KPMG

Decoding Value: the metrics and drivers of value creation

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Establishing value creation goals

Defining value creation

Most companies recognise the importance of value creation, but rarely is it clearly defined.

We believe in taking an investor mindset, with the quote below best depicting a North Star for value creation in mature companies.

> **A company's objective should not be simply to grow; it should be to grow such that it creates value. A company creates value when its investments earn a return higher than the opportunity cost of capital."**
>
> **- Michael Mauboussin**

This definition of value creation can be tweaked depending on role:

Founder / Company management

Increasing long-term returns by intelligently allocating capital and enhancing competitive advantages.

Investor perspective

Identifying and investing in companies at fair prices, that can sustainably generate long-term returns above their cost of capital.

Measuring value creation

Having defined value creation we next need to identify the relevant metrics to assess value.
This is complex as it depends on several factors:

1. **Lifecycle stage**: the focus of a company's strategy and activities at a certain stage of its development
2. **Sector variables**: industry specific characteristics In addition, another relevant factor is:
3. **Cost of capital**: which represents the hurdle rate against which value metrics are measured.

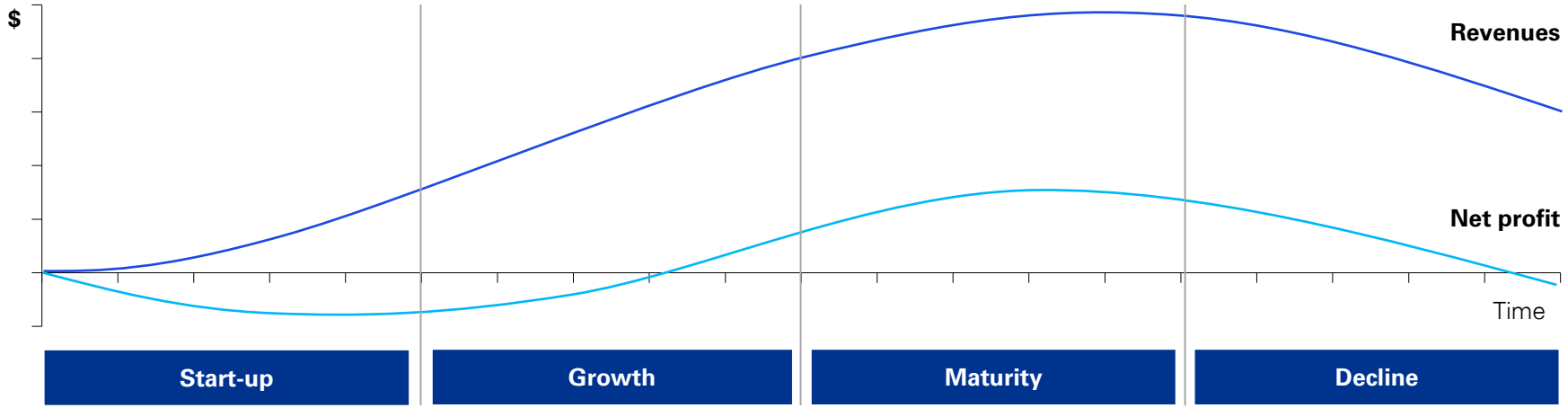
We explore how to navigate these three factors to define your key value metrics next.

> **What gets measured gets managed."**
>
> **- Peter Drucker**

Company lifecycle dynamics and value metrics

Assessing whether a company is creating value requires understanding where it stands in its lifecycle.

Broadly speaking, businesses go through four key phases: start-up, growth, maturity, and either decline or stagnation.



	Start-up	Growth	Maturity	Decline
Revenue growth	Minimal or negative; establishing initial sales	Rapid increase; expanding customer base	Slowing; approaching market saturation	Negative; decreasing sales
Margins / Profitability	Typically unprofitable; high initial expenses	Approaching break-even; improving margins	High and stable; consistent earnings	Declining; shrinking profit margins
Cash flow	Negative; high burn rate	Improving; reinvestment of earnings into growth	Strong positive cash flow; surplus capital	Deteriorating; potential liquidity issues
Management focus	Achieving product-market fit; validating business model	Scaling operations; optimising processes	Maintaining market position; cost management	Cost reduction; exploring turnaround strategies

Indicators by company lifecycle stage

Key performance indicators of enterprise value creation depend on its lifecycle stage. Examples of key measures by stage are set out below:

	KPI	What it is	What it indicates
Start-up	**Customer acquisition cost (CAC)**	Total cost required to acquire a new customer	Sales and marketing effectiveness
	Customer lifetime value (CLTV)	Total revenue expected from a customer over entire relationship	Worth and loyalty of customers; future revenue potential
	MAUs / DAUs	The number of unique users who engage with a product or service within a month or a day	User engagement and growth
	Net burn rate & runway	Monthly cash outflows less inflows; No. of months can operate without exhausting cash reserves	Sustainability of operations without additional funding
Maturity	**Diluted Earnings per share (EPS)**	Net income divided by total shares outstanding plus all convertibles / options	Profitability per-share including potential dilution
	Free Cash Flow (FCF) per share	Operating cash flow minus capital expenditures divided by shares outstanding	Ability to generate surplus cash after maintaining capital base
	Economic profit	NOPAT minus the opportunity cost of capital	Generation, or destruction, of wealth
	Return on invested Capital (ROIC)	NOPAT divided by invested capital	Effectiveness of using capital to generate returns

	KPI	What it is	What it indicates
Growth	**Revenue growth rate**	Increase in sales over a period of time	Market acceptance and potential for expansion
	Gross profit (& gross margin)	Revenue minus COGS (as a percentage of sales)	Network effects / Unit economics
	Operating margin	% of revenue that becomes operating profit after expenses	Operational efficiency and company's ability to control costs
	Customer retention rate	% of customers continuing to use product over a period	Customer loyalty
Decline	**Cost reduction**	Reduction of operational and production costs	Ability to maintain profitability despite declining revenues
	Asset turnover ratio	Revenues divided by total assets	Efficiency of using assets to generate sales
	Debt to Equity ratio	Total debt divided by total equity	Financial leverage and ability to meet the obligations
	Divestiture proceeds	Cash from selling non-core underperforming assets	Ability to gain liquidity and focus on core business areas

Sector influences on measuring value

Just as the key metrics of value differ at different stages of the company lifecycle, they also differ by sector.

For example, in industrial manufacturing, freight and raw material costs are key drivers of Cost of Goods Sold (COGS). Thus, streamlining the supply chain and optimising logistics can directly influence COGS, presenting tangible opportunities for value enhancement. In contrast, such drivers would hold little relevance for firms in financial services.

