Afterpay

ASX Ticker: APT

It's been a wild ride for payment pioneer Afterpay. Throughout what has been a turbulent year, the business has always maintained strong lines of communication with the market.

By Alan Deans

AFTER THE FACT

Cover Story

The actions taken by tech star Afterpay Touch Group to allay investor concerns earlier this year about its core online payment service provide valuable lessons for all listed companies. Hit by claims on prime-time TV's *A Current Affair* that teenagers were abusing its app-based lay-by system to buy alcohol and go on shopping sprees, top executives rapidly moved to calm fears. Concerns had also been circulating on a couple of other hot button issues. They were that a crackdown was required on financing rules that could impact Afterpay, and worries senior executives could reduce their shareholdings.

The top three executives at Afterpay were interviewed by *Listed@ASX* to detail how they managed the fall out. Executive chairman Anthony Eisen, chief executive officer Nick Molnar and group head David Hancock were calm and reflective about the outcomes. Clearly, however, they had been feeling the heat.

Nick Molnar
CEO, Afterpay

Let's set the scene. The trio successfully managed the merger in mid-2017 of the ASX-listed Touchcorp with Afterpay to fire up an ambitious global growth strategy to revolutionise the way millennials shop both online and in store. The technology has global implications for boosting the sales of major retailers and they are eagerly signing up to use it. That is partly because it can also provide them with precise, timely intelligence on what Afterpay users are responding to and buying. That unique business model has already led major groups like Calvin Klein, Coach, Country Road, David Jones, Just Jeans, Myer, Sephora and Tommy Hilfiger to become clients. And that was before Afterpay kicked off this year in the US and the UK.

By April this year, the company was firmly entrenched as a stellar growth stock in investors' minds along with other recent local listings like Appen, Updater and Wisetech Global. Its board was on the verge of announcing a note offering and agreements were being finalised for an eagerly anticipated launch into the potentially huge US market. Afterpay's share price had nearly trebled during the preceding nine months to touch a peak of $7.80. The *A Current Affair* controversy belted the price, however, leading to a sell off down to $5.35 in the space of one month.

Executives were forced to react to what Hancock concedes were lots of calls from investors wanting to know what was going on. Afterpay's growth meant its share register had greatly expanded to include more than 100 institutions from Australia and offshore. There were many private investors too, some having been in the stock for years and with a large chunk of their wealth riding on Afterpay's success. The executive team knew many of them personally, and felt a deep obligation towards them.

"It is fair to say that, as individuals, we were very hands on from the early stages [of Afterpay]," Eisen says. "A lot of what was produced for the market came from us [three executives]. The approach we took was to always speak plainly and clearly, in the same way we speak to our team members. We did not outsource the capital markets responsibilities. We knew it was a very important stakeholder group in the long term, therefore the way we approached that was to make sure we were communicating in a common language coming from the same source. That clarity of communication was really important. We took that on a day-to-day perspective. In hindsight, that has been very beneficial because there is a clear line of communication and consistency inside the company as well as outside."

Hancock goes further. "We have been fortunate in that there's a large pool of very loyal retail investors for which we are very thankful. The next thing is the quality of the analysts. They understand the story, and they dig deep. We have good coverage. We have some of the best investors globally on our register, whether they be among the most successful fund managers or specialists, and some only hold Afterpay in Australia.

"We gained a lot through the fact that we listed. We were able to give a lot of comfort around compliance. One of the things we were most pleased about last year is that we had only been listed for 12 months, but we were finalists in the Australasian Investor Relations Association's annual awards for best investor relations by an ASX Mid-Cap 200 company. For us, that was recognition around governance, around disclosure, around setting a standard that other tech companies definitely want to hit. It was voted for by fund managers. Of all the other awards that we won, that was really important because it said we had really great support from the investment community.

"We have never tried to sell the story. We just tell it. There is a fundamental difference. We just tell it as it is, and investors can make up their own minds and make their own decisions. We just have to lay out the facts."

The composition of the register was important from the early days. So was delivering on its value proposition. Eisen says, "we never went out to the market with forecasts, but we did say we intended to scale the business and that would become evident by the number of retailers on our platform. Much more importantly, was the way customers adopted the service and continued to re-use it. The market was very, very keen in that early period to see how the business developed from a scalability perspective but also how we performed behind that.

