



Lendlease pivots to investments to reduce volatility in earnings

Company/ASX Code	Lendlease Group/LLC
AGM date	Friday, 18 November 2022
Time and location	10am AEDT, Wesley Conference Centre, 220 Pitt Street Sydney
Registry	Boardroom
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Lewis Gomes assisted by Peter Gregory
Pre AGM Meeting?	Yes with Chairman Michael Ullmer, Chairman People & Culture Committee Elizabeth Proust, Company Secretary Wendy Lee

Monitor Shareholding: The individuals (or their associates) involved in the preparation of this voting intention have shareholdings in this company.

Summary of issues

Lendlease (LLC) has had a difficult 3 to 4 years, beginning with its ill-fated acquisition of the former Baulderstone Abi Engineering Group from German constructor Bilfinger Berger at an initial investment of about \$1 billion to form Lendlease Engineering (LLE). Significant project losses and writedowns soon followed and eventually LLC sold the engineering division to Spanish group Acciona and the services division to a grouping of similar businesses. However, claims from Acciona and ongoing liabilities on past projects have continued to impact on LLC’s financial results. It is thought that total losses from this venture have cost LLC shareholders some \$2 billion to \$3 billion. FY22 saw further writedowns and provisions which are described later.

LLC now runs the company through 3 main business lines, Investments, Development and Construction. Development has traditionally been a strong source of revenue and operating margin but the returns have been quite lumpy and subject to delays in planning approvals, construction issues and, in recent years, all of the problems arising from COVID restrictions and supply chain costs. LLC has also realised that in some cases it was booking profits ahead of actual progress so that the overall impact was to reduce the attractiveness of Development.

Consequently, LLC has now turned its attention to its Investments business by bringing in capital partners such as super funds and other passive investors as joint venture partners at the commencement of development projects, instead of when the project is completed. This enables LLC to take full management control and earn a management fee which can extend beyond the duration of construction into operation and maintenance. LLC is looking ultimately to take minority equity in these projects, typically around 25%, but securing ongoing management fees while considerably de-risking its exposure to things going wrong. LLC is now also partnering with investors to purchase buildings and developments being undertaken by third parties, a recent example being a City of London office tower to be fully leased to Deutsche Bank wherein LLC has teamed with NSW Treasury Corporation (TCorp) as foundation investors at a buy-in cost of GBP809 million.

The pivot towards Investments is being led by LLC's new CEO, Anthony (Tony) Lombardo who took over from Steve McCann in May 2021. Tony was member of Steve McCann's executive team and knows the business well. Not surprisingly, there have been quite a few departures since Tony took the top job as he restructured the business and sought to cut internal costs which had become excessive.

Proposed Voting Summary

Item No.	Resolution description	Voting Intention
2a	Election of Nicholas Roland Collishaw as Independent Non-executive Director	For
2b	Re-election of David Paul Craig as Independent Non-executive Director	For
2c	Re-election of Nicola Wakefield Evans as Independent Non-executive Director	For
3	Remuneration Report	For
4	Approval of allocation of performance rights to the MD	For

Item 1: Consideration of Financial Reports - No vote required

Financial Performance

LLC reported a Statutory Loss after Tax of \$99 million which comprised a core operating profit of \$276 million, a loss on non-operating items of \$333 million and a non-core loss of \$42 million. The core operating profit of \$276 million was down from \$377 million in the prior year with lower Development earnings. Reductions in annualised overhead costs of \$170 million were achieved but restructuring costs associated with these changes were \$342 million after tax. An impairment of intangibles relating to its digital investments incurred another loss of \$55 million after tax. LLC managed to make a full year distribution to security holders of 16 cents per security, well down on the 27 cents for FY21 and 33 cents for FY20.

Respective EBITDA contributions from the three operating businesses were \$497 million from Investments (up 80% on FY21), \$181 million from Development (down 61%) and \$131 million from Construction (down 24%). Overall core operating profit was down 27% from FY21. LLC is well capitalised with gearing at 7.3%, interest cover of 5.6 average cost of debt 3.6%.

