Alternative Assets Valuation

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David L. Larsen CPA / CEIV / ABV

Managing Director, Kroll

Alternative Investment Fund Valuation

David L. Larsen

CPA/ABV/CEIV
Managing Director, Kroll

- Member IVSC Standards Review Board
- Former Vice Chair International Private Equity and Venture Capital Valuations Board
- Member FASB Valuation Resource Group
- Member AICPA PE/VC Valuation Guide Task Force
- Lead drafter of the PEIGG Valuation Guidelines

About Kroll

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Kroll Alternative Asset Advisory

Kroll is a market leader in providing investors and managers with valuation services related to alternative investments, specifically securities and positions for which there is no "active market" quotations.

Key Highlights

- Kroll client base consists of more than **600 alternative asset** fund managers and investors in the **U.S. and globally**
- We perform in-depth valuation analyses of all asset types for clients across the spectrum of banks, hedge funds and private equity firms globally:
  - **70% of the top 25** largest Hedge Funds
  - **70% of the top 25** largest Private Equity Funds
  - **50% of the top 25** largest publicly traded Hedge Fund platforms (business development companies or "BDCs")
  - **80% of the top 30** Limited Partners listed by PEI
  - Our client base includes **18 BDCs** (17 public, 1 private)
  - **Venture capital, Private debt** and **mid-market private equity funds** are the fastest growing segment of our client base
- We review or value over **10,000 investment positions** on a quarterly basis, including derivatives and structured products
- We have **18 full-time Alternative Asset Focused Managing Directors** and draw from Kroll's pool of over 1,000 valuation professionals with wide ranging sector and asset class expertise across the spectrum

What we do

- Kroll provides an objective and independent third-party perspective on all classes of illiquid securities assisting alternative investment managers in the U.S. and globally
- Kroll assists clients with design and implementation of best-in-class valuation policies and procedures including drafting and ongoing review of valuation processes and procedures to ensure best practice
- Our services sought by our clients for several mission critical applications include:
  - Financial and management reporting
  - Transaction support
  - Audit and stakeholder requirements

Kroll Alternative Asset Advisory practice enables alternative investment managers to enhance their valuation process with the independence and objectivity that investors require.

Agenda

Alternative Investment Fund Investors

Alternative Investment Fund Investors

1. Public & Private Pension Plans
2. Sovereign Wealth Funds
3. Insurance Companies
4. Banks
5. Other Corporate Entities
6. High Net Worth Individuals
7. Fund of Funds
8. Other

Forms of Alternative Investments

Limited Partnership Interest

- PE/Buyout
- Venture Capital / Early Stage
- Hedge
- Credit
- Infrastructure
- Real Estate
- Fund of Funds
- Other

Direct/Co-Investments

- Common Equity
- Preferred Equity
- Debt
- Other

Emerging Vehicles (monthly or daily pricing)

- Interval Funds
- Target Date Funds
- “40 Act Funds”
- Other

Agenda

Basis of Value

What basis of value is most applicable for Alternative Asset Investors for financial / investor reporting?

- Cost
- Lower of cost or impaired value
- Fair Value
- Market Value
- Fair Market Value
- Investment Value
- Liquidation Value

Fair Value Definition has Aligned!

Fair Value is defined by:

- IFRS 13,
- FASB ASC Topic 820 (formerly SFAS 157), and
- GASB (US Government Accounting Standards Board) Statement 72

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. (emphasis added)

Why Fair Value?

- Fair Value is the basis investors use to report periodic (quarterly/yearly) performance to their investors, beneficiaries, boards, etc.
- Fair Value is the best basis to make "like to like" asset allocation decisions.
- Fair Value is an important data point in making interim investment (manager selection) decisions on a comparable basis.
- Fair Value is often necessary as a basis to make incentive compensation decisions at the investor level.
- Fund Investors need consistent, transparent information to exercise their fiduciary duty.
- Fair Value provides valuation information on a comparable basis for monitoring interim performance. An arbitrary reporting basis such as cost does not allow comparability.
- Most investors, including pension funds, are required by relevant accounting standards to report their investments on a Fair Value basis.
- Investment Companies (under IFRS & US GAAP) are exempt from consolidation rules because their investments are carried at Fair Value.

