



In this quarterly, we highlight the challenges the banking sector faces in our articles *“This is important”* and *“Good vs Bad Buybacks.”* We then explore the work of Ken Allen at global logistics provider DHL in our piece *“Simple is hard”* and why common sense often leads to corporate success.

To round this out, we comment on the economic fallout getting increasing attention in our piece *“Productivity – or lack thereof.”* We then address the significance of scale and leadership in our core portfolio holding, ResMed.

Finally, we explore the link between working-from-home and productivity, before highlighting the sustainability practices of our holdings in our ESG article.

**Photo.** *The Black Rhinoceros is a powerful specie, weighing in at over two tonnes, has poor vision, can sustain speeds of over 50 kilometres per hour and lethal to unsuspecting humans.*

*Investors who stood in the way of the share market this year, are likely to have suffered a similar fate, reinforcing the long-term performance power of sharemarkets and businesses to renew and evolve.*



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 19-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,

While the share market performance for the June quarter surprised many, the financial year results are likely to have amazed even more. It begs the question, why do markets behave contrary to the underlying conditions, baffling investors who shift in the prevailing winds rather than sticking with a long-term investment strategy?

It was a year packed with dangerous undercurrents: the Russian-Ukraine conflict extending into its second year, the hiking of U.S. interest rates at the fastest pace in over 40 years, the U.S. debt ceiling impasse dominating financial headlines over the latter half, and the tide of data pointing to an economic slowdown and imminent recession.

Under such circumstances, it would have been difficult to predict a positive outcome for financial markets. Yet that is exactly what transpired; our All-Ordinaries Index ended at 7402, up 9.7% for the period, highlighted in Figure 1.

Elsewhere, the U.S. Dow Jones Index ended up 11.8%, while the Nasdaq Index reversed the negative backdrop of 2022, finishing the year up 25.0%.

There are, however, areas of genuine concern. While the U.S. may have averted defaulting on its financial obligations, instead suspending the debt ceiling for two more years, it remains an area of intense focus. The question of debt though extends well beyond governments and into corporate life. A little over twelve months ago, the Fed fund rate in the U.S. sat below two percent, having climbed from its then low range of 0%-0.25% following the onset of COVID-19.

Today, it has more than doubled, perched at 5.00%-5.25%. It now stands at its highest level in 16 years, as the Federal Reserve zeroes in on its two percent inflation target. In doing so, it has reset the relationship between the cost of debt funding, economic growth, and cash deposit rates, with significant consequences for governments, businesses, and consumers.

Figure 1: S&P/ASX 200 Financial Year 2023 Performance

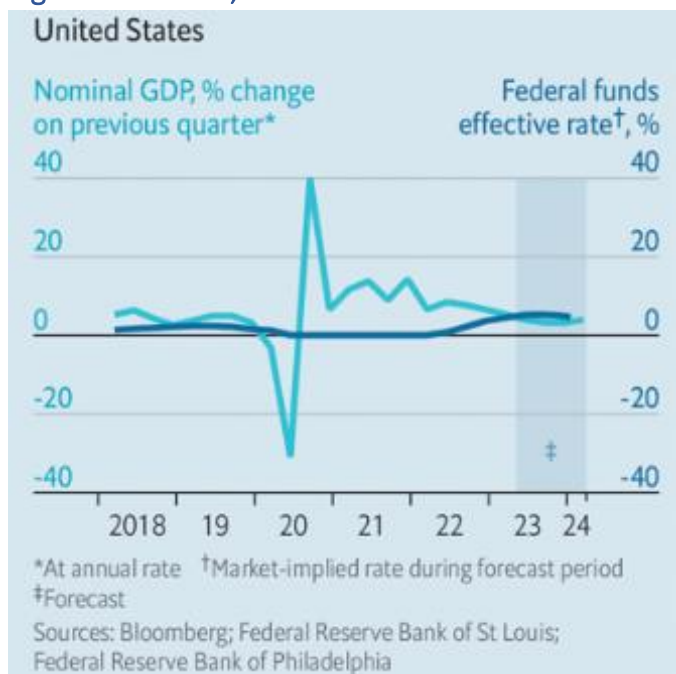


Source: Bloomberg, The Australian

The Economist's appropriately titled article, *"The American credit cycle is at a dangerous point,"* published in May 2023, addresses the main concern we see. Since 2009 the world has been accustomed to nominal interest rates sitting below economic growth rates. Credit funding grew as a result, as all groups looked to take advantage of the apparent benefits.

Now, as Figure 2 highlights, nominal interest rates and GDP growth are at an intersection. It mattered less before, but according to Carl Riccadonna of BNP Paribas, *"This is where the rubber really meets the road for the economic cycle. This is the point at which, if you're a business, your revenues are now growing more slowly than your cost of financing."*

Figure 2: Rubber, meets the road



Source: The Economist

The Economist notes, *"The troubling conclusion from this expression applies to debt. In an  $i > g$  world (where nominal interest rates exceeds nominal growth), growth in the revenues, wages, or tax receipts that a debtor earns, will be slower than the interest accumulating on their borrowing, meaning that debt levels have the potential to explode."*

In the current environment, high rates will expose governments and businesses that continue to operate with budget deficits or the wrong business model, as the article states: *"It is far easier to swallow a high cost of capital when it is matched by high returns on said capital. And that will not be the case for much longer."*

For those companies that have shunned debt and operated with net cash balances, the current environment is now supportive of their stance. The lift in cash deposit rates also delivers an economic return that either reduces financing costs or positively contributes to group net profits. An increasing number are also undertaking share buyback programs using part of their cash balances.

This shift from relying on debt to generate shareholder growth to a situation that rewards the individual strengths of a business will, in our opinion, distinguish many companies during this period. It will expose those sectors, most notably the banks, which rely on debt and leverage to generate growth. Our two feature quotes for this quarterly, presented below, highlight the challenges the banking sector is likely to face.

More broadly and looking beyond the cohort of global central bankers fixated on inflation, we concur with the views of Bank of England Chief Economist Gertjan Vlieghe who, as expressed by Macquarie Group Global Head of Strategy Viktor Shvets, *"identified three structural forces that were working over the previous decades and are likely to become even stronger in years to come, keeping long-term growth and interest rates low: indebtedness, demographics and wealth inequalities. In our view, one should add technological developments – Information Age – to this laundry list. It is the intersection between all these strong secular forces that supports our longue durée expectations of constrained growth and inflation, as well as declining neutral rates."*

In this quarterly, we expand on these issues in our articles *"This is important"* and *"Good vs Bad Buybacks."* We then explore the work of Ken Allen at global logistics provider DHL in our piece *"Simple is hard"* and why common sense often leads to corporate success.

To round this out, we comment on the economic fallout getting increasing attention in our piece *"Productivity – or lack thereof."* We then address the significance of scale and leadership in our core portfolio holding, ResMed.

Finally, we explore the link between working-from-home and productivity, before highlighting the sustainability practices of nib holdings in our ESG article.

For the June quarter, the portfolio delivered a gross positive return of **5.13%** compared to the S&P ASX All Ordinaries Accumulation Index, which recorded a gain of **1.01%**.

For the financial year, the portfolio delivered a gross positive return of **16.62%** compared to the Index which recorded a gain of **14.75%**.

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

Regards,

Selector Investment Team



*“There’s no question an inverted yield curve doesn’t work for banks. It violates the fundamentals of their business models, and the longer it’s inverted, the more challenging the environment becomes for banks.”*

**Neel Kashkari, Minneapolis Fed President**

*“If you step back to first principles, banks make their money by taking risks. They are bundles of risk. They leverage their balance sheets. They take in deposits, and with them make loans or invest in securities and the assets they buy go up and down. While these banks are less leveraged than they were in the 07-08 crisis by a lot, they are still leveraged. I like to say, you can drown in the ocean, and you can drown in a pond. If you have equity to assets of 7.5% to 8.5% you don’t have to have much of a loss on the assets side before you have a run on the bank.”*

**Sallie Krawcheck, CEO and Co-Founder Ellevest**

## PORTFOLIO OVERVIEW

Table 1: Performance as at 30 June 2023\*

	3 Month	6 Month	1 Year	3 Year	5 Year	10 Year	15 Year	Since Inception
Fund (net of fees)	4.71	10.89	14.79	5.95	5.65	12.38	10.57	9.88
Fund (gross of fees)	5.13	11.75	16.62	7.67	7.53	14.39	12.59	11.93
All Ords. Acc. Index	1.01	4.65	14.75	11.42	7.35	8.80	6.55	8.02
Difference (gross of fees)	4.12	7.10	1.87	(3.75)	0.18	5.59	6.04	3.91

\*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

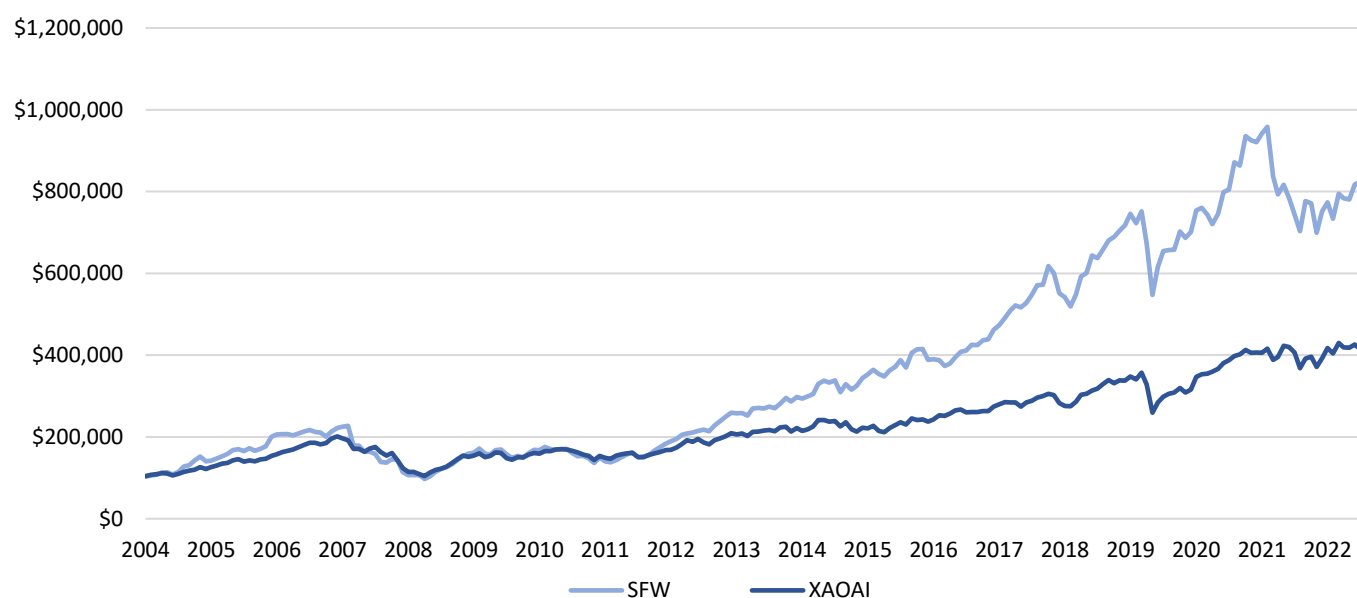


Table 2: Fund's Top 10 Holdings

Top 10 June 2023	%	Top 10 March 2023	%
carsales.com	7.35	carsales.com	7.12
TechnologyOne	7.20	Altium	6.86
Altium	6.72	TechnologyOne	6.66
Cochlear	5.44	Cochlear	5.56
CSL	5.29	CSL	5.44
James Hardie Industries	5.07	Aristocrat Leisure	5.19
Aristocrat Leisure	5.06	ResMed	4.85
ResMed	4.60	Reece	4.44
Reece	4.45	James Hardie Industries	4.33
Nanosonics	3.63	Nanosonics	4.15
<b>Total</b>	<b>54.81</b>	<b>Total</b>	<b>54.60</b>



Table 3: Unit prices as at 30 June 2023\*\*

Unit Prices	Entry Price	Mid Price	Exit Price	Mid Price (Cum Distribution)
	\$3.1005	\$3.0928	\$3.0851	\$3.2668

\*\* FY23 distribution total of \$0.17604 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 2023 quarter

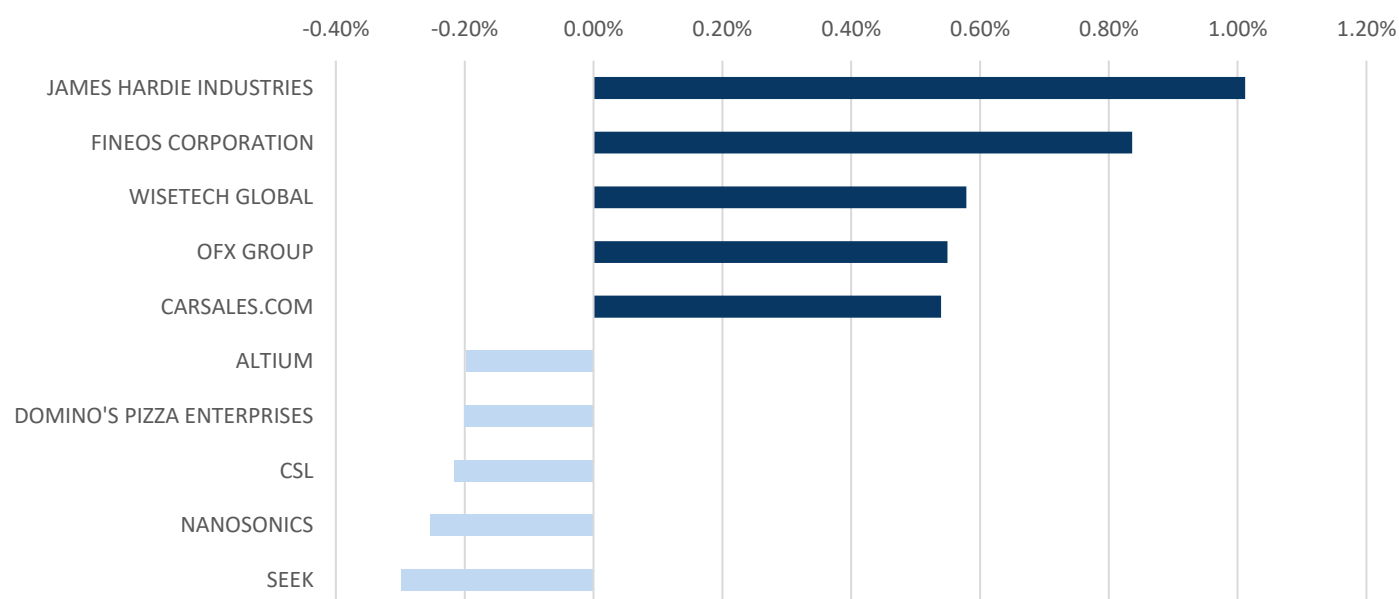
S&P ASX Industry Sectors	Quarter Performance (%)
Information Technology	21.03
Utilities	4.36
Energy	3.56
Industrials	3.05
A-REITS	1.76
Financials	1.46
Telecommunications	1.40
Consumer Staples	(0.13)
Consumer Discretionary	(1.87)
Materials	(2.57)
Healthcare	(3.18)

Table 5: Fund's industry weightings

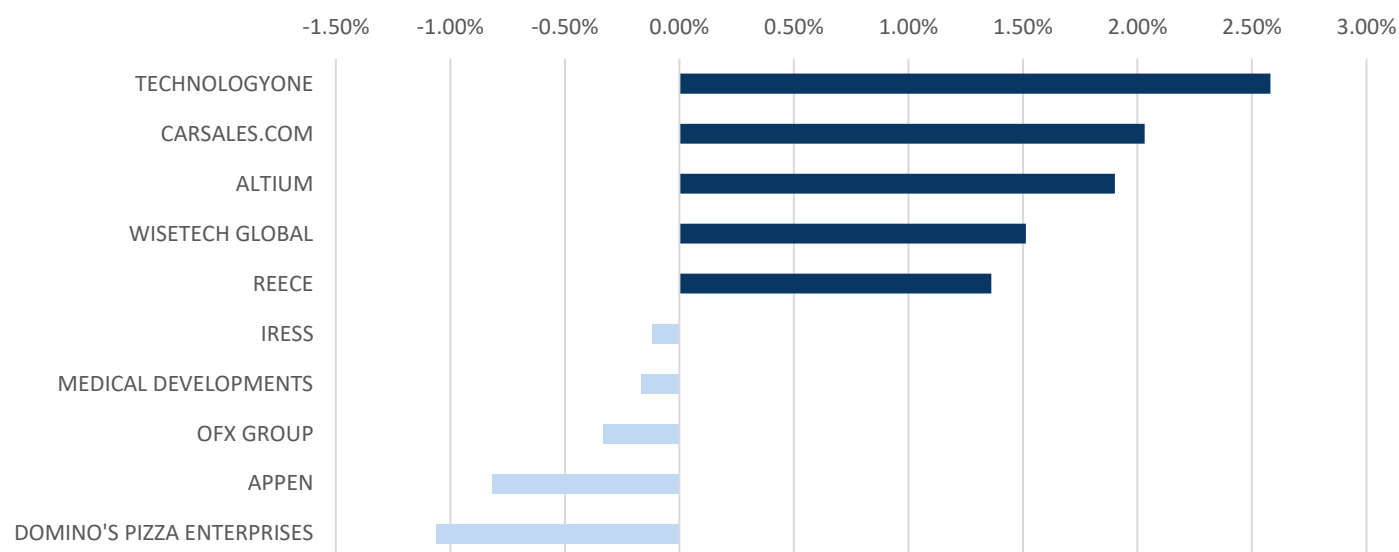
Industry group	June 2023 (%)	March 2023 (%)
Software & Services	26.26	23.82
Health Care Equipment & Services	16.55	17.77
Consumer Services	13.60	13.56
Media & Entertainment	12.96	12.89
Capital Goods	6.59	6.58
Pharmaceuticals, Biotech & Life Sciences	5.46	5.69
Materials	5.07	4.33
Commercial & Professional Services	3.47	3.42
Insurance	2.65	2.36
Financial Services	2.65	3.37
Automobiles & Components	1.95	2.13
Consumer Durables & Apparel	1.42	1.35
Cash & Other	1.36	1.18
Household & Personal Products	N/A	1.55

## PORTFOLIO CONTRIBUTORS

Graph 2: Contributors and Detractors – June 2023 quarter



Graph 3: Contributors and Detractors – June 2023 Financial Year



### Top quarterly contributors

#### 1. James Hardie Industries (ASX:JHX)

In May, James Hardie, a global leader of fibre cement released its FY23 results. Group revenue rose 4% to US\$3.6b while adjusted net income fell modestly to US\$606m. The company continues to experience weaker housing demand across all three segments (North America, APAC, and Europe), particularly in new construction. Total volumes declined by 5%, although the shift to premium products and price increases has helped offset this.

Adjusted operating margins (EBIT) fell by 2% to 20.6%, primarily due to inflationary pressures and lower volumes.

#### Q4 Result

James Hardie maintains its focus on balancing strategic investments in growth initiatives, such as brand marketing and sales support, with profitable share growth. This renewed focus, combined with improved volumes, led to a stronger performance in the fourth quarter. EBIT margins increased by 2% to 29% in North

America (NA), 4.2% to 28.9% in APAC, and 5.2% to 6.7% in Europe compared to Q3.

### Volume Share

The business is taking proactive steps to achieve strong results in this challenging environment. The company has prioritised volume share, focusing on the repair and remodel (R&R) segment, which represents 65% of volumes.

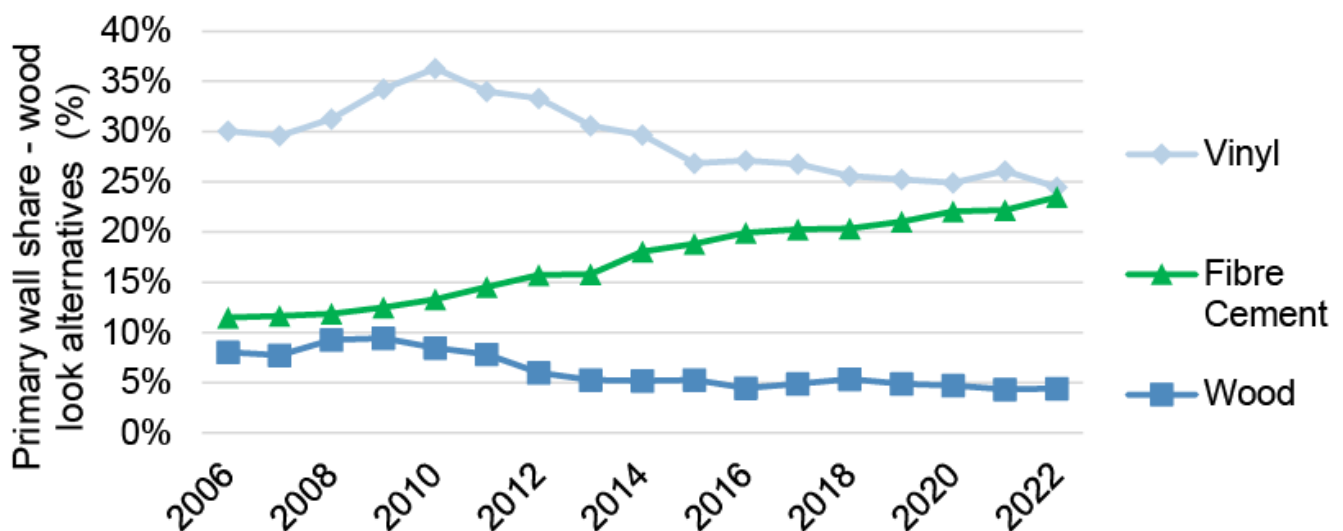
In R&R, James Hardie is delivering innovative solutions to drive price/mix and profitable share. ColorPlus is a core tenet of this strategy, a higher margin product that grew

by 2% in NA despite the 14% volume decline in the region. It remains a key growth lever, with the company using its most knowledgeable sales team to grow share.

In the new construction market, builders are more price sensitive. To address this, James Hardie has reintroduced its lower-priced, generic Cemplank product and plans to use it selectively. The company's primary goal in this challenging environment is to gain market share.

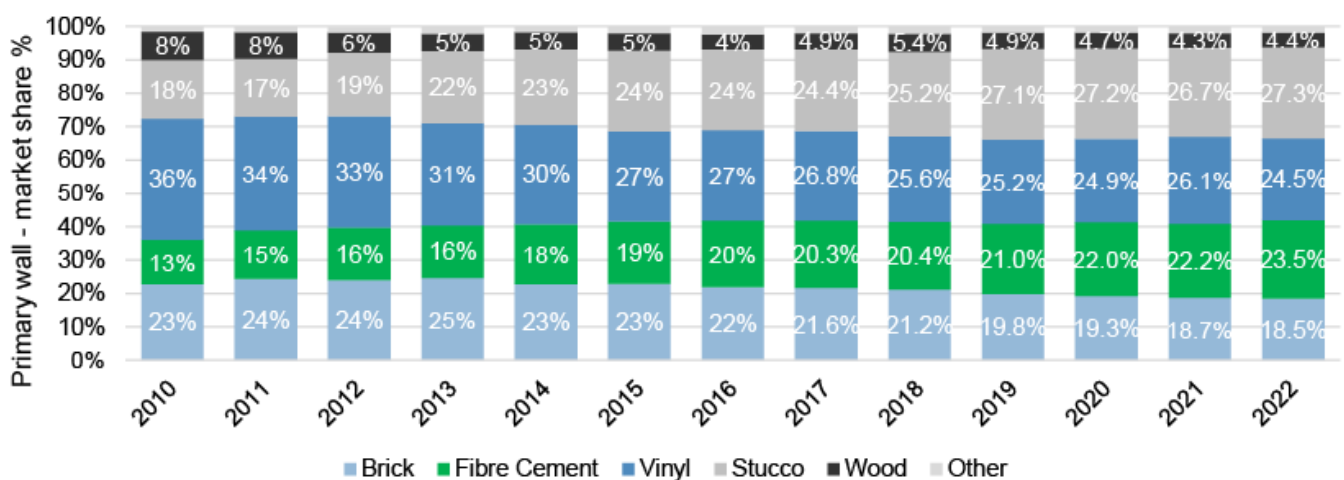
Figure 3 and Figure 4 illustrates the significant market share growth that fibre cement has achieved over time.

Figure 3: Primary wall share of single family homes across 'wood look' material in US



Source: JP Morgan Research

Figure 4: Primary wall market share of single family homes by siding type in US



Source: JP Morgan Research

## Guidance and Outlook

Given the uncertain macro backdrop, James Hardie provided first quarter rather than full year guidance. The group expects Q1 NA volumes of 680-710m square feet, NA EBIT margins of 28-30% and group adjusted net income of US\$145-US\$165m. The expected adjusted net income reflects flat growth at the midpoint compared to the prior comparative period of US\$154.3m.

The company also provided a comprehensive market update, with James Hardie maintaining a slightly more negative view on the U.S. housing market, anticipating a market decline of 14%-19%. Despite the challenging economic conditions, the company aims to outperform the market, benefit from net price improvements, reduce cost per unit, and maintain flat selling, general and administration (SG&A) expenses across all regions.

The company continues to target operating margins above 25% in North America and APAC and mid-single digits in Europe. James Hardie has a market capitalisation of \$17.5b and net debt of \$948m, resulting in a net leverage ratio of 1x. In the interim, the company has opted to replace ordinary dividends with a share buyback program.

## 2. FINEOS Corporation Holdings (ASX:FCL)

FINEOS Corporation has announced a new Tier 1 contract with The Guardian Life Insurance Company of America (Guardian), a leading provider of employee benefits and financial wellness solutions in the U.S. The five-year agreement covers the full-stack of FINEOS products including AdminSuite, Policy, Billing, Absence and Claims and is expected to deliver first-year revenues of US\$10m to US\$14m.

Guardian Life is owned by Berkshire Life Insurance Company, with a premium pool of US\$4.8b. The company has had a history of in-house platform development, highlighting the significance of this outsourced partnership deal with FINEOS.

The company expects to report revenue closer to the lower end of its current guidance range of €124m-€128m with management remaining focused on delivering free cash flows in the second half of FY24.

FINEOS has a market capitalisation of \$700m.

## 3. WiseTech Global (ASX:WTC)

There was no material news during the quarter.

## 4. OFX Group (ASX:OFX)

In March, international payment services supplier OFX Group reported its full year 2023 result. Revenue (fee and trading income) increased 42.4% to \$225m and underlying operating profits (EBITDA) grew 40.3% to \$62.4m. The strong growth was driven by the addition of Canadian based FX business, Firma in May 2022. Firma contributed \$59.7m to revenue over the 10 months of ownership (26.5% of revenue).

