16 October 2018

International Valuation Standards Council
41 Moorgate
London
EC2R 6PP

Re: IVS 2017 Proposed Revisions Exposure Draft

Dear Members of the International Valuation Standards Council:

We appreciate the opportunity to respond to the International Valuation Standards Council's (IVSC's) invitation to comment on the proposed revisions to IVS 2017.

This letter generally summarizes the view of PricewaterhouseCoopers after consultation with members of our network of firms. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We appreciate the efforts of the IVSC to advance an integrated set of valuation standards and generally support the proposed revisions. We do have concern, however, that the terms proposed to be added to the Glossary are inconsistent with the manner in which the terms are commonly used, and as a result could create confusion in the marketplace. Accordingly, we do not believe these terms should be defined in IVS 2017.

Appendix A includes responses to the questions for respondents. Our response to Question 1 expands on our concern regarding the Glossary. Appendix B includes additional comments on the proposed revisions and editorial suggestions.

If you have any questions on the content of this letter, please do not hesitate to contact Helen Mallovy-Hicks, Global Valuations Leader (+1 416 814 5739), or Adam Smith (+1 646 818 8098).

Yours faithfully,

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Appendix A – Questions for respondents

Question 1: Do you believe that IVS should define the terms Price, Cost, and Value? If so, please discuss why you think the additional definitions are necessary.

We generally do not believe that the proposed definitions of price, cost, and value are helpful or consistent with the way those terms are commonly used. The valuer should consider the guidance on how such terms are defined within the applicable standard based on the scope of work outlined in IVS 101. In addition, we are not aware of the stakeholder need the IVSC is attempting to address by defining these terms. If the IVSC decides to move forward with defining these terms, we encourage them to publish a "basis for conclusions" explaining why these definitions are being added to the glossary, the stakeholder need that they are meant to address, and how the Board feels these particular definitions address those needs.

We believe the proposed definitions could create confusion in the marketplace. For example, replacement value and replacement cost are typically used interchangeably in the insurance industry. These definitions may imply that replacement value and replacement cost should be different. In addition, many standard setters and regulators define value through reference to price and/or cost. For example, the International Accounting Standards Board under International Financial Reporting Standards and the Organization for Economic Co-operation and Development define fair value using the term price.

We do not believe the proposed definitions should be included in IVS. But if the IVSC decides to include them, we have specific comments on the proposed definitions.

> *Price: The word "price" refers to the amount received to sell an asset or paid to transfer a liability. Because of the financial capabilities, motivations or special interests of a given buyer or seller, the price paid may be different from the value which might be ascribed to the asset by others."*
>
> We believe the second sentence should be removed in its entirety. We believe if there is an observable transaction, there is a rebuttable presumption that the exchange is an orderly transaction between market participants which reflects the "value." We further note that the use of the word "value" within this definition does not seem consistent with its proposed definition.
>
> In addition, because in our experience "price" can also be used in the context of proposed or hypothetical transactions (e.g., listing price, bid price, ask price), the definition should not be limited to solely refer to amounts received. It is also unclear if contingent amounts or installment payments should be included in the "amount" considered in determining "price."
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> *Cost: The word "cost" refers to the amount required to acquire or create the asset as of a particular date."*
>
> We see a range of specific types of "costs" being used in the marketplace (e.g., historical cost, current cost, replacement cost, reproduction cost). In our experience, it is rare for the term "cost" to be used without further explanation for what is meant, which limits the usefulness of this definition.
>
> It is also not clear from this definition which costs should be considered in the acquisition and/or creation of an asset. For example, it is unclear if "cost" considers only direct costs or should include indirect costs and/or opportunity costs. In addition, it is unclear when an asset is acquired, how the definition of "cost" differs from the definition of "price."
>
> *Value: The word "value" refers to an opinion of the valuer of the estimated amount consistent with one of the Bases of Value set out in IVS 104, or in instances in which value and price are equivalent, the word "value" refers to a fact.*

We believe the proposed definition more accurately defines the term “Opinion of value,” rather than “value.” However, we do not see a need to define either term within IVS. Further, we note that this is not the definition of “value” that is intended when this term is used to describe various bases of value (e.g., fair value, fair market value). For example, the IVS’s definition of Investment Value is “the value of an asset to a particular owner or prospective owner for individual investment or operational objectives.” Substituting the proposed definition of “value” for the “value” in this context would create a circular definition.

