

# VALENS RESEARCH



## The Roots of Value and Value Creation

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January 2017

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Plans

Actions

Results

Forecasts

Plans

Actions

Results

Forecasts

Strategy

Execution

Performance

Valuation

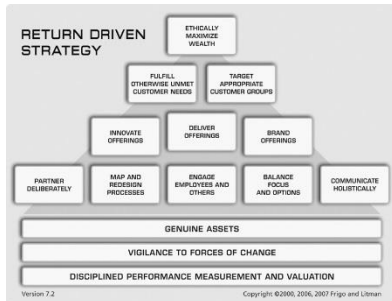
## Plans

## Actions

## Results

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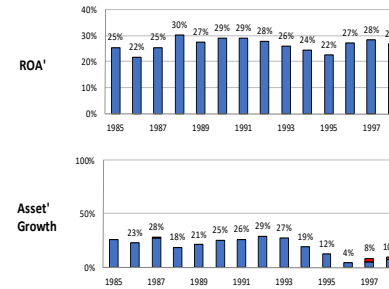
### Strategy



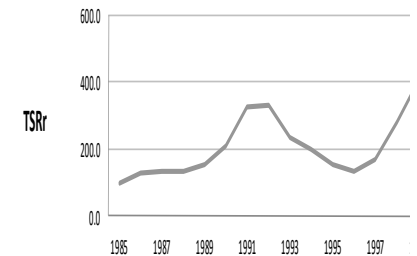
### Execution



### Performance

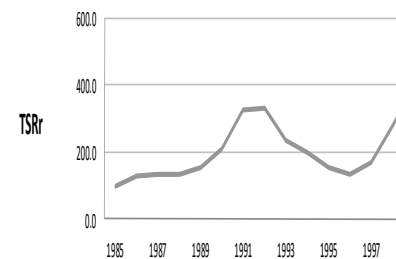


### Valuation



## Forecasts

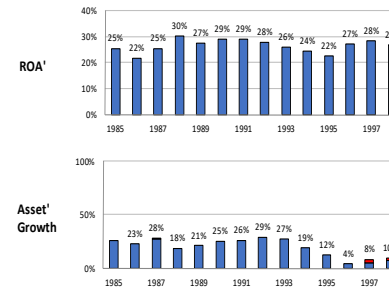
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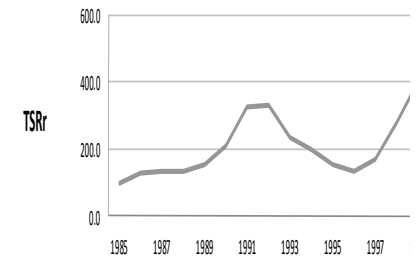
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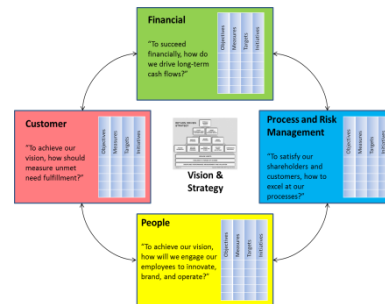


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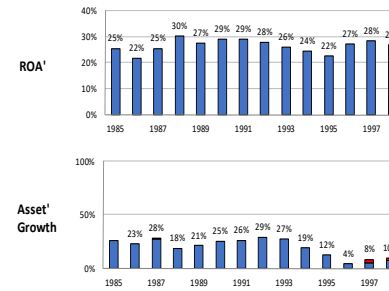
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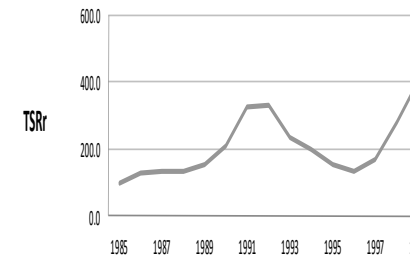
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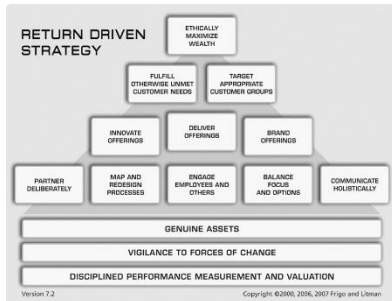
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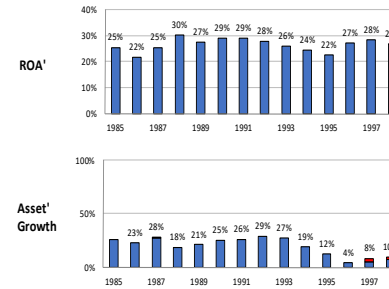
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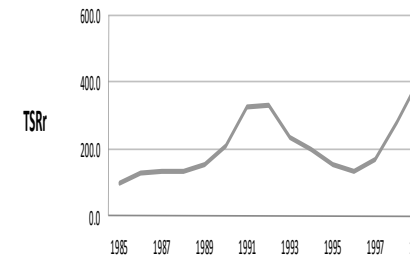
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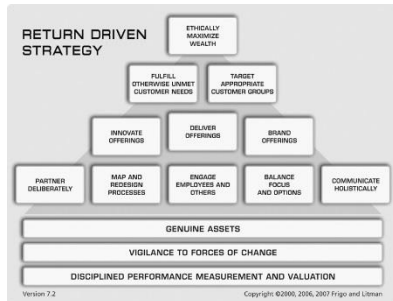
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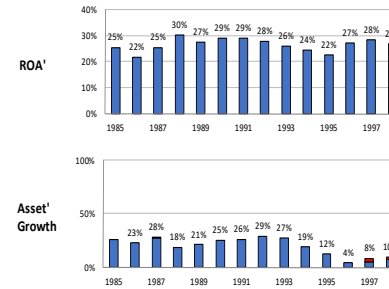
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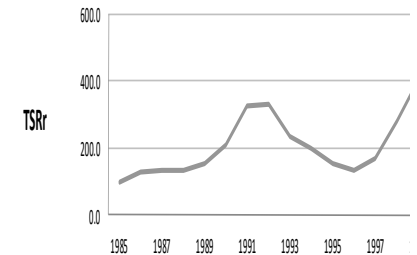
### Execution



### Performance



### Valuation



# THE ROOTS OF VALUE

# THE ROOTS OF VALUE

Valuation



$$\Sigma = \frac{\text{Forecasted FCF}}{1 + \text{Cost Capital}}$$

*future* cash generated  $\uparrow$   
vs. *future* cash invested  $\downarrow$

# THE ROOTS OF VALUE

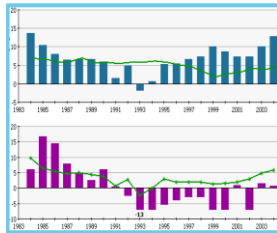
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$$\Sigma = \frac{\text{Forecasted FCF}}{1 + \text{Cost Capital}}$$

*future cash generated* ↑  
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## Performance



### Return On Assets

Margins X Turns

$\frac{\text{Sales Less Expenses}}{\text{Sales}}$

EBITDA%  
COGS% SGA%

### Growth in Assets

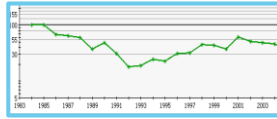
Turns X Sales Δ

$\frac{\text{Sales}}{\text{Assets}}$

CAPEX%, NWC%, R&D%  
Other LT Assets

# THE ROOTS OF VALUE

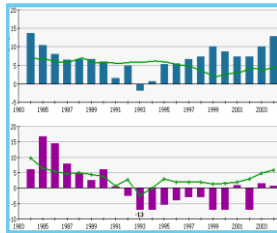
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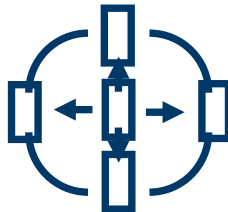
*future cash generated* ↑  
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## Performance



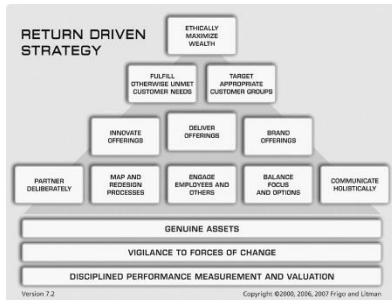
| Return On Assets                                  |   |       | Growth in Assets                      |   |         |
|---|---|-------|---------------------------------------|---|---------|
|   | X |       |                                       | X |         |
| Margins   |   | Turns | Turns                                 |   | Sales Δ |
| $\frac{\text{Sales Less Expenses}}{\text{Sales}}$ |   |       | $\frac{\text{Sales}}{\text{Assets}}$  |   |         |
| EBITDA%<br>COGS% SGA%                             |   |       | CAPEX%, NWC%, R&D%<br>Other LT Assets |   |         |

