2012 IPEV Valuation Guidelines Proposed Revisions

The IPEV Board is proposing minor revisions to the existing International Private Equity and Venture Capital Valuation Guidelines to ensure alignment with FASB ASC Topic 820 and IFRS 13. The Board requests your comments and welcomes suggested conceptual or wording recommendations.

FASB/IASB Fair Value Background

In May 2011 FASB Amended ASC 820 (amendments contained in Accounting Standards Update (ASU) 2011-04) and the IASB issued IFRS 13. IFRS 13 and ASC 820 are now substantially congruent. IFRS 13 is effective January 1, 2013. Amended ASC 820 was effective January 1, 2012

While IFRS 13 is the first effort of the IASB to define Fair Value Measurement, because it is substantially congruent with FASB's ASC 820, there are limited impacts on the IPEV Valuation Guidelines as they were already congruent with ASC Topic 820. A summary of the US and International GAAP changes follows.

Changes to ASC 820/ Newly Issued IFRS 13

Significant ***changes*** to existing U.S. GAAP pursuant to ASU 2011-4 (which are incorporated in IFRS 13) include the following:

- **Financial instruments: Highest and Best Use and In Use valuation premise**. The concepts of Highest and Best Use and In Use valuation premise are now only relevant when measuring the fair value of nonfinancial assets. They can no longer be applied to financial assets.
  - The unit of account used in the measurement of financial instruments is based on the specific ASC topic or IFRS under which fair value measurement is required
  - Because of limited unit of account guidance contained in the US Accounting rules governing Investment Companies (ASC Topic 946 – Investment Companies; the accounting guidance in US GAAP that requires the use of fair value for Private Equity and Venture Capital Funds), some might interpret the new guidance as precluding an investor from considering its controlling equity ownership when valuing a debt investment in the same underlying company. Some might also conclude that individual shares of a private company are the unit of account to be valued, rather than the entire position owned by an investor. (Note: The IASB guidance which would allow Investment Companies using IFRS to report controlled investments at fair value remains under discussion). However, FASB and the IASB have stated that a Market Participant perspective should be maintained.
- **Block discounts**. The prohibition on the use of block discounts is now extended to Levels 2 and 3 of the valuation hierarchy (previously, US GAAP was silent on the use of block discounts for Level 2 and Level 3 valuation inputs). The accounting Boards

espouse the principle that a premium or discount that reflects size as a characteristic of a company's holding should not be reflected in the fair value measurement.

However, if a premium or discount is a characteristic of the instrument itself, it can be reflected in the fair value measurement. (See ASU 2011-4, BC 79: "*The amendments specify that when a Level 1 input is not available, a fair value measurement should incorporate premiums or discounts if market participants would take them into account in a transaction for the asset or liability. However, the Boards decided to clarify that the application of premiums or discounts must be consistent with the unit of account in the Topic that requires or permits the fair value measurement*.")

For example, if a company owns a 60% interest in a private company and a market participant would price the 60% interest on a "control" basis, then the "premium" associated with control would appropriately be a characteristic of the fair value measurement. This of course is subject to the unit of account prescribed by the specific ASC Topic/ IFRS under which the fair value measurement is required.

- In some cases, it may be challenging to separate the blockage (liquidity) adjustment from the individual instrument liquidity adjustment, especially when the fair value measurement utilizes inputs from other block trades.
- It may also be challenging to determine control premiums or minority discounts. Therefore, it is important to focus on amount that a market participant would pay for the investment.
- The prohibition on blockage discounts does not disallow the application of other discounts as long as that is consistent with the relevant unit of account, or, absent such guidance, with the way Market Participants would consider the fair value measurement.

- **Calibration Requirement**. The Boards now explicitly require the entry price to be calibrated with the valuation techniques expected to be used in the future.

  FASB ASC **820-10-35-24C and IFRS 13 paragraph 64 state: "***If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be* ***calibrated*** *so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps a reporting entity to determine whether an adjustment to the valuation technique is necessary (for example, there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, a reporting entity shall ensure that those valuation techniques reflect observable market data (for example, the price for a similar asset or liability) at the measurement date."*

  For example, assume the acquisition price of an investment was deemed fair value (e.g. an orderly transaction price) and represented an EBITDA multiple of 8 when comparable company EBITDA multiples were 10. In future periods, when estimating fair value judgement is required whether or not the 20% discount to comparable company multiples should be maintained or should change at each subsequent measurement date.

Clarifications to ASC 820—Included in IFRS 13

ASU 2011- 4 also provides some ***clarifications*** to the existing guidance in ASC 820:

- Premiums and discounts (other than block discounts). Premiums and discounts (i.e. control/minority) may be used as long as they: 1) would be considered by Market Participants acting in their economic best interest; 2) are appropriate given the attributes of the asset or liability; and 3) are consistent with the unit of account prescribed by the GAAP pursuant which the fair value measurement is required.
- An explicit presumption that, absent evidence to the contrary, the market in which the entity would normally enter into transaction is presumed to be the principal (or most advantageous) market.

Convergence in Fair Value Measurement

With the issuance of IFRS 13, U.S. GAAP and IFRS are substantially converged in the area of fair value measurements. A few differences remain between IFRS 13 and ASC 820, including:

- Wording and style
- Differences in references to other IFRSs and US GAAP
- Differences in disclosures
- US GAAP provides specific guidance on when Net Asset Value (NAV) may be used by a limited partner to estimate the fair value of an interest in a fund (limited partnership interest). IFRS is silent on the use of NAV to estimate the fair value of an interest in a fund.

Questions for Reviewers

You have been provided with the following redline version of the updated IPEV Valuation Guidelines. All changes to the 2010 version of the IPEV Valuation Guidelines have been highlighted. The IPEV Board requests your input on the following questions:

1. Do any changes need to be made to the updated draft to ensure that entities that adopt or comply with the IPEV Guidelines would be compliant with ASC 820 / IFRS 13?

   Note: the IPEV Board acknowledges that a preparer does not need to follow the IPEV Valuation guidelines to comply with GAAP. However, it is the IPEV Board's intent to be able to represent that if fair value is measured using the IPEV Valuation Guidelines, the resultant fair value measurement will be ASC 820 / IFRS 13 compliant.

2. Do the format changes make the document more readable?

3. Do you have any other suggestions that would enhance the IPEV Valuation Guidelines?

Please provide your comments or suggestions on the proposed update, to IPEV Board member David Larsen of Duff & Phelps LLC at david.larsen@duffandphelps.com, on or before September 28, 2012.

Summary of Proposed Changes to IPEV Valuation Guidelines

Proposed changes to the IPEV Valuation Guidelines include the following:

1. Format:
    a. Glossary to the back
    b. Guidelines (bold text) moved to standalone Section I
    c. Old Section I becomes Section II
    d. Old Section II becomes Section III
    e. Added paragraph numbers for guidelines for ease of use and cross reference
2. Technical:
    a. Conformed to IFRS 13 /ASU 2011-04/ASC 820
    b. Incorporated selected IPEV FAQ responses
    c. Clarified FV of Debt vs Par Value of Debt
    d. Added Contractual Rights (Contingent Consideration) discussion
    e. Added unit of account discussion

International Private Equity And Venture Capital Valuation Guidelines

Edition September 2012

International Private Equity and Venture Capital Valuation Guidelines

These guidelines have been developed by the IPEV Board with the valuable input and endorsement of the following associations:

AFIC - Association Française des Investisseurs en Capital*
AIFI - Italian Private Equity and Venture Capital Association
AMEXCAP - Mexican Private Equity Association
AMIC - Moroccan Private Equity and Venture Capital Association
APCRI - Portuguese Private Equity and Venture Capital Association
ASCRI - Spanish Private Equity and Venture Capital Association
ATIC - Tunisian Venture Capital Association
AVCA - African Venture Capital Association
AVCAL - Australian Private Equity and Venture Capital Association
AVCO - Austrian Private Equity and Venture Capital Organization
CAPE – China Association of Private Equity
BVA - Belgian Venturing Association
BVCA - British Venture Capital Association*
BVK - German Private Equity and Venture Capital Association e.V.
CVCA - Canada's Venture Capital and Private Equity Association
CVCA - China Venture Capital Association
CVCA - Czech Venture Capital and Private Equity Association
DVCA - Danish Venture Capital Association
EMPEA - Emerging Markets Private Equity Association
EVCA - European Private Equity and Venture Capital Association*
FVCA - Finnish Venture Capital Association
HKVCA - Hong Kong Venture Capital Association
HVCA - Hungarian Venture Capital and Private Equity Association
ILPA - Institutional Limited Partners Association
IVCA - Irish Venture Capital Association
LAVCA - Latin American Venture Capital Association
LPEq - Listed Private Equity
LVCA - Latvian Venture Capital Association
MENA Private Equity Association
NVCA - Norwegian Venture Capital & Private Equity Association
NVP - Nederlandse Vereniging van Participatiemaatschappijen (Dutch Private Equity and Venture Capital Association)
NZVCA - New Zealand Private Equity and Venture Capital Association
PPEA - Polish Private Equity Association
Réseau Capital - Québec Venture Capital and Private Equity Association
RVCA - Russian Private Equity and Venture Capital Association
SAVCA - Southern African Venture Capital and Private Equity Association
SECA - Swiss Private Equity and Corporate Finance Association
SLOVCA - Slovak Venture Capital Association
SVCA - Singapore Venture Capital and Private Equity Association
SVCA - Swedish Private Equity and Venture Capital Association

(Endorsement as of ~~22~~ XX ~~July~~ October ~~2009~~2012)

* AFIC, BVCA and EVCA founded the IPEV Board in 2005.

