



cutting through complexity

CORPORATE FINANCE

Australian Valuation Practices Survey 2015

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Section 1:

Foreword

“It became evident that the survey was filling a real gap in the Australian market based upon the feedback and queries we received on the 2013 survey.”

Welcome to KPMG’s Australian Valuation Practices Survey 2015. This is KPMG’s second survey and it builds on the findings of our inaugural 2013 survey. We hope it will offer a unique reference point for corporate financiers and financial analysts, providing insight into the valuation parameters and approaches currently being used.

For the first time, the survey also covers real estate and tangible asset valuations.

It became evident that the survey was filling a real gap in the Australian market based upon the feedback and queries we received on the 2013 survey. We trust that this will continue to be the case, especially given the continued volatility in the financial markets which makes assessments and assumptions around valuations, and in particular expected shareholder returns, very challenging.

The last couple of years have also shown us that a standard textbook approach to valuation analysis does not always reflect commercial reality and has resulted in corporate financiers and analysts often deviating from these approaches.

Thank you to everyone who completed the survey. Your time, efforts and insights are, as always, invaluable.

Thank you also to those members of KPMG’s Valuation Services team who initiated the inaugural survey and lead this year’s analysis.

Please feel free to discuss the results of the survey with us. All feedback is warmly welcomed.

Sean Collins

Partner in Charge, Valuation Services

KPMG Corporate Finance

Section 2:

Executive summary

– equity valuations

This year we have captured the views of 29 participants across a wide range of industries including Big 4 accounting firms, investment banks, infrastructure funds, valuation boutiques and large corporates. Their responses provide considerable insight into the valuation methodology adopted in the Australian market.

For the first time we also included questions around general market expectations and asset valuations from a non-technical point of view.

Key non-technical findings

- **The board has final say on doing deals.** The biggest challenge to successfully completing deals over the next 12 months is the willingness of boards to do so, whilst the availability of assets and asset values will also be important determinants.
- **Deal activity on the rise.** Most participants believe the number of deals will increase in 2015 and that scrip will be used in two thirds of transactions.
- **Independent expert reports to remain steady.** The number of Independent Expert Reports (IERS) is expected to remain steady over the next 3 years compared to FY14.
- **Expensive assets abound.** In terms of asset classes, 59 percent of the participants believe real estate was overvalued, 37 percent believe infrastructure was overvalued and 45 percent believe equities were overvalued at the end of 2014.
- **ASX on the decline.** Accordingly, 68 percent of the participants believe the S&P/ASX200 index will decrease over the next 3 years when compared to FY14.
- **No sign of a decrease in impairment charges.** Impairment charges are expected to remain steady during 2015 when compared to 2014.
- **Financial reporting influence.** There has been an increase in the consideration of financial reporting implications when evaluating or advising on a deal.

“59 percent of the participants believe real estate was overvalued, 37 percent believed infrastructure was overvalued and 45 percent believe equities were overvalued.”

Section 3: Commercial environment

“The biggest challenge to successfully completing deals over the next 12 months is the willingness to boards to do so, whilst the level of M&A activity and values will also be a determinant.”

Figure 1: What do you see as the biggest challenge to successfully completing deals in the next 12 months?

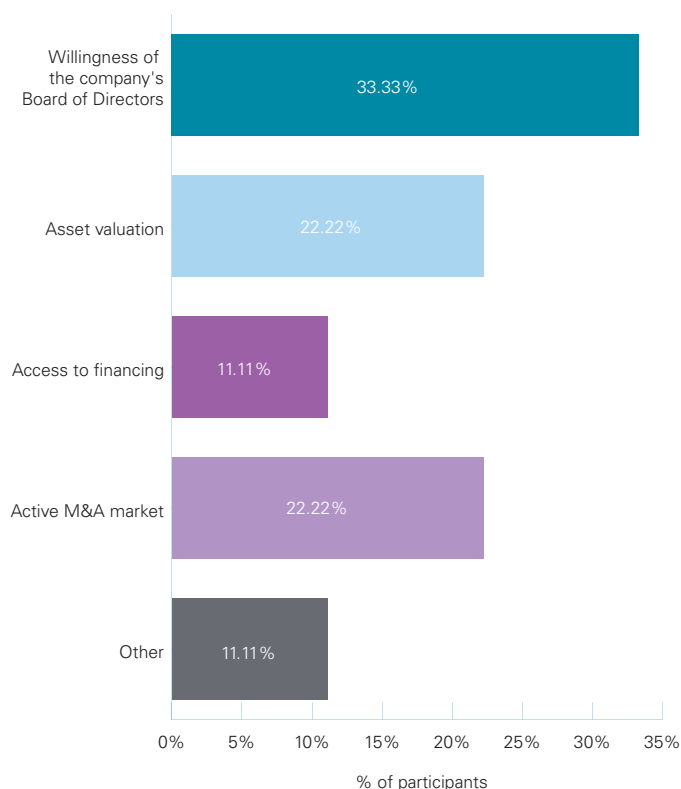
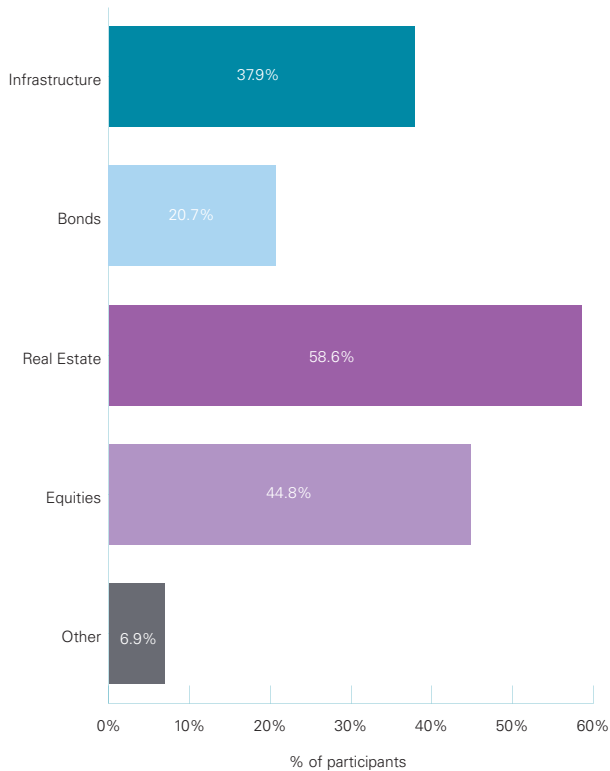
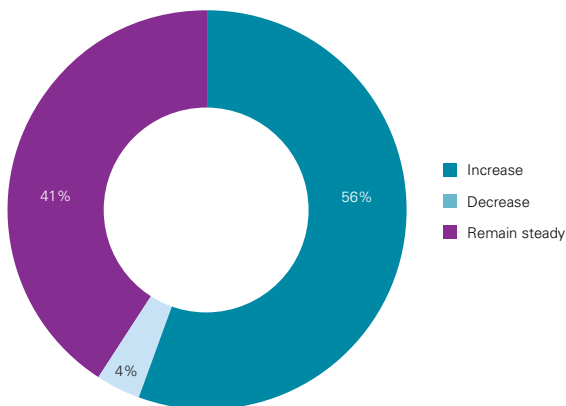


Figure 2: Are any of the following Australian asset classes, in your opinion, currently overvalued?



“In terms of asset clauses, more than half the participants believed real estate is over-valued.”

Figure 3: Do you expect the number of deals completed to increase, decrease or remain steady in the next 12 months?

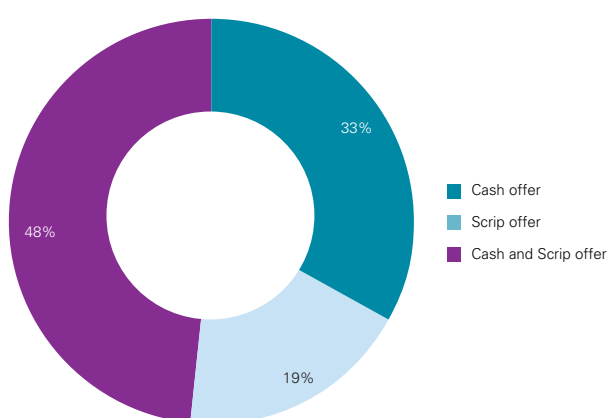


“The majority of participants expect the number of deals to increase over the next 12 months.”



“A cash and scrip offer is expected to be the most common form of consideration to complete deals.”

Figure 4: What do you expect the preferred deal structure to be in deals over the next 12 months?



“The number of IER’s is expected to remain steady over the next 3 years compared to FY14.”

Figure 5: During FY12, FY13 and FY14 the number of Independent Expert Reports completed was 204, 182 and 200 respectively. Do you expect the number of Independent Expert Reports completed to increase, decrease or remain steady over the next 3 years compared to FY14?

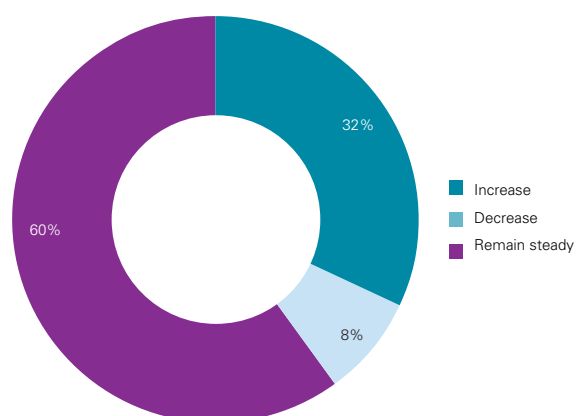
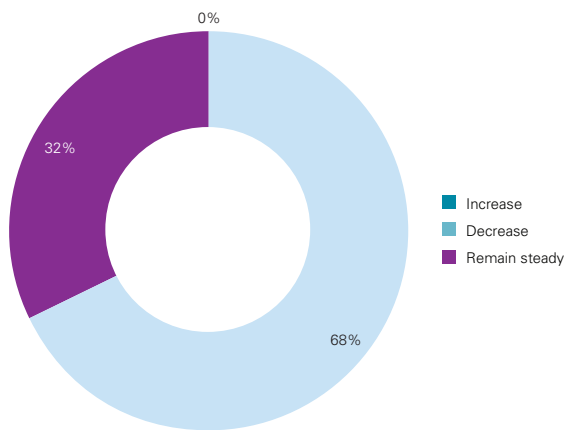
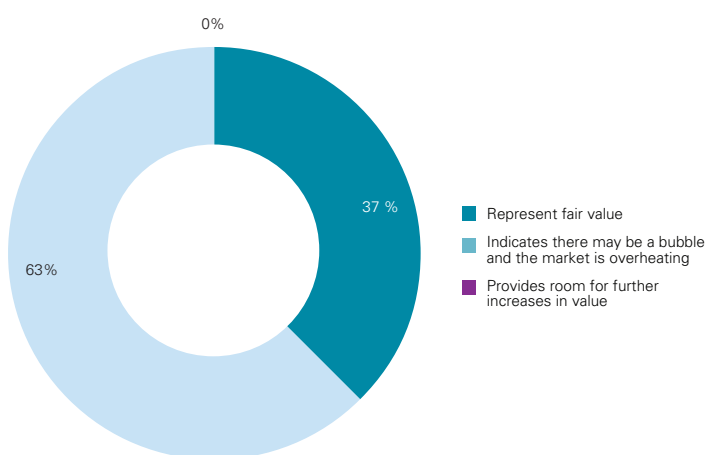


Figure 6: During FY12, FY13 and FY14 the total return of the S&P/ASX200 accumulation index was -6.4 percent, 21.6 percent and 19.7 percent respectively. Do you expect the total return of this index to increase, decrease or remain steady over the next 3 years compared to FY14?



“68 percent of the participants believe the S&P/ ASX200 accumulation index will decrease when compared to FY14.”

Figure 7: As a general observation, do you believe that the prices paid for Australian Infrastructure assets (e.g. ports; toll roads):



“Only 37 percent of the participants believe that the prices paid for Australian Infrastructure assets represent fair value.”

Section 4: Impairment issues

“Impairment related work and impairment changes are expected to remain at the levels experienced in 2014.”

Figure 8: Has the volume of impairment related work conducted by your firm, increased, decreased or remained steady in the past 12 months?

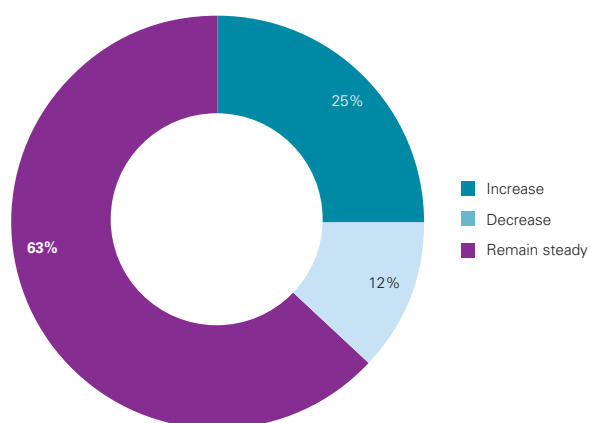
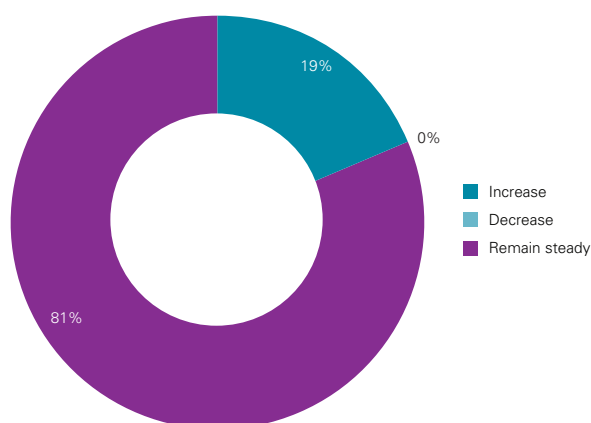


Figure 9: Do you expect impairment charges to increase, decrease or remain steady in the next 12 months?



Section 5: Valuation methodologies

Income and market approaches are the most popular

In 2015, the income approach (or discounted cash flow (DCF) approach) and the market approach (eg: price earnings ratio) proved to be equally popular as the primary valuation methodologies used by the participants. The survey shows the income and market approaches are used 'always' or 'sometimes' by 100 percent of participants. In contrast, 20 percent never use the asset based methodology. While this is similar to our 2013 Valuation Practices Survey findings, the bias then was towards using the income approach.

Figure 10: **Survey 2015** – How often do you use the following valuation approaches assuming a going concern?

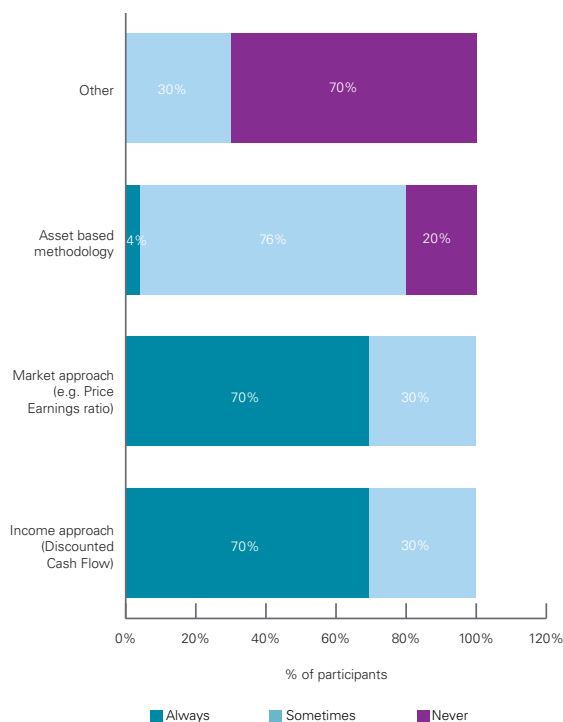
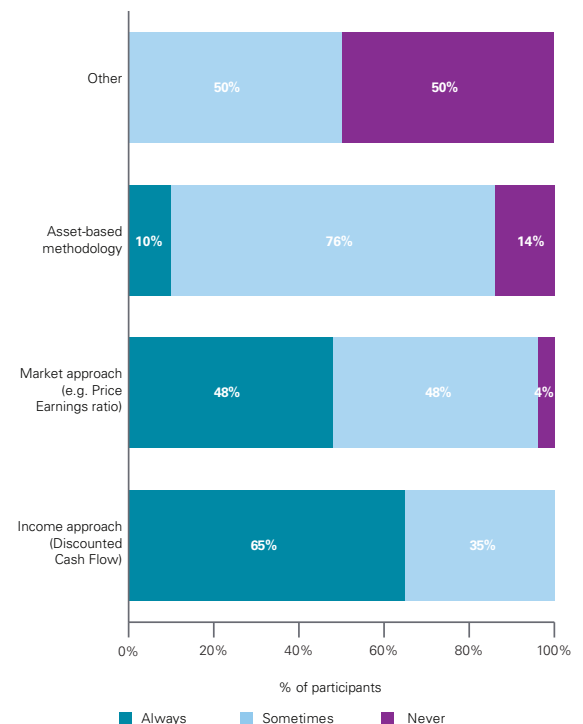


Figure 11: **Survey 2013** – How often do you use the following valuation approaches assuming a going concern?



Other methodologies used by participants:

- Cross-check to a RAB multiple or similar
- Valuation benchmarks – ie. value per unit of resource/reserve
- Rule of thumb for smaller valuations
- Probability Weighted NPV; Real Options

Section 6: Market approach

No change to multiples

In looking closer at the market approach, our 2015 findings show no material change for a number of the valuation multiples. Revenue, price to book ratios, and price to pre-tax earnings all remain fairly steady. The most favoured multiple – Enterprise Value/Earnings Before Interest Tax Depreciation & Amortisation (EBITDA) – has only increased its popularity. Every participant always or sometimes uses it, with three quarters always.

Figure 12: **Survey 2015** – When using the market approach, how often are the following valuation multiples used?

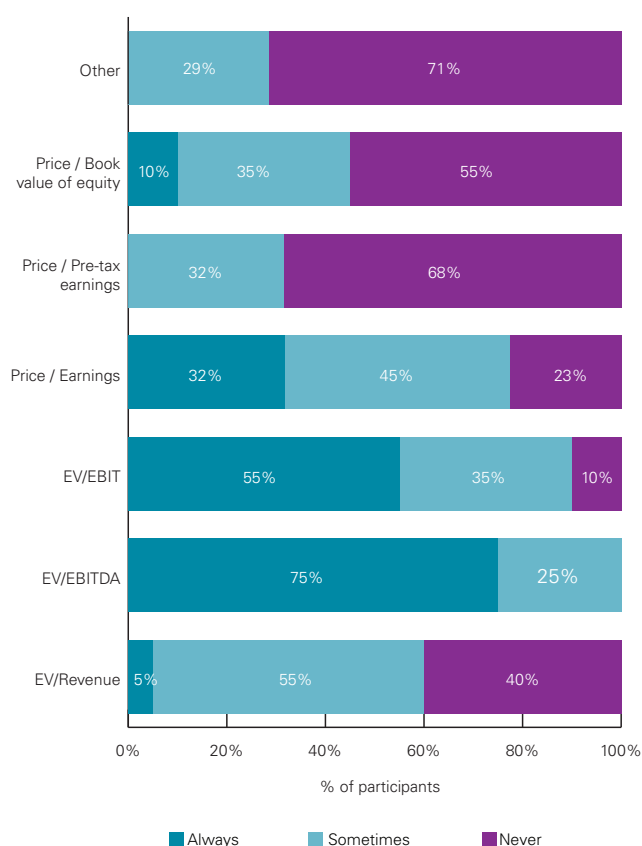
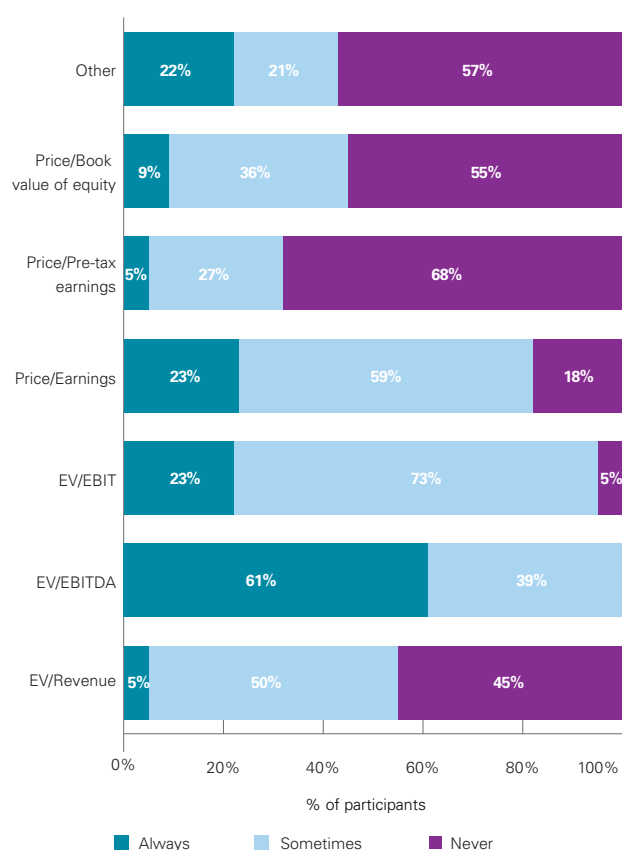


Figure 13: **Survey 2013** – When using the market approach, how often are the following valuation multiples used?



