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Another strong year for Technology One

Company/ASX Code	**Technology One / TNE**
AGM time and date	**10:30am (AEST) Brisbane time Wednesday, 21 February 2024**
Location	Brisbane Convention and Exhibition Centre, Merivale St, South Brisbane
Registry	Link Market Services
Type of meeting	Hybrid
Monitor	Paul Donohue, David Loosemore and Richard Hemphill
Pre-AGM Meeting	Yes, with Pat O'Sullivan (Chair), Jane Andrews (NED), Cale Bennett (CFO) & Stephen Kennedy (Company Secretary).

Monitor Shareholding: The individual(s) (or their associates) involved in the preparation of this voting intention have a shareholding in this company.

1. How we intend to vote

Item	Resolution description	Intention
1	Remuneration Report	For
2	Re-election of Peter Ball (NED)	For
3	Re-election of Sharon Doyle (NED)	For
4	Grant of FY24 LTI options to the Managing Director	For

2. Summary of Issues and Voting Intentions for AGM

We have no concerns about any of the resolutions but will be asking questions at the AGM on the following topics.

- **Cyber incident.** What did the thorough investigation into last year's cyber incident reveal?
- **UK acquisition.** Seeking more information on the acquisition that was prudently abandoned after extensive due diligence.
- **Board skills matrix.** Why doesn't Technology One disclose individual director skills and the level of expertise?
- **Future growth.** What will be the drivers of future growth?

See ASA Voting guidelines and Investment Glossary for definitions.

3. Matters Considered

Overview

Technology One is a Brisbane based, enterprise software company focussed on a handful of sectors such as local government and higher education. They develop, market, sell, implement and support their own software. This “one stop shop” approach is rare among enterprise software vendors who often rely on third parties.

The company has successfully transitioned to a “software as a service” (SaaS) model in which customers access the solution over the Internet rather than having it installed on their own equipment. SaaS customers pay an annual subscription rather than purchasing a perpetual license. This provides reliable, annually recurring revenue (ARR). The company has committed to moving all remaining on-premise customers to SaaS by October 2024.

Future growth is expected to come from winning new customers, existing customers adopting more modules, product enhancement, improved profit margins and growth in the United Kingdom. In November, they looked at a strategic acquisition in the UK higher education sector but ultimately did not proceed.

Results

The company announced a strong set of financials for the year ended 30 September 2023. Revenue is up 19% to $441.4m. Annual Recurring Revenue (ARR) is up 23% to $392.9m and is on track to surpass their forecast of $500m by FY25, a year earlier than previously planned. Profit is up 16% to $129.9m (before tax) and $102.9m (after) which beat guidance.

Expenses are also up 21% to $311.5m which includes some one-off items and a bring forward of R&D costs. This year they spent 26% of their revenue on R&D up from 21% last year. This increased expenditure resulted in flat margin of 30%. Margin growth is expected to return in FY24 thanks to the economies of scale from the SaaS model. Put simply, as they land and expand customers, the platform lets them grow revenue with little additional ongoing expense.

The company’s balance sheet is very strong with net assets of $306m and no debt.

The Board announced a special dividend of 3 cps bringing the total dividend to 19.52 cps which is up 15% on last year. Three year rolling total shareholder return (TSR) is 97% with this year's TSR at 48%.

Tech One’s customer metrics are very impressive. Their churn rate, a measure of how many customers leave during the financial year, is very low at 1%. This year they started reporting a new metric, Net Revenue Retention (NRR), which measures their ability to retain & grow revenue from existing customers. This has been increasing since a dip in FY20 and now stands at 119%.

Financial performance

(As at FYE)	2023	2022	2021	2020	2019
NPAT ($m)	102.9	88.8	72.7	62.9	58.5
UPAT ($m)	102.9	88.8	72.7	62.9	58.5
Share price ($)	15.51	10.60	11.36	7.94	7.18
Dividend (cents)	19.52	17.02	13.91	12.88	11.93
TSR (%)	48	-5%	45	12	31
EPS (cents)	31.71	27.51	22.64	19.75	18.43
CEO total remuneration, Statutory ($m)	2.52	2.30	1.95	1.77	1.61

Key events

Key events during the reporting period included.

