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Dealmakers Column

Decoding the valuation report process

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In the aftermath of Dodd-Frank's implementation, all registered private equity firms received letters from the Securities and Exchange Commission introducing the SEC's Presence Exams. These exams, designed to engage, examine and report on areas of risk, largely focused on marketing claims, portfolio-management practices, and valuation methodologies. Two years later, in 2014, the SEC director assessed that over half of the completed exams uncovered compliance issues. It should come as no surprise, then, that these areas are attracting increased scrutiny from both regulators and LPs.

Consequently, most GPs have spent considerable time formulating robust valuation policies to facilitate consistency and transparency. Just as important are the actual valuation reports that execute upon the stated policies and track the specific inputs and considerations that feed into each fair-value assessment.

Typical elements of valuation reports should include the discussion of enterprise milestones, the identification of competitors with an industry outlook and the reconciliation of past with prospective financial performance. Whether employing a market or income approach, the factors that give CFOs the biggest headaches lie in those areas that are also the most subjective—supporting forecast assumptions, selecting market multiples, or developing risk-adjusted discount rates. The subjective nature of valuing Level 3 assets underlines the importance of a comprehensive and well-organized valuation report. Any solid valuation framework should include the cooperation of concerned parties to limit conflicts of interest and personal biases often present when making complex financial decisions.

To learn about Murray Devine's focused and reliable approach, read more here.

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