

Proskauer's Secondaries School: GP-leds & Continuation Funds

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Proskauer»

Welcome



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Agenda – Before the break



Introduction to GP-Led Transactions: The Spectrum of Options



Introduction to Continuation Funds

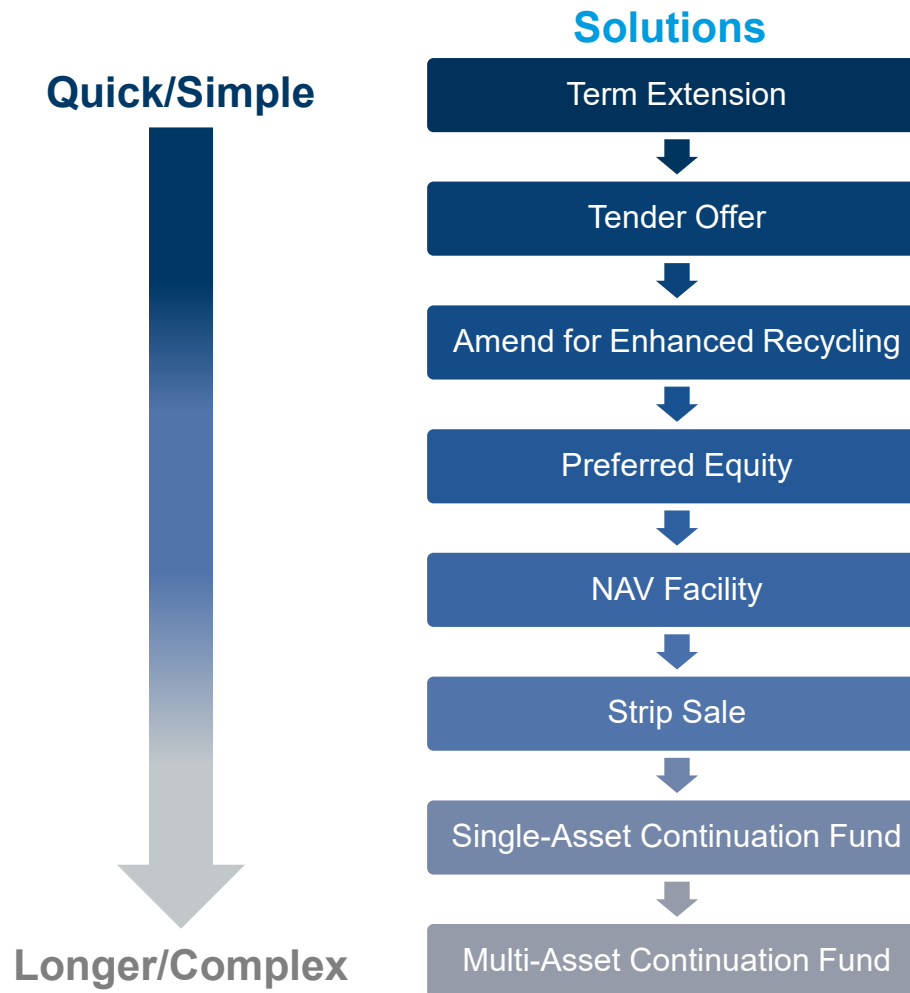


Continuation Fund Stakeholders: Goals & Concerns