- 20 Mar 2023. Entered the S&P/ASX 100 index.
- 31 Oct 2023. Launched a new way of implementing their product which they branded "SaaS+". This is effectively a fixed price contract which greatly de-risks the project for their clients. To date, 34 customers have used this method and it's now the only option offered in the UK.
- 10 May 2023. A trading halt is requested after unauthorised access to a back-office system. The halt is lifted two days later after the company confirms the SaaS platform was not impacted and no customer data was compromised.
- 21 Nov 2023. Announced a $2m expense related to due diligence on a potential UK acquisition that did not proceed. This occurred outside the reporting period which ended on September 30, 2023.

Key board or senior management changes

- 26 Feb 2023. Ron McLean retired from the board after last year's AGM. He had been involved with the company for 31 years, firstly as an executive and later as a non-executive director.
- 26 May 2023. Chandan Potukuchi was appointed as Chief Technology Officer. Previously he worked at another enterprise software company, SAP, where he led a global software engineering team.
- 17 Jul 2023. Paul Jobbins resigned as Chief Financial Officer and was replaced by Cale Bennett who previously worked at Corporate Travel Management.
- 15 Aug 2023. Ed Chung (CEO) was appointed to the board as Managing Director.

Governance

With the exception of John Mactaggart, Richard Anstey (by virtue of his 19 year tenure on the board) and Edward Chung, the board consists of independent directors with Patrick O'Sullivan acting as an independent & non-executive chair. The annual report provides a biography of each director which suggests the board has a diverse mix of experience, expertise and tenure with the company.

Technology One publishes a skills matrix which lists the board's collective experience in areas such as strategic and commercial acumen, finance and taxation, risk and compliance, etc. This meets the minimum disclosure required from a listed company but there is room for improvement. The skills matrix does not indicate each director's proficiency in a skill or even the board's collective expertise. It effectively says, "one or more directors hold these skills at an unspecified level of competency". That is hardly useful information for shareholders.

Culture

Technology One monitors several employee centric metrics which point to a satisfied and well-engaged workforce. Employee net promotor score increased to +34, up slightly on last year. Team engagement rose from 90% to 96%. Voluntary turnover dropped sharply from 21% to 11% and during the year they promoted 130 team members.

They have completed a two year refresh of the "TechOne Way" which describes the purpose, values and practices which underpin their corporate culture.

They were awarded Employer of Choice for 2023 in the Australian Business Awards, for the eighth year in a row. A new employee share plan which gives one free share for every two shares purchased has been warmly received with 44% of employees now participating.

The company donates 1% of time, product and profit to charitable causes and has an admirable record of assisting disadvantaged communities.

Sustainability/ESG

Technology One publishes a comprehensive Sustainability Report covering all the common environmental, social and governance issues such as carbon footprint, responsible sourcing, modern slavery, diversity, ethical business, etc. They examine these from the perspective different stakeholders, i.e. customers, shareholders, team members, community, suppliers, government and regulators.

They decreased their scope 1 & 2 emissions by 19% against their FY22 baseline with a target of 80% reduction by 2025 and 100% by 2030. While this is commendable, their biggest contributions to greenhouse gasses (travel and third-party services) are scope three and are excluded from these targets. Their total emissions across all scopes grew by 44% during the year, mainly due to air travel increasing.

It is worth noting that as customers move to the SaaS platform, their energy usage will reduce because they don't have to run on-premise equipment. Although this pushes up Technology One's scope 3 emissions, the net effect is a reduced carbon footprint which is good for the planet.

Diversity

Information Technology is a male dominated industry, so the company's 38% gender equality rate is impressive. They have a goal of 30% for female board membership but, with the increase in board size from eight to nine, they went backwards this year from 25% to 22%. The ongoing board transition may provide opportunities for improving the gender balance.

