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### Selection of Valuation Dates for a Secondary Market Transaction

The situation is that the seller (1) wants to make sure they are fully compensated for cash flows that occur between the valuation date and the closing date; and (2) the seller understands from the GP that one of the portfolio companies will experience an unrealized gain in the upcoming quarter and wants to make sure that they are being compensated for that increase of value. Therefore, should the seller wait for the next quarter and use that later quarter as the valuation date so that the cash distribution is off the table and the unrealized gain is booked on the balance sheet? Or should the seller just use the most recent already issued quarterly report as the valuation date? This case looks at the valuation dates of 12/31/06 and 3/31/07, and assumes that a closing occurs on 4/15/07. However, the actual closing would occur several months later if the seller decided to wait until the 3/31/07 reports were actually available.

### XYZ Fund Balance Sheet

	<u>12/31/2006</u>	<u>3/31/2007</u>	
Cash	-	5.00	Capital call for \$5 for follow-ons
Company A	25.00	-	Company sold between 12/31/06 and 3/31/07 at NAV
Company B	25.00	35.00	Company experienced \$10 unrealized write-up
Company C	25.00	25.00	No change
Company D	25.00	25.00	No change
NAV	100.00	90.00	

Three events took place at the fund between 12/31/06 and 3/31/07. A capital call was issued for a follow-on round in one of the companies, but the investment was not yet made as of 3/31/07 so held as cash on the balance sheet. Furthermore, Company A was sold for an amount equal to its reported value in the interim. Finally, Company B was written-up to reflect positive developments at the company.

## Valuation Date Reconciliation

12/31/2006	NAV	100.00	Valuation Date
1/15/2007	Contribution	5.00	
2/15/2007	Distribution of Comp A	(25.00)	
3/31/2007	Unrealized gain Comp B	10.00	
3/31/2007	NAV	90.00	Alternate Valuation Date

Regardless of the valuation date, the buyer has to evaluate what it thinks the companies are worth. A buyer will estimate when it believes the portfolios companies will exit and for how much, and then offer the present value of that cash flow stream to the seller. In the following example, no assumptions are made for the fees and carried interest of Fund XYZ for simplification.

## Discounted Cash Flow to Determine Price

Valuation Date	12/31/2006
Close Date	4/15/2007
Discount Rate	15%

Price at Close Date	NPV	Close Date	Future Values		
		4/15/2007	6/30/2007	12/31/2008	12/31/2011
<u>Assets</u>					
Cash	3.88	-	-	-	7.50
Company A	-	-	-	-	-
Company B	36.42	-	37.50	-	-
Company C	29.51	-	-	37.50	-
Company D	19.40	-	-	-	37.50
Purchase Price (total NPV)		(89.21)			
Net Cash Flow		(89.21)	37.50	37.50	45.00
XIRR	15%				
Multiple	1.35x				

The buyer is willing to pay \$89.21 for the portfolio that they are acquiring at the close date. This represents a 9% premium to the 12/31/06 valuation date, or a 1% discount to the 3/31/07 valuation date. The price reflects the net present value of the anticipated future cash flows from the portfolio. As Company B is expected to exit soon and for an amount slightly higher than the anticipated write up on the 3/31/07 financials, the seller is being fully compensated for the increase in unrealized value in the portfolio.

Price at Valuation Date	Valuation	Future Values					
	Date	12/31/2006	1/15/2007	2/15/2007	6/30/2007	12/31/2008	12/31/2011
<u>Assets</u>							
Cash	-	(5.00)	-	-	-	-	7.50
Company A	-	-	25.00	-	-	-	-
Company B	-	-	-	37.50	-	-	-
Company C	-	-	-	-	37.50	-	-
Company D	-	-	-	-	-	-	37.50
Purchase Price	(109.21)						
Net Cash Flow	(109.21)	(5.00)	25.00	37.50	37.50	37.50	45.00
IRR	13%						
Multiple	1.27x						

This is a different calculation than the one done above. The calculation here takes all cash flows from the valuation date through termination. The returns are lower than the returns calculated at close due to the weight of the \$20 of cash flows that occurred with absolute certainty. Thus the seller is being compensated dollar for dollar for the distribution that took place after the valuation date but before the closing.

### Purchase Price Adjustments

Purchase Price at Valuation Date (12/31/06)	109.21	9% premium to 12/31/06 NAV
Interim Contributions	5.00	
Interim Distributions	(25.00)	
Adjusted Purchase Price (Wire Amount)	89.21	1% discount to 3/31/07 NAV

### Conclusion

From the buyers perspective, it does not matter which valuation date is used. The seller is only going to be offered \$89.21 at close. This equates to a purchase price at the 12/31/06 valuation date of \$109.21, adjusted for subsequent actual cash flows; or \$89.21 if the alternative valuation date of 3/31/07 is used, then adjusted for subsequent cash flows before close if there are any. The selection of valuation dates only matters from an accounting or optics perspective when discussing discounts or premia relative to a specific valuation date. In this example, the seller is deciding between booking a 9% premium or a 1% discount. The receipt in dollars by the seller at close won't change no matter which valuation date is used.

The largest impact to valuation date selection is when can a sales process begin. Waiting for the next quarterly report because unrealized gains are expected will (1) decrease the premium or increase the discount on an accounting basis, and (2) delay the beginning of a sales process introducing risks to the transaction. A seller is better off using the most recent issued quarterly statements and beginning the sales process.