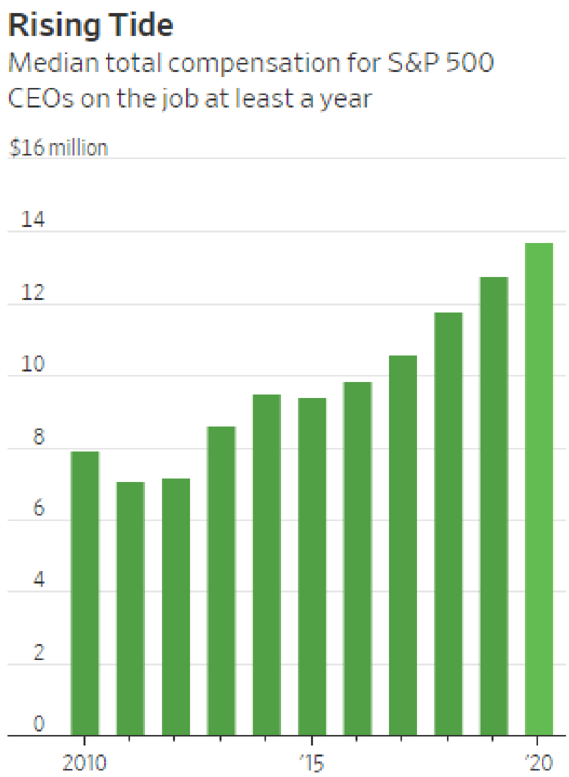
# Selector High Conviction Equity Fund Quarterly Newsletter No.71

# March 2021




In this quarterly edition, we review performance and attribution and provide a snapshot of company results from the recent February reporting season.

We discuss the widely used PE ratio, the conundrum of owning 'stranded assets', and China's latest five-year plan targeting self-sufficiency via leadership in science and technology.

We review "Black Box Thinking" and consider the book's relevance to our portfolio.

On our cover is the eye-opening remuneration levels of US CEOs. We highlight how this relates to our portfolio and the way we vote. As reference, we include our Environmental, Social and Governance (ESG) and Voting Policy 2021.

Chart. Median total compensation for US S&P 500 CEOs. Source: MyLogIQ, WSJ.

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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 – MARCH QUARTER

Dear Investor,

Twelve months on, the alphabet guess work is over. Earlier predictions on whether the world would experience a L, U, W, Z or even a Nike Swoosh-shaped economic recovery can now be put to bed, as the letter V has emerged victorious.

When The Conference Board[1], an organisation that analyses economic trends, surveyed 606 global CEOs for their view in July 2020, 42% picked a U-shaped recovery and another 32% chose L. Under these scenarios the duration of a recovery would have ranged from one to several years. Only 11% suggested a V-shaped outcome, a recovery of less than one year.

Rapid and unprecedented stimulus actions by governments and further loosening of monetary policies led to stronger economic activity and a quicker recovery in employment ranks. As we look beyond the current quarter and as markets reopen post vaccination program rollouts, this recovery is expected to strengthen.

During March, the U.S. Biden Administration got the green light to fulfil its electoral promise of providing relief in response to the worst economic crisis since the Great Depression. The US$1.9t coronavirus funding bill, known as the American Rescue Plan, includes (amongst other benefits) direct payments of US$1,400 to millions of low to middle income Americans.

Passed by the U.S. Senate with a final vote of 50-49, President Biden's 2021 stimulus package is one of the largest rescue measures in U.S. history and easily surpasses the 2008 Global Financial Crisis Troubled Asset Relief Program (TARP) of US$700b, used in bailing out the banking institutions.

A second Biden package is expected to follow, earmarked for infrastructure that could take the whole fiscal outlay to circa US$4.2t[2]. It is worth noting these funding measures are in addition to the already US$2.25t Coronavirus Relief Bill (CARES Act) introduced by former President Donald Trump in March 2020.

According to the Brookings Institute, this one time stimulus is projected to, *"... boost economic activity, as measured by the level of real domestic product (GDP), by about 4 percent at the end of 2021 and 2 percent at the end of 2022... By late 2021, we would likely see the economy operating above its maximum sustainable level. That positive output gap would likely put upward pressure on inflation, which the Federal Reserve has said would be welcome. Beyond 2021, while estimates show an economic 'soft landing', the slowdown could be more abrupt and painful than our projections suggest."*

Those surveyed by Bloomberg are predicting average GDP growth rates of 5.5%, while Goldman Sachs is sitting at 7.7%. The market response is always forward looking, and, in this regard, expectations of rising inflation has triggered a sharp response through higher U.S. 10-year bond yields, up to recent highs of 1.75%, compared to 0.70% twelve months earlier. In turn, the surging yield has led to a share market volatility hit, a somewhat normal and reactionary outcome.

From our vantage point we see these actions for what they are. Two of the most extreme situations in living memory; a global health induced COVID economic shutdown, now followed by a re-opening of trade, driven by the U.S. Government's massive fiscal stimulus package. This will cause stresses and severely impact supply as businesses readjusts. Ultimately though we see a return to some normality heading into 2022, rather than runaway inflation or rising interest rates.

The sugar hit from fiscal stimulus will pass and businesses will once again be judged on their individual merits, rather than a stampede from one asset class to another. Some call this rotation, but rotation into what?

While we cannot justify many of the high valuations floating around in the newer technology sector, we can also extend this thinking to other parts of the market, such as resources. Selling iron ore for around US$170 per tonne, up 87% over the past twelve months, against a production cost base of US$20 per tonne and largely to one country (China), may be delivering the huge profits to the likes of BHP and Rio Tinto. However, putting it on

[1] *See Appendix 1 for greater detail.*

[2] *See Appendix 2 for greater detail.*

a future multiple that appears altogether unsustainable is perhaps equally risky.

We touch on some of these aspects in two of our quarterly articles, *"What a PER does not capture"* and *"Stranded assets"*. We provide commentary on reporting season and review *"Black Box Thinking"*.

We discuss China's new five-year plan, which was released in March with an emphasis on increasing research and development spend, specifically across science and technology.

So as not to be left behind, U.K. Prime Minister Boris Johnson echoed similar commitments during the month, stating that science and technology is now *"a metric of global power"* and *"This government will invest more in research and development than any of our predecessors, because innovation is the key to our success at home and abroad. From speeding our economic recovery, to shaping emerging technologies in accordance with freedom and openness, we will better protect ourselves against threats to our economic security."*

In addition, we touch on the thorny issue of CEO compensation, as the chart on the cover page of our latest quarterly illustrates, and why we place such high importance on voting at annual general meetings. This is covered in our Voting policy and included in Selector's Environmental, Social, Governance ESG Policy 2021 edition.

As we move into the second quarter of 2021 and beyond, we would caution investors in extrapolating Government stimulus programs and the flow on effects on business performance as anything but normal.

Within this setting our overarching focus, as always, will be on backing those management teams and companies that continue to build out their competitive offering, with one eye on the now and the other on the future.

This requires a very fine balance as *"Black Box Thinking"* author Matthew Syed rightly puts, *"success is about developing the capacity to think big and small, to be both imaginative and disciplined, to immerse oneself in the minutiae of a problem and to stand beyond it in order to glimpse the wider vista".*

We would suggest there are many businesses in the portfolio that aptly fit that description.

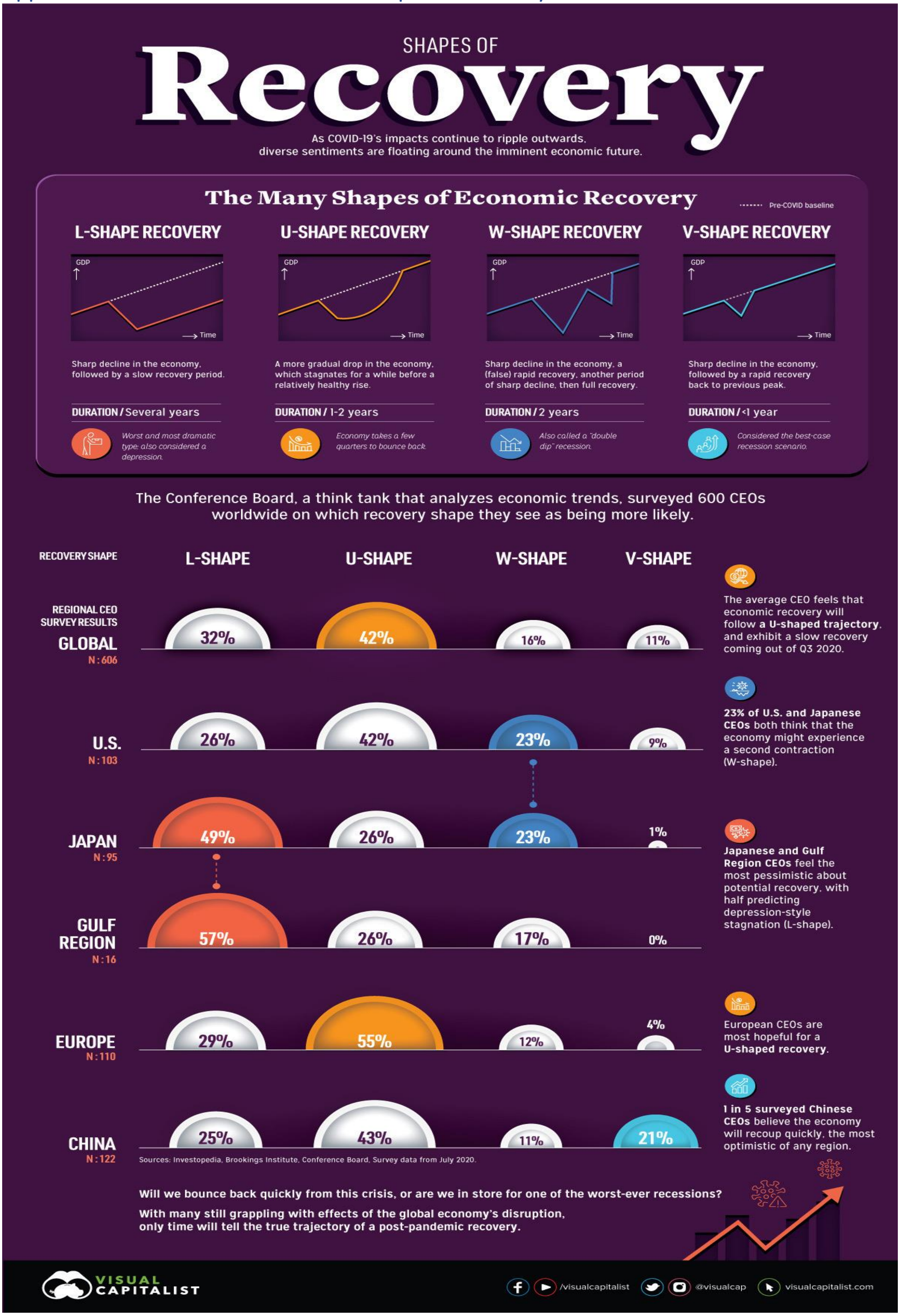
For the March quarter, the Portfolio delivered a gross negative return of **1.91%** compared to the S&P ASX All Ordinaries Accumulation Index, which posted a gain of **3.61%.** For the financial year to date, the Portfolio delivered a gross positive return of **13.43%** compared to the Index, which has posted a gain of **19.86%**.

We trust you find the report informative.

Regards,

Selector Investment Team

## Appendix 1: The Conference Board – shapes of recovery




*Source: The Conference Board*

## Appendix 2: Breakdown of proposed funding in the U.S. $2.25t Infrastructure Plan

| Type of investment | Spend (US$b) | Description |
|---|---|---|
| Transportation infrastructure | 621 | Includes funds for i) repairing roads and bridges, ii) modernising public transit, iii) rail repairs and service, iv) electric vehicle funding, and v) improvements to ports, waterways, and airports. |
| Water infrastructure | 111 | Priorities include replacing lead pipes and service lines and upgrading and modernising water, wastewater, and storm water systems. |
| Digital infrastructure | 100 | Funding for high-speed broadband. |
| Power infrastructure | 100 | Improving the resiliency of the electricity transmission system and includes investment and production tax credits for clean energy generation and storage and funding for plugging orphan oil & gas wells. |
| Housing infrastructure | 213 | Priorities include producing, preserving, and retrofitting more than one million affordable and energy efficient housing units and building more than 500k homes for low and middle-income housing. |
| Education and health care infrastructure | 147 | Funds are for new public schools, community college facilities, child-care facilities, and VA hospitals |
| Care economy infrastructure | 400 | This is for expanding access to care for the elderly and persons with disabilities. |
| Research & Development investment | 180 | Proposed funding for new technologies such as artificial intelligence, biotechnology, and computing. There is also funding to establish the U.S. as a leader in climate science. |
| Manufacturing investment | 300 | Focus is on strengthening supply chains for critical goods, pandemic protection, and clean energy investment. There is also an intention to increase access to capital for domestic manufacturers. |
| Workforce Development | 100 | Funding for training programs and targeted opportunities in underserved communities. |

*Source: Macquarie Research*

Link to infrastructure plan: *The White House. 2021. FACT SHEET: The American Jobs Plan | The White House. [online] Available at: https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/*

*"Winners require innovation and discipline, the imagination to see the big picture and the focus to perceive the very small. The great task rarely achieved is to blend creative intensity with relentless discipline so as to amplify the creativity rather than destroy it. When you marry operating excellence with innovation you multiply the value of your creativity."*

**Jim Collins**
**American researcher and author**
**of bestseller 'Good to Great'**

# PORTFOLIO OVERVIEW

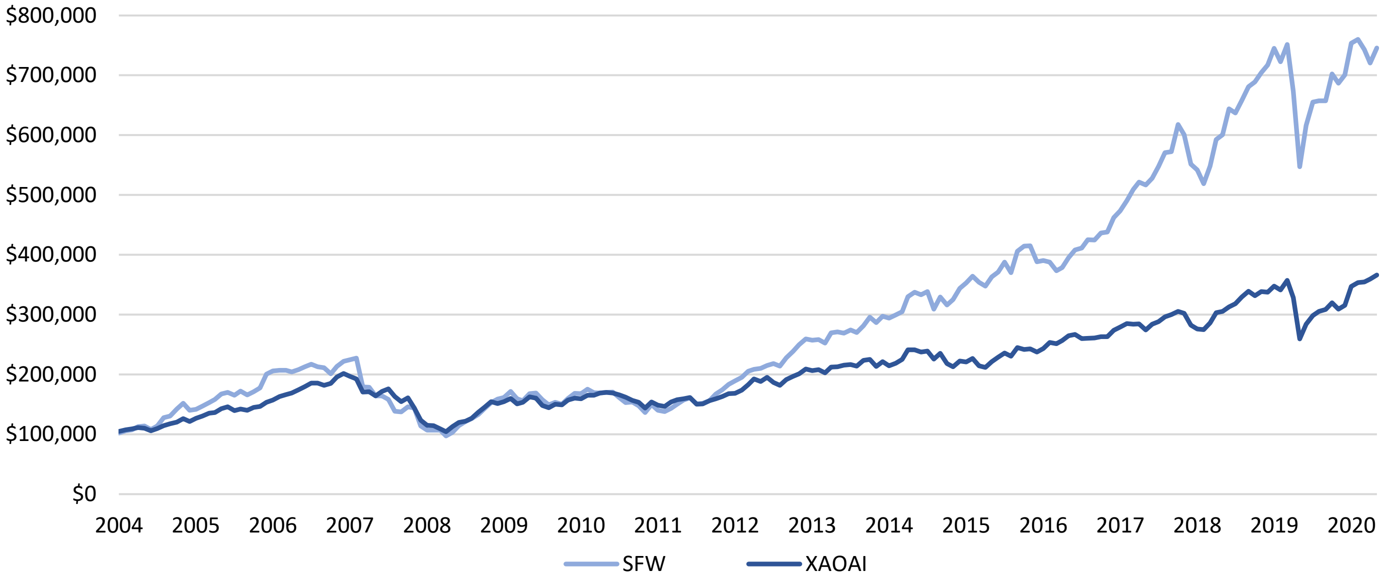
## Table 1: Performance as at 31 March 2021*

| | 3 Month | 6 Month | 1 Year | 3 Year | 5 Year | 10 Year | 15 year | Since Inception |
|---|---|---|---|---|---|---|---|---|
| Fund (net of fees) | (2.31) | 7.99 | 33.78 | 10.88 | 13.36 | 13.79 | 8.47 | 10.90 |
| Fund (gross of fees) | (1.91) | 8.52 | 36.28 | 13.00 | 15.48 | 15.92 | 10.46 | 13.01 |
| All Ords. Acc. Index | 3.61 | 18.56 | 41.14 | 10.09 | 10.57 | 7.97 | 6.48 | 8.22 |
| Difference (gross of fees) | (5.52) | (10.04) | (4.86) | 2.91 | 4.91 | 7.95 | 3.98 | 4.79 |

*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 March 2021 | % | Top 10 December 2020 | % |
|---|---|---|---|
| Domino's Pizza Enterprises | 6.68 | James Hardie Industries | 6.28 |
| James Hardie Industries | 6.39 | Domino's Pizza Enterprises | 5.90 |
| Aristocrat Leisure | 5.69 | Aristocrat Leisure | 5.07 |
| Reece | 5.50 | Reece | 4.86 |
| TechnologyOne | 4.97 | SEEK | 4.80 |
| SEEK | 4.68 | ResMed | 4.65 |
| Cochlear | 4.48 | Altium | 4.41 |
| ResMed | 4.21 | carsales.com | 4.36 |
| carsales.com | 3.79 | Nanosonics | 4.23 |
| CSL | 3.74 | Iress | 4.15 |
| **Total** | **50.13** | **Total** | **48.71** |

## Table 3: Unit prices as at 31 March 2021

| Unit Prices | Entry Price | Mid Price | Exit Price |
|---|---|---|---|
| | $3.1579 | $3.1500 | $3.1421 |