ASA focus issues (not discussed elsewhere)

<u>Cybersecurity event</u>

In May 2023, Technology One detected unauthorised access to an internal back-office system called Microsoft 365. They initiated a pre-prepared cyber response strategy, setting up a war room within 45 minutes, alerting authorities, releasing a statement to the ASX, requesting a trading halt and engaging leading security and forensic experts. This initial investigation confirmed the SaaS platform was not impacted, and no customer data was accessed. The trading halt was lifted on this news.

At the time, the CEO said "As the investigation progresses and further facts are established, we will keep all relevant stakeholders updated". Curiously, there was no further public announcement on this topic.

We questioned this radio silence at our pre-AGM meeting and were told they had "said all they wanted to say on this matter". This is a disappointing attitude. While any cyber breach is regrettable, it appears Technology One's response was exemplary. We think shareholders should have been informed of the facts uncovered by the detailed investigation, as promised by the CEO.

<u>Potential acquisition</u>

During the year, Technology One looked at buying a UK based, higher education software provider. After performing thorough due diligence, they put forward a proposal, but the potential acquisition failed to meet their criteria and the deal did not proceed. This exercise cost in the region of $2m and we applaud the deal team's discipline in walking away when the numbers did not stack up.

The Australian Financial Review published an article in which Ed Chung (CEO) is quoted as saying "we decided it wasn't the right time for us … it might come back around later, but it wasn't the right time".

That article also speculated the target was Tribal Group which appears to be the largest UK listed company in this sector. Around this time frame, Tribal agreed to a deal with a US based software company called Ellucian. That sale has now been blocked by Tribal's major shareholder.

At our pre-AGM meeting, Technology One would not comment on the acquisition target as this is commercially sensitive information. Patrick O'Sullivan (Chair) did say they have a strong balance sheet and no debt. They are always on the lookout for suitable M&A candidates and will, no doubt, make an acquisition at some point in the future.

4. Rationale for Voting Intentions

Resolution 1. Remuneration Report (FOR)

Technology One's senior executives and board members do not appear to be excessively compensated compared to their peers in similar organisations. The structure of the remuneration report is largely in line with ASA guidelines. Refer to Appendix 1 for more details.

We will vote in favour of the Remuneration Report.

Resolution 2. Re-election of Director – Peter Ball (FOR)

Peter Ball is a Chartered Accountant and business advisor. He was a partner at KPMG for more than 25 years where he held senior roles in strategic planning and governance. He has an entrepreneurial spirit and has been involved with several startups.

Mr Ball's other commitments are modest and there is no concern about his workload. His holding in Technology One shares is more than 1½ times his annual director's fees. He has been on the board since March 2020 and is Chair of the Audit and Risk Committee.

We will vote in favour of Peter's re-election.

Resolution 3. Re-election of Director – Sharon Doyle (FOR)

Sharon Doyle is Executive Chair of InterFinancial, a corporate advisory firm specialising in M&A, capital raising and growth consulting. She has excellent experience with high tech companies with steep global growth curves and a strong understanding of the SaaS dynamic.

Ms Doyle is a Non-Executive Director of Auto & General, the company behind the Budget Direct insurance brand. There is no concern about her workload. Her holding in Technology One shares is more than 1½ times her annual director's fees. She has been on the board since February 2018.

We will vote in favour of Sharon's re-election.

Resolution 3. Grant of Securities to the MD & CEO for FY24 Long Term Variable Reward (FOR)

This item relates to the CEO, Edward Chung's, long term variable reward for FY24. Because Mr Chung is an Executive Director, shareholder approval is required to grant him securities.

Given that we support the remuneration report, we also support this resolution.

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Appendix 1
Remuneration framework detail

CEO remuneration framework for FY23	Target % of Total	Statutory % of Total	Statutory $m
Fixed Remuneration (FR)	33%	25%	0.549
Short Term Incentive (STI) - Cash	27%	47%	1.050
Short Term Incentive (STI) - Deferred	7%	10%	0.231
Short Term Incentive (STI) - Equity	0%	0%	0
Long Term Incentive (LTI)	33%	18%	0.391
Total	100%	100%	2.525

- The target amounts in the table above are the amounts that were envisaged in the design of the remuneration plan.
- In Technology One's case an "Executive Net Profit Before Tax" percentage is set at the outset of the CEO's contract. This determines STI which increases in value over the years as the company's profits increase.
- Actual amounts are rounded up.

