Australian Shareholders' Association

Australian Shareholders' Association Limited
ABN 40 000 625 669
Suite 11, Level 22
227 Elizabeth Street, Sydney NSW 2000
PO Box A398, Sydney South NSW 1235
t (02) 9252 4244 | f (02) 9071 9877
e share@asa.asn.au

Digesting big acquisitions to remain competitive in tough marketplace

Company/ASX Code	IOOF/IFL
AGM date	25 November 2020
Time and location	9.30am AEDT, virtual, on the lumi platform
Registry	Boardroom
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Alan Hardcastle assisted by Christine Haydon
Pre AGM Meeting?	Yes with chair Allan Griffiths, non-executive director John Selak and chief executive officer Renato Mota

The individuals involved in the preparation of this voting intention have no shareholdings in this company.

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required

Summary of ASA Position

In what it describes as a once in a generation opportunity, IOOF (IFL) launched in August a successful $1.44b acquisition of MLC Wealth. Subject to regulatory bodies, IFL expects APRA approval in the first quarter of 2021 and ACCC approval in this calendar year.

With the MLC Wealth business on-board, IFL states it will be the number one retail wealth manager by funds under management, administration and advice (FUMA) at some $510b; the number two super provider with $173b of funds under administration; and the number one 'advice business' by the number of advisers at 1,884 advisers (should all MLC advisers transition across).

In undertaking one of Australia's largest ever capital raisings to fund that acquisition, IFL raised the ire of both financial observers and smaller retail shareholders. The accelerated non-renounceable entitlement offer (ANREO) of 1 for 2.09 shares at $3.50, complemented with a share placement plan (SPP) resulted in minimal retail acceptances and significant share dilution.

The MLC Wealth play comes closely on the heels of IFL's acquisition of ANZ's Pensions & Investments (OnePath) . They are large and complex businesses to integrate into IFL's existing operations, as well as having required significant internal financing as well as the capital raisings.

Underpinning its 'transformational strategic focus', the company's key pillars are Advice 2.0 (advice), Evolve21 (the platform suite) and P&I (ANZ) integration. Subsequent to the Hayne Royal Commission, and in a problematical financial industry, the company believes the key pillars will deliver on its strategy of 'advice-led advice management'.

"(The) MLC transaction will deliver significant benefits for all stakeholders including our shareholders with EPS accretion of 20%+," CEO Renato Mota told the ASA. The time frame is three years. Based on scale and IT investment, IFL believes it is a low cost provider. It's had a pretty impressive track record over the decades in building a business through acquisitions and, in turn, successful integrations.

Governance and culture

Having appointed two new independent non-executive directors in 2019 (refer to ASA voting intentions FY19), IFL has a board that reflects both experience in the company's business and the industry in which it operates; and fresh talent to oversee critical areas such as IT and financial services. The company has a 33% female board representation while its senior management ranks comprise about a >30% female representation. Succession planning is an ongoing focus and IFL believes it has both chair and CEO positions covered with 'very strong candidates' for both roles should the need arise.

Included in IFL's response to Covid 19 were decisions to freeze non-executive director (NED) fees for the fifth year in a row; the chair and CEO took a 20% reduction in pay for six months from 1 August 2020; and all other NEDs and the CFO took a 10% pay reductions for the same period. The company did not accept any federal government assistance.

Withdrawals due to Early Access to Superannuation impacted negatively to the tune of $743m and IFL expects continued reduction with the scheme's extension. However, the company is fully supportive of the federal government's scheme and, under its ClientFirst approach, ensured 97% of all payments were paid within five business days (for P&I, 83%).

From October 2021 ASIC will require financial product firms to develop products that meet the needs of consumers in their intended markets. IFL says it already provides a large variety of products that cover a variety of target markets and notes its distribution channels mean products will get to the right consumers.

Financial performance

IFL's underlying net profit after tax (UNPAT) was $124m, down 22% from the $183m in FY19, while its statutory net profit after tax (NPAT) of $147m was up 414% on FY19 - boosted by substantial profits on the sale of non-core businesses. UNPAT was negatively impacted by Covid 19 market movements; reduced gross margins due to the Early Access to Superannuation legislation; and 'competitive dynamics'. The Company declared a final dividend of 11.5cps totalling 27.5cps for FY20, compared with 44.5cps FY19 - all fully franked. That took the total dividend payout ratio to 75%, within IFL's stated payout range of 60 to 90% of UNPAT. Total shareholder return (TSR) was a disappointing 1.8% but better than FY19's -38.3%. A marginally lower share price and reduced dividend income conspired to this flatlining. For FY20 IFL's total FUMA reached $202.3b, up a prodigious 46% on FY19 (not including P&I).

