



HOULIHAN LOKEY

# Fund-Level Transactions: Resilient Through a Turbulent Year

Throughout 2020, we observed a record number of fund-level affiliate transactions. In the first half of the year, as COVID-19 disrupted the markets, we observed sponsors pursuing “internal” or affiliate transactions to stabilize portfolio companies and take advantage of distressed opportunities. Throughout the second half of the year, as confidence and stability returned to the market, we observed a strong rebound in more traditional affiliate transactions.

Regardless of market conditions, affiliate transactions are an important strategy for GPs, and sponsors are undertaking an increasingly wide variety of transactions to optimize their portfolios, retain attractive assets, and manage end-of-life funds. As a result, limited partner advisory committees (LPACs) are increasingly approached by sponsors in connection with such transactions, and sponsors must implement best practices to manage the actual or perceived conflicts of interest. Independent financial advisors can help sponsors mitigate legal and regulatory risk, limit execution risk, and improve the transparency of these transactions.

## Types of Fund Affiliate Transactions

Fund affiliate transactions throughout 2020 have taken many forms—some with a third-party transaction process such as GP-led fund restructurings and many without any arms-length price discovery:

- **GP-Led Portfolio Restructurings:** Transactions involving the sale of some or all of a portfolio remaining in a fund in order to provide investors with a liquidity option and give the sponsor additional time to optimize the assets.
- **GP-Led Single-Asset Transactions:** The sale or recapitalization of a single portfolio company in order to provide investors with the option of near-term liquidity or a longer hold time.
- **Cross-Fund Transactions:** Transactions between related funds, such as the sale of an investment between funds or a merger of portfolio companies owned by different funds.
- **Principal Trades:** Transactions between a GP or fund executive and a related fund or affiliate.
- **Fund Seeding:** The contribution of existing investments into a new fund vehicle prior to an external capital raise.
- **Contractual Arrangements:** Service agreements between portfolio companies or funds.
- **Other End-of-Life Solutions:** A variety of asset assignment strategies to facilitate closing down a fund.

## Key Observations Throughout The Year

**GP-Led Transactions Become Mainstream:** GP-led fund restructurings have continued to gain prevalence in recent years and have now become an accepted path to liquidity for existing portfolios or single assets. According to Greenhill, GP-led transactions accounted for \$26 billion of transaction volume in 2020 in line with 2019 volume, albeit representing a greater share of the market at 44% of total secondary transaction volume.

**Single-Asset Transactions Continue to Grow:** While the multi-asset GP-led transaction is still the most predominant, single-asset transactions continued their upward trajectory throughout 2020. These transactions have become a useful tool to allow sponsors the ability to provide existing investors with a liquidity option while enabling the sponsor to retain a key asset for the benefit of its broader investor base. According to Greenhill, the proportion of single-asset transactions contributed to 31% of GP-led volume, representing an increase of 5% compared to 2019.

**Significant Growth in Cross-Fund Transactions:** Sponsors today have increasingly complex fund family dynamics as they manage multiple asset classes, maintain concurrent active funds, and have increased co-investor participation. As a result, sponsors have continued to explore an ever-increasing set of transactions to manage portfolios. In 2020, we observed a record number of transactions that crossed funds or otherwise placed the sponsor in a potential conflict-of-interest position (e.g., mergers of portfolio companies held in different funds, sales of portfolio companies from older vintage funds to a newer fund, acquisitions of third-party targets by portfolio companies in which equity capital is provided by a subsequent fund, etc.).

**Growing Complexity in Cross-Fund Transactions:** In addition to the transaction types listed above, sponsors are increasingly pursuing more complex cross-fund transactions to optimize opportunities. Throughout the year, we observed numerous situations with highly complex transaction structures, including:

- i. **Buy-and-Split Transactions:** Sponsor acquires a third-party target, splits the target into two or more distinct companies or “perimeters,” and either merges the newly formed perimeters with existing portfolio companies or becomes an independent portfolio company.
- ii. **Roll-Up IPO or SPAC Sales:** Sponsor merges several portfolio companies into a combined entity and then takes the “CombinedCo” public via an IPO or sale to a SPAC.
- iii. **Fund Mergers:** Sponsor combines the assets from two or more existing funds into a single fund (open or closed-end) with an indefinite life.

