

A professional business meeting in a modern office setting. A man in a dark suit and tie is smiling and gesturing with his hands while speaking to a woman in a light-colored blazer. They are seated at a table with a laptop, a tablet, and several documents, including one with a blue bar chart. The background shows a bright, open-plan office with glass partitions.

# VALUATION SERVICES

## EMPLOYEE SHARE SCHEMES

# VALUATION SERVICES

## EMPLOYEE SHARE SCHEMES

Listed and unlisted companies alike can benefit from well-structured and implemented employee share schemes, to align employee and company interests. This guide provides an overview of the key valuation considerations in relation to an employee share scheme.

Australian companies utilise employee share schemes (ESS) as a component of remuneration and for performance recognition. Employee share schemes are often classed as long-term incentive (LTI) or short-term incentive (STI) plans, forming a component of employee remuneration.

In this document, we discuss the following:

- ▶ Typical ESS instruments
- ▶ ESS valuations
- ▶ How BDO can assist you.



# TYPICAL ESS INSTRUMENTS



## OPTIONS

- Rights to acquire ordinary shares in the Company for an exercise price
- Options may vest upon meeting pre-specified conditions
- May be exercised prior to expiry



## PERFORMANCE RIGHTS

- Rights to acquire ordinary shares in the Company at vesting typically with no exercise price being payable
- Reward value to the employee typically is equal to the share price at vesting
- May be settled in shares or cash



## SHARE APPRECIATION RIGHTS

- Entitlement to a reward payment
- Based on the increase in share price over a specific period of time



## LOAN SHARE PLAN

- Employees may be given a limited-recourse (and sometimes interest-free) loan to acquire shares in the Company
- The shares remain restricted until vesting conditions are met and loan repaid

# ESS VALUATIONS

The valuation of shares/options/rights or other instruments issued under an ESS is required for financial reporting purposes. A valuation may also be necessary for income tax purposes, with reference to the Australian Taxation Office's ESS valuation requirements. The value of an ESS instrument may be dependent on the following key variables:

Grant Date	Life of the Instrument
Share Price at Grant Date	Exercise Price
Dividend Yield	Risk-Free Rate
Share Price Volatility	Vesting conditions

In valuations completed for financial reporting purposes under AASB 2:

- ▶ Non-market vesting conditions do not affect the value of the ESS instrument at the grant date. Instead, they impact the estimated number of instruments that will vest
- ▶ Market vesting conditions affect the value of the ESS instrument at grant date
- ▶ Non-vesting conditions also affect the value of the ESS instrument at grant date.

The value of an option/right or other similar instrument issued under an ESS is generally comprised of two components:

<b>Intrinsic Value</b> Difference between the share price and the exercise price	<b>Time Value</b> Value related to the term of the instrument and the expected net growth associated with its volatility and net return metrics
---	--

## PERFORMANCE CONDITIONS

In order to appropriately incentivise key staff, a company may consider a vast array of potential performance conditions which align with the company's strategic focus and which must be met in order for the securities issued under the short-term or long-term incentive (STI & LTI) plans to vest. Examples of performance conditions include:

<b>Non-Market Conditions</b> EBITDA growth, EPS growth Sales growth Milestone achievement (e.g. clinical trial)	<b>Market Conditions</b> Share price growth, TSR, Price/TSR growth relative to peer group
---	--

## VALUATION METHODOLOGIES

It is important to value an instrument using the correct valuation model. The choice of model will heavily depend on the terms of the instrument. Common models for valuing ESS instruments include:



### BLACK SCHOLES MODEL

- ▶ Considers the difference between share price and exercise price and the intervening impacts of volatility, dividend yield and risk free rate in a single calculation
- ▶ Can be utilised for majority of instruments with fixed/variable terms to expiry.



### BINOMIAL MODEL

- ▶ Similar to Black Scholes with more transparency and more detailed step by step calculations
- ▶ More flexibility at each step of the calculation, for example, for a change in conditions.



### MONTE CARLO SIMULATION

- ▶ More complex than Black Scholes and Binomial and may provide more precision
- ▶ Useful for instruments with market conditions
- ▶ Utilises a simulation model to calculate a probability weighted aggregation of expected values for numerous iterative alternative price/market condition scenarios.

For a simple ESS instrument (e.g. with only a service condition), all the valuation methods above provide the same value.

## ACCOUNTING

Equity instruments granted under an ESS by reporting entities are required to be reported in the company's financial statements in accordance with AASB 2: *Share Based Payment*. AASB 2 generally requires that these instruments be measured with reference to the value of the equity instrument granted, rather than the value of the service provided in exchange for the grant.

