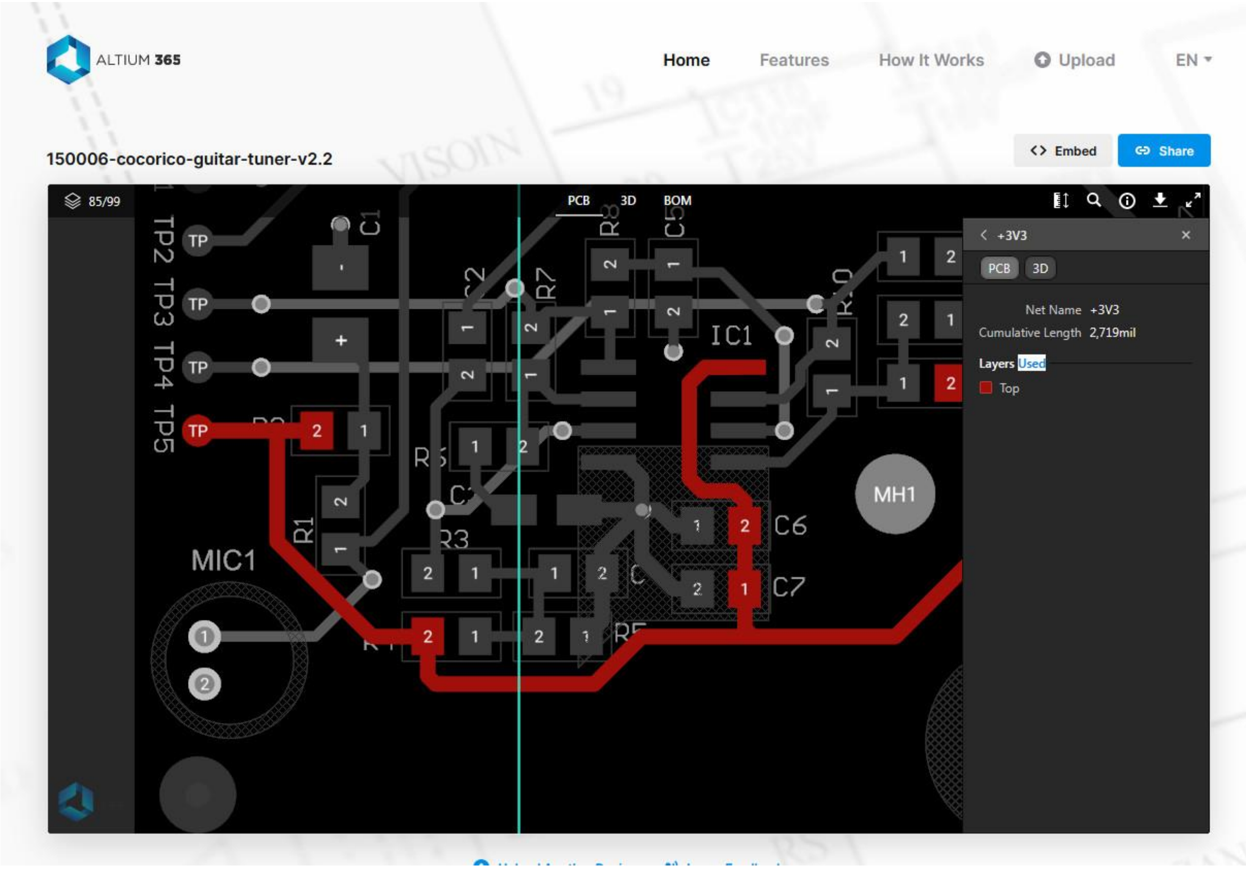
Figure 27: Eagle PCB in the Altium 365 online viewer



Source: Lemmens, L., 2020. Get To Know Altium Designer 20 And The Altium 365 Platform. [online] Elektor. Available at: <https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform> [Accessed 11 December 2020].

As a long time Altium Designer user, I am absolutely thrilled by Altium 365. This is really what we needed and what we had been looking for — for years now. Altium Designer may not necessarily be the most affordable schematic/PCB design solution but considering the time that can be saved by including all stakeholders in the development at a very early stage by using this CAD software combined with Altium 365, even the stingiest boss can hopefully see the benefits of investing in an Altium Designer license.

The article referenced can be accessed from: https://www.elektormagazine.com/news/altium-designer-20-altium-365-platform ***SFM***

PROXY VOTING – LOTTERY TICKET?

Back in our December 2019 Quarterly Newsletter we wrote an article titled "Pick a chart". At the time we were quite incensed at the way remuneration voting outcomes resulted in random outcomes that seemed to punish some businesses more than others. On that occasion we highlighted how Carsales.com (2019 annual general meeting) and CSL (2016 annual general meeting) had been dealt a negative first strike against its remuneration report, while leading local banker Commonwealth Bank of Australia (2019 annual general meeting) sailed through.

Obviously share price performance and financial metrics were not the key determinants under the microscope, because on both points Carsales.com and CSL have excellent records.

Commonwealth Bank itself is not too shabby on the score but the external events of 2019, following The Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry, resulting in the loss of its CEO and the remediation provision of $2.1b, hardly raised a peep from the industry's proxy advisors.

We wrote at the time, *"These are organisations that provide research and voting services to shareholders, primarily institutional investors. In some instances, the proxy advisors are owned by the investors in which they represent, namely a collection of the industry superannuation fund providers.*

Proxy advisors seek to provide a collective voice on a range of issues including remuneration, as well as environmental, social and governance matters.

As businesses are increasingly complex, proxy advisors attempt to engage with pertinent issues that may influence how their clients should vote. Whilst they serve important purposes for their constituents and we support the independent voices, not all proxy advisors are the same. Some look to address company matters at meetings on a case-by-case basis, while others take a blanket approach that looks to impose an outcome irrespective of circumstances.

The power shift to proxy advisors, largely a result of the increasing level of company ownership by the industry super funds, has given rise to a collective, unified voice that aims to effect change. In addition, many investors, including the industry's asset managers, have abdicated their duties to vote, leaving the door open for proxy advisors to dominate proceedings."

As we traversed COVID-19 and entered the back half of 2020, attention shifted to the new company format of virtual annual general meetings. Technical aspects aside, these forums enable investors to listen and participate online, irrespective of physical location.

Within this context Commonwealth Bank held its annual meeting during October. Prior to the event, the industry's main proxy advisors were jockeying for their respective voices to be heard. On this occasion the matter gaining most attendance related to the remuneration report, involving the group's CEO Matt Comyn and the executive team.

The company's annual report for 2020 tabled the remuneration results for the year. Generally, the majority of executives of publicly listed companies are remunerated on three levels; a fixed base salary, a short-term incentive and a long-term reward.

The challenge however is the lack of consistency in how these programs apply. Each organisation carries out its remuneration activities on an individual basis, leading to differing outcomes and views.

