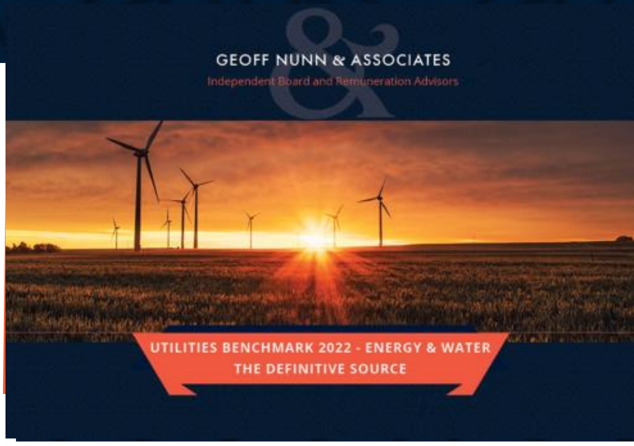
GEOFF NUNN & ASSOCIATES

Governance and Board Advisors

Governance Update: Executive and Board Remuneration in the Utilities Sector

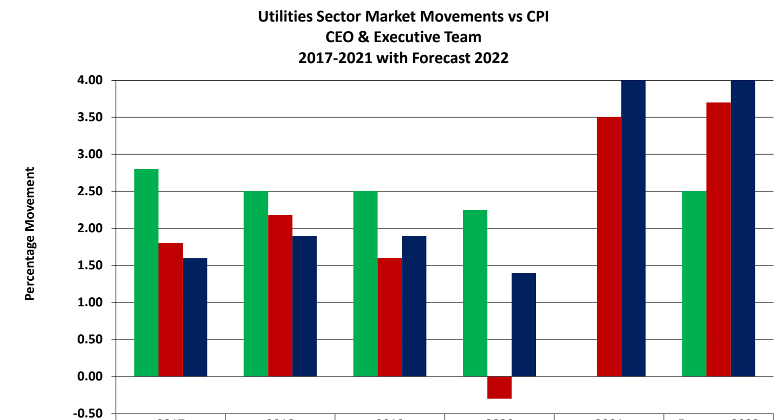
April 2022



Remuneration Benchmarking in the Utilities Sector

Our Forecast for 2022

We have noted a degree of pressure in the market for increases in executive FAR in 2022. Some CEOs and executive teams have not received a remuneration review for 2+ years. In parts of the country executive remuneration levels in the Utilities Sector have remained static for up to 5 years. This has occurred at a time of unprecedented challenge. Our 2022 forecast is for annual reviews in the range of 2.0% to 2.5% as set out in the following:



	2017	2018	2019	2020	2021	Forecast 2022
Utilities Sector	2.80	2.50	2.50	2.25	0.00	2.50
CPI Australia	1.80	2.18	1.60	-0.30	3.50	3.70
CPI NZ	1.60	1.90	1.90	1.40	4.90	4.80

The Board & Executive Remuneration Landscape in 2022

We believe boards and remuneration committees will continue to exercise restrain despite pressure for upward review and an increase in the forecast CPI movement in 2022

The business landscape contains a range of significant risk factors in 2022. The pandemic is far from over and geopolitical and environmental challenges abound on every front. There are major initiatives underway in both energy and water companies. The "Sun Cable" project of David Griffin is just one example of how Australia has the opportunity to lead the world in renewable energy. This project aims to generate up to 3.2 kv of solar energy and transmit this to Singapore via 4200 km of undersea cable supplying 15% of Singapore's electricity needs.

Continued on Page 2

Utilities Benchmark 2022 Report

The Utilities Benchmark is the most comprehensive analysis of board, CEO and executive remuneration in the Utilities Sector that has ever been undertaken in Australia and New Zealand.

Now Available

See: https://www.gna.net.au/utilities-benchmark

Geoff Nunn & Associates

Geoff Nunn & Associates was established in 1993 as an independent provider of remuneration and governance services to the government and corporate sectors. We specialise in working with Boards and CEOs in the areas of board and executive remuneration strategy, corporate governance, board dynamics and renewal, and governance structures.