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 – March 2021 quarter

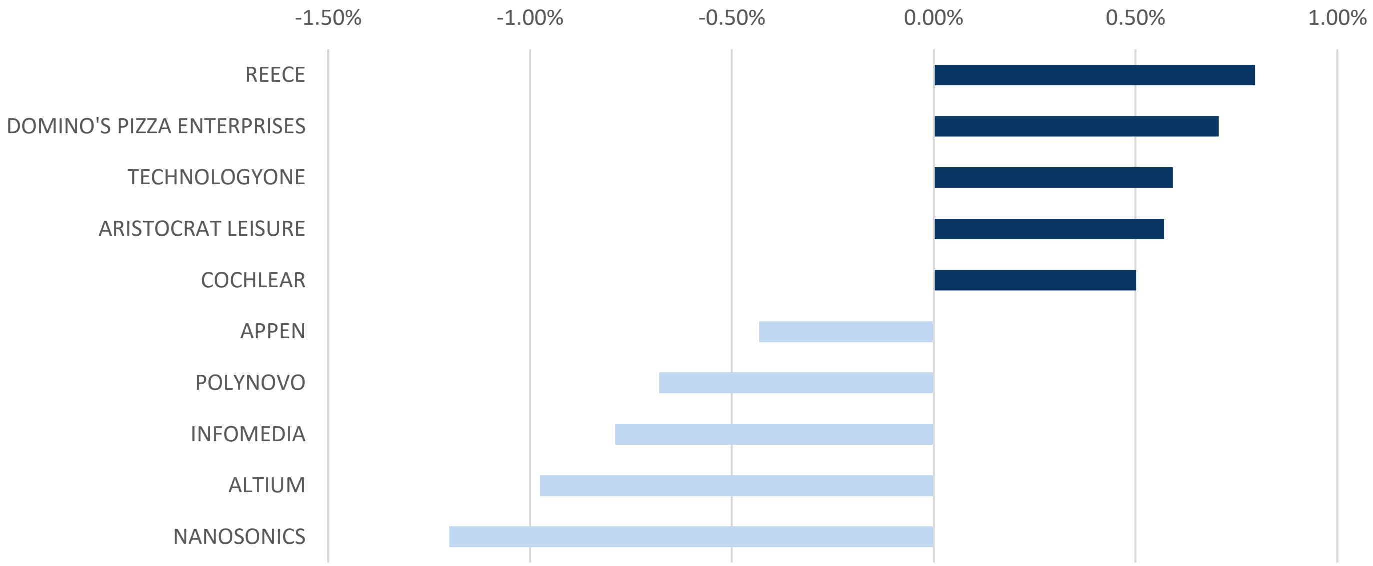
| S&P ASX Industry Sectors | Quarter Performance (%) |
|---|---|
| Financials | 11.32 |
| Consumer Discretionary | 7.44 |
| Telecommunications | 7.05 |
| Energy | 2.86 |
| Materials | 0.66 |
| Consumer Staples | (0.80) |
| A-REITS | (1.13) |
| Industrials | (1.83) |
| Utilities | (2.64) |
| Healthcare | (2.90) |
| Information Technology | (11.53) |

## Table 5: Fund's industry weightings

| Industry group | March 2021 (%) | December 2020 (%) |
|---|---|---|
| Software & Services | 22.84 | 24.04 |
| Consumer Services | 18.21 | 17.70 |
| Health Care Equipment & Services | 14.29 | 16.30 |
| Media & Entertainment | 9.84 | 10.64 |
| Capital Goods | 8.68 | 7.81 |
| Materials | 6.39 | 6.28 |
| Diversified Financials | 4.48 | 4.74 |
| Pharmaceuticals, Biotech & Life Sciences | 4.16 | 3.97 |
| Cash & Other | 2.93 | 0.29 |
| Household & Personal Products | 2.49 | 2.41 |
| Insurance | 2.13 | 2.50 |
| Automobiles & Components | 2.12 | 1.94 |
| Consumer Durables & Apparel | 1.42 | 1.38 |

# PORTFOLIO CONTRIBUTORS

## Graph 2: Contributors and Detractors – March 2021 quarter




## Top quarterly contributors

### *1. Reece (ASX:REH)*

Refer to the reporting season article below.

### *2. Domino's Pizza Enterprises (ASX:DMP)*

Refer to the reporting season article below.

### *3. TechnologyOne (ASX:TNE)*

During the period, TechnologyOne held its annual general meeting. The company remains on track to deliver strong Software-as-a-Service (SaaS) annual recurring revenue and profit growth for full year 2021.

SaaS continues to be the primary opportunity across the company's key markets of local government, higher education and government related businesses. Management has affirmed a strong pipeline for 2021 and will provide further details at its first half results.

TechnologyOne has a market capitalisation of $3.1b with net cash of $125m.

### *4. Aristocrat Leisure (ASX:ALL)*

Aristocrat Leisure's annual general meeting held in March reaffirmed the group's positive business momentum. The company's land-based operations have continued to maintain or enhance market leading share, a result of strong customer support and investments undertaken during the period.

The digital business is also growing share across the core genres of Social Casino, Social Casual and Strategy and RPG. Increased investments in user acquisition (UA) and design & development (D&D) to scale existing while introducing new games has led to strong growth in digital bookings. Management is intent on accelerating the positive progress enjoyed in this division, as reflected in the recent acquisitions of proven, world-class game studios, Neskin and Proteus.

As a content provider, Aristocrat's people are paramount towards the long-term success of the business. The company has reiterated a 'people first' focus, which we cover in more detail in our article "Remuneration, and why we vote the way we do".

Aristocrat Leisure has a market capitalisation of $23.5b.

### *5. Cochlear (ASX:COH)*

Refer to the reporting season article below.

## Bottom quarterly contributors

### *1. Nanosonics (ASX:NAN)*

Refer to the reporting season article below.

### *2. Altium (ASX:ALU)*

Refer to the reporting season article below.

### *3. Infomedia (ASX:IFM)*

Refer to the reporting season article below.

### *4. PolyNovo (ASX:PNV)*

Refer to the reporting season article below.

### *5. Appen (ASX:APX)*

Refer to the reporting season article below.

# WHAT A 'PER' DOES NOT CAPTURE

Undertaking a comparative analysis of businesses through a price to earnings ratio (PER) is a lazy way to invest. Pick the low PER stocks, accompanied in most instances by overly generous dividend payouts and hey presto you have what appears on paper to be low risk and better valued stocks.

This short cut investment approach is alive and well, even among the most established and reputable of investment houses, despite considerable shortcomings.

Calculating a company's PER requires a relatively straightforward formula: 'the share price of the business divided by the net profits expressed as earnings per share (EPS). The higher the PER number the more you are paying for the business and vice-versa.

Now of these two inputs, the share price is a given. It is set by the stock market and as proponents of the efficient market hypothesis would argue it incorporates all the important and available information known. We would beg to differ.

No single ratio can tell you all you need to know about a stock, and in fact the EPS calculation is not as straightforward, involving all manner of financial gymnastics to get to the bottom line. The accountants have engineered a job for life, ably supported by the auditing community who make sure everything is in order, or qualified.

What makes the PER comparison difficult is the very thing that should make it easy. That is, the lack of consistency in calculating the most important input, net profits. What gets included (the type of expenses), what is missing (outlays that are capitalised and not expensed), what is applied differently (rate of depreciation write-off against assets) and what is random (one off gains and losses), are the very things that make this output, and what investors are relying on, such a hit and miss process.

To deduce that a portfolio with a lower average PER carries less risk and therefore by definition, greater potential upside, is like comparing apples with oranges. The obvious fact that they are both fruits is where any similarity ends.

The PER itself is reflective of what an investor is prepared to pay for a business compared to its earnings. Generally, it captures either historical or past earnings and some expectation of future profits. A low multiple is often attributed to lower growth businesses. Conversely a high PER is associated with a higher earnings profile.

Obviously, a lower ratio is preferred, being a quicker period for the investment outlaid to be recouped, but in truth that is where the assumptions stop, and the realities start.

Unlike an asset class, like a toll road, that has some sort of revenue predictability (at least we thought it did until COVID came along), most businesses are dynamic. Regulation, competition, new markets, loss of clients and economic impacts, all go into the mix to define how well a business may perform.

A PER of 10 might sound great on the surface but anyone owning Telstra, of which we are not one, are still holding their breath, having witnessed the slide in profits and the cut in dividends over the past decade. The share price over this period remains largely unchanged at roughly $3.40, despite a recent high point of $6.59 in 2015 and its listing price of $3.40 back in 1997.

The introduction of the Federal Government's wholly owned wholesale internet monopoly operator, the National Broadband Network (NBN) certainly changed the dynamics of this industry over recent years and its longer term impact is still to play out.

For Telstra shareholders, however, what is crystal clear is a business that has delivered diminishing returns and a highly leveraged balance sheet; a result reflective of the intensity of capital reinvestment and accompanying shareholder pressure to maintain an unsustainable level of dividend payments.

In 2010, Telstra's net debt stood at $13.9b, with revenues of $25b and reported net profits of $3.9b. In June 2020 reported net debt had risen to $16.8b, while net profits had collapsed to $1.8b on group revenues largely unchanged at $26b. These metrics, as crude as they are, do not portray a flattering story. For investors, hopes of future earnings are now being pinned on an asset sell-off program and the extension of the company's national mobile dominance with the rollout of its 5G network.

Today, the business trades on a historical PER of 22, more than double what it was in 2010. This is not a result of a share price (numerator) increase, rather the earnings per share (denominator) has slumped. The debt profile is higher, but interest payments have also fallen, in part due to the lower interest rate environment, thereby disguising another concern.

Finally, despite the pressure for capital reinvestment, dividends are being maintained at 16 cents per share, equivalent to a 100% payout of profits, but down from the 28 cents paid a decade ago.

So, what are investors to make of a PER? In short, it is crude and hides all manner of business sins. The absolute number may indicate the level of risk one is exposed to, but in truth investing is not that simple. As Telstra shareholders have unfortunately experienced, the long-term success and sustainability of a business goes well beyond a company's PER score. There is more that goes into the mix of what makes a good business, as well as the risks at play, than just a raw number.

We have written at length in earlier quarterlies on some of these metrics, many qualitative in nature. Below we expand on a few, but it should not surprise our readers to know that the last thing we consider in any company analysis process, is the valuation. It is not that we are dismissive of this, but more that the long-term success of any business is dependent on multiple factors.

Top of the list is the business team, which we loosely term management. The focus however extends beyond the chief executive officer (CEO) and finance personnel. While the CEO is critical in setting the strategy and direction, the best companies are those with a collective purpose from the top down. There needs to be buy in from the board all the way to the office junior. It is this very buy in, what we call culture that is nurtured over time.

Culturally aligned businesses have that special x-factor and are often seen in founder-led organisations. They have a clearly focused purpose, a true north star pursuit, involving a strategic intent. Importantly, success is measured against internal objectives, rather than market obsessed yearly metrics.

We focus on the long-term financial trends to gauge the progressive health of a business. A pause in earnings growth, or a commitment to invest further, is often frowned upon by analysts as it has a direct impact on carefully crafted financial discounted cashflow models (DCF*). A DCF valuation, one that aims to capture the long-term discounted cash flows of a business, can vary so dramatically on any given event, that it leads to manic whips in business valuations and share price targets.

Given all the moving parts that impact the running of a business, short-term events are not only likely but normal. Sticking a share price valuation based on a DCF, which is frankly ridiculous to measure[1] in the first instance, is illustrative of an industry obsessed with a just-in-time investing mentality.

In contrast, exceptional business leaders approach the task of leading differently. Short-term disappointments are par for the course, as is the drive to innovate and remain focused.

A culturally aligned team in pursuit of its business objectives often displays common traits, including:

1. Founder or significant investor base allowing for shareholder alignment.
2. An ownership approach that measures success over decades not months.
3. A reinvestment commitment that sits at the core and preferably expensed.
4. A balance sheet that is not 'debt' optimised, providing flexibility and latency to move.
5. A shareholder relationship that values transparency and delivers actions that advances a purpose that are in the best interests of owners, including society.
6. The pursuit of leadership, often doing the unconventional.

When you package this up, while it is a powerful combination it is not without its heartaches. The zigs and zags in business are tough enough, only made more difficult when operating in a public environment.

As we all know good news gets rewarded and the not so good harshly dealt. It is little wonder why many boards and management teams choose their words carefully when discussing performance or trading updates.

Delivering tough news is never easy nor is a change to a dividend policy done lightly, but that is exactly what is needed at times. Without firm action, the risk of long-term damage is simply magnified.

The Telstra board's decision to maintain a dividend payout policy in excess of 100%, when clearly the business was under competitive pressure and capital reinvestment was a priority, is still hard to fathom or stomach.

Shareholder pressure drove this outcome, now reflected in a higher debt profile and a less flexible balance sheet. Even today the board is prepared to compromise itself in order to satisfy investor and market demands.

If nothing else, the board's primary role is as custodians of a business, while management should be focused on driving a better, more sustainable enterprise.

With all that in mind, what is an appropriate PER? The short answer is it depends.

As to what it depends on, well that list is extensive: how you get to that ratio; whether the management team are investing for the long haul or executing to extract maximum short-term gains; whether the balance sheet is clean and cashed up or swimming in debt; whether auditors are having to justify the accounts or approve how costs are capitalised; or do the numbers just flow effortlessly off the page, reflecting a level of conservatism that all investors are entitled to.

Ultimately, it requires a level of understanding that can only be achieved by getting into the nitty gritty. Only then will an apple to apples comparison be at least considered possible.

## *Ridiculous DCF

A discounted cashflow (DCF) model is great for generating a price target, often impressively close to a share price, because it has so many convenient levers. Yet a DCF fails to fit our common-sense approach and according to Investopedia[3] it has the following issues, which we agree with.

DCF common-sense issue #1

The most obvious real-world issue is that the uncertainty with cash flow projection increases each year in the forecast. A DCF model often uses five or even 10 years' worth of estimates. The outer years of the model are likely to be total shots in the dark.

DCF common-sense issue #2

Free cash flow projection involves estimating capital expenditures for each model year. Again, the degree of uncertainty increases with each additional year in the model.

In the real-world, capital expenditures can be largely discretionary; in a down year, for example, a company's management may rein in capital-expenditure plans (the inverse may also be true). Capital expenditure assumptions are usually quite risky.

DCF common-sense issue #3

Perhaps the most contentious assumptions in a DCF model are the discount rate and growth rate assumptions. All manner of discount rate assumptions can be applied to an equity DCF model. The various approaches are quite theoretical and may not work well in real-world investing applications.

Perhaps the biggest problem with growth rate assumptions is when they are used as a perpetual growth rate assumption. Assuming anything will hold in perpetuity, other than a toll road, goes against our common-sense approach. ***SFM***

[3] *Investopedia. 2021. Top 3 Pitfalls Of Discounted Cash Flow Analysis. [online] Available at: https://www.investopedia.com/investing/pitfalls-of-discounted-cash-flow-analysis/#:~:text=The%20most%20prevalent%20is%20that,total%20shots%20in%20the%20dark .*

# STRANDED ASSETS

> *"Stranded assets are investments that are not able to meet a viable economic return and which are likely to see their economic life curtailed due to a combination of technology, regulatory and market changes."*

Bankers are familiar with the term stranded assets, investors less so. The current decade is likely to change all that and investors will do well to understand the consequences.

First, let us take a step back in time. It is the year 1962 and the company is Berkshire Hathaway. Warren Buffett had just stepped up to invest in a struggling textile business. It was a value play, with all the visible attractions that such assets tend to exhibit; low valuations, excess capital tied up in hard assets and the promise of running a better, more efficient operation.

There was only one problem, the textile business was a poor one. Buffett knew that and had planned to offload the business to management, who originally agreed to terms and then reneged. Buffett doubled up, took control and acknowledging the poor financial outlook confronting the textile business, stopped investing. He diverted his energy and money into investments, specifically insurance, starting with National Indemnity in 1967 and subsequently auto insurer Geico, which was fully acquired in 1996. As they say, the rest is history.

Buffett as we all know is no ordinary investor. Even though he refers to the purchase of the Berkshire textile business as one of his worst investment decisions, he did not compound the error. He had seen the writing on the wall and in his 1985 letter to shareholders made a point to share his hard earned lessons to investors, *"I won't close down businesses of sub-normal profitability merely to add a fraction of a point to our corporate rate of return. However, I also feel it inappropriate for even an exceptionally profitable company to fund an operation once it appears to have unending losses in prospect."*

In Buffett's 2012 shareholder letter the message of where not to invest was crystal clear, *"Generally speaking, it pays to stay away from declining businesses. It's very hard. You'd be amazed at the offerings of businesses we get where they say... it's only six times EBITDA, and then they project some future that doesn't have any meaning whatsoever. If you really think a business is declining, most of the time you should avoid it."*

It is not always obvious that a business is in decline. As societies change and new technologies are rolled out their impacts are felt by business and consumers alike. These slow-moving trends may appear benign at first, but they invariably exert their influence on how capital is deployed.

Capital is the great leveller, flowing to where the returns are greatest, rather than where it is needed most. A business that becomes stranded, is one that is caught between the here and now and the future. And as Buffett determined, it is unwise to deploy more capital into a business that is in a rate of decline. When the economics of the business no longer support it, it is time to get out.

We learnt this valuable lesson when we exited our investment in liquefied natural gas (LNG) operator, Oil Search during 2020. Its main asset, the world class Papua New Guinea (PNG) LNG project commenced production in 2014. It had transformed the company by providing a very competitive and abundant energy source at a low-cost to a growing global audience. Management was first class and despite PNG's political instability, the company's presence in the region appeared assured.

All this changed when a new PNG Government took a combative approach to future LNG development. The company looked to augment its PNG operations by buying into a highly prospective oil province on the North Slope, Alaska.

The PNG situation was tricky but not terminal. Drilling for oil in Alaska was, however, something different. It is not that management were cavalier or wrong in their assessment of the significant opportunity present, but more so the world's view of these types of endeavours had changed. They had become for all intents and purposes non-bankable.

While drilling had confirmed a significant oil resource, funding the project's development would ultimately require the support of the banking fraternity.

What changed? No doubt COVID-19 did not help the matter, with a collapse in demand sending oil prices spiralling to decade lows. Environmental concerns have always existed, but the North Slope is home to some of the global industry's oil majors, like ConocoPhillips, while the Prudhoe Bay region of Alaska is home to five of the top ten producing oil fields in the United States of America.

Now, we would surmise that climate change and the growing global acceptance for action, has permanently altered the investment resource landscape. Governments will no longer endorse new projects without extensive due diligence and environmental analysis. Investors, led by the powerful industry superannuation funds, will now screen out sectors, industries and companies that no longer meet long-run acceptable metrics or member expectations.

In this instance the *"canary in the coal mine"* is the coal industry itself. Targeted as a non-investable asset class by prominent investors, including the world's largest fund manager, the US$8.7t BlackRock Group led by CEO Larry Fink, coal has figuratively speaking become a dirty word.

The writing was on the wall for not only the coal industry to see, but also those operating in exploration and development, including the likes of Oil Search. We exited our investment knowing this was a business under increasing operational duress and exposed to investor and funding scrutiny.

We lost money but that did not alter our view that this was the correct course of action. In the end, the bankers had raised the alarm bell. This was an acknowledgment of the shifting sands, driven by climate change action. While others may see an opportunity to invest in an asset class that, while wounded by COVID, will recover, we see ongoing structural weakness. We moved on.

History provides a wonderful catalogue of past winners disrupted by human advancements. Kodak and Blockbuster are two names that come to mind, along with companies who have been in the line of fire with the shift from fixed telephony to mobile, cash to digital payments, or even shopping malls to online retail. These seismic shifts are not necessarily felt overnight, but ultimately there will be an impact.

Many investors often confuse the past with the future. Find a business, value it using simplistic metrics like its net asset backing, a price earnings ratio or what appears to be a very low earnings before interest, tax, depreciation and amortisation (EBITDA) multiple, while at the same time being seduced by a tempting yield.

It is easily done when the investment also comes with a known brand. However, as Buffett discovered with the Berkshire textile business, reputation counts for nought. You only need to look at a handful of recognised brands to realise the challenging landscape they have now found themselves in. Think telecommunication operator Telstra, energy providers such as AGL and Origin Energy, insurers including reputable names QBE and IAG, and property plays like Scentre Group (operator of Westfield).