Other multiples used by participants:

- EV/RAB
- EV/Reserves
- EV/Production
- EV/passenger

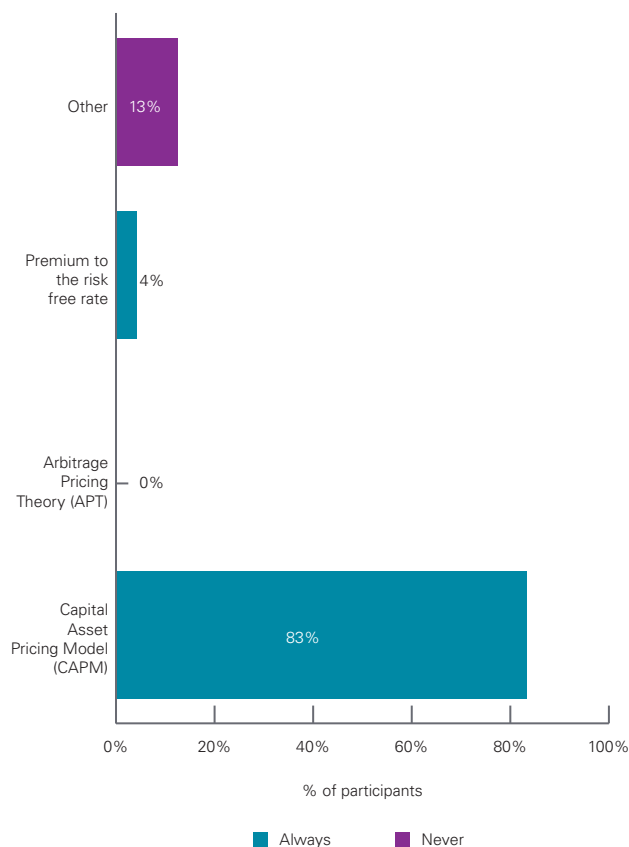
Section 7:

Income approach: discounted cash flow

Capital asset pricing model still the way to determine the cost of equity

So far as the income approach is concerned, there is no obvious change in the methods employed when calculating the cost of equity to value future cash flows to equity. Not surprisingly, the capital asset pricing model is as popular as ever when deriving a cost of equity estimate. A substantial 83 percent of participants prefer it to any other method. In direct contrast the arbitrage pricing theory still has no support at all.

Figure 14: **Survey 2015** – Which of the following method(s) do you usually employ when calculating the cost of equity to value future cash flows to equity?



Going for Gordon Growth

The Gordon Growth model (or perpetuity method) continues to be popular when calculating the Terminal Value in a DCF valuation. The survey shows 58 percent always use it while 42 percent sometimes use it. In using this method, the Consumer Price Index (CPI) is commonly used as a proxy for the perpetuity (or residual) growth rate.

While a large proportion of respondents use the Exit Multiple model (85 percent), most (60 percent) only sometimes use it.

Figure 15: **Survey 2015** – When calculating the Terminal Value in a DCF valuation what method(s) are considered?

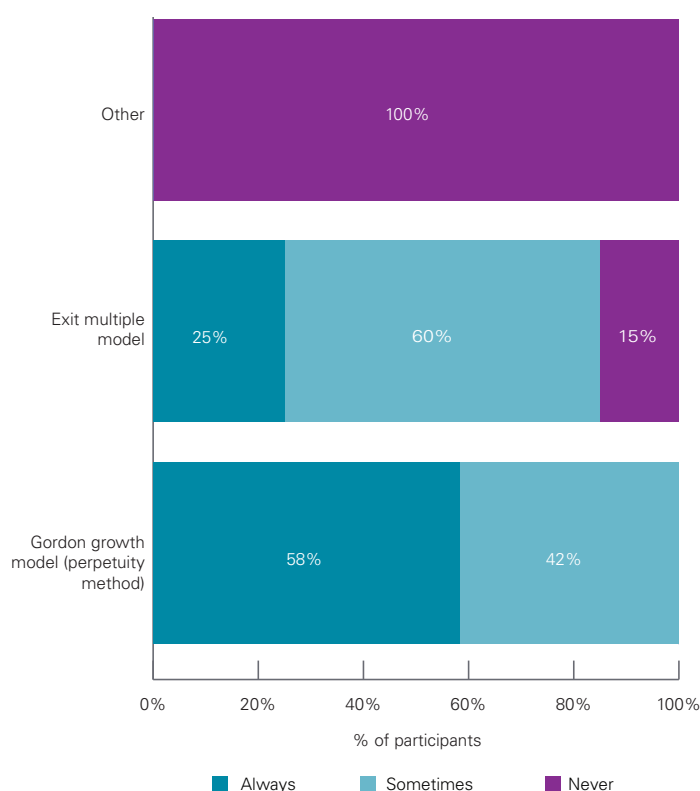
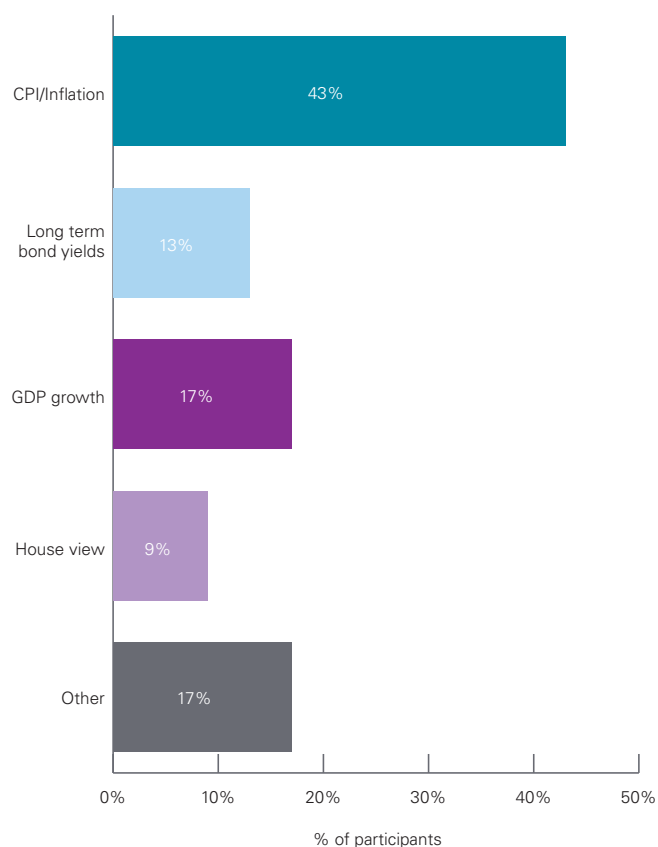


Figure 16: **Survey 2015** – If the Gordon Growth method is employed, how do you usually determine the perpetuity (residual) growth rate?



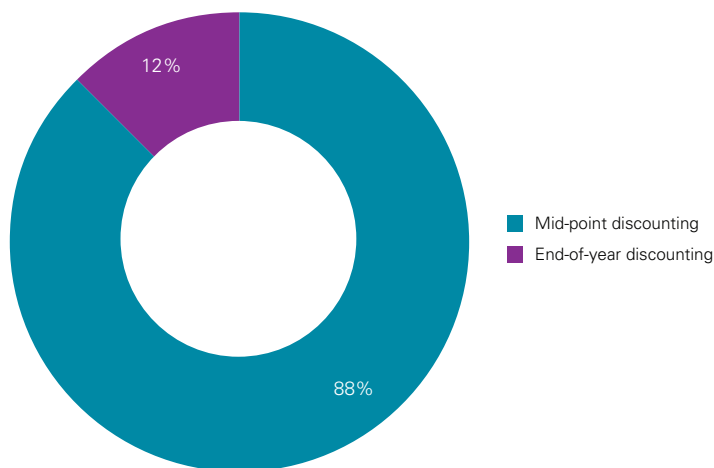
Other growth rates used by participants:

- Unless there is a reason to expect a decline we allow for inflation and some real growth (subject to reasonableness).
- Long term asset growth prospects
- Asset specific growth depending on various factors such as growth capex, etc.

Midyear discounting preferred

When conducting a DCF valuation, you can choose between the mid-point or end-of-year convention for the purposes of discounting. According to the survey, most respondents (88 percent) usually prefer mid-year discounting. That's not altogether surprising given it assumes that cash flows are generated evenly throughout the period.

Figure 17: **Survey 2015** – When conducting a DCF valuation what discounting convention is usually employed?



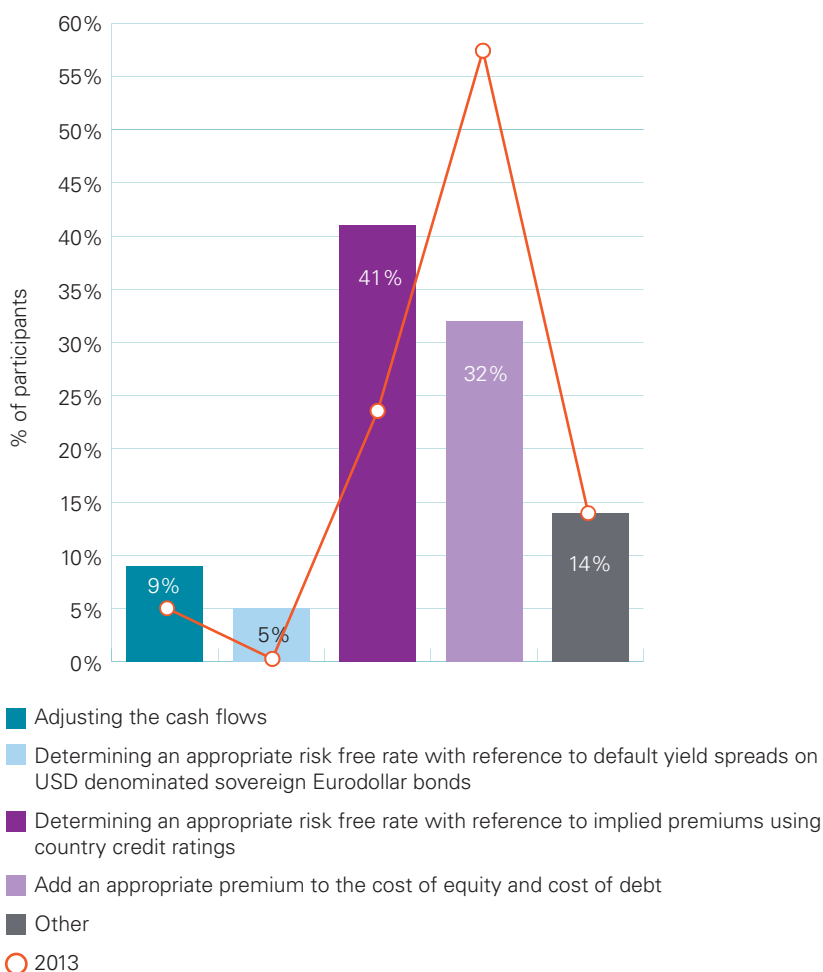
Section 8:

Adjusting for country risk premium

Discount rate adjusted for country risk

Consistent with KPMG's 2013 survey, most participants (41 percent) tend to adjust the discount rate for country risk by determining an appropriate risk-free rate using country credit ratings or (32 percent) by adding a premium to the cost of equity and the cost of debt.

Figure 18: **Survey 2015** – How do you generally adjust for country risk when valuing an asset in a developing country?



Other methodologies used by participants:

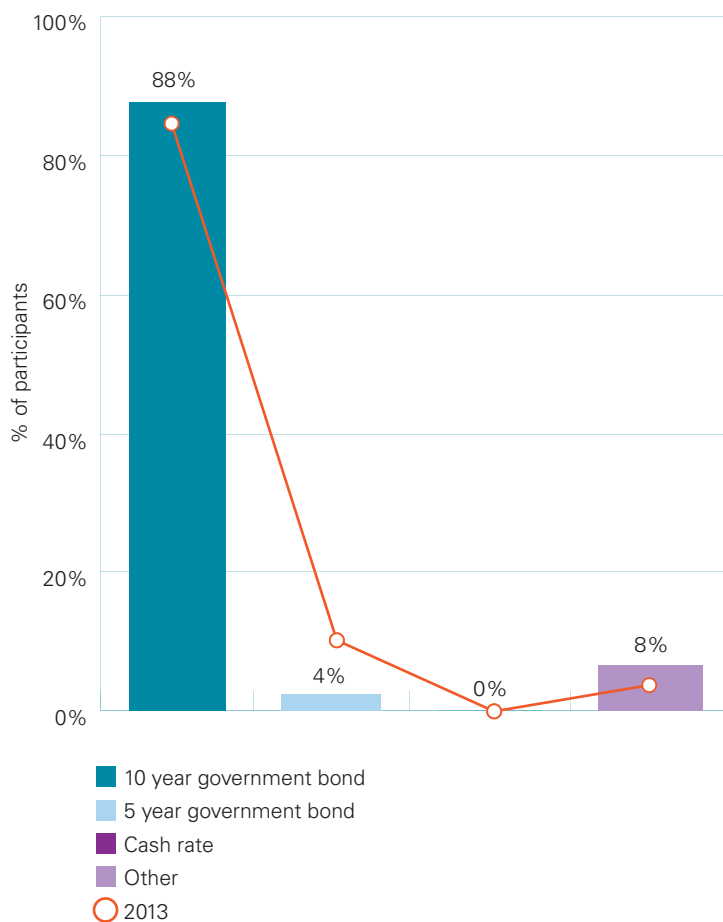
- All of the above
- Host country 10 year bond yield vs USD 10 year bond yield

Section 9: Benchmarking the risk-free rate

10-years still a preferred proxy

Most participants continue to use the yield on 10-year government bonds as a benchmark for the risk-free rate in Australia with a substantial 88 percent choosing to do so as a general rule.

Figure 19: **Survey 2015** – Which of the following are generally used as a benchmark for the risk free rate in Australia?



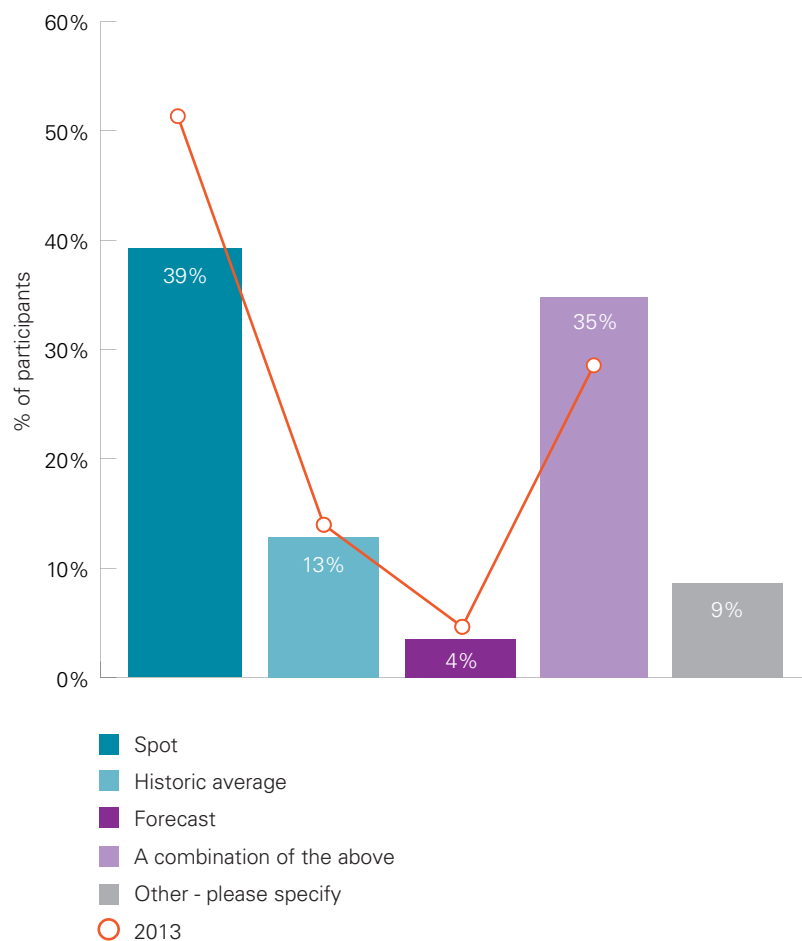
Other benchmarks used by participants:

- House view of long-term rate
- 10 year or duration matched

On the spot

Similar to KPMG's 2013 survey, there is some variation in how the risk-free rate is derived. A little more than a third of the participants (39 percent) use the spot government bond yield as a proxy for the risk-free rate. However, 35 percent choose to favour a combination of the spot, historic average and forecast to benchmark the risk-free rate.

Figure 20: **Survey 2013 / 2015** – How do you derive the risk free rate when using the yield on a government bond as a proxy?



Other approaches used by participants:

- Either spot or historic average depending on the nature of the valuation
- Look at both spot and historical average

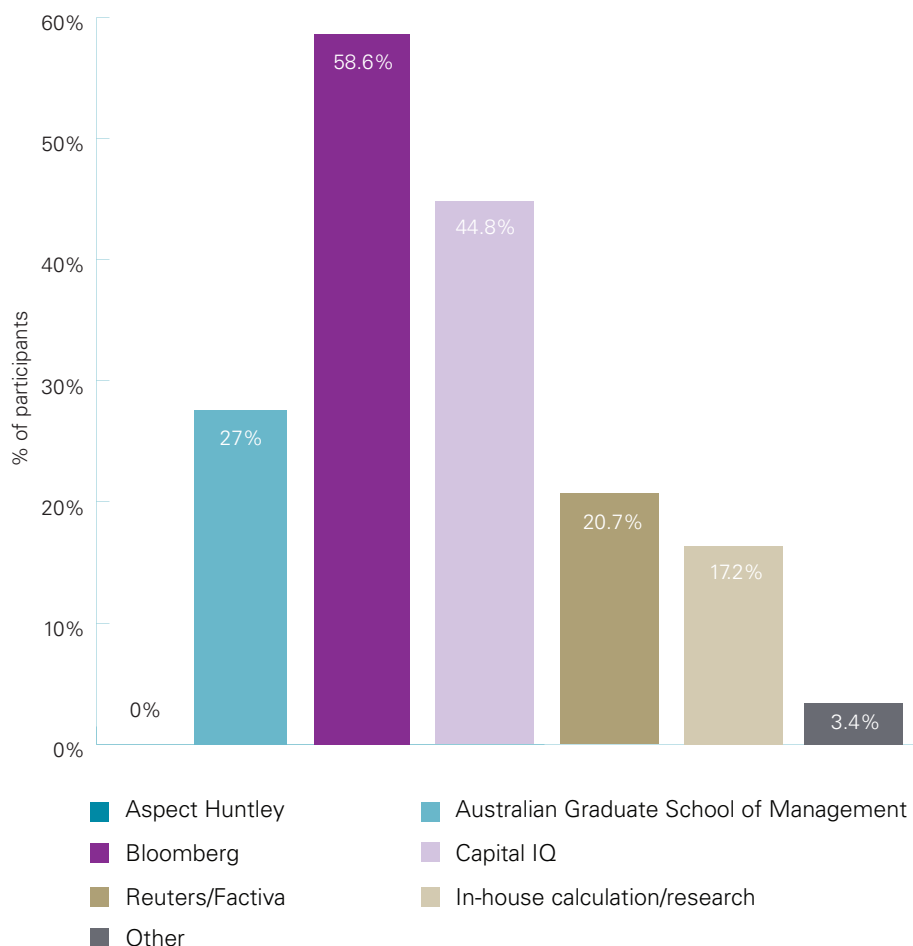
Section 10:

Understanding beta

Bloomberg takes top honours for beta information

When it comes to sources of information for beta estimates, the preferred service providers are clear: Bloomberg attracts almost 60 percent of participants' votes, while Capital IQ stands next in line with almost 45 percent.

Figure 21: **Survey 2013 / 2015** – Which of the following service providers are used as a source of information?



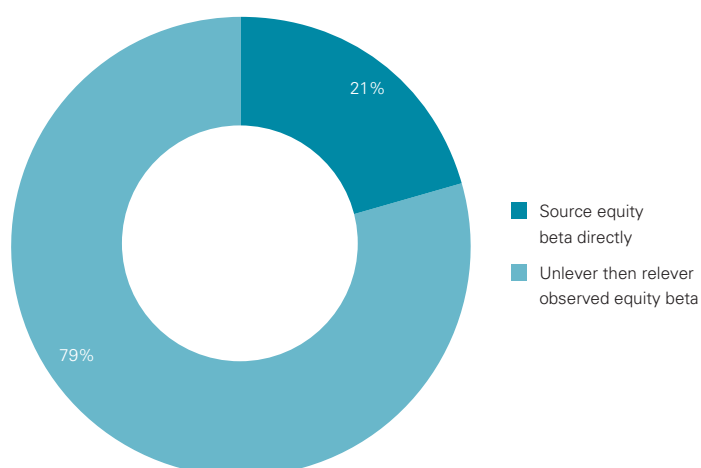
Other methodologies used by participants

- Fact set

All in the leverage

The vast majority of participants (79 percent) unlever and relever the observed equity betas to apply them to their subject company. A mere 21 percent choose to apply equity betas sourced directly from comparable companies. This is consistent with our 2013 survey.

