

# Hermes Investment Management

## **Dynamic Valuation by Relationships**

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Bringing Data Science to Finance

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For professional investors only

# Context

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Institutional investors seem to be forced to invest in ways which damage economies, societies and environment

- ▶ We need to improve the stewardship of investments and the quality of relationships
- ▶ Companies and their shareholders are interdependent and have the opportunity to co-create a sustainable future
- ▶ We need to shift our focus from short-term transactions to long-term relationships

# Challenges with current valuation approaches (e.g. DCF, CFROI)

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- 1. They provide one, theoretically correct, valuation for a listed firm while**
  - ▶ the actual market values constantly fluctuates and
  - ▶ investment returns represent the change in price not the price itself
- 2. They are static until their next update, which is normally earliest in a quarter**
- 3. They struggle to integrate non-monetary key performance indicators of business**

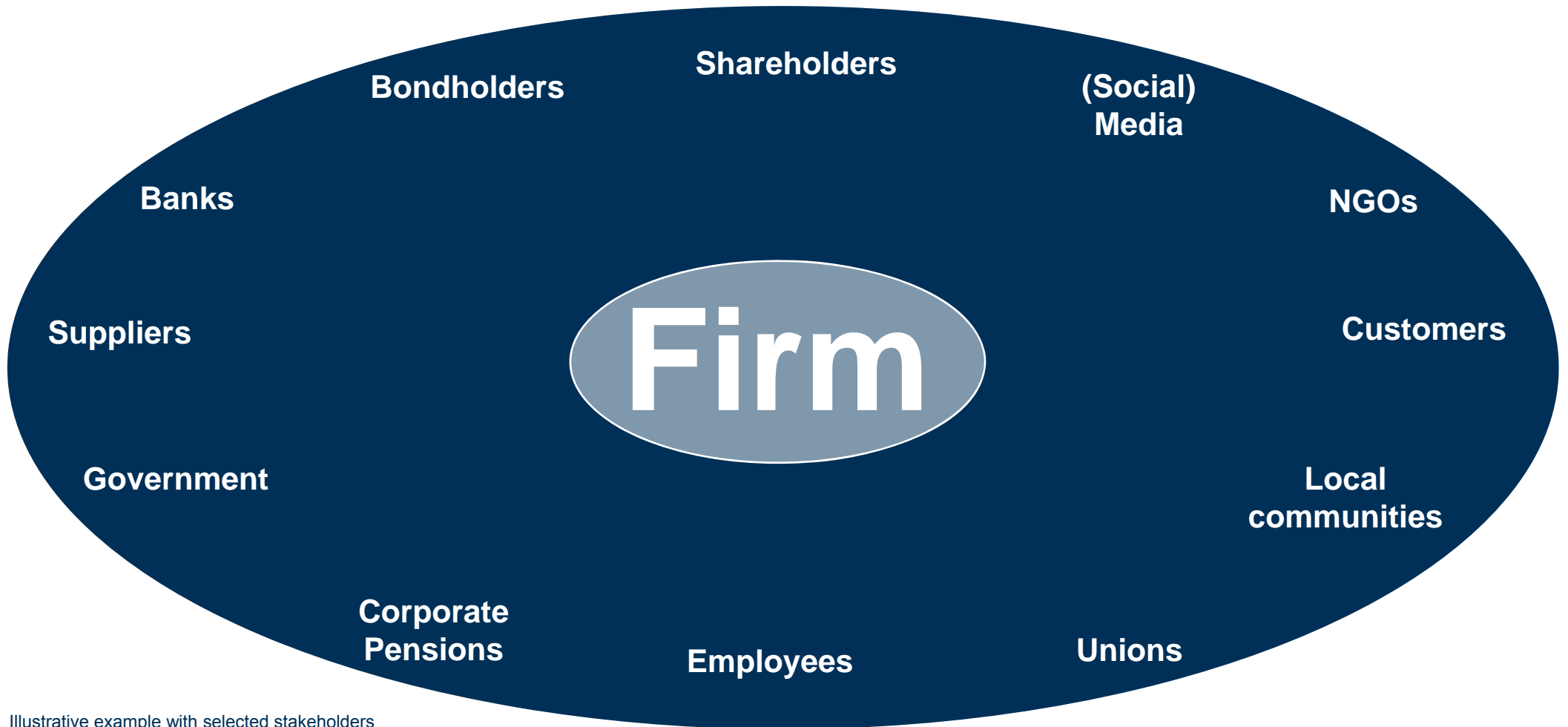
# Can any quarterly updated DCF explain Apple's share price development?



