28 July 2022

Aroa Biosurgery Limited (ARX)

The company will hold its Annual Shareholders Meeting at **1.00pm Wednesday 10 August 2022.**

The location is **the Company's office 64 Richard Pearse Drive Mangere Auckland.**

You can also join the meeting online here.

Company Overview

Aroa Biosurgery was founded in 2008, based on the regenerative properties of ruminant forestomach extracellular matrix (ECM) technology initially investigated and developed by Dr. Brian Ward the company's CEO and Managing Director and the largest shareholder. The company, which was formerly called Mesynthes, initially contracted scientists from Industrial Research Ltd to get started and then rapidly transitioned to its own internal development team to accelerate commercialization. Early in 2014, Aroa Biosurgery relocated and expanded into a new purpose-built facility in Auckland.

Endoform™ Dermal Template, its first product for chronic non-healing wounds, was launched in the United States by Hollister Inc. (USA) in 2013 after obtaining U.S. Food & Drug Administration (FDA) clearance and breakthrough reimbursement from the Centre for Medicare and Medicaid Services for an ECM based product allowing widespread access in all sites of care. In 2018, the company acquired back Endoform™ Dermal Template and formed a joint venture to continue to deliver this product to its customers.

Its first commercial surgical product, a Reinforced Bioscaffold developed in collaboration with Tela Bio Inc. (USA), was cleared by the FDA in December 2014 and clinical studies were initiated in the United States in May 2015 for use in ventral hernia repair and abdominal wall reconstruction.

The company listed on the ASX in July 2020.

Current Strategy

The company's strategy is to develop, manufacture and distribute medical and surgical products to improve healing in complex wounds and soft tissue reconstruction. Its strapline is "Unlocking regenerative healing for every*body".*

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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

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Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	**Assessment**	**Notes**
Directors Fees	A	See below.
Director share ownership	A	Not disclosed if Directors are required to own shares however we note Directors Fees are partly paid by way of share options.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	See below.
Director Independence	G	A majority of Directors are independent
Board Composition	G	See below.
Director Tenure	A	See below.
ASM Format	G	Hybrid meeting. See below.
Independent Advice for the Board	G	See below.

Directors Fees: The company has offered share options to Directors as part of their fees from FY2023, with the value of the share options not explicitly included within the fee pool (we do note that the total benefit for directors, including the value of options, still falls within the limits of the approved fee pool).

NZSA generally discourages the use of options or share-based payments for directors, as they affect independence in decision-making. The company itself notes that "*that no performance-based compensation shall be offered in order to ensure that objectivity in decision making is not compromised.*" However, NZSA would consider share options (depending on exercise price) a form of performance incentive for Directors.

We do consider that share-based benefits are suitable in some circumstances, including cash-constrained 'startup' companies. We do not consider Aroa to meet this combined criteria. For reasons of pragmatism, we also recognise the role share options play in attracting US-based directors. Aroa has 2 US-based directors, Steven Engle and John Pinion.

Where share-based benefits are made, we believe they should fall within the fee pool limits approved by shareholders.

We note that no share options were issued to directors in FY2022, a situation more in keeping with NZSA's policies. We would encourage Aroa to review its Director remuneration policies to reflect the balance between a global framework adapted for local market conditions and practices.

Executive Remuneration: The CEO is paid a base salary and a short-term incentive (STI), both in cash. It is proposed at this year's ASM to also establish a long-term incentive (LTI), paid by way of share options.

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure 'groups'), weightings, targets and the level of achievement associated with any awards.

The STI is calculated at between 25% and 40% of the base salary. While the types of measures that determine the payment are disclosed, there is no disclosure as to weighting, targets or methodology.

The LTI schemes (including the issue of share options to directors) are subject to shareholder resolutions as set out in the Notice of Meeting. For the CEO, the proposal includes both "service-based" (50%) and "performance-based" (50%) share options.

The service-based options are subject continued employment as at 31/3/2024 and 31/3/2025. NZSA does not generally support LTI schemes awarded solely on the basis of tenure. In this instance, however, we recognise the value in providing incentives for staff retention given limited market availability for staff and Aroa's ongoing growth.

For the performance-based options, the measures, weightings and methodology are clearly disclosed in the Notice of Meeting and include a clear alignment with shareholder return (note, as the scheme comes into effect, NZSA would expect to see this methodology disclosed in future annual reports).

Golden parachutes/handshakes: The CEO and Managing Director is the founder and largest shareholder so it is unlikely these or similar payments are offered, however in the interests of good disclosure and transparency there should a statement in the Annual Report.

Board Composition: The Corporate Governance Statement sets out a list of Board skills and experience required to govern the company. However, the Annual Report does not include a skills matrix that attributes skill sets to individual Directors to demonstrate how they contribute to the governance of the company.

