FINEXSI

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VALUATION AFTER IFRS 16

Impacts on valuation methodologies

November 2019

IFRS 16 : fundamentals: what are we taking about?

Principles

- IFRS 16 is a new standard published in January 2016

  Subject : leases contracts accounting (operating and financial leases)

- How did this happen?

  Sir David Tweedie, former Chairman of IAS and now former chairman of IVSC as well, declared that “he would like to fly on an aircraft that actually appears on the balance sheet.” This has now happen.

- Mandatory application beginning with fiscal year opened after 2019, 1st January.

- IFRS 16 provides a single lessee accounting model, requiring lessees to recognize in the balance sheet all leases, with :
  1. Recognition of an asset (representing the “right of use” the leased asset during contract) ;
  2. Accounting of a liability (obligation to pay the rent).

- IFRS 16 impacts on the P&L (Profit and Loss statement):
  - Only the variable lease payments not included in the measurement of the lease liability remain in the P&L ;
  - Depreciation charge for the right-of-use asset ;
  - Interest expense on the lease liability as a component of finance costs.

- **Converting cash payments of rents into :**
  - **Interest payments**
  - **Debt reimbursements**

Exclusions

- Exclusions (source IFRS 16 standard) :
  - Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources ;
  - Leases of biological assets within the scope of IAS 41 Agriculture held by a lessee ;
  - Service concession arrangements ;
  - Licenses of intellectual property granted by a lessor ; and
  - Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

- 2 cases of exemptions :
  1. Short terms contracts (less than one year)
  2. Low value assets (under $5,000)

IFRS 16 : major estimates: what are we taking about?

⚠ Major estimates

Initial measurement of lease liability

An **entity shall determine the lease term** as the non-cancellable period of a lease, together with both :

(a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option ; and

(b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

Focus on LVMH : see slide 10

Fixed payments during the lease term less any lease incentives

Variable lease payments during the lease term that depend on an index or a rate

Exercise price of a purchase option if the lessee is reasonably certain to exercise that option

Payments of penalties for terminating the lease.

Amounts expected to be payable by the lessee under *residual value guarantees*

→ Initial measurement of **lease liability**

→ Discounted flows

The discount rate should be :

- Implicit interest rate in the lease, if that rate can be readily determined.
- If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

Focus on LVMH : see slide 10

IFRS 16 introduces a notional cost of the rent liability, not observed in USGAAP (ASC 842), which is worsening comparability between the two standards.

Initial measurement of the right of use asset

Initial measurement of **lease liability** + Payments made at or before commencement date less any lease incentive received + Any initial direct costs incurred + An estimate of costs to be incurred in dismantling and removing the underlying asset = Initial valuation of the **Right of use assets**

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IFRS 16 : before / after - impacts on balance sheet and P&L

Balance sheet

Before IFRS 16

Assets		Liabilities	
		Equity	
No entry	0	No entry	0
Non current assets		Non current liabilities	
No entry	0	Supplier debt for rents to pay	+
Current assets		Current liabilities	

After IFRS 16

Assets		Liabilities	
		Equity	P&L impact
Right-of-use asset	+	IFRS 16 non current financial debt	+
Non current assets		Non current liabilities	
		IFRS 16 current financial debt	+
No entry	0	No Supplier debt for rents	0
Current assets		Current liabilities	

P&L

Before IFRS 16 – P&L		After IFRS 16 – P&L	
Rents	-	Rents (only variable part)	+
EBITDA		EBITDA	+
No depreciation	0	Depreciation of the right of use	-
EBIT		EBIT	+
Interest expense on IFRS 16 debt	0	Interest expense on IFRS 16 debt	-
Net profit / loss		Net profit / loss	?

- New asset : "right of use"
- New financial debt « IFRS 16 debt » concerning the lease contracts
- No more supplier debt for rents and no more off balance sheet detailed disclosure on the related commitment

- Reduction of the rent expenses in the P&L (only variable part not included in the right-of-use asset valuation)
- Depreciation of the right of use (new asset after IFRS 16) over the lease period
- Interest expenses on the IFRS 16 debt, calculated according to the discount rate (notional cost of the debts which is causing an improvement of the EBITDA).