Regardless of industry, businesses typically rely on three integral levers to navigate the complex terrain of value creation:

Revenue enhancement

Cost reduction

Cash release

Pulling the right sector-specific value levers is necessary to yield results. For example, to generate revenue growth, a technology firm could focus on disruptive innovations and monetising data, while for a healthcare provider, increasing patient volumes and service efficiency would be more effective. Similarly, a retail chain might target inventory management for cash release, whereas a construction company could better achieve this by looking at project billing cycles and capital expenditure.

Acknowledging the diversity of value drivers across sectors is critical when exploring ways to generate value or minimise its erosion.

	Example sectors	Consumer Goods & Retail (offline)	Industrial Manufacturing	Financial Services (lending)
	Core financial value metrics (mature stage)	• Same-store sales growth • Revenue growth • Gross and operating margin • Inventory turnover ratio • ROIC	• Revenue growth • Gross and operating margin • Asset utilisation and ROA • Cash conversion cycle • ROIC	• Net Interest Margin (NIM) • Net Fee Income • Cost-income ratio • Loan to deposit ratio • Non-performing loan ratio • Return on Equity (ROE)
Value Creation Opportunities	**Revenue enhancement**	• Product innovation • Market expansion • E-commerce optimisation • Pricing strategies • Cross-selling and upselling	• Product mix optimisation • Aftermarket services • Account management optimisation • Product customisation and specialisation	• Customer segmentation • Market expansion • Channel mix optimisation • Digital product development • Distribution model
	Cost reduction	• Alternative sourcing strategy • Supply chain efficiency and logistics streamlining • Store footprint rationalisation	• Manufacturing process improvement • Energy and materials savings • Overhead cost management	• Outsourcing and shared services • Process re-engineering and automation • Branch network optimisation
	Cash release	• Payment term optimisation • Lean inventory management • Tax efficiency • Capex planning	• Asset utilisation and lifecycle management • Inventory optimisation • Real estate consolidation • Capex planning	• Capital allocation and optimisation • Risk management • Divestitures • Tax efficiency

Factors impacting cost of capital

Cost of capital

Capital is primarily sourced in the form of debt and equity. Because most firms are funded through a different mixture of these capital types a **'weighted average cost of capital' (WACC)** is used - which calculates a firm's average cost of financing from all sources, weighted by their proportion in the capital structure.

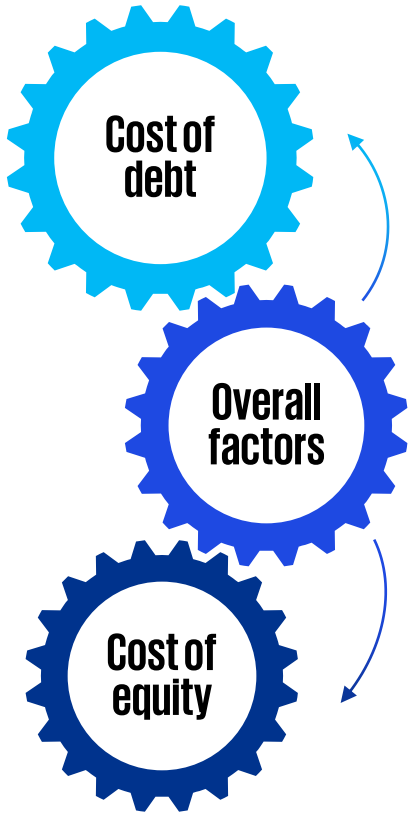
In practice, most companies and sophisticated investors set a required **hurdle rate** in excess of WACC when contemplating capital allocation decisions.

WACC is impacted by both internal and external factors:

01 **Internal factors** – for example, a company's level of debt relative to equity; inherent risks specific to a company's operating model, business model or market position

02 **External factors** – for example, prevailing interest rates, corporate tax rates, changes to regulatory, geopolitical or sector risk

Factors impacting cost of capital



- **Interest Rates:** Prevailing market rates influence borrowing costs
- **Credit Rating:** Affects the interest rate a company can secure
- **Tax Rates:** Interest is tax-deductible, influencing the after-tax cost
- **Loan Terms:** Maturity period and covenants can impact cost
- **Debt Level:** High debt may increase risk, leading to higher interest rates

- **Capital Structure:** Proportion of debt vs. equity financing
- **Economic Conditions:** Inflation, economic growth, and stability
- **Industry Risk:** Specific risks associated with the industry sector
- **Regulatory Environment:** Laws and regulations affecting operating model, compliance and capital structure
- **Country Risk:** Political and economic risks in different countries

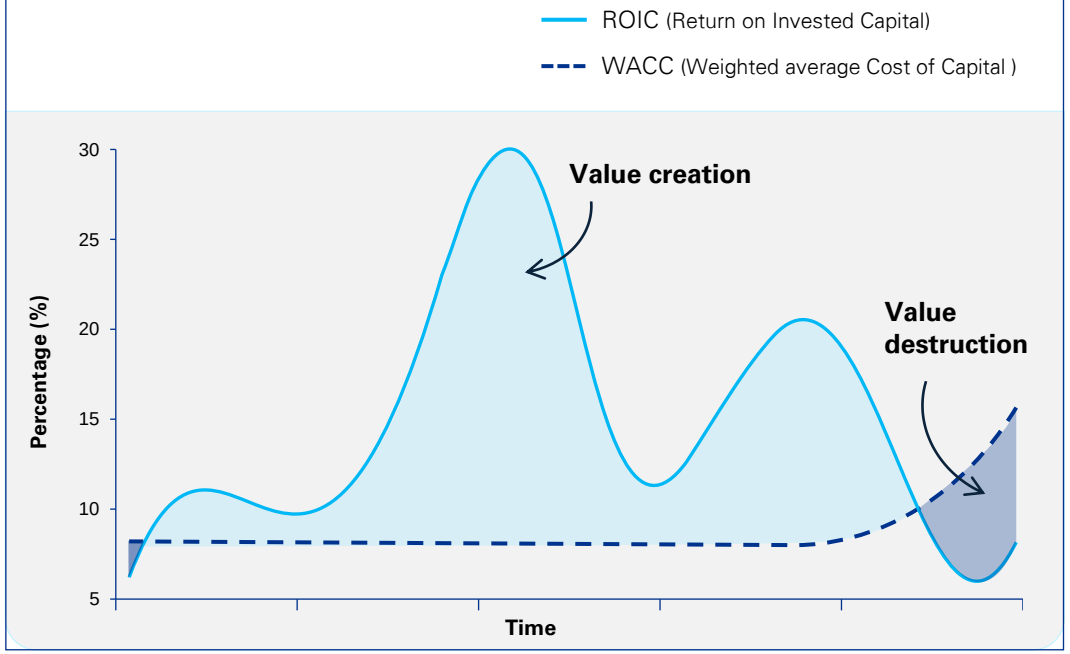
- **Risk-Free Rate:** Usually the yield on government bonds
- **Market Risk Premium:** Expected return over the risk-free rate
- **Beta Coefficient:** Measures stock volatility relative to the market
- **Dividend and Share buy-pack policy:** Expected dividends and buy-backs influence investor returns
- **Growth Expectations:** Higher growth prospects can affect required returns