OFX revenue is comprised of two items;

1. The net margin made on each foreign exchange transaction completed, otherwise known as Net Operating Income (NOI) and;
2. Associated income earned through the transaction process (treasury revenue).

For the year NOI increased 45.6% to \$214.1m, supported by stable group average transaction values (ATV) of \$29,100 (+3.6%) and double-digit transaction volume growth to 1.34m (+13.8%). Total turnover for FY23 was \$39.1b, up 17.9%.

Importantly, OFX has been able to expand its average NOI margin on all foreign exchange transactions from 0.44% to 0.55%. Of this, 0.05% (45% of the increase) came from the Firma acquisition, with the remaining improvement reflecting the company's growing pricing power and business scale, and benefits flowing from a focus on customer service and risk management.

OFX ended the full year in a solid financial position with \$67m of available cash and total debt of \$65m. Bad and doubtful debts were \$2.5m, representing 1.2% of revenue, sitting below historical levels of 2%-3%. Management noted the majority of provisions are in North America, driven by U.S. and Canadian banking structures.

## Segment Performance

### Corporate (59% of revenue)

OFX's decision to focus more on the B2B (business to business) segment three years ago is paying off with the group benefiting from a growing customer base which are less sensitive to changing economic conditions and transact more frequently than the high value consumer segment.

For the year, Corporate (ex Firma) grew 11.1% to \$124.6m, driven by the number of transactions per active client increasing 7.9% to 24.5 transactions,

partially offset by ATV (ex Firma) declining 3.3% to \$31,900.

With the integration of Firma complete, management have turned its focus on growing the portion of digital transactions, currently representing approximately 6% of Firma's revenue. Firma operates a highly personalised offering where most transactions occur over the phone. OFX aims to progressively shift Firma onto the OFX digital platform, introducing additional features to improve and scale the number of transactions undertaken per customer (currently at 17.3 transactions).

### Paytron

In the period the company announced the acquisition of Paytron, a Sydney based payments company that further extends the Group's corporate offering to include a multi-currency card, sitting alongside a fully automated billing, payroll and expense interface. The acquisition remains consistent with the company's ambitions to generate value for corporate customers beyond spot rates. The acquisition was funded through a \$6m upfront investment and up to 11.25m of deferred performance shares tied to development and revenue milestones.

The business was founded in 2020, has a full-time employee base of 19 and transacted over \$1.0b of payments through its network.

### High Value Consumer (34% of revenue)

Consumer remained flat over the period with management pointing to lower asset prices negatively impacting transaction activity. OFX continues to see consumer as an important category for the business given the high recurring revenues and unmet need for clients valuing trust, risk management and simplistic offerings.

Management expects the number of active clients to slowly decline given the decision to prioritise resources towards its corporate offering. Despite this, the consumer segment is expected to deliver single digit revenue growth over the long run.

### Enterprise (3% revenue)

Enterprise activation has been disappointing to date with the group struggling to convert and activate larger customers. As a result, the company has redirected its attention to small and medium sized businesses which can quickly adopt and realise the benefits of OFX's

solution. The company aims to use these smaller customers as case studies for larger prospects.

Over the second half, the pipeline prospects grew from 56 to 67 customers.

### R&D and Outlook

For the period, intangible investments grew 69% to \$17.7m, supporting ongoing improvements to payment capabilities (\$4m), risk and security (\$6.8m) and overall client experience (\$6.9m). The substantial increase reflects OFX's ability to access more talent through internal hiring and outsourcing initiatives.

Platform investment remains a key focus for management to grow its differentiated offering and improve scale. Recent initiatives include bolstering fraud protection through implementing a global customer biometric identification and verification system as well as improving connections to banking partners to enhance flexibility and cost efficiencies.

Longer term, OFX aims to further improve the client onboarding experience, by enhancing the number of services available and providing for a higher number of transactions per client. The acquisition of Paytron is illustrative of this approach.

For the full year 2024 management provided guidance of Net Operating Income (excluding Paytron) of \$225m-\$243m (up 5%-13.5%), core underlying EBITDA (ex Paytron) of \$63m-\$74m (up 1%-18.6%) and intangible investments (excluding Paytron) of \$17m-\$19m (-4% to +7% on FY22).

OFX has a market capitalisation of \$476m and announced a 12 month on-market share buyback program of up to 10% of shares outstanding.

### 5. [carsales.com \(ASX:CAR\)](#)

There was no material news during the quarter.

### Bottom quarterly contributors

#### 1. [SEEK \(ASX:SEK\)](#)

SEEK held its Investor Day in April led by CEO Ian Narev. The event showcased the company's progress in advancing the employment marketplace opportunity across the 'core' ANZ and Asia markets. The company presented a long-term \$2b revenue opportunity by FY28, led by yield growth in ANZ and double-digit growth in Asia. The company expects operating margins to remain above 50%.

In ANZ, SEEK announced an outcome-based pricing model reducing risk for hirers and capturing additional value by utilising the companies advanced matching engine to recommend experienced, suitable candidates. In Asia, the company is implementing a freemium model that was successfully operated by Zhaopin. This can help drive a network effect as volumes from hirers drives higher candidate engagement thereby improving the platform's attractiveness. The move will expand the company's presence in lower wage jobs and generate incremental revenues through optional upgrades for hirers.

SEEK has updated its guidance for FY23, with revenues to reach \$1.25b (down from \$1.26b), while maintaining operating earnings and net profit forecasts of \$560m and \$250m respectively. Additional Investor Day insights can be found in the SFML March Quarterly.

SEEK has a market capitalisation of \$8.6b and net debt of \$1.1b.

## 2. Nanosonics (ASX:NAN)

Nanosonics announced the resignation of CFO McGregor Grant, who served in the role for 12 years. The company has begun the search for a new CFO. There was no other material news during the quarter.

## 3. CSL (ASX:CSL)

In June, CSL provided an update on the impact of foreign currency movements on its FY23 forecast profit. The company now expects a foreign currency headwind of approximately US\$230m-US\$250m, an increase from the previous estimate of US\$175m.

While currencies will fluctuate, the underlying performance of CSL has been strong with the company expecting to report net profit after tax and amortisation (NPATA) at the top of the guidance range of US\$2.7b-US\$2.8b on a constant currency (cc) basis at its full year result in August.

CSL acknowledged the wide range of analyst profit projections for future years and indicated that the

company anticipates growth in NPATA for FY24 of circa 13%-18%, equal to a range of US\$2.9b-US\$3.0b in cc.

CSL has a market capitalisation of \$134.4b.

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

This month, Domino's Pizza Enterprises announced a series of measures aimed at achieving near-term cost savings and improving operational efficiency. As part of these cost initiatives, the company plans to; 1. Exit the loss-making Danish market and close 27 stores in the region, 2. Optimise its corporate store network by closing 65-70 underperforming stores and accelerate refranchising efforts for corporate 'turnaround' stores, 3. Streamline core operations, and 4. Deliver on planned commissary closures in Southeast Asia.

In total, the company expects to deliver annualised cost savings of \$53m-\$59m, with a third of these savings to be passed back to franchisee owners, while incurring one-off costs of \$80m-\$93m in FY23. The proposed closures represent circa 2.0% of the company's current 3,827 store global footprint.

While the company has reported improved same-store sales (SSS) in the current quarter, FY23 SSS remain below the company's medium-term outlook of 3%-6% in annual growth. Organic new store openings for FY23, prior to the store closures, are expected to be +6%-7% with no change to the long-term target of 7,100 stores by 2033.

Domino's has a market capitalisation of \$3.9b.

## 5. Altium (ASX:ALU)

In June, Altium announced that its Non-Executive Chairman of 16 years Sam Weiss would step down by November 2023, subject to a suitable replacement being found, as the company seeks to expand the governance capability and capacity of the Board to support its strategic direction to transform the global electronics industry. Weiss will continue to serve on the Board and retaining a significant personal investment holding of over 1.9m shares, valued at \$70m.



## ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE (ESG)

### ▪ ESG risk of the portfolio

Table 6: SFML ESG Scores

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



## ESG 2.0 Roadmap

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

**Roadmap scorecard**

9 filters applied to each portfolio business

\*Modern Slavery (MS)

The ESG 1.0 Roadmap, developed in-house in 2019, defines ESG issues that may impact companies and applies a score of 1 or 0 for each of the 12 areas under consideration. The ESG 2.0 Roadmap iteration was created in 2021, with changes integrated into our portfolio models thereafter. The ESG 2.0 Roadmap consists of 9 areas under consideration.

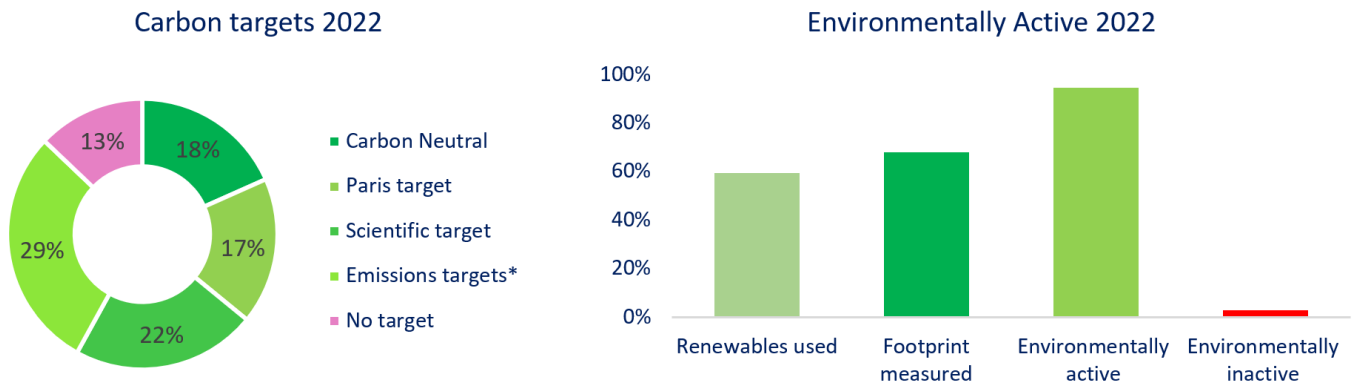
The following is a breakdown of each consideration:

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

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

## Carbon Risk Analysis

Figure 5: Portfolio Reporting 2022



### What we are seeking

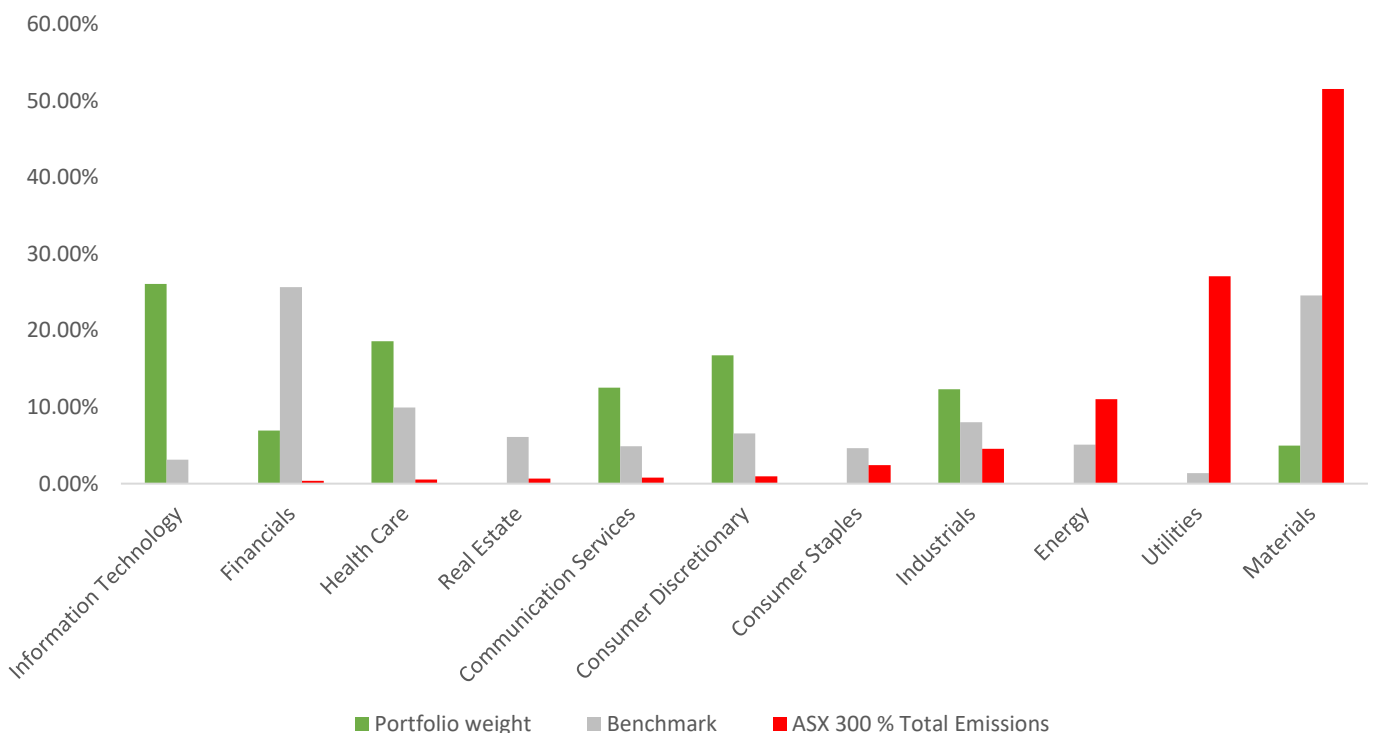
- Paris targets
- Science based targets
- Emissions targets
- Renewable energy targets

### What we are monitoring

- No efforts
- No accountability

Source: SFML Research

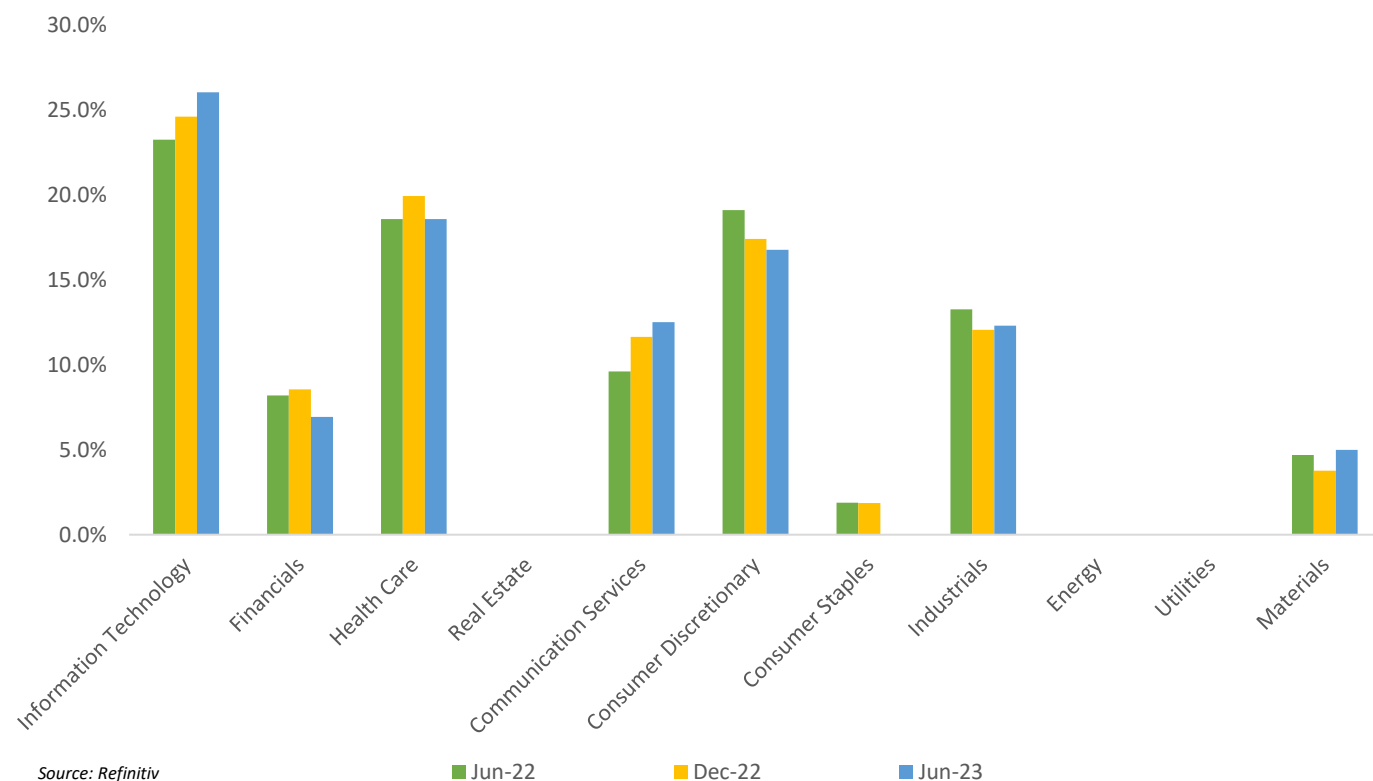
Graph 4: SHCEF vs ASX 300 Carbon Exposure 30 June 2023



\*Estimates based on Refinitiv

Source: Refinitiv

Graph 5: Portfolio Carbon Exposure Periodic Change



Source: Refinitiv

Table 7: SFML Portfolio carbon intensity

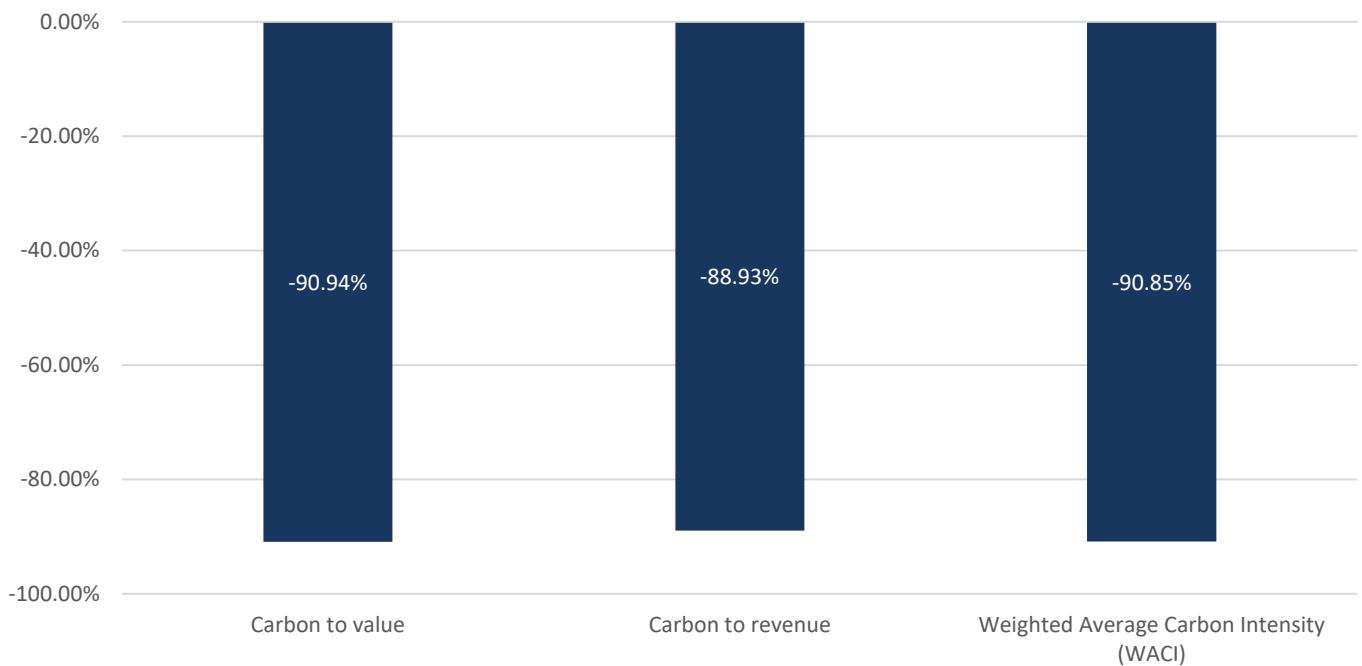
Carbon intensity method <sup>1</sup>	SFML	Benchmark <sup>2</sup>
Carbon to value invested	4.47	49.33
Carbon to revenue	16.88	152.55
Weighted Average Carbon Intensity (WACI)	13.51	147.69

Source: Refinitiv

1. Denominated in tonnes per CO<sub>2</sub>e/AUD\$m
2. Benchmark used is S&P/ASX 300

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

Graph 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 90.94% and 88.93% respectively. SFML's WACI is 90.85% lower than the index, due to no exposure to Energy and Utilities sectors, and low exposure to the Materials sector.

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

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

Source: SFML & Refinitiv Estimated CO<sub>2</sub> Emission data

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

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

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

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

Source: SFML & Refinitiv CO<sub>2</sub> Emission data

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

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

Company	CO <sub>2</sub> Emissions (Tonnes)	NPAT <sup>1</sup> (AUD \$m)	EPS <sup>1</sup> (\$)	Value of Carbon Tax (\$)	Cost of Carbon Tax (\$m)	Impact on NPAT (%)	EPS Post Carbon Tax (\$)
JHX	662,727	621.60	1.98	90	59.65	(9.60%)	1.79
CSL	347,000	3,109.57	6.92	90	31.23	(1.00%)	6.85
REH	60,166	392.49	0.61	90	5.41	(1.38%)	0.60
DMP	52,162	166.73	1.90	90	4.69	(2.82%)	1.85
RWC	47,198	189.52	0.30	90	4.25	(2.24%)	0.29
FLT	33,489	-287.18	-1.44	90	3.01	(1.05%)	-1.42
RMD	23,028	1,074.96	7.89	90	2.07	(0.19%)	7.87
ARB	19,810	122.01	1.49	90	1.78	(1.46%)	1.47
FPH	15,119	355.31	0.61	90	1.36	(0.38%)	0.61
ALL	11,512	948.50	1.67	90	1.04	(0.11%)	1.67

Source: Refinitiv CO2 Emission data

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

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

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

#### ESG incorporation into investment process

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

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

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

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

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

#### ESG incorporation into research

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

This is a risk out process. We are trying to take as much risk off the table as possible before we invest. The key areas of risk we focus on are board and management competency and the culture they are responsible for, business qualities, balance sheet and capital management. We believe a common-sense approach holds that a net cash balance

sheet carries lower risk and more optionality than an optimised or extended balance sheet. We ultimately compare equity risk to a risk-free rate.

Before we invest, we seek to understand which risks a business can control verse those outside its control. For this to be possible, risk must be reported in a consistent and transparent fashion, to avoid any surprises. Here we are considering the possibility of assets becoming stranded (environment) or compromised (Social, Governance, legal, IP, cybersecurity as examples).

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

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

Our approach has been consistent since inception. It is framed by our Roadmap. This template is both qualitative and quantitative in nature, it focuses our research efforts on the aspects of ESG that we hold important in assessing the risk associated with a long-term investment. This internal scoring system is integrated into our financial model.

Our Roadmap provides a repeatable framework that drives our corporate engagement program, our quantitative program of financial modelling including our stock universe data screen, and our structured voting program. It also holds a strong relevance to our portfolio construction.

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

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

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

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

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

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

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

As part of our corporate engagement program, in 2022 we have proposed a sustainable capital management program to businesses we engage with. The ongoing ability to deliver strong ESG outcomes requires long term business sustainability. The model that SFML promotes is a sustainable approach to ongoing re investment into innovation and R&D programs, a sensible payout ratio, and a consistent buyback of shares that drives real EPS growth over the long

term while maintaining a strong balance sheet. These financial elements promote business sustainability that are hallmarks of good financial stewardship including. We have actively discussed this model with:

- carsales.com
  - Fisher & Paykel Healthcare
  - TechnologyOne
  - Cochlear
- **Details of any ESG research sources (internal and external) used during the reporting period.**

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

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

All research is undertaken in house by the Portfolio Managers and investment team. This is an intensive, granular and in-depth approach to continuous learning. We believe this is a differentiated approach that generates strong ESG outcomes.



## TIME TO MOVE ON

The gravitational pull today is all about inflation. No one talks about the Global Financial Crisis (GFC) anymore. Why would they, it was 15 years ago. COVID-19 is just that, a massive misstep in how not to deal with a virus. Now three years on it is becoming a distant memory but the price tag of shutting down the world has left governments reeling with big debt balances and structural challenges.

Now we have inflation, today's focal point. In truth, it has already passed peak and becoming yesterday's story. Investors who continue to focus on inflation and interest rates are failing to join the dots.

When the various central bank governors, be it Jerome Powell of the U.S. or Australia's own Philip Lowe, can command and dominate front page media headlines alongside endless interviews, you know you are past peak.

The share market equivalent is the bell hop or taxi driver, or more likely your Uber, giving you stock tips. At such times, it is a point of peak frenzy, just like the GFC and COVID.

Those who choose to take cover now or take the conservative investment route of sitting in cash for fear

of such trends continuing are reacting to the past, rather than setting forth into the future.

As the Wall Street Journal concluded in its July article and before the latest release of the U.S. Consumer Price Index (CPI) for June, *"Measure It Differently, and Inflation is Behind Us"*.

As James MacKintosh wrote, if the U.S. Federal Reserve measured price changes the way Europe does, core inflation would have already been below 3% and dropping further in June. Instead, measured in U.S. terms, core inflation sat far higher at 4.8%.

Why the discrepancy? The main reason between Europe and the U.S. methods is based on, *"the imaginary cost of what a homeowner would pay to rent their house, which makes up about a third of the U.S. core CPI. Known as 'owners' equivalent rent' or imputed rent, the measure has long had its critics. Exclude something that no one actually pays, and the weight of which in the index is calculated from guesses by homeowners of the rental value of their house, and core inflation is looking basically fine, at just 2.3%."*

Figure 6 illustrates this point graphically, focusing on the Core HICP and its equivalent to how Europe calculates inflation.

Figure 6: Measuring inflation Differently

### Measuring Inflation Differently

U.S. year-on-year inflation rate



Note: CPI is consumer price index, PCE personal consumption expenditure price index, HICP harmonized index of consumer prices. CPI, HICP through June, PCE through May.

Sources: Bureau of Labor Statistics (HICP), Federal Reserve Bank of St. Louis (PCE, CPI)

Source: Wall Street Journal 12 July 2023

Determining interest rate settings on such flawed outcomes leads to unintended biases, only compounded by the hype and media attention that follows.

