



**International Private Equity and Venture Capital Valuation
Guidelines**

International
Private Equity and
Venture Capital
Valuation Guidelines

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International Private Equity and Venture Capital Valuation Guidelines

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Preface

The International Private Equity and Venture Capital Valuation (IPEV) Guidelines (‘Valuation Guidelines’) set out recommendations, intended to represent current best practice, on the valuation of private equity Investments. The term “private equity” is used in these Valuation Guidelines in a broad sense to include Investments in early stage ventures, management buyouts, management buyins, infrastructure, mezzanine capital and similar transactions and growth or development capital.

The Valuation Guidelines, as presented in Section I, are intended to be applicable across the whole range of Alternative Investment Funds (seed and start-up venture capital, buyouts, growth/development capital, credit, etc.; hereafter collectively referred to as Private Equity Funds) and financial instruments commonly held by such Funds. They also provide a basis for valuing Investments by other entities, including Fund-of-Funds, in such Private Equity Funds. The Valuation Guidelines have been prepared with the goal that Fair Value measurements derived when using these Valuation Guidelines are compliant with both International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP). Other jurisdictions that use a similar definition of Fair Value, such as “willing buyer and willing seller” may also find these Valuation Guidelines applicable. It should be noted that these Valuation Guidelines may for good reason differ from guidance published by others with respect to valuing privately held securities issued as compensation.

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

Where there is conflict between the content of these Valuation Guidelines and the requirements of any applicable laws or regulations or accounting standard or generally accepted accounting principles, the latter requirements should take precedence.

No member of the 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 Valuation Guidelines nor for the consequences of reliance or otherwise on the provisions of these Valuation Guidelines.

These Valuation Guidelines should be regarded as superseding the previous 2012 Valuation Guidelines issued by the IPEV Board and are considered in effect for reporting periods beginning on or after 1 January 2016. Earlier adoption is encouraged.



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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 Valuation Guidelines is to set out best practice where private equity Investments are reported at 'Fair Value' and hence to help 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 practices worldwide and these Valuation 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 Valuation 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 performance of a portfolio in the interim. 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 global financial reporting standards and in particular IFRS and US GAAP have been considered in the preparation of these Valuation 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.

Financial reporting standards do not require that these Valuation Guidelines be followed. However while Valuers must conclude themselves whether or not their Fair Value measurements are compliant with relevant financial reporting standards, measuring Fair Value in compliance with relevant financial reporting standards can be achieved by following these Valuation Guidelines.

These Valuation Guidelines are intended to represent current best practice and therefore will be revisited and, if necessary, revised to reflect changes in regulation or accounting standards.

These Valuation Guidelines are concerned with valuation from a conceptual, practical, and investor reporting standpoint and do not seek to address best practice as it relates to 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 Valuation Guidelines between the **basis of valuation** (Fair Value), which defines what the carrying amount purports to represent, a **valuation technique** (such as the earnings multiple technique), which details the method or technique for deriving a valuation, and **inputs** used in the valuation technique (such as EBITDA).



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Private equity by its nature utilizes confidential, non-public information. However, 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.

Readers should note that these Valuation Guidelines address financial valuation issues only. The IPEV Board, after thorough discussion and consultation, has concluded that matters relating to the reporting and evaluation of non-financial factors or inputs in the context of a Fund's responsible investment practices, including environmental, social and governance factors, are conceptually included in these Valuation Guidelines where their impact is financial, but are otherwise outside the scope of this document.

This 2015 edition of the Valuation Guidelines includes the following changes from the 2012 edition:

1. Clarifying edits made to improve readability and reduce potential confusion:
 - a. Minor edits made throughout the document to improve readability and clarity of understanding.
 - b. Deleted reference to the IPEV Investor Reporting Guidelines as the responsibility for Reporting Guidelines has reverted back to Invest Europe (formerly the European Private Equity & Venture Capital Association).
 - c. Addition of Section II subheadings to improve readability
2. Technical Clarifications:
 - a. Update on IASB Unit of Account Progress
 - b. Added new guideline 1.6 to emphasize the need for consistency.
 - c. Modified footnote 4 of guideline 2.4 to clarify how to consider the value of debt for purposes of determining the value of equity.
 - d. Minor edits to guideline 2.2, 2.4 (iii) & 2.6 to improve understandability.
 - e. Added new guideline 2.7 to describe backtesting.
 - f. Added new guideline 3.2 (ii) to clarify valuation techniques.
 - g. Guideline 3.4 reworded to differentiate between earnings multiples and revenue multiples.
 - h. Guidelines 3.5 through 3.9 reordered to improve the logical flow.
 - i. Removed the negative bias towards DCF and highlighted accounting guidance with respect to considering the number of valuation techniques.
 - j. Section II clarifying edits and expanded discussion of changes in valuation techniques, calibration, backtesting and the use of multiples
 - k. Specific Considerations expanded to include:
 - i. 5.10 Non-control minority positions
 - ii. 5.11 Mathematical Models (guidance updated)
 - iii. 5.12 Sum of the Parts



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Financial Reporting Standards

United States and International financial reporting standards (used interchangeably with accounting standards) were amended in 2011 resulting in a common definition¹ of Fair Value and a common approach to measuring Fair Value. Other jurisdictions use a definition of Fair Value which is substantially similar with US GAAP, IFRS and the definition used in these Valuation Guidelines.

The measurement of Fair Value under US GAAP and IFRS is dictated by *Accounting Standards Codification (ASC) Topic 820, Fair Value Measurement* as issued by the Financial Accounting Standards Board (FASB), and IFRS 13, *Fair Value Measurement* as issued by the International Accounting Standards Board (IASB). Other accounting standards dictate when Fair Value is required or permitted. In the United States, FASB ASC Topic 946, *Investment Companies* requires assets of Investment Companies to be reported at Fair Value. Various IFRS require or permit certain financial instruments to be reported at Fair Value.

On October 31, 2012, the IASB amended IFRS 10, 12 and 27 such that IFRS, under specific circumstances, now requires “control” Investments held by entities meeting the definition of an investment entity to be reported at Fair Value rather than being consolidated at cost.

These Valuation Guidelines are focused on the consistent measurement of Fair Value. Other accounting concepts such as disclosure requirements or day-one gains/losses are beyond the scope of these Valuation Guidelines.

Unit of Account

Background

US and International financial reporting standards require the Fair Value of an asset to be measured consistently with the level of aggregation (Unit of Account) dictated by the accounting standard requiring or permitting its measurement at Fair Value (for example, ASC Topic 946, *Investment Companies*, in the United States or internationally IFRS 9 and 10, and International Accounting Standard (IAS) 27, 28, 39 and 40).² The Unit of Account is a level of aggregation concept that was developed for financial reporting purposes (that is, it addresses the way in which assets and liabilities are to be aggregated or disaggregated in the financial statements).