## Execution



## Plans

### Strategy



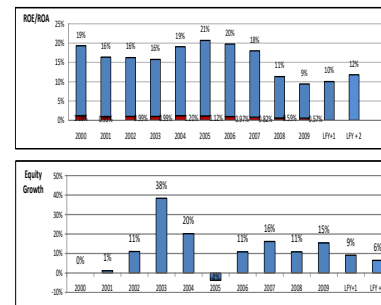
## Actions

### Execution



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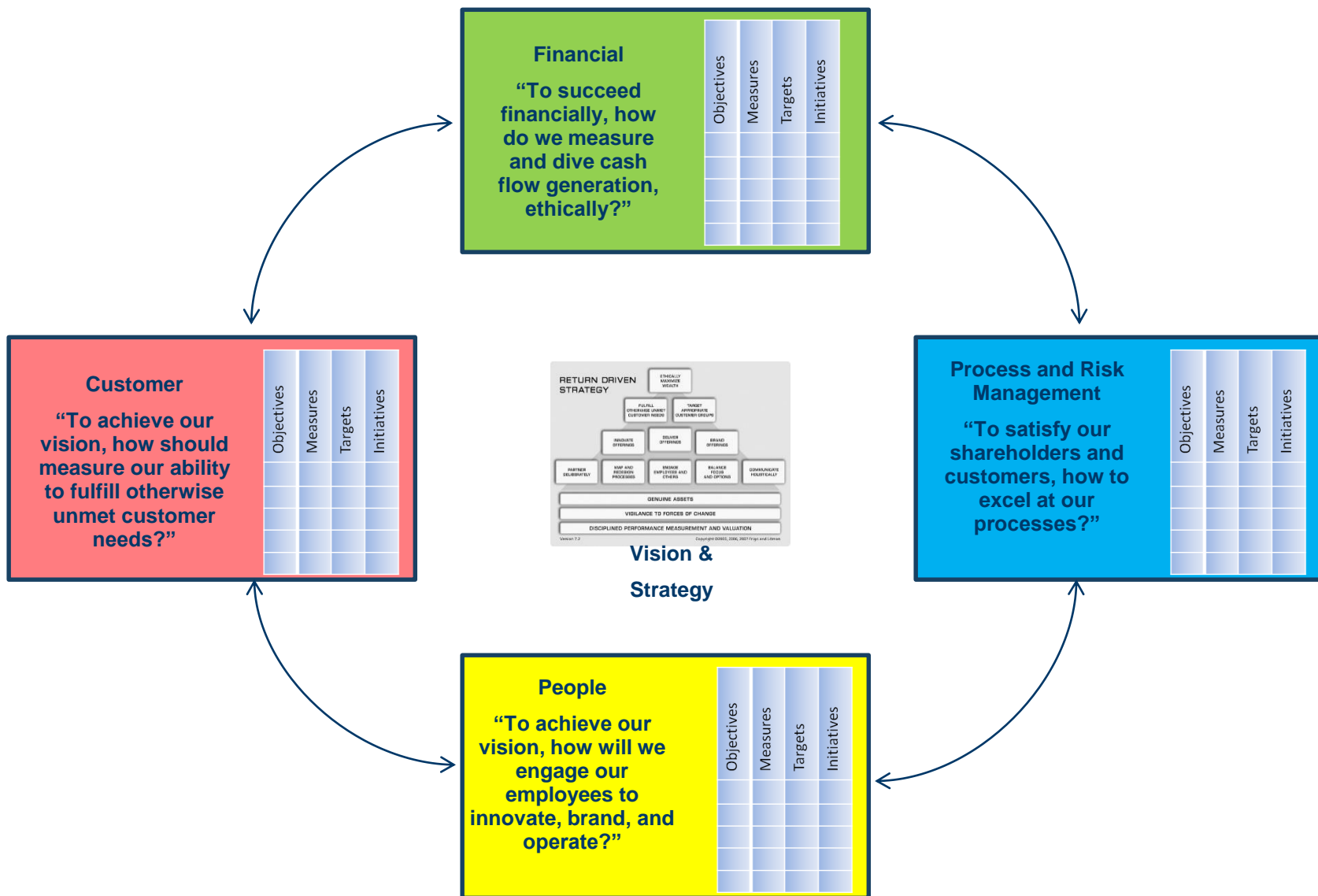
### Performance



## Forecasts

### Valuation





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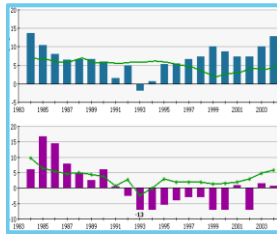
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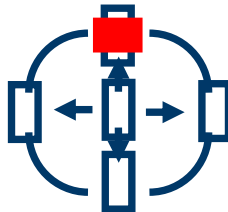
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## Performance



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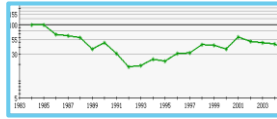
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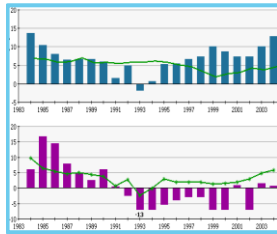
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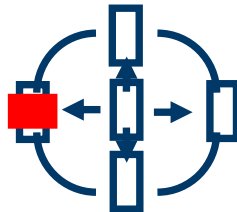
## Performance



$$\begin{array}{c} \text{Return On Assets} \\ \swarrow \quad \searrow \\ \text{Margins} \quad \times \quad \text{Turns} \\ \hline \frac{\text{Sales Less Expenses}}{\text{Sales}} \quad \times \quad \frac{\text{Sales}}{\text{Assets}} \\ \hline \begin{array}{c} \text{EBITDA\%} \\ \text{COGS\% SGA\%} \end{array} \quad \begin{array}{c} \text{CAPEX\%, NWC\%, R\&D\%} \\ \text{Other LT Assets} \end{array} \end{array}$$

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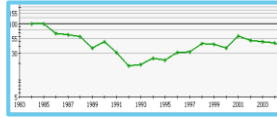
## Execution



# customers, PoPs  
Market dominance  
Price  $\Delta$   $\times$  Volume  $\Delta$   
% repeat purchases

# THE ROOTS OF VALUE

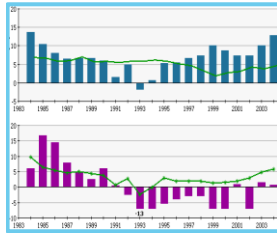
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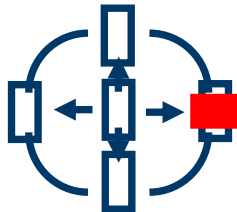
*future cash generated* ↑  
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## Performance



| Return On Assets                                  |   |       | Growth in Assets                      |   |         |
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| Margins   | X | Turns | Turns                                 | X | Sales Δ |
| $\frac{\text{Sales Less Expenses}}{\text{Sales}}$ |   |       | $\frac{\text{Sales}}{\text{Assets}}$  |   |         |
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## Execution



# customers, PoPs  
Market dominance  
Price Δ X Volume Δ  
% repeat purchases

# stores, bikes, sq. ft.  
% sold new products  
Capacity: people/AUM  
Six sigma flaws target

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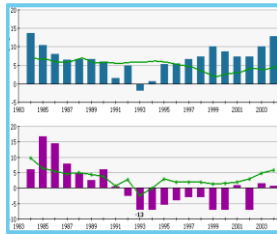
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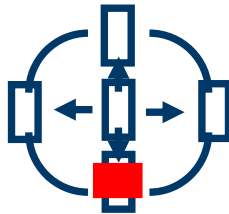
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R & D% of sales  
Employee turnover  
Training hours per yr  
% free research hrs.

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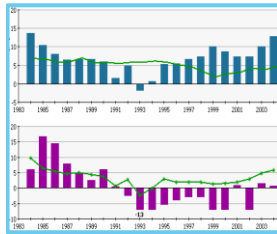
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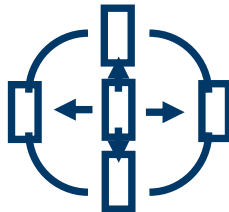
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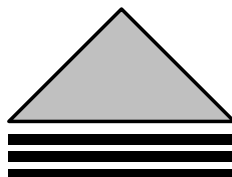


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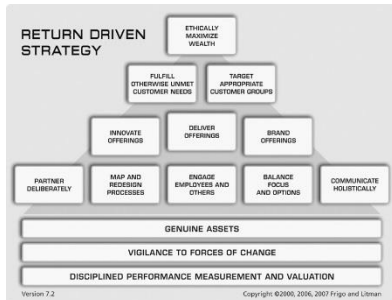
R & D% of sales  
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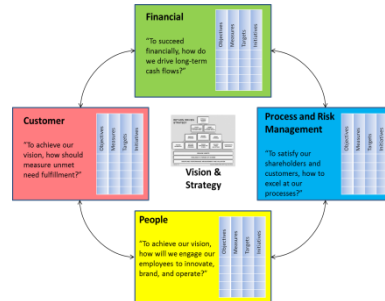
# Plans

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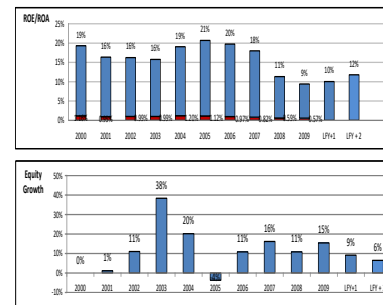
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# Results