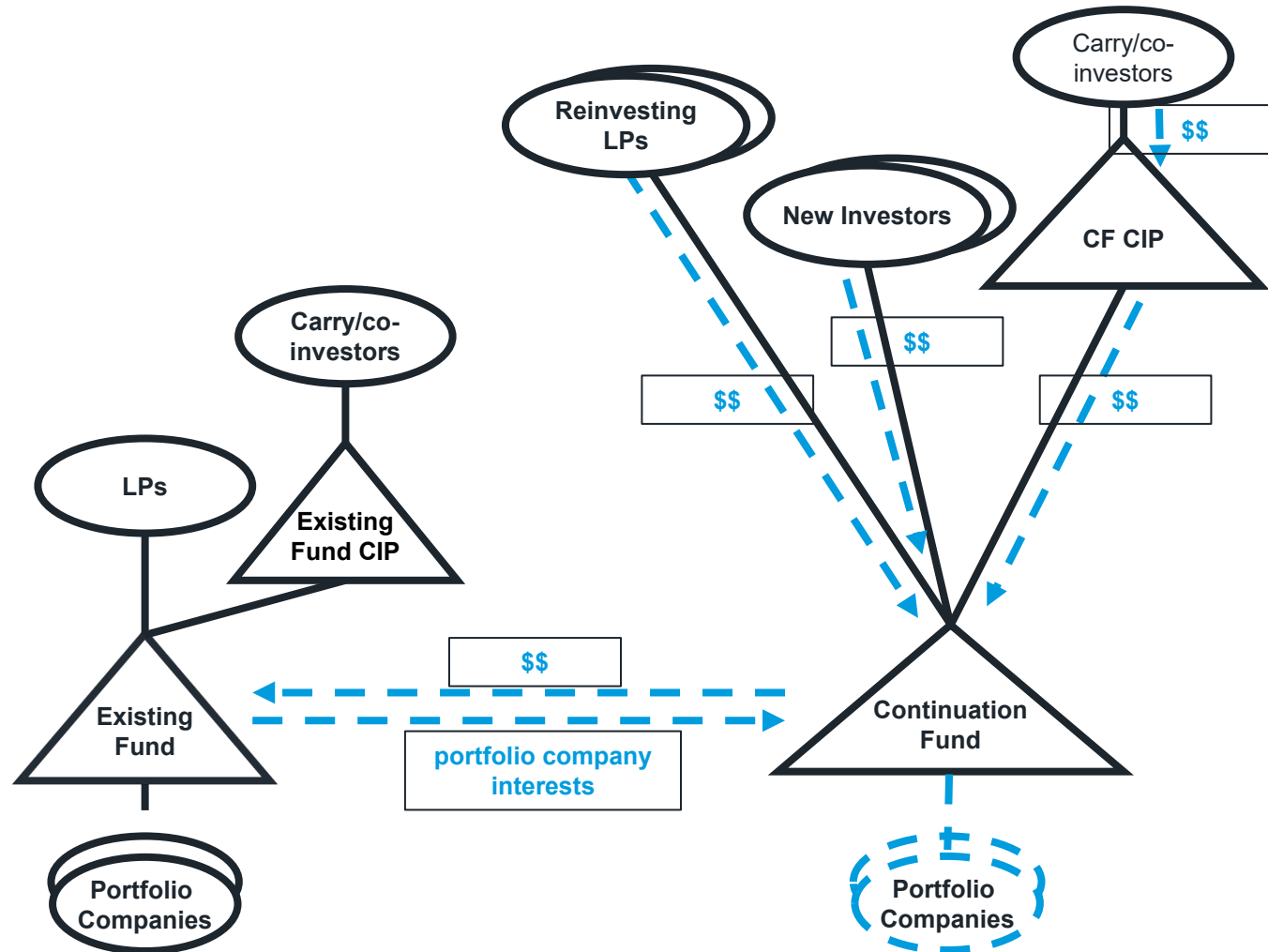


Economic Concepts

GP-Led Transactions Options at-a-Glance



Continuation Funds: Rationale; Pros & Cons



Key Risks

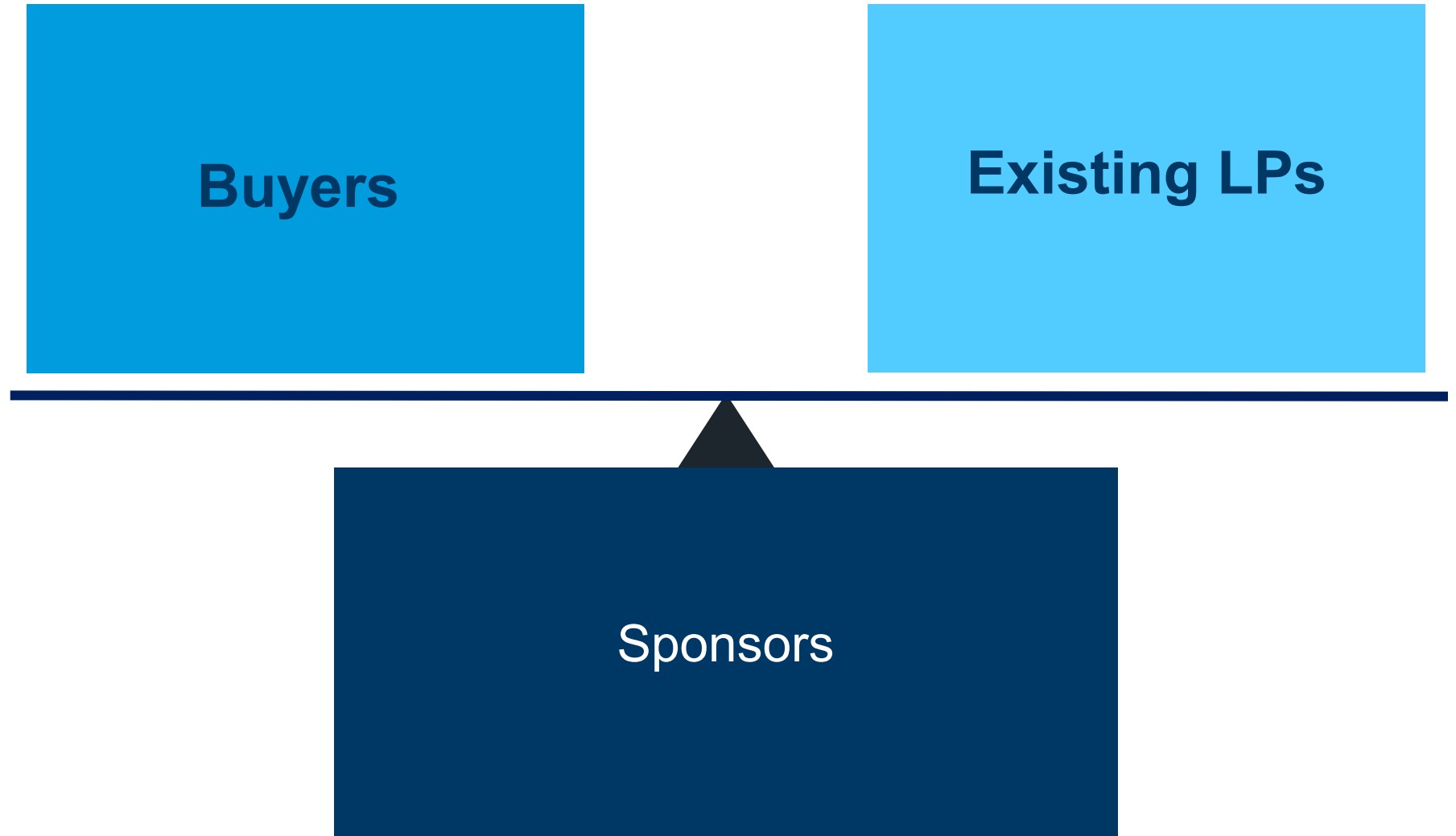


Fiduciary issues and
conflicts of interest

LPAC / LP
engagement and
consent

Tax structuring
and regulatory
considerations

Stakeholders



Economic Interests: General Concepts

Crystallized Carry

