FAO Paul Cunningham
Chair
International Private Equity and Venture Capital Valuation Guidelines Board

By email: contact@privateequityvaluation.com

27th November 2018

Dear Mr Cunningham,

RE: BVCA response to the draft amendments of the International Private Equity and Venture Capital Guidelines

The British Private Equity and Venture Capital Association ("BVCA") is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, the BVCA represents the vast majority of all UK-based firms, as well as their professional advisers and investors. Over the past five years (2013-2017), BVCA members have invested over £32bn into nearly 2,500 companies based in the UK. Our members currently back around 3,380 companies, employing close to 1.4 million people on a full-time equivalent basis ("FTEs") across the world. Of these, around 692,000 FTEs are employed in the UK.

We welcome the opportunity to comment on the 2018 draft amendments to the International Private Equity and Venture Capital Guidelines ("IPEV Guidelines"). The BVCA would like to emphasise its endorsement of the IPEV Guidelines as they remain a practical, pragmatic and helpful guide for our members on a difficult and highly judgemental area.

Feedback on the amended IPEV Guidelines

<u>Calibrating to the Price of a Recent Investment</u>
We note that the Price of Recent Investment is no longer the default for determining fair value, per Guideline 3.10 and that this is in line with the treatment under IFRS 13. This will be a challenge for some of our members such as those with early stage investments, where this is the most common valuation method and where other indicators of fair value are not typically available and so could be the best available method of valuation. The Price of Recent Investment methodology may be a reasonable indicator of fair value, but we recognise this will require full analysis of the performance and operations of the underlying business and external environment between the investment date and measurement date.

Although we acknowledge that the Guidelines do not focus on procedures, it would be helpful to include some explanation on what is expected of an investor in documenting how they have calibrated price of recent investment with another technique when there is no obvious indication of a discount or premium existing.

The Board should also note that the Price of Recent Investment methodology may not be wholly representative of Fair Value in situations where the Seller willingly undersells the Underlying Business, as they prefer selling to one investor rather than another for reasons other than price.

Calibration and back testing

The inclusion of the section on 'Application of Guidelines' (on page 8) refers to the need for a robust valuation process including calibration of valuation inputs and incorporation of back testing. We acknowledge the focus of the Guidelines is to articulate best practice on valuations and do not seek to provide details on procedure. However, any additional detail on the need for calibration and back testing as part of the valuation process would be welcomed, as practice in this area could be improved.

Similarly, the penultimate paragraph on page 13 alludes to back testing, but is not directly or explicitly referenced. We would suggest that this is made clearer, perhaps by referencing to Guideline 2.7 on page 17.

As part of Guideline 2.7, the Board could also consider back testing, not just for the price an investment is sold for compared to its last fair value, but also to back test assumptions that have been used, such as the maintainable EBITDA used or the normalised net debt.

Consistent Valuation Techniques

Guideline 1.6 states that "fair value should be estimated using consistent Valuation Techniques…". We would suggest that this should occur on a "comply or explain basis". Where a valuation technique is changed, an explanation should be provided for doing so.

Unit of Account

The last two paragraphs on page 12 discuss realisations through a sale or floatation of the underlying business and the basis for determining fair value if such a sale occurs, or if individual instruments are transacted. It would perhaps be more appropriate for these paragraphs to be included in Guideline 1.7 'Unit of Account.'

Use of Multiples – Differences in GAAP

The Board should consider including a general note for users on the importance of considering the underlying GAAP in determining comparable multiples as part of Guideline 3.4. For example, R&D is rarely capitalised in the USA, but under IFRS, the 'D' (development) could be. The impact of IFRS 16 on classification of leases will also be relevant.

Active Markets

Active Markets are referenced in Guideline 3.6. Any guidance on what is and is not an active market would be welcomed by our members to reduce the judgement and subjectivity required to determine an answer.

Blockage Factors and Discounts
The example as part of Guideline 3.6(ii/iii) on page 28 notes that a contractual restriction could be attributable to a security. However, in practice, the lock-up is on the holder, not the security itself, and therefore a discount would not be allowed.

Discounted Cash Flows
We are concerned that the language used in Guideline 3.8 Discounted Cash Flows (DCF) is negative and may dissuade users from using this as a valuation method. We would suggest this section is revisited, as there are a number of investments, particularly in infrastructure, where the DCF methodology would be most appropriate.

On page 31, where valuations of 'performing debt investments' using DCF is considered, we suggest that the Guidelines note that this is only appropriate where there is not a liquid price for such investments.

Net Assets
It would be helpful to clarify as part of Guideline 3.9(i), and the accompanying explanation, that net asset value (NAV) means net assets when considered on a fair value basis. NAV is not the same as Net Book Value, where certain items will be held at held at historic cost and not at fair value. It may be more appropriate to include this as part of the discussion on Valuing Fund Interests on page 36 onwards as the net assets approach is sometimes used when there is a liquidation or an orderly wind-up.

Indicative Offers
We would suggest developing Guideline 5.7 on Indicative Offers and expanding it to cover binding offers and post valuation date funding rounds as further evidence of the fair value at the valuation date.

Sum of the Parts
Any guidance on the Sum of the Parts methodology as covered in Guideline 5.12 would be welcome, especially where and how the overhead costs per unit should be valued.

Real Estate Investments
The Board could consider referencing the European Association for Investors in Non-Listed Real Estate Vehicles (INREV) for further guidance on Real Estate Investment valuations.

Drafting comments
The terms Investee Company and Underlying Business are used interchangeably throughout the Guidelines. The Board should ensure that the terms are used consistently. If the terms are considered to have different meanings or if they are intentionally used interchangeably, that should be clarified for users.

On the contents page, Introduction should refer to page 6, not 5.

For consistency, “accounts” should read “financial statements” on the second paragraph of page 6.

The fourth paragraph of page 13 refers to “firmly determined” (…true performance is firmly determined”). We are not sure that this the correct or best term to use.

We also question whether the example on page 17 is entirely correct. It is not the absolute movement between the two multiplies (12x to 15x) rather the percentage movement between the two multiples of the comparable company that should be applied. This is correctly clarified in the final paragraph of page 23.

We have noted that the English US spelling “rigor” has been used on page 18. We acknowledge that these are international guidelines and suggest the Board ensures a consistent approach is used.

In the second paragraph on page 19, please note the repetition of “section” and the reference should be to “section II 3.6”, not “II 3.9”

The table on page 21 under the shaded Guideline 3.3 does not add value and simply repeats 3.3 therefore this can be removed.

For clarity, in the final paragraph of page 43, we would suggest adding “investments’ following ‘these’: “typically these <u>investments</u> are valued on the basis of a DCF calculation.”

We would be happy to discuss the contents of this letter with you. Please do not hesitate to contact the BVCA if you have any questions.

Yours sincerely,

Amy Mahon

Chair, BVCA Legal and Accounting Committee