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What’s the valuations process?

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Ben James (BJ): Hello, and welcome to this film on valuing private companies. It's a really important topic, James, and it's your area of expertise. Where do we start?

James Yuill (JY): Sure. I think when it comes to valuing private companies, there's three key things we're thinking about. The first of those is the resource that we put to it and the governance around it. The second is the frequency and how often do we deal with valuations and factor market volatility. And then the third is the modelling itself. What's actually driving the numbers in the end?

BJ: I think it's a really important topic. And I want to reassure the audience about how robust our process is. Let's bring those three points to life by taking a private company through the journey of valuation. Private company A, where do we start?

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JY: Sure. I think that point of transaction, the point of investment is always going to be your starting point. We want to make sure that we're comfortable it's arm's length, who is involved, the quantums. A lot of these companies are at later stage. It's substantial rounds with numerous investors, which helps with that. And then from there, we want to build it into our valuations schedule. And that's where we start to bring in our independent external input through S&P.

BJ: What is our schedule for valuing private companies?

JY: The fundamental is always that we will value everything at least once per quarter.

BJ: Every private company?

JY: Every private company, at least once per quarter. And S&P will come into that. They will review it all once per quarter.

BJ: Who's S&P? What do they do?

JY: They're an external firm. They're a financial firm that provide numerous

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services, but valuations is one of them. They look at equity valuations for numerous people, including for us. They will assess all of our holdings.

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BJ: They send in a list of valuations for our private companies and then your team steps in and starts their work?

JY: Exactly. We’ll scrutinise everything we get from them. We’ll challenge the approach, but also we're double-checking all the data, everything that's actually driving that end result.

BJ: Who's on your team that does this, by the way?

JY: In the operational team, we've got a number of analysts and the manager that look through all those reports that come from financial background too that have a lot of experience in looking at these valuations.

BJ: And are the investment managers those who make the decisions part of that team?

JY: No. That's the important part around not marking our own homework. We keep that separate. We're completely independent from the investment floor. We will liaise with them to make sure we have all the news from these companies and that we understand what's going on. But other than that, the valuations are driven separately.

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BJ: S&P Global give you a valuation for company A. You then check against your own thinking about company A. And what happens when you disagree?

JY: We'll put our challenge to S&P and whether it be data-related or approach-related, they can rebut that and challenge. Or they may take on board what we've said and change it, but only if they are comfortable. Fundamentally, this is their opinion.

BJ: How do you come up with a valuation? What things do you look at?

JY: It's all really around the fundamentals of the company. Performance, the financials, what's actually happening, but the milestones as well. Are they achieving the things we thought they would or have they missed deadlines? There are key factors, as is the broader external markets. Looking at a peer set, looking at the listed markets, what's changed in terms of market sentiment?

BJ: You have a list of similar companies or related companies in the public space that are listed companies and see how they've moved. What if private company A doesn't have a peer in the public market?

JY: And that's often the case. And that's where the challenge comes in. And that's about thinking outside the box, looking for companies that overlap in specific ways. They might not be exactly the same, but do they have the same growth trajectory? Do they have the same margins? Are they operating in the same industry? And building a set that overall captures all of those elements. And you have the market sentiment influencing from different angles.

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BJ: You and S&P Global have now agreed in the price. Then what happens?

Rachael Callaghan (RC): Then it comes to the Private Companies Valuations Committee, which is part of the internal valuations process and governance structure at Baillie Gifford. Again, this is an entirely independent function within the valuations process. None of the valuations committee are on the investment floor. It's another arm's length independent scrutiny and challenge of both S&P's work, but also the internal valuations work that James' team does. And the Valuations Committee has to then further rubberstamp and approve all of the valuations that come past the group.

And we meet monthly to interrogate and challenge those valuations that we see and provide different insight from our roles around Baillie Gifford.

BJ: That's it then. We get to that point and that's the valuation done. Company A is worth X billion dollars?

JY: If only. There's then further levels to the governance, which is an important part of the process and something we take a lot of confidence from. The fact a lot of these companies are held by investment trusts, you've then got two further layers of governance really there. You've got your boards, independent boards that each of these trusts have. Completely external to Baillie Gifford itself. They will review all of these valuations every six months. They will see everything we see.

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They see the full reports, any backup they want. And they'll challenge the valuations themselves. That then goes through audit. Each of those trusts, there's different auditors involved. We've got four different external firms.

BJ: Like PWC, KPMG, etc., those big...?

JY: Yes, three of the Big Four and different teams from within them as well. And I think importantly, also at different times in the year. The year ends for our trusts are many and varied. We have a lot of investments, some of the examples you named earlier. A lot of our investments are held in numerous portfolios. They're being scrutinised by boards and different boards and have different auditors looking at them at multiple points in the year.

BJ: Company A could be held in four or five different investment trusts and vehicles which look at it in their year ends, whether that's March, April, June, August, September. And they do that twice a year because they do half-years as well. And they're having different auditors, which then also look at it. And can they challenge and change the valuation as well?

JY: Absolutely. The boards, they have to be comfortable with the valuations. If they're not, then they can change the valuations to what they see is appropriate. And that's what the auditors will then sign off on.

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BJ: That happens as a standard, once every quarter. But what about in really volatile or the periods or if news comes in just after you value private company A, what happens then that changes that thought?

JY: That's where the frequency and the modelling is key. We think about trigger events. We're always monitoring within the team to see, has an event happened that might shift the value of a company? Financial performance outside the expectations, milestones being hit or market volatility. The comparable companies, have we seen an upward or a downward shift since we last valued? And making sure that we're reflecting that in the valuation and updating in as close to real time as we can.

RC: Have you marked your own homework at any point? And how accurate are you with your valuations process?

JY: Yes. What we've essentially had is the market marking our homework. We've had these price discovery events. And by that, we mean, effectively, transactional activity. A company raises new equity. It's acquired. It might be listing. Either way, the market has attached a value to the company.

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BJ: If somewhere in the public, away from us, a company has raised money or it's been acquired and the price has been publicly stated, this is worth this?

JY: Exactly. Whenever that happens, we'll look at the valuations we have in place. How is it trending? Where were we before that happened? To see how we fared. And importantly, what we want to see is a mix. You're never going to get valuations perfect. They are estimates. But sometimes you want to see it go up a bit, sometimes down a bit. If you're always going up or you're always going down, that's a sign of bias in your process. You might always be too aggressive or you might always be too conservative.

And that's what we've seen. If we take the last 15 transactions or price discovery events that we've seen, we've had ten we've had to mark up a little bit and five we've had to mark down. And the average movement we've seen across all the 15 is about a 10 per cert uplift following a price discovery event. And that gives us confidence that the process has balanced, that we're not always going one way or the other. And we'll always be doing that back testing to make sure that that hasn’t crept in.

BJ: Thanks. It's a really important topic. We could talk about it for a long time. If you want any more information, viewers, please go to our website to look at our policies and so on. But thanks for watching this film and look out for other films in the series on investing in private companies at Baillie Gifford.

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