Australian Shareholders' Association

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Minimising risks, building on utilities growth base with blue chip clients

Company/ASX Code	Service Stream Ltd (SSM)
AGM date	21 October 2020
Time and location	10am, Virtual
Registry	Computershare
Webcast	Virtual
Poll or show of hands	Poll on all items
Monitor	Alan Hardcastle assisted by Christine Haydon
Pre AGM Meeting?	Yes, with chair Brett Gallagher

Please note any potential conflict as follows: Christine Haydon, who was involved in the preparation of this voting intention, has a shareholding in this company.

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

Summary of ASA Position

This is the first year ASA has monitored Service Stream Ltd (SSM), an ASX200 company. An initial proxy vote was conducted at the company's 2019 annual general meeting and a report of that meeting is on the ASA website. First listed in late 2004, SSM has undergone significant growth through organic initiatives and acquisitions. This financial year has seen inclusion of the full year's figures of recently acquired Comdain Infrastructure. Today, SSM has a market capitalisation of some $740m. The most preferred expansion path, organic growth remains a key focus for the business with the board revealing there is a strong and growing pipeline. Management will continue to assess merger and acquisition opportunities that support an expansion of the SSM's service offerings and open up its addressable market.

Governance and culture

SSM operates with a workforce of more than 5,200 comprising some 2,200 employees and 3,000 subcontractors. The company emphasises that it has rigorous subcontractor engagement processes to minimise risks of triggering industrial relations activity. SSM publishes a skills matrix of its board and the company states it's intent on attracting and retaining 'top gender diverse talent'.

Financial performance

On the back of revenue up 9% to $929.1m, the company's earnings before interest tax depreciation amortisation (EBITDA) jumped 17.9% to $105.6m although NPAT was marginally lower by 1.1% at $49.3m, due to a one off change to accounting standard (AASB 16 Leases).

Dividend was steady at 9cps equating to a payout ratio of 74% based on statutory earnings per share (EPS) - down 7.4% at 12.13c. SSM's utilities division is proving to be the growth driver with revenue up $45.3% to $384.1m while the telecommunications division recorded a 7.7% lower revenue at $544.2m. More than 84% of the company's business is annuity style work programs, thus reducing risk.

Key events

Deemed an 'essential service', SSM has been relatively unaffected by COVID-19 but sensibly the company has been careful not to deliver any forecasts regarding its clients' activities. The SSM business has remained resilient to COVID-19's impacts. The company and its subcontractors do not procure significant materials in order to complete works and services - they are provided by clients on a 'free issue' basis. Some projects have been delayed due to clients encountering shortages of their free-issue materials.

Key Board or senior management changes

In response to the ASA's position on gender diversity, SSM's chair has signaled the company's intent to achieve a target of at least 30% women on the board and "is a key consideration as the board executes its succession plan in FY21." Pleasingly, the company does present a comprehensive board skills matrix in its governance statement.

ASA focus issue

Responding to the ASA's questions regarding the ASIC Info Sheet 245 on 'board oversight and discretion in executive variable pay schemes', the company explained its audit & risk committee receives audit (internal and external) reports on all aspects of the business, including matters relating to health, safety and environment (HSE) processes and systems, payroll, accounts payable etc. The remuneration and nomination committee is chaired by one of its independent non-executive directors who is not the board chair. External input is sought on the setting/benchmarking of executive and board remuneration. Chair of the remuneration and nomination committee reviews all minutes taken during a meeting. Additionally, all minutes are independently reviewed by each committee member in attendance.

