Australian Shareholders' Association

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Defying retail gravity

Company/ASX Code	JB Hi-Fi/ JBH
AGM date	Thursday 24 October 2019
Time and location	Computershare Yarra Falls, 452 Johnston Street Abbotsford Vic
Registry	Computershare
Webcast	No
Poll or show of hands	Poll on all items
Monitor	Mike Robey assisted by Brian Chapman
Pre AGM Meeting?	Yes, with Chair Greg Richards, CFO Nick Wells and IR Doug Smith

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

Summary of ASA Position

JB Hi-Fi continues to defy the “online is the only future” pundits and in 2019 maintained steady growth in all major financial measures of between 3.5 and 7.6%. Many analysts had written down bricks and mortar retail, given the continuing decline in performance of the older premium Emporium businesses Myer and DJs with the consequence that JB is one of the most heavily shorted stocks on the ASX200 (12.5% at last count). Despite this, the company continues the boring business of moving boxes as efficiently and effectively as it can, in both the consumer discount electronics stores (JB Hi-Fi) and whitegoods (The Good Guys). They have a clear operational excellence focus and claimed competitive advantage in the cost of doing business (CODB) which they benchmark regularly. They also believe they match delivery time promises of Amazon in Australia. The much anticipated decimation of traditional retail in Australia that was expected after the entry of the US behemoth Amazon has not yet occurred. JB are fully aware of the risks this disruptor invokes and have continued to grow the online and online to offline business offers, though online accounts for only about 5.5% of sales. Sales, earnings before interest and tax (EBIT) and net profit after tax (NPAT) have nearly doubled over 5 years, in the time when those drinking the online Kool-aid were predicting rapid decline. Consequently, the share price has moved up about 50% since the calendar year start and recent updates seem to point to more of the same.

One aspect of business that the Board stresses is that although they do long-term planning, much of the business of box moving retailers is about being nimble enough to turn over product categories quickly and not be caught in a cost trap. They make few big bets on products (but many smaller ones) and are subject to suppliers which are non-exclusive and willing to stimulate their competitors in order to push more through the channel. Hence their focus is on cost leadership through operational excellence.

Governance and culture

As well as the culture of competitive advantage through operational excellence mentioned above which measures and constantly reduces the cost of doing every aspect of their business, JB has attracted product savvy young store staff, allowed them to dress as they wish (within reason) and modestly supported many of their social causes. For some time, this has been part of their discount store value proposition; namely a knowledgeable casually dressed service person who is a lot like their customer, in contrast to the runway model of traditional Emporia. They have a program to improve gender diversity across all levels in the business, since their current profile demonstrates a rapid drop in the percentage of women, the more senior the role. They report on this yearly but seem stalled in outcomes. One of the non-financial hurdles to the new CEO incentive scheme is in fact diversity. The Board culture is one of no-nonsense with strong retail credentials, and at 29% female effectively meets the ASA gender diversity guideline.

Even the annual report is refreshing free of padding and is concisely laid out. There are no fancy graphics, no pictures of happy staff or directors and it has a down to business feel about it, in a year they deservedly could have trumpeted their success.

Financial performance including dividends and shareholder returns

Sales grew 3.5% to $7.1b, EBIT 6.4% to $372.8m, and NPAT 7.1% to $249.8m. The fully franked dividend of $1.42 grew 7.6%. The business has now nearly $3b in market capital.

Key events such as restructures, acquisitions, buy backs and capital raisings

JB consolidated its headquarters during the year to Southbank, near the financial centre of Melbourne, by combining the separate JB and The Good Guys (TGG) offices on opposite ends of suburban Melbourne. This was one of the final stages of integration of the recently (2016) acquired TGG business and was managed at no incremental cost.

Key Board or senior management changes

There were no board changes this year

ASA focus issues

The board has put in place a minimum shareholding requirement which requires the CEO to hold 1.5 times fixed pay in shares, Key management personnel (KMP) to hold 1.0 times and board members to hold 1.0 times base Board fees, all within 5 years, so they meet the ASA guidelines of "**skin in the game**". Part of the reasoning for the change to the new variable reward plan (VRP) structure (explained below) is to build more skin in the game.

Gender Diversity at board level effectively meets the ASA guideline (29% vs 30% target).

Remuneration structure does not comply with the ASA guidelines and will be discussed below.

Shareholder participation. There were no capital raisings this year

Summary

(As at FYE)	2019	2018	2017	2016	2015
NPAT ($m)	250	233	172	152	136
UPAT ($m)	250	233	208	152	136
Share price ($)	25.85	22.52	23.71	23.81	19.24
Dividend (cents)	142	132	118	100	90
TSR (%)	21.7	1.5	2.1	29.3	11.9
EPS (cents)	217.4	203	154	154	138
CEO total remuneration, actual ($m)	2.627	3.361	3.055	3.071	

For 2019 the CEO's total actual remuneration was **52 times** the Australian Full time Adult Average Weekly Total Earnings of $88,150 (based on May 2019 data from the Australian Bureau of Statistics).

