Fédération Française des Experts en Evaluation

**IVSC**
**IVSC Standards Review Board**

1 King Street,
EC2V 8AU
London
United Kingdom

Paris,
20 September 2017

**Response to the IVSC Standards Review Board Invitation to Comment – IVS Agenda Consultation 2017**

The Fédération Française des Experts en Evaluation (FFEE) welcomes the opportunity provided by the IVSC Standards Review Board to comment on Agenda Consultation 2017.

The Fédération Française des Experts en Evaluation (FFEE) is a Professional Body Organisation that brings together the most representatives French professional organisations in the three areas of activity of the IVSC - Real estate, Business valuation, Financial instrument. Our Federation consists of 12 national organisations that are all representatives of at least one of the three areas of activity.

# QUESTIONS

## IVS GAP ANALYSIS

**Question 1: Do you agree with the current categorisation and timings of the topics contained in the gap analysis and if not why?**

FFEE globally agrees with the timings contained in the gap analysis.

FFEE considers that there is one matter which appears important in our practice, which is both (i) price vs value and(ii) discounts and premia. This matter is especially important for a reviewer of an offer price for instance, which has to compare such price with a valuation through a multicriteria approach and discuss the fairness of such price accordingly.

This has to do with control premium and synergies and disynergies as well, which would be part of the matter.

This has to do with effect of a transaction for various group of shareholders, for which calculations of dilution or accretion effects on future earnings per share are important in a fairness opinion.
As they are relevant for valuers, it seems to us that IVS should deal with those types of matters, with a certain level of priority.
These matters are to be dealt through discussion papers.

Concerning
- Biological assets: a comparison should be done with IAS 41 "Agriculture"
- Discount rates: Guidance notes should also be written
- Early stage/Development Stage Valuations: Discussion Papers and Guidance Notes should be added
- Inventory: It should concern the TA Board, not the BV board as it is in relation with accountancy.
- Price vs. Value: a definition should be written in a glossary
- Complex Capital Structures and Alternative Financing Arrangement concern Financial Instruments
- Discount Rates and Premiums: a focus could be made to compare US and EU, a focus on synergies could also be added.
- Privitisation: add Nationalisation
- Valuation in Markets Susceptible to Change: a focus should be made on valuation in time of economic crisis

**Question 2: Are there any other topics which you believe should be included or deleted from the IVS gap analysis and if so why? (Please state the relevant specialism, categorisation and timing for any proposed additional topics).**

FFEE considers that one topic could be usefully added. It refers to the use of financial statements and reporting, for the matter of(i) identifying the relevant aggregates (ie sales, EBITDA and EBIT) and(ii) make sure how those aggregates are defined and reported by the companies to value in order to make the adequate potential adjustments if some appears necessary in certain circumstances.
Definition of those aggregates depends on the accounting standard institutions. The bridge between those definitions and the adequate aggregates to be used in a valuation approach (on comparables primarily) is on relevance in our view.
They could be a matter for a discussion paper.

## NON-FINANCIAL LIABILITIES

**Question 1.1: Is the valuation of non-financial liabilities a critical area that should be addressed by the IVSC? Please explain why.**

The valuation of non-financial liabilities is a critical area that should be addressed by the IVSC because of the weight of this matter and the diversity of those assets.

**Question 1.2: Should IVS provide a separate definition of liabilities? If yes, do you agree with the definitions provided by the FASB and IASB, please explain why?**

IVS should provide a separate definition of liabilities by reference with FASB and IASB or others international framework.

**Question 1.3: What non-financial liabilities do you observe in practice? For each liability, what valuation methods do you most commonly see used? Which of the non-financial liabilities you listed have the greatest diversity of valuation in practice?**

Because of the diversity of non-financial liabilities, it is not possible to determine non-general or specific valuation that would be commonly used.
Among the non-financial liabilities, it must be stressed that there is in practice a great diversity of valuation for subordinated or non-subordinated securities and specific equities.

**Question 1.4: Do you agree with the decision to exclude financial liabilities from this ITC? If yes, do you think IVSC should add financial liabilities as a possible project(s) in the future?**

We agree with the decision to exclude financial liabilities from this ITC, and consider that IVSC should add financial liabilities as a possible project in a medium term.

