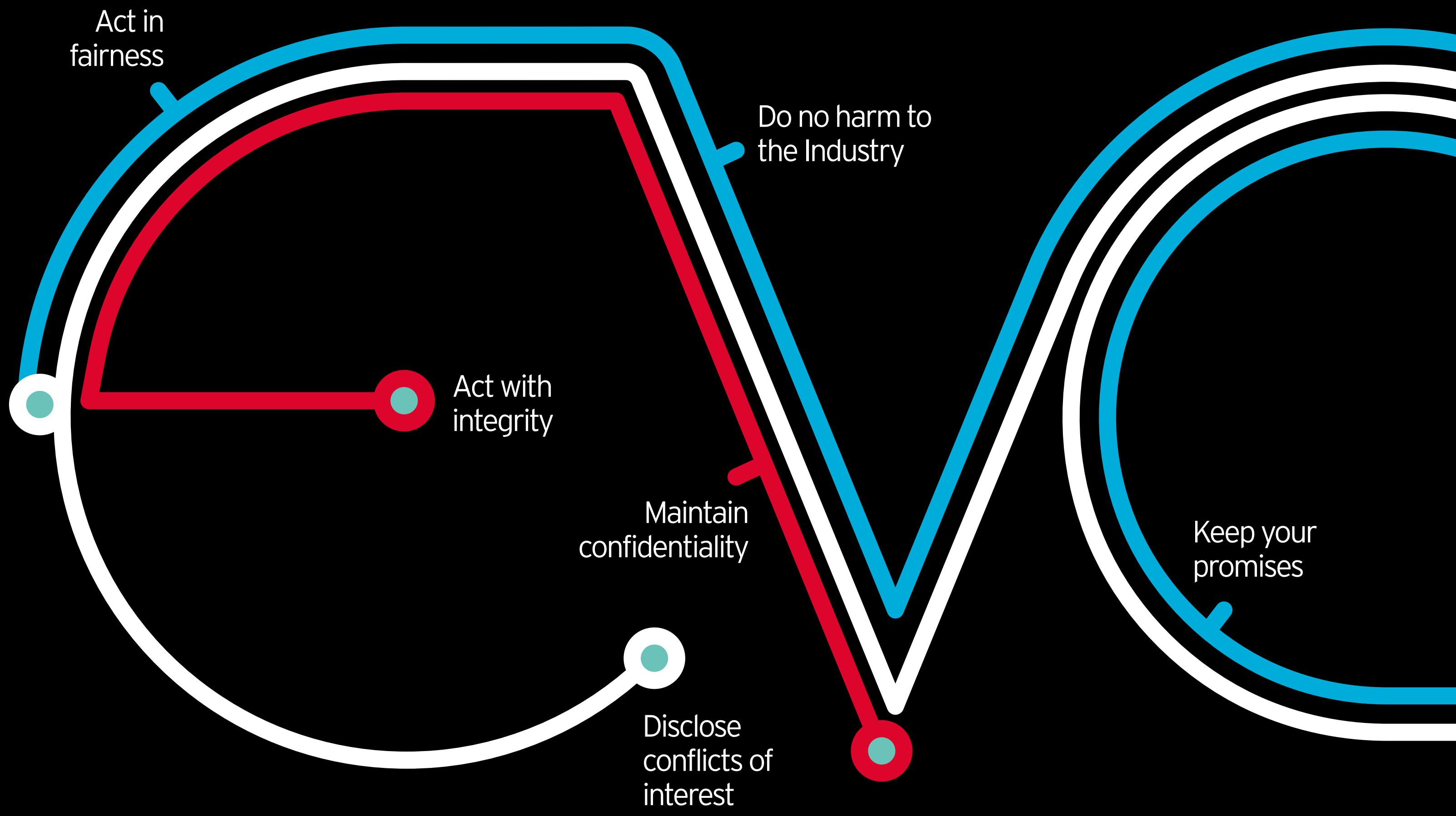
EVCA Handbook

Professional Standards for the Private Equity and Venture Capital Industry

Edition January 2014



EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL ASSOCIATION

Table of contents

The EVCA is the pan-European industry association for investors and managers in the Private Equity and Venture Capital Industry. Its membership represents the full range of Private Equity activity, from early-stage Venture Capital firms to the largest Private Equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices, as well as welcoming associate members from related professions.

Introduction to the Handbook
The Promotion of Professional Standards

The EVCA promotes the highest ethical and professional standards within the Private Equity and Venture Capital Industry.

This Handbook brings together the key elements of governance, transparency and accountability that are expected of Industry participants. It provides accessible, practical and clear guidance on the principles that should govern professional relationships between all those engaged in the Industry, with a particular focus on the relationship between GPs and their LPs, and between GPs and their Portfolio Companies. The GP/LP terminology used in this Handbook is explained under the heading The long-term partnership between GPs and LPs.

In addition, the Handbook includes the core financial recognition and reporting requirements for Private Equity Funds, in the form of the IPEV Valuation and IPEV Investor Reporting Guidelines, as also endorsed by the EVCA, as well as the Code of Conduct for Placement Agents so as to provide an efficient "one stop" location for all aspects of Professional Standards.

Our high ethical standards
Ethical behaviour is fundamental to the success of our Industry. Industry participants operate in an environment of trust. GPs and LPs within the Industry are entitled to expect their peers and Portfolio Company co-investors to act in accordance with the highest ethical and professional standards and are expected to behave in a similar manner towards Portfolio Companies, service providers and other stakeholders. Further, in order to ensure sustainable and equitable conditions for the Industry across Europe, it is in members' best interests to promote confidence in the Industry for the public at large. EVCA membership creates a responsibility to act in a manner that is both ethical and beneficial to the interests of the Industry and its stakeholders.

Observance of the standards set out in this Handbook enables the EVCA to better represent the interests of its members.

Our Industry is based on an active investment and ownership model involving two key relationships:

1. The long-term partnership between GPs and LPs
Private Equity and Venture Capital is foremost a co-investment and ownership model for investments in unlisted (privately held) companies of all sizes and at all stages of development. Typically the Funds raised for such investments are structured as closed-ended Limited Partnerships. The investors are the limited partners, and are referred to as the LPs, and the investment manager is the general partner, and is referred to as the GP. While other legal forms are also commonly used – for the sake of simplicity, the terms GP and LP are used generically throughout this Handbook whatever the legal structure of a particular Fund.

The nature of the long-term partnership formed through negotiations between GPs and LPs is fundamental to how the Industry operates and is what sets it apart from other asset classes. Private Equity Funds typically have a lifespan of at least 10 years. During the life of a Fund the GP and LPs actively engage to ensure high professional standards are followed in all aspects of the investment and management of the Fund. LPs demand accountability, transparency and alignment of interest from the GPs and the GPs demand accountability, transparency and timely engagement from the LPs.

2. The active and responsible ownership of Portfolio Companies by GPs
Private Equity is generally characterised by a high level of engagement between the GPs and the Portfolio Companies. GPs are able to bring not only investment capital, but also experience and knowledge as well as networks to the Portfolio Companies. GPs play an active role through their board representation in the strategy and direction of the Portfolio Company in order to create lasting value for all stakeholders. Good corporate governance is key to creating lasting value. GPs demand rigorous accountability, transparency (through monitoring and reporting), adoption of best practices and alignment of interest from Portfolio Companies.

An Industry committed to good corporate governance
The Industry has been and continues to be instrumental in developing good corporate governance standards in unlisted companies. Successful investment requires well-informed decision making at all levels and by all parties. At its core, good governance creates alignment of interests and the environment for the attitudes, mechanisms and behaviours that allow this well-informed decision making to take place. Poor governance can lead to misalignment of interests, bad decisions and business failures.

Purpose of the Handbook
This Handbook aims to help members of the EVCA exercise business judgment and act with integrity. Private Equity and Venture Capital investment may give rise to situations in which there is a conflict of interest between various parties involved in a Fund, business, transaction or negotiation. It is the intention of this Handbook that those participants in the Industry who follow the guidance within it will be able to manage such conflicts openly, honestly and with integrity.

This Handbook is drafted so as to be applicable to as wide a range of situations and circumstances as possible, as well as a broad range of investment situations, from seed and development capital to large leveraged buyouts or buy-in transactions. No particular operational jurisdiction is envisaged and therefore references to shareholders, the board and management should be taken as functional titles rather than particular legal structures.

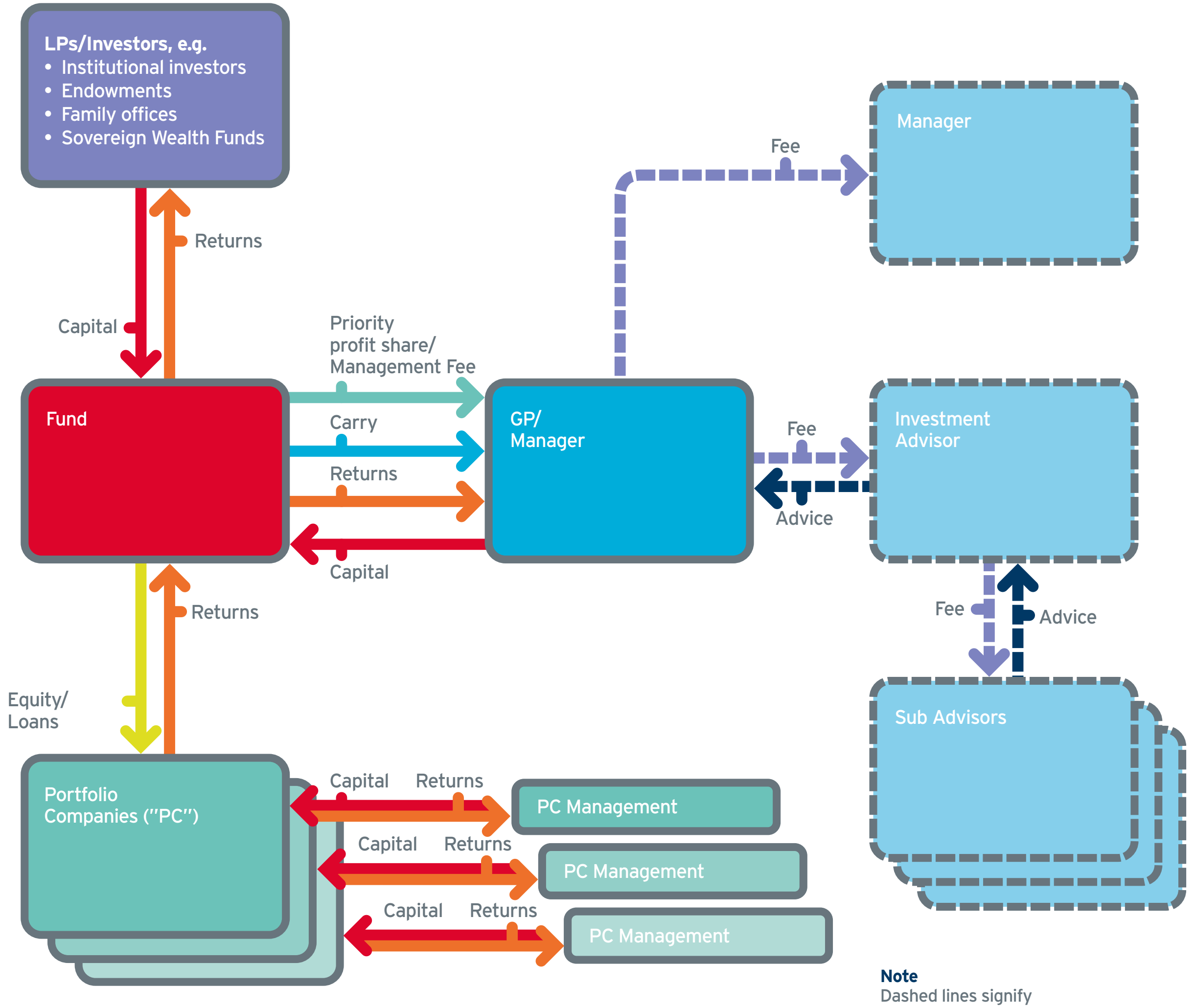
Editing notes
The Handbook is a dynamic document. The EVCA's Professional Standards Committee has responsibility for maintaining the Handbook. The Professional Standards Committee welcomes your feedback and suggestions for editing. Please direct any comments to handbook@evca.eu. The Handbook will be formally reviewed annually. It has most recently been reviewed in January 2014 by the Professional Standards Committee, including member consultation. The EVCA may also issue updates to the Handbook to reflect Industry developments.

History of the Handbook
The Industry's original Code of Conduct, published in 1983, has been developed over the years, having regard to the "Model Code of Ethics: A Report of the SRO Committee for the International Organisation of Securities Commissions (IOSCO)" published in June 2006. This recommends that firms engaged in the financial services Industry adopt as ethical principles Integrity and Truthfulness; Promise Keeping; Loyalty-Managing and fully Disclosing Conflicts of Interest; Fairness to the Customer; Doing no Harm to the Customer nor the Profession and Maintaining Confidentiality.

Current version
The EVCA Handbook integrates all EVCA professional standards documents, namely the EVCA Code of Conduct (October 2008, reprint July 2011), the EVCA Governing Principles (May 2003, updated 2010) and the EVCA Corporate Governance Guidelines (June 2005, updated 2010). These are replaced in their entirety by this Handbook, whose first version was published in January 2013. This version was published in January 2014.

Typical fund structure

The diagram below sets out a typical Fund structure showing the relationship between LPs and GP and Fund and Portfolio Companies. This is illustrative only. There may be variation to this model.



Note
Dashed lines signify optional variations

Section 1
Code of Conduct

Code of Conduct

1 Act with integrity
2 Keep your promises
3 Disclose conflicts of interest
4 Act in fairness
5 Maintain confidentiality
6 Do no harm to the Industry

The Code of Conduct is mandatory for all members of the EVCA.

The objectives of the Code are:

- to state the principles of ethical behaviour that members of the EVCA abide by;
- to assert on behalf of the membership the collective observance of high standards of commercial honour and just and equitable principles of trade and investment; and
- to provide the basis for consideration of, and dealing with lapses in, professional conduct within EVCA membership.

Compliance with the Code is mandatory for all EVCA members and their affiliates and is dealt with through the Professional Standards Committee on behalf of the Board of Directors of the EVCA. In the event of a proven serious case of misconduct by a member, the sanction is expulsion of that member from the EVCA.

Section 2
Commentary on the Code of Conduct

The following section includes commentary which is helpful in the application and interpretation of the Code. Further explanation on how the Code itself can be used in practice is set out in Section 3.

The six principles that comprise the Code stand together as a whole rather than being independent from one another.

A litmus test for application of these six principles is a personal conviction that your actions would stand up to public scrutiny. An alternative test is to judge your actions by reference to whether you would find it acceptable for other parties to pursue a similar course of action under similar circumstances.

2.1 Act with integrity

Integrity is the fundamental building block of trust in business relationships.

Trust is built upon repeated interactions between individuals that involve clarity, reliability and honesty. Integrity implies that competitive advantage and commercial success are derived through the application of superior individual and collective skill and not through the use of manipulative or deceptive devices or practices. The GP will act with integrity towards its LPs, Portfolio Companies and other stakeholders and will seek to ensure that the Portfolio Company conducts its business with integrity. The GP expects the same from its LPs in all areas where they interact. Acting with integrity implies not seeking to evade or avoid the consequences of error.

2.2 Keep your promises

Ethical business behaviour implies keeping promises regardless of whether or not there is a legal obligation to do so.

Within the Industry, commitments are often made subject to the provision of further information, carrying out due diligence, the results of uncertain external events and other matters. This means that clarity about what is actually committed and what is still subject to further investigation is very important.

Promises are made in the light of circumstances which are known at the time that the promise is made. The ethical individual or business only makes promises which they reasonably believe are capable of being fulfilled.

Promises are of equal importance regardless of to whom they are made.

2.3 Disclose conflicts of interest

Conflicts of interest can occur when a person who has a duty to another also has a personal or professional interest that might interfere with the exercise of independent judgment. They inevitably arise within business. A GP should seek to manage conflicts of interest fairly. Where these conflicts of interest affect LPs, the GP should always consult with the LP Advisory Committee as part of this process. Conflicts can arise between the GP and the Fund and its LPs; between different Funds; between different LPs in the Fund; between LPs of different Funds managed by the GP; and between the Fund and other investors in the respective Portfolio Companies. To facilitate the management of conflicts, LPs should ensure they declare their own conflicts of interest in any situation, for example if the LP is an investor in two Funds managed by the GP and one Fund is selling an investment to the other Fund. Conflicts of interest should be diligently identified and disclosed to all parties concerned.

2.4 Act in fairness

Fairness means playing by the rules, whether legislative or not, based on facts and circumstances.

Rules for conducting business in our Industry may vary between countries, regions, societies, legal systems and transactions. It is important that members understand the different rules that apply to their particular business or situation. A GP should pay due regard to the interests of LPs in the Fund taken as a group and should, where relevant, consult with the LP Advisory Committee or all LPs. An LP should pay due regard to the interests of the Fund as a whole and how their individual behaviour may implicate the Fund, the other LPs or the GP. LPs should engage with the GP and other LPs in a timely manner when situations arise which require an LP vote under the Fund documents.

A GP should pay due regard to the information needs of LPs in the Fund, and communicate adequate information to them in a way which is clear, fair and not misleading. Good investor relations for a GP depend upon clear disclosure and timely communication of relevant and material information. The GP will seek to establish transparent communication with Portfolio Company management. LPs should also communicate clearly and promptly with the GP.

2.5 Maintain confidentiality

In the ordinary course of business, individuals and firms will obtain commercially sensitive information from other market participants. The GP will treat Portfolio Company or LP information as confidential and will not make use of that information in a way that is detrimental to the Portfolio Company or LP. LPs should also comply with the contractual requirements to maintain confidentiality, for example on receiving confidential information when carrying out due diligence on a Fund (to which it may or may not decide to commit), or when receiving information as an LP in the Fund.

In an effort to safeguard the commercial interests of disclosing parties, reasonable steps should be taken to protect information from inappropriate disclosure and due care should be taken to follow any agreed procedures.

2.6 Do no harm to the Industry

Success in commercial enterprise requires the pursuit of competitive advantage.

The pursuit of competitive advantage is not in itself harmful to the Industry. Industry members should, however, conduct their business in a responsible manner and not engage in practices that are foreseeably damaging to the public image and general interests of the Industry and its stakeholders. All participants in the Industry should promote best practices for the wider benefit of long-term, sustainable investment, economic growth and value creation.

Section 3
Guidance on the Application of the Code of Conduct: Questions and Answers

Outline

This section of the Handbook is intended to provide illustrations by way of questions and answers both for the establishment and management of a Fund as well as to provide guidance on how the Code may apply during the life cycle of a Fund. In doing so, it takes account of common market practice and corporate governance in the Industry wherever possible.

The illustrations are not intended to be exhaustive or prescriptive. While the questions are intended to provide a useful resource, it should not be assumed that "one size fits all". Some of the scenarios may be inappropriate as a result of the size, nature, local environment and complexity of some GPs' operations. The differing investment objectives of Funds may also mean that the examples are not appropriate to all Funds.

Local legal and regulatory requirements, and the extent to which there are fiduciary relationships and obligations, differ in the various European jurisdictions. The principle is that these legal requirements are observed in all relevant jurisdictions. This document does not describe those requirements or provide a complete or mandatory statement of the duties of those involved in the establishment and management of Funds. It is not a substitute for professional advice, which should still be obtained where appropriate. The Industry participants should also be familiar with and mindful of applicable national and supranational corporate governance guidance.

While endeavouring to reflect anticipated pan-European legislation and regulation, this document does not reflect the impact of differing legal structures used for Private Equity and Venture Capital vehicles. In particular, it is assumed that Funds are being marketed to sophisticated LPs and hence this document does not reflect the large range of legal protections surrounding investments that are marketed to retail investors.

The Q&A covered in section 3, is set out under a number of headings, which are highlighted in the grid. The Q&A itself follows this grid.

3.1 Fund formation

There are a number of factors that the GP's Fundraising Team should consider and address during its initial planning. Doing so will help the Fundraising Team to ensure the GP will be able to operate the Fund with due skill, care and diligence and ensure an adequate level of financial and operational resources for the management of the Fund. A well-structured Fund will be better placed to accommodate different types of LP and also able to maximise any regulatory and tax efficiencies. In this section it is acknowledged that the GP may not be a formed legal entity at the time the Fund launches. The term "Fundraising Team" is used to denote the key persons involved in the Fundraising process and who, once the Fund is formed, will also be closely involved in the Fund throughout its life.

3.1.1. Early stage planning

Question

What issues should the Fundraising Team consider and address during its early stage planning?

Explanation

Appropriate early stage planning of a Fund is vital to its success. It helps to focus the Fundraising Team so that effort and cost are not expended inappropriately. Planning during this stage will normally outline all of the Fundraising Team's activities up to the first closing of the Fund.

Recommendation

The Fundraising Team's early stage planning should address the following issues:

- what the Fund's investment policy, investment objectives and investment strategy will be and, if applicable, deal flow allocation to prior Funds and cross-over Fund investments;
- what minimum and maximum Fund size the Fundraising Team will need to establish to implement the investment strategy;
- what will be the length of the Investment Period and the term of the Fund;
- from what type of LPs the Fundraising Team intends to try and raise Commitments for the Fund and in which jurisdictions those potential LPs are based (as this can impact on the structure(s) to be used);
- consideration of the costs of the Fundraising;
- what human resources the Fundraising Team will need to put in place in order to implement the Fund's objectives, in particular who the relevant investment and industry professionals will be and ensuring such individuals are likely to remain committed to the Fund for its duration;
- what cash resources should be budgeted and what the appropriate Management Fee is for the Fund;
- what the appropriate profit share and Carried Interest structure will be, in particular focusing on the apportionment of Carried Interest between the Fundraising Team, timing of payment and GP Clawback mechanisms (e.g. Clawback and escrow arrangements);
- how responsible investment considerations will be incorporated into the organisation and investment and portfolio monitoring processes;
- consideration of the existing Fund's constitutional documents, if applicable, to ensure that the Fundraising Team is aware of any restrictions contained in those documents as to timings in relation to raising new Funds, scope, etc.

3.1.2. LPs and marketing

Question

What matters regarding potential LPs and marketing of the Fund should be considered at the early stages?

Explanation

An efficient and well-planned marketing campaign is vital in ensuring that Fundraising is successful. Many European as well as non-European jurisdictions regulate the marketing of Funds and restrict solicitation to certain types of LPs (such as sophisticated and professional investors) and in some jurisdictions, these restrictions may apply to early informal discussions with potential LPs. Planning identifies relevant jurisdictions giving the Fundraising Team the opportunity to obtain appropriate advice.

Along with the advent of pan-European regulation, the marketing of Funds within the EU may depend on the jurisdiction of the Fund vehicle, as well as the location of the GP/manager. An EU-wide "marketing passport" will be available to those EU-based GPs/managers who comply with the relevant requirements set out in the Alternative Investment Fund Managers (AIFM) Directive. Special care should be taken whilst this new legislation takes shape as all the details of the implementation have yet to be finalised.

Recommendation

The Fundraising Team should clearly identify the regulatory landscape, particular LPs and types of LPs that they wish to attract to the Fund in any relevant jurisdiction. Before commencing Fundraising, the Fundraising Team should establish what restrictions apply to the marketing of Funds in each jurisdiction where they wish to market the Fund.

Consideration should also be given to the content of the due diligence information to be provided to prospective LPs and the medium through which it will be delivered. For example, will the information be available electronically through a virtual data room hosted on a secure area of the GP's website, or on a secure data hub site. Thought should also be given as to how meetings with prospective LPs will be held. For example, will they all be one-on-one meetings or should an initial launch meeting be arranged to which all prospective LPs are invited to enable them to meet a cross-section of members of the GP's team.

3.1.3. Structuring

Question

What matters in relation to the structure of the Fund should the Fundraising Team consider during early stage planning?

Explanation

Although the final structure of a Fund will be determined at a later stage, a proposed structure is necessary both from a regulatory and commercial perspective to allow the Fundraising Team to market the Fund. Certain categories of target LP may have an impact on the structure of the Fund (such as US-based ERISA LPs). The solutions to these issues tend to be similar in all Funds and they may be addressed at the planning stage if it is intended to market the Fund to such LPs.

Recommendation

The Fundraising Team should identify a proposed structure for the Fund, including suitable vehicle(s) for the Fund. Wherever possible, the GP should take account of likely requirements of targeted LPs when considering these structures (including their tax requirements and regulatory requirements of different vehicles in different jurisdictions). During the Fund structuring stage, the GP should also consider what arrangements it will make for the custody of investments held by the Fund.

3.2 Fundraising

The Fundraising stage (which is also often referred to as the marketing stage) is the stage at which the GP's relationship with the LPs is established. This relationship with the LPs should rest on the six principles of the Code, together with the requirements of transparency and the fiduciary duties of due skill, care and diligence.

3.2.1. The Fundraising process

Question

Who takes part in the Fundraising process?

Explanation

A Private Equity Fundraising is a complex and time-intensive process with many parties involved. It needs to be planned and prepared well in advance. Thought should be given to how much of the process can be managed in-house by the GP and what roles can be played by advisors.

Recommendation

The Fundraising Team, which may already be involved with earlier Funds under management, will need to balance their time spent on Fundraising with their time managing such Fund investments. The key player in the Fund formation process is the Fundraising Team. Typically a Placement Agent, lawyers, accountants and Fund administrators would also be included in the process.

3.2.2. The Fundraising Team

Question

How should responsibility during the Fundraising period and prior to the establishment of the Fund structure be apportioned?

Explanation

During the Fundraising period, various key people from the GP will be involved in the Fundraising, even if some of the legal entities forming the structure of the Fund have not yet been established and the structure of the Fund is yet to be finalised. This Fundraising Team will usually have certain responsibilities during Fundraising e.g. responsibilities for complying with applicable marketing laws, responsibilities for the information provided on the Fund to potential LPs and responsibilities relating to the verification of the origin of capital invested with a view to preventing money laundering.

Recommendation

Tasks and responsibilities during the Fundraising stage should be clearly identified and apportioned among those involved in the Fundraising appropriately.

It should also be made clear to potential LPs which responsibilities will be undertaken by the GP once it is established and what (if any) the Fundraising Team's role will be once this is in place.

3.2.3. Target LPs

Question

Which potential LPs should the Fundraising Team target?

Explanation

In many jurisdictions there are restrictions on the types of LPs to whom it is permissible to promote Funds. Investments in Private Equity and Venture Capital Funds are usually primarily aimed at sophisticated LPs or professional investors who are considered to be fully aware of the potential risk of making an investment in a Fund.

Often restrictions only permit marketing of Funds to potential LPs for whom they are suitable. The tests for determining suitability vary from jurisdiction to jurisdiction. In some areas, the potential LP's net worth or the minimum size of investment may be one ground for permitting marketing.

Recommendation

The GP should comply with any local legal restrictions on marketing Funds. Failure to comply with these requirements may mean that any agreement to invest may be unenforceable. In some jurisdictions breach of these restrictions is also a criminal offence and, in addition to being liable for damages, the GP may be subject to fines and imprisonment.

Usually Fundraising is restricted to targeting potential LPs who can reasonably be considered to be experienced enough to properly evaluate the risk of the investment. Investing LPs should be obliged to confirm in their application documents that they are suitably experienced and that they understand and accept the risks of the investment.

The Fundraising Team should maintain a record of all persons to whom it markets the Fund and a record of all information provided to them. The Fundraising Team will normally start by targeting existing LPs if they have already raised a Fund, as new investors will typically take comfort from re-investment by existing investors.

3.2.4. Origin of capital

Question

Should the Fundraising Team be responsible for controlling the origin of the Capital Commitments offered for investment in a Fund with a view to preventing money laundering or other illicit practices?

Explanation

The definition of what money laundering is and the application of anti-money laundering legislation can vary from jurisdiction to jurisdiction. However, there are general requirements and a common ground with respect to anti-money laundering legislation stipulated in the guidelines issued by the Financial Action Task Force and these include checks not only on the investing entity but also for establishing who the "ultimate beneficiary" is, to prevent investors from laundering money through Funds.

Recommendation

Legal advice should be obtained on this matter as early as possible to ensure that all relevant money laundering checks are undertaken and properly documented. These checks should in all cases comply with the relevant local rules in any jurisdiction where the Fund is marketed and or the domicile of the fund vehicle where the subscription money will be received. In addition, during Fundraising, steps should be taken to ensure that investments are not made to effect money laundering. These steps should include verifying the origin of Capital Commitments offered for investment and the identity of potential LPs. Investment should not be accepted where the source of the investment causes concern (e.g. where the investment originates in a FATF black-listed country) or the LP's (or its beneficial owners') identity cannot be verified.

Subscription documents should include suitable warranties from LPs in the Fund regarding the origin of money invested, although such warranties should not be considered to be a substitute for making appropriate enquiries. The Fund documents may include provisions that allow the GP to require LPs to withdraw from the Fund, if the GP reasonably believes that the investment has been made in order to undertake money laundering.

Irrespective of considerations concerning compliance with law, a GP should take care only to introduce bona-fide, long-term partners into the partnership.

3.2.5. LPs

Question

What factors regarding LPs should the Fundraising Team consider?

Explanation

The quality and reliability of each LP affect all those investing in a Fund, as Drawdowns can be made throughout the life of the Fund. If one LP defaults, even when suitable sanctions are applied, other LPs are likely to be disadvantaged especially if the Fund cannot honour its investment commitment. Managing a default situation requires GP time, in addition this may reflect negatively on the GP and its reputation.

Moreover, whilst all LPs should be afforded equal and fair treatment, some LPs may require specific opt-out or excuse clauses that will prevent them from participating in certain investments. If these issues are not addressed during Fundraising, the Fund may find it more difficult to make investments, or be forced to find additional financing at short notice. GPs should ensure that the Fund documents require LPs to provide any necessary identification information that the GP is obliged to provide to authorities during the life of the Fund. Failure or refusal to comply with this requirement should provide the GP with the right to require the LP to withdraw from the Fund.

Another consideration is the long-term nature of the relationship with a prospective LP and if they are likely to invest over multiple Fund cycles.

Recommendation

It is difficult to foresee the default of an individual LP, however the Fundraising Team can reduce the overall risk and impact of default by obtaining a sufficient level of diversification by type and geography of LPs and to the extent possible build a balanced LP base avoiding concentration risk.

LP default is a relatively rare occurrence, but carries serious implications. Therefore, robust contractual default provisions are required to protect both LP and GP interests.

Any withdrawal of an LP should be subject to strictly defined exceptional situations.

Fund documents should contain a right to require the withdrawal of an LP who is causing serious legal, regulatory or taxation problems for the Fund.

3.2.6. Structure of the offer: terms of investment

Question

Should different LPs be offered different terms?

Explanation

The terms of investments in a Fund will normally be subject to and the result of negotiation. In a partnership, it is generally presumed that all LPs will be treated equally and fairly. LPs may be keen to get certain preferential rights or economic advantages (such as positions on the LP Advisory Committee, preferential Co-investment rights, reduced Management Fees or a participation in Carried Interest). Trade and strategic investors will have different priorities in investing to those of financial investors.

The extent to which specific LPs are granted influence over the management of the Fund should be considered carefully. If such influence alters the management structure of the Fund it can compromise LPs' limited liability. Substantial influence on the management of a Fund (in particular the decisions to invest or divest) can subject the Fund to merger regulations and notification requirements with undesirable consequences for it and the LPs.

Recommendation

Whenever possible, the GP should try to ensure that all LPs in the Fund benefit from equal treatment. Different terms can be offered to different LPs, but, wherever possible, preferential treatment or specific economic benefits to individual LPs or LP groups should be justifiable (e.g. with reference to the amount invested by a preferred LP or by specific experience of an LP which adds additional value to the Fund).

Also, any preferential treatment should be clearly disclosed to all other LPs from the outset in a way that such LPs at least know that certain other LPs may benefit from preferential treatment. If certain LPs are on different terms, this can impact on LP alignment of interests.

LPs should not generally participate in the day-to-day management (including the investment decision process) of the Fund. Where they do so, they and their fellow LPs should be aware of the legal risks that arise from doing so in certain jurisdictions and which may mean that an LP loses its limited liability. They may also expose themselves to claims from other LPs.

In determining initial terms and subsequent negotiations with potential LPs, a GP should consider the alignment of interest of the group with all LPs.

Where a Fund is structured as multiple parallel partnerships or entities, the Fundraising Team should prevent one such entity or a single minority LP (in the context of the whole Fund) being able to unduly influence the Fund or block special resolutions without adequate justification.

3.2.7. Structure of the documents

Question

What documents should the Fundraising Team produce with respect to the Fund and what matters should it address?

Explanation

Due to the ongoing negotiations until final closing of a Fund, documents tend to be continually revised to reflect all discussions with LPs. However, certain core elements describe the offer and its essential characteristics.

These core elements will usually be addressed in a combination of documents which will normally include a private placement memorandum (often the main "marketing" document) and the constitutional documents of the Fund. The Fundraising Team will normally also assemble a comprehensive data pack or virtual data room and documents about the Fund and its investment strategy, collectively comprising the due diligence materials.

Local laws in the jurisdictions where the Fund is marketed may set out requirements on the structure and content of the private placement memorandum and Fund documents.

Continuous amendment of documents creates a risk that not all LPs receive the same information about the Fund before they make an investment.

Recommendation

A draft private placement memorandum or similar Fund documents should typically be made available to LPs prior to first closing. Constitutional documents establishing the Fund should also be produced.

Appropriate records should be kept to ensure that all LPs are able to review the same information. The use of due diligence rooms (physical or virtual) can be an effective way to provide information to prospective LPs. Between the first and final closings this information should be updated if changes are required and such updates should be disclosed to both existing and potential LPs, so that all have had access to the same information.

Appropriate advice should be sought on the requirements of the laws in all jurisdictions where the Fund is promoted.

The Fund documents should contain full and true information presented in a manner that is clear, fair and not misleading. Appropriate steps should be taken to ensure and record the accuracy and completeness of the documents, employing third-party advisors where appropriate e.g. auditing of a GP's track record.

The Fundraising Team should ensure that it can justify expressions of belief and statements made in the Fund's marketing materials using reliable documents and research, updating where necessary until the Fund has closed.

As a general rule, any changes to the Fund documents would require the approval of LPs. However, there will typically be a carve out for changes agreed after the first close with prospective investors in the Fund which are not adverse to the interests of existing LPs. These changes can be made by the GP without LP consent in order to facilitate its Fundraising efforts, provided however that where any LP is adversely affected by the change in question then the affected LP would have to consent to the change.

3.2.8. Terms in the Fund documents

Question

What are the typical terms to be set out in the Fund documents?

Explanation

The Fund documents should set out the key terms and provide the framework within which the GP will operate the Fund. It is recommended that the Fund documents should address, at a minimum, the following matters:

Team
- a description of the management structure and the management team, identification of the key executives of this team and the regulation of a Keyman event (such as departure of a key executive);
- a description of the team's skills and experience;
- details of team continuity, dynamics, decision-making processes and team succession;

Track record
- the track record of prior investments made by the GP;

Investment strategy
- the investment scope of the Fund;
- the investment policy, investment criteria and Investment Period of the Fund, including the applicable investment, lending and borrowing guidelines and investment restrictions. (NB: These must be set out particularly clearly as, often, these important matters will not be set out in any detail in other key documents, and they are usually incorporated by cross-reference to the private placement memorandum);
- the responsible investment policy of the Fund and the procedures for ensuring compliance with such policy;

Structure and powers
- a description of the legal structure of the Fund;
- a summary of the powers of the GP;
- conflict of interest resolution procedures;
- remit and composition of the LP Advisory Committee;
- the reporting obligations that the GP will have to LPs;
- carried interest escrow, clawback and true-up provisions, and other LP protections (including keyman and GP removal provisions);
- transfer of LP interest provisions;

Financial
- the cost and fee structure (including differentiating between costs borne by the Fund and those borne by the GP. Usually, placement agent fees should be borne by the GP and LPs should not be reimbursed for due diligence costs during their review of the Fund. A cap is normally set on Fund inception costs including legal and accounting fees etc.);
- how any Transaction fees and directors' fees received by the GP will be treated;
- the GP Commitment and Carried Interest arrangements;
- the mechanics for Drawdown of Commitments and default mechanics in the event of LPs' defaults on Drawdowns (which should normally impose significant sanctions on default to reduce the risk of such default);
- the valuation policy that will apply;
- if applicable, the pricing of interests, units, shares, etc. in the Fund;
- how Distributions to LPs will be made;
- indemnification provisions;

Co-investments and follow-on investments
- Co-investment rights and powers;
- the policy on Co-investment with other Funds managed by the GP or any of its associates;
- the provisions that the GP will make for follow-on investments;

Term, Exits and new Funds
- the term of the Fund, the process for extending the Fund and termination and liquidation procedures for the Fund;
- Exit strategies;
- the circumstances in which investments may be purchased from or sold to other Funds managed by the GP or its associates;
- any restrictions on the circumstances in which the Fundraising Team or the GP will be permitted to establish any other Fund with a similar investment strategy or objective;

Risk factors
- a summary of the risk factors that are relevant to investment in the Fund, including a general warning to LPs of the risks that are inherent in investing in Funds, and also any particular risk factors that may adversely affect the Fund's ability to carry out the investment policy or to meet any projection or forecast made.

The Fund documents (private placement memorandum or similar and constitutional documents) should be prepared and made available to LPs in sufficient time for them to consider them prior to closing and to allow time for negotiation with LPs. Appropriate subscription documents and confirmation of participation should also be circulated.

The Fundraising Team should take advice on whether the law in any jurisdiction where the documents will be sent requires any other matters to be addressed.

