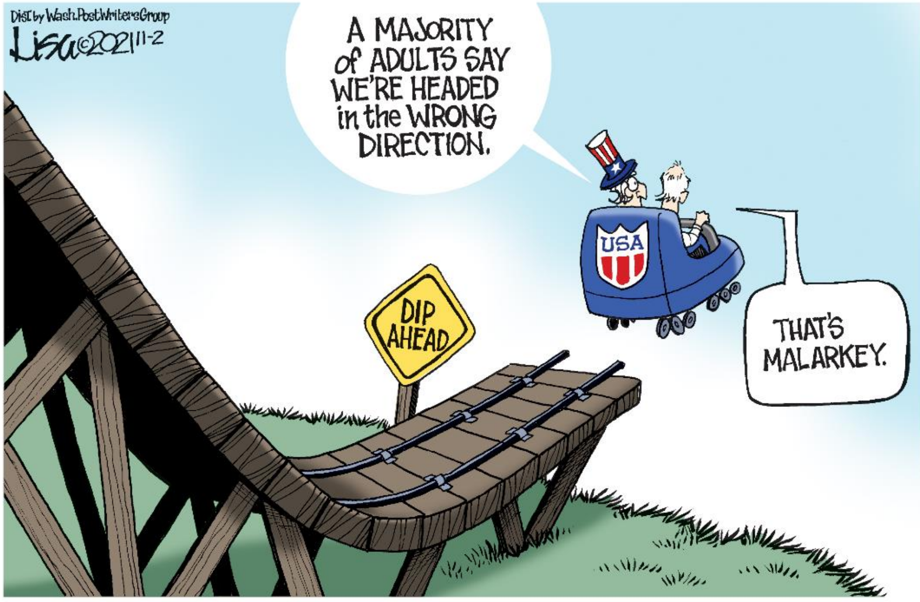
Selector High Conviction Equity Fund Quarterly Newsletter No.78

December 2022



In this quarterly edition we review SFML performance, attribution, ESG and company results from reporting season. We start with our macroeconomic outlook for 2023, dovetailed with a debt perspective viewed over the decades. We follow this up with our take on what makes for “A Quality Business”.

We then focus on the tectonic shifts in digital technology in “Turning point”. Following this, we provide insights into recent company AGMs and results. We discuss the path of a business when leaders move on in “Succession”.

In our ESG review we focus on a proven performer, TechnologyOne and provide an update on “Green Energy” within Selector.

Photo. Central bankers at the wheel. We suggest you hang on.
Source. Wash.PostWritersGroup

Selector Funds Management Limited
ACN 102756347 AFSL 225316
Level 8, 10 Bridge Street
Sydney NSW 2000 Australia
Tel 612 8090 3612
www.selectorfund.com.au

selector

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

We focus on stock selection, the funds are high conviction, concentrated and index unaware. As a result, the portfolios have low turnover and produce tax effective returns. Our ongoing focus on culture and financial sustainability lends itself to strong ESG outcomes.

Selector has a 18-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.

CONTENTS

IN BRIEF – DECEMBER QUARTER

Dear Investor,

As we close out the last quarter of 2022, the conversation in financial markets is shifting to 2023, which by all accounts is likely to be just as eventful. Central bankers dominated headlines this year, pushing the war in Ukraine off the front page.

In the U.S., from a standing start of zero in March, the Federal Funds rate hit 4.5% at year-end. This compared to median projections made at the time of 2.75%, heralding the fastest rate hikes in decades. The Reserve Bank of Australia (RBA), although moving less aggressively, lifted rates on eight consecutive occasions, ending the year with cash rates at 3.10%.

Such fast and aggressive moves, unheralded in our lifetime, are directed at slowing growth and lifting unemployment to hit the Fed's annual inflation policy target of 2.0%. The fear of ending with embedded inflation has become the central bank's primary concern. Nothing else comes close, and talk of an impending recession heading into 2023 is almost greeted with a sense of relief by our policymakers.

But it is worth pausing momentarily to consider how these cash rates translate in the real world. In the U.S. a 4.5% cash rate converts to a new 30-year average mortgage rate of 7.3%. Average prime lending rates are in the same ballpark, reflecting cash rates plus 3.0%, while long-dated corporate bond yields now sit close to 6.0%.

With the U.S. Federal Reserve indicating further rate hikes are necessary, higher funding costs will create a significant burden on all borrowers and a handbrake on business activity. It shouldn't be a surprise that economists now sit in unison, predicting the U.S. economy will enter a recession during 2023. Australia is expected to avoid a recession, with GDP forecasted to stay above 1.0%, although it's a far cry from the 5.9% annual figure posted in the latest September quarter.

While economists have a very poor historical track record forecasting recessions, bond markets are the opposite. With the 2-year and 10-year bond yield spread now the most inverted since the 1980s, a situation where longer-term bonds have lower yields or returns than short-term instruments, there is a collective agreement in financial markets that the economy will contract during 2023.

The extent of the contraction is anyone's guess, although the Federal Reserve is aiming for a "soft landing", despite its poor track record of performance to date. To get there, unemployment needs to rise from its current level at 3.7%. Forecasters are pencilling in levels above 5% as a likely outcome.

If they perform to expectations, inflation should moderate, and a more sustainable global economy will emerge in the back half of 2023. The worst scenario is embedded inflation and benign economic growth, namely stagflation.

And frankly, this is our concern; a good deal of inflation would have reverted if given a transitory period to deal with the impact of COVID and the Ukraine war. The use of the word transitory is important to call out. During the height of COVID-19, from 2020 through to 2022, the long-term structural consequences were still to play out.

It was suggested then that business travel would never return to pre-COVID levels, and consumers would bypass physical shopping. In reality, the opposite is true; travel has returned with a vengeance, only thwarted by the lack of airline capacity, while consumers have ditched their masks and returned to the shops in combination with online.

What appears more permanent and structural is the work-from-home phenomena and the unrelenting adoption of digital technology to drive business efficiency. In this context, transitory suggests two years rather than weeks or months in addressing the economic impacts.

The main drivers of inflation have already peaked and are in decline, be they supply chain and logistical costs, raw material inputs, and shortages impacting used car values, food, and general energy costs, namely oil.

State Street Global Advisors, the world's third biggest asset manager sits in this camp. Head of Investments Jonathan Shead notes a range of leading inflation indicators – notably Brent crude oil, off by 60% from its recent peak of US$135 a barrel to US$76 a barrel in December – suggest a *"powerful disinflationary episode lies ahead. We're watching this over-tightening very closely. We think the speed of rate hikes has been necessary, but we're past peak inflation."*

The central bankers appear aligned on this point, but the fear of being wrong on inflation is forcing their hand further.

Stock markets have responded to differing degrees, with technology and more industrial-based businesses marked down aggressively, while mining and commodity-related sectors surge in value. Locally this has been borne out by the extraordinary outcome of mining companies collectively contributing more than 50% of all listed company earnings during the year, driven largely by record iron ore, gas, and coal prices.

Talk of a "super cycle", defined as a sustained period of increasing commodity demand, flies in the face of economic reality. China's growth rate, which is currently under pressure, has been the key driver of commodity prices, consistently investing more than 40% of its GDP in core infrastructure.

Many commodities are at price levels that now appear unsustainable while newer minerals, including lithium stocks operate in "bubble" territory. Investment house Goldman Sachs points out that the lithium sector's total market capitalisation has run from $15b to $60b in just two years on the back of soaring prices.

An induced recession and the subsequent slowdown in global growth is expected to further impact commodity prices heading into 2023. The key U.S. ISM Manufacturing Index, a composite index regarded as one of the most reliable indicators of economic activity, which gives equal weightings to new orders, production, employment, supply deliveries, and inventory, is trading below 50%. According to Macquarie Bank Economist Rick Deverell, this is likely heading to 40%.

Ed Yardeni, President of Yardeni Research provides a sensible view of what may unfold, "*Call it a soft landing, call it a rolling recession, a growth recession, whatever the case. It will be the most widely anticipated recession of all time. It could be the start of a return to the 'old normal' before the financial crisis, when we had inflation and interest rates of more like 3% to 4% and the economy growing around 2%.*

With this as a backdrop, Microsoft CEO Satya Nadella makes a compelling point. For the 2023 first quarter earnings update, where Microsoft Cloud revenue exceeded US$25b and was up 31% in constant currency terms, CEO Nadella noted *"The case for digital transformation has never been more urgent or more clear. Digital technology is a deflationary force in an inflationary economy."*

In this quarterly, we start with our macroeconomic outlook for 2023, dovetailed with a debt perspective viewed over the decades. We follow this up with our take on what makes for "*A Quality Business*".

We draw on the tectonic shifts in digital technology in our article "*Turning point*", drawing on the work of Viktor Shvets. His book *The Great Rupture* follows the advice of Winston Churchill, *"the longer you can look back the further forward you can look"*. In *The Great Rupture*, Shvets considers the path humans and nations have taken over centuries and what may now lie ahead. He refers to this period as the Information Age, *"The Information Age is going far beyond mere muscles and boredom. It is attacking cognitive functions and threatens within decades to completely upend the entire system of economic and societal interactions*."

While investors invariably gauge a company's progress via the share market scoreboard, its share price, it represents a point in time assessment. Business success is never as straight forward as this. This was clearly on show this year with investor apathy towards many sectors of the market irrespective of actual business performance. To that end share price performance hinged more on how interest rates would impact valuations rather than a proper appreciation of key performance metrics including revenue growth, profits, and reinvestment attitudes.

On this point we provide some thoughts in our two articles "*Insights*" and *"Succession*". The first considers presentations from recently held annual general meetings and in some instances, company result updates. We view these insights as important markers from a historical perspective and a lead indicator to future performance.

The second piece discusses the path of a business when leaders move on. Some are thoughtful and do it well, while others encounter difficulties when poorly executed.

As we look to 2023, the risk of recession and the consequential unknowns is top of mind for many investors. Businesses that are: global leaders; with strong recurring earning profiles; paying conservative dividends; reinvesting consistently in future products and services; and operating with either cash on the balance sheet or low levels of debt are not the preferred investment choice currently.

We take the opposite view and see considerable merit in an approach that aims to deal with short-term challenges while positioning for longer-term success.

The macroeconomic agenda that has driven performance this year will likely give way to a re-appreciation of individual company performance within a global setting that is likely to see lower global growth, the emergence of disinflation, and the potential for interest rate cuts.

In our ESG review we focus on a proven performer, TechnologyOne, provide an update on "*Green Energy*" within Selector and comment on portfolio companies that have reported during the period.

For the December quarter, the Fund delivered a gross positive return of **4.94%** compared to the S&P ASX All-Ordinaries Accumulation Index, which posted a gain of **8.77%**.

We appreciate your ongoing support and trust you find the quarterly informative.

Regards,

Selector Investment Team

"Industrial Revolution of the eighteenth to twentieth centuries have directly contributed to the collapse of non-Western societies and caused massive global dislocations, and all they did was to diminish the importance of muscle power and replace the most routine of occupations.

The Information Age is going far beyond mere muscles and boredom. It is attacking cognitive functions and threatens within decades to completely upend the entire system of economic and societal interactions"

Viktor Shvets – Author
"The Great Rupture – Three empires, four turning points and the future of humanity"

PORTFOLIO OVERVIEW

Table 1: Performance as at 31 December 2022*

	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	15 Year	Since Inception
Fund (net of fees)	4.52	3.52	(24.28)	(1.09)	6.48	12.12	6.19	9.54
Fund (gross of fees)	4.94	4.36	(23.41)	0.51	8.39	14.15	8.13	11.59
All Ords. Acc. Index	8.77	9.65	(2.96)	5.79	7.22	8.78	5.07	7.98
Difference (gross of fees)	(3.83)	(5.29)	(20.45)	(5.28)	1.17	5.37	3.06	3.61

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

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

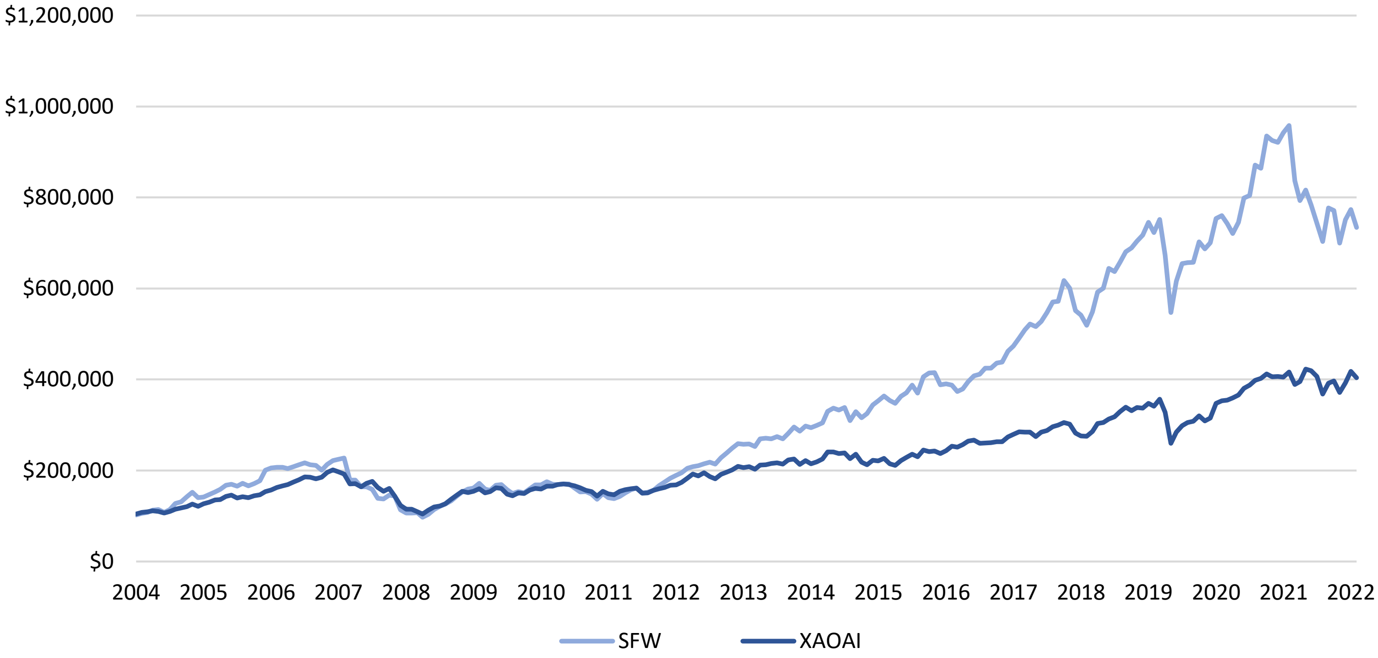


Table 2: Fund's Top 10 Holdings

Top 10 December 2022	%	Top 10 September 2022	%
Altium	6.62	Altium	6.85
carsales.com	6.54	carsales.com	6.25
TechnologyOne	6.40	CSL	5.89
CSL	5.64	ResMed	5.65
Cochlear	5.04	TechnologyOne	5.52
ResMed	4.91	Aristocrat Leisure	5.13
Aristocrat Leisure	4.52	Cochlear	5.00
Computershare	4.39	James Hardie Industries	4.68
Domino's Pizza Enterprises	4.30	Computershare	4.37
Reece	3.84	Reece	4.01
Total	**52.20**	**Total**	**53.35**

Table 3: Unit prices as at 31 December 2022

Unit Prices	Entry Price	Mid Price	Exit Price
	$2.9554	$2.9480	$2.9406

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

Table 4: ASX sector performance – December 2022 quarter

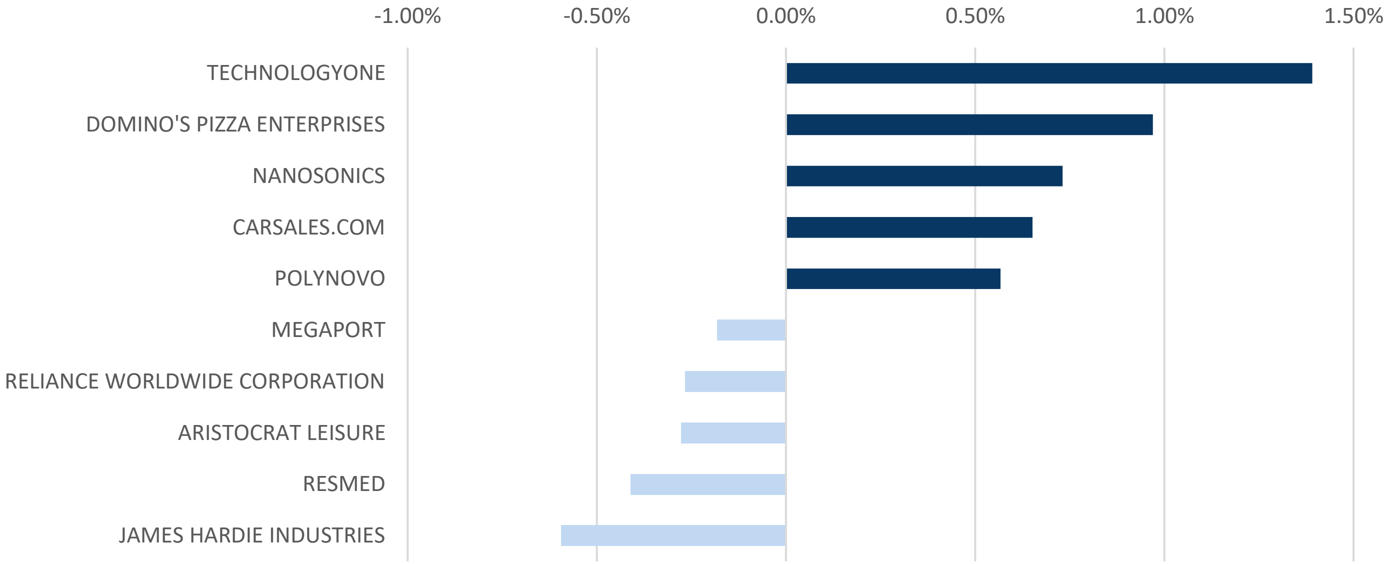
S&P ASX Industry Sectors	Quarter Performance (%)
Utilities	26.77
Materials	15.04
A-REITS	9.74
Financials	9.49
Energy	7.61
Industrials	6.49
Telecommunications	4.39
Consumer Discretionary	3.93
Information Technology	2.46
Healthcare	1.83
Consumer Staples	1.65

Table 5: Fund's industry weightings

Industry group	December 2022 (%)	September 2022 (%)
Software & Services	27.53	27.27
Health Care Equipment & Services	16.77	16.09
Consumer Services	13.89	13.34
Media & Entertainment	11.48	10.21
Pharmaceuticals, Biotech & Life Sciences	5.98	6.29
Diversified Financials	5.65	5.87
Capital Goods	5.65	6.32
Materials	3.80	4.68
Insurance	2.86	2.78
Cash & Other	1.77	1.95
Automobiles & Components	1.73	1.91
Household & Personal Products	1.59	1.94
Consumer Durables & Apparel	1.29	1.35

PORTFOLIO CONTRIBUTORS

Graph 2: Contributors and Detractors – December 2022 quarter



Top quarterly contributors

1. TechnologyOne (ASX:TNE)

Please refer to Reporting Season article below.

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

In December, Domino's Pizza Enterprises undertook a $150m institutional placement and $15m share purchase plan at $66.38 and $64.54 respectively, in total issuing circa 2.5m new shares. The institutional placement was well supported and completed at no discount to prior trading. These funds will be used to acquire the remainder of the German joint venture with any surplus to be applied towards debt reduction.

CEO Don Meij commented, *"We look forward to acquiring full ownership in Domino's Pizza Germany and continuing to build the momentum across our network and delivering value to our customers, team members, franchisees and investors."*

Despite a challenging short-term outlook, the company reaffirmed its FY23 guidance of exceeding the net profit after tax from FY22 excluding currency impacts.

Domino's Pizza Enterprises has a current market capitalisation of $6.6b.

3. Nanosonics (ASX:NAN)

At its 2022 Annual General Meeting, Nanosonics provided a strong trading update for the first four months to 31 October 2022. Revenue increased 42% to $52.6m, driven by improved market conditions and a successful transition to a direct sales model in the U.S. The global installed base of Trophon units continues to grow, up 815 units to 30,665.

Having established themselves as the standard of care in Australia and North America, the company sees a significant global opportunity for Trophon. Nanosonics estimates the Total Addressable Market (TAM) in North America at 60,000 units and 40,000 units each in Europe & Middle East and Asia Pacific. As at 30 June 2022, market penetration in North America was 44% and 5% in Europe & Middle East and Asia Pacific. The company remains focused on investing in people, operations and product innovation to drive customer awareness and become the standard of care in the latter.

Nanosonics has a market capitalisation of $1.1b. The company maintains a strong balance sheet with $94.5m of cash and no debt.

4. carsales.com (ASX:CAR)

Please refer to succession article below.

5. PolyNovo (ASX:PNV)

In November, PolyNovo undertook a $53m capital raise comprising of a $30m institutional placement, $20m retail entitlement offer and a $3m director placement at

$1.90 per share; representing a 9.1% discount to recent trading.

The raise will fund initiatives to accelerate global growth, including expanding its sales and commercial presence in the U.S. by 40 staff (54%) over FY23. The group will also expand its headcount in new markets including Canada, India and Hong Kong.

Additionally, PolyNovo announced the construction of a new co-located production, R&D and office facility in Port Melbourne. This facility will dramatically increase scale and manufacturing efficiency by adopting modularity, flexibility and automation. Management expects the new facility to increase capacity by five-fold, supporting circa $500m of sales. Construction is expected to begin in financial year 2024 and cost approximately $25m.

Polynovo Chairman David Williams commented, *"PolyNovo is clearly at an exciting inflection point having achieved a significant number of milestones, including our first $5m revenue month in September and establishment of operations in Canada, Hong Kong and India. Our US business continues to grow rapidly and is profitable. We are incredibly excited about the journey ahead and have high conviction that now is the right time to accelerate our global growth ambitions to capitalise on our strong recent momentum."*

PolyNovo has a market capitalisation of $1.7b.

Bottom quarterly contributors

1. James Hardie Industries (ASX:JHX)

In November, leading fibre cement producer James Hardie reported its Q2 FY23 result with net sales growing 10% to US$997.6m and adjusted net income (NPAT), excluding asbestos payments, up 13% to US$175.8m. Despite volume pressures, the sale of higher value products improved the price mix in all regions.

In recognition of difficult macro-economic conditions and expectations of a sharp decline in new housing construction activity, management downgraded full year net income guidance to US$650m–US$710m, compared to its earlier US$730m-US$780m profit range. At the midpoint, the updated guidance now reflects a 10% increase on the 2022 level, verse the 22% improvement first envisaged.

To ensure flexibility, the company to replace its dividend with an ongoing buy-back program, initially valued at up to US$200m.

James Hardie has a current market capitalisation of $13.2b.

2. ResMed (ASX:RMD)

Please refer to Reporting Season article below.

3. Aristocrat Leisure (ASX:ALL)

Please refer to Reporting Season article below.

4. Reliance Worldwide Corporation (ASX:RWC)

In October, Reliance Worldwide Corporation provided a trading update for the first quarter of FY23. Sales for the period increased 23% to US$303.1m including the recently acquired EZ-Flo which contributed US$53.8m. As a result of higher costs and lower volumes, adjusted operating margins (EBITDA) were 20.9%, down from 26.6%, resulting in adjusted EBITDA of US$63.2m, down 4%.

Across all regions, price increases significantly reduced the overall impact of higher commodity costs with Reliance also focused on reinvigorating its cost-out programme going forward. Management remains confident in its ability to execute well in what will likely be a more challenging environment.

Reliance has a market capitalisation of $2.7b and net debt of US$518.2m, down US$32.9m primarily as a result of the sale of a property in the U.K.

5. Megaport (ASX:MP1)

In October, Global cloud enabler Megaport reported its first quarter 2023 results. Revenue increased 37% to $33.7m and gross profit after direct network costs and partner commissions were up 51% to 21.7%. On a quarter on quarter (QoQ) basis, monthly recurring revenue grew 9% to $11.6m, driven by a strong result in the U.S. market (+13% to $6.5m).

The company grew its indirect sales channel (PartnerVantage) by 102 new partners with an additional 38 transacting (up 31% and 77% QoQ respectively).

The PartnerVantage program allows Megaport to expand its customer reach by integrating value added distributors such as global system integrators, managed service providers and resellers to sell the group's services. The benefit for Megaport is twofold. Firstly, it enables the company to educate sellers at scale, thereby widening its customer reach. Secondly it improves the platform's value proposition by enabling both the capital equipment and network solution to be offered to a customer in a single transaction.

While it took management longer than expected to implement the solution, they remain confident in the strategy, noting a strong pipeline of customers and growing monthly recurring revenue per partner (up 18% QoQ to $5,000 per month).

The group remains on track to reach profitability in FY24 on an exit runway basis and posted its second consecutive period of positive operating profits (normalised EBITDA excluding one-off non operating expenses) of $1m. Megaport is well funded with cash on hand of $69.4m.

Megaport operates in 145 cities, across 25 countries and has a market capitalisation of $1.1b.

ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE (ESG)

- **ESG risk of the portfolio**

Table 6: SFML ESG Scores

Company Name	ESG Roadmap	ESG Score
ARISTOCRAT LEISURE	2.0	8
ALTIUM	2.0	6
APPEN	2.0	8
ARB CORPORATION	2.0	6
BLACKMORES	2.0	6
BREVILLE GROUP	2.0	5
CARSALES.COM	2.0	8
COCHLEAR	2.0	7
COMPUTERSHARE	2.0	8
CSL	2.0	8
DOMINO'S PIZZA ENTERPRISES	2.0	5
FINEOS CORPORATION HOLDINGS	2.0	6
FLIGHT CENTRE TRAVEL GROUP	2.0	8
FISHER & PAYKEL HEALTHCARE CORPORATION	2.0	8
INSIGNIA FINANCIAL	2.0	5
INFOMEDIA	2.0	4
IRESS	2.0	7
JAMES HARDIE INDUSTRIES	2.0	7
JUMBO INTERACTIVE	2.0	6
MEGAPORT	2.0	4
MEDICAL DEVELOPMENTS INTERNATIONAL	2.0	6
NANOSONICS	2.0	8
NEARMAP	2.0	6
NIB HOLDINGS	2.0	9
OFX GROUP	2.0	7
POLYNOVO	2.0	7
REA GROUP	2.0	9
REECE	2.0	9
RESMED	2.0	8
RELIANCE WORLDWIDE CORPORATION	2.0	9
SEEK	2.0	9
TECHNOLOGYONE	2.0	7
WISETECH GLOBAL	2.0	8

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)

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 of the 12 areas under consideration. The ESG 2.0 Roadmap iteration was created in 2021, with changes integrated into our portfolio models thereafter. The ESG 2.0 Roadmap consists of 9 areas under consideration.

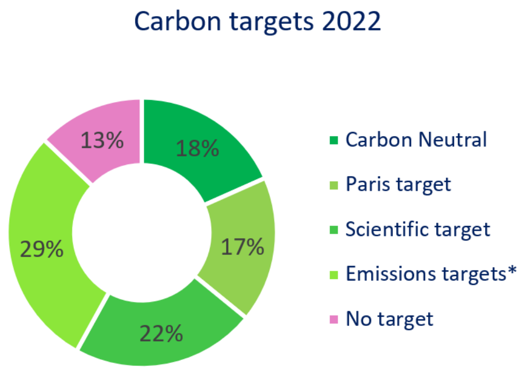
The following is a breakdown of each consideration:

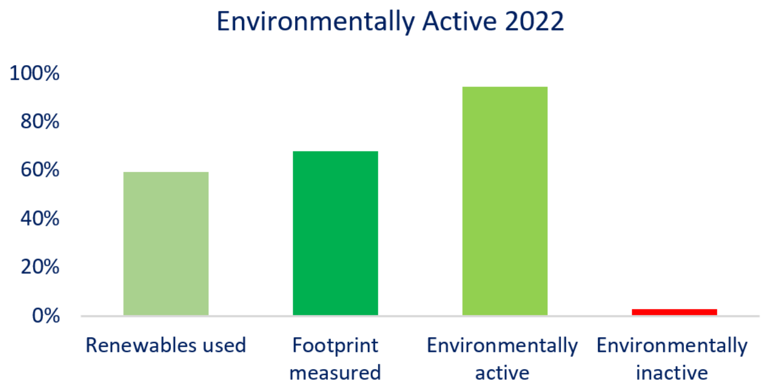
- Climate targets – Assessment of the company's plans relating to carbon neutrality, Paris commitments, scientific targets, or emission targets. "0" rating for no effort.
- Renewable targets – Assessment of the company's documented use of renewables mix or implemented targets for renewable energy.
- 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.

The ESG Roadmap is reviewed quarterly with data updated annually by reporting companies. Further detail on our ESG Roadmap can be found in the SFML ESG & Voting Policy 2022, available at https://selectorfund.com.au/esg

▪ Carbon Risk Analysis

Figure 1: Portfolio Reporting 2022





What we are seeking

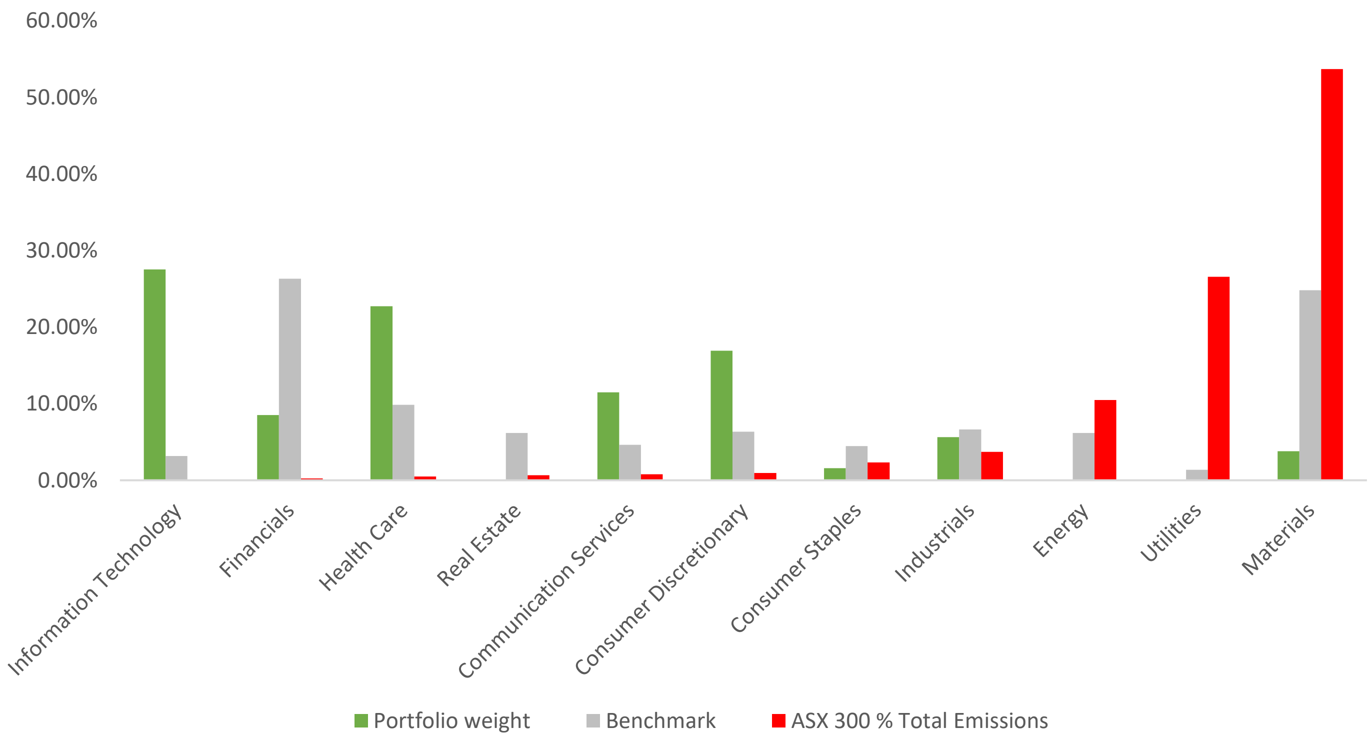
- Paris targets
- Science based targets
- Emissions targets
- Renewable energy targets

