



In this quarterly edition we review SFML performance, attribution, ESG and company results from the May reporting season. Our lead article focuses on the recession fears plaguing markets today.

We then move onto the critical juncture businesses face before small can become big, before discussing the attributes of what Jim Collins describes as 10Xers and profiling two portfolio holdings that fit the bill.

This quarter also saw us travel to Korea and Japan, visiting the international operations of two core holdings. To conclude, we profile a new portfolio holding WiseTech Global, a business with considerable long-term potential.

Photo. Left was British Explorer Robert Falcon Scott; Right was Norwegian Explorer Roald Amundsen. Both were similar in age and experience and departed their journeys for the South Pole within days of each other. Only one made it back. So, what separated them?



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.

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IN BRIEF – JUNE QUARTER

Dear Investor,

The June quarter saw a continuation of the macroeconomic drivers that have dictated investor sentiment since the start of the new calendar year. Under such sustained pressure, namely surrounding the upward direction in interest rates, inflation, and the continuation of the war in Ukraine, investors have sought refuge.

The Federal Reserve has accentuated investor fear, lifting the Fed funds rate by 75 basis points (bps) to a range of 1.50%-1.75%, the largest increase in nearly 30 years. Chairman Powell reiterated his objective to tame inflation at all costs before it becomes entrenched, *“we really need to restore price stability... need to, ...must do.”*

With the U.K. likely in recession, sentiment in Germany plunging, G4 money supply negative, and G4 fiscal and monetary stimuli down US\$5-6t, U.S. bond yields have taken a fall, with yield curves flattening and some inversions occurring. The Atlanta Fed's Q2 GDP data suggests a reading of -1% annualised, following on from -1.6% in Q1. All but indicating a looming recession.

Markets are now pricing in a Fed funds rate that will reach 3.5% by year end, before central bank policy pivots towards rate cuts in 2023. The risk of policy error is high, as is normal.

There are no straight forward answers to these concerns. The war, COVID, energy shocks, labour shortages and supply logistics are all conspiring in driving up costs. Businesses are feeling the pressure and consumers are equally exposed.

In May, the Australian Financial Review (AFR) wrote that sentiment among fund managers was about as low as it goes. Annual cash weightings were up from 4.1% to 6.1%, while positioning in the technology sector swung from 40% overweight to 12% underweight.

JP Morgan strategists noted, *“small cap stocks in the U.S. currently trade near the lowest valuations ever. Many equity market segments are down 60-80%. Positioning and sentiment of investors is at multi-decade lows.”*

Business fundamentals continue to be ignored, providing stellar opportunities for those with a long-term mindset who understand the power of compound earnings.

In this instance, we refer to businesses performing well. The recent May reporting season is illustrative of this. Within our portfolio, Aristocrat, James Hardie, TechnologyOne, OFX and Carsales' June update all recorded strong operational numbers and positive outlook statements for the quarter.

Our internal metrics present a portfolio that is 97% profitable, 86% dividend paying, with 47% net cash balance sheet. A common thread of recurring earnings and sustainable cashflows, enable high levels of reinvestment that drive significant latency across the businesses we own.

In the last six months valuations have compressed sharply as bond yields have more than doubled. The latency that now exists across the portfolio holdings runs contrary to the chorus of concerns.

As is often the way, the crowd's response to date has been predictable, helped in large part by the investment community's propensity to follow popular opinion. This approach, considered a top-down view, often leads to investors reacting to short-term events rather than a more measured longer-term perspective.

We are very mindful of the strains and concerns currently buffeting local economies, but a bottom-up business by business assessment reflects the fundamentals. It pushes the noise of the market to one side and importantly, provides the consistency of thought and potential of compounding to shine.

Quality businesses that the portfolio holds, with sustained cashflows that can compound earnings into the future, will remain sought after by investors.

In this quarterly edition, our lead article focuses on the recession fears plaguing markets today. We then move onto the critical juncture businesses face before small can become big, before discussing the attributes of what Jim Collins describes as 10Xers and profiling two portfolio holdings that fit the bill.

This quarter also saw us travel to Korea and Japan, visiting the businesses of Carsales' Encar and Domino's Pizza Enterprises' Japanese operations.

To conclude, we profile a new portfolio holding WiseTech Global, a business with considerable long-term potential.

For the June quarter, the Portfolio recorded a gross negative return of **13.87%** compared to the S&P ASX All Ordinaries Accumulation Index, which posted a loss of **12.91%**.

For the financial year, the Portfolio delivered a gross negative return of **19.31%** compared to the Index, which posted a loss of **7.44%**.

It is worth noting the portfolio is industrially focused, with no Utilities or Energy exposure, which were the two top performing sectors during the financial year delivering positive returns of **29.3%** and **24.5%** respectively.

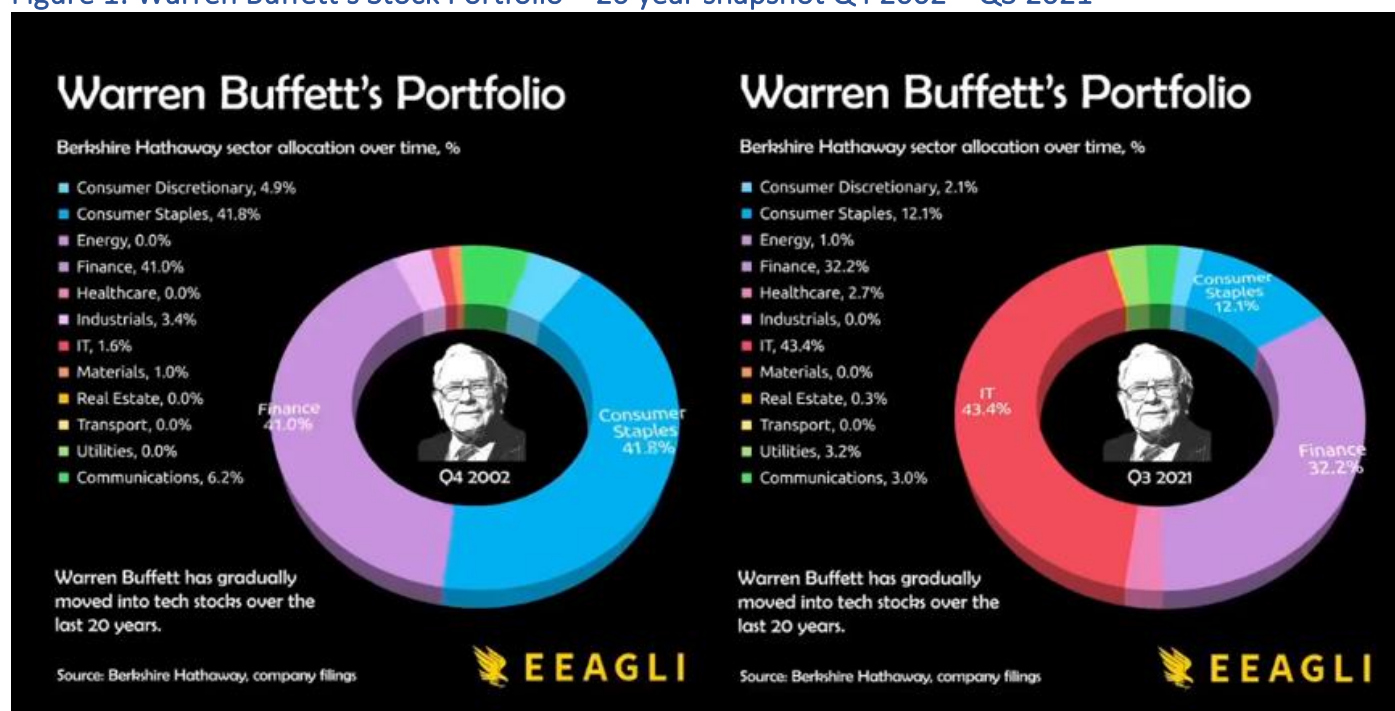
The Portfolio's major exposure to the Information Technology, Consumer Discretionary and Healthcare sectors delivered negative returns of **38.7%**, **22.8%** and **10.6%** respectively.

We trust you find the report informative.

Regards,

Selector Investment Team

Figure 1: Warren Buffett's Stock Portfolio – 20 year snapshot Q4 2002 – Q3 2021



Source: Eeagli

“If you are not aligned, it is friction, it is tension. When you get an exit point with a partner that has a short-term horizon and you’re playing the long game, well then it is a short game, long game partnership, it’s not as effective as it can be.”

Don Meij – Domino’s Pizza Enterprises CEO

CEO Don Meij’s quote is in reference to the joint venture partnership that the company held with Bain Capital during 2013-2017 in Japan.

The key point is the mismatch of expectations that existed between the short-term goals of Bain Capital and the long-term aspirations of Domino’s.

In 2017, the company moved to full ownership of Domino’s Japan. As CEO Meij explained in reference to the friction that can exist when there isn’t alignment, ***“We weren’t able to implement that until we acquired 100% of the business and that was to roll OneDigital in. And then it went to another level again.”***

That ‘another level’ refers to the extraordinary growth achieved since 2017. The OneDigital platform was the missing piece, that enabled the Domino’s full technological capability to be rolled out in the region. Since 2017, operating profits have almost tripled, from \$56m to \$164m in 2021 off the back of 800 stores.

The company’s stated aspiration is to have 2,000 stores by 2033, having surpassed 900 in 2022.

Lesson for investors

The mismatch that CEO Meij’s speaks about can be equally applied to investors. Our aim is to identify, invest and stay the course with companies that offer a compelling ability to grow and compound earnings over time.

Domino’s is testament to that, but this equally applies to other companies held within the Fund including Aristocrat Leisure, ARB Corporation, carsales.com, James Hardie Industries, Cochlear, ResMed, CSL and Altium to name a few.

If our efforts are mismatched to those of our investors, there is friction, there is tension. We are playing the long game and we trust our investors are doing the same.

We encourage investors to watch the Domino’s Japan video, which can be accessed [here](#).

PORTFOLIO OVERVIEW

Table 1: Performance as at 30 June 2022*

	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	15 Year	Since Inception
Fund (net of fees)	(14.22)	(26.85)	(20.57)	0.39	8.63	14.47	6.36	9.61
Fund (gross of fees)	(13.87)	(26.60)	(19.31)	2.26	10.59	16.54	8.30	11.67
All Ords. Acc. Index	(12.91)	(11.50)	(7.44)	3.81	7.15	9.35	4.68	7.66
Difference (gross of fees)	(0.96)	(15.10)	(11.87)	(1.55)	3.44	7.19	3.62	4.01

Inception Date: 30/10/2004

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

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

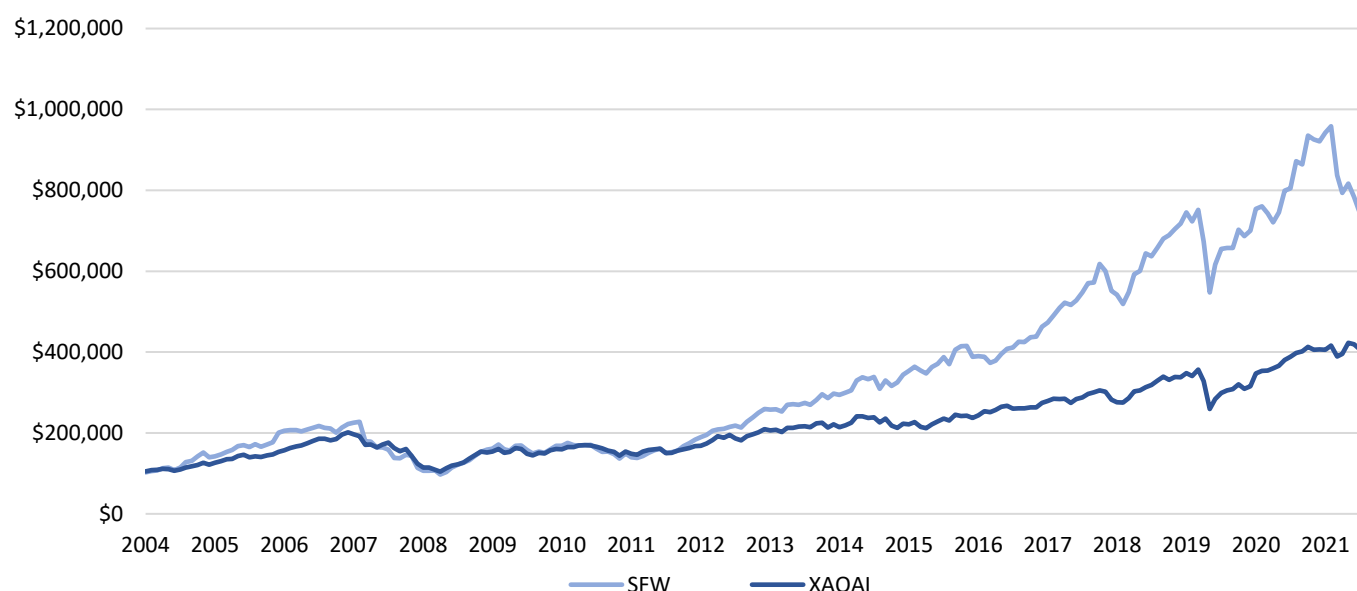


Table 2: Fund's Top 10 Holdings

Top 10 June 2022	%	Top 10 March 2022	%
carsales.com	5.82	Altium	5.45
TechnologyOne	5.37	James Hardie Industries	4.98
CSL	5.34	TechnologyOne	4.98
Aristocrat Leisure	5.15	Cochlear	4.93
ResMed	4.95	Aristocrat Leisure	4.92
Cochlear	4.85	carsales.com	4.81
Altium	4.80	ResMed	4.68
James Hardie Industries	4.36	CSL	4.66
Computershare	4.36	Domino's Pizza Enterprises	4.60
Domino's Pizza Enterprises	4.16	Reece	4.56
Total	49.16	Total	48.57

Table 3: Unit prices as at 30 June 2022**

Unit Prices	Entry Price	Mid Price	Exit Price	Mid Price (Cum Distribution)
	\$2.8549	\$2.8478	\$2.8407	\$2.9112

**FY22 distribution total of \$0.0663 per unit

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 – June 2022 quarter

S&P ASX Industry Sectors	Quarter Performance (%)
Energy	1.45
Utilities	0.61
Healthcare	(1.93)
Industrials	(2.18)
Consumer Staples	(3.40)
Telecommunications	(10.12)
Financials	(14.87)
Consumer Discretionary	(15.08)
Materials	(16.19)
A-REITS	(18.86)
Information Technology	(27.19)

Table 5: Fund's industry weightings

Industry group	June 2022 (%)	March 2022 (%)
Software & Services	26.80	27.39
Health Care Equipment & Services	15.03	14.73
Consumer Services	14.92	15.78
Media & Entertainment	9.49	9.84
Capital Goods	6.32	7.05
Pharmaceuticals, Biotech & Life Sciences	5.59	5.25
Diversified Financials	5.07	5.85
Cash & Other	4.99	1.10
Materials	4.36	4.98
Insurance	2.64	2.39
Household & Personal Products	2.02	1.93
Automobiles & Components	1.71	2.25
Consumer Durables & Apparel	1.07	1.46

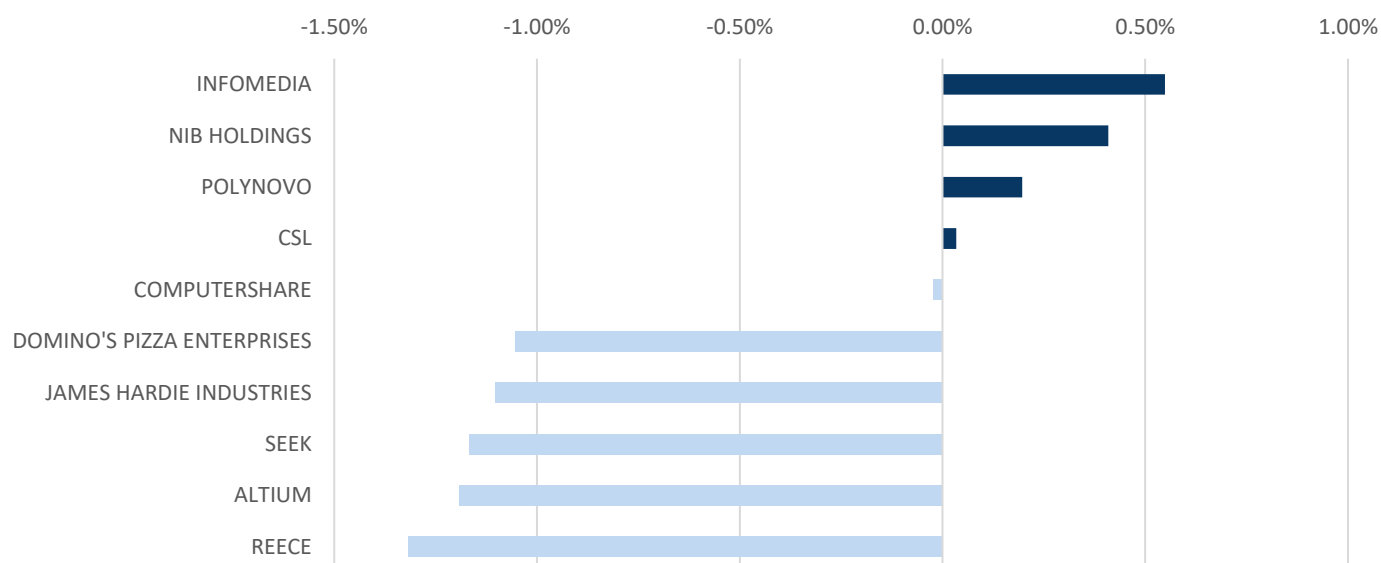
Table 6: Portfolio turnover as at 30 June 2022

Period	Turnover %
1 Year	7.45
2 Years	5.76
3 Years	5.44
5 Years	6.72
10 Years	6.77
Since inception	6.42

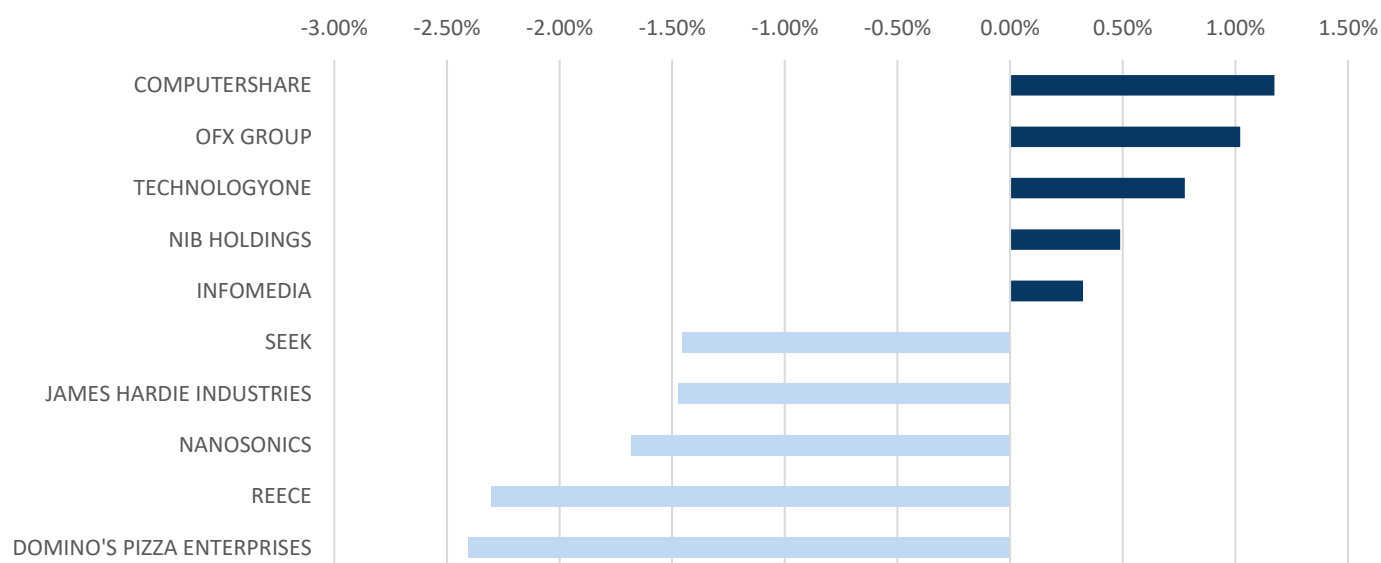
- Turnover shown as annualised percentages
- Turnover = Lesser of purchases or sales divided by average funds under management for the period

PORTFOLIO CONTRIBUTORS

Graph 2: Contributors and Detractors – June 2022 quarter



Graph 3: Contributors and Detractors – June 2022 financial year



Top quarterly contributors

1. *Infomedia (ASX:IFM)*

In May, the company received two indicative proposals for 100% acquisition from TA Associates and Battery Ventures with the latter offering the higher price of \$1.75.

Since then, the company received an additional non-binding proposal from Solera Holdings at \$1.70 per share while Battery Ventures has chosen not to proceed with the process. With two separate offers on the table, the

Board will seek to engage further and grant due diligence to both parties.

2. *NIB Holdings (ASX:NHF)*

There was no material news during the quarter.

3. *PolyNovo (ASX:PNV)*

In April, PolyNovo released a 3Q trading update delivering quarterly revenue of \$12.3m up 59%. The result was driven by strong momentum in the U.S. with sales up 79% to \$9.5m, alongside solid performances across ANZ and Europe. The company also finalised the

sale and leaseback of its Port Melbourne headquarters for \$6.35m.

The search for the new CEO has taken longer than expected, with several candidates being considered.

4. *CSL (ASX:CSL)*

There was no material news during the quarter.

5. *Computershare (ASX:CPU)*

There was no material news during the quarter.

Bottom quarterly contributors

1. *Reece (ASX:REH)*

There was no material news during the quarter.

2. *Altium (ASX:ALU)*

There was no material news during the quarter.

3. *SEEK (ASX:SEK)*

There was no material news during the quarter.

4. *James Hardie Industries (ASX:JHX)*

Please refer to May Reporting Season article below.

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

Please refer to Domino's articles below.

ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE (ESG)

▪ ESG risk of the portfolio

Table 7: 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.

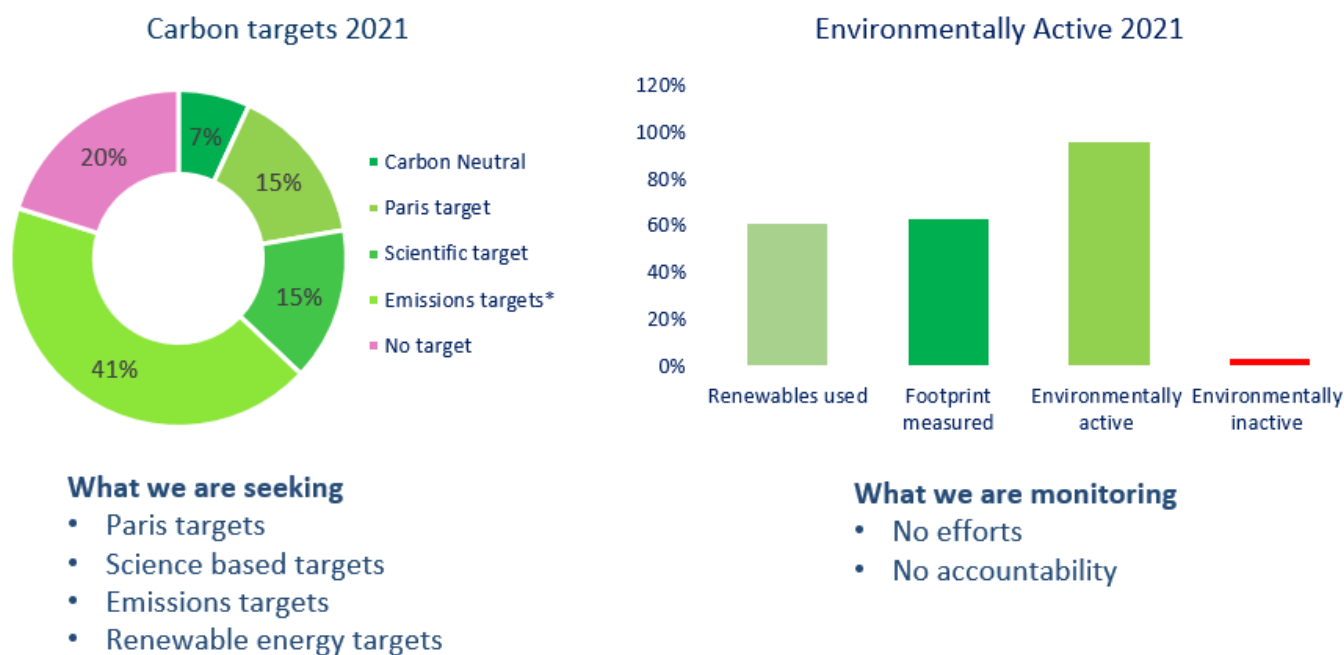
The following is a breakdown of each consideration:

- 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 2021, available at <https://selectorfund.com.au/esg>

