afterpay

Afterpay Limited ASX: APT

ASX Announcement

(all currency figures are in Australian dollars unless otherwise stated)

14 April 2020

BUSINESS UPDATE AND RESPONSE TO COVID-19

Afterpay Limited (**Afterpay or the Group**) is pleased to provide a business update for the three-month period ended 31 March 2020 (Q3 FY20) and details relating to its COVID-19 response plan (Response Plan).

The recent and current period has presented a number of challenges globally in relation to the social and economic impacts of the COVID-19 virus. While it is too early to estimate the broader economic impacts, Afterpay has acted quickly to implement the first phase of a Response Plan to manage the business through this evolving cycle.

The Response Plan includes a number of priorities across all aspects of the business including, taking care of our people and protecting our strong relationships with customers and merchants. Our focus is on limiting losses, preserving margins and protecting our strong balance sheet. The nature of Afterpay's service, business model and strong capital position provides flexibility and a number of advantages in terms of responding to the current environment.

KEY HIGHLIGHTS

- Strong performance continued across the business with underlying sales at $7.3b year to date (YTD), growing 105% compared to the prior corresponding period (pcp). This growth rate is broadly in line with H1 FY20 compared to H1 FY19.
- March was the Group's third largest underlying sales month on record, behind the seasonally higher months of November and December 2020, while Q3 FY20 underlying sales increased 97% on Q3 FY19.
- Afterpay income margins for the month of March and for FY20 YTD are higher than H1 FY20.
- Gross Losses (Group) for the month of March is estimated to be approximately 1.0% (unaudited), in line with H1 FY20, notwithstanding increased contribution from newer markets that are initially higher loss early in lifecycle.
- Pre-emptive adjustments to risk settings has had a positive impact on loss performance lead indicators in the second half of March and early April.
- Net Transaction Margin (NTM) on a FY20 YTD basis is approximately 2% (unaudited) and broadly in line with H1 FY20, despite an increase in contribution from lower margin, earlier stage international regions in Q3 FY20 relative to H1 FY20.
- Mature ANZ region continues to be highly profitable[1] and underlying cash flow positive. Estimated profitability on a YTD basis has increased relative to H1 FY20 and for the month of March relative to the pcp. ANZ is a blue-print for the profitability to be achieved in new markets over time.

1. EBITDA pre share-based payment expenses.

- Strong balance sheet and liquidity position means we have no requirement to raise capital in the foreseeable future. As at 31 March 2020, the Group had $541.1m of cash and $719.2m of total liquidity, higher than the last reported results for H1 FY20.
- Downside scenario modelling suggests that the Group is adequately capitalised to support operations for multiple years based on its current cash flow, balance sheet and liquidity position.

1. OUR PEOPLE

Managing the health and wellbeing of our people has been our first priority. We have taken the necessary measures to ensure the health and safety of our global workforce with all employees working from home since mid-March. This transition occurred seamlessly with no impact to the provision of services to our customers.

We continue to communicate with our employees regularly to ensure they are receiving constant updates on how the business is tracking and the various actions we are taking. We are also providing support to employees and their families as they need it.

2. BUSINESS PERFORMANCE

Q3 FY20 AND FY20 YEAR TO DATE (YTD)

GLOBAL (A$) (unaudited)	Q3 FY20	Q3 FY19	Q3 Variance	Q3 FY20 YTD	Q3 FY19 YTD	YTD VARIANCE
UNDERLYING SALES	**2.6b**	**1.3b**	**97%**	**7.3b**	**3.6b**	**105%**
ANZ	1.5b	1.0b	40%	4.6b	3.0b	50%
US	1.0b	0.3b	263%	2.4b	0.5b	354%
UK	0.1b	-	-	0.3b	-	-

GLOBAL (unaudited)	AS AT 31 MAR 2020	AS AT 31 MAR 2019	VARIANCE
ACTIVE CUSTOMERS	**8.4m**	**3.8m**	**122%**
ANZ	3.2m	2.6m	21%
US	4.4m	1.1m	283%
UK	0.8m	-	-
ACTIVE MERCHANTS	**48.4k**	**27.3k**	**78%**
ANZ	38.6k	24.8k	56%
US	9.1k	2.5k	271%
UK	0.6k	-	-

