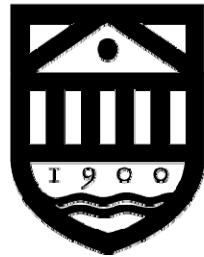


TUCK SCHOOL OF BUSINESS AT DARTMOUTH



CENTER FOR  
PRIVATE EQUITY  
AND ENTREPRENEURSHIP

## **Final Results of 2007 Valuation Survey**

**July 2007**

# Agenda

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# Executive summary

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## The Study

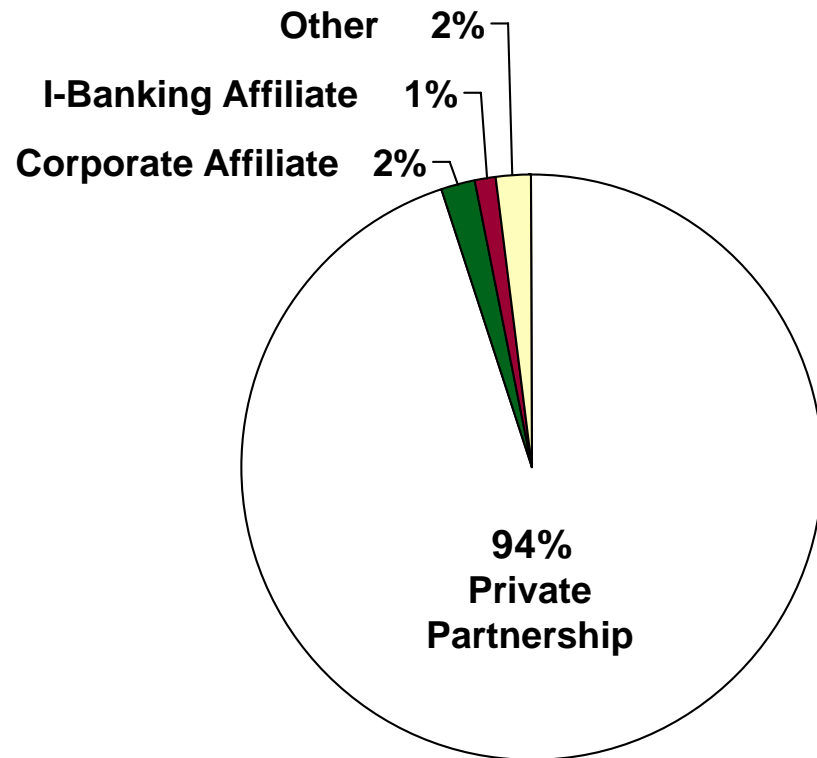
- This report describes the results of the 3<sup>rd</sup> survey conducted by the Center regarding valuation practices in the private equity industry. This survey followed closely the format of the previous 2005 survey with some adjustments based on the increasing influence of FASB's Fair Value Project. Both the 2007 and 2005 surveys sought to address the adoption of industry guidelines, valuation practices, and auditor oversight. The first 2003 survey explored the need for valuation guidelines, identified potential sponsors of a guideline, and measured general awareness of valuation issues.
- 136 private equity funds, from both the venture and buyout perspective, completed the 2007 survey (21% response rate)

## Key Findings

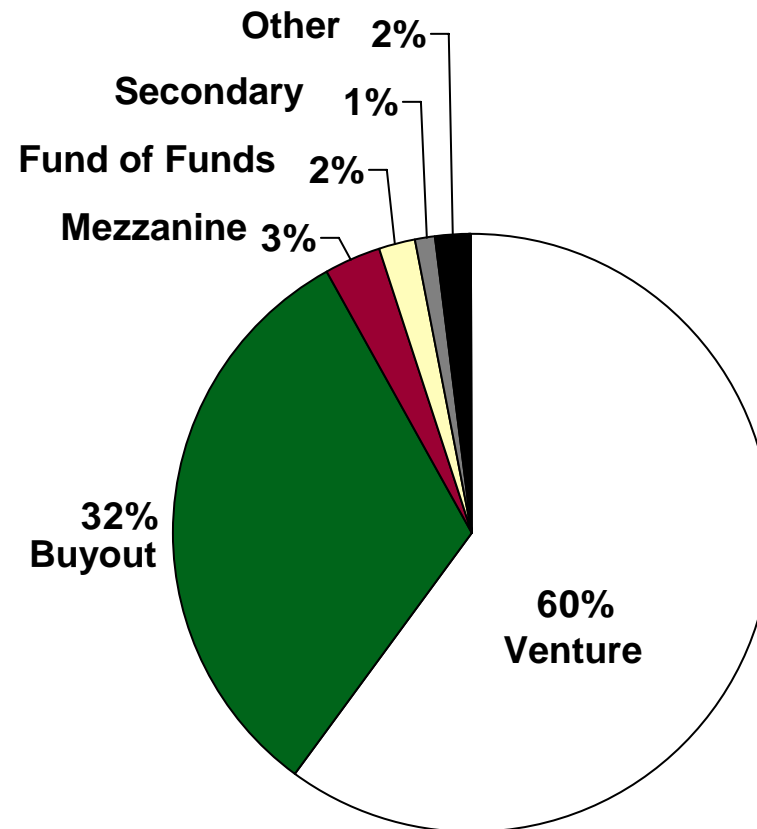
- 42% of all respondents have adopted the PEIGG guidelines (vs. 19% in 2005)
- Buyout firms are adopting PEIGG at a greater rate than venture firms
- 86% of respondents have done or will consider non-round write-ups
- Auditors are paying more attention to portfolio valuation but qualified opinions have not increased significantly
- GPs believe that LPs are increasingly concerned about fair value
- 39% of respondents agree with a potential exception to fair value practice regarding portfolio companies with less than one year of revenues
- A majority of respondents see US and international guidelines converging within 5 years

# Characteristics of valuation survey respondents

*“How would you describe yourself as a sponsor of funds?” (n= 136)*



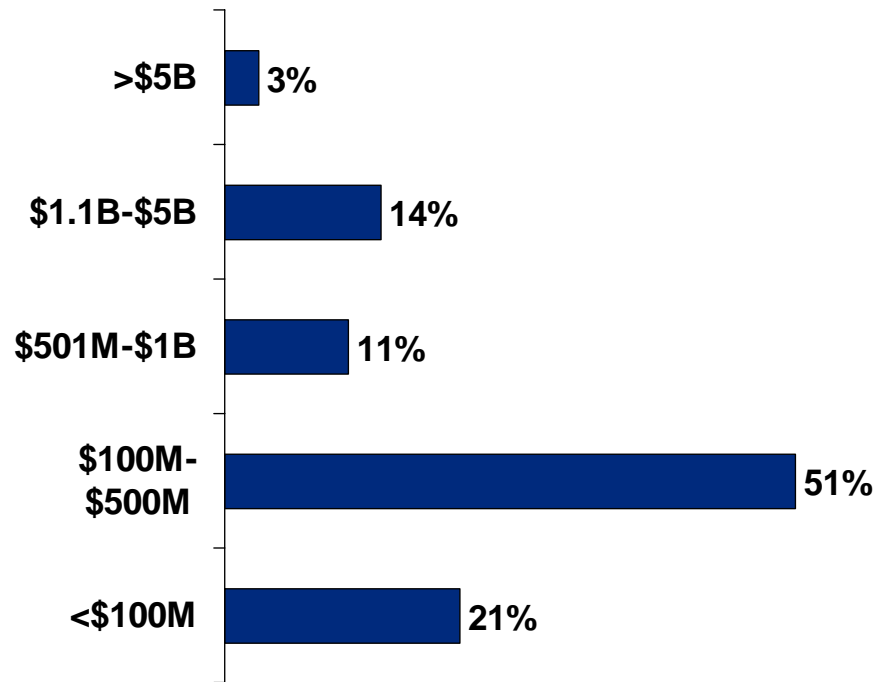
*“How would you characterize the majority of your funds?” (n=136)*



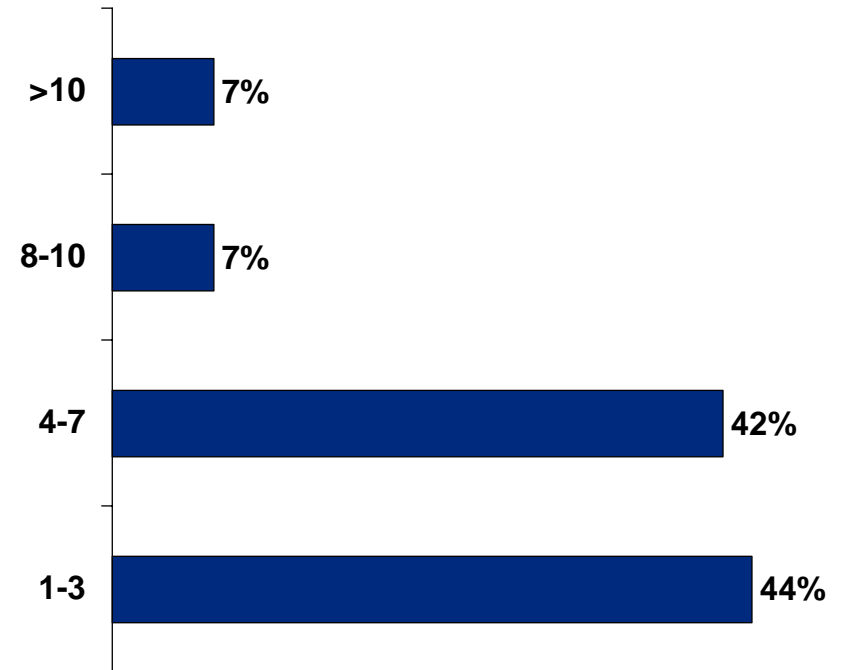
## Characteristics of valuation survey respondents (cont'd)