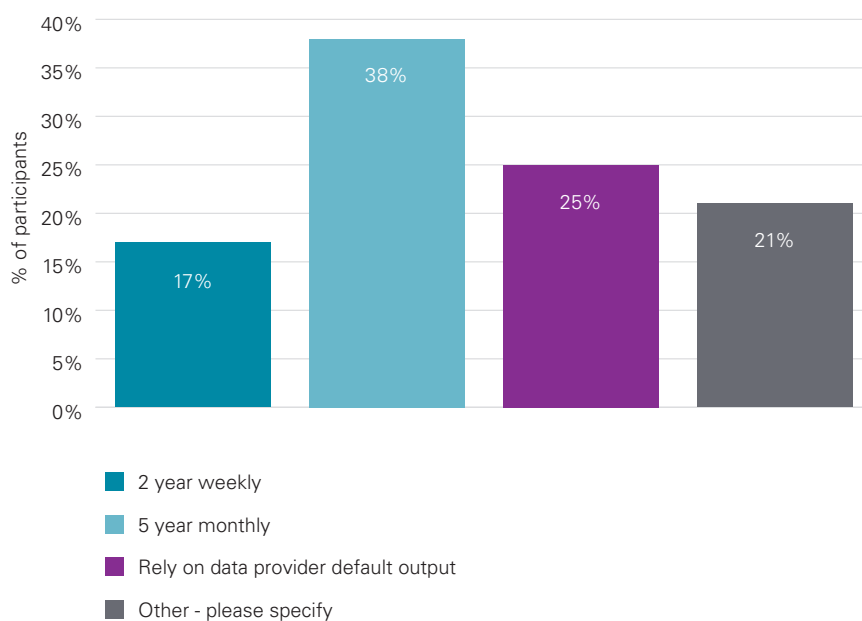
Figure 22: **Survey 2015** – Do you apply equity betas sourced directly from comparable companies, or first unlever and relever the observed equity betas to apply to the subject company?



Timeframes for adjusting beta

The majority of participants (38 percent) make reference to monthly observations over a five year period when calculating beta. However, it is worth noting that one quarter rely on a data provider's default output.

Figure 23: **Survey 2015** – When calculating the Beta, generally what period and frequency do you deem to be most appropriate?



Other methodologies used by participants:

- Multiple time periods and frequencies and understand reasons for differences
- 48 monthly observations
- Both 2 year weekly and 5 year monthly – depends on the sector
- 5 year monthly or based on sensitivity analysis (correlation to market of stocks)

Section 11:

The equity market risk premium

Australian market risk premium steady at 6 percent

Survey participants continue to show a clear bias towards using an equity (market) risk premium (EMRP) for Australia of 6 percent. This stands in contrast to the United States and the United Kingdom where a relatively wide range appears to be used. Participants use an equity risk premium for the US of between 5 and 6 percent. The UK, on the other hand, sits mainly at 5 percent but with some using 6 percent.

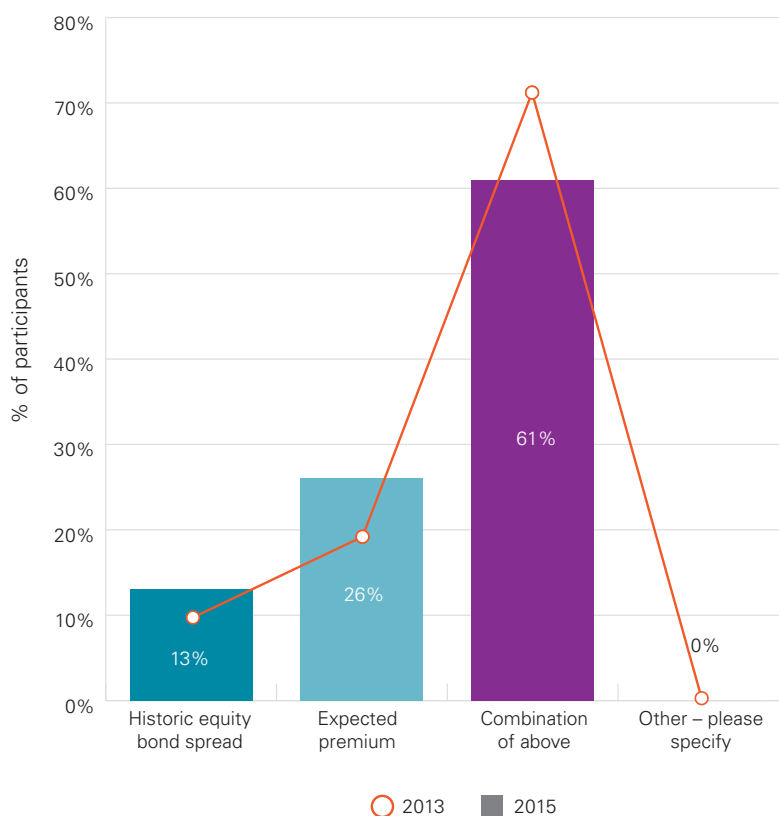
Figure 24: **Survey 2013/2015** – What equity market risk premium do you use when making use of the Capital Asset Pricing Model in percentage terms when valuing assets in the following countries?



Mixed rationale behind market risk premia

While a small portion (10 percent) indicate the use of the historic equity bond spread and others (19 percent) rely on the expected premium, a large majority of participants (71 percent) use a combination of the two when setting the market risk premium.

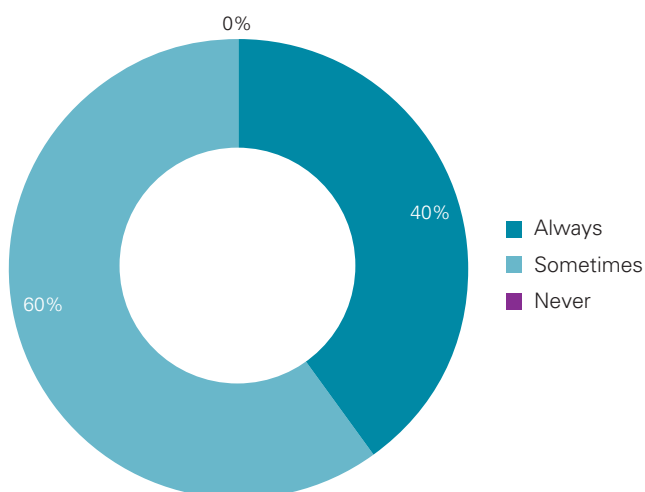
Figure 25: **Survey 2013/2015** – Which of the following would you consider to be the rationale for selecting the market risk premium?



The alpha effect

For the most part, participants tend to add a premium to reflect unique risks not modeled in forecast cash flows. The survey indicates that no participant 'never' makes an adjustment for such risks.

Figure 26: How often do you adjust the CAPM rate of return by a premium, to reflect unique risks that are not modelled in the forecast cash flows (alpha)?



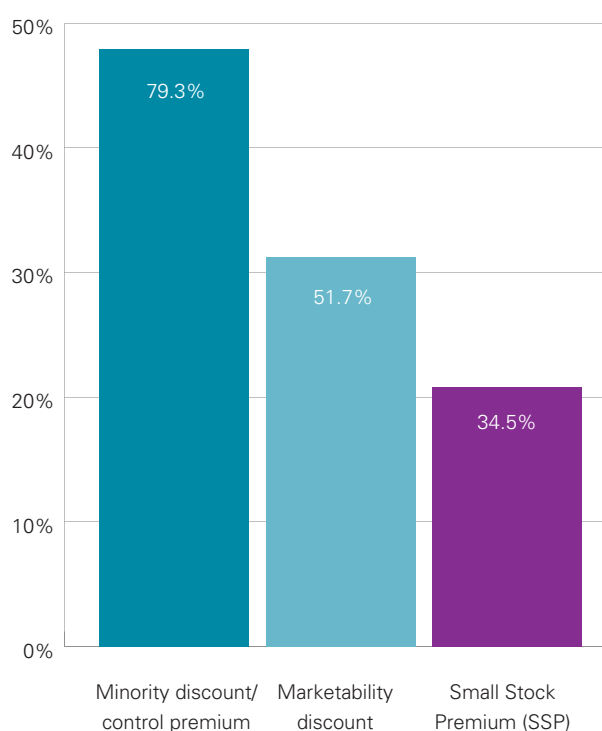


Section 12: Discounts and premia

Preferred discounts and premia

Almost 80 percent of participants consider minority discounts and control premia when conducting valuations. However, a marketability discount is also considered by 52 percent, as is a small stock premium to a lesser extent.

Figure 27: Which of the following discounts/premia are often considered when conducting valuation analysis?



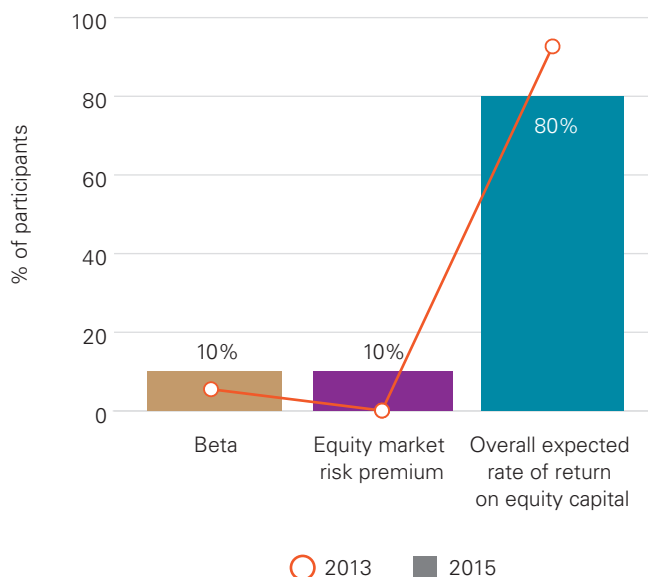
Section 13:

Analysing the small stock premium

Small stock returns

The 2015 survey results are consistent with those of 2013. Most participants adjust the overall expected rate of return on equity capital to reflect the additional risks associated with smaller companies.

Figure 28: In relation to the Small Stock Premium (SSP) which factor is adjusted?



Small stock premium inverse relationship

It is clear that there is an inverse relationship between the size of the SSP and the size of the entity. The 2015 results suggest an increase in the SSP applied to companies with a market cap less than \$250 million.

A large number (44 percent) of participants rely on in-house views regarding the SSP. Together with subjective assessments of the premium, this accounts for two thirds of the participants who responded to this question.

Figure 29: **Survey 2015** – What is the benchmark SSP applied given the size of the entity?

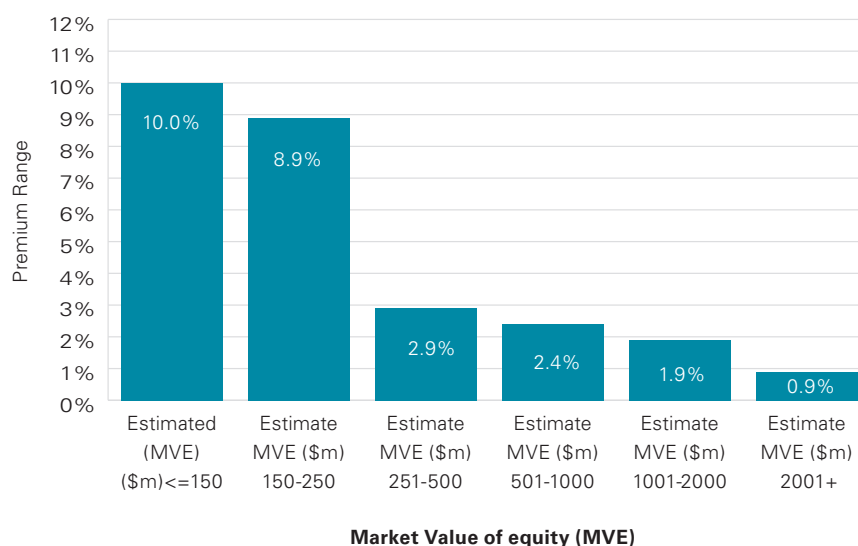


Figure 30: **Survey 2013** – What is the benchmark SSP applied, given the size of the company or entity?

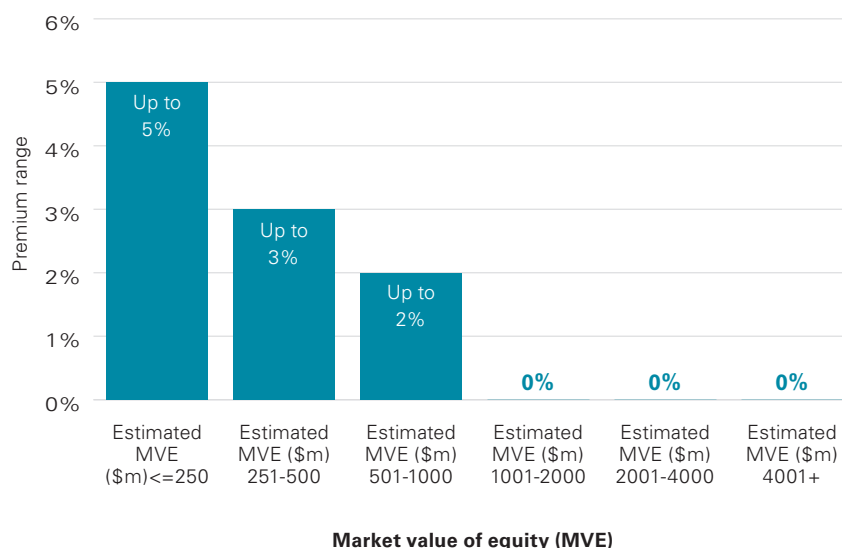
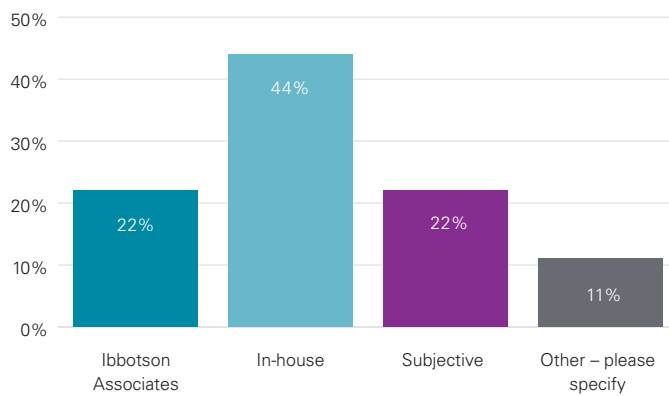


Figure 31: Which sources do you generally consult in estimating an appropriate SSP?



Other methodologies used by participants:

- All of the above

Section 14:

Marketability discount

Marketability discount inverse relationship

The 2015 results are consistent with those of 2013. It is clear that there is an inverse relationship between the size of the marketability discount being applied and the size of the stake being valued.

Figure 32: **Survey 2015** – What benchmark discount is applied given the size of the stake being valued (unlisted companies)?

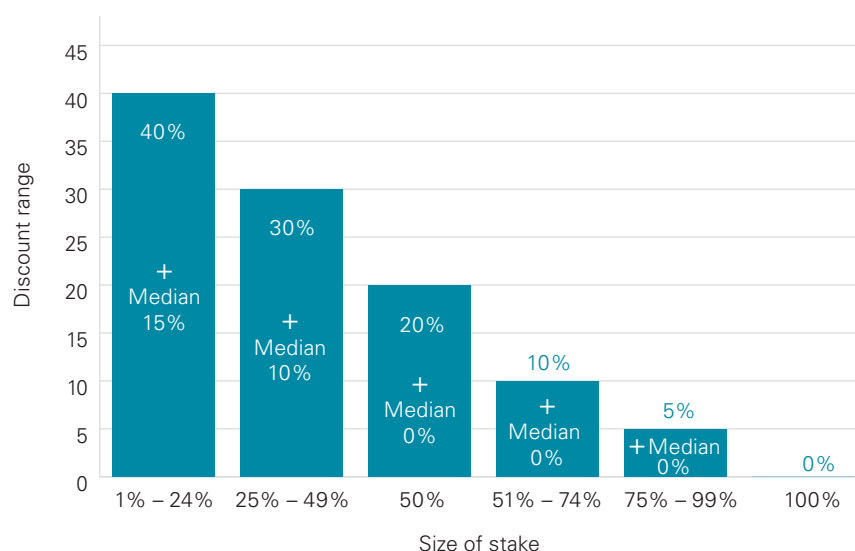
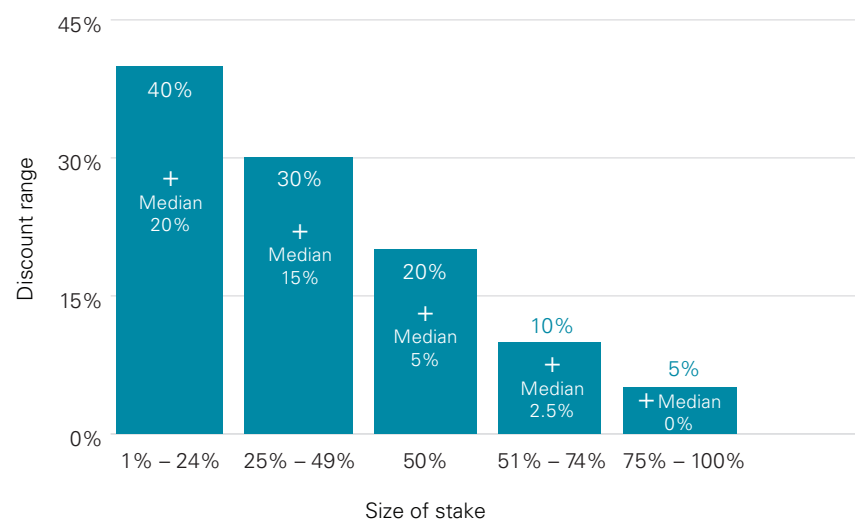


Figure 33: **Survey 2013** – What benchmark discount is applied given the size of the stake being valued (unlisted companies)?



Section 15:

Control premium

The benchmark premium

The premium range being considered by participants is consistent with that observed in the 2013 survey. However, it is worth noting that the median control premium decreased in 2015, from 22.5 percent, for a 51 percent to 74 percent stake, to 15 percent and 30 percent, for a 75 percent to 100 percent stake, to 25 percent.

Figure 34: **Survey 2015 – Control Premium.** Please indicate the benchmark premium normally applied given the size of the stake being valued.

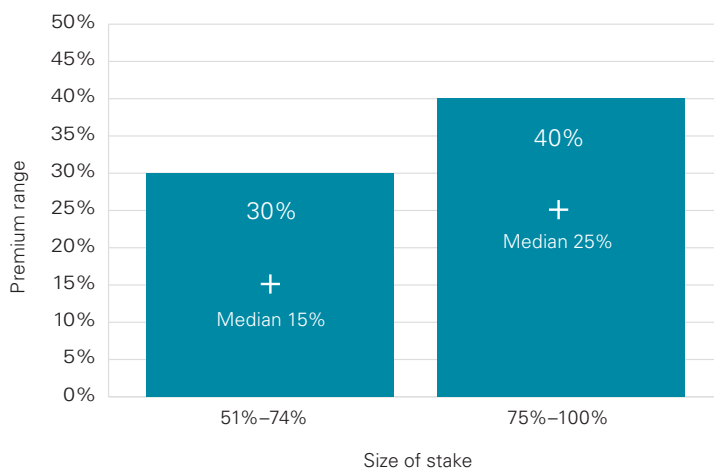
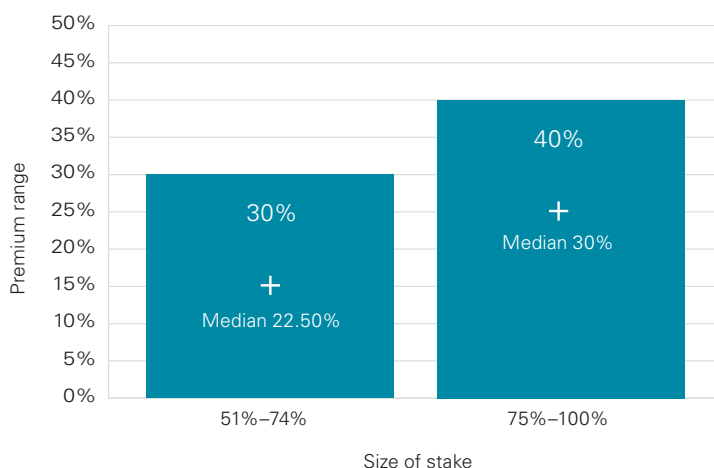


Figure 35: **Survey 2013 – What benchmark control premium is applied given the size of the stake being valued?**



Section 16: Minority discount

Not so minor discounts

The 2015 results are consistent with those of 2013. It is clear that there is an inverse relationship between the size of the minority discount being applied and the size of the stake being valued.