Fast forward from here, inflation will likely become a rear vision event. What will follow, is likely to surprise more, low inflation, subdued global growth and investors

focused on identifying those exceptional businesses that can deliver real earnings per share growth, in a far more competitive market.

Inflation may have been a short-term global shock event, but it is now time to move on. **SFM**

## THIS IS IMPORTANT

*“Unfortunately, a highly leveraged economy can unwittingly be sitting with its back at the edge of a financial cliff for many years before chance and circumstances provoke a crisis of confidence that pushes it off.” – Carmen M. Reinhart & Kenneth S. Rogoff, authors of *This Time is Different*.*

In our March 2023 Selector Quarterly Newsletter, we discussed the role of debt and credit in the economic cycle. We shared insights from Ray Dalio, founder of hedge fund Bridgewater Associates, on his template of *How the Economic Machine Works*.

In May 2023, at the Berkshire Hathaway AGM, Vice Chairman Charlie Munger said in response to a question on the current situation surrounding the U.S. debt ceiling outlook, *“If you keep printing and spending money it will eventually cause bad trouble. I think we will pay a price if*

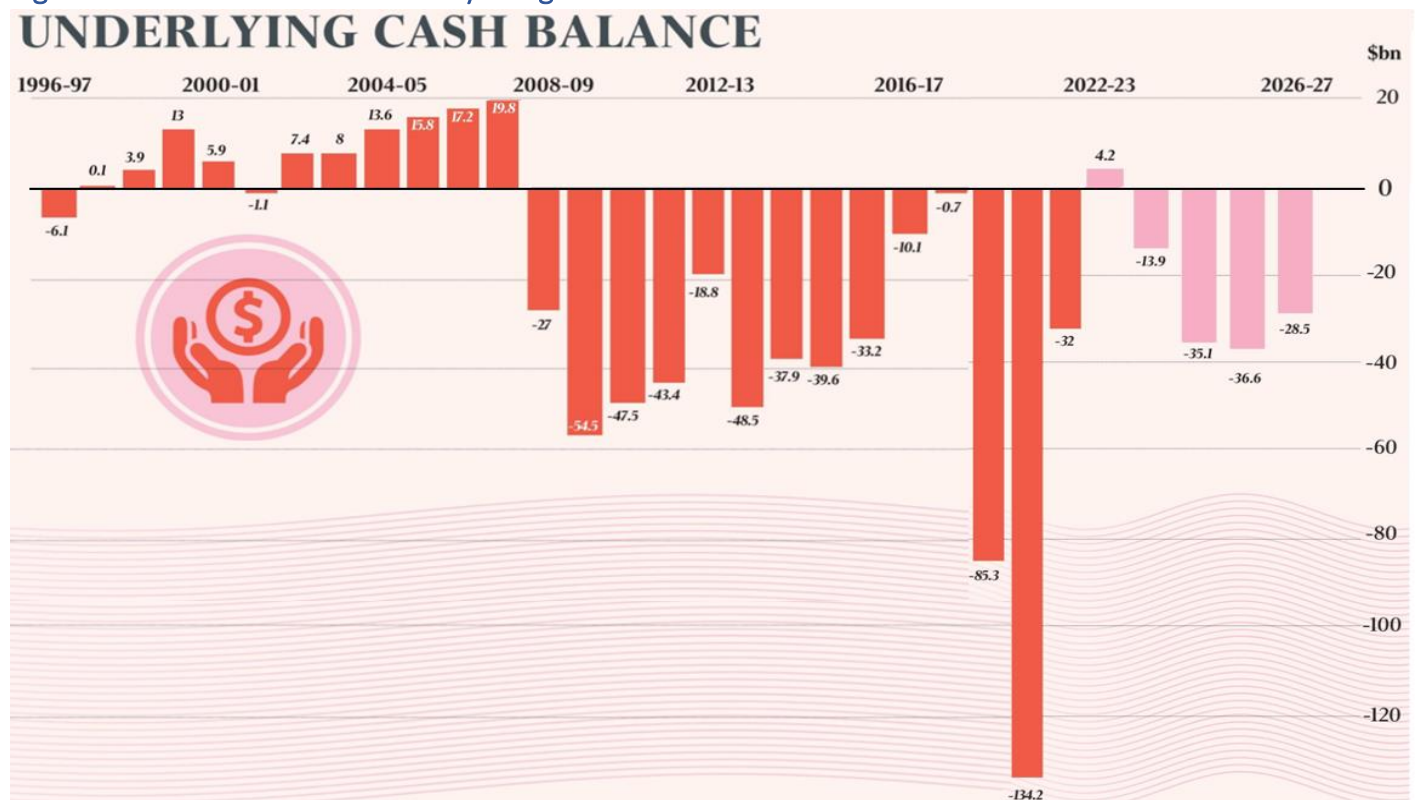
*we give up our old ways entirely and go to a new world where we just print money to make it easier to get through the year”.*

### Inflection point

We are not one to make big calls; that is not our style. What we aim to do is to build on our learnings from our time in the market. And looking back over the decades, what is most evident is the significant impact debt crises’ have on businesses and economies.

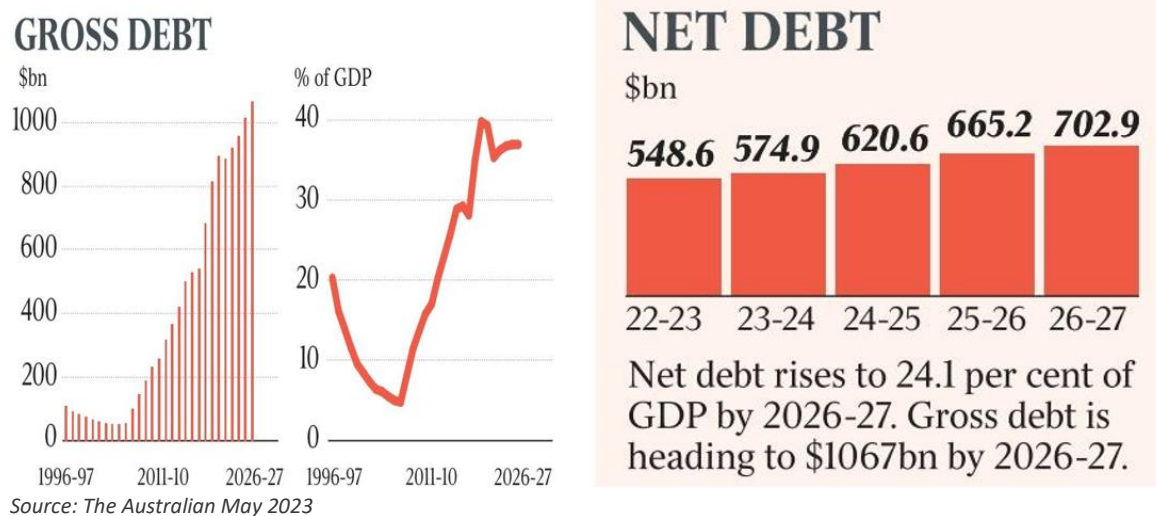
When our government handed down its annual Budget in May, it reported a small surplus, the first in many years. However, the forward-looking numbers were less comforting. As [Figure 7](#) highlights, the government is projecting annual budget deficits in the outer years of 2026-27.

Figure 7: Federal Government May Budget 2023



Source: The Australian May 2023

Figure 8: Australia Gross and Net Debt



Equally, the country's gross debt position is forecast to rise from current levels and above \$1.0t, representing a figure just shy of 40% of Australia's Gross Domestic Product (GDP). On a net debt basis, the number is lower and budgeted to hit \$703b by 2026-27, although the annual direction is still heading upwards to 24% of GDP.

While as a nation we are adding to our debt and projecting annual deficits, the situation in the U.S. appears more dire. Figure 8 provides a snapshot of the current situation, with gross debt now nudging the country's-imposed debt ceiling limit of US\$31.4t, equivalent to 117% of the country's GDP.

The U.S. Congressional Budget Office is also projecting ongoing budget deficits in the forward years, as far out as 2033. This paints a picture of ongoing debt concerns.

These figures are not intended to alarm but to educate. As Dalio noted, the economy functions using debt and credit. When undertaken in a sensible fashion, it promotes economic growth. The danger occurs when debt is used as a backstop, without any intention for individuals, corporations, or governments to act sensibly. Munger highlights this concern, "If you keep printing and spending money, it will get you into trouble."

In the book, 'This Time is Different', published in 2009, authors Reinhart and Rogoff trace the world's financial system over eight centuries. What is remarkable is their opening comments (noting they were made 14 years ago).

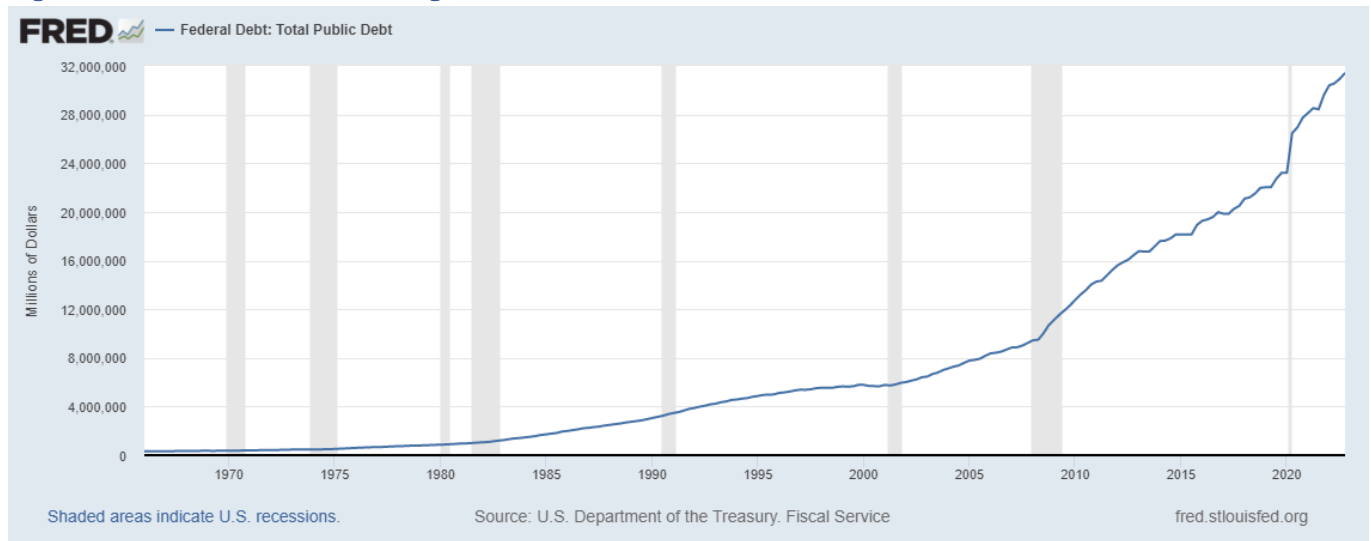
*"If there is one common theme to the vast range of crises we consider in this book, it is that excessive debt*

*accumulation, whether it be by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom. Infusions of cash can make a government look like it is providing greater growth to its economy than it really is. Private sector borrowing binges can inflate housing and stock prices far beyond their long-run sustainable levels, and make banks seem more stable and profitable than they really are. Such large-scale debt buildups pose risks because they make an economy vulnerable to crises of confidence, particularly when debt is short term and needs to be constantly refinanced."*

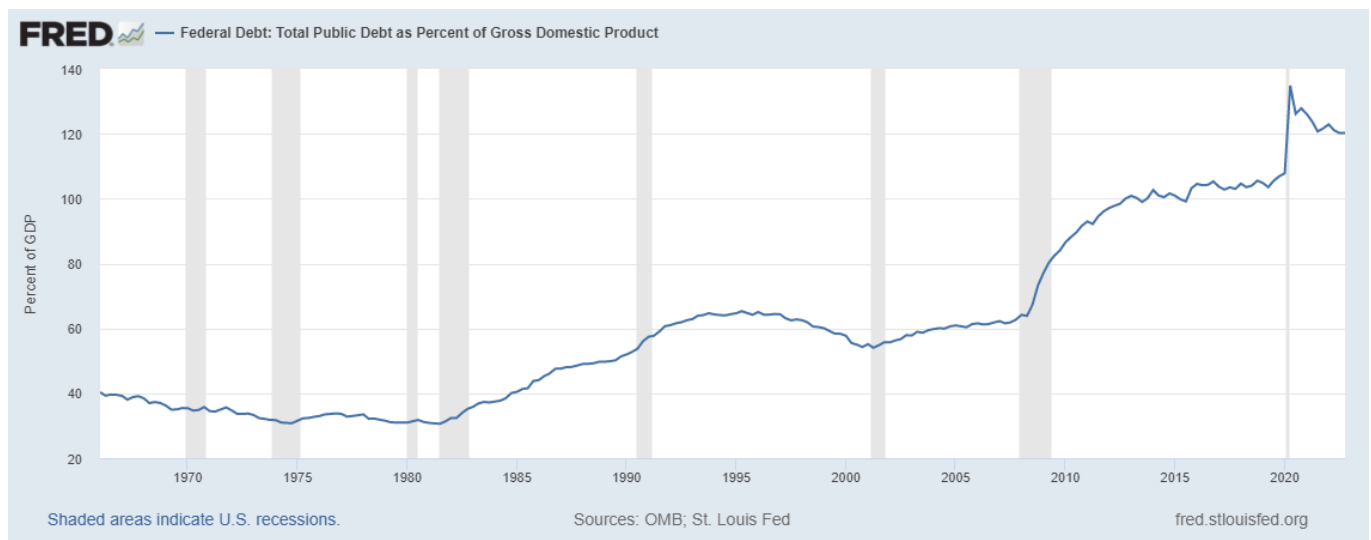
A driving factor leading to debt crises is what the authors refer to as "the fickle nature of confidence" and follows something like this: "Highly indebted governments, banks, or corporations can seem to be merrily rolling along for an extended period, when bang! – confidence collapses, lenders disappear, and a crisis hits."

Banks are never too far away from the action, and it is easy to see why, "Banks traditionally borrow at short term. That is, they borrow in the form of deposits that can be redeemed on relatively short notice. But the loans they make have a far longer maturity and can be difficult to convert into cash on short notice.... A bank with a healthy deposit base and a large portfolio of illiquid loans may well have bright prospects over the long term. However, if for some reason, depositors all try to withdraw their funds at once – say, because of panic based on a false rumour that the bank has lost money gambling on exotic mortgages – trouble ensues."

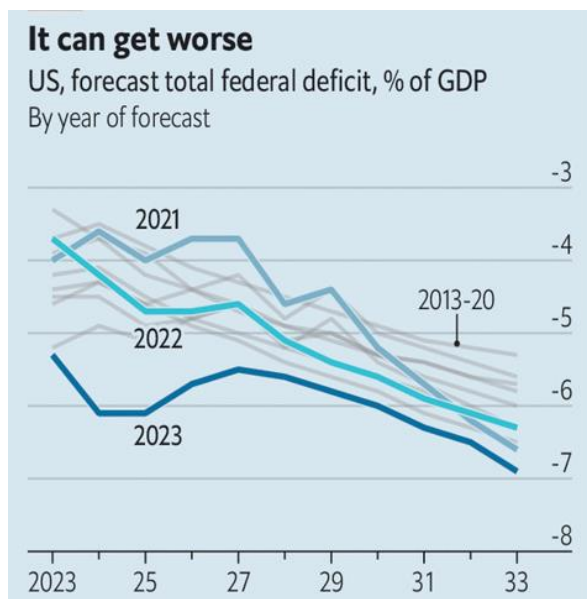
Figure 9: U.S. Gross debt & budget deficits



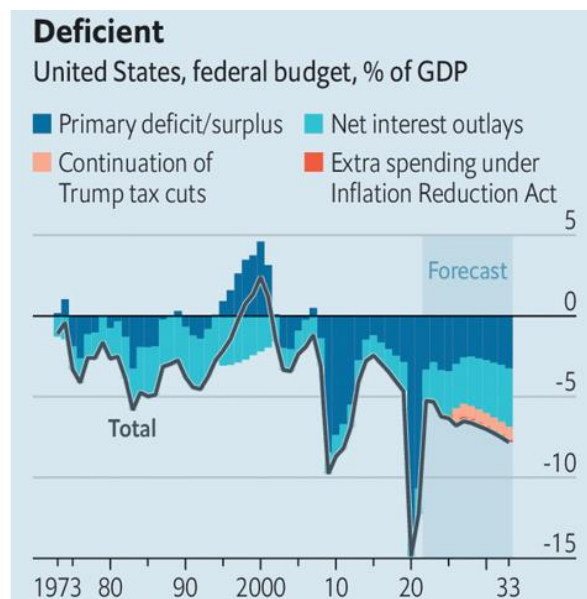
Source: U.S. Department of Treasury Fiscal Services



Source: U.S. Department of Treasury Fiscal Services



Source: Congressional Budget Office; The Economist





## 2023

In March 2023, the U.S. experienced a series of regional bank runs involving Silicon Valley Bank, Signature Bank, and First Republic Bank, resulting in federal regulators shutting down operations or forcing their sales to national players, including JP Morgan Chase & Co.

In Europe, Switzerland's second largest bank Credit Suisse collapsed when nervous clients pulled their deposits and investors began selling out of the listed stock. Despite financial assistance from its central bank, the fate of Credit Suisse was already sealed, and the forced solution was a government-brokered deal to sell the bank to the country's largest banking institution UBS.

Today the situation remains fluid. Speaking on the topic, renowned money manager Stanley Druckenmiller says, *"When you have free money, people do stupid things. When you have free money for 11 years, people do really stupid things. So, there's stuff under the hood, it's starting to emerge. Obviously, the regional banks recently, we had Bed, Bath and Beyond file for bankruptcy. But I would assume there's a lot more bodies coming."*

It would be hard to disagree that these recent events are isolated, considering that since March 2022, the U.S. Federal Reserve has presided over the steepest tightening in interest rates, which has no precedent in recent history. Many, including Druckenmiller, now consider a hard economic landing as the most likely outcome.

And looking further out Druckenmiller is more bearish; the debt ceiling isn't even the main issue, rather the ongoing budget deficits causing a fiscal crisis of ever rising debt levels.

As he describes it, the current attention around U.S. debt ceilings was like focusing on *"whether a 30-foot wave will damage the pier when you know there's a 200-foot tsunami 10 miles...think about it; in 20 or 30 years, there will be fewer young workers, many more seniors that need support...and the starting point is the highest national debt in our history. So, if you believe you will have as comfortable a retirement as the current seniors, think again. If you believe that we will have resources to fight climate change, think again. The arithmetic just doesn't work out."*

This attached video link ([Generational Equity](#)) is one that Druckenmiller gave in September 2013. It is insightful and speaks to the issues that the U.S. Government now faces.

## Taking control

Whether these views prevail, share markets don't always follow the script. Similarly, no business is bulletproof to the economic environment.

The scars of the Global Financial Crisis of 2008 and more recently, COVID-19 should all teach us that taking control is important.

This brings us to balance sheets. There remains a corporate mindset that debt is good, is necessary, and that cash is a dead weight on generating acceptable returns on capital.

It is a nonsense approach that needs dispelling, a view we have shared with company boards and management teams.

External shocks and rapid loss of investor confidence are very real risks at play. A business caught in the crosshairs of this environment, or facing its own internal setbacks is far better placed to tackle these challenges if it is not weighed down by the burden of servicing a debt commitment.

Why is this important? Reinhart and Rogoff shed light in their book, *"Often, however, banking problems arise not from the liability side but from a protracted deterioration in asset quality, be it from a collapse in real estate prices or from increased bankruptcies in the non-financial sector."*

If you extend that thinking to a business, what invariably occurs on the liabilities side is items like inventory, payables or debt can remain largely unchanged or worsen in difficult times. On the asset side the situation is more extreme: when revenues fall off, gross margins are pressured, profit margins contract, and cash levels drop.

In extreme situations, owners are left with the dilemma of cutting costs and placating banks to weather the storm. What may have been a comfortable level of debt during the good years, often defined as a company's leverage ratio (net debt/EBITDA), soon deteriorates as operating profits fall and net debt remains unchanged.

### The 'myth' of the lazy balance sheet

Finance school teaches us that companies should carry debt. Too much debt is dangerous, but too little or none at all is seen as running an 'inefficient' or 'lazy' balance sheet. The fact this myth continues to this day and is still cited by company boards and management teams as a sensible strategy needs to be challenged.

We own companies that carry debt. A few that come to mind include CSL, SEEK, carsales.com, and ResMed. Most of this debt has come from acquisitions undertaken in recent years. The decision to use debt in these instances is sound and we see merit in their respective strategies. But it doesn't mean it comes without risk.

In all instances these companies have robust business models, excellent profit margins, and prudent banking terms to reduce leverage. Importantly, their approach to debt management is a conservative one.

This is best illustrated by healthcare provider ResMed, which has undertaken multiple acquisitions in the past and raised debt before returning to a net cash position in subsequent years. Such an approach strikes us as both sensible and prudent, and typical of a company founder approach.

Contrast this to conventional wisdom that promotes a leveraged balance sheet, often accompanied by high dividend payouts and share buybacks. Optimising a company's financial position to within an inch of its

corporate life is the counterargument of prudence. And yet, many boards embark on such a strategy.

### Cash

We are fond of cash-rich balance sheets, often a by-product of companies with strong market positions and highly scalable business models with excellent profitability.

They also exhibit a simple approach to business life – highly focused in a chosen field, with a discipline to grow organically.

The appeal is not only the wonderful financial metrics that flow, but the business latency provided when things don't go to plan. Having the capacity to deal with inevitable rainy-day events or the ability to pounce on near-term opportunities is an asset, one which is largely under appreciated by the investment community.

Across our portfolio holdings, some 54% of businesses are in a net cash position, while only 14% have a gearing ratio above one times operating profits.

### Comment

When given the opportunity to express a view, we are openly encouraging our management teams to choose the conservative route, by paying down debt, conserving cash, and prudently managing the business to operate across all conditions.

And if Druckenmiller is right in his prediction, such advice may prove invaluable. **SFM**



## GOOD VS BAD BUYBACKS

Not all company buybacks are good. Some in fact lead to bad outcomes driven in part by inappropriate capital management practices that are not in the long-term interests of investors.

In the U.S., buybacks are a normal tool used by companies to manage capital allocation. It is important to understand the nuances of why this practice is more prevalent in the U.S. compared to Australia.

Equity dilution or the issue of new shares is a big factor. In the U.S., a large percentage of an executive's remuneration package is linked to the issue of annual performance equity, which can result in material share capital dilution. To counter that, boards allocate capital to buy back shares, with the intention to minimise dilution while effectively supporting the share price.

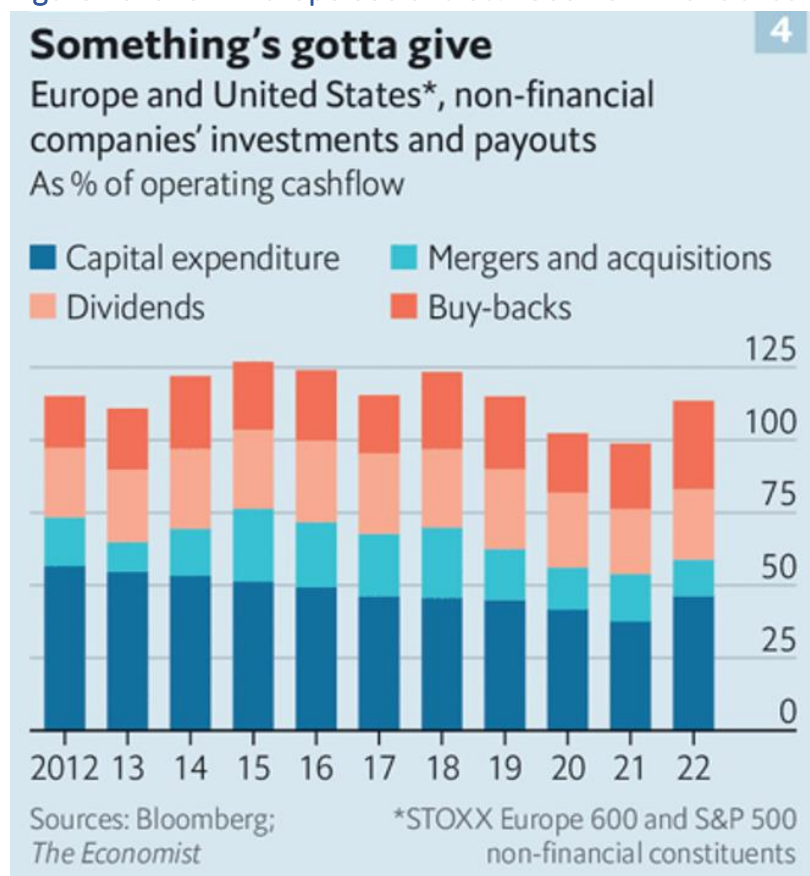
In practice this may be a reasonable approach, noting many U.S. companies are not big dividend payers. The problem we see is the ultimate method of payment. It's

called debt. Many use corporate debt to buy back shares, a bit like *"robbing Peter to pay Paul"*, or the equivalent of paying off one debt to create another.

A company in the position of using existing cash or working within its cash flow envelope should consider buybacks if it does not impinge on the core requirements: business capital expenditure, investment in research and development (R&D), or inorganic activity, including acquisitions. In short, buybacks should be a last resort and undertaken in a conservative, financial manner.

Figure 10 would indicate that for the top non-financial U.S. and Europe companies, undertaking buybacks using debt is now almost a way of life. Over the past decade, it has become 'normal' to spend more than a company's operating cash flow to purchase shares on market. This is best illustrated by the orange bars, which have consistently sat above 100%.

Figure 10: STOXX Europe 600 and S&P 500 non-financial constituents capital allocation



Source: The Economist

As The Economist rightly points out this may have worked in a low interest environment, *“But if they wish to avoid a sustained drag on profitability from higher interest rates, they will soon need to start paying down those obligations. At current debt levels, every percentage-point rise in interest rates will wipe out roughly 4% of the combined earnings of these firms, according to our estimates. Many businesses will have no choice but to cut back on dividends and on share buybacks, which will squeeze investor returns.”*

All this leads us to some interesting observations and discussion points with management.

### Cash is an asset

Conventional financial wisdom would argue that a company carrying net cash is inefficient, under geared, with a “lazy balance sheet”. Nothing could be further from the truth. Over the past decade or so, you could make the argument that holding cash provided little in direct financial returns, with cash rates barely above one percent.