"Our business is all about customers and retail, but underpinning it are sophisticated processes around governance and also around technology, risk and data analytics. While we scaled quickly, what the market was attuned to was the rigidity of the business model and that the processes were there. We were rigorously measured on those different aspects.

"The other interesting point is that we are a start-up that has grown very quickly. But a lot of our technology and processes have been in existence for a very long time and have a solid track record. The Touch, in Afterpay Touch, arises from our technology partner, which was Touchcorp, itself a listed entity. A lot of the underpinnings of the Afterpay system today relates to technology that sat within Touchcorp, and provided payment and risk services to the likes of Optus, Medicare via HiCaps and others, and the electronic payment servicing in 7Eleven. Yes, we are a new company, but some of the core scalability and technology underpinnings have a long history."

"THE KEY THING WE FOCUS ON IS DEVELOPMENT OF OUR BUSINESS."

ANTHONY EISEN

A Current Affair's coverage of Afterpay featured interviews with and footage of teenagers. The program previously aired segments on consumer credit, and featured Afterpay along with new products being offered by other fintech players. This time around, however, it concentrated solely on Afterpay. The report revealed online accounts had been set up by teenagers too young to qualify for credit. One underage teen had ordered alcohol using a false ID to set up an Afterpay account. Comments

**Anthony Eisen,
Executive chairman,
Afterpay**

David Hancock,
Group head,
Afterpay

included that Afterpay should be subjected to credit regulations. David Hancock was interviewed too, saying the company was making changes, including more identity checks. The publicity came on the heels of several print media articles on issues including stockbroker reviews, short selling pressures and a potential tightening of consumer credit laws. A storm clearly was breaking, and it was hitting on a number of fronts.

For its part, Afterpay acted quickly and decisively. One key decision was to focus attention on its customers and investors rather than the media.

"I don't think we have ever had a media strategy," Eisen explains. "We have always focused on trying to do the right thing by our customers. One of the really pleasing things through this process is how customers responded. We never saw them respond in a negative way. In fact, they have been very vocal and very supportive. They are the ones who understand the product best, why we created Afterpay and why it serves their interest. For us, there was no media strategy. There has always just been a customer strategy to make sure that our product and processes are well understood."

In fact, Afterpay says its customer base continued to grow as evidenced by the response on social media. "There is a group on Facebook called We Love Afterpay," Nick Molnar says. "It has 124,000 members. That customer love flowed through, and helped us to navigate the issues. In our key messages, we were never defensive. We were self-reflecting. We made changes quickly once we identified what the problems were and the customers reacted really well to that. They supported it, and they backed us up in the media. They are very vocal about how much they love us, and they are very supportive."

Early in April Afterpay lodged a company update to investors, nearly two weeks before *A Current Affair* went to air. Eisen says that was not something ASX asked them do to. "It was really just trying to be very consistent in our dialogue. We didn't think that it was a requirement or appropriate to say anything more than that. We maintained the dialogue around the core business, and how that was travelling and what the product was designed to do and how it was being used. Investors have a very effective way of finding out the story for themselves. Whether it's talking to our retailers, and understanding the impact we are having on their businesses. That's what good investors do. More than anything else, we never had to provide more information other than our consistent messaging and our regular updates."

The statement reiterated the commitment to responsible customer spending, and said it was upgrading procedures to curtail underage usage. It also gave details about share escrow provisions for its core executives, adding that Eisen and Molnar might sell up to 10 per cent of their individual shareholdings during the upcoming 12 months. This was aimed at the market's short selling concerns. It also flagged that it would soon issue a business update.

A week later, the second update provided more reassurance to investors about the underlying business performance. It revealed sales were up 400 per cent in the three quarters ending March, with $1.45 billion of underlying sales processed through its platform during that period. It also said significant new retailers were signing up to the platform and plans were on track for entry to the US.

Eisen says: "There is no doubt that, being listed, market communication is very important. That is as much about talking about what we are doing and also when we will update the market next. It was very important to set a communication path and our execution path. It was about creating a consistent form of messaging. That we understood the issues, and this is what we were doing. That became a core priority for us."

