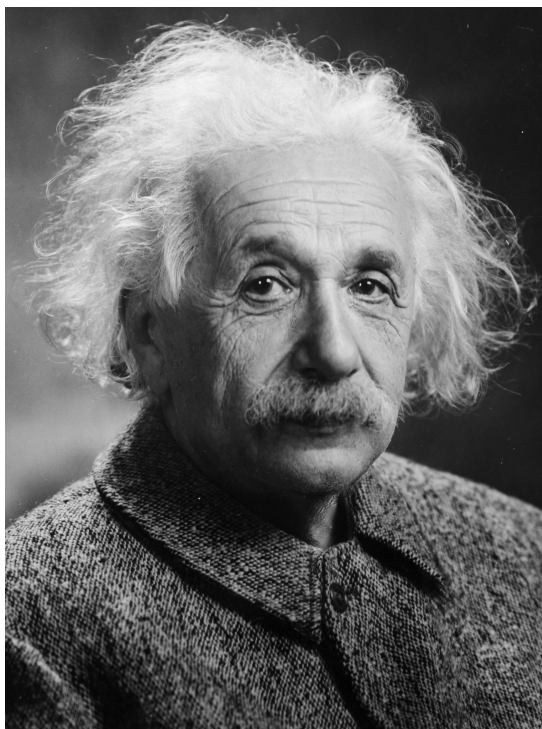


Selector High Conviction Equity
Fund Quarterly Newsletter No.93
September 2026



In this Quarterly we review six global leaders who reported in the August 2026 results season. Each business is on a journey, the common theme is high margin recurring revenue and sensible balance sheet management. Albert Einstein features on our cover this Quarter. While there is no link to attribute the famous "Compound interest is eighth wonder of the world" quote to Mr Einstein, its importance holds. In this results season 86% of the portfolio reported higher EBITDA. We review a short history of compounding and contrast businesses we view as quality compounders, in Hidden Treasure, to the current index crowding mandated by the Australian Federal Government in our article "Apparent Safety". We ask the question. Whose interests are best served by this folly? ... What would Mr Einstein think?

Photo: Albert Einstein is permanently linked to compounding

Source: Global Governance Forum

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selector



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

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

Selector has a 21-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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Portfolio Overview

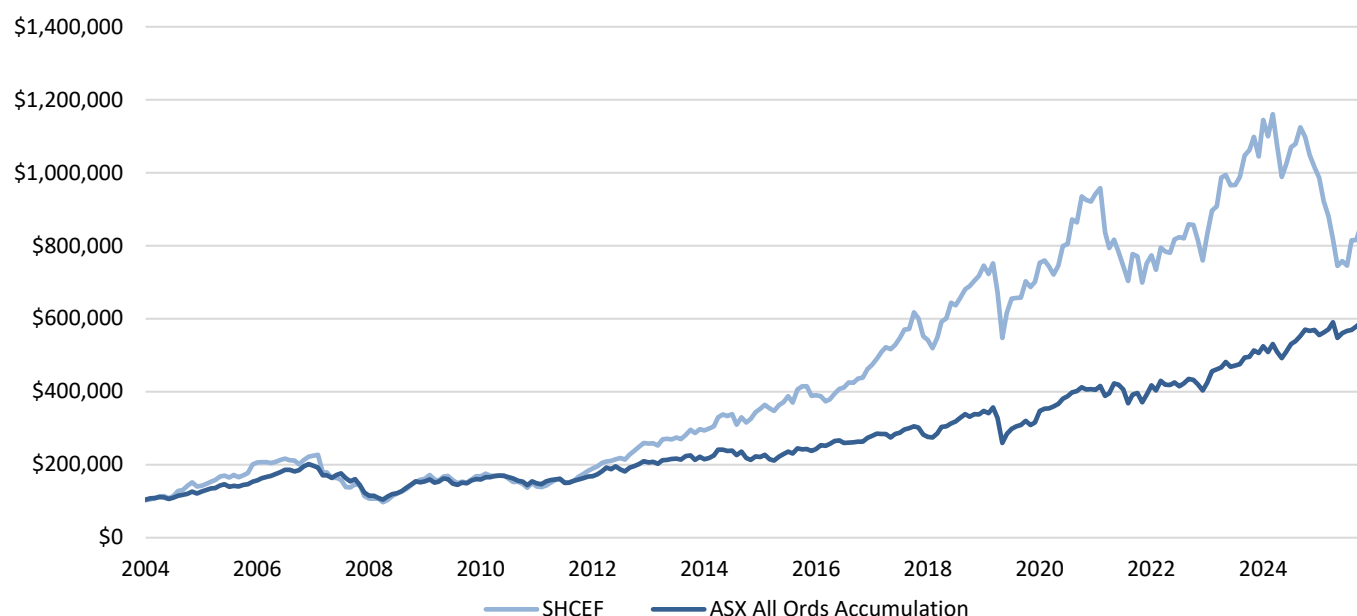
Performance as at 30 September 2026¹

	3 Month	6 Month	1 Year	3 Year ²	5 Year ²	10 Year ²	15 Year ²	20 Year ²	Since Inception ²
Fund (gross of fees)	(1.03)	8.26	(23.13)	(0.34)	(2.71)	6.87	12.57	7.87	9.99
Fund (net of fees)	(1.41)	7.48	(24.28)	(1.81)	(4.11)	5.09	10.64	6.00	8.04
All Ords. Acc. Index	1.01	5.05	1.43	11.04	7.20	9.01	9.68	7.07	8.30
Difference (gross of fees)	(2.04)	3.21	(24.56)	(11.38)	(9.91)	(2.14)	2.89	0.80	1.69

Inception Date: 30/10/2004

¹Performance figures are historical percentages. ²Returns greater than 1 year are annualised and assume the reinvestment of distributions. Past performance should not be taken as an indicator of future performance.

Gross value of \$100,000 invested since inception



Portfolio's Top 10 Holdings

Top 10 September 2026	%	Top 10 June 2026	%
Aristocrat Leisure	7.92	TechnologyOne	8.50
TechnologyOne	7.85	Aristocrat Leisure	8.37
Resmed	6.94	CAR Group	6.93
James Hardie Industries	6.68	Nanosonics	6.86
Nanosonics	6.46	James Hardie Industries	6.82
CAR Group	6.20	Pro Medicus	6.53
Fisher & Paykel Healthcare	5.94	Resmed	6.09
Reece	5.49	Reece	5.23
FINEOS Corporation Holdings	5.43	FINEOS Corporation Holdings	5.21
Pro Medicus	5.42	Fisher & Paykel Healthcare	5.04
Total	64.34	Total	65.58

Unit prices as at 30 September 2026

Unit Prices	Entry Price	Mid Price	Exit Price
	\$2.4580	\$2.4519	\$2.4458

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.

ASX sector performance – September 2026 quarter

ASX Industry Sectors	Quarter Performance (%)
Healthcare	25.60
Energy	14.75
Materials	3.02
Utilities	1.38
Financials	(1.72)
Consumer Staples	(1.76)
Industrials	(4.98)
Telecommunications	(5.24)
Information Technology	(7.81)
A-REITS	(8.95)
Consumer Discretionary	(10.96)

Fund's industry weightings

Industry group	September 2026 (%)	June 2026 (%)
Health Care Equipment & Services	29.00	27.98
Software & Services	15.82	16.13
Media & Entertainment	12.65	12.94
Consumer Services	9.20	10.08
Materials	6.68	6.82
Pharmaceuticals, Biotech & Life Sciences	6.23	6.33
Capital Goods	5.49	6.15
Consumer Durables & Apparel	4.79	4.80
Commercial & Professional Services	4.59	4.39
Automobiles & Components	2.97	2.87
Financial Services	1.31	1.08
Cash & Other	1.26	0.42

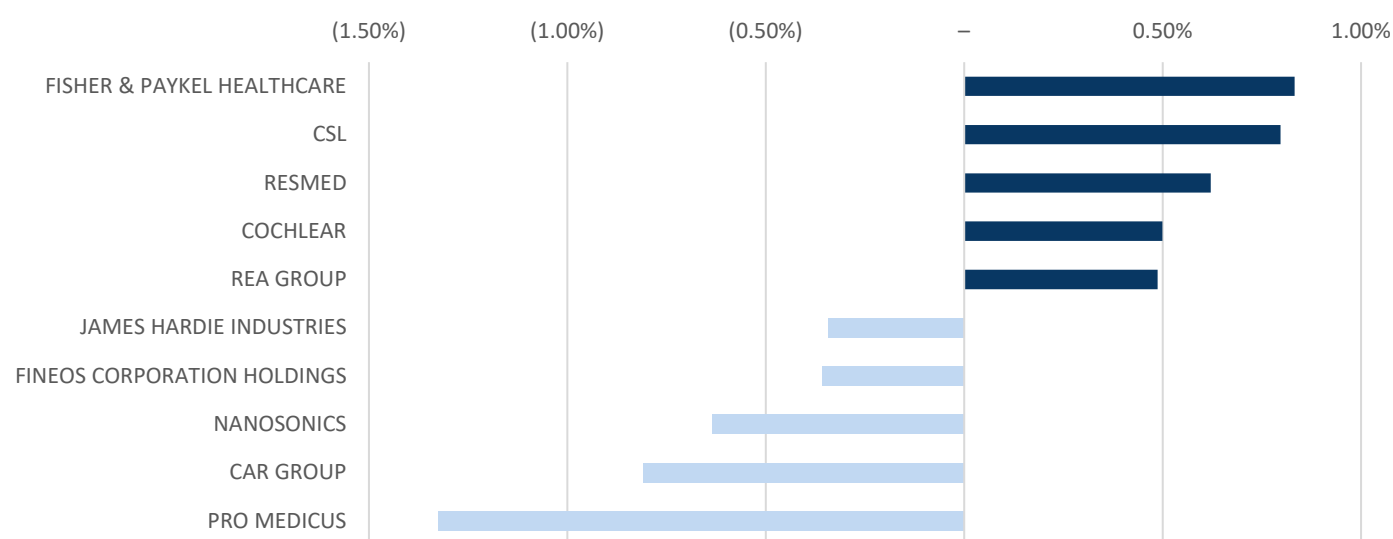
Portfolio turnover as at 30 September 2026

Period	Turnover %
1 Year	0.50
2 Years	4.19
3 Years	6.46
5 Years	6.25
10 Years	7.28
15 Years	6.66
20 Years	6.28
Since inception	6.00

- Turnover shown as annualised percentages
- Turnover = Lesser of purchases or sales divided by average funds under management for the period
- Turnover calculation excludes cash flows greater than 1% of FUM over any given period

Portfolio Contributors

Contributors and Detractors – September 2026 quarter



“The world is awash in debt. The only way for us to get out of this is to grow our way out of it”

Scott Bessent, the U.S. Treasury Secretary addressing the G20 Summit in North Carolina in September, laying out the case for growth.

In Brief

Dear Investor,

Amongst a long list of defining events during the September quarter, the most notable was the investment spend directed at the build out of data centres.

Such is the enormity of the outlay that it now rivals past industrial and mining investment booms.

Led by the demands of generative AI and hyperscale cloud platforms, capital expenditure from the world's largest technology firms is transforming data centres from simple IT hubs into the foundational industrial engines of the global economy.

As we discuss below, framing the capital outlay is an exercise of thinking really big. The term 'hyperscale' is in essence a massive industrial facility designed to efficiently handle extreme computing, storage and networking workloads for cloud and artificial intelligence services.

At a base cost of US\$30-US\$50 per megawatt (MW) of power capacity, a typical 100MW AI fully equipped data centre would set you back US\$3b to US\$5b. These have now been surpassed by the likes of Microsoft and Oracle committing to 1- gigawatt (GW) data centres, with a fully fitted out site costing upwards of US\$60b.

1873

At this juncture, it is perhaps worth pausing for a moment to consider the 1850-1870 era. The era was characterised by the building of railroads across continents, and the U.S., in particular, stood out for this infrastructure build.

Prior to 1850, the U.S. had about 9,000 miles of railroad track run by a number of independent operating companies. However, the decade that followed saw the rail network more than triple to over 30,000 miles of track.

When the U.S. Government passed the Land Grant Act of 1850, it opened millions of acres of public land to states that were passed onto railroad companies. In turn, land was sold to settlers for cash, while the additional millions required to build the tracks were raised by selling stocks and corporate bonds to wealthy investors in New York and Great Britain.

By the early 1870s, the U.S. rail network had doubled to 70,000 miles, and with this explosive growth came speculative banking loans and over expansion. Of the roughly 364 railroad companies that operated, 89 fell into bankruptcy, which in turn triggered a broader economic depression.

As the author Liaquat Ahamed detailed in his book 'The Rothschilds, the First Great Depression, and the making of the Modern World', the root cause of the 1873 panic was over a decade in the making.

Fuelled by an intense period of 'railroad' build, Ahamed wrote of its historical significance.

"Across the Atlantic in the United States it was the railroad companies that bore the brunt of the fall. Railroad stocks fell by almost 50 per cent between the summer of 1873 and the summer of 1877. Railroad bonds fared almost as badly. They had taken on so much debt-over the previous seven years - borrowing three dollars for every dollar of equity - that between 1874 and 1876, a third of US railway bonds which amounted to \$2.2 billion all went into receivership. It was to be the worst three-year period of corporate defaults in American history, even worse than the Great Depression. Over the rest of the decade a further 20 per cent would default and by 1879 more than half of the railway bonds issued in the United States had stopped paying interest."

The trigger for what became known as 'Black Friday, September 19, 1873' followed the failure of Jay Cooke & Co, a major backer of the Northern Pacific Railroad. As a result, the collapse that ensued led to a full-blown run on the New York banking system, *"The New York Stock Exchange took the unprecedented step of suspending trading entirely - the market would remain closed for ten days."*

Compared to today's data centre build, Ahamed noted, *"The \$500 million that went into U.S railway bonds annually during the boom years of the early 1870's would today be the equivalent of \$600 billion, roughly what is projected to be invested by major tech companies in 2026."*

Data Centres

The crisis of 1873 was foreshadowed by an extraordinary boom that led to a massive spike in

international trade, a surge in capital investment, which ultimately resulted in careless lending practices, share market speculation and over investment.

Today, the excitement sits with data centres. The AI world that we now live in requires data centres to do the heavy lifting. Importantly, as demand for AI intensifies, so does the necessity for more data centres. The sheer quantum required is on a vast scale.

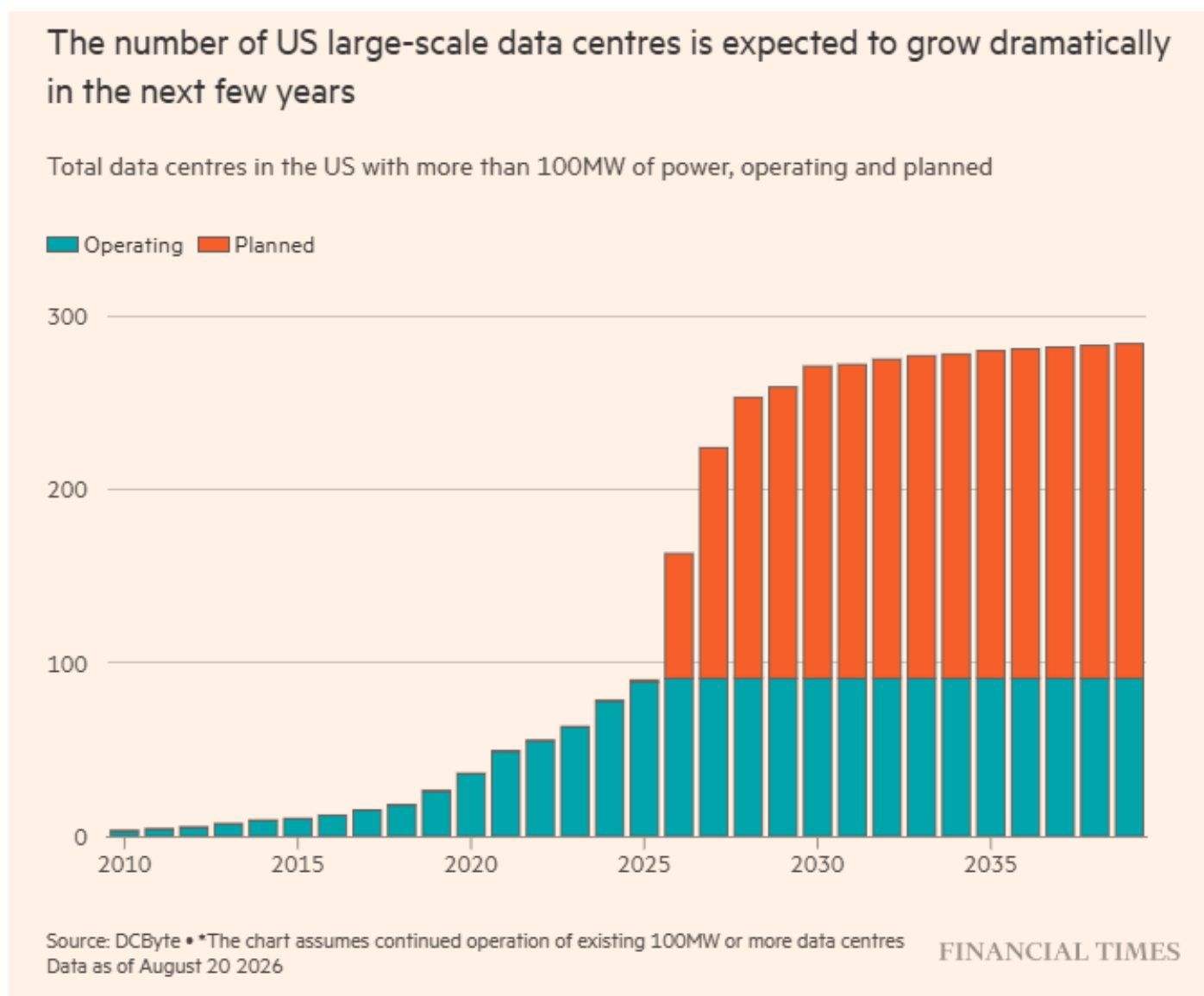
Numbers are thrown about, but by 2030, technology companies are expected to invest US\$7 trillion into data

centres. The big technology groups, Nvidia, Microsoft, Meta, Amazon, Alphabet and Oracle are committing large sums, all at the same time.

A situation not lost on Liaquat Ahamed, "Everyone has decided they want to be in the railroad business."

As the Financial Times reported on August 26, the U.S. large scale data centres are expected to grow dramatically over the forward years.

Figure 1: Data Centre expansion estimates



Source: Financial Times August 2026

Economic modelling undertaken by Apollo economist Torsten Slok has concluded that the Hyperscaler capex is likely to run at an eye watering 3% of U.S. gross domestic product (GDP) every year from 2027 to 2029. This is twice as fast as the telecom build out in the late

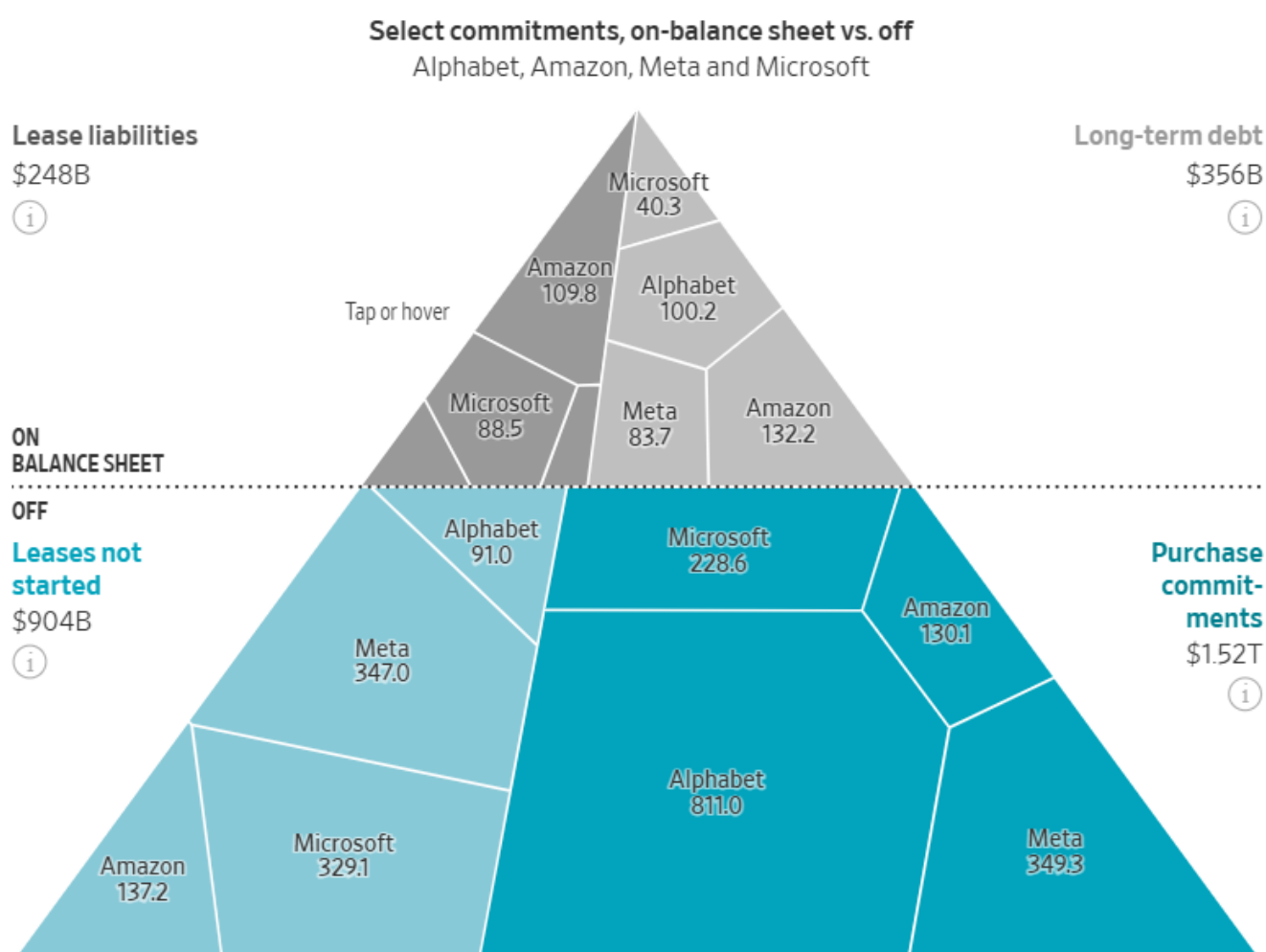
1990s and twice as fast as the U.S. housing peak of the early 2000s.

In short, the data centre outlay is bigger and faster than previous cycles, and at an even greater share than what the railways represented at the 19th-century height.

With such heightened investment, comes the issue of funding. As the Financial Times wrote, “The frenetic pace of activity across capital markets has been startling. Starting late last year, the hyperscalers have tapped the US\$11.7 trillion US corporate debt market repeatedly, so much so that they have to begin raising debt in foregoing currencies to broaden the investor pool. The financing requirements for AI are stretching Wall Street’s resourcefulness - and its resources.”

As **Figure 2** illustrates, funding for the data centre buildout is not always transparent. While the Hyperscalers have disclosed funding needs and its impact on the balance sheet, in this example, totalling US\$604b, there is more that sits below the line. These investments are reflected in purchase commitments and leases not yet started, which total an even bigger number, over US\$2.4 trillion.

Figure 2: Funding AI



Note: Data are as of each company’s most recent quarterly filing and in billions, except where noted.
Source: WSJ analysis of company filings

Source: Wall Street Journal

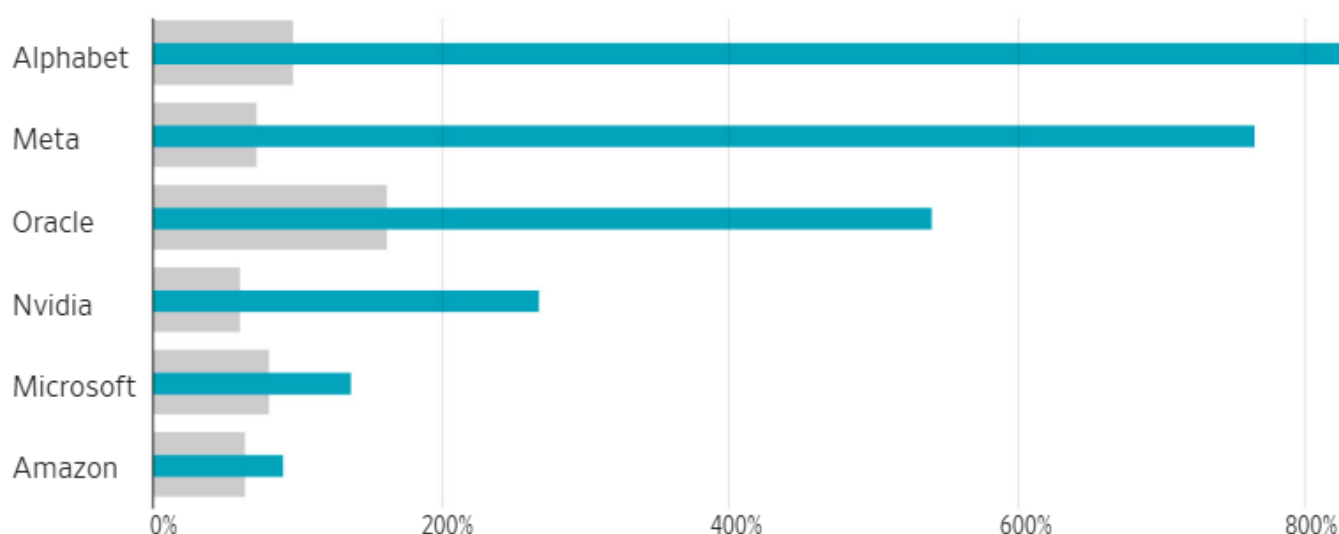
As WSJ journalists Peter Rudegeair and Peter Santill outlined on 16 August 2026, “Each quarter, big tech companies disclose their massive capital expenditures on artificial-intelligence infrastructure, from data centers to chips. But those figures don’t come close to expressing the full extent of future spending to which

Google parent Alphabet, Meta Platforms, Oracle and many others have committed. That is because a huge swath of their coming financial obligations aren’t reflected on their balance sheets.”

Figure 3 reflects the most recent security filings, highlighting total obligations among the Hyperscalers.

Figure 3: Hyperscalers data centre funding commitments and obligations**Percentage change from a year earlier**

■ Off-balance-sheet obligations ■ Capital expenditures



Note: Changes in off-balance-sheet obligations are based on the combined totals of leases not started and purchase commitments. Capex growth is based on trailing 12-month expenditures. All data are as of June except Nvidia, which are as of April, and Meta, which are as of July.

Source: WSJ analysis of company filings

Source: Wall Street Journal

All this activity has attracted investor interest, excited by the promise of AI. The backing of the technology Hyperscalers has convinced investors that this asset class is worth it. While Microsoft may be a triple A-rated company, any extension to other lesser-known parties should be treated with caution.

This is evident in our own market, with the soon to be listed Firmus group attracting frenzied interest, having been heavily backed by AI chip leader Nvidia. This, alongside other ASX data centre participants, including the likes of ASX-listed Maas Group and Megaport, has underscored the big capex lift that is required.

To be clear, there is little argument that AI adoption is growing rapidly and redefining all aspects of daily routines. Hyperscalers, equally, see the importance of being at the front of the AI demand curve.

The real concern lies beyond the initial build, when, according to Andy DeVries from credit research house CreditSights, *“the supply of AI computing capacity will begin to outstrip demand after 2029, leading to significant reverberations beyond the current bubble. This will trickle through the whole AI ecosystem.”*

Yields

It is hard not to notice one asset class that is attracting global attention, bonds. The focus is on the U.S. 30-year bond yields that have moved from a low of 4.61% in February 2026, to its recent high point of 5.28%. Elsewhere, be it Japan, Australia, or the U.K., a similar pattern is playing out.

Whether it is a function of wars, government debt balances, AI investment or inflation, the outcome is the same. High interest rates are impacting investment activities and impacting business sentiment. The U.S. housing market is a case in point, with weak new housing starts a direct function of 30-year fixed mortgage rates holding above 6.5%

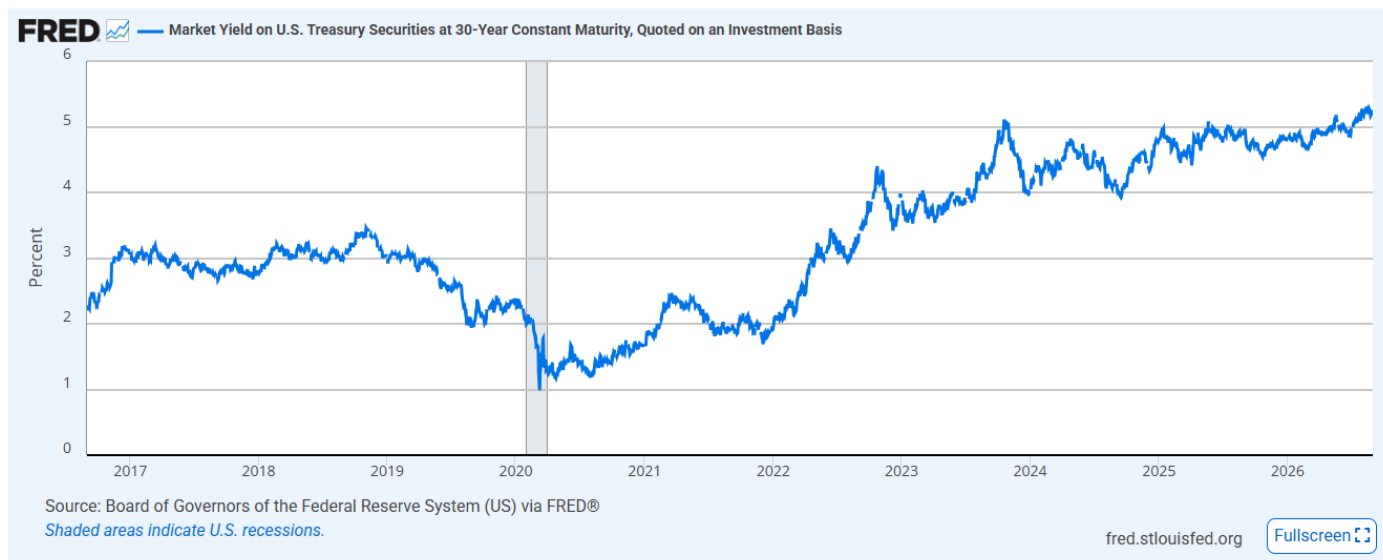
The imbalance in bond demand and supply is further impacting yields, with investors holding the stronger hand as more supply hits the market. All in all, as yields rise, its impact on borrowers and governments who are funding growing deficits, face the dilemma of dealing with an ever-increasing interest bill.

