
EFRAG Conference

“Accounting Meets Valuation”

Fair Value – the practice

Considerations when using fair value

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Prepared For



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1. Fair Value: history within IFRS
2. Fair Value: relevance versus reliability
3. Valuation methods used in practice
4. Fair Value and market prices

Fair Value: history within IFRS – relevant dates

- 2005: mandatory adoption IFRS – strong impact on:
 - ❑ Business Combinations
 - ❑ Share-based Payment
- 2008: FASB issues SFAS 157 (Fair Value Measurements & Disclosures)
- 2013: IFRS 13 Fair Value Measurement
- 2018: IFRS 9 Financial Instruments
- Special attention: IAS 36 Impairment of Assets

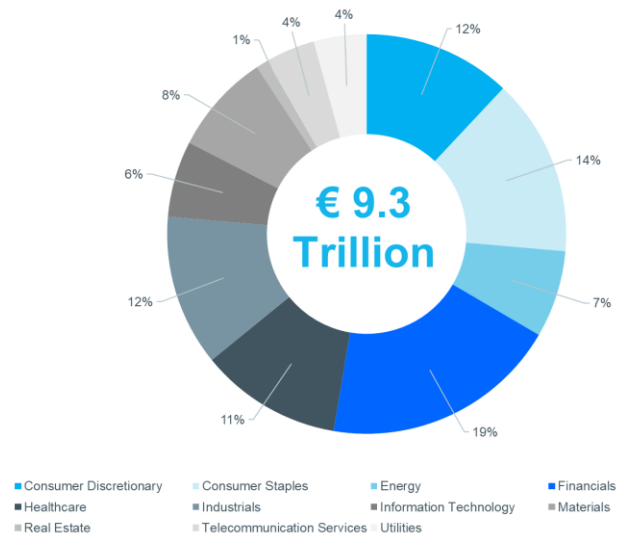
Fair Value: relevance versus reliability

- Fair Value accounting - a step towards:
 - Market prices
 - Comparability
- Relevance: is related to stronger role of financial markets
- Reliability: prices are objective, values not
- Useful information: level of sophistication of users
- Consistency and disclosure: preparers should be encouraged

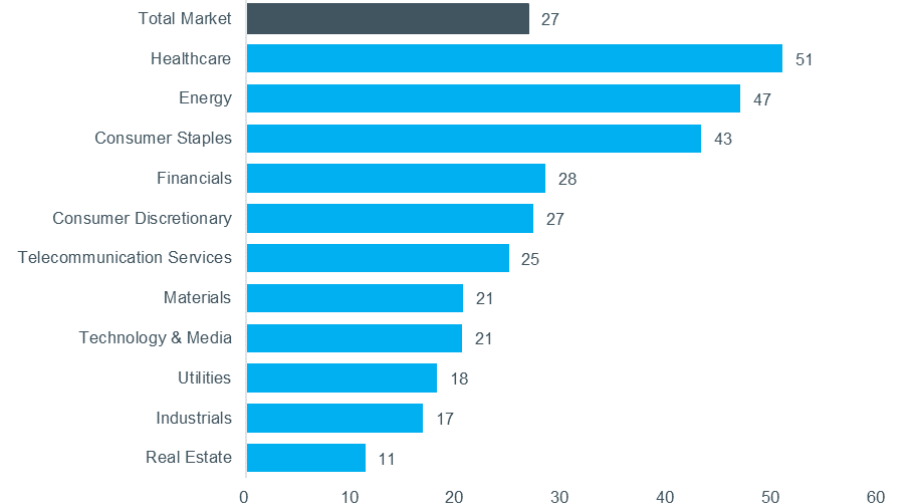
Market prices: example S&P Europe 350 index

Relevance of market cap

Market Capitalization by Sector



Average Market Capitalization by Sector (in € billions)