Investors have been put on notice. COVID-19 not only impacted our lives in a direct and meaningful way, but it also shocked us into action and accelerated a permanent shift in business and consumer behaviour.

At the core, technology will continue to be the great disrupter. Adopting a status quo approach is a recipe for failure as advancements continue at a rapid pace. One must only look at the swift vaccine response to COVID-19 to appreciate the role technology is having in the field of science.

Directors too are coming to grips with a company's licence to operate, now increasingly captured under the heading Environmental, Social and Governance (ESG). It is no longer good enough to just voice concern, investors are demanding action. This is akin to renowned management guru Peter Drucker's approach, *"what gets measured, gets managed"*.

As we saw during the last quarter, some companies shocked investors twice. Take energy provider AGL as an example. First, it pre-reported an earnings downgrade, never a positive experience.

Second, it reported a $1.9b write down to its asset value, accounting for onerous wind farm contracts written during 2006 and 2012, while increasing provisions for environmental restoration of its fossil fuel assets. Further impairments of $532m were made on its natural gas assets.

All up a $2.7b hit to a business caught in the middle of an energy transition movement from carbon to renewables. Addressing investors at the group's recent 2021 half year result, AGL CEO Brett Redman outlined the difficult task facing the group. He stated the company is "*actively assessing our business model and capital structure to maximise shareholder value and support our evolving strategy as the shaping forces of customer needs, community expectations and technology continue to accelerate*."

We suspect we are going to witness a lot more write downs as companies assess the negative ramifications of technological impacts and competitive market forces. The danger comes when a traditional utility type operation, carrying inflated asset values and accompanied by high leverage in the form of debt, realises the world has changed. As one side of the balance sheet shrinks, the implications are felt on the other in the form of higher gearing ratios and lower returns to investors.

The general insurance industry is another grappling with a host of challenges. Near zero global interest rates has driven low returns on an insurer's 'float' (representing premiums collected before payouts are made), while ongoing external shocks continue to deliver long duration risk. For our liking it is an industry with too many unknowns, inexplicably caught in the past and unable to predict the future, while providing investors little in the way of reassurance.

We may struggle as investors to understand why some businesses and sectors are valued so highly while others languish, but invariably the forces at play are right, capital will flow to where it should.

And here it is worth watching what the bankers and insurers are doing. As the world's underwriters of capital and risk, their actions carry weight. A case in point, in 2019 eleven major banks with significant holdings in the global shipping industry signed onto an extensive set of guidelines.

Christened the Poseidon Principles, the guidelines were designed to accelerate decarbonisation across the sector. By measuring annually, the carbon intensity of a signatories shipping portfolio, it sets a benchmark for what it means to be a responsible bank in the maritime sector, while simultaneously forcing change down the line.

We certainly do not take anything for granted. While our day to day lives have been turned upside down in many ways, the era of technological disruption and scientific discovery may be at its infancy.

When a company finds itself on the wrong end of business economics, no share price level is cheap enough. To borrow a line from Buffett, *"Time is the friend of the wonderful business, the enemy of the mediocre."* ***SFM***

# REPORTING SEASON SNAPSHOT

## Altium (ASX: ALU)

After eight years of consecutive, double-digit growth, electronic printed circuit board (PCB) designer Altium experienced a challenging first half, with revenue declining 3% to US$89.6m. CEO and Executive Director Aram Mirkazemi explained the first half was *"Altium's pitstop",* reflecting the external pressures from COVID-19 and the organisation's hard pivot to the cloud, otherwise known as its *"Netflix Moment"*.

At the end of the period, the company's subscriber base stood at 52,157 seats, up 12%. The impact of COVID-19 was most readily seen in the lower uptake of new perpetual licence sales, down 15% for the half. This was compounded by licence compliance challenges in China, weighing down on the group's performance in region. Importantly, while perpetual licences decreased, term-based licenses more than doubled over the period, boding well for Altium's goal of reaching 80% recurring revenue by 2025, off its current base of 65%.

With over 100,000 engineers using Altium Designer worldwide, it is the most widely used professional PCB design tool and the key enabler for the company to dominate the PCB industry.

Complementing this core business is Altium's cloud business NEXAR, which seeks to drive industry transformation. NEXAR, houses the Altium 365 cloud platform, online parts catalogue provider Octopart and Smart Manufacturing. Following two years of organisational transition, NEXAR is pioneering an industry shift to real time collaboration that connects online design, product development and parts sourcing all the way through to manufacturing. In essence it is the digitisation of this space.

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 designs. Through the company's latest platform offering, Altium 365 users host their designs on the cloud and can collaborate seamlessly across the supply chain in real time.

For the fragmented electronics industry, Altium 365 is aimed at managing production risk and driving productivity. There are now 9,300 active monthly users and 4,400 active monthly accounts on the platform since its launch in May 2020. 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 use, 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.

With these changes comes the opportunity for stronger growth as CEO Mirkazemi explains, "*As part of this transition, our team has switched from one engine of growth with one flywheel to two engines of growth with four independent flywheels. These new flywheels are built to drive adoption of our CAD tools and cloud platform. For the adoption of CAD tools, there are two dedicated flywheels that focus on high-volume and high-touch sales. And for the cloud platform, there are two additional flywheels that focus on bringing customers to the cloud and bringing partners to the ecosystem that is being built around Altium 365. These flywheels are fully formed and are beginning to spin out. Our focus is now fully dedicated to building ever-increasing momentum in these flywheels*."

The group's strategic decision to singularly focus on Altium's connected platform offering, led to the decision to divest the non-core TASKING business for US$110m. CEO Mirkazemi outlined the reasoning behind the move, "*While TASKING is a great business, it does not play a central role in our design to realization strategy for the electronics industry, which is being delivered through our new cloud platform Altium 365. The divestment of TASKING will free up organizational capacity and allow Altium leadership to focus on our main game, which is to expand Altium 365 and accelerate its adoption"*.

Altium confirmed that full year 2021 revenue guidance is likely to settle at the lower end of the previously indicated range of US$190m to US$195m, along with operating profits (EBITDA) of US$70m to US$76m.

Altium closed the period with cash of US$88.3m (excluding the TASKING proceeds of US$110m), no debt and a market capitalisation of $3.6b.

## Appen (ASX: APX)

Following its solid first half result, Appen released a trading update to the market in November, lowering underlying operating earnings (EBITDA) guidance for full year 2020 within the range of $106m-$109m, compared to the $125m-$130m previously guided. The full results were released in February, with group revenues rising 12% to $599.9m and underlying EBITDA improving by 8% to $108.6m, representing an EBITDA margin of 18.1%.

Both updates prompted broad market sell offs, with Appen's near term growth expectations lowered due to:

1. Exchange rate headwinds
2. The impact of COVID-19 on new business development and renewals with smaller customers
3. Reprioritisation of projects 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, were less than expected, *“Our major customers rely on advertising as their major source of revenue, and hence, they reacted by deferring some projects and reallocating resources to new product developments to lessen their reliance on advertising. This, in turn, impacted our revenue to the extent that we did not see the uplift in revenue from our major customers in Q4 that we have seen in other years.”*

We note the near-term concerns that surround – major technology players facing external pressures including – changes to IDFA (Identity for Advertisers) for Apple users to opt in to tracking data, and multiple anti-trust cases, brought by state and federal regulatory bodies in the U.S., in relation to monopolistic behaviour around digital advertising. Perceived earnings uncertainty is driven by Appen's dependency on major technology firms – as these tech titans look to diversify digital advertising revenue, they are reprioritising resources into new product areas which involve Appen.

Importantly, management is confident data requirements are not being brought in-house. Appen has seen a 34% year-on-year increase in projects with existing customers, which CEO Brayan notes as *“extremely positive”* and indicative of the importance Appen's offering has to the future growth within these organisations.

CEO Brayan also highlighted a gradual recovery stating, *“In regard to our major customers and projects that were deferred or impacted by resource reallocation, we are seeing most of the material projects that were deferred in the second half recommence in the first half of '21, and present indications suggest a steady return of the projects that were impacted late in 2021.”*

As we highlighted in our December quarterly 2020 newsletter, Appen operates as a leader within the relevance space, having a proven ability to efficiently scale its crowd workers as demand requires. Globally, there is only one competitor with the scale to compete effectively. This was private equity owned Lionbridge, recently acquired by Canadian communications and information technology company TELUS International for US$935m.

Despite the pressures, the Relevance segment grew revenues by 15% to $538.2m and operating profits by 8% to $112.7m. The group’s Speech and Image division, encompassing speech, text, image and video data labelling recorded revenues down 10% to $61.2m, as the inconsistent nature of work has led to some customers deferring projects due to COVID. Operating profits fell by 42% to $12.4m, as the company continues to invest in building the right base to facilitate growth as activity returns.

The business continues to invest to grow its technology offering. This transition was accelerated with the acquisition of Figure Eight in 2019 for a total consideration of $287m, a best-in-class machine learning annotation platform. Appen – offers an integrated, secure solution alongside its leading crowd workforce, allowing clients to create, manage and monitor data labelling projects, while providing efficiencies within the crowd data labelling and hiring processes.

This strategic play has positioned Appen well from a product and technological standpoint. The annotation platform expands Appen's reach to companies without their own platform, which bodes well for potential customer growth and diversification.

Four of Appen's top five major global technology customers use the annotation platform, as it can service a range of use cases and data types that their own platforms cannot. Appen becomes increasingly integrated with clients' operations as they transition more projects over to the platform. This leads to improved productivity and quality of work as well as better predictability and visibility of future projects and revenue. The company already has one enterprise-wide platform agreement with an existing major customer valued in excess of US$80m. We consider this is a strong endorsement of the company's technological capability and representative of the integral role Appen has in this customer's new and existing product roadmap.

Additional investments across sales and marketing, augmented with material software development spend has positioned the business to remain at the industry forefront, as evidenced by:

- Signing a record 136 new customers in 2020 across multiple industries, geographies, data modalities and use cases.
- Committed revenue of $92.0m in 2H20 or 31% of total revenue, up from $36.3m in 1H20 or 12% of total revenue.
- Revenues in China has grown 60% quarter on quarter across the full year, with the business servicing the major Chinese technology players.

In its outlook statement, Appen has flagged near-term challenges due to the timing of project deliveries and a stronger Australian dollar. The company expects its underlying EBITDA for FY21 to be in the range of US83m-US$90m, representing growth of 17-28% from FY20 excluding the foreign exchange gain.

Appen operates in the Artificial Intelligence (AI) space, which has increased in importance over the past year as organisations accelerate their digitisation initiatives. Financially, Appen has a capital light balance sheet and the ability to self-fund its growth initiatives for the foreseeable future. Management are focused on matters within their control, which is to maintain the delivery of high quality data at speed for customers, while investing to build a sustainable business for the long-term.

Appen has a market capitalisation of $2.0b and net cash of $78m.

## carsales.com (ASX: CAR)

Leading online automotive listings business carsales.com released its first half FY21 results in February. For the half, the company reported revenue of $199m and net profit after tax of $61m, a decline of 7% and 14% respectively against the prior corresponding period (pcp).

This result reflects the difficult trading conditions posed by the COVID-19 health crisis. Despite this, investments in international markets continue to provide significant scope for carsales, with offshore markets now contributing 25% or $26.3m of total look-through operating profits (EBITDA).

It is important to note that the result is muddied by the COVID-19 Dealer Support Package which saw $11m in fees waived over the period. Adjusted for the support package and other one-offs, the company reported revenues down 2% to $210m while net profit after tax lifted 17% to $74m

These figures reflect an expansion in core business margins as the company reduces costs, exits under-performing businesses and focuses on improving general business profitability.

On the domestic front dealer sales volumes and traffic to the website remained resilient, assisted in part due to Carsales' support package. Strong demand for used cars encouraged dealers to continue to invest in depth products despite the backdrop of a tougher economic environment.

The group's Media division fared less well, impacted by a challenging new car market, that was further complicated by cuts to car manufacturers advertising budgets.

While the effects of COVID-19 have been similarly felt offshore, the group's operations in both South Korea and Brazil delivered strong performances for the period.

Wholly owned Encar (South Korea) delivered revenue of $38.6m and operating profits of $20.6m, an increase of 19% and 26% respectively. This result was underpinned by the Guarantee Vehicle Inspection and Dealer Direct (similar to Carsales' Instant Offer product) services.

Webmotors (Brazil), of which Carsales has a 30% ownership stake, delivered revenue of $32.5m and operating profits of $15.4m, a decrease of 21% and 15%

respectively, driven by unfavourable currency movements. In constant currency, Webmotors grew revenue 11% with operating profits increasing 21%.

On a look-through basis, International businesses contributed revenues of $53.8m and operating profits of $26.3m for the period, an increase of 5% and 29% respectively.

The majority of these businesses are market leaders, providing a long runway for growth.

Carsales has a market capitalisation of $5.0b and a net debt of $361m.

## Cochlear (ASX: COH)

Leading global bionic ear manufacturer Cochlear delivered a less eventful 2021 half year result, following a tumultuous end to the previous period that included an adverse legal decision, the initial onset of COVID-19 and a $1.1b capital raising. The group's overall financial metrics were solid. A softer first quarter was followed by a much improved second period, with revenues down 1% in constant currency (cc) to $742.8m and underlying net profits falling 4% cc to $125.3m.

Cochlear implant numbers recovered strongly, with revenues rising 1% to $455m, offset by modest declines in Services down 2% to $215m and Acoustics off by 7% to $73m. This was underpinned by the group's developed market regions with unit sales up 5%, offset by unit declines of 30% in emerging markets. Importantly, surgeries have returned to pre-COVID levels across several developed markets, while new candidate pipelines are quickly rebuilding.

One region worth highlighting is China. The company has committed capital to building a manufacturing base in the country and has successfully grown unit sales over the years. While the company is loath to break down unit sales by region, China sits within the top three alongside the U.S. and Germany. It is a powerful position, noting the significant unmet demand that resides in the country.

Amidst the crisis, Cochlear has maintained its investments in research and development (R&D) and people. Choosing not to reduce its workforce has allowed employees to focus on providing superior customer service and support.

The recent release of four new products, including the off the ear Kanso 2 sound processor, has further differentiated the company's product portfolio. This innovation mindset is explained further in our *"Black Box Thinking"* article. Overall, these initiatives have led to market share gains and helped further cement its leadership position within the profound hearing loss market.

Financially, Cochlear now has significant flexibility, operating with a net cash balance of $502m, while also continuing to generate free cash flows. The group declared an interim dividend of $1.15 per share, which represents a payout ratio of 60% and signals the group's confidence in its outlook and ability to generate positive returns.

The passage of time has undoubtedly given more certainty around Cochlear's operating environment. Hospitals are better informed and equipped to deal with the virus, while nationwide vaccination programs are accelerating. Cochlear is poised to benefit as elective surgeries are reprioritised, having fortified its balance sheet and improved its competitive moat during COVID.

Having managed the impacts of COVID, the opportunity ahead for Cochlear is to grow its implant base, with the company noting *"less than 10% of people who would benefit from an implantable hearing solution are treated".* Despite being the market leader with a differentiated product portfolio, the industry has struggled to increase penetration rates as awareness and knowledge amongst audiologists, ENT (ear, nose and throat) specialists and consumers remains low.

Management have developed an improved understanding of the referral channels through investments in the Cochlear Provider Network and Sycle acquisition.

Importantly, they have shown a willingness to invest in growth, and as market leaders with a long-term focus, we remain confident on improved cochlear implant penetration rates going forward. This large total addressable market also provides a lever for sustainable, organic earnings growth over the long-term.

Cochlear has a market capitalisation of $14.0b and net cash of $502m.

## Domino’s Pizza Enterprises (ASX: DMP)

Domino’s Pizza Enterprises has transitioned to the new COVID-19 world in better shape than most. As a digitally driven, home based food delivery business, the group’s global footprint has thrived under the restrictive lockdown conditions created by the pandemic. Executing under such fluid conditions is no easy feat, especially while maintaining exacting health standards.

Domino’s demonstrated strong operational performance as network sales increased 16.5% to $1,843m and total same store sales (SSS) grew by 8.5%.

The current climate led to a notable uplift in online orders, now representing 77% of sales compared to 65% in the prior comparative period. In total, 131 new stores were also added during the half, a significant acceleration from the five year range of 70-85 stores.

The company lifted underlying operating profits (EBIT) by 32.3% to $153m, while underlying net profits rose 32.8% to $96m. Strong cash conversion of over 90% and lower capital expenditure saw the business cut net debt by $70m to $377m, resulting in a healthy leverage ratio of 1.1x, down from 1.5x in June 2020.

Breaking down the geographic regions, the revenues and EBIT of each are as follows:

- Australia and New Zealand (ANZ): $383m (+11.6%), $63.7m (+9.8%)
- Europe: $324.8m (+15.6%), $44.4m (+19.2%)
- Japan: $387.3m (+37.5%), $55.5m (+106.6%)

Looking at these numbers, the differing growth rates across each region are clear. As CEO Don Meij notes, *“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.”*

As Domino’s expands further into these newer markets, its recipe for success holds steady; continuing to drive repeat purchases at affordable prices through its three core pillars of Product, Service and Image (PSI).

Although the go-to-market proposition differs across regions, CEO Meij explains, *“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.”*

Japan is a perfect example of this, having undergone significant operational and strategic change in order to fine tune its local PSI proposition. This included:

1. Half price carry out and no minimum delivery – making their offering more affordable for singles.
2. Back of house dough making – meaning complete dough balls are not being sent to the far ends of Japan, enabling a more efficient supply chain, thereby lowering input costs.
3. National input pricing (similar to Australia) – meaning a store outside the major cities of Japan will now have the same input 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.

Japan delivered the standout result for the period, recording SSS growth of 36.4% and increasing its network store count by 68 to 742. The opportunity ahead for Japan is to expand this proven PSI model into new and existing territories, with management aiming to double the store count by 2030-2032. The extraordinary levels of trading from the recently opened stores in Hokkaido, highlights the unmet demand in Japan, with the region's population size of 5.2m (equivalent to that of Sydney) further illustrating the growth runway ahead.

Similar expansion opportunities are also present in Europe, most notably Germany and France. Overall, the company plans to double its global store count from 2,795 to 5,550 by FY25-FY33, with a split of around 2,850 stores in Europe, 1,200 stores in ANZ and 1,500 stores in Japan.

Once scale is achieved, Domino's PSI value proposition subsequently improves; as more stores open, Domino's fortressing strategy results in new store being located physically closer to the customer.

The result is fresher pizzas delivered in less time and reduced costs for both the franchisee and the corporate business to advertise nationally. The group has shown confidence in delivering to this strategy and importantly, has the balance sheet and team to execute.

We remain confident in the management team and the Board who have shown an ability to overcome challenges and external pressures to deliver earnings growth for both its shareholders and franchisees.

Domino's Pizza Enterprises has a market capitalisation of $8.9b and net debt of $377m.

## Flight Centre Travel Group (ASX: FLT)

With international borders facing hard lockdowns and domestic travel in a state of flux, it is no surprise that Flight Centre Travel Group’s performance was significantly impaired over the half.

