



Afterpay gets its act together

Company/ASX Code	Afterpay Touch Group/APT
AGM date	Wednesday 13 November 2019
Time and location	10:30am, Herbert Smith Freehills, 101 Collins Street, Melbourne, VIC
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Hans Ha assisted by Robin Burrows
Pre AGM Meeting?	Yes with Interim Chair Elana Rubin

Item 1	Consideration of accounts and reports
ASA Vote	No vote required

Summary of ASA Position

Governance and culture

Afterpay Touch Group (Afterpay) is making several changes in its remuneration in 2020 financial year (FY20). The company will introduce an equity component to their Fixed Annual Remuneration (FAR) in the form of Restricted Share Units (RSU). They will also introduce a balanced scorecard for Short Term Incentives (STI) and a 3-year Long-Term Incentive (LTI) with 2 performance hurdles. All Non-Executive Directors (NEDs) will be required to hold equity worth their annual fee, 3 years from their initial appointment.

Financial performance

Afterpay is a modern-day instalments payment service that enables customers to 'buy now, receive now, and pay later'. Business revenue consists of merchant fees, late fees and transaction processing services (Pay Now). The majority of the income comes from merchant fees

Total income was up 86% from \$142.3m to \$264.1m, statutory Earnings Before Interest Taxes Depreciation and Amortisation (EBITDA) fell from \$15.8m to (\$9.3m), a 159% drop. Afterpay also incurred a loss after tax of 387%, as loss grew from \$9m in FY18 to \$43.8m in FY19. According to the company, Australian and New Zealand businesses recorded positive EBITDA and the losses were from expanding into UK and US markets.

Key events

Afterpay partially completed a capital raising via placement and SPP (share purchase plan) in FY19. The Company raised \$317.2m from institutional investors and the SPP is on hold due to an AUSTRAC investigation requiring an external audit of Afterpay to examine its compliance with the Anti-Money Laundering and Counter Terrorism Financing Act 2006.

The Company is waiting for the final report to be released before resuming the SPP (proceeding at director's discretion but Afterpay is committed to keep the record date and pricing structure).

Key Board or senior management changes

Mr Anthony Eisen stepped down as Executive Chairman and Ms Elana Rubin has been appointed Interim Chair. Afterpay is searching for a Chair and additional Directors.

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

Ms Elana Rubin is the only woman in the 5-person board, a 20% female representation at Board level. While this is lower than ASA's preferred 30% female representation, the company is still new and has been an ASX listed company for less than 3 years. ASA's meeting with the board indicated that the Company is very open to working towards diversity targets and aims to have a gender diverse board.

The capital raising allocated only 9.09% (less when actual amount raised is calculated) of the total amount to be raised to retail shareholders. This was lower than the proportion of the share register represented by retail shareholder base, so as a result, retail shareholders' ownership of the Company seems to have been diluted. To minimise dilution, we will ask Afterpay to raise its SPP cap to reflect retail shareholdings and advocate for fairer capital raisings in the form of PAITREO (pro-rata accelerated institutional entitlement offer and a retail entitlement offer).

Summary

(As at FYE)	2019	2018
NPAT (\$m)	(42.8)	(7.6)
UPAT (\$m)	(35.3)	(4.6)
Share price (\$)	25.07	9.35
Dividend (cents)	0	0
TSR (%)	168.13	-
EPS (cents)	(0.17)	(0.03)
CEO total remuneration, actual (\$m)	*0.348	**4.566

*The CEOs STIs are being withheld until the AUSTRAC final audit is released and have not been included in the calculation

**This includes \$4.175m worth of options vested by the CEO and the figure is a result of significant increases in the share price. Share prices were \$9.35 at the time of vesting and the options had a strike price of \$1, which was the value at the grant date.

For 2019, the CEO's total actual remuneration was **3.95 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Note - For May 2019, the Full-time adult average weekly total earnings (annualised) was \$88,145 (<http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0>, "Full-time adult average weekly total earnings", Trend(a)).

Item 2	Adoption of Remuneration Report
ASA Vote	For

Summary of ASA Position

Afterpay has announced significant changes in its existing remuneration for FY20 after receiving a near-strike with 20.3% voting against last year's remuneration report.

