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SCA shows resilience in face of COVID-19

Company/ASX Code	SCA Property Group (SCP)
AGM date	Wednesday 25 November 2020
Time and location	2.00pm AEDT Virtual (https://agmlive.link/SCP20)
Registry	Link Market Services
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Lewis Gomes assisted by Pamela Murray-Jones
Pre AGM Meeting?	Yes with Chair Philip Marcus Clark and Deputy Chair Steven Crane

The individuals (or their associates) involved in the preparation of this voting intention have security holdings in this company.

	Consideration of accounts and reports
ASA Vote	No vote required

Financial performance

In a year that will always be remembered for the impacts of COVID-19, SCA Property Group (SCA) ended the financial year in a relatively strong position compared with many other companies in the retail sector. While statutory profit - or Net Profit After Tax (NPAT) - was down 22% to $85.5 million compared with FY19, mainly due to property valuation decreases, Funds From Operations (FFO) were down by only 0.7% to $140.8 million. FFO per unit was 14.65 cents, down 10.3% compared to last year while total distributions of 12.5 cents per unit (cpu) were down 15% from last year's 14.7 cpu, in part due to a 15.8% increase in the number of issued units at year's end following a capital raising in April and May 2020.

The difference between the NPAT and FFO comprised $87.9 million of fair value property negative adjustments partly offset by a gain of $51.4 million in financial derivatives, and other negatives of nearly $20 million. The portfolio weighted average cap rate softened slightly to 6.51% while net tangible assets per unit was $2.22 versus $2.27 at the end of FY19.

Both supermarket moving annual turnover (MAT) growth and discount department store MAT growth were up from FY19 at 5.1% and 7.6% respectively. Portfolio occupancy was 98.2% but concessions had to be made in the form of reduced rents and increased incentives for specialty stores to maintain high occupancy levels. During FY20, there were 232 lease renewals (215 in FY19) and 146 new lease deals (87 in FY19) indicating a higher than average turnover of leases as might have been expected due to COVID-19 trading constraints.

The direct impact of COVID-19 on FFO for FY20 was $20.5 million (or 2.13 cpu) based on $1.6 million in extra cleaning, $4.5 million in waived rent and $14.4 million in Expected Credit Loss (ECL). The cash shortfall for FY20 was $26.8 million which included $4.1 million of rent owing from FY19.

A trading update released to the ASX on 27 October showed a pleasing uptick in activity and rental collections, notwithstanding the continued lockdown in Victoria. Overall trading in Q1 FY21 showed a 9.0% increase on Q1 FY20 with supermarkets and discount department stores trading strongly. The provisioned ECL at 30 June 2020 of $15.3 million has been reduced by $3.4 million due to greater payments received for back rent than was assumed at the time. In another positive sign, SCA completed the acquisition of its first centre in the Northern Territory at Bakewell near Darwin for a fully let yield of 7.2%.

Key events

The most significant key event was, of course, the impact of COVID-19 which began in Australia around mid-March and soon led to widespread shutdowns of workplaces, shopping malls, restaurants and cafes, and tourism activities. To some extent, SCA was better placed than many others in that almost all of its neighbourhood and sub-regional shopping centres are located in the suburbs and are anchored by the major supermarket chains which experienced a surge of buying activity as people stocked up on groceries and other necessities. However, the specialty stores, which account for about half of SCA’s rental income, were quite severely affected by forced closures or simply insufficient numbers of customers due to lockdowns and health fears.

An indication of the immediate impact on SCA can be seen in its unit price which was at a near record of $3.17 on 19 February and subsequently fell to $2.05 on 19 March. The unit price steadied in the following months, ending the financial year at $2.18 and rising to $2.32 by the end of October.

As a precautionary measure, the board of SCA implemented a capital raising in April, with $250 million coming from institutional investors and, subsequently, $29.3 million from retail investors at a price of $2.16 per unit in May. Somewhat surprisingly, the institutional demand was very strong at approximately 3.5 times the target while the retail component fell short of its target of $50 million, the latter outcome probably being a response to the considerable uncertainty and caution amongst retail investors at the time. The company also secured an additional $200 million line of credit to ensure it was able to meet a medium term note repayment in early 2021. Gearing ended the year at 25.6%, below the company’s target range of 30% to 40%.

