

"PRICE IS WHAT YOU PAY. VALUE
IS WHAT YOU GET"

WARREN BUFFET



Agenda

1 One size doesn't fit all



2 Due diligence is key



3 It seems cash is not always the king



4 Timing is everything



5 Personality bias



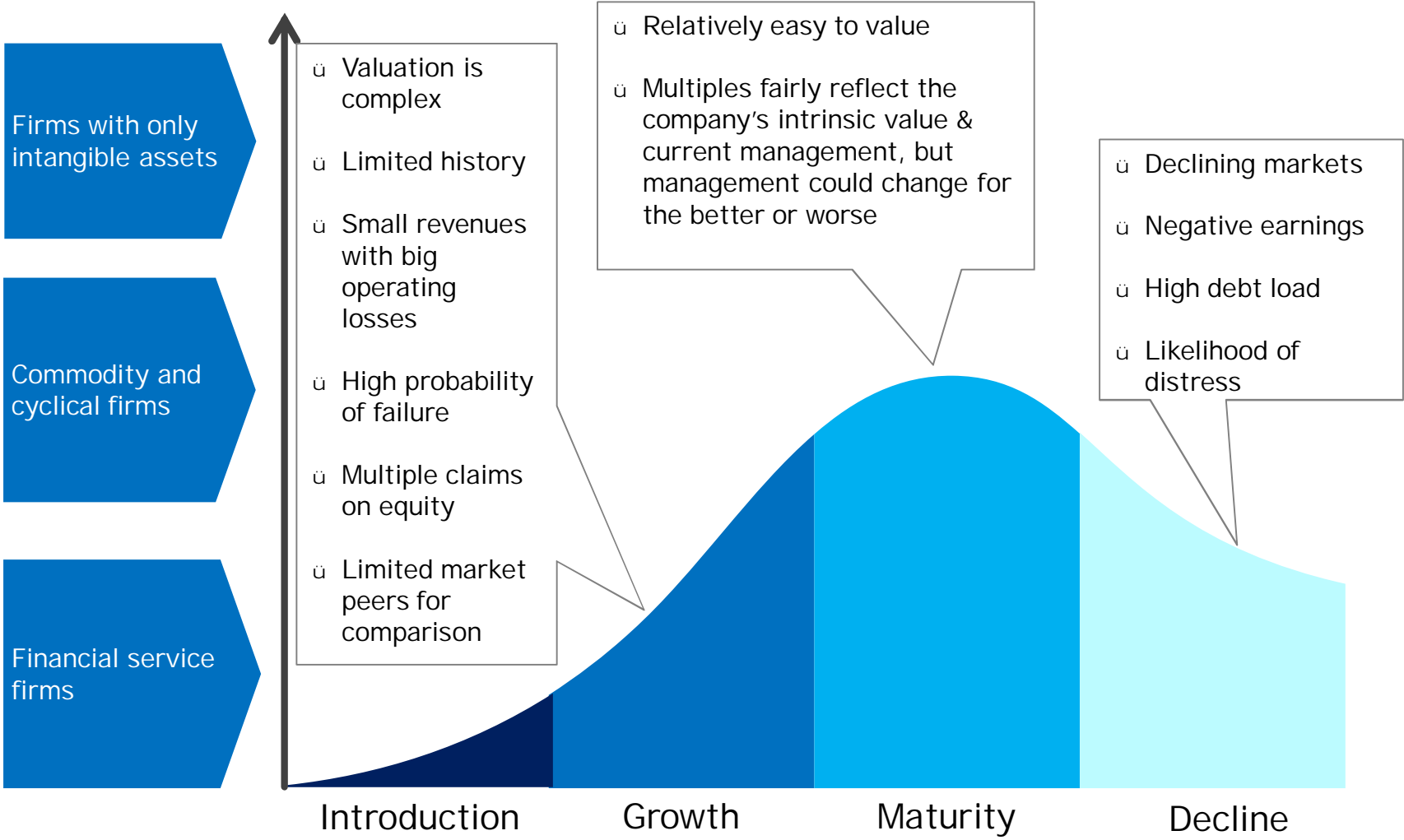
6 Health check on valuations



One size
doesn't fit all



Challenges in valuing companies across the business lifecycle



A photograph of two men in a dimly lit office at night, focused on their work. They are seated at desks with large computer monitors. The man in the foreground is wearing glasses and a dark shirt, looking intently at his screen. The man behind him is also looking at his monitor. The scene is illuminated by desk lamps, creating a professional and concentrated atmosphere. The text 'Due diligence is key' is overlaid in white on the lower left portion of the image.