Figure 36: **Survey 2015** – Minority interest discount

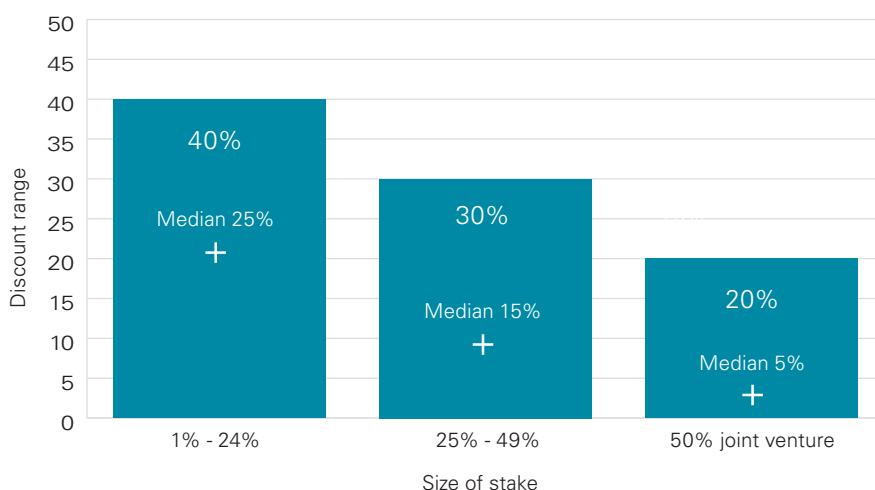
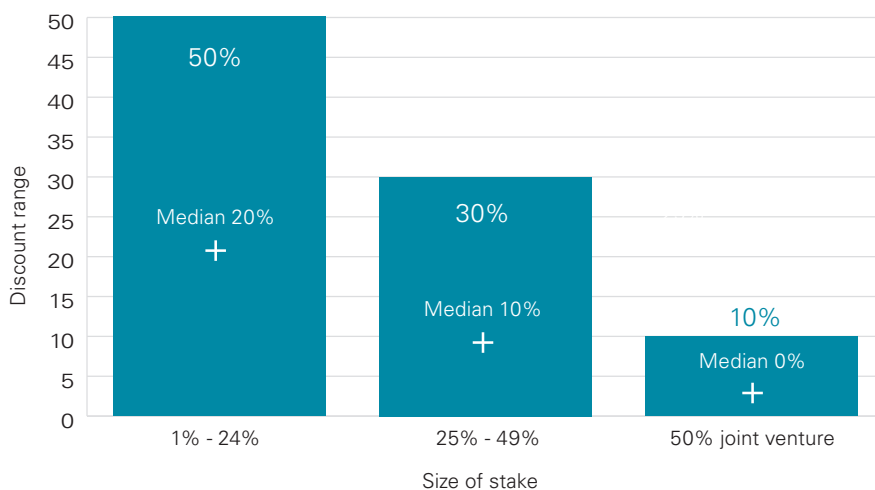


Figure 37: **Survey 2013** – What benchmark discount is applied given the size of the stake being valued (unlisted companies)?



Section 17:

Accounting, ESG and miscellaneous factors

Environmental, social and governance factors

While all participants are clearly considering Environmental, Social and Governance (ESG) factors when performing valuations, most (60 percent) appear to be doing so qualitatively. This is similar to 2013, although our latest survey shows that a further 30 percent adopt a qualitative and quantitative approach.

Figure 38: **Survey 2015** – How do you account for Environmental, Social & Governance (ESG) factors when performing valuations?

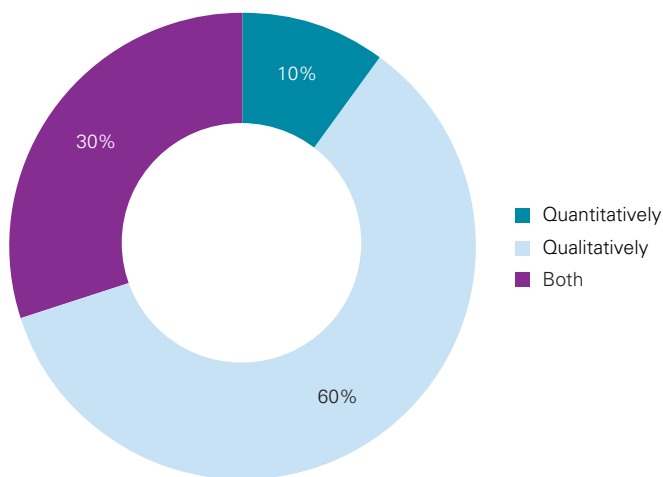
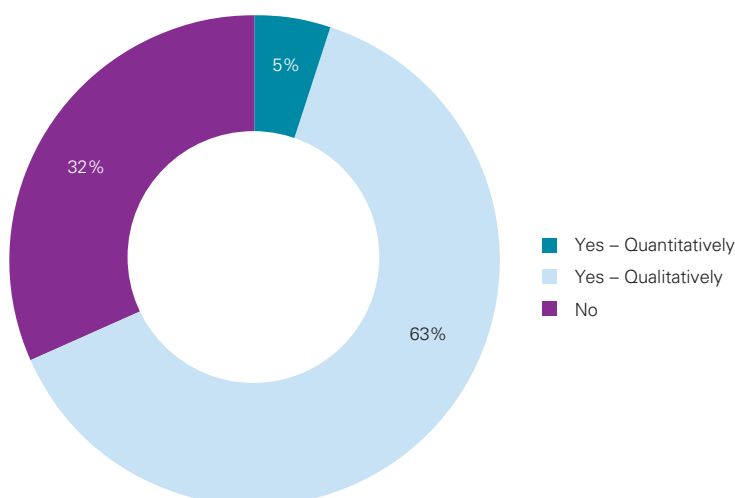


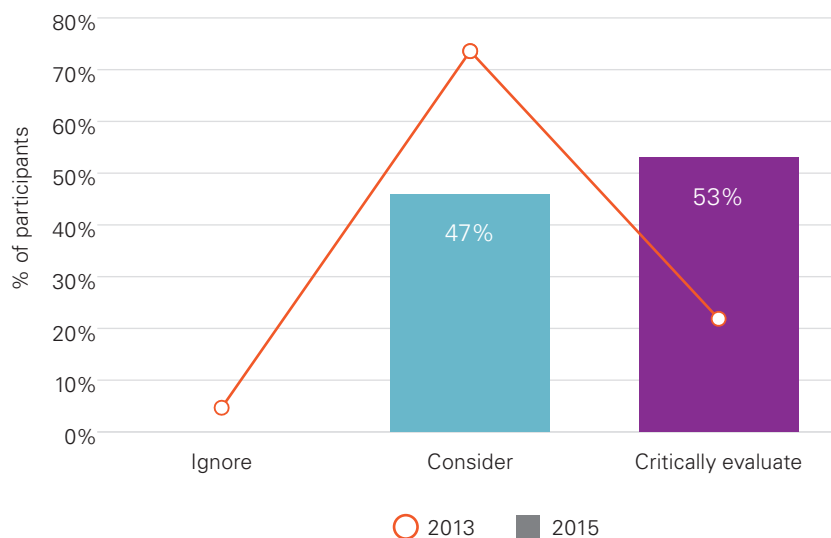
Figure 39: **Survey 2013** – Do you consider Environmental, Social & Governance (ESG) factors when performing valuations?



Getting serious about the impact of accounting standards

It would appear the 2015 survey participants give more consideration to the impact of accounting standards on future financial statements when evaluating or advising on a deal. More than half (53 percent) of participants critically evaluate this impact. This differs significantly to the 2013 survey where only 21 percent of participants undertook a critical evaluation.

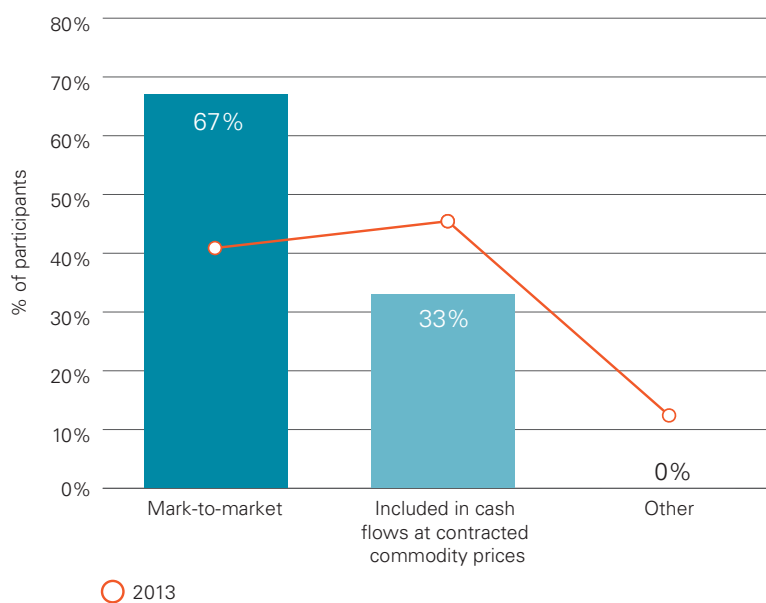
Figure 40: **Survey 2013/2015** – To what extent do you consider the impact of accounting standards on future financial statements when evaluating or advising on a deal?



More hedge books get marked to market

While almost half the 2013 participants (47 percent) preferred to include hedge books in the cash flows at contracted commodity prices, about two thirds (67 percent) of this year's participants are choosing to treat them as mark-to-market.

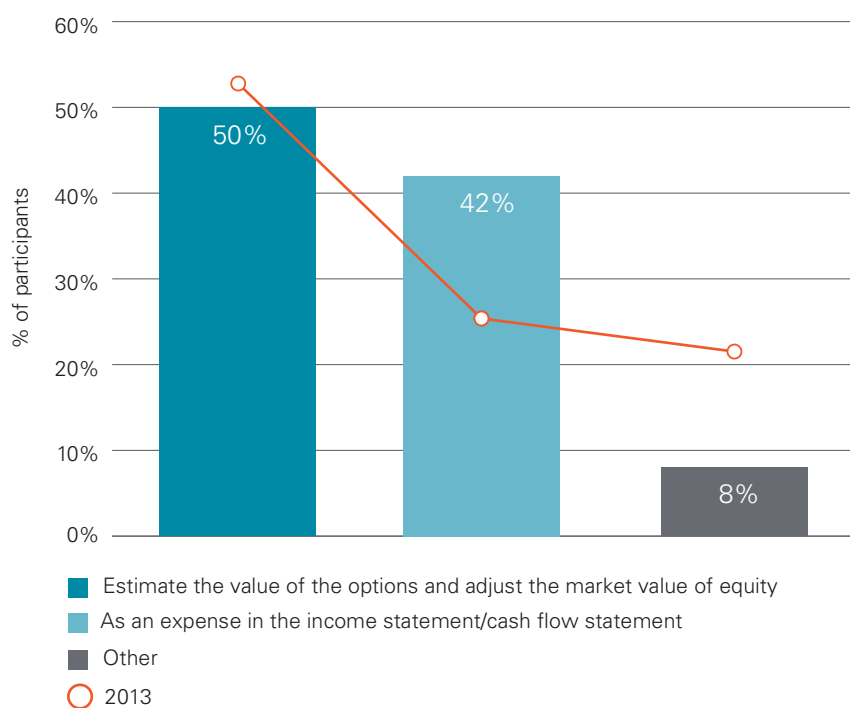
Figure 41: **Survey 2015** – Please indicate how you treat hedge books in business valuations:



The value of employee options

When it comes to employee options, half the survey's participants choose to adjust the market value of equity by the market value of the options. This remains consistent with the 2013 findings. Nonetheless, there has been a notable rise in the number of participants who treat it as an expense in the income statement or cash flow statement – 42 percent in 2015, compared to 26 percent in 2013.

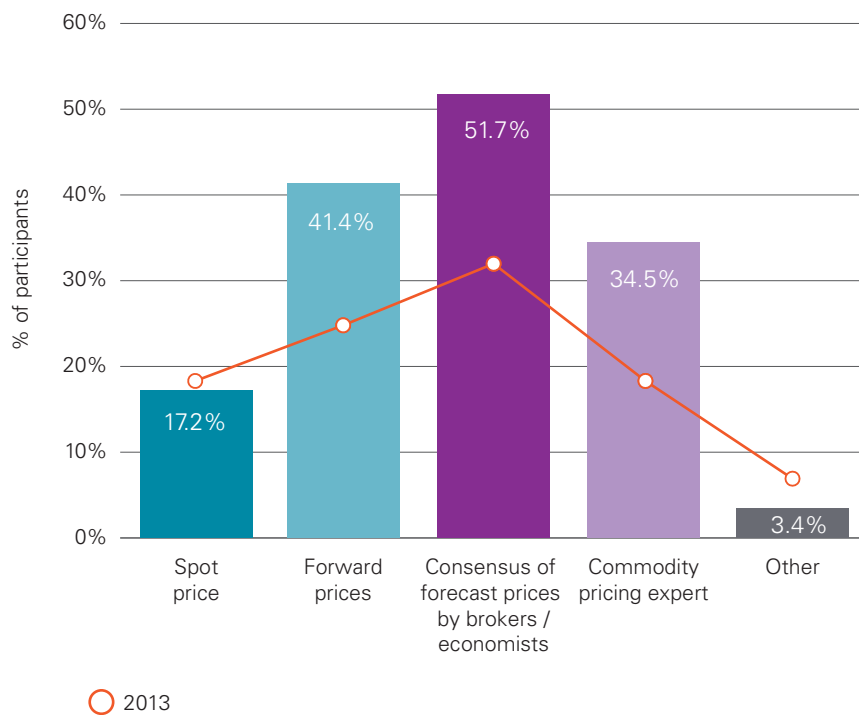
Figure 42: **Survey 2013/2015** – How do you treat employee options in the valuation?



Pricing in commodities

Participants continue to be divided in terms of how they estimate expected commodity prices for a valuation. While just over half (51.7 percent) look to a consensus of forecast prices by brokers and economists, a substantial 34.5 percent turn to a commodity pricing expert for assistance. Then again, the spot price or forward prices also make for popular methodologies with nearly 58.6 percent of participants (17.2 percent and 41.4 percent respectively) using either one.

Figure 43: **Survey 2013/2015** – Please indicate how you determine expected commodity prices for valuation purposes:



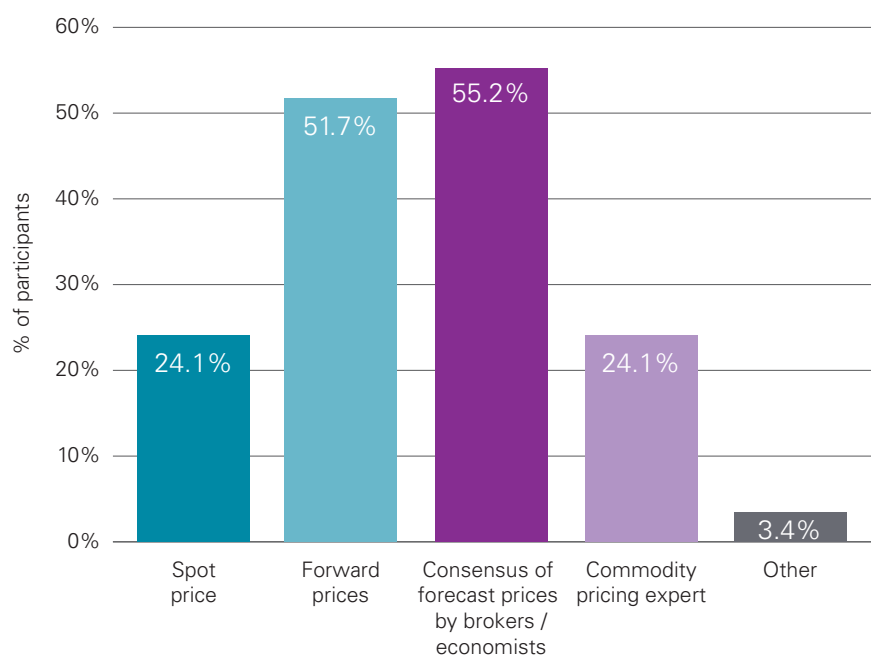
Other methodologies used by participants:

- Combination of spot, forward and consensus

Working out the exchange rate

Most of the participants (55.2 percent) choose to rely on a consensus of forecast prices by brokers and economists to determine the expected foreign exchange rate. 51.7 percent look to forward prices for guidance. This is consistent with the approach followed to determine expected commodity prices.

Figure 44: Please indicate how you determine expected foreign exchange rates for valuation purposes.



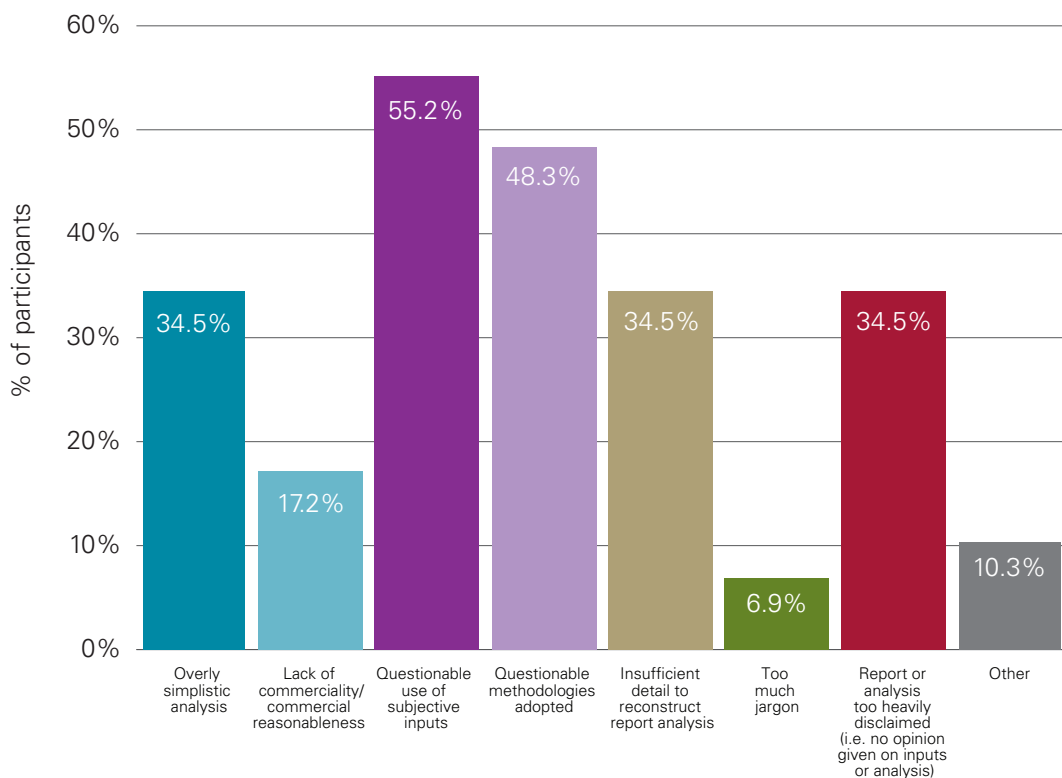
Other considerations by participants:

- Combination of spot, forward and consensus

Third party bias

It's not always easy to rely on third party valuations. For our participants, the main concerns relate to the questionable use of subjective inputs and an apparent lack of commerciality or commercial reasonableness. A little more than 55 percent underlined subjectivity as an issue, while about 48 percent questioned the commercial quality of the valuations.

Figure 45: What are the most common issues encountered when reviewing third party valuations?



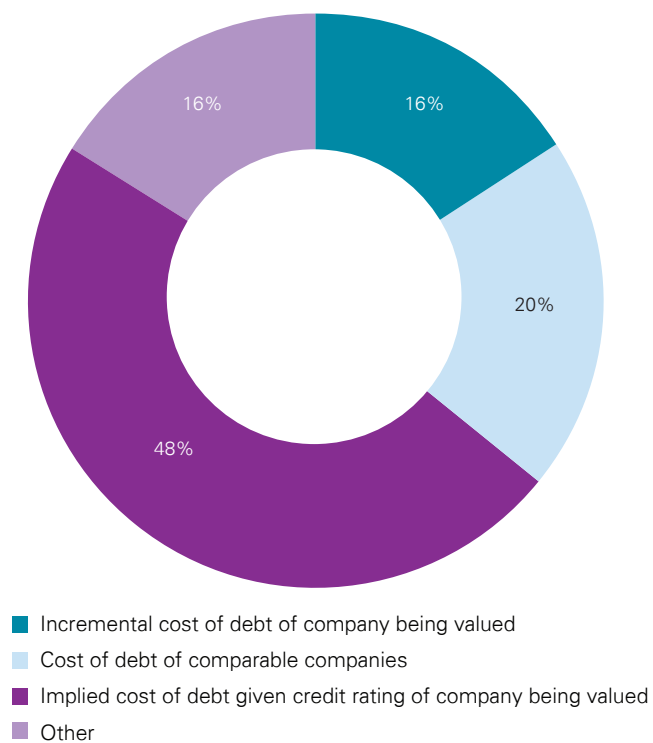
Other issues encountered by participants:

- Misunderstanding of basic concepts
- Errors with pre-tax and post-tax discount rates.
- Poor understanding of the nature of some risks.
- Incorrect use of most likely cash flows instead of expected cash flows.
- Poor understanding of standards of value.
- Related party transactions are not adequately reviewed

Relying on a company's credit worthiness

When it comes to working out the cost of debt in a given valuation, there are a number of methodologies that find favour. However, participants commonly (48 percent) choose to use the company's credit rating.

Figure 46: How do you determine the cost of debt for valuation purposes?



Other considerations by participants:

- All of the above
- Cost of debt for generic owner of set of assets

Section 18:

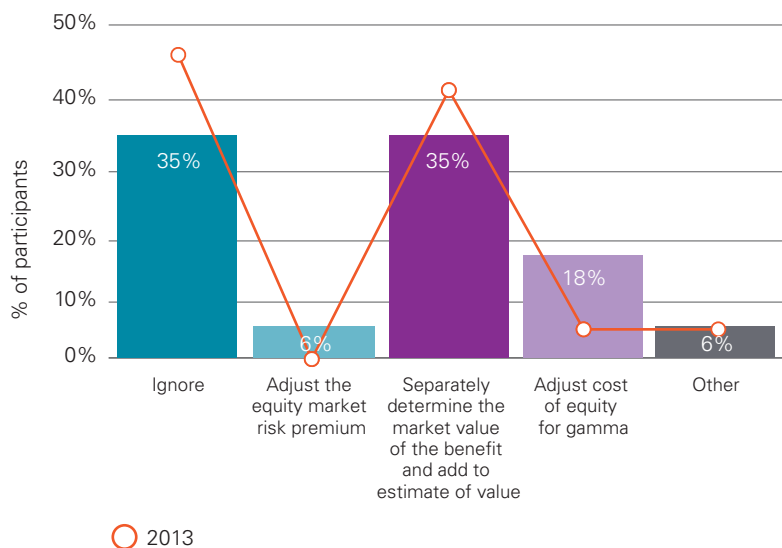
All about imputation credits

Regarding imputation credits

There is little sign of change in how participants choose to treat imputation credits when valuing a business. While 35 percent ignore them altogether, just as many separately determine the market value of the benefit and add this to the estimate of the value.

In direct contrast, infrastructure-related investments are treated quite differently. Very few (6 percent) ignore imputation credits, the sizeable majority (69 percent) choosing to include imputation credits attaching to dividends at an assumed utilisation rate.

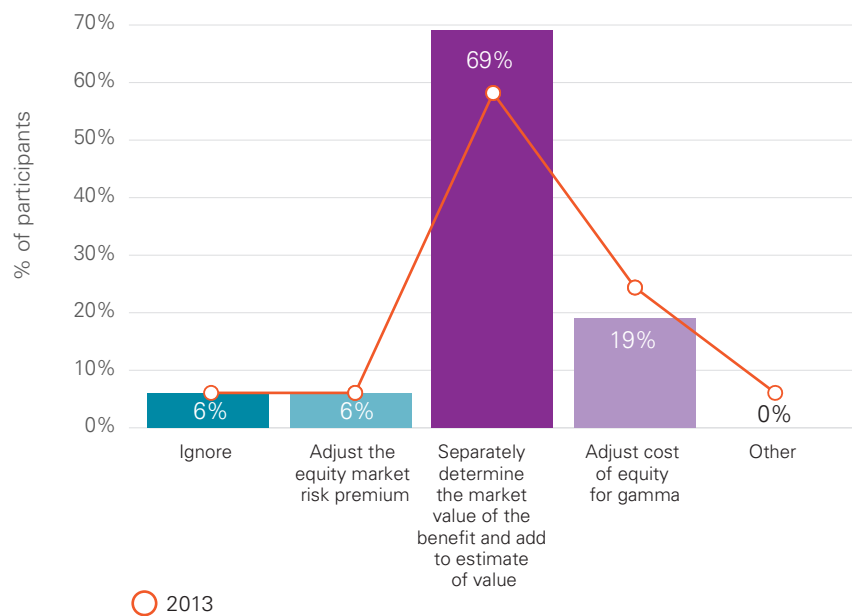
Figure 47: **Survey 2013/2015** – How do you treat imputation credits in business enterprise valuations (other than infrastructure investments)?



Other methodologies used by participants:

- Depends on the potential buyer

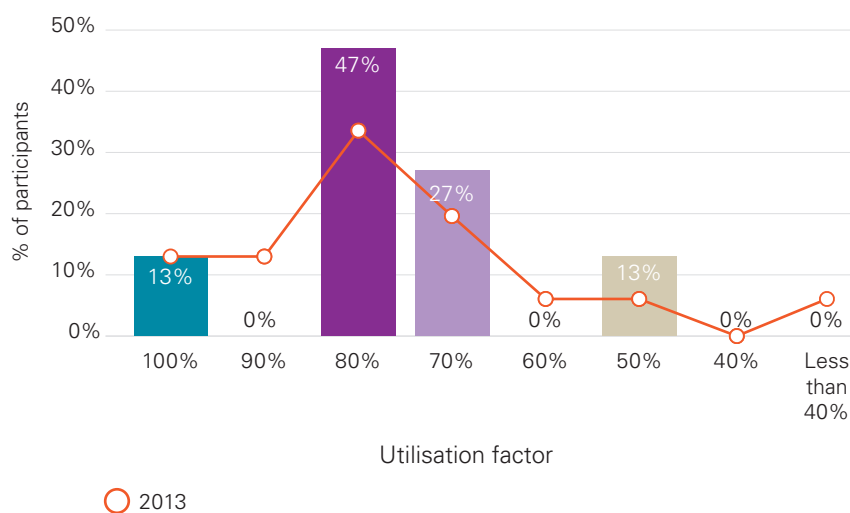
Figure 48: **Survey 2013/2015** – How do you treat imputation credits when valuing an infrastructure investment?



Making the most of franking credits

The survey shows some disparity regarding the utilisation rate of imputation credits. Nonetheless, similar to the 2013 survey, there is a clear concentration with 74 percent of participants using 70 – 80 percent of the benefit.

Figure 49: **Survey 2015** – Where imputation credits are included in the cash flows, what utilisation factor do you assume?





Section 19:

Introduction to real estate

Real Estate

Our inaugural real estate section provides some interesting insights. The survey was provided to a range of real estate advisors including valuers, investors and consultants. Fourteen real estate advisors completed the survey.

Key findings

It's all about capital and cash. Capitalisation and discounted cash flow approaches are the most utilised primary and secondary methods of valuation across all asset classes respectively. When adopting these approaches, valuers use excel-based models more than industry accept software. The cost of licenses for the software may be a reason for this, particularly for the smaller and independent practices. However, more likely is the need to factor in specific issues relating to an individual property, which may not be possible in the framework of a structured software program.

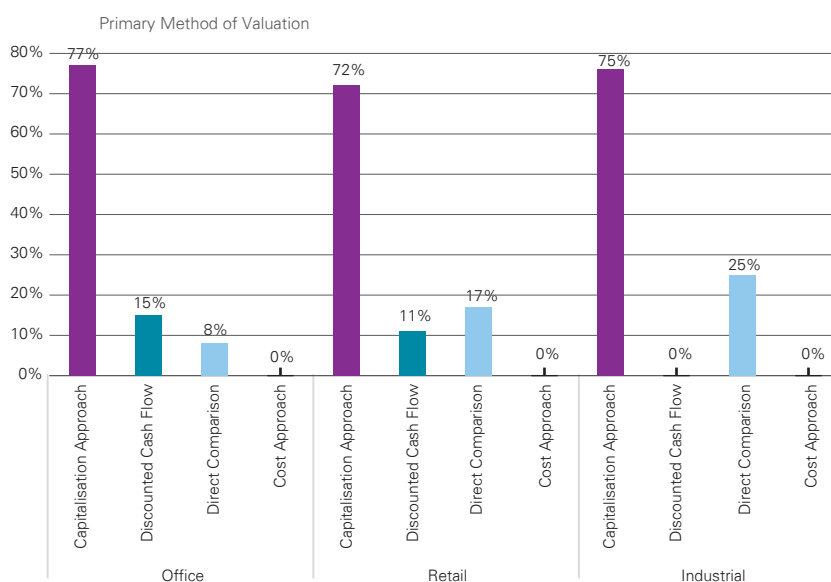
- **Adopting a standard approach to valuation.** Valuers generally adopt a similar approach to valuations across all asset classes. This includes:
 - *using 2 years of pending lease expiries to make capital adjustments*
 - *using 50 basis points difference between the capitalisation rate and terminal yield when using the DCF approach, and*
 - *waiting either one or more years between the revaluation of assets either for internal or external purposes, (although 2 or more years is considered more acceptable for external valuations).*
- **A buoyant real estate market.** The common view is that both sales and leasing activity has increased across all asset classes over the past 12 months. Valuers believe this trend will continue over the forthcoming 12-month period.
- **Steady returns to continue.** While an uplift in activity is welcomed by landlords/ investors, both leasing incentives and face rents have remained steady and valuers expect them to continue to do so over the next 12 months.
- **Yields on the decline.** Valuers believe yields have decreased across all asset classes in both the primary and secondary markets over the past 12 months and will continue to do so over the next year, albeit with variations between the asset classes. This means they have experienced growth in capital values and there is an expectation this will continue.

Section 20: Valuation methodologies

Deriving market value

The capitalisation approach is clearly the predominant method applied in deriving market value across all real estate asset classes.

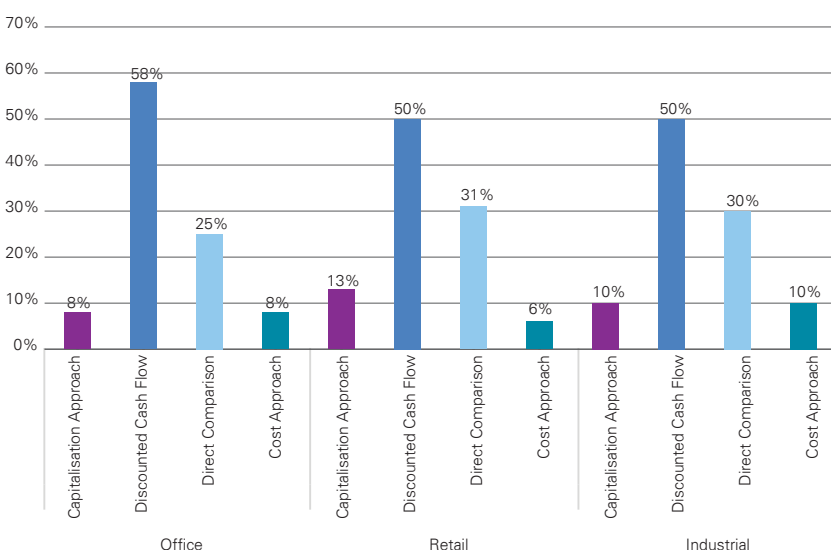
Figure 50: What are your most utilised primary methods of valuation?



Cash is important

The DCF approach is the second most preferred method applied in deriving market value across all real estate assets. This is followed by the direct comparison approach.

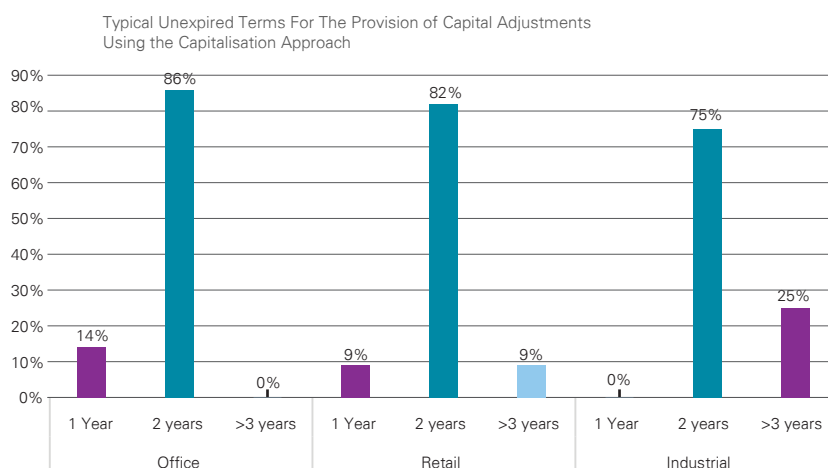
Figure 51: What are your most utilised secondary methods of valuation?



Consideration to capital adjustments

Our survey indicates that the majority of participants use 2 years of pending lease expiries to make capital adjustments for valuations across all sectors. Adjustments that extend beyond this time frame appear more prevalent in the industrial sector than in office or retail.

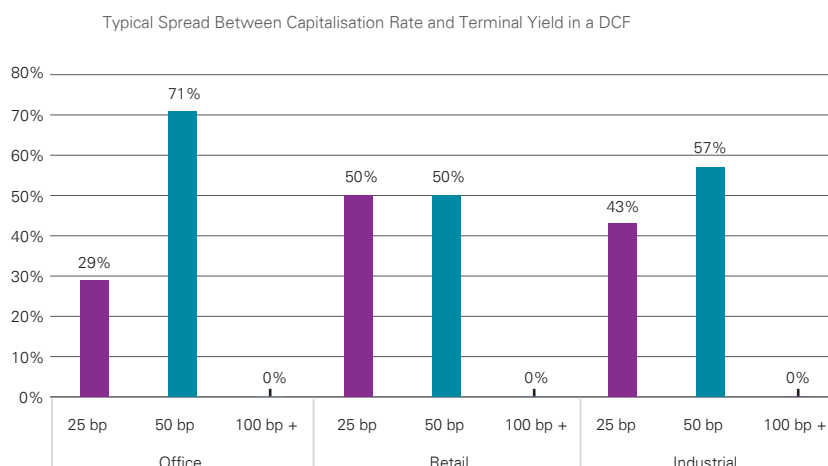
Figure 52: When using the capitalisation approach, within how many years of pending lease expiries do you typically make capital adjustments in the valuation?



50 bp the norm for DCFs

In all sectors, the majority of valuers use a 50 basis points difference between the capitalisation rate and terminal yield when adopting the DCF approach to valuation. While a smaller portion are happy to employ a 25 basis points difference, there is no support for 100 basis points.

Figure 53: When using the discounted cash flow approach, what is the typical spread between your capitalisation rate and terminal yield?

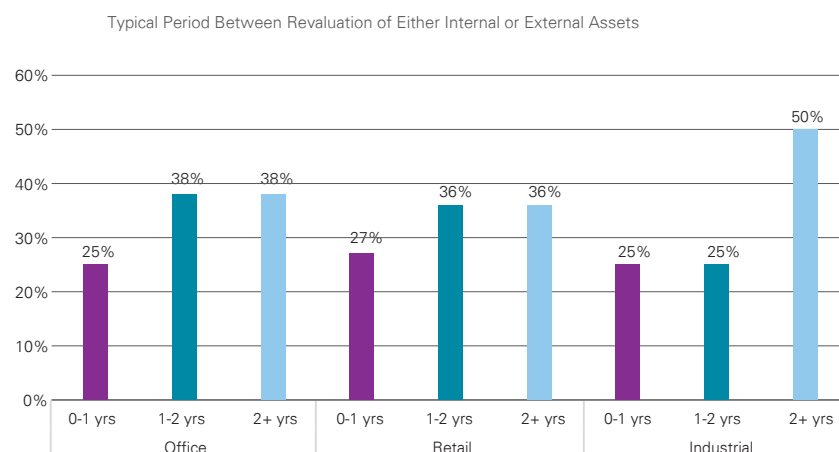


Section 21: Valuation cycle

A good time to revalue

The typical period between the revaluation of assets for either internal or external purposes is 1 or more years for office and retail assets and more than 2 years for industrial assets. However, some participants consider it necessary to carry out revaluations within 12 months of a previous valuation, across all asset classes.

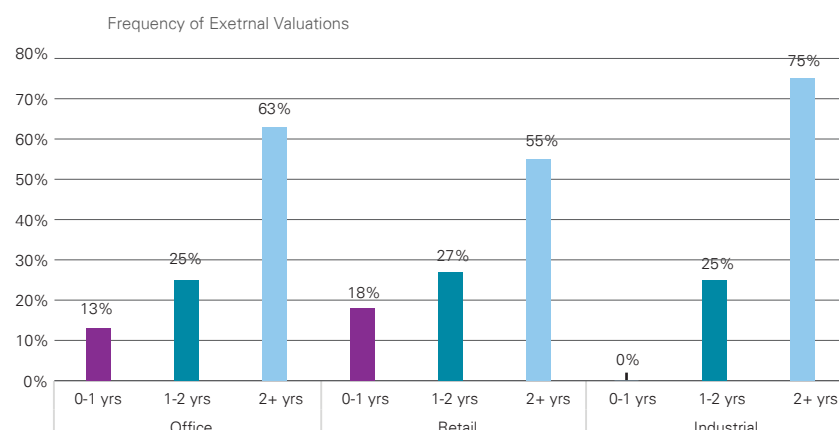
Figure 54: What is the typical period between revaluations of assets, whether it be internal or external?



The need for regular external valuations

Our survey shows that external valuations are required relatively frequently across the board. In all asset classes, they are overwhelmingly sought after 2 or more years.

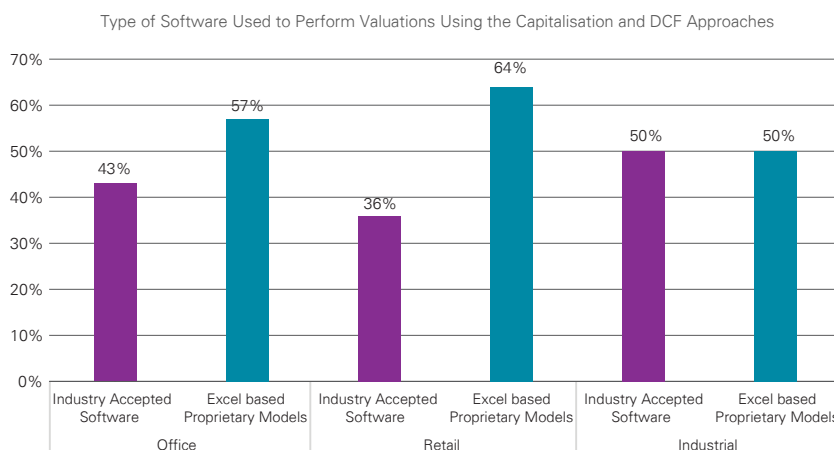
Figure 55: In your experience, how often are external valuations sought?



Excel leads the way in office and retail valuations

The survey findings show that a higher proportion of participants use excel-based proprietary models compared with industry accepted software when undertaking a valuation of either office or retail assets. As regards industrial assets, both are used equally.

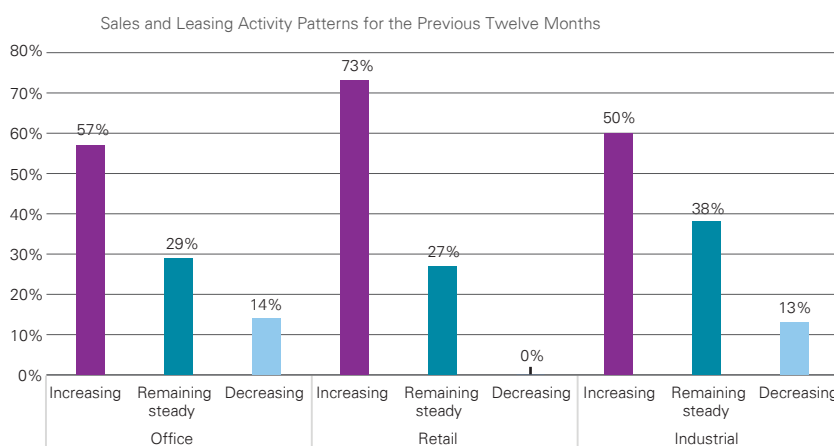
Figure 56: When applying the capitalisation approach and DCF approach, do you or your valuers use industry accepted software or excel based proprietary models?



Real estate remains active

The 2015 survey shows that participants have experienced an overwhelming increase in sales and leasing activity across all asset classes over the past 12 months. Only 14 percent experienced a decline in the Office sector, 13 percent in the Industrial sector, with no reported decline in the Retail sector.

Figure 57: How would you describe sales and leasing activity in your sector/s of expertise over the last 12 months?

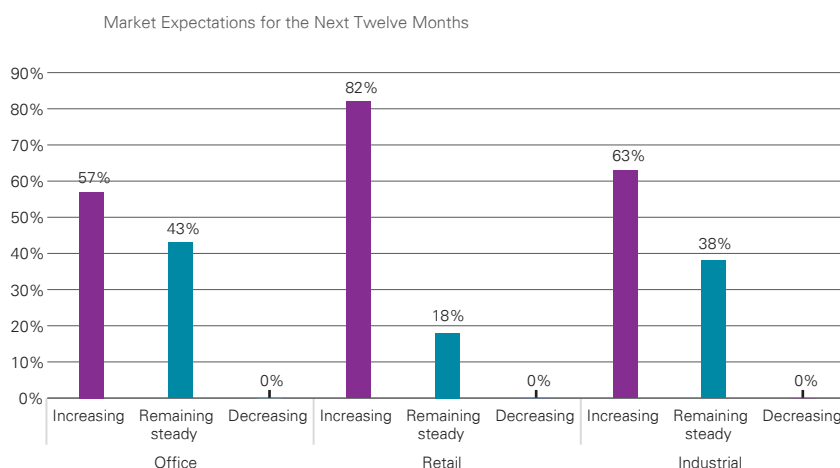


Section 22: Sales and leasing activity

Valuers confident market will continue to strengthen

A high proportion of participants continue to be bullish about all sectors of the real estate market, predicting a continued rise in sales and leasing activity over the next 12 months.