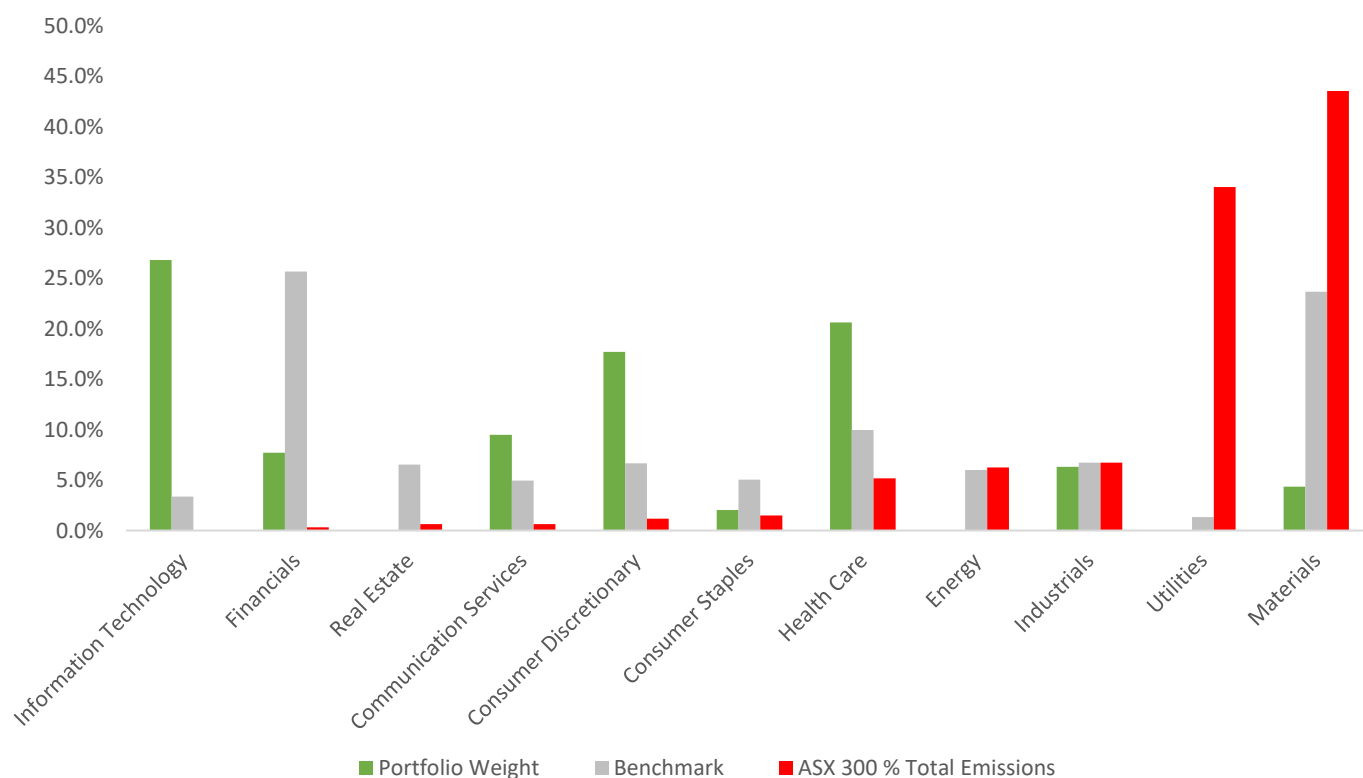
Carbon Risk Analysis

Figure 2: Portfolio Reporting 2021



Source: SFML Research

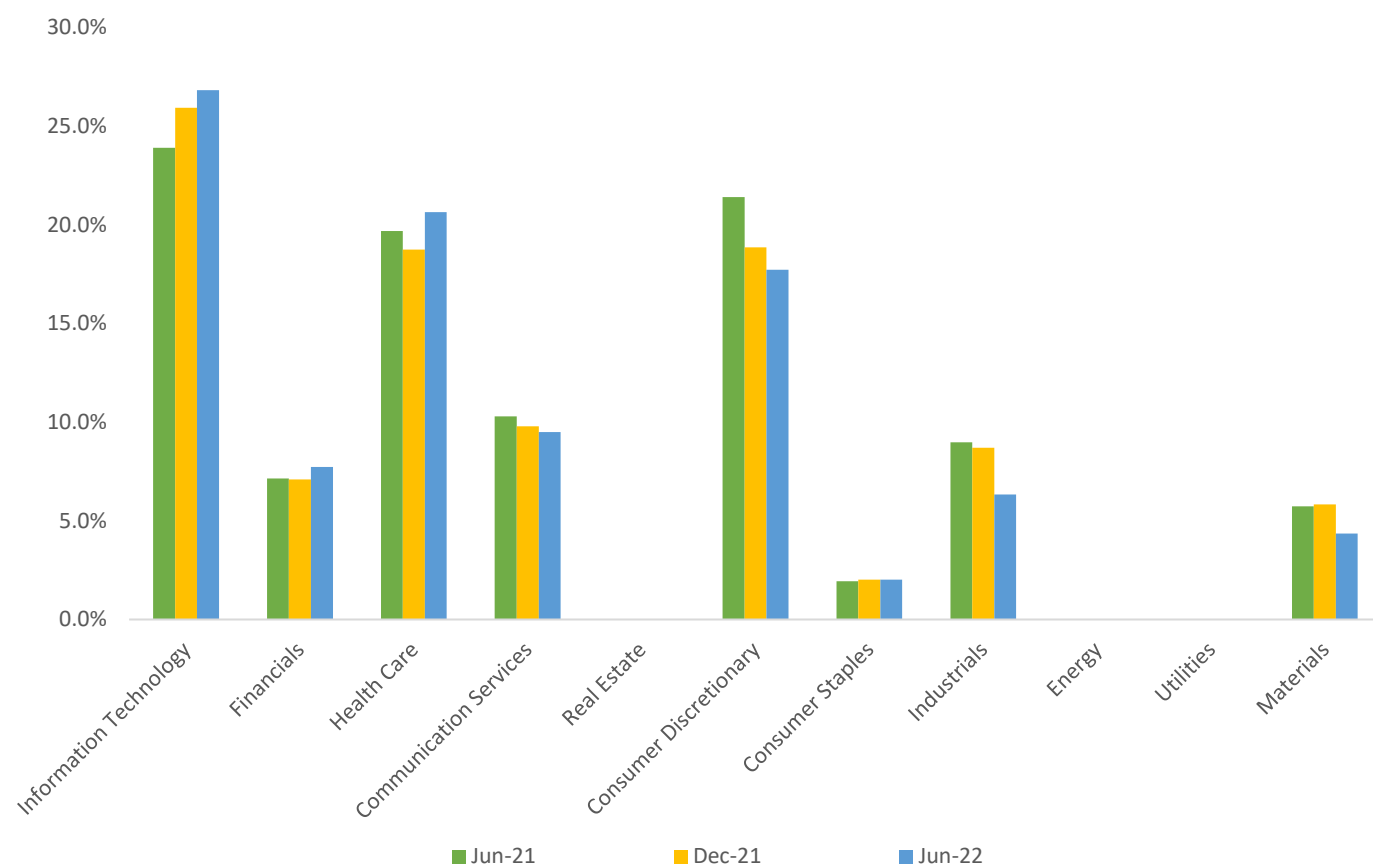
Graph 4: SHCEF vs ASX 300 Carbon Exposure 30 June 2022¹



Source: Refinitiv

¹ ASX 300 Index estimated using Vanguard Australian Shares Index ETF

Graph 5: Portfolio Carbon Exposure Periodic Change



Source: Refinitiv

Table 8: SFML Portfolio carbon intensity

Carbon intensity method ¹	SFML	Benchmark ²
Carbon to value invested	4.74	116.22
Carbon to revenue	18.62	280.83
Weighted Average Carbon Intensity (WACI)	21.90	202.37

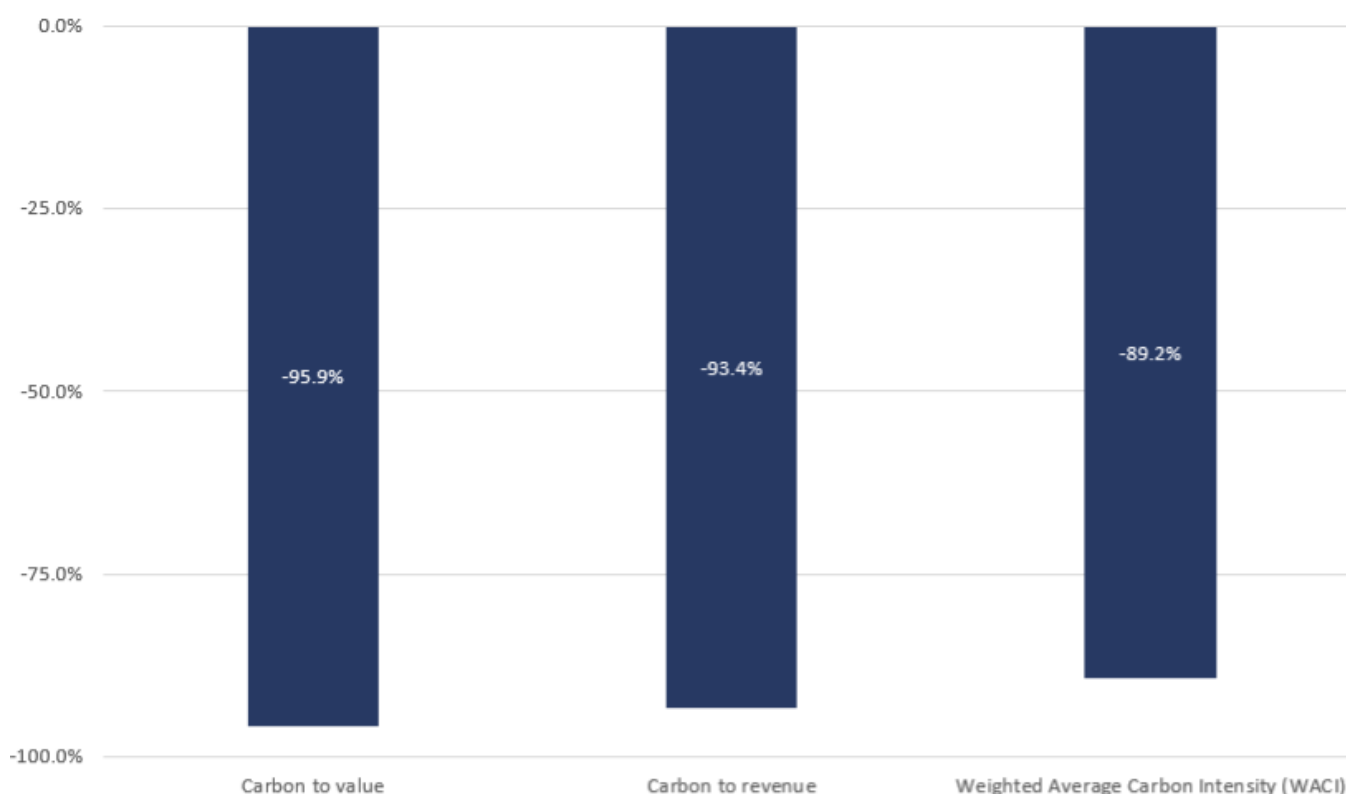
Source: Refinitiv

1. Denominated in tonnes per CO₂e/AUD\$m

2. Benchmark used is Macquarie True Index-Australian Shares Fund, an approximation of S&P ASX30

- **Carbon to value invested** – this calculation is the aggregation of estimated owned constituent greenhouse gas emissions per \$1m market capitalisation as at 31 December 2020. 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 6: 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 95.9% and 93.4% respectively. SFML's WACI is 89% lower than the index, due to no exposure to Energy and Utilities sectors, and low exposure to the Materials sector.

Table 9: SFML Top 10 emitters and total Portfolio Revenue impact of AUD\$90 Carbon tax

Portfolio	LTM Revenue (\$m)*	Estimated CO ₂ Emissions (Tonnes)	\$90 Carbon Tax (\$m)	Impact on LTM Revenue (%)
SFML Top 10 Emitters	40,915.18	1,304,349	117.39	(0.29%)
SFML Portfolio – Total	52,335.96	1,371,583	123.44	(0.24%)
ASX300 Top 30 Emitters	458,387.54	216,705,671	19,503.51	(4.25%)
ASX 300 Index – Total	938,332.01	233,754,518	21,037.91	(2.24%)

Source: SFML & Refinitiv Estimated CO₂ Emission data

* LTM (Last Twelve Months) revenue as of 31 December 2021

Note: ASX 300 index revenue impact from a carbon tax is 9.5x larger than SFML portfolio

Table 10: 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 Estimated CO₂ Emission data

Note: ASX300 Top 30 Emitters revenue impact from a \$90 carbon tax is 14.8x larger than SFML Top 10 Emitters

Table 11: SFML Portfolio Top 10 Emitters Carbon Tax Scenario Testing

Company	CO ₂ Emissions (Tonnes)	FY21 NPAT (AUD \$m)	EPS FY21 (\$)	Value of Carbon Tax (\$)	Cost of Carbon Tax (\$m)	Impact on NPAT (%)	EPS Post Carbon Tax (\$)
JHX	603,840	353.83	0.79	90	54.35	(9.78%)	0.72
CSL	344,000	3,197.71	7.03	90	30.96	(0.78%)	6.97
ALL	129,024	820.00	1.29	90	11.61	(1.24%)	1.27
CPU	63,953	254.74	0.45	90	5.76	(1.67%)	0.45
REH	43,835	286.00	0.44	90	3.95	(1.17%)	0.44
FLT	34,328	-433.46	-2.18	90	3.09	(0.71%)	-2.19
DMP	33,539	184.01	2.13	90	3.02	(1.17%)	2.10
RMD	22,171	638.87	4.40	90	2.00	(0.16%)	4.39
ARB	16,405	112.90	1.40	90	1.48	(0.92%)	1.37
FPH	13,253	503.23	0.87	90	1.19	(0.17%)	0.87

Source: SFML & Refinitiv Estimated CO₂ Emission data

We provide a more detailed review of the impact of a carbon tax on SFML's portfolio in the article below, *SFML 2022 Climate Commitment*.

▪ 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.

MAY REPORTING SEASON

■ Aristocrat Leisure (ASX:ALL)

In May, global gaming operator Aristocrat Leisure reported a strong half year 2022 result. Group revenue increased 23.1% to \$2,745m and EBITDA grew 30.3% to \$970.3m.

In a period of mixed operating conditions and global supply chain disruptions, Aristocrat continued to take share in all market segments. Aristocrat Gaming, the group's land-based division, was a key standout with revenue increasing 38.3% to \$1,432.8m, supported by market leading game performance. The company's digital business, Pixel United highlighted its diverse gaming content, with revenue increasing 6.4% to US\$953.4m during a period of industry-wide moderation in overall mobile gaming demand post COVID.

This result was underpinned by the group's industry leading investments in people, product and innovation, to support sustainable growth over the long run. During the half, Design and Development (D&D) spend increased 28.8% to \$313m. This fully expensed investment represents 11.4% of revenue.

The company maintained strong operating momentum with operating cashflow increasing 42% to \$502.4m, net profit after tax up 46.5% to \$530.7m, and 76% of total revenue recurring in nature.

Post the lapse of the proposed Playtech acquisition in February, the company's \$1.3b equity raise further strengthened the balance sheet, ending the period in a net cash position of \$523.5m. With sufficient funding capacity, management announced an on-market share buy-back of up to \$500m.

Aristocrat Gaming: 52% of Group revenue

Aristocrat operates in 326 licensed jurisdictions, across 102 countries. Geographically, the Americas region (U.S, Canada and South America) represents 80% of revenues, followed by Australia and New Zealand (ANZ) with 16%, and International (Asia, Europe and South Africa) at 4%.

The company operates a leasing (Gaming Operations) and outright sales model, representing 53% and 47% of revenue respectively. For the half, Gaming Operations revenue increased 32.1% to \$765.9m and Outright Sales revenue grew by 46.2% to \$666.9m.

Gaming Operations

Aristocrat's Gaming Operations business operates solely in North America and consists of Class II and Class III electronic gaming machines. Revenue is earned as a fixed fee, or percentage of daily wins per installed unit. Over the half, the installed base increased by 5,540 units to 56,094 units, with almost all machines operational at period end.

Aristocrat's gaming content continues to outperform the market. Leading research firm Eilers & Krejcie awarded the company 18 of the top 25 premium leased games, including the entire top 10. Additionally, Aristocrat was recognised as having four of the top five new premium leased games.

Through strong game performance and buoyant North American market conditions, the group increased its industry leading average fee per day by 18% to US\$55.75. Demonstrating an established pipeline of new content, management remains confident with its ability to take market share.

Outright Sales

Outright Sales is Aristocrat's global gaming division, which sells Class III electronic gaming machines across all regions. For the half, Aristocrat sold 18,445 units up 53% from the prior corresponding period (pcp), whilst maintaining its market leading average selling price of US\$17,508 in North America and \$22,882 in ANZ.

In the Americas, North America outright sales increased 78%, with volumes up 4,765 units, driven by growth in customer capital commitments and new adjacencies.

During the period, Aristocrat expanded its gaming offerings across the Video Lottery Terminal (VLT) and Washington CDS segments, and also entered the Kentucky & Louisiana Historic Horse Racing segment. These adjacencies remain in its infancy with management pointing to clear growth opportunities. The company also launched cashless functionality on its gaming cabinets, now live in 13 Boyd Gaming properties across the U.S.

In ANZ, revenues increased 6.5% to \$222.7m, supported by the launch of its new MarsX Cabinet. International

revenues more than doubled to \$63.7m, aided by large openings in the Philippines.

Aristocrat continues to build out its customer relations team and is focused on the development of leading gaming content, the key to winning long-term deals.

For the half, Aristocrat's Outright Sales represented 25% of all units sold in North America.

Pixel United: 48% of group revenue

Pixel United is Aristocrat's digital free-to-play gaming segment, which operates in three genres: Social Casino, Social Casual, and RPG (Role Playing) Strategy & Action.

For the half, the group maintained strong portfolio momentum with seven of the top 100 mobile games in the U.S. over the 12 months to 31 March. Pixel also retained its number one position in Social Slots and Squad RPG, and its number two position in Casual Merge.

Management continues to invest in new features, content and live operations (updates), to deliver higher engagement and improved in-game monetisation. For the half, fully expensed user acquisition spend increased 4% to US\$262.2m.

The company's strategic focus on user quality is progressing well. Average bookings per daily active user are up 11% to US\$0.80, whilst daily active users decreased 11.9% to 5.9m users.

Social Casino: 51% of revenue

Social Casino remains the leading growth driver for the group, with bookings up 10% to US\$483m. Management attributed this strong performance to growth within the Lightning Link and Cashman Casino games.

RPG, Strategy and Action: 35% revenue

Within RPG, Strategy and Action, bookings were up 9% to US\$333.9m. The group's flagship game, RAID: Shadow Legends transitioned into profitability three years after launch. Management remains confident in the long-term lifetime value of the game, driven by targeted feature and content updates. Recently launched action title Mech Arena is scaling well, with management highlighting strong marketing execution as a response to recent changes to Apple's advertising structure.

The company also called out the growing momentum of its proprietary platform, Plarium Play. Enabling a more immersive experience, it now accounts for 27% of total

RPG, Strategy and Action revenue. Further, Plarium Play bypasses Apple's 30% take rate of all in-app purchases, resulting in improved margins.

Social Casual: 14% revenue

In Social Casual, bookings decreased 12.3% to US\$134.5m off the back of a strong pcg performance and maturing of the portfolio. Whilst the Social Casual segment has lacked momentum since being acquired in 2017, management have implemented a clear strategy to revitalise the segment, including the appointment of Larry Plotnick as the CEO of Big Fish, formerly head of games at Amazon.

Additionally, the group finalised a minority investment in Ultracine, a game studio in Montreal, specialising in the development of fashion and design simulation games. This investment extends on the company's recent acquisitions of Futureplay and Playsoft. These initiatives have materially expanded content capabilities in adjacent genres and provided access to leading regional talent hubs.

The pipeline for new game titles remains strong. Over ten titles are in active development for planned launches over the next few years. By the end of calendar year 2022, management are targeting the release of Merge Gardens. Following this, the group are planning two game launches in 2023 within Social Casino and RPG, Strategy and Action genres.

Real Money Gaming

Post the Playtech offer rejection the group accelerated a build and buy strategy, announcing plans to enter the North American Real Money Gaming (RMG) market with two major customers across two jurisdictions, by the end of calendar year 2022. With Aristocrat having direct control of the go-to-market strategy, management is confident it will produce a superior outcome than what was expected from the Playtech acquisition.

Entering the RMG market remains a logical growth and diversification strategy, providing the ability to leverage both land-based and digital content and talent. CEO Trevor Croker highlighted this in his investor call remarks, *"It provides another channel for the distribution of our world-leading content. It leverages our strengths, including our proven ability to attack attractive adjacencies through strong investment and effective execution."*

The new RMG business will be run by Mitch Bowen, previously CEO of Aristocrat Gaming. Given the additional investment required, the group is guiding to D&D spend modestly above the historical range of 11%-12% of revenue. The company will also accelerate the assessment of M&A opportunities to add key capabilities and technology to scale faster.

Over the medium term, Aristocrat are pursuing a significant share of the U.S. iGaming (online casino) market, valued at a total addressable market (TAM) of US\$8.2b in 2021. Within five years of launching, the company aspires to be active in at least 70% of regulated jurisdictions across North America.

Long-term objectives remain unchanged, with the group's goal to be the leading gaming platform for the global online RMG industry.

The global online RMG (online casino, sports betting and lotteries) TAM is estimated at US\$70b. Within this, the U.S. market opportunity is expected to grow to US\$19.6b by 2025.

Outlook

While no formal outlook was provided, Aristocrat plans for continued growth over the full year. In Aristocrat Gaming, management expect to sustain 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 Pixel United, the group are targeting growth in bookings volume and profitability.

Aristocrat Leisure has a current market capitalisation of \$24.3b and declared an interim dividend of 26 cents per share.

▪ Fisher & Paykel Healthcare (ASX:FPH)

Leading respiratory care manufacturer, Fisher & Paykel Healthcare delivered a solid FY22 result, despite the 15% fall in operating revenues to NZ\$1.7b and 28% decline in net profits to NZ\$376.9m. To provide some perspective, the prior comparative period (pcp) experienced peak COVID demand for hospital hardware and consumables. Compared to FY19, Fisher & Paykel recorded revenue and net profit growth of 57% and 80% respectively.

Gross margins declined 59 basis points (bps) to 62.6%, impacted by higher freight and input costs. Over time, gross margins are expected to return to the 65% long-

term target, driven by price rises and reduction in freight costs.

Long-term investing

While the primary focus since 2020 has been to ramp up manufacturing to service the elevated levels of demand for hospital products, Fisher & Paykel also remain steadfast on accelerating research & development (R&D) and sales expenditure. For the year, R&D spend rose 13% to NZ\$154m (9.2% of revenue), while selling, general and marketing expenses increased 23% to NZ\$393.1m (23.4% of revenue).

The company remains focused on doubling revenue every five to six years and achieving a long-term operating margin of 30%, with increased investments today expected to deliver towards these targets. While costs have risen in the period, operating margins have remained above its long-term margin target, sitting at 30.1%.

Hospital (72% of revenue)

Hospital revenue fell 19% to NZ\$1.2b, as elevated demand for hardware and consumables normalised in the second half. This primarily resulted from Hardware sales dropping 41% to NZ\$326m. Management expects further reductions, with Hardware sales still three times higher than pre-COVID levels, while global hospitalisations have subsided. New application consumables, which consists of nasal high flow (NHF) therapy grew by 2%, reflecting the larger installed base.

Fisher & Paykel estimates hospitals have purchased the equivalent of NZ\$880m, or 10 years' worth of hardware over the past two years. With humidifiers (hardware) readily available across hospitals, the opportunity for the group now is to translate the visible benefits, and recent experiences for healthcare professionals using NHF therapy on COVID-19 patients, into clinical practice for the general respiratory disease population.

Management believes average utilisation of hospital hardware is currently around 60-70% of pre-COVID levels. For consumables to return to 85% levels, the company has modelled a scenario showing constant annual growth rates (CAGR) of:

- 18% over 3 years
- 13% over 4 years
- 10% over 5 years

To drive this, Fisher & Paykel is investing in sales staff across regions, supported by five new clinical papers recommending NHF. 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 adopt this as the standard of care is sizeable.

CEO Lewis Gradon notes *“we have a proven 50-year track record of changing clinical practice. And never before in our history that we change clinical practice with the significant advantage that our customers already have the hardware. I already have the clinical experience of it, and they already have access to have such a huge amount of clinical evidence.”*

Homecare (28% of revenue)

The Homecare division, which caters for the home treatment of respiratory support and obstructive sleep apnea (OSA) patients, continues to remain an important pillar for growth. Revenue grew 1% to NZ\$469.5m, with consumables up 3% to NZ\$395m and hardware down 10% to NZ\$75.1m.

The result was impacted by a competitor recall for sleep apnea devices leading to consumable masks growth tempering. The company is well positioned longer term, with a portfolio of unique masks. Notably, the Evora full face mask, which has experienced one of the most positive launches in the U.S.

New Products

Fisher & Paykel's R&D team introduced four new products at its investor day:

- **Airvo3** – the next generation device. Includes an integrated battery and closed loop oxygen control, which is expected to remove barriers for adoption across the wider hospital.
- **SI400 gas humidifier** – an easy-to-use gas diffuser for laparotomy surgery. Provides maximum heat transfer while not impeding on any aspects of the surgery.
- **Optiflow Switch and Trace** – expands the opportunity for NHF for use in anaesthesia applications. Benefits the anaesthesiologist by delivering high flows of humidified air to patients, reducing the risk of respiratory failure.

Manufacturing

The company 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. To support longer-term growth, Fisher & Paykel has earmarked investments totalling NZ\$700m towards land and buildings over the next five years. The company also expects to announce a new offshore manufacturing location outside of its existing regions.

Looking ahead

Given the short-term uncertainty, guidance has not been provided for FY23. Management remains confident in the long-term prospects of the business, with significant opportunity to drive clinical change.

CEO Lewis Gradon notes, *“Going forward, we haven't wavered from our long-term sustainable profitable growth aspiration. We've got an exciting opportunity to apply our 50 years of experience and changing clinical practice to what is now a customer base that already has the hardware and already has the clinical experience. That enables us to bring forward new products and applications and global sales, manufacturing and distribution investment.”*

Fisher & Paykel Healthcare has a market capitalisation of \$11.1b and net cash of NZ\$221.6m.

■ James Hardie Industries (ASX:JHX)

In May, leading fibre cement producer James Hardie reported its fourth quarter and full year 2022 result. Strong financial momentum has continued, with quarterly net sales growing 20% to US\$968.2m and adjusted net income (NPAT), excluding asbestos payments, up 42% to US\$177.5m. For the year, net sales lifted 24% to US\$3.6b, while adjusted NPAT rose 36% to US\$621m.

Adjusted NPAT margins improved from 15.7% to 17.2%, despite significant inflationary cost pressures and increased investment initiatives. This is the result of strategic execution which will be explained below.

Strategic execution

Since FY19, James Hardie has undergone significant transformation led by three global foundational initiatives:

- **HMOS (Hardie Manufacturing Operating System)** – a globally integrated management system, which has driven consistent manufacturing production runs, leading to improving yields (reduced waste). Otherwise known as LEAN manufacturing, the efficiencies

from this program have driven margin expansion.

- **Customer engagement** – strategic partnerships with key customers has created greater alignment on shared goals. These deeper relationships have enhanced future order visibility.
- **Supply chain integration** – greater clarity into customer demand requirements. Products can now be provided at the right time, which has led to improved working capital dynamics.

This strategic execution has resulted in a step change in financial performance, with group revenue and earnings increasing at four-year constant annual growth rates of 15% and 20% respectively.

Go-Forward Strategy

In 2021, James Hardie extended its foundational strategy with three initiatives to drive business growth, irrespective of market conditions. These include:

1. Penetrating and driving profitable growth in existing and new segments, especially within the Repair and Remodel (R&R) market
2. Marketing directly to the homeowner to create true demand for its products
3. Commercialising global innovations by expanding into new categories

1. R&R focus

The strategic focus on the R&R market, particularly in North America (NA), presents a significant opportunity for sustainable demand. While R&R already accounts for approximately 65% to 70% of current sales in NA, the opportunity set remains vast, with more than 44m homes in NA over 40 years old.

James Hardie is differentiating in R&R with its high-value ColorPlus product, which grew at 27% for the year and exceeded overall group volume growth. As demand mix shifts to high-value products, higher sales and improving margins flow to James Hardie and its distribution partners.

2. Direct marketing

James Hardie is focused on delivering marketing campaigns in differentiated regions, such as the North-East and Mid-West U.S., where products such as ColorPlus compete strongly against vinyl and paint. Initial marketing has seen the three targeted markets for

ColorPlus grow volumes 11% more than regions without these campaigns.

The company's 360-degree marketing campaign has started positively, with new web sessions increasing 5x annually and leads more than doubling. By engaging directly with the ultimate decision maker, the homeowner, James Hardie is driving true customer demand for its solutions. Effective marketing is building awareness for James Hardie's differentiated product offerings to a widespread audience, with the primary benefits expected to flow through in later years.

3. Innovation

The third pillar is product innovation. Over the past year five new products have launched, including Hardie Textured Panels in North America, Hardie brand VL Plank in Europe, and Hardie brand Fine Texture Cladding in Australia.

Early market acceptance has seen James Hardie commit to delivering additional new products within six months, and regularly thereafter. Revenue from innovation remains small today, however, these products are expected to meaningfully contribute over the medium to longer term.

For the year, R&D expenses rose 19% to US\$34.4m.

North America

Since 2019, North America has seen net sales rise 52% to US\$2.6b and operating profits grow 91% to US\$741m. The business is now significantly larger with the benefits of scale, LEAN manufacturing and high-value products, leading to an increase in adjusted EBIT (operating) margins from 23.1% to 29.1%.

For 2023 James Hardie expects further improvement, with net sales growth of 18-22% and operating margins lifting within the range of 30%-33%. Two scheduled price increases, in July 2022 and January 2023, are expected to contribute 7% in price and mix growth, while high-value R&R products support volume growth.

Europe

Following the acquisition of Fermacell in 2018, Europe has grown operating earnings five-fold. In FY22, net sales grew 20% to €420.5m, while operating profits rose 51% to €54m, representing margins of 12.9%. Excluding the impact of hyperinflation, margins would have been

greater than 14%, albeit still markedly lower than group margins.

Management reiterated confidence on its 10-year vision of the region; reaching €1b in revenue at 20% operating margins in its tenth year of operations. CFO Jason Miele noted, *“a very large opportunity they're attacking. We think it will be successful and it will take us that next step towards what will become a €500m fibre cement business alongside what we believe will become a €500m fibre gypsum business in our goal to get to €1b within the first 10 years.”* At 20% operating margins, this would represent an almost four-fold increase on today's profits.

Asia Pacific

Since 2019 Asia Pacific has delivered exceptional growth, with net sales and adjusted EBIT rising 27% and 58% respectively. FY22 net sales rose 22% to A\$777.7m, while operating earnings increased 23% to A\$217m. Operating margins of 28% reflects a 570-basis point increase since FY19. Momentum in this region is strong, as management continues to see opportunities in driving share gains, while improving operational performance.

Capital expansion

To meet future demand, over the next four years James Hardie expects to invest between US\$1.6b and US\$1.8b in expansion projects across all regions. This is reflective of management's focus on driving profitable organic growth.

Asbestos Injuries Compensation Fund (AICF)

A total of US\$248.5m was paid by James Hardie into the AICF during 2022, reflecting 35% of the group's free cash flow. With the AICF now holding A\$350m in net assets, the company's future contributions are expected to fall materially, with management anticipating a lower payment of US\$118m for 2023, equivalent to 19% of free cash flow.

Outlook

For FY23, the company has reaffirmed guidance for net operating profit to be within the range of US\$740m-US\$820m. This represents a 26% increase at the midpoint relative to FY22.

James Hardie has a current market capitalisation of A\$16.8b and net debt of US\$761.4m.