Addressing the G20 Summit in North Carolina in September, the U.S. Treasury Secretary, Scott Bessent

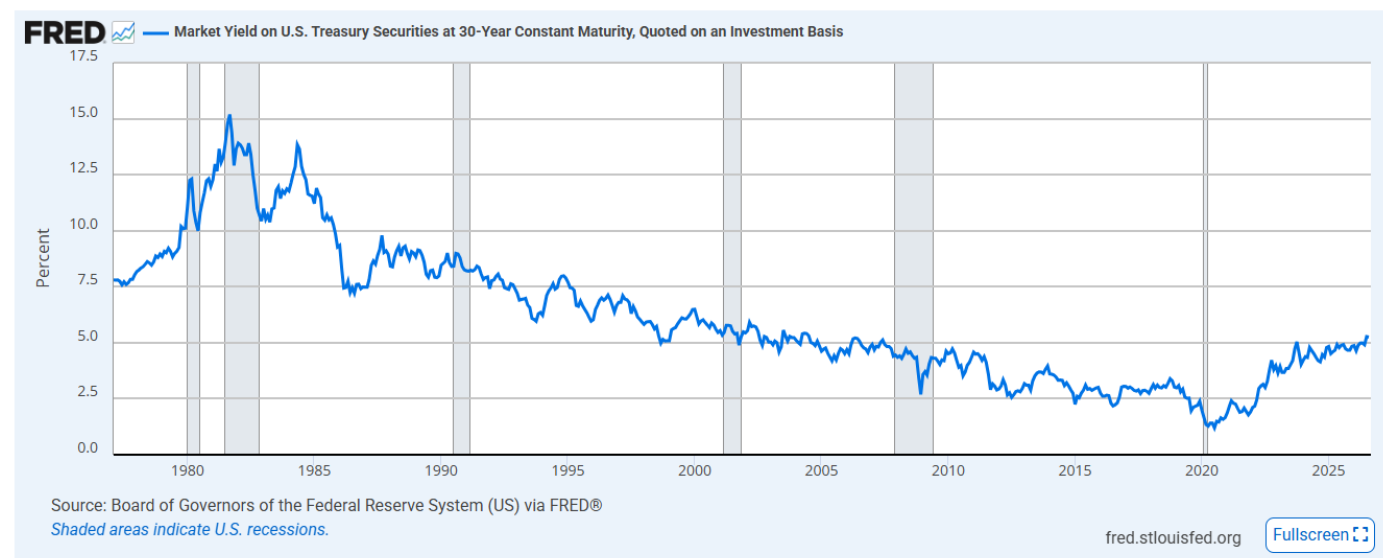
laid out the case for growth, “*The world is awash in debt. The only way for us to get out of this is to grow our way out of it.*”

Figure 4: U.S. 30-year bond yields

Period: 2016-2026



Period: 1977 - 2026



Source: Board of Governors Federal Reserve System (US) via FRED

Company reporting season

The businesses we own are selected for their individual attributes and collectively that forms the portfolio. We

have no interest in smoothing returns or replicating share market indexes. The industry is full of ‘passive’ investors, for fear of disappointing.

A teacher asks her class a question

There are ten sheep in a pen. If one jumps out, then how many are left?

All said nine, except one who said there would be none left

The teacher said, "obviously you don't understand math"

The student replied, "no, you don't understand sheep"

The rise of passive investing, as defined by U.K. Fund Manager Terry Smith, debunks the word 'passive': *"instead money going into index funds is invested in proportion to the market value of the companies in the index. This is far from a passive strategy; in fact, it is a momentum strategy."*

There are certain business attributes that we seek out. Having company founders onboard is a high bar, invariably providing shareholder alignment and an approach that is often steeped in sensible decision making, with long duration thinking.

Businesses like Pro Medicus, Reece, Resmed, ARB, Telix Pharmaceuticals and FINEOS, clearly fall into this bucket.

Then there are the near adjacent founder type companies, those that have undertaken succession and have remained authentic to their cause. The CAR Group, Breville, Computershare, Fisher & Paykel Healthcare, TechnologyOne and REA Group are a few that make the grade.

But founder alignment is not enough. They need to show leadership qualities, not just in market share but in financial performance. A preference for businesses that can generate organic growth, reflected in sustained top line revenue growth, alongside improving gross margins, flowing to higher operating profits, and fuelled by a reinvestment mentality that funds future performance, all internally generated from cashflows.

Any business that can execute to this degree, over a long enough period, are the exceptions. Many of the businesses named above have done just that. Long duration compounders, conservatively managed and sensibly aligned with shareholders, that is reflected in

the most tangible way, with higher revenues, bigger profits and net cash on the balance sheet.

Importantly, over half the portfolio, in percentage terms, operate with net cash for one simple reason: things can and do go wrong. That is the nature of business, markets and competitive forces.

This reporting season scorecard read well. The share market, which is never one to reward poor performance, delivered positive endorsements across the majority of holdings held, as reflected in the strong monthly fund returns generated in August.

On the ground

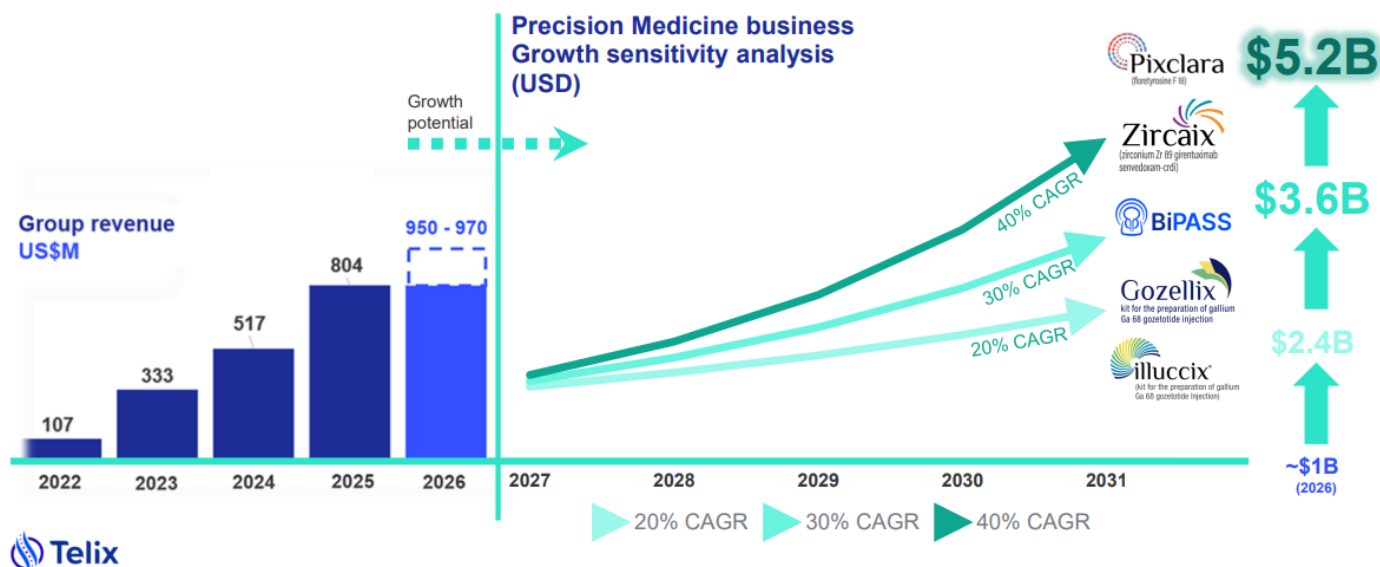
During September we travelled to the U.S., attending investor days held by James Hardie and Telix Pharmaceuticals, as well as travelling to Indianapolis to visit the operations of infection prevention leader Nanosonics. Each business has set a high bar for ongoing success and are clear market leaders in their respective fields.

Telix, specifically, has an ambitious agenda, covering radiopharmaceuticals targeting prostate, kidney and brain cancer treatments.

The company is delivering on this agenda and this year it is guiding to revenues of US\$950m-US\$970m, derived solely from one treatment, the prostate diagnostic segment. The opportunity set beyond this first target is real and is being advanced with an annual US\$270m research and development budget. At the full year results presentation delivered in February 2026, the company provided a five-year outlook on what could unfold. The business and management are executing to this target, and our visit only reinforced the real and significant opportunity that lies ahead.

Financial impact

5-year outlook: Building on BiPASS, Pixclara, Zircaix (+...+)



Source: Telix Pharmaceuticals Feb 2026 full year results presentation

Quarterly

In this quarterly, we provide commentary on a series of companies that reported during the period and why they have such strong appeal. We discuss why 'compounding' is the most quoted idea in investing and the least acted upon. Every investor agrees with it, but very few build a process around it, and the gap between agreement and action is where returns are lost.

We follow up with articles that are reflective of the times, including the industry's passive approach to

allocating capital, which has become the hallmark of our superannuation industry. We also take a deeper look into the opaqueness and leverage that sits within banks and add a perspective on the new U.S. Fed Chair, Kevin Warsh.

We value your ongoing investment and trust you find the quarterly informative.

Regards,

Selector Investment Team

Environmental, Social and Corporate Governance

The September quarter: WiseTech Global gained an independent Chair and ASIC closed its investigations with no action; three annual meetings, 25 board and executive changes, and our first carbon comparison built on company-reported emissions.

How ESG works in our process

ESG sits inside the three programs every business we research goes through: **corporate engagement**, **quantitative modelling** and **voting**. We look for businesses with leadership, competent management we can trust, a strong balance sheet and disciplined capital management, and each of those has its roots in culture. We believe culture and ESG are intertwined, with culture driving the social and governance outcomes we see.

Financial sustainability comes first. A business without it cannot make the long-term commitments that good social, governance and environmental outcomes depend on. So we ask which risks a business controls and which sit outside its control: assets that could be stranded on the environmental side, or compromised on the social, governance, legal, intellectual-property or cyber side. While we will still be surprised at times; we look for reporting that is clear and consistent enough to show most of these risks early.

We take risk out before we invest. The risks we focus on are the board and management and the culture they are responsible for, the qualities of the business, the balance sheet and capital management. We hold that a net cash balance sheet carries lower risk and more optionality than an optimised or extended one, and we compare equity risk with a risk-free rate.

All research is done in-house by the Portfolio Managers and the investment team, and every resolution is researched and voted in-house. We are index unaware, so if we cannot establish confidence in the board, the management and the culture they are responsible for, we do not invest.

Leading development in Q3 — Governance: WiseTech Global

WiseTech Global now has an independent Chair. Raelene Murphy, a director since 1 January 2026, became Chair on 7 July 2026. Founder Richard White stepped down as Chair and stays on the board as an executive director and Chief Innovation Officer. Tim Ebbeck joined on 1 September to chair the Audit and Risk Committee, and Jeff Howard became Chief Financial Officer on 28 September, ending an interim arrangement that had run since October 2024. The board now has an independent Chair, an independent Audit and Risk chair and an independent majority.

ASIC has closed both of its investigations with no action. The governance investigation of the company, begun in late 2024, ended with a no-action letter. After the quarter, on 15 October 2026, ASIC closed its investigation into share trading by Mr White and two other current employees, also with no-action letters. These were investigations, not charges, and no findings were made.

This is the governance change SFML wanted to see: a founder still contributing to the business he built, under a board led independently of him. One regulatory matter remains open. The ACCC is investigating the company under the Competition and Consumer Act, set out in the legal register below.

The quarter at a glance

Measure	September quarter 2026
Annual meetings held	3
Resolutions put and voted	23
Resolutions carried	23
Board and executive changes (directors, CEOs, CFOs)	25, at 12 companies
Open material legal or regulatory matters across holdings	13, at 6 companies
Portfolio carbon intensity (WACI) against the S&P/ASX 300 ¹	8.92 (SFML) vs 143.11 (S&P/ASX 300)

Annual meetings held from 1 July to 30 September 2026. A resolution not put to the meeting is not counted. ¹Weighted Average Carbon Intensity, tonnes of carbon dioxide equivalent per A\$1M of revenue for both (S&P's figure converted from US dollars at the Reserve Bank rate of A\$1 = US\$0.6977, 30 September 2026); the two figures are on different bases, explained in the carbon section. Source: SFML governance reports; SFML FSSGEAR 2026.

Annual meetings in 2026 so far

Three holdings met in the quarter: OFX Group on 5 August, James Hardie on 20 August and Fisher & Paykel

Healthcare on 25 August. With TechnologyOne, Aristocrat, FINEOS and Telix earlier in the year, 56 resolutions have been put at seven meetings, and every one carried.

Company	Meeting	Resolutions put	Carried
TechnologyOne	18 February	6	6
Aristocrat Leisure	19 February	6	6
FINEOS	14 April	6	6
Telix Pharmaceuticals	21 May	15	15
OFX Group	5 August	4	4
James Hardie Industries	20 August	12	12
Fisher & Paykel Healthcare	25 August	7	7
Total, 7 meetings		56	56

Resolutions put and carried at each meeting, from each company's results of meeting announcement.

Where shareholders pushed back

Most resolutions carry with little opposition, so we list only those that drew 15% or more of votes cast against

them, or failed. Three themes stand out: directors' fees, equity grants to directors, and executive equity.

Company	Meeting	Resolution	Against	Result
FINEOS	14 April	Grant 150,000 options to Michael Kelly, Chair and Chief Executive	16.2%	Carried
Telix Pharmaceuticals	21 May	Equity grants to four non-executive directors (highest vote against shown)	35.0%	Carried
James Hardie Industries	20 August	Re-elect Nigel Stein, Chair	15.9%	Carried
James Hardie Industries	20 August	Equity grant to the Chief Executive, Aaron Erter	20.0%	Carried
James Hardie Industries	20 August	Raise the directors' fee pool 18%, to US\$4.5M	22.2%	Carried
Fisher & Paykel Healthcare	25 August	Raise the directors' fee pool 20%, to NZ\$2.1M	19.5%	Carried

Percentages of votes cast, from each company's results of meeting announcement. A resolution is listed at 15% or more against, or if it failed.

Remuneration strikes

Under the Corporations Act a vote of 25% or more against the remuneration report is a strike. Two strikes

in a row put a spill resolution to the meeting, on whether every director should stand for re-election.

Company	Remuneration report vote	Where it stands
OFX Group	First strike in 2025, 39.95% against	Second strike avoided: the 2026 report carried on 5 August, so no spill resolution was put
James Hardie	2025 report defeated	Irish company, outside the two-strikes rule. The 2026 say-on-pay vote carried with 3.65% against
WiseTech Global	First strike in 2025, 49.47% against	Second strike possible at the 27 November meeting. If 25% or more vote against, a spill resolution is put
CSL	Second strike in 2025, 42.32% against; spill defeated	The count has reset; a strike at the 27 October meeting would be a first strike
Reece	Second strike in 2025, 44.73% against; spill defeated	The count has reset; a strike at the 30 October meeting would be a first strike
Reliance Worldwide	Second strike in 2025, 35.17% against; spill defeated	The count has reset; the 2026 Notice carries no spill resolution, so the 23 October meeting cannot trigger one

From each company's Annual Report, results of meeting announcements and 2026 Notice of Meeting.

WiseTech is the one to watch. Its 2025 report drew 49.47% against. A second strike on 27 November would put a spill resolution to the same meeting.

From our meetings this quarter

Telix: a board that is now working. Telix has had three Chairs in twelve months, which was our main governance concern about the company this year. We met chief executive Christian Behrenbruch on 1 September. Our read from that meeting is that the reconstituted board, with Dr Mark Nelson as interim Chair and three directors elected in May, is working exceptionally well. What remains on our list is the

remuneration design and the open SEC inquiry and US class action, which the legal register below sets out.

Board renewal

In the quarter, 25 directors, chief executives and chief financial officers at twelve of our holdings joined, left or changed role, or had the change announced. Much of it is planned renewal: at Breville and Flight Centre the new director joins before the long-serving one leaves, at Flight Centre and WiseTech Global a new director takes the Audit and Risk chair, and CSL has begun succession for its Chair.

Company, date	Change
WiseTech Global, 7 July	Raelene Murphy became independent Chair; Richard White stepped down as Chair and stays as an executive director and Chief Innovation Officer
Cochlear, August	Richard Freudenstein took over the chair of the People and Culture Committee from Christine McLoughlin, who remains a member
Flight Centre, 28 August	Gareth Turner appointed and named the next Audit and Risk chair; Robert Baker to retire at the November meeting after 13 years
WiseTech Global, 1 September	Tim Ebbeck appointed as an independent director and Audit and Risk chair
Computershare, 3 September	Alexis George appointed as an independent director
Reliance Worldwide, 3 September	Michael Ferraro appointed as an independent director
REA Group, 3 September	Kelly Bayer Rosmarin to retire at the October meeting
ARB, 11 September	Andrew Stott to retire at the October meeting; Ian Foston nominated for election
Breville, 15 September	Rob Perry joined the board, as announced on 19 August; Dean Howell to retire at the November meeting
CSL, 17 September	Carolyn Hewson intends to retire once the chief executive, Chair and board succession work is done, which CSL expects to take 12 to 18 months; Chair Brian McNamee has said this is his last term
Cochlear, 18 September	Professor Ian Meredith to join the board on 1 December
CAR Group, 22 September	Kee Wong retired after more than eight years
Reece, 23 September	Angela Mentis not seeking re-election at the October meeting
PolyNovo, 18 and 28 September	Dean Phizacklea and Andrew Price appointed; Dr Robyn Elliott and Christine Emmanuel-Donnelly not standing for re-election at the October meeting
WiseTech Global, 28 September	Jeff Howard started as Chief Financial Officer, ending Caroline Pham's interim term

2026; the date the change took effect, or the date it was announced for a change still to come. Computershare announced its appointment on 11 August. CSL's changes are from its Notice of Meeting of 17 September and, for Brian McNamee, its 2026 Annual Report; REA's, Reece's and PolyNovo's retirements from their Notices of Meeting of 3, 23 and 28 September. Source: each company's ASX announcement, Annual Report and Notice of Meeting, as recorded in the SFML governance reports.

Legal and regulatory register

Six holdings carry 13 open, material legal or regulatory matters. We count a matter as material and open when

it is named, still open, and is a class action, a regulator's investigation or enforcement action, or a named lawsuit. Ordinary-course claims and settled or provided-for matters are left out.

Company	Open matters	What the matters are
Cochlear	1	Product-liability claims over CI500 implants recalled in 2011; insurers have agreed to indemnify, subject to deductibles
CSL	1	Europe revoked the Tavneos marketing authorisation after 30 June; CSL Vifor is engaging with regulators on the ADVOCATE study
James Hardie	3	A US securities class action, consolidated Illinois state securities cases over its acquisition of AZEK, and an Australian class action set for trial on 15 February 2027
Resmed	4	Four patent cases with Cleveland Medical Devices and Fractus, three of them brought against Resmed; each is stayed or awaiting rulings
Telix	2	A US Securities and Exchange Commission (SEC) document request, with no charges; and a US securities class action, with a motion to dismiss filed
WiseTech Global	2	An Australian Competition and Consumer Commission (ACCC) investigation notified on 19 August, with a search warrant executed; and a 2024 shareholder class action

Status at each company's balance date or later announcement. Source: company Annual Reports and ASX announcements, as recorded in the SFML governance reports.

The new matter this quarter is WiseTech's. The ACCC told WiseTech on 19 August that it is investigating alleged contraventions of the Competition and Consumer Act, and executed a search warrant for documents on the supply of global logistics services and software. WiseTech says it is cooperating fully and no findings have been made.

Financial sustainability: capital management

Strong ESG outcomes need a business that lasts. The approach we discuss with boards is steady reinvestment in innovation and research, a sensible payout ratio, and a consistent buyback that drives real earnings per share growth, all on a strong balance sheet. We prefer that repeatable program to one-off special dividends. How our holdings compare:

Company	Capital management
Cochlear	Its capital management is consistent with this approach
Reece	Uses a flexible buyback within its capital management
OFX Group	Chose a flexible buyback over reinstating the dividend
Computershare	Removed its leverage target once its cash position improved
Fisher & Paykel Healthcare	Its capital management is consistent with parts of this approach
TechnologyOne	Our views align on balance-sheet discipline; we differ on special dividends, which we do not support
CAR Group	We have discussed the payout ratio and the pace of debt reduction with the board

Source: SFML FSSGE Policy and engagement record, SFML FSSGEAR 2026 \$6.

Pay: one-off awards this reporting season

A sign-on, retention or termination award sits outside the pay framework shareholders approve each year, so

we record every one in our governance report for the company. The table shows a selection; several follow a change of chief executive or chief financial officer.

Company	One-off awards disclosed
REA Group	A new Chief Executive and Chief Financial Officer: a A\$550,000 cash sign-on and equity sign-on awards of up to A\$449,882 and A\$450,022 for the Chief Executive, a A\$377,358 relocation payment for the Chief Financial Officer, and termination payments to the departing pair
CSL	A one-off A\$5.8M grant of restricted share units to the interim Chief Executive; a US\$1.8M termination benefit to the former Chief Executive
James Hardie	A US\$1.0M one-time award to the Chief Executive that must be used to buy shares, replacing half of a rejected FY26 grant; US\$4.0M in promotion awards to one executive
CAR Group	A A\$791,667 gardening-leave payment to the former Chief Executive, and options worth A\$646,461 to the new Chief Financial Officer
Resmed	A US\$3.3M sign-on equity award and US\$150,000 sign-on cash to the new Chief Financial Officer
PolyNovo	A A\$600,000 one-off equity award to the new Chief Executive on joining
Flight Centre	A retention incentive for the Chief Executive of the Leisure business, outside the standard framework
SEEK	A one-off grant of restricted rights to the Chief Financial Officer for work over several years, including the platform unification
Cochlear	A performance-based retention award for senior executives from FY27; the value is to be set out next year

A selection; every award is recorded in the company's SFML governance report. Source: company Annual Reports, Remuneration Reports and proxy statements, as recorded in the SFML governance reports.

Social: modern slavery

Fisher & Paykel Healthcare found possible breaches of local labour law at four suppliers, on overtime pay, working hours and safety. One fixed every issue within FY2025 and three are on development plans; it has suspended new business with a supplier whose problems persisted after a re-audit.

SEEK's risk is on its own platform: fraudulent hirers asking candidates for upfront payments in Indonesia, a compromised hirer account on JobsDB Hong Kong, and

hirers linked to a South-East Asian trafficking and scam network, each removed or remediated as found. Both are from the companies' 2025 Modern Slavery Statements.

Carbon risk analysis

We compare our portfolio's carbon intensity with the S&P/ASX 300, using the figures S&P Dow Jones Indices publishes for the index. Our holdings' emissions are the figures each company reports, with no estimates.

Carbon intensity method	SFML ¹	S&P/ASX 300 ²³⁴
Carbon to value invested	3.16	57.60
Carbon to revenue	11.88	199.65
Weighted Average Carbon Intensity (WACI)	8.92	143.11

¹SFML uses a proxy portfolio that represents the average weights of its portfolios; market values and exchange rates at 30 September 2026. Company-reported Scope 1 and 2 emissions (location-based Scope 2 where disclosed, no estimates), tonnes CO₂e per A\$1M invested (carbon to value) or per A\$1M of revenue; holdings weighted by the proxy portfolio's weights, covering 99.6% of the invested portfolio; holdings with no Scope 1 and 2 figure (MVP (by its ASX code), PolyNovo) are left out and the remaining weights scaled to 100%. ²S&P Dow Jones Indices, S&P/ASX 300, ESG Characteristics, as of 30 September 2026. S&P counts operational and first-tier supply chain greenhouse gas emissions, which include part of each company's suppliers' emissions; SFML's figures are Scope 1 and 2 only, so the two columns are not on the same basis. ³S&P publishes its figures per US\$1M; SFML converts them to per A\$1M at the Reserve Bank rate of A\$1 = US\$0.6977 on 30 September 2026, the rate used for SFML's own column (tonnes per US\$1M × 0.6977). ⁴Change of source: to 31 December 2025 this comparison used the Macquarie True Index-Australian Shares Fund as an approximation of the S&P/ASX 300, on LSEG (London Stock Exchange Group) data (benchmark WACI 101.92 at 31 December 2025). Those figures are not comparable with the S&P figures shown. Source: SFML FSSGEAR 2026 §10.

- Carbon to value invested – owned emissions per A\$1M of market capitalisation, so the emissions an investor is responsible for follow its level of ownership.
 - Carbon to revenue – owned emissions per A\$1M of apportioned revenue.
 - Weighted Average Carbon Intensity (WACI) – each company's emissions over revenue, weighted by its share of the portfolio.
- Two holdings make up 82% of the emissions:** James Hardie, which makes fibre cement, and CSL, which makes plasma therapies and vaccines. No other holding accounts for more than 5.2%.

Holding	Latest year	Scope 1+2 (tCO ₂ e)	Share of total
James Hardie Industries	2026	692,976	54.4%
CSL	2026	347,887	27.3%
Reece	2026	66,593	5.2%
Reliance Worldwide	2026	33,610	2.6%
Resmed	2025	27,530	2.2%
Fisher & Paykel Healthcare	2026	18,468	1.5%
Aristocrat Leisure	2025	16,823	1.3%
ARB	2026	16,019	1.3%
Cochlear	2026	14,100	1.1%
Computershare	2026	11,733	0.9%
Other 12 holdings		27,041	2.1%
Total, 22 reporting holdings		1,272,780	100.0%

The ten largest emitters; the other 12 reporting holdings are summed. Each holding's own latest reported year, from its Annual Report or sustainability report, so the years differ; no estimates. Scope 2 is location-based where the company discloses it; Nanosonics discloses market-based only; Pro Medicus and TechnologyOne do not state their basis. No Scope 1 or 2 figures on file: PolyNovo, MVP (by its ASX code). Source: SFML FSSGEAR 2026 §10.

Portfolio	Scope 1+2 (tCO ₂ e) ¹	A\$90 carbon tax
SFML reporting holdings – total	1,272,780	A\$114.6M

¹Scope 1 and 2, as reported by each company; no estimates. Carbon tax at A\$90 a tonne = emissions × 90. Source: SFML FSSGEAR 2026 §10.

Nature and biodiversity

Most holdings report on climate under the new Australian standard, AASB S2, and say nothing about nature: no biodiversity policy, no Taskforce on Nature-related Financial Disclosures (TNFD) report, and

no water or materials target. SEEK is the only holding to name a TNFD-aligned assessment, and it has not started. For the digital businesses that is a low-risk gap. It matters most for the three holdings we rate as most exposed, and for CSL, whose water target is off course:

Holding	The gap we raise with them
James Hardie	No commitment to certified fibre for the cellulose pulp in its product, and no figure for land disturbed or restored. The most nature-dependent holding, and the least governed against its footprint
Telix	Names ecosystems, water and hazardous waste as topics but rates them all below the financial-materiality bar; no biodiversity policy and no water or waste target
Fisher & Paykel Healthcare	The strongest reporter in the portfolio, but no target for water use (149,875 cubic metres in FY26) or for plastics, its two largest exposures
CSL	Water use at its priority sites is 32% above the FY2021 level against a target of no growth, and the site biodiversity assessments were deferred

Source: each company's FY2026 Annual Report and sustainability report, SFML FSSGEAR 2026 §9.

We treat nature as a governance and engagement matter, set by how material it is to each business. It is not a reason to sell; it is raised through our engagement and voting.

The coming meetings

Most of our holdings meet in October and November. We will report the results next quarter.

Meeting date	Company	Meeting date	Company
8 October 2026	REA Group	4 November 2026	Nanosonics
15 October 2026	ARB	5 November 2026	Breville Group
23 October 2026	Reliance Worldwide	11 November 2026	Flight Centre
26 October 2026	Cochlear	12 November 2026	Computershare
27 October 2026	CSL	18 November 2026	Resmed
30 October 2026	CAR Group	18 November 2026	SEEK
30 October 2026	PolyNovo	25 November 2026	Pro Medicus
30 October 2026	Reece	27 November 2026	WiseTech Global

Source: each company's Notice of Meeting or announced meeting date.

Exclusions. We do not invest in businesses earning more than 10% of revenue from thermal coal, businesses that make or sell munitions or weapons, or tobacco businesses. The SFML FSSGE (Financial Sustainability, Social, Governance and Environmental) Policy is at selectorfund.com.au/esg.

FINEOS Corporation (ASX:FCL)

FINEOS is an Irish enterprise-software company, listed on the ASX through depositary interests. It predominantly earns in USD, reports in euro, on a December year-end with an AUD market capitalisation. It sells the FINEOS platform — a cloud SaaS core system of record and claims, absence and leave, policy administration, billing and payments to life, accident and health insurers — and is used by six of the top ten tier-one United States employee-benefits carriers and more than fifty insurers in total.

The market prices the company on a high-single-digit revenue growth rate. That number is real and it is also close to meaningless, because it is the average of two lines moving in opposite directions on purpose. Subscription revenue grew 15% and crossed a majority of the total for the first time. Services revenue fell slightly, as system integrators are taking on more of the implementation work, a deliberate run-off of the low-margin half.

Underneath the average, this was a confirmation half. Company-defined EBITDA rose 32.3% to a record 24.0% margin, while operating expenses fell 2.7%, the business returned to statutory profit, and it generated €10.9m of free cash flow on zero debt. The operating-leverage

inflection is now two periods deep rather than a single print.

The result

- Total revenue €72.5m, up 7.9% (up 7.2% at constant currency)
- Subscription revenue €41.9m, up 15.0% — now 57.8% of the total
- Annual recurring revenue €87.8m, up 14.9%
- Net revenue retention 115.3%, disclosed for the first time
- Gross profit €54.6m at a 75.4% margin, down 1.2 points
- Company EBITDA €17.4m, up 32.3%, at a record 24.0% margin
- Operating profit €2.2m, against a €1.3m loss; net profit €1.9m
- Free cash flow €10.9m; cash €39.0m with no external debt

One correction to the company's own material: the media release stated that gross margin "increased by 6.3 percentage points", which conflates the 6.3% growth in gross profit euros with a margin movement. The correct figure, from both the accounts and the slides, is a 1.2 point *decline* to 75.4%.

Revenue by type	H1 FY26	H1 FY25	Change
Subscription	€41.9m	€36.4m	+15.0%
Services	€30.2m	€30.4m	(0.7%)
Initial licence fees	€0.4m	€0.3m	+23.3%
Total revenue	€72.5m	€67.2m	+7.9%

The mix shift is the whole story: subscription crossed a majority of revenue for the first time at 57.8%, while services fell as system integrators took on more implementation delivery. Each point of that shift drops through to margin.

The operating-leverage equation sits below the gross-profit line. Product development and delivery costs fell 11.3% to €26.6m, so total operating expenses fell 2.7% to €37.2m, even as revenue grew, which is what lifted EBITDA 32.3% and the margin 440 basis points in a single year. General and administration costs rose 30% to €9.3m, the one cost line moving the wrong way, and sales and marketing remains strikingly small at €1.7m. This is a business that sells through reference accounts and system integrator relationships rather than a field force.

The amortisation gate

The single most important line in the FINEOS accounts is amortisation, and it is the reason the reported returns look nothing like the economics. €14.5m of amortisation reduces company EBITDA of €17.4m to €2.2m of operating profit. Of this charge, only €1.0m is amortisation of acquired intangibles, while €13.2m relates to internally developed software. We treat the latter as a real economic cost that we do not add back.

The consequence is that canonical return on capital employed is 5.0%, on annualised EBITDA of €6.4m

against €126.9m of capital employed. On any earnings-based return screen the business looks weak. It is not. The charge is the accounting shadow of a €93m capitalised-development base, which an increasing recurring-revenue line is progressively outgrowing. The return re-rates as revenue scales past the fixed development base. That is a timing effect, not a decline, but it is also the reason an investor who cannot look through the gate will not own this business today.

FINEOS invested €24.5m in research and development in the half, roughly 34% of revenue, of which €15.1m qualified for capitalisation under the accounting standard and is amortised over three to ten years. The policy is compliant and consistently applied, and our response is to strip the internally developed amortisation back out of EBITDA rather than to treat the accounting as aggressive. The more interesting fact is that product development and delivery costs *fell* 11.3% in the half. Development spend fell in absolute terms, while revenue and recurring revenue grew, which is exactly what a maturing platform's reinvestment curve should look like.

Cash flow

Operating cash flow was €26.8m, against €30.1m in the prior half, and it is seasonally flattered: subscription invoices are predominantly issued in the first half, so deferred revenue rose €18.1m. Capital expenditure of €16.1m was almost entirely capitalised software. Free cash flow of €10.9m compares with €6.4m for the whole of FY2025.

We flag the seasonality honestly — annualising a first-half cash figure overstates the through-cycle rate — but the direction is unambiguous: negative €8.4m in FY2024, positive €6.4m in FY2025, positive €10.9m in this half alone, with cash rising to €39.0m and no external debt in the structure. Two subscription and services invoices totalling about €8.0m were issued after the balance date and collected in July, and the company front-loaded its annual insurance and software licence payments into the first half. On the same zero-debt balance sheet, underlying current cash is closer to €50m. Against that sits a €3.2m provision for an estimated infrastructure-spend commitment shortfall due in late 2027, a real future outflow, not a cash add-back.

