



Sydney Airport materially impacted by COVID-19

Company/ASX Code	Sydney Airport Limited/ SYD
AGM date	22 May 2020
Time and location	Virtual
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Julieanne Mills and Carol Limmer
Pre AGM-Meeting?	Yes, Video conference with Chairman: Trevor Gerber, GM Safety Sustainability and Environment: Jane Rotsey, and GM Investor Relations and Financial Control: Belinda Shaw.

An individual involved in the preparation of this voting intention has a shareholding in this company.

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

Summary of ASA Position

If you were only looking at the 2019 Annual Report one could believe that Sydney Airport is a safe and consistent income stream for retail shareholders. How things have changed with the current pandemic!

While Sydney Airport is not alone, it really does stand at the fore front of this COVID crisis and will certainly feel the pain of this period of isolation and travel restrictions possibly well into the future.

This is a highly geared company with \$10bn of interest bearing liabilities. \$1.3bn of debt is maturing in 2020.

Sydney Airport has \$430M in cash \$1.75bn in undrawn bank facilities and a new \$600M USPP bond market debt funded in June 20. While the availability of \$2.8bn of liquidity covers the debt maturing in the next 12 months it certainly does not look good for dividends in the short and medium term.

Ultimately will our travel behaviours change, how long will it take to get back to a positive cash flow, and when will the company be able to pay its considerable interest payments on debt, and dividends, out of cash flow again?

Governance and culture

Sydney Airport has two Directors that have been on the board since the airport was sold to Macquarie in 2002 the Chairman, Trevor Gerber, and John Roberts. Trevor Gerber has been

Chairman of Sydney Airport for 5 years. He is also a Director of Tassal and Chairman of Vicinity. The ASA is concerned about the independence of the board and its level of diversity. While there have been some changes over the past couple of years, it is considered that renewal is necessary to reinvigorate and diversify thinking and risk. A Board Skills Matrix is included in the Annual Report and they have now included the number of directors with those skills.

It is pleasing to see that there is now a policy for directors to have 1 year's base fees (Net) worth of shares over 3 years starting 2019 -2021. Current Directors fees start at \$175k for a member and \$481k for the Chair. There are additional committee fees. There were no share purchases by Directors in 2019. While Mr Gerber, Mr Roberts, Mr Gonski and Ms Sherry have a reasonable holding, Grant Fenn has no shareholding. The ASA likes to see Directors with "skin in the game" It is good to see Ms Sherry has recently bought shares.

Financial performance

Sydney Airport revenue in 2019 was \$1.6bn, made up of Aeronautical Revenue \$740m, Retail \$375m, Property and car rental \$251m, Parking and ground transport \$162m. Operating expenses not including recoverable security was around \$205m. Net finance costs in 2019 were \$420m and CAPEX \$385m

It has \$195m of Capital expenditure commitments over the next 4 years.

Contractual cash flows for 2020 were \$1.89bn including \$820m of CIBs Capital Indexed Bonds due within the year. Commitments over the next 5 years of \$5bn

An announcement on the 20th April shows a significant impact to revenue with dividends for the first half cut, an additional \$850 m of bank debt facility put in place, and cost cutting measures including a 20% cut to CEO and Director's fixed pay for 3 months. Capex has been reduced to \$150-200m. The company is utilizing these quiet times to continue with reduced building works.

More than 50% of revenue comes from aeronautical contracts with Qantas and Virgin contributing 40-50% of that. Qantas is currently refusing to pay its landing fees and Virgin is in voluntary administration, airlines around the world are struggling and IATA is predicting a fall of 97% in International travel. This aligns with the early April figures of passenger numbers which are down 97%.

Retail outlets have been closed since mid-March with only a few food retailers open and very low passenger numbers. Retailers will be feeling the pain. Rental leases will be under pressure.

Ultimately Sydney Airport is a landlord to airlines, retailers, hotels and parking lots in a time when International travel is looking very precarious, domestic travel limited and government restrictions on travel and landlords.

Another business update is expected prior to the AGM around the 20th May.

Key events

COVID-19 certainly presents challenges to airport passenger numbers, retail revenue, airline landing fees revenues (PAX) While the company has been proactive in organising capital and that is to be commended, there is still a chance that a capital raising could occur later in the year if these conditions persist.

While the company expects to be compliant with its covenant requirements, there is some concern over the possibility of breaching debt covenants in a worse case scenario. Transparency around those debt covenants would be helpful.

Key Board or senior management changes

The new 2018 CEO, Geoff Culbert seems to have stepped up to the job, with continued growth in 2019 under the difficult circumstances of global uncertainty and bushfires. He embraced ESG issues and negotiated a sustainability loan that will potentially reduce costs. 2020 however, will certainly test his mettle.

The Board believes it has planned for a range of potential contingencies and has access to sufficient funds to ride out this storm. However, there is significant debt attached to this company at relatively high interest rates and there is limited income in the immediate future with the possibility for this situation being extended well beyond a 12 month time frame.

The CEO was quoted as saying in February “that this would be a short term issue”. It does make you question his perception of potential risk in these times. Geoff Culbert has 178,609 shares

ASA focus issue (not discussed under remuneration report or re-election of directors)– i.e. shareholder participation (if relevant)

The Annual Report is clear and concise once you get past the repetitive marketing spin.

