

AFTERPAY TOUCH GROUP LIMITED

(ASX: APT)

ASX Announcement

20 November 2017

Chairman's Address – 2017 Annual General Meeting

Introduction

On behalf of the Afterpay Touch Group Limited Board, it is a pleasure to address shareholders at our 2017 Annual General Meeting.

The 2017 Financial Year Was Significant for Our Company

It's hard to believe that it was only 3 years ago, in late 2014, that we founded Afterpay with a clear mission to revolutionise the way people shop in this country while encouraging responsible customer spending.

It is pleasing to reflect on the milestones we have achieved in our short history, including the May 2015 Afterpay listing on the ASX and the merger with Touchcorp Limited, Afterpay's original technology partner, in July 2017, to become the Afterpay Touch Group.

Today, we are a company that:

- Is the leading “buy now, pay later” service provider in the Australian and New Zealand market
- Partners with over 10,000 retailers including some of the best Australian and global retail brands
- Has served 1.3 million end customers, maintaining a sustained and highly engaged relationship with them, having now completed over 8 million transactions
- Maintains payments service relationships with some of the biggest consumer facing organisations and financial institutions in Australia and overseas
- Is proud to have a team comprising some of the best talent in this country as it relates to our customer, retail and technology fields of expertise
- A company that has recently been admitted into the S&P/ASX 300 index

The Merger Between Afterpay and Touchcorp in June 2017 Is Transforming

Afterpay merged with Touchcorp at the very end of the 2017 financial year.

The rationale for the merger was, and remains, very clear:

As a combined entity, the Afterpay Touch Group is vertically integrated from a technology and end to end service delivery perspective. Clear synergies exist in relation to platform development and systems which will increase our pace of innovation and speed to market.

In the few months since the transaction completed, the merger has already transformed our capabilities. There is no doubt that this was the right decision in terms of preparing our Company to take advantage of the significant expansion opportunities that are immediately apparent. Some of these will be touched upon a little later.

The Afterpay and Touchcorp teams have always operated under the same roof but coming together under the same name has already made a profound difference to the way we work together, to our productivity and in facilitating a true shared vision of what we can achieve.

The passion to add value to the lives of our customers and retail partners through innovative technology, our people, our principles and our processes has never been stronger.

The appointment of David Hancock as Group Head has been a very welcome and important development towards implementing our post-merger structure and strategy and ensuring the combined resources of our enlarged group are well integrated and supported. David has been associated with Afterpay since inception as an investor and Board member and has already delivered tremendous support and leadership to the business.

A key reason for David's appointment is to ensure that Nick Molnar, as co-founder and CEO of Afterpay, has the ability to maintain resolute focus on the growth and development of the Afterpay business and is well supported from a technology and operational perspective. That strategy is working well.

In addition to the combined Afterpay and Touchcorp teams, we have recruited significant talent into the company over the past 12 months, preparing us well for the opportunities we see ahead.

At Afterpay Touch we recognise that whilst our customers are at the centre of what we do it is our people that turn our strategies and focus into action.

I am so pleased to say that we have been able to attract and retain great people. The Board is committed to being an 'employer of choice'. The executive team recognise that in the tech world that there is a 'war for talent' and as such go out of their way to make a difference with a variety of activities designed to engage and retain. Notwithstanding this, we also recognise that our compensation and benefits needs to be competitive in an employment landscape that is looking for the best. We are in the process of finalising a Long-Term Incentive Plan that aligns with shareholders and staff to build long term value and will revert with further details.

The Board has been expanded with Mike Jefferies and Elana Rubin, both previous directors of Touchcorp, adding to the original Afterpay Board. As a combined team, the Afterpay Touch Board is working well and I thank my fellow directors for their amazing contribution, passion and support to me, Nick, David and the entire executive team throughout the merger process and subsequently.

Corporate Governance

The Board of Afterpay Touch considers good corporate governance a priority. It has adopted policies and practices to ensure the Board remains effective and has the composition to adequately discharge its responsibilities and duties, and maintain best practice governance. A summary of our corporate governance activities and policies are available on our website.

The Afterpay Business

Afterpay is a unique service which was founded to champion the customer's best interests and to help customers budget for life's little extras without the need to enter into a traditional loan or often high interest credit product.

Our products are innovative, simple, transparent and our business model is uniquely aligned to the customer in a way that makes them feel good and responsible at the same time.

The value proposition to both customers and retailers is very clear:

For the customer, we give them the opportunity to purchase, at no extra cost, a non-major item that they desire or need and to pay it off, in full, over a short instalment period – rather than enter into an ongoing credit arrangement that may accumulate or never get paid off.

For the retailer, we help customers connect with their brands, materially improve conversions and average order values, lower returns and promote customer loyalty.

Afterpay is clearly resonating:

We now have approximately 1.3 million customers. More importantly, and despite our rapid on-boarding of new customers (over 3k per calendar day), well over 80% of transactions by value per month are made by repeat Afterpay customers.

