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DUFF & PHELPS

ARE MARKET VALUES FAIR?

Goodwill Impairment Study for Italy and comparison with Germany and United States

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Agenda

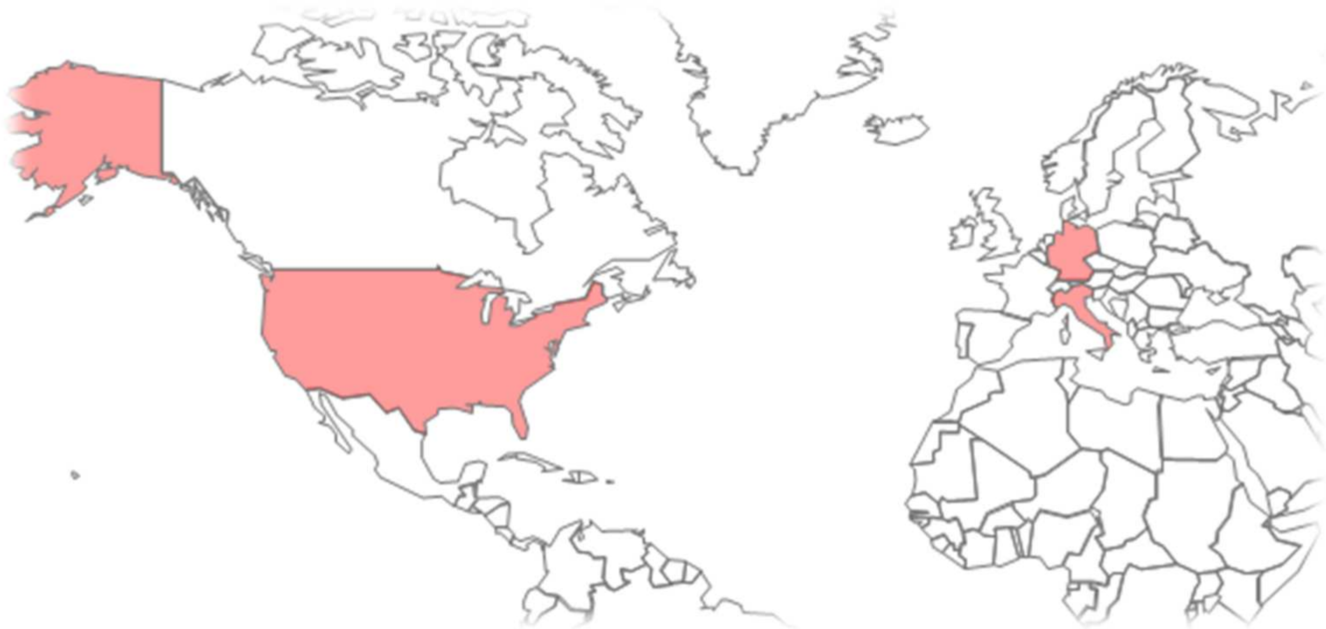
- Introduction
- Overview of Goodwill Impairment Studies
- Goodwill Impairment and Market-to-Book Value
- Statistics by Industry
- Focus on the Italian Market
- Discount rate
- Disclosure in 2011 Annual Reports
- Summary of the analysis
- Conclusions

Introduction

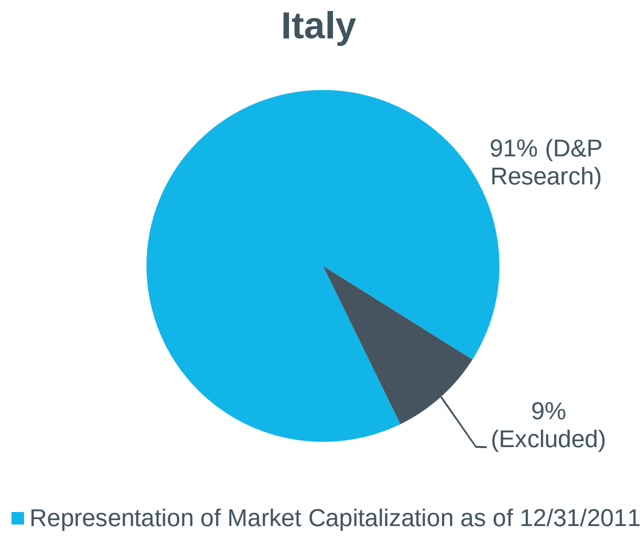
- Purpose Study: impairment test comparison Italy, Germany and US.
- Focus on public Italian Industrial Companies and on the main drivers of the impairment test.
- Impairment Test and value drivers (KPIs).

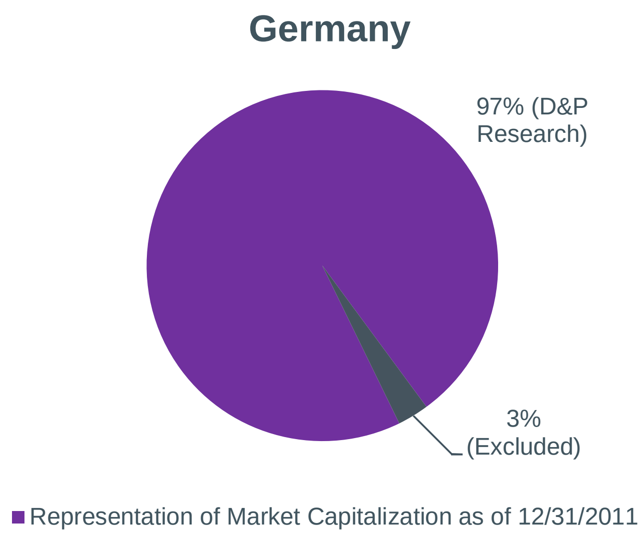
Overview of Goodwill Impairment Studies

- Strong attention of IASB
- Link to market price developments
- Specific Italian components
- IFRS vs Italian GAAP vs US GAAP