Disclaimer

The information contained within this paper has been produced with reference to the contributions of a number of sources. The IPEV Board has taken suitable steps to ensure the reliability of the information presented.
However, the IPEV Board nor other named contributors, individuals or associations can accept responsibility for any decision made or action taken, based upon this paper or the information provided herein.

For further information please visit: www.privateequityvaluation.com

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Preface

These Guidelines set out recommendations, intended to represent current best practice, on the valuation of private equity and venture capital investments. The term “private equity” is used in these Guidelines in a broad sense to include investments in early stage ventures, management buyouts, management buyins and similar transactions and growth or development capital.

The ~~recommendations~~ Guidelines, as presented in Section I, are intended to be applicable across the whole range of Private Equity Funds (seed and start-up venture capital, buyouts, growth/development capital, etc) and financial instruments commonly held by such Private Equity Funds. They also provide a basis for valuing investments by other entities, including Fund-of-Funds, in such Private Equity Funds. The Guidelines have been prepared with the goal that fair value measurements derived when using the Guidelines are compliant with both International and United States Generally Accepted Accounting Principles (IFRS 13 / FASB ASC 820).

~~The~~ Individual ~~recommendations~~ Guidelines are outlined in Section I. Section II, presents ~~themselves~~ the Guidelines themselves surrounded by a border and set out in bold type ~~are surrounded by a border and set out in bold type~~, ~~whereas~~ with accompanying explanations, illustrations, background material, context and supporting commentary, ~~which are provided~~ to assist in the interpretation of the ~~recommendations~~Guidelines~~, are set out in normal type~~. Section III provides application guidance for specific situations.

Where there is conflict between ~~a recommendation~~the content of ~~contained in~~ these Guidelines and the requirements of any applicable laws or regulations or accounting standard or generally accepted accounting principle, the latter requirements should take precedence.

No member of the International Private Equity and Venture Capital Valuation Guidelines (‘IPEV Guidelines’) Board (‘IPEV Board’), any committee or working party thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Guidelines nor for the consequences of reliance or otherwise on the provisions of these Guidelines.

These Guidelines should be regarded as superseding previous Guidelines issued by the IPEV Board with effect for reporting periods post 1 ~~July 2009~~January 2013.

Introduction

Private equity managers may be required to carry out periodic valuations of Investments as part of the reporting process to investors in the Funds they manage. The objective of these Guidelines is to set out best practice where private equity Investments are reported at 'Fair Value', with a view to promoting best practice and hence helping investors in Private Equity Funds make better economic decisions.

The increasing importance placed by international accounting authorities on Fair Value reinforces the need for the consistent use of valuation standards worldwide and these Guidelines provide a framework for consistently determining valuations for the type of Investments held by Private Equity Funds.

Private Equity Funds are typically governed by a combination of legal or regulatory provisions or by contractual terms. It is not the intention of these Guidelines to prescribe or recommend the basis on which Investments are included in the accounts of Funds. The IPEV Board confirms fair value as the best measure of valuing private equity portfolio companies and investments in private equity funds. The board's support for fair value is underpinned by the transparency it affords investors in funds, which use fair value as an indication of the interim performance of a portfolio. In addition, institutional investors require fair value to make asset allocation decisions, and to produce financial statements for regulatory purposes.

The requirements and implications of financial reporting standards and in particular International Financial Reporting Standards and US GAAP have been considered in the preparation of these Guidelines. This has been done, in order to provide a framework for Private Equity Funds for arriving at a Fair Value for Investments which is consistent with accounting principles.

It is not a requirement of accounting principles that these Guidelines are followed. However compliance with these accounting principles can be achieved by following the Guidelines.
These Guidelines are intended to represent current best practice and therefore will be revisited and, if necessary, revised to reflect changes in international regulation or accounting standards.

These Guidelines are concerned with valuation from a conceptual standpoint and do not seek to address best practice as it relates to investor reporting, internal processes, controls and procedures, governance aspects, Committee oversights, the experience and capabilities required of the Valuer or the audit or review of valuations.

A distinction is made in these Guidelines between the basis of valuation (Fair Value), which defines what the carrying amount purports to represent, a valuation methodology (such as the earnings multiple technique), which details the method or technique for deriving a valuation, and inputs used in the valuation methodology (such as EBITDA).

Private equity by its nature utilizes confidential, non-public information. Yet Investors in Private Equity Funds need sufficient, timely, comparable and transparent information from their Managers which allows Investors to:

- Exercise fiduciary duty in monitoring deployed investment capital
- Report periodic performance to ultimate Investors, beneficiaries, boards, etc., as applicable

- Prepare financial statements consistent with applicable accounting standards.

Investors may also use the fair value information to::

- Make asset allocation decisions.
- Make manager selection decisions.
- Make Investor level incentive compensation decisions.

The IPEV Board has prepared separate Investor Reporting Guidelines. The IPEV Investor Reporting Guidelines (IRG) are a globally applicable set of disclosure principles and practices designed to provide general partners and their limited partners with guidance in presenting their investments and investment performance over the life of a fund.

The IPEV IRG may be obtained at: http://www.privateequityvaluation.com/ipev-board/reporting-guidelines/ipev-reporting-guidelines/index.html.

Section I: ~~Determining Fair Value~~Valuation Guidelines

1. The Concept of Fair Value

1.1~~The~~ Fair Value is the price ~~at~~ that would be received to sell an asset in ~~which~~ an orderly transaction ~~would take place~~ between Market Participants at the ~~Reporting~~ Measurement Date.

1.2 For ~~Quoted~~ Actively Traded (Quoted) Instruments, available market prices will be the primary basis for the determination of Fair Value.

1.3 For Unquoted Investments, the estimation of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised at the ~~Reporting~~ Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.4 Some Funds invest in multiple securities or tranches of the same portfolio company. The determination of unit of account is expected to be on the same basis that a Market Participant would transact. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate investments made in series A, series B, and series C, then, fair value would be estimated for the aggregate investment in the Investee Company. If a Market Participant would be expected to transact separately, for example selling series A, independent from Series B and Series C, or if debt investments are purchased or sold independent of equity, then fair value may be more appropriately estimated for the individual instruments.

2. Principles of Valuation

2.1 The Fair Value of each Investment should be assessed at each ~~Reporting~~ Measurement Date.

2.2 In estimating Fair Value for an Investment, the Valuer should apply a methodology or methodologies that is/are appropriate in light of the nature, facts and circumstances of the Investment and its materiality in the context of the total Investment portfolio and should use reasonable data and market inputs, assumptions and estimates.

2.3 ~~The~~ Fair Value is estimated by the Valuer, whichever valuation methodologies are used, from the Enterprise Value, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation methodologies;

(ii) Adjust the Enterprise Value for items that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors, to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;

(v) Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.

(vi) If the price of the initial investment in an Investee Company is deemed fair value (e.g. the transaction is orderly; at arm's length; willing buyer and willing seller), then the valuation techniques that are expected to be used to estimate fair value in the future should be evaluated using market inputs as of the investment date. This process is known as calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate fair value at inception and therefore that the valuation techniques using future current market inputs will generate fair value at each subsequent Measurement Date.

2.4 Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

3. Valuation Methodologies

3.1. General

A. In determining the Fair Value of an Investment, the Valuer should use judgement. This includes a detailed consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the substance of the Investment, which may take preference over the strict legal form.

B. Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the ~~Reporting~~ Measurement Date.

3.2. Selecting the Appropriate Methodology

The Valuer should exercise their judgement to select the valuation methodology or methodologies ~~that is the~~ most appropriate for a particular Investment.

3.3. Price of Recent Investment

In applying the Price of Recent Investment methodology, the Valuer uses the initial cost of the Investment itself, net of transaction costs, or, where there has been subsequent investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in any case assess at each ~~Reporting~~ Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

3.4. Multiples

In using the Earnings Multiple methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) **Apply a multiple that is appropriate and reasonable (given the risk profile and earnings growth prospects of the underlying company) to the maintainable earnings of the company;**

(ii) **Adjust the Enterprise Value for surplus assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;**

(iii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;**

(iv) **Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of a potential buyer.**

3.5. Net Assets

In using the Net Assets methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) **Derive an Enterprise Value for the company using appropriate measures to value its assets and liabilities (including, if appropriate, contingent assets and liabilities);**

(ii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and**

(iii) **Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.**

3.6. Discounted Cash Flows or Earnings (of Underlying Business)

In using the Discounted Cash Flows or Earnings (of Underlying Business) methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) **Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that quantifies the risk inherent in the company;**

(ii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;**

(iii) **Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.**

3.7. Discounted Cash Flows (from the Investment)

In using the Discounted Cash Flows (from the Investment) methodology to estimate the Fair Value of an Investment, the Valuer should derive the present value of the Investment~~,~~ using reasonable assumptions and estimations of expected future cash flows and the terminal value and date, and the appropriate risk-adjusted rate that quantifies the risk inherent to the Investment. The implied discount rate at initial investment is adjusted over time for changes in market conditions.