In the case of Commonwealth Bank and focusing specifically on the short-term variable remuneration (STVR), the board agreed to reward CEO Comyn with a $2.42m payment, made up of cash (50%) and deferred equity (50%). This represented a STVR payout of 73%, compared to the maximum that could have been received for the year. The results of the CEO performance outcomes are shown below in Figure 28, along with the rationale behind each decision.

Figure 28: Commonwealth Bank 2020 remuneration outcome

2. Variable remuneration outcomes for the financial year ended 30 June 2020

CEO STVR performance outcomes

Reflective of Group performance, the CEO's 2020 financial year STVR outcome is: **73% of max**

Measure, rationale and commentary	Weight	Scorecard result: Threshold 50%	Scorecard result: Target 100%	Scorecard result: Stretch 150%	% of STVR maximum
Financial Strong underlying financial performance, however NPAT outcome materially impacted by significant provisions for expected future loan impairments. PACC outcome impact less material given long-tail nature of potential impact: • Group cash NPAT – below threshold (Actual: $7,449 million).	15%	8,122	8,520	8,919	0%
• Group underlying PACC – above threshold (Actual: $3,913 million).	15%	3,730	4,214	4,699	7%
Customer NPS outcomes for consumer, business and IB&M customers, with reference to complaints remediation: • Consumer, business & IB&M NPS ranked #2 or higher for majority of the 2020 financial year. • Progress addressing systemic challenges and underlying causes.	10%				6%
People Group People measure results (focus on culture, wellbeing, talent and capability): • Significant increase in employee engagement indicating strong pride, satisfaction and connection with the Bank. • Ongoing renewal of executive and senior leadership teams, with targeted growth in critical capability, and delivery of cultural change.	10%				9%
Strategy Progress on and quality of implementation of the APRA RAP: • All APRA RAP milestones delivered on plan to the Independent Reviewer, with the Second Foundational Review approved.	30%				22%
Significant progress on the delivery of Group strategic priorities: • Continued focus on innovation with the launch of Vonto, Home-In and CommSec Pocket, and innovation capability (x15 ventures, Klarna). • Strengthened leadership position in digital (online, Banking app). • Significant progress on targeted divestments and simplification of portfolio.	20%				19%
Overall CEO STVR outcome					63%
Values assessment • Role modelled the Group's 'Should We' test through the bushfire, drought and coronavirus pandemic responses, displaying national and Bank leadership. • Demonstrated personal care and support for customers and communities, including through Compassionate Care and Financial Abuse support initiatives.			Exceptionally Demonstrated		No adjustment
Risk and reputation assessment • Clear tone from the top on risk compliance and the control environment, with notable progress in Financial Crime, data management and the RAP.			Fully Met		No adjustment
Board discretion • Industry leadership and contribution at a national policy level to the challenges faced by our customers, communities and the economy particularly over the second half of the 2020 financial year and the practical and ongoing steps taken to assist our customers, people and their communities.					10%
Overall adjusted CEO STVR outcome					**73%**

Source: Commonwealth Bank 2020 Annual report

The STVR components make for interesting reading and allow for comparison with other organisations. In the case of Commonwealth Bank, only 30% of the maximum STVR that could be earned was tied to a financial outcome. Here, the CEO achieved 7% out of a 30% maximum scorecard, a clear failure.

The balance of the 70% comprised of customer (10%), people (10%) and strategy (50%). The biggest component within this metric, comprising 30%, related to meeting the Australian Prudential Regulation Authority (APRA) Remedial Action Plan (RAP), flowing from the Royal Commission into Misconduct a year earlier.

Overall, the CEO scored a total STVR of 63% based on these metrics. At the discretion of the board, this was upsized to 73% taking into account the leadership actions undertaken during the second half of 2020.

In a year when all publicly listed companies have been scrutinised for paying out any type of bonuses, this level of reward certainly attracted conflicting views from those in the financial community.

Of the four most powerful local proxy advisors – ISS Australia, CGI Glass Lewis, the Australian Council of Superannuation Investors (ACSI) and Ownership Matters – it was ISS that questioned the merit of the payout.

As head of research Vas Kolesnikoff commented prior to the October annual general meeting (AGM), *"In CBA's case, the stock price has gone down 30 to 40 per cent, results are down 11 per cent for the year and the bonuses are getting bigger. Since when do you get a bonus for fixing a failure."*

"What are you paying for? For fixing stuff you did wrong that caused shareholder losses through fines and legal costs in the first place."

Off the back of these views, ISS Australia advised shareholders to vote against the company's remuneration report. Others it seems though, including CGI Glass Lewis, Ownership Matters and the ACSI, saw things differently and endorsed the report.

Their support was sufficient to carry all resolutions. In fact, the two most contentious, the remuneration report and the granting of securities to the CEO, passed with 79% of voting in favour.

Over at The Star Entertainment Group, things were a little different. In what was a particularly difficult last quarter of financial year 2020, COVID-19 and government actions effectively shut the group's operating casino businesses in New South Wales and Queensland.

Laying off the bulk of its 9,000 staff, the company qualified for JobKeeper and undertook significant measures to keep the business afloat. Management avoided seeking new equity from shareholders, but cost-cutting and banking support allowed the business to weather the storm.

At the group's AGM, the Chairman and CEO outlined the steps taken, including the cuts to director fees and management salaries of upwards of 50% for the last quarter of the year.

Of the $64.8m in JobKeeper subsidies received, it was confirmed that, *"Every dollar was used for the purpose the Government intended. Eighty-five percent flowed directly to team members who were stood down or working reduced hours. The remainder was used to return team members to their roles; an option that otherwise would not have been viable. There was no connection between JobKeeper and bonuses."*

It would seem the actions required of Star management were extraordinarily more difficult in keeping things afloat, compared to those at the bank.

Like Commonwealth Bank, the Star's financial gateway hurdle for 2020 was not met. The Board, however, used its discretion for the first time and approved a limited equity award, subject to a one-year retention restriction.

The short-term incentive (STI) was awarded to 784 staff participants within the program, with the CEO and CFO both receiving 48% of their STIs. These were measured against non-financial but equally important outcomes including: reaching agreement with the New South Wales Government on gaming taxes, concluding negotiations with the Queensland Government on casino exclusivity, delivery of the new Sovereign premium gaming project in Sydney, and maintaining construction delivery timelines on the new $1.6b Queens Wharf Brisbane casino.

Obviously in a year as difficult as 2020, the decision to award any manner of short-term bonuses needs to be carefully considered and sensitive to government received handouts like JobKeeper. The Star's motives for paying some level of STIs appears genuinely aligned to the positive actions taken in an extraordinary year and one that was government induced.

However, the view taken by a subset of shareholders, most notably the proxy advisors was a dim one. While all resolutions put to the meeting passed, the company received its very first strike against its remuneration report, with 49% voting against the resolution.

This was clearly a protest vote and didn't extend to the awarding of long-term performance rights to the CEO, which was carried with 83% of the vote in favour.