OFX Group (ASX:OFX)

International payment services provider, OFX Group reported its full year 2022 result in May. The group delivered a record performance, with revenues up 17.7% to \$158m and underlying operating profits (EBITDA) rising 53.1% to \$44.5m.

The result was underpinned by investments in people and technology, with the purpose of driving operational efficiencies and business scale.

During the year, OFX complemented its organic growth with two acquisitions. The first was the payment of \$98m to acquire Canadian Corporate foreign exchange provider Firma. The second, a \$6.1m equity investment in TreasurUp, represents a 44.98% equity holding and strengthens the group's Corporate and Online Seller offering.

The company maintains a strong balance sheet, with \$84.2m of cash on hand. During 2022, a reinvestment program totalling \$10.5m covering product, risk management and payments was undertaken.

Company background – laying foundations for growth

As a business, OFX generates revenue by facilitating foreign exchange transfers, otherwise known as Net Operating Income (NOI).

For financial year 2022, OFX reported Total Transactional Turnover of \$33.2b up 33% and NOI of \$147m, an increase of 24.7%. On a per transaction level, the company generated an average NOI margin of 53 basis points. As the business scales, NOI growth is achieved by increasing the volume of transactions (turnover), whilst managing costs. Reported net profit doubled to \$24.5m.

In a market dominated by incumbents, clear competitive advantages alongside a strong and trusted brand is required to attract customers. As such, OFX has invested heavily in building out the product and service offering, reflected in growing customer awareness, leading to strong transactional growth.

Less obvious has been the investment in core infrastructure to create prudent risk management protocol and scalable systems. Whilst this process took longer than expected, with net profits remaining stagnant in the intervening years, OFX has created an embedded solution that offers leading risk management, real-time payment capabilities and competitive pricing.

This combined value proposition has seen the formation of strategic customer relationships, leading to higher transaction frequency.

For context, it took OFX 15 years to record a monthly turnover of \$1b in 2013. It took another five years to hit a monthly turnover of \$2b, and a further three years to hit \$3b. The momentum in turnover has provided the capacity to reinvest in the core infrastructure ahead of the next stage of growth.

Segment and Regional Performance

OFX operates across the four segments of Corporate, High Value Consumers, Enterprise and Online Sellers, within three geographic regions; Asia Pacific (Asia, Australia and New Zealand), North America (U.S. and Canada) and EMEA (U.K, Europe, Middle East and Africa).

All regions grew revenue by double digits, with Asia Pacific up 12.8% to \$83.7m, North America up 27.8% to \$43.1m and EMEA up 26% to \$28.9m. APAC remains the most mature market for the company, whilst North America and EMEA are in its infancy.

Encouragingly, North America and EMEA are displaying the benefits of scale, with increases in EBITDA outpacing revenue growth. In the period, North American EBITDA more than doubled from \$4.9m to \$11.2m. Likewise, EMEA EBITDA rose 82% to \$6.6m. Management noted improvements in system efficiency were lowering the marginal cost of additional transactions, leading to operating leverage.

For the financial year, APAC, North America and EMEA reported EBITDA margins of 24.5%, 25.9% and 26.3% respectively.

Across the business segments, Corporate and High Value Consumers remain the key growth drivers for OFX, aided by record average transaction values (ATVs) of \$28,100 during the financial year. Excluding the one-off offshore share purchases in fiscal year 2021, ATVs grew by 23.5% on the prior corresponding period (pcp).

Active clients remained steady, up 3.3% on the pcp to 143,100 users and transaction per active client increased 7.3% to 8.2, excluding offshore share purchases.

High Value Consumer: 47% of group revenue

The High Value Consumer segment benefited from unusually strong ATVs of \$21,200, leading to revenue

increasing 24.5% to \$71.3m. For financial year 2023, management is expecting ATVs to normalise to approximately \$19,000.

Investment in payment capabilities and security continues to drive transaction volumes in higher value use cases. For the period, property related transfers increased 47% and wealth related transfers were up 24%. OFX brand awareness is improving as the company scales, giving management confidence in longer-term growth opportunities.

Corporate (43.3% of group revenue)

For the year, Corporate revenues increased 14.5% to \$65.7m. Investment in marketing is resonating, and benefiting from strategic partnerships, including the North American National Hockey League (NHL) where OFX is the league's official currency exchange provider. Additional investments in fraud protection and payment capabilities are also driving customer adoption rates.

The group's \$6.1m investment in TreasurUp, a software company specialising in risk management programs, is progressing well. Management noted the integration of TreasurUp services into the OFX platform is enabling corporate and online seller customers to derive greater value, through additional security and control measures.

Online Seller (5.7% of group revenue)

In Online Sellers, revenue grew 2.7% to \$8.8m. Amazon marketplace remains a compelling opportunity for OFX, especially in Europe. Asia functioned as a headwind during the period following increased COVID activity in financial year 2021. Excluding Asia, segment revenue grew 15.7%.

Enterprise (4% of group revenue)

Enterprise revenue increased 31.1% to \$6m, driven by existing client demand. Management remains optimistic within this space, pointing to a Serviceable Addressable Market (SAM) of \$49m from existing customers. The pipeline for new customers is healthy, but conversion rates continue to be below management's expectations. OFX remain focused on reactivating the Enterprise pipeline and converting deals in financial year 2023.

FIRMA acquisition - accelerating scale

In December OFX announced the acquisition of Firma, a Canadian based global corporate foreign exchange company, for \$98m. In financial year 2021, Firma reported revenues of \$51.9m and an EBITDA of \$10.9m.

Over 80% of Firma's transactions flow from the North American market, followed by the U.K with 11% and ANZ at 9%.

With over 190 employees and servicing approximately 9,600 active corporate clients, the acquisition is expected to materially bolster the group's turnover and presence within the North American market. Currently, 7% of Firma's revenue is derived from digital transactions, presenting a clear opportunity for OFX to transform the digital experience for existing customers.

Guiding to an underlying EPS accretion of 20% for financial year 2023, the acquisition fundamentally scales the existing North American operations, doubling transaction turnover and adding depth and R&D capability.

The acquisition was funded from a \$100m debt facility that is fully drawn down, with intentions to completely repay this over a four year period. The transaction was completed in April 2022 and management are guiding to approximately \$11m EBITDA contribution from Firma for the remaining 11 months of fiscal year 2023.

Outlook

OFX ended the financial year in a strong position, with 77% of revenues recurring in nature. Including Firma, management has guided to a net operating margin of \$200m-\$212m and underlying EBITDA of \$55m-\$60m.

The added scale benefits provided by Firma has enabled the company to accelerate investment activities across all business segments. OFX has guided to investments between \$12m-\$16m for fiscal year 2023, up from \$10.5m.

For financial year 2023, priorities include the integration of Firma, ongoing development of the Corporate and Online Seller segments and European expansion, aided by Firma's higher active customer base. As at May 2022, the acquisition of Firma's U.K. business remains subject to regulatory approval.

OFX has a market capitalisation of \$605m, and a net debt position of approximately \$15.8m.

▪ TechnologyOne (ASX:TNE)

Global enterprise resource planning (ERP) software provider, TechnologyOne reported its half year 2022 result in May. The group delivered a lift in revenue of

19% to \$172.5m and rise in net profit before tax 14% to \$42.6m.

The business performed strongly across all six industry verticals. The top three were Local Government, Higher Education and Government, up 19%, 49% and 21% respectively.

SaaS

SaaS annual recurring revenue (ARR), seen as a better indicator of management execution and business quality, delivered organic growth of 44% to \$225.1m. Revenue from SaaS and Continuing Business now represents over 97% of total revenue, as non-recurring legacy licence fees reduce.

With the end of its on-premise offering marked for October 2024, the company is experiencing an acceleration of customers transitioning to its Cloud platform. Notably, a record 138 customers were added during the half, up 24% on the prior comparable period (pcp), bringing the total number of customers under the SaaS platform to 714 at period end.

This shift to the cloud, in particular, has elevated the business to new horizons. What TechnologyOne offers is business critical software for universities, local governments and alike.

CEO Edward Chung explains the benefits of its solution, *"Our global SaaS ERP is the future of enterprise software. It provides our enterprise customers a mission critical solution to run their entire business on any device, anywhere, at anytime. It also allows them to innovate and meet the challenges ahead with greater agility and speed, without having to worry about underlying technologies. This makes life simple for them."*

As such, customers don't shift unless forced to. This is best reflected in the company's high customer retention rate, which sits at 99% across all markets.

U.K.

Despite entering the U.K. in 2006, TechnologyOne is only starting to reap the years of investment. For the half, the group reported a profit of \$2.3m, an increase of more than 100% on the pcp. ARR saw a similar improvement, ending the period at \$17.6m with the newly acquired higher education operator, Scientia contributing \$7.9m.

CEO Chung reiterated his confidence in the acquisition of Scientia, *"We first acquired them late in calendar 2021,*

and it's a strategic product to further build out our footprint in our OneEducation solution in the U.K. as well as Australia. It's a mission-critical product. It's required by universities. It's very sticky. It helps run their business."

The short-term focus is integrating Scientia onto the Global ERP platform, followed by a complete rewrite and re-engineering of the product onto the SaaS architecture. The first version of Scientia on SaaS was released during the half.

By moving to SaaS, Scientia's 97 blue-chip University partners will have access to TechnologyOne's entire enterprise suite for higher education, comprising 14 products and hundreds of modules.

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, code line and experience.

The business is in a strong leadership position. Currently, it is 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 a 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. and Digital Experience Platform (DXP) are poised to contribute meaningfully long-term. With that in mind, research and development (R&D) spend remains a high priority, rising 20% to \$41.5m, representing 24% of revenue.

R&D growth is expected to revert to 8% over the forward years. A total of \$500m has been invested over ten years to maintain innovation across new and existing products.

Outlook

For FY22, management expects SaaS ARR to organically grow by more than 40% and profit before tax to lift 10%-15%. As the transition to SaaS continues, the group's dependency on legacy licence fee reduces, with \$12m in revenue anticipated for the full year, down from \$18m in FY21.

Beyond 2022, management confirmed ARR is on track to achieve the targeted \$500m run rate by 2026, with operating margins lifting from the current 31% to a minimum level of 35%.

Observation

Since its establishment 35 years ago, the TechnologyOne business is now on track to deliver earnings consensus group revenues of \$359m for 2022. In 2026 this is expected to hit \$500m (ARR), with management pointing to a further double of \$1.0b by 2031. 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 \$3.6b and net cash of \$116.4m. The company also declared an interim dividend of 4.2 cents per share. **SFM**

RECESSION, FEAR AND LOATHING WORK

In our Macro article last Quarterly Newsletter, we mentioned the word recession nine times and reproduced charts of how global leaders perform through recession.

Fast forward one quarter and the red lights of recession are flashing daily. G4 (Eurozone, UK, USA and Japan) money supply has fallen off a cliff, 2-year and 10-year yield curves are showing inversions, indicating expectations of declining growth, and business and consumer confidence has plummeted. The U.K. is broken again; you might wonder if this is a political or economic comment, but politics generally takes a back seat to significant macroeconomic concerns. Germany, an industrial leader of the EU, is under extreme pressure. While China, at a different stage of a self-inflicted cycle, is stimulating aggressively.

In the U.S., Q1 recorded negative growth (-1.6%) and indicators from the Atlanta Fed signal a negative Q2 reading (-1.2% as at July 8). Meanwhile Fed minutes of June 14-15, delivered on July 8, mention on four occasions they expect growth in Q2, despite having cut GDP growth forecasts.

It's not just economic data. The cracks are being revealed across big and small enterprises. This month Revlon, a U.S. cosmetics stalwart for ninety years, filed for Chapter 11 bankruptcy protection, as did SAS (Scandinavian Airlines) Europe's eighth largest airline.

Small businesses, the life blood of job creation, are rapidly disappearing from high street locations. Dry cleaners, cafes and specialty retail (non-scale) are closing, robbed of their footfall as global cities that supply the traffic remain more than half empty. CBDs in the U.S. are around 44% of pre-pandemic office occupancy. Australian CBDs are only a tad higher.

The compounding effects of no customers and absent staff are creating its own challenges. While the jobs market data remains strong, we see other areas of concern.

Surveys reveal 68% of U.S. workers will actively seek an alternative workplace if their employers mandate any return-to-office policy. Flexible working has many benefits, but not at the risk of productivity. Low margin

businesses will not survive a combination of higher costs (inflation) and lower output.

Visiting a business with empty seats and a CEO in the corner is an unnerving experience. When more than half of your staff have no intention to come to the office, or will leave if mandatory policies are implemented, you have a big problem. Major banks and financial services companies will be the working-from-home (WFH) guinea pigs. Their boards are unable to make a policy decision; weighing lower productivity against high turnover has resulted in paralysis.

In the Netherlands, WFH is set to become a civil right. The legislation has passed the lower house and now just requires the nod from the senate. If approved, employers who refuse flexibility must provide a valid reason. The Netherlands might be an outlier, but it's also an indicator of the future. The only solution we see here is a strong culture. This is years in the making and not something turned on overnight.

Recession fears are being stoked by interest rate expectations. Between December 2021 and May 2022, the yield on Australia's 10-year Government Bond increased by 250%. This reflects the December pivot in global monetary policy, whereby rates are being hiked at extraordinary pace, with the neutral rate (or r^*) a destination that must be reached fast, and at any cost.

At the same time, signs inflation and commodities have peaked, or well on its way to, are emerging. The Fed minutes indicate an expectation that inflation will fall in 2023, and markets have priced in rate cuts. While some of the extremely hawkish language may well be central bank jawboning, which is understandable, the rhetoric suggests rate increases will be implemented along with falling growth and declining inflation. If this is the case, it will not last long, as argued by Macquarie's Victor Shvets.

Outcomes are not set in stone, and it appears the only certainty is central bank policy error. We believe a steadier approach to rate rises would be appropriate.

Australia, with strong trade figures driven by record commodity prices, is not immune. Households bought into the RBA's commentary that rates would not rise until 2024. They responded by scooping up cheap money

and increasing exposure to a topy housing market. A neutral rate of 3% will be painful in the real world. The magnitude of the shift is significant for the geared household, who will see mortgages well above 5% as a result.

We hold the view that we will return to a world of low growth and relatively low interest rates. Not dissimilar to pre-pandemic conditions.

In a recession, typically job loss and business failures leading to insolvency are the greatest concerns. Debt is the driver of the latter and was where both Revlon and SAS came undone.

When a company takes on debt, control passes from the boardroom to the bank. The more debt, the more control is transferred. A recession will reduce earnings; this is temporary and shouldn't be feared. However, if high levels of debt are involved the tables turn quickly.

Lower earnings and fixed debt are the two necessary ingredients to offer up more control to the bank. A board who has lost control has two options: a dilutive capital raising at a low point in equity value, or an administration process.

If the cost of debt is rising, because of aggressive rate hiking, while earnings are falling, the above scenario is potentially accelerated.

We can't predict the earnings impact of a pending recession. This will differ for each business. We do however know the repercussions of debt.

Debt will rapidly come into focus in the event that these recession fears become reality.

Our portfolio is positioned to enable us to look through recession, in relation to both debt and dilution.

- 97% profit
- 47% Net cash
- 76% < 1x Net debt to EBITDA

In May's mini reporting season, James Hardie, OFX, Aristocrat and TechnologyOne, produced strong results and outlook statements. In June, Carsales delivered a strong trading update and outlook.

With reporting season only a few weeks away, more truth, rather than noise, will be revealed. Our expectations are for muted guidance as the outlook remains unsettled. The businesses with recurring revenues, sustainable cashflows and manageable debt ratios will move through a recession, and some will even accelerate.

Examples include:

- Computershare's bankruptcies business has underperformed under record low and negative interest rate policies. Higher rates are set to change this dynamic and will also benefit its income from client balances. 2x Net debt to EBITDA.
- CSL blood plasma collections in the U.S. face fewer headwinds in downturns. 2.65x Net debt to EBITDA.

Others will be impacted, though not fatally:

- FINEOS has stated recession slows decision-making of large insurance carriers. FINEOS has no debt.
- SEEK clearly stated at the half year that macro tailwinds of the job markets had been a decisive driver. 2.7x Net debt to EBITDA.
- For Flight Centre the question is, can travel return to pre-pandemic levels in a recession? It's unlikely, but anyone who has queued for two hours in the Sydney International Departure pen mid-week, in an attempt to fly to New Zealand, might beg to differ. Demand combined with very high seat costs is driving TTV gains. The issue that remains is capacity (inventory of seats), which will not reach 70% of pre-pandemic levels in Asia Pacific until 2023. Flight Centre has no debt but convertible notes.
- All businesses need to increase their use of technology to drive efficiencies. Arguably, this is more important in tough times. Herein lies Altium's sweet spot: offering software used to deliver both printed circuit board design and parts procurement solutions. Where the company faces a headwind is the sales compliance business in China. Lockdowns make compliance, a face-to-face business, near impossible. Altium has no debt. **SFM**

SMALL BECOMES BIG

Sometimes small companies become big.

In our opinion, investors often underestimate the difficulty of converting from a small fledgling organisation into one that has scale and long duration success.

For those that can make the transition, the other mistake often made is underestimating how big, big can be.

ARB Corporation

Four-wheel drive parts manufacturer ARB is illustrative of this transition from small to big. First, a little history is warranted.

Formed in 1975, the group's founders began with good intentions to build better products. In 1987, ARB floated on the Australian Stock Exchange, valuing the business at \$6.6m.

As the market capitalisation suggests, ARB was a fledgling business back then. At the end of its first year as a public company, sales sat at just \$1.5m and the group's bottom line was barely profitable.

When you are this small, every dollar counts and getting to the next critical juncture is measured in years rather than days.

Here we would make the first observation. A business needs scale to advance. While not universal in its application, a level of profitability is essential. In our experience and without being too prescriptive, the \$10m profit mark represents an important milestone.

A company that can reach this level of profitability, while possessing many other important attributes, has the capability of accelerating.

ARB had those attributes. Founders with common sense, conservatism, attractive financial metrics, and a growing reputation for building quality products.

However, converting ideas into success requires more than just a corporate purpose and hard yakka. There are bills to pay and capital required for investment. Publicly listing a business adds even more expensive layers, usually at a time when it is least afforded.

Sixteen years

It took ARB sixteen years to reach \$10m in net profits. In 2003, the company recorded sales of \$88m and a bottom-line return of \$10.3m. Even then, the financial attractiveness of the firm was on show, recording net profit margins of 11.7%.

Five years on

In 2008, ARB recorded sales of \$172m and net profits of \$19.6m. A near doubling of profits in five years, on maintained profit margins of 11.3%. At this point, you could have packed your bags and ventured off in search of another ARB type opportunity.

Five years on

In 2013, the company doubled again. Sales lifted to \$292m and net profits rose to \$42.4m, on margins of 14.5%.

We have referred to companies like ARB as "compounders". They have delivered sustained growth rates over long periods, accompanied by commensurate levels of profitability and share price performance.

2021-2022

In 2021, ARB reported sales of \$623m and an adjusted net profit (excluding COVID benefits) of \$106m and maintained margins of 17%.

This trend has continued into the new financial year. First half sales increased 26% to \$359m, while net profits rose 27.5% to \$68.9m, on margins of 19.2%. Market estimates have the business earning over \$130m for the full year.

The ARB illustration is not a one-off. And while not all small businesses have enjoyed the level of success ARB has delivered over the years, there are many on that path.

The likes of enterprise company TechnologyOne (founded in 1987) and more recently, online lottery operator Jumbo Interactive, are following suit on a similar trajectory.

But some are showing promise

Others are clearly showing promise. Here we would call out two companies held within the Fund: foreign exchange (FX) provider, OFX and global electronic automotive parts catalogue provider, Infomedia.

OFX

One word, marathon. That's how we referred to global FX provider, OFX in a profile piece in our September 2021 Quarterly Newsletter.

While the company has grown in business scale and expanded globally since its founding in 1998, and subsequent public listing in 2013, profits have been in a holding pattern.

The 2013-2021 financial table referenced in that article highlighted two aspects. Firstly, the company had little trouble growing FX transactions, with turnover rising from \$9b to \$25b. Secondly, revenues (representing margins earned on turnover) more than doubled from \$52m to \$118M.

The problem was the bottom line. On a reported basis it actually went backwards, from \$17.1m to \$12.8m. Despite generating over \$10m in profits, the company was ill-equipped to meet the necessary costs of operating across multiple global jurisdictions, including the U.S., Europe, and Asia.

Perhaps it is important to note that COVID impacted 2021 profits, with 2020 a better reference guide, in which the company delivered net profits of \$20.3m.

We concluded our piece with the view the company was heading to a better place; the hard yards of investment

had been made, underpinned by a more enduring, recurring revenue business model.

2022 investor day

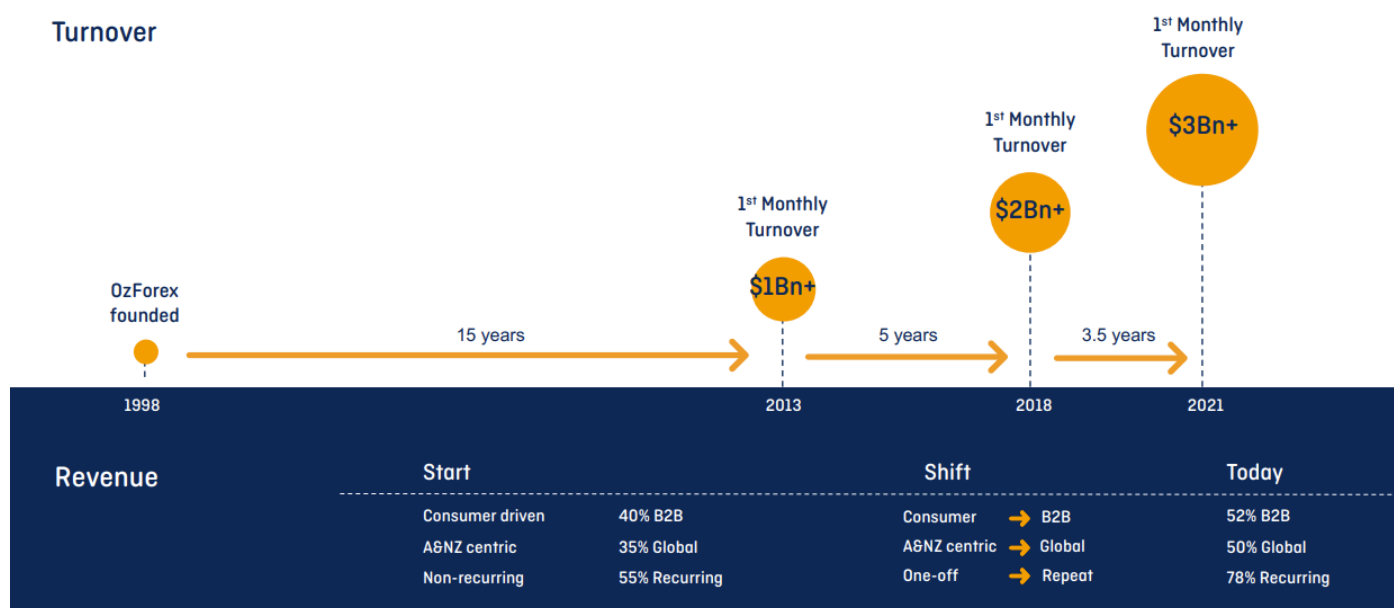
In March, the company held an investor day and updated on trading conditions. The news was positive across key metrics: turnover guided to be up at least 30%; net operating income up a forecast 23% to 25% to \$145m-\$147m; and operating profits (EBITDA) advancing 41% to \$48% to \$43m-\$45m for the period ending 31 March.

As pleasing as these numbers were, one of the most pertinent slides presented by the company appeared on page 5 (see Figure 3).

It captures the important role time plays and what can happen with scale. As is illustrated, the company took 15 years to reach its first \$1b turnover month. In 2018, some five years later, it hit the \$2b monthly rate. In 2021, just over three years, it exceeded \$3b. OFX aptly named the slide "Building momentum".

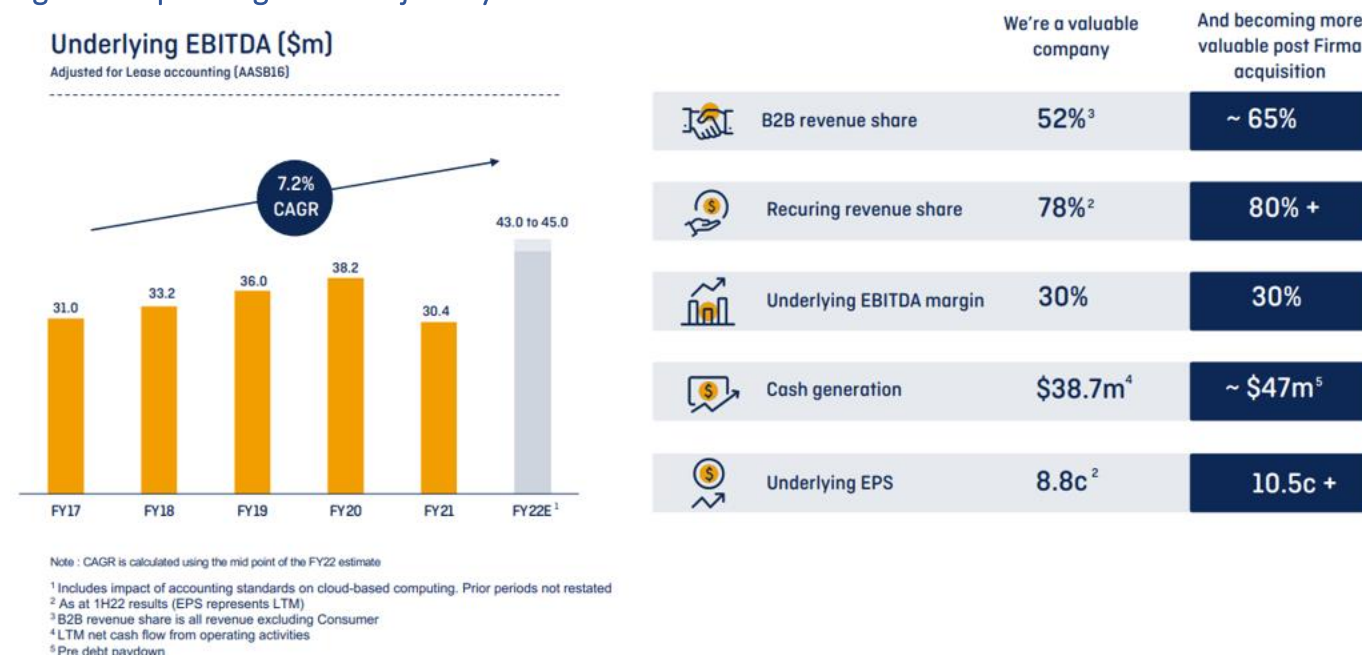
Skander Malcolm, having joined as the new CEO in 2017, confirmed as much, noting *"every region and every segment was growing double digit"*. Most importantly, the company was now enjoying operating leverage, with operating profits growing at a faster rate than revenues.

Figure 3: OFX – Turnover



Source: OFX March 2022 investor day presentation

Figure 4: Operating Profit Trajectory 2017-2022



Source: OFX March 2022 investor day presentation

“A more valuable company”

The business maturity and passage of time has made OFX “a more valuable company”. The financial metrics are reflective of this. A deliberate focus on servicing corporates and business enterprises (B2B), has driven higher levels of recurring revenues, translating to improving operating margins, alongside a capital light business model.

Figure 4 highlights the step change now underway, with the company guiding to 2022 profits exceeding previous periods by a considerable margin.

Firma acquisition

The company is now on a different footing, with clear operational momentum. The acquisition of Canadian Firma Foreign Exchange Corporation (Firma) in December 2021 builds upon that.

Interestingly, the Firma business was also founded in 1998 and has earned a strong reputation within its client base of 9,600 corporate customers, serviced across the group's nine global offices.

Importantly, the purchase allows OFX to bulk up its existing North American operations, while supporting

the company's agenda to target the higher valued corporate market segment.