The opposite was also true for debt. Low corporate borrowing rates encouraged executives, operating less than attractive business models, to take on increasing levels of gross debt that could be considered neither prudent nor sensible.

Today, this has flipped. Cash is now more attractive with companies benefiting from higher cash rates. Conversely, debt is now more expensive, not only due to higher borrowing costs but also as a result of the tightening credit supply outlook.

This situation is evident in recent company results, namely OFX Group and Aristocrat Leisure. In both instances, high interest rates earned on internally held cash has resulted in greater levels of interest income, going some way to offset interest expense on borrowed funds.

### OFX Group

In the case of OFX’s full year 2023 results announced in May, the company reported an interest expense of \$5.9m compared to \$717,000 in 2022, as the company took on debt to fund its recent acquisition of Firma.

In contrast, the company’s circa \$84m of company held cash delivered a paltry \$403,000 in interest income in 2022. In 2023, this figure improved to \$3.9m with

management pointing to a further lift in 2024, largely offsetting the group’s interest expense.

This outcome better portrays the group’s conservative management of its balance sheet and underscores why the board also announced an initial 12-month program to undertake an on-market buyback program of up to 10% of company shares.

### Aristocrat Leisure

In a similar vein, Aristocrat Leisure reported for the first half ending March 2023 gross debt of \$2,303m and gross cash of \$2,743m, implying a net cash position of \$440m. Normally this would deliver sufficient interest income to offset interest expense but in 2022 the company reported borrowing costs of \$77.8m and interest income of just \$2.8m.

For the period ending March 2023, the situation had improved with borrowing costs dropping to \$72.7m and interest income climbing to \$48.5m. This example illustrates the dilemma of acting prudently, despite the obvious negative impact it can have on company profitability.

Unlike OFX, Aristocrat has been more active on the buyback front, having originally commenced a \$500m program back in May 2022. The company extended its buyback program this year, purchasing an extra \$500m shares in February 2023, and then in May 2023 when it delivered its half year results.

All up, the company has earmarked \$1.5b of shareholders capital to the program, which is scheduled to end in May 2024.

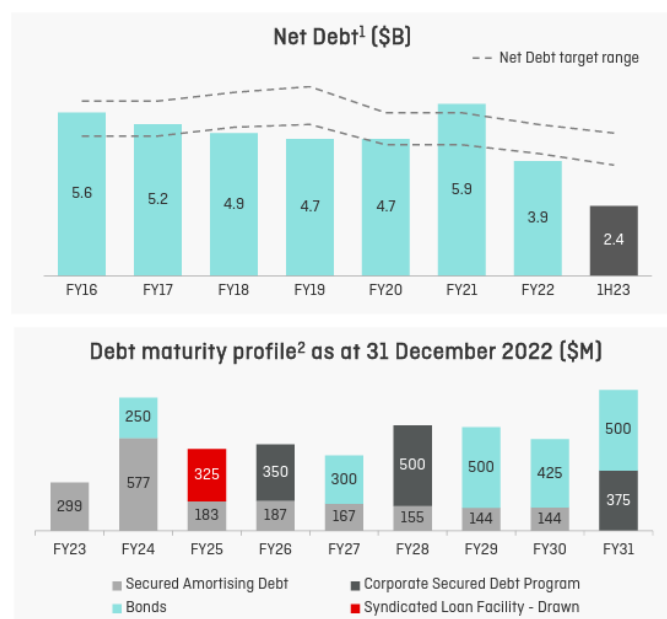
### Qantas

While we are owners of both OFX and Aristocrat Leisure, we are not investors in Qantas. The company weathered the COVID-19 impact, raised \$1.3b in new equity and is now on a better and profitable path.

That confidence saw the company announce a \$400m buyback, followed by an additional \$500m at the group’s February 2023 half year result.

At the time, group net debt stood at \$2.4b, less than the company’s targeted range of \$3.9b to \$4.8b, and a leverage ratio of 2.0x to 2.5x. The return of travel has strengthened the company’s cash flow outlook, but this has led to greater demands on capital expenditure.

**Figure 11: Qantas optimal capital structure**  
Maintaining an optimal capital structure



#### Net Debt

- Net Debt<sup>1</sup> at \$2.4b
- Liquidity of \$5.4b including \$4.1b cash<sup>3</sup> and committed undrawn facilities of \$1.3b maturing in FY24, FY26 and FY27
- Unencumbered asset base >\$4.0b<sup>4</sup>
  - Includes ~\$3.0b of unencumbered aircraft (~54% of the Group fleet<sup>5</sup>), spare engines and other assets

#### Gross Debt Structure

- Reduced >\$1.3b gross debt since FY20 in line with Recovery Plan target
- Balance Sheet settings
  - Minimal refinancing risk across maturity profile
  - Flexibility to prepay secured debt and unencumber assets
- No financial covenants
- Maintained Moody's (Baa2) "stable" investment grade credit rating



1. Net Debt under the Group's Financial Framework includes net on Balance Sheet debt and capitalised aircraft lease liabilities. Capitalised aircraft lease liabilities are measured at fair value at the lease commencement date and remeasured over lease term on a principal and interest basis. Residual value of capitalised aircraft operating lease liability denominated in foreign currency is translated at the long-term exchange rate. For a detailed calculation of the Net Debt target range, please see slide 15 in the Supplementary Presentation. 2. Cash debt face value maturity profile excluding leases. 3. Includes cash and cash equivalents as at 31 December 2022. 4. Includes aircraft valuations based on the Aircraft Value Analysis Company Limited (AVAC) as at 31 December 2022. 5. Based on number of aircraft as at 31 December 2022.

Source: Qantas company presentation material February 2023

In 2023 Qantas lifted full year capital expenditure to \$2.6b-\$2.7b, while in 2024 the company has indicated a likely outlay of \$3.0b-\$3.2b. Over the next five years to 2028, the company has outlined total new committed aircraft delivery expenditure totalling US\$5b (A\$7.6b).

The board's approach in optimising its capital allocation process sits at odds with how we see the world. Rather than holding excess debt, we think it would be more prudent to hold excess cash. Capital expenditure demands are committed and ongoing as the company updates its aging aircraft fleet.

According to Simple Flying, Qantas operates a fleet of 116 aircraft, comprising entirely of Airbus and Boeing. *"The average age of a plane in Qantas' fleet is 15 years — the highest of any major international airline in Australia. For reference, the average age of a plane is around 10-year mark for aircraft belonging to competitors like Cathay Pacific, Emirates and Qatar Airways."*

Maintaining what the company terms *"an optimal capital structure"* (see Figure 11) clearly suggests that management is wedded to having a significant net debt position as part of its capital allocation framework.

However, the recent lesson if there is one to be learnt, is the need for capital flexibility in a world increasingly exposed to external shocks. Under such circumstances it would pay to adopt a more conservative and sensible financial approach.

#### Buybacks

We now have five companies in our investment portfolio undertaking share buybacks: Aristocrat Leisure, Cochlear, James Hardie, Jumbo Interactive, and OFX Group. Only one from the list, James Hardie currently operates with net debt, albeit at a conservative level of less than one times group operating profits.

In addition, the company is committed to the buyback program at the expense of paying dividends and remaining within its cash flow envelope.

Of the remaining four, the adoption of buybacks talks to the financial strength of the respective balance sheets and the flexibility it affords management to consider longer term capital allocation planning.

In the case of Cochlear, the company announced in February its intention to commence *"a progressive on-market share buyback program with the aim of reducing*

*the cash balances to around \$200m over a number of years.”*

The most appealing aspect of this approach is its duration. It is a long-term program that reduces the level of equity on issue while delivering on other capital initiatives including the payment of dividends, *“A progressive buy-back program aligns with the interests of our shareholders by reducing shares on issue, by providing gradual accretion in earnings per share and dividends per share over the long term.”*

### Good vs Bad Buybacks

We titled this article “Good vs Bad Buybacks” for the simple reason that capital allocation decisions are not always conducted in the best interest of the company and by default, its long-term shareholders.

In fact, you could extend that thinking to high dividend payout policies and usage of debt to fulfil these objectives.

When you boil it down, the pain of bad capital allocation decisions are often felt well down the investment track. Companies and boards that are seduced to sustain unrealistic capital allocation obligations in the interim are aiming to please the wrong audience.

The rightful owners are the ones who balance the needs of a business to remain well funded and conservatively run, alongside a capital allocation policy that is sensible, sustainable, and delivers long-term outperformance outcomes.

If you get the mix right, all investors should be happy. A company like Cochlear is close to the mark. It operates a global business with a clear competitive moat, enjoying market leadership benefits.

The company avoids capitalising research and development expenditure (R&D), preferring to fully expense these significant annual investments in the year incurred. During 2023 this is expected to exceed \$200m.

Alongside the R&D investment, the long-term business roadmap requires forward investment across sales, marketing, and general infrastructure. It is a hefty annual bill that impacts short-term profitability. The benefit of this outlay is reflected in the outer years, in the most tangible of ways, with better sales and higher profits.

On delivering to its long-range objectives, the board have landed on a sensible capital allocation policy that is considerate of all shareholders.

The dividend payout ratio has been set at 70%, a little too high for our liking, but reflects the after-tax profit that remains after all expenses have been fully accounted for.

Of the remaining 30%, the introduction of a buyback adds another important component. Its aim will be to use some of the excess cash in a measured way, deployed over years so that it can be incrementally accretive, and in the first instance, *“equivalent to half a percent of shares on issue.”*

### Comment

This approach makes imminent sense to us, a proactive desire to do everything with a long-term founder like mindset.

We can only hope that other companies will consider the merits of this thoughtful approach to what is often an ad-hoc capital allocation process, delivering questionable long-term outcomes. **SFM**

## SIMPLE IS HARD

*“We have a strategic plan. It’s called doing things.”*

When it comes to investing, there is no one-size-fits-all approach. Every time new financial information comes to hand, investors need to connect the dots. But with so much happening beneath the surface, it is difficult for outsiders to fully appreciate what is going on.

This information asymmetry, combined with the current economic and technological impacts, makes investing more challenging than it has ever been. We do not pretend to have the answers; we acknowledge there is a lot we do not know.

So, what gives us the conviction to invest?

Ultimately, it comes down to those in charge, the collective team led by the Chief Executive Officer (CEO).

These roles involve significant personal commitment, carrying immense responsibility and open to ever increasing public scrutiny. CEOs, in particular set the example from a leadership and cultural standpoint. It is not a role for the faint hearted and one we have genuine respect for.

What has remained central to our investment philosophy since day one is the importance we place on having a high-quality management team that we deem trustworthy.

With that said, the challenge for many is being patient enough to allow the team to deliver. Humans tend to place greater emphasis on the here and now, largely at the expense of future prospects.

Microsoft co-founder Bill Gates illustrates this point well, *“We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don’t let yourself be lulled into inaction.”*

The Australian Financial Review recently produced a four-part series on blood plasma company CSL, excellently profiling its history since listing in 1994. The scoreboard would attest that the business has been on a very good path, but simply looking back over the past 29

years to come to that view misses the point. Success is a grind; it takes effort, it requires capital, it involves risk taking, and above all, it takes time.

### Radical Simplicity

A favourite question we ask our leaders is what they are reading. It is both an educational question and one based on curiosity. During our recent investor trip to Europe, one book that came up in conversation was Ken Allen’s autobiography on DHL Express.

Not many would be familiar with its corporate history. Unlike listed rivals United Parcel Services (UPS) and FedEx, the business is housed within another listed entity Deutsche Post. It is nevertheless a remarkable story, drawing on the powerful discipline of attaining simplicity.

Allen describes simplicity as a *“word that articulates many of my favourite things: the idea of something being of humble origins, free of ostentation, uncomplicated, unrestricted, understandable, actionable and of having one main cause”*.

The title of the book *Radical Simplicity* summarises Allen’s perspective on achieving success in business: Keep it simple.

In 1969 DHL Express was founded, and in 1985 Ken Allen joined the business as a Finance Manager in the Middle East office. He has worked extensively across the group’s global operations, troubleshooting when needed and taking on CEO roles in EMEA, Canada, the U.S., and ultimately as DHL Express group leader in 2009, which he held until 2018.

Since then, Allen has been at the helm of DHL’s new eCommerce Solutions division to position the company on e-commerce opportunities across Europe and the world.

In 2002, the business was operating in over 227 countries and territories and was losing €150m a year. In the same year, it was acquired by Deutsche Post and in 2008, buffeted by the Global Financial Crisis, the business delivered a record loss of €2.2b.



***“Being a global CEO can often feel like being a gardener in a cemetery – there are a lot of people underneath you, but none of them are listening.” Ken Allen***

Reflecting on that time, Allen says, *“In 2009, DHL was 40 years old, yet had never been consistently profitable. The bottom line was measured in terms of packages and customers satisfied, rather than on return on assets. DHL focused on customer satisfaction, but never had the financial discipline to convert this satisfaction into profit.”*

Allen’s ability to convert the complex into a simple, concise strategy across all DHL global geographies made him the man for the job. And it proved to be a winning asset, as Allen went on to deliver the most important attribute to success – execution of the plan. Noting that in this instance, 90% of execution relied on getting the over 100,000 DHL employees on board.

In 2009, Allen proceeded to simplify an overly complex business. As he noted, *“Most strategies are like New Year’s resolutions, full of really good intent but no desire or a capability to execute.”*

To achieve success, Allen focused on one simple purpose, *“to build the Greatest International Express Company on the planet”*. Everything the business did would be dedicated to building out the global network and exiting non-core functions. The four pillars fundamental to the strategy became clear to everyone in the organisation, from top to bottom, and included:

1. Motivated People – who will deliver;
2. Loyal Customers – which will result in;
3. Great Service quality – who will drive in;
4. Profitable Network – which will then allow us to reinvest in all of the above.

Over the next ten years, this back-to-basics approach transformed DHL into a powerful and profitable global leader. To be clear, strategy is of no value unless financials follow, being the only true marker of excellence. To that end, Allen pushed profit and loss responsibility down to business units while keeping a centralised network view to extract the best possible value from everything the company undertook.

In 2018, DHL Express made more than €1.9b in operating earnings before interest and tax, generated over €1.0b in free cash flow, and invested €1.0b in capital expenditure.

Such success can be put down to many things, but the power of a focused strategy, communicated effectively and executed throughout an organisation, enabled the turnaround.

As Allen states, *“A key part of leadership is being able to evolve one’s language in a way that empowers people to win. Champion teams and champion companies have their own vocabulary.”*

At its core lies a seemingly simple task.

*“We have a strategic plan. It’s called doing things. Execution is the tough, difficult, daily grind of making sure we are constantly improving our customer intimacy, service quality, people motivation and bottom line. It’s the daily review of performance and the idea of making sure that we have the people and processes in place to out-execute our competition in the marketplace, day in day out. Superb execution is not just about doing the right thing, it’s about doing the right thing faster, better, more often and more productively than our competitors. That is hard work, and it is driven by a high-performance culture.”*

It’s easy to nod in agreement at this and then move on. Ultimately, it’s just words and reviewing companies that have succeeded is like backing winners just after they pass the post. Yes, many have good intentions like Ken Allen and never get their business ‘flywheel’ moving.

But as Gates noted, we have an ability as humans to underestimate progress or success over the long run. Allen succeeded in getting to an inflection point in the business measured not in months or even years but over a decade.

Global Management Consultant A.T. Kearney when reviewing the business gave it the highest praise, *“DHL Express has delivered one of the biggest turnarounds in the history of transportation”*. [Figure 12](#) bears testimony to that, as does the company’s balanced scorecard during Allen’s CEO era.

Figure 12: A.T. Kearney Review of DHL

## Results and Analyst Expectations for DHL Express



## How can DHL Express maintain its momentum in a changing world?

Source: Stifel, Nicolaus & Company analyst report, A.T. Kearney

*“Ken focused the entire company on the single mission of being the premier international express company. That required the company to exit many domestic markets, but also raised the average revenue to the price points attached to international service.*

*The higher yield drove higher earnings that enabled investments in the business, such as new planes and sorting facilities. It was a bold move and required a leap of faith. But Ken deftly and quickly led the company through the transformation.*

*And the rapid success gave the organisation confidence that they could maintain the earnings momentum and*

*deal with the next horizon of challenges, like the growth in B2C and heavier shipment weights.*

*The decentralised structure of DHL, which one might think a hindrance to a rapid turnaround, was rather an enabler because of the culture of accountability and innovation.*

*The creativity and commitment of the executive team was amazing. Ken and his team kept raising the bar in healthy increments and the organisation responded.*

*DHL Express quickly developed a cadence of consistent sustainable growth and improvement.” – Jeff Ward, A.T. Kearney, Global Management Consulting.*



Figure 13: DHL Express balanced scorecard 2008-2018

**BALANCED SCORECARD**

<b>Motivated People*</b>		<b>2008</b>	<b>2018</b>
Employee Opinion Survey	Employee Engagement	63%	88%
	Active Leadership	60%	87%
	Customer Focus	72%	91%
	Strategy	56%	88%
	Best Place to Work (Globally)	-	6 <sup>th</sup>
	External HR Awards	-	160
<b>Great Service Quality</b>			
	Transit Time Achievement (All Faults)	94.3	96.1
	Customer Service Awards	-	200
	Days Sales Outstanding (Willingness To Pay)	42	35
<b>Loyal Customers</b>			
	Market Share (TDI)	29%	38.1%
	Net Promoter Score	-	32
<b>Profitable Network</b>			
	EBIT	(€2.2bn)	€1.95bn

\*Based on our annual employee opinion survey

Source: Radical Simplicity, Ken Allen

**Creating simplicity is hard**

Apple's Co-Founder Steven Jobs walked, talked, and executed on creating simplicity and beauty, but openly communicated the extraordinarily difficult task of achieving such levels, *"Simple can be harder than complex: you have to work hard to get your thinking clean to make it simple. But it's worth it in the end because once you get there, you can move mountains."*

**Our take**

This year the Selector business celebrated its twentieth year of operation. Our investment philosophy has evolved, becoming clearer and simpler. This has reinforced the power of what a business can achieve

over the long run, when led by extraordinary individuals who embody qualities that Allen possesses; that strive for leadership, set clear goals, and deliver on financial targets.

Our track record is to identify and invest for the long haul. Since 2003 our flagship fund, the Selector High Conviction Equity Fund, has invested in 89 companies. Over this twenty-year period, nine businesses have been taken over, fifty have been divested, and thirty have remained.

Our portfolio turnover is low; on average only 6.4% of our investment holdings are sold in any one year. We aim to make fewer decisions and invest alongside businesses

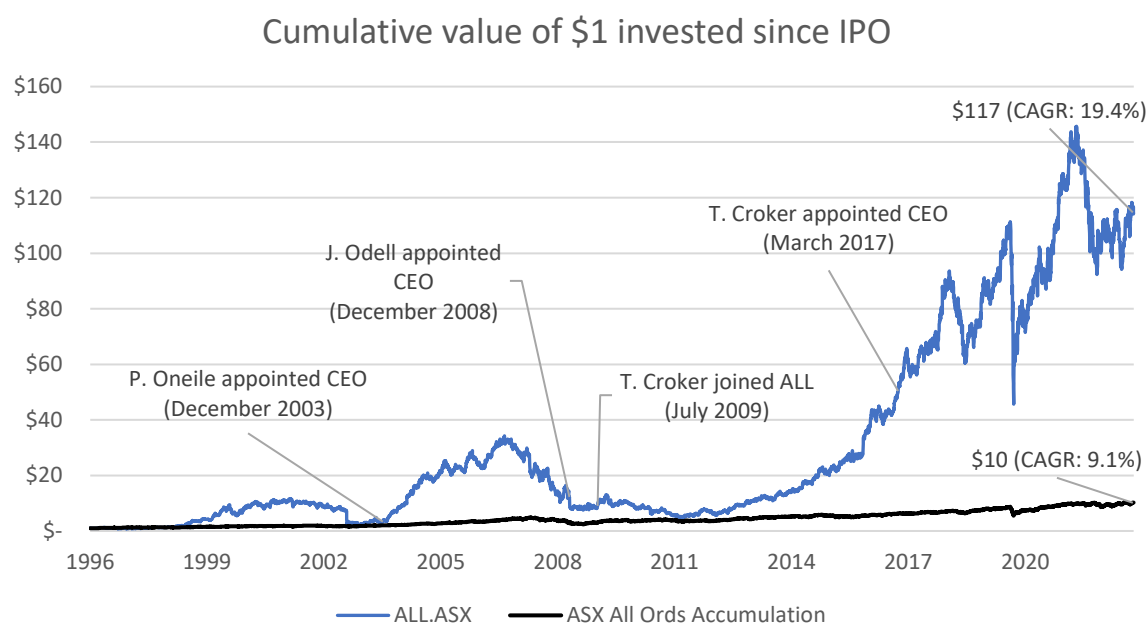
and individuals who want to win and are transparent and culturally aligned in that pursuit. So, it shouldn't surprise that our tenure to hold stocks is long. Today over 60% of the portfolio has been held in businesses stretching over 10 years and 13% over 15 years.

Companies like Aristocrat Leisure, carsales.com, Cochlear, CSL, nib holdings, Reece, ResMed, SEEK, TechnologyOne are a few that make this list. In every

instance, it has been an iterative process and combination of culture, leadership, and financial discipline that has gone on to deliver exponential performance.

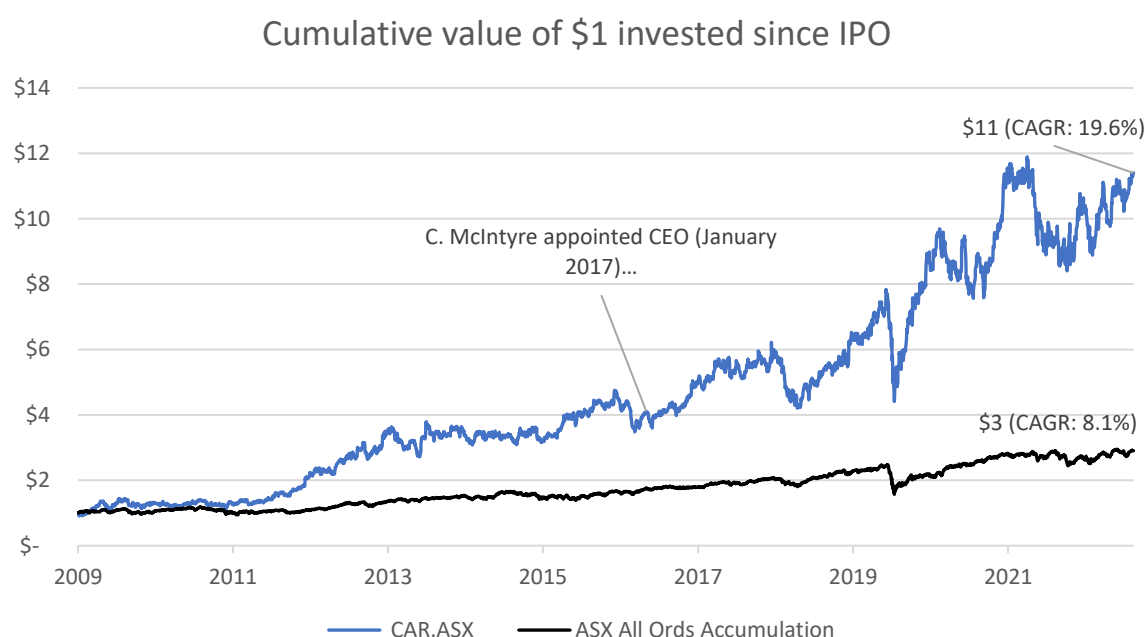
The figures below illustrate the individual share market performances of these companies measured over their respective lifecycle, and compared to our main share market, the All Ordinaries Accumulation Index.

