

Integration of PRI Guidelines

FEB 2020:

Appen

Executive Summary

Appen Ltd. engages in the development of human-annotated datasets for innovative machine learning and artificial intelligence systems. With expertise in more than 180 languages, a global crowd of over 1 million skilled contractors, and the industry's most advanced annotation platform, Appen works with leading companies and governments worldwide.

We opened our position in the company in August 2017. The company exhibits strong financial fundamentals and is well aligned with ESG trends. However, in completing our ESG analysis process, some concerns have arisen that demand our attention, in particular:

- No external carbon risk reporting.
- The Chairman, Mr. Chris Vonwiller, is a non-executive director and the board has determined that he cannot be considered an independent director due to his substantial shareholding in the company.
- In FY18, 5 major customers contributed to 89% of Appen's revenue. The company's acquisition of Figure Eight and Leapforce has improved that concentration, however the extent is unknown.
- Appen does not have measurable objectives for achieving gender diversity. The board had considered setting gender diversity targets but decided not to go ahead with it as the company already recruits based on no bias and has a culture that supports gender diversity.

We have identified these ESG concerns and will continue to monitor them. However, we are confident in Appen's future despite these concerns due to our belief that the underlying fundamentals that drive the business are strong. Appen draws alignment with ESG trends of:

- Increased use of AI and machine learning.
- Convergence between automation, AI, IoT, analytics and low code platforms.
- Augmented intelligence on the rise.
- Increased demand for natural language processing.
- Conversational artificial intelligence is gaining in popularity.
- Demand for computer vision is increasing.
- Increased use of artificial intelligence by governments.

We believe that Appen is in an optimal position to take advantage of these tailwinds and will have sustainable growth for the foreseeable future. We acknowledge that some concerns remain that we will continue monitoring; however, we are confident in our valuation as well as our investment in Appen.

Strategy

This section focuses on ESG issues emanating from communications around the company's strategy of exploiting opportunities and managing risks. The rise of shareholder activism, public and media attention on corporate responsibility, and increasingly informed consumers requires companies to actively consider and manage ESG risks in order to successfully execute on their given strategy. We think in terms of fundamental company strategy.

HIGH LEVEL ESG RECOGNITION

How does the company act as a positive force for environmental concerns?

A list of significant issues that relate to maintaining and creating sustainable environmental outcomes. Examples include sustainable power use, reduction and reuse of water, sustainable end of product life considerations, and pollution mitigation during manufacturing processes.

- Appen is a professional, knowledge-based workplace with minimal environmental footprint.
- Each of Appen's offices has recycling facilities.
- The company encourages the thoughtful use of resources.
- Except for air travel, which is necessary given the global nature of business, the company has a low carbon footprint.
- They reduce their need to travel through the judicious use of video and phone conferencing.
- Million plus workers working from across the globe using internet-based tools, with minimal carbon impact.
- No significant raw materials or resources consumed by the company.
- Appen has not breached any environmental regulations.
- They provide sufficient ESG data in their Annual Report and on their website.

How does the company not act as a positive force for the environment?

A list of significant issues that relate to maintaining and creating sustainable environmental outcomes. Examples include sustainable power use, reduction and reuse of water, sustainable end of product life considerations, and pollution mitigation during manufacturing processes.

- No external carbon risk reporting.

How does the company act as a positive force for social concerns?

Here we focus on sustainable outcomes for people. Does this company act for the betterment of individuals and society? These are broad ranging issues and topics, but some examples include improving mental health, providing engaging workplaces and appropriate remuneration, improving financial outcomes for customers, improving learning outcomes, improving general health outcomes for customers, increasing access, and allowing human expression at a higher level.

- Appen has an active Corporate Social Responsibility (CSR) program that supports those in need in countries in which they operate.
- Participation in any CSR initiatives is encouraged, and community projects are publicised and celebrated via intranet.
- Appen has raised funds for several of its employees in need. Appen matches all money raised.
- They have supported research and have provided technical and linguistic resources to further research and community projects.