For the half year period, the company reported total transaction value (TTV) of $1.5b, only 12% of that reported for the prior corresponding period (pcp). This resulted in an underlying loss before tax of $247m, a stark contrast to the $103m profit reported in 2020.

In response, the company has significantly reduced costs; almost 70% over the past twelve months from $1.35b to $421m. The impact to the organisation has been severe with annualised costs now running at around $840m, compared to the group’s 2019 run-rate of $2.7b. This has resulted in the group requiring $10b of TTV sales to achieve breakeven result.

There is no doubt that the events of the past twelve months have forced management’s hand and led to a business reset, with the group’s global footprint of land based stores cut from around 1,500 to the current level of circa 730.

Employee numbers, which totalled some 20,000, have been reduced to 4,268 selling staff. These drastic cuts have allowed management to better control the re-introduction of fixed and variable costs, as and when domestic and international travel corridors reopen.

Importantly, the remit to lift spending will fall under the direct responsibility of the two key executives of Corporate and Leisure. In short, these executives are directly accountable to driving profitable, margin expanding growth.

This will see a positive shift in group profit before tax margins, with the Leisure business forecast to improve to 2%, while Corporate is set to hit 3%, thereby providing a group margin in excess of 2%. This also compares to the 1.45% margin achieved in 2019 and is well north of what market analysts are factoring into future forecasts.

Despite the extremely difficult trading conditions, the company continued to invest in building out its technology platform. Co-founder and Managing Director Graham Turner explained, *“with an eye to the future, we have balanced the short-term need to reduce costs in a low revenue environment with the long-term need to invest in and enhance key assets. In this regard, we have maintained capital expenditure on key leisure and corporate technology projects at pre-COVID levels and have now started to deploy a number of important new products for our customers and our people”*.

Flight Centre is well placed for the recovery phase as vaccine rollouts progress; now operating as a leaner, more efficient organisation. While the recovery is still in the early stages, positive signs are evident. A case in point was the strong and immediate rebound in leisure and corporate travel as border restrictions eased at the back end of 2020. As a result, the December month saw revenue of $33.5m, a record for the COVID-19 period.

Importantly, the group has made significant efforts to shore up its balance sheet with an extended liquidity runway of over $1.2b, including a net cash position of $1.0b.

While the company has not provided guidance due to continued uncertainty, Flight Centre is targeting a return to breakeven in both Corporate and Leisure during calendar year 2021.

Flight Centre has a current market capitalisation of $3.7b.

## Infomedia (ASX: IFM)

Infomedia, a leading Software as a Service (SaaS) provider in parts, service and data insight solutions to the automotive industry, released its first half FY21 results in February. A highlight in the half was the launch of the company’s Next Gen SaaS platform. This step change sees Infomedia progress from selling single point solutions to offering a digital, integrated platform that increases dealer productivity and drives customer retention. In total, Infomedia services 180,000 users in 186 countries.

Despite the difficult economic backdrop Infomedia posted a resilient result with revenue holding steady at $48m. The company's key internal performance metric, Cash EBITDA, which represents operating profit adjusted for capitalised cash costs, declined 16% from $11.4m to $9.5m largely reflecting the sustained investment in the Next Gen platform rollout.

Beneath the headline number, Infomedia's Service products division, which enables service desks to accurately quote on work undertaken during scheduled car servicing, performed well with revenue rising 9% to from $18.1m $19.8m over the period.

This was offset by Parts, the industry's leading Electronic Parts Catalogue platform, with revenues declining 6% from $28.3m to $26.7m. The decline, was driven by lower one-off revenue, temporary financial concessions provided to customers experiencing severe business challenges, and unfavourable currency fluctuations.

Under the current management team lead by CEO Jonathan Rubinsztein, significant change across culture, technology, product delivery and sales are evidence of material progress in the last five years. That said the business remains a work in progress. Ongoing internal rearrangement and accountability for delivery of results in the U.S. are needed before a true step change in growth is to be sustained

Infomedia ended the half with net cash of $97m, bolstered by $84m of new equity proceeds received in 2020. The capital raising aimed to take advantage of acquisition opportunities during a period of market disruption. While the market was disappointed by slow progress, we applauded management and the board for walking away from an acquisition that did not have cultural alignment.

Ongoing travel restrictions surrounding COVID-19 have also impeded the rollout of new contract wins including Ford Europe, Audi Australia, along with a number partnership models in the United States.

While *"opening"* conditions, driven by vaccine programs, are set to improve, revenue growth over the second half will likely remain modest with more significant growth expected in FY22.

Infomedia has a current market capitalisation of $603m.

### James Hardie Industries (ASX: JHX)

By all measures global fibre cement manufacturer James Hardie's third quarter 2021 result was exemplary. For a second consecutive quarter, the company reported record levels in net sales, adjusted EBIT and EBIT margins, adjusted net operating profit after tax, and operating cash flow.

Since joining the company in 2019, CEO Jack Truong has spearheaded a significant transformation centred around:

1. Becoming a world-class manufacturer through the execution of LEAN manufacturing.
2. Transforming the commercial organisation to be truly customer focused; and
3. Integrating the supply chain with customers to capture mutual benefits.

Through LEAN, the manufacturing network is on a continuous improvement path of becoming more predictable and with less variations in production, quality and efficiency. While not only enhancing the service provided to customers, LEAN has driven cumulative cost savings of over US$83m in the 21-month period since inception, including US$61m in North America.

To be truly customer focused, James Hardie has adapted its well known pull approach to a push-pull strategy. Educating builders on Hardie products continues to be important in driving (or pulling) demand.

But as Truong rightly identified, the company's true customers are the dealer groups, those that sell the product. By partnering with these groups and ensuring that agreements are mutually beneficial, James Hardie can both push and pull demand.

In order to execute on the push-pull strategy effectively, integrating the supply chain with customers has been essential.

As Truong explains, *"This is to ensure that we're able to continuously service the market seamlessly to our customers, provide them with the products they want, when they need them. This integrated approach to managing the supply chain with our customers have led to a more optimal working capital for both our customers and James Hardie*".

The US$90m and US$200m drop in inventory and working capital respectively over the financial year to date, is illustrative of management's step-change approach.

The effects of this operational transformation are clear in the results. At a group level, net sales increased 6% to US$2,102m and adjusted operating profits (EBIT) increased 25% to US$456m over the past nine months.

The group's largest market, North America, saw volumes in the exterior business grow 9% over the same period, resulting in net sales of US$1,485m up 11%. LEAN manufacturing savings, coupled with improved volumes resulted in operating profits lifting 24% to US$435m, while margins improved from 26.1% to 29.3%.

Europe had a difficult start to the year as it battled with country shutdowns and a lack of sufficient scale to offset higher production costs due to COVID-19. Volumes improved however in Q3, with sales up 12% and EBIT margins making up for lost ground returning to 10%. In the Asia-Pacific market, margins improved from 23.3% to 28.4% over the financial year to date, as the company exited the non-profitable James Hardie Systems business and shifted production from New Zealand to Australia.

The group's financial discipline was reflected in higher cash flows, up 72% to US$678m, with capital expenditure contained to US$77m for the period.

James Hardie ended the period with net debt of US$864m, down from US$1.0b at the end of FY20. The company has continued to invest in market leading technology with a global innovation platform set to be released in the coming months.

Given the strong operating performance and balance sheet, James Hardie has announced the payment of a special dividend of US$0.70 per share and plans to restart the payment of ordinary dividends sooner than expected.

In a similar vein the company has also upgraded guidance for the full year, now expecting net operating profit to be within the range of US$440m and US$450m. This is a substantial increase on the previously guided range of $US380m and US$420m.

James Hardie has a current market capitalisation of $18.5b.

## Megaport (ASX: MP1)

Global cloud enabler Megaport reported an improved half year 2021 result, across a range of operational and financial metrics.

From a high level, group revenues grew by 39% to $36m and normalised EBITDA improved by 15% to negative $8.7m.

Following an initial capital intensive land grab, which involved the rapid global expansion into physical data centres across Asia-Pacific, the U.S. and Europe, the group is now pivoting towards commercialising its vast ecosystem network.

Products such as Megaport Cloud Router (MCR) and Megaport Virtual Edge (MVE) are examples of this. Both solutions are layered on the existing network at low additional costs, driving incremental revenues at very high margins. The group is now using this network solution to extend to a much wider audience, by pivoting the sourcing of its audience base from a direct sales channel (in-house) to an indirect partnered model through global organisations, including Cisco and VMware.

The business is now at critical scale and on track for earnings profitability. It is operating in an industry where cloud service providers such as Microsoft, Google and Amazon are recording exceptional results and enterprise data centre players, such as Equinix and Digital Realty, continue to expand.

However, within this ecosystem the company offers a differentiated solution and perhaps more importantly, has positioned itself as an independent player, servicing all aspects of the cloud market from enterprise to cloud service provider.

As a global leader in the field, the Megaport offering provides optionality for customers to expand across 23 countries, 130 cities, 716 data centres and 220 cloud on-ramps.

Megaport is led by a motivated and capable CEO in Vincent English and an Innovation Committee comprised of Founder Bevan Slattery and former Equinix Co-founder Jay Adelson.

The company is in an enviable financial position, holding net cash of $128m and expects to be EBITDA breakeven on an exit run rate by the end of this financial year and cash flow breakeven on an exit run rate in FY22.

Megaport has a current market capitalisation of $1.9b.

## Nanosonics (ASX: NAN)

In February, global leader in infection control solutions Nanosonics reported its first half financial year results for FY21. Under the leadership of CEO Michael Kavanagh, Nanosonics is laying the foundations of a long duration business. This is underpinned by its focus on infection control, the importance of which has become increasingly apparent throughout the recent pandemic.

The company continues the rollout of trophon2, an automated high-level disinfection (HLD) unit for ultrasound probes, with the installed base now reaching 25,100 globally, up 12% over the prior corresponding period (pcp).

Nanosonics' revenue comes from both selling trophon machines and the consumables required to operate a disinfection cycle. Over the period, consumables and services contributed $33.7m of revenue, 1% down on the prior period.

While the result was flat, two distinct periods of performance were evident: a weaker first quarter impacted by reduced ultrasound volumes, as hospitals focused on managing COVID-19 patients and a stronger second quarter as demand returned, with the primary distributor, GE Healthcare, recommencing purchases.

The same was also true for capital equipment, however the bounce back in the second quarter was insufficient to make up for the shortfall. For the half, capital equipment sales accounted for $9.4m of revenue, 35% down on the pcp.

While the recent pandemic has created short-term complexities in placing units in hospitals, outbreaks of this nature serve to highlight the importance of infection control, which lays at the heart of Nanosonics' offering. The company believes that as hospitals progress past the management of the current pandemic, the trophon offering will become even more compelling. An increase in enquiries globally is helping validate this hypothesis.

Nanosonics' strategy to go "*wide and deep*" refers to its efforts of not only extending the company's geographic footprint, but also further penetrating within each hospital setting.

In the U.S., the installed base sits at 22,120, compared to an estimated 40,000-unit opportunity. Growing awareness is expected to drive increasing adoption across Europe while in the Asia Pacific region, the Japan strategy continues to progress with five distribution agreements now in place.

Entry plans into China is underway, whilst regulatory approvals have been received for both Thailand and Indonesia, with Malaysia underway.

With total revenue of $43.1m, down 11%, the group delivered profit before tax of $0.2m, down from $6.7m.

The decline was a result of the impacts of COVID-19 on revenue, ongoing investment in R&D and the strengthening Australian dollar. Despite this, the company's balance sheet remains robust with $88m in cash and negligible debt, providing an ongoing foundation for continued investment.

R&D spend has focused primarily on a new technology platform, along with a solution for further digital traceability and reporting, which have been under development for the past few years.

At the last full year result, the company noted that several opportunities for enhancement to the platform had led to a delay in the finalisation of that project, which is now expected in 2022.

Over the period, Nanosonics invested $7.6m in R&D, representing 18% of total revenue.

While not providing specific guidance due to continued uncertainty around COVID-19, CEO Michael Kavanagh commented, "*Based on current market improvements the Company is anticipating ongoing growth in total revenue and profitability into the second half, driven by increasing installed base growth and increased usage of consumables across all regions. With COVID-19 vaccination programs underway, the Company is optimistic that overall market conditions, in particular access to hospitals, are likely to continue to improve.*"

Nanosonics has a current market capitalisation of $1.7b.

## PolyNovo (ASX: PNV)

Manufacturer of bio-resorbable polymer solutions, PolyNovo reported a softer first half 2021 result. This was largely a consequence of the second wave of COVID, which disrupted its global sales momentum.

Total revenues increased by 24% to $12.6m, comprising Novosorb Biodegradable Temporizing Matrix (BTM) sales of $11.3m up 31.2% and BARDA revenue of $1.4m.

BTM sales were lumpy as a result of reduced hospital access and elective surgeries. Strong BTM revenue growth of 75% in the first quarter was offset by the weaker months of October and November, coinciding with COVID infection rates increasing across the U.S. and Europe. The first quarter is a better indication of the growth rates the company is experiencing during normal operating conditions.

Despite the disruptions, management has maintained its rollout strategy across multiple markets. PolyNovo received approvals to enter 10 new countries across Asia and Europe during the period, with distributors appointed in these markets.

Of existing regions, PolyNovo is expanding into new hospitals and territories. In the U.S., 22 new customer accounts were added, while two U.S. Group Purchasing Organisations (GPO) and an Integrated Delivery Network (IDN) were signed.

The GPO and IDN partnerships represent a significant milestone, as they broaden PolyNovo's access to hundreds of additional healthcare providers. In Europe, 30 new accounts were signed, with a further 30 evaluations under progress.

In March, PolyNovo announced the execution of its third U.S. GPO. The company has partnered with Premier Inc, a major U.S. GPO, to allow Premier member hospitals to access BTM on special pricing and terms.

Managing Director Paul Brennan explained, *"This signing with Premier, the second largest GPO in the US, is a major milestone... GPO agreements put our disruptive BTM on a much larger list of hospitals than our sales team can get around in the short-term. We will continue expanding our sales team into new markets to support hospitals and surgeons but now also to match the geographical footprint of the GPOs. We look forward to demonstrating improved health economic benefits for Premier hospital members and their patients"*.

Premier services roughly 4,100 health facilities and hospital members. Of particular interest to PolyNovo are the more than 2,000 acute care facilities of which 100 are designated as trauma centres.

The operational scope and capability at PolyNovo have clearly grown, only made more apparent through the growing employee headcount, sitting at 91 compared to 70 in the prior comparative period.

The current focus is on BTM, which has a significant opportunity to disrupt the wound management market as an organic, fully resorbable alternative to the incumbent animal derived applications. This market has lacked innovation and is ripe for disruption from a differentiated product with clear regenerative benefits like BTM.

Beyond BTM, PolyNovo is seeking to leverage its patented NovoSorb bio-resorbable polymer technology across alternative applications, including hernia, breast, muscle repair and diabetes to name a few.

The company has recently brought R&D in-house to accelerate the development of these products. Hernia is a near term opportunity, with the factory build and commissioning of equipment progressing towards potential product launches across markets in FY22.

As PolyNovo broadens its product portfolio through its differentiated NovoSorb technology, the use of existing resources should lead to faster ramp ups and scale benefits.

CEO Paul Brennan has led PolyNovo's global expansion efforts in a conservative manner, choosing to reinvest cash flows while steadily ramping up the sales and marketing team. Management is confident in its ability to grow the business using existing cash flows, having last raised capital in 2017.

PolyNovo currently generates gross margins above 90%, which reflects the operating leverage potential within the business.

PolyNovo has a market capitalisation of $1.9b and is in a net cash position.

## REA Group (ASX: REA)

Digital real estate advertiser REA Group delivered a robust half year 2021 result. The company benefited from an improvement in listing volumes off the back of higher consumer confidence, propelled by record low interest rates and increased lending from banks.

This saw the group deliver a modest 2% dip in revenues to $430.4m, while operating profits increased by 9% to $290.2m.

Although the macroeconomic picture is positive and does provide a tailwind, the real value proposition lies in REA Group's widening audience metrics against its nearest competitor, Domain Holdings. During the half, REA Group recorded total average monthly visits of

115m, 3.2 times that of Domain's and a unique average monthly audience of 12.3m, representing some 60% of the adult population. With these comparative audience metrics, it is little wonder why it is a popular choice across the board, from agents to home sellers and home buyers.

REA Group has leveraged this dominant position by introducing innovative, value-add (depth) products for an additional cost. An example is Premiere Listing, which provides greater ad exposure and has enabled the company to grow revenues regardless of listing volumes.

Depth penetration and pricing is expected to rise, as the cost for these products are still only a fraction of a sellers' actual spend. Management continues to innovate in this space and REA are also targeting other value-add products across rent, data and agent match to maintain its strong growth trajectory.

The domestic business is highly scalable, operating at 67% EBITDA margins. The group is seeking to replicate this success in other international markets. To date REA Group has achieved mixed success in investments across Asia, India and the U.S. However, the increasing structural shift to digital is translating abroad.

On that note, two important callouts are:

1. News Corporation's majority owned U.S. based realty group Move Inc, which REA has a 20% ownership stake in, reached profitability and contributed a $9.4m operating profit to the group during the half.

2. The company took a controlling interest in Elara Technologies, the leading online real estate advertiser in India, increasing its stake from 13.5% to 59.65%, with a total expected payment in the range of US$50m-US$70m.

In March, the company announced the proposed acquisition of the ASX listed Mortgage Choice (ASX:MOC) group, a leading Australian mortgage broking business.

Operating through more than 500 brokers and 370 franchises, Mortgage Choice has a current loan book of $54b and settled $11b worth of loans during 2020.

The acquisition aligns with REA's financial services strategy as it leverages the company's digital expertise, access to its existing property seeker audience and unique data insights. Importantly it leverages REA's leads and provides increased choice in property finance.

The combination of Smartline, REA's existing broker business and Mortgage Choice will deliver increased scale via a national footprint which is complimentary.

Scale matters in all financial services businesses. This transaction will see REA move from 2% of mortgage application submissions to 5%-6% nationally. This gives REA a larger seat at the table with banks to negotiate better rates and faster application processing times.

For first half FY21, Mortgage Choice reported revenue of $22.2m and net profit after tax of $4.2m. The proposed transaction is expected to be immediately EPS accretive for the group. Synergies will come from technology spend, regulatory spend and costs associated with public company overheads. These will be meaningful in relation to the Mortgage Choice bottom line.

The full cash offer of $1.95 per share, confers an enterprise value of $244m, representing a 66% premium to the Mortgage Choice pre offer share price. The deal will be debt funded, utilising REA's existing facilities.

While the deal remains subject to court and shareholder approval, the board of Mortgage Choice have unanimously recommended shareholders vote in favour of the scheme of arrangement.

At the half year the company declared an interim dividend of 59c per share, representing a payout ratio of approximately 45%.

REA Group has a market capitalisation of $19.4b and net debt of $60m.