Figure 14: Aristocrat Leisure (1996-2023)



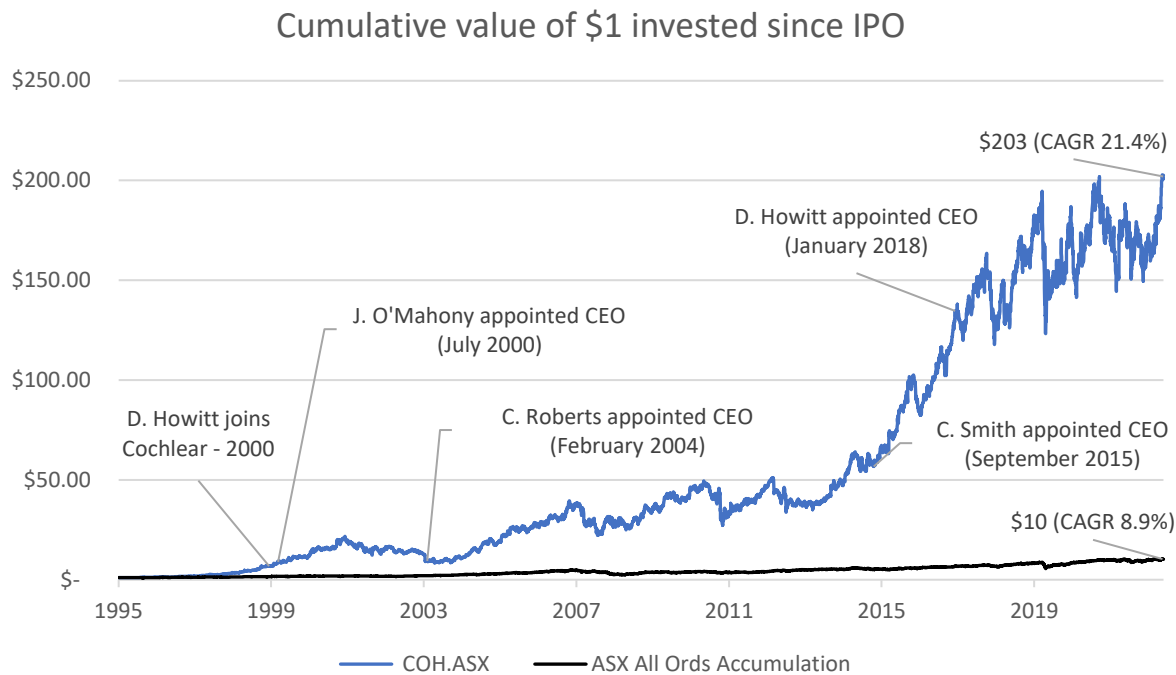
Source: SFML, Refinitiv

Figure 15: carsales.com (2009-2023)



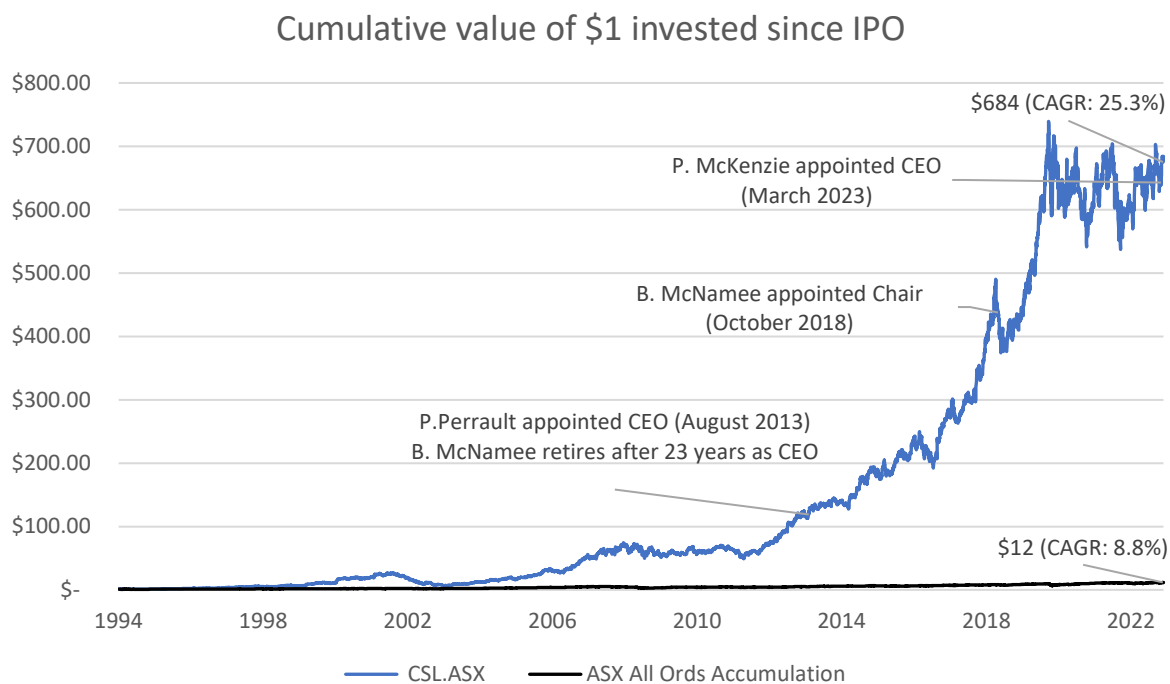
Source: SFML, Refinitiv

Figure 16: Cochlear (1995-2023)



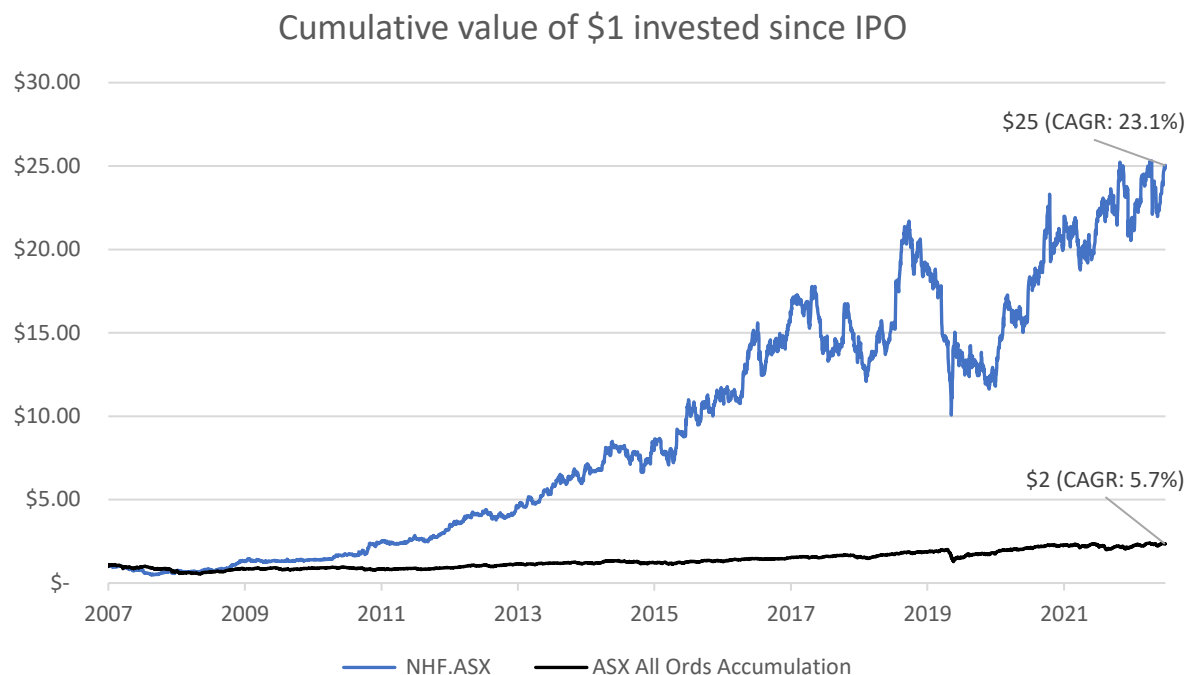
Source: SFML, Refinitiv

Figure 17: CSL (1994-2023)



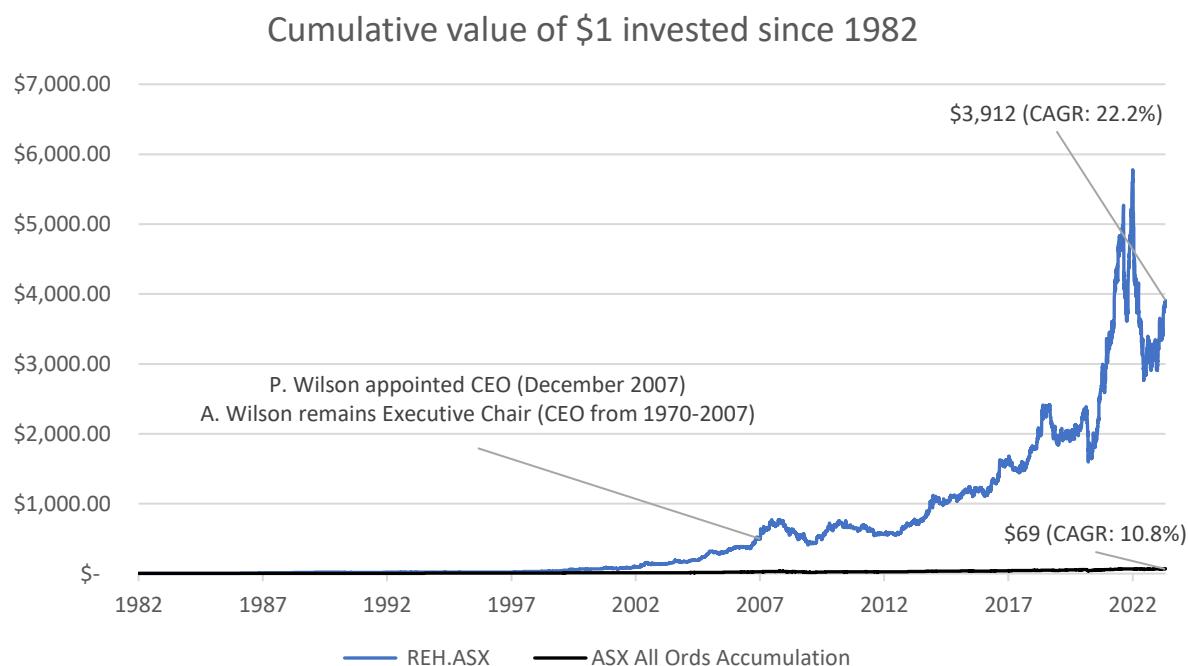
Source: SFML, Refinitiv

Figure 18: nib holdings (2007-2023)



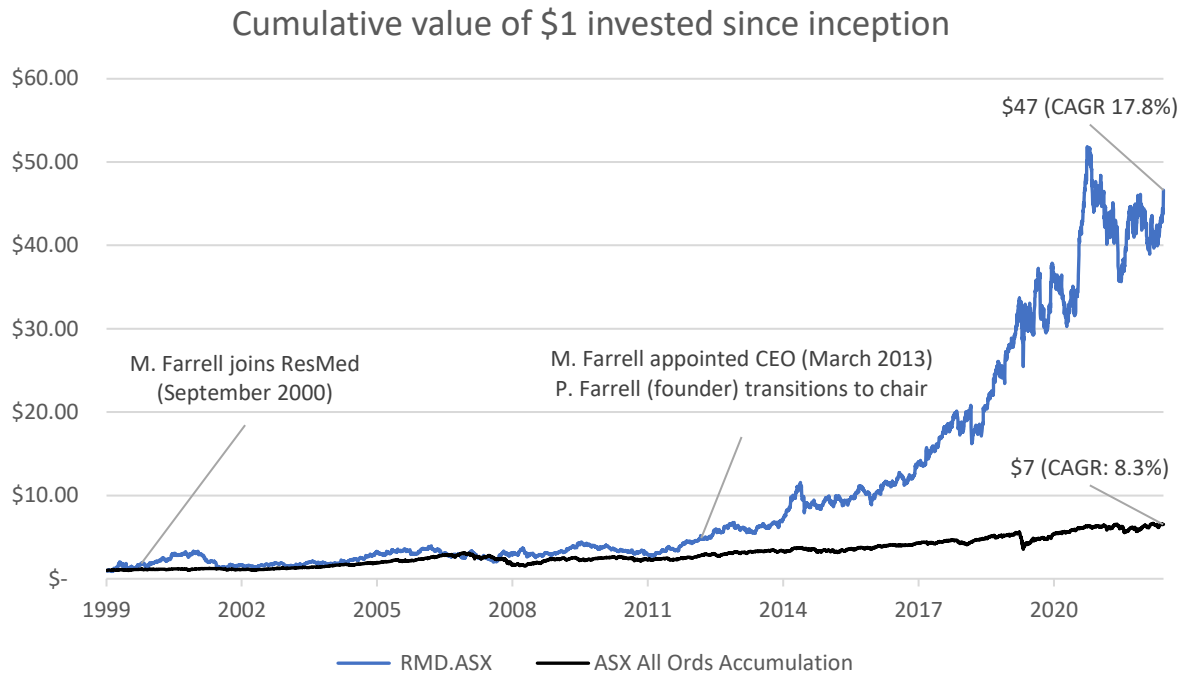
Source: SFML, Refinitiv

Figure 19: Reece (1982-2023)



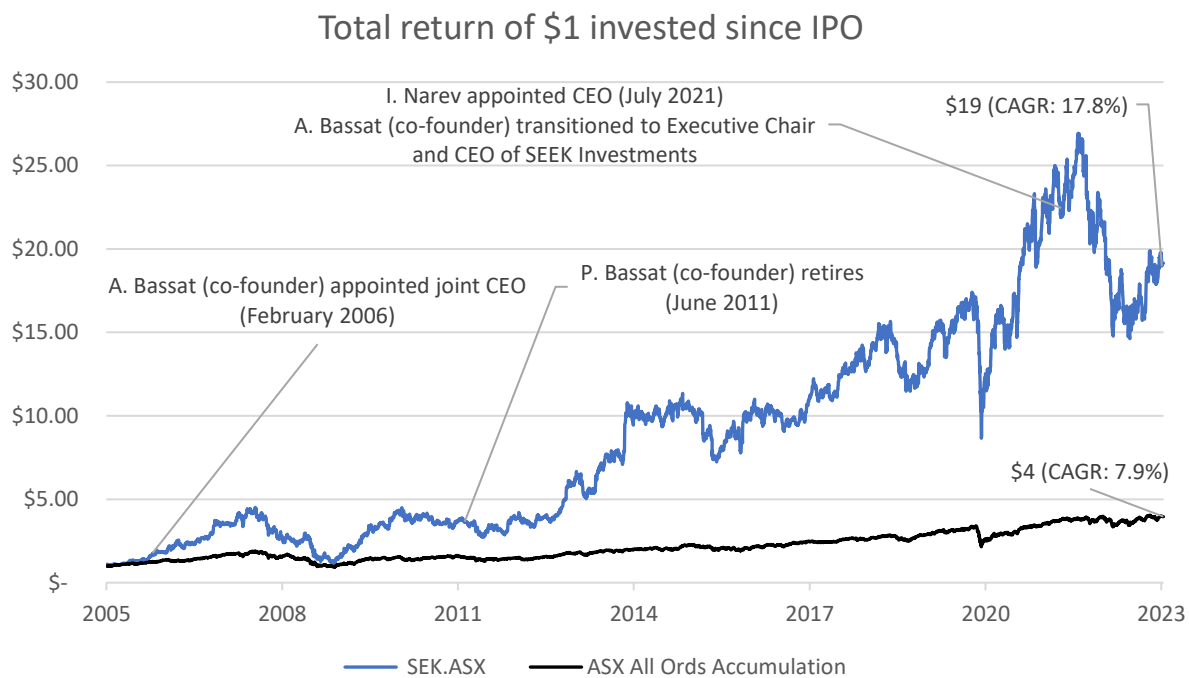
Source: SFML, Refinitiv

Figure 20: ResMed (1999-2023)



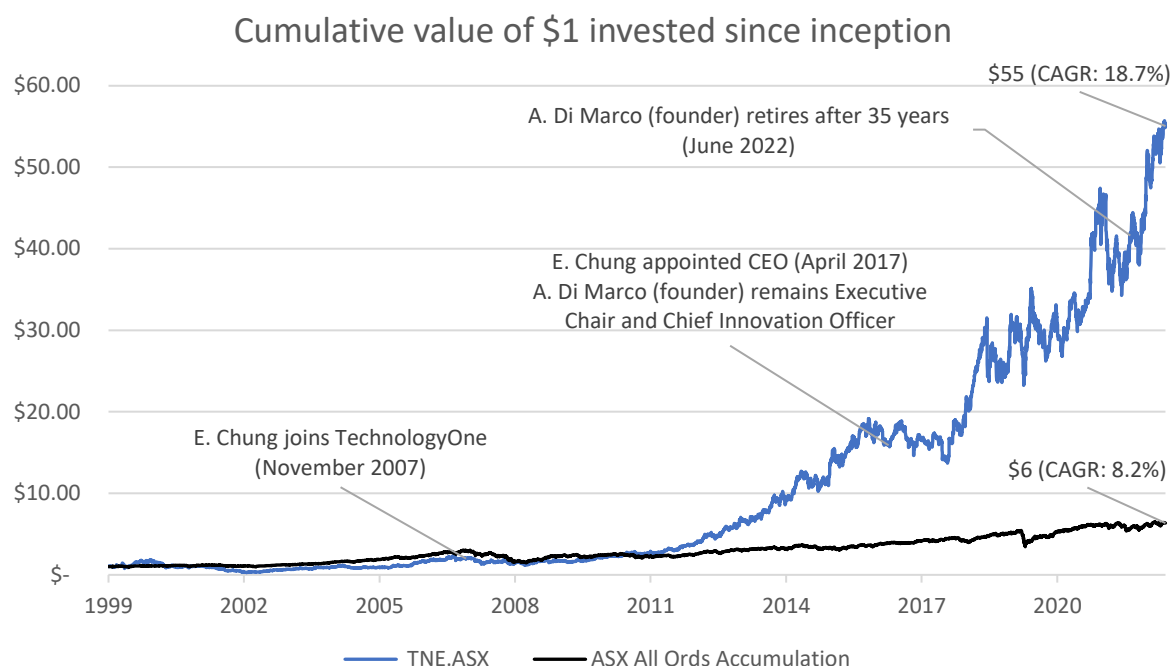
Source: SFML, Refinitiv

Figure 21: SEEK (2005-2023)



Source: SFML, Refinitiv

Figure 22: TechnologyOne (1999-2023)



Source: SFML, Refinitiv

When viewed over a company's lifecycle the progress of each is clear. The companies of ten years ago have morphed, become better, more focused, and more profitable. Importantly, they aspire to grow and invest further in both its people and in servicing the end customer.

Allen rightly noted when looking back over his 35 years at DHL Express, *"In every conversation with a DHL employee, I ask them the same question over and over again, 'How can we make things better – for ourselves, for our customers and for the world?' I believe that no phase in business is truer than 'good is the enemy of great'. A lot of people may say that they want to be great, but don't want to it enough to pay the price. Great results require great effort."*

In our opinion, this last point on seeking greatness separates many businesses and individuals. At the annual Macquarie Australian Conference held in May, we listened to many presenters. One that stood out was Wesfarmers CEO Rob Scott, a former Australian Olympian medallist and now leader of one of this country's largest conglomerate businesses, housing the likes of Bunnings, Kmart, and Officeworks.

If you consider performance in numbers, over a long duration, say twenty years, Wesfarmers has done okay,

having almost quadrupled in value. A similar sized business, Telstra in comparison has done poorly, having largely flat-lined. CSL, a standout performer and one which some may argue is an unfair comparison, has risen close to sixty times over the same period.

When Scott began his presentation to the investor-based audience, he opened with the following, *"Wesfarmers' primary objective is to provide a satisfactory return to shareholders"*.

The word 'satisfactory' conjures up all sorts of responses, but none are overly positive. You could liken it to aiming for a C+ or B- in an exam, but certainly not an A.

The message may be correct, but it speaks more to the challenges this conglomerate of separate businesses faces than management's ability to herd them forward.

In contrast, the similarities between Ken Allen's DHL and CSL are very apparent. CSL operates across several medical disciplines, including blood plasma fractionation, specialty drugs, influenza vaccines, and more recently iron therapies. There is diversity to this offering, but each is striving for global leadership across multiple medical fields.

***“The ability to simplify means to eliminate the unnecessary, so that the necessary may speak.” Hans Hofmann***

It also adopts a winning mentality embodied by the original CEO and now chairman of the company, Brian McNamee. From the company’s public listing in 1994, McNamee has been the driving force, setting the tone and embracing a winning culture to strive for excellence and to expand offshore.

Such an approach was clear in 2000 when McNamee unveiled its first important decision, *“It was the start of the journey. We had already sold off JRH and animal health, so we were narrowing our focus as a company. I kept saying we couldn’t be a diversified conglomerate, we had to focus.”*

McNamee believed in scale efficiency, scale innovation, and globalisation and focused the business in the areas where it could excel. Outgoing CEO Paul Perreault continued that tradition, empathising that CSL took on what others were reluctant to tackle. Case in point was the purchase of Seqirus, and more recently Vifor as he states, *“These are the things that other companies don’t look at.”*

And now incoming CEO Paul McKenzie is reinforcing the company’s long-term commitment, *“That relationship between R&D, operations and commercial is critical to the success of CSL yesterday, today and in the future. We’re on a journey of sustainable and profitable growth. A lot of it is continuing to focus on the key things we need to do – differentiate ourselves as the plasma donor place of choice, continue to drive the efficiency and yield...continue to differentiate our portfolio across all the businesses – be it women’s health with iron or flu differentiation – make sure the Vifor acquisition is successful and that the sum of the parts is more than any individual part...and then we really need to be the promoter of choice.”*

Certainly, what resonates as we travel and visit CSL’s operation in Australia, the U.S., and Europe are its people. There is genuine buy-in and understanding of what is at stake. CSL Plasma general manager, Walter Charles says it best, *“What comes across most compellingly is the humble nature of the Australian culture. It permeates kind of how we operate, how we think about what it is we do, this servant leadership construct of wanting to get after helping patients and making sure that we are singularly focused on that outcome.”*

#### Core message

There is no doubt that individuals like Ken Allen at DHL Express and opportunities to invest in a business like CSL may be rare, but they do exist. Given sufficient time, the ability to transform an average company from good to great is what many investors fail to grasp.

Finding that combination of people, with good business economics founded on returns on capital employed and free cash flow, alongside a healthy dislike of using debt, is a good starting point. A picture paints a thousand words, and as the share price charts above illustrate, these businesses have become stronger, more focused, and more resilient. And many, like online employment leader SEEK have moved further, shedding non-core operations and doubling down efforts on its core strength, that of online employment marketplaces both locally and offshore.

There is a danger when investing of outsmarting yourself. Knowing where the edge of your own smartness lies is an important aspect of applying sensible investing. Ken Allen might even call this type of investing simple. We call it common sense.

We leave the last word to Allen – *“Be yourself because everyone else is taken.”* **SFM**



## PRODUCTIVITY – OR LACK THEREOF

### Paul Krugman – American economist

*“Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”*

*Productivity is commonly defined as a ratio between the output volume and the volume of inputs. In other words, it measures how efficiently production inputs, such as labour and capital, are being used in an economy to produce a given level of output.*

*Productivity is considered a key source of economic growth and competitiveness and, as such, is basic statistical information for many international comparisons and country performance assessments. For example, productivity data are used to investigate the impact of product and labour market regulations on economic performance.*

*Productivity growth constitutes an important element for modelling the productive capacity of economies. It also allows analysts to determine capacity utilisation, which in turn allows one to gauge the position of economies in the business cycle and to forecast economic growth. In addition, production capacity is used to assess demand and inflationary pressures.”*

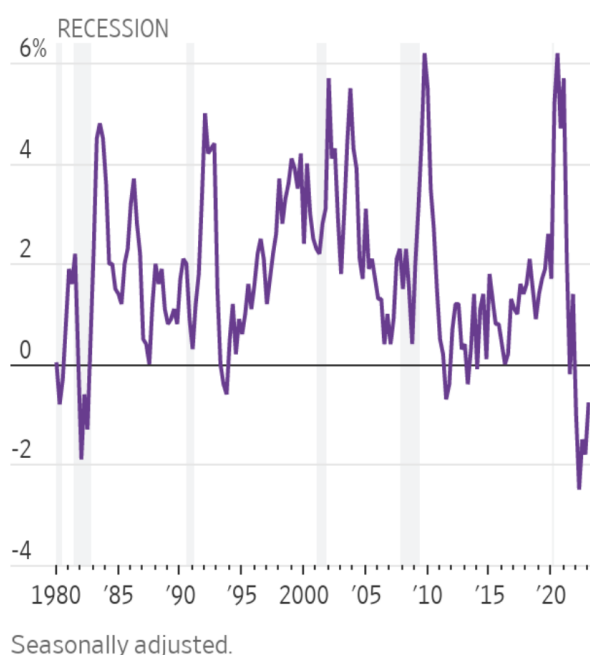
*“One of the most widely used measures of productivity is Gross Domestic Product (GDP) per hour worked. This measure captures the use of labour inputs better than just output per employee.”*

### The U.S.

*In the U.S. the data sets show conflicting outcomes. While employment remains robust it is not translating into economic output. As the Wall Street Journal reported in early June, “The dichotomy emerges from the divergent behaviour of employment and output, two key indicators of economic activity. In May, employers added 339,000 jobs, bringing the total number of jobs added this year to nearly 1.6 million, a gain of 2.5% annualized. But real gross domestic income, a measure of total economic activity, shrank in both the fourth quarter and the first quarter. Two negative quarters of output growth are one indicator of a recession.*

*The economy has gone through periods where output has expanded faster than employment, but seldom the other way around, said Ryan Sweet, chief U.S. economist at Oxford Economics. What explains these dissonant signals is productivity, or output per hour worked: It is cratering.*

Figure 23: Nonfarm business labour productivity



Source: U.S. Labour Department

That raises questions about whether the much-hyped technology adoption during the pandemic and, more recently, artificial intelligence is making a difference. It also raises the risk that the Federal Reserve will have to raise interest rates more to tame inflation.

Labour productivity fell 2.1% in the first quarter from the fourth at an annual rate and was down 0.8% in the first quarter from a year earlier, the Labour Department said Thursday. That is the fifth-straight quarter of negative year-over-year productivity growth — the longest such run since records began in 1948." (See [Figure 23](#)).

While Krugman has spoken about the importance of productivity and GDP as a key measure, another important indicator is Gross Domestic Income (GDI). "Those calculations are derived from gross domestic product, which shows output rising at a 1.3% annualized rate in the first quarter. But another key measure— gross domestic income—declined, implying an even bigger productivity collapse", explains the WSJ.

"GDI is the yin to GDP's yang, measuring incomes earned in wages and profits, while GDP tallies up purchases of

goods and services produced. In theory, the two should be equal since someone's spending is another's income.

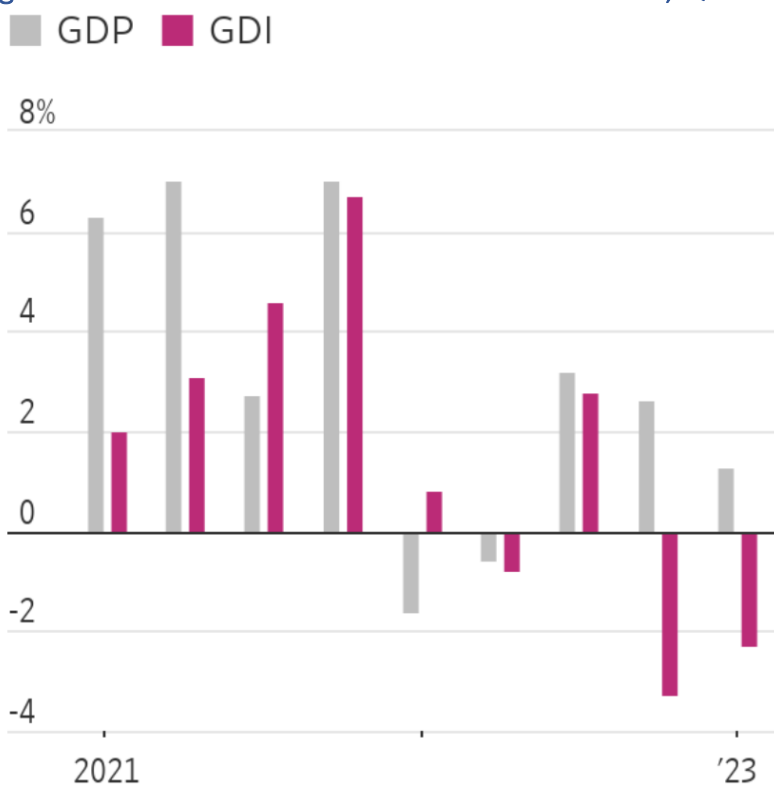
They never exactly match because of statistical challenges. Lately, though, the divergence is dramatic. "Over the past two quarters, real GDP shows the economy expanding by 1.0%, not far off potential growth, whereas GDI shows it contracting by 1.4%, which amounts to a decent-sized recession," said Paul Ashworth, chief U.S. economist at Capital Economics. The divergence is ominous: GDI previously undershot GDP dramatically during the 2007-09 financial crisis and in the early 1990s recession, Ashworth said." (See [Figure 23](#)).