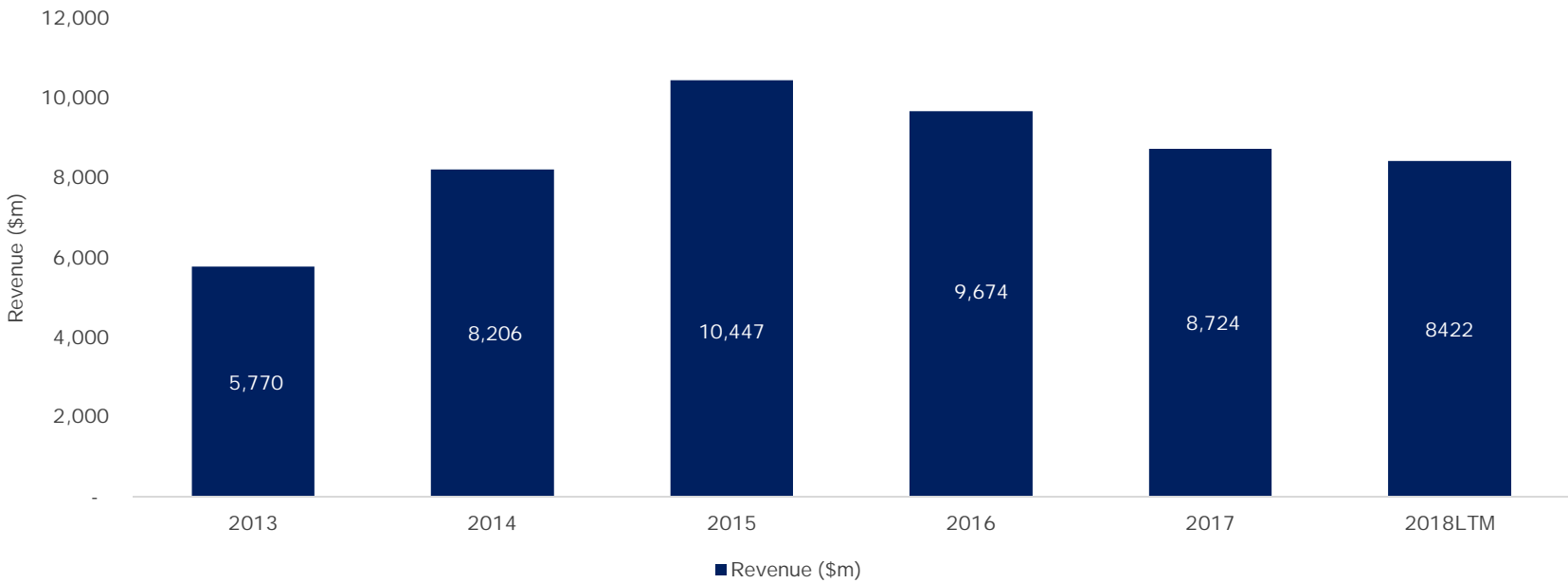
Due diligence is
key

Valeant's meteoric rise was entirely driven by acquisitions

Valeant business model of growth through acquisitions

- ▶ 23 acquisitions totaling \$26.4 billion during 2013-2015
- ▶ 18 out of the 23 were private companies
- ▶ 2 major acquisitions of a public company (Salix for \$12.5 billion) and one of a private business (Bausch and Lomb for \$8.7 billion)

Valeant has seen explosive growth since 2010, with revenues increasing from \$1.2 billion to almost \$10 billion in 2015 and EBITDA surging from \$450 million to \$5 billion during the same period



Source: Publicly available information

Valeant's acquisitions, price inflation business model drew in the likes of Sequoia Fund and Bill Ackman

Buy low, Sell high

- ▶ Main acquisition strategy was buying companies that owned the rights to "under priced" drugs and repricing to what the market would bear

Use debt capacity

- ▶ Valeant had no qualms about using its borrowing capacity to fund its acquisitions, unlike other mature drug companies

R&D is not sacred

- ▶ Valeant was one of the few companies in the business that viewed R&D like any other capital investment and scaled it back, as the payoff decreased