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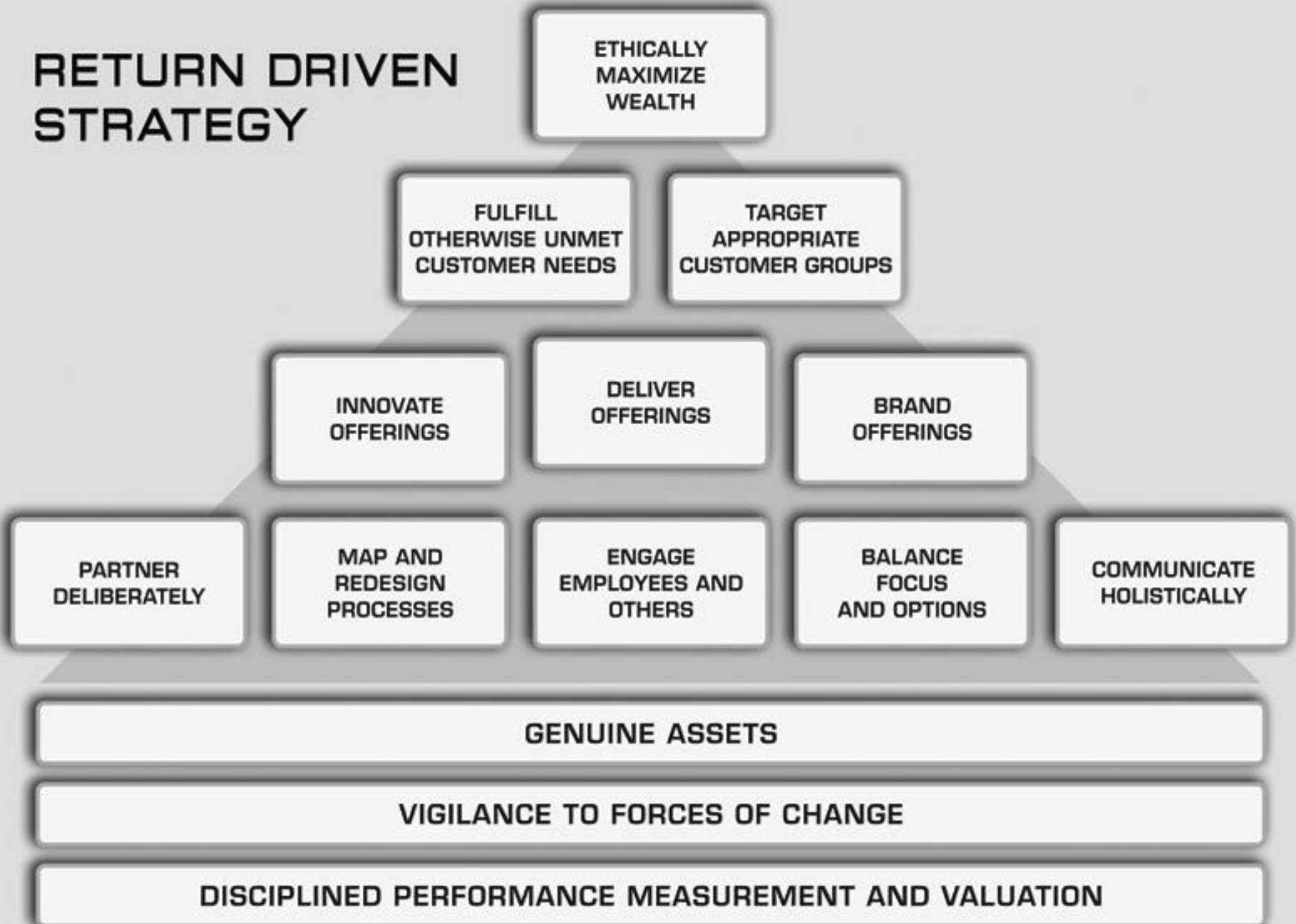


# Forecasts

## Valuation



# RETURN DRIVEN STRATEGY



# THE ROOTS OF VALUE

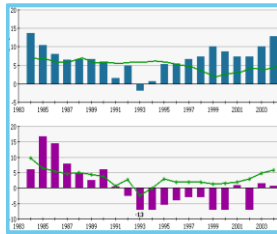
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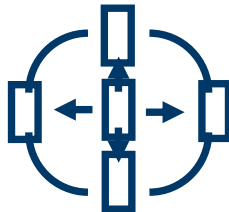
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## Execution

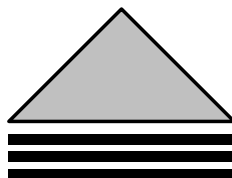


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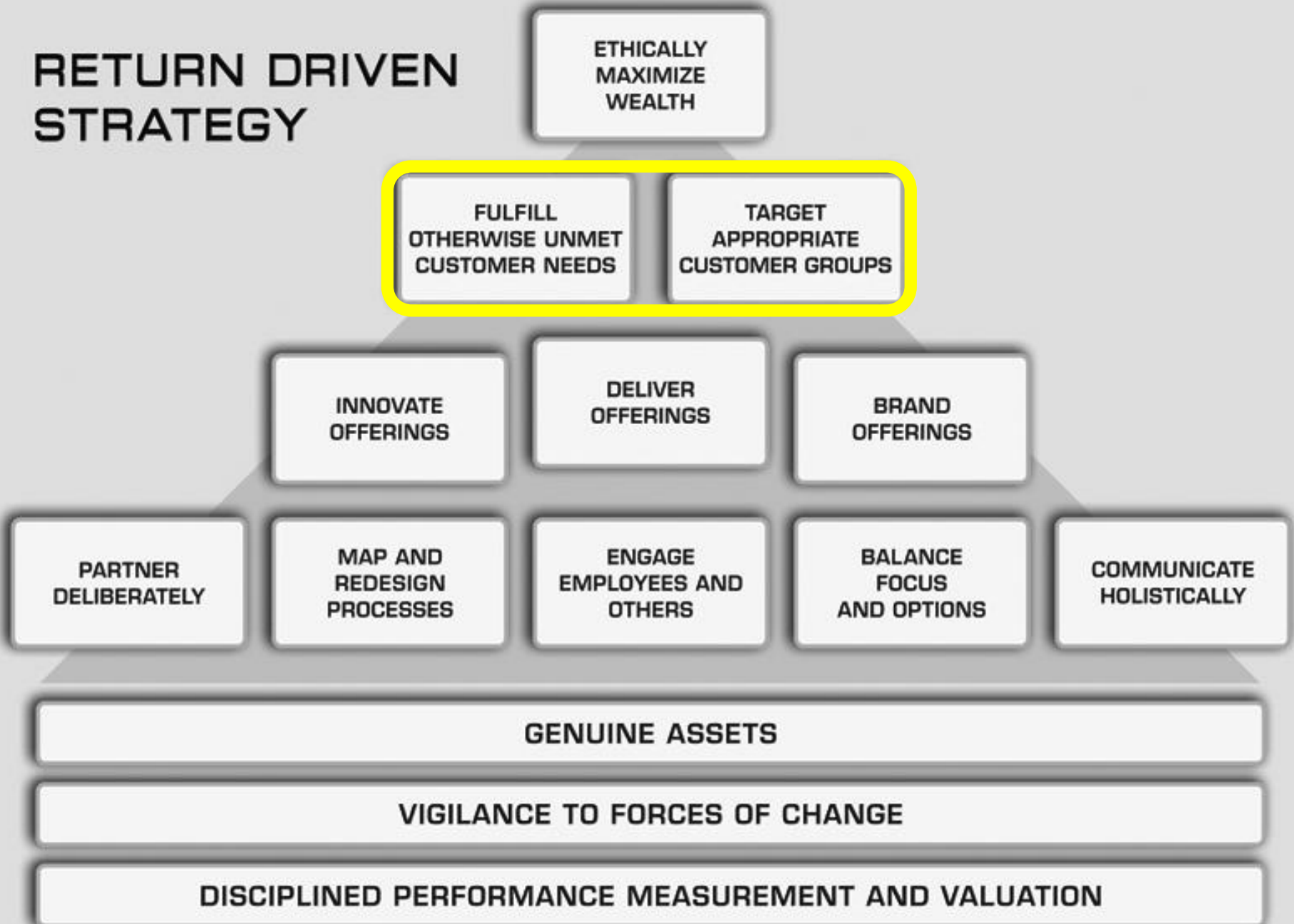
R & D% of sales  
Employee turnover  
Training hours per yr  
% free research hrs.

## Strategy



Is management aligned with investors?  
Do offerings serve unmet needs with pricing power?  
Do underlying market size and growth rates lead to goals?  
Are Genuine Assets deployed to protect valuable actions?

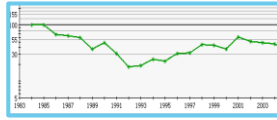
# RETURN DRIVEN STRATEGY





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*future cash generated* ↑  
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### Enterprise Value

LESS:

Book debt

“Capitalized” Leaseholders’ debt

Pension & OPEB debt

Preferred stock

Minority Interests

Other claims on Enterprise Value

---

Existing equity value

/ Appropriate # of shares

---

Business Equity Value Per Share

+ Cash & Other Value per share

---

**= Equity value per existing share**

# THE ROOTS OF VALUE

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*future cash generated* ↑  
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### Enterprise Value

LESS:

Book debt

“Capitalized” Leaseholders’ debt

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Minority Interests

Other claims on Enterprise Value

---

Existing equity value

/ Appropriate # of shares

---

Business Equity Value Per Share

+ Cash & Other Value per share

---

**= Equity value per existing share**

Market cap  
is total  
equity  
value

Share count  
is arbitrary  
therefore,  
price per  
share is  
arbitrary

Share count is arbitrary  
therefore, price per share is  
arbitrary (market cap is not)

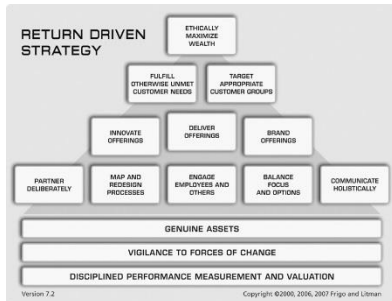
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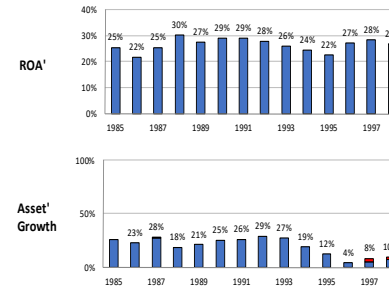
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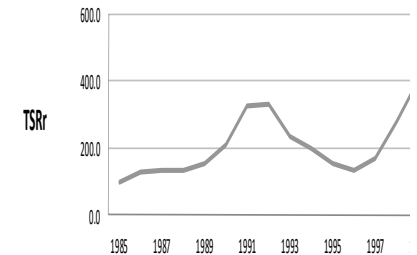
### Execution



### Performance



### Valuation



# VALENS RESEARCH

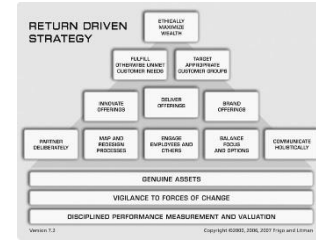


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# What gets measured gets done

## Leading versus Lagging Indicators

### Determining the right leading metrics for resulting in the desired lagging metrics

Activities:

ETHICALLY  
MAXIMIZE  
WEALTH

GENUINE ASSETS

VIGILANCE TO FORCES OF CHANGE

DISCIPLINED PERFORMANCE MEASUREMENT AND VALUATION



Monetary goals:

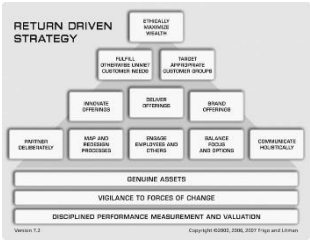
Monetary goals:

Level of cash flow

Volatility/stability of cash flow

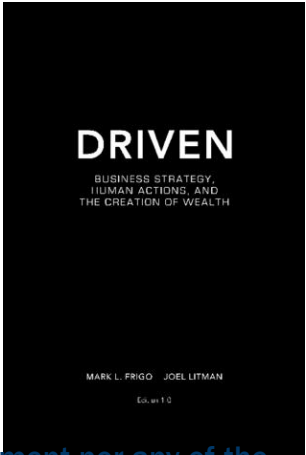
Purpose of the cash flow

# Insights from Return Driven Strategy



In order to achieve wealth,  
shouldn't we first define it?

