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Big Problem with Risk Management.

Company/ASX Code	**United Malt Group (UMG)**
AGM date	**11 February 2022**
Time and location	10 am. Virtual meeting.
Registry	Link Market Services Limited
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Elizabeth Fish assisted by Helen Manning
Pre AGM Meeting?	Yes with Chairman Graham Bradley, Renee Jacob (Investor Relations), Jane McAloon (Chair of the Rem committee) and Amy Spanik (CFO).

Please note any potential conflict as follows: The individual(s) (or their associates) involved in the preparation of this voting intention have shareholdings in this company.

Summary of issues for meeting

The ASA's biggest concern is related to one-off losses contributed to by what appears to be risk management shortcomings. Total losses were $21.1m

The first one-off loss related to a UK grain storage contractor, where UMG lost $4.7m when the contractor entered administration. The ASA monitors note the statement regarding stock held at 3rd party locations on page 30 of the FY21 AR (Annual Report): "When United Malt purchases stock that is held at a third-party location, we secure certificate of ownership or title of the goods. We also purchase appropriate insurances against physical damage to our stock in transit, stored at our sites or stored at third party sites". Clearly the practice was not followed in this case. At the pre-AGM meeting the Chairman did not answer our question as to if, or why, this particular asset was not covered by insurance. He said that UMG had a long-standing relationship with this entity and they were seeking legal redress to get back what 'was theirs' and there is no reason to expect the value would not be recovered. ASA appreciates the establishment of the loss provision reflects a lower degree of certainty of the recovery.

The second relates to an increase in the write off provision of $16.4m to cover the bad debt of an Asian customer (p27 of the AR). At the pre-AGM meeting we asked the Chairman to identify this customer. The Chairman said he was unable to do that due to customer confidentiality. He went on to say that legal redress wouldn't be possible here, because it was in a country in Asia that didn't have this support. He said that UMG had a long-standing relationship with this entity and hinted that it was due to a severe impact from COVID-19. ASA notes that the provided amount to be written off is 1.3% of total FY21 revenue. At the FY20 pre-AGM meeting we asked how the Executive and Board ensure that the risk appetite for UMG is readily understood by all levels of staff in the business now that some staff are working from home and some may occasionally operate in roles outside official description. The Chairman responded saying he saw the company as small and that the biggest risk, movement of customers, isn't a problem because the small number of customers are kept in touch with by a tight management team.

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

Summary of ASA Position

Financial performance

The global COVID-19 pandemic continued to disrupt the business, in terms of supply chains and negative impact on malt demand as in-premises consumption was affected by a number of lock-down restrictions.

Revenue at $1,235m was down 4% on FY20 of $1,289m. Expenses were 98% of revenue, while for FY20 expenses were just 95%. The ASA thought that given the majority of setup costs for the demerged company should have been recognised in FY20 the proportion of expenses to revenue is very high and we asked why it should be. The response was that FY20 was only impacted by COVID in the 2H, while in FY21 the business was exposed to a full year of trading with COVID conditions. A number of one-off items and other ongoing costs impacting the FY21 trading outcomes were the cost of closing Grantham of $3.1m, the losses in the UK and Asia referred to earlier of $21.1m, change to the accounting treatment for software $6.5m and transformation projects costing $4.5m.

We asked about the ERP and Transport Management System (TMS) projects that we understand are close to conclusion; in particular about the cost /benefits from these two projects. We were told the ERP, a three- year project, is in progress. Due to the change in accounting treatment for SaaS (Software as a Service) the costs associated with the ERP implementation are now expensed rather than capitalised. The FY21 charge was $6.5m, forecast spend in FY22 and FY23 for the ERP is approximately $10m and $4m respectively. The TMS is partially implemented and is providing benefits already. It will be fully in use by the end of the calendar year. While specific individual benefits for the two systems have not been disclosed, the two projects form part of the transformation project, which is expected to deliver $30m in net benefits by FY24.

