Australian Shareholders' Association

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Coles Group – Bigger than Newcastle

Company/ASX Code	Coles Group
AGM date	Wednesday 13th November 2019
Time and location	1:30pm Melbourne Convention and Exhibition Centre, Melbourne Room
Registry	Computershare
Webcast	Yes
Poll or show of hands	e.g. Poll on all items
Monitor	Stewart Burn assisted by John Whittington
Pre AGM Meeting?	Yes with Chair James Graham and Richard Freudenstein

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

Summary of ASA Position

Coles Group was spun out from Wesfarmers with the new board appointed on 19 November 2018. Considering the difficulties in the sector it did very well reporting sales revenue growth of 3.2%, declaring a total dividend of 35.5c. Previously it had a fully internal board appointed by Wesfarmers. Now all seven non-executive directors (NEDs) have had line management responsibility in areas related to Coles with the new CEO Steven Cain having been appointed by Wesfarmers. Coles has developed a very strong governance culture set out in their report.

Coles Group is restructuring its supply chain to increase automation in a deal with Witron, for the setting up of two automated distribution centres by investing over $900m (spread over a period of six years) in the deal. The deal is expected to generate savings of over $1 billion through an increase in operational efficiency.

Coles was in a difficult situation with Viva Energy, where Coles was setting the retail price with no control over costs and was thus uncompetitive. After tough negotiations Coles has entered a more mutually agreeable arrangement with Viva which should result in more traffic and they have received a payment of $137m and are now only responsible for the Coles express retail business. With regards to its hotel business it has now established the Queensland Venue Co joint venture with Australian Venue Co. (AVC). This means that Coles Group is now focused on Supermarkets, Liquor and Express.

Summary

(As at FYE)	**2019**
NPAT ($m)	1,467^
UPAT ($m)	1,078.2
Share price ($)	13.35
Dividend (cents)	35.5
TSR (%)	6.9
EPS (cents)	80.8
CEO total remuneration, actual ($m)	5.4

^or 1,343m excluding significant items

For 2019, the CEO's total actual remuneration was **61 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Item 2.1	**Re-election of James Graham as a Director**
ASA Vote	**For**

Summary of ASA Position

James Graham served as a NED with Wesfarmers for 20 years prior to retiring in July 2018. He was appointed by Wesfarmers as the Chair of Coles Group on the 19 November 2018. He currently holds 460,188 shares and acts as chairman for both Coles Group and Gresham Partners.

As Mr Graham was with Wesfarmers as a NED, during both the acquisition and disposal of Coles he was asked about his independence as Chairman of Coles Group. He stated that no Wesfarmers director ever participated in Coles board meetings and that his role on the board of Coles was significantly different to that of Wesfarmers.

Whilst we believe him to be non-independent due to his tenure at Wesfarmers, given he is the only non-independent on the board and there is a need for some corporate knowledge from Wesfarmers days, the ASA supports his re-election.

Item 2.2	**Re-election of Jacqueline Chow as a Director**
ASA Vote	**For**

Summary of ASA Position

Ms Chow was appointed to the board of Coles Group on 19 November 2018. She currently has 20,000 Coles Group shares and is a director of NIB holdings. She has extensive experience on performance transformation with McKinsey Consulting as well as experience in the retail industry with Fonterra, Campbell Arnott's and Kellogg's.

She appears to have a skill set that is valuable to the board and the ASA supports her re-election

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

Summary of ASA Position

CEO rem. framework	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration Cash	2.1	42.6%	2.1	31.3%
Fixed Remuneration Equity	1.05	21.3%	1.05	15.6%
STI - Cash	1.26	25.6%	2.52	37.5%
STI - Equity	0.00	0%	0.00	0%
LTI	0.522	10.5%	1.05	15.6%
Total	4.93	100.0%	6.72	100%

Note: Transition incentives have been excluded

The remuneration report is generally compliant with ASA guidelines, although the remuneration table did not detail actual remuneration amounts. Coles Group will endeavour to address this issue next year. The details given for fixed remuneration and short-term incentives (STI) and long-term incentives (LTI) for 2019 were clear and reasonable, however; these appear to be transitional values and the actual position for 2020 could be more clearly stated.