### Australia

The question post COVID-19 is whether the world can deliver higher productivity levels. Our Reserve Bank Governor Philip Lowe has been vocal that without productivity growth, it would be difficult to enjoy a pay rise higher than inflation.

[Figure 25](#) and [Figure 26](#) illustrate Australia's GDP is heading in one direction currently, and the RBA appears determined to maintain this trajectory, despite the rhetoric and need for higher productivity.

**Figure 24: U.S. Gross Domestic Product and Income, Quarterly**



Inflation- and seasonally adjusted annual rate

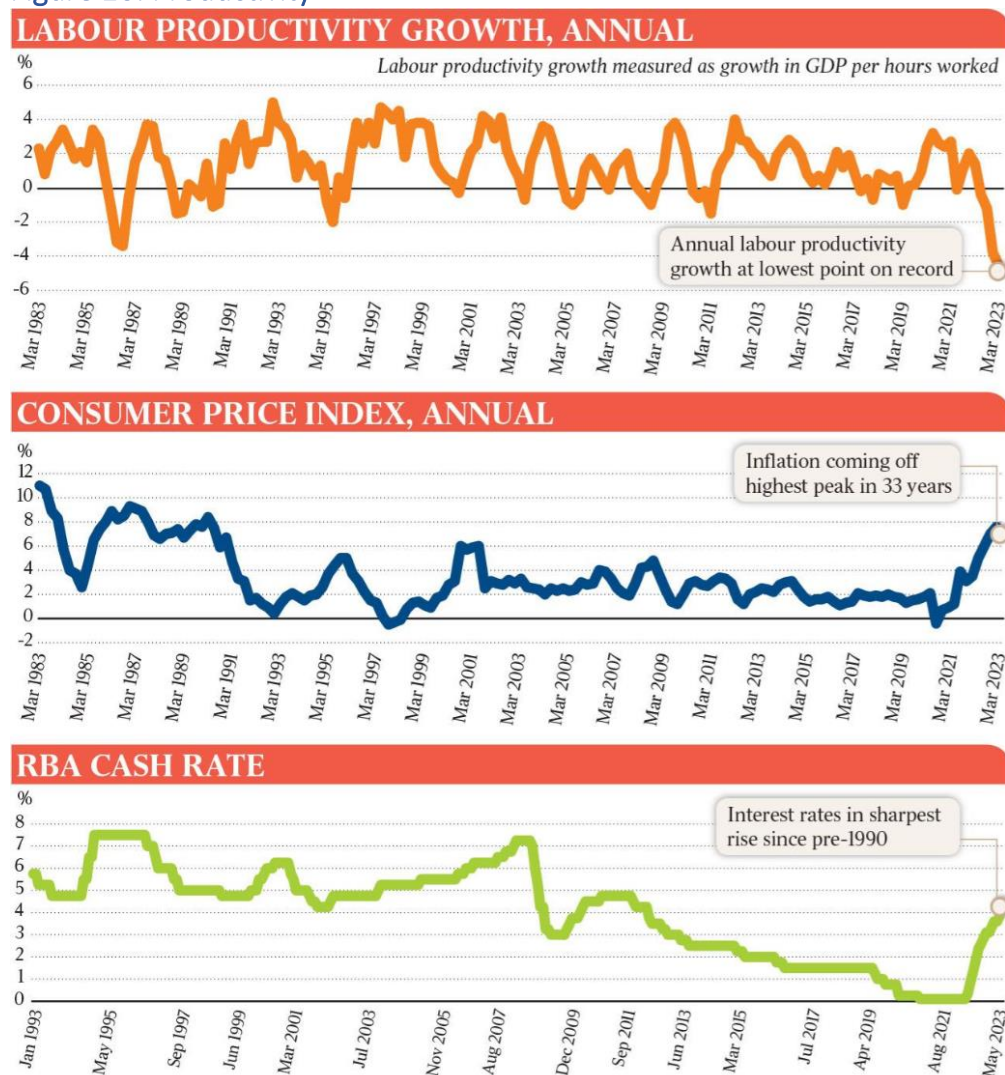
Source: U.S. Commerce Department

Figure 25: Quarterly Gross Domestic Product (GDP) growth



Source: Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product March 2023

Figure 26: Productivity



Source: ABS, RBA

Lowe's concerns regarding productivity were delivered prior to The Fair Work Commission's announcement of a 5.75% lift to the nation's minimum wage level, stating, *"The problem now, is that there has been no increase in the economy's output per hour of work since the pandemic arrived. With productivity growth flatlining, unit labour cost growth has accelerated to 7 per cent in the past year: costs that businesses will seek to recover by putting up prices."*

Adding further to these business imposts, the Reserve Bank saw fit to lift cash rates again in June, from 3.85% to 4.10%, as it continues to ignore the broader economic data, instead preferring to remain utterly fixated on one data point: inflation.

### Fertility

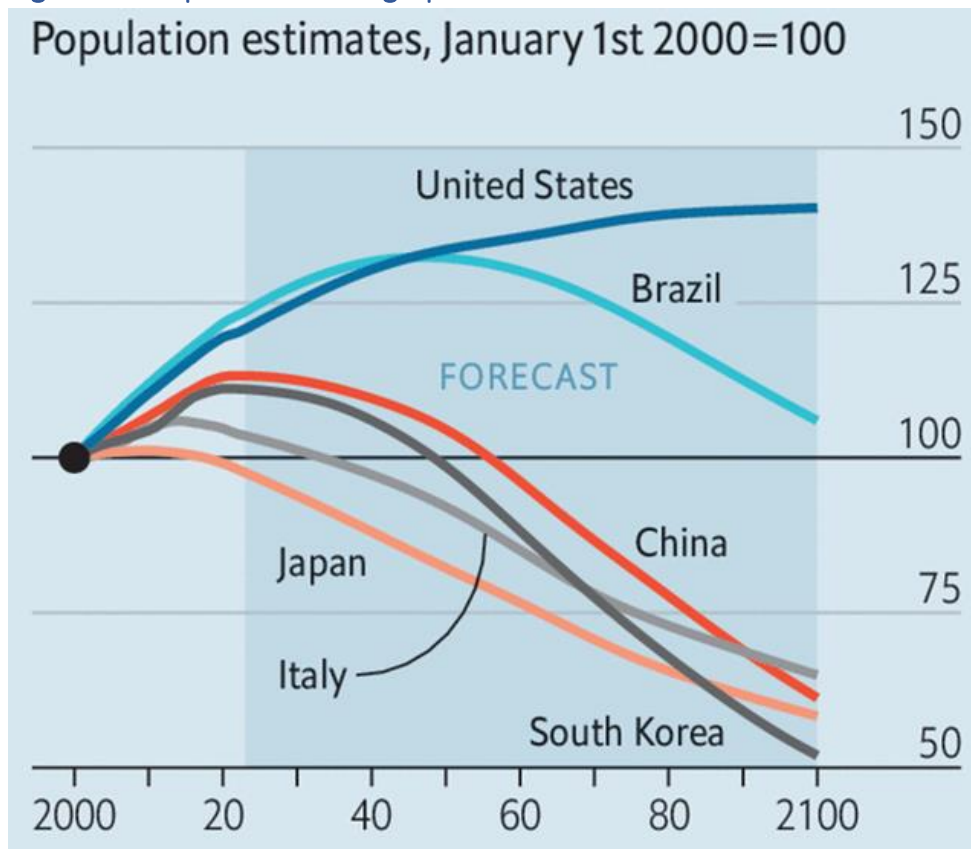
Productivity can also be tied to population demographics. In our December 2022 Quarterly Newsletter, we highlighted that a country's population demographics once in train, is very difficult to derail or fudge, other than through migration.

In Figure 27, The Economist highlighted the expected population trend in certain countries, including the U.S.,

China, and Japan. The baseline starting point was 2000, with the UN Population Division extrapolating out to 2100. The respective country trend lines are clearly negative, suggesting significant challenges ahead for many nations, notably China, Italy, and Japan.

The article states, *"Instead of a population structure shaped like a pyramid, with each new generation bigger than the one that preceded it, or even a pillar, with all generations similar in size, these countries will become inverted pyramids, with older generations replaced by smaller and smaller cohorts. In parts of the world this has already happened: the number of Chinese aged between 21 and 30 has already fallen from 232m at its peak in 2012 to 181m in 2021. The decline will accelerate rapidly in the 2040s, leaving China with fewer than 100m people in the same pool in the mid-2050s. The population of Europe in the same age category will fall from around 85m to below 60m over the same period. The obvious way to compensate for dwindling birth rates is immigration, which is on the rise in much of the rich world, despite the political tensions it has generated in recent years."*

Figure 27: Population Demographics



Source: UN Population Division, The Economist

## Banking - going digital

In June, the Australian Banking Association (ABA) released some interesting banking trends that are likely to surprise a few. Firstly, as the Australian Financial Review (AFR) reported, digital wallet payments have skyrocketed.

*"The value of transactions using cards on smartphones has risen from \$746 million in 2018 to more than \$93 billion in 2022, according to an extract of the ABA research, while the number of cards registered to mobile wallets rose from just over 2 million to 15.3 million over the same period. Customers are now undertaking 98.9 per cent of all bank transactions digitally and report the highest satisfaction using this channel. Meanwhile, branch transactions have fallen 46 per cent in the four years to the end of the 2022 financial year. The ABA report confirmed declining cash use, which now represents just 13 per cent of customer payments by number, down from 70 per cent in 2007."*

Secondly, our banking industry, dominated by the big four institutions, is feeling the force of competitive disruption from newer entrants. Apple's encroachment is causing angst amongst banking CEOs.

Commonwealth Bank CEO Matt Comyn likened Apple's influence in the smartphone market to that of Standard Oil and Microsoft, *"If you think about competition law and antitrust cases over the last 80 years, they have really been framed around gatekeepers, Bell/AT&T: Standard Oil: Microsoft - they would be the three. In this area, I would like to think more regulation is inevitable - you can see what is happening in Europe, in particular -*

*but it is a question of what is the pace of that regulatory change in Australia."*

In 2019, Apple launched its Apple Card in the U.S. with banking partner Goldman Sachs. In April 2023, Apple added a savings account to the mix, also provided by Goldman, with a 4.15% interest rate. Apple took a further dive into the payments space in May, teaming up with Westpac and Tyro in Australia to allow businesses to receive payments from customers with their iPhone rather than through a payment terminal.

The longer-term implications are now front of mind. For starters, banks will be forced to engage with the enemy, in this case, Apple. Then there is the issue of fees, or more precisely the level of fees that banks now must pay Apple for the services provided. Since 2016 when Apple Pay first arrived the AFR reports that its use, *"has allowed Apple to suck up more than \$110 million in revenue each year from Australian Banks. It is an amount only heading in one direction, as smartphone payments surge."*

And for Apple, while everyone is familiar with the sale of iPhones, services revenue now represents US\$80b per annum or roughly 20% of the group's annual revenue base of US\$400b.

It is little wonder that Warren Buffett, at the Berkshire Hathaway 2022 Annual General Meeting held in May 2023, when questioned on the firm's significant shareholding in Apple responded, *"Our criteria for Apple was different than the other businesses we own —it just happens to be a better business than any we own."* **SFM**



## RESMED – A LEADER SCALING NEW HEIGHTS

*“Scale is the key to unleashing the full potential of any idea or innovation.” – Jeff Bezos*

In his aspiration of building the Everything Store, Jeff Bezos’ inherent focus on reinvestment and scale transformed Amazon into the dominant E-commerce player it is today. With its wide selection of goods available for next day delivery at low prices, competitors are all but left to catch up.

Market leaders, such as Amazon, are businesses we seek to invest in as they possess competitive advantages and economies of scale. These companies likely have greater market influence, bargaining power, and profitability. They are often more resilient and can reinvest more to enhance its value proposition.

Another example is ResMed, which we review in this article, a global leader in connected digital solutions for sleep apnea, respiratory care, and out-of-hospital care. The company embodies the qualities that Jim Collins describes as the *“magical alchemy of great results”* developed from the combination of discipline and entrepreneurship, which has led the business to its current leadership position.

### The core

ResMed was founded in 1989 through a management buyout of Baxter's obstructive sleep apnea (OSA) division. Led by Peter Farrell, the company commercialised a prototype for continuous positive airway therapy (CPAP) to treat patients with sleep apnea.

The company grew from humble beginnings, with no staff, manufacturing presence, or revenue to launch from.

More than 30 years on, ResMed has a market capitalisation of US\$32b and generates circa US\$4b revenue across its various segments. The sleep business remains the core earnings driver, with the device and mask still the fundamental method for today's therapy.

### What is Obstructive Sleep Apnea (OSA)

OSA is a prevalent sleep disorder characterised by the partial or complete blockage of the upper airway leading to abnormal breathing. Symptoms include snoring and excessive sleepiness. If left untreated, OSA can cause serious health complications, including cardiovascular disease, diabetes, and mental health issues.

The severity of OSA is determined using the apnea-hypopnea index (AHI), which measures the average number of breathing disruptions per hour of sleep. There are three categories: mild, moderate, and severe. [Table 11](#) provides a breakdown of this.

**Table 11: AHI Index**

Severity of OSA	Number of breathing events per hour
Mild	5-14
Moderate	15-30
Severe	>30

*Source: Sleep Foundation*

Moderate OSA is characterised by an AHI of more than 15 per hour, meaning the patient stops breathing for over 10 seconds at least once every four minutes. Individuals with moderate to severe OSA are considered clinically significant, as they are more likely to have a diminished quality of life.

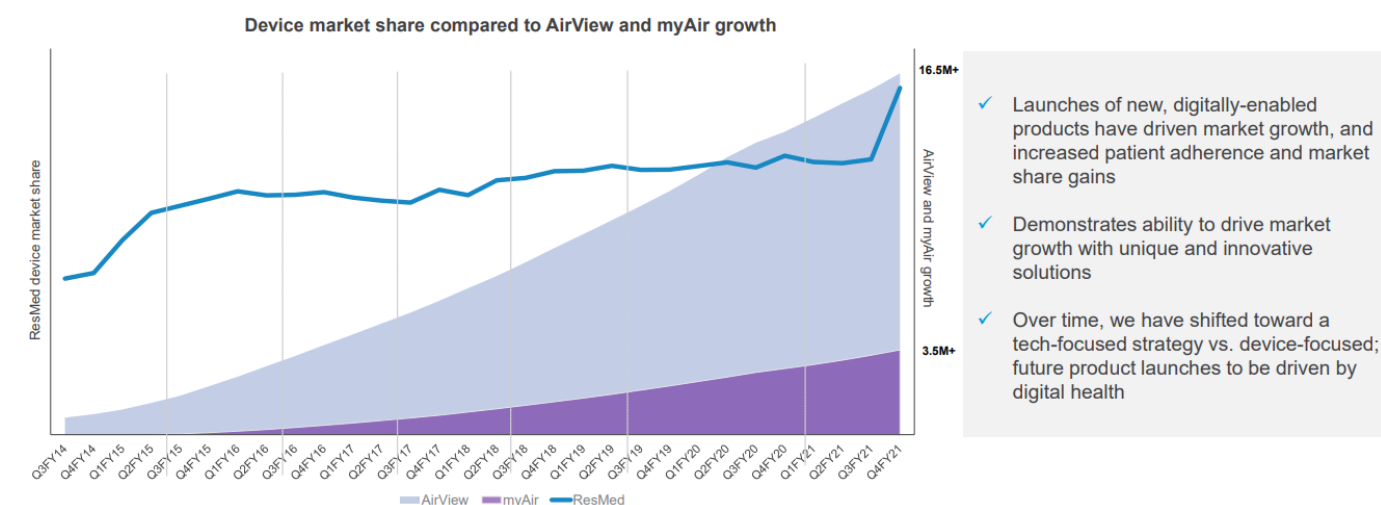
According to a 2019 Lancet study, approximately 936m people between the ages of 30 and 69 worldwide are estimated to have some form of sleep apnea. 425m fall into this moderate to severe category. The opportunity is significant, with over 80% of sleep apnea sufferers left undiagnosed.

Continuous positive airway pressure (CPAP) therapy is the recommended treatment for individuals with sleep-related breathing issues. It involves administering a constant level of pressure to the patient through a machine and discreet mask. ResMed is the leader in CPAP and is investing to drive greater adoption.



Figure 28: Device Market Share

## Shift to digitally-enabled treatment has fueled growth



Source: ResMed 2021 Investor Day

### Industry Landscape

The CPAP market is highly concentrated; within devices, ResMed and Philips Respironics held an estimated 60% and 30% share respectively pre-COVID. ResMed has seen consistent growth in market share, as depicted in Figure 28. Fisher & Paykel Healthcare is another reputable player competing in the masks category.

In June 2021, ResMed's nearest competitor, Philips Respironics initiated a worldwide recall due to potential health risks related to sound abatement foam in select devices. The recall affected its first-generation DreamStation devices, which accounted for approximately 95% of the group's registered sleep units.

The scale of the recall has been significant; Philips needs to remediate around 5.5m devices. To put this into perspective, Philips produces 1m devices annually. The company has ramped manufacturing by a factor of three, while sales of new devices are on hold.

During this time, the recall duration has been extended, and the FDA has identified more issues with other products. In the recent quarterly, Philips reported they had successfully remediated 95% of devices and shipped the majority to patients.

The company also remains in discussions with the U.S. Department of Justice regarding a consent decree, with

manufacturing halted while facilities and processes are assessed. Philips expects a decision in the second quarter, but the timeline remains in the hands of the FDA.

ResMed is in a formidable position; as the clear market leader with the number two player side-lined, the company is experiencing unprecedented demand from providers and distributors alike.

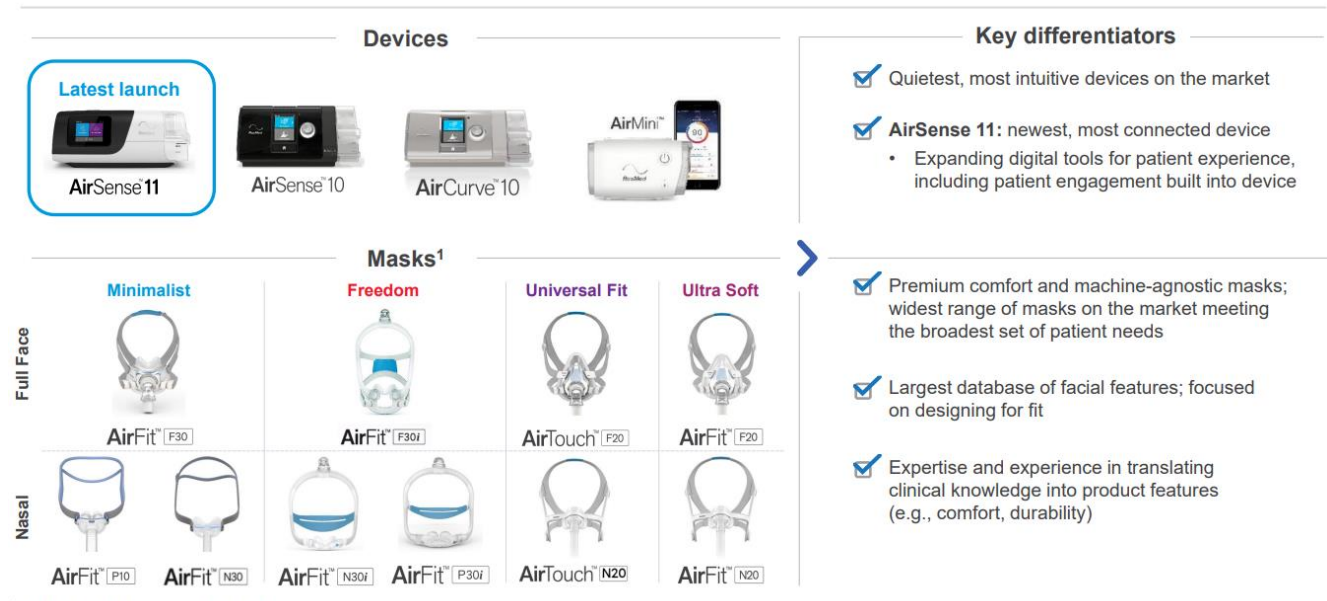
### Positioned to win

ResMed has significant scale with operations in over 140 countries, seven manufacturing facilities, and a 10,000-strong workforce. It has established itself as the clear market leader for new sleep apnea patients and has the largest installed base.

By many accounts ResMed has a clear strategic advantage with its vast medical data of over 14.5b nights, a patient base of 20.5m on the AirView platform, and 17m cloud-connectable devices globally. Along with its digitally focused product portfolio, ResMed has consistently outperformed the industry.

With Philips prioritising its recall, ResMed is driving permanent market share gains as clinicians and Durable Medical Equipment (DME) providers embrace the company's superior cloud-connected devices and platform ecosystem.

Figure 29: ResMed OSA Product Portfolio



Source: ResMed 2021 Investor Day Presentation

## Products

Product innovation remains a core pillar of success for ResMed. The business caters to a range of patient needs by offering highly connected, quiet, and comfortable solutions [see Figure 29].

ResMed has enhanced its products by combining a leading platform with extensive digital capabilities. For clinicians, the AirView platform integrates patient data from their devices into the system, creating seamless compliance monitoring.

The AirSense 11 launch further strengthens the digital proposition. Featuring an easy-to-use touchscreen, automatic humidifier and airflow controls, and greater integration with the myAir app, the product enables comprehensive sleep tracking and personalised coaching.

Early results show AirSense 11 has achieved record patient adoption rates on the patient myAir app, more than double AirSense 10 levels. The benefits are twofold: higher engagement increases the stickiness of patients, benefiting clinicians and distributors, and as a result, drives higher reimbursement, recurring mask sales, and improved patient outcomes.

ResMed continues to elevate and differentiate its solutions, with AI being the next focus as it introduces AI-driven coaching features across its AirSense devices.

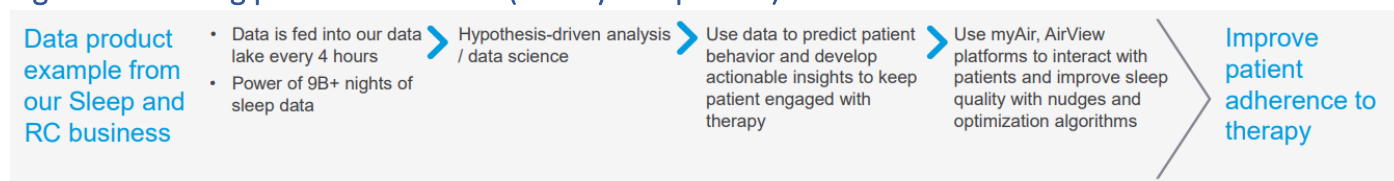
While ResMed has the capacity to ramp up manufacturing, the challenge lies in supply chain procurement due to the global shortage of electronic components (semiconductors). Expanding AirSense 11 production remains a top priority and should drive stickiness and growth as more stakeholders experience the benefits of a data-led and connected ecosystem.

## Medium-term growth

ResMed's near-term priority has been addressing supply chain challenges to meet the unprecedented demand. As the supply-demand dynamic normalises, ResMed will turn on demand generation initiatives to tap into the underpenetrated global sleep apnea market.

ResMed, in conjunction with its partners, is actively innovating and leveraging digital-powered care models to create more effective approaches for sleep apnea patient identification, screening, diagnostics, treatment, and management. The initiatives aim to provide an end-to-end digital experience for patients, streamlining and integrating the entire journey.

Figure 30: Driving patient adherence (90-day compliance)



### Driving personalization at scale

Source: ResMed 2021 Investor Day Presentation

The company's demand generation initiatives include experimenting with low-cost channels like social media in large population markets. It also has strategic partnerships, such as joint ventures with CVS and Google-owned Verily, that combine traditional bricks-and-mortar approaches with digital media and search. ResMed expects to launch these programs later in the year to drive more prospective patients into the funnel.

With AirSense 10 and 11 in tow, ResMed is well positioned to capture demand once patients are diagnosed. Providers can enjoy streamlined workflows and improved patient outcomes through increased compliance. Figure 30 depicts the focus on personalisation to drive adherence.

Although pricing has been favourable since COVID, the outlook remains unknown. ResMed is targeting volume growth and manufacturing efficiencies to achieve its revenue and margin objectives. Additional pricing benefits could provide an upside.

### Market Share

Industry dynamics have shifted considerably due to Philips' recall with ResMed's device market share rising from 60% in 2019 to 84% in 2022. In the mask segment, where Philips remains active, ResMed has increased market share from 60% to 69%. These numbers demonstrate ResMed's increasing dominance and the declining position of Philips, reflecting diminishing scale for the company.

### Return of Philips

There remains uncertainty on when Philips will return and what demand will look like at that time.

Philips remains challenged in the near term with its long-running recall, the potential consent decree, a new management team, staff reductions, and multiple class action lawsuits. Recovering from a consent decree can be

difficult, with potential increased compliance costs and penalties, such as profit disgorgement.

The FDA acknowledges the recurring issues at Philips and has received over 98,000 complaints regarding the recall. The FDA also classifies this as *"a Class I recall, the most serious type of recall."* The timeline and extent of Philips' recovery carries significant uncertainty.

However, the market does desire a number two player. It is expected that Philips will eventually return and regain sales. The manner and level of focus with which they re-enter the sleep business remains the question.

Philips has not been able to focus on product development, sales, and marketing, resulting in stagnant product offerings and relationships. Meanwhile, ResMed has and continues to offer a superior platform and product portfolio to patients, physicians, and providers, which is expected to increase loyalty as they recognise the benefits.

Within an industry that has solid long-term growth potential, ResMed has the value proposition to retain its market share. The company also believes it can drive industry growth rates faster than pre-COVID levels, with an untapped device upgrade opportunity among existing patients.

### Other Respiratory care

ResMed's scope expands beyond sleep apnea to include conditions such as chronic obstructive pulmonary disease (COPD) and asthma. While still in its earlier stages, these initiatives offer ample growth opportunities in the COPD (380m patients) and asthma (330m patients) markets.

The high healthcare costs associated with COPD and asthma, coupled with the significant unmet needs, create opportunities for ResMed to enhance patient experiences and improve therapy. These markets present longer-term growth prospects.