- Global underlying sales for FY20 YTD grew by 105% compared to FY19 YTD, driven primarily by the accelerated growth in the US and continued significant contribution from ANZ.
- Q3 FY20 global underlying sales grew by 97% compared to Q3 FY19, again driven by growth in the US (up 263%) and ANZ (up 40%) and increasing contribution from the UK.
- US performance remained particularly strong in Q3 FY20 with the level of underlying sales broadly in line with Q2 FY20 despite the seasonally softer retail market.
- Underlying sales in ANZ, our most mature market, represented approximately 57% of total GMV in Q3 FY20, with the US contributing 38% and the UK contributing 5%.
- Underlying sales from in-store in ANZ increased by 75% compared to Q3 FY19, however growth began to moderate from mid-March 2020 onwards as government-enforced COVID-19 related retail trading restrictions commenced.
- Global average order value for the quarter was approximately $150, in line with past experience.

3. TRADING PERFORMANCE THROUGH MARCH AND EARLY APRIL 2020

MARCH 2020

- At this point in time, it is difficult to identify any sustained trends, in any of our regions, as a result of the impacts from COVID-19.
- For the month of March, underlying sales across all markets were strong with average daily underlying sales up ~12% on January and February.
- Afterpay Day on 19-20 March showed a marked increase in daily underlying sales, illustrating customer appetite notwithstanding the new and sudden impact to their work and living conditions (particularly in Australia).
- Online sales in March represented 88% of total global underlying sales, demonstrating our significant exposure to online spending which is beneficial in the current environment.

SECOND HALF OF MARCH AND EARLY APRIL 2020[2]

- Underlying sales in the second half of March moderated at a Group level but varied by region and merchant category.
- Moderation of underlying sales coincided with introduction of government-enforced lock-down/isolation protocols across the various regions in mid-March and risk adjustment measures implemented by Afterpay at the same time (see section 7 below).
- Global underlying sales in the second half of March versus first half of March were 4% lower. Regionally, ANZ was 2% lower, US was 5% lower and the UK was 15% lower.

2. First half of March is the period 1-15 March 2020. Second half of March is the period 16-31 March 2020.

- ANZ online sales showed a marked uptick in the second half of March (up 8% on first half of March), while in-store volumes were significantly impacted (down 29% on first half of March).
- Initial skew and increase in online was weighted towards necessity, personal care and homeware categories, however this trended back somewhat towards lifestyle and luxury categories following the initial impact of changes to living conditions.
- Travel, ticketing and entertainment categories remain significantly depressed.
- We have experienced positive growth in April month-to-date in all markets with average daily underlying sales up approximately 10% on the second half of March globally.

4. CUSTOMERS

- Active customers continued to grow strongly totaling 8.4m globally at end of Q3 FY20, representing 122% growth on the pcp.
- Customer growth has continued strongly since the end of H1 FY20, with the US and UK, in particular, increasing 24% and 30% respectively. This increase followed the record number of new customers acquired in November and December 2019.
- Strong active customer growth continued throughout March and early April.
- We are still on track to achieve our previously stated objective of 9.5m customers by 30 June 2020. However, given the possibility that new customer growth may be further moderated if conditions worsen, and additional risk measures may be implemented in the coming months, we are withdrawing this guidance at this time.

5. MERCHANTS

- Active merchants reached 48.4k globally at the end of Q3 FY20, representing 78% growth on pcp, supported by strong merchant additions across all regions.
- New merchants continue to on-board in all markets at volumes in line with pre COVID-19 levels.
- We are proactively developing initiatives to add increasing value to our merchants throughout this period and identifying opportunities to support merchants experiencing difficulties.
- Our diversified merchant portfolio provides Afterpay with no single or significant merchant concentration risk.