Figure 58: Where do you see sales and leasing activity moving in the next 12 months?



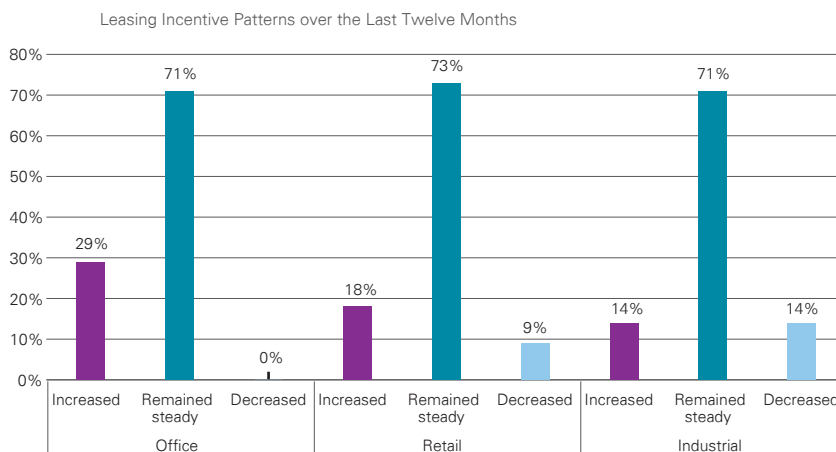
Section 23:

Leasing incentives

No change to leasing incentives

The survey findings show that leasing incentives have mostly remained steady over the past 12 months across all asset types.

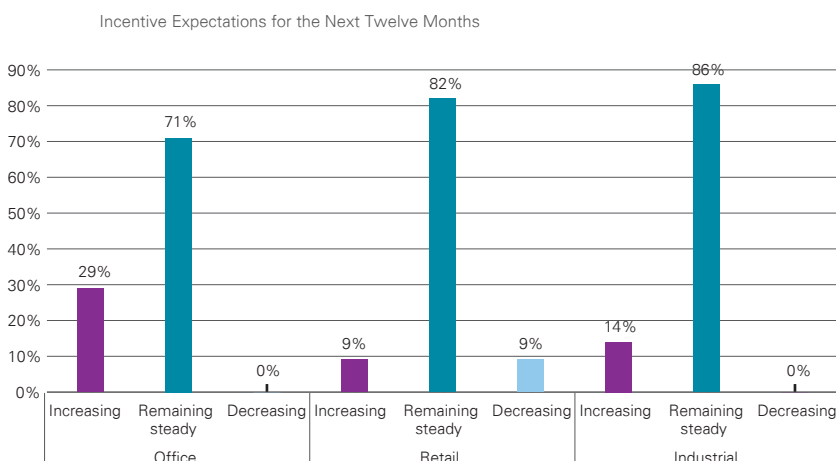
Figure 59: How have leasing incentives changed in your specific sector over the last 12 months?



More of the same

Similar to the previous period, participants expect incentives to remain steady across all asset classes over the next 12 months.

Figure 60: What are your expectations in respect of leasing incentives in the next 12 months?

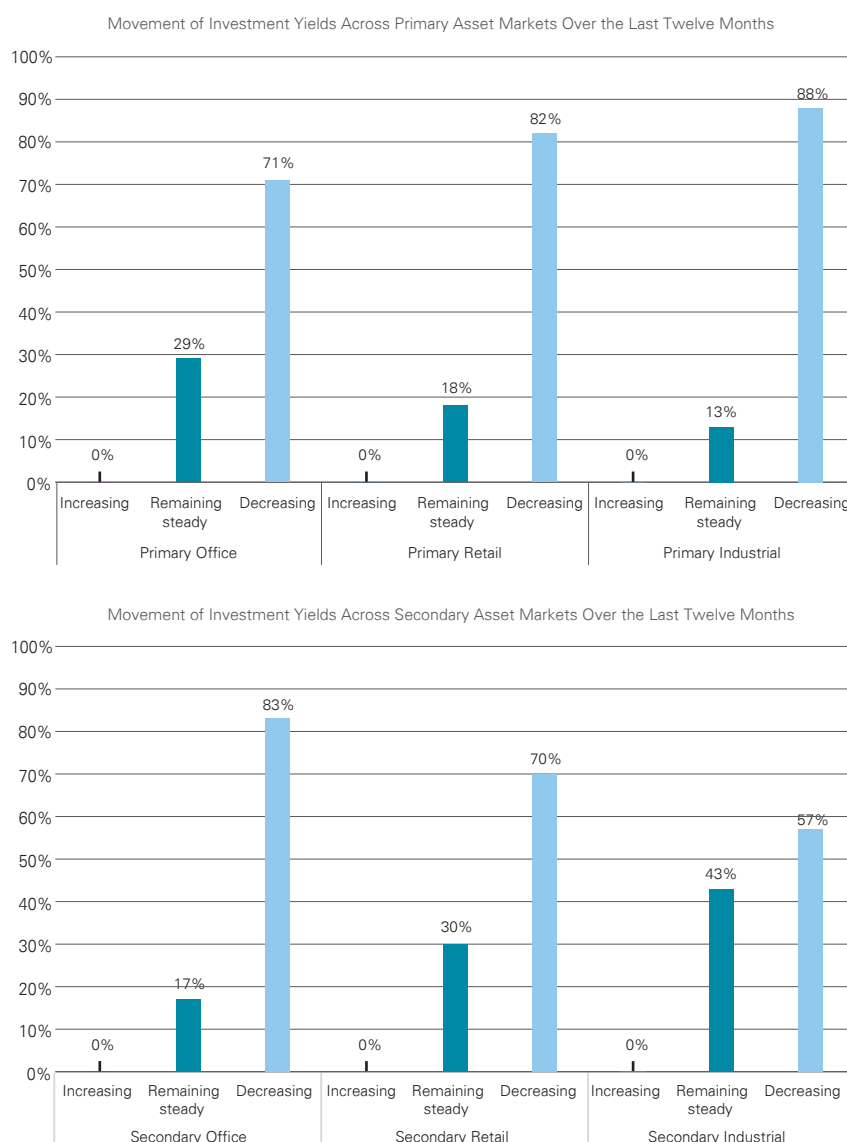


Section 24: Yields

Yields take a dip

In the main, participants have witnessed yields decrease across both primary and secondary asset markets over the past 12 months.

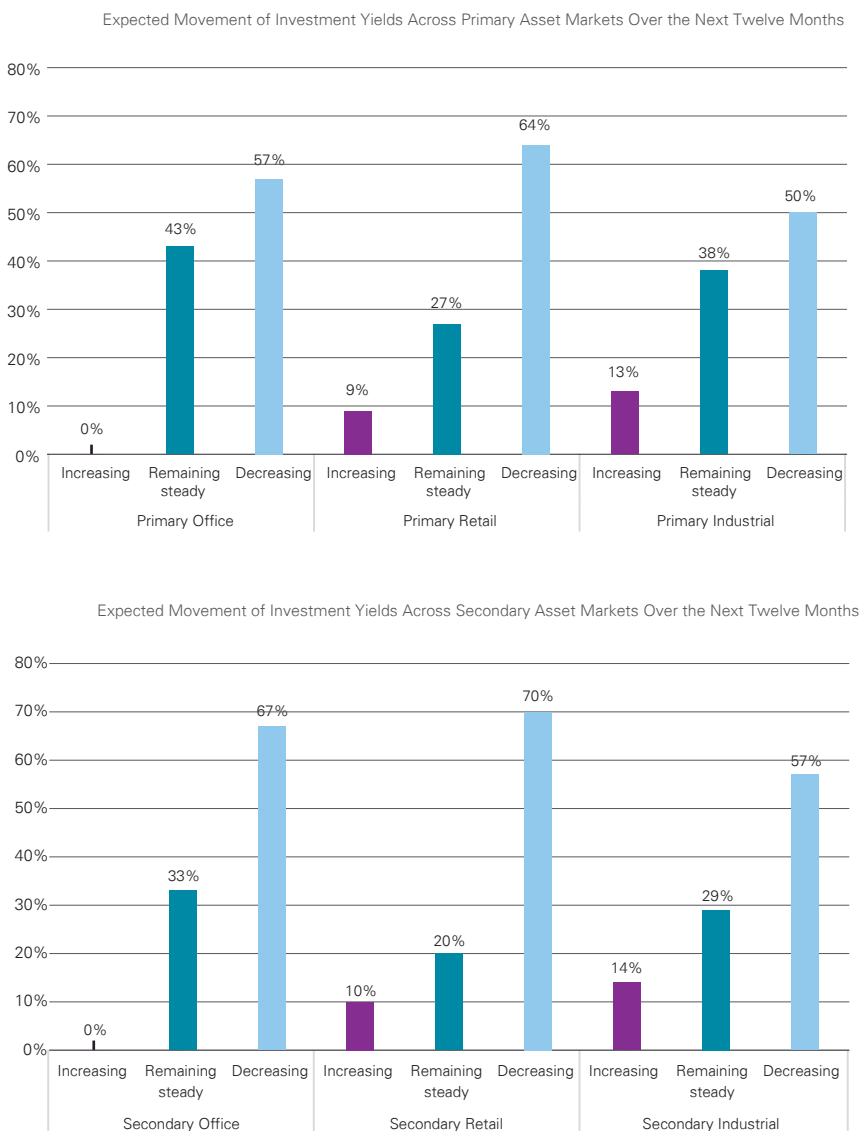
Figure 61: Where have you seen investment yields moving across both primary and secondary markets in the last 12 months?



Low expectations for yields

Similar to the previous 12 months, most participants expect yields to continue their decline across both primary and secondary asset classes over the next 12 months. However, a small proportion believe the retail and industrial markets will not perform as well as the office market.

Figure 62: Where do you see investment yields moving in both primary and secondary markets in the next 12 months?

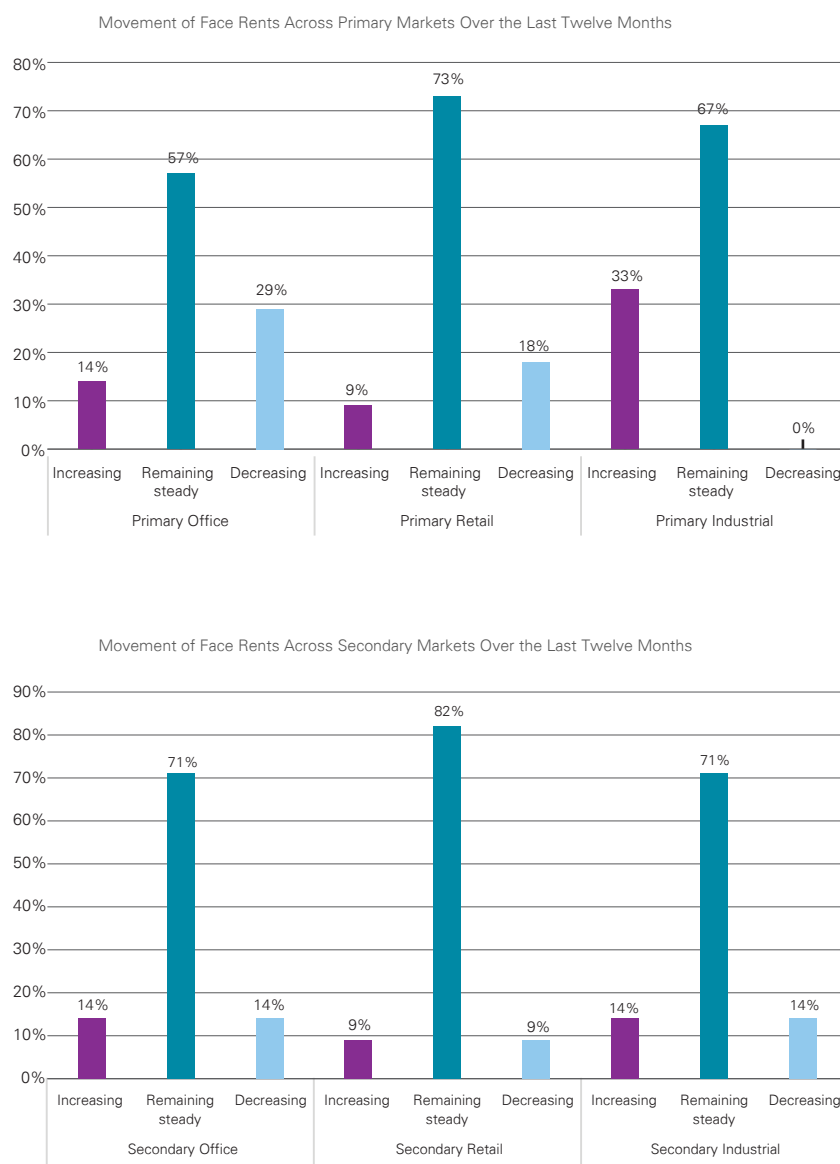


Section 25: Rent

Stable face rents

According to the survey's participants, face rents have largely remained steady across both primary and secondary markets for all asset classes over the past 12 months.

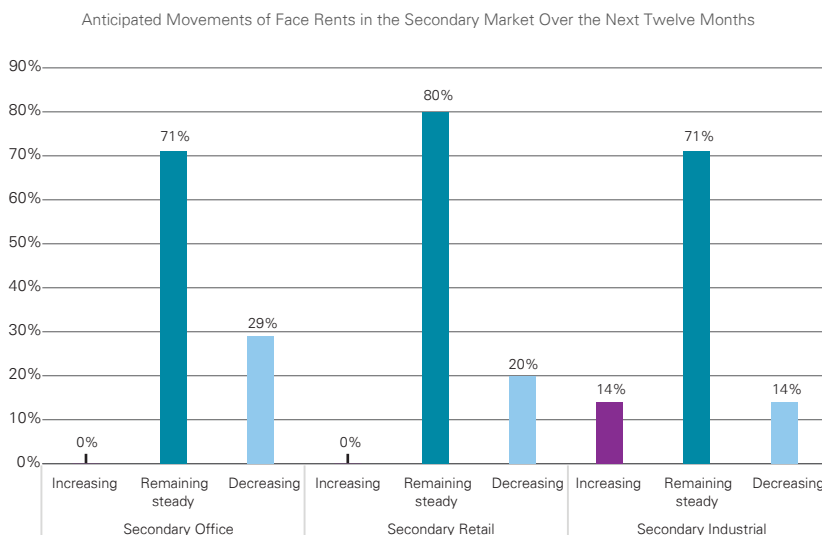
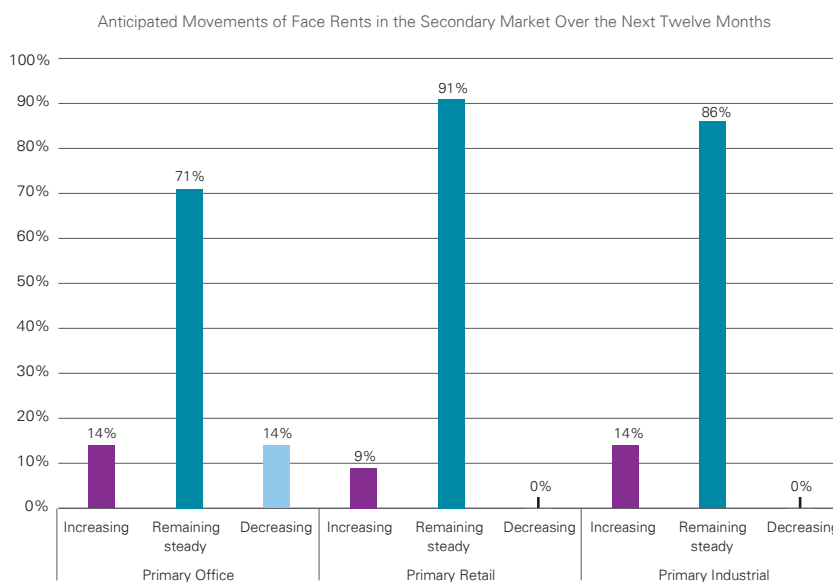
Figure 63: Where have you seen face rents moving across both primary and secondary markets in the last 12 months?



No about face for rents

Face rents are expected to remain steady across both primary and secondary markets in relation to all property classes over the next 12 months.

Figure 64: Where do you see face rents moving in both primary and secondary markets in the next 12 months?





Section 26:

Introduction to tangible assets

Tangible Assets

This second Valuation Practices Survey extends its reach to tangible assets. Once again, the findings are revealing, offering unique insights for practitioners and clients alike. Nine tangible asset valuers completed the survey.

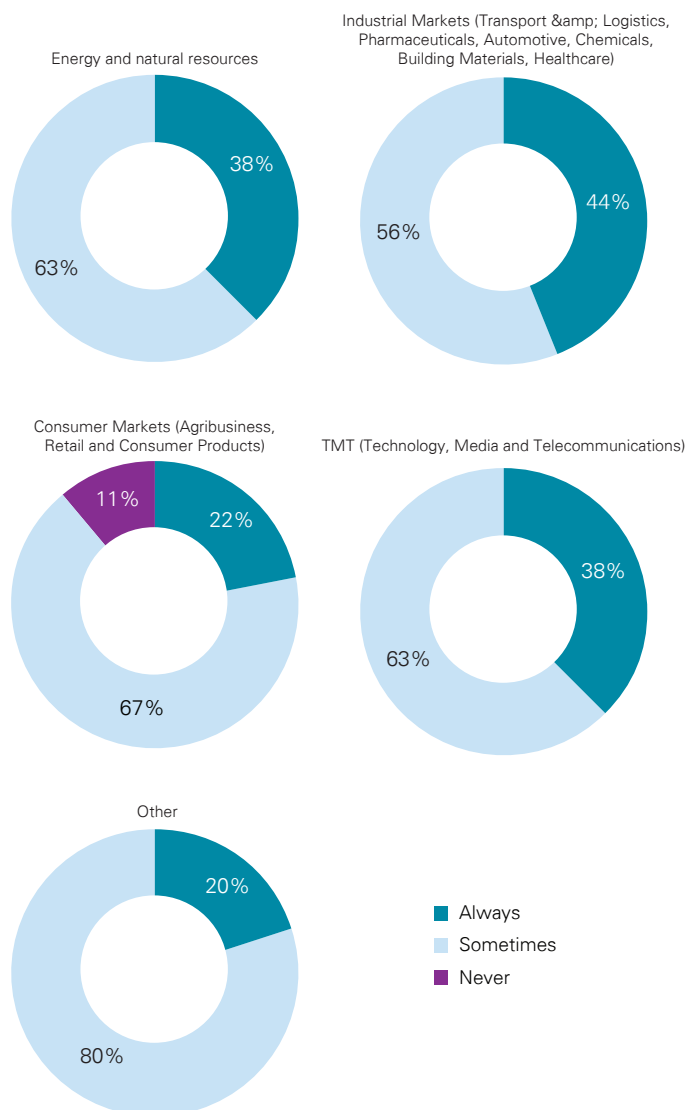
Key insights

- **The usual suspects.** With a financial year characterised by no 'extraordinary' tax and accounting requirements or regulations, participants indicate that they performed valuations in a variety of sectors and industries. All of them were exposed to the lead sectors of our region such as energy and natural resources, industrial markets and telecommunications.
- **Hundred percent.** We found that all participants use a combination of indirect and direct approaches in performing their valuations.
- **Digging for data.** More than 80 percent of the participants are doing research to determine the most appropriate useful/economical life of their assets. As such, about 27 percent rely on client information, 23 percent engage external technical people and about 31 percent use data from previous engagements. Only 15 percent rely solely on publications.
- **Need for funding?** Of the participants, 66 percent do not usually include finance costs, in addition to all direct and indirect costs, when building a full replacement cost new estimate.
- **Try to optimise.** About 86 percent of the participants often apply optimisation adjustments during replacement cost analyses. For example, they optimise the number of assembly lines or entire network of assets. The remaining 14 percent apply them in every engagement.
- **Cost to capacity.** About 43 percent of the participants use the 0.6 exponent factor in utility/cost to capacity calculations in lieu of supporting information/benchmarks. The remaining 57 percent rarely or never use this kind of calculation.
- **Never old enough.** Of the participants, 67 percent indicate they prefer to extend the Normal Useful Life (NUL) rather than the Remaining Useful Life (RUL) when considering a long life asset that is already in excess of its NUL but still in good condition.

Business as usual

Last year, no particular sector dominated the market, according to the survey's findings. All the participants performed work for clients in different industries and were exposed to multiple sectors over the past 12 months. This factor highlights and is symptomatic of a financial year characterised by no external requirement or regulation for tax or accounting compliance.

Figure 65: Which of the following sectors do you frequently work in?