Because financial reporting is meant to portray economic phenomena, the Unit of Account attempts to describe the specific way that an Investment is owned, including the legal rights and obligations of ownership and its relationship to other ownership rights in a complex

¹ Fair Value is defined by US and International accounting standards as: “the price that would be received to sell an asset or paid to transfer a liability in an Orderly Transaction between Market Participants at the Measurement Date.” IFRS 13 paragraph 9, ASC Topic 820-10-15-5. These Valuation Guidelines focus on Fair Value measurement from a Private Equity Fund perspective which generally focuses on underlying portfolio Investments, e.g. assets, and therefore for ease of drafting do not focus on the “or paid to transfer a liability” portion of the accounting definition.

² The international accounting guidance for private equity Investments is contained in IFRS 9, *Financial Instruments*, IFRS 10, *Consolidated Financial Statements*, IAS 27, *Consolidated and Separate Financial Statements*, IAS 28, *Investments in Associates*, and IAS 40, *Investment Property*. IFRS 9 will replace IAS 39 *Financial Instruments: Recognition and Measurement*.



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capital structure. However, actual transactions may not and do not actually have to take place at the Unit of Account level specified by accounting standards.

ASC Topic 820 and IFRS 13

Fair Value measurement guidance articulated in both ASC Topic 820 and IFRS 13 states: “An entity shall measure the Fair Value of an asset or liability using the assumptions that Market Participants would use when pricing the asset or liability, assuming that Market Participants act in their economic best interest.”³ Neither ASC Topic 820 nor IFRS 13 specify the Unit of Account for assets or liabilities, but rely on other accounting standards to do so.

US GAAP – ASC Topic 946

In US GAAP, ASC Topic 946 specifies that an investment company must measure its investments in debt and equity securities at Fair Value. An entity then refers to ASC Topic 820 for Fair Value measurement guidance. In the absence of more specific Unit of Account guidance from ASC Topic 946, entities measure the Fair Value of their debt and equity securities consistently with how Market Participants would act in their economic best interest.

Alternative interpretations of Unit of Account under IFRS

Market Participants generally view the Investment or entire Interest to be the Unit of Account with which they would transact. IFRS 10 states that the Fair Value of controlled investments held by investment entities should be measured at fair value through profit or loss in accordance with IFRS 9. IAS 27 and IAS 28 also permit certain entities to measure their Investments at Fair Value through profit or loss in accordance with IFRS 9. IFRS 9 then refers to IFRS 13 for specific Fair Value measurement guidance. IFRS 9 has been interpreted by some to require the Unit of Account of a financial instrument to be assessed as a single or individual share. Although a single share Unit of Account interpretation applies to actively traded securities (see Section I paragraph 3.6 of these Valuation Guidelines), there are different interpretations of the Unit of Account for non-actively traded securities:

- One interpretation is that because IFRS 10 and IAS 28 refer to measuring Fair Value in accordance with IFRS 9, the Unit of Account is determined by IFRS 9 and is a single share. However, actual transactions for non-actively traded securities rarely take place on a single share basis.
- Another interpretation is that the Unit of Account is determined by IFRS 10, IAS 27 and IAS 28 as the “Investment”, which is not necessarily a single share. This interpretation more fully matches how Market Participants transact.

The IASB is considering amendments to IFRS to clarify these interpretations. Based on deliberations to date, it appears that the IASB concurs with industry practice that the Unit of Account would be the entire interest if that is the basis upon which Market Participants would transact. While it is important that a Fund’s auditors agree with management’s conclusion on the Unit of Account, management must take responsibility for the accounting conclusions reached, including the appropriate Unit of Account. If there are any further discussions or decisions by the IASB or the FASB on this issue, these Valuation Guidelines will be updated accordingly.

³ IFRS 13 paragraph 22; ASC Topic 820 paragraph 820-10-35-9.



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Consistency with how Market Participants transact

Because private equity transactions typically do not happen for individual shares, these Valuation Guidelines do not address how to value a single share of a non-actively traded security. In the absence of Unit of Account guidance to the contrary, these Valuation Guidelines have been prepared with the premise that the Fair Value measurement should be consistent with how Market Participants would transact in their economic best interest.

Examples where the investment is in multiple securities / tranches

As the Unit of Account concept must be judgementally applied, in the absence of specific guidance, we offer the following examples to help clarify how such judgements may be reached:

- Some private equity managers invest in multiple securities or tranches of the same portfolio company. Unit of Account would be expected to be determined on the same basis that Market Participants (willing buyers and sellers) would enter into an Orderly Transaction. If Market Participants would be expected to purchase all positions in the same underlying portfolio company simultaneously, then Fair Value would be measured for the aggregate investment in the portfolio company. If individual tranches of securities would be purchased by Market Participants individually, then the Unit of Account and the basis for determining Fair Value would be the individual tranche.
- If a Fund only holds a debt instrument within a portfolio company's capital structure, the Unit of Account would be the individual debt instrument and the Fair Value of the debt instrument would be measured using the perspective of a Market Participant and would include cash flow (coupon payments), risk, and time to expected principal repayment.
- If a Fund holds both debt and equity Investments in the same portfolio company and Market Participants would transact separately, purchasing a debt position independently from an equity position, then Unit of Account and Fair Value would be measured separately for the debt and equity positions.
- If a potential Market Participant buyer would or could purchase individual shares of an interest in a private company, then the Unit of Account may be a single share. However, generally in the Private Equity industry, Market Participants purchase a meaningful ownership interest in a private company, by acquiring more than single private shares.

Value of the entire Enterprise generally the appropriate starting point

Generally it is appropriate to use the value of an entire Enterprise (business) as a starting point for measuring Fair Value if Market Participants would use such an approach regardless of the accounting Unit of Account. This is because private equity investors often invest in-concert with one another and realise value only when the entire Enterprise is sold. Further, private equity returns are usually proportionate to the equity position held. Therefore, the hypothetical sale of an Enterprise is a fundamental premise used by Market Participants to determine Fair Value. Common adjustments necessary to allocate Enterprise Value on a Unit of Account basis to measure Fair Value are discussed in these Valuation Guidelines. In situations where a market participant would not use enterprise value as a starting point, for example if a non-control position is owned and the sale of such a position would not be realized through the sale of the enterprise, the sale of the individual interest, without the sale of the enterprise would be considered. (See further discussion at Section III 5.10)

The above discussion of Unit of Account is for informational purposes and represents the IPEV Board's interpretation of relevant accounting standards in the context of how Market



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Participants transact in the private equity industry. While it is important that a Fund's auditors agree with management's conclusion on the Unit of Account, management must take responsibility for the accounting conclusions reached, including the appropriate Unit of Account.

Valuation Standards

Global Valuation Standards continue to evolve. The IPEV Board has entered into an understanding with the International Valuation Standards Council (IVSC) with the objective of promoting consistency between the IPEV Board's Valuation Guidelines and the IVSC International Valuation Standards (IVSs) and to enable these Valuation Guidelines to be positioned as providing sector specific application guidance of the principles in IVS. A valuation of private equity investments prepared in accordance with the IVSs and following the Valuation Guidelines will be consistent with the requirements of applicable financial reporting standards and will also maximise Investor's trust and confidence. Further information about the IVSC, the IVSs and the IVSC Code of Ethical Principles for Professional Valuers is available at <http://www.ivsc.org/>.