3.2.9. Presentations to LPs

Question

What responsibilities arise with respect to marketing presentations?

Explanation

Presentations and information provided by the Fundraising Team that influence LPs' decisions are often subject to the law of all jurisdictions where a Fund is promoted. These laws will often apply to information provided to LPs, irrespective of the media by which it is communicated.

In some circumstances, presentations may be made to potential LPs at an early stage and the information provided to them may influence their decision to invest, even though they have not yet received any formal Fund documents. It is important that potential LPs are made aware of any changes to information provided to them at any point during the Fundraising process, so that they are able to make a balanced investment decision based on correct information.

Recommendation

As mentioned in the section on "LPs and marketing" above, the Fundraising Team must comply with local laws relating to the marketing of Funds in all jurisdictions where the Fund is promoted and appropriate professional advice should be obtained.

The team should ensure that information provided to potential LPs and promotional statements made to them in whatever form (e.g. in telephone calls, meetings, slide presentations, letters, emails, websites, etc.) even at an early stage, is correct and fairly presented. Any subsequent material changes to such information should be communicated to potential LPs.

3.2.10. Responsible investing

Question

What information should GPs provide to LPs on the issues of responsible investing?

Explanation

The topic of responsible investing is becoming increasingly important to LPs who require consideration to be given to environmental, social and governance factors in the GP's investment processes.

Recommendation

GPs should clearly define and document their responsible investment policy and procedures for compliance with such policy and will typically be asked by LPs to provide information both during due diligence and throughout the life of the Fund. The GP should disclose any industry association memberships or affiliations.

3.2.11. Track records

Question

What information should be provided about the track record of the GP?

Explanation

Potential LPs will expect detailed track record information of the GP to be available as part of the due diligence process. It is very easy for such material to be misread or to mislead potential LPs, particularly in view of changing circumstances or if there is selective presentation of material.

Recommendation

Marketing laws generally prohibit the presentation of track record information on a "cherry picking" basis. Information with respect to the track record should not therefore be made on the basis of selective data that is unrepresentative, misleading or incomplete. The basis of all such statements should be fully disclosed in the Fund documents. In particular, the period to which any track record information relates should be disclosed. Gross and net track record information should be calculated and compiled in accordance with the valuation and accounting standards appropriate for the Fund's jurisdiction. Any use of benchmarks must be appropriate, consistent and clearly defined.

The Fundraising Team should ensure that when there is any material change that affects such information prior to final closing, it is disclosed to all LPs.

Track record information may be confidential (for example, to previous employers or Portfolio Companies) and the Fundraising Team should ensure that appropriate consent is obtained before it is used.

3.2.12. Forecasts

Question

Should the Fundraising Team make forecasts?

Explanation

The Fundraising Team may wish to make forecasts regarding likely performance in the Fund's chosen sectors, target IRR and money multiple. However, it is very easy for such material to be misread or to mislead potential LPs, particularly in view of changing circumstances or if there is selective presentation of material.

Recommendation

Forecasts are legally not required in institutional products/private placements and are therefore not a typical feature of the Fund documents. The making of forecasts within the Fund documents is ultimately a business and economic decision of the GP/Fundraising Team when marketing the respective product.

If the GP/Fundraising Team decide to include forecasts in an offering document, such forecasts must not be made on the basis of data that is unrepresentative, misleading or incomplete. Further, the relevant data, the assumptions and the approach taken to produce the forecasts should be fully disclosed in the Fund documents.

3.2.13. Time period for Fundraising

Question

Is there any specific period during which Fundraising must be completed?

Explanation

It is important Fundraising does not continue indefinitely, as this can prevent the GP from implementing the Fund's investment strategy, while resources continue to be committed to marketing.

Recommendation

The Fundraising Team and the GP should ensure that Fundraising is completed within a reasonable time after first closing of the Fund. Market terms typically dictate that a final close should take place within a prescribed period of the first close, unless by LPs' consent.

Consideration should be given to levying an equalising interest payment from LPs who commit to the Fund after the first closing to reflect the cost of money for LPs committing at an earlier stage of the Fundraising process. The purpose of this is so that all LPs can be treated as if they had committed at the first closing. The equalising payments are generally credited pro rata among the existing LPs and not treated as an asset of the Fund.

3.3 Investing

When making investments on behalf of the Fund, the GP should implement the Fund's investment policy with due skill, care and diligence and in accordance with the agreements the GP has made with the LPs in the Fund.

A GP should be mindful of the responsible investment impact of the conduct of its business and should give due consideration to material risks and opportunities associated with responsible investment factors such as environmental, social and governance (ESG) factors throughout the period of its investment.

3.3.1. Due diligence

Question

What due diligence should be done when evaluating an investment and to what level of detail?

Explanation

The due diligence process undertaken by the GP is vital. The information acquired during the process, together with the GP's own knowledge and expertise, will form the basis of any investment decision.

The due diligence process will investigate a wide range of aspects of the target company's business including commercial, financial, tax, legal, regulatory, technology, environmental, social and governance aspects and management capability. The objective will be to gain a detailed understanding of the prospects for the target company, evaluating the risks and issues it is facing or may have to face in the future that may play a part in the GP's investment decision and the ultimate success of the Portfolio Company over the projected Investment Period.

From this, an assessment will be made of potential for value creation and ultimately Exit opportunities from the investment for the Fund.

Recommendation

A GP should seek sufficient information to allow it to properly evaluate the investment opportunity being proposed and to establish the value of the target company. The information sought should address all appropriate issues (which may include the financial position of the target company, the experience and ability of its management team, the market in which the target company operates, the potential to exploit any technology or research being developed by the target company, possible scientific proof of any important concept, protection of important intellectual property rights, pension liabilities, possible environmental liabilities and other responsible investment factors in the broader context, litigation risks and insurance coverage).

The due diligence process should also include testing the assumptions upon which business plans are based, verifying the identity, experience and capability of GPs and co-investors, and objectively evaluating the risks that may arise from investing and the potential return on investment.

Other appropriate checks, as required by LPs, regulators and other stakeholders should be carried out. This specifically includes checks being made on the sellers to ensure that the investment does not facilitate money laundering, and to ensure that the investment complies with anti-corruption or anti-bribery regulations.

3.3.2. Costs

Question

Is it right to expect either the Fund or GP to reimburse LP due diligence costs?

Explanation

On occasion, LPs may request for the GP to partially or fully reimburse the cost of the Fund review process e.g. travel expenses, consultants, advisers, legal fees, etc.

Recommendation

It is not a generally acceptable practice for LPs to expect that their due diligence costs should be reimbursed either by the Fund or the GP when considering an investment in a Fund. This practice is likely to be unacceptable to the other committed LPs, who would ultimately bear the burden of these costs. It could also leave the LP in question and GP open to accusations of bribery.

Question

Should costs incurred by the GP during the Fundraising process be borne by the Fund or the GP?

Explanation

The Fundraising process can be a costly exercise, with several parties involved including a Placement Agent, lawyers, accountants and Fund administrators. The GP should ensure that thought goes into budgeting for the process and how the advisors will be paid.

Recommendation

It is generally accepted that Placement Agent fees should be paid by the GP and not out of the Fund itself. Lawyers, accountants and Fund administrators can be paid out of the Fund formation costs up to an agreed cap.

3.3.3. Approach to responsible investment

Question

How should a GP approach responsible investment factors?

Explanation

A GP should be mindful of the risks posed and opportunities presented to its Portfolio Companies by responsible investment factors. The success of an investment may be impacted not only by its financial performance but also by other performance criteria. A GP needs also to be mindful of its own LPs' approaches to responsible investment and to seek to comply with their requirements, which may include expectations as regards reporting on responsible investment factors in the investment and ownership processes and in some cases exclusions from investing in certain sectors.

Recommendation

GPs should integrate consideration of responsible investment risks and opportunities into their due diligence and investment approval processes and keep their investment documents and processes under periodic review.

Any staff training needs on responsible investment matters should be addressed. Evaluation of responsible investment matters should not be limited to legal compliance, but could also include potential future regulation and marketplace factors such as existing or emerging voluntary standards; consumer expectations and client requirements; and broader issues that could have reputational impact.

Where the GP has identified risks and opportunities (including ESG risks) that are deemed material to the success of the investment, the GP should ensure that practices are developed to mitigate associated risks and pursue opportunities. The implementation and effectiveness of these practices should be monitored as appropriate. Noting that the marketplace context could change, the GP should occasionally undertake to update the responsible investment risk/opportunity analysis and revise, remove or add policies as appropriate. Where the Fund's LPs have expressed an interest in responsible investment factors, the GP should seek to report to these LPs on a suitably regular basis. The GP may also choose to send unsolicited reports on responsible investment factors to all LPs.

3.3.4. Investment decision

Question

How should a decision to invest in a Portfolio Company be reached by a GP?

Explanation

Any decision by a GP to make an investment involves an appraisal of the opportunity and an evaluation of the risks versus the rewards of the opportunity. The information on which this decision will be based will usually have been gathered and critically appraised within the team of executives working on the transaction during the due diligence phase. The quantities of information, however, will normally be so great that it will need to be summarised before it is presented to the Investment Committee or other decision-making body of the GP that ultimately decides whether or not to make an investment.

Undertaking a successful due diligence exercise that confirms the validity of the underlying assumptions of a business plan will not generally be sufficient in itself. What is also required is the experience of the senior executives of a GP to add value to the due diligence exercise by critically evaluating the information collected by applying their depth of business and investment experience.

Recommendation

The results of the due diligence exercise and the GP's senior executives' recommendations should be distilled into a comprehensive written investment proposal which accurately reflects the potential of the target company, addressing a range of both financial and non-financial factors. As part of this process, consideration will also have been given as to whether the proposed investment fits the investment criteria and complies with the investment restrictions in the Fund documents. The investment proposal is an important document; not only does it provide a written record of the information considered in making an investment decision, but it will typically contain the core investment thesis that will continue to provide the yardstick by which the success of an investment will be judged during its regular review by the GP.

Investment decisions should be made by suitably senior and experienced personnel of the GP; normally these individuals will form an Investment Committee. Typically, the experienced individuals responsible for evaluating and proposing an investment will not be involved in making the final investment decision. If there are any significant changes to an investment proposal, further review, evaluation and additional approvals may be required.
It is good practice to use the underlying reports from which the investment proposal is drawn to form an important source document for strategic review and performance for the Portfolio Companies.

3.3.5. Structuring investments

Question

What factors should the GP consider when structuring and negotiating an investment?

Explanation

Investments by Funds can be structured in many ways. In some cases the Fund may be a passive minority investor in a Portfolio Company, while in others, the Fund may obtain substantial or indeed full control over the Portfolio Company. In determining how the investments should be structured, consideration should be given to the jurisdiction in which the investment is to be made, the investment strategy of the Fund and whether the investment is to be the acquisition of a minority or majority interest in a Portfolio Company.

The Fund may also need to carefully consider its position and strategy when investing alongside other parties (e.g. as part of a syndicate) and whether it owes any duties or obligations to others as a result.

It is possible for the structure of an investment to impose liabilities and responsibilities on the Fund beyond those envisaged and any such restrictions will typically be thoroughly investigated with the help of the Fund's lawyers.

Recommendation

The GP should structure and negotiate each investment made by the Fund in such a way so as to ensure that it meets both the obligations to and the interests of the Fund.

When structuring any investment the GP should take steps to minimise any adverse tax or other consequences. For example, the GP should take into consideration ERISA requirements where there are US based ERISA LPs, of any investment for the Fund and its LPs, which may require certain information and observer/board rights to be obtained in respect of the Portfolio Company.

3.3.6. Responsibilities to other shareholders in the same or other classes of shares and to bondholders

Whether as a shareholder in the Portfolio Company, or through provisions agreed in the Investment Agreement, the Fund has ownership responsibilities and should exercise those responsibilities proactively and in a way that continually supports the value of the Fund's investment.

Question

How should the Fund conduct itself in relation to other investors in the Portfolio Company?

Explanation

In some jurisdictions, it is common practice in the Industry for different classes of investors to acquire different types of securities according to their relative position in the transaction, the nature and level of the risk they are taking on and the relative value they are bringing to the investment.

The returns for each type of security, whether equity or debt, will typically vary depending on certain outcomes. It is therefore possible that conflicts may arise between holders of different classes of securities if expectations are unclear or based on erroneous assumptions, or if actual Portfolio Company performance is not as projected at the outset.

Recommendation

The negotiation of shareholder rights should be conducted openly and with clarity among all investors in the Portfolio Company.

Due consideration should be given in advance to potential areas of conflict and where conflict does arise, the resolution of that conflict should, to the extent possible, be conducted fairly and in such a way that the outcome does not impact the value of the Portfolio Company.

3.3.7. Investment Agreement

Question

What documents should constitute the Investment Agreement and what commercial terms will they address?

Explanation

There will be a large number of documents produced during the process of making an investment, for example shareholders' and investor rights' agreements, articles of association and loan agreements, these are collectively referred to in this Handbook as the Investment Agreement. The content of these will be influenced by many factors, for example local legal and regulatory requirements and structural and tax considerations, such as whether a minority or majority interest is to be acquired.

The documents will need to fully reflect all aspects of the agreed transaction and take account of the commercial terms that the GP has agreed with other shareholders (if any) and the Portfolio Company. It is common practice for the roles of the GP, other parties and the management team of the Portfolio Company in relation to the running of the Portfolio Company, to be set out in the Investment Agreement at the time of the investment.

These commercial terms may address the following matters, although this varies depending on whether a minority or majority interest in the Portfolio Company is acquired:

- ownership and control of the Portfolio Company post-investment;
- share transfers (mandatory, permitted and prohibited) and pre-emption rights;
- incentives for the management team of the Portfolio Company and obligations imposed on them;
- division of managerial responsibilities following the investment;
- warranties, representations and indemnities;
- investment performance milestones and any future obligations to provide further funding;
- board and shareholder consents needed before specified actions are taken;
- agreements with lenders to the Portfolio Company and inter-creditor arrangements;
- quality, quantity and frequency of information that is to be provided;
- Exit provisions such as tag-along or drag-along rights and/or compulsory sale provisions to resolve any deadlock regarding a sale, and also order of priorities on a liquidation[1]; and
- the consideration of responsible investment factors.

There is a strong likelihood that local legal advice will be required in the drafting of the various documents constituting the Investment Agreement.

Recommendation

These matters should be considered when negotiating an investment to ensure that the legal documents reflect the commercial terms negotiated by the GP. The team should consider using local legal advice on the appropriate manner for recording what has been agreed.

3.3.8. GP's consent to Portfolio Company actions and board appointments

Question

Through what mechanisms should the GP seek to ensure that it is able, on behalf of the Fund, to influence a Portfolio Company?

Explanation

There are a number of different ways in which the GP can ensure that the Fund can influence a Portfolio Company. Which of these will be appropriate will depend on a number of factors (including the size of the Fund's investment and the level of influence that the GP considers to be appropriate). If the Fund holds a majority shareholding in the Portfolio Company, it will have the ability, as a matter of company law, to effect a number of decisions, and in so doing influences the Portfolio Company by virtue of this majority shareholding. The GP may also seek to specify certain rights in the Portfolio Company's constitutional documents and agree contractual rights in the Investment Agreement it enters into with the shareholders of the Portfolio Company, such as obtaining (i) investor consents; and (ii) board appointments.

1 Note, (i) a tag-along is a right for a shareholder to insist that his/her shares are bought on the same terms by the same purchaser as another shareholder who is selling his/her shares; and (ii) a drag-along right entitles a selling shareholder, such as a Private Equity investor, to require the remaining shareholders to sell to a third-party purchaser on the same terms.

(i) Investor consents
In some jurisdictions, it is common in the Investment Agreement between the Fund and the Portfolio Company for certain actions of the Portfolio Company to be subject to the prior consent of the GP on behalf of the Fund in its capacity as shareholder. These are commonly called "investor consents".

Where the GP has appointed individuals to the Portfolio Company's decision-making body, their consent may also be required before certain action can be undertaken by the Portfolio Company, although they will often be under a duty to act in the best interests of the Portfolio Company, rather than the Fund.

The availability and level of investor consents that are deemed appropriate will vary depending on the size and nature of the Fund's investment.

(ii) Board appointments
The GP will typically also consider making:

- appointments to the board or other decision-making bodies of the Portfolio Company (see further the section on "Board participation" below); and
- appointments of persons to internal committees of the Portfolio Company (e.g. advisory committees or the remuneration and audit committee, where relevant).

It is important to note that individuals appointed to sit on the board of the Portfolio Company by the GP may have responsibilities both towards the GP, who has arranged their appointment, as well as to the Portfolio Company and all its shareholders as a company director (as well as to the company's creditors in certain circumstances). Typically, such individuals, as directors of the Portfolio Company, will be required to act in the best interests of the Portfolio Company. The Portfolio Company's interests may conflict with those of the Fund and in such circumstances the director must act in accordance with the duties owed to the Portfolio Company.

Recommendation

In relation to investor consents, the GP should consider requiring the Portfolio Company to obtain investor consents for corporate, financial and accounting, business and other key matters. The list of matters will vary depending on the relevant jurisdiction, the size of investment and the shareholding held, but the following should be considered:

- significant developments in the business (e.g. capital expenditure, new issues of capital, disposals of a significant amount of assets including real estate, changes to the Portfolio Company's constitution);
- changes in the capital structure and borrowing arrangements;
- changes in leases or other material contracts;
- material litigation claims;
- changes of control, acquisition or disposal of shares by other shareholders;
- adoption of the Portfolio Company's audited accounts;
- making any dividends or distributions;
- adoption of a new business plan;
- changes to the Portfolio Company's key management or their remuneration;
- adoption of or changes to the communication policy;
- developments in the financial or other performance criteria of the Portfolio Company which will materially change the nature of the business in which the Fund has invested;
- winding up or dissolving the Portfolio Company; and
- any transactions between Portfolio Company and Shareholder, Portfolio Company management or other related parties.

Investor consents, while needing to be comprehensive in scope, must not be so wide-ranging as to restrict the management team's ability to run the Portfolio Company or take up excessive amounts of the GP's time. The above list is not exhaustive, rather it gives an indication of some typical matters which are subject to investor consent.

When considering the advantages to the Fund of taking any control rights, the GP should also consider possible liabilities or restrictions imposed by law on those exercising certain types of control.

3.3.9. The Portfolio Company's corporate strategy

Question

To what extent is the GP on behalf of the Fund responsible for the definition and execution of the Portfolio Company's corporate strategy?

Explanation

At the time of investment by a Fund, the investment decision is normally taken in support of a specific strategy, business plan and management team. Frequently, through the negotiation process leading up to investment by the Fund, the GP will have had significant input in determining the target's future corporate strategy. Over a period of time, this business strategy may need to be refined and amended.

Recommendation

The GP should be an active participant through its board representation or, where permitted by the relevant company law in a particular jurisdiction, through the exercise of shareholder voting or contractual rights in the setting of the Portfolio Company's strategy. The responsibility for execution of strategy sits with the board and management team of the Portfolio Company. The GP should ensure that it remains informed on the progress being made towards achievement of the strategy. Where appropriate, the GP, once again through its board representation or through the exercise of shareholder voting or contractual rights, where so permitted, should be available to advise and assist where the strategy needs to be refined and amended.

Further, the GP should ensure that the Portfolio Company understands the importance of having the right mechanisms and processes in place for responsible, efficient and appropriate decision-making and effective corporate governance.

The degree of activism of the GP will vary according to the nature and structure of investments made and the jurisdiction in which the Portfolio Company is located. The GP should therefore ensure its level of involvement is suitable relative to the circumstances of a particular Portfolio Company and the Fund's ownership strategy/policy.

3.3.10. Co-operation with co-investors and syndicate partners

Question

What relationship should the GP have with co-investors and other members of a syndicate in which the Fund participates?

Explanation

Where an investment has been syndicated or there are co-investors, a GP may not be able to control an investment and may have to co-operate with other shareholders in order to achieve defined goals and build a consensus as to appropriate actions to be taken.

Recommendation

The GP should act in the interests of the Fund and any other clients investing in the relevant Portfolio Company and identify and manage any conflicts of interest that may arise between them. Wherever possible, the GP should not accept any obligations in favour of other investors, unless it would be in the Fund's interests to have some agreement or understanding with those investors.

3.3.11. Co-investment and parallel investment by the GP and its executives

Question

What issues should the GP consider regarding Co-investment and parallel investment by itself, its associates or its executives?

Explanation

Where the Fund documents permit the GP, its associates or its executives to co-invest or make parallel investments alongside the Fund, there is potential to create a conflict of interest for the GP.

Recommendation

Subject to what is provided in the Fund documents, details of Co-investment arrangements should be disclosed to the Fund's LPs. To avoid the potential of prejudice to the Fund's interest, it is recommended that such documents only permit Co-investment or parallel investment by the GP, its associates or its executives where investment and divestment is exercised on a pro-rata basis with the Fund, in the same securities, at the same time and on the same terms. If this recommendation is not followed, it is particularly important that the operation of the Co-investment arrangements should be disclosed to LPs and documented.

3.3.12. Co-investment and parallel investments by LPs and other third parties

Question

What issues should the GP consider regarding Co-investment and parallel investments by LP co-investors and other third parties?

Explanation

In some circumstances, LP co-investors in the Fund or other third parties with whom the GP has some relationship may wish to invest directly into a company that the GP is considering investing in on behalf of the Fund. Allowing such direct investment can be detrimental to the Fund's interests; if the investment proves to be successful and the Fund's investment allocation was reduced to allow direct investment by the Fund's LPs and third parties, the return to the Fund's LPs will be reduced. Such syndication may, however, allow smaller Funds to invest in larger target companies than might otherwise be the case, while still complying with any diversification restrictions in the Fund documents.

Recommendation

The GP should determine the Fund's appetite for each investment and only after that should Co-investment and/or parallel investments be considered (apart from in the case of pre-arranged and disclosed Co-investment arrangements or where the LP co-investor lends special expertise or other value to the transaction). Details of Co-investment arrangements should be disclosed to the Fund's LPs.

When a conflict of interest arises, it should be resolved in accordance with the GP's conflict of interest resolution procedures. LPs may place themselves in conflict of interest situations where they engage in co-investment. The conflict may be more problematic where the LP also sits on the LPAC. The criteria for invitations for LPs to co-invest present another potential source of conflicts of interest. The parameters of any co-investment process should be clearly set out to all LPs in advance.

3.3.13. Divestment planning

Question

How should the GP plan for the disposal of an investment?

Explanation

It is important to ensure that before an investment is made the key investors agree a common strategy for realising the investment.

It will not always be possible to achieve this strategy, for example if the investment fails to perform and/or purchasers decline to come forward or conditions are not favourable for an IPO, but it is desirable to agree an Exit strategy in advance.

Recommendation

The divestment or Exit process should be discussed with co-investors, other syndicate members and the management team of the Portfolio Company before the initial investment. The GP should seek to ensure that, on investment, it negotiates suitable mechanisms to ensure that any deadlock regarding divestment of an investment can be resolved in a manner appropriate for the Fund.

3.4 Management of an investment

Good management of an investment is essential if a Fund is to maximise its returns. Value in an investment can be wasted and opportunities missed if this part of the investment process is not undertaken properly. The Private Equity model of active investment management and long-term value creation requires that the conventional rights and entitlements associated with share ownership are accompanied by responsibilities towards Portfolio Companies and towards LPs in the Funds invested in those Portfolio Companies.

The following sections on investment monitoring and exercise of GP consents reflect the duties of the GP towards the LPs invested in its Funds to both effectively monitor and manage the investments. The section on board participation reflects the duties of directors appointed by the GP to serve the interests of the Portfolio Companies.

3.4.1. Investment monitoring

Question

How should the GP monitor an investment made by the Fund?

Explanation

The Investment Agreement should ensure that the GP regularly receives sufficient information from a Portfolio Company allowing the GP to monitor and appraise both the financial and non-financial performance of the investment and sufficient resource should be allocated by the GP to review, monitor and analyse such information.

This investment monitoring function and information flow should enable the GP to confirm that the investment is progressing in accordance with the relevant business plan and the GP's investment thesis. It should also provide sufficient information to identify any failures to meet targets or milestones and form the basis of remedial plans where necessary.

Recommendation

The GP should ensure that it dedicates sufficient time and resources to monitoring the investments of the Fund and apportions these resources and responsibilities appropriately.

The GP must not disclose any information that it may receive on behalf of the Fund from a Portfolio Company in a manner that may breach any duty of confidence that it may owe to the Portfolio Company. However, the GP should seek to negotiate appropriate rights to disclose information to the Fund's LPs so that they may, in turn, monitor their investments in the Fund.

The GP should prepare regular written analyses of investments which should be reviewed by the senior executives of the GP. The written analyses should address performance of the Portfolio Company against the agreed investment thesis and its targets and milestones detailed in the business plan for the Portfolio Company. It should also note significant developments since the last review and those likely to occur in the near term, provide information on any changes to personnel and the financial and non-financial status of the Portfolio Company, and recommend any remedial action that the GP should consider taking in order to ensure the Portfolio Company continues to hit the targets set.

Question

What are the responsibilities of the GP in relation to performance information of Portfolio Companies?

Explanation

Most jurisdictions have legislative obligations regarding information to be provided to shareholders of Portfolio Companies. However, it is common practice for Funds that invest in Portfolio Companies to require more frequent and detailed information than required by legislation. In particular, the GP may require more frequent and detailed information regarding the Portfolio Company in order to fulfil its contractual obligations to the LPs in the Fund.

Recommendation

The GP should agree non-legislative information requirements with the Portfolio Company's management that take into account its own reporting obligations, its ability to perform its responsibilities on behalf of the Fund, as shareholder and the efficient and effective use of resources within the Portfolio Company. Typically, key performance indicators (KPIs) are developed that allow Portfolio Company management and the GP to carefully monitor company performance.

The GP should treat corporate information which it obtains confidentially and with due consideration to commercial sensitivity and the needs of the Portfolio Company's other stakeholders and should ensure that its own LPs are bound by similar confidentiality obligations with respect to such information in the Fund documents.

3.4.2. Environmental factors

Question

What environmental factors should the GP consider in relation to the management of the Fund's Portfolio Companies?

Explanation

Generally, GPs should support a prudent approach to environmental challenges within their Portfolio Companies. These challenges could concern a range of factors including resource use, waste production and disposal; emissions to air, land and water; energy use, cost of carbon and climate change; biodiversity and habitat conservation.

Recommendation

Due diligence into prospective investments should include an evaluation of the likely environmental impact of the conduct of such business. GPs should recommend to the boards of Portfolio Companies, pursuant to shareholder documents, to identify and take material environmental factors into account in the formulation of the Portfolio Company's business plan. GPs are generally expected to actively manage environmental risk factors in Portfolio Companies.

3.4.3. Social factors

Question

What social factors would be applicable to the conduct of the Fund's Portfolio Companies?

Explanation

Generally, factors which affect the workforce, customers, suppliers and communities of a Portfolio Company should be evaluated at board level. Social factors can include stakeholder dialogue and observance of core labour standards in areas such as child labour, forced labour, trade union rights and discrimination in the labour market.

Recommendation

Human rights are likely to be an integral part of the social factors and board level discussions may include development of strategies to prevent direct and indirect involvement in human rights violations. Depending on the size and nature of the business, a Portfolio Company may also consider introducing a corporate social responsibility programme and publishing corporate social responsibility reports. A GP should ensure that such items are put on the agenda for board discussion where appropriate.

3.4.4. Governance factors

One of the key areas of due diligence that should be completed by a GP prior to investment is corporate governance at the prospective Portfolio Company. The corporate governance systems, processes and controls applied by the senior management team at the company will reveal much about the effective running of the business to be invested in. A business with effective corporate governance in place will provide a strong platform for the rapid implementation of value building initiatives. A business with weak, ineffective corporate governance will make a higher risk investment but is likely to reap considerable benefit from the implementation of robust governance systems and processes that are suitable for the business.

Effective corporate governance, once installed, should support the decision-making process and follow-through within the organisation and the alignment of interests across the stakeholders in the business including management, employees and the GP itself.

Question

What governance processes are applicable at the Portfolio Company for the conduct of a Fund's business?

Explanation

A Portfolio Company is likely to be provided with guidance on governance requirements by the GP at initial investment. In some cases, the implementation of specific requirements will be a condition of closing the transaction. The management of a Portfolio Company can be strongly influenced by the attitude of the GP to board effectiveness, controls, checks and balances. If not already in place, the GP should typically ensure that each Portfolio Company has appropriate governance structures to safeguard against fraud, bribery and corruption and to ensure internal financial control, quality assurance, risk and conflict management and transparent reporting and communication. Ensuring these objectives are achieved whilst preserving the autonomy of the Portfolio Company board to drive business growth and not hamper it with bureaucratic processes and controls, is an important balance to achieve and to be able to demonstrate at the point at which the business is sold.

Recommendation

To ensure that Portfolio Companies are applying appropriate good governance practices and standards, the GP should ensure it remains up to date and familiar with good practice and guidance in the respective countries and industries in which its Portfolio Companies are based. This can be done in a number of ways, for example through a suitable law firm or advisor which can ensure that relevant Codes and standards are understood, particularly by those individuals who will be representing the GP on the board of the Portfolio Company. Also, by recruiting and installing experienced executives to the board or respective supervisory committees of the Portfolio Company, who can demonstrate a good understanding of and track record in applying the required governance standards and practices. Finally, it is important that the GP also demonstrates to its wider stakeholder community sound environmental, social and governance (ESG) practices and standards that are both appropriate and proportionate to its own business.

Where the GP has identified risks and opportunities (including ESG risks) that are deemed material to the success of the investment, the GP should ensure that practices are developed to mitigate associated risks and pursue opportunities. The implementation and effectiveness of these practices should be monitored as appropriate. Noting that the marketplace context could change, the GP should occasionally undertake to update the responsible investment risk/opportunity analysis and revise, remove or add policies as appropriate. Where the Fund's LPs have expressed an interest in responsible investment factors, the GP should seek to report to these LPs on a suitably regular basis. The GP may also choose to send unsolicited reports on responsible investment factors to all LPs.

3.4.5. Board participation

Question

How should the GP act in relation to the board of the Portfolio Company?

Explanation

The GP will frequently appoint one or more experienced members of its own staff or representatives to the board of the Portfolio Company. Typically, designees of the GP will have in-depth experience of the sector and will have been involved in the original due diligence and review of the investment.

There are many variations on the overall composition of boards, but in relation to non-executive members of the board, these may include some/all of the following: one or more single directors who are members/employees/representatives of the GP of the Fund; an independent non-executive chairman; and/or, an independent non-executive board member. These non-executive members of the board may be selected as they have specific and appropriate industry knowledge and insight.

Recommendation

The GP should ensure that the board is structured and appointments are made in the best interests of the Portfolio Company.

The relationship between the board and the management of the Portfolio Company should be clear and supported by appropriate documentation of roles and responsibilities.

Question

Whose interests do the GP-appointed director look after on a board?

Explanation

Whatever the means of appointment, directors do not serve the interests of one particular shareholder but act in the interests of the Portfolio Company. The position of director is a fiduciary one. A director does not act as the representative or advocate of the body which appointed him. Fiduciary duties are generally are summarised as a duty of loyalty to the company, a duty to avoid and disclose conflicts, duties of confidentiality, to act in good faith, to exercise care, skill and diligence and to act with integrity.

A GP-appointed director should always be aware that he/she must act in the interests of the Portfolio Company and all its shareholders. Where conflicts arise, the GP may need to excuse the director from meetings and may need to reach investment related decisions in full disclosure of the director's conflict of interests. The GP should ensure that its board appointee(s) clearly disclose any conflicts of interest with respect to their role as members of the board promptly when they arise.

Question

What does being a board member entail?

Explanation

The overriding principle of fiduciary duty to the company and all its shareholders apply to the whole board. A director is expected to devote such time and diligence as is reasonably necessary to further the business of the company. Attendance at and being well prepared for board meetings should be assumed. Directors with particular skills may be asked to serve on additional board committees such as directors with accountancy training serving on audit committees.

Recommendation

A director should be prepared to invest time in his role as a director to understand the needs of the company and to participate in review and decision-making affecting the business.

The GP should ensure that its appointee(s) to the board fully understand their responsibilities to the GP and their legal duties to the Portfolio Company as a member of the board.

Question

What skills does the GP-appointed director need to be a board member?

Explanation

Many skills are applicable to membership of a board of directors. The company may particularly need directors with industry experience, with legal, corporate finance or accounting experience or with general management experience. All these skills, plus the ability to evaluate risk and other skills, are likely to be needed by every company over time and are unlikely to be offered by one sole director. Therefore, the ability to work collaboratively and openly with senior management and other directors is also of great importance.

Recommendation

The GP should encourage its board appointee(s) to seek appropriate support and training to enable them to carry out their duties as board members to the best of their abilities and in accordance with their legal duties and contractual commitments. The GP should seek to ensure that all appointees to the board are individuals of appropriate authority, skill and experience who can provide value and insight to the Portfolio Company.

Question

What is the best size for a board?

Explanation

Thinking has evolved on optimum board size. Factors to bear in mind in considering board composition include the skills required to run the business, the interests of the shareholders and their desire for active participation in decision-making, the governance and logistics and costs implications of convening a large group of people frequently and the need for balanced decision-making through diversity of opinion.

Recommendation

No number can be stipulated for optimum board size but the board should periodically review its composition and its success and adjust its size accordingly.

Question

What liabilities come with board membership?

Explanation

Some directors may be unwilling to accept office because of the potential liabilities attaching to the position. The office of director is a position of responsibility and trust and no one should be forced into accepting the position. Directors may incur personal liabilities in particular for failure to maintain company books and records or for transactions at an undervalue and in certain insolvency situations. Directors are generally entitled to expect indemnification from the company and from their appointing GP in the case of GP-appointed directors as well as Directors and Officers liability insurance (often called "D&O" insurance).

Directors should be able to obtain legal or other specialist advice for complex board decisions and should have the assurance of legal and insurance protections when properly conducting their duties.

Question

How many board seats should an individual accept?

Explanation

Someone with a track record of good performance as a board director may find themselves invited to join multiple boards. This may lead to the person having limited availability to perform their duties fully.

Recommendation

A director should only accept the number of board seats that they can reasonably expect to discharge properly, taking into account unforeseen developments in companies and the need to participate not only in full board meetings but also in committees and to devote sufficient time to review board information.

Question

What about best practice governance guidance?

Explanation

There are a number of think tanks and organisations offering best practice guidance on the office of director and on the governance of boards. There are also variations between jurisdictions.

Recommendation

A GP in a position to nominate directors to boards of Portfolio Companies should be aware of best practice guidance and factor this into its own board nominations and expectations of its directors.

Question

Is a diversity policy necessary?

Explanation

Boards function as decision-making and review forums involving people with differing skills and approaches. Diversity of skills and styles leads to balanced and informed decision-making.

Recommendation

In reviewing board composition, the board should be aware of the benefit of diversity in its selection. A policy need not be codified to be effective, but it may be helpful to have a written diversity policy to further the selection process.

Question

What are the key components of the Portfolio Company's strategy that are the responsibility of the board?

Explanation

A Portfolio Company's strategy consists of a number of core components. First and foremost is the development of long-term value creation through sources of current and future revenue. Of importance here are the efficient and effective delivery of appealing products and services, the development of competitive future products and services, attracting and retaining talent and management capacity, the effective use of available resources (including financial resources) and obtaining future financial resources to help grow the business effectively and efficiently.

Recommendation

A key component of the Industry's investment and ownership model is to ensure that the interests of the members of the Portfolio Company board are aligned. All members of the board should seek to understand, support and further develop the business strategy of the Portfolio Company and should challenge that strategy in the context of their individual understanding of market, product, service and financial developments as appropriate. The GP representatives also bring additional value over and above their own personal knowledge, skills and experience, having the wealth of knowledge from across the GP firm to draw upon for the benefit of the Portfolio Company when required.

Question

What is the board's role in relation to the identification and assessment of the risks and opportunities of the Portfolio Company?

Explanation

A key element of a Portfolio Company's business strategy execution is the identification and assessment of risk and opportunity, including decisions on what levels of risk are acceptable, what risks are associated with each opportunity, how such risks can be mitigated and controlled and how to manage the business accordingly.

Recommendation

All members of the board should participate in risk and opportunity identification and assessment across all business areas, including the review of financial and non-financial factors.

Question

What is the board's role in relation to the management of risk of the Portfolio Company?

Explanation

The components of risk management include the clear communication of the values of the Portfolio Company and its appetite for risk, for example when pursuing new business opportunities, the allocation of roles and responsibilities and the design and implementation of policies and procedures relating to the identification, control and management of risk, and the measurement of and timely reporting on the impact of risk on performance.

Recommendation

Each member of the board is responsible for risk identification and management and should take an active role in ensuring that the management of the Portfolio Company establish effective policies and procedures that adequately address the identification and control of risk. Members of the board should actively and regularly seek assurance that risk management procedures are in place and are operating effectively.

Question

How should the board determine what constitutes a reasonable structure and level of remuneration for Portfolio Company employees and management?

Explanation

Remuneration and reward mechanisms for investments in Portfolio Companies will include incentives which are determined by the GP (typically for senior level executives) as well as those determined by the board of the Portfolio Company. Sometimes these activities will be led by a remuneration committee.

The structure and remuneration of Portfolio Company executives and senior management should provide an incentive for excellent long-term performance and reward for sustainable results. Balancing remuneration in the context of the relevant industry, the expertise and contribution of individuals and the long-term needs of the business are key roles of the board.

Recommendation

Frequently in Private Equity and Venture Capital investing, the Portfolio Company executives will have built in incentivisation at the time that the original investment by the Fund is structured and executed. The board's (or remuneration committee's) role should therefore be more appropriately focused on ensuring that existing incentives continue to be appropriate for both the business and the shareholders as the circumstances of the business change over time.

