



Investment Philosophy and Process

Sunbird employs a *Quality and Value* investment philosophy that has been developed over the past 15 years. Our 28 years of experience has led us to conclude that *Quality and Value* are the two most important factors in generating portfolio alpha and lowering portfolio risk. Academic studies also point to this conclusion.

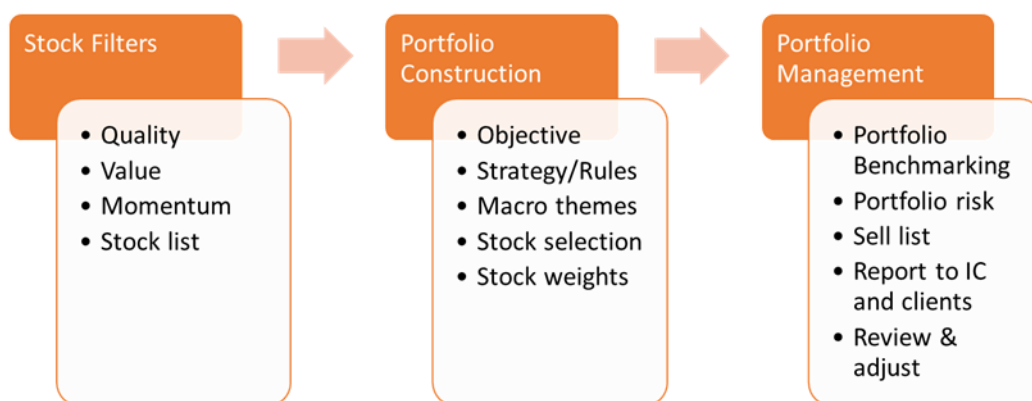
The process has three steps:

Step 1: We seek quality stocks that offer value and are preferably in a medium-term (5-year) uptrend.

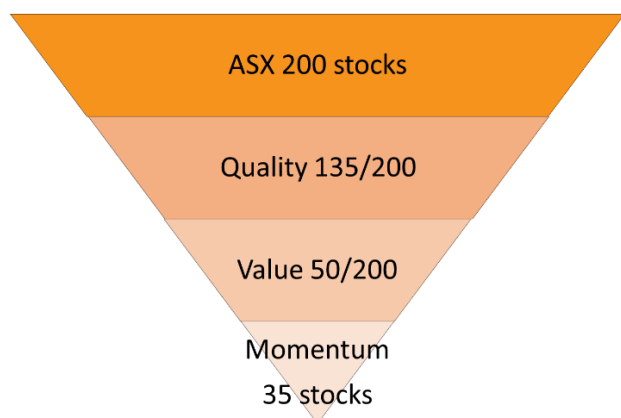
Step 2: We construct a number of different portfolios ranging from High Growth to Income. Portfolio strategy and rules provide the portfolio framework and boundaries. Macro themes influence GICS sector allocations. Stock selection is based on the stock list from Step 1.

Step 3: We manage and measure portfolio performance and risk metrics against portfolio objectives. Progress is reported regularly to the Sunbird Investment Committee and clients. Portfolio reviews and adjustments are made regarding outperformance or underperformance.

Sunbird Investment Process



Sunbird Stock Filters



Three filters:

Quality - assess each company in the universe across 9 quality factors. A company needs to score 70% or above to meet our definition of quality. This screen typically reduces the universe to around 135 stocks.

Value - to determine value, a company must be able to deliver an IRR greater than its discount rate. This process typically reduces the universe down to 50 stocks or 25% of the original universe.

Momentum - the final screen seeks stocks that are in a medium-term (5-year) uptrend. This screen further reduces the sample size down to around 35 stocks or 18% of the original universe.



What is Quality?

Sunbird has developed what we believe to be the most comprehensive and strict quality filters in the market. We score each company in the entire stock universe against 9 quality factors. Each stock is scored out of 80 and converted to a % score. Those stocks scoring 70% or above are classified as quality stocks and form our quality universe. Further, we develop risk scores for each stock that determine the discount rate to be applied in the valuation process. Risk scores are kept simple and range from 0.9 (lower risk), 1.0 (market risk), 1.1 (higher risk).

We are looking for companies that operate in industries with favourable industry dynamics, that have strong competitive advantages, high profitability, good quality earnings, sustainable growth, low to moderate gearing, reasonable ESG qualities, low to moderate stock volatility and low to moderate company risk.

