TANARRA

3 April 2024

The Board
Lendlease Group
International Towers Sydney Exchange Place
300 Barangaroo Avenue
Barangaroo NSW 2000

TIME FOR FUNDAMENTAL CHANGE AT LENDLEASE

The upcoming Investor Day in May is a pivotal moment for Lendlease. We believe the company and its strategy need fundamental change. This letter explains why.

We believe that a democratic public debate about the future direction of public companies between a board and a company's owners is a good and healthy thing. If it helps produce a better investment performance and a more competitive cost of capital for Lendlease, that's very positive and in the company's interests. Such debate may contribute to underperforming companies staying public, not falling prey to an opportunistic takeover bid and becoming part of the increasing narrative of the Australian equity market of well-known companies disappearing into private ownership.

Our objective since first investing in Lendlease in 2021 has been for the company to return to the stature it once held as an industry icon, while at the same time generating excellent returns for all securityholders. It's undoubtedly a company with a great skill set and the ability to produce inspiring city-reshaping projects such as Barangaroo. It has a great history; in order to have a great future, it needs to have a much more competitive cost of capital, which starts with a better security price and investment returns on its business activities.

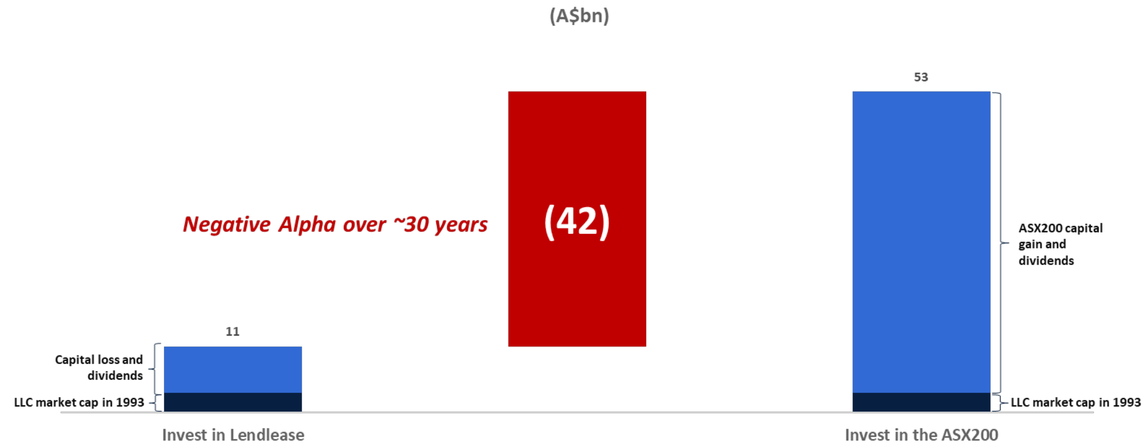
To this end, we have, as you are aware, supported your and management's strategy of business simplification. From close observation over time, we have come to the view that the company's challenges run much deeper than exiting a few business lines considered to be no longer core.

We believe that

- The diversified global champion "flywheel" business model is fundamentally broken
- The culture does not enable success, and
- Capital allocation is skewed by misplaced targets and lacks appropriate discipline

and that therefore a radical overhaul of the company and its strategy is imperative – not just for future success, but for its survival.

The judgement of the financial markets is unfortunately clear over any time period, including since the launch of the new strategy (down 47%, a bigger fall than all other major Australian property companies). The security price is now less than what it was 30 years ago. If investors owning Lendlease had simply invested instead in an ASX index tracker 30 years ago, they would be $42bn better off today. The performance is not remotely acceptable. A good starting point would be for the board and management to acknowledge this publicly in plain terms.