Our Services

- Board & Executive Remuneration
- Innovative Remuneration Solutions
- Utilities Benchmark
- Remuneration Governance
- Board Governance Advice
- Facilitated Boardroom Dialogue
- Focused Board Renewal
- Board Charter Drafting

Geoff Nunn
Board Advisor &
Remuneration Specialist
0418 595 107
gtnunn@gna.net.au
www.gna.net.au

The State of the Utilities Market: Remuneration Reviews 2022

Executive Review Factors for 2022

The conduct of Fixed Annual Reviews for the CEO and executive team in 2022 raises a number of key remuneration governance issues. We suggest remuneration committees take into account the following factors when considering how to proceed with this year's review:

1. **Benchmarking.** The market has been relatively flat for the last 2 years. You need to benchmark your executives against like organisations to get a feel for your current positioning. Further restraint might be appropriate. Our 2022 ***Utilities Benchmark*** provides the ideal starting point for your market reality check.

2. **Executive Team Profile:** We believe the following roles will continue to be in demand during 2022:

   - Chief Executive Officer
   - Chief Operating Officer
   - Chief Financial Officer
   - General Manager People & Culture
   - Chief Information Officer
   - General Manager Strategy
   - General Manager Assets/Major Projects

   Demand will push up rates as companies vie for top performers. Whist remuneration is only one factor in an executive's decision making about changing jobs, it is an important one. High calibre executives know their worth in the marketplace. Major developments, particularly in the renewables space, will continue to fuel demand for these roles.

3. **Affordability.** Our ***Utilities Benchmark*** indicates that revenue and return on equity were down for many companies in 2020 and 2021. Some expect a modest recovery in 2022. The degree to which this is achieved remains to be seen.

4. **Other Risk Factors include:**

   - **Pandemic Risk**: high infection rates continue resulting in employees being unable to work for periods of time and customers unable to pay bills.
   - **Climate Risk:** environmental degradation resulting in further catastrophic weather events which damage infrastructure.
   - **Economic Risk:** a meltdown in financial markets which results in an increase in the cost of capital and rising unemployment.
   - **Cyber Risk:** attacks on key operational systems.
   - **Geopolitical Risk:** major conflicts destabilising global markets as with the current conflict in the Ukraine.

Financial Volatility Set to Continue in 2022

During 2020 and 2021 financial performance declined for many utility companies. Revenue was down for some as was return on equity (ROE). Many water companies, particularly those in regional areas, struggle to make positive returns as their population base is spread over a large area. Of the 30 water companies in our ***Utility Benchmark*** the median ROE for 2020 at 1.9% and 3.5% for 2021.

Government owned energy utilities posted similar results to water utilities with median ROE for 2020 at 1.5% and 4.4% for 2021. Private sector energy utilities fared better with ROE of 7.8% and 7.2% respectively. Both are down from 2019 pre-pandemic levels of government energy companies at 8.0% and private energy companies at 8.4%.

The relative decline in financial performance has impacted STI and LTI awards. As mentioned previously most water companies do not offer an STI plan. For those that do, and they are mostly in Queensland, many did not make an award in 2021. Several government owned energy utilities also did not make awards in 2021.

Private sector energy based utilities fared better with most making STI awards of between 40.0% and 100.0% of the maximum. There was one notable exception. AGL Energy did pay an STI to its CEO or executive team in 2021. The same company reported 0.0% vesting on its FY 2019 LTI.

Most remuneration committees will be assessing financial and non-financial risks and testing whether their executive remuneration strategy remains appropriate in the current environment. The move to reduces STIs and at the same time increase LTIs is questionable as market volatility is set to continue. Our perspective is to focus on getting FAR right and making appropriate adjustments to the KPIs underpinning the STI.