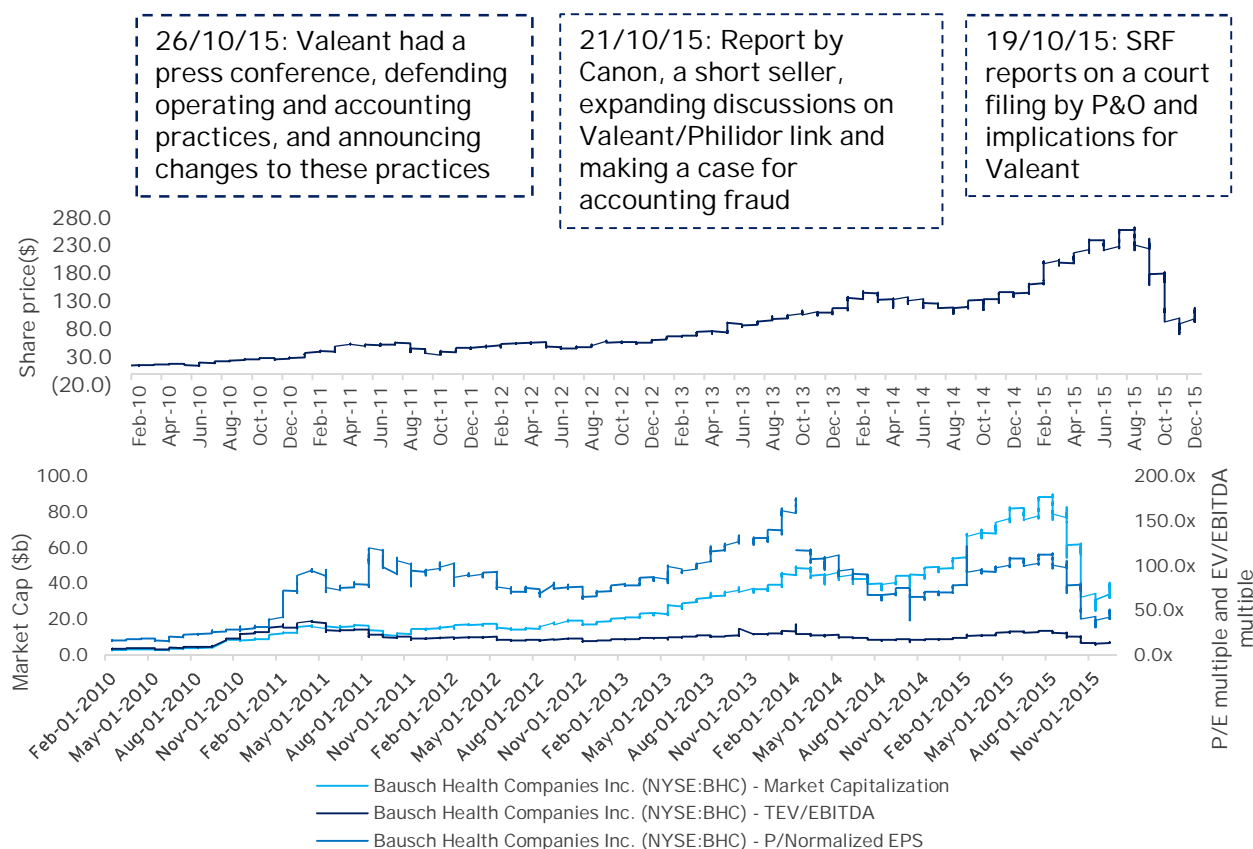
Quick conversion to earnings

- ▶ Its acquisitions seemed to translate quickly into revenues and operating income, vindicating their strategy
- ▶ As an added bonus, the company used its acquisition-related expenses to keep its tax bill low, keeping its effective tax rate below 10%

Valeant's the pharmaceutical equivalent of Enron?

What triggered its dramatic collapse?

- ▶ Citron Research, known for its investigations on short-selling strategies, published a report aiming to challenge Valeant's accounting policies
- ▶ That report claimed that Valeant had hidden a relationship with shadowy pharmacy entities and that it had used that relationship to cook its books



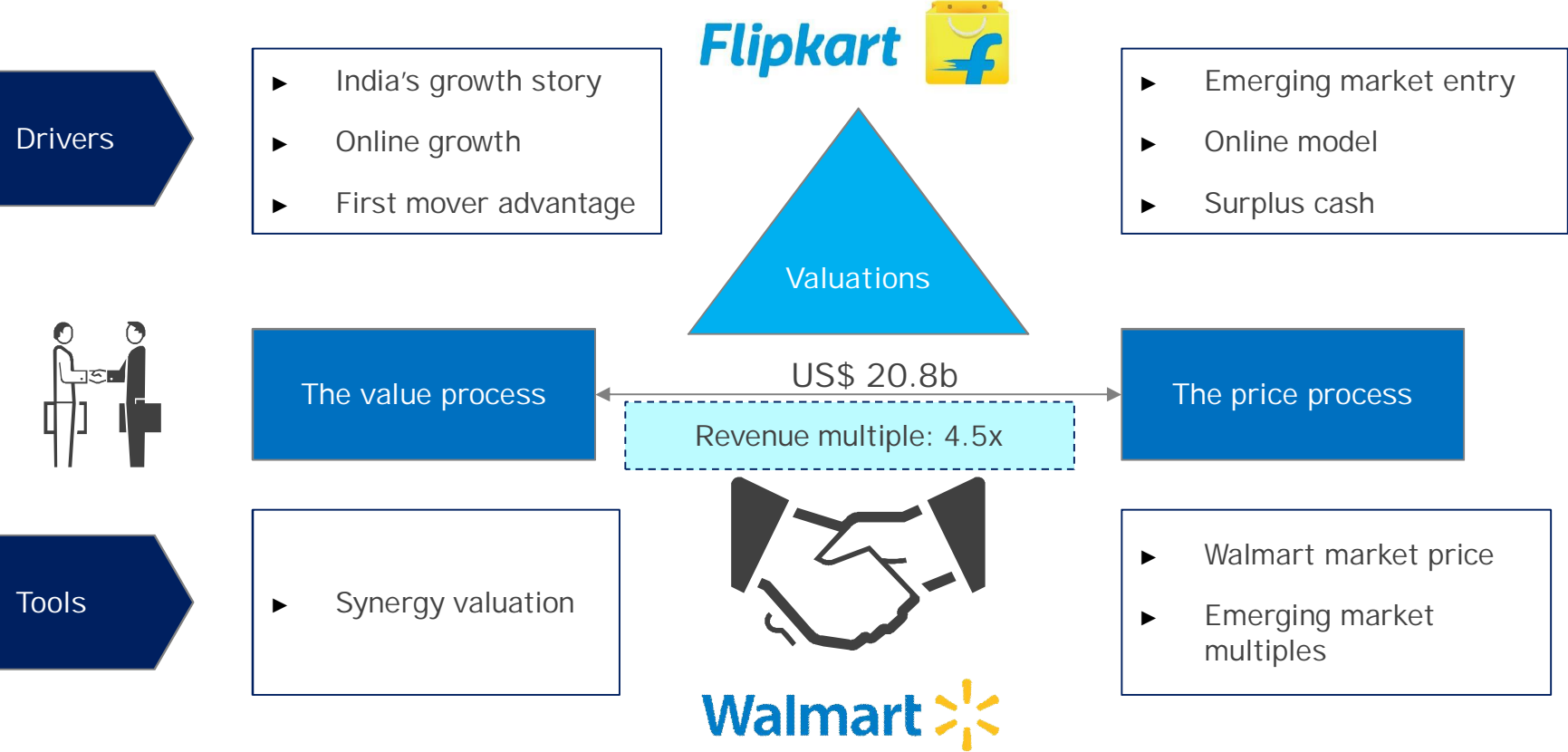
CEO (Now Ex) of Valeant, Michael Pearson, was forced to sell \$100 million of his shares in the company to cover a margin call

Hillary Clinton slammed Valeant for its drug price hikes and vowing to 'go after' them as a campaign promise



