Australian Shareholders' Association

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Refining margins hit severely but possible upside in revised Coles agreement

Company/ASX Code	Viva Energy Group (VEA)
AGM date	Thursday 23 May 2019
Time and location	11am, Clarendon Room A, Melbourne Convention and Exhibition Centre, 1 Convention Centre Place, South Wharf, Melbourne
Registry	Link
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	John Whittington
Pre-AGM Meeting?	Yes, with Chair Robert Hill

Item 1	**Financial report, directors' report, and auditor's report**
ASA Vote	No vote required

Summary of ASA Position

Viva Energy was listed on the ASX on 13 July 2018 with previous owner, Vitol Investment Partnership still owning approx. 45% of the company. Viva Energy supplies fuel through a national network of retail sites, the majority of which are Shell branded, and directly to commercial customers. It also owns and operates Shell's old refinery at Geelong.

<u>Financial performance</u>

In FY18 Viva Energy's total revenue increased 18% to $16.395m with the addition of 90 retail sites, and the acquisition of a 50% interest in the Westside Petroleum business.

Reported net profit after tax (NPAT) for the year was $579.6m (up 100%) but this includes a one-off deferred tax benefit of $358.4m so, excluding this, revenue was down significantly. The company claimed an underlying NPAT based on replacement cost of $293.0m (down 19%). The various business areas were only reported at EBITDA (earnings before interest, tax, depreciation, and amortisation) level with retail up 0.2% to $608.8m, commercial up 3.9% to $323.5m, refining down 55% to $124.5m, and supply, corporate and overhead costs reduced by 5.8% to $528.2m.

Cash flow from operations was up 77% to $287.2m. No dividends were paid during the year but a first dividend of 4.8 cents was announced in Feb 2019. Total shareholder return to 31 December was -28% from the initial public offer (IPO) price however the share price has subsequently increased and it is now back close to the IPO price.

<u>Key events</u>

Other than the listing on the ASX mentioned above there were no key events during the year. Following the end of the year however a major change was made to the Alliance agreement with

Coles Express which means that Viva will have full responsibility for the retail fuel offering, including pricing and marketing from March 2019. This is expected to lift volumes (and retail market share) which has declined in recent times. They also announced the purchase of the 50% of Liberty Oil's wholesale business they did not already own.

Key Board or senior management changes

No changes to the board or senior management have occurred since the IPO.

ASA focus issue

Remuneration disclosure is generally poor (see below for details). Size of executive shareholdings ("skin in the game ") is good but size of non-executive director (NED) shareholdings is somewhat disappointing with all NEDs holding shares worth about 12% of their remuneration where we would have expected at least 33% (or more) at this stage.

Board composition is satisfactory, and we have yet to have any concerns regarding shareholder participation.

Summary

(As at FYE)	**2018**	**2017**
NPAT ($m)	579.6	354.9
UPAT ($m)	293.0	361.0
Share price ($)	$1.80	N/A
Dividend (cents)	0	N/A
TSR (%)	-28%*	N/A
EPS (cents)	15.1	N/A
CEO total remuneration, **statutory** ($m)	5.840	Not disclosed

*from IPO price

For 2018, the CEO's total actual remuneration was **67 times** the Australian Full time Adult Average Weekly Total Earnings (based on November 2018 data from the Australian Bureau of Statistics).

Item 2	**Appoint Auditor**
ASA Vote	**Undecided**

Summary of ASA Position

As the company is newly listed and, as the proposed auditor PricewaterhouseCoopers (PwC) has not been approved by shareholders, this resolution is required at this first AGM.

PwC is also the auditor for Vitol Investment Partnership, the seller into the recent IPO (and retaining around 45% of total shares), so we are concerned about any conflict of interest. We are currently seeking information about how directors are managing this potential conflict of interest.

If we are satisfied that this conflict of interest is being appropriately managed, we will support the resolution.

Item 3	**Adopt remuneration report**
ASA Vote	**Against**

Summary of ASA Position

The presentation of the Remuneration Report is understandable and gives a good sense for how they have structured remuneration. Unfortunately, however, it does not outline the 2019 short-term incentive (STI), and long-term incentive (LTI) schemes, nor does it include a table of actual remuneration, so we don't know what the executives actually took home in 2018.

The 2018 remuneration structure had three ongoing components – fixed remuneration, STI, and LTI. Until 1 January 2020 they will also have a generous residual LTI scheme initiated by their previous owners and disclosed in the prospectus to the IPO. The CEO's fixed remuneration is $896,000 (this was lower prior to the IPO due to the higher incentive payments at the time).

