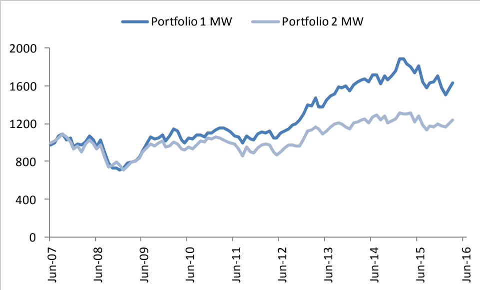
AUSTRALIA

Companies with positive employee trends outperform – the signal has strengthened in line with more thorough ESG corporate reporting



Source: Macquarie Research, June 2016

* **Portfolio 1** – a portfolio of companies with leading scores on employee indicators

** **Portfolio 2** – a portfolio of companies with weaker scores on employee indicators

*** Sentiment weighted – takes into account the relative strength of scores, so a company with a +3 will have 3x the weight in the portfolio compared to a company with a score of +1

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Macquarie Securities (Australia) Limited

ESG

Employee Indicators

Event

- We update our Employee Indicators database for the ASX200, which involves the collection of relevant company reported data.

Impact

- **Human capital larger than tangible capital.** Linking employee indicators to company value and performance is gaining increasing traction in the Australian market, with investors considering a broad range of metrics that influence company performance. Investors are increasingly drawing on a variety of tools to assess and value human capital. As a standard practice, tangible capital is an asset and reported in the financial statements, whereas human capital is mostly ignored by accountants. Yet, academia estimates the value of intangible capital is larger than that of physical capital and there is a growing body of evidence that links performance to employee engagement. Although our analysis is based on a limited dataset which is sometimes subject to inconsistent reporting, the lack of disclosed data is becoming less of a challenge over time as the data points reported on employee indicators have more than doubled over the past 5 years.
- **Positive indicators on employees a signal for future share price.** For this report, we have created a dynamic portfolio of companies with leading scores (*Portfolio 1**) and compared the performance to a portfolio of companies with weaker scores (*Portfolio 2***). Over the past 9 years, Portfolio 1 has consistently outperformed Portfolio 2, a result that is robust on an equal, market-cap, or 'sentiment' weighted portfolio. Our preferred 'sentiment'*** weighted portfolio has produced annual outperformance of 2.2% pa since inception and the strength of the signal has improved in line with more thorough ESG corporate reporting with relative outperformance of 6.6%pa over the past 3 years. We also tested the change in the score and found that a change in score has consistently been a predictor and signal for future share performance as well.
- **Financial implications of human capital.** Tied in with productivity is employee satisfaction and motivation. Furthermore, managing absenteeism and staff turnover can provide a competitive cost advantage over peers, as illustrated by **WBC**'s higher labour productivity compared to **ANZ**, which equates to a 6% revenue differential. Safety is an important facet to manage as incidents can trigger delays, shutdowns and increased scrutiny. The increase in fatalities at the diversified miners at managed sites (5 at **BHP,** 4 at **RIO)** also adversely impacted executive remuneration outcomes**.** While industrial action has, on average, cost 1-4% of revenue for a handful of companies historically, the number of employees involved in industrial disputes in Australia has now dropped to a 9-year low.

Outlook

- Companies with a positive score that we also have an Outperform recommendation on are: **AMC, ANN, ANZ, BSL, CGF, COH, CWN, DOW, GMG, HGG, LLC, MFG, MGR, QAN, SEK, SUN, TAH** and **WBC**. In our expanded ex-100 universe, they include: **BTT** and **PRG**. Those with a weaker score and an Underperform recommendation are: **AWC, BHP** and **WOW** as well as **NST**, **RRL, SCP** in the ex-100 universe.

Executive summary

As a standard practice, tangible capital is an asset and reported in the financial statements, whereas human capital is mostly ignored by accountants. Yet, academia estimates the value of intangible capital is substantially larger than that of physical capital and there is a growing body of evidence that links company performance to employee engagement.

This ESG report incorporates the latest set of disclosures to create a dynamic model focusing on a range of employee engagement metrics – surveys, staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Our database is over a 9-year period for the ASX100 and from 2014, we extended coverage to ASX200 from ASX100.

Although our database is based on a limited dataset, below are key findings from our Employee Engagement survey.

- **Industrial relations disputes at a 9-year low.** Industrial action has, on average, cost 1-4% of revenue for a handful of companies historically. However, the number of employees involved in industrial disputes with ASX listed companies[1] has dropped to a 9-year low. **AZJ** is the only company on our "Room to Improve" list in this assessment, with previous industrial activity impacting the bottom line.
- **Productivity gains can be material.** Debate over remuneration and productivity will remain topical as resource companies focus on cost-cutting and the political discourse remains on productivity gains and industrial relations. Among the banks, **ANZ** has lower productivity than peers. **WBC**'s high labour productivity equates to an additional 6% in revenue. **NAB** has clawed back some of the lost productivity in recent years, equating to a 3% benefit in revenue terms.
- **Employment engagement surveys show clear leaders.** More than 70% of ASX100 companies conduct an Employment Engagement Survey. **AGL, BTT, EPW, LLC, MYR, SEK** and **SGP** perform well in this category. Research has shown that engagement provides a competitive edge and can improve productivity and profitability.
- **Workplace diversity is an indicator to broader human capital management.** Approximately 95% of companies disclose information on gender diversity due to ASX reporting guidelines. A company's ability to attract, retain and promote female staff provides an indication of broader human capital management.
- **Health and safety often tied to management bonuses.** Safety incidents can trigger delays to projects or lead to temporary shutdowns that may impede production. Safety lapses can also lead to increased scrutiny by unions or government bodies or can affect the ability of a company to win future tenders. Fatalities at the diversified miners at managed sites increased in 2015, with 5 at **BHP**, 4 at **RIO** and this outcome adversely impacted executive bonuses.
- **Managing absenteeism and staff turnover can provide cost advantage over peers.** Low absenteeism is a lagging health indicator that is typically associated with positive trends in staff morale and productivity. **IAG** staff 'max' out their sick leave while some companies such as **ANZ, CGF** and **MGR** manage absenteeism well.
- **Low voluntary staff turnover** (when an employee chooses to leave an organisation of his or her own accord) is a sign of positive employee engagement. Companies with low rates of staff turnover are: **CBA, COH, TLS** and **WBC**. Higher staff turnover has an implied productivity cost and could position the firm at a cost disadvantage relative to competitors.

Companies that are in Portfolio 1[2] that also have an Outperform recommendation are: **AMC, ANN, ANZ, BSL, CGF, COH, CWN, DOW, GMG, HGG, LLC, MFG, MGR, QAN, SEK, SUN** and **WBC**. In our expanded ex-100 universe, they include: **BTT** and **PRG**.

Companies in Portfolio 2 that have an Underperform recommendation are: **AWC, BHP** and **WOW** as well as **NST**, **RRL, SCP** in the ex-100 universe.

[1] In Macquarie's coverage universe
[2] Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score.

Employee Engagement Leaders Outperform

Macquarie's Employment Engagement index is a lead indicator

Using the data on employee indicators, it is possible to create two portfolios that we rebalance at each review and track the performance of.

For this analysis, we create two portfolios based on a range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. A score of +1 is assigned for "Leaders" in an employee metric and a score of -1 is assigned for those companies with "Room to Improve". A company's score is the net of the accumulated scores.

For example, a company with strong performance in turnover (+1) and safety (+1) will receive a +1 score for each of these categories, resulting in a net score of +2. A company with weak performance in diversity (-1) but strong in staff turnover (+1) and absenteeism (+1) will receive a net score of +1.

In our quant analysis, we construct two portfolios:

- *Portfolio 1* includes all companies with a net positive score.[3]
- *Portfolio 2* includes those with a net negative score.

In the charts below, we use a dynamic portfolio over nine years and track it relative to the sample group on an equal-weighted, market-cap and sentiment-weighted basis.

<u>**All of these scenarios produce outperformance by Portfolio 1 when compared to Portfolio 2. The findings appear robust and consistent over time.**</u>

Our preferred methodology is to take account of the relative strength of each company. The sentiment weighted index means that a company with an employee engagement score of +3 would be weighted at 3 times that of a company on +1. Conversely, a company with a score of -3 would be weighted at 3 times that of a company on -1.

Under this 'sentiment' scenario, the outperformance of Portfolio 1 relative to Portfolio 2, since inception in 2007, is 2.2% pa.

Moreover, as the strength of the signal has improved in line with more thorough corporate reporting, it is notable that in the past three years, Portfolio 1 has outperformed Portfolio 2 by 6.6%pa, or 6.0% over the past five years.

<u>**We have also tested whether a change in score is a predictor for future share performance and conclude that a change in our Employee Engagement score is an indicator of future share price performance, as shown in the charts overleaf.**</u>

This statement holds true when measured on a market cap, equal and sentiment weighted basis. Using our preferred methodology to take account of the relative strength of each company, the outperformance of Portfolio 1 relative to Portfolio 2, since inception in 2007, is 4.5% pa.

Companies in the ASX100 with a positive change in score that have been upweighted in our Portfolio 1 (+) are: **BSL, CWN, DMP, DOW, GMG, HGG, SEK, SGP, QAN, TLS, WPL** and **SCG**.

Companies with a negative change in score that have been included in our Portfolio 2 are: **BHP, GPT, RIO, SGM** and **WOW**.

[3] Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score. Further detail on methodology is discussed later in this report.

Fig 1 ESG scores lead indicator for performance (sentiment weighted)

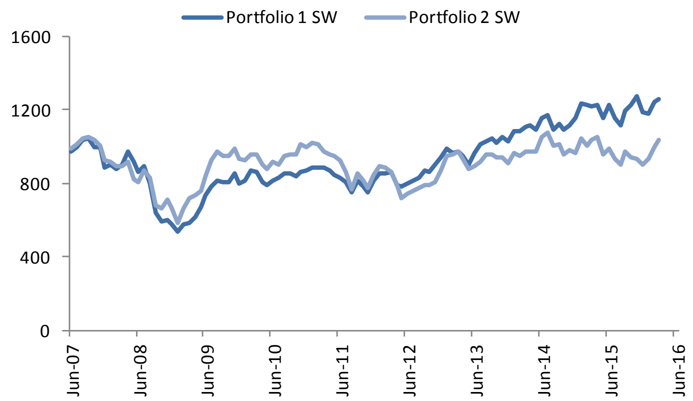


Fig 2 Change in EE score indicator for performance (sentiment weighted)

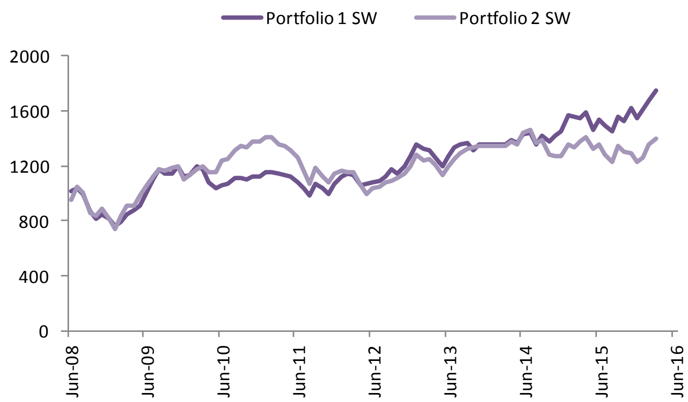


Fig 3 ESG scores lead indicator for performance (equal weighted)

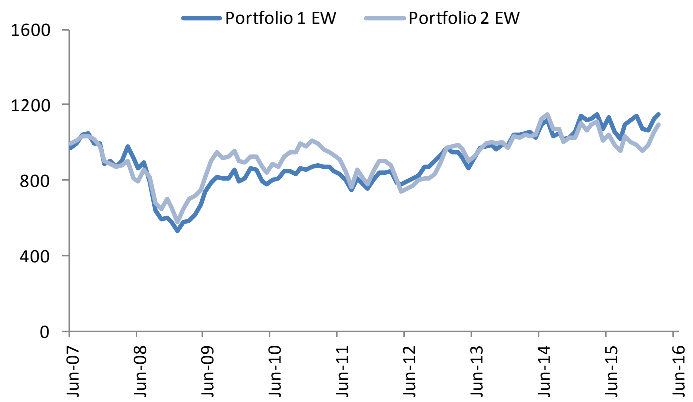


Fig 4 Change in EE score indicator for performance (equal weighted)

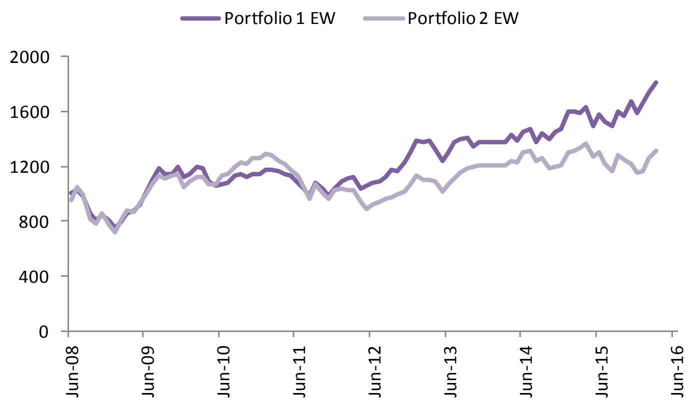
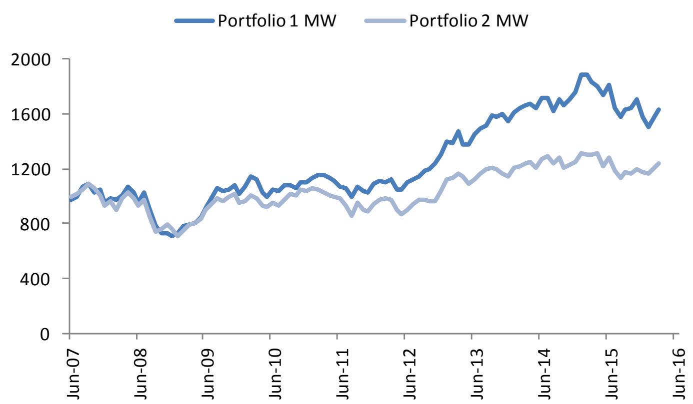
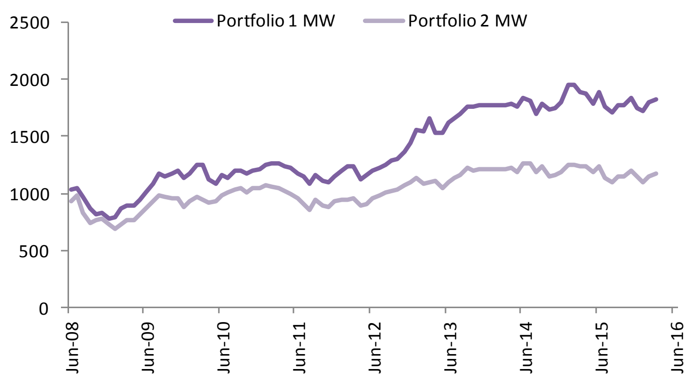


Fig 5 ESG scores lead indicator for performance (market cap weighted)



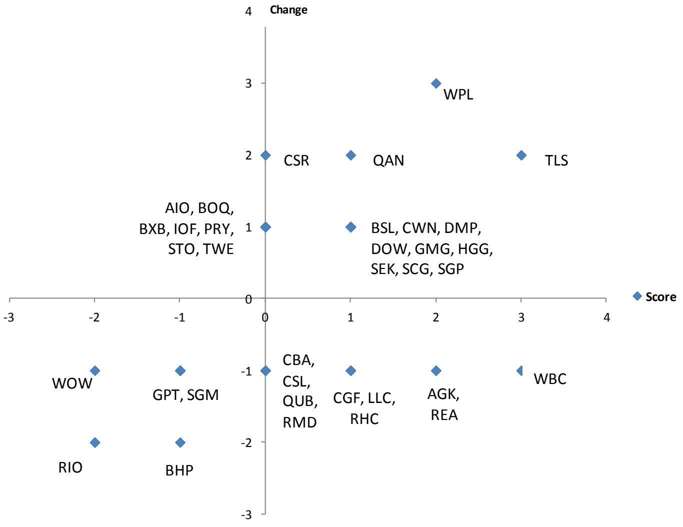
Source: Company data, Macquarie Research, June 2016

Fig 6 Change in EE score indicator for performance (market weighted)



Source: Company data, Macquarie Research, June 2016

Fig 7 Employee Engagement score and change plot



Source: Company data, Macquarie Research, June 2016

Fig 8 Change in score indicator for performance

- Companies in Portfolio 1 have outperformed those in Portfolio 2[4]
- Companies with a positive change in score have outperformed companies with a negative change in score
- Companies in the top right quadrant are in our Portfolio 1 and have had a positive change in score in the 2015 survey. This includes: **BSL, CWN, DMP, DOW, GMG, HGG, SEK, SGP, QAN, TLS, WPL** and **SCG**
- Companies in the bottom left quadrant are in Portfolio 2 and have had a negative change in score in the 2015 survey. This includes: **BHP, GPT, RIO, SGM** and **WOW**.

Source: Company data, Macquarie Research, June 2016

[4] Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score. Further detail on methodology is discussed later in this report.

Summary – the Macquarie Dynamic Employee Engagement Index

The summary of the corporates on each of the employee indicators is presented below. A more detailed discussion of each employee indicator is discussed later in this report.

Fig 9 Employee scorecard

Employee engagement indicator	Key determinant	Leaders	Room to improve
Employee engagement survey	Strong benchmarked score; improving trend	AGL, ANZ, BTT, EPW, HGG, LLC, MYR, REA, RHC, SEK, SGP, SUN, TAH, TLS, WPL	WOW
Staff turnover	Low staff turnover relative to industry benchmark; improving trend	AIO, COH, GMG, HSO, NAB, TLS, WPL	ANZ, BLD, CMW, ORG, GPT, OSH, MMS, SGM, RIO, WES
Absenteeism	Low absenteeism relative to Australian benchmark; improving trend	ANZ, CMW, CGF, MGR, WDC	AIO, IAG, MMS
Remuneration and productivity	Improving revenue to wage cost ratio while maintaining or improving average employee wage	AZJ, CWN, DMP, EGP, NAB, MFG, QAN, WBC	BLD, CAB, KAR
Diversity	High proportion of women in senior management, particularly relative to the overall company workforce and considering industry average levels of participation; improving trend, or EOWA Employer of Choice	AGL, AMC, AZJ, CRZ, JHC, MFG, MTS, MYR, NCM, PRG, REA, S32, TLS, WBC	AWC, GTY, HZN, JBH, NST, RRL, SCP, VRT, WSA
Industrial disputes and workplace rights	Room to improve defined as greater than 2.5% of total workforce involved in industrial action ballots over the past 2 years		AZJ
Occupational health and safety	Low injury frequency and severity rates, including fatalities; clearly documented safety policies, procedures, and leading indicators; improving trend	AMC, ANN, BSL, DOW, OSH, WPL, WBC	AZJ, BHP, CIM, EGP, HSO, NCM, RIO, S32, SUL, WOW

Source: Company data, Macquarie Research, June 2016

Employee Engagement scorecard

A company's Employee Engagement score is a cumulative score on each of the categories: employee engagement, turnover, absenteeism, remuneration, diversity, industrial disputes and occupational health and safety. For example, a company that is a leader in diversity (+1) and turnover (+1) will receive a net score of 2 (+1 for diversity and +1 for turnover), or a company that is a leader in diversity (+1) but behind peers in absenteeism (-1) will receive a net score of zero (+1 for diversity, -1 for absenteeism = 0)

According to our survey, the top ranking employee engagement companies with a score of more than 1 are: **WBC, AMC, AGK, NAB, TLS, WPL** and **MFG**. In our expanded ASX200 universe, **MYR** was the only ex-100 with a score of more than 1. The companies with a negative score of more than -1 are: **BLD**, **RIO** and **WOW**. In our expanded ASX200 universe, the only inclusion is **MMS**.