Notes on actual CEO remuneration

- Edward Chung's remuneration is modest compared to other ASX 100 CEOs.
- His fixed remuneration is only one quarter of his total remuneration with the remainder at risk.
- The value of STI has increased over the years as the company's profits have increased.
- Consequently, STI now represents more than half of his remuneration although 10% of that is deferred.

Notes on the FY23 remuneration framework

Technology One's remuneration framework is unchanged this year. Their key executives participate in a profit share model that it is heavily biased towards variable remuneration. With the bulk of their reward at risk, executive performance is encouraged as underperformance would have a significant negative impact on their remuneration. The elements of the framework are as follows.

- **Fixed remuneration.** This is the base salary plus superannuation. This component is quite low compared to other ASX-listed technology companies.

- **Short Term Incentive (STI).** At the start of their employment contract, each KMP is allocated a percentage of the company's Net Profit Before Tax. Although the percentage is fixed, if company profit grows over time the size of the STI will increase accordingly.

  STI has a single hurdle, i.e. EPS Growth over one year. In other businesses, this might be a cause for concern as it could encourage short-term thinking or risk taking. However, with a Software as a Service (SaaS) model, with its relatively fixed cost base, today's sales turn into not just this year's earnings but also ongoing Annual Recurring Revenue (ARR) which provides long term shareholder value. STI is uncapped on both the upside and downside.
- **Deferred STI.** An additional amount, equal to 25% of the STI, is deferred for two years. If an executive resigns within this period, they forfeit any deferred STI.
- **Long Term Incentive (LTI).** LTI is typically 75% to 100% of fixed remuneration. LTI only vests if performance targets are met over three years. There are two hurdles, Relative TSR (25%) and EPS growth (75%). Relative TSR is measured against the ASX All Technology Index (XTX). Executives can take their LTI as options or equity performance rights or a combination of both.

Alignment with ASA remuneration guidelines

The remuneration report is largely aligned with the ASA guidelines with some exceptions.

- As profits have grown, STI now represents 57% of the CEO's remuneration. While the STI is at risk, the time frame is short. ASA prefers more than 50% of a CEO's pay to be genuinely at risk, mostly in the form of an LTI.
- LTI is assessed over a three year performance period. ASA prefers at least four years.
- 100% of STI is paid as cash, some of which is deferred. ASA prefers at least 50% of STI to be paid in equity with a minimum 12 month holding lock.

Notes on the FY23 executive remuneration outcomes

Observations this year include.

- Executive remuneration as a percentage of Net Profit Before Tax has been decreasing YoY from 7% in 2020 to only 4% in 2023.
- Continuing KMP remuneration (excluding last year's retention bonuses) increased 5% which seems modest compared to the 16% increase in NPBT.
- Fixed remuneration is up only 1.5% (including an increase in the Superannuation Guarantee rate) which is less than inflation.
- Short Term Incentives were up 15% in line with profit growth.
- Long Term Incentives vested at 100% as both hurdles were met.
- No board discretion was exercised and no further Retention LTIs were granted.

Notes on the FY23 board remuneration outcomes

Observations this year include.

- At last year's AGM, the Director Fee Pool was increased from $1.5m to $2m. This was the first increase in four years.
- This year, Director fees increased 20% from $145,230 to $175,000. The Independent Chair's fee increased 107% from $145,230 to $300,000. Each committee chair receives an additional $27,500.
- One of the rationales for last year's fee pool change was to increase these fees, so the changes were expected.
- Independent remuneration benchmarking available to the ASA suggests the new fees are not excessive for a company with a $5b market capitalisation.
- All Director's hold shares in Technology One worth at least one year's fees.