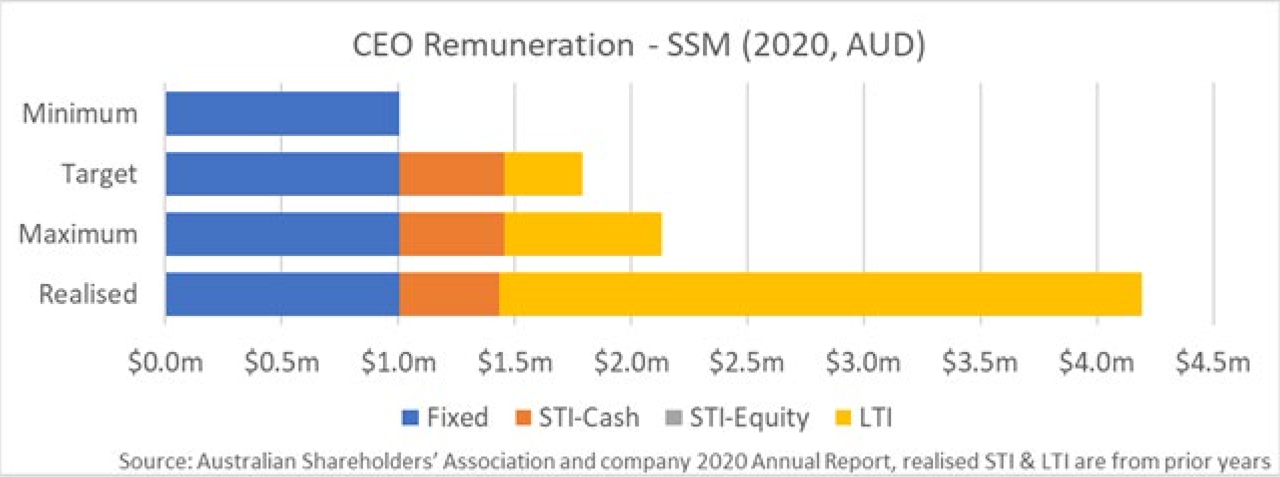
Summary

(As at FYE)	**2020**	**2019**	**2018**	**2017**	**2016**
NPAT ($m)	49.3	49.9	41.1	28.4	20.0
UPAT ($m)	58.8	57.7	41.5	29.1	20.0
Share price ($)	1.905	2.81	1.51	1.32	0.785
Dividend (cents)	9.0	9.0	7.5	4.5	2.5
TSR (%)	-29%	92%	20%	74%	175%
EPS (cents)	12.13	13.09	11.29	7.78	5.2
CEO total remuneration, **statutory** ($m)	1.607	2.105	1.869	1.358	0.819

For 2020, the CEO's total statutory remuneration was **18 times** the Australian full time adult average weekly total earnings (based on August 2020 data from the Australian Bureau of Statistics).

Resolution 1	Adoption of Remuneration Report
ASA Vote	**Against**

Summary of ASA Position



**significant realised remuneration due to vesting of generous share grant under discontinued ESBIP scheme*

A remuneration scheme, introduced in 2014 with a five-year lifetime, has this year been replaced with a new scheme. It comprises fixed salary, short term incentives (STIs) and long term incentives (LTIs). The LTI program, previously known as the executive share-based incentive plan (ESBIP) is now known as the employee share ownership plan (ESOP). On a number of fronts, SSM's remuneration scheme fails to comply with ASA guidelines and, in general, is not transparent and for retail shareholders is difficult to understand. This is disappointing for a new scheme which should clearly be demonstrating that senior executives' remuneration is aligned with shareholders' interests.

Instead of using earnings per share (EPS), SSM uses adjusted EPS for the LTI, made more unpalatable when it makes up some 80% of the total FY20 tranche LTI performance rights. (FY18 and FY19 tranches 50% of LTI rights). EPS targets, set by the board, are not disclosed. 20% of performance rights granted for the FY20 tranche (50% for FY18 and FY19) are predicated on relative total shareholder return (TSR) using the ASX 200 Industrials index peer group. Presumably vesting can occur even if SSM's actual TSR is negative. Rather than the ASA's preferred four years, LTI performance rights have three year performance hurdles.

Payment of the short term incentive plan (STIP) is subject to an achievement of at least 90% of the group's EBITDA target, being 50% of the performance, regardless of personal performance. The group's EBITDA target is not disclosed. If that criteria is satisfied then the other 50% is individual performance, half of which is a KPI financial goal. The ASA would like to see at least 50% of the STIP paid in equity, whereas SSM will pay it as 100% cash.

The ASA believes it vital that SSM presents a realised/actual remuneration summary clearly setting out fixed, STI and LTI amounts for the CEO and KMPs. Based on the number of non-transparent and 'adjustable' guidelines with which the ASA has issues, we vote against this resolution.

Resolution 2	**Re-election of Peter Dempsey as a Director**
ASA Vote	**For**

Summary of ASA Position

Peter Dempsey has been on the Board for 10 years and so, with his re-election for another term, he will have served 13 years when he next comes up for re-election. He would thus not be recognised by the ASA as an independent director. Initially chair from November 2010 to February 2015, Peter Dempsey then moved to a non-executive director role in March 2015. Possessing a wealth of construction and development experience, he spent 30 years with Baulderstone including five years as managing director. Peter Dempsey is very invested in SSM, holding more than 1m shares, and he holds only one other public company board position. There is a board succession plan slated for FY21; the ASA believes the company is committed to diversification; and it applies a published skills set matrix. We support Peter Dempsey's re-election.

Resolution 3	**Approval of LTI grant to CEO Leigh Mackender**
ASA Vote	**Against**

Summary of ASA Position

Shareholders are asked to approve a FY21 Tranche, under the ESOP, of 361,879 shares being 75% of Leigh Mackender's fixed remuneration at $1.8667 per share. 50% of shares will vest when adjusted EPS for FY21, FY22 and FY23 targets are met. 50% to vest when TSR ranks in the top quartile of relevant peer companies (ASX200 Industrials). Regarding EPS, 0% vest if below the previous year's adjusted EPS; 40% vest at the previous year's adjusted EPS; and then are proportional up to 100% for 100% and above.

SSM says any shareholder concerns that EPS targets are not disclosed and maybe insufficiently challenging are addressed. 'EPS targets set directly relate to each year's corporate budget which is approved only by the board after rigorous review to ensure they contain sufficient stretch,' states the company. However, based on the ASA's assessment of the company's remuneration scheme (see Resolution 1) we vote against the approval of LTI grants to the CEO.