Cost of capital and value creation

WACC relevance to value creation

Cost of capital changes flow into contemplation of whether an investment is value accretive, either via the discount rate in a Discounted Cash Flow (DCF) valuation of a company or a project - or via a change in valuation multiple.

For growth and maturity stage companies, the spread between its return on invested capital, and the related cost of capital, measures whether it is value accretive / generating 'economic profit'.

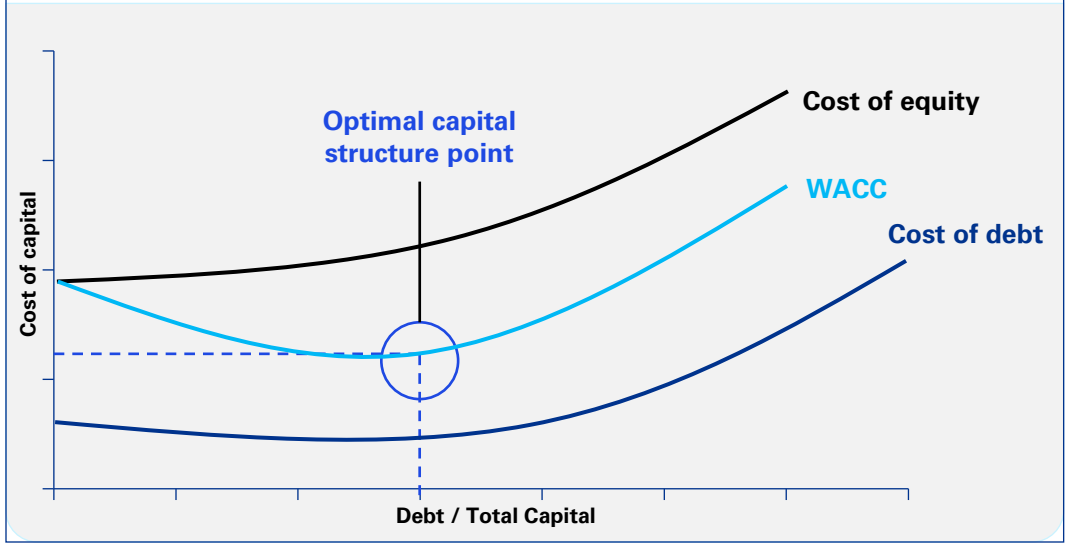


Impacts of changes in WACC

WACC varies over time due to external factors. For example, as interest rates rise, WACC increases, meaning discount rates increase (or valuation multiples fall) making inorganic or organic investments less value accretive. And vice versa.

Lowering WACC for a given business is a potential area for value creation – for example by:

- Reducing cost of Debt – e.g. through creating competition among banks to reduce costs, replacing bank debt with debentures, etc
- Reducing cost of Equity – e.g. by reducing perceived market risk (e.g. via exit from higher risk sectors or geographies), or creating a new class of preferred shares or hybrid instruments
- Improving the mix of Equity or Debt to a more optimal level



Value creation in practice – identifying value levers

From theory to application

How does looking through the lens of lifecycle stage, sector variables and macro factors enable an investor or executive to understand the value dynamics of a particular company? An example allows us to work through the assessment of value drivers and value creation opportunities:

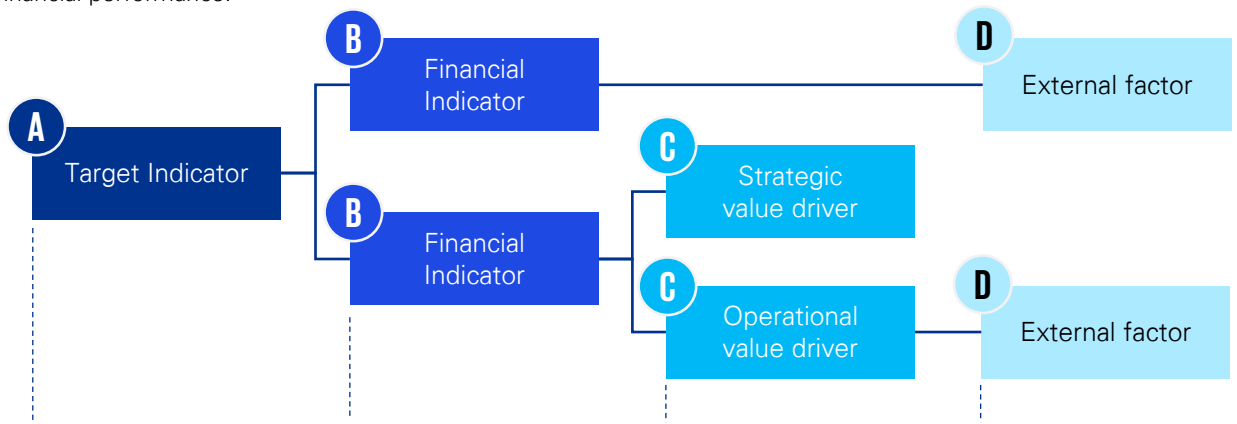
CarPro Market

The fictitious company is an automotive parts supplier, headquartered in Hong Kong SAR ("HKSAR").

It sells automotive parts to consumers via own stores (HKSAR, Chinese Mainland, and Singapore) and ecommerce (HKSAR, Chinese Mainland, and SEA markets), as well as to a small number of affiliated retailers in secondary markets. The company sources a wide range of parts from suppliers primarily located in Asia and Europe, while also manufacturing in-house. Its product range is predominantly for internal combustible engine (ICE) cars, but sales for electric vehicles have been increasing and now represent 15% of revenues.