3.8. Industry Valuation Benchmarks

The use of such industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a common sense-check of values produced using other methodologies.

3.9. Available Market Prices

A. Instruments quoted on an active stock market should be valued at ~~their bid prices~~the price within the bid-ask spread that is most representative of fair value on the ~~Reporting~~ Measurement Date. ~~If bid price is not required by accounting regulation and not deemed to be appropriate, the most representative point estimate in the bid/ask spread may be used.~~ The Valuer should consistently use ~~either the bid price or~~ the most representative point estimate in the bid/ask spread.

B. Discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.

C. Discounts should not may be applied to prices quoted on in an Active Market, unless if there is some contractual, Governmental or other legally enforceable restriction that would impact the value price realised a Market Participant would pay at the Reporting Measurement Date.

4. Valuing Fund Interests

4.1. General

In estimating the Fair Value of an interest in a Fund, the Valuer should may base their estimate on their attributable proportion of the reported Fund Net Asset Value (NAV) if NAV is derived from the fair value of underlying investments and is as of the same measurement date as that used by the valuer of the fund interest.

4.2. Adjustments to Net Asset Value

After the Valuer determines that the reported NAV is an appropriate starting point, it may be necessary to make adjustments based on the best available information at the Reporting Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager.

4.3. Secondary Transactions

When a Valuer of an interest knows the relevant terms of a Secondary transaction in that particular Fund and the transaction is considered orderly, the Valuer should may consider the transaction price as one component of the information used to determine the Fair Value of a fund interest.

Section II: Explanatory Comments-Determining Fair Value

1. The Concept of Fair Value

1.1 ~~The~~ Fair Value is the price ~~at which~~ that would be received to sell an asset in an orderly transaction ~~would take place~~ between Market Participants at the ~~Reporting~~ Measurement Date.

1.2 For Actively Traded (~~Quoted~~ Quoted) Instruments, available market prices will be the primary basis for the determination of Fair Value.

1.3 For Unquoted Investments, the estimation of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised at the ~~Reporting~~ Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.4 Some Funds invest in multiple securities or tranches of the same portfolio company. The determination of unit of account is expected to be on the same basis that a Market Participant would transact. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate investments made in series A, series B, and series C, then, fair value would be estimated for the aggregate investment in the Investee Company. If a Market Participant would be expected to transact separately, for example selling series A, independent from Series B and Series C, or if debt investments are purchased or sold independent of equity, then fair value may be more appropriately estimated for the individual instruments.

The objective is to estimate the hypothetical exchange price at which Market Participants would agree to transact at the ~~Reporting~~ Measurement Date.

Fair Value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distressed sale. However the hypothetical exchange price must take into account current market conditions for buying and selling assets.

Although transfers of shares in private businesses are often subject to restrictions, rights of pre-emption and other barriers, it should still be possible to estimate what amount a willing buyer would pay to take ownership of the Investment.

The estimation of Fair Value assumes that the time period required to consummate a transaction hypothetically began at a point in time in advance of the Measurement Date such that the hypothetical exchange culminates on the Measurement Date. Therefore, a discount for marketability (e.g. the time required to effect a transaction) is not appropriate.

2. Principles of Valuation

2.1 The Fair Value of each Investment should be assessed at each ~~Reporting~~ Measurement Date.

In the absence of an active market for a financial instrument, the Valuer must estimate Fair Value utilising one or more of the valuation methodologies.

2.2 In estimating Fair Value for an Investment, the Valuer should apply a methodology or methodologies that is/are appropriate in light of the nature, facts and circumstances of the Investment and its materiality in the context of the total Investment portfolio and should use reasonable data and market inputs, assumptions and estimates.

In private equity, value is generally crystallised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes~~,~~. T~~t~~he value of the business as a whole at the Reporting Date (Enterprise Value) will often provide a key insight into the value of investment stakes in that business.

Accounting Standards require that fair value be determined at the "unit of account" level, i.e. the level in which the financial instrument is aggregated. Unit of account guidance for private equity and venture capital is limited. Therefore, it is appropriate to assess unit of account from the perspective of a Market Participant. For example, if value is crystallized as described above, then Enterprise Value would be used by a Market Participant to determine the orderly price they would pay for an Investment.

Alternatively, if a Market Participant would transact for individual instruments, such as debt, or a single Series of equity, then fair value would be more appropriately assessed at the individual instrument level.

2.3 ~~The~~ Fair Value is estimated by the Valuer, whichever valuation methodologies are used, from the Enterprise Value, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation methodologies;

(ii) Adjust the Enterprise Value for items that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;

(v)	**Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.**
(vi)	**If the price of the initial investment in an Investee Company is deemed fair value (e.g. the transaction is orderly; at arm's length; willing buyer and willing seller), then the valuation techniques that are expected to be used to estimate fair value in the future should be evaluated using market inputs as of the investment date. This process is known as calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate fair value, at inception and therefore that the valuation techniques using future current market inputs will generate fair value at each subsequent Measurement Date.**

It is important to recognise the subjective nature of private equity Investment valuation. It is inherently based on forward-looking estimates and judgements about the Underlying Business itself: its market and the environment in which it operates; the state of the mergers and acquisitions market; stock market conditions and other factors that exist at the ~~Reporting~~ Measurement Date.

Due to the complex interaction of these factors and often the lack of directly comparable market transactions, care should be applied when using publicly available information regarding other entities in deriving a valuation. In order to determine the Fair Value of an Investment, the Valuer will have to exercise judgement and make necessary estimates to adjust the market data to reflect the potential impact of other factors such as geography, credit risk, foreign currency, rights attributable, equity prices and volatility.

As such, it must be recognised that, whilst valuations do provide useful interim indications of the progress of a particular Investment or portfolio of Investments, ultimately it is not until Realisation that true performance is firmly determined. A Valuer should be aware of reasons why realisation proceeds are different from their estimates of Fair Value.

Fair Value should reflect reasonable estimates and assumptions for all significant factors that parties to an arm's length transaction would be expected to consider, including those which impact upon the expected cash flows from the Investment and upon the degree of risk associated with those cash flows.

In assessing the reasonableness of assumptions and estimates, the Valuer should:

- to the extent the entry price is deemed fair value, test (or calibrate) valuation techniques expected to be used at subsequent valuation dates, using input data at inception to ensure that the techniques provide a resultant fair value estimate equal to the entry price; (note: calibrated valuation techniques are used with then current market inputs at subsequent Measurement dates);
- note that the objective is to replicate those that the parties in an arm's-length transaction would make at the Reporting Date;
- take account of events taking place subsequent to the Reporting Date where they provide additional evidence of conditions that existed at the Reporting Date;
- take account of current market conditions at the reporting date; and

- take account of materiality considerations.

{Note the following section was moved from 2.4 below}

Apportion the Attributable Enterprise Value appropriately

The apportionment should reflect the respective amounts accruing to each financial instrument holder in the event of a sale or flotation at the Measurement Date. As discussed further in section III 1.8, where there are ratchets or share options or other mechanisms (such as 'liquidation preferences', in the case of Investments in early-stage businesses) in place which are likely to be triggered in the event of a sale of the company at the given Enterprise Value at that date, these should be reflected in the apportionment.

The estimation of Fair Value should be undertaken on the assumption that options and warrants are exercised, where the Fair Value is in excess of the exercise price and accordingly it is a reasonable assumption that these will be exercised. The aggregate exercise price of these may result in surplus cash arising in the Underlying Business if the aggregate exercise price is significant.

Differential allocation of proceeds may have an impact on the value of an Investment. If liquidation preferences exist, these need to be reviewed to assess whether they are expected to give rise to a benefit to the Fund, or a benefit to a third party to the detriment of the Fund.

Where significant positions in options and warrants are held by the Fund, these may need to be valued separately from the underlying investments using an appropriate option based pricing model.

When subtracting outstanding debt from Enterprise Value to determine the Fair Value of Equity Instruments, judgement should be exercised to ensure that the value of debt subtracted represents a Market Participant perspective. For example, if debt must be contractually repaid upon the sale of the Underlying Business, then a Market Participant would deem the Par Value of Debt (or the amount to be repaid) to equal the Fair Value of Debt for purposes of determining the value of equity.

2.4 Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

-Private Equity Funds often undertake an Investment with a view to build, develop and/or to effect substantial changes in the Underlying Business, whether it is to its strategy, operations, management, or financial condition. Sometimes these situations involve rescue refinancing or a turnaround of the business in question. Whilst it might be difficult in these situations to determine Fair Value, it should in most cases be possible to estimate the amount a Market Participant would pay for the Investment in question at a point in time.

