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

# Telstra revamps remuneration following first strike

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| **Company/ASX Code** | Telstra Corporation Ltd/TLS |
| **AGM date** | Tuesday 15 October 2019 |
| **Time and location** | 9.30am, Melbourne Room, Level 2, Melbourne Convention and Exhibition Centre, 1 Convention Centre Place, South Wharf, VIC |
| **Registry** | Link Market Services |
| **Webcast** | Yes at Telstra.com/agm |
| **Poll or show of hands** | Poll on all items 3, 4, 5 (and 6 if required) |
| **Monitor** | Sue Shields |
| **Pre-AGM Meeting?** | Yes, with Chair John Mullen, Chair of the Remuneration Committee Peter Hearl and Head of Investor Relations Ross Moffat. |

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| **Item 1 & 2** | **Chairman and CEO presentations and discussion of financial statements and reports** |
| **ASA Vote** | No vote required |

**Summary of ASA Position**

**Financial performance:**

Although results were in line with guidance, Telstra had another testing year in which total income fell by 2.6 per cent to $27.8 billion, earnings before interest taxation depreciation and amortisation (EBITDA) decreased 21.7 per cent to $8.0 billion, underlying EBITDA excluding the recurring in-year headwind of the nbn, fell 11.2 per cent to $7.8 billion and net profit after tax (NPAT) shrank by 39.6 per cent to $2.1 billion.

The main reason for the decline in EBITDA was the impact of the nbn, with Telstra absorbing around $600 million of negative recurring EBITDA in the period.

However, Telstra believes FY19 saw the turning point in the fortunes of the company and says the clearest view of future financial performance is provided by looking at underlying EBITDA excluding the recurring in-year headwind of the nbn, which in the 2020 financial year (FY20) is expected to grow by up to $500m.

The dividend fell again this year to 16 cents per share comprising 10 cents ordinary and 6 cents special. The ordinary dividend represents a 59% payout ratio on FY19 underlying earnings while the special dividend represents a 63% payout ratio of FY19 net one-off nbn receipts. The FY19 ordinary dividend is below the pay-out ratio of 70 to 90% of underlying earnings which is one of the principles of Telstra's capital management framework.

When questioned about this the Chair explained that in determining the FY19 dividend the Board took into account the overall capital management framework including the objectives of maintaining financial strength and flexibility.

**Key events:**

Telstra reported significant progress in the T22 strategy announced just over 12 months ago. It is on track to achieve its $2.5 billion net cost reduction target by FY22 reporting a reduction in underlying costs of $456 million in the year, around 75 per cent of the net 8,000 direct workforce role reductions have been identified and Telstra InfraCo is now a standalone infrastructure business unit within Telstra. Also, the number of Consumer & Small Business fixed and mobile plans were reduced from over 1800 to 20.

**Key board or senior management changes:**

Appointed in 2016 Jane Hemstritch resigned from the Board in January to further develop her philanthropic interests while Eelco Blok was appointed in February. As at 30 June 2019, there were two female directors on the Board, Nora Scheinkestel and Margaret Seale representing a female gender representation of 22 per cent against ASA guidance of 30 per cent. When queried at the pre-AGM meeting, the Chair confirmed that the board is firmly committed to its 40 per cent female diversity objective and advised that two new highly qualified female appointments were pending announcements, one certainly before the AGM.

**Summary**

| As at FYE | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| NPAT ($ billion) | $2.149 | $3.529 | $3.874 | $5.849* | $4.305 |
| UPAT ($ billion) | $2.149 | $3.529 | $3.874 | $3.832 | $4.114 |
| Share price ($) | $3.85 | $2.62 | $4.30 | $5.56 | $6.14 |
| Dividend (cents) | 16 | 22 | 31 | 31 | 30 |
| TSR (%) | 53% | -34% | -17% | 4% | 23.7% |
| EPS (cents) | 18.1 | 30.0 | 32.5 | 47.4* | 34.5 |
| CEO total remuneration, actual ($m) | $4.998 | $3.745 | $5.208 | $6.768 | $4.082 |

*Includes proceeds from Autohome shares

For 2019, the CEO's total actual remuneration was 57 times the Full-time Adult Average Weekly total earnings based on May 2019 data from the Australian Bureau of Statistics.