**LPs, LPACs, and Co-Investors Seek Advisors:** Investors are increasingly looking to hire their own financial advisors to help navigate the challenges of complex and conflict-prone situations. Examples of these situations include: (i) LPs/LPACs seeking advice on key issues in advance of a public listing (e.g., liquidity issues, lockup provisions, crystallization of carried interest, valuation considerations, etc.); (ii) co-investors seeking buy-side support in advance of a significant direct investment opportunity (e.g., financial modeling support, valuation analytics, exit opportunity assessment, etc.); and (iii) LPACs seeking analysis around a sale process run by a sponsor (e.g., overview of the process, analysis of certain economic aspects of bids received, proposed allocation of value between the GP and LPs, etc.).

**Positive Momentum for 2021:** Despite COVID-19, 2020 was a record year for secondary fundraising. Additionally, while U.S. PE fundraising is on track to slow modestly in 2020, dampened by the pandemic, it is expected to rebound next year, surpassing the \$316.9 billion high-water mark set in 2019. With significant dry powder for both secondaries funds and newly launched PE funds, we expect continued growth in fund-level transactions.

## Fiduciary Considerations for Sponsors

Fund affiliate transactions present potential conflicts of interest, valuation complexities, and enhanced execution risk. Such transactions are expected to come under heightened scrutiny in the coming years given (i) recent changes to the regulatory environment and (ii) increased investor oversight.

- i. The Biden administration and new leadership at the SEC are expected to bring substantive changes on the regulatory front. In general, market participants can expect the SEC to be more aggressive, and the following years are likely to bring an increase in enforcement activity. Both public and private funds should anticipate greater scrutiny related to a number of topics, including conflicts of interest and valuation disclosures.
- ii. As affiliate transactions continue to gain widespread adoption, funds' investors or LPACs are regularly approached to waive conflicts. We expect investors will continue to increase their oversight of these transaction processes.

As investors and regulators increase examination of affiliate transactions, sponsors must implement best practices to manage the actual or perceived conflicts of interest. An independent financial advisor can assist sponsors in satisfying their legal, regulatory, and contractual duties in connection with an affiliate transaction. Fairness or valuation opinions may serve to both protect the sponsor and facilitate discussions about the transaction with the LPAC and other parties. The receipt of independent advice and a financial opinion by a sponsor in affiliate transactions has become a widely adopted best practice.

# Selected Houlihan Lokey 2020 Transactions

Houlihan Lokey has been at the forefront of providing fairness opinions to sponsors in many of the largest and most complex affiliate transactions. We assisted dozens of sponsors in 2020 across a wide range of GP-led portfolio, single-asset, and cross-fund transactions.