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Section I: Valuation Guidelines

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the 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.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. 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 Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

1.6. Fair Value should be estimated using consistent valuation techniques from Measurement Date to Measurement Date unless there is a change in market conditions or Investment specific factors which would modify how a Market Participant would determine value. The use of consistent valuation techniques for investments with similar characteristics, industries and/or geographies would also be expected.

2. Principles of Valuation

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

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual financial instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:



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- (i) **Determine the Enterprise Value of the Investee Company using the valuation techniques;**
- (ii) **Adjust the Enterprise Value for factors 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 the value of any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid⁴) 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.**

2.5. 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.

⁴ Some Valuers may question whether the Fair Value of debt or the face value of debt should be deducted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances when establishing the value of debt to be deducted. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it could be assumed that a change in control would take place upon the sale of the Investment at the Measurement Date. However, if debt would be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value that debt for the purpose of valuing the equity instrument. Approaches to establishing the value of debt to be deducted could include:

- (a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control does not take place as of the Measurement Date) by incorporating into the Fair Value of equity the impact, if any, of non-market terms associated with the debt and the impact on value, if any, of the change in control provision at the ultimate exit date; or
- (b) Assuming that a hypothetical change in control takes place on the Measurement Date, resulting in the value of debt deducted being equal to the face or par value of debt.

An additional question arises if debt includes a prepayment penalty. In such circumstances, consideration must be given to the price at which Market Participants would transact to maximize value. The prepayment penalty would be incorporated into the value of debt deducted based on the probability it would be paid. When using a Market Participant perspective, the value of debt deducted may or may not equal the face or par value of debt depending on the facts and circumstances. If debt is required to be repaid upon a change of control with a prepayment penalty, the probability of the prepayment penalty being assessed would be incorporated into the value of debt deducted. If debt is not required to be repaid upon a change of control, then the value of debt that would be deducted from Adjusted Enterprise Value would be impacted by favorable or unfavorable terms (such as interest rate) of the debt.



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2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly⁵), 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 date the investment was made. 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 updated market inputs as of each subsequent Measurement Date will generate Fair Value at each future Measurement Date.

2.7. Valuers should seek to understand any substantive differences that legitimately occur between the exit price and the previous Fair Value assessment. This concept is known as Backtesting. Backtesting seeks to articulate:

- (i) What information was known or knowable as of the Measurement Date;**
- (ii) Assess how such information was considered in coming to the most recent Fair Value Estimates; and**
- (iii) Determine whether known or knowable information was properly considered in determining Fair Value given the actual exit price results.**

3. Valuation Methods

3.1. General

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

3.1 (ii) 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 Measurement Date.

3.2. Selecting the Appropriate Valuation Technique

3.2 (i) The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

3.2 (ii) The Valuer should use one or more of the following Valuation Techniques, taking into account Market Participant assumptions as to how Value would be determined:

A. Market Approach

- a. Price of Recent Investment (3.3)**
- b. Multiples (3.4)**
- c. Industry Valuation Benchmarks (3.5)**
- d. Available Market Prices (3.6)**

⁵ A Forced Transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.



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- B. Income Approach
 - a. Discounted Cash Flows (3.7, 3.8)
- C. Replacement Cost Approach
 - a. Net Assets (3.9)

3.3. Price of Recent Investment

In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs⁶, 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 if deemed to represent Fair Value and 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 all cases assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

3.4. Multiples

Depending on the stage of development of an Enterprise, its industry, and its geographic location, Market Participants may apply a multiple of Earnings, or of Revenue. In using the Multiples valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

- (i) Apply a multiple that is appropriate and reasonable (given the size, risk profile and earnings growth prospects of the underlying company) to the applicable indicator of value (Earnings, or Revenue) of the company;
- (ii) Adjust the Enterprise Value for surplus or non-operating 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 potential Market Participants. Judgement is required in assessing a Market Participant perspective.

3.5. Industry Valuation Benchmarks

The use of 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 sanity check of values produced using other techniques.

⁶ Depending on the applicable accounting standards, Transaction Costs in some cases are required to be capitalized as part of the cost basis of an Investment. However, Transaction Costs are not considered a characteristic of an asset and therefore should not be included as a component of an asset's Fair Value.



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3.6. Available Market Prices

3.6 (i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.

3.6 (ii) Blockage Factors 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.

3.6 (iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay for the securities at the Measurement Date.

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

In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique 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 captures the risk inherent in the projections;**
- (ii) Adjust the Enterprise Value for surplus or non-operating 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 Market Participants. Judgement is required in assessing a Market Participant perspective.**



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3.8. Discounted Cash Flows (from an Investment)

In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Debt Investments or Interests with characteristics similar to debt.

3.9. Net Assets

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

- (i) Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and 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 using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

4. Valuing Fund Interests

4.1. General

In measuring the Fair Value of an interest in a Fund the Valuer 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, except as follows:

- (i) if the Fund interest is actively traded Fair Value would be the actively traded price;
- (ii) if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.



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4.2. Adjustments to Net Asset Value

If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the 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. If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

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 orderly, the Valuer must consider the transaction price as one component of the information used to measure the Fair Value of a Fund interest.



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Section II: Explanatory Comments - Measuring Fair Value

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the 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.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. 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 Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

1.6. Fair Value should be estimated using consistent valuation techniques from Measurement Date to Measurement Date unless there is a change in market conditions or Investment specific factors which would modify how a Market Participant would determine value. The use of consistent valuation techniques for Investments with similar characteristics, industries and/or geographies would also be expected.

The objective of measuring Fair Value is to estimate the price at which an Orderly Transaction would take place between Market Participants at the Measurement Date.

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

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, subject to such restrictions.

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, Fair Value



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should reflect the actual amount that a seller would receive in an Orderly Transaction under current market conditions at the Measurement Date. An additional discount for Marketability (where Marketability is defined as the time required to effect a transaction) is not appropriate. Liquidity or illiquidity (meaning the frequency of transactions) is taken into account by Market Participants and should be a factor used in assessing Fair Value.

Fair Value measurements are determined consistent with the ownership structure of the Investment. That means that Fair Value is determined independently for each reporting entity.

Once a valuation technique has been selected, it should be applied consistently (from Measurement Date to Measurement Date); however a change in technique is appropriate if it results in a measurement that is more representative of Fair Value in the circumstances.

Examples of events that might appropriately lead to a change in valuation technique:

- The stage of development of the Enterprise changes (from pre revenue to revenue to earnings)
- New markets develop
- New information becomes available
- Information previously used is no longer available
- Valuation techniques improve
- Market conditions change.

Further, subject to utilizing market participant perspectives, Investments with similar characteristics, stages of development, geographies and/or industries would be expected to be valued using consistent valuation techniques.



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2. Principles of Valuation

2.1. The Fair Value of each Investment should be assessed at each 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 techniques.

