



Corporate Governance Principles in respect of investee companies

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Introduction

This document outlines Magellan Asset Management Limited's ("Magellan") core principles on corporate governance. Magellan's Governance & Advisory group is responsible for voting on the proposals put forth by portfolio companies ahead of shareholder meetings and for leading engagement with portfolio companies on corporate governance issues. This reflects Magellan's fiduciary duty to its clients, Magellan's attitude as an engaged shareholder and the strong belief that corporate governance can impact shareholder value.

Magellan intends to vote in a manner that is in the best interests of its clients and that is most likely to protect and promote the long-term economic value of the companies in which Magellan invests. These guidelines are intended to serve as a framework and are not intended to limit the analysis of, and the way in which Magellan responds to individual proposals. In the absence of a specific principle, Magellan will evaluate each resolution or proposal in the context of jurisdictional best practice and vote in a manner most likely to maximize the long-term value of its clients' interests. The guidelines will be applied with discretion, taking into consideration the range of facts specific to each company and each proxy proposal.

1. Corporate Governance Principles

The principles are grouped into topics that commonly appear on the agenda of shareholder meetings.

- Board of Directors
- Compensation
- Shareholder Rights & Defenses
- Audit-Related

Social & Environmental issues are not addressed in these guidelines as they are separately assessed by Magellan's Investment Team which has developed an understanding of the key issues for each company as part of Magellan's investment analysis process as it relates to consideration of Business Risk and/or Agency Risk ratings.

As a long term investor, Magellan is committed to engaging with portfolio companies and the Governance & Advisory group will liaise directly with companies on corporate governance issues. On company-specific matters, the Governance & Advisory group will consult with Magellan's research analysts and all voting recommendations will be reviewed by the Lead Portfolio Manager.

In certain jurisdictions, trading restrictions in respect of shares eligible to be voted may apply for a period of time around the shareholder meeting date. Because such trading restrictions can hinder portfolio management, Magellan's policy is to refrain from voting in circumstances where such restrictions apply.

2. Board of Directors

2.1. *Chair and CEO separation*

We strongly support the separation of the Chair of the board and CEO. We believe combining the two positions places too much power in the hands of a single individual. As Chair and CEO, an individual has substantial influence in appointing and shaping the composition of a company's board. In contrast, where the roles of CEO and Chair are separate, the influence of each individual over the composition of the board is greatly reduced. A board is established to provide a separation of powers between the governance and the executive management functions. Combining the roles of CEO (the executive powers) and Chair (the governance powers) undermines the proper separation of these functions. We do not believe that the appointment of a lead independent director overcomes this issue.

2.2. *Chair independence*

Chair independence is not critical, however a lead independent director should be appointed where the Chair is not independent. The lead independent director should be appointed by the independent directors.

2.3. *Board independence*

Magellan believes a company's board of directors should be comprised of at least a majority of independent directors.

Common impediments to director independence include:

- Employment by the company as a senior executive within the previous three years;
- Substantial business or personal relationships with the company or the company's senior executives; and
- Any other relationship or dependency that could interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

We do not support limiting director tenure, however will factor tenure into our consideration of board independence.

We do not believe that a large direct or indirect shareholding precludes any director from being independent. Indeed we look favourably on directors and nominees that are aligned with shareholders through a large shareholding.

2.4. *Committee independence*

We believe all of the board's key committees should be comprised of at least a majority of independent directors.

2.5. Proxy contests

We will consider director nominees in contested elections on a case-by-case basis, giving consideration to the following factors:

- Long-term financial performance of the target company relative to its industry;
- Management's track record;
- Background to the proxy contest;
- Nominee qualifications and any compensatory arrangements;
- Strategic plan of dissident slate and quality of critique against management;
- Likelihood that the proposed goals and objectives can be achieved (both slates);
- Stock ownership positions; and
- Whether the nominee is independent or, if not, the impact on the independence of the board if the nominee was elected.

2.6. Proxy access

We will review proxy access proposals on a case-by-case basis, taking into consideration concerns around the current board of directors and if the proposal is appropriately structured. We generally do not support proposals that could expose the company to abuse by investors who lack a meaningful long-term interest in the company.

2.7. Majority voting

We generally support director election by majority vote in uncontested elections. Majority voting standards support director accountability to shareholders. In contested elections, where there are more nominees than there are board seats, we support a plurality voting standard.