Hancock says: "It was us being very clear what our requirements were. We have always been focused on delivering on what we say in a timely manner. When it came to the announcement, it was that we were making a significant capital investment to make changes, to identify some of the issues. There was never a financial loss. It was very interesting, because being under 18 and using the product … you can be 17 and use a credit card and different forms of finance out there. We took the view that this product was for over 18s.

"Yes, there were breaches of our rules. But we stuck to our core values, and we think that is important to communicate that to the market along with the financial impacts. It was clear there were no financial impacts, but what is important is the reputation of the company and integrity of the product. We don't look at the share price. The market will determine what the price is. What we focus on is doing what we say we will deliver on.

"While this was taking place, we took on all of the commentary. One of the issues was that we had built a robust system, but we needed to do a couple of things better. That was around the misuse of the service. We absolutely looked at that, and we took on the feedback, invested heavily and changed levels of how we identified our customers. When we went back to the market, they understood what we were doing."

Tracking Afterpay's share price, it took less than three months to recover its April high of $7.80. That confirms the success of its strategy to communicate openly with investors, and it also indicates the ongoing delivery of expectations on business growth. By mid-May it announced its US launch. It had teamed up with Urban Outfitters, a retailer with $US3.5 billion in in-store and digital sales. That is about as much as Australia's entire online fashion clothing sales.

Molnar explains: "The market wanted to know what the US launch was going to be about. To launch with the biggest millennial fashion group in the US, which trades in the billions of dollars of revenue, as our first retailer really set ourselves up for a great launch and it exceeded expectations. While this was going on, we were still executing. We said that not only were we going into the US, we said here is our strategy, our first partners and our resume. The market started to turn around. They focused again on the execution of the business and the opportunity that we had in front of us."

By the time of its next market update late in July, Afterpay reported full year underlying sales growth of $2.18 billion, up 289 per cent. Its retail base had grown to 16,500 customers and the total number of users who had bought online since inception grew to 2.2 million. More than 400 retailer contracts had been signed in the US alone. This disclosure caused a spike in the share price from $10.44 to $15.04. One month later, and the share price went on another tear. Annual group EBITDA was up 380 per cent to $33.8 million on revenues of $142.3 million. This pushed shares to an all-time high of $21.13 each.

Putting that performance into context with where it was positioned before its media troubles began, Afterpay's share price had risen three-fold. The company was worth well over $1 billion in market capitalisation, and on that measure was larger than the lowest capitalised companies included in the S&P/ASX 100 index.

"The market will set the share price and not us," Eisen says. "The key thing we try to focus on is development of our business. What has been a significant movement since that period is how we have grown and continue to resonate in Australia and New Zealand, and how our product has been developing at the same time. Then there's moving offshore.

"Over that time, it also became clear Afterpay wasn't just an online proposition. You could use it in-store and be part of retail innovation. We continue to illustrate that. Afterpay was also becoming a destination for consumers, as opposed to just a simple product to do a transaction. This was an intrinsic element for our company all along, but it became exposed over that period.

"Of course, the US is still early days but we have been able to illustrate that we have a core value proposition that can resonate internationally. Some of the best retailers in the world are taking it seriously and integrating the product as part of their own priorities. These are core business development areas. The other factor that

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DAVID HANCOCK

gained resonance with investors was our team, and our ability to attract fantastic talent. When we were launching in the US, we announced some significant hires, some of whom probably encapsulate leading talent in the world as it relates to risk analysis, data analytics, technology development and retail engagement.

"From an investor's perspective, while it is early days, we were exposing elements of how we can scale according to our core values in more than one location. There is always quite a bit going on, but from an investor perspective it's always testing the core elements.

Hancock: "The key is that we have a bunch of people who don't miss a beat. Even when we are doing capital raisings, the share market is up or there is some macro issue, we just want to ensure that the company can keep executing and not miss doing what we say we will do. The way that we have set it up is that it's important that investors know what's happening, but the reality is that we need to keep a core focus and keep the staff engaged."