What we are monitoring

- No efforts
- No accountability

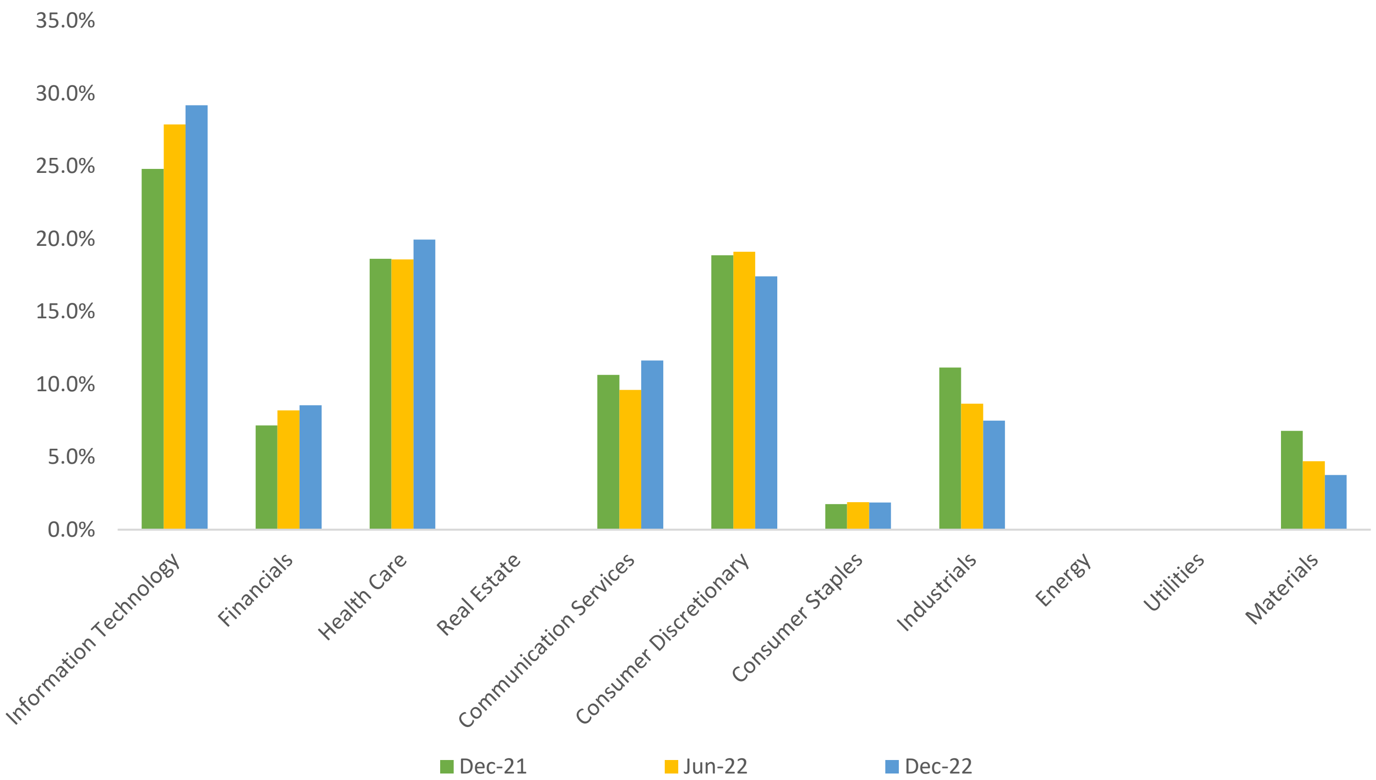
Source: SFML Research

Graph 3: SHCEF vs ASX 300 Carbon Exposure 31 December 2022



Source: Refinitiv

Graph 4: Portfolio Carbon Exposure Periodic Change



Source: Refinitiv

Table 7: SFML Portfolio carbon intensity

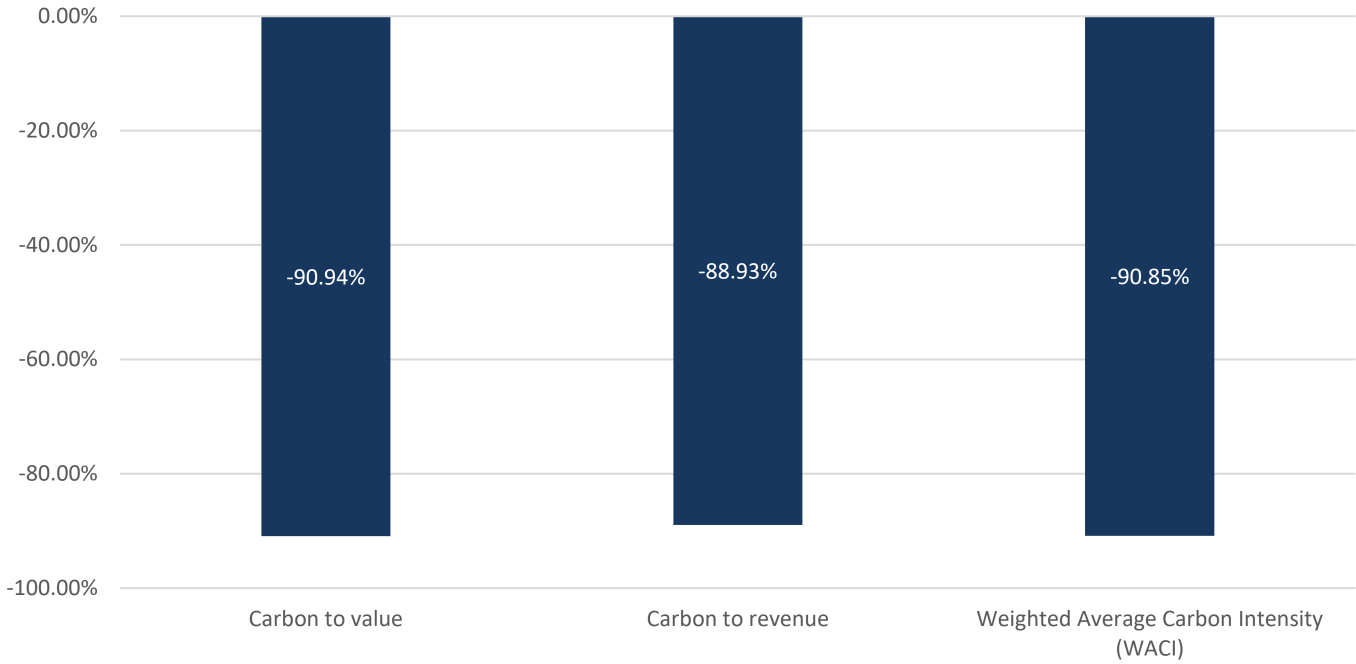
Carbon intensity method[1]	SFML	Benchmark[2]
Carbon to value invested	4.47	49.33
Carbon to revenue	16.88	152.55
Weighted Average Carbon Intensity (WACI)	13.51	147.69

Source: Refinitiv

1. Denominated in tonnes per CO2e/AUD$m
2. Benchmark used is S&P/ASX 300

- ***Carbon to value invested*** – this calculation is the aggregation of estimated owned constituent greenhouse gas emissions per $1m market capitalisation as at 31 December 2022. It allocates the emissions investors are responsible for based on their level of ownership, enabling them to measure their contribution to climate change.
- ***Carbon to revenue*** – this calculation reflects the aggregation of estimated owned constituent greenhouse gas emissions per $1m generated in apportioned revenues. It allocates the emissions investors are responsible for based on their ownership of company revenues.
- ***Weighted Average Carbon Intensity (WACI)*** is the weighted average of individual company's estimated carbon intensities (emissions over revenues), weighted by the investment proportion of the constituents.

Graph 5: SFML Carbon Intensity Relative to ASX 300



Source: Refinitiv

SFML's carbon to value invested and carbon to revenue are both lower than the S&P ASX 300 index, at 90.94% and 88.93% respectively. SFML's WACI is 90.85% lower than the index, due to no exposure to Energy and Utilities sectors, and low exposure to the Materials sector.

Table 8: SFML Top 10 emitters and total Portfolio Revenue impact of AUD$90 Carbon tax

Portfolio	Revenue ($m)[1]	CO_2 Emissions[2] (Tonnes)	$90 Carbon Tax ($m)	Impact on Revenue (%)
SFML Top 10 Emitters	45,865.50	1,272,210	114.50	(0.25%)
SFML Portfolio – Total	64,908.02	1,329,185	119.63	(0.18%)
ASX300 Top 30 Emitters	543,110.17	200,715,768	18,064.42	(3.33%)
ASX 300 Index – Total	1,112,392.82	217,908,546	19,611.77	(1.76%)

Source: SFML & Refinitiv Estimated CO2 Emission data

1. Last reported financial year values as at 31 December 2022
2. Scope 1 and 2 emissions (estimated if not reported).

*Note: ASX 300 index revenue impact from a carbon tax is **9.8x** larger than SFML portfolio*

Table 9: Fundamentals behind comparing SFML Top 10 Emitters and ASX300 Top 30 Emitters

Portfolio	Percentage of Total Portfolio	Percentage of Total Portfolio's Emissions
SFML Top 10 Emitters	44.85%	95.10%
ASX 300 Top 30 Emitters	32.33%	92.71%

Source: SFML & Refinitiv CO2 Emission data

*Note: ASX300 Top 30 Emitters revenue impact from a $90 carbon tax is **13.3x** larger than SFML Top 10 Emitters*

Table 10: SFML Portfolio Top 10 Emitters Carbon Tax Scenario Testing

Company	CO_2 Emissions (Tonnes)	NPAT[1] (AUD $m)	EPS[1] ($)	Value of Carbon Tax ($)	Cost of Carbon Tax ($m)	Impact on NPAT (%)	EPS Post Carbon Tax ($)
JHX	662,727	621.60	1.98	90	59.65	(9.60%)	1.79
CSL	347,000	3,109.57	6.92	90	31.23	(1.00%)	6.85
REH	60,166	392.49	0.61	90	5.41	(1.38%)	0.60
DMP	52,162	166.73	1.90	90	4.69	(2.82%)	1.85
RWC	47,198	189.52	0.30	90	4.25	(2.24%)	0.29
FLT	33,489	-287.18	-1.44	90	3.01	(1.05%)	-1.42
RMD	23,028	1,074.96	7.89	90	2.07	(0.19%)	7.87
ARB	19,810	122.01	1.49	90	1.78	(1.46%)	1.47
FPH	15,119	355.31	0.61	90	1.36	(0.38%)	0.61
ALL	11,512	948.50	1.67	90	1.04	(0.11%)	1.67

Source: Refinitiv CO2 Emission data

1. Last reported financial year values as at 31 December 2022

- **How ESG factors are incorporated into research and decision-making processes**

We believe ESG is incorporated into our investment process and our research efforts. We make this distinction to provide further insight.

ESG incorporation into investment process

ESG consideration is integrated into the three core areas of our investment process:

1. Corporate engagement program
2. Quantitative modelling program
3. Voting program.

The three programs of work listed above are applied consistently to each business that we research. Ultimately, we are seeking businesses with leadership qualities, run by competent management teams, underpinned by a strong balance sheet and with a focus on capital management. Each of these four elements has its roots in culture and ESG.

We believe Culture and ESG are intertwined. We consider them both integral to our assessment of a business. Voting is the other half of ESG, all resolutions are documented, researched and voted inhouse.

Our ongoing focus on the individual culture and financial sustainability of a business lends itself to strong ESG outcomes at a business and portfolio level. This is evidenced by portfolio emissions significantly lower than index emissions, coupled with outperformance since inception.

ESG incorporation into research

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, to avoid any surprises. Here we are considering the possibility of assets becoming stranded (environment) or compromised (Social, Governance, legal, IP, cybersecurity as examples).

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. This template is both qualitative and quantitative in nature, it focuses our research efforts on the aspects of ESG that we hold important in assessing the risk associated with a long-term investment. This internal scoring system is integrated into our financial model.

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. It also holds a strong relevance to our portfolio construction.

Our Roadmap has a material bearing on our investment process from screening ideas to portfolio construction. As an example, we highlight the top left-hand corner of the Roadmap, “Individuals we can trust”. If we are unable to establish confidence in management, board and the culture that they are responsible for, we will not invest in a business. We are index unaware and have the luxury of sitting on the sideline or saying no to an investment.

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

In 2019 we developed our ESG Roadmap which provides an additional framework for integrating ESG into our research. It is also incorporated into our financial models. This is an iterative approach whereby we are building upon successful initiatives and discarding those that do not add value to our process.

We have taken progressive steps to better understand environmental risk. We measure emissions targets and renewables use across the portfolio. We also measure portfolio emissions against index emissions.

We have long had confidence that our process drives strong ESG outcomes in relation to social and governance issues. We believe our long-term outperformance and low turnover is evidence of this. It is now also apparent, from the portfolio reporting discussed above, that we are driving equally strong ESG outcomes in relation to environmental issues.

In addition, we use our templates and framework to actively seek better transparency and financial disclosure from the companies we invest in.

- **Examples of where ESG issues have been integrated into investment analysis and decision-making processes including company engagement and voting**

As part of our corporate engagement program, in 2022 we have proposed a sustainable capital management program to businesses we engage with. The ongoing ability to deliver strong ESG outcomes requires long term business sustainability. The model that SFML promotes is a sustainable approach to ongoing re investment into innovation and R&D programs, a sensible payout ratio, and a consistent buyback of shares that drives real EPS growth over the long term while maintaining a strong balance sheet. These financial elements promote business sustainability that are hallmarks of good financial stewardship including. We have actively discussed this model with:

- carsales.com
- Fisher & Paykel Healthcare
- TechnologyOne
- Cochlear

- **Details of any ESG research sources (internal and external) used during the reporting period.**

We endeavour to read widely. This includes publicly disclosed documents, such as annual reports, sustainability statements, company and board charters and broker research. We subscribe to news services, various publications and a global business transcript service that also collates broker research and financial data.

SFML also recently integrated a new financial platform, Refinitiv, which provides extensive ESG coverage and data insights across ASX All Ordinaries securities. Refinitiv's reported and estimated emissions data has been used to generate the detailed analysis of SFML's portfolio emissions as seen above. Refinitiv will also enable data to be refreshed more frequently.

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 believe this is a differentiated approach that generates strong ESG outcomes.

REPORTING SEASON SNAPSHOT

- Aristocrat Leisure (ALL:ASX)

In November, global gaming operator Aristocrat Leisure reported a strong full year 2022 result. Group revenue increased 18% to $5,574m and operating earnings (EBITDA) grew 20% to $1,851m.

The result was driven by a standout performance in the Group's land-based Gaming Operations with revenue up 31% to $2,983m. Aristocrat's digital game division Pixel United posted a resilient result, with revenue down 1% to US$1,835m during a period where the group ceased sales in Russia, impacting revenues by 3%, alongside a weaker digital gaming environment.

For the year, operating cash flows were $1,246m, down 6% on the prior corresponding period (pcp) due to a deliberate increase in inventory to minimise part shortages. The company also reduced group debt levels from $3,236m to $2,457m, utilising part of the $1.3b equity raising proceeds following the failure of the announced Playtech acquisition. Aristocrat ended the period with net cash of $564m and completed $340m of its planned $500m share buyback program.

The company maintained its industry leading investment with Design and Development (D&D) outlay increasing 26% to $667m. This fully expensed investment represents 12% of revenue and supports ongoing product, game and cabinet innovation as well as talent acquisition and development.

Segment Performance

Land-based (54% of revenue)

In the Land-based gaming segment, Aristocrat operates a leasing (Gaming Operations) and outright sales model, which represents 54% and 46% of revenue respectively. Gaming Operations revenue increased 23% to $1,619m and Outright Sales revenue grew 43% to $1,364m. North America (NA) remains the group's largest market, accounting for 81% of revenue.

Gaming Operations:

The Gaming Operations division operates solely in NA, where revenue is earned as a fixed fee or percentage of daily wins per installed base. Average fee per day increased 9% to US$55.78, with Aristocrat remaining the clear industry leader on this metric. Total installed machine units were up 10% to 59,199.

Management is focused on delivering continued market share gains, supported by strong customer service and market leading content as highlighted below:

- Highest performing game portfolio with 18 of the top 25 leased games (including entire top 11) from leading gaming research group Eilers & Krejcik in October 2022
- Land-based supplier (fourth year in a row) and slot manufacturer of the year at the 2022 global gaming award.
- Gaming portfolio performance of 1.4 times floor average at casinos, exceeding all other suppliers

The strong growth, post the re-opening of casinos is underpinned by Aristocrat's core objective to partner with customers and help solve their commercial needs. This has been achieved by leveraging its speed of execution, marketing efforts and data analytics & insights to help improve gaming floor performance.

This decision has seen customers transition from transactional-led interactions to longer-term, strategic relationships that generate more sustainable earnings.

Outright sales

Outright sales reflect the Group's global gaming division operating across North America (NA), Australia and New Zealand (ANZ) and select international regions.

In the Americas, outright machine sales were up 66% to 19,366 units driven by larger customer capital budgets and market share gains. The average selling price also increased, up 8% to US$18,524 due to higher take up of the company's new MarsX cabinets.

In the adjacent slot gaming market in NA, Aristocrat continues to grow within Video Lottery Terminals and Washington CDS machine segments. During the year, the group entered the Kentucky Historical Horse Racing and New York Lottery markets. These adjacencies remain in their infancy but have clear growth opportunities supported by leading gaming content.

The ANZ region continues to perform well, supported by higher take-up of MarsX cabinets and market leading cabinet sale shares.

International experienced significant growth over the period with revenue more than doubling due to large openings in the Philippines.

Aristocrat Gaming operates in 325 licensed jurisdictions, supported by 12 global game studios and approximately 4,000 employees.

Digital (Pixel United): 46% of revenue

Pixel United posted a resilient result with management delivering above-industry performance in a period when total gaming market revenue declined by 5% to $81.7b. With a weaker industry environment, Aristocrat was prudent on User Acquisition (UA) spend which declined 8% to US$479.5m or 26.1% of revenue.

The result was underpinned by share gains in core genres of Social Casino and Social Slots via continued investment in new features, content and live operations (updates) to deliver higher engagement and improved in-game monetisation. Additionally, investments were made to bolster core game development, talent and capabilities globally through four new talent hubs in Poland, Spain and Canada.

The Company's strategic focus on user quality is progressing well with average bookings per daily active user up 10.8% to US$0.82. In the same period, daily active users decreased 23.6% to 5.5m users.

The Social Casino segment continues to perform well, supported by a loyal customer base and strong growth in Lightning Link and Cashman Casino titles.

In RPG/Strategy/Action, revenue was relatively flat over the period with leading game Raid Shadow Legends (Raid) transitioning away from aggressive UA spend to higher profitability. This decline in revenue was largely offset by growth in recently launched action title Mech Arena. The group's commission-free PC platform PlariumPlay continues to experience solid take up and contributed 26% of Plarium revenues, versus 20% in the pcp.

Social Casual experienced a material decline, reflecting the maturing of the game portfolio and reduced UA spend. Whilst the segment has lacked momentum, management have implemented a clear strategy to revitalise the segment. An example of this was the appointment of Larry Plotnick, the former head of games at Amazon, as the group’s Big Fish CEO in May and Joe Kaminkow as Chief Innovation Officer in October. Mr Kaminkow is a renowned game designer holding over 130 patents and has been tasked to drive innovation across new gaming products and mobile game genres.

The pipeline for new game titles remains strong with 10-15 titles in active development for planned launches over the next few years.

Pixel United ended the year with approximately 2,900 employees across 21 global game studios and remains a top five mobile game publisher in tier one Western markets.

Table 11: Digital segment performance

	Bookings (USD m)	Change	% Total Revenue
Social Casino	953	5.0%	52%
RPG/Strategy/Action	630	-0.4%	35%
Casual	243	-20%	13%
Total	1,826	-1%	100%

Source: Company Financials

Real Money Gaming (RMG): Anaxi

Anaxi is Aristocrat's newly formed RMG division which is initially targeting the U.S. iGaming (online casino) market.

Over the long run, the group aims to penetrate at least 70% of the regulated jurisdictions across NA and become the leading platform for global online RMG. The division is headed by Mitch Bowen, Aristocrat's prior CEO of Land-based.

Management has implemented a buy and build strategy to scale the division. This includes medium-term investments to build the technology infrastructure, product portfolios and capabilities to ensure the business can compete. Similarly, Aristocrat will seek to acquire companies that can accelerate the group's platform capabilities and offering.

Aristocrat currently has eight games approved for the NA market and expects its Remote Game Server (gaming distribution platform for operators) to be approved late this calendar year (CY). The group is working with two key customers and expects to be live in three jurisdictions in early CY23.

The global online RMG total addressable market (TAM) is estimated to be US$83b. Within this, the U.S. market opportunity is expected to grow from US$25b to US$30b by 2030.

Outlook

While no formal outlook was provided, Aristocrat expects continued growth over the full year, including higher net profits. In Land-based, management is focused on sustaining its market leading positions, measured by the number of installed machines, fee per day and growth in floor share across key gaming outright sales. In Digital, the group is targeting growth in bookings volume and profitability.

Aristocrat Leisure has a current market capitalisation of $21.9b.

▪ Fisher & Paykel Healthcare (FPH:ASX)

In November, leading respiratory care manufacturer, Fisher & Paykel Healthcare reported its 1H23 result. Revenue was down 23% to NZ$690.6m and net profits reduced 57% to NZ$95.9m. The performance is reflective of the pull forward of hospital hardware and consumables from elevated COVID demand in the prior period. Compared to 1H20, Fisher & Paykel's revenue grew 21%.

Gross margins declined 325 basis points (bps) to 60% due to higher freight, input costs and manufacturing inefficiencies from lower volumes. Management expects gross margins to return to its 65% long-term target over time, driven by price rises, lower freight costs and scale efficiencies.

The company continues to reinvest for future growth, with research & development (R&D) spend up 11% to NZ$84.2m (12% of revenue) and selling, general and marketing expenses rising 7% to NZ$202.3m (29% of revenue). These increased investments combined with lower revenue led to operating margins (EBIT) falling to 18.3% compared to 33.6% in the prior period.

Fisher & Paykel remains focused on achieving its long-term operating margin target of 30%, with increased investments today expected to deliver a doubling of revenue every five to six years.

Hospital (64% of revenue)

The group's hospital division has been a significant COVID beneficiary with demand for hardware and consumables elevated since 2020. As global hospitalisations subside, this benefit has become a headwind with sales of hardware normalising while hospitals destock high levels of consumables. These challenges are expected to be short-lived, with consumables sales showing signs of recovering, as evidenced by sequential increases seen since May.

For the half, Hospital revenue declined 35% to NZ$438.7m with hardware and consumables sales falling 74% and 14% respectively.

Looking at the bigger picture, Fisher & Paykel remains in an enviable position having sold the equivalent of NZ$880m, or 10 years' worth of hardware to hospitals over the past two years. With humidifiers readily available across hospitals, management has the opportunity to translate the visible benefits, and recent experiences for healthcare professionals using nasal high flow (NHF) therapy on COVID-19 patients, into clinical practice for the general respiratory disease population.

The company has invested in sales staff across regions to drive higher utilisation and clinical change. While there is a growing body of clinical guidelines and economic evidence encouraging the early use of NHF, penetration remains low and the opportunity for clinicians to grow usage across the hospital is sizeable.

CEO Lewis Gradon highlights the opportunity ahead, *“Never before in our history have we changed clinical practice with such a significant advantage. Our customers already have our hardware, they already have clinical experience with its use, and they already have access to a huge amount of clinical evidence. This gives us confidence that we can continue to build on our proven 50-year track record and reach more patients with our respiratory therapies. We continue to be confident executing on our long-term growth opportunities.”*

Homecare (36% of revenue)

The Homecare division produces devices and masks for the home treatment of respiratory support and obstructive sleep apnea (OSA) patients. While overshadowed by Hospital in recent times, Homecare continues to remain an important pillar for growth.

Management is primarily focused on the development and sales of high quality masks for OSA patients. For the half, masks revenue grew 16% to $215m and contributed around 86% of division sales. The strong growth is reflective of its successful US launch of the Evora full face mask, which is an impressive result given the weak operating environment for new patient starts. Total Homecare revenue rose 10% to NZ$249.9m.

New Products

Despite the manufacturing focused period of COVID, Fisher & Paykel consistently grew its investment in R&D. This has enabled the company to sustain a robust pipeline across various indications and release new products across respiratory support, laparotomy surgery and anaesthesia.

These innovations are expected to drive future growth. Airvo 3 is a prime example, with the new device having an integrated battery and closed loop oxygen control, which is expected to remove barriers for adoption across the wider hospital. The company has begun commercialising the opportunity in ANZ and is seeking regulatory approval across the U.S. and Europe.

Manufacturing

The group has accelerated the completion of its third manufacturing facility in Mexico and the ground works for a fifth R&D and manufacturing facility in New Zealand. Fisher & Paykel also announced a new offshore manufacturing facility in Guangzhou, China, with the rationale to produce a select range of products to service the large local markets around Asia.

Outlook

Given the short-term uncertainty, guidance has not been provided for the full year. Management remains confident in the long-term prospects of the business, with significant opportunity ahead to drive clinical change.

CEO Lewis Gradon notes, *“Our confidence in the future is unchanged, evidenced by the significant level of investment in new product development, our global sales force and our infrastructure.”*

Fisher& Paykel Healthcare has a market capitalisation of $13.62b and net debt of NZ$42.6m. The company also paid an interim dividend of NZ17.5c per share.

- ## OFX Group (OFX:ASX)

In November, international payment services supplier OFX Group reported its first half 2023 result. The group delivered a record half with revenue (fee and trading income) up 49.9% to $110.9m and underlying operating profit (EBITDA) increasing 59.4% to $32.3m.

OFX revenue is comprised of the net margin made on each foreign exchange transaction, otherwise known as Net Operating Income (NOI) and associated income earned through the transaction process (treasury revenue). For the half, NOI increased 53.4% to $105.3m. Total transaction volumes (turnover) were up 32.6% to $19.9b, driven by higher group (ex. Firma) average transaction values (+14.5% to $29,600) and transaction volumes (+15.8% to 670,700).

The strong growth was driven by the addition of Canadian based FX business, Firma (excluding U.K. operations) for five months to 30 September 2022. For the period, Firma's revenue grew 32.6% to $24.5m.

Management noted the “outstanding acquisition" of Firma and have identified numerous digital initiatives to enhance platform capabilities, risk management and scale. Currently, only 6% of Firma's revenue comes from digital transactions.

Importantly, OFX has been able to expand its average net income margin on all foreign exchange transactions from 0.43% to 0.53%. Of this, 0.40% of the NOI margin increase came from the Firma acquisition with the remaining improvement reflecting the company's growing pricing power through increased scale, its focus on customer service and risk management.

For the half, bad and doubtful debt was $1.2m and includes $0.3m from Firma operations. This represents 1% of total revenue which is materially lower than 1H20 and 1H21 levels of 1.8% and 1.9% respectively. Management noted the majority of provisions are in North America, driven by U.S. and Canadian banking structures.

Segment Performance

Corporate and Consumer (93% of revenue)

On a combined basis, Corporate and High Value Consumer account for 93% of group revenue. Critically, these areas predominately support recurring transactions which account for 87% and 75% of segment revenue respectively.

Management remains confident these segments will continue to grow, aided by strong average transaction values and investments in systems to improve customer onboarding and service.

Online Sellers (4% of revenue)

The Online Sellers segment continues to face challenges within Asia, leading to revenue being flat on the prior comparable period (pcp) at $4.2m. Excluding Asia, revenue increased 6.9% with solid growth in North America and Europe, Middle East and Africa (EMEA).

The long-term opportunity in e-commerce remains positive with management maintaining investment in the platform and capabilities with two new currencies (Japanese Yen and Polish Zloty) added during the half.

Enterprise (2.8% of revenue)

Enterprise activation has been disappointing to date with the group struggling to convert larger customers. As a result, the company has redirected its attention to small and medium sized businesses which can quickly adopt and realise the benefits of OFX's solution. The company aims to use these smaller customers as case studies for larger prospects.

As at 31 September 2022, Enterprise had 71 active prospects, up from 48 on 31 March 2022.

R&D and Outlook

OFX ended the period in a strong position, aided by better than expected performance from Firma and heightened market volatility. This resulted in management upgrading FY23 guidance for net operating income including Firma, from $200m-$212m to $215m-$222m and underlying EBITDA from $55m-$60m to $62m-$67m.

The group has also increased its committed to lift reinvestments from $12m-$16m to $15m-$17m, reflecting management's confidence in scaling the business to meet future demand.

Majority of this investment will go into technology resources including:

- Increase automation tools to drive faster payments
- Enhanced onboarding processes to bolster risk and compliance
- More efficient operation tools to improve customer response times and the quality of service

Over the half, OFX onboarded an additional 134 employees (ex Firma) across the business, bringing total full time employees including Firma to 712. This includes an additional 54 staff in technology resources and 40 new employees in sales and marketing.

OFX has a market capitalisation of $585m, and a net debt position of $34.3m (excluding cash held as bank collateral).

- ## ResMed (RMD:ASX)

In October, leading out-of-hospital medical device, mask, and software provider, ResMed reported its first quarter 2023 result. Group revenue rose 9% in constant currency (cc) to US$950m while operating profits lifted 4% in cc to US$291m.

Global device revenue grew 9% in cc to US$518m, with the company's re-engineered card-to-cloud device seeing strong traction in the U.S., offset by lower adoption across Rest of World. The company continues to experience unprecedented demand resulting from a competitor recall with supply remaining the primary constraint.

Masks and Other revenue grew 8% in cc to US$327m, as strong resupply outweighs the headwind from lower new patient starts. Software as a Service (SaaS) revenue lifted 9% in cc to US$106m.

Gross margins rose moderately to 57.6%, with the company still impacted by higher freight, component supply and manufacturing costs. The medium-term opportunity is to return gross margins back to historical levels of around 60% via manufacturing optimisation as supply chains normalise and higher freight prices begin to abate.

Philips Recall

ResMed continues to experience unprecedented demand from its largest competitor’s full product recall of DreamStation 1 CPAP (Continuous Positive Airway Pressure) devices.

In October Philips confirmed an estimated 4m replacement devices and repair kits had been produced out of an expected replacement base of 5.5m units. The company expects to complete the field action by early 2023. Philips also notes the U.S. Department of Justice, acting on behalf of the FDA, remain in discussions regarding the terms of a proposed consent decree to resolve the identified issues. In addition, Philips is also subject to an investigation as a defendant in several class-action lawsuits. Finally, the company recorded a EUR 1.3 billion non-cash charge in the third quarter ending September for the impairment of goodwill of this business.

CEO Mick Farrell provides his take on the situation, *“The re-engineering and re-cultural training…that type of change requires a lot of work. And I would think people will have to move from development and R&D back to what I would call quality remediation and quality systems improvement.”*

While Philips is out of the market, ResMed is driving permanent market share gains, as clinicians and Durable Medical Equipment (DME) providers experience its best-in-class cloud connected devices and platform ecosystem. Philip's internal forecasts confirm these expectations.

Historically, ResMed and Philips together supplied more than 90% of the market for CPAP devices.

Supply imbalance

While ResMed has capacity to ramp up manufacturing, the challenge lies in supply chain procurement due to the global shortage of electronic components (semiconductors). An interim solution has seen ResMed supply a redesigned card to cloud AirSense10 machine, which does not require the in-demand communications chips. This has helped bridge the near-term supply-demand imbalance, with take-up in the U.S strong.

This was reflected with U.S. device sales in the recent third quarter up 23% to US$340m and masks up 11% to US$239m.

The company is also engaging with its network of suppliers and partnering to bridge this imbalance. The recent STAR Supplier event was used to instil the message that greater component allocation would provide inherent benefits for patients, providers and physicians globally. CEO Mick Farrell is confident these partnerships can deliver improved allocations, *"As a consequence of these partnerships, our suppliers are responding positively, and I can share this, we expect steady increase in ResMed's device production each quarter throughout this fiscal year and beyond."*

Medium-term growth

Looking beyond the persistent supply-demand imbalances, ResMed’s ability to grow remains significant with an estimated addressable global market of over one billion sleep apnea patients. The company continues to innovate to identify, screen, diagnose, treat and manage a larger audience of patients in a more streamlined manner.

In large population markets such as China, India and Brazil the group is experimenting with different methods to drive demand using channels such as social media which are relatively low cost. This augments the existing initiatives including a joint venture with the U.S.’s largest pharmacy chain CVS, a traditional bricks-and-mortar approach, combined with the Verily-Primasun joint venture executing via digital media and search. Verily is progressing well, with the team expected to implement new programs in CY23 to drive demand.

Once a patient is diagnosed, ResMed is well positioned to capture demand through its market leading platform and product offerings that have proven to drive efficiencies and deliver the best outcomes for patients and providers. The launch of ResMed's AirSense 11 platform is reflective of this, increasing patient engagement levels through record adoption rates on the myAir app at double the rates experienced on the AirSense 10 platform.

The inherent benefits of a connected ecosystem are clear with CEO Farrell noting, *"Published real-world evidence data show that we achieved 87% adherence rates when our full tech stack is used, including both myAir and AirView. Clearly, increasing production of the AirSense 11 platform remains a top priority for ResMed, and we are doing that every quarter."*

SaaS

SaaS has brought an adjacent revenue stream through exposure to areas such as skilled nursing and home hospice. The company is seeing pent-up demand for technology in these out-of-hospital care settings, as providers seek better care outcomes and lower overall costs. During the period, SaaS revenue grew by 9% and is expected to maintain high single-digit growth rates in FY23.

ResMed expanded its SaaS portfolio outside the U.S. and into Germany with the acquisition of MEDIFOX DAN. MEDIFOX provides mission-critical solutions in major care settings for home health, nursing homes and outpatient therapy. The acquisition broadens the SaaS portfolio into new care settings such as outpatient therapy and provides an opportunity to accelerate SaaS innovation and growth in a new market. The company expects to close the acquisition before the end of the calendar year.

ResMed has a market capitalisation of US$33.1b and net debt of US$588m pre the MEDIFOX Dan purchase of US$1.0b. The company declared a quarterly dividend of US44c per share.

▪ TechnologyOne (TNE:ASX)

Global enterprise resource planning (ERP) software provider TechnologyOne reported its full year 2022 result in November with revenue increasing 18% to $369.4m and net profit before tax, coming in at the top end of guidance at $112.3m, up 15%.

The business performed strongly across all six industry verticals with the top three of Local Government, Higher Education and Government, up 20%, 45% and 18% respectively.

TechnologyOne has established itself as the market leader in the Local Government and Higher Education sectors. During the year, the business closed 20 major local government and 10 major Higher Education deals, delivering total contract values of $63.9m and $47m respectively.

SaaS

SaaS annual recurring revenue (ARR), seen as a better indicator of management execution and business quality, delivered growth of 43% to $274.2m. Revenue from SaaS and Continuing Business represents over 97% of total revenue, as non-recurring legacy licence fees are deliberately reduced.

With the end to its on-premise offering nearing, the company has experienced an acceleration of customers transitioning to its Cloud platform. At year end, there were over 800 total customers under the SaaS platform, an increase of 27% on the prior comparable period (pcp).

With on-premise originally scheduled to end in October 2024, the transition is now complete ahead of time. CEO Edward Chung commented “We also exceeded our ambitious annual recurring revenue (ARR) targets and ended legacy licences. I’m proud to announce that we have successfully completed our strategy ahead of schedule. No other ERP company in the world has successfully made the transition to SaaS without impacting its customers and/or its profit growth.”

It is this shift to the cloud that has elevated the business to new horizons. TechnologyOne offers business critical software for universities, local governments and alike. As such, customers don’t shift unless forced too. This is best reflected in the company’s high customer retention rate, that sits at 99% across all markets, while for the year, customer churn was well under one per cent.

Net revenue retention (NRR), a measure of the percentage of recurring revenue retained from existing customers, is seen as a leading industry metric with the world’s best in ERP delivering NRR between 115% and 120%. In FY22, TechnologyOne reported NRR of 116%, and if maintained at these levels will enable the business to double in size every 5 years.

U.K.