There may be situations where:

- the range of reasonable Fair Value estimates is significant;
- the probabilities of the various estimates within the range cannot be reasonably assessed;

- the probability and financial impact of achieving a key milestone cannot be reasonably predicted; and
- there has been no recent investment into the business.

While these situations prove difficult, the Valuer must still come to a conclusion as to their best estimate of the hypothetical exchange price between willing Market Participants.

Estimating the increase or decrease in Fair Value in such cases may involve reference to broad indicators of value change (such as relevant stock market indices). After considering these broad indicators, in some situations, the Valuer might reasonably conclude that the Fair Value at the previous ~~Reporting Date~~Measurement Date remains the best estimate of Fair Value.

Where a change in Fair Value is perceived to have occurred, the Valuer should amend the carrying value of the Investment to reflect the ~~estimated impact~~new Fair Value estimate.

{Note the following section was moved to 2.3 above}

~~**Apportion the Attributable Enterprise Value appropriately**~~

~~The apportionment should reflect the respective amounts accruing to each financial instrument holder in the event of a sale or flotation at the Reporting Date. As discussed further in section II 1.8., where there are ratchets or share options or other mechanisms (such as 'liquidation preferences', in the case of Investments in early stage businesses) in place which are likely to be triggered in the event of a sale of the company at the given Enterprise Value at that date, these should be reflected in the apportionment.~~

~~The estimation of Fair Value should be undertaken on the assumption that options and warrants are exercised, where the Fair Value is in excess of the exercise price and accordingly it is a reasonable assumption that these will be exercised. The aggregate exercise price of these may result in surplus cash arising in the Underlying Business if the aggregate exercise price is significant.~~

~~Differential allocation of proceeds may have an impact on the value of an Investment. If liquidation preferences exist, these need to be reviewed to assess whether they are expected to give rise to a benefit to the Fund, or a benefit to a third party to the detriment of the Fund.~~

~~Where significant positions in options and warrants are held by the Fund, these may need to be valued separately from the underlying investments using an appropriate option based pricing model.~~

3. Valuation Methodologies

3.1. General

A number of valuation methodologies that may be considered for use in estimating the Fair Value of Unquoted Instruments are described in sections 3.3. to 3.8. below. These methodologies should be amended as necessary to incorporate case-specific factors affecting Fair Value. Methodologies for valuing Quoted Instruments are described in section 3.9. below. For example, if the Underlying Business is holding surplus cash or other assets, the value of the business should reflect that fact.

Because, in the private equity arena, value is generally crystallised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes, the value of the business as a whole at the ~~Reporting~~ Measurement Date will often provide a key insight into the value of investment stakes in that business. For this reason, a number of the methodologies described below involve estimating the Enterprise Value as an initial step. If a Market Participant would be expected to maximize value through the sale of the entire business, the estimation of the Fair Value of individual financial instruments would include an assessment of the allocation of the Enterprise Value to the value of individual financial instruments.

There will be some situations where the Fair Value will derive mainly from the expected cash flows and risk of the relevant financial instruments rather than from the Enterprise Value. The valuation methodology used in these circumstances should therefore reflect this fact.

A. **In determining the Fair Value of an Investment, the Valuer should use judgement. This includes a detailed consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the substance of the Investment, which may take preference over the strict legal form.**

Movements in rates of exchange may impact the value of the Fund's Investments and these should be taken into account.

B. **Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the ~~Reporting~~ Measurement Date.**

3.2. Selecting the Appropriate Methodology

3.2The Valuer should exercise their judgement to select the valuation methodology or methodologies ~~that is the~~ most appropriate for a particular Investment.

The key criterion in selecting a methodology is that it should be appropriate in light of the nature, facts and circumstances of the Investment, the expected view of relevant Market Participants, and its materiality in the context of the total portfolio of Investments. The Valuer may consider utilising further methodologies to check the Fair Value derived, ~~if~~ as appropriate.

When selecting the appropriate methodology each Investment should be considered individually. ~~Where an immaterial group of Investments in a portfolio are similar in terms of risk profile and industry, it is acceptable to apply the same methodology across all Investments in that immaterial group. The methodology applied should be consistent with that used for material investments with a similar risk profile in that industry.~~

An appropriate methodology will incorporate available information about all factors that are likely materially to affect the Fair Value of the Investment.

The Valuer will select the valuation methodology that is the most appropriate and consequently make valuation adjustments on the basis of their informed and experienced judgement. This will include consideration of factors such as:

- the results of testing (calibrating) techniques and inputs to replicate the entry price of the Investment;
- the relative applicability of the methodologies used given the nature of the industry and current market conditions;
- the quality, and reliability of the data used in each methodology;
- the comparability of enterprise or transaction data;
- the stage of development of the enterprise;
- the ability of the enterprise to generate maintainable profits or positive cashflow; and
- any additional considerations unique to the enterprise.

In assessing whether a methodology is appropriate, the Valuer should be biased towards those methodologies that draw heavily on market-based measures of risk and return. Fair Value estimates based entirely on observable market data should be of greater reliability than those based on assumptions. In some cases observable market data may require adjustment by the Valuer to properly reflect the facts and circumstances of the entity being valued. This adjustment should not be automatically regarded as reducing the reliability of the Fair Value estimation.

Methodologies utilising discounted cashflows and industry benchmarks should rarely be used in isolation of the market-based measures and then only with extreme caution. These methodologies may be useful as a cross-check of values estimated using the market-based methodologies.

Where the Valuer considers that several methodologies are appropriate to value a specific Investment, the Valuer may consider the outcome of these different valuation methodologies so that the results of one particular method may be used as a cross-check of values or to corroborate or otherwise be used in conjunction with one or more other methodologies in order to determine the Fair Value of the Investment.

Methodologies should be applied consistently from period to period, except where a change would result in better estimates of Fair Value.

The basis for any changes in valuation methodologies should be clearly understood. It is expected that there would not be frequent changes in valuation methodologies over the course of the life of an investment.

The table below identifies a number of the most widely used methodologies

Methodology
Price of Recent Investment (Market Approach)—
Multiples (Market Approach)
Net assets (Cost Approach)
Discounted cash flows or earnings (of Underlying Business) (Income Approach)
Discounted cash flows (from the Investment) (Income Approach)
Industry valuation benchmarks (Market Approach)

3.3. Price of Recent Investment

Where the Investment being valued was itself made recently, its cost may provide a good indication of Fair Value. Where there has been any recent Investment in the Investee Company, the price of that Investment will provide a basis of the valuation.

The validity of a valuation obtained in this way is inevitably eroded over time, since the price at which an Investment was made reflects the effects of conditions that existed on the date that the transaction took place. In a dynamic environment, changes in market conditions, the passage of time itself and other factors will act to diminish the appropriateness of this methodology as a means of estimating value at subsequent dates.

In addition, where the price at which a third party has invested is being considered as the basis of valuation, the background to the transaction must be taken in to account. In particular, the following factors may indicate that the price was not wholly representative of the Fair Value at the time:

- different rights attach to the new and existing Investments;
- disproportionate dilution arising from a new investor;
- a new investor motivated by strategic considerations;
- the transaction may be considered to be a forced sale or 'rescue package'; or
- the absolute amount of the new Investment is relatively insignificant.

This methodology is likely to be appropriate for all private equity Investments, but only for a limited period after the date of the relevant transaction. Because of the relatively high frequency with which funding rounds are often undertaken for seed and start-up situations, or in respect of businesses engaged in technological or scientific innovation and discovery, the

methodology will often be appropriate for valuing Investments in such circumstances. Fair Value would be indicated by the post money valuation.

The length of period for which it would remain appropriate to use this methodology will depend on the specific circumstances of the Investment and is subject to the judgement of the Valuer.

In stable market conditions with little change in the entity or external environment, the length of period for which this methodology is likely to be appropriate will be longer than during a period of a rapidly changing entity or external market environment.

3.3 In applying the Price of Recent Investment methodology, the Valuer uses the initial cost of the Investment itself, net of transaction costs, or, where there has been subsequent investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in any case assess at each ~~Reporting~~ Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

The Price of Recent Investment methodology is commonly used in a seed, start-up or an early-stage situation, where there are no current and no short-term future earnings or positive cash flows. For these enterprises, typically, it is difficult to gauge the probability and financial impact of the success or failure of development or research activities and to make reliable cash flow forecasts.

Consequently, the most appropriate approach to determine Fair Value is a methodology that is based on market data, that being the Price of a Recent Investment.

If the Valuer concludes that the Price of Recent Investment, unadjusted, is no longer relevant, and there are no comparable companies or transactions from which to infer value, it may be appropriate to apply an enhanced assessment based on an industry analysis, sector analysis and/or milestone analysis.

