GEMFIELDS

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11 March 2021

Gentlemen,

Letter re Update on Executive Remuneration

Thank you for your letter dated 25 February 2021 regarding executive remuneration.

Annual Bonus

At the outset, it should be made clear that Free Cash Flow ("FCF") is not defined under International Financial Reporting Standards ("IFRS"). Gemfields has attempted to provide clarity on the definition used for the purposes of the FCF KPI in the GGL Executive Director Short Term Incentive Scheme, which is consistent with Gemfields' FCF reporting in recent years.

In your letter, you refer to the definition of FCF, noting (i) some confusion regarding the source of the figure used and (ii) our exclusion of working capital. In respect of the former, it appears you are misreading the layout of the Consolidated Statement of Cash Flows ("CSCF"). With respect to the latter, we believe you may not appreciate fully the nature and extent of the working capital swings arising from the auction revenue platform used by the Group. These matters are set out in further detail below.

The Gemfields CSCF is in line with IFRS (IAS 7 *'Statement of Cashflows'*). There are 3 sections: 'Cash flow from operating activities', 'Cash flow from investing activities' and 'Cash flow from financing activities'. Each section is subtotalled (with the sum of all three representing the overall movement in cash during the period).

It would appear that your comment *'Cash flow from operating activities (taken from the Consolidated Statement of Cash Flows) is actually the profit/loss before tax per the Income Statement'* is based on your misreading of the heading of the first section of the CSCF. To reiterate - 'Cash flow from operating activities' is <u>not</u> '*profit/loss before tax per the Income Statement*', as you suggest.

Tax paid is a clearly a key factor in assessing FCF. Tax has therefore previously been, and will continue to be, taken into account when calculating FCF.

For interest, we summarise below the definitions used by peer group companies:

Company	KPI	Definition
Alrosa	Free Cash Flow	Cash flow from operating activities less cash outflow for financing capital expenditures (according to the "Purchase of property plan and equipment" line of Consolidated statement of Cash Flows).
Gemfields Group Limited	Free Cash Flow	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.
Lucara Diamond	Operating Cash Flow per Share	Cash flows from operating activities, less changes in non-cash working capital items, divided by the basic weighted average number of common shares outstanding for the period.
Petra Diamonds Limited	Operational Free Cash Flow	Cash generated from operations less capital expenditure for the year as per the Consolidated Cashflow Statement.

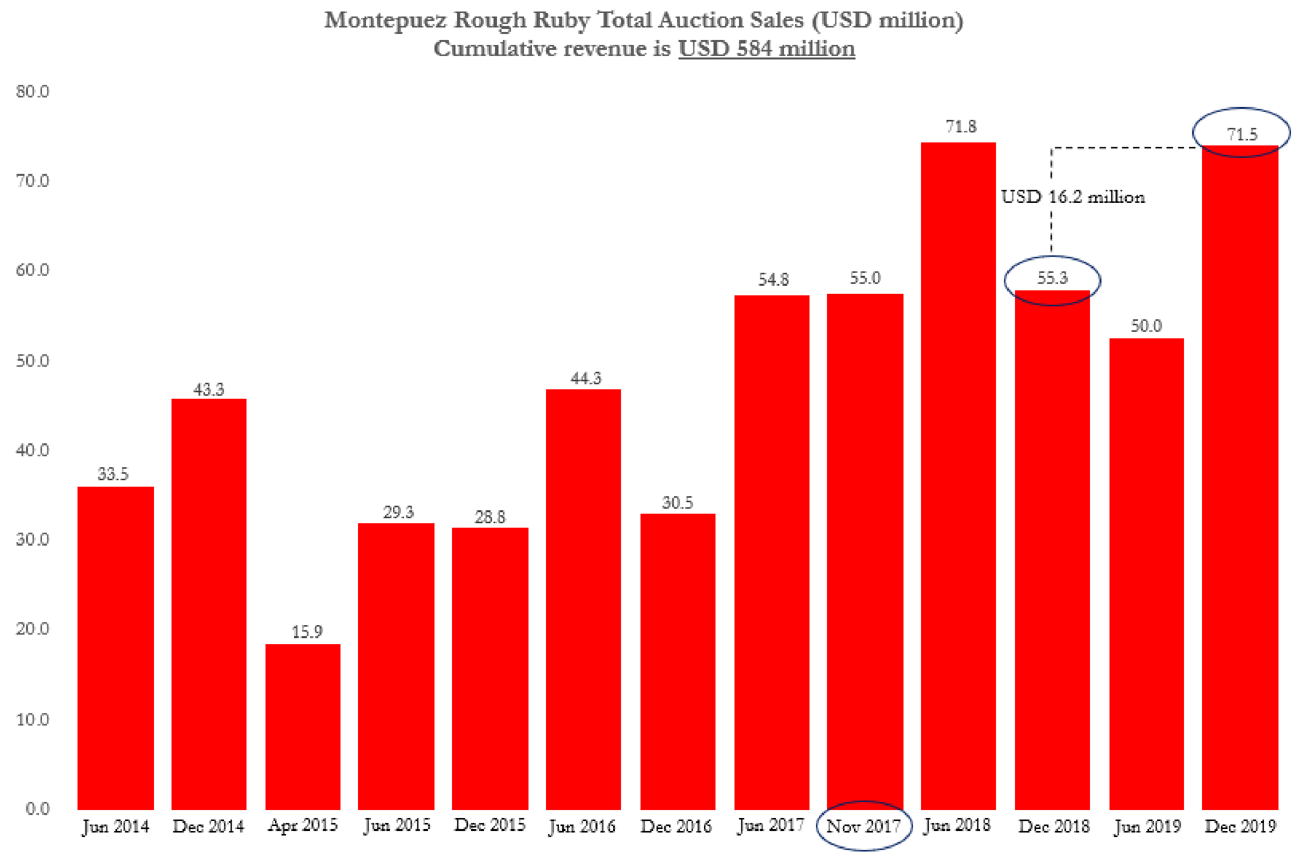
Please note that none of these companies explicitly use a reference to '*net cash flow from operating activity*' in their definitions as you suggest is the 'norm'.

