

Terminal Value, A Perspective

Utpal Sheth

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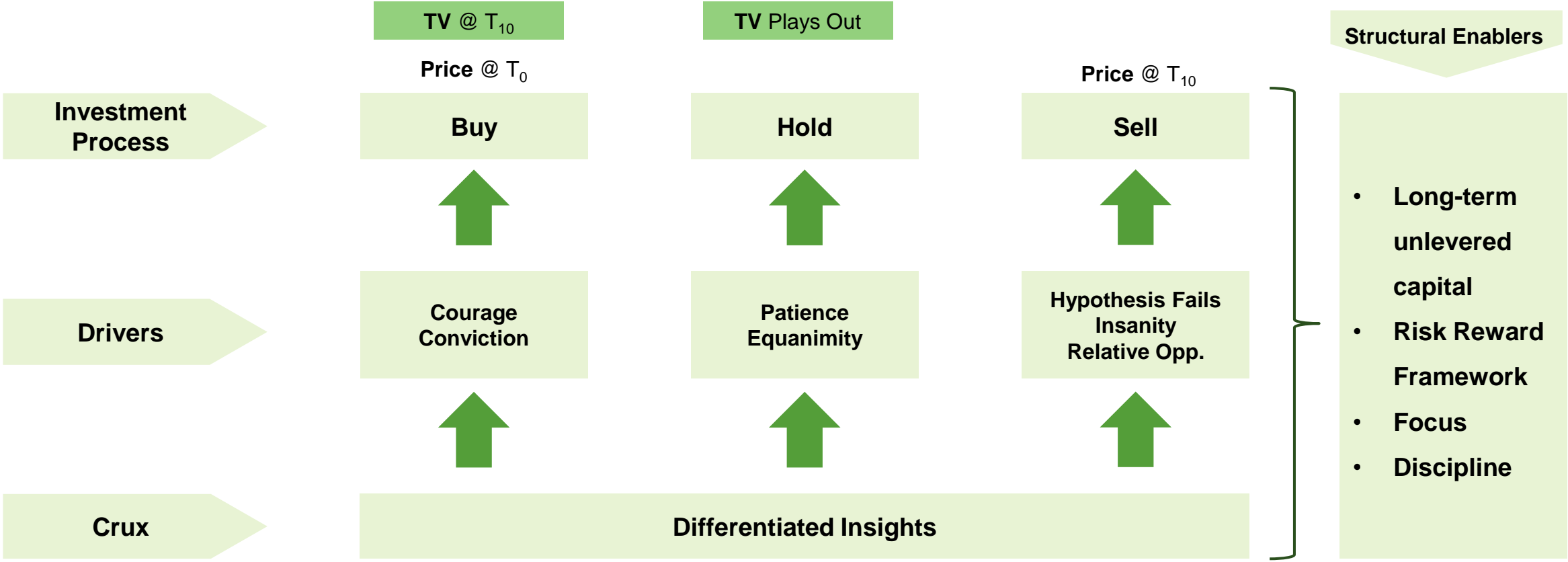




**“Success does not lie in managing complex
uncertainties, but in realizing unrealized
simplicities”**

Chris Begg

Value Chain of Long-term Investing driven by Differentiated Insights



The journey from buy decision to sell decision is the journey from the price today to the price in future guided by terminal value as we perceive today and in the interim period

Terminal Value: Conventional Understanding

“Terminal value (TV) is the value of an asset, business, or project beyond the forecasted period when future cash flows can be estimated. Terminal value assumes a business will grow at a set growth rate forever after the forecast period. Terminal value often comprises a large percentage of the total assessed value.”

“I’d rather be vaguely right than precisely wrong”

John Maynard Keynes

$$\text{Terminal Value (TV)} = \frac{(\text{FCF} * (1 + g))}{(d - g)}$$

FCF = forecasted cash flow

d = discount rate

g = terminal growth rate

Terminal Value (TV)

Source: Investopedia

What is Terminal Value (TV)?

- Nebulous
- Distant
- Dynamic
- Multi-variate
- Unknowable Truth
- Multiple states of existence

Which lies beyond the horizon...



Matthew McConaughey winning best actor in 86th Oscars, 2014

TV as a Sociological Concept, rather than a Financial Concept

Per Max Weber,

- Terminal values are the **ultimate ends or goals** that we wish to achieve
- **Value that something has of itself**, independently of its relations to other things

→ **Absolute**, rather than a relative concept

→ Once TV is not relative, it has a **very liberating effect** since it liberates investors from being chained to other values

→ TV is not value arbitrage, nor is it catalyst-driven unlocking. TV encourages **long-term compounding framework**

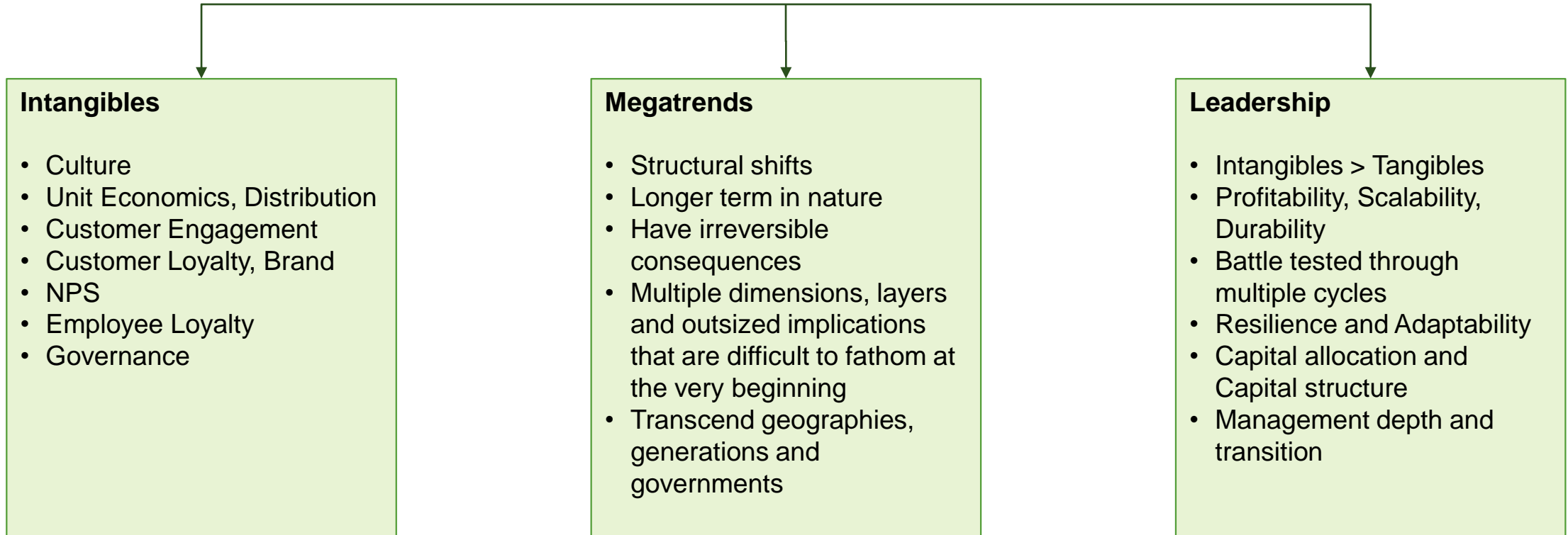
→ TV is not IRR-driven, **liberating you from constraints of Value today**



