Australian Shareholders' Association Limited
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A quieter year

Company/ASX Code	Iluka Resources Ltd/ILU
AGM date	Tuesday, 7 May 2024
Time and location	9.30 am, Perth Convention & Entertainment Centre, 21 Mount's Bay Road, Perth
Registry	Computershare
Type of meeting	Yes – hybrid meeting (https://meetingnow.global/MQC94NW)
Poll or show of hands	Poll on all items
Monitor	John Campbell assisted by Leanne Harrison
Pre AGM Meeting?	Yes with People & Performance Committee chair Andrea Sutton

Monitor Shareholding: The individual(s) (or their associates) involved in the preparation of this voting intention have shareholding in this company.

How we intend to vote:

No.	Resolution description	
1	Re-election of Mr Rob Cole as a director	For
2	Re-election of Ms Andrea Sutton as a director	For
3	Adoption of Remuneration Report	For
4	Approval of 2023 STIP equity grant to Managing Director Tom O'Leary	For
5	Approval of 2023 LTIP equity grant to Managing Director Tom O'Leary	For
6	Appointment of KPMG as auditor in place of PWC	For

Summary of issues for meeting

Iluka had a quiet year in 2023 in comparison to 2022 when it demerged Sierra Rutile and committed to the rare earth refinery. In 2023, a slump in Chinese demand for Iluka's products around the middle of the year led to reduced sales and a 43% build-up of inventory. This and capital expenditure created negative free cash flow and a significant drop in dividends for shareholders. We await the March quarterly report due out shortly before the AGM to see if sales have reduced the stockpiles so as to stop the bleed of cash flow. We remain worried about shareholder dividends in the next few years whilst the rare earth facility is constructed and brought up to full production and will ask at the AGM if the dividend policy is fair to shareholders during the construction/ramp-up period.

The current reduced profitability of its mineral sands business triggered an impairment assessment of the Cataby/South West unit encompassing the production of synthetic rutile which concluded that no impairment was required to be recognised in 2023. Iluka's synthetic rutile production requires the use of coal as a reductant of the ilmenite ore produced from its mines. This and its energy use in production generally put the Capel facility in the category of asset subject to the Albanese government's 'safeguard mechanism' requiring a legislated 5% per annum reduction in emissions to 2030. One of the assumptions made in reaching the favourable impairment assessment involved the safeguard mechanism and we will ask about its impact on the carrying value of assets in this segment which represents about 50% of the company's assets.

We understand that prices for neodymium, praseodymium dysprosium & terbium (Nd, Pr, Dy, Tb), the sought-after magnet rare earth elements, have fallen significantly since the decision was made to construct a rare earth refinery at Eneabba. At the same time, Iluka has announced that the capital costs of RE refinery project have escalated significantly from the initial $1.0 to 1.2bn to $1.7 to $1.8bn. We shall ask how this additional expenditure is to be funded and if it is in shareholders' best interests to continue construction when product prices are depressed.

<u>Accounts and reports</u>

(As at FYE)	**2023**	**2022**	**2021**	**2020**	**2019**
NPAT ($m)	343	589	366	2410	(276)
UPAT ($m)	343	597	315	151	279
Share price (closing) ($)	6.60	9.53	10.10	6.46	4.73
Cash dividend (cents)	23	37	14	2	13
Simple TSR (%)	-28.3	-9.7	58	34.1	-15.8
EPS (cents)	80.5	139.3	86.7	24.5	-71
CEO total remuneration, actual ($m)	2.622	3.760	4.515	4.280	2.644

For 2022, the CEO's total realised remuneration was 27 times the Australian average full time adult weekly total earnings ($98,217.60 per annum in November 2023).

Simple TSR is calculated by dividing the change in share price plus dividends paid during the year, excluding franking, by the share price at the start of the year. For 2022, this ignores the demerger dividend of 1 Sierra Rutile share additional to the cash dividends shown above. Sierra Rutile shares (ASX: SRX) traded at about 30c per share for a period of in excess of a month after initial listing.

Referring to the production information set out on page 163 of the annual report, results were significantly impacted by reduced sales volumes for all products - zircon (30%), rutile and synthetic rutile (33%), ilmenite (32%) - whilst prices were maintained or improved. Overall revenue per tonne improved 4% but reduced sale tonnages caused revenue from operations (p164) to decline 19% or $285.5m whilst cost of goods sold increased fractionally (0.8%). Total inventories in note 14 increased 43% or $243.1m. These two factors are primarily responsible for net cash flow from operating activities dropping from $601.5m in 2022 to $89.6m in 2023 (a fall of $511.9m).