## Reece (ASX: REH)

Leading plumbing group Reece delivered a robust first half result, lifting group revenues by 4% to $3.1b and normalised operating earnings (EBITDA) by 12% to $349m. Australia and New Zealand (ANZ) and the U.S. both performed well, with revenues in each region rising by 7% in constant currency.

ANZ continues to deliver standout EBITDA margins, growing 0.80% to 15% for the period. The business remains a clear market leader across many real-world metrics. This is neatly evidenced by an employee engagement score of 82, some eight points above the industry benchmark.

Another noteworthy mention is the group's proven capabilities in the digital world, delivering a 70% increase in online sales in the period. The Reece digital journey has been 10 years in the making and continues at pace. The complete roll out of Field Pulse, a digital suite of administration tools that assist a *"tradie"* run his or her business, is evidence of this.

Investment in this ongoing digital transformation will continue at the expense of margin expansion, which we expect will moderate as a consequence.

Reece is seeking to translate this success to the U.S. operations over time. Data driven insights will prevail here rather than an institutional imperative for growth. The prize is clear, with the U.S. currently generating around half the EBITDA margins of ANZ.

While the competitive landscape differs significantly, there is vast opportunity for growth:

- The business' cultural base will increase through training, mentoring and recruitment programs. In turn improving operating efficiencies and the all-important customer service and experience levels.
- A fit for purpose eCommerce platform will be introduced, in addition to new shop formats and a store rollout program.
- Acquisitions, which are heavily sought after at present will play a role, with the company noting there are *"plenty of Todd Pipe equivalents out there"*.

None of these opportunities will be realised overnight. The journey is for the rightful owner, the patient long-term shareholder.

CEO Peter Wilson explains the U.S. strategic rationale well, *"I've been saying this since we did the acquisition nearly three years ago, this is a very long-term play for us. We call this a 20 year story and we've bought a platform in the Sunbelt and we are over the next number of years looking to build capabilities in lots of different areas including stores, people, digital supply chains. So we are balancing how we build that and it's a long-term journey."*

CEO Wilson also noted the resilience of the business model, only made more apparent during the COVID period, and the strength of the leadership teams now firmly in place in both Australia and the U.S.

It is worth noting here, with a view to long-term real earnings per share (EPS) growth, that our stock selection process seeks to identify management teams who think and act like owners and are willing to invest for the long-term.

The benefits of scale, which are not achieved overnight, are testament to these characteristics. The Reece management team embodies this, having effectively grown the business since 1969 while not selling a single share.

The pre-emptive and decisive $642m capital raising in April 2020 has reduced net debt to $611m. This is under 1x net debt to EBITDA when leases are excluded, providing management with ample operational flexibility during these uncertain times.

Reece has a market capitalisation of $11.6b.

## ResMed (ASX: RMD)

The global pandemic has been an accelerant for change across various industries, and health care has no doubt been recognised as a sector ripe for disruption given the inefficiencies that exist within.

In particular, the areas of digital health, out-of-hospital care and data analytics have seen positive momentum, all of which benefit ResMed.

However, this has not always been the case. ResMed marked its push into the digital space with the US$800m acquisition of Brightree in 2016, pivoting the company away from being just a pure manufacturer of medical products into a software-led company.

The investment, which was recognised as speculative at the time, has not only led to the integration of cloud technology in ResMed's devices, known as AirView Solutions, but also assisted home medical equipment providers, predominantly in the U.S., transition their operations online.

By offering an end-to-end digital ecosystem, physicians and the company can leverage technology, big data and advanced analytics to improve the outcomes for patients, while also lowering health care costs for private payers.

With 13.5m cloud connectable devices, 15m patients on AirView Solutions and importantly, 8 billion nights of respiratory medical data in the cloud, ResMed has shown an ability to scale its technology to support the growth across its ecosystem.

In another quarter impacted by COVID-19 induced lockdowns, ResMed recorded high single digit growth, with group revenues up 7% constant currency (cc) to US$800m and net income up 12% to US$179.5m.

Notably, the company delivered these results with negligible tailwinds from COVID related ventilator sales and a benign but improving sleep apnea diagnosis environment, which has recovered to 70-90% of pre-COVID levels.

The resilient growth has been underpinned by ResMed's re-supply program, a by-product of the investments made across digital solutions, as outlined above.

Despite lower diagnosis levels, Global Devices grew by 5% cc to US$393m, highlighting the greater contribution of device re-supply sales from existing patients. Global Masks and other revenue also increased by 9% cc to US$315.2m, and now represents 45% of total sleep and respiratory care revenue.

CEO Michael Farrell noted a *"modest improvement in adherence and really good improvement in mask resupplies"*.

From a patient perspective, CEO Farrell explains the simplicity of the automated re-supply process.

*"When they get a text response or an app click and a chance to say, yes, I want that new mask, I want that new tubing, I want that humidifier. They're clicking it at much higher rates and getting closer to, frankly, what they should have always done, which is keeping respiratory hygiene at top of mind."*

While other non-essential health care providers may have struggled, the company's quick adoption of digital solutions during COVID has helped drive growth. With the foundations now in place, CEO Farrell believes this marks a *"permanent shift in the adoption curve for their broad range of digital solutions."*

The company remains committed to research and development (R&D) and has increased investments in digital health technology, as well as hardware, software and clinical research. R&D spend increased by 10% to US$55m for the quarter and sits at 7% of group revenues.

Importantly, 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 Farrell reiterated three key operating priorities, *"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."*

Financially, ResMed is highly cash generative and operates a conservative balance sheet. During the quarter, the company reduced its net debt position to US$570m.

In terms of capital allocation CFO Brett Sandercock notes, *"our solid cash flow and liquidity provide flexibility in how we allocate capital. We have focused on paying down debt as well as ensuring we have cash reserves to support the company through the uncertainty caused by the ongoing pandemic. Going forward, we plan to continue to reinvest for growth through R&D. We will also likely deploy capital for tuck-in acquisitions, such as Snap, which was completed during the third quarter of fiscal year 2020."*

We are more than willing to back this management team, who have a proven track record of making positive capital allocation decisions for the long-term success of the business.

The company declared a quarterly dividend of US39c per share.

ResMed has a market capitalisation of US$28.5b. ***SFM***

# BLACK BOX THINKING – BOOK REVIEW

To stay ahead of the competition, is it about the big picture or the finer details?

*"The simple answer, however, is that it has to be both. At the level of the system and, increasingly, at the level of the organisation, success is about developing the capacity to think big and small, to be both imaginative and disciplined, to immerse oneself in the minutiae of a problem and to stand beyond it in order to glimpse the wider vista."*

In his book Black Box Thinking, author Matthew Syed outlines what separates the great businesses from the average and how *"..the deepest and most overlooked truth is that innovation cannot happen without failure. Indeed, aversion to failure is the single largest obstacle to creative change."*

Most of us often look at the end result of someone's endeavour to judge success. The assumption that things just happened, when in fact what is often required are dramatic leaps, followed by a series of small steps.

One of the most inspiring examples is that of James Dyson, the inventor of the Dyson vacuum cleaner. As Syed writes in the chapter *"How failure drives innovation",* Dyson's creativity was in many ways a response to a problem, driven by frustration rather than a stroke of genius.

*"People think of creativity as a mystical process. The idea is that creative insights emerge from the ether, through pure contemplation. This model conceived of innovation as something that happens to people, normally geniuses. But this could not be more wrong. Creativity is something that has to be worked at, and it has specific characteristics. Unless we understand how it happens, we will not improve our creativity, as a society or as a world."*

Dyson soon discovered the problem was the bag not the suction, but it took a curious mindset to throw away the bag and reinvent the vacuum cleaner. He tried and failed, triggering new learnings, before trying and failing again, until slowly the design improved.

*"Dyson was not the first to come up with the idea of a cyclone vacuum cleaner. He was not even the second, or the third. But he was the only one with the stamina to fail his concept into a workable solution. And he had the rigour to create an efficient manufacturing process, so he could sell a consistent product. His competitors confronted the same problem and had the same insight. But they didn't have the same resilience to make their idea work, let alone take it on to a working production line."*

*"James Dyson worked his way through 5,127 prototypes, while his competitors didn't get through the first 100, not because he was more intelligent, but because he was more resilient."*

As Dyson himself noted, *"The creative leap may have been a crucial and a precious thing, but it was only the start of the creative process. The real hard yards were done patiently evolving the design via bottom-up iteration"* because *"The original idea is only 2 per cent of the journey. You mustn't neglect the rest."*

## Marginal gains

Those marginal gains build over time and create an enormous barrier for others to jump. As the book notes, *"Trial and error, failure, marginal gains based on feedback. Syed shows that these are the things that actually create progress and improvement. He debunks the myth that great leaps forward come solely from a single creative spark. Instead they are a combination of slow, grinding, evolutionary progress, in combination with the received wisdom of previous generations."*

The example of the Mercedes Formula One team is an astonishing application of marginal gains and where attention to detail is staggering.

As technical leader of the Mercedes F1 Team Paddy Lowe notes, *"When I first started F1, we recorded eight channels of data. Now we have 16,000 from every single parameter on the car. And we derive another 50,000 channels from that data."*

Drilling deeper the real action lies in the pit stops, *"The secret to modern F1 is not really to do with big ticket items; it is about hundreds of thousands of small items, optimised to the nth degree. People think that things like engines are based upon high level strategic decisions, but they are not. What is an engine except many iterations of* *small components? You start with a sensible design, but it is the iterative process that guides you to the best dilution. Success is about creating the most effective optimisation loop."*

*"We make sure we know where we are going wrong, so we can get things right."*

In summary, it is about breaking down a big problem into small parts in order to rigorously establish what works and what doesn't and knowing how to improve on that.

As author Matthew Syed highlights, it is also an approach that the aviation industry has fully embraced. The indestructible 'black box' fitted to all commercial aircraft contains the flight data that allows investigators to best determine what went wrong.

It is not perfect but reflects a forensic approach to identify the reason for the accident, establish new procedures and introduce necessary changes immediately so the same air crash never happens again. Importantly, the aviation industry releases its findings publicly to promote openness and accountability.

## Looking beyond the name, the price-to-earnings ratio, the yield.

Once you realise how important the task of getting to the front is, or even staying there, an investor's focus quickly shifts to other matters. Jim Collins, an American researcher and author of many bestselling books, including Good to Great, has spent a lifetime on researching what separates the few great companies from the host of good ones.

*"Winners require innovation and discipline, the imagination to see the big picture and the focus to perceive the very small. The great task, rarely achieved is to blend creative intensity with relentless discipline so as to amplify the creativity rather than destroy it. When you marry operating excellence with innovation you multiply the value of your creativity."*

This combination of operating excellence and innovation is a tough act. However, those that are prepared to sacrifice short-term profits, have the temperament to fail in order to learn, and relentlessly work on extracting those marginal gains over the long run, have a chance to create something special.

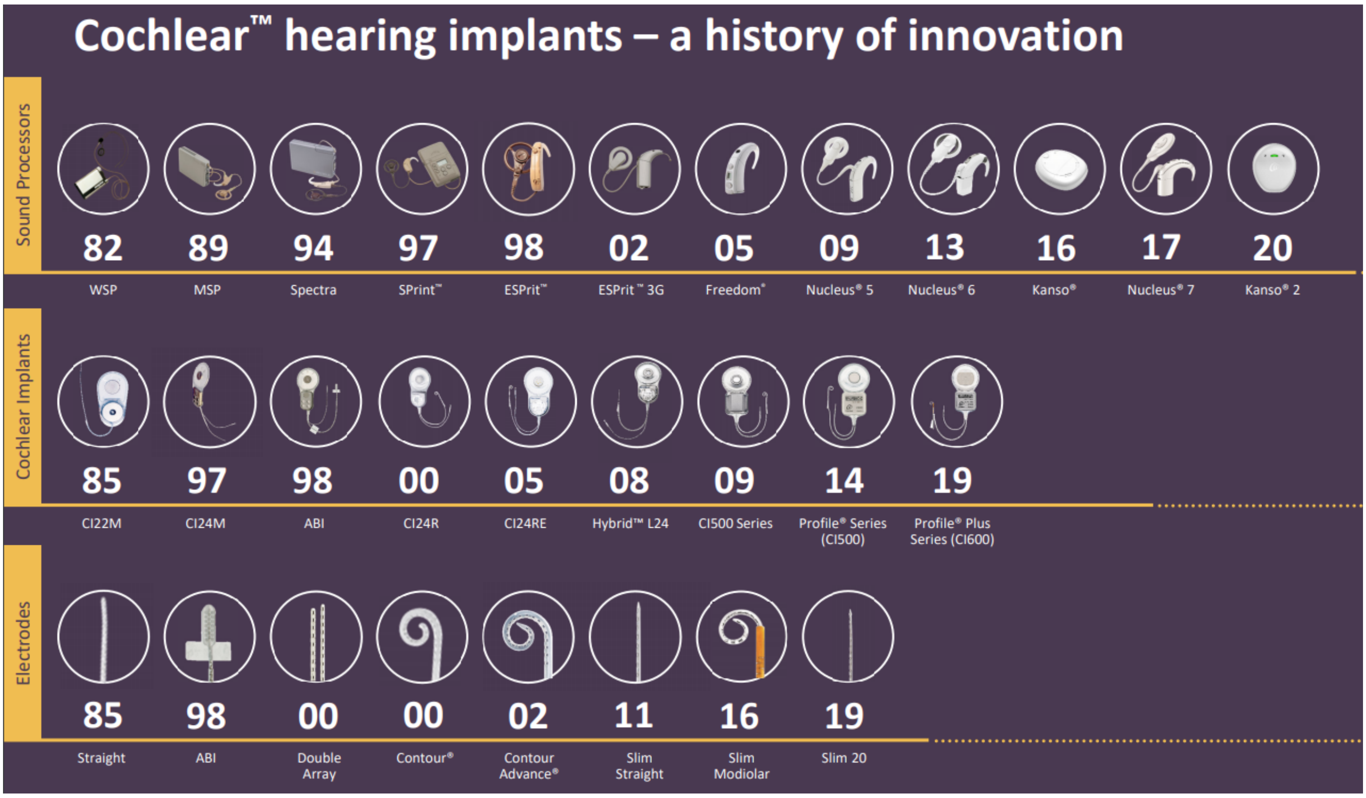
Reporting season offers an opportunity to look beyond the raw numbers and consider more deeply whether a company has the necessary application to shift from good to great. With this in mind, we highlight below three investments that remain core to our portfolio.

## Cochlear

When the world's leading cochlear implant company presented its first half result in February, it was not the profit numbers that stood out, even though they were incredibly strong during a COVID impacted half, but rather slide 21 in the appendix section of its presentation pack.

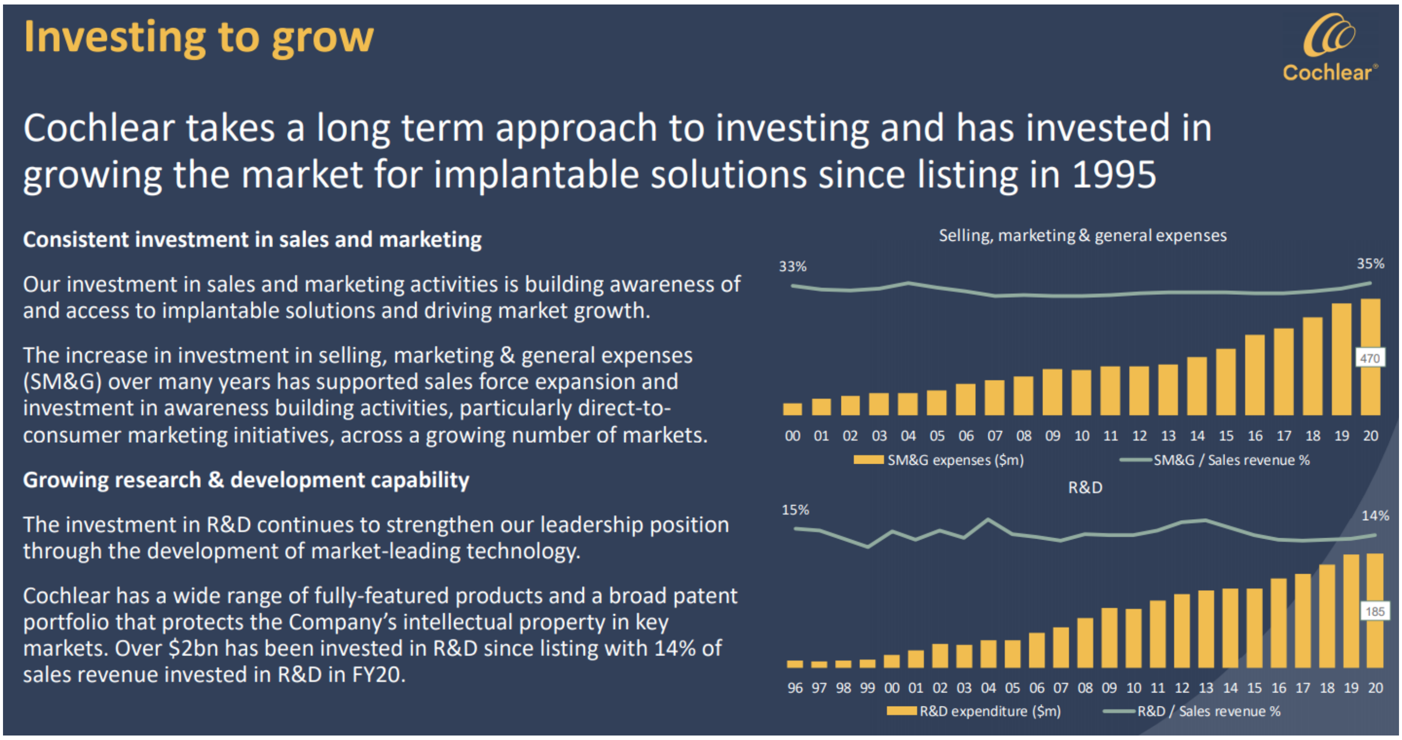
Shown below in Figure 1, the company's history of innovation was on full display, denoted by the year of product release. This is a powerful illustration of technology step change as well as eking out those all-important marginal gains.

## Figure 1: Innovation pathway




*Source: Cochlear Half Year 2021 Results Presentation*

## Figure 2: Investment pathway




*Source: Cochlear Half Year 2021 Results Presentation*

Figure 3: Cochlear implants - behind and off the ear


*Source: Cochlear Half Year 2021 Results Presentation*

This year Cochlear celebrates 40 years of operation, a wonderful achievement. Even more impressive though has been the group's discipline to invest. Nothing illustrates this better than Figure 2, outlining two important investment buckets.

The first is the over $2b invested in product research and development since the company's stock exchange listing in 1995. The second is the annual spend required in building a global business.

Today the company is in the enviable position of being the global leader, but to stay in front requires the internal mindset to break new ground.

Enter the Kanso (meaning 'simplicity' in Japanese) sound processor, the world's first off the ear cochlear implant originally approved in 2016. Unlike the traditional behind the ear implant, the Kanso offers recipient's greater choice. With no cables, small and discreet in appearance and having fewer competitors, it is winning considerable market share.

