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

A well-performing retail giant trips up on underpayment scandal

Company/ASX Code	Woolworths Group Limited/WOW
AGM and EGM date	Monday 16 December 2019
Time and location	Int'l Convention Centre Sydney, Pyrmont Theatre, 14 Darling Drive, Pyrmont, NSW
Registry	Link Market Services
Webcast	Yes, link at https://www.woolworthsgroup.com.au/page/investors/our-performance/webcasts/
Poll or show of hands	Poll on all items
Monitor	Don Adams assisted by Julieanne Mills
Pre AGM Meeting?	Yes, with Chair Gordon Cairns; Chair, People Performance Committee Holly Kramer; Company Secretary Marcin Firek; and Investor Relations Manager Paul van Meurs

Everything was looking good for Woolworths (performance, strategy, governance) until 30 October 2019 when the company announced a major historical underpayment of salaried staff. The underpayment occurred as a result of managers on salary not being paid what they would have earned under the General Retail Industry Award if the latter amount were higher than their salary. Overtime and penalty rates would have enabled managers to earn more than their salary under the award Woolworths had agreed to, but these payments were not made. The company announced that the total amount of remediation could be in the range $200-300 million. They have apologised and plan to make backpay payments as soon as practicable. We return to this issue when we discuss the Remuneration Report under Agenda Item 3 below.

Governance

Woolworths has strong corporate governance policies. The Board is experienced, diverse, independent and shows an excellent coverage of required skills. There are five women in the nine Board members, making the company's diversity significantly better than most other ASX-listed companies.

The company has strong policies on the environment, workplace safety, community involvement, responsible sourcing, gender equality, labour relations and others. These are detailed in Woolworths' detailed Sustainability Report.

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

Financial performance

Woolworths had sales of nearly $60 billion in Financial Year 2019 (FY19), up 3.4% from FY18 normalised for the 53-week year in 2019. Underlying Profit After Tax (UPAT) increased by 7.2% normalised. Dividends were flat at 102 cents, but the 2018 dividend included a 10-cent special dividend. The company also returned $1.7 billion to shareholders with an off-market share buy-back completed in May 2019.

The buy-back came from the proceeds of the sale of the petrol business to EG Group in April. This sale yielded a before-tax profit of $1,088 million (m). They also conducted a major review of the Big W business with some store closures. This created a $371 million loss due to lease cancellations and asset write-downs. The large difference between NPAT and UPAT is due mainly to these two significant items.

Australian Food

This is the largest business in Woolworths with sales of $39.57 billion, up 3.3%, normalised for the 53-week year, from FY 2018. Roy Morgan reported that Woolworths had 34% of the Australian market in calendar 2018, followed by Coles at 27.6%, Aldi at 11.4% and IGA at 7.1%. Woolworths sees potential threats coming from emerging players such as Kaufland, CostCo and particularly, Amazon Fresh. They are responding by introducing more digital and online technology in the stores and through Woolies X.

Earnings Before Interest and Taxes for Australian Food was up by 3.8% normalised and ROFE (return on funds employed) for this unit was a healthy 140% which was down from 171% in the previous year.

Woolies X

This business is both separate to, and integrated with, the store based Australian Food business. It is responsible for developing and introducing digital technology into the stores as well as running the online businesses. For example, they developed the Scan&Go smartphone app which is being trialled in stores now. The stores also play a major role in picking orders for the online business.

Online sales of $1,444 m were up 31% from FY2018. EBIT was not reported for this unit.

New Zealand Food

Woolworths operates in New Zealand under the Countdown brand, and they rank second in food sales in that country. Sales of $6,712m and EBIT of $296m were up by 2.4% and 1.0% normalised respectively.

Endeavour Drinks

This unit is mainly Dan Murphy's and BWS. Sales of $8,657m were up by 3.2% normalised from $8,244m but EBIT of $474m fell by 9.7% normalised. This was due, in part, to a $21m impairment charge in the Summergate business. In February 2019, they established an Endeavour X unit to promote digital and online technology inside the drinks business in a similar way to Woolies X.

Big W

Big W had strong sales growth in 2019, up 4.2% to $3,797m. Once again there was no EBIT with a loss before interest and tax (LBIT) of ($85m). This is before the significant items of ($371m) mentioned above.

Hotels

The hotels business had Sales of $1,671m (+1.8% normalised) and EBIT of $261m (down 0.5% normalised).

Summary

(As at FYE)	**2019**	**2018**	**2017**	**2016**	**2015**
NPAT ($m)	2,693	1,724	1,535	(1,235)	2,146
UPAT ($m)	1,752	1,605	1,422	1,476	2,453
Share price ($)	33.22	30.52	25.54	20.74	27.39
Dividend (cents)	102	103	84	77	139
TSR (%)	14.9	22	27	(23)	(18)
EPS (cents)	206	133	119	(98)	171
CEO total remuneration, actual ($m)	12.60	3.87	4.47	2.18	1.7

For 2019 the CEO's total actual remuneration was **143 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Strategy

The key elements of Woolworths strategy appear to be:

1. Strengthen the customer experience in food and defend against the threat from Amazon Fresh and the like, by developing and pushing out digital and online technology.
2. Concentrate on bringing Big W to profitability before deciding what to do about it.
3. Separate the drinks and hotels businesses into a separate company, albeit one with strong links to Woolworths.