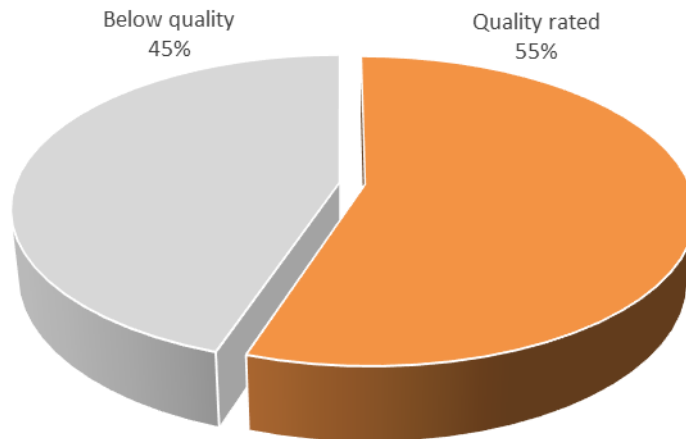
Quality filters

Industry /10	Macro drivers, Market size, Growth rate, Life-cycle, Industry profitability, Industry structure, Barriers to entry, Competition intensity, Government regulation and taxes
Competitive Advantages /10	Product, Price, Distribution, Location, Marketing, Brands, Service, Reputation, Patents, Licenses, Market share, Assets, Productivity, Technology, Management, Corporate culture, Scale, Capital strength
Profitability /10	Profit margins, ROE, ROA, ROCE
Earnings quality /10	Track record, Volatility of revenue & earnings, EBITDA cash conversion, Sustainability of revenue, Key customer risk, Contract risk
Sustainable Growth /10	Past growth, guided growth, consensus growth, theoretical growth rate (ROE x retention rate), industry/peer growth
Gearing /10	Net Debt/EBITDA, Net Debt/ND+E, Net debt/market cap, Interest cover
ESG /5	Refinitiv Environmental, Social, Governance score, converted to a score out of 5
Volatility /5	Lower vol = higher score, Short term volatility and long-term beta scores combined and converted to a score out of 5
Company risk /10	Lower risk = higher score Macro risks, Industry risks, Regulatory risks, Company-specific risks



Quality database

The outcome of this process is a quality database that holds the quality and risk scores on each stock. By 2023, the Sunbird quality database held quality data on 261 stocks, with 144 or 55% rated as quality and the balance below quality.



Below we show a snapshot of the quality database for 10 stocks. This database runs to 261 stocks and can be sorted by a variety of ways, including Quality sector, GICS sector or market cap.

Company Profile							Quality rating										Risk rating				
Rank	Code	Company Name	Share price	Market cap	Market Weight	ASX Index	GICS Sector	GICS Industry	Industry /10	Competitive advantages /10	Profitability /10	Earnings quality /10	Sustainable growth /10	Gearing /10	ESG/5	Share volatility /5	Company Risk/10	Score out of 80	Quality Score /100%	Risk factor	Discount rate (% p.a.)
1	CSL.AX	CSL Ltd	282.98	136,379,525,047	5.12%	ASX 20	Health Care	Pharmaceuticals, Biotechnol	10.0	9.0	9.0	9.0	9.0	8.0	4.0	4.2	9.0	71.2	89.0%	0.90	8.1%
2	RMD.AX	Resmed Inc	30.99	45,797,259,026	1.72%	ASX 50	Health Care	Health Care Equipment & Ser	9.0	9.0	9.0	7.0	9.0	9.0	3.7	4.1	8.5	68.3	85.4%	0.90	8.1%
3	WOW.AX	Woolworths Group Ltd	33.84	41,142,030,365	1.54%	ASX 20	Consumer Staples	Food & Staples Retailing	8.0	9.0	8.0	9.0	7.0	9.5	4.2	4.3	9.0	68.0	85.0%	0.90	8.1%
4	ASX.AX	ASX Ltd	67.72	13,102,769,187	0.49%	ASX 50	Financials	Diversified Financials	8.0	9.5	8.0	9.0	7.0	10.0	2.9	4.2	9.0	67.6	84.5%	0.90	8.1%
5	COH.AX	Cochlear Ltd	207.80	13,661,562,583	0.51%	ASX 50	Health Care	Health Care Equipment & Ser	9.0	9.0	9.0	8.0	8.0	9.0	3.3	3.8	7.5	66.6	83.3%	1.00	9.0%
6	GMG.AX	Goodman Group Ltd	18.64	35,031,904,483	1.32%	ASX 20	Real Estate	Industrial Global	8.0	9.0	8.0	8.0	8.5	9.5	2.9	3.6	8.5	65.9	82.4%	0.90	8.1%
7	TNE.AX	TechnologyOne Ltd	13.51	4,382,401,841	0.16%	ASX 200	Information Technology	Software & Services	8.0	8.0	9.0	8.0	8.0	10.0	3.0	4.0	7.0	65.0	81.2%	1.00	9.0%
8	REA.AX	REA Group Ltd	120.05	15,851,604,300	0.60%	ASX 50	Communication Services	Software & Services	8.0	9.0	10.0	8.0	7.0	9.0	2.4	3.3	8.0	64.7	80.9%	1.00	9.0%
9	NWL.AX	Netwealth Group Ltd	13.18	3,212,569,235	0.12%	ASX 200	Financials	Diversified Financials	8.0	8.0	9.0	8.0	8.0	10.0	2.1	3.5	8.0	64.6	80.8%	1.00	9.0%
10	COL.AX	Coles Group Ltd	16.69	22,324,984,131	0.84%	ASX 20	Consumer Staples	Food & Staples Retailing	8.0	8.0	7.0	9.0	6.5	9.5	4.1	4.1	8.0	64.2	80.3%	0.90	8.1%