Sociologist Max Weber

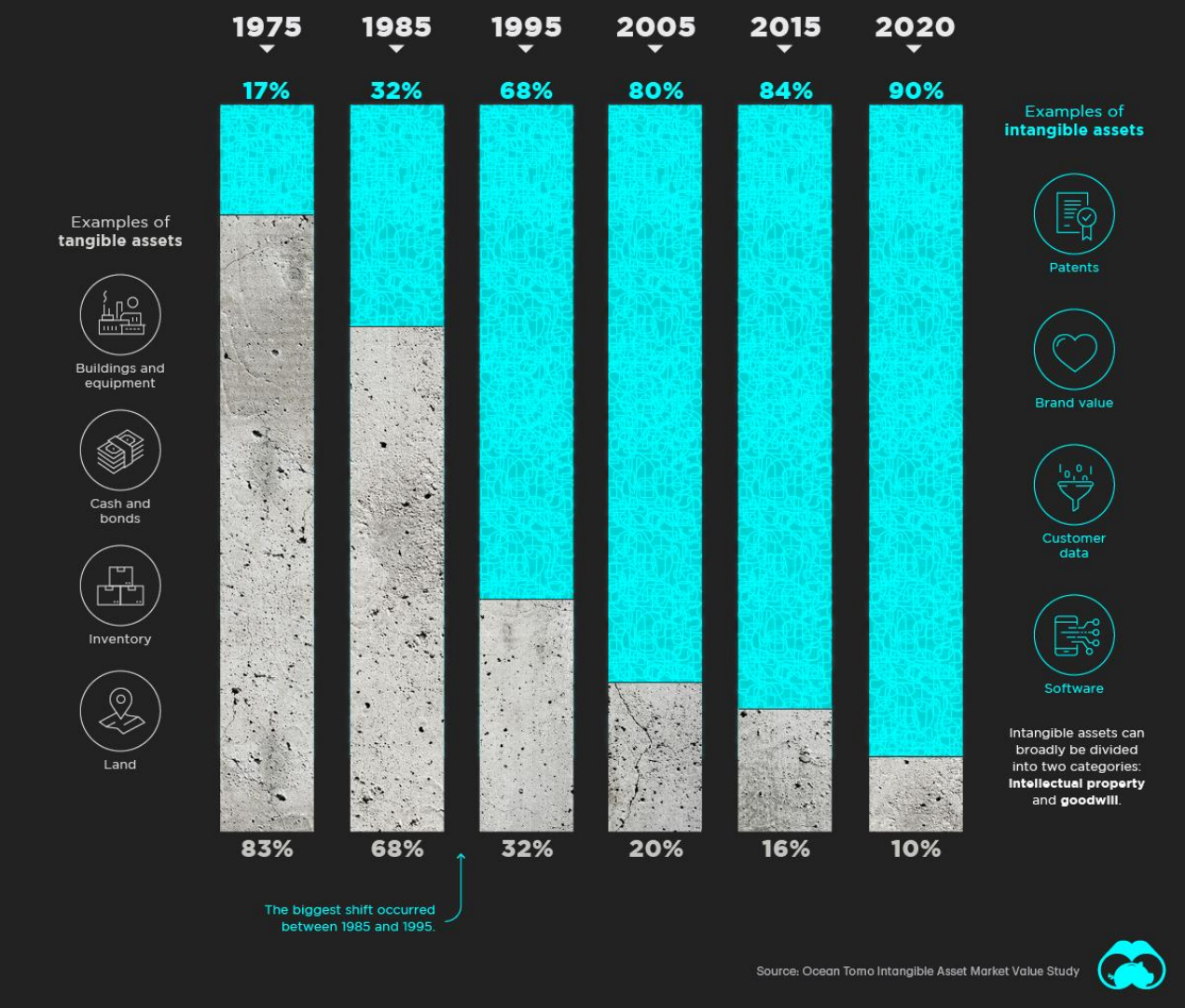
Magic created at intersection of Intangibles, Megatrends & Leadership

Terminal Value = f(Intangibles, Megatrends, Leadership)



Intersection of the above results in disproportionate impact on Terminal Value; a multi-sigma event, traditional valuation metrics cannot reflect this “Outlier” event appropriately

TV through the prism of Intangibles



- **Greatest source of TV are Intangibles**
- **“Soft” Assets give today’s companies their hard competitive edge**
- **Thinking beyond the label of ‘value’ and ‘growth’ is critical**

TV through the prism of Intangibles

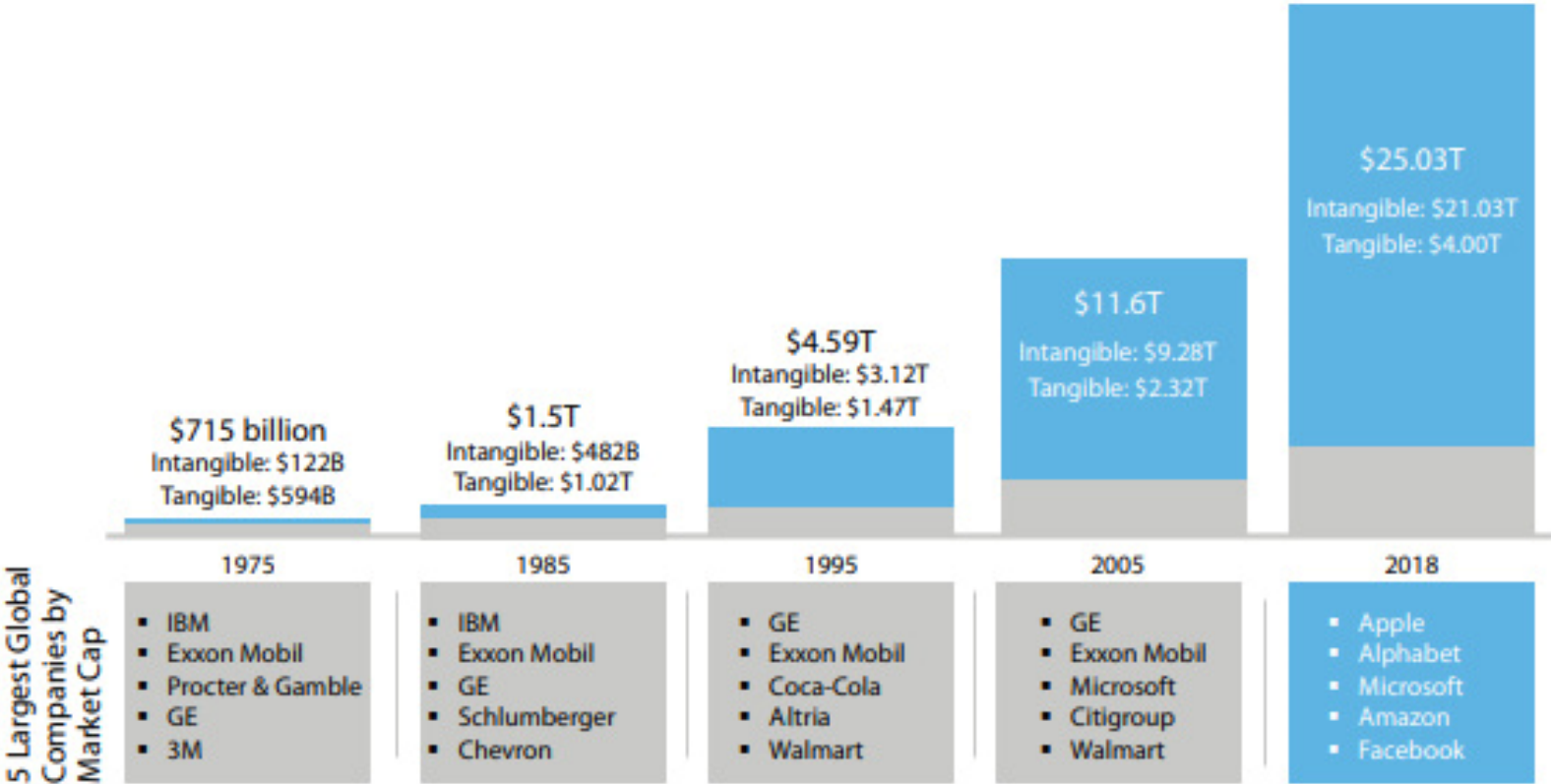
Tangible Assets vs. Intangible Assets for S&P 500 Companies, 1975 – 2018