- They have CSR partnerships with Translators without Borders and National Council of Disability Affairs in Manila, Philippines.
- Employees can raise awareness around a need by contacting the CSR committee and asking for it to be a focus for employees around the globe. Funds raised are matched by the company.
- Appen strives to ensure crowd workers have sustainable conditions and endeavors to pay remuneration at or above the local minimum wage.
- Provides employment to over a million people across the globe through crowdsourcing.
- They support cultural and ethnic diversity in their workforce.
- Employees population is 61% female and 39% male.
- Appen launched a new initiative in 2019 to further develop and promote female leaders.
- The company focuses on inclusion and career development to improve diversity in the workforce.
- They actively support people with disabilities.
- In the Philippines, they had initially onboarded over 50 people with partial or full hearing impairment to support image annotation work. They now have over 200 people.
- The company has a Crowd Code of Ethics which shows their dedication to the well-being of their crowd and is built on the foundation of:
 - Fair pay - Appen's goal is to pay their crowd above minimum wage in every market where they operate.
 - Inclusion - they offer opportunities for individuals of all abilities and backgrounds.
 - Crowd voice - the crowd has a valued voice. Their feedback is acted on and helps make Appen a better organisation.
 - Privacy and confidentiality - information collected about the crowd is solely for the purposes of the project. Appen takes precautions to protect that information and does not release private data on individuals to third parties without consent.
 - Communication - Appen believes in helpful, transparent and responsive lines of communication with their crowd.
 - Wellbeing - Appen promotes wellness, community and connections through online forums and best practices.
- The Company has a Diversity Policy which it shares on its website.
- It has a diverse employee base, employing people in the USA, Australia, UK and the Philippines.

How does the company act as a positive force for governance concerns?

- The company has Board-endorsed policies and statements which focus on company culture including their Corporate Governance Statement, Code of Conduct and Diversity Policy.
- Appen does not tolerate behavior at odds with the company's culture and has taken action on rare occasions when it is needed.
- Appen's Corporate Governance Statement sets out how they meet or exceed the requirements of the ASX Corporate Governance Council's Principles and Recommendations.
- The board has established an Audit and Risk Management Committee and a Nomination and Remuneration Committee.
- The Audit and Risk Management Committee has at least three members, all of whom must be non-executive directors and a majority of whom are independent directors. The Chairman should be an independent non-executive director, who is not the chairman of the board.
- The Nomination and Remuneration Committee should have at least three members, the majority of whom are independent directors. The Chairman should be an independent director.

- The Board maintains a Board Skills Matrix that lists out all the skills and experience considered by the board to be important for its directors to collectively possess.
- The Board assesses the independence of all directors against the criteria outlined in the Governance Principles and has disclosed the names of directors it considers independent.
- The company has laid solid foundations for management and oversight. They have disclosed the roles and responsibilities of its board and management; and those matters expressly reserved to the board and those delegated to management.
- The Chief Executive Officer/Managing Director (CEO/MD) oversees the day-to-day management of the business. The CEO/MD manages the Group in accordance with the strategy, plans and policies approved by the board.
- The delegations are reviewed by the Board from time to time.
- The Board operates under a formal charter.

How does the company not act as a positive force for governance concerns?

Examples of points that might go here include appropriate remuneration both in terms of total amount and or incorrect alignment of incentives. We also look at the strength of the board and power of the CEO to influence governance. Another significant area is the appropriateness of response by management and the board to environmental and social issues as they arise.

- In FY18, 5 major customers contributed to 89% of Appen's revenue. The company's acquisition of Figure Eight and Leapforce has improved this concentration; however, the extent is unknown at this stage. It should be noted that by the nature of the few companies deploying large AI projects, concentration is inherent for Appen. It is the largest technology companies in the world that are undertaking the most ambitious AI projects and so the bulk of Appen's work comes from those few companies.
- The Chairman, Mr Chris Vonwiller, is a non-executive director and the board has determined that he cannot be considered an independent director due to his substantial shareholding in the company.

What external ESG factors affect the company?

This includes domestic and international government policy, market competition forces, and micro and macroeconomic drivers.

- Increased use of AI and machine learning.
- Convergence between automation, AI, IoT, analytics and low code platforms.
- Augmented intelligence on the rise.
- Increased demand for natural language processing.
- Conversational artificial intelligence is gaining in popularity.
- Demand for computer vision is increasing.
- Increased use of artificial intelligence by governments.
- Chinese AI market is growing at 55% annually.

How has the company demonstrated its awareness of ESG factors in the economy and within its industry?

- Appen has linked its strategy to major ESG trends as discussed on page 9.
- Developing and releasing new features to increase competitive advantage.
- By trying to establish its presence in a high growth country like China.
- By acquiring Leapforce and Figure Eight. Figure Eight's clients include the United States Government.