Question 2: Do you believe IVS should define Calculation and Calculation Engagement? Please explain why.

We believe the IVS should be more principles-based rather than rules-based and that the IVSC should focus on establishing a set of standards which, if followed, results in a high-quality valuation prepared under generally recognized best practices.

Attempting to define “calculation” and “calculation engagement,” could have unintended consequences when engagements that do not meet the precise definition within the IVS could claim to not be calculation engagements simply because of minor or inconsequential differences from the exact definition.

Ultimately, if the IVSC decides to define Calculation and Calculation Engagement, we encourage you to consider the existing definitions established by valuation organizations in countries like Canada, the U.S. and Australia. In addition, you should consider the additional disclosures that are typically required when a valuer performs a calculation, which make it clear to users that limited procedures and analyses were performed and that the conclusion could be different if a more thorough analysis were done.

Question 3: Should a Calculation be IVS compliant, and if so, what differences in the scope of work and disclosures outlined in IVS should be required by the valuer?

In our experience, calculation engagements can involve minimal diligence and analysis. They are frequently undertaken by valuation professionals, but they do not always reflect valuation best practices. We believe it is clear, particularly with the proposed changes to IVS 102 and 105, that what most people call a “calculation engagement” would not be compliant with IVS.

We do not believe it is beneficial for valuation practitioners to be able to state that calculation engagements were prepared in compliance with International Valuation Standards, as this dilutes the meaningfulness of IVS as an indicator of quality. As such, to the extent IVS addresses calculation engagements at all, it should be clear that it is reasonable and appropriate for valuation professionals to perform calculation projects in certain circumstances, but that they involve limited diligence and analysis and require additional disclosure to avoid misleading users.

Question 4: Should IVS provide examples of “substantial” limitations? If so, please provide examples of such limitations.

We believe the IVS should be more principles-based rather than rules-based. We do not believe the IVSC should provide examples of substantial limitations. We believe there will always be a measure of professional judgment that is needed to identify when limitations are substantial, limiting the usefulness of any examples provided. We are also concerned that when standard setters attempt to provide examples that are not meant to be comprehensive, there can be a subset of stakeholders who read those examples very narrowly. We further note that the language in IVS 105 already provides some additional context for this concept.

Question 5: Do you agree with the suggested changes to IVS 105 section on Discount Rates? If not, please provide details of the additional information you think should be included or excluded from this section.

We generally agree with the suggested changes. We agree with the requirement that there should be some level of quantitative support for any discount rate adjustments. While there may be qualitative support for making an adjustment, ultimately, the amount/magnitude of the adjustment must be supported in some way. We note that quantitative support may still involve some amount of judgment and is not necessarily an exact calculation/reconciliation.

See Appendix B for further comments and suggested edits.

Question 6: Do you agree that the methods are more relevant to business valuation and the placement in IVS 200 is appropriate? If no, please explain why.

While we believe there may be circumstances when the option pricing method (OPM) and probability-weighted expected return method (PWERM) may be relevant to other types of assets and liabilities, we agree that they are most commonly applied in the context of business valuations and we do not object to their placement in IVS 200.

Question 7: Are there additional methods that should be included in the proposed revisions, for example the Hybrid Method? If yes, please discuss the additional methods to consider.

We do not believe there are any additional methods that should be included at this time. As the Hybrid Method uses an OPM within the framework of a PWERM, it could be argued that it is already sufficiently addressed. In the future, the IVSC could consider addressing simulation/Monte Carlo models and lattice models, but we do not believe the amendments should be delayed to accommodate inclusion of those models.

We believe, however, that paragraph 130.5 should be more clear that there are other reasonable methods. We believe that it is important not to be too prescriptive and leave room for judgement of the valuer.