IFRS 16 : before / after - impacts on cash flow statements

Cash flow statements

Before IFRS 16		After IFRS 16	
Cash flow statement		**Cash flow statement**	
Rents	-	Rents (only variable part)	+
Net operating cash flow		**Net operating cash flow**	+
No CAPEX	0	Capex if new contracts	-
Net Investing cash flows		**Net Investing cash flows**	-
No interest expenses	0	Interests on IFRS 16 debts	-
No repayments of IFRS 16 debts	0	Repayments of IFRS 16 debts	-
		New IFRS 16 debts if new contracts	+
Net financial cash flows		**Net financial cash flows**	-

Comments

- **Increase of the net operating cash flow (before working capital impact) because of the reduction of the rent expenses.**
- **Decrease of the financial cash flows due to the rents analysis as interest expenses and debt repayments.**
- **If new contracts :**
  - CAPEX due to the accounting of those new assets
  - New IFRS 16 debts for each contract

- **Contrary to what was commonly observed before IFRS 16, EBITDA is not anymore the primary cash flow generation indicator for a company, because :**
  - The cash flows concerning rents are now in the investing and financial cash flows (for a major part);
  - To analyse the forecasted cash flow, it is necessary to take into account CAPEX and debts repayments concerning the lease contracts : cash flows concerning rents are no longer within EBITDA (except for the variable part of it, if any).

CAC 40 analysis : which industries are the most affected ?

Impact on cash flows and financial debts

- **IFRS 16 increases the operating cash flows, due to the transfer of rents in interest and repayments of debt**
- **IFRS 16 increases the financial debt value**
- **Among the most affected industries, according to the CAC 40 analysis (French index), and based on the available information, are :**

Industries	Companies	Estimated increase of: Operating cash flows * (in the statements of cash flows)	Estimated increase of: Financial debt	Estimated increase of: Gearing (percentage points)	Causes
Luxury trademarks Retail	Hermès	+ 12 %	+ 1 965 %	+ 19 pts	Large number of : ➢ Rented stores ➢ Warehouses ➢ Offices
	LVMH	+ 16 %	+ 90 %	+ 34 pts	
	Kering	+ 49 %	+ 84 %	+ 41 pts	
	Carrefour	+ 57 %	+ 55 %	+ 41 pts	
Hotel industry	Accor	+ 19 %	+ 28 %	+ 14 pts	Mainly due to the rented lands and buildings of its hotels.
IT Services	Atos	+ 25 %	+ 23 %	+ 17 pts	Rental contracts for : ➢ Offices and production centers ➢ IT equipments ➢ Cars
	Capgemini	+ 30 %	+ 25 %	+ 11 pts	
Media Advertising	Publicis Groupe	+ 25 %	+ 49 %	+ 35 pts	Rental contracts for offices buildings
	Vivendi	+ 18 %	+ 21 %	+ 9 pts	

* Most of those companies don't itemize, by financial indicator, the IFRS 16 P&L impacts in the H1 2019 financial statements. For example, Hermes disclose a P&L restated from the IFRS 16 effects for FY2018 and H1 2018 but not for H1 2019.

Focus on LVMH : one of the most affected companies (1/5)

Impact on balance sheet

CONSOLIDATED BALANCE SHEET

ASSETS (EUR millions)	Notes	June 30, 2019	Dec. 31, 2018[a]	June 30, 2018[a]
Brands and other intangible assets	3	16,893	17,254	17,026
Goodwill	4	16,406	13,727	14,026
Property, plant and equipment	6	16,225	15,112	14,162
Right-of-use assets	7	12,138	-	-
Investments in joint ventures and associates	8	715	638	640
Non-current available for sale financial assets	9	910	1,100	883
Other non-current assets	10	1,454	986	1,062
Deferred tax		2,077	1,932	1,775
Non-current assets		**66,818**	**50,749**	**49,574**
Inventories and work in progress	11	13,561	12,485	11,883
Trade accounts receivable	12	3,004	3,222	2,738
Income taxes		334	366	463
Other current assets	13	3,208	2,868	2,860
Cash and cash equivalents	15	3,999	4,610	4,222
Current assets		**24,106**	**23,551**	**22,166**
Total assets		**90,924**	**74,300**	**71,740**