Operating cash flow less capital expenditure and other investing cash flows is called free cash flow; this was negative for 2023. Iluka's dividend policy is to distribute 40% of mineral sands free cash flow not required for balance sheet or investing purposes plus revenue from Deterra Royalties ($30.5m). The interim dividend in September 23 and the final paid last month of 4c per share make an aggregate of 7c ($30m), compared to the equivalent dividends in respect of the 2022 financial year of 45c ($190m). *[Cash dividends in the panel above represent the final dividend of 20c paid in March and the interim dividend of 3c paid in September.]*

We await the March quarterly report to see if prices have remained stable and if sales have improved since year-end.   A return to better levels of profitability, and particularly dividend, which could lead to an improved share price, is contingent on a significant increase in sales volume. China represented about 40% of 2023 zircon sales and its real estate industry remains depressed by prior year measures. Iluka also has a new competitor in Australia, the Thunderbird mine in the Kimberley region of WA, owned jointly by Yansteel and Sheffield Resources, said to be the one of the largest and highest-grade deposits globally, with first product expected to have been available to customers by now.

Governance and culture

The company has a small board with a good cross-section of skills and 50% female membership. We looked for a board skills matrix showing each director's skills but the matrix only shows the collective board skills. We believe that showing individual skills would provide important information for shareholders in considering director elections and re-elections and urge its inclusion in future. We have no other issues with governance arrangements.

Iluka continues to employ 24% female in the total workforce and over 4% Aboriginal and Torres Strait Islander peoples, including 19% at Jacinth- Ambrosia (down from 21% in 2022.)

Key events

The decision to go ahead with the development of the Balranald deposit in NSW was made at the start of the year and has been progressed including through site access road and engineering activity. A further decision was made to undertake a definitive feasibility study for the Wimmera deposits in Victoria which has not yet been concluded. It was decided to take kiln 1 out of production late in the year whilst sales levels remained depressed.

Key Board and senior management changes

There were no changes to board or executive KMP since last year's AGM.

Sustainability/ESG

There is improved disclosure in the annual report of environmental impacts and plans to achieve carbon neutrality and the data book contains an auditor's report to provide assurance on the company's sustainability reporting. However, the statistics for 2023 indicate that despite reduced production levels, most measures of environmental impact were negative – more CO_2 emissions than 2023, more tailings created, more water used, more nitrous-oxide emitted, etc. We are advised that this is the result of the operating two kilns for most of the 2023 calendar year.

Rationale for Voting Intentions

Resolution 1 Re-election of Mr Rob Cole as a director (for)

Mr Cole was appointed to the Board in 2018, contributing 35 years' experience in commercial business strategy and planning experience in the energy and resource sector. He was previously Managing Director of Beach Energy and over eight years in senior roles with Woodside Petroleum. He is currently chair of Perth Airport, a member of the Council at Curtin University and NED at Cleanaway. Rob Cole is Chairman of the Board, Chair of the Nominations and Governance Committee and a member of the People and Performance Committee, and the Sustainability Committee.

Resolution 2 Re-election of Ms Andrea Sutton as a director (for)

Ms Sutton was appointed to the Board in 2021, contributing over 25 years of resources and corporate experience, including a range of executive roles within the Rio Tinto group, including: operational management; health, safety, and environment; human resources; and infrastructure management. She is currently chair of Water Corp, NED at Perenti, Red 5, Australian Naval Infrastructure, and a Board member at Australian Nuclear Science and Technology Organisation and National Australian Association of Women in Operations. Despite concerns of a heavy workload, we are supportive of her re-election. Andrea Sutton is Chair of the People and Performance Committee and a member of the Nominations and Governance Committee.

Resolution 3 Adoption of Remuneration Report (for)

The Remuneration Report clearly describes the remuneration structure which is not dissimilar to many other companies. Disclosure is made of take-home pay – the MD's is shown as $2.6m a significant fall from 2022's $3.76m which included $771,000 from the vesting of his 2019 long-term incentive performance shares together with $43,000 in accumulated dividends thereon. Due to a change in the structure of the long-term bonus, there were no LTIP entitlements due to be assessed in respect of 2023. The MD's realised pay compares with $4.1m determined under the accounting standard's complex method of determining the value of incentives, and with his 2023 target total remuneration of $4.2m as shown in the table in the appendix at the end of these voting intentions.

As in prior years, we have two concerns with Iluka's remuneration structure:

- There is only one hurdle for the long-term incentive performance rights – that is to achieve a level of total shareholder reward comparable to or better than a comparator group of resource companies. The ASA prefers there be two hurdles, one of which is TSR and the other is an absolute measure such as return on capital or earnings per share. Iluka's results are dependent upon commodity prices over which management has little control and its rare earth refinery is not expected to generate profits for several years which also makes this hurdle difficult to set for the current appraisal period.
- There is little transparency in terms of the goals set for targets in financial performance hurdles. Iluka claims this is because of commercial confidentiality and we have no reason to dispute that assertion.