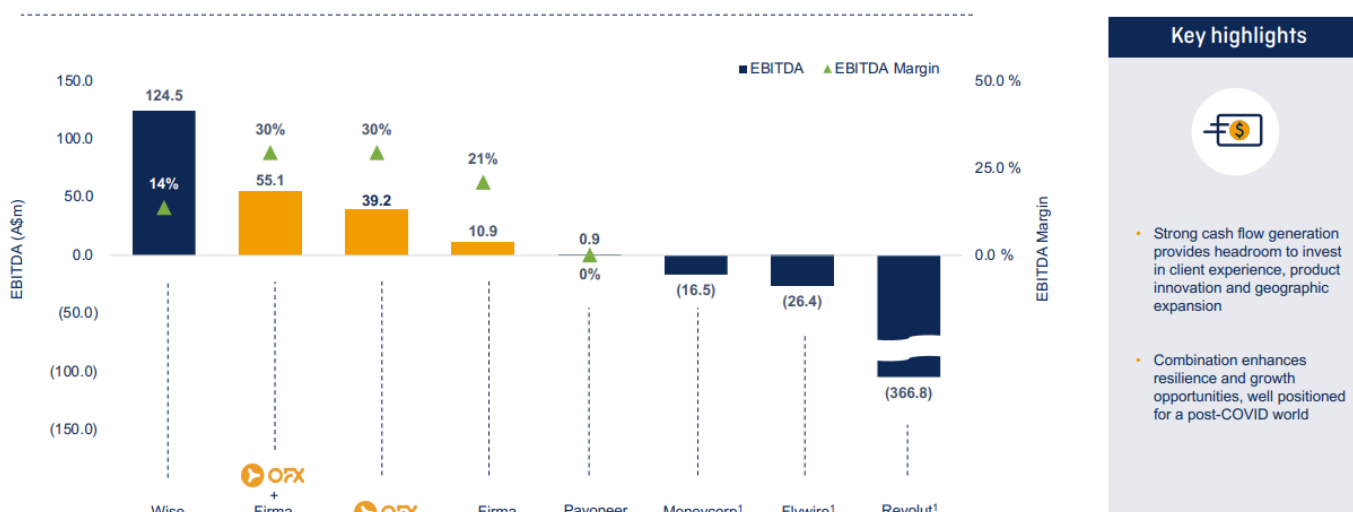
CEO Malcom highlighted this at the time of purchase, “This is our first major acquisition and very much aligned to our strategy of building scale in the Corporate segment and growing the North American region. Firma generates strong earnings from a high-quality customer base and has an excellent service culture, so there is a lot of alignment with OFX. By bringing our businesses together we become a much bigger Corporate specialist with a strong recurring base and considerable growth opportunities.”

The Firma purchase price of \$98m, compares to reported revenues in 2021 of \$52m and operating profits of \$11m. The company has chosen to use existing cash, as well as a new \$100m debt facility, leaving the business well funded on a leverage ratio (net debt/EBITDA) of 1.5x. The strong free cash flow generative qualities of OFX, has the business paying down this debt within a relatively short period of four years.

Post the Firma acquisition, the combined group's global relevance is reflected in Figure 5.

Figure 5: OFX and Firma

OFX combined will be one of the most profitable cross border payments companies (LTM EBITDA)¹



Source: OFX March 2022 investor day presentation

Comment

OFX has made the important transition to a bigger, more profitable business, underpinned by high levels of recurring earnings. In market capitalisation terms, it remains small at just \$600m. The next five years could change all that.

Infomedia

Another company with a long history is online electronic parts catalogue operator, Infomedia. Founded in 1987, the company went public in 2000. Going back into the archives, we wrote about the business in our March 2014 Selector Quarterly Newsletter.

It has been a long road for Infomedia, promising much but unable to get out of first gear. The business model is highly attractive; providing a global offering, market leadership in product segments, highly recurring operating margins, and capital light.

Where the issue lies is accelerating beyond the \$10m profit mark. Despite a couple of notable contract setbacks, the revenue line has marched higher over the 21 years since listing. In 2021, the company recorded sales just shy of \$100m, in contrast to the \$21m notched

up in 2000. Worth noting is the long-term relationships created with their customers, with 95% of revenues recurring in nature.

Despite the growth in sales, profits have not kept pace. The business has faced similar issues to OFX, requiring greater investment to support a global offering that had yet to reach commercial scale. The transition to a new CEO is currently underway. Importantly, what he will inherit is a strong and supportive board, net cash on the balance sheet and a business with strong operational momentum.

SimplePart & Nidasu acquisitions

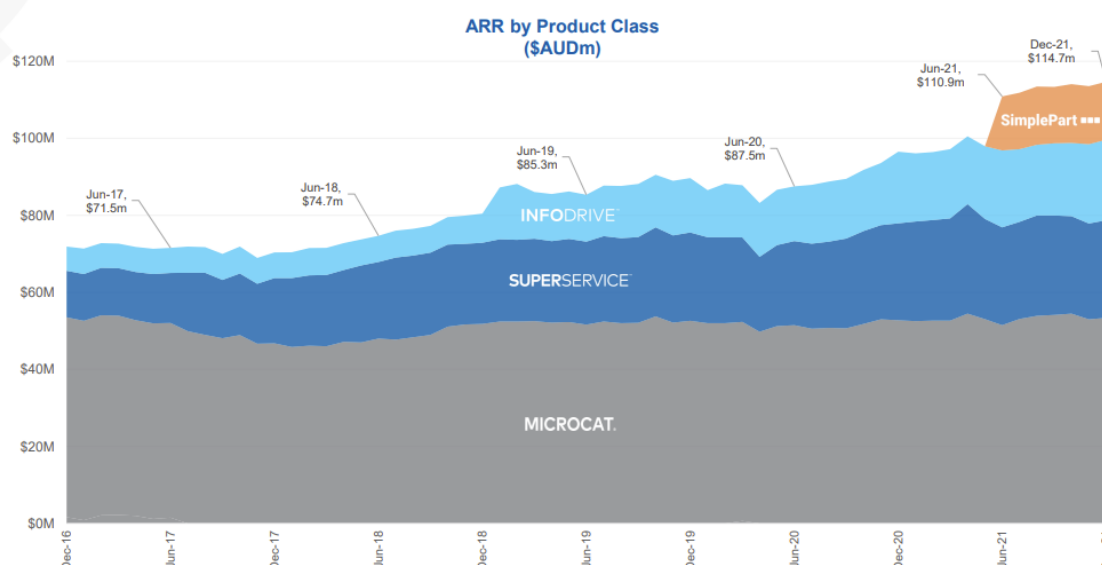
The recent acquisition of U.S. based SimplePart in May 2021, will help drive scale in the North American market, and open opportunities in other regions of the world. Data analytics provider Nidasu, acquired in 2018 for a total consideration of \$10.9m, further complements the automotive product offering, with each business growing at double digit rates.

Figure 6 illustrates the momentum now underway across the group's product segment offerings.

Figure 6: Infomedia Scaling

Higher growth ARR building off a solid core

INFOMEDIA™



Source: Infomedia HY22 results presentation

The group is now tracking towards sales of \$120m for FY22, having set an aspirational target of \$200m by 2025. Profits are expected to follow, after a period of significant and sustained capital reinvestment. In the first half of 2022, the group recorded underlying net profits of \$8.6m, noting the company's amortisation charges now largely offset the capitalisation of research and development costs.

For the full year, a figure closer to \$20m is expected. This represents an important milestone. Should future revenue targets be met, profits should scale materially, signifying a step change from small to big.

In May, the company received two indicative proposals for 100% acquisition from TA Associates and Battery Ventures with the latter offering the higher price of \$1.75.

Since then, the company received an additional non-binding proposal from Solera Holdings at \$1.70 per share

while Battery Ventures has chosen not to proceed with the process. With two separate offers on the table, the Board will seek to engage further and grant due diligence to both parties.

Overview

A business that can cover its costs, while delivering a small profit is a good start. A better business is one that is making enough profits to sustain its growth.

Getting to that critical juncture is what investors often overlook. It's both harder and takes longer to achieve. But once there, the acceleration can be much faster than anticipated.

The single biggest error investors can make, is losing patience just as the business is gaining traction. Or worse, jumping off way too early.

ARB's corporate history is illustrative of how small can become big. **SFM**

DISCIPLINE – 20-MILE MARCH

It seems only fitting that at a time when all the talk is about inflation and things outside a company's control we would discuss the one thing in their control, business discipline.

Author Jim Collins has made himself a household name amongst investors and business leaders with insights gleaned over decades of research. In that context, it is easy to dismiss some of the conclusions he draws, but the evidence is compelling and the truth hard to ignore.

Collins shot to fame with his bestselling book, *Good to Great*, which explores the common features of greatness and why some companies make the leap. In 2011, a decade after the book was first released, Collins and colleague Morten Hansen extended their research findings in *Great by Choice*.

The conclusions reaffirm why some companies are destined for success. Spoiler alert: it's not down to luck, but rather a relentless and disciplined path to sustain a business.

Today

Today's investors are influenced by the macroeconomic backdrop. Contrary to this, Collins suggested a fundamental approach centred on business and its people.

The truly outstanding companies displayed certain behavioural traits that led to their success, despite the economic conditions. They weren't immune to such external events, but instead had the ability to adapt and maintain a business cadence.

Collins coined these companies '10Xers', all which exhibited the following three traits:

1. Fanatic discipline
2. Empirical creativity
3. Productive paranoia

The discipline to stay the course and maintain a rhythm of investment and the long-term pursuit of an end goal. The creativity to accelerate when required and consolidate when appropriate. And finally, a paranoia that never takes things for granted.

Some will cast their eyes at Collins' list of qualities, deeming them great to imagine but unlikely.

Yet when you get to the numb of what Collins is describing, the difficulty is all in the execution.

We own some truly outstanding businesses and leaders. Only time will tell whether they are worthy of being labelled a 10Xer, but their track record to date makes them contenders.

Investors have a choice. Focus on the share price for direction, or consider the steps a business is taking to judge progress. We suggest the latter, despite the short-term pain often endured.

Amundsen

Collins and Hansen posed the following question in *Great by Choice*: *"Why did the 10X companies achieve such spectacular results, especially when direct comparisons – companies operating in the same fast-moving, unpredictable, and tumultuous environments – did not? Part of the answer lies in the distinctive behaviors of their leaders."*

The pair researched a number of companies to cement their learnings and draw conclusions. Below is a direct extract from the book illustrating some of the findings. The outcomes discussed should be compulsory reading for leaders, to get an insight into the principles of a great business.

Book Extract – Are you an Amundsen or a Scott?

In October 1911, two teams of adventurers made their final preparations in their quest to be the first people in modern history to reach the South Pole. For one team, it would be a race to victory and a safe return home. For the second team, it would be a devastating defeat, reaching the Pole only to find the wind-whipped flags of their rivals planted 34 days earlier, followed by a race for their lives – a race that they lost in the end, as the advancing winter swallowed them up.

All five members of the second Pole team perished, staggering from exhaustion, suffering the dead-black pain of frostbite, and then freezing to death as some wrote their final journal entries and notes to loved ones back home.

It's a near-perfect matched pair. Here we have two expedition leaders – Roald Amundsen, the winner, and Robert Falcon Scott, the loser – of similar ages (39 and

43) and with comparable experience. Amundsen and Scott started their respective journeys for the Pole within days of each other, both facing a roundtrip of more than 1,400 miles into an uncertain and unforgiving environment, where temperatures could easily reach 20° below zero even during the summer, made worse by gale-force winds.

And keep in mind, this was 1911. They had no means of modern communication to call back to base camp – no radio, no cell phones, no satellite links – and a rescue would have been highly improbable at the South Pole if they screwed up. One leader led his team to victory and safety. The other led his team to defeat and death.

What separated these two men? Why did one achieve spectacular success in such an extreme set of conditions, while the other failed even to survive? It's a fascinating question and a vivid analogy for our overall topic. Here we have two leaders, both on quests for extreme achievement in an extreme environment. And it turns out that the 10X business leaders in our research behaved very much like Amundsen and the comparison leaders behaved much more like Scott.

Amundsen and Scott achieved dramatically different outcomes not because they faced dramatically different circumstances.

In the first 34 days of their respective expeditions, according to Roland Huntford in his superb book *The Last Place on Earth*, Amundsen and Scott had exactly the same ratio, 56%, of good days to bad days of weather. If they faced the same environment in the same year with the same goal, the causes of their respective success and failure simply cannot be the environment. They had divergent outcomes principally because they displayed very different behaviours.

So, too, with the leaders in our research study. Like Amundsen and Scott, our matched pairs were vulnerable to the same environments at the same time. Yet some leaders proved themselves to be 10Xers while leaders on the other side of the pair did not.

Let's first look at what we did not find about 10Xers relative to their less successful comparisons: They're not more creative. They're not more visionary. They're not more charismatic. They're not more ambitious. They're not more blessed by luck. They're not more risk-seeking. They're not more heroic. And they're not more prone to

making big, bold moves. To be clear, we're not saying that 10Xers lacked creative intensity, ferocious ambition, or the courage to bet big. They displayed all these traits, but so did their less successful comparisons.

So then, how did the 10Xers distinguish themselves? First, they embrace a paradox of control and non-control. On the one hand, 10Xers understand that they face continuous uncertainty and that they cannot control, and cannot accurately predict, significant aspects of the world around them. On the other hand, they reject the idea that forces outside their control or chance events will determine their results; they accept full responsibility for their own fate.

10Xers then bring this idea to life by a triad of core behaviours: fanatic discipline, empirical creativity, and productive paranoia. And they all led their teams with a surprising method of self-control in an out-of-control world.

The 20-Mile March

Imagine you're standing with your feet in the Pacific Ocean in San Diego, looking inland. You're about to embark on a 3,000-mile walk, from San Diego to the tip of Maine. On the first day you march 20 miles making it out of town.

On the second day you march 20 miles. And again, on the third day you march 20 miles, heading into the heat of the desert. It's hot, more than 100°F, and you want to rest in the cool of your tent. But you don't. You get up and you march 20 miles. You keep the pace, 20 miles a day.

Then the weather cools, and you're in comfortable conditions with the wind at your back, and you could go much farther. But you hold back, modulating your effort. You stick with your 20 miles.

Then you reach the Colorado high mountains and get hit by snow, wind, and temperatures below zero – and all you want to do is stay in your tent. But you get up. You get dressed. You march your 20 miles.

You keep up the effort – 20 miles, 20 miles, 20 miles – then you cross into the plains, and its glorious springtime, and you can go 40 or 50 miles in a day. But you don't. You sustain your pace, marching 20 miles.

And eventually, you get to Maine.

Now, imagine another person who starts out with you on the same day in San Diego. He gets all excited by the journey and logs 40 miles the first day.

Exhausted from his first gigantic day, he wakes up to 100° temperatures. He decides to hang out until the weather cools, thinking, "I'll make it up when conditions improve." He maintains this pattern – big days with good conditions, whining and waiting in his tent on bad days – as he moves across the western United States.

Just before the Colorado high mountains, he gets a spate of great weather and he goes all out, logging 40-to-50-mile days to make up lost ground. But then he hits a huge winter storm when utterly exhausted. It nearly kills him, and he hunkers down in his tent, waiting for spring.

When spring finally comes, he emerges, weakened, and stumbles off toward Maine. By the time he enters Kansas City, you, with your relentless 20-mile march, have already reached the tip of Maine. You win, by a huge margin.

Now, think of medical-equipment maker Stryker as a 20-Mile March company.

When John Brown became CEO of Stryker (SYK) in 1977, he deliberately set a performance benchmark to drive consistent progress: Stryker would achieve 20% net income growth every year. This was more than a mere target, or a wish, or a hope, or a dream, or a vision. It was, to use Brown's own words, "the law." He ingrained "the law" into the company's culture, making it a way of life. (Twenty percent may seem like a high bar, but for a small company in an explosive industry, it was achievable.)

Brown created the "Snorkel Award," given to those who lagged behind; 20% was the watermark, and if you were below it, you needed a snorkel. Just imagine receiving a mounted snorkel from John Brown to hang on your wall so everyone can see that you're in danger of drowning. People worked hard to keep the snorkel off their walls.

Stryker's annual division-review meetings included a chairman's breakfast. Those who hit their 20-Mile March went to John Brown's breakfast table. Those who didn't went to another breakfast. "They are well fed," said Brown, "but it is not the one where you want to go."

If your division fell behind for two years in a row, Brown would insert himself to "help," working around the clock

to "help" you get back on track. "We'll arrive at an agreement as to what has to be done to correct the problem," said the understated Brown. You get the distinct impression that you really don't want to need John Brown's help. According to Investor's Business Daily, "John Brown doesn't want to hear excuses. Markets bad? Currency exchange rates are hurting results? Doesn't matter." Describing challenges Stryker faced in Europe due partly to currency exchange rates, an analyst noted, "It's hard to know how much of [the problem] was external. But at Stryker, that's irrelevant."

From the time John Brown became CEO in 1977 through 1998 (when its comparison, USSC, disappeared as a public company), and excluding a 1990 extraordinary gain, Stryker hit its 20-Mile March goal more than 90% of the time. Yet for all this self-imposed pressure, Stryker had an equally important self-imposed constraint: to never go too far, to never grow too much in a single year. Just imagine the pressure from Wall Street to increase growth when your direct rival is growing faster than your company.

In fact, Stryker grew more slowly than USSC more than half the time. According to the Wall Street Transcript, some observers criticised Brown for not being more aggressive. Brown, however, consciously chose to maintain the 20-Mile March, regardless of criticism urging him to grow Stryker at a faster pace in boom years.

John Brown understood that if you want to achieve consistent performance, you need both parts of a 20-Mile March: a lower bound and an upper bound, a hurdle that you jump over and a ceiling that you will not rise above, the ambition to achieve and the self-control to hold back.

Southwest's radical restraint

When we began this study, we thought we might see 10X winners respond to a volatile, fast-changing world full of new opportunities by pursuing aggressive growth and making radical, big leaps, catching and riding the Next Big Wave, time and again. And yes, they did grow, and they did pursue spectacular opportunities as they grew.

But the less successful comparison cases pursued much more aggressive growth and undertook big-leap, radical-change adventures to a much greater degree than the 10X winners. The 10X cases exemplified what we came to call the 20-Mile March concept, hitting stepwise

performance markers with great consistency over a long period of time, and the comparison cases did not.

The 20-Mile March is more than a philosophy. It's about having concrete, clear, intelligent, and rigorously pursued performance mechanisms that keep you on track. The 20-Mile March creates two types of self-imposed discomfort: (1) the discomfort of unwavering commitment to high performance in difficult conditions, and (2) the discomfort of holding back in good conditions.

Southwest Airlines, for example, demanded of itself a profit every year, even when the entire industry lost money. From 1990 through 2003, the U.S. airline industry as a whole turned a profit in just six of 14 years. In the early 1990s it lost \$13b and furloughed more than 100,000 employees; Southwest remained profitable and furloughed not a single person. Despite an almost chronic epidemic of airline troubles, including high-profile bankruptcies of some major carriers, Southwest generated a profit every year for 30 consecutive years.

Equally important, Southwest had the discipline to hold back in good times so as not to extend beyond its ability to preserve profitability and the Southwest culture. It didn't expand outside Texas until nearly eight years after starting service, making a small jump to New Orleans. Southwest moved outward from Texas in deliberate steps -- Oklahoma City, Tulsa, Albuquerque, Phoenix, Los Angeles -- and didn't reach the Eastern Seaboard until almost a quarter of a century after its founding. In 1996 more than 100 cities clamoured for Southwest service. And how many cities did Southwest open that year? Four.

At first glance, this might not strike you as particularly significant. But stop to think about it. Here we have an airline setting for itself a standard of consistent performance that no other airline achieves. Anyone who said they'd be profitable every year for nearly three decades in the airline business -- the airline business! -- would be laughed at. No one does that. But Southwest did. Here also we have a publicly traded company willing to leave growth on the table. How many business leaders of publicly traded companies have the ability to leave gobs of growth on the table, especially during boom times when competitors do not leave growth on the table? Few, indeed. But Southwest did that too.

Some people believe that a world characterised by radical change and disruptive forces no longer favours

those who engage in consistent 20-Mile Marching. Yet the great irony is that when we examined just this type of out-of-control, fast-paced environment, we found that every 10X company -- unlike their less-successful peers -- exemplified the 20-Mile March principle during the era we studied."

Closer to home

During the quarter, several businesses held in the portfolio reported their results to the market. These included Aristocrat Leisure, James Hardie, OFX Group, TechnologyOne and Fisher & Paykel Healthcare. Whilst at different stages of their business life, if you apply the Collins factors discussed earlier, there is a pathway of excellence clearly on display.

Two that particularly shine out are cloud software provider, TechnologyOne, and respiratory specialist, Fisher & Paykel Healthcare.

TechnologyOne

We introduced TechnologyOne in our December 2020 Quarterly Newsletter article, "May the cloud be with you". It has been a long journey for the business. Established in 1987, it listed on the Australian Stock Exchange in 1999. Today, the business is led by CEO Edward Chung, having joined the firm in 2007.

His mentor, current Chairman and co-founder Adrian Di Marco, has cultivated the business over its 35-year history and navigated it successfully through four key transition periods. On each, the business has evolved into a stronger, more resilient unit. Years of consistent revenue growth and profits delivered is testament of the '10Xer' traits entrenched in the business: discipline, creativity, and productivity paranoia.

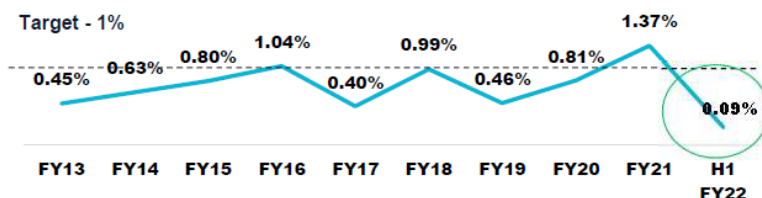
Perhaps the watershed moment for the company, however, was its radical embrace of the cloud. First unveiled in 2015, this bold move continues to prove widely beneficial. Providing improved business visibility and earnings predictability, it is now elevating the company to new horizons.

Offering business critical software for universities, local governments and alike, the company sees little customer churn. In fact, it boasts a customer retention rate of 99% (see [Figure 7](#)), demonstrating the stickiness of its software.

Figure 7: Business Customer Retention Rate

99% customer retention across all markets

**Customer Churn 10 years
Based on Total ARR¹**

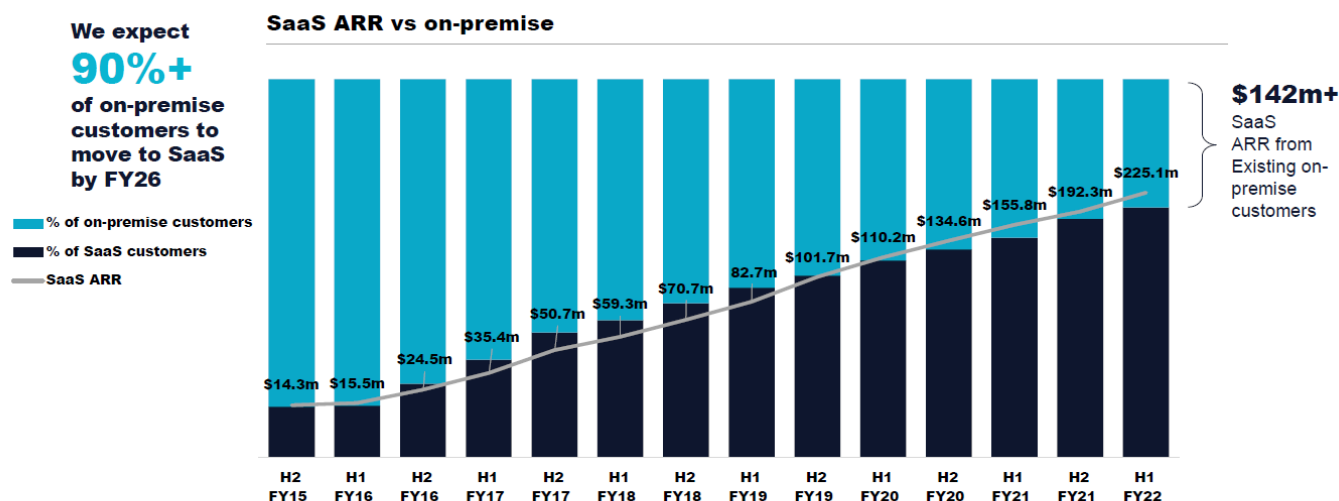


¹ Total ARR = SaaS ARR + On-premise Annual Licence ARR
H1 FY22 represents churn for the 6 months to 31 March 2022

Source: TechnologyOne HY22 Presentation

Figure 8: Transition to Annual Recurring Revenue (ARR)

\$142m ARR Runway moving on-premise to SaaS by FY24



Includes additional ~\$20m SaaS ARR runway from existing on-premise customers of Scientia
Total Scientia SaaS ARR included in H1 FY22 is \$3.0m

Does not include ARR from additional product penetration or new Customers

Source: TechnologyOne HY22 Presentation

The company is targeting annual recurring revenue (ARR) to surpass \$500m in 2026. Additional growth opportunities will be driven by new product modules and the emergence of the U.K. operations.

Importantly though, management remains focused on delivering its 10%-15% annum sales target; a sustainable cadence that allows the business to grow sensibly.

Over its corporate life, the company has avoided growth by acquisitions. Instead preferring an organic path, which is all internally funded.

The company invests heavily in research and development, running at 24% at the full year, but

sustains a sensible dividend policy (see [Figure 9](#)), while retaining a net cash balance sheet, which stood at \$116m in May.

Collins refers to companies that carry cash as having productive paranoia, likening it to climbers carrying extra oxygen canisters when ascending Mount Everest.

“Financial theory says that leaders who hoard cash in their companies are irresponsible in their deployment of capital. In a stable, predictable, and safe world, the theory might hold; but the world is not stable, predictable, or safe. And it never will be.”

Figure 9: TechnologyOne Dividend History

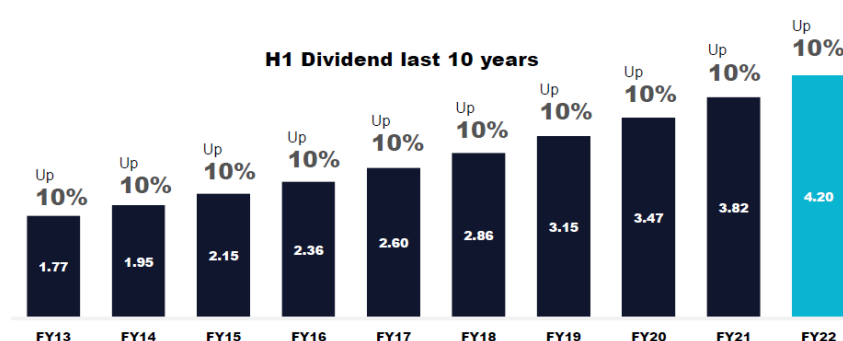
Interim Dividend up 10%

We remain confident about the outlook for the full year

Half 1 4.20 cps,
up 10% (60% franked¹)

Payout
ratio of
41%

Compound
Growth
10%



Notes:

- ¹ Dividends are not fully franked as a result of tax benefits from the R&D Tax Concession and the TechnologyOne Share Trust
- We have continuously paid a dividend since 1996 (through Dot-Com and GFC)
- The Board considers the payment of a Special Dividend at the end of each year taking into consideration franking credits and other factors
- The Board continues to consider other Capital Management initiatives including acquisitions

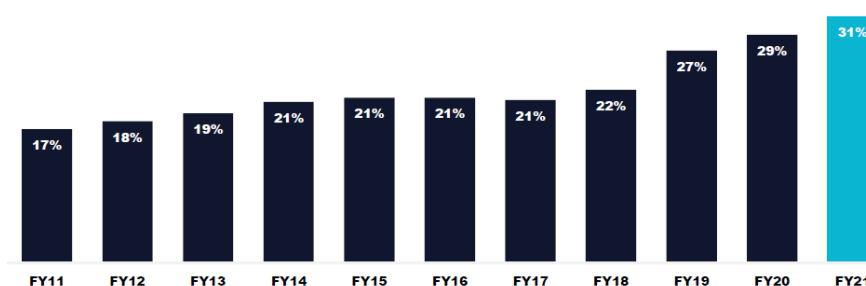
Source: TechnologyOne HY22 Presentation

Figure 10: Profit Before Tax Margins

Profit margin to improve to 35% in the next few years

FY21 Profit Before Tax Margin was 31%

Driven by the significant economies of scale from our single instance global SaaS ERP solution



Source: TechnologyOne HY22 Presentation

The business leverage enjoyed is best reflected in profit before tax margins, outlined in Figure 10. For 2022, the company is forecasting this to hit 31%, with an expectation of 35% in the forward years as ARR approaches \$500m. Figure 11 reinforces the quality of

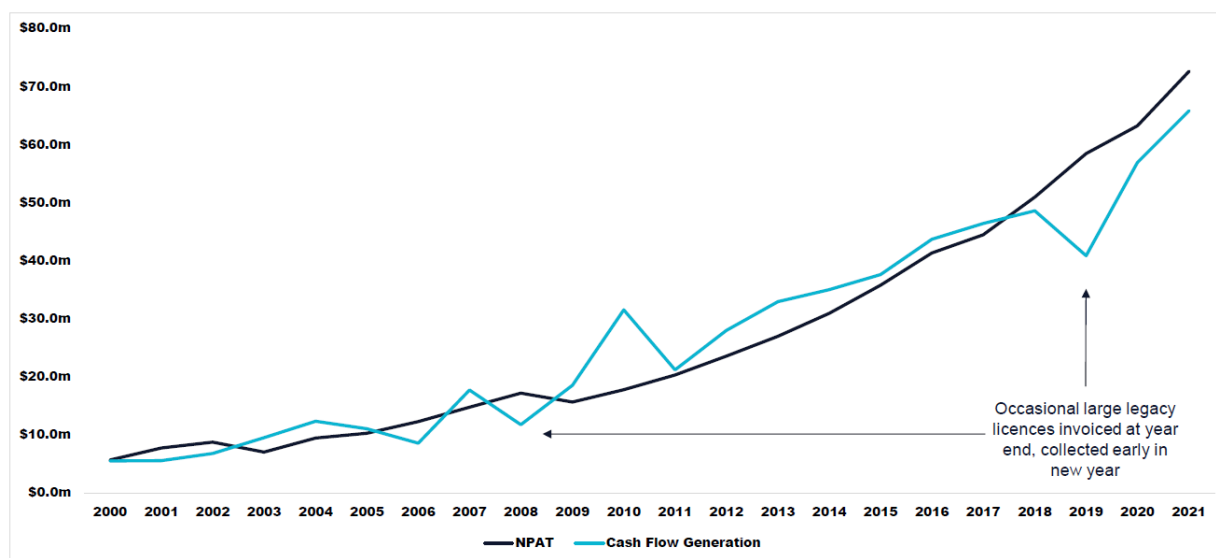
profits, with cash flow conversion highly predictable and recurring.