LIABILITIES AND EQUITY (EUR millions)	Notes	June 30, 2019	Dec. 31, 2018[a]	June 30, 2018[a]
Equity, Group share	16.1	33,678	32,293	29,990
Minority interests	18	1,712	1,664	1,492
Equity		**35,390**	**33,957**	**31,482**
Long-term borrowings	19	5,588	6,005	6,692
Non-current lease liabilities	7	10,139	-	-
Non-current provisions and other liabilities	20	3,647	3,188	3,381
Deferred tax		5,123	5,036	4,958
Purchase commitments for minority interests' shares	21	9,989	9,281	9,461
Non-current liabilities		**34,486**	**23,510**	**24,492**
Short-term borrowings	19	7,890	5,027	5,659
Current lease liabilities	7	2,029	-	-
Trade accounts payable	22.1	5,163	5,314	4,608
Income taxes		800	538	651
Current provisions and other liabilities	22.2	5,166	5,954	4,848
Current liabilities		**21,048**	**16,833**	**15,766**
Total liabilities and equity		**90,924**	**74,300**	**71,740**

(a) The financial statements as of December 31 and June 30, 2018 have not been restated to reflect the application of IFRS 16 Leases. See Note 1.2 regarding the impact of the application of IFRS 16.

- **New asset : 12 138 m€ "right of use"**
  - ⇨ New asset
  - ⇨ Represent 13% of the balance sheet total
- **Nature of the assets :**
  - ⇨ Stores for 9 598 m€ (79%)
  - ⇨ Offices for 1 443 m€ (12%)
- **IFRS 16 debts : 12 168 m€ (10 139 current / 2 029 non current)**
  - ⇨ High impact compared to the equity
  - ⇨ Significant evolution of the gearing
- **Financial debts : 13 478 m€ (5 588 non current / 7 890 current)**
- **Content of note 1.2 about the IFRS 16 effects on the H1 2019 financial statements : extracts (free translation)**
  - ⇨ About the contracts duration

> Geographic implantation scope of the Group leads him to meet a wide **variety of legal terms in the establishment of contracts**. The **duration of the contract** generally taken into account for the calculation of the liability is that of the **contract initially negotiated, without taking into account early termination options or extension**, except in special cases.

  - ⇨ About the discount rate

> The discount rate is **determined for each contract** by reference to the **marginal borrowing rate** of the contracting subsidiary. Because of the Group's financing organization, […] this marginal borrowing rate is **generally defined, in practice, as the sum of the risk-free rate for the contract currency, by reference to its duration, and the Group's credit risk for this same currency and duration reference.**

Focus on LVMH : one of the most affected companies (2/5)

Impact on cash flows

CONSOLIDATED CASH FLOW STATEMENT

(EUR millions)	Notes	June 30, 2019	Dec. 31, 2018[a]	June 30, 2018[a]
I. OPERATING ACTIVITIES				
Operating profit		5,241	9,877	4,578
(Income)/loss and dividends received from joint ventures and associates	8	(9)	5	(2)
Net increase in depreciation, amortization and provisions		1,193	2,302	1,066
Depreciation of right-of-use assets	7.1	1,171	-	-
Other adjustments and computed expenses		(197)	(219)	(178)
Cash from operations before changes in working capital		**7,399**	**11,965**	**5,464**
Cost of net financial debt: interest paid		(37)	(113)	(73)
Lease liabilities: interest paid		(109)	-	-
Tax paid		(1,191)	(2,275)	(907)
Change in working capital	15.2	(1,873)	(1,087)	(1,323)
Net cash from operating activities		**4,189**	**8,490**	**3,161**
II. INVESTING ACTIVITIES				
Operating investments	15.3	(1,423)	(3,038)	(1,204)
Purchase and proceeds from sale of consolidated investments	2	(1,885)	(17)	(5)
Dividends received		1	18	18
Tax paid related to non-current available for sale financial assets and consolidated investments		-	(2)	(1)
Purchase and proceeds from sale of non-current available for sale financial assets	9	(81)	(400)	(47)
Net cash from/(used in) investing activities		**(3,388)**	**(3,439)**	**(1,239)**
III. FINANCING ACTIVITIES				
Interim and final dividends paid	15.4	(2,412)	(3,090)	(2,039)
Purchase and proceeds from sale of minority interests		(9)	(236)	(72)
Other equity-related transactions	15.4	82	(205)	(23)
Proceeds from borrowings	19	2,988	1,529	1,571
Repayment of borrowings	19	(956)	(2,174)	(822)
Repayment of lease liabilities	7.2	(1,071)	-	-
Purchase and proceeds from sale of current available for sale financial assets	14	-	(147)	(131)
Net cash from/(used in) financing activities		**(1,378)**	**(4,323)**	**(1,516)**
IV. EFFECT OF EXCHANGE RATE CHANGES		**15**	**67**	**29**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS (I+II+III+IV)		**(562)**	**795**	**435**
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	15.1	**4,413**	**3,618**	**3,618**
CASH AND CASH EQUIVALENTS AT END OF PERIOD	15.1	**3,851**	**4,413**	**4,053**
TOTAL TAX PAID		**(1,256)**	**(2,314)**	**(951)**

(a) The financial statements as of December 31 and June 30, 2018 have not been restated to reflect the application of IFRS 16 Leases. See Note 1.2 regarding the impact of the application of IFRS 16.