Investors don't always *want* Fair Value, but they NEED fair value!

Alternative Asset Valuation Guidance

- IVSC – General Valuation Guidance
- IFRS 13 /ASC Topic 820 & IFRS 9 – Accounting Requirements & Disclosure
- IFRS – No specific Guidance for valuing Fund Interests
- IPEV – Specific Alternative Asset Valuation Guidance
- US AICPA PE/VC Guide – Detailed Valuation Guidance including case studies
- AIMA
- PEIGG

IFRS 9 Considerations

IFRS 9 B5.2.3: **All investments in equity instruments and contracts on those instruments must be measured at fair value.**

Financial assets are measured at:

- Fair Value through profit and loss ("FVPL");
- Fair Value through other comprehensive income ("FVOCI"); or
- Amortized cost.
  - Equity investments are automatically measured at FVPL, except for where the entity has made an irrevocable election at initial recognition to account for the equity investment at FVOCI.
  - Debt investments are now classified based on a 'cash flow characteristics' test and a 'business model' test, except where the entity has made an irrevocable election at initial recognition to account for the investment at FVPL to eliminate or significantly reduce an accounting mismatch.

Even if a Fund Manager could convince their auditor to report Debt Investments at amortized cost – Investors NEED Fair Value!

IFRS 9 Requires Fair Value for Debt Investments when

- The investment has contractual terms which give rise to cash flows which do not solely consist of payments on specified dates of principal or interest;
- The investment is held within a business model whose objective may be partly achieved by selling financial assets prior to their contractual maturity; or
- The entity has made an election to account for the investment at FVPL to reduce an accounting mismatch.

Key areas of focus where the New (2019) AICPA PE/VC Guide may clarify best practices

- Consider the time horizon of the investment when estimating the value of debt for the purpose of valuing equity and the value of any NOLs, even when valuing a controlling position
- For debt investments with warrant coverage, allocate value between the debt and warrants to report the fair value as separate line items on the schedule of investments
- Estimate the value of the enterprise for the purpose of valuing equity interests in the enterprise without consideration of premia or discounts
- Estimate the fair value of debt and the value of debt for the purpose of valuing equity consistent with the cash flows, the market yield, and the remaining expected term

Key areas of focus where the New AICPA PE/VC Guide may clarify best practices: (Cont'd)

- For equity investments in portfolio companies with complex capital structures, consider alternative methodologies or apply appropriate adjustments when using the option pricing method (OPM) to allocate value between classes of equity
- Estimate value by calibrating the selected valuation model to any recent transactions and then update these assumptions for changes between the transaction date and the measurement date
- Perform backtesting to improve the fund's valuation processes
- Exclude transaction costs from the fair value of investments on day 2; that is, the fair value immediately after the transaction close may be less than the capitalized cost
- Nuanced areas, such as contractual restrictions (Chapter 13)

Agenda

Key Alternative Investment Valuation Considerations

Valuation Approach

- Market Approach
- Income Approach
- Replacement Cost

Calibration

Unit of Account

Alternative Investment Valuation Nuances

- Transaction Costs
- Backtesting
- Valuing debt for purposes of valuing equity
- Actively Traded
- Valuing Fund Interests

Valuing an Interest in an Alternative Investment Fund

If Actively Traded – P*Q

If decision to sale the interest has been made – expected sales proceeds

Otherwise:

- Properly Vetted/Adjusted NAV
- Secondary Market Pricing
- Discounted Cash flows

Valuation Inputs

Level I Inputs

- Quoted prices (unadjusted) in active markets for identical assets or liabilities at the valuation date
- Active Market, is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on a meaningful and ongoing basis

Level II Inputs

- Quoted (bid / exit value) prices for similar assets or liabilities in active markets, or bids in markets that are not active, if the transaction is representative of what the subject asset or liability would transact at (actionable broker quotes)
- Inputs other than quoted prices that are observable and most market participants would consider in pricing the subject asset or liability (i.e., interest rates, volatilities, prepayment speeds, loss severities, credit risks, default rates, etc..), represented by objective market data
- Pricing service's reports for homogeneous securities

Level III Inputs

- Unobservable inputs for the asset or liability
- Reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability
- Should be developed based on the best information available under the circumstances