The board should determine the appropriate levels of remuneration of Portfolio Company executives and regularly evaluate and review remuneration levels and, where appropriate, introduce changes thereto. Conflicts of interest in establishing or reviewing remuneration levels for board members should be avoided wherever possible and managed openly and constructively in all cases.

3.4.6. Exercise of GP consents

The level of GP (investor) consents that are deemed appropriate, will be agreed when negotiating the Investment Agreement. This is considered in the section "GP's consent to Portfolio Company actions and board appointments" above.

Question

What factors should the GP take into account when evaluating shareholder consent issues in a Portfolio Company?

Explanation

Normally, an investment will be structured in such a way that certain proposals of the Portfolio Company will require consent from investors, including the Fund. These shareholder consents should be differentiated from consents required from members of the Portfolio Company's board where the GP has appointed one or more executives to the board.

Recommendation

The GP should ensure that when giving or withholding consent it acts in the best interests of the Fund and in accordance with its policies. Executives who are on the board of a Portfolio Company normally have to act in the best interests of the Portfolio Company. It may therefore be advisable to have a different member of the GP staff or representative exercising shareholder consents.

3.4.7. Exercise of influence on responsible investment factors

Question

How should a GP exercise its influence with regard to responsible investment policies relating to a Portfolio Company?

Explanation

A GP may be in a position of considerable influence as regards the development, implementation and monitoring of ESG policies within Portfolio Companies.

The GP, ideally through the information produced and provided by the Portfolio Company, should be in a position to identify, monitor and where necessary, support the mitigation of relevant risks and recognition and pursuit of opportunities in responsible investment matters within the Portfolio Company. These may manifest themselves in a wide variety of ways from the specification of and capital investment into a new production facility through to the criteria applied to potential add-on investment targets for the Portfolio Company.

Recommendation

The GP should ensure appropriate board level awareness of responsible investment matters relevant to the country and sector of the Portfolio Company, including familiarity with appropriate external guidance issued by national, supranational and private bodies.

A GP should aim to ensure its own and its Portfolio Companies' awareness and due consideration of responsible investment guidance and Codes of Conduct as applicable to the sectors and geographic regions in which each Portfolio Company operates.

3.4.8. Responsibilities in relation to other stakeholders

Question

To what extent does the GP have responsibilities in relation to other stakeholders?

Explanation

The nature of Private Equity and Venture Capital investments is such that, in certain jurisdictions, it is not uncommon to operate with different classes of securities with different rights and obligations attached to them.

Additionally all Private Equity and Venture Capital investments will have other stakeholders including, but not restricted to, employees, customers, suppliers, regulators, trade unions and the wider community.

Recommendation

The GP should act openly, honestly and with integrity, balancing the interests of the Portfolio Company, and the needs of effective decision-making with an informed understanding of the needs and information requirements of other stakeholders.

3.4.9. Follow-on investments

Question

What provision should the GP make for follow-on investments?

Explanation

It may be necessary or desirable to make further investments into a Portfolio Company (e.g. to fund future expansion plans or to re-finance a poorly performing Portfolio Company).

The opportunity to make a follow-on investment in a successful Portfolio Company may give rise to a conflict of interest where the GP is managing more than one Fund that has invested, or where the GP or its associates have invested directly in the Portfolio Company.

Recommendation

The Fund's constitution should make provision for further investments into a Portfolio Company by allowing the GP to retain an appropriate amount of capital to make appropriate follow-on investment(s) where necessary after the end of the Investment Period. How such follow-ons are dealt with is something that should be clearly set out in the Fund documents.

Decisions to make such follow-on investments should be subjected to the same rigour and made in the same manner as the original decision to invest and should be supported by adequate written evidence that demonstrates a clear benefit to the Fund in making the further investment and that the decision is supported by the Fund's policies.

Any conflict of interest that arises out of an opportunity to make a follow-on investment should be resolved in accordance with the GP's conflict of interest resolution procedures.

3.4.10. Underperforming investments

Question

What steps should be taken when an investment fails to meet the targets established in its business plan?

Explanation

Unfortunately not all investments will succeed, and while it may not be possible to save an investment made into a Portfolio Company with a fundamental structural problem, it may be possible to turn around a poor performance record or preserve value in an investment through:

- meeting with the management of the Portfolio Company to discuss performance and to agree strategies and tactics through which turnaround can be achieved;
- increasing the frequency and depth of monitoring of the investment and meetings with management;
- agreeing the need for and type of remedial action required with management. This might include the introduction of expert advisory firms to help solve issues, develop new approaches and identify new opportunities;
- supporting the company with outside resources;
- introducing changes in the Portfolio Company's management team, perhaps introducing a senior level "trouble-shooter"; and
- agreeing to reschedule payments (e.g. loan or fixed payment commitments) to allow a Portfolio Company "breathing room" with its bank(s).

GPs should be aware that while bankruptcy laws may vary from country to country, they may impose a personal liability on a Portfolio Company's directors (including "shadow" directors) if they permit the Portfolio Company to carry on trading in certain circumstances.

Recommendation

As soon as information, received as part of the monitoring process, reveals that an investment is not "performing", the GP should look to take rapid action and meet with the management of the Portfolio Company and, as necessary where the underperformance is financial, other providers of finance such as banks and co-investors, to agree remedial action plans and any additional information requirements.

When managing underperforming investments, the GP should ensure that sufficient resources remain committed to the monitoring and management of other investments. If the GP has appointed director(s) to the board, if permitted in the particular jurisdiction, consideration should be given to having a different executive responsible for exercising the Fund's rights as shareholder to reduce conflicts of interest. It is important that communication with LPs remains open and clear in order to manage expectations in relation to the investment.

GPs and Portfolio Companies should consider the need for timely provision of information to and communication with stakeholders when an investment is in difficultly. The timing of communication with employees can be particularly complex.

3.5 Disposal of an investment

Disposal of an investment is a vital stage in the life of a Fund. The outcome of the disposal process will determine the return to LPs and will establish the basis on which the GP's performance will be judged (by the LPs, those to whom the GP markets future Funds and by the wider community).

The disposal process will also involve interaction with other parties, such as co-investors and the Portfolio Company, and can also give rise to conflicts of interest. It is important that these are appropriately managed by the GP.

3.5.1. Implementation of divestment planning

Question

When should the sale of an investment take place?

Explanation

Establishing the appropriate point to dispose of an investment is not simply a matter of the GP exercising its judgment to decide when value has been maximised or the extent of a loss minimised. There may be considerations other than "paper" profits or loss that are relevant when considering an Exit (e.g. the future prospects of the Portfolio Company and the GP's reputation within the broader community). The GP may also have set out a divestment strategy to LPs in the Fund, co-investors and other syndicate members, which could impact upon when an investment can be realised.

Recommendation

The GP should, as far as is possible, dispose of investments at a time and in a manner that accords with any existing divestment strategy and maximises the return to the Fund's LPs. GPs should be mindful of the aim to divest the Fund's assets within the lifetime of the Fund.

3.5.2. Responsibility for divestment decision-making

Question

Who should make the decision to realise an investment?

Explanation

Any decision to realise an investment involves a comparison of the present value of an investment, its potential future value and the opportunities to realise that value in the future. It is important that the GP's decision to dispose of an investment is subject to the same checks, level of analysis and procedures that an investment decision is subject to.

Recommendation

The GP should establish a process for deciding whether and how to dispose of an investment. Wherever possible this process should mirror the process that is followed when considering an investment decision and any proposed divestment should be subject to equally rigorous checks.

3.5.3. Warranties and indemnities

Question

Should warranties and indemnities be given on Exit?

Explanation

A purchaser of a Portfolio Company may seek a range of warranties and indemnities from the Fund. Negotiation over these will often be a key issue for the GP when disposing of an investment. During negotiations, the GP must consider the risks and detriment to the Fund in giving such warranties and indemnities against any enhancement of return that they could bring.

When deciding whether to give a warranty or indemnity, the GP should also take into account the remaining life of the Fund and the fact that in the future it may be difficult to draw down cash or re-draw distributions from investors to meet liabilities in the event of a claim. It may be necessary to establish an escrow account, and time limitations and financial caps should definitely be considered and negotiated where possible.

Recommendation

GPs should normally only give warranties and indemnities on behalf of the Fund on a disposal where this is expected to produce an enhanced return for investors, or the warranties relate purely to title to shares owned by the Fund and authority to enter into the transaction documents. The liability under such clauses should be capped in quantum and time and the GP should seek to ensure that the Fund is able to meet these liabilities. An escrow account is commonly used to fulfil this purpose and could be set up at the time of the Exit. In order to achieve an added layer of security that the Fund will be able to meet any liabilities, the original Fund documentation should contain an investor clawback provision, enabling a certain percentage of distributions to be clawed back from investors should this become necessary even after the end of the life of the Fund. This provision should be limited in time and amount, as investors will otherwise not agree to it. The GP may also take out insurance that affects the Fund's ability to give warranties and indemnities and may help to meet the expectations of a potential purchaser.

3.5.4. Cash vs. shares/earn-outs on realisation

Question

Should a cash Exit always be sought?

Explanation

A GP's obligation is to seek the best returns from an investment for the Fund and the GP must consider opportunities to effect non-cash disposals in light of this. It may be that, for example, there is no cash purchaser for an investment, or that a cash price is offered but at a lower valuation than a "share for share" swap into a quoted vehicle, or that the Fund can participate in the future value of an investment through an earn-out.

Any decision to accept a non-cash disposal is also likely to involve additional costs. For example, there will be a cost in safeguarding and administering any quoted investments held by the Fund. There are also risks of falls in the market.

Cash returned is also an important measure of performance; LPs may also have concerns about receiving Distributions in specie and there may be restrictions upon a holder's ability to sell quoted securities, also known as "lock-up periods".

Recommendation

GPs should carefully assess any non-cash offer consideration in an Exit balancing the immediate value of any cash offer; the life cycle of the Fund; the need to return cash to LPs; the potential future value and Exit opportunities in any securities offered; and the ability to hedge against downside market risks.

3.5.5. Sale of a Portfolio Company between Funds managed by the same GP

Question

Should one Fund managed by the GP be permitted to purchase the investments of another Fund managed by the same GP?

Explanation

Although it might be the right time for one Fund to Exit (for example, because of the life cycle of a Fund), there may still be future value which can be created in the investment through a secondary buyout (where a Fund sells its stake in a Portfolio Company to another Fund managed by the same GP).

In these circumstances, there will be conflicts of interest that need to be managed: for example, price and whether warranties are to be given and the conditions attaching to them.

Recommendation

The sale of investments between Funds operated by the same GP is not recommended and could lead to legal consequences or be forbidden in some jurisdictions.

In cases where such sales and/or Co-investments between Funds are contemplated, GPs should ensure that they discuss this transaction at the earliest opportunity, with the relevant LPACs (LP Advisory Committees) for the Funds and that the LPs in both Funds are fully aware of the transaction. The GP should strictly adhere to the conflict management provisions set out in the Fund documentation and also its own internal conflict management policy.

Whenever considering such a transaction, a GP must be able to demonstrate that no Fund has been preferred at the expense of another (for example, by arms-length negotiation or obtaining an independent valuation of the investment). Teams acting for each of the Funds should be clearly separated and appropriate information barriers should be erected.

3.5.6. Managing quoted investments

Question

What issues should the GP consider when managing quoted investments?

Explanation

There are a number of issues that affect the GP when it holds quoted investments. Dealing in such investments will often be subject to additional regulation (such as prohibitions on insider dealing and market abuse). The GP may also need to consider the impact of its dealings on the market in the Portfolio Companies securities.

In many jurisdictions it is illegal to deal in securities issued by quoted companies when in possession of unpublished price-sensitive information relating to that company's business.

Where a GP has maintained a close relationship with a Portfolio Company after a flotation there are circumstances where the GP may receive such information. This may prevent the GP from selling an investment until that information is public.

Market rules may also prescribe certain periods in which the Portfolio Company directors may not deal in investments. These rules may also be relevant where an employee of the GP remains a director following a flotation. The risk of the GP committing an insider dealing offence is increased where the GP maintains a presence on the Portfolio Company board.

In many jurisdictions insider dealing is a criminal offence, punishable by imprisonment and substantial fines. Insider dealing may also allow anyone who has suffered a loss as a result of the GP's conduct to recover any loss that they have suffered from the GP.

The GP should recognise and observe any applicable Codes of Conduct concerning responsible investment management which are relevant to the listed securities markets in which the GP operates.

Recommendation

The GP should adopt appropriate policies on the management of quoted securities, including considering whether it is appropriate to retain a seat on the board.

The GP must ensure that it does not breach prohibitions on insider dealing and market abuse when managing quoted investments.

Where the GP retains a relationship with a Portfolio Company whose securities are quoted, the GP should ensure that it does not utilise any confidential information it acquires to determine or influence its disposal policy, unless that information is available to all of the Portfolio Company's shareholders. Most LPs generally expect GPs to sell largely tradable shares after an IPO in a timely fashion.

3.6 Distributions

Distributions to LPs during the life of a Fund and during its liquidation are an important obligation of the GP, as the returns distributed to LPs are the most tangible measure of the GP's performance. The GP must ensure that it effects Distributions as required by the Fund documents at all times.

3.6.1. Distribution provisions

Question

What provisions should be made regarding Distributions from a Fund to LPs?

Explanation

Clarity over what is distributed, how it is accounted for in the calculation of Carried Interest and how a distribution may impact uncalled Commitments to the Fund are all important issues. Addressing these will ensure that disputes do not arise as to the apportionment of profits and losses between the GP and the LPs and that there is clarity regarding the LPs' outstanding liability to the Fund.

Recommendation

The Fund documents should include adequate provisions on Distributions. These provisions should address at least the following issues:

- how profits and losses will be allocated between the GP and the LPs (the inclusion of a clear statement of intent on how the operation of the Carried Interest allocation will work and/or a description of the Distribution of proceeds waterfall will help this);
- when Carried Interest allocated to the GP may be distributed;
- GP Clawback provisions;
- what special provisions may relate to Distributions to the GP in respect of the GP's investment in the Fund;
- the extent of the GP's discretion to make Distributions;
- whether Distributions can be made in specie;
- how any Distributions in specie will be valued (generally this should be on a conservative basis or where freely tradable, reflecting the average daily trading price over an appropriate number of days). Due to restrictions on certain LPs concerning Distributions in specie, the process for making such Distributions should be set out clearly in the Fund documents;
- the extent to which Distributions will take account of taxation liabilities;
- the extent to which the GP may be permitted to re-invest capital gains, dividend and other income, rather than distributing it;
- the need for Distribution notices to identify clearly whether any of the Distribution being made increases the LPs' uncalled Commitment to the Fund, or is potentially subject to recall at a later date and if so under what provision of the Fund documents;
- LP Clawback provisions;
- the source of the distribution, e.g. sale of a company, interest payment from bridge financing, etc.;
- when Distributions will be made.

3.6.2. Timing of Distributions

Question

When should Distributions be made?

Explanation

Distributions are expected to be made as soon as possible after an investment has been realised and proceeds have been received by the Fund. Prompt Distributions improve the internal rate of return of a Fund.

Recommendation

Distributions should be made in accordance with the relevant provisions in the Fund documents.

Before making a Distribution, the GP should consider the Fund's reserves for follow-on investments and current and foreseeable liabilities and assets (including liabilities for tax, escrow and Clawback provisions and contingent liabilities such as those under warranties and indemnities). Distributions should not be made if this would cause the Fund to become insolvent or unable to meet its reasonable future liabilities.

Before making a Distribution in specie, any restrictions on transfer of the relevant investments should be considered.

3.7 LP relations

Good relations between LPs and GPs are the essence of a strong partnership. Ongoing relations with LPs are a vital issue for the GP to address to ensure good governance. Implementing appropriate processes will also allow the GP to operate more efficiently, by reducing the number of ad hoc enquiries that the GP receives from LPs. In many jurisdictions there will be obligations imposed on the GP to report to LPs, although on commercial grounds many GPs exceed these obligations.

3.7.1. Reporting obligations to LPs

Question

What reports should the GP make to LPs?

Explanation

Reporting obligations are important for LPs wishing to monitor the status of their investment. The nature of Funds means that valuing an investment on an ongoing basis is difficult and, without information from the GP, LPs cannot effectively monitor the performance of the Fund or report to their beneficiaries in a satisfactory manner.

Recommendation

The IPEV Investor Reporting Guidelines and IPEV Valuation Guidelines should be followed.

It is normal for all LPs to be sent a list of all partners in the Fund following final closing.

The Fund documents should contain provisions regarding the GP's obligations to provide reports to LPs. These provisions should address the following matters:

- the frequency of reports to be made;
- the information to be contained in these reports;
- the form and frequency of responsible investment reporting;
- the basis of valuation that will be used for such reports; and
- the manner in which the reports are to be made (e.g. in writing, by email, via a secure website);

3.7.2. Transparency to LPs

Question

What general conduct issues should the GP consider with regard to LP relations?

Explanation

In its relations with LPs, a GP is to be proactively transparent within the confines of its obligations toward others, including a general principle of equal treatment of stakeholders. Thus, established reporting obligations occasionally need to be supplemented by disclosure of significant issues or even consultation with LPs. When doing so, the GP must take care not to breach confidentiality obligations, whether contractual or regulatory, do harm to the interests of Portfolio Companies and their business partners or compromise LPs by incurring such obligations on their behalf.

Recommendation

The GP should seek transparency in its relationship with LPs by ensuring that all LPs receive all significant information regarding the Fund in a clear and timely manner, provided that communicating such information is permitted by law. The GP should not breach confidentiality obligations binding on it but should seek to be relieved of such obligations if they prevent proper reporting to LPs.

Certain LPs and types of investor will require different information, or information presented in a different way, to satisfy their own tax, regulatory, responsible investment policy or commercial obligations.

GPs should be receptive to such requests, but should also take care not to compromise fiduciary duties to Portfolio Companies (and thereby their other investors). When committing to fulfil a special request on an ongoing basis, the GP should consider updating its general information to LPs accordingly, alternatively disclosing special arrangements to other LPs, all in the interest of securing parity of treatment of LPs and timely disclosure of information.

3.7.3. LP relations generally

Question

What other arrangements should the GP make with regard to LP relations?

Explanation

A transparent and trust-based relationship between the LPs and the GP is key, and this requires good and clear communication throughout the Fund's life.

Recommendation

Suitable arrangements should be made to respond to queries from LPs promptly as they arise, as well as complying with the obligations in the Fund documents on reporting and, if relevant, meetings. The use of due diligence rooms can be an effective way to provide information to prospective LPs.

It is strongly recommended that an annual LP meeting is held. It provides an excellent opportunity for the GP and LPs to meet together in person. There is no fixed agenda for annual meetings. As a guide, however, the general aim should be to update LPs on the progress of the fund(s) and provide an overview of developments in the market, along with any relevant updates on the GP's team or processes. It can be helpful to consult with LPs when preparing for the annual meeting to get a sense of the best balance to be achieved between overview and detail. It is also advisable to inform LPs of investments and divestments as and when they occur. Consideration should be given to providing access through webex, conference call or other, secure, interactive methods for those LPs who are unable to attend in person.

Regular conference calls or webcasts are an efficient method of keeping all LPs up to date between annual meetings. Having a secure area on the GP's website, or using one of the secure electronic data hub site providers is an increasingly common way for GPs to make documents and notices available to LPs.

3.7.4. LP conflicts of interest

Question

How should conflicts of interest between LPs within a Fund, or between LPs of different Funds managed by the same GP, be handled?

Explanation

Most of the time LPs' interests will be fully aligned with each other. On some occasions, however, situations can arise where LPs' interests can conflict. For example, if an investment has been made by two Funds of different vintages managed by the same GP, then a conflict may arise between the LPs with regards to the timing of the Exit, or in relation to making any follow-on investment. Similarly, if an investment is being sold by one Fund managed by the GP and bought by another that the GP manages, then conflicts may arise between the LPs of the two Funds over the valuation placed on the Portfolio Company.

If some LPs have co-invested in a Portfolio Company alongside the Fund's GP, circumstances could arise in which these LPs' interests may conflict with those of LPs who have not co-invested.

Whenever any conflicts arise, it would be expected that the GP will consult with the LP Advisory Committee of the relevant Fund(s). Sometimes, however, the LP Advisory Committees of different Funds managed by the same GP meet together as one committee, or there may only be one committee for all Funds managed by a GP.

Recommendation

When LPs are consulted by the GP on a situation likely to involve a conflict of interest between any of the LPs, they should immediately disclose all conflicts they may have to the GP and the other LPs of the relevant fund(s). In this way the situation can be discussed in an open manner. The context in which views are expressed can be better understood, so enabling conclusions to be arrived at which are based on as full an understanding of everyone's position as possible.

3.7.5. LP Advisory Committee

Question

What role should the LP Advisory Committee ("LPAC") play?

Explanation

One of the ways our Industry facilitates an interactive relationship between the GP and the LPs is through the use of an LPAC. A well-functioning LPAC should help ensure good governance of the Fund by addressing conflicts of interests and be a helpful resource for the GP. Just as GPs bring the benefit of their wider investment experiences to Portfolio Companies, LPs can provide useful insight from their Fund investing experience to the GP.

For legal reasons it is important that LPs do not become involved in the management of a Fund. In particular, LPs should not be involved in making investment or divestment decisions. This should be the sole responsibility of the GP. Nor are LPs able to represent or act on behalf of other LPs in a Fund.

Recommendation

The role of the LPAC should be to advise and not to make decisions. It is most effective when it acts as a sounding board for the GP on all matters which impact the governance of the Fund. The LPAC ought to be consulted on all conflicts of interest relating to the Fund.

The LPAC should not become a barrier to the GP communicating directly with all LPs in the Fund. For example, while the LPAC can provide a useful forum for discussion and feedback to the GP, changes which will impact all LPs need ultimately to be put to all LPs.

To be of greatest value to the GP, the composition of the LPAC should be thought about carefully to ensure a broad and balanced range of perspectives are included. The individual members of the LPAC should have an appropriate level of Fund investing experience so that a full contribution to the discussion can be made.

The role of the LPAC should be described in the Fund documents. It is usual for members of the LPAC to be indemnified by the Fund and for it to be clear that there is no fiduciary duty owed by members of the LPAC to the rest of the LPs in the Fund.

There should be a separate LPAC for each Fund raised by the GP.

LPACs should be run on a good governance basis, with the agenda and supporting papers circulated in good time ahead of the meeting, members declaring any conflicts at the start of the meeting and formal minutes taken and circulated in a timely fashion. The minutes of any LPAC meeting should also be available to all LPs.

LPAC meetings should be held at least once a year and should be capable of being convened, at the request of the GP or any of the LPs, at other times.

The LPAC may be chaired by either the GP or one of the LPs. The names of those LPs on the LPAC should be made known to all LPs in the Fund. LPAC meetings should be allowed to be held without the GP being present.

The number of members on the LPAC should be appropriate for the size of the Fund but not so large as to make effective discussion difficult.

LPs on the LPAC must be careful to respect the confidentiality of the information received and discussions held in these meetings.

3.7.6. Keyman Provisions

Question

What issues should be addressed regarding Keyman Provisions in the Fund documents?

Explanation

A very important aspect of LPs' due diligence before deciding to commit to a Fund, is determining the investment skill of the people managing/advising the Fund. During the long life of a Fund it is possible that some of the key members of the team may leave. If this happens it may result in a material change to how LPs regard the quality of the team managing/advising the Fund.

Recommendation

The Fund documents should identify the key individuals in the GP responsible for the day-to-day management of the Fund. They are likely to be the most experienced people who are key to managing that specific Fund.

Keymen are expected to devote substantially all their business time to the Fund. It would be normal that this includes provision for spending appropriate time with predecessor Funds and, in due course, with successor Funds. If it is agreed between the GP and LPs that a senior member of the GP is included in the Keyman Provisions, who is perhaps not so directly involved in the day-to-day management of that particular Fund, then a lesser time allocation is usually agreed.

The consequences and procedures for dealing with the situation when a Keyman ceases to devote the necessary time to a Fund (the triggering of the Keyman Provisions) should be clearly set out in the Fund documents.

Usually the triggering of Keyman Provisions causes the investment period to be temporarily suspended. The procedures for what happens next should enable the situation to be resolved promptly. The GP will normally tell all LPs immediately when the Keyman Provisions have been triggered and set out the plan to address the situation. LPs should engage promptly with the GP to achieve a timely resolution. It is common to include provisions to enable a Keyman to be replaced and so avoid the Keyman Provisions being triggered, or to resolve the situation if the Keyman Provisions have been triggered.

It is normal to require a majority vote of all LPs to agree to any Keyman replacements, or to lift the suspension of an investment period. It is important for the good governance of the Fund that LPs participate when a vote is required.

3.8 Secondaries

3.8.1. Overview

Question

What are Secondaries?

Explanation

The expression "Secondaries" may be used in different contexts in the Industry. The first context is a transfer of an interest in a Fund by an LP to another LP, which may be either an existing LP or an LP new to the Fund. Fund interests in general are illiquid investments which are not traded on a recognised investment exchange. A privately negotiated contract of secondary sale is formed between transferor and transferee, usually subject to GP consent on behalf of the Fund. The GP and remaining LPs will be concerned in particular to ensure confidentiality provisions are observed in any such transfer and that all obligations are properly transferred so that the Fund may continue to function with the new investor in place.

In contrast, the term secondary (direct) sale is used to describe the sale by a Fund of its interests in one or more Portfolio Companies to a Fund managed by a different GP. This constitutes an investment realisation by the Fund. Depending on the circumstances, it may be that no alteration is required to the investment documents, or alternatively, new investment documents will be negotiated and put in place.

Recommendation

On the transfer of any asset, professional advice will be required to make sure no existing rights are contravened and that all obligations are properly transferred. Investors, be they GPs in Portfolio Companies or LPs in Funds, should be particularly careful not to breach confidentiality constraints and pre-emption rights in negotiating such transfers.

3.8.2. LP Secondary Transactions

Question

What procedures should be followed in a secondaries sale?

Explanation

It is likely that some LPs, at some point during the life of the Fund may wish to or need to seek to sell their participation in the Fund. This can arise for a variety of reasons and need not have anything to do with the performance of the Fund. When such a situation arises, there are administrative protocols which need to be followed to ensure the transfer is handled properly in accordance with both the procedures and requirements set out in the Fund documentation and general law. The LP buying the participation will need to satisfy all the Fund requirements. It is important that in the process confidentiality be maintained with respect to information about the Fund and its underlying investments.

In Funds with a high number of LPs, the GP may also need to be mindful of the obligations under general law with regard to the trading status of the Fund and so may need to limit the number of secondary transactions which may take place in any year.

Recommendation

It is standard practice to state in the Fund's documentation that the GP's consent to an LP transfer may not be unreasonably withheld. When an LP is seriously considering selling their participation, they ought to contact the GP at the earliest opportunity and the GP should reconfirm the procedures to be complied with and documentation to be completed before any transfer can be finalised.

The GP and LP should discuss what information about the Fund and its investments can be shared with who at what point in the process of executing the secondary sale. Disclosure should, in accordance with industry practice and protocol, ideally be timed to take account of the Fund's financial, investment and general reporting cycle. This helps to minimise disruption to the Fund's operations, and also expenses incurred in connection with the transfer, as well as to ensure fairness to all stakeholders.

3.9 Winding up of a Fund

The liquidation of a Fund must be undertaken with care by the GP to ensure that neither the Fund, the LPs, nor the GP are exposed to unacceptable potential liabilities following liquidation.

3.9.1. Liquidation

Question

What issues should the GP address on liquidation?

Explanation

The liquidation of a Fund will, generally, mean that the assets will be distributed to LPs. This means that if claims are subsequently brought against the Fund, there are unlikely to be funds available to meet those claims.

Recommendation

On liquidation, the GP should make a thorough assessment of the risk of claims against the Fund and should ensure suitable sums are held in escrow/are subject to Clawback arrangements to meet such claims. The escrow provision should also apply to a portion of the Carried Interest, or alternatively the Carried Interest should be subject to Clawback for a specified period following the end of the life of the Fund.

3.9.2. Fund documents

Question

What provisions should the Fund documents include on liquidation?

Explanation

The GP's powers and responsibilities on liquidation will usually be set out in the Fund documents. It is important that these provisions are clear and exhaustive to reduce the likelihood of disputes on liquidation.

Recommendation

The Fund documents should include provisions on liquidation addressing:

- the GP's power to realise the Fund's investments;
- the extent of LPs' and Carried Interest holders' liability following liquidation;
- the period in which liquidation should be effected; and
- escrow and/or Clawback arrangements to cover potential future liabilities.

3.10 Management of multiple Funds

A successful GP will often manage more than one Fund in the same market. This can give rise to conflicts of interest and make it difficult for the GP to act in the best interests of all of the Funds it manages.

3.10.1. Conflicts of interest

Question

What should a GP do when a conflict of interest arises between Funds that it manages?

Explanation

Conflicts of interest can arise relatively easily where a GP manages multiple Funds. For example, one Fund managed by a GP may acquire an investment being disposed by another, or opportunities for follow-on investment may arise that cannot be exploited by both Funds.

Conflicts can also arise when multiple Funds hold investments in a Portfolio Company and a disposal opportunity arises. It is possible that it may not be in the best interests of all Funds to dispose of the investment (e.g. where one invested on terms that mean disposal would crystallise a loss to that Fund, while another Fund would realise a profit).

Recommendation

The GP should discuss all conflicts of interest with the LPAC of both Funds before making any decision about the best course of action to take. The GP should establish procedures to identify, disclose and resolve conflicts of interest. These should be set out in the respective Fund documents.

3.10.2. Establishment of new Funds

Question

When should the GP establish further Funds?

Explanation

The GP could prejudice the interests of LPs in an existing Fund by establishing a Fund with a similar investment strategy too soon after establishing the existing Fund. Doing so can dilute the return to LPs in the existing Fund and compromise the GP's ability to implement the existing Fund's investment policy. It can also give rise to conflicts of interest if an investment in a Portfolio Company is split between different Funds.

Recommendation

A GP should seek to avoid making new investments in a Portfolio Company from more than one Fund which it manages. In general, a new Fund should not be established until the existing Fund is substantially invested/committed. Fees on prior Funds generally reduce when the Fund is substantially invested or a new Fund is raised. Specific limits on when a new Fund may be marketed or closed should be set out in the Fund documents.

3.11 GP's internal organisation

For the purposes of this section 3.11, management are those members of the board who have executive roles within the GP's organisation and those other employees of the organisation who work with the executives to deliver the business strategy of the GP. Their responsibilities in relation to governance of the business include responsibility for the specific and detailed implementation of the strategy.

The GP has responsibility to ensure that it has adequate resources to source, analyse, negotiate and advise on potential transactions as well as to invest in, manage and divest Portfolio Companies. This includes, in particular, human resources, compliance and financial resources.

3.11.1. Management are responsible for establishing the control environment

Question

How should management go about establishing the control environment?

Explanation

Management are responsible for ensuring that throughout the GP organisation employees recognise and respond to the need for integrity and ethical behaviour in relation to the achievement of the GP's and its investment portfolio's goals. A high standard of corporate governance sets the framework to meet these goals effectively.

Recommendation

Management should identify, select and adopt an appropriate governance and control framework taking into account the size and complexity of the business and should communicate the key features of that framework, applying it consistently and effectively.

3.11.2. Management are responsible for establishing procedures for risk assessment

Question

What procedures should be established for appropriate risk assessment on an ongoing basis?

Explanation

Risk assessment includes determining an appropriate risk appetite, identifying specific risks, assessing the effectiveness of controls over specific risks and comparing residual risk to the overall appetite for risk that has been agreed. Effective procedures for risk assessment cover strategic and operational matters and operate on a regular and rolling basis.

Any procedures or processes introduced to an organisation should normally be subjected to an analysis comparing cost and benefits. The introduction of risk assessment procedures should acknowledge that much of what happens in business process is the proactive assessment and mitigation of risk and that therefore the introduction of risk assessment procedures is partly a matter of making explicit what is already in place. This is particularly true in the case of Private Equity and Venture Capital firms that typically will have well developed risk assessment and mitigation approaches and processes.

Recommendation

Risk assessment should cover at least:

- strategic risk;
- risk within the core business processes; and
- risk within the resource management processes.

Where appropriate, specialist help and advice should be sought when dealing with specific risk areas, for example market/public relations risk, treasury risk, labour relations risk, regulatory risk or information technology risk. The assessment of risk should be a regular ongoing process and not a "once a year" exercise.

3.11.3. Management are responsible for control activities

Question

How can management fulfil their obligations in respect of control activities?

Explanation

Control activities are those elements in business and financial processes which help prevent errors and omissions from occurring or which detect when errors or omissions have occurred.

In a well-governed organisation, all members of the management team are aware of the importance of control activities and acknowledge their responsibilities for control activities in their particular area ensuring the importance of these are communicated to members of their team. Control activity is not just the remit of one particular function within the organisation, e.g. compliance and risk or finance, and it is important for all members of the management team to acknowledge this.

Recommendation

Management should ideally conduct a review of control activities on a regular basis covering both the design and operation of those activities.

3.11.4. Human resources

Question

What responsibilities does a GP have with regard to human resources?

Explanation

Employees and others engaged by the GP are a vital resource. If this resource is not adequate or is not maintained and appropriately managed, the GP may not be able to implement the Fund's investment policy.

Recommendation

The GP should, at all times, have a staff of adequate size and appropriate competence to ensure that it is able to fulfil its obligations to all Funds under management. These staff should be appropriately allocated.

The GP should implement human resources management processes to administer appropriate functions (such as payment of taxation and social security contributions) and to implement any training and development policies.

The GP should implement arrangements requiring its employees to conduct themselves in an appropriate manner.

The GP should ensure that it implements appropriate succession planning arrangements to ensure that the quality of its key personnel is maintained over time.

The GP should ensure that it has sufficient skill and experience to manage and maintain LP relationships.

3.11.5. Incentivisation

Question

How should the GP incentivise its staff?

Explanation

An incentivised and motivated team is vital to the success of the GP. By adopting appropriate policies to maintain a stable and motivated team, the GP is likely to improve returns to LPs.

Recommendation

The GP should ensure suitable remuneration for its staff. An important factor in the development and structuring of a remuneration scheme will be to ensure that it creates an alignment of interests between the employee, the GP and the LPs in the Fund. The GP should ensure that Carried Interest and similar arrangements are structured in a balanced manner to motivate and incentivise the team and its key members throughout the life of the Fund. The GP should also ensure that there are provisions that set out the extent to which individuals are permitted to participate in Carried Interest arrangements upon leaving the employment of the GP.

3.11.6. Financial resources

Question

What financial resources should the GP maintain?

Explanation

It is becoming common for LPs to request due diligence information on GPs' financial resources. It is important that the GP monitors its own financial resources to ensure that they remain sufficient to allow the GP to trade and to implement the investment policies of the Funds under management.

Recommendation

The GP should maintain adequate financial resources to allow it to continue trading during the life of all Funds under management. In addition, GPs should be prepared to respond to due diligence requests for information on financial resources.

The GP should implement internal financial reporting procedures to ensure that it effectively monitors its financial position on an ongoing basis. If the GP becomes aware that its financial resources have been seriously eroded, it should liaise with the LPs in its Funds to agree suitable measures to remedy the situation.

3.11.7. Segregation of Fund assets

Question

Should the GP make particular arrangements regarding Fund investments and cash under its control?

Explanation

In the event of the GP becoming insolvent or being the subject of legal proceedings, it is essential that assets it holds or controls on behalf of Funds are protected and cannot be used to discharge the liabilities of the GP. To ensure that this is the case, Fund assets must be segregated from the GP's own assets.

Recommendation

The GP should make appropriate arrangements to ensure that Fund assets (including cash) are segregated from its own assets.

When the GP achieves this by lodging assets with an external custodian, the GP should ensure that such assets are appropriately protected by the custodian and that there is a suitable written agreement with the custodian.

3.11.8. Procedures and organisation

Question

What other procedures and organisational measures should the GP implement?

Explanation

While the efficient operation of the GP will be ensured by adhering to general principles of good governance and general business management, there are certain matters that are specific to the Industry that the GP should address.

Recommendation

The GP should implement procedures to address the following matters (which are in no particular order):

- personal dealing in investments by GP staff and if necessary, with other parties with whom the GP is dealing;
- decision-making on investment in target companies and disposal of Portfolio Companies on behalf of the Funds;
- storage (and as required, confidential destruction) of documents and record-keeping;
- outsourcing of material functions (particularly where they may impact on the management of Funds);
- prevention of money laundering and other forms of financial crime;
- business continuity in the case of a disaster;
- insurance requirements to protect both the GP and the Funds it manages, for example Directors & Officers insurance for executives appointed as directors on Portfolio Company boards and professional indemnity insurance, if applicable; and
- the protection of the Fund and the GP in the event of key employee departures.

3.11.9. Internal reviews and control

Question

What internal reviews and controls should be established to ensure that the interests of LPs are protected and the terms of the relevant agreements adhered to?

Explanation

LPs place a high degree of trust in a GP, committing their capital and in effect "locking it up" over the medium to long term.

The best assurance and control mechanisms for an LP are the regular flows of information, communication and face-to-face meetings with GP's senior management. Formal procedural steps should however also be put in place that provide a reasonable level of assurance that the terms of the agreements and any particular laws are being adhered to.

Recommendation

A GP should make provision for internal review procedures which allow the board of the GP to gain a reasonable level of comfort that the terms of the agreement with any LP or customer and any applicable legal requirements are being followed.

These procedures should be overseen by a member of staff of sufficient seniority and independence and with sufficient resources to ensure that they are undertaken effectively.

3.11.10. Management are responsible for the organisation's information and information systems and for communications within and outside the organisation

Question

What are management's responsibilities in relation to information?

