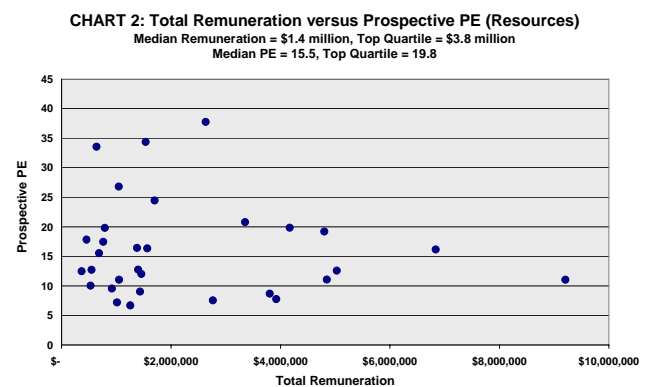
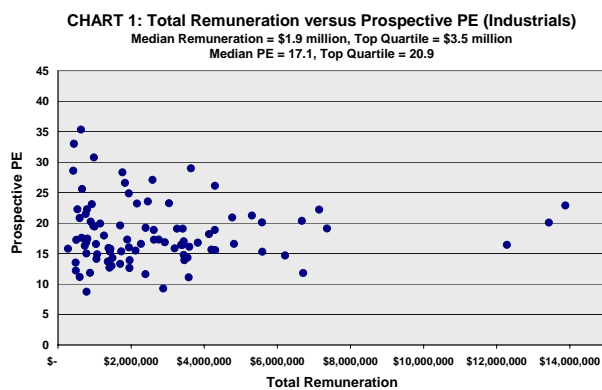


CEO Remuneration – Enough?

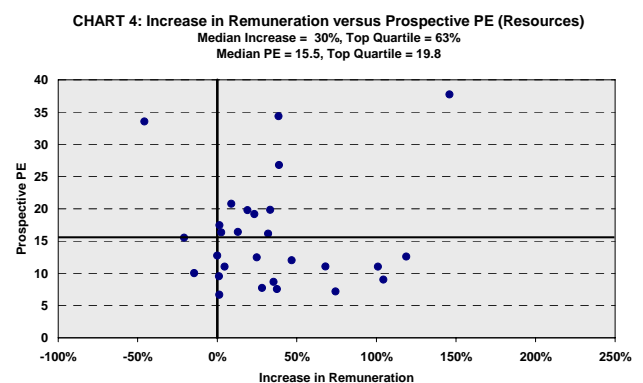
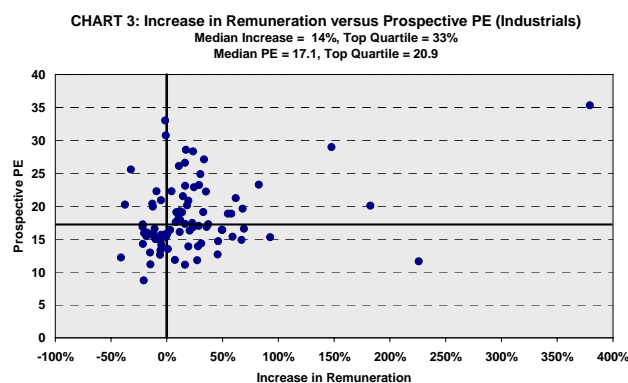
The long bull run has driven up the total remuneration of Chief Executive Officers but the size of their salary increases does not always correlate to the performance of their companies. In some cases, CEO remuneration is more reflective of sector than actual company performance while evidence suggests those working in boom sectors continue to benefit long after the boom has passed. In this newsletter, we examine executive pay and its relationship, if any, to company valuation and shareholder returns. The data we have used were supplied by CGI Glass Lewis, who in turn extracted the data from the Annual Directors' Report for 2006 and 2007 provided within a company's annual report. Termination payments were excluded from the calculation.

What the data show?

Charts 1 and 2 show total CEO remuneration for 2007 against the prospective PE ratio as at June 2007 for their company. This was carried out for Industrials excluding Financials (Chart 1) and Resources (Chart 2). One would expect that companies that pay their executives higher than average have prospective PE ratios greater than the industry median. The data do show that there is some tendency for high priced stocks to have highly paid CEO's but the relationship is weak. Some highly paid CEO's manage conservatively valued companies.



We next looked at the annual increase in CEO remuneration from 2006 to 2007 against prospective PE for the Industrials excluding Financials (Chart 3) and Resources (Chart 4). Interestingly, a number of company CEO's achieved substantial increases in remuneration while managing companies that are not highly regarded by the market. Also, thanks to the phenomenal run in commodity prices, CEO's within the Resources sector generally experienced substantial increases in remuneration from 2006 to 2007: the median and top quartile increases were 30% and 63% respectively. This compares with median and top quartile increases of 14% and 33% respectively for our Industrials basket.