Despite entering the U.K. in 2006, TechnologyOne is only starting to reap the years of investment, reporting a profit of $2.4m, an increase of more than 52% on the pcp. ARR saw a similar improvement ending the period at $17.5m, with the acquired higher education operator, Scientia, contributing $7.9m in its first full year of ownership.

The near-term focus is to integrate Scientia onto the Global ERP platform, followed by a complete rewrite and re-engineering of the product onto the SaaS architecture. By moving to SaaS, Scientia's 97 blue-chip university customers will have access to TechnologyOne's entire enterprise suite for higher education.

The first version of Scientia on SaaS was released during the year with 16 customers contracted to transition onto the SaaS platform.

Strategy

TechnologyOne' s vision is to build and deliver quality products and services that transform businesses while reducing friction for customers. This is underpinned by the core belief in "The Power of One", being one vendor with a single vision, written in one code line with level high user experience. TechnologyOne are also responsible for implementing their own software.

The business is in a strong leadership position as the only enterprise vendor to offer a true Global SaaS ERP solution that enables customers to work anywhere on any device with core functionality, security and a consistent interface to ensure customers have a frictionless experience.

Whilst the use case is large, TechnologyOne has chosen to focus on six key market verticals: Local Government; Education; Health and Community Services; Asset and Project Intensive Industries; and Corporates and Financial Services. With only 15% market penetration in any one vertical, the runway for growth is substantial.

R&D

While near-term growth will be driven by the migration to SaaS, segments such as the U.K., Digital Experience Platform (DXP) and Solution as a Service, are poised to contribute meaningfully longer-term. With that in mind, research and development spend remains a high priority, rising 20% to $92.2m, representing 25% of revenue.

To maintain innovation across new and existing products, over $800m has been invested since establishment 35 years ago. During the year, TechnologyOne launched its fourth generation global SaaS ERP, CiA, having re-engineered the entire ERP code base using SaaS technology.

Seen as the next logical evolution of SaaS and a game changer in the ERP industry, Solution as a Service will enable TechnologyOne to deliver the entire outcome faster, incorporating product implementation into one single annual fee for the customer.

TechnologyOne estimates there is $2b in ARR whitespace, where the business can innovate, expand and upsell, to its existing APAC customer base. Continued investment in R&D over the next five years, sees whitespace double to $4b with Solution as a Service generating a further 40% or $1.6b in the markets they serve.

Outlook

While no formal guidance was provided, the company has good momentum heading into financial year 2023. Management confirmed the business is on track to surpass the targeted $500m ARR run rate by 2026 and will continue to double in size every five years. This reflects increasing product depth, diversity of product sets and improving customer success within the larger U.K. market.

TechnologyOne has a market capitalisation of $4.6b and net cash of $175.9m. The company also declared a final dividend of 12.82c per share, Including a special dividend of 2c per share. ***SFM***

MACRO JANUARY 2023

In one of our recent Newsletter articles "Recession, fear, and loathing work", we wrote:

"Our view remains that we will return to a world of low growth and relatively low interest rates. Not dissimilar to pre-pandemic conditions.

A recession will reduce earnings…if high levels of debt is involved the tables turn quickly.

Lower Earnings and fixed debt are the combination that delivers more control to the bank.

…We don't really know the earnings impact of a pending recession, it will differ for each business, but we do know the repercussions of debt."

We have also previously noted that inflation may well "*turn out to be transitory."*

The root cause of inflation is the flow-on effects of extreme government intervention on the supply side (i.e., pandemic border and business closure), combined with emergency monetary policy, fiscal responses, and extraordinary stimulus.

In hindsight, cutting global supply and pumping money direct to bank accounts was always going to cause significant wash through effects. The War on Ukraine compounded the above-mentioned inflationary pressures and introduced a new unknown timeline this time last year.

One year on and much has changed. With supply self-correcting, the removal of emergency monetary policy and the end of direct stimulus, price stability is returning. Today we are seeing this come through in manufacturing, goods, and price data.

Rates have moved higher and faster than expected. Global GDP growth is in decline and recessions of sorts are consensus. It would make some sense that lower growth will at some point drive interest rates lower.

And while our views are largely consistent, unknowns remain. These include:

- Fed policy error, peak rates and duration, credit, and unemployment trajectory
- Earnings impact
- Deleveraging effects
- Geopolitics and War
- Demographics and workers
- Deglobalisation and Energy transition costs
- Technology and productivity

We attempt to provide consideration of each of these unknown elements below.

Fed policy error, peak rates and duration, credit, and unemployment trajectory

We can be confident inflation will not be the lead story of 2023, based on the most recent data points released on 12 January.

- U.S. Core CPI is running at 3.14% on a three-month annualised basis excl. energy and food, the slowest pace in 15 months. This is not "sheep stations" from the Fed's 2% target.
- U.S. Goods deflation is -4.8% on a three-month annualised basis. Used cars are washing out and won't be repeated. This impact should taper.
- U.S. Component services is 1.2% on a three-month annualised basis, this is closely followed by Fed Chair Powell as a proxy for wages.

After six months of price falls, Barron's this week noted, "*everywhere we look, the price of goods is coming down. Steel? Aluminium? Copper? Oil? Corn? They're all down 30%, on average, from the highs reached last year."*

While commodity stocks, the trade of 2022, remained the rock of equity markets into the new year, Barron's concludes that disinflation and even prospects of deflation are going to be the bogeyman in 2023.

M2 has largely been drained from the market, and this will be a driver.

"M2 exploded during the pandemic and correctly predicted that we would get inflation and now if you look at the same chart M2 growth has declined dramatically," said St. Louis Fed President James Bullard. "That bodes well for disinflation, but it's actually turned negative in recent readings.

M2, which measures cash in circulation plus dollars in bank and money-market accounts, swelled by more than 40% during the pandemic as the central bank flooded financial markets with emergency liquidity.

It peaked at $21.7 trillion in March 2022 and has since declined to $21.4 trillion in November. If the downward trend continues, it will deliver the first annual decline since records began in the 1950s."

The combination of inflation, M2, credit availability, and employment data will ultimately determine peak cycle interest rates and their duration. Fed Chair Jerome Powell has been at pains to explain future policy is data dependent. That means academics are looking down at their models and pausing each month to see the incoming data. This is a classic rear vision mirror approach that facilitates reactionary policy, usually after the event.

It is no wonder central banks are prone to error. If we were to lay a bet, it would be here because history is clearly on this side of the wager. To be fair the narrow mandate of the Fed is a difficult path to navigate. Ray Dalio of Bridgewater Associates believes it is a much harder job than investing and Paul Tudor Jones of Tudor Investments equates the difficulty of this undertaking to a perfect lunar landing.

Our concern is that low global growth, which is clearly on our doorstep today, and sharply higher interest rates will cause a period of deleveraging as income growth falls well behind the cost of servicing the record levels of debt.

Using monetary policy to reduce unemployment by 1%-2%, to return inflation to 2%, in a jobs market with underlying structural issues (1.7 openings per worker equating to 10m to 11m job vacancies) requires higher interest rates for longer. Higher rates remove credit availability (a proxy for underlying liquidity), which culminates in deleveraging. If a self-reinforcing deleveraging spiral takes hold, lower rates will follow once again.

It should be remembered that monetary policy alone rarely restarts growth. After the Great Recession of 2007-2008 we had a lost decade in equities. In the 1930's central banks coined the phrase "pushing on a piece of string," referring to the frustrating task of re-establishing growth.

We cannot help thinking that a soft landing, or even the beautiful deleveraging articulated by Ray Dalio, which requires nominal growth above nominal interest rates, are unlikely outcomes.

Earnings Impact

We don't really know the earnings impact of a pending recession.

Bob Prince Co-CIO at Bridgewater Associates has suggested that a 2% increase in unemployment, which he calculates is necessary to achieve the Fed mandated target of 2% inflation, will drive a 20% decline in S&P earnings.

Market forecasts range from Prince's -20% view of earnings all the way to positive outcomes for 2023. Starting the week of 16 January, U.S. Quarterly earnings results and particularly outlooks will provide the first glimpse of the correct answer. ASX companies will report in the second week of February, and while some businesses will surprise to the upside, we expect outlook statements will be cautious.

While all recessions differ, our take is that some businesses are better positioned to navigate a recession than others. A business with unique intellectual property (IP) that drives an 80%-90% recurring revenue with high margins, resulting in sustainable cash flows and a net cash balance sheet, will outperform a price taker who relies on a commodity-like product or commodity price tethered to global demand. The skinnier margins of the latter have less ability to weather an impending storm. Resources companies are flush with cash today, but they require ongoing long-term reinvestment into an uncertain price and demand environment.

As always, our focus will be at the business level. TechnologyOne released its 2022 Annual report on 16 January, a positive document reflecting a business with global momentum.

Deleveraging effects

As far as risks go, central bank policy error may be the number one risk in 2023. With central bank policy error comes the risk of deleveraging. We have included a visual of global debt metrics, depicting public and private debt, and M2 as a proxy for credit availability. We note in the U.S. this rate hike cycle has been the fastest and highest in modern history.

Deleveraging, when it takes hold, can render monetary policy useless for periods, prolong a recession and can result in depression when policy is mishandled. Deleveraging can be both inflationary and deflationary in nature depending on the circumstances of the country.

Domestically funded countries with a reserve status currency, such as the U.S., tend to fair the best.

As we enter 2023, a real risk is central bank policy error. A business with leadership and strong balance sheets may be impacted, but they will prevail. This is a cornerstone of what we consider to be a quality business. Those businesses without differentiation and with a combination of low margins, weak cash flow, and high debt will have a more challenging pathway.

Geopolitics and War

Over the past couple of years, inflation was boosted by a combination of rates that were too low, a post pandemic supply-chain crunch and soaring energy prices due to Russia's invasion of Ukraine. While the temporary or transitory factors are adjusting and abate, as noted above, more structural issues cannot simply be discounted.

War is historically inflationary. As a country moves to a war footing, production lines shift to the war effort, and this is funded by governments, initially through reserves and then with growing debt. Today the Russian Federation (RF) is on a war footing. The rest of the EU is not. For the RF, a loss will have devastating economic repercussions compounded by potentially significant financial reparations funded by its dwindling energy power base. The West and the EU know that a loss of Ukraine is not an option. The U.S. is using debt to fund its participation. See Debt Visuals further below.

Increased spending on defence is also inflationary. This investment does not add to productivity. Australia is buying HIMARS from the U.S. (300km range) rather than investing in industries that create jobs on home soil, while Japan is also intent on rearming its homeland. Japanese efforts are a part of a controversial new National Security Strategy that aims to double defence spending to 2% of gross domestic product (GDP) by 2027. China's response was scathing.

The geopolitics of 2020-2022 has played out with two distinct blocks emerging, autocracy and democracy. As a result, globalisation is thought to be at a crossroads. Supply chain security (duplication) is another form of investment/inflation that does not add productivity unless better technology is deployed. This should not be discounted, and nor should globalisation be considered dead. We discuss this below.

Xi Jinping's all-out war on COVID-19 at the five yearly Communist Party Congress in October, followed by a backflip to embrace an open world in January, illustrates the idiosyncrasies of geopolitics. This is not limited to autocracies. New Zealand's Arden, the then Australian Prime Minister, and State Premiers also embraced zero tolerance before the inevitable failings of that policy became apparent.

Poor policy can result in wasted investment. As noted, deglobalisation is not productive nor is isolationist policy. This can result in wasted decades.

Demographics and workers

Demographics is a long-term driver, and it's easy to wheel out the favourable statistics, but few investors hold assets long enough for the arguments to be relevant, or the investment outcomes proven.

Birth rates are falling in the U.S. After the highs of the baby boom in the mid-20th century and the lows of the baby bust in the 1970s, birth rates were relatively stable for nearly 50 years. But during the Great Recession, from 2007-2009, birth rates declined sharply, and they've kept falling. In 2007, average birth rates were right around two children per woman. By 2021, levels had dropped more than 20%, close to the lowest level in a century.

This undoubtedly has long-term impacts that need to be thought through carefully at a macro, national (education and immigration), sector, and business level. Today the labour market is in focus.

We note that Fed Chair Powell has consistently called out a structural issue in the labour market. Today it stands at 1.7 job openings per available worker. Along with credit (liquidity), this is an area to pay close attention to as it's a key source of sticky or less transient inflation. Some investors have called into question the relevance of the 2% inflation target for this reason.

Our view is that wage inflation will ease as prospects of a global recession rebalance the power dynamics between industry and labour.

Deglobalisation and Energy transition costs

The new geopolitics is splitting the world into two blocs, with the potential of reversing some or all the globalisation of the past three decades. This argument means more investment is needed to re-create production lines and supply chains that bypass China, Russia, and other autocratic states, with efficiency likely to fall, as security issues rather than costs and margin dictate location.

Subsidies for microchip factories in the U.S. and Europe are the obvious expense to society, but barring some new detente, similar subsidies are likely to spread to other high-technology sectors. Doubling up production and supply chains directly reduces productivity, meaning more inflation for the same amount of economic growth.

Olivier Blanchard, a former chief economist of the International Monetary Fund and now at the Peterson Institute for International Economics, stated,

"Central banks are totally committed to getting inflation under control. The issue is whether they go back to 2% (inflation target) or do they aim for something slightly higher. I'm less convinced that central banks will be willing to lift interest rates enough to get inflation back to super low levels if the trends outlined above continue."

Mr. Blanchard says *"a rough guideline is to assume that every additional 1% of GDP that goes into investment means the real, after-inflation interest rate needs to be 1 percentage point higher.*

Treat military spending as akin to investment, albeit with no return, and it could easily add 1% of GDP on its own, or more than double that to return to 1980s Cold War levels.

A serious effort to stick to the Paris goals on climate change could add another 1% to 2% of GDP, and that's before spending to remove China from supply chains."

Swathes of global trade is controlled by "for-profit" public corporations subject to analyst and shareholder scrutiny. We don't imagine many management teams will front boards with capital expenditure programs duplicating supply chains with no benefits attached.

"What we are witnessing is not a collapse of globalization. It is more a reshaping of it," says Dani Rodrik, a Harvard University professor, whose 1997 book, "Has Globalization Gone Too Far?", was among the first to warn of the risk of popular backlash against globalization.

World trade as a share of overall economic activity peaked at 61% in 2008, at the apex of China's power, when a global financial crisis that started in the U.S. caused a worldwide recession. Trade has since receded to 57% of economic activity, according to World Bank data, still far greater than estimates of 31% on average during the 1970s, 36% during the 1980s or 40% in the 1990s.

Mr. Rodrik, for one, doesn't expect to see global trade slump to anywhere near the approximately 10% of economic output that occurred in the 1930s. Multinational companies have invested too much in global supply chains to allow them to disappear.

It should be remembered that supply chain is not a set and forget exercise. It requires continual investment for growth and efficiencies to be achieved. Today, the best solution may be in locations other than China.

"China's technical capabilities are high, but labour costs have risen, and it has become difficult to secure workers," a spokeswoman from Uniqlo a fast-retailing company says. *"In Vietnam and Bangladesh, it's easy to recruit workers."*

"'Vietnamese leaders aim to be neutral in global politics and Vietnam is not interested in picking fights. Their focus is on growth, prosperity and inviting foreign direct investment. What you have in Vietnam is everything we wanted in China, minus ambitions for world dominance, says Mr. Lewis Houston-based ECV Holdings, his company seeks to build a power plant to fuel industrial parks around Ho Chi Minh City. The plant will be supplied largely by liquid natural gas imports from the U.S."

Technology and productivity

Technology, while clearly out of favour today both politically and in the investor's eye, has a huge role to play in the advancement of society and productivity. Again, these benefits should not be discounted.

Technology is deflationary in the sense that it can increase efficiency and productivity, leading to lower prices for goods and services. This is often referred to as the "falling price" of technology.

Figure 2: The target chamber of LLNL's National Ignition Facility

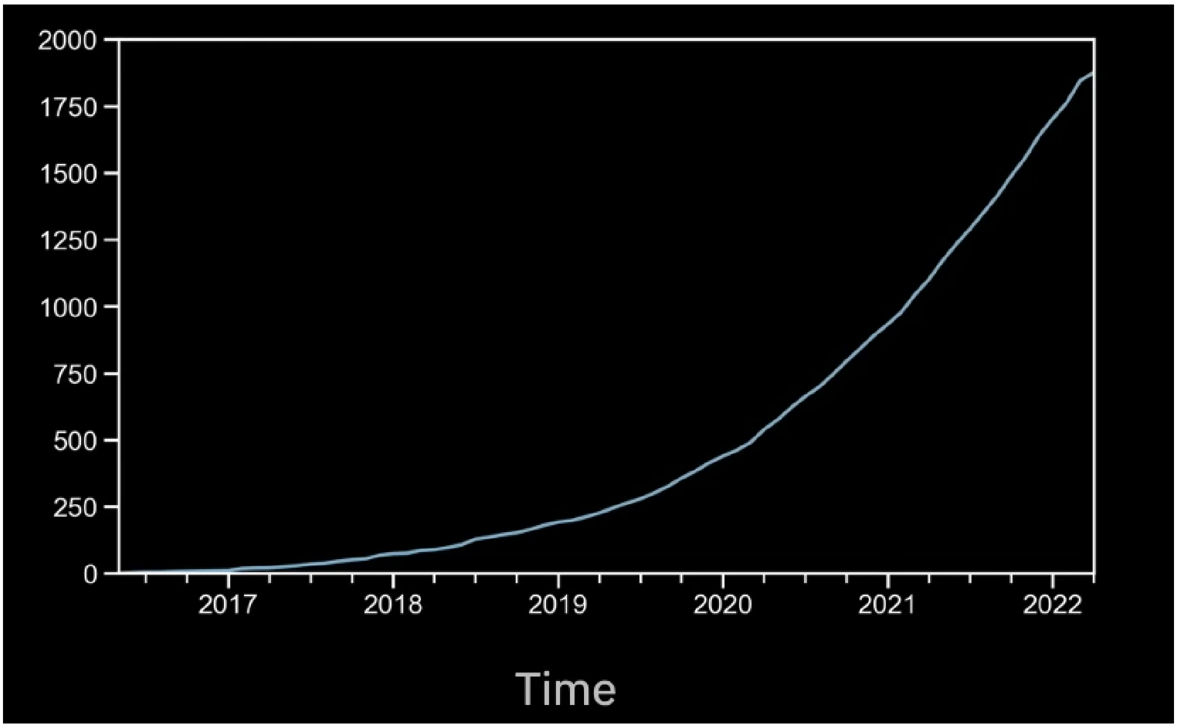
Source: Lawrence Livermore National Laboratory

Technology and productivity

Counter arguments that the highest productivity gains from technology have already been extracted don't hold water. In fact, the answers cannot be known.

Quantum computing, more than 50 years in the making, and recent advances in Nuclear Fusion (see Figure 2) are examples of technologies with game-changing potential.

Figure 3: Cumulative Research Papers Using IBM Quantum and Qiskit



Source: IBM

On 5 December, a team at Lawrence Livermore National Laboratory (LLNL's) National Ignition Facility (NIF) conducted the first controlled fusion experiment meaning it produced more energy from fusion than the laser energy used to drive it.

"The pursuit of fusion ignition in the laboratory is one of the most significant scientific challenges ever tackled by humanity, and achieving it is a triumph of science, engineering, and most of all, people," LLNL Director Dr. Kim Budil said.

"This astonishing scientific advance puts us on the precipice of a future no longer reliant on fossil fuels but instead powered by new clean fusion energy," U.S. Senate Majority Leader Charles Schumer (NY) said.

While largely a political statement, fusion will have a role to play in the energy transition of the decades ahead.

The current obstacles this technology faces, in terms of laser efficiency and magnate technology (the preferred methodology to contain white hot magma required for "ignition"), may well be solved by the quantum chips being built today by IBM, Google, Diraq, and Prof. Michelle Simmon's Silicon Quantum Computing, the latter two both based in Australia.

Compounding quality

We earlier referenced one of our recent articles, "Recession, fear and loathing work." In it, we explored a central theme that the impact of a recession in lowering earnings will not be a uniform event. Company fundamentals will play a significant role in navigating slowing demand and tighter credit.

There are considerable unknowns as 2023 unfolds, and we have highlighted the key macro elements that will shape the investment landscape ahead.

We are seeking to capture as much earnings per share growth as possible over the long term, and our portfolio is well positioned to deliver against the headwinds we face.

Compounding is a key driver of our long-term success. To do this we focus on what we regard as quality attributes, outlined in the following article.

Our strategy is consistent and considered, and it has delivered a long-term track record of outperformance. ***SFM***

Table 12: Portfolio Metrics

	Fund
Number of holdings	33
% Porfolio Profitable	95.29%
% Portfolio with Net Cash	49.51%
% Portfolio with Net Debt/EBITDA < 1x	77.44%
% Portfolio paying a dividend/buyback	85.97%

Source: SFML Research

Table 13: Share price vs Earnings and Dividend changes*

	EBITDA	**Dividends per share**	**Share price (CY22)**
Increased	80.57%	63.52%	18.89%
Maintained	0.00%	13.31%	0.00%
Decreased	19.43%	9.84%	81.11%
Total	**100.00%**	**86.67%**	**100.00%**

Source: SFML Research

**Annual EBITDA, Dividend and share price changes as a percentage of portfolio. Half year 2022 figures used for investments with a December financial year end.*

% portfolio not paying a dividend = 12%

A QUALITY BUSINESS

*"I think unfortunately in this gold rush mentality that we have been in for the last five years there has been not enough focus on **business model quality**. So, when push comes to shove, there actually aren't that many great businesses that can go public. Because I think if you're going to thrive as a public company, it presupposes that you make more money than you spend.*

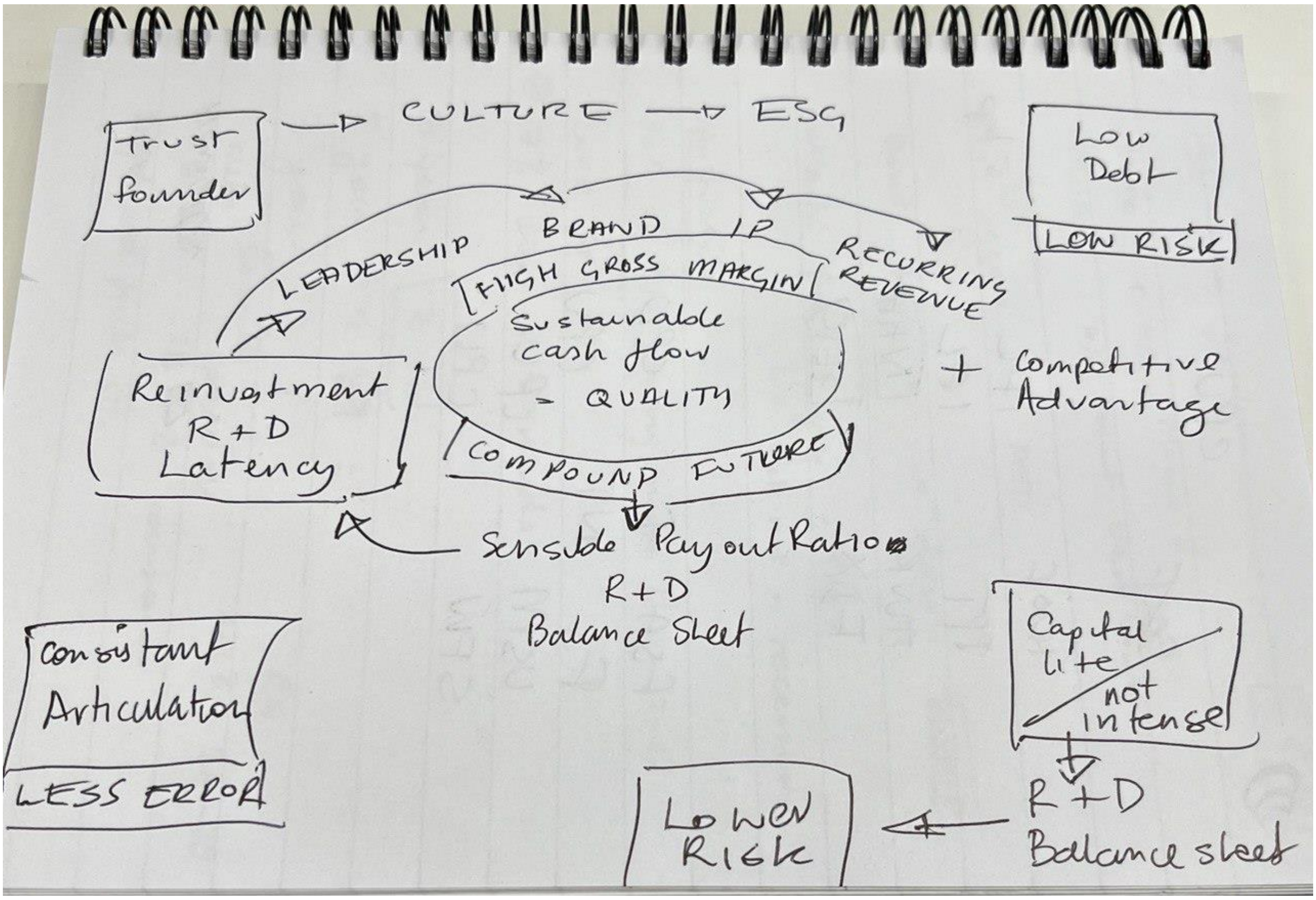
And it's weird but I think people in Silicon Valley are almost like "Why is that important?". They don't appreciate the fact that you have to be self-sufficient and self-sustaining."

Venture capitalist Chamath Palihapitiya is an outspoken voice in Silicon Valley. The voices worth listening to seem to cut to the chase with unassuming language. Aligning quality to sustainable profits seems so simple and so logical.

Palihapitiya argues that selling a story to raise capital, rounds A through to E, is in itself unlikely to be sustainable simply because cycles happen.

The concept of business quality is multi-faceted. We have long used a mud map that revolves around cash flow sustainability. It requires People, Business, Balance Sheet, and Capital Management as outlined below. Refer to our roadmap in Figure 4 for the qualitative and quantitative attributes we seek.

Figure 4: Qualitative and Quantitative Attributes Roadmap



Source: SFML Research

People

- Honesty. This drives good governance, and importantly business sustainability
- A founder with ownership and ongoing at-risk equity drives TRUE alignment
- A culture where small problems are owned and solved by process – large are elevated fast
- Passion is a thirst for knowledge and leadership in this space – it's a 24/7 endeavor that makes investing so powerful
- Latency. Consistent long-term investment that delivers business step change

Business

- Focus
- Leadership, brand, intellectual property (IP), and recurring revenue translate to cash flow sustainability
    - Leadership results in higher margins
    - Recurring revenue. We refrain from putting multiples on contracts, one-off sales, and commodities
    - IP and research and development (R&D) fuel latency (future profits)
- Compounding. Combining cash flow sustainability and competitive advantage
- Scale or scalability
- Technology that is developed out, single code, cloud based
    - Platform
    - Ecosystem
- Capital intensity is light
    - Enables higher levels of R&D
    - Lower balance sheet risk

Balance Sheet

- Net cash is preferred
- Optionality is valuable
- Business equivalent of a "Get out of jail card"

Capital management

- Sustainable cash flow conversion
- Free cash flow is king
- Sensible payout ratio that enables reinvestment at higher incremental return on capital
- R&D expensed, measured as % revenue, maintains leadership and IP. Drives latency

Long-term

- Real EPS growth is only generated over the long-term
- Quick wins and luck are often not repeatable
- The power of investing is compound returns – this is a long-term phenomenon

Risk

- All the above
- Structural decline
- Disruption by competitor

Why we seek quality

- All companies change over time and quality is about a journey, a direction of travel.
- We rarely find responsible stewards directing companies with overstretched balance sheets or with deteriorating franchises for other than a brief period or extenuating circumstances
- We consider a sizeable proportion of our investment universe as totally uninvestable
- We believe by investing in quality companies we can control risk in businesses which we are not running ourselves and so preserve capital for clients

Other factors

Leadership

Businesses with the best quality items become industry leaders and set the standard for others in the market to follow. If a business can continue to create high-quality products and upgrade and adapt the products to meet customer demand, that business can lead the way for others in the industry.

Training

If a business wants to improve quality, it should start with offering its employees a thorough training program. Training teaches employees to perform tasks in precise and efficient ways to create a high-quality product. In training, managers can discuss their own definitions of quality and ways of achieving it. For employees, training can demonstrate new techniques and strategies so that the processes and procedures of the business remain up to date.

The best way to train is to provide autonomy through operating experience, with guidelines. Those who seek to excel will rise, after making mistakes on the way, through persistence and dedication.

Valuation

Valuation comes last but remains an integral part of our process. Our financial modeling process aims to create a granular understanding of the numbers behind the income statement balance sheet and all-important cash flow statement of a business.

We are calculating over 50 financial ratios in the process. Importantly we are looking at the trends over time, remembering quality is about a journey, a direction of travel.

EBITDA

The industry valuation benchmark is earnings before interest, taxes, depreciation, and amortisation (EBITDA). EBITDA multiples for business valuations are exclusively used by Private Equity for M&A purposes. Over 90% of our portfolio generates consistent or growing EBITDA so this is a relevant measurement.

We use a more conservative fully depreciated financial metric.

Buyout – owning the business

Buyout = EBITA / Enterprise value – cash + debt

The buyout depicts an owner's mentality, referring to 100% of a business's earnings.

This whole of business valuation or earnings yield (a reverse P/E) can be compared to a (long-term) risk-free rate.

By removing depreciation (a non-cash cost in an income statement that lowers profits but does not impact cash flow), we are taking a more conservative approach. We also consider debt, as in our view a debt-fuelled business is less sustainable, higher risk and of less interest to us. The P/E metric is oblivious to debt levels.

We are trying to combine three things here:

1. Risk out – take as much risk off the table as possible, through our process, before we invest
2. Understand what long-term earnings reward is on offer for taking a long-term equity risk
3. We are trying to find earnings that can compound over time

Revenue

In a software as a service (SaaS) business the EBITDA being generated may be masked (loss making unit) or non-existent. This is not always a good proxy of future earnings.

A fast-growing SaaS business requires a significant upfront investment, which may be expensed, or part expensed before EBITDA. The recurring revenue model of a SaaS business, assuming churn is low and stable, should drive growing bottom-line profits as the business scales and matures. Attractive margins will expand as it spends less.

Measuring revenue makes sense for a SaaS valuation, but only if it has ongoing high growth. If the SaaS business does not grow then the revenue will not be there to support the forecast profit in the future, which is what the valuation is based on.

Multiple

The multiple is one of the most important pieces of the equation and is affected by dozens of factors related to the business. Those factors span a wide variety of financial and operational aspects, but it boils down to the sustainability, scalability, and transferability of the business. No simple answer exists.

A multiple is susceptible to being too large and shrinking too much. The latency in a business makes it difficult for outsiders to be precisely accurate at a point in time.

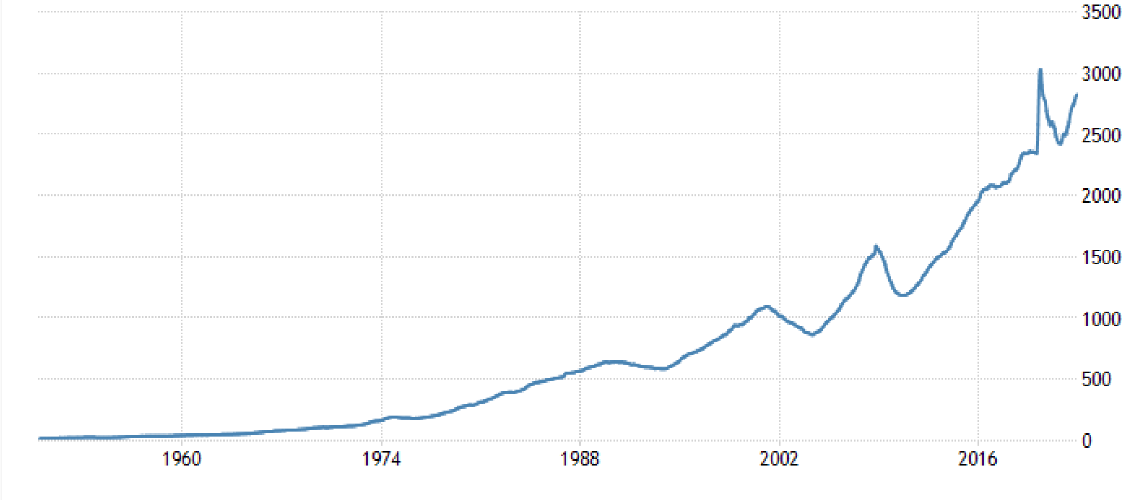
The rise of the intangible asset

Warehouses and factories are increasingly replaced by digital solutions as companies rapidly advance in technological capability. Innovation ideas (IP) and R&D investment is a growing source of income for companies worldwide. The race for ideas and the pursuit of knowledge for creativity emphasise the increasing role of intangible assets and the need to quantify them.

