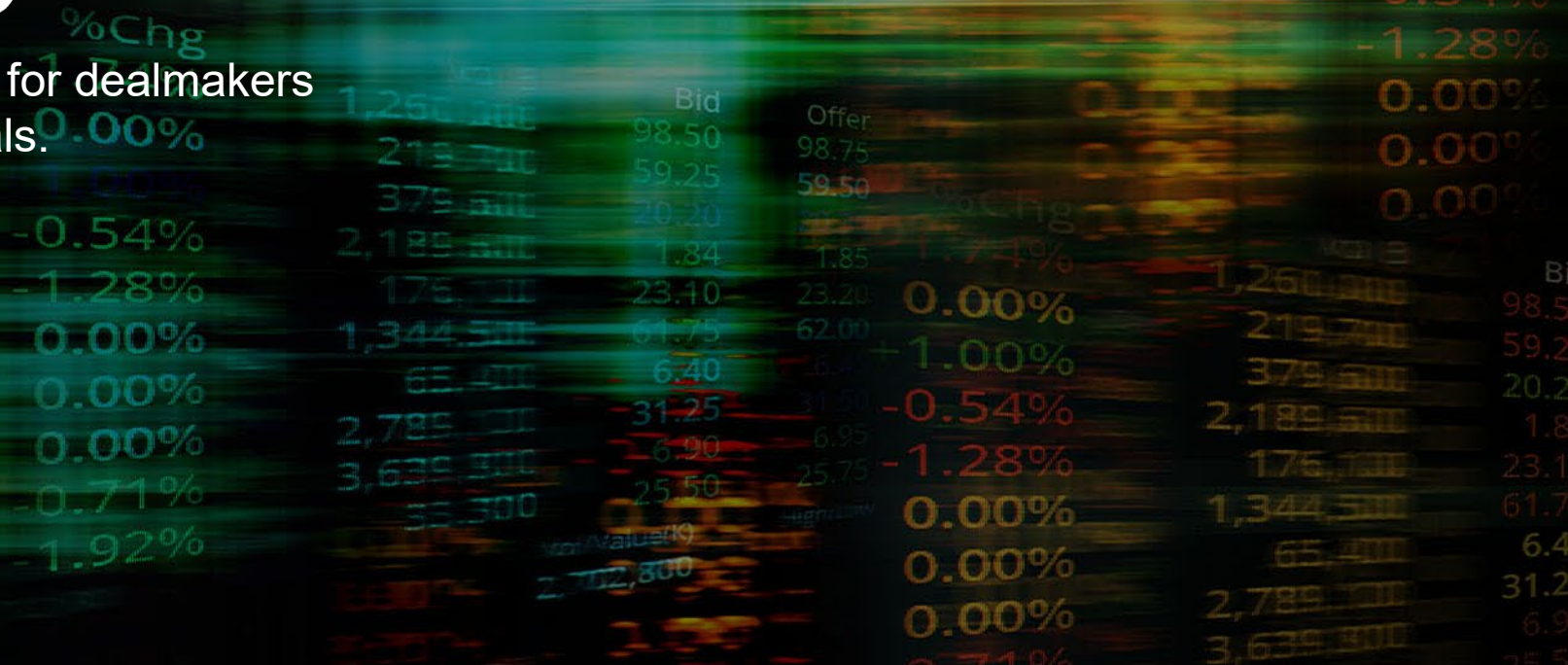


PRIVATE CAPITAL CONFERENCE SERIES

# Private Equity Academy

A series of masterclasses designed for dealmakers and other private equity professionals.

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# Meet Your Presenters

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**Liam Arthur**

Partner  
Private Equity M&A

+44.20.7280.2182

[larthur@proskauer.com](mailto:larthur@proskauer.com)



**Adam Creed**

Partner  
Private Equity M&A

+44.20.7280.2020

[acreed@proskauer.com](mailto:acreed@proskauer.com)



**Nick Wardle**

Associate  
Private Equity M&A

+44.20.7280.2246

[nwardle@proskauer.com](mailto:nwardle@proskauer.com)

# Introduction

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## Sponsor perspective on equity documents – control investment

- 3 key topics:
  - **Liquidity**
    - ability for sponsor to realise value for all parties, ultimately via an Exit
  - **Governance**
    - ability to control company at board and shareholder level and protect investment
  - **Incentivisation**
    - ability to incentivise current and future management to drive value