Summary

(As at FYE)	2019	2018	2017	2016	2015
NPAT (\$m)	215	371	348.6	319.6	281.1
NOR (\$m) Net Operating Receipts	905.7	860.9	787.3	675	577.8
Share price (\$) at year end	8.66	6.73	7.05	5.99	6.35
Dividend (cents)	39	37.5	34.5	31	25.5
TSR (%)	34.7	0.6	23	-1.1	41
Cash flow per stapled security (cents)	40.1	38.2	35	30.2	26
CEO total remuneration, actual (\$m)	3.388**	4.792*	4.818	3.325	3.852

*Includes \$1.7m one off payment for incentives forgone at previous employer.

**The CEO received other payments of \$339k for incentives forgone

- For 2019, the CEO’s total actual remuneration was **37.8 times** the Australian Full time Adult Average Weekly Total Earnings (based on Nov 2019 data from the Australian Bureau of Statistics).
- Net operating receipts are a proxy for cash flows available to pay SYD distributions and reflects a sustainable return whilst still investing in infrastructure.

Item 2	Adoption of Remuneration Report
ASA Vote	Against

Summary of ASA Position

	Target \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	\$1.5m	33%	\$1.5m	29%
STI - Cash	\$1.2m	26.4%	\$1.8m	33.6%
STI – deferred cash (20%)	\$300k	6.6%	\$450K	8.4%
LTI	\$1.5m	33%	\$1.5m	29%
Total	\$4.5m	100%	\$5.25m	100%

The STI is measured: 50% Financial, 30% strategic, and 20% culture. Financial measures are shared across all KMP with expectations of meeting budget and some growth.

The STI is all paid in cash with 20% deferred over 2 years. The ASA would prefer to see this in Equity and a 50:50 split. The Max STI of 150% FAR is now reflected in the Annual report.

The LTI is measured on 50% TSR (against comparative ASX 100) with vesting starting at the 50th percentile, and 50% CPS (cash flow per stapled security) with vesting occurring after 6% growth. It is measured over 3 years only.

Maximum opportunity provides an incentive for exceptional performance.

The Board's comments, in the NOM, regarding "reviewing the CEO'S remuneration for 2020 in light of COVID-19" will hopefully not be used to shift the goal posts. The current environment is not conducive to salary increases in fact a reduction in remuneration is more likely to be warranted given the shareholders returns and significant cash flow reduction. A 20% reduction for just 3 months is being applied to CEO pay and directors' fees. ASA would prefer this reduction (if not more) applied for a longer period, especially given the pain being experienced by shareholders e.g. loss of dividend and low share price.

Board committee fees had previously increased in 2019 by 7% and fees sit at the 25th percentile.

Item 3	Re-election of Ann Sherry AO as a Director
ASA Vote	Undecided

Summary of ASA Position

Ann Sherry AO was appointed to the board in 2014. She is Chair of the Nominations and Remuneration Committee She has been a Director of NAB since 2017, she is also a Director of Palladium Group, Infrastructure Victoria, Cape York partnerships, MCA and Chair of UNICEF. She was the CEO and Chair of Carnival Australia up until 2019.

A very heavy workload for a Director under these conditions and while she adds considerable diversity, we felt that this workload could be too much, especially given the impact COVID-19 is having on travel and banks. We would like to hear from her on how she will manage this workload.

Ann Sherry had 22,000 shares in Dec 2019. Ann Sherry purchased another 16,000 shares in March 2020.

Item 4	Re-election of Stephen Ward as a Director
ASA Vote	Undecided

Summary of ASA Position

Stephen Ward LLB was appointed a Director to the Sydney Airport Board in 2011 when the company was part of Macquarie. He is a consultant and an ex-partner of NZ legal firm Simpson and Grierson. He is also a NED of NZX and Restaurant brands New Zealand and sits on the National Provident Fund board. He has a number of other voluntary board roles in NZ.

Stephen is Chair of Safety Security and Sustainability committee.

Stephen Ward has been a Director for 9 years and this election would take him to 12 years. Along with Mr Gerber 18 years and Mr Roberts 18 years. The ASA believes that the board would benefit from further renewal, diversity and more independence. After this tenure the ASA will no longer consider Mr Ward independent. The ASA would like Mr Ward to speak to the meeting about how he will manage his relatively heavy workload across two countries during COVID. We are currently undecided about our re-election vote, and would like our concerns to be addressed at the AGM and will vote accordingly.

Steven Ward has 51,818 shares

Item 5	Approval of CEO Long Term Incentives to Geoff Culbert for 2020
ASA Vote	Against

Summary of ASA Position

The CEO's LTI for 2020 is a maximum of \$1.2M equal to an allocated 134,103 performance rights based on VWAP over 20 days from date of full year results of \$8.95. The LTI's are conditional on achieving sustained growth and long term financial performance and shareholder returns. 50% TSR and 50% CPS where the minimum rights 50% at the 50th percentile and 100% at the 75th percentile. If the TSR is negative the performance condition will not have been achieved

Changes to the LTI plan 2019-2021 have seen the introduction of a new CPS CAGR target of 6-12%, the removal of the discretionary element from the performance-based conditions and is conditional on AGM approval.

The performance period is still 3 years only.

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