

Spotlight on Continuation Funds

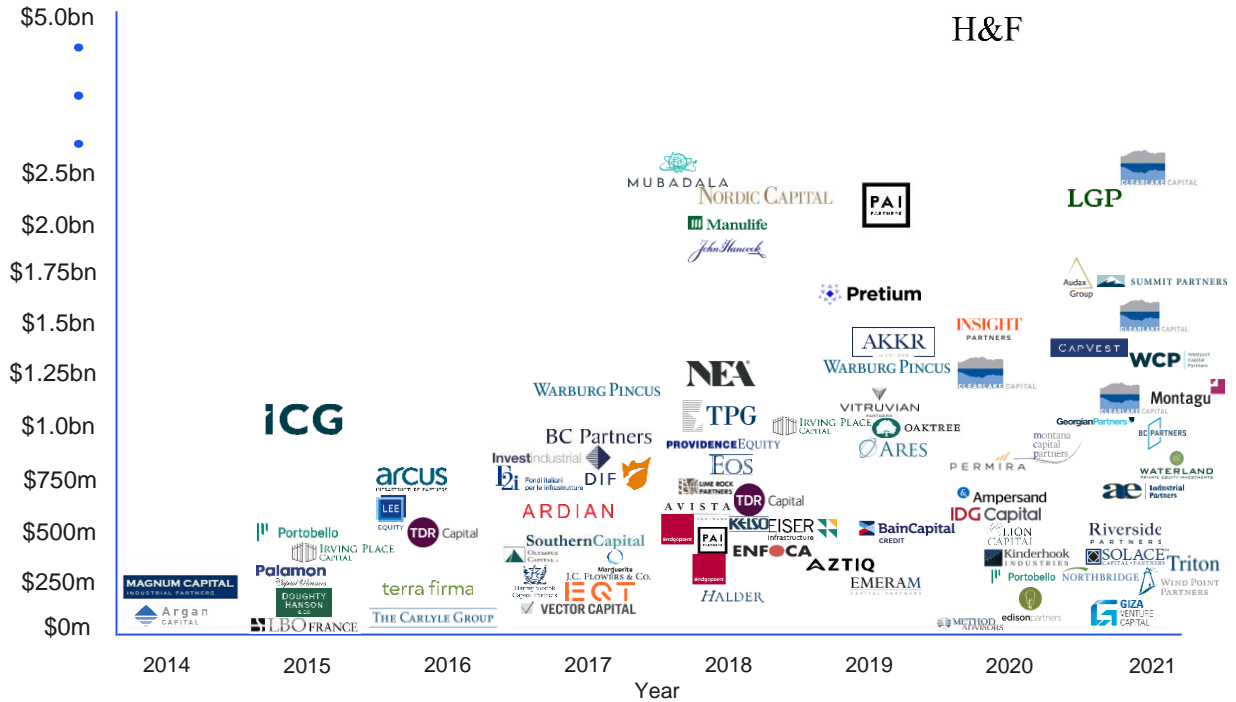
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The Rise of Continuation Funds (1/2)

