

Express Scripts, Inc. (ESRX)

Values in Millions except per share amounts

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- Current Option Liability (2012) - big increase with Medco acquisition.
 - Recent share price appreciation increases this liability to over \$730 million.
 - The more the share price rises, the bigger the liability.

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
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Employee Stock Options (ESOs) affect the economics of businesses in two ways:

1. The economic cost of annual option grants is a compensation expense
2. The value of all outstanding ESOs is a liability we deduct from free cash flows available to existing shareholders.

Calculating the Annual ESO Costs**a. Annual ESO expense is calculated by multiplying the value of each option granted by the net number of options expected to vest****The net number of options expected to vest equals the number of options granted minus the total number of options expected to be cancelled between the grant and vesting dates**

Cumulative ESO Outstanding At End of Fiscal Year	44.5	52.6	51.6	47.9	44.8	32.1	28.7	24.0	21.2	16.8	14.2	16.4	13.3	13.7	44.2
ESO Granted During Fiscal Year	29.9	13.5	14.3	9.8	7.6	1.1	6.0	8.0	3.6	4.8	3.6	4.8	2.5	3.3	3.6
ESO Cancelled During Fiscal Year	10.5	2.3	2.8	1.2	1.0	0.6	2.2	4.0	1.2	1.2	1.2	0.4	0.5	0.5	1.1
ESO Churn Rate	20.0%	4.3%	5.5%	2.6%	2.1%	1.9%	7.7%	16.7%	5.7%	7.1%	8.5%	2.4%	3.0%	3.8%	8.0%
ESO - Number of Options at End of Vesting Period	15.3	11.8	12.0	9.1	7.1	1.1	4.8	4.6	3.0	3.8	2.8	4.5	2.3	2.9	2.8
ESO - Value of Each Option Granted During Fiscal Year	\$1.13	\$2.02	\$1.36	\$2.38	\$2.70	\$3.72	\$3.56	\$3.78	\$7.11	\$6.42	\$8.94	\$7.27	\$15.97	\$14.74	\$15.13

Because ESOs are actually warrants-we convert them into options to calculate the Annual ESO Expense

Total Adjusted Basic Shares Outstanding	563.7	623.0	659.6	669.9	667.7	654.8	639.7	612.0	580.4	537.6	512.0	543.4	551.7	514.6	775.5
ESO Warrant Conversion Rate	97.4%	98.1%	98.2%	98.7%	98.9%	99.8%	99.3%	99.2%	99.5%	99.3%	99.5%	99.2%	99.6%	99.4%	99.6%
● ESO Expense (Employee Stock Options)	\$16.81	\$23.50	\$16.04	\$21.38	\$18.99	\$3.98	\$16.81	\$17.37	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
ESO Expense as a % of Revenue	0.6%	0.5%	0.2%	0.2%	0.2%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ESO Expense After Tax	\$9.41	\$13.74	\$11.08	\$14.23	\$12.21	\$2.45	\$10.38	\$11.01	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
ESO After Tax as % of Revenue	0.3%	0.3%	0.2%	0.2%	0.1%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ESO Expense Per Share	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.00	\$0.02	\$0.02	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Diluted GAAP EPS	\$0.08	\$0.25	(\$0.01)	\$0.20	\$0.32	\$0.40	\$0.45	\$0.67	\$0.84	\$1.08	\$1.54	\$1.56	\$2.17	\$2.53	\$1.76

2. Calculating The Value of All Outstanding ESOs-the Hidden Liability**Though we are currently unable to display much of the data we use to calculate this liability; we will provide an outline of the steps involved in the calculation.****We aim to make this data available for presentation as soon as possible.****First - we gather all information on each Tranche of Outstanding ESOs****Next - we calculate the Value of Each Option Using the Black-Scholes Model with the following Assumptions**

Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ESO - Risk-Free Rate	5.0%	5.4%	6.4%	3.3%	3.2%	2.6%	3.1%	4.0%	4.9%	4.5%	2.5%	1.8%	1.5%	1.2%	0.6%
Vesting Period	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3
Stock Price Volatility	44.0%	59.0%	58.0%	55.0%	54.0%	52.5%	44.0%	37.5%	32.5%	30.0%	33.5%	37.0%	38.4%	36.6%	35.5%

This calculation yields the Value of Each Warrant**Next - we determine the number of years before each warrant vests to calculate the expected net number of warrants that will be exercised****Next - we convert the warrants into call options to arrive at the Fair Market Value of Each Option****Next - we calculate the value of each tranche of outstanding options:****Next - we sum the option value of each tranche to calculate:**

● Value of Outstanding ESO After Tax	\$63.09	\$84.04	\$174.52	\$127.36	\$111.61	\$106.23	\$103.10	\$233.36	\$140.54	\$264.65	\$110.98	\$257.97	\$273.67	\$151.77	\$628.88
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