Explanation

Effective management by the GP depends on the ability of individuals to make well-informed decisions. The accuracy, timeliness and relevance of information on which to base decisions is therefore of paramount importance.

Businesses generate large amounts of information: about customers and markets; historic, current and future financial and non-financial performance; profitability, efficiency and effectiveness; and about risk and the management of risk. One of the key roles of the GP's executives is the assimilation of the data and management information being generated at a Portfolio Company level. Analysis and assessment of this information is critical to gaining a clear insight into the Portfolio Company and as a result ensuring the most effective management of the Portfolio Company at a strategic, tactical and operational level.

Recommendation

Management should ensure that the organisation's information is:

- accurately compiled;
- clear and unambiguous;
- kept secure and confidential; and
- provided in a timely and appropriate format and manner.

Question

What are management's responsibilities in relation to information systems?

Explanation

Business is largely dependent on up-to-date computer technology for the recording, storing, processing and reporting of information. The suitability, efficiency and security of information systems are vital to the ability of the business to function effectively.

Recommendation

Management should regularly assess the suitability, security and reliability of the business information systems used by the GP.

Question

How should management approach communication of information?

Explanation

Management need to communicate both internally within the GP and externally with LPs and advisors.

For example, management will inform GP employees about strategy and expected performance and will give LPs and, as relevant, other stakeholders trading updates and other information.

Recommendation

Internal and external communications should be:

- based on accurate information and honest interpretation;
- clear, unambiguous and suitable for the target audience; and
- delivered in a timely manner.

Members should contribute such data about themselves and their Portfolio Companies as may be requested by the EVCA from time to time and which is to be used on an aggregated and anonymous basis.

It is good practice to nominate a member of management to take overall responsibility for the GP's public relations strategy.

3.11.11. External communication

Question

How should management approach external communication with a wider stakeholder group?

Explanation

A greater understanding among the general public for the Private Equity and Venture Capital Industry, its working methods and what it brings to the real economy enhances the Industry's ability to match investment capital with investment opportunities. Communication with the parties concerned in connection with acquisitions and implementation of change programmes in the Portfolio Companies is an integral and important part of the value creation process and is already to a large extent encompassed by the Industry and its Portfolio Companies.

At the same time the rapid growth of the Industry over the past decade implies that an increasing number of people are today employed by companies that are wholly owned or controlled by the Industry. In summary this creates a need for a comprehensive and common set of recommendations regarding transparency and disclosure of information by the Industry to a wider stakeholder group.

Recommendation

GPs should have a website in order to provide information regarding themselves and their investments in a timely fashion.

The GP's website could include information on:

- the legal structures (form) of its Funds;
- an overview of the GP ownership structure;
- senior management or senior investment professionals;
- size and investment strategy of the different Funds;
- Fund investors by category and geography;
- primary contact person for each Portfolio Company;
- investments made with the following information about each Portfolio Company:
  - date of investment
  - date of divestment
  - type of industry
  - link to the Portfolio Company's website
- applicable guidelines for portfolio valuation and reporting to investors;
- policies regarding handling of potential conflicts of interest;
- policies regarding responsible investment;
- press releases issued by the GP;
- the name of the individual who is the press contact.

3.11.12. Market Transparency – EVCA Research and Data

Question

How should members of the EVCA contribute toward ensuring the transparency of the industry?

Explanation

With the growth of the Private Equity Industry comes increased public attention. Politicians and regulators call for increased transparency. They also put forward regulatory initiatives that require all Industry participants, particularly LPs but also GPs, to operate on a documented basis of knowledge. Many data providers operate in the field, but have varying resources to allocate to data collection and all rely on voluntary, intermittent submissions, mainly from GPs.

Due to the EVCA's structure as a co-operation between GPs and LPs, EVCA Research and Data department [http://www.evca.eu/knowledgecenter/default.aspx?id=544] is uniquely positioned to collect, analyse and disseminate data on all relevant components of the Private Equity Industry throughout Europe. However, in order to make the most of this position, EVCA Research and Data department relies on submissions from all member groups.

Recommendation

LPs and GPs should structure their contractual arrangements so as to allow for the submission of information to EVCA Research and Data department and should generally encourage industry participants to contribute to establishing EVCA Research and Data as an information provided trusted both by industry participants, academia and regulators.

3.11.13. External assistance

Question

What other resources should the GP have available?

Explanation

GPs vary in their size and experience but no GP is likely to have all the internal resources necessary to deal with every possible matter for which it is or becomes responsible.

The establishment of a Fund and its operation frequently involve specialist considerations in many jurisdictions.

Recommendation

A GP should obtain appropriate specialist and technical advice in order to carry out its duties. Legal, tax and accountancy advice will almost always be necessary and sometimes other specialist consultants (e.g. environmental, scientific and technological) may be requested.

3.11.14. Considerations relating to monitoring of governance – GP governance

Question

What will prospective investors consider when carrying out due diligence on a GP's governance procedures?

Explanation

As part of the due diligence process of a GP by a prospective investor during, for example, Fundraising, a number of factors in relation to the operation of the GP will be carefully scrutinised. The due diligence process will normally look at the GP's:

- corporate governance processes
- policies and procedures
- investment, divestment and Portfolio Company decision-making processes
- reporting processes
- compliance and risk management processes
- business continuity plans
- conflicts of interest management and resolution procedures (likely to include conflicts between employees and the GP, third parties and the GP, the GP and the LPs and between the LPs themselves).

Recommendation

It is important that a core team, typically including representatives from across the GP's operational areas, regularly reviews the requests being made by LPs for information on processes, policies and controls and that the information being supplied is kept current and is provided in a consistent manner. Ideally this information should be held in an electronic format that can be easily collated depending upon the request and to the extent possible is compatible with the LP's own systems.

A record should be kept of when and what information has been supplied to each LP. This group should review and agree to new requests or requests for information that has not been supplied in the past. Where possible and practicable, the GP should benchmark the type and level of information it is supplying against its peers as transparency and a willingness to provide such information can be one of the factors an LP will use when deciding which GP(s) will receive a capital allocation.

Question

How regularly should the GP review the performance and appropriateness of its own corporate governance procedures, those of the Fund and at the level of the Portfolio Company?

Explanation

In the Private Equity environment, there are several layers of governance considerations.

First, the GP's business should have its own internal processes and procedures concerning corporate governance, which should be kept under continuous assessment to ensure that they remain appropriate. The frequency and detail of review will be different for different GPs depending on their size, complexity, LP base, geographical reach and a range of other factors.

Second, governance at Fund level should be taken into consideration by GPs both at the Fund structuring stage and also during the life of the Fund. Most Funds (structured as Limited Partnerships) will create a fiduciary relationship between the GP and the LPs. LPs will not be involved in the management of the Fund, but do however have a role to play in relation to certain decisions to be made, such as whether or not to remove the GP under the so-called fault/no-fault divorce provisions, to approve amendments to the Fund terms, to terminate the Fund, etc.

A number of LPs may also play a role as members of an LPAC (see section 3.7.5). LPs sitting on the LPAC will usually be asked to consider issues concerning conflicts of interest, Keyman events, approval of valuations, etc. The LPAC has a role to play in governance, however, governance is not just limited to those LPs on the LPAC; as mentioned above, all LPs have a role to play.

Good governance implies that conflicts of interest should not be left to the discretion of the GP. Conflicts can arise in a variety of situations, including GPs (or GP staff) holding an interest in a company which the GP recommends for investment to the Fund, Co-investments by GP staff alongside the Fund, the GP acting for competing Funds, deal allocation between different Funds managed by the GP, etc.

Sometimes conflicts can also arise between LPs, such as when some LPs have more than one interest in Funds managed by the GP, especially if those LPs carry a majority on the LP Advisory Committee. LP conflicts of interest are considered in more detail in section 3.7.4. While LPs do not owe any fiduciary duties to one another, it is the GP's duty to manage such conflicts when they arise and to treat all LPs fairly while acting in the best interests of the Fund as a whole.

Third, the governance of a Portfolio Company needs to be considered by the GP. Once an investment is made, Portfolio Company governance should be kept under continuous assessment to ensure that it remains appropriate. However, the frequency and detail of review will be different for different companies. This is explored more fully in section 3.4.4.

Recommendation

The GP should implement and monitor corporate governance processes and procedures at the GP level. These processes and procedures should be reviewed by the GP on a regular basis to ensure policies are up to date and are being implemented. They should also be discussed with the LPAC and communicated to all LPs.

The GP should ensure LPs are involved in the governance of the Fund by establishing an LPAC, conducting regular meetings with LPs and ensuring reporting and communication with LPs are of a high standard.

The GP should also work with its Portfolio Companies to establish monitoring programmes which as a minimum ensure that all elements of the corporate governance framework are reviewed at least annually.

Glossary

"Carried Interest"
A share of the gains realised from a Fund's underlying investments. The GP is required to invest in the Fund in order to be entitled to receive Carried Interest. Carried Interest is generally regarded as the main incentive to the GP and is a key mechanism for aligning the GP and LP interests in a Fund.

Carried Interest is typically 20 per cent of the Fund's net gains and is payable to the GP only once LPs have been repaid an amount equal to their drawn down Commitments plus a "preferred return". Depending on the jurisdiction, the GP may be required to make a significant investment alongside the LPs in the Fund to obtain the right to receive Carried Interest. Carried Interest is sometimes referred to as "carry".

"Clawback"
GP Clawback is the repayment of any excess Carried Interest received. It is designed to protect LPs and requires those who receive Carried Interest to return amounts received in excess of the amount they should have received. The mechanisms used to achieve such repayment include a combination of the use of escrow arrangements (where a certain portion of the Carried Interest is put into an escrow account to secure clawback obligations) and periodic or annual true-up mechanisms.

Note that a "true-up" is a calculation to determine how much Carried Interest is due to the GP based on all cash flows to the date of calculation. An "interim true-up" is one which is calculated during the life of the Fund and takes into account the value of unrealised investments. A "final true-up" takes place at the end of the life of the Fund, when all proceeds have been distributed. If the amount of Carried Interest due to the GP, based on the true-up calculation, is less than the amount the GP has actually received, then the excess amount is required to be returned to the Fund.

LP Clawback is a mechanism which requires LPs to return Distributions to cover potential Fund liabilities including indemnification obligations and can be payable after the end of the life of the Fund.

"Code"
The Code of Conduct, which is as follows:

1. Act with integrity
2. Keep your promises
3. Disclose conflicts of interest
4. Act in fairness
5. Maintain confidentiality
6. Do no harm to the Industry

Compliance with the Code is mandatory for all members of the EVCA and their affiliates.

"Co-investment(s)"
In relation to an LP Co-investment, this is a Co-investment by an LP in a Portfolio Company alongside a Fund, where the LP is an investor in such Fund.

The term Co-investment may also be used to refer to an external syndication of a Private Equity financing round.

In contrast, the terms "consortium deal" or "club deal" are typically used to describe a situation where two or more Funds with different GPs club together to acquire a majority stake in a Portfolio Company.

"Commitment(s)" or "Capital Commitment(s)"
An LP's contractual commitment to provide capital to a Fund up to the amount subscribed by the LP and recorded in the Fund documents, also known as such LP's Fund interest. This is periodically drawn down by the GP, to make investments in Portfolio Companies and to cover the fees and expenses of the Fund.

"Distribution(s)"
All amounts returned by the Fund to the LPs. This can be in cash, or in shares or securities (in the latter case known as "Distribution(s) in specie").

"Drawdown(s)"
LP Commitments to a Fund are drawn down as required over the life of the Fund, to make investments and to pay the fees and expenses of the Fund. When LPs are required to pay part of their Commitment into the Fund, the GP issues a Drawdown notice. Drawdowns are sometimes referred to as "capital calls".

"Environmental, Social and Governance" ("ESG")
ESG is a phrase commonly used interchangeably with responsible investment. It generally implies an interest from the investor in the Environmental and Social impact performance of the company and the governance put in place to manage these areas.

"ERISA"
The US Employee Retirement Income Security Act of 1974, as amended.

"Exit(s)"
Realisations of investments made by a Fund. This will normally take the form of a sale or flotation (IPO) of the Portfolio Company.

"Fund(s)"
A Private Equity or Venture Capital Fund. A closed-ended Limited Partnership is a common structure used for such a Fund, but other legal forms are also used e.g. FCPR, KG, SICAR, AB, BV and NV, etc.

"Fundraising" and "Fundraising Team"
The process by which money is raised to create a Fund. Funds are typically raised directly by the professionals (Fundraising Team) who are actively involved in the sourcing, analysis, negotiation and subsequent monitoring of potential transactions on behalf of the Fund. The Fundraising Team may choose to work in conjunction with an intermediary (usually called a Placement Agent) particularly when looking to establish relationships with new LPs.

"GP"
GP is the term typically used to refer to the different entities and professionals within a Private Equity firm which source, analyse, negotiate and advise on potential transactions as well as invest and manage the Fund. It is this definition which is used for the purposes of this Handbook. More specifically it means the general partner of a Limited Partnership. The term GP may also be used to refer to the manager or investment adviser of a Fund, depending on the Fund structure.

"Holding Period"
The length of time an investment remains in a Fund.

"Industry"
Private Equity and Venture Capital Industry.

"Investment Agreement"
This is the agreement typically entered into by the Fund(s), the GP, the Portfolio Company(ies) and the management team of the Portfolio Company, which sets out the investment to be made by the Fund(s) in the Portfolio Company and the terms agreed between the Portfolio Company shareholders.

For the purposes of section 3 of this Handbook, reference to Investment Agreement also includes the articles of association of the Portfolio Company, shareholder loan agreements, investor rights' agreements and other such agreements between the Portfolio Company shareholders.

"Investment Committee"
It is normal for a GP to have an Investment Committee, which is the board of the GP or a specific body within the GP making the ultimate investment and divestment decisions. It will typically also make ownership-related decisions during the Holding Period of those investments, including follow-on investment decisions.

"Investment Period"
Typically the initial few years of a Fund's term, during which time it is intended that the Fund will make its investments.

"IRR"
The Internal Rate of Return or "IRR" is the calculation used to measure the return of a private equity Fund. IRRs are used in private equity instead of time-weighted returns ("TWRs"), which are more common in other asset classes.

Technically, the IRR is defined as the discount rate which, when applied to all the cash flows in the Fund and the fair value of the Fund's assets at a point in time, would produce a net present value of zero. It is therefore the best measure for comparing the performance of different Funds covering different time periods. In common parlance, the IRR represents an absolute measure of the cash flow return of a Fund at a point in time.

The IRR can be calculated on a net basis (meaning net of fees, expenses and Carried Interest) or a gross basis (meaning before fees, expenses and deduction of Carried Interest).

The IRR is calculated as an annualised compounded rate of return, using actual cash flows and annual valuations.

"Keyman(men)" and "Keyman Provisions"
The key senior professionals actively involved in the sourcing, analysis, negotiation and subsequent monitoring of potential investments made by a Fund are typically identified and named in the Fund documents as Keymen. Provisions are made regarding what happens should any of these individuals cease to devote sufficient time to the Fund, so called Keyman Provisions.

"LP"
An investor in a Fund. More specifically it means the limited partner in a Limited Partnership. LPs in a Fund include sophisticated investors, experienced high net-worth individuals and entrepreneurs, sovereign wealth funds, endowment funds, foundations and family offices.

"Limited Partnership"
A legal structure commonly used by many Private Equity and Venture Capital Funds. It is used especially when catering for broad categories of international investors and looking to make cross-border investments. The partnership is usually a fixed-life investment vehicle, and consists of a general partner (the GP/manager of the Fund which has unlimited liability) and limited partners (the LPs which have limited liability and are not involved with the day-to-day operations of the Fund).

"LP Advisory Committee" ("LPAC")
The LPAC is typically comprised of a cross-section of LPs in a Fund. The role of the LPAC is essentially to be consulted by the GP on conflicts of interest and generally to act as a sounding board for the GP.

"Management fee(s)" or "Priority Profit Share"
These are the terms that are used to refer to the fee/profit share paid by the Fund to the GP. The Industry's basic partnership model of investments between LPs and GPs rests on the 80/20 split of profits. For the GP to be able to employ and retain staff in order to invest and properly manage the Fund until such time as profits are realised, it will typically receive, on a quarterly basis, an advance from LPs to cover the Fund's overhead costs. This management charge, funded out of LP Commitments, is generally equal to a certain percentage of the committed capital of the Fund during the Investment Period and then as a percentage of the cost of investments still held by the Fund.

"Most Favoured Nation"
A Most Favoured Nation (or "MFN") clause is a common protection sought by LPs found in the constitutional documents or the side letter. In an MFN provision, the GP assures the LP that it will benefit from side letter provisions granted to other LPs. The MFN provision usually carves out side letter provisions that relate to tax or regulatory considerations of individual LPs.

"Placement Agent"
A person or entity acting as an agent for the Fundraising Team in raising investment funds. Placement Agents should comply with the EVCA's separate code of conduct for Placement Agents (see the appendix).

"Portfolio Company(ies)"
A company or companies in which a Fund has made an investment.

"Private Equity"
Private Equity provides funding in equity form from Funds to acquire a majority or minority stake in Portfolio Companies in different stages of development across a wide range of industries. The term is widely used and encompasses Venture Capital (typically a minority stake invested in an early-stage or pre-profitable business), through to enterprise capital (a minority or majority stake invested in Portfolio Companies at critical points of their development). When majority stakes are acquired through enterprise capital investments, these are commonly referred to as "buyout" transactions.

"Responsible Investment"
The term Responsible Investment refers to the expectation from asset owners that the breadth and depth of interest that investment managers will take in the performance of the companies in which they invest should encompass more than only the financial return. Commonly, a responsible investor will be interested in the Environmental and Social impact performance of the company and the governance put in place to manage these areas. This focus gives rise to the term Environmental, Social and Governance (ESG) investing.

"Secondary Investments" or "Secondaries"
These terms are typically used to refer to the transfer of an LP's contractual commitment and interest in an existing Fund to another LP ("secondary fund investment"). In contrast, the term secondary (direct) sale is used to describe the sale by a Fund of its interests in one or more Portfolio Companies to a Fund managed by a different GP.

"Transaction Fee(s)" and "Broken Deal Fees"
A Transaction Fee is a corporate finance or M&A fee charged by the GP to the holding company making the acquisition of a Portfolio Company.

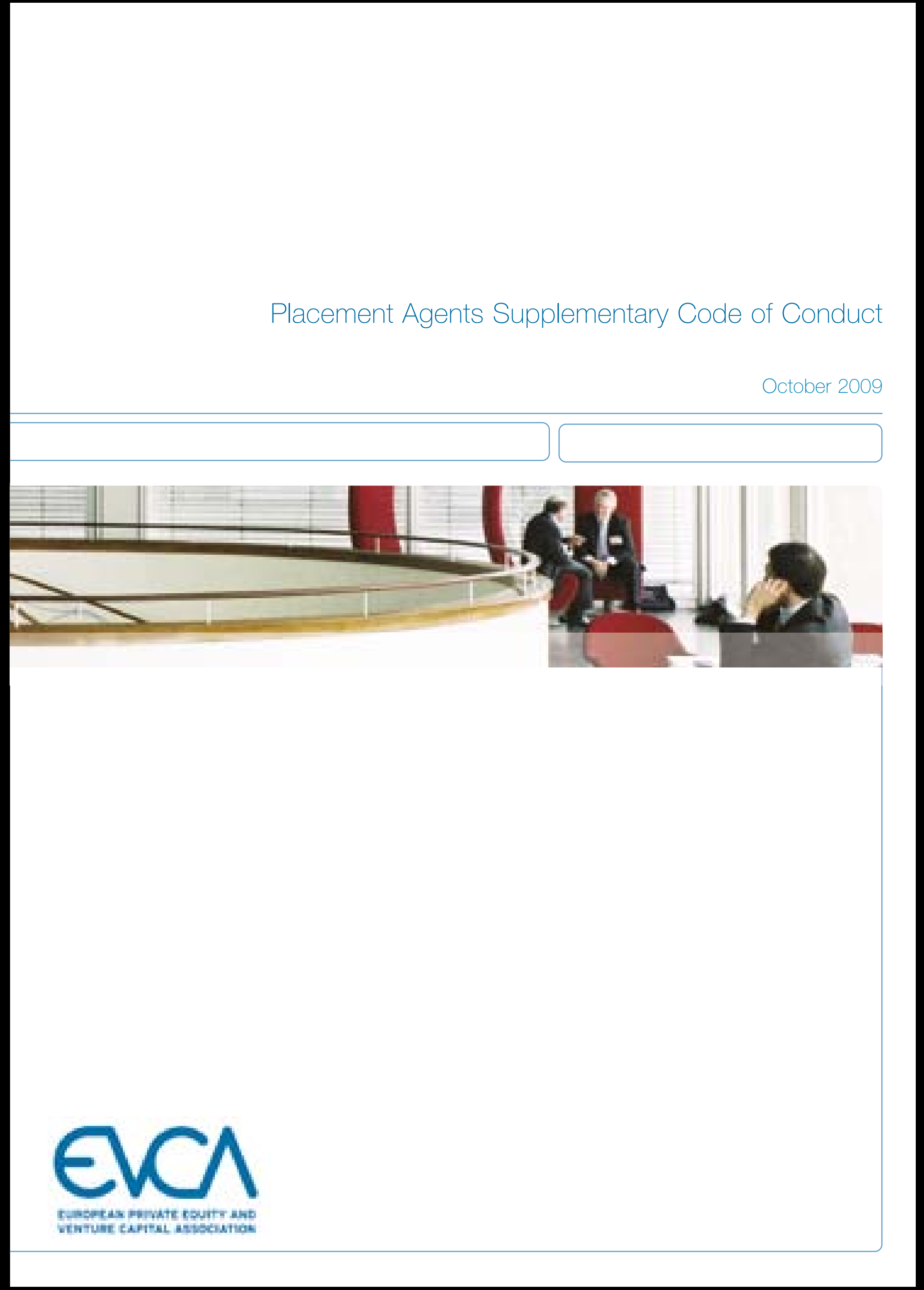
Broken Deal Fees (also referred to as "abort costs") are costs incurred by the GP in pursuing a deal that falls through (e.g. accountants, lawyers, due diligence costs etc.).

Such fees can be offset against the Management Fee.

"Venture Capital"
Funding typically provided in equity form to companies in early stages of their life cycles, i.e. seed, early-stage, development, or expansion. Historically the term was used to refer generally to all Private Equity investments which is why many Private Equity associations refer only to Venture Capital in their name.

Appendix

Code of Conduct for Placement Agents



EVCA Professional Standards

For the Private Equity and Venture Capital Industry

EVCA Code of Conduct
EVCA Code of Conduct (Placement Agents Supplement)
EVCA Governing Principles
EVCA Corporate Governance Guidelines
International Private Equity and Venture Capital Valuation Guidelines
EVCA Reporting Guidelines

About EVCA

The EVCA is the voice of European private equity.
We represent venture capital, mid-market private equity, the large majority investors and institutional investors, speaking for 700 member firms and 400 affiliate members.
In the last five years, EVCA members have invested 160 billion euros in 7,000 companies across Europe, making a valuable contribution to growth and innovation.
The EVCA shapes the future direction of the industry, while promoting it to stakeholders like entrepreneurs, business owners and employee representatives.
We explain our industry to the public and engage in debate with policymakers, so that our members can conduct their business effectively.
The EVCA is responsible for the industry's professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.
Thanks to our industry research teams, we have the facts when it comes to European private equity. The EVCA has 25 dedicated staff working in Brussels to make sure the industry is heard.

Contents

Placement Agents Supplementary Code of Conduct

1. Preamble

This Supplementary Code is additional to the EVCA Code of Conduct (the "Code"). It is to be read and implemented in conjunction with the Code by all member firms the business of which encompasses acting as a placement agent.

This Code has been produced by EVCA in acknowledgement of the importance of the role of the placement agent in successful capital raising for private equity and venture capital firms. It seeks to reflect the bona fides and professional rigour which member firm placement agents undertake at present and are expected to continue to bring to their work in support of their clients in the industry.

The role of the placement agent has developed significantly over the past ten years and is seen as an important and positive component within the industry. EVCA resolved to introduce the Supplementary Code (a) to reflect the established institutionalisation of the placement agency business model, (b) to highlight the importance of such role in private equity fund-raising (c) to maintain and publish benchmarks in the practices of placement agents for the benefit of all member firms, (d) to encourage the furtherance and continued support of strong ethical principles in this segment of the market by placement agents and those that engage them, (e) to emphasise the necessity of adherence to high standards of compliance and regulation wherever a member firm operates and (f) to impose requirements as to transparency and accountability of dealings.

EVCA recommends all applicable member firms append the Supplementary Code to their terms of engagement for client care letters at the initiation of any new instruction.

EVCA will continue to monitor the Supplementary Code. Compliance with it is a prerequisite to membership of EVCA by any member firm engaging in placement agent activity. The sanction for non-adoption or for proven breach of the Supplementary Code or proven misconduct by a member is expulsion of that member from EVCA.

2. Rules

1. Regulation and Authorisation

1.1 A Firm conducting placement agent activity must be in the habitual, systematised business of acting as a placement agent.

1.2 Where local laws require it, a Firm must be registered and/or authorized with, and regulated by, as applicable, appropriate regulatory bodies in each jurisdiction in which it undertakes regulated activities.

1.3 A Firm's representatives who are not acting in a strictly administrative or ministerial capacity should possess the licenses or certifications required by legal, governmental, regulatory or self regulatory organizations to which the placement agent or its representatives are subject, including, as required, the more stringent certifications for those acting in a supervisory capacity.

1.4 A Firm should operate in an environment with established compliance and oversight processes.

2. Conduct of Business

2.1 A Firm is expected to maintain high standards of probity, integrity and professionalism in the conduct of its business.

2.2 A Firm should perform reasonable due diligence in respect of a Client commensurate with the scope of its engagement.

2.3 A Firm should maintain professional relationships with a meaningful number of investors which seek to invest in private equity, and typically should be retained to raise capital from all or a significant sub-set of such investors.

2.4 A Firm should enter into a written contract with a Client (i) specifying the scope of services the Firm will perform and the fee arrangement, and (ii) confirming the Firm will adopt and adhere to the Code and this Supplementary Code.

2.5 A Firm should not make or offer to make any payment or other consideration with a view to enducing a third party to enter into contractual negotiations with a Client.

2.6 A Firm should keep records of the performance of its duties for a minimum period of five years (longer in accordance with applicable law), available for inspection by the relevant Client

Placement Agents Supplementary Code of Conduct

3. Expertise and competence

3.1 Staff shall be appropriately qualified, authorized and supervised commensurate with the capacity in which they are employed, the jurisdictions in which they operate and their seniority.

4. Disclosure

4.1 A Firm should disclose, upon the request of a prospective or existing investor, the fee arrangement the Firm has agreed to with a prospective or existing Client or its manager in respect of such investor's investment in such Client or its funds. The Firm should disclose to a prospective or existing Client any other payments received or made by it in connection with its activities on behalf of that Client. A Firm should not make or offer to make any payment with a view to inducing a third party to enter intocontractual negotiations or contact with a prospective or existing Client.

4.2 Any political or quasi-political donation made by any placement agent firm, any affiliate or representative of the firm or any employee (or immediate family member of employee) shall be disclosed to prospective and existing Clients, to prospective and existing investors of such Clients, to regulatory bodies and to decision-making bodies connected to that recipient firm or individual upon request.

4.3 Any Firm engaging any former employee of a government pension plan or any one in the decision-making chain of command regarding an investment by such government pension plan in a Private Investment Fund must make full disclosure of such engagement to its prospective and existing Clients and Clients' investors and such person must agree not to solicit such government pension plan for at least three (3) years.

4.4 Any sub-placement agent retained by a Firm must (i) be disclosed to a prospective or existing Client and its investors, and (ii) must undertake to ensure its compliance with the Code and this Supplementary Code.

4.5 The Firm shall take reasonable steps to procure that any sub-placement agent retained by a prospective or existing Client or its applicable manager must (i) be disclosed to the Firm (ii) to the Client's prospective and existing investors and (iii) must undertake to ensure its compliance with the Code and Supplementary Code, failing either of which stipulations, the Firm must cease to act on its instruction for the Client.

4.6 A Firm's role, and the role of any sub-placement agent, should be disclosed within marketing materials issued by the Client or otherwise in connection with the Client's fund-raising.

3. Explanatory notes to the Code

Definitions:
Client: an EVCA Member firm which engages a placement agent in an advisory and/or fund-raising capacity
Firm: an EVCA Member firm carrying on business as a placement agent

Note to Rule 1

In respect of the applicable regulatory requirements for placement agents operating in Europe for example, in the United Kingdom this would be the pursuant to the Financial Services Authority and in non-EU countries, for example, the US, this would be the Securities and Exchange Commission ("SEC") and the US Financial Industry Regulatory Authority, Inc. ("FINRA").

Note to Rule 2

In respect of staff qualifications, for placement agents operating within Europe, for example, in the United Kingdom, staff performing controlled functions are to be approved persons under the Financial Services and Markets Act 2000 and in non-EU countries, for example, in the US this would be the Series 7 and 63 licenses for its representatives, and the Series 24 for those individuals acting in a supervisory capacity. Firms are expected to maintain and monitor appropriate training, competence and professional development of all staff. Firms are expected to be in compliance with the relevant training and competence regime stipulated by applicable regulators in their country of domicile.

Note to Rule 4.1 and Rule 4.6

Where a Client views the terms of engagement of the Firm as commercially sensitive, the Client may require confidentiality undertakings from investors to whom the information is disclosed.

Note to Rule 4.2

Certain institutions prefer that no political donations are made whatsoever. The expression quasi-political is to be broadly construed to include campaign contributions, lobbying organizations, trades unions and individuals and to encompass donations to individuals, corporate bodies and other associations.

EVCA
EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL ASSOCIATION

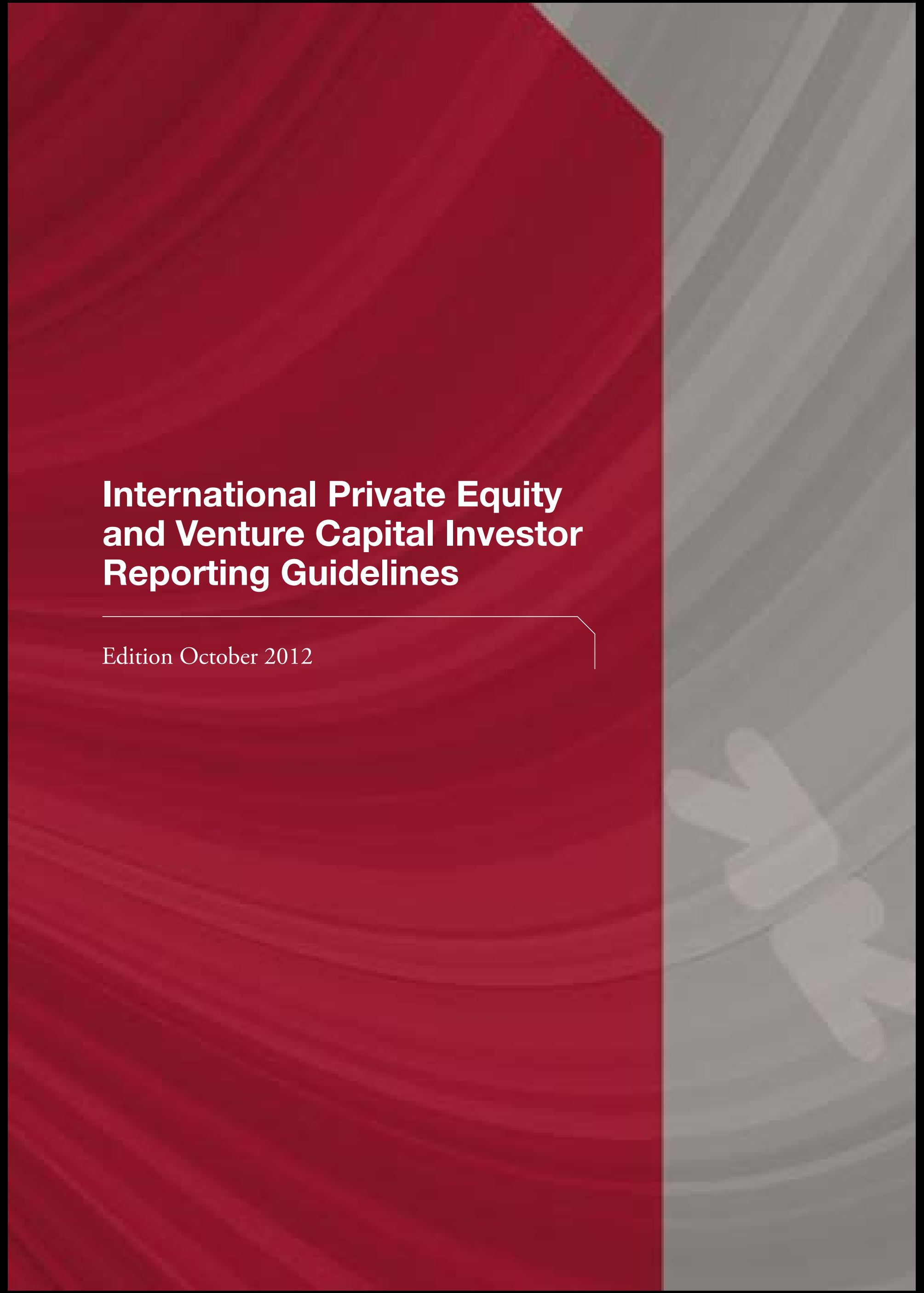
The Placement Agents Supplementary Code of Conduct is published by the European Private Equity and Venture Capital Association © EVCA October 2009

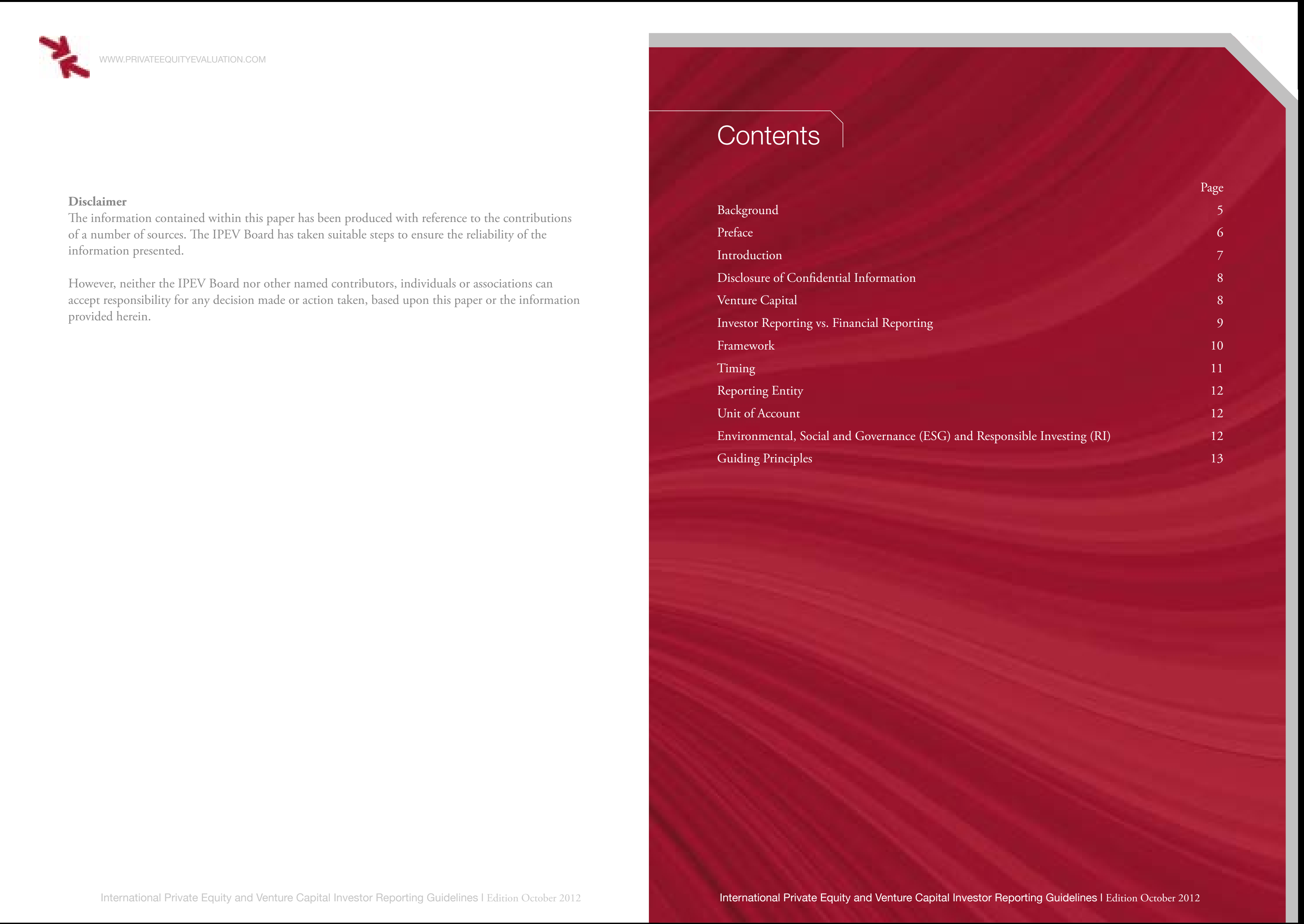
Bastion Tower, Place du Champ de Mars 5, B-1050 Brussels, Belgium Tel: + 32 2 715 00 20 Fax: + 32 2 725 07 04 e-mail: info@evca.eu web: www.evca.eu

IPEV Reporting Guidelines

This document includes the latest International Private Equity and Venture Capital (IPEV) Investor Reporting Guidelines (edition October 2012), which are also available on the IPEV website at www.privateequityvaluation.com.

