



APA Pivots to Renewables as CEO retires

Company/ASX Code	APA Group/APA
AGM date	Wednesday 19 October 2022
Time and location	Wesley Conference Centre, 220 Pitt St Sydney and online at https://meetings.linkgroup.com/APA22
Registry	Link
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Lewis Gomes assisted by Sue Howes and Miles Wu
Pre AGM Meeting?	Yes with Chairman Michael Fraser, Acting CEO Adam Watson, IR Manager Andrew Gibson, Head of Net Zero Andrew Dyer

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

Summary of issues for meeting

More a difference of perspective than an issue, we would prefer to see APA reduce distributions to fund capital expenditure (CAPEX) longer-term and reduce dependence on debt, particularly given the financial uncertainty that is likely to persist until the next tranche of debt needs to be refinanced. However, the company does seem to manage risk around debt very well.

APA is in the process of redefining its long-term strategy around the direction for the company, which includes a pivot to renewables and abandonment of US acquisitions. We are eager to see the completion of this work.

The transition at the top seems to be going well, although Adam Watson is currently acting CEO while a search is carried out. We hope for a smooth transition of leadership.

Proposed Voting Summary

No.	Resolution description	
1	Adoption of the Remuneration Report	For
2	Approval of APA Group's Climate Transition Plan	For
3	Re-election of Mr James Fazzino	For
4	Re-election of Ms Rhoda Phillippo	For

Consideration of accounts and reports - No vote required

Governance and culture

The Board have a diversity of skills, experience, background, gender and tenure and seems to have managed the change in senior management and strategic direction well.

While the Board has remained stable, there has been considerable movement in upper management (see below). The balanced scorecard results would seem to indicate that the Board has high expectations of management regarding people and culture and this can only be a good thing going forward.

Financial performance

The company provided an additional meeting for ASA monitors with the acting CEO, previous CFO, Adam Watson. We found the meeting very productive, and Mr Watson gave us considerable comfort on the safe pair of hands he will be providing for the business.

Key on our list is sustainability of dividends given the company targets a given distribution increase, much of which came from return of capital this year, backed by an increasing debt load. APA's approach is to mitigate financial risk by:

- Ensuring market facing contracts have inflation increases built in;
- Hedging out both interest and currency risk on debt;
- Managing free cash flow effectively;
- Setting the distribution rate to get the right balance between dividends and CAPEX.

While its management in this regard is sound and sensible, we still have some concerns from the point of view of longer-term shareholders. Net profit after tax (NPAT) is affected by depreciation while free cash flow remains strong. This results in dividends being funded from equity and reserves due to the operation of the accounting standards while debt increases to fund CAPEX and acquisitions.

Our preference would be for the company to reduce the payout ratio to allow it to internally fund its CAPEX and reduce debt, thus reducing longer-term risk for the company, but we are aware that most analysts don't see it this way and push the company for ever increasing distributions.

We asked specifically about the non-operating items in the accounts. The Basslink interest has been well documented in the financial press. The Contract for difference is mostly a non-cash accounting item marking to market the different energy prices in the market, as is the WGP hedge (which requires electricity market prices to be used in the accounts even though the existing hedges have been replaced by new).

The payroll review is an obligation under Fair Work to go back several years and check wages paid.

Technology transformation will result in higher costs for the next few years while systems are upgraded as part of the ERP plan being implemented, which includes reinventing of back-end processes and systems and an upgrade to the billing system.

Key events

After several years searching for a suitable business acquisition in the US the company has decided to turn their attention from the US, while still maintaining in the short-term incentives (STIs) an item regarding making an acquisition. The long-term incentive (LTI) has a longer-term goal of

ensuring that any new business opportunities meet with a required minimum return on investment (ROI) such that the internal rate of return needs to be higher than the weighted average cost of capital. Our discussions indicated that this is applied to all deals, including the Ausnet acquisition, which ended up being abandoned as the APA share price dropped thus violating this requirement.

The company has released its Climate Transition Plan, which seems thorough and comprehensive, while it is in the process of resetting its strategy with a priority on pivoting to renewables infrastructure.

Key Board or senior management changes

At the close of FY22 there were 8 directors including the CEO Rob Wheals. On 22 August 2022, APA announced that Rob Wheals was stepping down at the end of September 2022. Adam Watson, the current Chief Financial Officer, was appointed Acting CEO while the board undertakes a full search process for a new CEO. Prior to joining APA, Adam was CFO for Transurban, he therefore has a strong background in infrastructure businesses which should be relevant as APA looks to actively participate in the development of renewable energy systems and infrastructure. APA's General Manager of Investor Relations, Kynwynn Strong, has been appointed as Acting CFO. Other management changes as a result of these moves are already underway.

It should be noted that as Acting CEO, Adam has not been appointed as Managing Director and is therefore not a formal member of the board. Of the other 7 board members, 3 are females giving a female director ratio now of 43 % which would become 38% if a male candidate is chosen as MD. Two current directors, James Fazzino and Rhoda Phllippo are facing re-election at this year's AGM.

The longest serving director, Steven Crane, joined the board in January 2011 and ceased as a director on 15th September.

The current mix of board skills and experience seems appropriate although no skills matrix is presented in the Annual Report. Given that many director skills matrices published by companies are rather generic and inclined to overstate the relevant skills applicable to the business, this absence may not be a bad thing.

