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INVESTMENT VALUE VS. MARKET VALUE IN THE VALUATION OF ASSETS IN EMERGING MARKETS

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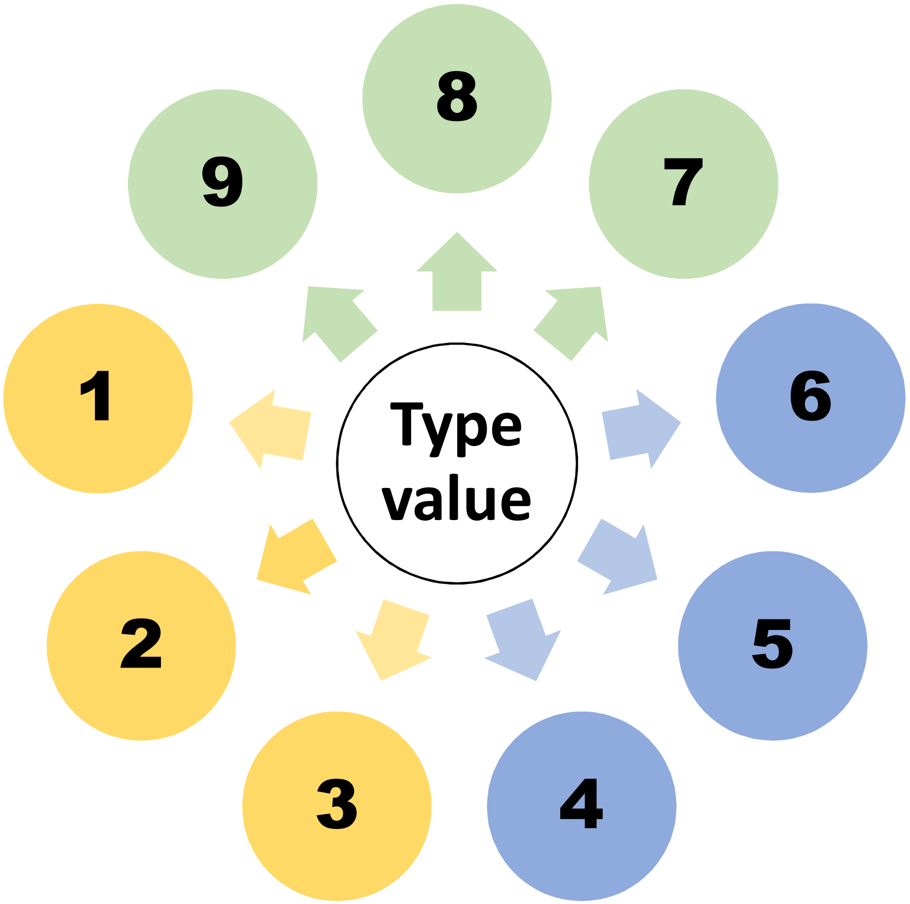
VALUE DIVERSITY
in valuation standards of TEGoVA (2016) and IVSC (2017)

'Value means nothing until it is defined.
No uniform value exists – assets may have
different value in different circumstances'.
Shannon Pratt (2006)



№	Type value	European Valuation standards, TEGoVA, 2016	International Valuation Standards, 2017
1	Market Value	x	x
2	Equitable Value	x	x
3	Investment Value	x	x
4	Market Rent		x
5	Synergistic Value		x
6	Liquidation Value		x
7	Mortgage Lending Value	x	
8	Insurable Value	x	
9	Special Value	x	

Value as a management tool

In corporate management value is:

- The main criteria for evaluating the effectiveness of any business activity;
- Measuring tool of enterprise performance;
- Factor in seeking new opportunities for growth;
- Unit of estimation depending on the activity of the market and the behavior of individual investors;
- Market insight on the benefit that brings the ownership of property at a particular point in time.

Value is a system forming factor in the new management concept of Value Based Management (VBM) whose essence boils down to maximizing the corporate value in the interests of owners/shareholders. In this concept there are two main types of value: *marketing value and investment value*.

Fundamental definitions of market value and investment value in valuation standards

	Type value	European Valuation standards, TEGoVA, 2016	International Valuation Standards, 2017
1	**Market Value**	"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm̓s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion. " (EVS 1)	„Market Value is the estimated amount for which an *asset* or liability *should* exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion". (IVS 104.30.1)
2	**Investment Value**	„Investment Value is the value of a property to a particular identified party for investment, owner-occupation or operational purposes."(EVS 2, 6)	„Investment Value is the value of an *asset* to a particular owner or prospective owner for individual investment or operational objectives". (IVS 104.60.1)