Item 2	**Adoption of Remuneration Report**
ASA Vote	**Against**

Summary of ASA Position

JBH modified its remuneration structure this year by ceasing their former fixed annual remuneration/short-term incentive/long-term incentive (FAR/STI/LTI) model and starting a new VRP which works as follows:

1. The CEO target maximum reward is 33% fixed and 67% variable
2. Variable award is paid as cash 25% in year one (Y1) and 25% restricted shares released in each of years 2 to 4, calculated by volume weighted average price (VWAP) at date of issue. This is tested only once at the end of Y1. The financial hurdle is a (challenging) earnings per share (EPS) growth.
3. The amount awarded is discounted by 20% to the former LTI opportunity under the previous structure to partially compensate for the single test.
4. Shares will be forfeited for bad leavers and are subject to clawback for misdemeanours.
5. There are minimum shareholdings required of all executives, encouraging retention of substantial shareholdings and thus aligned with shareholder interests.

This does not comply with ASA guidelines, however the quantum of payments in what was a successful business year is no more than under the former conventional STI/LTI structure, so it is evident that the structure did not have the purpose of simply providing a high variable component to the executive. The board argues that due to the current business of retail, the former more conventional plan delivered either 'all or nothing' outcomes and did not align well with shareholder interests. In addition, the volatile nature of retail makes most financial performance measures very difficult to set fairly in the long term, particularly given the high rate of shorting of this stock. The argument for the progressive issue of restricted shares is that simple share price gains are what all the executives strive for, for that quantum of shares they have been awarded in Y1. They claim the executives are thus better aligned with shareholders. If the business declines everyone sees quite clearly exactly how much they are losing with each fall in share price. Psychologically it is also simple, since it is well known that most investors have a greater fear of crystallising a loss than missing out on a gain, so perhaps the JB executives will feel more motivated to keep the share price up!

This type of combined plan has been one of the more popular of the controversial combined plans which are under cautious observation by analysts. The criticism is that it removes the long-term focus of executives and may not be fit for purpose. JB's counter is that it is easier and more relevant to their very volatile business, in difficult trading conditions, where a significant element of the market effectively betting against them by shorting their stock.

On the fixed remuneration, recent benchmarking led the board to increase the FAR between 3 and 8.4%, with the (young) CFO receiving a 16.6% pay rise. A check with the Industry benchmarks for similar sized companies confirmed that all outcomes were in the band of peer companies. The Board remuneration was similarly in keeping with similar sized and similarly complex companies.

Whilst we empathise with the Board's frustration with conventional STI and LTI structures, we believe there should be long term financial measures attached to any remuneration structure and therefore cannot endorse this VRP. We will offer support in reviewing any changes in the coming year.

	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.349	40%	1.349	33%
VRP - Cash	0.535	16%	0.685	17%
VRP Shares	1.510	44%	2.054	50%
Total	3.394	100.0%	4.088	100%

The incentive scheme has a single combined structure, called a VRP which is a four-year plan with a single test period after the first year. The financial hurdle is EPS and constitutes 75%. The balancing 25% has strategic measures which include diversity, safety, strategic initiatives and Investor relations. The VRP is paid in cash 25% for Y1 and restricted shares in equal components in Years 2 to 4.

Item 3a	**Re-election of Greg Richards as a Director**
ASA Vote	**For**

Summary of ASA Position

Greg has been a Director since 2007 and Chairman since 2012, and has overseen steady growth in profit, EPS and pretty well every other financial measure in the business every year since taking the chair, to make a simple discounter one of the strongest retail stocks on the ASX. He holds no other Directorships. Even though he is deemed by the ASA to no longer be independent in this coming term, he, along with the Group CEO Richard Murray are a team that other retailers no doubt envy.

Item 3b	**Re-election of Mark Powell as a Director**
ASA Vote	**For**

Summary of ASA Position

Mark, appointed in 2017, is a globally very experienced retail executive who came to the group through the Good Guys acquisition. He is also a director of the Kiwi Property Group and his experience is well aligned with the needs of a cross Tasman group.

Item 4	**Approval of LTI grant to CEO/Managing Director First Name Surname**
ASA Vote	**For**

Summary of ASA Position

The approval is sought for the issuing of 51,723 restricted shares, amounting to $1.6m computed at the VWAP for the 5 trading days prior to the issue of the 2019 results. This is the first of the VRP payments. This amounts to 76.5% of the maximum available, largely owing to the EPS growth (75% of the reward) of 7.1%. Interestingly, even the 25% of the reward allocated to strategic initiatives only achieved a score of 76%, confirming that the targets are challenging.

The individuals (or their associates) involved in the preparation of this voting intention have no shareholding in this company.