

The Impact of Secondary Transactions on Business Valuations

An Analysis of the key risks and best practices to strengthen your next valuation

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KNOWLEDGE

Learning Objectives

CPE Information
Recommended CPE: 1
Delivery Method: Group Internet Based
Field of Study: Specialized Knowledge
Program Level: Basic
Advanced Preparation: None
Prerequisite: None



Identify what secondary transactions are and their prevalence.



Discuss draft guidance released by an AICPA taskforce on secondary transactions.



Describe key considerations to assess the impact of secondary transactions on fair value.



About the Presenter Nadia Carey

- CFO Advisory Senior Director at Armanino Advisory LLC
- Background in Valuation of Venture Capital Funded Companies
- Employment and Professional Organizations
 - Armanino Advisory LLC 2010 - Present
 - American Institute of Certified Public Accountants (AICPA), Forensic & Valuation Services Section
 - California Society of Certified Public Accountants (CalCPA)
- Education
 - University of California, Santa Barbara
 - Santa Clara University – Leavey School of Business



About the Presenter Jason Woon

- Partner - Valuation & Financial Modeling Services at Armanino Advisory LLC
- Background in Big Four firm and Public Companies
- Employment
 - Armanino Advisory LLC 2022 – Present
 - Coinbase 2022
 - SoftBank Investment Advisers 2021 - 2022
 - KPMG 2011 – 2021
 - Clark Nuber 2008 - 2011
- Education
 - University of Washington (B.A. in Accounting and Finance)
 - University of Michigan (MBA)

Armanino's Valuation & Financial Modeling Team Can Help



Mergers, Acquisitions and Dispositions

- Valuations of consolidated businesses
- Valuations of business ownership interests
- Intangible asset valuations/EPS impact
- Real Estate valuations
- Earnout valuation
- Purchase price allocation (§1060/ASC 805)
- §280G analysis
- Impairment testing (ASC 350/ ASC 360)



Other Financial Reporting

- Lease accounting / Incremental borrowing rate (ASC 842)
- Current expected credit loss (CECL)
- Portfolio valuation / Mark-to-market (ASC 820)
- Shared-based payments (ASC 718)
- Pay vs Performance
- Debt (ASC 470) and Derivatives (warrants, options, convertibles, swaps) (ASC 480 / ASC 815)



Bankruptcy and Reorganization

- Establishing the value of the business under liquidation premise
- Measuring reorganization value
- Legal entity restructuring and reorganizations
- "Fresh Start" accounting (ASC 852)
- Real Estate liquidation value
- Legal entity restructuring and reorganization



Litigations and Dispute Resolution

- Business, real estate and contractual disputes
- Insurance claims
- Tax-related conflicts
- Purchaser representative
- Voting/Non-Voting shares
- Marital separation / divorce



Strategic Planning

- Financial modeling (custom financial analysis/model validation)
- Three statement modeling and long-range forecasting
- Collateral or secured financing/refinancing
- Licensing or Relicensing
- Expansion opportunities (space/lease optimization)
- Valuations needed for net operating loss study (IRC 382)
- Tax planning and compliance
- Estate and gift planning / compliance



Section 1

Secondary Transactions & Market Trends

Impact of Secondary Transactions on Business Valuations

What is a Secondary Transaction?

- A primary transaction is completed by the company issuing securities directly – often original issuances.
- The primary market for early-stage private company stock is often the venture capital market.
- A secondary transaction is the purchase or sale of existing equity securities completed in either a private transaction or through a secondary exchange.
- Secondary markets are any market in which equity securities are bought and sold in transactions between parties other than the Company itself.