The database is regularly reviewed and updated at least twice a year. Research notes are made on each stock so that the reasoning behind the rating scores is saved for future reference. Once a company is quality rated its quality score will tend to move gradually (either higher or lower) over time.

What is Value?

Sunbird has developed an Internal Rate of Return (IRR) model to determine value. We assess the expected positive cashflows from the stock (dividends and capital value at year-10) versus the negative cashflow (acquisition price) to determine an IRR. We then compare the stock's IRR to its discount rate to assess whether the stock offers value or not.

Our standard discount rate is derived from the capital asset pricing model (long term 10-year bond yield + an Equity Risk Premium or ERP).

Our current discount rate is: 10-year bond yield (3.0%) + ERP (6.0%) = 9.0%.

We then adjust our standard discount rate by the stock's risk factor (0.9, 1.0 or 1.1x) to determine an appropriate discount rate for the risk of the stock.

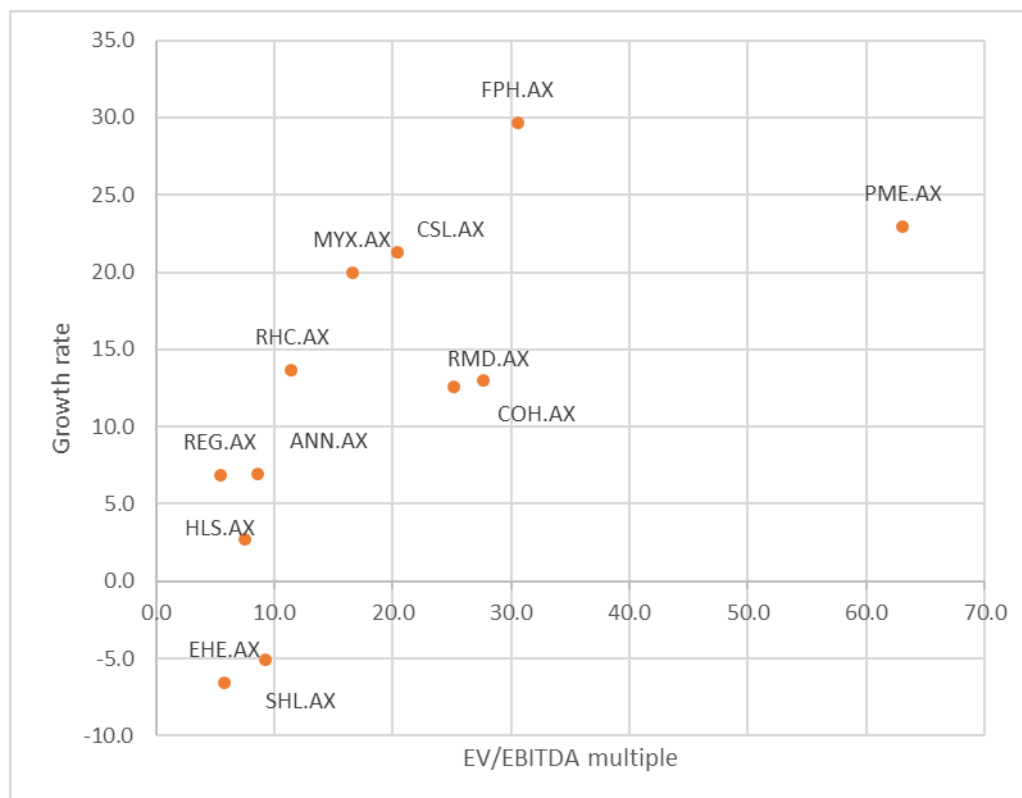


The valuation process involves initially identifying quality stocks that look to offer reasonable value based on multiples (P/E, EV/EBITDA, Price to Book or Yield).