- **Increase of the operational cash flows for 1 062 m€**
  - ⇨ Depreciations of the right-of-use assets : 1 171 m€ : increase of the cash flow
  - ⇨ In the cash flow statement, the interest expenses regarding the IFRS 16 are below the operating cash flow calculation for 109 m€.
- **Reduction of the financial cash flow due to the classification of the 1 071 m€ amount as a financial flow**
- The IFRS 16 opening effects on the assets are disclosed in note 6 “Property, Plant and Equipment” on a separate line. After the IFRS 16 application, all the new “right of use” booked by LVMH are included in the “Operating Investments”.

Focus on LVMH : one of the most affected companies (3/5)

LVMH P&L, for illustration

CONSOLIDATED INCOME STATEMENT

(EUR millions, except for earnings per share)	Notes	June 30, 2019	Dec. 31, 2018[a]	June 30, 2018[a]
Revenue	24	**25,082**	**46,826**	**21,750**
Cost of sales		(8,447)	(15,625)	(7,130)
Gross margin		**16,635**	**31,201**	**14,620**
Marketing and selling expenses		(9,563)	(17,755)	(8,305)
General and administrative expenses		(1,789)	(3,466)	(1,679)
Income/(loss) from joint ventures and associates	8	12	23	12
Profit from recurring operations	24	**5,295**	**10,003**	**4,648**
Other operating income and expenses	25	(54)	(126)	(70)
Operating profit		**5,241**	**9,877**	**4,578**
Cost of net financial debt		(51)	(117)	(56)
Interest on lease liabilities		(145)	-	-
Other financial income and expenses		(9)	(271)	34
Net financial income/(expense)	26	**(205)**	**(388)**	**(22)**
Income taxes	27	(1,431)	(2,499)	(1,264)
Net profit before minority interests		**3,605**	**6,990**	**3,292**
Minority interests	18	(337)	(636)	(288)
Net profit, Group share		**3,268**	**6,354**	**3,004**
Basic Group share of net earnings per share *(EUR)*	28	**6.49**	**12.64**	**5.97**
Number of shares on which the calculation is based		503,611,097	502,825,461	502,816,581
Diluted Group share of net earnings per share *(EUR)*	28	**6.48**	**12.61**	**5.96**
Number of shares on which the calculation is based		504,554,724	503,918,140	504,102,671

(a) The financial statements as of December 31 and June 30, 2018 have not been restated to reflect the application of IFRS 16 Leases. See Note 1.2 regarding the impact of the application of IFRS 16.

- **According to the notes (Note 1.2) :**

The impact of applying IFRS 16 on profit from recurring operations and net profit **is not material.**

⇨ **No specific information concerning the IFRS 16 effects on the P&L is given**

Given the **importance of leases to the Group's activities**, and in order to **present consistent performance indicators**, independently of the fixed or variable nature of lease payments, **specific indicators are used for internal performance monitoring requirements and financial communication purposes**; in particular, **capitalized fixed lease payments are deducted in their entirety from cash flow** in order to calculate the aggregate entitled "Operating free cash flow". In correlation, the **liability for capitalized leases is excluded** from the definition of net financial debt.

⇨ **Performance indicators are restated of the IFRS 16 impacts**

Focus on LVMH : one of the most affected companies (4/5)

1 View of analysts on IFRS 16 Standard

- **Analysis of the analysts' reaction to the H1 2019 results of LVMH and the first application of IFRS 16 standard.**
  - Are they talking about that standard ?

- **How do the analysts include the standard in their estimates ?**
  - Are they talking about a change in their estimates from the IFRS 16 standard ?
  - Are they specifying an aggregate including the impact of the standard ?

- **How do the analysts implement the standard in their valuation ?**
  - Are they talking about a change in their valuation from the IFRS 16 standard ?
  - Are they specifying a valuation from a "IFRS 16 case" ?
  - Which level of net debt they take in account in their models ?