- By investing in resources, facilities and technology to fulfill government needs.
- By following the trend towards the gig economy and providing access to a crowd of over 1 million skilled contractors to their clients.

Where has management demonstrated its commitment to addressing ESG challenges?

- Through exceptional environmental, social and governance initiatives.
- By linking their strategy to major industry trends.
- By making it possible for people across the world to find gainful employment with Appen.
- Comprehensive reference to ESG factors in the ESG report provided in the Annual Report.
- By striving to ensure crowd workers have sustainable conditions. They endeavour to pay remuneration at or above the local minimum wage.
- Launched a new initiative in 2019 to further develop female leaders.

How has management demonstrated its knowledge on the company's ESG risks?

Examples and quotes of management addressing relevant ESG risks.

Through its exceptional governance standards such as:

- Two-tiered board structure consisting of the Board of Directors and Management.
- The board has established an Audit and Risk Management Committee and a Nomination and Remuneration Committee.
- The Audit and Risk Management Committee has at least three members, all of whom must be non-executive directors and a majority of whom are independent directors. The Chairman should be an independent non-executive director, who is not the chairman of the board.
- The Nomination and Remuneration Committee should have at least three members, the majority of whom are independent directors. The Chairman should be an independent director.
- The Board maintains a Board Skills Matrix that lists out all the skills and experience considered by the board to be important for its directors to collectively possess.
- By promoting a value-centric culture focusing on performance, honesty, humility and grit.

“We’ve built a strong reputation at Appen as a leader in high-quality data for machine learning. We’ve accomplished this by hiring some of the brightest, most dedicated talent. If you have a passion for working in a high-growth, customer-focused environment, this is the place for you.” - *Mark Brayan, CEO*

How does strategy align with ESG opportunities?

A broad look at how underlying strategy fits or does not fit with ESG trends. For example, a battery manufacturer aligns with the movement towards stored energy, an online retailer aligns with the movement from instore to online purchases.

- Substantial increase in engineering investment for future proofing.
- By regularly releasing new features, Appen will ensure it maintains its competitive advantage.
- Appen continues to broaden its customer base and target organic growth. Appen has added new customers with the acquisition of Figure Eight and continues adding names to its list.
- Establishing a presence in China as the Chinese AI market is poised to grow at 55% annually.
- Appen is also focusing on getting business from the government as they increase their investment in AI-augmented technology.
- The Figure Eight acquisition will help bring in business from its government clients.
- By following the trend towards the gig economy and providing access to a crowd of over 1 million skilled contractors to their clients.

Is there evidence of the company reporting highlighting future ESG risks and does the strategy allow for these anticipated risks?

- An ESG summary is provided in the annual report but detailed information regarding future ESG risks is not available.
- Strategy aligns with some ESG trends but is not specifically geared towards future ESG risks to the company.

What is the extent of ESG performance reporting?

Does the company anticipate upcoming ESG challenges and make provisions for them today? For example, an insurer raises premiums for house insurance in areas prone to severe thunderstorms in light of climate change data that predicts more intense weather events in the future.

They have provided an ESG summary in their annual report. The same summary is available on their website too.

Do reports link ESG factors to financial performance?

No.

What is the company's position in relation to current and potential operational licences, supply chain, and resource bottlenecks?

We must consider these constraints as they represent a significant risk to business operations. Has the company given these current and or potential bottlenecks due consideration? Can we see any concerns?

- The company has no licences or patents.
- They employ over a million people across the world through crowdsourcing.
- Their main challenge is to find the right employees and to train them.
- While their highly scalable crowd-sourced delivery model is proven and aligns well with their customers' needs, delivering a step change in volume and quality depends on their enabling technology that enhances the productivity of the crowd.

What is the extent of management involvement of customers, employees, government, and other stakeholders? How do they gather data on their sentiment/opinion?

Considers how well management engages these parties in seeking their input and feedback on ESG issues. In the second part we consider the mechanism for how this data is gathered.

- Annual general meetings and other shareholder meetings.
- Company website.
- Press releases.
- Annual and interim reports.
- Earnings calls.
- Presentations.
- SEC filings.

No information on how they gather data on sentiment/opinion.

How responsive is the company to investor engagement?

Metric hard to ascertain, however management is quite forthcoming in answering all questions posed on earnings calls.

Does the board support ESG issues?

How supportive and engaged is the board on ESG issues? Without their support it will be very hard for management to progress on ESG issues.

Yes.

