Business Value Driver

Finance

Access to and management of financial capital to support execution of strategy and investment in growth opportunities through retaining financial market support.

Financial management and value creation

We recognise that prudent financial management is an essential component of preserving and growing value for all our stakeholders. The trust placed in us by financial markets is integral to our ability to fund our operations and invest in new products and services to support our customers and the communities in which we operate.

Strategic context

As Australia's second oldest publicly listed company, AGL has a long and proud historical relationship with Australian investors. At 30 June 2019, we had 114,217 individual shareholders, representing primarily everyday Australians either directly or via their super funds, as well as many of Australia's and the world's largest pension funds.

We also have longstanding relationships with our lending banks, including major Australian institutions as well as banks throughout Asia. We have established a successful bond issuance program in both the US Private Placement and Australian Medium Term Note markets, enabling us to diversify our funding from long-term, competitively-priced sources. We have a Baa2 credit rating with Moody's Investors Service.

AGL recognises that capital allocation during a time of a transitioning energy market must be disciplined. We have to ensure that we are both creating value for the long-term, while protecting ongoing returns. Our five capital allocation principles govern our approach to new investment and capital management (these are described in detail in the Allocating capital for growth table), and when combined, continue to drive strong outcomes for shareholders.

The principal metrics we use for remuneration, as reflected in the Remuneration Report, are Underlying Profit after tax, return on equity and relative total shareholder return. These metrics form a core component of our remuneration framework – Underlying Profit for short-term incentive (STI), and return on equity and relative total shareholder return for long-term incentive (LTI). In this way, we seek to ensure short and long-term executive pay outcomes correspond with shareholder returns. STI scorecards have been re-designed to focus on meaningful objectives that reward for beyond 'business as usual' in our financial performance as well as improving customer experience, engagement of our people and the safety of our workforce and contractors. We are also tailoring objectives to the individual accountabilities of our executives.

Creating value

Delivering shareholder value	KPI	FY19	FY18[1]	FY17	FY16	FY15
Underlying Profit after tax was $1,040 million, up 2%. This result reflects the strong operation of our energy supply portfolio.	Underlying Profit after tax	$1,040m	$1,018m	$802m	$701m	$630m
Return on equity was 12.5%, down 0.6 percentage points reflecting an increase in AGL's equity base.	Return on equity (%)	12.5	13.1	10.2	8.3	7.2
AGL's total shareholder return in FY19 was -1.8%, compared with +12.6% for the S&P/ASX100 Index. While the FY19 outcome was better than FY18, we recognise that this was not a positive outcome for shareholders.	Total shareholder return (%)	-1.8	-12.3	42.4	22.3	14.8

1. Restated for adoption of AASB 9 Financial Instruments and AASB 16 Leases.

Legend

- Improving trend and/or satisfactory outcome
- Neutral trend
- Deteriorating trend
- KPI linked to remuneration outcomes for CEO and Key Management Personnel (page 58)

Allocating capital for growth

To assist stakeholders with monitoring and understanding the principles by which we make decisions about financial capital, since December 2017 we have communicated our performance relative to five capital allocation principles.

Capital allocation principles		FY19 outcome
1. Maintain balance sheet strength consistent with Baa2 credit rating to enable optimal response to opportunities as they emerge	✓	AGL continued to maintain a strong balance sheet consistent with a Moody's Baa2 credit rating, with gearing of 23.5% at 30 June 2019 and ample headroom coming into FY20.
2. Maintain target dividend payout ratio of 75% of Underlying Profit after tax, franked to 80%	✓	Dividends increased by 2 cents per share on the prior year and were consistent with policy.
3. Maintain optionality on our balance sheet to drive improved return on equity over time	✓	During the year AGL divested non-core assets with the completion of the sale of a portfolio of small generation and compressed natural gas refuelling assets, known as AGL's National Assets portfolio.
4. Application of threshold hurdle rate supported by ongoing analysis of cost of capital and appropriate risk adjustment for competing investment classes	✓	AGL continued to ensure all of the projects we are undertaking as part of our capital investment plans are incrementally positive to shareholder value. This included $388 million of growth and transformation capital expenditure. This included investment in the Barker Inlet Power Station, upgrades to Loy Yang A and Bayswater power stations, the completion of our Customer Experience Transformation program and the upgrade to our enterprise resource planning systems (PT3).
5. Return excess cash to shareholders if more accretive opportunities are not identified within a reasonable time-frame	✓	AGL redeemed $650 million worth of subordinated notes on 11 June 2019 using cash reserves and existing bank debt facilities. An on-market share buy-back has been announced for FY20.

Key relationships and trade-offs with other Business Value Drivers

As identified on pages 12 to 23, we are investing significant financial capital (both operating expenditure and capital expenditure) in projects and systems aimed at enhancing other Business Value Drivers, as well as investing for sustainable financial returns.

In making investment decisions, AGL is constantly balancing the need to create value for all stakeholders with the financial impact of the investment on AGL's overall position. This includes weighing up the need to maintain short-term financial performance while also creating long-term value.

Beyond FY19

As the energy market continues to transition and present short-term challenges to our financial performance, focus on effective capital allocation and business optimisation will be a priority.

More information

The Operating and Financial Review (page 37) outlines AGL's financial performance for FY19.

Full financial accounts are available from page 82.