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Solid result for McMillan Shakespeare despite headwinds

Company/ASX Code	McMillan Shakespeare Ltd/MMS
AGM date	22 October 2019
Time and location	10am State Library of Victoria, 328 Swanston St., Melbourne
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Michael Muntisov assisted by Brian Chapman
Pre AGM Meeting?	Yes with Chair, Tim Poole, and Company Secretary/CFO Mark Blackburn

Item 1	**Consideration of financial report**
ASA Vote	No vote required

Summary of ASA Position

Financial Performance:

The company has three clearly defined business segments. Group Remuneration Services, GRS (salary packaging and motor vehicle novated leases), Asset Management, AM (financing and ancillary services for vehicles and equipment for corporates) and Retail Financial Services, RFS (Vehicle finance, insurance and warranty for car dealers/retail customers).

75% of the underlying Net Profit contribution comes from the GRS business.

In the 2019 finnancial year (FY19), revenues were up by less than 1%, and underlying profit was down by 5%. This was a result of lack lustre economic conditions, particularly in the UK, and a weak car sales market. However, a relatively strong performance in the GRS business including the new Plan Partners business made up for the poorer performance in the other businesses. The statutory result was impacted by a $18.3m impairment write-off in its RFS business.

The company has also signalled that it is undertaking a strategic review of its UK business.

Total dividend was 74 cents per share (cps) up from 73 cps.

Key Events:

The scheme of arrangement to acquire the Eclipx Group (ECX) did not proceed after some weak interim results from ECX.

The new Plan Partners business operating in the National Disability Insurance Scheme sector recorded its inaugural positive profit contribution.

Progress in the digitisation initiative 'Beyond 2020' which aims to reduce costs, improve sales conversions and improve customer experience.

In August 2019, the company announced a share buy-back scheme to return capital and franking credits to shareholders.

Board and management changes:

No changes.

ASA Focus Issues:

McMillan Shakespeare has 17% female directors (1 of 6) versus ASA guideline of 30%. It does not have a majority of independent directors which has been an ongoing issue for several years. Two of the directors have been on the Board for more than 12 years and are substantial shareholders. For more on this see Item 4.

McMillan Shakespeare has a policy for "skin in the game" for Senior Management and Board that is not as strong as ASA's guidelines. However, all but one of the directors meets the ASA guidelines.

McMillan Shakespeare calculates equity remuneration at "fair" value which is contrary to ASA's preferred approach of using face value. More on this under Item 5.

Summary

(As at FYE)	**2019**	**2018**	**2017**	**2016**	**2015**
NPAT ($m)	63.7	50.3	67.9	82.5	67.5
UPAT ($m)	88.7	93.5	87.2	87.2	70.2
Share price ($)	12.21	16.00	13.40	13.68	12.09
Dividend (cents)	74	73	66	63	52
TSR (%)	-19%	25%	-1.7%	13.2%	33.8%
EPS (cents)	77	60.9	81.6	99	87
CEO total remuneration, actual ($m)	$0.92	$0.89	$0.92	$0.87	$0.96

For 2019 the CEO's total actual remuneration was **11 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Item 2	Adoption of Remuneration Report
ASA Vote	**For**

Summary of ASA Position

McMillan Shakespeare overhauled their remuneration structure in FY18. It involves a fixed remuneration component (69%, down from 92% in FY17) plus a Long-Term Incentive (LTI) component which is all equity. There is no Short-Term Incentive (STI).

There are two performance criteria for FY19 measured over the subsequent 3-year period. They are earnings per share (EPS) compound annual growth rate (CAGR), and Return on Capital Employed (ROCE). The threshold and target levels for these measures are discussed under Item 5.

Historically the ASA has voted for the remuneration report because of the tightly controlled level of remuneration. This tight control continues as shown by the CEO's maximum opportunity being 20% below the median CEO package of ASX peer companies (according to Godfrey 2019 survey).

So at a high level, the ASA welcomes the tight control of pay. On the downside the remuneration scheme fails to meet a number of guidelines advocated by the ASA including:

- Total remuneration at risk is less than 50% (31% at maximum opportunity, see table below – an improved 43% proposed in FY20)
- Fair value is used to determine number of performance grants. The company states in the Notice of Meeting that it will adopt "face value" from FY21 onwards. See also Item 5.
- The LTI performance period of 3 years is less than the ASA guideline of at least 4 years

Remuneration targets for the CEO in FY19 are summarised below. No LTI grants vested this year. The actual "take home' pay is disclosed in the remuneration report as $0.92m.