Key events

In essence, the Board believes that in the short to medium term (one to two years) industry margins will come under further pressure and competition will get even tougher (Vanguard being one of the latest players). IFL said it needed to acquire MLC Wealth with urgency in order to build even greater mass (following its relatively recent acquisition of ANZ P&I) to gain more cost advantages as well as ensure that MLC Wealth did not fall into the hands of an aggressive competitor.

The speed with which IFL acted was predicated, according to the chair, on the need for 'certainty' in achieving a successful outcome in the face of other competitors wanting the MLC business. The ASA raised a number of issues pertaining to the accelerated non-renounceable entitlement offer (ANREO) and the share purchase plan (SPP). Notably, why the much preferred pro-rata accelerated institutional with tradeable retail entitlement offer (PAITREO) and volume weighted average price (VWAP) methods were not applied. The ASA also questioned as to whether the company was 'in breach' of the spirit of the ASX's 25% ('Covid') rule.

The fund raising comprised a $1.040m fully underwritten institutional placement and ANREO; $250m of incremental senior debt; $200m in subordinated loan issues to NAB; and $40m of existing IFL cash.

The IFL chair explained the board considered a range of factors in determining the offer structure including certainty of funds (needing an underwritten offer), fairness, size of the discount and timetable. Based on those factors and taking into account the magnitude of the equity raising and the company share register composition, it was concluded an underwritten ANREO was optimal and provided the most certainty of success.

The company also concluded an SPP, with VWAP, on the same timeline as the ANREO but at a different price, was considered inappropriate.

The chair believes that smaller retail shareholders invest in IFL for income (dividends) and the company will continue to pay at the upper end of the dividend range of 60 to 90% of UNPAT (hopefully about 80%). And that with ongoing cost saving synergies the share price will go up.

In the meantime the subsequent - to the raising - share price falls suggests the market believes IFL overpaid for the MLC Wealth business. The retail offer was heavily under-subscribed while institutional underwriters have taken on further paper losses.

Key board or senior management changes

Perhaps the most important move in IFL's key management personnel (KMP) ranks is the appointment of Chris Weldon to a newly created role of chief transformation officer. Reporting directly to the CEO, he previously worked in a number of IFL roles and before that was employed by MLC leading its product developments.

Summary

(As at FYE)	**2020**	**2019**	**2018**	**2017**	**2016**
NPAT ($m)	147.0	28.6	88.3	116.0	196.8
UPAT ($m)	128.8	197.8	191.4	169.4	173.4
Share price ($)	4.92	5.17	8.99	9.80	7.83
Dividend (cents)	27.5	44.5	54	53	54.5
TSR (%)	1.8	(38.3)	(2.8)	23.3	(6.8)
EPS (cents)	42	8.1	26.4	38.7	65.7
CEO total remuneration, actual ($m)	1.36	2.2*	2.9	5.0	3.6

For 2020, the CEO's total actual remuneration was **15 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).
*Figure includes the award former CEO Chris Kelaher received combined with the award current CEO Renato Mota received until his appointment.

Item 2a	**Re-election of John Selak as a director**
ASA Vote	**For**

Summary of ASA Position

Mr John Selak, a non-executive director of IFL since 2016, is chair of the group remuneration committee and a member of various other committees. His shareholding equates in value, at present share prices, to his annual director fees.

John Selak's workload is relatively light for apart from his IFL role, he holds no other public company positions, just a couple of private company board roles. Highly experienced as a global corporate finance executive, he was a partner in Ernst & Young's corporate finance practice from 2000 to 2016. His experience in domestic and global mergers and acquisitions (M&A) makes John Selak a valuable board member.

