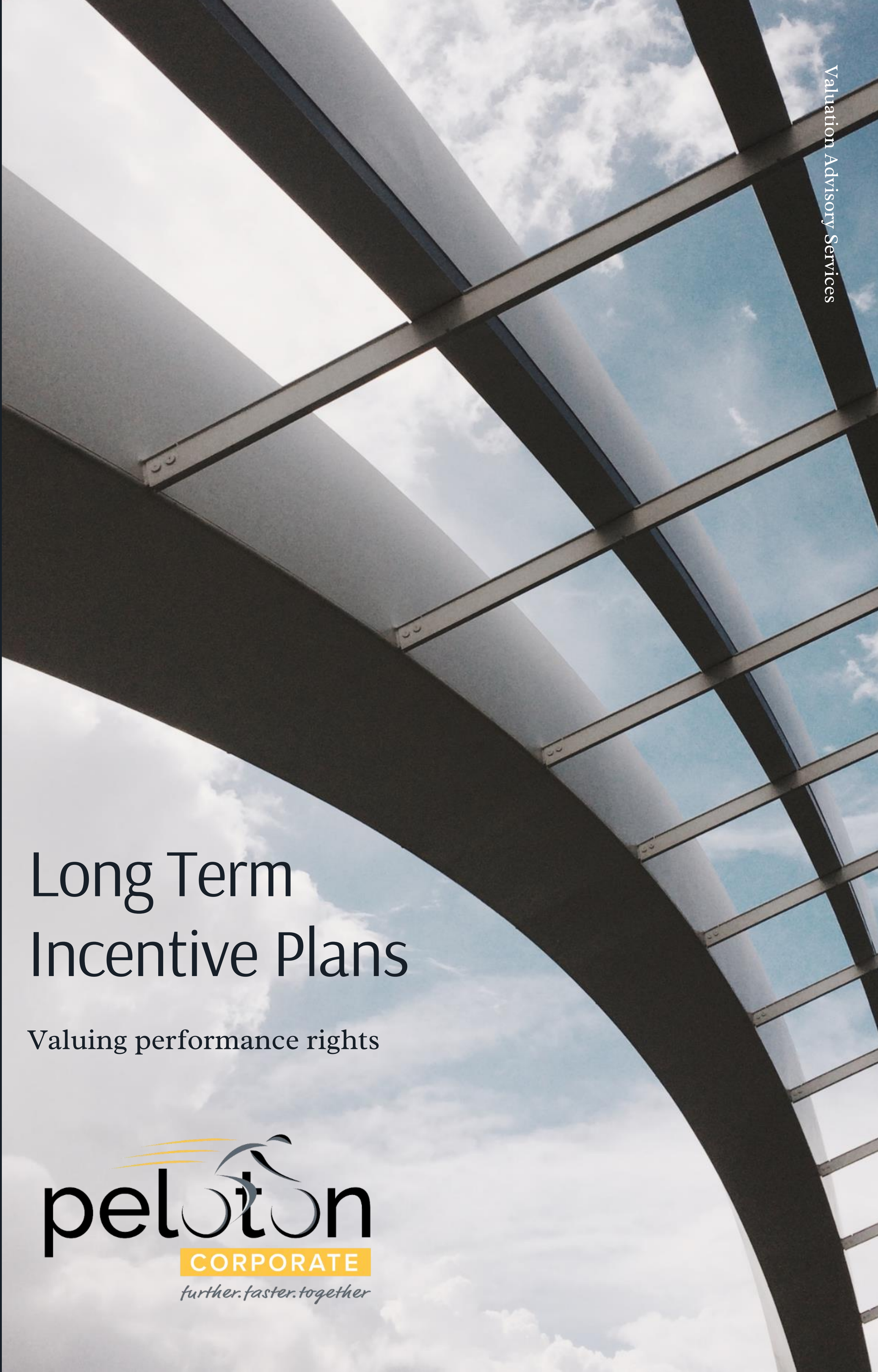

Valuation Advisory Services

Long Term Incentive Plans

Valuing performance rights

peloton CORPORATE

further.faster.together

creating, capturing, communicating value

Peloton Corporate [“Peloton”] is a leading Australian valuation and advisory practice servicing international, ASX-listed, privately-owned businesses and high-profile corporate and government clients.

Manage your Share Based Payment through Peloton

Peloton has extensive experience in delivering share based payment services to both ASX listed and private companies.

Learn more about our valuation advisory services.

- Grant date valuation
- Ongoing hurdle tracking
- Vesting-date hurdle tracking

Clients & engagements

Below is a sample of our clients and engagements focusing on valuation and testing of share based payments.

