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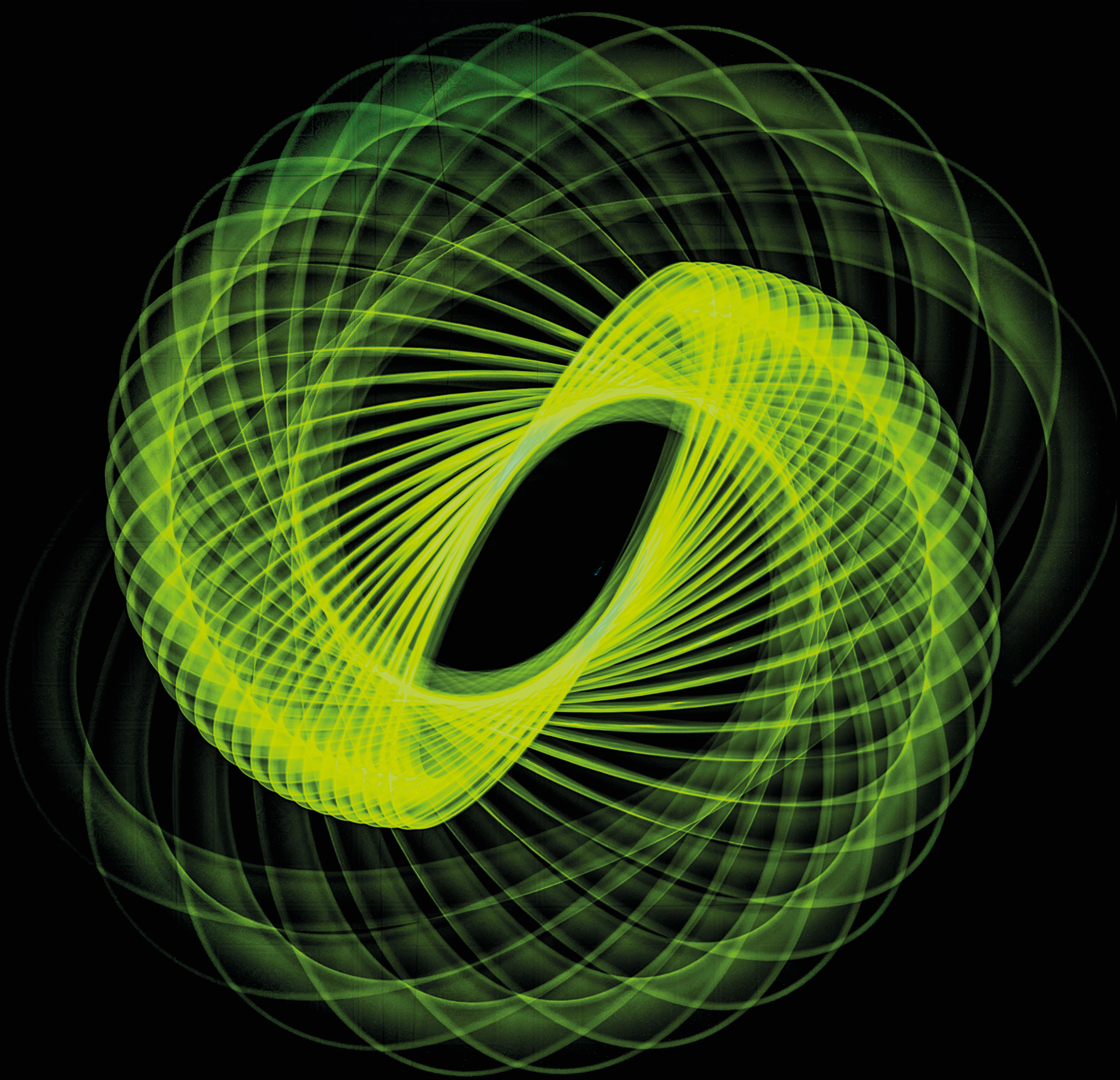


Analysis on Australian Executive Remuneration

Trends in Australian Company Long Term Incentives

January 2022

79%

of LTI Plans use RTSR as a hurdle

93%

of plans that contain RTSR use it as the main hurdle

>100%

increase in the number of ASX IPOs

There remains a continuing shift away from broad market indices towards **industry-specific** comparator groups

The inclusion of **global peer entities** in RTSR comparator groups has become increasingly popular

Australia's **start-up boom** has resulted in a rapidly growing number of businesses adopting share-based remuneration policies

Executive Summary

Deloitte performs market trend analysis on executive-level remuneration for ASX listed companies each year. In this analysis, companies within the ASX 100 were selected for the purpose of providing market-based insights into emerging and ongoing trends in long term incentives for the period between 2015 and 2021.

Our analysis focuses on the approaches to compensation structures, performance hurdle consideration, total shareholder return benchmarking and valuations. In addition, we have analysed emerging market trends in the way listed companies pay their employees and retain talent.

Observations

01. Relative Total Shareholder Return (RTSR) remains the most commonly used performance metric for long-term incentives (LTIs); approximately 79% of companies sampled in the ASX 100 used RTSR. This is a continuing trend from 2020.

