Portfolio valuation methodology

A description of the methodology used to value 3i's portfolio is set out below in order to provide more detailed information than is included each year in the accounting policies for the valuation of the portfolio.

The valuation of 3i's portfolio for the interim and annual accounts is arrived at using a systematic process based on objective criteria. The aim is to value the portfolio as a whole on a prudent and consistent basis. There has been no change to the valuation policy since 3i's flotation in 1994 and it complies in all material respects with the guidelines of the British Venture Capital Association.

Quoted investments Quoted investments are valued at the closing mid-market price at the balance sheet date, except for investments quoted on secondary markets including AIM which are discounted by 25%. Where there are restrictions on dealing in quoted investments, an appropriate discount is applied to the restricted shares.

Unquoted equity shares A three-stage valuation process is used:

1 The first stage is to value all unquoted equity investments in the manner described below:

New investments are generally valued at cost for the first 12 months or, if later, until the receipt of audited accounts covering a period of at least six months since the date of investment.

Any investment in a company which has failed or is expected to fail within the next 12 months is valued at nil.

The value of other investments (except technology investments) is arrived at by applying 3i's proportion of equity shares held to the valuation of the company calculated by multiplying the latest audited earnings by the average price-earnings ratio of the relevant sector of the FTSE SmallCap Index (or international equivalent), adjusted downwards by 3i to exclude loss-making companies. If the result of this calculation is less than half of 3i's share of net tangible assets, then the investment is valued at half of 3i's share of net tangible assets. The value of technology investments is arrived at as set out above except that where the investment is in a company which is performing to plan the valuation is not initially reduced below cost.

2 All investments valued at more than £4 million by the first stage of the process, together with any investments which the local office responsible for the investment considers to have a value in excess of £4 million and all technology investments valued at cost, are individually reviewed in line with internal guidelines for factors which may affect the value and their valuations may, as a result, be adjusted. These factors include:

- reliable financial information more recent than the audited accounts;
- non-recurring profits and losses and abnormal tax charges;
- imminent sale or IPO;
- significant third party transactions, which includes further rounds of finance to technology companies. Valuation increases are only recognised where there are substantial new outside investors and significant milestones have been achieved;
- for technology companies where cost or carrying value is no longer considered appropriate, investments are reduced to a fair value using the most appropriate criteria available;
- potential issues of shares dilutive to 3i or other shareholders;
- forecasts by the investee business of lower earnings;
- an industry standard basis of valuation, for example property companies, which are valued by reference to their net assets;
- large cash holdings; and
- very high gearing.

This process applies to approximately two-thirds of unquoted equity investments by value.

3 The third stage is to apply the following discounts to reflect the illiquidity of unquoted investments:

• investments valued at cost or half net tangible assets	nil
• investments valued at expected disposal proceeds or IPO value	10%
• investments valued on an earnings basis	25%

Unquoted fixed income shares and loan investments Unquoted fixed income shares and loan investments are generally valued at cost unless the company has failed or is expected to fail within the next 12 months when they are valued at the lower of cost and net recoverable amount.

An analysis of the equity portfolio by valuation method is given in the portfolio analysis on page 70.