It perfectly illustrates the importance of innovation. As Tony Manna, President of Cochlear North America says, *"Our recipients are at the heart of everything we do at Cochlear, and delivering Kanso to the market is in direct response to us listening to our customers."*

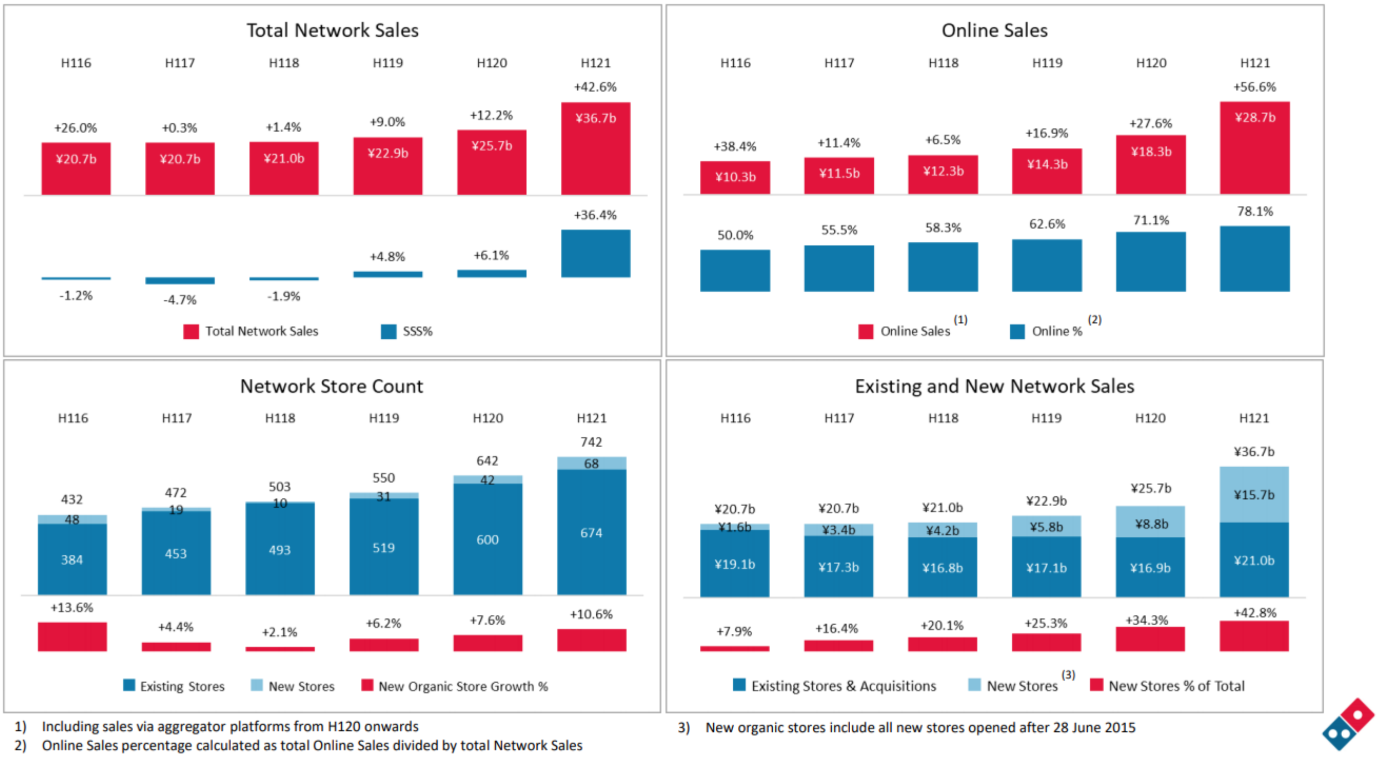
Having weathered COVID-19, the company continues to push the technological boundaries and invest to increase recipient awareness, while also building out the necessary infrastructure to support a larger global business.

## Domino's Pizza Enterprises

If any company epitomises the notion of marginal gains, it is global pizza operator Domino's Pizza Enterprises. The business has grown in stature, now operating in nine countries with a store footprint of 2,795 sites and annual network sales exceeding $3.2b.

The numbers delivered this half were truly outstanding, with global sales up 17% to $1.8b and operating profits up 32% to $153m. This leverage and scale are reflective of a business that is now benefiting from the hard yards of earlier years.

## Figure 4: Japan – Dashboard




*Source: Domino's Pizza Enterprises Half Year 2021 Results Presentation*

Expanding to new territories, including the likes of France, Japan and Germany, does not happen without a disciplined, committed and experienced management team. Add to this, the business of selling pizza the Domino's way is not for the faint hearted. It requires a franchisee base that embraces operational excellence and a high volume mentality mindset.

A case in point is Japan, a market that the company first entered in 2013 through a joint venture arrangement. Under the leadership of Josh Kilimnik, Japan's transformation has been exceptional. Rather than accepting the status quo and taking a blanket approach, Kilimnik and the management team revisited what had worked in other markets and more importantly, how the Japanese model differed. It really came down to *"challenging the standard stuff"* and improving the value offer until it was right.

It was not rocket science, but it did require a bottom-up data driven understanding of the local market and the brand's proven business formula, gleaned over decades of operation.

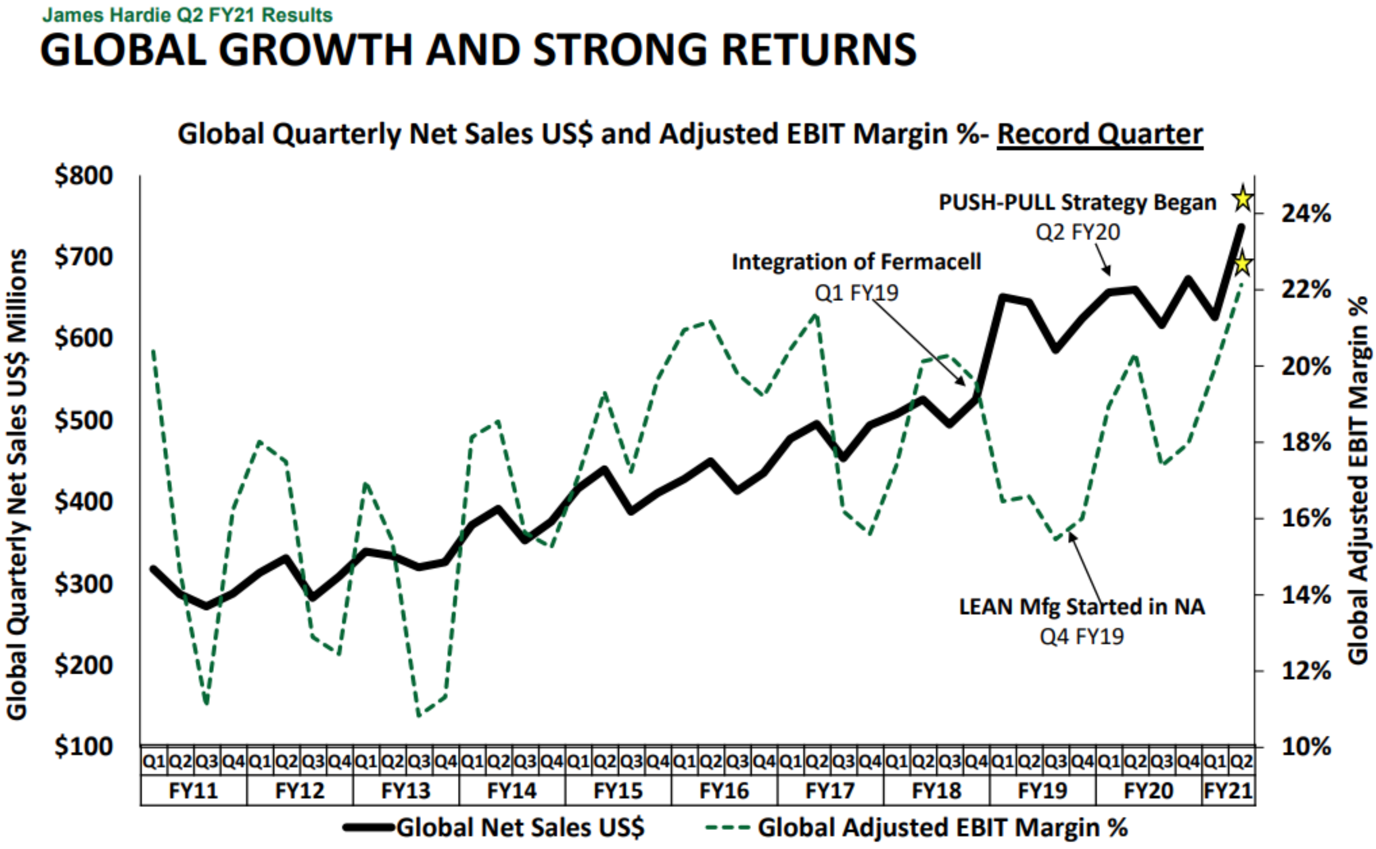
The results, as shown in Figure 4, speak for themselves. Looking at the progressive half year results from 2016 to now, it is clear the early years reflect little top line or store count growth. Yet small gains over a period have helped create the right formula and the business is now growing rapidly.

For the half, the Japan market saw a 36% gain in network sales and 68 new stores opened during the period. The store count now sits at 742, a big leap from the 432 in 2016. Long-term the company has called out 1,500, but even this we suspect will prove to be conservative based on an addressable market that now extends throughout Japan.

These learnings and the resulting cross pollinations of ideas are shared amongst all the executives, so that each region can benefit. It is a core advantage that the company is prepared to exploit, along with the opportunity to expand into newer markets.

So, what does Domino's look like in ten years' time? Probably significantly bigger, more profitable and a geographically larger version of its current self, with a laser focus on pizza as its core market.

## Graph 3: U.S. net sales and operating margins track record




*Source: James Hardie Industries Q2 2020 Presentation Material*

## James Hardie Industries

We may surprise investors by including a manufacturer of building materials to our company profiles, but it is here on merit.

Prior to the appointment of CEO Jack Truong in 2019, the business was a good but inconsistent performer. Having established itself in Australia, the company entered the U.S. market in the 1990s, starting from scratch in selling its fibre cement siding products.

The U.S. market thus became its clear focus, despite having a very good local position. It is a credit to previous management that the company has overcome asbestos litigation, whilst building a 90% U.S. fibre cement market share within the overall building materials segment.

Jack Truong is now intent on building on this solid foundation, one that is underpinned by a strong product proposition and protected by core intellectual property.

To help set the business up for success though, a few gaps in its offering, from manufacturing right through to customer delivery, required greater rigour.

The first big move was the introduction of the Hardie Manufacturing Operating System (HMOS) in 2019, which provides management and plant operators manufacturing visibility.

At its core, HMOS works to standardise processes and replicate best practices globally. This paved the way for establishment of LEAN manufacturing principles, which to-date has driven consistent operating performance with excellent financial outcomes.

During this formative period, its go-to-market strategy also came under review, with the company moving away from its well known pull approach, to a broader push-pull strategy.

Educating the builders (pull) was always a brand building approach that drove awareness and demand. But as Truong rightly identified, the company's true customer is the dealer groups, those that sell the product. Combining the two is an illustration of re-examining, enhancing and incorporating change that can be built upon. Graph 3 highlights quarterly net sales and operating margins since 2011. The introduction of LEAN in 2019, whilst still early days, is beginning to bear fruit.

The third important piece added was a focus on innovation. The company achieved its number one position by developing a product solution that was superior to alternatives. Whilst this remains the case, it has failed to build upon this. Internally, it now sits as a high priority and the first glimpses of new offerings are expected to be unveiled during 2021.

Early days yes, but there is a purpose and belief within to build a world class organisation, or as CEO Truong describes it, *"our strategic transformation from a big, small company to a small, big company."*

Based on the company's performance to-date, the signs are good. Revenues and profits are up, margins are strong, and reinvestment is underway. The conservative balance sheet position illustrates the progress made, with substantial debt repaid following the company's US$559m 2017 purchase of German based building materials group Fermacell.

You should never get too carried away with short-term success, but there is much to like and admire in the way James Hardie has defined a long run path.

## Final comment

Black Box Thinking is illustrative of what can be achieved when failure is accepted as an integral part of the process. As Dyson points out, *"We do not want to know how to apply the rules; we want to break the rules. We do that by failing - and learning."*

The learning part is the key; it is the enabler that encourages action when there is no end point in sight.

Investors would do well to focus less on the here and now and more on the horizon. If Cochlear management had really known what was involved and the capital required so many years ago, they may never have started.

To that end the truly great businesses do not take short cuts, they invest up front and continue to do so even when it comes at a great cost to profits.

Matthew Syed sums it up nicely when he says we forget or fail to appreciate that progress is often a *"combination of slow, grinding, evolutionary progress, in combination with the received wisdom of previous generations."* ***SFM***

# CHINA'S ROADMAP – SCIENCE AND TECHNOLOGY

In March 2021, the Chinese government unveiled its 14th five-year plan. If you count back, the first five-year plan was announced in 1953 covering the period up to 1957. It was also just after the Chinese Communist Party (CCP) took control of the country in 1949.

Under the leadership of Chairman Mao Zedong, the CCP prioritised economic development, focusing on urban and industrial infrastructure projects.

A nation that lacked infrastructure and economic wellbeing required a roadmap. At the time, the country's climbing birth rate, alongside a population approaching 600m, dictated a focus on production to meet economic and social demands.

Like all plans the goals were ambitious and the outcomes not always known.

By the end of 1957 China had delivered some impressive outcomes:

- Industrial output doubled, driven by an annual growth rate of 16%.
- Steel production, its main focus, grew from 1.3m tonnes to 5.2m. Coal and petrochemicals also saw growth.
- The urban population increased from 57m to 100m.
- Life expectancy grew from 38 years to 57 years.
- Urban incomes improved by 40%.

According to Chairman Mao such improvements had merit, *"If China becomes prosperous, just like the standard of living in the Western world then (people) will not want a revolution."*

The current five-year plan, which was approved on 11 March, will commence this year and run until 2025. The country also outlined long range objectives through the year 2035, marking only its second time setting a 15-year plan.

The plan acts as a reinforcement of the strong signal sent to Chinese industry to move away from fossil fuels. The country is referenced as being the world's largest emitter of planet heating gases, responsible for about 28% of total global emissions.

President Xi Jinping is pushing China towards green technology and has committed to reach peak emissions by 2030 and carbon neutrality by 2060.

Perhaps the biggest shift will be a ramp up in green technology investment, covering the build out of one of the world's largest networks of electric vehicle charging stations, the rise of battery storage and the rollout of wind and solar farms in remote areas of western China, to power cities down its more populated east coast.

Breaking from tradition, no formal GDP growth rate was set, replaced instead by other specific targets. This includes the urban unemployment rate and annual research and development (R&D) spend, highlighted in Figure 5.

## Figure 5: Key elements of China's five-year plan

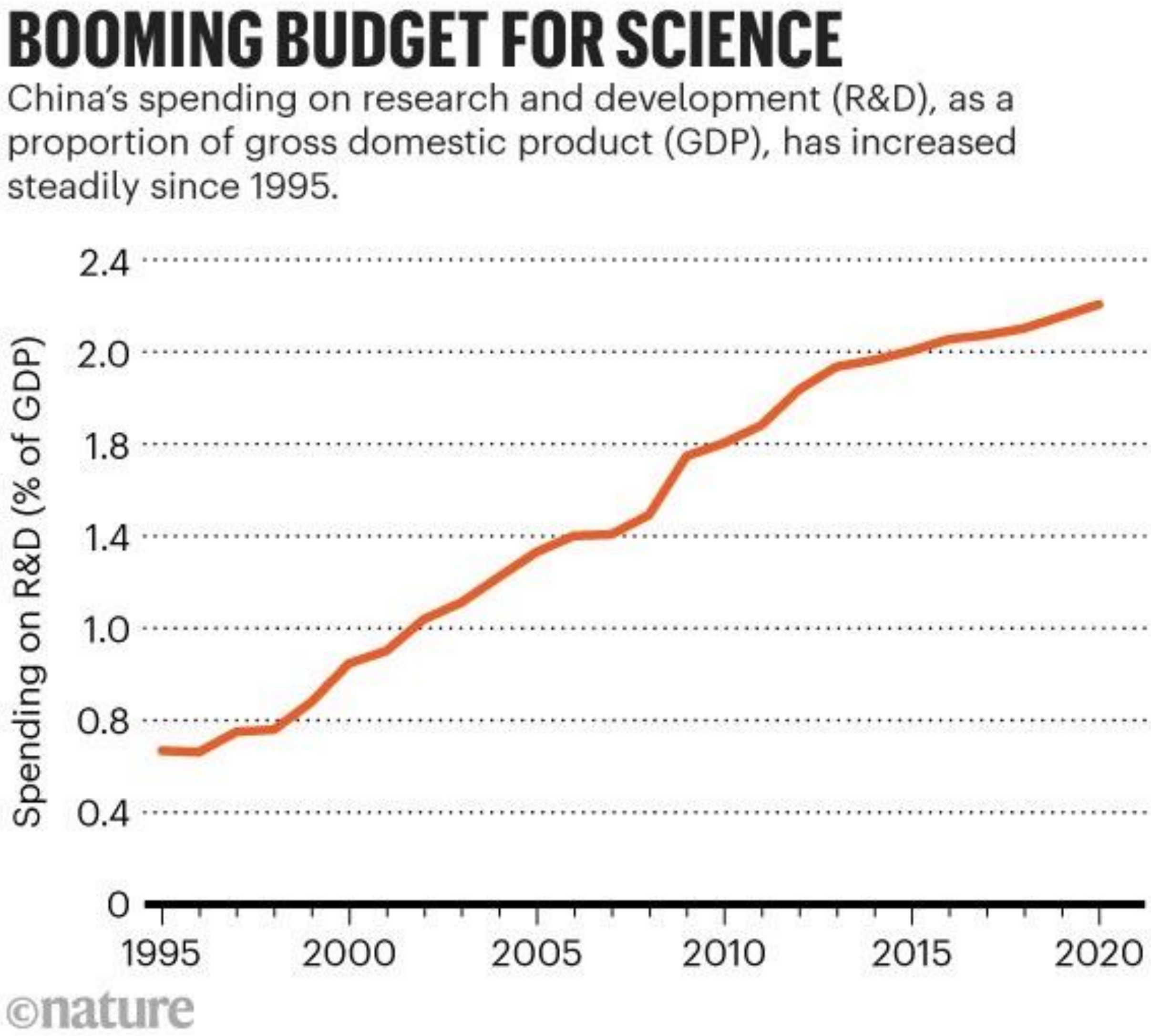

*Source: Government Work Report 2021*

Importantly, the shift in emphasis towards R&D spending signals the country's push for greater self-reliance in areas including technology and science. These endeavours cover artificial intelligence, clinical medicine and genomic research, all of which require greater collaboration with industry and business.

While the country is committed to lifting its current R&D spend of US$600b (see Graph 4) by more than 7% annually, a greater portion of this spend will be directed towards basic research. Following the U.S.-China conflict, the country is also lagging in the field of semiconductor manufacturing, a critical component of President Xi Jinping's *"made in China 2025"* ambitions.