**Question 1.5: Do you think IVSC should add financial instruments, pension liabilities, and insurance liabilities as a possible project(s) in the future?**

We also consider that financial instruments, pension liabilities and insurance liabilities have to be a medium-term project.

**Question 1.6: Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?**

We consider that Alternative C (Hybrid Approach) best fits to the matter because it is an approach well adapted to the diversity of the non-financial liabilities and to the creativity of the matter.

**Question 1.7: Are there methodologies and best practices utilised by the insurance industry that the Boards should consider for inclusion in future standards? If so, please discuss.**

We don't have any specific answer to this question.

## DISCOUNT RATES

**Question 2.1: Are additional standards related to the derivation of discount rates a critical area that should be addressed by the IVSC? Please explain why.**

Standards included in IVS 105 § 50.29 to 50.31, already lay the ground for discount rate:

- What is the objective of the discount rate?

- Which methods can be used?
- Which inputs/parameters should be included?

Derivation of a discount rate is a combination of inputs that must be independently assumed according to their field of application. Therefore, calculation should be supported by a framework to lead Valuers in the criteria selection rather than a prescriptive rational guide to be scrupulously applied.

IVSC could provide a guidance, regarding components of the discount rate listed in chapter 2 and explore if those inputs are:

- Generally used and accepted by the market (consensus, common practice…)
- Referring to any documentation for further investigation (newspapers, database, literature...)
- Referring to a type of operation (transaction, transmission, capital raise, risk of litigation, legal purpose…)
- Differing according to specific context (industry, listed company, international exposure…)

For instance, we observed that the market provides "good practices" and abundant documentation on main inputs such as the Equity premium, the risk-free rate or the Beta. Most of the time, information is coming from listed company. We could then expect from IVSC some derivation to non-listed companies.
However, those observations are not common for inputs such as size premium or company specific risk premium. These parameters often play the adjustment role when deriving the discount rate, which can be a source of litigations and errors.

**Question 2.2: Given the extensive use of the CAPM for derivation of discount rates used in business enterprise and asset valuations, do you agree with the Boards proposal to issue new standards to target diversity in practice related to discount rate derivation? Please explain why.**

As the CAPM model is disputed by some financial researchers, Valuers tend to introduce a variety of inputs supposed to cover weaknesses of the model. Therefore, a new standard would be helpful to:

- Identify specific cases for which the CAPM Model is not usable, particularly for investors whose portfolio is non-diversified who invest in non-listed company: the CAPM model is often used despite it could be inadequate.
- If CAPM is not usable, provide a guidance of how a derived model could fill the gap
- When CAPM is usable, explain how to determine each input, and more specifically to make sure that they are coherent between them.

**Question 2.3: Which inputs have you observed to have diversity in practice that would benefit from additional guidance in IVS and why?**

All inputs have diversity in practice but some are more sensitive than others.
<u>A/ Inputs with convergence on common methods</u>
The Risk-Free Rate, Equity Risk Premium, Beta, Capital Structure & cost of debts are generally well documented but, they have diversity in practice. For instance, inputs such as Risk free rate can sometimes strongly vary considering historical, spot or adjusted rate. So, a book of best practice would be helpful.
<u>B/ Inputs with divergence on common methods</u>

We have noted 3 main inputs that will benefit from an additional guidance.

- The Company Specific Risk Premium, could be benchmarked by giving an application field. For instance, some High concentration of a market, a leader position or a concentration in customers/suppliers are not always included in the discount factor. This is all the more sensitive when valuing an unlisted company.
- The CRP (Country risk premium), Damodaran model is often used, as it is free, but this input is not commonly observed. Therefore an additional guidance seems to be necessary.
- Size premium would finally strongly benefit from good practices for the following reasons:
  - it is often used as an adjustment factor and need more documentation (For instance, in Europe, Eric Peek study is a good basis),
  - some appraisers also use it to take account for illiquidity (arguing that a small firm has more chances to be illiquid),
  - some appraisers prefer to use the total beta, although it also seems to cover a liquidity issue rather than size issue

Moreover, some inputs can both be part of the business plan and the discount rate. It may then be useful to share allocation "market principles" between different risk areas, avoiding for example to account twice for the same risk factor.

