Australian Shareholders' Association

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Commodity prices boost S32 earnings

Company/ASX Code	South32 Ltd (S32)
AGM date	Thursday 27 October 2022
Time and location	12 noon AWST - Hybrid/Level 17, 108 St George's Terrace, Perth
Registry	Computershare
Webcast	Yes – hybrid via https://meetnow.global/S32AGM2022
Poll or show of hands	Poll on all items
Monitor	Alan Dickson assisted by John Campbell
Pre AGM Meeting?	Yes with Chair Karen Wood and Wayne Osborn, chair REM committee

The individuals (or their associates) involved in the preparation of this voting intention have a shareholding in this company.

Summary of issues for meeting

South32 is asking shareholders to approve its climate change action plan – see item 5 below. This is an innovative move by a company's board which is very concerned about the impact of the company's operations on the environment.

Buoyant commodity prices have driven a record result for South32 in 2022, with net profit of US$2,669m, more than double that of its previous best year in 2018. Its total dividend from 2022 results of US25.7c (interim dividend 8.7c, final dividend 14c and special dividend 3c) paid as AUD 37.08c eclipses the total 2021 dividends of US6.9c/AUD9.3c.

Proposed Voting Summary

No.	Resolution description	
2	Re-election of Frank Cooper AO and Dr Futhi Mtoba as Directors	For
3	Adoption of Remuneration Report	For
4	Grant of awards to Executive Director Graham Kerr	For
5	Advisory vote on climate change action plan	For

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required
Currency	**The annual report is prepared in US dollars, being the functional currency of South32. All amounts stated in this section of the voting intentions are in US dollars unless stated to the contrary.**

Summary of ASA Position

Financial performance

Being a globally diversified mining and metals company, South32 is a price-taker at the mercy of international commodity prices, exchange rates and international tensions such as those between China and Australia. The earnings analysis chart on page 42 of the annual report provides a graphic illustration of the impact higher commodity prices had in driving the year's underlying EBIT from $1,039million in FY21 to $3,967million in FY22.

Prices were strong for all commodities produced except for silver which suffered a 17% decrease in average realised price in FY22. By comparison, metallurgical coal (used in steel production) increased 231% in average realised price and most other commodities quoted prices were 30-40% better than FY21. Since year-end, most metal prices have slipped somewhat but relevant currencies have also fallen in value as against the US dollar reducing South32's cost of production in USD terms, so the September 2022 Quarterly Production report due out about the time of the AGM will be interesting.

In comparing the 2022 results with 2021, there were no one-off items affecting FY22 results, but FY21 results were impacted by two major one-off items:

- a decision by the NSW Independent Planning Commission to refuse an application for the Dendrobium Next Domain (DND) project at Illawarra Metallurgical Coal led South32 to impair the carrying value of its mine property and associated equipment to the extent of $728m pre-tax/$510m after tax, and
- South32 incurred a loss on disposal of its interests in South African Energy Coal (SAEC) $159m pre-tax; together with operating losses at SAEC for the year of $194m after tax, SAEC cost the group $337m in 'bottom line'.

Following recently completed studies South32 has decided not to proceed with the DND plan and source coal from other areas of their leases. Production from the complex is anticipated to be 7.4Mt in FY23 and then reduce to 5.5Mt from FY24 to FY28.

Net cash flow from operating entities was strong at $3,070m (FY21 $1,405m), reduced by the acquisition of Sierra Gorda copper (45% interest) for $1,420m, and other capex and investing activity $665m (FY21 $608m), but South32 continued its share buy-back programme spending $128m (FY21 $346m) and paid dividends of $660m (FY21 $115m) leaving an increment to net cash of $760m (FY21 $296m). At balance date, South32 had cash and cash equivalents of $2,365m (FY21 $1,613m). The Board to pay a final ordinary dividend and special dividend of $337m (FY21 257m) which will be paid in October.

