



Selling off the Engineering Division: Does it lend a new lease to profits?

Company/ASX Code	Lendlease/LLC
AGM date	Wednesday November 20, 2019
Time and location	10:00am Four Seasons, George St Sydney
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Allan Goldin and Lewis Gomes
Pre AGM Meeting?	Yes, with Chair Michael Ullmer, Company Secretary Wendy Lee and by phone Jane Hemstritch Chair of People and Culture Committee

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

The Financial Year 2019 (FY19) financial results were significantly impacted by writedowns arising from the Engineering business following substantial losses on several road projects, most notably NorthConnex tunnels for Transurban in Sydney and two smaller projects in Brisbane. The losses only came to light early in FY19 although delays on NorthConnex had been publicly known for some time. A provision of \$500m was made in the first half, after which LLC resolved to dispose of the Engineering and Services businesses and it then made an estimate of a future provision of \$450m to \$550m for the costs of divestment, including indemnities on ongoing projects.

Unsurprisingly, risk has become a major focus of the Board. Under new Chair Michael Ullmer, the previous Board Risk Committee has been restructured so that it now includes all directors and allocates more time to addressing large transactions, visiting offices and sites, and meeting with executive teams. It is hoped that after such a concentrated forensic examination of the Engineering business has taken place, all the risks have been identified and provision made for all liabilities, but with underground construction projects it appears that until the project is ended one cannot be sure that all problems have been identified.

There are formal offers to purchase the Engineering and Services businesses together and individually, and it is hoped that the sale process can be concluded in the near future. These businesses have been labelled “non-core” and are shown separately in the accounts from the ongoing business streams (Development, Core Construction and Investments). Taking out the non-core results, the Group’s results would have been respectable, not great, but OK.

What is fantastic is the almost \$100 billion juggernaut of development pipeline, which is being examined to see if some of these projects can be brought forward. For instance, in this pipeline, putting aside those ready for delivery, looking at the broad master plan in the agreements and options there are more than 5,000 apartments to build and then rent and a staggering 22,000+

apartments for sale. Currently the target is to have 1,000 to 2,000 apartments settle a year, so obviously if more can be constructed and settled each year the income will come forward. However, this will also be dictated by demand in different areas' credit conditions etc, but hopefully we will hear more in early 2020.

Similarly, in Communities there are 50,000 lots in 17 locations primarily around Australia's major cities. Land development was softer this year. A number of the purchasers are first and second home buyers who thought they would be able to manage payments when they agreed to the purchase, but at the time of settlement, with the banks tightening up on credit, there has been more defaults than normal. So, the 3,000 to 4,000 targeted settlement a year is very dependent on credit and first home owners' grants. This year the Group's major apartment settlements were in the sought after Sydney Darling Square which has meant that defaults were below average.

On the flip side is the infrastructure maintenance type area such as the more than 50 USA military housing estates where the Group has an equity interest of \$35.5 billion but provides steady earnings of \$35m in revenue every year. This amount jumps every few years when upgrades to the facilities are required, providing the business with the ability to earn an additional profit from undertaking this work.

There is also the \$35.3 billion Funds Under Management (FUM) generating \$144 million of operating earnings, responsible for more than 33% of the group's Core Business Earnings Before Interest Taxes Depreciation and Amortisation with much more to come. This is the fastest growing Group division (in 2014 it was worth \$16 billion) and importantly it is an area that on an ongoing basis has very limited risk.

The Lendlease focus on reducing injuries is obviously important when you are involved in so many large scale projects, what is less recognised is the focus the Company has on helping the mental health of employees. The company considers it a pressing need and has instituted Employee Assistance Programs in every country they operate in.

Board renewal is happening in the form of Baroness Margaret Ford. Appointed in October 2019, Baroness Ford has non-executive experience in development, construction and infrastructure financing added to her background in urban development and housing, and experience in regeneration, planning and public sector reform. She joins the board on March 1, 2020. In addition, talks are at an advanced stage to appoint a USA-based non-executive director with experience in development and real estate. Making way for Baroness Ford is Steve Dobbs who is retiring after the upcoming AGM after 5 years of service. We understand that further Board changes are being contemplated.

Financial Summary

(As at FYE)	2019	2018	2017	2016	2015
NPAT (\$m)	467	792.8	758.6	698.2	618.6
Share price (\$)	13.00	19.81	16.65	12.60	15.03
Dividend (cents)	42	69	66	60	54
TSR (%)	(33)	24	38	(13)	20
EPS (cents)	82.4	136.1	135.2	126.3	112.4
CEO total remuneration, actual (\$m)	6.547	7.977	8.654	7.487	8.449

For 2019 the CEO's total actual remuneration was **74.3 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Item 2(a)	Re-election of Mr David Craig as a Director
ASA Vote	Against

Summary of ASA Position

David Craig joined the Board in March 2016 and holds 50,000 shares. His previous experience includes 37 years in finance, accounting, audit, risk management, strategy and mergers and acquisitions in the banking, property and professional services industries. He was the Chief Financial Officer (CFO) of Commonwealth Bank of Australia and CFO for Australand Property Group (now Frasers).