**Question 2.4: What other methods of deriving discount rates for business enterprise valuation do you commonly observe in practice? For each method, do you commonly observe diversity in practice in its application?**

WACC is one of the most common practice observed when deriving discount rate.

IRR also is a very common practice observed when deriving discounts rates. It offers possibility to assess management estimates and measure the implied risk of a project.

Deriving discount rate from a cash-flow multiple of a comparable sample can also be a helpful method. However, that must be performed with an unleveraged capital structure (unlevered free cash flow). What's more, this method is more used to corroborate a CAPM or a WACC approach.

As mentioned above for private firms, some appraisers use total beta to include a size premium. Since there are not many sources, Damodaran developments are often used/quoted.

**Question 2.5: Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?**

Alternative C would be the optimal choice for the following reasons:

- A best practice technical guidance should cover the main contexts of valuation, and consequently the method and input choices.
- Valuers would have guidelines when they work on out of the ordinary assets

- Appraisers would have to justify why a best practice is not applied which could then should reduce litigations
- With current practices and related documentation on all discount rate components, Valuers could refer to standards if they are challenged on their work (for instance in fiscal or litigation context)

## EARLY STAGE COMPANY VALUATION

**Question 3.1: Are additional standards for the valuation of early-stage companies a critical area that should be addressed by the IVSC? Please explain why.**

As noticed on a relevant maneer by the ITC, early stage company valuation is an issue. It has to be addressed by the IVS on an appropriate way. In a first step, observation of the paper to be issued by AICPA is certainly the right thing to do. But it should happen that IVS would have some additional value on this matter based on the experience of International practices or new sectors.

**Question 3.2: In which areas of the valuation of early-stage companies do you see the greatest diversity in practice? Are there additional areas of concern not noted above in this ITC? If so, please discuss.**

The concerns posed by the ITC are relevant. One thing could be added regarding the use of third party expertise to help qualify the level of maturity of a project (in bio and med tech for instance)

**Question 3.3: Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?**

This is not a matter for a new standard. Early stage company is nothing else than a certain category of business but as such the IVS standard as described in IVS2017 may apply.
Alternative B certainly is the most relevant one in a first step.
In the future, depending on the ITC and the issuance of a discussion paper, it could occur that a specific technical guidance would be relevant and useful for valuers.

## INVENTORY

**Question 6.1: Should IVS provide separate standards for valuing inventory? Please explain why.**

FFEE position: We believe NO.

For several cumulative reasons:
First, as noticed in the ITC this is an accounting matter, which mainly occurs in business combination processes. This is not by nature a matter for IVS but for accounting standards setters like FASB or IAS.

Certainly IVS has to follow the work and standards issued either by those institutions, or AICPA but it does not seem relevant or a priority for IVS to deal with this matter. It could be of interest to follow whether accounting standards are convergent or not, and what approaches are defined by those principles.

Fédération Française des
Experts en Evaluation

Second, even if IFRS (ie IFRS3, IAS 2, or IFRS 13) donnot give much guidance on the calculation of the fair value of inventories, this is not the purpose of IVS to interfere in producing such guidance.

**Question 6.2: What methods for the valuation of inventory do you most commonly see used in practice?**

Under IFRS, IFRS 3 implies to use the sales method. It seems complicated to imagine that IP costs could be part of it.

**Question 6.3: Do you agree with the decision to focus on the application of the Comparative Sales Method? If not, please discuss the other methods that should be included in the performance framework.**

In case a technical guidance paper is prepared (that we do not feel as a priority for IVS), yes. It appears that this matter is a matter for both TA and BV boards to follow and advise rather than BV board only, inventory being an asset which could be part in a share deal or all in an asset deal
Cost methods are purely cost accounting and accounting matters.

If the IVSC Standards Review Board would find it useful, we remain available for any further questions.

Yours sincerely,

**Gilles de Courcel**
**Chairman**

**Amaury Catrice**
**Executive Director**