In such circumstances, industry-specific benchmarks/milestones, which are customarily and routinely used in the specific industries of the Investee Company, can be used in estimating Fair Value where appropriate. In applying the milestone approach, the Valuer attempts to ascertain whether there has been a change in the milestone and/or benchmark which would indicate that the Fair Value of the investment has changed.

For an investment in early or development stages, commonly a set of agreed milestones would be established at the time of making the investment decision. These will vary across types of investment, specific companies and industries, but are likely to include;

Financial measures:

- revenue growth;
- profitability expectations;
- cash burn rate;

- covenant compliance.

Technical measures;

- phases of development;
- testing cycles;
- patent approvals.
- regulatory approvals

Marketing and sales measures:

- customer surveys;
- testing phases;
- market introduction;
- market share.

In addition, the key market drivers of the Investee Company, as well as the overall economic environment, are relevant to the assessment.

In applying the milestone analysis approach, the Valuer attempts to assess whether there is an indication of change in Fair Value based on a consideration of the milestones. This assessment might include considering whether:

- there has been any significant change in the results of the Investee Company compared to budget plan or milestone;
- there have been any changes in expectation that technical milestones will be achieved;
- there has been any significant change in the market for the Investee Company or its products or potential products;
- there has been any significant change in the global economy or the economic environment in which the Investee Company operates;
- there has been any significant change in the observable performance of comparable companies, or in the valuations implied by the overall market;
- any internal matters such as fraud, commercial disputes, litigation, changes in management or strategy

If the Valuer concludes that there is an indication that the Fair Value has changed, they must estimate the amount of any adjustment from the last Price of Recent Investment. By its very nature such adjustment will be subjective. This estimation is likely to be based on objective data from the company, and the experience of the investment professionals and other investors.

However, the necessity and magnitude of the adjustments are relatively subjective and require a large amount of judgment on the part of the Valuer. Where deterioration in value has occurred, the Valuer should reduce the carrying value of the Investment reported at the previous Reporting Date to reflect the estimated decrease.

If there is evidence of value creation, such as those listed above, the Valuer may consider increasing the carrying value of the Investment. Caution must be applied so that positive developments are only valued when they contribute to an increase in value of the Underlying Business when viewed by a Market Participant. When considering these more subtle indicators of value enhancement, in the absence of additional financing rounds or profit generation, the Valuer should consider what value a purchaser would place on these indicators, taking into account the potential outcome and the costs and risks to achieving that outcome.

In the absence of significant revenues, profits or positive cash flows, other methodologies such as the earnings multiple are generally inappropriate. The DCF methodologies may be utilised, however the disadvantages inherent in these, arising from the high levels of subjective judgement, may render the methodology inappropriate.

3.4. Multiples

This methodology involves the application of an earnings multiple to the earnings of the business being valued in order to derive a value for the business.

This methodology is likely to be appropriate for an Investment in an established business with an identifiable stream of continuing earnings that are considered to be maintainable.

This section sets out guidance for preparing valuations of businesses on the basis of positive earnings. ~~For~~ However, for businesses that are still in the development stage and prior to positive earnings being generated, multiples of actual or projected revenue may be used as a basis of valuation. A revenue multiple is commonly ~~the product of~~based on an assumption as to the 'normalised' level of earnings that can be generated from that revenue. The methodology and considerations set out here for earnings multiples equally apply if a multiple of revenue is utilised.

This methodology may be applicable to companies with negative earnings, if the losses are considered to be temporary and one can identify a level of 'normalised' maintainable earnings. This may involve the use of adjusted historic earnings, using a forecast level of earnings or applying a 'sustainable' profit margin to current or forecast revenues.

The most appropriate earnings to use in this methodology would be those likely to be used by a prospective purchaser of the business.

3.4 In using the Earnings Multiple methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) **Apply a multiple that is appropriate and reasonable (given the risk profile and earnings growth prospects of the underlying company) to the maintainable earnings of the company;**

(ii) **Adjust the Enterprise Value for surplus assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;**

(iii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;**

(iv) **Apportion the Attributable Enterprise Value appropriately between the relevant financial Instruments using the perspective of a potential buyer~~instruments.~~**

Guidance on the interpretation of underlined terms is given below.

Appropriate multiple

A number of earnings multiples are used, including price/earnings (P/E), Enterprise Value/earnings before interest and tax (EV/EBIT) and depreciation and amortisation (EV/EBITDA). The particular multiple used should be appropriate for the business being valued. (N.B: The multiples of revenues and their use are presented in 3.8. Industry Valuation Benchmarks).

In general, because of the role of financial structuring in private equity, multiples should be used to derive an Enterprise Value for the Underlying Business. Where EBITDA multiples are available, these are commonly used. When unavailable, P/E multiples may be used since these are more commonly reported. For a P/E multiple to be comparable, the two entities should have similar financing structures and levels of borrowing.

Therefore, where a P/E multiple is used, it should generally be applied to an EBIT figure which is adjusted for finance costs relating to operations, working capital and tax. These adjustments are designed to eliminate the effect on the earnings of the acquisition finance on the Enterprise Value since this is subsequently adjusted.

By definition, earnings multiples have as their numerator a value and as their denominator an earnings figure. The denominator can be the earnings figure for any specified period of time and multiples are often defined as 'historical', 'current' or 'forecast' to indicate the earnings used. It is important that the multiple used correlates to the period and concept of earnings of the company being valued.

Reasonable multiple

The Valuer would usually derive a multiple by reference to current market-based multiples, reflected in the market valuations of quoted companies or the price at which companies have changed ownership. The multiple derived from the acquisition price is calibrated with the multiple of comparable companies expected to be used in ongoing valuation estimates. Differences between the acquisition multiple and the comparable companies multiples are monitored and adjusted, as appropriate, over time, given differences between the Investee company and the comparable companies.

For example, assume the acquisition price of an investment was deemed fair value (e.g. an orderly transaction price) and represented an EBITDA multiple of 8 when comparable company EBITDA multiples were 10. In future periods, when estimating fair value judgement is required as to whether or not the 20% discount to comparable company multiples should be maintained or should change at each subsequent measurement date.

This market-based approach presumes that the comparator companies are correctly valued by the market. Whilst there is an argument that the market capitalisation of a quoted company reflects not the value of the company but merely the price at which 'small parcels' of shares are exchanged, the presumption in these Guidelines is that market based multiples are indicative of the value of the company as a whole.

Where market-based multiples are used, the aim is to identify companies that are similar, in terms of risk attributes and earnings growth prospects, to the company being valued. This is more likely to be the case where the companies are similar in terms of business activities, markets served, size, geography and applicable tax rate.

In using P/E multiples, the Valuer should note that the P/E ratios of comparator companies will be affected by the level of financial gearing and applicable tax rate of those companies.

In using EV/EBITDA multiples, the Valuer should note that such multiples, by definition, remove the impact on value of depreciation of fixed assets and amortisation of goodwill and other intangibles. If such multiples are used without sufficient care, the Valuer may fail to recognise that business decisions to spend heavily on fixed assets or to grow by acquisition rather than organically do have real costs associated with them which should be reflected in the value attributed to the business in question.

It is important that the earnings multiple of each comparator is adjusted for points of difference between the comparator and the company being valued. These points of difference should be considered and assessed by reference to the two key variables of risk and earnings growth prospects which underpin the earnings multiple. In assessing the risk profile of the company being valued, the Valuer should recognise that risk arises from a range of aspects, including the nature of the company's operations, the markets in which it operates and its competitive position in those markets, the quality of its management and employees and, importantly in the case of private equity, its capital structure and the ability of the Fund holding the Investment to effect change in the company.

When considering adjustments to reported multiples, the Valuer should also consider the impact of the differences between the liquidity of the shares being valued and those on a quoted exchange. There is a risk associated with a lack of liquidity or marketability. The Valuer should consider the extent to which a prospective acquirer of those shares would take into account the additional risks associated with holding an unquoted share.

In an unquoted company the risk arising from the lack of ~~marketability~~ liquidity is clearly greater for a shareholder who is unable to control or influence a realisation process than for a shareholder who owns sufficient shares to drive a realisation at will. It may reasonably be expected that a prospective purchaser would assess that there is a higher risk associated with holding a minority position than for a control position.

The multiple at the date of acquisition should be calibrated against the market comparable multiples. Differences, if any, should be understood and similar differences may be expected or need to be understood at subsequent valuation dates.

For example, the reasons why the comparator multiples may need to be adjusted may include the following:

- the size and diversity of the entities and, therefore, the ability to withstand adverse economic conditions;
- the rate of growth of the earnings;
- the reliance on a small number of key employees;
- the diversity of the product ranges;
- the diversity and quality of the customer base;
- the level of borrowing;
- for any other reason the quality of earnings may differ; and
- the risks arising from the lack of ~~marketability~~ liquidity of the shares.

Fair Value measurements should not include a premium or discount that is inconsistent with the instrument (unit of account) being valued. Blockage factors are not allowed by accounting standards.