For all the latest updates to the Guidelines and/or to ask questions to the IPEV Board, please visit the IPEV website. The site also includes a complete listing of endorsing associations and IPEV supporters.





WWW.PRIVATEEQUITYVALUATION.COM

Disclaimer
The information contained within this paper has been produced with reference to the contributions of a number of sources. The IPEV Board has taken suitable steps to ensure the reliability of the information presented.

However, neither the IPEV Board nor other named contributors, individuals or associations can accept responsibility for any decision made or action taken, based upon this paper or the information provided herein.

International Private Equity and Venture Capital Investor Reporting Guidelines | Edition October 2012

Contents

International Private Equity and Venture Capital Investor Reporting Guidelines | Edition October 2012

WWW.PRIVATEEQUITYEVALUATION.COM

Background

The EVCA requested the IPEV Board to update the prior EVCA Reporting Guidelines after considering current Fund Manager and Investor needs throughout the world. The historical EVCA Reporting Guidelines along with other reporting guidelines prepared by AVCAL, PEIGG, ILPA and others were considered prior to establishing these best practice Guidelines. These Guidelines have been prepared after seeking input from all constituencies involved with private equity: Managers / General Partners / GPs, Investors / Limited Partners / LPs and service providers. The terms Manager, General Partner or GP and Investor, Limited Partner or LP are used interchangeably throughout these Guidelines.

The IPEV Board proposes that these Reporting Guidelines be adopted by all private equity firms in order to create a reporting framework for the whole of the industry allowing for greater comparability and enhanced analysis of Fund performance. The Board recognizes that some firms will wish to disclose additional information to that specified in these Guidelines and it is not the Board's intention to restrict such disclosure in any way. Further it is not appropriate to mandate a specific format, as the nature of each Fund's investments differs.

It is not the purpose of these Guidelines to encourage or require redundancy in the information exchanged between Managers / GPs and Investors / LPs. Judgment must be exercised in how, where, and when to communicate critical investment information.

While the Guidelines do not address marketing materials (including offering memorandums) or other forms of Investor communication such as conference calls and webcasts, the methodologies and assumptions underlying such exchanges of information are expected to be consistent with information prepared by the Manager using these Guidelines, specifically that Investments are reported at Fair Value consistent with the IPEV Valuation Guidelines.

WWW.PRIVATEEQUITYEVALUATION.COM

Preface

These Guidelines set out recommendations on the reporting of detailed fund and investment information by Fund Managers. The term "private equity" is used in these Guidelines in a broad sense to include investments in early stage ventures, management buyouts, management buyins, infrastructure, mezzanine debt and similar transactions and growth or development capital.

These Guidelines are intended to be applicable across the whole range of Private Equity Funds (seed and start-up venture capital, buyouts, growth / development capital, etc) and financial instruments commonly held by such Private Equity Funds. Accordingly, because these Guidelines do cover such a wide spectrum, the information needs for each such type of Fund and its underlying Investors must be considered. Ultimately, General Partners and Limited Partners should exercise their judgment in determining the timing, format and content of the reported information. These Guidelines may not be fully applicable to listed entities or fund of Funds.

Investors have expressed a desire for detailed information beyond that which is provided in the applicable GAAP (whether IFRS, U.S. or other standards) or statutory financial statements ("GAAP Financial Statements" or "GAAP FS"). The information identified in these Guidelines does not supersede the negotiated reporting outputs detailed within the founding documents of each Private Equity Fund. Instead, they are intended to provide Investors with detailed information to further enhance their analyses of Fund performance and to improve their ability to exercise their individual fiduciary duties. While in most, if not all, respects the informational reporting recommendations contained in these Guidelines are intended to be supplemental to general purpose GAAP Financial Statements, such supplemental information should be developed from the same records of the Fund Manager as are the GAAP FS. A key factor allowing comparability of Funds is a consistent framework for determining value. Therefore, compliance with the IPEV Valuation Guidelines aids comparable reporting.

These Guidelines do not provide specific templates. The Guidelines are principle based, allowing Fund Managers to best articulate information about the Fund and individual investments. Examples will be provided, and updated from time to time, on the IPEV website, http://www.privateequityvaluation.com.

No member of the International Private Equity and Venture Capital Valuation Guidelines Board ('IPEV Board'), any committee or working party thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Guidelines nor for the consequences of reliance or otherwise on the provisions of these Guidelines.

These Guidelines should be regarded as superseding previous Guidelines issued by the EVCA and other endorsing organisations.

Introduction

The IPEV Investor Reporting Guidelines (IRG) are a globally applicable set of disclosure principles and practices designed to provide General Partners and their Limited Partners with guidance in presenting their Investments and investment performance over the life of a Fund.

- **Global Guidelines based on disclosure principles**. The IPEV IRG include global, voluntary disclosure principles used by private equity Managers to ensure fair presentation and full disclosure of investment information. The IRG make it possible for private equity Managers around the world to harmonize relevant information communicated to Investors located throughout the world through providing principle-based best practice guidance, but without mandating specific reporting formats. This promotes comparability and gives current and potential Investors more confidence in the integrity of the information and the general practices of a compliant firm.
- **Participation and Collaboration.** The participation of national PE and VC associations from around the world helps ensure effective implementation and on-going development of the IPEV IRG. Collaborative development is critical to acceptance and usage. IPEV has more than 40 endorsing associations from around the world, and along with the members of the IPEV Association, the participating groups provide an important link between the IPEV Board and the General partners and Limited Partners actively involved in Investor reporting. This also ensures that there is balanced input into the IPEV IRG as they are updated in the future.
- **Compliance and Voluntary Self Regulation.** Adopting IPEV IRG is voluntary. Private equity Managers choosing to comply with IPEV IRG assure Investors that the historical performance they report is both complete and fairly presented. The IPEV IRG represent a commitment to Investor reporting that meets the needs of Investors and that is embodied in current commonly accepted industry practice. Compliance demonstrates a firm's commitment to transparent communication with LPs. GPs complying with the IPEV Valuation and Investor Reporting Guidelines benefit from a framework and a knowledge that LPs have consistent and directly comparable investment information from all their GPs.

Disclosure of Confidential Information

Private equity by its nature utilises confidential, non-public information. Yet Investors in Private Equity Funds need sufficient, timely, comparable and transparent information from their Managers which allows Investors to:

- Exercise fiduciary duty in monitoring deployed investment capital
- Report periodic (quarterly / yearly) performance to ultimate Investors, beneficiaries, boards, etc., as applicable
- Prepare financial statements consistent with applicable accounting standards.

Investors may also use the supplemental information recommended in these Guidelines to assist in:

- Making asset allocation decisions
- Making manager selection decisions
- Supporting Investor level incentive compensation decisions.

Private Equity Funds are typically governed by a combination of legal, regulatory, and agreed contractual terms. It is not the intention of these Guidelines to prescribe the exact format that Managers should use in reporting to Investors. Managers should have the latitude to develop reporting formats which correlate to the individual nature of their investments and their Investors. These Guidelines highlight the essential content that should be reported to Investors and additional information which may be important to Investors.

The requirements and implications of International Financial Reporting Standards and US GAAP have been considered in the preparation of these Guidelines. These Guidelines do not intend to repeat GAAP FS financial accounting and reporting requirements, but to expand upon such information in a more detailed and consistent manner to further enhance an Investor's ability to evaluate and compare such data.

Venture Capital

These Guidelines cover a wide spectrum of Private Equity Funds. Some Managers report on a limited number of Investments while others report on hundreds of Investments. For example, the information needs of a venture capital Investor may differ from the information needs of a large buyout Investor. Therefore, judgment must be applied in applying these Guidelines to different types of Funds.

Investor Reporting vs. Financial Reporting

Normal contractual negotiations between GPs and LPs establish requirements for a Fund to provide GAAP Financial Statements and related audits. Local regulations and historical practice drive the format and content of GAAP Financial Statements prepared in accordance with applicable Generally Accepted Accounting Principles and / or statutory requirements. Regulatory bodies such as the U.S. Securities and Exchange Commission, the European Union and National Governments, have issued additional regulations, such as the Alternative Investment Fund Managers Directive (AIFMD), which impact the application of GAAP and require certain disclosures.

Investor reporting typically goes beyond GAAP financial and regulatory reporting and covers the cumulative results for the Fund over its lifetime, insights into the progress and current prospects of the Fund's Portfolio Companies, and other information often unique to the particular Fund and its investment process. The goal of these Guidelines is to provide guidance on Investor reporting that is distinctive to private equity.

Certain local regulations might also require GPs to provide information to their Investors beyond GAAP financial reporting (e.g. the AIFMD in Europe). It is not the intention of these Guidelines to describe specific regulatory requirements and these Guidelines should not be considered as a substitute for complying with regulatory requirements.

GPs often provide integrated GAAP financial statements and investment reporting in their reporting packages provided to LPs. There are a number of disclosure items that are distinctive to Private Equity Funds which may be included in the financial statement reporting for these Funds rather than in the Investor reporting. Both current period information and inception to date cumulative summaries are often incorporated into the GAAP financial statements and supplemental Investor reporting packages. However, Investor reporting may need to expand upon information reported in the financial statements as follows:

- Realised gains and losses determine the returns to the LPs and cash returns and multiples based on realised transactions are often an important measure of progress of a Fund to date. In addition, Investors need information concerning unrealised gains and losses to provide a measure of progress at given points in time.
- "Capital at Risk" or other risk measures are becoming increasingly common metrics used by Investors.
- Unfunded Commitments are important for LPs as they review their asset allocations and manage their cash and short-term investments in relation to their unfunded capital commitments.
- Cumulative reporting for capital accounts and the components that make up the capital account (including, but not limited to, management fees, Contributed Capital, Distributions, Carried Interest, unrealised gains and losses, ending balance) for both the Investor and the Fund Manager show how the performance of the Fund has been split between the GP and the LP. Carried Interest is an important part of the economics of a Private Equity Fund.

- Specific information related to the performance of underlying Portfolio Companies, beyond that which is included in GAAP financial statements, is used by many Investors to manage their overall investment program.

The following diagram highlights the interaction of Investor reporting and GAAP financial statements (also understood to mean statutory reporting). These Guidelines are focused primarily on guidance for Investor reporting and are not meant to cause redundant information to be disclosed. To the extent some of the following information is already included in the financial statements it would not need to be included again in the Investor reporting:

Framework

This document presents two forms of guidance:

- **Essential Disclosures** include information that should be provided, if applicable, to enable Investors to monitor their investment in a Fund, understand underlying portfolio investments, and more fully exercise their fiduciary duties.
- **Additional Disclosures** whose adoption is left to the discretion of the Fund Manager. These items are either intended to ease the reporting and monitoring processes of the Investors or to provide additional information for selected Investors.

A significant factor to be considered in the reporting of information to Investors is the impact of local open disclosure or Freedom of Information (FOIA) laws or other local regulations. The issues arising from additional disclosures beyond Fund level performance are potentially significant for both Managers and Investors. As a result, the Guidelines were developed to set forth best practices in reporting, assuming that detailed Portfolio Company and other similar information would be kept confidential and would not be disclosed beyond the private equity firm and the Investor. Within their respective organisations, Fund Managers and Investors should make their own judgments regarding their level of comfort in disclosing or receiving confidential information. It should further be noted that Portfolio Company information belongs to the Portfolio Company and not necessarily the Fund Manager or the Investor.

Timing

Investor reporting is needed on a timely basis to enable Investors to perform investment analysis. Reported information should be delivered when required by the Investor. Information need not be delivered all at once. It is common for GPs to provide all information together in one reporting package. While exact timings are usually agreed within the Fund Formation Documents, suggested timings are as follows:

The information called for in these Guidelines should be provided within 45 to 60 calendar days after quarter-end and within 75 to 90 calendar days of year-end. Some LPs require Net Asset Value (NAV), based on an estimate of Fair Value of underlying Investments, on a timely basis in order to prepare their own financial reports. For those LPs estimated NAV should be available as quickly as possible, but within 45 calendar days of quarter-end.

While not a subject of these Guidelines, where required, quarterly unaudited GAAP financial statements should be provided within 45 to 60 calendar days of quarter-end. Audited GAAP financial statements should be prepared annually within 90 calendar days of year-end.

While subject to the type of Fund and Fund Formation Documents, the frequency of information provided should be as follows:

Reporting Area	Frequency of Reporting for Essential Disclosure Items
1. Fund Information	
1.1 Fund Overview	Annually with changes Quarterly
1.2 Executive Summary	Quarterly
1.3 Fund Status	Quarterly
2. Investor Information	
2.1 Cash Flow and Net IRR Calculation	Quarterly
2.2 Individual Capital Account	Quarterly
2.3 Capital Call Notices	Each Transaction
2.4 Distribution Notices	Each Transaction
3. Fees, Carried Interest, & Related Party Transaction Information	
3.1 Management Fees and Related Party Transactions	Quarterly
3.2 Carried Interest	Quarterly
4. Investment Portfolio Information	
4.1 Current Portfolio Summary	Quarterly
4.2 Realized Portfolio Summary	Quarterly
4.3 Portfolio Company Detail	Annually with changes Quarterly
4.4 Movement in Fair Value of the Portfolio	Quarterly

Reporting Entity

The information described in these Guidelines should generally be reported on an individual Fund or legal entity basis. Some Managers use structures where parallel funds invest in the same Portfolio Companies. Some information, as deemed helpful to Investors, should be aggregated across parallel funds. Further, as appropriate, disclosure of Portfolio Company information should be aggregated across funds.

Unit of Account

Some Funds invest in multiple securities or tranches of the same Portfolio Company. The disclosures described in these Guidelines are expected to be on the same basis that the Fund Manager would transact. If the Fund Manager expects to transact all positions in the same underlying Portfolio Company simultaneously, then, disclosures would be for the aggregate investment in the Portfolio Company. If the Fund Manager expects to transact separately, for example selling a debt position independently from an equity position, then disclosures may be more appropriate for the individual instruments.

Environmental, Social and Governance (ESG) and Responsible Investing (RI)

Many Investors have adopted responsible investing polices as a part of their investment programs. These policies may include a focus on environmental, social and governance factors, including risks and opportunities, affecting both a Fund and / or specific Portfolio Companies. Should a Fund Manager wish to report on ESG matters, such reporting could be done in conjunction with quarterly investment reporting, and such reporting might cover some or all of the following items:

- Description of compliance with Fund level ESG parameters as agreed with Investors
- Method for establishment and communication of ESG performance criteria for individual Portfolio Companies
- Portfolio Company ESG performance measurement
- Impact of the Fund Manager on Portfolio Company ESG risks and opportunities.

At this time, approaches to ESG continue to evolve and have not yet reached a level of consensus to be included formally as a part of the Investor Reporting Guidelines. As these Investor Reporting Guidelines head to publication, we are aware of Managers and Investors who are actively working on developing ESG reporting standards. We plan to monitor these developments and future updates to the IRG may include ESG reporting elements.

WWW.PRIVATEEQUITYEVALUATION.COM

Guiding Principles

In order to create consistent industry best practice reporting, it is recommended that GPs adopt the principles outlined in these Guidelines. Some GPs may wish to provide the Additional Disclosures identified in the Guidelines or additional information to that specified in the Guidelines. It is not IPEV's intention to restrict such disclosure in any way. Adopting these Guidelines requires judgment, and would include providing the Essential Disclosures, to the extent appropriate. Essential Disclosures, where appropriate and if legally disclosable, should be considered to be the baseline against which such judgments should be made after taking into account the size and strategy of the individual Fund. It is not possible for guidelines to anticipate every future circumstance. Providing Investors with the Essential Disclosures, to the extent appropriate given a Fund's strategy, qualifies a Fund Manager to claim compliance with these Guidelines.

Because of existing agreements in Fund Formation Documents, it may not be possible to immediately adopt these Guidelines. It would be expected that these Guidelines are adopted over time for existing Funds and as part of the Fund formation process for new Funds.

When reporting to Investors, the Fund Manager should consider and observe the following reporting principles:

- Relevance. The information provided should allow Investors to monitor their individual investment
- Transparency. The information on relevant topics regarding the evolution of the Fund's performance should be communicated to Investors in a transparent manner
- Consistency. The information provided to Investors should be consistent over time, taking into account changing LP information needs and changes in accounting standards
- Accuracy. The information provided to Investors must be correct in all material aspects.

All Investor reporting, including underlying calculations, should be presented in the functional currency of the Fund.

Consideration should be given to providing Investor reporting in electronic format.

Section I: Reporting

WWW.PRIVATEEQUITYEVALUATION.COM

1. Fund Information

1.1. Fund Overview

Purpose

The Fund Overview provides Investors with general information about a Fund (the legal entity in which they are invested), allowing them easy access to Fund terms without requiring them to consult the Fund Formation Documents. Many Managers utilise structures which may include parallel funds to meet the needs of individual Investors. As appropriate, certain information should be aggregated for parallel funds.

Essential Disclosures

- Fund full name
- Fund currency
- Total Commitments (including parallel funds), where appropriate
- Fund term
- Investment period criteria and end date
- Investment strategy by stage, geography and sector
- Key economic terms including:
  - Management fee terms
  - Distribution provisions
  - Profit and loss allocation, Carried Interest and preferred return, if applicable
- GP Name and size of GP Commitment (including parallel funds)
- If the Fund consists of multiple partnerships and / or the GP commitment is from a separate partnership / structure, such as co-invest vehicle, provide disclosure detailing the size and nature of the GP Commitment
- Vintage Year (The definition of vintage year differs around the world. Therefore, include the Managers definition of vintage year, and provide information for alternative definitions, for example the date of legal formation and the date of first capital call)
- First Close date
- Final Close date
- Fund's domicile, legal form and structure
- Manager of the Fund
- Financial year-end of the Fund
- If applicable, a statement that the IPEV Investor Reporting Guidelines have been adopted, with exceptions, if any, described

Additional Disclosures

- Members of the Limited Partner advisory committee
- The Fund's Fair Value estimation policies, processes and procedures

1.2. Executive Summary

Purpose

The Executive Summary gives the GP an opportunity to provide LPs with information concerning key aspects and the current activity in the Fund, similar to a management discussion and analysis, without the need for the LP to review the whole report to discover significant items.

In many jurisdictions, LPs may use Net Asset Value as determined by the GP as the starting point in estimating the Fair Value of the LPs interest in the Fund for their own accounting and reporting purposes. The Executive Summary may contain information which supports the LPs Fair Value estimates.

Essential Disclosures

- New Investments, including brief description of Investee's business and stage of investment
- Follow-on investments
- Realisations
- Significant events with current Investments (IPOs, mergers, acquisitions, etc.)
- Overview of investment performance, including changes in Fair Value
- Changes, if any, to the Fund's Fair Value estimation policies, processes, or procedures
- Significant events within the Funds Manager / GP / investment advisor, including personnel changes, change in control, etc.
- Changes in investment strategy

- Material amendments or changes to the Fund Formation Documents
- A notification of the timing and nature of Fund meetings
- The extent to which NAV or partners' capital has been adjusted to reflect earned, or deemed Carried Interest and potential clawbacks
- If an advisory committee has decision-making powers, description of decisions taken including background information
- A statement of compliance with the IPEV Valuation Guidelines, with exceptions, if any, described

Additional Disclosures

- Presentation of a value progression chart, showing the change in Fair Value of the Fund over its life, which may include total Contributed Capital, cumulative Distributions, and residual Fund value net of management fees and Carried Interest
- Statement of compliance with the Investment policy outlined in the Fund Formation Documents
- If applicable, a statement of compliance with environmental, social and governance or other responsible investing parameters of the Fund
- If applicable, the extent to which the Fund uses an internal or external third party valuation expert
- If applicable, key findings in the Fund's advisor or external administrator's independent compliance or control reports
- Comparison of historical realisations to last reported Fair Value

1.3. Fund Status

Purpose

The Fund Status provides Investors with current performance and commitment information.

Essential Disclosures

- An aggregated Investor summary of:
  - Total Contributed Capital / Draw Downs / Paid In Capital
  - Total remaining Commitment callable (available for drawdown) / Uncalled Capital
  - Impact of management fees and other fees (explain if included in Committed Capital or if in addition to Committed Capital)
- Cumulative Distributions to the Investors and to the Fund Manager, including Carried Interest, if any
- If applicable, recallable Distributions
- Total Fair Value of portfolio
- Total other assets and liabilities, if applicable
- Net Asset Value (total Fund and net to LPs / Investors)
- Gross Portfolio IRR
- Fund Net IRR to LPs / Investors
- Multiples to LPs / Investors
  - Distributions to Paid In Capital (DPI)
  - Fund NAV (net of management fees and Carried Interest) to Paid In Capital (RVPI)
  - Total value to Paid In Capital (TVPI)
  - Paid In Capital to Capital Commitment (PICC)
- Total invested in Portfolio Companies
- If applicable, note of:
  - Leverage of the Fund, including debt, guarantees, charges, warranties, indemnities or other contingent liabilities
  - Guarantees made by the Fund to or on behalf of Portfolio Companies, and their impact on Fund Fair Value, if any

Additional Disclosures

- Best estimate of potential Draw Downs and Distributions for the next reporting period
- Total additional committed to Portfolio Companies and planned for follow-on investments, as required

2. Investor Information

2.1. Cash Flow and Net IRR Calculation

Purpose

The Cash Flow Schedule provides details on Capital Calls and Distributions to allow LPs to understand aggregate LP level cash flows used to calculate Fund Net IRR to LPs.

Essential Disclosures

- Aggregate cash flows between Fund and LPs (combined) by date
- Net IRR (net of Carried Interest)

Additional Disclosures

- Aggregated for the Fund, an analysis of cumulative proceeds distributed, with sufficient detail, such as cost, gain and income, as applicable

2.2. Individual Capital Accounts

Purpose

The current period and since inception Capital Account information provides individual Investors with current and cumulative information on their individual investment in the Fund, and allows for analysis of income allocations.

Essential Disclosures

- Information for the relevant investor
  - Total Commitment
  - Percentage ownership of the Fund:
    - Percentage ownership of all LP commitments
    - Percentage ownership of entire Fund (including GP and parallel funds)
    - Profit sharing percentage
  - Total Contributed Capital (current period)
  - Total Contributed Capital (since inception)
  - Unfunded Commitment
  - Distributions (current period -designate if any distributions are recallable)
  - Distributions (since inception -designate if any distributions are recallable)
  - Fund performance, noting separately cumulative and current period, as applicable:
    - Management fees
    - Operating income / loss
    - Realised gains / losses
    - Unrealised gains / losses
  - Specify allocation to Carried Interest partners, if separate from the GP, including any non-standard or asymmetrical allocations, such as LP opt outs or special LP provisions, if any
- Capital account at Fair Value at the end of the reporting period
- Confirmation that LP NAV is reported net of unrealised Carried Interest attributable to the GP. Alternatively, provide an estimate of unrealised carry assuming that all Investments are realised at their reported Fair Value at the measurement date
- Treatment of negative LP Capital Accounts, if any

Additional Disclosures

- Upon request, a cash flow schedule detailing individual Investor's amounts and dates of Draw Downs and Distributions since inception

2.3. Capital Call Notices

Purpose

Over the life of a fund, Managers will draw down capital from Investors and they should notify them for each Draw Down in accordance with the Fund Formation Documents. Any net Capital Calls (net of Distributions) should include the information items under both Capital Call and Distribution notices noted below.

Essential Disclosures

- Due date of the Capital Call
- Amount of the Capital Call in total for the Fund and for the relevant Investor

- Wire transfer instructions for the Capital Call
- Commitment held by the individual Investor
- Cumulative Called Capital (inclusive of this Capital Call) and remaining Unfunded Commitment
- Reason for the Capital Call, and where applicable an analysis of the individual components of the Capital Call

2.4. Distribution Notices

Purpose

When Managers make Distributions, Investors should be notified, with each Distribution, the information required in accordance with the Fund Formation Documents.

Essential Disclosures

- Payment date of the Distribution
- Amount of the Distribution in total for the Fund and for the relevant Investor
- Cumulative Distributed amount (inclusive of this Distribution) individually for the Investor and aggregated for the Fund
- Statement as to whether the Distribution is recallable
- Allocation of the Distribution between cost, gain and income
- Bank account details identifying where the Distribution will be made

Additional Disclosures

- Description of the individual proceeds distributed, with sufficient detail, such as cost, gain and income, as applicable.

3. Fees, Carried Interest and Related Party Transaction Information

3.1. Management Fees and Related Party Transactions

Purpose

Providing detail on how fees paid by the Fund are calculated allows Investors to analyse the management fees charged to verify compliance with Fund Formation Documents.

Essential Disclosures

- Management fees paid and / or accrued by the Fund and the basis of calculation
- If applicable, the cost or valuation base used to calculate the Fund management fees
- The treatment of transaction or other fee income that can be offset against management fees will be specific to each individual Fund. Where applicable, Fund disclosures should include:
  - Statement of benefits and fees received, delineated by principal categories (e.g. underwriting fees, transaction fees, consulting fees, directors and monitoring fees, deal fees, broken deal fees, etc.) received by the Fund Manager or its affiliates
  - Fees received should be disclosed in total for the Fund / Fund Manager and broken down by Portfolio Company or transaction which generated them

3.2. Carried Interest

Purpose

The Carried Interest calculation provides information which allows Investors to analyse the Carried Interest deducted from, allocated

to, or deemed allocated to the GP. The Fund Formation Documents dictate the mechanics of the Carried Interest. Calculations are generally most appropriate when presented from inception of the Fund.

Carried Interest calculations are unique to each Fund and vary according to the type of Fund. Essential Disclosures should provide sufficient transparency to allow LPs to analyse the Fund allocation of Carried Interest.

Essential Disclosures

- Description of the Carried Interest calculation or excerpt from or reference to the Fund Formation Documents, including an explanation of the basis of the calculation
- Key mechanics included in the calculation of Carried Interest, including where applicable:
  - Clawbacks
  - Tax allocations, if any
  - Hurdle Rate calculations
- Fund level Carried Interest paid from inception to the Reporting Date and since the last Reporting Date
- Fund level Carried Interest allocated or deemed allocated from inception to the Reporting Date and since the last Reporting Date
- Clawback payable, if applicable

4. Investment Portfolio Information

4.1. Current Portfolio Summary

Purpose

The Current Portfolio Summary provides information on each Investment in the portfolio that helps Investors analyse current holdings.

Depending on the type of Fund, for example venture capital Funds, the information noted below may not be applicable or may be deemed confidential and as such would not be disclosed.

Essential Disclosures

- Portfolio Company name
- Whether the company is quoted or unquoted; if quoted, state the ticker symbol
- Date of investment
- Geography
- Industry
- Percentage ownership; diluted and / or undiluted, as applicable
- Cost of Investment (cumulative and remaining)
- Fair Value of the Investment (in accordance with International Private Equity and Venture Capital Valuation Guidelines)

Additional Disclosures

- Stage of investment
- Meaningful performance information such as:
  - Total Return for each Investment (Including realised proceeds)
  - Multiple of invested capital (MoIC)
  - Holding period
  - Gross Portfolio IRR (see section II)

4.2. Realised Portfolio Summary

Purpose

Starting from inception, a Realised Portfolio Summary of a Fund provides information on realised investments to inform Investors about sales or disposals that have occurred over the life of a Fund.

Essential Disclosures

- Portfolio Company name
- Date of initial investment
- Disposal date (s), where applicable
- Geography

- Industry
- Total return for the Investment, broken down by:
  - Cost of realised Investment
  - Realised gains / losses
  - Interests and dividends received in cash (may not be applicable for VC)

Additional Disclosures

- Meaningful performance information such as:
  - Total Return for each Investment (including realised proceeds)
  - Multiple of invested capital (MoIC)
  - Holding period
  - Gross Portfolio IRR (see section II)
- Exit route

4.3. Portfolio Company Detail

Purpose

The Portfolio Company Detail provides Investors with detailed information on each Investment, updated when significant changes occur, to assist in the analysis of the portfolio since inception.

Disclosures are generally provided at least annually or quarterly where there has been a significant change. The extent of disclosures may depend on the strategy of the Fund. For example, not all disclosures noted below would be applicable to early stage venture capital Investments. The GP may decide to also include disclosures provided for in 4.1 above.

Essential Disclosures

- Company level information
  - Legal and / or trading name of the Portfolio Company, including any name changes
  - Website, if any
  - Brief description of the industry, business and marketplace
  - Statement of the Fund's role in the investment (lead, co-lead, etc.)
  - Board representation (if any)
  - Identify the deal partner(s) responsible for making and monitoring the investment, if applicable
  - Currency of the Investment
  - Portfolio Company debt, if significant
- Ownership information
  - Type and quantity of securities held, if relevant
  - Exchange rate used for conversion at the Reporting Date, if currency is other than Fund's currency
  - Amount invested by the Fund
  - Valuation of investment, in accordance with the IPEV Valuation Guidelines
  - Enterprise Value of the company (at initial investment and current, specifying whether pre or post money)
  - Debt, EBITDA, or other earnings multiples if used to determine Fair Value
  - Specific valuation methodology used in accordance with the IPEV Guidelines
  - Explanation of any significant changes in valuation compared to the previous reporting period
  - For quoted shares, price and any discounts applied, and the basis for applying a discount, if any
  - Any realisation restrictions over the investment (i.e., a lock-up period on listed shares)
  - Outstanding commitments and contingent liabilities and any other exposures of the Fund to the Portfolio Company, such as guarantees
- Company Performance Information
  - Disclose any estimated contingent proceeds or contractual rights not recorded in the financial statements or not reported at Fair Value
  - Any deferred proceeds, escrow accounts and earn-outs together with discounts applied
  - For partially realised investments, the percentage of the Fund's investment sold

Depending on the nature of the disclosure, the GP may decide to include performance information in the Executive Summary, on a case by case basis.

  - A description of the company's status compared to the expectation at the time of the Investment
  - Brief analysis of significant events during the reporting period and anticipated events

The Essential Disclosure items below may not be relevant to early stage venture capital Investments.

  - Historic profit and loss, if applicable
  - Sales / turnover, if applicable
  - EBITDA and additional key performance indicators as appropriate for the type of company and industry (e.g. gross profit, EBIT, cash and cash equivalents, net earnings, net debt, etc.)
  - Schedule of debt maturity

Company level operating data should be provided in the Portfolio Company reporting currency.

Additional Disclosures

- Summary investment thesis
- Name of the CEO
- Description of environmental, social and governance risks and opportunities specifically affecting the Portfolio Company and measures taken by the Fund Manager to manage them
- Name of significant syndication partners and co-investors
- Exit plans, where applicable
- Key performance metrics used by the GP to monitor the Investment

4.4. Movement in Fair Value of the Portfolio

Purpose

The Movement in Fair Value of the Portfolio between each reporting period provides Investors with a summary of those investments made, realised and changes in value during the period and since inception.

Essential Disclosures

- For all current Portfolio Companies:
  - Prior period Fair Value
  - Any investments made during the period
  - Proceeds during the period
  - Realised gain / loss during the period
  - Any increase / decrease in Fair Value during the period
  - The Fair Value at the Reporting Date
  - Explanation of any significant changes in valuation compared to the previous reporting period (e.g.: improved earnings, changes to comparables, changes to capital structure, etc.)
  - Changes in valuation techniques or methodologies from previous period

Additional Disclosures

The additional disclosure items below may not be relevant to early stage venture capital Investments.

- If applicable, an attribution table showing the value created and the drivers thereof considering the following:
  - Earnings based impacts
  - Margin related impacts
  - Changes in growth / risk profile and financial market conditions (e.g.: multiple expansion or contraction)
  - Capital structure and balance sheet impacts (e.g.: leverage repaid)
  - Currency translation impacts, if any

Section II: Performance Measurement and Reporting

1. Internal Rate of Return

The most common measure of performance within the private equity industry is the internal rate of return or IRR.

Additional frequently used measures of performance within the private equity industry are the multiples to Investors of:

- Distributions to Paid In Capital (DPI);
- Residual Value to Paid In Capital (RVPI);
- Total Value to Paid In Capital (TVPI).

IPEV recommends the internal rate of return and the multiples mentioned above as being the most appropriate performance indicators.

2. Two Levels of IRR Advocated by IPEV

Accurate IRRs can only be computed when all Investments have been realised and the cash has been paid back to Investors, after the deduction of Carried Interest, management fees and other applicable professional and ancillary charges. This is the net ('cash-on-cash') return after the Investment has been wholly realised.

The primary users of IRR information are LPs, their advisors and potential new LPs. These users need to be able to assess returns on an interim basis. Such interim returns are no more than indicators of the ultimate IRR. The more mature an investment portfolio is, though, the more confidence one may generally ascribe to these interim statistics.

IPEV advocates that performance be measured at two levels:

a. Gross Portfolio IRR

This return takes account of all of the following:

- All the cash outflows (investments) and inflows (divestments, including realisation values, interest and dividends, repayments of principal of loans, etc.) which take place between the Fund and all of its Investments, independently whether realised or not;
- The valuation of the unrealised portfolio (consisting of wholly unrealised investments and the unrealised portions of partially realised investments). By definition, the unrealised portfolio excludes cash and other assets held by the Fund.

This return does not include the impact of Carried Interest or charges of any kind, such as management fees paid to the private equity firm by the Investor, fees paid by a Portfolio Company either to the Fund or the private equity firms, and fees paid or due to lawyers, accountants and other advisers.

While generally a single IRR result is reported, the gross return on all Investments should be analysed for both realised and unrealised returns:

For realised investments, the return takes account of all of the cash outflows (investments) and inflows (divestments, including realisation values, interest and dividends, repayments of the principal of loans, etc.) which take place between the Fund and its realised investments.

For the purposes of the realised investment return, all proceeds from a holding in a Portfolio Company shall be taken into account for this calculation, including proceeds from partially realised companies.

It is difficult to allocate cost for partial realisations. To allow greater comparability, these Guidelines recommend that for partially realised investments, cash outflows (investments) should be allocated between realised and unrealised on a pro rata basis at the dates of each cash outflow.

For fully unrealised investments, the IRR calculation takes account of all the cash outflows (investments) and inflows (interest and dividends) to the extent they refer to the unrealised Portfolio Company, and the valuation of the unrealised Portfolio Company. Unrealised investments should be valued at Fair Value, in accordance with the IPEV Valuation Guidelines.

b. Fund Net IRR to LPs / Investors

This measures the return earned by the Investors in the Fund, and takes account of:

- The actual cash flows which take place between the Fund and the LP taking account of the following:
  - the Fund Manager's Carried Interest
  - the management fees paid to the Fund Manager by the Investors
  - all other applicable professional and ancillary charges which are paid out by the Fund in the course of investing, managing, and divesting from the investment portfolio
  - Valuation of the unrealised portfolio (consisting of the unrealised portions of partially realised investments, wholly unrealised investments and also including cash and other assets), after adjusting appropriately for Carried Interest. When the portfolio is fully realised / fully distributed, the net return is the 'cash-on-cash' return to the Investors.

Should private equity Managers and / or their Investors consider it desirable to do so, the performance calculated for any of the levels given above, may be analysed to demonstrate the contribution made by the individual elements of which they are made up. In addition, such calculations should include both realised and unrealised investments.

The ability to analyse the impact of the valuation of the unrealised portfolio on the performance may be particularly relevant as valuations can be no more than indicators of the ultimate IRR when all investments have been wholly realised.

To enable the returns calculated in accordance with the different levels to be comparable, all relevant parameters must be treated in an identical manner. It is for this reason that the standard principles have been developed, which are set out on the next pages.

3. Principles of Calculating Returns

Commitments made by a Private Equity Fund to a Portfolio Company

The cash outflows should be taken to be the amount actually invested in a Portfolio Company at a given point in time, i.e. on a gross return basis. A Private Equity Fund may commit itself to making a series of investments in a Portfolio Company over an extended period of time. In such circumstances, the timing and amounts of the individual cash flows of the past only should be taken into account.

Commitments made by an Investor to a Private Equity Fund

An LP will commit itself to making a series of investments in a Fund over a period of time, up to their Committed Capital. The cash outflows should be taken to be the amount actually drawn down by a Private Equity Fund from Investors at given points in time. In such circumstances, the timing and amounts of only the individual past cash flows should be taken into account.

Equity received in lieu of cash

Any equity received by a Private Equity Fund in lieu of cash in respect of services rendered to a Portfolio Company (for instance, services of directors, provision of guarantees) should be considered as investments of zero cost.

Net return to Investors; Carried Interest and the unrealised portfolio

When calculating the net return to the Investor, as regards the valuation of the unrealised portfolio, appropriate provision should be made for the deduction of Carried Interest calculated on the basis of the assets being realised at the carrying value.

Realisations

Depending upon the provisions of the Fund Formation Documents, shares in companies which are floated and distributed in-kind should be considered realised upon date shares are converted into cash to the benefit of the Investor, or are transferred to the Investor. It is implicitly recognised therefore, that shares cannot be regarded as realised whilst any trading restrictions are in place.

As regards the calculation of the gross return on realised investments only, a written off Investment should be considered as having been realised as soon as the earliest of any of the following or like events takes place: when bankruptcy proceedings are instigated against a Portfolio Company; when a Portfolio Company ceases to trade; when a Portfolio Company enters into arrangements with creditors which result in the Investment being written down to zero; when insolvency proceedings are begun.

Investments which have been completely sold, subject to a proportion of deferred consideration / earn out, should be defined as realised investments. If required by applicable GAAP, an estimate of the Fair Value of deferred proceeds or earn out should be included as if it were a unrealised investment at the Reporting Date.

Share exchanges

Private equity firms sometime exchange part or their entire stake in a Portfolio Company for shares in another company. Where such an exchange takes place, the new shareholding should be treated no differently than if it was part of the shareholding in the original Portfolio Company. .