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

In private equity, value is generally realised 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 Measurement Date (Enterprise Value) will often provide a key insight into the value of Investment stakes in that business.⁷

If value is realised 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 individual shares, debt tranches, or a single series of equity, then Fair Value would be more appropriately assessed at the individual instrument level.

⁷ Some have interpreted International accounting standards as requiring the Unit of Account to be a single share of a private company (see discussion of Accounting Standards and Unit of Account on pages 6 through 9 of these Valuation Guidelines). These Valuation Guidelines do not address a single share Unit of Account conclusion (other than for actively traded securities) as a Fair Value measurement for a single share of a private company generally does not occur in practice and therefore would not reflect Market Participant assumptions and would not provide a meaningful measurement of Fair Value.



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2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual equity instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:

- (i) Determine the Enterprise Value of the Investee Company using the valuation techniques;**
- (ii) Adjust the Enterprise Value for factors 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 the value of any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid⁸) 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.**

⁸ Some Valuers may question whether the Fair Value of debt or the face value of debt should be deducted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances when establishing the value of debt to be deducted. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it could be assumed that a change in control would take place upon the sale of the Investment at the Measurement Date. However, if debt would be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value that debt for the purpose of valuing the equity instrument. Approaches to establishing the value of debt to be deducted could include:

- (a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control does not take place as of the Measurement Date) by incorporating into the Fair Value of equity the impact, if any, of non-market terms associated with the debt and the impact on value, if any, of the change in control provision at the ultimate exit date; or
- (b) Assuming that a hypothetical change in control takes place on the Measurement Date, resulting in the value of debt deducted being equal to the face or par value of debt.

An additional question arises if debt includes a prepayment penalty. In such circumstances, consideration must be given to the price at which Market Participants would transact to maximize value. The prepayment penalty would be incorporated into the value of debt deducted based on the probability it would be paid. When using a Market Participant perspective, the value of debt deducted may or may not equal the face or par value of debt depending on the facts and circumstances. If debt is required to be repaid upon a change of control with a prepayment penalty, the probability of the prepayment penalty being assessed would be incorporated into the value of debt deducted. If debt is not required to be repaid upon a change of control, then the value of debt that would be deducted from Adjusted Enterprise Value would be impacted by favorable or unfavorable terms (such as interest rate) of the debt.



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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 and expectations that exist at the 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 measure 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, while valuations do provide useful interim indications of the progress of a particular Underlying Business or Investment, 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 and consider such reasons in future Fair Value estimates.

Apportion the Attributable Enterprise Value appropriately

The apportionment should reflect the respective amounts accruing to the holder of each financial instrument and all other financial instruments (regardless of holder) in the event of a Realisation at the Measurement Date. As discussed further in section III 5.8, 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.

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.

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.

When subtracting outstanding debt from Enterprise Value to measure the Fair Value of Equity Instruments, judgement should be exercised to ensure that the Fair Value of debt represents a Market Participant perspective. For example, if debt must be repaid upon the sale of the Underlying Business, which is often the case in a private equity transaction, then a Market Participant transacting in their economic best interest, may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. If debt would not be repaid when the Enterprise is sold, then the Fair Value of debt would not necessarily equal the Par Value of debt.



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If debt must be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value debt for purposes of valuing an equity instrument:

- (a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control has not yet taken place as of the Measurement Date, but incorporating into the Fair Value of the debt the existence of the change in control provision); or
- (b) using a term of zero on the basis that a hypothetical change in control has taken place (that is, assuming that the change in control takes place on the Measurement Date, resulting in the Fair Value of debt being equal to the face or par value of debt)

As previously stated, when using a Market Participant perspective, the Fair Value of debt may equal the face or par value of debt depending on the facts and circumstances. If debt is not required to be repaid upon a change of control, then the Fair Value of equity would be impacted by favorable or unfavorable terms (such as interest rate) of the debt, or in other words, the Fair Value of debt reflecting the favorable/unfavorable elements would be subtracted from Adjusted Enterprise Value.

It should be noted, however, that if debt is a standalone Investment, a Market Participant would take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which may **not** be equivalent to Par Value.

2.5. 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. While it might be difficult in these situations to measure 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



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these broad indicators, in some situations, the Valuer might reasonably conclude that the Fair Value at the previous 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 new Fair Value estimate.

2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly⁹), 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 date the investment was made. 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 updated market inputs as of each subsequent Measurement Date will generate Fair Value at each such date.

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 have an 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:

- note that the objective is to replicate those assumptions that the parties in an arm's-length transaction would make at the Measurement Date;
- take account of events taking place subsequent to the Measurement Date where they provide additional evidence of conditions that existed at the Measurement Date that were known or knowable by Market Participants;
- take account of then current market conditions at each Measurement Date; and
- to the extent the initial 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 valuation techniques result in an initial Fair Value estimate equal to the entry price (**Note:** at subsequent Measurement Dates the calibrated valuation techniques are used with then current market inputs reflecting then current market conditions.).

Calibration is a powerful tool which can assist in capturing the impacts of control and Liquidity, among other inputs, on a Fair Value measurement. For illustrative purposes, assume an Investment is purchased at Fair Value at an implied 10x EBITDA multiple. At the time of purchase, comparable companies are trading at 12x EBITDA. When compared to the comparable companies, the 10x entry multiple incorporates Liquidity, control and other differences between the Investment and comparable companies. At future Measurement Dates, judgement would be applied to determine how to move the acquisition multiple of 10x in relation to changes in the multiple of comparable companies.

For example, if the comparable companies moved from 12x to 15x, the Valuer may conclude that the two turns of EBITDA difference at entry (10x vs 12x) should be maintained, resulting

⁹ A Forced Transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.



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in a Fair Value estimate derived by applying a 13x multiple to the subject company's updated EBITDA. Similar judgements would be made using inputs for other valuation techniques. The Valuer would not automatically use the entry difference (2x) at future valuation dates, but would determine how much a Market Participant would be willing to pay for the Investment using the calibrated entry inputs as a point of reference.

Similar calibration concepts can be used with an income valuation approach. The discount rate implied at acquisition can be deconstructed into its component parts based on the weighted average cost of capital, which will, in particular, provide a basis for a company specific risk premium, also known as alpha. The components of the weighted average cost of capital would then be updated at future Measurement Dates based on then current market conditions (with adjustments to the alpha based on company specific facts and circumstances) and applied to most likely cash flows at that point in time.

Backtesting

Backtesting is the process of comparing an actual liquidity event (sale, IPO, etc.) to the most recently determined Fair Value estimate. When the valuation implied by an actual realization or liquidity event is compared to Fair Value estimates at the most recent Measurement Dates, the Valuer is provided with additional information to help assess the rigor of the Fair Value estimation process. This does not mean that the exit price should equal the previous Fair Value measurement, but should be used as an input to continuously improve the rigor of the Fair Value estimates.

