



Extreme Makeover: ESPP Edition

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Materials Slides

http://www.sos-team.com/pdfs/espp_makeover.pdf

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Agenda

- ESPP Foundations
- Currently trending
- ESPP Look Book
- Make over stories
- Finding your fit
- Just a touchup? Or a whole new look?
- Does this look fit your budget?

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Foundations

- Prior to FAS 123R (ASC 718), ESPPs were common programs, and, where offered, nearly always provide 15% discount AND look back, with no compensation expense.
- The compensation cost resulting from FAS 123R (ASC 718), along with overall concern about dilution and stock programs, caused some companies to discontinue the plans, or convert to “safe harbor” plans (5% discount, no look back).

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Foundations

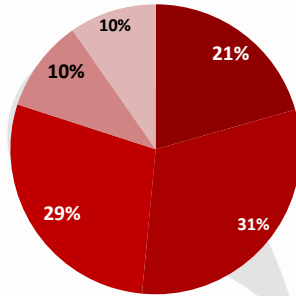
- Despite FAS 123R (ASC 718), ESPPs are still an important component of many equity compensation plans.
- ESPPs can help promote an ownership mentality across a broad base of employees at a relatively low cost.
- Plan design, particularly those related to discount rates and look-back periods, often have a big impact on participation rates.

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Foundations

Research indicates that stock plans increase employee loyalty

More loyal as a result of stock plan grants



- 52% of all respondents state that stock plans increase loyalty to their employer
- Stronger loyalty impact for respondents with options / restricted stock awards
- Loyalty impact increases with compensation

Strongly Agree Somewhat Agree Neutral Somewhat Disagree Strongly Disagree

Source: Fidelity Stock Plan Services Participant Survey, January 2012

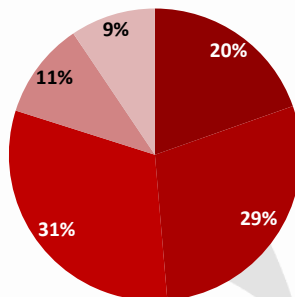
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Foundations

Research also indicates that stock plans increase employee motivation

Work harder knowing my stock plan will reward me



- 49% of all respondents state that they work harder knowing that they are linked to company performance
- Stronger motivation impact for respondents with options / restricted stock awards, but not as strong as loyalty
- Motivation impact increases with compensation

Strongly Agree Somewhat Agree Neutral Somewhat Disagree Strongly Disagree

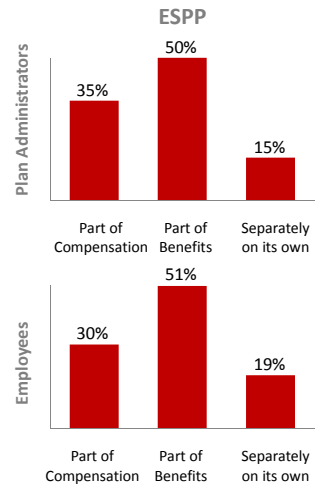
Source: Fidelity Stock Plan Services Participant Survey, January 2012

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Currently Trending

- Compared to RS and SOP, ESPP is more likely to be considered a benefit rather than compensation
- The most common reason for implementing an ESPP is to remain competitive in hiring practices
 - 29% - To remain competitive in hiring and attracting new employees
 - 21% - To retain more highly valued employees and reduce attrition
 - 20% - To supplement employee compensation

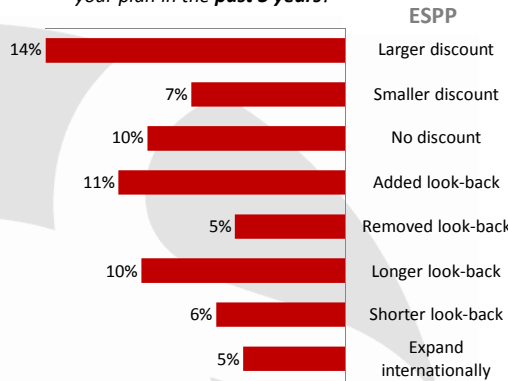


Fidelity Stock Plan Decision Maker Research Study, December 2012

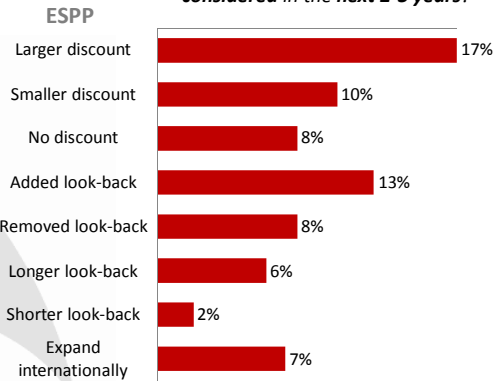
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Currently Trending

What changes *have you made* to your plan in the **past 3 years**?