Figure 31: Market opportunities

## Proactive care to capture significant underpenetrated markets

### Chronic disease is the largest driver of healthcare spending in developed economies

#### Sleep apnea

- **Leading indicator**, and a contributing factor, to many chronic illnesses
- More than **80% undiagnosed**
- Demonstrated positive dose-response relationship between **CPAP usage and lower healthcare costs**

#### COPD

- Largely undiagnosed COPD sufferers in high-growth markets such as China, India, Brazil, and E. Europe >100M<sup>2</sup>
- Acute treatment costs to healthcare systems are large
  - Europe: €48B per year<sup>4</sup>
  - U.S.: ~\$50B per year<sup>5</sup>
- More than 3M people worldwide die each year due to COPD<sup>1</sup>

#### Asthma

- Significant opportunity to improve adherence and improve patient-physician interaction
- Leveraging Propeller for increased data related to symptom occurrence and acute triggers
- Opportunity to partner with patients, providers, pharmaceutical companies, and payors to drive improved quality of life

### Total addressable market

936M sleep apnea patients

380M COPD patients<sup>2,3</sup>

330M asthma patients<sup>6</sup>

Well-positioned to expand proactive treatment of chronic diseases

Source: ResMed William Blair 42nd Annual Growth Stock Conference Presentation

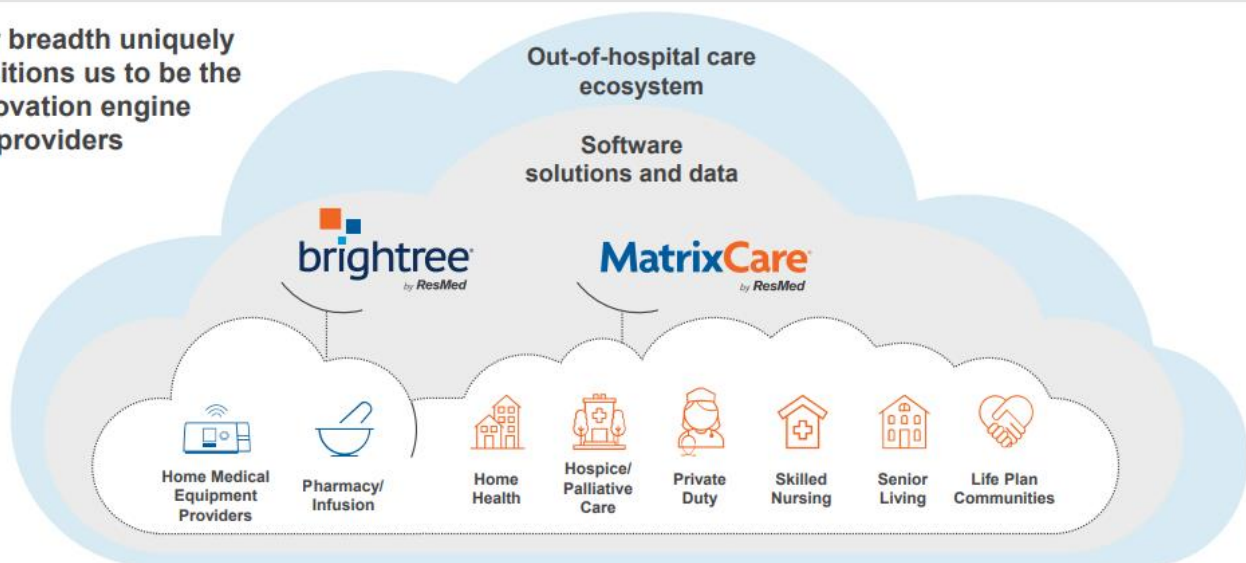
### Software as a Service (SaaS)

ResMed has evolved into a digital health organisation that goes beyond manufacturing medical devices. This transformation was possible through strategic acquisitions, such as Brightree and MatrixCare, which offer essential software for out-of-hospital patient care, supporting improved patient outcomes and business efficiencies.

As shown in Figure 32, Brightree and MatrixCare serve different verticals. Brightree focuses on providing solutions for Home Medical Equipment providers and pharmacies. The acquisition has also enhanced the technological infrastructure within ResMed's existing business, enabling the digital capabilities in its sleep devices and automating mask resupply.

Figure 32: Software and services for out-of-hospital care

Our breadth uniquely positions us to be the innovation engine for providers



We are the gateway to out-of-hospital care

Source: ResMed 2021 Investor Day



MatrixCare provides software solutions in various areas, including home health, skilled nursing, and hospice. The COVID-19 pandemic has underscored the significance of remote monitoring and personalised healthcare, and software-as-a-service (SaaS) has emerged as a clear solution to improve outcomes and reduce costs.

The increasing need for enhanced out-of-hospital care, driven by aging populations, rising costs, labour limitations, and the desire for better compliance, presents a significant unmet need for SaaS providers.

As a digital healthcare leader, ResMed understands the opportunity and remain committed to improving the lives of 250m individuals in out-of-hospital healthcare by 2025. The company has reinvested to develop a comprehensive offering across eight verticals, leveraging valuable data that positions itself to grow faster than the market. SaaS revenue for FY23 is projected to reach US\$500m.

SaaS plays a crucial role in providing data, insights, and analysis that benefit the entire enterprise. The ultimate objective is to create a world-leading digital health platform that integrates with highly connected devices powered by AI, resulting in improved outcomes for

clinicians, hospitals, providers, payors, and importantly, the patients. Figure 33 illustrates this.

### Financials

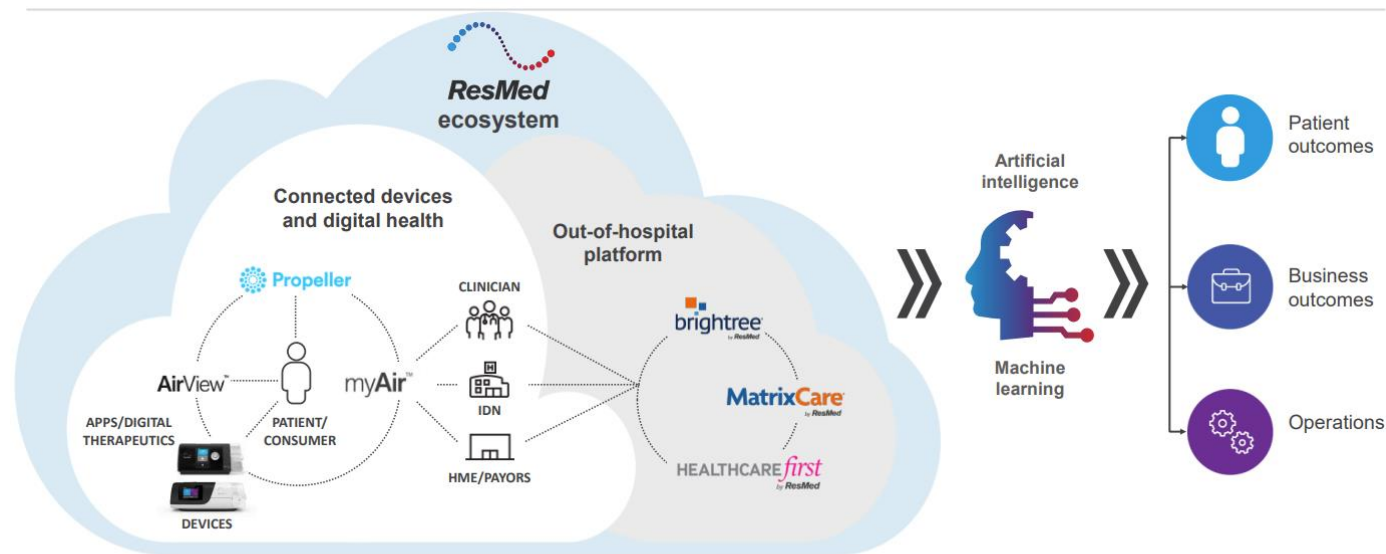
ResMed maintains a strong financial profile, reporting around US\$4b in revenue with gross margins of 57%.

Increased freight and component supply costs, as well as manufacturing inefficiencies, have impacted gross margins. There is a medium-term opportunity to restore margins to historical levels of around 60% by optimising manufacturing processes and normalising supply chains.

ResMed dedicates approximately 21% of revenue to sales, general, and administrative (SG&A) expenses, and 7% to research and development (R&D). These costs support ResMed's continual leadership by driving top-line growth, market penetration, and innovation.

Despite this investment, the company maintains operating margins (EBIT) of 30%, while non-GAAP net income is expected to rise to US\$1b. ResMed's high-margin profile and strong cash generation enable consistent reinvestment in growth and the ability to capitalise on opportunities that arise, such as the recent Philips recall. The company has a proven track record of execution in revenue and earnings growth.

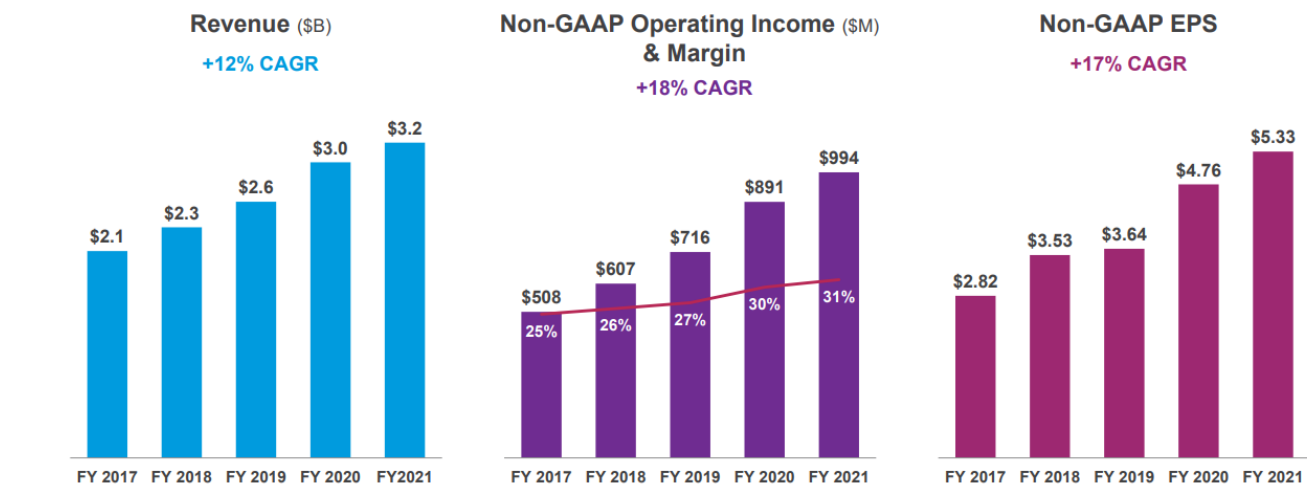
Figure 33: Digital Health ecosystem



Focused on interoperability so our ecosystem works with the broader healthcare ecosystem

Source: ResMed 2021 Investor Day

Figure 34: Company Financials



Source: ResMed 2021 Investor Day

### Capital Management

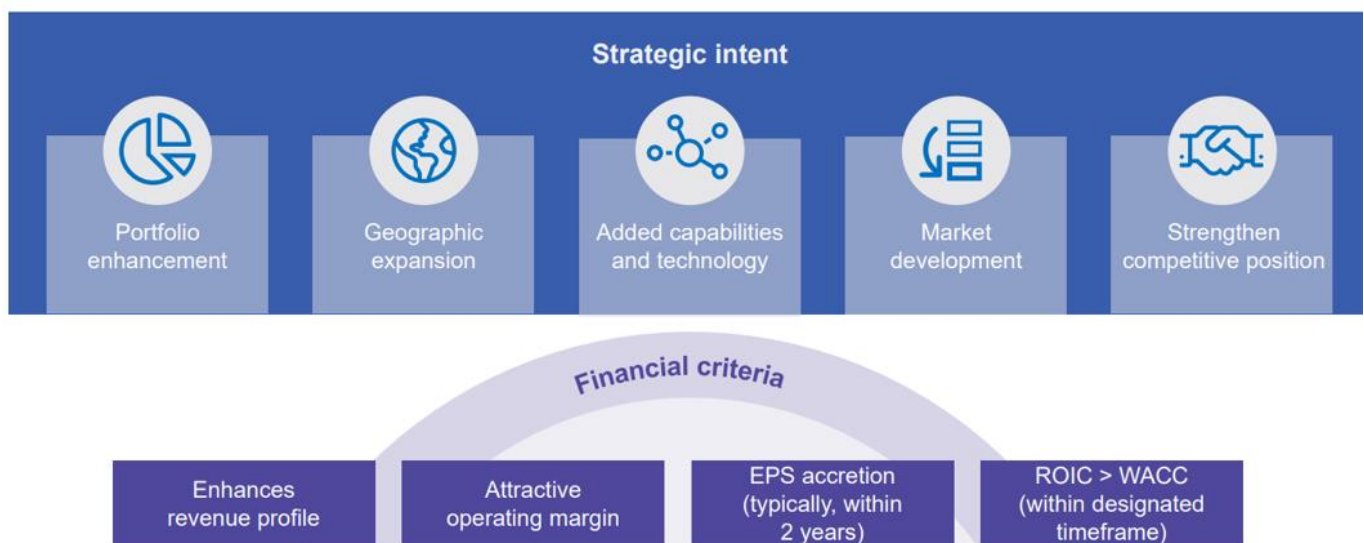
From a capital management perspective, ResMed has balanced organic investments and acquisitions well to improve its portfolio of solutions. Key highlights in this regard include:

- **Dividends** – The company maintains a conservative payout ratio of 30%, allowing shareholders to receive an annual cash return while reinvesting back in the business.
- **Capex** – ResMed completed the construction of a next-generation manufacturing site in Singapore in 2022. This facility doubles capacity and is expected to deliver gross margin improvements.

- **Acquisitions** – In June, ResMed acquired MEDIFOX DAN, expanding its presence in SaaS to new care settings and extending its reach beyond the U.S. by entering the European market. The company adopts a conservative approach to acquisitions, as reflected in Figure 35.

ResMed has a return on invested capital of 21%, highlighting the strong track record and the inherent value of reinvesting capital back into the business. The company has the appropriate capital management framework to maintain continued leadership.

Figure 35: Approach to M&amp;A



Source: ResMed 2021 Investor Day



## Management

ResMed's success is largely attributed to decisions made by its management team, led by CEO Michael Farrell, CFO Brett Sandercock, and COO Rob Douglas, who assumed their roles in 2013, 2006, and 2013 respectively. They have played a crucial role in the company's transformation from a sleep device manufacturer to a global digital health leader.

The management team also boasts a deep bench of long-tenured executives, reflecting ResMed's commitment to cultivating talent and promoting from within, and its strong company culture.

## Risks

There remain risks to the business, including:

- Product recalls
- Regulatory challenges
- Disruptive technologies and competition
- M&A
- Supply chain

Additionally, operating within the complex U.S. healthcare system with distorted incentives can lead to

inefficient outcomes, potentially undermining the expected results of even the best products or services.

ResMed has effectively managed these risks through a robust framework for product development, regulation, and M&A. The company also remains attentive and invested in some new sleep apnea technologies.

## Summary

ResMed holds a dominant market position, supported by a compelling product proposition, strong management, significant scale, impressive profit margins, and a commitment to consistent reinvestment.

The company operates in promising markets that directly impact health, well-being and performance, and are innovating to enhance the overall ecosystem.

Importantly, as the clear market leader, over a significantly weakened number two player, the business is in a formidable position to drive leadership and is positioned for long-term success. **SFM**

## WORK-WISE OR WORK-SHY?

You would think from May and June's "blowout"\* jobs reports, cascading headlines, and the hive of hawkish activity at central banks that global economies are booming.

Here's the puzzle: Other recent data suggest disinflation has taken hold and that recession may be closer. The dichotomy emerges from the divergent behaviour of employment and output, two key indicators of economic activity.

In May, employers added 339,000 jobs (before being revised down to 267,000, no eye-popping headline was generated from the latter), bringing the total number of jobs added this year to nearly 1.6m, a gain of 2.5% annualised.

In June it was only 209,000 jobs added (\*not the ADP's near 500,000 reported the day prior, which made a wave of headlines). It was the 30th consecutive month of gains in American payrolls, however, it was also the weakest monthly jobs added since this post pandemic streak started.

But real gross domestic income (GDI), a measure of total economic activity, shrank in both the fourth quarter and the first quarter. Two negative quarters of output growth are one indicator of a recession.

*"The economy has gone through periods where output has expanded faster than employment, but seldom the other way around",* said Ryan Sweet, chief U.S. economist at Oxford Economics.

### Productivity

What explains these differing signals is productivity, or output per hour worked. This is cratering. That raises questions about whether the much-hyped technology adoption during the pandemic and, more recently, artificial intelligence, are making a difference. It also increases the risk that the Federal Reserve will have to raise interest rates more to tame inflation.

Usually, employment plummets during recessions because as factories, offices and restaurants produce less, they need fewer workers. That clearly isn't happening. *"If you look at the early 2000s, that was what was called a 'jobless recovery,' because employment took a long time to come back even though the economy was 'growing,'"* said Ryan Sweet. *"This time around it could be the opposite — the economy could be contracting, but you're not seeing job losses."*

One reason could be labour hoarding. After struggling to hire and train workers during the pandemic-induced labour crunch, employers are now balking at letting them go, even as sales slip. Given the labour market's unusual tightness, this is unlikely to last indefinitely.

### Work from Home

It is also plausible that the shift to working from home generated a hit to productivity, whose impact grows with the cumulative loss of creative exchange and mentoring. During the early stages of pandemic related work from home, studies indicated productivity gains.

It is no coincidence that the crackdown on remote work is happening as some industries cool. Job cuts across Wall Street and Silicon Valley have handed power back to businesses. However, even in tech and finance some employees are standing their ground. In May, Amazon said that 300 employees staged walkouts over the e-empire's return-to-work policies (the organisers said it was closer to 2,000).

Remote work has a target on its back. At the extreme, as always, is Elon Musk who has long been calling out (his) lazy workers. In May, Musk accused WFH proponents as morally dubious. *"The laptop class is living in la-la land",* Musk told CNBC.

*"People building the cars, servicing the cars, building houses, fixing houses, making the food, making all the things that people consume. It's messed up to assume that, yes, they have to go to work, but you don't".*

\*ADP jobs data was the blowout, the data is from June ADP® National Employment Report™ produced by the ADP Research Institute® in collaboration with the Stanford Digital Economy Lab ("Stanford Lab"). It is not the same as statistics reported by the Labour department. The magnitude of difference was 497,000 to 209,000. The later may be revised down. Few

headlines come from revisions down. References, WSJ, The Economist, Federal Reserve Bank of New York

*"It's a productivity issue, but it's also a moral issue. People should get off their goddamn moral high horse with this bull---- because they're asking everyone else to not work from home while they do. It's wrong."*

Now even Banking CEO's, like Jamie Dimon of JPMorgan Chase, are intent on making working from home a relic of the pandemic. For staff at America's biggest lender and other Wall Street stalwarts like Goldman Sachs, five-day weeks are back for good. Big tech firms are also cracking the whip. Google's return-to-work mandate threatens to track attendance and factor it in performance reviews. Meta and Lyft want staff back at their desks, demanding at least three days of the week in the office by the end of the summer. With bosses clamping down on the practice, the pandemic-era days of mutual agreement on the desirability of remote work seem to be over.

### Research that changed

Unfortunately for the WFH believers, new research mostly runs counter to the perceived productivity benefits, showing that offices, for all their flaws, remain essential.

A working paper published in 2020 by Natalia Emanuel and Emma Harrington, then both doctoral students at Harvard University, found an 8% increase in the number of calls handled per hour by employees of an online retailer that had shifted from offices to homes. The study is often thought to be the starting point for the pro-WFH movement as it duly racked up headlines across the globe.

It turns out that it was not the first study, nor was the outcome all that it was purported to be.

Far less noticed was a revised version of their paper, published in May 2023 by the Federal Reserve Bank of New York, by the same authors. The boost to efficiency had instead become a 4% decline.

The researchers had not made a mistake. Rather, they received more precise data, including detailed work schedules. Not only did employees answer fewer calls when remote, but the quality of their interactions also suffered. They put customers on hold for longer. More also phoned back, an indication of unresolved problems.

The revision comes hot on the tails of other studies that have reached similar conclusions.

David Atkin and Antoinette Schoar, both of the Massachusetts Institute of Technology, and Sumit Shinde of the University of California, Los Angeles, randomly assigned data-entry workers in India to labour either from home or the office. Those working at home were 18% less productive than their peers in the office. Michael Gibbs of the University of Chicago and Friederike Mengel and Christoph Siemroth, both of the University of Essex, found a productivity shortfall, relative to prior in-office performance, of as much as 19% for the remote employees of a large Asian IT firm. Another study determined that even chess professionals play less well in online matches than face-to-face tilts. Yet another used a laboratory experiment to show that video conferences inhibit creative thinking.

The reasons for the findings will probably not surprise anyone who has spent much of the past few years working from a dining-room table. It is harder for people to collaborate from home. Workers in the Fed study spoke of missing their *"neighbours to turn to for assistance"*. Other researchers who looked at the communication records of nearly 62,000 employees at Microsoft observed that professional networks within the company become more static and isolated. Teleconferencing is a pale imitation of in-the-flesh meetings: researchers at Harvard Business School, for example, concluded that *"virtual water coolers"*—rolled out by many companies during the pandemic—often encroached on crowded schedules with limited benefits. To use the terminology of Ronald Coase, an economist who focused on the structure of companies, all these problems represent an increase in co-ordination costs, making collective enterprise more unwieldy.

Some of the co-ordination costs of remote work might reasonably be expected to fall as people get used to it. Since 2020, many will have become adept at using Zoom, Webex, Teams, or Slack. But another cost may rise over time: the underdevelopment of human capital. In a study of software engineers published in April, Drs Emanuel and Harrington, along with Amanda Pallais, also of Harvard, found that feedback exchanged between colleagues dropped sharply after the move to remote work. Drs Atkin, Schoar and Shinde documented a relative decline in learning for workers at home. Those in offices picked up skills more quickly.

The origins of the view that, contrary to the above, remote working boosts productivity can be traced to an

experiment nearly a decade before the pandemic, which was reported by Nicholas Bloom of Stanford and others in 2013. Call-centre workers for a Chinese online travel agency now known as Trip.com increased their performance by 13% when remote — a figure that continues to appear in media coverage today. But two big wrinkles are often neglected: first, more than two-thirds of the improved performance came from employees working longer hours, not more efficiently; second, the Chinese firm eventually halted remote work because off-site employees struggled to get promoted. In 2022 Dr Bloom visited Trip.com again, this time to investigate the effects of a hybrid-working trial. The outcomes of this experiment were less striking: it had a negligible impact on productivity, though workers put in longer days and wrote more code when in the office.

### The price of happiness

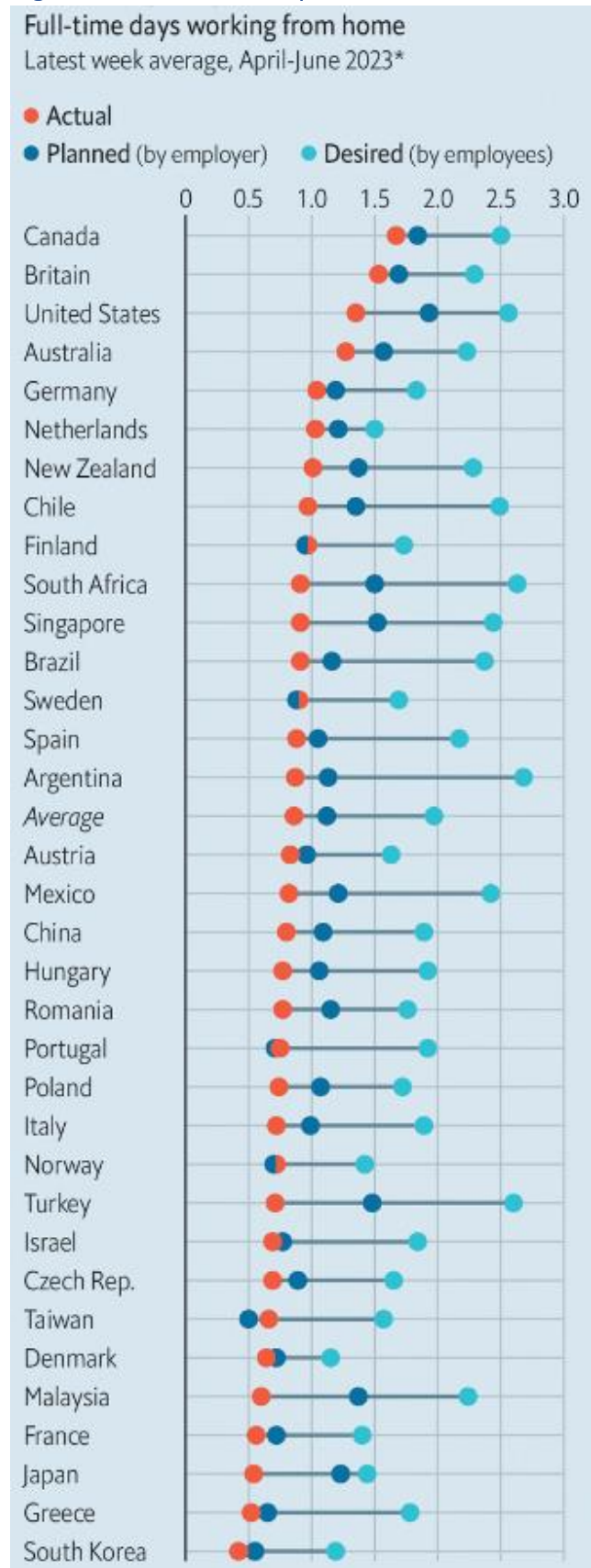
There is more to work (and life) than productivity. Perhaps the greatest virtue of remote work is that it leads to happier employees. People spend less time commuting, which from their vantage-point might feel like an increase in productivity, even if conventional measures fail to detect it. They can more easily fit in school pickups and doctor appointments, not to mention the occasional lie-in or midmorning jog. And some tasks—notably, those requiring unbroken concentration for long periods—can often be done more smoothly from home than in open-plan offices. All this explains why so many workers have become so office-shy.

Indeed, several surveys have found employees are willing to accept pay cuts for the option of working from home. Having satisfied employees on slightly lower pay, in turn, might be a good deal for corporate managers.

Desire for more remote work is not surprising. The time saved not having to battle public transport or congested roads allows for a better work-life balance. On average, 72 minutes each day is saved when working remotely, which adds up to two weeks over a year, according to a paper by Nicholas Bloom and colleagues, of WFH Research based in Stanford.

Employees also report that they feel most engaged when working remotely, according to a poll last year by Gallup. On average globally, workers value all these benefits to the tune of an 8% pay rise, implying that some would take a pay cut to keep the privileges.