New companies in Portfolio 1 include: **BSL, CWN, DMP, DOW, GMG, HGG, QAN, SEK, SGP** and **WPL**.

Companies removed from Portfolio 1 are: **BHP, CBA, CSL, MND** and **RMD**. In the ex-100, **AAD**, **AHG**, **BPT**, **PMV**, **QUB**, **JHC** and **OFX** were removed.

New companies in Portfolio 2 include: **AWC, BHP, BLD, GPT** and **RIO**. Companies that have been removed from Portfolio 2 are: **AIO, BOQ, BRG, BXB, CDD, CHC, CSR, HZN, KAR, KMD MGX, MTS, NST, PBG, PRY, QAN, SIP, SFR, STO, TWE** and **WPL. ARI** and **TOL** have been removed due to delisting.

Employee Engagement scorecards

Fig 10 Employee Engagement Scorecard – Top 100

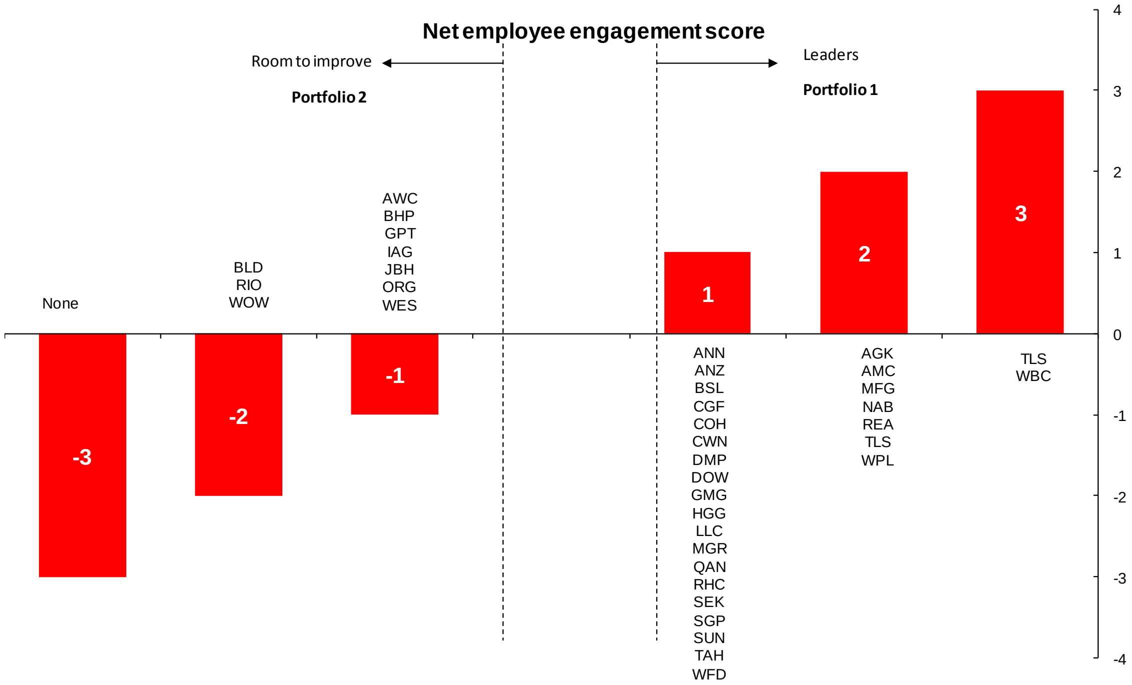
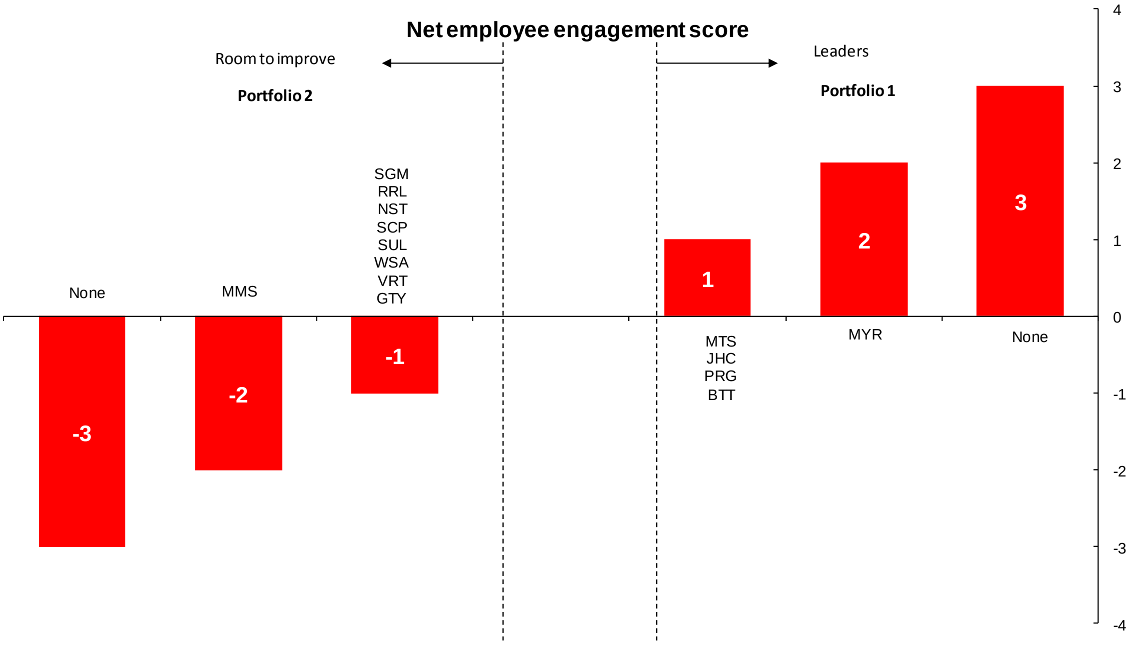


Fig 11 Employee Engagement Scorecard – ex 100



Source: Macquarie Research, June 2016

Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score. Further detail on methodology is discussed later in this report.

Scorecard movers

It is also worth noting those stocks that shifted when compared to our previous survey.

Fig 12 Scorecard movers – companies with change in score vs. previous – Top 100

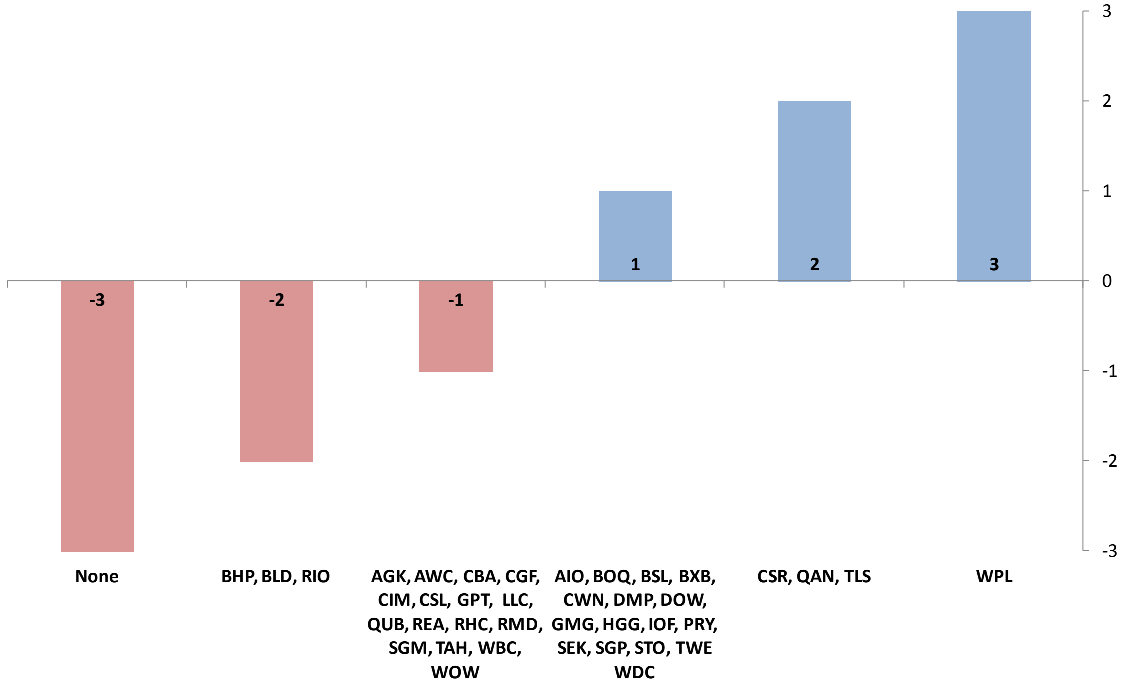
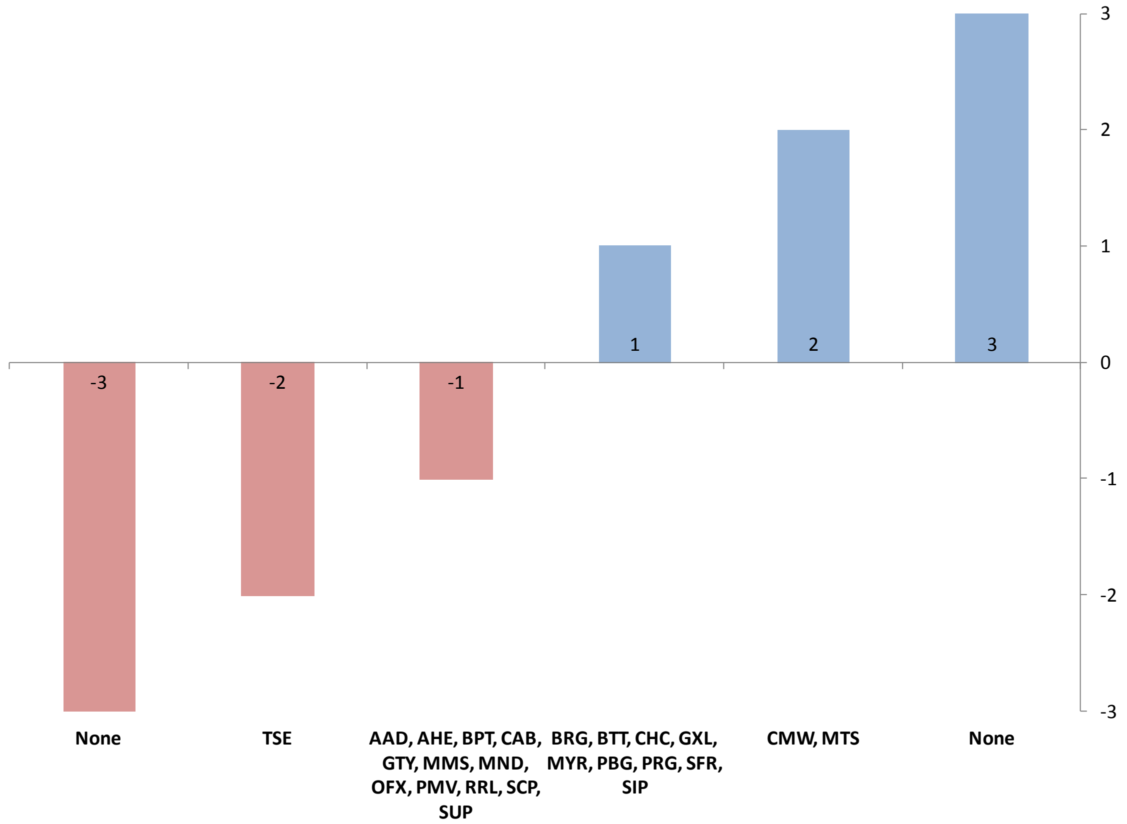


Fig 13 Scorecard movers – companies with change in score vs. previous – ex 100



Source: Macquarie Research, June 2016

As shown in the charts, there are a number of companies that had changes to their score, which resulted in companies either moving in or out of the portfolios.

Companies that moved out of Portfolio 2 and into Portfolio 1[5] include: **MTS, QAN** and **WPL**. While **MTS** improved its safety record, there is still work to do with the retailers reporting injury frequency rates multiples that of the mining companies.

QAN shifted into Portfolio 1 due to improved productivity metrics; however, the disclosure on key employee statistics has dropped off relative to prior periods. However, this example highlights one key shortcoming of the employee engagement scores – that it *does not include undisclosed information.* QAN did not provide data on certain employee engagement metrics that it has in the past and received a net score of zero on these compared to a negative score previously.

Admittedly, this does create an incentive for poorly performing employee engagement companies not to disclose useful information, and also creates an incentive for companies to selectively disclose employee data, providing a more (or less) favourable view than would result from complete disclosure.

However the alternative is to make assumptions about employee engagement with no quantitative (or qualitative) information. On balance, the potential bias from only including reported data is preferable to ad-hoc assumptions about undisclosed information.

The only company to shift from Portfolio 1 to Portfolio 2 was **BHP**. This was due to the change in the safety score on the back of the fatalities at the managed sites. There were 5 fatalities compared to zero in the prior year. This figure excludes fatalities at non-operated sites and the Samarco incident.

This disclosure bias gap appears to have narrowed over recent years as the list of "Leaders" in the ASX200 is 32 vs. "Room to improve" at 22, which may reflect generally improving trend in disclosure on employee engagement as Australian corporates increasingly focus on human capital. This compares to earlier surveys where the leaders list was twice as long.

[5] Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score. Further detail on methodology is discussed later in this report.

Employees as an asset – engagement as ascribing and tracking value

A growing body of evidence finds a positive causal link between employee engagement and company performance. Intuitively, most companies rely on their ability to engage with their staff in order to successfully do business and it is an oft-repeated phrase by companies around the world that people are a company's biggest asset.

Companies need to be able to attract and retain staff to meet their plans. For example, contractors need to have strong relationships with staff to prevent turnover, meet the requirements of the resources and energy sector and avoid industrial relations disputes. Minimising industrial disputes is also an issue in the transport sector. The financial sector is focused on retaining talent, while a wealth of evidence suggests that improved employee engagement can increase sales in the retail sector.

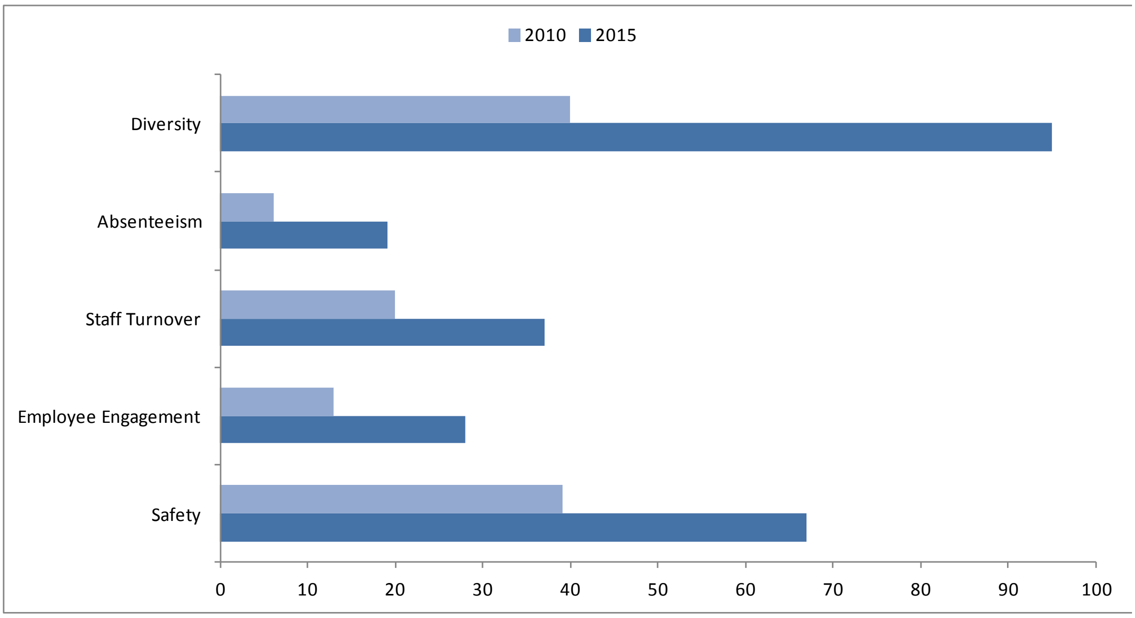
Yet linking employee engagement to company value and performance is a difficult process.

Nonetheless, we have created an employee engagement database across metrics including: staff survey results, turnover, absenteeism, female representation in senior management, all industrial action ballots against listed companies, all available occupational health and safety data, and productivity and remuneration metrics. Each of these components has its own direct and indirect business cost, however they also combine to provide an over-arching view of employee engagement.

The limited corporate disclosure of environmental, social and governance (ESG) has hindered research. However, improving corporate disclosure means that this can now be assessed in an Australian equity market context. This report builds on our previous studies, which provide a regular comprehensive view of staff engagement across Australian companies and the implications for investors.

The lack of disclosed data is becoming less of a challenge over time. Put simply, as ESG disclosure improves, the strength of the 'signal' in determining employee engagement leaders improves. The number of data points on employee indicators has more than doubled over the past 5 years and there has been a significant improvement in reporting, as illustrated below.

Fig 14 Improved reporting on employee indicators in past 5 years in the ASX100



Universe is ASX100, Reporting of key employee indicators

Source: Company data, Macquarie database, June 2015

Given the changes to the ASX Corporate Governance guidelines regarding disclosure of "E" (environment) and "S" (social) data, we expect further improvement in reporting of employee metrics in the coming years.

Gender diversity is the most commonly reported data metric with 95% of ASX100 now reporting on workforce diversity. This is followed by safety, where almost 70% of companies in the ASX100 are reporting on safety. Absenteeism seems to be the most underreported relative to the other metrics.

Our database is compiled across a total of 256 companies that have been in or out of the index over the period, or 174 companies in the ASX200 as at 1 April 2016.

The data has been collated from: ~1,100 annual reports; ~350 sustainability reports, as well as Equal Opportunity for Women in the Workplace Agency (EOWA) reports; industrial action ballots lodged with Fair Work Australia; Macquarie Securities' own database; and other complementary sources.

This database provides a unique and useful tool, with the extensive range of sources allowing for reliable benchmarking and hence a dynamic, rolling annual index of employee engagement leaders and those with room to improve.