The value of carried interest as *finally determined* based on a distribution of the target portfolio companies (valued at the negotiated transaction value) by the original fund pursuant to the fund waterfall.

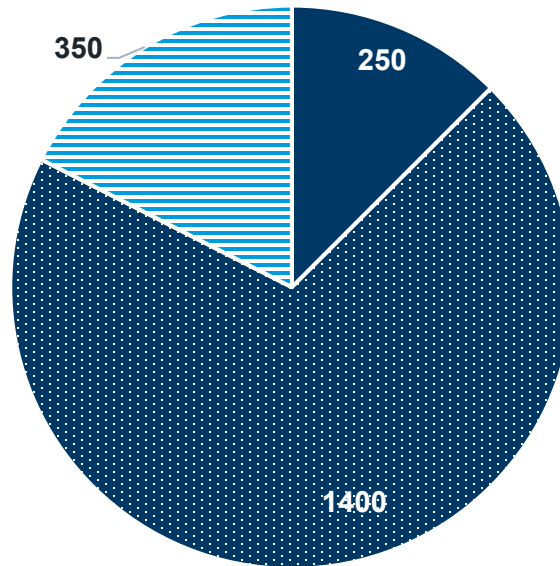
- Selling LPs
 - GP crystallizes carry
- Rolling LPs (new economic deal)
 - GP crystallizes carry
- Status Quo LP
 - ***GP does not crystallize carry***