What this changes is the character of the investment. FINEOS no longer needs external capital to fund its own

development. The capitalised-development base is being paid for out of operating cash, while the platform outgrows it. There is no refinancing risk and no balance sheet path to permanent impairment.

What we are watching

The gross-margin slip is the one line to confirm at the full year. Cost of sales rose 13.4% against 7.9% revenue growth on higher employee and contractor delivery costs. Management guides the full-year margin to return closer to the FY2025 76.2%. We read it as timing and mix rather than structural erosion. However, for a business whose entire thesis is a guided margin walk toward 40%, a gross-margin step-down is the line that deserves the most scrutiny.

Founder control is absolute, and it cuts both ways. Michael Kelly founded FINEOS in 1993, runs it as executive chairman and chief executive, and holds 50.46% of the register (174.0m depositary interests, worth roughly A\$341m). He took no options for six years after the 2019 listing, has never sold, and keeps buying; his first-ever grant, in April 2026, was 150,000 options. When the person who knows the business best owns half of it and keeps adding, that is the strongest alignment signal a controlled company can offer. It is also total key-person concentration, with a combined chairman and chief executive role and a four-person board. While the board may miss the dedicated chartered-accountant financial acumen following the retirement of a director, management depth and duration is real. While we currently view the board as fit for purpose, minority shareholders are relying on the founder's alignment substituting for structural protection. That alignment is genuine, but it is also the single point of risk.

Net revenue retention was disclosed for the first time, and it is strong. At 115.3%, the installed base is expanding at 15% net of churn, with carriers adding lines of business, lives and claims on a platform they already run. This is the metric that best separates a durable subscription compounder from a flat maintenance-revenue base, and it is the quantitative expression of the switching costs: a tier-one customer's own chief-executive-level review has conceded that the cost of moving off is prohibitively high.

The commercial engine added two new logos and a ten-year expansion. Australia's Motor Accident Insurance Board and an unnamed North American

carrier took the claims administration suite; OneAmerica cross-bought modules and signed a ten-year contract for two more. New Zealand's Accident Compensation Corporation completed its migration onto the platform within two years, demonstrating strong implementation capability, which in enterprise insurance software is not always a given.

Guidance

FINEOS has met every guided revenue, cost and free-cash-flow line it has set since moving to calendar-year reporting — three years, three lines each, no misses. FY2025 was the year the free-cash-flow guidance stopped being aspirational at €6.4m positive, the first full calendar year of self-funding since the 2019 listing.

Medium-term target	FY2027	FY2029	At H1 FY26
Subscription share of revenue	65%	75%	57.8%
Gross margin	75%	80%	75.4%
EBITDA margin	25%	40%	24.0%
R&D share of revenue	30%	25%	~34%

Management's reaffirmed medium-term targets against the half just reported. The EBITDA margin is already within a point of the FY2027 goalpost — the margin walk is running ahead of schedule, and it is being driven by cost discipline rather than one-off items.

Conclusion

At A\$1.96, the shares trade at roughly 4.0x recurring revenue and 2.4x forward revenue, against the mid-teens revenue multiples that listed vertical insurance-software peers command. The market is anchoring on a high-single-digit headline growth rate and a 5.0% return on capital, both of which are artefacts — one of a deliberate services run-off, the other of a non-cash amortisation charge — rather than descriptions of the business underneath.

Two of the standard screens we run — the buyout spread and the return on capital — come out poorly, and both do so for the same reason: they are computed on trough earnings that a non-cash amortisation charge and a deliberately suppressed services line hold down. On the forward earnings base the business is walking

The line to watch rather than celebrate is revenue. FY2025 revenue of €138.4m cleared its own €138m floor by €0.4m, and did so only because a €3.3m currency headwind absorbed what the constant-currency result of €141.7m would otherwise have added. With 71% of revenue earned in USD, a further move in the euro is the risk sitting under the guidance, not a change in the subscription engine.

FY2026 revenue guidance of €147m to €152m has now been reiterated three times unrevised: at the FY2025 result, first-quarter update, and latest half-year result. We read that as genuine confidence in the outlook rather than an unchanged number that has not been revisited.

toward, neither looks the same. The moat is one Strong Helmer power — Switching Costs, on a mission-critical system of record with multi-year implementations, retention above 90% and net revenue retention of 115.3% — with scale economies and process power Moderate.

The thesis rests on three things staying true: the revenue mix continues to shift toward the 65% and 75% subscription targets and drops through to margin; the switching costs help retain the installed base and open to cross-selling opportunities with the migration to cloud, which the retention figure says they do; and that the founder's 50.46% continues to substitute for the governance protections a controlled company otherwise lacks. All three are currently intact and trending favourably.

Where it trades	Value	Basis
Price	A\$1.96	~1 August 2026
Market capitalisation	A\$676m	345.0m CDIs on issue; roughly €391m
EV / annual recurring revenue	~4.0x	EV ~€352m on ARR of €87.8m
EV / revenue	~2.4x	On the FY2026 guidance midpoint of ~€149.5m
Free cash flow yield	~5.6%	H1 free cash flow annualised — seasonally elevated
Net cash	+€39.0m	No external debt; excludes lease liabilities

The things that would change our reading are specific and testable: subscription growth below 5%, net revenue retention below 105%, EBITDA margin failing to hold 22% at the full year, free cash flow turning negative again, or the founder selling. Absent those, this is a

founder-owned, net-cash, cash-generative business growing recurring revenue at about 15%, with a margin walking from 24% toward 40%, at a fraction of the multiples its listed peers carry.

James Hardie Industries (ASX:JHX)

When we last wrote about James Hardie at length, the AZEK acquisition was a controversy rather than a business. The three objections were dilution, the absence of a shareholder vote, and the listing designation. At the time, we said that the first was real in the short term, the second was a legitimate grievance, and the third was a side show. What we could not do then was see how the combined company would work.

This is the first full quarter of combined ownership, and it is a clean beat-and-raise. Net sales and adjusted EBITDA both exceeded the guidance issued in May, the FY27 outlook was lifted, and the two numbers that most matter to the thesis moved the right way: adjusted EBITDA margin expanded 230 basis points to 28.6%, and net leverage fell from 3.30x to 2.70x in a single quarter.

For a first integrated quarter — historically the most error-prone period after a transformational deal — that is a meaningful execution signal.

The result

One thing to flag on the headline before the numbers. AZEK closed on 1 July 2025, the start of the second quarter of FY26, so the prior-year comparative excludes it entirely and the reported +64% net sales growth is not like-for-like. The meaningful reads are the pro-forma comparison and the organic volume line.

- Net sales US\$1,474.6M, up 12% pro-forma (up 64% reported)
- Siding & Trim US\$859.8M, up 34% — and up 20% on organic volume
- Deck, Rail & Accessories US\$305.1M, down 5% pro-forma on a channel inventory reset
- Adjusted EBITDA US\$422.1M, up 16% pro-forma, at a 28.6% margin — up 230 basis points
- Operating income US\$217.7M, up 57%; net income US\$104.3M, up 67%
- Adjusted diluted EPS US\$0.36, up 13%
- Free cash flow US\$254.2M, up 145%
- Net debt US\$4,016.4M, down US\$281.6M in the quarter; net leverage 2.70x from 3.30x

The most important line in the profit and loss is the one that barely moved. Gross margin held at 37.2%, down just 20 basis points, even though the acquired decking business carries a structurally lower gross margin and dilutes the mix. Volume leverage in siding and the

Hardie Operating System cost program almost fully offset it, a materially better outcome than the 300 basis points of gross-margin contraction the prior full year delivered.

Adjusted EPS grew 13% against 16% pro-forma EBITDA growth, and the gap is share count: 584.3m diluted shares against 431.1m, a 36% increase, because 148.9m shares were issued as AZEK consideration. That is the dilution the market objected to, arriving on schedule and exactly as advertised.

A definition change worth naming

Effective 30 June 2026, James Hardie revised its definition of adjusted EBITDA to exclude share-based compensation, citing transparency and peer comparability. Prior periods were recast, so the year-on-year improvement is barely affected — 2.3 percentage points of margin expansion on the new definition against 2.5 on the old.

What does not survive the change is any comparison against adjusted EBITDA as the company published it before that date, including against the original guidance base. On the old definition, this quarter's figure is US\$407.3m at a 27.6% margin rather than US\$422.1m at 28.6%; the FY26 figure is US\$1,265.8m at 26.2% rather than US\$1,303.1m at 26.9%. Share-based compensation is a real cost of employing people, non-cash or not, and a company that removes it from its own headline measure has made its margin look 100 basis points better without anything changing in the business. We use the reported figure because it is the company's, and we note what it now excludes. The beat against guidance is comfortable on either basis.

Cash flow and the deleveraging

This is the quarter that validates the balance-sheet leg of the thesis. Free cash flow more than doubled to US\$254.2M, on operating cash flow of US\$344.0M and capital expenditure that fell to US\$89.8M. James Hardie reports under United States accounting standards, which puts interest paid inside operating activities, so that figure is already struck after the cost of the debt.

US\$254.2m of free cash flow funded a US\$281.6m reduction in net debt, with the US\$400m 5.000% senior unsecured notes redeemed in June. The single clearest driver of the step-up is the roll-off of the FY26

acquisition and integration cost bulge, US\$206.9m for that full year, with acquisition-related expense down 43% to US\$16.6m this quarter. Management guides FY27 free cash flow of at least US\$500m and capital expenditure to be in the range of 6% to 7% of net sales, down from 7.9%, stating the current footprint needs no significant new capacity in the near term.

The permanent claim on cash is the asbestos program (US\$33.1m paid this quarter, US\$107.0m for FY26), which will drag cash conversion by several points every year regardless of operating performance. It is a known, actuarially bounded liability rather than a surprise. Management reaffirmed the target of net leverage under 2.0x by the end of the second quarter of FY28; on the trailing-twelve-month free cash flow run rate of US\$356.4m, that path is arithmetically credible.

Research and development

Research and development (R&D) was US\$15.4m in the quarter, roughly 1.0% of net sales, and US\$60.7m for FY26 at 1.3% intensity. All of it is expensed; capitalised R&D is nil. That is low by software standards and appropriate for a building-products manufacturer, as the value here is not in the spend but in the speed of commercial deployment.

Two programs carry that argument. **ColorPlus Reset** is a three-tier pre-finished siding system designed to eliminate job-site painting and close the installed-cost gap with vinyl. It was developed, tested and regionally deployed inside eighteen months, and the Midwest East region, which has been live since April 2025, is generating a consistent 10% to 20% ship-to-revenue uplift. **Trim-Over** is a proprietary installation method for fitting fibre-cement trim directly over existing vinyl, and the mechanism is elegant: boards are scored and snapped on site, producing one rough end and leaving the factory edge precision-perfect, and every visible joint is lapped by a factory edge rather than an on-site cut. As no precision cutting team is needed, installation time falls about 30% and the cost lands near half of a full replacement. Cutting labour, not product cost, has been the structural barrier in the more than US\$40b United States vinyl-siding retrofit market, and this removes it.

What we are watching

The securities litigation broadened this quarter, and no reserve is recorded. The United States federal class action reached the motion-to-dismiss stage, with the

Company's motion filed on 22 June 2026 and briefing scheduled to complete on 5 October 2026. Separately, three state-court actions by former AZEK stockholders were filed in February and March 2026, one of them naming the auditor as a co-defendant. In the quarter, the two Illinois cases were consolidated, the New York action was voluntarily discontinued, and a combined Illinois complaint was filed. A second Australian group proceeding was also filed in April. James Hardie believes the United States claims are without merit and has recorded no reserve, judging a loss neither probable nor reasonably estimable. This keeps the chief executive's trust register on watch.

The destocking that triggered the litigation has reversed into genuine volume recovery. North American fibre cement returned to 20% organic volume growth and the siding segment's adjusted EBITDA margin expanded 140 basis points to 33.5%. The very inventory dynamic the plaintiffs allege management downplayed in mid-2025 has now unwound into demand. That is the single most important operational data point in the quarter, and it is worth holding both facts at once: the litigation is broader, and the underlying allegation looks more cyclical with every passing quarter.

The decking business went backwards, and that is where the synergy case must be proved. Deck, Rail and Accessories net sales fell 5% pro-forma as distributors and dealers worked down inventory. Management frames it as a deliberate channel reset rather than end-demand weakness, with sell-through approaching double-digit growth and accelerating each month, outpacing shipments, and both North American segments entering the second quarter on normalised inventory. It is a reminder that the United States repair-and-remodel and outdoor-living cycle remains soft.

Synergies are running ahead of schedule. US\$29m of cost synergies were banked in the quarter on top of US\$37m in FY26, against a US\$125m three-year target — management's own word is "ahead of schedule". The US\$500m five-year commercial-synergy program, which is the cross-sell of siding and decking through shared pro-dealer channels, is on track and supported by a recently announced expanded nationwide distribution agreement.

Guidance

Every guided line was beaten. Consolidated net sales of US\$1,474.6m came in US\$120.6m (or 8.9%) above the top of the US\$1,315m to US\$1,354m range; adjusted EBITDA of US\$422.1m was 12.6% higher under the new definition and still 8.6% above it on a like-for-like basis. Siding and Trim beat its net sales guide by 10.1% and decking beat both of its lines.

The FY27 outlook was lifted to net sales of US\$5.564bn to US\$5.723bn, adjusted EBITDA of US\$1.536b to US\$1.625bn, and free cash flow of at least US\$500M. The three-year record behind that raise is consistent: FY2025 met every guided line, and FY2026 met or beat every line on the AZEK-inclusive basis, with consolidated adjusted EBITDA of US\$1,265.8M finishing above the raised top of its range. The one place we would put an asterisk is FY2026 free cash flow, which cleared its US\$200M floor by only US\$5.9m on our own operating-cash-less-capital-expenditure convention.

Conclusion

Where it trades	Value	Basis
Price	US\$28.42	NYSE; ASX close A\$40.42, 7 August 2026
Market capitalisation	US\$16.49bn	580.4m shares; roughly A\$23.5bn
EV / adjusted EBITDA	13.8x	On trailing-twelve-month adjusted EBITDA of US\$1,488.8M
Free cash flow yield	2.2%	Trailing-twelve-month free cash flow US\$356.4M
Net debt / adjusted EBITDA	2.70x	From 3.30x; target below 2.0x by Q2 FY28
Canonical ROCE	10.5%	Trailing twelve months; depressed by the AZEK capital step-up
3yr forward buyout yield	7.5%	On EBITA grown for three years; 13.8x trailing EV/EBITDA today

Return on capital is depressed for a specific reason: the AZEK acquisition added roughly US\$8bn of goodwill and intangibles to the capital base, so the group figure is diluted by the deal rather than by operating deterioration. The core siding franchise earns a far higher return on its own capital.

The quarter resolved two of the three things left open a year ago. The fibre-cement destocking was cyclical, and it is reversing. The AZEK debt is a scheduled repayment rather than a structural overhang, and it is being repaid faster than the schedule requires. The third — the securities litigation — is still open and, if anything, broader.

What has to be true from here is straightforward. The United States repair-and-remodel and new-construction cycle has to recover enough to sustain mid-single-digit-plus organic siding volume growth, because that single variable drives the margin, the cash flow and the deleveraging pace simultaneously. The integration has to deliver its US\$125m of cost and

US\$500m of commercial synergies, turning decking from a mix-diluter into a cross-sell engine. And the balance sheet has to reach under 2.0x without a large adverse cash event.

The moat is unchanged at two Strong Helmer powers: Scale Economies, as the largest North American fibre-cement manufacturer with a lean-manufacturing cost advantage, and Branding, in the named-specification pull the Hardie mark carries. Switching costs and process power remain Partial. Four things are working: the moat, the growth, the structural tailwind and the operating scorecard. Four are not yet resolved: the shares trade at 13.8 times trailing EV/EBITDA, group return on capital is 10.5%, the CEO's

trust register stays on watch until the class action resolves without an adverse conduct finding, and net leverage at 2.70x is a long way from where a fortress balance sheet sits, though it is falling on a credible path.

None of the four shows permanent structural decline. The deleveraging and the volume recovery are moving the picture in the right direction quarter by quarter.

Nanosonics (ASX:NAN)

Nanosonics reported a 2.7% revenue year and the shares fell 16% on the day. Neither number tells you much on its own, because the group profit and loss is really two businesses added together and then presented as one.

The trophon franchise, the ultrasound-probe disinfection installed base, earned A\$50.6m of EBIT, up 5% reported and 16% at constant currency, on operating expenses that fell 1%. CORIS, the endoscope-reprocessing platform that has regulatory clearance in four jurisdictions and almost no revenue, cost A\$34.6m. The reported group EBIT of A\$16.0m is the first figure less the second, exactly. That is not an accident of accounting; it is a decision, made deliberately and disclosed clearly.

What the market reacted to was something narrower and, we think, more important than the headline: core consumables revenue was flat against an installed base that grew 6%. In a razor-and-blades business, this is the one line that is not allowed to go sideways.

The result

- Revenue A\$203.9m, up 2.7% reported and 6% at constant currency (A\$211.5m)
- Recurring revenue A\$149.2m — 73.2% of the total
- Gross profit A\$156.8m at a 76.9% margin, down 1.3 points
- EBIT A\$16.0m, down 10.2%; A\$21.6m at constant currency, up 21%
- NPAT A\$17.8m, down 13.7%; EPS 5.90 cents
- Free cash flow A\$17.4m, down 50.6%
- Cash A\$155.2m, no borrowings
- SFML canonical ROCE 18.7%, from 31.8%

Currency does most of the work between the reported revenue and constant-currency, accounting for an A\$7.6m drag on revenue and A\$4.7m on EBIT. The gross margin decline splits almost evenly: 0.6 points of product mix, 0.7 points of a stronger Australian dollar. Tariffs were not the driver this year, as Nanosonics recovered A\$2.5m of United States tariffs paid up to February 2026, leaving A\$0.6m residual. That recovery does not repeat, which is the principal reason FY27 gross margin is guided down.

The consumables line

Core consumables were A\$92.6m against A\$92.2m, up 0.4% reported and 4% at constant currency, while the cumulative installed base rose from 37,000 to 39,230 devices. On average installed base, core consumables revenue per device fell from A\$2,569 to A\$2,429, down 5.4% reported and 1.7% at constant currency. The entire investment case rests on each installed device throwing off a growing, predictable annuity. A flat consumables line against a growing fleet is precisely the evidence that would falsify it.

Management indicated on the results call that roughly A\$2m of the shortfall was a weather event in the north-east of the United States in the third quarter, which reduced hospital foot traffic and subsequently reversed in the fourth quarter. Add it back and constant-currency revenue per device is A\$2,576 against A\$2,569, essentially flat rather than down. However, this was an unaudited quantum given on the call, not a disclosed restatement, so the concern remains open. It resolves in one number in February: core consumables revenue per average installed device at the FY27 half.

Two things support management's reading. Total annuity revenue per average installed device was A\$3,859 at constant currency against A\$3,808, up 1.3%, driven by an increase in service revenue to 14% reported and 19% at constant currency, which offset the softness. And the competitive evidence points the other way to attrition: placements of 4,230 devices were the strongest in three years, North American placements hit a record of 3,880, and North American upgrades jumped 32% to 1,980. Asked directly whether retiring the original trophon EPR was costing consumables volume, management said it has not lost a single large account that went to evaluation, and some low-volume users who moved to a competing chemistry have since returned. A franchise losing its base does not simultaneously set a placement record.

The second-half shape is harder to dismiss. First-half revenue grew 9.2%; the derived second half was A\$101.7m against A\$105.0m, down 3.2%, with second-half EBIT down 16.4%. The company publishes no constant-currency split by half, so shareholders cannot separate currency from demand, which sits

awkwardly beside a results narrative leaning on second-half pricing strength.

Cash flow

Free cash flow halved to A\$17.4m and cash conversion fell from 136.3% of EBITDA to 70.5%. Four items explain the A\$21.4m fall in operating cash flow: supplier and employee payments up A\$17.7m, the non-recurrence of a A\$2.8m government grant that closed on 30 June 2025, customer receipts down A\$2.3m, partly offset by lower tax paid. The payments increase is working capital; inventories rose 48% from A\$18.6m to A\$27.6m, a deliberate pre-position for the CORIS launch and a trophon volume year, and receivables rose A\$7.8m to A\$45.7m, faster than the 2.7% revenue growth.

One detail deserves stating because it changes what the operating line means. Interest received of A\$5.8m sits inside operating cash flow. That is 25.9% of the reported figure, and it is a return on the cash pile rather than on the business. Strip it and cash from trading operations was A\$16.7m. We would treat A\$17.4m of free cash flow, 8.5% of revenue on a 76.9% gross margin, as the honest current run rate, and we expect it to fall again in FY27 as the investment step-up lands before the revenue does.

Research and development

Research and development (R&D) fell 8.4% to A\$31.8m, easing from 17.5% of revenue to 15.6%. That is a rotation, not a retreat: trophon spend fell 17% to A\$10.3m as trophon3 and trophon2 Plus moved from development into launch, while total CORIS operating spend rose 13% to A\$34.6m. On the derivation, CORIS now consumes roughly two-thirds of the entire R&D budget.

Nanosonics capitalises nothing. Development is expensed as incurred, leaving zero intangible assets on the balance sheet. As a result, there is no development asset to impair, amortise or write back, and no goodwill, cash-generating-unit test, or discount-rate assumption anywhere in the accounts. Three consequences follow. Reported earnings absorb the full CORIS cost in the year it is spent. The day CORIS revenue arrives, the operating leverage is unusually clean, as there is no amortisation tail to absorb. And the embedded option — clearances in four jurisdictions, five live reference sites, the PULSS technology — carries a book value of zero.

The risk is not the accounting; it is that two-thirds of the research budget now sits on a product with no revenue history, and the company has not disclosed a cumulative-to-date CORIS investment figure against which to size the bet.

What we are watching

CORIS is through the gates and the unit economics are now on the record. Approvals in Australia, Europe and the United Kingdom, a first FDA clearance in the United States with a second submitted, five controlled-market-release sites live across four markets, and a phased FY27 launch (the UK, Ireland and Australia first, the United States second) targeting 20 to 30 sites. Management's indicative economics are the reason the A\$34.6m is defensible: capital pricing at three to five times a trophon unit, consumables at four to six times the price per cycle, roughly ten cycles per device per day against trophon's utilisation, and service attachment of 80%-100% against trophon's 55%-60%, into a stated addressable market above 60 million procedures. Those figures are expressly flagged as early-stage estimates subject to change.

The company hired the incumbent's operator to run the launch market. Bill Haydon joined as Regional President, North America in December 2025 from Cantel, a global leader in infection prevention and endoscope reprocessing. Ronan Wright, running Europe and the Middle East, came through Pentax Medical, Johnson & Johnson's Advanced Sterilization Products and Wassenburg. Nanosonics is entering endoscope reprocessing with two regional presidents drawn directly from the franchises it will compete against. In other words, channel knowledge that is worth more at this moment than at any other point in the company's history.

One geography carries the franchise. North America is 91.4% of revenue, 91.7% of device placements and 99.0% of upgrades. Tariffs, currency movements, United States elective-procedure volumes and the competitive entry the company itself flags in its guidance assumptions, are therefore one correlated exposure rather than four independent of each other. Against that, consumables manufacturing has now moved from Australia to Indianapolis, framed in the sustainability report as a transport-emissions initiative, but commercially a tariff hedge, bringing a growing share of consumables production inside the wall.

The balance sheet is being used rather than hoarded.

A\$155.2m of cash, no borrowings, a A\$20m buyback completed during the year at an average A\$3.606 per share and a further A\$40m authorised for FY27 — all while funding A\$34.6m of annual CORIS investment and a new headquarters lease. Capital returned and a second platform funded from the same balance sheet, with no recourse to equity markets.

There is still a founder in the room. Nanosonics is not a business that has been handed over to professional management and left there: co-founder Maurie Stang remains involved in an advisory board capacity and the family retains a substantial position on the register. That is an SFML engagement finding rather than an Annual Report disclosure (the Annual Report does not attribute

founder status to any holder), but it is the correct way to read the alignment here, and it complements the fact that every director and executive held or added shares during the year and none sold.

Guidance

Nanosonics missed its FY26 revenue guidance and exceeded everything else. Constant-currency revenue of A\$211.5m landed A\$3.5m below the A\$215m-A\$223m range, growing 6% against 8%-12% guided. Gross margin of 76.9% sat in the upper half of the 75%-77% range. Operating expenses of A\$141.4m came in A\$5.6m below the bottom of the A\$147m-A\$151m range, which was a favourable miss and the reason earnings held while revenue did not.

Year	Line	Original guidance	Actual	Outcome
FY2024	Revenue	+15–20%, cut to A\$164–171m in Feb	A\$170.0m, +2%	Miss
FY2025	Revenue	+8–12%, upgraded in-year	A\$198.6m, +17%	Beat
FY2026	Revenue	A\$215–223m CC, +8–12%	A\$211.5m CC, +6%	Miss
FY2026	Gross margin	75–77%	76.9%	Met
FY2026	Operating expenses	A\$147–151m, +6–9%	A\$141.4m, +4% CC	Beat

Each row is scored against the original guidance, because that is what the Company undertook at the start of the year. On the operating-expense row, coming in below guidance is the favourable direction. Outcomes are SFML assessments of delivery against guidance.

The pattern across three years is consistent and worth mentioning: Nanosonics forecasts its own cost base reliably and its customers' capital budgets poorly. That is exactly what to expect from a business selling capital equipment into hospital budget cycles, and it is the exposure the FY27 range carries again, with a first CORIS revenue contribution that has never been forecast before.

FY27 guidance is revenue of A\$220m-A\$228m, gross margin of 74%-76% on a full twelve months of United States tariffs at 12.5%, operating expenses of A\$156m-A\$163m, with the majority of the growth relating to CORIS, and CORIS revenue in the low single-digit millions. Nanosonics does not guide an earnings figure. On our arithmetic, the range implies group EBIT before other income of anywhere between negative A\$0.2m and positive A\$17.3m, midpoint near A\$8.5m, against A\$16.0m delivered. A second

consecutive year of earnings compression is therefore the guided base case rather than a downside scenario.

The most important thing management said about the step-up is that it does not repeat. Asked on the call whether the A\$34m CORIS cost base would be stable, management said the FY26 increment was specialist sales headcount in the launch regions, installation support and marketing, and that it will not step up again. That converts a 10%-15% operating-expense increase from an open-ended commitment into a one-year build. It is commentary rather than guidance, and the FY28 operating-expense line will be the test.

Conclusion

FY26 confirmed the franchise and challenged the flywheel. The trophon business is high-return, still taking placements at a three-year record, and generating expanding operating leverage, while funding

a second platform out of its own cash flow. Canonical return on capital fell from 31.8% to 18.7% — roughly half an earnings story and half a capital-base story, since capital employed rose 53% largely on the new headquarter's lease. The result did not break the thesis, instead it removed the margin for error.

The franchise itself is not in question. Nanosonics is high-return, debt-free, carries one Strong Helmer power in its Switching Costs, and sits in front of a structural tailwind. However, on this result, the switching-costs advantage is narrowing. What has changed is the price of admission relative to what the business is currently delivering: a three-year forward buyout yield of 3.4%

and a three-year reported revenue CAGR of 7.1%. At A\$3.08, the market is paying roughly fair value for the guided base case, with the CORIS optionality lightly priced or unpriced.

Two things would materially change that reading. The first is two consecutive halves of rising constant-currency consumables revenue per installed device, which would settle whether this year's flat line was weather driven or the beginning of something structural. The second is CORIS clearing the top of its own 20-30 site target. The single number that starts to answer the first arrives in February.

Pro Medicus (ASX:PME)

Pro Medicus reported a 130.3% increase in net profit and did not have a 130% year. It had a very good year, with revenue up 22.9%, the underlying operating margin widening again to 74.9% and six renewals from six on full five-year terms at higher rates, wearing a headline that belongs to something else entirely.

The something else is a A\$10m secured loan the company made to 4D Medical, which was marked up by A\$172.0m at balance date. That single revaluation turns a 24% underlying result into a 130% reported one. And it is already reversing: 4D Medical's share price fell from A\$4.53 at 30 June to A\$3.71 by 17 August, which the company itself discloses would cut the carrying value from A\$182.0m to A\$149.1m. That is, a A\$32.9m reversal in seven weeks, before the FY27 accounts had opened.

We underwrite the A\$196.1m of underlying operating profit, not the A\$377.5m of reported profit before tax. On that basis, this is an exceptional franchise doing exactly what it has done for a decade, priced at roughly 139x underlying earnings.

The result

- Revenue A\$261.7m, up 22.9% reported and 28.4% at constant currency
- North America A\$236.8m, up 24.0% — 90.5% of group revenue
- Underlying EBIT A\$196.1m, up 24.4%, at a 74.9% margin, up 90 basis points
- Underlying NPAT A\$144.7m, up 24.1%; A\$154.5m and up 32.5% at constant currency
- Reported NPAT A\$265.3m, up 130.3% — including a A\$174.2m unrealised fair value gain
- Operating cash flow A\$127.5m, up 14.5%; free cash flow A\$118.8m
- Dividends 69.0 cents fully franked, up 25.5%
- Net cash A\$216.1m; no borrowings

The margin arithmetic is worth pausing on, because it is the whole business in one line. Employee benefits, the largest cost by a distance, rose 16.0% against 22.9% revenue growth and 13.3% headcount growth. That gap is the 90 basis points of margin expansion. A business with a 74.9% operating margin that is still growing, at scale, after a decade of doing so, is a rare thing; the chief executive's own observation is that the margin runs at roughly three times the nearest competitor's.

The order book

The commercial year is the part of this result that will still matter in five years. Six contracts came up for renewal, with each renewed: Northwestern Health at A\$37m, Medstar A\$31m, Allegheny A\$28m, FMOL Health A\$20m, Ohio State A\$16m and Zwanger-Pesiri A\$9m. All six were signed for a full five-year term, most with higher minimums, at increased fees per transaction. The 100% renewal record since inception is intact.

That is the direct refutation of the argument that artificial intelligence will let health systems build or buy something cheaper. When a client's contract expires and is re-signed for five more years at a higher price, it has answered the question in the only way that counts.

New business added A\$407m in the second-best sales year on record, anchored by UC Health Colorado at A\$170m over ten years and Beth Israel Lahey Health at A\$90m over seven. Five-year total contract value signed now stands at A\$1.75b and minimum contracted revenue over the next five years is A\$1.3b, up 41% — a floor that excludes any exam volumes above the contracted minimums.

Two other things ran alongside. Cardiology has become a repeatable second product rather than a single win, taken by Vancouver Clinic, TidalHealth, Medstar and Ohio State in the year. Health systems are shifting from separate specialty-specific viewers and archives to a unified solution, largely because cardiac imaging is becoming just as data-intensive as radiology. Implementation speed is also now a competitive advantage in its own right: sixteen go-lives in one year, including four Trinity Health cohorts, delivered on or ahead of schedule, with large projects completed four to five times faster than the industry norm. Quicker implementation means revenue starts sooner, the client incurs its switching cost once and sooner, and the reference base grows.

Cashflow

Operating cash flow of A\$127.5m against reported profit of A\$265.3m looks alarming for about as long as it takes to remove the A\$174.2m non-cash mark. Measured against underlying earnings, conversion is

88% for a business that pays its tax in cash (A\$57.8m) and carries almost no capital intensity.

The line we are watching is receivables. Trade and other receivables rose A\$33.6m to A\$100.4m, up 55.7% against 22.9% revenue growth, and receipts from customers of A\$244.2m trailed revenue by A\$17.5m. Management's explanation is that implementations were weighted to the late second half, which is consistent with the operational record and with the go-live schedule. It is also an explanation that has to be validated in FY27 rather than assumed: if the receivable does not unwind as those contracts bill through, it becomes a question about collection on the largest contracts rather than about demand.