We also asked about the FY21 dividend of 5.5c per share, as we were concerned that a company would pay a large dividend under the current circumstances. Profit in FY21 was $13.8m, EPS 4.6c, total dividends paid was $16.5m. or 5.5c per share. Profit in FY20 was 45.6m, EPS 16.8c and dividend paid 3.9c per share. The dividend policy is stated to be: to distribute approximately 60 per cent of Underlying NPAT. We asked why the Board would base payment of dividends on underlying rather than statutory profit; is there is not some danger of running down the retained earnings over time and how far will the company go in increasing dividends year on year?

The Chairman responded saying the Board wanted to establish UMG as providing a reasonable and steady income stream for shareholders, with a target of 60% of underlying profit for this. In other words, to be a consistent dividend paying company. The dividend this year was at 48% of underlying profit and underlying was used to ignore the abnormal items. Since payment is at 48% the Board has the option to increase dividends to the payout target of 60%. The Chairman also said that hopefully in future years there will be no difference between the underlying and statutory profit.

Prior to the Pre AGM meeting, we noted the references to the company's expansion activities at Arbroath, Inverness and Perth and we took the opportunity to ask how the company is ensuring that the additional capacity will be fully utilised. Ms Amy Spanik updated us, saying UMG now had 80% of the additional capacity filled with firm contracts (from distillers). She also said that it was typical to have orders out 2 to 3 years, but they can get 5 years. Therefore, they are confident to get a rate of return on this expansion. The increase to the PPE (Property Plant and Equipment) class of asset ($80m) is mostly related to the Scottish build and the Perth kiln.

<u>Key Board or senior management changes</u>

Mr Darren Smith left the organisation in March 2021 and was replaced by Mr Tiago Darocha who is described as the Chief Operating Officer.

Mr Simon Tregoning retired from the Board in February 2021.

<u>Sustainability and Corporate Governance</u>

The company has produced a Sustainability Report and a Corporate Governance Statement for the second year running as a part of the increased reporting by many ASX listed companies. At our pre-AGM meeting we were interested to see how a company like UMG finds and approaches this kind of reporting particularly given that the reporting mentions that they are commencing work towards aligning the climate change reporting with the Task Force on Climate-related Financial Disclosures (TCFD).

The Chairman sees the climate change initiatives as being customer driven (and also shareholder driven). He sees the TCFD reporting as involving collecting a lot of data they don't currently have. TCFD reporting involves scenario analysis. The 2021 Sustainability Report states that they are looking at the high emissions case (4 degree warming) and low emissions (the 1.5 degree warming) as per the latest guidelines (released August 2021 by the International Panel on Climate Change – the IPCC). The Chairman believes that there is a lot of work to go into this. Work is also required to be looking at Scope 2 and Scope 3 emissions.

UMG see 4 areas they are addressing:

- Water: They describe this as their main current focus. They use a lot of water in the processing, so they are looking at options to recycle and reuse water.
- Sustainability of Agriculture: In the 2021 Sustainability report it is made clear that barley is the key input and ingredient for the core business of the company. The report talks about an initiative to grow winter barley in the northern hemisphere (this is higher yielding and requires less irrigation). Mention was made of experimenting with differing varieties of grain. Mention was also made of some reliance on growers obtaining their own certification.
- Food Security: This is seen as the responsible and right thing to do. In the 2021 Sustainability report this is described as

- Work to ensure the supply chain uses sustainable practices.
    - To protect soil, air and water
    - Safe working conditions
    - Compliance with human, labour and land rights

- Compliance with laws and international treaties

- Good management practices and continuous improvement

- Energy Usage: This is seen as a big challenge for the company. For example, gas is used in heating and drying during processing. Improving the technology is one way to improve usage here and a key reason for the work at the Perth kiln.

Summary

(As at FYE)	**2021**	**2020**	**2019**	**2018**	**2017**
NPAT ($m)	13.8	45.6	56.9	N/a	N/a
UPAT ($m)	34.0	57.4	N/a	N/a	N/a
Share price ($)	4.10	4.12	N/a	N/a	N/a
Dividend (cents)	5.5	3.9	N/a	N/a	N/a
Simple TSR (%)	.85%	N/a	N/a	N/a	N/a
EPS (cents)	4.6	16.8	22.4	N/a	N/a
CEO total remuneration, actual ($m)	1.468	1.628	1.83	N/a	N/a

For 2021, the CEO's total actual remuneration was **15.7 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2021 data from the Australian Bureau of Statistics).