- Through its approach to governance.
- Providing the 'crowd' remuneration at or above the minimum wage.

Financial Reporting

INCOME STATEMENT

REVENUE

Identify the main drivers of revenue for both volume and price.

Appen offers a variety of services to help improve the data that drives search engines, eCommerce, natural language processing, conversational tools, computer vision, other software and applications.

Drivers of price and volume include:

- Ability to provide high quality human annotated data used to build and improve AI systems.
- Global crowd of over 1 million skilled contractors available for collecting and annotating data.
- Speed at which data is collected.
- Highly competitive market.
- Leading position in high-potential government market due to Figure Eight acquisition.

How do these drivers align with sustainable ESG factors?

With IoT and artificial intelligence growing in prominence, there's been a steady increase in the demand for quality annotated data.

A few factors that drive demand are listed below:

- Increased use of natural language processing.
- Convergence between automation, AI, IoT analytics and low-code platforms.
- Increased investment in artificial intelligence in China.
- Government investment in artificial intelligence.
- Augmented intelligence is on the rise.
- Conversational artificial intelligence is becoming commonplace.
- Computer vision is gaining popularity.

What are the future prospects for these drivers? Including the fundamental tailwinds that support their future growth.

- Globally, artificial intelligence is finding usage in an increasing number of software and appliances.
- There is a blurring of lines between AI and IoT as they continue to gain in popularity.
- Artificial intelligence is expected to grow at 55% in China.
- Chat bots and other conversational tools are, to an extent, replacing interactions with humans.
- Governments across the world are also investing in AI to improve processes.
- Increasing reliance on the internet and IoT-enabled devices.

What major risks exist in the potential of these future prospects to not become a reality?

We see a strong demand for quality annotated data going forward. However, there are some concerns listed below:

- Technology failure - a technology failure could impact both Appen and its customers. It could severely dent Appen's reputation too.
- Competition - a disruptive competitor may come in the way of Appen's growth.
- Macroeconomic influences - companies may delay or reduce expenditure on newer technologies including AI and IoT.
- Economic downturn could have an adverse effect on expense allocated for data annotation services or language processing services by client companies.

How might ESG trends impact this company's core markets?

- Social and governance trends across the industry act as significant tailwinds to support Appen's growth.
- Globally, AI is being used in numerous developing fields and industries.
- Artificial intelligence is expected to grow at 55% in China. Appen is looking to expand into China.
- Chat bots and other conversational tools are, to an extent, replacing interactions with humans. Appen provides data to make conversational tools smarter.
- Governments across the world are also investing in AI to improve processes. With the acquisition of Figure Eight, Appen stands to benefit from the US Government's push towards AI.
- Appen provides or improves data used for the development of machine learning and artificial products. With the data annotation market expected to grow to \$1.6 billion by 2025, there will be strong demand for quality annotated data.

What legislative or regulatory change is anticipated?

No data.

Are the company's key markets sustainable in terms of resource use and disposal?

Yes.

- Appen is a professional, knowledge-based workplace with minimal environmental footprint. Resource use and disposal are for the most part, not applicable.
- The company's offices include recycling facilities and the company encourages thoughtful use of resources.
- They have a low carbon footprint, except for air travel, which is necessary given their global nature of business.

Are the company's key markets sustainable in terms of consumer preferences and social trends?

It's very important to consider not only how the alignment of the revenue drivers fits with consumer preferences and social trends but how robust these trends are.

Yes.

- Artificial intelligence is finding increasing usage in various software and appliances.
- Artificial intelligence is expected to grow at 55% in China.
- Chat bots and other conversational tools are, to an extent, replacing interactions with humans.
- Governments across the world are increasingly investing in AI to improve processes.

COSTS

RAW MATERIALS

Consider the scarcity of main inputs and whether supply chain risks are appropriately managed. Is it possible that the company is paying more for sustainable products, which will increase immediate costs but reduce future costs associated with changing supplier or of supply being restricted?

Access to materials can be a key determinant of company earnings, depending on the industry. We assess access to materials by evaluating the strength of stakeholder relationships with, for example, suppliers, host governments, local communities, and contractors.

Are raw materials scarce?

No.

Are operations energy intensive?

No.

Are employees sufficiently motivated in the context of peers and management?

Fairly motivated. Exact number or percentage of employees leaving is not known.

“80% of the company’s core workforce say they are satisfied. In the last year, their attrition rate has dropped 5%” - *McLaren, 2019.*

Is there a risk input costs will rise?