This has hastened the need for closer links between the research community and industry, in order to deliver real world applications. In a lesson to our own government, the plan will involve tax cut incentives for the private sector to invest in more basic research driven science.

Graph 4: China's R&D spend




*Source: OECD, National Bureau of Statistics of China*

The country's leaders have also signalled an intent to tackle China's growing private and public debt levels, now sitting at 280% of GDP.

Even more pressing has been the country's decline in births, acknowledged by Beijing as its "low fertility trap".

Despite a raft of new measures including the lifting of its one child policy, first introduced in 1979 and abandoned in 2016, the birth rate has fallen to its lowest level in seven decades. And the future indications on population targets are no less positive.

If we were to venture out to 2100, granted that is an 80-year span, a new report from the medical journal The Lancet suggests China's population is projected to drop from the 2017 level of 1.4b to 723m, a decline of 48%.

Further, the number of working age people is also expected to reduce significantly, with the 20-24 age bracket showing a 64% drop, being a prime age for the country's military. Table 6 sets out The Lancet findings by its authors.

## Table 6: Projections for Top 10 Countries by Population

| Country | 2017 | 2100 | Percentage Change |
|---|---|---|---|
| China | 1,413 million | 732 million | -48% |
| India | 1,381 million | 1,093 million | -21% |
| United States | 325 million | 336 million | 3% |
| Indonesia | 258 million | 229 million | -11% |
| Pakistan | 214 million | 248 million | -16% |
| Brazil | 212 million | 165 million | -22% |
| Nigeria | 206 million | 791 million | 284% |
| Bangladesh | 157 million | 81 million | -48% |
| Russia | 146 million | 106 million | -27% |
| Japan | 128 million | 60 million | -53% |

Source: Stein Emil Vollset and coauthors, "Fertility, mortality, migration, and population scenarios for 195 countries and territories from 2017 to 2100: a forecasting analysis for the Global Burden of Disease Study," The Lancet, July 14, 2020.
• Get the data • Created with Datawrapper

*Source: The Lancet*

Mark Regets, a labor economist at the National Foundation for American Policy commented on this, *"A falling population has serious implications for the average age in society. In percentage terms, the size of the labor force will fall even more than the size of the population."*

## Comment

China's new five-year plan is a break in tradition. No formal growth target is provided, but an elevated number is still required for the country to double GDP by 2035. Rather, the CCP is targeting reinvestment and an aim to have greater influence in the important fields of science and technology.

This contrasts to the original targets set out in its inaugural five-year plan of 1953, one that was reliant on maximising steel production and fossil fuel consumption.

Time will tell on whether global events interfere with these lofty ambitions. ***SFM***

# REMUNERATION AND WHY WE VOTE THE WAY WE DO

The chart we posted on our cover page this quarter was an eye opener for us, yet maybe it should not have been. We do not invest directly in U.S. listed equities, but our portfolio generates increasing earnings from the U.S. The chart, which shows a surge in median pay for S&P 500 CEOs in 2020, appeared in the Wall Street Journal (WSJ) accompanied by the following comments.

*"At* Norwegian Cruise Line Holdings *Ltd.— which recorded a $4 billion loss last year after* sailings stopped *and revenue fell 80%—CEO Frank Del Rio's pay doubled to $36.4 million, in part with bonuses tied to a three-year contract extension, according to the company's proxy.*

*'We believe these changes were in the best interests of the company and secured Mr. Del Rio's continued invaluable expertise,' the spokesman said. 'Our management team took quick, decisive action to reduce costs, conserve cash, raise capital' and is executing a plan to relaunch its ships."*

In 2019, Norwegian Cruise Line generated record adjusted earnings per share based on net income of US$930m. In contrast, Aristocrat Leisure (ALL) reported net profit after tax and amortisation (NPATA) of AUD$887m.

Needless to say, this is not a like-for-like comparison by any means. Nor is Aristocrat's CEO Trevor Croker's 2020 total remuneration of AUD$4.5m, including base, short-term incentive (STI) and long-term incentive (LTI) (2019 AUD$5.6m). In fact, CEO Croker is not even inching close to the lowest median remuneration on the chart, dating as far back as 2011.

It is an important comparison to make, however, as CEO Croker and CFO Julie Cameron Doe are both based full time in the U.S. As are five other CEOs of businesses we own, not to mention the U.S. country heads running business units that are major earnings contributors.

Today, nearly all CEOs are appointed after an *"exhaustive global talent search"*. In short, Australian companies are competing for global talent, either directly or indirectly, in the same pool represented in the chart. It would not be a big stretch to suggest that all top C suite executives based in Australia also cast an eye across the Atlantic when evaluating remuneration opportunities.

In its 2020 remuneration report Aristocrat stated,

*"Aristocrat's senior leadership is predominantly US based, and the business must increasingly attract and retain leaders in US and other markets with technology and global management skillsets. US market practice (in particular) places a greater emphasis on at-risk opportunity, and significant equity grants are more commonly used for talent attraction and retention (than in Australia).*

*The continued expansion of Aristocrat's digital business, which now contributes over half of Group revenue, reinforces the need for Aristocrat's remuneration structures to evolve and take into account global pay philosophies, particularly those in the technology industry."*

These comments are unlikely to surprise many. Something lesser known is the blank cheque warfare undertaken by Scientific Games Corp (SGMS market capitalisation US$4.1b) and now chaired by former Aristocrat CEO Jamie Odell. Jamie Odell no doubt has a strong understanding of both the talent and pay scales within Aristocrat's ranks.

In the People & Culture Committee Chair's Letter, Kathleen Conlon lays down some home truths.

*"In addition, we have continued to see an intensifying war for talent over the past 12-18 months, with competitors (and the U.S. market in general) offering higher STI opportunities and LTI grants at a quantum of 2 to 3 times fixed remuneration, further reinforced by the fact that in many instances these grants are unhurdled. Your Board's view is that it is imperative for shareholders that Aristocrat secure and attract the critical leadership it requires to fully execute its medium-term growth strategy. In the context of a competitive talent environment where there is a "live" retention risk, the Board has taken a number of proactive steps. Specifically, the Board has reworked the at-risk ratios, adjusted fixed remuneration where it is out of benchmark and provided special equity grants to address the near-term substantial gaps in our offer. These special equity grants*

*apply only to senior executives and not to the CEO and Managing Director. We have put robust strategic hurdles against these special equity grants (which the Board will continually test) in order to ensure they are aligned with shareholder interests and deliver sustainable benefits."*

At the back end of this newsletter, we share our 2021 Voting policy outlining how we vote. This policy is closely tied to our corporate engagement program, designed to provide us with cultural insights, an understanding of management contribution and continuity, along with access to board and committee members.

Our voting, like our stock selection (bottom-up), is driven by the individual circumstances and requirements of each business. We are seeking to achieve strong long-term outcomes.

Each business differs, as does the CEO's remuneration. We have long backed equity alignment in this regard. At Flight Centre, CEO Graham Turner earned total remuneration of AUD$675,000 in 2019 and AUD$600,000 in 2020. This reflects the founder mentality he has adopted. Important to note here is all Turner's direct reports earn more than he does.

CEO Turner, we suspect, would no more than grunt at Del Rio's lofty ticket. We do not think he is a flight risk. ***SFM***

# ENVIRONMENTAL, SOCIAL AND GOVERNANCE, ESG POLICY 2021


## Digital references

Carbon Neutral: https://carbonneutral.com.au/yarra-yarra-biodiversity-corridor/

TCFD Task Force on Climate – Related Financial Disclosure: https://www.fsb-tcfd.org/

Gold Standard: https://www.goldstandard.org/impact-quantification/certified-sdg-impacts

Harvard Business Review:

- https://hbr.org/2021/01/esg-impact-is-hard-to-measure-but-its-not-impossible
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*The responsible company,* Chouinard & Stanley (2016) Published by Patagonia Works.

## Introduction

Selector Funds Management Limited (SFML) acknowledges the importance of an integrated and consistent approach to Environmental, Social and Governance (ESG) risk factors across each aspect of our investment decision making process.

We extend this consideration to our own business activities. We place the highest priority on the wellbeing of our team – their safety, work life balance and financial security – the strength of our governance program, where we complement our internal process with external oversight and expertise, and finally our environmental impact, including measuring and offsetting 100% of the carbon footprint that we generate each year.

While our carbon footprint is small at 100 tonnes of carbon emissions in 2019, and vastly lower in 2020 as COVID-19 restricted our ability to travel, it remains important to offset all our emissions as a message to our team, their children, and our stakeholders.

We have achieved this offset through a partnership with Carbon Neutral to support their Yarra Yarra Biodiversity Corridor initiative. This Australian Native Reforestation project aims to restore habitat loss and deforestation in the Northern Wheatbelt of Western Australia. Carbon Neutral is certified by The Gold Standard, which ensures projects achieve genuine outcomes that deliver with as much impact as possible.

We are planning more ambitious projects for the future.

When we consider our investment process from an **environmental (E)** perspective, the research is compelling. At the extreme, some assets will become stranded by the impacts of climate change, while other companies may become uninvestable, due to a set of business risks that can no longer be quantified.

Yet we believe standardised reporting across our investment universe remains some way off. For this reason, SFML is a supporter of the Task Force on Climate-Related Financial Disclosure (TCFD) Asia Pacific region, which promotes the pursuit of leadership and responsibility in this endeavour, across the global financial community.

Our key environmental climate related agenda at SFML is promoting transparency and consistency of reporting on financial targets. We believe that when financial targets are set, the complex task measurement can start.

SFML seeks to understand the many and varied **social (S)** factors affecting a company's financial performance from both short and long-term perspectives. Areas of focus are human capital management and specifically remuneration and the behaviours it drives. Management of supply chain risk and end customer relations are areas of importance that drive or reduce market share. In assessing these examples and others, we are attempting to distinguish one off or short-term noise from longer term structural issues that inevitably erode shareholder returns.

Corporate **governance (G)** involves a set of relationships between a company's management, board, shareholders, and external stakeholders. Clearly SFML has a role to play here. We have a structured process for voting on each resolution that crosses our table. We believe this approach means our collective voice (representing you – our client) is heard over the long term. Here we can be responsible for meaningful change.

## Executive Summary

Our confidence in tackling this broad agenda stems from our belief that Environmental, Social and Governance consideration is embedded at the centre of each of the four elements of our stock selection process: **people**, **business**, **balance sheet** and **capital management,** a proxy for real earnings per share (EPS) growth. ESG is not simply tacked on as a final question before closing a meeting, or a tick of the box exercise.

Companies with superior cultural behaviours are better disposed to responsible management of ESG issues. They increase shareholder wealth through higher staff engagement and retention (people), they pursue business leadership through consistent reinvestment (business), and they are better managers of financial risk (balance sheet), including cashflows and earnings (capital management).

In our experience, given time, superior culture drives real earnings per share growth. This meets our long-term requirements, while contributing positively to the development of society and the communities in which our selected businesses operate. This reflects responsible* business practice.

Conversely, companies unwilling (**people** or **business**) or financially unable (**balance sheet** or **capital management**) to sufficiently support an internal culture that factors in ESG issues, risk delivering diminished investment returns over the longer term. If they are lucky enough to remain a going concern this is irresponsible business practice.

In this document:

- We explain how our **investment process**, including our historic focus on culture and sensible financial outcomes, lends itself to strong ESG outcomes. This is based on our belief that strong culture drives strong ESG outcomes.
- We outline our **mandate exclusions**, or negative screen, which increases the ESG quality of our stock selection process. We also summarise how our investment **universe** is reflective of our approach to driving better ESG outcomes.
- We discuss how our **Roadmaps** provide the consistent and repeatable framework used to execute our strong **corporate engagement** and **quantitative programs,** both of which we believe drive superior ESG outcomes.

In recent years we have taken progressive steps to better understand Environmental risk and we are actively seeking better financial disclosure from the companies we invest in. This is addressed in our **Climate Focus.**

Finally, we review our **structured approach to voting** in our adjoining **voting policy.**

## Investment Process

All research is undertaken in-house by the Portfolio Managers and investment team. This is an intensive, granular and in-depth approach to continuous learning. We seek businesses with leadership qualities, run by competent management teams, underpinned by strong balance sheets and with a focus on capital management. This approach lends itself to strong ESG outcomes. Our approach is to fully integrate ESG into each of these four areas.

This is a risk out process. We are trying to take as much risk off the table as possible before we invest. The key areas of risk we focus on are board and management competency and the culture they are responsible for, business qualities, balance sheet and capital management. We believe a common-sense approach holds that a net cash balance sheet carries lower risk and more optionality than an optimised or extended balance sheet. We ultimately compare equity risk to a risk-free rate.

Before we invest, we seek to understand which risks a business can control verse those outside its control. For this to be possible, risk must be reported in a consistent and transparent fashion, so as to avoid any surprises.

Risk sits in each bucket of E, S and G. Our program of corporate engagement has aided our understanding of risk in the S and G buckets since inception. In more recent years we have taken progressive steps to better understand Environmental risk and today, we are actively seeking better financial disclosure from the companies we invest in.

Our conviction in this process generates a concentrated portfolio of our best ideas, or our highest quality stock picks. The aim is to capture as much real earnings per share growth as possible over the long-term.

Our approach has been consistent since inception. It is framed by our Roadmap, which is both qualitative and quantitative in nature. Our Roadmap provides a repeatable framework that drives our corporate engagement program, our quantitative program of financial modelling including our stock universe data screen, and our structured voting program. Each of these programs are discussed below.

These areas of work however are not rigid, they evolve over time as we continuously seek to incorporate better solutions. By way of example, today we employ more human capital, with more diversity of thought, have better external and internal business systems, use and develop more technology and automation, and we have more robust compliance systems aided by external expertise, than was the case in the first year of operations 17 years ago.

This consistent reinvestment in our business, over time, has driven continuous improvement of the investment process.

## Mandate Exclusions

The mandate exclusions or negative screen, 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.

We are transparent in acknowledging our investments in the gaming sector. We have high expectations of these companies in relation to S, social responsibility.

We expect these companies to play a leadership role, global where possible, in responsible gaming initiatives including addressing problem gambling. We will divest when this hurdle is not met.

## A Universe that drives better ESG outcomes

- In general, we have sought ideas from the ASX 300.
- Our focus is on industrial companies.
- In the past 10 years we have not owned, Real Estate Investment Trusts (REITs), Banks, General Insurers, Resources, or Junior Miners.
- We do not own Energy.
- Our universe will typically have a lower capital intensity and lower carbon footprint as a result.
- While hundreds of models have been built since inception, +90 models are currently up to date, per reporting period, and feed our stock universe data pool.
- Inclusions from outside this index and select competitors are added (for example, we may include a business with a capital structure where the free float may not meet Index requirements).
- Our universe is subject to change and is reviewed after each reporting season for relevance.
- Based on our four areas of focus, (people, business, balance sheet capital management) that our universe is a higher quality subset of the ASX 300.
- We rank our universe by buyout, Roadmap score, yield.

## Figure 6: SFML Roadmap

| Qualitative | | | Quantitative | | |
|---|---|---|---|---|---|
| Management Qualities | Owner Qualities | Focus | Growth | Business Franchise | Balance Sheet |
| Individuals we can trust | Material equity holding | Business point of difference | Reinvesting in business R&D | Financial Metrics Working Cap | Low debt levels |
| Organic business focus | Common bond ordinary shareholder | Core Business | Capacity to grow EPS organic | Pricing Power within industry | Simple structure |
| Clear articulation strategy | Track record Inc ESG | Not react to share market pressure | Free cash flow | ROCE | Maintenance Cap Ex |

**Roadmap scorecard**
18 filter Quantitative and Qualitative score card applied to each business
Minimum score of 10 / 18 sort for portfolio inclusion

*Source: SFML Research*

## Roadmap

The purpose of our Roadmap is to enable us to operate under a consistent framework that is repeatable.

The Roadmap was developed when SFML was established, 17 years ago, and is a qualitative and quantitative business score card. Businesses are scored on 18 attributes. This score is integrated into our financial model and is reviewed at the half and full year results. One of these attributes is the company's ESG track record, which directly addresses ESG factors within a business.

In addition, we consider seven of the remaining 17 roadmap qualities to be directly related to ESG on the basis that they are measuring cultural elements within the business. We believe Culture and ESG are intertwined. We consider them both integral to our assessment of a business. Ultimately, we are seeking a higher quality subset of businesses that can deliver real EPS growth over the long term.

The seven elements include:

- Individuals we can trust – relates to ESG.
- Clear articulation of strategy – relates to ESG.
- Common bond with ordinary shareholders – relates to ESG.
- Not reacting to share market pressure – relates to Governance.
- Core business – relates to ESG.
- Free cash flow – relates to ESG.
- Low debt levels – relates to ESG.

## ESG 2.0 Roadmap

The ESG 1.0 Roadmap, developed in-house in 2019, defines ESG issues that may impact companies and applies a score of 1 or 0 for each area under consideration. The ESG 2.0 Roadmap iteration was created in 2021, with changes integrated into our portfolio models thereafter.

### Figure 7: SFML ESG 2.0 Roadmap

| Consideration | | | |
|---|---|---|---|
| Environment | Climate Targets | Renewable targets | Progress against target |
| Social | Human Capital Management | Community (including MS*) | Best Interests |
| Governance | Board effectiveness | Shareholder interests | Risk & Litigation |

**Roadmap scorecard**
9 filters applied to each portfolio business

*Modern Slavery (MS)

*Source: SFML Research*

The following is a breakdown of each consideration:

- Climate targets – Assessment of the company's plans relating to carbon neutrality, Paris commitments, scientific targets, or emission targets. "0" rating for no effort.
- Renewable targets – Assessment of the company's documented use of renewables mix or implemented targets for renewable energy.
- Progress against targets – Measuring progress made against announced targets. "0" rating for no effort.
- Human Capital Management – *"Is there a history of human rights violations, workplace and IR disputes, discrimination and harassment claims?"*
  Rating of the company's employee engagement, turnover and productivity. Compare the company's work, health and safety (WHS) standards against peers, including their recording and track record of incidents.
- Community – Rating of the company's community engagement and social licence to operate. Consider whether the company has a framework on social issues across its supply chain, including labour standards, child labour, health & safety, discrimination, and harassment.
- Best Interests – *"Is the company behaving in a manner that is in the best interests of stakeholders."*
- Board effectiveness – Assessment of the board including industry experience, independence, age, diversity, tenure, equity ownership and capacity.
- Shareholder interests – Assessment of the remuneration structure, shareholder communication, corporate disclosure, and reliability of financial statements. Test the factors against the company's corporate strategy and whether they are in line with shareholder interests.
- Risk & Litigation – Rating of the company's internal risk and control framework.

## Corporate Engagement Program

Our Corporate Engagement program is a foundation of our investment process. We engage with board members and management teams, attend Annual General Meetings (AGM), and undertake site visits. Two Portfolio Managers attend these meetings which can occur in office, onsite and at interstate or international locations of interest. In addition, we have the highest quality technology systems deployed in all conference areas to aid this program where travel is not permitted.

We engage with management to understand the culture of a business, the reason it is in existence and its prospects for the future. We do this because we believe culture is the most important driver of future business success.

