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Bigger acquisitions impacts EPS

Company/ASX Code	GUD Holdings
AGM date	Thursday 27 October 2022
Time and location	11am RACV Club Bourke St Melbourne
Registry	Computershare
Type of meeting	Hybrid
Poll or show of hands	Poll
Monitor	Claudio Esposito
Pre-AGM Meeting?	Yes with Chair Graeme Billings, Chair of Remuneration David Robinson, Company Secretary Malcolm Tyler

Monitor Shareholding: The individual involved in the preparation of this voting intention has no shareholding in this company.

Summary of issues for meeting

GUD continue to expand into new geographies through a very active acquisitions program which forms part of their growth strategy. The company is growing their manufacturing base and whilst ACSI have ranked GUD basic for their reporting of their environmental impact in 2021, GUD believe that measures have been put in place that improve on these evaluations into the future.

GUD are also facing supply chain headwind and is faced with uncertainty as the Ukrainian war continues and China's strict covid policies cause delays.

Proposed Voting Summary

No.	Resolution description	Vote
2	Re-election of Mr Graeme Billings	For
3	Adoption of Remuneration Report	For
4	Approval of LTI grant to Managing Director	For
5	Approval of award of STI deferred equity grant to Managing Director	For
6	Financial Assistance – Banking facilities and AutoPacific Group acquisition	For

Summary of ASA Position

Governance and culture

GUD had made several changes to their remuneration. In an effort to modernise their previous structure and with the advice of consultants, the board felt that components of the remuneration needed to be raised to a more competitive level so in 2021 they had agreed to change the short-term incentive (STI) target (26% fixed remuneration to 40%) and maximum pay out figures (up to 75%), to add environmental social and governance (ESG) components consisting of three metrics and a portion of deferred equity if successful, commencing FY22.

The remuneration package offered to Mr Whickman (CEO) appears to be well balanced. The STIs comprise a mixture of equity and cash and a one year holding lock once vested. A mix of profitability (EBITA) and ESG targets are used to measure performance. Given the company's industry impact on climate, this would be reasonable. The LTI is measured over three years and uses relative total shareholder return (TSR) to measure long term performance. Both STI an LTI have profitability targets and an ESG component. The ESG component consists of a safety metric, an employee engagement and an ethical sourcing metric. The ESG component of both the STI and LTI will not vest unless an earnings gateway is achieved.

GUD's independence policy indicates that directors should have no commercial affiliation with the company or its suppliers in order to maintain business at 'arm's length' in spite of Mr Billings and Mr Robinson lengthy stay on the board (11 years). The issue of tenure is not considered in GUDs policy. GUD believe that chairman having tenure can only benefit the company because of deeper understanding. GUD maintain that whilst Mr Billings has served for many years, he has only served in the role of Chair for three years. We have stated our position to GUD indicating that ASA would not consider him independent after 12 years.

GUD's board consists of five non-executive directors plus the CEO. There are two women on the board which meets our gender diversity policy guidelines. The board have a good body of experience and the workload is within policy limits for the busiest directors we have noted.

The annual report still lacks a granular skills matrix and has been a source of discussion with ASA in previous years. We're hopeful that the outcome of our discussion will lead to action.

Financial performance

GUD recorded a statutory NPAT of $27m (55% down on FY21) with an underlying NPAT $88m. The difference is reflective of the acquisitional costs of primarily Vision X and APG and impairment charges to Davey's Inventory and Intangibles amounting to around $53m plus $10m worth of amortisation charges.

GUD's revenues have increased by 50% to $835m inclusive of acquisitions. Overall each business did well with the auto business revenues growing by 30% (6.5% organic growth), and Davey grew by 12%.

It is also important to note that the acquisitions of Vision X and APG will also contribute to a higher proportion of earning next year benefitting from a full 12 months of earnings as well as synergies gained. GUDs underlying performance over the long term however has unfortunately been lacklustre with revenue growth and EPS staying relatively stagnant. The acquisition of APG and Vision X has increased the earnings markedly for FY22 and changed that trend.

Key events

GUD had engaged in their largest acquisition to date this financial year with the acquisition of Auto Pacific Group (APG). The transaction cost $745m and consisted of $405m (54%) equity raise and $282m (38%) debt funding. In addition, $75m worth of GUD shares was offered to the Private Equity group holders, Private Equity Partners (PEP) valued at around $11. The capital raise was a non-renounceable prorated offering to its existing retail shareholders with a 1 for 3.46 share offering. Approximately 50% of the existing retail base took up the offering.

