
Gemfields Group Limited (the “Company”): Shareholder communication – engagement on remuneration post 2022 AGM vote and proposed new LTIP
September 2022

Introduction

The purpose of this note is to:

1. engage with shareholders on remuneration in view of the 27.1% adverse vote at the AGM in June 2022 on the company’s remuneration policy in line with the requirements of the King IV Report on Corporate Governance
2. set out to shareholders information on a new long-term incentive plan which Gemfields is planning to implement subject to shareholder approval

1. Consultation with shareholders in line with King IV

The Board notes that at the AGM in June 2022, 72.5% and 82.5% of votes were cast for the Remuneration Policy and Remuneration Implementation Reports respectively. The substantial majority of votes were cast in support of both the Remuneration Policy and Implementation Report. The Board notes that more than 25% of votes were cast against the Remuneration Policy.

The Board recognises that a significant minority of shareholders have concerns and so wishes to continue the dialogue to address them. A shareholder call on remuneration took place on 8th October 2021 and the Board considered points made on and after the call in taking decisions around the year end, as described in the 2021 annual report, and as it considered and developed its proposed new LTIP, while conscious that the substantial majority of votes on both resolutions were cast in support of the resolutions.

The table below summarises the points related to remuneration raised in the October 2021 call and the company’s response to those points.

Point	Detail	Company response
Bonus – Definition of free cash flow	Definition of free cash flow - should be after working capital movements	<p>The Company has previously considered this matter. The key driver behind movements in working capital lies largely with the movement in the auction receivables balance. Accordingly, the timing of auctions around the year-end directly impacts the working capital movement. By taking free cash flow before working capital movements, the Company is ensuring that only auctions held in the period under review are included in the bonus for that period. Using this approach also allows management to focus on the optimal timing of auctions from a commercial perspective rather than giving consideration to working capital impacts.</p> <p>It is also worth noting Gemfields has an excellent record over many years in terms of receiving payment from auction winners. Any</p>

		concern relating to bonuses being paid based on accrued revenue rather than cash received should therefore be allayed.
Bonus – board discretion	The determination of bonuses is still at the discretion of the Board, which opens up the opportunity for subjective bonus determination.	Annual bonuses always need to be subject to Remcom discretion, primarily to protect the Company against anomalous outcomes from bonus workings. The company stated in the 2021 annual report (page 101): “Under the new structure, the Committee will have an overriding discretion to adjust bonus payments from formulaic outcomes in light of the Committee’s overall assessment of (1) overall performance and (2) HSEC matters.”
Bonus – request to use forward targets	Prefer bonuses to be based on objective measurable targets. The company new policy for 2020 was to pay bonus based on improved performance against the prior year and the previous 3 years. A concern raised that this could result in distortions as a result of adverse prior performance (for example Covid) as well as material structural changes e.g. acquisitions or disposals. Prefer KPIs to be based on budgets/forecasts that take into account material changes.	<p>The Company considered this in developing new bonus structure. Per the statement in 2021 Annual report (page 98): “The Committee determined that the approach of comparing performance against prior performance was more effective and appropriate than setting forward targets for a number of reasons, including that a number of central KPIs, such as carat production and rock handling, and so free cash flow, revenue and cash costs, are outside the scope of management control and that the setting and measuring of targets involves a significant degree of judgement and subjectivity and can create perverse incentives. The Committee sees that annual bonus worked effectively during 2021 and will operate annual bonus in a similar way in 2022.”</p> <p>The approach encourages ongoing growth and continuous improvement by incentivising management to focus on outperforming the trailing numbers. The approach also avoids the risk of low-balling forward-looking targets and budgets, and the temptation to over-play any negative economic outlook. It is important to note that Remcom has discretion to ensure bonus reflects the committee’s overall assessment of relative performance. It was noted in the 2021 annual report that in determining bonus payments in respect of 2021, the Committee disregarded 2020 performance, which was severely negatively impacted by the Covid-19 pandemic, comparing 2021 performance to 2019 and the three-year period ended December 2019.</p>
Historic long-term incentives (LTIP)	Would like the agreements, in terms of which options	The company has reviewed the position. There is no scope for the Company to

significant number of historic options held by leavers	survive after the departure of employees, to be reviewed and if possible to terminate these options.	terminate these historic options unilaterally. As at 31 July 2022 there were 88.5 million options outstanding representing 7.5% of the outstanding shares. 33.5million options with an exercise price of ZAR3.45 will lapse in September 2022 if they are not exercised, reducing the number of options to 55.0 million, or 4.7% of the issued shares.
Benchmarking	Would like disclosure of the benchmarking of remuneration conducted on a regular basis.	The Company commissioned an external benchmarking exercise as referred to in the 2021 annual report. The names of the companies included in the comparator group were set out on page 103 of the 2021 annual report.
General remuneration	- Would like to see lower fixed remuneration with potentially higher variable remuneration linked to performance.	Remuneration currently includes a major performance-related element with annual bonus at up to 100% of salary and market value option awards. The CEO was last granted options in 2017 and the CFO in 2018. The company intends to make new long-term incentive awards following implementation of the new LTIP.