Making the connection on why the Commonwealth Bank remuneration resolution passed through without a strike, while the Star failed is difficult to reconcile. The cynics would argue that pushing for a strike keeps the proxy advisors in a job. The lack of accountability and consistency, as we observed with these two examples, makes it difficult to predict future outcomes.

Perhaps it would help if these reports were made public, so all investors could better understand the rationale behind the decision-making process that supports one but not the other.

Until then, annual general meetings and the resolutions to be considered are becoming the domain of the very few powerful proxy voting groups.

PolyNovo

We were going to leave the discussion here, but then came the virtual annual general meeting for biotechnology company PolyNovo during November. For those keen to learn more we would direct you to our September 2019 Quarterly Newsletter report available on our website for a deeper dive into the group's operations and its extraordinary success to date. The following is an extract from that report.

The technology – NovoSorb

Biodegradable Temporising Matrix (BTM)

"The NovoSorb BTM is a wound dressing designed to aid human tissue regeneration where the dermal structure of the skin has been damaged. The layer of the skin, otherwise known as the dermis, houses all the blood vessels, elastin and cellular structure. Whenever the underlying structure of this is lost, regeneration is made possible with the use of polymer technology. The BTM technology is based on a proprietary polyurethane foam (PolyNovo) material that is fully biodegradable. As a result, the polymer is able to break down into natural and non-toxic by-products, which are cleared from the body by normal renal discharge.

Important to note, and unlike competitor products, the NovoSorb polymer is a purely synthetic compound and free of any animal by-products. This is a unique feature, since it eliminates the risk of rejection and is more cost efficient. Available in film sheets, typically 10cm by 20cm in size and 2mm thick, the NovoSorb is applied as a base layer directly to the wound without any need for preparation."

The result is minimal scarring, positive cosmetic outcomes and excellent functional movement. While it is currently approved for the treatment of chronic wounds, such as burns, as a platform technology its application extends far wider."

The board and management need to be congratulated on the results achieved thus far. Even more importantly, the transition to a successful, commercial, global organisation is not an easy path. Polynovo is not there yet, but the pieces are falling into place.

Approved for sale in major regions including Australia, the U.S. and Europe, BTM sales are ramping up, doubling from its base of $9m in 2019 and hitting $19m in 2020. The company is hesitant to provide guidance, but similar levels of growth rates are expected over the immediate future.

However, to build a long-term sustainable business requires a great deal of things coming together. Firstly, the people have to be excellent, engaged and culturally aligned. Our discussions with board members, management and our own site visits, to operations in Australia and the U.S. testify to the quality of this team and the important transition currently underway.

Secondly, the product or in this case, the platform technology needs to stack up. One can't always know for sure of the ultimate success of any new treatment but the rapid take up of the NovoSorb BTM product by major hospitals globally is a great early indicator of what the medical community things of this treatment offering.

Finally, to allow for the business to grow and sustain itself, the financials need to be in place. Here the company, led by its Chairman and its largest personal shareholder David Williams, has deliberately avoided raising additional capital, choosing to work within its means. With a cash balance of circa $12m and a modest level of debt, the company is currently operating at a break-even basis, prudently investing as cash flow allows.

The global team is now eighty strong with new appointments, at both the board level and management ranks, of the highest order.

The executive team is led by CEO Paul Brennan and CFO Jan Gielan, both on fixed base salaries of $388,127 and $200,000 plus superannuation, respectively. The larger long term incentive reward comes if success is delivered. For the executives, the board chose the issue of shares and options to each, spread out over three years to 2023 and predicated on hitting certain milestones.

In the case of CEO Brennan, who joined in 2015 when the business was in the formative stages, the reward is significant, allowing him to own up to 3.3m shares, in three equal tranches, over three years, if the company's market value remains above $2b for a minimum period of three consecutive months. No cash, just equity and predicated on success, because the market valuation of the business will not stay up without it.

Remuneration report 2020 result

Clearly some have problems with the size of the long-term incentive as well as the plan's vesting hurdles. This was evident at the 2020 annual general meeting, when the non-binding remuneration report was defeated 49.7% to 50.3%. Suffice to say results of this nature are not delivered unless proxy advisors are casting their votes against the motion. In this instance, it led to a negative first strike being recorded.

We voted in favour because we understand that what the company is undertaking is significant. This is also not lost on one of the newest board members Dr Robyn Elliott, who joined as a non-executive director of the company in October 2019. Currently the Senior Director for Strategic Expansion Projects at CSL Behring, her role helps oversee the more than US$1b of capital expenditure programs. Her 30 years of commercial experience at global organisations will provide valuable input as the business scales.

At the annual meeting, she spoke on her election resolution;

"Thanks very much, David. And firstly, let me give a personal welcome to the shareholders today. I think it's great that you've taken the time to really hear a little bit more about the amazing PolyNovo journey.

As David said, I've spent the last 30 years really committed to improving patients' lives through focusing on the technical aspects of pharmaceutical product development, registration, commercialisation, operations, and my greatest passion, which is quality audits.

And so during that time, I've been really fortunate enough to work in both local companies and, of course, the large organisation that CSL has become today. Currently, I am responsible for quite a large capital expansion portfolio in the order of around $1 billion of capital. And really, my job is to think about business strategy and value realisation.

And what that means is on a daily basis, I am thinking about business growth. I'm really trying to work out how to deliver business growth, optimizing project plans, funds, budgets. And in the current world, of course, that ensures we have to be agile. And along the way, I've learned a couple of really interesting things.

So as David said, for teams to be successful you have to have capital. And so PolyNovo has really been at the forefront of that thinking. But they also have to have some other fundamentals. So, they have to have a clear strategy and one where every member of the team knows what their role is in delivering. There needs to be processes in place where the decisions that are made are based on data. And as a scientist, I'm really passionate about using data well.

And most importantly, teams have to have a culture that's really valuing high performance and recognising the commitment of the team members. And so I've really been delighted over the last 12 months working with the PolyNovo Board to say that PolyNovo has a very clear vision for the future.

The technology platform that Paul was talking about it's real. A lot of companies talk about having a platform. In PolyNovo's case, it really is a platform technology that can deliver great value and change people's lives.

We have a really experienced Board, and they are out to make a difference in the world. So I am really grateful for the opportunity to continue to contribute to PolyNovo's Board. I am a very hands-on Board member, and I continue to be excited about the opportunity to support Paul and Anthony and really the entire operations team as we look to deliver against the really expansive growth strategy that we have at PolyNovo over the coming months and years."

Dr Elliott's assessment is a considered one. Success is predicated on many things coming together. Remove one piece and things start to fall apart. The way the proxy advisors approach the task is a siloed one, cherry picking without due consideration to the broader outcomes.

Choosing to vote in favour of all the directors up for election but voting against the remuneration report is typical of this one-dimensional approach. Remember, it was the board who considered and put forward the remuneration report. Why vote in favour of the directors if you don't agree with the manner in which they approach the important task of remunerating key executives.

It makes little sense and illustrates the ridiculous nature of proxy advisors voting down resolutions to make a point. Even more galling is the way institutional investors and industry superannuation funds abdicate their fiduciary responsibility to the proxy advisors.

