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pg	Extract	Comment
3	**1** This Exposure Draft states that the DCF method should not be judged on the basis of whether or not the explicit cash flow assumptions are ultimately realized but rather on the degree of market support for the assumptions at the time they were made. **Do you agree that the DCF method, if properly applied, can be used as a method to arrive at market value?**	Agree Note that it is almost 100% certain the forecast cash flows for a business will not be achieved. The forecast cash flows represent the expected set of cash flows. The TIP should also emphasized that the DCF method should be used in conjunction with other supporting valuation methods
3	**2** The IVPB has concluded that although there may be distinct terms and types of analyses that apply respectively to real property valuations and business valuations, the underlying DCF method is identical in each case. **Do you agree that the underlying DCF method described in this paper applies equally to the valuation of real property and businesses? If not, please explain the differences that you believe exist?**	We agree that the broad concepts of discounting cash flows are identical irrespective of the asset category or investment type. Best estimates of forecasts are made and an appropriate discount rate to reflect risk is considered. However, we believe it is critical to note that property DCF valuations *are different* to business valuations for the following reasons: • Cash flows are derived differently for property and business valuations • Discount rates are derived differently for property and business valuations • Valuation cross checks are different for property and business valuations • One clear difference is that properties are supported by the value of the real property, whereas many businesses do not have real property – rather the bulk of the value is intangible in nature. The guidance needs to place greater distinction between Business DCF valuations and Property DCF valuations.
3	**3** This Exposure Draft states that the discount rate should be determined based on the risk associated with the cash flows (para 10), whether the DCF model is being used to determine a market value or investment value. **Do you agree, or do you consider that other matters should be taken into account in determining the appropriate discount rate?**	We would expect significant discussion around cross checking valuation results with relevant implied multiple cross checks. Cross checks are critical in considering the reasonableness of the valuation and they can highlight errors (i.e. if the implied multiples are too high/low relative to market evidence). In relation to property valuations all inputs should be market based not just the discount rate. There are factors other than risk that should be reflected in the discount rate. For example the length of the term of the cash flow or the iconic nature of the building may impact on the discount rate. Even if all the other factors are taken using market parameters the discount rate is simply the investor's view reflecting the attraction of the investment which may include matters other than risk.

3	**4** A number of different methods are identified which can be applied to the calculation of the terminal value at the end of the cash flow period (growth, fading growth, net asset value, salvage value, etc). For long-life real property assets or going concern businesses the Board believes a constant growth model is the most commonly used method, coupled with a cross check for the reasonableness of the figure, eg by reference to the implied exit multiple. **Do you agree that the most commonly adopted terminal value calculation at the end of the explicit forecast period is the 'constant growth' model, cross-checked for sensibility to an implied capitalisation rate or exit multiple? If not please identify what other method you most commonly use?**	<u>Business Valuation</u> Terminal values should be considered from as many angles as possible (i.e. cross checked) similar to that of a standard valuation. That stated, we would suggest that constant growth models are the most common approach, but in many instances a multiple based approach is more valid. <u>Property Valuation</u> It is common practice in Australia to capitalize the beginning of the year after the final year income to arrive at the terminal value. This process is adopted globally by many of the global valuation firms.
3	**5** The Exposure Draft explains that cash flows can be developed on the basis of alternative financial assumptions, eg inclusive or exclusive of anticipated inflation, inclusive or exclusive of tax etc. Providing the discount rate used is consistent with the financial assumptions in the cash flows the valuation result should not be affected by the alternative used. **Do you agree that providing a discount rate is used that is consistent with the financial assumptions made in calculating the cash flows that the choice of using explicit or implicit financial assumptions in the cash flows should not affect the valuation result?**	Theoretically if assumptions are applied consistently you should get the same answer. In practice this is often difficult to achieve without 'back solving'. The valuer needs to determine the best way to undertake the valuation which generally means making as few subjective assumptions as possible. <u>Business Valuation</u> In terms of post tax / pre tax valuations we would almost always recommend that the valuation is undertaken on a post tax basis. Much of the debate on pre-tax valuations has been triggered by IAS 36 and the misunderstanding between the spirit of the standard and the black letter interpretation some apply. It is important to note the guidance in the Exposure Draft that was the forerunner to the standard which recognizes the problem with pre-tax approaches. <u>Property Valuation</u> In terms of post tax / pre tax valuations we would almost always recommend that the valuation should be inclusive only of those transaction taxes common to all property transactions i.e., Stamp Duty, GST, VAT etc. Apart from the standard transaction taxes it is common practice in Australia when valuing real property to undertake all valuations on a pre-tax basis. We believe it is appropriate to agree that discount rates should be adjusted for explicit growth and financial assumptions and should not affect the valuation result.