02. Market-based performance hurdles dominate as the most popular metric for determining LTI remuneration for ASX 100 executives. Typically, this is either a singular hurdle or paired with one or more non-market-based hurdles such as earnings per share (EPS), return on invested capital (ROIC) and environmental, social, and governance (ESG) targets.

03. There continues to be increased attention on the curation of RTSR comparator groups by way of the impact of COVID-19 on recent LTI payouts. This has brought into question the appropriateness of using a general market index comparator group. Australian Boards have been shifting their comparator groups from broader local, market-based indices to sector-specific indices. Some companies in niche sectors or markets have overcome the issue of a limited number of local comparators by selecting international peers.

04. The proportion of target executive remuneration dictated by long-term incentive plans has increased from 2015 to 2021. We continue to observe a rise in shareholder involvement and activism, as well as stricter regulation of executive pay.

05. Materials, health care and information technology companies have relatively high proportions of LTI at over 40%

06. RTSR remains the dominant performance hurdle, which aims to strengthen the alignment between executive remuneration and company performance. There are however, design and calculation considerations which if overlooked can have unintended consequences and impact determined payout amounts. Common pitfalls in designing RTSR plans include:
    - The selection of an appropriate comparator group
    - Treatment of corporate actions
    - Managing international peers
    - Treatment of dividends
    - Determination of averaging periods

07. Shareholders continue to increasingly scrutinize executive remuneration structures, particularly amidst the challenges of the COVID-19 pandemic. There is an increasing focus on the level of executive remuneration and the aligment of incentive plan structures to shareholder interests, however the "two strike rule" is yet to yield a board spill.

08. 2021 is the year of start-ups. A record number of IPO listings have taken place this year, with the number having doubled from 2020. In addition, the 2021-2022 Federal Budget announced a number of policy revisions which make share-based payments via employee share option plans (ESOPs) more attractive to employers and employees, including easing of tax rules and an increase in the value of issuable shares for private entities. We expect the increase in prominence of share-based payments to be compounded by the growth of pre-and post-IPO companies seeking to attract and retain talent as we move into 2022.

Manage your Share Based Payment through Deloitte

Deloitte has extensive experience in delivering share-based payment services to both ASX listed and private companies, including:

- Valuation of employee share plans in accordance with AASB 2
- RTSR tracking and calculation of LTI payouts
- Share based payment management and accounting
- TSR calculation methodology, design, and governance

Deloitte has a suite of digital applications which could assist you with valuation, accounting and reporting for your LTI plans. Details about these tools are presented at the end of this report.

Our Analysis

Relative TSR remains a popular benchmark

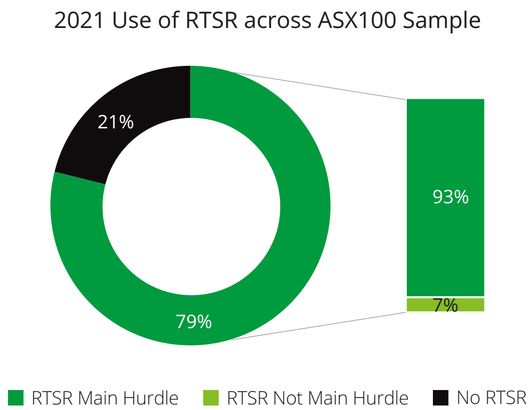
Relative Total Shareholder Return (RTSR) remains the most commonly used performance metric for determining LTI remuneration. RTSR compares investor returns for a company against a peer group of companies over a long-term performance period.

Performance hurdles are predetermined thresholds relating to the performance metrics that determine the level at which LTI plans vest. These hurdles are selected by companies' Boards which may include market-based performance hurdles and/or non-market-based performance hurdles[1]. Many companies use both market and non-market-based hurdles in setting LTI plans.

Deloitte found that while market-based performance hurdles such as RTSR continue to dominate LTI schemes, companies often also include non financial metrics, such as reaching ESG targets.

- Approximately 79% of companies in our sample used Relative Total Shareholder Return (RTSR)
- This proportion represents a slight decrease over the past six years with a corresponding increase in non-market-based performance hurdles
- 2021 saw more companies remodelling their LTI performance hurdles in response to uncertainty following the COVID-19 pandemic. These changes include qualitative metrics such as the maintenance and improvement of employee and customer safety, and reaching sustainability targets
- In 2021, of the 79% of sampled companies that use RTSR, 93% use it as the primary performance hurdle

Figure 1: Use of RTSR across the ASX 100

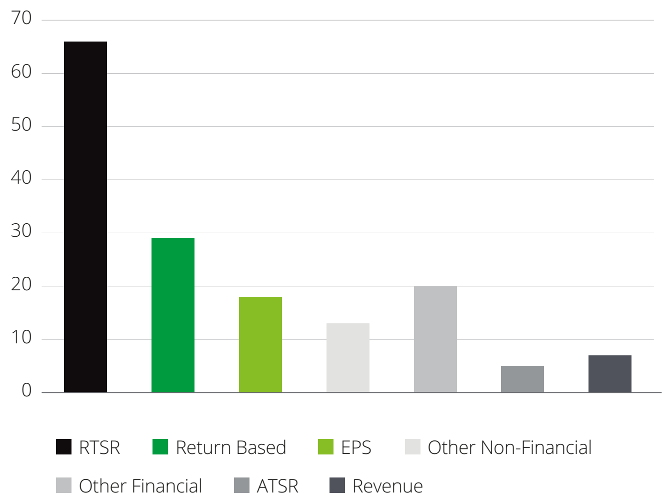


Deloitte analysis based on a sample of ASX 100 companies

The above performance measures are often supplemented by 'non-financial' measures which, while not directly measured in short-term financial accounts or share price metrics, can be material drivers for long-term financial performance. Examples of non-financial measures are project-based targets, sustainability targets, safety outcomes, customer satisfaction and employee turnover.

