



R&D investments bearing fruit

Company/ASX Code	Codan Limited/CDA
AGM date	Wednesday 31 October 2018
Time and location	11 am, Codan, 2 Second Avenue, Mawson Lakes SA 5095
Registry	Computershare
Webcast	No
Poll or show of hands	Poll only if significant proxies against.
Monitor	Stefan Landherr, assisted by Malcolm Keynes
Pre-AGM Meeting?	Yes, with CEO/MD Donald McGurk and CFO/Secretary Michael Barton

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

Summary of ASA Position

Governance and culture

Codan has a consistently high standard of corporate governance and has a good internal culture exemplified by the significant number of long-serving employees (20+ years).

Financial performance including dividends and shareholder returns

Codan has delivered an excellent financial performance in FY1718. Although revenue, profits, and dividends all dropped slightly compared to the previous record year (see table below), the share price increased by 27%, yielding an impressive total shareholder return (TSR) of 33%.

The company has continued to broaden its range of markets and products in order to reduce earnings volatility. The company has also defined a 'baseline' level of predictable earnings (with anything above that considered unpredictable outperformance) and the board has adopted a two-tiered dividend policy to reflect this.

The Minetec technology is beginning to bear fruit - a favourable partnership agreement with the US giant Caterpillar Corporation and also a contract with BHP.

Importantly for a high-tech company, Codan is maintaining a sensible level of investment in engineering and product development and is actively pursuing new growth opportunities including defence applications.

Codan remains debt free with an increased cash position of \$27m and is thus on the lookout for advantageous acquisition(s).

Key events such as restructures, acquisitions, buy backs and capital raisings

- The sale of the old Newton property is due to be finalised in 2020.

Key Board or senior management changes

- Non-executive director Jim McDowell resigned to take up an important government position. Codan is seeking a replacement with technical expertise and international experience.

ASA focus issues (not discussed under remuneration report or re-election of directors)

- **Board composition: Compliant except** only one female director out of 5 (= 20 %)
- **Skin in the game: Compliant** – but new director Ms Gramp will need to increase her shareholdings substantially over the next two years.
- **Shareholder participation: Not compliant** – no breakdown of number of shareholders voting.

Summary

(As at FYE)	2018	2017	2016	2015
NPAT (\$m)	41.6	43.5	15.5	12.4
UPAT (\$m)	39.8	44.7	21.1	12.7
Share price (\$)	2.98	2.34	1.18	1.15
Dividend (cents)	12.5	13.0	6.0	3.5
TSR (%)	33	109	10	60
EPS (cents)	22.1	24.2	8.7	7.1
CEO total remuneration, actual (\$m)	1.15	1.42	0.96	0.68

For 2017/18 the CEO's total actual remuneration was **13.4 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2018 data from the Australian Bureau of Statistics).

Item 2	Adoption of Remuneration Report
ASA Vote	For

Summary of ASA Position

- (a) **The fixed remuneration** of directors and executives is in line with similar companies.
- (b) **The short-term incentive (STI)** scheme is that executives receive a 50% bonus for achieving specified performance hurdles, mainly financial measures, and the bonus can go higher for exceeding the performance hurdles. This year all five executives received an STI bonus reflecting the company's good performance. Overall, the total executive bonuses were approximately 60%

of their total fixed remuneration. The bonus is paid as a mix of cash and equity. Pleasingly, the company has moved to a 50:50 cash/equity split this year and is planning to move even further to a 40:60 split next year.

(c) **The long-term incentive (LTI)** scheme is a performance rights plan based on growth in earnings per share over a three-year period. Up to 50% of an executive's fixed salary is converted to share performance rights (using market price) but these rights vest in full only if the 'baseline' earnings per share (as mentioned in item 1 above) grow by 15% per annum (compounded) over the next three years. The threshold for vesting is a growth rate of 5% per annum (compounded). If the growth rate is between 5% and 15% per annum, a pro-rata vesting will occur. Although scheme's three-year performance period does not meet the ASA guideline of four years, the shares are not issued until the financial year after vesting occurs and there are significant escrow conditions. Furthermore, the hurdles are quite challenging and the scheme has been applied consistently over the years. For example, the performance rights granted in December 2013 lapsed in June 2016 because the three-year aggregate performance target was not reached.

(d) **Overall**, the Codan remuneration structure is aligned with shareholder interests and we support the resolution.

However we suggest two improvements to meet ASA guidelines:

- (1) Include a table of actual "take-home" pay for senior executives; **(ASA 2018 Focus Issue)**
- (2) Increase the LTI vesting period from three years to four years.

Item 3	Re-election of Mr David Simmons as a Director
ASA Vote	For

Summary of ASA Position

Mr Simmons has been an independent non-executive director since May 2008 and was appointed by the board as Chairman in February 2015. He has worked in the manufacturing industry throughout his career and has extensive financial and general management experience, including 16 years as MD of Hills Industries. His professional background and experience make him well qualified to be a director (and Chairman) of Codan, where he chairs the Remuneration and Nomination Committees. We note that since he has been a director for 10 years, the ASA would not classify him as an independent director after the end of his next term.

Mr Simmons sits on only two other boards, including one as Chairman, and therefore meets ASA directorship workload guidelines. Mr Simmons also meets the ASA Guidelines on shareholdings, and we will vote for his re-election.

Item 4	Approval of LTI grant to CEO/Managing Director Donald McGurk
ASA Vote	For

Summary of ASA Position

The proposed grant is based on the company's performance rights plan outlined in Item 2 above.

The proposal is to grant to Mr McGurk 91,972 performance rights, valued at \$3.1675 each, equating to 50% of his fixed pay of \$582,643 (i.e. \$291,321). The performance rights have been valued at the 5-day volume weighted average share price (VWAP) immediately following the release of the company's FY18 results in August.

The performance period is three years and the threshold performance hurdle is 5% compounded annual growth in 'baseline' earnings per share (EPS) over the period, with full vesting if 15% compounded annual growth is achieved. Thus, these rights will vest in full, at nil exercise price, in June 2021 if the cumulative EPS over the performance period is 62.30c, and a pro-rata vesting will occur if the cumulative EPS over the performance period is between 51.64c and 62.30c.

Mr McGurk was granted 296,877 performance rights in November 2014, and these vested in full this year. He currently holds 236,948 performance rights issued in 2015 and these are also likely to vest in full.

Although the three-year performance period does not meet the ASA guidelines of four years, the shares are not issued until the financial year after vesting occurs and there are significant escrow conditions. Furthermore the proposed grant has significant performance hurdles and is in aligned with shareholder interests, so we support the resolution.

Note on 'baseline' EPS

The Board sets 'baseline' EPS each year, broadly in line with its philosophy of baseline earnings for dividend purposes.

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

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