Some intangible assets are protected legally where they meet the criteria for intellectual property protection and rights. Intellectual property rights are often granted for innovative products and processes (through patents); cultural, literary, or data software works (copyrights); designs, trademarks, microchips, and trade secrets. ***SFM***

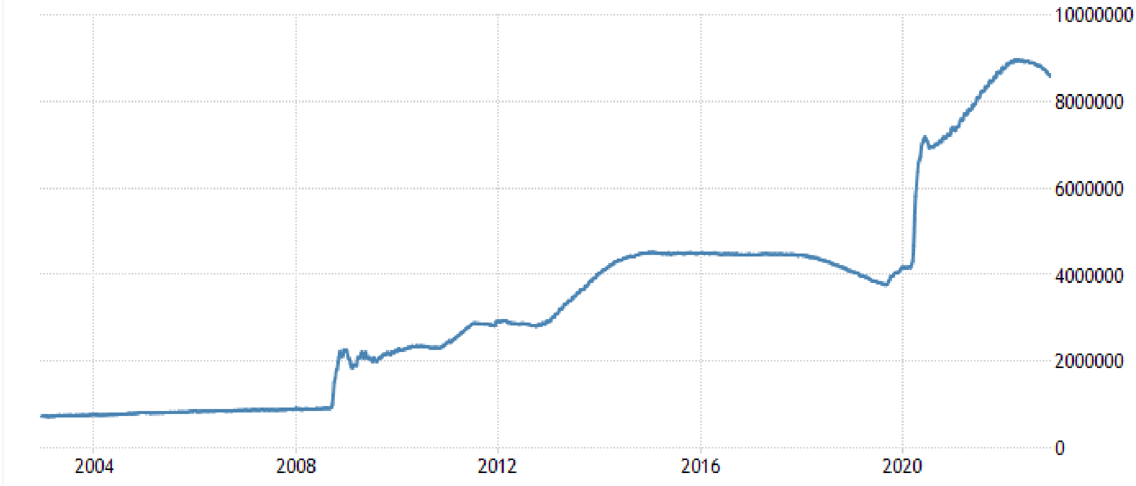
DEBT VISUALS OF SOFT LANDINGS: U.S., AUSTRALIA, EU

Chart 1: Loans to private sector in the USA increased to US$2,829b in December 2022



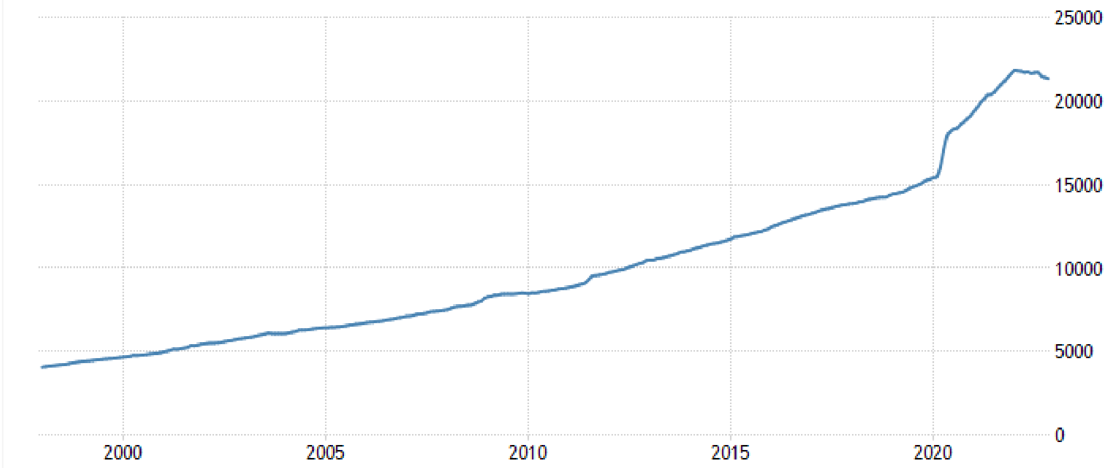
Source: Federal Reserve

Chart 2: Central Bank balance sheet in the U.S. decreased to US$8,585b in November 2022



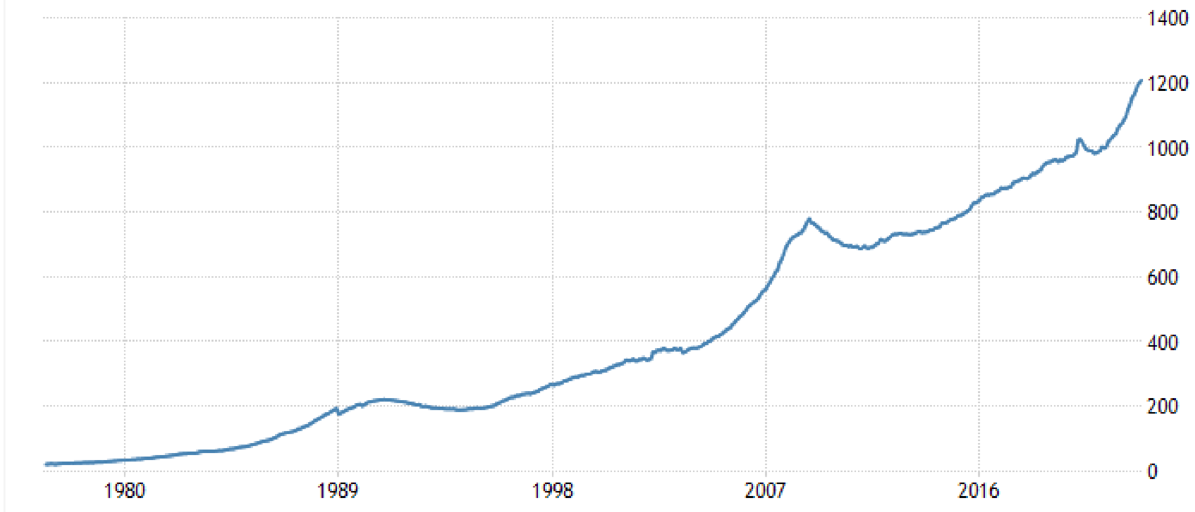
Source: Federal Reserve

Chart 3: Money Supply M2 in the U.S. decreased to US$21,352b in November 2022



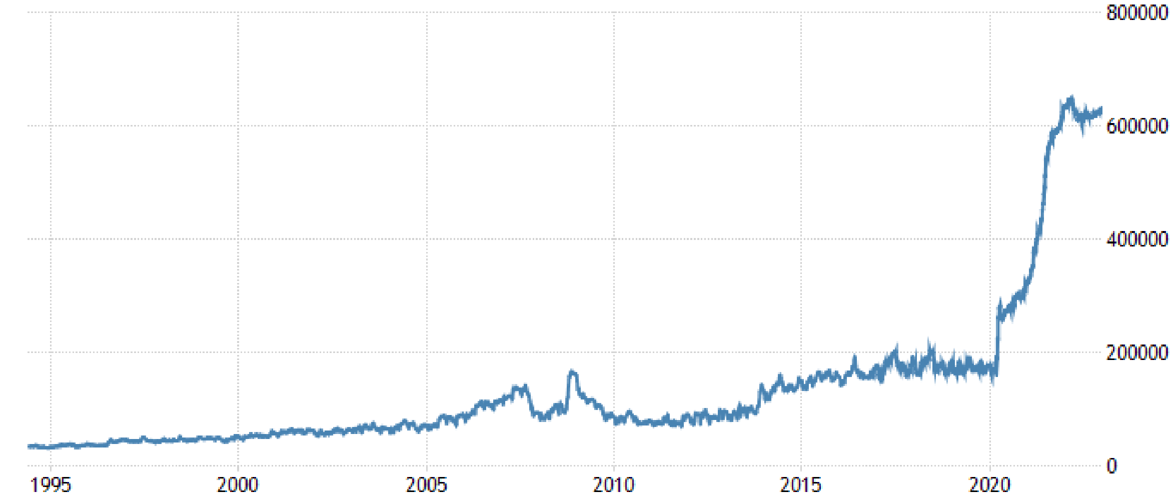
Source: Federal Reserve

Chart 4: Loans to private sector in Australia increased to A$1,208b in November



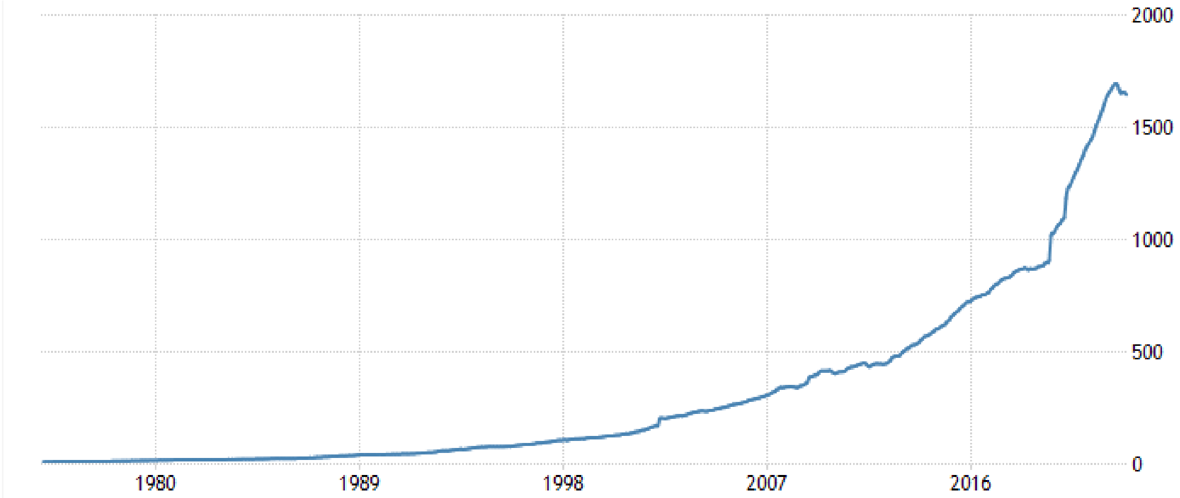
Source: Reserve Bank of Australia

Chart 5: Central Bank balance sheet in Australia decreased to A$623b in January 2022



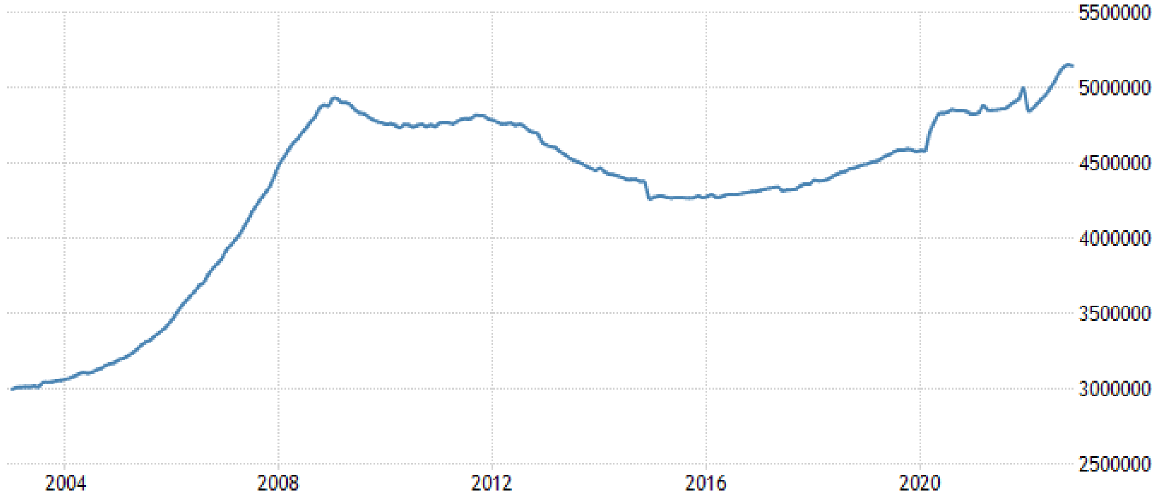
Source: Reserve Bank of Australia

Chart 6: Money Supply M1 in Australia decreased to A$1,646b in November 2022



Source: Reserve Bank of Australia

Chart 7: Loans to private sector in the Euro Area decreased to €5,146b in November 2022

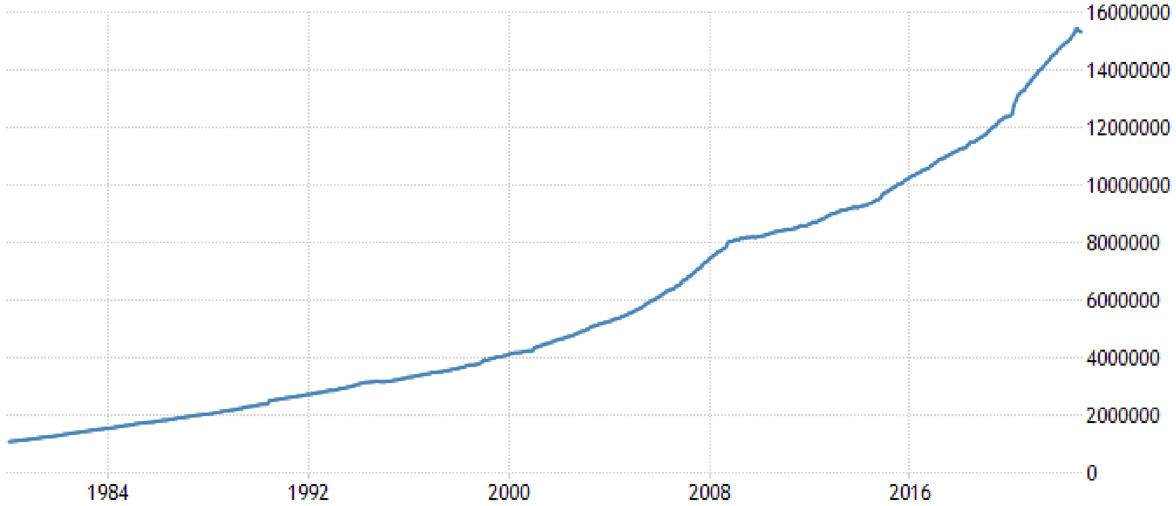


Source: European Central Bank

Chart 8: Central Bank balance sheet in the Euro Area increased to €7,968b in January 2022

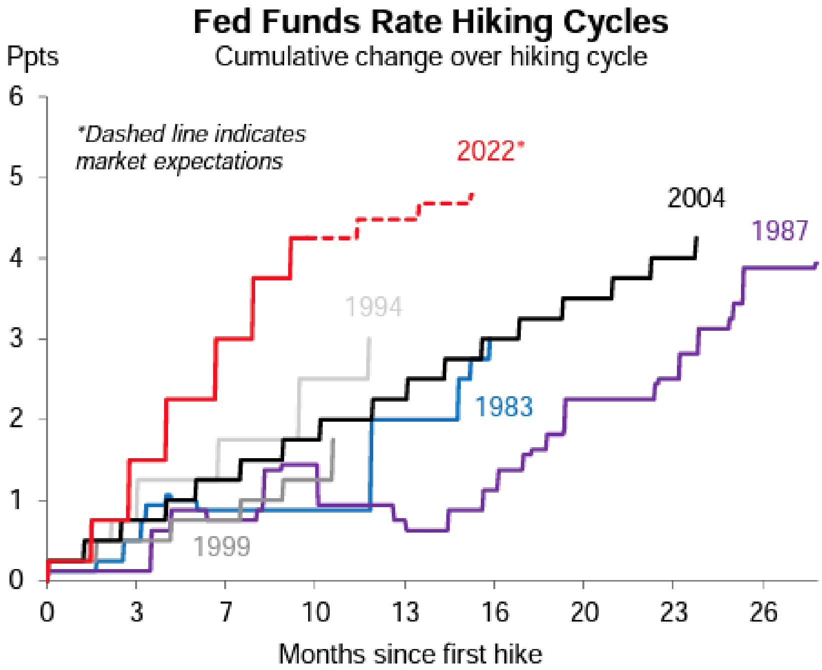
Source: European Central Bank

Chart 9: Money Supply M2 in the Euro Area decreased to €15,332b in November 2022



Source: European Central Bank

Chart 10: Federal Reserve has delivered the fastest rate hiking cycle in modern history



Source: Macquarie Macro Strategy

TURNING POINT

"While most decisions are trivial, they do accumulate, and like an avalanche, they occasionally morph into tectonic shifts that substantively alters history." – Viktor Shvets

Viktor Shvets

In his book, *The Great Rupture: Three Empires, Four Turning Points, and the Future of Humanity*, author Viktor Shvets explores how the past shapes the future and the key turning points that changed the course of history.

"In a matter of several decades between 1433 and 1485, China, Russia and the Ottomans independently decided that interactions with foreigners, civil and property rights, education, and freedom to exchange views were all contrary to the views of the state and societal cohesion."

Such decisions, *"...largely preordained their decline and collapse. The embrace of freedom, choice, civil rights and innovation had the opposite effect on the West."*

It led Shvets to consider and conclude, *"What kind of environment makes individuals innovative, what kind of stimuli, incentives and institutions create an economy that encourages technological creativity? Why were and are there societies that have more creative individuals in them than others? This key question goes to the heart of the historical civilization and divergence between China, Russia, and the Ottomans on the one hand and the Western world on the other. The unshackling of the human mind and the consequent burning desire to explore and innovate that engulfed the West in the fifteenth century was the final stepping-stone on the West's journey toward global dominance."*

Figure 5 and Figure 6 illustrate the period between the 1400's and the modern day. Specifically, it highlights the growing gap in the share of the global economy and Gross Domestic Product (GDP) per capita between key nations comprising the West and East civilisations up until the 20th century.

Note China's declining share of the global economy over the ensuing decades, only reversing in 1990. In contrast, the West and its offshoots have lifted their share from 17% to 38% over the same interval, as Figure 5 illustrates.

Where this matters most is the level of GDP per capita between the key nations. The West led by the U.S., Britain and Japan have enjoyed rising consumer propensity, while China and Russia remain at underwhelming levels as Figure 6 sets out.

Figure 5: Share of Global Economy - Key Nations 1400-2015 (GK$1990)

Year	**1400**	**1500**	**1700**	**1900**	**1950**	**1970**	**1990**	**2000**	**2015**
China	30.0%	24.9%	22.3%	11.1%	4.6%	4.6%	7.8%	11.8%	17.1%
India	25.0%	24.4%	24.5%	8.6%	4.2%	3.4%	4.3%	5.2%	9.0%
China + India	**55.0%**	**49.3%**	**46.8%**	**19.7%**	**8.8%**	**8.0%**	**11.9%**	**17.0%**	**26.1%**
Britain	0.9%	1.1%	2.1%	9.4%	6.5%	4.4%	3.5%	3.3%	2.6%
U.S.	0.0%	0.0%	0.2%	15.8%	27.3%	22.4%	21.4%	21.9%	17.5%
Germany	3.0%	3.3%	3.7%	8.2%	5.0%	6.1%	4.7%	4.2%	4.0%
Other	13.1%	13.8%	15.2%	18.3%	18.0%	18.9%	17.3%	16.2%	14.0%
West & Offshoots	**17.0%**	**18.2%**	**22.0%**	**51.8%**	**56.8%**	**51.7%**	**46.8%**	**45.6%**	**38.1%**
Japan	3.0%	3.1%	4.1%	2.6%	3.0%	7.4%	8.6%	7.2%	4.8%
West & Offshoots + Japan	**20.0%**	**21.3%**	**26.2%**	**54.4%**	**59.8%**	**59.1%**	**55.4%**	**52.8%**	**42.9%**

Source: Maddison database, 2018

Figure 6: GDP Per Capita - Key Nations 1200-2015

GDP Per Capita (GK$1990)

	India	Egypt	China	Russia	Turkey	Japan	Britain	US
1200			870			560	700	
1400			1032			552	1,090	
1500			858			550	1,114	
1600	682	475	865	552		605	1,123	
1700	622	500	840	610	600	600	1,630	527
1800	569	600	614	688	643	703	2,080	1,296
1850	556		600			780	2,997	1,849
1900	600	705	545	1,237	900	1,180	4,492	4,091
1950	619	910	568	2,841	1,623	1,850	5,441	6,213
1970	868	1,254	776	5,575	3,078	9,714	10,767	15,030
1990	1,309	2,523	1,448	7,779	5,399	18,789	16,430	23,201
2000	1,897	3,453	2,635	5,261	6,502	20,497	20,279	28,702
2015	4,279	4,669	7,582	9,238	9,510	22,791	24,321	32,900

Index (Great Britain = 100%)

	India	Egypt	China	Russia	Turkey	Japan	US
1200			124%			80%	
1400			95%			51%	
1500			77%			49%	
1600	61%	42%	77%	49%		54%	
1700	38%	31%	52%	37%	37%	37%	32%
1800	27%	29%	30%	33%	31%	34%	62%
1850	19%		20%			26%	62%
1900	13%	16%	12%	28%	20%	26%	91%
1950	11%	17%	10%	52%	30%	34%	114%
1970	8%	12%	7%	52%	29%	90%	140%
1990	8%	15%	9%	47%	33%	114%	141%
2000	9%	17%	13%	26%	32%	101%	142%
2015	18%	19%	31%	38%	39%	94%	135%

Source: Stephen Broadberry; Guan Hanhui, David Li, "China, Europe and the Great Divergence," 2017; Sevket Pamuk,"Estimating Economic Growth Rates in the Middle East," 2006; Maddison database 2018; TED database, 2018

Despite the East's positive trend of improvement, is history repeating itself?

"*There are times when a single decision has the ability to alter the course of history*."

The invasion of Ukraine by Russia and China's appointment of Xi Jinping for an unprecedented third term as President, point to crucial inflection points.

China's improving economic flight path over the past two decades is now under serious risk of stalling. Under normal protocol, President Xi would have stepped down after ten years as leader. However, having now abolished term limits and appointed key allies, he could potentially stay in power for life.

Kenneth Rogoff

Kenneth Rogoff from the Australian Financial Review wrote on this very point in an article titled "China's diminishing returns under Xi" on 1 November 2022.

"The Communist Party of China's 20th National Congress, which gave President Xi Jinping an unprecedented third term as general secretary also featured a leadership shake-up that replaced market-oriented technocrats with Xi loyalists, raising questions about China's plans for its faltering economy.

Excessive state control, after all, is a tried-and-true recipe for becoming mired in the middle-income trap that Chinese leaders have long vowed to avoid.

The breakneck pace of state-guided investment in real estate and infrastructure – China's go-to stimulus strategy – has generated diminishing returns, with slowing economic growth implying an inevitable fall in housing and office prices. This is especially true in the smaller, poorer, and less-developed cities that collectively account for more than 60 per cent of China's GDP.

Housing prices in so-called third-and-fourth-tier Chinese cities have fallen by roughly 15-20 per cent over the past two years. Some form of sustained financial stasis will most likely ensue. But even if it does not look quite like a Western-style banking crisis, the concomitant fall in lending will still inhibit growth.

Real estate constitutes such a large share of China's economy that a sustained slowdown could cause years-long stagnation akin to Japan's lost decades since 1990. Counting direct and indirect demand, real estate accounts for roughly 23 per cent of production and 26 per cent of final demand (the latter figure includes net imported content).

Before the last couple of years, the spectacular rise in Chinese housing prices was underpinned by ultra-fast growth in incomes, with expectations of future growth pushing prices ever higher. If income growth stalls, China's residential and commercial real-estate prices could collapse like a house of cards, taking down the banks and the local governments that have been furiously lending to the sector.

Many – particularly in the media – seem to believe that China's recent real-estate meltdown, including the spectacular default of property developer Evergrande, can be attributed to government efforts to crack down on excessive credit.

But it would be more accurate to say that, by and large, government policies have propped up housing prices – for example, by limiting citizens' ability to invest in other assets. Real-estate prices are falling simply because decades of overbuilding have left supply outstripping demand in many areas.

China's economic growth has been slowing for years, but recently the decline has accelerated. Given the external and internal headwinds China is facing, the International Monetary Fund's forecast that the economy would grow by 4.4 per cent in 2023, after 3.2 per cent expected growth this year, seems optimistic.

The government's strategy of cracking down on tech companies and education entrepreneurs while supporting state-sponsored investment projects looks more like an instrument of control than a sensible economic strategy that could move China closer to becoming a high-income economy.

Moreover, the fact that China's growth strategy is proving less effective means that it needs to invest greater amounts to achieve the same rate of GDP growth per person. Decreasing returns on real estate and infrastructure investments are among the main drivers of the collapse in Chinese productivity, especially since 2014.

China's problems recall the Soviet Union's diminishing returns on its investments in steel plants and railroads, and Japan's construction of "bridges to nowhere" in the late 1980s and 1990s. After decades of building real estate at breakneck speed, soaking up raw materials from all over the world, China now finds itself with a housing and commercial real estate stock similar to those of much wealthier countries such as Germany and France.

Alas, gone are the days when China could rationalise soaring housing prices and endless new construction by pointing to rising incomes. True, China can avoid some of the protracted problems that defaults in the West often trigger (and which can take years to resolve), owing to the government's tight control over the legal system.

The government controls key information and seems to treat data on home and apartment vacancy rates – which could shed light on the extent of overbuilding – as a state secret. But the scale of the problem is such that not even the Chinese government can hide its effects, even though it will undoubtedly try.

China and the global economy appear to be at a turning point. Heightened political tensions, together with deglobalisation, look set to slow productivity and raise long-run inflation worldwide. Forward-looking *indicators of long-term real interest rates have shot up, while the stunning rise of the US dollar continues to expose financial fragilities.*

Given that Europe is headed for a deep recession and that the United States seems to be headed for a slump as well, China cannot count on exporting its way out of its real-estate-driven slowdown.

It is very much in the world's interest that China finds a solution to its real-estate sector's overbuilding problems and avoids prolonged economic instability.

More than two years ago, at a time when the overwhelming consensus in academic and policy circles was that China could easily overcome the adverse legacy of overbuilding, I suggested that the country had likely hit "peak housing". Today, with the Chinese government even less inclined to adopt market-oriented reforms, a smooth landing seems less likely than ever."

While governments can fiddle with economic activity to generate growth, it is powerless when it comes to dealing with the long-term social repercussions of bad demographics and the brain drain that befall societies imposing restrictions on human endeavour.

Shvets' personal background straddles both the East and West, first born and raised in Russia, followed by long working stints in China and the U.S. His perspective on the global economy and politics is grounded in first hand local knowledge. On Russia he notes, "*Since the 1400s, Russia has been consistently one or two centuries behind the West. By the time Russia's social and institutional settings began to change in the 1860s-80s, the West was ready moving from the First to the Second Industrial Revolution…By the time the Soviet Union caught up with the Second Industrial Revolution (early to mid 1970's, the West already started to move into the Information Age. As a result, Russia, which in the late 1600s enjoyed the standard of living of 50 percent of Britain and was not far away from the US, had dropped by 1900 to around 25 to 30 percent of the US GDP per capital, and indeed that pretty much where Russia remains to this day. It is essentially a petro and nuclear state with limited innovation or new industries."*

Peter Zeihan

Peter Zeihan, geopolitical strategist and author covered many macroeconomic trends during his appearance at the UBS Conference in Sydney in November. One that caught our eye was focused on worker demographics, in part because you can't fudge it or change the outcome other than through migration.

Chart 11 gives a snapshot of the average working cohorts in specific countries. Here Zeihan defines workers into five buckets: Silent, Boomers, Gen X, Millennials, and the Zoomers.

The U.S. has long been dominated by the Boomers. Reaching 65 this year, they are on average the oldest and largest working generation and retiring en-masse. In their replacement are the youngest and smallest generation, the Zoomers. The outcome of this mismatch is a calculated 400,000 worker shortfall this year alone.

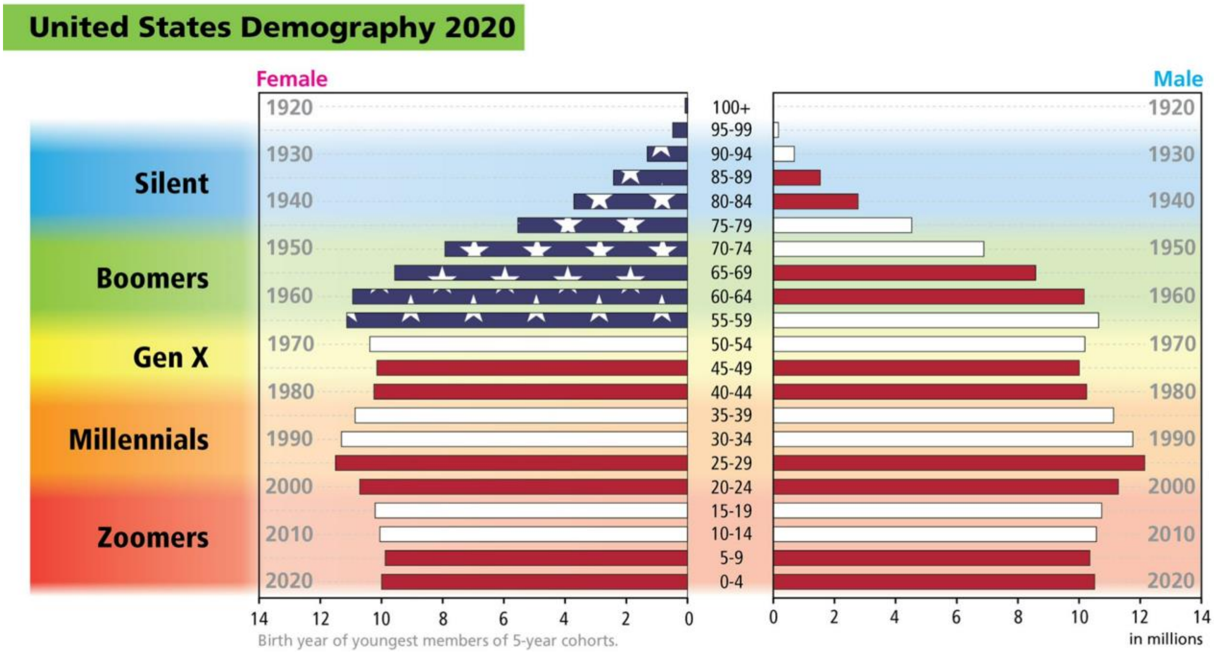
Demographics don't lie. Therein providing a clear outlook for the next 20 years. On this basis the profile of the working population isn't set to improve for at least the next 12 years, peaking in 2034, with a shortfall of one million workers annually.

Everywhere else the situation is so much worse. While the U.S. benefited from the baby Boomers who had children (the Millennials), the same cannot be said for Germany or Japan, reflected in Chart 12 and Chart 13. Zeihan pointed out the charts for these countries represent terminal demographic structures. For Germany specifically, it signifies the last decade of economic expansion and its industrial model as "*they are literally running out of workers*".

And then there is China, highlighted in Chart 14 (old data) and Chart 15 (new data).