Recent transactions involving the sale of similar companies are sometimes used as a frame of reference in seeking to derive a reasonable multiple. It is sometimes argued, since such transactions involve the transfer of whole companies whereas quoted multiples relate to the price for 'small parcels' of shares, that ~~they~~ recent transactions provide a more relevant source of multiples. However, ~~their~~ the appropriateness of the use of recent transaction data ~~in this respect~~ is often undermined by the following:

- the lack of forward looking financial data and other information to allow points of difference to be identified and adjusted for;
- the generally lower reliability and transparency of reported earnings figures of private companies; and
- the lack of reliable pricing information for the transaction itself.

It is a matter of judgement for the Valuer as to whether, in deriving a reasonable multiple, they refer to a single comparator company or a number of companies or the earnings multiple of a quoted stock market sector or sub-sector. It may be acceptable, in particular circumstances, for the Valuer to conclude that the use of quoted sector or sub-sector multiples or an average of multiples from a 'basket' of comparator companies may be appropriate.

Maintainable earnings

In applying a multiple to maintainable earnings, it is important that the Valuer is satisfied that the earnings figure can be relied upon. Whilst this might tend to favour the use of audited historical figures rather than unaudited or forecast figures, it should be recognised that value is by definition a forward-looking concept, and quoted markets more often think of value in terms of 'current' and 'forecast' multiples, rather than 'historical' ones. In addition, there is the argument that the valuation should, in a dynamic environment, reflect the most recent available information. There is therefore a trade-off between the reliability and relevance of the earnings figures available to the Valuer.

On balance, whilst it remains a matter of judgement for the Valuer, he should be predisposed towards using historical (though not necessarily audited) earnings figures or, if he believes them to be reliable, forecast earnings figures for the current year.

Whichever period's earnings are used, the Valuer should satisfy himself that they represent a reasonable estimate of maintainable earnings, which implies the need to adjust for exceptional or non-recurring items, the impact of discontinued activities and acquisitions and forecast material changes in earnings.

3.5. Net Assets

This methodology involves deriving the value of a business by reference to the value of its net assets.

This methodology is likely to be appropriate for a business whose value derives mainly from the underlying Fair Value of its assets rather than its earnings, such as property holding companies and investment businesses (such as Fund of Funds as more fully discussed in 4. Valuing Fund Interests).

This methodology may also be appropriate for a business that is not making an adequate return on assets and for which a greater value can be realised by liquidating the business and selling its assets. In the context of private equity, it may therefore be appropriate, in certain circumstances, for valuing Investments in loss-making companies and companies making only marginal levels of profits.

3.5 In using the Net Assets methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive an Enterprise Value for the company using appropriate measures to value its assets and liabilities (including, if appropriate, contingent assets and liabilities);

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.

3.6. Discounted Cash Flows or Earnings (of Underlying Business)

This methodology involves deriving the value of a business by calculating the present value of expected future cash flows (or the present value of expected future earnings, as a surrogate for expected future cash flows). The cash flows and 'terminal value' are those of the Underlying Business, not those from the Investment itself.

The Discounted Cash Flows (DCF) technique is flexible in the sense that it can be applied to any stream of cash flows (or earnings). In the context of private equity valuation, this flexibility enables the methodology to be applied in situations that other methodologies may be incapable of addressing. While this methodology may be applied to businesses going through a period of great change, such as a rescue refinancing, turnaround, strategic repositioning, loss making or is in its start-up phase, there is a significant risk in utilising this methodology.

The disadvantages of the DCF methodology centre around its requirement for detailed cash flow forecasts and the need to estimate the 'terminal value' and an appropriate risk-adjusted discount rate. All of these inputs require substantial subjective judgements to be made, and the derived present value amount is often sensitive to small changes in these inputs.

Due to the high level of subjectivity in selecting inputs for this technique, DCF based valuations are more useful as a cross-check of values estimated under market-based methodologies and should only be used in isolation of other methodologies under extreme caution.

In assessing the appropriateness of this methodology, the Valuer should consider whether its disadvantages and sensitivities are such, in the particular circumstances, as to render the resulting Fair Value insufficiently reliable.

3.6 In using the Discounted Cash Flows or Earnings (of Underlying Business) methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that quantifies the risk inherent in the company;

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.

3.7. Discounted Cash Flows (from the Investment)

This methodology applies the DCF concept and technique to the expected cash flows from the Investment itself.

Where Realisation of an Investment or a flotation of the Underlying Business is imminent and the pricing of the relevant transaction has been substantially agreed, the Discounted Cash Flows (from the Investment) methodology (or, as a surrogate, the use of a simple discount to the expected Realisation proceeds or flotation value) is likely to be the most appropriate methodology.

This methodology, because of its flexibility, is capable of being applied to all private equity Investment situations. It is particularly suitable for valuing non-equity Investments in instruments such as debt or mezzanine debt, since the value of such instruments derives mainly from instrument-specific cash flows and risks rather than from the value of the Underlying Business as a whole.

Because of its inherent reliance on substantial subjective judgements, the Valuer should be extremely cautious of using this methodology as the main basis of estimating Fair Value for Investments which include an equity element.

The methodology will often be useful as a sense-check of values produced using other methodologies.

Risk and the rates of return necessary to compensate for different risk levels are central commercial variables in the making of all private equity Investments. Accordingly there exists a frame of reference against which to make discount rate assumptions.

However the need to make detailed cash flow forecasts over the Investment life may reduce the reliability and crucially for equity Investments, there remains a need to estimate the 'terminal value'.

Where the Investment comprises equity or a combination of equity and other financial instruments, the terminal value would usually be derived from the anticipated value of the Underlying Business at Realisation. This will usually necessitate making assumptions about future business performance and developments and stock market and other valuation ratios at the assumed Realisation date. In the case of equity Investments, small changes in these assumptions can materially impact the valuation. In the case of non-equity instruments, the terminal value will usually be a pre-defined amount, which greatly enhances the reliability of the valuation.

In circumstances where a Realisation is not foreseeable, the terminal value may be based upon assumptions of the perpetuity cash flows accruing to the holder of the Investment. These circumstances (which are expected to be rare in private equity) may arise where the Fund has little ability to influence the timing of a Realisation and/or those shareholders that can influence the timing do not seek a Realisation.

3.7 **In using the Discounted Cash Flows (from the Investment) methodology to estimate the Fair Value of an Investment, the Valuer should derive the present value of the Investment, using reasonable assumptions and estimations of expected future cash flows and the terminal value and date, and the appropriate risk-adjusted rate that quantifies**

the risk inherent to the Investment. The implied discount rate at acquisition is adjusted over time for changes in market conditions.

3.8. Industry Valuation Benchmarks

A number of industries have industry-specific valuation benchmarks, such as 'price per bed' (for nursing-home operators) and 'price per subscriber' (for cable television companies). Other industries, including certain financial services and information technology sectors and some services sectors where long-term contracts are a key feature, use multiples of revenues as a valuation benchmark.

These industry norms are often based on the assumption that investors are willing to pay for turnover (revenue) or market share, and that the normal profitability of businesses in the industry does not vary much.

3.8 **The use of such industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sense-check of values produced using other methodologies.**

3.9. Available Market Prices

Private Equity Funds may be holding actively traded Quoted Instruments, for which there is an available market price.

A. **Instruments quoted on an active stock market should be valued at ~~their bid prices on the Reporting~~the price within the bid-ask spread that is most representative of fair value on the Measurement Date. ~~If bid price is not required by accounting regulation and not deemed to be appropriate, the most representative point estimate in the bid/ask spread may be used.~~ The Valuer should consistently use either the bid price or the most representative point estimate in the bid/ask spread.**

For certain Quoted Instruments there is only one market price quoted, representing, for example, the value at which the most recent trade in the instrument was transacted.

For other Quoted Instruments there are two market prices at any one time: the lower 'bid' price quoted by a market maker, which he will pay an investor for a holding (i.e. the investor's disposal price), and the higher 'ask' price, which an investor can expect to pay to acquire a holding. However, as an alternative to the bid price (where not required by regulation), is the mid-market price (i.e. the average of the bid and ask prices), where this is considered the most representative point estimate in the bid/ask spread.

This methodology should apply when the prices are set on an Active Market.

B. Discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.

If a market is deemed **not** to be active, the Valuer would augment quoted prices with additional valuation techniques.

C. Discounts should not be applied to prices quoted on an Active Market, unless there is some contractual, Governmental or other legally enforceable restriction that would impact the value a Market Participant would pay ~~realised~~ at the ~~Reporting~~ Measurement Date.

In determining the level of discount to apply, the Valuer should consider the ~~extent of compensation a holder~~ impact on the price that a buyer would require when comparing the Investment in question with an identical but unrestricted holding.

A Valuer may consider using an option pricing model to value the impact of this restriction on realisation~~, –~~. ~~H~~However, in practice for restrictions which only cover a limited number of reporting periods, this is simplified to a simple mathematical discount to the quoted price.

The discount applied should appropriately reflect the time value of money and the enhanced risk arising from the reduced liquidity. The discount rate used is a matter of judgement influenced by expected volatility which should reduce to zero at the end of the restriction period.