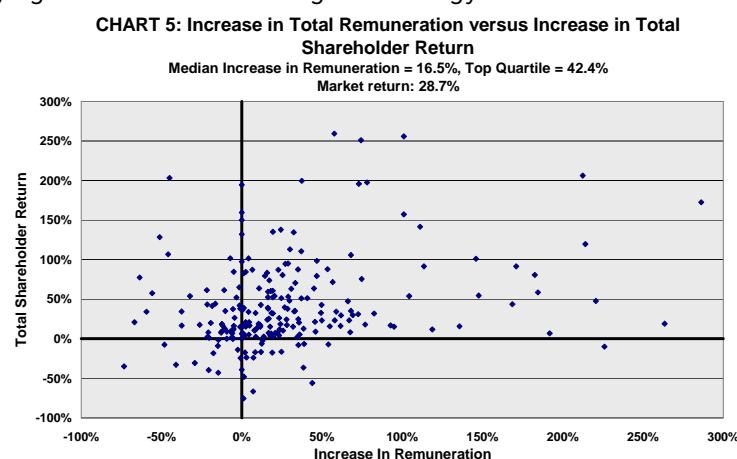


CEO Remuneration – Enough?

The median total CEO total remuneration across the top 140 companies for 2007 was \$1.94m while when we last conducted this research in 2002 across the same range of companies, the result was \$1.12m. The increase over the 5 years has been a hefty 73% whereas the increase in the average wage has been less than 20% over the same period.

As larger market capitalisation companies tend to pay their executives more than median, we conducted the above analysis using total remuneration as a proportion of net profit after tax against prospective PE with similar results. Interestingly, the median total remuneration as a percentage of company net profits was 1.8% for 2007 while the result was 1.3% in 2002. So at a time when company profit share of GDP is high and the labour share is low, CEO's are getting a bigger piece of the profit pie.

Examining total shareholder returns (TSR) over the 2007 financial year against an increase in total remuneration from 2006 to 2007 (Chart 5) revealed increases in remuneration were generally accompanied with increasing shareholder returns. Ideally a TSR relative to peers should be measured. Other metrics along with TSR should be used, such as growth in reported earnings, although these are open to manipulation, or, better still, company operational measures. The exceptions to the rule (the bottom right hand corner of the chart in particular) were not numerous. They were achieved however by those CEO's of companies in current high growth sectors: Mining and Energy.



Examining total remuneration as a percentage of company net profits by sector for almost 300 companies revealed some interesting results. Focusing on the median outcome across each GICS sector showed that CEO's in the IT sector achieved the highest compensation on this measure, notwithstanding the lower net profit levels of IT firms relative to those in other sectors. Maybe the excessive remuneration levels lavished during the technology boom have not yet been fully moderated. By contrast, in the Healthcare sector, where the median company net profit was lower than that for IT, CEO's were more moderately compensated. The other high paying sector on this measure was Energy – a sector that promises substantial increases in forward earnings. Results within sectors have also highlighted some outliers. Within the Consumer Discretionary sector, CEO's for the Ten Network and JB Hi-Fi were highly paid, in contrast to those who head Harvey Norman and the Seven Network. Within the Financials sector, Babcock and Brown was the clear outlier, followed by Macquarie Bank. The St George and Commonwealth banks were at the other extreme while within the Mining sector, CEO's of gold producers were the highest paid on this measure.

Where to from here?

Total shareholder returns over the 2008 financial year will be depressed for the majority of companies while the growth in earnings will be slower than in previous years. This should lead to a lower rate of CEO remuneration increase in 2008. Investors should be vigilant of attempts to compensate CEO's for the reduced value of their Long Term Incentive (LTI) plans (via option repricing and increasing use of performance rights) and variations of the remuneration framework from normal market practice. Use of novel remuneration frameworks that some investors may not have the resources to assess properly should also be discouraged. A move away from a TSR metric for LTI's to qualitative and operational measures would be positive as the TSR measure can be subjected to market forces beyond a CEO's control. Total CEO remuneration is clearly now at elevated levels, any further increases from here require sound justification.

Disclaimer

This newsletter has been prepared and is being distributed by WestLB Mellon Asset Management (Australia) Pty Ltd ("WMAM Australia"). It is for information only and is not intended to be an offer or solicitation, or a basis for any contract to purchase or sell any security, or other instrument, or for WMAM Australia to enter into or arrange any type of transaction as a consequence of any information contained herein. Information in this newsletter is believed to be reliable but WMAM Australia do not represent, warrant or guarantee that this information is accurate, complete or suitable for any purpose and it should not be used as a basis for investment decisions or tax advice. Opinions expressed may change without notice. This material is for institutional investors only and is not intended for distribution to private investors. Past performance should not be taken as an indication or guarantee of future performance. WMAM Australia may from time to time on behalf of its clients invest in, or sell short, any stock mentioned.