



THE SHARE VALUATION WORKED EXAMPLES GROUP IN THE CHANGING VALUATION LANDSCAPE

William Franklin, Partner, Pett Franklin LLP

Webinar

Monday 11 January 2021 11:00-11:45 am

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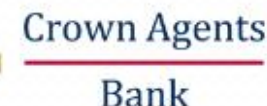


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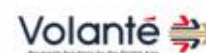
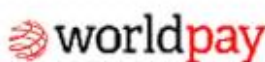
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TODAY'S AGENDA



- 11:00 – 11:05 Chairman's Introduction
- 11:05 – 11:30 Keynote Address
- 11:30 – 11:45 Questions & Answers

TODAY'S SPEAKER



William Franklin

Partner

Pett Franklin

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➤ William Franklin - 11 January 2020

The Share Valuation Worked Examples Group In The Changing Tax Valuation Landscape

What is the WEG



- WORKED EXAMPLES GROUP
- Sponsored by Esop Centre Proshare EOA SPLG and HMRC
- Committee of valuers and advisers including head of SAV from HMRC
- Create more worked examples
- Build on those already set out by HMRC in their manuals
- Collaborative
- Open source

Relevance



- Tax valuations for Employee Share Schemes in unquoted companies matter because;
 - If awards of shares, determine income tax payable on award
 - Can set value from which employee benefit from growth
 - Set limits of awards within government schemes e.g. £250k EMI limit or £3,200 SIP limit
 - Employee Share Schemes important for growth sectors of the economy eg life sciences

QUESTION

- What do YOU think a “best estimate” should mean in a range of potential values?
 1. The **highest** possible potential value in that range
 2. The **average** of the possible potential values within that range
 3. The **most probable** of the possible potential values within that range

Landscape

- Pre 1997
 - Siege warfare / case law warfare
- Post 1997
 - Acceleration in share schemes in unquoted companies- EMI
 - Climate change
 - More commercial approach
 - Agreement procedures (upfront) - Brown certainty
- Generous discounts from March 1982 CGT rebasing
- “Golden age”

Overreach

- Growth shares
- ESS mistake
- Diversion of HMRC resources
- Withdraw of Best Estimate Agreements and PTVC
- Clouds over government EMI scheme agreements
- Resources to Reduction of Tax Gap/ Transfer Pricing
- Not public service certainty of tax role

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Lookback



- Uncertainties / Divergent Views
- Information standard
- Growth Shares
- Development Companies
- Discounts - International comparisons
- Best Estimate; role and meaning

WEG

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- Lost dialogue with withdrawal of PTVC
- Worked Examples Group
- Narrow down range of uncertainty
- Collaborative approach
- Open source
- Buffer / filter
- Not a backdoor PTVC

New ownership structures

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➤ CICs

➤ EOTs

EOT Pamela worked example

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https://sharevaluationweg.org/Worked_examples/EOT_company.html

Share Valuation WEG

Worked Examples

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Worked examples

Submit an example

EOT Company ("PAMELA")

Pamela Limited is an owner managed business which was founded by its CEO Ms Pamela Smith. Pamela Limited has grown steadily since it was started 20 years ago.

1) Ms Pamela Smith is looking to retire in a few years time and in the meantime would like to scale back her involvement with the business. From time to time the business has received approaches from potential purchasers but Ms Pamela Smith would prefer Pamela Limited to continue to be independent after she retires and be run by the management team and employees who have helped her build the business.

2) A couple of years ago she arranged for the company to issue free shares to all the employees under the government's Share Incentive Plan (SIP). The result was that Ms Pamela Smith held more than 95% of the company's single class of ordinary shares and the employees held the remaining shares through the SIP.

3) Valuation of the ordinary shares was agreed with HMRC for those SIP awards. This involved a theoretical calculation of the value of Pamela Limited of £3M based on a multiple of profits, with a large discount for the individual shareholdings being very small, uninfluential minority holdings in an unquoted company.

4) A few weeks ago Ms Pamela Smith converted Pamela Limited into an Employee Ownership Trust ("EOT") owned company under FA 2014 Schedule 37 rules by selling 70% of the Ordinary shares to the EOT, leaving her with over 25% and the employees holding the balance of the shares.