What changes to your plan *are being considered* in the **next 2-3 years**?



Fidelity Stock Plan Decision Maker Research Study, December 2012

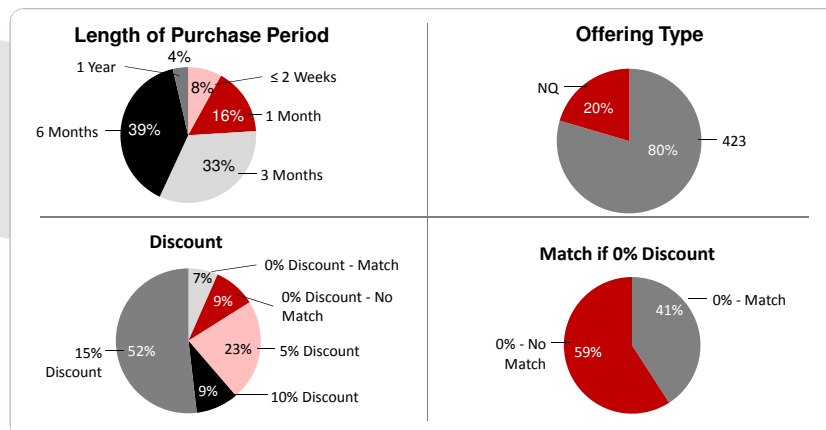
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Currently Trending: The Hot Looks of ESPP

- Broad based
- Cash inflow
- Guaranteed appreciation
 - With right combination of discount, look back, and offering
- Employee motivation, loyalty, engagement
- Opportunity for employee ownership outside of constraints of 401K
- Non-Excessive
- Expense efficient
- Minimal share usage (no ISS concerns)
- Corporate tax deduction
 - Section 423 – upon disqualifying disposition
 - Non Section 423 – upon purchase

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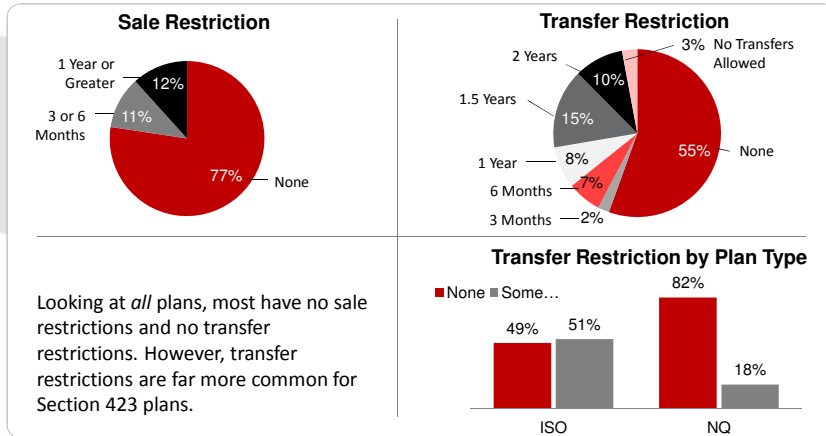
Today's Hottest ESPP Looks: Plan Design Features



Fidelity/Radford ESPP analysis, October 2014; Fidelity ESPP clients as of March 31, 2014.

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Today's Hottest ESPP Looks: Plan Design Features