Calibration

- Calibration is required by IFRS 13 when the initial transaction is at Fair Value
- Calibration is the process of using observed transactions in the portfolio company's own securities, especially the transaction in which the Fund entered a position, to ensure that the valuation techniques that will be employed to value the portfolio company investment on subsequent measurement dates begins with assumptions that are consistent with the observed transaction
- On the transaction date, when the transaction price represents fair value, calibrated inputs used with applicable valuation techniques will indicate that the fair value of the portfolio company investment equals the transaction price
- These input assumptions should then be updated to reflect changes in the investment and market conditions at subsequent measurement dates

Simple Example:

- Company is purchased at a 10X multiple of EBITDA
- Comparable companies are trading at 12X EBITDA
- At future measurement dates, based on facts and circumstances, determine if the 2 turns difference should remain, increase or decrease, when determining the multiple used to determine fair value with respect to movements in the comps

Equity – Valuation Decision Tree

Starting point: Initial investment or Last Round of (arm's length) Financing

1. Barring contradictory information, the cost (excluding transaction costs) of an investment may be deemed the "exit" price on the date of investment and is therefore often used as its initial Fair Value (FV).

Thereafter

Calibrate Key Performance Indicators (KPI) to determine relative changes in value going forward

2. Is Investment actively traded in a public market?

Yes

3. Is there a legal restriction?

Yes

3a. FV is determined as the market price times the number of shares held less a possible discount. Support discount with Finery model or protective put value.

No

3b. No legal restriction attributable to the security, FV is the price times quantity. No discount is allowed even if the number of shares owned is large relative to the average daily trading volume.

No

4. Is there adequate / reliable information available to base a discounted cash flow analysis?

Yes

4a. Apply the DCF method to estimate FV

Yes & *No*

5. Is there a comparable company (or transaction) from which Fair Value can be derived?

Yes

5a. Use comparable company / transaction valuation techniques to determine FV

No

6. Does the portfolio company have positive sustainable performance (egg. positive recurring EBITDA)?

Yes

6a. FV may be determined as EBITDA (or other metric) times a reasonable marketplace multiple for the company

No

7. Has there been any material change in the portfolio company's results compared to budget, plan, etc.? Have the KPIs changed relative to expectations? Has there been any key change in its market or its (potential) products? Has there been any major change in the global economy or the economic environment in which the investee co. operates.

Yes

7a. For positive change(s), there is an indication that FV has increased. Determine FV using objective data from the company (KPI), investment professionals and other investors