Value in human capital

Physical capital is an asset and reported in the financial statements, whereas human capital is mostly ignored by accountants. Yet, academia estimates the value of human capital is substantially larger than that of physical capital[6].

There are limitations in recognising and measuring the value of human capital in balance sheets because the current accounting standards are insufficiently developed to introduce a system of people-based accounting.

Yet, the changes in corporate value over the past 30 years illustrate why it may be an increasing area for investors to focus on.

Thirty years ago, 80% of a company's value was easy to enumerate by accountants as it comprised mostly physical (tangible) assets. However, it is now estimated that up to 80% of a company's value is determined by intangible assets being brand, value, intellectual property and people.[7]

It is not so much that this report estimates the value of human capital but rather we observe indicators of employee health in the context that we regard human capital as an asset.

Employees are still an asset – even in difficult times

A final comment is that economic conditions remain challenging and it is tempting to disregard human capital concerns in favour of a focus on cost-cutting and productivity. And despite difficult trading conditions and, in some instances, necessary job-shedding by Australian corporates, employee engagement should still be a focus, as it is both achievable and can be supportive of productivity initiatives.

[6] Measuring Human Capital – An OECD Project, 2012 (Gang Lui)
[7] The Future of Investment Human Capital, 2011

Macquarie's Employee Engagement database

With this context we now extend our dynamic model of employee engagement, incorporating the latest set of disclosures and results to provide an up-to-date rebalance of our portfolios.

In doing so we review the following metrics:

- staff survey results, response rates, targets, frequency, and survey provider;
- staff turnover rates, its reporting basis and performance relative to the sector norms;
- absenteeism compared to the Australia-wide private sector average;
- the proportion of women in the workforce, management and senior management, diversity targets and the implied retention rate of female staff;
- every industrial action ballot against a listed company for the past five years and what proportion of staff were involved;
- all available occupational health and safety metrics including lost-time injury frequency rates, total recordable injury frequency rates, injury severity rates (days lost per injury), fatalities, and other information on workers compensation claims compared to industry benchmarks (with a focus on the severity of injuries); and
- productivity and remuneration metrics including revenue to wage cost ratios and average wage cost per employee.

Each of these components has its own direct and indirect business cost; however they also combine to provide an over-arching view of employee engagement. Each of the employee metrics is discussed in detail overleaf.

Employee engagement surveys

Disclosure differs across the sample

"There is a direct correlation between high-performing businesses and highly engaged employees. High employee engagement is not the only ingredient for business outperformance, but it's near impossible to achieve without it." – EPW (ERM Power, Chairman's AGM address)

The workforce drives productivity and is an important driver of shareholder value. Culture and employee engagement are important foundations for worker productivity and business outperformance.

Of the companies in our sample, 114 disclose that regular employee engagement surveys are conducted. However, as in prior years, the level of information provided to shareholders varies considerably.

Unlike financial disclosures, there are no clear reporting standards for employee engagement and sometimes there is a selective bias in disclosing the data that is released. Nonetheless, we continue to see improved disclosure on non-financial metrics, particularly from ASX100 companies.

The use of employee engagement surveys in the ASX100 sample is high, with 70% of companies (or ~60% in ASX200) conducting regular employee engagement surveys and quite often, including the score or participation as a key performance indicator (KPI) in the short term incentive (STI) scheme plan.

However in our sample, we found that just over a third of these (35%) of the ASX100 companies actually provide investors with the employee engagement score, or 28% of the ASX200. The remaining companies may provide a participation rate, commentary or simply that the survey is undertaken.

Forty-one companies in our coverage provide scores on their employee engagement surveys, namely, **AGL, AIO, ANZ, BPT, BEN, BOQ, BXB, CBA, CGF, CHC, CMW, CPU, CTX, DXS, EPW, HGG, GNC, ILU, LLC, MGR, MMS, MYO, MYR, NAB, ORG, PGH, QAN, REA, RHC, SEK, SGP, AST, SUL, SUN, TAH, TCL, TLS, WHC, WOW, WPL** and **SCG.** The majority (83%) conduct annual surveys but some undertake less frequent surveys, typically biennial.

There is improved disclosure of employee engagement in the ex-100 compared to previous reviews. Of the 39 companies that provide an employee engagement score, nine are ex-100 compared to only four in the prior survey. The ex-100 companies that provide employee engagement scores are **BPT, CHC, CMW, MMS, MYO, MYR, PGH, WHC** and **SUL**.

The new entrants to the 2015 survey are: **BOQ, BTT, CGF, EPW, MYO, PGH, TCL, WHC, WOW, WPL** and **SCG**. **WOW** used to only provide the participation rate but now discloses the employee engagement score. The improved reporting reflects the increased emphasis on non-financial metrics disclosure, particularly for human capital metrics. More than half of the new entrants are ex-100.

An additional eight companies, namely **AHG, AMC, ANN, CVO, IOF, OFX, ORI** and **WES** provide a participation rate only whereas **ABC, AMP, ASX, CCL, CTX** and **QBE** provide select relevant context on the results. For example, **ANN** disclosed participation rate of 90% and said the global results surpassed peer companies but work still needs to be done in some areas and **AMP** provided selected results on aspects of the survey.

There are only a few companies that provide less information on employee engagement than in the past. **CIM, FMG** and **SGH** no longer provide the employee engagement score despite disclosing it in the past.

WBC stopped conducting their employee engagement survey from 2014 due to implementation of a "major cultural programme". However, **WBC** has indicated the traditional survey will resume from 2016. **TLS** and **DXS** will also conduct another employee survey in 2016, switching to surveys being conducted biennially. **NAB** changed survey provider to Right Management from Hay and achieved a score of 52% which is above the global financial services benchmark but below the global high performing benchmark.

We no longer include results from **TOL** following its delisting.

For the remaining companies that conduct employee engagement surveys, only scant information is provided other than the existence of a survey and possibly a reference to the fact that the results of the employee engagement survey are assessed as part of their management incentive plans. This includes **AAD, AIO, AZJ, BHP, CRZ, DLX, EGP, FDC, FXL, GNC, GOZ, IRE, ISD, MYO, OFX, ORI, PGH, QBE, REC, RIO, RMD, TPI, TTS** and **WDC**. An example is **QBE**, which marked employee engagement "above target" in their 2015 Remuneration Report.

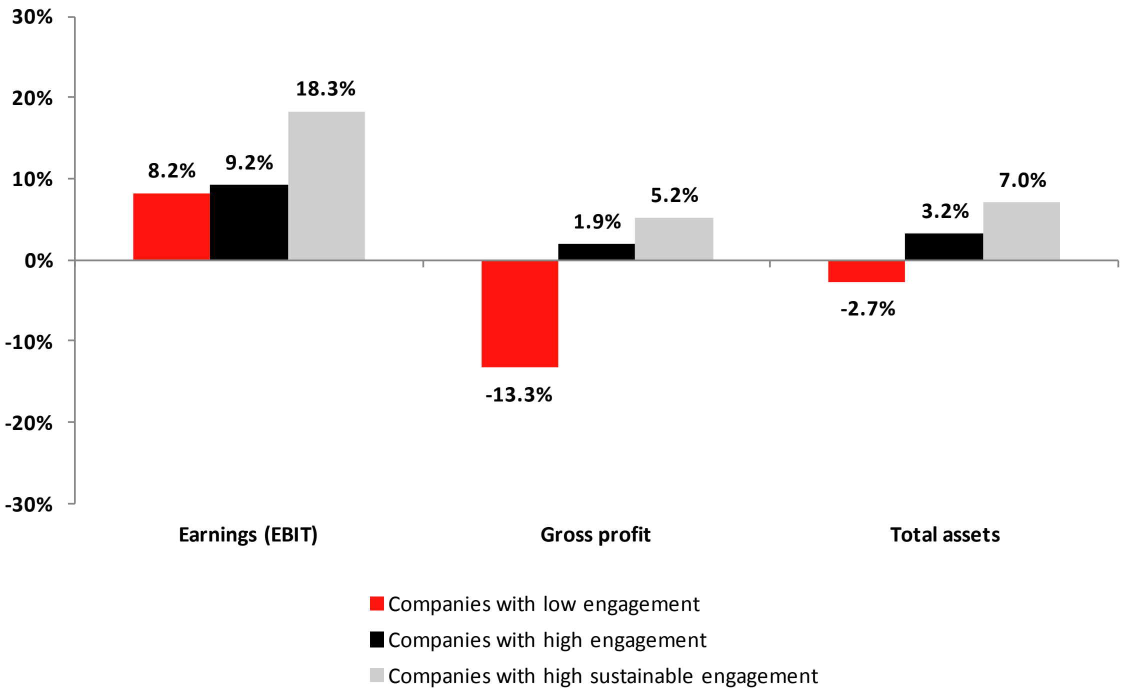
There are also a number of companies that have started undertaking employee engagement surveys or flagged their intentions to undertake one in 2016, namely: **AHY**, **EVN, FLT, GUD, HSO** and **S32**.

Corporations, such as **TAH,** are increasingly recognising the benefits of fostering employee engagement and the correlated benefits in terms of organisational outcomes such as productivity, profitability or competitive advantage.

These outcomes are consistent with *Aon Hewitt's* conclusion that finds that "companies that get engagement right can enjoy a surplus of competitive advantage in talent strategy and business results that is hard for others to replicate".

In a recent study done by Towers Watson, the consulting group identified that "sustainable engagement" – which combines engagement, enablement and work environment – drive better financial outcomes, as illustrated in the chart below.

Fig 15 Sustainable engagement is linked to better financial performance



Measures growth over prior year versus sector, one-year performance. Based on a study conducted by Towers Watson of 41 global companies.

Source: Towers Watson, "Taking Engagement to New Heights", June 2015

Towers Watson concluded the benefits for high sustainable engagement are in productivity which enhances earnings growth and drives improved profitability. This study supports the body of evidence that "validates the quantifiable relationship between levels of organizational engagement and financial performance".

Similarly, research conducted by Gallup shows that there is a noticeable difference in key business outcomes. Specifically, they highlighted that top quartile employee engagement companies outperform bottom quartile units in customer ratings, productivity and profitability; as well as exhibiting lower absenteeism, turnover, product quality and safety issues.

Employee Engagement scorecard

Participation in employee engagement surveys reflects the corporate assessment of employee engagement as a potentially material ESG issue, stemming from their ability to attract and retain staff, as well as broader improved trends in corporate ESG disclosure.

Furthermore, employee disengagement is costly for corporates as it affects productivity and performance of the workforce.

In assessing each of the surveys, there can be a lack of comparability across different survey providers and as such, we have assessed company results separately.

In addition to the 114 companies that publicly reference employee engagement surveys, a significant number of other companies likely also undertake these surveys but do not disclose the results. As a result, it is not possible to rely on the above disclosures in isolation.

That said, we can identify clear leaders in the sample, of which some are listed below:

- **AGL** – the score of 76% is relatively stable on the prior year and puts the company in the ORC "International Best Performing Zone". The Board retained the FY16 target to achieve an employee engagement score of more than 75% and people management is included as one of the non-financial measures for determining short term incentive entitlements,
- **ANZ** – achieved an employee engagement score of 76% despite bank-wide changes during the year. The Board upped the target for FY16 to 78% as they recognise the importance of an engaged workforce being an important driver of sustainable long term performance,
- **BTT** – although not disclosing the score, **BTT** achieved a 5% uplift in employee engagement since the last measurement was taken in 2013, advancing the organisation's standing within the top quartile of Aon Hewitt's Best Employer range,
- **EPW** – is the only ex-200 to be included in our employee engagement leaders board. Its engagement and enablement scores of 72% and 75% respectively place the firm in the top 30 global high-performing companies in the Hay Group's client base of more than 400 companies and 6.5 million employees,
- **HGG** – achieved an employee engagement score of 89% in 2015, a 2ppt increase on the prior survey. HGG undertakes regular pulse check surveys and notes a link between high retention rates and employee engagement scores,
- **LLC** – discloses a sustainable engagement score[8] (includes engagement, enablement and energy) of 85% which is 5% higher compared to the previous survey and places the firm in line with Global High Performing Companies,
- **MYR** – further improved the employee engagement score to 84% from 83% in the previous survey. In 2014, MYR was the highest ranking out of 182 surveys conducted by ORC International, which won MYR the "Excellence in Employee Engagement" award,
- **SEK** – with an employee engagement score of 80%, Aon Hewitt named SEEK a 2015 "Aon Hewitt Best Employer", recognising the business has one of the highest levels of employee engagement reflecting its culture and people practices,
- **SGP –** maintained employee engagement score of 85%, which places the firm above both the Australian national norm and Towers Watsons Global High Performing norm.
- **SUN –** improved score for a third consecutive year to 77%, which is above both the Hays Group Global High Performing norm and internal targets. This score was achieved with a high participation rate of 91%.
- **TAH –** further improved employee engagement score to 3.89 from 3.81 using the Gallup assessment tool. This places it in top quartile growth in engagement levels since 2011. Employee engagement is a key tenet of management's scorecard targets.

There is a smaller list of companies that undertake less frequent surveys which have been retained in our Leaders list – **REA**, **TLS** and **RHC**. Previously, we had excluded companies that did not have an employee engagement score in the assessment period. However, the revised methodology recognises scores for less frequent surveys, up to a maximum of 2 years.

[8] Towers Watson sustainable engagement score

For example, **TLS** did not undertake an employee engagement survey in 2015 but in the prior year's results, achieved results above both Australian and international global norms. The next survey will be conducted this year. Similarly, **RHC** undertakes surveys on a biennial basis, with another result due this year.

In addition to the above**,** we note that **AHG, PRG, CTD** and **IAG** make reference to their employee engagement survey score being either above the comparable benchmark or outperforming the relevant sector but do not provide a score. Similarly, **CSR** and **CTX** refer to improved employee engagement but do not provide a score.

The following companies saw notable improvements in their employee engagement score:

- **BOQ** – *(new entrant)* experienced a massive improvement in its 2015 employee engagement score to 67% from 43%. While the score is still below the objective to be in the "top quartile of the AON Hewitt Global Best Employer Engagement Meter", it is a significant jump and was also accompanied by material improvements in its net promoter scores (for customer advocacy),
- **BXB** – improved employee engagement score to 72% from 70%, just shy of the performance norm of top quartile organisations of 73%. We like the level of disclosure and transparency on BXB employee engagement. Disclosure on the participation rate, engagement score, positioning relative to peers, clarity on targets and achievement or not of those targets, is in our view, is a comprehensive approach to managing the human capital base.
- **ORG** – achieved a score of 52% from 47% in the prior survey. While this score is below the AON Hewitt Australian average of 57%, the improvement was achieved with a significant amount of change and resizing of the business. Notably, the employee engagement score was introduced in 2015 as a key performance indicator (KPI) in its executive remuneration framework,
- **PPT** – the 2015 employee engagement score saw a 15 point increase on the prior year. Only 10% of organisations who work with AON Hewitt globally experience an increase in employee engagement of greater than 14 percentage points in any one year. Employee engagement was a key focus area for management in 2015 and people/ employee engagement is 15% of their KPI's in their short term incentive (STI) balanced scorecard,

Based on our assessment, we have included in our 2016 "Room to Improve" list,

- **WOW** – the results of the first phase of WOW's three part employee engagement survey were released in the 2015 Annual report. The engagement score of 66% decreased by 2% relative to the prior year. This result falls below industry standards but is a management focus area.

Fig 16 Employee Engagement Survey Scorecard

	FY10	FY11	FY12	FY13	FY14	FY15
Leaders (+1)	CCL NAB ORG SGP WBC	ANZ SGP STO WBC	AGK NAB SGM SGP WBC	AGK MMS MGR REA SUL SUN TLS WBC	AGL ANZ CBA FMG LLC MGR MYR REA RHC SGP SUN TAH TLS	**AGL** **ANZ** **BTT** **CMW** **EPW** **HGG** **LLC** **MYR** **REA** **RHC** **SEK** **SGP** **SUN** **TAH** **TLS** **WPL**
Improvers	CCL NAB ORG	ANZ MGR	BEN BXB GNC MGR SUN	ANZ IFL QAN	BXB DXS NAB SPN	**ANN** **BOQ** **BXB** **ORG** **PPT**
Room to improve (-1)	ANZ GFF	AGK CBA	SUN		PPT	**WOW**
Regressors	IAG	AGK CBA		FMG NAB	GNC	

* Companies are assessed on the employee engagement score and leaders will typically have a strong benchmarked employee engagement score

Source: Macquarie Research, April 2016

Fig 17 Employee Engagement surveys - sample

Company	Frequency	Response rate	Score	Target score	Previous score	Survey basis	Comments
AGK	Annual	78%	76%	75%	FY14: 77%	ORC	In ORC's "International Best Performing Zone"
ANZ	Annual	n/a	76%	75%	FY14: 73%	Company	Increased target for FY16 to 78% from 75%
CMW	Annual	n/a	73%	n/a	FY14: 89%	n/a	Shifted to an external provider and score is top quartile
EPW	n/a	n/a	72%	n/a	n/a	Hay	The only ex-200 to be included in our engaged leaders. Scores put group in global high performing range
HGG	n/a	n/a	89%	n/a	87%	n/a	Notes link between high retention and engagement
LLC	Biennial	n/a	85%	n/a	FY14: 80%	Tower Watson	Score places firm in Global High Performing companies
MYR	Annual	n/a	84%	83%	FY14: 83%	ORC International	Had won the Excellence award in Employee
SEK	Biennial	n/a	80%	n/a	FY14: 75%	Aon	Aon Hewitt's Best Employer (2015)
SGP	Annual	n/a	85%	n/a	FY14: 85%	Towers Watson	Score is in Towers Watsons Global High Performing Norm
SUN	n/a	91%	77%	n/a	FY14: 73%	Hay Group	Above Hay Groups Global High Performing norm and internal targets
WPL	n/a	n/a	70%	n/a	n/a	n/a	Results are above oil and gas industry benchmark
WOW	Annual	80%	66%	n/a	n/a	Towers Watson	First phase of a three part survey. First result falls below industry standards but is a management focus area
BOQ	Annual	n/a	67%	n/a	43%	Aon Hewitt	New entrant with massive improvement in score to top quartile of Aon Hewitt Global Best Employer
BXB	Annual	93%	72%	73%	FY14: 70%	n/a	Result is just shy of top quartile norms. Best disclosure.
ORG	18mth	86%	52%	n/a	47%	n/a	Score below Aon Hewitt Australian average and was during a significant change and resizing of the business
NAB	Annual	85%	52%	n/a	FY14: 69%	Right Management	New methodology adopted

Source: Macquarie Research, April 2015

Staff turnover

Managing turnover can provide a competitive edge

With employee engagement surveys forming a disparate and inconsistent data set, an alternative indicator is staff turnover. This is especially true given that leaving an organisation is one of the more obvious signs of employee disengagement.

There are 44 companies in our sample group that have provided turnover data. An additional 13 companies provide commentary on staff turnover but do not provide statistics. Typically, we would see about 50% of the ASX100 in our survey provide information on staff turnover, or 30% of the ASX200. However, it is likely that *all* companies retain staff turnover data as it is often used internally – for employee management, as well as accounting purposes.

One key strength of staff turnover data is that, unlike employee engagement, there are clear reporting standards.