We discussed with GUD that, overall, we were happy with the offering with the exception that those who did not wish to participate were not entitled to sell the rights to be bought from potential participants on market (ASA's preferred raising method via a PAITREO). Had this been the case it would have compensated them for the dilution incurred which saw GUDs capital base expand by 40%. GUD explained to us that the capital had been raised quickly and with no sufficient time to allow for trading of existing shareholder rights.

There was also a smaller but important acquisition, Vision X, for $52m which markets auto lighting and complements the business BWI (acquired back in 2015). If the Vison X performs well, an additional $20m will be paid to the owners as an earn out which GUD believe is likely. Both companies are highly complementary to their current product range and have already contributed significantly to their revenue base after only 6 months of earnings contributions.

GUD are confident of further earnings growth after a full 12 months plus synergies acquired over the years. The acquisitions have changed the company's capital structure and whilst its ability to service this debt is still manageable (2.4X EBIT) they have an internal limit of 3.5 so they not concerned. The gearing however has risen substantially to 70% which is reflective of the financial risk assumed by the business. GUD are confident to get these ratios down to a more comfortable limit in the next two years.

GUD also had around $55 million in impairment charges due to the Davey water business. GUD has restructured Davey's management team from the bottom-up and installed a new MD. Follow on changes saw certain write downs after having discovered redundant inventory held over several years. A combination of cost incurred from changed management and write downs will ultimately gets expensed through the accounts pushing down Davey's earnings.

Key Board or senior management changes

GUD has installed a new MD within the Davey water business as part of a performance review conducted which had shown Davey's underlying performance below expectations.

Davey had experienced supply chain impacts to revenues and inventory problems such as outdated stock and shortages of product lines ultimately affecting sales. The cost in restructure was explained earlier but GUD are happy with changes they've managed to put forward and GUD expect see a positive impact by FY23.

ASA focus issues

As indicated previously, GUD have engaged in reasonably fair capital raising programs allowing retail shareholders to subscribe to prorated share issue however they fell short when not offering trading rights.

GUD have incorporated ESG into their remuneration plans to help drive outcomes, have structured acquisitions to capture a growing market of electric vehicles and non-internal combustion engine businesses. GUD also have an in-depth safety infrastructure and practices and continue to foster a culture of safety as evidenced comprehensively in the annual report.

GUD also do not have a minimum shareholding policy. I had discussed ASA's views and while they understand its importance, they won't make it policy. GUD encourage a shareholding but do not agree with having it mandated. Their view is that it's their choice and having executives accumulate shareholding without a policy is testament within itself. The CEO as well as some directors have volunteered to accumulate a shareholding. Mr Whickman opted to commit to having a meaningful shareholding and sought out a loan from GUD of around $300,000 with the board's approval. The loan is not non-recourse and is an interest-bearing loan above the company's cost of capital issued not long after he was appointed.

Summary

(As at FYE)	**2022**	**2021**	**2020**	**2019**	**2018**
NPAT ($m)	27.3	61.0	43.7	59.6	101.8
UPAT ($m)	88.9	64.0	48.2	60.9	88.9
Share price ($)	7.99	11.99	11.51	10.01	14.16
Dividend (cents)	39.0	57.0	37.0	56.0	52.0
Simple TSR (%)	(31)	9	19	(26)	13
EPS (cents)	22.9	67.0	50.4	68.9	58.6
CEO total remuneration, actual ($m)	2.06	1.80	1.21	1.11*	1.97

* This represents the combined pay of the previous CEO who received $0.299m statutory renumeration for the period 1 July 2018 to 30 September 2018 and the new CEO who received $0.810m for the period 1 October 2018 to 30 June 2019. Statutory NPAT and EPS are the audited figure from the financial accounts. Underlying NPAT is (usually) an unaudited figure used in management presentations or commentary. Total Shareholder Return is calculated as the share price change over the year plus the dividend declared during the year, divided by the share price at end of previous year. This may differ from the figure quoted by the company.

National office will record Actual earnings and calculate the CEO's total actual remuneration compared to annualised Australian Full time Adult Average Weekly Total Earnings (based on data from the Australian Bureau of Statistics http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0). Actual earnings are ASA defined as the cash payments made during the year (FR, STI, deferred STI, plus any vesting of equity incentives at share price on date of vesting).

Simple TSR is calculated by dividing (change in share price plus dividend paid during the year, excluding franking by the share price at the start of the year.

