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Big Changes for Woolworths

Company/ASX Code	Woolworths Group Limited
AGM date	Wednesday 27 October 2021
Time and location	2:00 pm online only at www.lumiagm.com/353431578
Registry	Link Market Services
Webcast	As above
Poll or show of hands	Poll on all items
Monitor	Don Adams assisted by Julieanne Mills
Pre AGM Meeting?	Yes, with Chair Gordon Cairns; Siobhan McKenna, NED and Chair – People Committee; Holly Kramer, Chair – Sustainability Committee; Kate Eastoe, Group Company Secretary; Paul van Meurs, Head of Investor Relations

The individuals involved in the preparation of this voting intention have a shareholding in this company.

Major moves for Woolworths

Following shareholder approval at a General Meeting in June 2021 the demerger of the Endeavour Group (Sales $11.6bn, Market Value $11.3bn) took place on the first day of the new financial year. This means that Woolworths is now out of the liquor, hotels and gaming businesses. They also moved from 47.5% to 75% of data analytics company Quantium paying $223m and purchased 75% of food services company PFD for $680m ($324m cash for 65% of equity, $249m for PFD distribution centres and $107m in contingent future settlement).

Other substantial moves since FY2021 ended include a $2bn off-market buy-back, two sustainability linked bond issues of EUR 550m and AUD 700m respectively, and the settlement of the underpayment class action for $50m.

Item 1	**Receive financial and other reports**
ASA Vote	No vote required

<u>Financial</u>

Woolworths financials for 2021 need to be looked at on a combined basis with Endeavour as well as the continuing operations. In the summary table below we present combined results and the continuing operations are shown below that. Remember the Endeavour was part of Woolworths for all FY2021.

Total revenue of $67.3bn ($55.7bn for WOW and $11.6bn for EDV) was up 5.7% from FY2020. Underlying profit was up 23% and Net Profit up by 78% since there had been negative significant items on FY2020. There was revenue growth for all businesses except New Zealand Food which fell by 2.5% in AUD but only 0.6% in NZD. E-commerce sales of $5.6bn were up 59% over FY2020.

EBIT increased by 11.1% for the continuing with a massive increase in Big W of 345%, $172m up from $39m in FY2020. This is heartening news since these have been the first years for Big W to show a profit.

Dividends, TSR and EPS all went up as shown in the table below.

Summary

This table is for the combined entity of WOW and EDV until end of FY2021.

(As at FYE)	**2021**	**2020**	**2019**	**2018**	**2017**
NPAT ($m)	2074	1165	2692	1724	1534
UPAT ($m)	1972	1602	1751	1605	1422
Closing Share price ($)*	44.42	37.28	33.23	30.52	25.54
Dividend (cents)	108	94	102	103	84
TSR (%)	21.9	15.3	12.3	23.1	25.5
EPS (cents	165	93	206	133	119
CEO total remuneration, actual ($m)	10.82	9.45	12.60	3.87	4.47

For 2021, the CEO's total actual remuneration was **118 times** the Australian Full time Adult Average Weekly Total Earnings (based on November 2020 data from the Australian Bureau of Statistics). * For 2021 the share price shown is the sum of the prices of one share each of WOW and EDV on 30/6/2021.

The table below shows the available data on a continuing operations basis, i.e., pro-forma showing results after excluding the businesses that would go to EDV:

(As at FYE)	**2021**	**2020**	**2019**	**2018**	**2017**
NPAT ($m)	1606	938	na	na	na
UPAT ($m)	1504	1249	1817	1676	1481
EPS (cents	128	74	na	na	na
Closing Share price ($)*	38.13	na	na	na	na

na = not meaningful or not provided

Endeavour

The demerger of Endeavour took place on the first day of FY2022 (28/6/2021) but the shares started trading on a deferred basis on 24 June. The share price on 30 June was $6.29.

At 27 June, Woolworths' balance date, the Equity of Woolworths is shown as $1.739bn. The next day, when Endeavour separated, they booked a gain of $6.1bn to Equity. This is due to the accounting requirements of the demerger and is explained in the Demerger Booklet and the Buy-back Booklet. Woolworths could hardly have undertaken the $2bn off-market buy-back otherwise, with lower Equity than that amount!

