Scientific Infra & Private Assets
An EDHEC Venture

Anchoring Private Valuation
Solving the stale NAV problem for investors in private assets

Quantifying Private Markets
London | Singapore

ANCHORING PRIVATE VALUATIONS

Problem statement: We know that using contributed or listed data leads to poor results because these datasets are typically not representative of the market segment of interest in terms of activity, business model or risk profile, and because they are not robust i.e., they contain too few data points to provide a good starting point for private market valuations that is not too noisy or biased.

The market anchoring approach: Asset pricing model cannot predict prices perfectly, but a good model calibrated with data coming from the relevant (private) market can provide a robust starting point or Market Valuation Anchor (MVA). Moreover, this MVA can be updated easily as it is recalculated each month, based on new market conditions, eliminating the staleness issues found in private valuations. Because the model is calibrated using private market prices, no illiquidity premium needs to be added to the valuation exercise, which removes a frequent contributor to valuation staleness since illiquidity premia a usually ad hoc and impossible to update.

A **Market Valuation Anchor** is characterized by three key features:
1. Granular sector and geography
2. Representative risk profile in terms of systematic risk factor exposures
3. Robust in terms of number of data points used to produce an average value

Once the MVA is obtained, it can be adjusted for asset- or deal-specific characteristics, which are clearly distinguished from the market effect on prices.

VALUATION METRICS COVERAGE

privateMetrics®

- USD50Tr+ Market Capitalisation*

- 1.2M+ private companies

- 10-year track record

- 150+ countries

- 60+ activity sectors

- 65M+ prices computed

infraMetrics®

- USD680bn Market Capitalization*

- 800+ private infrastructure companies

- 25 countries

- 33 activity sectors

- 23-year track record

- 400k+ prices computed (equity and debt instruments)

* as of 31 Dec 2023

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In practice: To create a valuation Anchor for a market multiple or discount rate, select a time period and start from a combination of market segments and geography, then create a risk adjusted comparable that matches the factor profile of the asset.

STEP 1

Pick geography & market segments (TICCS® or PECCS®)
Combine segments like activity and business model for more granularity.

STEP 2

Customize βs for Asset *i*
For each known risk factor, the company fits into a peer group by risk exposure.

STEP 3

Compute Valuation Anchor
Because each factor is independent, the multiples can be averaged across factors to get the Anchor multiple.

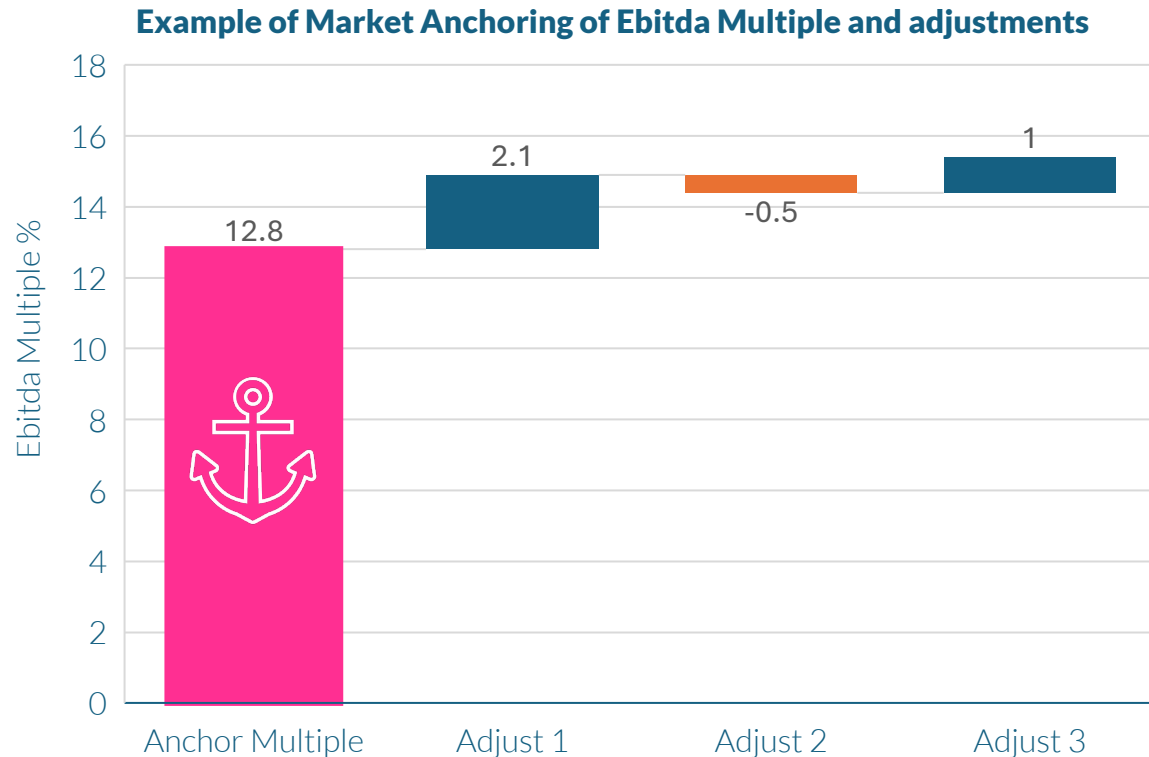*Data and functionalities available in MSEXCEL*

