CUSTOMIZED ERP

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The Core Principle

- A company's risk exposure comes not from where it is incorporated but from where it does business.
- The equity risk premium that you should use for a company should reflect its operating risk exposure.

Operating Exposure Measures

Measure	Advantages	Disadvantages
Revenues	1. Available for most companies. 2. Least accounting interference 3. Always positive	1. Does not capture exposure from production and operations. 2. May be hedged.
Operating Income or EBITDA	1. More closely tied to value.	1. Accounting number and can reflect other other factors. 2. Can be negative. 3. Not available for many companies.
Production/Operations	1. May reflect risk exposure better. 2. Not available for many companies.	1. Not available for many companies.

Let's start easy: A company that breaks revenues down by country – Ambev in 2012

Country	*Revenues*	*ERP*	*Weight*	*Weighted ERP*
Argentina	$ 19.00	15.00%	9.31%	1.40%
Bolivia	$ 4.00	10.88%	1.96%	0.21%
Brazil	$ 130.00	8.63%	63.73%	5.50%
Canada	$ 23.00	6.00%	11.27%	0.68%
Chile	$ 7.00	7.05%	3.43%	0.24%
Ecuador	$ 6.00	18.75%	2.94%	0.55%
Paraguay	$ 3.00	12.00%	1.47%	0.18%
Peru	$ 12.00	9.00%	5.88%	0.53%
Total	$ 204.00		100.00%	9.28%

A little messier.. Breakdown by region – Coca Cola in 2012

Region	*Revenue Weight (2014)*	*Regional ERP*	*Weight * ERP*
Eurasia & Africa	6.98%	8.94%	0.62%
Europe	12.43%	6.97%	0.87%
Latin America	11.83%	10.42%	1.23%
North America	55.27%	5.81%	3.21%
Asia Pacific	13.49%	7.19%	0.97%
Coca Cola			**6.90%**

The Ambiguous Mess – Amazon in February 2016

Region	*Revenues*	*ERP*	*Weight*	*Weighted ERP*
North America	$ 63,708	6.47%	64.27%	4.16%
Rest of the World	$ 35,418	8.41%	35.73%	3.00%
Total	$ 99,126		100.00%	7.16%

The bottom line

- Work with what you are given: You have to work with the data that you have, not the data that you wish you had.
- Don't be afraid to make assumptions: Make your best assumptions. Not making an assumption may be a bigger (and worse) assumption than making one.
- It is okay if you are wrong: Getting your equity risk premium to the second decimal point is not that important or consequential.