Buy-back of $2bn shares

In August 2021 Woolworths offered to buy back $2bn of its shares at a price which would be a discount of 10-14% of the market price. These have become standard transactions for companies with a high level of franking credits and a solid balance sheet. The buy-back price is structured as a small capital component and a larger franked dividend which appeals to investors with a 0% tax rate (charities, endowments, pension funds), or to a lesser extent, a 15% tax rate (superannuation funds). The result will be announced on 18 October, a few days after this report is written, but it can be expected that the shares will be bought at a discount of 14%. This benefits the other shareholders who do not participate and that is some recompense for the loss of potential franking credits. Indeed, the discount might have been greater except for ATO rules limiting the discount to 14%.

COVID

Woolworths was affected in various ways by the COVID pandemic. Reduced business in CBD Metro stores created a $50m asset impairment charge. COVID infections and isolation requirements caused staffing problems in distribution centres and stores and the company brought in labour hire staff to mitigate. They have encouraged staff to be vaccinated and have brought vaccination teams to distribution centres, but at present they are not making it mandatory.

Quantium

Woolworths has owned a 47.2% interest in this data analytics company since 2013 but moved to a 75% position in April 2021 by buying a further 27.8% interest for $223m. Accounting rules required them to update the book value of the existing shares to market and accordingly they booked a $221m profit on revaluation as a significant item. The minority owners of Quantium have a put option to sell their stake to Woolworths at a price which appears to be determined by performance against the business plan. Woolworths have a corresponding call so the effect will be for Woolworths to own 100% of Quantium. The liability for the put option is being recorded in Woolworths' accounts at $390m. This seems high for 25% since the price paid for 27.8% implies that the total value of Quantium is $802m.

Quantium is headquartered in Sydney but operates globally providing data analytic systems to draw useful business information out of huge transaction databases. Woolworths values the services that Quantium provides. Quantium's profit in FY2021 was $56m but of this only $20m related to the core operations.

PFD Food Services

In August 2020 Woolworths announced that they would buy into PFD Food Services for $550m. They would buy 26 distribution centres for $249m and 65% of the company for $301m. PFD supplies to commercial kitchens such as cafes and restaurants. The deal was subject to ACCC approval, and it was expected that there could be trouble obtaining it. In particular, PFD's competitors in the food service industry objected to the deal.

On 10 June 2021 ASIC approved the transaction and on 28 June (post Woolworths' balance date) Woolworths paid $324m cash for 65% of the shares in PFD. They also accrued a liability of $107m representing the present value of a likely future payment if PFD achieves certain performance goals. The total is $680m when one also adds the $249m paid for the distribution centres.

In addition, there is a put option arrangement (similar to the Quantium deal) for Woolworths to acquire the other 35% of PFD from the minority owners three years after the acquisition date. Woolworths estimate the size of that potential liability to be in the range of $400m to $450m.

Underpayment of managers

To the end of FY2020 Woolworths had allowed a total of $500m for the remediation of this problem. During the FY2021 the Fair Work Ombudsman announced that they had checked Woolworths's calculations and would file suit against the company since their figures exceeded the reimbursement that Woolworths was paying by a substantial amount. The company expects that this will go to court since the issue centres on the language of the General Retail Industry Award which is apparently ambiguous in places.

In October 2021 Woolworths settled a class action claim by agreeing to pay $2,500 each to 20,000 present and past managers for a total of about $50m. This is an additional expense of the underpayment issue.

Sustainability Linked Bonds

In September 2021 Woolworths announced that they had issued these bonds as part of a $1.5bn debt funding plan to fund the Quantium and PFD acquisitions among other corporate purposes. They issued one lot for EUR 550m and another for AUD 700m. These bonds have provisions that the interest rates will increase if the company fails to achieve its emission reduction targets for FY2025 and FY2029. Apparently there is an appetite for such securities among institutional investors looking for "green" assets.