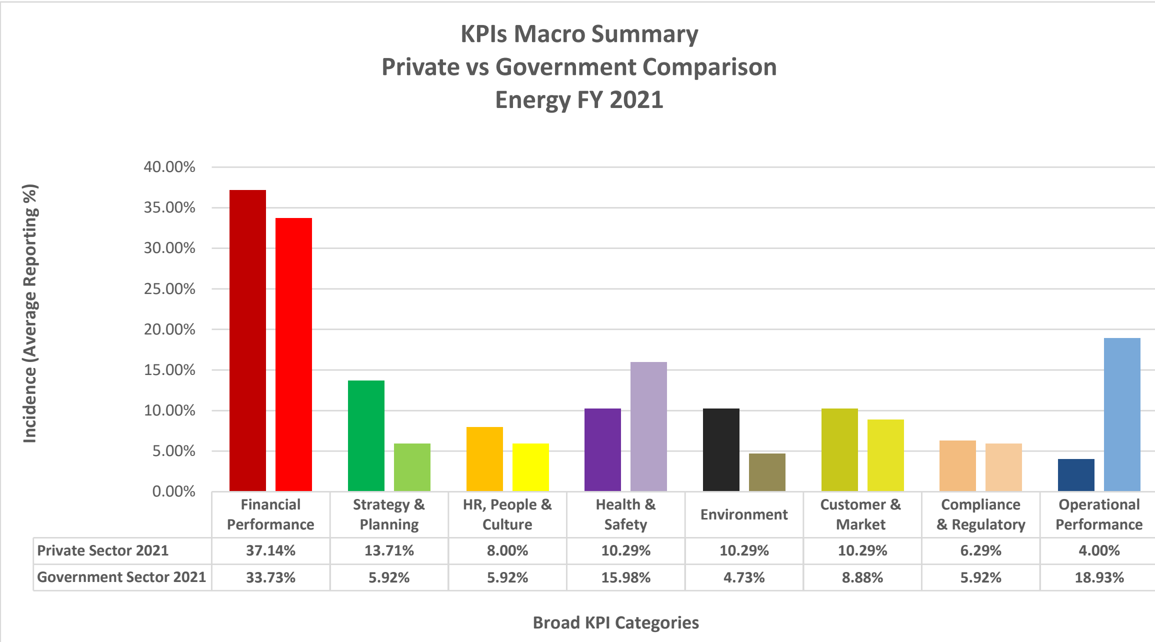
Geoff Nunn
Board Advisor &
Remuneration Specialist
0418 595 107
gtnunn@gna.net.au

www.gna.net.au

The Performance Paradox

Metrics May Mask Extraordinary Contribution

Over the last 25 years the measurement of corporate performance against various KPIs has assumed prominence in organisational thinking. Most utilities measure various aspects of corporate performance in a balanced scorecard type format. Financial reporting takes centre stage as does operational performance. Customer and safety come next followed by people metrics. Environmental performance is now firmly on the agenda and is gaining traction in corporate reporting. The following graph is extracted from our ***Utilities Benchmark*** 2022 and reflects the incidence of reported KPIs in energy-based utilities:



	Financial Performance	Strategy & Planning	HR, People & Culture	Health & Safety	Environment	Customer & Market	Compliance & Regulatory	Operational Performance
Private Sector 2021	37.14%	13.71%	8.00%	10.29%	10.29%	10.29%	6.29%	4.00%
Government Sector 2021	33.73%	5.92%	5.92%	15.98%	4.73%	8.88%	5.92%	18.93%

In many instances corporate performance, as well as individual performance, is factored into annual FAR reviews as well as being the key driver of STI and LTI awards. We've seen environmental performance just beginning to emerge as a measure in STI and LTI scorecards.

From a remuneration governance perspective we ask whether what gets measured constitutes the totality of corporate and individual performance. Over the past two years many directors, CEOs and executives have made an extraordinary contribution toward maintaining the financial viability and operational sustainability of their organisations. The have faced declining revenues, in some instances, as customers struggle to pay their bills, catastrophic weather events and fires which have damaged critical infrastructure, workplace restrictions which meant that many employees have been required to work from home for extended periods.

If we look at scorecard results alone they may well reflect a decline in corporate performance across a range of indicators. However, if we regard the events of the past two years as a *force majeure* then a different performance perspective emerges.

How Should Remuneration Committees Respond?

Most executive annual review processes, STI and LTI awards, operate at the discretion of the remuneration committee and board. In some instances the formula based approach underpinning STI and LTI calculations might deliver a modest or zero result in 2022.

Our suggestion to remuneration committees is to look beyond the numbers when determining increases to FAR and STI awards. By all means consider financial performance but also take into account what the corporate scorecard might have looked like without the extraordinary efforts of the CEO and executive team.

We suggest FAR reviews be pitched at 2.0% to 2.5% with the possibility of going above these figures for top contributors. We also suggest STI awards in the range of 50.0% to 75.0% of maximum where the affordability test is met. Equity-based LTIs will need to be treated in accordance with scheme rules to meet the requirements of institutional and retail investors.