Turnover can be reported either as voluntary staff turnover, including only those employees who voluntarily leave an organisation during the year, or total staff turnover, which includes staff who are dismissed or made redundant. In a number of cases, companies fail to specify whether turnover statistics are voluntary or total.

Voluntary turnover is arguably the more useful category for investors as it is not as heavily influenced by economic conditions. Of course, voluntary turnover will also experience some cyclicality as an improved economic outlook and tight labour markets inevitably result in greater competition for staff and higher turnover, however, it also provides a clearer picture of how companies in the same sector are dealing with the challenge.

To make an assessment of whether reported levels of turnover are objectively 'high' or 'low' requires an industry benchmark, which is available from the ABS Labour Mobility survey. That said there are some methodological differences, with the ABS data most closely approximating total turnover but with no distinction for staff on temporary short-term contracts – implying that the ABS data likely overestimates industry-level turnover rates.

Based on the ABS data, *total staff turnover in Australia averages 20% per annum* but it does fluctuate each year depending on labour market conditions.

The ABS Mobility data release is updated irregularly and in the latest survey (2013), total turnover dropped to 18.2%, with around 63% of staff leaving roles voluntarily. This suggests an average rate of voluntarily staff turnover in Australia of about 11.1%.

Staff turnover scorecard

Given industry-level benchmarks from the ABS data and disclosed data from peers, there are a few key observations.

First are companies with low rates of voluntary staff turnover, especially relative to their respective industries, namely **CBA, COH, TLS** and **WBC**. For these companies, relatively low staff turnover rates suggest strong performance on employee engagement and for some this can be confirmed by publicly disclosed improved employee engagement scores.

By comparison, relatively high turnover rates were recorded at **ANZ, SUN, TCL** and **WES**.

For **WES**, retail trade tends to have higher staff turnover than other industries, due to the skew of younger workers (<25) and casual workforce. Similarly, **SUN,** like other insurers, tends to experience higher staff turnover due to call centre turnover which has been reported to be as high as 40% in some call centres[9].

For **TCL**, it is a company specific issue, with Queensland the main factor in the increase. TCL took over Queensland motorways in July 2014 and the increased turnover most likely reflects integration synergies.

[9] ORG said their Call Centres' voluntary turnover rates usually sit at around 40 per cent. This has the effect of increasing the overall organisation employee turnover rate by 2-3%. Turnover rates include employees who leave voluntarily; they do not include employees who leave due to dismissal, redundancy, company transfer, retirement or death in service.

Other companies where call centres affect staff turnover include: **IAG** (10.8%) and **TLS** (10%). However, these two companies have managed turnover down from much higher levels when compared to previous years.

There are also a number of companies with higher reported total turnover due to staff redundancies and downsizing during the period. These include **STO** where total turnover reported at 25%, however 20% relates to non-voluntary turnover or redundancies as the size of the business shrunk by 20%. **OSH**, which reported total staff turnover of 26.5%, is also in this category; as is **CHC**, which reported 20% total turnover, of which 9.3% was involuntary. In contrast, **AST** reported an increase in voluntary turnover due to increased competition for talent.

Amongst the banks, an improvement in staff turnover at **CBA** to 10% has put them on par with **NAB**, the market leader. This compares to an increase in staff turnover at both **WBC** at 11% and **ANZ** at 14.1%.

A number of companies have included staff turnover as a key performance metric for management. For example, **CMW** has an internal target to reduce staff turnover to below 14%. Other companies that have staff turnover as a KPI include **CDD, MTR, NWH** and **WOR.**

In our sample set, **AIO, WHC** and **TLS** were the notable improvers in the staff turnover category.

BLD employee turnover was 15% and has stabilised after a period of extensive organisational and portfolio restructuring.

Select companies have focussed on female retention and turnover, including **WPL**, which reported female turnover of 3.1% compared to the group average of 5.7% and **ORG**, which has switched from reporting company turnover to female turnover only. **CTX** has a target to reduce female turnover at the professional level to below 6% and reported 4.1%.

The database now includes the following companies for the first time: **GMG, RIO, AST, WDC, WES,** and **SCG**.

BXB, CSR, GNC, HGG and **ILU** have stopped releasing staff turnover data. **ORG** has switched to reporting voluntary turnover for females only despite reporting organisational turnover in the past. **MGR** and **LLC** have stopped reporting their “talent” attrition or turnover which has been disclosed in prior years.

NCM, RMD and **SYD** have not yet disclosed data but are likely to report when their sustainability reports are released.

Lastly, we note an increasing number of companies is referring to managing staff turnover levels but accompanying data has not been provided. For example, **ALS** advises that staff turnover is low in its senior management and executive teams and **SRX** states that overall turnover levels are low. However, neither provides the data behind the commentary.

Fig 18 Staff turnover scorecard

	FY10	FY11	FY12	FY13	FY14	FY15
Leaders (+1)	AQP BHP FMG MCC ORI OSH OST PNA SGP STO WPL	**AGP** BHP COH FMG OST PDN	**BHP** COH FMG NAB OST TLS WBC	**AGK** AIO AWE BCI BHP CBA COH FMG TCL WBC	**AGK** AIO BCI BP COH FMG NAB RHC RMD SGM WBC	**AIO** **COH** **GMG** **HSO** **NAB** **TLS** **WPL**
Improvers	AQP BLD CSR NAB	MGR WOW	AGK ORI TLS	IAG MGR RHC SUN	AZJ BLD CGF CSR IAG ORG	**BLD** **CBA** **TLS** **SGP** **WOW**
Room to improve (-1)	MGR OZL	ANZ BLD LEI ORI	IAG MGR WOW	BLD BOQ BXB SGM SGP WDC WOW	ANZ BOQ BXB KMD MGR MMS SGP TCL WOW	**ANZ** **BLD** **CMW** **GPT** **ORG** **OSH** **MMS** **SGM** **RIO** **WOW**
Regressors	STO	BLD SGP ORI	WOW WPL	ORI	AWE ORI	**CGF** **FMG** **IPL**

*'Leaders' and 'Room to improve' are generally assessed on both outright performance and trend versus prior years, while 'Improvers' and' Regressors' reflect performance against pcp

Source: Macquarie Research, June 2016

The costs of staff turnover

Lastly, staff turnover has a cost, namely the cost of separation, replacement, training, lost productivity and lost business as a result of staff leaving. More specifically, examples include:

- the cost of other employees filling in while the position is vacant and the resulting lost productivity;
- the cost of management, human resources and administration time in processing the staff member's departure;
- lost knowledge, skills and contacts from the departing staff member;
- the cost of management, human resources and administration time in hiring a new employee including recruitment fees, time taken with interviews and pre-employment tests;
- the cost of induction training, other training and training materials and supervision; and
- the decline in productivity as the new employee skills up in the position.

These costs are not just upfront cash costs but also implied costs and productivity losses.

Based on academic and industry-level studies, **the rule of thumb is that the total equivalent cost (including lost productivity) of replacing a staff member is 150% of their annual salary**.

Using this approximation, as well as data for employee numbers and average remuneration levels, it is possible to calculate the implied cost of staff turnover. In reality, the 150% replacement cost varies across sector and is likely to vary depending on the skill level of the employee.

Voluntary, rather than total, staff turnover arguably provides a better view of costs. This is because employees that are dismissed or made redundant are often not replaced, or replaced with an employee with greater overall productivity.

The reason we are isolating voluntary turnover, rather than total, is aptly demonstrated by downsizing and redundancies, as has been the case of **OSH** and **STO**. The deterioration in market conditions has triggered the need to resize the cost base.

At **STO**, total turnover increased to 25% from 10% in the prior year. However, of the reported turnover 20% relates to non-voluntary turnover associated with the reduction in the workforce by 20% relative to the prior period. Similarly, **OSH** reported staff turnover of 26.5%, of which 20% was involuntary, reflecting restructuring and the 22% reduction in headcount.

So how material are these costs? And how much would a company save if it were to reduce its staff turnover to the industry average?

The answer is that for **ANZ, IAG, SUN** and **WES,** the higher staff turnover has an implied productivity cost of about 1% of revenue.

BXB has stopped disclosing staff turnover data but did say that employee turnover increased relative to the 19% in the prior reporting period due to circumstances in the recycled pallets provision. There is high turnover in the pallets recycling division due to the physical nature of the work. The staff turnover implies a cost disadvantage relative to industry peers, equating to 2% of revenue. **BXB** has had specific issues relating to staff turnover that are being addressed by management. We estimate that expenses could be reduced by as much as 10% from reduced staff turnover.

For the major banks, there is clear differentiation between **ANZ** and the rest of the sector.

Voluntary staff turnover at **ANZ** deteriorated to 14.1% from 13.1% in the previous survey. This higher level of staff turnover compared to the other majors has an implied cost disadvantage compared to the rest of the sector, equating to 2.3% of higher wage expense. The implied productivity cost of higher staff turnover equates to about 1.2% of revenue per annum.

Although this can be partially explained by **ANZ**'s higher exposure to Asia, where staff turnover tends to be higher, it is also the case that the domestic franchise experiences higher staff turnover compared to the other major banks.

Notably, **NAB** and **CBA** have closed the competitive gap on industry leader **WBC** due to a notable improvement in staff turnover at the bank.

NAB management had identified staff turnover as a 'material' issue for 2014, acknowledging the link between staff and productivity, customer loyalty and profitability. Voluntary turnover improved to 10% over the year, as management focussed on retention of talent, employee engagement and organisational stability.

At **BOQ**, the implied productivity cost of higher staff turnover equates to about 6% of revenue per annum. The regional bank has a cost disadvantage relative to peers due to the high staff turnover in the business. We estimate that expenses could be reduced by as much as 10% from reduced staff turnover.

The improvement in total staff turnover at **WOW** to industry norms (to 22% from 25%) has closed the competitive disadvantage that it had relative to peers. As discussed in last year's report, we estimate that there was a 1% cost disadvantage relative to peers.

Companies that manage their staff turnover can create a competitive advantage relative to peers due to their lower cost base. This is the case for: **AIO, AZJ, COH** and **TLS.** The implied productivity gains from lower staff turnover for these companies equates to a cost benefit of 2-4%, as shown in the charts overleaf.

Fig 19 The implied cost of staff turnover (sorted by cost $m)

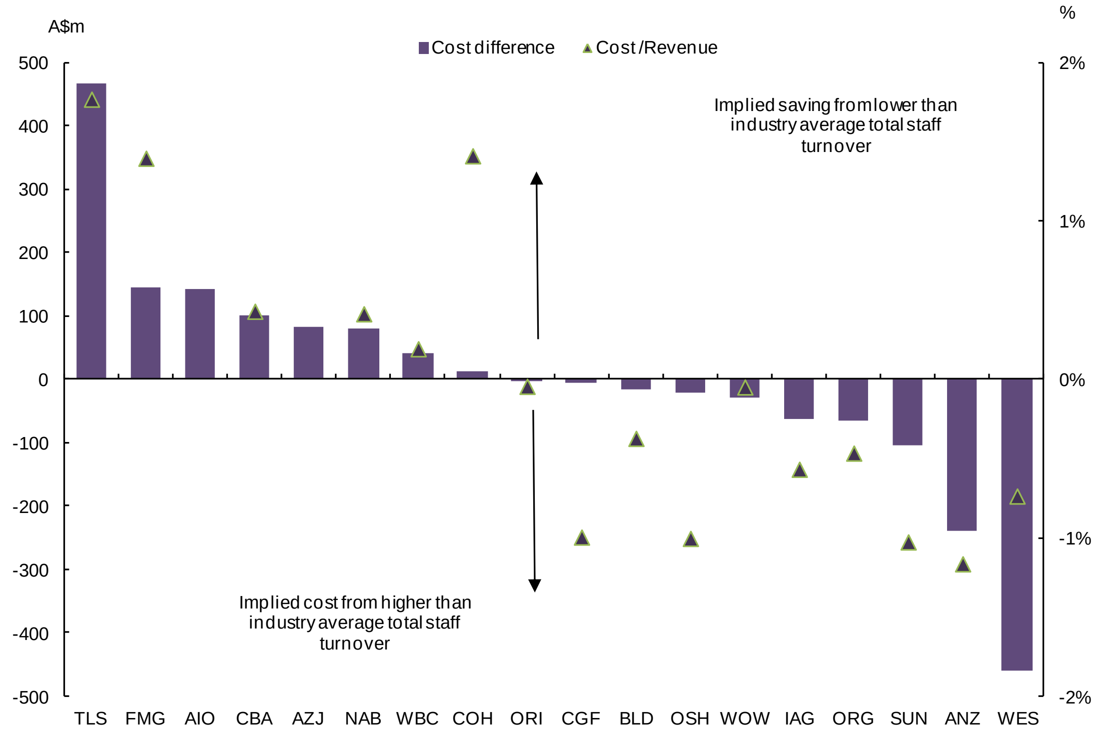
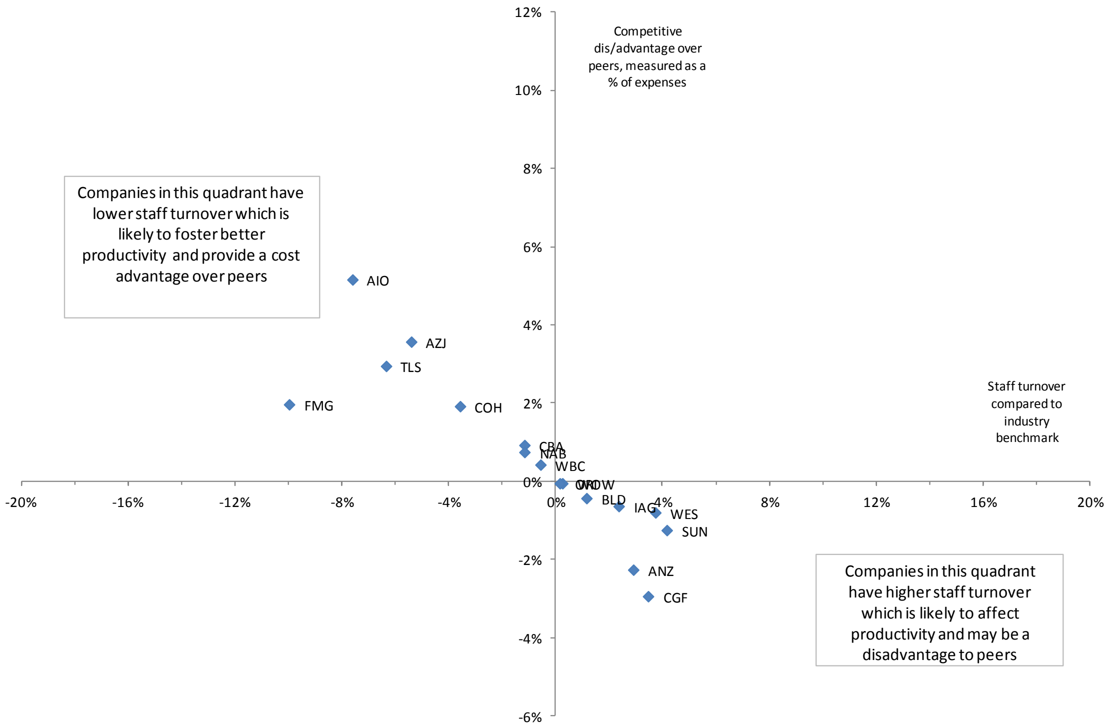


Fig 20 Staff turnover can impact competitive advantage



Source: Company reports, Macquarie Research estimates, June 2016

Absenteeism

Sick of it

Related to turnover is staff absenteeism, defined as employees that are absent from work either on sick leave or on an unapproved basis. Academic evidence suggests a strong link between engagement and absenteeism. Absenteeism is estimated to account for 3-5% of scheduled work time.[10]

Certainly there is some degree of absenteeism that is inevitable, as staff become ill or need to care for dependent children or elderly relatives. However, it is also the case that up to 20% of Australian workers report taking sick leave when it was unnecessary.

Moreover, a leading cause of sick leave is reported to be work stress. Hence the combination of staff engagement, flexible working arrangements, strong occupational health and safety practices and health and wellbeing assistance should be able to minimise absenteeism.

This level of absenteeism has a very real cost. With absenteeism in Australia averaging 8.6 days per employee[11], we estimate the cost of absenteeism in Australia in lost wages is $23b per annum.

Moreover, these estimates exclude productivity losses, overtime for other staff to cover absent employees, and underutilised overheads. The indirect costs include service disruption, poor morale, negative public perception and increased stress load for the team.

Absenteeism is regarded as a lagging health and well-being indicator for the workforce. Low absenteeism is typically associated with positive trends in staff morale, engagement and productivity.

Only 21 Australian companies within our sample set publicly report absenteeism metrics, namely, **AIO, ANZ, BHP, CBA, CGF, CMW, DXS, GMG, GPT, IAG, MGR, MMS, NAB, RHC, RIO, SGP, SYD, TLS, TCL, WBC** and **WDC. CMW, DXS, GMG** and **SCG** are new inclusions in this review, having not disclosed this information previously. With the exception of **CMW** and **MMS,** there are no other ex-100 companies to report absenteeism data.

Despite the inherent usefulness of absenteeism as a key performance indicator for human resources and the wide collection of absence data for this purpose, only 20% of ASX100 report absenteeism data to investors. This is up from 13% in the prior survey, possibly reflecting enhanced responsibilities on social reporting per the revised ASX Corporate Governance guidelines last year.

That said, many more companies likely collect and monitor data. For example, **AMC** collects absenteeism data but does not report on it on a consolidated basis.

Coverage on absenteeism data remains heavily underweight relative to other ESG metrics, with only 21 companies reporting on absenteeism. However unlike prior periods, no companies stopped releasing absenteeism data in this annual survey.

Disclosure at a sector level varies considerably.

The banks (excluding the regional banks) and property stocks adopt best practice reporting on human capital metrics. All 4 of the major banks and ~70% of the ASX100 property companies provide absenteeism data. Sectors with no or low absenteeism data disclosed include retailers and oil/gas companies.

Finally, it is important to note that there is a lack of consistency with reporting on absenteeism data, which makes comparisons difficult. For example, ANZ excludes carers leave to calculate absenteeism whereas WBC adopts an all encompassing definition of “incapacity of any kind”. The lack of standardised reporting remains a problematic issue for investors interpreting the data.

Notwithstanding the small size of the dataset, we make the following observations.

[10] 2014 Absence Management Survey, Direct Health Solutions
[11] 2015 Absence Management Survey, Direct Health Solutions

Staff absenteeism scorecard

Absenteeism is a relevant and monitored indicator for employee health. Based on our analysis, we estimate that absenteeism, on average, represents ~2-3% in lost wages.

In the private sector, industries that tend to have higher levels of absenteeism are telecommunications, call centres, transport and healthcare. Comparative assessments based on the industry in which the company operates in are taken into consideration in this analysis, particularly for **TLS** and **RHC**.

There is a lack of consistency with reporting on absenteeism. This is taken into consideration when making our assessment. Examples of these inconsistencies in reporting are:

- **ANZ** excludes carers leave to calculate absenteeism whereas **WBC** adopts an all encompassing definition of "incapacity of any kind".
- **MGR** reports absenteeism to include sick leave only, whereas **SGP** has a broader definition inclusive of personal or carers leave.