He is currently President of the Financial Executives Institute of Australia and Deputy Chair of the Victor Chang Cardiac Research Institute

The Board believes Mr Craig brings broad commercial, financial, risk and strategic expertise. He has over 22 years of direct property segment experience through leading the property development team and overseeing significant property and workplace transformation projects at CBA and as CFO of Australand Property Group. Geographically, David has worked in three of the four regions that Lendlease operates in including Australia, the Americas and overseeing Asian operations.

ASA met with Mr Craig prior to writing this VI and it was very useful and enlightening to learn how much more time he puts into the Group over and above his director duties both in the area of governance and mentoring financial personnel.

We have a problem voting for anyone who was a senior executive of a bank in the recent past which in this case is amplified because he was both heavily penalised and named by his previous employer. We will be voting our undirected proxies against this resolution.

Item 2(b)	Re-election of Nicola Wakefield Evans as a Director
ASA Vote	For

Summary of ASA Position

Nicola Wakefield Evans joined the Board in September 2013 and holds 30,248 shares. Ms Wakefield Evans was Managing Partner, International at King & Wood Mallesons (KWM) in Hong Kong where she was responsible for the overall governance and strategic positioning of the business in the Asia region. In addition to holding a number of senior management and leadership roles she has been involved in a number of significant and ground-breaking M&A transactions.

Currently she is a non-executive Director of Macquarie Group Limited. Other current appointments include Chair of the 30% Club (Australia), Director of the Clean Energy Finance Corporation, Director of UNSW Foundation Limited, Director of Australian Institute of Company Directors, Director of Chief Executive Women, Director of MetLife Insurance Limited and Director of the Goodes O'Loughlin Foundation Limited

The Board believes Ms Wakefield Evans has strong business, management, legal and corporate governance experience, having provided advice to a broad range of companies in diverse industries including in the Lendlease core segments of Development, Construction and Investments. In addition to her extensive international experience in three of the four regions where Lendlease operates including Australia, Asia and the Americas, Ms Wakefield Evans also has significant safety and ESG experience gained through her roles chairing the Sustainability Committee at Lendlease and a number of other entities

Although at the AGM, ASA may ask some questions concerning her workload we will be voting undirected proxies in favour of this resolution.

Item 3	Adoption of Remuneration Report
ASA Vote	Against

Summary of ASA Position

	Target \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	2.2	31%	2.2	23.1%
STI - Cash	1.2	17%	1.8	19%
STI - Equity	nil		nil	
LTI	3.7	52%	5.5	57.9%
Total	7.1	100.0%	9.5	100%

The Lendlease remuneration report is very well explained, detailed and at the same time being easy to read, a very rare combination.

The failure of the Group to meet its financial target means that this component of the short-term incentive (STI) was not awarded. The fiasco in the Engineering business means the CEO rightly forfeited any entitlement to this bonus. It appears that any of the other Key Management Personnel (KMP) who had any oversight of this Division also lost the non-financial part of their STI. However, the others still seemed to obtain 100% of their non-financial awards. The Group quite correctly detailed how senior executives suffered considerable loss in value to June 30, 2019 on shares held in October 2018, but so did retail shareholders. Happily both groups have seen recovery in the value of their shares.

Lendlease is one of a small handful of the ASX 200 who pay the STI all in cash. The argument that it is a smaller portion of overall pay and is therefore not very relevant. It is difficult to understand why, if 50% of this bonus was paid in deferred equity shares for a year or two, it would act as a disincentive.

Our previous LTI concerns with Return On Equity having been too low a hurdle has been dented with Engineering problems resulting in a significantly lower figure than in the past. We assume this made the award which would have vested in 2018 more difficult, in addition to the next two years of vesting. With the relative TSR responsible for 50% of this long-term bonus it is unfortunate that a Company believes that when their performance is only average that 25% of the overall long-term bonus is paid.

A greater concern is the fact that the Company which has and is building its business on long term development projects thinks that 3 years is a long enough time over which to measure performance. Lendlease like a few others is now vesting the LTI spread over 3, 4 and 5 years which besides aiding retention and making clawbacks easier, results in some greater alignment with shareholders over the last couple of years.

What disturbs ASA the most is that a portion of the STI used to be paid in deferred equity and part of the LTI was measured over 4 years. However, these important features were lost when correctly the focus was put more on 3 years than 1 year for bonus payments. In our opinion not a necessary step to make this transition.

Hopefully next year there will be some return to part equity in short term and longer measurements for LTI so we can once again support the Group's remuneration structure.

Even without these changes we will still review and examine how the Company performs, to see the alignment with at risk incentives, particularly short term to see if we should consider revising our vote in the future.

Item 4	Approval of LTI grant to CEO Stephen McCann
ASA Vote	Against

Summary of ASA Position

This resolution is the granting of a maximum 385,440 performances rights with an actual value on grant of \$5,550,000. To convert all of these to no cost shares requires fully meeting the hurdles outlined in the remuneration report.

Although we voted against the Remuneration Report we strongly considered voting for this resolution, however what tipped us against it, is that even although this bonus is for future performance, it was too hard to vote for a potential bonus for someone who oversaw such a disastrous destruction of profit.

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

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