



UBS Investment Research

An analyst view on financial reporting

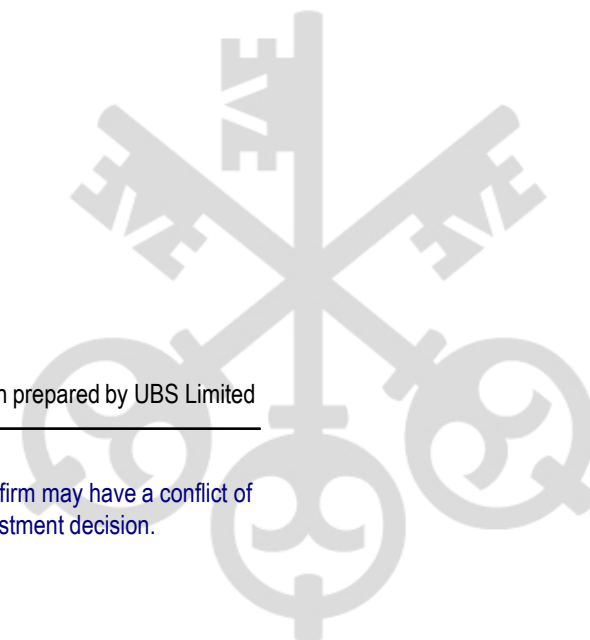
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What analysts do not want from companies



Use of financial statement information

- **Ex-ante or valuation role of accounting information**
 - Evaluate the return potential of investment opportunities
- **Ex-post or stewardship role of accounting information**
 - Monitor the use of capital once committed

Our focus is on the valuation role of accounting information

Key analyst role is to derive target equity values

	Discounted cash flow	Valuation multiples
Equity value	Dividend Discount Model	PE, Price to Book Value
Enterprise Value	Enterprise Free Cash Flow	EV/ EBITDA, EV/ OpFCF

Examples of UBS European Equity Research

Shell - Valuation: Buy, Price Target 2100p (€24.7/share)

We find ourselves increasingly comfortable with the outlook although still concerned around some unreasonable market expectations for the cash cycle. Our price target is set at 2011 EV/DACF of 5.9x, a 7% premium to the sector average. This equates to a P/E of 9.2x. With good volume growth and an undemanding multiple we see Royal Dutch Shell as the valuation reference point for the sector.

HSBC – Valuation: Neutral, Price Target 720 p

We value the group based on a one stage Gordon growth model. We have reduced our price target by 80p to £7.20. This reflects a reduction in our sustainable return on invested capital from 13% to 11%. Our 10% cost of equity and 3% growth rate remain unchanged.

Akzo Nobel – Valuation: Buy, Price Target €61

Our target price of €61/ share is DCF derived. We think that structural changes in Akzo's business will lead to a contraction of the c15% valuation gap to US peers Sherwin Williams and PPG (consensus).

Source: UBS Research

Comparing DCF and Valuation Multiples

- **Discounted Cash Flow**

- Forecast relevant future cash flows
- Estimate discount rate
- Discount cash flows to get Enterprise Value
- Deduct claims from EV to get equity value
- **An absolute valuation approach**