It seems cash is not
always the king

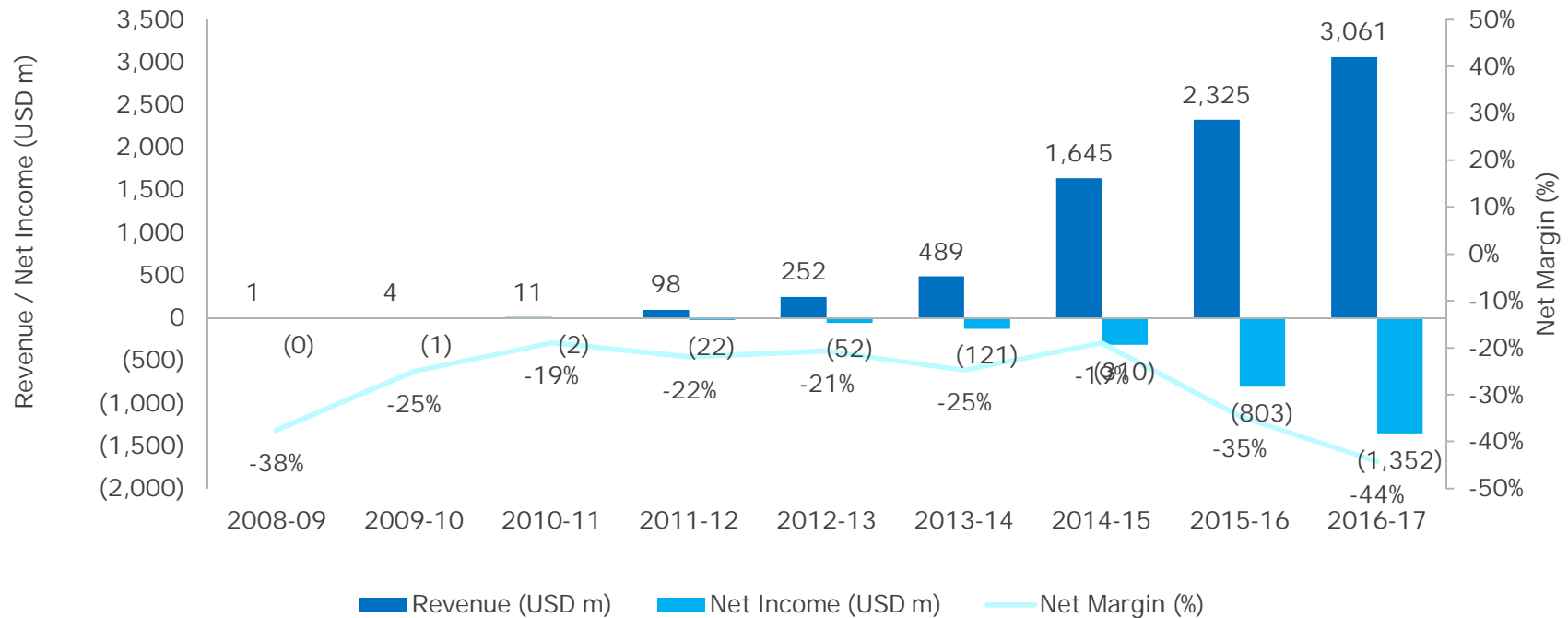
Why did Walmart pay \$16 billion for a 70% stake in Flipkart?



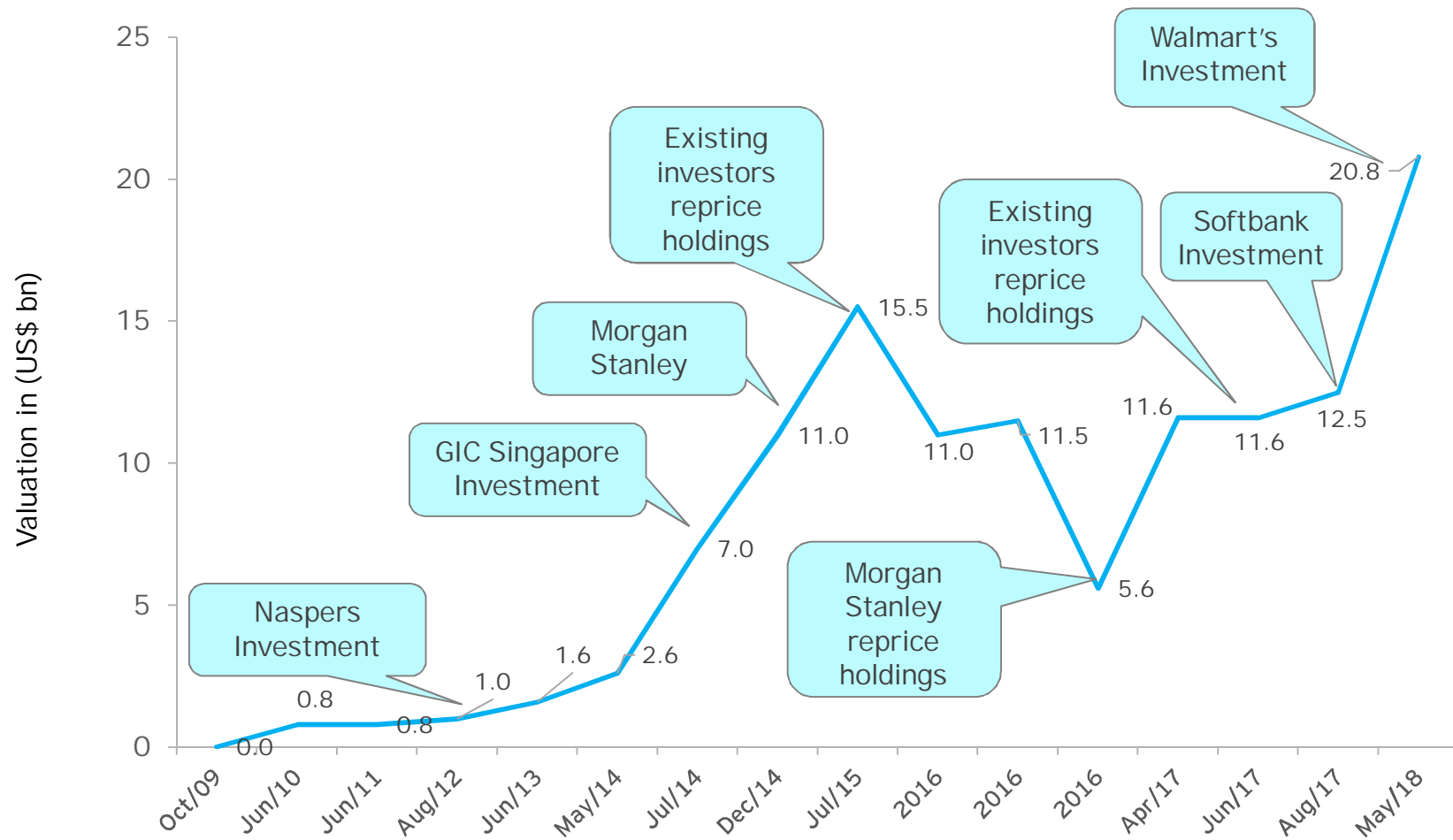
Flipkart's losses have scaled up despite strong revenue growth