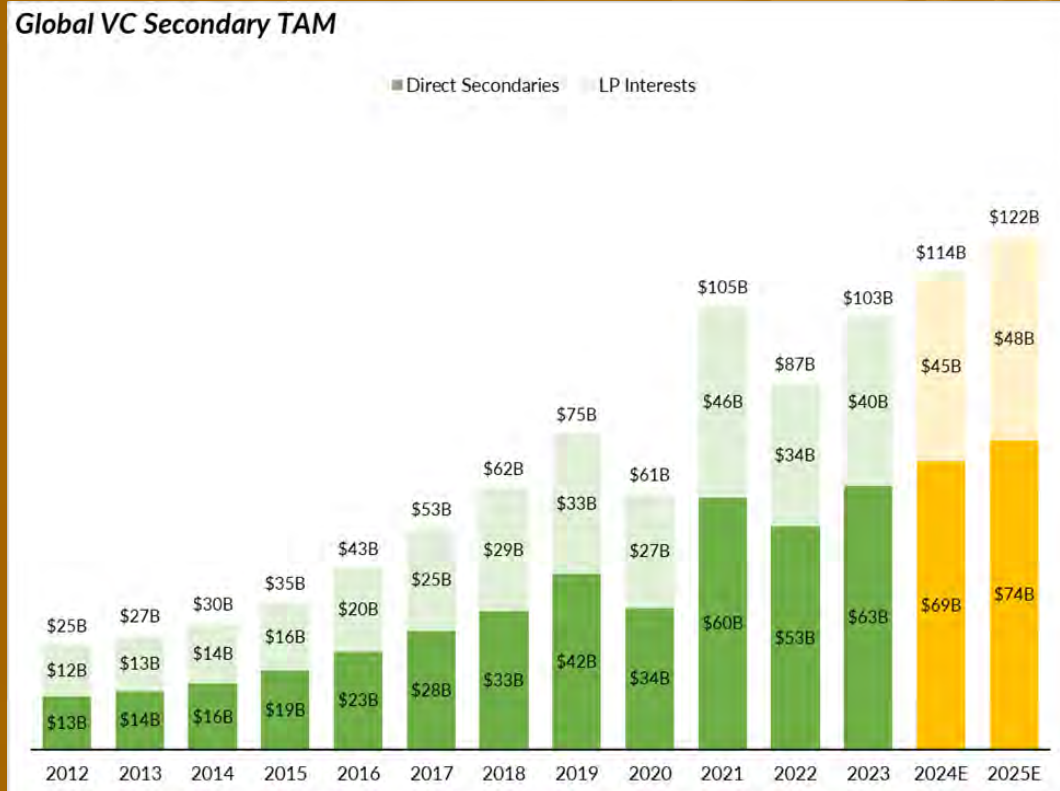
Impact of Secondary Transactions on Business Valuations

Common Types of Secondary Transactions

- Secondary exchanges
- Right of First Refusal
 - Prevent outside parties from gaining access to shares
- Employees or early shareholders sell to new or existing investors
 - Sometimes concurrent with a primary financing transaction
 - Investor obtains a target ownership %
 - Employee compensation
- Tender offers
 - Company initiates and facilitates the transaction
 - Company controls which buyers and sellers participate and predetermines the price.
 - Sometimes negotiated concurrently with a primary financing transaction
 - Investor obtains a target ownership %
 - Employee compensation

Impact of Secondary Transactions on Business Valuations

Growing Importance of VC Secondaries



Source: Pitchbook; Industry Ventures Market Intelligence (as of January 2025).

Most Valuable Privately-Held Technology Companies

Company Name	Latest Known Valuation ...	Total Raised	Latest Round Date	Headcount	1 Year Headcount Growth
SpaceX	\$350B	\$15.7B	Dec 11, 2024	14,640	18.2%
ByteDance	\$230B	\$20.8B	Sep 3, 2024	43,226	8.5%
OpenAI	\$164B	\$49.0B	Feb 11, 2025	5,149	213.8%
Stripe	\$70.0B	\$14.2B	Sep 13, 2024	10,644	21.2%
Databricks	\$62.0B	\$14.4B	Dec 17, 2024	10,046	24.1%
Anthropic	\$60.0B	\$8.92B	Jan 23, 2025	1,084	170.3%
Revolut	\$45.0B	\$4.81B	Aug 16, 2024	15,967	38.4%
xAI	\$45.0B	\$61.3B	Dec 25, 2024	1,526	1,614.6%
Waymo	\$45.0B	\$27.4B	Nov 5, 2024	2,935	7.1%
X	\$44.0B	\$22.8B	Sep 30, 2024	4,745	104.1%
Canva	\$32.0B	\$1.08B	Oct 31, 2024	6,894	5.5%
Anduril	\$28.0B	\$6.91B	Feb 7, 2025	3,505	72.2%

Source: position.so (as of February 2025)



Section 2

Draft AICPA Guidance Released June 2024

Valuation of Privately-Held-Company
Equity Securities Issued as Compensation

Impact of Secondary Transactions on Business Valuations

Working Draft of Chapters 8 & 9

- Chapter 8: *Inferring Value from Transactions in a Private Company's Securities*
 - Framework for evaluating the impact of primary and secondary transactions for **ASC 718**
 - Key considerations in **assessing relevance** of secondary transactions
 - **Calibration** of fair value of equity securities to prices paid in secondary transactions
 - **Degree of weight** to place on transaction prices
 - Emphasizes guidance in **ASC 820**
- Chapter 9: *Selected Accounting and Disclosure Matters*
 - **Accounting** considerations related to secondary transactions
 - **Disclosure** considerations regarding stock compensation awards

Impact of Secondary Transactions on Business Valuations

Fair Value FASB ASC 820 & FASB ASC 718

ASC 820: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date.