Over the next 45 minutes, we will focus on the first of these – ***the ability to achieve an Exit***

- Transferability of equity, the rights of various stakeholders, and the conditions under which Exits can occur
- Explore each of these aspects, providing context, market norms, and examples to illustrate the complexities involved
- Not just legal formalities; key to a successful Exit strategy

# Sponsor Viewpoint

## Core Principle

- Ability to Exit from the investment should not be hindered, impeded or fettered in any way

- **Freely transferable shares**
- **Right for sponsors to force an exit by way of an IPO or sale**
- **Control of the exit process**



# Transferability

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- **Sponsor Transferability:**  
Ability to freely transfer securities subject only to customary tag along rights for management and minorities
  - Tag: proportionate or full?
  - Syndication right?
- **Control timing and form of Exit**
- **Transferability for Others:**  
For other shareholders, such as minority investors or management, the ability to transfer shares is significantly restricted:
  - prevent unwanted third parties from becoming stakeholders
  - maintain the stability of the company's ownership
  - maintain economic alignment of economic interest



# Investor and Management Roles in an Exit

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- Investor dictates timing, structure, pricing and other terms and conditions of any Exit.
- Investor engages advisers.
- Management ensure that such actions are taken as requested of them to achieve the Exit.
- Extensive obligations on Management at Exit including preparing the marketing materials, VDD reports, participating in Q&A sessions and providing a customary warranty package.
- Co-operation and collaboration between Investor and Management is often vital for a successful Exit.
- Must be no ability for Management to fetter or hinder the Exit timetable or process.

# Management Rollover

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- Expectation that management roll a portion of their equity into the new or continuing entity post-exit.
- This aligns their interests with the new owners and can be a condition for the deal.
- The market views this as a standard expectation, although the specifics can vary based on the negotiation strength of the management team and the dynamics of the deal.



# Management Rollover (cont.)



- Management equity, and sweet in particular, is primarily for alignment and incentivisation.
- Separate classes of shares and protected class rights create a potential for minority holdouts and roadblocks to exit.
- As a rule, these should be minimised, e.g., by stipulating that the sponsor and management strip equity are treated as a single class, perhaps with limited carve outs to protect management's fundamental rights.
- This point should also be considered in relation to any other instruments – e.g., loan notes.

# Exit for Sweet?

- When less than 100% of the company is sold, the treatment of sweet equity can vary.
- The terms of the sweet equity often dictate whether management can participate in a partial exit.
- Market norms can differ, but generally, there is a preference for allowing management to realize some liquidity in such scenarios, provided it does not disrupt the overall exit strategy.



# Drag Along



## Ability to Drag

- The "drag-along" right is a powerful tool for the sponsor to compel minority shareholders to join in the sale of a company
- Ensures that a potential buyer can acquire 100% of the company without holdouts.
- In practice, the drag-along provision is a standard feature in equity documentation, reflecting the market's recognition of its importance in facilitating clean exits.

# Drag Along (cont.)

## Cash vs Non-Cash Consideration

- Drag-along rights often come with stipulations regarding the form of consideration, such as cash or stock of the acquiring company.
- Preference for cash consideration is prevalent, as it provides immediate liquidity for the shareholders being dragged.
- However, non-cash consideration can be negotiated, and liquid, marketable securities can reasonably be accepted by most sellers.

## Underwater Drags

- Treatment of loan notes/other instruments where value breaks above the equity



# Is a Continuation Fund an Exit?



- A sale to a continuation vehicle (CV) is a nuanced form of exit and can be a way to extend the investment period for a successful asset.
- While not a traditional exit, it does provide partial liquidity and can reset the clock on the investment horizon.
- The market view on CVs as exits is mixed, but sponsor-friendly equity documents tend to be permissive.
- Commercial question as to whether economics of management sweet should be triggered as if on a true exit.
- Is carry triggered?

# Exit in IPO Context

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- Significant liquidity event and a path to exit for PE sponsors.
- Customary lock-up agreements that delay full liquidity, while management and other shareholders might have different terms
- Consideration given to how the existing share classes receive their entitlements through a single class post-IPO<sup>1</sup>

## Ability to effect IPO is key:

- Ability to require minority shareholders to transfer shareholding to a newly formed entity for listing
- Reorganisation of existing equity classes into a single class for the IPO (exception to class rights?)
- Obligations on management to participate in roadshows and generally cooperate with IPO process
- Obligation to agree to “customary” lock ups or other restrictions

# Conclusion

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