2 Methodology

- **A sample of 6 analysts has been retained :**
  - (JP Morgan, UBS, Deutsche Bank, HSBC, Société Générale and RBC)

- **The notes have been published after the announcement of H1 2019 LVMH results (July, 24th).**

- **The estimates from the notes has been compared with the estimates published before the H1 results.**

Focus on LVMH : one of the most affected companies (5/5)

View of analysts on IFRS 16 Standard

Retained Analysts	Comments on IFRS 16 (Post LVMH H1 2019 results)	Impact of IFRS 16 on analyst estimates and valuation
J.P.Morgan	*« Post & Pre IFRS 16 small confusion : Current EBIT came facially in line with our expectations up by 14% but comparing apples to apples, ie post IFRS16 to post IFRS 16 this was a 2% miss (LVMH chose not to report both pre & post IFRS16. Consensus was also pre IFRS 16 ».*	✓ **Change to "IFRS 16 vision" about estimates** ✓ **Remains with a "cash vision" in the DCF model :** - EBITDA & CAPEX are "cash" - Net debt doesn't include the debt related to IFRS 16 application
UBS	Not a word about the IFRS 16 Standard	✗ **No comments on the estimates** ✓ **Remains with a "cash vision" in the DCF model :** - EBITDA & CAPEX are "cash" - Net debt doesn't include the debt related to IFRS 16 application
RBC	Not a word about the IFRS 16 Standard	✗ **No comments on the estimates** ✓ **Remains with a "cash vision" in the DCF model :** - EBITDA & CAPEX are "cash" - Net debt doesn't include the debt related to the IFRS 16 application
HSBC	*« IFRS 16 had a positive impact of EUR77 at the EBIT level (and a negative EUR 145m impact at the financial level » - « In Selective distribution, margin was up 40 bp to 10,1% (vs. HSBCe 9,5%), mostly driven by a 70bp impact from IFRS 16 ».*	✓ **Estimates unchanged** ✓ **Remains with a "cash vision" in the DCF model :** - EBITDA & CAPEX are "cash" - Net debt doesn't include the debt related to the IFRS 16 application
Deutsche Bank	*« Nonetheless, IFRS 16 provided a small EUR 77m contribution on EBIT, especially on F&L and Selective Retailing ». Net net, EBIT was a 4% miss at the consolidated level and in the F&L divisions »*	✓ **Present estimates including IFRS 16 impact** ✗ **No comments on the valuation**
SOCIETE GENERALE	*« There was no FX impact, 1H include a EUR 100m boost from the implementation of IFRS 16, and mix was favourable »*	✗ **No comments on the estimates** ✓ **Remains with a "cash vision" in the DCF model :** - EBITDA & CAPEX are "cash" - Net debt doesn't include the debt related to the IFRS 16 application

Source : Capital IQ

Links between financial information including IFRS 16 and valuation methods

1 DCF valuation method

- **Needs to analyse the EBITDA and its calculation to identify how to deal with the IFRS 16 flows :**
  - Exclusion of the rents expenses for the EBITDA or reprocessing of the EBITDA calculation ?
  - How to be sure that EBITDA is as cash as possible ?

➔ **Impacts on the cash flow calculation**

- **IFRS 16 estimates may be different between companies in one industry :**
  - Discount rate calculation for each company according to its own interpretation of IFRS 16, its geographical location.
  - Leases terms used, especially concerning the buildings rents.

➔ **Impacts on the debt valuation :**
  - **Longer the leases terms are, higher the debt is**
  - **Higher the discount rate is, lower the debt is**

➔ **Impacts on the gearing, according to those estimates, which may cause problems on comparability between issuers.**

- **Needs of CAPEX analysis according to the term of each debt contract** because, according to IFRS 16, each lease contracts is analysed as an asset, which have to be renewed by the end of its useful life.

➔ **Impacts on the cash flow calculation**

➔ **Impacts on the terminal value calculation**

2 Trading comparable or transactions comparable

- **Some analysis have to be made before calculating any multiple :**

- **Needs to analyse the EBITDA and its calculation in every company of the analysed sample to identify how they delt with the IFRS 16 flows :**
  - How are treated the rents in the EBITDA calculation: duration is a key issue and variable rents as well
  - Does it allow comparison between companies?