Perhaps they should spend a few moments listening to these annual meetings or engaging with individuals like Dr Elliott and extraordinary individuals like her to really grasp what is at stake it, the delivery of a 'life changing technology'. ***SFM***

2021 CLIMATE COMMITMENT

COVID-19

Like climate related insurance risk, COVID-19 has a short tail and a long tail.

There is no doubt that COVID-19 dominated headlines, public policy and financial markets in 2020.

In 2021 the expectation is for vaccination rollouts across the developed world with the goal of controlling global transmission rates. Success could see us moving away from the politics of knee jerk lockdown policy. An optimistic view may include the gradual reopening of global borders within the calendar year. Unfortunately, as the worldwide race to vaccinate entire populations gets underway, dysfunctional systems and inequality will be exposed.

COVID-19 economic fallout in the form of publicly held debt will likely be felt for years to come. Many private businesses have been dealt a similar set of cards, that is, having no alternative than to take on debt to survive.

To put this into perspective, in early January we spoke with an owner-operator of a boutique Pacific Island resort. Over two decades, the operating family has managed a successful debt free operation. Today they estimate the business will be six years behind plan by the time operations normalise. That is a downgrade of magnitude on anyone’s terms.

We are looking to a post COVID-19 world or a COVID-19 normal world where we successfully learn to deal with both the short and the long tail impacts of a pandemic. Under such a scenario, collectively, our focus can return to longer-term issues that need to be addressed for a sustainable global future. One where we do better than stumble from global crisis to crisis losing decades of productivity along the way due to entrenched shortsightedness.

Paris

In this note we outline our 2021 climate change initiative, a subset of our ongoing Environment, Social and Governance (ESG) commitment.

Our starting reference point is The Paris Agreement, which came into force in 2016. It is a platform to strengthen the response to the threat of climate change and it has shifted the conversation to a fundamental economic and financial risk return discussion.

The purpose of the Paris Agreement is to hold the increase in global average temperature to ‘well below 2°C above pre-industrial levels’. The Paris Agreement also sets an aspirational target of a 1.5°C limit. In addition, the parties to the agreement aim to reach carbon neutrality (i.e. achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases) by 2050.

The Paris Agreement is grounded in the idea of common but differentiated responsibility. It requires parties to communicate nationally determined contributions (NDCs), which are publicised intended reductions in greenhouse gas emissions, specific to each participating nation.

These NDCs will be reviewed at five-year intervals, enabling parties to demonstrate a progression and increased ambition over time. The Paris Agreement has no mechanism for enforcing compliance against parties – rather it relies on transparency to incentivise ongoing participation in the framework it creates.

Local failure

Australia should be a global leader in this space, but instead our leadership has dithered. We view this failure as systemic. It sits alongside our antiquated taxation platform, shortsighted Research and Development (R&D) policies and our inability to attract and incentivise the technology and science-based industries of the future. Instead, we export talent.

Australia’s intended NDC, which the Federal Government published in August 2015 in advance of the Paris Agreement coming into effect in November 2016, committed Australia to implementing an 'economy-wide target to reduce greenhouse gas emissions by 26 to 28 per cent below 2005 levels by 2030’.

Australia has, however, qualified its targets by reserving the right to adjust its target. We have not made a commitment towards carbon neutrality for the second half of this century.

The Federal Government outlined its approach to action on climate change in the Climate Solutions Package, published on 25 February 2019. This is a continuation of its direct action policies and promises investment in low-cost emissions abatement technology and clean energy through a climate fund.

Federal Energy and Emissions Reduction Minister, Angus Taylor has also flagged the development of a technology roadmap, which will guide government investment in clean technology solutions. The focus of which has shifted away from wind and solar, which Angus Taylor now considers to be *"commercially viable"*, to storage and grid integration technologies.

In addition to these policies, the Federal Government is seeking to rely on carry over units from the Kyoto Protocol (the targets for which Australia had managed to exceed). This practice was the subject of extensive negotiation at the Conference of the Parties to the UNFCCC in Madrid in December 2019 (COP25). Several groups of countries opposed the practice which Australia was proposing to adopt, although the issue was not resolved at COP25.

State governments, by contrast, have made more aspirational commitments, with all states and territories adopting a target of net zero emissions by 2050. Similarly, the Federal Labor opposition has adopted a 2050 goal of net zero emissions, a position supported by the Business Council of Australia and the Australian Industry Group. Third party research institutes, including Climate Action Tracker, have rated Australia's commitments as being incompatible with a 1.5°C or 2°C limit.

From a regulatory perspective, Australia has seen heightened engagement, supervision and recommendations from the RBA, APRA, ASIC, Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board around response to and obligations related to the financial risks of climate change.

Selector ESG

Global institutions are making progress. This time last year we outlined the position being taken by Blackrock. In Australia, our largest super funds have developed constructive policies and are similarly taking leadership. We have referenced material from two of these institutions in this note.

SFML sits in a unique position as a small business. We have been entrusted, by our clients, with part or all their superannuation and lifesavings. Collectively they represent a diverse range of employed and retired Australians, blue collar and professional, either directly or via institutional investors. This grouping also includes all the members of our team. On behalf of all our stakeholders, it is incumbent on us to champion increased transparency, better disclosure, good governance and strong risk management. We see this as a common-sense approach to long-term investment.

In addition, we believe all companies and organisations have a responsibility to consider the risks of climate change and to ensure their business is resilient in a low carbon future.

It starts with culture

Environmental, Social and Governance (ESG) considerations are fully integrated into our portfolio construction process and evolves as we learn. It is adapted to ensure it adds value to the process and remains relevant to our long-term goals.

We have long believed culture and ESG are intertwined. We consider them both integral to our assessment of a business.

We have focused on people and culture as a key driver of long-term sustainability since our inception in 2004. We believe the culture of a business ultimately drives attitudes towards business sustainability. This includes the board and management teams' disposition towards disclosure, transparency, the short and long-term horizons, R&D, capitalisation of expenditure, use of debt, issuance of equity and the broad risks attached to ESG. Effectively all the 18 elements of our investment roadmap.

Over past decades the focus on Social and Governance issues have no doubt won out ahead of the Environmental considerations. This is likely due to the greater difficulty of tackling this issue. As part of our ESG journey and to better address Environmental issues, we are building out our climate commitment in 2021, which we discuss below.

The recap

First let us recap where we stand today on ESG and what was achieved in 2020.

Our investment process currently includes three important aspects. Firstly, we employ mandate exclusions, sometimes referred to as a negative screen. Secondly, we have a strong program relating to company engagement. Thirdly, we have a structured in-house voting program. These three elements are explained in more detail below.

The mandate exclusions, which have been adopted across all our portfolios include:

- Business generating >10% revenue from thermal coal
- Business that manufactures or sell munitions or weapons, and
- Tobacco related businesses

Our cultural assessment of a business or potential investment, has been driven by our company engagement program since inception. This is a foundation of our investment process. We engage with board members and management teams, attend AGMs and undertake site visits.

