International Private Equity and Venture Capital Valuation Guidelines Board

By email: contact@privateequityvaluation.com

27 November 2015

Dear David Larsen,

Re: Consultation on proposed update to IPEV Guidelines

Thank you for the opportunity to respond to the current consultation on the revision to the IPEV Valuation Guidelines. On behalf of the Legal and Technical Committee of the BVCA, I outline our comments in response to the specific questions contained within the consultation below.

The BVCA would like to emphasise its strong support for the IPEV Guidelines and note that these continue to enjoy strong support and near universal adoption by our members. We believe these remain a practical, pragmatic and helpful guide to a difficult and highly judgmental area.

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 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £30 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 490,000 people and almost 90% of UK investments in 2014 were directed at small and medium-sized businesses.

1. Do any changes need to be made to the update draft to ensure that entities that adopt or comply with the IPEV Valuation Guidelines would be compliant with relevant accounting standards?

In our opinion the interaction between the IPEV Valuation Guidelines and relevant accounting standards is clearly articulated within the text.

2. Do the organizational changes make the document more useable?

In our opinion the organisational changes within the document help to simplify and clarify the guidance.

3. Are the additions and edits to Section III Special Considerations, specifically 5.10 through 5.14, helpful?

The additions and edits are generally helpful. The BVCA notes that the mathematical models referred to in 5.11 are generally not used by our buy-out PE house members. The concept of applying probabilities to different economic and business outcomes is more likely to be applied by

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houses engaged in early stage venture type investment although their use of a detailed mathematical model to support their analysis is likely to be limited.
We note that there are no sections 5.13 or 5.14 in the draft published.

4. Should additional topics be covered in the Special Considerations section? If yes, which topics?

The Guidelines reference in a number of places the importance of adjusting enterprise value for "surplus assets and excess liabilities and other contingencies". We consider that IPEV could consider incorporating more detailed guidance on how these adjustments might be evaluated and applied in practice

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

Backtesting

We support the additional guidance in this area but do highlight that evaluating differences between a multiple used for a valuation estimate with the multiple subsequently achieved on exit will always be inherently difficult due to the lack of insight into the assumptions the buyer adopted when determining what they were prepared to pay.

Credit funds

We consider that the application guidance section 5.5 dealing with Mezzanine debt investments could be enhanced and expanded. In particular we note that a number of our members do evaluate whether price quotations publicised by brokers represent reliable indicators of value and have developed internal processes to evaluate the degree of reliability. We recognise that this is a highly judgmental area given the difficultly in establishing the liquidity of the assets in question but believe that the IPEV guidelines could cover fair value issues associated with credit funds in more detail as these become a more significant feature of PE and alternatives asset managers.

Fund interests

We note the comment in section 4.1 that "Fair value for an underlying fund is, at its most basic level, equivalent to the summation of the estimated fair value of underlying Investments as if realised on the Measurement Date". It is not entirely clear whether "Fair value for an underlying fund" refers to the fair value of an equity holding in a fund or the fair value of the assets in a fund. If the former then we believe that this statement is not strictly true since there are a number of issues which might cause the fair value of an equity interest in a fund to differ from the attributable share of the fund's NAV (principally restrictions in the ability of investors in funds to freely trade their investments, the impact of limited liquidity in the equity interest in the fund where these are tradable and the impact of future fund commitments).
As the Guidelines partly explain there is specific recognition of this in US GAAP through the use of the "practical expedient" but in our opinion the underlying technical argument could be expressed with greater clarity in the Guidelines.

Section 3.6(iii) – discounts applied to quoted investments

We consider that the Guidelines could consider in more detail what “restriction attributable to the security, not the holder” might mean in practice. In the context of the trend towards IPOs as a common form of exit we note that there may be some inconsistency around how legal restrictions are analysed and attributed by valuers.

Typos

Footnote 8 on p21 does not match footnote 4 on p12 (the footnotes matched in the previous Guidelines and it appears footnote 8 has not been updated).

The feedback questions 3 and 4 refer to “Special Considerations”. In the draft updated Guidelines (p44) and also in the 2012 Guidelines, the text refers to “Specific Considerations”.

There is a typo on the first row of page 25 (Backtesting section) of the draft updated Guidelines. It should be “actual liquidity event” not “actual liquidity even”.

Please contact Gurpreet Manku at gmanku@bvca.co.uk if you would like to discuss any of the above in more detail.

Yours faithfully

Simon Witney
Chairman, BVCA Legal & Technical Committee