<p><b>Audax Private Equity</b> has completed its first Continuation Fund. The Continuation Fund is comprised of \$1.7 billion in capital commitments, which funded the purchase of portfolio companies from Audax Private Equity Fund IV. The transaction was led by Alpinvest Partners, Lexington Partners, and Hamilton Lane</p> <p><b>Largest Portfolio Companies:</b>      </p> <p>Fairness Opinion</p>	<p><b>CAMDEN PARTNERS</b> Camden Partners Strategic Fund V, L.P. and certain affiliated funds have contributed certain investments to a new investment vehicle capitalized by Origami Capital Partners, LLC</p> <p>Fairness Opinion</p>	<p><b>ColonyCapital</b> has agreed to acquire an equity interest in <b>Vantage YieldCo</b> consisting of certain stabilized hyperscale data center assets of </p> <p>Fairness Opinion</p>	<p>Funds managed by <b>DOMINUS CAPITAL</b> have entered into an agreement to combine  and </p> <p>Fairness Opinions</p>	<p><b>GIZA VENTURE CAPITAL</b> has transferred interests in five portfolio companies to Giza V Continuation Fund, providing Limited Partners with a cash distribution option</p> <p>Fairness Opinion</p>	<p>Funds managed by <b>HELLMAN &amp; FRIEDMAN</b> have transferred certain ownership interests in  to affiliated funds</p> <p>Fairness Opinion</p>
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<p> has completed an all-equity consolidation of the company's three predecessor entities and received an increase to its total equity commitment from funds managed by <b>Kayne Anderson Capital Advisors, L.P.</b></p> <p>Valuation Opinion</p>	<p><b>PERMIRA</b> has transferred four assets into a new investment vehicle capitalized by <b>Coller Capital</b></p> <p>Fairness Opinion</p>	<p>Funds managed by <b>REDBIRD CAPITAL PARTNERS</b> have sold certain assets of  to <b>Vida Capital</b></p> <p>Financial Opinion</p>	<p>Funds managed by <b>REVELSTOKE CAPITAL PARTNERS</b> have engaged in a recapitalization transaction involving <b>FAST PACE HEALTH</b> <b>URGENT CARE</b></p> <p>Fairness Opinion</p>	<p>Funds managed by affiliates of <b>ROARK CAPITAL GROUP</b> have entered into an agreement for <b>INSPIRE Brands</b> to acquire <b>DUNKIN' BRANDS.</b></p> <p>Fairness Opinion</p>	<p><b>SIRIS Capital Group, LLC</b> has completed strategic equity investment in  in connection with its recapitalization and spin-off from </p> <p>Financial Advisory Services</p>
<p><b>web.com</b> a portfolio company of <b>SIRIS Capital Group, LLC</b> has merged with the Web Presence business of  to form <b>newfold digital</b></p> <p>Financial Advisory Services</p>	<p>Funds managed by <b>STONE POINT CAPITAL</b> have engaged in a recapitalization transaction involving <b>Alliant</b></p> <p>Fairness Opinion</p>	<p>Funds managed by <b>STONE POINT CAPITAL</b> have engaged in a recapitalization transaction involving </p> <p>Fairness Opinion</p>	<p>Funds managed by <b>STONE POINT CAPITAL</b> have engaged in a recapitalization transaction involving <b>PRIMA Capital Advisors LLC</b></p> <p>Fairness Opinion</p>	<p><b>cambium LEARNING GROUP</b> a portfolio company of <b>VERITAS CAPITAL</b> has acquired <b>Rosetta Stone</b></p> <p>Financial Opinion</p>	<p>Funds managed by <b>Westport Capital Partners LLC</b> have sold certain ownership interests in  to affiliated funds</p> <p>Fairness Opinion</p>

## Partnering With the Right Advisor

Houlihan Lokey is the market leader in providing valuation and fairness opinions to sponsors in connection with affiliate transactions. We have provided these opinions to leading sponsors in connection with fund transfer, fund restructuring, and other portfolio company transactions over the past several years. Our Fund Opinions team can leverage Houlihan Lokey's broad capabilities during an affiliate transaction in ways unlike any other advisor. These capabilities include:

- **No. 1 Global M&A Fairness Opinion Advisor Over the Past 20 Years**
- **No. 1 M&A Advisor for All U.S. Transactions**
- **No. 1 Global Investment Banking Restructuring Advisor**
- **Named Best Valuations Firm for Hard to Value Assets by HFM's U.S. Services Awards in 2020**
- **13 sector teams with deep industry expertise**
- **Among the largest Financial Sponsors Group and Capital Markets practices with unique access to investors and insights**

These capabilities provide an unparalleled offering to the market and distinguish Houlihan Lokey as a trusted advisor to both GPs and LPs.

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