The nature of the company's board indicates some commitment to thought and experiential diversity. We note the weighting towards biotech-related and investment experience. From a representation perspective, we note that Aroa has an all-male Board.

Director Tenure: NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

The CEO and Managing Director was appointed in 2007. We recognise the unique role played by a founder on a company's Board. Another (non-independent) Director, Philip McCaw, who also holds 5.75% of the company's shares, was appointed in 2008.

We note the Chair, Jim McLean, has been on the Board since 2011. The other 3 directors were appointed between 2015-2019. In line with our comments above, we recognise the difficulty in sourcing directors with the appropriate functional experience for Aroa's business.

This makes it all the more critical for Aroa to focus on managing director succession. NZSA would expect to see greater clarity on future board succession for the independent directors, to better balance the risks associated with a sudden transition and/or loss of institutional knowledge with the need for ongoing Board innovation.

ASM Format: NZSA prefers 'hybrid' ASM's (i.e., physical, and virtual) as a way of promoting shareholder engagement while maximising participation.

Independent Advice for the Board: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

In general, the disclosures and processes around internal and external assurance and advice are appropriate. As regards risk management, the Annual Report and Corporate Governance Statement addresses risk management in general however, we note there is no disclosure in the Annual Report around non-financial risks and how these are mitigated and addressed.

It is unclear as to the extent to which other assurance staff have unfettered access to the Board, or whether Board members are able to seek external advice to support decision-making as required. However, NZSA also notes that the company's processes are ISO-accredited and are also subject to regular review by Ministry of Agriculture and Fisheries and other third parties, in the context of its underlying business.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure
Audit rotation	A	

Audit Rotation: Whilst the company ensures the Lead Audit Partner is rotated at 5 years, it does not disclose if the Audit Firm is rotated at 10 years. Regardless of rotation, NZSA expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	G	No donations were made.

Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	n/a	No dividend was paid
Capital Raise process	A	See below.

Policy Theme	Assessment	Notes
Takeover or Scheme	n/a	*n/a if no takeover*

Capital Raise process: The company raised capital by way of a Placement and a Share Purchase Plan. NZSA's preferred method is a renounceable rights offer so shareholders can maintain their proportionality or derive some value from the sale of rights.

We note that the Placement was issued at a minor discount to the prevailing share price, therefore there was no impact on underlying shareholder value.

Financial Summary: ARX's share price fell from $1.24 to $0.73 (as of 18th July 2022) over the last 12 months – a 41% decline. This compares unfavourably with the NZX 50 which declined by 12% in the same period. The capitalisation of ARX is $250m, and were it listed on the NZX would place it 66th out of 132 companies making it a mid-sized company.

Metric	2022	2021	Change
Revenue	$39.7m	$22.3m	78%
Gross Profit	$30.3m	$15.5m	95%
NPAT	-$8.4m	-$19.2m	n/a
Gross Profit Margin	76%	69%	10%
EPS[1]	-$0.024	-$0.064	n/a
PE Ratio	n/a	n/a	
Current Ratio	11.90	3.19	273%
Debt Equity	0.12	0.36	-67%
Operating CF	-$11.5m	-$5m	n/a
NTA Per Share[1]	$0.24	$0.13	81%
Dividend Per Share[1]	$0.00	$0.00	

[1] *per share figures based off actual shares at balance date (not weighted average)*

ARX had an impressive year on the metrics with revenue improving by 78% and a largely diminished loss being reported. Revenues were up to $39.7m and NPAT was -$8.4m down on prior years loss of -$19.2m. ARX are listed on the ASX but being a NZ company, financials are measured in NZD.

Revenues were up 78% to $39.7m and with a *gross profit margin* of 76% enabled them to deliver *Gross Profit* of $30.3m. *NPAT* was -$8.4m but this was a substantial reduction on FY21's -$19.2m. *Operation Cashflow* was -$11.5m.

The company is in sound financial position with cash of $56.2m ($50m being held in term deposits), a *current ratio* of 11.9 and a low *debt equity ratio* of 0.12. The company does not have any interest-bearing debt. The company completed a successful capital raise in August 2021 which netted NZ$47.7 million.

NTA per share is $0.24 and shares trade at a 201% premium to NTA.

Founder, CEO and managing director, Brian Ward, has a 9.67% stake in the company.

Directors receive a mix of cash and share options as their remuneration. Remuneration ranges from $80.9k for the lowest paid director, to $144k for the Chair. Brian Ward in his capacity as CEO, also received a mixture of cash and share options totalling $1.1m for FY 22.