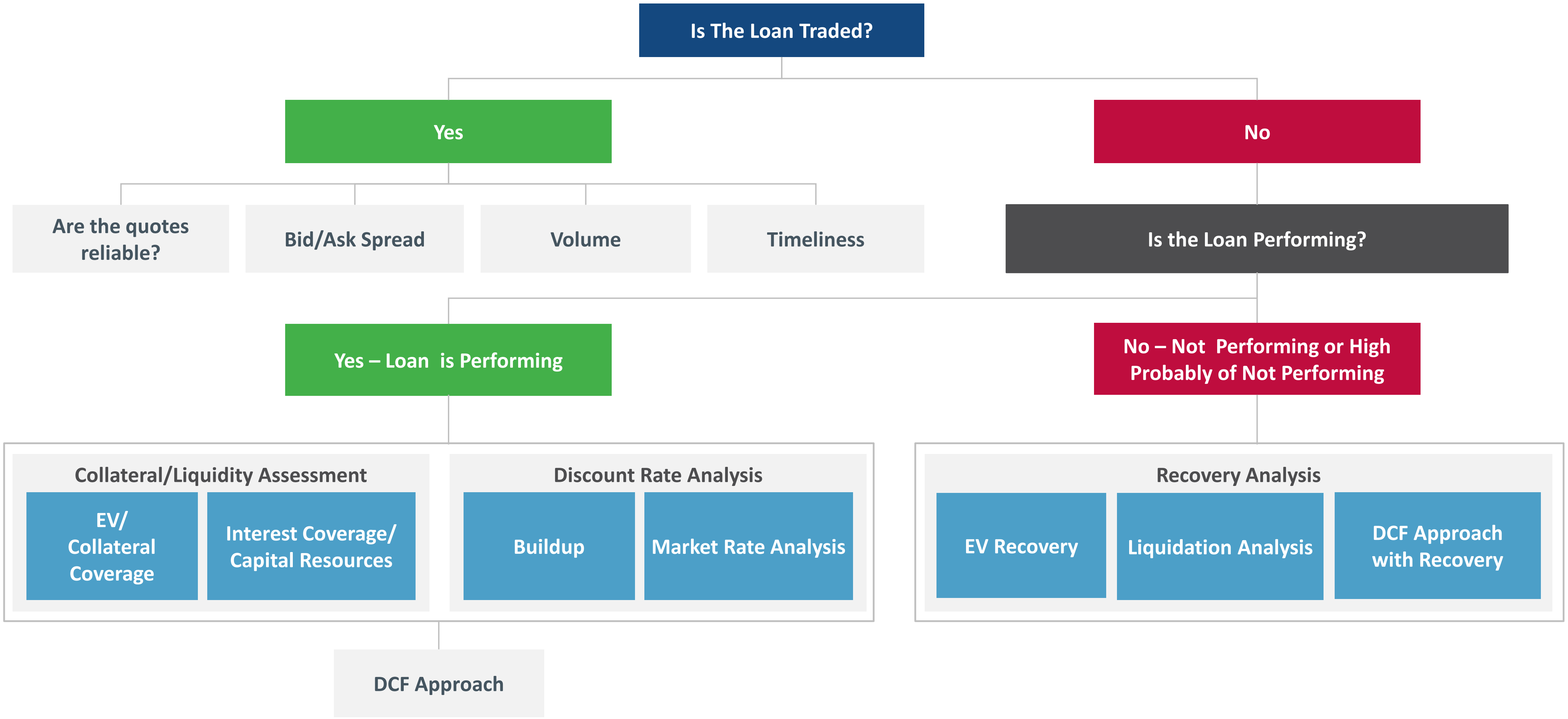
7b. For negative change(s), there is an indication that FV has decreased. Determine the FV decrease to be recorded based on objective measures and manager experience.

No

7c. If no, the value of most recent round of financing may be the best estimate of fair value.

8. Reconcile utilized valuation approaches based on confidence in the respective inputs and resulting FV estimates.

Debt – Valuation Decision Tree



Suspended Trading

Index Approach (limited time)

Market Participant Approach:

- Determine why trading was suspended (irregularities?)
- Determine availability and reliability of current financial information
- Determine implied enterprise value, given historic trading levels
- Calibrate enterprise value with market comparable and entry assumptions
- Calculate implied multiples (P/E or Ebitda) based on available historic earnings data compared to the implied enterprise value
- Review: Investment thesis; Entry price; price target; etc.
- Portfolio managers assess at what price they would invest today
- Portfolio managers assess the "haircut" required to invest based on unknowns
- Identify comparable companies and see how Ebitda or P/E multiples have moved between the date of suspension and the valuation date
- Understand the business model and determine expectations of how EBITDA should have moved from the time of last reported financial information to the valuation date.

Agenda

Conditions Required which allow an LP to use NAV to estimate the Fair Value of a Fund Interest

IFRS Silent on the use of NAV to determine the Fair Value of an LP interest.

FASB/GASB/IPEV state that NAV can used to estimate Fair Value for Investments which are required or permitted to be recorded or disclosed at fair value including interests in Fund-of-Funds, Hedge Funds, Real Estate Funds, Private Equity Funds (Buyout, Venture Capital, Mezzanine Debt) etc., which are not actively traded, if the following conditions are met:

- The fund meets the definition of an investment company. (ASC Topic 946)
- Net Asset Value (“NAV”) is Fair Value based (ASC Topic 820/IFRS 13 compliant).
- NAV is as of the same date as the investor's measurement date (e.g., no reporting lag).

Conditions to use NAV as an LP's estimate of Fair Value

The Fair Value of an investment that does not have a readily determinable Fair Value may be determined by using the NAV per share (or its equivalent)…if the NAV per share (or its equivalent) of the investment is calculated:

- As of the measurement date
- Generally, in a manner consistent with the Financial Accounting Standards Board's measurement principles for investment companies (ASC Topic 946). (e.g., NAV is derived based on valuing underlying investments at Fair Value consistent with Topic 820 / IFRS 13).