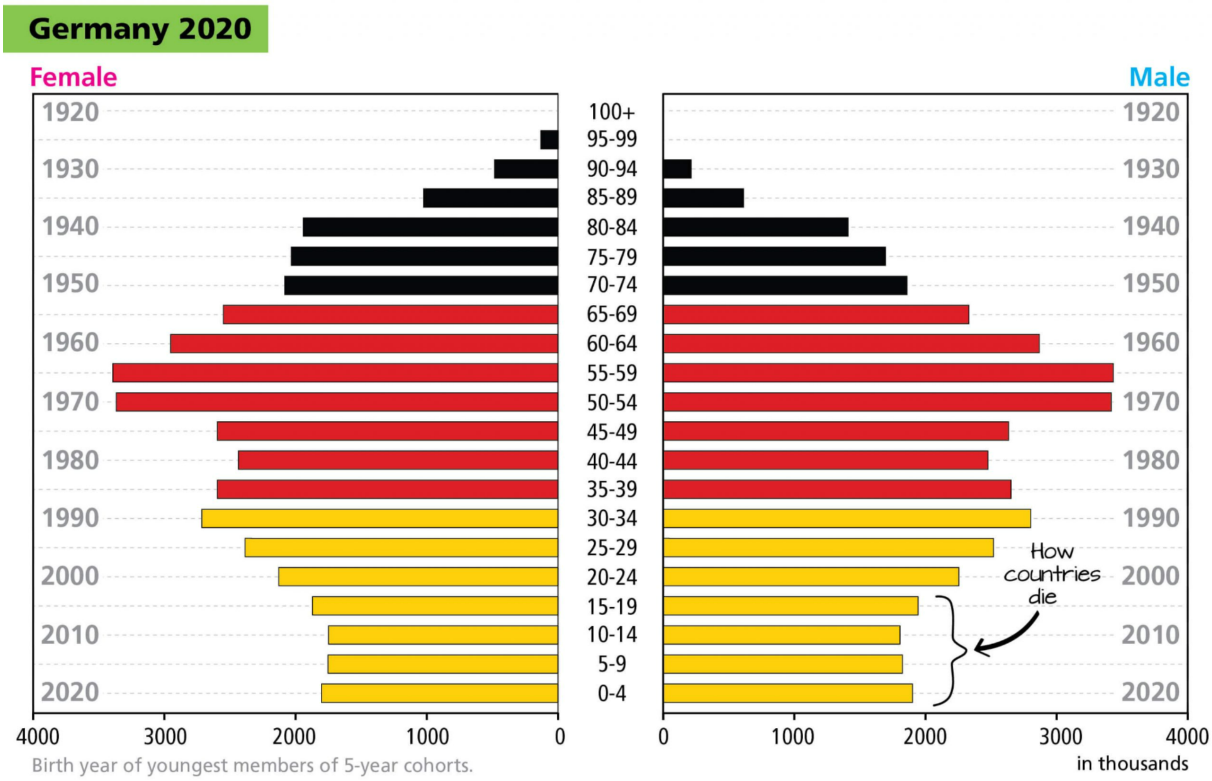
Zeihan reinforces this point, noting China "*is already the most distorted and fastest ageing working padre in human history. And we now know that data is wrong. Over the last two years the Chinese have been updating their worker demographic information and they have come to the public, with a grudging conclusion that they have over counted their population by in excess of 100 million people. All of whom would have been born since the one child policy was adopted 40 years ago, which is a fancy way of saying that the missing millions* *are all aged under 40. Suggesting that these yellow bars don't even exist. That doesn't simply make China the fastest ageing society in human history, they were that already. That means this is a country in the early stages of demographic disillusion. And there is not an economic model or theory that humans have dreamt up yet that will support what will be in just eight years. This is the final decade of the Peoples Republic of China (PRC) and their manufacturing will go before the country does."*

Chart 11: The United States of America Working Population Chart 2020



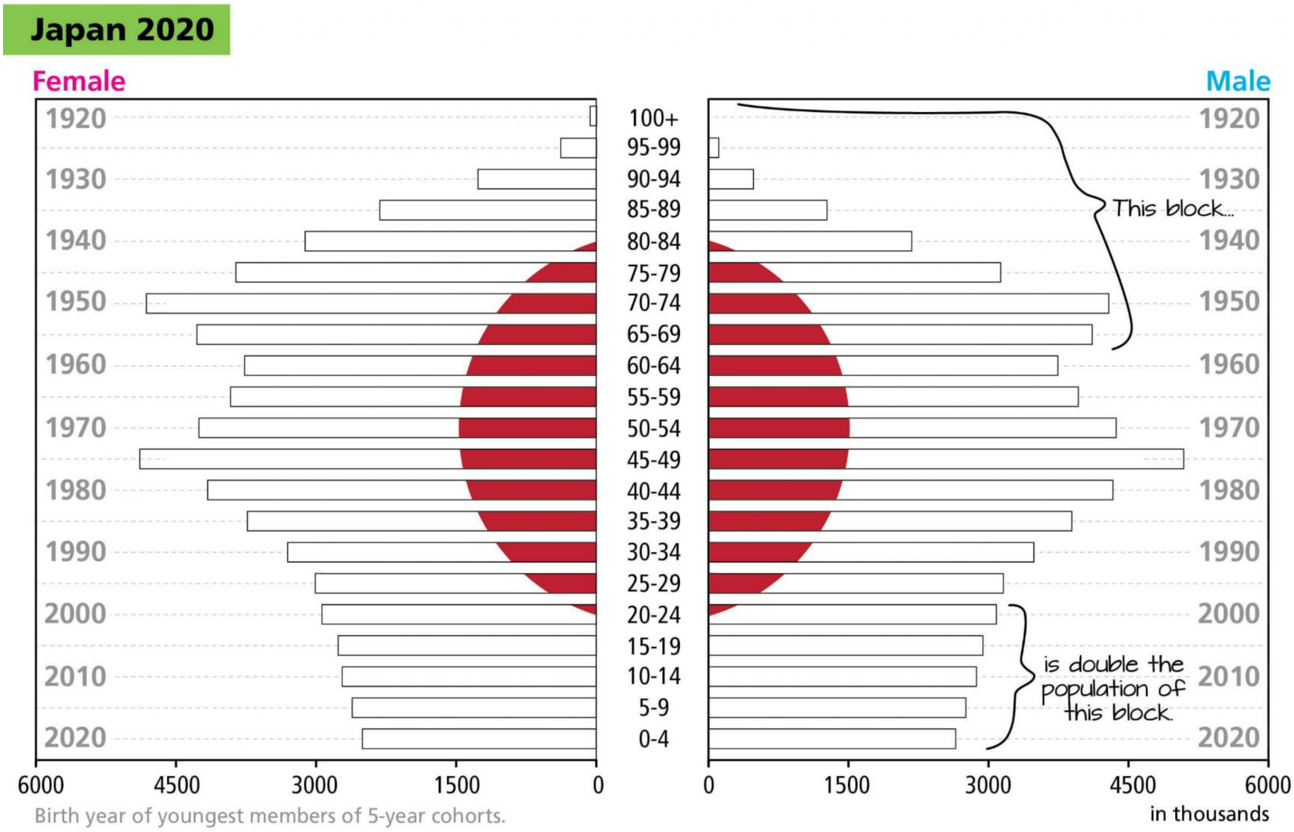
Source: UNPD, Zeihan on Geopolitics 2020

Chart 12: Germany Working Population Chart 2020



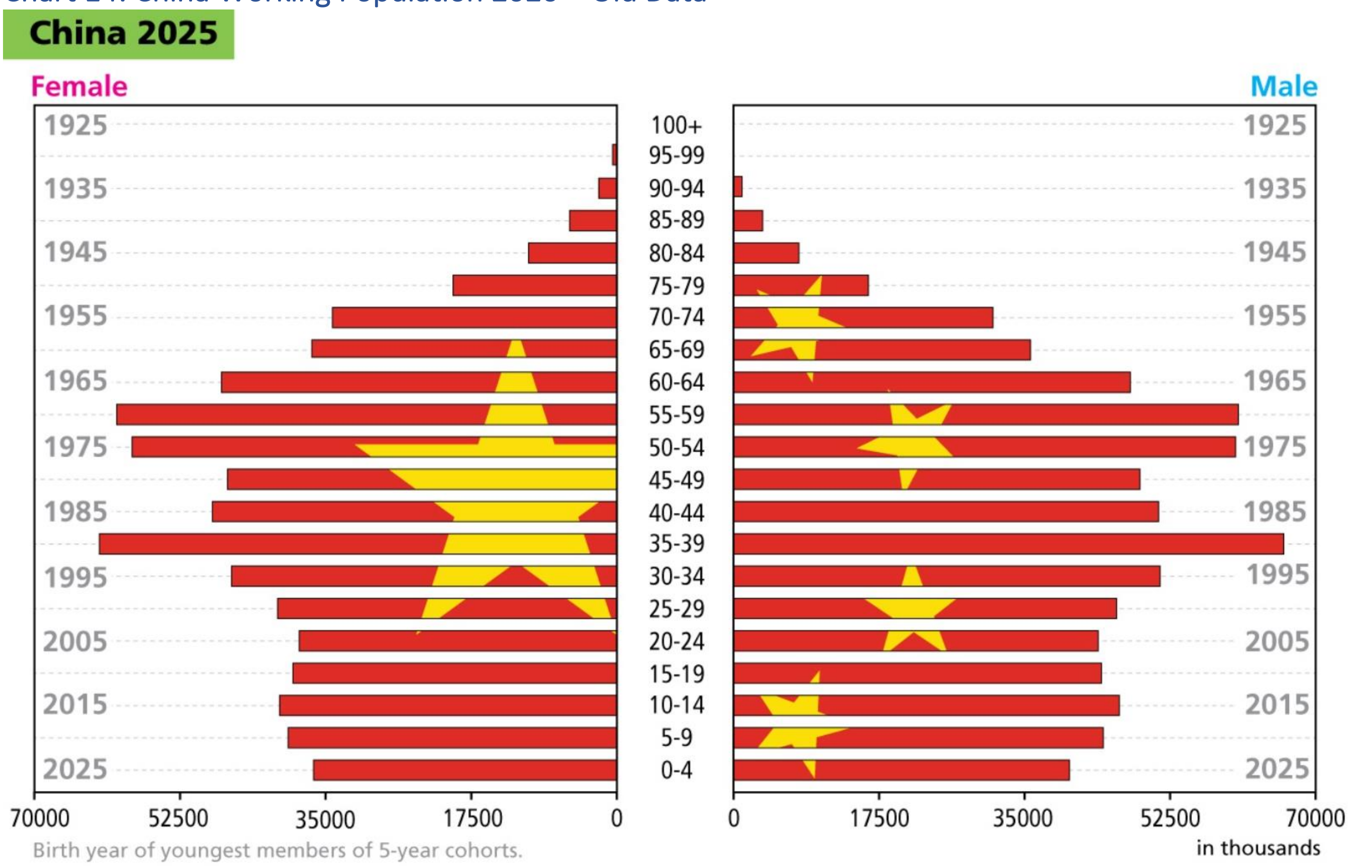
Source: UNPD, Zeihan on Geopolitics 2020

Chart 13: Japan Working Population Chart 2020



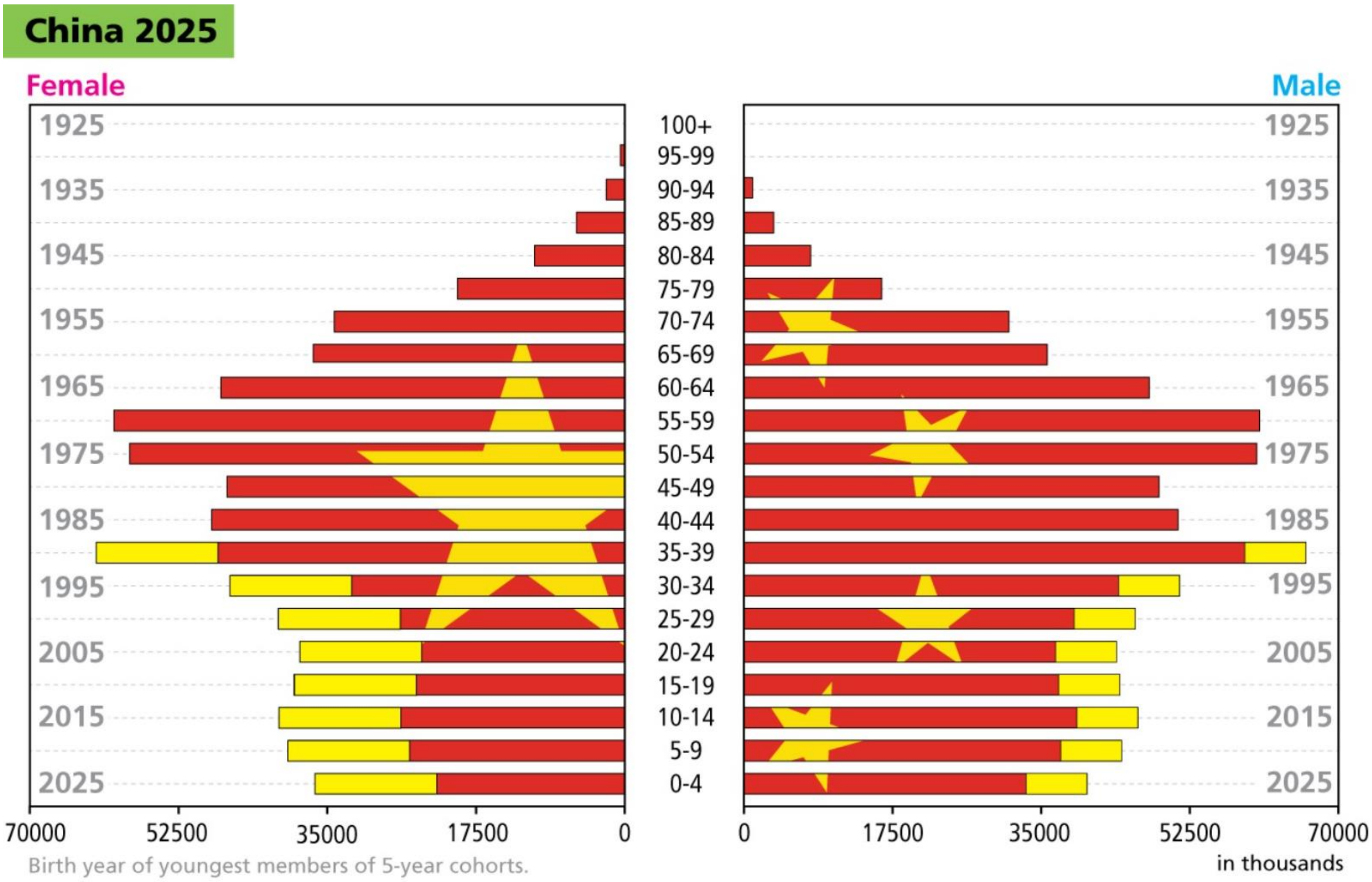
Source: UNPD, Zeihan on Geopolitics 2020

Chart 14: China Working Population 2020 – Old Data



Source: UNPD, Zeihan on Geopolitics 2020

Chart 15: China Working Population 2020 – New Data



Source: UNPD, Zeihan on Geopolitics 2020

Human Endeavour

Shvets' analysis of history would suggest that when a nation loses its right of relevance, social and economic decline is inevitable. This should not come as a surprise, since talent will always seek a better path.

"In the space of a decade in the early part of the twentieth century, the three great empires collapsed, with incalculable consequences, for their people but also for the world at large.

After three years of upheavals, China's last dynasty (Qing) finally expired in 1912. Despite various attempts to resurrect the Manchu dynasty that ruled China since 1644, none were successful. In the following seven decades, China plunged into the horrors of state disintegration, wars, occupation, and the communist takeover, which reduced the once-proud empire to penury. Less than five years later, Romanov's dynasty that ruled Russia since 1613 collapsed when its last tsar, Nicholas II, abdicated. Unlike in China, there was no serious attempt to revive it, and after the communist coup in October 1917, a different political order was ushered in, bringing with it the horrors of Stalinism, wars, and ultimately disintegration of the state, which was reduced by the 1990's to the frontiers that Russia occupied in the early eighteenth century.

Five years later in November 1922, the world witnessed the final abolition of the Ottoman Sultanate and the end of the dynasty that ruled extensive areas of the Middle East, North Africa, and the Balkans since the fourteenth century. While its death was a pronounced affair, 400 to 500 years prior to the Ottomans were on the verge of altering history by driving Christian rulers from Significant portions of the European continent.

There were several "ramps" that these societies could have taken over the last 500 years to negate their fifteenth century curses, but until China's embrace of market reforms in the 1980's, none were taken... Perhaps even more importantly, the question is why Western civilizations had taken the opposite side of this trade, and continued to evolve, grow, and dominate the world without any meaningful interruption for at least five centuries."

Analysing why these empires collapsed, the overarching conclusion draws on the failure of each to implement structural reforms aimed at creating transparent property and civil rights, as well as energising its industrial and agricultural base. By intentionally removing itself from the global flow of ideas, these empires adopted a heavy '*fortress mentality*', operating within an autocratic state.

Today, Russia and China find themselves travelling along a similar path. Both are becoming increasingly isolated, as nations disengage, and companies look to relocate to open economies. The onset of the Information Age is now set to test further the mettle of all players.

Schvets describes this as the fourth turning point, *"Global productivity over the last two decades had slowed again to less than one percent for most developed and even some developing nations. I believe that this reflects the onset of the Fourth Turning Point, or what is often described as the Third Industrial Revolution or the Information Age. While its origins can be traced as far back as 1971, it is only in the last decades that it has started to have a meaningful impact. The information Age is rewiring every aspect of economies and societies, and unlike the first two industrial revolutions that were designed to complement humans, the Information Age is aiming at nothing less than a complete replacement of contemporary economic models and turning on its head the importance of labor and capital inputs. It is also profoundly altering relationships between humans, societies, and technology. This inevitably leads to social dislocations, feeding populism and backlash against prevailing orders. It is also starting to alter the prerequisites for success, whether at individual, country, or civilizational levels.*

While the information Age is a natural progression of the previous revolutions, it also represents a radical break with the past and is a far deeper and more comprehensive rupture than anything that has occurred since at least the fifteenth century."

"… As Ray Amara, a late professor from Stanford, once postulated, we overestimate the impact of a new technology in the short run but understate the impact over the longer term. While the first decade after discoveries is usually full of justified fear, the second and third decades are characterised by complacency, followed by the realisation that the initial fears were justified after all. The next two decades will be that period of transition from complacency to panic."

Comment

No nation, be they West or East, will be immune to the pace of disruption that is before us. To put that into some context, McKinsey Global Institute estimates the pace of change is at least ten times quicker than in the nineteenth and twentieth centuries, but also far deeper and broader.

Further, in 2019 the same institute updated the level of global debt. The data revealed that the level of financial leverage exploded from a historic figure of around one to one and a half times global GDP through the 1950s-80s to the current position of more than three times the global economy, or debt levels well over US$250t. Note these figures were calculated pre-COVID, thereby proving conservative.

Figure 7: Global Debt Burden (US$ trillion – % of GDP)

	Households	Non-Financial Corporates	Financial Corporates	Government	Total
GDP US$ trillion					
1990	10	10	7	10	37
2000	17	24	24	20	85
2007	35	43	54	35	168
2019	48	74	63	70	255
% GDP					
1990	41%	41%	29%	41%	152%
2000	44%	72%	59%	55%	230%
2007	58%	76%	87%	58%	279%

2019	60%	92%	81%	89%	322%

Source: McKinsey Global Institute; IIf – April 2020

With a global economy hooked on debt, the Information Age promises to disrupt and create significant dislocations for all participants.

The freedom to exchange ideas and discoveries is likely to prove decisive, while any nation that denies the human endeavour to explore, innovate, and prosper only acts to impede its own progress. On this score the West appears to have a strong lead, accounting for around 70% of global Research and Development and over 80% of patent families. And in the areas of computer science, biotechnology, the life sciences, and new materials, the West's share is even greater.

At this critical turning point, could history be repeating itself? ***SFM***

INSIGHTS

You can always glean something from new information. Often, it's as simple as the power of a business captured in a single chart, or the presentation of numbers to drive home a point. Below we discuss recent insights from the annual general meetings (AGM) and company updates delivered during the past quarter.

REA Group

The evolution of a business from a single offering to a multi-layer is years in the making. Australia's leading online property operator, REA Group fits that description as Figure 8 depicts, "*We have evolved from a residential listing portal to a property, finance and data business.*"

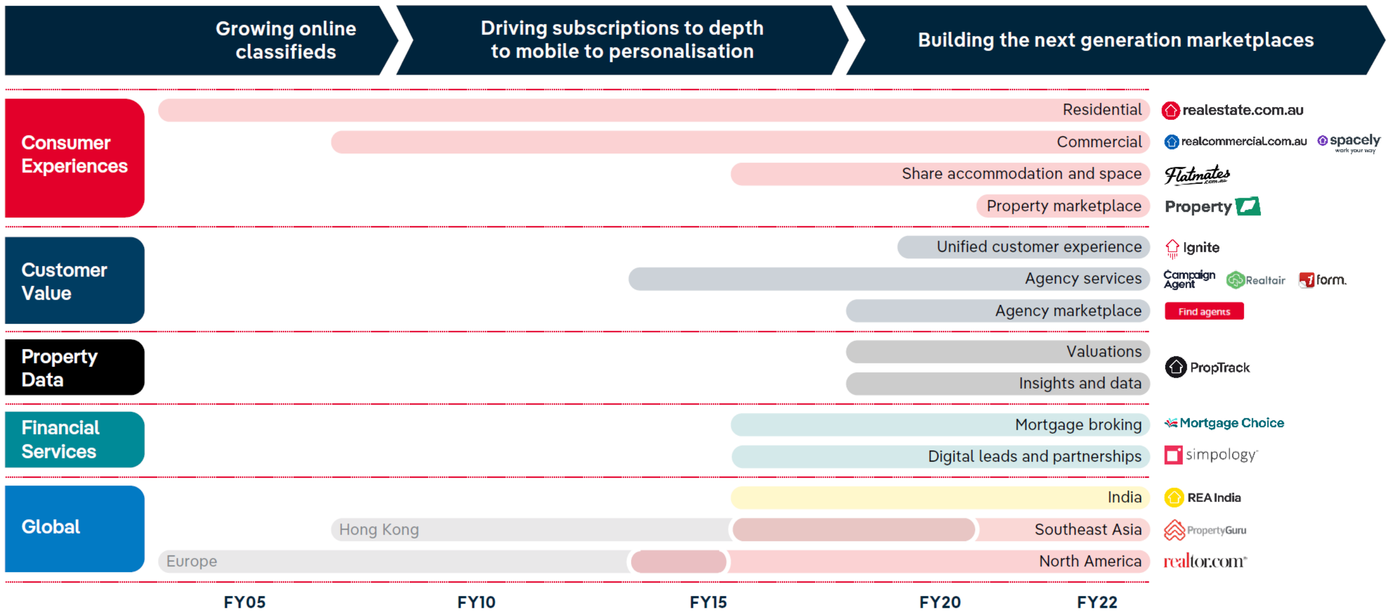
In 2005, the business was in its sixth year of public life. The growth in online classifieds was accelerating and the company was proving to be the key winner. The next decade saw a continuation of this trend. The company aided its advance with a move into commercial online classifieds advertising, followed by a radical overhaul of its revenue model, shifting from a traditional monthly subscription model to a depth property offering centred on mobility and personalisation.

It proved a masterstroke, driving strong earnings growth now supported by its move into multiple business adjacencies, including rental accommodation, financial services, and most recently data via its Proptrack market offering.

Offshore expansion has proven less fruitful to date. A notable exception is the company's early move into India in 2015, which is showing strong promise as the country's leading online classifieds property player.

Overall, this impressive evolution is illustrative of a company that continues to invest heavily to deliver long-term performance. Since 2015 the pace of investment has accelerated, adding scale and customer connection points all centred on property.

Figure 8: REA Evolution



Source: REA Group AGM Presentation 2022

Breville Group

When CEO Jim Clayton took on the top job in 2015 it was with a clear message: to make it a better business. The important pieces including product design, the brand, and the beginnings of offshore expansion, were already in place. What CEO Clayton delivered was the successful elevation of the business.

He set the narrative early in his appointment. As good as Breville was, the company needed to invest more and scale product development from design to delivery at a much faster rate. This required a complete rethink, and inevitably a shift, across all aspects of the business.

This entailed:

- Continuous advancements in product development
- Restructuring into a global organisational model
- Implementation of a global operational backbone
- Deployment of a global technology backbone
- The addition of global functional experts
- Building a global go-to-market capability
- Expanding the group's geographical addressable market
- Enabling a platform evolution centred on vertical product offerings and digitally supported
- Complemented products with a solution offering
- Enhanced corporate capability, allowing for brand acquisitions

What Figure 9 highlights are the financial achievements of this significant re-investment program. The important metric to highlight is the compound annual growth rates of revenue and operating profits (EBIT) outlined in the last column. Revenues have grown just shy of 22%, while EBIT has compounded at 16% over the period 2018-2022.

In isolation this outcome would suggest operating margins are in decline, lacking the benefits of scale. As the Marketing/R&D/Technology Spend scorecard reveals, the opposite is true. The company continues to invest heavily and divert more funds into product innovation and marketing support. In 2018, investment spend lifted from $79m, or 12.3% of group revenue to $196m, or 13.8% in 2022.

It should surprise few, that by favouring the long-term interest of a business ahead of short-term profits, the company has delivered strong financial performance and multiple product design accolades.

Figure 9: The Breville Investment Roadmap

Acceleration Program Scorecard

Acceleration Program Scorecard	FY18	FY19	FY20	FY21	FY22	FY18-FY22 CAGR
BRG Revenue (AUDm)	**646.8**	**760.0**	**952.2**	**1,187.7**	**1,418.4**	**21.7%**
Revenue Yr/Yr Growth	*6.8%*	*17.5%*	*25.3%*	*24.7%*	*19.4%*	
Global Segment Revenue	**522.2**	**612.0**	**764.4**	**984.2**	**1,178.5**	**22.6%**
Global Segment CC Growth	13.4%	12.0%	20.1%	37.0%	18.0%	
Global Segment GM%	38.2%	38.2%	35.7%	36.9%	36.4%	
Distribution Gross Profit	30.0	37.7	48.0	50.8	57.2	
BRG EBIT	**86.9**	**97.3**	**109.9***	**136.4**	**156.4**	**15.8%**
EBIT Yr/Yr Growth	*10.0%*	*12.0%*	*12.9%*	*24.1%*	*14.7%*	
Marketing/R&D/Technology Spend**	79.4	94.5	113.1	160.0	195.6	**25.3%**
Marketing/R&D/Tech as % Revenue	12.3%	12.4%	11.9%	13.5%	13.8%	
ROE	21.5%	22.7%	17.9%	19.7%	18.9%	
ROA	13.5%	14.1%	11.3%	13.0%	10.7%	
AUD:USD (yearly average)	0.775	0.716	0.671	0.747	0.726	**-1.6%**
Yr/Yr Change	*2.8%*	*-7.7%*	*-6.3%*	*11.3%*	*-2.8%*	

* Normalised EBIT as reported in FY21.

** While our core target metric is Marketing and R&D as a percent of Net Sales, Technology is included in this version of the scorecard because at this point in the program, it is difficult to separate Technology spend from Marketing and R&D spend.

Source: Breville AGM Presentation 2022

CSL

When a company can grow its revenue line so consistently over a long period, with the majority attained organically, it stands to reason that it must be doing something right. Figure 10 and Figure 11 illustrate the company's past and provide a glimpse into the future.

Underpinning its performance has been an unwavering commitment from management to remain focused on its core disciplines, and invest to deliver on future outcomes. Since its privatisation and public listing onto the stock exchange, the company has become the global leader in blood plasma collection, with more than 300 collection centres in the U.S., Europe, and China.

Its unwavering promise to "*save and improve lives*" also explains why research and development (R&D) investment is one of the highest priorities within the group. Figure 11 showcases the evolution of drug discovery from Phase 1, and its hopeful progress through Phases 2 and 3, with the end goal of registration and eventual marketing.

Visually, the company has a strong product pipeline, and even more impressive is the number of drugs awaiting registration. The recent acquisition of iron deficiency global leader Vifor Pharma only strengthens the quality of the pipeline further.

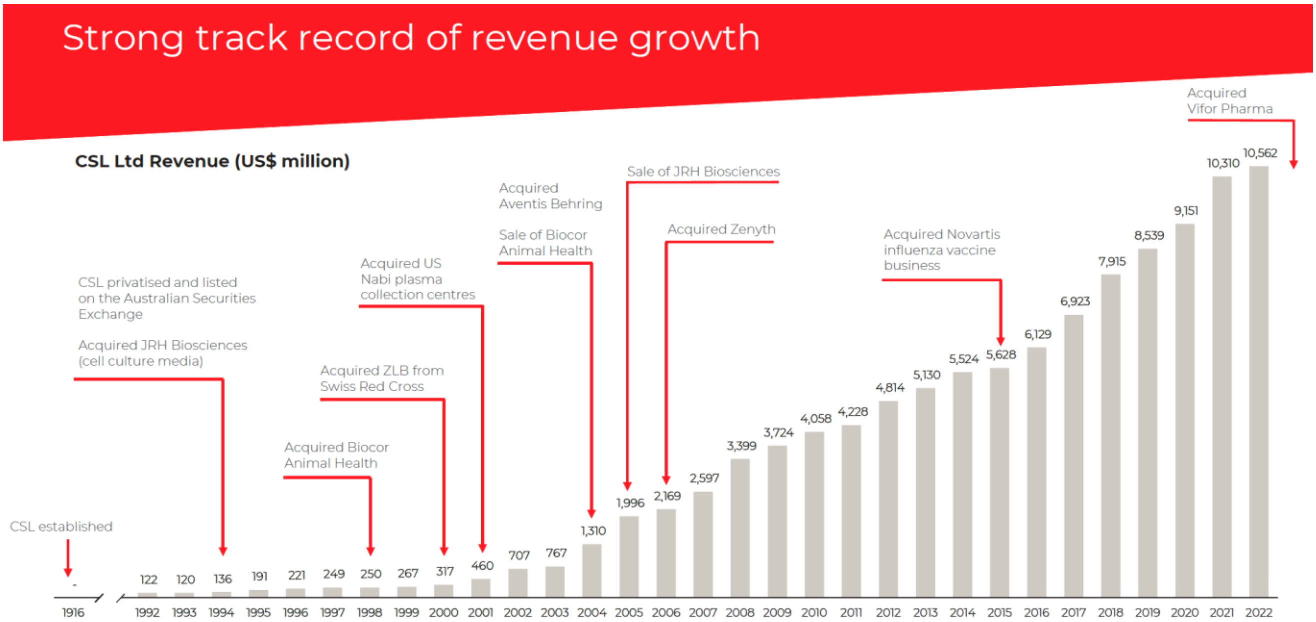
At the group's October 2022 R&D day, the company's Executive Vice President and Head of R&D, Bill Mezzanotte noted that at least 10 drug candidates in the current portfolio could become standard-of-care treatments, while three could become blockbuster drugs with huge market sizes, or high price points.

"But all 10, if they're standard of care, should hit close to that magical 50 percent market share because they will be the product that people will want to use. I look at that more than the dollars. The impact of this suite of products across this suite of diseases is in the millions of patients, and that will translate into [billions] of dollars."

Drug discovery is extremely difficult to execute, which highlights why CSL does it so well. Its success is founded on plasma as Head of R&D Mezzanotte explains, "*But we're 40 years into [plasma products] and we haven't seen peak sales yet, which is remarkable. What that does for an organisation, this kind of predictable sales, is it allows us not to panic. I don't care what news you read, Merck, J&J, they're looking for ways to replace the lost revenue from some blockbuster product ... they start to make bets that maybe they wouldn't make [otherwise], and there's a hidden impetus to overreach. The plasma business keeps us from making panicked decisions."*

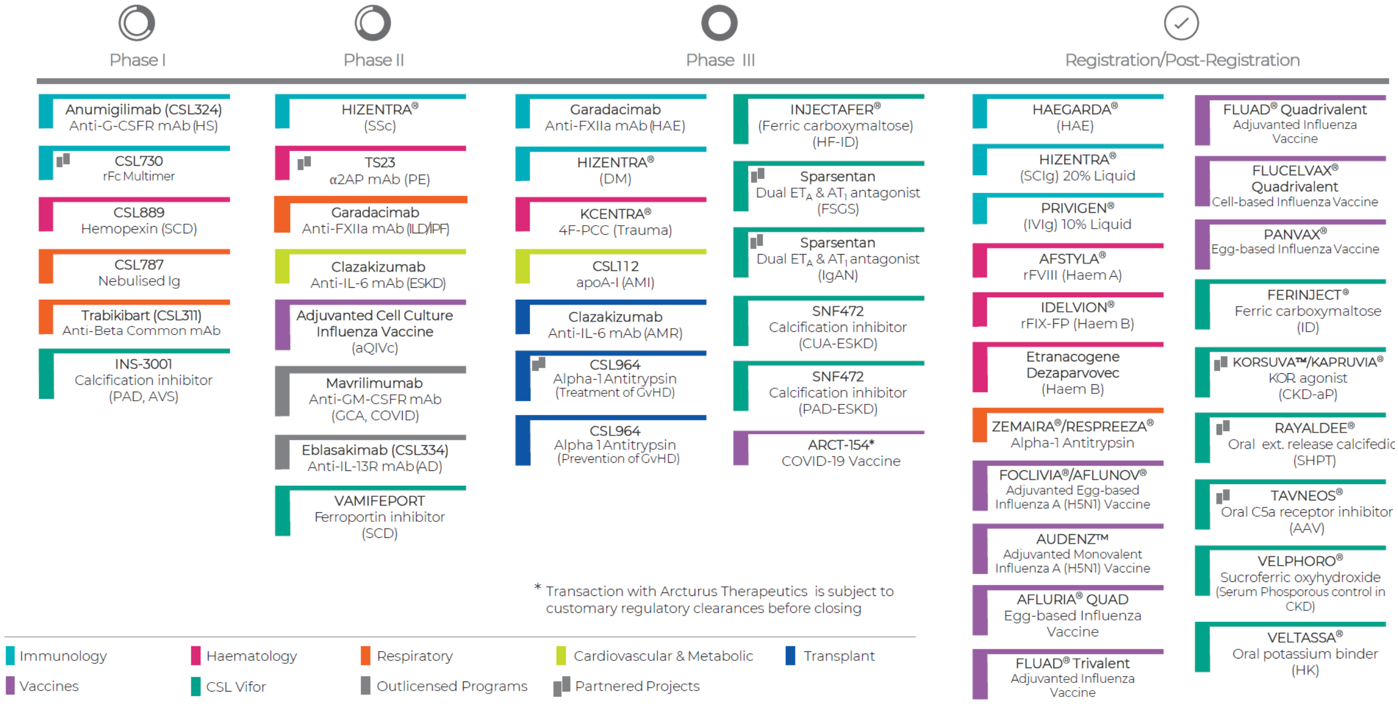
Investors should appreciate that CSL is a rare company continuing to strive for outstanding performance and a commitment to its patient group. In doing so, management have established an enviable record worth pursuing.

Figure 10: Historical Revenue Performance 1992-2022



Source: CSL AGM Presentation October 2022

Figure 11: CSL R&D Pipeline



Source: CSL R&D Investor Day Presentation 2022

Computershare

Acquisitions are hard to do. They involve investment capital and combining potentially different cultural baggage from two companies. If done well, however, they can reenergise an organisation, spurring them on to bigger and better things. This was certainly the case for CSL when they acquired Aventis Behring back in 2004, and hopefully Vifor Pharma in 2022.

The Computershare business has undergone its own evolution. During its formative years, bolt-on acquisitions were frequently undertaken, as illustrated by its vast global network in Figure 12.

In 2021, the company embarked on its largest acquisition to date, the US$1.0b purchase of the Wells Fargo Corporate Trust Services, now renamed Computershare Corporate Trust (CCT).

The difficulty of this deal stemmed from the need to separate the business from the existing Wells Fargo operating platform. This will require significant investment and execution risk, but as CEO Stuart Irving commented at the October 2022 annual general meeting, the timing has proven ideal.

With global interest rates rising, the business financial metrics have improved markedly. At the time of acquisition, CEO Irving set out the CCT acquisition metrics (see Figure 13). The US$1.0b outlay was expected to generate a post-tax ROIC (Return on Invested Capital) of at least 15%, or US$150m by 2025.

Such has been the sharp rebound in interest rates, giving Computershare the ability to earn interest income on funds held on trust, that the management now envisages an ROIC of at least 30%, or double that of its original expectations. To put that into context, the original deal suggested an operating profit (EBITDA) purchase multiple of 8.9x (US$112m). This is now expected to improve to 2x (US$500m) once estimated synergies of US$80m are included.

More importantly, the CCT acquisition provides the group with the necessary foundations to undertake further bolt-on purchases. Its long-term importance should not be underestimated.

Figure 12: Computershare Global Network

Source: Computershare AGM Presentation 2022

Figure 13: CCT Acquisition Metrics

March 2021 acquisition announced. Completed November 2021	$1bn capital deployed. Raised $634m via Entitlement Offer + $237m debt, to fund	$84m EBITDA CY 2020, including $84m MI. $61bn client balances including Money Market Funds	6% pre acquisition ROIC, identified $80m synergies by 2027
Expected to be EPS neutral pre synergies; 15% accretive post. 15% ROIC target by 2025	February 2022 – first two months' annualised EBITDA $58m, including $45m MI. Guidance upgraded – assumed 25bps US rate rise April 1st	August 2022 – 2H annualised EBITDA $180m, Group debt leverage improved below target range ahead of plan	Expected FY23 EBITDA circa $450m. $80m synergies affirmed with upside. ROIC over 30%

Source: Computershare AGM Presentation 2022

OFX Group

The business metrics for foreign exchange currency provider, OFX continue to improve. Under the dual partnership of CEO Skander Malcolm and CFO Selena Verth, the business has invested and been steered sensibly, as highlighted in Figure 14. The shift to Corporate now dominates group revenues, driven by higher recurring revenues and improved margins.