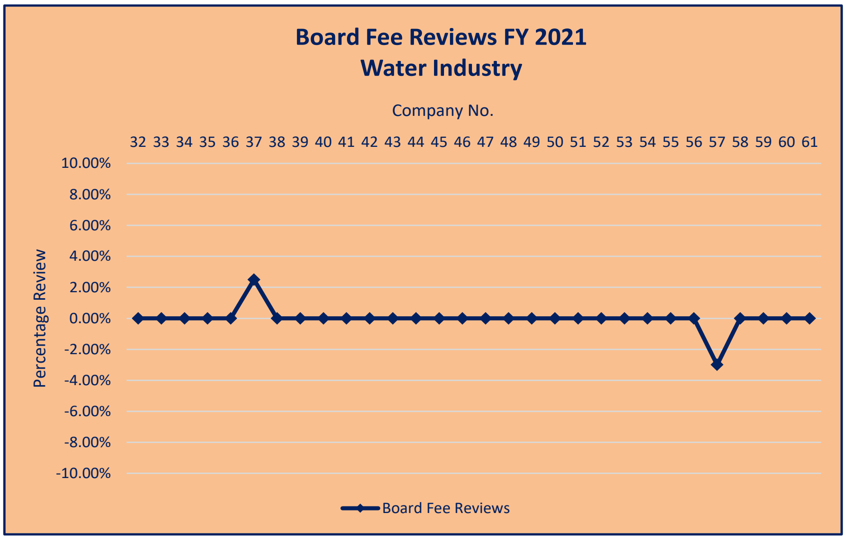
Geoff Nunn
Board Advisor &
Remuneration Specialist
0418 595 107
gtnunn@gna.net.au

www.gna.net.au

Board Reviews 2022
The Governance Dilema

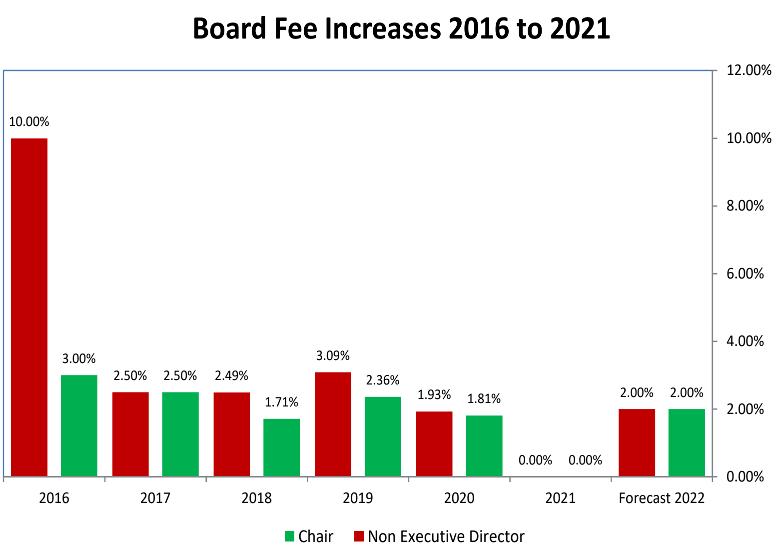
Board Reviews Were Flat in 2021

According to our ***Utilities Benchmark 2022*** (now available at https://www.gna.net.au/utilities-benchmark) very few companies reviewed directors fees upward in 2021. The following graph illustrates the incidence of board reviews in the water industry for 2021:



A similar trend was reported for energy-based utilities. Notwithstanding this apparent stagnation in the NED market we believe there will be a modest recovery in board fee increases and our forecast is 2.0%. The following graph reflects our analysis of movement in board fees for the last five years with the forecast for 2022:

Data for this chart is drawn from a variety of sources including published board surveys and our own utilities benchmarking for the last 4 years.



Factors Influencing Board Reviews in 2022

As with executive FAR reviews discussed on Page 2 there are a range of factors to take into account when considering the annual review of board fees:

1. **The View of Key Stakeholders.** If the company is listed, institutional investors will make their views known. In private companies the owners will be keen to contain board costs. But at the same time they need to know whether the fees they are paying are appropriate to recognise director contribution.

   Almost all of the government energy utilities and water companies in our ***Utilities Benchmark*** are subject to some form of regulation when it comes to setting board fees. If fees in your company are lagging in the market there may be scope to present a case to the relevant regulatory body. Benchmarking is a critical part of this process.

2. **Affordability.** Board Fees usually form a very small part of the company's overall remuneration budget. Any upward adjustment may therefore have minimal cost implications. Having said this its probably not the best time to be a market leader in terms of board fees.

3. **Directors Contribution.** Directors have made an extraordinary contribution to the viability and sustainability of their organisations over the last two years. May companies have held additional board meetings and set up special purpose board committees to deal with circumstances. It may be timely in 2022 to recognize this contribution with a measured uplift in board fees.

Contact Geoff Nunn on the email or phone number below if you wish to initiate an benchmark review of board fees in your organisation.

Geoff Nunn
Board Advisor &
Remuneration Specialist
0418 595 107
gtnunn@gna.net.au
www.gna.net.au