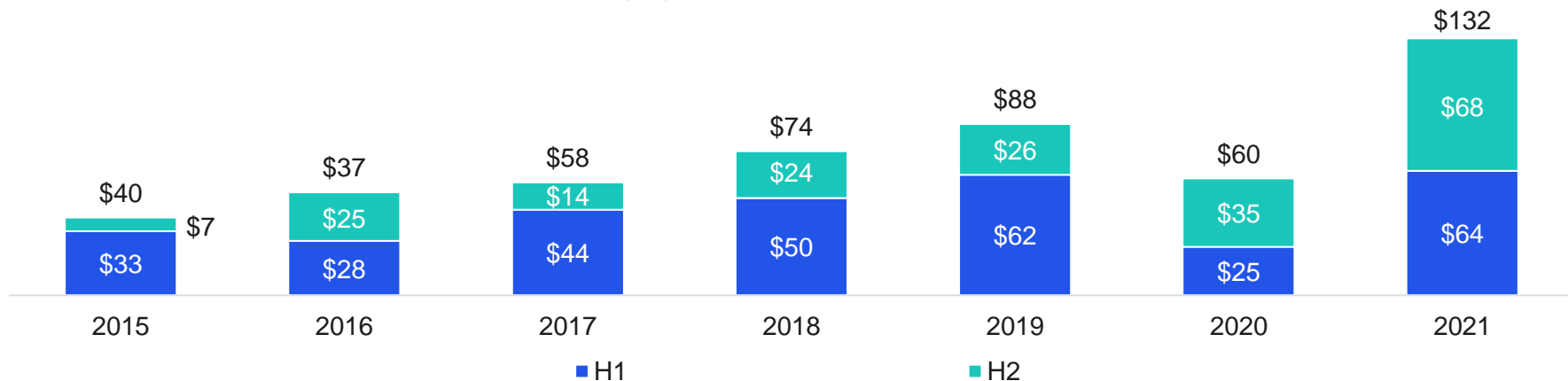
Secondary Market

- ▶ The secondary market provides liquidity to otherwise illiquid interests in private funds
- ▶ Secondaries transactions started out with the sale and purchase of limited partner (LP) interests, but now encompass a range of transaction types, including the increasingly popular continuation fund deals (the principal type of “GP-led transaction”)
- ▶ The secondaries market has grown rapidly over the last few years, with aggregate market volume increasing from \$37B in 2016 to \$132B in 2021

EXAMPLES OF CONTINUATION FUND TRANSACTIONS



SECONDARIES TRANSACTION VOLUME BY YEAR (\$B)

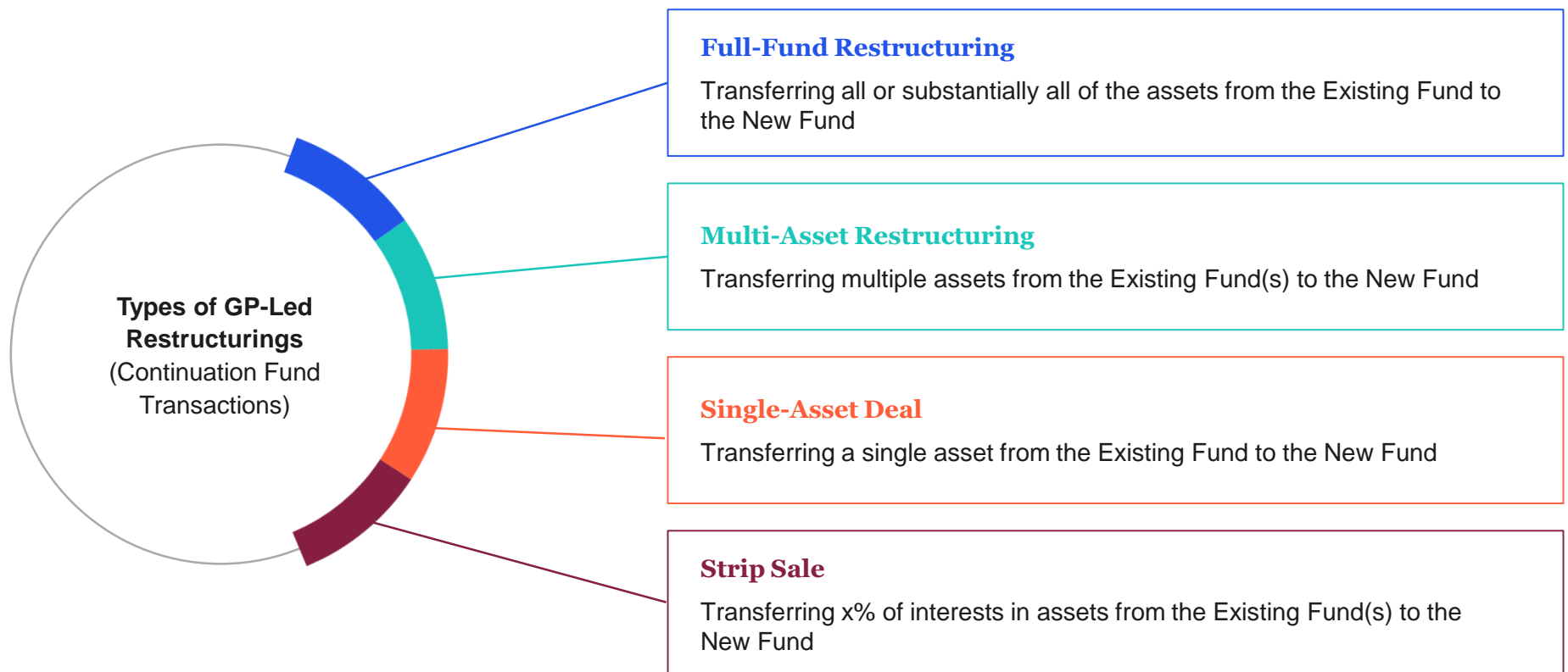


Source: Jeffries Global Secondary Market Review, January 2022

The Rise of Continuation Funds (2/2)

What is Driving the Increasingly Popularity of GP-Led Deals Over The Last Few Years?