- Platform operation and innovation expenses are likely to see a steady increase.
- Global expansion costs could increase significantly as they expand into other countries.
- Crowdsourcing costs could rise as minimum wages continue to increase especially in developing economies.

Is the company aware of these risks?

Yes.

Do cost projections take into account these risks?

Unknown.

TABLE 1: GROSS INCOME AS A PORTION OF REVENUE

Company	FY18	FY17	FY16
Appen	22.8%	21.57%	22.93%

Gross income as a portion of revenue. Source: Factset.

Table 1 shows gross income for Appen remaining consistent relative to revenue growth.

Competitors for Appen are private companies and thus no data is available for comparison.

LABOUR

Labour costs can account for most operating costs and careful management is required to maintain competitive advantage. Employees will consider the reputation of a company in evaluating job prospects. Company profile includes its management of social and environmental responsibilities and companies will struggle to maintain competitive advantage if talented graduates choose not to work for them. Labour efficiency is a consideration and achieved through higher productivity or lower costs and both are often achieved through non-monetary benefits. We also look at staff turnover and look at staff training spend as a percentage of gross profit. Be sure to consider the context as to the business model and extent of technology use.

In assessing a company’s efficiency in labour and spend on R&D, we use these metrics as a portion of gross income. We use gross income instead of revenue as gross income are the funds available for these investments. If we use revenue, then a company could be running at a loss compared to its profitable competitor and still spend a similar portion. However, it would not be as sustainable as its

competitor as it did not use cash flow generated from its own activities for these expenses. Labour is measured in gross income above and in general and administrative expenses below.

TABLE 2. GENERAL AND ADMINISTRATIVE EXPENSE AS A PORTION OF GROSS INCOME.

Company	FY18	FY17	FY16
Appen	8.1%	8.0%	14.3%

Table 2. General and Administrative expense as a portion of gross income. Source: Factset.

Table 2 above shows a significant decrease in G&A expense relative to gross income in FY17. It stays consistent in 2018. A slight increase might be expected in the future as global operations expand.

Competitors for Appen are private companies and thus no data is available for comparison.

R&D INVESTMENT

In many industries R&D drives a company's ability to exploit ESG trends. We analyse R&D spend as a portion of gross income in order to gauge commitment to R&D and technological differentiation.

TABLE 3. R&D SPEND AS A PORTION OF GROSS INCOME AND TOTAL (USD BILLIONS).

Company	FY18	FY17	FY16
Appen	NIL	NIL	NIL

Table 3. Investment in R&D as a portion of gross income and total in millions of USD. Source Factset.

No data available regarding Appen's R&D expense.

Competitors for Appen are private companies and thus no data is available for comparison.

What is the product development strategy? What is the percentage of sales from new products?

- Enabling technology that enhances the productivity of the crowd.
- Improving existing products and adding new products to enable delivery of higher volumes of high-quality data at faster speeds to cement Appen's competitive advantage.
- Unified Language Resources and Content Relevance teams to provide a more optimised and efficient customer experience.

No data provided on breakdown of sales from new products.

What are the pending patent applications and is there in-house venture capital?

No pending patent applications and no in-house venture.

NON-RECURRING AND EXCEPTIONAL EXPENSES

Analysis of the company's exposure to risks such as litigation or weather events to quantify the threat to future earnings.

What are the incentive structures?

The company's remuneration policy is to:

- implement remuneration structures designed to attract and retain high quality directors and be globally competitive and continually benchmarked to attract, retain and motivate senior executives with the expertise to enhance the performance and growth of the company and create value for shareholders.
- ensure that:
 - executive directors and senior executives are encouraged to pursue the growth and success of the company (both in the short-term and over the longer term), without taking undue risks.

- non-executive directors' remuneration is consistent with their obligation to bring an independent judgement to matters before the Board.
- review the employment conditions of Appen's employees on an ongoing basis to ensure the company remains competitive in terms of remuneration and other incentives; and
- review employee incentive plans from time to time with a view to further aligning management and employees' interests with those of the company and shareholders.

What is the extent of stakeholder research?

Extensive.

- Appen has a very informative website which includes a blog, white papers, data sheets, webinars, success stories and presentation.
- There is information available regarding the services and solutions it provides and the industries it provides those solutions and services to.

What is the company doing to mitigate ESG risks in regards to costs?