One further item from the investing line deserves mentioning, because the investment portfolio has quietly become a second business. Non-current other financial assets went from A\$7.3m to A\$189.4m in a single year: the A\$182.0m 4D Medical instrument, a A\$7.3m stake in Elucid Bioimaging, and a further A\$36.2m of current debt instruments and hybrids. The CEO frames 4D Medical and Echo IQ as strategic investments with algorithm-reselling potential and notes the company has done well on return on capital. Both things are true. It also means an A\$18b-plus company's reported earnings now move materially with the share prices of two ASX small caps.

Research and development

Capitalised development was A\$8.2m, or 3.1% of revenue, amortised over five years; intangible assets of A\$22.1m sit on a A\$610.1m balance sheet and there is no acquired goodwill in the group. The accounting is conservative in the way that matters; the entire intangible base is internally generated software, and the great majority of the engineering cost flows through the A\$42.1m employee benefits line at the Berlin development centre, rather than onto the balance sheet.

The important number here is not the A\$8.2m capitalised, but the A\$42.1m of employee cost that produced two production-ready products in a single year, while the operating margin continued to widen. Digital pathology is live in Europe, with the United States to follow. An AI-driven reporting platform that replaces legacy third-party reporting systems is also in production in Europe, with a United States launch planned for the first half of calendar 2027. Neither is yet

a revenue line. That is the signature of a business whose research spend is genuinely incremental rather than maintenance: the platform does not need to be rebuilt to carry a new modality. We would become concerned if capitalised development began growing materially faster than revenue, as that would suggest the one-platform claim was breaking down into separate products. At 3.1% of revenue and falling as a share, it is not.

What we are watching

North America is now a structural concentration, not an incidental one. At A\$236.8m of A\$261.7m, it is 90.5% of revenue and compounded at 26% a year, while Australia grew 5% and Europe 3%. Every material driver of the thesis, including pricing, renewals, implementation cadence and the artificial-intelligence opportunity, is a bet on United States health-system procurement, and there is no second geography of scale to absorb a United States-specific reimbursement, regulatory or budget shock.

Recurring-revenue disclosure has not kept pace with the valuation. Pro Medicus does not disclose annual recurring revenue, net revenue retention, gross churn or customer acquisition cost. For a business valued at roughly 139x underlying earnings, the absence of the standard software quality metrics means the market is underwriting a 100% renewal record and a contracted minimum. While both are real, neither reflect the disclosure a comparably valued software business would ordinarily provide.

The founders are still in the room and still buying. Dr Sam Hupert, the CEO, and Anthony Hall, an executive director, co-founded the business and hold 23.16% and 23.14% respectively. With 46.3% between them, they serve as the only two substantial shareholders on the register. Both co-founders added stock during the year. This underscores the founder-in-place alignment of the strongest kind, as the people running the business effectively carry the same downside as the register.

Guidance

Pro Medicus maintains a standing position of providing no numerical guidance to the market, verified across three annual reporting periods. However, it publishes precise, board-approved, quantified targets in its remuneration report, and those are the best available measure of whether management forecasts its own

business. On that scorecard, the FY26 record is split, and the split is instructive.

Year	Internal target	Actual	Outcome
FY2024	Underlying EBIT A\$111.4m	A\$105.0m	Miss — 24.6% payout
FY2024	Underlying revenue A\$152.0m	A\$152.5m	Beat
FY2025	Underlying EBIT A\$147.5m	A\$152.4m	Beat — 136.3% payout
FY2025	Underlying revenue A\$196.5m	A\$206.3m	Beat — 188.9% payout
FY2026	Underlying EBIT A\$210.0m	A\$199.5m	Miss — below threshold, nil payout
FY2026	Underlying revenue A\$259.2m	A\$266.6m	Beat — 151.4% payout

Targets and outcomes are on the remuneration-report underlying basis, which is not the statutory basis used elsewhere in this summary — the A\$199.5m and the A\$196.1m are different measures and must not be compared. Outcomes are SFML assessments of delivery against guidance.

The pattern is consistent across three years: Pro Medicus forecasts its revenue well and its earnings badly, and it misses in the same direction each time. Revenue exceeded target in all three years. Earnings missed in two of the three, and in both misses, the board stated the same cause: implementations arriving later than budgeted in FY24, contract go-lives arriving later than budgeted in FY26. The FY26 miss was large enough that no short-term incentive was paid on the earnings measure.

For a business whose revenue is contracted years ahead at a 74.9% margin, the risk was never demand. It is the gap between signing a contract and rolling it out. We read that as a scheduling problem inside an extraordinary order book, rather than a demand problem. Regardless, it is the single most useful thing to press management on, and the question is not how large the contracted pipeline is, it is what the board now assumes about the lag between signature and revenue.

Conclusion

Where it trades	Value	Basis
Price	A\$192.57	ASX close, 18 August 2026
Market capitalisation	A\$20.12bn	104.5m shares on issue
P/E — underlying	139.0x	75.8x on reported earnings, which include the mark
EV / underlying EBITDA	97.5x	On underlying EBITDA of A\$204.2m
Free cash flow yield	0.59%	All-in free cash flow A\$118.8m
3yr forward buyout yield	1.97%	On EBITA grown at 25% for three years
Canonical ROCE	61.8%	101.1% excluding the after-tax fair value gain
Net cash	A\$216.1m	Debt-free

Nothing in this result weakens the business. The moat is two Strong Helmer powers: Counter-Positioning — a cloud-native streaming platform sold on transactions that incumbents cannot match without cannibalising perpetual-licence revenue and retiring on-premise estates — and Switching Costs, evidenced by six of six customers renewing on five-year terms at higher fees. Scale economies and process power are Moderate and strengthening. Return on capital, growth, the structural tailwind and the alignment of the two founders who own 46.3% of the register are all as strong as they have been.

What the result does not resolve is the price. At roughly 139x underlying earnings, 97x underlying EBITDA and a three-year forward buyout yield of 1.97%, the shares embed more than a decade of uninterrupted execution. That leaves no margin for a missed renewal, or a delayed implementation cohort. This year's own remuneration scorecard shows that delayed implementation cohorts are precisely what this business gets wrong when it gets something wrong.

So, the honest summary is a very good year inside a valuation that requires every subsequent year to be one too. The number that would change that picture is the price rather than anything currently in the accounts.

Telix Pharmaceuticals (ASX:TLX)

There is a particular kind of company that is hard to own and harder still to explain: the one whose consolidated numbers describe a business nobody would buy, wrapped around a division almost anybody would. Telix is that company, and this half is where it became impossible to miss.

The group earned a canonical return on capital employed of 11.9%. That is the number a screen sees, and on its own it says nothing interesting. Underneath it, Precision Medicine, the prostate and brain imaging franchise that is the entire earnings base, turned US\$166.0m of segment net operating assets into US\$132.4m of half-year operating profit. Annualise it and the core earns roughly 160% on the capital it uses. Make that core wear every dollar of central overhead, all US\$50.1m of it on an annualised basis, and it still earns 129%. Two loss-making segments and a corporate cost base sit between that number and the group average, and they are there on purpose.

So the question this half asks is not if Telix is a good business. It is whether the deliberate losses are buying something worth the price, and whether the balance sheet can carry them while we find out.

The result

Revenue grew 22.3% and Telix reported its first meaningful statutory profit. All figures are US dollars; Telix reports in USD and lists on both the ASX and Nasdaq.

- Revenue US\$477.4m, up 22.3%

- Gross profit US\$260.3m at a 54.5% margin, up 1.1 points
- Research and development US\$123.8m, up 51.8% — 25.9% of revenue
- Operating profit US\$46.4m, against US\$10.4m
- Adjusted EBITDA US\$52.0m, against US\$21.0m
- Profit after tax US\$38.3m, against a US\$2.3m loss
- Operating cash flow US\$23.0m, up 29.8%
- Net debt US\$264.5m excluding leases, at 2.6 times annualised group adjusted EBITDA
- SFML canonical ROCE 11.9%, from 5.1%

The composition deserves saying plainly, because Telix says it plainly itself. A US\$40.0m non-refundable payment from Regeneron and US\$5.6m of net other gains together account for US\$45.6m of the US\$46.4m operating profit. Strip both and the group made roughly US\$0.8m at the operating line — still a US\$10m improvement on the prior half, and still the right way to read it. The number we would rather own is the 110 basis points of gross margin, which is franchise economics rather than a payment.

The core, and everything else

Precision Medicine grew revenue 27% to US\$388.6m, expanded gross margin a point to 65%, and lifted operating profit 31% to US\$132.4m — a 34% segment margin on a business still adding countries. Illuccix now holds marketing authorisations in 24 countries. Quarterly global sales stepped from US\$150m in the first quarter of 2025 to US\$202m in the second quarter of 2026. This is not a franchise defending a position; it is one taking share.

Segment	Revenue	R&D	Operating profit
Precision Medicine	US\$388.6m	(US\$54.5m)	US\$132.4m
Therapeutics	—	(US\$68.0m)	(US\$31.3m)
Manufacturing Solutions	US\$88.7m	(US\$2.8m)	(US\$32.9m)
Total segment	US\$477.4m	(US\$123.8m)	US\$68.1m

H1 2026. Inter-segment eliminations of US\$1.5m in gross profit and US\$1.5m in R&D are carried in the total, not the segment rows.

Total segment adjusted EBITDA of US\$76.5m less US\$25.0m of unallocated general and administration cost gives group adjusted EBITDA of US\$52m. A fifth of segment earnings is consumed centrally before a dollar reaches the shareholder.

Therapeutics spent US\$68.0m of research and development and recorded a loss of US\$31.3m. Manufacturing Solutions also recorded a loss of US\$32.9m at the operating line and widened its adjusted EBITDA loss from US\$12.7m to US\$23.0m, an 81% increase, as the Seneffe, Yokohama and North

Melbourne capacity build ran ahead of revenue; its gross margin fell from 9.5% to 5.4% of segment revenue. This segment is now the single largest drag on group returns, consuming roughly US\$46m a year against annualised group adjusted EBITDA of about US\$104m. The strategic case is that owning production and distribution de-risks the therapeutic launches. That logic is coherent, but it is also unguided, leaving the second-half earnings bridge dependent on a loss for which no number has been provided.

Cashflow

The cash statement is the most honest page in the result. Operating cash flow of US\$23.0m is already levered; Telix classifies both interest paid of US\$7.0m and interest received of US\$2.2m inside operating activities, so no adjustment is needed to see what the equity actually keeps. On US\$477.4m of revenue, that is under 5% of sales converted to cash, and after US\$14.5m of property capital expenditure it kept US\$8.6m.

That is not a criticism so much as the arithmetic of funding a therapeutics pipeline and a manufacturing network out of an imaging franchise. But it is the reason cash rose 78% to US\$251.9m on financing rather than on operations. The US\$118.4m net financing inflow is April's refinancing: US\$600m of 1.50% convertible notes due 2031 replaced roughly 98% of the A\$650m 2.375% notes due 2029, delivering a lower coupon, a two-year extension and a US\$2.9m accounting gain on the repurchase. Extending the runway at a reduced cost is worth more here than the coupon saving alone. The full-year cash flow will show whether this is an investment phase with an inflection or a treadmill.

Research and development

Research and development (R&D) rose US\$42.2m to US\$123.8m, and the split is clean: US\$68.0m into Therapeutics, US\$54.5m into Precision Medicine, US\$2.8m into Manufacturing Solutions. Telix expenses it all as incurred. Intangible additions in the half were US\$0.3m against US\$123.8m expensed, so the reported profit carries the full cost of the pipeline and there is no capitalised balance waiting to be written off if a program fails. Conservative accounting at the right stage.

What we are watching

Zircaix is blocked on manufacturing, and the delay is Telix's own. On the August earnings call, CEO Christian Behrenbruch named third-party manufacturing deficiencies as the outstanding item. Asked how much of the remaining timeline sat within the company's control, he answered, "All of it", accepting resubmission "in the next month or two" as a reasonable expectation. Behrenbruch separately decoupled the delay from the corrected Complete Response Letter of April, calling that "an administrative matter on the FDA side". So this is an execution item, not a regulatory verdict. That is a worse place for it to sit at a company spending heavily in owned manufacturing capacity precisely to control this supply chain.

An at-the-market equity facility was opened on results day. Telix can now sell American Depositary Shares at its discretion under an agreement with two investment banks. It controls timing and minimum price. But a company that has just refinanced US\$600m and holds US\$252m of cash does not open one because it has no use for equity, and it was announced in the same release as the result rather than separately.

Against that, three things went right. Pixclara carries an FDA goal date of 11 September 2026, making it the nearest dated catalyst in the portfolio. BiPASS, nearing enrolment completion, is designed to move PSMA imaging to the pre-biopsy decision. Telix estimates this would add more than 800,000 scans a year against a current addressable market of roughly 670,000, creating an option on doubling the market rather than on taking share of it. And the board was rebuilt in three months, with two former chief financial officers of substantial listed medical businesses and a former Pfizer chief medical officer appointed in May. Audit depth went from one director to three, while clinical-regulatory depth arrived as the regulatory and legal matters demand it.

Guidance

Telix has exceeded its revenue guidance in each of the past two full years. FY2024 delivered US\$516.6m against a US\$445m to US\$465m range and FY2025 delivered US\$803.8m against US\$770m to US\$800m. In the half, it reaffirmed FY2026 revenue at the upper end of US\$950m to US\$970m, with total revenue and other income above US\$1b. Precision Medicine is guided to grow about 25%.

The important detail is what the guidance excludes. It is built on approved products and geographies only, so neither Pixclara nor Zircaix contributes a dollar to the range. That is the right way to guide, and it makes that very number a floor on the commercial franchise rather than a forecast of the company.

The spending line moved the other way. Research and development guidance set at US\$200m to US\$240m in February, and raised to US\$230m to US\$270m at this result — stepped up US\$30m at both ends nine weeks into the second half, with the half already running at roughly a US\$248m annualised rate. That is a decision rather than a cost overrun, and management attributes its affordability directly to commercial performance and the Regeneron payment. But it means the FY2026 earnings outcome is now a function of a spending range whose midpoint has moved while the revenue range has not, against a first half that carried US\$40.0m of income that will not repeat in the same form.

Conclusion

The half confirmed the commercial thesis and did not resolve the structural one. Precision Medicine is working better than we underwrote it. The Therapeutics investment has not yet become revenue generating, and Manufacturing Solutions is losing more, faster, than a year ago.

The case here turns on returns rather than on entry price. A core earning 129% to 160% on its own net operating assets on every overhead basis is a rate of return that very few businesses of this size produce, and it is the reason the group's 11.9% is the wrong number to look at. Against it, the three-year forward buyout yield of 4.7% is a reminder that the market is not being asked to pay a modest price for that core. The moat is one Strong Helmer power — a Cornered Resource, narrowly scoped to the two approved PSMA imaging products and the owned isotope-production technology, with switching costs, process power and scale economies real but short of their strict bars.

Where it trades	Value	Basis
Price	A\$14.21	SFML watchlist close, 1 August 2026
Market capitalisation	A\$4.83bn	339.785m shares; US\$3.45bn at 1.4007
Net debt (excl. leases)	US\$264.5m	Borrowings US\$516.4m less cash US\$251.9m
Net debt / adj EBITDA	2.6x	Group; 1.0–1.2x on the Precision Medicine core
3yr forward buyout yield	4.7%	On EBITA grown at 20% for three years
Levered FCF yield	0.5%	US\$8.6m x 2 on market capitalisation

The free cash flow yield is the arithmetic of the investment phase, not a valuation signal — it measures what the group keeps after funding two segments that are losing money by design.

The bear case is operational and financial rather than legal. A second Complete Response Letter on Zircaix, with Precision Medicine otherwise on track, would take FY27 adjusted EBITDA below US\$100m and, on our work, the shares roughly 25% below the current price. Manufacturing Solutions losses continuing to widen at this half's rate, taking net leverage past three times, compresses the equity by a similar amount for a different reason. The genuine tail is a Precision Medicine share loss to a competing PSMA agent or a

payer reimbursement reset. This scenario strikes the one segment carrying the group, and because the core is the whole valuation, the equity impairment there is materially larger than the earnings impact.

The single unresolved constraint is leverage, and it is not the litigation. Net debt of US\$264.5m sits at 2.6x annualised group adjusted EBITDA and 1.0-1.2x on the core. That is what makes the at-the-market facility matter more than its announcement suggested, and it is the reason the unguided manufacturing loss is worth

more attention than the guided revenue line. That said, a circa \$30m manufacturing loss today becomes a key source of competitive advantage in the future when therapeutics are real. In radio pharmacy, manufacturing and supply chain are the binding constraint, which very few competitors have solved for.

What we are watching, in order: the leverage, that manufacturing loss, and one unfiled application whose timing management has told us is entirely within its own control.

WiseTech Global (ASX:WTC)

Revenue rose 79.3% and every margin in the business fell. Both facts have the same cause, and it is not a deterioration: e2open, bought for US\$2.1b and consolidated for eleven months, arrived carrying a 36.5% underlying EBITDA margin against a CargoWise core running at 52.8%. Mix does the rest.

So the headline growth rate is the least informative number in the result. Strip the acquisition out and organic revenue grew 6.3%. That is the number the thesis has to live with, and it sits below the 8% bar we require.

Set against that is genuine evidence the integration is working — group EBIT was flat in the first half followed by 43.9% growth in the second, as roughly US\$115m of annualised savings landed — and a balance sheet deleveraging faster than management promised. For a first year of ownership, this is doing what it should. What it is not, yet, is a business whose organic engine has re-accelerated.

The result

- Revenue US\$1,395.9m, up 79.3% — but up 6.3% organically
- CargoWise revenue US\$756.9m, up 10.9%; e2open US\$541.2m over eleven months
- Gross margin 77.4%, down 8.8 points — 85% excluding e2open
- Underlying EBITDA US\$644.5m, up 55.7%, at a 46.2% margin (core 52.8%, e2open 36.5%)
- Statutory net profit US\$178.7m, down 11.0%; underlying US\$313.5m, up 29.0%
- Levered free cash flow US\$242.2m, against US\$216.2m
- Net debt US\$1,876.5m, from US\$102.4m of net cash a year earlier
- SFML canonical ROCE 13.3%, down 813 basis points

Three profit numbers are worth putting next to each other, because the accounts never do. Statutory net profit fell 11.0%, underlying net profit rose 29.0% and profit after tax before acquired amortisation, the measure whose definition did not change this year, rose 20.6%. The truth is between them. The business genuinely earned more; the gap to statutory is real cash interest and real restructuring cash; and the gap between the two underlying measures exists because the definition of underlying net profit was widened this

year to re-add restructuring and divestment items, in the same year that restructuring costs net of tax were US\$51.2m against US\$1.2m. The reported 29% growth is flattered by that choice.

The franchise, measured rather than asserted

What has not changed is the moat, and WiseTech is one of the few businesses that can put numbers against it. There are over 45,000 CargoWise-certified professionals in the market, with customer attrition below 1% for 14 consecutive financial years. More than 99% of CargoWise revenue is recurring, with only 3% of that growth coming from the underlying market expansion over the past decade. The rest is derived from rollouts, price, new product and new customers.

The pipeline is larger than the delivered base: 61 large global freight-forwarder rollouts are secured, of which 49 are in production and 12 are contracted, with less than a quarter of expected users live. Four new rollouts were secured during the year and five moved from contracted into production. Customer concentration also fell sharply; the top ten customers went from 27% of group revenue to 17%, with no single customer above 10%.

The most strategically interesting comment from management this year was not in the slides. Asked what the transition to the new CargoWise Value Packs commercial model had taught them, the CEO explained why the change happened in the first place: it came *"at a time when AI was suddenly becoming quite widely adopted in the industry and changing how licensing had to work. Charging by seats was simply not a proposition that we could manage to do anymore."* If AI reduces the number of people a customer needs, per-seat software pricing shrinks with the customer's headcount. The vendor ends up short for its customers' productivity gains. WiseTech has repriced onto transactions and value ahead of that, positioning itself to capture the benefits of AI-driven customer savings as revenue rather than as a threat. That is the best argument in this result that the disruption case has the direction wrong. It is also an argument about pricing architecture, and it still has to translate into revenue. The model launched in December 2025 and more than 95% of CargoWise customers were on it within seven months, with new small and medium enterprise signings up about 55%.

Cash flow

Operating cash flow rose 38.9% to US\$509.6m. However, WiseTech classifies interest paid within

financing activities and interest received within investing, so neither is deducted in arriving at that figure. On a business now carrying US\$1,876.5m of net debt, that classification is worth US\$114.1m a year.

Free cash flow	FY2026	FY2025
Operating cash flow (after tax)	US\$509.6m	US\$367.0m
Payments for intangible assets	(US\$142.5m)	(US\$126.5m)
Property, plant and equipment, net	(US\$10.8m)	(US\$23.0m)
Free cash flow — before net interest	US\$356.3m	US\$217.5m
Net interest paid	(US\$114.1m)	(US\$1.3m)
Free cash flow — levered	US\$242.2m	US\$216.2m
Memo: Company-stated free cash flow	US\$410.7m	US\$287.0m

The levered figure understates the run rate, because US\$78.9m of restructuring and acquisition cash and US\$46.9m of one-off financing transaction costs will not repeat. But US\$242.2m is this year's cash, and on the market capitalisation it is a 2.5% yield. We would want levered free cash flow above US\$400m in FY27 — which the guided earnings range and a normalised restructuring load should deliver — before treating the cash conversion story as re-established.

Research and development, and 1,700 people

Total research and development (R&D) investment rose 29.2% to US\$340.7m, but fell as a share of revenue from 33.9% to 24.4%, and the capitalised proportion fell from 55.0% to 45.1%. Both falls are mix — e2open's sales-led heritage reinvests less and capitalises less. Excluding it, the core reinvested 30% of revenue, down four points, and capitalised 52%, three points lower than guided. That last miss runs in the favourable direction: capitalising less pushes more development cost through the profit and loss rather than onto the balance sheet, which depresses reported earnings and improves its quality. A miss on that line would be capitalising *more* than guided, not less.

The output measure moved the right way — 1,827 new CargoWise enhancements delivered, up nearly 50%, taking the five-year total past 6,500 on more than US\$1.1b of investment. The input measure moved a very long way in the other direction. On the results call, the CEO disclosed that the AI transformation program removed "1,200 roles from WiseTech globally, and that's about 50% of product and development and

customer service", on top of more than 500 role reductions earlier in the year under a separate efficiency program. Roughly 1,700 roles went in one year, and the two functions that build and support the product carry about half the people they did.

Read one way, delivering 50% more enhancements from half the headcount is the clearest evidence available that AI has changed the cost of building software. Read another, it is a capability reduction whose cost is not captured in a single year's output count. Both facts are simultaneously true, but which of the two dominates from here is the central open question. We would want two more halves of delivery, and the attrition series holding below 1%, before treating the gain as structural.

What we are watching

The core's quality metric has gone backwards four years running. The underlying Rule of 40, excluding e2open, fell from 52% to 45% this year, but the reported measure has fallen every year since FY23: 65% to 60% to 51%. Core underlying EBITDA margin was 52.8% against 53.2%, so the core absorbed the savings from its own restructuring programs and still lost four-tenths of a point, which the company attributes to higher legal, compliance and advisory fees. The headline group Rule of 40 of 114% is an acquisition artefact and should be disregarded.

CargoWise missed a range the company had reaffirmed six months earlier. FY26 CargoWise growth was initially guided at 14%-21% in August 2025 and was reaffirmed as late as February 2026 (with four months

of the year remaining). The company subsequently delivered 10.9% revenue growth, 3.1 points below the bottom of a range. It is the third consecutive year the CargoWise range has not been met, which is why the FY27 guide of about 12%-20% carries less weight than a first-time range would.

Return on capital fell 813 basis points and cannot be tested where it matters. Canonical ROCE of 13.3% is struck on a capital base now carrying US\$2,664.2m of goodwill and US\$864.4m of acquired intangibles from an acquisition eleven months old. As the company does not report assets by segment, the return on the CargoWise core cannot be isolated. That is a genuine analytical constraint rather than a formality: the return has to be read off a blended number that nobody believes represents the franchise.

Governance is under repair rather than repaired. The FY25 remuneration report drew a 49.47% first strike and a co-founder's re-election drew 21.84% against. The board's response was substantive — the carried-forward incentive was cancelled even though its performance conditions had been met, weightings are now disclosed, and an independent chair was installed — but the one-year performance period shareholders objected to was reviewed and retained. A shareholder class action, commenced in November 2024, remains open, and its described scope broadened this year. On 19 August 2026, one week before this result, the company was notified of an Australian Competition and

Consumer Commission investigation into an alleged contravention. No provision is recognised for either. And the CFO has now been operating as an "interim" for two full financial years, steering the company through a US\$2.1b acquisition and a US\$2.2b debt raising — an endorsement of the individual, but not a substitute for filling the seat.

Guidance

WiseTech exceeded the line the market doubted most and missed the one that matters more. The former is the balance sheet: net leverage came in at 2.7x against a 3.0x target guided six months earlier, and the forward path was upgraded in the same breath — FY27 from about 2.5x to about 2.2x, and the sub-2.0x commitment pulled forward from August 2028 into FY28. Interest cover is 5.3x against a 3.0x minimum, the covenant limit steps down to 3.5x from 1 July 2026, and US\$780.0m of the revolving facility is undrawn. For a company that drew US\$2.4b twelve months ago, deleveraging 0.3x faster than promised is the most thesis-relevant number in the result.

Group revenue landed at the bottom of its US\$1.39b-US\$1.44b range and guidance-basis EBITDA came in just above the top of its range, driven by the acquisition and cost program rather than underlying organic growth. FY27 revenue growth is guided at 6%-10%, a range that brackets our 8% bar rather than clearing it.

Conclusion

Where it trades	Value	Basis
Price	A\$43.49	ASX close, 24 August 2026 — the last settled pre-result close
Market capitalisation	A\$14.62bn	336.1m shares; US\$9,793m at 0.67
EV / underlying EBITDA	18.1x	20.9x on reported EBITDA
Underlying P/E	31.2x	54.8x on statutory net profit
Levered free cash flow yield	2.47%	4.19% on the Company's own free cash flow measure
Net debt / underlying EBITDA	2.91x	SFML basis; Company-stated 2.7x on facility-adjusted earnings
3yr forward buyout yield	6.96%	On EBITA grown at 16% for three years

The moat is unchanged and it is the Elite tier: three Strong Helmer powers — Switching Costs, Scale Economies and Network Economies — with Process Power present. Very few businesses in this universe carry three, and the fourteen-year sub-1% attrition record is the kind of evidence most moat claims never produce.

What sits against that is the combination of price and organic growth. Group organic growth of 6.3%, and FY27 guidance of 6%-10%, are a long way below the rate the reported 79.3% implies. Return on capital of 13.3% is struck on a goodwill-heavy base that cannot be

segmented. And the shares are 51% above their June low, which is where the asymmetry available at the half-year has gone.

The franchise is intact, the integration is running ahead of its own plan, and the deleveraging is the most convincing part of the result. Three things would change the reading materially: the core's Rule of 40 stopping its four-year fall, CargoWise growth landing inside its own guided range for the first time in four years, and levered free cash flow above US\$400m. None of the three, which are yet to happen, are unreasonable on the guided earnings base.

Hidden Treasure

The market prices reported numbers. That works when the reported numbers are a faithful proxy for the business, however, it fails when the accounting is recording the cost of the future, while the operating metrics are tracking the compounding of the present.

Three portfolio holdings are in that position today. In each case, the gap is disclosed rather than hidden — it sits in the segment note, the revenue mix table, or the research line, one page past the headline. Each example below carries the observation that would prove it wrong.

FINEOS: a subscription annuity under services runoff

FINEOS sells core administration software to group life, accident and disability insurers. Large U.S. carriers sit on

the platform through multi-year subscription contracts. This subscription model is the compounder, forming a predictable revenue stream as it renews, organically expands with policy volume, and carries the margin profile of enterprise software.

Two things sit on top of it. Implementation services are large in the early years of a carrier relationship and then run off as the client goes live, so a declining services line offsets a growing subscription line. And years of capitalised product investment are now being amortised through the profit and loss statement. **Neither is a cash cost of the current business.**

FINEOS — the rotation, in the company's own numbers	FY2022	FY2023	FY2024	FY2025	H1 FY2026
Subscription revenue (€m)	53.8	62.4	69.9	75.6	41.9
Subscription % of total	42.3%	49.9%	52.5%	54.6%	57.8%
Services revenue (€m)	71.4	60.8	62.3	62.2	30.2
Gross margin	65.3%	68.5%	75.4%	76.2%	75.4%
EBITDA margin (company-defined)	~5%	~2%	15.2%	21.9%	24.0%
Net profit after tax, statutory (€m)	(26.0)	(21.4)	(5.8)	0.9	1.9

FY2022 to FY2025 are full years; H1 FY2026 is the six months to 30 June 2026 and is not comparable in absolute terms to the full-year columns beside it. It is shown to place the ratios, not to imply a sixth year of revenue.

Read the two ratio rows and the argument makes itself. Subscription revenue has expanded from 42.3% of total revenue to 57.8%, fifteen and a half points of mix in four and a half years. Gross margin has lifted from 65.3% to 75.4% and the company-defined EBITDA margin is up from about 5%, through about 2%, to 24.0%. That is operating leverage arriving on a broadly fixed cost base, already in the reported numbers, but not in the line most people read.

In the half itself, subscription revenue grew 15.0% to €41.9m, while services fell 0.7% to €30.2m. Group EBITDA rose 32.3% to €17.4m. Statutory net profit was €1.9m — against a €14.5m amortisation charge, a non-cash figure roughly seven and a half times the reported bottom line.

The founder is not diversifying. Michael Kelly built the product and owns just over half the company: 174,000,279 shares, a stake of roughly A\$341m and about 500 times his annual remuneration. He took no options for six years after the listing, has never sold, and added 295,742 shares over the last twelve months.

Telix: a 65% gross margin franchise paying for its own pipeline

Telix's commercial imaging business is disclosed as its own segment, and on a standalone view it is one of the highest-return businesses we own. **Precision Medicine earned US\$132.4m of operating profit on US\$388.6m of revenue in the half — a 34% operating margin on a**

65% gross margin — on US\$166.0m of segment net operating assets, an annualised return of about 159%.

The group result looks nothing like that, because two other segments are deliberately loss-making.

Telix H1 2026 by segment	Revenue	Gross profit	R&D	Operating profit / (loss)
Precision Medicine	US\$388.6m	US\$254.0m	(US\$54.5m)	US\$132.4m
Therapeutics	—	—	(US\$68.0m)	(US\$31.3m)
Manufacturing Solutions	US\$88.7m	US\$7.8m	(US\$2.8m)	(US\$32.9m)

Therapeutics has no revenue: it is a pipeline carried at cost. The two loss-making segments together cost US\$64.2m of operating profit in the half.

Therapeutics is a pipeline funded out of operating cash rather than through stock issued. Manufacturing Solutions is the line least understood — isotope production is the limiting factor in radiopharmaceuticals, and owning supply is what lets a company launch, scale and defend products others cannot. **We would be less sanguine about it if it were not widening: that segment's adjusted EBITDA loss**

grew 81% year-on-year to US\$23.0m, and it is not guided. That is a real reservation and we hold it alongside the argument, not instead of it.

The natural objection is that a mid-cap cannot run a late-stage pharmaceutical pipeline. The disclosures say otherwise, and the comparison is sharper than the usual framing of it.