Figure 36: Remote Prospects



Source: The Economist, WFH Research

## A winning team

At Selector we are thinking about this at both the portfolio level and at our team level.

Internally we think like a successful sports team. We are after all competing daily. We focus on bringing our best and applying it to the details we encounter each day. Our founder has instilled a routine of the “triple check”. It’s a simple concept aimed at achieving exactly what it states, a check performed three times. And it is applied across the board in all we do in conjunction with our “buddy system”.

Mistakes are still made, and the notion of failure leading to improvement is embraced. We believe that this part of our internal culture has enabled us to be exceptionally proud of our long-term track record.

Now consider a coach faced with a combination of the outcomes of the studies we considered above including;

- Less feedback and discussion,
- Lower levels of collaboration,
- Lower levels of skills attained,
- Team members happy to accept lower pay to avoid the commute to training.

It is probably fair to say that almost any coach would feel the need to immediately address these issues.

During the quarter we held a conversation with a successful multi-decade and recently retired fund manager. He neatly summed up the situation when we asked him about his view on WFH. He noted that “*more than 50% of any business is all about the people*”. He saw no compelling reason to stay at home or avoid your colleagues at the office.

We would agree on both fronts. Firstly, culture and people trump all. And secondly if either of these observations relating to staying at home or avoiding the office hold true, there is likely an issue that needs to be addressed immediately.

But it was his parting comment that really stuck. “*It is the incidental conversations that occur in the office that stop you getting to the cliff edge*”.

We will continue to ask ourselves and all the businesses within the portfolio questions relating to people and culture. **SFM**



## NIB HOLDINGS – SUSTAINABILITY

nib has been helping people live healthier lives for over 70 years. From its humble beginnings in 1952 at Newcastle's BHP steelworks, the group now provides health and medical insurance to over 1.7m Australian and New Zealand residents, and 180,000 international students and workers in Australia. Additionally, nib is a leading travel insurer in Australia and a global distributor of travel insurance, ensuring financial protection and peace of mind for travellers.

### Private Health Insurance and sustainability

Private health insurance (PHI) is a key factor in promoting positive social outcomes within the healthcare system.

By offering comprehensive coverage options, such as vaccinations, health screenings, and chronic disease management, PHI enables individuals and families to proactively manage their health, and receive timely medical interventions. Longer term, through increased focus on preventative care, it can help reduce the incidence of chronic diseases and the need for more costly treatment.

PHI also helps alleviate the burden on public healthcare systems by reducing wait times and overcrowding, and freeing up resources for those who need them most.

Complementing this, insurers often invest in community health programs, preventive initiatives, and health

promotion campaigns, contributing to the overall wellbeing and improved health outcomes of the society they serve.

Nevertheless, others will argue private health insurance carries potential social disadvantages, including the risk of exacerbating inequality by providing better access to care for those who can afford it and the high cost of premiums that may pose financial challenges.

### Materiality

Materiality assessments give a company the opportunity to identify, prioritise and assess the relative importance of environmental, social, and governance (ESG) issues to their organisation. It involves engaging with several key stakeholders, including (but not limited to) executives, shareholders, suppliers, regulators, and customers. Once completed, the company should have a more holistic view of the ESG issues that matter the most to its stakeholders and its long-term success.

nib's most recent materiality assessment, completed in FY22, considered where the business had the most impact on the environment, economy and people, as well as what had a significant impact on the business. The material topics, as shown in [Figure 37](#), unsurprisingly centred around personalising health services using data science & technology and the responsible management & protection of data.



Figure 37: Materiality Assessment results

**Both impact and financial materiality**

- Personalising health services using data science and digital technology
- Ensuring the responsible management and protection of data

**Financial materiality**

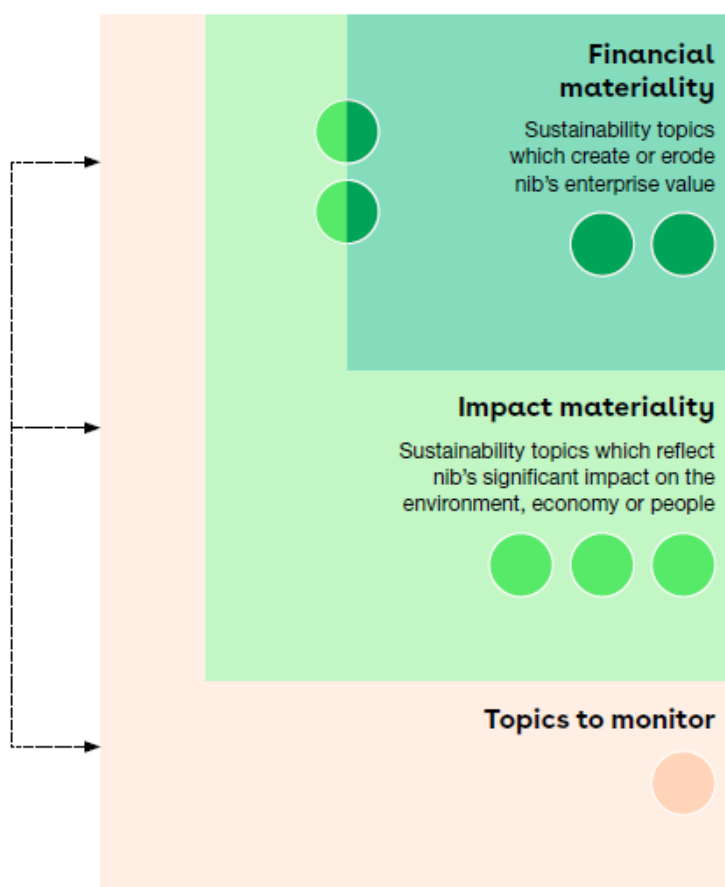
- Revitalising our value proposition to enhance population health
- Investing in innovation to anticipate customer needs

**Impact materiality**

- Expanding benefits to empower members and deliver holistic care
- Enhancing employee wellbeing in an inclusive work environment
- Navigating the health impacts of climate change

**Topics to monitor**

- Managing the evolving ESG expectations of investors



Source: NHF 2022 Sustainability Report

**nib's Sustainability Principles**




nib's purpose is to improve the health of people and communities through more cost-effective, sustainable, and fair healthcare systems while recognising the influence of social, economic, and environmental factors on health.

During CY2022, nib published an impressive 11 environmental, social, and governance (ESG) related documents. Amongst this is the group's fourth annual sustainability report, third Modern Slavery report, and its inaugural Task Force on Climate-Related Financial Disclosures (TCFD) Report.

The group's approach to sustainability is centred around five core principles (Figure 38) being:

- **Population Health** – improve the population health of members and the communities they serve.
- **Natural Environment** – help protect the planet for years to come.
- **Economic Development & Employment** – offer initiatives that foster safety, wellbeing, inclusion, diversity of thought, and professional development.
- **Community Spirit & Cohesion** – help the community build resilience and reduce inequalities.
- **Leadership & Governance** – commitment to achieving and demonstrating the highest standards of corporate governance.

Figure 38: nib Sustainability Principles

 <b>Population Health</b>	 <b>Natural Environment</b>	 <b>Economic Development &amp; Employment</b>	 <b>Community Spirit &amp; Cohesion</b>	 <b>Leadership &amp; Governance</b>
<p>The quality of peoples' health is influenced by the communities where they live and work.</p> <p>We develop and support community-based programs, which aim to control and limit disease, improve health literacy and enhance overall population health, with a focus on holistic care and preventative health measures.</p> <p>We also invest in innovation and the personalisation of health services through data science and digital technology to deliver benefits that empower our members to live healthier lives.</p>	<p>The quality of the natural environments in which we live are similarly influential on people's health.</p> <p>The quality of air and water, biodiversity and climate stability are crucial to the health and wellbeing of our stakeholders.</p> <p>We will improve our business processes to limit our impact on the environment.</p>	<p>We believe investment and employment are important to the overall health and wellbeing of our communities and that we have a leadership role to play in encouraging inclusion and equal opportunity.</p> <p>Our procurement policies enable our business to be mindful of potential downstream effects of our supply chain and we aim to ensure our suppliers comply with applicable laws and standards of business ethics, health and safety and environmental protections.</p>	<p>Strong community spirit and cohesion are good for the psychological and physical resilience of communities.</p> <p>We believe a strong sense of belonging, social justice, practicing tolerance and respect of differences is essential to fostering resilience in healthy communities.</p> <p>Our partnerships with the community build resilience and reduce inequalities, with a special focus on preventative health, mental wellbeing and Aboriginal and Torres Strait Islander health.</p>	<p>We strongly believe in the importance of having the highest standards of ethical practice, good governance, risk management, data management and security in business and public institutions.</p> <p>We understand the risks associated with our business operations and the potential consequences for our stakeholders in failing to manage these risks.</p> <p>We understand how the behaviour of companies like ours can influence others operating in our communities.</p>

Source: NHF 2022 Sustainability Report

We provide further detail on each below.

### Population Health

nib aims to improve population health among its members and the community. Key highlights include funding over 375,000 hospital claims and 3.6m ancillary claims, totalling over \$2 billion in FY22.

The group has embarked on a Payer to Partner (P2P) journey, transitioning from a traditional claims payer to a health partner. In doing so, it has introduced various programs focused on personalised treatment and preventative health measures for members. Examples include the nib Nurture Pregnancy eLearning program, sharing resources for healthy pregnancies, and the nib Skincare online tool, offering personalised insights for skin health. These initiatives have empowered thousands of individuals and families to make more informed decisions.

Health management programs play a vital role for members, with a significant number of participants across different regions. The company has launched new programs in partnership with Honeysuckle Health, covering mental health, cardiac rehabilitation, and home chemotherapy treatments.

In a first for the industry, nib introduced a non-health insurance offering called GreenPass. It's a revolutionary

health membership designed to promote healthier lifestyles without the need for traditional health insurance. With personalised benefits and affordability in mind, GreenPass offers exclusive access to several health and wellness perks. Members can enjoy tailored health plans, discounted wellness services, rewards for achieving health goals, online skin checks, fitness tracking, and exclusive pricing with nib's network of providers. Developed in response to the preferences of young individuals, GreenPass has already gained over 13,000 members since its April 2022 launch.

### Natural Environment

During the year, nib made significant progress in its climate action journey. The business became a carbon neutral business for the first time, offsetting its carbon emissions by purchasing carbon credits. The group also took steps to reduce emissions, including using 100% renewable energy, implementing a responsible travel policy, and repurposing IT equipment.

The business has committed to achieving net-zero emissions by 2040 and science-based targets aligned with the Paris Agreement. Pleasingly, nib has already achieved its initial near-term target of halving Scope 1 and 2 emissions by 2030.

In the short term, the group aims to further reduce Scope 1 and 2 emissions and 25% of Scope 3 emissions by 2030. An emission reduction roadmap has been developed to help guide measures in collaboration with partners, suppliers, employees, and investment managers.

In addition to addressing carbon emissions, nib has published a TCFD report and participated in the Carbon Disclosure Project for the fifth consecutive year.

nib remains committed to responsible investment; during the most recent reporting period, all investments complied with the Responsible Investment Policy and asset managers maintained their commitment to the United Nations Principles for Responsible Investment (UNPRI).

Figure 39 shows key metrics relating to the Natural Environment principle.

Figure 39: Key metrics for Natural Environment



### Emissions<sup>1</sup>

	FY22	FY21
<b>Group emissions (tonnes CO<sub>2</sub>-e)</b>		
Scope 1	0.9	23.8
Scope 2	30.4	419.4
Scope 3	8,243.6	6,474.1
<b>Total emissions</b>	<b>8,275.0</b>	<b>6,917.3</b>
<b>Scope (tonnes CO<sub>2</sub>-e)</b>		
<b>Scope 1</b>		
Fuel	0.9	0.0
Natural gas	0.0	23.8
<b>Total</b>	<b>0.9</b>	<b>23.8</b>
<b>Scope 2</b>		
Electricity	30.4	419.4
<b>Total</b>	<b>30.4</b>	<b>419.4</b>
<b>Scope 3</b>		
Business travel	286.3	133.8
Electricity	407.2	805.5
Employee commuting and working from home	647.4	560.3
Natural gas	32.6	6.0
Office equipment and paper	673.5	250.3
Third party services	6,092.6	4,675.1
Waste	95.2	22.7
Water	8.8	20.3
<b>Total</b>	<b>8,243.7</b>	<b>6,474.1</b>
<b>Country/Region (tonnes CO<sub>2</sub>-e)</b>		
<b>Australia</b>		
Scope 1	0.0	23.8
Scope 2	20.5	288.5
Scope 3	7,344.9	5,845.2
<b>Total</b>	<b>7,365.4</b>	<b>6,157.60</b>
<b>New Zealand</b>		
Scope 1	0.9	0.0
Scope 2	0.0	5.6
Scope 3	869.8	538.1
<b>Total</b>	<b>870.7</b>	<b>543.7</b>
<b>Overseas</b>		
Scope 1	0.0	0.0
Scope 2	9.9	125.3
Scope 3	29.0	90.8
<b>Total</b>	<b>38.9</b>	<b>216.1</b>

	FY22	FY21
<b>Carbon offset</b>		
Carbon credits purchased <sup>2</sup>	7,000	–

<b>Emissions intensity</b>		
Scope 1 & 2 (tonnes CO <sub>2</sub> -e)		
Employee (FTE)	0.023	0.383
Customer <sup>3</sup> ('000)	0.018	0.269
Revenue (\$m)	0.011	0.172
Total emissions (tonnes CO <sub>2</sub> -e)		
Employee (FTE)	6.130	5.979
Customer <sup>3</sup> ('000)	4.825	4.205
Revenue (\$m)	2.997	2.685

### Activities

	FY22	FY21
<b>Business travel (km)</b>		
Air	843,082.1	200,250.0
Land	1,567,560.8	2,767,126.7
Electricity – renewable (kWh)	899,393.3	358,196.4
Electricity – other (kWh)	858,543.2	1,726,465.3
Gas (GJ)	505.2	461.0
Paper (tonnes) <sup>4</sup>	25.7	51.3
<b>Waste (tonnes)</b>		
Landfill	74.4	18.1
Diverted	20.8	5.3
Water (ML)	4.3	9.9

### Efforts to reduce paper consumption

Members with email as preferred method of contact		
Australian Residents Health Insurance	90.8%	86.4%
International Students Health Insurance	99.7%	99.4%
International Workers Health Insurance	99.7%	99.8%
New Zealand	92.7%	91.1%
Shareholders on partial eComms	4.9%	3.7%
Shareholders on full eComms	49.0%	48.2%

### Occupied building ratings<sup>5</sup>

Auckland	4.5 star NABERSNZ energy rating
Melbourne <sup>6</sup>	5 star NABERS energy rating and 5 star NABERS water rating
Newcastle	5 star NABERS energy rating and a 4 star NABERS water rating
Sydney	5 star NABERS energy rating

Figure 40: Employee engagement scores

	FY22	FY21
<b>Employee experience</b>		
Employee engagement score <sup>5</sup>	75%	69%
Employee inclusion score <sup>5</sup>	80%	n/a
Employee wellbeing score <sup>5</sup>	74%	n/a

Source: NHF 2022 Sustainability Report

### Economic Development & Employment

nib employs over 1,350 employees across five countries. In terms of gender diversity, nib has committed to a 40/40/20 (female, male, any gender) target. In FY22, female representation comprised 56% of leadership roles and 64% overall within the nib group.

nib's approach to hybrid working provides employees with choice and ensures no employee is disadvantaged based on their work location. The group has implemented learning and development opportunities, leadership development programs, and policies to foster a diverse, equitable, and inclusive workplace.

To better cater to the diverse needs of its employees at various life stages, nib has improved its Parental Leave and Leave policies, acknowledging the significance of providing adequate support. The company's dedication to diversity, equity, and inclusion was acknowledged externally, most notably by its inclusion in the prestigious Bloomberg Gender Equality Index.

Employee wellbeing and inclusion are now measured alongside engagement. In the most recent survey, the group achieved high scores in all three areas, with the engagement score up six basis points to 75% from the prior year (Figure 40 above provides engagement scores for FY22 and FY21).

### Community Spirit & Cohesion

nib focuses its efforts on partnerships within the community to build resilience and reduce inequalities. The group maintains a flexible funding approach to allow partners to innovate and adapt to the community's health and wellbeing needs.

Initiatives include supporting mental health programs for students through partnerships such as Batyr and funding Lifeline's online self-help toolkit for all Australians seeking mental health support. The group expanded its Health Smart program to New Zealand, partnering with mental health care platform, Clearhead and the University of Otago to empower young people to make healthier choices.

Employees continued to contribute to the community through the nibGive program, raising funds for local charities. Volunteering opportunities have also resumed post COVID-19 with companies such as OzHarvest, Ronald McDonald House, and Lifeline. The Footprints Network, founded by nib's travel brand World Nomads, committed \$135,000 to six international community development programs through micro-donations received from customers.

Figure 41 provides key metrics relating to the Community Spirit & Cohesion principle.

Figure 41: Key metrics for Community Spirit &amp; Cohesion



## Community Spirit & Cohesion

### nib foundation

	FY22	FY21
<b>Grants</b>		
Prevention Partnerships	\$900,00	\$742,132
Health Smart Grants	\$421,001	\$340,000
Aboriginal Health Partnerships	\$160,125	\$150,000
Community Partners	\$185,000	\$641,000
Employee nominated Good Cause Grants	\$30,000	\$30,000
<b>Total</b>	<b>\$1,696,126</b>	<b>\$1,903,132</b>

### Charity partnerships

	FY22	FY21
Prevention Partnerships	4	4
Health Smart Grants	10	10
Aboriginal Health Partnerships	2	3
Community Partners	4	9
Employee nominated Good Cause Grants	6	6
<b>Total</b>	<b>26</b>	<b>32</b>

### Customer giving

	FY22	FY21
<b>Donations</b>		
Donations received	\$122,769	\$54,740
Number of donors	23,931	15,219
<b>Funding</b>		
Funding allocated	\$134,929	\$36,965
Charities funded	6	2
Projects funded	6	2
Countries impacted	6	2

### Employee giving

	FY22	FY21
Employee fundraising donations	\$17,590	\$21,001
Company and nib foundation matching donations	\$17,590	\$20,599
Charities supported	10	13
<b>Employee volunteering</b>		
Charities assisted	8	8
Volunteer hours	961	661
Employee participants	120	108
Value of time	\$70,983	\$37,163

### Brand partnerships:

Newcastle Knights (NRL & NRLW)  
 Richmond Football Club (AFL & AFLW)  
 Richmond Korin Gamadji Institute (KGI)  
 The Blues (Super Rugby & Super Rugby Aupiki, NZ)

### Community sponsorships:

Awabakal Community Events  
 Minerva Network  
 The Trainer Group – 'Game Changer'

Source: NHF 2022 Sustainability Report

## Leadership & Governance

nib prioritises ethics and governance in every decision to ensure responsible and transparent operations.

In an effort to enhance the group's risk management capability, optimisations were made to its Risk Management Framework, operational testing, and internal audits. Compliance training was conducted for all employees to ensure an understanding of standards and regulatory requirements. Information security and cybersecurity were the main focus areas, resulting in ISO 27001 certification and initiatives to reduce cybersecurity risks.

Additionally, the group implemented data governance and clinical governance frameworks to ensure safe and effective management of data and healthcare services. Through enhanced statements and annual reporting, nib also demonstrated its commitment to human rights and modern slavery risk management.

Ongoing stakeholder engagement remained a focus, helping nib to better align its efforts to the needs of various stakeholders. Engagement with regulatory authorities, such as APRA, contributed to compliance measures with a new standard that aims to strengthen the link between remuneration practices, risk management, and performance outcomes.



## nib Thrive

nib believe that few things have a greater social impact than keeping people healthy and supporting people with disabilities. nib Thrive is the group's National Disability Insurance Scheme (NDIS) business, which provides a range of services to help NDIS participants get the most out of their plans, including:

- **Plan management:** nib Thrive can help NDIS participants to understand their plans, find providers, and manage their budgets.
- **Support coordination:** nib Thrive can provide support coordinators to help NDIS participants to identify their goals, develop plans, and access the supports they need.






- **NDIS marketplace:** nib Thrive operates the Kynd NDIS marketplace, which allows NDIS participants to search for and book support services.
- **Education and training:** nib Thrive offers a range of education and training resources to help NDIS participants and their families to understand the NDIS and make informed choices.

## Looking ahead

As shown in Figure 42, nib has set sensible and achievable targets for FY23 across each sustainability principle, including achieving a 76% employee engagement score, implementing five new health management programs, and validation from the Science-Based Target Initiative of the group's net-zero targets.

Figure 42: Sustainability targets for FY23

### FY23 sustainability targets

 <b>Population Health</b>	 <b>Natural Environment</b>	 <b>Economic Development &amp; Employment</b>	 <b>Community Spirit &amp; Cohesion</b>	 <b>Leadership &amp; Governance</b>
45,000 people enrolled in General Wellbeing Support programs across the Group	Conduct new climate change scenario analysis	Maintain 40/40/20 gender mix in Board, Executive, heads of business units, team leaders and manager positions	1,320 employee volunteering hours	Introduce a metric into Executive remuneration incentives based on the FY23 sustainability targets outlined in this report
Implement 5 new health management programs aligned to our clinical focus areas across the Group	Science-Based Target Initiative validation of our net zero targets	Overall employee engagement score of 76% or greater	250,000 people reached via nib foundation's Prevention Partnerships <sup>6</sup>	Complete continuous improvement plans with at least 30 suppliers
12,000 members enrolled in health management programs across the Group	Maintain Scope 1 and 2 emissions and 2.5% reduction in Scope 3 emissions	All active Executive successors complete our Leading Business and Strategy Development Program	Develop and launch <i>Innovate</i> Reconciliation Action Plan	Implement new Compliance Policy and update Compliance Management Framework to align with ISO 37301:2021
20,000 health checks undertaken by nib members		Enable nib's distributed working model and promote safe working practices by ensuring all active employees complete nib's annual online ergonomic self-assessment (and follow up actions if relevant) for their remote workspace	More than 50% of our sponsorship portfolio advocating for equality and diversity <sup>7</sup>	Meet all annual compliance and assurance requirements in order to maintain ISO/IEC 27001:2013 certification of nib's Information Security Management System (ISMS)

Source: NHF 2022 Sustainability Report



## Conclusion

nib has demonstrated its unwavering commitment to sustainability through its comprehensive Sustainability Report for 2022. The company's efforts to reduce its carbon footprint, promote diversity and inclusion, and enhance member wellbeing highlight its dedication to creating a sustainable future. Furthermore, nib's transparent reporting practices and measurable targets

underscore its accountability and drive for continuous improvement.

As nib continues to integrate sustainability into its core business strategy, it serves as a shining example of how organisations can make a positive impact on the planet and society while achieving long-term financial success.

**SFM**

## COMPANY ENGAGEMENTS – JUNE 2023 QUARTER

Date	Company	Description
3-Apr	FCL	FINEOS Corporation Holdings Dublin, Ireland Site Visit
4-Apr	SEK	SEEK Investor Day
4-Apr	OFX	OFX Group UK Site Visit
4-Apr	FLT	Flight Centre Travel Group UK Site Visit
5-Apr	ALU	Altium UK Site Visit
20-Apr	IRE	Iress Investor Day
26-Apr	APX	Appen Management Meeting
27-Apr	BKL	Blackmores Management Meeting
28-Apr	RMD	ResMed 3Q23 Results Call
2-May	CPU	Computershare Macquarie Australia Conference
3-May	FLT	Flight Centre Travel Group Macquarie Australia Conference
3-May	WTC	Wisetech Global Macquarie Australia Conference
3-May	SHL	Sonic Healthcare Macquarie Australia Conference
3-May	ARB	ARB Corporation Macquarie Australia Conference
3-May	BRG	Breville Macquarie Australia Conference
3-May	PNV	PolyNovo Macquarie Australia Conference
3-May	NAN	Nanosonics Macquarie Australia Conference
3-May	JIN	Jumbo Interactive Macquarie Australia Conference
4-May	NHF	nib holdings Macquarie Australia Conference
4-May	PME	Pro Medicus Macquarie Australia Conference
4-May	CPU	Computershare Management Meeting
8-May	REH	Reece US Site Visit
8-May	REH	Reece US Site VIsit
11-May	PNV	PolyNovo US Management Meeting
12-May	REA	REA Group 3Q23 Results Call
15-May	ALL	Aristocrat Leisure Proposed Acquisition of NeoGames Investor Call
15-May	SEK	SEEK Management Meeting
16-May	JHX	James Hardie Industries 4Q23 Results Call
16-May	APX	Appen Equity Raising investor Call
17-May	JHX	James Hardie Industries 4Q23 Post-results buy-side round table
18-May	ALL	Aristocrat Leisure HY23 Results Call
19-May	OCL	Objective Corporation Investor Day
22-May	REH	Reece Management Meeting
22-May	IFM	Infomedia Management Meeting
23-May	DMP	Domino's Pizza Enterprises Management Meeting
23-May	IFM	Infomedia Barrenjoey Managent Meeting
23-May	OFX	OFX Group FY23 Results Call
23-May	TNE	TechnologyOne HY23 Results Call
23-May	MP1	Megaport UBS Management Meeting
23-May	OFX	OFX Group Management Meeting
24-May	OFX	OFX Group Barrenjoey Management Meeting

Date	Company	Description
24-May	ALL	Aristocrat Leisure Management Meeting
25-May	TNE	TechnologyOne Management Meeting
25-May	LMW	Light and Wonder Jarden Management Meeting
26-May	FPH	Fisher & Paykel Healthcare FY23 Results Call
26-May	TNE	TechnologyOne Barrenjoey Management Meeting
26-May	APX	Appen Annual General Meeting
26-May	TNE	TechnologyOne Goldman Sachs Management Meeting
26-May	APX	Appen Technology Day
29-May	FPH	Fisher & Paykel Healthcare Management Meeting
7-Jun	IFM	Infomedia SimplePart Product Demo
13-Jun	DMP	Domino's Pizza Enterprises FY23 Trading Update and Cost Initiatives
13-Jun	IFL	Insignia Financial JPM Management Meeting
14-Jun	CSL	CSL Trading Update
21-Jun	FLT	Flight Centre Travel Group Business Presentation
26-Jun	APX	Appen Management Meeting
27-Jun	CKF	Collins Foods FY23 Results Call
28-Jun	SOM	SomnoMed Goldman Sachs Management Meeting
28-Jun	ALL	Aristocrat Leisure Barrenjoey Insights Call with Red Wind Casino

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