Question 8: Are there additional topics within Early Stage Company Valuation that you feel should be included in IVS or explored further by the Boards? Please provide an outline for any topics suggested.

We note that the OPM and PWERM methods are not solely applicable in the valuation of early stage companies and may be appropriate for growth and mature companies as well. However, we do not believe the standard currently implies or states that these methods are only applicable to early stage companies. A better characterization for these methods would be that they are most applicable to companies with complex capital structures.

To the extent the IVSC wants to address early stage company valuations, we believe potential topics could include:

- The venture capital (VC) life cycle
- Consideration of survival statistics and VC success statistics (ideally discussion of the distribution of outcomes)
- Discussion of bid-ask spreads and liquidity considerations in the VC market
- Examples of valuation techniques used in the market, including:
    - VC method
    - Real options/probabilistic discounted cash flow
    - Market based
    - Scorecard style methods (e.g. Berkus)
    - Inferring values from class transactions (i.e. backsolve methods)
- VC discount rates
- Market sizing and mature margin/exit multiples estimates for differing types of business

Question 9: Do you feel that the inclusion of the “As Is” and “As Proposed” value for the Development Property will reduce the risks in relation to the valuation of development property? If no, what additional information would you like to see included?

We believe the requirement to provide both an “As Is” and “As Proposed” value could be helpful in ensuring that valuations of development properties prepared by different valuers are more consistent and comparable, as currently valuers may only provide either an “As Is” or “As Proposed” value rather than both.

Question 10: Should the valuer be compelled to state the method of valuation they have used in their calculation of market value and report the assumed (or calculated) Developers Profit when reporting market value? If no, please explain why not?

Yes, the valuer should state the method of valuation used in their calculation of market value. We believe this is already required by IVS 103, *Reporting*, which states that a valuer’s report must convey the approaches and methods used as well the key inputs and assumptions.

Appendix B – Other Comments

IVS 105

1) Paragraph 10.9 – In addition to discussing limitations related to agreed-upon approaches, methods, and procedures, we believe this paragraph should mention limitations related to inputs and assumptions used in the valuation.
2) Paragraph 10.9 – If the Board ultimately does not define "calculation engagement," we believe the language in paragraph 10.9 in 105 should be edited as follows:

   "10.9 In certain circumstances, the valuer and the client may agree on the valuation approaches and methods the valuer will use or the extent of procedures the valuer will perform. Depending on the limitations placed on the valuer and procedures performed, such circumstances (sometimes referred to as calculation engagements) ~~could be better characterised as a calculation of value and thus~~ may not be ~~an~~ IVS compliant ~~valuation~~."
3) Paragraph 50.6(e) – We believe that it is not really a matter of "typical" regarding whether cash flows are "expected" or "most likely." We suggest the IVSC provide additional guidance to clarify that the important principle is to understand what type of forecast is being used so that the valuer can select an appropriate discount rate. In addition, there are other types of cash flows that may be used, such as "contractual" cash flows that are used in the valuation of many financial instruments or "successful case" cash flows that may be used in early stage PE/VC portfolio company valuations.
4) Paragraph 50.6(d) - We suggest the bullet be revised to reflect that "currency risk" and "country risk" are different and should be considered and quantified separately, if applicable. The concept of currency risk in the context of a valuation is that the currency used to develop the projections will dictate the selection of certain of the inputs utilized to quantify the cost of capital (i.e., the discount rate would be applicable for discounting a certain type of currency). Alternatively, country risk is generally meant to capture the potential cash flow risk from political, macroeconomic, and financial risk associated with a business operating in a particular country (i.e., cash flow risk independent of currency denomination).
5) Paragraph 50.32 - Consider updating the bullets to reflect that the weighted average cost of capital (WACC) is a concept (i.e., the weighted average of the after-tax cost of debt and cost of equity) as opposed to a method of quantifying a discount rate. Alternatively, as the other bullets (i.e., CAPM, observed rates/yields, build-up method) are in fact methods of quantifying assumptions (cost of equity and cost of debt) that are required to develop the weighted average cost of capital, WACC should be removed from this listing.
6) Paragraph 50.33 – Consider including a third corroborative analysis that is often performed: comparing implied multiples from the income approach with guideline company market multiples.
7) Paragraph 50.34(d) - We suggest replacing the word "duration" with "time horizon," as the word duration may be ambiguous, referring to maturity or finance duration.
8) Paragraph 50.38(d) - Consider adding further detail regarding how "qualitative factors" should be considered. We assume the intention of this bullet is that the valuation practitioner should understand the quantitative/qualitative factors unique to the subject company and confirm that these factors are reflected in the relationship between the subject company's prospective financial information (PFI) and (1) the historical financial performance of the subject company; (2) the historical and projected performance of the industry; and (3) the historical and projected economic performance of the country/region in which the subject company operates (i.e., the other procedures). Said another way, if the subject company's PFI diverges from projections from

