

South32 awaits appeal decision on Worsley's future

Company/ASX Code	South32 Limited/S32
AGM time and date	12 noon AWST, Thursday, 24 October 2024
Location	Perth Convention and Exhibition Centre, 21 Mounts Bay Road, Perth, WA
Registry	Computershare
Type of meeting	Hybrid – online at https://meetnow.global/S32AGM2024
Monitors	John Campbell & Alan Dickson
Pre-AGM Meeting	with chair Karen Wood & NED Wayne Osborn

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

1. How we intend to vote

No.	Resolution description	
2	Re-election of director Wayne Osborn	For
3	Election of director Sharon Warburton	For
4	Adoption of the FY24 Remuneration Report	For
5	Grant of Options to Executive Director	For
6	Approval of leaving entitlements	Against

NOTE: South32 reports in **US dollars** and all amounts in this report are in **US\$** unless stated to the contrary.

2. Summary of Issues and Voting Intentions for AGM

- The EPA's conditions of approval for the next phase of bauxite mining for the Worsley Alumina Refinery were handed down in early July 2024. The conditions are deemed impractical by South32, and this has resulted in a post-tax impairment of \$388m. Whilst an appeal process is underway and could result in the write-back of the impairment if successful, perhaps the writing is on the wall for strip mining bauxite in both local hardwood and equatorial forests. It can be seen as a dichotomy between forest conservation to save the lungs of the world and the need for aluminium as a commodity essential for a low-carbon future. South32 is confident that its rehabilitation of disturbed land is adequate to rebuff the conservation argument.
- The entry of Indonesia as a major source of nickel has reduced the price of the metal to a level where South32 has found it necessary to charge profit and loss with a post-tax impairment of \$248m for its Cerro Matoso nickel mine in Colombia – a study is underway to determine if it should continue in operation.

- Whilst there was a release of a previous impairment at the Illawarra coal segment prior to completion of its sale post-balance date, the two foregoing post-tax impairments to Worsley and Cerro Matoso totalling \$636m are the main factors responsible for converting \$380m in underlying earnings into a net loss of \$203m after tax. We agree that these factors are outside management's control.
- Last year we voted against the remuneration report and in consequence against the allocation of rights to CEO Graham Kerr mainly on the grounds that we did not believe that executives should gain bonus rewards for financial measures when net profit was negative. Last year underlying earnings of \$916m were similarly converted to a net loss after tax of \$197m by a \$1300m impairment to the Hermosa Project. We believed that there was considerable debate about the extent to which this impairment was within or outside management's control and our vote against the remuneration report reflected this view. As the impairments this year were caused by factors outside management's control, and because we have no significant issue with the structure or management of remuneration, we are inclined this year to support the report and the allocation of rights to the CEO.

3. Matters Considered

Accounts and reports

Financial performance

(As at FYE)	2024	2023	2022	2021	2020
NPAT (\$m)	-203	-173	2669	-195	-65
UPAT (\$m)	380	916	2602	489	193
Share price (A\$)	3.66	3.76	3.94	2.93	2.04
Dividend (US cents)	3.6	21.9	14.2	2.4	5
Simple TSR (%)	-1.70%	3.70%	47.10%	48.10%	-34.90%
EPS (US cents)	-4.5	-3.8	57.4	-4.1	-1.3
CEO total remuneration, actual (A\$m)	7.935	3.377	4.287	3.6	3.216

Simple TSR is calculated by dividing change in share price plus dividend paid during the year, excluding franking, by the share price at the start of the year. The dividend is converted to 5.59 Australian cents for this purpose.

South32 is a diversified miner:

- **Bauxite/Alumina** – South32 has two operations, Worsley Alumina in Western Australia and the Alumar alumina refinery in Brazil, the latter which includes an equity accounted interest in the Mineracao Rio do Norte (MRN) bauxite mine. They contributed underlying EBIT of \$131m and share of loss of \$11m, respectively (FY23 - EBIT \$68m & loss \$45m), before the post-tax impairment of \$388m against Worsley due to EPA's ruling on its mining plans as referred to above. Worsley's EBIT result improved mainly through lower raw material costs for caustic soda but throughput was well below nameplate capacity of 4.6m

tonnes. Conversion of its boilers from coal to gas together with other planned emission-saving measures are expected to enable the refinery to keep within Safeguard Mechanism emission limits, but supply of bauxite is a major issue given the current EPA requirements which South32 believes are impractical.