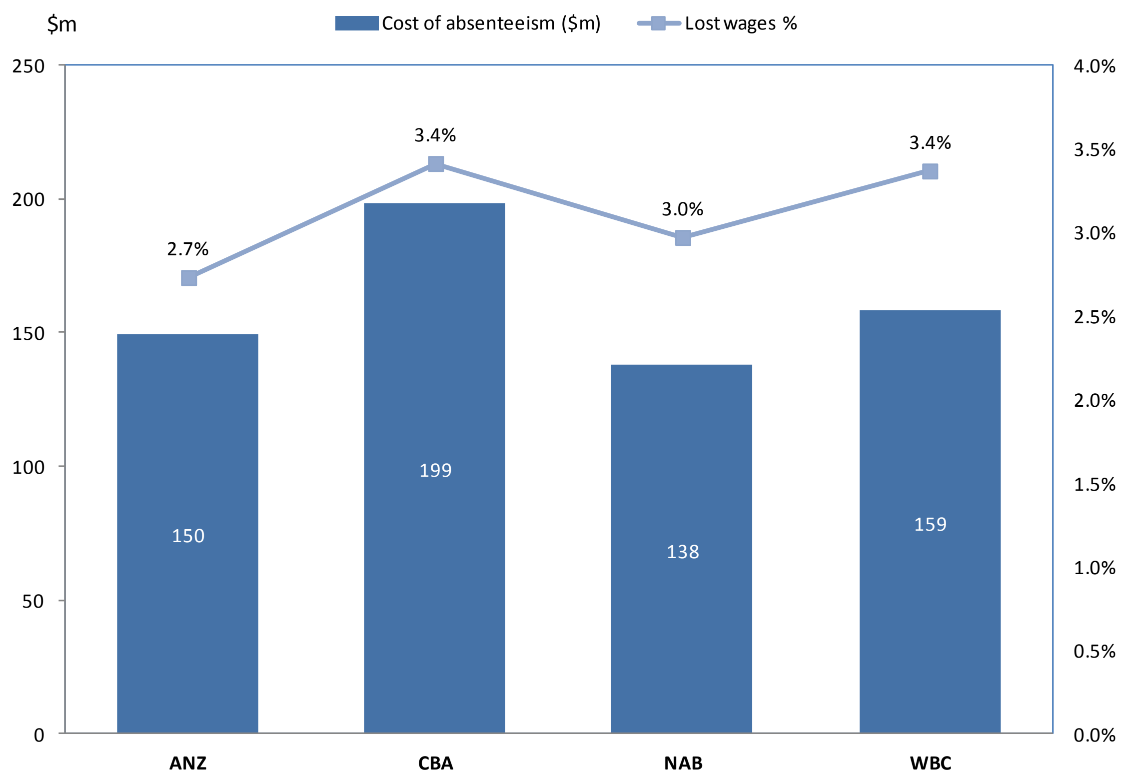
The lack of standardised reporting on social statistics, such as absenteeism, remains a problematic issue for investors.

Notwithstanding the above, we make the following observations:

Financial sector – wages a bank lever

All of the major banks disclose data on absenteeism. we estimate that absenteeism costs the major banks on average ~3% per annum in wages expense, as shown in the chart below.

Fig 21 Absenteeism costs the major banks up to 3.4% per annum in lost wages



Source: Company data, Macquarie estimates, April 2015

Absenteeism is regarded as a lagging health and well-being indicator for the workforce. Low absenteeism is typically associated with positive trends in staff morale, engagement and productivity.

The first thing to highlight when comparing the absenteeism data on the major banks is the lack of consistency with reporting. **ANZ** excludes carers leave from its calculations, whereas **WBC** includes "incapacity of any kind". Although sick leave is estimated to represent ~70% of absenteeism, carers leave and unexcused leave are also considered to be 'absent' days.

For **ANZ**, the improvement in the absenteeism rate to 4.8 days per year from 5.2 is said to reflect improved trends in employee morale and productivity, both factors which contribute to low absenteeism rates.

The differential between absenteeism rates for **ANZ** and **WBC** indicates an implied cost disadvantage of 0.7% on wage expenses for **WBC**.

Elsewhere in the financial sector, absenteeism at IAG equates to 4.4% of wage expense, compared to the average in the sample of 2.6%.

At **IAG,** absenteeism was similar at 11 days per employee, which exceeds the standard 10 sick days per year and the national average. This result comes as a surprise given the strong emphasis IAG places on ESG principles more broadly. Yet it is important to look at the result in the context of the composition of the workforce, given the large number of call centre staff, which typically are subject to both high staff turnover and absenteeism rates.

None of the fund managers in our survey provide absenteeism data. Although the staff expense to income ratio is typically more than 40% in this sector, human capital reporting is light relative to the other listed financial companies that we survey. Staff expenses are also a high proportion of the cost to income ratio for the healthcare sector, but absenteeism is not reported with the exception of **RHC**.

Property sector – absenteeism managed well

Absenteeism is reported by ~70% of the ASX100 property groups, with **MGR** and **CMW** the sector leaders in this assessment.

Asciano – impacted by change

AIO has been included in our FY15 “Room to improve” list. There was a notable deterioration in the absenteeism rate at **AIO** in FY15 to 9.5 from 6 in the prior year. This represents a doubling of the absenteeism rate over the past 3 years.

While there has been a change to the reporting statistics in FY15 to include Mountain Industries, much of the increase in absenteeism reflected the amount of change going on across the business. Examples of change include the redevelopment of Port Botany which saw high rates of absenteeism in 1Q just before the workforce was halved and changes in the rail business.

The initiative at Port Botany is expected to produce an annualised benefit of $60m. The aforementioned spike in absenteeism is likely to be a frictional cost for implementing a transition to step change the cost base. We would expect this to be temporary and if there is a reversion next year, then AIO will be taken out of this list.

Fig 22 Absenteeism scorecard

	FY10	FY11	FY12	FY13	FY14	FY15
Leaders (+1)	CBA SGP TEL	CBA SGP STO	CBA RHC	ANZ CBA CGF GPT MGR TCL WDC	ANZ CGF MGR TCL WBC	**ANZ** **CMW** **CGF** **MGR** **WDC**
Improvers			NAB	WBC	CBA	**MGR** **TLS**
Room to improve (-1)	IAG QAN	IAG NAB QAN WBC	IAG QAN WBC	IAG QAN	IAG MMS NAB TLS	**AIO** **IAG** **MMS**
Regressors		IAG NAB		TEL	AIO	**AIO**

A leader will typically be characterised as having low absenteeism rate outright, or relative to sector benchmark

Source: Macquarie Research, April 2016

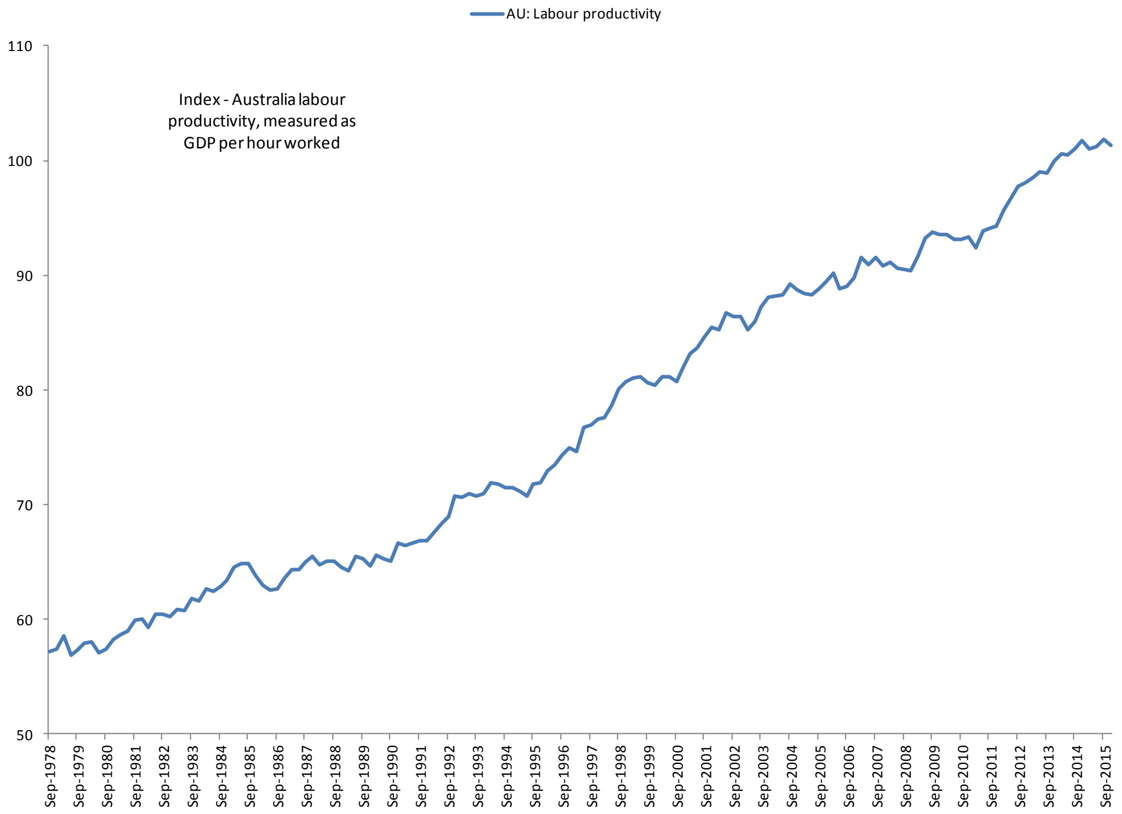
Remuneration and productivity

Working existing staff harder

Having looked at some of the results of employee engagement, it is also worthwhile discussing the potential causes. One other dimension to employee engagement is remuneration and associated to this is productivity growth.

As shown in the table below, productivity has steadily improved over the past two decades. However, productivity growth did stall in 2015.

Fig 23 Employment conditions are deteriorating as firms are working their staff harder



Source: ABS, Macquarie Research, April 2016

In recent years, employment growth in Australia had stagnated and labour productivity increased, indicating that firms were working their existing staff harder. This stalled in 2015 and despite the challenging economic environment, remuneration still matters for employee engagement.

Put simply, *falling average wages and declining labour productivity are likely to result in poor employee engagement, while rising average wages and improving labour productivity are likely to result in strong employee engagement*.

The *debate over remuneration and productivity levels is likely to remain topical over 2016* as companies focus on cost control and the political discourse remains on productivity growth and industrial relations.

Size matters

With the exception of **CBA**, the major banks (**ANZ, NAB** and **WBC**) had modest reductions in their workforce sizes in 2015.

In the resources sector, employee numbers have shrunk in response to the deterioration in market conditions. Employee numbers have dropped by 8% at **RIO** and 11% at **FMG**. After adjusting for the demerger of S32, **BHP**'s workforce reduced by 4%. This was the second consecutive year with declines in employee numbers.

Other companies that reduced their workforce size in response to the deterioration in market conditions include: **OSH** down by 14%, **STO** down by 19% and **WPL** down by 9%.

Given the prospects of further job cuts in response to the deterioration in market conditions, it will be important to see how redundancies and downsizing will impact productivity without sacrificing employee engagement, which is an important barometer of organisational health. Studies show that employee engagement should still be a focus, as it is both achievable, and can be supportive of productivity initiatives.

Other companies that have resized due to reshaping of the businesses in response to change in market conditions are: **AIO** (down 7%), **SGM** (down 10%) and **GWA** (down 30%).

For the contractors, the reduction in staff reflects the change in market conditions. Staff numbers were reduced by 15% at **MND** and 12% at **WOR**. Despite lower profitability, productivity per employee has remained somewhat resilient, as the decline in revenue has been accompanied by appropriate staff reductions.

The size of **ORG**'s workforce was up by 3% but organisational change coupled with asset sales is likely to trigger material changes in next year's survey.

There are several companies that have undergone significant organisational change, which has triggered a material change in workforce size. This includes:

- **AGL** where the workforce has increased by 32% following the acquisition of MacGen;
- **RHC** where the number of employees doubled to 60,000 following the acquisition of Generale de Sante in France,
- **UGL** – employee numbers dropped to 8,000 from 52,000 due to the sale of DTZ business in November 2014.
- **ORI**, where total employee numbers reduced by over 1,000 due to the sale of the Chemicals business and by over 800 due to transformational restructuring activities.

Reflecting the uneven growth pattern in the economy, the healthcare companies are seeing the opposite in business conditions, with growth in their workforces. Examples include **CSL** (up 8%), **RMD** (up 6%) and **PRY** (up 10%) that have increased their workforce size in the past 12 months. Other healthcare companies have increased workforce size due to acquisitions.

Selected financial institutions are also expanding their workforces such as: **MFG** (up 25%), **BTT** (up 18%), **CGF** (=28%) and **HGG** (up 4%).

It is important to contrast these two sectors as in an economic downturn, employees are even more concerned about engagement.

Productivity – an important lever

Comparisons of pay levels between individual companies are difficult. Accounting treatment of the employee wages and benefits in the annual reports varies; companies have differing regional profiles for the location of staff; and, mergers and acquisitions activity can significantly alter the wage profile of a company.

Nonetheless, there are some notable observations from comparing average remuneration and labour productivity levels (defined as total revenue per employee and the revenue to wage cost ratio) both across time and between companies.

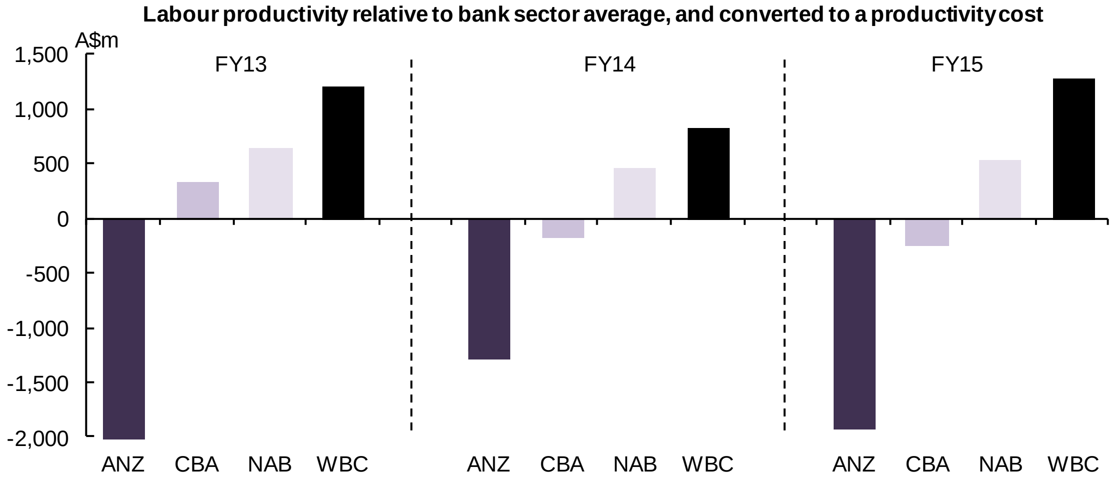
In the banking sector, productivity improved with all the banks experiencing revenue growth and all but CBA reducing their workforce size, albeit modestly.

It is worth noting the discrepancy in productivity at the major banks. At 3.7x, labour productivity at **ANZ** remains noticeably below the other major banks, with **CBA** at 4.1x, **NAB** at 4.2x and **WBC** at 4.4x revenue to wage cost ratio. Previously, ANZ has had push back in negotiations with the Financial Services Union on linking performance outcomes and pay outcomes.

- If **ANZ** were to raise its labour productivity to be in line with the average of the four major banks, this would equate to an additional $1.9bn (9%) in revenue per annum.
- **NAB** has maintained productivity at 4.2x revenue to wage cost. We estimate that the improved productivity recently equates to a 2.8% benefit in revenue terms each year.

- At 4.4x, **WBC** generates the most revenue per wage expensed. It has historically been the sector leader in labour productivity and generated an additional $1.2m (6%) in revenue per annum from better labour productivity.
- **CBA**'s productivity is sitting at the sector average and was the only bank to see an increase in its workforce size in 2014.

Fig 24 Higher labour productivity directly converts to more dollars



Source: Company data, Macquarie Research, June 2016

Among the smaller banks, BOQ's labour productivity is distorted by the exclusion of franchisee branch staff from FTEs while BEN's productivity lags at 3.3x.

An environment of *rising average wages and improving labour productivity is an indicator of strong employee engagement*.

In some cases, declining labour productivity is because the pace of wages growth has exceeded the pace of revenue growth, while in other instances wages have flat-lined and revenue gone backwards. While both are obvious issues for investors, from an employee perspective the latter is likely to have a more negative impact on engagement.

The question then becomes, what does this say about employee engagement? Falling average wages and declining labour productivity are likely to result in poor employee engagement, while rising average wages and improving labour productivity are likely to result in strong employee engagement.

Hence, remuneration and productivity levels do equate both to higher employee engagement and money in the door for companies.

That said, it is not just remuneration to which employees respond. A related aspect is benefits and working conditions, such as overtime and average working hours, employee share schemes, flexible working hours, health and well-being programs, staff discounts and deals, further study assistance and parental and other leave entitlements. Yet corporate information on these issues is scant.

Fig 25 Remuneration and productivity scorecard

	FY10	FY11	FY12	FY13	FY14	FY15
Leaders (+1)	BEN BOQ CGF DJS OSH	ASX BEN DJS MGR	CBA CSL WBC WES	CBA CRZ CSL LLC PRY RIO WBC	ANN CSL CRZ IFL LLC NAB MFG REA WBC	**AZJ** **CWN** **DMP** **EGP** **MND** **NAB** **MFG** **QAN** **WBC**
Improvers	BEN BOQ CGF DJS OSH	ASX BEN DJS MGR	AMC SUN TLS	ANZ BEN BLD PPT	AIO CPU PPT	**PPT**
Room to improve (-1)	GFF LLC	LLC	ANZ BEN	MTS	MTS MYR	**BLD** **CAB** **KAR** **TSE**
Regressors	GFF LLC	LLC	COH MYR	ASX TLS	DOW MYR	**CTX** **FMG** **MTS**

A leader will typically have an improving revenue to wage cost ratio while maintaining or improving average employee wage. Rising average wages and improving labour productivity are likely to result in better relative employee engagement.

Source: Macquarie Research, June 2016

Workplace diversity

Acts as an indicator of broader human capital management

A diverse workplace makes economic sense.

Both Australian and global research indicates that gender diversity enhances productivity and financial returns of a company. For example, companies in the top quartile of diversity were more likely to have above average financial returns, according to a 2015 report by McKinsey & Company.

Diversity information became a pre-requisite of corporate reporting following revisions to the ASX Corporate Governance Guidelines in 2011. While the recommendations are not mandatory, listed companies need to disclose the extent to which they have followed the recommendations or explain why not.

Given the existing disclosure guidelines, our survey responses on diversity are numerous, at 166 companies. For both the ASX100 and ASX200, 95% of the companies report on gender representation in the workforce. Additionally, more than 40% of these disclose gender diversity targets.

While gender diversity certainly relates only to a subset of employees, a company's ability to attract and retain female staff does act as an indicator of human capital management and employee engagement, promotion and retention within the business.