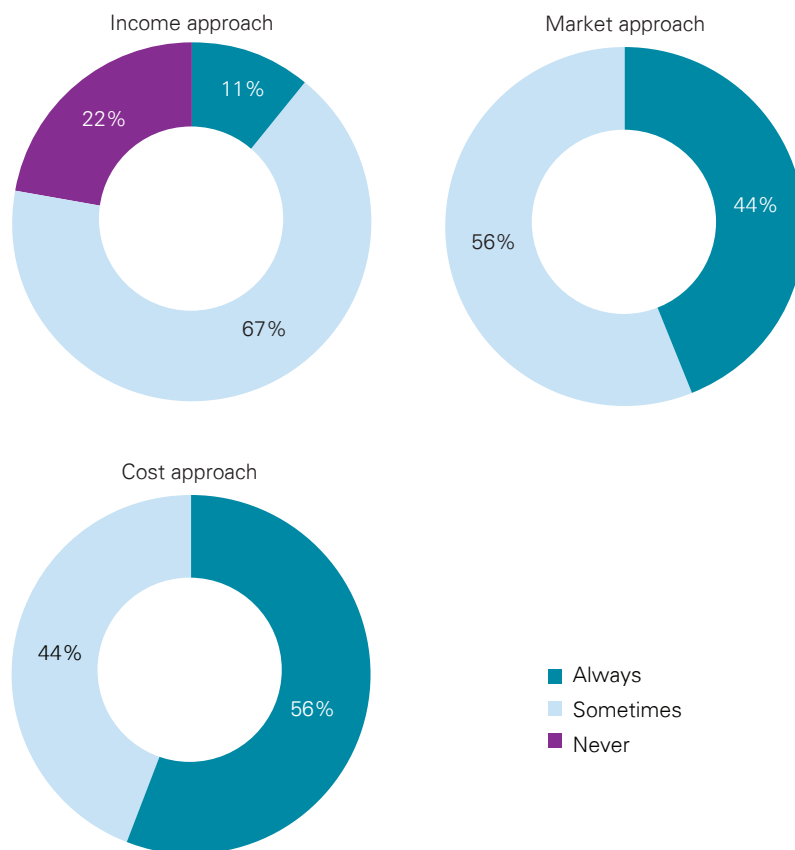


Section 27: Valuation methodologies

Market, cost and...

The survey shows that the market and cost approaches are the most commonly adopted methodologies to value tangible assets. However, the majority of the participants indicate they sometimes also consider and/or utilise the income approach to perform their valuations.

Figure 66: Which of the following methodologies does your firm frequently employ when conducting valuation analysis?



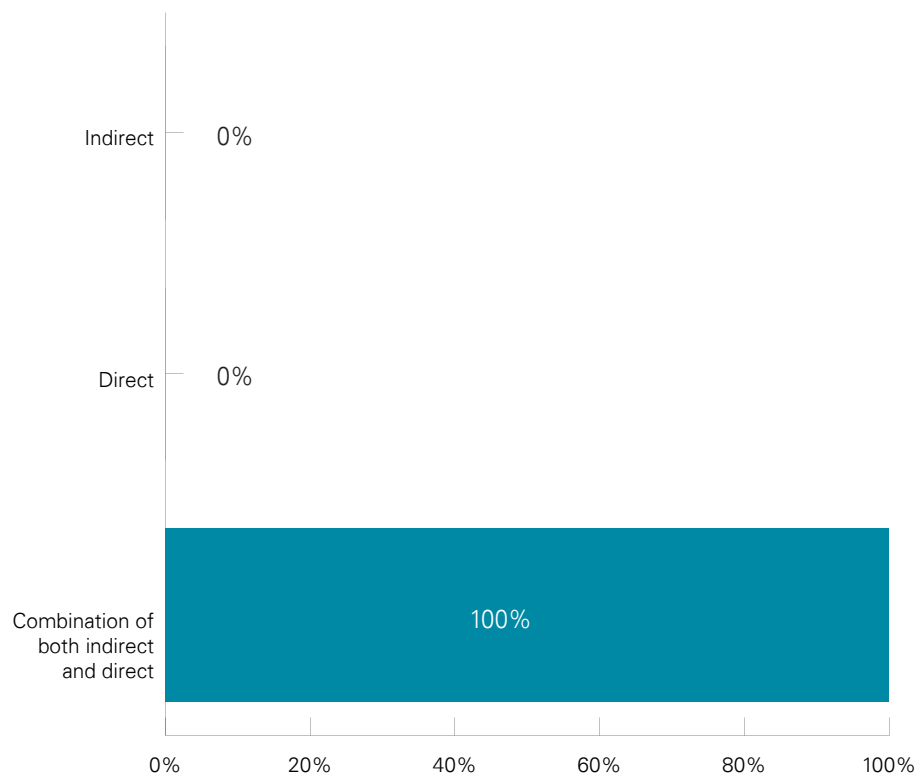
Section 28:

Cost approach

Comfort in the accounting data

The Fixed Asset Register (FAR) is the first reference point for all the participants. When they apply the cost approach, the indirect approach is always used as a comparison to the direct approach. On the other hand, when participants review a third party valuation, they complain about extensive use of the indirect method and of relying on FARs that are deemed inaccurate.

Figure 67: When applying cost approach, which is more commonly used?



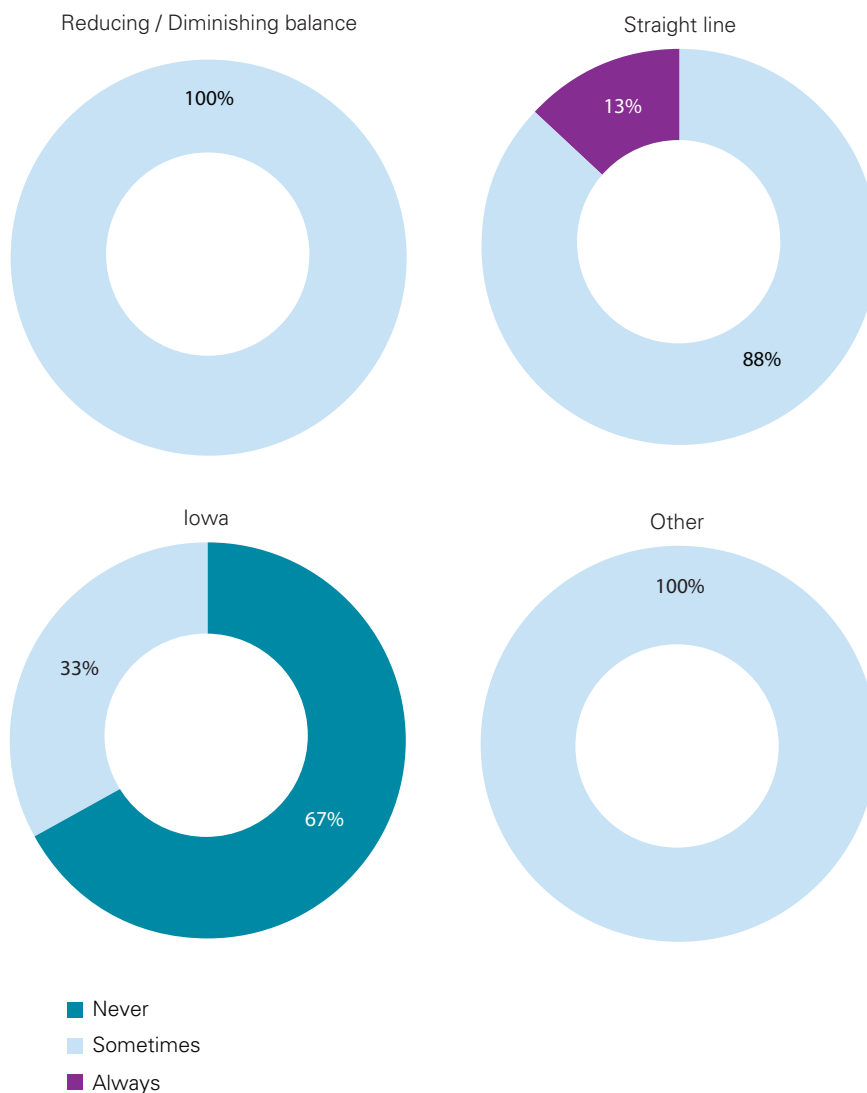
Section 29:

Depreciation profiles

Keen to use market based depreciation methods

The straight line and the diminishing value are the most commonly used depreciation profiles. However, if possible, all the participants are keen to use depreciation methods based on market based observations. These may include units of production and condition adjusted depreciation, sums of the years' digits, among others.

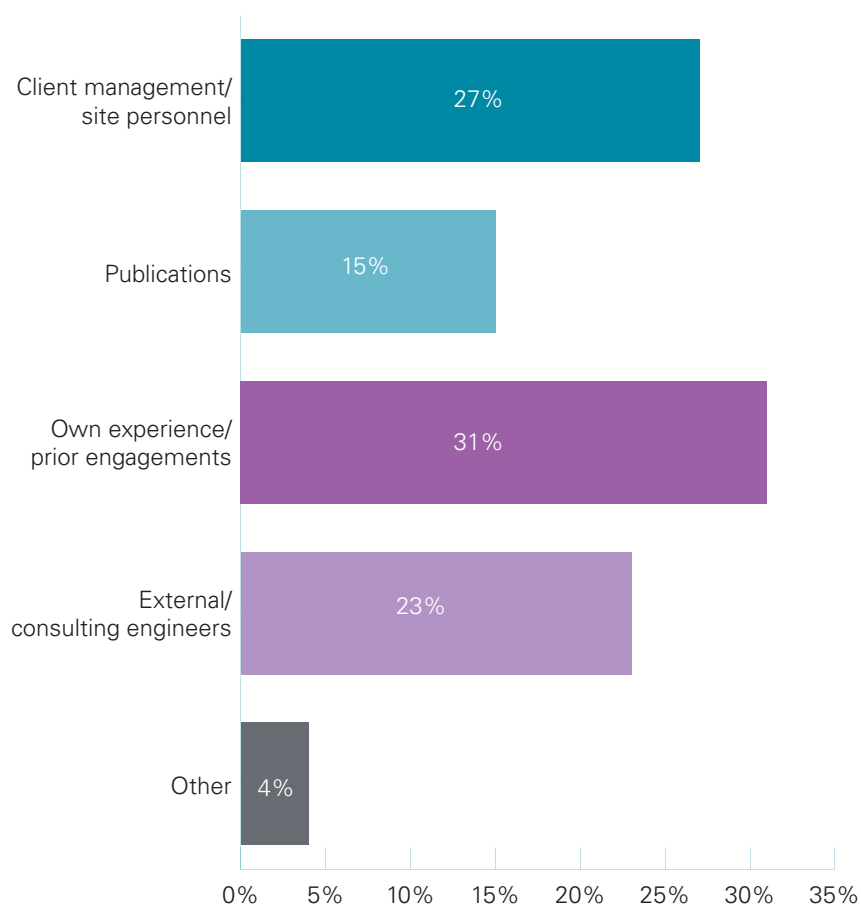
Figure 68: Which of the following depreciation profiles do you frequently use?



Life experiences

There are different factors influencing an asset's life, its ultimate length depending on the mechanical efficiency, technological potential and commercial adequacy of the product. The survey participants are most likely to draw on their own experience to determine the useful life of data rather than turning to the taxation or accounting rulings that may or may not appropriately reflect the technical/economic lives of the assets.

Figure 69: Where do you often source your normal useful life data?





Section 30:

Replacement cost considerations

Not everything black on white

The findings show participants investigate and determine the life of assets from a variety of sources including sector experts, client management/site personnel and external/consulting engineers. They do not solely rely on data from publications such as American Society of Appraisers, Marshall and Swift, and Australian Taxation Office publications.

Figure 70: Where do you often source RCN data?

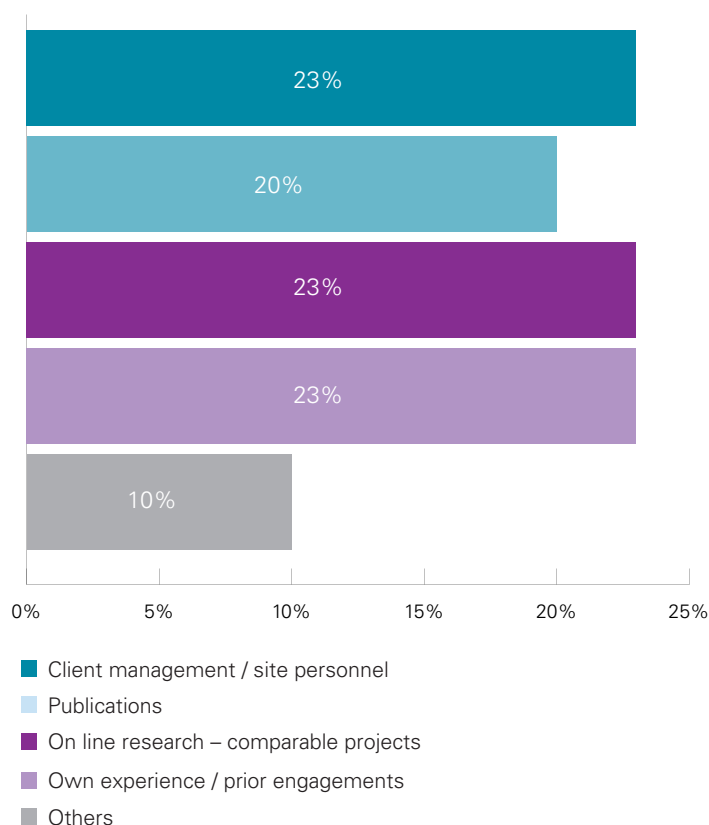
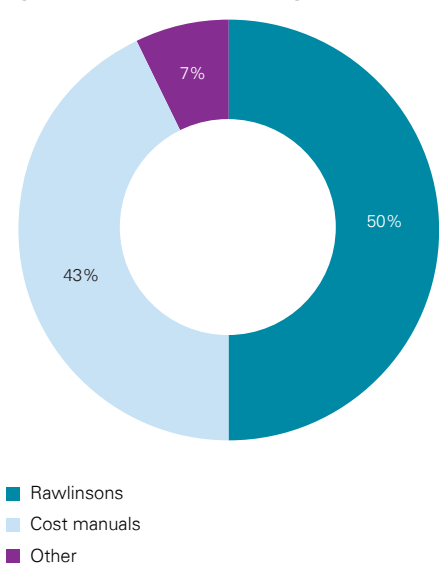


Figure 71: Publications being consulted



Financing the project

The International Valuations Standards Council (IVSC) guidelines allow for finance costs and interest during construction to be calculated using typical debt to equity ratios, cost of debt, and draw down schedules over the construction period. The participants indicate that they do not usually consider these costs in their valuations.

Figure 72: Do you typically include finance costs in addition to all direct and indirect costs when building a full replacement cost new estimate?

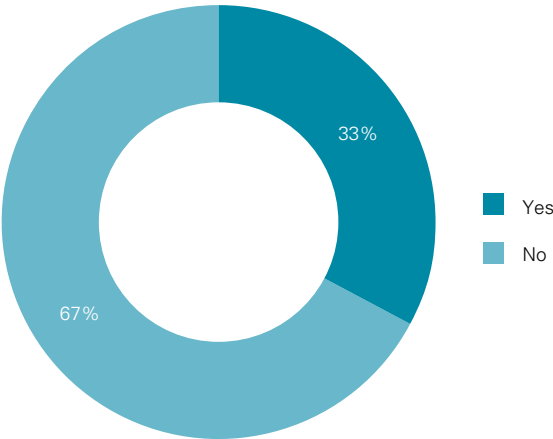


Figure 73: When considering application of finance costs, do you typically apply these when the project construction time is?

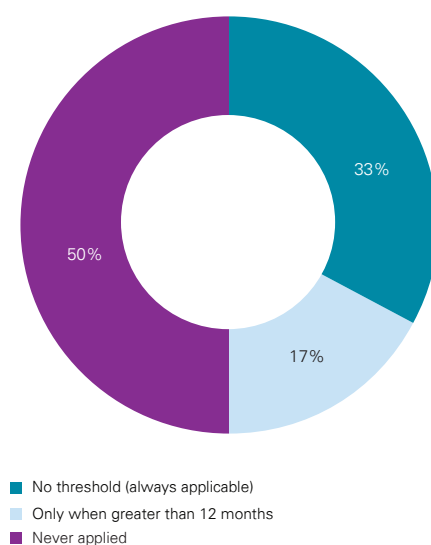
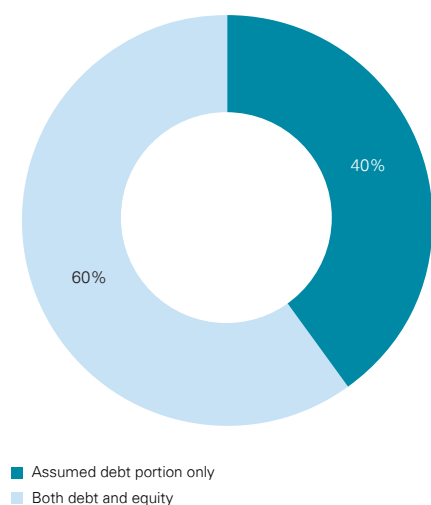


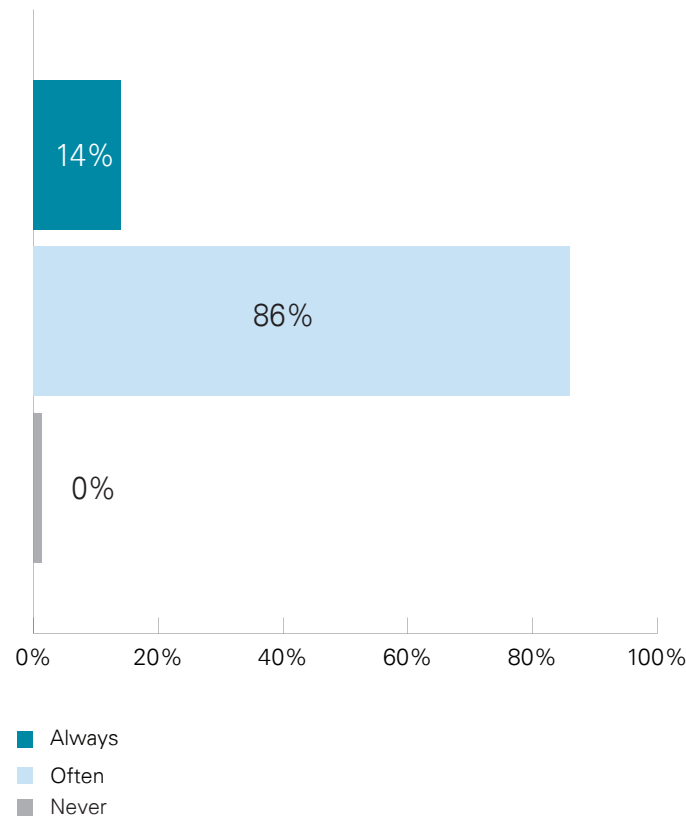
Figure 74: Do you consider interest during construction applicable to the portion of the total construction cost that would be funded by?



Optimising the cost

The survey findings highlight the fact that research and/or other sources are not the most accurate starting points when trying to determine the cost of replacing something new. Often – if not always – participants need to apply optimisation adjustments during replacement cost analyses, for example, by optimising the number of assembly lines or entire network of assets (that is, by reconfiguring them).

Figure 75: How often do you apply optimisation adjustments during replacement cost analyses e.g. optimise number of assembly lines or entire network of assets?



EPCM

The survey provides evidence that participants use Engineering Procurement Construction Management (EPCM) in a consistent manner throughout different sectors and industries.