ASC 718: The amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.



Impact of Secondary Transactions on Business Valuations

Fair Value Hierarchy – ASC 820

- Level 1: Quoted Prices for **Identical** Assets in **Active Markets**
 - Most reliable
 - Example: Publicly traded stocks
- Level 2: **Observable Inputs** in **Inactive Markets** or for similar (but not identical) assets
 - May require adjustment
 - Example: Certain corporate bonds
- Level 3: **Unobservable** Inputs
 - **Model-based**, significant assumptions and expert **judgement**
 - Example: Private company valuations

Impact of Secondary Transactions on Business Valuations

Implications for Secondary Transactions

- Valuation techniques should **maximize the use of relevant observable inputs** and minimize the use of unobservable inputs.
- **Prioritize** transactions within a private company's securities.
- If the transaction is for a different security of the enterprise, is not in the principal market, or does not take place on the measurement date, then the transaction price would **need to be adjusted**.
- Secondary markets for private companies would **not** typically be considered active markets.
- Secondary transactions often see common stock purchased at the **same or similar price** as preferred, ignoring inherent liquidation preferences.

Impact of Secondary Transactions on Business Valuations

Fair Value
FASB ASC 820
&
FASB ASC 718

Key Principles

- Orderly transaction
- Principal market or most advantageous market
- Market Participants are knowledgeable and act in their economic best interest
- As of the Measurement Date



Impact of Secondary Transactions on Business Valuations

Principal Market

- The market with the **greatest volume and level of activity** for the asset or liability
- Does **not** require a structured, formal or organized market
- All available trading data must be considered, even thinly-traded secondary markets
- If there is no principal market, the most advantageous market is used instead; this is the market that maximizes the amount received after considering transaction and transportation costs.
- In the absence of an organized market, assess what would be the principal market, and consider the *principal-to-principal market*
 - Market in which transactions are negotiated independently with no intermediary
 - Little information about those transactions may be made available publicly

Impact of Secondary Transactions on Business Valuations

Market Participants

- Independent
- **Knowledgeable**
- Willing (not forced)

- Primary transactions **do not occur** in the principal or most advantageous market.
- Level of information available in a primary transaction **should not be viewed as the most relevant comparison** in determining the degree of information available to market participants.

- Participants in secondary transactions that occur in the principal market **are considered market participants** in those transactions.
- Information customarily available to market participants is the relevant threshold, **even if that is a lesser degree of information** than would be available to investors who have access to management of the company.
- The lesser level of information in a secondary transaction compared to a primary transaction **is not an indication that less weight should be placed** on the transaction price.

Impact of Secondary Transactions on Business Valuations

Orderly Transactions

- If a transaction is orderly, the task force believes the price would **need to be given weight**.
- Due diligence and discussions with management and the board of directors are customary for primary transactions.
- Secondary transactions often do not have access to this degree of information but that **does not preclude the transaction from being considered orderly**.
- The secondary transactions may not be the sole or primary basis for measuring fair value.
- May be appropriate to augment the transaction price with other valuation techniques.