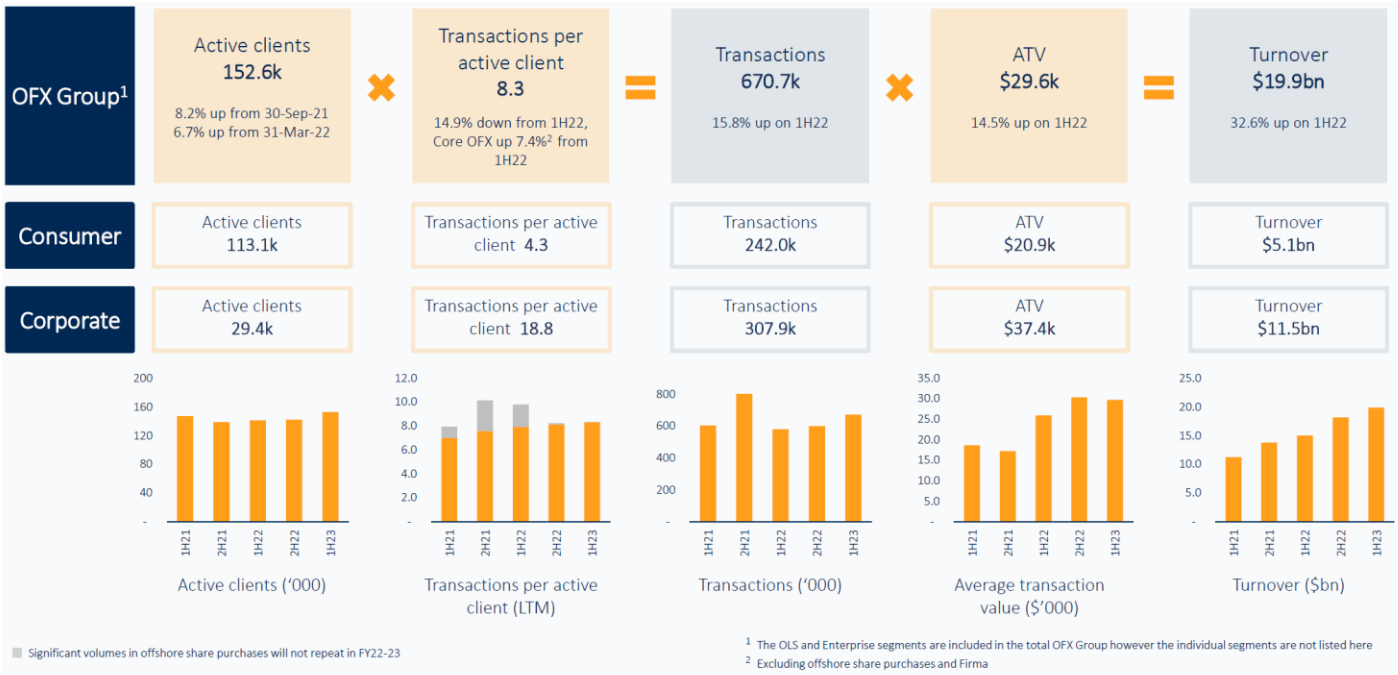
The recent acquisition of Canadian foreign exchange operator, Firma further strengthens the group's global footprint, alongside improving operating metrics. Figure 15 talks to the net operating income (NOI) margin story.

NOI is the margin OFX earns on each dollar of foreign exchange transacted. In the company's September 2022 half year financial result, this improved from 0.43% to 0.53%, an increase of 23%. Some 40% or 0.04% came through the Firma acquisition.

The enlarged group is now expected to turn over more than $40b in foreign currencies per annum for consumer and corporate clients, highlighting the significance of even small margin improvements.

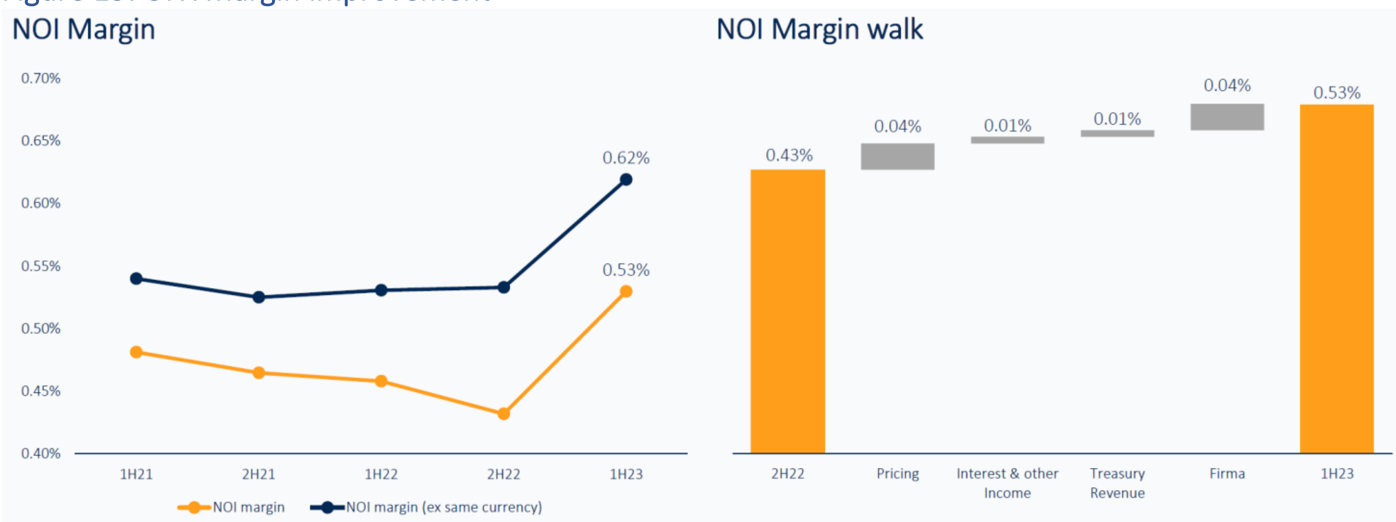
The foundational pieces are now in place for continued improvement, alongside aspirations of building a bigger, more scalable business.

Figure 14: OFX Business Metrics



Source: OFX Interim Result 2022

Figure 15: OFX Margin Improvement



Source: OFX Interim Result 2022

Altium

If there is one slide or update that investors eagerly await at annual general meetings (AGM), it is the outlook statement or earnings guidance. All other matters fall by the wayside. But as we have attempted to highlight in this article, important messages are often found in the most unlikely places.

Our attendance at Altium's over two-hour AGM in mid-November provided such an outcome. President and Executive Director, Sergey Kostinsky and interim Chief Financial Officer, Richard Leon conducted a live question and answer addressing shareholders.

The first by Kostinsky was centred on the topic, "*Value creation at Altium, our secret sauce*". Specifically, he addressed the company's ability to consistently deliver market share growth and financial performance to create value.

How is that done?

As Kostinsky explained the challenge is to solve for two distinct needs, "*to grow consistently in our traditional PCB business AND at the same time to have breakthroughs that bring new opportunities for growth, for example our cloud business, we talk about these as*

High Impact performance and Transformative performance, respectively."

Fundamental to the success of both is innovation and culture.

Consistent execution requires the High Impact performance team members.

Again, Kostinsky explains, "...*high impact performance needs to be focused on taking something that already exists and is working, and optimising it to maximise its potential. To do this, you need highly disciplined execution, as efficiency is the key. You need to find weak spots, and eliminate them, and be constantly finding small incremental improvements. Our traditional PCB business is like that. It has been performing incredibly well for many years, yet we work relentlessly to improve it*."

The *"AND"* as Altium likes to put it, is equally important. Transformative performance is the process of starting from scratch and creating something special.

Altium points to its cloud offering, Altium365 as transformative. It requires fast experimentation and the ability to quickly identify value to achieve real breakthroughs. The willingness to fail fast, regroup, and try again is the most difficult step.

As such, different compensation and performance metrics are required for these two groups of individuals. The High Impact performers are highly skilled operators, they prefer less risk and predictability in terms of their compensation.

In contrast, Transformative performance requires an entrepreneurial mindset, accepting higher risk and by default, higher compensation for breakthrough success.

Kostinsky continues, "*Altium applies performance management to those who perform well and have the potential to do even better. We want to help achievers to excel to their potential, and that is the essence of performance management at Altium."*

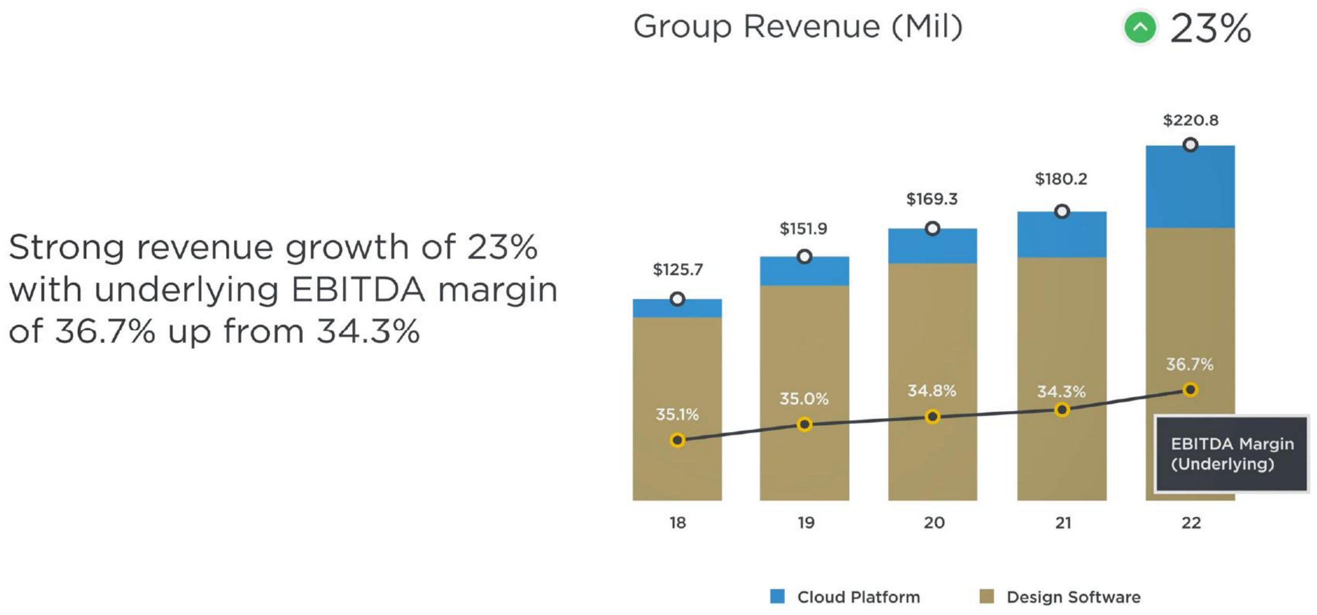
Interim CFO Richard Leon then takes the microphone, discussing how "*Altium's exceptional journey requires exceptional people.*" The analogy that CFO Leon draws upon is that of a football team, as depicted in Figure 16.

1. The Specialist (Goalkeeper), responsible for protecting the team at important moments
2. The Driver (Midfielders), the heart and work horse of the team
3. The Striker (Forward), that rare talent that pulls off the unlikely
4. The Underwriter (Coaching the team), not on the pitch but strategically important to success

Figure 16: Altium's Talent Roster

Source: Altium AGM Presentation 2022

Figure 17: Altium's Scoreboard



Source: Altium AGM Presentation 2022

CFO Leon concludes, *"This makes clear that we have high expectations for our staff, and we hold ourselves accountable for both excellent performance and excellent results, because it's not enough to simply play well – it's all about winning."*

TechnologyOne

Australia's largest enterprise resource planning (ERP) Software-as-a-Service (SaaS) company delivered a strong set of numbers at its recent full year results in November 2022. Total revenues rose 18% to $369m, profit after tax was up 22% to $88.8m, and full year dividends lifted 22% to 17.02 cents per share, having compounded at 13% over the past decade.

The revenues, profits, and shareholder returns reflect a business posting consistent performance metrics. Yet, it was the slides that followed, which illustrated why the company deserves its high standing in the marketplace. In short, the business has built a formidable standing across *all* six key business vertical markets it's chosen to focus on.

This laser focus, and the way the company supplies mission-critical enterprise-grade software to over 1,200 customers, is what stands it apart from global competitors.

Figure 18 and Figure 19 show the key metrics that talk to this long-term compounding success.

A business that has to replace revenues each year with new customer purchases is more cyclical and therefore prone to swings in revenues and profits.

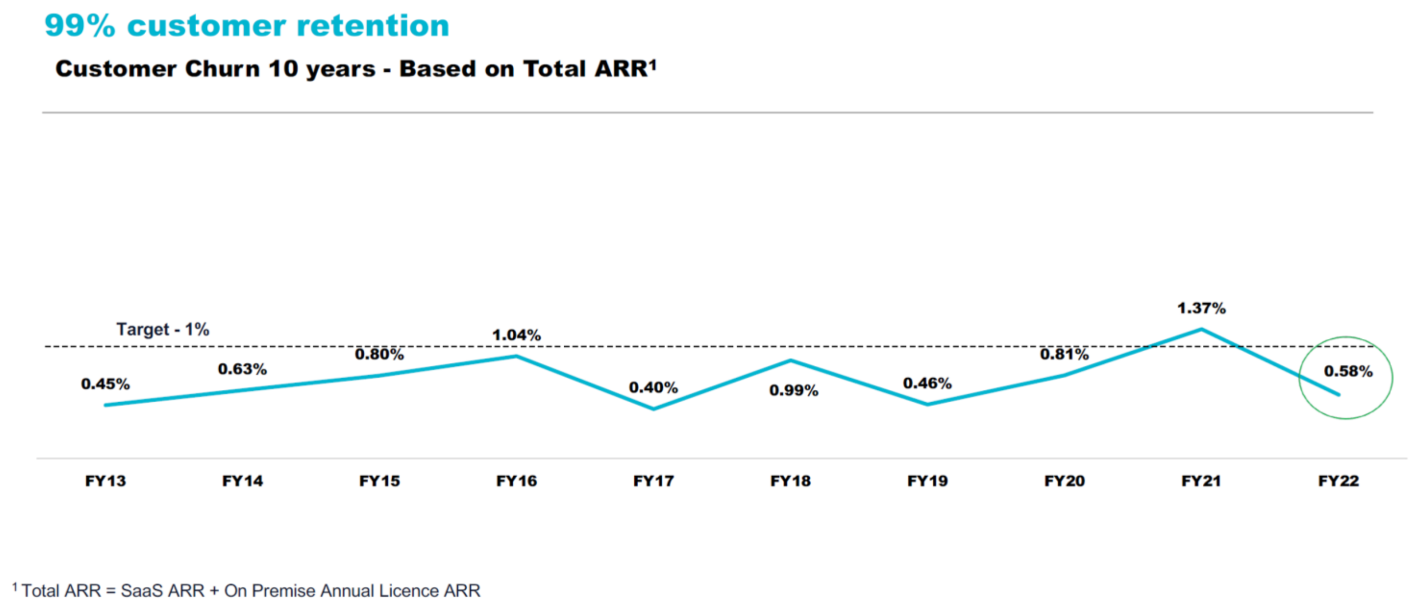
Now contrast that to a company that can reliably count on repeat business from an installed and growing customer base. In such a scenario, the business is valued more highly, enabling consistent product reinvestment and predictability of revenue and profit generation.

As Figure 18 illustrates, TechnologyOne has historically retained greater than 99% customer engagement, with customer churn running at less than one percent per annum. This speaks to both product and service performance, and its overall customer acceptance within the market.

Figure 19 goes a step further and shows how the company can grow through new customer wins. Net Revenue Retention (NRR) has consistently been over 100%, illustrative of a business that is not only retaining customers but winning new accounts.

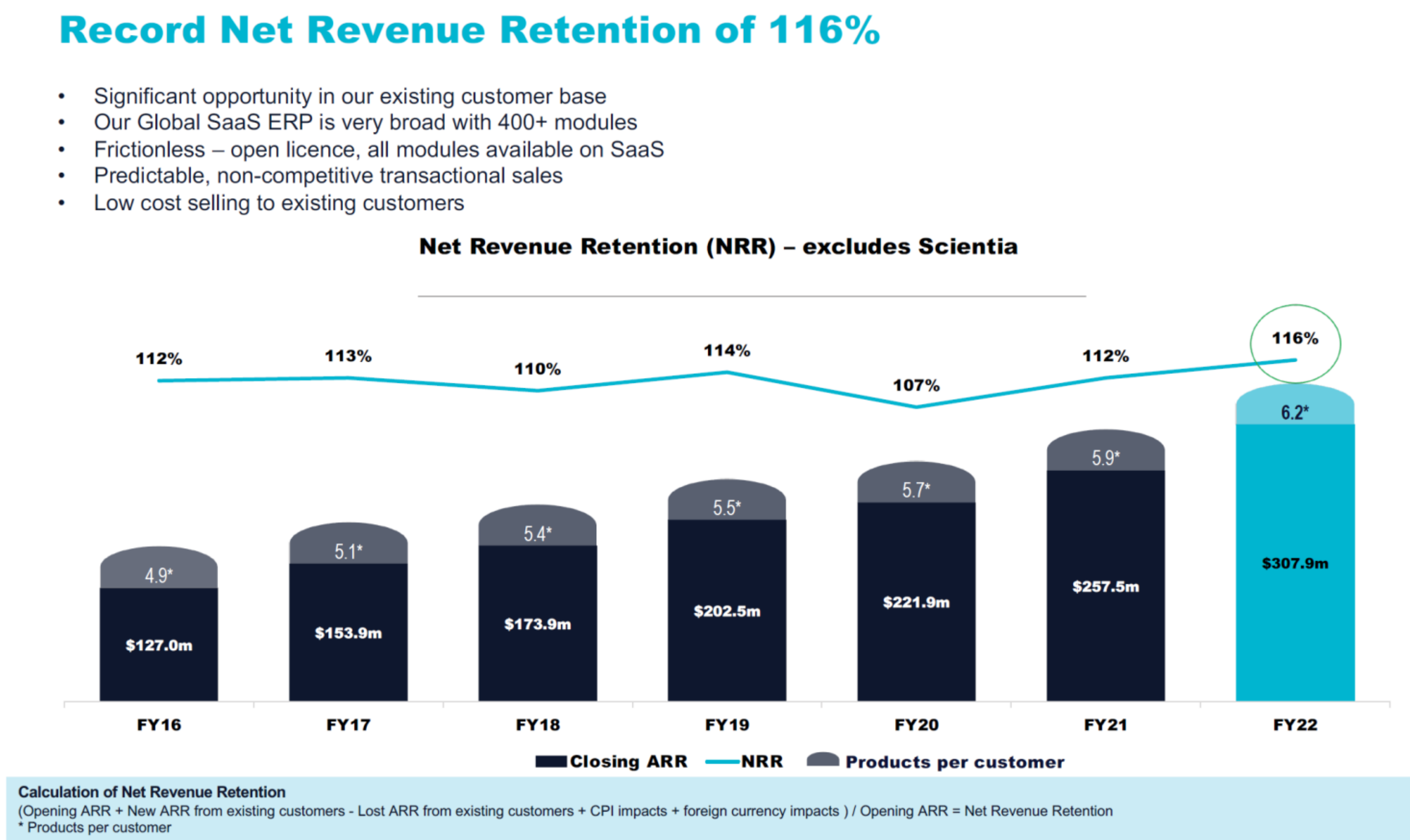
Since 2016, NRR has hovered at 112%. In 2022, this spiked to a record 116%, reflecting global best outcomes. Just as important, the number of products per customer has jumped from 4.9 to 6.2, giving substance to management's *"land and expand"* mantra and providing additional incentive to sustain product development spend.

Figure 18: TechnologyOne Customer Churn Profile



Source: TechnologyOne Full Year Presentation 2022

Figure 19: TechnologyOne Customer Net Retention Profile



Source: TechnologyOne Full Year Presentation 2022

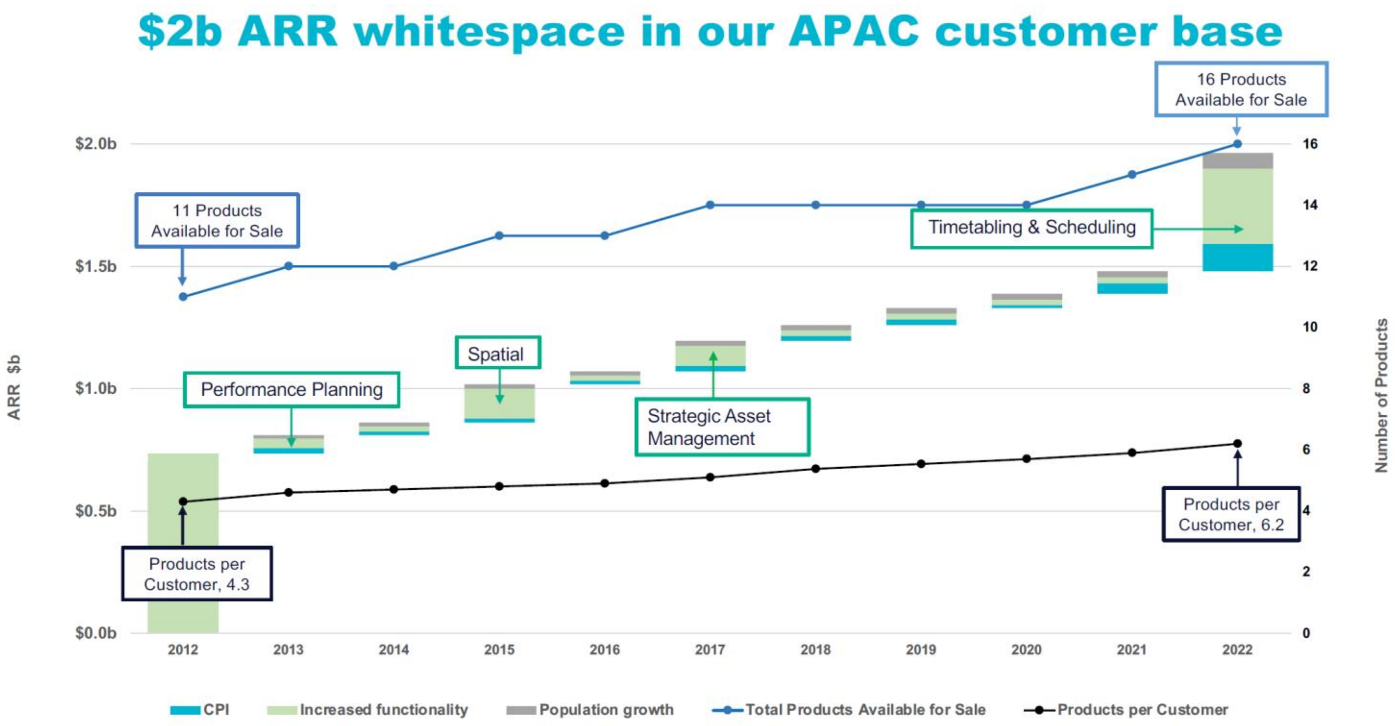
To that end, Figure 20 and Figure 21 talk about the *"whitespace"* market opportunity. Figure 20 provides a snapshot looking back over the past decade. Here management talk to an Annual Recurring Revenue (ARR) total addressable opportunity of $2.0b within its currently defined product set, should all 16 currently available products be fully adopted by the whole customer base. This compares to the group's current products per customer sale rate of 6.2 and ARR run-rate of $321m, implying a market share of 16%.

Looking out over the next decade, Figure 21 highlights a potential doubling of the ARR opportunity to $4.0b for the Australian region. This is based on new product releases scheduled for 2023-2025, including DXP Local Government, DXP Student Management, and AppBuilder. In total, this would lift products per customer availability from 16 to 21.

The company has outlined its aspirational goal of delivering $500m+ ARR by 2026, and thereafter doubling over the ensuing five years out to 2031. This would suggest group ARR of $1.0b and pre-tax profits of $350m (compared to $112m in 2022), based on conservative margin levels of 35%.

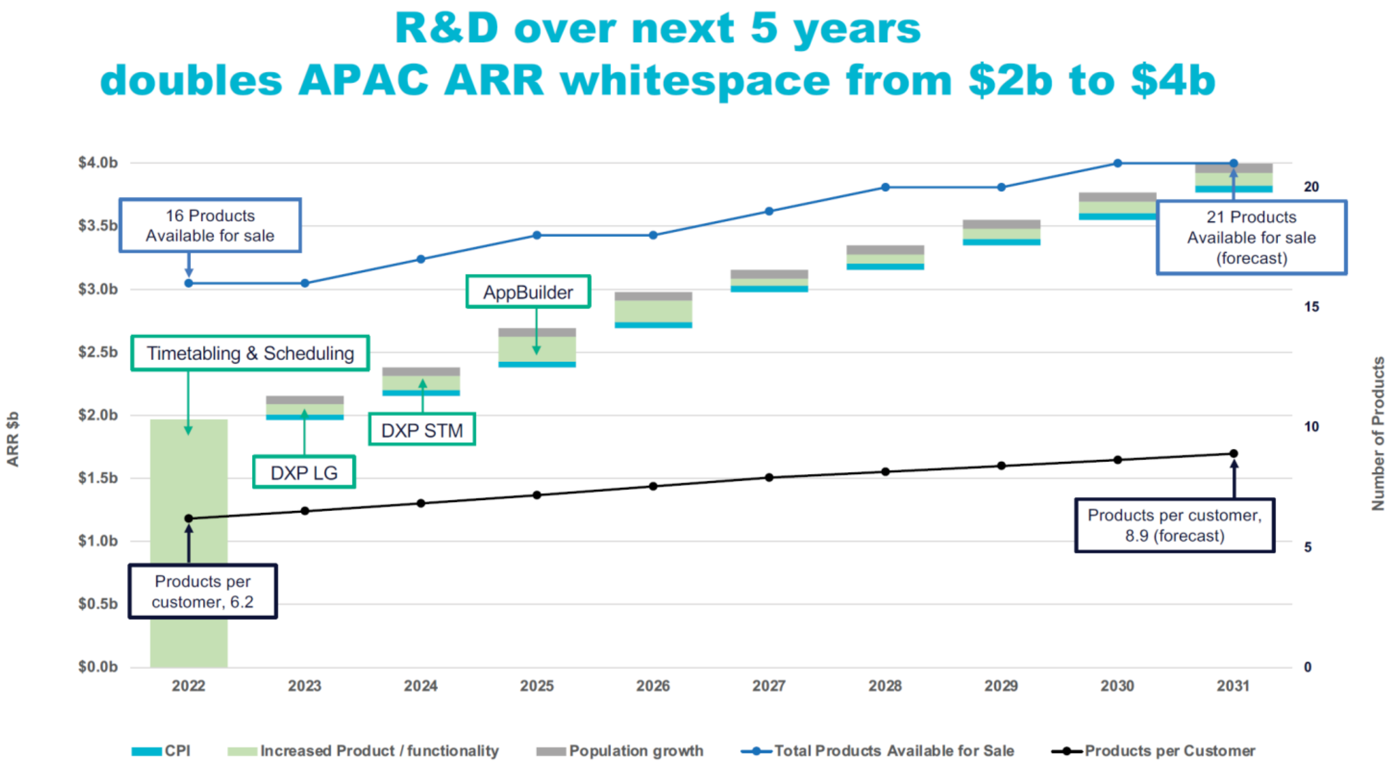
In our experience, the organic building of a business franchise, augmented by such powerful metrics of NRR and ARR, and enhanced by product expansion, is rare. The combination of these powerful forces is seeing an even rarer outcome at play: revenue and profit predictability.

Figure 20: TechnologyOne Market Opportunity 2012-2022



Source: TechnologyOne Full Year Presentation 2022

Figure 21: Technology One Market Opportunity 2022-2031



Source: TechnologyOne Full Year Presentation 2022

Comment

Some companies go through the motions when discussing updates with investors. A few will go the extra mile and take you deeper inside the organisation, revealing the essence of why they succeed.

In those moments it pays to turn up, listen and appreciate what is on offer, because to understand something matters. ***SFM***

SUCCESSION

"Those who spend most of their energy reacting to change will do exactly that, expend most of their energy reacting to change. In a great twist of irony, those who bring about the most significant change in the world, those who have the largest impact on the economy and society, are themselves enormously consistent on their approach. They aren't dogmatic or rigid, they're disciplined, they're creative, they're paranoid."

Success is not built overnight. It is a process, a constant push to create a better outcome. Listen to almost any success story and you'll begin to observe a few common attributes: a consistent message, a great idea, and a burning desire to build something special. What is often required to get it from good to great is the sheer energy and disciplined persistence – pursued over time.

The difficulty therefore is not starting, rather sustaining the pursuit.

Businesses are living things, each with their own identity and encountering all manner of challenges along the way. Their life cycle is unknown; some endure, while many fade away. So, how do many continue the pursuit when time ticks away? Succession.

Across multiple annual general meetings this year, we farewelled long-term founders from their roles. Whilst there are a number we've featured here, two in particular stood out.

The Reece Group

Alan Wilson, the founder of The Reece Group, has stepped down from his role as Chairman to take up an executive director role. Wilson joined the Board in 1969 and held the position of Managing Director from 1974 to 2008. In 2001 he became Chairman.

The Reece Group has navigated succession well, perhaps the best we can recall.

In 2008, Alan's son Peter Wilson took the reins as Group CEO. He has guided the business along its desired path ever since, *"Our unwavering focus on the long term helps us to keep one step ahead of our competitor's needs."*

There are a few milestone items worth calling out here. First is the ongoing refinement of plumbing operations in Australia and New Zealand.

Second and undeniably the bigger task at hand, worth measuring in decades rather than years, is the U.S. opportunity. Here the company makes no apologies for its aspirational pursuit to beat U.S. giant Home Depot at servicing the plumber. Their vision statement echoes this, *"We will be the trade's most valuable partner."*

In 2023, this starts earnestly with the single branding of the group's existing 204 U.S. store network, complemented by an annual rollout of 10-15 new store locations.

The company is equipped with a clear vision, operating in two of the most dynamic markets available, underpinned by its customary long-term mindset.

While the Reece family is collectively the largest owner with 68% of the register, the increasing scale of the business and its growing geographical diversity requires greater executive input.

In the U.S. the appointment of Sasha Nikolic as its CEO has been a positive step. There is energy and total commitment to the vision, an individual that could go the distance.

In Australia, the role of the CEO has been less fruitful. The previous appointee, Gavin Street left with little said publicly. His replacement Marius Vermeulen, having taken the role in 2021, stepped off in late 2022 citing personal reasons. This has forced Peter Wilson to carry the load as both ANZ and Group CEO in the interim.

As the business grows, the pressure to find future leaders intensifies. But the company's ability to attract the right people who stay true to the vision, irrespective of the circumstances that arise, is a defining strength.

Nothing reflects this more than the group's approach in identifying its next Chair, one dictated not by time but by the suitability of the individual. Peter Wilson noted, *"As we look to appoint our next Chair, we will do this the Reece way, with a long-term lens and a clear* *view of the skills and profile we need for our next stage of growth."*

On our assessment, Reece remains in good hands and clear of short-term distractions.

ARB Corporation

At ARB, Australia's largest manufacturer and distributor of four-wheel parts accessories, a similar story to Reece is evident.

The business today has a vast international presence. There are offices in the U.S., Europe, and the Middle East, and an export network extending across over 100 countries.

At its core, the company philosophy has never wavered from its original course: quality, reliability, and practicality above all else.

In 2022, co-founder Roger Brown moved into a non-executive role following a lifetime commitment to the company. He served as Chairman for 35 years since the group's public listing in 1987 and over 40 years since its origins in 1975.

Brother Andrew Brown remains an executive director, having held the role since 1987 in addition to his managing director responsibilities. Alongside Brown is newly appointed CEO Lachlan McCann.

The move is a step out for the Brown brothers, handing the day-to-day running of the business to an internal candidate, albeit one who has been with ARB since 2001.

McCann has significant experience, including Managing Director of the Thailand manufacturing operations between 2010-2014, General Manager of International and OEM sales from 2014-2018, and most recently as Chief Operating Officer.

McCann works alongside Damon Page, who joined as the group's CFO in 2014.

Roger Brown and co. have always kept a low profile, relying on the financial numbers to do the talking. That said, the planned appointment as part of a smooth transition in roles is exemplary as Brown noted, *"We are very pleased with Lachlan's promotion to the role of Chief Executive Officer. Lachlan has made a strong contribution to ARB over many years and is committed to our core values of excellence, with passion. We are confident that his leadership, drive and global Four-Wheel drive industry experience will underpin the company's ongoing growth. We wish him every success in his new role."*

Already the combination of CFO Page and CEO McCann is evidence of a maturing business that has not lost sight of its vision nor purpose, making ARB one of the best-performing companies on the Australian stock exchange. Further, it speaks volumes to how the Brown's and the Board have undertaken the important task of executive succession.

TechnologyOne

While Alan Wilson and Roger Brown have chosen to remain on their respective boards, Adrian Di Marco, co-founder of Australia's largest software enterprise business TechnologyOne, decided on a complete exit. As co-founder alongside fellow investor partner Dugald Mactaggart, Di Marco's involvement spans 35 years taking it from start-up to ASX listed.

Today, the company boasts a formidable track record of growth, profitability, and capital management. It reflects Di Marco's foresight to adapt the business to meet the changing industry landscape. Like all good founders, he has carefully selected those who are now entrusted to lead the business.

In February 2022, Di Marco made clear his intention to fully step aside on 30 June. *"Today's announcement is the final step of a carefully planned transition, that started with the appointment of our long-serving Chief Operating Officer, Mr. Edward Chung to the role of CEO in 2017, the renewal of our Board over the last 5 years, and the recruitment of a very experienced Deputy Chair Mr. Pat O'Sullivan."*

The appointment of Edward Chung as CEO and Managing Director reflects the extent to which founders will assess future leaders. Hired from Queensland Rail in 2007, Di Marco recalls Chung's progression.

"I thought he is so young, I don't think he's up for the job. From accounts, I put him into R&D. He ran R&D. And I put him into consulting and then into sales. The guy was so smart. I remember one day saying to Ed, 'Why won't you break?''

In a similar vein, the choice of the Chair role was not the traditional pick. In June 2022, Patrick O'Sullivan was appointed.

"Pat worked for the Packers and he had taken over as chairman of carsales.com, another founder-led business. He also was on the board of Afterpay, so he knew what family businesses were like."

TechnologyOne possesses wonderful attributes rarely on offer: a founder-led, highly profitable, highly recurring revenue business combined with a conservative mindset, investing heavily to stay at the forefront of industry change, while retaining substantial cash to weather the inevitable storms.