In guidance provided for FY 23, ARX expects Product revenue of NZ$51-55 million, to deliver 30-40% growth on FY22, whilst product gross margins are expected to increase to 77%. ARX are also continuing to invest in their US salesforce and product development.

Resolutions

1. **To re-elect James McLean as an Independent Director.**

   James (Jim) McLean was appointed to the Board in August 2011 and is the Chair. He is also Chair of Prevar Limited, R J Hill Laboratories Limited, and Information Tools Limited. He was Chair of the New Zealand Institute of Plant & Food Research and Chair of its predecessor HortResearch, as well as several private businesses and start-up companies. He served on the board of the then Foundation for Research, Science, and Technology including five years as deputy Chair. Jim was an executive and director of Genesis Research & Development Corporation Limited during its early stages through public listing.

   We will vote undirected proxies **IN FAVOUR** of this resolution.

2. **To re-elect Steven Engle as an Independent Director.**

   Steven Engle was appointed to the Board in April 2015. He is also the non-executive Chairman of the Board of Prescient Therapeutics Ltd., an ASX listed clinical stage oncology company, and a director of the board of Author-it Software Corporation, a developer of authoring information solutions for pharmaceutical and biotechnology companies. He is a former director of industry associations, BIO, BayBio and BIOCOM, and was a member of the board of the Lupus Foundation of America. He is the Chief Executive Officer of CohBar, a clinical stage biotechnology company developing mitochondria-based therapeutics to treat age-related diseases and extend healthy lifespan. He is resident in the United States.

   We will vote undirected proxies **IN FAVOUR** of this resolution.

3. **That the Board is authorised to fix the auditor’s remuneration for the coming year.**

   This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

The following resolutions are in relation to share options awarded to Non-Executive Directors as part of their Director Fees.

Full details are set out in the Notice of Meeting.

4. **Grant of Share Options to James McLean.**

   James (Jim) McLean is the NZ-based Chair of Aroa. As per our commentary earlier in this report, NZSA does not support share-based or benefits or performance-based incentives to Directors, as this has the potential to impact independent decision-making. This is also not market practice in NZ or Australia.

   Given this, we will vote undirected proxies **AGAINST** this resolution. NZSA notes that we would have likely supported an equivalent level of cash fixed remuneration.

5. **Grant of Share Options to Steven Engle.**

   Steven Engle is a US-based director. As per our commentary earlier in this report, NZSA does not support share-based or benefits or performance-based incentives to Directors, as this has the potential to impact independent decision-making.

   However, for pragmatic reasons, we also accept that share-based benefits are a common form of director remuneration in the US and that Aroa will benefit from Directors based in its core market.

   Given this latter point, we will vote undirected proxies **IN FAVOUR** of this resolution.

6. **Grant of Share Options to Phillip McCaw.**

   Philip McCaw is a NZ-based non-independent Board Member, who is also a 5.75% shareholder. As per our commentary earlier in this report, NZSA does not support share-based or benefits or

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performance-based incentives to Directors, as this has the potential to impact independent decision-making. This is also not market practice in NZ or Australia.

Given this, we will vote undirected proxies **AGAINST** this resolution. NZSA notes that we would have likely supported an equivalent level of cash fixed remuneration.

7. Grant of Share Options to John Pinion.

Steven Engle is a US-based director. As per our commentary earlier in this report, NZSA does not support share-based or benefits or performance-based incentives to Directors, as this has the potential to impact independent decision-making.

However, for pragmatic reasons, we also accept that share-based benefits are a common form of director remuneration in the US and that Aroa will benefit from Directors based in its core market.

Given this latter point, we will vote undirected proxies **IN FAVOUR** of this resolution.

8. Grant of Share Options to John Diddams.

John Diddams is an Australian based independent Board Member. As per our commentary earlier in this report, NZSA does not support share-based or benefits or performance-based incentives to Directors, as this has the potential to impact independent decision-making. This is also not market practice in NZ or Australia.

Given this, we will vote undirected proxies **AGAINST** this resolution. NZSA notes that we would have likely supported an equivalent level of cash fixed remuneration.

The following resolutions related to the granting of Share Options under the Long-Term Incentive (LTI) to the Chief Executive Officer.

Full details are set out in the Notice of Meeting.

9. Grant of 2022 LTI Share Options to Brian Ward.

10. Grant of 2023 LTI Share Options to Brian Ward.

We will vote undirected proxies **IN FAVOUR** of these resolutions.

Proxies

You can vote online at https://www.votingonline.com.au/arxagm2022/

If you wish to appoint a proxy you must complete the Proxy/voting Form.

Instructions are on the Proxy/voting Form sent to you.

Voting and proxy appointments close **1.00pm Monday 8 August 2022.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA