The Appraisal Practices Board
Working Group 3 –
The Measurement and Application of Market Participant Acquisition Premiums
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June 13, 2013

RE: Discussion Draft -- The Measurement and Application of Market Participant Acquisition Premiums

Dear Working Group Members,

The International Private Equity and Venture Capital Valuation Board (IPEV Board) appreciates and welcomes the opportunity to respond to the Board's Discussion Draft. There is great importance for the private equity investment community to be able to obtain and rely on consistently determined fair value estimates. Fair Value Measurement is a subject area where preparers, users, auditors and valuers face challenges in both estimating and understanding true measures of value.

The International Private Equity and Venture Capital Valuation Guidelines (IPEV Valuation Guidelines), launched in March 2005 last revised in December 2012 (available at www.privateequityvaluation.com), provide the private equity industry with best practice in consistently estimating the fair value of investments compliant with IFRS and US GAAP. Valuation guidelines are used by the private equity and venture capital industry for valuing private investments and provide a framework for fund managers and investors to monitor the value of existing investments. The IPEV Valuation Guidelines have been endorsed by 42 private equity and venture capital associations around the world, including the Private Equity Growth Capital Council and the National Venture Capital Association in the United States.

Fundamentally, we believe that the private equity and venture capital industry would be best served if the Board's document were to cross reference the IPEV Valuation Guidelines for industry specific direction. If this is not deemed acceptable to the Board, then we believe our targeted responses to the Discussion Draft may be of assistance.

Our responses to the Discussion Draft are general in nature and are presented with the objective of providing the Board and Working Group with practical input from the perspective of the global private equity industry. Our views should be considered from the perspective of industry best practice used in the private equity and venture capital, and not necessarily from the perspective of a technical independent valuation service provider with a broader audience. Because of the unique nature of the private equity and venture capital industry, in particular regularly valuing illiquid or infrequently traded assets, we can provide the Board and Working Group with our experience of the challenges inherent in exercising judgment to value such assets consistent with the principles espoused by both the IASB and FASB, in this industry segment.

The IPEV Board supports the use of fair value as the best measure of valuing private equity portfolio companies and investments in private equity funds. The following represent our general comments and comments with respect to selected specific questions which pertain to private equity and venture capital. We have not responded to questions we deemed more applicable to general valuation service situations.

General Comments

We appreciate the Working Group's thoughtful approach to the topic of "control premiums." We support the focus on economic reality using market participant perspectives.

The term "control premium" means different things to different people. Further the concept of a control premium may pre-suppose the existence of a minority discount. As more fully described below, market participants in the private equity and venture capital industry do not typically think of value in the context of control premiums or minority discounts. Therefore, it is critical that concepts be clearly defined and articulated such that the use of the term control premium does not force the use of a minority discount and that resultant valuation measurements do not differ from the perspective of market participants.

For the private equity and venture capital industry market participants pay what they pay. They don't identify a price and then add a premium or deduct a discount. Further, while the price paid for an investment may mathematically be more or less than some other price, that fact does not mean that valuation estimates are arrived at using a premium or discount. In addition, for many situations, the price paid by a "control" investor is the same as that paid by a "minority" investor. Artificially imposing or implying the need for a premium or discount when it does not exist in the real transaction world of private equity and venture capital would be exceedingly unfortunate.

Marketability

The concept of marketability and the potential need for a marketability discount is often misunderstood. It should be made clear that ASC 820 and IFRS 13 presume that the marketing period for any asset began sufficiently in advance of the measurement date such that a transaction occurs on the measurement date. Therefore, if marketability is intended to mean the time it would take to effect a transaction; ASC 820 and IFRS 13 do not allow any time related adjustment. The fact that an asset may be illiquid affects its price but does not change the presumption that the asset is sold on the measurement date.

Discussion question regarding lines 939-1042:

Are the concepts in the preceding section consistent with the AICPA Technical Practice Aids TIS Section 6910.34 and TIS Section 6910.35 regarding Investment Companies (issued February 2013). Please elaborate.

We believe that the Discussion Draft is fairly consistent with the AICPA Practice Aids. We do recommend that the Working Group clarify several important matters:

- While the discussion on pages 39-41 is directionally correct, it is not consistent with the way market participants arrive at value. Private equity investors may implicitly consider the impact of enhanced cash flows and their target return objective (cost of capital) when pricing an investment, they do not do so because they may obtain control. It is very common for a group of investors to enter a transaction together where no single investor has control. While the price paid may be more than the actively traded price, for example in a take private transaction, the excess price is not a control premium as no investor has control. However the investors do work in concert with one another to improve performance and accrete value. Further, when two investors purchase a company, one with control and one without control, generally they do not pay different prices. Again, private equity investors do not price or think of transactions from the perspective of a control premium or a minority discount. They determine the price they are willing to pay based on facts, circumstances and return assumptions and then pay that price. Most agreements do not allow disproportionate returns. As such, while one investor may have "control" implicitly for private equity transactions there is no premium associated with control because the "control" investor is aligned with the minority investor and returns are pari-passu.

- Lines 966-976 indicate that investment companies have unique rights and privileges. Fair value should reflect those rights and privileges. Therefore the implication of lines 1006-1007 that the "specific position of an individual investment company" is not relevant, is not accurate. Discrete investments held by various investors incorporate particular characteristics which often are available to all investors in the group.
- The discussion of drag along and tag along rights misses two key points:
    - The fact that rights exist is not sufficient. It should be demonstrated that there is a history of obtaining value from such rights; and
    - Especially for early stage investments, the fact that rights are routinely modified in subsequent financing rounds must be taken into consideration.

The value of individual ownership interests within the capital structure is increasingly becoming an area where different judgments are applied. Fundamentally this is because of differences in opinion related to interpreting unit of account. The IPEV Valuation Guidelines use as their starting point the estimation of enterprise value of an investee company. This is because market participants in the private equity and venture capital space generally consider overall enterprise value as the basis for evaluating the price they will pay both for control and minority investors. Market participants in the private equity and venture capital industry would not comprehend how or why enterprise value would not be a starting point and how or why the value of an investment would not equal the percentage of the enterprise that is owned. Said differently, the concept of a Market Participant Acquisition Premium ("MPAP") as used in the Discussion Draft is not applicable to the private equity and venture capital industry and if applied to the industry would be very confusing. The use of MPAP as described in the Discussion Draft risks creating a scenario where participants in the private equity and venture capital industry create inconsistent valuation estimates for financial statement purposes and then would be required to create a market participant focused valuation estimates for analysis, evaluation and reporting to their investors,

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We appreciate the opportunity to provide the Board with our feedback. We would be pleased to discuss any questions you may have with you. Please direct specific questions to David Larsen, 415-693-5330 or david.larsen@duffandphelps.com.

Very truly yours,

/s/ Emile Van Der Burg

The International Private Equity and Venture Capital Valuation Board

Emile Van Der Burg

Chairman of the IPEV Board

The International Private Equity and Venture Capital Valuation Guidelines

The International Private Equity and Venture Capital Valuation Guidelines (IPEV Guidelines) were launched in March 2005 and were last revised in December 2013 to reflect the need for greater comparability across the industry and for consistency with IFRS and US GAAP accounting principles. Valuation guidelines are used by the private equity and venture capital industry for valuing private equity investments and provide a framework for fund managers and investors to monitor the value of existing investments. The IPEV Guidelines are based on the overall principle of 'fair value' in order to be consistent with IFRS and US GAAP.

The International Private Equity and Venture Capital Valuation Board (IPEV Board) reports and is accountable to a general assembly composed of all the endorsing associations to manage the evolution of the guidelines going forward. The IPEV Guidelines have been endorsed globally by 42 national and regional trade associations, including the Private Equity Growth Capital Council and the National Venture Capital Association in the United States.

For more information: http://www.privateequityvaluation.com.