Key requirements include:

- ▶ Fair value measurement of the ESS equity instruments at grant date
- ▶ Consideration of market conditions and non-vesting conditions in measuring the fair value of the shares/options/rights granted
- ▶ Consideration of employees' service conditions (e.g. an employee must be employed by the company) and other non-market vesting conditions in estimating the number of shares/options/rights which are expected to vest
- ▶ Expensing the calculated value over the term of the instrument.

## TAXATION

The taxation of employee share scheme arrangements was simplified in 2015, as outlined in our ESS e-book<sup>1</sup>.

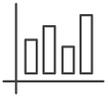
In summary, income tax can now apply on the exercise of share options, rather than when the options are capable of exercise. This means the taxing point is much more aligned to the availability of the cash required to pay the tax. This makes the tax implications of share ownership in an employing company less onerous to employees.

1. <https://www.bdo.com.au/en-au/insights/tax/articles/employee-share-schemes>

# HOW BDO CAN ASSIST YOU



We are well-versed in a variety of valuation techniques for both simple and complex ESS valuation, including the Black-Scholes, Binomial, Monte Carlo and other methods for ESS plans which incorporate market and non-vesting conditions.



We assist clients to develop and structure STI and LTI plans with appropriate performance conditions, including business milestones, revenue or profit targets and share price hurdles.



We have a complete understanding of the requirements of all relevant accounting standards, including the valuation differences between securities issued with market-based vesting criteria versus non-market based vesting criteria.



We understand the taxation implications and ATO reporting requirements of STI and LTI plans, both for company and the employee perspectives, and work closely with our clients to assist them.



We provide clients with a range of other services including producing tailored spreadsheets to assist in recognising the ESS expenses where large numbers of employees have received equity instruments.

We assisted a listed engineering and construction company to develop their STI and LTI programs including:

- ▶ Provision of structuring advice for their staff incentive program (for approximately 50 executives) including assistance with developing performance conditions
- ▶ Provision of advice in relation to accounting treatment for financial reporting purposes
- ▶ Valuation advice for the proposed grant of employee options to 300-400 employees
- ▶ Development of a financial model to assist the company with its accounting entries.

## OUR EXPERIENCE

BDO's global Corporate Finance team has 1,200 professionals in 60 countries. In Australia, we have over [80 corporate finance partners and professional staff in our eight offices](#).

Our team has advanced financial analysis and modelling skills and an in-depth understanding of the valuation requirements of ESS.

Our recent ESS experience includes:

### Construction Contractor (LTI)

We completed an ESS valuation for financial reporting purposes using Monte Carlo simulations to calculate TSR against the ASX 200 over the performance period. We built a financial model to enable the client to account for option vesting for financial disclosure purposes.

### Medical Researcher (LTI)

We completed an ESS valuation for management and financial reporting disclosure which included a combination of market and non-market conditions. We utilised a Black Scholes model with functionality for multiple tranches.

### Veterinary Services

We carried out a valuation of ESS options and loans. The ESS arrangement included a market based hurdle utilising a relative TSR, compared with 100 comparable ASX companies. We utilised Monte Carlo simulations in our valuation.

### Healthcare Provider

We completed a valuation of LTI and STI plans.

### Fast Food Franchise

We assisted with a valuation of LTI plan options, using a binomial option pricing model.

### Electrical Products Producer

We carried out a valuation of performance rights.



**NEED HELP?**

TO CONTACT US TODAY, [CLICK HERE](#). ALTERNATIVELY, PLEASE CALL US ON 1300 138 991



**NEW SOUTH WALES**  
**NORTHERN TERRITORY**  
**QUEENSLAND**  
**SOUTH AUSTRALIA**  
**TASMANIA**  
**VICTORIA**  
**WESTERN AUSTRALIA**

1300 138 991

**[www.bdo.com.au](http://www.bdo.com.au)**

**Distinctively different – it's how we see you**  
**AUDIT • TAX • ADVISORY**

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact the BDO member firms in Australia to discuss these matters in the context of your particular circumstances. BDO Australia Ltd and each BDO member firm in Australia, their partners and/or directors, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO refers to one or more of the independent member firms of BDO International Ltd, a UK company limited by guarantee. Each BDO member firm in Australia is a separate legal entity and has no liability for another entity's acts and omissions. Liability limited by a scheme approved under Professional Standards Legislation other than for the acts or omissions of financial services licensees.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2018 BDO Australia Ltd. All rights reserved. BNE\_06/18