This is essentially a risk out process. We are aiming to take as much risk off the table before we invest in a business, by determining that a business meet our four requirements of stock selection. As many of our investors understand, we are seeking businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets, with a focus on capital management. The goal is to capture as much real earnings per share growth as possible over the long run.

Through our company engagement we can exert influence for change on a business. Undoubtedly this is stronger when we have an aggregate holding within the top 20 shareholders of a business. That said, arguably we have more influence when we have a long-term professional relationship with a public company, its management team and board. Areas we have long championed include, having the optionality of a strong cash balance sheet, writing off all R&D in the year it is incurred and a sensible dividend payout ratio that allows ample reinvestment for future earnings growth. None of this is earth shattering or rocket science, it is just a common-sense approach.

Importantly we vote as long-term owners of a business and we attend AGMs in person where possible, although in the year just past this has been virtual. In relation to voting, we have adopted a structured program of work that dovetails with company engagement program. We review, vote and document each company resolution put to shareholders within our portfolio. This is a substantial piece of work undertaken by the portfolio managers and the investment team.

Alongside our company engagement program, we believe this proactive approach to voting drives a better insight and a greater understanding of a business, and the issues and risks it faces, than would occur if we otherwise outsourced our voting responsibilities or simply followed the recommendations of a proxy advisor service.

ESG 2020

When we look back on 2020, we believe we made progress in our ESG endeavours.

We undertook a program of reviewing the corporate governance documents and board charters of companies we invest in and we provided feedback to board members and management. The highlights of this program include change, which were adopted by the companies that we engaged. We had successes on several fronts here. Chiefly in gaining insights into how companies operate and the deployment of internal resourcing. Secondly, we encouraged the updating of documents, corrected missing links and this arguably promoted better disclosure. We encouraged others by offering up examples of what we considered to be best in class governance disclosures.

Our ESG roadmap was integrated into our company financial modelling program. Like our quantitative and qualitative roadmap that we adopted at inception in 2004, we set out to develop an ESG roadmap in late 2019. This was integrated into our models in 2020 and is scored each time a company reports financial results.

The premise is, if the right questions are asked at regular intervals and recorded, then we are well placed to observe trends over time, be they positive or negative. The ESG roadmap consists of three categories: Environmental, Social and Governance (our original roadmap has two, Quantitative and Qualitative), with 12 subcategories that prompt the evaluation of multiple questions. A simple 1 or 0 scoring system is applied. We do not obsess on the scores generated; we are looking for trends over time.

The intention is the ESG roadmap will evolve to ensure relevance and value add. For instance, after a year in use we have determined that two categories can be merged. Simple, repeatable processes are often more effective.

In 2020 we undertook 480 company engagements. Each one represents a cultural review of a business, where both qualitative and quantitative areas of the business are examined. We consider each engagement to be a page in our book of knowledge that develops over time. Two portfolio managers attend each meeting and notes are recorded and stored. A subset of these engagements was specific to ESG related matters.

We also established an ESG Resource Centre on our internal workflow platform, Monday. Again, this is not ground breaking news. It does however bring together all the ESG related material and public documents relating to our portfolio into one location. This important digital hub drives significant efficiency for our internal investment team. It has become the foundation of our voting program.

In 2020 we considered, debated and recorded our views, and voted on 183 resolutions put to shareholders. A portion of resolutions were referred to the boards, from which they originate from, for clarification. We also actively ask our companies to engage with us on any matters that proxy advisors are pushing back on.

In the period, we abstained from a small handful of resolutions that related to approval of equity raisings that we participated in. Our process is hands on and labour intensive, involving a contribution from our investment team and principally the portfolio managers. This retains the granularity of information that would otherwise be ceded if this process is to be outsourced.

In 2020 we discussed ESG matters in our Quarterly Newsletter. Several of our long-term investors have shown an increased interest in what we are doing behind the scenes and we have upped our communications in response to these requests.

Finally, on 30 June 2020 we completed our Inaugural (2019) carbon measurement. A 100% carbon offset was achieved and certified. We have communicated this in previous newsletters.

Climate 2021

Across our portfolio of holdings, in 2021 we will advocate for the recognition, establishment and inclusion of Paris based targets and or science-based climate targets, emissions targets and or renewable energy targets. Once these base targets are established, progress can be tracked.

We are also monitoring our companies for no efforts, no accountability. We are not proposing to exit investments based on our climate policy. We believe we can have far greater impact via our company engagement program and our voting program.

Our advocacy will extend to the principals of the Task Force on Climate Related Financial Disclosure (TCFD), for which we have recently applied to become a signatory. This advocacy is discussed below.

Limitations

There are of course limitations in what we are trying to achieve and it is important to understand these also. Reporting is not uniform across companies and not all are reporting on climate related matters.

Many factors are at play here. At the extreme end, some businesses are not resourced nor have the expertise to provide data. Some simply have not seen the writing on the wall. At some point these businesses may find these attitudes, if entrenched, limit capital availability.

Others have large, entrenched carbon footprints, such as heavy industry, which take considerable time to address in a meaningful way.

Of course, many companies are reporting climate related data, including emission levels and renewable targets. Rarely is this data directly comparable. The information gaps are significant, and they will likely remain that way for some time to come. We believe a simple unified approach across financial markets will go some way to addressing this.

Finally, at SFML, we are generalists not experts; we learn as we go and adapt. We see this as a journey we will all collectively benefit from in the form of sustainable future portfolio returns.

Why Paris and TCFD

The financial risks associated with climate risk are very real and many examples can be drawn upon.

In its 2018 Climate Report, Oil Search presented scenario testing that demonstrated the viability of its asset base. While the Alaska North Slope assets stands up under scenario testing, the asset value may also be affected by the ability to fund development by raising new debt. As US institutions have become increasingly wary of climate advocacy, some have stated they would avoid funding North Slope development. For Oil Search, as a direct result of this shrinking pool, the cost of funding via syndicates, while still available, will likely be higher. The future opportunity to refinance debt may become harder, or they could face reduced tenor of borrowing available to the organisation. As a result, returns and asset values will be lower.

Clearly one of the most heavily exposed industries is insurance. It is feasible that insurance underwriters, with both short and long tail books, may be holding risk that is no longer quantifiable. Sitting alongside them, in this high-risk category, are those with physical assets that stand in the way of extreme weather events.

The damage done to coastal property from single large swell events can be astounding. In recent years, close to home, we have seen public and private property destroyed. Examples include freak swell events that hit Manly's Marine Parade in 2016, sleepy (often no surf) Collaroy Basin in February 2020 and Byron Bay's Clarkes Beach in December 2020. But the risk is not limited to these extreme events. While Sydney Airport does not face storm surf events, its runway that juts out into the calm waters of Botany Bay is at risk of a rising sea level. We don't have portfolio exposure to these examples.