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*“What is the total committed capital of your most recent fund?” (n=136)*



*“How many total funds has your firm/partnership raised?” (n=134)*

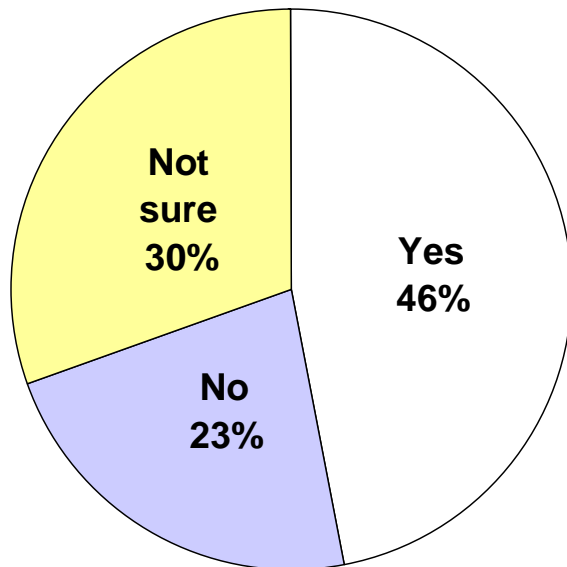


# Opinions on development of guidelines remain consistent

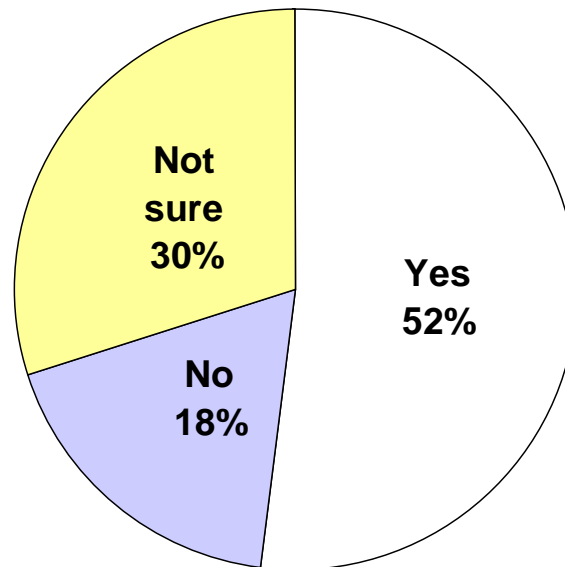
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*“Would you like to see an industry standard for valuation practices?” (n=133 in 2007)*

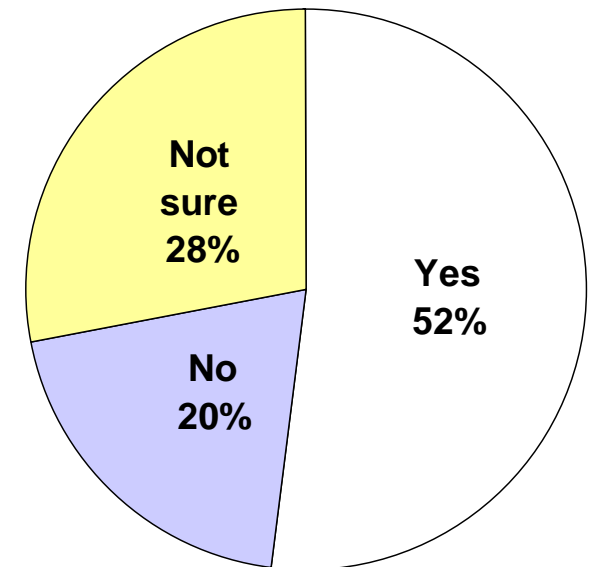
2003



2005



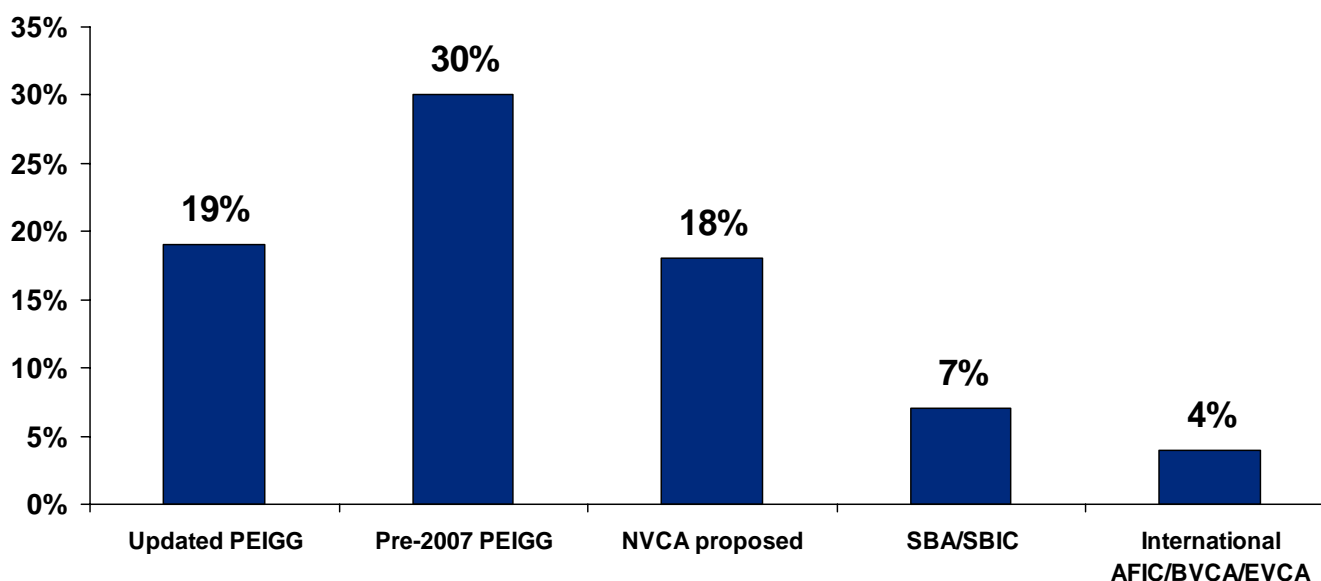
2007



## Formal adoption of guidelines has increased significantly

*“Has your firm formally adopted any of these guidelines or proposed guidelines for valuation? (check any that apply)” (n=108)*

- 42% of the 136 total survey respondents formally adopted the updated PEIGG (2007) guidelines or the original PEIGG (pre-2007) guidelines or both. In 2005 only 19% of 102 total respondents had adopted PEIGG.



Note: For each percentage shown above, 100% = 136 respondents who participated in the survey

Interesting additional responses:

- “We use Mexican GAAP”
- “Our own, which is to under promise and over deliver”
- “Cost for 6 months, then amortize up to outside FMV”

## Buyout firms have adopted PEIGG at a greater rate than VCs

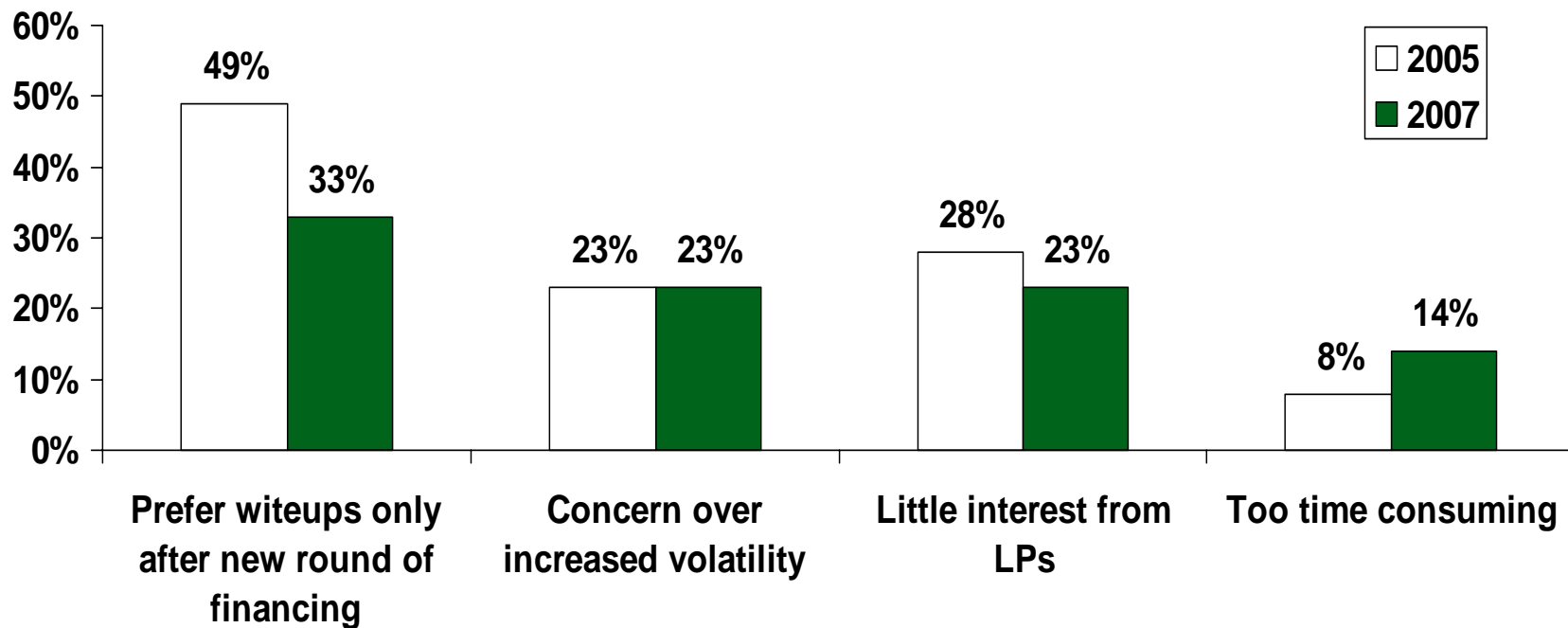
*“Has your firm formally adopted any of these guidelines or proposed guidelines for valuation? (check any that apply)”*

| Adopted                             | Buyout |     | Venture |     |
|-------------------------------------|--------|-----|---------|-----|
|                                     |        |     |         |     |
| <b>2007 PEIGG only</b>              | 5/44   | 11% | 9/82    | 11% |
| <b>Original PEIGG only</b>          | 13/44  | 30% | 15/82   | 18% |
| <b>Both 2007 and original PEIGG</b> | 7/44   | 16% | 5/82    | 6%  |
| <b>Total PEIGG</b>                  | 25/44  | 57% | 29/82   | 35% |
| <b>“NVCA”</b>                       | 2/44   | 5%  | 22/82   | 27% |

Note: The denominator is the total number of respondents (categorized as buyout or venture) who participated in the survey

# Decreasing objection to non-round write-ups

*“If you have not implemented the pre-2007 PEIGG guidelines, please explain why not (check any that apply)” (n=98)*



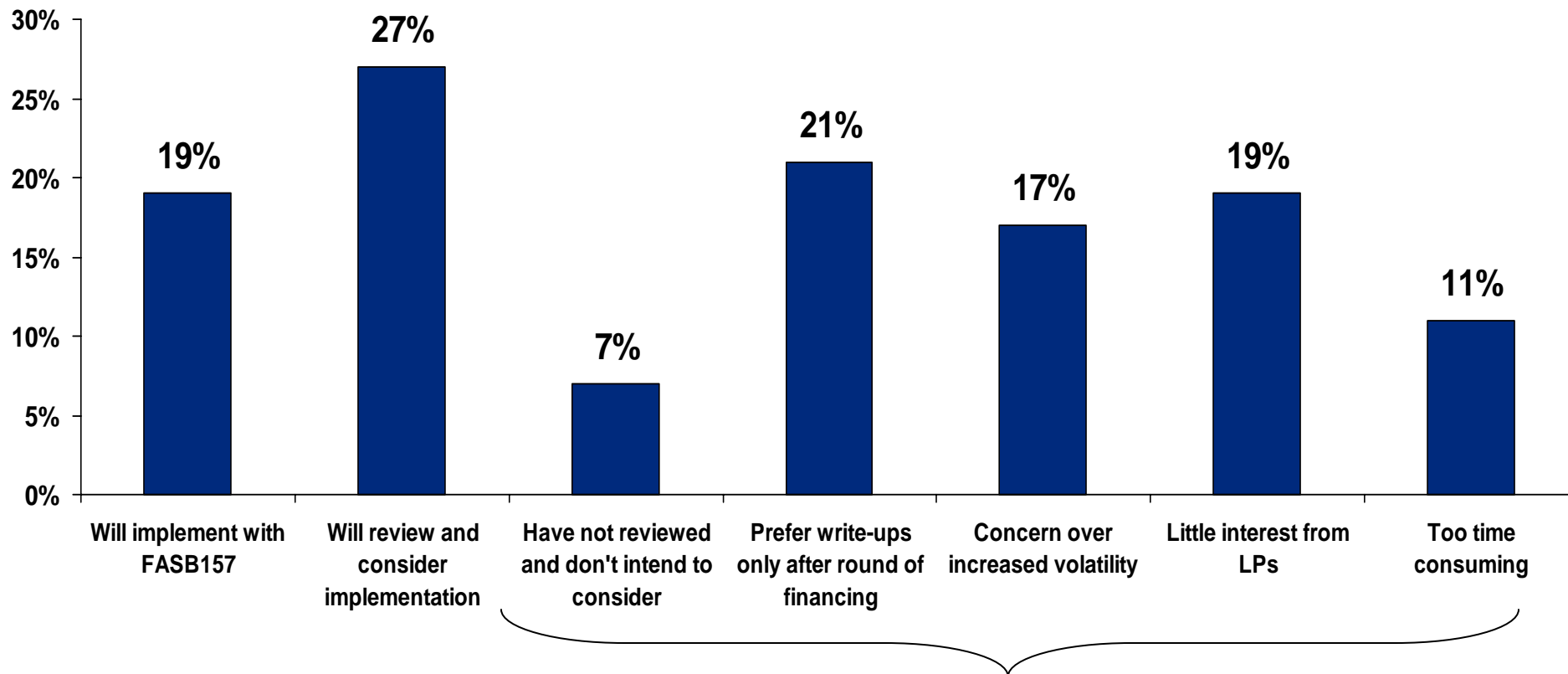
Note: For each percentage shown above, 100% = 98 respondents who answered the question

Other responses included:

- “We use SBA/SBIC guidelines”
- “No materiality threshold”
- “Too speculative and open to gamesmanship”

## 2007 PEIGG guidelines are under review

*"If you have not implemented the 2007 PEIGG guidelines, please explain why not (check any that apply)" (n=113)*



**...but the same issues still have significant presence**

Note: For each percentage shown above, 100% = 113 respondents who answered the question. Percentages will not add up to 100% because respondents could check more than one answer.

## Some resistance to Paragraph 30

- 17% of respondents selected PEIGG’s paragraph 30, specifying non-round write-ups and write-downs under certain circumstances, as the main reason for not adopting PEIGG
- 7% of the respondents adopted PEIGG in principle, except for Paragraph 30

*“What role did PEIGG Paragraph 30 (specifying non-round write-ups and write-downs under certain circumstances) play in your firm’s decision to adopt/not to adopt the pre-2007 PEIGG guidelines or the 2007 PEIGG guidelines?” (n=117)*

|   |      |
|---|------|
| Kept us from adopting   | 10%  |
| We adopted the pre-2007 PEIGG guidelines in principle except for Paragraph 30 | 4%   |
| We adopted the 2007 PEIGG guidelines in principle except for Paragraph 30     | 3%   |
| We would not have adopted either of the PEIGG guidelines anyway               | 25%  |
| No role   | 8%   |
| We adopted pre-2007 PEIGG as written  | 23%  |
| We adopted 2007 PEIGG as written  | 11%  |
| Other   | 15%  |
| Total   | 100% |

Other responses included:

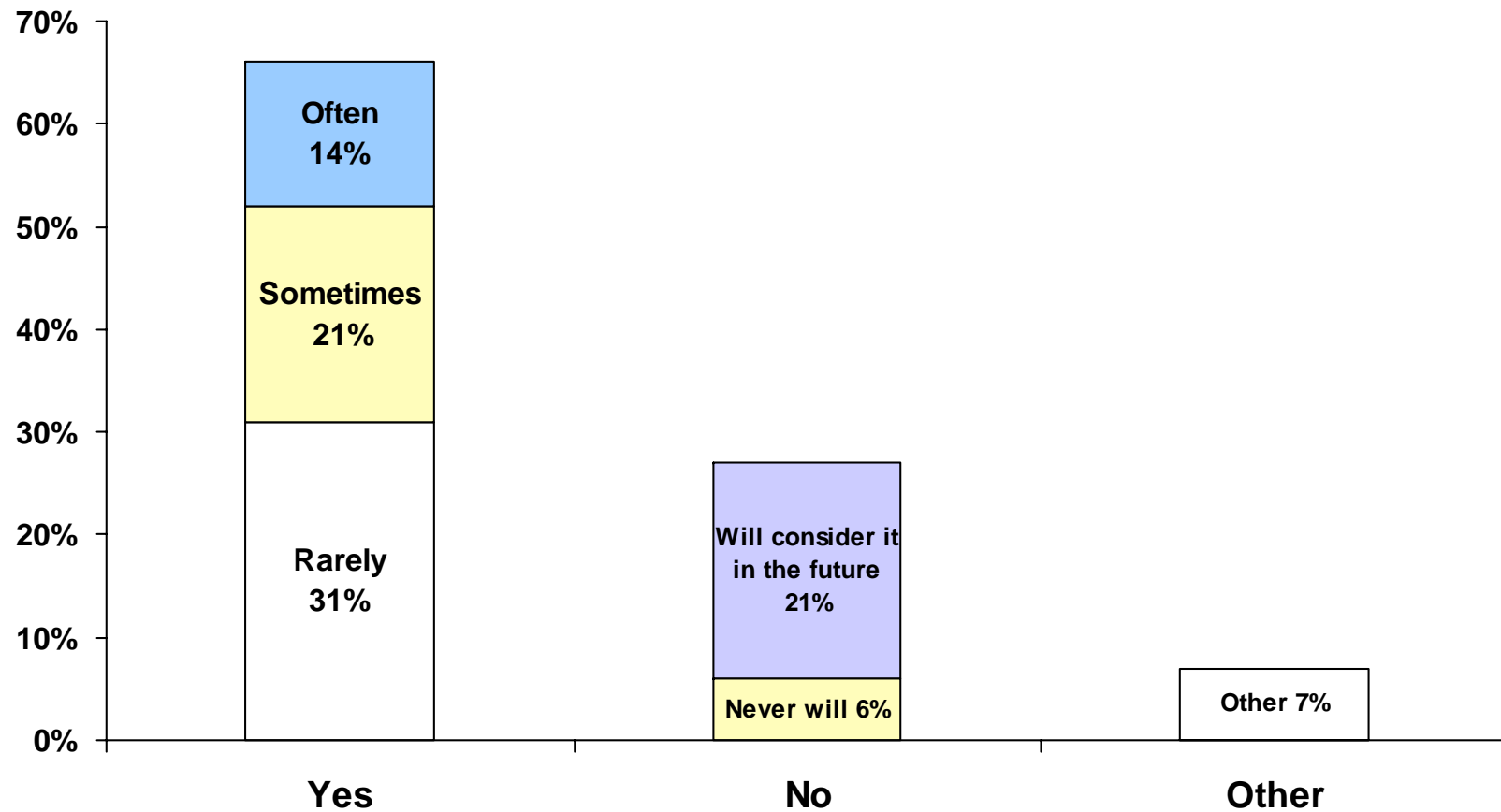
- “Paragraph 30 didn’t stop us, but 157 will make us do it”
- “We adopted FAS157 not using PEIGG as guidance”

Note: For each percentage shown above, 100% = 117 respondents who answered the question

# 86% of respondents have done or will consider non-round write-ups

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*"Has your firm ever done a non-round write-up?" (n=132)*



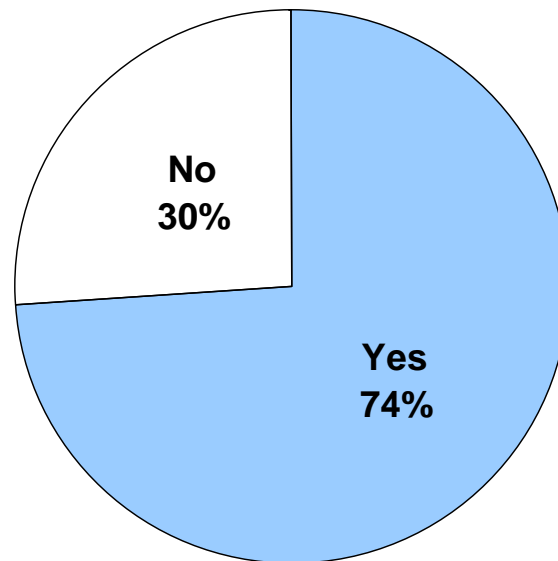
Note: For each percentage shown above, 100% = 132 respondents who answered the question

## Auditors are paying more attention to portfolio valuation

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- Nearly 75% of the survey respondents have received increased attention from their auditor regarding portfolio valuation in FY2006 vs. FY2005
- In the 2005 survey only 52% of respondents expressed increased attention from auditors

*“Have you experienced increased attention from your auditor in FY2006 vs. FY2005?” (n=133)*

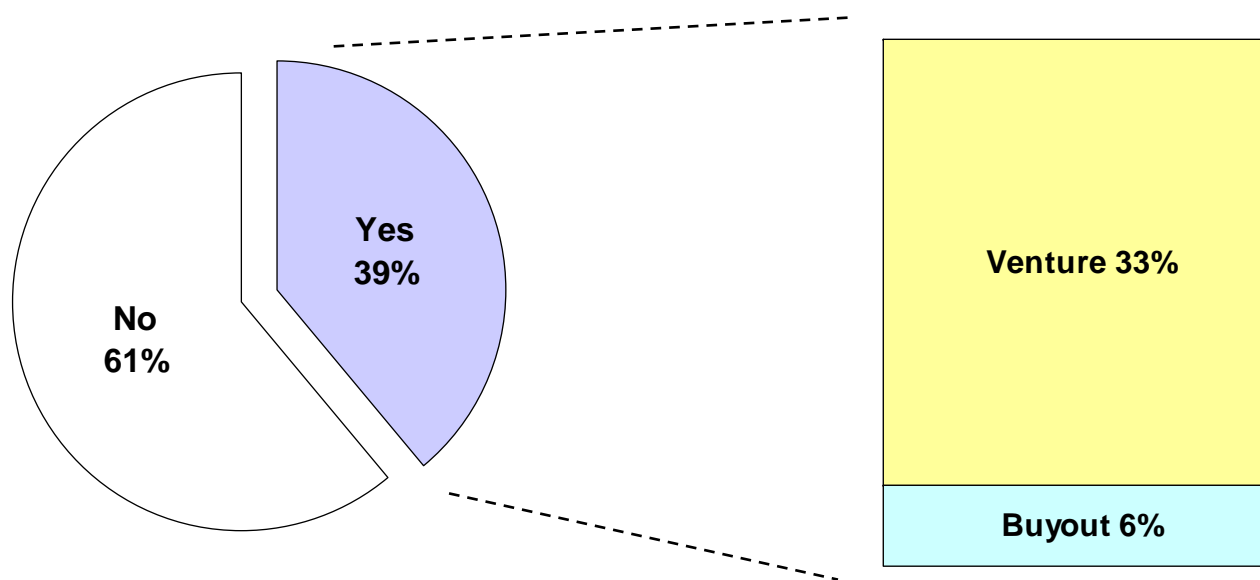


Note: For each percentage shown above, 100% = 133 respondents who answered the question

## Adoption of fair value concepts is taking time

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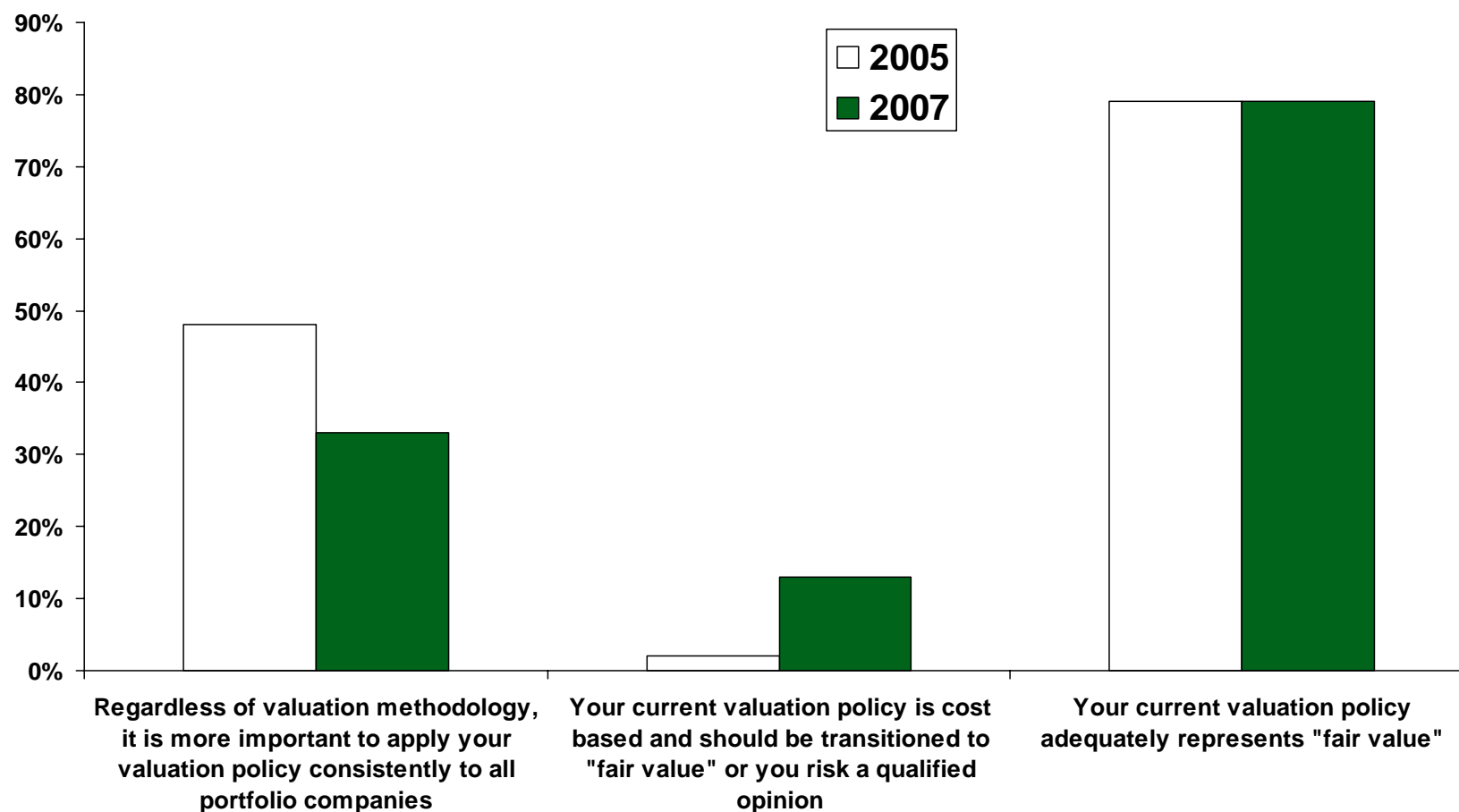
*“If your valuation policy does not allow for non-financing round write-ups, does your independent auditor accept this without qualification as GAAP “fair value”?” (n=69)*



Note: For each percentage shown above, 100% = 69 respondents who answered the question

# Auditors are less about consistency and more about fair value

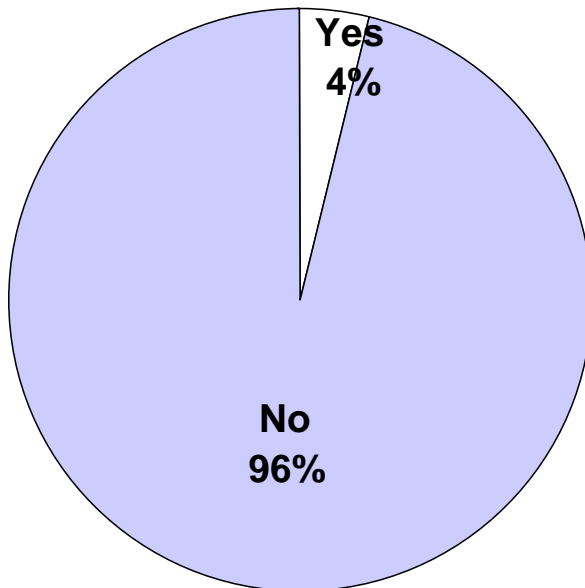
*“What have been your independent auditors' requirements regarding valuation? (check any that apply)” (n=129 in 2007)*



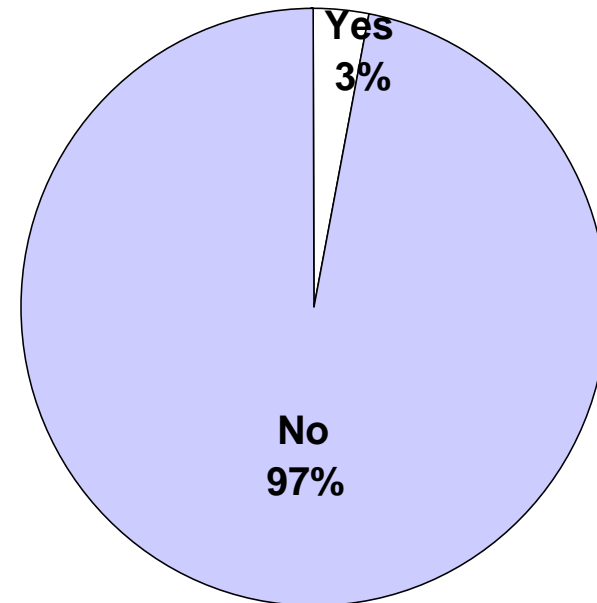
Note: Percentages will not add up to 100% because respondents could check more than one answer

# Qualified opinions are remaining steady vs. 2005 survey results

*“Have you been issued a qualified opinion for FY2005 or FY2006 for not using fair value?” (n=130)*



*“Do you expect to be issued a qualified audit opinion for FY2006 for not using fair value?” (n=130)*

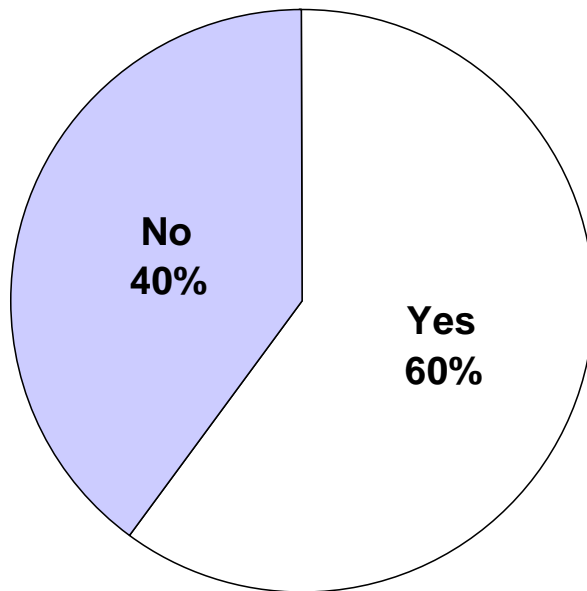


# GPs believe LPs are less willing to overlook qualified opinions

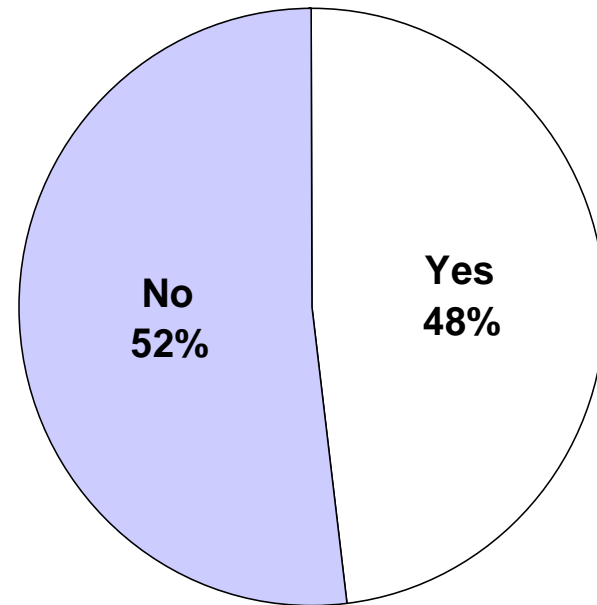
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*“Do you believe limited partners are willing to overlook qualified audit opinions as long as fund performance is satisfactory?” (n=129 in 2007)*

2005



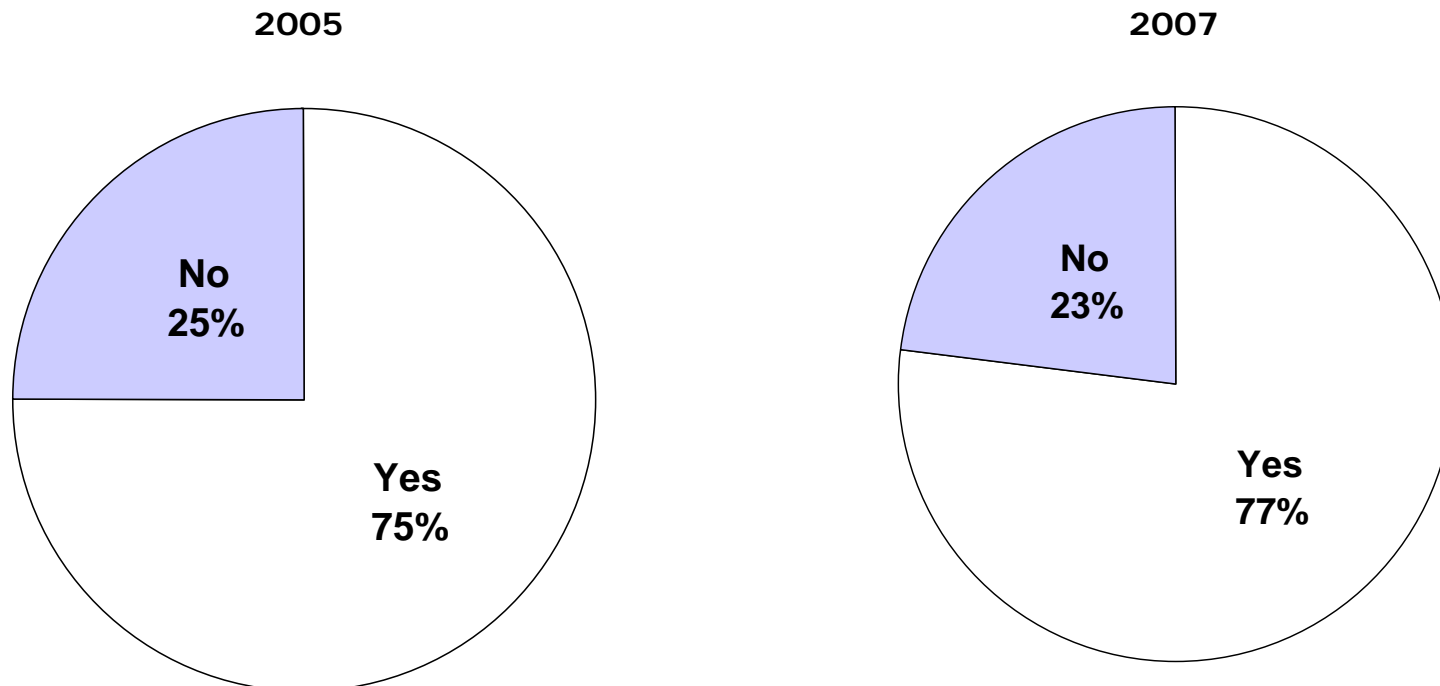
2007



# Continued willingness to modify policy to avoid a qualified opinion

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*“Would you change your valuation policy in order to receive an unqualified opinion?” (n=121 in 2007)*

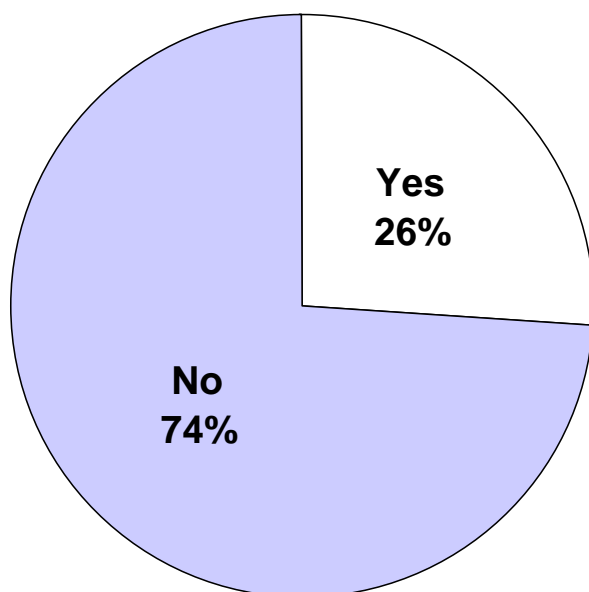


## The use of side schedules continues

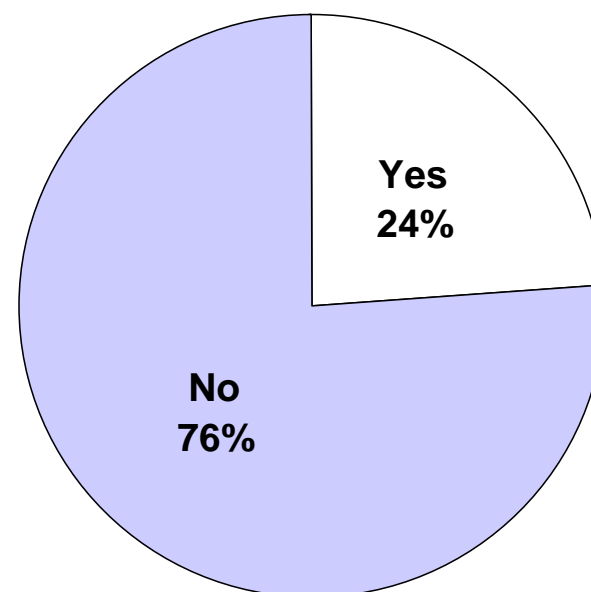
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*“Do you provide your investors with "side schedules" that contain up-to-date valuation estimates that differ from audited financial statements?” (n=131 in 2007)*

2005



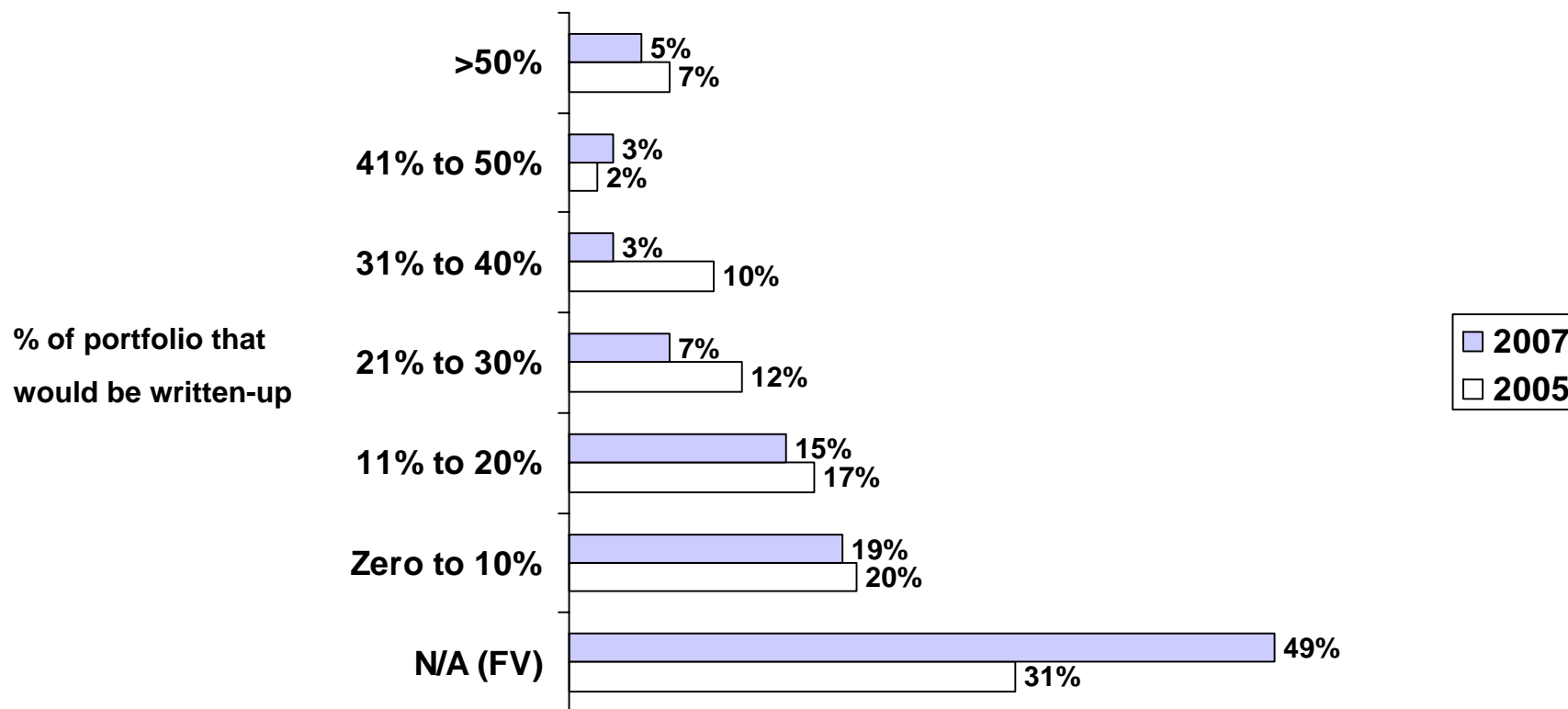
2007



## Fair value will impact portfolio write-ups

- In the 2007 survey, 51% of respondents indicated that at least part of their portfolio would be written up if they were to apply fair value principles. This is down from 69% in 2005.

*“If you only allow write-ups on a new financing round but you were to apply “fair value” principles, on average, what percentage of your portfolio companies would likely be written up that aren't written up now?” (n=116 in 2007)*

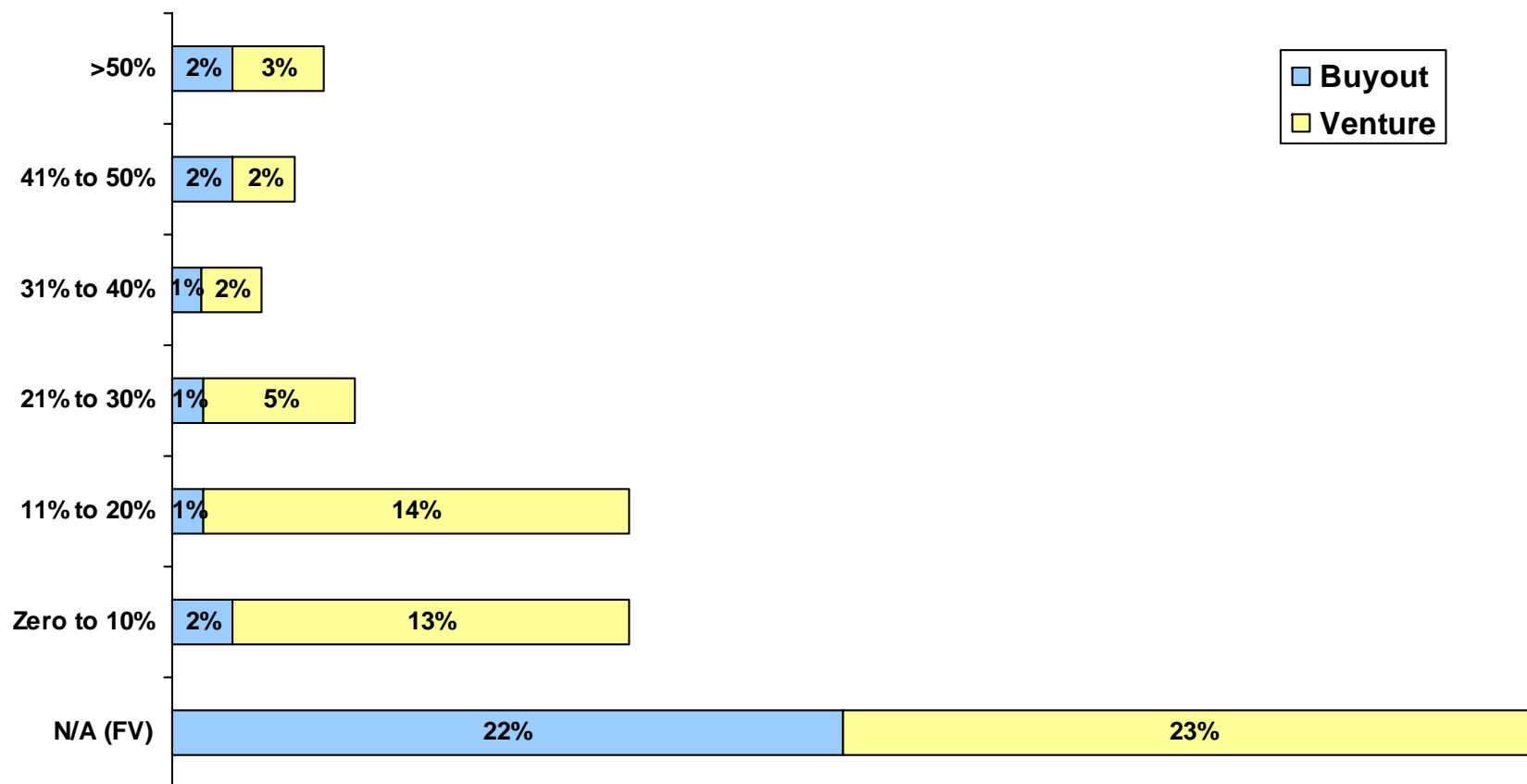


Note: For each percentage shown above, 100% = 116 respondents who answered the question

# Most of the write-ups will be in venture portfolios

*"If you only allow write-ups on a new financing round but you were to apply "fair value" principles, on average, what percentage of your portfolio companies would likely be written up which aren't written up now?" (n=117)*

% of portfolio that would be written-up

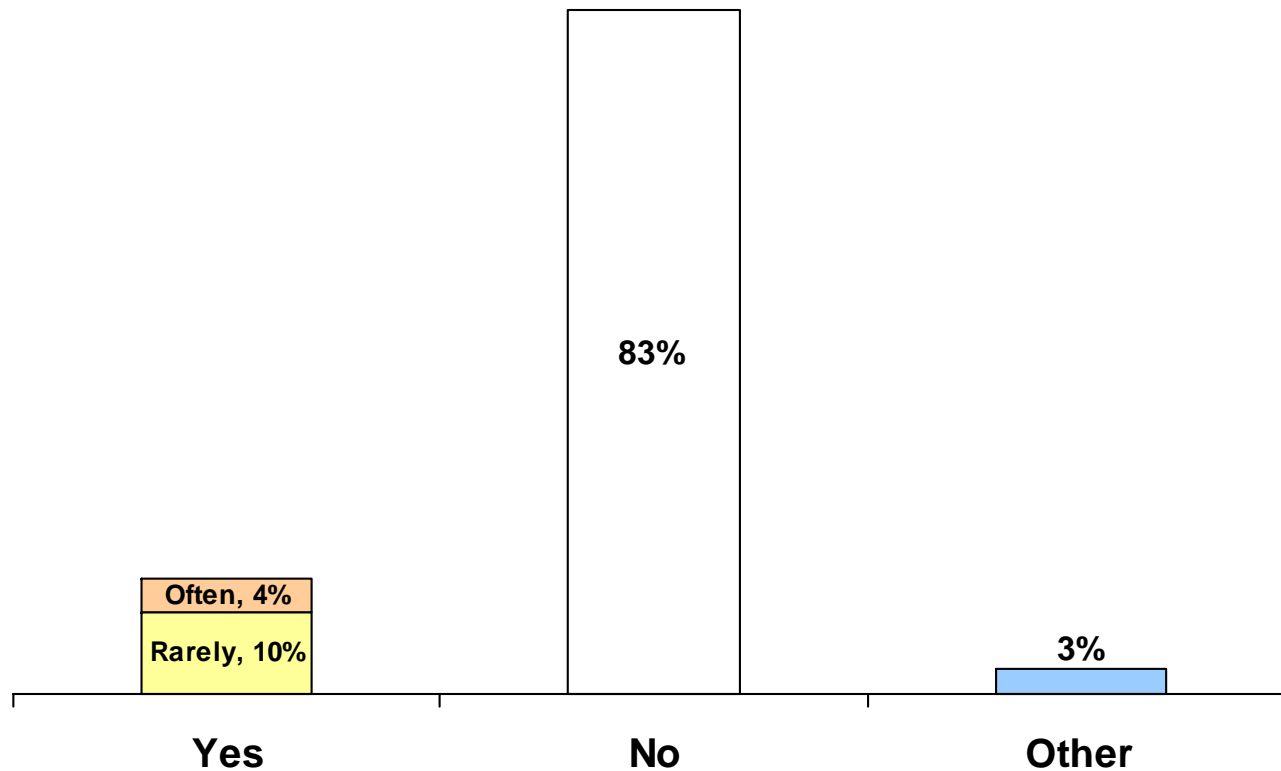


Note: For each percentage shown above, 100% = 117 respondents who answered the question

# Use of third party portfolio valuation services is rare

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“Do you use third party services for your portfolio valuations?” (n=133)



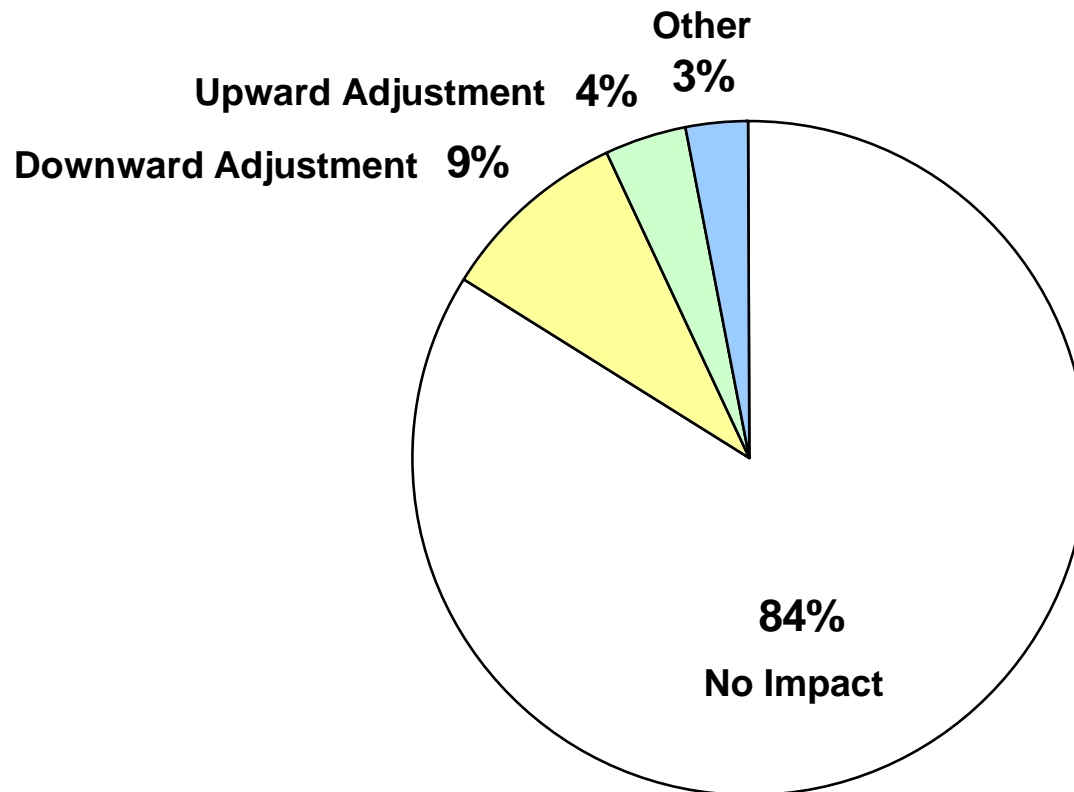
“Other” responses mention  
409a requirements

Note: For each percentage shown above, 100% = 133 respondents who answered the question

# FASB 157 transaction cost rule will not affect carrying values

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*“How will the FASB 157 requirement to ignore transaction costs impact your carrying values?” (n=129)*

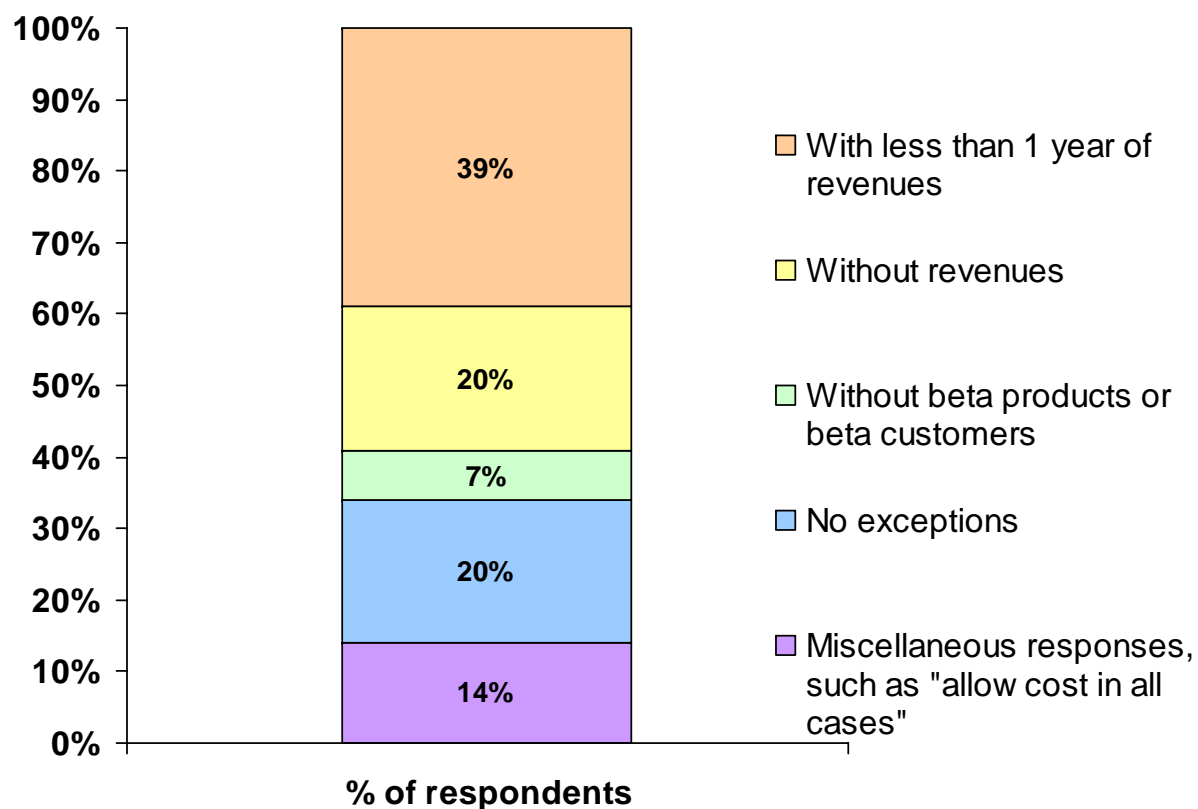


Note: For each percentage shown above, 100% = 129 respondents who answered the question

## Some interest in the concept of exceptions to fair value

*“Regarding the idea of FASB making an exception to fair value practices and FASB 157 for valuing early stage companies, with which of the following do you agree the most” (n=122)*

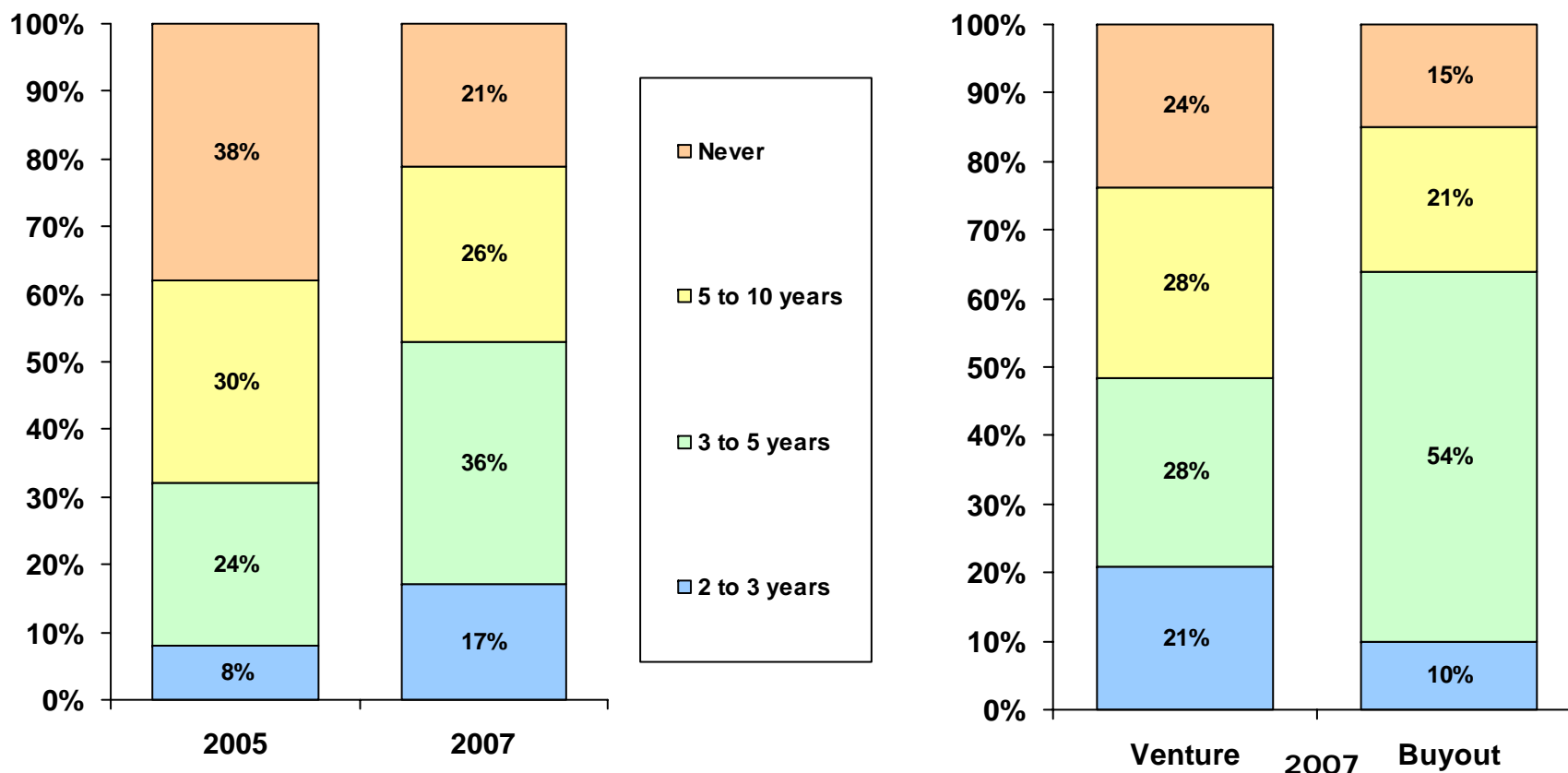
FASB should make exceptions to fair value practices for early stage companies...



Note: For each percentage shown above, 100% = 122 respondents who answered the question

# Convergence of PEIGG and international guidelines

*“Considering the increasing globalization of investing and the greater number of cross-border investments, will the International private equity and Venture capital Valuation Guidelines (IPEV) and US industry valuation guidelines (PEIGG) converge?” (n=121 in 2007)*



Notes: 1) For the 2007 column above, 100% = 121 respondents who answered the question

2) For the 2007 venture column on the right, 100% = 72 venture respondents who answered the question

3) For the 2007 buyout column on the right, 100% = 39 buyout respondents who answered the question

# About the Center for Private Equity and Entrepreneurship

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The Center for Private Equity and Entrepreneurship aims to produce practical and insightful global private equity and entrepreneurship research and education. The Center is an independent source of information on best practices and trends in private equity and entrepreneurship. It covers both macro and micro issues relating to private equity in areas such as capital markets, financing structures, governance and entrepreneurship. The Center is actively involved in the practitioner communities of private equity and entrepreneurship, both to gain information about current trends and challenges and to share insights and solutions. The Center interacts with institutional investors, venture capitalists, buy-out investors, corporate venturers, angel investors, entrepreneurs, portfolio companies, industry lawyers and accountants, industry associations, and the media.

A thought leader in the fields of private equity and entrepreneurship, the Center's work is represented in prestigious publications and industry conferences. The Center is a regular contributor to the *Venture Capital Journal*, a leading industry magazine, and its directors are sought as authorities by top business publications, such as *The Wall Street Journal* and leading television media such as *CNBC*. The Center seeks to educate Tuck students in private equity investing and entrepreneurial management through such courses as Private Equity Finance and Advanced Entrepreneurship and through supporting internships, fellowships and independent studies.

For additional information on the Center for Private Equity and Entrepreneurship please visit: [www.tuck.dartmouth.edu/pecenter](http://www.tuck.dartmouth.edu/pecenter)

# Acknowledgements

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- The development of the survey questionnaire, analysis of the survey data, and presentation of the survey results were conducted by:
  - Adjunct Associate Professor Fred Wainwright
  - Professor Colin Blaydon
  - Research Assistant Joaquin Villarreal
  - Research Assistant Jenna Atwood
- The Center wishes to thank Joaquin Villarreal and Jenna Atwood for their work in analyzing survey data and coordinating survey operations.