Taxation

Interest payments, dividends and capital gains received from Portfolio Companies that are paid net of tax withholdings should be grossed up so as to be treated as pre-tax cash flows for the measure of gross return. Tax impacts, such as withholding tax, should be included in the calculation of the gross and net IRR.

Timing of cash flows

IRRs are recommended to be calculated on the basis of daily cash flows using the actual date of the cash flow, or monthly. When calculated on a monthly basis, the date attributed to each cash flow should be the same day of each month (e.g. the last day of the month etc).

Appendix: Definitions

WWW.PRIVATEEQUITYEVALUATION.COM

The following definitions shall apply in these Guidelines:

Capital Call / Draw Down	Draw down by the Fund Manager of the Fund of additional capital from Investors, both amount and timing of notice in accordance with the Fund Formation Documents.
Called Capital / Contributed Capital / Draw Downs or Paid In Capital	An amount that is called by way of a call notice by the Fund Manager for the Fund, requiring Investors to provide capital in accordance with the Fund Formation Documents.
Capital at Risk	The amount an Investor may lose if a Fund provided no returns. Generally, the amount consists of invested (Called) Capital, less non recallable distributions.
Carry / Carried Interest	The Fund Manager's or any entities' or persons' involved with the management of the Fund, share in the net profit of the Fund as set out in the Fund Formation Documents.
Commitment / Capital Commitment / Committed Capital	The total amount which an Investor commits to invest in a Fund.
Distribution	Payout of any amount or asset passed on by the Fund to the Investor.
Distributions to Paid in Capital (DPI)	Represents the cumulative distributions to Investors / LPs divided by the cumulative Paid In Capital.
Enterprise Value	The Enterprise Value is the value of the financial instruments representing ownership interests in an entity plus the net financial debt of the entity.
Fair Value	The Fair Value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.
Final Close	Date on which the Fund is closed to any further subscriptions of interests from Investors.
First Close	Date on which the first Investors are admitted into a Fund.
Fund (or Private Equity Fund)	The Fund or Private Equity Fund is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at all stages of private equity Investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles, established with the intent to exit these investments within a certain timeframe.
Fund Formation Documents	The entire set of legal documents, including side letters, agreed by the Investors and Fund Manager, covering the establishment, management, and winding up of the Fund; also referred to as the Limited Partnership Agreement (LPA).

Fund Manager / Manager / General Partner / GP	The person or entity with the responsibilities and obligations of the management of the Fund, as set out in the Fund Formation Documents.
Fund Net IRR to Investors / LPs	The IRR which considers the actual net cash inflows and outflows from/to the Investors up to and including a specific date, including NAV at that date.
Gross Portfolio IRR / Gross IRR	An IRR calculated at a specific date which uses actual cash flows by the Fund for Investments, actual cash flows returned to the Fund from investments (e.g. dividends, fees, distributions), and a final cash inflow representing the Fair Value of unrealised investments at the Reporting Date. Expenses such as management fees are not included.
Hurdle Rate / Preferred Return	A rate of return beyond which the Fund Manager may earn Carried Interest.
Investee / Investee Company / Portfolio Company	The term Investee Company or Portfolio Company refers to a single business or group of businesses in which a Fund is directly or through holdings invested.
Investment	An Investment refers to all of the financial instruments in an Investee Company held by the Fund.
Investor / Limited Partner / LP	The person or entity investing in a Fund.
IRR	Internal rate of return.
Net Asset Value ('NAV') or Partners Capital	NAV of a Fund is the amount estimated as being attributable to the Investors in that Fund on the basis of the Fair Value of the underlying Investee Companies and other assets and liabilities.
Paid In Capital	Refer to Called Capital.
Paid In Capital to Capital Commitment (PICC)	Called Capital divided by Committed Capital.
Reporting Date	The Reporting Date is the date for which the report is being prepared, in accordance with the Fund Formation Documents.
Residual Value to Paid In Capital (RVPI)	Calculated as the residual value divided by Paid In Capital.
Total Value to Paid In Capital (TVPI)	Calculated as the sum of the Distributions to Paid In Capital plus Residual Value to Paid In Capital.
Uncalled Capital / Unfunded Commitment	Capital Commitment less Called Capital.
Vintage Year	As definitions differ, clearly articulate the Manager's definition of Vintage Year, for example, the date of legal formation, the date of first Capital Call, or the date of first Investment. In addition, it is useful to provide the data points for alternative definitions. The Vintage Year selected should be consistently applied across the life of the Fund.

WWW.PRIVATEEQUITYEVALUATION.COM

Endorsing Associations

<left blank intentionally>

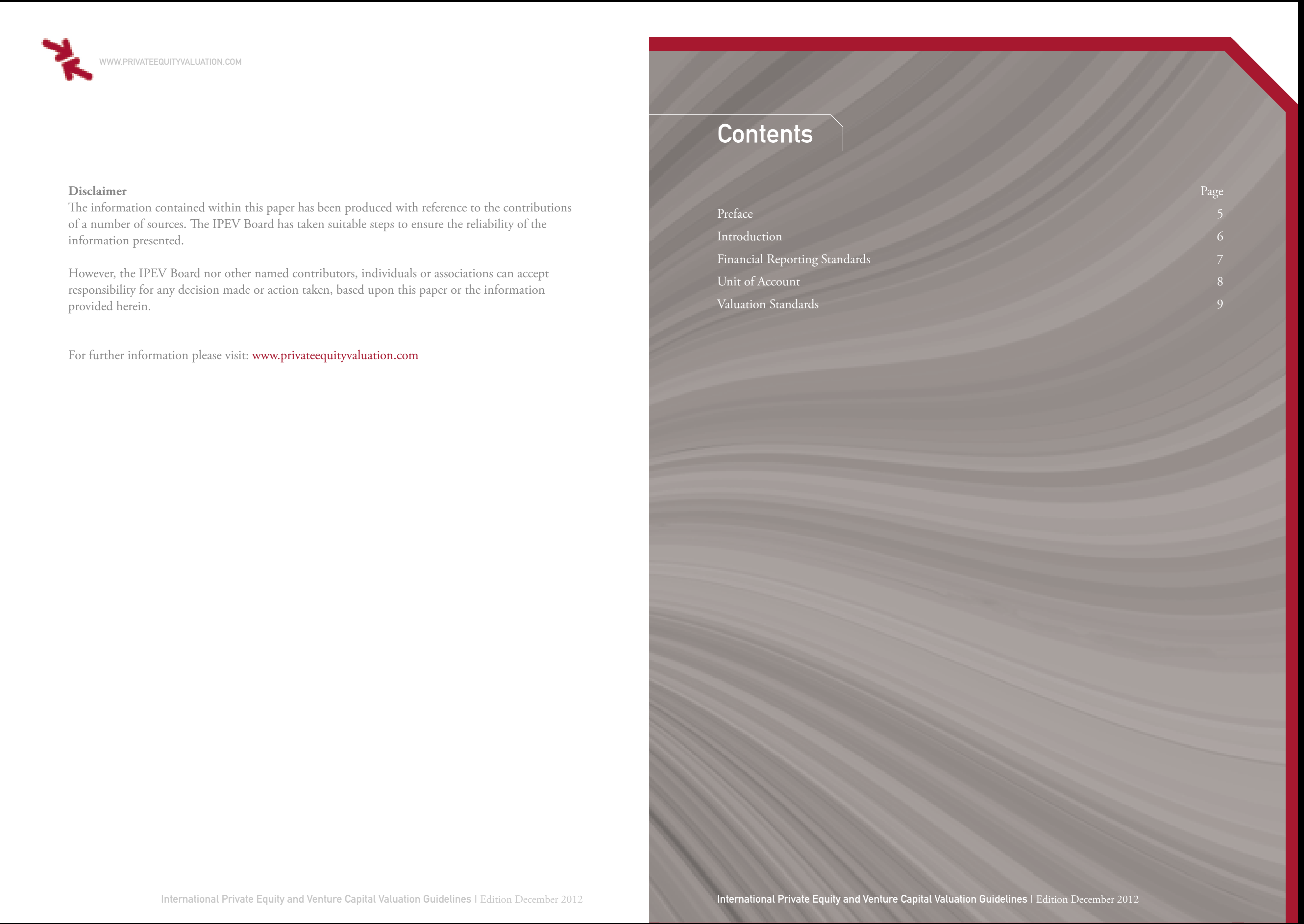
IPEV Valuation Guidelines

This document includes the latest International Private Equity and Venture Capital (IPEV) Valuation Guidelines (edition December 2012), which are also available on the IPEV website at www.privateequityvaluation.com.

For all the latest updates to the Guidelines and/or to ask questions to the IPEV Board, please visit the IPEV website. The site also includes a complete listing of endorsing associations and IPEV supporters.


International Private Equity and Venture Capital Valuation Guidelines

Edition December 2012


WWW.PRIVATEEQUITYVALUATION.COM

Disclaimer
The information contained within this paper has been produced with reference to the contributions of a number of sources. The IPEV Board has taken suitable steps to ensure the reliability of the information presented.

However, the IPEV Board nor other named contributors, individuals or associations can accept responsibility for any decision made or action taken, based upon this paper or the information provided herein.

For further information please visit: www.privateequityvaluation.com

International Private Equity and Venture Capital Valuation Guidelines I Edition December 2012

Contents

International Private Equity and Venture Capital Valuation Guidelines I Edition December 2012

WWW.PRIVATEEQUITYVALUATION.COM

Preface

The International Private Equity and Venture Capital Valuation (IPEV) Guidelines ('Valuation Guidelines') set out recommendations, intended to represent current best practice, on the valuation of private equity investments. The term "private equity" is used in these Valuation Guidelines in a broad sense to include investments in early stage ventures, management buyouts, management buyins, infrastructure, mezzanine debt and similar transactions and growth or development capital.

The Valuation Guidelines, as presented in Section I, are intended to be applicable across the whole range of Private Equity Funds (seed and start-up venture capital, buyouts, growth/development capital, etc.) and financial instruments commonly held by such Private Equity Funds. They also provide a basis for valuing investments by other entities, including Fund-of-Funds, in such Private Equity Funds. The Valuation Guidelines have been prepared with the goal that Fair Value measurements derived when using these Valuation Guidelines are compliant with both International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP). Other jurisdictions that use a similar definition of Fair Value, such as "willing buyer and willing seller" may also find these Valuation Guidelines applicable.

Individual Valuation Guidelines are outlined in Section I. Section II presents the Valuation Guidelines themselves surrounded by a border and set out in bold type, with accompanying explanations, illustrations, background material, context and supporting commentary, to assist in the interpretation of the Valuation Guidelines. Section III provides application guidance for specific situations.

Where there is conflict between the content of these Valuation Guidelines and the requirements of any applicable laws or regulations or accounting standard or generally accepted accounting principles, the latter requirements should take precedence.

No member of the IPEV Board, any committee or working party thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Valuation Guidelines nor for the consequences of reliance or otherwise on the provisions of these Valuation Guidelines.

These Valuation Guidelines should be regarded as superseding previous 2009/2010 Valuation Guidelines issued by the IPEV Board with effect for reporting periods post 1 January 2013.

WWW.PRIVATEEQUITYVALUATION.COM

Introduction

Private equity managers may be required to carry out periodic valuations of Investments as part of the reporting process to investors in the Funds they manage. The objective of these Valuation Guidelines is to set out best practice where private equity Investments are reported at 'Fair Value' and hence helping investors in Private Equity Funds make better economic decisions.

The increasing importance placed by international accounting authorities on Fair Value reinforces the need for the consistent use of valuation practices worldwide and these Valuation Guidelines provide a framework for consistently determining valuations for the type of Investments held by Private Equity Funds.

Private Equity Funds are typically governed by a combination of legal or regulatory provisions or by contractual terms. It is not the intention of these Valuation Guidelines to prescribe or recommend the basis on which Investments are included in the accounts of Funds. The IPEV Board confirms Fair Value as the best measure of valuing private equity portfolio companies and investments in Private Equity Funds. The board's support for Fair Value is underpinned by the transparency it affords investors in Funds, which use Fair Value as an indication of the interim performance of a portfolio. In addition, institutional investors require Fair Value to make asset allocation decisions, and to produce financial statements for regulatory purposes.

The requirements and implications of global financial reporting standards and in particular IFRS and US GAAP have been considered in the preparation of these Valuation Guidelines. This has been done, in order to provide a framework for Private Equity Funds for arriving at a Fair Value for Investments which is consistent with accounting principles.

Financial reporting standards do not require that these Valuation Guidelines be followed. However while Valuers must conclude themselves whether or not their Fair Value measurements are compliant with relevant financial reporting standards, measuring Fair Value in compliance with relevant financial reporting standards can be achieved by following these Valuation Guidelines.

These Valuation Guidelines are intended to represent current best practice and therefore will be revisited and, if necessary, revised to reflect changes in regulation or accounting standards.

These Valuation Guidelines are concerned with valuation from a conceptual, practical, and investor reporting standpoint and do not seek to address best practice as it relates to internal processes, controls and procedures, governance aspects, committee oversights, the experience and capabilities required of the Valuer or the audit or review of valuations.

A distinction is made in these Valuation Guidelines between the basis of valuation (Fair Value), which defines what the carrying amount purports to represent, a valuation technique (such as the earnings multiple technique), which details the method or technique for deriving a valuation, and inputs used in the valuation technique (such as EBITDA).

WWW.PRIVATEEQUITYVALUATION.COM

Private equity by its nature utilizes confidential, non-public information. Yet Investors in Private Equity Funds need sufficient, timely, comparable and transparent information from their Managers which allows Investors to:

- **Exercise fiduciary duty in monitoring deployed investment capital**
- **Report periodic performance to ultimate Investors, beneficiaries, boards, etc., as applicable**
- **Prepare financial statements consistent with applicable accounting standards.**

Investors may also use the Fair Value information to:

- Make asset allocation decisions
- Make manager selection decisions
- Make Investor level incentive compensation decisions.

Readers should note that these Valuation Guidelines address financial valuation issues only. The IPEV Board, after thorough discussion and consultation, has concluded that matters relating to the reporting and evaluation of non-financial factors or inputs in the context of a Fund's responsible investment practices, including environmental, social and governance factors, are conceptually included in these Valuation Guidelines where their impact is financial, but are otherwise outside the scope of this document.

The IPEV Board has prepared separate Investor Reporting Guidelines. The IPEV Investor Reporting Guidelines (IRG) are a globally applicable set of disclosure principles and practices designed to provide general partners and their limited partners with guidance in reporting their investments and investment performance over the life of a fund.

The IPEV IRG may be obtained at: http://www.privateequityvaluation.com/ipev-board/reporting-guidelines/ipev-reporting-guidelines/index.html.

Financial Reporting Standards

United States and International financial reporting standards (used interchangeably with accounting standards) were amended in 2011 resulting in a common definition[1] of Fair Value and a common approach to measuring Fair Value. Other jurisdictions use a definition of Fair Value which is substantially similar with US GAAP, IFRS and the definition used in these Valuation Guidelines.

The measurement of Fair Value under US GAAP and IFRS is dictated by *Accounting Standards Codification* (ASC) Topic 820, *Fair Value Measurement* as issued by the Financial Accounting Standards Board (FASB), and IFRS 13, *Fair Value Measurement* as issued by the International Accounting Standards Board (IASB). Other accounting standards dictate when Fair Value is required or permitted. In the United States, FASB ASC Topic 946, *Investment Companies* requires assets of Investment Companies to be reported at Fair Value. Various IFRS require or permit certain financial instruments to be reported at Fair Value.

On October 31, 2012, the IASB amended IFRS 10, 12 and 27 such that IFRS now requires "control" investments held by investment entities to be reported at Fair Value rather than being consolidated at cost.

These Valuation Guidelines are focused on the consistent measurement of Fair Value. Other accounting concepts such as disclosure requirements or day-one gains/losses are beyond the scope of these Valuation Guidelines.

Unit of Account

US and International financial reporting standards require the Fair Value of an asset to be measured consistently with the level of aggregation (Unit of Account) dictated by the accounting standard requiring or permitting its measurement at Fair Value (for example, ASC Topic 946, *Investment Companies*, in the United States or internationally IFRS 9 and 10, and International Accounting Standard (IAS) 27, 28, 39 and 40).[2] The Unit of Account is a level of aggregation concept that was developed for financial reporting purposes (that is, it addresses the way in which assets and liabilities are to be aggregated or disaggregated in the financial statements).

Because financial reporting is meant to portray economic phenomena, the Unit of Account attempts to describe the specific way that an investment is owned, including the legal rights and obligations of ownership and its relationship to other ownership rights in a complex capital structure. However, actual transactions may not and do not actually have to take place at the Unit of Account level specified by accounting standards.

Fair Value measurement guidance articulated in both ASC Topic 820 and IFRS 13 states: "An entity shall measure the Fair Value of an asset or liability using the assumptions that Market Participants would use when pricing the asset or liability, assuming that Market Participants act in their economic best interest."[3] Neither ASC Topic 820 nor IFRS 13 specify the Unit of Account for assets or liabilities, but rely on other accounting standards to do so.

1 Fair Value is defined by US and International accounting standards 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." IFRS 13 paragraph 9, ASC Topic 820-10-15-5. These Valuation Guidelines focus on Fair Value measurement from a Private Equity Fund perspective which generally focuses on underlying portfolio investments, e.g. assets, and therefore for ease of drafting do not focus on the "or paid to transfer a liability" portion of the accounting definition.

2 The international accounting guidance for private equity investments is contained in IFRS 9, Financial Instruments, IFRS 10, Consolidated Financial Statements, IAS 27, Consolidated and Separate Financial Statements, IAS 28, Investments in Associates, and IAS 40, Investment Property. IFRS 9 replaced IAS 39 Financial Instruments: Recognition and Measurement, however as IFRS 9 is not yet effective, these Valuation Guidelines apply equally to IAS 39.

WWW.PRIVATEEQUITYVALUATION.COM

In US GAAP, ASC Topic 946 specifies that an investment company must measure its investments in debt and equity securities at Fair Value. An entity then refers to ASC Topic 820 for Fair Value measurement guidance. In the absence of more specific Unit of Account guidance from ASC Topic 946, entities measure the Fair Value of their debt and equity securities consistently with how Market Participants would act in their economic best interest.

In IFRS, the recent revisions to IFRS 10 state that the Fair Value of controlled investments held by investment entities should be measured at fair value through profit or loss in accordance with IFRS 9. IAS 27 and IAS 28 also permit certain entities to measure their Investments at Fair Value through profit or loss in accordance with IFRS 9. IFRS 9 then refers to IFRS 13 for specific Fair Value measurement guidance. IFRS 9 appears to require the Unit of Account of a financial instrument to be assessed as a single or individual share. Although a single share Unit of Account interpretation applies to actively traded securities (see Section I paragraph 3.9 of these Valuation Guidelines), there are different interpretations of the Unit of Account for non-actively traded securities:

- One interpretation is that because IFRS 10 and IAS 28 refer to measuring Fair Value in accordance with IFRS 9, the Unit of Account is determined by IFRS 9 and is a single share. However, actual transactions for non-actively traded securities rarely take place on a single share basis.
- Another interpretation is that the Unit of Account is determined by IFRS 10, IAS 27 and IAS 28 as the "Investment", which is not necessarily a single share. This interpretation more fully matches how Market Participants transact.

While it is important that a Fund's auditors agree with management's conclusion on the Unit of Account, management must take responsibility for the accounting conclusions reached, including the appropriate Unit of Account. If there are any further discussions or decisions by the IASB or the FASB on this issue, these Valuation Guidelines will be updated accordingly.

Because private equity transactions typically do not happen for individual shares, these Valuation Guidelines do not address how to value a single share of a non-actively traded security. In the absence of Unit of Account guidance to the contrary, these Valuation Guidelines have been prepared with the premise that the Fair Value measurement should be consistent with how Market Participants would transact in their economic best interest.

As the Unit of Account concept must be judgementally applied, in the absence of specific guidance, we offer the following examples to help clarify how such judgments may be reached:

- Some private equity managers invest in multiple securities or tranches of the same portfolio company. Unit of Account would be expected to be determined on the same basis that Market Participants (willing buyers and sellers) would enter into an Orderly Transaction. If Market Participants would be expected to purchase all positions in the same underlying portfolio company simultaneously, then, Fair Value would be measured for the aggregate investment in the portfolio company. If individual tranches of securities would be purchased by Market Participants individually, then the Unit of Account and the basis for determining Fair Value would be the individual tranche.
- If a Fund only holds a debt instrument within a portfolio company's capital structure, the Unit of Account would be the individual debt instrument and the Fair Value of the debt instrument would be measured using the perspective of a Market Participant and would include cash flow (coupon payments), risk, and time to expected principal repayment.

3 IFRS 13 paragraph 22; ASC Topic 820 paragraph 820-10-35-9.

WWW.PRIVATEEQUITYVALUATION.COM

- If a Fund holds both debt and equity Investments in the same portfolio company and Market Participants would transact separately, purchasing a debt position independently from an equity position, then Unit of Account and Fair Value would be measured separately for the debt and equity positions.
- If a potential Market Participant buyer would or could purchase individual shares of an interest in a private company, then the Unit of Account may be a single share. However, generally in the Private Equity industry, Market Participants purchase a meaningful ownership interest in a private company, by acquiring more than single private shares.

Generally it is appropriate to use the value of an entire Enterprise (business) as a starting point for measuring Fair Value if Market Participants would use such an approach regardless of the accounting Unit of Account. This is because private equity investors often invest in-concert with one another and realise value only when the entire Enterprise is sold. Further, private equity returns are usually proportionate to the equity position held. Therefore, the hypothetical sale of an Enterprise is a fundamental premise used by Market Participants to determine Fair Value. Common adjustments necessary to allocate Enterprise Value on a Unit of Account basis to measure Fair Value are discussed in these Valuation Guidelines.

The above discussion of Unit of Account is for informational purposes and represents the IPEV Board's interpretation of relevant accounting standards in the context of how Market Participants transact in the private equity industry. Ultimately, Unit of Account judgements are a matter for the Fund as confirmed by the Fund's auditor.

Valuation Standards

Global Valuation Standards continue to evolve. The IPEV Board has entered into an understanding with the International Valuation Standards Council (IVSC) with the objective of promoting consistency between the IPEV Board's Valuation Guidelines and the IVSC International Valuation Standards (IVSs) and to enable these Valuation Guidelines to be positioned as providing sector specific application guidance of the principles in IVSs. A valuation of private equity investments prepared in accordance with the IVSs and following the Valuation Guidelines will be consistent with the requirements of applicable financial reporting standards and will also maximise Investor's trust and confidence.

Further information about the IVSC, the IVSs and the IVSC Code of Ethical Principles for Professional Valuers is available at http://www.ivsc.org/.

Section I: Valuation Guidelines

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate investments made in series A, series B, and series C, then, Fair Value would be estimated for the aggregate Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

2. Principles of Valuation

2.1. The Fair Value of each Investment should be assessed at each Measurement Date.

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment in the context of the total Investment portfolio and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual equity instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation techniques;
(ii) Adjust the Enterprise Value for factors that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors, to derive an Adjusted Enterprise Value for the Investee Company;
(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid[4]) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;
(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;
(v) Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.

WWW.PRIVATEEQUITYVALUATION.COM

2.5. Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly[5]), then the valuation techniques that are expected to be used to estimate Fair Value in the future should be evaluated using market inputs as of the date the investment was made. This process is known as Calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate Fair Value at inception and therefore that the valuation techniques using market inputs as of each subsequent Measurement Date will generate Fair Value at each such date.

3. Valuation Methods

3.1. General

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

3.1 (ii) Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the Measurement Date.

3.2. Selecting the Appropriate Valuation Technique

The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

3.3. Price of Recent Investment

In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs[6], or, where there has been subsequent investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only if deemed to represent Fair Value and only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in any case assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

4 Some Valuers may question whether the Fair Value of debt or the face value of debt should be subtracted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it assumes that a change in control takes place upon the sale of the Investment at the Measurement Date. However, if debt must be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value debt for purposes of valuing an equity instrument:
(a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control has not yet taken place as of the Measurement Date, but incorporating into the Fair Value of the debt the existence of the change in control provision); or
(b) using a term of zero on the basis that a hypothetical change in control has taken place (that is, assuming that the change in control takes place on the Measurement Date, resulting in the Fair Value of debt being equal to the face or par value of debt)
When using a Market Participant perspective, the Fair Value of debt may equal the face or par value of debt depending on the facts and circumstances. If debt is not required to be repaid upon a change of control, then the Fair Value of equity would be impacted by favorable or unfavorable terms (such as interest rate) of the debt, or in other words, the Fair Value of debt reflecting the favorable/unfavorable elements would be subtracted from Adjusted Enterprise value.

5 A forced transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.

6 Transaction costs are not considered a characteristic of an asset and therefore should not be added or included as a component of an asset's Fair Value..

WWW.PRIVATEEQUITYVALUATION.COM

3.4. Multiples

In using the Earnings Multiple valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

(i) Apply a multiple that is an **appropriate** and **reasonable** indicator of value (given the size, risk profile and earnings growth prospects of the underlying company) to the **maintainable earnings** of the company;
(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;
(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;
(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

3.5. Net Assets

In using the Net Assets valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and contingent assets and liabilities);
(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and
(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

3.6. Discounted Cash Flows or Earnings (of Underlying Business)

In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that captures the risk inherent in the projections;
(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;
(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;
(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of Market Participants. Judgement is required in assessing a Market Participant perspective.

3.7. Discounted Cash Flows (from the Investment)

In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Investments with characteristics similar to debt.

3.8. Industry Valuation Benchmarks

The use of industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sanity check of values produced using other techniques.

3.9. Available Market Prices

(i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.
(ii) Blockage Factors that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.
(iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay at the Measurement Date.

4. Valuing Fund Interests

4.1. General

In measuring the Fair Value of an interest in a Fund the Valuer may base their estimate on their attributable proportion of the reported Fund Net Asset Value (NAV) if NAV is derived from the Fair Value of underlying Investments and is as of the same Measurement Date as that used by the Valuer of the Fund interest, except as follows:
(i) if the Fund interest is actively traded Fair Value would be the actively traded price;
(ii) if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.

4.2. Adjustments to Net Asset Value

If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager.
If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

4.3. Secondary Transactions

When a Valuer of an interest knows the relevant terms of a Secondary transaction in that particular Fund and the transaction is orderly, the Valuer must consider the transaction price as one component of the information used to measure the Fair Value of a Fund interest.

Section II: Explanatory Comments- Measuring Fair Value

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate investments made in series A, series B, and series C, then, Fair Value would be estimated for the aggregate Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

The objective is to estimate the price at which an Orderly Transaction would take place between Market Participants at the Measurement Date.

Fair Value is the hypothetical exchange price taking into account current market conditions for buying and selling assets. Fair Value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distressed sale.

Although transfers of shares in private businesses are often subject to restrictions, rights of pre-emption and other barriers, it should still be possible to estimate what amount a willing buyer would pay to take ownership of the Investment, subject to such restrictions.

The estimation of Fair Value assumes that the time period required to consummate a transaction hypothetically began at a point in time in advance of the Measurement Date such that the hypothetical exchange culminates on the Measurement Date. Therefore, Fair Value should reflect the actual amount that a seller would receive in an Orderly Transaction under current market conditions at the Measurement Date.
An additional discount for Marketability (where Marketability is defined as the time required to effect a transaction) is not appropriate. Liquidity or illiquidity (meaning the frequency of transactions) is taken into account by Market Participants and should be a factor used in assessing Fair Value.

2. Principles of Valuation

2.1. The Fair Value of each Investment should be assessed at each Measurement Date.

In the absence of an Active Market for a financial instrument, the Valuer must estimate Fair Value utilising one or more of the valuation techniques.

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment in the context of the total Investment portfolio and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

In private equity, value is generally realised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes. The value of the business as a whole at the Measurement Date (Enterprise Value) will often provide a key insight into the value of Investment stakes in that business.[7]

If value is realised as described above, then Enterprise Value would be used by a Market Participant to determine the orderly price they would pay for an Investment. Alternatively, if a Market Participant would transact for individual instruments, such as individual shares debt tranches, or a single series of equity, then Fair Value would be more appropriately assessed at the individual instrument level.

2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual equity instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation techniques;

(ii) Adjust the Enterprise Value for factors that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors, to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid[8]) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;

7 Some have interpreted International accounting standards as requiring the Unit of Account to be a single share of a private company (see discussion of Accounting Standards and Unit of Account on pages 6 through 9 of these Valuation Guidelines). These Valuation Guidelines do not address a single share Unit of Account conclusion (other than for actively traded securities) as a Fair Value measurement for a single share of a private company generally does not occur in practice and would therefore not provide a meaningful measurement of Fair Value.

8 Some Valuers may question whether the Fair Value of debt or the face value of debt should be subtracted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it assumes that a change in control takes place upon the sale of the Investment at the Measurement Date. However, if debt must be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value debt for purposes of valuing an equity instrument:
(a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control has not yet taken place as of the Measurement Date, but incorporating into the Fair Value of the debt the existence of the change in control provision); or
(b) using a term of zero on the basis that a hypothetical change in control has taken place (that is, assuming that the change in control takes place on the Measurement Date, resulting in the Fair Value of debt being equal to the face or par value of debt)
When using a Market Participant perspective, the Fair Value of debt may equal the face or par value of debt depending on the facts and circumstances. If debt is not required to be repaid upon a change of control, then the Fair Value of equity would be impacted by favorable or unfavorable terms (such as interest rate) of the debt, or in other words, the Fair Value of debt reflecting the favorable/unfavorable elements would be subtracted from Adjusted Enterprise value.

WWW.PRIVATEEQUITYVALUATION.COM

(v) Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.

It is important to recognise the subjective nature of private equity Investment valuation. It is inherently based on forward-looking estimates and judgements about the Underlying Business itself: its market and the environment in which it operates; the state of the mergers and acquisitions market; stock market conditions and other factors and expectations that exist at the Measurement Date.

Due to the complex interaction of these factors and often the lack of directly comparable market transactions, care should be applied when using publicly available information regarding other entities in deriving a valuation. In order to measure the Fair Value of an Investment, the Valuer will have to exercise judgement and make necessary estimates to adjust the market data to reflect the potential impact of other factors such as geography, credit risk, foreign currency, rights attributable, equity prices and volatility.

As such, it must be recognised that, while valuations do provide useful interim indications of the progress of a particular Underlying Business or Investment, ultimately it is not until Realisation that true performance is firmly determined. A Valuer should be aware of reasons why realisation proceeds are different from their estimates of Fair Value and consider such reasons in future Fair Value estimates.

Apportion the Attributable Enterprise Value appropriately

The apportionment should reflect the respective amounts accruing to the holder of each financial instrument and all other financial instruments (regardless of holder) in the event of a realisation at the Measurement Date. As discussed further in section III 5.8, where there are ratchets or share options or other mechanisms (such as 'liquidation preferences', in the case of Investments in early-stage businesses) in place which are likely to be triggered in the event of a sale of the company at the given Enterprise Value at that date, these should be reflected in the apportionment.

The estimation of Fair Value should be undertaken on the assumption that options and warrants are exercised, where the Fair Value is in excess of the exercise price and accordingly it is a reasonable assumption that these will be exercised. The aggregate exercise price of these may result in surplus cash arising in the Underlying Business if the aggregate exercise price is significant.

Where significant positions in options and warrants are held by the Fund, these may need to be valued separately from the underlying Investments using an appropriate option based pricing model.

Differential allocation of proceeds may have an impact on the value of an Investment. If liquidation preferences exist, these need to be reviewed to assess whether they are expected to give rise to a benefit to the Fund, or a benefit to a third party to the detriment of the Fund.

When subtracting outstanding debt from Enterprise Value to measure the Fair Value of Equity Instruments, judgement should be exercised to ensure that the Fair Value of debt represents a Market Participant perspective. For example, if debt must be repaid upon the sale of the Underlying Business, which is often the case in a private equity transaction, then a Market Participant transacting in their economic best interest, may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. If debt would not be repaid when the Enterprise is sold, then the Fair Value of debt would not necessarily equal the Par Value of debt.

It should be noted, however, that if debt is a standalone Investment, a Market Participant would

take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which may **not** be equivalent to Par Value.

2.5. Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

Private Equity Funds often undertake an Investment with a view to build, develop and/or to effect substantial changes in the Underlying Business, whether it is to its strategy, operations, management, or financial condition. Sometimes these situations involve rescue refinancing or a turnaround of the business in question. While it might be difficult in these situations to measure Fair Value, it should in most cases be possible to estimate the amount a Market Participant would pay for the Investment in question at a point in time.

There may be situations where:

- the range of reasonable Fair Value estimates is significant;
- the probabilities of the various estimates within the range cannot be reasonably assessed;
- the probability and financial impact of achieving a key milestone cannot be reasonably predicted; and
- there has been no recent investment into the business.

While these situations prove difficult, the Valuer must still come to a conclusion as to their best estimate of the hypothetical exchange price between willing Market Participants.
Estimating the increase or decrease in Fair Value in such cases may involve reference to broad indicators of value change (such as relevant stock market indices). After considering these broad indicators, in some situations, the Valuer might reasonably conclude that the Fair Value at the previous Measurement Date remains the best estimate of Fair Value.

Where a change in Fair Value is perceived to have occurred, the Valuer should amend the carrying value of the Investment to reflect the new Fair Value estimate.

2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly[9]), then the valuation techniques that are expected to be used to estimate Fair Value in the future should be evaluated using market inputs as of the date the investment was made. This process is known as Calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate Fair Value at inception and therefore that the valuation techniques using market inputs as of each subsequent Measurement Date will generate Fair Value at each such date.

Fair Value should reflect reasonable estimates and assumptions for all significant factors that parties to an arm's length transaction would be expected to consider, including those which impact upon the expected cash flows from the Investment and upon the degree of risk associated with those cash flows.

In assessing the reasonableness of assumptions and estimates, the Valuer should:

- note that the objective is to replicate those that the parties in an arm's-length transaction would make at the Measurement Date;
- take account of events taking place subsequent to the Measurement Date where they provide additional evidence of conditions that existed at the Measurement Date that were known or knowable by Market Participants;
- take account of current market conditions at the Measurement Date; and
- to the extent the initial entry price is deemed Fair Value, test (or calibrate) valuation techniques expected to be used at subsequent valuation dates, using input data at inception to ensure that the techniques provide a resultant initial Fair Value estimate equal to the entry price; (**Note:** at subsequent Measurement Dates the calibrated valuation techniques are used with current market inputs reflecting then current market conditions.);

9 A forced transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.

WWW.PRIVATEEQUITYVALUATION.COM

3. Valuation Methods

3.1. General

A number of valuation methods or techniques that may be considered for use in measuring the Fair Value of Unquoted Instruments are described in sections 3.3. to 3.8. below. These valuation techniques should incorporate case-specific factors affecting Fair Value. For example, if the Underlying Business is holding surplus cash or other assets, the value of the business should reflect that fact to the extent a Market Participant would attribute value to such items.

Techniques for valuing Actively Traded Instruments are described in section 3.9.

Because, in the private equity arena, value is generally realised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes, the value of the business as a whole at the Measurement Date will often provide a key insight into the value of Investment stakes in that business. For this reason, a number of the techniques described below involve estimating the Enterprise Value as an initial step. If a Market Participant would be expected to maximize value through the sale of the entire business, the estimation of the Fair Value of individual financial instruments would include an assessment of the allocation of the Enterprise Value to the value of individual financial instruments.

There will be some situations where the Fair Value will derive mainly from the expected cash flows and risk of the relevant financial instruments rather than from the Enterprise Value. The valuation technique used in these circumstances should therefore reflect this fact.

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

Underlying Businesses may operate using multiple currencies. Investments may be denominated in currencies other than the Funds reporting currency. Movements in rates of exchange may impact the value of the Fund's Investments and these should be taken into account using a Market Participant perspective.

3.1 (ii) Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the Measurement Date.

3.2. Selecting the Appropriate Valuation Technique

The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

The key criterion in selecting a valuation technique is that it should be appropriate in light of the nature, facts and circumstances of the Investment and in the expected view of

Market Participants. The Valuer may consider utilising further techniques to check the Fair Value derived, as appropriate.

When selecting the appropriate valuation technique each Investment should be considered individually.

An appropriate valuation technique will incorporate available information about all factors that are likely to materially affect the Fair Value of the Investment.

The Valuer will select the valuation technique that is the most appropriate and consequently make valuation adjustments on the basis of their informed and experienced judgement. This will include consideration of factors such as:

- the relative applicability of the techniques used given the nature of the industry and current market conditions;
- the quality, and reliability of the data used in each valuation technique;
- the comparability of Enterprise or transaction data;
- the stage of development of the Enterprise;
- the ability of the Enterprise to generate maintainable profits or positive cashflow;
- any additional considerations unique to the Enterprise; and
- the results of testing (calibrating) techniques and inputs to replicate the entry price of the Investment (**Note:** at subsequent Measurement Dates the calibrated valuation techniques are used with updated inputs reflecting then current market conditions.).

In assessing whether a technique is appropriate, the Valuer should maximise the use of techniques that draw heavily on observable market-based measures of risk and return. Fair Value estimates based entirely on observable market data are deemed less subjective than those based on Valuer assumptions. In some cases observable market data may require adjustment by the Valuer to properly reflect the facts and circumstances of the Instrument being valued. This adjustment should not be automatically regarded as reducing the reliability of the Fair Value estimation.

While accounting standards do not specify a hierarchy of valuation techniques, for the private equity industry utilising discounted cashflows and industry benchmarks in isolation, without using market-based measures would be considered rare and then only with caution. These techniques may be useful as a cross-check of values estimated using the market-based valuation techniques.

Where the Valuer considers that several techniques are appropriate to value a specific Investment, the Valuer may consider the outcome of these different valuation techniques so that the results of one particular valuation technique may be used as a cross-check of values or to corroborate or otherwise be used in conjunction with one or more other techniques in order to measure the Fair Value of the Investment.