➔ **Analysis to be made before any comparison to be sure that the EBITDA of the company sampled is comparable.**

- **For the same reasons as for the DCF calculation, the debts analysis has to be made before the calculation of the company equity, used to determine comparable or transactions multiples**
  - Different estimates used for the IFRS 16 debt calculation, in terms of discount rates or rents **duration** taken into account which impacts the financial debt.
  - If the financial debt calculation of the peers is not similar, a reprocessing of the debt calculation may be needed.

➔ **Risk that, due to the accounting treatment of IFRS 16, the financial statements of the companies selected may not be comparable for the purpose of valuation**

Contrary to what was commonly observed before IFRS 16, EBITDA is not anymore the primary cash flow generation indicator for a company (see slide 6). As a consequence :

- It impacts the valuers' methodology
- Does the EBIT will become the new financial performance indicator ? If it is, this is a **non cash indicator**.

Discounted Cash Flows – IFRS 16 impact (1/2)

- **Impact on the EBITDA :**
  - The EBITDA is now determined before the rent expenses.
  - The EBITDA is higher in the IFRS 16 case.
  - The EBITDA is no longer an appropriate indicator of the Cash Flow generation.
  - The level of EBIT are close in both cases, because of the lease amortization in the IFRS 16 case.

- **Impact on the CAPEX:**
  - At the end of the lease contract on which the right of use is determined (and the valuation period), it is necessary to include in the cash flow an investment to simulate the renewal of the lease agreement (€ 100 k + € 138 k of CAPEX in the following case).

- **Impact on the Net Debt :**
  - The Debt related to the leases' obligations (€ 690 k in the following case) is now included in the bridge between the Enterprise Value and the Equity Value.

- **Tax effect :**
  - Because of the difference between the rents and the amortization (€ 155 k vs. € 138 k in the following example).

- **Impact on the value :**
  - There is no impact on the equity value (except the tax effect)

Discounted Cash Flows – IFRS 16 impact (2/2)

1 Example – DCF valuation (Cash Vision)

- **Main assumptions :**
  - PGR (1) : +1,5% ;
  - WACC (2) : 10% ;
  - Annual rent : € 155 k ;
  - Tax rate : 33% ;
  - Net Debt : € 500 k
  - Lease contract maturity : 5 years

	Business Plan 2019E	2020E	2021E	2022E	2023E	TV
Sales	**5 000**	**5 075**	**5 151**	**5 228**	**5 307**	**5 386**
Growth (%)	*nd*	*1,5%*	*1,5%*	*1,5%*	*1,5%*	*1,5%*
- **Rents**	**(155)**	**(155)**	**(155)**	**(155)**	**(155)**	**(155)**
- Other costs	(3 500)	(3 500)	(3 500)	(3 500)	(3 500)	(3 500)
EBITDA	**1 345**	**1 420**	**1 496**	**1 573**	**1 652**	**1 731**
- D & A	(200)	(200)	(200)	(200)	(200)	(200)
EBIT	**1 145**	**1 220**	**1 296**	**1 373**	**1 452**	**1 531**
- Normative tax	(378)	(403)	(428)	(453)	(479)	(505)
+ D & A	200	200	200	200	200	200
- Capex	(100)	(100)	(100)	(100)	(100)	(100)
+/- Variation de BFR	(50)	(50)	(50)	(50)	(50)	(50)
= **Free Cash-Flow (FCF)**	**817**	**867**	**918**	**970**	**1 023**	**1 076**
= **Discounted FCF**	**779**	**752**	**724**	**695**	**666**	**7 498**

Σ Discounted FCF	3 617
+ Discounted TV	7 498
= **Enterprise value**	**11 115**
- Net Debt	(500)
= **Equity value**	**10 615**

2 Example – DCF valuation (IFRS 16)

- **Main assumptions :**
  - PGR : +1,5% ;
  - WACC : 10% ;
  - Annual rent : € 155 k ;
  - Lease contract maturity : 5 years
  - Cost of debt : 4%
  - Lease Amortization per year : € 138 k ;
  - Present value of the leases : € 690 k (3) ;