It is transforming itself from a company where the board and its remuneration resembles a start-up, to a more established, mainstream S&P/ASX100 business.

Key characteristics of the Remuneration Scheme in FY20:

- An introduction of Restricted Share Units (RSU) at face value as component of Fixed Annual Remuneration (FAR)
- RSUs will vest annually over 3 years in 3 equal tranches
- STIs will be paid in cash but will be positioned at a low level relative to peer companies
- Introducing a performance hurdle for STIs, weighted 50/50 financial and non-financial measures
- Introducing a 3-year LTI Scheme with 2 performance hurdles: Gross Merchandise Value (GMV (i.e. underlying sales)) and Net Transaction Margin (NTM).
- LTIs are awarded in options and the performance hurdles are equally weighed
- 50% of the LTIs will vest at target and 100% at maximum
- The founders will forego receiving any RSUs and STIs due to their existing shareholdings and legacy arrangements. They will remain on their current base salary until a review is conducted in FY20
- NEDs are required to hold equity worth their annual fee, 3 years from appointment

2019 CEO rem. framework	Target \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	0.348	69.46%	0.348	53.46%
STI - Cash	0.150	29.94%	0.300	46.08%
**Options and other payments	0.003	0.6%	0.003	0.46%
Total	0.501	100.0%	0.651	100%

** Under the Group's one-off equity award arrangement, KMPs are eligible to receive one-off equity awards (in the form of options, loan shares or rights) in Afterpay equity at the time they commence employment. CEO has already received one-off option in the previous years.

The area of the remuneration ASA favours:

- Having an equity component in the form of RSUs at the FAR level
- Introducing an STI Scoreboard to measure performance
- Introducing an LTI Framework where options vest at an exercise price above the market price in addition to having to achieve their performance hurdles
- CEO/MDs total remuneration is conservative at below 7th percentile of the market capitalisation comparison group
- Having an actual remuneration table for Key Management Personnel (KMP)
- Requiring NEDs to hold equity
- Directors and KMP having plenty of skin in the game where their awards are challenging and genuinely at risk

Areas where ASA is taking notice:

- Cash only for STIs. ASA prefers equity to be added with a deferral period in the STIs. (Afterpay has addressed this by keeping STIs low, below median, and keeping equity in RSUs rather than pay a higher STI. ASA finds this reasonable)
- 50% financial and 50% non-financial weight for STIs. ASA prefers a higher financial weight (Afterpay has explained that some non-financial measures had financial links to it e.g.: Number of Active Customers & Merchants, Net Transaction Loss (NTL))
- 3-year LTIs. ASA prefers longer hurdles (4-5 years or longer) or a holding lock in the LTI to make up for the duration of the performance period
- Gradual vesting of LTIs over cliff vesting where awards do not suddenly vest all at once when the KMP reaches the award threshold
- Use of Performance Rights over Options for increased transparency. (Afterpay has addressed the high exercise price results in a lower pay out compared to using Performance Rights unless the share price doubles. The exercise price is also measured using market value (VWAP), which is transparent. ASA finds this works in this case)

Afterpay was open to our suggestions and said they would take note. Speaking with the company, we found the motivation, intentions and their actions of aligning shareholders interests was there. While Afterpay's way in doing so was different from our guidelines, it seems to achieve the overall outcome ASA is looking for.

We support this resolution.

Item 3	Increase in Non-Executive Director's Fee Pool
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder approval to increase the maximum fee pool from \$700,000 to \$1.8m, which comes to a \$1.1m increase.

This increase is required for the following reasons explained below:

- Increasing the fees for existing Directors to reflect its size among its peers
- To recruit at least two additional Directors and a Chair
- Recruiting overseas Directors at competitive rates

Afterpay has said that the search is going well, where a mix of skills and attributes are being considered, along with diversity where the company is not only looking at gender but also at the diversity of ideas and experiences.

This fee increase is still to be positioned below the median fee pool of its peer group by market cap where it sits at \$1.95m and Afterpay also requires Directors to own at least their annual respective fee in equity within three years of their tenure so this is also something ASA favours.

This increase is part of the transformation process of a Board that resembles a start-up to a mature, established S&P/ASX100 company.

ASA understands this transformation and as the Board has shown how it will align with shareholder interests, we support this resolution.

