



Returning to a post COVID normal

Company/ASX Code	Data#3 Limited / DTL
AGM date	Thursday 27 th October 2022
Time and location	2:00 pm AEST Data#3 Head Office, 555 Coronation Drive, Toowong, QLD
Registry	Link Market Services / Computershare
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Paul Donohue
Pre AGM Meeting?	Yes, with Brem Hill, Chief Financial Officer

Monitor Shareholding: The person who prepared this voting intention has no shareholding in this company.

Summary of issues for meeting

- Some concerns about the CEO remuneration but not enough to stop us voting in favour.
- Changes to the constitution to allow wholly virtual meetings is against ASA policy.
- A board skills matrix was prepared but not published.
- Good progress on gender equity but no targets for the all-male senior leadership team.

Proposed Voting Summary

No.	Resolution description	Outcome
2	Resolution 1: Adoption of the remuneration report	For
3	Resolution 2: Election of Director - Ms Susan Forrester	For
4	Resolution 3: Re-election of Director - Mr Mark Esler	For
5	Resolution 4: Increase in Non-Executive Director fee pool	For
6	Resolution 5: Approval to issue Rights to a related party: Mr Laurence Baynham	For
7	Resolution 6: Amendments to the Company's constitution	Against

Summary of ASA Position

Consideration of accounts and reports - No vote required

Company Overview

Data#3 is a Queensland based technology company which has been operating for over forty years and has been listed since 1997. Their customers are large corporate and public sector organisations, mostly in health, education and resources. Two thirds of their revenue is recurring based on three to five-year contracts.

They resell software from organisations such as Microsoft and Adobe and hardware from the likes of Cisco and Dell. They also have a services division providing skilled people for consulting, IT support, infrastructure project management, managed services, recruitment and contracting. The revenue split between these three functional areas is:

- Software \$1433m / 65%
- Infrastructure \$440m / 20%
- Services \$318m / 15%

Data#3 is not directly comparable to other ASX listed technology companies such as WiseTech (logistics software), Altium (electronics design software) or Technology One (enterprise software). Those are all high margin businesses that develop their own software. As a reseller of other company's products, Data#3 is a low margin business, but it still makes a tidy profit thanks to its revenue of \$2.2b.

Having said that, there are pockets of high margin, such as consulting and managed services. These are growing quickly, and the company's strategy is to accelerate that growth.

Fun fact... the "#3" part of their name comes from the original IBM PC which was the first to put the "3" and "#" symbols on the same key. Apparently, this was so revolutionary back in 1984 that the newly merged company incorporated it into its name.

Reporting Period Overview

Things seem to be getting back to normal for Data#3 after the disruption of the pandemic. Their customers put some big technology transformation projects on hold and switched instead to remote working / online collaboration initiatives. As we exit the pandemic, the transformation projects are starting back up leading to a good pipeline of work. One example is the Queen's Wharf development in Brisbane for which Data#3 is providing network technology.

A lingering problem are computer chip shortages and supply chain issues which impacted their hardware suppliers. This caused long delivery times and resulted in a backlog of orders that could not be invoiced by the end of FY22. The company estimates \$6m of profit was deferred until the FY23 period. The issues are improving but Cisco, in particular, still has significant delivery delays.

The company has strong relationships with strategic partners and are the number one Australian reseller for Microsoft, Cisco and Hewlett Packard and top five for Dell. During the year they received eighteen accolades from vendors with the most notable being:

- Cisco Global Software Partner of the Year.
- Microsoft Worldwide Device Distributor/Reseller Partner of the Year.
- Microsoft Worldwide Surface+ Partner of the Year.

Governance and culture

Data#3 publishes a Corporate Governance Statement on their website which addresses each of the principles from the ASX Corporate Governance Principles and Recommendations.

They produce a board skills matrix but don't publish it despite the ASX recommending its disclosure.

The Board has established the usual oversight committees which all have an almost 100% attendance rate. The entire board attended every monthly board meeting. The company published a tax transparency report under the voluntary Tax Transparency Code.

Data#3 seems to have a good workplace culture with the latest employee satisfaction survey scoring 4.44 out of 5 and the average employee staying with them for almost six years.

They won the "5-Star Employer of Choice Award for 2022" by Human Resources Director Magazine and were certified as a "Family Inclusive Workplace" by UNICEF Australia and Parents at Work.

They have committed to developing a Reconciliation Action Plan to progress reconciliation across their organisation and the communities in which they operate.

Financial performance

Data#3 posted impressive results with revenue up 12% to \$2.2 billion and profit after tax up 19% to just over \$30 million. Earnings per share and the fully franked dividend both increased by about 19%. The company has a strong balance sheet with no borrowings.

Despite these good numbers, the company was not immune to the sell off in technology stocks and the share price was, at the time of the results, down 16.9% resulting in a total shareholder return for the financial year of -13.7%.

Key events

During the year, Data#3 implemented a new enterprise resource planning (ERP) system based on Microsoft Dynamics 365. This will improve pricing, sales order management and customer interaction. The \$6m of capitalised development costs will be amortised over a five-year period.

Key Board or senior management changes

Susan Forrester is seeking election to the board.

Brem Hill intends to retire as CFO at the end of calendar year 2023, having been with the company since 1991 and serving as CFO since 1999.

Two new executive roles were created during the financial year. Both positions were filled by internal candidates who had been with the company for some time.

Chief Technology Officer, Graham Robinson. The CTO position is an investment by Data#3 to continue to build and strengthen its relationships with world-leading technology partners and ensure that Data#3 is ahead of the technology curve to help customers to deliver their digital future.

Chief Customer Officer, John Tan. The newly formed role is responsible for creating and managing the strategy, operational direction and subsequent activities for Data#3's business units of infrastructure solutions, software solutions and services sales.

ASA focus issues (not discussed elsewhere in this report)

Sustainability

Some highlights from the 2022 Sustainability Report.

- Pangolin Associates conducted a comprehensive assessment of greenhouse gas emissions attributable to Data#3's business operations.
- This examined both direct environmental impact, and indirect contributions along the supply chain.
- They now have a baseline against which to measure improvements and have committed to producing the report annually.
- The company has a target of net zero emissions before the Brisbane 2032 Olympic Games.

Diversity

The diversity policy covers gender, age, ethnicity, and cultural background but the only published statistics relate to gender. Gender equity targets exist for all employees, management team and the board but not for the Senior Leadership Team (SLT) which is comprised of three males. Goals for FY22 and recent progress is summarised below.

Segment	Gender 2021	Gender 2022	Gender Goal	Outcome
All employees	35% F / 65% M	33% F / 67% M	Maintain or increase female %	Slight drop.
Management team	30% F / 70% M	30% F / 70% M	Maintain or increase female %	Maintained.
Senior leadership	0% F / 100% M	0% F / 100% M	None	No change.
Board	20% F / 80% M	33% F / 67% M	Increase female to 30%.	Ms Susan Forrester is standing for election.

It should be noted that the IT industry is historically skewed to a male workforce and the ~30% female participation rates are well above the industry average.

The question of SLT diversity, or lack of it, was raised at the pre-AGM meeting. Data#3 acknowledged the imbalance but pointed out that the team is small and changes to its membership are not common. Setting a goal that had no realistic chance of achievement was thought to be counter productive. The impending retirement of SLT member Brem Hill may provide an opportunity for the SLT to consider a female candidate.

Summary

(As at FYE)	2022	2021	2020	2019	2018
NPAT (\$m) Attributable to members	30.26	25.41	23.63	18.11	14.07
Share price (\$)	4.66	5.61	4.54	2.12	1.60
Dividend (cents)	17.9	15.0	13.9	10.7	8.2
Simple TSR (%)	-13.7%	26.9%	120.7%	39.2%	-2.8%
EPS (cents) Basic	19.61	16.51	15.35	11.76	9.14
CEO total remuneration, actual (\$m)	1.105	1.034	1.135	1.074	0.880

Adoption of Remuneration Report

There were a few items relating to CEO remuneration that were contrary to ASA guidelines.

- Only 42% of the CEO's remuneration is at risk. ASA prefers at least 50%.
- STI is paid as 100% cash. ASA prefers at least 50% to be paid in equity with a minimum 12 month holding lock.
- STI is assessed and awarded quarterly which is very short term. ASA prefers some of the incentive was deferred.
- LTI is based on earnings per share measured over three years. ASA prefers four to five years.

These concerns were raised in the pre-AGM meeting and sensible explanations were provided. We also note that Data#3 is a member of the S&P/ASX300 index whereas the ASA voting guidelines are designed for ASX200 members.

It seems likely the remuneration structure will improve in FY23. Refer to appendix 1 for more information.

ASA will vote in favour of the remuneration report.

Election and re-election of directors

Ms Susan Forrester joined the board on 30 March 2022 and now seeks formal shareholder approval. She is very well qualified and her focus on governance and equal opportunity would be a valuable contribution to any board. The only concern is her workload. She is chair at Jumbo Interactive and Health Engine as well as a non executive director at Plenti. This is at the upper boundary of the ASA workload guidelines.

Pre-AGM discussions with Data#3 have clarified the situation. Health Engine is unlisted (they pulled a planned IPO in 2021) and does not require much attention from Ms Forrester. She also stepped down from some other positions to free up time for Data#3. The board has no concerns about her workload.

Mr Mark Esler joined the board in 2019 and seeks re-election. Mr Esler's long IT career is invaluable to the Data #3 board, especially as he is the only board member, apart from the CEO, who has worked in the IT industry. He spent almost 30 years at Data#3 in a variety of roles before retiring as Queensland General Manager in 2014, so can he really be considered independent? Additionally, Mark holds an indirect interest in 2.8m shares representing an 1.8% shareholding.