The company has a market capitalisation of \$3.2b, with net cash of \$116m. Figure 12 profiles its share price performance over the past decade.

Figure 11: Cash Flow Conversion

Appendix C: Long history of strong cash flow generation

Cash Flow Generation² will continue to grow as NPAT¹ grows



¹ This graph shows previously reported NPAT to FY18 and has not been restated for AASB15

² Cash flow generation is operating cash flow from operations less capitalised development costs, capitalised commissions and lease payments

Source: TechnologyOne HY22 Presentation

Figure 12: Share Price Performance 2012-2022



Source: Iress

Comment

TechnologyOne looks like a Collins 10Xer company and its performance, certainly over the past decade, would suggest its inclusion is warranted.

Fisher & Paykel Healthcare

For respiratory care group, Fisher & Paykel Healthcare to succeed over the long-term, it needs to change clinical practice. This is a process of innovating, failing, and innovating again.

Clinicians also need to see merit in adopting new ways and they rely on healthcare authorities approving use, subject to meeting safety and efficacy thresholds.

In our September 2021 Quarterly Newsletter, we noted management's stated intentions for success, *"We aim to grow our business in a way that is sustainable over the long-term by creating better products, extending our global reach and changing clinical practice."*

The company's track record until 2020, to sustainably double revenue every 5-6 years, was in keeping with this statement.

Then came COVID, which led to an explosion in hardware demand. Over the forward years ending March 2022, the company subsequently quantified the COVID impact, selling over NZ\$880m worth of equipment, equal to 10 years of hardware sales in just two years.

At the company's May investor day held in New Zealand, CEO Lewis Gradon refers to this surge as a 'bump'. [Figure 13](#) highlights this.

A key distinguishing factor, as Collins points out, of a 10Xer company is their ability to deal with extraordinary and unpredictable situations. Fisher & Paykel met the strong demand under extreme circumstances, ramping up manufacturing and hiring additional staff in spades, all while maintaining the usual business cadence of investing in innovation and development.

Relentless

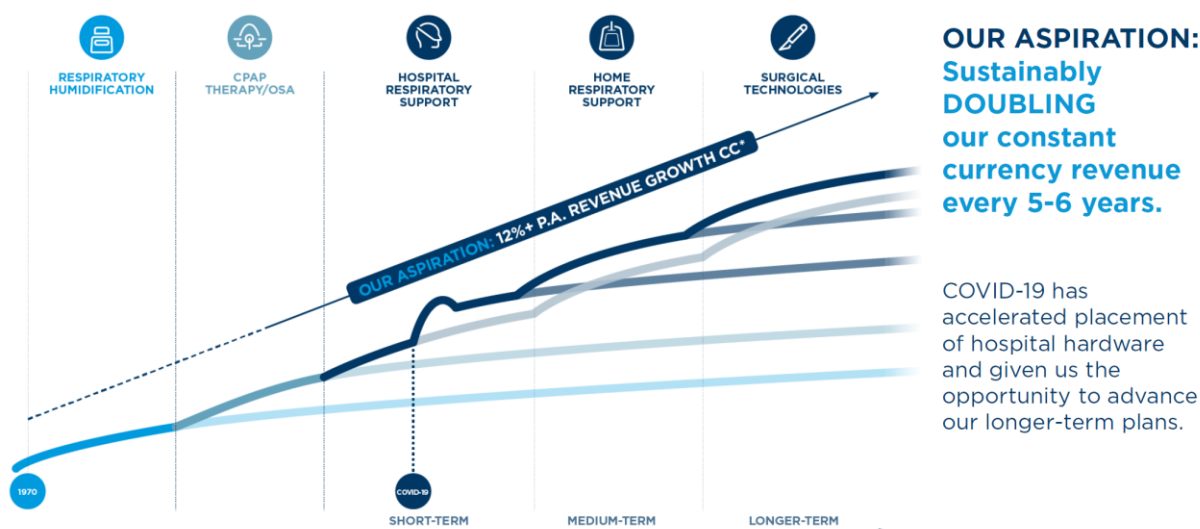
The company regards its innovation approach as *"relentless"*. This discipline, alongside a patient focused culture to enable clinical practice change, remains its foundational bedrock.

The latency that exists within the business is reflected in the release of new product applications highlighted during the investor day. This included:

1. AIRVO 3 Nasal High Flow system
2. Surgical Humidification Gas Diffuser
3. Optiflow Anaesthesia
4. Optiflow Switch
5. Optiflow Trace
6. EVORA Full face mask

Figure 13: COVID 'bump'

Our aspiration - now



The image above is an illustration of the company's long-term growth aspirations. It is not a graph and should not be interpreted as being indicative of levels of revenue or profitability in the short term.

Fisher & Paykel
HEALTHCARE

Source: Fisher & Paykel Healthcare Investor Day May 2022

Disciplined execution

COVID provided the company with a challenge going into 2020 and a challenge exiting 2022. This time, the issue is lower hardware sales as demand comes off peak levels, offset by a larger installed consumable base. Management is unable to quantify the short-term impacts but are steadfast on the long-term expectations.

Figure 14 outlines the market opportunity across the two settings of Hospital and Homecare. It is an addressable

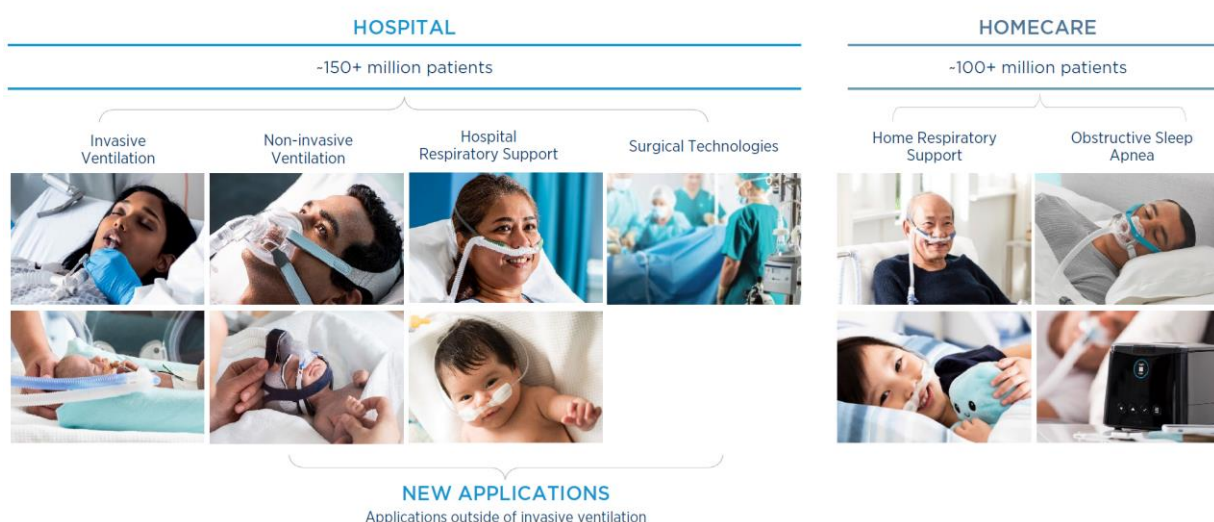
market of NZ\$25b, comprising over 250m patients. For context, the company reported group revenues of NZ\$1.7b for 2022.

Over the past decade, the company's new consumables, led by Optiflow, has gained increasing traction within the Hospital setting. The growing body of clinical evidence, as shown in Figure 15, provides confidence that adoption will flow.

Figure 14: Market Opportunity

~NZ\$25+ billion and growing market opportunity

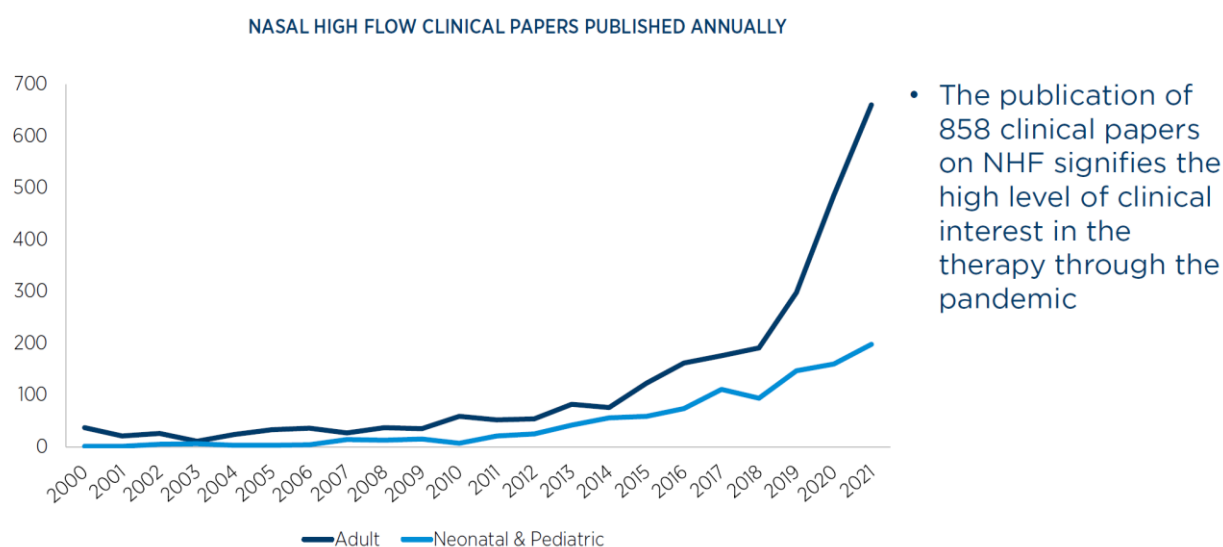
Total addressable market estimates



Source: Fisher & Paykel Healthcare FY22 Presentation

Figure 15: Optiflow Nasal High Flow Clinical Papers

Optiflow NHF - a growing body of clinical evidence



Source: Fisher & Paykel Healthcare FY22 Presentation

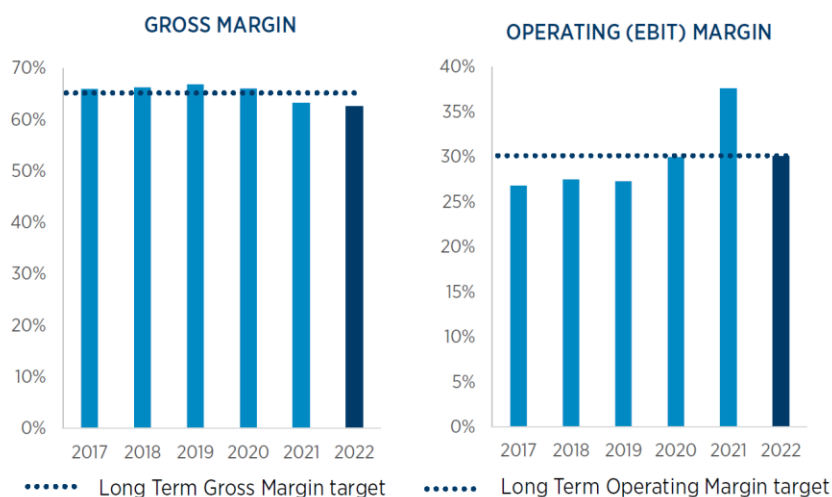
Figure 16: Sustainable Profitability

Long term margin targets

- Long term gross margin and operating margin targets remain unchanged
- Freight rates expected to remain elevated in the near term

Accelerated investment in:

- R&D – Surgical technologies, Home respiratory support
- Anesthesia sales team



Source: Fisher & Paykel Healthcare Investor Day May 2022

Not only has the company excelled in building a world class healthcare respiratory business, but it has also sustained financial discipline.

Figure 16 shows consistent high gross margins, enabling increased research and development spend, and as a flow on, global manufacturing expansion and ongoing geographical reach.

All this has been achieved without a need for acquisitions, internally funded, and a history of paying dividends.

At year's end, the company had cash of NZ\$222m and a market capitalisation of NZ\$11.3b.

Comment

Our comments on TechnologyOne applies equally to Fisher & Paykel Healthcare. The 10Xer qualities are

clearly on display, matched only by its ability to consistently deliver.

Collins: Great by choice

The term 10Xers suggests something special. The challenge of sustaining a pursuit, let alone a business venture over a long duration, is not only difficult but demanding. Collins provides a guidepost on what special looks like and from where we're standing, both TechnologyOne and Fisher & Paykel Healthcare fit the bill.

The mistake investors often make is underestimating how valuable these types of businesses truly are and their ability to not only survive, but to create and endure.

SFM

ENCAR – VISTING SEOUL

“We pour the water, to grow the flower.”

Encar CEO Kim Sang-beom, affectionately known as SB, describes his role at South Korean online used car platform provider, not as a founder of the business but one entrusted to take it from “*adolescence to adulthood*”.

Our visit in April to Encar’s operations in South Korea’s capital, Seoul, marked our first trip to the country. South Korea’s population at 52m is double that of Australia. The city is modern and unlike other Asian cities we have visited. If pushed, it is a mix between a U.S. town, like Chicago and aspects of China. Its people are incredibly friendly and polite.

The most interesting visual aspect of Korean life are the number of coffee shops that occupy the city streets. One local described Seoul as the coffee capital of the world. Considering Australia’s love of coffee, it is hard to be sure where they rank, but Korean people display an affluent lifestyle.

Apartment living is the primary place of residence and car ownership is the main form of transport, alongside the city’s subway system. Online shopping is established and as we learnt, its acceptance extends beyond groceries to other activities, such as purchasing a car.

Why visit Seoul?

In 2014, Australia’s leading online automotive selling platform, Carsales acquired 49.9% in South Korea’s up and coming online automotive equivalent, Encar.com. The group outlaid \$126m for its stake, with the aim of replicating its local success. In 2017, Carsales moved to full ownership, paying \$244m for the remaining 50.1%.

The Encar business was first established in 2000 by one of South Korea’s largest “Chaebol”, the SK Group. Chaebol refers to a large industrial conglomerate or organisation run by a person or family. The SK group is comprised of 95 subsidiaries that share the brand name. In 2014, the SK Group chose to sell down its interest in Encar to Carsales, before completely exiting in 2017.

At the time of purchase, Encar was turning over revenues of A\$22m and earning operating profits of A\$12m. The business is led by SB, alongside a loyal and committed

group of key executives, who have been with the company since inception in 2000.

Our visit to Encar reflects our approach to investing. Financial reports provide the framework to assess a business but ascertaining the culture of an organisation requires an on the ground assessment. We were fortunate enough to meet with management at Encar’s head office in Seoul, before visiting two of the 42 current offsite branch facilities, where used car dealerships are located.

At the conclusion of our meeting and visits, it was clear Encar is an industry disruptor and enjoying considerable success.

Encar business model

Carsales estimates the used car market in Korea turns over some 1.5m vehicles per annum. Unlike Australia where consumers can sell to each other, Koreans largely rely on dealers. This is carried out at regional branch sites, where buyers directly engage with dealers.

The main problem with this relationship, which became clear on our visit, is the buyer’s distrust of the dealers. False information, particularly concerning a vehicle’s safety profile, has seen Encar build a more compelling offer to better bridge the credibility gap that exists between the two parties.

How have they done this?

Standard classified advertising was the traditional method used by dealers. In the case of market leader Encar, a \$20 fee was charged to dealers to advertise a used vehicle. Some charge no fees, as is the case for the group’s main online competitor KB Cha Cha Cha, illustrating the competitive nature of the industry.

Despite this, Encar is the number one operator having been at the forefront of disruptive industry transformation. In 2014, the traditional online car classifieds service represented Encar’s core business offering, delivering 84% of group revenue. In 2017, the group challenged the used car selling landscape with a new offering.

Led by Encar’s strategic business to consumer (B2C) product executive Doohyun Hwang, a veteran of the business, the company launched Guaranteed Offer,

designed to address the lack of trust that existed between buyers and dealers. For a five-fold increase on the standard rate of \$20 per vehicle, Encar's Guaranteed stamp (\$100 per vehicle) signifies the details surrounding the car specifics and crash history are accurate.

Encar places itself in strategically co-located branches, or near dealer branches, throughout South Korea. It's here that the detailed assessment is carried out to confirm the following:

1. The vehicle exists at the dealership
2. The vehicle has not been involved in a car accident affecting its frame
3. The specifications advertised are correct

This may sound like standard practice in most countries, but the South Korean used car market is apparently subject to dealers taking advantage of unsuspecting buyers. Encar's Guaranteed stamp of approval is a rare win-win outcome. Buyers are happy to pay more for the peace of mind it provides, while dealers maintain their gross margins, and in some cases are able to lift them, by passing on the extra cost to buyers.

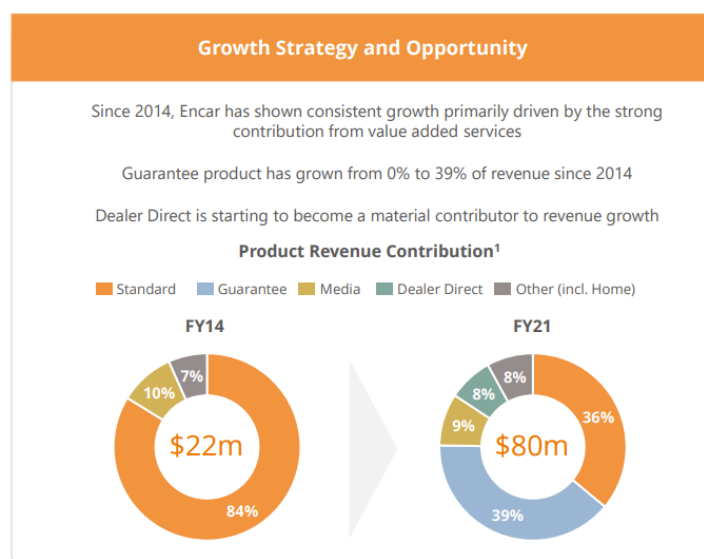
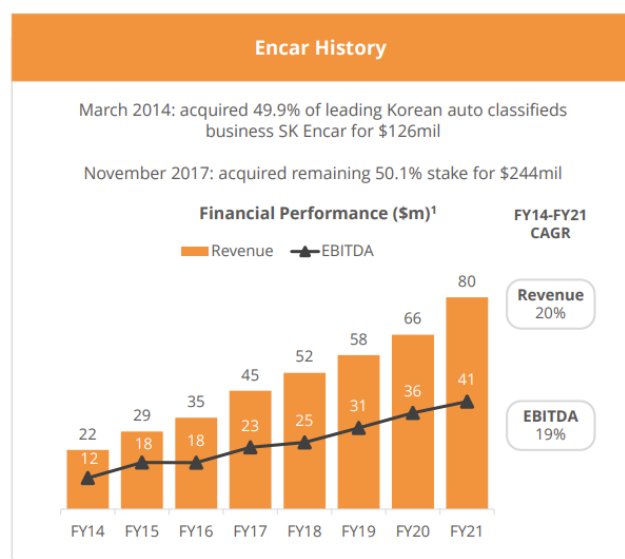
To date, Guaranteed Offer has resonated strongly among buyers and dealers.

It's delivered a better customer experience and quicker turnover of product, due to the independent nature of the service. Encar package the offer with high quality photos, which are then uploaded to the site.

During our visit, we travelled to two co-located branches. The first, a traditional older site with cars sitting in a dusty carpark and dealers eager to pouch. The second was a modern storied property that housed the vehicles, providing excellent facilities to undertake the service. In total, Encar operates in 42 branches, with management pointing to a potential 70 in the fullness of time.

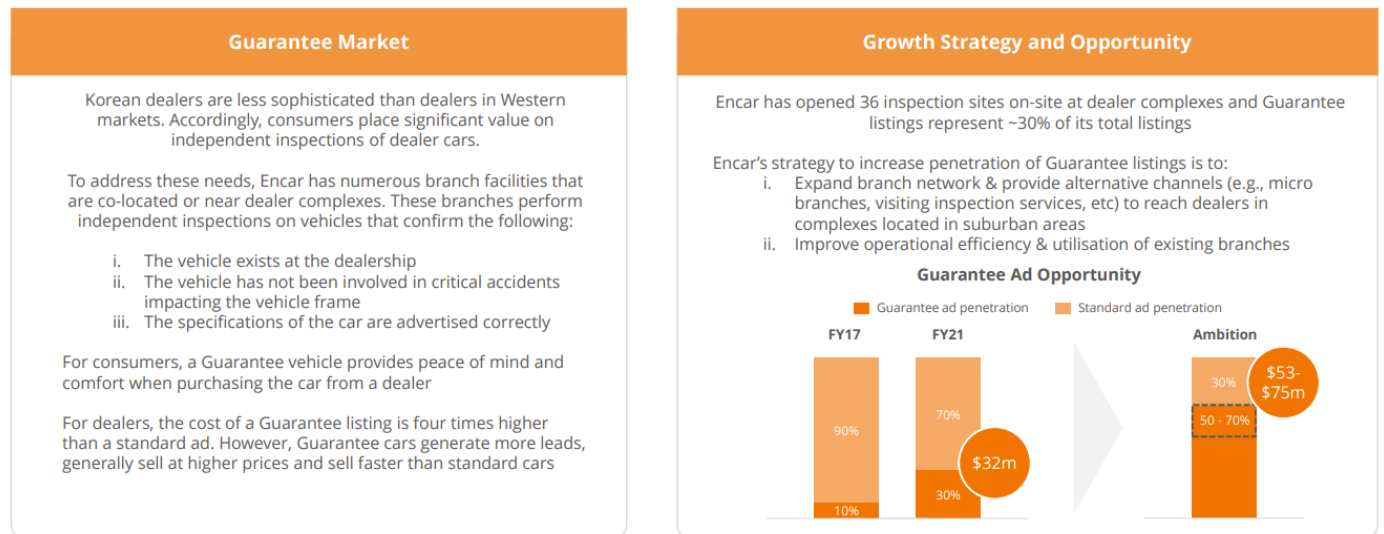
Figure 17 and Figure 18 profiles the financial pathway of Encar since 2014, and the growth of Guaranteed Offer since its launch. In relatively short order, the group's revenue split has shifted. The traditional used car classifieds ads now make up 36% of the revenue pie, while the group's most successful offering to date, Guaranteed Offer comprises of 39%. It is still early days, with only 25%-30% of dealers taking up the Guaranteed Offer. Although with education, the expectation is to see further dealer acceptance.

Figure 17: Encar - Financial Timeline 2014-2021



Source: Company Investor Day December 2021

Figure 18: Guarantee Opportunity



Source: Company Investor Day December 2021

GALLERY

The following photos include our visit to two branch locations. The first, the older less appealing and the second, the more modern, professional establishment.

Location 1: Gangnam-gu-Yulhyeon-dong branch (old style)

Figure 19: Dealer shop repairs



Source: SFML South Korea Trip

Figure 21: Encar facility co-located with dealers



Source: SFML South Korea Trip

Figure 20: Cars in outdoor carpark



Source: SFML South Korea Trip

Figure 22: Dealer used car with red Guaranteed stamp (top right hand)



Source: SFML South Korea Trip

Location 2: Suwon-si-Gosaek-dong branch (new style)

Figure 23: Multi-tiered complex, housing used cars undercover



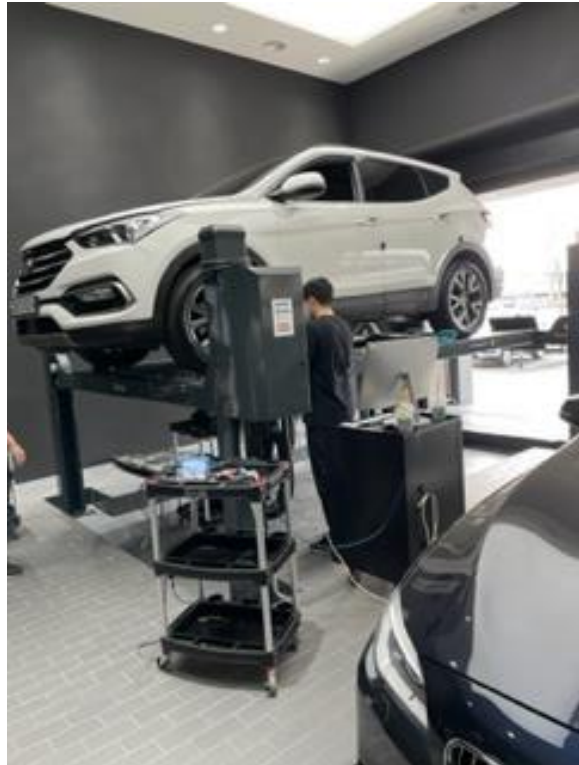
Source: SFML South Korea Trip

Figure 24: Modern professional surrounds



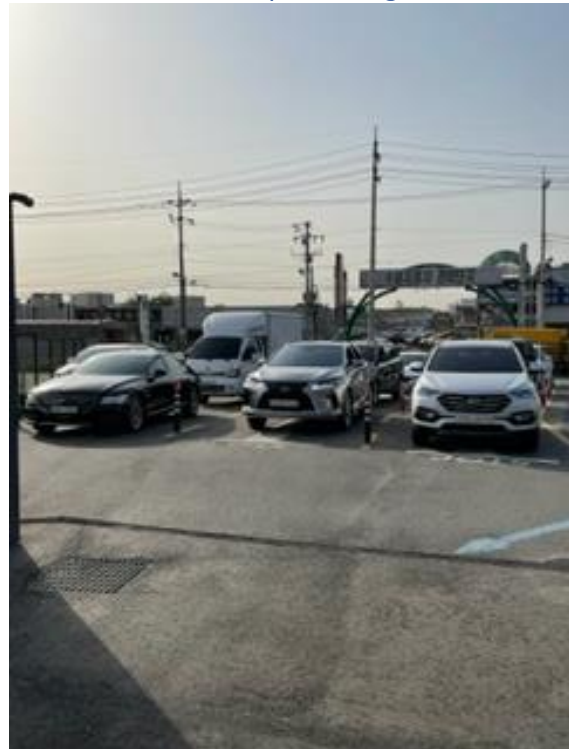
Source: South SFML Korea Trip

Figure 25: Encar undertaking vehicle premium service on behalf of customer



Source: SFML South Korea Trip

Figure 26: Afternoon, 5pm, with dealers three wide and three deep, waiting for Encar service.



Source: SFML South Korea Trip

Figure 27: Encar production facility co-located, with images uploaded to the site



Source: SFML South Korea Trip

Encar future strategy – digital retailing

Figure 28 sets out the Encar business vision. As Mr Hwang explained to us over the course of the day, this is a deeply thought-out vision, stretching back to 2014. In a competitive world, the necessity to modernise and remain relevant is ever present. The move from standard ads to Guaranteed Offer has more to play out, but there are more business layers required to be truly sustainable.