Reconciliation

Following the Darwin Dan Murphy's problem in FY2021 Woolworths, through its Chair Gordon Cairns, has engaged in discussion with indigenous communities. The planned update of the 2019 Reconciliation Action Plan (RAP) has been deferred while this engagement occurs. They are in the process of strengthening indigenous affairs management. They have achieved an objective from the 2019 RAP report for the number of indigenous staff to match the proportion in the Australian population since about 5,000 of Woolworths staff are indigenous.

Sustainability

In 2020 Woolworths published a major Sustainability Report with broad ranging targets to be achieved by 2025. This year they published the 2021 Sustainability Report which covers their progress towards the 2025 targets, such as 100% green electricity and zero food waste to landfill by 2025. There is far too much material in the Report to summarise here, but it can be downloaded from https://www.woolworthsgroup.com.au/page/investors.

Woolworths have diversity targets of at least 40% female workers at each level. The Sustainability Report shows that they have yet to achieve this ratio for Executives (30.6%) and Senior Managers (37.9%).

We asked the company if they were worried by reports of environmental issues with Tasmanian salmon farming. They described themselves as "very concerned", they have visited suppliers and are looking to see if Tasmania's regulation matches best global practice.

Modern Slavery

One can also download Woolworths' Modern Slavery Report from the web address above. Woolworths use the phrase "Responsible Sourcing" to describe the action in this report. They report that in FY2021 they conducted 561 audits of suppliers out of which they found 20 Zero Tolerance cases.

Board and Governance

The Woolworths Board is well structured with a useful mix of experience and skills. The Board Skills Matrix shows excellent coverage, there is a nice mix of tenure amongst the directors and a substantial number have global experience.

Two new members have been appointed this year and are standing for election at this AGM. Gordon Cairns told us that they were selected after a rigorous search process which started with about 100 names. We discuss the new directors below when considering their election.

The respected Company Secretary Marcin Firek moved to another senior position during the year and Woolworths found it necessary to replace him with two people, Kate Eastoe and Michelle Hall, who each now hold the Company Secretary title.

All three directors standing for election have been assessed as independent by the Board.

Item 2(a)	Re-election of Gordon Cairns as a Director
ASA Vote	For

The highly respected Gordon Cairns has been a director and Chairman since September 2015. The Notice of Meeting describes his skills and experience as Chair and in executive positions in large companies. It also refers to the rigour he brings to Board discussions and the passion for Woolworths. While Chair at Woolworths he has driven a strategic transformation of Woolworths through rigorous capital management and a clear strategic plan.

Gordon Cairns has advised that this is the last time he will stand for election. He could not say how the Board will replace him as Chair, but he did indicate a preference for an internal candidate to provide continuity.

Item 2(b)	Election of Maxine Brenner as a Director
ASA Vote	For

Maxine Brenner joined the Board in September 2020 following the retirement of Jillian Broadbent.

Ms Brenner has a strong background in law and as a corporate adviser. The Notice of Meeting shows her experience as a company director and describes how she has transformed the group's risk management framework in her short time as director and Chair of the Risk Management Committee. Gordon Cairns told us that she brings strong governance skills to her position.

Item 2(c)	Election of Philip Chronican as a Director
ASA Vote	**For**

Philip Chronican joined the Board on 1 October 2021. He replaces Michael Ullmer who will retire at the conclusion of the 2021 AGM on 27 October after nine years' service. As shown in the Notice of Meeting, Mr Chronican has substantial experience in banking and finance and is therefore an appropriate replacement for Mr Ullmer who had similar strengths. Gordon Cairns identified his background in finance as the key attribute he will bring to the Board. He has a reputation as "advocating for greater transparency and ethics in banking, and promoting workforce diversity".

Item 3	Adoption of Remuneration Report
ASA Vote	**For**

The remuneration policy is described in the Appendix. Since it is substantially the same as last year apart from two changes to the targets for STI and LTI the ASA will vote undirected proxies in favour of adopting the report.

We continued pointing out to the Chair, as we do every year, that the ASA prefers a period longer than three years for testing and vesting LTI.

The ASA also discussed with Gordon Cairns whether the CEO's remuneration is too high. Mr Banducci sometimes features in articles and reports discussing whether CEO pay is too high in Australia. Mr Cairns said that executive remuneration was based on comparable companies on a global basis. The target level of remuneration is $7.8m as it has been for the last few years. Woolworths strong performance and its rising share price have pushed the CEO's realised remuneration above $10m in the last three years, except for FY2020 when Brad Banducci voluntarily forfeited his STI as a consequence of the underpayment issue.