- ▶ Over \$100 billion of dedicated secondary dry powder
- ▶ At the sponsor level, need to address succession issues/investment team re-incentivization
- ▶ Desire to maintain AUM while generating DPI (distributions to paid-in-capital)
- ▶ Turn existing co-investment AUM into fee-paying AUM
- ▶ LPs' desire for liquidity in older vintage funds
- ▶ From the secondaries investors' perspective, the search for alpha outside of traditional LP portfolio trades

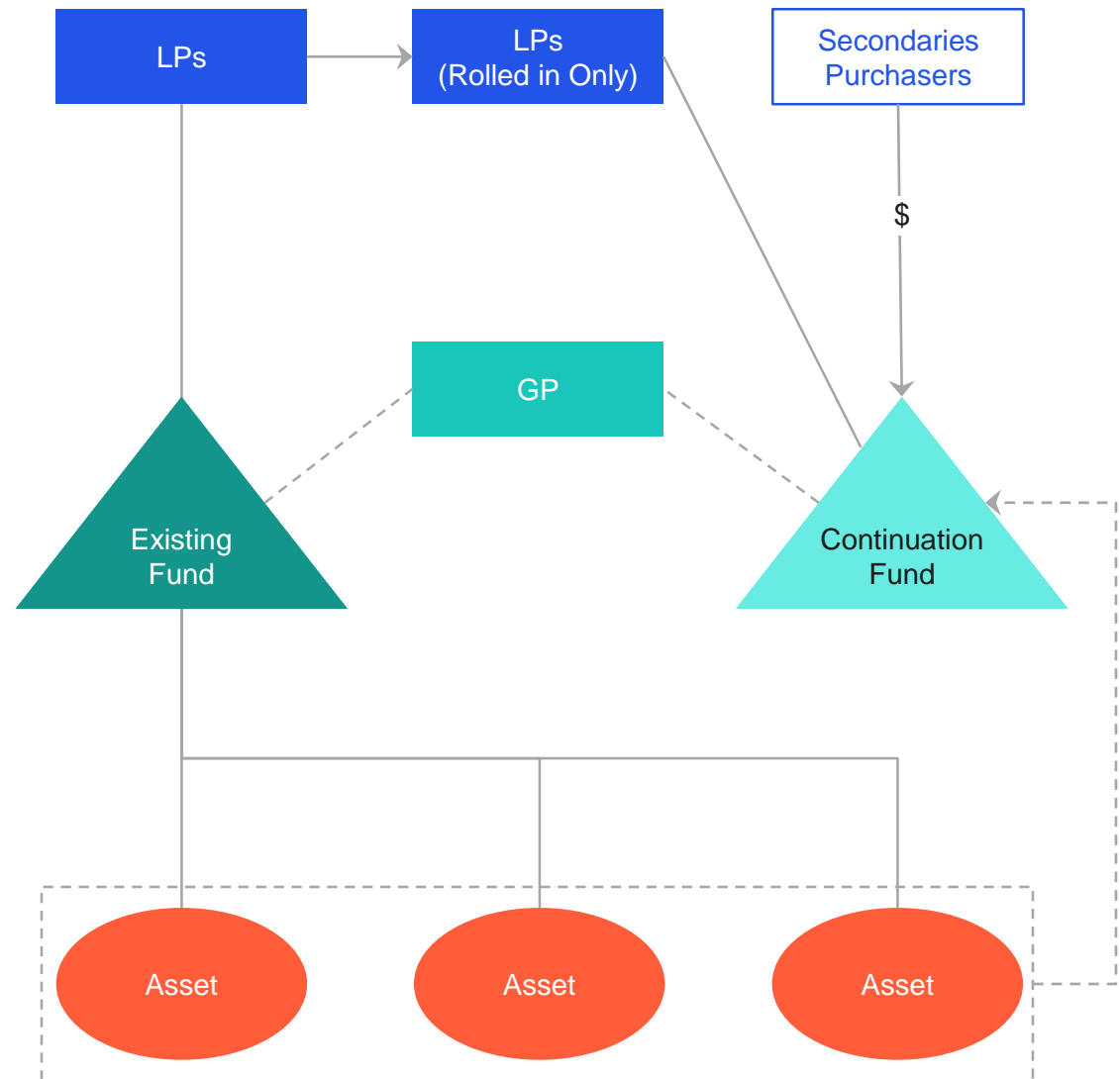


Simplified Continuation Fund Structure

Structure

- ▶ The most common “GP-led transaction” involves setting up a new, continuation fund and transferring one or more assets (or a portion of assets) to this new fund, which is capitalized by specialist secondaries investors