Example MVA for a US healthcare equipment B2B company in April 2023

		April 2022	Data points
Global Market Ebitda Multiple		23.6x	4.9M
MARKET SEGMENTS			
	United States	17.7x	374k
Health Equipment & B2B		24.2x	82k
RISK FACTOR PROFILE	**within the Mkt segments**		
Size	Low Exposure	28.9x	8k
Growth	High Exposure	23.1x	12k
Leverage	Neutral Exposure	27.7x	32k
Profitability	Med-Low Exposure	24.3x	26k
Maturity	Low Exposure	28.9x	4k

MVA Multiple	**24.9x**

ANCHORING PRIVATE VALUATIONS

Example of Market Anchoring of Ebitda Multiple and adjustments

Once the Market Anchor Valuation is established for a given value date, **idiosyncratic adjustments can be made by investors.**

Starting from the Anchor Rate provides an **explicit measure of asset-level adjustments since they** are not mixed with market-level considerations. This helps documenting, updating and justifying them.

The Anchor stays dynamic: it is updated monthly in privateMetrics without making static assumptions about an "illiquidity premium" or a public market beta, which are unknown and impossible to update.

THE BENEFITS OF ANCHORING PRIVATE ASSET VALUATIONS (1)

A quantitative, model-based approach to private asset valuation presents multiple advantages:

1. It is **robust**: the calculation is <u>customized</u> to reflect the segments and the risk factor profile of the assets of interest while relying on enough datapoints.

2. It is **transparent**: the factors contributing to the valuation are explicit and defined, based on an economic rationale e.g., higher profits equates higher value (everything else held equal), and documented to be persistent.

3. It is **dynamic**: on each valuation date, a new market benchmark can be used (they can be calculated monthly), anchored to the asset's risk profile (which may have changed) and adjusted to reflect asset-specific elements.

   A major improvement on non-robust or traditional approaches is that **the NAV never becomes stale**: it is anchored to a continuously evolving private market benchmark.

THE BENEFITS OF ANCHORING PRIVATE ASSET VALUATIONS (2)

4. Anchoring the valuation creates a **clear distinction between systematic (market-level) and idiosyncratic (asset-level) risks**: this approach dispenses the valuer from assuming the existence of an 'illiquidity premium' since the inputs do not come from listed markets, but instead from the same illiquid markets in which the assets are priced.

   All systematic or market elements are taken care of in the first two steps (benchmarking and anchoring) and any asset-specific adjustment can be clearly documented and justified.

5. Anchoring is consistent with investors' **prudential and fiduciary duties**: NAVs that are not stale or smoothed allow investors to measure and manage risk and ensure the fair reporting of valuations to final investors in pension plans, insurance and wealth management products.

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CONTACT US

Start Your Private Asset 2.0 Journey Today

email: sales@scientificinfra.com
web: www.scientificinfra.com

London Office
10 Fleet Place,
London EC4M 7RB
United Kingdom
+44 (0)207 332 5600

Singapore Office
One George Street
#15-02
Singapore 049145
+65 66538575

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