ASX ANNOUNCEMENT

26 August 2021

Appen 2021 Half Year Results

Appen Limited (ASX: APX) a global leader in the development of high-quality annotated datasets for machine learning and artificial intelligence, has today announced its results for the half year ended 30 June 2021.[1]

All amounts in US$, unless stated otherwise

- Group revenue of $196.6M, down 2.0%, due to lower Global Services revenue as Global customers[2] allocated resources to new, non-advertising projects in the first half of 2021
- Global Product revenue of $22.3M, up 15.2%, as Global customers invested in new AI use cases supported by Appen's annotation platform and tools
- New Markets revenue of $47.8M, up 31.5%, driven by China, new Enterprise customer wins and product-led growth
- Acquisition of Quadrant, a global leader in mobile location and Point-of-Interest data, further extends our product offering
- China continued to grow strongly, with 1H21 revenue 5.8x 1H20 revenue
- Annual contract value (ACV) of $119.6M, up 16%
- Underlying EBITDA[3] of $27.7M, down 14.3%, due to higher costs related to growth investments
- $66M in cash at 30 June 2021
- Interim dividend of A$ 4.5 cps, 50% franked, flat on 1H20 dividend

Appen's Chief Executive Officer Mark Brayan said, "As expected, our first half results were impacted by our global technology customers' focus on new AI products and applications, as they broaden their revenue base outside of digital advertising and respond to data privacy changes. This resulted in lower ad-related services revenue, but higher product revenue as Global customers used our market-leading annotation platform and tools for new AI use cases."

"We expect these new programs to grow and augment our ad-related programs as our Global customers rely on our expertise and product capabilities to help them develop the breakthrough AI-driven products of the future," he added.

"Our investments in product development, engineering and sales also supported strong revenue and customer growth in New Markets and provide a foundation for further growth."

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[1] All comparisons are to the half year ended 30 June 2020, unless stated otherwise.
[2] Major US technology companies.
[3] Underlying EBITDA excludes restructure costs, acquisition related share-based payment expenses and transaction costs, and for 1H20, fair value (consideration) adjustments for the Figure Eight acquisition.

OPERATING PERFORMANCE

Global Services revenue of $148.8M was 9.2% lower as Global customers prioritised their spend on new and non-advertising related projects in the first half.

A range of factors have accelerated our Global customers' strategic transition to a broader revenue base, including the impact of COVID-19 on digital advertising in mid-2020, competition, ongoing regulatory scrutiny, and the changing privacy landscape.

Non-ad related projects now comprise 75% of total revenue from Global customers.

In the first half of 2021 alone, we commenced work on 100 new projects with our Global customers and 97 were not advertising related.

This reflects our Global customers' focus on additional areas for growth, such as AR/VR and geolocation based services. Deferred non-ad projects largely returned after the slowdown in the last quarter of 2020, and we expect continued revenue growth from these projects as customers continue to diversify and as products approach commercialisation.

Our Global customers are also working on new approaches to ad-targeting that manage privacy issues, including federated and on-device learning, and differential privacy techniques. We anticipate opportunities to support these programs as solutions are adopted and new training data is required. Ad-related projects came back at a slower pace in the first half. Higher volumes and revenue growth are expected in the second half, but at a lower rate than non-ad projects.

New Markets revenue was up 31.5%, due to product-led growth, and strong performance in our China and Enterprise businesses. Our sales teams also leveraged the reopening momentum to win 74 new customers in the six months to 30 June 2021.

Within New Markets, Global Product revenue was up 15.2% as Global customers used our products to enable their new AI investments. Their use of our annotation platform was a key driver of committed revenue, which was 31% of total revenue, up from 12% in the first half of 2020.

Our product capabilities also helped to drive revenue in our Enterprise division, as we supported an increasingly diverse range of industries and AI uses cases.

New deployments of machine learning powered automation also resulted in quality and efficiency improvements on live customer projects.

Recognising the extent of the opportunity, we spent 10.8% of revenue on product development in the first half of this year, to tap the expanding market and increase productivity.

Our acquisition of Quadrant – a global leader in mobile location and Point-of-Interest data – expands the breadth of Appen's data capabilities and product offering for existing customers and opens new growth opportunities in the global location intelligence market.

To further drive our product strategy and roadmap, Sujatha Sagiraju will join Appen as Head of Product, after more than 20 years at Microsoft. Starting as a software engineer, Sujatha went on to spend almost 10 years as Principal Product Manager for Bing, and most recently was Senior Director, AI Platform with responsibility for the AzureML growth strategy.

The organisational restructure announced in May is complete and all our teams are now aligned to our customer centric and product-led strategy.

Revenue in China grew at a compound rate of 60% in the last five quarters, as we deepened our relationships with China's leading technology companies and won new customers. This enabled us to extend our position in speech, image and autonomous vehicles, and to take share in the domestic language market.

