Gemfields Group Limited: Update re shareholder communication on executive remuneration
10 February 2021

Introduction

Further to the voting on resolutions related to remuneration at the Company's AGM in June 2020, the Company arranged a shareholders' conference call on 16th July 2020 following which a response to shareholders' comments, including new annual bonus arrangements, was prepared and circulated to shareholders and a further shareholder call took place on 14th December 2020.

This note sets out the Company's further response to points and questions put by shareholders on its annual bonus proposals during the December 2020 call.

The Remuneration Committee is very grateful to the shareholders who participated in the remuneration feedback sessions, and for their views which have assisted in shaping adjustments to remuneration policy.

Summary

During the call on 14th December 2020, shareholders' points included the following:

- Shareholders were supportive of a balanced scorecard approach. There was some debate about whether the number of criteria was too many.
- Some shareholders expressed concern about the approach of measuring metrics against the previous year and the previous three years, rather than setting specific forward targets.
- Shareholders stated the importance of getting the Free Cash Flow definition correct.
- Shareholders suggested a Return on Capital criterion be considered.
- Shareholders agreed that bonuses should be subject to malus and clawback provisions.
- Shareholders asked whether bonus deferral had been considered.

Annual Bonus

The Remuneration Committee considers the type and balance of the KPIs to be effective and appropriate. These KPIs are, in declining order of weighting:

1. Free cash flow
2. Revenue
3. Total cash operating cost
4. HSEC (Health, Safety, Environment, Community)
5. Total premium carats produced
6. Total rock handling
7. Fabergé cash consumption
8. Balance sheet
9. Strategy / Business Development / Development Projects / Organic Growth
10. Leadership / Organisational / People Development / Staff turnover
11. Financial and Shareholder Reporting / Auditors / Accounting / Controls.

Some of the shareholders indicated they wished to see defined targets or “stretch targets”. The Remuneration Committee believes that setting forward stretch targets creates a number of issues. Setting forward targets involves a significant degree of judgement and subjectivity and can create perverse incentives. This is particularly so for Gemfields, where the volatility in both gemstone quality and mining grade (and the arising impact on revenues and therefore free cash flow) leaves considerable scope for wide-ranging target setting.

The new scheme therefore benchmarks performance against prior years across a broad and balanced range of KPIs, requiring no judgment or subjectivity. The scheme effectively sets the “target” (a better phrase would be a “measurement benchmark”) as the level of performance attained in prior years. However, and critically, whereas the traditional KPI approach pays out a bonus of X% for achieving the “target”, the new scheme would typically pay no bonus for merely attaining the same performance as in prior years. This creates a strong focus on ongoing improvement across the various KPIs. When a shareholder asks “what does success look like?”, the answer is “beating the performance attained in prior years”. As such, management know clearly what they are aiming for.

In relation to free cashflow (“FCF”), the Remuneration Committee is satisfied that FCF attained in the assessment year be compared with the FCF attained in prior years. A key point is that the FCF is calculated in a consistent manner. 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.

The question of whether to include a return on capital metric relates to the choice and balance of KPIs. The Remuneration Committee is satisfied that the structure is effective, fair and appropriate. If the Company performs positively in respect of operational, financial (including FCF) performance, return on capital / equity will follow. FCF is a pertinent metric and takes into account the capital being “invested” in the business in the form of expansionary and sustaining capex.

The Remuneration Committee noted the point made by one shareholder in relation to considering the adoption of deferring a portion of bonuses. The Remuneration Committee will keep the matter of bonus deferral under review.

Long Term Incentives

The Remuneration Committee does not intend, at this time, making changes to the prevailing share incentive scheme given that it represents a legally binding arrangement.

Gemfields may in due course consider a new approach to long term share incentive awards. The Company will consult with as many shareholders as practicable in advance of any proposed amendments and will seek formal shareholder approval for any new plans in advance of implementation.

To provide reassurance to shareholders in relation to the level of dilution arising from the existing arrangements, the Company sets out summary points below:

a. 117.6 million awards are outstanding, equivalent to 10.1% of issued shares.
b. While this percentage is significant, dilution may be low given the structure of the awards (including the exercise price and lapsing profile).

c. 55.8 million awards (47% of the outstanding awards) have an exercise price of ZAR 3.45 (presently equivalent to GBP 0.17). These commence lapsing from September 2022 and are fully lapsed in September 2024.
d. Of these 55.8 million, 50% are held by leavers and the balance (27.9 million / or 2.4% of issued shares) are held by the CEO. Of the current total outstanding awards, approximately 38% lapse by December 2022 and 74% lapse by December 2023.
e. The total awards with exercise prices between ZAR 1.91 to ZAR 2.97 are 62 million (5.3%)
f. The weighted average exercise price of the outstanding options is ZAR 2.94 (£0.14).

The Remuneration Committee's intent is to keep matters of remuneration under ongoing review and to take account of shareholder views and this will continue to be the committee's approach.