Kagiso Asset Management Remuneration Policy Framework

2016

KAGISO
Asset Management

Introduction

Executive and non-executive directors are appointed by shareholders and are custodians of the business on behalf of shareholders.

The levels of remuneration for executive and non-executive directors should be aimed at attracting, retaining and incentivising directors to create value for shareholders. Given that remuneration has implications for corporate performance and shareholder returns, shareholders have a mandated role to play in the area of approving remuneration policies that have been established through formal and independent procedures.

Kagiso' s principal remuneration objectives:

- Remuneration policies should be based on the principle of "pay for performance" and alignment with shareholders.
- We prefer a structure that has a higher weighting towards at risk or variable remuneration, with clearly defined performance objectives that are tiered and purposefully calibrated to stretch management to outperform.
- We would prefer lower than market base salaries and higher than market variable or at risk remuneration potential, with clearly defined performance objectives that create an alignment to shareholders.
- Kagiso is not averse to higher than market total remuneration that is sufficiently aligned to shareholders.
- Long term performance incentive structures that are aligned with financial and non-financial issues including those of an ESG nature.
- In determining the above we would consider:
  - Reasonability of total compensation vs peers and other companies of similar size or complexity.
  - We would be against golden parachutes for early termination of service or if triggered by a takeover.
  - We would be against pure retention based incentive structures as they do not align the interests of management and shareholders.
  - We would be against excessive base salaries or total guaranteed packages as an excessive base would distort total remuneration and would not align the interests of management and shareholders.

Remuneration Performance objectives:

- We would prefer a combination of metrics that incorporate profitability, returns and cash flow.
- We would prefer remuneration performance metrics that measure returns relative to assets or capital, (Return on Invested capital (ROIC), return on Equity (ROE), Return on Assets (ROA), and Return on Capital Employed (ROCE)) as they closely focus management on existing asset stewardship, and value enhancing investments. Return based measures should carry the highest weighting of all the evaluation criteria.
- Where profitability growth measures such as headline earnings per share (HEPS) growth or EBITDA growth are used, we would encourage the inclusion of return metrics as well -as explained above.
- Relative metrics such as Total shareholder return (TSR) should only be evaluated against a suitable peer group that is clearly defined and disclosed. In the absence of a suitable peer group, appropriate economic benchmarks should be constructed.
- Individual performance targets for executives should be clearly disclosed so that shareholders are able to hold management to account.
- We are in favour of remuneration policies that encourage share ownership as a retention tool for executive management.

- The calculations of these performance metrics should not make adjustments for items, such as amortisation of intangibles, transaction costs or any other amount that represent management's allocation of shareholder capital. Ratios should also ensure consistent application of these adjustments to both the numerator and denominator.
- Share appreciation rights schemes with no performance targets are not ideal as they as they are a pure retention tool, which we are not in favour of (in particular for very senior executives).
- Where share options are used as part of an incentive structure, the strike price is important.
  - Strike prices should not be struck too low as this could lead to value destruction for shareholders with virtually no performance required.
  - Strike prices should also not be struck too high as to create a disincentive for management.
  - In all situations the strike price should take cognisance of the director's best estimate of intrinsic value of the company and must avoid a free-rider situation, where shareholders are diluted with no performance from management.

Remuneration structure:

- We prefer lower base salaries (or total guaranteed packages), with higher weighting towards at risk or variable remuneration. The end result should be <u>higher than market potential</u> for executives that back themselves to perform, and deliver above average returns on capital to shareholders.
- We evaluate at risk pay in relation to the proportion that is cash based and proportion that is share based.
  - We would prefer a higher weighting to share based remuneration that has a longer deferment and performance period, typically a minimum of 3 years.
    - In this deferment period performance objectives should be applied.

An example of a remuneration policy that Kagiso favours: FirstRand:

- Remuneration policy framework:
  - Structure is more aligned to Short Term Incentives but it is deferred over a three year period with 33% vesting p.a with KPI's still maintained.
  - KPIs are :
    - ROE vs cost of equity
    - Earnings growth over NIACC (NIACC is defined by FirstRand as, "the amount of earnings left after shareholders and other capital providers are paid for their investment at the prescribed level")
    - Performance within overall group risk appetite
    - Quality of earnings
    - Recognition of establishment of a business or turning an established business around
  - LTIP targets:
    - EPS which equals or exceeds South African nominal GDP plus 1% on a cumulative basis over a three year period
    - ROE must be equal to or greater than COE+5% over the three year performance period.
- Reasons we like the structure:
  - Management KPIs are geared to optimal capital management. NIACC (net interest after cost of capital), an EVA measure, is the key benchmark. Our interactions show that this measure is well understood, and engrained deep into the senior management layers.
  - Successful banks are in many ways successful human resource companies. In this regard FSR has successfully created a talent magnet due to its innovative and entrepreneurial culture. Successes have been rewarded financially and through

recognition, and we are able to see the positive result of this policy over a number a years: a more solid management team than peers, and better returns.

- Proof of effectiveness:

Source: FirstRand