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I Want Value… But What Do I Actually Want?

"Value : A quality or idea that is considered important. The word value comes from the Latin Valere, which means: Be worth. Value is defined as the worth, usefulness or importance of someone or something."
Courtesy of Professor Google

Value for money. I value our friendship. Value versus return. My personal values. Value of my personal wealth. Valuations. Loan to valuation ratio. Value of the dollar. Value of my time. Our corporate values.

Value Value Value……it's a blur but what does it really mean?

I'm prepared to have a crack but first, a caveat. Given that trying to discern value in its many forms is a bit like attempting to quantify the meaning life (if anyone knows, call me please) I will confine my observations to management rights, motels and the like. Let's start with the age-old misconception that price and value are somehow joined at the hip. They are not. It is true that the amount paid for a good or service may create some sense of value for a consumer but make no mistake, price is not the principle driver. A great example is the cost of, let's say, a legal due diligence report. Is the best value the cheapest quote that fails to cover the bases or the dearest quote that ends up saving the buyer from possible bankruptcy? In my mind the value lies in the outcome and if El Cheapo Lawyers miss crucial matters that place a consumer at risk then, at whatever price, there is no value in the service. You get what you pay for and paying for something that doesn't do what it says on the box makes no sense. There is no value other than the illusion (delusion?) that a part of the process has been ticked.

I would argue that if there is any real link with value it lies in quality, not price.

In my mind the broader way in which we should be looking at value is inextricably linked to risk, quality and return. In our game the perception of value, as defined in the minds of buyers, is driven by numerous factors, some material and some imagined. There are those who would argue that the market drives value but what is the market of not the cohort of buyers who evaluate opportunities and make investment decisions accordingly. Some will see value in a proven business being sold on a 6.5 times multiple while others will see value in lower multiples for higher risk struggling businesses with upside and the opportunity for higher capital growth. Neither buyer is wrong. It's just that both must understand the dynamic at play. The whole value/risk ratio gets out of kilter from time to time and that's when buyers come unstuck.

If we take the value concept one step further, we meet the elephant in the room. Yep, you guessed it, very very cheap debt. Our domestic interest rates are at record lows so even at quite high multiples the value equation, seen through the prism of return on equity, is absolutely compelling. It won't always be thus. At some point (don't ask me when) rates will start to go the other way and value will erode. The cost of debt has a positive impact when rates are low and a double whammy when rates are high. As rates rise less people feel comfortable borrowing and those who do have less money to play with, so demand suffers. In our game that's not just demand for the assets we sell, finance or otherwise advise, it's also demand from travellers who are in turn impacted. Basic economics tells us that price and demand move in concert so any fall in demand will have an inevitable impact on value.

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I guess the point here is that value, risk , quality and return are inextricably linked, and we need to ensure we bear this in mind at all times. Value can be quickly eroded by changes in the availability of capital and the cost of debt together with roll-on impacts on demand. A prudent buyer or advisor will certainly take future probability into account when making investment decisions.

In closing a few thoughts on retaining value. I've written about body corporate and landlord relationships and communication before so let's focus on value as a mathematical outcome. In the somewhat esoteric world of economists and valuers there lurks the concept of the net present value of future cash flows. Put simple, mainly because that's the only way I can, a future income has a value today. Put even more simply, your agreement top up or lease term extension has a real and tangible value. A 5x5 motel lease or a 25 year caretaking agreement is worth more than a 5x2 lease or 15 year agreements. Like any commercial arrangement or investment that makes you money, the longer you can lock in the income the more it's worth.

I reckon there's almost never any real value in cheap and cheerful. You get what you pay for and if you don't pay much you don't get much. The trick is to determine how much you want to pay and what you are prepared to accept. If you don't mind running out of oxygen at the top of Everest then surely the cheapest expedition will do. For me, a few extra bottles of air would be well worth a few more dollars spent.

That's value.

PS : If you are a business borrower here's some unsolicited advice. Take a leaf out of the residential property sector and use this historically benign interest rate environment to pay off debt and build a rate rise risk buffer. I shall refer to this in future as the RBARRRB……there will be a test.

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