If NAV per share (or its equivalent) … is not determined as of the measurement date or is not calculated in a manner consistent with the measurement principles for investment companies:

- The investor should consider whether an adjustment to the most recent NAV per share (or its equivalent) is necessary.
- The objective of any adjustment is to determine the NAV per share (or its equivalent) for the investment that is calculated as of the measurement date in a manner consistent with the measurement principles for investment companies.

Remember the LP paradigm: LP's need fair value-based NAV

Determining whether NAV is robustly Fair Value based

Determination as to whether NAV is based on robustly determined fair value includes:

- Initial due diligence (procedures performed before the initial investment).
- Ongoing monitoring (procedures performed after the initial investment).
- Financial reporting controls (procedures related to the accounting for, and reporting of, the investment).

Additionally, consideration should be given to:

- GPs fund's fair value estimation processes and control environment
- GPs policies and procedures

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Additionally, consideration should be given to:

- Use of independent third-party valuation experts to augment and validate valuations
- Use of and Compliance with IPEV Guidelines
- Qualifications, if any, of the auditor's report on the investee fund’s financial statements.
- Back testing last reported fair value of underlying investment to exit price.
- Values make sense, generally trend with appropriate benchmarks
- Whether there is a history of significant adjustments to the NAV reported by the investee fund manager
- Appropriate adjustments are made for fees, carried interests and claw backs

Valuing (LP) Fund Interests – Diligence and Monitoring

Investors should consider the robustness of Investment Manager valuation processes when performing due diligence and investment monitoring.

- **Pre-investment Due Diligence:**
  - Obtain Investment Manager’s Valuation Policy and review it to determine if, when followed, the underlying investments would be reported at fair value
  - Review financial statements, Quarterly reports, annual meeting information, etc. for evidence that the fund is following its stated procedures (i.e., reporting Fair Value)
  - Interview Manager regarding the valuation process, data collection and information management, documentation / reporting, and any special situations (earn-outs, derivative agreements, liabilities, etc.)

Monitoring

- **Consider factors that demonstrate a robust valuation process**
  - Changes in values of underlying investments (or NAV) compared to market trends (strategy, sector, industry, comparable index, etc.)
  - Cross holdings across multiple funds have consistent marks
  - Use of third party
  - Back testing of realized values to previous valuation estimates (Investment Manager-provided analysis)
- **Best practices for funds that have potential issues or those that might not be reporting Fair Value**
  - Establish monitoring report / heat map to facilitate frequency and depth of future reviews
  - Conduct independent valuation analysis and adjust NAV appropriately
  - Request for third party oversight

Valuing (LP) Fund Interests

Using NAV to Measure Fair Value of Fund Interests

NAV	FV Based	Non-FV Based
In Phase	Qualitative Assessment	Adjust NAV or use another method
Not In Phase	Bring In Phase or use another method	Adjust NAV & Bring In Phase or use another method

Agenda

What makes Early-stage Companies Unique or Hard to Value?

Factors affecting valuation models or assumptions

- Product, service or business model is disruptive to traditional businesses (no established leader or historical data may be superseded)
- Financial results are highly volatile and unpredictable
- Path to IPO is much longer than normal due to extensive sources and willingness of private capital to fund business
- Competition with other new companies
  - Extensive capital is focused on growth and market share (unit metrics helpful but sustainable model delayed)
  - Winner take all situations
- Capital from limited sophisticated investors; funding runway may terminate abruptly
- Lack of information
- Too big to swallow; limiting exit plans
- Secondary market may be meaningful or may be misleading at any point in time
  - Private deals
- Regulatory changes are likely as agencies are dealing with disruption of traditional business models
- Complex capital structures
  - Unique deal terms
  - Changing structures (as new investors demand terms to change, or deals are done without notification)

How Venture Capital Investments Are Priced

For buyout investments, deals are often priced based on traditional Income Approach or Market Approach models

VC investments, however, are valued based on a combination of judgement, risk profiles, industry insights, and most of all negotiation. For rounds with multiple investors, prices are often set by a few lead investors, with other investors left with a "take it or leave it" price

If we can't duplicate the process (the negotiation involving multiple parties) used to price the investment, how do we determine Fair Value???