Note: Data as per Refinitiv as at 28 March 2024

In our view, there are three fundamental problems:

<u>Broken Business Model</u>

- The company is unfocused and overextended with multiple, often-unrelated activities spread across four continents that arguably draw more disadvantages from common ownership than advantages
- A conglomerate business model is only effective if its divisions would also be successful under independent ownership. None of your divisions presently make an adequate operating margin or ROIC, so the conglomerate structure simply aggregates three underperforming businesses.

Investments is also far too dependent on deal flow generation from Development to have a self-reliant winning culture

- The opaque and long-term economics of most of your activities enables cross-subsidisation and cost-shifting between divisions, reducing true performance clarity and accountability
- Lendlease today is simply too small and lacks the scale and balance sheet in a global context to be more than a marginal player in many international markets. Marginal and substandard economics are the consequence.

<u>Culture Does Not Enable Success</u>

People dealing with the company and former company insiders routinely describe the culture as bureaucratic, arrogant, top heavy, risk-averse and siloed, with far too many management layers, international committee meetings and even cases of public in-fighting between divisions. Even with the recent headcount reductions, there's simply too many people and not enough role accountability. Much of this flows from the overextended global business model that the company has pursued. Staffing needs to be drastically slim-lined, and the culture made more accountable and fit to compete and succeed in the highly competitive modern business environment in which the company now finds itself.

<u>Capital Allocation is Skewed by Misplaced Targets and Lacks Appropriate Discipline</u>

The company's approach to capital allocation prioritises growth for growth's sake ($70bn Investment FUM, $8bn Development completions pa) over returns (ROE target of 8-10% - inadequate for the business' risk profile, for reasons explained below). Like any incentive effect, it's produced the outcome that's the likely consequence of the incentive. In Lendlease's case, that's a bloated and overextended balance sheet replete with very long dated projects with next to no returns for many years, coupled with a dreadful security price for investors.

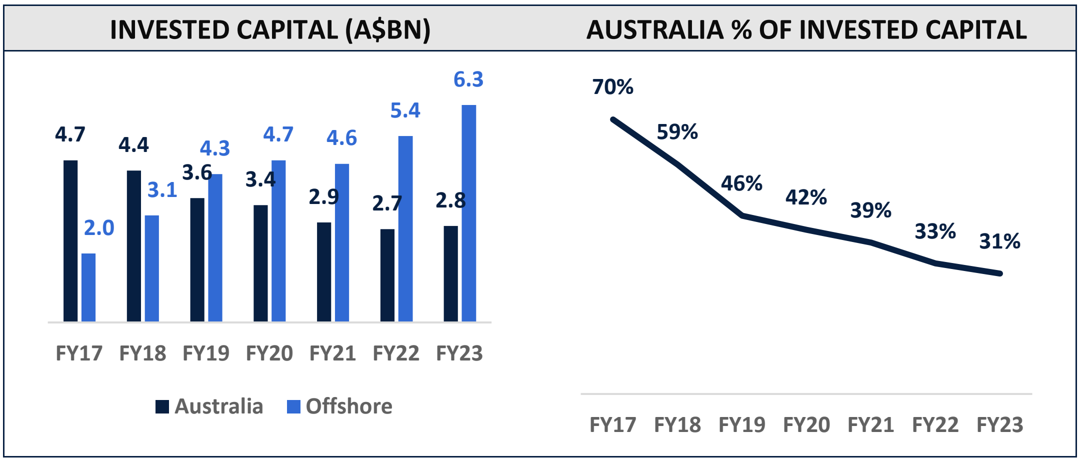
Even since Tony Lombardo was appointed CEO in 2021 and embarked on his business "*Reset*" and simplification strategy, the asset base of the company has increased from $15.5bn to $16.9bn at end of calendar 2023. The security price is down 47%. And according to the 2023 Annual Report, the company has now finished with its *Reset* phase and has moved into a *Create* phase, which implies even further capital investment.