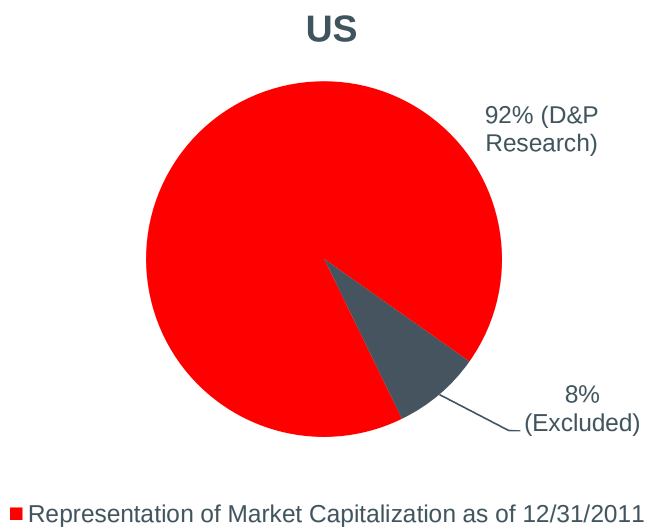


The sample – 200 companies for Italy



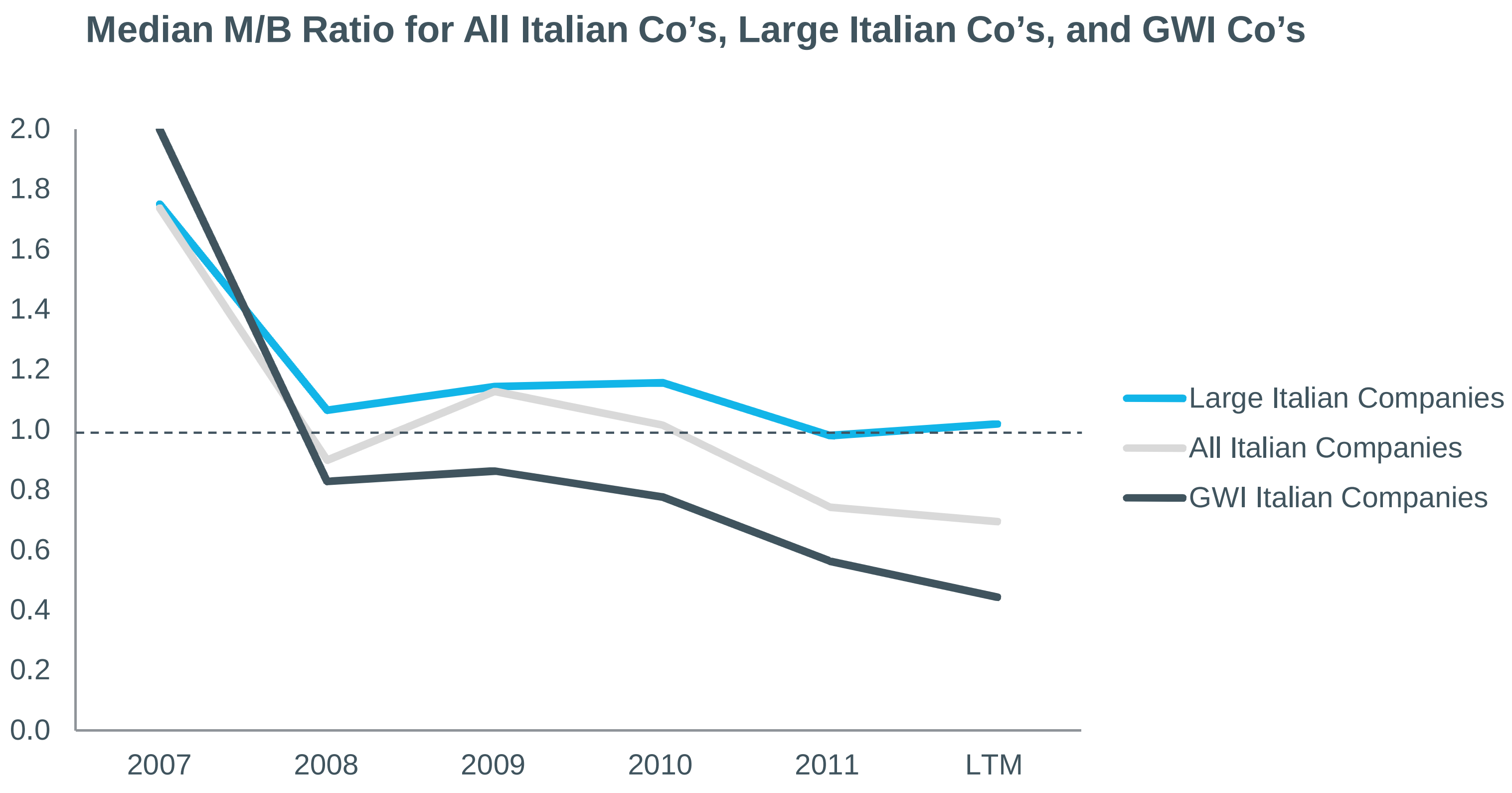


- Total numbers:
  - 202 companies for Italy
  - 723 companies for Germany
  - 5,004 companies for the U.S.



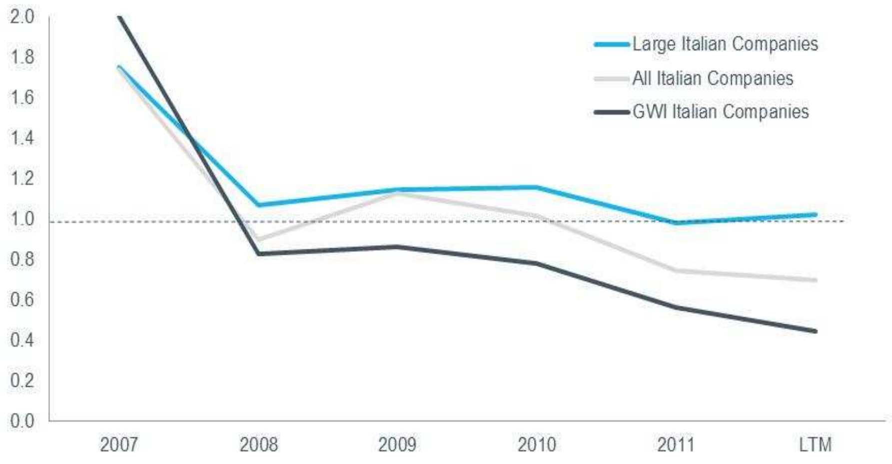
Goodwill Impairment Risk and M/B Ratio

- Market to Book Ratio = Market Price / Book Value
- On the basis of market price per 1 share