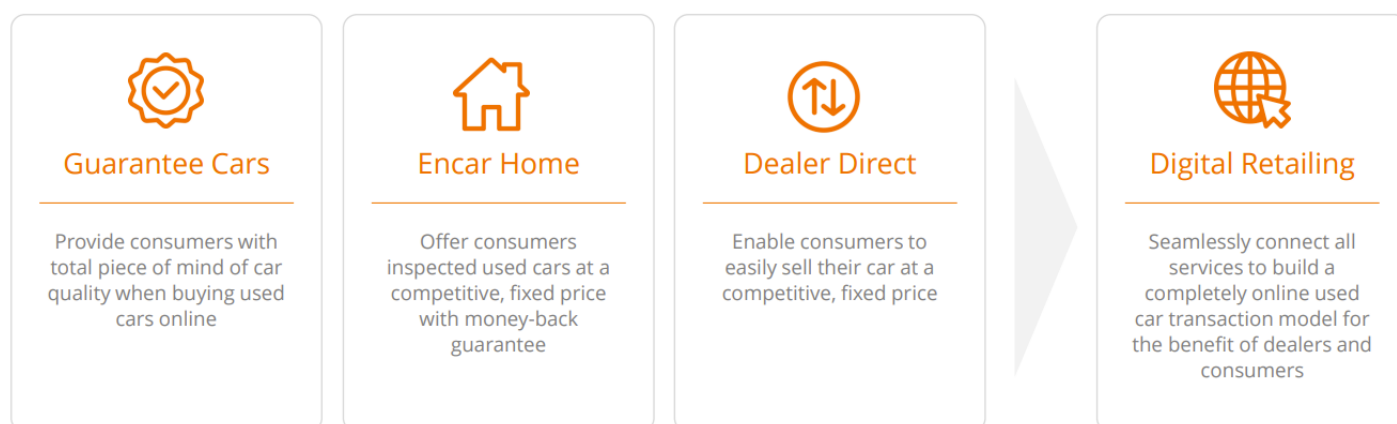
To that end, Dealer Direct and Encar Home are extensions to the model, underpinned by the shift to online transactions. In Dealer Direct, dealers bid for used cars, offering buyers a fixed price. It's a hassle-free service for buyers, while dealers pay Encar a fixed figure

of \$230 for each vehicle purchased. Encar currently has 2,300 dealers signed up and competing for business. The company estimates the market opportunity is valued at \$240m annually.

Encar Home is the next product extension. Buyers purchase the vehicle online, at a fixed price, alongside a money-back guarantee and without any direct dealer interaction. Encar is the public face in this model, answering all customer queries and charging the buyer \$200 per vehicle. Encar estimates a market opportunity of \$60m, with over 13,000 vehicles already on site and vehicle return rates sitting at a low 5%-7%.

Figure 28: Encar Strategy

Re-orienting Encar from a classifieds model to a fully online car transaction platform



Source: Company investor day December 2022

Classifieds to online transaction platform

Encar and management have a clear and focused strategy to re-orientate the business from its traditional classifieds business model, to a fully online car transaction platform. Figure 28 shows the steps the company has taken, and continuing to take, in preparedness for the inevitable online transition.

Encar has 200 employees at its offices in Seoul, plus 100 at the group's various branch locations. In a highly competitive world for talent, the group has experienced some key losses recently, a situation that is under active internal discussion in a means to address.

In terms of customer relationships, there are some 35,000-40,000 used car dealers operating in Korea, of which 25,000 deal with Encar. According to the company, knowing which dealer to do business with is a real skill

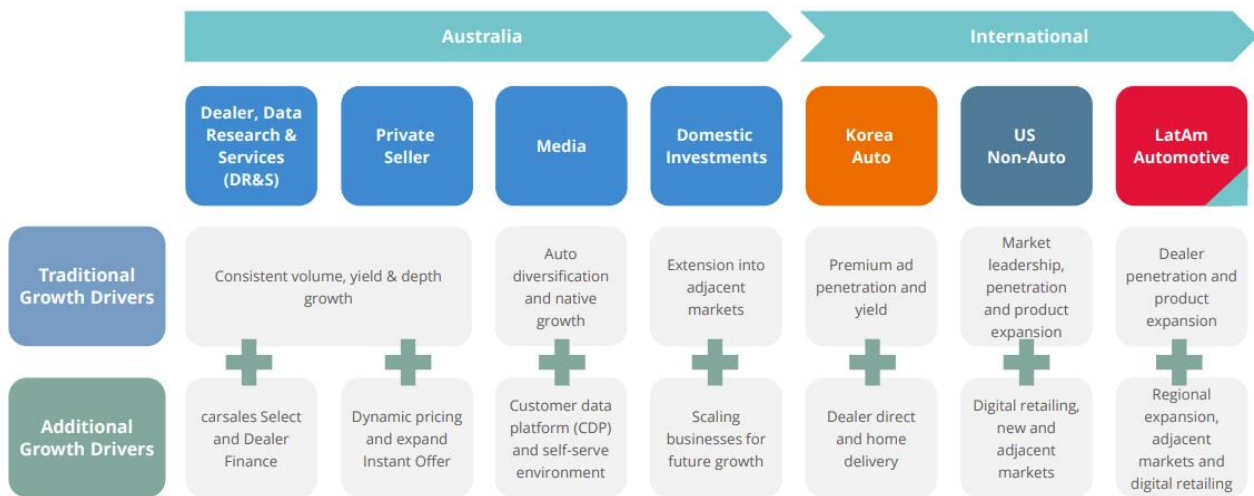
set that separates Encar from all other competitors. Any dealer that does not maintain honesty will be cut quickly.

The company is not standing still, as Figure 28 illustrates. Specifically for the South Korean market, management point to a current total addressable market (TAM) opportunity of \$550m, comprising:

1. Standard plus Premium adds – \$110m
2. Dealer Direct – \$240m
3. Encar Home – \$60m
4. Other – \$140m

The business currently turns over \$80m, earning operating profits of \$40m. This is not without its challenges though.

Figure 29: Carsales International Market Opportunity Set



Source: Company investor day December 2021

New entrants

In March 2022, the Ministry of SMEs and Startups in Korea gave the green light for large automotive companies to enter the second-hand car market. Since 2013, new car vehicle vendors have been restricted in operating in this market. The ban was set to expire in 2019, but COVID put a hold on that. Now, three years on, the ban has been lifted and carmakers can apply for licenses.

To date, only Hyundai and its subsidiary Kia have been given permission. The final tick of approval, however, is subject to the Used Car Federation. Ironically, the Federation is comprised of dealers who have the most to lose from their entry into the market and are therefore vehemently opposed to their participation. Figure 30 was taken as we entered the old branch site, with a Korean banner displaying opposition to Hyundai's entry into the used car market.

Figure 30: Hyundai Opposition



Sign in South Korea opposing Hyundai access to used car market at Gangnam - gu - Yulhyeon-dong branch

So far, Hyundai is yet to enter the market. In order to meet customer satisfaction, it has stated all cars sold will go through some 200 performance tests and maintenance services and be given the “Certified Pre-Owned” mark.

Encar management are respectful of their competitors, particularly ones as large and powerful as Hyundai. However, as Mr Hwang describes, *“an eel is very hard to catch”*. In other words, Hyundai will try to take advantage of the market opportunity but will encounter significant problems.

They certainly pose a risk, but it is hard to see how Hyundai improves the offering for dealers or customers. According to Mr Hwang, Encar enjoys excellent relationships with dealers. Add to this, the end outcome for the dealer across both companies. Whilst Hyundai’s entry poses a potential threat to their livelihood, Encar’s product offerings, like Guaranteed Offer and Dealer Direct, are intended to enhance dealer gross profits.

Five years out

Encar management are focused and driven to succeed. There is a founder mentality evident and paranoia of dealing with unknowns. Led by SB and the executive team, the business is investing for long-term success, driving disruptive change and leading from the front. The transition from standard ads to the premium Guaranteed Offer, extending to Dealer Direct and now Encar Home delivery, is reflective of this.

Mr Hwang notes there is more to do, including the roll out of Encar Pay (allowing for online payment whilst cars

are under 7-day warranty periods), finance offerings and a seamless online transaction experience. This additional layering of higher valued services, would aim to lift the average revenue per customer from \$200 to around \$400, thereby improving revenue and gross profit metrics.

The wholly grail is marrying an offline infrastructure offering with a seamless online platform experience. According to Mr Hwang this has not been done anywhere in the world and if successful, would allow it to be “cut and pasted” into other Carsales markets.

When asked what is possible, Mr Hwang’s response highlighted the industry transition underway. Today, the customer is the dealer, and this is unlikely to change any time soon. Look out five to ten years however, and Encar’s customer will be the buyer. Encar will shift from a dealer centric listed based offering, to a seller centric transaction based platform. The task is to at least grow the business five-fold and if SB had his way, ten times.

Comment

People make things happen. When good people leave an organisation, the loss is felt years later. Similarly, when they stay the best years are ahead. Encar has a dedicated team, with a clear focus and a commitment to disrupt, and to lead from the front. When housed within a much larger and equally committed parent like Carsales, it is a powerful combination. **SFM**

DOMINO'S PIZZA JAPAN

When we last visited Japan, it was June 2018. At the time, newly appointed Japan CEO and president Josh Kilimnik was in the early stages of repositioning the company's core offering from a purely one-off or special occasion meal, to one in keeping with the company's high volume trading mentality.

Domino's involvement in Japan is nearing a decade. In 2013, the group purchased 75% in the franchise from former owner, U.S. Private equity firm Bain Capital for \$211m. It subsequently moved to full ownership in 2017. All up, the company's purchase totalled \$253m.

Kilimnik's appointment, as we outlined in our June 2018 Selector Quarterly Newsletter, was an important inflection point for the business. As an experienced Domino's executive, Kilimnik leaned heavily on data to guide his decision making and transition the business to what it is today. No longer a meal reserved for special occasions, but rather one to be consumed as part of the everyday culture.

According to Kilimnik it was McDonalds who had "cracked the code" with burgers, having successfully moved away from the event culture, supported by strong sales store growth. Domino's, by comparison, had struggled with low single digit sales growth and anaemic store growth. At the time of Kilimnik's appointment, there were 503 Domino's stores on the ground. More than half were corporate owned, with the business turning over network sales of \$484m and delivering operating profits of \$51m.

In the preceding four years, a lot has happened.

Operationally, big changes were consistent with Domino's operational model in other markets. There was no need to reinvent the offering; the playbook was tried and tested. Essential to its success though, was a business reset that also considered the local environment and culture.

Management introduced core Domino's systems, complemented by new initiatives. These included:

- OneDigital online sales platform.
- New "Barbell" menu strategy and half priced carry out offering.

- Introduction of in-store dough making, which improved efficiency.
- Implementation of a national ingredient pricing agreement across stores, thereby opening up inaccessible prefectures (regions).
- Undertaking an aggressive store rollout to reach a scalable national presence.

In 2020, COVID-19 hit global economies. Japan was not spared, but this event allowed Domino's to prosper. Considered an essential business, demand for door-to-door delivery skyrocketed. The statistics speak for themselves.

Our travels to Japan in late April required an abrupt change of plans, when visa entry into the country was denied due to COVID restrictions. Subsequently, our in-person meeting with the region's Chief Operating Officer (COO), Ben Osborne, was conducted over Zoom, as we continued our travels to South Korea.

Ben Osborne

Recently promoted to his new role in 2021, Ben Osborne is illustrative of the deep talent within the global operations. While he doesn't fit the bill of being a former Domino's franchise owner, the entry point for many of his counterparts, COO Osborne's connection still runs deep. COO Osborne began his Domino's journey as a delivery driver in 2004, followed by stints in store and regional manager roles, which led to his appointment as Franchise Consultant in 2012.

COO Osborne carried out the role in all Australian states, before joining the Japan team in 2019 and working alongside CEO Kilimnik. In 2021 he took on his new role, signing up for at least the next five years, residing in Japan. The following comments bring to light some new learnings since our last update.

Why Japan?

The response by COO Osborne is consistent with many within the Domino's environment; it's the opportunity and the challenge. In the case of Japan, the first challenge is the language barrier. The second is the significant opportunity to scale out the store footprint. In the words of COO Osborne: *"The upside was so big."*

The Team

The Domino's Japan team has remained consistent. The most recent change was the region's Chief Technology Officer, replaced by Tony Sai in 2019. The executive team comprises eight individuals, including COO Osborne, CEO APAC Kilimnik and APAC Marketing Officer Todd Reilly, supported by divisional leaders, referred to as "Bochu".

The appointment of Todd Riley as Chief Marketing Officer, previously CMO of Australia Pacific, is illustrative of the relocation of talent across markets to support expansion. The addition of the Taiwan market will see Riley also responsible for that region.

COVID

The group has experienced headwinds. More recently, general inflationary impacts on commodity prices and staff requirements. As COO Osborne explained, you can either approach these as challenges or opportunities. Competitors, including the major Quick Service Restaurants (QSR), have resorted to hefty price rises. Domino's has increased prices modestly, but continues to differentiate by focusing on value and volume.

Critical to this is the "Barbell" offering, with price points that cater for different customer groups. On one end, there is a "meal for one" under ¥1000 or A\$10. At the other end of the scale would sit the family offer at ¥3,000 or A\$30.

During the latter half of calendar year 2021, Japan emerged from its COVID-19 state of emergency. COO Osborne noted in the fullness of time, this period will be considered a "blimp on the radar" in regard to the group's growth profile.

Focused

The team is focused on a number of objectives, outlined below:

- Increase the basket size, by offering more value, not by lifting prices.
- Where prices are lifted, it is selective and unavoidable.
- Promote and support Japanese farming, via ingredient purchases and registered charity.
- Maintain Barbell strategy, so that it captures the entire customer spectrum.
- Continue to invest in delivery.

- Greater adoption of tracking, to better appreciate the customer lifetime value and frequency of transaction.

Next steps

- To better define store size in different regions and locations.
- Data to support expansion.
- Operationally, re-examine staff scheduling and labour expenditure in a tighter market.

1. Appointing a franchisee

- Business review undertaken with franchisee, looking out five years.
- Capital position considered.
- Internal Domino's consultants assigned to franchisees to oversee their progress. Domino's Japan has 11 consultants in place, with the aim to lift to 12.
- Store sites are identified.
- Franchisee works with development team on selecting appropriate site, internal team members and cash flow expectations.
- Store layout reviewed.
- Store manager identified.
- Team hiring underway, typically 20 in total, can leverage up to 27 at peak trading times.
- Staff rostered, with 80% of business done in 20% of time (Friday-Sunday).
- Cashflow reviewed, aiming for capital payback within three years on typical capital outlay of 380 million Yen (upwards of A\$400k)

2. Franchisees

- Japan model is very attractive for entrepreneurial operators, with very few alternative options in the market.
- Ability to own store, with small capital outlay and payback within three years.
- Today, there are 132 franchisees.
- The depth of new franchisees is strong, reflected in the absolute number and the number of stores per franchisee (now sitting at 3.5 per franchisee).

Top three priorities

- Focus on "single unit economics", by controlling food waste, growing incremental sales and improving store efficiencies using data.
- Key output measure is operating profit per store (EBITDA).

Success is measured by

1. Overall store count
2. Measuring unique franchisee number growth

The aim is to lift both store numbers and the number of unique franchisee numbers. This is to avoid over dependence on a few and lifting the quality across the whole franchisee network.

Culture

Anyone who has visited or researched the Domino's business model would appreciate the role culture plays. It runs deep within the company and in our opinion, is a clear competitive advantage across the QSR landscape.

While it may not be necessarily unique, it is nonetheless a strong suit that COO Osborne and the Japan team are endeavouring to grow.

Domino's are entrepreneurial by nature. Over the course of 2021 and onwards, management have focused on growing the franchisee network in a similar vein. In short, identifying entrepreneurial talent to run the show. This has been a proven model based on success achieved to date. COO Osborne now wants to extend this within the group's own corporate store network. With over 393 corporate stores, out of a total network of 900, employees are encouraged to embrace ownership roles.

Domino's Japan has introduced business programs to support ongoing corporate development, including:

- **Franchisee Business School** – aimed at continuous training program of the franchisee store managers.
- **Franchisee Business Review** – undertaken quarterly to review short, mid and long-term owner goals.

"The nail that sticks up, gets nailed down"

Each store undergoes a review process and is given an Overall Evaluation Report (OER) outcome. Measured between 0–5, 4 is the aim and expectation. A score of 5, a rare feat, equates to exceptional performance across all business metrics.

The reports also highlight owners experiencing difficulties, as the Japanese quote above so aptly describes. In response, the Franchise Kaizen Operations 360 Bootcamp has been introduced to assist underperforming franchisees. In the unlikely scenario that issues can't be resolved, franchisees are often

exited. This has only occurred two to three times over recent years.

COO Osborne commented that to succeed in Japan, the team – being the whole network – needs to succeed. Across the current 900 stores, total employee numbers exceed 22,500.

Japan market

In Japan, the main pizza competitors include U.S. based Pizza Hut, Pizza La and a host of smaller independent operators. The pizza category is roughly a ¥230b (A\$2.5b) market, with Domino's Japan enjoying the biggest slice (of the pizza) at 40% share.

When compared to the overall QSR offering, inclusive of burgers, chicken offerings and other food services, the total market is valued at 10,200b Yen (A\$112b). The pizza category represents a market share within the 2%-3% range.

Across the QSR market, delivery remains the biggest driver of growth. Domino's is well positioned in this regard. A full end-to-end customer offering, as is the case at Domino's, helps deliver at speed and remove the reliance on aggregators like Uber. The biggest challenge, and one that is likely to persist as more businesses start to adjust to this new age of delivery, is the ability to attract and retain labour.

Next five years

Japan is now at a critical scale, with 900 stores on the ground and a pathway to 2,000 over the ensuing decade. By comparison, McDonalds' operates just under 3,000 stores, yet continues to enjoy same store growth as the food category continues to grow.

For Japan, COO Osborne and the team are clear on the objectives:

- Maintain market expansion across Japan's 47 prefectures (regions).
- Undertake store splits to fortress within the territories.
- Focus on single unit economics, output being operation profits as key financial metric.
- Improve sales penetration per store, comparator being established markets like Australia.

In COO Osborne's mind, with so much white space on offer, sustaining large store opening numbers above 100 per annum is not the constraint. The challenge or

opportunity is to secure staff and carry out the training required.

At the core sits Project 3Ten, with the goal to *“prepare a hot, freshly made pizza ready for carry-out within three minutes, or safely delivered to our customer's door within ten minutes.”* This remains the bedrock to the group securing long-term market share growth, in an era where, *“the mostly efficient player will win.”*

Exciting times

Commitment is the key to long-term success. COO Osborne, having signed up for another five years, is up to the challenge. When asked how he felt about his remuneration in the context of his role and own expectations, there was little hesitation it was both fair and rewarding. With an equity (share ownership) component, the key metric for achievement is centred on delivering earnings per share growth (net profit).

Key to this will be management's ability to build a broad-based footprint across franchise and corporate stores, alongside a growing franchisee base, delivering a growing multiplier effect across the group.

The group's commitment to support local farmers is an important step. The introduction of “farmer market stalls” represents Domino's preparedness to support local ingredients and communities at risk of dying out. Since 1995, there has been a 65% drop in the number of Japanese farmers and of those that remain, over 60% are great than 65 years of age.

Comment

The company's progress in Japan remains impressive. The store count numbers and profits posted thus far are testament to a solid foundational base. Having reached a critical store count, the next phase is to secure long lasting market growth across the country's 47 prefecture landmass.

To that end, Japan management continues to invest heavily in building out a franchisee network capable of supporting a growing store base.

South Korea – site visit with Domino's South Korea owners

While our trip to Japan was postponed, we were fortunate enough to extend our knowledge of the Domino's global business in South Korea. The South Korea Domino's (SKD) franchise is controlled by one

individual, Mr Kenny Oh. Having met with Mr Oh and his son, a few observations are worth sharing.

Mr Oh gained control of the SKD operations in 1993, when total store count sat at 23. He saw the potential and the changing eating habits within his country, and at a very young age set out to pursue the opportunity.

Today, SKD operates 473 stores throughout the country: 203 corporate, and 270 franchise, alongside 122 franchisees. No financials were discussed, but our feedback from other industry players suggests the business under earns in comparison to other Domino's markets.

Mr Oh is an entrepreneur at heart, operating a private business with desires to grow further. In 1993, Pizza Hut was the market leader. In 2013-14, SKD unseated Pizza Hut as leading pizza chain. Today, Pizza Hut operates some 100 fewer stores than SKD.

There are a host of other competitors, including local and international players such as Papa Johns and Mr Pizza. Competition is fierce, witnessed by the 30%-40% pizza discount offers we encountered. SKD has responded with similar price promotions, alongside challenges encountered elsewhere, including labour and food costs. Our experience and sampling of the product at both a corporate and franchise story was of high quality. Typical of the Domino's offering, the stores were clean, efficient and the staff were well across the details. Our two pizzas, with the discount, cost about A\$14 each and the presentation was excellent.

The SKD business metrics are similar to Domino's Pizza Enterprises (DPE), with online representing 80% of orders, while the mix of delivery to takeout sits lower at a 60%-40% split. Mr Oh can see the opportunity to grow store numbers up to 1,000, with the size of store varying from 70 – 130 square metres, depending on the location and population.

One noticeable aspect of South Korean life is the apartment as a home. South Koreans, we were told, are quick to embrace the use of online shopping across all daily requirements, even for the purchase of used car vehicles. The SKD food offering fits this growing trend, requiring ongoing business investment across information technology, data analytics and digital platform development. Mr Oh's sons are directly responsible for running these functions, including the

important role of Human Resources. As is the case at DPE, SKD also need to contend with franchisees that are non-performing, by removing or taking over control.

Perspective on Domino's Pizza Enterprises

An important outcome of our meeting was the high regard held for DPE CEO Don Meij and the management team across the DPE organisation. It was very clear they see DPE as the best global operator across the Domino's global network, reflected in the success enjoyed in Japan under the leadership of CEO Kilimnik, and the European region in general.

DPE's acquisition of Domino's Taiwan, announced in June 2021 for a total consideration of \$79m, was also a surprise to Mr Oh. However, he acknowledged this market would likely be met with similar success under the leadership of the DPE management team. There are 161 stores currently operating, with a long-term aspirational opportunity to exceed 400.

Our meeting reinforced the global power of the Domino's brand, and in particular the very high standing DPE and its management team have by fellow franchisee operators.

DPE global footprint

At the recent Domino's Pizza Inc. (DPZ) quarterly update, held on 28 April 2022, the U.S master franchisor confirmed global store numbers. In the U.S., DPZ operate a total of 6,597 stores, split 400 wholly owned corporate and the balance of 6,197 as franchisees.

Internationally, another 12,464 stores operate under franchisee agreements. Of these, DPE operate 3,227 with long-term aspirations of 6,650 out to 2033. However, in today's terms, DPE is a very important contributor and franchisee operator, representing 26% of the international stores and 17% of the total global store network of 19,061. **SFM**

GALLERY

Figure 31: Domino's corporate store in Seoul, South Korea



Source: SFML South Korea Trip

Figure 32: Our finished presented in-store ordered product



Source: SFML South Korea Trip

Figure 33: South Korean market, significant delivery demand



Source: SFML South Korea Trip

Figure 34: Domino's menu option



Source: SFML South Korea Trip

10 REASONS WHY DOMINO'S JAPAN CAN OPEN +2,000 STORES

In a transaction-based model, such as stockbroking, pulling on the levers of a discounted cash flow (DCF) can become addictive, a bit like *"going a few rounds on a one arm bandit"* (playing a poker machine) at your local club. The big difference is the poker machine has a mathematical algorithm that can't be fiddled or beaten, while an analyst with a DCF can control the outcome to suit her or his needs (anchoring). Hiding behind this outcome, which purports numerical rigour is a somewhat workshy approach in our view.

In considering the big picture, we seek a perspective that relates to business performance over time.

Figure 35: The inner garden of Meiji Jingu Park that houses three bonsai



Source: SFML Japan Trip

Compounding is rather like watching a bonsai grow. It's the polar opposite of the excitement generated by the one arm bandit, and it can't be gamed like a DCF. In any one quarter compounding is invisible. But in the long-term, its impact on numbers is a thing of beauty.

Over time Domino's Pizza Enterprises (DPE, S&P ASX code DMP) has delivered the following financial results.

In 2005 DPE delivered:

- EBITDA \$19m
- NPAT \$8m

In 2021 DPE delivered:

- EBITDA \$425m
- NPAT \$188m

Don't be surprised when time delivers further significant growth. We provide 10 thoughts which we consider will aid Domino's Pizza Japan's (DPJ) path to double its store footprint. Store count growth is likely to be included in future remuneration targets sharpening the delivery of targets.

1. White space

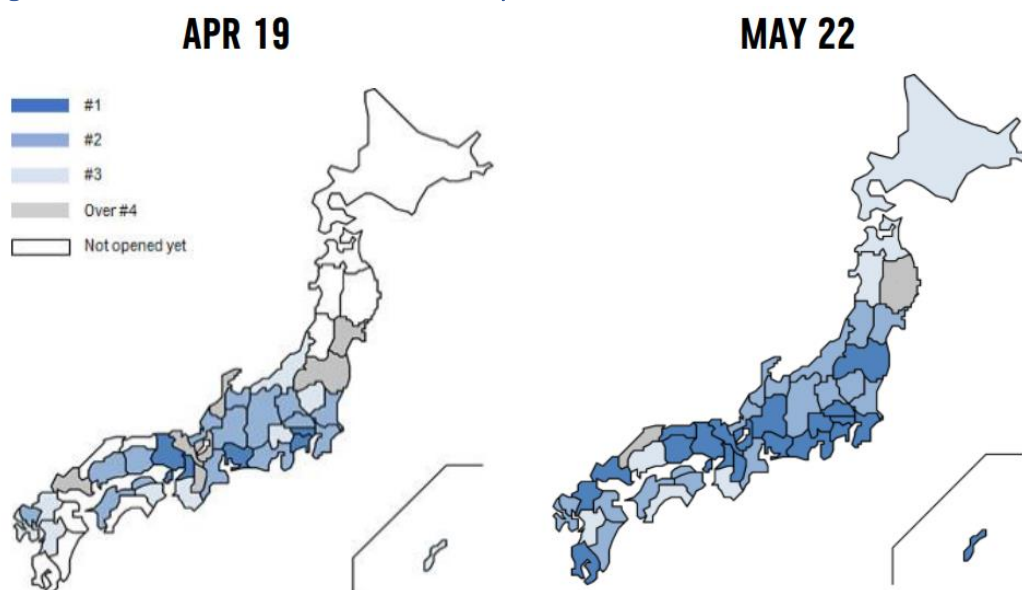
With 927 stores on the ground in June 2022, the white space or store count upside and the high order count opportunity were the key attractions when Chief Operating Officer Japan, Ben Osborne inked a new five-year contract to stake his 17-year DPE career in Japan. His contract runs until December 2026.

We would describe Osborne as out of the Rennie (CEO Europe), Stoffel (CEO Germany) and Kilimnik (CEO APAC) mould; seemingly young, engaged and with a confidence that comes with tenure and being across the detail. His top three priorities are: Single Unit Economics, Growth and Store Count, and Unique Growers. We discuss the latter below.

No doubt McDonalds are setting the QSR (Quick Serve Restaurant) pace in Japan with 3,000 stores. While on the flip side, stagnating store count growth at Pizza Hut and Pizza La sees them both at less than 500 and 600 stores respectively. Their growth is subdued for different reasons, including private equity ownership and a multi-brand strategy in the case of Pizza La.

Domino's Japan clearly has its eyes set on following the success of McDonalds in the region. While the destination is by no means a *fait accompli*, over the next three to four years DPJ's pathway to 2,000 stores is relatively straightforward.

Figure 36: Domino's Market Position by Market



Source: Domino's Asia Investor Day Presentation

A scientific approach to site selection is underway to fill the white space on the map, with the aim to create the #1 market position in all 47 prefectures. DPJ is currently #1 by market position in 20 prefectures, up from eight in FY19 pre-pandemic. This indicates traction, and when combined with a new store opening pipeline currently extending out to 18 months, momentum is apparent.