Impact of Secondary Transactions on Business Valuations

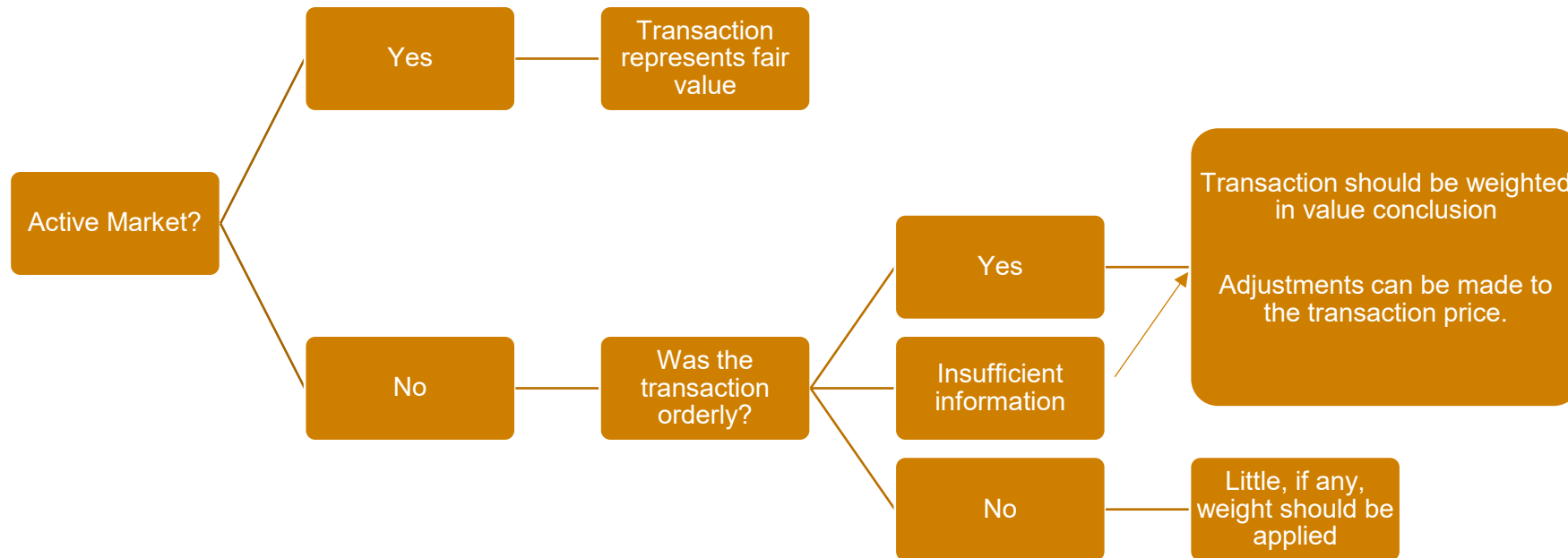
Weighting Considerations

- Number of transactions
- Proximity to the measurement date
- Pricing consistency
- Consistent information among buyers and sellers
- 100% weight is not required, all relevant facts and circumstances should be considered.
- If there is only **one** secondary transaction, it may not be the sole indicator of fair value because the market is **not active**.
- The greater the **number** of transactions, the greater **proximity** of those transactions to the measurement date, and the greater the **consistency in pricing** of those transactions, the less appropriate it becomes to place weight on other indications of value, including indications of value based on primary transactions.

Impact of Secondary Transactions on Business Valuations

Weighting Considerations

Section 8.07 - in most cases, the transaction price should be weighted



Impact of Secondary Transactions on Business Valuations

Weighting Considerations

Less Weight on Transaction Price

Intent to **compensate**

De minimis transaction price for both parties

Significant market changes since transaction occurred

Between related parties

Not recent

More Weight on Transaction Price

Multiple transactions, consistent pricing

Buyers and sellers had similar information

Broad numbers of sellers

Occurred in the principal market

No ordinary income compensation expense recorded

Company had limited or no involvement

Early-stage company, R&D phase, no product revenues

Impact of Secondary Transactions on Business Valuations

Calibration to Observable Transaction Prices

- **Required** if transaction meets fair value criteria
- Consider extent to which buyers place value on the liquidation preference.
 - Common Stock Equivalent method may be appropriate
 - Option Pricing Models may over-value liquidation preferences
- Build valuation models that use **unobservable inputs**
- **Calibrate unobservable inputs** such that the resulting value equals the transaction price.
- In subsequent periods, this analysis provides a foundation to determine appropriate adjustments.

Impact of Secondary Transactions on Business Valuations

Key Takeaways

- Maximize the use of observable inputs
- Transaction price can be adjusted for facts and circumstances
- Weighting does not have to be 100%
- The guidance generally leads to increased weighting to secondary transaction prices compared to previous practices.
- Valuation models can and still should be used, even if there are secondary transactions
- Common stock equivalent (CSE) allocations may also be used, with OPM

Impact of Secondary Transactions on Business Valuations

Commentary

- Weighting judgements may vary among audit teams and valuation specialists
- Extra step in valuation process, more time involved to analyze secondary transactions
- Audit process may be more involved
 - Specific data and questions surrounding nature and characteristics of secondaries
- Company management can help:
 - Track information on secondaries
 - Inquire with valuation specialist how the new guidance has been considered
 - Inquire early for auditor input

Thank you for
attending

Additional Questions?

Reach out to us at

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