Matt's



Activities:

**ETHICALLY  
MAXIMIZE  
WEALTH**

**FULFILL  
OTHERWISE UNMET  
CUSTOMER NEEDS**

**TARGET  
APPROPRIATE  
CUSTOMER GROUPS**

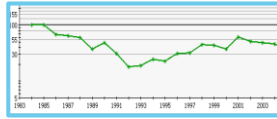
**GENUINE ASSETS**

**VIGILANCE TO FORCES OF CHANGE**

**DISCIPLINED PERFORMANCE MEASUREMENT AND VALUATION**

# THE ROOTS OF VALUE

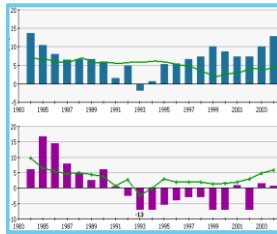
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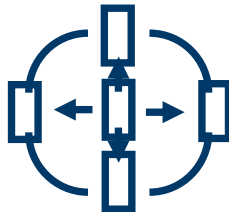
*future cash generated* ↑  
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## Performance



| Return On Assets      |   |       | Growth in Assets                      |   |         |
|-----------------------|---|-------|---------------------------------------|---|---------|
|                       | X |       |                                       | X |         |
| Margins               |   | Turns | Turns                                 |   | Sales Δ |
| Sales Less Expenses   |   |       | Sales                                 |   |         |
| Sales                 |   |       | Assets                                |   |         |
| EBITDA%<br>COGS% SGA% |   |       | CAPEX%, NWC%, R&D%<br>Other LT Assets |   |         |

## Execution

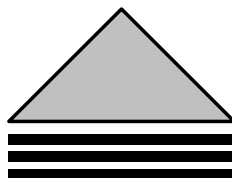


# customers, PoPs  
Market dominance  
Price Δ X Volume Δ  
% repeat purchases

# stores, bikes, sq. ft.  
% sold new products  
Capacity: people/AUM  
Six sigma flaws target

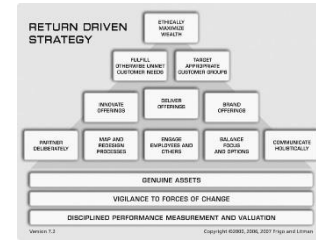
R & D% of sales  
Employee turnover  
Training hours per yr  
% free research hrs.

## Strategy

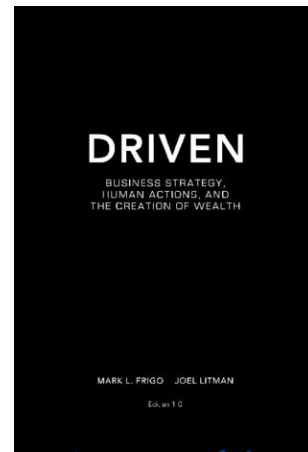


Is management aligned with investors?  
Do offerings serve unmet needs with pricing power?  
Do underlying market size and growth rates lead to goals?  
Are Genuine Assets deployed to protect valuable actions?

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Is it really, truly, absolutely  
the brand?



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August  
2003



## Special Report

# THE 100 TOP BRANDS

Here's how we calculate the power in a name

**T**o rank the world's 100 most valuable global brands, we set three hurdles that all contenders have to meet to merit consideration.

First, they must have brand values greater than \$1 billion. They also have to be global in nature, meaning they must derive at least a third of their sales from outside their home countries and have significant distribution throughout the Americas, Europe, and Asia. Finally, they must have publicly available marketing and financial data. That excluded some big brands, such as Visa International, the BBC, and Mars.

How do you place a value on a brand? Some attempts rely on little more than opinion polls or ad spending. *BusinessWeek* selected Interbrand's method because it values brands the same way analysts value other assets: on the basis of how much they're likely to earn in the future. Those projected

profits are then discounted to a present value based on how risky the projected earnings are—that is, the likelihood that they will, in fact, materialize.

To start the process, Interbrand first figures out what the brand's overall sales are. (The brand may be almost the entire company, as in the case of McDonald's Corp. For others, such as Marlboro, it may be just a portion.) Next, with the help of analysts from J.P. Morgan Chase & Co., Citigroup, and Morgan Stanley, Interbrand projects net earnings for the brand. It then deducts a charge for the cost of owning the tangible assets, on the theory that whatever income is generated beyond that cost is due to intangible factors. This is the economic value added by things like patents, customer lists, and, of course, the brand.

The next step is to winnow the earnings generated by the brand from the

earnings generated by other intangibles. For example, are people buying Shell gasoline because of the brand name or because the gas station is conveniently located? Interbrand uses market research and interviews with industry executives to sift through those variables.

The final phase is to analyze the strength of the brand to figure out how risky those future brand earnings are. To calculate the brand's strength, Interbrand looks at seven factors, including the brand's market leadership, its stability, and its ability to cross geographic and cultural borders. The risk analysis produces a discount rate that is applied to the brand earnings to come up with a net present value. *BusinessWeek* and Interbrand believe this figure comes closest to representing the true economic value of that complex array of forces that make up a brand.

# Sample of Top Brands

| Company and Ticker    |      | 5yr<br>median<br>ROA' | 5yr<br>mean<br>ROA' | 5yr<br>median<br>V/A' | 5yr<br>mean<br>V/A' |
|-----------------------|------|-----------------------|---------------------|-----------------------|---------------------|
| ADIDAS-SALOMON AG NPV | ADSG | 12.4                  | 12.3                | 2.0                   | 2.0                 |
| AMAZON COM INC COM    | AMZN | 5.3                   | 1.4                 | 5.2                   | 6.9                 |
| APPLE COMPUTER INC CO | AAPL | 1.9                   | 2.9                 | 1.2                   | 1.5                 |
| AVON PRODS INC COM    | AVP  | 21.2                  | 21.4                | 6.0                   | 6.1                 |