There are a number of initiatives targeting diversity at the board level, including the Australian Institute of Company Directors (which has recommended that all boards of the ASX200 set a target of 30% to be female by the end of 2018); and the Australian Council of Superannuation Investors (which has set the same goal for 2017).

Retention of female talent to management level is a signal of engagement

We assess the performance on workplace diversity based on the representation of women in senior management, particularly relative to the overall company workforce and considering industry levels of participation and the trend.

The representation of women in senior management varies by industry.

Factors that affect gender diversity include (but are not limited to) culture and workplace flexibility. Generally, the resources companies have the lowest representation of females in the workforce, whereas retail and healthcare have relatively high levels of women in the workforce.

That said, the mining and transport sectors have a focussed commitment to attracting, developing and retaining female staff. The mining and transport sector in particular outperform other industries in terms of reducing the gender pay gap.

While the overall representation of females in both of these industries is lower overall when compared to the financials or healthcare sector, the retention and promotion of women in the workforce seems to be statistically higher, as shown in the table overleaf.

Diversity scorecard

To compile our leaders list, we are looking for companies that are committed to build a pipeline of female talent to fill senior roles in the future. In this regard, we look at the percentage of women in senior management compared to the total workforce as an indicator for strong or weak retention and promotion of female talent.

Companies that have a high female participation rate and high retention of female talent include: **GMA, JHC, MGR, MFG**, **MQA, MYR, NSR, PMV**, **SRX** and **WBC**.

Companies that have similar rates of women in senior management as there are the rest of the business, strong retention of female talent, even if overall levels of female staff are low in that industry. Some notable companies in this regard are: **ABC, AIO, AMC, ARB, ASB, AZJ, BXB, NCM** and **MND and SYD, S32 and TSE**.

Among the major banks, **WBC** has the strongest female retention, with 46% representation of women in senior management, up from 44% pcp. This reflects its commitment to playing a leading role in gender diversity and strong leadership accountability on this issue. This compares to 35% for **CBA** and 32% for both **ANZ** and **NAB**.

WBC has an aspiration target of 50% of leadership roles to be held by women by 2017. For senior management representation, **CBA** will re-set gender targets this year whereas NAB is aiming to achieve 35% by 2017. **ANZ** has a “medium-term’ target of 40% and a long-term target of 50%.

Perhaps the most prominent workplace survey in Australia is the Equal Opportunity for Women in the Workplace Agency (EOWA) Employer of Choice award.

The guidelines for receiving the award have a qualitative focus, requiring companies to offer paid maternity leave, undertake annual gender equity pay analysis, provide regular appropriate workplace behaviour training and have policies and a culture that support workplace flexibility. This differs to our quantitative methodology, but there is an overlap with four of our Leaders being recipients of the EOWA Award in 2015, namely: **CRZ, TLS** and **WBC**.

However, a number of companies also perform poorly on diversity.

At **JBH** and **DMP,** only 8% of senior managers are females compared to 39% and 26% of the workforce respectively. This converts to an implied rate for retention and promotion of female talent of 20-30%. By comparison and notwithstanding the different retail models, at **HVN, MYR** and **AHG** the implied promotion and retention rate is 70-80%, which suggests stronger promotion of retention of females in the workforce.

Similarly, at **SCP** and **VRT,** only 9% and 18% of senior management are women, compared to 62% and 87% of the total workforce, respectively. This converts to an implied rate for retention and promotion of female talent of 15% and 20% respectively.

At **AWC, HZN, RRL, SFR** and **TNE**, there are no women represented at the key management level even though they represent a reasonable proportion of the workforce, ranging from 19% for **RRL** to 36% for **TNE**.

Moreover, a high level of attrition in female talent is seen at a number of companies, where the proportion of women in senior management is less than 30% of the level at the company as a whole. This includes: **GTY, GUD, NST, RHC** and **WSA**.

The composition of the workforce has changed following business change at **AGL** following the inclusion of newly acquired employees from AGL Macquarie.

Fig 26 Diversity scorecard

	FY10	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**
Leaders (+1)	AMC ANZ BXB CBA CPU CSL CSR MCC OST RHC RIO SEK SGP TLS WBC WOW	AGK AGO CPU DJS IPL LEI LLC LYC ORI OST PRY QAN SHL TLS WBC	AIO AMC BPT BXB DJS FLT GNC ORI LYC MYR PRU TLS WBC	AGK AHE ALS AMC AZJ BPT CWN DJS FXL GPT HGG KMD MGR MFG MTU MYR REA RIO SRX TCL TEN TLS WBC WTF	AAD AGK AHE AMC AZJ BXB CGF JHC MFG MGR MTS MYR OFX PPT PMV TLS WBC REA	**AGK** **AMC** **AZJ** **CRZ** **JHC** **MFG** **MTS** **MYR** **NCM** **PRG** **REA** **S32** **TLS** **WBS**
Improvers	CPU CTX FGL RMD SGP TLS	ANZ LEI LLC ORI PRY QAN UGL WBC WES	UGL TOL	BOQ CDD LYC MFG SEK TCL	SUN	**AIO** **CTX** **MGR** **OSH** **RIO**
Room to improve (-1)	ANN BLY CWN JHX LEI LLC MTS NCM ORI OZL SGM TOL UGL WPL	FXJ JBH RHC SGM TOL	BOQ DOW JBH ORG RHC RRL WHC	AQA ASL DLX FMG GMG HZN JBH KAR NUF ORG RRL SFR TRS	BCI BRG CDD CHC FMG GXL ORG HZN JBH KAR PBG PRY SFR VRT STO TOL TWE WSA WPL	**AWC** **GTY** **HZN** **JBH** **NST** **RRL** **SCP** **VRT** **WSA**
Regressors	CWN DJS IPL OZL PPT PRY QAN UGL	PRY	IPL	AGO CRZ RMD	BXB SEK	**RHC** **GUD**

A leader is typically characterised by a high proportion of women in senior management, particularly relative to the overall company workforce and considering industry average levels of participation. In this analysis, we also observe improving trend and/or EOWA Employer of Choice

Source: Macquarie Research, June 2016

Industrial disputes

Fewer large-scale industrial disputes

In 2015, the industrial landscape in Australia was characterised by more smaller scale disputes rather than the large scale disputes that were a feature in prior years (2008: TLS; 2011: BHP, QAN, TOL; 2013: TOL)

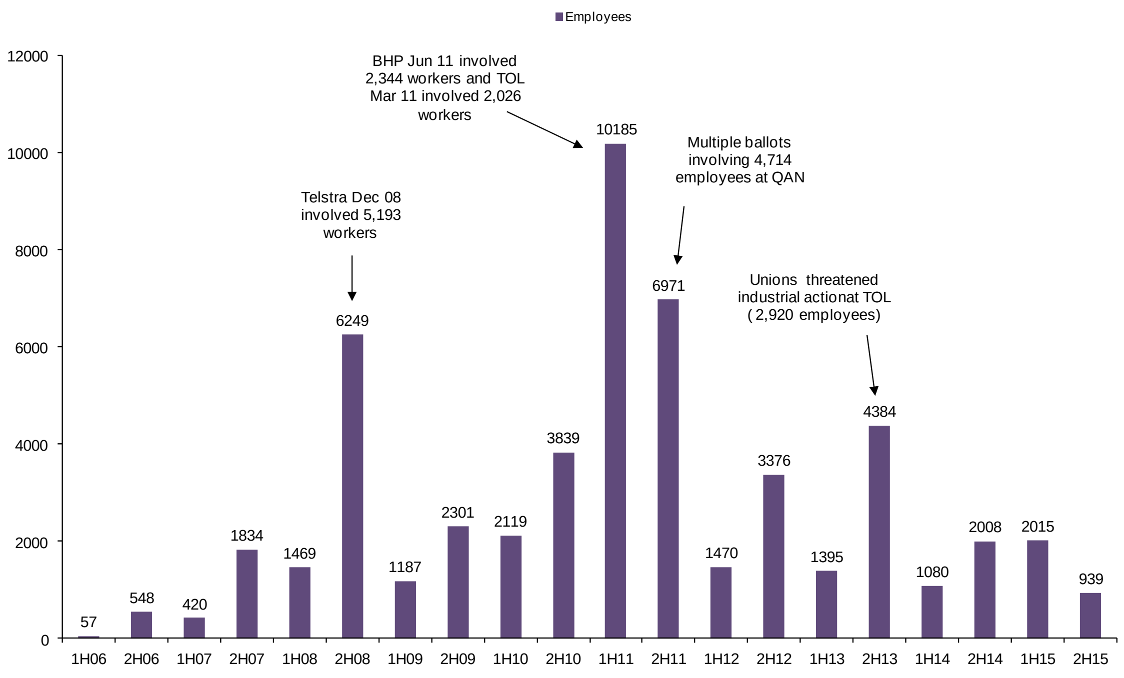
The number of Australian employees involved in new industrial disputes was the lowest level in 8 years for 2015, although the number of protected action ballots filed with Fair Work of Australia (FWA) increased to 76 from 67.

A protected action ballot to authorise industrial action must be undertaken before industrial action can be lawfully taken. This is then filed with the FWA.

While not implying that industrial action will definitely occur following the result of each of these ballots, they are nonetheless a necessary precondition for workers to undertake protected industrial action. Moreover, they demonstrate a break-down in negotiations, as determined by FWA, and a certain lack of goodwill.

As shown in Figure 27, there has been a material reduction in the number of large-scale industrial disputes that were a feature in prior years.

Fig 27 Fewer large-scale industrial disputes in recent years, at an 8 year low



2011 had several disputes involving >1,000 employees (BHP, AZJ, TOL) and multiple strike actions at QAN. The BHP Queensland coalmine dispute came to a head in October 2012 after almost two years of negotiations but the industrial action resulted in $2-5b in forgone coal production revenue, impacting approximately 2-4% of total revenue. This had a knock-on effect to AZJ revenues by reducing the quantity of coal to be transported. Disputes at QAN led to the grounding of the fleet, costing the airline $194m (and a further $85m per month had it continued). In 2013, the largest industrial dispute was filed by the Transport Worker's Union (TWU) against TOL. However, industrial action was averted as both parties agreed to revised terms of an enterprise agreement which covers 40% of their domestic workforce.

Source: Fair Work Australia, April 2015

Quite often, the cost of industrial action is difficult to quantify and is specific to each individual company. In addition to lost labour, there are forgone revenue or production opportunities and other indirect impacts from strike activity, such as brand damage. Or industrial disputes can also hinder their ability to meet contractual and customer expectations, which can lead to customer penalties.

Related to industrial action are other questions over workplace rights, such as freedom of association, and prevention of discrimination, harassment or unfair dismissal.

While there have been several high (and low) profile cases involving listed companies over recent years, it is difficult to establish whether there is pattern of incidents that reflects on systemic issues and the workplace culture at different organisations.

Indeed, a common feature of quality sustainability reporting is a thorough outline of policies, procedures and training as it relates to workplace rights issues. This includes: anonymous whistle-blowing services, independent employee assistance programs, complaints resolution processes, details of the workplace Code of Conduct and regular appropriate workplace behaviour training.

Below are examples of the financial impacts of recent industrial disputes for listed companies.

Fig 28 History of costs associated with industrial disputes

Code	History of costs associated with industrial disputes
QAN	Industrial disputes in FY12 cost $194m (and would have been a further $85m per month if continued)
AIO	Impact to EBIT of $6.2m (~1%) and $24m in FY12 (~4%)
BHP	FY11: ongoing industrial action at BMA coal mines resulted in $2-5b in forgone coal production
AZJ	BMA coal mine dispute had knock-on effect to by reducing quantity coal to be transported by 5-8t
AZJ	FY14 industrial relations strike estimated financial impact up to $2m EBIT
AIO	FY13: $6.2m (~1%) to EBIT, FY12: $24m (~4%) to EBIT
CSR	12 day stoppage at Dandenong estimated to cost less than 1% of EBIT
SIP	~1-2% of EBIT in FY12 but industrial action averted in FY13
BSL	FY13 dispute limited to days lost, 'dumping of steel' (more costly) avoided due to injunction

Source: Company reports, Macquarie Research estimates, April 2016

Industrial relations scorecard

Companies in the “Room to improve” category have greater than 3% of the total workforce involved in industrial action ballots lodged in Australia over the past two years.

Only one company in our sample group is included in this year’s: **AZJ**.

Fig 29 Industrial relations scorecard

	FY10	FY11	FY12	FY13	FY14	FY15
Leaders (+1)						
Improvers	QAN TLS		TLS			**BSL**
Room to improve (-1)	AIO AMC AZJ BLD CSL CSR CWN FGL FXJ MTS STO	AGK AIO AMC AZJ BHP CSR CWN FXJ MTS QAN STO TOL	AGK AIO APA AZJ BHP BSL FXJ OST QAN SIP TOL TWE	AGK AIO ARI AZJ BKN BSL CSR SIP TOL TSE	AIO ARI AZJ BKN CSR SIP TOL	**AZJ**
Regressors	AIO CSR FXJ MTS STO	AIO AZJ BHP FXJ QAN	BSL	QAN		

The “Room to improve” category is those companies that have greater than 3% of the total workforce involved in industrial action ballots lodged in Australia over the past two years

Source: Company data, Macquarie Research, April 2016

As foreshadowed, industrial action remained topical for **AZJ** in 2015 as expired agreements covering some 6,000 employees remained outstanding. A landmark decision was made by the Fair Work Commission in April 2015 to terminate a dozen enterprise bargaining agreements that had expired. An appeal from the unions was dismissed in the Federal Court in September 2015.

This outcome has accelerated the shift of all AZJ employees to contemporary employment conditions which are designed to provide productivity enhancements and cost reductions across the business. In fact, the redesign of the enterprise agreements are key enablers of the predicted productivity benefits for shareholders in the coming years.

AZJ has a history of disputes with unions and the associated industrial activity cost has impacted the bottom line (refer to Figure 28) but implementation of new agreements is likely to lead to productivity benefits for shareholders.

For **QAN,** industrial relations will remain topical. At **QAN**, there have been no work days lost to industrial action since 2011 despite implementing a major business transformation including implementation of 18-month wage freezes. However, the transport sector has a highly unionised workforce compared to others and both companies have a history of costly disputes such as **QAN** grounding its fleet in FY12, costing shareholders $194m.

ANZ resolved a dispute with the Financial Sector Union in 2015 and avoided industrial action. This follows a break-down in negotiations in 2014 when 65% of the 14,155 staff that voted against the revised enterprise bargaining agreement and rejected the deal.

The financial sector has not seen large scale industrial action in over a decade. However, the Financial Sector Union (FSU) rallied support to reject the proposed ANZ enterprise bargaining agreement.

Staff expenses are the biggest single cost of bank operating expenses, comprising almost 60% of ANZ total operating expenses.

BSL is included in our ‘Improvers’ list this year. This case study provides an illustrative example of positive engagement and a constructive outcome for both unions and shareholders.

In June 2015, the media speculated on the closure of Port Kembla. BSL responded, saying that a decision had not been made but acknowledged that the costs of manufacturing steel were too high and an alternative lower cost approach was being discussed with unions, as part of the Enterprise Agreement negotiations at Port Kembla.

The outcome of the negotiations was disclosed in October 2015. The revised enterprise agreement included a 3 year wage freeze and workplace restructure, which are expected to contribute to $60m of annualised labour cost savings. There was no industrial action during this negotiation period, a contrast to prior periods.

The companies that were removed from our “Room to improve” list in this survey include: **AIO, ARI, CSR, SIP** and **TOL** (de-listed). **TSE** and **BKN** were removed due to cessation of coverage of these stocks.

For **AIO**, approximately 75% of employees are covered by enterprise bargaining agreements and disputes with the unions have led to multiple business disruptions in recent years. The industrial disputes at **AIO** had an impact to EBIT of $6.2m in FY13 (~1% of total EBIT) and $24m in FY12 (~4% of total EBIT).

The removal of these companies does not necessarily mean that they don’t have an industrial relations issue but may reflect our methodology as we capture a two-year period but some companies may not have EBAs up for renegotiation during that time.

We also use a 3% ‘relevance’ threshold. For example, **WES** and **CSL** have had numerous protected action ballots filed within the last 12 months but the number of employees involved was less than 3%.

There are limitations to the methodology that we have adopted if the company has international employees as these disputes are not captured. Non-operated sites are also excluded, so the industrial action in the Bass Strait oil fields which led to closure for 45 days and impacted quarterly production for BHP is not included in this assessment. The operation in the Bass Strait is jointly owned by BHP and ExxonMobil but operated by Esso, which is owned by ExxonMobil.

Occupational health and safety

Attentive and engaged employees less likely to make safety lapses

The final employee metric that is publicly disclosed and provides an indicator of employee engagement is occupational health and safety.

Safety issues have come to the fore following amendments to national legislation that came into effect 1 January 2012. The legislation introduced new obligations and personal liability for directors that breach their responsibilities under new occupational, health and safety laws.

From an employee engagement perspective, attentive and engaged employees are less likely to make errors or occupational health and safety lapses.

Likewise a safe workplace is more likely to engender a positive attitude towards the employer. Indeed, there has been a quantitative and qualitative link shown between engagement and safety across the academic literature and case studies.

Furthermore, safety incidents can have an immediate financial impact triggering delays to projects or a temporary shutdown which may impede production. Safety lapses can often lead to increased scrutiny by unions or government bodies or can affect the ability for a company to win future tenders, particularly for government work.

Likewise safety is an important issue to manage in the sense that an operator needs to establish and maintain their ‘social license to operate’ in the communities that lie or are within the areas of the region in which it operates.

Incidences such as the tragic dam failure at one of **BHP**’s joint ventures in Brazil, Samarco, highlight the human, environmental, operational and financial impacts of events. Production has ceased, guidance has been revised and a settlement has been reached with the Federal Attorney General of Brazil, the States of Espirito Santo and minas Gerais and other public authorities relating to the incident. Other litigation is pending.

Another example is **FMG** – experienced a series of incidents at the Christmas Creek site in WA in 2014 which resulted in the suspension of surface mining. There were two fatal incidents and one serious injury which resulted in the Department of Mines and Petroleum issuing special directions ensuring that **FMG** tightens safety procedures.

The shutdown at the **FMG** sites would have decreased productivity by ~550kt but the impact on a go-forward basis is in terms of regulatory scrutiny, social licence to operate and ongoing compliance with WA DMP orders.

Safety in numbers

Our analysis on occupational health and safety covers 87 companies, or 63% of companies surveyed in the ASX200[12], up from 48% previously. The reporting rate is slightly higher in the ASX100, at 67% (was 50% previously). A handful of companies with December year-ends have yet to provide their updated data. We would expect around 70% of the ASX100 companies in the survey provide data on occupational health and safety.

The first point to note in comparing safety performance is that there exists a wide range of safety metrics.

<u>LTIFR is the most commonly reported safety performance indicator for ASX companies, with more than 80% of companies that report on safety statistics disclosing their LTIFR.</u> Yet it also has severe limitations, which is why companies are increasingly reporting alternative metrics such as TRIFR, which are less subject to reporting bias.