While these supplementary measures are often used by ASX entities, RTSR remains the most widely used metric and is the only metric observed in over 50% of the sampled ASX 100 companies.

Figure 2: Frequency of Performance Metrics



Deloitte analysis based on a sample of ASX 100 companies

[1] Long-term incentive offers generally hinge on one of two types of performance metrics; market, and non-market. Market hurdles are those concerned with the equity value or share price of a company while non-market-based hurdles are typically internal measures or financial reporting metrics like earnings per share (EPS) and revenue growth (i.e. revenue CAGR). Since the key objective of long-term incentives is to attract and retain leading talent, these metrics should be selected so as to facilitate accurate measurement of key performance indicators (KPI's).

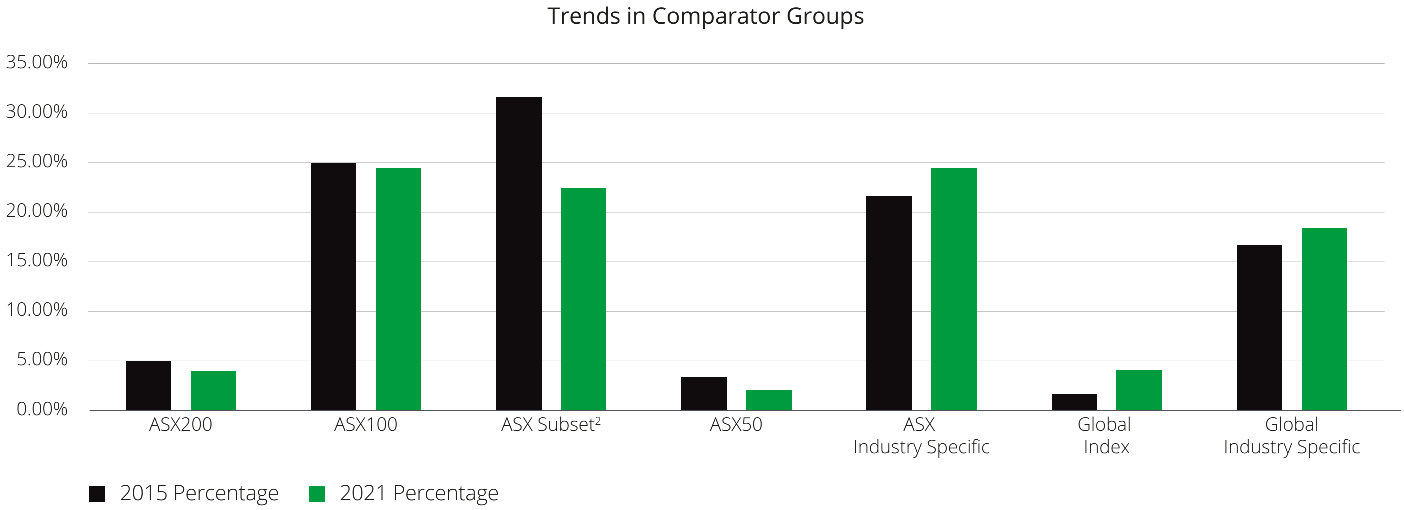
Relative TSR: Selection of Comparator Groups

Selecting a comparator group to benchmark your company's TSR performance hurdle against presents a complex challenge to governance boards. A critical decision in the plan design phase is whether or not to benchmark TSR against published indices (such as the ASX 100, the ASX 200, etc), or to define a customised comparator group representing direct competitors and other similar entities.

While there is often a desire to benchmark performance against specific and direct competitors, this presents a trade-off between selecting more relevant and targeted performance hurdles and ensuring a sufficiently sized and diverse comparator group to determine representative vesting outcomes.

COVID-19 has demonstrated the benefits of selecting a comparator group based on comparable companies, as the impact of the pandemic has varied across industries. A challenge with using a customised peer group is often how to deal with a small comparator group, which can result in volatile payouts that are highly sensitive to small changes in the performance of comparators and payout rankings which are not mathematically feasible or aligned with actual performance. Our analysis indicates that Australian companies are increasingly adapting to this challenge by including global competitors in their comparator groups - a trend which we expect to continue as companies recover from COVID-19 downturns.

Figure 3: Comparator groups used for RTSR



Deloitte analysis based on a sample of ASX 100 companies

In analysing ASX 100 companies over the period 2015 to 2021, we found that:

- There has been a shift away from published Australian indices, such as the ASX 100, towards specific groups to better align the comparator group with the entity's industry and sector
- The inclusion of global entities within comparator groups of Australian companies has grown more prominent.