One bright note is that second half earnings were substantially better than first half earnings. Core profit in H2 was \$248 million compared with \$28 million in H1 while Development commencements were \$4.4 billion in H2 compared with \$1.5 billion in H1. LLC believes it is on track to achieve its stated aim of \$8 billion of completions per annum by 2024. It has formed approximately \$11 billion of partnerships to drive growth in funds under management and has record work-progress of \$18.4 billion.

Key Events

As summarised above, the key events for LLC were the departure of the former CEO and elevation of Tony Lombardo to the CEO/MD roles, the significant restructuring of the business with associated costs and savings, and the pivot from Development to Investments. The intention of these changes is to derisk the business by bringing in capital partners and to provide a more durable source of revenue through management fees.

Key Board or Senior Management Changes

The appointment of a new CEO after the departure of the former CEO and subsequent changes made by the new CEO were the key changes made in FY22. Of particular note was the departure of Denis Hickey, formerly head of LLC's USA operations after receiving a \$5 million Bespoke Incentive award for his role in securing and developing the successful Google Development Venture in the USA. Following the appointment of Tony Lombardo as the new CEO, Denis's role became redundant and he was released from LLC but retains his awards which have performance period and vesting obligations. There were no changes at the board level.

ASA Focus Issues

LLC has a well-established corporate culture and governance framework. It has an experienced board of 9 members with a 10th member to join the board in December 2022, comprising 6 men and 3 (soon to be 4) women. It will have a female percentage of directors of 40% from December, meeting established good practice but amongst its executive ranks, the percentage of females is low, probably because the industry has historically been a rather male-dominated one. It is noted, for example, that of the 7 listed KMP's in the Annual Report, all are male. LLC does claim to have 32% of women in its "leadership" ranks, although it is unclear how widespread this cohort is. A skills matrix is presented with each director's skills being recorded, albeit on a rather self-assessed basis.

The annual report contains a lot of detail on the company's policies covering sustainability, health and safety, first nations matters, climate change issues and risk management.

Outlook

The key issue going forward for LLC is whether it can make the transition to a focus on Investments as the primary source of recurring profits and an avoidance of the losses and further writedowns that have impacted the company in recent years. The company has taken significant steps towards that objective but it may be several years before the fruits of this reset become clear.

Summary of Performance (as at FYE)

Item	2022	2021	2020	2019	2018
NPAT (\$m)	(99)	222	(310)	467	793
UPAT (\$m)	276	377	206	632	708
Share price (\$) 30 June	9.11	11.50	12.37	13.00	19.74
Dividend (cents)	16	27	33	42	69
Simple TSR (%)	(19)	(6)	(2)	(33)	24
EPS (cents) statutory	(14.4)	32.5	(51.8)	80	137
CEO total remuneration, actual (\$m)	3.32	4.14*	3.61	6.55	7.98

*For 11 months as the CEO left on 31 May 2021 and includes termination payments of \$1.9 million

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

Item 2a: Election of Nicholas Roland Collishaw as Independent Non-executive Director

Nick Collishaw joined the board in December 2021 and is a member of the audit, nomination, people & culture and risk committees. He has considerable experience as a property executive, having held CEO roles with Mirvac and Centuria, and senior leadership roles with several other property companies. He is currently a non-executive director of Centuria Capital Group.

The ASA strongly supports the addition of property expertise to the board, which previously has been lacking. The ASA will therefore vote all undirected proxies in favour of the election of Nicholas Collishaw.

Item 2b: Re-election of David Paul Craig as Independent Non-executive Director

David Craig joined the board in March 2016 and is chairman of the audit committee and a member of the nomination, people & culture and risk committees. He has had a 40 year career covering finance, accounting, mergers & acquisitions in the banking, property and professional services industries. He has been the CFO of the Commonwealth Bank, Australand Property and accounting firm PwC. He has no other non-executive director roles with other listed companies

The ASA considers that he has been an effective director of LLC and will therefore vote all undirected proxies in favour of the re-election of David Craig.

Item 2c: Re-election of Nicola Wakefield Evans as Independent Non-executive Director

Nicola Wakefield Evans joined the board in September 2013 and is chairman of the sustainability committee and a member of the audit, nomination and risk committees. She has had a diverse career as a corporate finance lawyer including international experience in New York and Hong Kong. She is a non-executive director of Macquarie Group and Viva Energy.