# Strong brands do not equal high valuation...

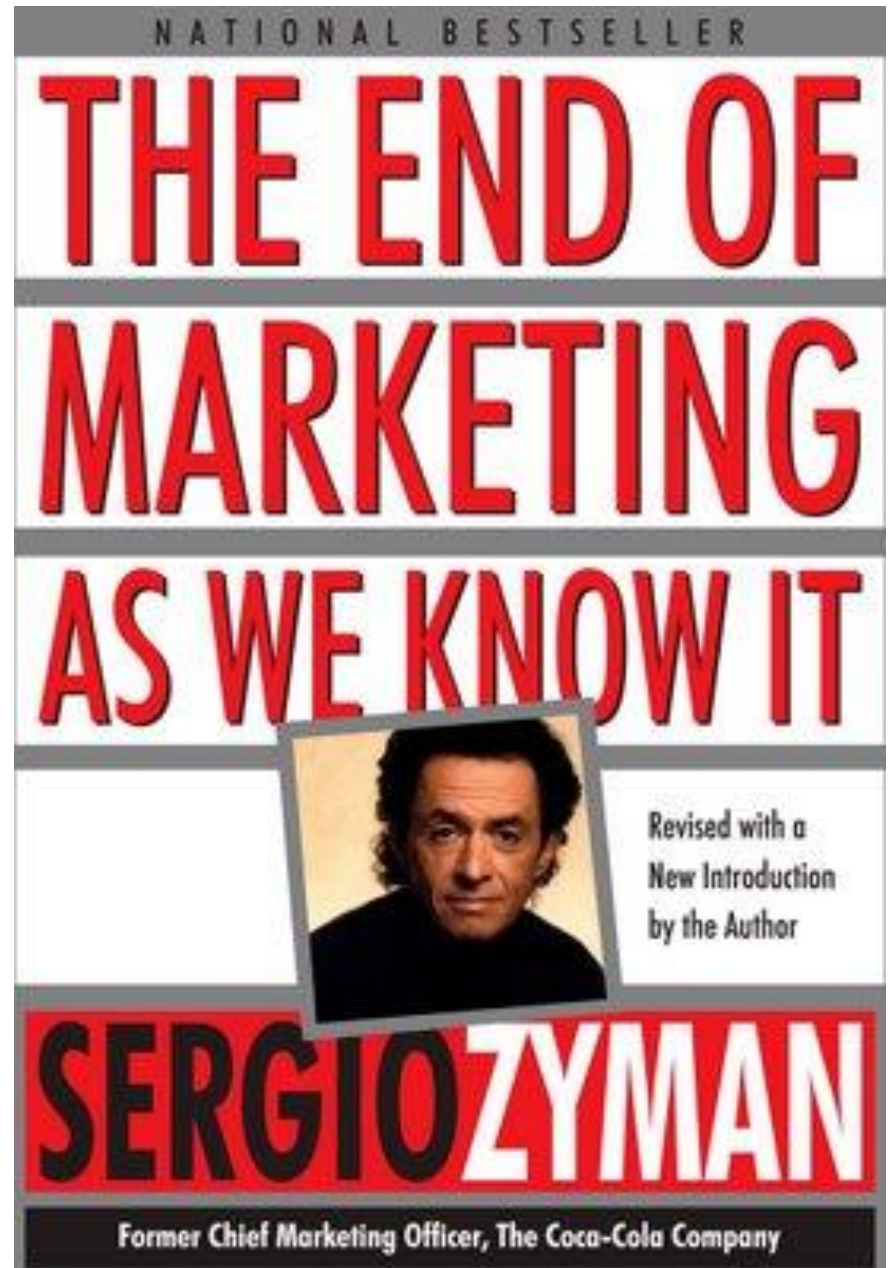
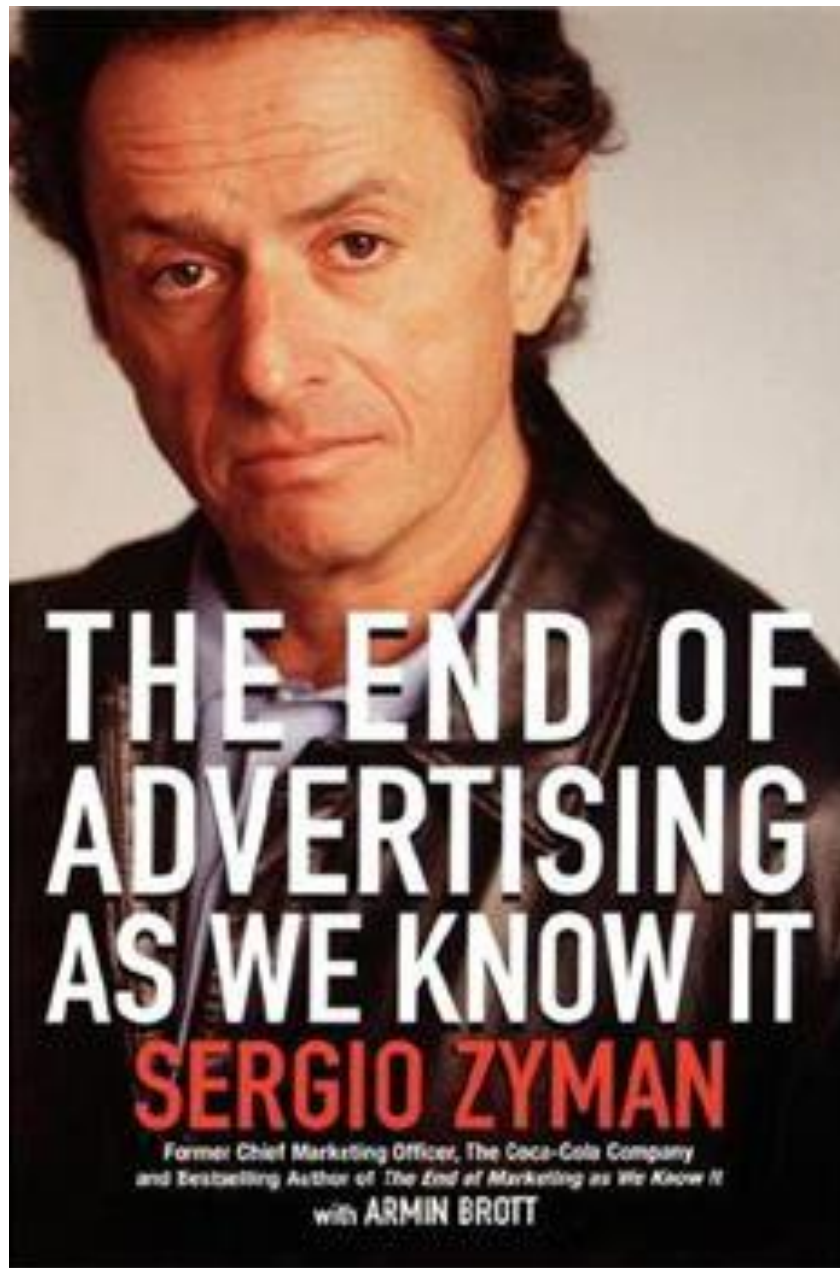
| Company                      | Ticker | 5-yr Median CFROI | 5-yr Mean CFROI | 5-yr Median VCR | 5-yr Mean VCR |
|------------------------------|--------|-------------------|-----------------|-----------------|---------------|
| ADIDAS-SALOMON AG NPV AD SG  |        | 12.4              | 12.3            | 2.0             | 2.0           |
| AMAZON COM INC COM           | AMZN   | 5.3               | 1.4             | 5.2             | 6.9           |
| APPLE COMPUTER INC COIAAPL   |        | 1.9               | 2.9             | 1.2             | 1.5           |
| AVON PRODS INC COM           | AVP    | 21.2              | 21.4            | 6.0             | 6.1           |
| AMERICAN EXPRESS CO C AXP    |        | 19.0              | 19.4            | 4.1             | 4.4           |
| BOEING CO COM                | BA     | 6.7               | 6.6             | 1.8             | 1.9           |
| BAYER MOTOREN WERK E BMWG    |        | 6.0               | 5.9             | 0.9             | 1.0           |
| BP ORD USD0.25               | BP     | 5.9               | 6.1             | 1.4             | 1.4           |
| ANHEUSER BUSCH COS IN BUD    |        | 13.5              | 13.2            | 3.4             | 3.4           |
| CITIGROUP INC COM            | C      | 16.5              | 16.1            | 2.6             | 2.8           |
| CANON INC NPV                | 7751C  | 9.6               | 10.0            | 1.6             | 1.6           |
| CARLSBERG SER'B'DKK20 CARLb  |        | 7.4               | 7.6             | 1.1             | 1.1           |
| COLGATE PALMOLIVE CO (CL     |        | 23.9              | 23.7            | 7.2             | 7.5           |
| CISCO SYS INC COM            | CSCO   | 11.9              | 11.5            | 3.9             | 4.7           |
| DAIMLERCHRYSLER AG OF DCXGn  |        | 2.7               | 3.0             | 0.7             | 0.7           |
| DELL INC COM                 | DELL   | 24.2              | 25.2            | 8.4             | 8.2           |
| DISNEY WALT CO COM DIS DIS   |        | 7.6               | 7.2             | 2.1             | 2.1           |
| EASTMAN KODAK CO COM EK      |        | 5.7               | 6.0             | 1.2             | 1.2           |
| ERICSSON(LM)TEL SEK1 SIERICb |        | -2.7              | 0.2             | 1.6             | 1.9           |
| FEDEX CORP COM               | FDX    | 4.6               | 4.6             | 1.3             | 1.3           |
| FORD MTR CO DEL COM P/F      |        | 3.2               | 3.1             | 1.0             | 1.0           |
| GILLETTE CO COM              | G      | 16.5              | 17.3            | 5.2             | 5.5           |
| GENERAL ELEC CO COM          | GE     | 18.4              | 18.1            | 4.2             | 5.3           |
| GAP INC DEL COM              | GPS    | 8.2               | 8.1             | 1.8             | 2.0           |
| GOLDMAN SACHS GROUP GS       |        | 12.9              | 13.3            | 2.2             | 2.3           |
| HARLEY DAVIDSON INC CO HDI   |        | 19.4              | 18.7            | 4.6             | 5.0           |
| HEINEKEN NV EUR1.60 HEIN     |        | 10.2              | 10.2            | 2.2             | 2.3           |
| HONDA MOTOR CO NPV           | 7267C  | 8.8               | 7.7             | 1.1             | 1.1           |
| HEINZ H J CO COM             | HNZ    | 17.9              | 17.3            | 3.4             | 3.6           |
| HEWLETT PACKARD CO C HPQ     |        | 8.2               | 7.9             | 1.6             | 1.7           |
| INTERNATIONAL BUSINESS IBM   |        | 8.8               | 9.1             | 2.9             | 2.9           |
| INTEL CORP COM               | INTC   | 10.7              | 11.0            | 3.6             | 3.3           |
| KIMBERLY CLARK CORP C KMB    |        | 12.0              | 12.3            | 2.7             | 2.9           |
| COCA COLA CO COM             | KO     | 29.5              | 30.6            | 7.2             | 7.6           |
| KELLOGG CO COM               | K      | 16.8              | 16.3            | 4.2             | 3.8           |
| LVMH MOET HENNESSY ELV MH    |        | 14.0              | 14.1            | 3.8             | 3.7           |
| MCDONALDS CORP COM           | MCD    | 7.6               | 7.6             | 1.6             | 1.6           |
| MERRILL LYNCH & CO INC (MER  |        | 11.8              | 11.7            | 1.9             | 2.0           |
| ALTRIA GROUP INC COM         | MO     | 23.4              | 23.4            | 3.7             | 3.7           |
| MERCK & CO INC COM           | MRK    | 16.8              | 17.4            | 3.1             | 3.5           |