Item 2b	**Re-election of Elizabeth Flynn as a director**
ASA Vote	**For**

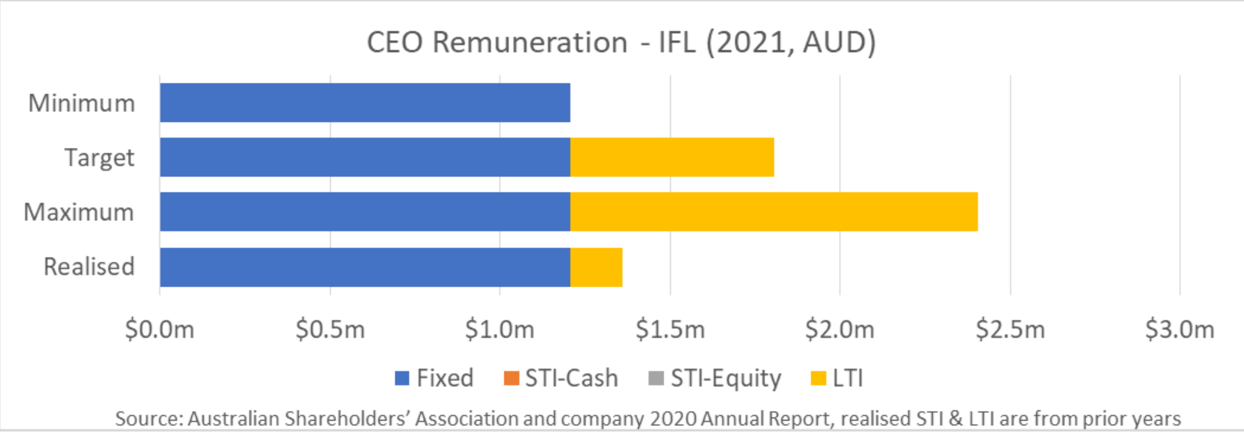
Summary of ASA Position

An IFL non-executive director since 2015, Ms Elizabeth Flynn has a professional background in law and governance. Most recently she worked in various compliance and legal roles with Aviva Australia (1998 to 2010) as well as having previously spent 18 years as a commercial lawyer with Minter Ellison. Elizabeth Flynn is chair of the group risk and compliance committee and holds various other committee roles.

She has no other public company positions but is a NED of AIA Australia, Colonial Mutual Life Assurance Society and AIA Health Insurance. Elizabeth Flynn has less than minimal 'skin in the game', her ordinary IFL shareholding totals just 33,157 shares, worth about 60% of her annual director fees. The ASA would want to see Elizabeth Flynn increase her shareholding in FY21.

Item 3	**Adoption of remuneration report**
ASA Vote	**For**

Summary of ASA Position



FY20 was a transitional year for remuneration; not representative of a typical year and so misleading. The new EEP scheme started July 2020 and the above graphic shows FY21, realised remuneration is for 2020.

The executive remuneration framework was redesigned in 2020, took effect 1 July 2020, and involved input from a remuneration consultant. Known as the executive equity plan (EEP), it sees long term incentives (LTIs) and short term incentives (STIs) removed for the CEO and KMPs. EEP is a mix of financial and non-financial priorities and is delivered wholly in equity with vesting over a four year period. FY20 has been a transitory one for the CEO and KMPs and no STIs were awarded. Recognising the current economic (Covid-19) environment, both the chair and the CEO took a 20% reduction in pay for 6 months from 1 August 2020 while all other non-executive directors (NEDs) and the chief financial officer (CFO) took a 10% cut.

The EEP is based 40% on relative total shareholder return (rTSR) assessed at the end of the four year performance period; and 60% on annual performance measures of which 10% is financial (achievement of an undisclosed UNPAT target) and 50% non-financial. The rTSR is judged against the ASX200, ranking in the top 50%. The EEP's non-financial measures include delivering against a board endorsed ESG scorecard; service delivery through adviser and member net promoter scores (NPS); employee engagement; and organisation transformation, set on an individual basis.

The EEP requires the CEO to accumulate shares in the company equal to 100% of TFR, to be met by June 2024.

While the ASA believes non-financial measures should be in the order of 10 to 30% of the award, IFL's total 50%. However, the company points out that in developing the EEP it took into account APRA's remuneration guidelines that seek 50% non-financial measures.

The ASA has engaged with IFL regarding its new EEP scheme and it's understood the company will be making some changes that will improve transparency. It remains a concern that under rTSR IFL could still reward executives while shareholders suffer from a negative TSR. Thus, this year we propose to vote for the IFL's transitional remuneration 'scheme' but look forward to it becoming more aligned to shareholders' interests.

Item 4	Grant of performance rights to the chief executive officer
ASA Vote	**For**

Summary of ASA Position

IFL is seeking shareholder approval for CEO Renato Mota to participate in the EEP through the grant of performance rights to the value of $1.2m for FY21. If approved, he will be granted 276,081 rights, based on the volume weighted average price (VWAP) at which the company's shares traded in the 20 days up to the commencement period.

The EEP is based on (relative) total shareholder return (rTSR) representing 40% of the grant and financial and non-financial measures representing the other 60%. As noted in the remuneration item 3, IFL has introduced 50% of the measures as being non-financial, in-line with APRA's recommendations post the Hayne Royal Commission.

The rTSR is measured against the ASX200 (excluding mining/resources). Above the 75th percentile 100% performance rights will vest; progressive vesting between the median 50th and 75th percentiles; and no vesting below the median.

Considering the CEO's remuneration sits about the medium to lower end median of similar sized financial companies, we propose to vote for this resolution. The ASA's concerns regarding IFL's remuneration scheme have been clearly expressed in item 3.

Item 5	Financial assistance
ASA Vote	**For**

Summary of ASA Position

This resolution seeks to approve the giving of financial assistance pursuant to the Corporations Act by the MLC Wealth Entities that will as part of the acquisition of National Australia Bank Ltd's wealth management business become subsidiaries of IFL.