2.7. Valuers should seek to understand the substantive differences that legitimately occur between the exit price and the previous Fair Value assessment. This concept is known as Backtesting. Backtesting seeks to articulate:

- (i) What information was known or knowable as of the Measurement Date;**
- (ii) Assess how such information was considered in coming to the most recent Fair Value Estimates; and**
- (iii) Determine whether known or knowable information was properly considered in determining Fair Value given the actual exit price results.**

Backtesting is not used to identify theoretical mistakes, if any, in the valuation process, but rather to encourage the Valuer to assess changes in information, market conditions, Market Participants, etc. that may have occurred between the Measurement Date and the exit date.

Backtesting can provide meaningful insights that could be applied when developing future Fair Value estimates. Over time, Backtesting provides the Valuer with a tool to assess whether there are inherent biases (e.g., overly conservative assumptions) built into the valuation process and thereby identify areas for potential improvement.



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3. Valuation Methods

3.1. General

A number of valuation methods or techniques that may be considered for use in measuring the Fair Value of Unquoted Investments are described in sections 3.3 to 3.8 below. These valuation techniques should incorporate case-specific factors affecting Fair Value. For example, if the Underlying Business is holding surplus cash or other assets, the value of the business should reflect that fact to the extent a Market Participant would attribute value to such items.

Techniques for valuing Actively Traded Investments are described in section 3.9 below.

Because, in the private equity arena, value is generally realised 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 Measurement Date will often provide a key insight into the value of Investment stakes in that business. For this reason, a number of the techniques 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 technique used in such circumstances should reflect relevant exit expectations.

There may also be some situations in which determining the Enterprise Value under the assumption that the Enterprise would be sold at the Measurement Date, may not be appropriate. For example, if a minority stake is being valued and the other owners' interests are not aligned, it may not be appropriate to assume a sale of the Enterprise and allocation of value as described below. In such circumstances alternative valuation techniques would be used as more fully discussed in Section III.5.10.

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

Underlying Businesses may operate using multiple currencies. Investments may be denominated in currencies other than the Funds reporting currency. Movements in rates of exchange may impact the value of the Fund's Investments and these should be taken into account using a Market Participant perspective.

3.1 (ii) 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 Measurement Date.



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3.2. Selecting the Appropriate Valuation Technique

3.2 (i) The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

3.2 (ii) The Valuer should use one or more of the following Valuation Techniques, taking into account Market Participant assumptions as to how Value would be determined:

- A. Market Approach**
 - a. Price of Recent Investment (3.3)**
 - b. Multiples (3.4)**
 - c. Industry Valuation Benchmarks (3.5)**
 - d. Available Market Prices (3.6)**
- B. Income Approach**
 - a. Discounted Cash Flows (3.7, 3.8)**
- C. Replacement Cost Approach**
 - a. Net Assets (3.9)**

The key criterion in selecting a valuation technique is that it should be appropriate in light of the nature, facts and circumstances of the Investment and in the expected view of Market Participants. The Valuer may consider utilising further techniques to check the Fair Value derived, as appropriate.

When selecting the appropriate valuation technique each Investment should be considered individually.

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

The Valuer will select the valuation technique 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 relative applicability of the techniques used given the nature of the industry and current market conditions;
- the quality, and reliability of the data used in each valuation technique;
- 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;
- any additional considerations unique to the Enterprise; and
- the results of testing (calibrating) techniques and inputs to replicate the entry price of the Investment. (**Note:** at subsequent Measurement Dates the calibrated valuation techniques are used with updated inputs reflecting then current market conditions. See also Section II 2.6)



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In assessing whether a technique is appropriate, the Valuer should maximise the use of techniques that draw heavily on observable market-based measures of risk and return. Fair Value estimates based entirely on observable market data are deemed less subjective than those based on Valuer assumptions. In some cases observable market data may require adjustment by the Valuer to properly reflect the facts and circumstances of the Investment being valued. Such adjustments should not be automatically regarded as reducing the reliability of the Fair Value estimation.

While accounting standards do not specify a hierarchy of valuation techniques, the use of multiple techniques is encouraged by some. In particular, IFRS 13 (and ASC Topic 820) states that “in some cases a single valuation technique will be appropriate (e.g. when valuing an asset or a liability using quoted prices in an Active Market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate. If multiple valuation techniques are used to measure Fair Value, the results (i.e. respective indications of Fair Value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A Fair Value measurement is the point within that range that is most representative of Fair Value in the circumstances.”¹⁰

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

Techniques 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 techniques should be clearly understood. It is expected that there would not be frequent changes in valuation techniques over the course of the life of an Investment.

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

Valuation Technique	Approach
Price of Recent Investment	Market Approach
Multiples	Market Approach
Industry Valuation Benchmarks	Market Approach
Available Market Prices	Market Approach
Discounted Cash Flows or Earnings (of Underlying Business)	Income Approach
Discounted Cash Flows (from an Investment)	Income Approach
Net assets	Replacement Cost Approach

¹⁰ IFRS 13 paragraph 63; Congruent with ASC Topic 820.



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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.

Validity of the Price of Recent Investment erodes over time

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 valuation technique as a means of estimating value at subsequent dates.

The Price of a Recent Investment valuation technique 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, this method will often be appropriate for valuing Investments in such circumstances. Generally, Fair Value would be indicated by the Post Money Valuation.

The length of period for which it would remain appropriate to use this valuation technique 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 market environment, the length of period for which this valuation technique is likely to be appropriate will be longer than during a period of rapid change.

Background to the transaction also needs to be taken into account

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 into 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 of existing investors arising from a new investor(s);
- a new investor motivated by strategic considerations; or
- the transaction may be considered to be a forced sale or 'rescue package'.

Price of Recent Investment is not a default

Notwithstanding the foregoing, at each Measurement Date, Fair Value must be estimated. Using the Price of a Recent Investment is not a default that precludes re-estimating Fair Value at each Measurement Date.



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3.3. In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs¹¹, 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 if deemed to represent Fair Value and 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 all cases assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

Price of Recent Investment Commonly used for seed, start-up and early stage Investments

The Price of Recent Investment valuation technique 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 measure Fair Value may be a valuation technique that is based on market data, that being the Price of a Recent Investment. Other valuation techniques, if used by Market Participants, may also be applicable.

Benchmark / milestone analysis to determine if Fair Value has changed

If the Valuer concludes that the Price of Recent Investment, unadjusted (except for transaction costs—see footnote 10), 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, scenario analysis (See Section III 5.11) 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. Missing a benchmark/milestone may provide indication of a decrease in value while exceeding a benchmark/milestone may provide evidence of an increase in value depending on the facts and circumstances.

Common milestones / benchmarks

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;

¹¹ Depending on the applicable accounting standards, Transaction Costs in some cases are required to be capitalized as part of the cost basis of an Investment. However, Transaction Costs are not considered a characteristic of an asset and therefore should not be included as a component of an asset's Fair Value.



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- 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.

Typical indicators of a change in Fair Value

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

Adjustment to Fair Value in such circumstances

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 judgement on the part of the Valuer. Where deterioration in value has



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occurred, the Valuer should reduce the carrying value of the Investment reported at the previous Measurement 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 Market Participant would place on these indicators, taking into account the potential outcome and the costs and risks to achieving that outcome.

