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Case Study

Employee Share Schemes and Business Valuations

Topics discussed in this paper include

Employee Share Schemes

Complex Valuations

Independence

To help retain experienced employees, a mid-sized IT consulting company formulated an employee share scheme. Due to the significant number of users relying on the valuation, and the size and complexity of the company, a premium business valuation report was required.

Background

Orange Digital, a mid-sized IT consulting company, had experienced significant growth over the past five years with offices in Auckland, Wellington and Christchurch. The four original Directors managed the business which now employed over 40 staff and boasted annual turnover exceeding \$15mil.

Almost all facets of the business were going well, apart from senior staff retention. Due to the high demand for senior IT consultants, and the highly mobile nature of this market segment, Orange Digital was experiencing a high turnover of management level consultants. In an attempt to mitigate this issue, the Directors resolved to formulate an employee share scheme.

Situation Analysis

The Directors of Orange Digital realised an independent fair market valuation of the company was called for. The valuation would need to satisfy multiple stakeholders: the Directors, senior management who were to be offered the shares and, naturally, the IRD.

Given the size of the company, both the number and variety of stakeholders with an interest in the result, and the number of elements to be considered, the valuation would need to be complex and extensive.

Elements to be carefully weighed would include the company's historical trading results, future cash flow forecasts and a full review of contracts with both suppliers and clients.

Comparisons needed to be drawn, relying upon research into similar companies listed on the NZX and their Price Earnings Ratios. Adjustments would then need to be made for differences in size, reliance on key personnel and liquidity before a valuation multiple could be adopted.

Outcome

The complex considerations underpinning the valuation report helped the Directors formulate and implement the employee share plan. Annual updates to the report are commissioned, reflecting changes in trading conditions, company forecasts and the state of the IT industry as a whole.

**An independent business valuation compiled by a professional can help.
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