Service industries and technology-based business have very light carbon footprints and lower climate related risk profiles by comparison. It is equally important these businesses understand they have a role to play. Recycling, natural lighting, energy efficient workplaces and renewable energy targets are equally viable approaches to climate policy. Our intention is to be on the front foot advocating and communicating this message.

The Paris Agreement targets have an important role to play here. They link the unequivocal science (see appendix) to the economic and financial risk argument. As a result, this is the starting point we have adopted.

One of the essential functions of financial markets is to price risk. Every investment has risk attached. Essentially when we invest, we target a return that compensates for the equity risk we take. This premise only holds if we understand the risks at hand. As discussed above, we aim to take as much risk off the table as possible before we invest. Our focus on balance sheet strength and sustainability of earnings is testament to this.

The financial crisis of 2007-2008 is an important reminder of the repercussions that weak corporate governance and risk management practices can have on asset values. Without the right information, long-term investors may incorrectly price or value assets, leading to a misallocation of capital.

A significant, and perhaps one of the most misunderstood risks that organisations face today relates to climate change. While certain insurance and physical assets may become uninvestable or even stranded, studies have shown that much of the impact on future assets will come through weaker growth and lower asset returns across the board.

From 2021, SFML has undertaken the process to become a supporting party to the Task Force on Climate Related Financial Disclosure (TCFD) and its principles, in pursuit of greater transparency on these important issues.

The TCFD was established by the Financial Stability Board (FSB) in 2015, at the request of the G20, to create a framework based on the Paris Agreement that could address the limitations, some of which we discussed above, and the complexity of the risks associated with climate change. The result was a set of recommendations or guideline for consistent *"disclosures that will help financial market participants understand their climate related risks."*

Our goal for 2021 is to adopt the aspects of this voluntary guideline that makes sense within the context of our investment process. This will enhance and strengthen our ongoing approach to ESG.

In 2021, we believe each and every company we invest in will be approaching the Environmental component, or the environment they co habit, including climate change issues, in a responsible fashion. Some for the first time and others with a greater understanding of the risk and opportunities they face. This journey is unique to each business and we will treat them as such. We know from experience that when we adopt a clear relevant framework, which can be applied consistently as part of our bottom-up stock selection process, the process is enhanced. Like our attempts to tackle ESG over the years, through our company engagement and voting programs, our approach will not be rigid, it will adapt as we learn. ***SFM***

References

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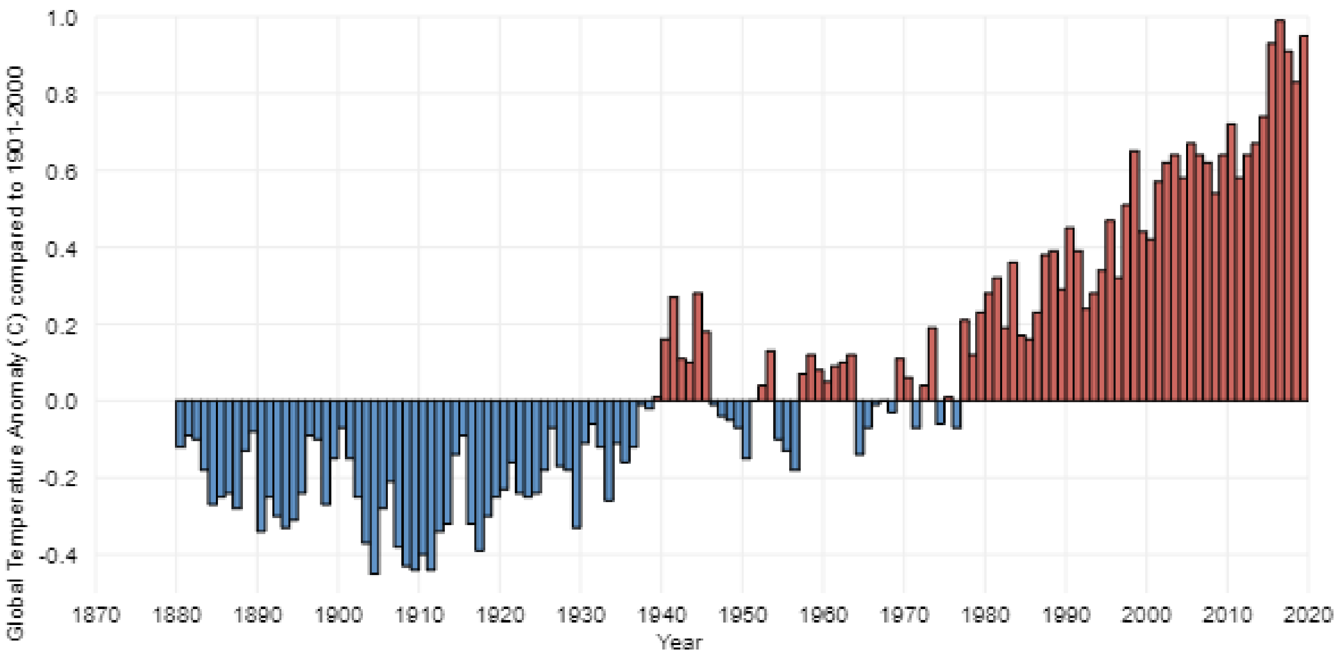
Appendix 1

Evidence of Temperature Warming

- The combined land and ocean temperature have increased at an average rate of 0.07°C per decade since 1880*
- The average rate of increase since 1981 has doubled to 0.18°C
- While warming is not uniform across the planet, the upward trend in the globally averaged temperature shows that more areas are warming than cooling