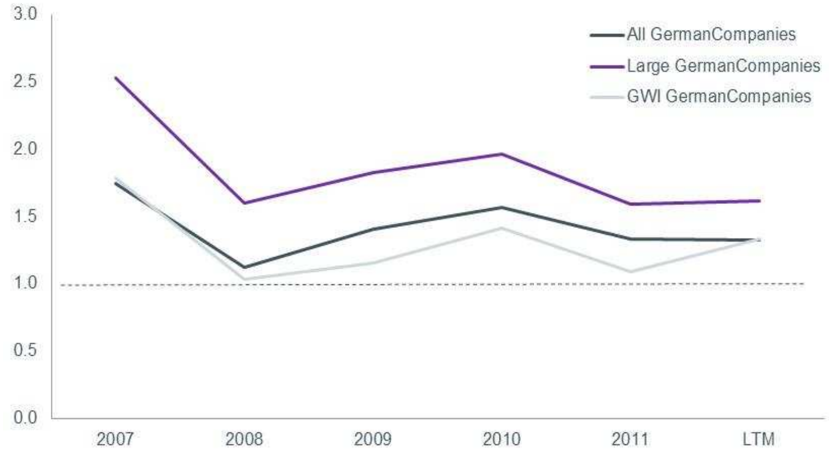


Goodwill Impairment Risk and M/B Ratio

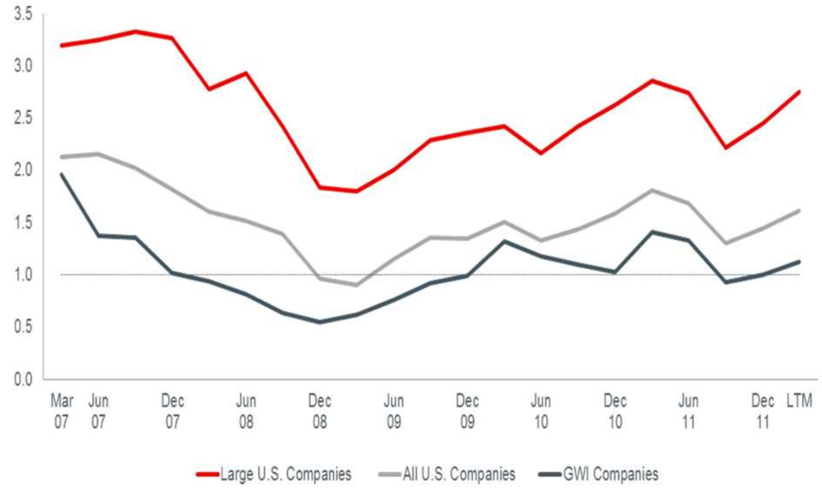
Italy



Germany



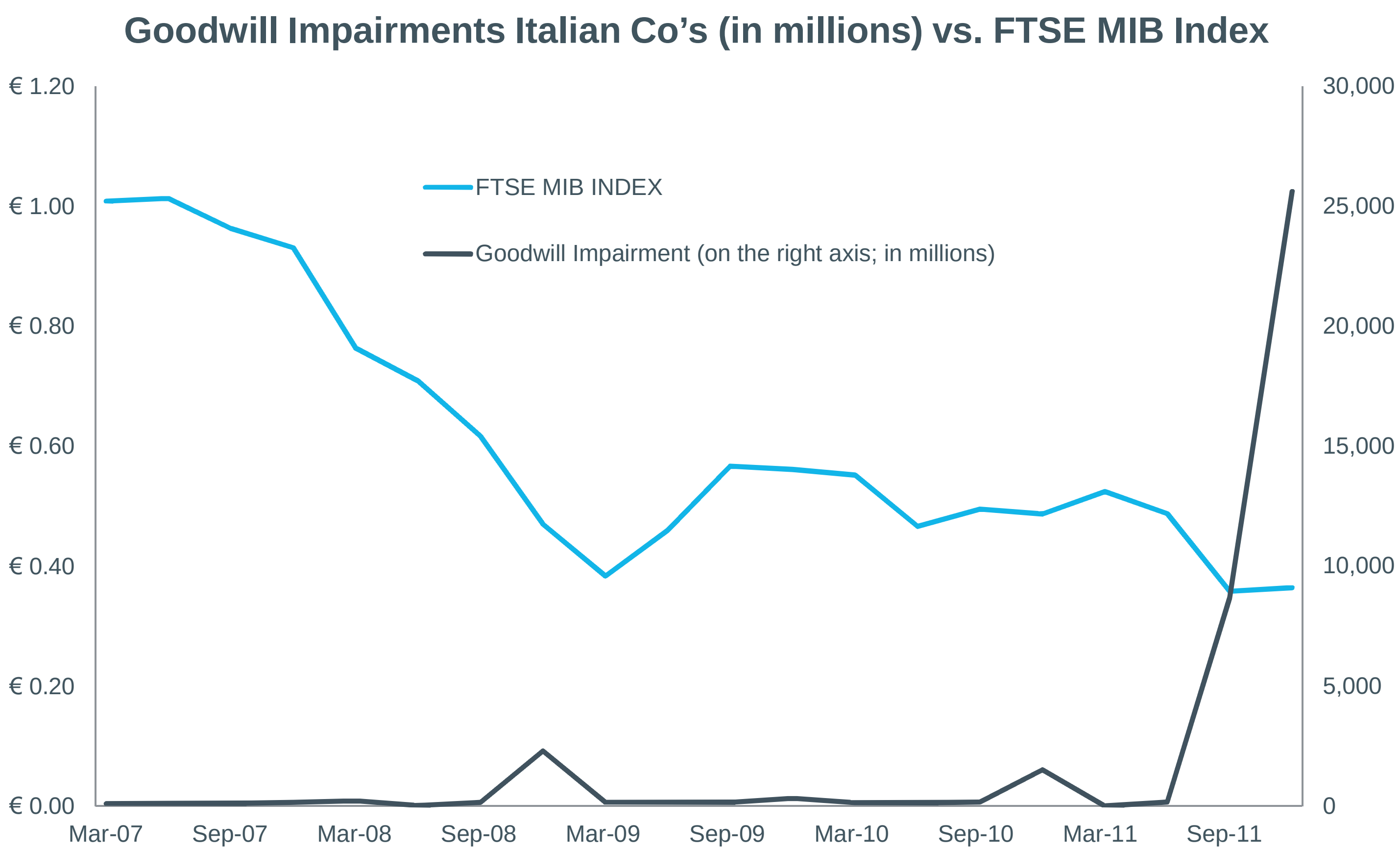
US



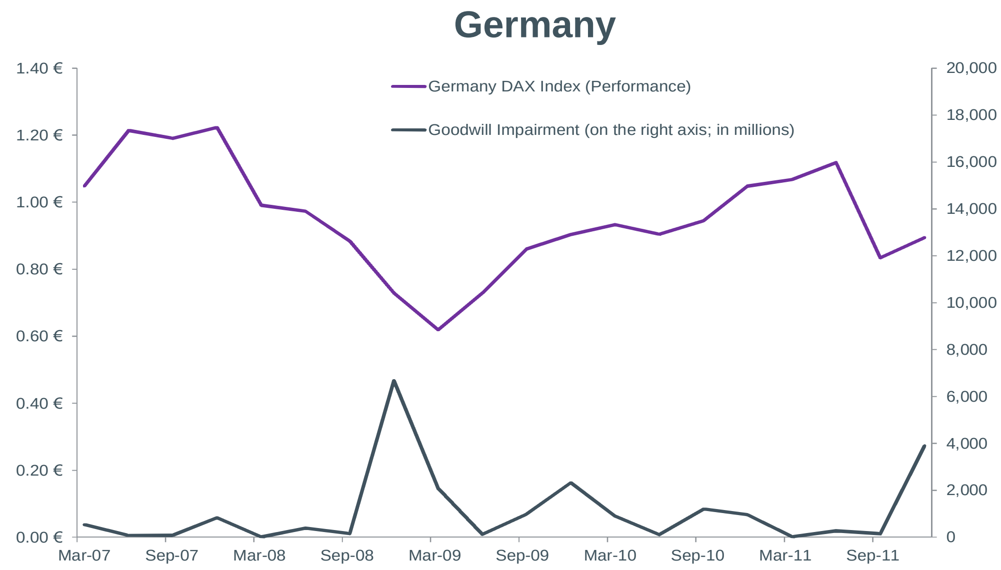
- Italy: more companies at risk
- No recovery yet in 2012 in Italy

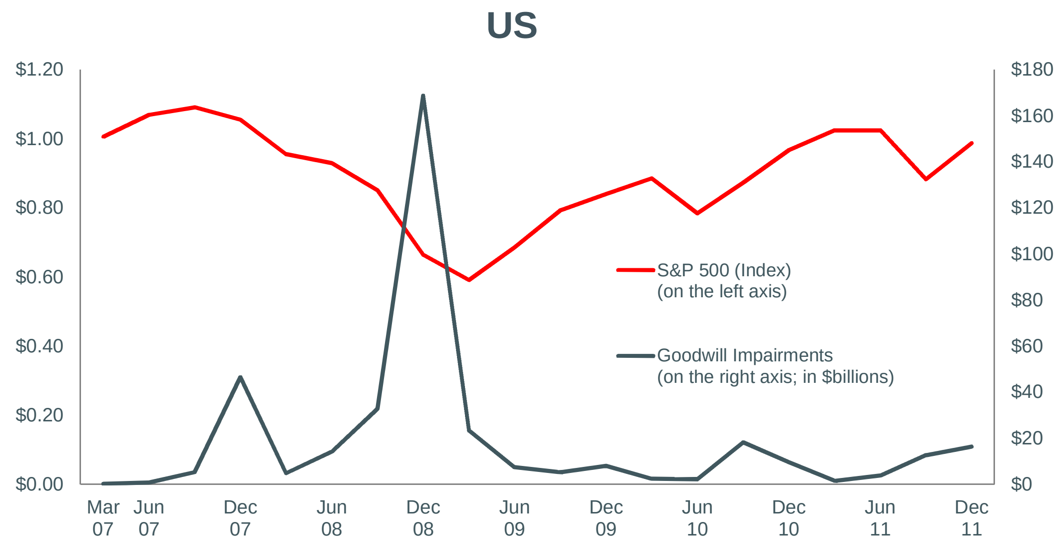
Goodwill Impairments in Italy: Historic Overview