Tangible Assets

- Easy to value
- Thick & efficient secondary markets
- Insurable

Intangible Assets

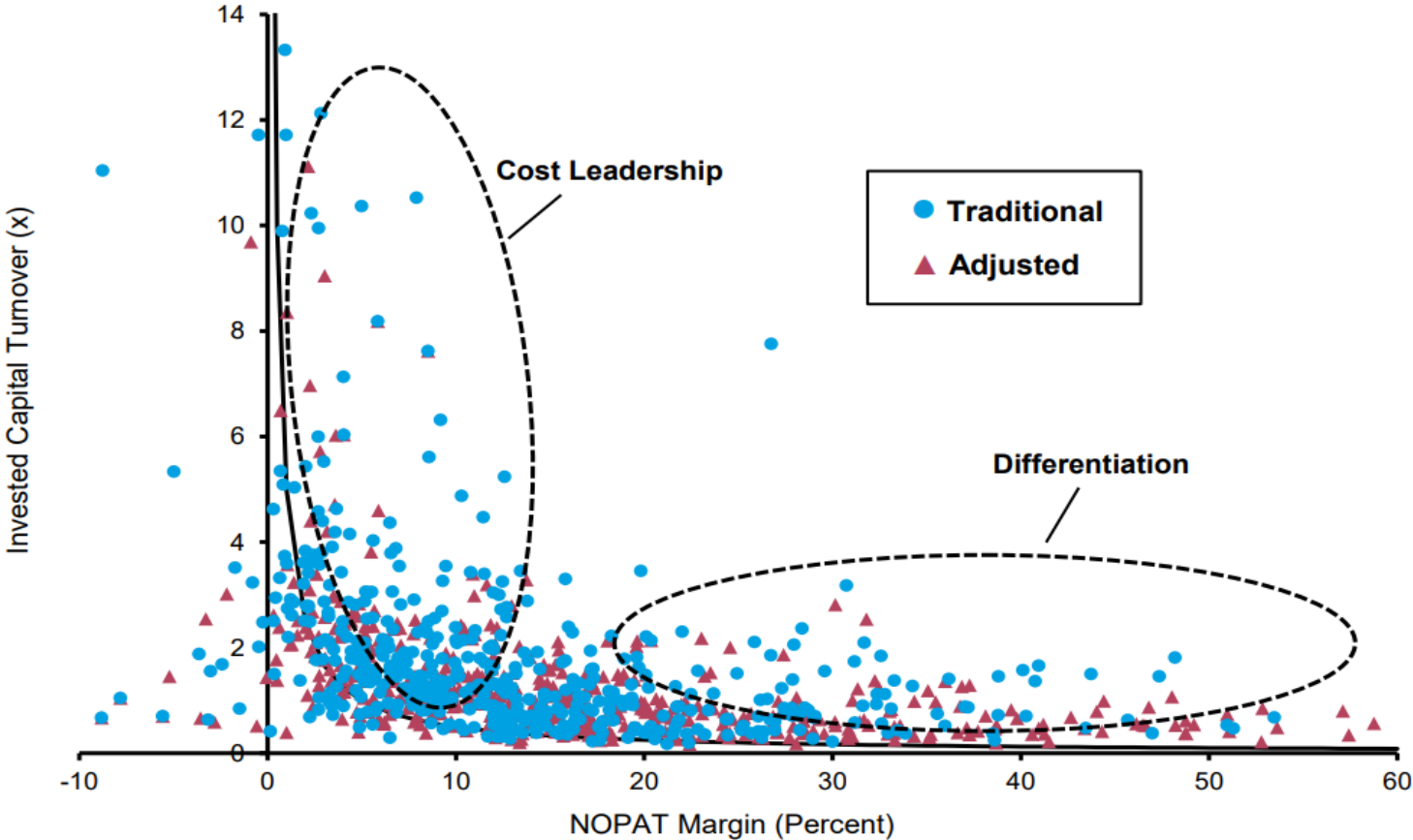
- Difficult to value
- Thin & inefficient secondary markets
- Difficult to Insure



Source: Aon, Visual Capitalist

TV through the prism of Intangibles

Exhibit 5: Traditional and Adjusted Drivers of ROIC, Top 500 Companies in Russell 3000, 2021



Source: FactSet and Counterpoint Global.
 Note: Top 500 companies by 2021 sales; Excludes financials and real estate; Truncated axes for visualization.

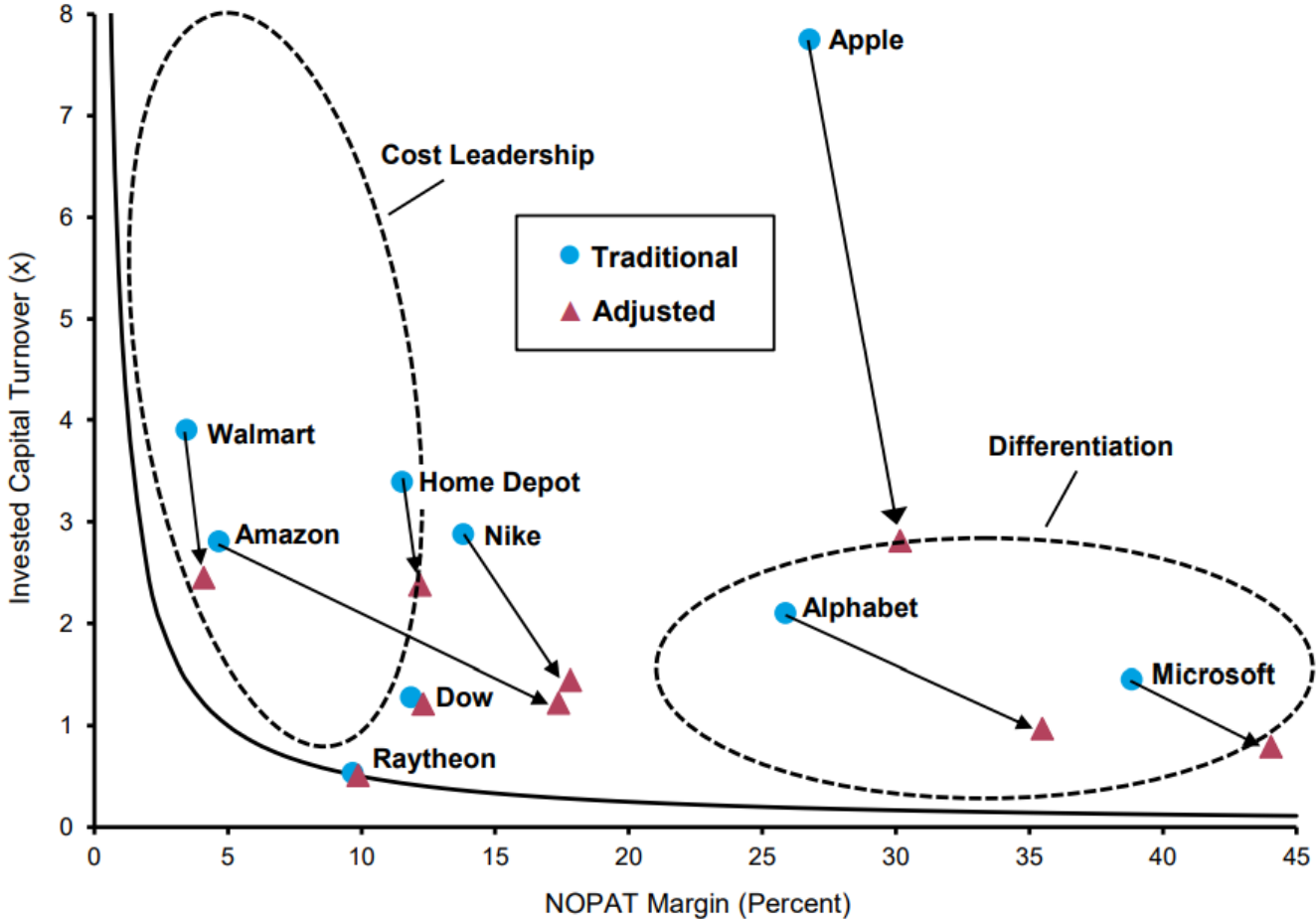
Note: Adjustment takes part of SG&A expense and reclassifies it as an investment. As a consequence, NOPAT and Invested Capital both increase

TV through the prism of Intangibles – Case Study



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Exhibit 6: Traditional and Adjusted Drivers of ROIC for Selected Companies, 2021



Critical to note **not just the movement** towards the bottom right, **but also the distance** the companies travel following the adjustment

Source: FactSet and Counterpoint Global.