Figure 29: History of global surface temperature since 1880



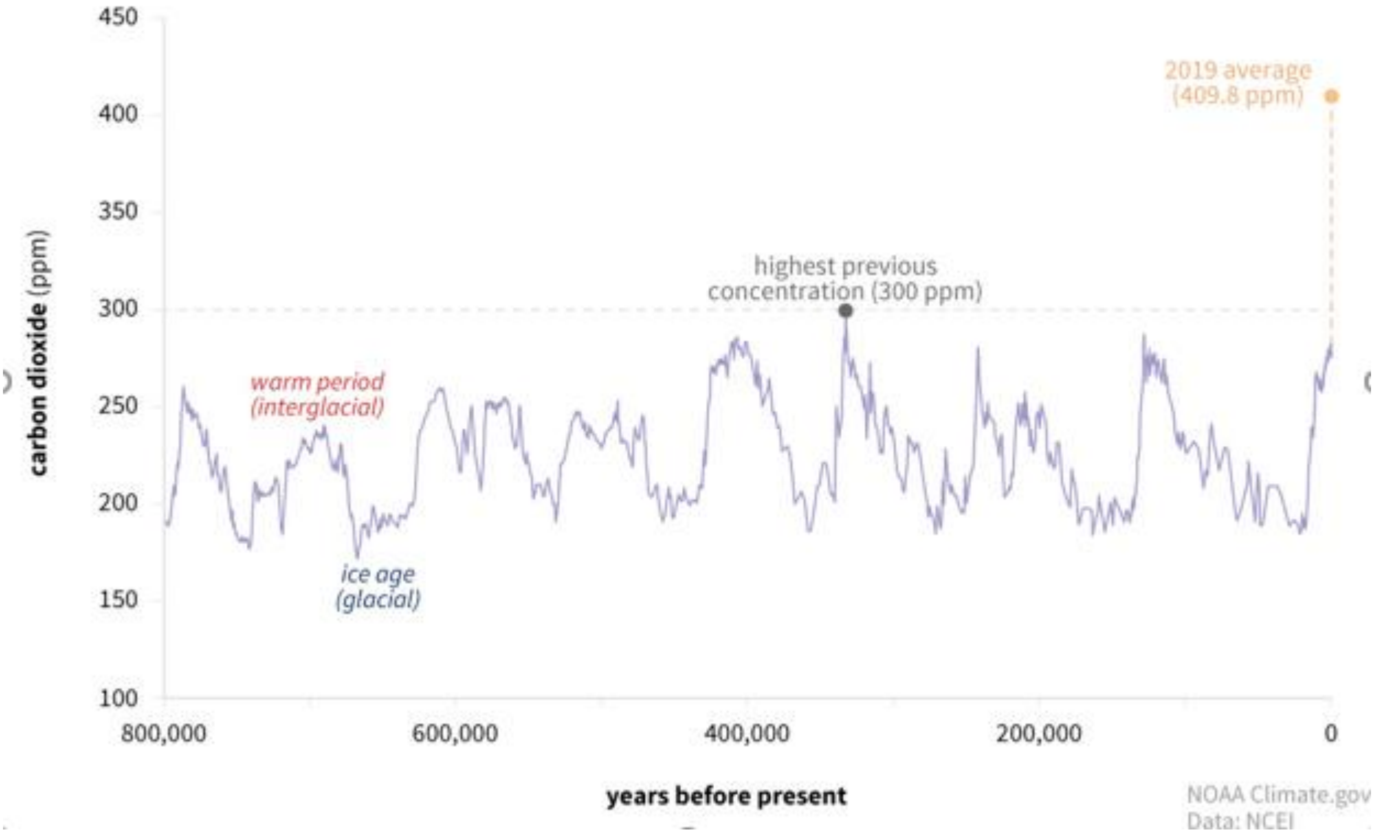
Source: Ncdc.noaa.gov. 2020. Global Climate Report - Annual 2019 | State Of The Climate | National Centers For Environmental Information (NCEI). [online] Available at: https://www.ncdc.noaa.gov/sotc/global/201913

Appendix 2

Evidence of Increase in C02

- The global average CO_2 levels in 2019 was 409.8 parts per million (ppm), the highest in 800,000 years
- The annual rate of increase in C02 over the past 60 years is 100 times faster than at the end of the last ice age 11k -17k years ago
- CO_2 amounts were last this high over 3 million years ago, when temperature was 2°–3°C higher and sea level was 15–25 meters higher
- CO_2 concentrations are driven by fossil fuels that people burn for energy

Figure 30: Carbon Dioxide over 800,000 years



Source: Ncdc.noaa.gov. 2020. Global Climate Report - Annual 2019 | State Of The Climate | National Centers For Environmental Information (NCEI). [online] Available at: https://www.ncdc.noaa.gov/sotc/global/201913

LAME DUCK AWARD FOR 2020

It would be remiss if we didn't hand out a prize for sheer incompetency, bordering on dishonesty, among our elected leaders.

Up north we have the newly re-elected Queensland Premier, Annastacia Palaszczuk. Ring fencing the borders has become a real skill among our leaders, easily done and with little thought to the deep impacts on society and the human suffering inflicted.

Down south we have Victorian Premier Daniel Andrews, who despite turning up to provide 120 consecutive days of COVID daily media briefing updates, could not remember who gave the order to use private security guards. This one decision, as tabled in the 500-page final report into the Victorian Hotel inquiry, led to more than 18,000 new infections and the deaths of 800 individuals.

Over to the west we have Premier Mark McGowan. Next to go to the polls in March 2021, Premier McGowan knows that when you are on a good thing you stick to it. Perhaps he could resurrect the state's rabbit proof fencing to keep all Australians out. Not one to slacken off, late in December he even had this sage advice for NSW Premier Gladys Berejiklian on the latest COVID outbreak, *"I just say to NSW they need to get it under control. This is causing grief all over Australia so they need to kill the virus in Sydney. Instead, they seem to be engaging in a form of whack-a-mole."* No prizes for guessing Premier McGowan, born in Newcastle, NSW, studied law and not science.

Figure 31: Rabbit proof fence

Source: The Rabbit Proof Fence of Australia. (2016). Retrieved 2 January 2021, from https://www.amusingplanet.com/2016/04/the-rabbit-proof-fence-of-australia.html?m=1

NSW Premier Gladys Berejiklian had to contend with her own inquiry, undertaken by the Independent Commission Against Corruption (ICAC) during October. Despite the fallout, where she admitted *"I stuffed up",* the government has traversed COVID in fine style, keeping the state open for business.

Finally, unrelated to COVID, we have our Prime Minister Scott Morrison who found time to oust Australia Post CEO Christine Holgate over the Cartier watch scandal. Ordering an independent report to get to the bottom of why the CEO rewarded four key executives with bonuses, delivered by way of Cartier watches with a combined value of $20,000, its public findings were meant to be delivered in late December. Instead, they have been deemed a *"cabinet secret".* This shock decision now focuses the attention back onto Prime Minister Morrison, who chose secrecy over transparency. CEO Holgate exits completely exonerated, but reputation damaged.

In the end, it was a close-run decision between Morrison and Andrews, but we give our lame duck award to Andrews for his sheer hubris and inability to acknowledge what it takes to lead, honesty. ***SFM***