NEW MERCHANTS

Key merchants who went live or contracted during Q3 FY20:

- **AU** - eBay, Samsung, Lancome AU, YSL Beauty, Kiehius, Kookai, Georgio Armani Beauty, Horseland Online, Pet Food Australia, Salt & Pepper
- **NZ** - Sunglass Hut, Mitre 10, Hush Puppies, Number One Shoes, Hannah's, Footlocker, Aje, Estee Lauder, RY NZ
- **US** - SHEIN, American Eagle, Romwe, The Hut Group, Perricone MD, Furla, Soko Glam
- **UK** - Kookai, Oh Polly, Elemis, Charles & Keith, RM Williams, Size, Tessuti, Foot Patrol

- Afterpay has also signed referral agreements with Wix across all four of Afterpay's active markets enabling Wix merchants to offer Afterpay to shoppers and this will be rolled out in the next few months. (Wix.com is a leading cloud-based development platform)

EBAY AUSTRALIA

- Partnership with eBay was formally launched in Australia from 3 April 2020, providing Afterpay with access to eBay's 40,000 Australian small and medium sized businesses and their customers.
- The partnership provides Afterpay customers with access to new items such as everyday essentials, homewares, tech and even pre-owned items.
- Strong initial customer response with eBay becoming a top performing Australian merchant within a few days from launch.

6. GLOBAL EXPANSION

- Work relating to our expansion into Canada is progressing well. Timing of our entry into this new region is yet to be confirmed, however we continue to target this calendar year.
- Preparations to launch in-store in the US are ongoing. Timing of our launch will be dependent on the timing of a recovery in offline retail in the US.
- At this point in time, our ambition to exceed our underlying sales mid-term target of approximately $20b by FY22 and NTM of 2% remains in place.

7. RISK MANAGEMENT FOCUSED ON LIMITING LOSSES AND PRESERVING MARGINS

AFTERPAY BUSINESS MODEL

- Core principles of the Afterpay business model align with a low risk profile and its rules reward responsible spending:
  - Low value transactions (average order value $150).
  - Purchases paid off in 4 instalments (low average instalment payment $37.50).
  - Every transaction assessed in real-time.
  - Customers immediately suspended from making further purchases if a single payment is late (only responsible spenders stay on the platform).
  - Payment terms cannot be extended – very short duration instalment payments (entire receivables book turns over < 30 days) and dynamic rules-based system allows us to see trends and react much faster than others.
  - Lower average outstanding balances at $211 (credit card average at $3,380) as at H1 FY20.
  - Payments and collection processes are automated and do not require the customer to initiate.

CUSTOMER PROFILE DYNAMICS

- The global median age of active customers as at 1 April 2020 is 33 years.
- The median age ranges of active customers during Q3 by region was:

REGION	AU	NZ	US	UK
MEDIAN AGE RANGE	33-34	29-31	32-33	31-32

- Repeat customers contributed 90% of total GMV over Q3 FY20 globally, highlighting the stickiness and quality of the customer base.
  - GMV contribution from repeat customers in the more mature region of ANZ continues to track in line with H1 FY20 (> 95%).
  - The contribution of GMV from repeat customers in the US and UK continues to increase as these markets scale.
- Research has shown[3] that in Australia, when compared to the general population:
  - 48.8% of Afterpay users are in the highest credit score categories and only 0.3% are in the lowest score categories.
  - Afterpay users have lower personal liabilities. This is consistent when matched to a group of similar age, gender and income consumers who are not Afterpay users.

DYNAMIC RISK BASED MODEL

- Multiple risk management levers can be adjusted simultaneously from three perspectives:
  - Regional: independent risk rules applied in each geography from a customer and merchant perspective.
  - Customer: independent transaction approval criteria by customer cohort, ranging from new customers to multi-year, high frequency tiers.
  - Product: independent transaction approval criteria depending on product risk classification.