The comparison the market is not making	Telix	CSL
Market capitalisation	A\$5.5B	A\$82.5B
Research spend, share of revenue	25.9%, rising — up 51.8% to US\$123.8m in the half	7.7%, falling — US\$1,223m, down from US\$1,359m and 8.7%
Named Phase 3 programmes	TLX591-Tx and TLX101-Tx, plus TLX250-Tx at Phase 2/3	VMX-C001 and clazakizumab in end-stage kidney disease
Reporting period	Half-year to 30 June 2026	Full year to 30 June 2026

Both research ratios are the companies' own disclosed percentages of their own revenue, which avoids a currency conversion — both report in US dollars while both market capitalisations are quoted in Australian dollars. Neither company publishes an exhaustive count of every trial it runs, so this compares named programmes as disclosed. CSL's FY2026 result also reports a positive Phase 3 readout for ANDEMBRY in children aged 2 to 11 supporting label expansion.

On the disclosed record, Telix names as many late-stage therapeutic programs as CSL (three against two, one of them at Phase 2/3), while carrying a market capitalisation fifteen times smaller. Telix funds them at 25.9 cents of every revenue dollar and rising; CSL funds its pipeline at 7.7 cents and falling, in a year in which the company also wrote off US\$590m of self-amplifying mRNA intellectual property.

Herein lies both the hidden treasure and risk, and they are the same fact. The reported loss is a decision to spend a high-return imaging franchise on a pipeline. If

the pipeline lands, the market has been pricing an option at cost. If it does not, the money is gone and the imaging franchise will have funded it.

Nanosonics: a cash cow funding a second train

The trophon franchise is a razor-and-blades engine running at a 76.9% gross margin across a 39,230-device installed base. Revenue was A\$203.9m in FY26, essentially double the A\$103.1m of five years earlier. Yet earnings before interest and tax fell 10.2% to A\$16.0m and net profit fell 13.7% to A\$17.8m.

Nanosonics — the cash cow and the second train	FY25	FY26	Change
Revenue	A\$198.6m	A\$203.9m	+2.7%
Gross margin	78.2%	76.9%	(1.3pp)
Earnings before interest and tax	A\$17.8m	A\$16.0m	(10.2%)
Net profit after tax	A\$20.7m	A\$17.8m	(13.7%)
CORIS investment (pre-revenue)	—	A\$34.6m	+13%
Installed base (devices)	—	39,230	+6%

The company spent A\$34.6m in FY26 on CORIS, a high-level disinfection platform for flexible endoscope reprocessing, which has essentially no revenue yet. That single line is larger than twice the fall in earnings. Nanosonics is now directing roughly two-thirds of its entire research and development budget at a product with no revenue history, aimed at a market that is, on the company's own statement, roughly fifteen times the ultrasound-probe opportunity that built the first franchise, against a stated procedural market above 60 million procedures.

The flat profit line is the shadow of that spending rather than the shape of the business, and the build cost is now largely behind the company: FY27 guidance lifts operating expenses 10% to 15%, while CORIS revenue remains in the low single-digit millions, which is the last heavy year before revenue arrives.

The base has a soft edge and we will not smooth it over. Core consumables revenue was flat at A\$92.6m against an installed base 6% larger, so consumables revenue per average installed device fell about 5%. Management attributes part of that to a third-quarter weather impact of approximately A\$2m; adding it back leaves the per-device figure flat at constant currency rather than down. Flat is not the same as growing. The company has also not disclosed a cumulative-to-date CORIS investment figure, which means nobody outside the business can size the total bet against the prize.

What would prove us wrong

An argument that cannot be falsified is not an argument. For each holding, the specific observation that would end it:

Holding	What would prove the argument wrong	What we watch
FINEOS	Subscription growth slows toward the services decline rate, or subscription gross margin falls	Subscription growth and mix percentage at each half; group gross margin
Telix	Precision Medicine gross margin compresses or imaging volume rolls over; or the Manufacturing Solutions loss keeps widening without a therapeutic approval	Segment gross margin and operating profit; the Manufacturing Solutions loss; the ProstACT Global readout
Nanosonics	CORIS fails to gain hospital adoption, or trophon consumables revenue per installed device keeps falling	Consumables per average installed device at constant currency; CORIS revenue against the FY27 cost step-up

None of the three is currently failing. Two carry a genuine qualification, stated above rather than in a footnote: the widening manufacturing loss at Telix and flat per-device consumables at Nanosonics. Both sit in

the watch column precisely because they are where this argument would break first.

The common thread is that the accounting records the cost of the future, while the operating metrics track the

compounding of the present. **Hidden treasure is only invisible from a reader who stops at the profit line,** which says more about attention and curiosity rather than cleverness, and is why we think it lasts: the disclosures are public, free and in plain sight, one page past the headline in all three cases.

Figures are drawn from the SFML research notes for each holding and the underlying filings — FINEOS H1 FY26, Telix H1 FY26, Nanosonics FY26 and CSL FY26 — and from CSL's FY26 results presentation. Periods differ by holding and are stated wherever a figure appears; Telix segment figures are half-year figures and are not annualised.

Apparent Safety

Australia compels its workers to save. The superannuation guarantee is 12% of wages and the pool is heading past A\$4 trillion. That capital is managed by institutions whose working definition of risk is set by the regulator, and the regulated definition is the volatility of a portfolio's return relative to a benchmark.

The consequence is not a mystery, it is an incentive. Institutions herd toward the index and, more specifically, the largest, most liquid names that pay a visible yield. In Australia, that means the banks, the miners and Telstra. This article asks what the member actually receives in that trade.

The trade, written down

A manager who sells a research-heavy compounder with a volatile share price and buys CBA is rewarded by the framework. Tracking error falls, the yield rises and career risk disappears. **Nothing about the underlying businesses has changed.** The exchange is rarely written down, and in the instance it is, it does not read the way it is sold.

What is bought are businesses growing earnings in the low-to-mid single digits — and in one of the three cases below, not growing them at all over the period. Two of the three carry material leverage. **The yield ranges from 3.2% to 4.4%, and that yield is the entire visible**

attraction. A 3% yield plus 5% earnings growth is an 8% return if the multiple holds. If the multiple compresses toward its own history, the return is lower and can be negative for years.

One thing needs saying plainly, because the opposite is often assumed. **The index names are not cheaper than the compounders they replace.** On enterprise value to EBITDA the three holdings covered in our "Hidden Treasure" article trade at 20.3, 79.1 and 37.2x, against roughly 24, 17 and 24x earnings for CBA, BHP and Telstra. The compounders are the more expensive assets on the level of the multiple. The argument is not about the level. **It is about what the multiple is being paid for** — 24x earnings for a business growing at 3% is a different proposition from a higher multiple on a business growing at 15% or more, and the difference compounds over a forty-year horizon, which a two-year tracking-error comparison misses.

Three case points over 24 months

The table compares the three companies at September 2024 and September 2026, and separates the shareholder return into its three components: earnings growth, dividend yield, and change in multiple. The purpose is not precision. It is to make the source of the last two years visible rather than assumed.

Metric	CBA	BHP	Telstra
Share price — Sept 2024	~A\$135	~A\$40	~A\$3.95
Share price — Sept 2026	~A\$159	~A\$67	~A\$4.72
Price change, 24 months	+18%	+68%	+19%
EPS — FY2024	567c	US\$2.73	~19.0c underlying
EPS — FY2026	657c	US\$2.60	19.9c reported
EPS growth, 2 years	+16%	(5%)	+5%
P/E — Sept 2024	~23.8x	~10.0x	~20.8x
P/E — Sept 2026	~24.2x	~17.0x	~23.7x
Multiple change	+2% — effectively nil	+70%	+14%
Dividend yield now	3.2%, franked	~4.0%, franked	4.4%, 90% franked
Payout ratio	~77% of FY26 cash NPAT	~68% of underlying	106% of reported EPS
Leverage	Bank balance sheet; CET1 12.3%	Net debt US\$8.7bn, 0.3x EBITDA	Net debt A\$17.3bn, ~2.0x EBITDA

CBA capital, return and balance-sheet figures are sourced to the CBA Appendix 4D and results presentation for the half year ended 31 December 2025. All share prices, all BHP and Telstra figures, and the FY2026 full-year EPS estimates are SFML estimates and interpretations of company disclosures and market data at 1 September 2026, rounded. BHP EPS is underlying, in US cents; the P/E divides an Australian dollar price by that EPS converted at approximately US\$0.68 for September 2024 and US\$0.66 for September 2026, and is sensitive to that assumption. Telstra FY2024 is underlying EPS and FY2026 is reported. Multiple change is computed from the unrounded ratios shown, not from rounded whole-number multiples.

CBA: the multiple did not move because it was already extreme

CBA is the best-run bank in the country and its own filings say so. In the half to 31 December 2025, it earned cash net profit of **A\$5,445m, up 6.1%**, on a cash return on equity of **13.8%** and cash earnings per share of 326c. Cost to income was 45.9%. None of what follows is a criticism of the operating performance.

The price is the point. CBA trades on about 24x earnings against a ten-year median in the high teens, and it traded at a similar level two years ago. The share price has therefore returned the earnings growth plus the yield and nothing else. It peaked at about A\$185 in mid-2025, about 28x the FY2026 earnings it has since delivered, and has since fallen back. Consensus has FY27 earnings growth at around 3%: the bank is growing at system. **A member buying at 24x is paying a growth multiple for a 3% grower with a 3.2% yield**, and the dividend funding that yield already sits near the top of the company's own stated 70%–80% payout band.

A bank balance sheet is leveraged by design, which is disclosed. At 31 December 2025, CBA carried **A\$1,408,728m of total assets against A\$77,232m of**

shareholders' equity — gross leverage of 18.2x, with equity equal to 5.5% of total assets. Risk-weighted assets were A\$505,310m, or 35.9% of the balance sheet, so the 12.3% capital ratio is struck against roughly a third of the assets. **The regulator's own unweighted leverage ratio for the same balance sheet is 4.7%.** That leverage is regulated and, at CBA, well managed. It is still leverage, and it appears nowhere in a tracking-error calculation.

BHP: the entire return was multiple expansion

BHP is the clearest case. Underlying earnings per share were US\$2.73 in FY24 and US\$2.60 in FY26 — over two years the earnings went backwards by about 5%. The share price rose from about A\$40 to about A\$67. **Every dollar of that return came from investors paying more for the same earnings**, the multiple moving from about 10x to about 17x.

The reason is copper, which has overtaken iron ore as the largest earnings driver, and the market is now capitalising BHP as a copper growth story. FY26 earnings rose about 30% on FY25 as commodity prices rose, a recovery from a trough rather than a new plateau. The balance sheet is genuinely strong at 0.3x EBITDA, and

BHP is the one company here where leverage is not part of the argument. **What a member buys today is cycle-sensitive earnings on a multiple that has not been sustained through a full cycle.** When commodity prices normalise, the multiple and the earnings compress together. A 4% yield does not protect against a simultaneous move in both terms.

Telstra: paying more than it earns

Telstra grew reported earnings per share about 5% in FY26, to 19.9c, and grew the dividend 10.5%, to 21c. **The dividend is 106% of reported earnings and about 82% of cash earnings.** The gap between those two figures is the whole of the defence: capital expenditure has been flat, while depreciation grows, so cash earnings run ahead of accounting earnings. Management says depreciation will keep growing. That is the tell — a dividend defended by an accounting gap the company itself expects to widen.

Net debt is about A\$17.3b, roughly 2x EBITDA and at the top end of the company's own stated range. A buyback of about A\$1b is running alongside the dividend, funded partly by that debt. The multiple moved from about 20.8x to about 23.7x, which is roughly three-quarters of the two-year return. **The 4.4% yield is real and it is being paid. The capacity to grow it is being borrowed.**

What the 24 months tell us

Price returns of +18%, +68% and +19% against earnings growth of +16%, -5% and +5%. The gap is multiple expansion: in BHP it is the whole story, in Telstra most of it, and in CBA the multiple was already at a level that leaves no room for a repeat.

Multiple expansion is a one-time gain. It cannot be banked twice. The member moving into these names today does not receive the last two years; they receive the next twenty. Over that horizon the return is

earnings growth, plus yield, plus or minus the change in multiple — growth of 3%-5%, yield of 3%-4.4%, and in at least two of the three cases, a multiple more likely to compress than expand from where it now stands.

Our approach here is Popperian, as it is throughout our macro work: we state in advance what would falsify the claim and then look for it. **The claim under test is that index and yield are safe.** What would falsify it is a period in which the return was delivered by multiple expansion on flat or falling earnings, leaving the next holder exposed to the reversal with no earnings stream to absorb it. **That is the BHP record of the past 24 months, on BHP's own disclosed earnings.** The framework did not notice, because the volatility was low — which is the finding in one sentence. The measurement did not miss the risk it was designed to detect. The issue is that what it measures is not the risk the member carries.

Is this in the best interests of superannuants?

The system was built to compound. A 25-year-old contributing today will draw on the balance in forty years, and over that horizon, volatility is close to irrelevant while the growth rate is very nearly everything. **The difference between compounding at 8% and at 12% over forty years is a final balance more than four times larger.** That is the number a member should care about, and it appears in no performance test.

The test rewards low tracking error measured over an eight-year window. It punishes the manager who owns a compounder through a period when the share price falls while the business improves, and rewards the manager who owns a resources major through a period when the share price rises while the earnings fall. **Both of those descriptions are drawn from the last 24 months and both are in the record above.**

Party	What they receive	What it costs them
The institution	Career risk, regulatory risk and headline risk all fall as the portfolio converges on the index	Nothing the framework measures
The superannuant	A lower-volatility quotation and a 3.2% to 4.4% yield	Lower long-run growth, exposure to multiple compression, leverage that sits inside the yield, and the largest weights in the companies that have already had their re-rating
Nobody	—	The gap itself. There is no test for the return a member did not receive because the compounders were sold to reduce tracking error

We do not argue that CBA, BHP and Telstra are bad businesses. Each is a strong franchise, and CBA in particular is among the best-run banks in the world on the measures it discloses. We argue that they are being bought for a reason that has nothing to do with their economics, at prices that have already absorbed a re-rating, by institutions optimising a regulatory statistic rather than a member outcome. When the reason for a trade is that it makes a portfolio look safer to a regulator, the trade is for the institution.

Our answer to the question we posed is no. The rotation from compounders into index and yield is in the interests of the institution. It is not, on this evidence, in the interests of the superannuant. Volatility is not risk. The permanent loss of compounding is.

This article is a condensation of The Banking Project — Part III, Apparent Safety: The Art of Index Crowding, September 2026. It carries no figure the source article does not carry. Selector Funds Management Limited does not hold Australian bank equities; the reasoning is set out across Parts I to III of that series.

The Eighth Wonder

Compounding is the most quoted idea in investing and the least acted upon. Every investor agrees with it. Very few build a process around it, and the gap between agreement and action is where returns are lost.

This piece traces where the mathematics came from, sets out what twenty-five and thirty years of compounding actually delivers, and identifies the five places where the rate leaks away before it reaches the investor. The conclusion, stated up front: compounding is not a strategy. It is an outcome. The strategy is choosing engines capable of running for decades, and then not switching them off.

Four thousand years, and the formula was never the problem

Nobody invented compound interest. It was discovered repeatedly, wherever people lent grain and silver and waited. What held it back was moral rather than mathematical: charging interest on interest, known then as anatocism, was widely held to be an abuse. Roman law capped rates, medieval usury doctrine restricted the practice, and the Qur'an condemns *riba* compounded over and over again. For centuries the mathematics was understood better than it was permitted.

The oldest known working sits on a clay tablet from Babylon, catalogued as AO 6770 and held in the Louvre, dating from roughly 2000 to 1700 BC. It poses the question every investor eventually asks: at 20 per cent a year, how long does a loan take to double? The scribe answered three years and 283 days. The correct answer is three years and 288 days. Four thousand years ago, a clerk in Mesopotamia was five days out.

Three dates matter after that.

- **1494.** Luca Pacioli publishes *Summa de Arithmetica* in Venice. Remembered as the father of double-entry bookkeeping and as Leonardo da Vinci's mathematics teacher, he sets out in the same volume what we now call the Rule of 72. Divide 72 by the rate to find the doubling time; at 6 per cent, twelve years. It remains the most useful piece of mental arithmetic an investor owns.
- **1613.** Richard Witt, a London mathematical practitioner, publishes *Arithmetical Questions* — the first book devoted entirely to compound

interest, carrying 124 worked examples built around 10 per cent, the maximum lawful rate of the day. Compounding stops being a curiosity and becomes a working tool.

- **1683.** Jacob Bernoulli asks what happens if interest compounds not annually or quarterly but continuously. The answer converges on 2.71828, later named *e* by Euler. A commercial question about interest on interest had delivered one of the fundamental constants of mathematics.

Two observations are worth carrying. The mathematics is ancient and settled; the difficulty has never been the formula. And the resistance to compounding was originally ethical where the modern resistance is psychological. Both amount to the same thing. Humans distrust a process whose results they cannot see arriving.

Square 32

The best explanation of compounding is still the oldest one, first recorded by the Arab historian Ibn Khallikan in 1256. A sage named Sissa ibn Dahir presents the game of chess to his king, who offers any reward. Sissa asks for grain: one grain on the first square, two on the second, four on the third, doubling until the board is covered. The king, thinking the request insultingly modest, agrees. He cannot pay — not because he is poor, but because the request is unpayable by anyone. The board totals roughly 922 billion tonnes of wheat, about 1,150 years of current global production.

The instructive part is not the size of the final number but the shape of the path. Halfway through the board, at square 32, the king has handed over about 215 tonnes of wheat — one large truckload. He is halfway to owing a thousand years of world production and it looks entirely manageable. Square 64 alone holds more grain than the previous 63 squares combined, and that is not a quirk of the puzzle. It is a property of every compounding series. Any investor who has held a quality business for a decade and felt underwhelmed has been standing on square 32. The arithmetic was working the entire time. It simply had not become visible yet.

What twenty-five and thirty years actually does

The table below shows \$100,000 compounding at a range of annual rates, with no contributions, no

withdrawals, no tax and no fees. It is the clean case, and everything that follows takes something away from it.

Annual return	After 10 years	After 20 years	After 25 years	After 30 years
6%	\$179,085 (1.8x)	\$320,714 (3.2x)	\$429,187 (4.3x)	\$574,349 (5.7x)
8%	\$215,892 (2.2x)	\$466,096 (4.7x)	\$684,848 (6.8x)	\$1,006,266 (10.1x)
10%	\$259,374 (2.6x)	\$672,750 (6.7x)	\$1,083,471 (10.8x)	\$1,744,940 (17.4x)
12%	\$310,585 (3.1x)	\$964,629 (9.6x)	\$1,700,006 (17.0x)	\$2,995,992 (30.0x)
15%	\$404,556 (4.0x)	\$1,636,654 (16.4x)	\$3,291,895 (32.9x)	\$6,621,177 (66.2x)
20%	\$619,174 (6.2x)	\$3,833,760 (38.3x)	\$9,539,622 (95.4x)	\$23,737,631 (237.4x)

Figures are nominal and pre-tax. The 20 per cent row is included as a reference point rather than an expectation.

The gap between 10 and 12 per cent looks like rounding. Over thirty years, the 12 per cent investor finishes with 1.7 times the money. Two percentage points of annual return, held for a working life, is not a small edge; it is a different outcome entirely. Ten times your money, meanwhile, is far more accessible than it sounds — eight per cent for thirty years, or 12 per cent for twenty. That is an ordinary quality portfolio held with discipline, not a heroic one. And at 15 per cent, the five years between year 25 and year 30 double the result again, from 32.9 times to 66.2 times. The final five years of a thirty-year hold are worth more than the first twenty combined.

Where the money actually arrives

Take \$100,000 compounding at 12 per cent for thirty years. The total gain is \$2,895,992. The first decade contributes \$210,585, or 7.3 per cent of it. The final decade contributes \$2,031,363, or 70.1 per cent. The final five years alone contribute \$1,295,986, nearly half the outcome arriving in the last sixth of the holding period. At 15 per cent the concentration is more extreme still, with the final decade delivering 76 per cent of the gain.

This is why Charlie Munger's rule — never interrupt compounding unnecessarily — is arithmetic rather than sentiment. An investor who does everything right for twenty-two years and then sells because the multiple looks stretched has forfeited most of the reason they invested. The reward for patience is not distributed evenly across the holding period. It is almost entirely back-loaded, and it is invisible until it is not.

The engine room: where the rate comes from

For a bank deposit the compounding rate is given. For a business it is manufactured, and understanding how is the whole of the analytical task. The identity is simple: sustainable growth in intrinsic value equals return on capital employed multiplied by the reinvestment rate. A business earning high returns that reinvests little compounds slowly. A business earning mediocre returns cannot compound quickly no matter how much it ploughs back, because it is ploughing back into low-return capital.

Three consequences follow directly. Return on capital is the ceiling. A business earning 10 per cent on capital cannot compound intrinsic value at 15 per cent, whatever management's ambition, and every claim to the contrary is an accounting artefact, an acquisition-funded expansion or a temporary mispricing. Reinvestment opportunity matters as much as return: a 30 per cent business with nowhere to deploy capital is a cash generator rather than a compounder, and the two should not be underwritten the same way. And capital management decides the exponent, because buybacks at high multiples, acquisitions at premium prices and dilutive equity issues, all quietly reduce the compounding rate. Over three years, the entry multiple dominates shareholder return; over thirty, business return dominates and the entry multiple becomes a rounding error.

The commentators

The most repeated line in the literature holds that compound interest is the eighth wonder of the world,

and it is attributed to Einstein everywhere. There is no primary source — no letter, no paper, no recorded remark. Quote Investigator traces the label to bank advertising copy from 1925 and finds no substantive evidence for Einstein, Rothschild or Rockefeller; the attribution appears in print decades after Einstein's death in 1955. There is something fitting in this. The most famous sentence about compounding is itself a compounding error, doubling every time it is repeated by someone who did not check.

Thomas Phelps published *100 to 1 in the Stock Market* in 1972 after forty years in the business. He studied every US stock that had returned a hundred times an investor's money between 1932 and 1971, found over 350 of them, and asked what they had in common. His answer was uncomfortable: almost none of the return came from timing, and almost all of it came from selection followed by inaction. At 20 per cent a stock reaches a hundredfold in twenty-five years; at 14 per cent it takes thirty-five. Almost nobody misses the target because their businesses were inadequate. They miss it because they did not hold long enough.

Hendrik Bessembinder is the modern empirical counterpart. Examining every US common stock in the CRSP database since 1926, he found roughly four in seven failed to beat one-month Treasury bills over their entire listed lives. The best-performing four per cent, around 1,092 names, account for all of the net wealth creation of the entire US market, while the other 96 per cent collectively matched Treasury bills. His global study of 64,000 stocks from 1990 to 2020 found the same shape, with the top 2.4 per cent accounting for all of the US\$75.7 trillion in net global wealth creation. Phelps studied the winners and asked how they were held; Bessembinder studied everything and showed how few winners there are. Together they define the task. A small number of businesses will compound for decades, and owning one and selling it early is functionally identical to never owning it.

The five leaks

The tables above describe a frictionless world. The real world imposes five charges on the compounding rate, each quantified below against the same thirty-year base case.

Leak	Mechanism	Cost over 30 years
Interruption	Five years parked in cash at 3% instead of 12%, then resumed. The rate is recovered; the lost compounding is not.	\$2,995,992 falls to \$1,970,773 — 34% of the outcome
Fees	A 1.5% annual fee on a 10% gross return leaves 8.5% net, charged on a base that should have been growing.	\$1,744,940 falls to \$1,155,825 — 34% of terminal value
Tax on turnover	Realising and taxing gains each year at 30% versus holding and paying once at the end. Deferred tax is an interest-free loan from the state.	\$2,127,195 falls to \$1,124,290 — churn nearly halves the result
Volatility drag	Geometric return sits below arithmetic return by roughly half the variance; a 50% loss needs a 100% gain to recover.	A 10% average with 20% volatility compounds nearer 8% — 10.1x rather than 17.4x
Inflation	Compounding in reverse. At 3% a year, purchasing power halves every 24 years.	\$2,995,992 nominal is worth \$1,234,309 in today's money — 30.0x becomes 12.3x

Two of these are chosen and three are imposed. Fees and turnover are decisions; volatility, tax regimes and inflation are conditions. Listing them together makes

the point that they are additive, and that a portfolio can lose more return to friction than it ever loses to bad stock selection. Note the symmetry: a five-year

interruption and a 1.5 per cent annual fee each cost roughly 34 per cent of the final outcome. Investors agonise over the former and sign up to the latter without reading the page. Inflation is larger than either, and it is the one nobody argues about because it never appears on a statement.

Duration, and the story that settles it

A compounding run ends in one of two ways. The business stops earning excess returns, or the holder stops holding. The first is an analytical problem. The second is behavioural, and by some distance the more common cause of failure.

The best illustration remains Robert Kirby's, published in the *Journal of Portfolio Management* in the autumn of 1984, while he was a portfolio manager at Capital Group. Kirby had advised a client for about ten years; her husband, a lawyer, handled the family finances. When the husband died, Kirby discovered that the man had been acting on every buy recommendation, putting roughly \$5,000 into each name, and ignoring every sell recommendation in his own account while executing them faithfully in his wife's. The result was an odd-looking portfolio. Some holdings had fallen below \$2,000. Several exceeded \$100,000. One was worth more than \$800,000 — larger on its own than his wife's entire managed portfolio — and it had begun as a small position in a company called Haloid, which became Xerox.

The instructive detail is that the stock selection was Kirby's own. Both portfolios were built from the same recommendations by the same analyst. The only difference was that one of them was left alone. Duration was the entire edge, and it was available to the professional as well as the amateur. Only one of them took it.

Writing down what would prove you wrong

A compounding thesis is a prediction about the future behaviour of a business, and like any prediction it is worth holding only if it can be proven wrong. If no observable result would cause you to abandon it, you are not holding a thesis; you are holding a preference. The practical discipline is to write the falsifiers down at the point of purchase, while judgement is unclouded by

ownership. For a compounding thesis the register should include, at minimum:

- Incremental return on capital falling below trailing return on capital for consecutive periods — the earliest signal that the reinvestment runway has ended, visible long before reported growth slows.
- Reinvestment rate rising while return on capital falls: capital is being deployed into progressively worse opportunities and the market has not yet noticed.
- Loss of pricing power in the core franchise, measured as price realisation below cost inflation over a full cycle.
- Structural share loss in the primary market, distinguished from cyclical loss by whether it persists through both a downturn and a recovery.
- Capital management behaviour inconsistent with stated returns — most commonly acquisitions that dilute group return on capital while being presented as accretive to earnings per share.

The register serves a second purpose beyond risk management. Without it, every fall in the share price becomes an argument for selling and every rise an argument for congratulation. With it, price movement is demoted to what it is, which is noise, and the only question that matters is whether the engine is still running.

The back half of the board

The mathematics of compounding was settled four thousand years ago and has not changed. What has never been settled is human behaviour in the presence of it. The Babylonian scribe could compute a doubling time to within five days. The king could not see past square 32. That gap, between what the arithmetic says and what the holder feels, is the entire opportunity and the entire risk.

For Selector, the implication is unchanged from the founding statement of 2003. Identify businesses with the leadership, returns on capital and balance sheet strength to compound for decades. Underwrite the engine rather than the price. Write down what would prove the thesis wrong. Then, absent that proof, do nothing. Most of the money is on the back half of the board, and almost everyone leaves the table before they get there.

Opaqueness + leverage = banks = avoid

Opaqueness + Leverage = Banks = Avoid

We do not own banks. Full stop.

On the ASX, the banking sector, inclusive of the four major banks plus a host of smaller players account for some 24% of the All-Ordinaries Index. If we include investment bank Macquarie, the figure nudges 27%. In essence, one quarter of our Index is comprised of bank stocks, with the most popular led by Commonwealth Bank and Macquarie.

Hopefully, by the conclusion of this article you will appreciate the reason why we choose to give these businesses and this sector a very wide berth.

Judo Bank

When upstart banker Judo Bank completed its initial public offering in November 2021, raising \$657m at an offer price of \$2.10 per share, it valued the small-and-medium-enterprise (SME) focused lender at approximately \$2.3b, making it the first fully licensed Australian bank to list on the ASX in 25 years.

Judo Bank had been the brainchild of international banker Joseph Healy, formerly a senior executive at National Australia Bank (NAB), who went on to co-found the company in 2016.

According to Healy, the reasoning was simple, the big incumbent banks had abandoned the SME market. He described this as "market failure", where bankers had lost the ability to scrutinise small business balance sheets and apply "judgment, not formula."

Healy saw the Judo offering as unique, *"This is a unique banking business model, there's nothing in the market that is comparable to it. The major banks focused too much on real estate backed collateral and not enough on cash flow, balance sheet capital or the character of prospective borrower."*

In 2024, Healy stepped aside as CEO, handing the reigns to fellow co-founder Chris Bayliss.

On 25 June 2026, the company notified the ASX that three loans, made to companies in different sectors and states, had soured.

Together, the loans totalled around \$75m, had experienced rapid deterioration in repayment ability, and one had fallen into administration. Bayliss as

reported by the AFR noted, *"We didn't have line of sight on these three. They weren't [sitting] in the over 90 [days late] bucket, and we were just looking at them with a glass half full lens. They deteriorated very rapidly. These things happen."*

Management's ASX announcement expressed disappointment but seemed unfazed by the events. Profit before tax was still expected to be 30% over 2025 levels at circa \$165m. The company was expecting this to lift another 30% to \$215m in 2027, alongside a strong capital position.

The group forecast a full year 2026 Gross Loans and Advances (GLA) balance of \$14.6b, with a net interest margin (NIM) of 3.2% (the core profitability metric between what it pays for funds on deposit and what it earns on a loan) and the impaired loans, including 90 days past due date, to be approximately 3.0%. On the bank's GLA of \$14.6b, applying this 3.0% across the portfolio would tally \$438m compared to the bank's equity position of \$1.7b. This equates to roughly 26% of total capital.

Yet just three bad loans wiped out \$75m in losses, suggesting that the balance of probable impaired loans could exceed the bank's collective provisioning.

The market responded as you would expect, with the bank's shares shedding 40% and valuing the company at \$1.0b.

Analysts were not convinced this was an isolated event. No apparent warning, given the company had updated the market in May, calls into question key concerns around a bank that earns higher margins and yet has limited visibility on the book.

These concerns, however, miss the big issue. That is, the relationship between a bank's equity capital base and the leverage that is applied to its lending operations. We note one broking analyst summed up the current Judo share price of \$0.92 in the following manner, *"Short term target price \$1.47/share, but we think by the end of this decade JDO could be worth over \$2/share. BUY. JDO is higher risk and cyclically exposed than the other major banks, but investors are compensated by higher returns at current prices."*

What about the downside? An equity base of \$1.7b protecting a gross loan exposure totalling \$14.6b. And

we are not even in a recession. Imagine a re-run of the global financial crisis or some other financial event. Banks have form during these moments. There is a need for more 'new' capital to offset the losses and rather ominously, the percentage of loans that become impaired, also rise.

We will leave Judo and turn to Westpac, as we delve a bit deeper.

Westpac

The structural argument — why Selector has chosen not to own banks.

Selector's investment philosophy seeks businesses with durable competitive advantages, high returns on capital, and the ability to compound intrinsic value over a multi-decade hold period. Australia's major banks score well on some of these criteria — switching costs are high, the APRA licence is a structural entry barrier, and the Big Four have compounded earnings through most economic cycles. Yet we have never held a bank equity, and the institutional explanation of why, follows.

The answer is a single number: 15.9x. That is Westpac's gross leverage ratio on 31 March 2026 — total assets \$1.17 trillion divided by total equity \$73.8b. A uniform 6.3% decline in asset values extinguishes equity entirely. This is arithmetic, not opinion.

At this leverage ratio, the margin for error is structurally thin. A bank's equity value is not the residual of a high-ROCE business compounding over time. It is the residual of a highly leveraged balance sheet that must

continuously roll \$37.2b of wholesale funding every twelve months, maintain deposit confidence across \$745b of callable liabilities, and absorb credit cycle impairments on a \$885b loan book. These are not tail risks. They are the operating conditions of the business model.