5) The sale of the 70% holding involved a Sale and Purchase Agreement. ("SPA") between Ms Pamela Smith and the EOT. The total maximum potential consideration for the sale of the 70% holding was agreed between Ms Pamela Smith and the trustees at £2.8 million based on a multiple of profits but with much of the consideration being deferred and dependent on the generation of future distributable profits and surplus cash after the change to EOT ownership. As a controlling interest was being sold there was no discount, unlike for the earlier SIP awards.

6) Under the SPA £800,000 is payable to Ms Pamela Smith immediately on completion from available cash and distributable profits. The balance of the maximum further potential consideration of £2 million is anticipated to be paid in 5 annual instalments of £400,000 over the next 5 years.

7) These instalments will only be paid, if in the future, the now EOT owned company generates sufficient surplus cash and profits to be able to gift money to the EOT to allow the anticipated instalments to be paid by the EOT to Ms Pamela Smith. If there are not sufficient distributable profits and cash generated in the future some or all of the consideration in excess of £800,000 cannot be paid to Ms Pamela Smith.

8) During the transitional period, while there is outstanding consideration due to Ms Pamela Smith, future profits of the company will be required to fund the paying off by the EOT of the consideration due to Ms Pamela Smith. As a result the potential for employees to receive dividends on their direct shareholdings is limited. But to deepen the employees' sense of ownership and responsibility, after the conversion to EOT status, direct employee share ownership is being increased by a new issue of free shares under the SIP. But these will be small minority holdings and control will remain with the EOT.

9) In the future after the end of the transitional period when the trust's obligations to the EOT have been fully discharged and future profits are fully available for shareholders it may then be appropriate to value further SIP share awards on a dividend basis of valuation.

10) But, as the fundamental economic nature of Pamela Limited's business has not changed following the conversion to EOT ownership, while future profits will be needed to fund the EOT's obligation to Ms Pamela Smith, a valuation based on a multiple of profits continues to be more appropriate with a discount for SIP shares being small uninfluential minority holdings in an unquoted company. However this theoretical valuation of Pamela Limited may also need to take into account, through a deduction (however determined) from the whole company value, for Pamela Limited's non-contractual obligation to fund the EOT from future profits to allow the EOT to pay the outstanding balance of the consideration to Ms Pamela Smith.

Current Projects



- Development Companies
- Growth shares
- Internally funded market makers

Fundamentals / Conflicts: Meaning of Best Estimate



- S272 + S273 - Willing buyer + willing seller
- Case law - best possible price
- Outlier? Rather than average / most probable
- Best Estimate by directors - average / most probable
- difficult to dislodge

QUESTION AGAIN

- What do YOU think a “best estimate” should mean in a range of potential values
 1. The **highest** possible potential value in that range
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Fundamentals / Conflicts: Significance of Exchange



- S272 + S273 - Exchange of shares between willing buyer + seller
- Development companies;
 - Shares issued by unquoted companies to fund its activities
 - Is this market value?
 - Is it a good proxy? / what adjustments or discounts are needed?

NEW QUESTION



- Is the price at which shares are issued by an unquoted development company to fund its continuing activities to develop new products and markets likely ***without any adjustment*** to be the same value that a willing buyer and a willing seller would exchange between them a small number of shares?
- Yes
- No

Questions?

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QUESTIONS AND ANSWERS



RESOURCES



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newspad

The Esop Centre's *newspad*, edited by Fred Hackworth, is a monthly publication providing in-depth coverage of the main international news in the employee share ownership field.

NB Reminder: The email address of Fred Hackworth, editor of *newspad*, has now changed to: fred_hackworth@zyen.com (please note the under-score). Please send all press releases, company bulletins and news items for *newspad* to the above address. Thank you.

January 2021

In this month's edition:

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- Centre warns against Budget CGT rises
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- Share options for all at furniture retailer
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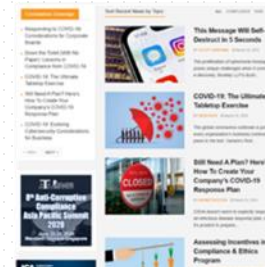
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(LF.10) Reduced Inequalities

In September 2015, 193 world leaders agreed to 17 Global Goals for Sustainable Development. If these Goals are completed, it would mean an end to extreme poverty, inequality and climate change by 2030.