Operating History

- ▶ Founded in October 2007 by Sachin and Binny Bansal, with about \$6000 in seed capital
- ▶ Revenues increased from less than \$1 million in 2008-09 to c. \$100 million in 2011-12 and accelerated, with multiple acquisitions along the way, to reach \$3 billion in 2016-2017
- ▶ Losses widened over the years despite drastic increase in revenues

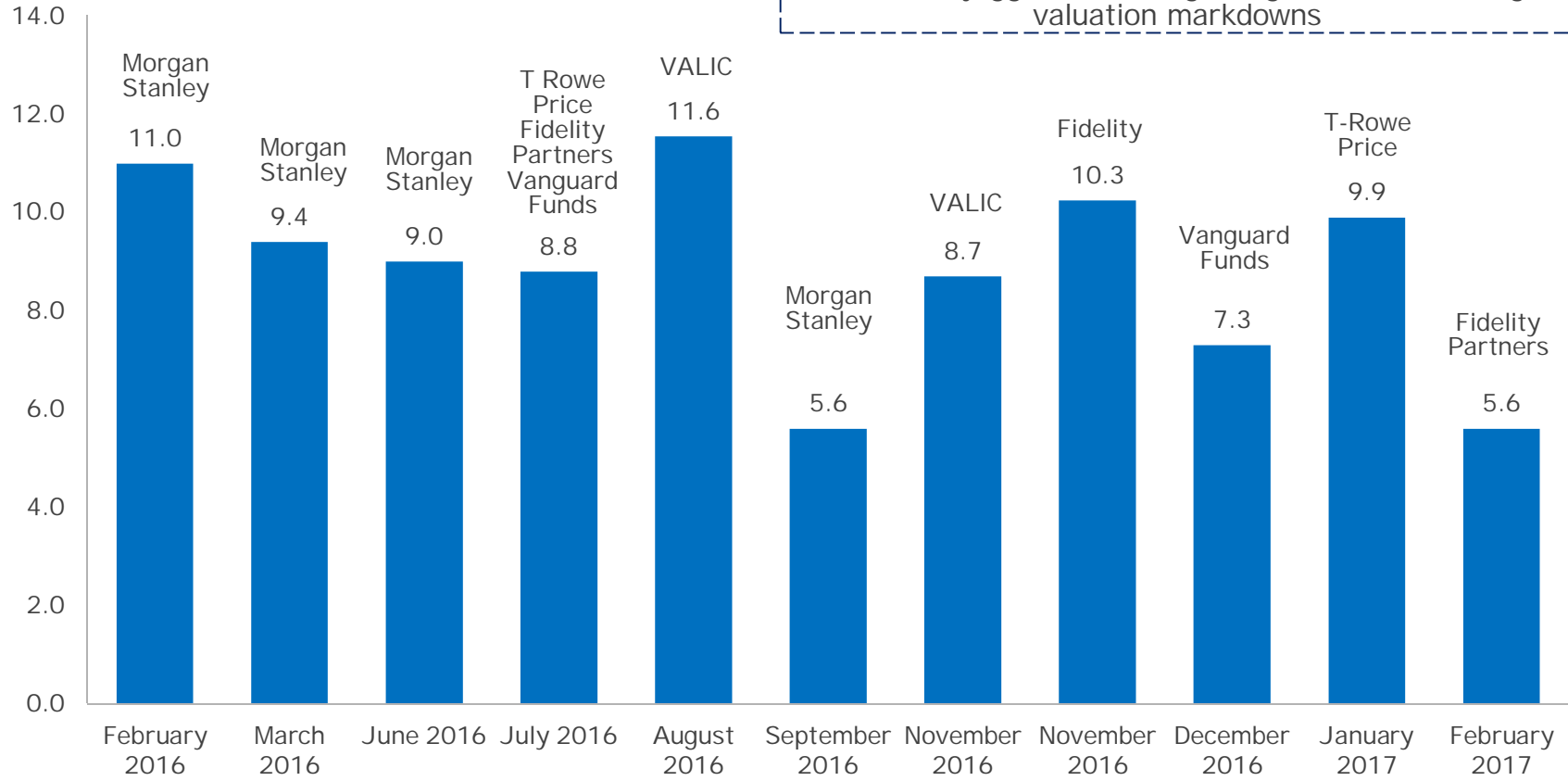


Flipkart has attracted a series of high-profile investors over the years



Valuation markdown with slowing growth

With slowing growth, unit economics and profitability remained pipe dreams
 &
 the Amazon juggernaut was gaining market - Leading to valuation markdowns



Source: Publicly available information

Timing is
everything



Why the GE Alstom deal—worth c.US\$16bn—made sense back then



Transaction Overview

- ▶ GE announced its acquisition of Alstom's Thermal, Renewables and Grid businesses on April 30, 2014. GE closed the transaction on November 2, 2015, after a lengthy regulatory review process