3. Compensation

3.1. Principles

Underlying all compensation evaluations are the below principles that we support when companies are designing and administering their compensation and award programs:

- Balanced compensation, with an emphasis on risk mitigation and the creation of long-term shareholder value. Pay practices must be designed to attract, retain and motivate key executives.
- To appropriately motivate, compensation packages should be structured and scaled to each executive's individual circumstances.
- Performance hurdles must be sufficiently challenging, and where hurdles are missed, pay must be withheld.
- We consider both the structure and merit of compensation and the absolute level of compensation.
- Compensation should be structured to balance individual performance (directly linked with the performance of the business unit the executive is charged with managing) and firm-wide performance.
- Maintain an independent and effective Compensation Committee to provide necessary oversight.
- Provide shareholders with clear, comprehensive compensation disclosures that incorporate appropriate assumptions related to the valuation of equity awards.
- Avoid the use of stock options as Magellan believes these are not properly aligned with the interests of shareholders.

3.2. Compensation structure

3.2.1. Base salary

Base salary should be reasonable and fair and reflect the executive's role and responsibilities.

3.2.2. Short-term incentives

Short-term incentives are an effective way to remunerate executives for performance on an annual basis. We do not set forth a preference for short-term incentives to be paid in cash or stock, however we support partial deferral in either cash or stock. Pre-established performance measures should balance individual and firm-wide performance and short-term incentives should be withheld if threshold or target measures are not met. We expect the size of short-term incentives to exhibit some relativity to annual base salary.

We regard equity awards that are subject only to time-based vesting provisions as deferred short-term incentives.

3.2.3. Long-term incentives

An appropriately structured long-term equity award program is an effective way to align the long-term interest of management with the interests of shareholders.

We are fundamentally opposed to the use of stock options as we believe these schemes are not properly aligned with the interests of shareholders. At grant, stock options are generally assessed to be worth between 25-30% of a company's share price, which creates significant leverage for option holders who can yield a significant payoff whilst shareholders enjoy only modest returns. In short, there is a non-linear payoff relationship between option holders and shareholders. Further, stock options are highly dilutive to existing shareholders and the upfront "assessed" issue value of options rarely reflects their true underlying market value. Pragmatically, we accept that options may always form part of a company's compensation structure however we believe stock options should be capped at a maximum of 25% of executives' target total direct compensation.

We believe long-term stock awards that incorporate sufficiently challenging performance hurdles over a number of years are a superior form of rewarding executives and aligning executive pay with shareholder interests. We therefore look for companies to have at least 20-25% of target executive compensation that is genuinely at risk over a number of years, with vesting subject to challenging performance hurdles.

Performance metrics should be disclosed, explained and aligned with the drivers of long-term value creation and a company's long-term strategy. Compensation should be withheld for below-threshold performance and appropriately reduced for below-target performance. Where only a target hurdle applies, compensation should be withheld for below-target performance. Where performance hurdles are relative measures, the peer group should be appropriate and compensation should be withheld or appropriately reduced for below peer-group performance.

3.3. Change-in-control (CIC)

When evaluating a company's CIC arrangements, we favour double-trigger vesting hurdles in order for unvested equity awards to be accelerated. We will also closely scrutinise the definition of change of control however this will be done on a case-by-case basis.

4. Shareholder Rights & Defenses

4.1. *Amend charter/articles/bylaws*

Shareholder rights are a fundamental privilege of stock ownership and key tenet of corporate governance. We do not support amendments to the company's charter/articles/bylaws in any manner that would reduce shareholder's rights.

4.2. *Shareholder rights plans*

We do not support shareholder rights plans, such as a poison pill, and will review on a case-by-case basis, focusing on the features of the plan.

4.3. *Shareholder ability to act by written consent or to call special meetings*

We support shareholders' ability to act by written consent¹ or to call special meetings, giving consideration to any waste of corporate resources in addressing narrowly supported interests.

4.4. *Dual class structure & voting rights*

We oppose dual classes of voting shares and support equal voting rights for all shareholders. We strongly believe that shareholders have a right to vote on proposals that provide for different voting classes of shares.

¹ In lieu of a shareholder meeting.

5. Audit-Related

Quality and accurate financial statements are critical to assessing a company's financial condition. We expect the Audit Committee to oversee the audit function at a company and facilitate quality, independent auditing. We expect the Audit Committee to comprise at least one financial expert in order for the Committee to have sufficient understanding of the financial issues unique to public companies.

Key corporate governance contacts

For further discussion on the corporate governance principles, please contact the Governance & Advisory group at Magellan Asset Management Limited

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