Shareholders have suffered substantially in 2023 through dividends reduced to very low levels and the share price cut by nearly a third over the year through concerns over the reduced economic growth in China and particularly the slump in its building industry. By comparison, management has done well in its short-term incentive earnings, achieving better than two-thirds of maximum STIP for the KMP group. It is apparent that the sales and profitability continued at the high 2022 levels for the first half of the year until impacted by the Chinese order slump later on in the year. Management then took action to reduce production.

Looking at justification for the high level of short-term incentive awarded (103-105% of target), the award would have been higher if the prescribed measures had been followed to the letter - the board exercised discretion to limit the award based on return on capital which was nearly double target and would have earned a stretch performance measure. In deciding whether the apparent discrepancy between negative shareholder return and awarded incentive is acceptable, we need to assess whether the board's People and Performance Committee set an adequately challenging target for performance. It is apparent when looking at historical results as set out on page 80 of the annual report that profits were at a level which compares well with the years prior to 2022 when they peaked as a result of high demand and good prices. Accordingly, the drop in share price is anticipatory of the decline in profitability to be expected in the current financial year unless demand picks up. It would be unfair to attribute the share price decline to management performance and we cannot find any reason to assert that the performance targets were too soft. Accordingly, we think the overall outcome of the remuneration structure to be fair if not obviously well-deserved.

Resolution 4 Approval of 2023 STIP equity grant to Managing Director Tom O'Leary (for)

Resolution 4 asks shareholders to approve the grant of 82,071 restricted shares to the MD, Tom O'Leary. This represents the equity half of his short-term incentive award being $582,400 (2022 - $1,487,640) in restricted shares (using the average market value (VWAP) of Iluka shares of approximately $7.10 (2022 - $10.43) in March 2024) being, in aggregate with the 50% cash component, 69.3% of the 2023 maximum STIP opportunity for Mr O'Leary. The MD's total 2023 remuneration therefore comprises his fixed remuneration (base pay + superannuation) of $1,400,000 plus the cash and equity STIP of $1,164,800 to equal $2,622,475 (2022 - $3,879,400) in 'take-home pay'. The restricted shares are expected to become free of disposal restrictions as to 50% in May 2025 and the balance in May 2026.

Resolution 5 Approval of 2023 LTIP equity grant to Managing Director Tom O'Leary (for)

Resolution 5 asks shareholders to approve a further allocation of 236,744 (2022 - 160,928) performance rights to Mr O'Leary. The award reflects an entitlement to the LTIP portion of his 2023 remuneration package being 120% of his fixed salary or $1,680,000 which will vest to the extent that a TSR hurdle is passed in the four-year period to 31 December 2027. One half of the rights will vest if Iluka equals the TSR performance of the comparator group with the balance vesting proportionate to its performance exceeding the comparator group by 75%. The number of rights has been determined using the same VWAP of $7.10.

Whilst the ASA would prefer all companies to adopt a 5-year period, Iluka operates in a competitive environment where it is necessary to remunerate at market rates to attract and retain skilled and experienced executives, particularly when entering a new field of endeavour – ie rare earths.

Resolution 6 Appointment of KPMG as auditor in place of PWC (for)

Iluka put their audit out to tender in 2023 and the tender was won by KPMG. There are arguments for and against the rotation of audit appointments and we have no reason to oppose this resolution.

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Appendix 1
Remuneration framework detail

The 2023 Executive Incentive Plan provided for the managing director to earn benefits to the value of $4.2m at target (300% of base) and $4.76m at maximum (340% of base) from a fixed pay (base pay + superannuation) of $1.4m as shown in the table below.

Non-executive directors' fees were unchanged in 2023. Executive KMP fixed salaries were unchanged form 2022 levels, including the MD's.

MD rem. framework for FY23	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed remuneration	1.4	33.33%	1.4	29.41%
STI - cash	0.56	13.33%	0.84	17.65%
STI – restricted shares	0.56	13.33%	0.84	17.65%
LTI – performance rights	1.68	40.00%	1.68	35.29%
Total	4.2	100.00%	4.76	100.00%

Other executive key management personnel had a remuneration structure of a similar nature to the managing director but to a target of 250% and a maximum of 280% of base pay.

The amount of the allocation of restricted shares is based on assessed performance in the 2023 financial year as determined by a scorecard for each executive. The company-wide performance achieved was assessed to be 99% of target then further modified by individual performance factors leading to the MD's award being 104% of maximum, and other executive KMP between 103-105% of target.

The incentive element of remuneration is split between restricted shares (to vest in equal instalments over 2 years commencing in 2025 without further testing) and performance rights (to be assessed against a TSR objective of minimum 50% and maximum 75% of a comparator group of companies based on the S&P 200 Resources Index over the 4 years commencing in 2024 and concluding at 31 December 2027). Both types of rights are awarded using average actual share prices to determine the number of rights allotted. Dividends are paid on restricted shares during the disposal restriction period. Dividends are not paid on Performance Rights.