The economic impact of COVID-19 has varied significantly across industries, and the impact that this has had on recent LTI payouts has brought into question the appropriateness of RTSR comparator groups. In response to COVID-19, we are seeing many companies reviewing the relevance of their RTSR comparator groups.

The analysis in Figure 3 indicates a shift in the market towards an industry/sector specific comparator group (which may include global entities). We expect the shift to continue as companies re-assess their comparator groups.

[2] ASX Subset refers to a general index which is defined by taking a published index (such as ASX100) and excluding specific companies, sectors or industries.

Impacts of COVID-19 on Executive Remuneration

Sentiment on the impacts of COVID-19 remain largely optimistic across most companies analysed. Some of the larger or more conservative companies implemented no change to their LTI plans, while others plan to review their remuneration strategy when disruptions from COVID-19 settle further.

"Remuneration outcomes reflect the strong performance of the Bank's leadership team against the backdrop of a challenging environment and ongoing support to our customers, our people and the communities we serve."

Commonwealth Bank of Australia 2021 Annual Report

"Given the high levels of uncertainty surrounding business performance as a result of the COVID-19 pandemic at the time the relevant budgets were set for the 2021 financial year, the Board set initial financial targets based on those budgets but determined that the 2021 KEEPP scorecard financial targets would be revisited around mid-financial year when there was expected to be more visibility of the impact of COVID-19."

Wesfarmers 2021 Annual Report

In contrast, companies in sectors most affected by the pandemic saw the greatest impacts to their executive remuneration plans.

"The impact of COVID-19 on Sydney Airport has been severe, with traffic numbers being down over 90% for much of the year. As a consequence, the strategic and operational priorities shifted markedly as the year progressed. Protecting our people and preserving the business rapidly became key objectives, and management was required to undertake a number of critical tasks."

Sydney Airport 2021 Annual Report

"The COVID-19 pandemic has significantly increased the demands on our executive cohorts at the same time as workloads and complexity have increased, their take home pay has fallen significantly, with no annual incentives for the past two years and a continued wage freeze. In 2021/22, our executive cohorts are again facing both an extremely high workload and the prospect of a third year of no annual incentives being awarded."

Qantas 2021 Annual Report

This year we have observed multiple LTI plans achieve zero vesting outcomes where plans were comprised of individual performance or non-market-based return metrics, due to the impact of COVID-19. One advantage of using a relative metric, such as RTSR, as a performance metric is that, when an appropriate comparator group is selected, it can produce more appropriate outcomes. This is because similar companies within a specific industry tend be affected similarly in extreme market conditions. In contrast, absolute metrics may result in unintended vesting outcomes when they are tested in significantly different market conditions to those in which they were set.

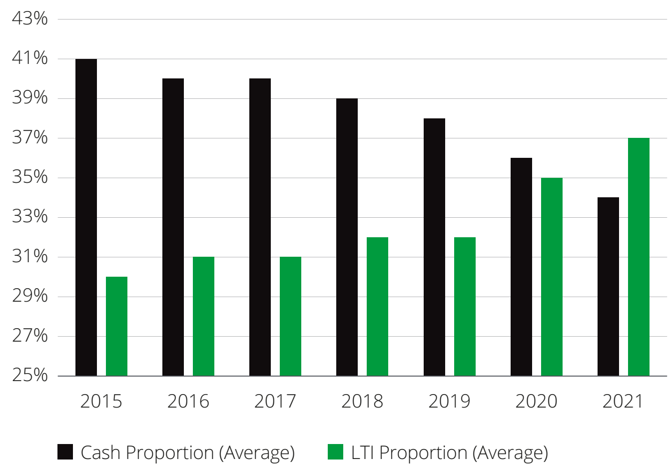
"The ROE metric has been removed from the FY22 LTI plan, with 75% of the outcome to be determined against relative TSR performance and 25% against carbon transition performance metrics. Carbon transition metrics will remain in the LTI plan for FY22 to ensure that the leadership team continues to focus on the responsible transition away from carbon-generated energy, in line with both the Transformation and Social Licence strategic objectives"

AGL 2021 Annual Report

Proportion of LTI as a percentage of Executive remuneration

The level of target LTI as a proportion of total executive remuneration has increased over the last 5 years, with the trend continuing from 2020 to 2021. LTI as a percentage of total executive remuneration has increased from 30% to 37%, with a corresponding decline in fixed remuneration.

Figure 4: Average fixed remuneration vs LTI portion for ASX 100 Executive Remuneration:

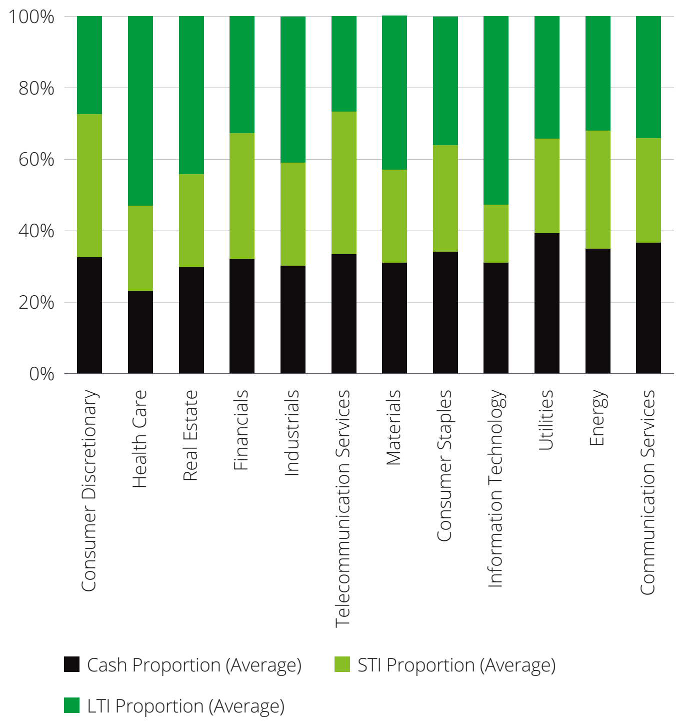


Deloitte analysis based on a sample of ASX 100 companies

In addition, our analysis reveals that the proportion of LTI in terms of total executive remuneration varies across industry:

- The consumer discretionary and telecommunication services sectors had the lowest proportions of LTI, with the highest proportions of short-term incentives.
- In contrast, health care, materials and information technology had relatively high proportions of LTI, but relatively low fixed remuneration components. The proportion of LTI for these three sectors exceeds 40%.

Figure 5: 2021 LTI proportion of executive remuneration by Sector



Deloitte analysis based on a sample of ASX 100 companies

Common pitfalls when using RTSR as a performance metric

Relative TSR LTIs aim to strengthen the alignment between executive remuneration and company performance. However, there are design and calculation considerations which, if overlooked, can have unintended consequences and alter the payout received.

Selection of an appropriate Comparator Group

As outlined above, the selection of a comparator group against which performance is measured can have a pervasive impact on the final payout. Careful consideration should be given to the following:

- Whether TSR is measured against a market index, or a defined group of peers
- The inclusion of global peers
- The structure of the vesting function, particularly for a small group of peers
- The inclusion of additional hurdles (e.g. TSR must be positive)

Treatment of Corporate Actions

Over the course of the performance period, the entities within the comparator group may experience certain events that will impact the availability of share price data. The treatment of these events may impact the calculation of TSR or the composition of the comparator group and has the potential to alter remuneration outcomes.

Managing International Peers

Our analysis within found that more and more LTI's linked to RTSR are including global peers. Measuring TSR across geographies can create challenges when dealing with different currencies, and different trading windows.

Treatment of Dividends

The treatment of dividends should consider whether the TSR calculation assumes dividends are held in cash or re-invested into shares, and the date at which dividends are re-invested. The treatment of cash and special dividends, as well as other corporate events which impact shareholder value must also be determined.

Averaging periods

Using the share price on performance start and end dates creates significant payout uncertainty. The use of averaging period smooths out this volatility, resulting in a payout which is less exposed to an anomaly. Our analysis has found that 1-3 month averaging periods are the most common across the sample of clients surveyed. Volume-weighting these averages is another mechanism which has the potential to reduce the impact of anomalies around TSR measurement dates.

Remuneration Report Strikes

It has been 10 years since the "Two-Strike Rule" amendment to the *Corporations Act 2001* (Cth) was introduced in 2011, whereby a shareholder vote of at least 25% against executive remuneration packages in two consecutive years may result in a voting out of the board. Our analysis on ASX100 companies over the past 2 reporting periods observed the following companies received remuneration report strikes.

Company	For	Against	Carried/ Not Carried	AGM Date	Reason for strike
AGL	53.50%	46.50%	Carried	7/10/2020	Reduced profit guidance and ongoing ESG concerns about LNG and coal.
AMP	32.75%	67.25%	Not Carried	8/05/2020	Executive remuneration remained high despite poor share price performance and financial concerns arising with the company.
CGF	71.75%	28.25%	Carried	29/10/2020	Executive bonuses were increased despite the company making a loss.
CWN	65.66%	34.34%	Carried	22/10/2020	Investors becoming concerned with regulatory risk surrounding Crown's Anti Money-Laundering obligations
CWN	69.27%	30.73%	Carried	21/10/2021	Crown received a second strike, however the newly appointed board avoided a spill, with shareholders hoping the board can turn the troubled company around.
DXS	34.23%	65.77%	Not Carried	19/10/2021	Shareholders agreed with proxies in voting against the sharp increases in total executive remuneration.
GMG	58.23%	41.68%	Carried	18/11/2021	10 year LTI plans for senior management deemed "excessive" by proxies.
IAG	42.75%	57.25%	Not Carried	22/10/2021	IAG shareholders voted against executive pay increases and bonuses when the company had made a loss.
LLC	52.66%	47.34%	Carried	20/11/2020	Shareholders did not believe deferred equity awards were reflective of FY20 performance. Additional concerns about the company using JobKeeper support to reflect performance.
NST	74.88%	25.12%	Carried	25/11/2020	Investors were dissatisfied with executive remuneration increases, justified by management describing the "hot" job landscape.
OSH	45.93%	54.07%	Not Carried	30/04/2021	Excessive remuneration paid to former CEO despite slashed forecasts and asset downgrades. Non-executive directors paid exceedingly above median.
QUB	47.02%	52.98%	Not Carried	26/11/2020	Bonuses increased despite the company relying on JobKeeper support.
RIO	39.16%	60.84%	Not Carried	6/05/2021	Investors concerned about the destruction of the Juukan Gorge to extend an iron ore mine.
SCG	48.97%	51.03%	Not Carried	8/04/2021	Shareholders were critical of executive remuneration packages while the business made a loss, decreased its portfolio and increased its debt.
SGR	55.00%	45.00%	Carried	22/10/2020	Bonuses increased despite the company relying on JobKeeper support.
TCL	74.26%	25.74%	Carried	21/10/2021	TCL shareholders agreed with proxy advisers in saying that executives' short-term remuneration was too lucrative