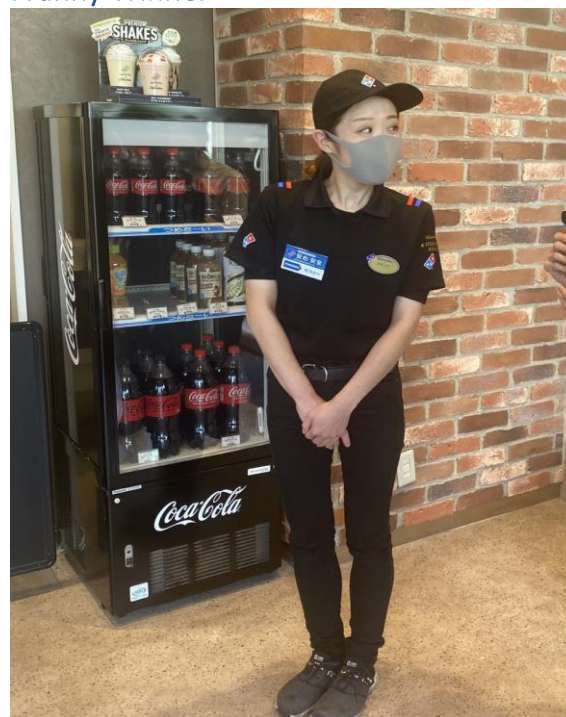
Significant operational hurdles have been overcome through initiatives such as in-house dough manufacture and supply chain harmonisation. Both have played an economic role in opening the regional markets, as will ongoing format iteration. Smaller footprints carry lower capital requirements and alter store payback metrics.

Importantly, the environment remains highly conducive to store openings. The best proxy for this is franchisee appetite, which we discuss below in (2) Unique Growers.

On the flip side, CEO APAC Josh Kilimnik posed the question, 'did we grow too fast?'. Kilimnik notes the pandemic produced a unique opportunity where sites were readily available, often at lower rents, which DPJ had a free run at with the people on hand. As a result, Japan grew fast.

There is no doubt when pushing less experienced store managers through the funnel much faster, the resultant

operational skill level in store is initially lower. This needs to be corrected and investment in the training platform is required. We understand this is now underway, see (10) Training Development below.

Figure 37: Japan's first female Franchisee and Gold Franny Winner²

Source: SFML Japan Trip

² Gold Franny's are awarded to teams that demonstrate great service, sales & store growth, give back to their communities, and support fellow franchisees. Globally awarded to the top 2% of franchisees.

2. Unique growers are healthy

Unique Growers is one important metric closely watched by Domino's management in Japan. If a franchisee opens one new store or five stores in the year, he or she is recorded as one unique grower.

It's important that store growth is not concentrated in the hands of a small subset of franchisees. While Mr. Naoto Senoo (25 stores), Mr Kazuya Fukumoto (21 stores), and Ms. Hikaru Oshima, Japan's first female franchisee, provide great inspiration to existing and prospective franchisees, growth for these highly capable entrepreneurs will max out at some point.

However, if unique growers increase on an annual basis the franchisee base is healthier. This indicates the leverage in the system and represents an improving runway to 2,000 stores. While we don't know the number, we do know the curve growth has been very close to linear.

It became clear in our discussions, that 50% of Japan's 133 franchisees aim to grow the number of stores they operate within the next one to two years. The subsequent conversion drives the number of unique growers.

3. Japan is like a brand new business

From our first two points, it becomes apparent that the number and quality of franchisees is central to the ascendancy of Japan. No surprises here, the operational excellence in the Netherlands and past performance issues in Australia can be traced to franchisee selection, training, and development.

A start up is often considered to be a company no older than three to five years. While Amazon has tried to hold onto its start-up culture for 25 years, putting DPJ in the same bucket may be a long bow. However, if you look under the hood the engine of Japan is the equivalent of a brand new business, only with a 927-store footprint delivering year-round monthly profitability!

When looking at its franchisee base, which is largely less than five years old, Japan can be considered brand new. Training, development, and the operational experience that only comes with time will deliver significant benefits in the years to come.

DPE acquired its stake from Bain in 2014. The exercise of an option delivered DPE 100% ownership of DPJ in 2018.

It's less well known that in 2014 DPJ had only a handful of franchisees, circa 12 in total, all who had been externally sourced by Bain rather than internally developed. Under DPE culture this path has delivered limited success, and all 12 have exited the business.

The current DPJ franchisee base has grown from 0 to 133 in the space of five years. In the most recent year, 33 managers made the jump from corporate store to running their own business for the first time.

New training pathways discussed below will drive a strong outcome. This is business latency. Naturally some franchisees won't go the distance and amicable exits have been reached, including the first franchisee-to-franchisee store trades.

As of early June DPJ also has a new CEO in Martin Steenks, a multi-decade executive who was formerly an 8-store franchise owner in the Netherlands. During his time as an operator, Steenks was recognised as one of the best, globally winning the Golden Franny in 2017. He was Domino's Netherlands Franchise Operations Director until September 2021, when he was appointed CEO of Taiwan.

Steenks has deep experience, is very well-liked and respected, and had an immediate impact on the Taiwan local franchisees in a short period.

Steenks will be backed up by a six strong leadership team with deep experience, including: CFO Eric Yutaka Tai (2016), COO Ben Osborne (2004), Corporate Operations Hiroshi Kakiuchi (1988), EVP Shin Sasaki (1988), CIO Tony Sai (2019), Supply Chain Masaru Fukazawa (2018). The team is also supported by CMO APAC Todd Reilly (2002). Steenks reports to CEO APAC Josh Kilimnik (1992).

Looking out to DPJ's 2032 store count target, a 260 strong franchisee base is conceivable. Considering deliverables to date and the combined achievements of this strong management team, 2,000 stores may prove to be another group milestone rather than a destination.

Japan has many drivers for a five-year-old business, but market penetration remains very low. We see latency rather than risk in these longer duration runways.

Many businesses take 10 years to get traction. Japan will hit that marker in five years time, and will likely be one of the most powerful engines of the wider DPE group.

4. Few alternative investment opportunities

On 7 May, The Economist noted: Policymakers now hope a bit of cost-push inflation may help to break Japan's entrenched deflationary mindset.

For decades, investing in Japan has been plagued by the fear of deflation. Real or imagined this has no doubt reduced risk appetite in Japan, while idling entrepreneurial spirit. Long-term this is an issue. Other cultural factors are also potentially at play, including a strong savings culture and an unusual depreciation cycle in housing.

The Japanese postal savings phenomenon is well known. It is a major financial institution that started in 1875 as a postal savings system and continues to operate today primarily out of post office branches. It manages over ¥230 trillion of assets and offers services in almost 24,000 post offices, each with a bank inside.

With more than 120m accounts, the postal savings system does everything from cashing checks, selling life insurance, issuing long-term certificates of deposit, providing automatic check-paying, and payroll deposit services.

Privatised in 2007, at times in its history it was the largest financial institution in the world. Since its conception it has played a significant role in providing economic services to people in Japan and making investments towards the economic and industrial development of the country.

Its significance and scale as an investment institution is further apparent, when you compare the US\$1.7t it manages to the US\$6.7t combined market capitalisation of Japanese Equities. Parking funds in postal savings is clearly a national pastime in this risk-averse culture.

According to brokerage firm Nomura, it takes 22 years for the value of the average Japanese house to depreciate to zero. Note, this is calculated separately from the land, which is more likely to hold its value. Most are knocked down and rebuilt.

The reasons for this rapid loss of value lie partly in tradition. The frequency of earthquakes also plays a part; large tremors tend to be followed by tougher building regulations. Many people want to live in a home built to the most recent standards.

Unsurprisingly, given the speed at which the house value falls to nothing, banks are more willing to offer loans for new places.

Chie Nozawa of Toyo University compares it to slash-and-burn farming. *"We are not building wealth,"* says Yasuhiko Nakajo, who leads the property department at Meikai University.

But Japan's throwaway housing culture, shaped by a once-urgent need to house growing numbers, makes no sense now that the population is shrinking. The country currently has an estimated 10m abandoned homes. This is expected to rise above 20m by 2033. That is a problem for entire neighbourhoods; a derelict lot drags down the value of nearby houses.

High postal savings and lower appetite for property ownership are entrenched cultural behaviours. Combined, they reflect two insights: low investment expectations and a paucity of entrepreneurial spirit. Our conversations with new franchisees concerning investment payback timeframes confirm our first presumption. The second notion, well considered by COO Osborne, is an ongoing challenge for DPJ management.

In an environment where investment opportunities are somewhat limited, Domino's Japan, through parent DPE, presents a very real investment opportunity for the willing. DPE provide a mix of lending for new stores (circa \$380k capital) and funding into established corporate stores, with significant handholding along the way and an ultimate put option, which is discussed below.

5. Low to no risk opportunity

If investing doesn't come naturally, the first question is often about the downside risk, 'when do I get back my 10 million Yen back?'

Through discussions it's clear not all 133 franchisees are destined to become millionaires and like their predecessors under Bain's ownership, not all will last. So, what risk are they taking? It would appear to us very little.

As signalled above, the capital requirement for a store is modest at an estimated \$380k (typical 130m store). This is below our Australian assumption of \$500k per store. For the smaller footprint stores being tested it may even be lower. DPJ is opening 80-90 stores with no dine-in

facilities in low foot traffic areas. It will also be used in some regional or marginal towns where a larger footprint is not viable.

A significant chunk, up to 70% of this, will be loaned to the franchisee by DPJ for a new store. So the risk to the franchisee remains low, based on the three outcomes we've considered below.

The first scenario is the store provides the franchisee with a job and business that performs in line with expectations. Under this scenario the franchisee continues operations.

If we consider store payback as a key metric, franchisee expectations have a wide range of anywhere between three to 10 years. Pre-pandemic investment recovery was around the five-year mark. Ultimately DPE's goal would sit around the three-year mark.

Scenario two occurs when things don't work out. DPJ run a similar franchisee rating system to Australia's A, B, C and F, with an operational evaluation on a scale of 1-5. Five being the gold standard, and rightly hard to achieve. Four or above, namely 4.2, is the goal according to COO Osborne.

Franchisees at the bottom end of the scale are subject to a week-long 360-degree boot camp. A huge turn around occurs when these events are attended with interest. This becomes clearly visible in approach, delivery times and the strong desire not to return to boot camp.

For those that don't cut it, the risk remains low. Franchisee transactions have started, and amicable exits have occurred. The final put option is that DPE will buy it back. It remains within DPE's interest to remove recalcitrant F's, or in DPJ's case repeating one-star offenders, by corporatising the store to prevent system or brand damage.

Scenario three is the success story. A franchisee has developed the skill set and entrepreneurial flare to build a mini empire.

We believe even the highest quality franchisees are likely to top out around 25 stores, recently achieved by Senoo-San, with Fukumoto-San seemingly hot on his heel with 21 stores verse 19 stores when we met in June.

At this scale, when well run, these mini empires can become profit machines for their owners. DPE has a long

history of promoting, identifying and recruiting management talent from the operational pool, by buying back blocks of successful stores and offering a wider management role within DPE in exchange for expertise.

While DPJ has a highly capable and newly installed CEO in Steenks, we believe it is only a matter of time before additional high performing native Japanese speakers join the DPJ management team.

Figure 38: 21 store owner, Fukumoto-San



Source: SFML Japan Trip

6. Scale matters

Scale provides access to TV markets. More scale means more marketing funds for further TV advertising.

TV is the most efficient driver of brand awareness. In Japan, TV works at the precinct level rather than on a national basis. As a result, the footprint in each prefecture creates a tipping point that drives TV advertising dollars.

DPJ is not currently achieving 52-week TV coverage across all regions. The longer-term goal is to become the #1 in each prefecture.

7. Economics improve with scale

When we think about the economic scaffold for DPE, it's a relatively simple calculation. We start with store numbers at a given point and multiply by our revenue per store to estimate a group network revenue (GNR). We then take a slice by multiplying our EBITDA margin estimate by GNR. A multiple we are comfortable with can then be applied.

This gives us a simple big picture view of the business at a point in the future, which can be compared to today. One of the biggest problems with this approach is no benefits of scale are assumed, as we have used a fixed EBITDA margin. In the real world this is not the case; scale does generate economic benefit.

Scale benefits many cost lines from an individual store to a country. At the store level, High Volume Mentality drives single unit economics. In a multi-franchise operation, rostering and labour efficiency will drive margin. Combining these drives a region, country, and ultimately the group with improved EBITDA margins.

A simple example of the benefit of scale for the store, region and country economics in Japan is the advertising cost burden across the current 927-store footprint.

In Japan, advertising spend is 12% of sales verse 4%-6% at a global system level. This is in effect buying sales due to immaturity of the market. It should also be noted Japan has a different market dynamic, which includes dining preferences and habits, and the diverse TV advertising market across the 47 prefectures. At some point towards 2,000 stores, advertising may normalise at say 8% of sales. In time this becomes part of the latency of scale.

8. Support systems around Franchisee

The 927 stores are currently split circa +410 corporate verse +510 franchised. These franchised stores are supported by 11 Field Consultant Team (FCT) members who have deep system experience, with 50% having clocked up more than 15 years.

We understand DPJ planned to add an additional FCT with the crossover of 500 franchised stores.

Figure 39: Giant screen performance dashboard, World's most modern Domino's store, Tokyo



Source: SFML Japan Trip

The FCT role is typical field consulting. They deal with an operational slate that includes:

1. Reviewing which stores should be opened and the number of stores
2. Sight identification in conjunction with development teams
3. Which franchisees should open stores
4. Advising franchisee on buying existing corporate stores verse opening a new store
5. Advise on Capital required
6. Cash flow study
7. Managers and staff needed in a new store
8. Recruitment and hiring six weeks out from opening a new store / local recruiters used
9. 20-person team (28 for Christmas or Golden Week)
10. Operational reviews and consulting post set up

Development team involvement includes:

1. Identifying sites and development teams
2. Store layout

Figure 40: COO Japan Ben Osborne, discussing prototype warming collection zone driving NPS



Source: SFML Japan Trip

9. Systems and Operations improvement

A significant operational piece which, “*can drive a big jump*” is still to be delivered. DPE is working on these in the background. Many iterative pieces will lead to material gains from the likes of scheduling data and labour expenditure.

Some legacy pieces still need to be removed. For example, transitioning from the older system Miri to newer APAC systems, such as the data capture system Pulse. In Brisbane, DPE are operating with Snowflake, which Japan is also looking to align with. In time Japan will also adopt an APAC like structure rather than the current silo model.

This is an operational journey which will include proven deployments. Microsoft Business Central (Dynamics 365) will replace a Japanese system. OLO, a leading open SaaS platform that powers online ordering and delivery programs for restaurants, which is currently deployed in Australia, will also be rolled out in Japan. Further, an updated training platform will be introduced, which we discuss below.

Local customisation of software systems will also be used to drive operational efficiencies. Japan is a unique market already benefiting from well understood operational iterations, including a combination of back-of-house dough, which opened the regions, commissary, and third-party dough.

Rostering, a critical workflow, is another example where a bespoke solution is required. Stores typically run with a 20-person team, which is extended to 28 for the Christmas and Golden Week periods. Typically, 80% of sales are achieved in 20% of the week.

A full 18-person team is required across the weekend trading window. Whilst a skeleton team is deployed for the other 80%, often comprising two makers and an additional delivery personal.

While the Tander rostering software is used globally, it has proven ineffective in Japan due to a tendency to overload shifts, driving poor store economics. This is all about the ability to run lean and efficient teams. As a result, rostering is done manually across Japan, which is neither optimal nor scalable. DPJ is currently building a Japan specific software to automate this workflow.

There is a bigger picture to consider here. DPE has a Group Chief Digital Experience Officer, Michael Gillespie. With more than 10 years' experience at DPE, Gillespie is responsible for all 10 DPE markets. The focus here is on global systems.

DPE also has a Group Head of Strategy & Insights (S&I), Pat Nestor, who is responsible for data, analytics, and insights. Similarly, this is a global role across DPE's 10 national markets.

Nestor is based in the Netherlands and joined DPE in May 2020 to take this newly created position, with the remit to help build the new S&I organisation and advance data-driven decision making across the company.

Nestor's previous experience includes working as a consultant for IBM within their Global Business Services organisation, and at Wayfair, online furniture and home goods retailer. Prior to this, Nestor spent about five years with Domino's Pizza Inc. (DPZ) in Ann Arbor, Michigan. At DPZ he held several leadership positions, including Director of Digital Analytics and Director of International Strategy & Insights.

The relationship with DPZ is important. Pooling of resources across technology development would fast track innovation. Shared learnings will benefit both parties. DPZ, for instance, is partnered with Salesforce because of size and scale, which DPE can easily tap into. Similarly, DPZ is considering adopting the DPE app, which will drive mutual benefit. Success here could see DPZ and DPE undertake a truly global approach to systems operations and technology development.

Ultimately DPZ needs to think of the U.S. as just another international market. The best path forward will be driven by centres of excellence established by DPE. At the end of the day this is the only path.

10. Training improvements

Our view is that training is essential for success in this market.

Culturally Japan is a rules-based society, which has both positives and negatives. Our experience is team

members will recite the DPJ mission statement that hangs on the wall daily. While rule-based compliance may be high, the tendency for team members to *"go the extra distance"* in all aspects of work may well be low.

In point (3) Japan is like a brand-new business, we discussed the rapid growth of franchisees over a relatively short period. Most franchisees have less than five years' experience running their own business.

Sustainable business momentum in Japan requires franchisees who are entrepreneurs, not ex-corporate store managers with bank loans. According to COO Osborne, if you're acting like a franchisee – *"you think, how do I find 4 more orders today?"*. While this requires the energy of a Rennie, Kilimnik or Steenks, it also requires confidence in the tools of trade, which must be learnt and then executed.

Ongoing training is critical in this process. Management has this in their sights. By year end, a 3.0 version training platform will be installed. Mammoth 1.0 was replaced by Mammoth 2.0. The 3.0 version, Path to Excellence currently operates in ANZ and is soon to be adopted in Japan.

It's a broad platform and importantly, has global content to drive global best practice outcomes. Modules include P&L training, local sales building plans, and how to link to payroll and all other systems in the tech stack. For corporate this will identify box tickers verse those focused on growing more sales.

While this may sound mundane it has key customer outcomes. For example, how behaviours correlate to better Net Promoter Score (NPS) outcomes. In terms of store economics, the key outcome is the ability to eventually run leaner teams with higher productivity.

This is a three-to-five-year journey. While incremental gains on a monthly and quarterly basis are likely to remain invisible, long-term these behaviours become entrenched and drive sustainability through higher store cashflows.

Five things that will occupy DPE thinking in relation to Japan

1. Must decide

Japan is a relatively new business for DPE in a unique market. There is no playbook here. At each roundabout a decision must be made. Fast iteration delivers outcomes, according to Amazon.

2. Entrepreneurial spirit

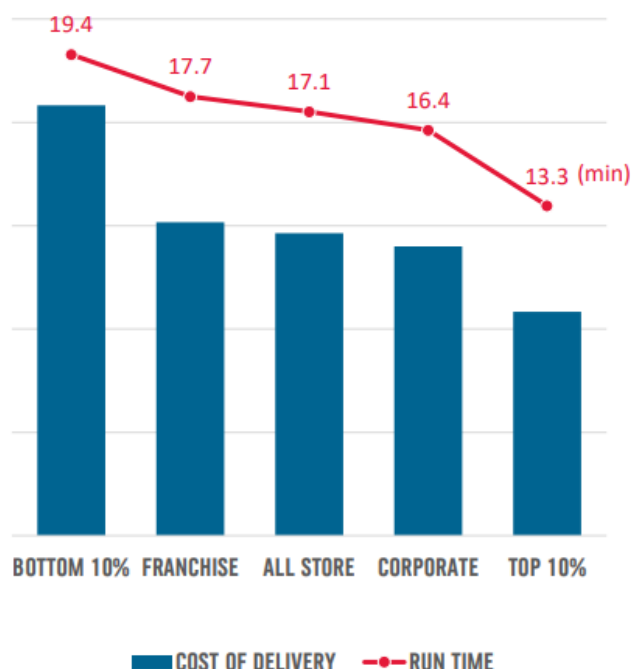
DPJ wants entrepreneurs because *“entrepreneurs do not act like store managers with bank loans. If you’re acting like a franchisee – you think..., how do I find 4 more orders today?”*.

We caution that it’s hard to find good people quickly. We see this as one of the main impediments to growth in any business.

3. Winning in Delivery

In their Japan Open Day presentation, DPE management presented compelling statistics on winning delivery, including cost per delivery verse run time (see Figure 41). This is all about execution, training, and a winning mindset. Japan might just come good here. They love winning pins, awards, and management accolades.

Figure 41: Productivity Proxy: Top 10% of stores have 20-30% lower delivery cost



Source: Domino's Asia Investor Day Presentation

4. Fortress, Carve outs and splits

The leading franchisees Senoo-San and Fukumoto-San, and those driven enough to follow in their footsteps will achieve success here. For those rated four or less, this is potentially a step too far.

5. High Volume Mentality

Executing on High Volume Mentality is hard. This is about training, experience, and the resilience required by an entrepreneur who gets up every day unsatisfied. No excuses work here. SFML has interviewed major system operators outside of DPE who have simply given up on this. They are getting beaten by competition as a result.

SFM

Footnote to trip

Whilst in Japan we were asked by a high profile, yet grounded analyst, *‘what the sell side was missing?’* Our answer was nothing!

Where we differ is philosophy. Collectively, we have access to the same information and the same people, but we are rarely on the same page.

Working in a transaction-based business model requires an outcome that is the antithesis of compounding.

Owning a business for the reward of real earning per share growth and dividend income is very different to making a DCF fit a given thesis designed to drive transactions, or to meet a company policy that determines a ratio of buy verse sell recommendations.

WISETECH GLOBAL – STREAMLINING LOGISTICS

COVID has brought about unprecedented disruption to global supply chains. Logistics providers, the enablers for the movement of goods, were overcome with the significant influx of orders, while lockdowns and other factors have accentuated the effects. The result being extended shipping delays for the end customer and soaring freight costs.

These factors have added to the complexity already evident within the logistics space. Those who adopted integrated, cloud-first software have fared better, leading to structural change with more industry players considering outsourcing their legacy systems.

Demand has risen for integrated solutions that enable providers to operate more efficiently and with greater confidence.

WiseTech Global is a key beneficiary here, providing the leading software solution for the logistics industry. The company links technology and productivity, offering a range of built-in capabilities to solve the various complexities across the supply chain. This will be discussed in further detail later.

Company Background

WiseTech Global was founded in 1994 with the purpose of removing pain points across international trade for importers, exporters, and logistics companies.

The software was originally built for the Australian logistics industry, reducing friction in local freight forwarding (the planning and buying of freight) and customs entry (movement of goods across borders), while also providing a back-office accounting solution. Packaged as one integrated system under the name Deliverance, WiseTech achieved solid market share gains in Australia.

Since then, co-founder and CEO Richard White has evolved the product into a truly global solution. The company has pivoted numerous times along the way, while remaining focused on the optimal long-term

outcome. This is best reflected in the philosophy of *“Slower today, faster forever”*.

Three key milestones underpin the company’s progression:

- **2004** – the complete rewrite of software to position it globally. Cannibalised the existing business with a new integrated platform.
- **2008** – the company transitioned to software as a service (SaaS) model, well ahead of its time. Positioned the product to benefit from subscriptions rather than one-off licence fees.
- **2014** – current generation of software, branded CargoWise One was launched. The upgrade included more products and enabled transactional pricing.

The launch of CargoWise One in 2014 marked a critical turning point. Up until then, the company had provided software solutions that required ongoing customisation. CargoWise One, which replaced this prior model, offered a standardised suite of logistics software applications, designed for all customer sizes. Importantly, it was scalable, catering single adopters to multiple users across geographies.

In 2016, WiseTech listed on the Australian Stock Exchange, raising \$125m at a market capitalisation of \$1.0b to embark on its next phase of growth.

With solid foundations in place, the company accelerated product development through acquisitions and internal research and development (R&D) initiatives. Progress has seen WiseTech add more than 4,000 capabilities and various adjacent products over the last five years.

WiseTech has become the outright global market leader. Servicing more than 18,000 customers, the company has a worldwide footprint covering 165 countries, operations in over 50 offices, and is supported by three regional hubs across Sydney, Chicago and Hamburg.

Table 12: Company Timeline

1994	Founded by Richard White and Maree Isaacs to develop freight forwarding and customs software solutions for Australian logistics providers.
1999	First acquisitions to grow product capability and customer base in Australia.
2004	Developed ediEnterprise, the second-generation global software solution with the entire product rewritten to focus on global and scalable capabilities.
2004	Raised capital to fund global expansion.
2006	Grew operations offshore and shifted focus to multi-regional logistics service providers. Rolled out product in North America, South-East Asia and the U.K.
2008	Introduced software-as-a-service (SaaS) and on-demand licensing.
2012	Released cloud-based capability, further enabling customers to access its software solution anywhere, anytime via internet connected devices.
2014	Launched third and current generation solution, branded CargoWise One, a deeply integrated global logistics platform.
2015	Raised \$35m in equity funding to accelerate growth, acquire customers and penetrate new markets.
2016	Listed on the Australian Securities Exchange raising \$125m at \$3.35 and valuing the business at \$1.0b.
2018	Completed 15 acquisitions to accelerate global growth.
2018	Launched global tracking in CargoWise One, covering vessels and containers for 90% of ocean volumes.
2019	Raised \$335.9m, via institutional placement and share purchase plan at \$20.90, to provide balance sheet flexibility and accelerate long-term organic growth.
2019	Responded to J Capital Research's short reports, noting the allegations across both documents to mislead and manipulate the market to the detriment of WiseTech's business.
2020	All the top 25 global freight forwarders and 42 of the top 50 third party logistics providers now use WiseTech's solutions.
2020	Renegotiated earn out arrangements for 17 strategic acquisitions to accelerate CargoWise One platform expansion and development, while also tightening focus. Resulted in \$147m reduction in contingent liabilities and equity issuances of \$81.4m.
2021	Entered the ASX 50.

Source: Company Announcements

Strategic Focus

WiseTech is a product-led organisation. The strategic mission is to design the end-to-end operating system for large, global logistic providers.

In its pursuit, WiseTech has founded a culture of innovation and productivity, seeking to *"test first, fail quickly and improve rapidly"*. As touched on earlier, the mantra *"Slower today, faster forever"* is also deeply engrained in the business, referencing the need to build things right the first time.

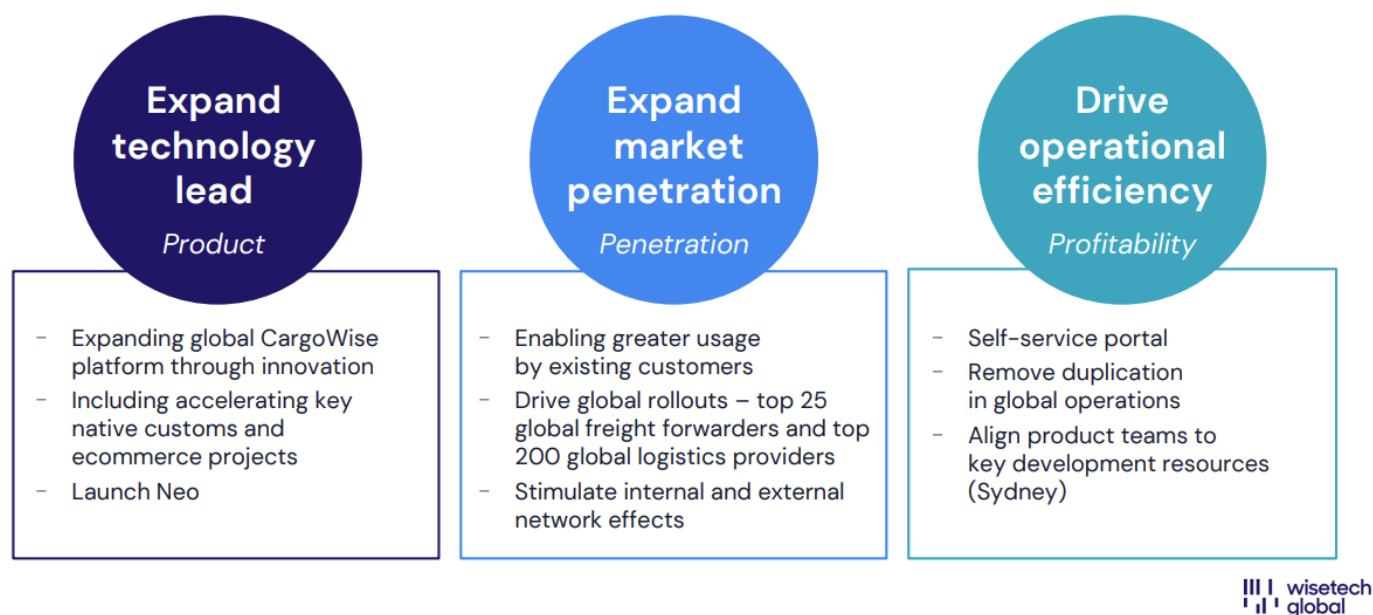
Almost three decades of reinvestment and 50% of the workforce operating in R&D, speaks to the focused effort to deliver the optimal solution.