- Crowdsourcing helps the company to keep costs low.
- Continued investment in new technology will help reduce costs and improve margins.

Does the company report on these risks?

Yes.

What is the company's capacity to sustain or improve operating efficiency?

Are operating margins improving vs peers?

TABLE 4. OPERATING MARGIN.

Company	FY18	FY17	FY16
Appen	16.67%	15.52%	19.64%

Table 4. EBIT/Revenue. Source: Factset.

Table 4 above shows a drop in operating margin in FY17 followed by a small increase in FY18. We are expecting the operating margin to continue increasing as cost-efficiency increases at scale.

Competitors for Appen are private companies and thus no data is available for comparison.

How is improvement being achieved: technology investment, energy and resource efficiency, new incentive systems, economies of scale?

Appen's strategy is to invest in new technology to reduce costs, improve margins and sharpen responsiveness to evolving customer requirements. Their highly scalable crowdsourced delivery model aligns well with their customer's needs. They can curate a crowd fairly quickly to deliver a step change in volume, leading to a fairly efficient solution for clients.

Is this sustainable? What is management doing to ensure continued efficiency?

Management has identified opportunities such as the dramatic growth of AI in China and machine learning applications in the financial and industrial sector. Identifying and successfully capitalising on such opportunities will ensure sustainability and continued growth of Appen.

TABLE 5. CEO REMUNERATION FY2018

Company & Market Val	Base Salary	Cash Bonus	Option Award	Stock Award	Other	TOTAL
Appen (\$2,085M)	\$484,960	\$375,000	\$15,041	\$828,921	\$28,698	\$1,732,620

Table 5 above shows a conservative CEO remuneration according to market standards.

Competitors for Appen are private companies and thus no data is available for comparison.

Growth in Shares Outstanding

Shares outstanding have grown at a CAGR of 5.95% over the previous 4 FYs.

BALANCE SHEET

ASSETS

Some balance sheet assets are easily measured and audited while others, such as intangible assets, are harder to gauge. ESG analysis helps us to provide a greater degree of certainty in relation to the fair value of some assets, e.g., the impact of energy efficiency standards on property values and the effect that changing consumer perceptions, or regulations, related to sustainability will have on the sale of inventory. ESG performance, such as employee engagement, environmental efficiency, and community investment, can indicate a company's commitment to its reputation and brand, and human capital. Integrating ESG factors highlights these issues.

What percentage of total assets are intangible assets?

TABLE 6. INTANGIBLE ASSETS AS A PORTION OF TOTAL ASSETS.

Company	FY18	FY17	FY16
Appen	50%	61.8%	27%

Table 6. Intangible assets as a portion of total assets. Source: Factset.

Table 6 shows Appen has a high value of intangible assets compared to their total assets. This would mainly be due to goodwill from several acquisitions most recently including Leapforce and Figure Eight. As Appen relies on crowdsourcing, the requirement for physical assets is relatively minimal.

Competitors for Appen are private companies and thus no data is available for comparison.

What are the environmental provisions and are they sufficient versus the company's historical costs and those of its peers?

Each of Appen's offices includes recycling facilities and the company encourages thoughtful use of resources.

No information on historical costs.

Do notes to the balance sheet recognise environmental risks to physical assets?

No.

Do notes to the balance sheet or management discussion recognise ESG risks to reputation?

Yes.

What percentage of total assets are intangible assets? To what extent do brand, reputation, human capital, management quality, and intellectual property compromise intangible capital?

Refer to table 6 above.

How strong is the company brand?

Strong and getting stronger.

What is the strength of customer satisfaction and loyalty?

No information available currently but a key initiative for 2019 was to focus on optimising customer experience through a single global Sales team and a combined Client Services division.

Does the company have pricing power?

- No. Highly competitive market may result in increased pricing and billing pressure.

How are employees incentivised and what is the degree of engagement and staff loyalty?

- What level of autonomy do employees have?
No data provided.
- Are there flat or hierarchical structures in place?
No data provided
- How is the company recruiting talented graduates?
No data provided.

What is the structure (relevant committees) and diversity of the non-executive board?

Appen's non-executive board comprises five independent directors with two of them being female. Relevant committees include:

- Audit and Risk Management Committee:
 - Robin Jane Low (Chair of the Committee).
 - Deena Robyn Shiff.
 - Christopher Charles Vonwiller (Chair of the Board).
- Nomination and Remuneration Committee:
 - William Robert Pulver (Chair of the Committee).
 - Stephen John Hasker.
 - Robin Jane Low.

