# WHAT DOES BREXIT MEAN FOR VALUATION?

NGFINANCE – MARKET & VALUATION UPDATE June 2016

## Brexit uncertainty added to pre-existing global concerns in Europe

After the UK referendum voted to leave the European Union, financial took a hammering, with sterling and the FTSE falling dramatically, before recovering some of the losses over the last days.

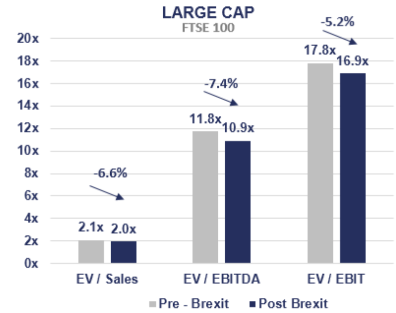
As the UK and the rest of Europe sober up to a prolonged period of political, economic and social uncertainty, we look at the collateral damage this uncertainty and market movement will likely cause on the valuation of tangible assets, intangible assets and companies going forward in the UK.

*"The economic and political uncertainty is currently overriding intrinsic valuation drivers. Over time, new political, trade and legal agreements will normalise long term asset valuations"*

**Market reactions since the anouncement of the referendum results**

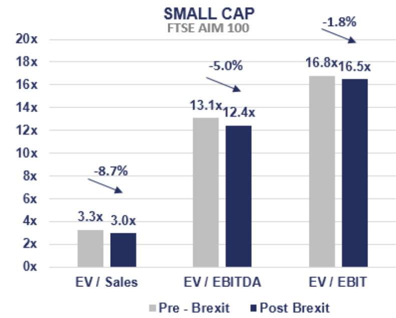
| Country | Index | Brexit Friday | Since Brexit | YTD |
|---|---|---|---|---|
| UK | FTSE 100 | -3.15% | 0.35% | 1.89% |
| UK | FTSE AIM | -3.18% | -4.04% | -5.58% |
| UK | FTSE 250 | -7.18% | -7.68% | -8.19% |
| Europe | EUROSTOXX 50 | -8.62% | -6.77% | -13.83% |
| France | CAC 40 | -8.04% | -6.06% | -9.53% |
| Belgium | BEL 20 | -6.40% | -5.73% | -10.88% |
| Switzerland | SMI 20 | -3.44% | -0.55% | -9.52% |

Source : InFinancials



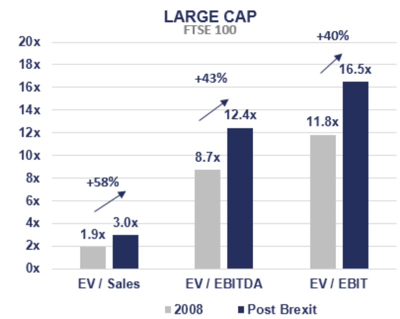

## Impact on the valuation of private companies

Valuations for privately held companies or assets are based on many parameters that have been impacted by the extra complexity, as well as the added uncertainty in forecasted business plans. Forecasting is particularly difficult in times of uncertainty and volatility, as cash flows become less certain whilst the riskiness of the company, or discount rate used to discount cash flows back to the present day, also rises.




## 6.4% real median loss on key valuation metrics

Valuation changes during the 2 days pre- and post-Brexit reveal a less gloomy picture than perhaps portrayed by the media, who focus on peak and trough intra-day movements. An analysis of the median metrics of the FTSE 100 large cap and AIM segment shows decreases of 6.6% on EV/Sales and 7.4% for EV/EBITDA between the pre- and post-Brexit prices. It is interesting to note that valuation levels on are still 46.7% margin compared to those of the 2008 crisis, indicating a far stronger fundamental valuation story across the economy.




Source: InFinancial, 2 days pre/post Brexit, median results, companies with clear net debt values and single class of shares listed, 16 Sept 08, 1-day post Lehman Brothers' bankruptcy

## Mechanical valuation degradation

The repercussions of the stock market volatility will be felt in private company valuations given the dependency on comparative valuation methodologies, in addition to revised forecast for each industry in a second step. We provide a short summary on how asset and company valuation will be affected by the different methods:

**Intrinsic valuation methods** such as the DCF will be impacted by the discount rates (a function of risk free rate, market correlation and volatility as well as the specific outlook for each company i.e. it's growth forecasts and overall cash flows.

**Extrinsic valuation methods** such as comparable listed companies approach will be impacted directly by the movement in market values, which has an immediate effect on the valuation of the target company. See the changes in value of the listed companies on the LSE for UK companies and their respective market places for business with international operations.

**Components of discount rates** A change in the present value of future cash flow due to the impact of the Brexit on all the key parameters of the discount rate (Weighted Average Cost of Capital). For example, the risk free rate, which is generally assumed to be the yield on UK sovereign debt, or gilts, moved in the opposite direction as expected. In fact, since the 23rd June the yield on gilts fell sharply, implying less risk, therefore we must look elsewhere to better understand the true risk free rate for a UK company. According to Credit Default Swap (CDS) markets, the risk of a default on U.K. sovereign debt has increased, with the cost of buying protection rising from 0.32% 0.47%, a three year high. In money terms, it now costs $47,000 a year to protect $10 million of U.K. sovereign debt for five years, compared with $32,000 before the referendum, a difference of 47%.

**Conclusion**: For investors, it is clear that fundamental valuation opportunities will emerge over the next few months, with the key being to retain a focus on the fundamental drivers of profit and long term growth in spite of the uncertainty and noise in the market. Pre-agreed deals may now have to be renegotiated and there may now be disagreements over the fair value of assets and liabilities. Moreover, many agreements of valuations overlooked by HMRC may have to be revisited.