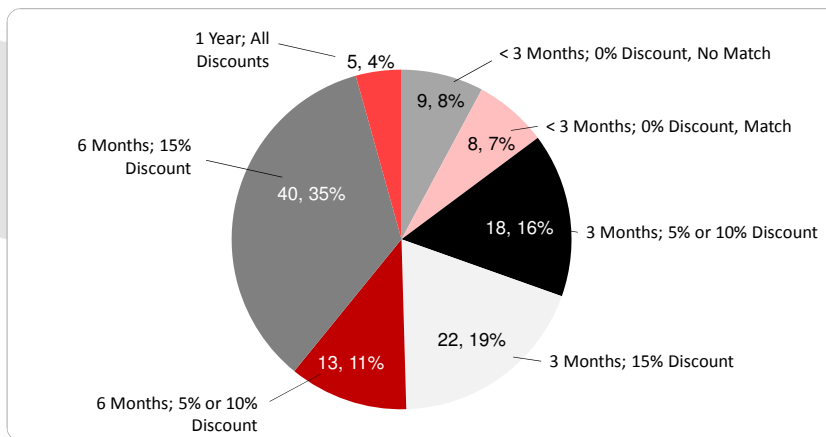


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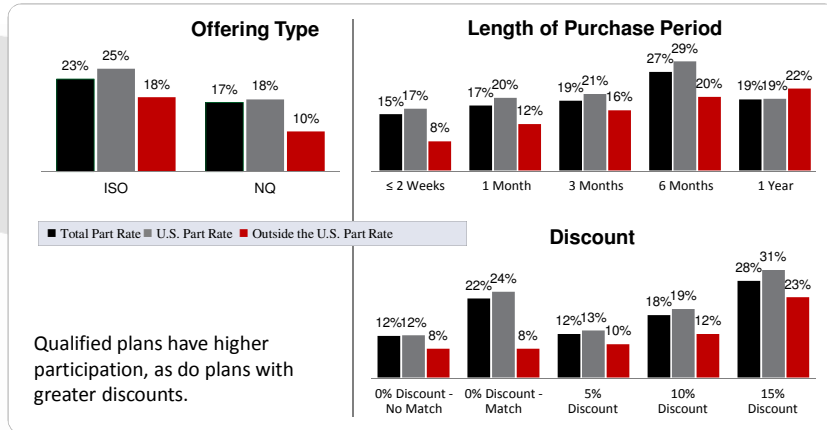
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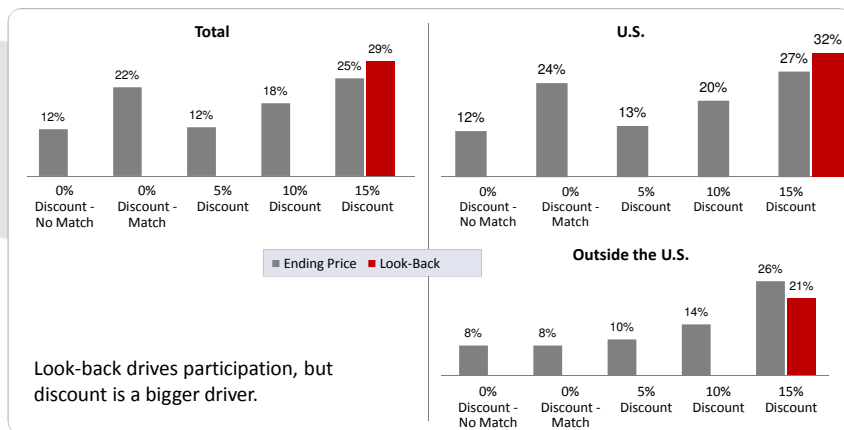
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Today's Hottest ESPP Looks: Participation



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Today's Hottest ESPP Looks: Participation



Fidelity/Radford ESPP analysis, October 2014; Fidelity ESPP clients as of March 31, 2014.

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Finding the Right Fit

- Tax Qualification
 - Section 423
 - Offers tax benefits to US employees; tax at sale; typically tax at purchase for OUS
 - Must meet § 423 requirement for eligibility, discount, offering length, limitations, etc.
 - Non qualified plan
 - Tax at purchase for US employees; typically tax at purchase for OUS
 - More flexibility with design considerations (i.e. matching shares)
- Design Choices
 - Discount
 - Look back
 - Offering Period
 - Other – purchase limitations, sale/transfer restrictions, eligible compensation, dates
- Design drives participation and compensation expense

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Finding the Right Fit: Set Up Considerations

- Shareholder approval
- US and OUS rollout plans
 - Operational and plan differences
 - Translation
 - Threshold considerations
- Multiple stake holders
 - Legal
 - Tax
 - Administration
 - Payroll
 - Human Resources
 - Finance

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Does this Look Fit Your Budget

- Style has a cost
- Understand your style
 - Tuxedo
 - Suit
 - Business Casual
 - California Casual
- Understanding your budget
 - Neiman Marcus?
 - Banana Republic?
 - The Gap?
 - Old Navy?

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History of Style

- APB Opinion No. 25 = Non-compensatory
- SFAS No. 123 (Revised) (Now ASC 718)
 - Expense impacts income statement
 - Non-compensatory if:
 - No “option-like” features
 - Discount not greater than 5%
- Staff Technical Bulletin 97-1 (STB 97-1) now 718-50
 - Fair Value determined on “Grant date” (enrollment date)
 - Value of ESPP has three components
 - Discount: Value of discount on enrollment date
 - Look-Back: Proportionate value of call option
 - No Beginning Price Share Limit: Proportionate value of put option
 - Represents additional shares that participants can purchase when the price declines during the period
 - Each purchase period is treated as a separate option

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Building Blocks of Style

ESPP Valuation Input Factors

Input	Description
Market Value	Market Value on Enrollment Date
Price	Market Value (No discount!)
Expected Term	Purchase period length No "guess work" like with options
Interest Rate	Treasury rates (http://www.federalreserve.gov/Releases/H15/data.htm)
Volatility	Same as for options – reflects expected term Historic, peer (recently public) implied
Dividend Rate	Reflects expected term

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Just a Touch Up? Or a Whole New Look?