DCF technique may be useful as a cross-check

In the absence of significant revenues, profits or positive cash flows, other methods such as the earnings multiple are generally inappropriate. The DCF technique may be utilised as a cross-check, however the disadvantages inherent in this technique, arising from the high levels of subjective judgement, may render the method inappropriate without corroborating support.

3.4. Multiples

This valuation technique involves the application of an appropriate multiple to a performance measure such as Earnings or Revenue, of the business being valued in order to derive a value for the business.

This valuation technique is likely to be appropriate for an Investment in an established business with an identifiable stream of continuing earnings or revenue that is considered to be maintainable.

This section sets out guidance for preparing valuations of businesses on the basis of positive earnings. In addition, 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.



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3.4. Depending on the stage of development of an Enterprise, its industry, and its geographic location, Market Participants may apply a multiple of Earnings or Revenue. In using the Multiples valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

- (i) Apply a multiple that is appropriate and reasonable (given the size, risk profile and earnings growth prospects of the underlying company) to the applicable indicator of value (Earnings, or Revenue) of the company;
- (ii) Adjust the Enterprise Value for surplus or non-operating 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 potential Market Participants. Judgement is required in assessing a Market Participant perspective.

Guidance on the interpretation of underlined terms is given below.

Appropriate multiple

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

Use of Earnings multiples

A number of earnings multiples or ratios are commonly 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 and should conform to Market Participant Assumptions.

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 EBITDA multiples are not available, P/E multiples may be used since these are 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 has been adjusted for the impact of finance costs relating to operations, working capital needs and tax impacts. These adjustments are designed to eliminate the effect on earnings related to the acquisition finance on the Enterprise Value since this is subsequently adjusted.



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Use of a Revenue multiple

For Enterprises that have sustainable earnings, it would be more appropriate to utilize an earnings multiple, however for Enterprises that have established operations but have not yet obtained sustainable profitability, a multiple of revenue may be appropriate to determine Fair Value. A revenue multiple is commonly based on an assumption as to the 'normalised' level of earnings that can be generated from that revenue. This valuation technique 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 revenue, using a forecast level of revenue or applying a 'sustainable' profit margin to current or forecast revenues.

The most appropriate revenues to use in this valuation technique would be those likely to be used by a prospective Market Participant purchaser of the business.

Reasonable multiple

Acquisition multiples vs quoted company trading multiples

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 on-going 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 comparable companies are correctly valued by the market. While 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 Valuation Guidelines is that market based multiples are indicative of the value of the company as a whole.

Identifying similarities and differences

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.

The impact of gearing (leverage) and tax on P/E ratios

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

EBITDA multiples and depreciation / amortisation

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



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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.

Adjusting for points of difference

It is important that the earnings multiple of each comparable company is adjusted for points of difference between the comparable company 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.

The impact of lack of Liquidity

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. 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 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 Market Participant purchaser would assess that there is a higher risk associated with holding a minority position than for a control position.

Calibration

Value attributed to a lack of Liquidity may be difficult to assess. Calibration provides a technique to objectively assess value attributed to a lack of Liquidity. 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.

Other reasons for adjustment

Other reasons why the comparable company 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



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- the risks arising from the lack of 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. However, investors in private companies generally consider their overall interest and the extent to which they act in concert with other investors. Judgement must be applied to individual facts and circumstances to assess the amount a Market Participant would pay in the context of the potential adjustments to multiples noted above.

Comparable recent transactions

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 recent transactions provide a more relevant source of multiples. However, the appropriateness of the use of recent transaction data 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;
- the amount of time that has passed since the transaction was negotiated/consummated;
- the impact of reputational issues, such as ESG (environmental, social and governance) and other factors; 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 comparable 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 comparable companies may be appropriate.

Maintainable earnings / Maintainable revenue

In applying a multiple to maintainable earnings, it is important that the Valuer is satisfied that the earnings figure can be relied upon. While 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.

Similar to the discussion above, in applying a multiple to maintainable revenue, it is important that the Valuer is satisfied that the revenue figure can be relied upon. While 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.



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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 revenue figures available to the Valuer.

On balance, while it remains a matter of judgement for the Valuer, a Market Participant perspective should be used either focused on historical earnings or focused on future earnings based on the availability and reliability of forward looking projections and multiples or historical results and multiples.

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. Such adjustments, if appropriate, should also be reflected in the multiple derived from comparable companies.

3.5. Industry Valuation Benchmarks

3.5. The use of 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 sanity check of values produced using other techniques.

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.

3.6. Quoted Investments

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

3.6 (i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.

For certain Quoted Investments 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 Investments 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



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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.

As previously noted, 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.

3.6 (ii) Blockage Factors 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 may consider the use of quoted prices supplemented by additional valuation techniques to measure Fair Value, as appropriate.

3.6 (iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay at the Measurement Date.

An example of a contractual restriction deemed attributable to the security could be an underwriter's lock-up as any buyer of the securities would be expected to abide by the same contractual lock-up provisions. An example of a restriction which would be deemed an attribute of the holder could be limitations on sale imposed by holding a Board of Directors seat. As the holder of the security is not mandated to hold a board seat, it is an attribute of the holder rather than an attribute of the security.

When applicable, to determine the level of discount to apply, the Valuer should consider the impact on the price that a buyer would pay 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. 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 used is a matter of judgement influenced by expected volatility which should reduce to zero at the end of the restriction period.

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

This valuation technique 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.



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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 valuation technique to be applied in situations that other techniques may be incapable of addressing. While this valuation technique 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 valuation technique.

The disadvantages of the DCF valuation technique 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.

There is no hierarchy of valuation techniques required by accounting standards. However, the use of multiple valuation techniques is encouraged. Therefore, while many industry participants believe that DCF based valuations are open to a high level of subjectivity in selecting inputs for this technique when valuing equity Investments for the private equity industry, Income based valuation techniques may be helpful in corroborating Fair Value estimates determined using market based techniques.

3.7. In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique 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 captures the risk inherent in the projections;**
- (ii) Adjust the Enterprise Value for surplus or non-operating 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 Market Participants. Judgement is required in assessing a Market Participant perspective.**

3.8. Discounted Cash Flows (from an Investment)

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

This valuation technique, because of its flexibility, is capable of being applied to all private



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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.

However, because of its inherent reliance on substantial subjective judgements, and because of the general availability of market based techniques, the Valuer should be cautious of using this valuation technique as the only basis of estimating Fair Value for Investments which include an equity element.

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 develop discount rate assumptions.

Terminal value estimation

However the need to make detailed cash flow forecasts over the Investment life (except in circumstances where Realisation is imminent) 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.

Realisation imminent and pricing agreed

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) valuation technique (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 valuation technique.