Financial Summary

Item (As at FYE)	2022	2021	2020	2019	2018
NPAT (\$m)	259.7	0.7	309.0	282.1	260.9
UPAT (\$m)	240.0	278.9	309.0	282.1	260.9
Share price (\$)	11.27	8.90	11.13	10.80	9.85
Dividend (cents)	53.0	51.0	50.0	47.0	45.0
Simple TSR (%)	32.6	(15.5)	7.7	14.4	12.3
EPS (cents)	22.1	0.1	26.2	23.9	22.9
CEO total remuneration, actual (\$m)	3.06	2.79	2.51	5.18	5.40

Note: There have been very minor restatements of past figure for net profit after tax (NPAT) and Underlying profit after tax (UPAT) based on the FY22 Annual Report. Simple total shareholder

return (TSR) is calculated by dividing (change in share price plus dividend paid during the year, excluding franking) by the share price at the start of the year.

Resolution 1: Adoption of Remuneration Report

Note no grants to Acting CEO as he is not a director of the company. He will still receive grants of securities as part of key management personnel (KMP) award scheme.

ASA considers the remuneration scheme to be appropriate for the company and is heartened to see the rigour with which performance is measured against goals. ASA will be voting all undirected proxies in favour of this resolution.

Resolution 2: Approval of the Climate Transition Plan

APA's Climate Transition Plan (CTP) was released to the ASX on 24 August 2022. It includes:

- An overview of APA's emissions profile across power generation, electricity generation and gas infrastructure. It includes Scope 1 and 2 emissions and an estimation of Scope 3 emissions.
- Updated climate targets, goals and commitments for 2030, 2040 and 2050 tailored to APA's specific businesses.
- An overview of APA's strategy and action plan for reducing operational emissions intensity of its power generation and electricity businesses and reducing the operational emissions associated with its gas infrastructure business.
- Analysis of the resilience of aspects of APA's asset portfolio under different climate scenarios.
- Information on APA's management of climate related risks and the governance systems overseeing them.

During the pre-AGM meeting with the Chairman, the ASA asked specifically about the involvement of directors in understanding and supporting the CTP and how governance by the board of the CTP actually works. The Chairman advised that all directors were involved in briefings and discussions on the CTP rather than it being left to one of the board committees. The personal engagement of all directors in the development and progress of the CTP is encouraging.

The ASA also met with the Head of Net Zero & Climate, Andrew Dyer, who has been instrumental in developing the details of the CTP and testing various climate scenarios on particular APA assets. Andrew demonstrated an impressive knowledge of climate related issues and the impacts on APA assets. We sought and received a detailed explanation of Scope 3 emissions and how they will be documented and reported over the next 3 years. The CTP is seen as a first step in APA's journey towards net zero, and will be progressively updated and communicated as work progresses.

As an overall observation, APA seems well placed to actively progress and implement its CTP as it pursues various renewable projects into the future and seeks to make its existing assets more resilient to climate change impacts. The Australian Council of Superannuation Investors (ACSI) has rated APA as being at the highest level, being Comprehensive, on a scale of 5.

This resolution is advisory only and not binding on the board, but the outcome of the vote will be taken into account in determining how APA progresses, evaluates and reports on its progress. APA will also be implementing various remuneration targets to incentivise KMP and other senior staff in meeting the objectives of the CTP.

On the basis of our assessment of the CTP and the outcomes of the various discussions held with APA, the ASA will be voting all undirected proxies in favour of the resolution.

Resolution 3: Re-election of James Fazzino as a Director of APA

James was appointed to the board in February 2019. He is a member of the Audit and Risk Management Committee and a member of the Health, Safety, Environment and Heritage Committee. He was formerly Finance Director, then CFO and finally CEO of Incitec Pivot Limited. He has experience both locally and internationally in industrial chemicals, fertilisers, explosives and manufacturing sectors.

He is currently Chair of Manufacturing Australia and Tassal Group Limited, and a director of Rabobank Australia Limited.

James has served as an effective and diligent director of APA, he is not burdened with too many other professional roles and hence the ASA will be voting all undirected proxies in favour of his re-election.

Resolution 4: Re-election of Rhoda Phillippo as a Director of APA

Rhoda was appointed to the board in June 2020 and is Chair of the Health, Safety, Environment and Heritage Committee and a member of the People and Remuneration Committee. Rhoda has spent much of her career in the telecommunications industry in the UK, New Zealand and Australia. She has considerable experience in the telecommunications, IT and energy sectors.

She is currently Chairperson of Kinetic IT Pty Ltd and a NED of Pacific Hydro. She is also an advisor to the board of Tally Group, and energy billing solutions provider.

Rhoda has served as an effective and diligent director of APA, she is not burdened with too many other professional roles and hence the ASA will be voting all undirected proxies in favour of her re-election.

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Appendix 1

Remuneration framework detail

CEO rem. Framework for FY22	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.675	29%
STI - Cash	1.040	18%
STI - Equity	0.520	9%
LTI	2.541	44%
Total	5.776	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.

While this company has targets set for STI, it only publishes maximum opportunity for remuneration. As such only the maximum is shown in the table above.

For the CEO, STI is 90% of Fixed Remuneration with an EBITDA gateway that determines the pool available.

STI is based on a balanced scorecard related to the strategic goals of the company. 2/3 is paid in cash with the remainder invested into restricted securities.

LTI is measured over three years and then vests over the following two-year period. The measures are 50% Relative TSR and 50% Return on Capital and rights are allocated based on VWAP. Actual remuneration is clearly reported in the annual report and the company requires the CEO to hold 100% of fixed remuneration in shares (other KMP 50%).