Item 2(a)	Re-election of Holly Kramer as a Director
ASA Vote	**Against**

Holly Kramer has been on the Board since 2016. She is Chair of the People Performance Committee and a member of the Nomination and Sustainability Committees. She holds 9,599 shares which just about covers her annual board fees. She has led the development of the executive remuneration policy and signed the Remuneration Report.

She has had a mixed record as a company director, particularly at AMP where ASA intended to vote against her at the AGM in 2018. She stepped down as a director before the meeting. Ms Kramer, with her responsibility as Chair of the People Performance Committee must bear some responsibility for the failure of the company to act promptly to reduce bonuses in light of the underpayment scandal.

For these reasons ASA will vote against her re-election.

Item 2(b)	Re-election of Siobhan McKenna as a Director
ASA Vote	**For**

Siobhan McKenna has been on the Board since 2016 and is a member of four board committees. She has experience as a director in both the public and private sectors. She holds 10,664 shares comfortably covering her annual board fees. She has solid experience as a director and executive and ASA will vote for her re-election.

Item 2(c)	Re-election of Kathryn Tesija as a Director
ASA Vote	**For**

Kathryn Tesija was also appointed to the Board in 2016 and she is a member of three committees. She has strong retail experience in the US and is a resident of that country. She holds 8,980 shares which is a little less than her annual fees. This is partly due to her fees being higher due to travel allowances, but also because it has not been possible for her to participate in the NED Equity Plan. This should be corrected at the AGM assuming that Item 5 is approved. She has solid experience as a director and executive and ASA will vote for her re-election.

Item 2(d)	Election of Jennifer Carr-Smith as a Director
ASA Vote	**For**

Jennifer Carr-Smith was appointed to the Board in May 2019 and is therefore up for election at this meeting. She is a member of the Nomination Committee. She holds no shares but the Woolworths policy (which matches ASA's policy) is that she should hold shares equal to 100% of her compensation within three years. She has solid experience as a director and executive and ASA will vote for her election.

Item 3	Adoption of Remuneration Report
ASA Vote	For

The table below illustrates the key management personnel (KMP) remuneration structure using the CEO, Brad Banducci's current package as an illustration. The target level compensation is split evenly between base salary, STI and LTI. The maximum opportunity increases STI by 150% and LTI by 170%.

STI is based on five hard measures (Sales, EBIT, Working Capital, Customer Satisfaction and Safety) and it is paid half in cash and half in equity which does not vest for two years. The performance for STI in 2019 was measured at 68.1% but this is then adjusted by the Board for individual performance. For example, the CEO was paid cash STI of $974,000, or 75% of his opportunity, up from the 68.1% level.

LTI is based on three-year performance of relative TSR, ROFE, and Sales/Square Metre, equally weighted. It is paid in share rights which only vest after three years to the extent that the performance targets are met. The rights are allocated at market price at the time of the award and they accrue additional rights equal to the value of dividends which will vest at the same time and to the same extent as the underlying rights. In FY19 the FY17 LTI that started on 1/7/17 was vested at 78.4% of the maximum.

CEO rem. framework	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	2.600	33%	2.600	24%
STI - Cash	1.300	17%	1.950	18%
STI - Equity	1.300	17%	1.950	18%
LTI	2.600	33%	4.420	40%
Total	7.800	100.0%	10.920	100%

The amounts in the table above are the statutory 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.

The STI and LTI values are based on the share price at grant and could change based on the share price at vesting as per the provisions of the remuneration report. This would indicate that the figures presented above are subject to change based on share price variations.

The CEO's actual compensation for FY 2019 of $12.6 million was made up as follows:

Base Salary ($m)	2.585
FY19 cash STI ($m)	0.974
FY17 DSTI, 63,387 shares at $33.22 (VWAP)($m)	2.106
FY17 LTI, 266,305 shares x 78.4% x $33.22 ($m)	6.936
TOTAL ($m)	12.601

The LTI component is high because the share price has increased considerably since 2017. Also, the maximum LTI award was 200% of base TFR at that time.

The remuneration report is comprehensive, but the amount of information included can sometimes be confusing. Remuneration policy satisfies ASA standards except for the three-year performance period for LTI. The Chair, Gordon Cairns, said that period was appropriate since they are in a quick turnaround business. For example, a supermarket built today should be profitable in six months.

The company also has "skin-in-the game" standards that exceed ASA guidelines. The CEO and Chair are required to have shares exceeding 200% of salary within three years, NED's 100% of base fees within three years, and other KMP 100% within five years.

