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Billion-dollar blunder in WSA takeover costs shareholders

Company/ASX Code	**IGO Limited/ IGO**
AGM time and date	**12 noon WST, Thursday November 16 2023**
Location	DoubleTree by Hilton, Perth Waterfront, 1 Barrack Square, Perth, Western Australia 6000
Registry	Computershare
Type of meeting	Hybrid by Lumi
Monitor	Derek Miller/ John Campbell
Pre-AGM Meeting	Yes with Michael Nossal, chair, and company secretary

Monitor Shareholding: The individuals involved in the preparation of this voting intention have shareholdings in this company.

1. How we intend to vote

No.	Resolution description	
1	Re-election of Ms Debra Bakker	Undecided
2	Election of Ms Samantha Hogg	For
3	Remuneration Report	Against
4	Issue of service rights to Mr Ivan Vella	For
5	Issue of Performance Rights to Mr Ivan Vella	For
6	Approval of termination payment to Mr Ivan Vella	Against
7	Change of Auditor	For

2. Summary of Issues and Voting Intentions for AGM

A year ago, we said that IGO was well governed and performing well, and, with the move away from gold by selling Tropicana and the move into Lithium mining and processing with the Tianqi Lithium Energy Australia (TLEA) Joint Venture, IGO had moved to a clean energy metals company. A year later, an impairment of great magnitude and two significant issues have emerged:

- A colossal blunder was made in acquiring Western Areas on 20 June 2022 for $1,260m only to find it necessary to impair the assets acquired by $968m a year later. No explanation is given as to how this came about, and it doesn't even crack a mention in the chairman's statement in the annual report. Mr Nossal took over the chair at the end of the November

2021 AGM. The mistake in purchasing Western Areas reflects poorly on the judgement of both board and senior management at the time, and while the acting CEO has expressed disappointment on the outcome of the reassessment of the accounting value at Cosmos and Forrestania to reflect higher capital and operating costs, challenges to the mine production schedule and delays in development at Cosmos, it is not enough. We shall ask why shareholders should be content to see the board remain intact after such a blunder.

- After a year of commissioning, the Kwinana lithium processing plant still has significant problems. It produced 1884 tonnes of lithium hydroxide ex its theoretical capacity of 20,000 tonnes. We shall ask where the problems have arisen, what has been achieved in FY24 to date and if the board is confident that the past problems have been overcome.

- The Nova nickel mine is IGO's most profitable, directly-owned, mine with high margins, but has only 3 years remaining Ore Reserves. With this in mind, a year ago IGO completed the takeover of Western Areas to give access to more nickel reserves. However, the recent major impairment (purchased for $1.26 billion written off $0.97 billion) of Western Areas' assets presumably undermines that intention and focus must return to Fraser Range exploration to locate reserves of nickel ore to keep Nova's production facilities operating past the end of current reserves.

On the other hand, the Greenbushes mining and processing operation had a very successful year returning a $1.6 billion share of its profits to IGO for its 24.99% share of the business. This was partly due to very high prices and mining ore above the long-term reserve grade (2.66% verses 1.9% Li_2O), giving a fantastic margin of 95%.

3. Matters Considered

Accounts and reports

IGO has expanded over the last 14 years from a small exploration company to a clean energy metals company producing nickel and lithium with a market cap of $11.6 billion at 1 July (a year ago it was $7.2 billion)

IGO had 3 operating assets this year:

1. Nova nickel mine that performed at guidance with a free cash flow margin of 39%.
2. Greenbushes mine that performed above guidance with an underlying free cash flow margin of 95%. Greenbushes mine reserve grade of 1.9% lithium oxide is the highest grade of all operating and proposed mines in Australia.
3. Forrestania mine (ex Western Areas) had a difficult year with mine operating issues and this resulted in high operating costs and zero margin. It has less than 6 months reserves remaining.

IGO continued a very active exploration programme with $65 to $75 million planned for next year. Priority areas are:

1. Fraser Range for base metals with emphasis on Nova & Silver Knight areas - with the short remaining life of Nova, this seems critical.
2. Forrestania area for nickel and lithium
3. Paterson region in the Pilbara primarily for copper
4. Kimberley region for copper again.