- ▶ LPs in the existing fund (or funds) can choose to either cash out or “roll” their interests into the continuation fund
- ▶ The transaction can maximize the value of the relevant assets that require more time and potentially more capital. The GP has an opportunity to refresh fund economics
- ▶ Between roughly 2007 and 2013, GP-led deals were associated with tail-end assets or “zombie funds.” Since then, continuation funds have grown in popularity among higher-quality sponsors, hitting an inflexion point in 2020; according to Evercore, GP-leds accounted for 50% of transaction volume in 2020 up from 33% in 2019
- ▶ Evercore estimates that GP-led deals accounted for \$68B of transaction volume in 2021

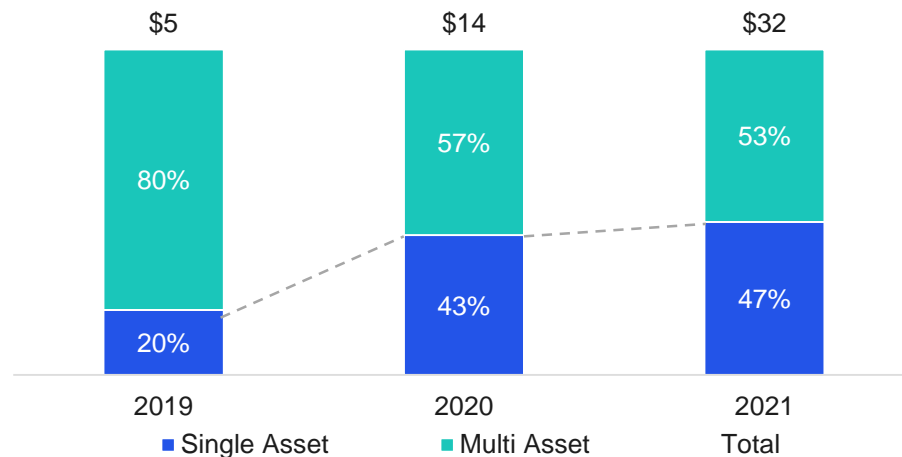
SIMPLIFIED SINGLE-ASSET TRANSACTION STRUCTURE



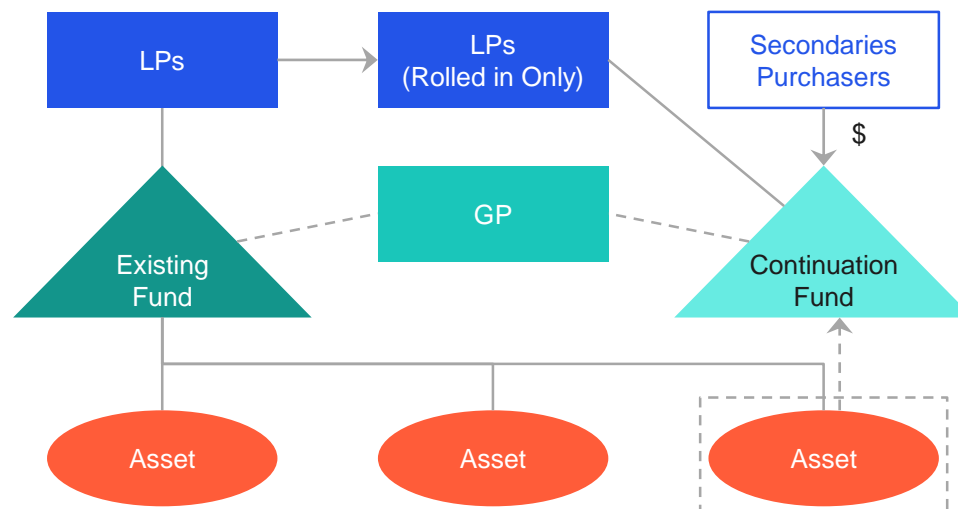
The Jewel in the Crown – Single-Asset Transactions