TV through the prism of Megatrends

“Megatrends are powerful, transformative forces that can change the trajectory of the global economy by shifting the priorities of societies, driving innovation and redefining business models. They can have a meaningful impact not just on how we live and how we spend money, but also on government policies and corporate strategies.”

Blackrock

“Megatrends are deep and profound trends, global in scope and long-term in effect.”

PwC

“The world is in the midst of a great transformation, from the Industrial era to the Information era”

John Naisbitt

Megatrends are inevitable, irreversible and irreplaceable!

Some Megatrends:

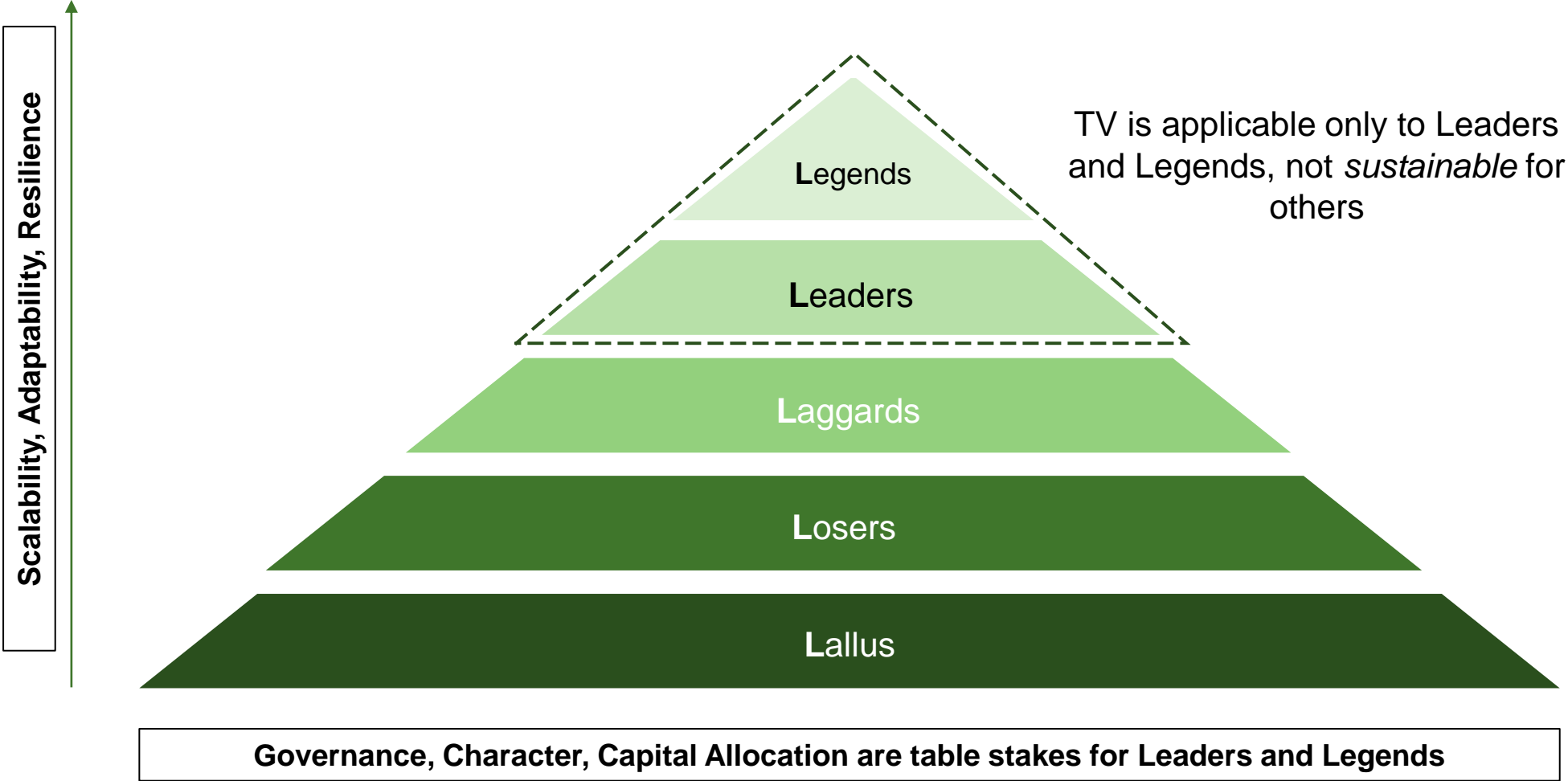
- Demographic dividend
- Consumerization
- Financial deepening
- Digitalization
- Climate change
- Artificial Intelligence
- Women empowerment
- Nuclear families
- Renewables
- EV and Autonomous Vehicles
- Digital Public Infra
-

TV through the prism of Leadership – Gorilla Investing

- Many Monkeys in a jungle, but very few Gorillas – **Rare**
- Gorillas are outsized as compared to Monkeys – **Dominant**
- Gorillas are not challenged by Monkeys – **Moats and Knights**
- Gorillas have a lifespan double that of Monkeys – **Longevity**
- Right Jungle (**Megatrend**) + Right Animal (**Leadership**)