We observed a consistent trend with shareholders expressing their discontent with executives using government subsidies such as JobKeeper to boost the appearance of financial performance and using this as a basis for increasing remuneration. Ongoing ESG concerns remain a priority in the energy and mining sectors.

The newly appointed Crown board convincingly avoided a spill despite being the only company to receive a second strike over the last 2 years. Given this outcome over two of the most difficult financial years, the relevance of the "two strike" rule remains in the discourse.

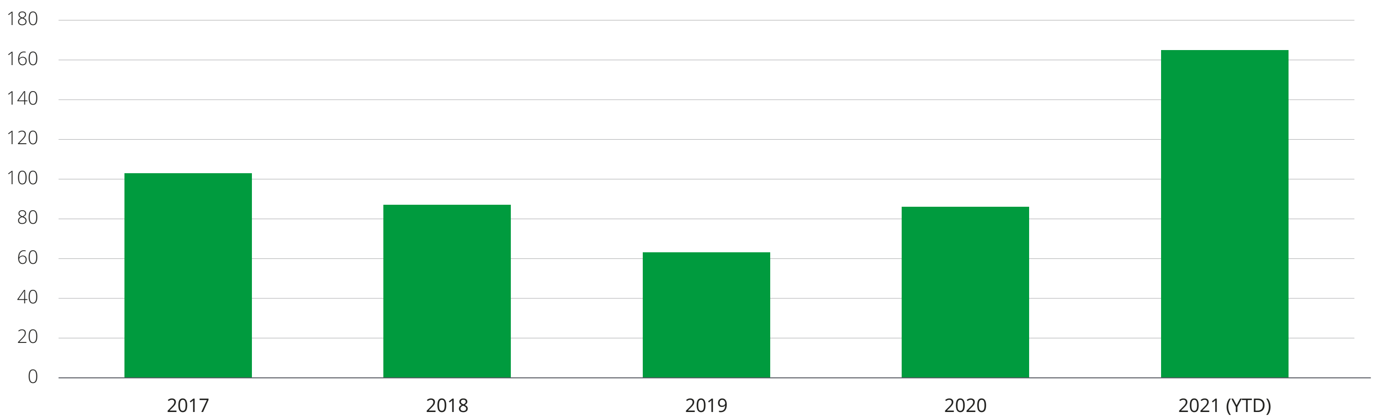
It is apparent that due to the difficulties brought upon Australian companies with the global pandemic, shareholders are paying even closer attention to executive remuneration, and scrutinising companies more closely to ensure executives' interests continue to align with the interests of shareholders.

The rise of share-based payments as a compensation alternative to employees

At the time of writing, there have been over 160 ASX IPO's in 2021. According to Reuters, this is twice the number seen in 2020 and almost triple that seen in 2019. Moreover, The Australian Securities Exchange identifies tech companies as the fastest growing IPO sector, with over 100 new tech IPO's in the last 5 years, and this continues to be the trend with a growing list of "buy-now, pay-later" start-ups and other fintech businesses. The velocity of these IPO's has led to a trickle-down effect wherein smaller and smaller market-cap entities are listing on the ASX.

Ultimately, we are seeing the start-up spike which began late 2020 continue through to the end of 2021. The 2021 Global Startup Ecosystem Report notes that Melbourne, Victoria is home to a growing 2,100 startups which have risen to almost $10b in value. Sydney also continues to be a major player as well, being home to 60% of Australian tech startups. AI, Big data and Fintech are listed as the major emerging startup industries, with Fintech comprising most unicorns.