- Few impairments until 2011
- More impairments at end of 2011 – some large ones



Goodwill Impairments: Italy vs. Germany - US

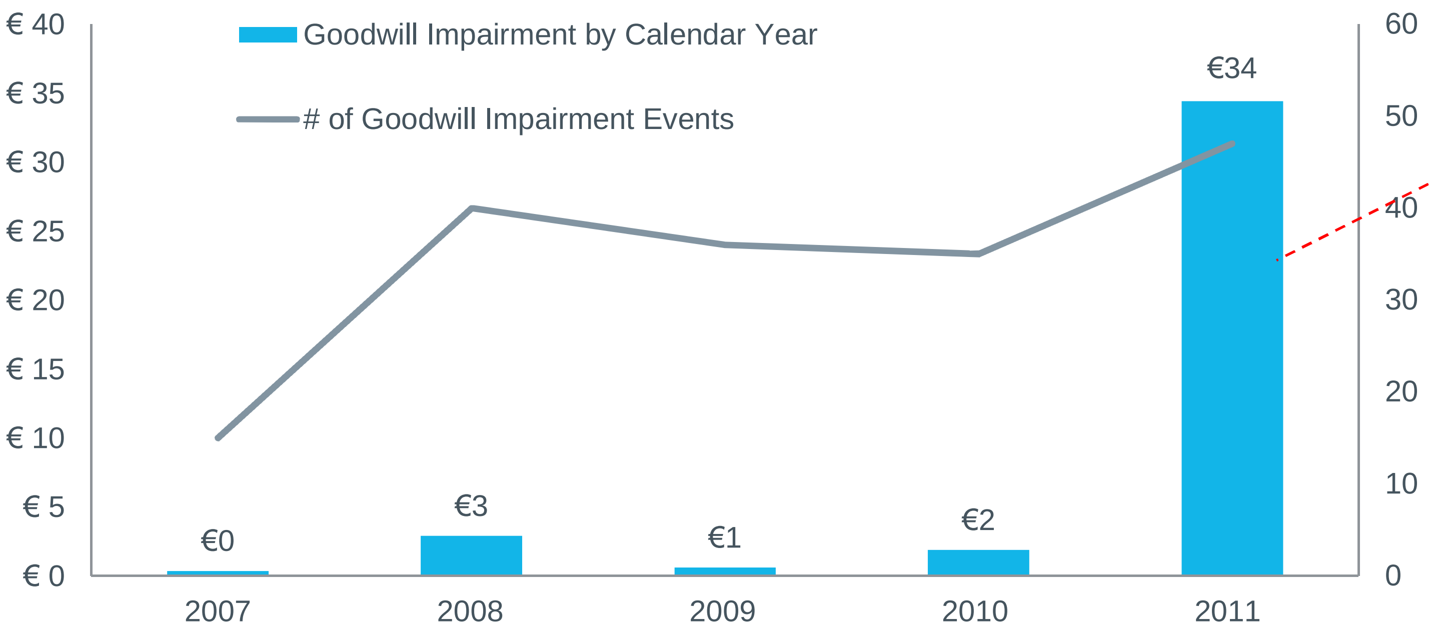




Goodwill Impairments in Italy 2007-2011

- Limited amounts until 2011
- Few larger impairments in 2011

Goodwill Impairment, Italian Companies (in € billions)



Rank 2011:

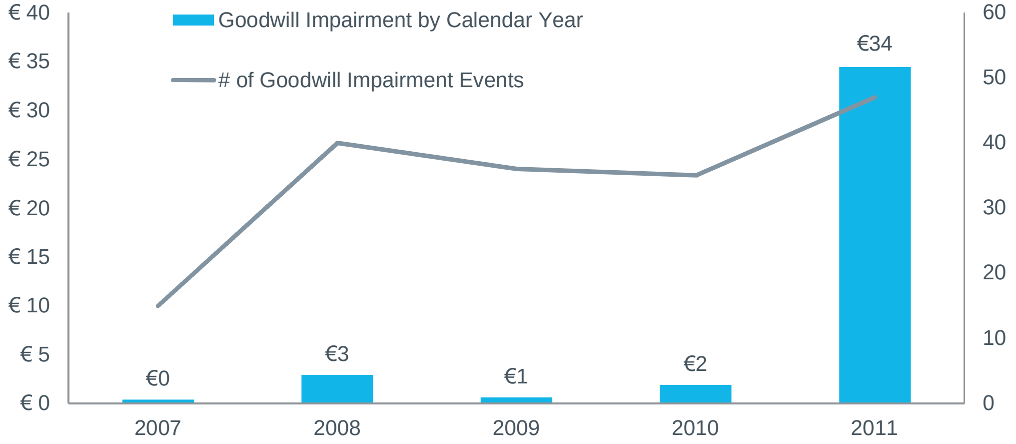
1.Intesa Sanpaolo S.p.A. €10bn

2.UniCredit S.p.A. €9bn

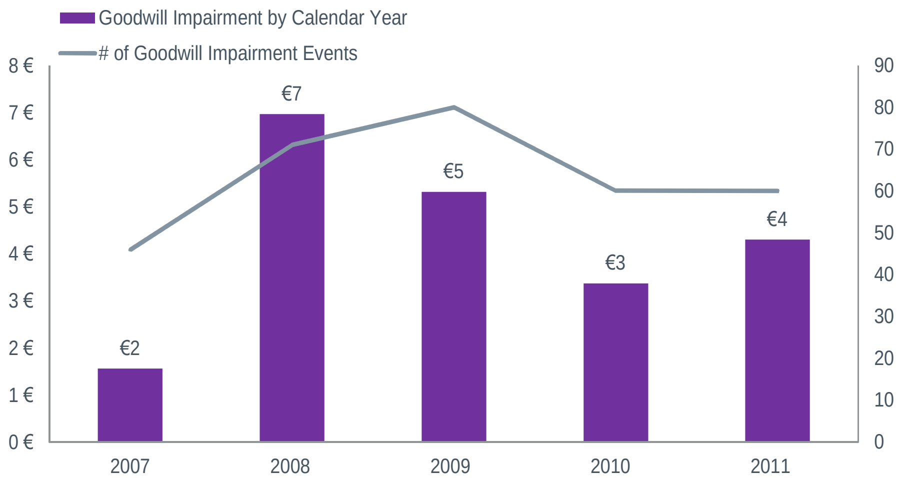
3.Telecom Italia S.p.A. €7bn

Goodwill Impairments 2007-2011

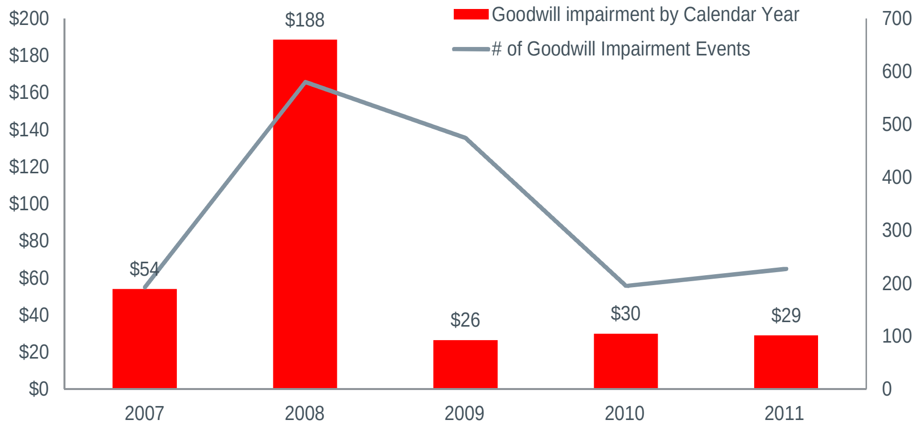
Goodwill Impairment, Italian Companies (in € billions)