- **Aluminium** – South32 has Hillside, a wholly-owned aluminium smelter at Richards Bay in South Africa, a partly owned and operated subsidiary Mozal Aluminium (63.7%) in Mozambique, and an interest in Brazil Aluminium (40%). They contributed underlying EBIT of \$130m and share of losses of \$30m and \$121m respectively (FY23 – \$191m, \$56m and loss \$136m). Hillside’s throughput was similar to FY23, with lower realised prices more than offsetting lower costs although Brazil’s smelter achieved a better result than in FY23 through more production.
- **Copper** – South32 has a 45% interest in the Sierra Gorda open pit mine producing a low-grade copper ore which averaged 0.36% copper in FY24, but also includes molybdenum, gold and silver. The non-operated operation contributed underlying EBIT of \$143m compared to \$217m in FY23 due to a number of factors.
- **Lead/Silver/Zinc** – South32 has a mine and processing plant at Cannington, Qld and an advanced development project at Hermosa, Arizona, both wholly-owned and operated. Ore produced at Cannington was lower grade than in FY23 but underlying EBIT improved from \$142m to \$206m due to better commodity prices. The Hermosa development contributed an EBIT loss of \$28m with capex being \$372m to advance the project.
- **Nickel** – The 99.9%-owned Cerro Matoso project in Colombia recorded a fall in underlying EBIT from 189M in FY23 to \$35m in FY24 before the post-tax impairment of \$248m because of low commodity prices for nickel, as referred to above. Realised nickel prices for the operation averaged \$6.17/lb in FY24 compared to \$7.76/lb last year. South32 is conducting a strategic review of the Cerro Matoso operation to determine if it should be put on care and maintenance.
- **Manganese** – South32 has two operations, the 60%-owned and operated subsidiary Groote Eylandt Mining Co in NT and a 54.6% interest in Hotazel Manganese Mines and 60% interest in Metalloys smelter, both in South Africa. Groote Eylandt was struck by a severe cyclone in March which flooded its mines, and damaged other infrastructure including a ship alongside the wharf causing major damage. Its underlying EBIT contribution reduced from \$266m in FY23 to \$61m in FY24 mainly in consequence of the event. Although partly self-insured, the damage claim has been accepted by the insurers but quantification and consequential loss will take some time to determine. The mine is still inoperable at this time and infrastructure needs continuing repairs to enable shipments to resume. The South African operation contributed a steady underlying EBIT contribution of \$45m.
- **Coal** – In FY21, South32 disposed of its South African energy coal assets and in FY24, it negotiated to sell its Illawarra coking coal assets to GM3, the sale being concluded post-balance date. Illawarra Coal contributed underlying EBIT of \$441m in FY24 compared to \$714m in FY23.

After equity accounting adjustments and inter-company eliminations, underlying EBIT in 2024 was \$886m by comparison to FY23 \$1616m. Net finance costs \$249m (FY23 \$188m), tax expense \$223m (FY23 \$457m), and royalty tax expense of \$36m (FY23 \$55m) reduced FY24

earnings to \$380m (FY23 \$916m) before impairments and other adjustments of \$583m (FY23 \$1089m) converted this to net loss of \$203m (FY23 \$173m).

Cash flow from operations was similar to FY23 at \$1,119m but was more than absorbed by capital expenditure and other investing activities, repayment of borrowings and dividends paid with the result that cash balances reduced from \$1258m to \$842m at balance date. Overall, a disappointing year from a shareholder perspective and we were surprised to see that the board has decided to pay a final dividend of US3.1cps (FY23 3.2c) equivalent to 4.6 Australian cents costing \$140m. In substance, as there are no profits in either of the last two financial years, dividends represent a return to shareholders of part of the cost of their investment.

We now have two major concerns:

- **Worsley** – Much depends on the outcome of the appeal against the EPA’s conditions to be applied to future bauxite mining areas and any ministerial directions which follow from that. The aluminium chain is a major asset of the group and curtailing or abandoning bauxite production would impact the long-term prospects of the group significantly.
- **Hermosa** - As in each of the FY20 to FY23 years, concern remains with the \$1.4 billion net assets of the Hermosa Project (after FY23 impairment of \$1.3 billion). The final investment decision for Hermosa has now been made in favour of mining the Taylor lead/zinc/silver deposit. Much depends on the profitability of the project once final approvals are in place whilst work continues to appraise the Clark manganese deposit. Recent news of the offer of a \$166m grant from the US Government for the construction of a manganese refinery for Clark will assist in getting this project to the approval stage.