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4	**6** This Exposure Draft is intended to identify best practice in the creation and application of discounted cash flow models. The Board has made the decision not to explain in detail the types of inputs that may be used in different situations or the investigations that may be appropriate. Neither are illustrative examples provided. The preliminary view of the Board is that detailed discussion of inputs or a limited range of examples is inappropriate because it could be misleading if it led readers to believe that these models were endorsed by IVSC or conversely, variations of these models in different situations were not appropriate. There are many industry specific sources for those who require training in the development and use of relevant DCF models. **Do you agree that more detailed discussion and examples of the valuation inputs into a discounted cash flow model are inappropriate? If not how much additional information do you think should be included in best practice guidance?**	We believe IVSC should encourage and work with local institutional organizations to develop guidance. Property Valuations The Exposure Draft should comment on the practice of combining different cash flows with different risk profiles into a single DCF i.e., combining development cash flows with that of stabilized asset cash flows and discounting both profiles at a single discount rate. We believe this approach has the effect of increasing the complexity and therefore risk associated with the cash flow.
7	Investment Value definition	We do not believe Investment Value is an appropriate basis of value. However as it is an accepted definition we would like to work with IVSC to better define the term including how and when it should be adopted. We would also like to see a reference to market value as well as specific differences discussed / highlighted.
8	**9".....**If a DCF model is being used to indicate investment value, the assumptions may be very different from those that would be suitable when using one to indicate market value. These differences are discussed later."	We do not believe the term Investment Value should be encouraged as a credible concept and or replacement to Market Value. We do not believe that a rational investor would, or indeed should, have assumptions in its valuation that are significantly different to market based inputs.
8	**11** "….may be necessary to estimate an appropriate discount rate by considering the risk premium that would be required by an investor, ie the additional return required over that obtainable from a 'risk free' asset such as a AAA rated bond."	There is no such thing as a 'risk free' asset. Long term bond rates are used as a proxy for a risk free asset. In markets where there are no AAA securities (and there are many) sovereign yields may still be valid as a starting point.

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11	**The DCF Method – Investment Value** **18** When the purpose of the valuation requires investment value to be estimated, the inputs used such as the discount rate, discount period and cash flow assumptions may not be the same as those that would be used by a general market participant. **19** The cash flows may be market derived or be specific to the asset or business being valued. The discount rate will used will [*sic*] normally be determined by entity specific criteria, eg a target rate of return, an opportunity cost or the entity's WACC rate. An example could be where a DCF model is used to calculate the investment value to a prospective buyer of a business. The prospective buyer may wish to determine at what value the actual cash flows of the target would generate its required target rate of return before entering the market.	As stated previously we have strong reservations about the premise that an investment value should be different to a market value. It suggests that the investor is willing to accept a rate of return below market (illogical), or demand a rate of return above market (understandable, but it may mean valid opportunities are over looked). Investment hurdles are valid, but they should be considered separately to market based assessments of value.
13	**25** When another valuation method is used as well as DCF, it is recommended that the report contain either a reconciliation between the result obtained in the DCF and the result obtained by the other method, or a clear rationale provided for preferring one or other of the methods as the better indicator of value.	As stated previously we recommend the valuer should, without exception, cross check his valuation result to other valuation metrics. For example, many business valuers would typically expect to see the implied multiples for a DCF based Enterprise Value cross checked to relevant market evidence such as EV/EBITDA, EV/EBIT, EV/RAB multiples for other transactions and/or trading data (allowing for adjustments for control, size, etc). Equity values could be consider implied P/E multiples and/or implied asset multiples relative to market based observations

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