The question for us is not whether Australian banks are well-managed (they are), well-regulated (also yes), or whether the sector has compounded returns over the past two decades (it has). The question is whether the asymmetry of the equity payoff, bounded upside from NIM and cost management and unbounded downside from leverage at 15.9x, meets our quality-compounder standard. It does not.

Our quality-compounder framework requires businesses where a bad year is an inconvenience, not an existential event. At 15.9x gross leverage, a bad year for a bank is a solvency scenario. That asymmetry — visible in every major banking crisis from 2008 to the collapse of Silicon Valley Bank (SVB) in 2023 — is not a cyclical feature of the sector; it is a structural feature of the business model. No capital ratio or regulatory framework has yet resolved the fundamental arithmetic of lending long and funding short at 16x leverage.

Westpac H1 FY26 — the result in context

Westpac's H1 FY26 result — released 5 May 2026 for the six months ended 31 March 2026 — delivered NPATA of \$3.6b, up 3% on H1 FY25. Cash earnings per share were \$1.06. The interim dividend was 77¢ per share, fully franked, flat on the prior corresponding period.

Figure 5: Westpac key financials

Metric	H1 FY26	H1 FY25	Chg YoY	FY2025
Net Interest Income (ex-NI)	A\$11,068M	A\$11,070M	0%	A\$22,464M
NIM (ex-notable items)	1.89%	1.92%	-3 bps	1.94%
Operating Expenses	A\$(5,724)M	A\$(5,535)M	+3%	A\$(11,916)M
Cost-to-Income Ratio	51.67%	50.00%	+167 bps	53.0%
Pre-Provision Profit	A\$5,344M	A\$5,535M	-3%	A\$10,548M
Impairment Charges	A\$(443)M	A\$(250)M	+77%	A\$(424)M
NPATA (cash earnings)	A\$3,616M	A\$3,501M	+3%	A\$6,972M

Source: Westpac HY26 accounts

The headline +3% NPATA growth conceals a deteriorating operating performance. Pre-provision profit fell 3% as flat NII met rising costs. The +3% NPATA outcome was delivered by a lower effective tax rate and modest impairment normalisation relative to H2 FY25, not by improved operating leverage.

NIM compression — the structural headwind

Net interest margin fell three basis points half-on-half to 1.89%, its lowest level in several years. The compression reflects deposit competition (term deposits repriced upward faster than mortgage repricing), a continued mix-shift toward lower-margin institutional and business lending, and elevated liquid asset holdings carrying below-mortgage returns. Management guided NIM to stabilise at current levels in H2 FY26, but the trajectory over the past eight halves has been consistently downward.

NIM sensitivity is significant: \$200M NPAT per basis point, based on \$1.04 trillion of average earning assets. A further 10bps of compression — plausible in a competitive deposit market — would remove \$2.0b of

annualised pre-tax profit, equivalent to approximately 14% of FY25 pre-provision profit.

The H1 FY26 result illustrates the structural trap of Australian bank equity ownership. NPATA grew 3%, a number that appears satisfactory in isolation. But the driver was tax, not operations; pre-provision profit fell, NIM compressed further, and costs rose faster than income. The result is consistent with a business where the structural tailwinds of Australian mortgage growth and oligopoly pricing are gradually being offset by deposit competition, regulatory capital requirements, and technology investment. Owning a bank for its dividend yield means owning the residual of this equation.

The balance sheet — institutionalised leverage at scale

The defining feature of any bank balance sheet is not the assets, but the relationship between the assets and the equity that supports them. On 31 March 2026, Westpac's balance sheet comprised:

Figure 6: Westpac balance sheet

Balance Sheet Item	31 Mar 2026	% of Total Assets
Total loans	A\$885,571M	75.4%
Liquid assets and trading securities	A\$156,481M	13.3%
Other assets	A\$132,665M	11.3%
Total Assets	A\$1,174,717M	100%
Customer deposits	A\$745,239M	63.4%
Wholesale funding	A\$281,462M	24.0%
Other liabilities	A\$74,193M	6.3%
Total Equity	A\$73,823M	6.3%

Source: Westpac HY26 accounts

Gross leverage: $\$1,174,717\text{m} \div \$73,823\text{m} = 15.9\times$. Equity represents 6.3% of total assets. A uniform 6.3% haircut on asset values, equivalent to a 6.3% decline in the loan book's recoverable value, reduces equity to zero. This is not a stress scenario; it is the basic arithmetic of the balance sheet.

The funding stack

Westpac funds \$1.1 trillion of liabilities through three primary sources. Customer deposits of \$745.2b (67.7%) are the lowest-cost and most stable funding source —

APRA's Financial Claims Scheme guarantees deposits up to \$250,000 per ADI per depositor, providing meaningful friction against a retail deposit run. Wholesale funding of \$281.5b (25.6%) is market-sensitive: it reprices at market rates and can withdraw rapidly in an acute liquidity event. Equity of \$73.8b (6.7%) absorbs losses and provides the regulatory capital base.

The critical vulnerability in this stack is not the deposit base, but the A\$37.2b of long-term wholesale funding

with residual maturity under twelve months. This amount must be continuously refinanced in institutional debt markets. Unlike retail deposits, there is no government guarantee, no FCS protection, and no RBA lender-of-last-resort commitment that substitutes for institutional market access. In a 2008-style wholesale market seizure, \$37.2b of refinancing needs becomes an immediate solvency question, not a ten-year liquidity management problem.

Regulatory capital — what it does and does not tell you

The bank's regulated capital (CET1) on 31 March 2026 was \$56m (12.42% of Risk-Weighted Assets of \$458.3b). This is 117 basis points above the Board's stated target minimum of 11.25% and represents A\$2.7b of surplus. The CET1 ratio is the primary regulatory lens through which bank capital adequacy is assessed, reflecting a genuine buffer against credit losses and operational shocks within the regulatory framework.

However, the CET1 ratio has two structural limitations as an equity investor's analytical tool. First, it is a risk-weighted measure: RWA of \$458.3b represents only 39% of total assets of \$1.2 trillion, because APRA's standardised and internal ratings-based (IRB) models assign lower risk weights to residential mortgages, government securities, and other lower-volatility assets. The risk weighting reflects regulatory assumptions, not market stress conditions. In a systemic crisis — 2008, 2020, SVB 2023 — those risk weights do not hold.

Second, the gross leverage ratio (15.9x) does not change as a function of RWA methodology. It is simply total assets divided by equity and it is 15.9x, regardless of what the risk-weighting assigns to any individual asset class.

Our take

The Australian bank regulatory framework — CET1 ratios, LCR, NSFR, the FCS deposit guarantee — is well-designed and has demonstrably reduced the probability of a systemic banking failure in Australia. We do not dispute this. What the framework cannot change is the gross leverage ratio, and what no capital ratio expresses is the simple fact that 6.3% of assets separates Westpac's equity from zero.

That number is why we choose not to own bank equities. It's not because of inadequate management or regulatory failure, but because the fundamental

asymmetry of 15.9x leverage is incompatible with the quality-compounder ownership standard.

The last word

It is with astonishment, when we peer across the ASX landscape, we see the level of demand for banks securities. We understand the attractiveness of dividends, and we acknowledge the sense of security a bank may cast, but a business built on leverage is just that, one that runs out of capital at precisely the wrong time.

If you consider that an exaggeration, then perhaps your memory does not go back far enough. History is littered with traditional banks and investment banks that have come and gone.

Consider Westpac again, first established in 1817. It fell on hard times during the 1990-92 recession years 'that we had to have'. It reported a loss of \$2b in 1992, following a series of bad bank lending deals coming home to roost, was raided by the late media baron Kerry Packer, before being rescued by Lendlease.

During that period Westpac shares fell 55%, as the bank dealt with its near-death experience. How close? In 1992 Westpac had only \$6.7b of equity supporting \$110b of assets, so the bad debt write-offs of \$5b in 1992-1994 almost wiped out its equity.

Today, thoughts of 1992 are distant. Even less so is the 2008 Global Financial Crisis, a mere 18 years ago. All the four major banks raised significant new capital, a collective \$11b, to bolster reserves and support acquisitions of weaker rivals.

Lessons learnt? Today, Westpac's leverage sits at 16x, with an equity base of just \$74b.

Investment banks are not immune, because they too indulge in serious leverage to drive returns. In our September 2024 Selector Quarterly newsletter, we wrote a piece on Long-Term Capital Management (LTCM). Below is an extract:

"LTCM is a wonderful example of what you see is not what you get. The period in which LTCM operated, 1994-1998 should be fresh in our minds but like the Global Financial Crisis (GFC) of 2007-2008 and even more recently COVID-19, investors are prone to forget.

Those fortunate to have operated in markets during these periods should have learnt some valuable lessons.

Importantly, authors like Lowenstein have also done their part in bringing to light past events.

At its conclusion, LTCM failed because its models which should have protected them on the downside, didn't.

The partners view of the world was that "Risk is a function of volatility. These things are quantifiable". As such, they were blinded by the power of their models, where volatility and not leverage was seen as the best proxy for risk.

At its peak in 1996 LTCM managed assets valued at \$140 billion with just \$4.7 billion of capital, a leverage of 30 times.

In reality, leverage and the inability to model for all events was its undoing. LTCM had in their corner Nobel Prize winners Robert C. Merton and Myron S. Scholes, who alongside Fischer Black, developed a new method in 1973 for determining the value of an option, known as the Black-Merton-Scholes option pricing formula.

This was where LTCM failed. Too much leverage, and a failure to model for unforeseen events. Lowenstein again, "Even when these models are applied by government regulators their application is flawed, because they look to past market history as received truth.

But markets, we must emphasise, are imperfect they are the agglomeration of myriad investors, most of whom usually act rationally, usually, as history as shown, but not always.

Even perfectly logical investors will panic, as will theatergoers at the mere possibility of fire, so as not to be last to the exit; this threat of contagion renders financial markets inherently unstable. The susceptibility to panic is especially troublesome when they manifest in credit markets.

Credit is a wager that the lender makes with respect to the borrower; every loan is a gamble on repayment. When the market's calculation is off, too many people are either offered credit or denied it.

This is the fear of systemic failure and why both LTCM and the collapse of the mortgage bubble were so

destabilizing. Each was caused by a condition of over-indebtedness."

At its conclusion, LTCM's cumulative loss was staggering, best summed up by Lowenstein, "Through April 1998, the value of a dollar invested in Long-Term quadrupled to \$4.11. By the time of the bailout, only five months later, precisely 33 cents of the total remained.

After deducting the partners' fees, the results were even sorrier: each invested dollar, having grown to \$2.85, shrank to a meagre 23 cents. In net terms, the greatest fund ever - surely the one with the highest IQ's - had lost 77 percent of its capital while the ordinary stock market investor had more doubled his money."

Closer to home, Macquarie Bank faced its own demons during the GFC. On Friday 10 October 2008, the shares were in free fall as investors read the room of what may follow. On Sunday 12 October 2008, the then Prime Minister Kevin Rudd put in place the Australian Guaranteed Scheme for large deposits and wholesale funding. This action effectively put a floor under the bank, provided breathing room and stopped a run on the bank.

The shares, having neared \$100 during 2007 hit a low of \$14.75 during the first half of 2009. Today, Macquarie trades at an all-time high of \$251 per share and 2008 is a very distant memory.

We titled this article "Opaqueness + leverage = banks = avoid". We extend that to any business that overly relies on debt for existence.

Good businesses should not require debt to succeed.

Compounders rarely do.

We want companies that can go the distance and use debt sensibly, be it for acquisitions or moments in time. What we aim to avoid is where our hand is forced, new capital is required and visibility is poor.

The long-term consequences for Judo Bank are yet to play out. But Judo Bank, Westpac and all the other banks will never make it onto our watchlist or portfolio holdings, for one basic reason, leverage.

The Chokepoint Is the 30-Year Bond

Global supply chains are not broken. They are expensive, rerouted and politically managed. That is a different condition from 2021 and it needs a different investment response.

Just over six months into the war between the United States, Israel and Iran, the physical system has adapted faster than most expected. The cost of that adaptation has migrated out of the shipping market and into the bond market. The chokepoint is no longer only the Strait of Hormuz. It is the 30-year bond — and the 30-year bond sets the multiple the market will pay for a long-duration business, whatever that business is earning on its capital.

The bond market is doing the talking

A point of precision first. The 10-year US Treasury yield is at a three-year high, not a multi-decade high. It touched 4.818% on 2 September 2026, the highest since November 2023, and closed near 4.79% on 4 September, the day an August jobs report of 162,000

landed against a consensus in the mid-50,000s — the strongest monthly gain since March, which lifted market-implied odds of a September rate hike to around 59% from 52%. **It is the 30-year bond that sits at multi-decade levels** — it reached 5.34% on 18 August 2026, its highest since 2007, before the Treasury intervened.

The move is global. German 10-year Bunds reached 3.39%, the highest closing level in around fifteen years, and 30-year Bunds are nearing levels last seen in 1998. Japanese 10-year yields are at multi-decade highs. Investors are demanding more term premium to hold long-dated sovereign debt everywhere, not only in the United States. Three forces are pushing US yields higher at once: oil and the inflation pulse it carries; the supply of paper, with US public debt reaching US\$40.05 trillion on 18 August and a deficit running at roughly US\$2.1 trillion; and competition for capital from record corporate issuance tied to the artificial-intelligence build-out.

Instrument	Level	Context
US 10-year Treasury	4.79%	Intraday high 4.818% on 2 September 2026; highest since November 2023
US 30-year Treasury	5.26%	Peak 5.34% on 18 August 2026 — a 19-year high
German 10-year Bund	3.39%	Highest closing level in roughly fifteen years
Fed funds target range	3.50% to 3.75%	FOMC meets 15 to 16 September 2026
Brent crude	US\$96+	Above US\$96 on 3 September 2026; peak US\$126.41 on 30 April 2026
US public debt	US\$40 trillion+	US\$40.05 trillion at 18 August 2026

Levels were current at 5 September 2026 and move daily. Every press-sourced figure in this piece was re-verified against the published record before publication, and against the primary document wherever one exists — the US Treasury buyback release, Governor Waller's speech text, the Bureau of Labor Statistics employment release and the New York Fed's index. Figures attributed to the US Government and to independent ship trackers are reproduced as reported and are contested; that contest is the subject of the section that follows.

Treasury Secretary Scott Bessent has chosen to fight. On 19 August 2026 the Treasury doubled the size of its nominal long-end liquidity-support buybacks — in the 10-to-20-year and 20-to-30-year sectors — from US\$2 billion to at least US\$4 billion per operation, effective 9

September through 4 November. Yields fell ten basis points on the announcement and gave it all back within 24 hours. The quarterly buyback envelope of US\$38 billion was not increased, only reallocated toward the long end, and auctions continue as scheduled — so **the**

Treasury is buying long bonds with one hand while issuing them with the other. An activist Treasury leaning against the long end is a signal in itself. It tells us the administration sees a 5%-plus long yield as a policy problem rather than a market-clearing price.

Hormuz: two sets of numbers

The war began on 28 February 2026 and within days the Strait was effectively closed. Around 20 million barrels a day of crude and products — roughly a fifth of global demand — stopped moving. Brent passed US\$100 in March, rose above US\$111 on 27 March — its highest since June 2022 — and peaked at **US\$126.41 on 30 April**, a four-year high. A ceasefire memorandum announced on 14 June took it back to the pre-war level of US\$73.21 by late June, before collapsing on 6 and 7 July when three commercial vessels were attacked and the truce was declared over. On 31 August two supertankers were struck exiting the Strait — reported hit by projectiles, claimed by Iran's Revolutionary Guard as naval mines, and disputed by the US. On 3 September Iran fired missiles and drones at US bases in Kuwait and the United Arab Emirates and Brent went back above

US\$96. The diesel crack breached US\$100 for the first time in Europe and hit a US record above US\$106 on 1 September — diesel costing more than twice the underlying crude.

Against that backdrop the official and independent numbers do not reconcile. US Energy Secretary Chris Wright told CNBC on 2 September that more than 17 million barrels transited Hormuz by ship on Monday 31 August, a wartime record, and that with four to five million barrels a day of Saudi and UAE pipeline bypass, regional exports now exceed pre-war levels. Kpler recorded five commodity vessels on the same day, none of them liquid tankers. TankerTrackers estimates crude flows have averaged around 4.9 million barrels a day since mid-July. The trackers offer a mechanical explanation — that the figure aggregates ship-to-ship transfers occurring over several days into a single day — and the Secretary's own numbers are not internally consistent: he has separately put the seven-day average leaving the Strait at almost 9 million barrels a day, plus 5 to 7 million leaving the region by other routes. **A 17 million barrel day and a 9 million barrel seven-day average are not the same claim.**

Measure	US Government view	Independent tracker view
Hormuz seaborne transit, 31 August 2026	17 million barrels plus	Five commodity vessels, no liquid tankers
Average crude flow since mid-July	Approaching the pre-war level	Around 4.9m bpd since mid-July
Regional exports versus pre-war	Above pre-war	Well below pre-war
Method	Military and DOE data; night escorts, transponders off	Satellite imagery and AIS tracking

The two columns are not struck on the same basis. The pre-war 20 million barrels a day and the Secretary's 17 million barrels are crude and refined products; the tracker estimate of around 4.9 million barrels a day is crude only. Part of the gap is measurement basis and part is method. Neither figure has been independently verified by Selector.

We cannot verify either number, so we read the price instead. Brent at US\$96 with a US\$100 diesel crack is not consistent with 17 million barrels a day flowing freely. **The market is trading the trackers, not the Secretary.** If the Secretary is right, oil should fall hard once the data catches up — that is a testable claim and we are watching for it.

China moved the cartel to the demand side

For fifty years the marginal barrel was set by producers. The Iran war exposed a different lever. China entered the crisis holding an estimated 1.2 to 1.4 billion barrels in strategic and commercial reserves, by far the largest stockpile in the world and, unlike the US Strategic

Petroleum Reserve, undisclosed. From April it cut imports by an estimated 3 to 3.5 million barrels a day and from May drew down inventories at around 1 million barrels a day, removing the world's largest buyer from the spot market at the exact moment supply collapsed.

The description of China as a new oil cartel is half right. It does not control supply; it controls the visibility and timing of a fifth of global demand. At a drawdown of around 1 million barrels a day, a 1.2 to 1.4 billion barrel stock is measured in years rather than months, even allowing that a large part of it is working inventory that cannot be drawn. **That is a put option under the oil**

price, held in Beijing, exercisable at a price of its choosing — and it means the pipelines and the naval escorts are being priced against a buyer who is deliberately sitting out.

The physical system: expensive, rerouted, working

The New York Fed Global Supply Chain Pressure Index jumped to 1.82 in April 2026, from 0.68 in March and 0.55 in February — the highest reading since the 1.86 of July 2022, but far below the 4.49 peak of December 2021. The Drewry World Container Index reached US\$4,639 per 40-foot box on 9 July, the highest since September 2024, and sat around US\$4,500 in late August. Shanghai to New York is above US\$9,500. Panama Canal congestion is back, with queue-jumping fees reported at US\$4 million for a single transit.

The telling detail is that rates are high while volumes are falling — August US container volumes were forecast down 4.2% year on year as tariff front-loading unwinds. **Shippers are paying more to ship less, because the supply side is fractured by chokepoints rather than by demand.** Underneath, the structural picture is oversupply: pre-war forecasts called for spot rates to fall up to 25% in 2026 as a large newbuild order book delivered. The war has masked that, not removed it. This is inflation by logistics, not shortage by logistics — and it reaches a portfolio twice, once through the cost line and once through the discount rate.

What it means for quality compounders

Duration is repricing, and it is the multiple that is moving rather than the business. Long-duration equities carry the same exposure to the 30-year yield as long-duration bonds. With the US 30-year at 5.26%, the multiple the market will pay for cash flows arriving a decade out has compressed — and it has compressed for every such business at once, regardless of how good any one of them is. Our defence is not to change what we own but to insist on the quality of the earnings the market is now discounting more harshly.

Pricing power is the test, and the evidence is already reported. Fisher & Paykel Healthcare expanded constant-currency gross margin by 122 basis points to 63.7% in FY2026 while absorbing roughly 90 basis points of US tariff headwind — which is to say the underlying improvement was larger still, and the customer rather than the shareholder carried the tax. That is what a moat looks like when it is measured rather than

asserted. A business that reports the opposite this half has told us something equally useful.

The reroute is the second test, and it is either evidenced or it is a plan. Breville delivered 80% of gross profit manufactured outside China by December 2025, on schedule to a twelve-month objective, converting what had been an open-ended tariff exposure into a finite one under the current regime. The distinction we draw is between a company that describes a diversification strategy and one that has already moved the production.

Inventory is a choice again. The 2021 lesson was that just-in-time fails under stress; the 2026 lesson is that just-in-case is expensive when the carrying cost of inventory is a 5% bond yield. Reece is the worked case. Net working capital rose A\$35m to A\$1,771m in FY2026, holding the ratio to sales at 19%, with higher inventory to support network expansion and the in-stock promise through a period of significant supply-chain disruption. Group President and Managing Director Sasha Nikolic told the August earnings call that *"our long-standing supplier partnerships and supply-chain capabilities allowed us to maintain a strong in-stock position through recent supply-chain disruptions, which continues to be a real competitive advantage for Reece"*. The company paid, in working capital and freight, for a share gain it can point to.

The same result carries its own qualifier and it belongs alongside the claim rather than in a footnote. Chairman and Chief Executive Peter Wilson said on the same call that the oil shock from the Iran war and the PVC event *"brought demand forward. And it's flown through"*. A disruption that pulls demand into the period flatters the half it lands in and creates the payback in the next one. Any read of a strong result struck inside a supply shock has to carry that qualifier.

Energy exposure is asymmetric, and so is the dispersion it creates. Fuel- and freight-dependent businesses face direct cost pressure; software and healthcare businesses face almost none. The spread in earnings quality across a portfolio will widen over the next two reporting periods. That is an opportunity for stock selection and a risk for index exposure — which is why a macro shock of this shape tends to suit a concentrated owner and punish a passive one.

Two clocks

That brings us to the larger effect, which is not what the shock does to the cost line but what it does to the price of the businesses — and those are not the same thing. **A quality compounder is valued off two variables that move on completely different clocks.** The discount rate is marked to the bond market every minute of every day. The return the business earns on its reinvested capital is marked twice a year, at results. When the long bond moves 50 or 60 basis points in a month, the first clock moves and the second does not, and the price moves with the first.

The consequence is that a period of rising long yields is a period in which compounding is systematically hidden. Earnings compound, capital is reinvested at the same high rate, the moat does its work — and the quoted price falls anyway, because the market is repricing the denominator. Nothing in the business has deteriorated. The reported evidence that it has not deteriorated arrives months later, in a result.

This is not only a market phenomenon. It is built into our own process. The yield we require from a business

before we will buy it is anchored to a government bond, and it therefore rises mechanically when yields rise. On the basis some of our notes use — the US 10-year plus one per cent — that hurdle stood at 5.66% against a 4.66% 10-year on 25 August 2026 and at 5.79% against the 4.79% close of 4 September. **The bar rose 13 basis points in ten days and not one business changed.** On the Australian basis, one and a half times the three-year government bond yield, the multiplier means every 10 basis points on the bond lifts the hurdle by 15. A rising term premium therefore tightens the screw twice: it compresses the multiple the market will pay, and it raises the yield we ourselves demand before we will act.

What the returns actually are

Set against that, the returns the businesses are earning have not moved. Seven of our twenty-three holdings earn a return on capital employed above 25%. The comparison below is that return against the US 30-year Treasury at 5.26% — not a valuation, but a measure of how far the reinvestment engine sits above the bond that is currently setting its price.

Holding	Return on capital employed	Gap to the 30-year bond	Balance sheet
TechnologyOne	167.8%	162.5pp	Net cash A\$245.5m
Pro Medicus	61.8%	56.5pp	Net cash A\$216.1m
REA Group	58.2%	52.9pp	Net cash A\$365.6m
Computershare	39.0%	33.7pp	Net debt US\$144.1m
Fisher & Paykel Healthcare	33.8%	28.5pp	Net cash NZ\$401.3m
Resmed	32.5%	27.2pp	Net cash US\$809.9m
Aristocrat Leisure	29.3%	24.0pp	Net debt A\$948.6m

Return on capital employed is Selector's canonical measure — EBITA divided by capital employed, from filing-sourced components, on the period stated in each holding's current research note. That is FY2026 for Pro Medicus, REA Group, Computershare, Fisher & Paykel Healthcare and Resmed, and the half-year to 31 March 2026 annualised for TechnologyOne and Aristocrat Leisure. TechnologyOne's figure sits on a very small capital base once cash is removed, which makes it correct but highly sensitive, and it should be read as a category rather than a precise rate. The gap is struck against the US 30-year as a single global long-duration reference and is not a currency-matched cost of capital.

The case that runs the other way

Computershare is the cleanest example in the portfolio of a business whose compounding is routinely hidden by a rate lens, and it runs in the opposite direction, which is what makes it useful. The market has historically priced the stock primarily on the sensitivity of its Margin Income — the yield earned on client float balances — so when rates fall it de-rates even as the fee engine

accelerates. FY2026 separated the two cleanly. **Margin Income fell 1.6% to US\$748.7m from US\$761.1m, while earnings before interest and tax excluding Margin Income rose 8.3% to US\$447.5m from US\$413.1m**, on a balance sheet that finished the year at near net cash. The rate-sensitive line went backwards and the fee engine compounded straight through it. The lens that priced the stock and the engine that produced the earnings were not the same thing.

When it is not hidden compounding

The argument has a hard limit, and stating it is the whole discipline. **A de-rating is only a hidden compounder when the compounding is still there.** Where the return on capital is itself falling, the lower multiple is not concealing anything — it is reporting something. WiseTech is the counter-example inside our own portfolio: canonical return on capital employed fell 813 basis points to 13.3% in FY2026, from 21.4%, on net debt of US\$1,876.5m. A business whose reinvestment return has halved toward the level of a corporate bond is not a compounder waiting for the discount rate to normalise. The test that separates the two cases is the

direction of the return on capital, and it is reported rather than inferred.

What would prove us wrong

The state of global supply chains in September 2026 is one of managed disruption. Oil is flowing at a level nobody can agree on. Freight is moving at prices that will not fall while chokepoints stay contested. China has become the swing buyer and is sitting on its hands. The Treasury is buying its own bonds to stop the long end telling the truth. Our thesis is that the physical shock has peaked and the financial shock has not — and that a discount rate marked every minute against a reinvestment return marked twice a year will diverge, most of all when the bond is moving fastest.

Claim	What would prove it wrong
The physical shock has peaked	Hormuz transit collapses again; Brent sustained above US\$110; Gulf output cuts return
The financial shock has not peaked	The US 30-year falls and holds below 5% without Treasury intervention; term premium compresses
China is the swing buyer	China resumes Gulf purchases at current prices; reserves drawn faster than expected
Compounding is being hidden, not lost	Return on capital falls at the holdings currently earning above 25%; margin compression appears at the businesses that have so far passed the cost through

We would rather be measured on the last row than any of the others. The first three are interesting and largely outside our control. The fourth decides whether the businesses we own are compounding through this or

merely surviving it — and unlike a view on Hormuz or the Federal Reserve, it will be answered in a result, on a date we already know.

Finding Herbie Faster

Eliyahu Goldratt and Jeff Cox published *The Goal* in 1984. It has sold more than seven million copies and remains one of the few management texts most plant managers have actually finished. Its central idea is illustrated not in a factory but on a hike.

A troop of boy scouts string out along a trail because one heavy-set boy, Herbie, walks slower than the rest. Speeding up the boys at the front only widens the gap. The column tightens only once Herbie moves to the front and the weight in his pack is redistributed. Forty-two years later, the framework is intact. What has changed is the speed at which a plant can execute step one — finding Herbie. This piece uses three Australasian medical-device holdings to show what that speed is worth, and where it is worth nothing at all.

Why improving everything is a trap

A system's output is set by its slowest dependent step — the constraint. Every improvement made anywhere else is, in Goldratt's language, an illusion: it produces inventory and operational expense, not throughput. His method reduces to five focusing steps: identify the bottleneck, exploit it, subordinate everything else to it, elevate it, then return to step one and do not let inertia become the new constraint. Using this methodology, the conventional cost accounting is also replaced with three measures: Throughput, the rate at which the system generates money through sales; inventory, the money tied up in things it intends to sell; and operational expense, the money spent turning one into the other. Progress is throughput rising while the other two fall. Anything else is local optimisation dressed as progress.

To illustrate this, the core concept used in the book is a game in which scouts pass matches down a line, each boy's output set by a die roll with an identical average. The line still falls behind and the shortfall accumulates rather than averaging out, because the steps depend on one another. A good roll cannot make up for someone else's earlier bad one, since a boy can only pass on matches he has actually received. Ordinary random variation, combined with dependent steps, destroys throughput on its own. No machine has to break down for the system to underperform.

What 'self-improving AI' actually means

Two different capabilities are routinely bundled under that label. The first is a shipping product, the second a hypothesis. The version that already works is self-supervised learning: hide a word in a sentence and ask a model to guess it, so the text supplies its own answer key and nobody has to label anything. A stronger version is learning by competition. In 2017, DeepMind's AlphaZero was given the rules of chess and nothing else, no opening theory or database of human games. Within hours of playing against copies of itself, it was beating the strongest conventional engine in the world. Most models are then trained once and shipped, like a textbook printed and put on a shelf. A model that keeps updating from what it observes in the field, by contrast, is using continual learning, and in industrial terms that is the commercially important step over the next few years.

The version people refer to when they get excited is different. Irving John Good, who worked alongside Alan Turing breaking German ciphers, wrote in 1965 that the first machine capable of designing a better one than itself would be the last invention humans ever needed. He called the result an intelligence explosion; today it is called recursive self-improvement. It does not exist in any meaningful industrial form, and nothing here depends on it.

The enabling technology underneath the useful half is the digital twin — a working simulation of a real plant, accurate enough that an experiment tried on a computer can be trusted. It is a flight simulator for a production line, and its value is that tests become free: a plant can be crashed a million times before Tuesday. The best public demonstration is not in manufacturing at all. Google's data centres are large and expensive to cool, and engineering teams had already spent years tuning that cooling. In 2016, Google deployed a machine-learning system trained against a simulation of the buildings, which drove an approximate 40% reduction in the energy used for cooling the centres. The lesson is not that the machine was clever. It is that a system optimised by good engineers still had 40% left of efficiencies, which nobody picked up.

Six Sigma's blind spot

Six Sigma began at Motorola in 1986, when an engineer named Bill Smith introduced the methodology to close the gap against Japanese manufacturers whose defect rates were an order of magnitude better. General Electric later industrialised it in the 1990s. The target is 3.4 defects per million opportunities, and the core tool is the control chart, invented by Walter Shewhart at Bell Telephone Laboratories in the 1920s to answer one question: is this reading ordinary noise, or a real problem? It works, and in regulated device manufacturing it is not optional — it is the reason an implant survives decades inside a skull and a breathing circuit does not fail in intensive care.

Six Sigma also carries a structural weakness that Goldratt identified before the methodology existed. It reduces variation, but it does not tell you which variation matters. A Six Sigma project is also a human artefact, taking three to six months, requiring a trained specialist and a cross-functional team, and its natural cadence is quarterly or slower. It also looks backwards, analysing what a process did. The forward-looking tool (experiment design) is expensive, as every run costs material, machine time and paperwork, so a well-resourced team might get through a few hundred experimental runs a year on a single critical process. Goldratt's diagnosis was that plants were drowning in improvement activity, while getting worse. Everybody was busy; throughput did not move. Six Sigma is an extremely good hammer with no opinion about which nail is load bearing.

Four things a constraint-aware system changes

The constraint moves faster than a human audit can find it. Herbie is a plot device — he stays put, which is why the plant can be reorganised around him. A real multi-product plant does not behave that way. Fisher & Paykel Healthcare runs hospital consumables, homecare masks, breathing circuits and hardware across East Tamaki in Auckland and Tijuana in Mexico; the binding step under one product mix is not the same under another, and the company itself names respiratory season severity as the swing factor in second-half hospital consumables growth. Human constraint identification is a sampling process, run monthly or quarterly through a management review. If the constraint relocates weekly, most of that review time is spent exploiting yesterday's Herbie. This is not smarter

analysis; it is a higher sampling rate on the only question that matters.