From these engagements, notes are produced and recorded. We consider each meeting as a page in the book of understanding an individual business and its culture. This work is a key plank of our understanding of the three categories of ESG.

We believe culture and ESG are intertwined, with the former driving the latter. We have focused on the culture that drives the social and governance process within a business since inception.

This granular approach in understanding the culture of each business aids our evaluation of the short and long-term remuneration structures tied to non-financial outcomes. This is described in our voting policy.

We have extended our Roadmap, in recent years, to address specifics such as Climate. We support TCFD in promoting consistency and transparency of financial reporting in this area. Our ESG Roadmap scoring system is integrated into our financial models alongside our original Roadmap.

## Climate Focus

Around the globe, regulation and legislation is starting to tackle the large, systemic and structural changes that limiting climate change will require. The Paris agreement of 2016, a platform to address and minimise rising global temperatures, has shifted the conversation to a fundamental economic and financial risk return discussion.

SFML believes 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.

Alongside our program of direct corporate engagement, SFML digests information from annual reports and climate change statements where available. Not all companies are reporting and for those who are, company reporting is often not directly comparable.

Across our portfolio of holdings, 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, this will not solve problems as we note in our concluding remarks. We believe we can have far greater impact via our corporate engagement program and our voting program.

In 2021, SFML became 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. We have adopted the aspects of this voluntary guideline that make sense within the context of our investment process. This will enhance and strengthen our ongoing approach to ESG.

## Quantitative Research Program

Our quantitative approach is centred on financial modelling also undertaken in-house. Individual company models are built using a consistent repeatable template. Information is taken from multiple annual reports and other publicly available documents. No information dumps occur as we prefer the granular approach of extracting and understanding the individual numbers behind the multiyear trends that are drawn out of this work.

While over 50 financial ratios are calculated in addition to our buy-out ratio, which we compare to a risk-free rate, it is the longer-term trends that hold our attention. While hundreds of models have been built since inception, >90 are continuously up to date, per reporting period, and feed our stock universe data pool.

This granular approach to understanding financial drivers of each business aids our evaluation of the short and long-term remuneration structures tied to specific financial outcomes.

Decisions about executive pay can have an indelible impact on a company. When compensation is managed carefully, it aligns people’s behaviour with the company’s strategy and generates better performance. When it is managed poorly, the effects can be devastating: the loss of key talent, demotivation, misaligned objectives, and poor shareholder returns. Given the high stakes, it is critical for boards and management teams to get compensation right.

This is described in our voting policy.

# VOTING POLICY 2021

## Introduction

The depth of our corporate engagement and quantitative research programs provides the groundwork for our structured voting program.

## Executive Summary

SFML has developed a cloud based ESG resource centre, which collates all the relevant public documents required by the Portfolio Managers and Head of ESG in reviewing the activities, processes, targets, and commitments made by the businesses we own. The centre includes annual reports, sustainability reports, AGM documents, corporate governance documents, relevant policies, and charters. It also includes our working notes.

Through our corporate engagement program, 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 pay-out ratio that allows ample reinvestment for future earnings growth. None of this is earth shattering or rocket science, it is a common-sense approach to investment and one that we apply to our own business and which extends to our voting policy.

In relation to voting, we have adopted a structured program of work that dovetails with our corporate engagement program. Importantly, we vote as long-term owners of a business and we attend AGMs in person where possible.

All resolutions are documented, considered, and commented on by the Portfolio Managers and Head of ESG, before votes are submitted. While we do not subscribe to any proxy services, our continuous dialogue with clients and the companies we own, enable us to quickly understand any areas of public interest which require our consideration. While this can be circular and time consuming, the granularity of this approach aids our continuous learning about the businesses and their stakeholders.

This is a substantial piece of work undertaken by the Portfolio Managers and the Investment team. Alongside our corporate engagement program, we believe this proactive approach to voting drives 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.

## Voting for Directors

Selector employs a qualitative approach to voting for directors. We do not believe a box ticking approach is sufficient.

Selector's votes are based on outcomes from our corporate engagement program run by our Portfolio Managers. We want to understand how a board and its directors are adding value.

This is a detailed research program that occurs across an entire year, but also benefits from the historic understanding of a business, its board and management that comes with long term ownership.

We believe we are further advantaged in this voting process, by our unique lens, having run our own businesses across decades.

## Voting on Remuneration

When voting on remuneration, we take into consideration both qualitative and quantitative achievements of the individual business measured against any strategic goals set by the board and executed by the management team.

The depth of our corporate engagement program informs our voting on remuneration. Individually we will consider leadership, transparency, strategic thinking, responsible conduct, and other attributes of the individual being remunerated. This relates to non-financial components of remuneration.

These non-financial metrics include:

- Reasonable short-term incentive (STI) & long-term incentive (LTI) remuneration structures that are in line with key performance indicators previously outlined by a company.
- Reasonableness of base.

- Component of performance award at risk to non-financial outcomes.
- Culture.
- Business leadership.
- Risk Management and ESG.

The consistency of our quantitative research program informs and aids our voting on remuneration. We consider the relevance of each financial metric, gateway and hurdle that comprises an individual's remuneration and the behaviours it drives in relation to the financial outcomes of the business. We evaluate the reasonableness of the entire remuneration outcome. We consider relevant market conditions for remuneration, which vary across industry and geography.

Our views are balanced by the need to retain and motivate quality leadership. We understand the disruption and dysfunction that goes hand in glove with the failure to achieve a positive outcome, at both management and board levels.

That said it cannot simply be a race to the top in executive remuneration, where all boards want to be just above midpoint. This type of thinking means that the midpoint continues to shift up without alignment to other stakeholders.

There is no best practice that works in all situations.

The financial metrics include:

- Component of performance award at risk to financial outcomes.
- Balance sheet optionality.
- Reinvestment.
- Growth in metrics including real EPS and real DPS.
- Responsible financial conduct of Management.

## Voting Procedure

SFML's voting process has been upgraded and systematised to incorporate digital distribution of AGM notices, resolutions, and reporting documents. This process is now cloud-based rather than a manual paper-based process.

The upgraded process enables all resolutions and supporting documents, including the annual report to be reviewed, commented and voted on by both Portfolio Managers and members of the Investment team. This can be undertaken from any mobile device at any location.

Upon notification of a vote, our investment team prepare the necessary information into our report format. This is then distributed to the Portfolio Managers digitally, whereby the respective decisions are made based upon the above information. The actions are then recorded and archived before the votes are lodged via an online proxy portal.

## Conclusion

SFML believes it is essential to consider the impact of material ESG risks on the long-term performance of our investments.

SFML's aim is to:

1. Understand, measure where possible, and monitor ESG risk in the context of our equity investments.
2. Make full use of our rights of ownership, on behalf of our investors, by voting on all relevant resolutions. We need to be able to justify our votes. This relies upon our corporate engagement program and our quantitative research program.
3. Drive common sense changes in business practice and financial management that benefit all long-term shareholders and stakeholders.
4. Continue along the pathway of learning across a diverse range of ESG related topics.

Independent research, and our own experience as a long-term investor, indicate that positive ESG outcomes are tied to better financial performance.

We acknowledge significant challenges exist in our ability to add value across an agenda as broad as ESG. Therefore, our approach to ESG needs to continue to evolve and we need to embrace continuous learning as individuals and as an organisation. We must fight our own bias in this process and while we continue to focus on bottom-up stock selection we also need to be mindful of the bigger picture.

*"Unintended consequences…. [can occur if] we fixate on one small part of a complex system, and in so doing come up with solutions to the wrong problem. ESG measures*

*can perpetuate this behaviour, especially when the measures and investor rewards remain tied to individual firms. At an individual level, for example, BP can take credit for reducing its emissions by selling its petrochemicals business. But that business and its emissions, of course, have not gone away."*[4]

Following in the footsteps of others, as we learn, we have tried to use our words carefully in this document. The use of the word *"sustainability"* was replaced with *"responsible"*, at the end of our twelfth paragraph.*

From The responsible company[5] we learnt that sustainability *"is a legitimate term that calls on us not to take more from nature than we give back…We have no business applying the word sustainable to business activity until we learn how to feed, clothe, and enjoy ourselves – and fuel the effort – without interfering with nature's capacity to regenerate*". Obviously with this context, we cannot make that claim.

Chouinard & Stanley outline some of the key issues that responsible companies will face over the next 50 years, in relation to Shareholders, Employees, Customers, Communities and Environment (Nature). They are interesting discussion points as we frame our view of the future.

Shareholders:

Accounting will become more complex. As ESG becomes mainstream companies will have to financially account for their impact on the environment. If not, they risk a shareholder revolt following a sudden rise in the price of carbon or drop in availability of fresh water. The United Nations has weighed in with the adoption in 2012 of an agreed method to account for the ecosystem value of natural resources like minerals, timber, and fisheries.

Employees:

There has been a fifty-year trend towards automation (technology), moving jobs offshore, improving wages in developing countries and a flattening of wages in advanced countries. The next fifty years will be marked by pressure to restore the living wage. It was assumed as late as the 1960's that the annual pay of one wage earner (usually male) should support his family. The new more modest goal has a worker paid one half of what it takes to support a family of four. To meet this goal will require further increases in productivity, most of which will come from automation (technology), which further depresses employment rates. More workers will be better paid, yet more people will be out of work.

Customers:

As things become more expensive, customers will become choosier and buy less. They will increasingly demand to know whether products qualify as healthy and humane. Any gaps will be easily exposed on social media.

Communities:

Responsible business will be required to accept its supply chain as part of its own, in relation to improved working conditions and environmental harm. Third party verification will become more important, and more companies will benchmark against social and environmental standards while working to raise the bar.

Environment:

As customers and clients learn more about the consequences of taking from the natural world at our current pace, they will pressure companies to do more, more quickly. Expenses will rise for natural resources (especially energy and water) and for waste disposal. Financial pressures will mount for those with weaker cashflows and balance sheets. To compete, a company will have to at least be as responsible as its competitors.

Fifty years out, it will be the leaders in these five categories of shareholder, employee, customer, community, and environmental engagement, that will prevail. These areas align closely with our own views on the importance that culture and its relationship with ESG will have on any given business.

We believe that ESG will increasingly be accepted as mainstream investing. We have confidence that our investment process, which promotes continuous learning via our work programs across corporate engagement, quantitative research and our structured approach to voting will add value in this space.

[4] *Harvard Business Review: https://hbr.org/2021/01/esg-impact-is-hard-to-measure-but-its-not-impossible?autocomplete=true*

[5] *The responsible company, Chouinard & Stanley (2016) Published by Patagonia Works.*

The journey at Selector started with extremely humble foundations, and today we hold on to these roots. It is just as well, because the reality is that investing itself can be a very humbling experience. We have long accepted the challenge of becoming better investors. To achieve this, we will continue to invest in human capital and our business, and we will maintain a cash balance sheet that supports this reinvestment.

On behalf of our team, we look forward to sharing further developments with our clients, investors, shareholders, and stakeholders in the future.

Tony Scenna | Portfolio Manager
Corey Vincent | Portfolio Manager
Kari Humphrey | Head of ESG
***SFM***

# COMPANY ENGAGEMENTS – MARCH 2021 QUARTER

| Date | Company | Description |
|---|---|---|
| 13-Jan | RMD | ResMed JPM Healthcare Conference |
| 23-Jan | NHF | NIB Holdings JPM Industry insight Call |
| 22-Jan | COH | Cochlear UBS Industry insight Call |
| 27-Jan | COH | Cochlear JPM Industry insight Call |
| 27-Jan | RWC | Reliance Worldwide 1H21 Trading Update |
| 29-Jan | RMD | ResMed 2Q21 Results Conference Call |
| 1-Feb | BKL | Blackmores Management Conference Call |
| 2-Feb | ART | Airtasker Morgans IPO roadshow |
| 2-Feb | ALL | Aristocrat Leisure Meeting with Chair |
| 15-Feb | NEA | Nearmap HY21 Results Conference Call |
| 15-Feb | MP1 | Megaport Management Conference Call |
| 16-Feb | ALU | Altium HY21 Results Conference Call |
| 16-Feb | BRG | Breville HY21 Results Conference Call |
| 16-Feb | BRG | Breville UBS Management Conference Call |
| 16-Feb | ALU | Altium UBS Management Conference Call |
| 16-Feb | BRG | Breville Macquarie Management Conference Call |
| 17-Feb | CAR | Carsales.com HY21 Results Conference Call |
| 17-Feb | ARB | ARB Corporation UBS Management Conference Call |
| 17-Feb | DMP | Domino's Pizza Enterprises HY21 Results Conference Call |
| 17-Feb | DMP | Domino's Pizza Enterprises JPM management Conference call |
| 17-Feb | NEA | Nearmap Macquarie Management Conference Call |
| 17-Feb | BRG | Breville JPM management Conference call |
| 17-Feb | CAR | Carsales.com UBS Management Conference Call |
| 17-Feb | NEA | Nearmap Citi Management Conference Call |
| 18-Feb | ARB | ARB Corporation Barrenjoey Management Conference Call |
| 18-Feb | IRE | IRESS FY20 Results Conference Call |
| 18-Feb | CSL | CSL HY21 Results Conference Call |
| 18-Feb | PME | Pro Medicus UBS Management Conference Call |
| 18-Feb | CAR | Carsales.com GS Management Conference Call |
| 18-Feb | NEA | Nearmap Management Conference Call |
| 18-Feb | NEA | Nearmap GS Management Conference Call |
| 19-Feb | CAR | Carsales.com Management Conference Call |
| 19-Feb | COH | Cochlear HY21 Results Conference Call |
| 19-Feb | DMP | Domino's Pizza Enterprises Citi Management Conference Call |
| 19-Feb | BRG | Breville Barrenjoey Management Conference Call |
| 19-Feb | IRE | IRESS Management Conference Call |
| 19-Feb | CAR | Carsales.com Morgans Management Conference Call |
| 19-Feb | DMP | Domino's Pizza Enterprises Management Meeting |
| 22-Feb | RWC | Reliance Worldwide HY21 Results Conference Call |
| 22-Feb | NHF | NIB Holdings HY21 Results Conference Call |
| 22-Feb | COH | Cochlear Macquarie Management Conference Call |

| Date | Company | Description |
|---|---|---|
| 22-Feb | IRE | IRESS Macquarie Management Conference Call |
| 22-Feb | CSL | CSL JPM management Conference call |
| 22-Feb | REA | REA Group Meeting with Investor Relations |
| 23-Feb | IRE | IRESS Barrenjoey Management Conference Call |
| 23-Feb | RWC | Reliance Worldwide Macquarie Management Conference Call |
| 23-Feb | SEK | Seek HY21 Results Conference Call |
| 23-Feb | PNV | PolyNovo HY21 Results Conference Call |
| 23-Feb | TNE | TechnologyOne Annual General Meeting |
| 23-Feb | JIN | Jumbo Interactive HY21 Results Conference Call |
| 23-Feb | COH | Cochlear Management Conference Call |
| 24-Feb | BKL | Blackmores HY21 Results Conference Call |
| 24-Feb | IFL | IOOF Holdings HY21 Results Conference Call |
| 24-Feb | APX | Appen FY20 Results Conference Call |
| 24-Feb | NAN | Nanosonics HY21 Results Conference Call |
| 24-Feb | SEK | Seek UBS Management Conference Call |
| 24-Feb | SEK | Seek Management Conference Call |
| 24-Feb | NAN | Nanosonics UBS Management Conference Call |
| 25-Feb | FCL | FINEOS HY21 Results Conference Call |
| 25-Feb | FLT | Flight Centre Travel Group HY21 Results Conference Call |
| 25-Feb | IFM | Infomedia HY21 Results Conference Call |
| 25-Feb | PNV | PolyNovo UBS Management Conference Call |
| 25-Feb | FLT | Flight Centre Travel Group UBS Management Conference Call |
| 25-Feb | APX | Appen Citi Management Conference Call |
| 25-Feb | NAN | Nanosonics Management Conference Call |
| 25-Feb | BKL | Blackmores Management Conference Call |
| 26-Feb | FCL | FINEOS Macquarie Management Conference Call |
| 26-Feb | IFM | Infomedia UBS Management Conference Call |
| 26-Feb | REH | Reece HY21 Results Conference Call |
| 26-Feb | ALL | Aristocrat Leisure Annual General Meeting |
| 26-Feb | BKL | Blackmores UBS Management Conference Call |
| 26-Feb | JIN | Jumbo Interactive GS Management Conference Call |
| 26-Feb | IFM | Infomedia UBS Management Conference Call |
| 26-Feb | IFL | IOOF Holdings JPM management Conference call |
| 26-Feb | PNV | PolyNovo Management Conference Call |
| 26-Feb | NHF | NIB Holdings Management Conference Call |
| 1-Mar | NAN | Nanosonics JPM management Conference call |
| 1-Mar | IFL | IOOF Holdings Management Conference Call |
| 1-Mar | APX | Appen UBS Management Conference Call |
| 1-Mar | NHF | NIB Holdings Macquarie Management Conference Call |
| 1-Mar | REH | Reece Management Conference Call |
| 1-Mar | NAN | Nanosonics Citi Management Conference Call |
| 1-Mar | JIN | Jumbo Interactive Management Conference Call |
| 2-Mar | NXL | Nuix UBS Management Conference Call |
| 2-Mar | RWC | Reliance Worldwide Management Conference Call |

| Date | Company | Description |
|---|---|---|
| 2-Mar | NXL | Nuix Macquarie Management Conference Call |
| 2-Mar | TNE | TechnologyOne UBS Management Conference Call |
| 3-Mar | ALU | Altium Management Conference Call |
| 3-Mar | APX | Appen Management Conference Call |
| 4-Mar | PNV | PolyNovo JPM management Conference call |
| 4-Mar | ARB | ARB Corporation Management Conference Call |
| 4-Mar | FCL | FINEOS Management Conference Call |
| 5-Mar | FCL | FINEOS UBS Management Conference Call |
| 5-Mar | FLT | Flight Centre Travel Group Management Conference Call |
| 5-Mar | PME | Pro Medicus JPM management Conference call |
| 9-Mar | FCL | FINEOS Citi Management Conference Call |
| 9-Mar | TNE | TechnologyOne Barrenjoey Industry Insight Call |
| 9-Mar | CSL | CSL Management Conference Call |
| 10-Mar | NEA | Nearmap JPM management Conference call |
| 11-Mar | MVP | Medical Developments International Management Conference Call |
| 12-Mar | PME | Pro Medicus Barrenjoey Product Demonstration |
| 15-Mar | MVP | Medical Developments International Taylor Collison Management Conference Call |
| 16-Mar | CSL | CSL Citi CIDP Industry Insight Call |
| 16-Mar | ALL | Aristocrat Leisure Management meeting |
| 23-Mar | FLT | Flight Centre Travel Group JPM management Conference call |
| 23-Mar | DOM.LON | Domino's Pizza Group PLC Citi Management Conference Call |
| 24-Mar | RMD | ResMed KeyBanc's Capital Market Conference |
| 30-Mar | ALL | Aristocrat Leisure Investor Roundtable Conference Call |