Lifecycle stage:	Mature
Sector variables:	Automotive, B2C and B2B
Cost of capital factors:	US tariffs on Chinese EVs and supply chain diversification, increase in counterfeit parts

At KPMG, we would typically start with a value driver tree to isolate the company's key value contributors, based on its unique characteristics. This maps the business model's causal relationships in generating value and provides a visual framework enabling the breakdown of complex drivers into manageable parts that can be targeted to uplift financial performance.



A

Represents the key result, typically expressed as a financial value.

B

Usually accounting measures (e.g., profit) which can be further broken down into financial sub-indicators (e.g., revenues). Cannot be directly controlled by management, rather are managed leveraging the upstream value drivers.

C

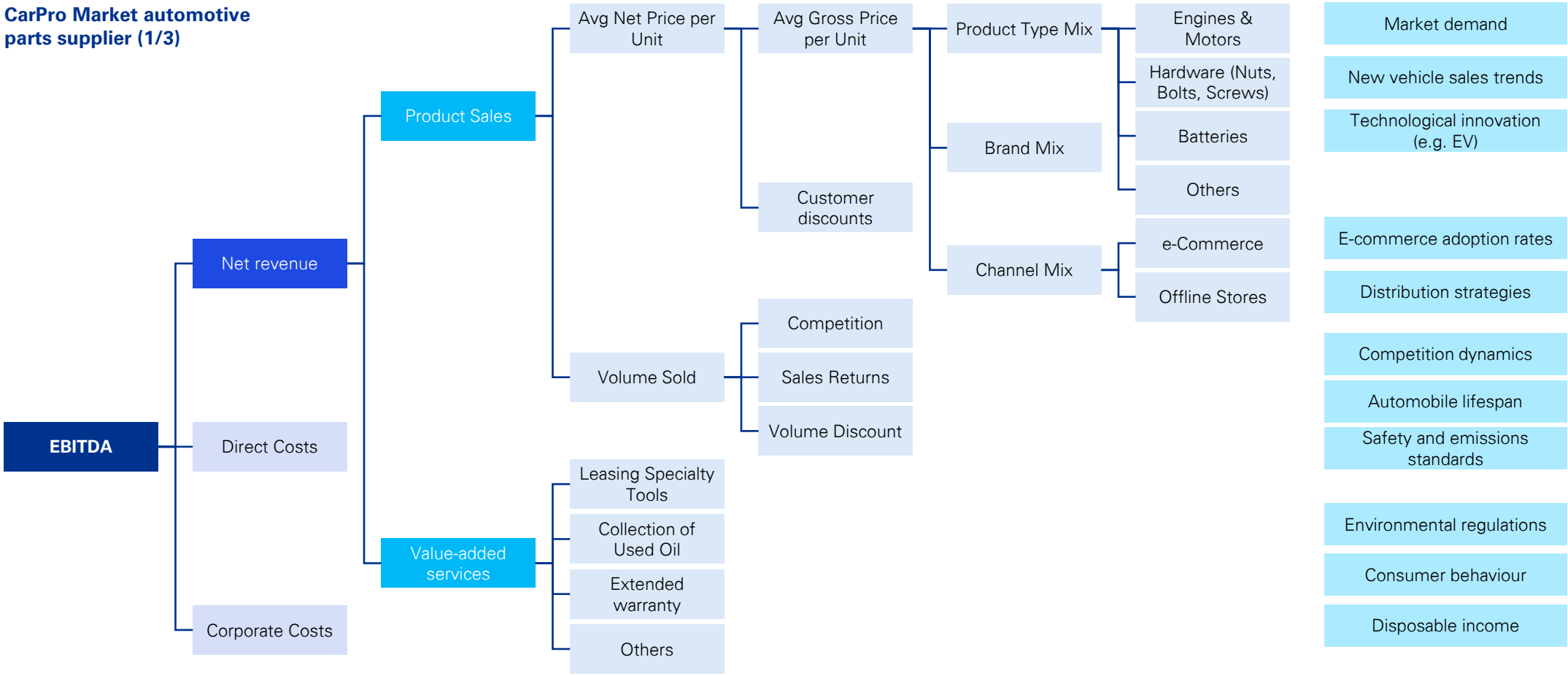
Factors that have a significant influence on the company's value creation and can be managed in a targeted manner. Categorised as strategic or operational. Ultimately, can be traced back to the three main categories: revenue, cost, and cash drivers.

D

Macro-economic, political, or social elements (e.g., exchange rates, market growth, changes in legislation) which are usually beyond the company's influence, yet still affect its ability to conserve and create value.

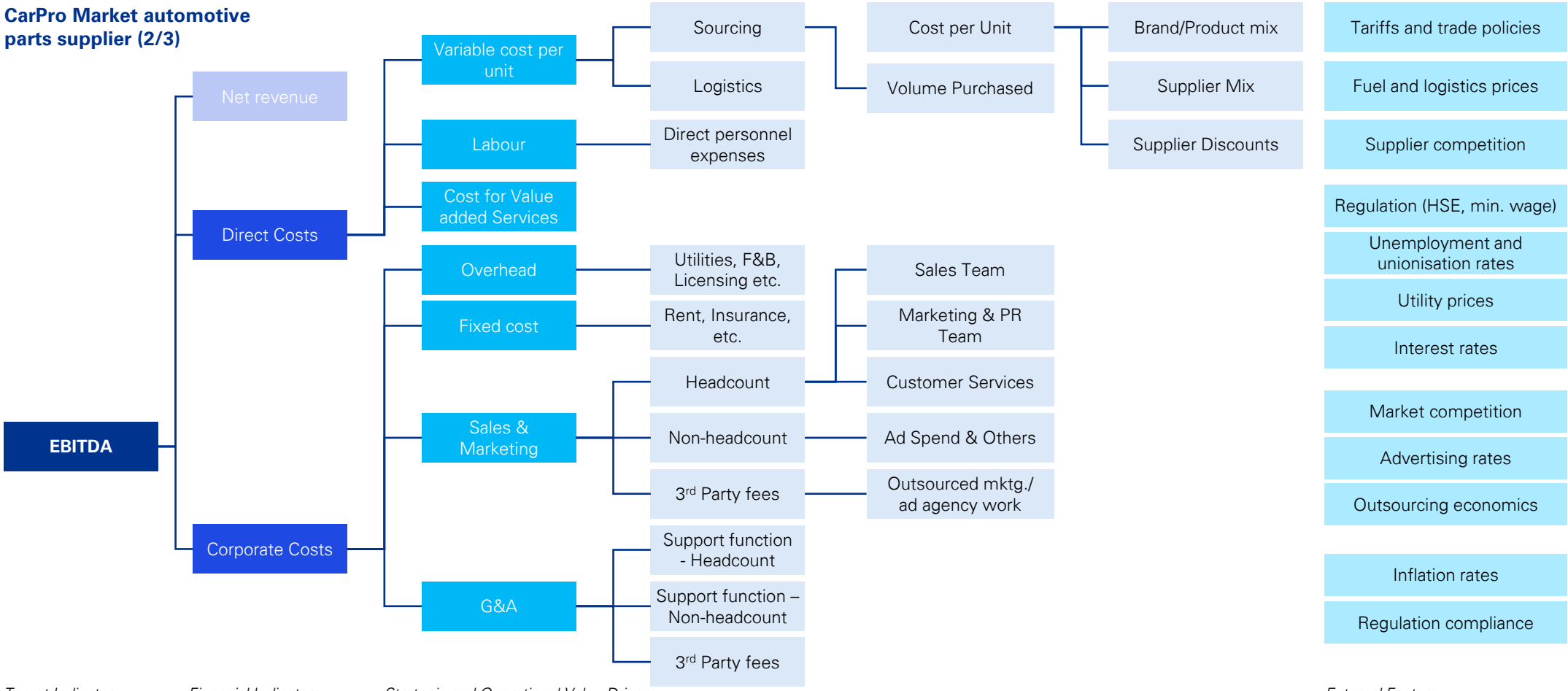
Value driver tree – breaking down revenue drivers