Goodwill Impairment, German Companies (in € billions)

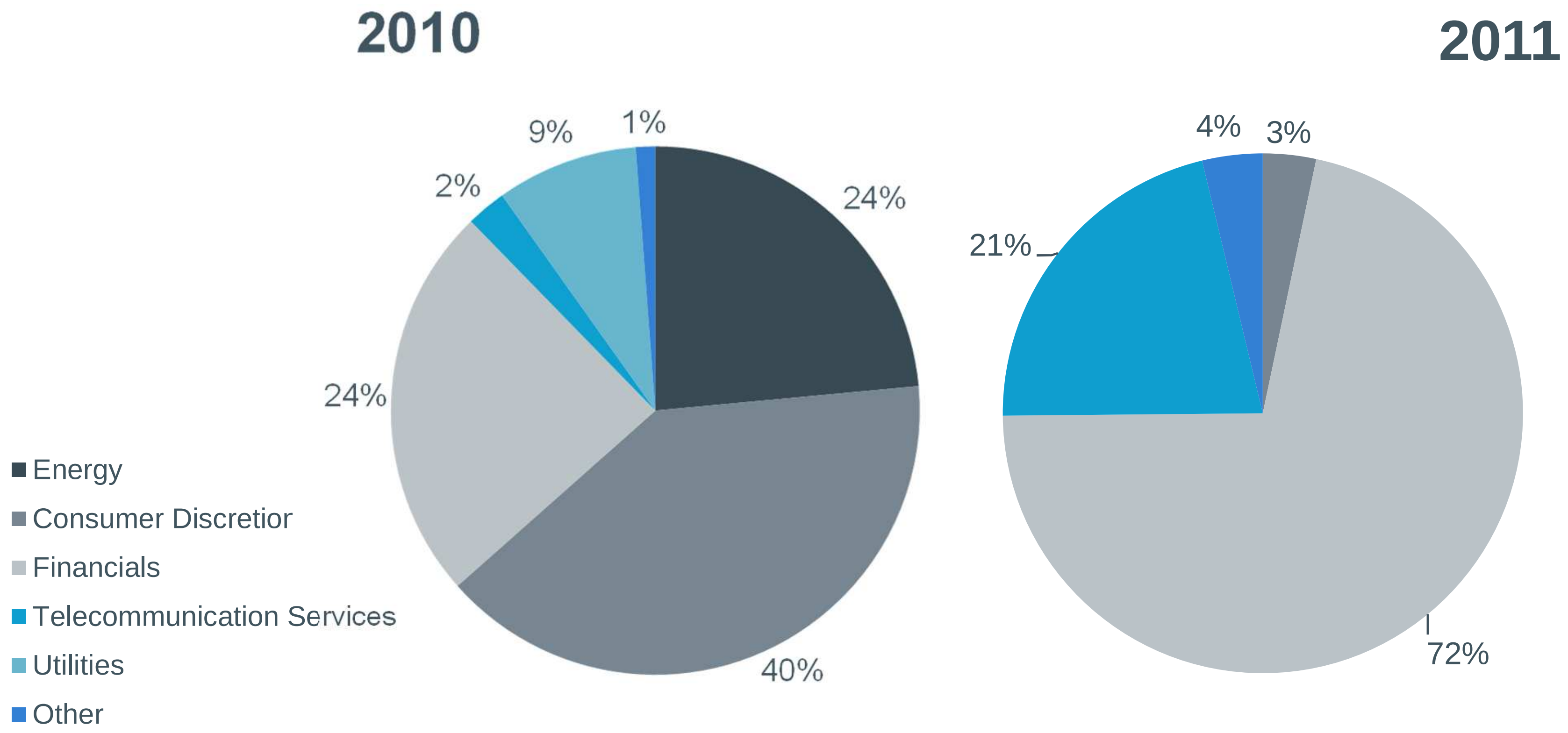


Goodwill Impairment, US Companies (in $ billions)



Goodwill Impairment by industry in Italy

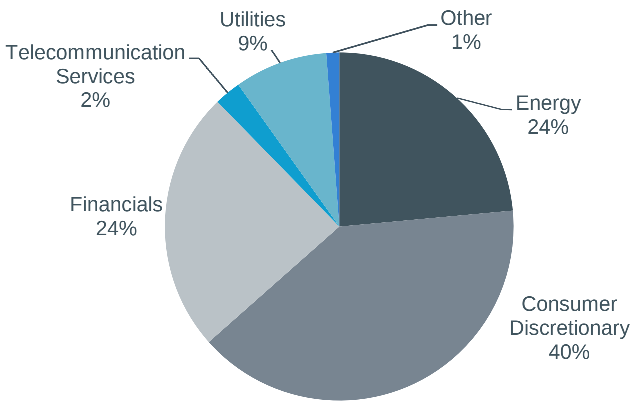
- 2011 strong focus on FS
- 2010 more evenly split - less than 10% of 2011total



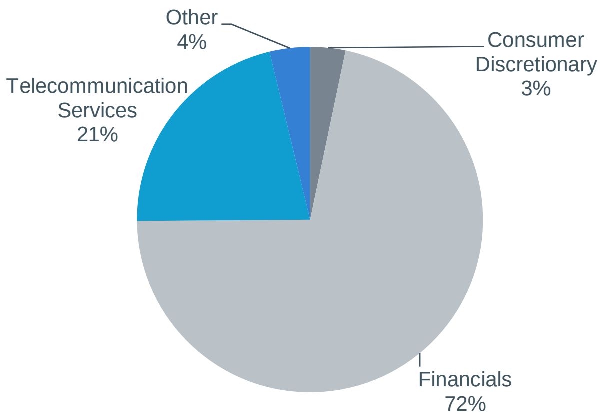
Impairment by Industry: Italy vs Germany - US

