

Austal's \$50m penalty for misreporting results

Company/ASX Code	Austal Limited/ASB
AGM time and date	2pm AWST Friday, 1 November 2024
Location	Fremantle Sailing Club, 151 Marine Terrace, Fremantle
Registry	Link Market Services
Type of meeting	Physical meeting with passive webcast - https://webcast.openbriefing.com/asb_agm_2024
Monitor	John Campbell assisted by Ros Ferguson
Pre-AGM Meeting	Requested

Monitor Shareholding: The individuals and their associates involved in the preparation of this voting intention have no shareholding in this company.

1. How we intend to vote

No.	Resolution description	
1	Adoption of the Remuneration Report	For
2	Election of Kathryn Toohey AM CSC	For
3	Election of Hon Richard Spencer	For
4	Election of Brent Cubis	Undecided
5	Approval of issue of share rights to Lee Goddard CSC	For
6	Approval of issue of share rights to Kathryn Toohey AM CSC	For
7	Approval of issue of share rights to Brent Cubis	Undecided
8	Approval of issue of share rights to Sarah Adam-Gedge	For
9	Approval of issue of LTI rights to Patrick Gregg	For
10	Approval of issue of STI rights to Patrick Gregg	For

2. Summary of Issues and Voting Intentions for AGM

- In August, Austal Limited (Austal) (ASX: ASB) advises that it had reached a global resolution with both the US Department of Justice (DoJ) and the US Securities Exchange Commission (SEC) to resolve previously disclosed investigations into the events leading up to the write back of work in progress (WIP) in July 2016. The investigations focused on the actions between 2013 and 2016 of former Austal USA employees to misstate Austal USA's performance and financial condition in Austal USA's financial statements that were

consolidated into the consequential statements and financial reports of Austal Limited. Austal has booked an expense of \$48.1m in FY24 to cover the US\$24m fine/restitution, some legal costs and expected costs of complying with other terms of the settlement. We will ask if Australian shareholders are eligible to share in the SEC's compensatory fund, and what further implications/repercussions have arisen from this calamity.

- There have been a significant number of changes in the board and in senior executives. We will ask why these occurred and if company morale is at a low level.
- Securing adequate work for the three Australasian shipyards continues to be a significant concern for us. We will ask if there is any good news about to break.

3. Matters Considered

Accounts and reports

Revenue for FY24 was \$1,469m compared to FY23 \$1,585m, but disclosed gross profit was \$173m (11.8%) vs \$99m (6.2%). The US segment had revenue of \$1174m and a profit before tax of \$93m whereas in FY23 its revenue was \$1225m and profit before tax \$5m and thus was responsible for the improved result. The FY24 result is after charging the foregoing \$48.1m provision for DoJ/SEC settlement but after crediting \$54m being profit on sale of US land and buildings.

The Australasian segment, comprising Henderson operations in WA together with shipyards in Vietnam and the Philippines and various service facilities, had revenue of \$303M (FY23 \$366m) and a loss before tax of \$13m (FY23 profit \$16m) reflecting under-utilised capacity in all yards.

In the US segment, support operations contributed \$68m and shipbuilding contributed \$25m of the \$93m profit before tax, and in Australasia support contributed a profit of \$10m against shipbuilding losses of \$22m. Corporate overheads and finance costs totalled \$39m in FY 24 (FY23 \$37m) aggregating net profit before tax of \$41m (FY23 loss \$16m) before tax expense of \$26m (FY23 tax credit of \$2m).

In looking at the results, much of last year's poor performance in the US was attributed to the first run of ships built with steel hulls as opposed to Austal's traditional strength in aluminium shipbuilding. Evidently, this has turned around in 2024 with the utilisation and release of an onerous contract provision of \$122m made in FY23 against the line of T-ATS tugboat contracts for the US Navy. This year, an onerous contract provision has been raised for \$29m against the floating dock program. Recently, it has been announced that Austal has been offered a US government grant to build a new facility to manufacture modules for the US nuclear attack submarine construction program and that Austal has won a new contract for submarine modules from General Dynamics, as primary contractor for submarine construction. Overall, Austal has a very impressive US order book provided the ships and modules can be built profitably.

Under-utilisation of Australasian shipyards is still very evident, but the report throws some daylight at the end of the tunnel for commercial ferry construction, where customers had been waiting in vain to find out if technology has advanced in the development of carbon-neutral propulsion systems to replace diesel. Further, Austal has been awarded a contract for building landing craft at Henderson for the Australian military, and it is hoped that its status as an Australian Strategic Shipbuilder will enable it to win naval vessel construction when a determination is made to award contract to replace existing surface warships.

Austal's current price/earnings ratio of 15 times reflects on the one hand the aspiration that earnings will improve to a more substantial level, and on the other the volatility of engineering company earnings by reason of the difficulties of estimating the profitability of unfinished work in hand. The Annual Report (AR) notes relating to impairments and onerous contracts indicate the high sensitivity of estimates to the assumptions made and this amounts to significant risk of misestimation. Austal has liabilities aggregating more than 50% of total assets but this is in part deferred income and borrowings are relatively low. No dividend has been declared for FY24.

Financial performance

(As at FYE)	2024	2023	2022	2021	2020
NPAT (\$m)	14.9	-13.8	79.6	81.06	88.98
UPAT (\$m)	14.9	-13.8	79.6	81.06	88.98
Share price (\$)	2.49	2.37	1.8	2.05	3.23
Dividend (cents)	0	7	8	8	8
Simple TSR (%)	5.1	35.6	-8.3	-34	-3.6
EPS (cents)	4.1	-3.8	22	22.6	25
CEO total remuneration, actual (\$m)	1.701	1.009	1.673	0.989	3.03

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.

Governance and culture

Austal was founded by John Rothwell in 1987, and he has served as CEO, executive chairman and more recently as non-executive chairman. He has handed over the reins to Richard Spencer who is a former US Secretary of State for the Navy with the distinction of having been sacked by Donald Trump. We also see this as a good move from a governance perspective because John Rothwell's long involvement with the company involved a real loss of independence and an independent chair is an important element of governance. Whilst Mr Spencer is not regarded as independent because of advice provided to Austal within the last year by a firm of which he is chair, he is closer to being independent than John Rothwell and may well become formally independent within a short period of time.

The board comprises 5 NEDs, John Rothwell and managing director/CEO Paddy Gregg. There are two women on the board and one in an executive KMP role – Michelle Kruger is president of Austal USA.

Corporate culture must be difficult to instil in a company such as Austal with relatively newly established operations in so many geographic locations. The failures of such culture in the past were laid bare by the DoJ/SEC investigation and penalty for financial misreporting at the US operation in the period 2013 to 2016. It will be a task for board and management to preserve a corporate culture where such failings are truly a thing of the past.

Key events

The settlement of the DOJ/SEC investigation was reported in August 2024 so technically does not qualify as a key event in FY2024 although it must have been a focus of management attention for several financial years. It was forecast in the half-year report that a settlement could involve a penalty of tens of millions of dollars and the installation of a monitor at the company's expense to oversee compliance measures and report to the DOJ on this.

Austal keeps the market well informed on new contracts won and vessels completed and handed over to their new owners.

Key board or senior management changes

The appointment of NED Richard Spencer as chairman has been commented on above. Two directors resigned since last AGM – Michael McCormack who had served as a director for just 4 years and recently Chris Indermaur who has been a director for 6 years. Their places have been taken by Katherine Toomey and Brent Cubis whose qualifications are set out in the notice of meeting as they are standing for election. The former president of Austal USA, Rusty Murdaugh departed the company and was replaced on an interim basis, later confirmed, by Michelle Kruger. Mr Ian McMillan tendered his resignation in July 2024 as chief operating officer Australasia and a replacement is yet to be announced.

Sustainability/ESG

Austal has indicated that it will publish its ESG report prior to the AGM but we have not had the opportunity to review it before publishing our voting intentions.

ASA focus issues (not discussed above or under remuneration report or re-election of directors)

We note that the AGM is not being held as a hybrid meeting to enable shareholders to attend remotely and to ask questions and vote on resolutions. A webcast is to be published on the company's website, but this falls short of our focus issue on fair treatment of shareholders.

We also prefer that the sustainability report is published at the same time as the annual report so as to permit shareholders to assess their investment from both a financial and sustainability perspective.

4. Rationale for Voting Intentions

Resolution 1 Adoption of Remuneration Report (for)

A summary of the remuneration framework is set out in Appendix 1. The report is clear and comprehensive and includes a table of take-home pay. The main exception to ASA guidelines continues to be the Long Term Incentive (LTI) measurement period of 3 years and not the minimum of 4 years required by ASA. However, we do not see this as a sufficient reason to vote against the report so we will support it.

Unlike FY23 when performance failed to meet threshold levels to activate the short-term incentive, STI in cash and share rights totalling \$1,306,801 were awarded to the CEO and other KMP executives. Similarly, one of the threshold levels for the 2022 long-term incentive hurdles was achieved being indexed TSR, and accordingly one third of the LTI rights vested at a value at grant date of \$183,567 (\$522,188 at year—end share price). The hurdles for return on equity or

earnings per share growth were not achieved so the remaining two-thirds of LTI share rights lapsed.

Resolution 2 Election of Katheryn Toohey AM CSC (for)

Ms Toohey was a senior officer in the Australian Army retiring as a major-general in 2023 and was awarded an AM for her exceptional service in capability development and education. Her experience in military procurement will be useful to Austal. Her primary degree is in electrical engineering, and she has no other listed company directorships.

Resolution 3 Election of Hon Richard Spencer (for)

A former US Marine Corps pilot, Mr Spencer had a career on Wall Street in finance in senior executive positions. He served as US Secretary of State for the Navy between 2017 and 2019. He is chairman of Bondi Partners, an advisory firm based in Australia offering strategic counsel and he is managing director of Pallas Ventures which focuses on emerging commercial technologies that have applicability in the national security arena. He has no other listed company directorships. Because Bondi Partner has provided Austal with strategic consulting services within the past 12 months, he is not eligible to be regarded as an independent non-executive director, but this will be reviewed with the passage of time and his experience and contacts will be useful for Austal. As regards the company's past history of non-compliance with corporate law and because Mr Spencer is a resident in the US, we will ask if he is satisfied that he is in a position to be aware of all developments at Austal so as to comply with regulations here and overseas such as continuing disclosure obligations.

Resolution 4 Election of Brent Cubis (undecided)

Mr Cubis is a nominee of Tattarang Ventures Pty Ltd, an Andrew & Nicola Forrest company holding 19.61% of Austal's shares. He is a chartered accountant who has held a number of senior CFO positions in companies including Cochlear and Nine Network. He is currently a non-executive director and audit committee chair of ARN Group and Silverchain Group, and has been in those roles with two delisted media companies. Apart from representing Mr Forrest's interest in Austal, we look forward to hearing him address the AGM to assess whether he will make a positive contribution to the board and assist in improving corporate culture to avoid the mistakes of the past.

Resolution 5 to 8 Approval of issue of share rights to non-executive directors (for)

The share rights are proposed under an existing incentive scheme which enables Non-executive Directors of the Company to progressively acquire a shareholding in the Company with a value equal to his/her total annual base Board remuneration (excluding committee fees). The scheme is an 'employee incentive scheme' for the purposes of the ASX Listing Rules although in order to preserve Director independence, it is not subject to Company performance measures or thresholds.

The issue of Share Rights under this scheme has been approved by Shareholders at each consecutive Annual General Meeting since the 2018 Annual General Meeting. Resolutions 5 to 8 seek Shareholder approval for 4 NEDs to acquire rights to the value of 25% of their base fees on a salary-sacrifice basis.

These share rights proposed for the three non-executive directors form part of the NED remuneration plan and assist these directors to build a stake in the Company up to the target

shareholding equal to annual base Board fees. Shares are purchased at market prices. ASA supports this resolution with reservations in the case of Mr Brent Cubis.

Resolution 9 Approval of issue of LTI share rights to Paddy Gregg (for)

In 2019 the Company established the Austal Limited Rights Plan (the Plan). The Plan is used to grant equity to eligible employees under the STI and LTI provisions. The Plan was approved at Company's 2022 Annual General Meeting. This resolution is required to enable the Company to continue with the grant of Rights under the Plan without using up any of its 15% Placement Capacity under ASX listing rules.

Approval is sought for the grant of up to 446,620 (FY23 446,244) rights to the MD/CEO in respect of the LTI for the 3 years ending 30/6/27. The grant is based on Mr Gregg's fixed remuneration of \$1,094,800 for FY25 (FY24 \$1,054,200) at the maximum opportunity of 100% and the relevant market-based share price of \$2.45 (average July 2024 market price). The share rights vest if performance conditions relating to total shareholder return, earnings per share growth and return on equity are met over the above three-year period. ASA supports this resolution.

Resolution 10 Approval of issue of STI share rights to Paddy Gregg (for)

Similarly, approval is sought for the grant of 104,504 (FY23 – nil) share rights to the MD/CEO representing the 50% of Mr Gregg's short term incentive payment earned in FY24 but which is deferred into equity. The number of STI Rights has been determined by dividing the face value of Mr Gregg's STI payment (\$512,341.20 in total, 50% of which is \$256,170.60) by market-based share price of \$2.45 as for the LTI. The basis of the STI award is set out in the appendix and was achieved by Mr Gregg during FY24. The rights are expected to vest in December 2024 and be converted to restricted shares with a 12-month holding lock. Again, we support this grant of share rights.

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Appendix 1

Remuneration framework detail

The framework is the traditional mix of fixed and at-risk remuneration. A summary of the framework is as follows and the table below sets out the exposure mix for the CEO:

Fixed pay (FR)

Short term incentive (STI)-awarded for the achievement of annual hurdles (set out in AR page 36), paid equally in cash and performance rights, with the equity component subject to a 12-month holding period (the USA President is paid wholly in cash)

Long term incentive (LTI) - awarded with performance rights against hurdles over a 3-year period, with a 12-month holding period. The 3 equally weighted hurdles are Indexed Total Shareholder Return, Earnings per Share Growth and Return on Equity

The incentive awards are determined as a percentage of FR and share entitlements are calculated at market price.

CEO rem. Framework for FY24	Target \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.05	51.3%	1.05	37.4%
STI - Cash	0.24	11.5%	0.36	12.6%
STI - Equity	0.24	11.5%	0.36	12.6%
LTI	0.53	25.6%	1.05	37.4%
Total	2.06	100.0%	2.82	100.0%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan.

The key performance indicators determining the amount of the award are individually set for executives and variously comprise revenue, EBIT, free cash flow, new vessel orders, strategic growth and safety.

The actual results of the STI in FY24 are that the CEO/MD and the CFO both achieved 72% of their target award whilst the president USA Michelle Kruger received 50% of her target award. By comparison in FY23 no STI awards were made because the profit gate applied in the STI plan was not passed – group EBIT needs to be at least 85% of budget for the STI to be awarded.

Similarly, in FY23, no LTI was awarded because none of the hurdles set were achieved. For the 2022 LTI award, the measure of indexed total shareholder return (iTSR) was passed but the other two hurdles, each accounting for one third of the award, were failed – earnings per share growth

and return on equity both being below the level required. The 2022 rights were issued at a value of 88c per right and one third of the number issued vested as at 30 June 2024 – for the CEO this amounted to 153,145 shares which would have been valued at \$134,002 at grant date but at year-end price were worth \$381,331.

Take-home pay has been calculated by the company on page 38 for Mr Gregg at \$1,700,524 for FY234 but this uses the value at grant date for the vested LTI shares – we would prefer to use the value at vesting which would be in the order of the amount shown above and would bring his take-home pay to approx. \$1,950,000 compared to \$1,008,781 for FY23 without any bonus being awarded.