Value Assessment – Screen 1

Sunbird assesses the stocks in each GICS sector by trading multiples to identify quality stocks that seem to offer reasonable value.

Example: Healthcare sector scatterplot based on EV/EBITDA



Value assessment – Screen 2

Once we identify a potential *Quality and Value* stock, we then conduct a detailed *Quality and Value* analysis and produce a company research report. In the detailed analysis, we build an internal rate of return (IRR) model to assess whether the expected return (IRR) of the stock exceeds its discount rate (R).

We view this as a practical approach as it replicates the actual investor's experience of buying a stock (negative cashflow) and receiving dividends (positive cashflow) and the exit price (positive cashflow) as their investment return. Effectively, we are assessing whether the stock has a reasonable chance of generating our discount rate, over a 10-year holding period.

The outcomes will be as follows:

IRR>R = undervalued

IRR=R = fair value

IRR<R = overvalued



Example: ASX (ASX)

ASX.AX	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32
EPS	2.63	2.79	2.96	3.13	3.32	3.52	3.73	3.95	4.19	4.40	4.62
DPS	2.36	2.50	2.65	2.81	2.98	3.16	3.35	3.55	3.76	3.95	4.15
Payout ratio	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%
EPS growth		6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	5.0%	5.0%
Share price	67.72										118.49
P/E (x)	25.7	24.3	22.9	21.6							25.6
Yield (%)	3.5%	3.7%	3.9%	4.2%							3.5%

IRR at current price		Assumptions	
Purchase Price	(67.72)	EPS 10-year CAGR	5.8%
Dividends Yr 1-10	32.86	Payout ratio increase p.a.	0.0%
Capital Price Yr10	118.49	Year 10 growth rate	5.0%
IRR (p.a.)	9.5%	Year 10 P/E ratio (x)	25.6
Required Return (p.a.)	8.1%	Year 10 Yield	3.5%
Fair Value (IRR=R)		Required return calculation	
Purchase Price	(75.60)	10-year bond yield	3.00%
Dividends Yr 1-10	32.86	Equity Risk Premium	6.00%
Capital Price Yr10	118.49	Equity market expected return	9.00%
IRR (p.a.)	8.1%	Stock risk factor (from Quality analysis) (x)	0.9
Required Return (p.a.)	8.1%	Required return	8.10%

ASX purchase price \$67.72

IRR at that price: 9.5% p.a.

Required return: 8.1% p.a.

IRR>R hence the stock offers value

Fair value of ASX: \$75.60 (the price where the IRR = R)

At a purchase price of \$67.72, ASX' expected return (IRR) is 9.5%, which is greater than its required return (R) of 8.1%. The stock is undervalued at \$67.72/share, based on the assumptions above right. Further, ASX offers value up to \$75.60, which is the point where its IRR of 8.1% = R of 8.1%.

Obviously, our assumptions are critical to the valuation and here we carefully monitor our growth trajectory, payout ratios, CAGR's and year-10 capital values to make sure they are reasonable and realistic. We are always conservative in our assumptions. We have a number of guides for growth forecasts which include historical growth rate, company guidance, consensus forecasts, theoretical growth rate ((1-payout)*ROE) and industry or peer group growth rates. Our year-10 capital values are based on reasonable P/E's and yields that are referenced to its growth rate and yield at year-10 and the stock's long term historical averages.

At each profit season we reassess our forecasts and fine tune our assumptions. We have over 15 years' experience using these models and have become increasingly accurate in our fair value assessments.



What is Momentum?

We are not chasing short term momentum. Rather, we want to see that the stock remains in a medium-to-long term uptrend. This is mainly to reduce downside risk as we prefer to “get on at the station” rather than “hoping the train will stop in front of us”. Here we observe medium and long-term price trends, as well as relative performance vs the S&P/ASX 200. We are typically looking for a 5-year up-trend and relative outperformance before investing.

Example: CSL

CSL lost considerable momentum over the 2021 and 2022 calendar years.

