Vol. 25 No. 1 March 2022

2 Bloor Street West, Suite 2603, Toronto, Ontario M4W 3E2
Telephone: (416) 961-5612 Fax: (416) 961-6158
E-mail: valuators@marmerpenner.com

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CPA, CA, CBV
Edited by Anna M. Barrett, BSc, CPA, CA, CBV, CFF

Adjustments Not to Consider When Valuing Restricted Share Units

We have written previously on the valuation of employee stock options and restricted share units as both are common types of equity-based compensation for senior employees at public companies. Restricted share units ("RSUs") are generally issued with a specified vesting period. The employee will receive these shares of the employer as long as he or she remains an employee to the vesting date(s).

As an example, a Royal Bank employee might be awarded 600 RSUs next month with one-third vesting each of the next three years on the anniversary of the award date. If these Royal Bank shares maintain their current $140/share value, the total award will be worth $28,000/year for each of these three years.

So, are the employee's unvested RSU's worth the full face value of regular freely-traded shares? No, because there is a control risk (mainly an employment termination risk) that they do not vest and an illiquidity discount, during that time until vesting, because they cannot be sold. Also, if the freely-traded shares pay dividends but the RSUs do not pay similar notional dividends, there should be a discount for that, too. Lastly, the RSU award is taxed as employment income upon vesting. That income tax liability does not reduce the value of the RSU per se but must be considered in calculating net family property.

So, the value of an RSU is the face value of a freely-traded share less the discounts for the risk of termination, illiquidity and possible loss of dividends.

Allow me to go off on a tangent for a moment. I hope it will resonate with you after some thought. I am reminded of a riddle I heard when I was ten years old: What weighs more – a hundred pounds of steel or a hundred pounds of feathers? Keep the answer in mind when I ask you this question: What is worth more - the $100 in someone's bank account that she received as a gift from her grandmother last year or the $100 she earned shovelling driveways on a snowy day last winter? The answer is, after the fact, both are worth exactly the same. Clearly, before the fact, we would prefer to be given $100 than have to work hard for it. But, after the fact, $100 = $100. Does one need to be a chartered business valuator to tell you that $100 = $100? No, but not all CBVs appear to agree.

In the January 2022 issue of *Money & Family Law*, another CBV wrote about the factors to consider when valuing RSUs. The other valuator correctly noted the discount for illiquidity and that it is generally calculated using the Black-Scholes put option valuation. The other valuator also noted the discounts for vesting risk and non-receipt of dividends as we mentioned above. However, the other valuator determined one other upward adjustment in arriving at the value of an RSU namely an "opportunity cost adjustment" being the value of not having to pay for the share. Remember that we start with the market value of a freely-traded share in valuing RSUs and then deduct the aforementioned agreed-upon discounts. Adding this "opportunity cost adjustment" appears to rest on the logic that the Royal Bank share Grandma gave me last year is worth more than the Royal Bank share I bought last year. We differ on this adjustment.