Experiments stop being scarce. A digital twin plus a learning agent changes the economics of experimentation by orders of magnitude. Instead of a few hundred physical runs a year, an agent runs millions of simulations overnight and proposes a handful worth trying on the real machine. The catch belongs in the same sentence: the twin has to be right. A learning agent will eagerly exploit an error in the simulation because, from its point of view, the error is simply a good result. It can find settings that produce brilliant simulated yield and terrible real parts. Validating the twin becomes the hard engineering problem, which is essentially a Six Sigma problem. The old discipline does not disappear; it moves upstream and becomes the quality gate on the simulator.

Buffers can shrink. Six Sigma attacks variation by shrinking it and Goldratt absorbed it in an inventory buffer ahead of the constraint. A forecasting model does something neither can: it predicts the variation. If a system can see in advance which batches will arrive late, the buffer protecting the constraint can be smaller for the same protection — throughput holds while inventory falls, and those two normally trade against each other.

Step five is about inertia, and inertia is human. Policies written to protect a bottleneck outlive the bottleneck: a scheduling rule, an overtime allocation, a capital-approval hurdle, each correct once and left in force long after the machine it was built around stopped being the slow step. Fisher & Paykel gives the cleanest documented example. Coming out of the pandemic, management described stepping away from a supply-at-all-costs mentality and returning to continuous improvement and operational efficiency. During COVID, capacity was the constraint, so maximising output regardless of cost was the right policy. Once the constraint moved, the policy had to be consciously dismantled by the company's CEO. It did not dissolve on its own.

Three holdings, ranked by what the technology is worth

Manufacturing exposure to closed-loop optimisation is not the same variable as franchise quality, and ranking the three by incremental value from this technology

inverts the usual quality ranking. That is the point of the exercise.

Fisher & Paykel Healthcare is the clearest case because manufacturing efficiency is an explicit and stated earnings driver rather than a hygiene factor. For the year to 31 March 2026, the company reported operating revenue of NZ\$2,308.4m, up 14% reported and 12% in constant currency, and net profit of NZ\$468.5m, up 24% and 28% respectively. Gross margin expanded 80 basis points reported, and 122 basis points in constant currency, to 63.7%, while absorbing approximately 90 basis points of United States tariff headwind. Management attributes part of that to manufacturing efficiency gains. Capital expenditure totalled NZ\$195.2m, of which NZ\$111.0m is contracted to the fifth building under construction at East Tamaki. High-volume repetitive processes with plenty of scope for sensors are the ideal substrate, the product mix is broad enough that the constraint genuinely wanders, and the denominator is a NZ\$2.3b revenue base compounding through a consumables annuity.

Resmed has spent the year demonstrating what a productivity pipeline is worth without using Goldratt's vocabulary. Non-GAAP gross margin reached 62.4% for FY26, up 240 basis points, with the fourth quarter alone delivering 90 basis points of expansion on 9% reported revenue growth. Capital expenditure stepped up 74% to US\$156.3m from US\$89.9m for manufacturing capacity and distribution, holding free cash flow flat at US\$1,649.5m — growth investment rather than maintenance drift. Resmed also supplies the cleanest illustration of a distinction Six Sigma cannot express: during the semiconductor shortage, the binding constraint sat in a supplier's chip fabrication plant, outside Resmed's own four walls, and no internal variance reduction could exploit a constraint the company did not own. The only available move was Goldratt's fourth step, elevate. That is, in practice, redesigning circuit boards around the components that could be obtained.

Cochlear is the instructive case, and the instruction is uncomfortable. The company attributed its FY26 trading difficulty primarily to hospital capacity constraints and a decline in referrals from the hearing-aid channel, cutting underlying net profit guidance on 22 April 2026 from A\$435–\$460m to A\$290–\$330m, with shares falling approximately 40% from pre-announcement levels. It delivered A\$322.4m at the upper end of the cut

range on sales revenue of A\$2,343.4m, down 1% reported and up 2% in constant currency, with gross margin down three percentage points to 71% and underlying EBIT down 22% to A\$432.6m. Read through Goldratt, Cochlear deliberately slowed its own plant because finished goods were building ahead of a market that could not absorb them. A yield project on the sound-processor line in the second half would not have produced anything; extra output would have become inventory, not sales. The binding constraints are surgeon and theatre capacity and the audiologist referral pathway, both outside the factory gate.

Where this fails

Four objections are worth taking seriously. Data is the constraint before compute is. Most plants have patchy sensor coverage and rely on critical process knowledge that often lives in the head of a long-serving operator and was never written down, so an optimisation agent fed bad data produces confident nonsense faster. The real capital-expenditure item is instrumentation, not models. Validated processes are designed not to change: regulatory architecture assumes a static process, and continuous autonomous adjustment therefore arrives last in the highest-risk product classes and first in packaging, logistics, scheduling and visual inspection. Goldratt's deepest point was about policy rather than machines. In *The Goal*, the two bottleneck machines get the attention, but the actual villain is the cost-accounting system that rewarded local efficiency and thereby manufactured the problem. And recursive self-improvement is not a product: continual learning, agentic tool use and simulation-based optimisation are sufficient for everything described here. Any claim leaning on the stronger version should be discounted heavily.

Questions worth putting to management

- How often does the plant formally re-identify its binding constraint — monthly, weekly, or continuously?
- When the constraint moves with product mix, how long is the lag before scheduling rules adjust?
- What proportion of automation capital expenditure is instrumentation and data infrastructure rather than physical equipment?
- Do you run a validated simulation of any production process, and how was the simulation itself proven accurate?

- What is the current buffer size ahead of the binding step, and has it fallen in the last three years?
- Which improvement policies are still in force from a constraint that no longer binds?
- If demand fell 20 per cent, where would the constraint relocate to?

What becomes computable, and what does not

Six Sigma is a methodology for reducing variation, while Theory of Constraints is for deciding where reducing variation is worth pursuing. They were never rivals. Goldratt's objection was to undirected improvement, not to statistical rigour. What a self-improving system adds is not a new theory, but a collapse in the cost of executing an old one. Constraint identification moves from a quarterly management judgement to a continuous calculation; experimentation moves from a few hundred physical runs to millions of simulated ones;

buffer sizing moves from a rule of thumb to a forecast. The limiting factor is not the methodology. It is data quality, regulatory architecture, and the willingness to retire policies that were once correct.

Across the three holdings, the pattern is consistent. Fisher & Paykel has the process substrate and the stated intent. Resmed is executing the thesis under a different name and reporting the basis points. Cochlear is the control case. And it's the control case that teaches the most, as it shows a company can have world-class manufacturing and still find that none of it matters when Herbie is standing in a hospital corridor rather than on the factory floor. Goldratt's closing question had three parts: what to change, what to change to, and how to cause the change. The first two are becoming computable. The third is a management problem, and it continues to be where most of the value is won or lost.

JHX 2026 Investor Day

James Hardie held its first investor day since the AZEK combination in New York on 15 September 2026. The interesting part was not the strategy, but rather the guidance page. The company reaffirmed both North American segments in unchanged dollars and took Europe out of the base, yet still raised its free cash flow line.

A company that raises its cash guidance while removing a business from the base is saying something specific: the improvement is coming from the operations it is keeping, not from the arithmetic of the one it is selling.

Underneath it is a simpler picture than the period since the deal closed would suggest. Capital expenditure falls by about a third over two years, the plants needed to support growth are already built and paid for, cost synergies arrive a year early, and the debt comes down.

What was said

Six commitments came out of the day, and they are unusually easy to score because most of them carry a date.

- FY27 net sales of US\$4,990m to US\$5,133m and adjusted EBITDA of US\$1,446m to US\$1,534m, both reaffirmed on an ex-Europe basis
- Free cash flow raised from at least US\$500m to more than US\$600m
- The US\$125m cost synergy target reached at a FY27 exit run rate, against an original FY2028 target — roughly a year early
- A medium-term growth algorithm of 4% to 7% organic growth above market, at 35%-plus adjusted EBITDA flowthrough
- Capital expenditure down to 6% to 7% of net sales in FY27 and 6% to 8% over the medium term, from 10.0% in FY25
- Net leverage below 2.0x by the second quarter of FY28, reaffirmed for the third time in two months

The shape of the restatement is evidence that *reaffirmed* is an accurate descriptor rather than a presentational one. The headline ranges fall because Europe comes out, but the segment ranges underneath them do not move at all. Siding and Trim stays at US\$3,226m-US\$3,314m of net sales and US\$1,045m-US\$1,106m of adjusted EBITDA. Deck, Rail and Accessories stays at US\$1,210m-US\$1,240m and US\$339m-US\$357m. Six weeks after raising them, with a quarter of trading behind it, management has not moved the businesses that carry the case.

Cash flow, and a raise larger than it looks

On the printed numbers the free cash flow guidance went up US\$100m. Read like-for-like, it is larger, because the old floor was struck with Europe inside it and the new one without. Europe generates roughly US\$46.7m a year of segment EBITDA less capital expenditure, so our reading is the underlying improvement is nearer US\$147m than the US\$100m printed. That is our derivation on the segment basis; Europe's free cash flow after tax and allocated corporate cost is not disclosed.

Three different free cash flow numbers for FY26 now circulate and all are correct, which is why the basis has to be named every time: US\$205.9m on the operating-cash-flow-less-capital-expenditure convention we use elsewhere, US\$314.1m on James Hardie's own definition, which adds back US\$108.2m of property disposal proceeds, and US\$425.3m pro-forma, including AZEK for the full year, which is the figure the investor day charts. The FY27 guide is on the company's definition, so the like-for-like comparison is against US\$425.3m — an increase of about 41%. All of these are struck after the cost of the debt: James Hardie reports under United States accounting standards, which classify interest paid as an operating activity, with US\$207.8m paid in FY26.

	FY25	FY26	FY27E	Medium term
Capital expenditure (% of net sales)	10.0%	7.8%	6–7%	6–8%
Free cash flow (US\$m)	589	425	600+	—
Free cash flow conversion	39%	30%	~38%	40%+

FY25 and FY26 are pro-forma and include AZEK. Conversion is free cash flow divided by adjusted EBITDA on the company's own definition. The FY26 trough is bridged on the company's own chart by US\$207m of deal and integration costs, which ties to the US\$206.9m of acquisition-related expense in the FY26 accounts.

Lower capital expenditure, on capacity already built

The capital expenditure step-down is the mechanism behind the cash, and the deck is direct about why it is available: it follows what the company calls substantial capacity investment. Two supports sit behind it, and both are genuinely useful to the thesis we underwrite.

The first is that the plants are not full. Fibre cement capacity utilisation is running at ~70%, decking at ~60% and PVC trim at ~65% — figures the company describes as directional rather than precise — with the Prattville fibre cement and Boise decking lines already installed. A business that can absorb a volume recovery into existing capacity is a different cash flow proposition from one that has to build for it.

The second is that the existing capacity is getting faster. The Hardie Advanced Manufacturing program has lifted fibre cement network line speed 5% over the last twelve months and is credited with roughly US\$1b of capacity capital expenditure deferral potential. That is potential rather than a commitment, and worth reading as such. The scale it sits against is real enough: 26 North American manufacturing sites, which the company values about US\$8b on a replacement-cost basis, of which more than US\$6b is its fibre cement footprint alone.

Debt down, and a buyback we would have sequenced differently

Net leverage fell from 3.30x to 2.70x in a single quarter as net debt dropped US\$281.6m, and the target of below 2.0x by the second quarter of FY28 — that is, by 30 September 2027 — was reaffirmed. Capital allocation was restated as four priorities rather than three: organic growth first, deleveraging second with the target named inside the priority itself, potential bolt-on acquisitions third, and shareholder returns fourth, described as opportunistic share repurchases.

The European disposal funds part of that. The headline is an enterprise value of about US\$980m, not a cash figure. On the company's own disclosed assumptions — US\$50m of transaction fees at a euro rate of 1.165 — gross consideration is US\$978.6m and about US\$929m after fees, before the debt, cash and working capital adjustments in the sale agreement and also any tax. Against that, US\$600m is earmarked for debt repayment and US\$250m for the buyback, which is about US\$850m of the roughly US\$929m. Completion is expected in the first half of calendar year 2027.

Our reservation is about sequence rather than quantum. The buyback restarts capital returns at 2.70x, a full turn of leverage above the threshold management itself set, and it is funded from an asset sale. Our house view on capital management favours a sustainable, repeatable program over one-off returns out of disposal proceeds. The investor day answered part of the question and left the rest open: *opportunistic* is the operative word, and ranking returns fourth behind bolt-on acquisitions confirms the authorisation is discretionary rather than the start of a standing program, which is the answer we would have chosen at this leverage. What is still unanswered is the timing against the proceeds. The company's own model assumes the full US\$250m is executed at US\$31 a share without saying when.

There is also an honest piece of arithmetic on the disposal that is worth stating plainly. Europe generates roughly US\$46.7m a year of segment EBITDA less capital expenditure. Repaying US\$600m at the group's 5.5% blended rate saves roughly US\$33m a year of pre-tax interest. Both figures are on the same pre-tax footing and they do not cover each other. The sale buys margin, focus and a buyback; it does not buy a materially faster path to the leverage target. That still has to be carried by operations and based on the numbers above, it is.

Growth without a housing recovery

The new growth algorithm targets 4%-7% annual organic growth above market at 35%-plus adjusted EBITDA flowthrough, built from net price, material conversion, and growth initiatives plus revenue synergies. Market improvement and bolt-on acquisitions are named as upside sitting outside the range rather than inside it.

The clause that matters is CEO Aaron Erter's own: the algorithm is driven by a US\$23b material conversion opportunity, self-help initiatives and US\$500m of anticipated revenue synergies, *all without underwriting a housing recovery*. That converts the United States housing cycle from a load-bearing assumption into upside, and it is the most consequential change the day made. The claim is testable and the test is already running — the first quarter delivered 20% organic volume growth in North American fibre cement against a market management itself calls challenged. That is the destocking reversal rather than the run rate, and the company's own sensitivity page assumes about 5.5% of outperformance, not 20%.

The conversion opportunity is the engine underneath it. North America is a US\$27b addressable market, of which the company can serve about US\$23b, up from US\$10b before AZEK, and between roughly two-thirds and 85% of the volume in each category still sits in the materials it is trying to displace. One point of conversion is worth about 4% of growth to the siding and decking category.

The most useful page in the deck is the sensitivity. Even the weakest of its three scenarios, with the market contracting 1.5%, carries about US\$730m of free cash flow. This is above the US\$600m floor and roughly 1.7x the FY26 pro-forma figure. It's this arithmetic that makes the leverage target look scheduled rather than hopeful.

The two synergies

The cost program arrives a year early. The full US\$125m target is now expected at a FY27 exit run rate against an original FY28 target, with the remaining pipeline named specifically: the Hardie Operating System extended into the decking and PVC trim plants, scale-driven procurement, systems consolidation and minor organisational work. Roughly US\$29m was realised in the first quarter and US\$37m across FY26, though those are amounts realised in a period and the

US\$125m is a run rate reached at a point in time, so the two are not the same measure and should not be added against each other. The single largest identified piece is the operating system going into the AZEK plants, targeted at more than US\$50m on its own. That is, over a third of the program from one lever. Pulling a target forward by a year is also a harder commitment than being ahead of schedule, because it names a date on which it can be scored.

The commercial program is the larger prize and the less proven one. The US\$500m five-year target stays on its original FY30 track, with US\$125m-plus expected at the FY27 exit run rate. What is new is that the activated tranche is now specified rather than described: Boise Cascade adding decking, regional distributors adding siding, Lansing adding trim, CBUSA taking the full portfolio, and contractor cross-sell.

The Boise Cascade arrangement is the one worth dwelling on. It is an exclusive national two-step distribution partnership encompassing one exclusive national partner plus six regional ones, a combined sales force of about 1,250 people, and access to decking dealers and retail. The problem it fixes is specific and was genuinely costly: James Hardie's distribution was fragmented across roughly four distributors per market, its decking and fibre cement distributors were entirely separate, and retail was untapped. One national partner incentivised to grow one brand, carrying the full portfolio rather than splitting it across competitors, is a materially different proposition.

Our view is that the Boise Cascade exclusive alone is capable of the full US\$500m, which would make the company's five-year target for all five activated channels conservative. That is our reading rather than a disclosed figure. James Hardie does not publish a channel-by-channel split of the US\$500m, and we would not invent one. The supporting evidence is the scale the company itself puts on a single distribution relationship elsewhere: the separate one-step partnership with ABC Supply is targeted at about US\$1b of combined sales within five years, and Hardie and AZEK trim currently sit in only about a third of ABC's PVC-carrying branches. The two figures are not measured the same way — ABC's is total sales through a channel and the US\$500m is incremental revenue synergy across all of them — but it gives a sense of what one national relationship can carry, and it is the reason we think the exclusive national two-step channel has been sized cautiously.

One company, not two

The integration theme running under all of it is that this is now a single business rather than a parent and an acquired subsidiary, and the clearest evidence was the presenter list. Six executives presented, three from each side: the chief executive, chief operating officer and chief sales officer from James Hardie, joining in 2022, 2007 and 2004; and the president of the North American building products group, chief marketing officer and chief financial officer from AZEK, joining in 2018, 2021 and 2022. The company's phrase is *best of both*, and the composition supports it — an AZEK executive runs the North American product group, a twenty-year James Hardie insider runs sales.

The operating side is the same story told through plants and channels. The Hardie Operating System — lean manufacturing, procurement, product reformulation and supply chain — targets about 1.5% of revenue in annual savings and is now being pushed into the AZEK plants. Commercially, four distributors per market become one national partner carrying everything, and one combined sales organisation sells the whole portfolio through a single relationship. The cost synergy and the revenue synergy are, in that sense, the same act viewed from two ends.

What we are watching

The securities litigation is unchanged and still open.

The United States federal class action reached the motion-to-dismiss stage with briefing due to complete on 5 October 2026, three state-court actions by former AZEK stockholders were consolidated during the quarter, and a second Australian group proceeding was filed in April. No reserve is recorded: the company believes the claims are without merit and judges a loss neither probable nor reasonably estimable.

Decking is where the commercial synergy case has to be proved. Deck, Rail and Accessories net sales fell 5% pro-forma as the channel worked down inventory. Management frames it as a deliberate reset rather than end-demand weakness, with sell-through outpacing

shipments, and the guide implies re-acceleration. That range has now been left unchanged twice, which makes it the line where a miss would show first.

The accounts change shape next quarter. Europe moves to discontinued operations from the second quarter of FY27, so prior periods are re-presented, the comparatives in the next three filings will not be the ones used here, and four segments become three. The ex-Europe guidance also states that it removes the European segment results only and does not consider any elimination of corporate expenditure. Those costs will stay in the continuing group unless separately removed, which makes the ex-Europe figure a ceiling rather than a central case until the first restated quarter. The cost of winding down the European fibre cement operations, which the sale does not include, has not been quantified.

In closing

The investor day did not change the business. It changed what is known about the cash the business will produce. The growth algorithm is a claim that will take years to test, and a material conversion opportunity has been part of this company's story for two decades. What is new and checkable inside twelve months is narrower and more useful: capital expenditure at 6%-7% of sales, a free cash flow floor above US\$600m struck on a smaller base, a cost synergy run rate to be banked by the FY27 exit, and net leverage on a dated path to below 2.0x by September 2027. The record behind those commitments is that James Hardie's dollar guidance is met once it is scored on the basis the company actually set it to — FY25 achieved on every line, every AZEK-inclusive FY26 range met or exceeded, and every guided line beaten in the first quarter of FY27.

The litigation remains open and the housing cycle remains soft. But a company that can raise its cash guidance, while selling a business, on capacity it has already paid for and is running at 70%, is converting the AZEK deal into cash faster than the original schedule implied. And that, rather than the disposal, is the most important thing the day established.

Warsh

The U.S. Fed – a new era

This current decade has already witnessed some historic pivot points. COVID-19 sits at the top, but looking forward, the longer lasting impacts are likely to flow from the adoption of GLP-1 drugs across a cohort of diseases and the evolution of Artificial Intelligence.

Less significant is perhaps the appointment of the new Federal Chair of the Board of Governors of the U.S. Federal Reserve System. This title was handed to Kevin Warsh on 13 May 2026, succeeding previous Chair Jerome Powell as the 17th Fed Chair. Warsh officially took office on 22 May.

The history of the U.S. Federal Reserve can be traced back to its creation in 1913 through the Federal Reserve Act, signed by then U.S. President Woodrow Wilson.

The Fed was created in response to a series of banking panics, notably in 1907, which exposed the lack of a central authority to act as lender of last resort. It set up 12 regional Reserve Banks under a Washington-based Board, balancing private banking interests against public oversight.

The U.S. Fed has intervened at critical junctures over the past century, including:

- **1930s:** The Fed's passive response to bank failures worsened the Great Depression, prompting the Banking Act of 1935, which centralized power in the Board of Governors and created the Federal Open Market Committee (FOMC as we know it today).
- **1951 Treasury-Fed Accord:** Ended the Fed's obligation to peg government bond yields, establishing monetary policy independence from fiscal financing.
- **1970s stagflation, known as the Volcker era (1979-87):** Paul Volcker raised rates aggressively (fed funds rate above 19%) to break double-digit inflation, cementing the Fed's inflation-fighting credibility.
- **Greenspan/Bernanke era:** Highlighted by the 2008 Global Financial Crisis, where the Fed became lender of last resort to the entire financial system, not just banks – QE, near-zero rates, and unprecedented balance sheet expansion (from under US\$1T to over US\$4T).
- **2020 COVID response:** Balance sheet went to roughly US\$9T, followed by the 2022-23 hiking cycle

to combat post-pandemic inflation – the fastest tightening since Volcker.

Changing of the guard

Old

Retiring U.S. Fed Chair Jerome Powell was one who stood in the spotlight. Since 1981, the FOMC had followed a standard schedule of eight meetings annually. The Chair would deliver the results of the Committee and undertake four press conferences per year, explaining the rationale behind the decisions.

In 2019, Powell doubled the frequency to eight, holding press conferences after every central bank meeting, in addition to unscheduled emergency meetings during COVID-19.

New

New Chair Kevin Warsh is unlikely to sustain this practice. Before we go there though, below is a piece written in our June 2026 Selector Quarterly newsletter, tracing his appointment and opening remarks.

Extract

On 17 June 2026, the new U.S. Federal Chair delivered his first press conference address. This was a watershed moment. It was in essence the passing of the old guard. Set ways replaced by a new, more contemporary approach.

Chairman Warsh, nominated by President Trump on 30 January 2026 and officially took office on 22 May 2026, to replace outgoing Jerome Powell, is resetting the role of the Federal Reserve Board.

This is an important event, a point in history. One where things that no longer work are replaced by better ways.

It is also important to consider Warsh's recent background. He aligns with the Treasury Secretary Scott Bessent, who oversaw the selection process of the new Chair and is a former colleague of famed investor Stanley Druckenmiller, who is on record for his views on the ballooning U.S. national debt, as a "*dire, long-term threat*". On this point there is clear agreement between the two.

The Chair makes it very clear in his prepared remarks that, "*This week's FOMC meeting exemplified the very*

best of the Fed's traditions: rigorous debate, open-mindedness, commitment to mission, responsibility, and accountability for performance. In this business, they all add up to one thing: getting monetary policy right - or as near to it as we can do."

This is clear, however, the more interesting comments discussed the way forward, *"On that score, you might have already noticed something: a difference in today's policy statement. It's a bit shorter, a bit simpler - and it dispenses with some older language. That statement just gives you the facts, as best we can judge it. Absent, also, is so called forward guidance, which we agreed was not well suited to the current policy conjuncture."*

The statement was brief at 130 words, down from the 341 delivered in April by the previous Chair. To that end, the Federal Reserve will be embarking on new initiatives that emphasise the need to remain relevant and present.

These initiatives will consider the appointment of task forces in five areas central to the broad conduct of monetary policy. They include:

- Federal Reserve communications
- Federal Reserve balance sheet
- The use and reliance on existing data sources
- Productivity and jobs in an era of transformation
- Inflation frameworks

These task forces will report back by calendar year end and with that, the implementation of changes that will be more constructive to policy settings.

High on the list relates to data, *"The third task force, the one that on data, will evaluate new information sources and consider methodological changes to improve data gathering, with the aim of giving policy makers more accurate, relevant, contemporaneous, and perhaps most important actionable information of the state of the economy"*.

This is shorthand for working on real, up to date data, the facts.

Anyone who doubts the capabilities of Chairman Warsh should consider his background. He sat as a Federal Governor between 2006-2011, having transversed the Global Financial Crisis.

This real experience, his opposition to the Federal Reserve's expansive balance sheet, having advocated for a much smaller level, and the prospects of a

productivity-enhancing boom in artificial intelligence, suggests this Federal Chair will be pragmatic and conservative in the Board's pursuits.

This may result in an era of strong growth coinciding with rising unemployment, which has been the case thus far. Under that scenario, meeting the Federal Reserve's twin objectives of price stability and maximum employment, may result in a lower interest rate environment. This is a critical point to consider.

We have a task force for that.

And in that context, AI will have an important role, likely to usher in an era of structural disinflation, which speaks to a secular, supply side driven decline in general price levels, that is not cyclical, in that it does not reverse with the next cycle.

This is an outcome of the declining power of labour and capital, as industries and individuals are hit by zero marginal cost waves, reflecting the dominant input of intellectual capital rather than physical exertion.

As Warsh explained at the press conference, *"With respect to AI and the growth of data centres and infrastructure around it, we're counting the demand side. And it is no doubt showing up in GDP figures. We can be less certain when we infer the timing and extent of the growth on the supply side. It may be an intuition the supply side is going to expand but it'll take longer. I just describe it this way. There's a race between supply and demand. Milton says the only thing we know about economics is there's a supply line, and a demand line, and they ultimately cross. When they cross and what are the implications for policy? The good news for you is we have a task force for that."*

Time will determine the success or not of Warsh's appointment as the new Federal Reserve Chair.

However, his use of plain 'speak', his market experience, his support for a less indebted balance sheet, and his preparedness to question the status quo in an era that will be defined by the acceleration of AI is a welcome step.

July 2026

On 29 July, Chairman Warsh delivered his second FOMC meeting and addressed the media thereafter. The prepared remarks, highlighted below, are in our opinion a 'new' approach in how the Fed operates and

communicates. It is already causing consternation in the market.

The FOMC meeting was also not unanimous, voting 9-3 in holding rates, the first dissent of Chair Warsh's tenure. This is a shift, representing a dissenting bloc, now on record in wanting to hike rates immediately.

"Today, as you know, our Committee decided to vote by a 9 to 3 vote to maintain the target range for the federal funds rate at 3 ½ to 3 ¾ percent. The Committee is continuing its policy of making ample reserves in the banking system. The economy is showing impressive resilience. Even with recent shocks, the trends are positive and reveal solid growth. Job gains have kept pace with the workforce, and the unemployment rate has changed little."

Inflation remains elevated relative to the Committee's 2 percent goal. The Committee remains resolute. You've heard this before, but we will deliver price stability.

As before, the policy statement conveys just the facts. It's steering clear of forecasting, a choice we consider especially prudent at these uncertain times.

Uncertainty, however, does not mean a lack of clarity. For some households, businesses, and market professionals, five years of high inflation have left a mistaken impression that is hard to shake: that the Fed's implicit inflation target was somehow above 2 percent.

Today

Figure 7: U.S. Unemployment rate 1950-2026



Source: U.S. Bureau of Labor Statistics

Let me reiterate: There is no soft inflation target, there is no soft implicit target — not on this Committee's watch. There is only a target, and it is 2 percent. Not one of my FOMC colleagues is under any illusion.

We have begun a new chapter, and we understand that the five-plus years of inflation above target cannot be cured in nine weeks – or by a single month of modest price decreases."

What is the Fed's remit?

The Fed operates under a dual mandate, set by the U.S. Congress via the Federal Reserve Act, which was amended in 1977:

- Maximum employment – keep the labor market as strong as sustainable
- Stable prices – informally targeted at 2% inflation adopting the Personal Consumption Expenditure Index (PCE).

A less-discussed third goal is often cited alongside these: moderate long-term interest rates, though in practice this is treated as a byproduct of achieving the first two rather than a separate operational target.

Beyond monetary policy, there is also the broader oversight extending to financial stability and the lender of last resort and systemic risk monitoring, as evident during the GFC and COVID-19.

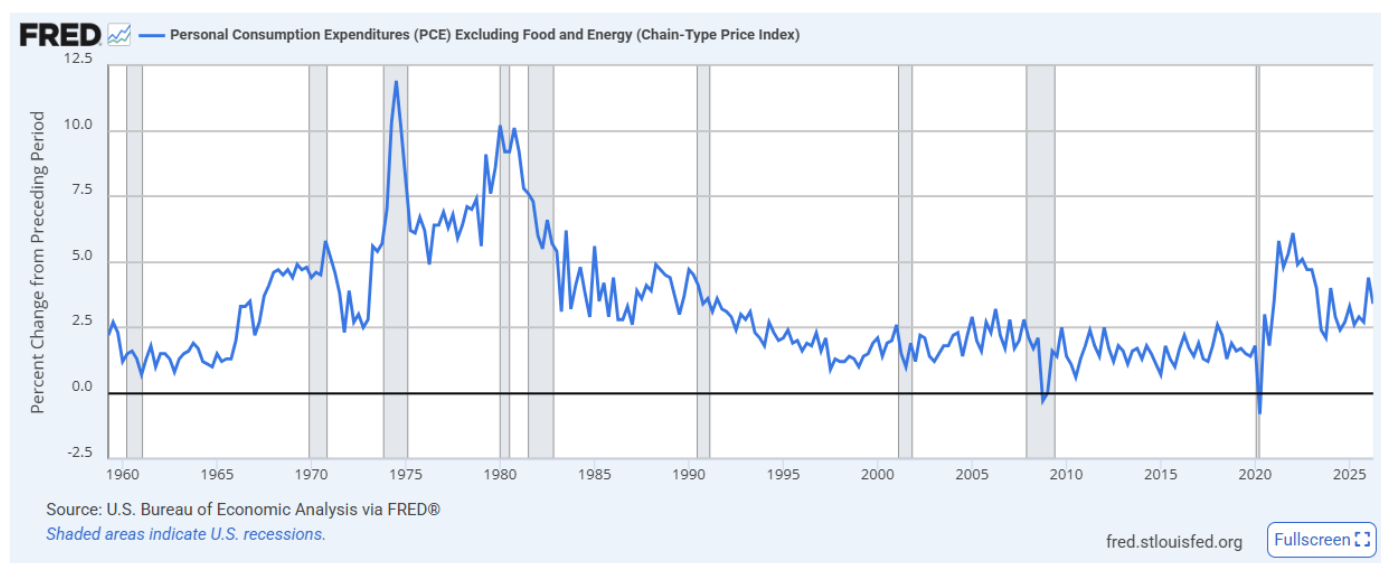
Considering all that has happened over the past five years, U.S. unemployment levels have remained low. In historical terms, the previous peaks experienced in 1983, 2008 and COVID-19, most recently, make today's number of around 4.2%, look incredibly strong from a Fed point of view.

Having withstood COVID-19, tariffs and ongoing wars, while continuing to deal with the twin economic impacts of sustained inflationary and high interest rates,

the Fed Chair continues to make the case that despite this, *"The economy is showing impressive resilience. Even with recent shocks, the trends are positive and reveal solid growth. Job gains have kept pace with the workforce, and the unemployment rate has changed little."*

So far, delivering on the Fed's first mandate, 'Maximum employment' looks on track.