Purchase Price

- ▶ c.\$16bn

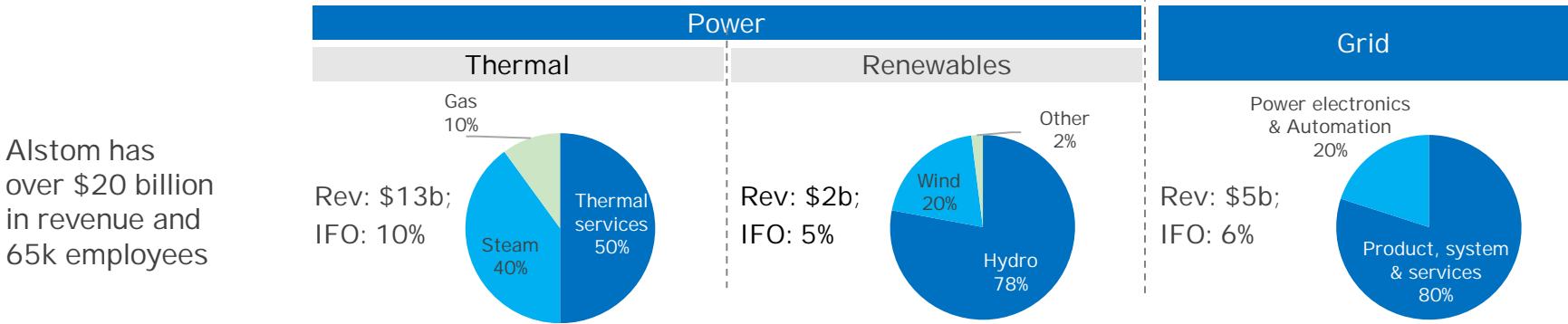


Transaction Multiple

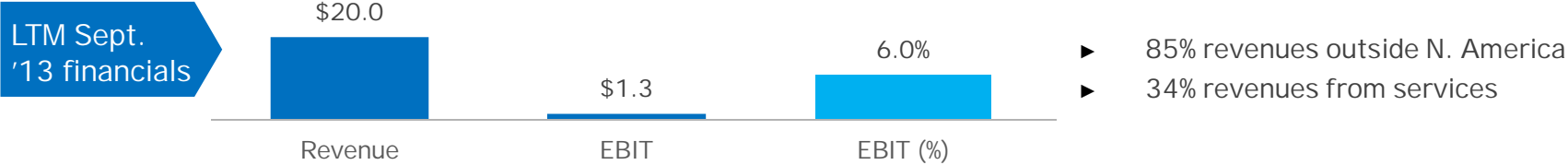
- ▶ All-cash transaction valued the Alstom assets at c.8x pro forma EBITDA

Why did GE buy Alstom?

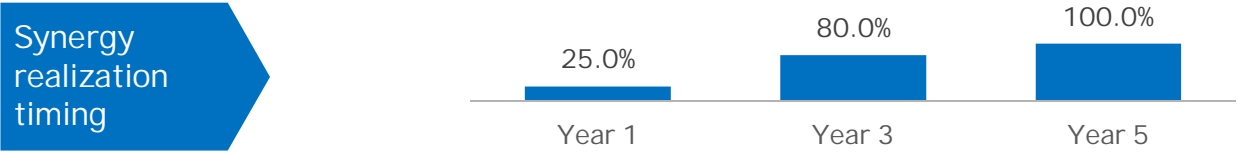
GE's vision of becoming a global powerhouse for thermal power equipment



Alstom brings complementary technology, global capability, a large installed base and talent to GE



Financially attractive with US\$ 1.2b of synergies within 5 years based on optimization of manufacturing and services footprint



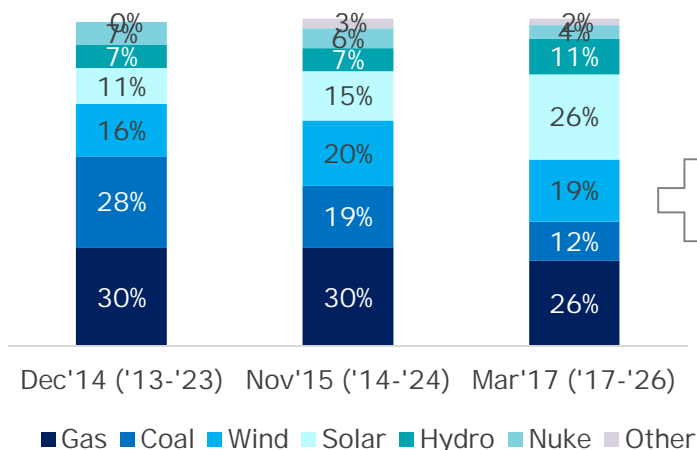
Source: Publicly available information

Victim of poor timing?

Timing

- ▶ GE plunged into natural gas power market but faced challenges due to shift in market's focus on renewable energy and cheap oil and gas prices
- ▶ Its natural gas turbines market shrank so fast that its EBIT dropped more than 80% YoY in its latest quarter

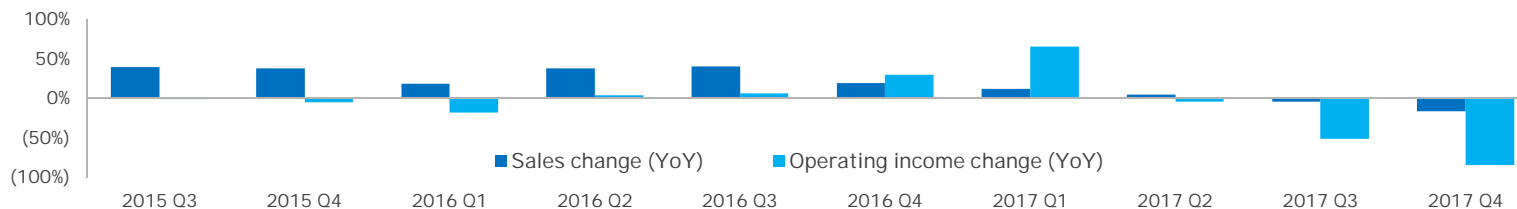
GW installed shows significant increase in renewables at expense of fossil



