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Stalled but not stopped

Company/ASX Code	Appen Limited /APX
AGM date	Friday 28 May 2021
Time and location	10 am Four Seasons Hotel, 199 George Street, Sydney. Numbers are limited and pre-booking is advised
Registry	Link Market Services
Webcast	Yes, hybrid meeting
Poll or show of hands	Poll on all items
Monitor	Mary Curran and Peter Gregory
Pre AGM Meeting	Face meeting with NED Bill Pulver and Linda Carroll, investor relations

The individual(s) (or their associates) involved in the preparation of this voting intention **has** a shareholding in this company.

Summary of issues for meeting

- Appen experienced deferred customer spending which it attributes to COVID-19. If any of these become permanent it will impact future results.
- Appen, while a technology company, has a high people cost. The increased use of technology and automation, while retaining quality will contribute significantly to improved gross margin
- As Appen operates predominantly in the US, currency movements (which is beyond the company's control) affect actual reported AUD results.

ASA will be attending the physical meeting voting our proxies and asking questions.

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

Summary of ASA Position

It has been a bit of a roller coaster ride for this well-regarded growth stock with a 12 month share price high of $43.66 and a low $10.65. Total shareholder return for the FY was 10.4% with a dividend increase of 11%. Deferred customers projects and lower ad spend due to COVID impacted the year, however the company is confident in the long-term opportunities in the AI training data market. The company first listed in January 2015 at 50 cents. No COVID-19 related payments were sought or received.

Appen is very focused on strengthening its core business while also expanding into new market opportunities. During the year an investment in sales and marketing yielded 136 new customers from a diverse range of industries including autonomous vehicles, aviation, fintech and medical technology.

With a global outlook, Appen provides data annotation services to the very large US tech giants as well as targeting growth markets, including government, China and select verticals such as automotive and finance. Data annotation services involve providing data sets to train artificial intelligence and machine learning applications to help these applications understand and interpret speech, natural language, images and human judgement. It is part of the Australian WAAAX group (Wisetech, Altium, Appen, Afterpay and Xero). The annual report provides an easy to read overview of the AI market opportunity.

The quality of its data annotation is a key point of difference for Appen, and this is achieved through a mix of technology and 1 million independent contractors throughout the world, known as the "Appen crowd". Appen works hard to maintain a fair, open and positive relationship with the crowd. Net Promoter Score (NPS) is used as the headline measure of crowd satisfaction and this metric is improving (48, up from 43 in 2018).

During the year Appen increased its direct employee headcount from 781 to 1,125 and has been able to seamlessly onboard these people and have them quickly contributing. Appen has an active program of monitoring Employee Engagement as shown by improvement in the headline score of 6% to 82% since last year.

Appen is highly dependent on both the Appen crowd and its employees, and while the board monitors the headline NPS and Employee Engagement scores, management extensively dissects the data behind these numbers to continually improve these relationships, identify and respond to issues, and maintain open dialog with their people.

Appen has a comprehensive and clearly explained risk management plan.

Appen recognize their vulnerability to data, security and privacy breaches and the criticality of this for their business. Their mitigation strategies are described in the risk management plan. During the pre-AGM meeting we observed that they have only one director with high competency in this space. Appen acknowledged this and provided a detailed explanation of their use of a rigorous testing regime, the high profile this issue has for management and the organisation as a whole, and their use of expert external consultants to assist with and oversee implementation and to advise the board on this matter.

The integration of Figure 8 is complete and a good adjunct to the business as it spreads the customer base and is an annotation technology platform which uses tools to transform unlabelled text, image, audio and video data into high-quality AI training data. The capability provided by Figure 8 opens up synergistic new markets for Appen.

Appen has a strong balance sheet, no debt and a strong cash position and will consider M&A that adds strategic value.

The financials in brief: revenue grew to $599.9 m million, an increase of 12%. Underlying EBITDA was $108.6 million, up 8%. Statutory EBITDA of $107.9 million up 23%. Underlying NPAT was $64.4 million down 1%.

Revenue recognition is the only mentioned Key Audit Matter (KAM).

During the year, the founder Christopher Vonwiller sold 2 million shares; he currently holds 9,060,286 shares, (7.45%) and there is no set sell down program in place. Likewise non-executive director, Bill Pulver sold 275,000 shares to diversify his portfolio; he currently holds 332,384 shares.

