

25 February 2021

**GROUNDSWELL
HOLDINGS**

Mr Martin Tolcher
1 Cathedral Piazza
London
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United Kingdom

Dear Sir

GGL : Update on Executive Remuneration - 10 February 2021

I refer to the abovementioned update.

Annual Bonus

With regard to the proposed change to the annual bonus we have concerns regarding the Free Cash Flow (FCF) measure which is explained as follows:

'FCF will be assessed as the cash flow from operating activities (taken from the Consolidated Statement of Cash Flows) less sustaining and expansionary capital expenditure and with working capital movements excluded.'

Regarding this assessment of FCF, we would like to draw your attention to the following:

- **'Cash flow from operating activities (taken from the Consolidated Statement of Cash Flows)'** is actually the profit/loss before tax per the Income Statement. This excludes any non-cash adjustments (including depreciation, fair value adjustments & impairments).
- Tax paid is not dealt with per this assessment.
- Working capital movements, which are specifically excluded, are normally a key component in any cash flow calculation.

It appears the use of **'cash flow from operating activities (taken from the Consolidated Statement of Cash Flows)'**, which excludes non-cash flow adjustments and tax paid, was an oversight. Our view is that the correct term should be **'net cash generated from operating activities'**. This would include non-cash flow adjustments and tax paid, however, it also includes working capital movements.

The exclusion of working capital movements was raised with Mark Lawrie and the concern appears to be that the holding of auctions around year end could result in large swings in working capital and distort performance of the business. This doesn't make sense to us as auctions are conducted at the same time each year and, given that the company has been operating continuously for a number of years, the **net** roll over effect should be minimal.

In fact, excluding the working capital movement could be highly prejudicial as illustrated by the latest available (30 June 2020) Interim Results. FCF, before working capital movements (page 45), was -\$39,9m but after movements was -\$9,8m (a **positive** \$30m swing, probably due to the decline in debtors resulting from the collection of opening debtor balances and lower new debtor balances due to delayed auctions).

Long-Term Incentives

According to the update there are no changes proposed to the long-term incentives. Furthermore, it appears that a sizeable number of the outstanding awards are held by leavers. According to the scheme, awards to employees who leave prior to vesting and/or exercise lapse *unless the Committee determines, at its absolute discretion, that an award shall not lapse.*

Since the intention of long-term incentives is to incentivise management and employees to align their interests with the performance of the business and the interests of shareholders it does not make sense for participants, who have left and have no role in the future performance of the business, to continue to participate.

Summary

In summary, our recommendations are:

Annual Bonus

As an overall principle, annual incentive schemes should be modelled around the norm, with the Board empowered to adjust for exceptional circumstances. We believe FCF is a key measurement of performance and should be calculated in line with generally accepted principles. Our view is that the statement set out in the update should be amended to:

*'FCF will be assessed as the **net cash generated (utilized) from operating activities (taken from the Consolidated Statement of Cash Flows)** less capital expenditure.'*

Long-Term Incentives

Long-Term Incentives should only apply to persons employed by the Group who will play a role in the long-term performance of the Group. As a result, our view is that awards should automatically lapse for any person on the date employment ceases and the rules should be amended to remove the discretion to vary this.

Yours faithfully

William Marshall-Smith

Groundswell Holdings (Pty) Ltd
Director

[Handwritten Signature]

Rational Expectations (Pty) Ltd
Director

[Handwritten Signature]

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