Seminar

Addressing Information Gaps in Business and Macro-Economic Accounts to Better Explain Economic Performance

New York, 23 – 24 June 2008
United Nations, Conference room C

Financial and non-financial reporting on intangibles and intellectual capital assets in company reports
A sell-side view on company reporting paucity
John Ballow
United Nations Seminar Presentation
“Financial and non-financial reporting on intangibles and intellectual capital assets in company reports”
June 24, 2008

“A sell-side view on company reporting paucity”
John J. Ballow

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530 Broadway
New York, NY 10012
If ‘Earnings’ represent only 5% of Enterprise Value, then what is the rest?

$19.516 trillion

100.0%

Russell 3000 Enterprise Value

$12.856 trillion

 Current Value

$1.008 trillion

2005 "Net Income"

5.2%

$6.660 trillion

34.1%

Future Value

Notes:
1. Current Value is defined as NOPAT / WACC and represents the Present Value of current operations in perpetuity.
2. Future Value is defined as Enterprise Value minus Current Value and represents the Present Value of the future incremental value the market expects the company to create in addition to the value to be delivered from current operations into perpetuity.
3. The Current Value and therefore the Future Growth calculations are sensitive to the market premium chosen (in this case 4.5%) – a higher market premium would see a higher WACC which would see a lower Current Value and an even higher Future Value.
4. Analysis does not include the Standard & Poor’s GICS industry group - real estate [4040].
The magnitude and importance of Future Value to Enterprise Value varies by industry
(4-digit GICS code), December 31, 2004

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>1010</td>
<td>127</td>
<td>1,420,795</td>
<td>(108,996)</td>
<td>1,311,799</td>
<td>(8.3%)</td>
</tr>
<tr>
<td>Materials</td>
<td>1510</td>
<td>124</td>
<td>552,143</td>
<td>164,666</td>
<td>716,809</td>
<td>23.0%</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>2010</td>
<td>185</td>
<td>792,565</td>
<td>527,630</td>
<td>1,320,194</td>
<td>40.0%</td>
</tr>
<tr>
<td>Commercial Services &amp; Supplies</td>
<td>2020</td>
<td>84</td>
<td>160,080</td>
<td>86,902</td>
<td>246,982</td>
<td>35.2%</td>
</tr>
<tr>
<td>Transportation</td>
<td>2030</td>
<td>55</td>
<td>209,961</td>
<td>204,731</td>
<td>414,692</td>
<td>49.4%</td>
</tr>
<tr>
<td>Automobile &amp; Components</td>
<td>2510</td>
<td>34</td>
<td>235,362</td>
<td>24,537</td>
<td>259,899</td>
<td>9.4%</td>
</tr>
<tr>
<td>Consumer Durables &amp; Apparel</td>
<td>2520</td>
<td>103</td>
<td>288,321</td>
<td>35,186</td>
<td>323,507</td>
<td>10.9%</td>
</tr>
<tr>
<td>Hotel Restaurants &amp; Leisure</td>
<td>2530</td>
<td>89</td>
<td>204,086</td>
<td>156,772</td>
<td>360,857</td>
<td>43.4%</td>
</tr>
<tr>
<td>Media</td>
<td>2540</td>
<td>79</td>
<td>288,262</td>
<td>524,305</td>
<td>812,567</td>
<td>64.5%</td>
</tr>
<tr>
<td>Retailing</td>
<td>2550</td>
<td>143</td>
<td>465,736</td>
<td>322,574</td>
<td>788,310</td>
<td>40.9%</td>
</tr>
<tr>
<td>Food &amp; Staples Retailing</td>
<td>3010</td>
<td>28</td>
<td>364,539</td>
<td>140,782</td>
<td>505,321</td>
<td>27.9%</td>
</tr>
<tr>
<td>Food, Beverage &amp; Tobacco</td>
<td>3020</td>
<td>52</td>
<td>696,755</td>
<td>59,116</td>
<td>755,871</td>
<td>7.8%</td>
</tr>
<tr>
<td>Household &amp; Personal Products</td>
<td>3030</td>
<td>23</td>
<td>228,262</td>
<td>126,224</td>
<td>354,486</td>
<td>35.6%</td>
</tr>
<tr>
<td>Health Care</td>
<td>3510</td>
<td>188</td>
<td>462,780</td>
<td>326,536</td>
<td>789,316</td>
<td>41.4%</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>3520</td>
<td>142</td>
<td>626,760</td>
<td>438,279</td>
<td>1,065,039</td>
<td>41.2%</td>
</tr>
<tr>
<td>Banks</td>
<td>4010</td>
<td>274</td>
<td>878,202</td>
<td>100,800</td>
<td>978,283</td>
<td>10.2%</td>
</tr>
<tr>
<td>Diversified Financials</td>
<td>4020</td>
<td>78</td>
<td>699,326</td>
<td>283,220</td>
<td>982,546</td>
<td>28.8%</td>
</tr>
<tr>
<td>Insurance</td>
<td>4030</td>
<td>96</td>
<td>572,642</td>
<td>(7,110)</td>
<td>565,532</td>
<td>(1.3%)</td>
</tr>
<tr>
<td>Software</td>
<td>4510</td>
<td>189</td>
<td>206,471</td>
<td>482,149</td>
<td>688,620</td>
<td>70.0%</td>
</tr>
<tr>
<td>Technology</td>
<td>4520</td>
<td>163</td>
<td>198,123</td>
<td>672,675</td>
<td>870,799</td>
<td>77.2%</td>
</tr>
<tr>
<td>Semiconductors</td>
<td>4530</td>
<td>99</td>
<td>71,916</td>
<td>286,233</td>
<td>358,149</td>
<td>79.9%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>5010</td>
<td>43</td>
<td>350,545</td>
<td>314,096</td>
<td>664,642</td>
<td>47.3%</td>
</tr>
<tr>
<td>Utilities</td>
<td>5510</td>
<td>93</td>
<td>822,592</td>
<td>153,277</td>
<td>975,870</td>
<td>15.7%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>2,491</strong></td>
<td></td>
<td><strong>10,796,225</strong></td>
<td><strong>5,313,865</strong></td>
<td><strong>16,110,090</strong></td>
<td><strong>33.0%</strong></td>
</tr>
</tbody>
</table>
Balance Sheets no longer adequately track the assets that are valued nor driving the value.