Insignia Financial

tassal

BESTON

aconex

CARBON REVOLUTION

Patties FOODS

IP Payments making cash flow

MyState

Slater + Gordon Lawyers

tarac technologies

CLEANSEAS

SELECT HARVESTS

PolyNovo®

ICON

Our approach

We help companies quantify key financial and non-financial performance measures

This helps to link short term outcomes and short-term incentives to long term outcomes and long-term incentive measures, that further can be communicated to shareholders.

We use both Black Scholes and Monte Carlo to value performance rights. For most financial measures we use Monte Carlo to value performance rights.

We are able to test the achievement of relative TSR performance. We conform to accounting standards such as AASB2 in the valuation and testing of shar- based payments.

Valuation methods used for share-based compensation

Valuing and expensing share-based compensation

AASB 2 requires each company using share-based incentives to have them valued so an annual expense can be allocated to the income statement.

For financial hurdles, as the expense is not directly observable, a valuation model must be used to calculate several unknown factors such as the probability of the hurdle exceeding a particular level and the probability of granted options actually being exercised.

Three valuation methods are available - Monte Carlo simulation, the Black-Scholes option pricing model, and the Binomial method (also called lattice model).
Our latest findings indicate that most companies use a combination of Monte Carlo and Black Scholes methods, depending on whether LTI awards are subject to market-based (e.g. TSR hurdles) or non market-based vesting conditions (e.g. ROE hurdles). Monte Carlo tends to be used for market based hurdles and Black Scholes for non market-based hurdles.

The use of the Black-Scholes option pricing model is ingrained in the thinking of many accounting firms and CFOs. Unfortunately, what few appreciate is that the Black-Scholes model is incapable of reliably valuing many LTI plans.

Employing the Black-Scholes model is useful for valuing options but completely ignores the performance hurdle and therefore overstates the expense. The only way to reliably value LTI plans is through the use of Monte Carlo simulation of the possible outcomes.

Valuation methods used for share-based compensation

Valuation of TSR hurdles is done primarily using Monte Carlo and Black Scholes Methods

The Monte Carlo approach can factor in the likelihood of an entity satisfying the TSR performance hurdles, as required by AASB 2. If the entity does not fully satisfy the TSR performance condition, not all of the underlying instrument (performance rights for example) will vest. In fact, it is possible that none of them will vest. By incorporating these possibilities, the Monte Carlo valuation can be lower – but nonetheless more accurate – than Black-Scholes.

As most CFOs and Remuneration Committee Chairs will be well aware, share-based expenses booked to reflect the TSR component of LTI hurdles are not able to be adjusted or 'trued up' to reflect the actual outcome of vesting calculations completed at the end of the performance period.

Specifically, AASB 2 (paragraph 23) does not permit subsequent accounting adjustments if TSR hurdled securities do not vest. As such, it is imperative that the fair value of share-based payments be accurately estimated when the securities are initially granted.

That means that any overstatement of the LTI annual expense as a result of using the Black-Scholes valuation model at the inception of the performance period is permanent – it cannot be reversed and hence reported entity profit performance is unnecessarily and negatively impacted.

So, while Peloton can and does use Black Scholes when appropriate, we focus on the Monte-Carlo based valuation and expensing techniques in all our client valuations.

Benefits of using Peloton

In our view, the following are the key benefits of an independent adviser.

- ✓ AASB 2 compliant
- ✓ Independent assessment
- ✓ Reliable inputs from independent sources
- ✓ Reliable outcome
- ✓ Least audit ‘friction’
- ✓ Outsource audit issues to experts
- ✓ Communications with proxy advisers and Australian Shareholder’s Association

Our services

Advice supported by the application of sound financial principles and extensive experience

Peloton 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.

Our services

Grant-date valuations

Reliable, AASB2-compliant valuations for financial reporting purposes and valuations for tax purposes. Valuations of performance rights are typically based on Monte Carlo simulations, rather than the Black Scholes Model, to appropriately account for the valuation impact of vesting conditions.

On-going hurdle tracking

Tracking the company's performance relative to the comparator group, throughout the vesting period, for internal reporting purposes.

Vesting-date hurdle testing

Independent assessment of performance relative to vesting conditions, at the end of the performance period, to determine the proportion of instruments that vest.
We also provide Incentive Plan design and implementation solutions and assistance in appropriate comparator group selection.

If you would like to learn more about our firm or discuss your valuation advisory needs, please use the details below to contact our team to arrange an introductory call.

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