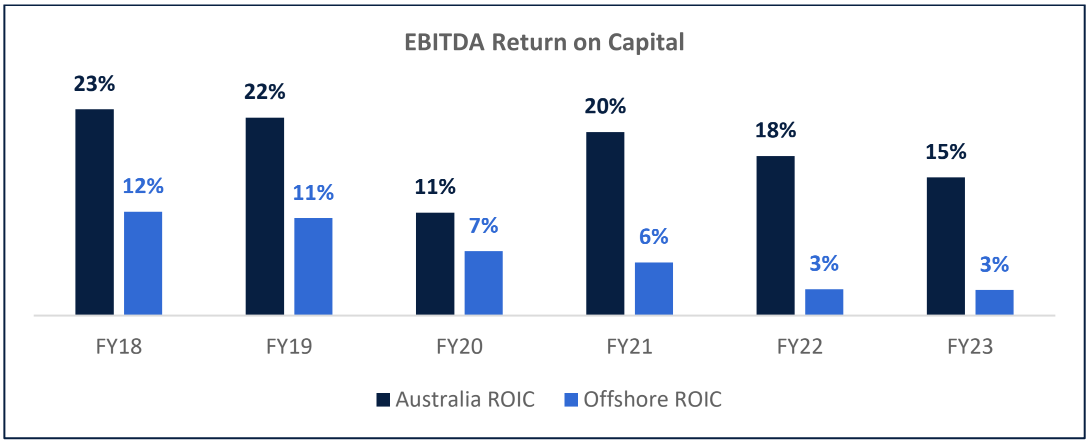
RECOMMENDATIONS - WHAT SHOULD BE DONE

We have eight recommendations as to what should be done, that we believe should be addressed at the Investor Day.

They are:

1. **Abandon the *Reset Create Thrive* strategy and focus on where Lendlease has a competitive advantage and right to win**. For Lendlease, the right foundation of competitive advantage lies in Australia, as can be seen from the charts below. The company's quest for international growth in recent times has diluted returns significantly from your high return Australian business and done real damage to the security price.





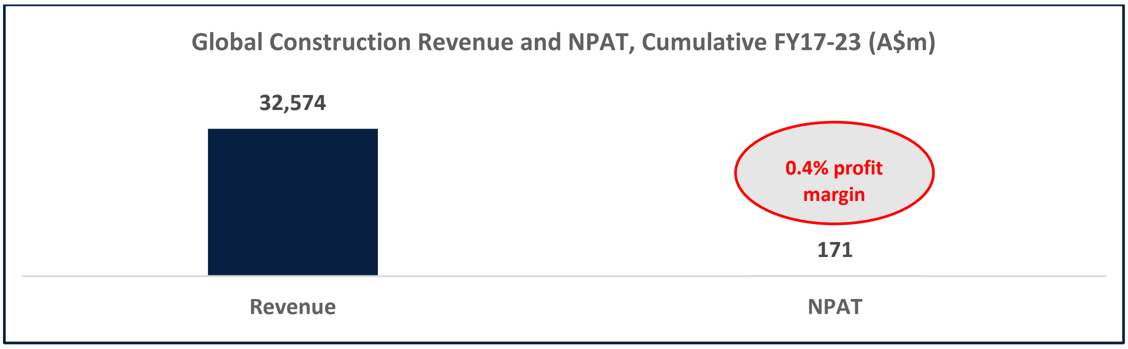
Our present view is that the company should demerge all or most of its international businesses into a separate vehicle focused on capital realisation, possibly with the retention of Singapore grouped with your Australian business. As a separate company, Australia(&Singapore)Co would be a highly investable business that has consistently generated >15% returns on capital. InternationalCo would begin as a discrete asset portfolio committed to realising its ~$4bn development asset base in an orderly value-preserving way. Through clever value-conscious stewardship and realisation of the portfolio, its team could earn the right to reinvest securityholder capital over time.