The 2018 STI, which could range from 0-134% of fixed remuneration for the CEO (0-107% for CFO), was based on a number of disclosed measures (60% financial, 20% strategic and "operational excellence", 10% safety and culture) and would be delivered 50% in cash and 50% in share rights. Half the STI share rights vest 12 months after the cash component is paid and the other half 12 months later. It also had a gateway condition that the prospectus forecast of underlying EBITDA must be met before any STI was payable. As the forecast was not met, no STI was paid.

The 2018 LTI, which could also range from 1-134% of fixed remuneration for the CEO (0-107% for CFO), is based on three measures.

Half of these rights will vest based on total shareholder return (TSR) from listing to 31 December 2020 relative to the ASX100. If TSR is below the 50th percentile then no rights will vest. If TSR is between the 50th and 75th percentile then a linear scale will apply from 50% vesting at the 50th percentile to 100% vesting at the 75th percentile. If TSR exceeds the 75th percentile then all rights will vest.

One quarter of these rights will vest based on free cash flow (FCF) between 1 January 2018 and 31 December 2020 and one quarter will vest based on the return of capital employed (ROCE) over the same period. If the (undisclosed) target is not met than no rights will vest. If the result is between the target and the stretch target, then a linear scale will apply from 50% vesting at the target to 100% vesting at the stretch target. If the result exceeds the stretch target, then all rights will vest.

All rights will lapse if the executives cease employment (other than through death, terminal illness, or disablement) before the rights vest, although the board does have some discretion. There are no voting rights or entitlements to dividends on unvested rights.

The fees (which incurred additional fees as part of the IPO) for non-executive directors (NED) seem high – well above the 75th percentile for similar sized ASX companies in 2018 and well above the median/50th percentile going forward.

Whilst we believe the remuneration structure to be good in a number of areas, we cannot support the report for the following reasons (most of which we believe are "beginner mistakes"):

- No information about the 2019 plans;
- No table of actual remuneration;
- No disclosure as to 2018 performance achieved;
- Poor disclosure of how the FCF LTI component is calculated and how both the FCF and ROCE components are actually measured;
- LTIs can be paid if shareholder returns are negative;
- LTI performance period of only three years;
- High NED fees;
- The aggressive vesting schedule; and
- The ability for the Board to vest 100% of LTIs on a change of control.

Item 4a	**Re-elect Robert Hill as a director**
ASA Vote	**For**

Summary of ASA Position

The Hon Robert Hill, a former barrister, solicitor and Australian Senator who was Minister for Defence, Minister for the Environment, Leader of the Government in the Senate, and Australia's Ambassador to the UN, was appointed to the board in June 2018 (although he was on the board of the previous unlisted company since February 2015). He has a shareholding equivalent to only 12% of his total remuneration.

Robert is not currently director of any ASX listed company but is Chair of one other company (Re Group) and of three other organisations (Antarctic Science Foundation, NSW Biodiversity Conservation Trust, and the Cooperative Research Centre for Low Carbon Living). We do not consider this workload excessive.

We believe that Robert is well qualified to contribute to the board and, whilst we are disappointed by his lack of "skin in the game" (ie shareholding), given it is less than twelve months since listing we will support his election.

Item 4b	**Re-elect Dat Duong as a director**
ASA Vote	**For**

Summary of ASA Position

Mr Duong, a nominee of Vitol Investment Partnership (around 45% owner of Viva Energy), is the Head of Investments for Vitol in Asia Pacific and has extensive international investment banking experience, particularly in downstream oil transactions. He was appointed to the board in June 2018 (although he was on the board of the previous unlisted company since January 2017) and holds no Viva Energy shares.

Mr Duong appears not to be a director of any other listed or unlisted company.

We believe that Mr Duong is very well qualified to contribute to the board and, whilst we are disappointed by his lack of personal “skin in the game” (ie shareholding), given he is an employee and representative of a 45% owner we will support his election.

Item 5	**Grant of performance rights to Scott Wyatt, the company’s CEO, under the Company’s long term incentive plan**
ASA Vote	**Against**

Summary of ASA Position

This is for the issue of a maximum of 541,198 performance rights worth $1.2m (based on a weighted average price over the period from 31 July 2018 to 31 December 2018) and is equivalent to 134% of fixed remuneration. Due to recent share price increase the award is now worth approximately $1.3m.

The structure appears to be the same as the 2018 LTI plan described above so the details will not be repeated here. FCF and ROCE targets have still not been disclosed.

We suspect that the quantum and structure of the plan may be suitable but have no way of knowing for sure due to the poor disclosure. As a result, we do not support this resolution.

The individual(s) (or their associates) involved in the preparation of this voting intention have no shareholding in this company.