CSL, 2-year chart



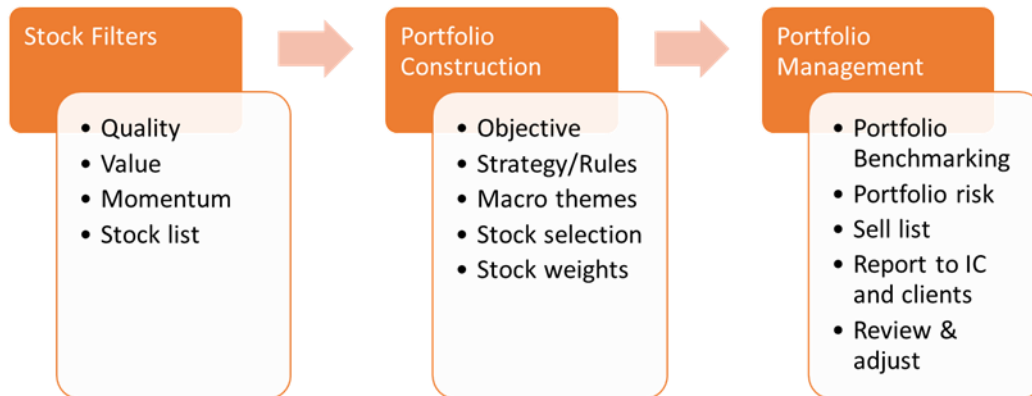
However, CSL remains in a medium-term uptrend and continues to outperform the S&P/ASX 200 over 5 years. CSL retains its medium-term momentum.

CSL, 5-year chart





Sunbird Investment Process



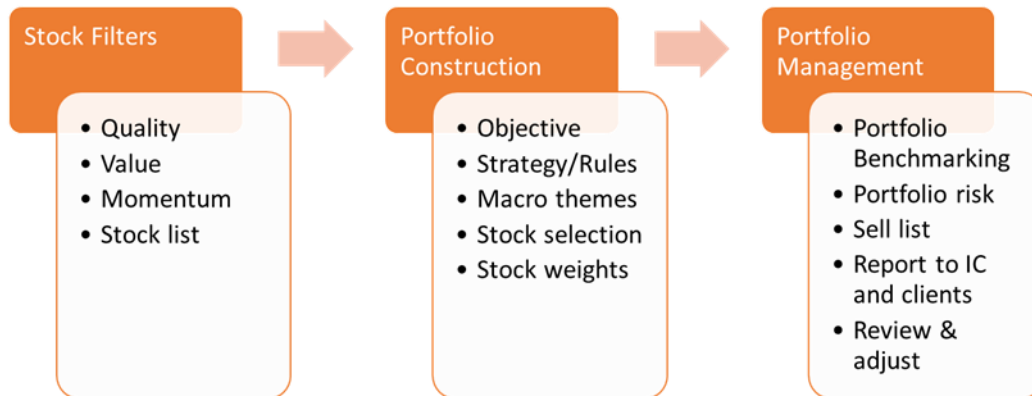
Portfolio Construction

After the **Stock Filter** step, we then move to **Portfolio Construction**. Here we apply the following framework:

- Portfolio objective (Growth, Core, Income, ESG)
- Portfolio strategy (asset allocation, universe, rules, constraints)
- Top-down inputs (20%)
 - Global megatrends (lasting decades)
 - Macrotrends (shorter term)
- Bottom-up inputs (80%)
 - Quality, Value, Momentum stock list
- Portfolio weighting considerations
 - Portfolio expected return and risk metrics
 - Portfolio yield
 - Portfolio stock correlations
 - GICS sector weights
 - Cash weighting
 - Weightings per ASX index (ASX 20, ASX 50, ASX 100, ASX 200)
 - Cyclical vs Growth vs Defensive exposure
 - Portfolio weighted overall quality and risk score
 - Manager conviction
 - Portfolio metrics (P/E, yield, growth, ROE)



Sunbird Investment Process



Portfolio management

Once the portfolio is constructed, it is implemented and managed. The **portfolio management** step involves ongoing monitoring of the portfolio against its return and risk objectives, handling any corporate actions and addressing any outperformance or underperformance issues.

The key processes include:

- Monitor portfolio returns and risk metrics vs portfolio objectives
- Attend to any corporate actions
- Report to the Investment Committee (IC) and clients monthly
- Identify potential stocks to SELL
- Identify potential stocks to add to the stock list
- Review and make portfolio change recommendations (if any) to the IC in response to periods of outperformance or underperformance
- Communicate any portfolio changes to clients and implement across IMA, SMA and MDA platforms
- Review portfolio stocks at each profit result and issue research updates to clients
- Review stock valuation models and fair values



Warnings, Disclosures and Disclaimer

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Warnings

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