Mostly established

- Amount of financing
- Security to be utilized; capital structure
- Timing of the investment
- Founder covenants / warranties
- Option pool

Mostly negotiated

- Milestones and follow-on investments
- Seniority, dividends, preference and conversion rights
- Investors' role in company management
- Limitations on dilution and other management spending
- Other rights (information, access and control)

Ownership percentage (including/excluding option pool)

Consideration for Valuing Early-Stage Companies

Understand the business, purpose, stage of life, market and previous investments to arrive at relevant valuation approaches

- Limited market-based approach
- Venture capital approach
- PWERM
- Contingency Claims / OPM
- Milestone based analysis
- Others

Customize global data and research for local business as local statistics are limited

Understand the drivers behind earlier investments and considerations given

Be cognizant of market misconceptions

- Fully diluted valuations
- Ignoring rights and preferences
- Ignoring calibration
- Using transaction benchmarks when not relevant

Having objectivity combined with judgement that comes from experience

Agenda

Valuation Guideline Changes

IPEV (International Private Equity and Venture Capital Board) Valuation Guidelines

- Updated Version December 2022
    - Incorporation of IPEV Board Special Guidance from 2020 and 2022
    - Additional guidance on valuing Early-Stage Investments
    - Addition of ESG considerations
    - Other enhancements to improve readability and consistent application

FASB ASU 2022-03 Contractual Restrictions

IVSC Revisions 2023

Where valuation practices may need improvement

Allocation of value between securities

- Debt and equity
- Preferred equity classes
- Warrant coverage

Level II assets

Consideration of transaction costs

- Entry
- During hold period
- Exit

Holding investments at cost for a specific fixed period of time

Calibration has not been robustly applied

Consideration of comparable transactions or changes in market returns

Valuing contingent contracts (aka earn-outs)

Agenda

Expanded Valuation Expectation from Regulators (Global)

- US SEC continues to focus on questions of valuation
- FCA in the UK doing a sweep focused on Valuation
- French regulator, recent large fines for failure to value properly
- Hong Kong SFC recently issued a Circular to Management Companies and Trustees/ Custodians of SFC-authorized Funds - Relating to Fair Valuation of Fund Assets:
  - Particularly applicable where the market value of a fund asset is unavailable or unreliable or becomes illiquid or hard-to-value as a result of significant market events.
  - Applicable to valuation of all types of assets of a fund including equities, fixed income and other investments.
  - All assets of a fund are fairly and accurately valued in good faith and in the best interests of investors
  - The Manager should establish comprehensive, documented policies and procedures to govern the valuation of assets of a fund
  - More information available on https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC92

Expanded Valuation Expectation from Regulators (Local)

Singapore Exchange (SGX) Regulation has signed an agreement with the Institute of Valuers and Appraisers of Singapore (IVAS) so that SGX may approach the institute if it needs advice on valuation concerns of listed companies or those applying to get listed.

In August 2012, Monetary Authority of Singapore (MAS) announced regulation that Fund Management Company (FMC) to ensure that Assets Under Management (AUM) are subject to independent valuation and customer reporting.

The requirement for independent valuation may be satisfied by having:

I. a third-party service provider

II. an in-house fund valuation function that is segregated from the investment management function.

Questions?

Agenda

Case Study A - Convertible Bond

Transaction

- $ 10 million shares of common stock @ $5
- Convertible Bond
  - Par Value $ 72 million
  - Term 7 years
  - Cash Interest Coupon 1.5%
  - Convertible into 10 million shares at $7 strike price

Loan to Management

- Par Value $ 50 million
- Term 5 years
- Secured by Management's common stock & personal assets
- If investor receives 8% IRR, No interest
- If investor does not receive 8% IRR, 2% PIK interest

Total Investment $ 172 million ($50 Common Stock + $ 72 Conv. Bond + $50 Mgt. Loan)

Questions:

- How should Fair Value be determined at future measurement dates? How to Calibrate?