	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	0.95	83%	0.95	69%
STI - Cash	0	0%	0	0%
STI - Equity	0	0%	0	0%
LTI	0.19	17%	0.42	31%
Total	1.14	100%	1.37	100%

The remuneration proposals for FY20 are discussed under Item 5 below.

Despite the weaknesses in the company's remuneration structure, the absolute quantum of CEO remuneration is well below his peers, the company does have at least two performance criteria in the LTI, the remuneration at risk has increased significantly and progressively over the last two years, and the company has committed to use 'face value' to calculate performance rights by FY21.

Given the tight control of the absolute level of executive remuneration, and the actions and commitments made by the company to improve their compliance with ASA guidelines, the ASA proposes to vote in favour of this resolution.

Item 3	**Re-election of Tim Poole as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Poole has been a director of McMillan Shakespeare for 6 years and Chair for 4 years.

He is currently also chairman of Aurizon Ltd, and a director of Reece Ltd. Mr Poole's director workload does not exceed the ASA guideline.

He is an experienced Independent Chair which is important given that the Board does not yet have a majority of independent directors. At our pre-AGM meeting the chair indicated that the Board is planning to appoint an additional independent director within the next 12 months.

The ASA intends to vote in favour of Mr Poole's re-election.

Item 4	**Re-election of Ross Chessari as a Director**
ASA Vote	**Against**

Summary of ASA Position

Mr Chessari has been a director of McMillan Shakespeare for 16 years. He is also a major shareholder controlling more than 7% of the company's shares. As such Mr Chessari is not considered to be an independent director.

The Board was relying on the ECX merger to bring on 3 new directors to resolve gender diversity and achieving a majority of independent directors on the Board. When the merger did not proceed in April 2019, the Board had to go back to a recruitment approach.

Nevertheless, our patience on this issue, which we have raised with the company over the last several years, has run out. Therefore, we propose to vote against the re-election of Mr Chessari, as his failure to be re-elected would automatically produce a Board with a majority of independent directors.

Item 5	**Issue of Performance Rights to Managing Director**
ASA Vote	**Against**

Summary of ASA Position

The LTI is designed to incentivise management to grow the company and its performance over the long term.

The company proposes to issue 69,178 Performance Rights to the CEO Mr Mike Salisbury. These represent an amount of $704,444 (43% of the total remuneration opportunity for FY20 - up from 31% in FY18, which is a positive) but they are valued at a 'fair value' of $10.18 per share, compared with the current 'face value' share price of around $16.

The ASA does not support the use of fair value as it is not a transparent measure for shareholders. For example, at the current face value share price, the total remuneration opportunity for the CEO would exceed $2million; moving from below median CEO pay for ASX peers to 12% above median. The company states in its Notice to Meeting that it will use the 'face value' methodology from FY21 onwards. At the pre-AGM meeting we queried why it was not adopted this year. The company believes that their approach has been transparent even though 'fair value' was used.

The rights will vest in five tranches if three performance measures are achieved over one-, two- and three-year performance periods.

The largest tranche (30% of rights) will vest if strategic outcomes are achieved in FY20 related to capital management, productivity including Beyond 2020 targets, and growth including accelerated performance from the Plan Partners business. The specific performance objectives and weightings will be disclosed in next year's remuneration report.

Two tranches (17.5% of rights each) are tested over two years, to FY21, and are measured against firstly EPS CAGR (range 6%pa (50% vesting) to 10.5%pa (full vesting)). Note that EPS CAGR over the last three years has been less than 1% pa. And secondly measured against ROCE (range 21.5% (50% vesting) to 23% (full vesting)). Note that ROCE over the last three years has averaged 20.3%.

The final two tranches (17.5% of rights each) are similar to the previous two but measured over a three-year period to FY22.

No vesting of any tranches will occur until FY22, meaning that the CEO still has to be with the company to benefit from achievement of the shorter-term measures.

The hurdles seem challenging, being higher than historic performance. However, the various performance periods are less than the minimum four-year period recommended by ASA Guidelines.

The first mentioned tranche is essentially a full equity-based STI award measured on one year's performance with a two year hold, which is acceptable to ASA. However, the two-year performance periods for two of the other tranches are not. The company said that this year's plan was designed with a 'retention' of KMP as a priority.

Overall, the spirit of the FY20 plan design is considered acceptable, but the use of 'fair value' for the awards, means that ASA proposes to vote against this resolution.

Item 6	Renewal of proportional takeover provisions of the Constitution
ASA Vote	**For**

Summary of ASA Position

This is a technical requirement to renew a provision in the Constitution which protects shareholders from unfavourable takeover practices. The ASA proposes to vote in favour of this resolution.

Note: The individual(s) (or their associates) involved in the preparation of this voting intention do not have a shareholding in this company.