Millennials comprise approximately 75% of Afterpay's customer base – and millennial users identified Afterpay's platform as a useful budgeting tool for making purchases¹. Millennials are now not just the largest demographic on the planet but they are directing the economy and society trends with their lifestyle preferences, brand perceptions and ability to embrace technology and innovation.

Our audience is highly social and vocal and our engagement with our customer base is strong and repetitive. In turn, this is a powerful connection point for our retail partners and

¹ Pureprofile nationally representative research commissioned by Afterpay in 2017

our ability to promote their brands and products.

Our retail partnerships now extend beyond 10,000. We partner with the best Australian and global brands and the results and network effect is driving an increasing amount of inbound retailer enquiry and adoption. Small to medium businesses are very important to the retail economy and we have recently been on-boarding 750 – 1,000 SMBs per month but we are still just at the beginning of that journey.

Our goal is to be an enduring partner with the retail industry and to add incremental value by promoting the customer's best interests at every stage.

Afterpay's contribution to the retail economy is being evidenced in multiple ways:

- Afterpay now accounts for over 20% of all online apparel sales in Australia and over 5% of all retail e-commerce
- Those sales are associated with higher conversions, higher average order values and higher repeat purchase rates
- Online shopping events like "*Afterpay Day*" have been very successful for our retail partners
- We estimate that Afterpay is now one of the largest generators of online qualified leads to Australian retailers through our app and online shop directories – customers come to Afterpay to decide where they want to shop, generating millions of retail impressions and leads per month

Our focus on data and analytics is unrelenting. Not just in relation to driving our risk and real-time decision engines but also in relation to developing retail insights to deliver more value to our customers and retailers via multiple connection points.

The protection and privacy of customer and merchant data is a very high priority for the Company and Board.

Afterpay's business model is unique

Afterpay generates its revenue primarily from the retailer as opposed to the customer. Afterpay, in turn, generates incremental business for the retailer and pays the retailer upfront, meaning customer non-repayment risk sits completely with Afterpay.

Consequently, we have 100% business alignment with promoting responsible customer spending because we don't make money from customers defaulting. To the contrary, Afterpay's business model is designed and only benefits from dealing with financially healthy customers who meet their commitments and can and do use the Afterpay service regularly.

Rather than accumulate interest bearing debt, our model encourages customers to pay off their items, in full, on time, over a short period. This appeals to customers because they are paying things off in short time frames, rather than adopting a 'never never' or 'kick the can down the road' approach. The majority of our customer base does not favour credit. This

correlates strongly to millennial trends and is evidenced by the fact that approximately 85% of all Afterpay transactions are linked to a customer's bank account via a debit card, as opposed to a credit card.

We do charge customers a late fee as an incentive to pay instalments on time but we do everything in our power to avoid this from happening because it is in our financial interest to do so.

We employ many measures to promote responsible customer spending. A few examples:

- Prior to each and every order being approved we employ our proprietary fraud and repayment capability check – Afterpay Touch has been a pioneer in the creation of this technology. The rate of transaction attempts that are not accepted is approximately 25%
- We apply strict personal order and account limits – it starts low and only increases if repayment history with Afterpay is positive
- Importantly, Afterpay only approves one order at a time and if a payment is not made on any due date, customers are not able to make any further purchases with Afterpay until their account is brought back in order
- We communicate with our customers regularly 'in advance' of payments becoming due, so we do everything we can to prevent late fees from occurring. The percentage of customers that pay late and pay late fees on all 4 instalment payments relate to less than 0.07% of total orders

We do appreciate that notwithstanding our strict rules-based approach, sometimes circumstances change and customers run into financial difficulty or encounter circumstances beyond their control. We follow an effective communication and hardship programme when those rare instances occur. We also engage with all major consumer advocacy groups to ensure we are aware of and can respond to individual cases. We have voluntarily joined the Financial Ombudsman service and our website promotes responsible customer spending and has links to multiple customer tools.

Afterpay is proud to have pioneered an innovative product which clearly fits within the regulatory framework, is a powerful alternative to credit and is designed to encourage responsible customer spending.

Our strategy is to work cooperatively and transparently with all key stakeholders relevant to our industry

As a new but fast-growing company our approach is to engage with all stakeholders in an open and transparent manner.

Our business was founded on innovation and customer centricity. We pro-actively engage with regulators and are always open to listening to key stakeholders and have the capability to adapt as our industry leading position continues to grow.

The Afterpay Business Grew Strongly in FY2017

In terms of all key metrics, Afterpay experienced rapid growth in FY2017. Pleasingly this growth was associated with positive net transaction margins and EBITDA profitability.