S&P 500 Index: Book Value as a Percent of Market Value

- 1980: 20% Unexplained Value, 80% Accounting Book Value
- 1990: 45% Unexplained Value, 55% Accounting Book Value
- Peak (3/2000): 85% Unexplained Value, 15% Accounting Book Value
- Post Crash (8/2002): 75% Unexplained Value, 25% Accounting Book Value
- Present (8/2005): 60% Unexplained Value, 40% Accounting Book Value
Why? The asset base has changed dramatically. Balance sheets ignore and under-manage value creating assets.

<table>
<thead>
<tr>
<th>Resource Form</th>
<th>Traditional Economic Capital</th>
<th>Intellectual Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Monetary Capital</strong></td>
<td>- Cash</td>
<td>- Formal JVs, Alliances</td>
</tr>
<tr>
<td></td>
<td>- Receivables</td>
<td>- Customer &amp; Client Contracts</td>
</tr>
<tr>
<td></td>
<td>- Investments</td>
<td>- Outsourcing Contracts</td>
</tr>
<tr>
<td></td>
<td>- Free Cash Flow</td>
<td>- R&amp;D Licensing Agreements</td>
</tr>
<tr>
<td><strong>Physical Capital</strong></td>
<td>- Inventory</td>
<td>- Software</td>
</tr>
<tr>
<td></td>
<td>- Property, Plant &amp; Equipment</td>
<td>- Software Code</td>
</tr>
<tr>
<td></td>
<td>- Land &amp; Buildings</td>
<td>- Documented Processes &amp; Methods</td>
</tr>
<tr>
<td></td>
<td>- IT Hardware</td>
<td>- Internal Control Systems</td>
</tr>
<tr>
<td><strong>Resource Recognizability</strong></td>
<td>- Earnings Quality</td>
<td>- Patents &amp; TM</td>
</tr>
<tr>
<td></td>
<td>- Receivables Quality</td>
<td>- Management Contracts</td>
</tr>
<tr>
<td></td>
<td>- Credit Ratings</td>
<td>- Union Contracts</td>
</tr>
<tr>
<td></td>
<td>- Debt Capacity</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>- Balance Sheet Strength</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>- Cash Surplus</td>
<td>-</td>
</tr>
<tr>
<td><strong>Intangible</strong></td>
<td>- Plant Flexibility</td>
<td>- Brands</td>
</tr>
<tr>
<td></td>
<td>- Plant Modernity</td>
<td>- Reputation</td>
</tr>
<tr>
<td></td>
<td>- Reliance on Strategic Resources</td>
<td>- Customer Loyalty</td>
</tr>
<tr>
<td></td>
<td>- Asset Tradability</td>
<td>- Stakeholder Support &amp; Influence Networks</td>
</tr>
<tr>
<td></td>
<td>- Infrastructure Accessibility</td>
<td>-</td>
</tr>
<tr>
<td><strong>Human Capital</strong></td>
<td>- Governance Processes</td>
<td>- Exercise Rights (right to design, right to tender)</td>
</tr>
<tr>
<td></td>
<td>- Org. Structure</td>
<td>- Tacit Knowledge</td>
</tr>
<tr>
<td></td>
<td>- Organizational Controls</td>
<td>- Capabilities</td>
</tr>
<tr>
<td></td>
<td>- Management Controls</td>
<td>- Experience</td>
</tr>
<tr>
<td></td>
<td>- Bench Strength</td>
<td>- Employee Loyalty</td>
</tr>
<tr>
<td></td>
<td>- Workforce Stability</td>
<td>-</td>
</tr>
</tbody>
</table>
Compounding the problem, business models have changed as well. 170 of the S&P 500 are no longer value chain companies.

<table>
<thead>
<tr>
<th></th>
<th>Pre-1780s</th>
<th>1780/1840s - 1995</th>
<th>1995 - Present</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Economy</td>
<td>Agricultural</td>
<td>Industrial</td>
<td>Knowledge</td>
</tr>
<tr>
<td>Business Model</td>
<td>Value Shop (brawn)</td>
<td>Value Chain</td>
<td>Value Chain (brain)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Value Network (heavy)</td>
<td>Value Network (light)</td>
</tr>
<tr>
<td>Key Value Outcome Asset Drivers</td>
<td>Human</td>
<td>Monetary &amp; Physical</td>
<td>Relational, Org. &amp; Human</td>
</tr>
</tbody>
</table>

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So how might we propose to measure all this? TRS Mapping™ - integrates market valuation, accounting, strategies and performance.
Exactly where have the shareholders returns come from?

TRS Mapping™ - illustrated with AstraZeneca.

Operating Strategies: 25.9%

Financing Strategies: 10.3%

TRS: 36.4%

$1.6 bn.

$6.1 bn.

$76.8 bn.

$1.2 bn.

$71.9 bn.

$70.2 bn.

$5.1 bn.

$9.6 bn.

$66.5 bn.

($64.8 bn.)

Growth Strategies: 4.6%