**Item 3 - Election and Re-election of Directors**

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| **Items 3a** | **Election of Eelco Blok as a director** |
| **ASA Vote** | **For** |

Mr Blok was appointed Non-executive Director in 2019. He has almost 35 years of telecommunications experience at a Dutch-based landline and mobile telecommunications company, KPN, where he was CEO for seven years until April 2018. From 2011 to 2017 he was co-chairman of the Dutch National Cyber Security Council an advisory body of the Dutch government and holds other relevant international Directorships and advisory positions.

He meets ASA workload guidelines and as at 30 June he held 75,000 TLS shares.

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| **Item 3b** | **Re-election of Craig W Dunn as a director** |
| **ASA Vote** | **For** |

Mr Dunn was appointed non-executive director in 2016. The then Telstra chair Catherine Livingstone said Mr Dunn was particularly recognised for his business performance and financial technology expertise across Asia. Chairn-elect John Mullen supported her by adding that his achievements and knowledge of how customers, services and technology come together was totally consistent with Telstra's strategic direction. He is Chair of the Audit & Risk Committee and a member of the Nomination Committee.

This resolution has been subject to special consideration for consistency by ASA as ASA voted against Mr Dunn's re-election as a non-executive director at the 2018 Westpac AGM. A director having a collective corporate responsibility was a factor in this decision particularly following the aftermath of the Banking Royal Commission. Mr Dunn, having joined in 2015, was the only Westpac director seeking re-election with tenure prior to the Commission. ASA noted that Mr Dunn was CEO of AMP from 2008 to 2013, a period commencing after ASIC's imposition of enforceable undertakings in 2004 and 2006, and prior to the board actions associated with the Royal Commission and ASIC reports. During his tenure at AMP there was the emergence of the charging fee-for-no-service.

The Telstra Notice of Meeting and Annual Report resume is transparent about Mr Dunn's background, maintains that he is a highly regarded business leader with more than 20 years' experience in financial services, pan-Asian business activities and strategic advice for government and major companies. The Board recognises the contribution that Mr Dunn can make to Telstra and supports his continuation as a director.

ASA has a guideline which requires consideration of whether a chair or CEO of an ASX200 company has been demonstrably responsible for key decisions which have led to poor performance over a sustained period.  We do not consider that this link has been demonstrated, and supports the importance of the skills he brings to Telstra. However, at the AGM, we will ask Mr Dunn if reflection on his experience at Westpac and AMP will add to his contribution to Telstra governance.

Mr. Dunn meets ASA workload guidelines and as at 30 June he held 73,173 TLS shares.

| **Item 3c** | **Re-election of Nora L Scheinkestel as a director** |
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| **ASA Vote** | **For** |

A director since 2010 Dr Scheinkestel is a member of the Nomination Committee, Remuneration Committee and the Audit & Risk Committee which she has chaired from 2012-2019.

Dr Scheinkestel is an experienced company director with a background as a senior banking executive in international and project financing. When questioned at the pre-AGM meeting about the length of her tenure the Chair advised that her re-election will provide continuity in light of recent changes on the Board and that this will most likely be her final term.