Source: Google Finance. For illustrative purposes only

# The Corporation and its stakeholders

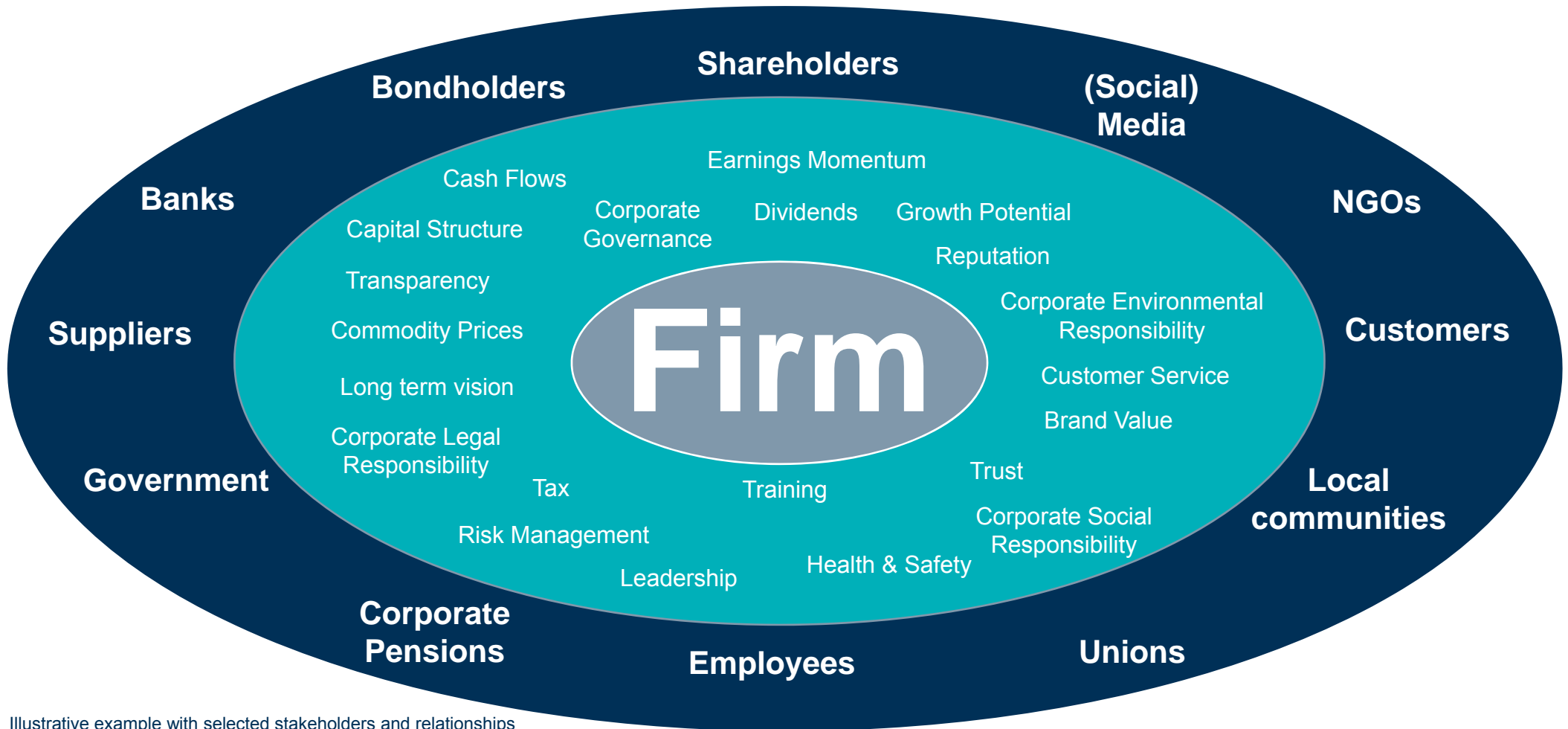
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Illustrative example with selected stakeholders

# The Corporation and aspects of its relationships

## Stakeholders relationships aspects



Illustrative example with selected stakeholders and relationships

# Valuation of the equity of a firm

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## Currently dominant valuation approach

- ▶ Value of Firm = Assumed Cash Flows / (Empirical Discount Factor \* Assumed Adjustments)

## Dynamic Valuation by Relationship Aspects

- ▶ Change in Market Value of Firm = Change in National Market Environment + Change in industrial market environment + change in global market environment + Change in Relationship Aspects

# Questions and conclusion

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1. How can we measure good relationships and how do they relate to value creation?
2. Do we need to quantify relationships in the non-financial areas?
3. How do externalities arise out of poor relationships?
4. How do fund managers respond to this proposal?



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## Our investment solutions include:

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Multi Asset Inflation

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