COMPANY ENGAGEMENTS – DECEMBER 2020 QUARTER

Date	Company	Description
1-Oct	ALL	Aristocrat Leisure Investor Roundtable Conference Call
1-Oct	RWC	Reliance Worldwide Investor Day
1-Oct	NAN	Nanosonics Management Conference Call
6-Oct	JIN	Jumbo Interactive Morgans Queensland Conference
7-Oct	FLT	Flight Centre Travel Group Morgans Queensland Conference
7-Oct	MP1	Megaport Morgans Queensland Conference
7-Oct	CTD	Corporate Travel Management Morgans Queensland Conference
7-Oct	NAN	Nanosonics GS Small/Mid-Cap Healthcare Forum
7-Oct	PME	Pro Medicus GS Small/Mid-Cap Healthcare Forum
8-Oct	PNV	PolyNovo GS Small/Mid-Cap Healthcare Forum
8-Oct	TLX	Telix Pharmaceuticals GS Small/Mid-Cap Healthcare Forum
8-Oct	ARX	Aora Biosurgery GS Small/Mid-Cap Healthcare Forum
8-Oct	4DX	4DMedical GS Small/Mid-Cap Healthcare Forum
14-Oct	CSL	CSL Annual General Meeting
14-Oct	JHX	James Hardie Industries Guidance Update Conference Call
15-Oct	ARB	ARB Corporation Annual General Meeting
16-Oct	DMP	Domino's Pizza Enterprises Management Conference Call
19-Oct	CBL	CBL Morgans Management Conference Call
19-Oct	IFM	Infomedia Management Conference Call
19-Oct	RBL	Redbubble Morgans Management Conference Call
20-Oct	CSL	CSL Annual Research & Development Briefing
20-Oct	COH	Cochlear Annual General Meeting
20-Oct	4DX	4DMedical UBS Management Conference Call
20-Oct	OFX	OFX Group GS Tech Forum
20-Oct	NEA	Nearmap GS Tech Forum
20-Oct	PBH	Pointsbet Holdings GS Tech Forum
21-Oct	NTO	Nitro JP Morgan Product Demo
21-Oct	NWL	Netwealth Group GS Tech Forum
21-Oct	MP1	Megaport MultiCloud Technical Workshop
21-Oct	NEA	Nearmap Management Conference Call
22-Oct	SGR	The Star Entertainment Annual General Meeting
22-Oct	MP1	Megaport Annual General Meeting
22-Oct	PBH	Pointsbet Holdings UBS Management Conference Call
26-Oct	SEK	Seek Virtual Morning Tea with Board
27-Oct	BKL	Blackmores Annual General Meeting
27-Oct	YFZ	Youfoodz Morgans IPO roadshow
27-Oct	IRE	IRESS Management Meeting
28-Oct	FCT	Firstwave Cloud Technology Quarterly Results Conference Call
28-Oct	BKL	Blackmores Management Meeting
28-Oct	Booktopia	Booktopia Morgans IPO roadshow
29-Oct	RWC	Reliance Worldwide Annual General Meeting

Date	Company	Description
29-Oct	REA	REA Group Elara acquisition Conference Call
29-Oct	JIN	Jumbo Interactive Annual General Meeting
29-Oct	REH	Reece Annual General Meeting
29-Oct	4DX	4DMedical UBS Management Conference Call
29-Oct	NEA	Nearmap Management Conference Call
30-Oct	RMD	ResMed Quarterly Results Conference Call
30-Oct	RMD	ResMed UBS Management Conference Call
30-Oct	CAR	Carsales.com Annual General Meeting
3-Nov	TLX	Telix Pharmaceuticals Strategic Licence and Commercial Partnership Conference Call
3-Nov	MVP	Medical Developments International Management Conference Call
4-Nov	SEK	Seek Management Conference Call
4-Nov	NXL	Nuix MS Management Conference Call
4-Nov	DMP	Domino's Pizza Enterprises Annual General Meeting
4-Nov	FCL	FINEOS Annual General Meeting
5-Nov	VAPO.NYSE	Vapotherm Quarterly Results Conference Call
5-Nov	IRE	IRESS Quarterly Results Conference Call
5-Nov	FLT	Flight Centre Travel Group Annual General Meeting
5-Nov	NHF	NIB Holdings Annual General Meeting
5-Nov	MP1	Megaport GS Australian Telco/Infrastructure challengers Conference
6-Nov	JHX	James Hardie Industries Annual General Meeting
6-Nov	REA	REA Group Quarterly Results Conference Call
10-Nov	JHX	James Hardie Industries Quarterly Results Conference Call
10-Nov	OFX	OFX Group 1H21 Results Conference Call
10-Nov	OFX	OFX Group GS Management Conference Call
10-Nov	OFX	OFX Group Management Conference Call
11-Nov	JHX	James Hardie Industries 1H21 Results Call
11-Nov	CPU	Computershare Annual General Meeting
11-Nov	IFM	Infomedia Annual General Meeting
11-Nov	OFX	OFX Group JP Morgan Management Conference Call
12-Nov	BRG	Breville Annual General Meeting
12-Nov	NEA	Nearmap Annual General Meeting
12-Nov	XRO	Xero 1H21 Results Conference Call
13-Nov	PNV	PolyNovo Annual General Meeting
16-Nov	Airtasker	Airtasker Macquarie Management Conference Call
16-Nov	MP1	Megaport UBS Australasia Virtual Conference
16-Nov	Chemist Warehouse	Chemist Warehouse UBS Australasia Virtual Conference
17-Nov	BRG	Breville UBS Australasia Virtual Conference
17-Nov	RWC	Reliance Worldwide UBS Australasia Virtual Conference
17-Nov	PME	Pro Medicus UBS Australasia Virtual Conference
17-Nov	NXT	NEXT DC UBS Australasia Virtual Conference
17-Nov	JIN	Jumbo Interactive GS Management Conference Call
17-Nov	REA	REA Group Annual General Meeting
18-Nov	IFL	IOOF Holdings JP Morgan meeting with Chief Advice Officer
18-Nov	ALL	Aristocrat Leisure FY20 Results Conference Call

Date	Company	Description
19-Nov	ALU	Altium Annual General Meeting
19-Nov	MP1	Megaport SD-WAN Industry Insight Conference Call
19-Nov	ALL	Aristocrat Leisure JP Morgan Management Conference Call
19-Nov	SEK	Seek Annual General Meeting
20-Nov	RMD	ResMed Annual General Meeting
20-Nov	4DX	4DMedical Annual General Meeting
24-Nov	NAN	Nanosonics Annual General Meeting
24-Nov	TNE	TechnologyOne FY20 Results Conference Call
24-Nov	NHF	NIB Holdings GS Management Conference Call
24-Nov	ALL	Aristocrat Leisure Management Conference Call
25-Nov	FPH	Fisher & Paykel Healthcare 1H21 Results Conference Call
25-Nov	IFL	IOOF Holdings Annual General Meeting
25-Nov	JIN	Jumbo Interactive Endeavour Management Conference Call
25-Nov	TNE	TechnologyOne Management Conference Call
30-Nov	BKL	Blackmores GS Management Conference Call
30-Nov	DMP	Domino's Pizza Enterprises GS Management Conference Call
30-Nov	DMP	Domino's Pizza Enterprises Domino's Virtual Investor Day
1-Dec	IFL	IOOF Holdings Investor Day
2-Dec	FPH	Fisher & Paykel Healthcare Group roadshow
2-Dec	FLT	Flight Centre Travel Group Management Conference Call
2-Dec	FPH	Fisher & Paykel Healthcare Management Conference Call
3-Dec	ALL	Aristocrat Leisure Management Conference Call
4-Dec	FPH	Fisher & Paykel Healthcare Group roadshow
8-Dec	AMX	Aerometrex Management Conference Call
9-Dec	IRE	IRESS Management Conference Call
10-Dec	MVP	Medical Developments International Capital Raising Conference Call
10-Dec	APX	Appen Trading Update Conference Call
14-Dec	CSL	CSL Management Conference Call
21-Dec	MVP	Medical Developments International Conference Call

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