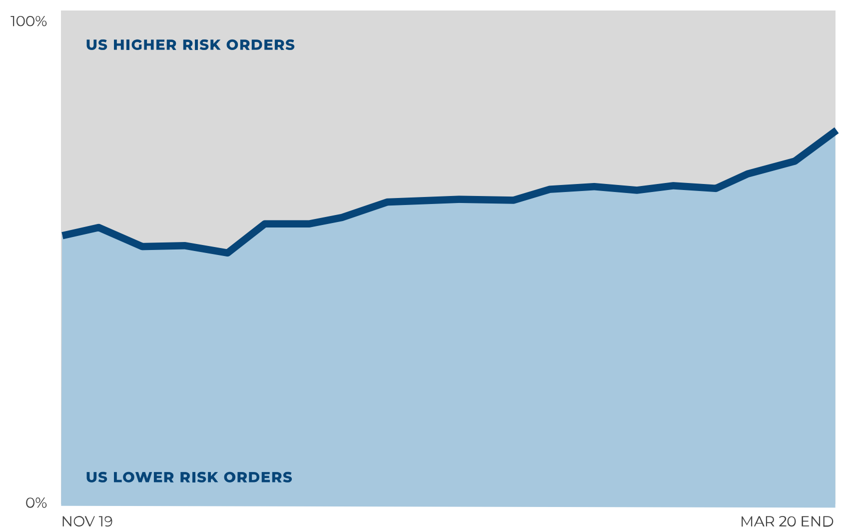
RISK SETTING MODIFICATIONS IN MARCH 2020

- Pre-emptive risk setting modifications were implemented in March to address global economic indicators.
- Overall spending limits have been tightened across the majority of customer risk profile tiers with a particular focus on:
  - Skewing underlying sales contribution towards lower risk and higher performing, returning customer cohorts.
  - Introducing first instalment payment upfront for the majority of customers in Australia (this is already in place in the US and UK).

3. Source: Alpha Beta research completed in April 2020 (relies on Afterpay data, Ipsos survey data, Alphabeta analysis)

- Tightening transaction approval parameters and spending limits on high risk products - particular focus on restricting high risk purchases from new and higher risk customers.

- Implementing tighter rules will place some constraint on maximising underlying sales growth in the short term.
- Due to short instalment payments cycle, risk setting changes in March are already being evidenced in the reduced underlying sales contribution from new and higher loss customer tiers:



- Contingency plans are in place to introduce further restrictions should there be a deterioration of portfolio payment recovery lead-indicators measured on a daily basis by region. Alternatively, measures can be reversed in short-order if performance and lead-indicators illustrate outperformance.

LOSS PERFORMANCE LEAD INDICATORS THROUGH MARCH AND EARLY APRIL

- Instalment repayments:
  - We have not experienced a material deterioration in loss performance indicators YTD, however it is still early days.
  - There was an increase in hardship claims in mid-March, but these are now trending down and overall levels remain within manageable portfolio parameters.
  - Strong payment recovery statistics maintained in second half of March demonstrating the benefit of our automated process.
  - Early indicators demonstrate favourable payment trends for orders placed after Mid-March, potentially resulting from a shift to more responsible spending by customers, the impact of pre-emptive adjustments to risk settings and the introduction of government stimulus initiatives.

8. PROTECTING STRONG BALANCE SHEET AND PRESERVING CAPITAL FLEXIBILITY

- Afterpay has a strong balance sheet and liquidity position as a result of capital management initiatives implemented pre-COVID-19 and as such has no requirement to raise additional capital for the foreseeable future.
- Cash, net cash and liquidity have all increased since last reported results as at 31 December 2019 and are at the highest reported level for the Group since inception.