TV through the prism of Leadership – 5L Grid

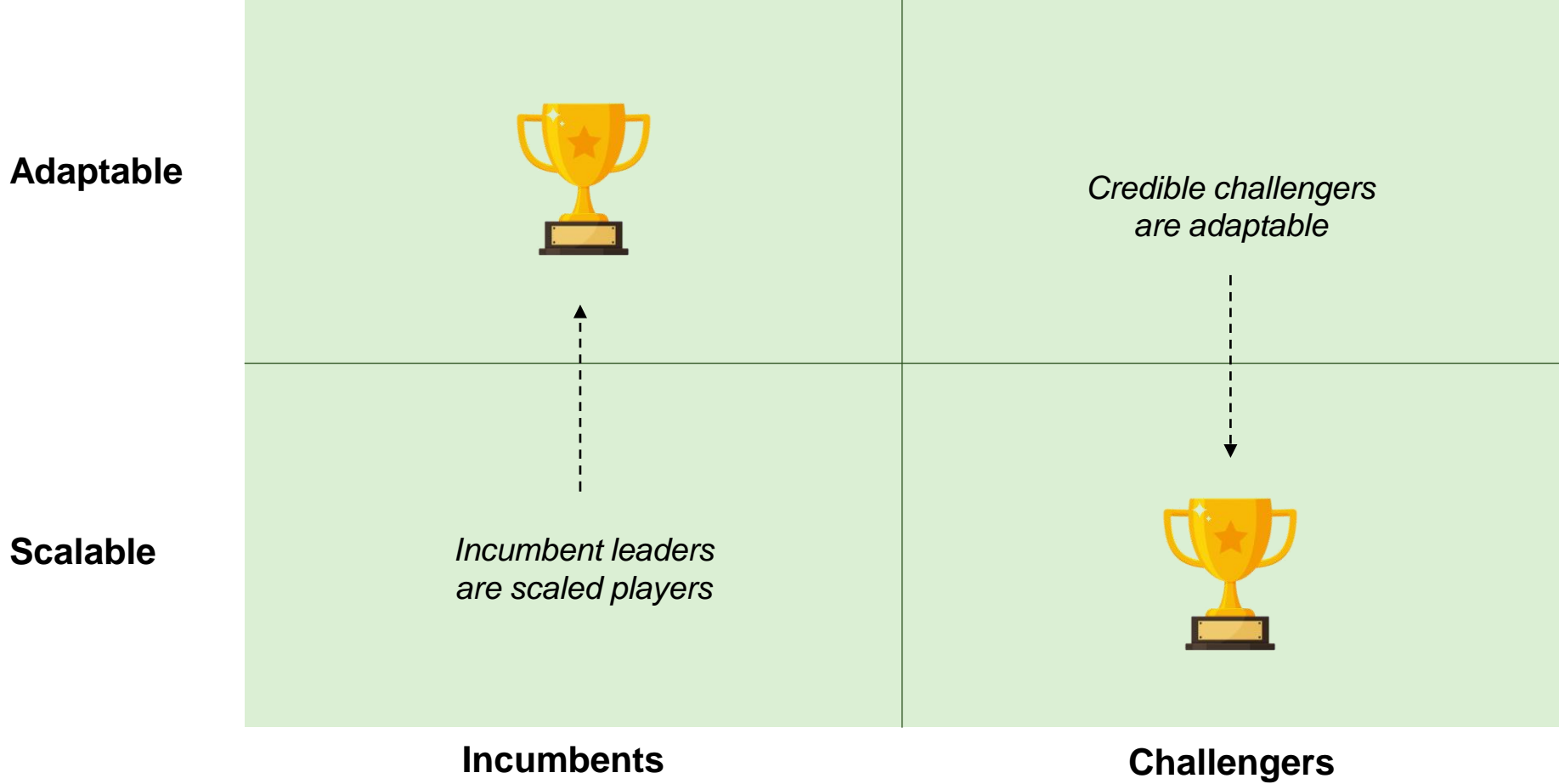


TV is not static - Value Migration is key

- Flow of economic and shareholder value away from obsolete business models to new, more effective designs that are better able to satisfy customers' most important priorities
- Value migration occurs when there is a disconnect between customer priorities and existing business design
- Types of Value Migration:
 - Value Migration across Geographies
 - China+1
 - Value Migration within Country
 - Unorganized to organized
 - Value Migration within Industry
 - Weaker to stronger
 - Less adaptable to more adaptable
 - Incumbents vs. Challengers
 - Value Migration within Company
 - Digital / Omni-channel
 - Disruption
- Detecting Value Migration:
 - Market share movements
 - Innovation leadership
 - Customer satisfaction scores
 - Policy changes
- Over time, we observe that:
 - **Pace of value migration has gone up**
 - **Quantum of value migration has also increased**
- In many cases, quantum of value migration may not be visible immediately / today. It needs to be discerned through the prism of Terminal Value