	Business Plan 2019E	2020E	2021E	2022E	2023E	TV
Sales	**5 000**	**5 075**	**5 151**	**5 228**	**5 307**	**5 386**
Growth (%)	*nd*	*1,5%*	*1,5%*	*1,5%*	*1,5%*	*1,5%*
- Other costs	(3 500)	(3 500)	(3 500)	(3 500)	(3 500)	(3 500)
EBITDA	**1 500**	**1 575**	**1 651**	**1 728**	**1 807**	**1 886**
- D & A	(200)	(200)	(200)	(200)	(200)	(200)
- **Leases amortization**	**(138)**	**(138)**	**(138)**	**(138)**	**(138)**	**(138)**
EBIT	**1 162**	**1 237**	**1 313**	**1 390**	**1 469**	**1 548**
- Normative tax	(383)	(408)	(433)	(459)	(485)	(511)
+ D & A	200	200	200	200	200	200
+ **Leases amortization**	**138**	**138**	**138**	**138**	**138**	**138**
- Capex	(100)	(100)	(100)	(100)	(100)	**(238)**
+/- Variation de BFR	(50)	(50)	(50)	(50)	(50)	(50)
= **Free Cash-Flow (FCF)**	**967**	**1 017**	**1 068**	**1 120**	**1 172**	**1 087**
= **Discounted FCF**	**922**	**882**	**842**	**802**	**764**	**7 577**

Σ Discounted FCF	4 211
+ Discounted TV	7 577
= **Enterprise value**	**11 788**
- Net Debt	(500)
- Net Debt IFRS16	(690)
= **Equity value**	**10 598**

(1) PGR : Perpetual Growth Rate
(2) WACC : Weighted Average Cost of Capital
(3) 690 = (138 *5)

Trading Comparable – IFRS 16 impact (1/2)

Example – EBITDA Multiples on a peer sample

Company	Market capitalization	Net Debt	Leases - IFRS 16 (3)	Enterprise Value		EBITDA		Multiples	
				EV	EV + Leases	EBITDA	EBITDA IFRS16	EV / EBITDA	EV+L [(1)]/ EB. IFRS16 [(2)]
Company A	2 000	300	450	2 300	2 750	350	(1) 500	6.6x	(4) 5.5x
Company B	2 000	300	900	2 300	(2) 3 200	350	500	6.6x	6.4x
Company C	2 000	300	1 500	2 300	3 800	350	500	6.6x	7.6x

- **Impact on the EBITDA :**
  - The EBITDA is now determined before the rent costs ;
  - The EBITDA is higher in the IFRS 16 case (1).

- **Impact on the Enterprise Value :**
  - The Debt related to the leases obligations is now included in Enterprise Value (2) ;
  - Because of that, the level of Enterprise Value is now **dependent to the estimates of the lease maturity and discount rates for each company.** (3)

- **Impact on the Multiples :**
  - The difference between the companies estimates about the maturity, create a huge spread between the multiples in the “IFRS 16 case” (4) ;
  - In that case, in order to have a relevant multiple, it is necessary to adjust the level of EV and EBITDA.

- **Point of attention :**
  - Difference could appear between analysts’ estimates (some will take the leases as a cost, and others could apply the IFRS 16 standard), generating a disruption in the multiples deriving from differences on methodologies and assumptions applied.

(1) EV+L : Enterprise Value + Leases
(2) EB. IFRS 16 : EBITDA IFRS 16

Trading Comparable – IFRS 16 impact (2/2)

Example – Luxury goods sector

Company	Market capitalization (M€) (1)	Net Debt (2)	Leases - IFRS 16	Enterprise Value		EBITDA (3)		Multiples	
				EV	EV + Leases	EBITDA	EBITDA IFRS16	EV / EBITDA	EV+L (4)/ EB. IFRS16 (5)
LVMH	188 763	8 684	12 168	197 447	209 615	12 197	13 368	16.2x	15.7x
KERING	60 052	2 134	3 448	62 186	65 634	2 468	2 809	25.2x	23.4x
HERMES PARIS	65 212	(3 429)	984	61 789	62 767	2 868	3 049	21.5x	20.6x

- **All the Multiples go down after implementation of IFRS 16 standard. It implies that the increase of EV (due to the IFRS 16 debt) is relatively less important than the impact on the EBITDA.**

- **It appears a huge difference between the amount of debt created by the IFRS 16 standard and the "value" created by the increase of EBITDA.**

- For example :
  - As you can see above, the level of IFRS 16 debt for LVMH is € 12 168 M ;
  - The increase of the EBITDA (including the depreciation of right of use) is about € 1 171 M ;