Italy

2010

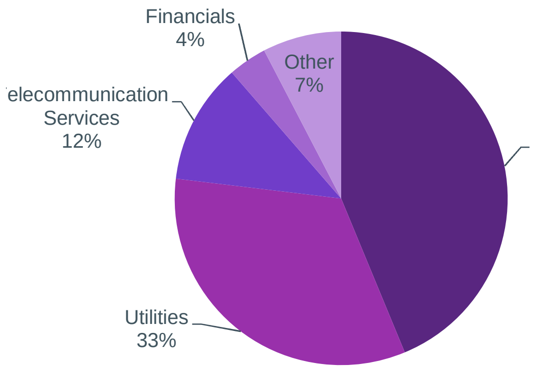


2011

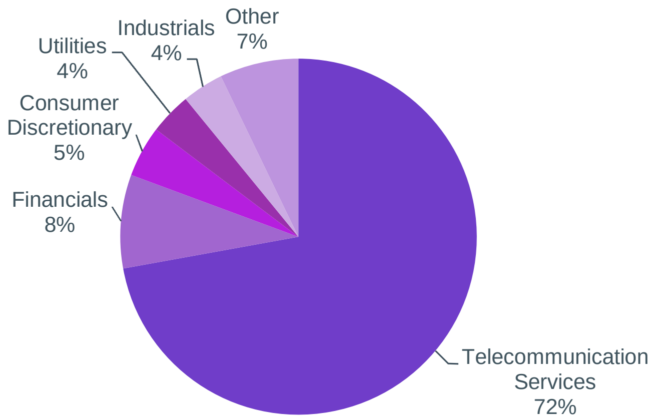


Germany

2010

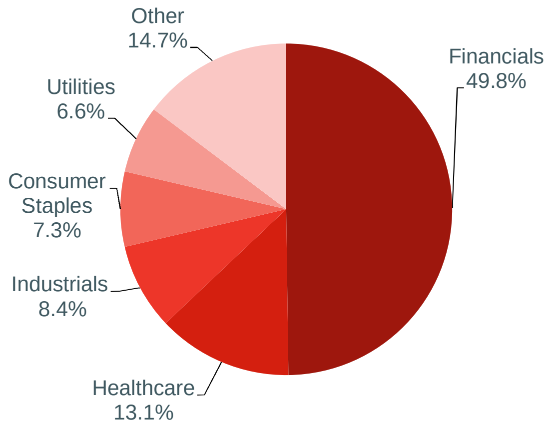


2011

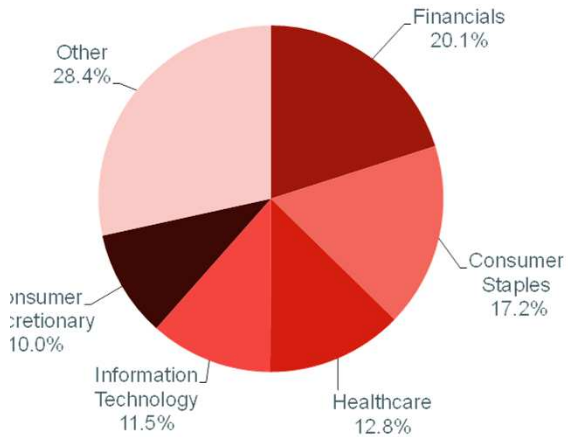


US

2010

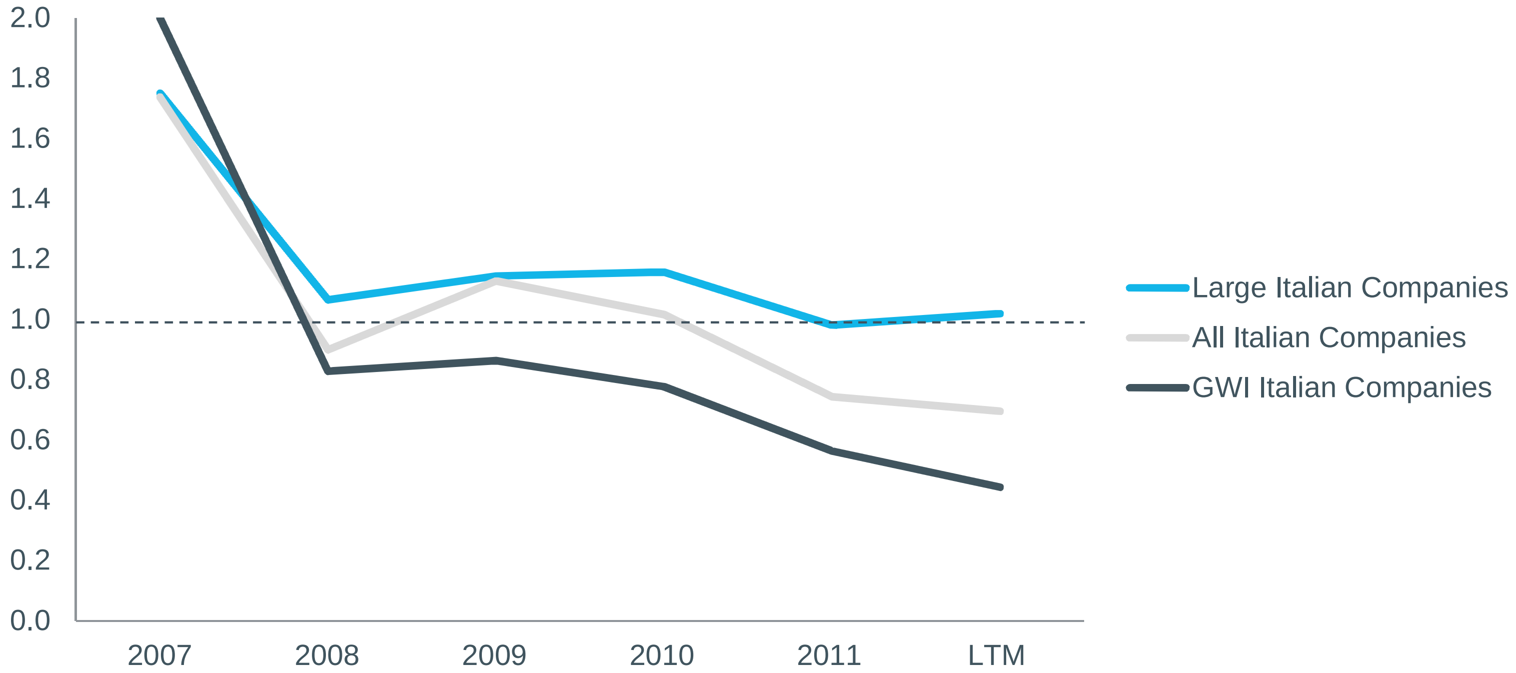


2011



Impairment Risk: Getting Back to M/B 2012 YTD

- Current (median) M/B Ratio = 0.6
- 40% of total BV equity at risk: approx Eur 150b!
- More than Eur 40b outside FS
- Could be goodwill and (in)tangible fixed assets



Focus on the Italian Market

- The impairment activity in 2011 in Italy has involved a larger proportion of the impairment presumption[1].

Amounts in Euro m	2010	2011
Impairment Presumption	133,505	148,343
GW Impaired	1,893	34,478
GW Impairment/Presumption	**1%**	**23%**

- We deemed appropriate to focus on Industrial Companies in order to better represent the Italian entrepreneurial landscape.

Amounts in Euro m	2010	2011
Impairment Presumption	28,695	43,565
GW Impaired	1,438	9,786
GW Impairment/Presumption	**5%**	**22%**

(1) Defined as the difference between Book Value and Market Capitalisation of a company

Focus on the Italian Market

- In the universe of the Industrial Italian Companies listed on the Milan Stock Exchange we selected only those presenting a high potential impairment presumption:
  - **Market to Book Value < 1** ➡ 61% of the considered universe;
  - **Company Performance vs local index[1]** ➡ 49% of the considered universe;
  - **Relevance of Goodwill on Total Assets > 5%** ➡ 50% of total considered universe;
  - **Relevance of Total Intangibles (including Goodwill) on Total Assets >20%** ➡ 42% of total considered universe.