Turning to your assertion that working capital movements should be included in the calculation of FCF (accompanied by the example laid out in your letter), you seem - perhaps inadvertently - to be reinforcing the very point we have made previously as to why these movements should be excluded. Put simply, FCF performance in a specific bonus assessment period should include revenues <u>generated</u> in that period.

Gemfields' revenues are unusually "lumpy". In addition, the typical auction schedule sees large auctions held in November and December each year. While the auction schedule remains reasonably consistent (Covid-19 excluded), the revenue generated at those auctions is not. The speed of customer payments can also vary, although the majority are cleared within 30 days of the end of an auction. Therefore, while your suggestion that '*the net roll over effect should be minimal*' is theoretically correct for many businesses, in reality Gemfields experiences significant working capital movements around the year-end which would distort the FCF if included. We believe therefore that the auction revenue accrued in a given financial year is a more appropriate assessment for bonus KPI purposes. By contrast, moving (say) 30% of an auction's total revenue into the following financial year on the basis that the actual funds were only received then, only serves to blur the picture of executive performance.

We set out below a summary of MRM's ruby auctions held since 2014. This highlights quite clearly the fluctuations that can occur, despite a relatively consistent auction schedule. The difference between the revenue generated in the auction held in December 2018 and that held in December 2019 is USD 16.2 million.

This will understandably lead to a significant increase in debtors in 2019 when compared to 2018 (i.e. it represents a negative movement in working capital despite improved auction revenues).



To highlight this further, the trade debtor balance for the year ended December 2019 was USD 62.5 million against USD 46.6 million in 2018, an increase of USD 15.9 million dollars. The majority of these balances relate to the respective December ruby auctions. It should also be noted that, in 2017, a ruby auction was held in November rather than December, which again affected the movement in working capital for the financial year.

There may be a concern in some industries that management could be rewarded for revenues that are reversed post the reporting period. Gemfields has no history of bad debts at its gemstone auctions (i.e. no income reversals have been required).

In summary, for many businesses, including movements in working capital when calculating FCF is the optimal way to analyse FCF generation for general purposes. For Gemfields' revenue model however, including working capital adjustments may distort significantly FCF analysis for bonus KPI purposes. Put another way, executive bonuses based on FCF including working capital may lead to higher bonuses being paid in weaker years (thanks to carried forward auction receivables) and supressed bonuses being paid in stronger ones.

In line with our previous reporting, the financial statements will continue to include a detailed calculation of FCF showing the component parts in the segmental reporting note.

Long-Term Incentives

The Employee Share Option Scheme ("ESOS"), as approved by shareholders via a special resolution at the AGM in June 2017, gives leavers the right to retain share options which are exercisable at the date employment ends. All share options that are not exercisable at the date employment ends automatically lapse. For the three previous directors who departed under the ESOS, there has therefore been no discretion applied. Please note that these options, amounting to 27,890,215 options with an exercise price of ZAR3.45, lapse in September 2022 in accordance with the terms of the ESOS.

Gemfields also operates a Company Share Option Plan ("CSOP"), a tax efficient plan for UK employees approved by HMRC. There are currently 5,109,900 options with an exercise price of ZAR2.30 and 300,000 options with an exercise price of ZAR1.91. Under the rules of the CSOP, leavers have only 6 months after their employment ends to exercise any vested options. Unvested options automatically lapse when their employment ends. Again, there is no discretion applicable.

I trust that the explanations above provide clarity on the matters raised in your letter.

Yours sincerely,

Martin Tolcher
Chairman