In addition to key metrics, several strategic milestones were achieved that provide platforms for larger future growth ambitions. These include:

- The launch of Afterpay “in-store” which opens-up a very large opportunity to modernise lay-by and provide retailers with substantial value across all channels. Our “in-store” rollout is gaining momentum as more of our major retailers seek to expand the Afterpay online service to their physical store networks.
- The Afterpay “App” continues to be rapidly adopted with more than 500k downloads since its release earlier in the year
- Our geographic expansion into New Zealand, confirms our ability to architect and execute international expansion opportunities while developing our home base retail partnerships into new markets
- The launch of a pilot programme with Jetstar, a first step into services as well as the travel industry. It is still early days but we are confident such diversification opportunities represent a large future opportunity to add more value to our customers and generate incremental underlying sales growth

Afterpay’s Growth Momentum Has Continued into FY2018

Underlying sales in FY2017 were approximately \$560m. Current underlying annualised sales based on recent monthly performance is over \$1.7b.

Customers and integrated retail merchant numbers continue to increase at historically high levels and are currently at approximately 1.3 million and over 10,000 respectively.

October underlying sales represented a more than 15% increase over September and we are just into the Christmas trading period. While we won’t make any predictions for December sales, we are pleased with Afterpay’s contribution to retail events such as the “click frenzy” promotion last week, wherein we experienced two of our biggest sales days in our history.

Revenue margins remain stable.

Net transaction loss (NTL) is expected to increase in Q2 FY2018 and is likely to be impacted by some degree of seasonality. As previously flagged, we think it is important to manage NTL within a range between 0.6% and 1% as we are currently performing and as we continue our rapid growth profile. The bulk of our losses relate to first time customers who never pay. While we continually seek to reduce the incidence of these losses, our systems and processes are designed to prevent these customers from using the service again so our NTL profile is expected to change as our product and customer base matures.

Other variable transaction costs have also remained fairly stable but we do expect to achieve some economy of scale benefits in 2H FY2018.

Investing Now to Take Advantage of Sizeable Future Growth Opportunities

We have been investing in our team and our platform capabilities to take advantage of what we perceive to be core growth opportunities. The major focus areas are:

- Developing our in-store market penetration and effectiveness
- Exploring new retail and service verticals that are suited to our customers' lifestyles
- Expanding our data and analytics capabilities from both a risk and retail perspective
- Developing retail partnership opportunities in more geographies

This investment will add to Afterpay's cost base in FY2018 but will allow us to play into a much larger addressable market opportunity. We do not perceive this investment or step-up in cost base will be required on an annual basis.

Our balance sheet is strong and well positioned to sustain rapid future growth in underlying sales.

Our warehouse funding facility with National Australia Bank has recently been approved for expansion from \$200m to \$350m.

The current capital structure and capacity provided by the new facility will give Afterpay even greater scope to grow retail sales in Australia. The weighted average duration of Afterpay's receivables book remains consistently short (under 30 days), providing scope to grow underlying sales by multiples of the current run-rate.

The term of the new facility will be 2 years. While the specific terms of the new facility are confidential, they represent an improvement with respect to both pricing and advance rates and cover all lines of business that Afterpay currently undertakes in Australia.

Afterpay appreciates its association with NAB and the relationship that has developed over the past 12 months. The NAB team has undertaken extensive work to understand the Afterpay business model, our capabilities and our approach to serving customers and the retail industry at large. We look forward to the opportunity to work even more closely with NAB in the future.

We are also excited to have commenced a banking relationship with ASB in New Zealand (part of the Commonwealth Bank Group). The ASB Facility is a NZ\$20 million Revolving Cash Facility that can be drawn to fund customer receivables. The initial term of the ASB Facility is for a period of 18 months. The arrangement will provide Afterpay with an efficient funding model and reinforces the commitment to the New Zealand market and the Company's plans for growth.

Touchcorp Core Businesses Remain a Focus

Touchcorp's three main business lines are Mobility, E-services and Health.

Mobility remains a core focus and we will invest in developing the technology and service delivery platform that underpins this business.

We are continuing to streamline our e-services businesses in Australia and Europe and we are developing health business opportunities and looking to leverage our strong technical and platform credentials in that market.

Touchcorp's key business units and recurring revenues remain stable but are not reflected in the FY2017 financial statements.

The Afterpay Touch Group will first report its financial statutory results on a fully combined basis for the six-month period ending 31 December 2017.

Notwithstanding the Afterpay business related investment outlined previously, merger cost synergies continue to be extracted.

In conclusion

It has been a strong start for Afterpay Touch as a listed company, but it is still early days on the path to achieving our ultimate goals to serve customers and retailers.

The passion to serve the customer, innovate and develop enduring retail relationships is what drives our entire team.

I'm delighted to lead a Board which oversees a company with such highly experienced, dedicated and talented management and staff. On behalf of the Board, I would like to thank all our employees, who in the last 12 months have worked extremely hard to implement our strategy and grow our Company. I would also like to thank our customers and retail partners – the two key stakeholders that drive our passion and purpose.

Thank you.

ENDS

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