With regard to the CEO, Mr Mark Palmquist, his annual base salary is unchanged from FY20. From May 2020 to September 2020, he elected to take a 20% cut in his base salary due to the impact of COVID-19 on UMG's business and in FY20 his short-term incentive (STI) payment was paid as equity. This equity vesting in 12 and 24 months, as a result 50% of the value of this STI is included in the figure for FY21 total remuneration actual.

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

Summary of ASA Position

The remuneration report very clear and easy to read.

For FY21 the remuneration at risk component consists of STI, measured over 1 year and an LTI grant with a three-year performance period. As a rule, STI is paid 50% cash and 50% deferred performance rights (PR). The deferred PR vest 50% at 12 and 24 months. PRs are allocated using volume weighted average price (VWAP).

Measured against the scorecard shown on p40 of the AR, STI includes a financial measure (EBIT) weighted at 50%, Environment, Health & Safety score at 15%, a customer and net promotor score of 15% includes the development of a customer action plan with the final 20% being based on the individual's performance, which includes agreed objectives tailored to the KMP's role. The minimum performance for EBIT was not reached, threshold was achieved for EH&S, and for NPS and customer performance and insight for the four KMPs, while only two of four KMP's achieved target performance for individual weightings. Both the CEO and CFO achieved only threshold for their individual performance, no doubt affected by the $21.1 inventory and debtor write down. In total the CEO achieved 33% of target STI, the remaining KMPs 33-37%. The EBIT metric was not disclosed.

For the LTI payments, KMP were assessed on three performance hurdles: Absolute Total Shareholder Return (ATSR) at 50%, the increase in share price over a 12-month period plus dividends paid, compounded over three years. At 25% Return on Capital Employed (ROCE), EBIT/Capital employed and in FY21 an additional and third measure at 25% termed "Strategic Execution". Vesting is to be assessed against realisation of the pre-determined metrics in three elements: Profitability and customer performance, repositioning of the operating model of UMG, and establishing and executing strategic growth opportunities. The ASA notes the metrics these elements are measured against will only be released at the completion of the three-year performance period, which commenced October 2020 and ends September 2023.

For aTSR, 25% of rights vest at minimum of target range, then move on a straight line until 100% at maximum. The FY 21 threshold was 6% and target was 10%. The ROCE target is set by the Board as part of the budgeting process each year. The FY21 ROCE target was 6% to 10%. 25% of rights vest at the threshold of 6%, then on a straight-line basis until target is reached. In addition, there is an ongoing service condition. No LTIs are due to vest until FY22.

At the FY20 pre-AGM meeting the ASA indicated that we like the additional third measure for LTI awards. We noted "that these measures will be assessed by the Board based on specific and quantified targets and that as these targets are commercially sensitive they will be disclosed more fully at the end of the three-year performance period".

The ASA expressed concern regarding undisclosed targets, and also that an LTI performance period of three years is considered to be too short and should be at least four years. We asked, "is the Board asking us to trust them on these undisclosed measures?" The Chairman's response was to reassure shareholders that the measures are 'highly' quantifiable, and that UMG will give the detail in 3 years. He also says that in the year after next they could consider taking the LTI period to 4 years. The Chairman though that as essentially a new company there will not be any LTI due for at least three years. He continued saying that it would not be good to signal these measures to competitors as it is the first year of a new company.

An additional one-off award was granted in FY20 to both the CEO and President, Processing to encourage retention and compensate for the fact that no LTI awards would be due to vest until 2022. Under this one-off award 280,543 rights were issued to the CEO and 57,223 to President, Processing. These rights were due to vest in September 2021 and the terms and conditions are as for the FY20 LTI. These rights did not vest as performance did not reach the required threshold for vesting and the rights lapsed. This one-off award was covered in p83 of the demerger scheme booklet.