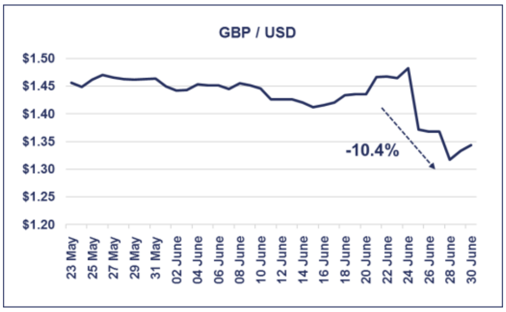
## Brexit to dampen GDP growth forecast for 2016 and beyond

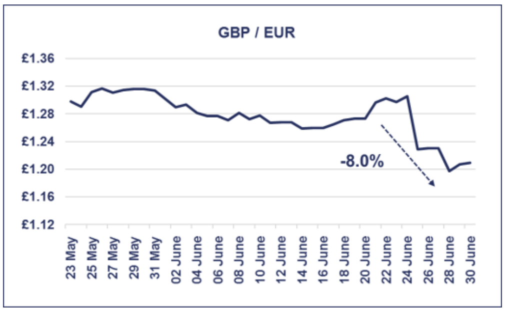
In this climate, with uncertainty prevalent across the UK, EU and the US, businesses will be reluctant to make long term capital investments, so GDP growth will likely drop. This should impact the expected growth rate of companies that generate their revenues from the national market. Indeed, in comments made this week, the Deputy Managing Director of the IMF Zhu Min estimated that UK GDP would decrease 1.4% accumulatively over 3 years, in a base case scenario, rising to 5.6% in a worst case, dependent on the level of political uncertainty

Bloomberg.com/videos

## International trade effect due to currency moves

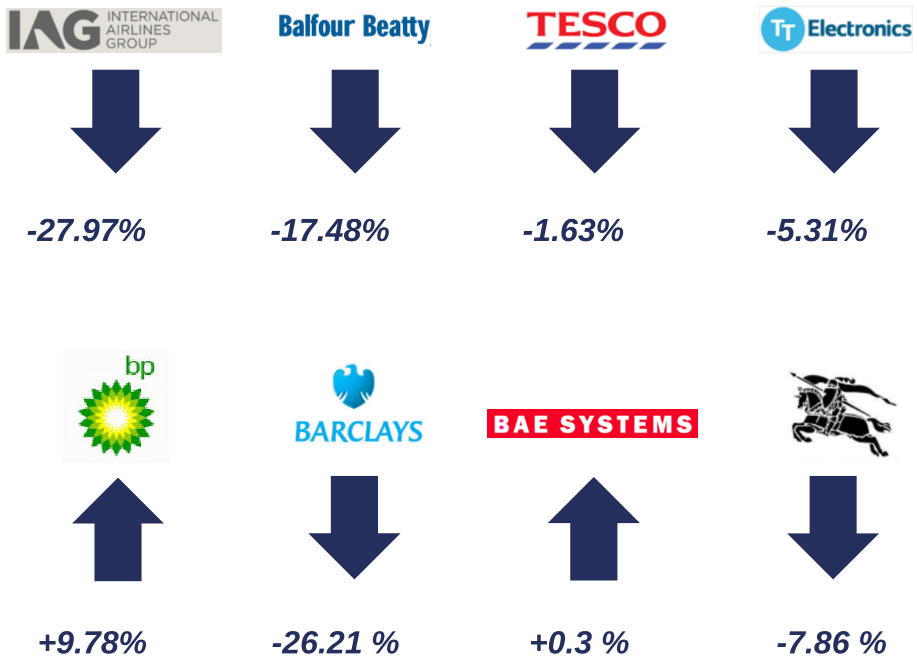
Perhaps the most dramatic mover has been pound sterling (-10.4%), which initially fell to 30 year lows versus the USD, down from the highs of $1.50 registered shortly after polls closed on referendum day. Weaker sterling should help UK exports become more competitive and could boost the earnings of many of UK's companies where the bulk of profits are made overseas. Nonetheless, imports of raw materials and other inputs to the production process will become more expensive, so the net impact on UK companies will be seen on a case by case basis.



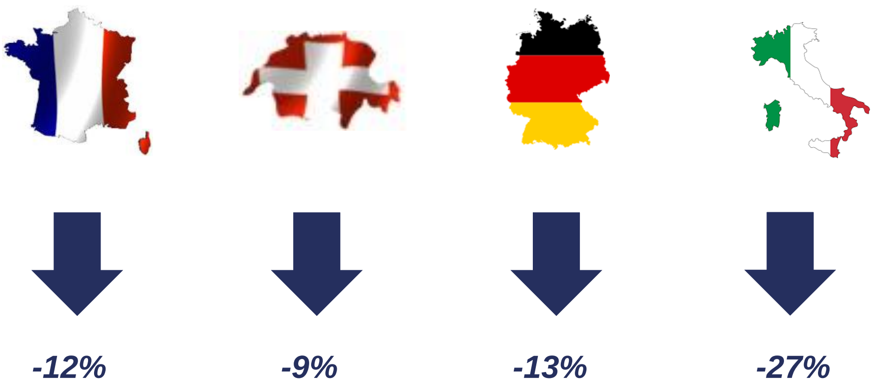



## Market movers since Brexit by industry

Notable movers since the Brexit referendum results were announced:




Notable moves in the banking sector in Europe since the Brexit referendum results were announced:



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## About NG Finance:

NG Finance, is a European independent firm specialised in Financial Valuation and Corporate Finance Advisory for listed and unlisted companies in France, Benelux, United Kingdom as well as Germany and Switzerland.


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