SCA successfully sold its SURF1 properties for $69.3 million (original cost of $60.9 million) for an internal rate of return of 11% per annum plus a potential performance fee of $0.4 million. While this deal seems to have been quite favourable, the Chair expressed the view that this investment was “hard work” and SCA is not rushing into similar new deals. SCA has also divested some assets in SURF2 and SURF3 in order to reduce gearing. SCA is also looking to sell its remaining holding in the listed entity CQR which has not been a positive experience for the company.

Key Board or senior management changes

SCA continues to be a well-run and transparent organisation with an appropriate balance of attention to its financial performance, its management and staff, its tenants and local communities and, of course, its unit holders.

The only changes to the board this year was the retirement of Philip Redmond effective 30 September 2020 and the elevation of Steve Crane to the position of Deputy Chair as well as Chair of the Remuneration Committee. The appointment of a Deputy Chair was made as a support to the current Chair, Philip Marcus Clark, who is seeking re-election at the upcoming AGM for what is understood to be his final term as a director of SCA. However, the point was made in our Pre-AGM meeting with both gentlemen that no decisions have yet been made on Philip's retirement or replacement.

We were also advised that the board is currently searching for a replacement director for Mr Redmond, preferably a candidate with significant retail and online experience and ideally with past CEO experience.

There were no changes in the management team during FY20.

Financial Summary

Item (as at FYE)	2020	2019	2018	2017	2016
NPAT ($m)[1]	85.5	109.6	175.2	319.6	184.7
FFO ($m)	140.8	141.8	114.3	108.4	100.1
Security price ($)	2.18	2.39	2.45	2.19	2.28
Distribution (cents)	12.5	14.7	13.9	13.1	12.2
TSR (%)	(4.1)	3.6	18.4	1.8	13.0
EPS (cents)[2]	26.90	16.33	15.30	14.70	13.75
CEO total remuneration, actual ($m)[3]	2.34	2.94	2.00	2.42	1.77

1.includes significant items 2. unadjusted for impact of equity raisings 3 Includes components of prior year STI and LTI awards

For 2020, the CEO's total actual remuneration was 25.4 times the Australian Full time Adult Average Weekly Total Earnings (based on May 2020 data from the Australian Bureau of Statistics).

Item 1	**Adoption of Remuneration Report**
ASA Vote	**For**

Summary

Executive total fixed remuneration was increased by between 5.2% and 6.0% on 1 October 2019 and was the first adjustment since October 2017. For FY20, the financial and operational targets were not met due to the impact of COVID-19 and, while the personal performance components of the Short Term Incentive (STI) were on track to be achieved, the board decided that no STI would be awarded for this year. The Long Term Incentive (LTI) award for FY16 vested in August 2019 at 95.86% of available units and deferred STI units also vested (refer Page 40 of the Annual Report).

STI would normally be paid 50% in cash following the release of the annual accounts while the other 50% would be in the form of deferred units held for 2 years from award. The LTI awards are tested over a 3 year period and retained for another year before vesting. For the STI award, financial measures comprise 80% of the assessment and 20% is gained from personal achievements. The LTI awards are assessed equally against 3 financial measures being relative TSR, growth in FFO per unit and ROE (refer Pages 46 to 50 of Annual Report).

While the board declined the STI award for FY20, it did approve the vesting of the FY17 LTI award which was due to be made in August 2020 as this award was made on achievements prior to the onset of COVID-19.

A 2.5% increase was made to NED base fees from 1 January 2020, prior to the pandemic, but there were no increases to committee fees.