Product innovation was also important to our Government business where we launched a new tiled imagery tool to support geospatial annotation. The early-stage market dynamics in the Government market have, however, resulted in longer sales cycles.

FINANCIAL PERFORMANCE

Group revenue of $196.6M was down 2.0%, due to reduced services revenue and the heavy skew in project timing and delivery to the second half of 2021. The growth rate was also impacted by a strong comparative period result and negligible impact from COVID-19 in the first half of 2020.

Gross margin was lower due to customer and project mix, as large legacy project volume growth slowed and early-stage projects commenced.

ACV of $119.6M was up 16% on the prior comparative period, due to the expansion in January 2021 of an enterprise-wide platform agreement with a Global customer.

Underlying EBITDA was down 14.3% to $27.7M, due to the fully annualised impact of FY20 growth investments, and 1H21 investment in New Markets. This was partly offset by a share-based payment expense true up adjustment for the 2020 Long Term Incentive Plan, based on an assessment of the probability of achieving hurdles.

A charge of $2.3M was taken to reflect restructuring costs incurred in the first half of 2021 and a provision for costs that will be incurred in the second half.

Underlying NPAT was down 35.0% to $12.5M, due to the increased amortisation associated with investment in product development.

Appen had no debt and a cash balance of $66M as at 30 June 2021. Cash conversion was 101% of underlying EBITDA.

The Board has determined an interim dividend of A$ 4.5 cents per share, 50% franked, flat on the 2020 interim dividend.

OUTLOOK

The planned investment in Quadrant's product and market expansion will reduce the full year underlying EBITDA guidance provided in February and May of $83M - $90M, by $2M, to $81M - $88M.

Full year underlying EBITDA is expected to be at the low end of this range due to ad-related project impacts.

Year-to-date revenue plus orders in hand for delivery in FY21 is approximately $360M as at August 2021. This is 10% above the August 2020 guidance of $328M which was 79% of full year 2020 revenue.[4]

The forecast is supported by a stronger order book, higher confidence in the pipeline, and the expected second half revenue skew (weighted to fourth quarter) due to our customers' delivery schedule for e-commerce, digital advertising, and search programs.

Second half revenue is expected to be in line with historic splits (excluding FY20), with full year revenue growth for Global Services at mid to high single digits and New Markets at circa 25%.

Gross margin is expected to improve in the second half, consistent with FY20, due to higher revenue and the customer and project mix.

[4] Year-to-date revenue and orders in hand in August 2020 was ~A$475M, equivalent to ~US$328M at the FY20 average AUD/USD FX rate of 69.04

There will be moderate expense growth in the second half. Restructure-related cost savings of approximately $15M are expected in FY22 and will be largely reinvested to drive product development and growth.

Full year underlying EBITDA margins are forecast to be in line with FY20.

FINANCIAL SUMMARY

US$M	1H21	1H20	% change
Global Services	148.8	163.9	(9.2%)
New Markets	47.8	36.3	31.5%
Other	0.0	0.3	
Total revenue	**196.6**	**200.5**	**(2.0%)**
Statutory EBITDA	**25.2**	**33.4**	**(24.6%)**
Underlying EBITDA[5]	**27.7**	**32.3**	**(14.3%)**
Underlying EBITDA margin	14.1%	16.1%	
Statutory NPAT	**6.7**	**14.9**	**(55.1%)**
Underlying NPAT[6]	**12.5**	**19.3**	**(35.0%)**

INVESTOR BRIEFING

A results briefing will be hosted by Mark Brayan, CEO and Kevin Levine, CFO at 11:00am AEST on Thursday 26 August.

The briefing will be webcast live at http://www.openbriefing.com/OB/4263.aspx

Those wishing to ask questions during the briefing can join via conference call. Please pre-register for the call at:
https://s1.c-conf.com/diamondpass/10014461-w4hlb3rg.html

[5] Underlying EBITDA excludes restructure costs, transaction costs, acquisition related share-based payment expenses, and for 1H20, fair value (consideration) adjustments relating to the Figure Eight acquisition.
[6] Underlying NPAT excludes after tax impact of restructure and acquisition related costs, such as acquisition related intangibles, share-based payments and transaction costs, and for 1H20, consideration adjustments relating to the Figure Eight acquisition.

The release of this announcement was authorised by the Board of Appen Limited.

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About Appen

Appen collects and labels images, text, speech, audio, video, and other data used to build and continuously improve the world's most innovative artificial intelligence systems. Our expertise includes having a global crowd of over 1 million skilled contractors who speak over 235 languages, in over 70,000 locations and 170 countries, and the industry's most advanced AI-assisted data annotation platform. Our reliable training data gives leaders in technology, automotive, financial services, retail, healthcare, and governments the confidence to deploy world-class AI products. Founded in 1996, Appen has customers and offices globally.