

IPEV Board, Special Valuation Guidance

31 March 2020

The IPEV Valuation Guidelines provide the framework for delivering LPs the fair value information they need. Given the magnitude of the current crisis accompanied by significant uncertainty, the board highlights the following for all managers and investors applying the IPEV Valuation Guidelines (“the Guidelines”) at 31 March 2020:

- The Guidelines should be consistently applied across all investment types, industries and stages of investment (early stage, mid stage and late state).
- Strong valuation processes should continue to be followed.
- Fair value does not equal a “fire sale” price.
- Fair value does represent the amount that would be received in an orderly transaction using market participant assumptions in the current market environment.
- Fair value is based on what is known and knowable at the measurement date.
- A view may need to be taken at the measurement date as to the potential for and impact of possible government subsidies that may impact individual companies and the overall economic environment. The impact of government subsidies or initiatives generally would not be reflected in the results of a portfolio company until it crystallizes or can be reasonably assured.
- Care should be taken not to “double dip” with respect to valuation inputs—if performance metrics have been adjusted to take into account lower expected performance, an appropriate multiple should be applied rather than a multiple derived from comparable public companies whose results have not yet included lower expected performance. The same concept applies when using the income approach, discounted cash flow (DCF). If future cash flows have been adjusted the increase in the discount rate may be less than the increase in the discount rate if cash flows have not been adjusted for the impact of the crisis.
- Market participant views matter – greater uncertainty may translate into greater risk which may translate into greater required returns which may translate into lower asset values.
- It may no longer be appropriate for recent transaction prices, especially those from before the expansion of the pandemic to receive significant, if any, weight in determining fair value.

The board further highlights the following with respect to valuing certain types of investments which should be considered on an investment by investment basis (further detail is included in the Guidelines):

Equity Investments

- As required by accounting standards (IFRS 13 and FASB ASC Topic 820) and thereby the Guidelines, actively traded securities are required to be reported, by rule, at $P * Q$ where P is the closing price on the relevant exchange at the measurement date and Q is the quantity of shares held. The Board understands that the public markets are currently very volatile, yet the financial reporting rule of $P*Q$ remains in place.



- The impact of the crisis on the portfolio company's revenue/customers, supply chain, and operations (including availability of employees and the leadership team to work remotely) must be rigorously considered at March 31, 2020.
- Estimates as to performance shortfalls for Q1, Q2 and beyond, to the extent possible are necessary. Updated performance projections are likely to be necessary.
- Appropriate multiples must be determined which reflect the current market environment including risk and uncertainty in projections and historical results.
- An appropriate multiple would be congruent with the metric to which it is applied. The percentage change in market capitalization of comparable public companies may provide a good proxy for the magnitude of the change to be expected in the multiple.
- If the metric has been adjusted for current conditions and future expectations and the public comparable company results do not yet reflect the change in results and expectations, then there would be less of an expected relative change in the multiple applied. If the metric has not be adjusted, then more of the relative change in public comparable companies would be applied.
- Greater uncertainty translates into greater risk and increased required rates of return, which generally would indicate that multiples will decrease, even in the absence of recent transaction data.
- Revenue and earnings metrics must be evaluated in the context of market participant perspectives. Generally, market participants focus on maintainable earnings or maintainable revenue. Therefore, one-time impacts would be excluded from the metric to which the multiple is applied.
- Notwithstanding the previous point, expected adverse performance in Q1 and Q2 2020 and beyond, if deemed one-time, would still impact cash balances and would be reflected as a deduction from enterprise value in estimating fair value.
- The selection of metrics base on last twelve months (LTM) or next twelve months (NTM) would be determined based on market participant expectations and the availability of applicable multiples.
- Liquidity needs must be evaluated; what is the likelihood of a debt covenant breach? What is the impact of extended reduced cash flow? What is the source of working capital required to "re-start" the business if impacted by the crisis?
- Scenario analysis is likely to be necessary to assess and incorporate the probability of the crisis extending for 3-, 6-, 12-, 18-months or longer.

Debt Investments

- The fair value of a debt investment, in the absence of actively traded prices, is generally derived from a yield analysis taking into account credit quality, coupon and term.
- Par value or face value or cost value is not automatically fair value, even if there is sufficient enterprise value to cover the liability.
- Fair value may, depending on the facts and circumstances, be equal to par value or face value or cost value.
- Credit quality (repayment risk) must be assessed similar to the Equity questions above.
- Non-performing debt is considered differently from performing debt.
- Credit spreads have widened for various industries, credit ratings, and terms.



Limited Partnership Interests

- Last reported Net Asset Value (NAV) if based on the fair value of underlying investments is generally the starting point for estimating fair value.
- Last reported NAV in many cases is 30 September or 31 December 2019.
- Given the potential significant change in value of underlying investments, LPs will need to not only cash adjust last reported NAV and adjust for publicly traded positions but will need to adjust for the value change of underlying holdings—hence the need for GPs to report as timely as possible.

The board does not consider this document to be all inclusive. It is provided to encourage valuers to think critically when estimating fair value at 31 March 2020. Primarily reference should be to the Guidelines themselves. Informed judgment is required, despite the challenging environment and potential difficulty to access some information. Every investment will need extra analysis. While this is a very unique time in history, LPs continue to be best served by GPs providing timely fair value information at 31 March 2020. Even in volatile dislocated markets, fair value remains the most relevant and reliable information for LPs.





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International Private Equity
and Venture Capital
Valuation Guidelines

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