3.8. In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Investments with characteristics similar to debt.



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The implied discount rate at initial investment is adjusted over time for changes in market conditions. In selecting a discount rate, it is important to consider not only the various inputs typically used to estimate the cost of capital, but also the differences between the Underlying Business and the selected comparable companies used in estimating the discount rate, which might indicate that a higher or lower cost of capital is appropriate. Calibration provides an indication of the way that Market Participants would value the investment as of the transaction date given the differences between the Underlying Business and the selected comparable companies. The initial implied yield and assumptions can then be adjusted to take into account changes in the Underlying Business and the market between the transaction date and each subsequent Measurement Date.

3.9. Net Assets

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

This valuation technique 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 valuation technique 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.

3.9. In using the Net Assets valuation technique to estimate the Fair Value of an Investment, the Valuer should:

- (i) Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and 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 using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.**



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4. Valuing Fund Interests

4.1. General

4.1. In measuring the Fair Value of an interest in a Fund the Valuer 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, except as follows:

- (i) if the Fund interest is actively traded Fair Value would be the actively traded price;**
- (ii) if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.**

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 Investments held by a Fund, as reported by the Manager, has been used as the basis for estimating the Fair Value of an interest in an underlying Fund.¹² (Note: As stated in Guideline 4.1 (i), if the Fund interest is actively traded, Fair Value would be determined using the actively traded price).

Fair Value for a Fund interest is, at its most basic level, equivalent to the summation of the estimated value of underlying Investments as if realised on the Measurement Date. The proceeds from such hypothetical Realisations would flow through to the investor in an amount equal to NAV. Therefore, NAV, when derived as the Fair Value of underlying Investments and adjusted for incentive payments, etc., provides the best indication of the cash flows an investor would receive at the Measurement Date, and thereby a clear indication of the value of the Fund interest. 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 determine the Fair Value of the Fund Interest, to the extent that the investor has evidence that the reported NAV is appropriately derived from the Fair Value of underlying Investments as part of a robust process. Typically, evidence as to a Manager's Fair Value approach, estimation procedures and consistency of application is gathered via initial due diligence, on-going monitoring, and review of financial reporting and governance of the investee Fund by the investor entity.

¹² FASB ASC Topic 820 (820-10-15-4 & 820-10-35-59 to 62) allows the use of NAV to measure Fair Value if certain conditions are met: the Investment is in a Fund (as defined by ASC Topic 946); and underlying Investments are reported at Fair Value as of the Measurement Date. IFRS is silent on the use of NAV and provides no further guidance on how to measure the Fair Value of a Fund interest. Generally under IFRS, NAV is used as a starting point with the Valuer assessing that reported net assets are valued compliant with Fair Value principles.



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Therefore, NAV, when derived from the Fair Value of underlying Fund Investments rigorously determined in accordance with the principles of Fair Value and these Valuation 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. If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the 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. If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

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

- significant time elapsing between the Measurement Date of the Fund NAV and the Valuer entity's Measurement Date. This would be further exacerbated by:
 - the Fund making 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;
- waived management fees included in NAV;
- impact of claw back provisions;
- 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 Measurement Date.



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4.3. Secondary Transactions

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

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, may be 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.

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. If orderly Secondary Transaction prices are available, but are not deemed active, then such prices should be augmented with other valuation inputs, generally NAV.

4.4. Discounted Cash Flows

In situations where a Valuer decides not to use or cannot use NAV as a starting point for determining Fair Value and orderly Secondary Transaction information is not available, the primary valuation technique available to estimate Fair Value for a Fund interest would be to perform a discounted cash flow analysis of all future cash flows for the Fund. Given the subjectivity involved, it is not expected that the DCF alternative would be used often in practice.



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Section III: Application Guidance

Introduction

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

5. Specific Considerations

5.1. 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 valuation technique, 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 preferred shares into common equity, combining outstanding preferred shares into a smaller number of shares (share consolidation) or even cancelling all outstanding shares before a capital increase.

5.2. 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 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;



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- 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;
- the seller is in or near bankruptcy or receivership (i.e. the seller is distressed);
- there was not adequate exposure to the market to allow for usual and customary marketing activities; and
- the transaction is considered an outlier by Market Participants when considering other similar transactions of the same or similar asset.

Determining whether a transaction is not orderly or merely reflects current distressed market conditions requires judgement.

5.3. Higher Ranking Instruments

Many acquisition structures include third party debt which ranks higher than the interests of the Fund, which is deducted from Adjusted 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 Measurement Date. Typically this is the par value since the debt is generally repayable at the time of disposal of the Investee Company and the Enterprise Value has been estimated on the basis of disposal at the Measurement Date as this is how Market Participants in the Private Equity industry view the realization process.

When debt must be repaid upon the sale of the Underlying Business, then a Market Participant may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. It should be noted however, that if debt is a standalone Investment, a Market Participant would take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which would generally **not** be equivalent to Par Value (see 5.5 below).

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.

5.4. 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



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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 may be the best indicator of Fair Value, unless market or company specific conditions exist which would indicate that Fair Value differs from cost.

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 to the extent a Market Participant would be expected to combine the overall Investment.

5.5. 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 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. The use of such prices is permitted to determine Fair Value if the Valuer has determined how a quotation or a price provided by a third-party source was determined and to what extent it is contemporaneous and actionable. The Valuer should understand what the source of the information was, the inputs and assumptions used and whether a quote is binding or not.

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 valuation technique 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.

If the mezzanine loan is one of a number of Investments held by a 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, to the extent that a Market Participant would



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combine the Investments. Depending on the facts and circumstances of the Investments held by a Fund, the Fair Value of a mezzanine loan may be equal to the par value of the loan if it must be repaid upon a change of control.

5.6. Rolled up Loan Interest

Many financial instruments commonly used in private equity Investments accumulate interest which is only realised 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.

5.7. Indicative Offers

Indicative offers received recently 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, indicative offers may provide useful additional support for a valuation estimated by one of the valuation techniques, but are generally insufficiently robust to be used in isolation.



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5.8. 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 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;
- guaranteed IRR;
- 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 Measurement 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.



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5.9. Contractual Rights

Increasingly, additional consideration dependent upon future events is used as a strategy for exiting an Investment. Upon the sale of an Underlying Business some consideration is received, with additional consideration potentially being deferred and received in the future. 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.

Because the interpretation of accounting standards differs and the treatment of so-called “gain contingencies” is not uniform, the Fair Value of contractual rights (gain contingencies) may not have been recorded in a Fund’s financial statements or related notes. However, in the context of a private equity or venture capital Investment, the sale of an Investment that includes potential future consideration is both contractual and qualifies as a financial instrument. 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 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 using cash flows which have been appropriately probability weighted for expected outcomes. The expected cash flows are then discounted using an appropriately chosen discount rate. Most likely cash flows, in their simplest form, are determined by assessing the probability and amount of payment at various points in time. Some Market Participants may use other valuation approaches to determine the value of such future cash flows.

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 often possible to keep the analysis relatively simple while still incorporating the material complexities of the contractual right, especially if the probability of success is low or the amount of the future consideration is small. As noted above, even though the interpretation of the proper accounting treatment of contractual rights differs (recognition as an asset in the financial statements vs. disclosure in notes to financial statements), Investors generally are in need of a Valuer’s estimate of the Fair Value of such contractual rights or contingent gains.