| Company                      | Ticker | 5-yr Median CFROI | 5-yr Mean CFROI | 5-yr Median VCR | 5-yr Mean VCR |
|------------------------------|--------|-------------------|-----------------|-----------------|---------------|
| MICROSOFT CORP COM           | MSFT   | 14.4              | 14.5            | 4.2             | 4.4           |
| NIKE INC CL B                | NKE    | 11.3              | 11.1            | 2.6             | 2.6           |
| NOKIA OYJ EUR0.06            | NOK1V  | 18.6              | 20.4            | 3.1             | 5.5           |
| NESTLE SA CHF1(REGD)         | NESN   | 13.4              | 13.4            | 2.1             | 2.2           |
| NINTENDO CO LTD NPV          | 7974C  | 8.8               | 9.1             | 3.0             | 2.5           |
| ORACLE CORP COM              | ORCL   | 19.9              | 20.3            | 6.7             | 9.1           |
| PEPSICO INC COM              | PEP    | 22.9              | 22.6            | 5.5             | 5.7           |
| PFIZER INC COM               | PFE    | 18.1              | 18.3            | 3.7             | 4.4           |
| PHILIPS ELEC(KON) EUR0.2 PHG |        | 2.9               | 3.1             | 1.2             | 1.2           |
| POLO RALPH LAUREN COR RL     |        | 11.9              | 11.4            | 1.7             | 1.7           |
| REUTERS GROUP ORD GBIRTR     |        | 9.5               | 10.5            | 2.7             | 2.8           |
| SAP AG ORD NPV               | SAPG   | 14.6              | 14.5            | 5.5             | 5.4           |
| STARBUCKS CORP COM           | SBUX   | 7.7               | 7.8             | 3.6             | 3.8           |
| SONY CORP NPV                | 6758C  | 6.7               | 6.4             | 1.2             | 1.3           |
| AT&T CORP COM NEW            | T      | 5.7               | 6.2             | 0.8             | 0.8           |
| TIFFANY & CO NEW COM         | TIF    | 11.4              | 10.8            | 3.0             | 2.7           |
| TOYOTA MOTOR CORP NPV        | 7203C  | 7.3               | 7.4             | 1.1             | 1.1           |
| TEXAS INSTRS INC COM         | TXN    | 8.9               | 9.2             | 2.7             | 2.6           |
| VIACOM INC CL B              | VIA.B  | 11.0              | 11.3            | 3.2             | 3.2           |
| VOLKSWAGEN AG ORD NPVOWG     |        | 2.5               | 2.4             | 0.6             | 0.6           |
| DOW CHEM CO COM              | DOW    | 2.8               | 3.0             | 1.2             | 1.2           |
| WRIGLEY WM JR CO COM         | WWY    | 17.9              | 17.9            | 6.1             | 6.2           |
| EXXON MOBIL CORP COM         | XOM    | 6.3               | 6.3             | 1.6             | 1.7           |
| XEROX CORP COM               | XRX    | 5.2               | 4.8             | 1.3             | 1.3           |
| YAHOO INC COM                | YHOO   | 6.9               | 7.4             | 3.5             | 4.3           |
| YUM BRANDS INC COM           | YUM    | 11.8              | 11.4            | 2.1             | 2.2           |
| SUN MICROSYSTEMS INC (SUNW   |        | 0.3               | 3.9             | 1.2             | 2.3           |
| MOTOROLA INC COM             | MOT    | 1.0               | 2.8             | 1.1             | 1.1           |
| TIME WARNER INC COM          | TWX    | 8.6               | 9.3             | 1.7             | 3.1           |
| MATSUSHITA ELC IND NPV       | 6752C  | 2.3               | 0.8             | 0.8             | 0.8           |
| ROYAL DUTCH PETROL EUI RD    |        | 7.4               | 7.4             | 1.5             | 1.6           |
| MATTEL INC COM               | MAT    | 15.3              | 15.3            | 2.6             | 2.6           |
| DIAGEO P L C SPON ADR N DEO  |        | 21.9              | 22.8            | 3.4             | 3.5           |
| BROWN FORMAN CORP CLBF.B     |        | 13.0              | 12.7            | 2.8             | 2.9           |
| PEARSON ORD GBP0.25 PSON     |        | 14.2              | 15.8            | 2.5             | 2.9           |
| HILTON HOTELS CORP CON HLT   |        | 9.7               | 9.8             | 1.6             | 1.7           |
| SIEMENS AG NPV(REGD) SIEGn   |        | 4.6               | 5.0             | 1.2             | 1.3           |
| SWATCH GROUP CHF2.25(EUHR    |        | 9.6               | 10.0            | 1.6             | 1.8           |
| BENETTON GROUP SPA EL BNG    |        | 8.5               | 8.1             | 1.5             | 1.7           |

|                    |            |             |            |            |
|--------------------|------------|-------------|------------|------------|
| <b>Top Brands</b>  | <b>9.7</b> | <b>11.2</b> | <b>2.2</b> | <b>3.0</b> |
| <b>S&amp;P 500</b> | <b>9.8</b> | <b>10.8</b> | <b>2.0</b> | <b>2.8</b> |

## Strong brands do not equal high valuation...

| Company and Ticker | 5yr<br>median<br>ROA' | 5yr<br>mean<br>ROA' | 5yr<br>median<br>V/A' | 5yr<br>mean<br>V/A' |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|
| Top Brands         | 9.7                   | 11.2                | 2.2                   | 3.0                 |
| S&P 500            | 9.8                   | 10.8                | 2.0                   | 2.8                 |



# Leading measures and metrics - Sales

number of sales calls made

calls by type of customer or prospect

pipeline fluidity

pipeline accuracy

forecast accuracy

number of orders in the pipeline

number of deals pending

compensation plan statistics,

product knowledge

selling skills

customer interaction

peer and support involvement

training

*Source: CRM.com*

# THE ULTIMATE QUESTION

Driving Good Profits  
and True Growth

FRED REICHHELD

About the book

Measuring your  
Net Promoter Score

Fred Reichheld:  
Author/Speaker

Related writings

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## Measuring your Net Promoter® Score

Asking the ultimate question allows companies to track promoters and detractors, producing a clear measure of an organization's performance through its customers' eyes, its Net Promoter® Score. Bain analysis shows that sustained value creators—companies that achieve long-term profitable growth—have Net Promoter Scores (NPS) two times higher than the average company. And NPS leaders outgrow their competitors in most industries—by an average of 2.5 times.

NPS is based on the fundamental perspective that every company's customers can be divided into three categories. "Promoters" are loyal enthusiasts who keep buying from a company and urge their friends to do the same. "Passives" are satisfied but unenthusiastic customers who can be easily wooed by the competition. And "detractors" are unhappy customers trapped in a bad relationship. Customers can be categorized based on their answer to the ultimate question.

The best way to gauge the efficiency of a company's growth engine is to take the percentage of customers who are promoters (P) and subtract the percentage who are detractors (D). This equation is how we calculate a Net Promoter Score for a company:

$$P - D = NPS$$

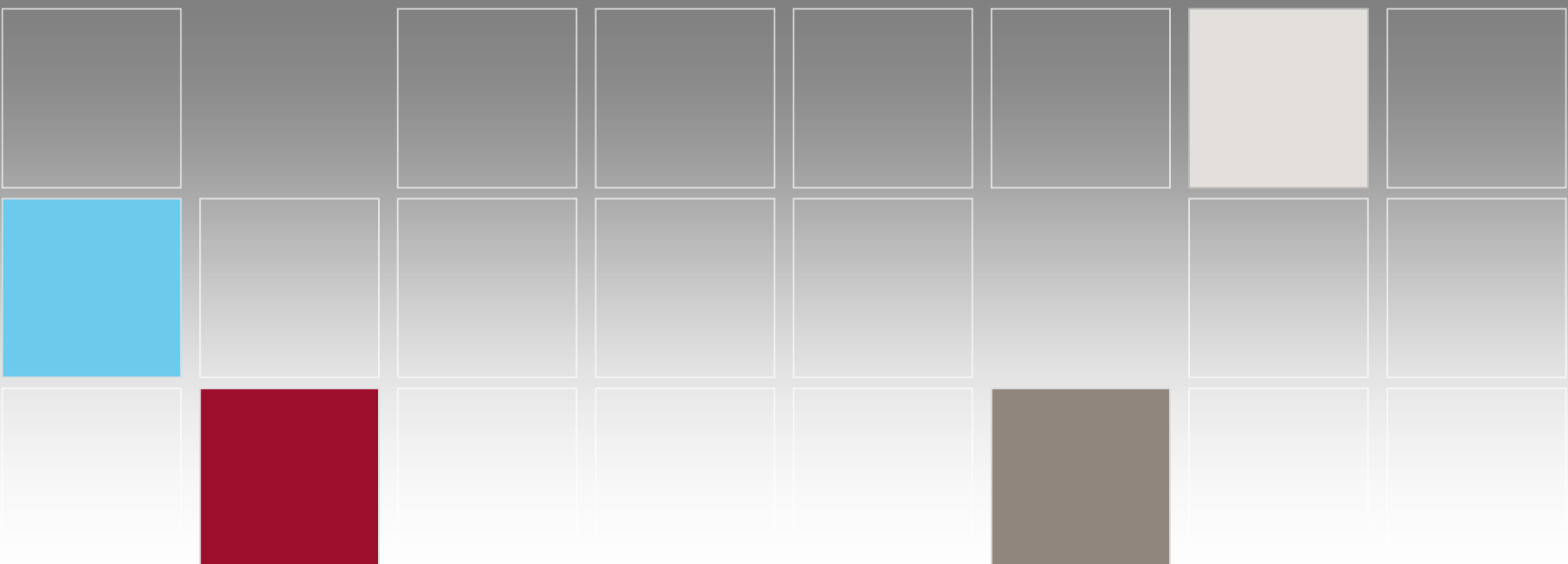
# Net Promoter Score

## NPS Stars

|                           |            |                         |            |
|---------------------------|------------|-------------------------|------------|
| <b>HomeBanc*</b>          | <b>82%</b> | <b>American Express</b> | <b>51%</b> |
| <b>Harley-Davidson</b>    | <b>81%</b> | <b>Commerce Bank</b>    | <b>50%</b> |
| <b>Costco</b>             | <b>81%</b> | <b>Dell</b>             | <b>50%</b> |
| <b>Amazon.com</b>         | <b>79%</b> | <b>Adobe</b>            | <b>48%</b> |
| <b>Chick-fil-A*</b>       | <b>73%</b> | <b>Electronic Arts</b>  | <b>48%</b> |
| <b>eBay</b>               | <b>72%</b> |                         |            |
| <b>Vanguard</b>           | <b>71%</b> |                         |            |
| <b>SAS</b>                | <b>70%</b> |                         |            |
| <b>Apple</b>              | <b>66%</b> |                         |            |
| <b>Intuit (TurboTax)*</b> | <b>66%</b> |                         |            |
| <b>Cisco</b>              | <b>58%</b> |                         |            |
| <b>FedEx</b>              | <b>57%</b> |                         |            |
| <b>Southwest Airlines</b> | <b>56%</b> |                         |            |

\* All NPS statistics are based on Bain or Satemtrix surveys, with the exceptions of Intuit, Chick-fil-A, and HomeBanc. For these firms, we used data that they provided. Their data was gathered in a reasonable (but not perfectly equivalent) fashion.