Case Study A - Convertible Bond (cont'd)

Calibration

- Is $ 172 million transaction at Fair Value?
- Disaggregate transaction price into components:
  - Common Stock: P*Q = $ 50 million
  - Option: Option Model = Fair Value $ 26 million
  - Determined that Repayment Risk of Bond and Management Loan were equivalent given underlying company performance provides repayment support; therefore, combined fair value of Bond (excluding option) and Mgt. Loan is $ 96 ($ 72 face + $ 50 face - $26 option)
  - Assessed probability of PIK interest being received
  - Modeled combined cash flows (using probability weighted PIK Interest for mgt. loan) with $ 96 initial fair value to determine implied yield at entry = 6.2%
  - Calculated Fair value of Bond and Mgt. Loan using expected cash flows discounted at 6.2%
    - Fair Value of Bond $ 54 million
    - Fair Value of Mgt Loan $42 million

Summary – Fair Value at inception

- Common Stock $ 50 million
- Option $ 26 million
- Bond $ 54 million
- Management Loan $ 42 million
- Total $ 172 million

Case Study A - Convertible Bond (cont'd)

Fair Value at Subsequent Measurement Dates:

- Common Stock Valued @ P*Q
- Option model updated to determine Value of Option
- Expected Cash flows updated for Bond
- Probability of achieving 8% IRR hurdle reassessed
- Expected cash flows of Mgt. Loan updated based on probability of PIK payment
- Discount rate updated
  - Initial Discount Rate Calibration 6.2% yield= 7-year swap rate of 2%, plus spread of 4.2%
  - Subsequent Discount rates calculated as:
    - Updated swap rate
    - Plus 4.2% spread
    - Plus, additional risk
- Expected Cash flows for Bond and Mgt. Loan discounted at updated Discount Rate

Case Study B - Actively Traded Securities

Publicly Traded Security ABC

- Fund Purchases 85% of outstanding shares of ABC at an average price of $ 6.
- 10% of ABC shares are owned by 2 hedge funds
- Remaining 5% of ABC shares are actively traded (trades occur every day), but volume is thin (hedge funds appear to be holding out for a premium price).
- Market Price (given thin volume) is $ 4.
- Fund plans to exit investment through sale to a strategic buyer (95% of prior PIPES have been exited in such a fashion)

Fair Value Determination?

- Multiple of EBITDA
- P times Q using $ 4 market price?
- Consideration of control?
- Other?

Case Study C - Use of Pricing Services: Broker Quotes

For infrequently traded securities, such as structured products (CDO’s ,CLO’s etc.):

- Are broker quotes sufficient to estimate Fair Value?
- Should broker quotes be based on contemporaneous trade data?
- What “level” is appropriate when using broker quotes (Fair Value Hierarchy Level 1, 2, or 3)?
- When should Models be used?
- Who should prepare and review a valuation Model?

Case Study D - Highly Leveraged Buyout

Buyout Fund Invests $100 for 100% of the Equity of Highly Leveraged Portfolio Company (HLPC)

- $100 EBITDA at date of acquisition, October 2018
- Debt $900; implied acquisition multiple of 10.0x

Mezzanine Fund provides entire debt financing of $900 at 10% fixed rate.

At December 2018 EBITDA is $50.

Using entry multiple of 10x, Enterprise value is $500.

Market rate of interest has decreased to 8%

Case Study D - Highly Leveraged Buyout (cont'd)

How should each security be valued at December 2018?

Buyout Fund Equity

- At 0 (debt exceeds enterprise value)?
- At $100 (not much time has passed, and investor expected low performance in early years)?
- Some Other Value?

Mezzanine Fund Debt

- $ 500 (utilizing the enterprise method)?
- $ 300 (estimated liquidation value)?
- $ 1,000 (adjusted for decrease in interest rate; investor expected early losses)?
- Other?

LP Valuation Exercise - A

ABC Fund

- Audited GAAP Financial Statements
- Policy to Record Investments at Fair Value
- Uses Third Party Valuation Expert to Validate Fair Value Estimates
- Schedule of Investments shows:
  - 3 investments at cost
  - 4 investments greater than cost
  - 1 investment less than cost
  - 1 investment written off
- Investment letter/ Annual Accounting Information provides description of steps taken to reach FV

How does LP determine Fair Value ?