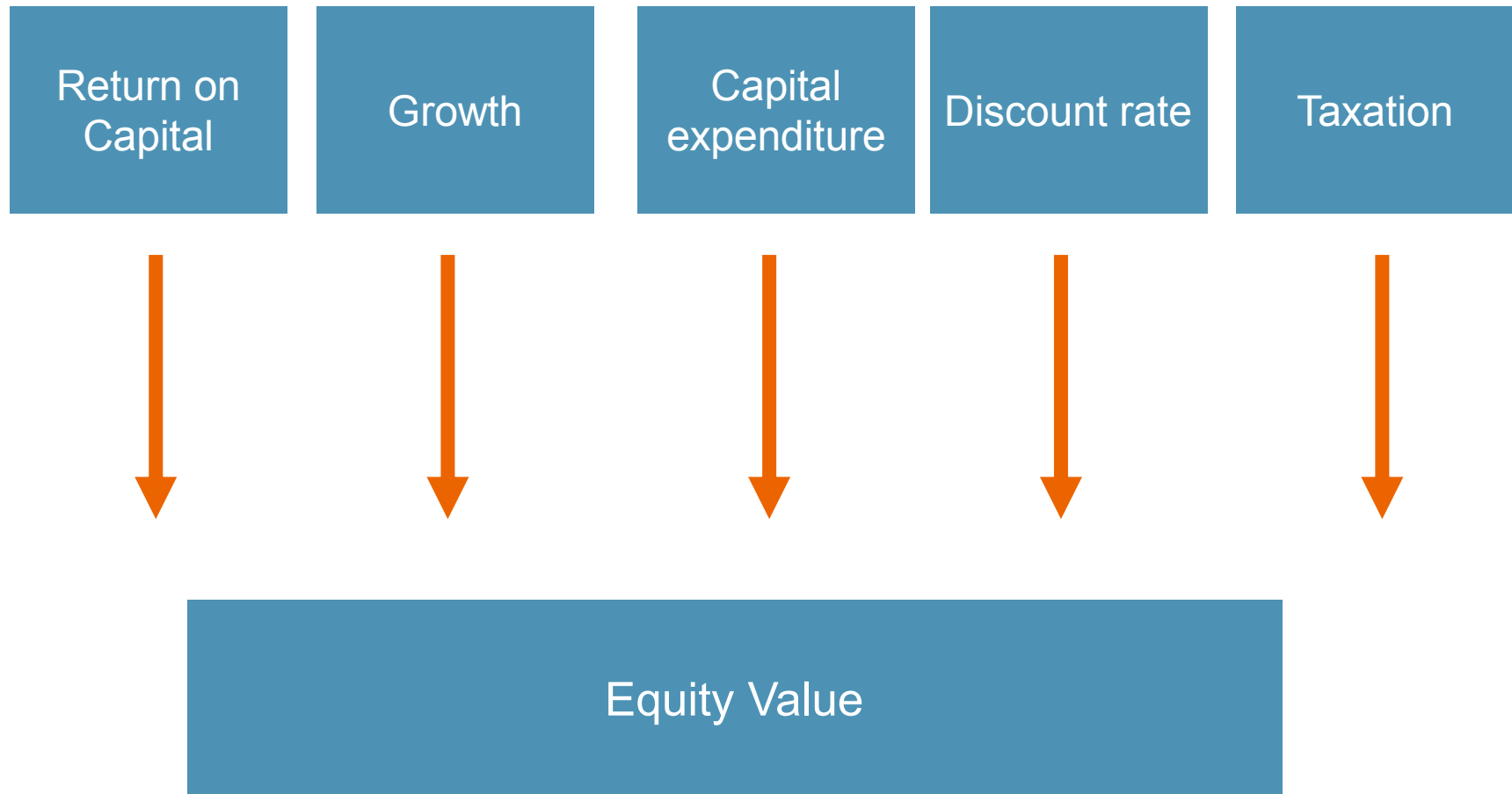
- **Valuation Multiples**

- Forecast relevant results component
- Derive target valuation multiple
- Obtain target enterprise value
- Deduct claims from EV to get equity value
- **A relative valuation approach**

Cash flows and claims

Comparability and consistency

Same value drivers matter for valuation



Financial reporting to gauge value drivers

- Comparable key performance metrics such margins, returns and income
- Balance sheet to reflects 'all' assets and liabilities to gauge risk
- Consistent treatment of similar transactions across companies
- Substance over form, with accounting to reflect underlying economics

Contribution of IFRS to financial analysis

- Principle based nature makes accounting better reflect underlying economics
- Single set of accounting standards enhances comparability in Europe
- Material improvements in key areas such as M&A, pensions and stock options
- The IASB is actively involving analysts and investors in standard setting

Challenges with IFRS in financial analysis

- Presentation choices in IFRS limit comparability of key metrics
- Accounting choices hamper comparability of invested capital and returns
- Strict rules can cause similar transactions to be reflected differently
- Financial reporting does not always reflect business model