Single-asset deal volume doubled to \$32B from an already record 2020 (almost triple 2019 volume), accounting for 47% of GP-led volume in 2021

TRANSACTION VOLUME BY YEAR (\$B)



SIMPLIFIED SINGLE-ASSET TRANSACTION STRUCTURE



Benefits of GP-Led Single-Asset Transactions

- ✓ Positive selection bias with respect to assets with growth potential in GP-led single asset deals. GPs get more time and (potentially) capital to develop the asset in a fund that is tailored for the purpose and receive management fees in return and a carried interest in future growth
- ✓ Locks in early returns for LPs, who are typically offered the option to cash out, or roll (in part or whole) into the new fund
- ✓ For “homerun” portfolio companies, allows GP the option to provide the portfolio company management with partial liquidity option and/or to revise underlying management incentive plans (but typically structured to avoid acceleration of vesting)
- ✓ GPs have the opportunity to reset GP economics, crystallize carry, increase AUM through potential buy-out of co-investors and other portfolio company equity holders
- ✓ There may be an opportunity for the GP’s capital and accrued carry to roll into the continuation fund on a tax-deferred basis, where LPs are also typically provided an option to sell interests in the new continuation fund for cash or roll on a tax-deferred basis (subject to an understanding of the particular facts and more detailed tax analysis)

Source: Evercore Secondary Market Survey Results, January 2022

Continuation Funds – Challenges to Consider

What restrictions are there on implementing a continuation fund?

Conflicts of Interest

- ▶ As the GP is on both sides of the transaction, potential conflicts of interest will need to be addressed. Clear commercial rationale should be provided and a robust and symmetrical disclosure process should be run for both existing LPs and potential secondaries investors. Often third party valuation or fairness opinions are also involved

LPAC/Investor Consent

- ▶ In general, sponsors should anticipate that LPAC consent will be required

Structuring Restrictions

- ▶ Consider tax implications of any structural changes, as well as on crystallization of carry and for relevant investors. Bear in mind regulatory restrictions as well as portfolio transfer issues, such as anti-trust, minority/co-investment rights and labor/union consultations. Need to consider any relevant restriction in the existing fund LPA(s) (e.g., restrictions on amendments, tweaks to expenses and distributions in specie provisions)

Existing Agreements

- ▶ Check if there are any successor fund restrictions or consent requirements in existing agreements at both fund and portfolio levels, such as in finance arrangements and key commercial contracts

Securities Regulator Scrutiny

- ▶ Relevant securities regulators may be able to review a transaction after the fact

Heavy Lift

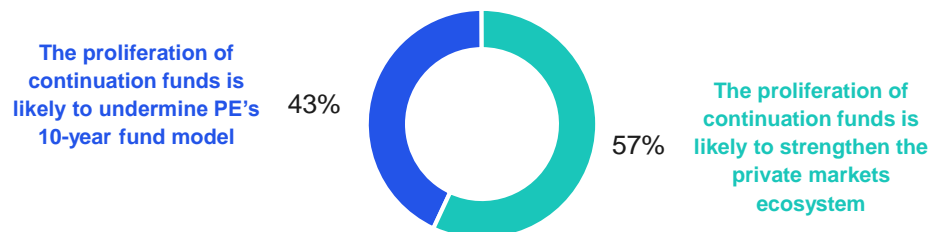
- ▶ Complex transactions with multiple parties that require substantial sponsor and investor time to implement. A combination of a fundraise and an M&A deal. However, these transactions tend to be lighter on diligence than regular way M&A, given track record in the fund, continuing GP, some rolling investors and often “skin in the game” from the GP
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LP Outlook and Key Statistics

Continuation funds are a “game changer” for the private equity ecosystem, LPs believe

LPs recognize that the rapid growth of continuation funds represents a significant evolution of the private markets ecosystem – an evolution whose implications are yet to be fully clear. A majority of PE investors believe the principal effect will be to strengthen the overall private markets ecosystem, but a sizable minority believe the change will be more profound, serving to undermine PE’s traditional 10-year fund model

IMPLICATIONS OF THE RAPID GROWTH IN CONTINUATION FUNDS – LPS’ VIEWS



Continuation funds are likely to be good owners of portfolio companies, LPs think

Two thirds of LPs believe that continuation funds are likely to prove good owners for their portfolio companies. However, some LPs remain to be convinced – one third believe that the companies in continuation funds might have had better prospects with different, third-party owners