CarPro Market automotive parts supplier (1/3)



Value driver tree – breaking down cost drivers

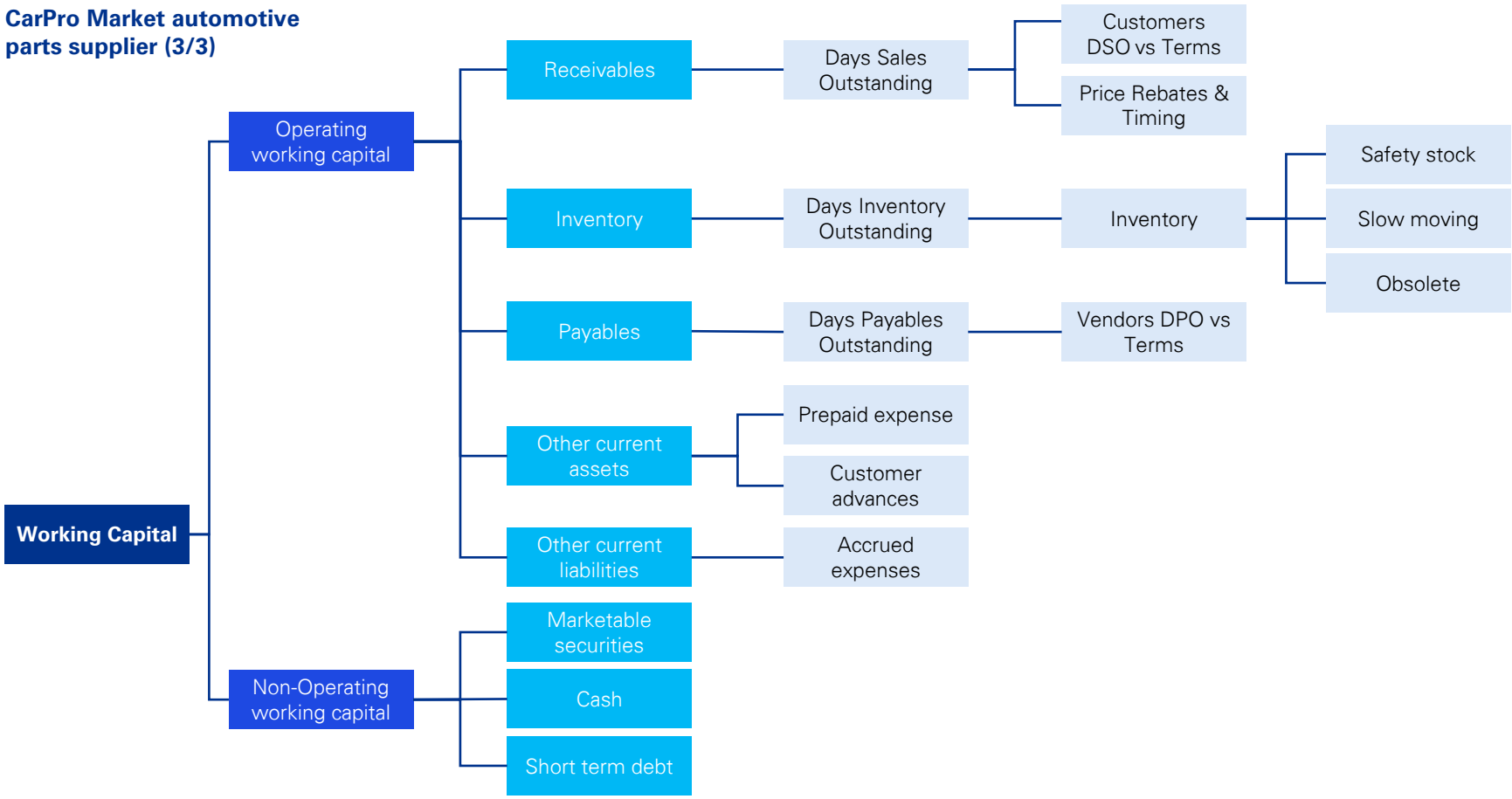
CarPro Market automotive parts supplier (2/3)



Target Indicator *Financial Indicators* *Strategic and Operational Value Drivers* *External Factors*

Value driver tree – breaking down working capital drivers

CarPro Market automotive parts supplier (3/3)



Target Indicator *Financial Indicators* *Strategic and Operational Value Drivers* *External Factors*

Uncovering value creation opportunities

Mapping out a value driver tree enables us to pinpoint the revenue, cost, and cash drivers with the most potential to deliver financial uplift as a result of value creation initiatives. In the case of our automotive aftersales company, there are several potential value creation opportunities which could be further tested, validated and quantified using analytics.