91 companies (42% of total Industrial Co.)
at high potential impairment presumption

[1] FTSEMIB in 2011

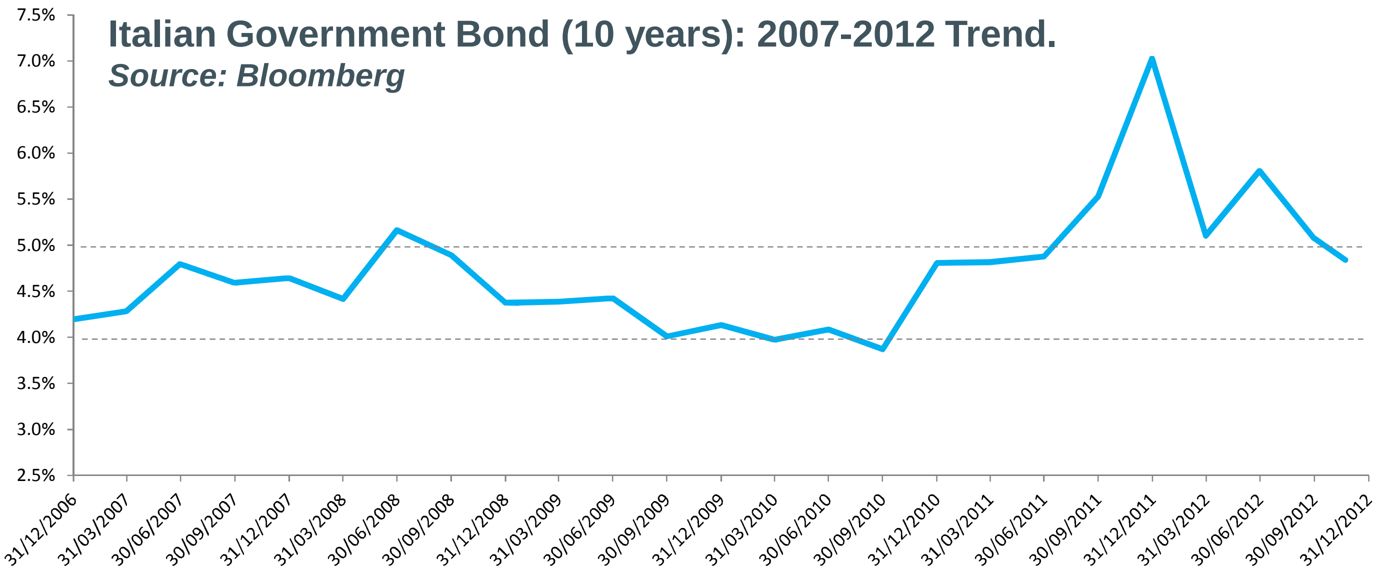
Focus on the Italian Market

- Reviewed 2011 annual reports of the selected 91 companies to gather information on **discount rates**, **long term growth rates**, **CGU structure** and **projections**.
- Companies grouped in 5 industries to capture potential differences among them.

2011 Data	Technology, Telecom & Media	Consumer	Oil & Gas	Utilities	Industrial	Total
Number of Companies	28	33	4	10	16	91
as % on Company Analysed	31%	36%	4%	11%	18%	100%
# Co. with Impairment on GW	12	12	2	6	6	38
as % on Total Industry	43%	36%	50%	60%	38%	
# Co. with Impairment on Intangibles	5	7	1	3	5	21
as % on Total Industry	18%	21%	25%	30%	31%	

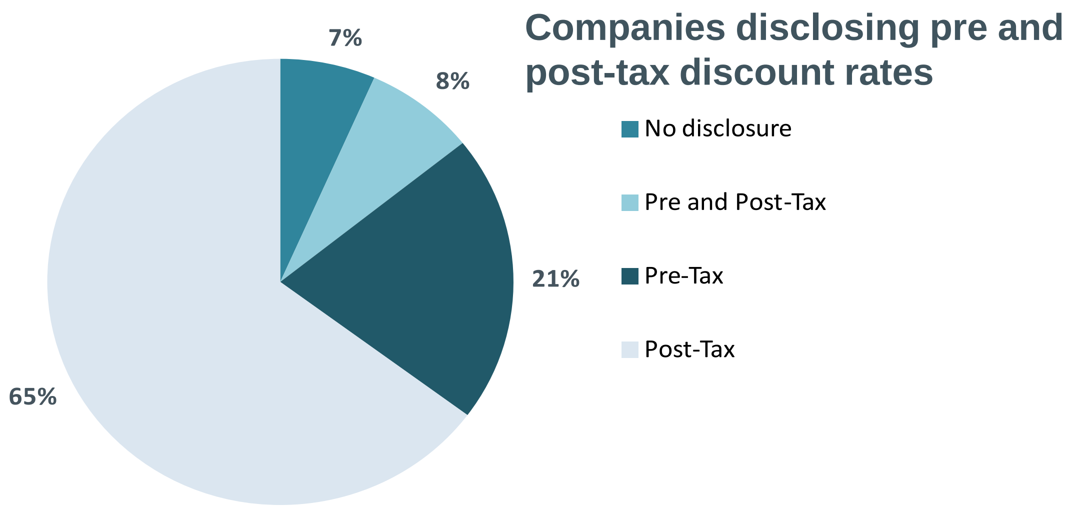
Discount rate

- With global financial crisis:
  - o growing interest and concern in the calculation of the cost of capital and the determination of its components (eg. the risk free rate that should be used);
  - o standards methods of estimating the cost of capital presents some problem and necessitates some further considerations;
  - o “flight to quality” flows.



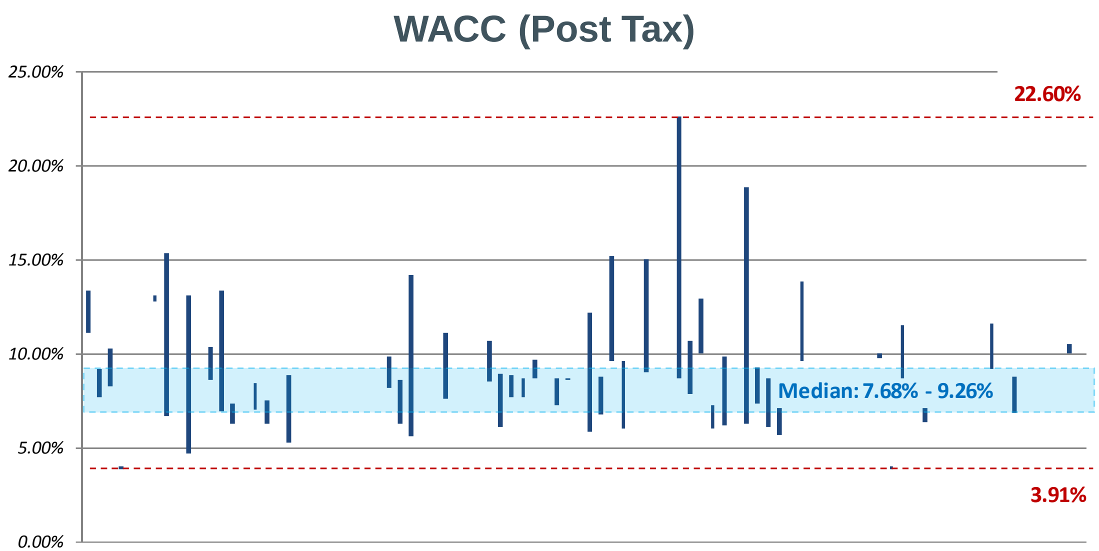
Disclosure in 2011 Annual Reports: pre vs. post-tax

- IAS 36 requires the use of “a pre-tax discount rate” for the discounting of cash flows,
- ... but has long been accepted by valuation practitioners that the direct determination of a pre-tax cost of capital is difficult if not impossible to derive.
- The majority of companies disclose the post-tax discount rate used in their impairment testing.