Our concern is that the large spend over a great many years on exploration has yielded little since the discovery of gold at Tropicana about 20 years ago. Exploration in the Fraser Range area, in particular, has failed to locate an ore body capable of sustaining the Nova processing plant when reserves at Nova are used up in 3 years' time. The acquisition of the Western Areas assets included the Cosmos mine in the Pilbara which IGO hoped would take over as the main producing asset if Nova has to close, but a review is under way to determine if it is viable after the impairment assessment made as at 30 June. It is critical for IGO's future in nickel mining that new ore bodies are discovered or that Cosmos proves to be a profitable operation.

Financial performance

IGO's owned operations had revenue of $1024m which was above FY22 of $903m and produced an EDBITDA of $460.4m at Nova and $275.5m at Forrestania. Its 49% share of Tianqi JV's 51% share of the Greenbushes operations revenue for FY23 was $2,624m (FY22 $470m), and its share of Greenbushes' EBITDA was $2,378m (FY22 $337m). This produced a share of its net profit of $1603.6m for IGO and contributed the major part of its underlying NPAT of $1,528m. Statutory NPAT was $549m after the $968m Western Areas impairment, compared to $331m the previous year.

Dividends from Tianqi JV boosted free cash flow from FY22 $367m to $775m for FY23, after debt repayments of $540m, dividends $144m and tax paid $185m. The balance sheet is healthy with current assets exceeding total liabilities. The share price which reached $16 briefly in July is down to $10.65 at the time of writing due to the bad news about Western Areas and falls in the price of lithium.

(As at FYE)	**2023**	**2022**	**2021**	**2020**	**2019**
NPAT ($m)	549	331	549	155	76
UPAT ($m)	1528	717	475	460	341
Share price ($)	15.30	9.94	7.63	4.87	4.72
Dividend (cents)	74	10	10	11	10
Simple TSR (%)	58.8	31.6	57.7	3.5	Minus 6.2
EPS (cents)	201.8	43.7	80.9	26.5	12.9
CEO total remuneration, actual ($m) (FY23 -acting CEO)	2.74	3.76	2.80	1.47	1.76

Simple TSR is calculated by dividing the change in share price plus dividend paid during the year, excluding franking, by the share price at the start of the year.

For FY23 the acting CEO's total actual remuneration was 27.6 times the annualised Australian Full time Adult Average Weekly Total Earnings (based on May 2023 data from the Australian Bureau of Statistics.)

Governance and culture

IGO culture is strongly focussed on safety and the environment, and this is emphasised in the Annual Report and the Sustainability Report. At the time of writing, the board comprises 7 directors, all independent and non-executive, four female (57%), and five directors have had resource industry backgrounds. Three are geologists by profession and one chemical engineer. Since Peter Bradford's death, there have been no executive directors pending Ivan Vella's commencement in December (see below). The longest serving director was appointed in 2014 and they all meet ASA guidelines as regards skin in the game and workload, but with two recently appointed directors still to acquire shareholdings in IGO. The number of female directors was reduced by one during the year when Kathleen Bozanic stepped down from the board to take on the role of chief financial officer but has been restored with the appointment of Samantha Hogg. Our concerns about the board are as to its judgement in approving the takeover of Western Areas, there being no mining engineers on the board, and the fact that its chairman, Michael Nossal, is non-resident in WA. In fact, there are only 3 WA resident directors, two interstate and two US residents.

Key events

As mentioned above the key event was the massive write-down of Western Area assets only acquired one year earlier - a write down of nearly one billion dollars. This will be a main point of ASA questioning.

Key board or senior management changes

In October 2022, the then managing director, Peter Bradford sadly and unexpectedly passed away. The chief operating officer, Matt Dusci was then appointed acting CEO and shortly before this occurred, the previous CFO decided to step down from the role for personal reasons and Kathleen Bozanic, who had been a non-executive director, was appointed as CFO. In June 2023, the appointment was announced of Mr Ivan Vella, a Rio Tinto executive, as the new CEO and managing director, taking up his duties from 11 December 2023. Mr Vella has impeccable qualifications for this role and acted as Rio's interim CEO after the Juukan Gorge debacle. His terms of employment are set out under remuneration below.