- Goal 10: Reduce inequality within and among countries.
- If the distribution of income, assets owned, and talent were to follow CBO's projections, income inequality will be greater in 2030 than it was in 2010.
- High growth over the past decade has been based on unsustainable resource exploitation, allowing the resulting growth in inequality and environmental cost to be critical to future social stability and to ensure strong sustainable growth in the coming decade.
- The increase in inequality observed in the last 20 years is a warning to future's social contract.
- America's slowest-growth period is pending a year that will further increase economic inequality at a time when income and wealth gaps are already widening.
- A failure to give the world's poorest women control over their bodies would widen inequality in developing countries and thwart progress towards global goals aimed at ending poverty by 2030.
- Under French leadership the G7 group of the 7 largest advanced economies plus the European Union will have to stop on fighting inequality, including poverty, induced by climate change.
- Leadership might require companies to take proactive and Schwartz for change on global inequality, including the work on equity, reducing inequality and more – could open a market opportunity of \$1 trillion by 2030.
- The next decade offers an opportunity to address Africa's urban poverty and inequality and shape development priorities to ensure that urbanization helps lower middle-income, fragile and vulnerable states.
- In Africa and in the LDCs, reducing poverty by 2030 will require both double-digit GDP growth and dramatic declines in inequality, shortening the path to the income challenges faced.
- The economic world of 2030 will be the most unequal in the coming decades – thereby reducing global inequality among countries and among world citizens.

(FS.3.05) Employee Share Ownership

Considering 73 percent of the 2021 global workforce will be Millennials and Generation Z, it's critical that organizations keep a pulse on employee engagement and do so in a way that's consistent with how the emerging generation communicates.

- Stop and see a continued emphasis to designers' understanding of workplace optimization with design that boosts office morale and employee wellness while facilitating a remote work environment.
- By 2026, Customer Profile (CPI) as a Key Employee-Driven Driver (KED) for Work that Drives Employee-Driven Drivers (WED) proposed continues to the EIC Corporate Governance Code, then 100% companies will be required to report on employee engagement, as announced earlier this year by Financial Reporting Council.
- For HR leaders looking to better determine the attitudes that drive employee turnover and increase retention, using AI to provide insights into employee engagement will be critical.
- By 2025, Artificial Intelligence (AI) will allow the rate of innovation to flow 2x faster to double Employee productivity gains are expected to increase 1.5 times.
- Artificial intelligence will double the rate of innovative improvements and improve employee productivity gains by 1.5 times in New Zealand by 2025.
- US health benefits costs per employee will increase 4.7% next year – slightly higher than inflation and less than the double-digit increases seen in prior years.
- With a tight labor pool, small businesses will feel 2021 in the year to focus on employee engagement and happiness.
- Nearly 20 percent of respondents also expect that automation will lead to some reductions in their full-time workforce by 2025, based on the job profiles of their employee base today.
- Employee wellness has been on trend for years, but expect to see some high-tech changes in 2021.
- By 2025, automation and artificial intelligence will reduce employee requirements in business shared-service centers by 43 percent, which sets the B2B market will up \$1 billion by 2025.
- This year, many organizations will look to employee scheduling software to solve problems around creating, publishing and managing employee schedules that include options to cover shifts to select process and improve data on sales to help identify customer traffic patterns to combine worker rates.

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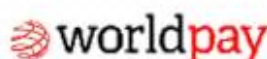
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Forthcoming Events

- Tuesday 12 Jan (11:00) What's The Gap? Basis Chance In The Age Of Parametric Insurance
- Wednesday 13 Jan (11:00) ID, A Digital Identity Service By Mastercard – Your Digital Identity, Your Choice
- Thursday 14 Jan (10:00) Addressing Data Privacy: Managing The Risk Of Future Liability
- Friday 15 Jan (12:00) 2021: The Road to Net-Zero Finance
- Monday 18 Jan (11:00) Patient Capital: The Key To Rebalancing Financial Markets?
- Tuesday 19 Jan (09:00) Psychology Of Leading A Hybrid Workforce

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