As in FY20 and FY21, our main concern remains with the $2,031m net assets of the Hermosa Project. We note that prior to a Final Investment decision that the Hermosa deferred expenditure on the zinc, lead, silver and manganese deposits may need to be impaired if that final investment decision due in mid-2023 is adverse. It seems we shall have to wait another year to find out if this project is a rose or a lemon. We also await the announcement of reserves and resources at the Sierra Gorda mine once these have been recalibrated to JORC reporting standards.

ESG, governance and culture

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 sustainability report and data book 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. For comment of the sustainability report, see item 5 below. 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 board is chaired by Karen Wood, who succeeded David Crawford in 2019. She 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. There are 6 other independent non-executive directors and a single non-independent director, the CEO, Graham Kerr. All directors have significant skin-in-the-game.

Key events such as restructures, acquisitions, buy backs and capital raisings

The major event of the year was the acquisition of a 45% interest in the Sierra Gorda copper mine in Chile. This is an open-pit mine with a processing plant producing copper and molybdenum concentrates. The direct cash costs relating to the acquisition of $1,421million were mainly documented as the discounted purchase of a shareholder loan requiring somewhat complex accounting in accordance with accounting standards (see page 162) of the Annual Report. In 4 months of ownership, the associate contributed $75m in underlying EBIT on a proportionately consolidated basis. South32 acquired a liability to Dutch taxation of US$156m of which US$130m arises from pre-acquisition tax liabilities and a dispute has arisen with the vendor as to who should bear this expense.

Key board or senior management changes

There were no changes to the board in FY22 or since. Noel Pillay was appointed Chief Operating Officer Africa & Colombia from 1 December 2021 to replace Mike Fraser and Jason Economidis, who was appointed acting Chief Operating Officer Australia in 2020, was confirmed in that role.

Summary

(As at FYE)	**2022**	**2021**	**2020**	**2019**	**2018**
NPAT (USDm)	2,669	(195)	(65)	389	1,332
UPAT (USDm)	2,602	489	193	992	1,327
Share price (AUD)	3.94	2.93	2.04	3.18	3.61
Dividend (US cents)	25.7	6.9	3.2	9.6	13.5
TSR (%)	47.1%	48.1%	(34.9%)	(7.65%)	41.99%
EPS (US cents)	57.4	(4.1)	(1.3)	7.7	25.8
CEO total actual remuneration, (AUDm)	4.287	3.600	3.216	13.195	7.839

For 2022, the CEO's total actual remuneration was **46 times** (FY21 39 times) the Australian Full time Adult Average Weekly Total Earnings (based on May 2021 data from the Australian Bureau of Statistics).

Item 2(a)	**Re-election of Mr Frank Cooper, AO as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Cooper, appointed in 2015, is a chartered accountant with a distinguished professional background in Perth and has been a director of Woodside Energy Group Ltd since 2013. He has a number of unlisted non-executive roles including commissioner and chair of the State Insurance Commission of Western Australia, pro-chancellor of the University of Western Australia, and a director of St John of God Australia Limited. Mr Cooper is the Chair of the Risk and Audit Committee.

Item 2(b)	**Re-election of Dr Ntombifuthi (Futhi) Mtoba as a Director**
ASA Vote	**For**

Summary of ASA Position

Dr Futhi Mtoba, appointed in 2015, is also a distinguished accountant having chaired Deloitte in Southern Africa. She is deputy chair of the Public Investment Corporation Ltd of South Africa and chair of its audit committee. She is also a director of Discovery Bank. She is a member of the International Monetary Fund's Advisory Group for Sub-Saharan Africa, the World Economic Forum Advisory Council and the United Nations Global Compact Board. She is a member of the nomination and governance and risk and audit committees.

Item 3	**Adoption of Remuneration Report**
ASA Vote	**For**
Currency	**The remuneration report is stated in Australian currency and all amounts below are AUD**

Summary of ASA Position

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 84 of the annual report comparing the CEO's fixed and total remuneration with peer groups. 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.