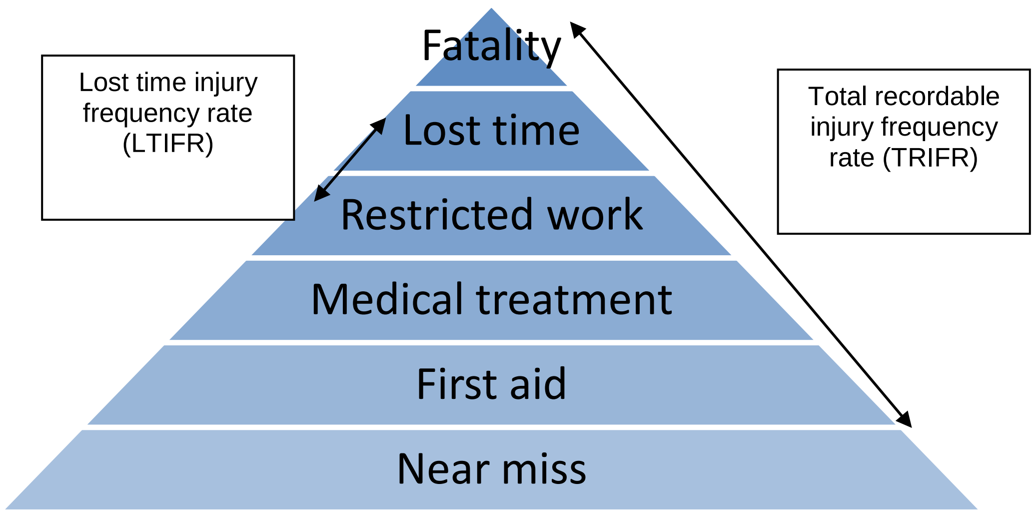
The result is a number of considerations across LTIFR, TRIFR, severity rates, fatalities, and other indicators such as workers compensation claims as well as leading indicators and the quality of the company’s commentary on safety policies and procedures. With this background, it is nonetheless possible to compare safety performance over time and between stocks in the same sector.

[12] We survey the ASX200 companies excluding REITS, infrastructure and utilities. We also exclude stocks with a predominantly non-Australian workforce which have either very different employee dynamics

As stated above, the most popular reported safety statistic is the LTIFR, with more than 80% of companies that disclose safety statistics reporting LTIFR per million employee hours. Eleven companies (including **BHP, BXB, ILU, IPL, JHX, ORI, QAN, REC, AST, S32** and **TPI**) have shifted away from reporting the traditional LTIFR, and now only disclose TRIFR. More than 40 companies report both of these safety metrics.

The shift to report TRIFR rather than LTIFR has stemmed from criticism about the different interpretations of “lost time” that has led to inconsistent reporting. That said, it is the most traditional safety indicator. The chart below clearly shows the coverage that each reported frequency rate covers.

Fig 30 Differences in coverage between two frequently used lag safety indicators



Source: Price Waterhouse Coopers report – Improving safety performance in the Australian mining industry through enhanced reporting, April 2015

Illustrating this point, **BLD** (which reports both the LTIFR and the TRIFR) states that the TRIFR, which includes both Medical Treatment Injury Frequency Rate (MTIFR) and Lost Time Injury Frequency Rate (LTIFR) for employees and contractors per million hours worked, is their preferred indicator of safety performance as separately reporting MTIFR and LTIFR is not always a clear or helpful indicator of injury severity and business impact.

The difference in coverage of the two indicators also highlights where the safety risks in the business lie. This is aptly illustrated by **WES**. WES reports a higher incidence in TRIFR of 39.5 per million employee hours compared to LTIFR of 7.3. The differential is a reflection of the type of injuries being reported. The higher TRIFR indicates there is a higher frequency of minor injuries. For example, a doctor visit may be required but the injury does not require time away from work. Refer to the arrows in the picture above for the different coverage of LTIFR and TRIFR.

The last point to note in the assessment of safety statistics is that the frequency rates are indicators of lost time or medical treatment injuries that occur for every million hours of employee work time. As such, these frequency rates are lag indicators for safety.

It is also important to consider the lead indicators and safety processes that have been adopted, such as injury prevention programmes, education on health and safety, site risk assessments, safety culture, or near miss reporting.

Sector safety

The resources sector has a tight focus on safety, and executive remuneration is often tied to at least one safety metric. The Board may exercise discretion on how this safety outcome is applied for short term incentive outcomes.

At **BHP**, the Board concluded that a zero outcome was appropriate for the health, safety, environment and community (HSEC) component of the short term incentive (STI) plan (which represents 20% of the total STI opportunity) due to the 5 fatalities that occurred in FY15. The Board also exercised discretion for the FY15 equity component of the incentive plan to lower the number of awards to be allocated due to the impact on the pricing period from the Samarco incident.

From FY16, the STI opportunity attached to health, safety, environment and community factors for **BHP** executives in the Group Management Committee has increased to 25% from 20% in FY15.

For **RIO**'s executive team, 20% of their short-term incentive plan was tied to safety in FY15, with an equal weighting to the LTIFR and AIFR[13], including a downward adjustment in the event of fatalities excluding non-managed sites. A non-managed site refers to one in which the miner has an interest but is not the primary operator of, such as Grasberg, which is 40% owned by **RIO**[14] but has Freeport as its primary operator. Two fatalities occurred at Grasberg in 2015, 6 in 2014 and 33 in 2013.

Following the 4 fatalities that occurred in FY15 on operated sites, the Board has stated that it recognises the need to increase fatality elimination efforts and has therefore flagged change from FY16. The weightings on safety measures will shift to: LTIFR (30%), AIFR (30%) and measures relating to the implementation of Critical Risk Management as a key fatality elimination programme. The safety result will continue to be adjusted for fatalities.

For **FMG**, up to 25% of the calculated short term incentive relates to safety outcomes. The weighting varies as it is dependent on the executive's role. For the CEO and Director of Operations, 25% of the FY16 STI weighting relates to safety metrics compared to the CFO level which is 15% (was 10% in FY15).

While **FMG** has considerably improved its safety record in recent years from 14.5 total recordable injury frequency rate per million hours worked in FY11 to 5.1 in FY15, **FMG** does lag **BHP** and **RIO**. However, **FMG** did not record any fatalities in FY15 after two in FY14.

Among the Australian-listed miners, **NST** appears to have the most work to do to improve safety performance, as measured by total recordable injury frequency rates. For **EPW** and **KAR**, safety is an important facet of executive remuneration.

Safety performance is also carefully managed in much of the materials sector, with exceptional safety performance at **AMC**, **ORA, ORI** and **IPL**. **CSR** and **SGM** lag the materials sector, albeit they have improved relative to the prior year.

In the construction industry, **DOW, MND, TSE** and **UGL** have made progress on their safety records in recent years and no fatalities were recorded during FY15 compared to 2 in FY14.

Safety metrics lag in the food and retail space. Safety metrics at **MTS, MYR, WES** and **WOW** are multiples of those in the materials and resources space, although the nature of the injuries differs. As discussed above, the difference in coverage of the two indicators highlights where the safety risks in the business lie. The retailers tend to have greater frequency of minor injuries which do not require time off work. Similarly, the transport sector is reporting double digit frequency rates for **BXB** and **QAN**.

In the financials sector, safety is well managed with average of 1.5 lost time injuries per million hours worked. All of the four major banks (**ANZ, CBA, NAB** and **WBC**) now have lost time injury rates of less than 2; however, *we would argue that injury statistics are a less relevant 'engagement' indicator for this sector when compared to say, a mining or construction company.* In other words, we regard safety indicators as a higher level of materiality and business risk for a mining or construction company compared to a bank and the severity of incidents is typically lower risk in a bank compared to a mining company.

[13] All Injury Frequency rate

[14] RIO has a joint venture interest attributable to the 1995 mine expansion, which entitles them to a 40% share of production above specified levels until the end of 2021 and 40% of all production after 2021. RIO has the ability to engage and influence through their representation on the Operating, Technical & Sustainable Development Committees

Fig 31 Resources reign in safety frequency (TRIFR)

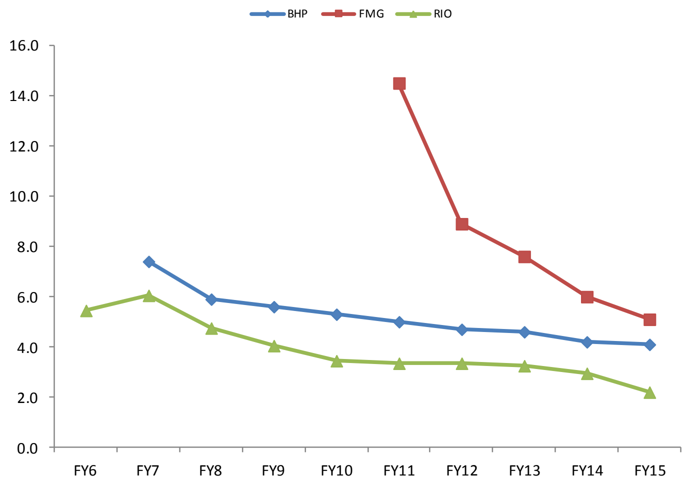


Fig 32 Retailers safety incidents weighted to TRIFR

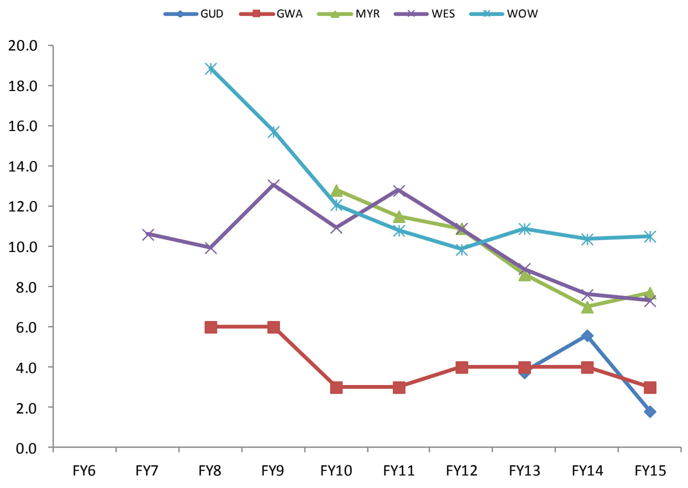


Fig 33 Contractors focused on safety (LTIFR)

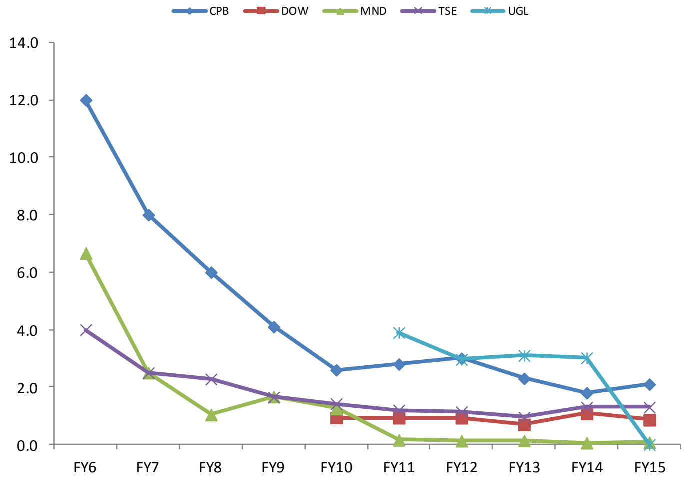


Fig 34 Financials - but less relevant indicator (LTIFR)

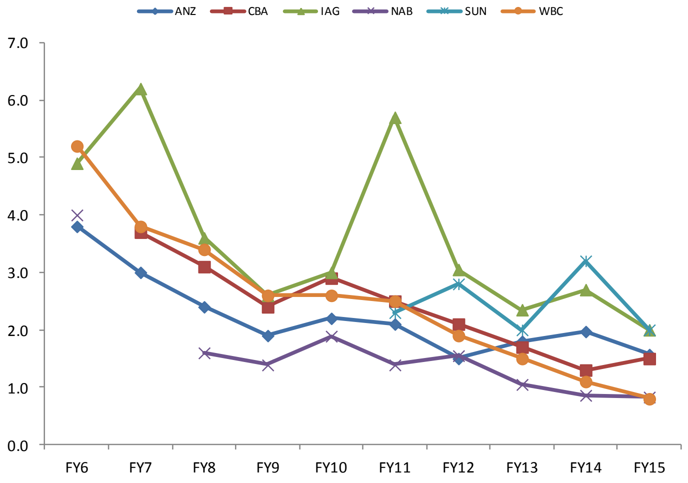
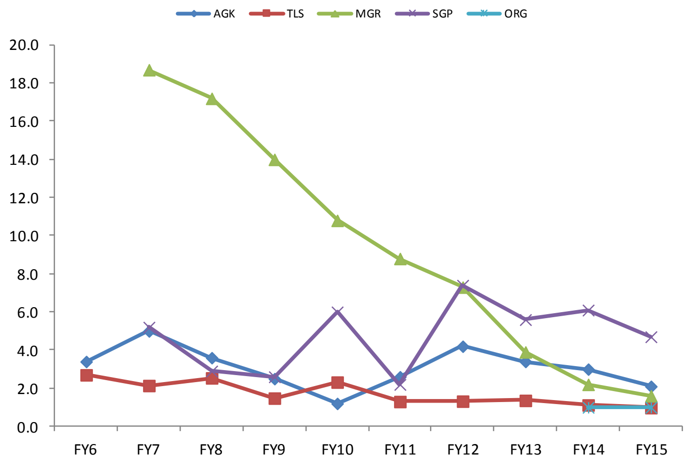


Fig 35 LTIFR most commonly reported safety statistic



Source: Company data, Macquarie Research, June 2016

Fig 36 Notes on reported safety statistics

- Almost 70% of companies in the ASX100 report a relevant safety metric (and 63% for ASX200). This is up from ~50% previously
- Reporting of safety statistics has increased over the past year after the revised guidelines on reporting non-financial metrics from the ASX Corporate Governance Council
- The most commonly reported safety statistic if LTIFR (lost time injury frequency rate); however some companies have shifted to reporting TRIFR only
- Injury frequency rates are a lagging metric for safety. Fatalities, injury prevention programmes, education on health and safety, site risk assessments, or near miss reporting are other indicators of safety culture

Source: Company data, Macquarie Research, June 2016

Safety scorecard

AMC, ANN, BSL, CSL, CTX, DOW, MND, NCM, STO, WBC, APA, AZJ, DXS and **TCL** all reported LTIFR of less than one in FY15 below 1.0 per million hours worked. **IOF, KAR, OSH and WSA** had an incident-free year of lost time injuries in their operations during the period.

It is worthwhile highlighting a string of companies that have had material improvements in their safety record over the recent years. These include **AGL, AMC, CIM, IPL, MTS, ORG** and **QUB.**

The need to consider data beyond injury frequency rates is amply demonstrated by **BHP**. **BHP** had a slight improvement on the injury frequency rate (LTIFR); however fatalities increased to five in 2015 from zero in the prior year. This figure excludes fatalities at non-operated sites.

As a result of the 5 fatalities that occurred in FY15, the Board concluded that a zero outcome was appropriate for the health, safety, environment and community (HSEC) component of the short term incentive (STI) plan (which represents 20% of the total STI opportunity). For FY16, the STI opportunity attached to HSEC for BHP executives in the Group Management Committee was increased to 25%.

The Board has not confirmed how FY16 executive remuneration will be impacted by the tragic dam failure in Brazil. However, the Board did exercise discretion for the FY15 equity component of the incentive plan to lower the number of awards to be allocated, as the pricing period coincided with the event. The share price was maintained which resulted in a lower number of awards being allocated than otherwise would have been the case.

The divergence in safety statistics also happened at **RIO**, where fatalities increased but injury frequency rates declined. The diversified miner reported the lowest injury frequency rate in their history; however, 4 fatalities occurred during the reporting period. This prompted a change in the way that safety component will be assessed for the FY16 short term incentive plan.

Note that the above fatalities exclude non-managed joint ventures. A non-managed site refers to one in which the miner has an interest but is not the primary operator of, such as Grasberg, which is 40% owned by **RIO**[15] but has Freeport as its primary operator. There was 1 fatality recorded at Escondida and 2 at Grasberg in FY15.

There were 2 fatalities reported at: **AZJ, NCM** and **S32** in FY15 Earlier this year, an NCM worker was freed from one of their mines (Gosowong) after reportedly being trapped for 8 days. When this occurred, all mining and processing operations were suspended. Gosowong accounted for 15% of the group's cash flow generating assets in FY15.

In FY15, there were 19 fatalities in our universe, similar to the previous year of 20. However there were fewer companies reporting fatalities. There were 8 companies that had fatalities compared to 15 in 2014.

Fig 37 Companies with fatalities of 2 or more in FY15

Company name	Code	Fatalities (2014)	Fatalities (2015)	Detail on FY15 fatalities
Aurizon	AZJ	np	2	2 AZJ employees and a contractor, road accident
BHP	BHP	0	5	4 were on-site, 1 occurred in off-site transportation accident
Newcrest Mining	NCM	1	2	2 reported in FY15, another 2 in FY16
Rio Tinto	RIO	2	4	4 isolated incidents at managed operations, 3 at non-managed JV
South 32	S32	np	2	2 at Worsley and Metalloys operations, another occurred in July

Source: Company reports, ASX, June 2015

The following companies reported no perils in FY15.

LLC had zero fatalities, a material reduction from the high-single-digit fatalities experienced during FY06 to FY09. **AIO, BLD, BSL, DOW, FMG, MIN, OSH, TSE** and **WOW** reported no fatalities, an improvement on the 1 or more fatalities in the preceding year.

Companies that report injury frequency rates below their peers include: **ANN** (frequency improved by 30% and injury and illness are at world class levels); **ASX** (injury frequency stated to be well below industry benchmarks) and **BSL** (which has received external recognition of accolades for safety).

[15] RIO has a joint venture interest attributable to the 1995 mine expansion, which entitles them to a 40% share of production above specified levels until the end of 2021 and 40% of all production after 2021. RIO has the ability to engage and influence through their representation on the Operating, Technical & Sustainable Development Committees

SUL reported deterioration in safety frequency as measured by the LTIFR, for FY15. However, the auto group has set a target of reducing LTIFR below 10.0 for 2016. This requires at least 25% improvement relative to FY15 in order to achieve this. The improvement in the safety plan is embedded in their executive remuneration structure for FY16.

New disclosures in the 2015 survey include the ex-100 companies, as well as **AHG, AHY, ASB, ASX, BEN, CGF, HSO, ORG, NVT, PRG.**

In addition to the above, we note that a number of ASX200 companies make reference to their occupational health and safety statistics – improvement, above peers, including in executive KPI's, or the collection of safety statistics - but do not provide any data. These include: **APN, EPW, SPO** and **VRT.**

Using safety metrics as a guide, strong or (notably improving) employee engagement is expected at the Leaders while weak employee engagement is indicated at those corporates that are in our "Room to improve" category.