the guideline public companies and or industry/economy, it does not necessarily mean that the PFI is inappropriate for use in the valuation; the valuation practitioner should understand the rationale for the differences and exercise professional judgement to assess whether this is appropriate based on the body of evidence obtained (both supporting and contrary).

9) Paragraph 50.38 - We suggest the IVSC consider whether a bullet point should be added as an additional procedure to assess the internal consistency of growth, profitability, and risk assumptions to address consideration of whether investment in capex/debt-free net working capital is sufficient to fund the profitability growth projected.

IVS 200

1) Paragraph 130.4 – We believe the appropriateness of the approach described in this paragraph is not just a matter of whether the entity has a simple capital structure. Rather, its appropriateness is also dependent on whether the company is distressed and whether the value of the company is significantly in excess of the amount of debt outstanding. The paragraph should be amended to be clear that this method is not appropriate for all companies with simple capital structures and that valuers should also consider whether the company is distressed or highly leveraged, as the method may not be appropriate in those circumstances.
2) Paragraph 130.7 - In general, we believe multiple approaches should be utilized to determine enterprise value. Once the enterprise value is determined, that value is then allocated between various classes of debt and equity as described in paragraph 130.1. With equity allocation methods, our experience in practice is that, assuming there are no market transactions, valuation practitioners typically select the method (e.g., CVM, OPM, or PWERM) that they consider most appropriate based on the facts and circumstances of the subject company and utilize only that method. The IVSC should remove this paragraph or revise it to be clear that the equity allocation methods would not be expected to corroborate one another and the valuer should base any conclusion of allocating value based on the most appropriate method.
3) Paragraph 130.11 - We suggest revising the following paragraph to read as follows: "Valuers should not assume that the value of debt, or debt-like securities, and its book value are equal without rationale for why."
4) Paragraph 130.12 through 130.19 – Throughout the section on the OPM, we believe that the language should be updated to reflect that the OPM is often performed on a total assets/enterprise value basis (rather than only on equity). In many cases, we believe it is actually more appropriate to include debt as a "breakpoint" in the analysis rather than applying the OPM only on equity value. It should also be clear that the selected inputs/assumptions (most notably volatility) should be consistent with the type of analysis being performed (equity volatility for an equity analysis, asset volatility for a total asset/enterprise value analysis).
5) Paragraph 130.12 through 130.19 - The discussion of the OPM technique focuses on the Black-Scholes-Merton (BSM) model. The BSM depends, inter alia, on a log normal distribution of returns and normal distribution of future asset prices. For early stage companies, the distribution of future asset prices can be highly skewed, and adopting a BSM model, which assumes normal distribution of values in the future, can lead to misleading conclusions. The standard should emphasize this point.
6) Paragraphs 130.10, 130.15 and 130.21 - We suggest that the guidance regarding the facts and circumstances when the CVM, OPM, and PWERM are appropriate should be consistent with the guidance in the Valuation of Privately-Held-Company Equity Securities Issued as Compensation Practice Aid (aka, the Cheap Stock Practice Aid) and/or the exposure draft of the AICPA Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies (generally referred to as the VC/PE Valuation Guide) unless there are specific reasons for divergence. For example, paragraph 130.15 as currently written could imply that the OPM is not suited for mature companies; however, our experience is that it is frequently applied to such companies.