Source: Reichheld, Fred. "The Ultimate Question: Driving Good Profits and True Growth." Harvard Business School Press 2006.



■ May 13, 2008

# The Impact of Human Capital on Investment Capital

Hewitt and HOLT: Examining human capital metrics that drive business performance

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# Talent Quotient Definition

Measuring and monitoring “pay progression”

The people getting the highest total pay increases...

...are they leaving or staying?



# TQ Impacts Business Results—Cross Industry Study<sup>1</sup>

- In both analyses, Talent Quotient is predictive of financial performance in succeeding years

| Deep Empirical Study<br>Companies grouped by<br>TQ result in 2001 (N=115) | Performance Measures in Following Three Years<br>(2001-04) |  |  |   |
|---|--|--|--|---|
|   | Revenue<br>Growth<br>(3Y CAGR)                             | Operating Cash<br>Flow Growth<br>(3Y CAGR) | CFROI <sup>®2</sup><br>(3Y annualized) | Total Business<br>Return<br>(3Y annualized) |
| <b>Bottom 1/3</b><br><b>(TQ Avg. 80)</b>                                  | 2.2%   | 5.0%                                       | -1.0%                                  | 11.7%                                       |
| <b>Top 1/3</b><br><b>(TQ Avg. 126)</b>                                    | 4.5%   | 11.6%                                      | 7.9%                                   | 15.1%                                       |
| <b>Difference</b>   | + 2.3%   | + 6.6%                                     | + 8.9%                                 | + 3.4%                                      |

<sup>1</sup> For detailed description of HCF™ methodology and results, see Valuation Issues Journal, Feb 2006: “[Optimizing Human Capital Investments for Superior Shareholder Returns](#)”.

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# TQ Impacts Business Results—Cross Industry Study<sup>1</sup>

In both analyses, Talent Quotient is predictive of financial performance in succeeding years

## “Best 10–Worst 10” Comparison

|                         | ■ Average<br>2004 TQ |          | ■ Sales Growth<br>3 year annualized<br>(ending 7/07) | ■ Total Return<br>3 year annualized<br>(ending 7/07) | ■ Price to Book<br>(at 7/07) |
|-------------------------|----------------------|----------|--|--|------------------------------|
| ■ <b>WORST 10 in TQ</b> | ■ 84                 | ■ Median | ■ 5.8%   | ■ 7.1%   | ■ 1.8                        |

■ <sup>1</sup> For detailed description of HCF™ methodology and results, see Valuation Issues Journal, Feb 2006: [“Optimizing Human Capital Investments for Superior Shareholder Returns”](#).

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# TQ Impacts Business Results—Cross Industry Study<sup>1</sup>

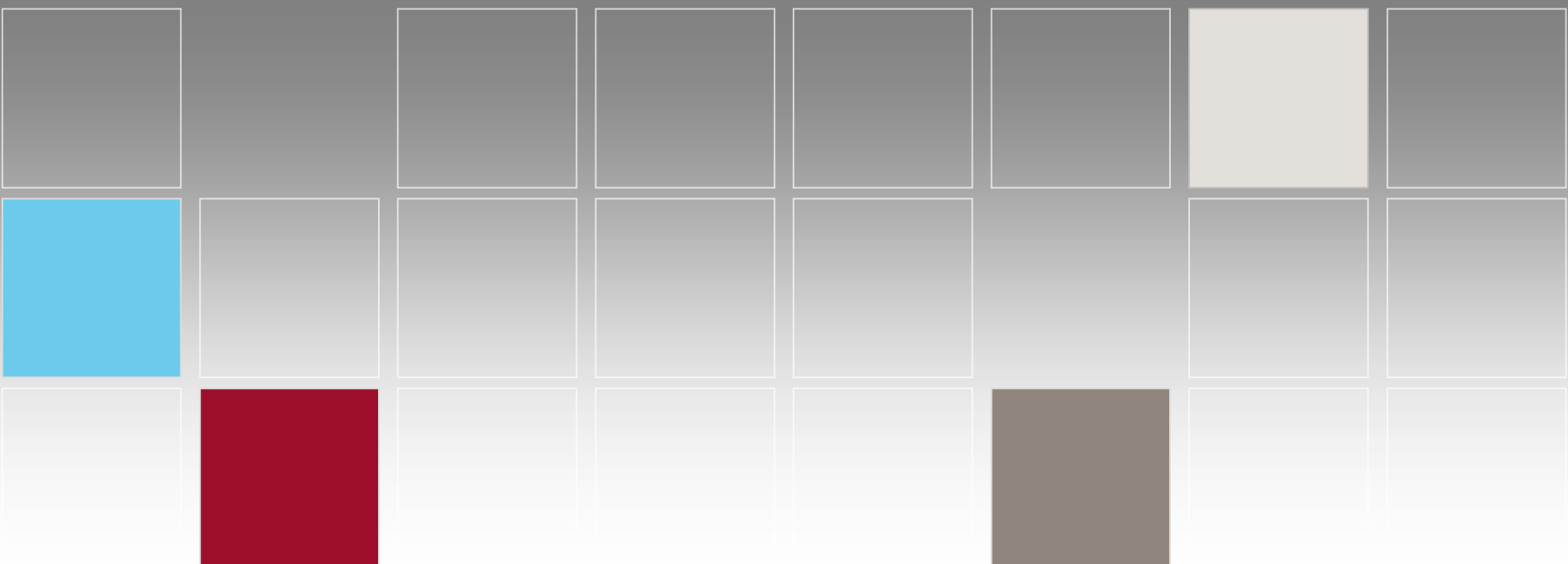
In both analyses, Talent Quotient is predictive of financial performance in succeeding years

## “Best 10–Worst 10” Comparison

|                         | ■ Average<br>2004 TQ |          | ■ Sales Growth<br>3 year annualized<br>(ending 7/07) | ■ Total Return<br>3 year annualized<br>(ending 7/07) | ■ Price to Book<br>(at 7/07) |
|-------------------------|----------------------|----------|--|--|------------------------------|
| ■ <b>WORST 10 in TQ</b> | ■ 84                 | ■ Median | ■ 5.8%   | ■ 7.1%   | ■ 1.8                        |
| ■ <b>BEST 10 in TQ</b>  | ■ 141                | ■ Median | ■ 8.0%   | ■ 13.2%  | ■ 2.9                        |

■ <sup>1</sup> For detailed description of HCF™ methodology and results, see Valuation Issues Journal, Feb 2006: [“Optimizing Human Capital Investments for Superior Shareholder Returns”](#).

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■ May 13, 2008

# The Impact of Human Capital on Investment Capital

Hewitt and HOLT: Examining human capital metrics that drive business performance

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# RETURN DRIVEN STRATEGY



INNOVATE  
OFFERINGS

DELIVER  
OFFERINGS

BRAND  
OFFERINGS

PARTNER  
DELIBERATELY

MAP AND  
REDESIGN  
PROCESSES

ENGAGE  
EMPLOYEES AND  
OTHERS

BALANCE  
FOCUS  
AND OPTIONS

COMMUNICATE  
HOLISTICALLY

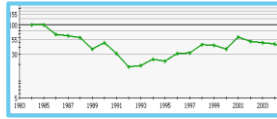
GENUINE ASSETS

VIGILANCE TO FORCES OF CHANGE

DISCIPLINED PERFORMANCE MEASUREMENT AND VALUATION

# THE ROOTS OF VALUE

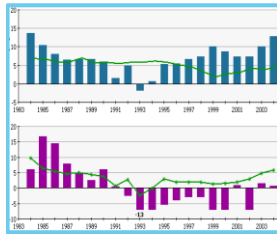
## Valuation



$$\Sigma = \frac{\text{Forecasted FCF}}{1 + \text{Cost Capital}}$$

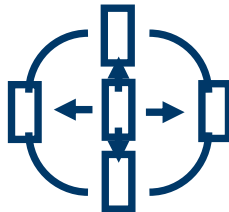
*future cash generated* ↑  
vs. *future cash invested* ↓

## Performance



| Return On Assets                                  |   |       | Growth in Assets                      |   |         |
|---|---|-------|---------------------------------------|---|---------|
| Margins   | X | Turns | Turns                                 | X | Sales Δ |
| $\frac{\text{Sales Less Expenses}}{\text{Sales}}$ |   |       | $\frac{\text{Sales}}{\text{Assets}}$  |   |         |
| EBITDA%<br>COGS% SGA%                             |   |       | CAPEX%, NWC%, R&D%<br>Other LT Assets |   |         |

## Execution

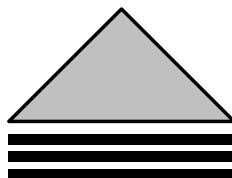


# customers, PoPs  
Market dominance  
Price Δ X Volume Δ  
% repeat purchases

# stores, bikes, sq. ft.  
% sold new products  
Capacity: people/AUM  
Six sigma flaws target

R & D% of sales  
Employee turnover  
Training hours per yr  
% free research hrs.

## Strategy



Is management aligned with investors?  
Do offerings serve unmet needs with pricing power?  
Do underlying market size and growth rates lead to goals?  
Are Genuine Assets deployed to protect valuable actions?