How dynamic and committed is executive management?

Very dynamic and committed.

Are pension assets being managed by ESG aware practitioners?

401k pension fund included in superannuation as part of executive remuneration. No data available on whether the members of the Remuneration Committee are ESG-aware practitioners.

LIABILITIES

Most examples more appropriately included in the cost analysis section. However, we consider these points below.

Are liabilities short or long-term? An ability to negotiate long-term debt agreements can signal a trusted relationship and lender confidence.

Two non-current debt facilities established in 2017 indicate the positive relationship and confidence Appen has with lenders.

How efficiently is working capital managed?

- DSO moved from 56.4 in 2014 to 70.1 days in 2018.
- DSP moved from 34.1 in 2014 to 26.9 in 2018.

The increase in DSO can be attributed to the large increases in receivables as well as concentration of 89% of revenue from 5 major clients. With no inventory metric and DSP decreasing, working capital overall seems well-managed.

How reliable are relationships with suppliers and customers?

In the past relationships have been quite reliable. No concerns have been mentioned regarding their suppliers or client retention in their financial reports.

What is the extent of off-balance sheet commitments?

\$5.34M operating lease commitments not recognised as a balance sheet liability.

Is excessive leverage eroding stakeholder trust and raising the cost of equity?

No.

Do debt covenants specify any aspects of ESG risk management?

No.

CASH FLOW STATEMENT

Adjustments to sales, earnings and costs completed in the previous section impact directly on cash flow. To flesh this out further, we investigate how ESG factors can impact cash flows regarding operating expenses, working capital management, asset maintenance, and capital costs.

Cash Flow From Operations

Earnings quality: If CFFO is significantly less than net income then the income statement may have been manipulated in order to improve headline figures such as EBIT and net income growth. Earnings quality and transparency can indicate ethical and efficient business conduct.

TABLE 7. CASH FLOW FROM OPERATIONS (CFFO) AND NET INCOME (MILLIONS AUD).

Metric	FY18	FY17	FY16
CFFO	\$46.80	\$13.38	\$12.68
Net Income	\$41.73	\$14.28	\$10.49

Table 7. CFFO and net income. Source: Factset.

As seen in Table 7 above, CFFO is higher than net income every year except FY17 where net income is slightly higher. This indicates mostly good earnings quality and transparency.

Are operating expenses being reduced by investment in new resource-efficient technology?

Yes.

- ~\$6M identified as efficiency gains from the Leapforce integration in 2018.
- Increased scalability of operations leads to operating cost-efficiency.

Is capital expenditure covering asset depreciation?

Yes.

Does capex investment in operational and resource efficiency today reduce the need for capex in the future and therefore point towards improvements in free cash flows?

No information available.

Does due diligence on acquisition targets cover long-term ESG risks? Is there a risk that inadequate ESG due diligence results in greater than expected environmental liabilities post-acquisition?

No information available.

Are there favourable long-term debt facilities that indicate a good relationship with lenders? What are the available borrowing costs? Could the company qualify for a lower rate if it improved its management of ESG risks, specifically in the case of project finance?

Two long-term debt facilities were established in 2017, one with a limit of A\$40M and the other with a limit of \$20M. Both have three-year terms and are not subject to annual reviews.

- Facility A was used to fund the Leapforce acquisition and is fully drawn. Mandatory prepayment of 7.5% of the outstanding principal balance of the facility is required if certain metrics are triggered, measured at each six-monthly reporting period ending on or after 30 June 2018.
- Facility B is used to fund working capital in connection with the Leapforce acquisition and general working capital requirements. It was fully repaid in 2018.

Both facilities attract interest at a margin over bank reference rates, based on the net leverage ratio. No indication of ESG factors affecting borrowing costs.

Valuation

Looking over the factors highlighted through the analysis above, how should the cash-flow projections be altered or what margin of safety do we require to be comfortable to make a purchase?

We are comfortable with our valuation of Appen and see no requirement to make any changes based on this ESG analysis.

References

McLaren, S., May, 2019 *“How These 4 Companies Are Embracing Flexible Work - and Why You Should Too”*.

Who is Blue Oceans Capital?

Fundamental, value based investments.

Blue Oceans Capital is an investment fund driven to achieve exceptional results with meaningful purpose through dedication to uncovering truth and applying our understanding of what is known and not what is forecasted. We invest in listed equities across the globe.

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