Carsales

At the 2022 annual general meeting, long-standing non-executive director Kim Anderson, up for re-election, was asked to nominate key highlights since joining the Board in 2012. Of all the notable achievements for a business that floated on a market valuation of $812m in 2009 and is currently trading at $7.0b, the standout highlight was the successful transition of the business from founder Greg Roebuck, to current CEO Cameron McIntyre in 2017.

Roebuck, who co-founded the business in 2002 along with several high-profile backers, chose to step down and hand the reins to McIntyre.

Having joined in 2009 as Chief Financial Officer, McIntyre moved into the group's Chief Operating Officer role before being appointed as Managing Director in 2017.

Roebuck had reached his natural level of involvement, prepared to pass the baton to his heir apparent in McIntyre. He remains a substantial shareholder, sitting on the company register with 3.3m shares. Roebuck is joined by co-founder Wal Pisciotta, who remains a non-executive director with 8.3m shares as of 30 June 2022.

Patrick O'Sullivan, a no-nonsense commercial director, is the company's Chair. Similar to TechnologyOne, the choice of board members is critical in sustaining the company's purpose and delivering on its long-term potential.

Under McIntyre's leadership, the executive team has expanded and individuals internally nurtured. A prime example is the company's current CFO William Elliott, who initially joined in 2015.

The move into the U.S. via the acquisition of non-automotive group Trader Interactive is the company's boldest step in its 25 years of corporate history. Here, management aims to leverage its technology and marketplace experience into new geographies, as evident by its successes in other regions, including Korea and Brazil.

Based on the track record to date, we would agree with Anderson that passing the baton from a founder to an executive who thinks and acts like a founder is a critical milestone.

Flight Centre Travel Group

Some founders have tried to move on but have returned, not yet ready to step down. CEO Graham Turner co-founded the business in 1981 and took the company public on the Australian Stock Exchange in 1995, with a market valuation of $75m.

In 2002 the company decided to split Turner's role, allowing him to focus on the strategy and pass on the day-to-day running to internal appointee and senior manager Shane Flynn.

In typical Turner style and frankness, when the move failed, the company openly discussed this outcome with shareholders in 2005, *"The dual leadership model that was introduced following Mr. Flynn's appointment in 2002 caused difficulties both internally and externally. This has prompted a return to a more traditional Flight Centre leadership structure; with Mr. Turner heading an executive team with almost 60 years combined experience within the company."*

The reason it failed was simple: it introduced complexity. A point Flynn himself highlighted, *"the change would take the company back to one of its great strengths - a simple leadership structure."*

Seventeen years after that reset, the company remains flat across its executive structure. The key individuals overseeing the global operations of this $3.3b market-valued business include CFO Adam Campbell with 15 years of Flight Centre experience; CEO of Corporate Chris Galanty with 25 years of tenure; CEO of Leisure James Kavanagh with 18 years; CEO of Supply, Melanie

Waters-Ryan with 35 years; and Graham Turner with a total of 41 years.

Having survived the Global Financial Crisis and now COVID-19, the transition of leadership will likely include someone from this grouping. Although it is highly likely Turner will remain connected in some capacity.

Domino's Pizza Enterprises

Domino's Pizza Enterprises remains a founder-led business. The company's Chair Jack Cowin is the largest shareholder, retaining a 26.7% holding.

Don Meij is the group's CEO. Entering the pizza industry in 1987, Meij became a Domino's franchisee in 1996 before moving into the role of Managing Director in 2002. The business went public in May 2005 with a market value on listing of $132m.

The company possesses significant executive depth across the 13 global market regions in which it operates. It remains a competitive point of difference alongside its proven High Volume Mentality business approach, which aims to increase profitability by delivering affordable products to increase customer count rather than increasing margins.

This philosophy and deep corporate memory is what sets the company apart from its peers. The business now covers three core regions, Australia and New Zealand, Asia Pacific, and Europe. Andre Ten Wolde is Europe CEO, and Josh Kilimnik oversees the APAC territories.

While external talent aims to fulfil certain internal skill sets, the majority of the group's executive leadership team comes from within. Culturally strong, the opportunity for succession is more apparent. However, CEO Meij has made known his intentions to stay on for the foreseeable future.

When the time comes, the question will be whether anyone can match CEO Meij's industry knowledge and genuine love of the business.

Cochlear

Unlike most companies mentioned in this article, Cochlear is not founder-led. When it listed in 1995, it had a market value of $125m. At the time, the group was led by Catherine Livingstone before external appointment, Jack O'Mahony took charge in September 2000.

Unfortunately, promising that the group could sustain high levels of revenue growth each year proved his undoing. Chris Roberts, another external appointment, took the reins in 2004. This time Cochlear found the right balance, an executive with substantial industry experience, having left health group ResMed to take on the top job.

Over the subsequent eleven years, Roberts instilled a disciplined, long-term commitment to build a global business franchise. Industry-leading LEAN manufacturing techniques were introduced, as was a relentless annual commitment to research and development investment.

The company shifted from a cottage industry operation to a world-class manufacturing operator, sustaining its global market-leading position. Retiring in 2015, the company looked inwards for its next CEO, settling on U.S. President Chris Smith. Personal factors made this a difficult transition. Eventually Dig Howitt, another internal candidate, took over in 2018 as the group's CEO.

CEO Howitt joined the company in 2000 and has covered multiple roles, including manufacturing, logistics, President Asia Pacific, and group Chief Operating Officer. He is joined by Chief Financial Officer Stu Sayers, a Cochlear employee since 2016, focused on the company's Services division. Similar long-standing employees include Jan Janssen who joined in the same year as Howitt and is the group's Chief Technology Officer.

Further afield, the list goes on:

- President North America Lisa Albert has been with the company since 1994
- President EMEA Richard Brook in 2003
- President Asia Pacific and Latin America, Anthony Bishop in 2016
- Global Strategic Marketing Vice President, Dean Phizacklea also in 2016
- Group Chief Information Officer, David Hackshall in 2015
- Vice President, Global People and Culture, Jennifer Hornery in 2008
- Global Supply Chain Vice President, Greg Bodkin in 2007

This level of executive tenure is reflected in the group's strong financial performance. It also demonstrates the maturity of a business that is prepared to take small, consistent steps to achieve long-term goals. With the track record to date, it is hard to imagine the next CEO would not be an internal appointment.

CSL

Not to be outdone, global plasma leader CSL has gone one better than Cochlear. The company has had just two leaders since listing in 1994, on a market valuation of $299m.

In an almost founder-style approach, current Chairman Brian McNamee commenced as the inaugural CEO of the business, joining in 1990 and remaining in charge until 2013. He returned as a non-executive director in 2018 before taking on the Chairmanship role that same year.

On his retirement, the company chose an internal candidate Paul Perreault to take over. Perreault joined the company in 2004, ultimately progressing to the role of Behring's President and Executive Vice President of Worldwide Commercial Operations and Business Development.

Under the leadership of both men, backed by a strong and stable executive team, the business has flourished. Most evident has been the level of consistency characterised by disciplined financial performance and a long-term commitment to research and development investment, augmented by bold acquisitive moves.

The business is today valued at $136b. It is rare to find the level of success CSL has enjoyed without acknowledging the extraordinary leadership of the Board and management team. In December, global plasma leader CSL announced the retirement of CEO Paul Perreault in March 2023.

His internal replacement, Paul McKenzie, will assume the role on 6 March 2023, having originally joined the group in 2019. The company notes, *"Since joining CSL as Chief Operating Officer in 2019, Dr. McKenzie has been accountable for optimising CSL's operations as well as growing the CSL Seqirus, CSL Plasma, and CSL Vifor businesses."*

Current Chairman and former CEO Brian McNamee, noted, *"Paul McKenzie is a patient focused global leader with a demonstrated track record of leading complex organisations and delivering outstanding business results. With his deep understanding of CSL's strategy, culture and operations, Paul is well-positioned to lead CSL to its next level of sustainable growth for our shareholders and the patients we serve around the world."*

The CSL business has evolved materially over the decades since listing in 1994, which now encompasses three core global franchise businesses namely, blood plasma, influenza, and renal and iron deficiency. However, it also reflects a preparedness to do things differently from the customary norms of most modern-day boards and to think and invest always with a long-term perspective.

The appointment of Paul McKenzie, an individual that has overseen all aspects of the organisation and importantly transitioned the business to operate as a global network allows the group's momentum to continue uninterrupted.

McKenzie also embraces the BHAG concept, '*Big Hairy Audacious Goals*' as the company looks out to 2030 and beyond.

NIB Holdings

Healthcare company NIB has all the characteristics of a founder-led business. The business morphed from its mutual status, listing on the stock exchange in 2007 at a market value of $442m.

Since listing, NIB has been guided by CEO Mark Fitzgibbon who joined the company in 2002. A remarkable feat. As the Australian Financial Review noted in October, *"This month Mark Fitzgibbon reached a rare milestone in corporate Australia. The chief executive of NIB, a $3 billion health insurer, has been in the role for 20 years, about four times the average for an Australia listed company CEO."*

Over the past two decades, the company has transitioned from a pure health insurer into CEO Fitzgibbon's preferred description as a healthcare company.

Growth has been achieved organically, alongside targeted healthcare adjacencies. The most recent example is its entry into the Plan Management industry, supporting the country's National Disability Insurance System.

The company has a strong, culturally aligned board and an executive team with deep experience. The appointment of seasoned Chief Financial Officer Nick Freeman in 2020 offers a glimpse of a potential future leader. In saying that, CEO Fitzgibbon notes the company has a *"pretty healthy pipeline"* of suitable replacements when the time is right to move on.

While COVID-19 provided a positive benefit to health insurance profits and margins, travel and international workers' and student's insurance suffered from imposed restrictions. The business is now enjoying the economic benefits of reopening and the increased demand for healthcare cover.

Despite his long tenure, CEO Fitzgibbon's guiding influence and sense of direction remain just as relevant today, *"I'm probably more effective in the sense that I have an even deeper understanding of the healthcare sector."*

The shareholder value created under his watch goes some way to support this view.

Great by Choice

The quote at the start of our article is from Jim Collins' book Great by Choice. The following extract, *"They aren't dogmatic or rigid, they're disciplined, they're creative, they're paranoid"*, applies appropriately to the next two companies.

Altium

Altium, the leader in electronic Printed Circuit Board (PCB) design, has been on a strategic path for well over a decade. Led by CEO Aram Mirkazemi, a close-knit management team and an aligned board, the company has delivered impressive performance. As the above extract makes clear, success requires discipline, creativity, and a degree of paranoia.

The Altium team certainly possess these attributes, and as substantial shareholders they are also transparent and aligned in their aspirations.

In 2012 the company spoke about its rebuilding phase surrounding PCB design. This was followed up in 2015 with an emphasis on financial performance to justify the years of investment. In 2018, management backed this up with aspirational targets, aimed at cementing a lead in the global PCB industry from existing incumbents.

The current period between 2021 to 2025 reflects a culmination of effort and its pursuit to dominate and transform the electronic design industry.

The achievement of these milestones has only been possible by consistent execution and a management team totally aligned to the task. Under CEO Mirkazemi's leadership, the business has pivoted at significant points.

Critical to this has been the role of key executives. In particular, Sergiy Kostinsky's role as Executive Director and more specifically Group President, provides a clear path to succession beyond CEO Mirkazemi. Importantly, their relationship is built on genuine respect of each other and the task at hand.

In the case of CEO Mirkazemi, his involvement with Altium stretches to the company's beginning. Firstly, as a Director of Research and Development (1991-1999), including the company's public listing in 1999. Mirkazemi took a brief break before returning in 2010 and then into the CEO role in 2014.

Kostinsky's involvement with the company began in 2001, following Altium's acquisition of the Dream Company. Like Mirkazemi, Kostinsky briefly left the business, only to return in 2010. He joined the Board in 2018 and has been instrumental in developing the company's cloud platform business offering.

CEO Mirkazemi, Group President Kostinsky, and Chairman Sam Weiss represent a unified approach to deliver on what the company has openly set down; to lead and transform an industry ripe for disruption.

WiseTech Global

A similar vision to dominate an industry, in this case global logistics, has been the driving force behind co-founder Richard White and Maree Isaacs' WiseTech business.

Founded in 1994, the company began by writing software code for the industry's freight forwarders. In 2008, the company introduced its Software-as-a-Service offering, followed by the launch of its flagship CargoWise global logistics platform in 2014.

The company listed in 2016 with a market valuation of $974m. Today it commands a market leading position, servicing 10 of the top 25 global freight forwarders and annually investing in excess of $180m as it continues to create breakthrough products.

The strength of the organisation is its people and leader. White noted this in the 2022 annual report, *"One team, one vision"*, and is further set out in the company's Credo.

"We favour principles over policy, open and frank communication over secrecy, agreement over control, results over busywork. We realise that real creativity is delicate and dies with processes, bureaucracy, chain of command and centralised decision making. Our work environment is flat and open, hierarchy rises only when essential and recedes immediately. We know that little things are infinitely the most important and that culture eats strategy for lunch."

Like Altium, WiseTech's executive team is equity aligned with long tenure. The company's progress to date has been well considered, and the question of who shall lead next is likely to be no different.

Not there yet

While our portfolio holdings listed above have dealt or are dealing with succession, some have stumbled.

Iress

CEO Andrew Walsh announced his intentions to retire from the company after a long stint, following a 13-year career as Managing Director and 21 years with Iress. Under his leadership, the company has significantly expanded through strong organic growth and strategic acquisitions, both locally and internationally.

The Iress team has been loyal and culturally strong. Whilst the Board, although supportive, has lacked depth. The pursuit of long-term business opportunities covering the wealth and financial data market space has resulted in a highly recurring revenue stream and a pipeline of future options. The company has always operated in a financially conservative manner, carrying low levels of net debt, and expensing all research and development expenditures.

This approach has not always delivered the desired bottom-line results, with revenues and profitability often lagging the necessary upfront investment required. Walsh took steps to change this trajectory. Scaling operations in large addressable markets was a key focus, honing in on the U.K., superannuation and investment infrastructure, alongside improving margins. With a renewed board, led by Chairman Roger Sharp, the company provided an aspirational outlook in 2021 to double net profits from current levels by 2025.

This remains the case today despite Walsh calling it a day. While his successor is not an internal candidate, the company did secure the services of what appears to be a very capable executive in Marcus Price. His background includes nine years as CEO of start-up company Property Exchange Australia (PEXA), Australia's first digital property exchange. Today PEXA captures more than 75% of all property transactions, ultimately leading to its trade sale in 2018 and public listing in 2019.

Now in the top job at Iress, Price is supportive of the path and targets previous management had set. While the choice of Price may prove correct, the company failed to provide succession leadership, probably highlighting internal shortcomings.

The question now is whether the company, under a new CEO, can effectively execute Walsh's original vision for Iress, *"Simpler, faster with higher returns"*.

Appen

In some instances, succession is forced with global data annotation leader Appen being the case in point. In this instance, the board led by Chairman Richard Freudenstein undertook an internal review leading to the decision to replace current CEO Mark Brayan with an external appointment. This is a difficult decision, noting CEO Brayan has successfully built the business over a period of seven years, having taken over from the company founders, Chris and Julie Vonwiller.

That said, the board has acted prudently and with far better information to make the call. Importantly, the search for a suitable candidate was undertaken over several months ultimately leading to the appointment of a North American based executive. This is an important point as the business dynamics and the company's core customer base resides in this market.

With that, Appen announced the succession of CEO roles from Brayan to Armughan Ahmad effective 30 January 2023, thereby ensuring a smooth transition.

The notice to the Stock Exchange announcing the change provided some initial background on the new appointment, *"Armughan brings over 25 years of global experience in the technology industry having led product, sales, and services organisations at KPMG, Dell Technologies, and Hewlett Packard in the past. In his most recent role as President and Managing Partner of Digital at KPMG in Canada, Armughan oversaw the firm's innovative services to product shift by delivering exponential technology-based market offerings to accelerate industry sector focused digital transformation for customers. Prior to KPMG, Armughan served as the Senior Vice President of Dell Technologies where he led Dell EMC's Cloud, High Performance Computing, Workload Solutions and Alliances businesses. Armughan previously held executive positions at Hewlett Packard, 3Com and other technology companies across US, Europe, and Asian markets."*

Chair Freudenstein added, *"As we scale Appen to its next phase of growth, the board felt it was important to appoint a successor with deep technology expertise in international markets. "Armughan is an outstanding candidate and is ideally suited to be the next CEO of Appen. He is one of the technology industry's most successful and respected executives having worked in both technology product companies in Dell Technologies, Hewlett Packard and also in the services industry transformation at KPMG. Armughan has an incredible track record of driving growth and operational excellence, he is passionate about customers and partners, strongly believes in company culture, and is focused on delivering best-in-class innovation."*

And from an incoming CEO perspective Armughan noted, *"Appen sits at the intersection of how the world is driving human progress forward by leveraging AI to gain further insights into their data and deliver new customer and employee experiences. The impact of AI on every part of our daily lives is changing at an exponential rate. The world needs an AI that is trusted and benefits people and society. "In my due diligence with industry partners and customers, I've found that Appen has the best technology in its category and delivers AI products and services to many of the world's largest tech companies and Fortune 500 customers globally. Above all, Appen has built an incredible team that is committed to driving innovation while putting customers first. I am looking forward to leading this talented organisation to deliver continued innovation for our customers, value for our shareholders, and enhanced experience for our crowd contributors and employees."*

As to whether this will work out best for the company, time will tell but we note that the one-off long term incentive offer of US$5m to be awarded over a three-year period to the new CEO is predicated on the share price of Appen appreciating 190% for half the allocation and the balance at 320%.

Based on the current share price of $2.50, this would suggest a share price of $7.25 to $10.50 would be required for these share grants to be of any value, providing a proper alignment between executives and shareholders.

While the company has encountered significant business headwinds during the course of 2022, we support the Board's actions in dealing proactively on the question of CEO succession.

James Hardie

The company is a true success story. It entered the U.S. market with zero share of the home siding market and developed fiber cement products, a new product category at the time, which today is the clear market leader. Much of that success can be sheeted home to the product's redeeming qualities and the group's committed executive leadership team.

Since 2005, the firm was led by U.S.-based Louis Gries. In 2019 Gries officially stepped down after 28 years of tenure, but the succession process had been four years in the making. The issue of why four years, resulted from an identified internal succession candidate failing at the last hurdle.

This setback led to the external appointment of Jack Truong to operate within the company on a trial period. In 2019, Truong was selected as the new CEO.

History now shows that while Truong succeeded in aligning the business operations as an effective global unit, he also failed the company's code of conduct, ultimately leading to his dismissal in early 2022.

Following an extensive executive search, including a review of all suitable internal candidates, the company has now chosen an outsider, Aaron Erter to run the business. He is supported by a deep and culturally aligned executive team, including CFO Jason Miele, President North America Sean Gadd, and Executive Vice President Global Operations Ryan Kilcullen, to name a few.

Whether the company has chosen well is too early to call, although the Board is confident in its decision. Here lies the biggest shortcoming of getting succession wrong; the truth as to whether CEO Erter is the right leader or not is an exercise in time, measured in months, if not years.

That is not to say internal succession doesn't carry its own failings, but a company forced to look out, with the clock ticking, has its hand forced. The hope is that having erred once, the company has chosen correctly, providing the leadership that a relatively young executive team can thrive on.

Blackmores

Anyone wanting an illustration of succession done poorly need not look further than Australia's leading complementary medicines company, Blackmores.

This year, the business celebrated 90 years of operation since its founding in 1932. While Marcus Blackmore is the largest shareholder with a reported 18.9% interest, the business was founded by his father, Maurice Blackmore.

In 2020, Marcus Blackmore stepped down from the company following 47 years of tenure, encompassing the roles of CEO, Director and Chairman.

The failing of the company can be largely sheeted home to Blackmore and the Board. As a founder-led business it should have better prepared the business for growth, with a focus on investment and executive leadership.

In short, the company was missing in action, benefiting more from luck rather than good management. The appointment of Christine Holgate as CEO and Managing Director in 2008 provided some direction and important markers for the business, including its direct commercial launch in China in 2013.

The business grew strongly, but Blackmore's constant interference with operational matters lessened its long-term progression.

In 2017, nine years after joining, CEO Holgate stepped down. Succession was not in place, and the Board's leadership search led to the appointment of the company's Chief Operating Officer Richard Henfrey as CEO.

The company's choice was a poor one, compounded by Board upheaval and the appointment of long-time director Brent Wallace as the new Chair in 2018.

CEO Henfrey resigned in 2019 following pressure from the Board and Blackmore in particular, *"The board want change, they sat down with Richard and said what they thought about where we should be going with the business and gave Richard the option of either staying with the business or resigning."*

External candidate, Alastair Symington was appointed as CEO in 2019. The subsequent board renewal process led to Blackmore stepping down and new independent directors appointed.

This has not gone down well, reflected in the disparaging way management and the Board were repeatedly questioned by Blackmore at the 2022 annual general meeting. The company also recorded a first strike against its remuneration report, and the potential of a second strike now hanging over the Board.

So why has this happened?

There are many views, but our take is a simple one. The founder and board failed in its primary duties, leaving the current executive team to pick up the pieces of long-term underinvestment and a cost base out of sync with current market conditions.

Despite ramblings from Blackmore and his trusted lieutenant Stephen Chapman, who joined the company board in 1993 and chaired the firm on a number of occasions, the lack of proper corporate governance and failure to address internal matters surrounding leadership and succession, has cost the company dearly.

Contrary to the views of Blackmore, the executive team led by Symington and new CFO Patrick Gibson are delivering on a long-term agenda to drive sustainable growth, and to restore gross and operating margins while maintaining business reinvestment. This will result in a lower dividend payout ratio but allow for a sensible re-allocation of capital into the required areas of the business.

It should come as no surprise then that the biggest impact being felt from the company's and the Board's lengthy inaction, is Blackmore himself. The question is now whether continuing interference and 'rock throwing' will lead to ongoing company disruption.

Opinion

Chairman and founder of Domino's Pizza Enterprises describes the role of a leader well, *"delegate but don't abdicate"*. Graham Turner, co-founder of Flight Centre Travel Group, notes one of the key lessons learnt is *"having a leadership team that you can totally trust to do the right thing and take the initiative is probably the major thing."*

WiseTech founder and CEO Richard White emphasises the company's core philosophy of *"slower today, faster tomorrow"* in reference to taking careful, meaningful steps to build a lasting business. Finally, Winston Churchill correctly identified the essence of any successful enterprise, *"We shape our culture, and thereafter it shapes us."*

Doing succession well is not easy. However, it is the most critical responsibility bestowed on any leader or board. While there are exceptions, those with a founder-led mindset care deeply about the long-term health of a business. To that end, people are a company's only truly sustainable competitive advantage – plan for change, invest in their development, and they will do great things. ***SFM***

FINANCIAL PERFORMANCE VS SHARE PRICE PERFORMANCE

Investors often confuse share price performance with financial performance. It follows the thought that if the share value of a business is rising, so too is its health and financial wellbeing. Conversely, a declining share price would suggest the opposite.

While the financials of a business should matter more, share price performance often lands in the spotlight. What drives such outcomes is not necessarily logical, or obvious at the time. Investor enthusiasm, momentum investing, or the fear of missing out are market terms used to describe why some sectors or companies do particularly well on the charts, even though the numbers would indicate otherwise.

Whether the market is efficient or not is open to differing views. Our approach, however, is to place greater faith in a business, its people, and its balance sheet to generate long-term earnings per share growth over daily, monthly, and yearly share price moves.

Below we highlight two companies: Aristocrat Leisure owned; and Mineral Resources, which is not held in our portfolio. Both businesses are proven performers and in the case of Mineral Resources, a founder-led success story.

Aristocrat Leisure

Chart 16 reflects the one-year share price performance of Aristocrat Leisure. It has dropped from a starting point of $43.57 to its ending price of $30.71 over the course of 2022.

Assessing how well the company was tracking based on its share price would have led you astray. In fact, the year was a very good one, and the numbers clearly reflect that. Figure 22 sets out the summarised financial numbers for 2022 compared to 2021.

Chart 16: Aristocrat Leisure - 12 Month Share Price Performance 2022

Source: Iress

Figure 22: Aristocrat Financial Performance Summary 2022

A$ million	Constant currency[2] 2022	2022	2021	Variance vs. 2021 Constant currency[2] %	Variance vs. 2021 Reported %
Normalised results[1]					
Operating revenue	5,305.0	**5,573.7**	4,736.6	12.0	17.7
EBITDA	1,753.6	**1,850.9**	1,542.9	13.7	20.0
EBITA	1,506.6	**1,592.9**	1,277.4	17.9	24.7
NPAT	946.7	**1,000.9**	765.6	23.7	30.7
NPATA	1,039.9	**1,099.3**	864.7	20.3	27.1
Earnings per share (fully diluted)	142.1c	**150.2c**	120.0c	18.4	25.2
EPS before amortisation of acquired intangibles (fully diluted)	156.0c	**165.0c**	135.6c	15.0	21.7
Total dividend per share	52.0c	**52.0c**	41.0c	26.8	26.8
Reported results					
Revenue	5,305.0	**5,573.7**	4,736.6	12.0	17.7
Profit after tax	900.8	**948.5**	820.0	9.9	15.7
NPATA	994.0	**1,046.9**	919.1	8.1	13.9
Balance sheet and cash flow					
Net working capital/revenue	1.2%	**1.2%**	(2.2%)	3.4pts	3.4pts
Operating cash flow	1,180.5	**1,246.0**	1,328.4	(11.1)	(6.2)
Closing net (cash)/debt	(599.0)	**(564.0)**	804.5	n/a	n/a
Gearing (net (cash)/debt to consolidated EBITDA[3])	n/a	**(0.3)x**	0.5x	n/a	0.8x

1. Normalised results are statutory profit (before and after tax), excluding the impact of certain significant items detailed on page 15.
2. Results for 12 months to 30 September 2022 are adjusted for translational exchange rates using rates applying in 2021.
3. Consolidated EBITDA for the Group as defined in Aristocrat's Syndicated Facility Agreement (also referred to as Bank EBITDA).

Source: Aristocrat Leisure Annual Report 2022

Notable points worth calling out:

- Operating revenue was higher at $5.6b compared to $4.7b, organically driven
- Operating profits (EBITA) higher at $1.5b, up 25% on the $1.3b delivered in 2021
- Net profits (NPATA) grew 27% to a record $1.1b
- Earnings per share grew 22% to $1.65
- Dividend per share grew 27% to $0.52
- Net cash of $564m

Design & Development spend

It is also worth commenting on the quality of the result. The company expenses all design and development (D&D) outlay rather than capitalising these costs, as is common practice.

In 2022 the company invested $667m, or 12% of group revenue on D&D, not an insignificant amount.

Fully expensing this investment has painted a very conservative picture of the company's financial account, while the actual investment is enabling future success.

Recurring revenues

In our eyes, not all revenues are created equally. A business driving a high level of recurring revenue deserves a higher premium. In 2022 over 75% of group revenues ($4.2b) were recurring, providing management the confidence to plan and re-invest.

Chart 17: Aristocrat Long-Term Share Price Performance Since 1996

Source: Iress

Comment

Aristocrat's long-term financial track record is strong, and under the leadership of CEO Trevor Croker the business has successfully taken on all comers, becoming the leading regulated gaming content operator globally and a top mobile games publisher.

The business employs over 7,500 people, covering 101 countries and 325 regulatory jurisdictions. The company was founded in the 1950s, went public in 1996, and secured its U.S. Nevada licence in 2000. The weak short-run share price performance posted during 2022 is counter to the actual long-run business deliverables, as reflected in Chart 17.

Mineral Resources

In 2022 Mineral Resources celebrated 30 years in business, led by its founder and CEO Chris Ellison. The below is an extract from CEO Ellison's letter to shareholders in the company's 2022 annual report.

"I've never stopped being excited about the future.

That's the ethos that MinRes was founded on from day one.

This year marks an important milestone – 30 years since MinRes was born as a two-person crushing company operating out of my lounge room with $10,000 and big dreams.

Fast forward to today, and we have grown to become a diversified top 50 ASX company employing nearly 5,000 people, with a market cap of more than $10 billion.

There's been enormous change in that period. But our excitement for the future has never wavered.

I want MinRes to always anticipate and help build the future – not let future conditions dictate our success. To always be looking down the road to see what's next.

As I look down the road today, it's paved with people who have the ideas and knowhow we need to succeed."

2022

The year has been an incredibly rewarding experience for shareholders, as Chart 18 highlights, with the company's share price rising from $52 to close the year at $77.20.

Chart 18: Mineral Resources Share Price Performance 2022

Source: Iress

Figure 23: Mineral Resources Financial Performance Track Record

Financial Summary ($millions unless otherwise stated)	2013	2014	2015[1]	2016	2017	2018	2019	2020	2021	2022
EARNINGS										
Revenue	1,097	1,899	1,299	1,178	1,458	1,624	1,512	2,125	3,734	3,418
EBITDA	383	554	283	278	473	575	386	2,006	2,183	969
NPAT	180	231	78	-26	201	272	165	1,002	1,268	351
Return on Revenue %	16%	12%	6%	-2%	14%	17%	11%	47%	34%	10%
Return on Equity %	18%	20%	7%	-3%	18%	21%	12%	44%	39%	11%
Diluted EPS (cents/share)	97.37	124.1	41.52	-13.31	107.66	145.3	87.09	532.96	673.18	184.87
BALANCE SHEET										
Total Assets	1,804	1,858	1,592	1,618	1,835	2,085	3,161	4,631	5,724	7,811
Total Equity	1,018	1,139	1,082	1,009	1,132	1,305	1,380	2,296	3,246	3,271
Net tangible assets per share ($/share)	5.08	5.75	5.44	5.14	5.64	6.58	6.89	11.78	16.55	16.67
CASH GENERATION										
Operating Cash Flow[3]	329	567	52	316	296	411	186	674	1,642	344
Net (Debt)/Cash	(310)	81	118	188	104	1	(897)	231	280	(698)
MARKET CAPITALISATION										
Number of shares on issue (millions)	186	187	188	187	187	188	188	188	189	189
Share price at 30 June ($/share)[2]	8.25	9.59	6.60	8.31	10.85	16.00	14.98	21.17	53.73	48.27
Market Capitalisation	1,534	1,789	1,238	1,553	2,033	3,003	2,818	3,990	10,141	9,133
RETURNS TO SHAREHOLDERS										
Total Shareholder Return (cumulative) ($/share)	9.07	11.03	8.44	10.38	13.34	19.07	18.58	25.31	59.64	55.93
Dividends declared (cents/share)	48	62	22.5	29.5	54	65	44	100	275	100

Source: Mineral Resources Annual Report 2022

However, comparing share price performance with financial performance does not necessarily line up as Figure 23 shows.

A few points worth calling out, contrary to what Chart 18 may be indicating:

- Revenue declined 8% to $3.4b during the year
- Operating profits (EBITDA) fell 56% to $969m
- Net profit (adjusted) fell 64% to $400m
- Earnings per share fell 64% to $1.85
- Dividend per share fell 64% to $1.00
- Net cash of $698m
- Issued capital unchanged since 2013

Business

Investors have looked through the poor 2022 financial performance and maintained their enthusiasm, with good reason. Since first listing in July 2006, with an issue price of $0.90 per share, the company's founder has built a successful business.

There are aspects of the company we gravitate to, including its founder-led origins, conservative balance sheet approach, and the fact its organic business growth is funded from internal cash flows. A case in point is the company's issued capital, which remains relatively unchanged at 189m shares since 2013.

Other business aspects we struggle with, like the fact it operates within the resources industry, is a price-taker, lacks any recurring revenue base, and requires big licks of capital expenditure to sustain production and extend resource mine-life. When tallied up they diminish the overall quality of the business and introduce risk factors that may become more apparent in time.

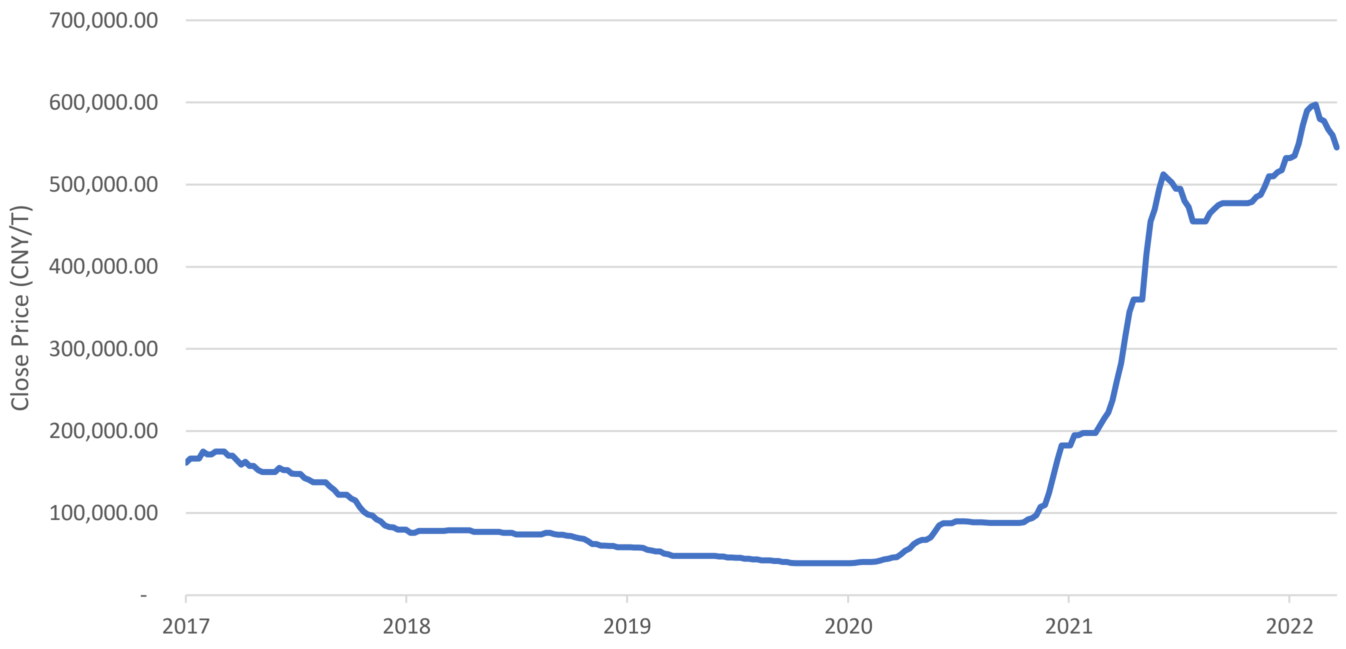
A good example is the lithium resources market. We cannot comment on the industry or the company's resource position. The business, however, speaks highly of the global opportunity and is committed, having identified lithium products as critical to a renewable future as the world looks to decarbonise.