Fig 38 Safety scorecard

	FY10	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**
Leaders (+1)	AGK AMC CCL CTX DJS DOW LLC NCM ORI OSH PNA RIO STO WPL	AMC ANN BHP DJS DOW FMG LLC MND NAB ORI PDN PNA QRN WOW	AMC ANN DJS FMG MND PDN PRU	AMC ARI AZJ CTX DLS DXS ILU MND NST	AMC BHP MND MMS NAB QUB	**AMC** **ANN** **BSL** **DOW** **OSH** **WPL** **WBC**
Improvers	AGK AMC BXB CPB CSR CTX DJS FMG GFF LLC MGR NCM ORG QRN (AZJ) RIO SGM TOL WES WOW	BHP BSL BXB CSL CSR DJS FMG GFF LLC MGR MTS ORI OST PDN PNA QRN (AZJ) SGM WOW	MGR	AWE CSR DOW	AIO GWA TOL	**AGL** **CSR** **DOW** **MGR** **ORG** **QUB** **STO**
Room to improve (-1)	AIO CSR GFF ILU JHX LEI OZL PDN	AIO AQP CSR GFF IAG LEI MTS TOL TWE UGL WES	CSR GNC LYC MYR QAN TOL TSE WES	AIO BKN EGP EVN LEI MTS MYR QAN SLR TOL WOW	AIO BXB CSR FMG QAN MGR MGX MTS NST SGM TOL WES	**AZJ** **BHP** **CIM** **EGP** **HSO** **NCM** **RIO** **S32** **SUL** **WES**
Regressors	ANN OZL	AGK AQP WES	QAN RHC	SGM	ARI	**AWE** **BXB** **IPL** **MMS** **WDC**

A leader will typically have low injury frequency and severity rates, including fatalities; and/or clearly documented safety policies, procedures, and leading indicators

Source: Company data, Macquarie Research, June 2016

Pulling it together – the Macquarie Dynamic Employee Engagement Index

The summary of the corporate scorecard on each of the issues is presented below.

Fig 39 Employee scoreboard

Employee engagement indicator	Key determinant	Leaders	Room to improve
Employee engagement survey	Strong benchmarked score; improving trend	AGL, ANZ, BTT, EPW, HGG, LLC, MYR, REA, RHC, SEK, SGP, SUN, TAH, TLS, WPL	WOW
Staff turnover	Low staff turnover relative to industry benchmark; improving trend	AIO, COH, GMG, HSO, NAB, TLS, WPL	ANZ, BLD, CMW, ORG, GPT, OSH, MMS, SGM, RIO, WES
Absenteeism	Low absenteeism relative to Australian benchmark; improving trend	ANZ, CMW, CGF, MGR, WDC	AIO, IAG, MMS
Remuneration and productivity	Improving revenue to wage cost ratio while maintaining or improving average employee wage	AZJ, CWN, DMP, EGP, NAB, MFG, QAN, WBC	BLD, CAB, KAR
Diversity	High proportion of women in senior management, particularly relative to the overall company workforce and considering industry average levels of participation; improving trend, or EOWA Employer of Choice	AGL, AMC, AZJ, CRZ, JHC, MFG, MTS, MYR, NCM, PRG, REA, S32, TLS, WBC	AWC, GTY, HZN, JBH, NST, RRL, SCP, VRT, WSA
Industrial disputes and workplace rights	Room to improve defined as greater than 2.5% of total workforce involved in industrial action ballots over the past 2 years		AZJ
Occupational health and safety	Low injury frequency and severity rates, including fatalities; clearly documented safety policies, procedures, and leading indicators; improving trend	AMC, ANN, BSL, DOW, OSH, WPL, WBC	AZJ, BHP, CIM, EGP, HSO, NCM, RIO, S32, SUL, WES

Source: Company data, Macquarie Research, June 2016

Employee Engagement scorecards

Fig 40 Employee Engagement Scorecard – Top 100

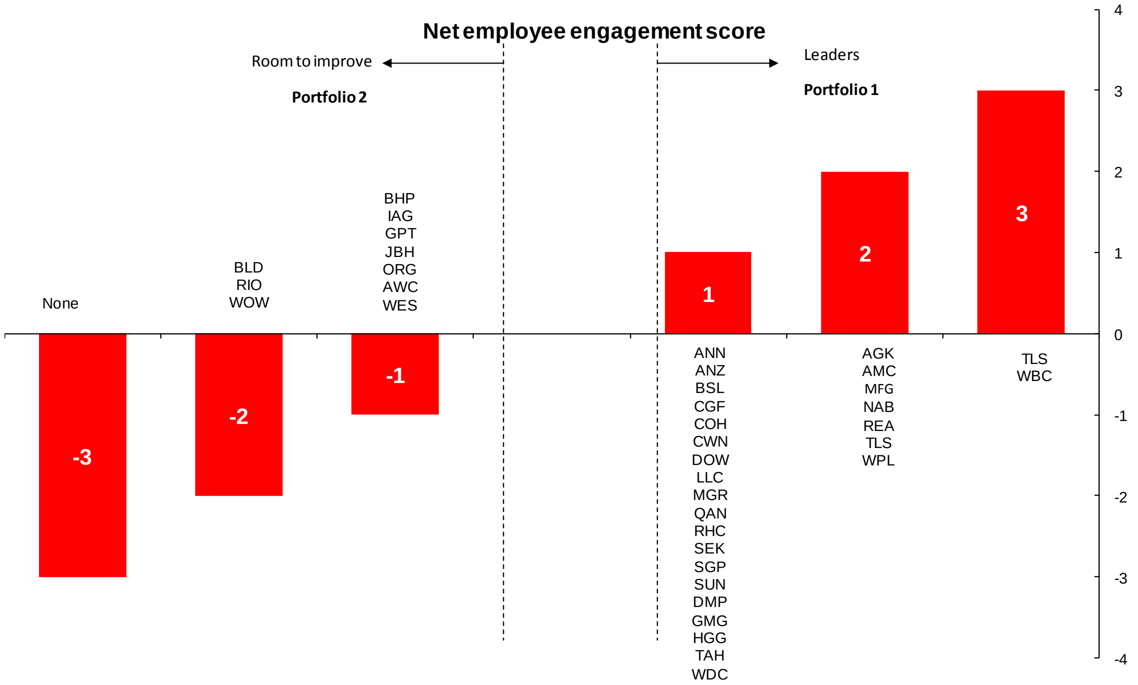
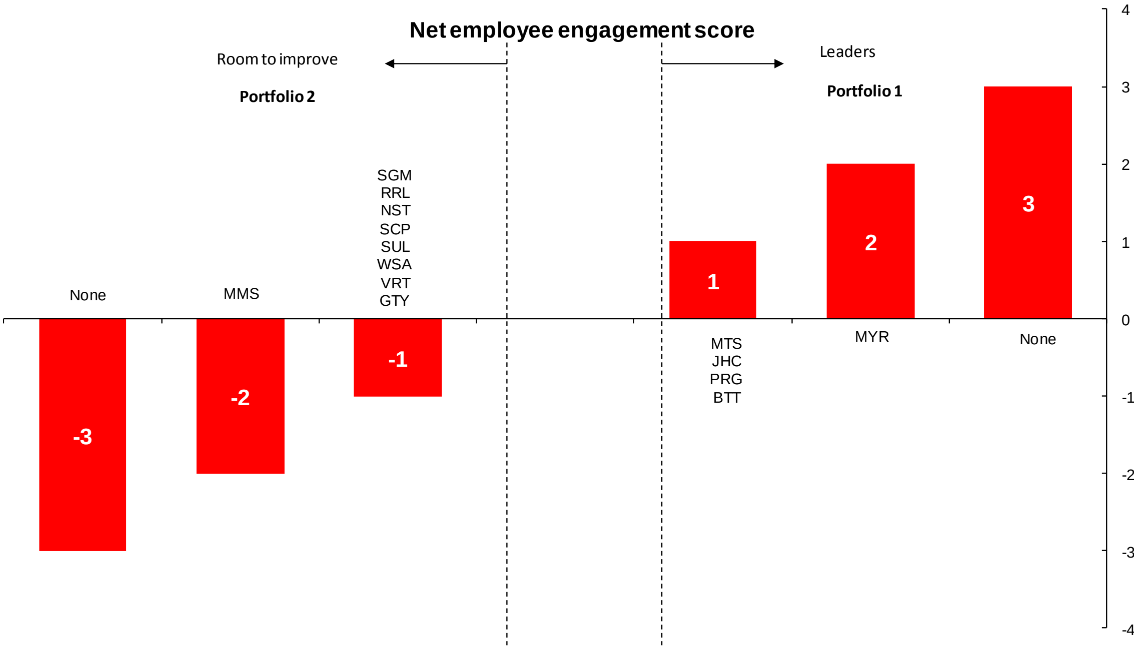


Fig 41 Employee Engagement Scorecard – ex 100



Source: Macquarie Research, June 2016

Portfolio 1 includes all companies with a net positive score based on range of employee engagement metrics – from surveys to staff turnover, absenteeism, pay and productivity, diversity, industrial disputes and safety. Portfolio 2 includes those with net negative score. Further detail on methodology is discussed later in this report.

Fig 42 Stocks mentioned in this report

Stock code	Company	Rating	Stock price (A$)	Target price (A$)
AAD	Ardent Leisure Group	Neutral	2.24	2.32
ABC	Adelaide Brighton	Neutral	5.51	5.1
AGL	AGL Energy	Restricted	18.92	Restricted
AHG	Automotive Holdings Group	Outperform	3.82	4.57
AHY	Asaleo Care	Neutral	2.07	1.95
AIO	Asciano	Restricted	8.86	Restricted
AMC	Amcor	Outperform	16.13	17.5
AMP	AMP	Neutral	5.52	5.8
ANN	Ansell	Outperform	19.10	23
ANZ	ANZ Bank	Outperform	24.96	29
APN	APN News & Media	Outperform	0.68	0.75
ARB	ARB Corporation	Neutral	16.56	15.35
ASB	Austal	Outperform	1.30	1.76
AST	AusNet Services	Outperform	1.56	1.83
ASX	ASX	Underperform	45.52	41.6
AWC	Alumina	Underperform	1.46	1.1
AWE	AWE	Outperform	0.89	1.2
AYS	amaysim Australia	Outperform	1.80	2
AZJ	Aurizon Holdings	Outperform	4.59	4.75
BCI	BC Iron	Underperform	0.13	0.07
BEN	Bendigo and Adelaide Bank	Neutral	9.39	9.5
BHP	BHP Billiton	Underperform	19.22	15.4
BLD	Boral	Neutral	6.60	5.6
BOQ	Bank of Queensland	Neutral	10.97	12
BPT	Beach Energy	Neutral	0.68	0.75
BSL	BlueScope Steel	Outperform	6.47	7.4
BTT	BT Investment Management	Outperform	9.41	10.42
BXB	Brambles	Neutral	12.77	12.7
CAR	Carsales.com	Outperform	12.70	12.05
CBA	Commonwealth Bank	Underperform	76.60	75.5
CCL	Coca-Cola Amatil	Underperform	8.75	8.91
CGF	Challenger	Outperform	9.32	10.23
CHC	Charter Hall Group	Outperform	5.22	4.99
CIM	CIMIC Group	Neutral	37.94	35.85
CMW	Cromwell Property Group	Restricted	1.04	Restricted
COH	Cochlear	Outperform	122.79	120
CPU	Computershare	Neutral	10.50	10.4
CSL	CSL	Outperform	117.26	115
CSR	CSR	Underperform	3.35	2.8
CTD	Corporate Travel Management	Neutral	14.55	13.15
CTX	Caltex Australia	Outperform	32.67	35
CVO	Cover-More Group	Outperform	1.44	2
CWN	Crown Resorts	Outperform	11.75	14.5
CYB	Clydesdale	Outperform	5.50	5.2
DLX	DuluxGroup	Neutral	6.29	6.1
DMP	Domino's Pizza Enterprises	Neutral	66.90	60.68
DOW	Downer EDI	Outperform	3.87	3.85
DUE	DUET Group	Outperform	2.35	2.44
DXS	Dexus Property Group	Outperform	8.86	8.73
EPW	ERM Power	Neutral	1.45	1.93
EVN	Evolution Mining	Neutral	2.28	2.2
FLT	Flight Centre Travel Group	Underperform	30.91	28.26
FMG	Fortescue Metals Group	Outperform	3.21	3.5
FXJ	Fairfax Media	Outperform	0.93	1.05
FXL	FlexiGroup	Neutral	1.92	2.08
GEM	G8 Education	Neutral	4.13	3.75
GMA	Genworth Mortgage Insurance Australia	Outperform	2.69	3.84
GMG	Goodman Group	Outperform	7.21	7.1
GNC	GrainCorp	Restricted	8.83	Restricted
GOZ	Growthpoint Properties	Neutral	3.28	3.51
GPT	GPT Group	Neutral	5.45	4.99
GUD	GUD Holdings	Neutral	8.81	8.1
GWA	GWA Group	Neutral	2.35	2.13
GXL	Greencross	Restricted	7.98	Restricted
HGG	Henderson Group	Outperform	5.15	5.76
HSO	Healthscope	Neutral	2.90	2.6
HVN	Harvey Norman	Neutral	4.41	4.65
HZN	Horizon Oil	Outperform	0.06	0.12
IAG	Insurance Australia Group	Neutral	5.72	5.6
IFL	IOOF	Outperform	8.10	8.9
ILU	Iluka Resources	Underperform	6.40	5.3
IOF	Investa Office Fund	Restricted	4.29	Restricted
IPL	Incitec Pivot	Outperform	3.37	3.85
IRE	IRESS	Neutral	12.24	11.19
ISD	iSentia Group	Outperform	3.87	4.25
JBH	JB Hi-Fi	Restricted	22.58	Restricted

Fig 42 Stocks mentioned in this report

Stock code	Company	Rating	Stock price (A$)	Target price (A$)
JHC	Japara Healthcare	Neutral	2.48	3.15
JHX	James Hardie Industries	Outperform	21.35	22.1
KAR	Karoon Gas	Outperform	1.38	3
KMD	Kathmandu	Neutral	1.38	1.6
LLC	LendLease Group	Outperform	13.48	16.05
MFG	Magellan Financial Group	Outperform	24.00	24.34
MGR	Mirvac Group	Outperform	2.02	1.95
MGX	Mount Gibson Iron	Neutral	0.19	0.2
MIN	Mineral Resources	Neutral	8.83	5.35
MMS	McMillan Shakespeare	Outperform	14.73	15.48
MND	Monadelphous Group	Underperform	7.21	5.95
MOC	Mortgage Choice	Outperform	1.67	2.23
MPL	Medibank Private	Neutral	3.23	2.92
MQA	Macquarie Atlas Roads Group	Outperform	5.36	5.39
MTR	Mantra Group	Outperform	3.93	4.61
MTS	Metcash	Underperform	2.00	1.6
MYO	MYOB Group	Neutral	3.35	3.37
MYR	Myer	Neutral	1.15	1.19
NAB	National Australia Bank	Neutral	26.62	29.5
NCM	Newcrest Mining	Neutral	22.06	16
NEC	Nine Entertainment Co. Holdings	Outperform	1.19	1.6
NSR	National Storage REIT	Neutral	1.87	1.82
NST	Northern Star Resources	Underperform	4.85	3.4
NUF	Nufarm	Outperform	7.75	8.95
NVT	Navitas	Neutral	5.37	4.73
OFX	OFX	Outperform	2.12	2.6
OML	oOh!media	Outperform	4.95	4.55
ORA	Orora	Outperform	2.78	2.95
ORE	Orocobre	Outperform	4.35	5
ORG	Origin Energy	Outperform	5.71	4.57
ORI	Orica	Underperform	13.27	13.66
OSH	Oil Search	Restricted	6.65	Restricted
PBG	Pacific Brands	Restricted	1.14	Restricted
PGH	Pact Group Holdings	Outperform	5.57	5.7
PMV	Premier Investments	Neutral	15.16	16.35
PPT	Perpetual	Neutral	42.38	43.3
PRG	Programmed Maintenance	Outperform	1.87	2.03
PRU	Perseus Mining	Outperform	0.54	0.65
PRY	Primary Health Care	Neutral	3.90	3
PTM	Platinum Asset Management	Neutral	6.38	6.22
QAN	Qantas Airways	Outperform	2.92	4.5
QBE	QBE Insurance	Neutral	12.21	12
QUB	Qube Holdings	Restricted	2.33	Restricted
REA	REA Group	Neutral	55.88	48.8
REG	Regis Healthcare	Neutral	4.62	5.2
RHC	Ramsay Health Care	Underperform	73.26	60
RIO	Rio Tinto	Outperform	45.22	52
RMD	ResMed Inc.	Neutral	8.17	8.4
RRL	Regis Resources	Underperform	3.35	2.5
S32	South32	Underperform	1.56	1.3
SAI	SAI Global	Outperform	3.32	4
SCG	Scentre Group	Underperform	4.67	4.09
SCP	Shopping Centres Australasia Property Group	Underperform	2.32	1.88
SEK	Seek	Outperform	15.75	17.45
SFR	Sandfire Resources	Neutral	5.64	5.6
SGH	Slater & Gordon	Underperform	0.45	0.66
SGM	Sims Metal Management	Neutral	8.31	8.9
SGP	Stockland	Underperform	4.64	4.11
SHL	Sonic Healthcare	Neutral	21.61	20
SPO	Spotless Group Holdings	Neutral	1.13	1.35
SRX	Sirtex Medical	Outperform	28.65	38
STO	Santos	Outperform	4.44	6
SUL	Super Retail Group	Outperform	8.94	9.7
SUN	Suncorp	Outperform	12.56	13.38
SYD	Sydney Airport	Neutral	7.22	7.23
TAH	TABCorp Holdings	Outperform	4.41	5.25
TCL	Transurban Group	Outperform	11.93	12.66
TEN	Ten Network Holdings	Neutral	1.07	1.35
TLS	Telstra Corporation	Neutral	5.58	5.75
TNE	Technology One	Outperform	5.41	5.5
TRS	The Reject Shop	Outperform	12.12	13.5
TTS	Tatts Group	Outperform	3.95	4.45
TWE	Treasury Wine Estates	Neutral	10.36	9.13
VRT	Virtus Health	Neutral	6.78	6.5
WBC	Westpac Banking Corporation	Outperform	30.26	33
WES	Wesfarmers	Outperform	40.73	42.61

Fig 42 Stocks mentioned in this report

Stock code	Company	Rating	Stock price (A$)	Target price (A$)
WFD	Westfield Corporation	Outperform	10.78	11.42
WHC	Whitehaven Coal	Underperform	0.95	0.4
WOR	WorleyParsons	Neutral	7.20	6.34
WOW	Woolworths	Underperform	21.81	20.15
WPL	Woodside Petroleum	Neutral	27.05	30
WSA	Western Areas	Outperform	2.04	2.5

Source: Bloomberg, Macquarie Research, June 2016; 7 June prices

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie – South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2016

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	50.34%	59.09%	46.67%	44.76%	60.66%	46.12%	(for global coverage by Macquarie, 3.72% of stocks followed are investment banking clients)
Neutral	34.14%	25.66%	32.00%	49.90%	30.33%	35.10%	(for global coverage by Macquarie, 4.79% of stocks followed are investment banking clients)
Underperform	15.52%	15.26%	21.33%	5.33%	9.02%	18.78%	(for global coverage by Macquarie, 2.31% of stocks followed are investment banking clients)

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