LP Action – Determines that ABC Fund's reported NAV is based on the Fair Value of Underlying Investments . NAV can be used as the LP Fair Value Estimate

LP Valuation Exercise - B

XXX – Fund

- Audited GAAP Financial Statements
- Policy to Record Investments at Fair Value
- Schedule of Investments shows 10 investments aged 6 months to 6 years
- All investments are held at cost
- Annual Meeting Presentation and LP letter give “true fair value” information

How does LP determine Fair Value ?

LP Action

- Ask for NAV derived from “true fair value”
- Ask for basis upon which “true fair value” was determined
- If reasonable, utilize “true fair value” based NAV rather than audited value (cost)

LP Valuation Exercise - C

ZZZ Fund

- No Audited GAAP Financial Statements
- Policy to Record Investments at cost
- Schedule of Investments shows 10 investments aged 6 months to 6 years
- All investments are held at cost

How does LP determine Fair Value ?

LP Action

- Call GP and get Fair Value information
- If GP says "no" – check if portfolio companies are held by other funds—use their valuation as appropriate
- Determine if information is available from quarterly letters, etc. for LP to determine Fair Value

If no Fair Value data is available, (depending on materiality) audit opinion could be impacted

- LP would need to estimate the fair value of each underlying investment, or
- LP would need to model all Fund Cash flows and discount at an appropriate rate

Where can we find Alternative Asset Fair Value Guidance?

- IPEV Valuation Guidelines (www.privateequityvaluation.com)
- PEI: Private Equity Valuation: The Definitive Guide to Valuing Private Equity
- AICPA Valuation and Accounting Guide: Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies
- AIMA AICPA TIS 2220 Long Term Investments (provides guidance on using NAV for valuing an LP interest
- AICPA TIS Section 6910:34 Application of the Notion of Value Maximization for Measuring Fair Value of Debt and Controlling Equity Positions
- AICPA TIS Section 6910:35 Assessing Control When Measuring Fair Value
- Kroll and other experienced valuation service providers

Questions?

David L. Larsen, CPA/ABV/CEIV

Managing Director, Alternative Asset Advisory Services

Kroll
+1 415 693 5330
David.Larsen@kroll.com

David Larsen is a Managing Director in Alternative Asset Advisory service line of Kroll. He has more than 38 years of transaction and accounting experience. He specializes in fair value accounting issues, and specifically in valuation, accounting, and regulatory issues faced by Alternative Asset managers and investors.

David advises leading Private Equity Managers and Institutional Investors and has advised numerous strategic and private equity acquirers in all areas of mergers, acquisitions, joint ventures, divestitures and valuation related maters. He provides valuation policy and process assistance to a number of the world's largest institutional limited partner investors and some of the world's largest alternative Investment managers. David is a member of the International Valuation Standards Council Standards Review Board, an advisor to and has served as Vice Chair of the International Private Equity and Venture Capital Valuations Board (IPEV), which in 2018 released updated International Private Equity Valuation Guidelines and serves as a member of the American Institute of Certified Public Accountants (AICPA) PE/VC Practice Guide Task Force. David has served as a special advisor to the Institutional Limited Partners Association; board member, project manager and technical advisor to the Private Equity Industry Guidelines Group and was instrumental in developing and drafting the Private Equity Industry Guidelines Group's Valuation and Reporting Guidelines; member of the Financial Accounting Standards Board's Valuation Resource Group responsible for providing the Board with input on potential clarifying guidance on issues relating to the application of the principles of FASB ASC Topic 820 (formerly SFAS No. 157), Fair Value Measurements and a member of the AICPA Net Asset Value Task Force.

Prior to joining Kroll, David was a Partner in KPMG LLP's Transaction Services practice, where he was the segment leader of KPMG's U.S. Institutional Investor practice. He served 13 years in KPMG's Seattle, Düsseldorf and Prague audit practices prior to moving full time to advisory work.

David received his M.S. in accounting from Brigham Young University's Marriott School, his B.S. in accounting from Brigham Young University. He is a certified public accountant licensed in California and Washington. David is also a member of the AICPA and the California and Washington Society of Certified Public Accountants and is a FINRA Series 7, 24 and 63 registered representative.