SUSTAIN ABILITY

ACTUARIES AND THE FUTURE

Non-Insurance Valuations in Practice

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Overview

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- Valuation examples
- Typical valuation processes
- Observations on GN552
- Summary

Introduction

- Background
- Scope

Valuation Examples

- Independent Expert’s Reports
- Business Valuations
- Economic Loss Valuation
- Option Valuation

Independent Expert's Report (IER)

- **Report to shareholders**
- **Governed by ASIC rules (PS75)**
- **Is it fair?**
  - ***"value of the offer price or consideration is equal to or greater than the value of the securities"* at 100% control**
- **Is it reasonable?**
  - **either fair or else shareholders should accept in the absence of a higher bid**

Business Valuations

- Valuing unlisted companies
- Range of reasons:
  - financial reporting
  - tax valuation
  - transaction support (whole or part interest)
  - family law

Economic Loss Valuations

- Litigation related
- Valuing benefits not received due to act or omission

Option Valuations

- Employee options (AASB2)
  - disclosure of executive remuneration
  - financial reporting
  - Covered by GN510
- Embedded derivatives (AASB139)

Common Definition of Value

- **Fair Market Value**
  - **arm's-length transaction**
  - **willing, but not anxious, buyer**
  - **willing, but not anxious, seller**
  - **both fully informed**
  - **undistorted market**

Typical Valuation Processes

- **Data**
  - in most businesses, past events have limited effect on future cash flows (miners are a significant exception)
  - management budgets and forecasts are usually optimistic
  - less direct relationship between investment market and earnings/cash flow than for insurance & wealth management
  - data to project future is often inadequate and/or imprecise
  - processes are therefore typically less sophisticated

Typical Valuation Processes

- **Common Methodologies**
  - Earnings multiple
  - Discounted cash flow (DCF)
  - Risk neutral methods used, but rare outside of options
  - Split out surplus assets and value separately
  - All methods need to be calibrated to market
  - Minority interest vs controlling interest adjustment
  - Negotiability adjustment
- **Cross-check with secondary method**

Observations on GN552

- **Applies to "economic valuations"**
  - **defined as "*the present value or cash equivalent at the valuation date (allowing for time and risk) of all the future cashflows and/or other measures of value that are expected to be derived from the ownership or use of an economic asset for the specified purpose.*"**
- **Unusual elements**
  - **not market value**
  - **"for the specified purpose"**

Observations on GN552

- **Derived from insurance specific valuation guidance note (now GN252)**
  - **some detail is excessive in wider arena**
  - **lack of active market for insurance liabilities**

- **Some methodologies are not reliable**
  - **stock ratios and flow ratios are “rules of thumb”, not valuation methods**

Observations on GN552

- **Methodologies should be market calibrated**
  - Replicating asset must produce market value
  - Earnings multiple should be calibrated to comparable multiples
  - DCF calibrated via discount rate (also secondary check)
  - Risk neutral based on market value for underlying security
- **What is the use of a valuation that does not reflect the market?**

Summary

- Most non-insurance valuations are market valuations
- Methodologies in GN552 can and should be calibrated to market
- Market-calibrated valuation is a market valuation
- GN552 should not be limited to "economic valuations"