CEO Remuneration Framework for FY20

Component	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	0.950	36.4	0.950	33.3
STI - Cash	0.356	13.6	0.475	16.7
STI - Equity	0.356	13.6	0.475	16.7
LTI	0.950	36.4	0.950	33.3
Total	2.612	100.0	2.850	100.0

The remuneration framework is generally in accordance with ASA guidelines except for the LTI testing and retention periods which are shorter than desired. This point was raised in the Pre-AGM meeting and SCA acknowledged our views but restated its past position that it thinks a 4 year deferral of LTI awards is reasonable and appropriate to its business. Given the performance of the business over such a challenging period and noting that no STI was paid for FY20 and that STI and LTI maximum awards are modest compared with most other companies, the ASA recommends voting FOR this resolution.

Item 2	**Re-election of Philip Marcus Clark as a Director**
ASA Vote	**For**

Mr Clark was first appointed to the board as a non-executive director and chairman in September 2012 when SCA was created by Woolworths to act as a landlord for a number of its shopping centres. He is now seeking re-election for what he states will be his final term. Mr Clark holds a number of other directorships with government and private boards and advisory roles with several tertiary institutions. Prior to joining SCA, Mr Clark was a managing partner of the law firm Minter Ellison (1995 to 2005) and Mallesons Stephen Jacques (1977 to 1993). He has been a director of several listed A-REITs.

The ASA has found Mr Clark to be an open and accessible chairman with a strong commitment to SCA's retail shareholder base. He is passionate about the success of SCA and has overseen steady growth of the business since its inception. He has laid the groundwork for his successor as chairman although, as noted earlier, no formal decision on this matter has been made by the board. On the basis that this is Mr Clark's last term as a director and in view of his strong contribution to SCA, the ASA recommends voting FOR this resolution.

Item 3	**Approval of LTI grant to CEO Anthony Mellowes**
ASA Vote	**For**

This resolution seeks approval of a grant of 443,759 LTI Rights as part of Mr Mellowes' FY21 remuneration package. The grant is based on a maximum LTI award of 100% of his TFR being $965,000 divided by the unit price of $2.1746 being the 5 day weighted average price following the release of SCA's 2020 full year results on 10 August 2020.

The ASA considers the quantum of the grant, being 100% of TFR, is reasonable and appropriate to the role of Mr Mellowes and recommends voting FOR this resolution.

Item 4	**Approval of LTI grant to CFO Mark Fleming**
ASA Vote	**For**

This resolution seeks approval of a grant of 213,257 LTI Rights as part of Mr Fleming's FY21 remuneration package. The grant is based on a maximum LTI award of 70% of his TFR being $463,750 divided by the unit price of $2.1746 being the 5 day weighted average price following the release of SCA's 2020 full year results on 10 August 2020.

The ASA considers the quantum of the grant, being 70% of TFR, is reasonable and appropriate to the role of Mr Fleming and recommends voting FOR this resolution.

Item 5	**Ratification of prior issue of stapled units**
ASA Vote	**For**

As noted earlier, SCA raised $250 million by way of the issue of 115,740,741 units at $2.16 in April 2020 pursuant to SCA's 15% capacity under ASX Listing Rule 7.1. SCA wishes to retain the flexibility to raise additional capital in the future, although it has no current plans to do so. If this resolution is approved, the earlier issue of units will not count towards SCA's capacity under the ASX Rule.

The ASA views this resolution as an appropriate precautionary measure commonly used by companies after raising capital from shareholders and other investors, and therefore recommends voting FOR this resolution.

Item 6	**Amendments of constitutions to provide for hybrid and virtual meetings**
ASA Vote	**For**

This resolution seeks to amend the constitutions of both the Shopping Centres Australasia Property Retail Trust and the Shopping Centres Australasia Property Management Trust to allow each Trust the ability to hold virtual or hybrid meetings once current temporary arrangements to permit virtual-only meetings put in place to deal with COVID-19 are withdrawn or expire.

The ASA sought assurances from SCA during the Pre-AGM meeting that this resolution is not intended to allow SCA to hold virtual-only meetings once COVID-19 restrictions on physical meetings are removed. Both the Chairman and Deputy Chairman gave assurances that this is not SCA's intention and further, that it greatly values unit holder participation in meetings and will continue to provide for physical meetings, complemented by video access for unit holders unable to attend, once it is able to do so.

On the basis of these assurances, the ASA recommends voting FOR this resolution.