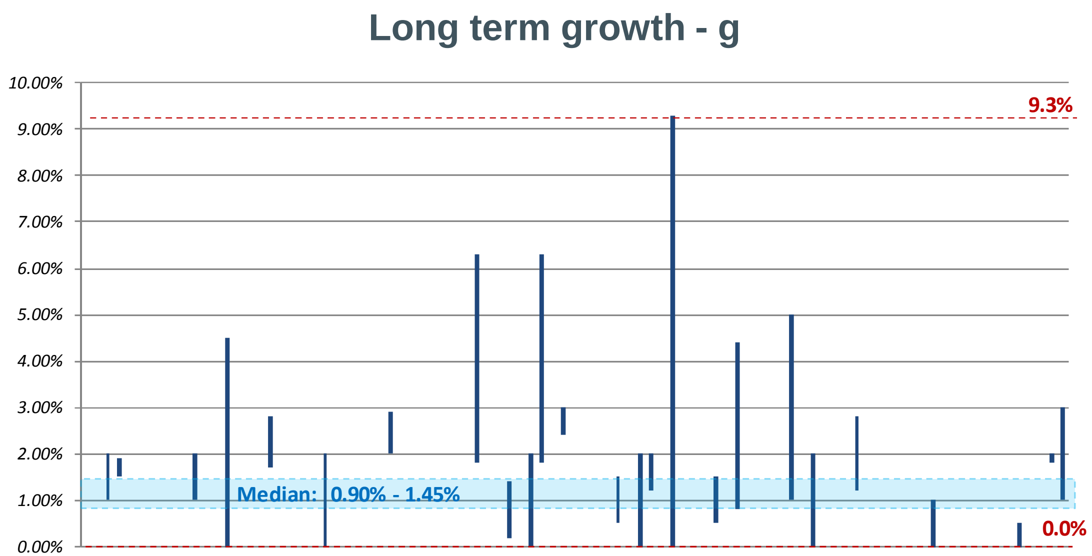
Disclosure in 2011 Annual Reports: WACC

- Overall observed range is wide (3.91% - 22.60%), due to companies having CGUs in emerging countries which require higher risks and returns.
- Median of the observed post-tax discount rates highlights a range of 7.68%-9.26%, implying a maximum 2% premium on the December 2011 Italian government bond of 7% (risk free rate).



Disclosure in 2011 Annual Reports: "g"

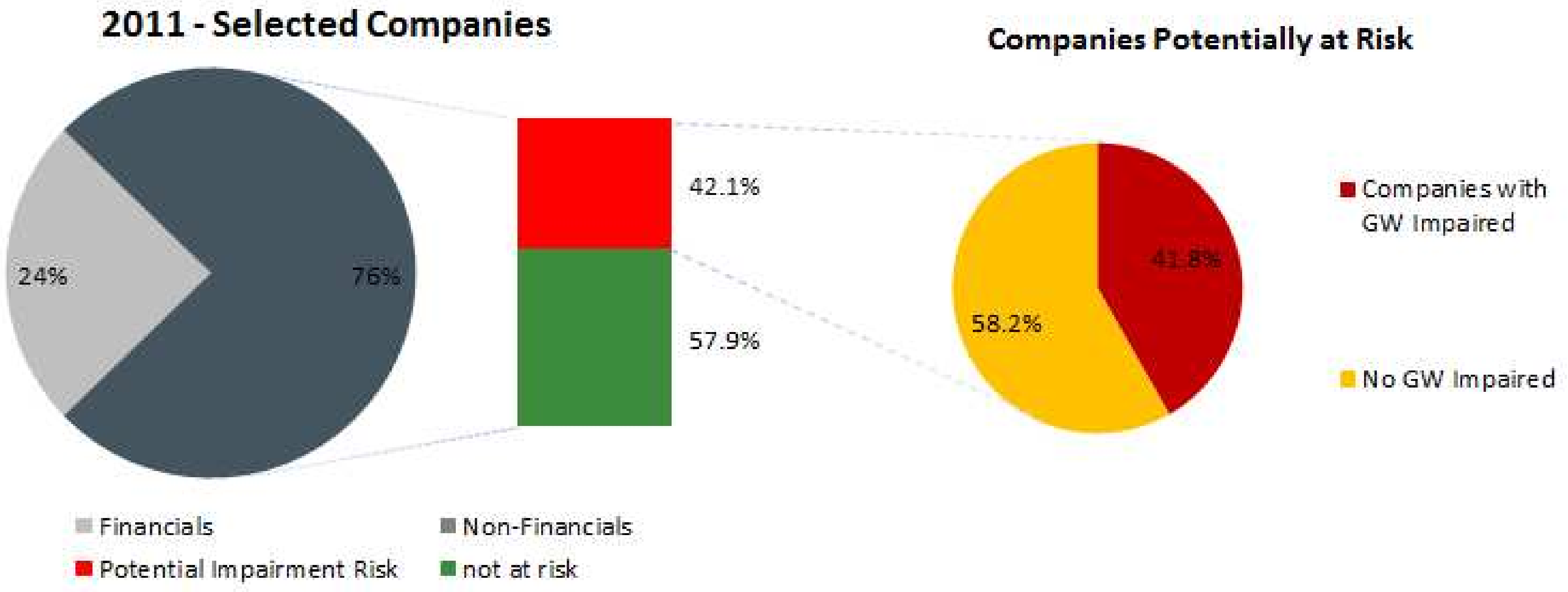
- Overall observed range in long term growth rate ("g") is wide (0.0% - 9.3%), due to companies having CGUs in emerging countries which show higher long-term inflation and GDP growth.
- Median observed long term growth rates highlight a range of 0.90%-1.45%.



Disclosure in 2011 Annual Reports: others

- Additionally we noted that 75% of the companies analysed mentioned the presence of a business plan, and the most common explicit projected period was 3-5 years.
- Business plans were not available for consistency check

Summary of the analysis



Conclusions

- In the non-financial sector approx. 4 out of 10 companies at high risk of impairment had actually impaired their GW,
- … but current market trading for all companies show that potential risk of goodwill impairment has further increased since December 2011.
- This will highlight some important considerations/questions:
  - Are drivers used consistent with the valuation process? Among these companies the WACC utilized could it be too low and the long term growth rates too high.
  - Are financial projections reliable? It is not possible to investigate the hypothesis behind those projections.
  - Is it possible to foreseen that the next year the goodwill will not be impaired based on the above points? It is clear that nothing could be assumed about the future.

Conclusions

- Key consideration: strong relevance of the correct use of the drivers in the impairment test processes and in the valuation in general.
- Which are mechanisms to put in place then to avoid wrong valuations?
  - o Stress on the importance of projections
  - o Historical analysis on revenues, margins and capital requirements
  - o Use the appropriate discount rate/WACC
    - risk free rate and “flight to quality”
    - historical/industry data on D/E ratio
    - beta and other premium
  - o Use of appropriate long term growth rate:
    - the link with WACC and risk free rate
    - the use of exit multiple as a cross-check
  - o Control methodology: market and transactions multiple
  - o Yearly cross check with external valuation providers and auditors

Contacts

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