Declining gas turbine orders for utility (c.88% of global turbine orders)

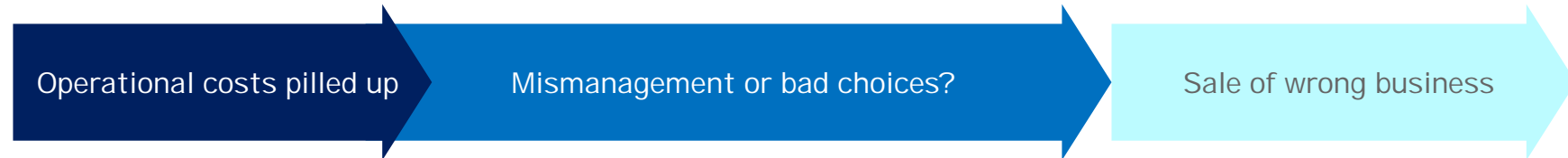
	Gas Turbine Order for Utility Use										
GW	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017E
Europe	13.0	6.8	4.9	2.7	1.6	1.8	0.8	0.4	0.0	0.3	0.4
United States	6.1	7.9	5.2	4.1	5.3	5.7	5.7	10.2	10.7	6.9	6.5
ME + North Africa	31.0	18.4	17.0	18.2	20.8	15.7	21.6	14.5	18.1	16.7	11.0
Asia ex Japan, China	5.0	6.8	1.9	7.9	10.2	7.5	7.3	5.7	7.8	3.9	5.0
China	1.3	1.6	1.4	3.5	11.9	9.4	6.6	2.7	5.9	5.1	5.0
Japan	0.9	1.6	0.6	2.1	5.1	2.1	0.8	4.0	1.7	2.0	2.5
Russia and CIS	5.3	9.7	4.3	2.6	6.0	4.7	5.6	3.0	3.8	2.7	3.0
Other	21.9	13.0	9.2	6.4	7.2	3.1	3.9	3.8	5.5	7.3	7.5
Total	84.7	65.9	44.4	47.7	68.0	49.9	52.2	44.3	53.5	44.9	40.9

Source: McCoy and JP Morgan estimates



Source: Publicly available information

What made things go from bad to worse? – Alstom acquisition is the answer



- ▶ Operating costs increased significantly with the addition of ~65,000 employees

- ▶ GE Power ramped up its production when demand waned, resulting in huge inventory backlog
- ▶ Cash flow was severely depressed due to:
 - ▶ falling operating income
 - ▶ rising inventory

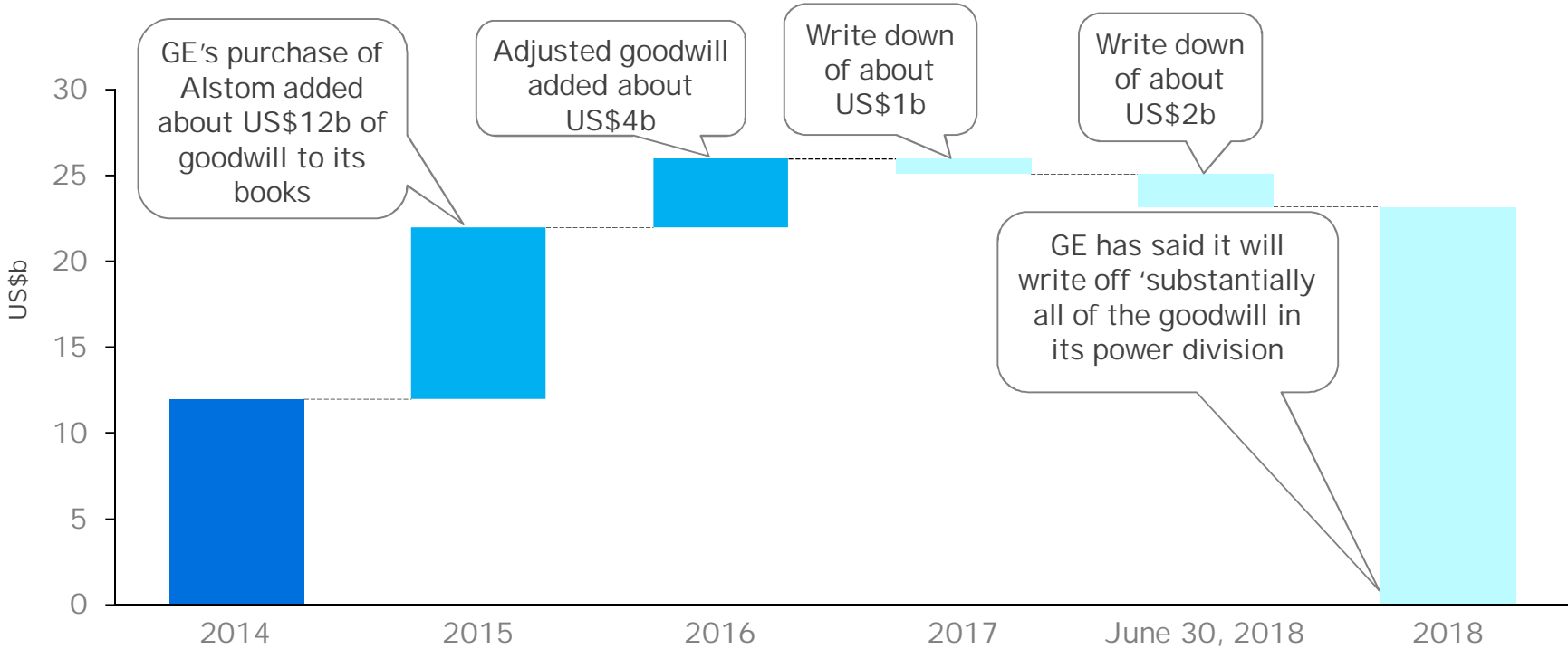
- ▶ In March 2017, GE announced to sell its profitable water business to French utility Suez SA and a Canadian pension fund, as a result of its combination with Baker Hughes (BHGE) which had an overlap with its water business
- ▶ As of date, BHGE has failed miserably