The case for a demerger should be comprehensively analysed at the Investor Day – on the basis of “if not, why not?” If the company does not go down this path, investors deserve to understand in detail why, given the impact the global growth strategy has had on securityholder returns. At present, the company’s position is it intends to have 40-60% of its capital base in Australia – which is absolutely “two bob each way”.

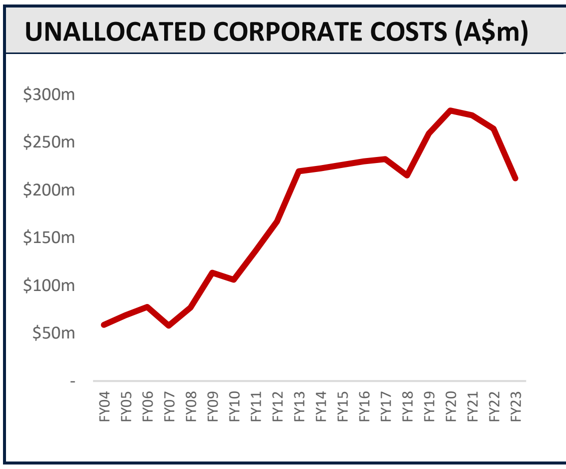
We believe there is plenty of growth runway available to Lendlease in its home market in the years ahead, through emerging and growing investment strategies such as Build to Rent, Mixed Use Urban Regeneration, Affordable Housing, and the simple need for more apartment stock to respond to a structurally growing population and a national housing supply crisis.

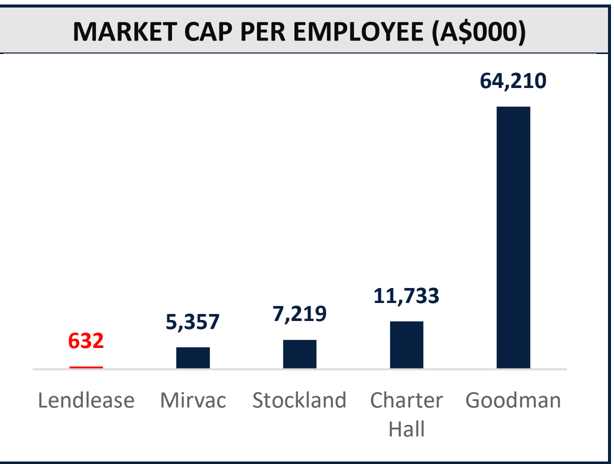
Until this fundamental strategic issue is resolved, there should be a moratorium on new asset or project acquisitions internationally until the company is producing acceptable investment returns on capital.

2. **Exit all international construction**. It's been a disaster for the company. A business that has generated $33bn in revenues since 2017 for only $170m of profits is simply unsustainable. We think the logic used to justify continuing to bid for new construction work is circular and self-fulfilling: that an increasing (or at least not reducing) external work book is required to retain staff and cover fixed costs, and avoid a goodwill write off. The continuing inflow of new work however makes exiting the business ever harder. According to the company's most recent annual report, it is presently targeting an **increase** in construction backlog from $8.3bn to a "steady" $10bn, for reasons that are completely unclear. Construction is a low margin business at best, replete with risk and high internal monitoring and risk management costs, at both management and board level. Trying to stay in narrower US life sciences and healthcare construction markets cannot work – those markets are small and will surely just produce the same mission creep as has occurred in the past to keep a workforce busy.



3. **Take a real knife to costs**. This is vastly more than a headcount reduction exercise, it's a complete cultural reset. Blow up the bureaucracy, bloat, excess layers of management, layers of leadership committees, the 700 or so people in finance, 200 in HR and 110 in sustainability. Commit to being a lean and efficient company, with real job accountability. Be transparent about the cost savings, rather than burying them in future development margins in a way that can never be verified.





4. **Set much more ambitious ROE targets that reflect the true risk profile of your business.** An 8-10% ROE target is unambitious and inappropriate for a business with Lendlease's risk profile. Investors can now get 8-10% returns in low-risk credit, why would they take on all your economic, market, operational, cost escalation, contractual and financial risk to generate that? We believe your ROE target should be mid-teens or more.