Governance and culture

The board is chaired by Karen Wood, who is an independent non-executive director with a long history of employment with BHP. Karen retired from BHP in 2014 and joined the board of South32 in November 2017. Of the remaining 8 independent non-executive directors at balance date, 4 remain from those appointed at the time of demerger from BHP in 2015 and one of those, Keith Rumble, is standing down at the AGM. Wayne Osborn, the only director to stand for re-election this year has advised that this will be his last term as a director if elected. Both Karen Wood and Xiaoling Liu were re-elected for new 3-year terms last year and Frank Cooper and Futhi Mtoba in 2022, with the other 3 NEDS all appointed during calendar 2023. All directors meet the ASA’s guideline of holding shares to the value of their annual board fees except for Jane Nelson (appointed May 2023) and Sharon Warburton (appointed November 2023).

The company’s culture has a major focus on safety which was rewarded by a fatality-free year in FY24. We have no significant concerns on governance.

Key events

The key events were the handing down of the EPA’s conditions for permitting future bauxite mining areas for Worsley, the Groote Eylandt cyclone damage, the go-ahead for the mining of the Taylor deposit at Hermosa, and the sale of Illawarra Coal, which have been commented upon above.

Key board or senior management changes

The appointment of Sharon Warburton as an independent NED in November 2023 was the only change to the directorate since the 2023 AGM. Jason Economidis' employment was changed from South32 to Illawarra Coal upon conclusion of sale terms to GM3 in March 2024 – he was previously chief operating officer Australia, and was succeeded by Vanessa Torres. This was the only change in executive KMP.

Sustainability/ESG

Sustainability and conservation of natural and heritage assets remain a major focus of community and investor concern. South32 has a well-established risk management framework and uses Global360 software to collect real time data to determine materiality of risk. The data is used to make adjustments to the way twelve identified strategic risks are addressed. South32 has published a sustainable development report and databook as separate documents but whilst the annual report contains references to them, we would have preferred to see a short and succinct summary of emissions and waste management results in the divisional reports within the annual report. As a further comment on what the already long annual report does NOT contain, we would like to see a five-year financial summary, comprehensively covering all financial and remuneration measures.

The sustainable development report is light on detail of how planned emission reductions will be achieved as a lot depends upon the ability of electricity suppliers in the various locations converting their generating capacity from coal or gas to renewable sources.

The sustainable development report discloses that South32 generated 20.3m (FY23 21.7m) tonnes of Scope 1 and Scope 2 CO₂-equivalent emissions from its operations in FY24 comprising those generated from its own operations and from the generation of purchased electricity, whilst its Scope 3 (value chain) emissions total 54.2m (FY23 65.0m) tonnes CO₂-equivalent, making it a sizeable contributor to global totals.

We recommend that shareholders read the sustainable development report which incorporates information about South32's steps to combat climate change. Many of the group's operations inevitably cause detriment to the environment because mining and refining operations produce emissions and waste. Minimisation of these impacts and subsequent rehabilitation of the environment is fundamental to sustainability and there are concerns about South32's damage to native forests in Australia and Brazil and its legacy of toxic tailings from bauxite operations in particular.

4. Rationale for Voting Intentions

Resolution 1 - Re-election of director Wayne Osborn (For)

Wayne Osborn is an electrical engineer, former CEO of Alcoa in Australia and has served as chair of the remuneration committee since demerger. He was a non-executive director of Wesfarmers Ltd until 2021, is resident in Perth and has adequate skin in the game. He is not over-committed in terms of governance guidelines about the number of directorships which may be held. He brings appropriate skills and experience to the adequately diversified board. We support his re-appointment.

Resolution 2 - Election of director Sharon Warburton (For)

Sharon Warburton was appointed a director in November 2023, this being the fourth listed company board on which she is a NED – she is chair of Wesfarmers’ audit and risk committee, and board member of Northern Star and Worley Ltd. She is also a board member of two unlisted companies and an Aboriginal corporation, and she is an adjunct professor at Curtin University. She is close to being over-committed but we understand her capacity and diligence are exemplary. She has good credentials as a chartered accountant with extensive commercial experience in executive roles. She was awarded Western Australia Telstra Business Woman of the Year in 2014. We support her appointment.