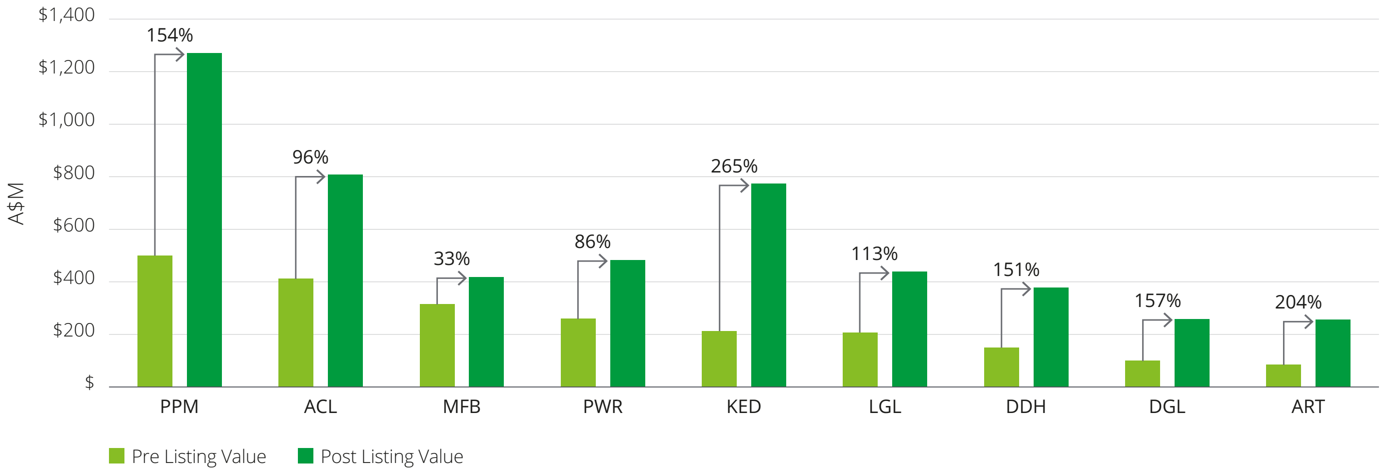
Figure 6: ASX IPOs over the last 5 years



Source: Thomson Reuters

It is common for start-ups and emerging businesses to adopt share-based payment policies as effective forms of employee retention and to align new employees to the goals of the business. It is also a useful way of reducing cash outflow in the beginning of a company's life. It is common for pre-IPO (private) and immediately post-IPO deal share prices to appreciate significantly, effectively increasing the remuneration conferred to employees via share-based payments. See the below chart for some of 2021's best performing pre-and post IPO performing entities.

Figure 7: Major Australian IPOs throughout 2021



Source: ASX Internal

Issuing share-based payment schemes to start-up employees is not without a variety of challenges. Often, determining an appropriate balance of cash and equity in employee remuneration proposes a significant challenge to financial managers, giving consideration to appropriate vesting schedules, performance conditions, and other plan terms. These challenges will typically translate into accounting and management difficulties.

Earlier this year, as part of the 2021-2022 Federal Budget, the Australian Government has committed to introduce reforms around the tax treatment of employee share schemes and share-based payment arrangements. This is set to significantly improve the equitable characteristics of such arrangements for not only start-ups and financial technology businesses but all entities who issue share-based payments to their employees.

Previously, share-based payment proceeds (to employees) experienced a "taxable event" when employees leave the firm (employment cessation). This has potential to result in a misalignment between tax liability and receiving payment from a share-based payment, which can act as a disincentive to participate in a share-based payment plan.

The removal of this provision means that share-based payments are simpler to structure. In addition, employees will not be required to sell a portion of their holdings to meet tax obligations. Furthermore, this ruling will reduce the need for complex tax liability determination consideration.

The above changes significantly increase the attractiveness of share-based payments to issuing entities. Compounded with the rise of start-up entities who typically employ these arrangements in their remuneration policies, we expect to see further rise in sharebased payment plans in both the listed and non-listed space.

As part of the Federal Budget, unlisted companies are now able to offer a maximum remuneration amount of $30,000 in equity to employees. Previously the limit was $5,000.

Common errors and oversights in share-based payments

With the popularity of share-based payments in emerging businesses, we have observed a large volume of start-ups and private entities making several key errors and oversights in their share-based payment accounting and valuation. This can cause material impacts and unintended consequences to employee payments and company equity. Our analysis has discovered the following common issues which need to be carefully considered:

- The determination of an appropriate and up-to-date share price for option valuations
- The determination of appropriate valuation inputs, including volatility and expected option term or exercise date
- The application of vesting conditions to the decided accounting policies, especially tranche-based vesting
- Modifications to existing share-based payments
- Consistent and compliant accounting policies and expense calculation adjustments including true-ups and non-vesting conditions.

Our Services

TSR incentive design

Deloitte is able to leverage its experience in assessing, valuing and analysing long-term incentive plans to assist companies in devising relevant and feasible LTI's which use RTSR as a performance metric in the pursuit of attracting and retaining suitable talent. We can assist with RTSR hurdle design – including selecting meaningful comparator groups, developing an assessment methodology and assisting with RTSR plan governance and consistency.

We also provide incentive plan design and implementation solutions, and assist in selecting appropriate comparator groups.

Valuation and hurdle assessment services for share-based payments

Deloitte provides end-to-end services to assist companies with their financial and internal reporting obligations for Employee Share Ownership Plans, Long Term Incentive Plans and other share-based payments.

Grant date valuations

We can assist with performing AASB 2[3] -compliant valuations for financial reporting purposes and valuations for tax purposes. Valuations of share-based payments with market-based performance hurdles are typically based on Monte Carlo simulations, rather than the Black Scholes Model, to appropriately account for the valuation impact of vesting conditions.