Type of Plan	Just a Touch Up	Make Me Shine	A Whole New Look!
5% discount no look back 6 month offering (i.e. safe harbor)	Reduce offering period to 3 months	Raise discount to 10% or 15%	Add look back Reduce offering period to 3 months Raise discount to 15%
Potential Impact on Participation			
Potential Impact on Expense	no change	\$	\$\$
Example Expense per Share	\$0	\$2 - 3	\$4.75

*Assumes \$20 FMV, 50% volatility, 1.5% risk-free interest rate

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Just a Touch Up? Or a Whole New Look?

Type of Plan	Just a Touch Up	Make Me Shine	A Whole New Look!
10% discount no look back 6 month offering	Reduce offering period to 3 months	Reduce offering period to 3 months and add look back	Reduce offer to 3 months, add look back, and increase discount to 15%
Potential Impact on Participation			
Potential Impact on Expense	(\$)**	\$	\$\$
Example Expense per Share	\$2.20	\$4.02	\$5.01

*Assumes \$20 FMV, 50% volatility, 1.5% risk-free interest rate
**If new offering, not modifying existing.

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Just a Touch Up? Or a Whole New Look?

Type of Plan	Just a Touch Up	Make Me Shine	A Whole New Look!
15% discount no look back 3 month offering	Add a look back	Extend offering period to 6 months and add a look back	Extend offering period to 12 months (with two 6-month purchase periods with a look back)
Potential Impact on Participation			
Potential Impact on Expense	Minimal	\$	\$\$
Example Expense per Share	\$5.01	\$5.85	\$7.03

*Assumes \$20 FMV, 50% volatility, 1.5% risk-free interest rate

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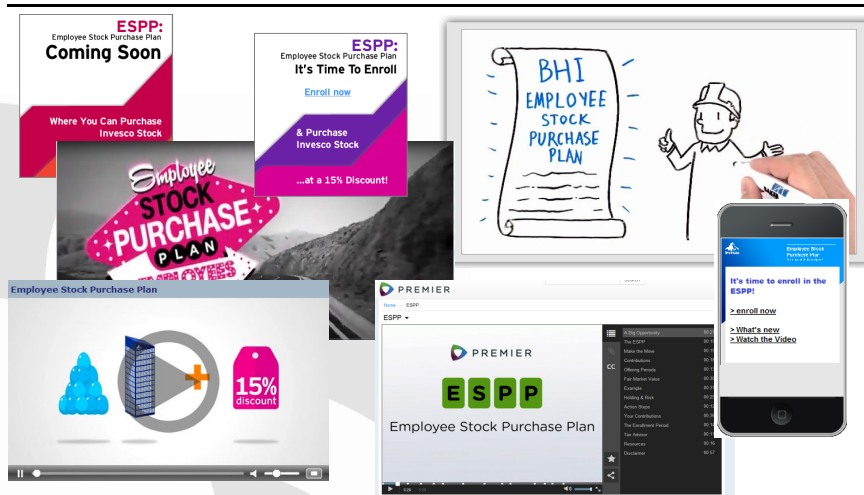
Just a Touch Up? Or a Whole New Look?

Type of Plan	Just a Touch Up	Make Me Shine	A Whole New Look!
Any plan design	Run a "campaign" around enrollment	Redesign communication and education pieces for enrollment campaign.	Add to communication and education for enrollment campaign, including video, broadcast voicemail, onsite banners and desk drops.
Potential Impact on Participation	↑	↑	↑
Potential Impact on Expense	no change	no change	no change

*Assumes \$20 FMV, 50% volatility, 1.5% risk-free interest rate

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ESPP Communication Makeover



Screenshots for illustrative purposes only.

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Do It Yourself! Estimating the Cost of a Makeover

ESPP Valuation & Expensing

- [Black-Scholes for ESPP - NASPP \(07/2005\)](#)
- [FASB Revises Expensing Treatment for ESPP - Towers Perrin \(09/2004\)](#)

For more information visit:
[NASPP Options Valuation Portal](#)
[NASPP Stock Plan Expensing Portal](#)

International ESPP

Screenshots for illustrative purposes only.

Other Considerations Reducing Expense

- Implement contributions limits based on max contributions for targeted employees
 - If targeted employees have average salary of \$80,000, limit contributions for all participants to \$8,000/year
- Exclude Section 16 officers
- Improve discount rather than look back

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