The ASA will recommend a vote in favour of this resolution. While the ASA takes the view that a three-year LTI period is too short to be truly judged as long term for a business in this category, we accept that the recent demerger does makes an extended period impossible to measure and we accept the Chairman's undertaking that the period will be reviewed in FY24. In addition, we feel that the CEO's target remuneration of $3.5m is excessive given the market capitalisation (cap) of $1.24b. We have based this last criterion on the Godfrey Remuneration Group (GRG) all industries remuneration guide for FY21, which found the median total remuneration package for an MD/CEO in the industrial and services sector with market cap of $1.2b was A$1.278m. However, we do also note that the STI performance measures are aligned with shareholders interest and look to be rigorously applied given Mr Palmquist received just 33% of his target. It should also be noted that Mr Palmquist will not be entitled to any LTI until FY22.

Item 3	**Re-election of Graham Bradley as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Bradley holds a BA, LLB from Sydney University, and LLM from Harvard. He was first appointed to the Board in January 2020 on the divestment of UMG from Graincorp Limited, having been appointed Chairman of Graincorp Limited from March 2017 to January 2020.

Presently Mr Bradley is also Non-Executive Chairman of Energy Australia Holdings, Virgin Australia International Holdings and Shine Justice Holdings Limited. He is also a Director of Hong Kong and Shanghai Banking Corporation and holds positions with Infrastructure NSW and is a member of the Advisory Council of the Australian School of Business at UNSW

Mr Bradley's 30 years of executive experience includes positions held at Perpetual, Blake Dawson and McKinsey & Company.

Mr Bradley holds 101,395 ordinary shares and increased his holdings in Fy21. His annual fee is $340,000. The ASA will support Mr Bradley's re-election.

Item 4	**Re-election of Mr Terry Williamson as a Director**
ASA Vote	**Against**

Mr Williamson holds a BEc degree and an MBA. He is a fellow of the Australian Institute of Company Directors, Chartered Accountants in Australia and New Zealand and CPA Australia. He was first appointed to the Board in March 2020.

Presently Mr Williamson has one other directorship as NED of Stockland Capital Partners, and Stockland Direct Retail Trust No1. His executive experience included roles as senior audit partner at Price Waterhouse, Chief Financial Officer Bankers Trust New York Group and as member of the Audit Committee of the Reserve Bank of Australia. He chairs the UMG Audit and Risk committee and is a member of the Environmental, Health and Safety Committee.

Mr Williamson holds 49,586 ordinary UMG shares. A minimum shareholding policy was approved in July 2020 stated NEDs should hold shares equivalent to one year's fees within five years of their appointment. At the 30 September share price of $4.10, his holding is well in excess of his $120,000 fee.

We would like Mr Williams, as Chairman of the Audit and Risk Committee to explain to the meeting how the Asian debtor was allowed to be indebted to UMG for $16.4m given there is no method of recovering overdue debts in that region. Further, how many other debtors does UMG have in this particular area?. After such spectacular failure in risk management the ASA cannot support Mr Williamson's re-election.

Item 5	**Approval of LTI grant to CEO/Managing Director Mr Palmquist**
ASA Vote	**For**

Summary of ASA Position

The proposed FY22 grant to Mr Palmquist is 295,208 Performance Rights. Representing the long-term incentive component of his FY22 remuneration package. Based on the Volume Weighted Average Price of United Malt shares over the consecutive 20-day trading period from 18 November to 15 December 2021 (inclusive) (being $4.19), the face value of the maximum number of Performance Rights represents 100% of Mr Palmquist's total fixed remuneration as at 1 October 2021. Details of the performance hurdles and performance period is covered in the discussion on the remuneration report at item 2. The value of the grant is $1,236,922.

Appendix 1
Remuneration framework detail

CEO rem. Framework for FY21	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.179	33.3%	1.179	29%
STI – Cash	.589	16.5%	.884	21%
STI – Equity	.589	16.5%	.884	21%
LTI	1.179	33.0%	1.179	29%
Total	3.536	100.0%	4.125	100%

The amounts in the table above are the amounts that are 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.