Source: Book: Value Migration by Adrian Slywotzky, Motilal Oswal Research

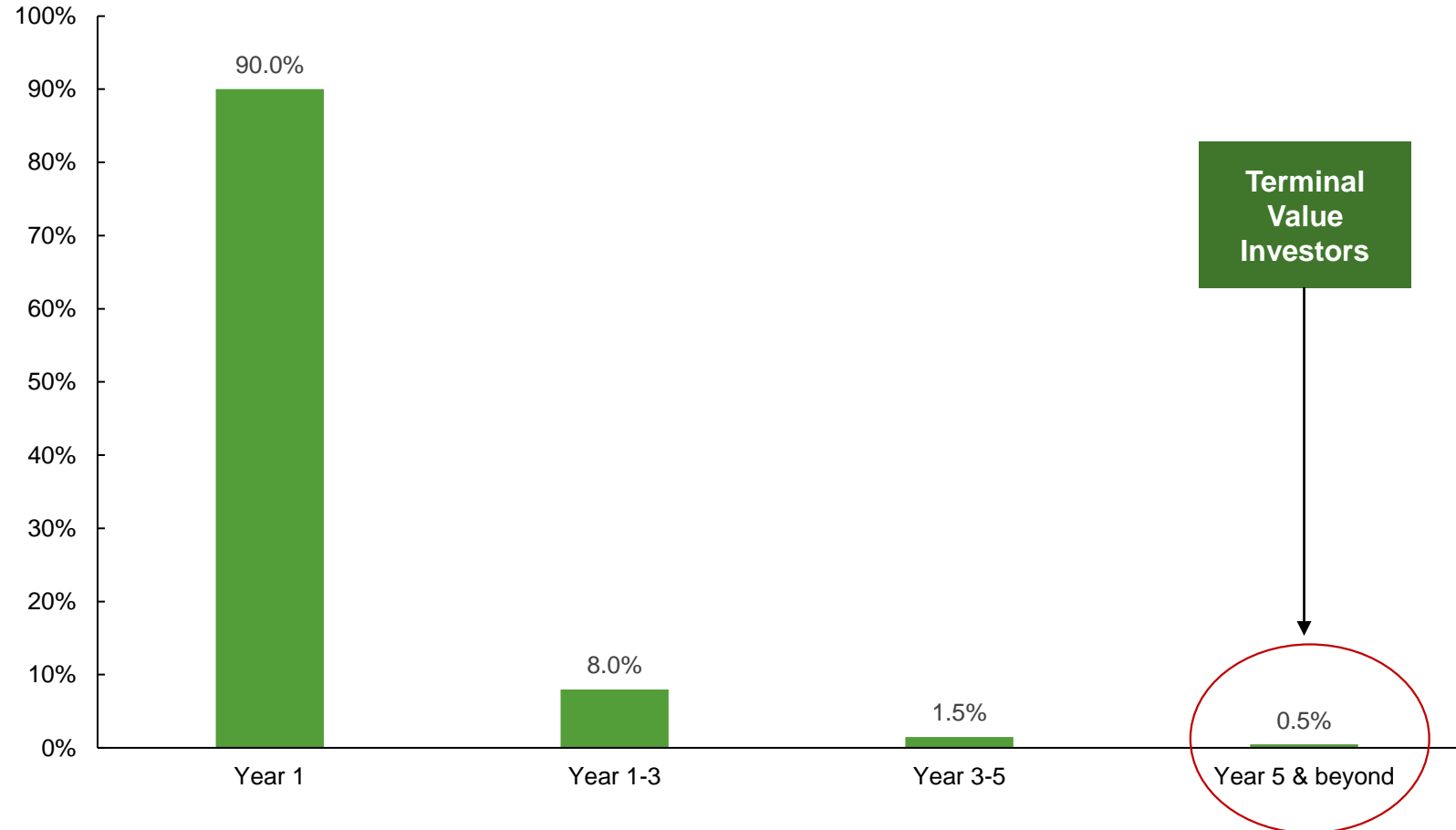
TV and Leadership in a Dynamic World



Preferred Investment Framework is Adaptable Incumbents and Scaled Challengers

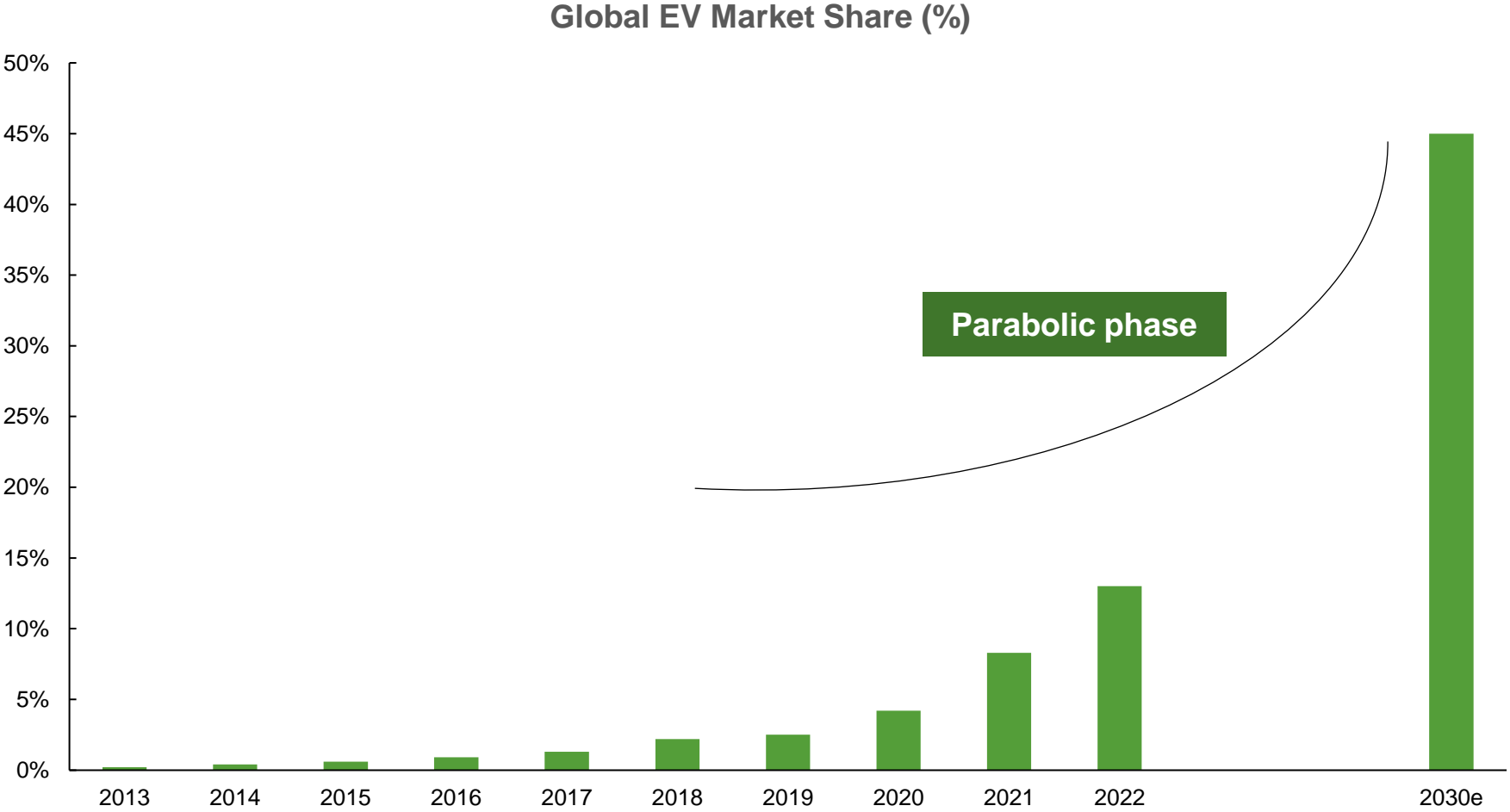
TV Investors: Est. Time distribution of Market Participants

Time Horizon of Investing (#e of Participants)



- **Short-term market participants focus on IRR, face re-investment risk and tax inefficiencies**
- **Long-term market participants focus on Terminal Value (>5 year time horizon)**
- **Competitive intensity for TV investing is much lower than for IRR investing**