The result of the misjudgment? GE announced a layoff of 12,000 people from its Power business in December 2017

How GE gained and then lost, goodwill

GE announced a \$23bn write off in October 2018

- ▶ Alstom assets actually had a negative net worth of \$7bn. The difference between that and the \$16bn price gives you close to \$23bn that was later written down



Source: Publicly available information

Personality Bias



Tesla is a 'story stock' where underlying value fades into background

Story Stock

- ▶ The story is so dominant in both how people price the stock and what determines its value that the numbers fade into the background

Musk both an asset and liability

- ▶ Musk is the engine behind the core vision of the world's transition to sustainable energy
- ▶ Musk's recent erratic behavior, infamous 'going private' tweet has led to sharp drop in valuation



CEO is woven into the cloth of the company

- ▶ Musk's legion of fans are a passionate bunch, bordering on hero worship
- ▶ Musk inspires employees and despite having a reputation of being a difficult boss, augurs immense respect

"Working with him isn't a comfortable experience, he is never satisfied with himself so he is never really satisfied with anyone around him...the challenge is that he is a machine and the rest of us aren't." - Tesla Employee on Musk

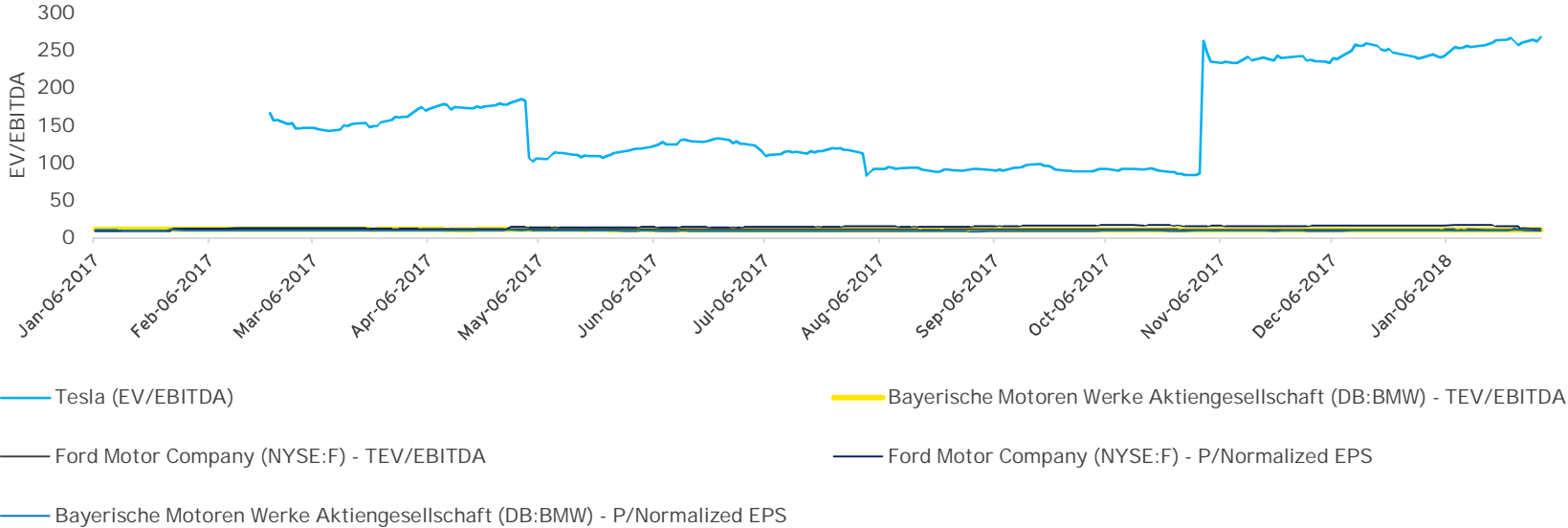
Tesla: Irrational Exuberance or Foresight?

Irrational Exuberance or Foresight?

- ▶ Most auto companies would be valued at a 6x – 10x EBITDA
- ▶ Tesla’s average EV/EBITDA multiple in 2018 was c.100x

Tesla already outperformed Ford and General Motors in market value last year and has thus risen to become the most valuable US carmaker.

In November 2018, it had surpassed BMW’s valuation also



Source: Publicly available information

Health check on valuations



Most common valuation issues

1. Selecting the right valuation approach and model // FCFF vs FCFE // PE vs EBITDA vs EBIT Vs Revenue
2. Earnings vs cash flows
3. Normalization adjustments
4. Flat growth vs Hockey stick projections // Growth // Risks // Earn out structures
5. Terminal value calculations (Capex / Working capital changes) // Discrete period // Perpetuity
6. Terminal growth rate // industry growth vs Exit multiple
7. Basis of discount rate // CoE vs WACC
8. Equity Value Vs Enterprise Value // Completion mechanism
9. Discounts and premia // DLOM
10. Valuation synthesis (Triangulation // football field)