Category	Value creation opportunity and uplift range[1]		Analytics to apply to validate and quantify			
A Revenue enhancement	**Pricing strategy:** use dynamic pricing to respond to market conditions, competitor pricing and customer demand	2-6%	Pricing positioning and dispersion analysis	Price elasticity of demand analysis	Cost-plus pricing analysis	Pricing segmentation analysis
	Product mix optimisation: rationalise underperforming SKUs and increase availability of parts for hybrid and EVs	1-4%	Full product profitability margin analysis	Price-volume-mix analysis	Product value Pareto analysis	Customer review analytics
	Market and channel expansion: increase geographical and digital footprint to serve new customers and increase revenues	1-3%	Sales channel footprint / white space analysis	Store portfolio type & footprint optimisation	Sales channel mix analysis	Store cohort and ramp-up analysis
	Targeted marketing: tailor marketing by customer segment, channel and purchasing behaviours	0.5-2%	RFM customer segmentation	Customer cohort analysis	Marketing spend elasticity analysis	Customer lifetime value
B Cost reduction	**Supply chain optimisation**: reduce supply complexity and obtain volume discounts by rationalising number of suppliers	2-4%	Supply chain model analysis	ABC inventory analysis	Inbound/outbound logistics analysis	Direct procurement efficiencies Example on slide 14
	Outsourcing of SG&A activities: reduce cost and enhance focus by moving non-core functions to external providers	5-10%	Full Cost to Serve analysis	G&A optimisation analysis	Salesforce effectiveness analysis	Centralised cost allocation analysis
	Procurement function improvement: drive efficiency in sourcing process by strengthening policies and discipline	1-4%	Supplier selection analysis	Supplier cost dispersion analysis	Procurement negotiation performance analysis	Indirect procurement category spend analysis
C Cash release	**Receivables optimisation**: offer early payment discounts for B2B customers and review credit policies	1-3%	Accounts receivable benchmarking	Contract terms compliance	Early settlement discount	Time to invoice analysis
	Demand forecasting: leverage analytics to improve forecasting to reduce stockouts and obsolete inventory	1-3%	Optimal stock level analysis	ABC/XYZ analysis	Inventory optimisation benchmarking	Item rationalisation analysis

Note: (1) Uplift range is a % of revenue, cost or working capital, in each respective category

KPMG's analytics led approach to value quantification

We use our proprietary Analytical Building Blocks (ABBs) to rapidly validate value creation hypotheses, establish performance baselines, and measure the potential uplift to enterprise value. This standardised data driven approach allows us to complete a diagnostic within a short timeframe.

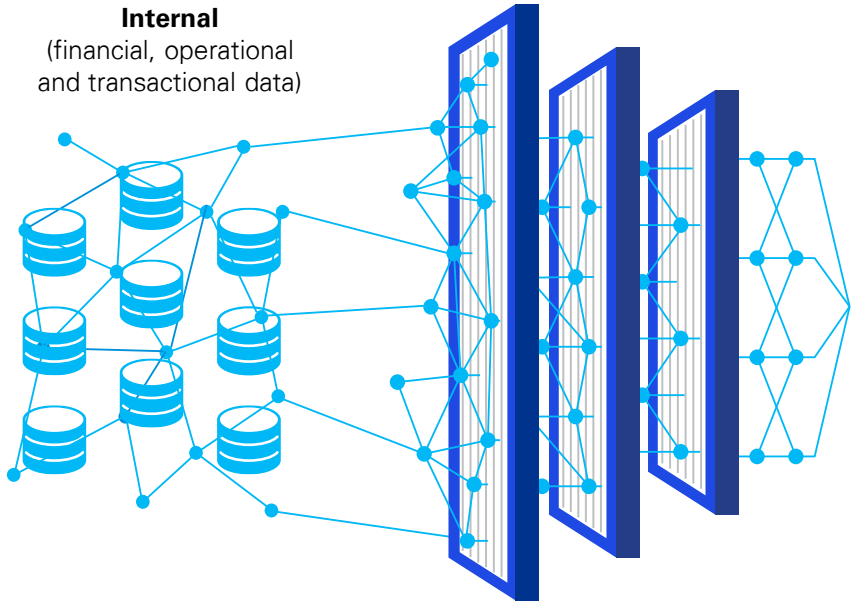
Data is collected from various sources

Cleansed and organised using pre-programmed tools

Insights and opportunity baselines are generated

Identifying and quantifying value creation opportunities tailored to the company situation

Internal
(financial, operational and transactional data)



External
(benchmarking, industry data)

Programmed analytical tools developed by data scientists

Buying

Identification of synergies and value opportunities alongside financial, commercial and operational due diligence

Selling

Acceleration of vendor due diligence. Articulation of equity story and input for valuation model

Turnaround

Optimisation of working capital to rapidly release trapped cash and preserve value. Margin improvement strategies.

Transform

Cost reduction through operational effectiveness, organisational rightsizing and supply chain optimisation initiatives.

Grow

Identification of market expansion, product portfolio optimisation and customer diversification opportunities

Analytics in action – supply chain optimisation opportunity

Below is an example illustrating the application of Analytical Building Blocks (ABBs) to evaluate and quantify the supply chain optimisation opportunity identified for CarPro Market:

Data input

Transactional level data

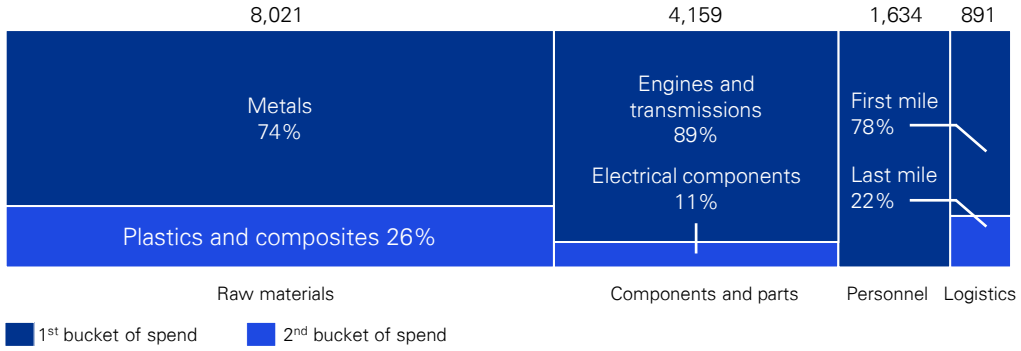
Automatic calculations

Workflow

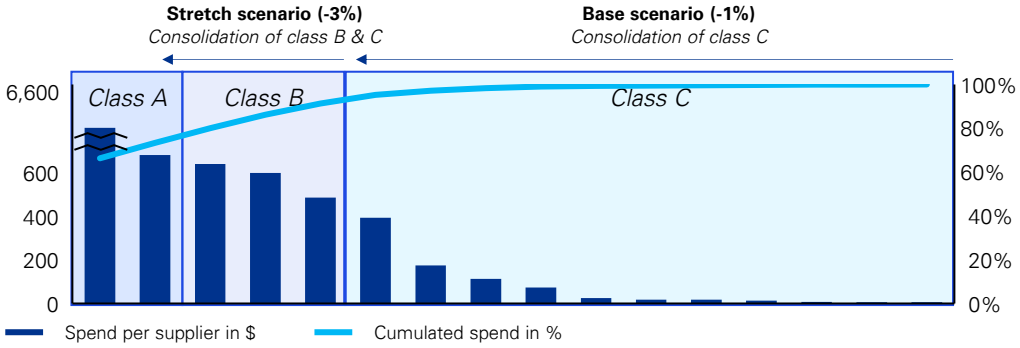
Analytical app

Sample output analytics

Breakdown of spend on direct purchases (In USD thousands)