A comparative analysis of investment value and market value

Comparison criterion	*Market value*	*Investment value*
Subject of valuation	A hypothetical investor with business opportunities. Collective vision of market participants about the value	Particular investor (or group of investors) with clearly defined investment goals and intentions. Individual vision of the value taking into account the synergy effect.
Used information	Open publicly available market information	Information available to the particular investor (or group of investors)
Objectivity of valuation	Objective impersonal valuation made in terms of the market	Realistic subjective valuation from the point of view of a particular investor and its parameters: hidden objectives, internal factors
Application	Determining the most likely selling price for which the object of valuation can be expropriated between a hypothetical seller and a hypothetical buyer	Determining the appropriateness of making investments in a particular object with a view to gaining income in the future.
Taking into account the synergy effect	Does not take into account the synergy effect for the potential buyer because of its hypothetic nature	Takes into account the synergy effect for the particular investor as a result of combining assets
Methodological approach used	Market approach, Income approach	Income approach, Cost approach
Prerequisites	Existence of an open competitive market and absence of exceptional circumstances	No competition for the asset subject to valuation and existence of exceptional circumstances, for example, criteria that are not typical for the market (motivation, synergy effect, specific rate of return, etc.)

A comparative analysis of investment value and market value

Subjective value assessment concept

Investment value

Estimated by financial analysts and valuers working for the investor

- Value of the use of the object of valuation
- Takes into account the motivation and strategy of a particular investor
- Considerably more subjective
- Reflects the future

Objective value assessment concept

Market value

Estimated by valuers working for the owner

- Market exchange value of the object of valuation
- Takes into account the motivation and perceptions of a particular market
- Considerably more objective under the influence of the market
- Reflects the present

A comparative analysis of investment value and market value

 	For an investor in **PACKAGES OF SHARES** or **REAL ESTATE** ***investment value*** is the present value of future benefits, which provide a specific target rate of return at a level of risk acceptable for the investor. Value for a particular investor taking into account the availability of equity, loan use options, lending conditions, management strategies, required rate of return, etc. • *Methods of determining investment value: DFCFF, Earn-out Model, Real Options Method*
 	For an owner ***market value*** of **PACKAGES OF SHARES** or **REAL ESTATE** is the present value of the object of valuation naturally formed on the market on the valuation date. It reflects the present on the basis of typical average values of sold objects of the same type. • *Methods of determining market value: Method of Market Multiples of Comparable Companies, Method of Market Comparables, Capitalization Method , DEVA, DFCFE*

CAUTION! Slippery Market Approach

The investment value is derived by transaction based multiples. It represents the value of an explicit investor and includes premiums/discounts that can be realized only by that investor through various types of synergies.

The market value is derived by multiples based on quotes of publicly traded shares. It could includes various types of premiums and discounts, e.g. size effect. It represents the objectives of the portfolio investor.

The Income approach is more flexible and can be tailored to the specific conditions and circumstances of a given transaction/acquisition.

Key differences between investment value and market value

Investment value

Market value

Key differences :

- In the estimation of future cash flows
- In determining the level of risk and the risk factors inherent to the object of valuation.
- In the required rate of return
- In the level of financial costs
- In the synergy effect from a combination with other significant operations, investments or investments in other assets.

Possible relationships between investment value and market value

Market value > Investment value	Market value = Investment value	Market value < Investment value
This inequality occurs most often on emerging markets. Due to their high volatility, insufficient reliability of information, existence of a beta-dilemma, frequent change of ownership of assets, and other factors, investors determine the value of the asset including a higher level of risk.	Equality between the two types of value occur also in cases where the estimated value of the asset is the highest of the reasonably permitted ones for the owner and the lowest of the reasonably permitted ones for the investor. The equality reflects the same benefit for the owner and for the investor.	A similar disparity exists in cases where the investor evaluates the asset as part of its production chain, and thus the investment valuation includes a synergy effect as well.

Case studies from emerging markets

A case study from Bulgaria
Market value > Investment value

- The market value of a non-public company in Bulgaria calculated by independent valuators as of 31st December 2016 according to the DEVA (Discount Economic Value Added) method in the amount of EUR 11,784,000 for 100% of the equity.
- The investment value of the same company determined as of 31st December 2016 according to the Earn-out Model by a foreign investor is EUR 6,900,000.

The difference between the market and the investment value in this case is caused by the different methods used for the valuation, the high level of risk and subjective assumptions, reported by the investor in the estimates, as well as by the various strategic visions of the owner and the investor about the future development of the company.

Case studies from emerging markets

A case study from Russia
Market value < Investment value

- In 2005 93.02% of Krivorožstal are bought by Mittal Steel Company-Investor Germany GMBH (now ArcelorMittal) for USD 4.79 billion. The initial value of these shares as determined by independent valuers is USD 1.98 billion.

The difference between the investment and the market value is a result of the fact that independent valuers determine the market value of Krivorožstal as a separate operating entity without taking into account the possible synergy effects for potential buyers. On the contrary, the investor determined the value of Krivorožstal taking the company as part of its production chain, evaluating all the additional advantages as a component of a big business

Thank You

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