Resolution 3 - Adoption of the FY24 Remuneration Report (For)

Remuneration of executive key management personnel cost South32 \$A14.0m in FY24 (FY23 - \$A10.4m) by the statutory measure set out on page 105 of the AR. By comparison, ‘take-home pay’ for the nominated executives per page 86 was \$A17.8m (FY23 \$A10.0m as disclosed in the 2023 annual report). Apart from changeover of personnel, the major increase in take-home pay was the partial vesting of the FY21 LTI to Executive KMP, including Graham Kerr’s FY21 LTI valued at \$A3.3M. In addition, his actual STI paid also increased from \$A1.4m in FY23 to \$A2.6M in FY24.

As stated in the opening paragraphs, last year we voted against the remuneration report and in consequence against the allocation of rights to CEO Graham Kerr mainly on the grounds that we did not believe that executives should gain bonus rewards for financial measures when net profit was negative. This year, an underlying profit of \$380m was converted this to net loss of \$203m by impairments for Worsley and Cerro Matoso (net of credits for Illawarra Coal) of \$583m. We accept that these impairments arose from events outside management’s control. Last year underlying earnings of \$916m were similarly converted to a net loss after tax of \$197m by a \$1300m impairment to the Hermosa Project. We believed that there was considerable debate about the extent to which this impairment was within or outside management’s control and our vote against the remuneration report reflected this view. Whilst we would still prefer there to be a positive net profit gate before management gained bonuses from financial measures, we think it would be too harsh to apply this where profits are hit by the effects of events outside management’s control. Our concerns with the structure or management of remuneration are relatively minor and are set out in the appendix, so we are inclined this year to support the report.

Resolution 4 - Grant of Options to Executive Director (For)

The resolution seeks to approve the FY25 LTI grant to Graham Kerr of 1,128,065 (FY24 LTI – 1,047,894) share rights which had a face value on 1 July 2024 of A\$4.14m (last year A\$3.98m), being his maximum opportunity for long-term incentive, together with share rights with a face value of A\$1.306m (FY23 A\$0.719m) for the equity component of his FY24 short term incentive. If approved by shareholders, the STI share rights will be granted as determined by the average face value of South32 shares for the relevant period in December 2024. The awards are in accordance with the remuneration structure set out in the remuneration report.

There is no performance hurdle for the deferred STI share rights, which will vest at the end of the two-year deferral period, subject to service, dealing and forfeiture conditions. Vesting of the STI rights is expected to occur following the release of the Company’s full year results for FY26 (i.e. in August 2026). Vesting of the LTI rights will be determined at the time of the release of the Company’s full year results for FY28 (i.e. in August 2028). The LTI rights will only vest to the extent

performance conditions have been satisfied as to 80% being TSR vs two comparator indices, and 10% as to climate change achievement, and 10% as to portfolio management. The rights will vest based on South32's achievement of an adequate TSR as specified for the two indices and performance at least meeting targets on climate change and portfolio management.

We do not object to the principles by which these awards have been determined and will vote in favour of the resolution.

Resolution 5 - Approval of leaving entitlements (Against)

The Corporations Act places a limit of 12 month's fixed pay on termination unless otherwise approved by shareholders. ASA opposes pre-approval of termination benefits which exceed 12 months' fixed pay except where payment of vested STI or LTI awards are likely to push a termination payment in excess of the 12 month limit. The approval sought is generalised and not restricted to the vesting of incentives or to particular employment conditions applicable to death or disablement of an executive. New contracts should not contemplate such pay outs in excess of 12 months' fixed pay, and specific (not generalised) approval should be sought before the event if such payments are considered necessary. If boards are concerned a termination payment will not be approved by shareholders, they will be less likely to approve them in the first place.

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Appendix 1

Remuneration framework detail

The remuneration report is stated in Australian currency and all amounts below are A\$.

The amounts in the table below 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. Maximum opportunity is the capped amount (based on share price at date of grant) which would be earned if all targets were well-exceeded. In the event, only part of the STI was approved and the FY21 LTI was only partly vested in FY24.

CEO rem. Framework for FY24	Target \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.991	29.4%	1.991	20.8%
STI - Cash	1.195	17.65%	1.792	18.75%
STI - Equity	1.195	17.65%	1.792	18.75%
LTI	2.389	35.3%	3.982	41.7%
Total	6.770	100.00%	9.557	100%

Whilst long, the remuneration report is to be commended for its clarity and layout, making it comparatively easy for the reader to assess the nature and fairness of the remuneration structure. We particularly commend the provision of information on page 90 of the annual report comparing the CEO's fixed and total remuneration with peer companies. The structure of executive remuneration follows well-established precedent of a fixed salary, short-term incentive split between cash and deferred equity on a 50/50 basis, and a long-term incentive on a 4-year appraisal period. There has been no change to the plan for FY24.