While the people and culture are integral to execution, CEO Richard White formally centres the strategy around the three Ps:

- **Product** – the CargoWise ecosystem.
- **Penetration** – growing market access across the top 25 global freight forwarders and top 200 logistics providers.
- **Profitability** – streamlining internal processes and allocating resources to maximise operating leverage and reinvestment opportunities.

Figure 42: 3Ps strategy

Capitalising on the strategic opportunity by focusing on the 3Ps



Source: WiseTech FY21 Results Presentation

Product

CargoWise primarily benefits:

- **Freight forwarders** – receives and ships goods on behalf of other companies.
- **3PL (third-party logistics) providers** – outsourced logistics services, encompassing anything that involves the management of one or more facets of procurement and fulfilment activities.

These are low margin businesses with complex shipping requirements and dynamic workflows, which are exposed to changing border legislations, international shipping orders and a myriad of stakeholders.

This is where WiseTech's fully integrated and highly scalable offering comes in. In its prospectus the company notes, *"Our CargoWise One software is mission critical for many of our customers as it enables them to manage highly complex, time-critical operations and often heavily regulated compliance requirements that are essential to their core business activities"*.

The all-in-one solution has modules across: Freight Forwarding, Customs Clearance, Land Transport,

Warehousing, Liner & Agency, Container Freight, Track & Trace, and Geo Compliance. Augmenting this are back-office modules for accounting, administration and management.

CargoWise is particularly differentiated for large global logistics providers. Its software runs on a single source of code, meaning changes are reflected across the whole system instantly. The benefit? Real-time visibility and the automatic flow of data through the chain.

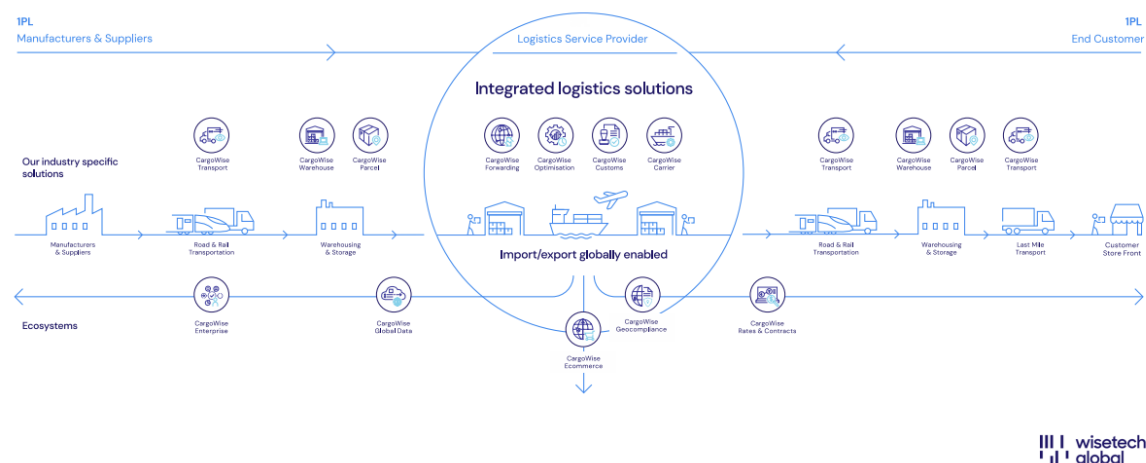
For logistics providers operating across numerous geographies, data only needs to be entered once within the integrated solution, driving scalable efficiency and global product consistency across the user base.

The CargoWise system is also updated regularly to keep at pace with changing laws and legislation. Millions of global variations are standardised and available across the one system instantaneously, ultimately helping the end-user stay compliant.

By reducing complexity, CargoWise customers can reduce operating costs (labour) and focus on higher value tasks to drive growth.

Figure 43: CargoWise platform

Designing integrated solutions for industry pain points



© 2020 WiseTech Global

Source: WiseTech FY21 Results Presentation

Product Vision

The current benefits of CargoWise are evident. However, there remains ample opportunity to continue developing more product features and capabilities that tap into other segments of the market.

One example is customs and border compliance. This remains the primary pain point for logistics providers, due to the complex border rules and requirements around documentation, accounting and taxation.

The company currently has customs coverage for 45% of global manufactured trade flows, encompassing all English-speaking countries. WiseTech has earmarked an aspirational development goal covering 90% of the market opportunity, with acquisitions having fast tracked this.

The combination of WiseTech's fully-fledged global freight forwarding solution, with an integrated customs and border compliance platform would extend the value proposition to another level.

WiseTech is also developing solutions that extend into new customer segments. One such product offering is CargoWise Neo, a longer-dated opportunity positioned for customers of logistics providers. This web portal will enable cargo owners, such as large manufacturers, to link directly with their logistics provider to plan, price, book, track, trace and manage their freight. It will

ultimately provide greater visibility and control, with early feedback positive.

As WiseTech layers the platform with additional features and capabilities, its competitive moat grows. Greater product uptake will also drive revenue growth. So not surprising, there is a relentless focus on R&D to drive continuous improvement and reduce pain points with the eventual goal of servicing logistics providers with a fully integrated solution.

Acquisitions

The second component of product development is acquisitions. The company has taken an aggressive approach here to rapidly acquire talent, expertise and build on existing global customs capabilities.

The key objective has been to accelerate the company's global customs capabilities by expanding its presence in non-English speaking geographies at pace, without significant execution risk involved. To date, acquisitions have played a pivotal role, accelerating the product roadmap and keeping ahead of competition.

WiseTech has acquired 41 companies post IPO, growing its footprint in new geographies and larger, globally capable adjacencies. Acquired business revenues totalled \$175m in 2021, while the company has outlaid over \$600m in capital and equity to secure ownership since IPO.

Table 13: WiseTech Acquisitions since 2015

Date	Company	Provider	Country	Total consideration (m)
Mar-15	Zsoft	Freight forwarding solutions	China	n/a
Jun-15	CoreFreight	Freight forwarding and customs solutions	South Africa	n/a
Sep-15	Compu-Clearing	Freight forwarding and customs solutions	South Africa	n/a
May-16	CCN Australia	Airline messaging distributor	Australia	€2.75
Feb-17	GmbH	Customs solutions	Germany	€6.00
Feb-17	ACO Informatica	Customs solutions	Italy	€1.20
Jul-17	TradeFox	Tariff research and compliance tools provider	Australia	n/a
Jul-17	Bysoft	Customs and freight forwarding solutions	Brazil	\$12.9
Aug-17	Digerati	Tariff research and compliance solutions	Australia, New Zealand	\$6.0
Aug-17	Prolink	Customs and freight forwarding solutions	Taiwan, China	\$3.7
Aug-17	CMS Transport Systems	Road transport and logistics Management solutions	Australia, New Zealand	\$9.0
Aug-17	Softship	Ocean carrier logistics solutions	Germany	\$18.6
Sep-17	Cargoguide	Air freight rate management solutions	The Netherlands	\$6.9
Sep-17	CargoSphere	Ocean freight rate management solutions	US	\$11.5
Dec-17	Microlistics	Warehouse management solutions	APAC, NA, Middle East	\$40.0
Dec-17	ABM Data Systems	Customs solutions	Europe	\$17.2
Dec-17	CustomsMatters	Customs solutions	Ireland, UK	\$2.8
Feb-18	Intris	Customs, freight forwarding and warehousing solutions	Belgium	\$17.4
Mar-18	LSP Solutions	Customs and warehouse solutions	The Netherlands	\$5.2
Apr-18	Forward, SoftCargo, EasyLog	Freight forwarding, logistics, customs and accounting solutions	South America, France	\$25.0
May-18	Ulukom	Logistics and customs solutions	Turkey	\$7.5
May-18	Less than Truckload	Transport management solutions	US	\$3.8
Jun-18	Fenix Data Systems	Customs management solutions	Canada	\$3.3
Jun-18	Pierbridge	Parcel shipping transportation management solutions	US	\$59.4
Sep-18	Multi Consult	Customs, freight forwarding, warehouse solutions	Italy	n/a
Aug-18	Taric	Customs management solutions	Spain	\$46.9
Aug-18	Trinium Technologies	Intermodal trucking transportation management systems	US, Canada	\$68.6
Oct-18	Tankstream	Learning management solutions	Australia	n/a
Oct-18	DataFreight	Customs, freight forwarding and warehousing solutions	UK	\$5.0
Oct-18	SmartFreight	Multi-carrier shipping software	ANZ, UK, Ireland, South Africa, Asia	\$55.0
Oct-18	CargoIT	Customs management and logistics solutions	Sweden	\$3.6
Feb-19	Systema	Customs management and logistics solutions	Norway, Denmark, Sweden	\$5.7
Feb-19	Containerchain	Container optimisation solutions	Global	\$92.0
Apr-19	Xware	Messaging integration solutions	Sweden	\$23.2
Sep-19	Cypress	Tariff management solutions	US	n/a
Aug-19	Depot Systems	Container yard and terminal management logistics solutions	US	\$7.1
Dec-19	Ready Korea	Customs, bonded warehouse and trade compliance solutions	South Korea	\$20.2
Jan-20	SISA Studio Informatica SA	Customs and freight forwarding solutions	Switzerland	\$24.4
Mar-20	SAD EC	Customs solutions	Poland	n/a
Nov-20	Kabushiki Kaisha Exas	Customs and freight forwarding solutions	Japan	\$2.1
Oct-21	Inobiz AB	Messaging mapping solutions	Sweden	n/a
Nov-21	Hazmatica	Hazardous materials transportation solutions	US	n/a

Source: Company Announcements

These acquisitions are seen as low risk partnerships with founder-led organisations, where often the leaders have continued to run their ship. Deals have also been agreed with smaller vendors who usually have existing relationships with WiseTech.

Acquiring these footholds has been critical in establishing local industry expertise at the borders of each country, strong management teams and an existing customer base. Table 13 provides an overview of acquisitions completed since 2015.

The business is now entering a period dominated by strong organic growth, as the frequency of acquisitions begins to slow. The focus has shifted to accelerating the integrations, with the partial or full close of earn-outs from cash to equity expected to create greater alignment to drive towards group objectives.

Beyond this point, management will target small tuck-in acquisitions, or larger strategically significant opportunities. In first half 2022, the company made two tuck-in purchases that complements the software.

Penetration

While WiseTech has a strong industry foothold, penetration among logistics providers is still in its infancy.

According to external research consultants, the total addressable market is valued at US\$15b. This comprises

US\$10b for software solutions and US\$5b for services, covering consulting and maintenance. In 2021, WiseTech reported group revenues of \$507m, of which CargoWise revenues totalled \$332m, representing only a small portion of the significant latent opportunity available.

The company has multiple levers of growth, with Figure 44 detailing the drivers of revenue over the past five years.

Existing and new customer rollouts is expected to remain the most significant driver. WiseTech is focused on growing geographic exposure and product modules across the top 25 global freight forwarders and the top 200 global logistics providers. This represents the largest revenue opportunity and is where CargoWise's value proposition is strongest.

The group has, in some way or another, been able to embed itself across all of the top 25 global freight forwarders, and 42 of the top 50 third party logistics providers.

Only 10 of the top 25 freight forwarders are in global rollout, defined as operating in at least 10 countries with over 400 customers. Of the remaining 15, management notes the majority operate under in-house legacy systems, of which 12 could be in play at some point.

Figure 44: CargoWise recurring revenue growth drivers

Details on inclusions in each category of revenue drivers

CargoWise recurring revenue growth drivers	Growth rate FY16 to FY21 (averages per year)	What's included
Large Global Freight Forwarder rollouts	12pp	Growth in users and transactions from Large Global Freight Forwarders ¹
New customers' FY17 to FY21 cohorts	6pp	New CargoWise customers recurring revenue growth from customer cohorts added from FY17 to FY21 (non Large Global Freight Forwarders)
New product features and enhancements reflected in price	4pp	Monetized new product features and enhancements and standard periodic price increases reflecting ongoing product development investment delivering enhancements
Existing customer growth and market share	3pp	Increased usage of CargoWise by existing (non-Large Global Freight Forwarders) customers adding transaction volumes, seats and new sites, utilization of new modules
Major new product releases	3pp	Significant new CargoWise product releases not included in new product features and enhancements
Market growth	3pp	Growth driven by changes in industrial production and world trade in manufactured goods

31% CAGR FY16 to FY21

28% CAGR from WiseTech specific growth factors

CargoWise recurring revenue growth drivers are averages over a five-year period; discrete annual growth drivers may vary each year

Source: WiseTech 1H22 Results Presentation

Figure 45: Penetration

Momentum through existing customer growth & new global rollout wins

2 new global rollouts by Large Global Freight Forwarders¹ secured since 1 July 2021:

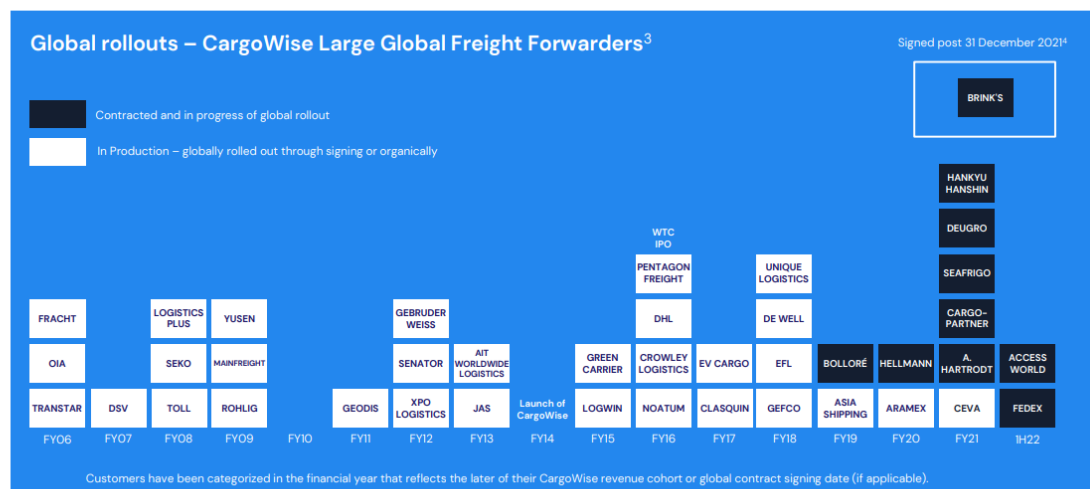
- FedEx
- Access World

Post 1H22 1 additional global rollout signing with Brink's.

As at 1H22, CargoWise had global rollouts 'In Production' or 'Contracted and In Progress' with **40 Large Global Freight Forwarders**:

- 31 'In Production'¹
- 9 'Contracted and In Progress'¹ (i.e. in the process of a global rollout)

Of the 40 global rollouts in place as at 31 December 2021, 10 are with Top 25 Global Freight Forwarders²



Source: WiseTech 1H22 Results Presentation

It's clear there is an opportunity for CargoWise to replace the legacy systems across these global logistics providers. The importance of straight through processing delivered digitally, is resonating within an industry where paper-based systems still dominate. WiseTech's central strategic premise is designed to accelerate growth, by leveraging these structural changes.

The onset of COVID and the supply chain issues that have followed, has provided a unique opportunity to accelerate CargoWise adoption, with WiseTech reporting strong demand and significant global customer wins during 2021, including FedEx Freight (see Figure 45).

With the implementation of software across business units, countries and modules, to be rolled out progressively over multiple years, future revenue growth is effectively locked in. Historically, global rollouts have driven a third of CargoWise's revenue growth over the last five years.

New product features and enhancements, along with industry consolidation are also expected to increase transactions on the CargoWise platform. Combined, the company has a clear opportunity to continue compounding revenue and earnings at double digit rates over the next decade.

Competition

WiseTech operates in a fragmented competitive space dominated by domestic or regional solutions. Whilst

other global integrated software providers exist, such as Blu Jay and Descartes, these players do not offer the same scale and international reach.

The true competition are legacy systems developed in-house by logistics providers. These systems are difficult to improve, but also hard to replace. They are underinvested and built using old methods, which has led to issues during COVID with the working from home model.

CargoWise is the obvious replacement, functioning in the cloud, fully integrated and with best of breed products. Management expects adoption to grow over time, as these legacy solutions becoming increasingly dormant.

Revenue Model

The launch of CargoWise in 2014, also coincided with an enhanced pricing model for the company. While existing users were kept on the historical Module User Licensing (MUL) model, new customers were signed under the Seats & Transaction Licensing (STL) model.

The STL model charges a fee per transaction and additional fees for services, on top of the subscription licence fee, which better aligns with monetisation of usage and transaction growth. MUL users continue to be phased out in preference of the STL model, which now makes up over 95% of all CargoWise users.

Table 14: Key CargoWise Metrics

CargoWise Metrics	Percentage
Recurring revenue – % total revenue	99%
On-Demand license revenue – % total revenue	99%
Gross profit margin	92%
Product design & development – % total revenue	12%
Total R&D – % total revenue	29%
Sales & marketing – % total revenue	6%
General & administration – % total revenue	15%
EBITDA margin	58%

Source: WiseTech 1H22 Results Presentation

Table 15: CargoWise vs Acquisition Historical Financials

Amount	FY18	FY19	FY20	FY21	1H22
CargoWise Revenue (\$m)	165.1	219.6	263.0	331.6	193.0
CargoWise EBITDA (\$m)	79.2	105.4	126.2	182.4	111.9
CargoWise EBITDA Margin %	48.0%	48.0%	48.0%	55.0%	58.0%
Acquisition Revenue (\$m)	56.5	128.7	166.4	175.9	87.9
Acquisition EBITDA (\$m)	(1.1)	2.7	0.5	17.3	25.6
Acquisition EBITDA Margin %	(2.0%)	2.1%	0.3%	9.8%	29.1%

Source: WiseTech announcements

Core Operating Metrics

The core CargoWise business exhibits world class operating metrics. Revenue is 99% recurring in nature, leading to less focus on sales and more investment towards improving functionality and future product development. At a group level, 90% of revenue is recurring, reflecting the greater proportion of one-time revenues of acquired businesses.

The core CargoWise business is highly scalable. Platform implementation is outsourced to accredited Wise Partners, while the company operates an efficient sales force targeting the largest logistics providers. Churn also remains historically below one percent. At the half, CargoWise delivered 92% gross margins and 58% EBITDA margins, while continuing to reinvest significantly in R&D.

Operating Leverage

In FY21, the company reported improving gross and operating margins, a reflection of WiseTech's increasing business efficiency and operational scalability. The three core areas of expenditure encompass product design and development (PDD), sales and marketing (S&M), and general and administration (G&A).

For 2021 operating expenditure totalled \$223m, or 43% of group revenue. Specifically, expensed PDD represented \$89m or 17% of total spend, S&M totalled \$45m or 9% and G&A, the balance at \$89m or 18%.

Also important to note that as the business scales and acquired companies are fully integrated, the level of percentage spend across the S&M and G&A business segments decline. Over time, group margins should continue to lift as more revenue is transitioned to

CargoWise. Table 15 illustrates the operating leverage since FY18 and the margin differentials.

R&D

The company has maintained a consistent R&D investment profile. Since 2017 over \$560m has been invested in product development, with the company adopting current accounting standards to either capitalise or expense this outlay.

In 2021, a total of \$167m was invested, with \$78m capitalised (47%) and \$89m (53%) expensed, as outlined under PDD operating expenses. Approximately 1,000 staff, or 50% of total employees, are involved in R&D operations, representing the company's largest expenditure at 33% of total group revenues.

The company notes 55% of total R&D spend is to support the maintenance of acquired legacy products. This level of spend will decline as acquired businesses are integrated, providing greater scope for targeted investment spend on new and existing products.

The human capital in R&D at WiseTech is a real differentiator. The group rewards those who are bold and willing to innovate, encouraging developers to think outside the box. Systems such as Productivity Acceleration Visualisation Engine (PAVE), digitise workflows and enable innovations to move from ideation to implementation, without the bureaucracy across other organisations.

This has driven leadership in the current operating system and is expected to deliver new products and enhancements that further improve the competitive position.

Full Year 2021 Financials

Since listing in 2016, WiseTech has delivered strong top and bottom-line compound growth. Revenues over this period, which also incorporate acquired businesses, have increased from \$154m to \$507m.

Net profits have performed just as well, growing from \$32m to \$106m, representing an earnings per share of 33 cents compared to 11 cents in 2017.

In 2021, the company reported at the top end of its guidance range, delivering group revenues up 18% to \$507m, or growth of 24% when reported on a constant currency basis. Within this figure, CargoWise revenues

rose 26% to \$332m, while acquired businesses delivered 6% growth to \$176m.

Gross margins expanded 3% to 85% while operating profits (EBITDA) rose 63% to \$207m, reflecting operating leverage and net cost business reductions undertaken during the year. These numbers also include \$8.2m of restructuring costs and foreign exchange headwinds of \$10.6m.

Group operating margins rose 11% to 41%, while the main CargoWise segment delivered margins of 55%, up 7% for the year.

Free cash flow, defined by operating cash flow less all capital expenditure, rose 149% to \$139m, with cash conversion remaining above reported EBITDA at 111%.

The company declared a fully franked 3.85 cent final dividend, taking the yearly payout to 6.55 cents per share, representing a 20% payout ratio. WiseTech ended the year with no net debt and a cash balance of \$315m.

For FY22, the company is guiding to 18%-25% revenue growth, indicating a range of \$600m-\$635m. Within this target, CargoWise is set to maintain its very strong revenue trajectory, with expected growth of 30%-40%. At the operating level (EBITDA), management is pointing to profit within the range of \$260m-\$285m, up 26%-38%, driving an improved operating margin of 43%-45%.

Founders

The company's founders Richard White and Maree Isaacs, as well as long serving company directors remain significant investors in the business.

As at June 2022, CEO White held 124m shares or approximately 38% of the company's issued capital. This was down from the 140m held in 2020 and reflects the CEO's stated intention to undertake minor reductions in his personal holding.

Combined with other individuals, company insiders hold around 50% of the capital. On this point the company's issued capital has expanded only twice since listing, from the starting 290m shares to the current 324m, following a raising of \$100m in 2018 and \$300m in 2019.

Summary

WiseTech's evolution has been nothing short of extraordinary. Business momentum has accelerated, while the product set remains highly relevant and well

entrenched within existing customers. The company is profitable, has high margins, and continues to fund innovation.

Management is thinking big and investing with a long duration viewpoint to become the software solution of choice for logistics providers. The size of the prize is

significant, with recent structural changes extending the need for truly integrated software.

WiseTech is in an enviable competitive position here, with clear leadership and a strategic vision to relentlessly extend its world class software solution. The company remains a long-term compound story, with decades of growth ahead of them. **SFM**

COMPANY ENGAGEMENTS – JUNE 2022 QUARTER

Date	Company	Description
4-Apr	JIN	Jumbo Interactive UBS Industry Insight Call
5-Apr	NEA	Nearmap Management Meeting
7-Apr	ALU	Altium Management Meeting
7-Apr	NEA	Nearmap Macquarie Management Meeting
7-Apr	RMD	ResMed JPM Industry Insight Call with AdaptHealth
8-Apr	RMD	ResMed JPM Industry Insight Call with Nationwide Medical
12-Apr	IRE	Iress Management Meeting
14-Apr	IRE	Iress Management Meeting
15-Apr	FCL	FINEOS Corporation Holdings Product Panel Discussion Webinar
26-Apr	MP1	MegaPort UBS Management Meeting
26-Apr	DMP	Domino's Pizza Enterprises Japan Management Call
28-Apr	CAR	carsales.com Encar Management Meeting
28-Apr	MP1	MegaPort Morgans Management Meeting
29-Apr	n/a	Domino's Korea Management Meeting
29-Apr	RMD	ResMed 3Q22 Results Conference Call
29-Apr	RWC	Reliance Worldwide 3Q22 Results Conference Call
2-May	COH	Cochlear Management Meeting
2-May	APX	Appen Management Meeting
3-May	RMD	ResMed Macquarie Australia Conference Webcast
3-May	COH	Cochlear JPM Industry Insight Call
3-May	CSL	CSL Macquarie Australia Conference Webcast
3-May	CPU	Computershare Macquarie Australia Conference Webcast
3-May	HUB	HUB24 Macquarie Australia Conference Webcast
3-May	FCL	FINEOS Corporation Holdings Macquarie Australia Conference Webcast
4-May	EDV	Endeavour Group Ltd Macquarie Australia Conference Webcast
4-May	FLT	Flight Centre Travel Group Macquarie Australia Conference Webcast
4-May	SHL	Sonic Healthcare Macquarie Australia Conference Webcast
4-May	PXA	PEXA Group Ltd Macquarie Australia Conference Webcast
4-May	NEA	Nearmap Macquarie Australia Conference Webcast
5-May	RWC	Reliance Worldwide Macquarie Australia Conference Webcast
5-May	ARB	ARB Corporation Management Meeting
5-May	IRE	Iress Annual General Meeting
5-May	NHF	NIB Holdings Macquarie Australia Conference Webcast
5-May	PNV	PolyNovo Macquarie Australia Conference Webcast
6-May	REA	REA Group 3Q22 Results Conference Call
6-May	MVP	Medical Developments International Management Meeting
9-May	IFL	IOOF Holdings JPM Management Meeting
12-May	RMD	ResMed UBS Industry Insight Call

Date	Company	Description
13-May	RMD	ResMed GS Industry Insight Call
16-May	BRG	Breville UBS Industry Insight Call
17-May	JHX	James Hardie Industries FY22 Results Conference Call
17-May	OFX	OFX Group FY22 Results Conference Call
17-May	JHX	James Hardie Industries Management Meeting
17-May	OFX	OFX Group Management Meeting
18-May	FLT	Flight Centre Travel Group Barrenjoey Industry Insight Call
19-May	ALL	Aristocrat Leisure 1H22 Results Conference Call
19-May	FLT	Flight Centre Travel Group Management Meeting
20-May	ALL	Aristocrat Leisure Barrenjoey Management Meeting
24-May	TNE	TechnologyOne HY22 Results Conference Call
24-May	RMD	ResMed E&P Management Meeting
25-May	FPH	Fisher & Paykel Healthcare FY22 Results Conference Call
25-May	OFX	OFX Group Barrenjoey Management Meeting
25-May	ALL	Aristocrat Leisure Management Meeting
25-May	TNE	TechnologyOne Management Meeting
25-May	NAN	Nanosonics Barrenjoey Management Meeting
26-May	FPH	Fisher & Paykel Healthcare Investor Day
26-May	FCL	FINEOS Corporation Holdings Citi Management Meeting
27-May	TNE	TechnologyOne Barrenjoey Management Meeting
27-May	APX	Appen Annual General Meeting
30-May	APX	Appen Citi Management Meeting
30-May	TNE	TechnologyOne Management Meeting
31-May	APX	Appen Management Meeting
31-May	FLT	Flight Centre Travel Group Barrenjoey Industry Insight Call
1-Jun	JHX	James Hardie Industries UBS Industry Insight Call
1-Jun	NAN	Nanosonics Management Meeting
2-Jun	REA	REA Group Investor Day
2-Jun	FPH	Fisher & Paykel Healthcare Management Meeting
3-Jun	JIN	Jumbo Interactive Management Meeting
3-Jun	FLT	Flight Centre Travel Group Management Meeting
3-Jun	DMP	Domino's Pizza Enterprises Management Meeting
6-Jun	DMP	Domino's Pizza Enterprises Asia Investor Day
7-Jun	DMP	Domino's Pizza Enterprises Asia Investor Day
7-Jun	APX	Appen Management Meeting
8-Jun	DMP	Domino's Pizza Enterprises Asia Investor Day
8-Jun	JIN	Jumbo Interactive Investor Day
8-Jun	FPH	Fisher & Paykel Healthcare Citi Industry Insight Call
9-Jun	RMD	ResMed William Blair 42nd Annual Growth Stock Conference
9-Jun	ARB	ARB Corporation Taylor Collison Management Meeting

Date	Company	Description
9-Jun	WTC	WiseTech Global Barrenjoey Industry Insight Call
15-Jun	RMD	ResMed Acquisition of MEDIFOX DAN
15-Jun	RMD	ResMed 43rd Annual GS Global Healthcare Conference
22-Jun	NAN	Nanosonics Barrenjoey Management Meeting
23-Jun	CPU	Computershare JPM Management Meeting
23-Jun	APX	Appen Investor Technology Day
24-Jun	IRE	Iress Barrenjoey Management Meeting
27-Jun	CAR	carsales.com Trader Interactive Acquisition Call

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