4. Valuing Fund Interests

4.1. General

Fund-of-Funds and investors in Private Equity Funds must value their Interest in an underlying Fund at regular intervals to support their financial reporting. Historically, the Net Asset Value ('NAV') based on the underlying Fair Value of the Investments, as reported by the Manager, has been used as the basis for estimating the Fair Value of an interest in an underlying Fund.

4.1 In estimating the Fair Value of an interest in a Fund, the Valuer should may base their estimate on their attributable proportion of the reported Fund NAVNet Asset Value (NAV) if NAV is derived from the fair value of underlying investments and is as of the same measurement date as that used by the valuer of the fund interest.

Fair Value for an underlying Fund interest is, at its most basic level, equivalent to the summation of the estimated value of underlying investments as if realised on the Reporting Date. The proceeds from such a realisation would flow through to the investor in an amount equal to NAV. This concept makes particular sense for closed-end Fund investors who realise cash returns on their investment when realisation events occur through the sale of the underlying portfolio companies.

As an investor in a Fund, reliance on a reported NAV provided by the investee Fund manager can only be used by the investor to the extent that they have evidence that the reported NAV is appropriately derived using proper Fair Value principles as part of a robust process. Typically, evidence as to the Fair Value approach, procedures and consistency of application is gathered via initial due diligence, ongoing monitoring, and review of financial reporting and governance of the investee Fund by the investor entity.

Therefore, NAV, when rigorously determined in accordance with the principles of Fair Value and these Guidelines, provides the best estimate upon which to base the Fair Value of an Interest in a Fund.

4.2. Adjustments to Net Asset Value

4.2 After the Valuer determines that the reported NAV is an appropriate starting point, it may be necessary to make adjustments based on the best available information at the Reporting Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager.

Factors which might result in an adjustment to the reported NAV would include the following:

- significant time elapsing between the ~~Reporting~~ Measurement Date of the Fund NAV and the Valuer entity's ~~Reporting~~ Measurement Date. This would be further exacerbated by:
    - the Fund making ~~additional~~ subsequent investments or achieving realizations;
    - the Valuer becoming aware of subsequent changes in the Fair Value of underlying investee companies;
    - subsequent market changes or other economic conditions changing to impact the value of the Fund's portfolio;
- information from an orderly Secondary Transaction if sufficient and transparent;
- the appropriate recognition of potential performance fees or carried interest in the Fund NAV;
- any features of the Fund agreement that may affect distributions but which are not captured in the NAV;
- materially different valuations by GPs for common companies and identical securities; and
- any other facts and circumstances which might impact underlying Fund value.

NAV should be adjusted such that it is equivalent to the amount of cash that would be received by the holder of the interest in the Fund if all underlying Investee Companies were realised as at the Reporting Date.

4.3. Secondary Transactions

Limited Secondary Transactions exist for Private Equity Funds. External market transactions for a Fund are typically infrequent, opaque and information is extremely limited. Secondary prices are negotiated, influenced by factors beyond Fair Value and based on assumptions and return expectations that are often unique to the counter parties. In addition, information relevant to specific transactions may not be deemed orderly and any pricing data available may no longer be current.

4.3 When a Valuer of an interest knows the relevant terms of a Secondary transaction in that particular Fund and the transaction is considered orderly, the Valuer should consider the transaction price as one component of the information used to determine the Fair Value of a fund interest.

In the event that the investor in the Private Equity Fund has decided to sell their interest in that fund, then data known from orderly Secondary Transaction prices is likely to be better evidence of Fair Value.

Any use of a Secondary Transaction price requires considerable judgement.

4.4. Discounted Cash Flows

In situations where either NAV or Secondary Transaction information is not available the primary method available to estimate Fair Value would be to perform a discounted cash flow analysis of all historic and future cash flows for the Fund. Given the subjectivity involved, it is not expected that the DCF alternative would be used often in practice.

Section III: Application Guidance

Introduction

Section II sets out the Guidelines and principles which represent best practice for the valuation of private equity and venture capital Investments. This section sets out further practical guidance to the application of those principles and methodologies to specific cases.

1. Specific Considerations

1.1. Insider Funding Rounds

The price at which a funding round takes place may be a clear indicator of Fair Value at that date. When using the Price of Recent Investment methodology, the Valuer should consider whether there are specific circumstances surrounding that round of Investment which may reduce the reliability of the price as an indicator of Fair Value.

Where there is a round of financing that involves only existing investors of the Underlying Business in the same proportion to their existing Investments (insider round), the commercial need for the transaction to be undertaken at Fair Value may be diminished. The Valuer needs to assess whether the transaction was appropriately negotiated and reflected the Enterprise Value at that date.

Nevertheless, a financing with existing investors that is priced at a valuation that is lower than the valuation reported at the previous Reporting Date (insider down round) may indicate a decrease in value and should therefore be taken into consideration.

Insider down rounds may take various forms, including a corporate reorganisation, i.e. a significant change in the common equity base of a company such as converting all outstanding shares into equity, combining outstanding preferred shares into a smaller number of shares (share consolidation) or even cancelling all outstanding shares before a capital increase.

It should be noted that a Board of Directors has the legal obligation to set the price of newly issued shares at an amount that is in the best interests of the Company's shareholders.

1.2. Distressed Market

Markets from which transaction data may be extracted may be viewed by Valuers to be 'distressed markets'. A distressed market does not mean that all transactions within that market may be deemed to be distressed and invalid for use as comparative purposes, however an individual transaction may be ~~distressed~~deemed not orderly. In these situations significant judgement is needed when determining whether individual transactions are considered orderly and thereby are indicative of Fair Value.

When considering whether a transaction may be deemed to be distressed or forced (e.g. not orderly), the Valuer may include such matters as the following indicators in their consideration:

- a legal requirement to transact, for example a regulatory mandate;

- a necessity to dispose of an asset immediately and there is insufficient time to market the asset to be sold;
- the existence of a single potential buyer as a result of the legal or time restrictions imposed; and
- there was not adequate exposure to the market to allow for usual and customary marketing activities.
- the transaction is considered an outlier by market participants when considering other similar transactions of the same or similar asset.

1.3. Deducting Higher Ranking Instruments

Many acquisition structures include third party debt which ranks higher than the interests of the Fund, which is deducted from the Enterprise Value to estimate the Attributable Enterprise Value.

For certain transactions, this debt is actively traded and may be acquired by the Investee Company or the Fund in the market at a price which is at a discount to the par value.

In calculating the Attributable Enterprise Value, the Valuer should deduct from the Enterprise Value the amount which is expected to be repaid in settlement of this debt at the ~~Reporting~~ Measurement Date. Typically this is the par value since the debt is repayable at the time of disposal of the Investee Company and the Enterprise Value has been estimated on the basis of disposal at the ~~Reporting~~ Measurement Date.

When debt must be contractually repaid upon the sale of the Underlying Business, then a Market Participant would deem the Par Value of Debt (or the amount to be repaid) to equal the Fair Value of Debt for purposes of determining the value of equity.

Where the debt is trading at a discount to par, this lower amount would not normally be deducted from the Enterprise Value until the Investee Company or the Fund has acquired that debt in the market at that value and intends to cancel the debt rather than seek repayment at par.

1.4. Bridge Financing

Funds, or related vehicles, may grant loans to an Underlying Business pending a new round of equity financing (Bridge financing). This may be provided in anticipation of an initial Investment by the Fund, or ahead of a proposed follow~~-~~on Investment.

In the case of an initial Investment, where the Fund holds no other investments in the Underlying Business, the Bridge loan should be valued in isolation. In these situations and if it is expected that the financing will occur in due course and that the Bridge loan is merely ensuring that funds are made available early, cost is likely to be the best indicator of Fair Value.

If it is anticipated that the company may have difficulty arranging the financing, and that its viability is in doubt, the Valuer should reassess Fair Value.

If the bridge finance is provided to an existing Investee Company in anticipation of a follow

on Investment, the bridge finance should be included, together with the original Investment, as a part of the overall package of investment being valued.

1.5. Mezzanine Loans

Mezzanine loans are one of the commonly used sources of debt finance for Investments. Typically these will rank below the senior debt, but above shareholder loans or equity, bear an interest rate appropriate to the level of risk being assumed by the loan provider and may have additional potentially value enhancing aspects, such as warrants.

Often these are provided by a party other than the equity provider and as such may be the only instrument held by the Fund in the Underlying Business. In these situations, the mezzanine loan should be valued on a standalone basis. The price at which the mezzanine loan was issued is a reliable indicator of Fair Value at that date.

The Valuer should consider whether any indications of deterioration in the value of the Underlying Business exist, which suggest that the loan will not be fully recovered. The Valuer should also consider whether any indications of changes in required yield exist, which suggest that the value of the loan has changed.

There are generally limited market opportunities for the holders of mezzanine loans to trade. There are agencies which regularly quote prices on these types of loans, however transactions cannot always be undertaken at the indicative prices offered. Prices reported of transactions should be considered by the Valuer as to whether these are a reasonable indication of Fair Value.