Total executive KMP remuneration on the accounting standards basis (ie accruing equity awards at fair value over their duration between grant and vesting) was A$15.0m for FY21 compared to A$13.6 as reported in last year's annual report. A number of changes were made to the remuneration plan for the CEO for FY22 of which the most significant is to reduce the multiple for the maximum long-term incentive from 3 times fixed pay to twice fixed pay. We are pleased to see this change take effect. Another change to the LTI was to introduce performance measures for climate change and portfolio management, with each being given a 10% weighting in the total assessment of the incentive. There were consequential adjustments to STI weightings of short-term performance measures. The overall structure of the CEO's remuneration is set out in Appendix 1. Other executive Key Management Personnel have similar structure with a higher percentage of fixed pay and lower incentives.

As regards the overall level of executive pay and the CEO's pay in particular, we recognise that 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. South32 justifies the level of executive remuneration on the basis of the nature of its business and international competition for executives of their calibre and the disclosed information as to peer group comparison provides support for South32's position.

For the short-term incentive, executives were assessed as having performed better than target for sustainability and strategic achievements, on almost on target for financial and production measures, and under target for return on invested capital, with an overall outcome on business measures of 99.6% of target. Due to the unfortunate death of a contractor at a South African site, a negative business modifier was applied by the board of 20% to the CEO and COO Africa at that time, and between 5% and 20% for other KMP, whereas a personal performance rating of 100% or better was applied. The overall outcome was that the total STI awarded was $5.608m compared to a possible total of $7.726m (see page 90).

As regards the long-term incentives eligible to vest in 2022, the company's TSR fell short of the hurdle represented by comparator indices. The global mining company index, against which two-thirds of the award was based, achieved a TSR of 88% over the 4 years to 30 June 2022, whereas the general MSCI index (one-third of the award) achieved TSR of 44%. South32's TSR for that period was 37% so the LTI benefits lapsed.

We have two 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. The amount of travel allowances paid in FY22 was insignificant.

Item 4	**Approval of grant of share awards to Executive Director Graham Kerr**
ASA Vote	**For**

Summary of ASA Position

The resolution seeks to approve the grant to Graham Kerr of 934,313 (last year – 1,267,015) share rights which had a face value on 1 July 2022 of A$3.81m (last year - A$3.63m), being his maximum opportunity for long-term incentive, together with share rights with a face value of A$1.215m (FY21 - A$0.879m) for the equity component of his FY22 short term incentive. The STI share rights will be granted as determined by the average face value of South32 shares for the relevant period in

December 2022 if approved by shareholders. The awards are in accordance with the remuneration structure set out in the remuneration report and commented upon by us in these voting intentions.

There is no performance hurdle for the deferred STI share rights, 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 FY24 (i.e. in August 2024). Vesting of the LTI rights will be determined at the time of the release of the Company's full year results for FY26 (i.e. in August 2026).

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 a TSR equal to or greater than the indices and the CEO meeting his targets on climate change and portfolio management.

Item 5	**Advisory vote on Climate Change Action Plan**
ASA Vote	**For**

Summary of ASA Position

We have no reason to vote against the company's climate change action plan which has been reviewed by the company's auditors. It 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 sustainability report discloses that South32 generated 21.0m (FY21 20.7m) tonnes of Scope 1 and Scope 2 CO_2-equivalent emissions from its operations in FY22 comprising those generated from its own operations and from the generation of purchased electricity, whilst its Scope 3 (value chain) emissions total 67.4m (FY21 61.5m) tonnes CO_2-equivalent, making it a sizeable contributor to global totals. We see a shortcoming in that the company's Sustainability Report does not address emissions on an operational basis with the short and longer-term targets for each operation and progress towards meeting them.

We recommend that shareholders read the sustainability report in full which incorporates the climate change action plan. 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 (if it is appropriate for shareholders to vote on such matters) we would prefer to be voting on the overall scenario than simply the climate change impacts.

Appendix 1
Remuneration framework detail

CEO rem. Framework for FY22	Target* AUD $m	% of Total	Max. Opportunity AUD $m	% of Total
Fixed Remuneration	1.815	29.4%	1.815	20.8%
STI - Cash	1.089	17.6%	1.634	18.8%
STI - Equity	1.089	17.6%	1.634	18.8%
LTI	2.178	35.3%	3.630	41.7%
Total	6.171	100.0%	8.713	100%

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