Key balance sheet metrics as at 31 March 2020 (unaudited):

- Total cash $541.1m ($425.6m as at 31 December 2019), comprising $515.0m cash and $26.0m unrestricted cash.
- Debt $355.7m ($416.9m as at 31 December 2019).
- Net cash/(debt) $185.4m ($8.7m as at 31 December 2019).
  - $150m Australian warehouse facility debt was drawn during Q3 as a prudent measure.
  - Afterpay's cash flow and balance sheet position receives a benefit during a declining underlying sales period from the repayment of previously funded receivables. The unwinding of receivables adds to Afterpay's total cash balance providing a natural balance sheet hedge against declining underlying sales.
  - Net cash has materially increased reflecting the fast release of cash from receivables book since 31 December 2019, notwithstanding the $150m debt drawdown.
- Liquidity $719.2m (excluding California eligible receivables totaling $39.6m[4]) ($672.1m as at 31 December 2019)
- Existing facilities have headroom of $662.5m to fund growth in receivables (additional growth capacity[5])

OVERVIEW OF AFTERPAY WAREHOUSE FACILITIES

- $1.2bn of warehouse receivables funding facilities diversified across three funding providers.
- No near-term maturities (average maturity of ~2 years and nearest significant maturity in May 2021).
- Currently only ~25% drawn.
- There are no traditional loan facility covenants linked to Afterpay's P&L or balance sheet position such as a net interest cover, gearing or leverage ratios.
- Subject to receivables performance parameters with significant headroom currently in place across all measures.
- Additional resiliency measures within our control:

4. Excludes approximately $39.6m of receivables generated in California which would add additional liquidity.
5. Additional debt drawdown capacity under the Group's receivables warehouse funding facilities.

- Afterpay has the flexibility to fund receivables outside of the warehouse facilities as required, including those which are past payment due date, which can improve the performance of the warehouses.
- Maintain a significant cash balance for additional liquidity and have rarely drawn down more than one third of our total funding capacity in even our strongest growth periods.

SHORT TERM COST MANAGEMENT WHILE MAINTAINING FLEXIBILITY TO GROW

- Afterpay is prudently reducing fixed cost expenditure in the event that a material downside underlying sales scenario occurs for a prolonged period.
- In a prolonged downside scenario, objective will be to moderate potential cash burn to preserve both a strong balance sheet position and recovery firepower.
- Business development investment, including marketing, will be maintained at an appropriate level but will be re-focused in-line with Response Plan priorities and market conditions.
- Cost savings across employment related and other operating expenses are being implemented as required.

DOWNSIDE STRESS TESTING SCENARIOS

- Afterpay has analysed how the business would perform under various material downside scenarios and is comfortable it would be adequately capitalised to support operations for multiple years.

9. REGULATORY UPDATE

RBA SURCHARGING

- We note the RBA's announcement that it has delayed the completion of its review until 2021.
- We have made a submission to the RBA's Issues Paper and will continue to engage with the RBA on its new timetable.

AUSTRAC

- AUSTRAC is still considering the Independent Auditor's report, and we continue to fully cooperate with AUSTRAC.

CALIFORNIA DBO

- Settlement with the California Department of Business Oversight (DBO) announced on 16 March 2020.
- Now operating under California licence with no business interruption.

GOVERNMENT POLICY UPDATE

- Afterpay welcomes government support for consumers and businesses at this time. Early indications suggest that stimulus measures are supporting consumer confidence during this period.
- The company supports government measures to ensure credit continues to flow through the economy. This includes the Australian Office of Finance Management's Structured Finance Support

Fund which is designed to support the provision of credit to households and businesses and can invest in structures with a wide range of underlying collateral.

Afterpay CEO Anthony Eisen commented:

"I am very grateful to the entire Afterpay team who have responded so effectively to protect the interests of our customers and merchant partners, while also dealing with the impacts of COVID-19 on their own lives. Our dynamic business model and strong balance sheet means we are well positioned to respond and adapt through this period. We are confident that our customer-centric model, which encourages budgeting and responsible spending, will be even more relevant in a post COVID-19 environment."

Authorised by:
Anthony Eisen
CEO & Managing Director

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For further information, contact:

Investors:	Company:	Media:
Marie Festa Director of Investor Relations marie.festa@afterpay.com +61 405 494 705	Christopher Stevens General Counsel & Company Secretary chris.stevens@afterpay.com	Melissa Patch Director of Communications melissa.patch@afterpay.com +61 412 124 195