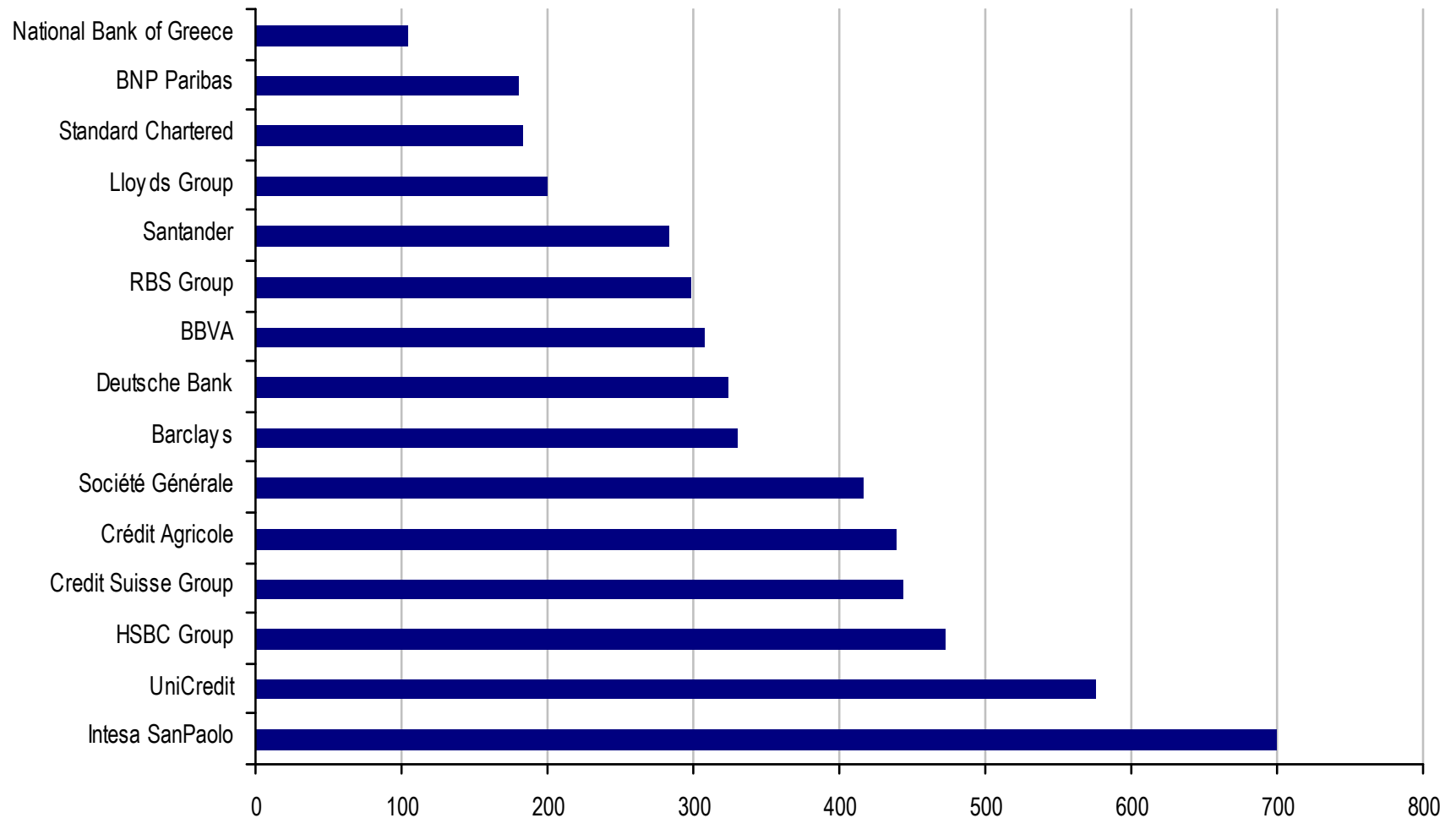
Addressing the challenges with IFRS

- Leasing
- Financial instruments
- Pensions
- Revenue recognition

Analysts in action?



Is more disclosure the answer? Top 15 European Banks



Source: UBS - Number of pages 2009 Annual Reports based on company information

Closing remarks

- With over 100 countries using IFRS, it has been a tremendous success
- US should join IFRS to make it a truly global accounting standard
- New wave of standards coming; investors prefer a 'big bang' transition
- IFRS has been a major improvement for the investment community but....

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