Item 2 Re-election of GA Billings

Mr Billings is up for re-election and was first appointed to the board in 2011. He was then appointed as chairman in 2019.He currently also chairs Austco Health Ltd and is a Non-executive Director and Chairman of the audit committee at Clover Corporation. Mr Billings workload is considerable but within limits for ASA policy standards. He graduated in commerce with many years working with PWC and has extensive experience as a non-executive director of multiple companies.

Whilst Mr Billings hasn't had experience directly within the auto business, he has had extensive experience as non-executive director encompassing healthcare, property and engineering services which services airlines, Oil and Gas, mining, water and data/communication.

Mr Billings has been on the board for 11 years and whilst under ASA policy he is considered independent, more than 12 years would be grounds to reconsider independence. Mr Billings' shareholding at a market value of around $240,000 is below ASA policy guidelines (one year worth of fees) as indicated earlier, GUD have no mandated policies for KMP or NEDs to hold a minimum shareholding. On the positive, Mr Billings has always retained some shareholding and has increased it around 9 times since 2015 so he has actively been accumulating over the years as opposed to selling down or not buying at all.

Adoption of the Remuneration Report

The 2022 STI structure has a maximum of 90% of fixed remuneration (FR, i.e. $942.6K) and is divided into a maximum of $628.4k cash and $314.2K deferred equity. If successful, the ESG component is awarded in equity deferred for 12 months and they have both STI and LTI have an EBITDA and ESG metric. The preferred STI structure for the ASA is 50% cash; 50% deferred equity in restricted shares, but this is however reasonable.

For FY22, Mr Whickman's restricted share award is 54% of the maximum amount payable. That is, $170k or 18,047 shares at the VWAP price of June 2022, being $9.43

The LTI is measured over three years and uses multiple metrics such as relative TSR, EPS and ESG metrics. A longer period would be preferred by ASA (4-5 years) however the ESG won't be paid unless an EPS gateway is achieved. The relative total shareholder return (rTSR) measures GUDs performance against peers, the EPS measures their performance directly and ESG allows for some environmental social governance accountability

The rTSR as of FY23 will been measured against the ASX 300 Consumer Discretionary Index which is a smaller group of 35 stocks and considered a better comparator than the previous comparator group, the ASX Small Ordinaries Index. See below for realised pay FY2022. Note that GUD also have included a table of actual realised pay in their report which follows ASA preferences.

Remuneration Structure	Payment
Total Fixed Remuneration	$1.0m Cash
Short Term Incentive	$0.515m Cash and Equity $0.170m held in escrow 12 months
Long Term Incentive	Equity Rights $0.384m (40,700 rights)
Total	$2.06m

Approval of LTI grant to Managing Director

The board seeks shareholder approval to grant Mr Whickman total of 92,336 rights for the next three-year performance period. These are calculated by dividing the target, namely 80% of his fixed salary of $1.088m by the 30 June 2022 VWAP of $9.43. They vest under three tranches, 40% for achieving an rTSR against a comparator group (with a hurdle requiring positive absolute TSR), 40% against an EPS target, and 20% against an environmental sustainability target, defined as a revenue share of products not designed for internal combustion engines. This is both innovative, with challenging targets and is aligned with ASA guidelines, so we will vote for this grant. This is the one of the first explicit and significant ESG components of an awards plan that we have seen in an industry which contributes much to global warming.

Approval of award of STI Deferred Equity to Managing Director

The board seeks shareholder approval to grant Mr Whickman total of 18,047 restricted shares for FY22 STI plan. Subject to assessment by the board, Mr Whickman will be entitled to receive $170,141 in deferred equity (16.2% of fixed remuneration) Both the cash and equity component requires a gateway based on return on net assets to be achieved in order to pay-out.

There is a holding lock of 12 months and may continue thereafter until such time as the share price exceeds the equity raise price conducted in December 2021 which was $10.41 (GUDs share price as of time of writing this report is $7.70)

The equity will also lapse should the CEO leave the company which reflects one of GUDs stated remuneration goals of retaining their executive talent.

Financial Assistance - Banking facilities and AutoPacific Group acquisition

GUD has requested shareholder approval for the financing of business activities of the acquired company Auto pacific Group. The company (APG) will be responsible for borrowing $382m and paying back the sum by 2026. They will also have a fixed loan of around $292m also payable by 2031. Given this loan is required to help facilitate operations at APG, ASA will vote in favour.

Appendix 1

CEO rem. Framework for FY23	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.047	51.3%	1.047	40%
STI - Cash	0.418	20.5%	0.785	30%
STI - Equity	0.157	7.7%	0.157	6%
LTI	0.418	20.5%	0.628	24%
Total	2.04	100.0%	2.617	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.