LP VIEWS ON CONTINUATION FUNDS AND THEIR PORTFOLIO COMPANIES



2021 KEY STATISTICS

\$68B

2021 GP-Led Transaction Volume

52%

GP-Led Share of Total Secondary Volume

84%

Continuation Fund Transactions
(% Share of GP-Led Volume)

48%

Single-Asset Transactions
(% Share of GP-Led Volume)

5 years

Average Asset Hold Period

76%

Buyout Assets
(% Share of GP-Led Volume)

70%

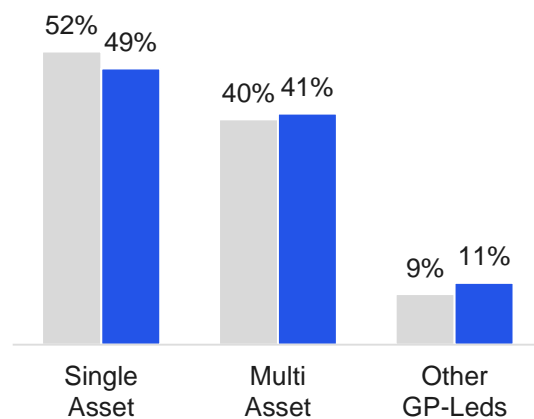
Multi-Stage Auctions
(% Share of GP-Led Volume)

Source: Collier Capital Global Private Equity Barometer, Winter 2021 – 2022 and Jeffries Global Secondary Market Review, January 2022

2022 Expected Deployment Trends

GP-Led Deployment by Deal Type

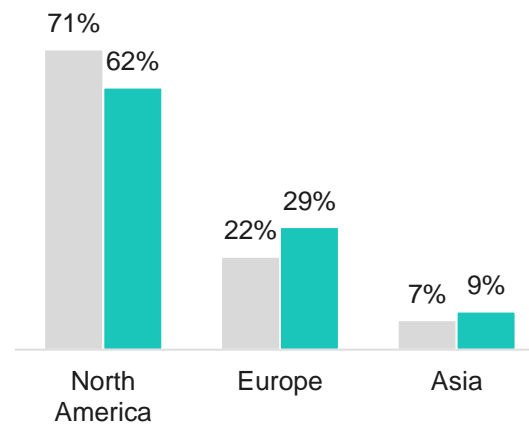
■ 2021 Actual Deployment
■ 2022 Expected Deployment



- ▶ Continued strong single-asset deployment is still expected in 2022 at still ~50% of the overall GP market
- ▶ Some bifurcation in single vs. multi-assets. Smaller subset of large firms actively looking to target single-assets vs. multi-assets (where the survey indicates broader buy-side appetite)

GP-Led Deployment by Geography

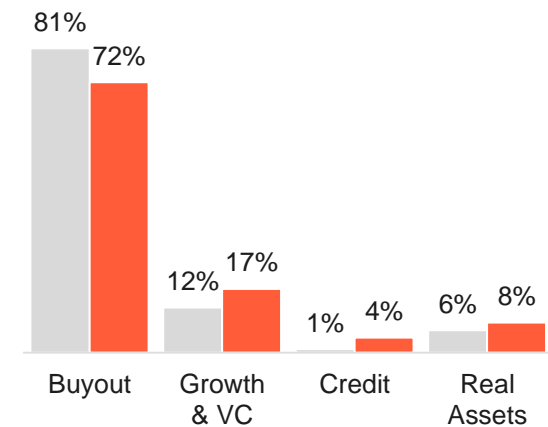
■ 2021 Actual Deployment
■ 2022 Expected Deployment



- ▶ U.S. expected to remain the largest part of the secondary market with a +55% share
- ▶ Some rotation in deployment back to Europe from the U.S. expected in 2022
- ▶ Likely representative of the expected rebound of the European LP-led market in 2022, which was quieter than some expected in 2021

GP-Led Deployment by Sector

■ 2021 Actual Deployment
■ 2022 Expected Deployment



- ▶ Buyout expected to remain the largest part of the market
- ▶ While not a target area for all buy-side firms (some not expecting any deployment), buy-side deployment in VC and Growth deals is still expected to increase in 2022
- ▶ Increased deployment also expected in private credit, infrastructure and real estate

Source: Lazard Private Capital Advisory: Sponsor-led Secondary Market Report 2021, January 2022