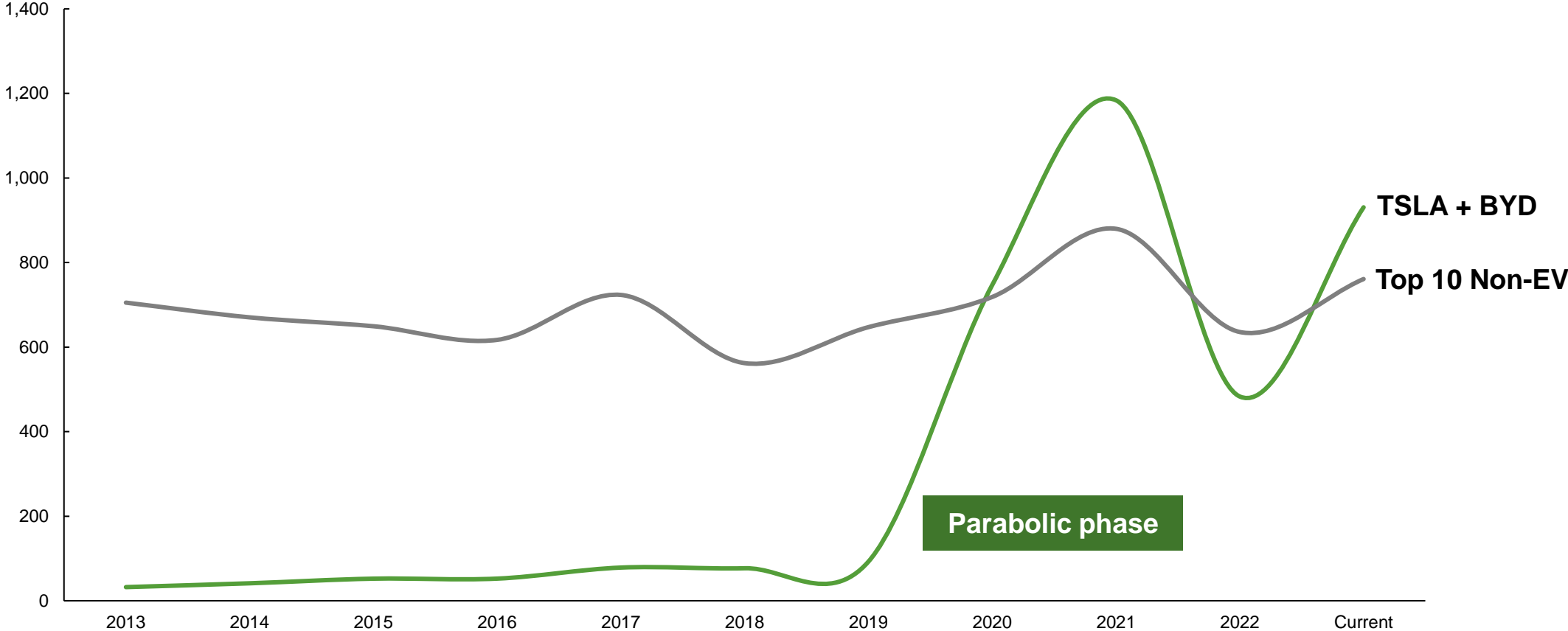
TV Megatrends: EV case study



Source: Internet Research

TV Leadership: EV case study

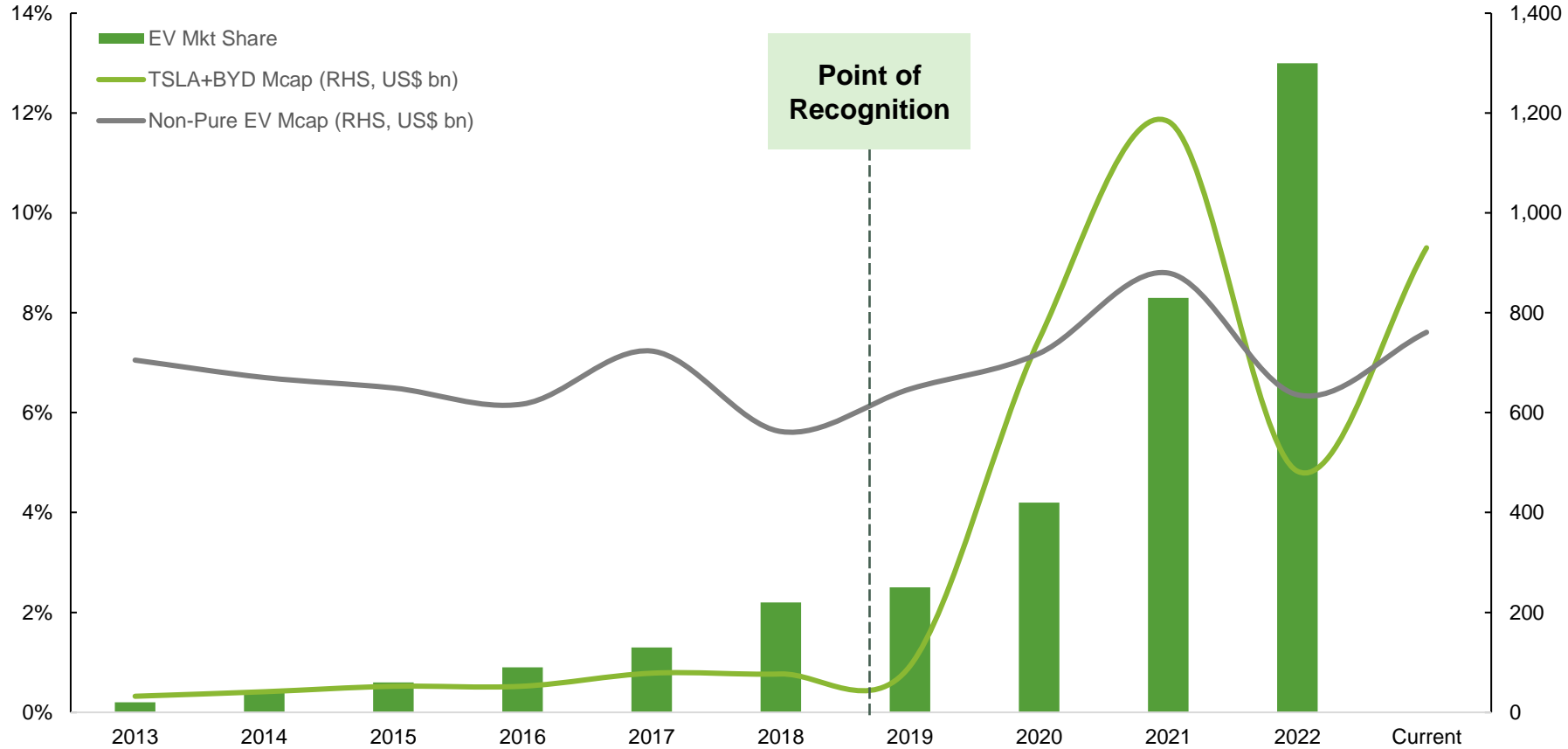
Market Cap of EV vs Non-Pure EV Auto Companies (US\$ bn)



Source: Internet Research, Top 10 Non-Pure EV Mcap includes Toyota, Mercedes, BMW, VW, Ford, Ferrari, Stellantis, GM, Honda and Maruti Suzuki

TV Investing: EV case study (combined picture)