This was also addressed in a pre-AGM discussion. It was agreed that Mark has many close friends within Data#3, but this did not stop him being independent. They do not want a board that is completely cut off from the business. In fact, they often invite managers to attend board meetings so the directors can get first hand information on strategy & operations. In addition, Data#3

waited five years before asking Mark to join the board as recommended by the ASX. Given that there are three other independent directors, we consider the board to be sufficiently independent

ASA will vote in support of both directors.

Increase in Non-Executive Director fee pool

Shareholders are being asked to approve an increase in the pool from which non executive director fees are paid from \$600K to \$900K. The current pool was set by shareholders in 2018. It is important to note that this pool increase does not mean the directors will get an immediate pay rise, although that is a likely future outcome.

The notice of meeting provides some rationale for the increase and more clarity was given at the pre-AGM meeting.

- The company is more complex than it was in 2018 and requires greater oversight. The strategy to accelerate the services division and large, complex contracts were cited as examples of complexity.
- The board may seek to add additional non executive directors in the future.
- Future board renewal may require outgoing directors and their replacements to sit on the board at the same time to ensure a smooth transition.
- An independent remuneration consultant advised the board that their director fees are too low making it hard to attract suitable talent.
- They want to maintain enough headspace in the pool so they don't have to ask shareholders for another increase in a few years.

ASA has access to market remuneration research from Godfrey Remuneration Group which shows the proposed pool is in line with other companies of a similar market capitalisation and the current chair and director fees are on the low end of the market norms. ASA intends voting for the pool increase.

Approval to issue rights to the CEO

This resolution relates to \$314K worth of long term incentive rights being granted to the CEO, Laurence Baynham. The hurdles are mentioned above. These rights are for FY23 and are similar to those granted in previous years.

Shareholder approval must be obtained to grant rights to a director. The notice of meeting makes it clear that if shareholders vote against this resolution, the company will find another way to remunerate the CEO, as the terms are part of his contract. We will be voting in favour of the grant of rights issue.

Amendments to the Company's constitution

Most of the proposed changes are minor administrative changes to align with new ASX guidelines or modern best practise. The only one change of any concern relates to the way in which general meetings can be held.

Currently, Data#3 holds hybrid meetings in which shareholders can attend in person or online. This is the company's preferred format and they have noticed greater participation from regional and interstate shareholders and analysts since they adopted this style of meeting. Hybrid is also ASA's preferred format.

However, in exceptional circumstances, the company wants the ability to hold a wholly virtual meeting with no face to face component. ASIC allowed this as a temporary measure during the pandemic and it is now a permanent option for companies whose constitution allows it. It is worth noting that ASIC has the power to temporarily allow a virtual-only meeting, even if the entity's constitution is silent on that topic. This ASIC power is only exercised in situations that are beyond the entity's control.

At the pre-AGM meeting, Data #3 made it clear that a virtual-only meeting would only be used in exceptional circumstances, if one was used there would be multiple ways to participate, and shareholder interaction would be ensured. Those assurances are welcome but a change to the constitution has long term ramifications, and we can't rule out future virtual meetings being detrimental to shareholders.

ASA guidelines are to vote against a change to a company's constitution that enables the holding of virtual-only shareholder meetings. We will be voting against the constitution change.

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Appendix 1 Remuneration framework detail

CEO rem. Framework for FY22	Target* \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	0.546	47%	0.546	36%
STI - Cash	0.262	23%	0.360	24%
STI - Equity	0	0%	0	0%
LTI	0.273	24%	0.546	36%
Total	1.15	100%	1.52	100%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan.

*Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting.

From the annual report “Since 2017 the group’s net profit has grown at an average compounded rate of 14.5% per year, the average executive remuneration has increased by an average compounded rate of 3.6% per year and total shareholder return increased by an average compounded rate of 35.6%”.

The CEO took home \$1.153 million which was slightly ahead of the target but well below the maximum. His short term incentive (STI) was 90% of target while long term incentive (LTI) was 138%. These two things balanced each other out.

Only 42% of the CEO’s remuneration is at risk compared to the ASA preference for at least 50%. At the pre-AGM meeting, Data#3 acknowledged that the at risk portion was low and that in FY23 this will rise to 47%. This will be achieved by weighting more towards long term incentives. This is a step in the right direction.

The STI has two types of hurdles. 70% financial and 30% non financial. The financial target is profit related but the exact details are not disclosed. The non financial targets are not disclosed.

The STI is paid pro rata so if the CEO hits 75% of the performance target he will receive 65% of the target STI.

STI is paid as 100% cash. ASA prefers at least 50% to be paid in equity with a minimum 12 month holding lock. Apparently in the past the STI was awarded as cash that had to be used to buy shares on market. This was cumbersome so they went back to 100% cash.

The STI is assessed and awarded quarterly which is very short term. ASA would prefer some of the incentive was deferred.

The LTI is based solely on earnings per share measured over three years. ASA prefers four to five years. The target for the LTI is not disclosed as this is considered sensitive information.

The number of LTI rights granted is calculated using a five day VWAP with no discount for anticipated future dividends. This is ASA's preferred method.

The LTI rights vest after two years vs ASA's preferred term of four or five years.