Sustainability/ESG

IGO has always had a strong focus on sustainability and safety as well as endeavouring to be a good citizen in terms of agreeing its land access with local indigenous groups, sponsoring indigenous employment and community support. Its Sustainability Report discloses a continuing focus on ESG and a commitment of significant funds to combat climate change, seeking to be carbon neutral by 2035, if not earlier, with respect to its managed operations.

4. Rationale for Voting Intentions

Resolution 1 and 2 - Re-election of and election of directors (vote undecided as regards the re-election of Debra Bakker but for the election of Samantha Hogg)

We shall ask why Ms Bakker, an experienced investment banker, did not recognise that the takeover of Western Areas was a colossal blunder that has cost shareholders over $1 billion.

Resolution 3 - Remuneration Report (against)

We attach an appendix showing the basis of the IGO remuneration plan and a table showing components of the acting CEO's remuneration for FY23. The changes in key personnel involving the passing of the former managing director caused some changes to the remuneration plan which follows the normal practice of a fixed salary, short-term incentive in cash and equity and a long-term incentive in equity. The acting CEO's pay structure set out in the appendix is applied in a similar manner to other KMP with lower levels of incentive pay and higher proportions in salary.

A change to the remuneration plan was introduced to compensate executive KMPs other than the acting CEO for the extra work entailed in managing the company without a chief operating officer. Each of these 3 executives was awarded an 'exertion and retention' payment of $165,000 for the CFO and $110,000 for the Chief Legal and People Officers in consideration of what is described to be their considerable additional workload. We can see some justification for this decision representing 28% (CFO) and 20% (CLO and CPO) of their total fixed remuneration. However, we are not convinced that this was the best method of dealing with the situation – we would have preferred to see another executive made acting COO as a KMP member.

In view of the urgency of discovering feasible nickel deposits preferably in the Fraser Range area to provide feed for the Nova processing plant, we query if the general manager exploration is worthy of KMP status since that role is critical in finding reserves to keep Nova going post the end of current 4.6m tonnes of ore reserves (about 3 years).

FY23 has seen shareholders hit by a $968m impairment of Cosmos assets acquired at the start of the financial year as part of the Western Areas takeover. This impairment of an asset acquired no more than 12 months prior has cost shareholders dearly in terms of current price and potential better deployment of these funds. Whilst the STI awards to executives in KMP positions for both years were only about half of the amount awarded in the previous year, the executives still received substantial awards under the company's remuneration plan. We will ask at the AGM why this is the case and what went wrong with IGO's due diligence exercise in bidding for Western Areas such that the errors of judgement made at that time are not appropriately reflected in employment or remuneration. We do not think the response to the impairment was sufficient in terms of its effect on executive remuneration.

The company continues to assess the long-term incentive on a three-year appraisal period which we believe to be too short, albeit there is a further one-year retention period before full vesting. For a company of IGO's size and status, we believe a 4-year LTI appraisal period is the minimum requirement and this is another reason why we will continue to vote against the remuneration report.

Apart for the query over the appropriateness of any incentive payments in view of the Western Areas impairment and the short LTI appraisal period, our other concerns with the remuneration structure are relatively minor, being that there is no mandatory cancelling of LTI vesting if TSR is negative (this being at board discretion) and that relative TSR allows vesting if IGO's TSR is at the median of the comparator group – ASA prefers vesting to commence only if TSR is above the median of comparator companies.

These concerns should be viewed in the context of a remuneration structure designed to retain staff at IGO in face of competition from other mining sector entities. The three-year appraisal period for LTI awards is the yardstick in many other such entities. The remuneration structure applies to a larger group of management staff in addition to the key management personnel listed in the report. Overall, we believe the remuneration plan for IGO KMP to be fair and reasonable as per its design, but we believe that IGO, now it is in the ASX200 and well into the upper end of that group, should be changing its LTI to a 4-year appraisal period.