When Afterpay's media issues emerged in April, it was transitioning from being a company focused on serving customers in Australia to having a fledgling business in New Zealand. Within six months, it had leaped across the Pacific Ocean to make its name a buzzword in the US. Since then, it has crossed the Atlantic to enter the world's third largest e-commerce market in the UK. It did that by purchasing 90 per cent of an existing local company, ClearPay Finance. To underpin these ambitions, it was able to complete a $108.1 million fully underwritten institutional placement and a $36.8 million share purchase plan.

This expansion has other facets. Afterpay's offices are both functional and regionally focused to best support its sales platform. For instance, its Sydney office is sales and marketing-orientated. The larger Melbourne base is used more as its technology centre. It is developing a centre of excellence in San Francisco, because of the deep pool of talent in that part of California. It also has sales teams in San Francisco, Portland and New York. The entry into the UK means that it will open offices in both Manchester and London, because that is where most retailers are concentrated. Its head count has grown to top 300 staff.

"A lot of people's lives have been transformed by the wealth that has been created out of this enterprise, and that is a real privilege for us," Hancock says. "That is a big custodian issue for us to think through. Then there are some awesome institutions. There are big cap, small cap. We have large cap global, specialist global. The really good thing is that interacting with these people, you learn a lot about what is happening out there. It's not just a one-way street. We're getting really good insights, learning a lot from other people and listening to investors.

"Now, people want to travel overseas and see what we are doing so the nature of the way that we communicate is going to change again. We are migrating from one-on-ones, we are now doing conferences with brokers. Increasingly, we are seriously thinking of having showcase studies. We might have investor days to access the specialists, if that is manageable. One dilemma for a growing company is you can spend all day every day doing this. But we have to run the company.

"We are now saying we have to run the business as our core focus, but given the level of inquiry we want to become more systematic in the way we approach it. We need to do the right thing by our stakeholders, but we need to have the right balance. We haven't outsourced it. One of the things that people like is to have access, to ring up Nick or one of us. It's hard to manage, and we may change that. But it's important for us to be very clear that we give access to the market."

Eisen continues: "The external perception of the opportunity has been illuminated as we have achieved more scale in Australia and moved into new geographies. What we do is fundamentally different in the way we influence customer behaviour. Retail has become a more recognised opportunity globally. So, the amount of investor sophistication and inquiry has definitely increased as we have scaled. That's a function of laying an initial path, but also what the potential opportunity is if you can execute well at this stage."

Reflecting more broadly about the steep growth curve that Afterpay is riding, the trio of executives admit to some surprise. "It has exceeded all of our expectations from a speed perspective, but also because of the reaction from our customers and how much they have expressed that they love us," Nick Molnar says. "What hasn't changed is our over-arching goal, mission and objectives, but the speed that we have achieved scale has definitely exceeded expectations.

"What we have created is truly a win-win. So, when we go to our retail partners and talk about our value proposition, they can see that clearly.