The ASA considers that she has been an effective director of LLC and will therefore vote all undirected proxies in favour of the re-election of Nicola Wakefield Evans.

Item 3: Remuneration Report

The remuneration report (pages 78 to 103 of the Annual Report) is generally comprehensive and well set out. Following the departure of the former CEO, and shareholder feedback on its remuneration framework, the board made a number of significant changes, for example:

- The quantum of remuneration for the new CEO was lowered
- The remuneration mix was rebalanced to place greater weight on long term performance
- Implemented Short Term Award (STA) deferral for the 50% share award over two years
- Removed the restricted securities plan
- Reduced the number of KPI's in the STA
- Increased the financial component of the STA from 50% to 65%
- Simplified the Long Term Award (LTA) to a maximum opportunity
- The LTA was restructured into 3 components being relative TSR (rTSR), return on equity (ROE) and growth of funds under management(FUM) with a 3 year testing period and released in 4 equal tranches at the end of years 3,4, 5 and 6.

In assessing the STA outcome, the board exercised its discretion in reducing the scorecard amount from 72% to 48% of maximum opportunity to better align with shareholder experience. There was no vesting of LTA given that the FY20 performance hurdles (then TSR and ROE) were not met. The LTA has not vested since 2016.

The ASA considers the new remuneration framework to be a considerable improvement on the former plan, particularly with the removal of the restricted share rights which were untested and vested subject only to continuing employment, that is, essentially deferred pay. The ASA will therefore vote all undirected proxies in favour of this resolution.

Item 4: Approval of Allocation of Performance Rights to Managing Director

Under Listing Rule 10.14, shareholder approval is required for the issue of securities to any director under an employee incentive scheme. While shareholder approval is not required if shares are purchased on market, LLC wishes to seek shareholder approval for transparency and good governance.

The proposed maximum opportunity LTA for the CEO for FY23 is 178% of fixed remuneration (FR) being \$3.2 million which converts to 314,928 performance rights based on the 20 day VWAP at 30 June 2022 of \$10.16. These rights will be spread equally across the 3 LTA metrics described above. The ASA considers the quantum and structure of the rights to be reasonable and will therefore vote all undirected proxies in favour of the equity grants to Managing Director and Chief Executive Officer Anthony Lombardo.

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Appendix 1

CEO remuneration framework detail for FY22

Remuneration Component	Target* \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.80	26%	1.80	24%
STI - Cash	0.90	13%	1.25	17%
STI - Equity	0.90	13%	1.25	17%
LTI	3.20	48%	3.20	42%
Total	6.80	100%	7.50	100%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan. The number of share rights is calculated at face value based on the 30-day VWAP at financial year end.

*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. Further details are provided in the Annual Report and Notice of Meeting.

Lendlease Remuneration Summary								
	FY22 CEO remuneration Plan						Actual FY22	
	Threshold		Target		Maximum		\$m	% of Total
CEO rem. Framework for FY22	\$m	% of Total	\$m	% of Total	\$m	% of Total		
Fixed Remuneration	1.8		1.8	26%	1.8	24%	1.8	60%
STI - Cash			.9	13%	1.24	17%	0.6	20%
STI - Equity			.9	13%	1.24	17%	0.6	20%
Total STI	**		1.8	26%	2.48	33%	1.2	40%
LTI	.43		3.23	47%	3.23	43%		0%
Total			6.82	100%	7.5	100%	3.0	100%

STI achievement

% of target	% of maximum
67%	48%

The LLC disclosure with its Remuneration Plan meets the requirements, is well explained and is clear. This is summarised in the table above. However, it is felt that there is an opportunity to give shareholders a greater understanding by ** including the amount to be paid at the threshold for STI.

It is noted that the STI threshold is the prior year performance, target is the LLC budgeted result and maximum represents exceptional over performance.

With the LTI:

- for the ROE and FUM measures there is zero payment at the threshold level
- for rTSR at the threshold level the payment of 40% (\$.43m) commences
- Each of these metrics is paid as a straight line from threshold to maximum according to achievement of the predetermined target.