To achieve a higher group level ROE, you need to have higher ROIC targets at the divisional level. In Investments, Lendlease should move to a more capital-light model, with more emphasis on active rather than passive funds management. It should improve returns by recycling capital more aggressively and selling down fund co-investments. $4bn tied up in an investment portfolio yielding sub 4% is a poor use of securityholder capital and will not generate a mid-teen bottom line ROE. A good fund manager does not retain FUM by holding blocking stakes in the funds it manages; it does so by delivering excellent performance returns to its investors.

5. **Drop the growth-for-growth's-sake growth and volume targets for Investment FUM ($70bn FUM) and development completions ($8bn pa) that were the product of the era of free money**. These arbitrary targets just encourage and sanction poor capital allocation. It's time for returns on capital and cash flow to be prioritised.

   A good step in this direction would be to exit very long dated, high-risk and unpredictable projects – e.g. Euston Station in the UK. These projects have many inherently uncontrollable factors and are reliant on high theoretical long-dated end-values to be successful. Euston won't start generating cash flow for over a decade even if HS2 ever reaches the station, which at this point is highly uncertain. Irrespective of theoretical IRRs, it's not a good use of a midsize public company's balance sheet, even before considering all the direct and indirect people costs involved.

6. **Recognise that your relations with a lot of your investors in your managed funds are not what they should be and need to be improved**. We have heard consistent feedback of investor dissatisfaction with Lendlease's management performance of many of these funds, often your largest. This is fundamental if Lendlease really is pivoting to an investment-led strategy. In particular, the APPF funds management agreements need to be restructured to address investor concerns.

7. **Radically improve the transparency and accessibility of your financial statements and public disclosures.** Lendlease is one of the most impenetrable companies to understand from outside of any company in the ASX. Cash flows are near impossible to reconcile with profits – there is a $4.6bn gap between statutory profits and free cash flow since FY14. This translates inevitably into less investor appetite to buy your securities. We suggest you disclose, for example, actual dollar cost savings from headcount reductions, gross and net, and where and when they show up in the P&L. A large proportion is said to benefit future development margins, but this is completely unverifiable, and in the meantime corporate costs in P&L did not decrease in 1H24. We suggest you disclose what total group overhead is, before allocations. We suggest you disclose the actual hurdles at which management incentives kick in. These matters are not commercially confidential and would shine a light on some important truths for your investors.

8. **Stop the "death by a thousand cuts" by below-the-line "non-operating and non-core" items every earnings result. Take conservative provisions now on questionable projects**. Lendlease has unfortunately earned a reputation over time for consistent below-the-line charges, which are also excluded from STI executive compensation plans. These have been a feature of results every year for the last six years, now totaling $1.85bn. There is a market expectation this will continue, and represent another major impediment to investor interest – where and when will the next landmine go off? For example, many in the financial and property markets believe that further impairments are likely at the Victoria Cross office project in North Sydney, which is still only 6% leased despite nearing completion. Moving Lendlease staff to North Sydney to fill a vacant building cannot be the optimal overall solution.

We trust you and the board will find these recommendations useful and positive. We have arrived at these views after close evaluation from being a securityholder for over two years now.

We are conveying the views solely as Tanarra, but are confident that many of the views expressed in this letter are widely shared in the equity market, as showed in the 2023 Remuneration Report vote.

We are also writing this in the belief that Lendlease can once again be a company that not only builds beautiful buildings, but also generates great returns for its investors. Many people in the Australian property industry – a lot of whom Lendlease trained – would love to see it recover its lustre. As a long-term investor and material shareholder, we are happy to go on this journey with the board and the company in the best interests of all securityholders, with the right strategic redirection.

Yours sincerely

John Wylie AC | Vid Rangaswamy | Lee Mickelburough