"Lithium remains one of MinRes' key pillars and through an ambitious growth strategy, the company has built a 30-plus year business horizon that will support the continued growth and diversification of its lithium portfolio in line with growing market demand."

In 2022 the Lithium business segment contributed $791m of revenue up from $130m in 2021, and operating profits (EBITA) totalling $566m from a previous year loss of $29m. In short, Lithium operations delivered 23% of group revenue and 70% of operating profits before head office costs, underlining its importance.

Chart 19 provides some colour on Lithium Carbonate pricing, which has risen from levels of CNY100,000 per tonne during recent years to well over CNY500,000 per tonne during 2022.

Chart 19: Lithium Carbonate Price Chart



Source: Refinitiv

Chart 20: Mineral Resources Long-Term Share Price Performance Since 2006

Source: Iress

Analysts forecast Lithium's contribution to group revenues and profits will rise substantially over the coming years. In addition to the company's other business earners, namely iron ore, mineral services, and energy.

All in all, the business has momentum and strong investor belief that earnings will grow significantly, although much is predicated on future commodity prices that sit outside the company's control.

The share market is clearly showing its support. Chart 20 highlights the surge in share price performance since 2021, despite the company delivering a substantially weaker financial performance in 2022.

Comment

Judging a company's performance solely on share price action rarely tells the whole story. In our examples, Mineral Resources has proven its capability to deliver, reflected by the strong market support of potential future achievements.

In contrast, the recent share price action of Aristocrat Leisure would suggest areas of concern or financial underperformance, when in fact the opposite is true.

In a 1987 letter to Berkshire Hathaway shareholders, Warren Buffett said it best when describing how the stock market approaches this delicate balance, "*In the short run, the market is a voting machine but in the long run, it is a weighing machine.*" ***SFM***

TECHNOLOGYONE – 2022 SUSTAINABILITY

Overview

TechnologyOne is Australia's largest global software as a service (SaaS) enterprise resource planning (ERP) solution provider. For more than 35 years, the company has been powering over 1,300 leading corporations, government agencies, local councils, and universities with enterprise software that is easy to use and adapts to new and emerging technologies.

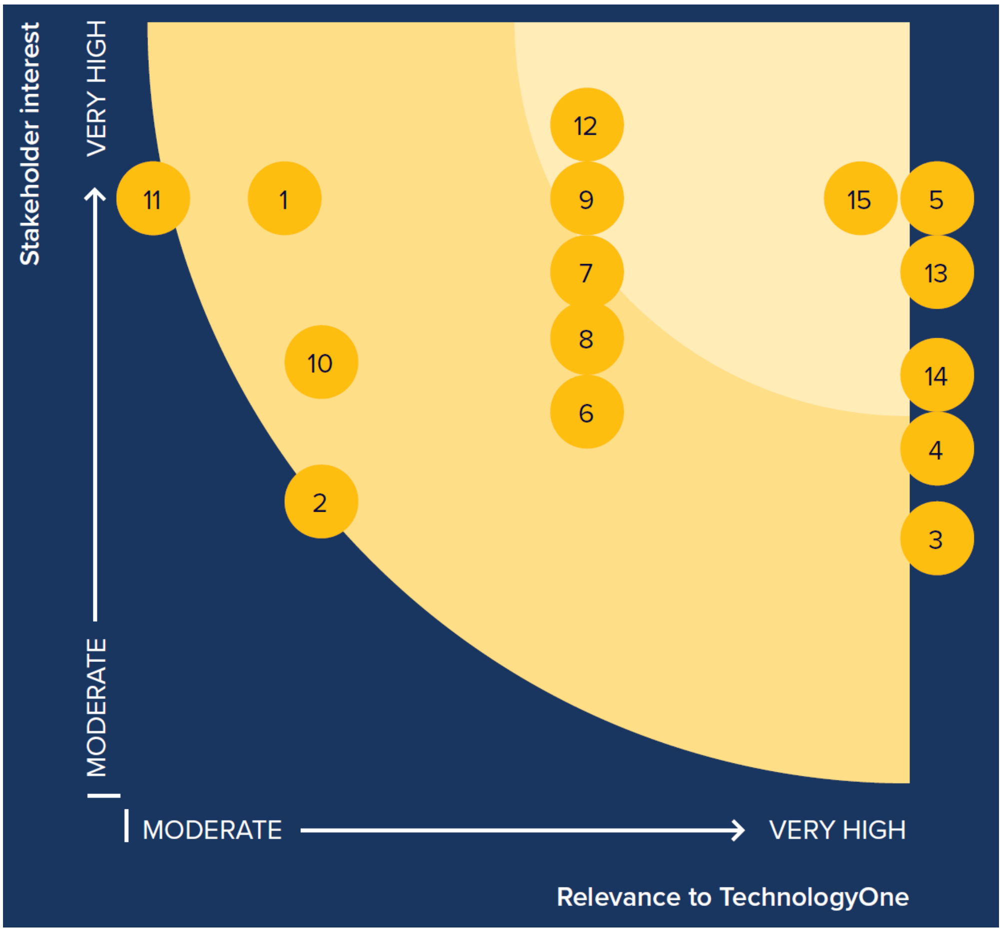
In December 2022, TechnologyOne published its fifth annual report on Environmental, Social and Governance (ESG) performance. The "Sustainability Report" builds on previous achievements and provides insight into future targets and goals.

Materiality assessment

During the year, the company undertook a materiality assessment to ensure its ESG agenda was in line with the interests of its stakeholders and the needs of the business. The process followed the Global Reporting Initiative (GRI) standards and was based on material relevance to its business model, corporate strategy, enterprise risks, and key performance indicators. The company also engages with its stakeholders on an ongoing basis and uses feedback from targeted surveys to inform its assessment.

Figure 24 shows the results of the assessment. Unsurprisingly, the two areas that ranked the highest were: Governance issues, including effective governance, risk, and compliance management; and Social issues, including data protection and cyber security, and customer expectations, satisfaction and retention.

Figure 24: TechnologyOne Materiality Matrix



Source: TechnologyOne 2022 Sustainability Report

Approach to sustainability

TechnologyOne has an ESG-related approach to sustainability that is driven by sound governance. The Board and Committees are involved in setting the ESG agenda and reporting, while the leadership within the business ensures ESG impacts are aligned with sustainability focus areas.

An ESG framework informs how the business is managed and assessed, accounting for the issues that matter most to stakeholders. Each team member is responsible for embedding sustainable practices into everyday operations.

Thirteen topics were identified in the materiality assessment, which have been split into six key areas of focus and sit under the three ESG pillars:

- Responsible Business (**G**) – Ethics, values and transparency; Innovation, research and development; and Effective governance and risk management.
- Our Economy (**G**) – Shareholder value.
- Our Customers (**S**) – Customer satisfaction and retention; Data privacy and security.
- Our People (**S**) – Employee health and wellbeing; Employee engagement and development; Workplace diversity and inclusion; and Talent attraction and retention.
- Our Community (**S**) – Responsible sourcing; Community investment.
- Our World (**E**) – Environmental impact reductions.

We provide further detail on key areas below.

Responsible Business

Ethics, values and transparency

The TechnologyOne Way, guided by the core beliefs and values of the company, promotes ethical and responsible business practices. This includes an emphasis on corporate governance, accountability, innovation, and transparency. It outlines the expectations of the company's directors, managers, and team members to act with integrity, follow best practices, and enhance the reputation and performance of the company. Transparency is also seen as critical to the success of the company, helping to foster open dialogue with stakeholders and demonstrate an understanding of ESG risks.

Effective governance and risk management

A comprehensive corporate governance framework, based on leading standards and industry best practice, exists to ensure the company operates responsibly and sustainably. Risk management and assurance controls are also in place to mitigate material risks such as cyber and people risk.

No material legal or regulatory non-compliances occurred during the reporting period.

Innovation, research and development

TechnologyOne has designed a cloud-based enterprise resource planning platform called CiA that gives users access to the entire suite of their products. CiA integrates 16 products across key industries and supports 300 modules with over 10,000 capabilities, allowing customers to manage their day-to-day operations through a single interface.

Over 800 organisations are on the TechnologyOne SaaS platform, with 100 customers using the new migration tool to transition to CiA frictionlessly during the year. CiA delivers several business and customer benefits, including a 25%-50% cost saving for small and medium-sized enterprises (SMEs), a 22% increase in developer productivity, a 15% reduction in asset-related labour costs, and a reduction in carbon emissions.

The company's commitment to research and development (R&D), spending circa 25% of revenue in FY2022, and twice-yearly Hack Days further demonstrates its dedication to innovation.

Our Economy

Shareholder value

TechnologyOne has been consistently profitable since 1992 and has a history of strong financial performance, including high levels annual recurring revenue from its SaaS offerings. The company attributes its success to its clear vision, strategy, culture, and investment in R&D, as well as a focus on strong financial performance and shareholder value.

TechnologyOne plans to achieve over $500m in annual recurring revenue by FY2026 and expects to see business growth of 15% or more per year in the coming years.

Our Customers

Customer retention and satisfaction

TechnologyOne is focused on achieving customer satisfaction and success through a comprehensive suite of fully integrated software products designed to deliver the best user experience.

The company surveys over 1,000 global customers annually and uses this feedback and the Net Promoter Score (NPS) to understand and improve customer satisfaction. TechnologyOne aims to continually better its NPS scores through various initiatives and alignment with industry benchmarks. The customer retention rate is considered a key measure of satisfaction, and remains at an impressive 99%.

Data privacy and cyber security

TechnologyOne operates on a shared responsibility model regarding the security and privacy of its platform. The company has invested in a stringent cyber program and has multiple certifications to ensure the highest safety standards. All team members receive annual privacy and security training, and their nominated Privacy Officers have a deeper understanding of privacy obligations.

In 2022, the group became a member of the Defence Industry Security Program (DISP), which recognises the alignment of security practices with the Australian Department of Defence. Membership in DISP comes with a range of benefits, including the ability to meet security requirements for defence contracts and tenders, access to security advice and support services, and the capability to manage security risks across a business. Additionally, DISP membership can give TechnologyOne a competitive advantage in tendering and bidding.

There were no notifiable data breaches or material security incidents during the reporting period.

Our People

Talent attraction and retention

TechnologyOne is committed to finding and retaining talented individuals by providing them with an environment to innovate and grow. There is a focus on job rotation, promotions, and capability development, as well as building talent pipelines with universities for their graduate and intern programs.

The business also provides an industry-leading onboarding package with an immersive O-Week program and a half-day volunteering experience. In the past year, TechnologyOne has more than doubled its graduate and intern intake and welcomed over 50 new team members through the acquisition of Scientia.

Team member engagement and development

The company invests considerable time and energy into employee engagement and culture-building initiatives to ensure its workforce is engaged and empowered. Twice-yearly employee Net Promoter Score (eNPS) surveys act as a key tool to measure engagement and commitment to the company.

In FY22, the survey provided an eNPS result of +33. This was a significant increase on the prior year's result of +17, and a notable step towards the company's FY26 target eNPS score of +50.

Figure 25 provides the eNPS scores for the prior five years.

Figure 25: TechnologyOne eNPS Ratings 2018-2022

Source: TechnologyOne 2022 Sustainability Report

To celebrate innovation and achievements, TechnologyOne hosts Hack Days, Regional Days, Townhalls, MARVEL Awards, and Service Recognition Awards. The senior leadership team are focused on ensuring all team members have a clear sense of purpose, and that the core values are infused throughout the company.

Leadership development avenues such as mentoring, coaching, and 360-degree feedback are also provided to current and emerging leaders. These values represent their default moral position and underlying principles when working with each other, customers, and the wider community.

Diversity and Inclusion

TechnologyOne is committed to creating an inclusive and diverse team, which is integral to its culture and commercial success. The company strives to foster an environment of trust and respect where everyone feels empowered to reach their full potential and has a sense of belonging. The anti-discrimination, workplace gender equality, diversity, sexual harassment, flexible working arrangements, and paid parental leave policies in place are evidence of the company’s commitment to equal opportunity.

The business also advocates for women in the technology sector, sponsoring both the Women in Technology and Women in Digital Awards. Strategies have been implemented to increase the number of women in senior roles, with a goal to include at least one female candidate for 70% of vacancies. To mark International Women’s Day, unconscious bias training was rolled out for team members and a new partnership with UNIQU was launched. Five of their female leaders are also engaged in mentoring high school students.

Team member wellbeing and health

TechnologyOne continues to be dedicated to supporting the mental, physical, and workplace wellbeing of their employees through a revised holistic wellbeing program. As part of this program, TechnologyOne has partnered with eight-time world surfing champion Stephanie Gilmore as the official Brand Ambassador. The company believes wellbeing is key to achieving their employee net promoter goal of +50.

Our Community

Community investment

The TechnologyOne Foundation's mission is to support disadvantaged youths by providing opportunities to transform their lives and create their own paths to success. As part of the 1% Pledge corporate philanthropy movement, the foundation pledges 1% of time, 1% of product, and 1% of profit to charitable causes.

Established in 2016 by founder Adrian Di Marco, the foundation's charity partners and programs include the Smith Family's Learning for Life program and other initiatives that support education, health, and sustainability for disadvantaged children and their families.

In the past year, the foundation supported over 30 charities through 3,811 volunteer hours and donated $1,121,077 through its programs, product discounts, and direct charitable donations. The foundation's goal is to assist 500,000 children to break the cycle of poverty through education, learning, health, and wellbeing support. It has already positively impacted the lives of over 72,000 children through microfinance loans.

The foundation also has a team member-generated giving program, which has raised over $71,000 for supporting charities and their social impact causes, including youth education, health and wellbeing, community disaster response, and Salvation Army flood relief.

Our World

Environmental commitment

TechnologyOne seeks to identify and manage both the risks and opportunities that arise from climate change and disclose its performance in line with the Task Force on Climate-related Financial Disclosures (TCFD). Cloud-based technology is seen globally as an important solution for reducing carbon emissions and energy consumption, and the company will prioritise significant investment towards innovation, new technologies, and enterprise software that can adapt to the needs of the present and future.

Furthermore, the company is committed to reducing its carbon emissions to the lowest amount possible and offsetting any remaining amounts to maintain carbon neutrality.

Carbon neutral certification

TechnologyOne has achieved Climate Active certification for its Australian and global operations and implemented plans to reduce its carbon emissions. To offset remaining emissions, TechnologyOne has purchased and retired certified carbon credits from projects related to wind power initiatives in India and the Oakvale Native Forest Protection Project in Australia.

The group aims to prioritise carbon credits that provide funds to underdeveloped communities without basic infrastructure. In 2022, 5,860.8 tonnes of greenhouse gas emissions were offset by the purchase and retirement of certified carbon credits.

Task Force on Climate-related Financial Disclosures (TCFD)

TechnologyOne has adopted an iterative approach to implementing the TCFD recommendations, which involve identifying, measuring, managing, assuring, and reporting on climate-related risks and opportunities.

The company will continue to assess how such risks and opportunities are quantified, how the Board integrates climate-related considerations into decision-making and strategy, and how engagement with key stakeholders is maintained.

Measuring and managing climate impact

TechnologyOne is carbon neutral for Scope 1, 2, and 3 emissions from their global operations and supply chain. To help with calculating their CO2-e emissions, the company engaged with Pangolin Associates. Total global emissions for FY22 amounted to 5,860 tCO2-e, with the emissions linked to their Australian operations seeing a decrease of 26% from the FY20 baseline.

The group is currently seeking to set meaningful 2025 and 2030 reduction targets. Figure 26 shows the progress to date of emission reductions across the group.

Conclusion

TechnologyOne continues to impress with its commitment and progress across the three ESG pillars, with sustainability deeply embedded into the value and beliefs of the business at every level. We are pleased to see TechnologyOne is making further progress in measuring carbon emissions across global operations and is committed to TCFD reporting.

As previously noted in our September 2022 Newsletter article, "ESG Spotlight – REA, SEK & CAR", we believe all companies should do what they can to protect the environment. Technology companies, who historically often lag behind other industries, citing a smaller environmental footprint, are no exception.

We look forward to seeing how future initiatives develop. ***SFM***

Figure 26: TechnologyOne Emissions Data

Metric	Unit	Target	FY20	FY21	FY22	Progress	Comments
Global GHG emissions (full scope)	tCO_2-e	FY22 baseline reductions	-	-	5,860	New	This year we calculated our emissions from our global operations
Australian GHG emissions (full scope)	tCO_2-e	FY20 baseline reductions	6,765	5,513	4,939	Achieved	
Per employee (total amounts / FTE)							
GHG emissions (full scope)	tCO_2-e	FY20 baseline reductions	7.3	6.7	5.7	Achieved	
Energy intensity	GJ	FY20 baseline reductions	7.6	3.6	3.1	Achieved	
Waste intensity	KG	FY20 baseline reductions	40.1	24.2	26.3	Achieved	
Water intensity	KL	FY20 baseline reductions	12.0	13.6	23	In Progress	FY22 increase is predominately attributed to the capture of increased office spaces through calculating our global emissions
Paper	KG	FY21 baseline reductions	-	6.0	0.5	Achieved	

New | Achieved | In Progress

Source: TechnologyOne 2022 Sustainability Report

THE RENEWABLE ENERGY JOURNEY

This note briefly outlines some options for consideration by SFML for both use of renewable energy for its own electricity needs and some options to assist our team in adopting renewable energy for home use. It also provides some background to ensure we are all talking the same language between carbon neutral and zero emissions energy.

While background elements may already be known, both the media we consume and the people we hear speaking publicly often lack a clear understanding of the complex concepts we are managing.

Background to electricity in Australia

Unless you are "off-grid," all electricity comes from the grid. Our transmission and distribution networks (i.e., the grid) merge the electricity produced by all generators regardless of fuel source. So, unless you are connected directly to a generator, you cannot know which fuel produced your electricity.

To encourage zero-carbon electricity production, Australia has created an accreditation system for renewable generators. Meaning for each megawatt (MW) of electricity produced, one Large Generation Certificate (LGC) is credited. And this is saleable in the market, separate to the electricity. LGCs are sold to people who are obligated to buy them (i.e., retailers must buy LGCs equal to 20% of the electricity they sell) and people wanting to use renewable energy.

Therefore to "use" renewable energy, you really need to "sponsor" renewable energy. That is:

1. Connect directly to a renewable generator – this is often called "behind the meter," which means taking your electricity directly from the generation source. Solar rooftop panels are a domestic example, and businesses that install solar farms next to them are similarly doing this; or
2. Purchase the LGCs from generators delivering clean renewable electricity to the network.

The LGC is proof you are buying renewable energy because you are supporting the renewable generator – they get paid for both the electricity *and* the LGC.

Accordingly, renewable electricity is currently more expensive than buying directly from the grid. Contrary to commentary stating *"renewables are cheaper than thermal"* – which is true on a "levelised cost of energy" (or production) basis. But the market has two separate costs – electricity, plus the LGC.

The LGC scheme expires on 31 December 2030 – the idea being there will be lots of renewables in the system and competitive at that point, as they produce electricity at a lower price than thermal generation (i.e., zero cost of fuel).

Why is renewable energy better for the environment than using a carbon-neutral electricity provider?

In short – electricity produced from renewable energy sources (solar, wind, hydro, geothermal, wave) is zero-emissions electricity. In other words, there is no carbon created from the transition of the fuel source to the power for use. And by paying for such electricity, you encourage more generators to develop renewable generation (see above).

Compare this to a carbon-neutral electricity provider, which buys energy from the grid (which is thermally generated). It then offsets the carbon emitted from production through a project that is certified. This process does not provide an economic incentive to build more renewable generation, but it does incentivise someone to undertake an approved activity.

There are two reasons we should be using renewable energy NOW (rather than offsets):

1. Given we have a limited carbon budget (i.e., the maximum amount of carbon we can cumulatively emit throughout human habitation to avoid tripping into a >2-degree temp increase (we are already going to breach 1.5)), we need to cut emissions as quickly as possible where we can. We note there are areas where zero emissions alternatives do not exist (e.g., air travel, large shipping, many manufacturing processes), and we should be preserving "offsets" for use on these rather than just being lazy about not using renewable energy sources "yet;" and

2. There is much debate about the nature of offsets. For example, are they doing what they say (i.e., quality), and are they improving the situation? Putting aside quality concerns and lack of monitoring, most current offsets are not improving the situation. They are simply not making things worse; for example, by not bulldozing the Amazon when you otherwise planned to. The best offsets are expensive and hard to deliver – including sequestration, which removes carbon from the atmosphere. For over 18 months, SFML has sponsored Climeworks to build and operate the Orca plant in Iceland. Orca is the world's first and largest direct air capture and storage plant, making carbon dioxide removal on a large-scale reality. More work is required for the globe to have industrial-scale sequestration, and this technology will remain expensive until it is scaled. It will, however, be required to meet Net Zero 2050, as there are likely to be several activities which still emit carbon. We need countervailing action to withdraw carbon from the atmosphere to avoid breaching the carbon budget.

Like most situations, beware of the cheap alternatives. Powershop, a carbon-neutral electricity provider, does not support renewable projects, and its carbon offsets are not based on sequestration (carbon fixation and removal). That is why they are cheap. Same with Qantas offsets.

RE100 – the benchmark proof of using renewable energy

https://www.there100.org/

RE100 is an initiative for business committed to 100% renewable energy by a target date set by each company. Most try to align with the required change to be consistent with the Paris Agreement (i.e., limit global warming to >2 degrees and preferably 1.5 degrees). Many Australian businesses have signed up (CBA, Westpac, Atlassian) and entered into contracts to buy their electricity directly from renewable energy generators and pay for the electricity and the LGC. Large users can sponsor the entire generator, for example, by agreeing to take 100% of the offtake of a solar or wind farm through to say 2030. That gets them an overall better price than smaller users who do not underwrite new development.

It is clear from the website that you must have valid certification of production to claim to use 100% renewable energy – and in Australia, that is an LGC.

Summary so far

Carbon neutral is better than nothing, but to encourage the uptake of renewable energy and claim that is what you use, you need to purchase LGCs.

They currently trade at about $50/LGC. It is a true market – as more renewables are developed more LGCs are available, driving down the price if you assume only those obligated to buy will buy (i.e., retailers to 20% of sales). We have seen significant voluntary demand (i.e., businesses signing up for RE100) meaning the price has risen lately. In essence, people are paying a premium for renewable energy.

You need one LGC for each MW of electricity that you use.

The "average" home uses about 5 MW per annum. So, going renewable costs about $250 over the ordinary cost of electricity. More than the cost of buying from Powershop (or equivalent) because it is the sponsorship of renewable energy rather than using lower cost (and sometimes dubious) carbon offsets.

Table 14: SFML Energy Consumption

	Energy Consumption (KWh)	LGCs required	Indicative renewable energy cost*
2018	9,907	10	$500
2019	16,127	17	$850
2020	14,130	15	$750
2021	13,982	14	$700
2022	16,113	17	$850
Total	**70,259**	**73**	**$3,650**

**At $50 per LGC*

What options are there for SFML?

SFML can purchase LGCs in respect of its electricity

This would allow SFML to legitimately state it uses 100% renewable energy – and to choose any electricity supplier it wants (i.e., hunt the best price, and buy LGCs).

SFML can purchase (in whole or part) LGCs in respect of staff usage

Multiple companies are supporting their staff to adopt renewable energy. Iberdrola Australia (the Australian subsidiary) has a program called Green the Team, in which it sells LGCs to businesses to offset staff electricity use.

It is an easy solution because it does not require our team to change their energy supplier, which is really their choice and risk. Instead, SFML team members, on an opt-in basis, estimate (or source from their bill) their electricity usage, and then SFML buys LGCs to match. As noted above, an average family uses about 5MW per annum and a single person is closer to 2MW.

Participating in a program such as this sends a strong message to our clients about the values and purpose of the business.

Go further on the sustainability platform for staff

Some bright entrepreneurs have started a platform called My Net Zero. Link here: [My Net Zero | Enterprise Grade SaaS Platform & Consultancy for Net-Zero Movement]

The My Net Zero proposition is broader than just energy, but it's effectively the same concept – businesses empowering their employees to make sustainability commitments. Iberdrola Australia is the exclusive energy partner, so it's an access point to the renewable energy outlined above, but does provide a broader suite of options for teams making sustainability commitments. The main aim of the program is to get big global companies like Amazon, Google, and Microsoft signed up at the corporate level and then filter this down to the staff. If successful, it could be meaningful.

SFML is not promoting any of these options but has responded thoughtfully to the question about renewable energy use in our business posed by our team and expanded our thinking about what might be possible.

Sylvia Wiggins contributed this article.

Ms Wiggins is a globally experienced senior executive and investment banker with a demonstrated track record over 25 years in public markets, with a focus on finance, strategy, and risk.

Ms Wiggins has been the CEO and CFO of public listed entities, with her most recent role as Executive Director – Finance & Commercial at ASX listed renewable energy company Infigen Energy.

Sylvia is a consultant to SFML.

SFM

WHAT THEY SAID

The Australian Financial Review posed a series of questions to executives during December. We list below companies held in the portfolio and the response from their CEO's.

Q: How do you expect the Australian economy to perform in 2023? What is the risk the economy slows below the federal budget forecast of 1.5 per cent next financial year in response to the RBA's rate hikes?

1. Mark Fitzgibbon, NIB Group

"I'm expecting inflation to ease as energy prices ease, production recovers and supply chains open up. I'll be surprised if we don't achieve at least 1.5 per cent growth. I think inflation is more about cost push than demand pull, so blunting demand with higher interest rates will only do so much."

2. Paul Perreault, CSL

"I think 2023 is shaping up as a pivotal year for the global economy, and Australia is no different. Higher interest rates should start to impact inflation, and there will likely be pressure on domestic demand which should start to normalise. Strong global demand for Australia's natural resources should somewhat offset this, so we believe 1.5 per cent growth is a reasonable forecast. Whether the headline growth rate slows a little below this forecast or not, we agree that the pace of economic growth will slow from the buoyant, above-trend pace of CY22. This is something we prepare for."

3. Owen Wilson, REA Group

"Fundamentally, the Australian economy remains healthy, and I think we'll see this underlying strength continue as we enter 2023. But it's also clear that some parts of the economy will face headwinds as the impacts of consecutive interest rate rises, higher inflation and softening consumer sentiment continue to flow through. In particular, it will take time for the full effects of rising interest rates to become apparent in the economy and on inflation.

From a property perspective, we are continuing to see healthy demand, although there is a level of caution from both buyers and sellers who are seeking greater certainty on the rates cycle following rapid successive interest rate hikes this year. We expect to see activity pick up once there's more clarity that we have reached, or are approaching, the top of the interest rate cycle.

Strong underlying fundamentals remain for the property sector, and the economy more generally, with unemployment at very low levels and increasing migration. Migration into Australia is further fuelling demand for housing, initially with rental properties, but longer term it will drive demand for new and established properties."

4. Dig Howitt, Cochlear

"We need to aim to create and sustain an environment that attracts investment and encourages innovation. A key opportunity Australia faces is to sustain and improve the competitiveness of our economy so that we generate sufficient productivity improvement to drive higher real wages. The key risk is that we don't improve productivity and then growth is likely to slow."

5. Richard White, WiseTech Global

"It's important not to think of the economy as homogenous and to note that not all business and industries are the same in terms of resilience, growth and value.

The tech industry is leading the economy in many ways and creating productive, useful, and powerful improvements to the businesses, to individuals, and to the world. The Australian tech industry is well established but has a lot of upside potential that is less to do with inflation, interest rates or the average of economic growth.

When we listed in 2016, the total tech part of the ASX/S&P 200 index was about 3 per cent, today it's about 9 per cent of the index. When you compare this to the US indexes, tech accounts for 27 per cent, so there's still a lot of upside opportunity.

Australia is a great place to do business. It's a smart country, we are a challenger economy, we have a strong society, a good education system, and a great system of laws.

What a tighter economy and higher interest rates does is move the focus to high quality, strong, profitable businesses that do not need frequent new rounds of capital raising to stay in business." ***SFM***

COMPANY ENGAGEMENTS – DECEMBER 2022 QUARTER

Date	Company	Description
5-Oct	CAR	carsales.com Barrenjoey Industry Insight Call
6-Oct	TNE	TechnologyOne 2022 Showcase
6-Oct	APX	Appen FY22 Trading Update
10-Oct	NAN	Nanosonics GS Small/Mid-Cap Healthcare Forum Day 1
10-Oct	PME	Pro Medicus GS Small/Mid-Cap Healthcare Forum Day 1
11-Oct	TLX	Telix Pharmaceuticals GS Small/Mid-Cap Healthcare Forum Day 2
12-Oct	CSL	CSL Annual General Meeting
12-Oct	NHF	nib holdings NIB Capital Raise - Entry into NDIS Plan Management
12-Oct	WTC	Wisetech Global Citi Australia & New Zealand Investment Conference
12-Oct	CAR	carsales.com Citi Australia & New Zealand Investment Conference
17-Oct	CSL	CSL Vifor Investor Briefing
17-Oct	MVP	Medical Developments International Management Meeting
18-Oct	COH	Cochlear Annual General Meeting
19-Oct	MP1	Megaport 1Q23 Results Conference Call
19-Oct	DMP	Domino's Pizza Enterprises UBS Industry Insight Call
19-Oct	PXA	PEXA Group Ltd Barrenjoey Industry Insight Call
20-Oct	MP1	Megaport JPM Management Meeting
20-Oct	BKL	Blackmores Annual General Meeting
21-Oct	BKL	Blackmores Macquarie Management Meeting
25-Oct	RWC	Reliance Worldwide 1Q23 Results Conference Call
25-Oct	PXA	PEXA Group Ltd Goldman Sachs Emerging Tech Conference
26-Oct	AD8	Audinate Goldman Sachs Emerging Tech Conference
26-Oct	OCL	Objective Corporation Goldman Sachs Emerging Tech Conference
27-Oct	RWC	Reliance Worldwide Annual General Meeting
27-Oct	MVP	Medical Developments International Annual General Meeting
27-Oct	REH	Reece Annual General Meeting
28-Oct	RMD	ResMed 1Q23 Results Call
28-Oct	ARB	ARB Corporation Annual General Meeting
28-Oct	CAR	carsales.com Annual General Meeting
28-Oct	PNV	PolyNovo Annual General Meeting
31-Oct	NAN	Nanosonics Management Meeting
2-Nov	DMP	Domino's Pizza Enterprises Annual General Meeting
3-Nov	CSL	CSL Research & Development Investor Day
3-Nov	JIN	Jumbo Interactive Management Meeting
4-Nov	JHX	James Hardie Industries Annual General Meeting
8-Nov	JHX	James Hardie Industries 2Q23 Results Call
8-Nov	OFX	OFX Group 1H23 Results Call
8-Nov	JHX	James Hardie Industries Barrenjoey Management Meeting

Date	Company	Description
8-Nov	OFX	OFX Group Management Meeting
9-Nov	REA	REA Group Q1 FY23 Results Call
9-Nov	JHX	James Hardie Industries Management Meeting
9-Nov	MP1	Megaport Management Meeting
10-Nov	REA	REA Group Annual General Meeting
10-Nov	PNV	PolyNovo Bell Potter Healthcare Conference
10-Nov	BRG	Breville Annual General Meeting
10-Nov	IFL	Insignia Financial Annual General Meeting
10-Nov	CPU	Computershare Annual General Meeting
10-Nov	CSL	CSL Citi mRNA Insight Call
10-Nov	JIN	Jumbo Interactive Annual General Meeting
14-Nov	BRG	Breville UBS Australasia Conference
14-Nov	FLT	Flight Centre Travel Group Annual General Meeting
15-Nov	CPU	Computershare UBS Australasia Conference
15-Nov	RWC	Reliance Worldwide UBS Australasia Conference
15-Nov	IFL	Insignia Financial UBS Australasia Conference
15-Nov	FLT	Flight Centre Travel Group JPM Management Meeting
15-Nov	DLG.MI	De'Longhi SpA JPM Post-3Q23 Results Management Meeting
16-Nov	IFM	Infomedia Annual General Meeting
16-Nov	ALL	Aristocrat Leisure FY22 Results Conference Call
17-Nov	ALU	Altium Annual General Meeting
17-Nov	RMD	ResMed Annual General Meeting
17-Nov	SEK	SEEK Annual General Meeting
18-Nov	NHF	nib holdings Annual General Meeting
18-Nov	NAN	Nanosonics Annual General Meeting
22-Nov	NAN	Nanosonics Barrenjoey Management Meeting
22-Nov	TNE	TechnologyOne FY22 Results Conference Call
22-Nov	PNV	PolyNovo Capital Raise Investor Call
23-Nov	WTC	Wisetech Global Annual General Meeting
23-Nov	MP1	Megaport Annual General Meeting
24-Nov	TNE	TechnologyOne Management Meeting
24-Nov	NAN	Nanosonics JPM Management Meeting
25-Nov	TNE	TechnologyOne Barrenjoey Management Meeting
25-Nov	NAN	Nanosonics Site Visit
25-Nov	BKL	Blackmores Management Meeting
29-Nov	FPH	Fisher & Paykel Healthcare 1H23 Results Call
30-Nov	IFL	Insignia Financial GS Management Meeting
1-Dec	DMP	Domino's Pizza Enterprises Capital Raise Investor Call
2-Dec	FPH	Fisher & Paykel Healthcare Management Meeting
5-Dec	PNV	PolyNovo Trading Update Conference Call

Date	Company	Description
5-Dec	FPH	Fisher & Paykel Healthcare Barrenjoey Management Meeting
5-Dec	FCL	FINEOS Corporation Holdings Management Meeting
7-Dec	IFM	Infomedia Investor Day
7-Dec	CPU	Computershare JPM Management Meeting
14-Dec	DMP	Domino's Pizza Enterprises Barrenjoey Management Meeting
14-Dec	FCL	FINEOS Corporation Holdings Annual General Meeting
14-Dec	APX	Appen Management Meeting