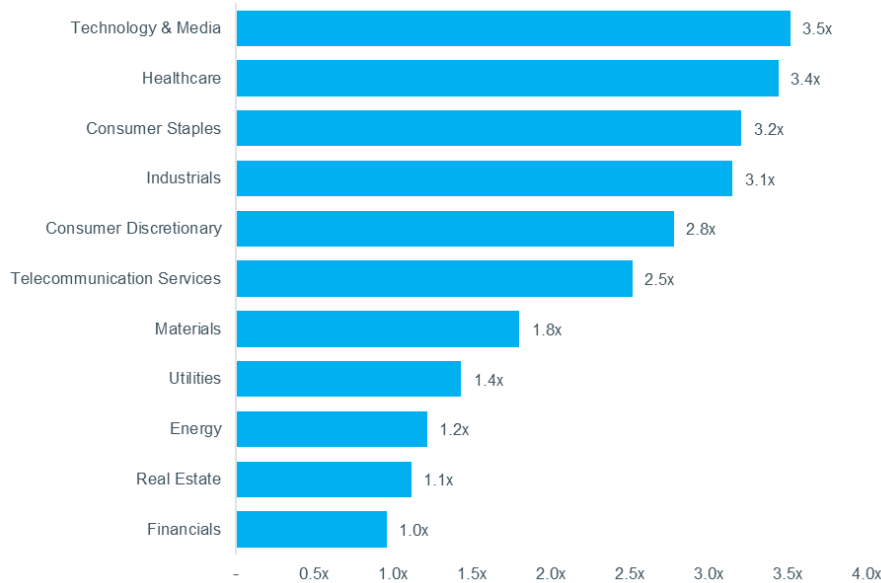


- Large amount of invested capital
- Investors require relevant information
- Comparison of market value and book value

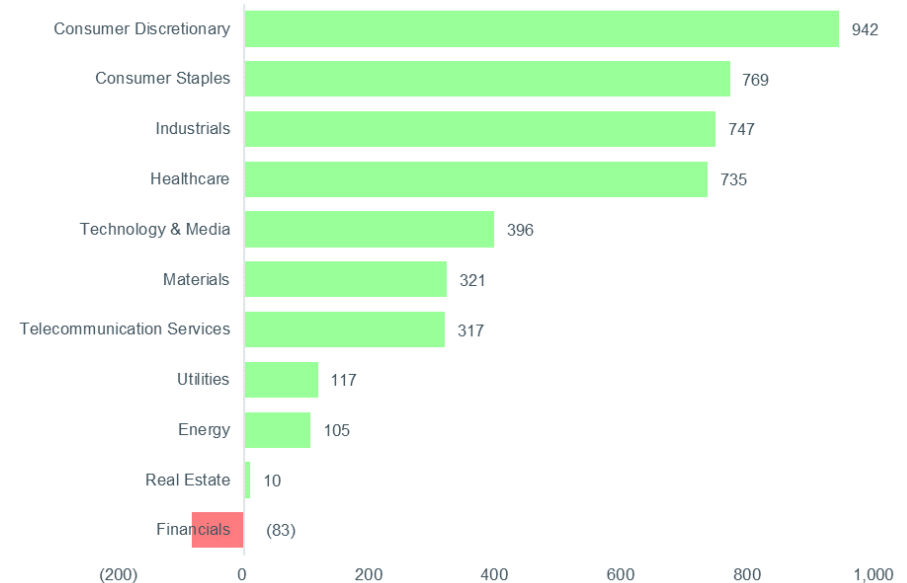
M/B ratio S&P Europe 350 index companies

Headroom (excess M over B value): explain or impair?

Market-to-Book by Sector



Headroom by Industry (in € billions)



- Very large headroom: requires explanation to investors
- Total headroom: € 4.4 trillion (almost 50% of total market cap)
- Financials: will IFRS 9 bring these large impairments?

Valuation Methods used in Practice

- Level 1:
 - ❑ Quoted prices in active markets for identical assets / liabilities
 - ❑ e.g., Financial Services, Mining & Minerals, Oil & Gas
- Level 2:
 - ❑ Observable inputs other than quoted market prices (as in L-1)
 - ❑ e.g., Financial Services, Consumer Discretionary, Telecoms
- Level 3:
 - ❑ Unobservable inputs, using best information available; might include entity's own data – market participant assumption
 - ❑ e.g., in all industries

Valuation Methods used in Practice (cont'd)

- Level 2: predominantly through Market Approach (e.g., multiples)
- Level 3: mostly through Income Approach (e.g., DCF analysis)
- Proportion of fair value assets to total assets of listed firms:
 - ❑ Grew from 18.8% in 2008 to 20.3% in 2013
 - ❑ Mostly in FS: from 25.8% to 29.3% (source: CPA Journal, July 2016)
- Financial Services: stock market values each \$1 of Level 1, 2, and 3 assets at \$0.98, \$0.97, and \$0.68
- Requires better disclosure: what data? Market participant view?

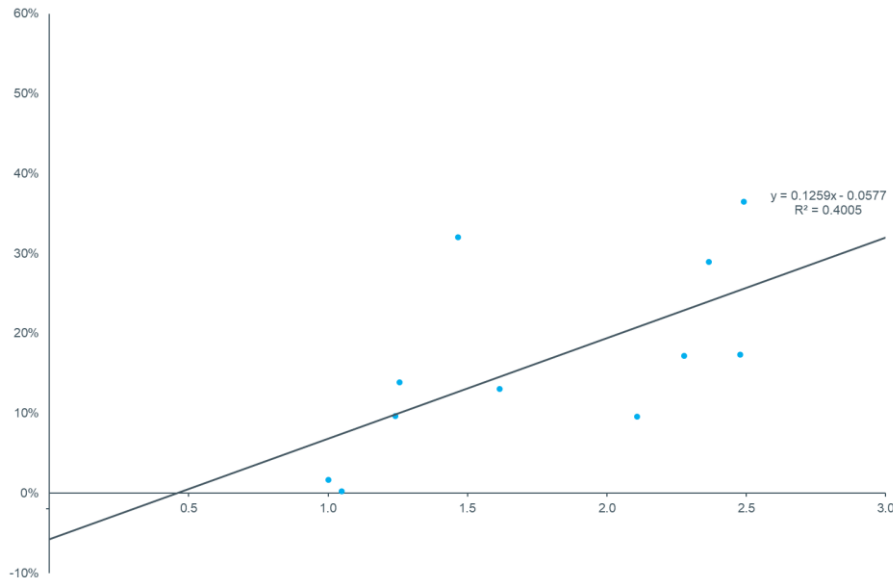
Valuation Methods used in Practice (cont'd)

- Fear for disclosure? Better be transparent – adverse selection and lower cost of capital (source: CFA Institute on Disclosures, July 2013)
- Need for more voluntary disclosure:
 - M/B ratio explanation
 - Return on Invested Capital
- Importance of consistency:
 - Explain development over time
 - In particular for Level 3
- Comparability:
 - Acquired versus autonomous growth / financing decisions

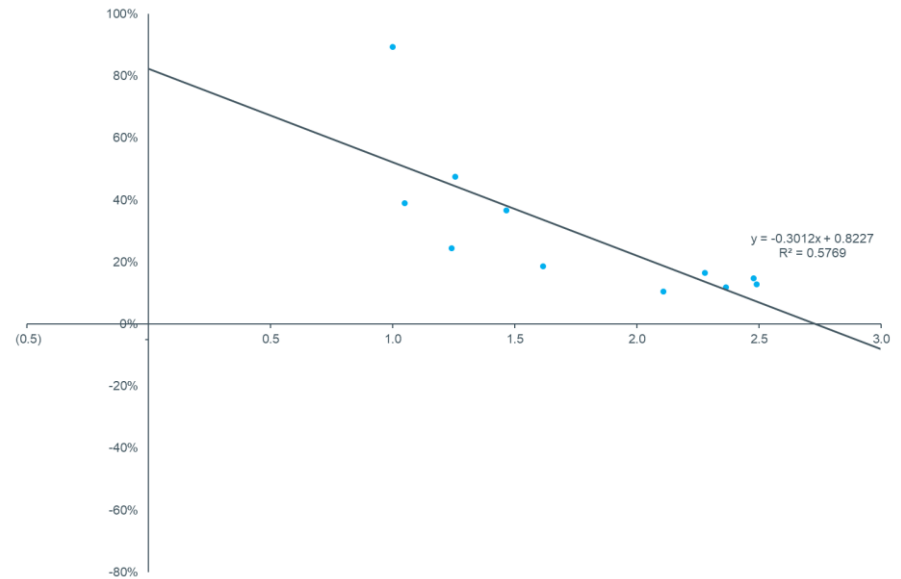
Goodwill & Intangibles and Capital Structure

S&P Europe 350 index companies

Goodwill & Intangible Assets as a % of MVIC / BVIC



Debt-to-Capital Ratio as % of MVIC / BVIC



- Goodwill & Intangibles: strong explanation of headroom
- Financing: debt financing of intangibles (goodwill?) possible
- Conclusion: informative for investors

Fair Value and Market Prices

- Increased volatility? Cause versus consequence?
- Markets generate often more information than assumed:
 - Are capital markets efficient?
 - Role of information generation by preparers
- Importance of Management Discussion & Analysis:
 - More on value drivers – less ‘boiler plate’
 - More forward looking?
- Financial instruments versus company / shareholder value:
 - Follow the market price
 - Follow the share price?