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5.10. Non-Control Investments

As noted in Guideline 2.4, generally Enterprise Value of the portfolio company is the starting point for determining Fair Value. This is because investors either have control or have invested together with other investors (and collectively have control) such that value at exit is maximized by the sale of the Enterprise.¹³

In certain limited circumstances, the unit of valuation may not be the overall enterprise. This may be the case where a non-controlling or minority interest is purchased and the controlling shareholders interests are not aligned with the non-controlling or minority shareholders. In such limited situations, value may not be maximized through the sale of the Enterprise, and/or the controlling shareholder may have no intent or need to sell the Enterprise.

In such situations, the Market Participant contemplated in the Fair Value determination is the hypothetical buyer for the minority interest, *not* a hypothetical buyer for the entire Enterprise. If the minority interest would be sold to a Market Participant without the Enterprise being sold, then the valuation technique(s) used to determine Fair Value would mirror those of potential Market Participant buyers of the position. In some circumstances a market approach may be applicable, though in other cases an income approach may be appropriate.

If an income approach (discounted cash flow) is used alone or in combination with a market approach, it would require estimation of future economic benefits and the application of an appropriate *discount rate* to equate them to a single present value. The future economic benefits to be discounted are generally a stream of periodic cash flows attributable to the asset being valued, but they could also take other forms under specific circumstances—for example, a lump sum payment at a particular time in the future with or without interim cash flows as would be the case where there is a contracted put option in place for the sale of the investment. Fair Value would represent the amount a Market Participant would pay in an Orderly Transaction for the non-controlling minority interest.

5.11. Mathematical Models / Scenario Analysis

Unlike derivatives and debt markets, mathematical option pricing models have not seen wide usage in the private equity marketplace. Such models are rarely used by Market Participants to determine the transaction price for an Investment. However, for certain early stage Investments, option pricing models (OPM) or probability-weighted expected return models (PWERM) are deemed by some to provide a reliable indication of Fair Value where a limited number of discrete outcomes can be expected.

To the extent a Market Participant would determine value of early stage (pre revenue, pre earnings) Enterprises using mathematical models or a scenario analysis, it would be appropriate to consider such valuation techniques in determining Fair Value. For example, Enterprise Value could be estimated by assigning probabilities to value increasing (future up round), value remaining the same (flat round), value decreasing (down round), and value eroding (zero return), taking into account anticipated dilution, if any, and then discounting the

¹³ For purposes of these Guidelines, control should not be interpreted in the context of accounting consolidation rules. It is the premise of these Guidelines that all Investments made by Investment Entities and Investment Companies are reported at Fair Value. Control in these guidelines is used for purposes of determining which entity or entities have the ability to cause the portfolio company or Investment to be sold at the Measurement Date.



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future funding event to the Measurement Date using an appropriate weighted average cost of capital. The Enterprise Value could then be allocated, again using estimated probabilities, to individual securities using a liquidation or exit approach meaningful for each scenario. It should be noted that selecting inputs for such techniques would be highly subjective.

5.12. Sum of the Parts

Fair Value is determined using Market Participant assumptions. For certain Investments, Fair Value is determined by aggregating the individual Fair Values of portions of the business. This may be the case in situations where an Underlying Business has distinct parts where Market Participants would apply different metrics to value each portion. In such circumstances, it may be appropriate to determine the Fair Value of each part and then aggregate the values to determine the overall Fair Value.



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Definitions

The following definitions shall apply in these Valuation Guidelines.

Active Market

A market in which transactions for an asset take place with sufficient frequency and volume to provide pricing information on an on-going basis.

Actively Traded Investment

A financial instrument traded in an Active Market. The necessary level of trading required to meet these criteria is a matter of judgement.

Adjusted Enterprise Value

The Adjusted Enterprise Value is the Enterprise Value adjusted for factors that a Market Participant would take into account, including but not limited to surplus assets, excess liabilities, contingencies and other relevant factors.

Attributable Enterprise Value

The Attributable Enterprise Value is the Adjusted 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.

Backtesting

The process of using the observed value of an Investment as implied by a sale, liquidity event (e.g., an IPO) or other material change in facts with respect to the Investment, related Investments, or the Enterprise, to assess the Fair Value estimated at an earlier Measurement Date (or Measurement Dates).

Blockage Factor

An adjustment that adds a discount or premia to 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. Blockage Factors 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

A commercial company or business financed through debt and equity capital provided by debt holders and owners.

Enterprise Value

The Enterprise Value is the total value of the financial instruments representing ownership interests (equity) in a business entity plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.



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Fair Value

Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants given current market conditions at the Measurement Date.

Fund or Private Equity Fund

The Fund or Private Equity Fund is the generic term used in these Valuation 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 Valuation 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 Enterprise or group of Enterprises in which a Fund is directly invested.

Investment

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

Liquidity

A measure of the ease with which an asset may be converted into cash. A highly liquid asset can be easily converted into cash; an illiquid asset may be difficult to convert into cash. Liquidity represents the relative ease and promptness with which an instrument may be sold when desired.

Market Participants

Buyers and sellers in the Principal (or Most Advantageous) Market for the asset that have the following characteristics:

- a. They are independent of each other,
- b. They are knowledgeable,
- c. They are able to transact,
- d. They are willing to transact, that is, they are motivated but not forced or otherwise compelled to do so.

Marketability

The time required to effect a transaction or sell an Investment. Accounting standards dictate that the Marketability period begins sufficiently in advance of the Measurement Date such that the hypothetical transaction determining Fair Value occurs on the Measurement Date. Therefore, accounting standards do not allow a discount for Marketability when determining Fair Value.

Measurement Date

The date for which the valuation is being prepared, which often equates to the reporting date.



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Most Advantageous Market

The market that maximizes the amount that would be received to sell an asset after taking into account transaction costs and transportation costs.

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 Measurement Date to allow for marketing activities that are usual and customary for transactions involving such assets; it is not a Forced Transaction.

Post Money Valuation

The value of a company after an investment has been made. The implied Post Money Valuation is calculated as the monetary amount of an investment divided by the equity stake gained in an investment.

Principal Market

The market with the greatest volume and level of activity for the potential sale of an asset.

Quoted Investment

A Quoted Investment 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.

Secondary Transaction

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

Unquoted Investment

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

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.

Unit of Account

An accounting term which identifies the level at which an asset is aggregated or disaggregated for Fair Value recognition purposes. Unit of Account is dictated by individual accounting standards which are subject to interpretation. Because Fair Value accounting standards seek to reflect the economic behaviour and the perspective of Market Participants these Valuation Guidelines generally use a Market Participant view in assessing the level of aggregation or



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disaggregation. For example where accounting guidance is open to interpretation, if a Market Participant would purchase an interest in a private company, not focusing on individual shares; the Unit of Account would be the overall interest purchased. However, if accounting standards clearly define Unit of Account, such guidance should be followed.

Valuer

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



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Endorsing Associations

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