

SPOTLIGHT ON COVID-19



HOULIHAN LOKEY

Fund Affiliate
Transactions
During Times
of Market
Disruption



COVID-19 and the sharp drop in energy prices have disrupted the M&A and financing markets. With limited access to traditional third-party transactions, sponsors may pursue “internal” or affiliate transactions to stabilize portfolio companies, manage portfolios, or take advantage of potential distressed M&A opportunities.

Types of Affiliate Transactions During Market Disruptions

Affiliate transactions can be utilized by sponsors as solutions to enhance portfolio company liquidity and manage late-stage fund issues. These transactions can be particularly useful to sponsors during periods of market uncertainty in order to prevent potentially highly dilutive financing transactions or asset sales at depressed valuations. Potential transactions during these periods can include:

- **Portfolio Company Support Financings:** Sponsors may invest new capital into a portfolio company to enhance liquidity and avoid potential defaults. Capital may be invested from a vehicle different than the one holding the portfolio company, and such capital can be in the form of debt, preferred stock, or common equity. Each of these alternatives can impact the economics of co-investors or other shareholders.
- **Portfolio Company Mergers:** Sponsors may combine portfolio companies in the same or adjacent businesses—often held in different funds—to rationalize costs and strengthen the enterprise. Also, an acquisition of a (potentially distressed) target by an existing portfolio company may be funded by a vehicle that is currently in the investment phase.
- **Late-Stage Fund Solutions:** As exits via M&A or GP-led secondary transactions are postponed, sponsors must still deal with funds that are at or near end of life. To avoid requesting an extension and possibly provide investor liquidity, sponsors may choose to either “cross trade” an asset or portfolio to a later vintage fund or structure continuation vehicles to lengthen hold times and allow for operational and valuation recoveries to occur.

Role of an Independent Financial Opinion

- An independent financial advisor can assist sponsors in evaluating the financial and valuation aspects of affiliate transactions.
 - A fairness or valuation opinion assists the GP in satisfying its legal, regulatory, and contractual duties in connection with such transactions and may serve to protect the sponsor from challenge and facilitate discussions about the transaction with the LP advisory committee and co-investors.
- During times of market uncertainty, an independent valuation of the asset(s) subject to a transaction or the evaluation of a security in connection with a related party investment is particularly important to ensure the analysis is up to date and reflects current market conditions.
 - Prior quarterly valuations may not reflect the status of the company's present operations or current market realities.

Recent Relevant Transactions

Houlihan Lokey is a market leader in providing fairness and valuation opinions to sponsors for a wide variety of fund transactions. Recent situations in which Houlihan Lokey has provided independent advice and opinions to sponsors amid business or economic uncertainty include the following:

- A sponsor invested additional capital into an oilfield services portfolio company via a PIK preferred stock. The opinion addressed the financial terms of the preferred.
- A sponsor combined a distressed manufacturer with a similar company acquired by a later vintage fund to enhance capabilities and eliminate costs.
- A GP entity of a sponsor purchased tail-end real estate loans and assets held in a very old fund in order to close out the vehicle after an asset sale fell through.
- A global bank/broker-dealer transferred a c. \$1 billion loan portfolio within the firm to free up regulatory capital.

For more information or to schedule a meeting, please contact us.

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