Figure 76: Please indicate typical EPCM estimates for P&E in the following sectors:

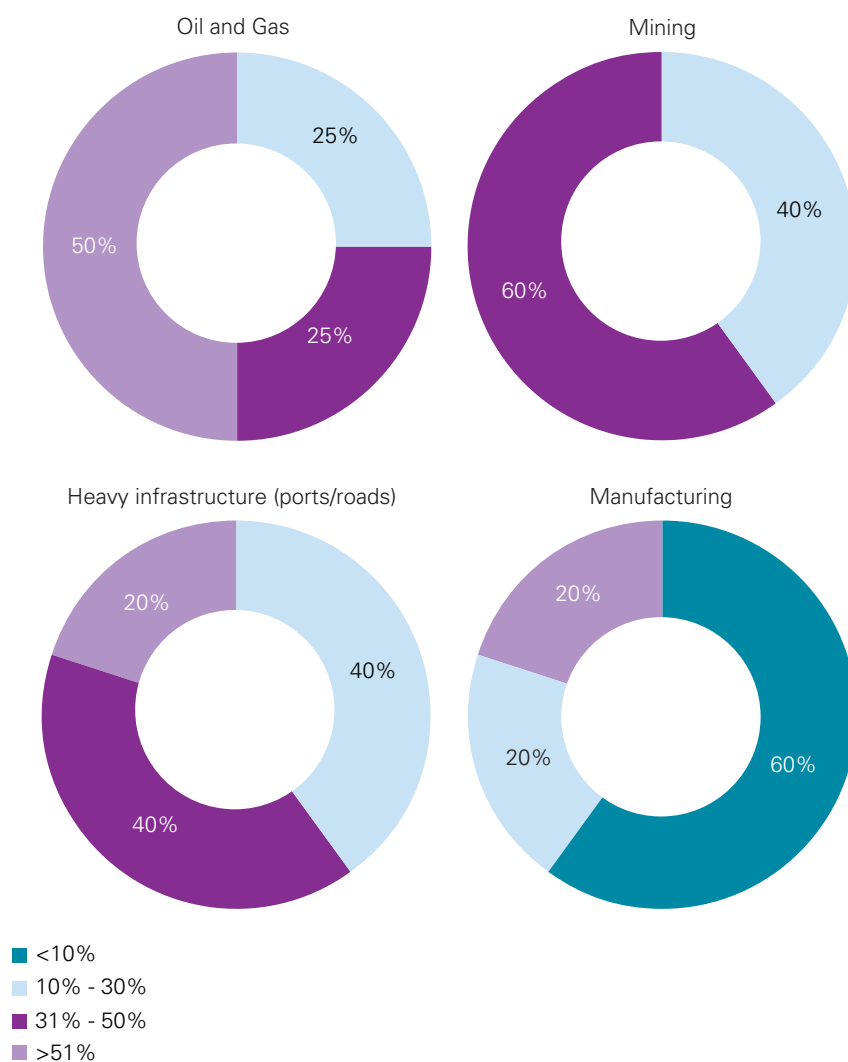
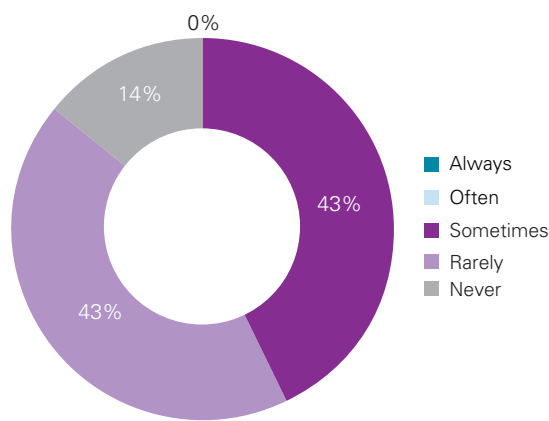


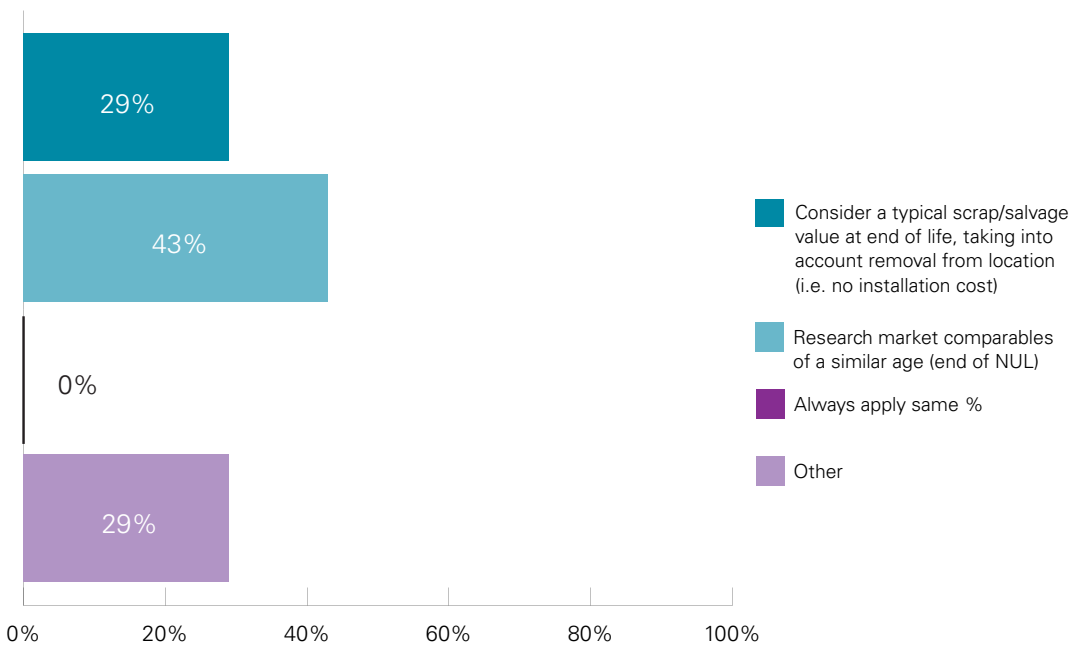
Figure 77: Cost to capacity estimates are often used in lieu of supporting information/benchmarks, how often do you use the 0.6 exponent factor for inutility/cost to capacity calculations?



Salvaging value

When considering residual values applied to certain asset classes, the majority of participants research market comparables of a similar age and/or consider a typical scrap/salvage value at end of life, taking into account its removal from the location.

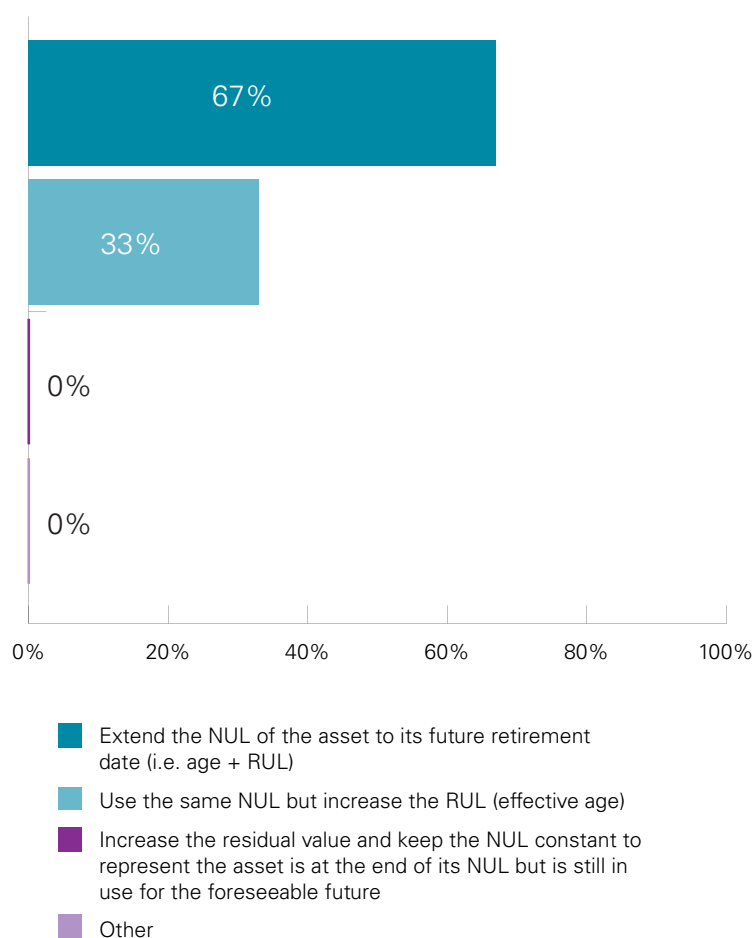
Figure 78: When considering residual values applied to certain asset classes do you:



Long life assets

When considering a long life asset that is already in excess of its NUL and has all engineering records showing it is likely to continue in use for the foreseeable future without any significant capital expenditures (capex), participants consider two options. Most (67 percent) prefer to extend the NUL of the asset to its future retirement date (i.e. age + RUL); the remainder choose to use the same NUL but increase the RUL (the effective age). They do not use any other type of adjustment.

Figure 79: If you considered a long life asset that is already in excess of its NUL, however, all engineering records show that the item is likely to continue in use for the foreseeable future without any significant capex. Would your preferred methodology be?



Functional obsolescence

The survey’s participants are consistent in the approach they take to assessing functional/technological obsolescence as regards utility analysis, net present value (NPV) of excess operating costs, and where the assumption is that the replacement cost captures any adjustments. They did not highlight any particular situation that gives rise to functional obsolescence.

Figure 80: Which of the following approaches do you frequently use to assess functional/technological obsolescence?

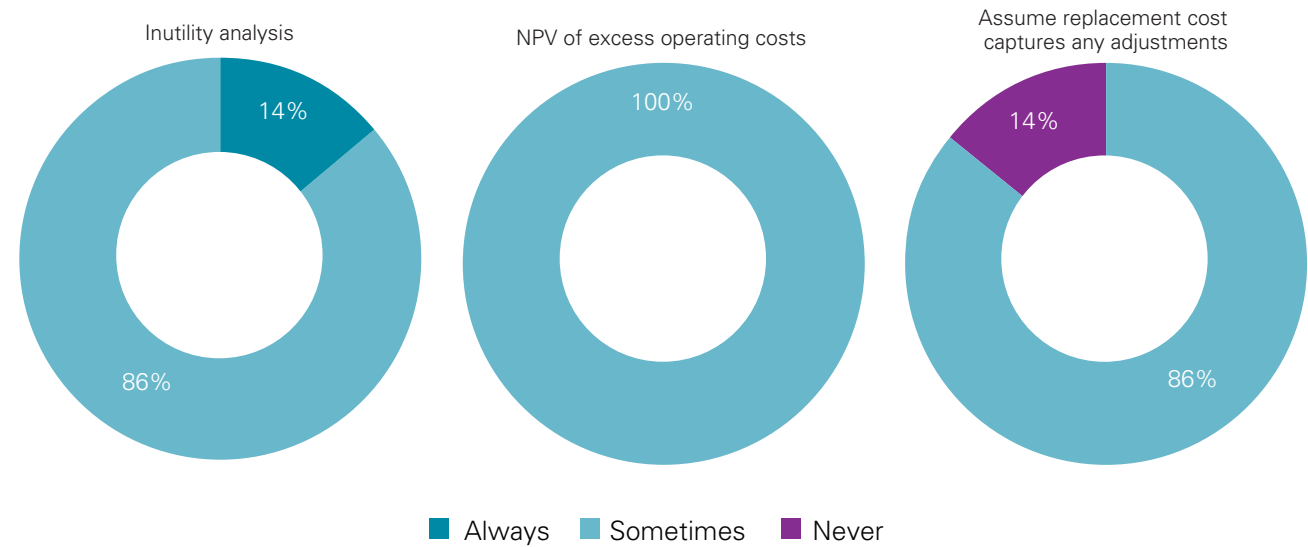
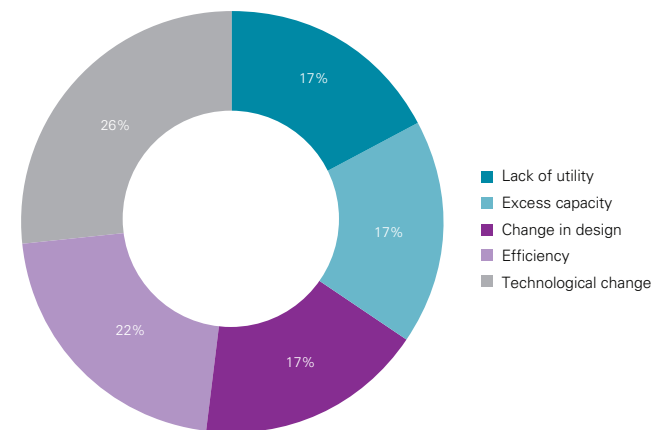


Figure 81: From your experience over the last 12 months, which of the following situations have given rise to functional obsolescence?



Assessing economic obsolescence

The survey participants equally favour inutility analysis, overall profitability of cost generating units (CGU)/business (enterprise value), and market sample/evidence vs. depreciated replacement cost (DRC) when determining any form of economic obsolescence.

Figure 82: What approach or approaches do you most commonly use to assess economic obsolescence?

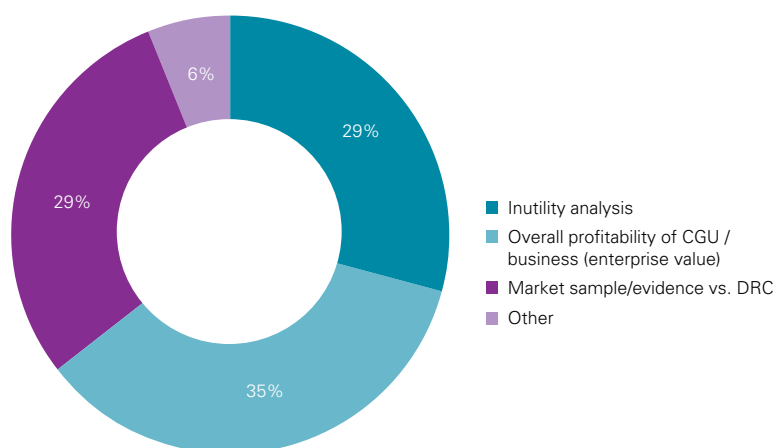
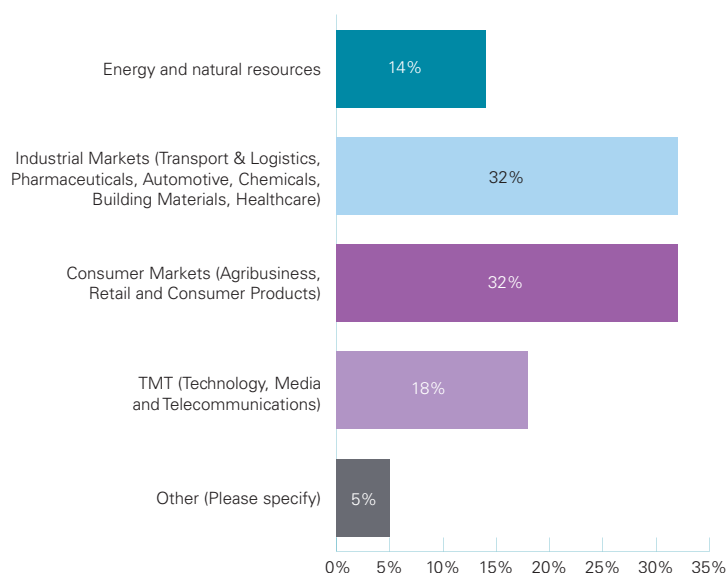


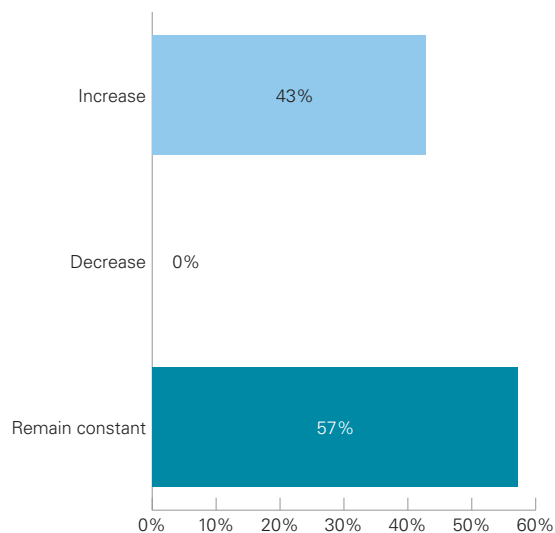
Figure 83: Over the last 12 months, which sectors have assets that required economic obsolescence adjustments?



Future economic expectations

Based on their recent experiences and discussions with the management of different companies they have worked for, all plant and machinery (P&M) participants expect economic obsolescence related issues (in general) to either increase or remain constant over the next 3 years.

Figure 84: Do you expect economic obsolescence related issues (in general) to increase, decrease or remain constant over the next 3 years?



Believe it only if you see it

The majority of participants attribute great importance to the site visit. They consider that the inspection of a single site should cover at least 50 percent of the value of the assets, while in the case of multiple sites, they indicate that a participant should visit more than 50 percent of them. Fourteen percent of participants underline insufficient site visit sampling as an issue.

Figure 85: What percentage of value capture is considered reasonable for a site inspection (single site)?

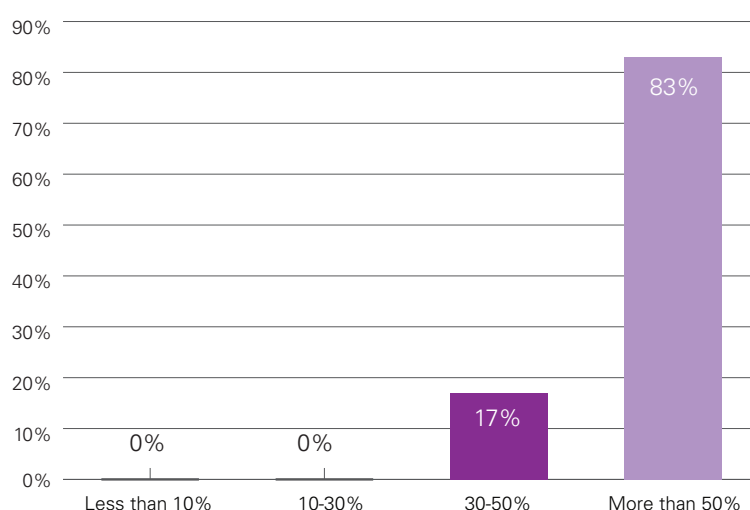
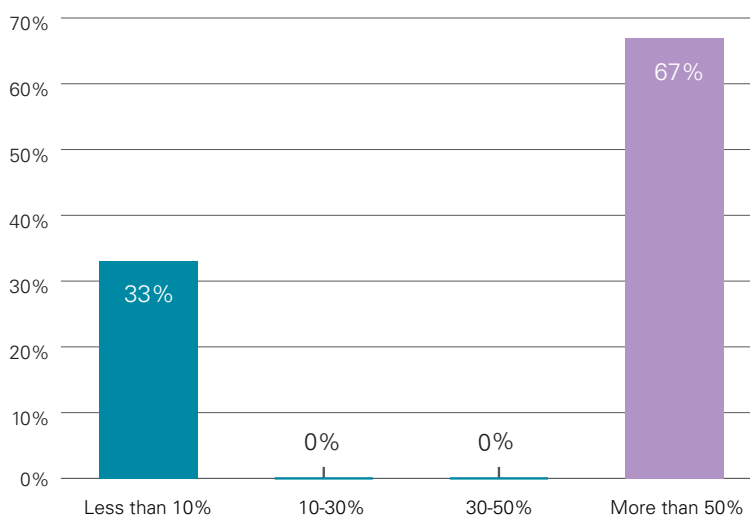


Figure 86: For multiple site/large portfolio engagements what size of site inspection sample is considered reasonable (as percentage of Cost/NBV)?



Making it immediately clear

The trend shows participants are concerned by the lack of the information and disclosures in reports. On the issue of reviewing third party valuations, one comment made was that while they find the participants have completed an adequate process, the report fails to document the matters considered, assumptions and judgments made.

Figure 87: What are the most common issues encountered during the review of third party valuations?

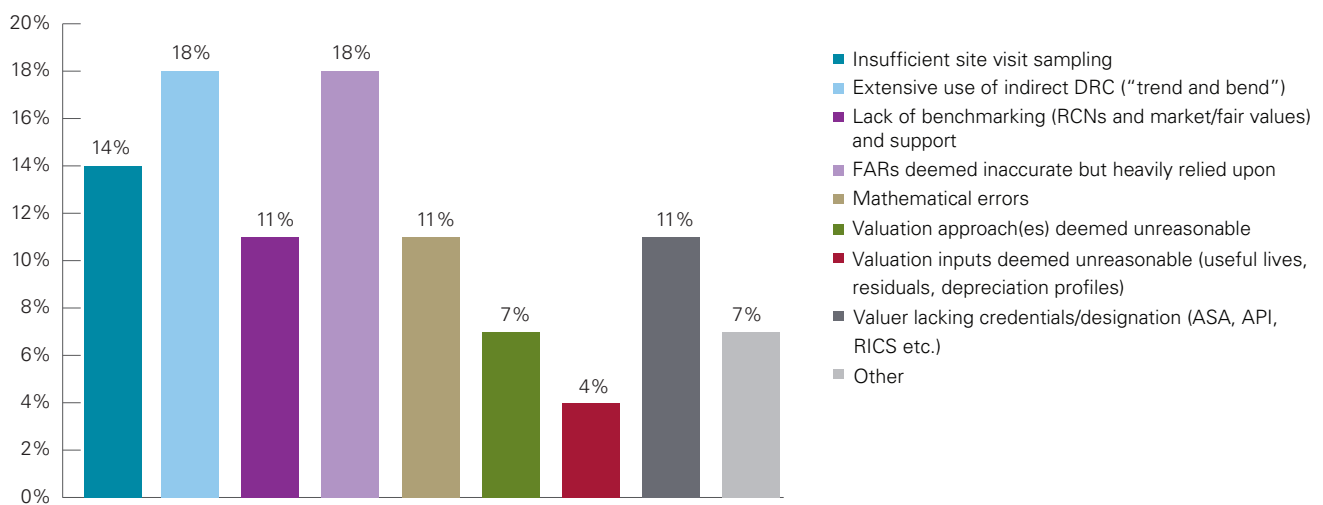
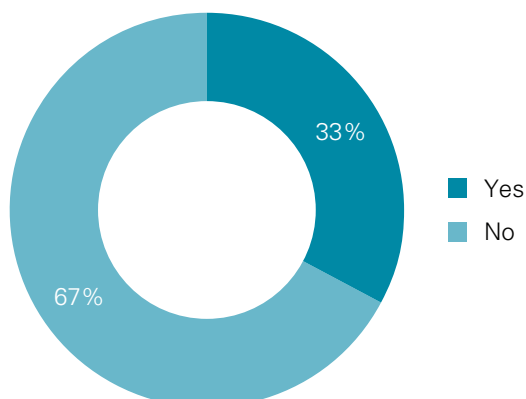


Figure 88: Have you seen recent scenarios where P&E fair value for accounting purposes differed significantly from market value for tax purposes (stamp duty, tax consolidation etc.)



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