Fixed remuneration was increased for both FY24 (generally 4.5%) and FY25 (4-6%). Cumulatively the increases give Mr Kerr a 8.5% increase over the two years and bring his salary to \$2.07m. Whilst at the top of the range for WA-based companies, this must be gauged against other large mining companies and reflects Mr Kerr's length of service in the role. Based on the information in the annual report and the fixed remuneration of BHP and Rio Tinto CEO's, Mr Kerr's package seems reasonable. South32 is a global mining company with high-risk operations with respect to both employees and neighbouring communities, and with its terms of trade basically out of management's control because of their reliance on commodity prices and currency exchange rates. This will need reassessment if South32 continues to sell off segments but seems fair enough for now.

Total executive KMP remuneration on the accounting standards basis (ie accruing equity awards at fair value over their duration between grant and vesting) was \$A14.08m (FY23 - \$10.35m), most of the apparent difference being due to new members of the KMP team not being in place throughout FY23. There were no significant changes to the terms of executive remuneration apart from fixed pay increases. Although the cost of non-executive director remuneration increased from \$A2.105m to \$A2.721m, there were no increases in non-executive directors' fees in FY24.

Travel and other allowances for non-executives increased from \$195k to \$290k reflecting the 2023 appointments of Carlos Mesquita and Jane Nelson who are both based in the Americas.

For the short-term incentive, executives were assessed as having performed slightly below target on all measures except Environmental and Social, where they scored 11.8% ex target of 10%. They were assessed at 23.3% out of 25% for safety and culture, 48.9% out of 57.5% for financial measures and 7.1% out of 7.5% for strategic delivery, giving them a scorecard score of 91.1% of target. Financial measures use a form of underlying earnings as the basis of calculation, applying budget commodity prices and exchange rates to actual outcomes to address the non-controllable effect of these factors from the calculation which also excludes impairments such as those for Worsley and Cerro Matoso this year and Hermosa last year. The remuneration plan allows for a board modifier to adjust the amount of short-term incentive to reflect overall business outcomes. For FY24, the board decided that no modification to the assessed scores was appropriate as the factors significantly affecting the results were outside management's control. Last year, the board considered the Hermosa impairment and the death of two employees at the Mozal aluminium refinery to be relevant in assessing the modifier and a negative business modifier was applied by the board. A personal performance rating of 88 to 135% was applied (CEO's factor was 120%). The overall outcome was that the total STI awarded was \$A5.642m (FY23 - \$3.724m) to Executive KMP.

As stated earlier in the voting intentions, we think that if underlying earnings are used as the hurdle for short-term incentives, there should be a threshold hurdle of an increase in statutory profit after tax (NPAT) before executives qualify for STIs. As the impairments this year were caused by factors outside management's control, and because we have no significant issue with the structure or management of remuneration, we are inclined this year to support the report and the allocation of rights to the CEO.

For the long-term incentives eligible to vest in full in FY24, the company's TSR for the four-year period 1 July 2020 to 30 June 2024 was to outperform the two TSR indices by at least 23.9% (or 5.5% per annum cumulative). To achieve vesting, the TSR must equal or exceed the TSR of two comparator groups, one being the chosen group of international mining companies and the other being the international MSCI index of large companies. The result on page 97 of the AR shows that South32's TSR fell short of the vesting threshold of the global mining company index (two-thirds of the award) by just 2%, whereas it beat the general MSCI index (one-third of the award) by 30% achieving one-third vesting of the award. This is the first time since FY19 that the LTI has been awarded and resulted in a 'take-home' benefit of A\$3.289m for Graham Kerr, of which A\$1.474m arises through the increase in value of South32 shares since the award of rights was determined in FY21.

We have two other concerns over the remuneration structure of a relatively minor nature as follows:

- the lack of a second hurdle to TSR in the financial yardsticks for the LTI incentive – we prefer to see a second absolute hurdle such as growth in earnings per share;
- travel allowances paid to non-executive directors which we still view as inappropriate. We are cognisant that both BHP and Rio Tinto have similar methods of compensating their non-executive directors for board travel and that there are significant calls upon their time involved in meeting their obligations.