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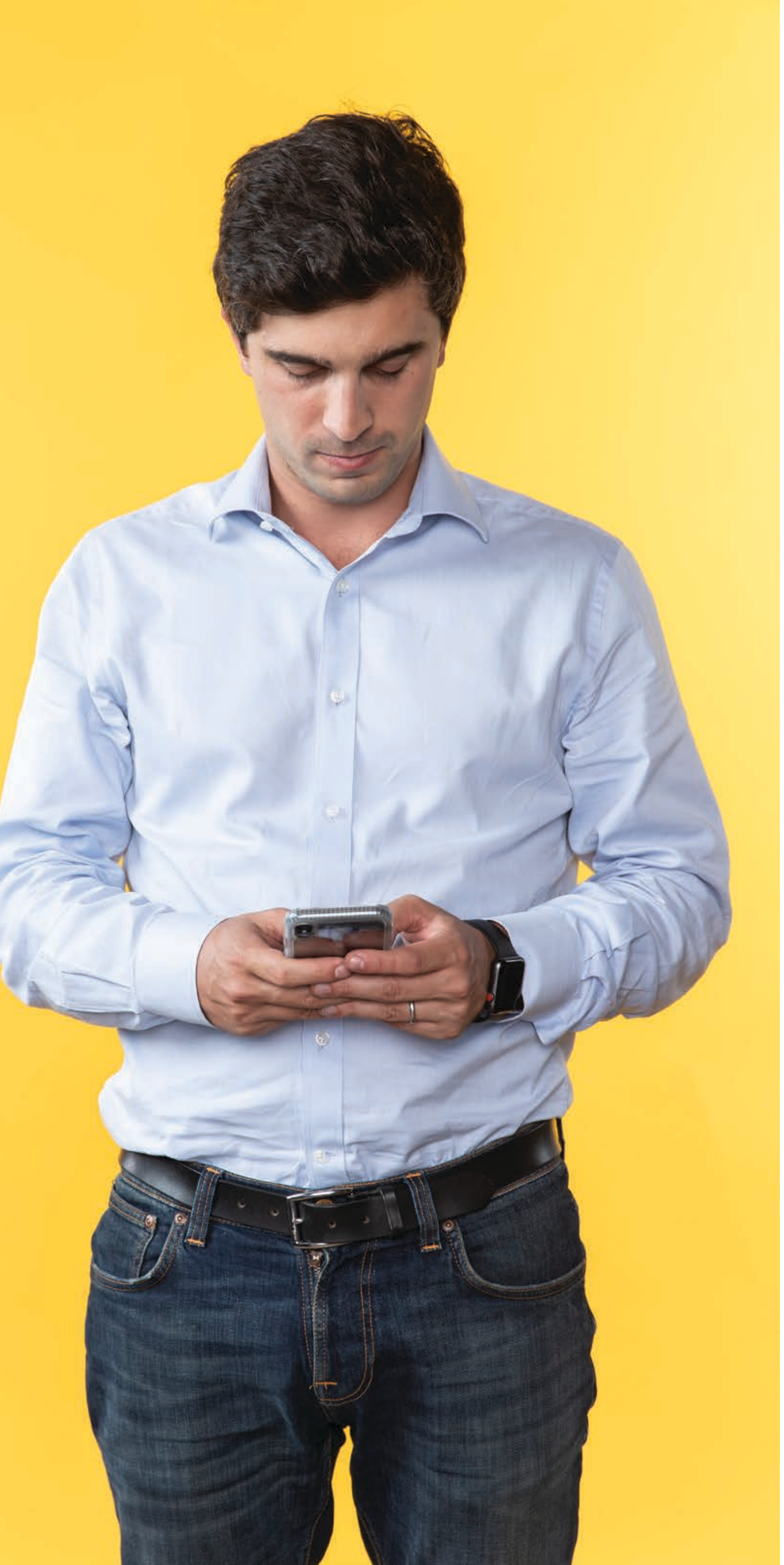
NICK MOLNAR



The model and the brand are so public-facing the network is self-fulfilling. As that grows, it has a snowball effect. The brand keeps getting out there and the customer base keeps building. The self-fulfilling cycle continues."

Eisen adds, "the core value we started from is that we are absolutely about the customer. What we do appears relatively simple, but we treat customers in a different way because we have listened to what their requirements are rather than developing a business model for a different constituency that uses customers to fulfill it. Everything we did from the start was intended to benefit a customer and give them choice and transparency.

"Predominantly that involved having a view about what millennial customers like to do and how they behave, and how they illustrate their own sense of responsibility through the way they do things. Without trying to oversimplify it, one of the great opportunities of starting the company was to understand what the millennial culture is, which really drives everything today. That means understanding why those behaviours and core values don't align any more to payment options, or financing features or products that were delivered in the past. It is really about being attuned to that millennial culture.

"Afterpay has become a fantastic platform from which customers seek out products and retailers. Our ability to present brands and products to new customers is a very big attraction. Retailers often know a lot about shoppers who have bought from them previously, but attracting new customers is always quite difficult. Over the last couple of years, Afterpay has become the largest lead generation in retail probably, after Google in Australia. Our ability to work in the retail fabric in a customer-centric way, is what really delivers results to retailers."

Molnar continues: "There wasn't a huge amount of science other than engaging friends of ours in the retail community to get their opinion on whether they thought it would work. You see a lot of products that create complexity, and people think complexity is good. Our approach was to keep the product uniquely simple. Everywhere you go, you know exactly what you are getting when you use it. It's exactly the same across the board. There was science underpinning the product in relation to the macro payment trends and where millennials were spending money differently to any previous generation, but the science behind the product was really just market knowledge and gut instinct."