She meets ASA workload guidelines and as at 30 June she held 130,478 TLS shares.

| **Item 4 (a) and (b)** | **Allocation of Equity to the CEO** |
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| **ASA Vote** | **For** |

Introduced and implemented for the 2018 fiscal year, the Executive Variable Remuneration Plan (EVP), was supported by the ASA as it was satisfied it was aligned to shareholder interests. As FY19 was well underway at the time of the “first strike” no change applies to CEO’s EVP outcome for the fiscal year 2019 and it was $5,344,040, 111.8% of target opportunity and 55.9% of maximum. This EVP outcome delivered 372,187 Restricted Shares and 558,281 Performance Rights based on a VWAP of $3.7332. ASA support for this resolution is consistent with the performance exhibited during FY2019. Changes which come into effect for FY20 are discussed under the resolution below.

| **Item 5** | **Adoption of Remuneration Report** |
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| **ASA Vote** | **For** |

ASA supported the Remuneration resolution at the 2018 AGM and although there was opposition from a major proxy advisor we held our ground expressing the view that the remuneration structure was consistent with Telstra’s long term strategy to both reorganise following the impact of nbn, and, to drive a customer oriented culture. Although not wholly in accord with ASA aspirations we determined, on balance, to support the resolution.

A “first strike” was recorded and the Board undertook a comprehensive review of the executive remuneration framework consulting widely with shareholder representatives including the ASA.

Telstra believes the EVP remains the most appropriate mechanism to reward performance but has made the following changes which will come into effect for the FY20:

- Increased weighting of “Financial” to “Strategic” performance metrics from a 50:50 to 60:40 ratio.
- Reduced the CEO’s maximum EVP opportunity from 400% of fixed remuneration to 300%.
- Reduced all group executive’s maximum EVP opportunity from 360% of fixed remuneration to 300%.
- Increased in the proportion of EVP delivered in equity from 35% Cash: 65% Equity (26% Restricted Shares: 39% Performance Rights) to 25% Cash: 75% Equity (35% Restricted Shares: 40% Performance Rights).
- Increased the vesting period of the Restricted Shares from a 2 year (100% “cliff” vesting) to a 4-year period (pro-rata vesting).
- Strengthened the second performance hurdle on the Performance Rights from a 100% “cliff” vest where the RTSR ranks at the 50th percentile of ASX 100 (excluding resources companies) to a sliding scale of 50% vesting at the 50th percentile of RTSR rising to 100% vesting at the 75th percentile. It will be assessed over a 5-year period from the start of the performance year.

The Board has acted upon the issues raised and changed remuneration structures accordingly. While there may be an opinion that the EVP multiple of 300% is still high, other changes particularly increasing the weighting of “Financial” to “Strategic” performance metrics from a 50:50 to 60:40 ratio and increasing the vesting period of the Restricted Shares from a 2 year (100% “cliff” vesting) to a 4 year period (pro-rata vesting) align with ASA criteria. Also, the 5-year RTSR on performance shares is ‘high ground’ compatibility with ASA guidelines.

The annual report includes a table showing actual take-home pay, equity awards made under the EVP are based on face value and Telstra’s policy for skin in the game aligns with ASA guidelines.
**CEO remuneration framework 2019**

| | **Target $m** | **% of Total** | **Max. Opportunity $m** | **% of Total** |
|---|---|---|---|---|
| **Fixed Remuneration** | 2.4 | 33 | 2.4 | 20 |
| **EVP - Cash** | 1.7 | 23 | 3.4 | 28 |
| **EVP - Equity** | 3.2 | 44 | 6.2 | 52 |
| **Total** | 7.3 | 100 | 12.0 | 100.0 |

The amounts in the table above have been compiled from figures available in the Annual Report and the summary of the service agreement for the CEO released on his assuming the role. They are the statutory amounts that appear to be envisaged in the design of the remuneration plan. 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. *The figures have not been verified with Telstra at time of publishing.*

From FY20, the maximum EVP will be reduced from 400% to 300% or a total maximum opportunity including fixed remuneration of $9.6m. The cash proportion of EVP will reduce from 35% to 25%.

| **Item 6** | **Spill resolution (conditional item)** |
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| **ASA Vote** | **Against** |

This item will only be put to the AGM if at least 25% of the votes cast on item 5 are Against votes. The ASA will oppose a spill resolution as it will have supported Item 5 and given the high level of expertise and performance which resides with the current board.

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