Since the cash flows associated with a mezzanine loan may be predicted with a reasonable amount of certainty, typically these are valued on the basis of a DCF calculation.

Warrants attached to mezzanine loans should be considered separately from the loan. The Valuer should select a methodology appropriate to valuing the Underlying Business and apply the percentage ownership that the exercised warrants will confer to that valuation.

In the event that the warrant position is significant, the Valuer may consider utilising one of the sophisticated option and warrant pricing models.

In the event that the mezzanine loan is one of a number of instruments held by the Fund in the Underlying Business, then the mezzanine loan and any attached warrants should be included as a part of the overall package of investment being valued.

1.6. Rolled up Loan Interest

Many financial instruments commonly used in private equity Investments accumulate interest which is only realised in cash on redemption of the instrument (e.g. deep discount debentures or Payment-in-Kind Notes).

In valuing these instruments, the Valuer should assess the expected present value of the amount to be recovered from these instruments. The consideration of recoverable amount will also include the existence of any reasonably anticipated enhancements such as interest rate step increases.

In a typical financing package, these are inseparable from the underlying equity investment and will be realised as part of a sale transaction.

The difference between the estimated recoverable amount (if in excess of the original cost) should be spread over the anticipated life of the note so as to give a constant rate of return on the instrument.

1.7. Indicative Offers

Indicative offers received from a third party for the Underlying Business may provide a good indication of Fair Value. This will apply to offers for a part or the whole Underlying Business as well as other situations such as price indications for debt or equity refinancing.

However, before using the offer as evidence of Fair Value, the Valuer should consider the motivation of the party in making the offer. Indicative offers may be made deliberately high for such reasons as: to open negotiations, gain access to the company or made subject to stringent conditions or future events.

Similarly they may be deliberately low if the offeror believes that the vendor may be in a forced sale position, or to take an opportunity to increase their equity stake at the expense of other less liquid stakeholders.

In addition, indicative offers may be made on the basis of insufficient detailed information to be properly valid.

These motivations should be considered by the Valuer, however it is unlikely that a firm conclusion can be drawn.

Accordingly, ~~typically~~ indicative offers ~~will~~ may only provide useful additional support for a valuation estimated by one of the valuation methodologies, but are insufficiently robust to be used in isolation.

1.8. Impacts from Structuring

Frequently the structuring of a private equity Investment is complex with groups of stakeholders holding different rights which either enhance or diminish the value of their interests, depending on the success or ~~otherwise~~ disappointments of the Underlying Business.

Valuations must consider the impact of future changes in the structure of the Investment which may materially impact the Fair Value. These potential impacts may take several different legal forms and may be initiated at the Fund's option, automatically on certain events taking place, or at the option of another party.

Common clauses include, but are not limited to:

- stock options and warrants;
- anti-dilution clauses;
- ratchet clauses;
- convertible debt instruments;
- liquidation preferences;

- commitments to take up follow-on capital Investments.

These rights should be reviewed on a regular basis to assess whether these are likely to be exercised and the extent of any impact on value of the Fund's Investment. At each Reporting Date, the Valuer should determine whether these rights are likely to be exercised.

In assessing whether rights are likely to be taken up by stakeholders, the Valuer may limit their consideration to a comparison of the value received by the exerciser against the cost of exercising. If the exerciser will receive an enhancement in value by exercising, the Valuer should assume that they will do so.

The estimation of Fair Value should be undertaken on the basis that all rights that are currently exercisable and are likely to be exercised (such as options), or those that occur automatically on certain events taking place (such as liquidation preferences on Realisation, or ratchets based on value), have taken place.

Consideration should also be given to whether the exercise price will result in surplus cash arising in the Investee Company.

Notwithstanding the above, when considering the impact of liquidation preferences, the Valuer should include in their assessment the likelihood of the Fund receiving their full contractual right under the preference. In practice, full value for the preference may not be achieved, particularly when this would result in other investors who are integral to the sale process (such as a continuing management team) receiving a significantly reduced value for their investment.

1.9. Contractual Rights

Increasingly, consideration dependent upon future events is used as a strategy for exiting an investment. The contractual right to future consideration can be very beneficial, especially for deals encircled with uncertainty; where significant potential value of a business lies in the outcome of future events. The contractual right to future consideration is often described as "contingent consideration."

Negotiating a contract for future consideration allows sellers to close a deal with the ability to realize a price they think is fair, taking into account future performance they deem both valuable and likely, but that has not yet been achieved. For buyers, the ability to contractually delay paying for value before it fully crystallizes protects their investment.

Historically, so-called "gain contingencies" have not been recorded in the financial statements at Fair Value. However, in the context of a private equity or venture capital investment, an exit price that includes potential future consideration is contractual. Said differently, a contractual right exists. The right itself is not contingent; the future consideration is variable depending on future events and outcomes. In many ways this is no different than the ownership in an underlying investee company; an ownership right exists; the future cash flows that will result from that ownership right are dependent (contingent) upon future events. The same concept applies to warrants or options. The ultimate value is contingent upon future events. To avoid confusion, and misapplication of Generally Accepted Accounting Principles, it is more appropriate to describe "contingent consideration" in its legal form, that being a "contractual right" to future consideration.

Due to the unique aspects of these types of rights, it is likely that an income approach (discounted cash flow) will be the best tool to estimate fair value. This requires the development of expected cash flows and an appropriately chosen discount rate. Estimated cash flows in their simplest form are determined by assessing the probability of payment at various points in time.

Cash flow assumptions should include the estimation of the likelihood and timing of various possible outcomes for achievement of the specified contingency and/or consider scenario-based projections relevant to the specified contingencies. The key starting point is to decompose the factors that would lead to a contingency being met (or not being met). The Valuer must identify sources of data to be used to support assumptions. It is possible to keep the analysis relatively simple while still incorporating the material complexities of the contractual right,

Definitions

The following definitions shall apply in these Guidelines.

Active Market

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

A market is considered active when transactions are taking place regularly at an arms length basis with sufficient volume and frequency to determine a price on an ongoing basis. The necessary level of trading required to meet these criteria is a matter of judgement.

Attributable Enterprise Value

The Attributable Enterprise Value is the Enterprise Value attributable to the financial instruments held by the Fund and other financial instruments in the entity that rank alongside or beneath the highest ranking instrument of the Fund.

Block Discount

A discount that adjusts the quoted price of a security because the normal daily trading volume, on the exchange where the security trades, is not sufficient to absorb the quantity held by the Fund. Block discounts are not permitted under US GAAP or IFRS.

Distressed or Forced Transaction

A forced liquidation or distress sale (i.e., a forced transaction) is not an orderly transaction and is not determinative of Fair Value. An entity applies judgement in determining whether a particular transaction is distressed or forced.

Enterprise Value

The Enterprise Value is the value of the financial instruments representing ownership interests in an entity plus the net financial debt of the entity.

Fair Value

The Fair Value is the ~~price at which an orderly transaction would take place between Market Participants at the Reporting Date (measurement date)~~price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

Fund or Private Equity Fund

The Fund or Private Equity Fund is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at all stages of private equity Investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles.

Fund-of-Funds

Fund-of-Funds is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at investment in underlying Private Equity Funds.

Investee Company
The term Investee Company refers to a single business or group of businesses in which a Fund is directly invested.

Investment
An Investment refers to all of the financial instruments in an Investee Company held by the Fund.

Liquidity
Liquidity is defined as the relative ease and promptness with which an instrument may be sold when desired.

Market Participants
Market Participants are potential or actual willing buyers or willing sellers when neither is under any compulsion to buy or sell, both parties having reasonable knowledge of relevant facts and who have the ability to perform sufficient due diligence in order to be able to make orderly investment decisions related to the enterprise.

~~Reporting~~Measurement Date
Is the date for which the valuation is being prepared, which equates to the ~~measurement~~reporting date.

Net Asset Value ('NAV')
NAV of a Fund is the amount estimated as being attributable to the investors in that Fund on the basis of the Fair Value of the underlying Investee Companies and other assets and liabilities.

Orderly Transaction
An orderly transaction is a transaction that assumes exposure to the market for a period prior to the Reporting Date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities.

Quoted Instrument
A Quoted Instrument is any financial instrument for which quoted prices reflecting normal market transactions are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.

Realisation
Realisation is the sale, redemption or repayment of an Investment, in whole or in part; or the insolvency of an Investee Company, where no significant return to the Fund is envisaged.

~~Reporting Date~~
~~Is the date for which the valuation is being prepared, which equates to the measurement date.~~

Secondary Transaction
A Secondary Transaction refers to a transaction which takes place when a holder of an interest in unquoted or illiquid Funds trades their interest to another party.

Unquoted Instrument

An Unquoted Instrument is any financial instrument other than a Quoted Instrument.

Underlying Business

The Underlying Business is the operating entities in which the Fund has invested, either directly or through a number of dedicated holding companies.

Valuer

The Valuer is the person with direct responsibility for valuing one or more of the Investments of the Fund or Fund-of-Funds.

Endorsing Associations