Woolworths has a minimum shareholding policy for KMP and directors and in the Remuneration Report they provide useful graphics showing KMP compliance. We suggested that they could also do that for directors.

Item 4	Approve Managing Director and CEO FY2022 Grant
ASA Vote	**For**

The issuance of shares to directors requires shareholder approval under the ASX listing rules. The grant is of performance rights equal to the maximum LTI that could be paid to the CEO divided by the share price at the date of the grant. The proportion of these rights that actually vest as shares in three years' time is determined by the rules of the LTI award, and the rights that do not vest will lapse.

The company has not asked for shareholder approval for the equity granted to the CEO as part of the STI plan. The ASX Listing Rules provide those shares bought on market, and not newly issued, do not require shareholder approval and Woolworths buys these shares on market. The ASA policies prefer, however, that all grants be approved by shareholders, whether newly issued or bought on market.

Item 5	**Approve Non-executive Directors' Equity Plans**
ASA Vote	**For**

There are separate NED equity plans for Australian and US-based directors due to different tax and securities laws. These plans grant no extra value but merely enable directors to use their directors' fees to purchase shares. They elect how much of their fees will go to shares before the start of the financial year and the company allocates shares to them quarterly. The shares vest every six months.

There is a small tax advantage to the plan, but the main benefit is that directors are not exercising discretion and so are not troubled by black out periods when share trading would not be allowed. The plan also helps directors satisfy the minimum shareholding requirement of holding shares worth at least one year's fees within three years of appointment.

Appendix 1
Remuneration framework detail

The remuneration framework for the CEO, Brad Banducci, is shown in the table below. There has been no changes since last year to either the structure or the amounts, but there are changes for FY2022 which we discuss below.

CEO rem. Framework for FY 2021	Target* $m	% of Total	Max. Opportunity $m	% of Total
Total Fixed Remuneration (TFR)	2.60	33%	2.60	24%
STI - Cash	1.30	17%	1.95	18%
STI - Equity	1.30	17%	1.95	18%
LTI	2.60	33%	4.42	40%
Total	7.80	100.0%	10.92	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.

You can see from the table that for target levels of achievement STI and LTI will be each awarded at 100% of TFR. The maximum awards are at 150% and 170% respectively. In FY2021 the plan achieved pay-outs of 115% of TFR for STI and 132% of TFR for LTI.

STI are paid 50% in cash and 50% in deferred equity. The level is determined by five equally weighted factors – Sales, EBIT, Days of Working Capital, Customer Satisfaction and Safety. In FY2021 stretch level were achieved on all factors except Customer Satisfaction which fell below target. This amount is then adjusted by a factor for individual performance. For example, the CEO received $3.3m in STI which is his TFR of $2.6m multiplied by 1.155 and then increased by a further 10%, presumably from the Board's assessment of his individual performance.

LTI was awarded as three-year deferred equity and vesting will be equally based on three measures – Relative TSR (achieved stretch), ROFE (fell below target) and Sales/m^2 (nearly at stretch level). The outstanding performance rights as at 27 June 2021 were increased by a factor of 1.1653 to compensate for the share price fall after the demerger of Endeavour.

For FY2022 there are two changes to the factors that determine the STI and LTI awards. The company spoke to the ASA, proxy advisers and some investors about these to gauge whether there could be any problems with them.

For STI, the Safety measure had focused on number of lost time incidents. The new measure will encompass all incidents and will be the average severity of safety incidents. The ASA questioned how severity would be measured since we were concerned that subjective judgement might be involved. Gordon Cairns reassured us that severity is measured on a strictly defined scale which would be subject to audit by corporate safety teams and internal audit.

LTI factors will continue to be relative TSR and ROFE, each now weighted at 40%. Sales/m^2 is to be replaced by a Reputation performance measure weighted at 20%. The measure is based on ratings by RepTrak, a global firm that has been measuring corporate reputations since 2004. More information about RepTrak can be found at https://www.reptrak.com/.