Pareto approach to metals & engines and transmissions suppliers (In USD thousands)



Value creation quantification

Summary of operational evidences

- Analysis of the direct purchasing expenditure base suggests that for all geographies, metals & engines and transmissions are focus areas given their high weighting in overall direct spending (around 65%)
- The pareto approach reveals imbalances in purchasing categories in terms of supplier classification, which generates operational inefficiencies and non-optimised costs for direct purchases

Revenue & EBITDA potential

Cost savings *Considering 12 months*	Base	Stretch
	$0.1m	**$0.3m**

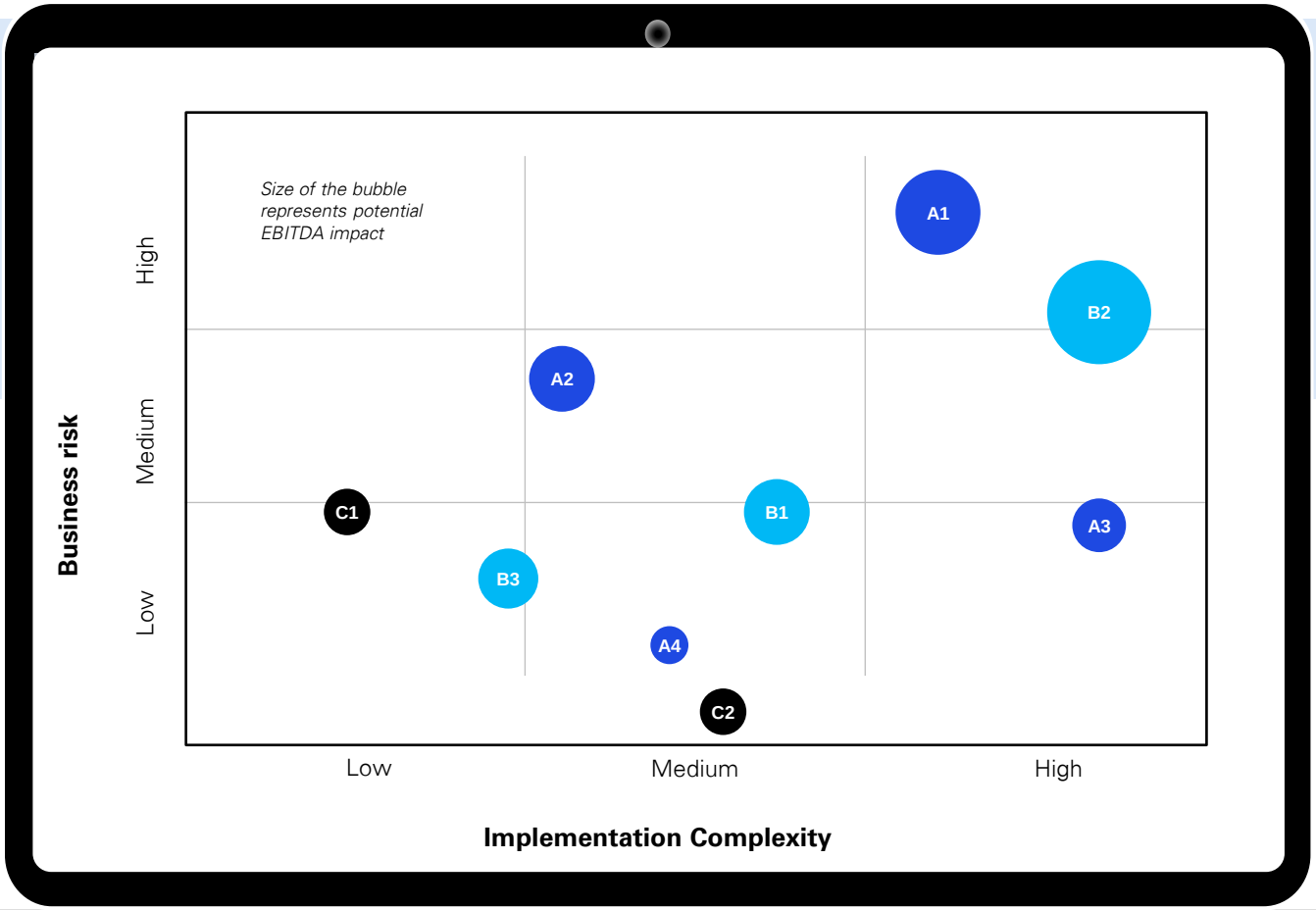
Opportunity sizing definition

- There is an opportunity to optimise the cost for value by consolidating purchasing volumes from specific strategic suppliers
- Consolidating class C suppliers into class A and B suppliers can generate cost savings of 1% (base scenario) whereas consolidating class B and C suppliers into class A suppliers can generate cost savings of 3% (stretch scenario)

Prioritising value creation initiatives

An initial diagnostic enables the quantification of potential financial impact of initiatives once one-off and recurring costs are factored in.

In addition to the 'size of the prize', assessing the business risk and implementation complexity of potential initiatives enables prioritisation so that investment is made where expected return is within cost and risk appetite.