As Coles is newly listed, this year all STI's are to be paid in cash. Next year it is proposed that STI's will be 50% cash and 50% equity thus meeting ASA guidelines. Resolution 4 (below) indicates that the LTI will increase from a maximum of 50% of fixed remuneration to 175% of fixed remuneration.

All NED's have a shareholding that exceeds one year's fees, although the CEO doesn't have a shareholding equal to his remuneration. This is expected to be addressed in future years.

For LTI's 50% are subjected to a return on capital (RoC) hurdle and 50% to a total shareholder return (TSR) hurdle. At the moment, the detail of the RoC hurdle is considered commercial-in-confidence. The TSR hurdle vests 50% at the 50th percentile, with straight line vesting to the 75th percentile, where 100% of shares are vested. Currently the LTI performance shares are vested after 3 years rather than the preferred 5 years period of the ASA. This issue has been raised with Coles and alternatives such as an additional 2-year holding lock were suggested. We will monitor this position on an on-going basis.

ASA supports the remuneration report.

Item 4	Approval of LTI grant of performance rights to the MD and CEO
ASA Vote	For

Summary of ASA Position

This for the issue of 275,901 performance rights worth $3.675m. This is equivalent to 175% of (unchanged) base salary and has been calculated based on face value (the volume weighted average share price in the ten trading days up to 30 June).

This is substantially more than the 50% of base salary used in the 2018 long term incentive programme calculation but the 2018 programme also included one-off transition (from Wesfarmers to Coles) payments of $2.4m made to Mr Cain in the 2018 financial year (FY18) and a further $1.5m to be paid in FY19 – none of which had performance hurdles – which have not been replicated in the FY19 remuneration award. This would suggest that Mr Cain's total remuneration for FY20 would be $6.2m at target which is slightly above the 50th percentile of the total remuneration packages for MD/CEOs of ASX companies with a market capitalisation over $10b (Coles' is $19b) [source Godfrey Remuneration Group] and considerably down on the $9.4m (at target) allowed for in the FY19 plan.

One half of these rights will vest based on relative total shareholder return (rTSR) of the company against the ASX100 index over the period from 1 July 2019 to 26 June 2022. If the company's rTSR over this period is less than the 50th percentile then no rights will vest. If the rTSR is between the 50th and 75th percentile then a linear sale will apply from 50% vesting at the 50th percentile to 100% vesting at the 75th percentile. If the rTSR is greater than the 75th percentile then all rights will vest.

The other half of these rights will best base on the company's RoC at 26 June 2022. If the company's RoC at this time is less than 95% of an undisclosed target, then no rights will vest. If the RoC is between 95% and 105% of target, then a linear scale will apply from no vesting at 95% of target to full vesting at 105% of target. If the RoC is greater than 105% of target, then all rights will vest.

If Mr Cain's employment is terminated due to cause or resignation, then all rights will lapse. In all other circumstances a pro rata number of rights will remain on foot as if he had not ceased employment. If there is a change of control (ie takeover) then unvested performance rights will vest on a pro rata basis although the board has discretion. There are also provisions for clawback (where payments need to be returned to the company) in certain circumstances such as fraud or serious misconduct.

We have concerns that this plan is based on performance over only a three year period (we believe a minimum of four years but preferably five or more is more appropriate for a company like Coles) and that the RoC targets have not been disclosed so are not transparent or immune from adjustment. However, we are also aware that this is the first time we have had the opportunity to engage with Coles regarding remuneration so are prepared to give them leeway this year. We will therefore support this item but will expect Coles to make improvements if we are to support it in future years.

Item 5	Appointment of Auditor
ASA Vote	For

Summary of ASA Position

An auditor needs to be appointed at the company's first AGM. Ernst & Young has been nominated by a shareholder who is also a director. The ASA supports this resolution.

Item 6 (a) and (b)	Amended to the constitution
ASA Vote	Against

Summary of ASA Position

This is a non-Board endorsed resolution proposed by the Australasian Centre for Corporate Responsibility (ACCR) and other supportive shareholders to allow shareholders at an AGM to express, in a non-binding resolution, "an opinion or request information about the way in which a power of the company partially or exclusively vested in the directors has been or should be exercised".

We believe that shareholders do not need to change the company's constitution to express their views to management and the directors. Coles Group produced a very comprehensive Environment and Social Governance Report which addresses many of the issues that the ACCR aims to raise with the board.

The individual(s) or their associates involved in the preparation of this voting intention have a shareholding in this company.