Figure 8: U.S. Personal Consumption Expenditure Index (PCE) 1959-2026



Source: U.S. Bureau of Economic Analysis FRED

From 1995 until COVID-19, PCE remained below 2.5% for an extended period. Since then, the Fed has battled a stubbornly high level of inflation. Sitting at 3.67% and well above the intended 2% target, Warsh addressed his thinking on this matter, *"Let me reiterate: There is no soft inflation target, there is no soft implicit target – not on this Committee's watch. There is only a target, and it is 2 percent. Not one of my FOMC colleagues is under any illusion. We have begun a new chapter, and we understand that the five-plus years of inflation above target cannot be cured in nine weeks – or by a single month of modest price decreases."*

While markets are increasingly concerned the Fed, led by Warsh, are not addressing one of the dual mandates, it is our view this Fed is asking questions and seeking deeper insights, before committing to any action.

Warsh

Past Fed Chairs, most notably Powell, often noted a reliance of future data readouts before acting on interest rates. As such, the Fed's "data dependency"

was a key feature of Powell's term, leading to more inaction.

Warsh, to use a yachting term, is tacking differently to Powell and others. The establishment of five task forces underscores an approach that seeks factual long-term data to uncover any trends, *"I'd like to believe that the Committee shares my views, which is the historic problem with data dependence is the data and the dependence. We are not relying on any one individual piece of data as cover or as an excuse, or as validation. What I care about, and what I think the Committee cares about, is trends on the data."*

Some may argue Warsh's approach is too hands off, ultimately leading to financial market dysfunction. Inaction to lift rates when inflation is clearly operating well above the designated target of 2 percent is the Fed sitting on its hands. But the counter argument is that the market is not waiting, it is acting independently of the Fed as Warsh explained, *"Two economic developments are worth highlighting. The first is a very notable change since our last meeting 42 days ago:*

nominal and real yields are materially higher across the Treasury curve.

In fact, some of the increases in market interest rates between FOMC meetings are among the most significant in the last two decades, ranking around the top decile or so. But if the Committee didn't change its policy rate, what happened? In the inter-meeting period, market attention centred on real data and real economic developments.

Prices reacted in real time to incoming information, and the reduction in forward guidance may have been a factor. Market participants are learning to play the ball, not the referee – and market prices will continue to respond in the direction and magnitude they see fit.

This is, in my view, a change for the better – and we are just getting started. After all, the central bank need not always and everywhere be the centre of attention. I understand the desire for rolling forecasts and commentary from this Committee. But for our part, we need to observe market reaction to developments, direct and unfiltered. I want to stress, of course, that decisions by this Committee matter a great deal. And where necessary and appropriate, we will not hesitate to act.”

Let the markets sort it out

Nowhere is this more evident than in the bond market, where Warsh has made his position very clear despite

ongoing pushback from commentators. “Letting buyers and sellers meet at prices for Treasuries, for the foreign exchange value of the dollar, and then trying to judge for ourselves, what does that mean about our remit? How are we doing on inflation? How are we doing on employment?”

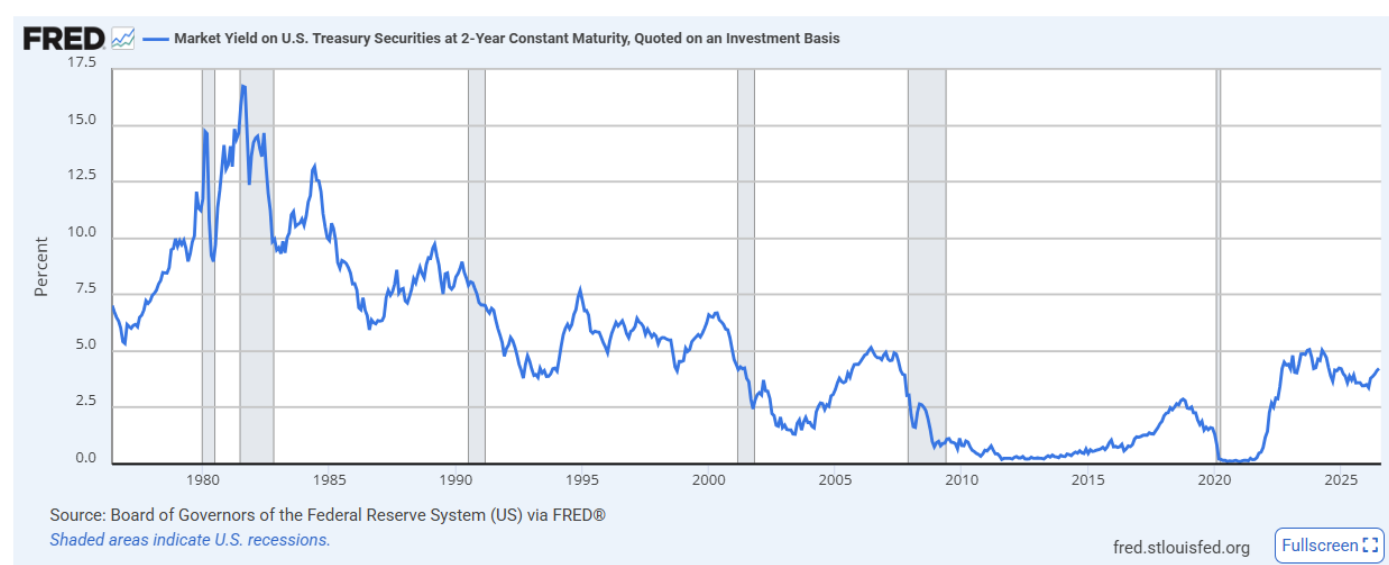
We're trying not to interfere with that market signal. That's part of the reason why we've been somewhat spare on our words, when we pulled back from forward guidance. So they're reacting to events, I would say, much more directly over the 42 days since we last met. This is a good thing.

As I mentioned in the prepared remarks, we've seen a material tightening, not just in nominal rates, but in real rates too, and we're observing it, we're trying to stay out of that because, you know, many of you might be interested in our reaction function, we're interested in the reaction of financial markets.”

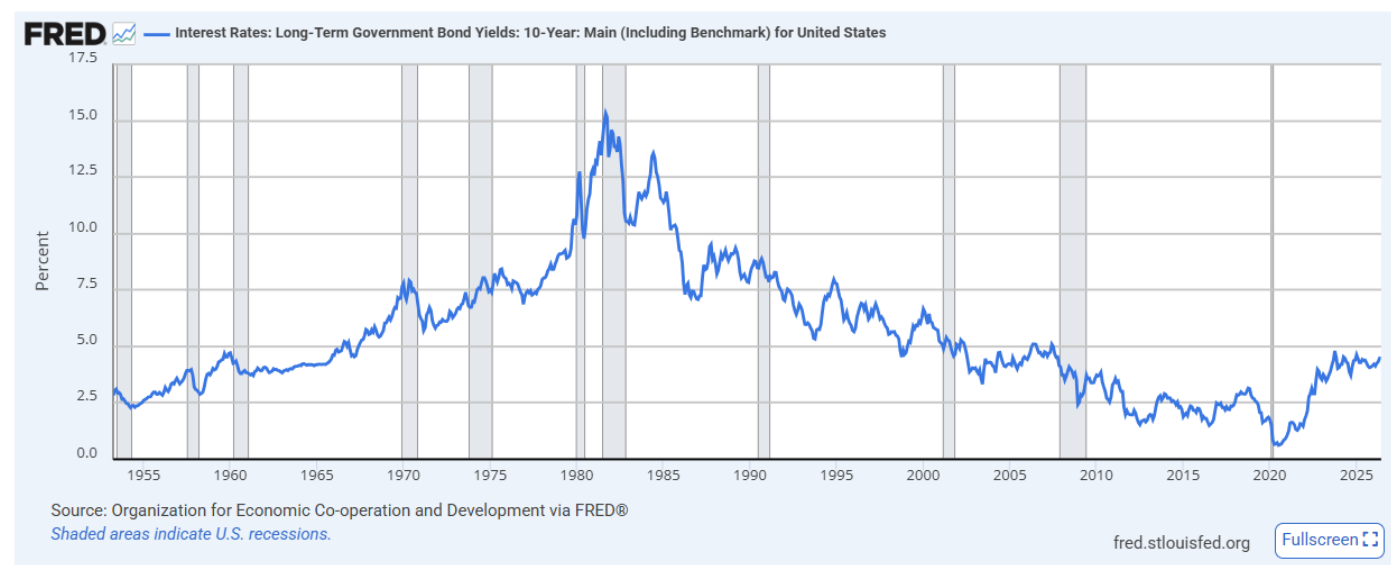
Figure 9, Figure 10 & Figure 11 plot the path of the two-, ten and thirty-year bond yields since 1953. As Warsh noted, while the Fed has kept the cash rate unchanged, the market is the ultimate adjudicator. At this juncture, it has determined both short term and long-term rates should be higher.

In short, the market is doing the heavy lifting, which Warsh openly supports “this is a good thing”.

Figure 9: U.S. 2-year bond yields 1990-2026



Source: Board of Governors of the Federal Reserve System (US) via FRED

Figure 10: U.S. 10-year bond yields 1953-2026

Source: Organisation for Economic Co-operation and Development via FRED

Figure 11: US 30-year bond yields 1984 - 2026

Source: U.S. Department of the Treasury via FRED

Signal and noise

The market's signal has yet to be answered by the FOMC, although the latest committee vote of 9-3 against a change in rates saw three dissents. From here, the pressure only mounts.

But there are some early indicators of what to expect.

Firstly, the five task forces will report back. The findings will undoubtedly have an impact on data, how it is accumulated and what should be ignored. The implications here could be significant.

Secondly, the currently accepted PCE inflation reading may be modified. One such alternative inflation gauge suggested by Warsh is the Dallas trimmed mean.

A trimmed mean is defined as "a statistical measure that calculates the average of a dataset after removing a specific percentage of the largest and smallest extreme values. It serves as a balanced compromise between the standard arithmetic mean and the median, preventing outliers from distorting the true center of the data".

Dallas trimmed mean

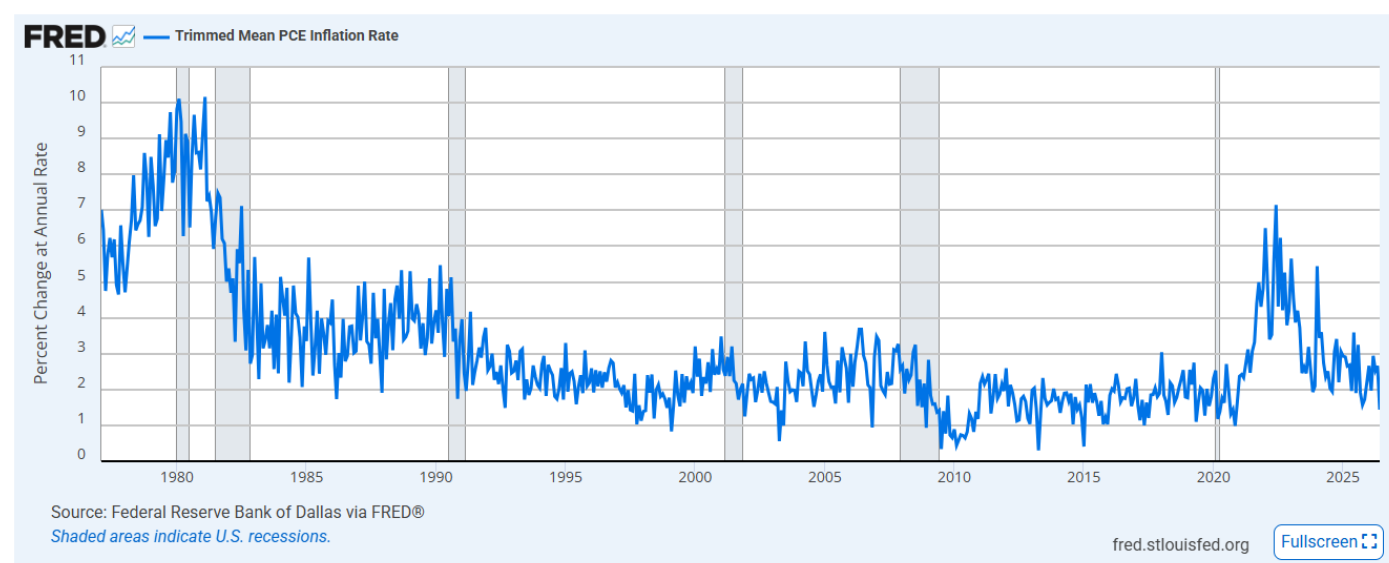
The Dallas trimmed mean is calculated by the Federal Reserve Bank of Dallas using data from the Bureau of Economic Analysis (BEA). By 'trimming', the Dallas Fed cuts the bottom 24% and top 31% of the weighted price-change distribution, trimming more the top increases than the bottom increases.

So rather than exclude food and energy, typical of traditional core inflation measures, the trimmed mean adapts every month to throw out whatever goods or services experienced the most volatile swings. By

filtering out temporary market 'noise', the ensuring 'signal' provides a clearer, more stable indicator of long-term inflation trends.

Warsh is clear that he is open to re-examining the data, *"But we have a data project that's trying to look and see whether we can't separate the noise from the signal. And so if you would hear a message from me, yes, I care about what the PCE prints are, I care about what the contributions are from CPI and everything else, but my – my lens is broader than that. Even though the remit is quite narrow."*

Figure 12: Dallas trimmed mean PCE inflation rate 1978-2026



Source: Federal Reserve Bank of Dallas via FRED

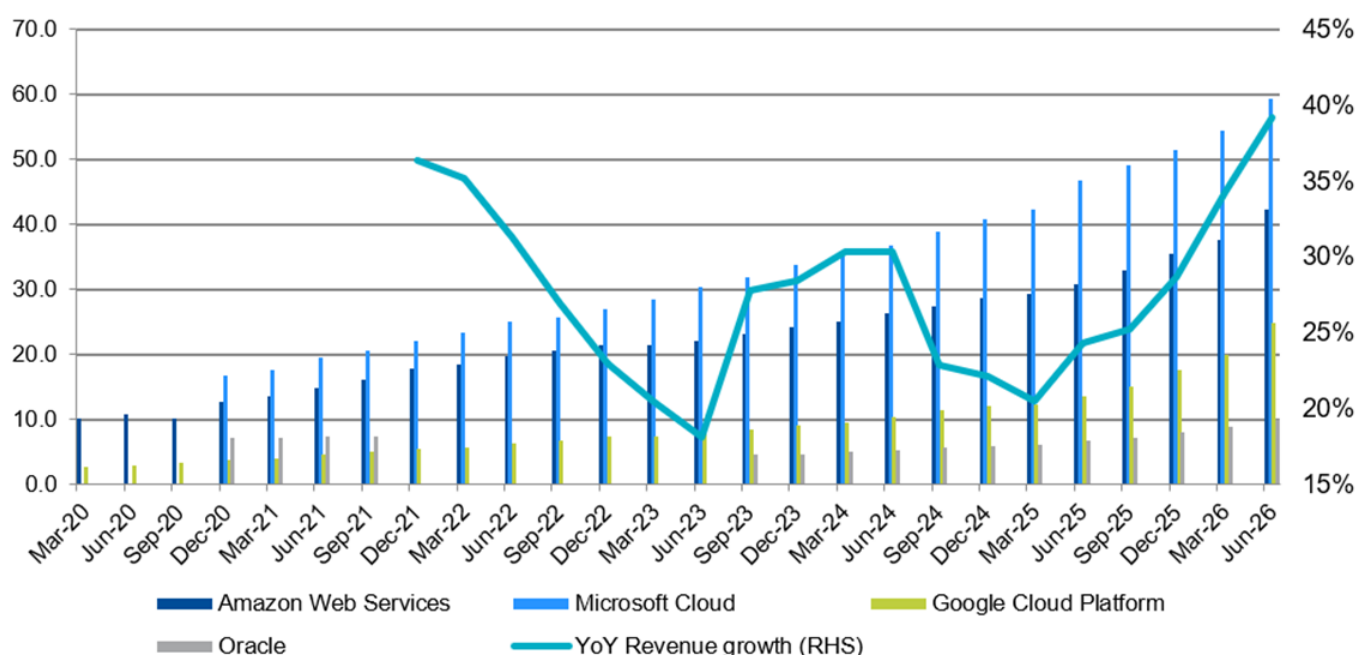
If the Dallas trimmed mean was adopted as the primary inflation measure, it would reveal a current U.S. inflation rate of 1.44%, as outlined in **Figure 12**, which would sit in stark contrast to the currently preferred PCE measure, indicating inflation running at an annum rate of 3.67% (see **Figure 8**).

The writing is on the wall

The appointment of Warsh as Fed Chair is a four-year term running out to 2030. In addition, his tenure as a board member runs for 14 years, ending in 2040. In joining the dots thus far, the Warsh era will be different. Apart from a review of data inputs and the likely change to preferred inflation measures, we suspect the Fed will maintain a much lower profile.

This could lead to fewer meetings, a cut from the current eight per year to perhaps the less traditional four.

The Fed is also examining the role of supply when shaping policy action. To date, it has been one sided as Warsh explained, *"In the A.I. related category of high-tech equipment and software, the most recent data shows four-quarter growth rates of nearly 20 percent. This is helping to sustain the healthy momentum of manufacturing output. More generally, capex is preparing the ground for future growth. Nonetheless, the precise timing and magnitude of effects on the supply side remain hard to predict."*

Figure 13: Cloud capex across the big four

Source: Morgans

Figure 13 profiles the capex spending of these four AI firms, with a clear surge up and to the right. This is but an inkling of what is happening within the AI ecosystem, however supply is coming and when it does, it will have an impact on pricing, demand and competition.

September

On 16 September, the U.S. Federal Open Market Committee (FOMC) voted 12-0, unanimously to lift the cash rate by 0.25% to 3.75% - 4.00%, the first lift since 2023.

A continuance of positive data, strong productivity gains, robust capital investment, and a unemployment rate where job gains have kept pace with it forced their hand. In all, it was concluded that the U.S. economy continues to expand at a solid pace, and with that an inflation rate that remains stubbornly above the stated goal of 2%.

As Warsh noted, "for more than five years, inflation has been running above target. So our predominant focus is on the price stability side of our mandate. The pain fact is that inflation is too high and has been for too long."

Warsh, as we have outlined, is a different Chair to his processors but even he has to tow the line when the committee members are all voting in one direction. While he carries the title of Chair, he still represents just one vote and as we found out in September, it was 11-0, prior to his vote, to lift rates.

The ensuing months will see whether further moves in rates are required but Warsh has expressed openly a view to be more pragmatic, less data dependent and less market intrusive. This latest action suggests he has more work to do, perhaps not helped by committee members who may not necessarily agree with his views or approach

What is next

Warsh has chosen a considered path, one dictated by a thorough re-examination of the data source and trends. As he has stated so clearly, and not to everyone's liking, "After all, the central bank need not always and everywhere be the center of attention."

Active fighting the crowd

The crowd is wrong when the logic is wrong.

And the logic is wrong when the basis on which it is based is flawed.

Our superannuation industry is awash in capital. It currently holds \$4.8 trillion of assets, spread across our leading industry super funds (38% share), self managed funds (23%), retail funds (20%) and other public corporate funds (19%).

Australian Prudential Regulation Authority (APRA) funds account for roughly \$3.2 trillion of the total. Australia now holds the fifth largest pool of investable retirement savings globally. Each year, the Government's Superannuation Guaranteed (SG) rate of 12% is applied against an individual salary and directed into an APRA regulated fund, or a self managed fund of your choice, overseen by the Australian Taxation Office (ATO).

The total domestic market capitalisation of the Australian Securities Exchange (ASX), tallying up the combined market values of the companies listed on the exchange, stands at approximately \$3.4 trillion, making it one of the top 20 largest listed exchanges globally.

Set against the \$3.4 trillion market, our \$4.8 trillion superannuation industry highlights a clear reality: Australia's super funds may be too big for the market it serves. By 2030, the super fund industry is expected to grow to \$6 trillion, while the number of industry super funds is anticipated to consolidate from roughly 75 to 45.

Performance test

Having mandated the SG levy, the government introduced the annual superannuation 'Performance Test' on July 1, 2021. The test, launched under the government's "Your Future, Your Super" reforms, was aimed at generating uniformity around performance and exposing fund underperformance. Funds that fail the benchmark test in consecutive years face strict consequences, the most severe resulting in the closure of the fund to new members.

This year, the BUSSQ (Building Union Superannuation Scheme Queensland) balanced growth MySuper investment option, with \$6.4b in retirement savings, failed the set benchmark by a slim margin of 0.022%. The fund must now write to its members to explain its

underperformance, while a second failure would see it legally prohibited from accepting any new beneficiaries.

Big Stick

The response from the BUSSQ trustees of the fund has been understandable, *"action has been taken to address this underperformance by taking targeted investment portfolio adjustments to improve returns."*

This approach, now pervasive in the super fund industry, marks a seismic shift from actively seeking businesses on their individual merits to passively selecting companies according to business market size and index relevance. It explains why every industry fund holds BHP and CBA in their top holdings, as it simply cannot afford to be caught on the wrong side.

Whether BHP and CBA underperforms matters little, as all the funds would have been on the same trade and index position. The goal of the fund trustees is to avoid the embarrassing situation BUSSQ now finds itself in, of having to explain why the fund is underperforming to all its current members.

The government has inflicted an outcome with all the unintended consequences. Yet it was obvious from the start that no fund or trustee would want to take on the risk of falling short.

Logic out the window

We have written enough on this matter, again in this and earlier newsletters, such is the impact it is having on share market valuations. However, as much as we would like to move on, the actions of our super fund industry leaders continue to lack logic or leadership.

At a recent event hosted in September by the Australian Financial Review (AFR) and attended by the big super funds and active fund managers, it was noted that *"the wave of money going into index and quant funds is flooding into top 10 stocks, driving up their valuations and hurting active fund managers"*, who are selecting businesses on merit.

When participants were asked the question, posed by the AFR, *"How have superannuation funds changed the way they're investing in Australian equities, and has it left the ASX worse off?"*

AMP Super chief investment officer, Anna Shelley, answered, *"There's no doubt that the Your Future Your Super test has made super funds favour more consistent, reliable returns, and so there's definitely been a pivot to higher weightings to passive, just to help that risk control, and higher weightings to quantitative and systematic strategies that are very risk controlled."*

Peter Barany, Australian Retirement Trust senior portfolio manager, added, *"It has just not been a stock picker's market. It's been a macro-driven industry market, which has hurt fund managers. Unfortunately, you've had this money extracted from the active managers because, frankly, I think it's performance chasing. I'm hoping there's still enough active managers after this cycle. I think there will be, but it'd be a shame to lose a lot of that talent to elsewhere because I think Australia needs a healthy, active fund manager industry."*

The missing piece in both these comments is the foundational basis on which decisions should be made in the first place.

Shelley calls out that the test has enabled *"more consistent, reliable returns"*, and *"higher weightings to passive, just to help that risk control"*, which frankly makes no sense and would probably have many fund management veterans shaking their heads in disbelief.

The logic this all hangs on is to passively follow the crowd, regardless of whether the investments are good or not, the value on offer and if it can be regarded as being in the best interest of fund members.

So long as the performance test is passed, then the aim has been met. For the trustees nothing else matters. Fund members are none the wiser and the industry carries on.

As fund manager Raaz Bunyan noted, *"The beauty about quant investing is they're happy to buy Woolworths at \$40 today when they wouldn't buy it at \$26, so in a way it is additive to what we do. When you've got a stock wrong, and you want to move it, that's when it's painful."*

Peter Barany adding, *"I think the price is set by intelligent, active money changing hands, not by money going into passive ... [However,] I think you need to get used to the fact that price is going to spend a longer time away from fundamental value. At the end of the*

day, it will revert to long-term intrinsic value, it may just take longer to get there."

Bunyan notes the distortions in our market, while Barany suggests the price outcomes are still driven by active manager actions rather than passive, momentum investing.

We sit on the side of Bunyan, which even Barany acknowledges, with stock prices likely to *"spend a longer time from fundamental value."*

The ice analogy

What is the ice analogy and its relevance here?

Formalised by three prominent economists, Sushil Bikhchandani, David Hirshleifer, and Ivo Welch, the ice analogy was used to illustrate the danger of information cascades, where people blindly copy the actions of others rather than evaluate a situation themselves. At its core was a simple question, *"Why does mass behaviour change so quickly and fragilely?"* Here's the analogy explained, *"Imagine people stepping onto a frozen lake: the first person walks out and happens to be safe, leading others to assume the ice is secure simply because someone else went before them."*

As more people join the crowd, a false consensus of safety is created, masking the growing physical danger until the ice suddenly collapses under the collective weight."

Ultimately, this thought experiment shows how crowds can manufacture a massive illusion of security while driving a system toward a hidden breaking point."

The three economists introduced this concept in their landmark 1992 academic paper titled, "A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades," published in the Journal of Political Economy.

As others have since noted, *"Before their paper, many thought that a crowd 'piling on' made a trend stronger and more robust. Bikhchandani, Hirshleifer, and Welch proved the exact opposite mathematically. They showed that when people ignore their own senses and just copy the person in front of them, the entire crowd's conviction is actually built on nothing but a single, early person's guess. Because the foundation is so thin, it takes only a tiny piece of contradictory data (a cracking sound) to cause the entire collective behaviour to instantly shatter or 'topple'."*

Active, alive, and well

The death of 'active' funds management is greatly exaggerated. There is pressure, no doubt, but the day of reckoning will arrive, because the fundamental logic that underpins the passive moves of today are lacking.

Charlie Munger got it right when he said, *"Mimicking the herd invites regression to the mean (merely average performance)."* The unintended consequences of such

actions are likely to put super funds directly at odds with APRA's requirements that they avoid doing what is *"not in the best interests of members."*

The year 2026 should be marked in investors' diaries as a point in time when the pressure to conform to an industry, so consumed with meeting manufactured investment outcomes, leaves it standing right in the middle of an unsustainable ice shelf.

Company Engagements

Date	Company	Description
01-Jul	ALL	Aristocrat Leisure Investor Briefing
01-Jul	OCL	Objective Corporation Barrenjoey Management Meeting
03-Jul	SLD	Saluda Medical Bell Potter Management Meeting
07-Jul	EIQ	EchoIQ Investor Briefing
09-Jul	RMD	Resmed UBS Industry Insights Call
09-Jul	WTC	WiseTech Global Management Meeting
10-Jul	RWC	Reliance Worldwide Barrenjoey Industry Insight Call
14-Jul	WTC	WiseTech Global UBS Industry Insights Call
16-Jul	FPH	Fisher & Paykel Healthcare Management Meeting
17-Jul	EIQ	EchoIQ Citi Managament Meeting
23-Jul	ALL	Aristocrat Leisure UBS Industry Insights Call
23-Jul	OFX	OFX Group Management Meeting
24-Jul	OFX	OFX Group Management Meeting
29-Jul	ALL	Aristocrat Leisure Barrenjoey Industry Insight Call
30-Jul	EIQ	EchoIQ Investor Briefing
05-Aug	OFX	OFX Group Annual General Meeting
06-Aug	REA	REA Group FY26 Results Call
07-Aug	RMD	Resmed FY26 Results Call
07-Aug	JHX	James Hardie Industries 1Q27 Results Call
10-Aug	CAR	CAR Group FY26 Results Call
10-Aug	CAR	CAR Group Barrenjoey Management Meeting
11-Aug	JHX	James Hardie Industries Macquarie Management Meeting
11-Aug	ALL	Aristocrat Leisure G2E Sydney
11-Aug	CAR	CAR Group E&P Management Meeting
12-Aug	CPU	Computershare FY26 Results Call
12-Aug	REA	REA Group Management Meeting
12-Aug	SEK	SEEK FY26 Results Call
12-Aug	CPU	Computershare Management Meeting
12-Aug	SEK	SEEK Barrenjoey Management Meeting
12-Aug	CPU	Computershare Barrenjoey Management Meeting
13-Aug	RMD	Resmed Management Meeting

Date	Company	Description
13-Aug	SEK	SEEK Management Meeting
13-Aug	SEK	SEEK Morgan Stanley Management Meeting
13-Aug	FCL	FINEOS Corporation Holdings FY26 Results Call
13-Aug	FCL	FINEOS Corporation Holdings Management Meeting
14-Aug	COST.NAS	Costco Barrenjoey Management Meeting
14-Aug	CAR	CAR Group Management Meeting
17-Aug	FCL	FINEOS Corporation Holdings Management Meeting
18-Aug	FCL	FINEOS Corporation Holdings Macquarie Management Meeting
18-Aug	RWC	Reliance Worldwide FY26 Results Call
18-Aug	CSL	CSL FY26 Results Call
18-Aug	PME	Pro Medicus FY26 Results Call
18-Aug	COH	Cochlear FY26 Results Call
19-Aug	BRG	Breville FY26 Results Call
19-Aug	BRG	Breville Macquarie Management Meeting
19-Aug	BRG	Breville Barrenjoey Management Meeting
19-Aug	COH	Cochlear Management Meeting
20-Aug	TLX	Telix Pharmaceuticals FY26 Results Call
20-Aug	BRG	Breville Morgans Management Meeting
20-Aug	PME	Pro Medicus Management Meeting
20-Aug	MVP	Medical Developments International FY26 Results Call
20-Aug	CSL	CSL UBS Management Meeting
21-Aug	JHX	James Hardie Industries Annual General Meeting
21-Aug	CSL	CSL Management Meeting
21-Aug	BRG	Breville Management Meeting
24-Aug	REH	Reece FY26 Results Call
24-Aug	MVP	Medical Developments International Management Meeting
24-Aug	BRG	Breville GS Management Meeting
25-Aug	ARB	ARB Corporation FY26 Results Call
25-Aug	NAN	Nanosonics FY26 Results Call
25-Aug	NAN	Nanosonics Barrenjoey Management Meeting
25-Aug	NAN	Nanosonics Cannacord Management Meeting
25-Aug	ARB	ARB Corporation Macquarie Management Meeting
25-Aug	REH	Reece Management Meeting

Date	Company	Description
25-Aug	ARB	ARB Corporation UBS Management Meeting
26-Aug	NAN	Nanosonics Management Meeting
26-Aug	FLT	Flight Centre Travel Group FY26 Results Call
26-Aug	PNV	PolyNovo FY26 Results Call
26-Aug	WTC	WiseTech Global FY26 Results Call
26-Aug	ARB	ARB Corporation Morgans Management Meeting
26-Aug	FLT	Flight Centre Travel Group UBS Management Meeting
26-Aug	NAN	Nanosonics GS Management Meeting
26-Aug	ARB	ARB Corporation Management Meeting
26-Aug	PNV	PolyNovo UBS Management Meeting
26-Aug	FLT	Flight Centre Travel Group Macquarie Management Meeting
27-Aug	WTC	WiseTech Global Barrenjoey Management Meeting
27-Aug	PNV	PolyNovo Management Meeting
27-Aug	FLT	Flight Centre Travel Group Management Meeting
28-Aug	WTC	WiseTech Global JPM Management Meeting
28-Aug	WTC	WiseTech Global Management Meeting
01-Sep	TLX	Telix Pharmaceuticals Management Meeting
01-Sep	TLX	Telix Pharmaceuticals JPM Management Meeting
04-Sep	TLX	Telix Pharmaceuticals Barrenjoey Industry Insight Call
08-Sep	PME	Pro Medicus Barrenjoey Management Meeting
08-Sep	4DX	4DMedical Barrenjoey Management Meeting
08-Sep	PME	Pro Medicus GS Management Meeting
08-Sep	4DX	4DMedical Management Meeting
09-Sep	NAN	Nanosonics Management Meeting
15-Sep	JHX	James Hardie Industries Investor Day
15-Sep	TLX	Telix Pharmaceuticals UBS Industry Insights Call
22-Sep	TLX	Telix Pharmaceuticals Investor Day
24-Sep	PME	Pro Medicus Barrenjoey Industry Insight Call
25-Sep	TLX	Telix Pharmaceuticals JPM Industry Insights Call

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