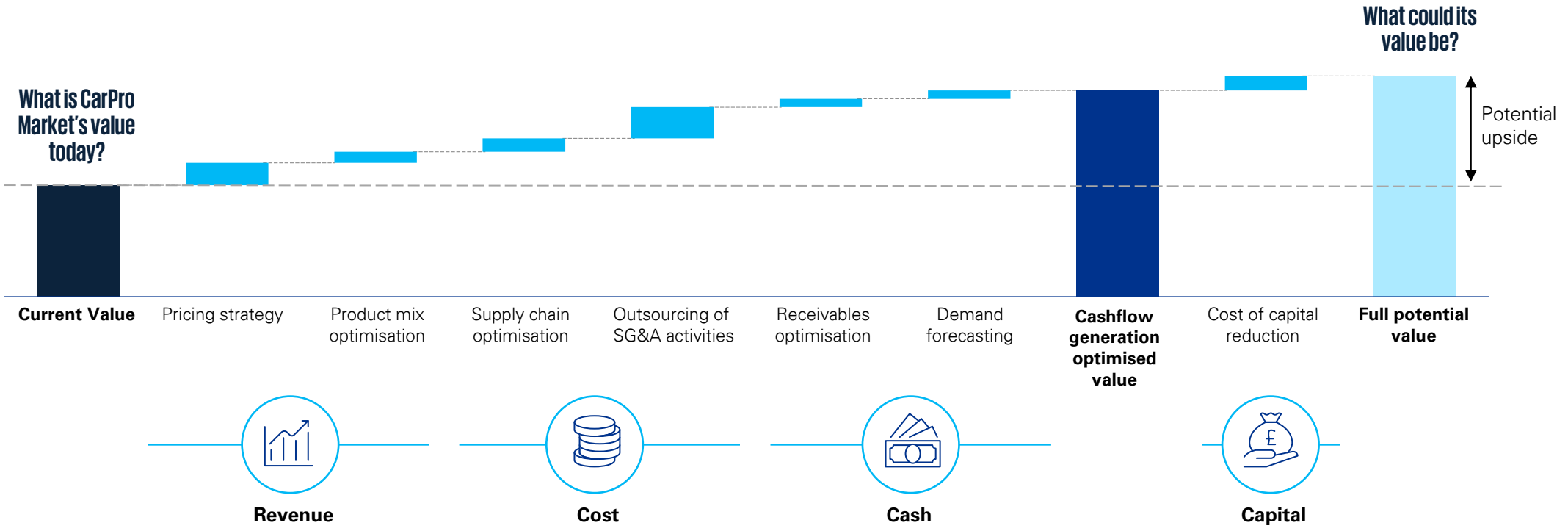


Value Creation opportunities

A1	Pricing strategy
A2	Product mix optimisation
A3	Market and channel expansion *(deprioritised)*
A4	Targeted marketing *(deprioritised)*
B1	Supply chain optimisation
B2	Outsourcing of SG&A activities
B3	Procurement function improvement *(deprioritised)*
C1	Receivables optimisation
C2	Demand forecasting

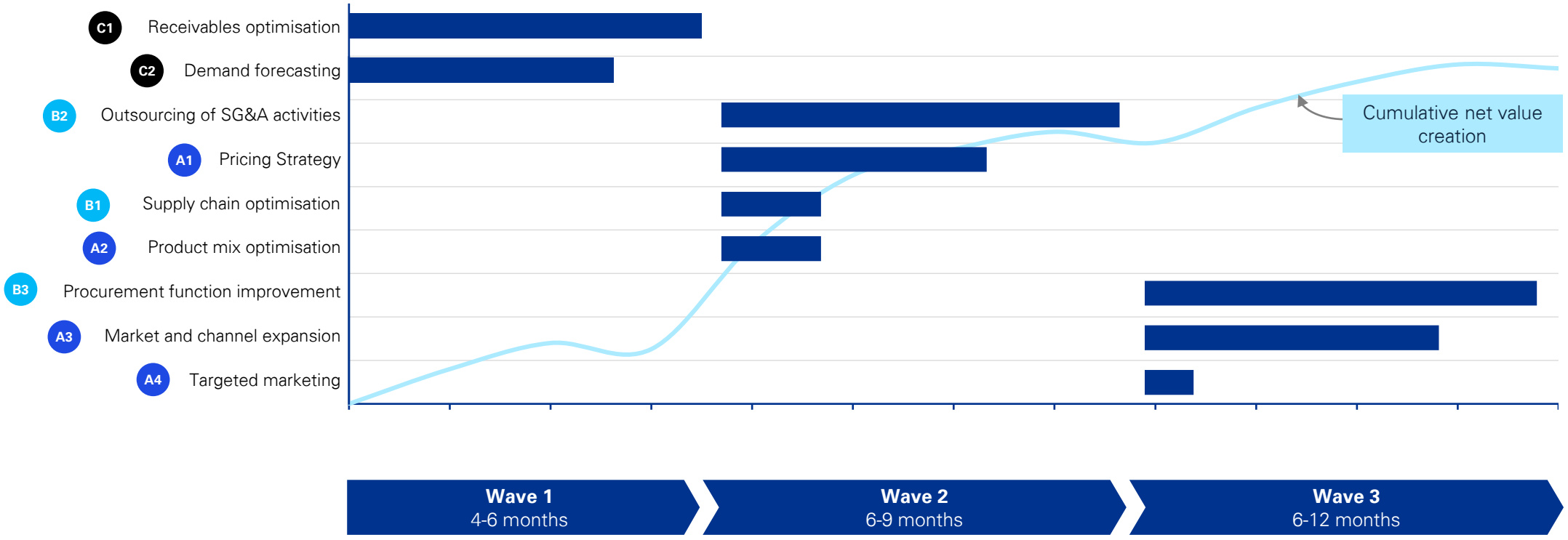
Maximising enterprise value

Implementation of the prioritised value creation initiatives drives an increased return on invested capital (ROIC). Additional interventions to help decrease the company's weight average cost of capital (WACC), maximising the value upside.



Executing change initiatives to realise the value

Prioritised initiatives are then sequenced into an implementation roadmap. Where possible we employ our self-funding approach to value creation, sequencing the initiatives in a cash-positive order for the company so that cash release achieved in the first wave initiative(s) (e.g. receivables optimisation) can help fund the initiatives that follow. We leverage sector and functional SMEs, supported by workflow tools and change methodologies, to deliver the transformation and realise the value.



KPMG playbooks and assets to accelerate value identification

CarPro Market provided an example of how we approach value creation. We work with clients across…

Situations

Various
Situations

- Buy
- Sell
- Turnaround
- Transform
- Grow

Areas of focus

Tapping into functional expertise across different
Areas of focus

Commercial	Tech & Digital	Operations	ESG & Energy Transition
HR & Organisation	Finance & Reporting	Working Capital	Risk, Compliance & Legal

Sectors

With playbooks tailored for
8 sectors and
23 sub-sectors
Leveraging
250+ Analytical Building Blocks (ABBs)

- Consumer & Retail
- Insurance
- Industrial Manufacturing
- Energy & Natural Resources
- Banking & Asset Management
- Tech, Media & Telecoms
- Healthcare & Life Sciences
- Business Services

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