EV Megatrend



2022 Global EV penetration was only **13%**

Combined Mcap of Top 2 EV Companies is **~US\$ 1tn**

Combined Mcap of Top 10 Non-EV Companies is **~US\$ 0.8tn**

% of Mkt Participants

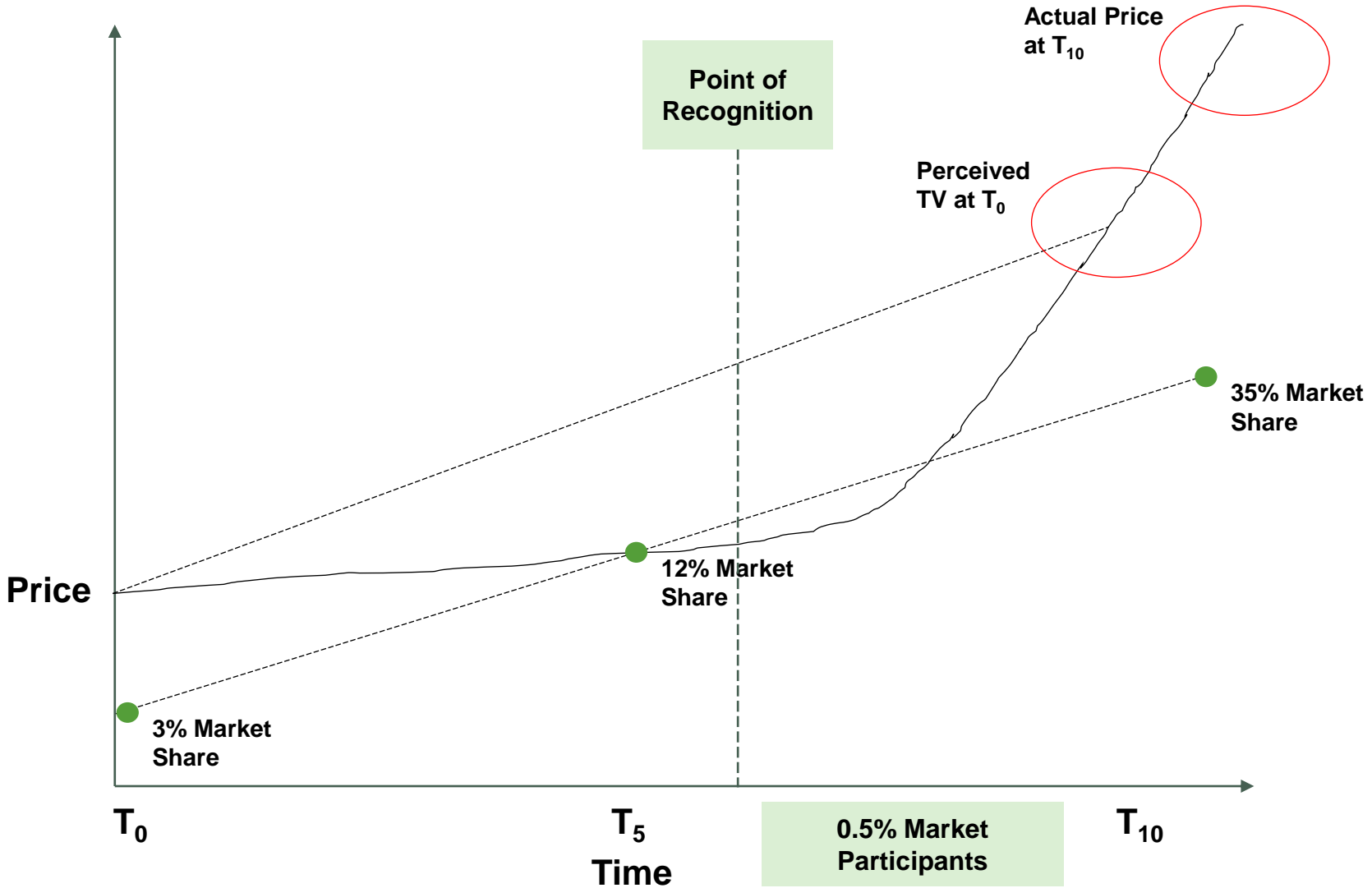
90%

8%

1.5%

0.5%

TV with all the Dynamic Variables

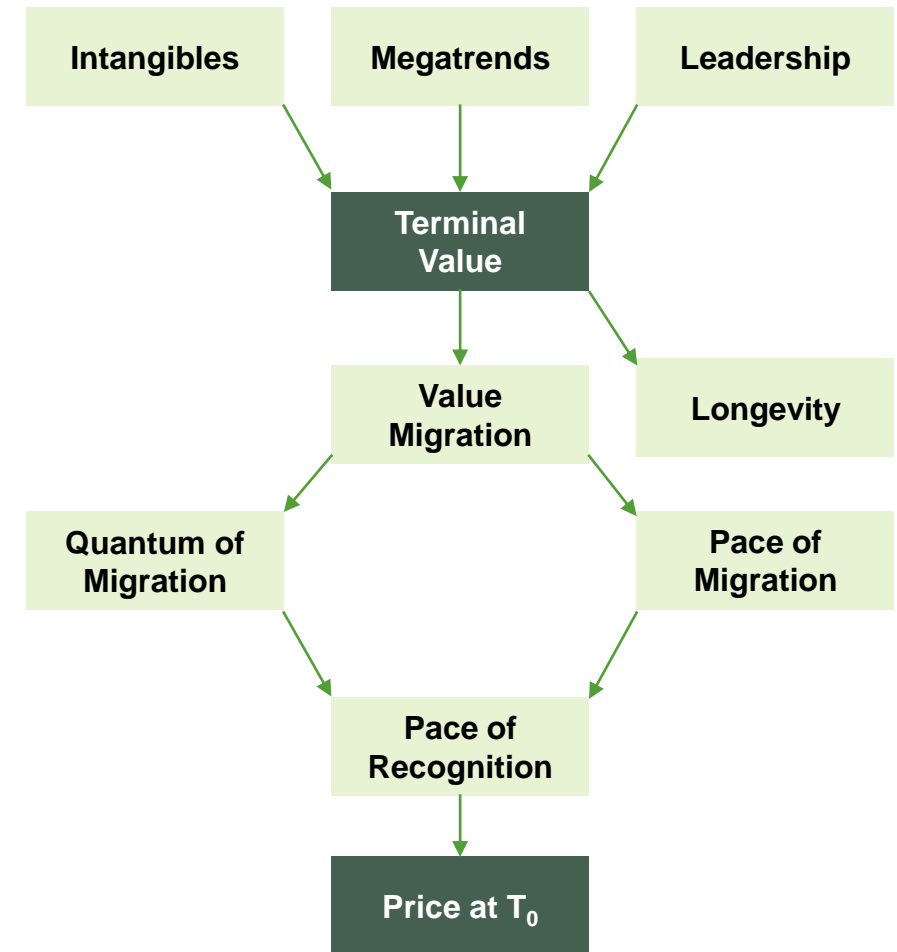


“Change happens slowly, and then suddenly”

Eric Schmidt

TV Investing: Key Variables

- Terminal Value is the most important determinant of **Long-term Investment Compounding returns**
- **Value Migration and Longevity** drive Terminal Value
- **Intangibles + Megatrends + Leadership** drives Value Migration and Longevity
- **Quantum of Value Migration** is rising at a **parabolic pace**
- **Pace of Value Migration** is rising at a **parabolic pace**
- **Recognition** of Value Migration is happening **more rapidly**
- Investors focusing on Terminal Value are **very few in proportion, leading to lower competitive intensity for TV Investing**



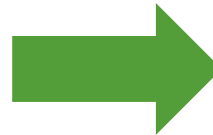
Conclusion

To make money in stocks, you must have:

- **The vision to see them**
- **The courage to buy them**
- **The patience to hold them**

Patience is the rarest of the three

Thomas Phelps in 100 to 1 In The Stock Market



To make money in stocks, you must have:

- **The vision to see Value Migration leading to Terminal Value**
- **The courage to buy the Terminal Value**
- **The patience to hold the Terminal Value playing out**

Patience is the rarest of the three

Parting Thoughts

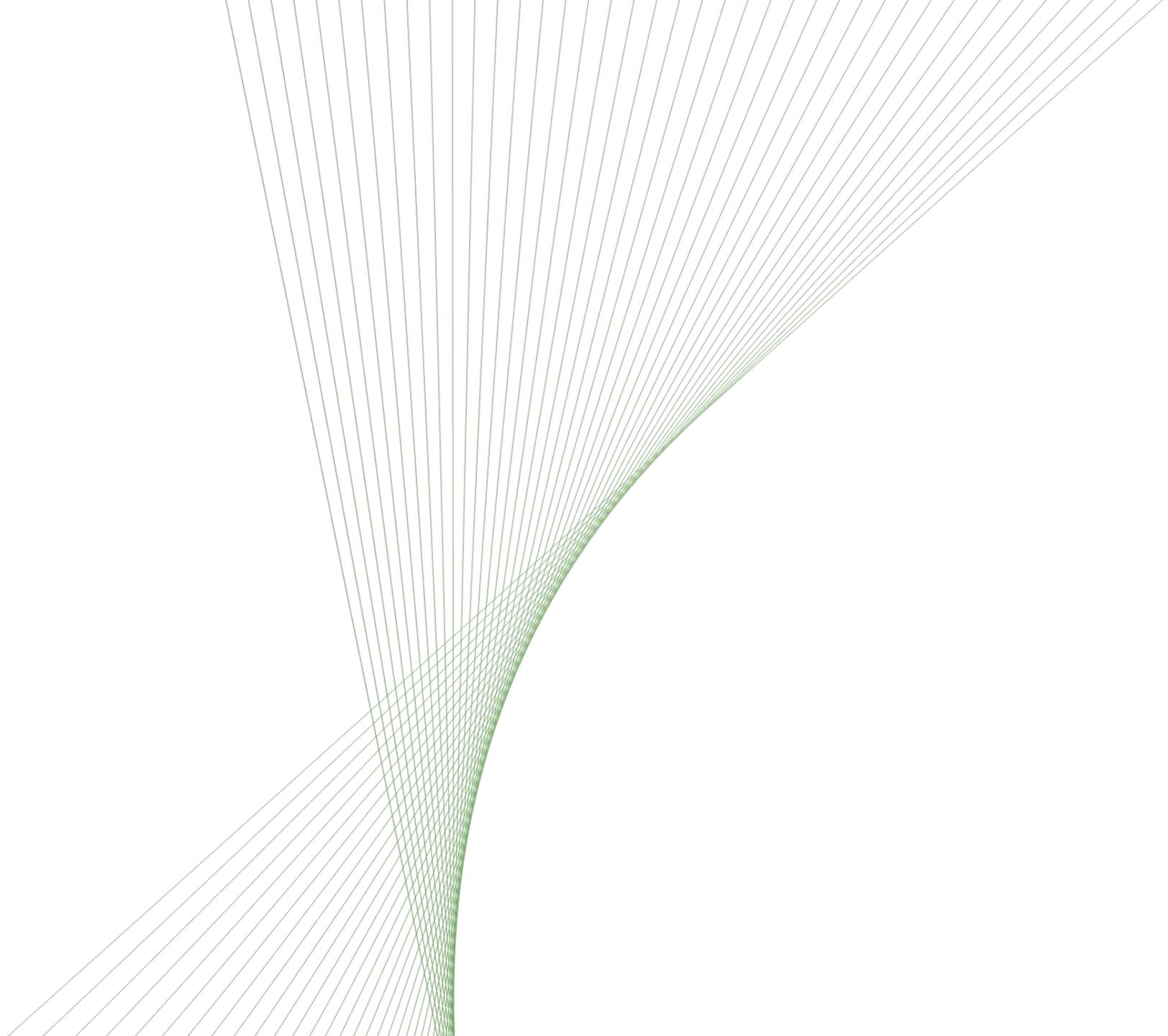
“Money itself isn't lost or made,
it's simply **transferred** from one perception to another”

Gordon Gekko, Wall Street

“Most people **overestimate** what can happen in **2 years**,
but **underestimate** what can happen in **10**”

Bill Gates

Thank You



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