Generally, we support the remuneration report, but there is the underpayment issue that was revealed on 30 October 2019. What we know is this:

1. Salaried managers in stores who worked overtime and on weekends should have been paid under the industry award if that would give them more than their salary.
2. Three managers complained about this in February 2019 and ASA was told that the Board became aware of the problem "almost immediately".
3. No announcement was made for about eight months, no provisions were made for remediation in the FY19 accounts.
4. The company has promised to provide full remediation to the 5,700 salaried team members who have not been paid their full entitlements and has apologised unreservedly. The first back payments will be made before Christmas. The total cost of remediation for the period from 2010 is expected to be in the range $200-300 million.
5. There have been no cuts to executive STI and LTI due to the compensation systems failure. In fact, Brad Banducci's FY19 STI payout was increased from 68.1% to 75%.

In a late development Woolworths announced on 27 November 2019 that the CEO and Chair would take responsibility for the issue. This was in response to questions from ASA and other shareholders representative groups. Mr Banducci will forgo his FY20 STI. This amounts to $2.6 million at the target level, or 33% of his total target remuneration. The Chair, Mr Cairns, will forgo 20% of his Board fee for FY20.

These are interim measures and the company's complete review including further consequences is expected to be complete by the time of the half-year announcement in February 2020. Mr Cairns said that he was taking a cut now as "the captain of the ship". Also, he pointed out that Mr Banducci's direct reports will suffer through the remuneration system since the ROFE component of STI (20%) and LTI (33%) will be lost due to remediation expenses.

We think that this is an appropriate first step, but we would have felt happier about it had it occurred closer to the announcement of the problem a month ago. Nevertheless, when we balance all of the above, we will vote proxies for the remuneration report.

Item 4	**Approval of FY2020 LTI grant to Managing Director and CEO, Brad Banducci**
ASA Vote	**For**

This is essentially a procedural motion to give the company the option of making the share grant to Brad Banducci which will vest in 2022 from newly issued shares. The LTI plan allows the company to buy shares on the market to make the grant or pay a cash equivalent. Neither requires formal shareholder approval. The Chair indicated that they felt it was good practice to seek shareholder approval in any case and ASA agrees.

The number of performance rights is 133,050 which is 170% of the TFR divided by the VWAP of the share price at 1/7/2019. This is the maximum number of shares which can be vested in 2022. ASA will vote for the motion.

Item 5	**Approval of US Non-executive Director Equity Plan**
ASA Vote	**For**

This is a straightforward motion to extend to the US resident non-executive directors the same opportunity as other directors to convert director's fees into equity. ASA supports this motion.

Item 6	**Approval of amendment to the constitution**
ASA Vote	**For**

At the EGM following the AGM shareholders will be asked to vote on the first step of a restructure scheme which will see Woolworths split off the Endeavour drinks business and the Hotel business into a separate company. We discuss this below.

This present motion is to give the Board more power to implement in-specie distribution of dividends and returns of capital in the future. It is not an unusual power, and it will avoid expensive and lengthy court hearings should the Restructure proceed. ASA will vote for the motion.

EXTRAORDINARY GENERAL MEETING

RESTRUCTURE SCHEME MEETING

This EGM will take place at the conclusion of the AGM with one item of business, to seek approval of the Restructure Scheme.

EGM	**Approval of Restructure Scheme**
ASA Vote	**For**

This Restructure is the first step in a three-step process to affect a separation of the drinks and hotels businesses into a separate entity called Endeavour Group.

Step 1. (This motion) All of Woolworths drinks businesses (Dan Murphy's, BWS, et al) and Woolworths 75% investment in ALH will be transferred into a new entity to be called Endeavour Group.

Step 2. Woolworths will merge ALH into the Endeavour Group by giving 14.6% of Endeavour to the Bruce Mathieson Group (BMG) in return for their 25% holding in ALH. This step does not require shareholder approval, so approving the Restructure gives a green light to this merger. After this step the portfolio of businesses owned by Woolworths is basically unchanged.

Is the swap of 25% of ALH for 14.6% of Endeavour Group a fair deal? It is difficult to say, but it will entitle the BMG group to roughly the same amount of profit from Endeavour that they currently get from ALH.

Step 3. Endeavour will be separated from Woolworths via a "demerger or other value accretive alternative". This is a vague proposition at this time, but fortunately the company will seek shareholder approval when it is ready to make for this step. Woolworths plans to retain a 15% stake in Endeavour Group after separation, possibly because there are integrated IT and logistics operations between the drinks and food businesses.

The total costs have been estimated at $275 million, and the cost of the first two steps is expected to be $125 million.

The advantages of the first two steps, which are being put to this EGM, are that it will simplify the corporate structure of Woolworths and after the ALH merger allow an integrated drinks and hotels business. There are potential cost savings in unifying system and processes across the retail drinks stores.

The third step will separate the Endeavour Group, and some may see an advantage in Woolworths getting out of the "booze and pokies" business.

ASA encourages shareholders to review the Restructure Booklet and vote their own preference. ASA will vote undirected proxies for the motion.

ASA is unable to advise shareholders on the third step which is ultimately a commercial decision where the determination of the shareholder vote should take account their specific circumstances and viewpoint.

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