Shareholders made a number of points in respect of future long-term incentive awards. The Company has made no option or long-term incentive awards since 2019.

Point	Detail	Company response
LTIP – policy for future leavers	Would like the policy in respect of future awards to be amended to ensure that options terminate on an employee leaving.	The new LTIP will contain standard leaver provisions. Awards held by leavers will normally lapse. For good leavers, the default position will be that awards are pro-rated/reduced to reflect the portion of the vesting period they were employed with awards retained being subject to performance conditions measured at the point specified at the award date.
LTIP – use of ZAR exercise price	Would prefer the share incentive scheme prices to be stated in either GBP or USD.	The Company, noting that the current scheme was designed when the Company only had a ZAR-denominated listing on the JSE, recognises the merits of applying either a GBP or USD exercise price for any future option awards and will consider this if and when it makes new option awards. Subject to implementation of the new LTIP, the Company does not expect to make market value option awards to executive directors or senior employees in the future.
LTIP – future share awards - applying financial	Prefer that awards should only vest on achieving strategic objectives like exceeding targeted return on	Under the proposed new LTIP, the vesting of awards will be subject to objective and demanding three-year performance conditions.

and strategic targets	capital employed, beating targeted growth in earnings per share and achieving other key strategic objectives	
LTIP – future share awards – minimum vesting period of 3 yrs	Awards should also only vest after a minimum period of 3 years (preferably longer at 5 years).	Under the new plan, the vesting period will be a minimum of 3 years. Vested awards will then be subject to a holding period of a further two years for Executive Directors.

1. New LTIP

Gemfields has historically used market value options issued under its 2017 Employee Share Option Scheme to make long term incentive awards to executives and employees. Options have been granted with an exercise price determined by the market value at the time of award, vesting in tranches over a five-year period from the award date and with no performance conditions attached. No new long-term incentive awards have been granted in over three years (since March 2019) and no awards have been made to executive directors since July 2018.

The Company believes that it is commercially necessary and in the best interests of the Company and its shareholders to make new long-term share awards in the near term to retain, motivate and attract key individuals and align them with Company performance and shareholders. The Company intends that new awards should comply with governance best practice and be competitive against arrangements in place at peer companies. The Company is therefore proposing to introduce a new long term incentive plan. The first awards would be made, subject to shareholder approval of the plan, around April 2023, shortly following the announcement of the results for the year to December 2022. Key terms of the plan are set out below.

Structure

- Performance share awards – awards of nominal cost options vesting after three years subject to continued employment during the vesting period and meeting objective 3-year performance conditions specified at award.
- Individual limits: Normal maximum annual award for executive directors at 150% of salary, maximum in exceptional circumstances (such as for recruitment), 300% of salary.
- Proposed award levels for 2023 award – 120% of salary for the CEO, 100% of salary for the CFO.

Performance shares

- Awards vest after three years subject to meeting objective three-year performance targets and continued employment during the vesting period.
- Performance conditions to be attached to awards, choice, weighting and pitching can be varied from year to year to reflect circumstances and outlook.
- Performance conditions for 2023 awards: 50% on a measure of adjusted earnings per share, 50% on Total Shareholder Return (share price performance plus dividends).
- The Committee may choose different performance targets for awards in subsequent years. It expects to use two or three performance targets for each award to provide balance whilst keeping it relatively simple.
- 25% of award vests at threshold target increasing on a straight-line basis to full vesting at a stretch target.
- Performance conditions are tested once and awards vest at the end of the three-year performance period.

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- To comply with governance best practice, a two-year holding period will apply post-vesting (i.e. shares acquired using vested options may not be sold for 2 years) for Executive Directors.
 - The Company sees that it is important to align other senior employees with the company and shareholders over the long term and so would expect to make awards to approximately 6-12 further senior people.
 - Change in control. Default position is that awards vest subject to testing of the performance conditions or assessment of performance against the performance condition by the Committee (with time pro-rating to reflect the portion of the vesting period up to date of takeover).
 - Good leavers: default position is that awards will be pro-rated (reduced) to reflect the portion of the performance period covered but run their course to be tested/vest at the same time as other awards.
 - Awards subject to conventional malus and clawback provisions.
 - Awards are subject to general Committee discretion to reduce awards from level produced by formulaic workings if it considers the level of vesting does not reflect overall performance, to reflect shareholders' experience and in the event of any exceptional negative event.

The Johannesburg Stock Exchange requires a fixed maximum number of shares to be used under the plan. The limit will be 118.3 million awards representing 10.0% of the current shares in issue. The maximum number which any one individual can receive is also required to be stated. This will be 23.7 million, 20% of the total limit.