Techniques should be applied consistently from period to period, except where a change would result in better estimates of Fair Value.

The basis for any changes in valuation techniques should be clearly understood. It is expected that there would not be frequent changes in valuation techniques over the course of the life of an Investment.

The table on page 25 identifies a number of the most widely used techniques.

3.3. Price of Recent Investment

Where the Investment being valued was itself made recently, its cost may provide a good indication of Fair Value. Where there has been any recent Investment in the Investee Company, the price of that Investment will provide a basis of the valuation.

Valuation Technique	Approach
Price of Recent Investment	(Market Approach)
Multiples	(Market Approach)
Net assets	(Cost Approach)
Discounted cash flows or earnings (of Underlying Business)	(Income Approach)
Discounted cash flows (from an Investment)	(Income Approach)
Industry valuation benchmarks	(Market Approach)

The validity of a valuation obtained in this way is inevitably eroded over time, since the price at which an Investment was made reflects the effects of conditions that existed on the date that the transaction took place. In a dynamic environment, changes in market conditions, the passage of time itself and other factors will act to diminish the appropriateness of this valuation technique as a means of estimating value at subsequent dates.

In addition, where the price at which a third party has invested is being considered as the basis of valuation, the background to the transaction must be taken in to account. In particular, the following factors may indicate that the price was not wholly representative of the Fair Value at the time:

- different rights attach to the new and existing Investments;
- disproportionate dilution of existing investors arising from a new investor(s);
- a new investor motivated by strategic considerations; or
- the transaction may be considered to be a forced sale or 'rescue package'.

This valuation technique is likely to be appropriate for all private equity Investments, but only for a limited period after the date of the relevant transaction. Because of the relatively high frequency with which funding rounds are often undertaken for seed and start-up situations, or in respect of businesses engaged in technological or scientific innovation and discovery, this method will often be appropriate for valuing Investments in such circumstances. Generally, Fair Value would be indicated by the post money valuation.

The length of period for which it would remain appropriate to use this valuation technique will depend on the specific circumstances of the Investment and is subject to the judgement of the Valuer.

In stable market conditions with little change in the entity or external market environment, the length of period for which this valuation technique is likely to be appropriate will be longer than during a period of rapid change.

3.3. In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs[10], or, where there has been subsequent investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only if deemed to represent Fair Value and only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in any case assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

The Price of Recent Investment valuation technique is commonly used in a seed, start-up or an early-stage situation, where there are no current and no short-term future earnings or positive cash flows. For these Enterprises, typically, it is difficult to gauge the probability and financial impact of the success or failure of development or research activities and to make reliable cash flow forecasts.

10 Transaction costs are not considered a characteristic of an asset and therefore should not be added or included as a component of an asset's Fair Value.

Consequently, the most appropriate approach to measure Fair Value is a valuation technique that is based on market data, that being the Price of a Recent Investment.

If the Valuer concludes that the Price of Recent Investment, unadjusted, is no longer relevant, and there are no comparable companies or transactions from which to infer value, it may be appropriate to apply an enhanced assessment based on an industry analysis, sector analysis and/or milestone analysis.

In such circumstances, industry-specific benchmarks/milestones, which are customarily and routinely used in the specific industries of the Investee Company, can be used in estimating Fair Value where appropriate. In applying the milestone approach, the Valuer attempts to ascertain whether there has been a change in the milestone and/or benchmark which would indicate that the Fair Value of the Investment has changed.

For an Investment in early or development stages, commonly a set of agreed milestones would be established at the time of making the investment decision. These will vary across types of investment, specific companies and industries, but are likely to include:

Financial measures:
- revenue growth;
- profitability expectations;
- cash burn rate;
- covenant compliance.

Technical measures:
- phases of development;
- testing cycles;
- patent approvals;
- regulatory approvals.

Marketing and sales measures:
- customer surveys;
- testing phases;
- market introduction;
- market share.

In addition, the key market drivers of the Investee Company, as well as the overall economic environment, are relevant to the assessment.

In applying the milestone analysis approach, the Valuer attempts to assess whether there is an indication of change in Fair Value based on a consideration of the milestones. This assessment might include considering whether:

- there has been any significant change in the results of the Investee Company compared to budget plan or milestone;
- there have been any changes in expectation that technical milestones will be achieved;
- there has been any significant change in the market for the Investee Company or its products or potential products;
- there has been any significant change in the global economy or the economic environment in which the Investee Company operates;
- there has been any significant change in the observable performance of comparable companies, or in the valuations implied by the overall market;
- any internal matters such as fraud, commercial disputes, litigation, changes in management or strategy.

If the Valuer concludes that there is an indication that the Fair Value has changed, they must estimate the amount of any adjustment from the last Price of Recent Investment. By its very nature such adjustment will be subjective. This estimation is likely to be based on objective data from the company, and the experience of the investment professionals and other investors. However, the necessity and magnitude of the adjustments are relatively subjective and require a large amount of judgment on the part of the Valuer. Where deterioration in value has occurred, the Valuer should reduce the carrying value of the Investment reported at the previous Measurement Date to reflect the estimated decrease.

If there is evidence of value creation, such as those listed above, the Valuer may consider increasing the carrying value of the Investment. Caution must be applied so that positive developments are only valued when they contribute to an increase in value of the Underlying Business when viewed by a Market Participant. When considering these more subtle indicators of value enhancement, in the absence of additional financing rounds or profit generation, the Valuer should consider what value a Market Participant would place on these indicators, taking into account the potential outcome and the costs and risks to achieving that outcome.

In the absence of significant revenues, profits or positive cash flows, other methods such as the earnings multiple are generally inappropriate. The DCF technique may be utilised as a cross-check, however the disadvantages inherent in these, arising from the high levels of subjective judgement, may render the method inappropriate without corroborating support.

3.4. Multiples

This valuation technique involves the application of an earnings multiple to the earnings of the business being valued in order to derive a value for the business.

This valuation technique is likely to be appropriate for an Investment in an established business with an identifiable stream of continuing earnings that are considered to be maintainable.

This section sets out guidance for preparing valuations of businesses on the basis of positive earnings. However, for businesses that are still in the development stage and prior to positive earnings being generated, multiples of actual or projected revenue may be used as a basis of valuation. A revenue multiple is commonly based on an assumption as to the 'normalised' level of earnings that can be generated from that revenue. The valuation technique and considerations set out here for earnings multiples equally apply if a multiple of revenue is utilised.

This valuation technique may be applicable to companies with negative earnings, if the losses are considered to be temporary and one can identify a level of 'normalised' maintainable earnings. This may involve the use of adjusted historic earnings, using a forecast level of earnings or applying a 'sustainable' profit margin to current or forecast revenues.

The most appropriate earnings to use in this valuation technique would be those likely to be used by a prospective Market Participant purchaser of the business.

3.4. In using the Earnings Multiple valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

(i) Apply a multiple that is an appropriate and reasonable indicator of value (given the size, risk profile and earnings growth prospects of the underlying company) to the maintainable earnings of the company;

(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

Guidance on the interpretation of underlined terms is given below.

Appropriate multiple

By definition, earnings multiples have as their numerator a value, such as price, Enterprise Value, etc., and as their denominator an earnings figure. The denominator can be the earnings figure for any specified period of time and multiples are often defined as 'historical', 'current' or 'forecast' to indicate the earnings used. It is important that the multiple used correlates to the period and concept of earnings of the company being valued.

A number of earnings multiples are used, including price/earnings (P/E), Enterprise Value/earnings before interest and tax (EV/EBIT) and depreciation and amortisation (EV/EBITDA). The particular multiple used should be appropriate for the business being valued. (The multiples of revenues and their use are presented in 3.8. Industry Valuation Benchmarks).

In general, because of the role of financial structuring in private equity, multiples should be used to derive an Enterprise Value for the Underlying Business. Where EBITDA multiples are available, these are commonly used. When unavailable, P/E multiples may be used since these are more commonly reported. For a P/E multiple to be comparable, the two entities should have similar financing structures and levels of borrowing.

Therefore, where a P/E multiple is used, it should generally be applied to an EBIT figure which has been adjusted for the impact of finance costs relating to operations, working capital needs and tax impacts. These adjustments are designed to eliminate the effect on the earnings of the acquisition finance on the Enterprise Value since this is subsequently adjusted.

Reasonable multiple

The Valuer would usually derive a multiple by reference to current market-based multiples, reflected in the market valuations of quoted companies or the price at which companies have changed ownership. The multiple derived from the acquisition price is calibrated with the multiple of comparable companies expected to be used in on-going valuation estimates. Differences between the acquisition multiple and the comparable companies multiples are monitored and adjusted, as appropriate, over time, given differences between the Investee company and the comparable companies.

For example, assume the acquisition price of an Investment was deemed Fair Value (e.g. an Orderly Transaction price) and represented an EBITDA multiple of 8 when comparable company EBITDA multiples were 10. In future periods, when estimating Fair Value judgement is required as to whether or not the 20% discount to comparable company multiples should be maintained or should change at each subsequent Measurement Date.

This market-based approach presumes that the comparable companies are correctly valued by the market. While there is an argument that the market capitalisation of a quoted company reflects not the value of the company but merely the price at which 'small parcels' of shares are exchanged, the presumption in these Valuation Guidelines is that market based multiples are indicative of the value of the company as a whole.

Where market-based multiples are used, the aim is to identify companies that are similar, in terms of risk attributes and earnings growth prospects, to the company being valued. This is more likely to be the case where the companies are similar in terms of business activities, markets served, size, geography and applicable tax rate.

WWW.PRIVATEEQUITYVALUATION.COM

In using P/E multiples, the Valuer should note that the P/E ratios of comparable companies will be affected by the level of financial gearing and applicable tax rate of those companies.

In using EV/EBITDA multiples, the Valuer should note that such multiples, by definition, remove the impact on value of depreciation of fixed assets and amortisation of goodwill and other intangibles. If such multiples are used without sufficient care, the Valuer may fail to recognise that business decisions to spend heavily on fixed assets or to grow by acquisition rather than organically do have real costs associated with them which should be reflected in the value attributed to the business in question.

It is important that the earnings multiple of each comparable company is adjusted for points of difference between the comparable company and the company being valued. These points of difference should be considered and assessed by reference to the two key variables of risk and earnings growth prospects which underpin the earnings multiple. In assessing the risk profile of the company being valued, the Valuer should recognise that risk arises from a range of aspects, including the nature of the company's operations, the markets in which it operates and its competitive position in those markets, the quality of its management and employees and, importantly in the case of private equity, its capital structure and the ability of the Fund holding the Investment to effect change in the company.

When considering adjustments to reported multiples, the Valuer should also consider the impact of the differences between the Liquidity of the shares being valued and those on a quoted exchange. There is a risk associated with a lack of Liquidity. The Valuer should consider the extent to which a prospective acquirer of those shares would take into account the additional risks associated with holding an unquoted share.

In an unquoted company the risk arising from the lack of Liquidity is clearly greater for a shareholder who is unable to control or influence a realisation process than for a shareholder who owns sufficient shares to drive a realisation at will. It may reasonably be expected that a prospective Market Participant purchaser would assess that there is a higher risk associated with holding a minority position than for a control position.

Value attributed to a lack of Liquidity may be difficult to assess. Calibration provides a technique to objectively assess value attributed to a lack of Liquidity. The multiple at the date of acquisition should be calibrated against the market comparable multiples. Differences, if any, should be understood and similar differences may be expected or need to be understood at subsequent valuation dates.

For example, the reasons why the comparable company multiples may need to be adjusted may include the following:

- the size and diversity of the entities and, therefore, the ability to withstand adverse economic conditions;
- the rate of growth of the earnings;
- the reliance on a small number of key employees;
- the diversity of the product ranges;
- the diversity and quality of the customer base;
- the level of borrowing;
- for any other reason the quality of earnings may differ; and
- the risks arising from the lack of Liquidity of the shares.

Fair Value measurements should not include a premium or discount that is inconsistent with the instrument (Unit of Account) being valued. Blockage Factors are not allowed by accounting standards. However, investors in private companies generally consider their overall interest and the extent to which they act in concert with other investors. Judgment must

WWW.PRIVATEEQUITYVALUATION.COM

be applied to individual facts and circumstances to assess the amount a Market Participant would pay in the context of the potential adjustments to multiples noted above.

Recent transactions involving the sale of similar companies are sometimes used as a frame of reference in seeking to derive a reasonable multiple. It is sometimes argued, since such transactions involve the transfer of whole companies whereas quoted multiples relate to the price for 'small parcels' of shares, that recent transactions provide a more relevant source of multiples. However, the appropriateness of the use of recent transaction data is often undermined by the following:

- the lack of forward looking financial data and other information to allow points of difference to be identified and adjusted for;
- the generally lower reliability and transparency of reported earnings figures of private companies;
- the impact of reputational issues, such as ESG and other factors; and
- the lack of reliable pricing information for the transaction itself.

It is a matter of judgement for the Valuer as to whether, in deriving a reasonable multiple, they refer to a single comparable company or a number of companies or the earnings multiple of a quoted stock market sector or sub-sector. It may be acceptable, in particular circumstances, for the Valuer to conclude that the use of quoted sector or sub-sector multiples or an average of multiples from a 'basket' of comparable companies may be appropriate.

Maintainable earnings

In applying a multiple to maintainable earnings, it is important that the Valuer is satisfied that the earnings figure can be relied upon. While this might tend to favour the use of audited historical figures rather than unaudited or forecast figures, it should be recognised that value is by definition a forward-looking concept, and quoted markets more often think of value in terms of 'current' and 'forecast' multiples, rather than 'historical' ones. In addition, there is the argument that the valuation should, in a dynamic environment, reflect the most recent available information. There is therefore a trade-off between the reliability and relevance of the earnings figures available to the Valuer.

On balance, while it remains a matter of judgement for the Valuer, a Market Participant perspective should be used either focused on historical earnings or focused on future earnings based on the availability and reliability of forward looking projections and multiples or historical results and multiples.

Whichever period's earnings are used, the Valuer should satisfy himself that they represent a reasonable estimate of maintainable earnings, which implies the need to adjust for exceptional or non-recurring items, the impact of discontinued activities and acquisitions and forecast material changes in earnings.

3.5. Net Assets

This valuation technique involves deriving the value of a business by reference to the value of its net assets.

This valuation technique is likely to be appropriate for a business whose value derives mainly from the underlying Fair Value of its assets rather than its earnings, such as property holding companies and investment businesses (such as Fund-of-Funds as more fully discussed in 4. Valuing Fund Interests).

This valuation technique may also be appropriate for a business that is not making an adequate return on assets and for which a greater value can be realised by liquidating the business and selling its assets. In the context of private equity,

WWW.PRIVATEEQUITYVALUATION.COM

it may therefore be appropriate, in certain circumstances, for valuing Investments in loss-making companies and companies making only marginal levels of profits.

3.5. In using the Net Assets valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and contingent assets and liabilities);

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

3.6. Discounted Cash Flows or Earnings (of Underlying Business)

This valuation technique involves deriving the value of a business by calculating the present value of expected future cash flows (or the present value of expected future earnings, as a surrogate for expected future cash flows). The cash flows and 'terminal value' are those of the Underlying Business, not those from the Investment itself.

The Discounted Cash Flows (DCF) technique is flexible in the sense that it can be applied to any stream of cash flows (or earnings). In the context of private equity valuation, this flexibility enables the valuation technique to be applied in situations that other techniques may be incapable of addressing. While this valuation technique may be applied to businesses going through a period of great change, such as a rescue refinancing, turnaround, strategic repositioning, loss making or is in its start-up phase, there is a significant risk in utilising this valuation technique.

The disadvantages of the DCF valuation technique centre around its requirement for detailed cash flow forecasts and the need to estimate the 'terminal value' and an appropriate risk-adjusted discount rate. All of these inputs require substantial subjective judgements to be made, and the derived present value amount is often sensitive to small changes in these inputs.

There is no hierarchy of valuation techniques required by accounting standards. However, due to the high level of subjectivity in selecting inputs for this technique when valuing equity Investments for the private equity industry, DCF based valuations are more useful as a cross-check of values estimated under market-based techniques and should generally not be used in isolation.

In assessing the appropriateness of this valuation technique, the Valuer should consider whether its disadvantages and sensitivities are such, in the particular circumstances, as to render the resulting Fair Value insufficiently reliable.

3.6. In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that captures the risk inherent in the projections;

(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of Market Participants. Judgement is required in assessing a Market Participant perspective.

3.7. Discounted Cash Flows (from an Investment)

This valuation technique applies the DCF concept and technique to the expected cash flows from the Investment itself.
Where Realisation of an Investment or a flotation of the Underlying Business is imminent and the pricing of the relevant transaction has been substantially agreed, the Discounted Cash Flows (from the Investment) valuation technique (or, as a surrogate, the use of a simple discount to the expected Realisation proceeds or flotation value) is likely to be the most appropriate valuation technique.

This valuation technique, because of its flexibility, is capable of being applied to all private equity Investment situations. It is particularly suitable for valuing non-equity Investments in instruments such as debt or mezzanine debt, since the value of such instruments derives mainly from instrument-specific cash flows and risks rather than from the value of the Underlying Business as a whole.

However, because of its inherent reliance on substantial subjective judgements, and because of the general availability of market based techniques, the Valuer should be extremely cautious of using this valuation technique as the only basis of estimating Fair Value for Investments which include an equity element.

The valuation technique will often be useful as a common sense check of values produced using other techniques.

Risk and the rates of return necessary to compensate for different risk levels are central commercial variables in the making of all private equity Investments. Accordingly there exists a frame of reference against which to make discount rate assumptions.

However the need to make detailed cash flow forecasts over the Investment life (except in circumstances where realisation is imminent) may reduce the reliability and crucially for equity Investments, there remains a need to estimate the 'terminal value'.

Where the Investment comprises equity or a combination of equity and other financial instruments, the terminal value would usually be derived from the anticipated value of the

Underlying Business at Realisation. This will usually necessitate making assumptions about future business performance and developments and stock market and other valuation ratios at the assumed Realisation date. In the case of equity Investments, small changes in these assumptions can materially impact the valuation. In the case of non-equity instruments, the terminal value will usually be a pre-defined amount, which greatly enhances the reliability of the valuation.

In circumstances where a Realisation is not foreseeable, the terminal value may be based upon assumptions of the perpetuity cash flows accruing to the holder of the Investment. These circumstances (which are expected to be rare in private equity) may arise where the Fund has little ability to influence the timing of a Realisation and/or those shareholders that can influence the timing do not seek a Realisation.

3.7. In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Investments with characteristics similar to debt.

The implied discount rate at initial investment is adjusted over time for changes in market conditions.

3.8. Industry Valuation Benchmarks

A number of industries have industry-specific valuation benchmarks, such as 'price per bed' (for nursing-home operators) and 'price per subscriber' (for cable television companies). Other industries, including certain financial services and information technology sectors and some services sectors where long-term contracts are a key feature, use multiples of revenues as a valuation benchmark.

These industry norms are often based on the assumption that investors are willing to pay for turnover (revenue) or market share, and that the normal profitability of businesses in the industry does not vary much.

3.8. The use of industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sanity check of values produced using other techniques.

3.9. Quoted Investments

Private Equity Funds may be holding Quoted Instruments, for which there is an available market price.

3.9 (i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.

For certain Quoted Instruments there is only one market price quoted, representing, for example, the value at which the most recent trade in the instrument was transacted.

For other Quoted Instruments there are two market prices at any one time: the lower 'bid' price quoted by a market maker, which he will pay an investor for a holding (i.e. the investor's disposal price), and the higher 'ask' price, which an investor can expect to pay to acquire a holding. However, as an alternative to the bid price (where not required by regulation), is the mid-market price (i.e. the average of the bid and ask prices), where this is considered the most representative point estimate in the bid/ask spread.

As previously noted, Fair Value measurements should not include a premium or discount that is inconsistent with the instrument (Unit of Account) being valued. Blockage Factors are not allowed by accounting standards.

3.9 (ii) Blockage Factors that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.

If a market is deemed not to be active, the Valuer would supplement the use of quoted prices with additional valuation techniques to measure Fair Value.

3.9 (iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay at the Measurement Date.

In determining the level of discount to apply, the Valuer should consider the impact on the price that a buyer would pay when comparing the Investment in question with an identical but unrestricted holding.

A Valuer may consider using an option pricing model to value the impact of this restriction on realisation. However, in practice for restrictions which only cover a limited number of reporting periods, this is simplified to a simple mathematical discount to the quoted price.

The discount applied should appropriately reflect the time value of money and the enhanced risk arising from the reduced Liquidity. The discount used is a matter of judgement influenced by expected volatility which should reduce to zero at the end of the restriction period.

4. Valuing Fund Interests

4.1. General

4.1. In measuring the Fair Value of an interest in a Fund the Valuer may base their estimate on their attributable proportion of the reported Fund Net Asset Value (NAV) if NAV is derived from the Fair Value of underlying Investments and is as of the same Measurement Date as that used by the Valuer of the Fund interest, except as follows:

(i) if the Fund interest is actively traded Fair Value would be the actively traded price;

(ii) if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.

Fund-of-Funds and investors in Private Equity Funds must value their Interest in an underlying Fund at regular intervals to support their financial reporting. Historically, the Net Asset Value ('NAV') based on the underlying Fair Value of the Investments, as reported by the Manager, has been used as the basis for estimating the Fair Value of an interest in an underlying Fund.[11]

11 FASB ASC Topic 820 (820-10-15-4 & 820-10-35-59 to 62) allows the use of NAV to measure Fair Value if certain conditions are met: the investment is in a Fund (as defined by ASC Topic 946); and underlying investments are reported at Fair Value as of the Measurement Date. IFRS is silent on the use of NAV and provides no further guidance on how to measure the Fair Value of a Fund interest. Generally under IFRS, NAV is used as a starting point with the Valuer assessing that reported net assets are valued compliant with Fair Value principles.

Fair Value for an underlying Fund interest is, at its most basic level, equivalent to the summation of the estimated value of underlying Investments as if realised on the Measurement Date. The proceeds from such a realisation would flow through to the investor in an amount equal to NAV. This concept makes particular sense for closed-end Fund investors who realise cash returns on their Investment when realisation events occur through the sale of the underlying portfolio companies.
As an investor in a Fund, reliance on a reported NAV provided by the investee Fund manager can only be used by the investor to the extent that they have evidence that the reported NAV is appropriately derived using proper Fair Value principles as part of a robust process. Typically, evidence as to the Fair Value approach, procedures and consistency of application is gathered via initial due diligence, on-going monitoring, and review of financial reporting and governance of the investee Fund by the investor entity.

Therefore, NAV. when rigorously determined in accordance with the principles of Fair Value and these Valuation Guidelines provides the best estimate upon which to base the Fair Value of an Interest in a Fund.

4.2. Adjustments to Net Asset Value

4.2. If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager. If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

Factors which might result in an adjustment to the reported NAV would include the following:

- significant time elapsing between the Measurement Date of the Fund NAV and the Valuer entity's Measurement Date. This would be further exacerbated by:
  - the Fund making subsequent Investments or achieving realizations;
  - the Valuer becoming aware of subsequent changes in the Fair Value of underlying investee companies;
  - subsequent market changes or other economic conditions changing to impact the value of the Fund's portfolio;
- information from an orderly Secondary Transaction if sufficient and transparent;
- the appropriate recognition of potential performance fees or carried interest in the Fund NAV;
- waived management fees included in NAV;
- impact of claw back provisions;
- any features of the Fund agreement that may affect distributions but which are not captured in the NAV;
- materially different valuations by GPs for common companies and identical securities; and
- any other facts and circumstances which might impact underlying Fund value.

NAV should be adjusted such that it is equivalent to the amount of cash that would be received by the holder of the interest in the Fund if all underlying Investee Companies were realised as at the Measurement Date.

4.3. Secondary Transactions

4.3. When a Valuer of an interest knows the relevant terms of a Secondary transaction in that particular Fund and the transaction is considered orderly, the Valuer must consider the transaction price as one component of the information used to measure the Fair Value of a Fund interest.

Limited Secondary Transactions exist for Private Equity Funds. External market transactions for a Fund are typically infrequent, opaque and information is extremely limited. Secondary prices are negotiated, may be influenced by factors beyond Fair Value and based on assumptions and return expectations that are often unique to the counter parties. In addition, information relevant to specific transactions may not be deemed orderly and any pricing data available may no longer be current.
In the event that the investor in the Private Equity Fund has decided to sell their interest in that Fund, then data known from orderly Secondary Transaction prices is likely to be better evidence of Fair Value.

Any use of a Secondary Transaction price requires considerable judgement. If orderly Secondary Transaction prices are available, but are not deemed active, then such prices should be augmented with other valuation inputs, generally NAV.

4.4. Discounted Cash Flows

In situations where a Valuer decides not to use or cannot use NAV as a starting point for determining Fair Value and orderly Secondary Transaction information is not available, the primary valuation technique available to estimate Fair Value for a Fund interest would be to perform a discounted cash flow analysis of all future cash flows for the Fund. Given the subjectivity involved, it is not expected that the DCF alternative would be used often in practice.

Section III: Application Guidance

Introduction

Section II sets out the Valuation Guidelines and principles which represent best practice for the valuation of private equity and venture capital Investments. This section, Section III, sets out further practical guidance to the application of those principles and techniques to specific cases.

5. Specific Considerations

5.1. Insider Funding Rounds

The price at which a funding round takes place may be a clear indicator of Fair Value at that date. When using the Price of Recent Investment valuation technique, the Valuer should consider whether there are specific circumstances surrounding that round of Investment which may reduce the reliability of the price as an indicator of Fair Value.

Where there is a round of financing that involves only existing investors of the Underlying Business in the same proportion to their existing Investments (insider round), the commercial need for the transaction to be undertaken at Fair Value may be diminished. The Valuer needs to assess whether the transaction was appropriately negotiated and reflected the Enterprise Value at that date.

Nevertheless, a financing with existing investors that is priced at a valuation that is lower than the valuation reported at the previous Reporting Date (insider down round) may indicate a decrease in value and should therefore be taken into consideration.

Insider down rounds may take various forms, including a corporate reorganisation, i.e. a significant change in the common equity base of a company such as converting all outstanding preferred shares into common equity, combining outstanding preferred shares into a smaller number of shares (share consolidation) or even cancelling all outstanding shares before a capital increase.

It should be noted that a Board of Directors has the legal obligation to set the price of newly issued shares at Fair Value in the best interests of the Company.

5.2. Distressed Market

Markets from which transaction data may be extracted may be viewed by Valuers to be 'distressed markets'. A distressed market does not mean that all transactions within that market may be deemed to be distressed and invalid for use as comparative purposes, however an individual transaction may be deemed not orderly. In these situations significant judgement is needed when determining whether individual transactions are considered orderly and thereby are indicative of Fair Value.

When considering whether a transaction may be deemed to be distressed or forced (e.g. not orderly), the Valuer may include such matters as the following indicators in their consideration:

- a legal requirement to transact, for example a regulatory mandate;
- a necessity to dispose of an asset immediately and there is insufficient time to market the asset to be sold;
- the existence of a single potential buyer as a result of the legal or time restrictions imposed;
- the seller is in or near bankruptcy or receivership (i.e. the seller is distressed);
- there was not adequate exposure to the market to allow for usual and customary marketing activities; and
- the transaction is considered an outlier by Market Participants when considering other similar transactions of the same or similar asset.

Determining whether a transaction is not orderly or merely reflects current distressed market conditions requires judgment.

5.3. Higher Ranking Instruments

Many acquisition structures include third party debt which ranks higher than the interests of the Fund, which is deducted from Adjusted Enterprise Value to estimate the Attributable Enterprise Value.

For certain transactions, this debt is actively traded and may be acquired by the Investee Company or the Fund in the market at a price which is at a discount to the par value.

In calculating the Attributable Enterprise Value, the Valuer should deduct from the Enterprise Value the amount which is expected to be repaid in settlement of this debt at the Measurement Date. Typically this is the par value since the debt is generally repayable at the time of disposal of the Investee Company and the Enterprise Value has been estimated on the basis of disposal at the Measurement Date as this is how Market Participants in the Private Equity industry view the realization process.

When debt must be repaid upon the sale of the Underlying Business, then a Market Participant may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. It should be noted however, that if debt is a standalone Investment, a Market Participant would take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which would generally not be equivalent to Par Value (see 5.5 below).

Where the debt is trading at a discount to par, this lower amount would not normally be deducted from the Enterprise Value until the Investee Company or the Fund has acquired that debt in the market at that value and intends to cancel the debt rather than seek repayment at par.

5.4. Bridge Financing

Funds, or related vehicles, may grant loans to an Underlying Business pending a new round of equity financing (Bridge financing). This may be provided in anticipation of an initial Investment by the Fund, or ahead of a proposed follow-on Investment.

In the case of an initial Investment, where the Fund holds no other Investments in the Underlying Business, the Bridge loan should be valued in isolation. In these situations and if it is expected that the financing will occur in due course and that the Bridge loan is merely ensuring that funds are made available early, cost is likely to be the best indicator of Fair Value.

If it is anticipated that the company may have difficulty arranging the financing, and that its viability is in doubt, the Valuer should reassess Fair Value.

If the bridge finance is provided to an existing Investee Company in anticipation of a follow on Investment, the bridge finance should be included, together with the original Investment, as a part of the overall package of Investment being valued to the extent a Market Participant would be expected to combine the overall Investment.

5.5. Mezzanine Loans

Mezzanine loans are one of the commonly used sources of debt finance for Investments. Typically these will rank below the senior debt, but above shareholder loans or equity, bear an interest rate appropriate to the level of risk being assumed by the loan provider and may have additional value enhancing aspects, such as warrants.

Often these are provided by a party other than the equity provider and as such may be the only instrument held by the Fund in the Underlying Business. In these situations, the mezzanine loan

should be valued on a standalone basis. The price at which the mezzanine loan was issued is a reliable indicator of Fair Value at that date.

The Valuer should consider whether any indications of deterioration in the value of the Underlying Business exist, which suggest that the loan will not be fully recovered. The Valuer should also consider whether any indications of changes in required yield exist, which suggest that the value of the loan has changed.

There are generally limited market opportunities for the holders of mezzanine loans to trade. There are agencies which regularly quote prices on these types of loans; however transactions cannot always be undertaken at the indicative prices offered. Prices reported of transactions should be considered by the Valuer as to whether these are a reasonable indication of Fair Value.

Since the cash flows associated with a mezzanine loan may be predicted with a reasonable amount of certainty, typically these are valued on the basis of a DCF calculation.

Warrants attached to mezzanine loans should be considered separately from the loan. The Valuer should select a valuation technique appropriate to valuing the Underlying Business and apply the percentage ownership that the exercised warrants will confer to that valuation.

In the event that the warrant position is significant, the Valuer may consider utilising one of the sophisticated option and warrant pricing models.

If the mezzanine loan is one of a number of Investments held by a Fund in the Underlying Business, then the mezzanine loan and any attached warrants should be included as a part of the overall package of Investment being valued, to the extent that a Market Participant would combine the Investments. Depending on the facts and circumstances of the Investments held by a fund, the Fair Value of a mezzanine loan may be equal to the par value of the loan if it must be repaid upon a change of control.

5.6. Rolled up Loan Interest

Many financial instruments commonly used in private equity Investments accumulate interest which is only realised on redemption of the instrument (e.g. deep discount debentures or Payment-in-Kind Notes).

In valuing these instruments, the Valuer should assess the expected present value of the amount to be recovered from these instruments. The consideration of recoverable amount will also include the existence of any reasonably anticipated enhancements such as interest rate step increases.

In a typical financing package, these are inseparable from the underlying equity Investment and will be realised as part of a sale transaction.

The difference between the estimated recoverable amount (if in excess of the original cost) should be spread over the anticipated life of the note so as to give a constant rate of return on the instrument.

5.7. Indicative Offers

Indicative offers received recently from a third party for the Underlying Business may provide a good indication of Fair Value. This will apply to offers for a part or the whole Underlying Business as well as other situations such as price indications for debt or equity refinancing.

However, before using the offer as evidence of Fair Value, the Valuer should consider the motivation of the party in making the offer. Indicative offers may be made deliberately high for such reasons as: to open negotiations, gain access to the company or made subject to stringent conditions or future events.

Similarly they may be deliberately low if the offeror believes that the vendor may be in a forced sale position, or to take an opportunity to increase their equity stake at the expense of other less liquid stakeholders.

In addition, indicative offers may be made on the basis of insufficient detailed information to be properly valid.

These motivations should be considered by the Valuer; however it is unlikely that a firm conclusion can be drawn.

Accordingly, indicative offers may provide useful additional support for a valuation estimated by one of the valuation techniques, but are generally insufficiently robust to be used in isolation.

5.8. Impacts from Structuring

Frequently the structuring of a private equity Investment is complex with groups of stakeholders holding different rights which either enhance or diminish the value of their interests, depending on the success or disappointments of the Underlying Business.

Valuations must consider the impact of future changes in the structure of the Investment which may materially impact the Fair Value. These potential impacts may take several different legal forms and may be initiated at the Fund's option, automatically on certain events taking place, or at the option of another party.

Common clauses include, but are not limited to

- stock options and warrants;
- anti-dilution clauses;
- ratchet clauses;
- convertible debt instruments;
- liquidation preferences;
- commitments to take up follow-on capital Investments.

These rights should be reviewed on a regular basis to assess whether these are likely to be exercised and the extent of any impact on value of the Fund's Investment. At each Measurement Date, the Valuer should determine whether these rights are likely to be exercised.

In assessing whether rights are likely to be taken up by stakeholders, the Valuer may limit their consideration to a comparison of the value received by the exerciser against the cost of exercising. If the exerciser will receive an enhancement in value by exercising, the Valuer should assume that they will do so.

The estimation of Fair Value should be undertaken on the basis that all rights that are currently exercisable and are likely to be exercised (such as options), or those that occur automatically on certain events taking place (such as liquidation preferences on Realisation, or ratchets based on value), have taken place.

Consideration should also be given to whether the exercise price will result in surplus cash arising in the Investee Company.

Notwithstanding the above, when considering the impact of liquidation preferences, the Valuer should include in their assessment the likelihood of the Fund receiving their full contractual right under the preference. In practice, full value for the preference may not be achieved, particularly when this would result in other investors who are integral to the sale process (such as a continuing management team) receiving a significantly reduced value for their Investment.

5.9. Contractual Rights

Increasingly, additional consideration dependent upon future events is used as a strategy for exiting an Investment. Upon the sale of an Underlying Business some consideration is received, with additional consideration potentially being received in the future. The contractual right to future consideration can be

very beneficial, especially for deals encircled with uncertainty; where significant potential value of a business lies in the outcome of future events. The contractual right to future consideration is often described as "contingent consideration."

Negotiating a contract for future consideration allows sellers to close a deal with the ability to realize a price they think is fair, taking into account future performance they deem both valuable and likely, but that has not yet been achieved. For buyers, the ability to contractually delay paying for value before it fully crystallizes protects their Investment.

Because the interpretation of accounting standards differs and the treatment of so-called "gain contingencies" is not uniform, the Fair Value of contractual rights (gain contingencies) may not have been recorded in a Fund's financial statements or related notes. However, in the context of a private equity or venture capital Investment, the sale of an Investment that includes potential future consideration is both contractual and qualifies as a financial instrument. Said differently, a contractual right exists. The right itself is not contingent; the future consideration is variable depending on future events and outcomes. In many ways this is no different than the ownership in an underlying investee company; an ownership right exists; the future cash flows that will result from that ownership right are dependent (contingent) upon future events. The same concept applies to warrants or options. The ultimate value is contingent upon future events. To avoid confusion, and misapplication of accounting principles, it is more appropriate to describe "contingent consideration" in its legal form, that being a "contractual right" to future consideration.

Due to the unique aspects of these types of rights, it is likely that an income approach (discounted cash flow) will be the best tool to estimate Fair Value. This requires the development of expected cash flows and an appropriately chosen discount rate. Estimated cash flows in their simplest form are determined by assessing the probability of payment at various points in time.

Cash flow assumptions should include the estimation of the likelihood and timing of various possible outcomes for achievement of the specified contingency and/or consider scenario-based projections relevant to the specified contingencies. The key starting point is to decompose the factors that would lead to a contingency being met (or not being met). The Valuer must identify sources of data to be used to support assumptions. It is often possible to keep the analysis relatively simple while still incorporating the material complexities of the contractual right, especially if the probability of success is low or the amount of the future consideration is small. As noted above, even though the accounting treatment of contractual rights differs (recognition as an asset in the financial statements vs. disclosure in notes to financial statements), Investors generally are in need of a Valuer's estimate of the Fair Value of such contractual rights or contingent gains.

5.10. Mathematical Models

Unlike derivatives and debt markets, mathematical option pricing models have not seen wide usage in the private equity marketplace. Such models are rarely used by Market Participants to determine the transaction price for an Investment. However, for certain early stage Investments, option pricing models (OPM) or probability-expected weighted return models (PWERM) are deemed by some to provide a reliable indication of Fair Value. In due course the IPEV Board expects to provide additional guidance on the use of OPM, PWERM and other techniques on the IPEV website, **http://www.privateequityvaluation.com/**, and in future updates to these Valuation Guidelines.

Appendix: Definitions

The following definitions shall apply in these Guidelines:

Active Market
A market in which transactions for an asset take place with sufficient frequency and volume to provide pricing information on an on-going basis. A financial instrument is regarded as quoted in an Active Market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The necessary level of trading required to meet these criteria is a matter of judgement.

Adjusted Enterprise Value
The Adjusted Enterprise Value is the Enterprise Value adjusted for factors that a Market Participant would take into account, including but not limited to surplus assets, excess liabilities, contingencies and other relevant factors.