DCF and Ratios 2015 07 v4 - Excel

Joel Litman

FILE HOME INSERT PAGE LAYOUT FORMULAS DATA REVIEW VIEW

Calibri 11

Paste

Font

Alignment

Percentage

Number

Styles

Cells

Editing

C3

|   | A | B     | C                         | D     | E     | F     | G     | H     | I     | J     | K     | L     | M     |
|---|---|-------|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1 Year                                  |   | 0     | 1                         | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    |       |
| 2                                       |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 3 Return On Assets (ROA)                |   |       | 6.0%                      | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6     |
| 4 Asset Growth Rate                     |   |       | 0.0%                      | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0.0%  | 0     |
| 5                                       |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 6 Assets                                |   | 1000  | 1,000                     | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| 7 Op Cash Flow                          |   |       | 60                        | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    |
| 8 CAPX                                  |   |       | -                         | -     | -     | -     | -     | -     | -     | -     | -     | -     | -     |
| 9                                       |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 10 Free Cash Flow                       |   |       | 60                        | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    | 60    |
| 11 Cost of Capital                      |   |       | 6.0%                      | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6.0%  | 6     |
| 12 Present Value of FCF                 |   |       | 56.60                     | 53.40 | 50.38 | 47.53 | 44.84 | 42.30 | 39.90 | 37.64 | 35.51 | 33.50 | 31.50 |
| 13                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 14 Enterprise Value (Net Present Value) |   | 1,000 |                           |       |       |       |       |       |       |       |       |       |       |
| 15 V/A'                                 |   | 1.0   |                           |       |       |       |       |       |       |       |       |       |       |
| 16 ROA-alone implied V/A'               |   | 1.0   |                           |       |       |       |       |       |       |       |       |       |       |
| 17                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 18                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 19 V/A' Divided by ROA' equals...       |   | 16.67 | V/E, aka "Cleaned-up P/E" |       |       |       |       |       |       |       |       |       |       |
| 20                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 21                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 22                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 23                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |
| 24                                      |   |       |                           |       |       |       |       |       |       |       |       |       |       |

Perpetuity Terminal Multiple

READY

5:27 AM 6/25/2016



# VALENS RESEARCH

## The Roots of Value and Value Creation

Professor Joel Litman  
June 2016

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# Unique measures and metrics

# Unique measures and metrics

**KO and 50 Foot/Population rule**

**Share of stomach**

**WMT and 10 Foot Rule**

**What are key units of measure with:**

**Asset managers?**

**Motorcycle makers?**

**Construction companies?**

**When is Six Sigma too “loose”?**

**What is being measured in Lean Manufacturing?**

# Measures and metrics for discussion

# Measures and metrics for discussion

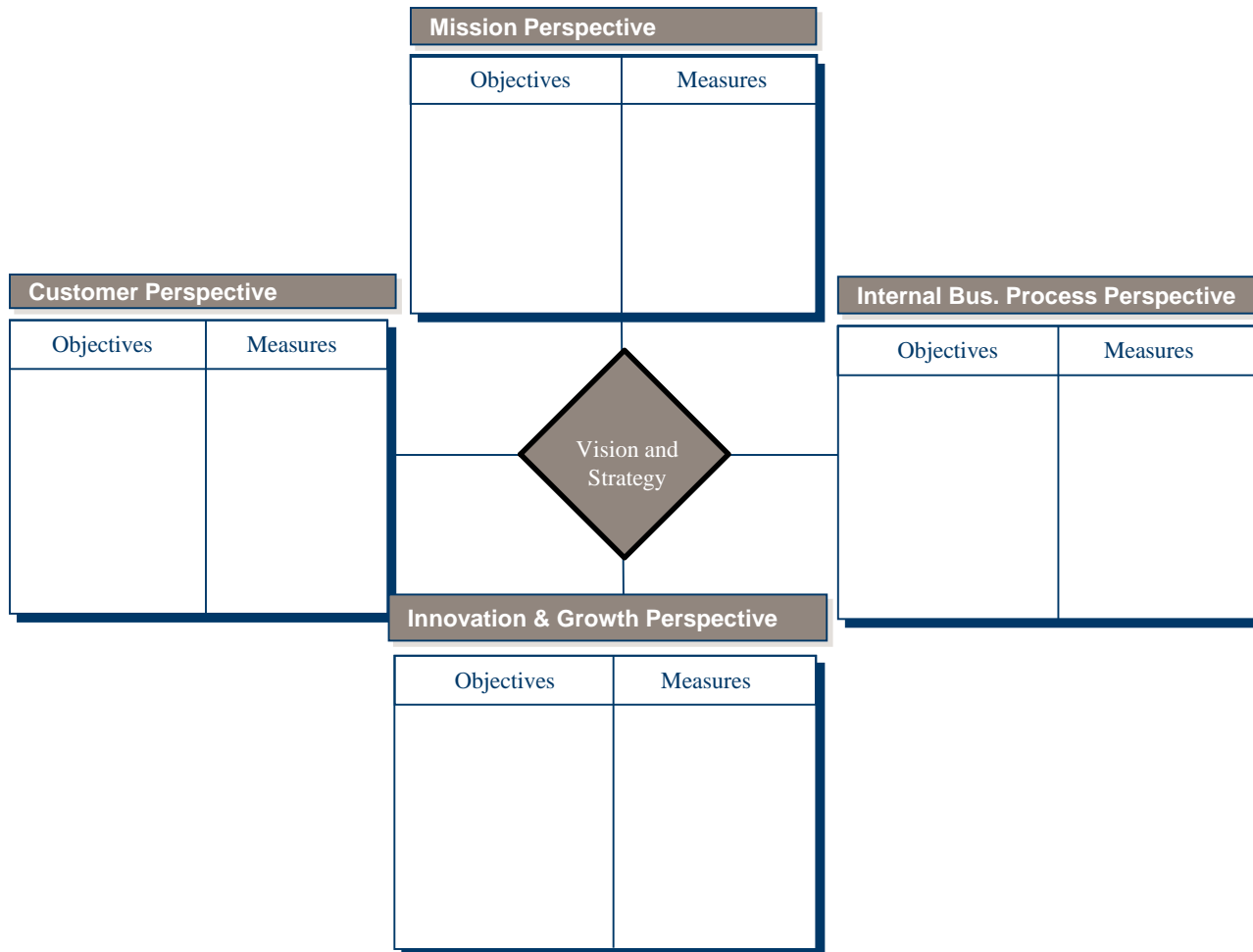
**Delivery speed (indexed against accidents and fines, Domino's)**

**Active consideration (active starts versus active opens, HSBC)**

**Raising price until 98% occupancy (not 100%)**

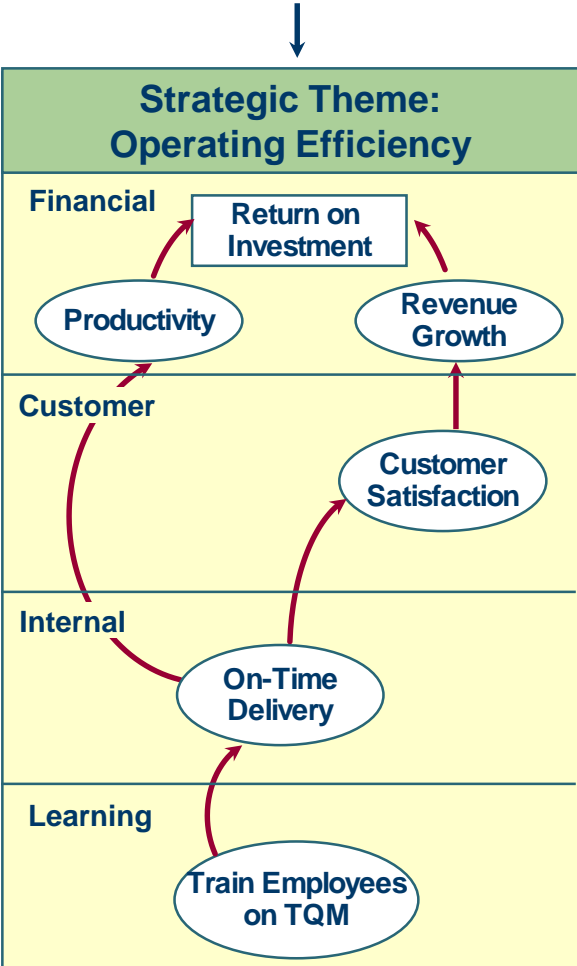
**Reach ^1 but page views ^2**

**% of add-ons versus base price**



# Balanced Scorecard Example

Strategy Map: Diagram of the cause-and-effect relationships between strategic objectives



## LEADING VERSUS LAGGING MEASURES

| Statement of what strategy must achieve and what's critical to its success | How success in achieving the strategy will be measured and tracked | The level of performance or rate of improvement needed | Key action programs required to achieve objectives |
|--|--|--|--|
| Objectives   | Measurement  | Target   | Initiative   |
| • Improve OTD  | • On Time Delivery   | • 95%  | • OTD optimization initiative                      |

# Thinking about each of the metrics

- Executive compensation
- Employee incentives
- Resource allocation decisions
- Mergers and acquisitions
- Growth strategies
- Investor relations and communications
- Nearly every facet of solid business strategy

***How do each of these decisions change when the guidelines of Disciplined Performance Measurement and Valuation are considered?***

# Disclosures

## Disclosures

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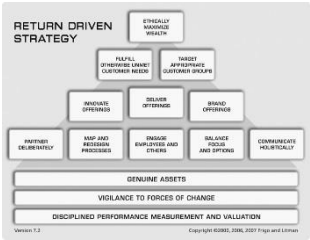
# Why the DEF14A? Because...

| TSR <sup>1</sup> Ranking Report Card |      |
|--------------------------------------|------|
| Alignment                            | High |
|                                      | Low  |
| Traditional Metrics                  | D    |
|                                      | C    |
| Value-Based Metrics                  |      |
| High                                 | A    |
|                                      | B    |

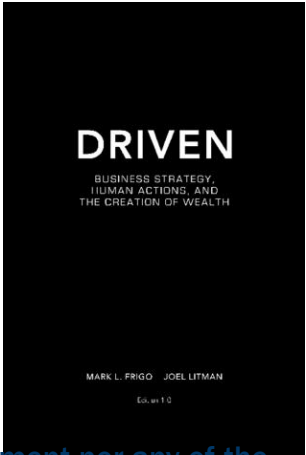
<sup>1</sup>TSR = total shareholder return

Courtesy of Hewitt Associates

# Insights from Return Driven Strategy



The difference between a  
business with a great product...  
and a great business



- The 8th Wonder of the World...
- The “*most powerful force in the universe...*”
- ...COMPOUND INTEREST

# RETURN DRIVEN STRATEGY