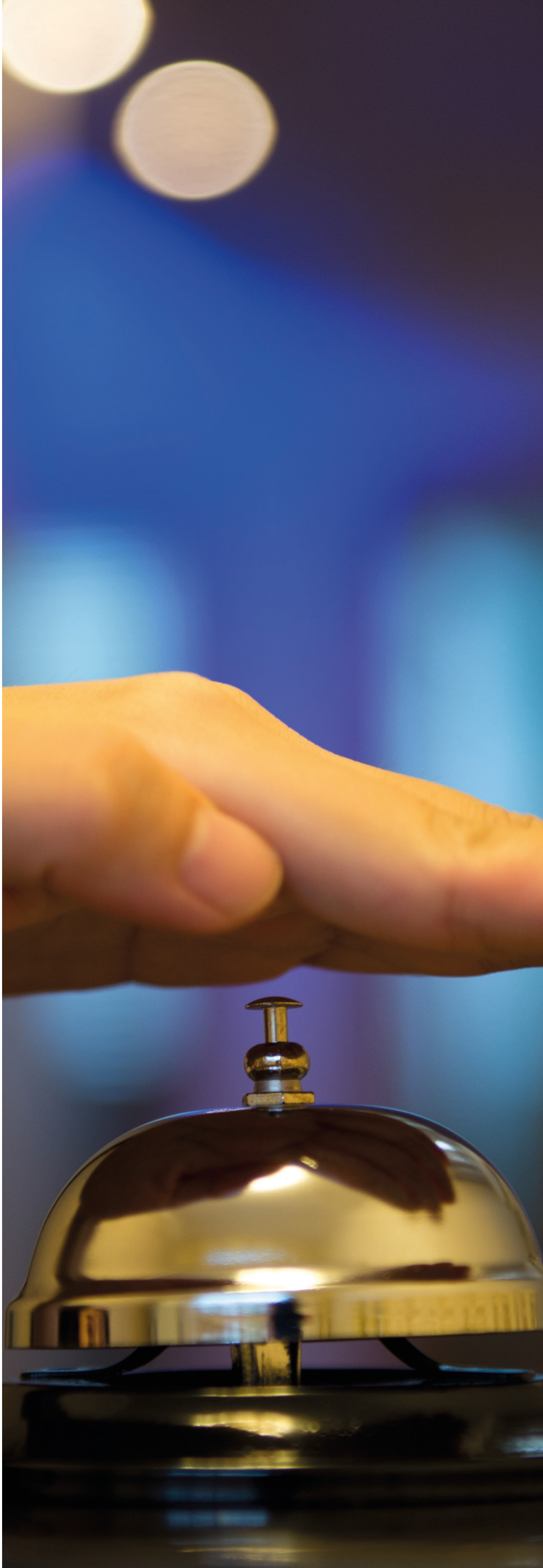
When performing valuations, we consider plan-specific factors including volume-based weighted average prices ("VWAP"), performance term, special dividends, as well as the treatment of corporate actions and events.

Ongoing hurdle tracking

We can aid in tracking the company's performance relative to the comparator group, throughout the vesting period, for internal reporting purposes.

Vesting date hurdle testing

We engage in external assessments of performance relative to vesting conditions at the end of the performance period, to determine the proportion of instruments that vest.

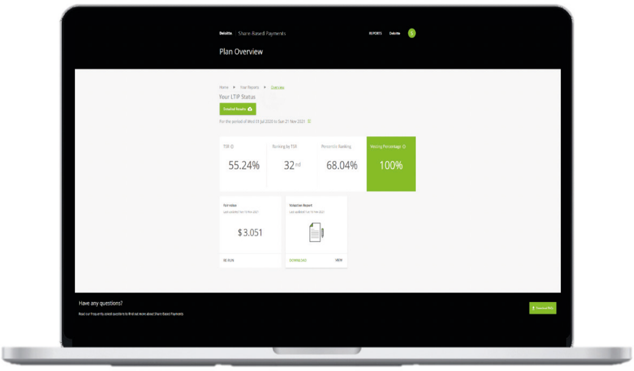


[3] AASB 2 refers to Australian Accounting Standard Board 2 Share Based Payment.

Our Solutions

Share Based Payments

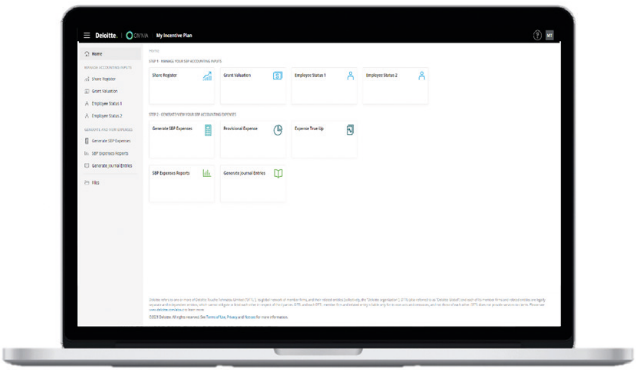
Our share-based payment tool helps our clients calculate AASB 2 grant date valuations within minutes. Our product also has the ability to track TSR performance against a defined peer group, with results automatically re-calculated on a daily basis.



My Incentive Plan

My Incentive Plan streamlines and reduces the risks associated with the share based payment accounting and reporting process by creating a single source of truth. Share based payment expense calculations are performed within a secure modelling engine, and enables users to mitigate the risk presented by performing and storing calculations of large data sets in excel.

My Incentive Plan will address the key accounting and reporting challenges discussed in this report, including the accounting treatment, expensing and vesting treatment as well as generating journal entries, effectively replacing the need for complex spreadsheets and time consuming year-end accounting procedures.



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