During year the retail shareholder (indicated by shareholders with 1 to 1,000 shares) base has grown from 18,419 to 40,175 shareholders.

At the release of the full year results in February, Appen stated that it expected underlying EBITDA for 2021 to be in the range of US$83-90 million.

Summary

AUD (As at FYE)	**2020**	**2019**	**2018**	**2017**
NPAT ($m)	$50.514m	$41.611	$41.728m	$14.282
UNPAT ($m)	$64.379m	$64.710	$49.028m	$19.749
Share price ($)	$24.69	$22.46	$12.83	$8.31
Dividend (cents)	10.0c	9.0	8.0	6.0
TSR (%)	10.4%	76%	55%	195%
Diluted EPS (cents)	40.85	34.60	38.55	14.36
CEO total remuneration, actual ($m)	$4.061	$4.791	$2.309	$0.829

For 2020, the CEO's total actual remuneration was 44 times Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Item 2	**Adoption of the Remuneration Report**
ASA Vote	For

Summary of ASA Position

While Appen is listed on the ASX, it is truly a global business, with the US as the source of 90% of revenue and its people based in 14 global locations. While headcount by geography data is not provided, it can be concluded that Appen's employees are predominantly US based. In determining the remuneration strategy, Appen seeks to attract and retain the high performing and experienced global executives with technology expertise that can enable success in this highly competitive sector while delivering strong outcomes for shareholders. As described in detail in the Annual Report the Remuneration Committee benchmarks both US technology companies and like sized ASX listed companies.

Appen, understands ASA guidelines and is working to achieve outcomes that are consistent with ASA principles. In so doing so Appen has a remuneration strategy that responds to both Australian and US employment markets and consequently, does not comply fully with ASA guidelines. Specifically, the STI is cash and has no equity component, the LTI period is 3 years compared to the 4 to 5 years preferred by ASA, and there is only one LTI hurdle (UBEPS) and this is based on underlying figures – note the use of underlying removes the cost of the major investments that are essential for the company's long-term future when assessing current performance.

Their remuneration strategy is seen to be robust and appropriate to its global business environment, and proactive and strategic approach to building the business. ASA is supporting this resolution.

Key aspects of the CEO remuneration plan are:

- 21.4% of at target remuneration is a fixed salary package.
- All variable incentives are linked to key financial measures. There are no non-financial measures.
- Emphasis is on performance-based pay with the CEO for FY20 having 78.6% of his at target income at risk.
- The short-term incentive target is based on achieving a 30% increase on last year for revenue and underlying EBITDA. For FY20 he achieved 71% of the target STI, equaling $531,760.
- The long-term incentive is awarded through granting and vesting of performance rights dependent on meeting the target of underlying basic earnings per share (UBEPS) increasing at a compound growth rate of 20% pa for 3 years. Continued employment for that period is also required. In 2020, the 20% UBEPS hurdle was not met and so the rights granted to the CEO in 2020 will now only vest if the higher cumulative growth rate is achieved by the end of 2022 and he is employed at 1 January 2023. (see the table at the top of page 67 of the 2020 Annual Report for details).
- The CEO is required to hold 50% of the after-tax shares issued from the performance rights for the period of his employment with Appen.

We thank the company this year for publishing both the actual and the statutory remuneration, which is found on page 62.

In 2020, the CEO's actual remuneration received was $4.1m and 81% was at risk and variable (STI and LTI). The biggest component was LTI of $2.8m, which comprised 68% of the CEO's total actual remuneration. This was due to the substantial increase in the Appen share price between when the rights were granted, up to three years prior, and when they vested in 2020. At grant date, the LTI value was $784k. By vesting date, the value had increased by 254% to $2.8m (see 2020 Annual Report bottom of page 68). The weighted average increase in the share price over the same period, based on the closing share prices at grant and exercise date, was 532%. Note due to the increase in the share price, it aligns with shareholder experience.

With regard to the board, all directors meet the minimum shareholding requirement of having the equivalent of one year's fees within 3 years of appointment. New director Vanessa Liu holds 1000 shares.

2020 CEO rem. framework	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	.75	21.4%	.75	19.4%
STI - Cash	.75	21.4%	1.125	29.0%
STI - Equity	nil	nil	.0	0
LTI	2.0	57.2%	2.0	51.6%
Total	3.5	100%	3.875	100%

The amounts in the table above are the statutory 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.

ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

Item 3	**Re- Election of Mr. Stephen Hasker**
ASA Vote	For

Summary of ASA Position

Mr. Hasker was elected to the Board in 2015 and seeks re-election. He is based in the Canada and has extensive global experience in technology. He is currently President and CEO of Thompson Reuters and has served as a senior advisor to TPG Capital, a private equity firm. He has worked at McKinsey and PricewaterhouseCoopers and is a qualified chartered accountant. **Holds 50,000 shares.**

ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

Item 4	**Re-Election of Ms Robin Low**
ASA Vote	For

Summary of ASA Position

Ms Low was elected to the board in 2014. She has extensive experience in finance, risk and business experience from her 28-year career at Pricewaterhouse Coopers. Other directorships AUB Group Limited, IPH Limited and Marley Spoon AG. She has a bachelor of Commerce and is a fellow of the Institute of Chartered Accountants. **Holds 172,946 shares**.

ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

Item 5	**Approval of grant of performance rights to CEO/Managing Director, Mr Mark Brayan**
ASA Vote	For

Summary of ASA Position

This resolution is a provision for 55,908 performance rights for FY21 if the CEO achieves the maximum LTI target.

These will be awarded, if at the end of the three year period (end FY23) the compound annual growth in Underlying Basic Earnings Per Share (UBEPS) for those 3 years is at least 20%. That is total growth of 73%. The value of the LTI grants is $26.83 per share (VWAP December 2020) equates to $1.5 million.

The performance conditions are detailed in the table on p12 of the Notice of Meeting, with the key points being:

- The maximum award will only be made if a 3 year CAGR in UBEPS of at least 20% is achieved
- One third (18,636 rights) of total available rights is tested each year for 20% growth in that year
- Then each year testing for 20% CAGR enables the awarding of available rights for the current and previous years
- If achievement is between 90 – 99% vesting will be scaled by 50 – 80%
- A condition of vesting is employment at 1 Jan 2024
- The value of the LTI grants is $26.83 per share (VWAP December 2020) equates to $1.5 million.

It is noted that the Notice of Meeting also describes a change of the STI/LTI incentive mix commencing with FY21. Our understanding of the new CEO remuneration plan is shown here.

2021 CEO rem. framework	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	.75	21.4%	.75	18.1%
STI - Cash	1.25	35.7%	1.875	45.5%
STI - Equity	nil	nil	.0	0
LTI	1.5	42.9%	1.5	36.4%
Total	3.5	100%	4.125	100%

The at target incentive component of the CEO's remuneration remains at 79%, but the at target STI increases from 27% to 45% of the total incentive. While it is understood that Appen has aggressive strategies and early runs on the board are critical for long term success, this change is

seen as unnecessarily reducing focus on the long term interests of shareholders. ASA will support this resolution but will seek further explanation of this change at the AGM.
ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

Item 6	**Amendment to the Constitution**
ASA Vote	For

Summary of ASA Position

There are two amendments proposed. One is to allow an increase in the maximum number of directors, which is currently seven, to allow ten. This is to allow a smooth transition as Appen is working through a period of board renewal, following the expected retirement of long serving directors in 2021. An increase of this number is unusual. However, as Appen have stated they do not intend, beyond transition arrangements, to increase the permanent membership above seven, we will support this change. See Item 7 below.

The second amendment is regarding restricted securities and is to bring Appen's constitution into line with the current ASX escrow regime.

ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

Item 7	**To increase the Non-Executive Directors' Fee Pool by $500,000**
ASA Vote	For

Summary of ASA Position

This resolution is to increase the fee pool from $900, 000 to $1,400,000. As the company is now working through a process of board renewal, this will allow some headroom while a greater number of directors are on the Board to allow for a smooth transition. Additionally, this increase will enable a global search for the calibre of the candidates who are able to support Appen's strategy implementation and are required for a company of Appen's global footprint. Te proposed individual director and committee fees are in keeping with a company with this sized market capitalisation. While it is it is only two years since the last increase, we feel that the size and complexity of this business, and the aggressive expansion strategy justify this change.
ASA WILL VOTE UNDIRECTED PROXIES IN FAVOUR

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