Resolution 4 & 5 - Approval of equity grants to incoming Managing Director & CEO (for)

As referred to earlier, Mr Ivan Vella, a Rio Tinto executive, was appointed as the new CEO and managing director, taking up his duties from 11 December 2023. Mr Vella has impeccable experience and qualifications for this role and acted as Rio's interim CEO after the Juukan Gorge debacle. His commencing total fixed remuneration is $1.4m and he will be entitled to an STI of 100% of TFR at target and 150% at maximum, and an LTI of 200% of TFR, all under the same principles of the existing remuneration plan. In addition, Mr Vella will be given 400,000 service rights to IGO shares vesting in 4 equal annual instalments from August 2024 to compensate him for the loss of his accumulated unvested share rights in Rio Tinto which we had estimated to have a value of $12m. We accept a grant of this nature has been offered to attract the services of an executive of Mr Vella's status and we will not object to his package of rights.

Resolution 6 - Approval of termination payment to Mr Ivan Vella (against)

ASA policy is against pre-approval of termination payments in excess of 12 months' pay. The Corporations Act prohibits the payment of termination payments in excess of that amount without shareholder approval. It is likely that any termination payment to Mr Vella would exceed that statutory limit because of accrued incentive payments, but we prefer to see shareholders given the opportunity to approve such payments knowing the circumstances of the executive's termination. We do not agree that pre-approval of such payments is appropriate and so will vote against this resolution.

Resolution 7 - Change of Auditor (for)

This does not appear to be anything other than a formality to approve the transfer of the audit appointment to a different BDO entity and we shall not oppose the resolution. BDO won a tender for the audit in 2017.

Appendix 1
Remuneration framework detail

Acting CEO rem. Framework for FY23	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.026	33.30%	1.026	35.97%
STI - Cash	0.410	16.70%	0.616	21.58%
STI - Equity	0.616	16.70%	0.923	32.37%
LTI	0.287	33.30%	0.287	10.07%
Total	2.339	100.00%	2.852	100.00%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan. Target remuneration is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting.

The remuneration report is reasonably easy to understand and contains adequate details of the arrangements.

Fixed salaries are set out in the annual report, and we have no reason to take exception to the amounts shown. The FY22 STI target opportunity is a percentage of fixed salary ranging from 50% for some KMP through to 100% for the CEO at target. Maximum STI is awarded for stretch performance up to 50% more than target. Of the total STI awarded, 40% is paid as a cash bonus post-year-end, and 60% in service rights of which half vest after 12 months' service and half after 24 months' service following year-end. The service rights are allocated based on the average market value of IGO's shares in the post-annual report period. Performance targets are set in 5 areas (with FY23 results in brackets) – ESG (17.1% ex 25%), operational performance (0% ex 20%), financial performance (10% ex 30%), strategic plan (10% ex 15%) and Board discretion (10% ex 10%). The board awarded the extra 10% to the scorecard to reflect the impact of Peter Bradford's passing, making a total award of 47.1% (FY22 110%) of target. Adequate details are given to enable an understanding of how the scorecard was evaluated and STI awards determined.

The FY23 LTI will be assessed over the period 1 July 2022 to 30 June 2025 against 6 hurdles, relative TSR, absolute TSR, ROCE, strategic delivery, and decarbonisation plan delivery. For the acting CEO, the LTI opportunity is 78% of fixed salary whereas for other KMP it is 81% of fixed salary. The award is designated in performance rights with their number determined by dividing the award with the average market value of IGO's shares in the post-annual report period.

The FY21 LTI was tested as at 30 June 2023 with IGO having achieved an excellent TSR of 204% over the three years ended on that date. Accordingly, 83.3% of the 25% available was awarded for relative TSR where IGO came on the 67th percentile of the companies in the comparator group, and 100% of the 25% available was awarded for the absolute TSR which required a 20% pa achievement. 100% of both other criteria was awarded because reserve growth exceeded baseline by more than 110% and average EBITDA margin was greater than 40%. As a result, all but 4.2% of the rights allocated for FY21 will vest in FY24 (this will mean that approximately 101,460 shares will vest for the acting CEO Matt Dusci, and lesser numbers for the CLO and CPO). By comparison, the FY20 LTI was tested as at 30 June 2022, and resulted in 83,738 shares worth $1.13m vesting for Matt Dusci and 32,710 and 34,579 shares worth $0.44m and $0.47m vesting for the CLO and CPO respectively. The value of these shares is shown in the diagram of realised pay on page 61.