Attributable Enterprise Value
The Attributable Enterprise Value is the Adjusted Enterprise Value attributable to the financial instruments held by the Fund and other financial instruments in the entity that rank alongside or beneath the highest ranking instrument of the Fund.

Blockage Factor
An adjustment that adds a discount or premia to the quoted price of a security because the normal daily trading volume, on the exchange where the security trades, is not sufficient to absorb the quantity held by the Fund. Blockage Factors are not permitted under US GAAP or IFRS.

Distressed or Forced Transaction
A forced liquidation or distress sale (i.e., a forced transaction) is not an Orderly Transaction and is not determinative of Fair Value. An entity applies judgement in determining whether a particular transaction is distressed or forced.

Enterprise
A commercial company or business financed through debt and equity capital provided by debt holders and owners.

Enterprise Value
The Enterprise Value is the total value of the financial instruments representing ownership interests (equity) in a business entity plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.

Fair Value
Fair Value is the price that would be received to sell an asset in an Orderly Transaction between market participants given current market conditions at the Measurement Date.

Fund or Private Equity Fund
The Fund or Private Equity Fund is the generic term used in these Valuation Guidelines to refer to any designated pool of Investment capital targeted at all stages of private equity Investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles.

WWW.PRIVATEEQUITYVALUATION.COM

Fund-of-Funds
Fund-of-Funds is the generic term used in these Valuation Guidelines to refer to any designated pool of investment capital targeted at investment in underlying Private Equity Funds.

Investee Company
The term Investee Company refers to a single Enterprise or group of Enterprises in which a Fund is directly invested.

Investment
An Investment refers to the individual financial instruments held by the Fund in an Investee Company.

Liquidity
A measure of the ease with which an asset may be converted into cash. A highly liquid asset can be easily converted into cash; an illiquid asset may be difficult to convert into cash. Liquidity represents the relative ease and promptness with which an instrument may be sold when desired.

Market Participants
Market Participants are potential or actual willing buyers or willing sellers when neither is under any compulsion to buy or sell, both parties having reasonable knowledge of relevant facts and who have the ability to perform sufficient due diligence in order to be able to make orderly investment decisions related to the Enterprise in the principal (or most advantageous) market for the asset.

Marketability
The time required to effect a transaction or sell an Investment. Accounting standards dictate that the Marketability period begins sufficiently in advance of the Measurement Date such that the hypothetical transaction determining Fair Value occurs on the Measurement Date. Therefore, accounting standards do not allow a discount for Marketability when determining Fair Value.

Measurement Date
The date for which the valuation is being prepared, which often equates to the reporting date.

Most Advantageous Market
The market that maximizes the amount that would be received to sell an asset after taking into account transaction costs and transportation costs.

Net Asset Value ('NAV')
NAV of a Fund is the amount estimated as being attributable to the investors in that Fund on the basis of the Fair Value of the underlying Investee Companies and other assets and liabilities.

Orderly Transaction
An orderly transaction is a transaction that assumes exposure to the market for a period prior to the Measurement Date to allow for marketing activities that are usual and customary for transactions involving such assets; it is not a Forced Transaction.

Principal Market
The market with the greatest volume and level of activity for the potential sale of an asset.

WWW.PRIVATEEQUITYVALUATION.COM

Quoted Instrument
A Quoted Instrument is any financial instrument for which quoted prices reflecting normal market transactions are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.

Principal Market
The market with the greatest volume and level of activity for the potential sale of an asset.

Realisation
Realisation is the sale, redemption or repayment of an Investment, in whole or in part; or the insolvency of an Investee Company, where no significant return to the Fund is envisaged.

Secondary Transaction
A Secondary Transaction refers to a transaction which takes place when a holder of an unquoted or illiquid interest in a Fund trades their interest to another party.

Unquoted Instrument
An Unquoted Instrument is any financial instrument other than a Quoted Instrument.

Underlying Business
The Underlying Business is the operating entities in which the Fund has invested, either directly or through a number of dedicated holding companies.

Unit of Account
An accounting term which identifies the level at which an asset is aggregated or disaggregated for Fair Value recognition purposes. Unit of Account is dictated by individual accounting standards which are subject to interpretation. Because Fair Value accounting standards seek to reflect the economic behaviour and the perspective of Market Participants these Valuation Guidelines general use a Market Participant view in assessing the level of aggregation or disaggregation. For example where accounting guidance is open to interpretation, if a Market Participant would purchase an interest in a private company, not focusing on individual shares; the unit of account would be the overall interest purchased. However, if accounting standards clearly define unit of account, such guidance should be followed.

Valuer
The Valuer is the person with direct responsibility for valuing one or more of the Investments of the Fund or Fund-of-Funds.

Endorsing Associations

AFIC
(Association Française des Investisseurs pour la Croissance)

Established in 1984, AFIC has 280 active members covering all types of private equity activities in France. In addition, AFIC has 200 associate members from a wide range of related professions who support and advise investors and entrepreneurs in the structuring and management of their partnerships.

By virtue of its responsibilities in the areas of compliance, controlling and establishing generally accepted practices, AFIC is one of two associations recognized by the French Financial Market Authority (AMF). Management companies must be AFIC members in order to be certified by the AMF. AFIC is the only professional association focused on the private equity business.

AIFI
(Italian Private Equity and Venture Capital Association)

AIFI was founded in May 1986 in order to promote, develop and institutionally represent the private equity and venture capital activity in Italy.

The Association is a non-profit organisation whose main activities are: to create a favourable legal environment for the private equity and venture capital investment activity, to analyse the Italian private equity market collecting statistical data, to organize business seminars and specialized courses addressed to institutional investors and to people interested in operating within the industry, to publish research papers regarding specific topics about the private equity market, to build up stable and solid relationships with other National Venture Capital Associations and key players in the international private equity market.

In order to carry out the above-mentioned activities, AIFI can rely both on its permanent staff and on different Technical Committees established with the task to carry out activities of study on specific matters and projects.

AMEXCAP
(Asociación Mexicana de Capital Privado, AC)

The Mexican Private Equity Association (AMEXCAP) is a non for profit organization, created in 2003, representing venture capital/private equity funds that actively invest in Mexico. Additionally, other affiliates that play an important role in the sector are members of the Association such as top consulting and law firms that are active in Mexico.

AMIC
(Moroccan Venture Capital & Private Equity Association)

Founded in 2000, AMIC is an independent professional association whose mission is to unite, represent and promote the private equity profession to local and international investors, entrepreneurs and governmental bodies.

AMIC counts 20 active members and 16 associated members (see list of members on our website).

The main mission of the association is to strengthen the private equity industry's competitiveness in Morocco and abroad through:
- Effective and clear communication on the private equity industry
- Executing reliable reports and surveys on the state of private equity in Morocco
- Active participation in discussions on any draft law regulating the sector
- Establishing a good governance and ethics code for the private equity industry and promoting compliance with such code
- Providing support services to members on regulatory issues related to the profession
- Development of a quality training program on all aspects of the private equity industry

Contact: Françoise Giraudon – De Donder fgiraudon@amic.org.ma

Address: 23, Boulevard Mohamed Abdou (siège CGEM) – Quartier Palmiers – 20 340 Casablanca – Morocco

www.amic.org.ma

APCRI
(Portuguese Private Equity and Venture Capital Association)

APCRI was established in 1989 and is based in Lisbon. APCRI represents the Portuguese private equity and venture capital sector and promotes the asset class. APCRI's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics. APCRI's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins. APCRI represents the vast majority of private equity and venture capital in Portugal. APCRI has 16 full members and 5 associate members. Full members are active in making equity investments primarily in unquoted companies. The associate membership can include those firms who invest directly in private equity but for whom this is not their principal activity, advisory firms experienced in dealing with private equity and educational or research based institutions closely associated with the industry.

ASCRI

ASCRI is a non-profit making association that was set up in 1986, to promote and develop the venture capital and private equity activity in Spain and represent, manage and defend its members' professional interests. The Association stimulates the promotion and information analysis in the venture capital/private equity sector in Spain, and provides the contact between Official Organisations, investors, professional advisers, business schools and other relevant institutions. At the end of May 2005, ASCRI had 84 full members and 28 associate members. The ASCRI's main activities are: Research activity, Organisation of different events such as: Annual General Assembly, ASCRI Congress, Training Seminars and Conferences/Workshops, Communication of investment opportunities between ASCRI members, and Institutional and lobbying activity.

ATIC
(Tunisian Association of Capital Investors)

The Tunisian Association of Capital Investors (ATIC) was created in 2004 to represent Tunisian managers of venture capital or private equity funds, whether using the SICAR, FCPR or Seed Capital type of vehicle. It is the official industry association vis-a-vis public authorities.

Goals of ATIC:
- Boost private investment through private equity resources;
- Offer a strategic support to PE players in Tunisia and contribute to their good governance;
- Lobby on behalf of the PE players with the Ministry of Finance, the market authorities, the parliament, and other governmental entities in order to help the investment environment and the regulation evolve and become more investor friendly;
- Help grow, develop and rebuild the economy;
- Help improve national productivity.

Committees, and working groups:
The purpose of these bodies is to come up with recommendations to reform the profession:
- Investor relations committee;
- Committee for judicial, legislative, and fiscal issues;
- Committee for statistics and communication;
- Committee for training;
- Committee for research;
- Fiscal Committee;
- Committee for Investment.

The ATIC has 45 members:
- 6 regional SICARs
- 9 banks, research firms, lawyers, etc.
- 7 Management Companies/GPs
- 16 Banking SICARs
- 18 Group SICARs

– Banking SICARs are funds (captive subsidiaries) of banking institutions that invest in SMEs;
– Private SICARs are affiliates of family-owned groups in Tunisia that invest in affiliates of the groups;
– The Management Companies are independent VC or PE teams that manage funds raised from local and international third parties;
– Regional SICARs are special funds created by the government to foster investments in challenging regions that lack private investments.

Most of these funds have been created thanks to fiscal incentive schemes implemented by the government to spur private investment in the country, either in specific sectors or in less developed regions.

WWW.PRIVATEEQUITYVALUATION.COM

AVCA
(African Venture Capital Association)

AVCA is an industry association supporting African private equity and venture capital investors through research, information dissemination, industry gatherings, advocacy, and training.

We represent African private equity and venture capital firms, institutional investors, foundations, international development institutions and global professional service firms, amongst others.

AVCAL
(Australian Private Equity and Venture Capital Association)

AVCAL represents the interests of Australia's venture capital and private equity industry. AVCAL's 50 investor members have A$10 billion under management.

AVCAL's roles include: promotion of the industry, education of practitioners, public policy development, staging networking events, application of valuation & disclosure guidelines, benchmarking IRRs, development of industry standard Limited Partnership agreement. AVCAL conducts about 40 networking events annually across Australia, and leverages its online presence at www.avcal.com.au for maximum efficiency.

AVCO
(Austrian Private Equity and Venture Capital Organisation)

AVCO is the National Association of Austria's private equity and venture capital industry, which covers more than 90% of the Austrian private equity market with its members.

- It works as a knowledgeable partner and independent information point for journalists, entrepreneurs, potential investors, private and public institutions as well as international bodies that are interested in Austria's private equity industry, its development and structure as well as its activities and performance.
- It acts as the official representative of the industry actively engaged in improving the tax-related, legal and economic policy environments in close connection with respective policy makers.
- As a proactive networking institution it promotes co-operation inside the industry as well as interaction with complementary players from other fields in order to intensify information flows and create learning loops.
- In addition it takes the role of an interface to international organisations exchanging experience, information and knowledge with other Private Equity and Venture Capital Associations in Europe, with the European Commission and further relevant institutions in order to put international best practice at work for Austria.

Currently AVCO is engaged to initiate internationally favourable private equity fund structures for Austria and recently AVCO has published Investor Relations Guidelines – behavioural standards for its members vis-à-vis their fund investors – in order to raise transparency and faith in private equity as a professional asset class in Austria.

In line with these efforts AVCO welcomes the International Private Equity and Venture Capital Guidelines and will be eager to support their introduction and accurate application by its members.

BVA
(Belgian Venture Capital & Private Equity Association vzw/asbl)

BVA was founded in 1986 as a professional association.

Its mission is to:

- Animate the Belgian private equity and venture capital industry by deploying a series of activities for its members and for other stakeholders in the prosperity of the VC/PE sector in Belgium. The objectives of the main animation activities are: to foster active networking amongst members of the BVA and between members of the BVA and other third parties, to provide extensive information to its members on all topics relevant to the VC/PE industry, to improve the quality of the operation of the sector.
- Promote the well-being of the Belgian private equity and venture capital industry towards all relevant third parties. The objectives of the promotional activities are:
  - to pro-actively represent the Belgian VC/PE industry to third parties as the industry's recognized spokesperson, to conduct active lobbying for (i) improvements to or (ii) the removal of obstacles from the structural context in which the Belgian VC/PE industry operates, to contribute to the continuous development of business in our industry.

BVCA
(The British Private Equity & Venture Capital Association)

The British Private Equity & Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity and venture capital industry in the UK. We drive forward the case for private equity and venture capital as the engine room of entrepreneurship and economic growth. As our members support growing businesses, so we support the collective impact of their investment by demonstrating its value to Government, the media and society at large.

More than 500 firms make up the BVCA membership and this number continues to grow. We represent 230 private equity, midmarket and venture capital firms with an accumulated total of over £200 billion funds under management; as well as nearly 300 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, academics and fellow national private equity and venture capital associations globally.

We provide our members and the wider industry community with a comprehensive portfolio of services and best practice standards including leading professional development courses, research, networking opportunities, proprietary publications and topical conferences, all designed to ensure our members and their teams have access to the broad range of skills and tools required to drive their firms and the industry forward.

www.bvca.co.uk
+44 (0)20 7420 1800

German Private Equity and Venture Capital Association

BVK
(Bundesverband Deutscher Kapitalbeteiligungs - gesellschaften – German Private Equity and Venture Capital Association e. V.)

BVK was founded in 1989. BVK represents most of the German private equity and venture capital firms as well as the German branches of foreign private equity and venture capital firms. As per March 31, 2005, BVK represented more than 180 private equity and venture capital firms. Apart from full membership BVK offers associate membership to companies and organizations working in this particular business sector, i.e. accountants, lawyers, consultants etc.

BVK serves as a link between government and business and represents its members' views, needs and problems while supplying information and discussing any particular political and economic subject with the relevant governmental institutions.

Science and research are becoming more and more interested in private equity and venture capital issues. BVK supports universities, colleges and their students with their research activities and problem solving.

On the international level BVK exchanges information with other national organizations in the economic sector and other international private equity and venture capital associations.

CAPE
(China Association of Private Equity)

The CAPE is a voluntary union and non-profit social group, jointly established by private equity industry players. CAPE has been guided and supported by relevant state authorities; Adhering to the principles of "Standardization, Internationalization, and Marketization", it provides services to various funds and intermediary institutions registered in China. We are also committed to building the self-regulatory discipline of the PE industry, safeguarding the legitimate rights and interests of members, improving member's professional capabilities, strengthening communication and cooperation among members as well as domestic and foreign PE investors, in order to promote the sound development of China's PE industry.

CAPE's main tasks are:

- Building the self-regulatory mechanisms of the PE industry
- Promoting the sound operation of China's PE industry and improving the regulatory environment
- Providing series of fund registration services
- Organizing relevant activities, building a communications platform for industry players
- Building an industry database, media platform, education and training system; improving research capability
- Cooperating with foreign institutions, upgrading industrial influence

www.chinacape.org

CVCA
(Canada's Venture Capital & Private Equity Association)

The CVCA – Canada's Venture Capital & Private Equity Association, was founded in 1974 and is the sole national representative of Canada's venture capital and private equity industry. Its over 1800 members are firms and organizations which manage the majority of Canada's pools of capital designated to be committed to venture capital and private equity investments.

CVCA members' collectively manage over $85 billion. CVCA's members actively collaborate to increase the flow of capital into the industry and expand the range of profitable investment opportunities.

This is accomplished by the CVCA undertaking a wide variety of initiatives, ranging from developing comprehensive performance and valuation statistics, education and networking activities to promoting the industry's interests with governments and regulatory agencies.

www.cvca.ca

CVCA
(China Venture Capital Association)

The China Venture Capital Association ("CVCA") is a member-based trade organization established to promote the interest and the development of venture capital ("VC") and private equity ("PE") industry in the Greater China Region. Currently CVCA has close to 100 member firms, which collectively manage over US$100 billion in venture capital and private equity funds.

CVCA's member firms have long and rich experience in private equity and venture capital investing worldwide and have made many successful investments in a variety of industries in China, including information technology, telecommunications, business services, media and entertainment, biotechnology, consumer products, and general manufacturing.

CVCA's mission is to foster the understanding of the importance of venture capital and private equity to the vitality of the Greater China economy and global economies; to promote government policies conducive to the development of VC and PE industry; to promote and maintain high ethical and professional standards; to facilitate networking and knowledge sharing opportunities among members; and to provide research data, industry publications and professional development for PE and VC investors.

CVCA is incorporated in Hong Kong with a representative office in Beijing. Funding for CVCA's activities come from membership dues. CVCA's membership is open to all China-focused professional venture capital and private equity organizations and corporate venture capital investors, and is also open to the related professional companies, which can join as CVCA associate members. CVCA has three liaison officers in Shanghai, Xi'an and Silicon Valley respectively facilitating local networking and communication.

Czech Private Equity & Venture Capital Association

CVCA
(Czech Venture Capital and Private Equity Association)

CVCA is an association representing companies active in the private equity and venture capital industry in the Czech Republic. CVCA has full members (private equity and venture capital fund managers) and associated members (companies providing advisory services to the private equity and venture capital industry). CVCA has 14 full members and 16 associated members as of May 2005.

CVCA's priorities are: increasing the awareness about private equity/venture capital among entrepreneurs, state administration and general public, promoting interests of CVCA members in contact with the government and other state authorities, providing information on the private equity/venture capital industry in the Czech Republic, providing platform for discussion among members of CVCA.

DVCA
(Danish Venture Capital and Private Equity Association)

DVCA is an association with the goal of strengthening its member's business, network, and competences. DVCA includes a broad range of high tech investors in Denmark. Furthermore the organisation covers the whole investment chain from individual business angels over venture capital companies to private equity and institutional investors.

DVCA was founded in 2000 and was in 2004 merged with the formerly known Danish Business Angel Network. The association is situated in the Old Stock Exchange, Slotsholmsgade, Copenhagen.

www.dvca.dk.

EMPEA
(Emerging Markets Private Equity Association)

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to catalyze private equity and venture capital investment in emerging markets around the world. With access to an unparalleled global network, EMPEA provides its members a competitive edge for raising funds, making good investments and managing exits to achieve superior returns. Our 300+ member firms, representing nearly 60 countries and more than US$1 trillion in assets under management, include the leading institutional investors and private equity and venture capital fund managers across developing and developed markets.

EMPEA believes that private equity can provide superior returns to investors while creating significant value for companies, economies and communities in emerging markets. Despite significant differences across emerging market regions, private equity firms face important common challenges and opportunities. EMPEA's global programming addresses these challenges through industry data, research, analysis, conferences, peer-to-peer networking and advocacy.

In pursuit of its mission, EMPEA works closely with national and regional venture capital associations, as well as international organizations and local governments.

www.empea.org

EVCA
(European Private Equity and Venture Capital Association)

The EVCA is the voice of European private equity.

We represent venture capital, mid-market private equity, the large majority investors and institutional investors, speaking for 700 member firms and 400 affiliate members.

In the last five years, EVCA members have invested 160 billion euros in 7,000 companies across Europe, making a valuable contribution to growth and innovation.

The EVCA shapes the future direction of the industry, while promoting it to stakeholders like entrepreneurs, business owners and employee representatives.

We explain our industry to the public and engage in debate with policymakers, so that our members can conduct their business effectively.

The EVCA is responsible for the industry's professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.

Thanks to our industry research teams, we have the facts when it comes to European private equity. The EVCA has 25 dedicated staff working in Brussels to make sure the industry is heard.

FVCA
(The Finnish Venture Capital Association)

The Finnish Venture Capital Association (FVCA) was established in 1990. The main objective of the FVCA is to enhance public confidence in venture capital and private equity, and also to increase awareness of venture capital and private equity as a part of established financial markets.

The FVCA aims to improve the conditions for venture capital/private equity activity in Finland by overseeing the general interests and business-ethics of the industry together with governmental and other institutions as well as by assisting in improving professional practices, co-operating with other national associations, and generating statistics regarding the industry.

The FVCA also strives to develop the business environment by, among other things, contributing to the creation and development of appropriate legal, fiscal and operational environments for investors as well as entrepreneurs.

Furthermore, the FVCA defines best practices and operational principles for the industry, while requiring members to comply with the FVCA Code of Conduct. The association also creates a unique network of contacts within the Finnish private equity and venture capital industry by providing a forum for exchange of views and experiences among its members and interest groups.

The FVCA has 39 full members who represent the vast majority of the Finnish venture capital and private equity companies. Full membership has been approved for equity investors and risk financiers representing private and public investment capital, captive funds and corporate ventures.

In addition, the FVCA has 51 associate members. Associate membership can be given to organizations and individuals with an interest in the venture capital and private equity industry.

www.fvca.fi

WWW.PRIVATEEQUITYVALUATION.COM

HKVCA
(Hong Kong Venture Capital Association)

Hong Kong Venture Capital Association was established on November 12, 1987 with the objectives of promoting and protecting the interests of the venture capital and private equity industry, networking and cooperation on regional and international front, and in raising the professional standards of the market.

Its 120 members are engaged in all levels of venture capital, expansion capital and buyout activities in China, Japan, Korea, Australia, Taiwan, Thailand, Singapore, and other markets in Asia. It is committed to the promotion of the venture capital industry as a financial and business partner to businesses and the creation of an environment that creates sound partnerships. It is dedicated to developing a high standard of professionalism in the market to ensure investor confidence in the asset class.

The Association provides an effective channel of communication for members to share information on developments within the industry in Hong Kong/PRC as well as on a regional and international level. It also works closely with the government and various trade bodies to further the interests of the industry.

HVCA
(Hungarian Venture Capital and Private Equity Association)

HVCA represents virtually every major source of funds and expertise of private equity in Hungary. HVCA aims to promote the development of the industry, and to create and follow the highest possible professional and ethical standards. HCVA was set up in 1991 and has developed considerably since then: the original five members have grown to 26 full members, 29 associate members and 9 individual members.

The Association provides a regular forum for the exchange of ideas among members, high-level discussions on the topical issues of the venture capital and private equity industry and the future trends. As the official representative of the industry it is in constant discussion with the financial and legislator institutions of the Hungarian State and with other professional organisations.

ILPA
(Institutional Limited Partners Association)

The ILPA is a non-profit organization committed to serving limited partner investors in the global private equity industry by providing a forum for: facilitating value-added communication, enhancing education in the asset class, and promoting research and standards in the private equity industry.

Initially founded as an informal networking group, the ILPA is a voluntary association funded by its members. The ILPA membership has grown to include more than 138 member organizations from 10 countries, who in total have assets under management in excess of two trillion U.S. dollars. Members of the ILPA manage more than US$300 billion of private equity capital.

The ILPA membership comprises corporate and public pension plans, endowments and foundations, insurance companies and other institutional investors in private equity. The ILPA holds semi-annual meetings for members.

IVCA
(Irish Venture Capital Association)

The IVCA is the representative body of the venture capital industry in Ireland. The association was established in 1985 to represent the views of its members and to promote the Irish venture capital industry. We seek to encourage co-operation and best practices within the industry and to facilitate those seeking venture capital.

The IVCA also continuously works with those individuals and organisations committed to fostering an economic and regulatory climate conducive to the growth and development of an enterprising economy.

LAVCA
(Latin American Private Equity and Venture Capital Association)

The Latin American Private Equity and Venture Capital Association (LAVCA) is comprised of over 150 firms, from leading global investment firms active in the region to local fund managers from Mexico to Argentina. Member firms control assets in excess of $50 billion, directed at capitalizing and growing Latin American businesses.

LAVCA plays an active role in the advocacy of sound public policy, and publishes annual ranking of the PE/VC environments of 12 key markets in Latin America.

LAVCA also produces targeted research and proprietary industry data, with nearly 200 firms reporting annual fundraising, exits and investments. In addition, the association's activities include investor education programs targeting global and Latin American LPs and networking forums in the US, Chile, Peru and Colombia.

www.lavca.org

LPEQ
(LPEQ Listed Private Equity)

LPEQ is an association of international listed private equity companies. Our goal is to increase awareness and understanding of listed private equity among institutional and retail investors, their advisers, commentators and the public.

www.LPEQ.com

LVCA
(Latvian Venture Capital Association)

To promote the development of venture capital sector in Latvia, the six biggest companies that operate in the venture capital sector in Latvia have founded a public organization: the Latvian Venture Capital Association. The founders of the association are fund management companies that manage investment funds of different value and function profile.

LVCA has the following missions: to inform businessmen and society about venture capital financing possibilities, to promote the exchange of opinions and experience of the members of the association, to represent opinions and interests of the members in negotiations with public authorities, to organize and to ensure cooperation with international or other countries' venture capital associations.

MENA Private Equity Association

The MENA Private Equity Association is a non-profit entity committed to supporting and developing the private equity and venture capital industry in the Middle East and North Africa.

The Association aims to foster greater communication within the region's private equity and venture capital net¬work and facilitate knowledge sharing in order to encourage overall economic growth, and will actively promote the industry's successes to local stakeholders and build trust with investors, regulators and the public regionally and internationally.

WWW.PRIVATEEQUITYVALUATION.COM

NVCA
(Norwegian Venture Capital & Private Equity Association)

NVCA is a non-profit association supporting the interests of the companies active in the Norwegian industry. NVCA was established in 2001 by the leading players, and represents today around 40 Norway-based private equity and venture capital firms, the vast majority of such firms in Norway. The 20 associated members are service providers to the industry such as lawyers, advisors, investors and corporate finance companies.

The purpose of the association is to promote an efficient private equity market, to improve the regulations of the industry, to promote entrepreneurship and to ensure political focus on Norway's position as a strong and attractive country for international investments. NVCA provides knowledge, analysis and general information to the Government and media to communicate the importance of the industry and it's role in the national innovation system and the general industrial development in Norway. NVCA is in this way the public face of the industry providing services to its members, investors and entrepreneurs as well as the Government and media.

NVP
(Nederlandse Vereniging van Participatiemaatschappijen)

The Dutch Private Equity & Venture Capital Association acts in the interests of private equity companies in the Netherlands. The aims of the NVP are: in cooperation with the government, work on an adequate regulatory framework for the private equity sector and its clients; inform entrepreneurs and businesses about the financing possibilities of private equity; inform investors about the characteristics of private equity as an asset class; raise awareness and improve the image of private equity to achieve aforementioned goals; contribute to further raising the level of professionalism of the private equity sector.

The NVP has about 70 members and 85 associated members. Members of the NVP represent 95% of the number of private equity investments and about 85% of the total invested capital in the Netherlands. More information about the activities of the NVP and its members can be found on www.nvp.nl.

NZVCA
(New Zealand Private Equity & Venture Capital Association Inc.)

The NZVCA's mission is to develop a world-best venture capital and private equity environment for the benefit of investors and entrepreneurs in New Zealand.

Our activities cover the whole spectrum of investment in New Zealand private enterprise including Angel investment, seed and early-stage venture capital through to development capital and private equity (including management buy-outs and buy-ins).

PSIK
(Polish Private Equity and Venture Capital Association)

PSIK represents private equity management firms operating in Poland. Its mission is to promote and develop the private equity and venture capital industry in Poland. PSIK comprises 87 institutions: 41 private equity management firms (full members) and 46 associate members that are law and consulting companies as well as banks cooperating with the private equity and venture capital industry.

The full members have more than EUR 21 billion under management and have invested in more than 700 Polish and CEE companies.

www.psik.org.pl.

Réseau Capital

(Quebec's Private Equity and Venture Capital Association) Réseau Capital, Quebec's Private Equity and Venture Capital Association, is the only private equity association that brings together all stakeholders involved in the Quebec investment chain.

Mission
The mission of Réseau Capital is to contribute to the development and efficient operation of the private equity industry, which plays a major role in the development and financing of businesses in Québec. Founded in 1989, Réseau Capital has more than 425 members representing private equity, labour-sponsored and other retail funds and public investment companies as well as banks and insurance companies, accounting and law firms, along with many professionals working in the field.

Main objectives
Réseau Capital works to promote the private equity industry in Québec through activities in five areas: ***training*** (provide members with access to training to keep them current on various issues they encounter and ways to deal with them), ***information*** (identify and effectively communicate information, particularly about the industry and various issues, to meet members' needs), ***networking*** (organize events for members to meet and network with other industry stakeholders, develop or enhance business relationships, and advance their knowledge in a friendly environment), ***promotion*** (promote understanding of the private equity ecosystem and inform direct and indirect industry players, the media, government authorities and the general public about the industry's achievements and economic contributions) and ***representation*** (ensure that the mutual interests of its members are taken into account by the various regulatory and governmental bodies when establishing policies or regulations and solve challenges in the private equity industry in the mutual interest of various members).

The full members have more than EUR 21 billion under management and have invested in more than 700 Polish and CEE companies.

RVCA
(Polish Private Equity and Venture Capital Association)

RVCA was set up in 1997. The central office of RVCA is situated in St.Petersburg. Today RVCA unites about 60 members more than half of them are private equity and venture capital funds.

RVCA's mission is to contribute to establishment and development of venture industry in Russia. RVCA's goals are: to create a political and entrepreneurial environment favorable for investment activity in Russia, to represent RVCA's interests in political and administrative agencies, in mass media, in financial and industrial circles in Russia and abroad, to provide informational support and create communicative forums for Russian venture market players, to create the stratum of experts qualified to work in venture business companies.

RVCA is the unique professional organization in Russia units the progressive financial institutions investing in private Russian companies. RVCA is generally accepted in the business community and by the Russian Government.

SAVCA
(Southern African Venture Capital and Private Equity Association)

SAVCA is a non-profit company based in South Africa that represents the interests of the participants of the private equity and venture capital industry in Southern Africa. All the key participants in the industry are members of the Association. Membership of SAVCA provides a high level of endorsement and denotes a high level of professionalism and integrity for the member firm. SAVCA plays a meaningful role in the Southern African private equity and venture capital industry by promoting the industry and its members, promoting self-regulation, setting professional standards, lobbying, disseminating information on the industry, arranging training for the staff of its members and researching the industry in South Africa.

SAVCA represents over 70 private equity and venture capital fund managers, the industry has over R 100 billion (c.US$ 12.5 billion) in funds under management with approximately 400 professionals.

www.savca.co.za

WWW.PRIVATEEQUITYVALUATION.COM

SECA
(Swiss Private Equity and Corporate Finance Association)

SECA is the representative body for Switzerland's private equity, venture capital and corporate finance industries. SECA has the objective to promote private equity and corporate finance activities in Switzerland. Members of the SECA include equity investment companies, Banks, Corporate Finance Advisors, Auditing Companies, Management Consultants and Private Investors.

The association is a non-profit organization and has the following purposes: to promote corporate finance and private equity activities in the public and the relevant target groups, to promote the exchange of ideas and the cooperation between members, to contribute to the professional education and development of the members and their clients, to represent the members views and interests in discussion with government and other bodies, to establish and maintain ethical and professional standards.

In addition to promoting corporate finance in the public, SECA provides a platform to its members to exchange information and experiences. The main activities of SECA are: seminars and events about relevant topics, publication of statistics about private equity investment and management buyout activities in Switzerland, weekly edition of a SECA eNewsletter (for free), contacts of other associations and state bodies.

SLOVCA
(The Slovak Venture Capital Association)

SLOVCA was created in 1995 with primary purpose to increase the awareness of private equity and venture capital to the public, such as the entrepreneurs, investment and banking institutions and the economic, political and regulatory bodies in Slovakia.

The mission of SLOVCA includes five key objectives: to provide information to those seeking capital for new and existing enterprises, to represent the interests of members before the government and other related institutions/agencies, to provide a forum for networking for members to exchange views and practices, to provide education and training for members of SLOVCA and others, to encourage the highest standards of business practices.

SVCA
(Singapore Venture Capital & Private Equity Association)

Established in 1992, the Singapore Venture Capital & Private Equity Association (SVCA) is a not-for-profit organisation formed to foster the growth of venture capital (VC) and private equity (PE) in Singapore and around the region. From a humble start of 2, our membership now exceeds 100 and continues to grow with the industry's development.

Since its inception, SVCA has championed various efforts to promote the local VC/PE industry through talks, workshops, seminars, conferences and networking events. The thrusts of SVCA continues to be (1) fostering a greater understanding of the importance of venture capital and private equity to the Singapore economy in support of entrepreneurship and innovation; (2) representing the local VC/PE industry in and outside of Singapore; (3) nurturing an environment conducive for advancing VC/PE investment and profession; and (4) providing a platform to match fund-seeking businesses with our members and the investment community.

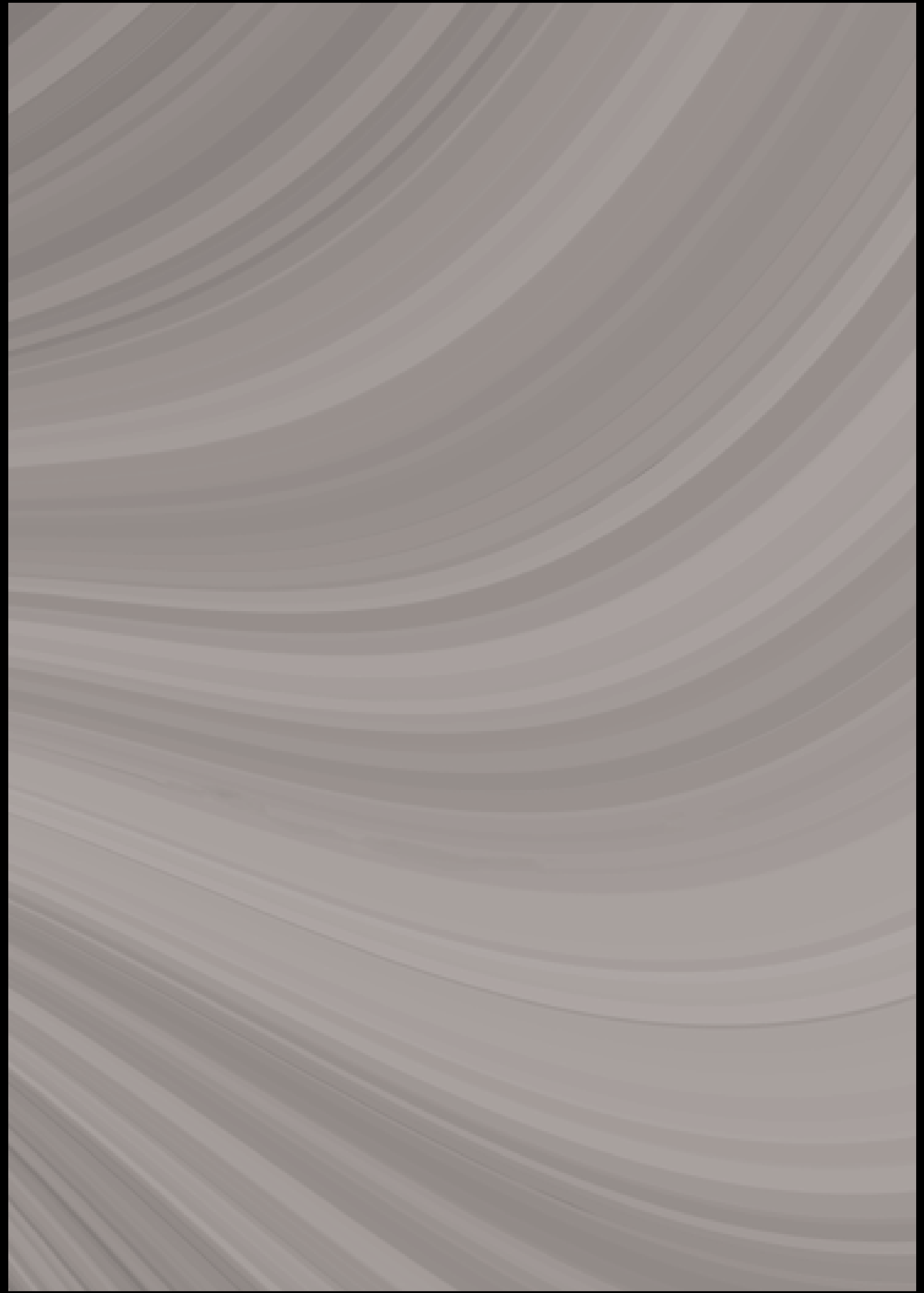
For more information please visit: www.svca.org.sg.

SVCA
(The Swedish Private Equity and Venture Capital Association)

The SVCA represents around 110 private equity firms as well as business angels and service providers. Sweden is one of the leading private equity markets with annual private equity investments over 1% of the national GDP. The Association was established 1985 and its objective is to work towards a well-functioning private equity industry in Sweden. This is done by supplying information and working for the professional development of the industry.

We aim to inform about how the industry functions and what frameworks are needed to facilitate entrepreneurs and investors so that together they can help the development of the Swedish economy and industry that is necessary for the country's future prosperity. We also inform about how investments in private equity funds have yielded a good profit over the long term for pension funds and other institutional investors. We work for the professional development of players active in the industry through education, ethical guidelines, transparency and valuation principles, networking and seminars with the participation of international colleagues, amongst many other things.

See www.svca.se for more information.



EUROPEAN PRIVATE EQUITY AND
VENTURE CAPITAL ASSOCIATION

European Private Equity & Venture Capital Association
Bastion Tower, Place du Champ de Mars 5, B-1050 Brussels, Belgium
Tel +32 2 715 00 20 www.evca.eu