Item 4	Re-election of Clifford Rosenberg as a Director
ASA Vote	For

Summary of ASA Position

Mr Clifford Rosenberg was appointed as a NED in Mar 2017 and chairs the Remuneration Committee and is a member of the Audit, Risk and Compliance Committee.

Mr Rosenberg has over 20 years experience working in digital companies as an entrepreneur and has held many senior roles in companies such as LinkedIn and Yahoo.

Mr Rosenberg is also a NED of ASX listed companies Nearmap Ltd, A2B Australia Limited and Technology One Limited. In addition, Mr Rosenberg joined the Board of Bid Corporation Limited, a publicly listed company in the Johannesburg Stock Exchange. Including his service to Afterpay, Mr Rosenberg holds 5 NED roles in total, on the limit of ASA's guidelines on director workload.

Mr Rosenberg brings a wealth of knowledge to the Board and has a considerable shareholding of over 650,574 shares, showing that he has considerable skin in the game to align with shareholders interests. ASA will support his re-election.

Item 5	Ratification of Issue of Shares Pursuant to Placement
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder ratification of the issuance of 13,793,104 shares at 17 June 2019 at an issue price of \$23 to certain institutional investors as part of its capital raising. Approving this resolution will refresh the 15% placement capacity of the company.

The proceeds will be used to support Afterpay's global growth strategy.

Item 6	Approval of Afterpay Equity Incentive Plan
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder approval to grant equity awards (Options and Rights) to eligible employees and Directors of the company.

The plan will be used to deliver the RSUs and LTI Awards for the new Remuneration Framework commencing at FY20.

This plan aims to attract, retain and motivate talent, align employee and shareholder interests through company ownership and skin in the game, and encourage employees to deliver the best performance results.

As this resolution results in employees having a larger shareholding of the company and encourages employees to have a longer-term view of the company, we support this resolution.

Item 7	Approval of LTI grant to CEO/Managing Director Anthony Eisen
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder approval to grant 125,000 options to Mr Anthony Eisen, co-founder and CEO/MD, as part of his LTI remuneration.

As Afterpay is still growing and expanding, they have focused on performance hurdles predominantly measuring growth. The LTI has 2 performance hurdles, Gross Merchandise Value (GMV) and Net Transaction Margin (NTM). Both are equally weighed and 50% of the LTIs will vest at target and 100% at maximum.

The options will have an exercise price of \$37.31, which is based on a 20% premium to the market value of the company's share price from the grant date (VWAP). So, in addition to achieving the performance hurdles, Mr Eisen will have to raise the share price above the exercise price to personally reap any benefits as the options will be deemed worthless unless doing so.

As of writing the share price has fallen below the VWAP price so this means Mr Eisen will have a larger hurdle to overcome to reap any benefits, where we see his awards being genuinely at risk.

While the options are valued using fair value (Black Scholes methodology), the exercise price of the option is valued using market value (VWAP) and is set at a 20% premium. While there is the risk that the company can aggressively raise the share price at the expense of the overall health of the company, the company has said that the RSUs will counteract such aggressive behaviour, as RSUs vest annually.

The LTI has a 3-year performance period, and while ASA prefers longer periods, we understand that the company has been around for less than 3 years as an ASX listed company and they have said they will continue to make changes based on investor sentiment.

ASA also prefers Performance Rights over options, but the way the LTI has been set up results in a more challenging hurdle as the options will have to reach the exercise price to have any sort of value and the CEO will have to at least double the share price for his award to be worth more than receiving his LTIs directly as Performance Rights.

ASA commends how the company is working hard to align with shareholders interest. We will support this resolution.

Item 8	Approval of LTI grant to Global Chief Revenue Officer and Executive Director Nick Molnar
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder approval to grant 125,000 options to Mr Nick Molnar, co-founder and Global Chief Revenue Officer, as part of his LTI remuneration.

ASA will support this resolution for the same reasons as mentioned in Item 7, as the terms are identical.

Item 9	Approval of Change of Company Name
ASA Vote	For

Summary of ASA Position

This resolution seeks shareholder approval to change the company name and update all references in the constitution from 'Afterpay Touch Group Limited' to 'Afterpay Limited'.

As this is a non-controversial resolution, we support this resolution.

One of the individuals involved in the preparation of this voting intention has a shareholding in this company.

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