ASX: ILU

Final Class Ruling from ATO

Demerger Accounting and Tax Treatment Explanatory Note

10 December 2020

This note has been prepared to assist investors and equity market analysts modelling the impacts of the Deterra Royalties Limited (ASX:DRR) demerger from Iluka Resources Limited (ASX:ILU). It is a guide only and all figures are subject to change and completion of Iluka's annual audit process.

The demerger of Iluka Resources Limited (Iluka) and Deterra Royalties Limited (Deterra) was implemented on 2 November 2020. The demerger separated Iluka's primarily mineral sands business from the royalty business, the cornerstone asset of which is the Mining Area C royalty.

Under the demerger, 80% of the issued Deterra shares were transferred to eligible shareholders (other than selling shareholders) and the sale agent (for selling shareholders) on a one-for-one basis. Iluka retained a 20% shareholding in Deterra as a long term investment.

On 9 December 2020, the Australian Tax Office published the final class ruling regarding tax treatment of the demerger. The full ruling can be found here ATO - Iluka Resources Class Ruling.

Share Distribution

The number of Iluka shares on issue on 2 November was 422,769,681, unchanged from prior to the demerger.

The number of Deterra shares on issue on 2 November was 528,462,101.

The difference in the number of shares on issue reflects the additional shares required for Iluka to retain a 20% interest in Deterra. Each Iluka shareholder was entitled to one Deterra share for each Iluka share held.

Cost Base Apportionment

The cost base of Iluka shareholders' pre-demerger holdings should be apportioned between their Iluka and Deterra shareholdings based on the following percentage:

Iluka – 54.91%; Deterra – 45.09%

This reflects the Volume Weighted Average Prices (VWAP) for the two entities in the 5 trading days post demerger (23-29 October) of $5.2083 and $4.2771 for Iluka and Deterra, respectively.

Further information on calculation of cost bases in a demerged entity is available from the Australian Tax Office: ATO - Cost Base Calculations

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Demerger accounting guidance

The following section has been prepared to explain the accounting treatment of the Deterra demerger in Iluka's 2020 full year accounts. Figures below are based on amounts disclosed in the Demerger Booklet (Deterra Royalties demerger booklet 10 September 2020), updated for publicly available market data (i.e. Deterra's VWAP in the 5 trading days post demerger of $4.2771).

PROFIT OR LOSS STATMENT

Iluka will recognise two gains in the profit and loss account for FY20:

1. Gain on disposal of Iluka's 80% interest in Deterra - The gain arises from the difference between 80% of the fair value of Deterra based on the 5 day VWAP post demerger and 80% of the book cost of Iluka's interest in Deterra.
2. Gain on Iluka's 20% retained stake (investment in associate) - This will initially be recorded at fair value in Iluka's balance sheet under accounting standards (See note 1 below).

This results in the following outcome for FY20:

Income statement – demerger line items	Note	**AUD$m**
Fair value of shares distributed	1	1,808.2
Less carrying value of net liabilities distributed		0.7
Transaction costs	2	(13.0)
Fair value gain on demerger distribution		**1,795.9**
Fair value of retained interest	1	452.1
Less carrying value of the retained share of net liabilities		0.2
Fair value gain on retained interest		**452.3**

No tax is payable on this amount.

Note 1: Fair Value of Deterra

Fair value on initial recognition is determined by reference to the VWAP for Deterra in the 5 trading days post demerger (23-29 October).

5 day VWAP	AUD$	4.277
Number of Deterra's Shares on initial listing	m	528.5
Fair value of Deterra at date of distribution	**AUD$m**	**2,260.3**

Note 2: Iluka's share of demerger transaction costs

BALANCE SHEET

Iluka will recognise a financial asset (investment in associate) on the balance sheet of $452 million initially. This results in an increase in equity of $452 million in its 2020 full year accounts.

ONGOING TREATMENT OF ILUKA'S DETERRA SHAREHOLDING

Iluka's 20% interest in Deterra will be equity accounted.

In each period (and assuming no change to Iluka's retained holding), Iluka's earnings from its holding will represent 20% of Deterra's NPAT, less depreciation on the equity-accounted investment of $452 million.

Iluka's cash flow from its holding will reflect 20% of the dividends paid by Deterra during the period (assuming no change to Iluka's retained holding). Assuming Deterra dividends are fully franked, these franking credits will flow to Iluka.

This document was approved and authorised for release to the market by Iluka's Managing Director.

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