→ **If you apply the initial EV/EBITDA multiple of LVMH (16.2x as above) to this amount (€ 1 171 M), it results € 18 970 M.**
→ **The difference between the debt related to the standard (€ 12 168 M) and the amount of additional EV (€ 18 970 M) is + € 6 802 M !**
→ **This "additional value" doesn't have any sort of economic fundamentals !**

(1) As of 24th pf October 2019
(2) As of 30th of June 2019 (31th of December 2018 for Hermes)
(3) LTM as of 30th June 2019
(4) EV+L : Enterprise Value + Leases
(5) EB. IFRS 16 : EBITDA IFRS 16

Overview of impacts on valuation methodologies

<table>
<tr><th colspan="2">Methodology</th><th>Description</th><th>Key IFR16 impacts</th></tr>
<tr><td rowspan="3">Retained Methodologies :</td><td>Discounted Cash Flow (DCF)</td><td>■ This method assesses the intrinsic value of the Company.
■ Free Cash Flows (FCF) are based on : EBITDA[1] – Tax – CAPEX [2] +/- Δ WCR [3].
■ Free Cash Flows are discounted using a weighted average cost of capital, which is the sum of the weighted average cost of equity and the after-tax cost of debt.
■ The sum of the present value of FCF and the Terminal value is the Enterprise Value (EV) of the Company.
■ The Equity Value of the Company is based on : EV – Net Debt – Minorities – Pensions + Associates.</td><td>× Impact on the EBITDA :
- The EBITDA is now determined before the rent costs ;
- The EBITDA is no longer a Cash Flow generation indicator
× Impact on the Capex :
- The subscription of a new lease contract increase the Capex for the year of subscription ;
- The Capex is now far from a Cash vision.
× Impact on the Net Debt :
- The Debt related to the leases obligations is now included in the Net Debt.</td></tr>
<tr><td>Trading Comparable</td><td>■ Selection of a peers sample.
■ Determine an average EV/EBITDA or EV/EBIT multiple based on the EV and EBITDA or EBIT estimated of the peers.
■ Apply the average multiple to the estimated EBITDA or EBIT of the Company to determine the EV of the Company.
■ The Equity Value of the Company is based on : EV – Net Debt – Minorities – Pensions + Associates.</td><td>× Same impact on the EBITDA as DCF Method mentioned above;
× Same impact on the Net Debt as DCF Method mentioned above ;
× Consistency of the estimates from both issuers and analysts (IFRS16 vs. Cash vision) on the EBITDA and Net Debt.</td></tr>
<tr><td>Transaction comparable</td><td>■ Selection of a transaction sample.
■ Determine an average EV/EBITDA or EV/EBIT multiple based on the transactions multiples.
■ Apply the average multiple to the estimated EBITDA or EBIT of the Company to determine the EV of the Company.
■ The Equity Value of the Company is based on : EV – Net Debt – Minorities – Pensions + Associates.</td><td>× Same impact on the EBITDA as DCF Method mentioned above;
× Same impact on the Net Debt as DCF Method mentioned above ;
× Consistency of the data from transactions analysed (IFRS16 vs. Cash vision of the Multiple).</td></tr>
</table>

(1) EBITDA : Earnings Before Interest Taxes and Amortization
(2) CAPEX : Capital Expenditure
(3) Δ WCR : variation in Working Capital Requirement

FINEXSI

Conclusion

- **It is difficult to give a final conclusion on that matter as of today, because we are in the middle of something which could really become unsatisfactory from the valuers' standpoint.**
  - The goal to have a better measurement than an off balance sheet information on leases is highly respectable
  - The goal to have a better practice and comparability between issuers is highly respectable as well.
  - Financial information given to the market could certainly be improved.
- **But we need to remind a few simple things: results is a matter of opinion when cash is a matter of fact.**
  - In that respect, EBITDA measurement is no longer a cash generation indicator; and we all knew the respective relevance of EBIT and EBITDA, and the importance of their precise analysis to compare adequately two issuers; EBITDA was an important indicator in that respect. We kind of loose it with IFRS 16.
  - Assumptions and assessments have to be made on both "rights of use" and "net debt": those assessments add complexity and could come to a situation where no comparison will be possible between issuers, if valuers are not in a position to have such detailed assumptions: duration of leases, variable rents, maturity of relevant debt, could come to very different practices, and material bias.
- **All will depend on the quality of information provided by issuers. Allowing analysts and valuers to apply both methodologies: with and without effect of IFRS 16, as they actually mostly do without IFRS 16.**
- **Thank you for your attention**