Economic Impact of Crystalizing Carry: An Example

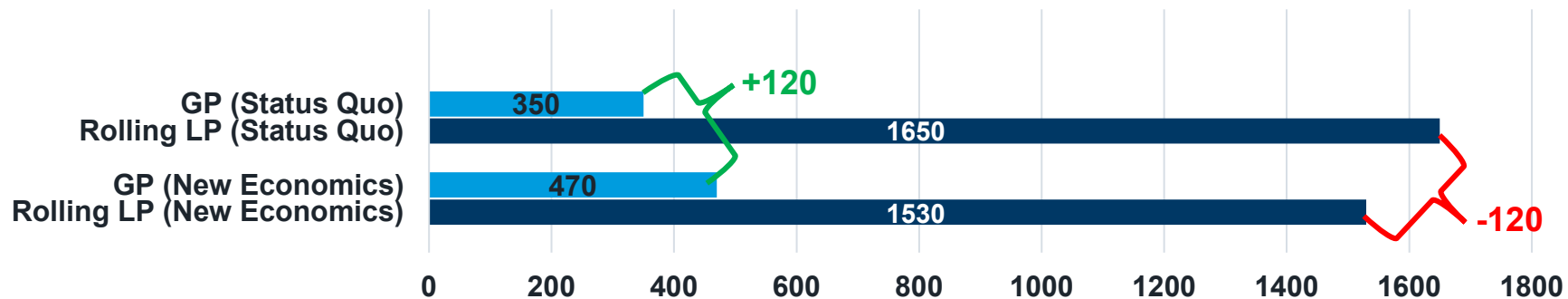
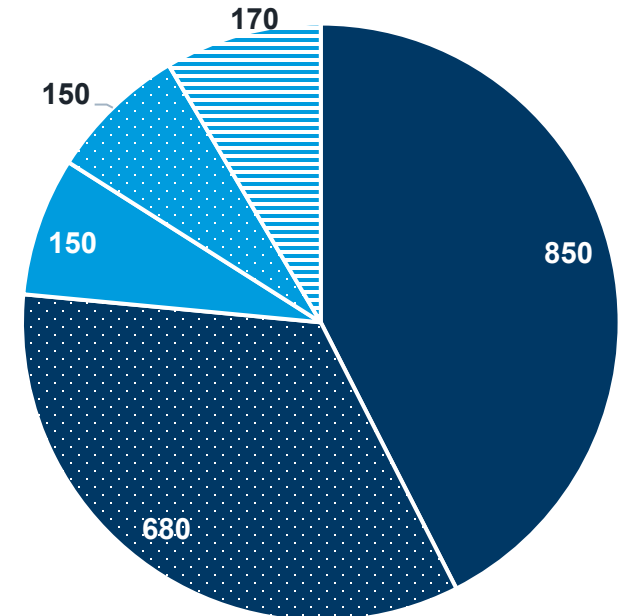
- Cost of target asset = 500
- Continuation fund transaction value = 2000
- Future gain (in CF) = 2000
 - Value of target asset at exit = 4000
- The carry rates for original fund and continuation fund = 20%
 - Assume no IRR/MOIC hurdles to carry
- LP elections: 50% sell & 50% roll

Economic Impact of Crystalizing Carry: Base Case

50% Status Quo Roll



50% Roll Into New Economics

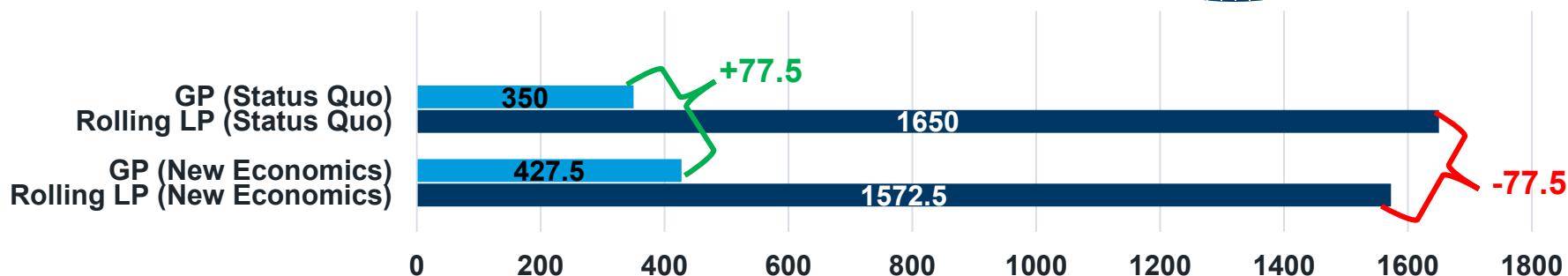
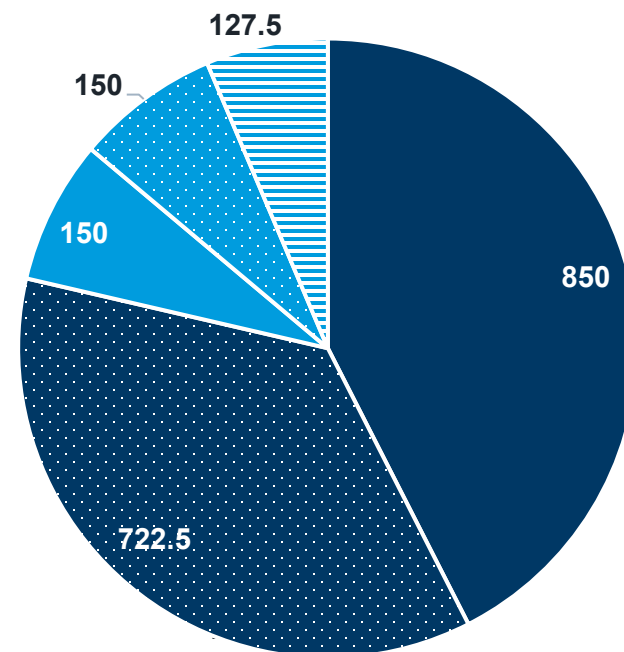
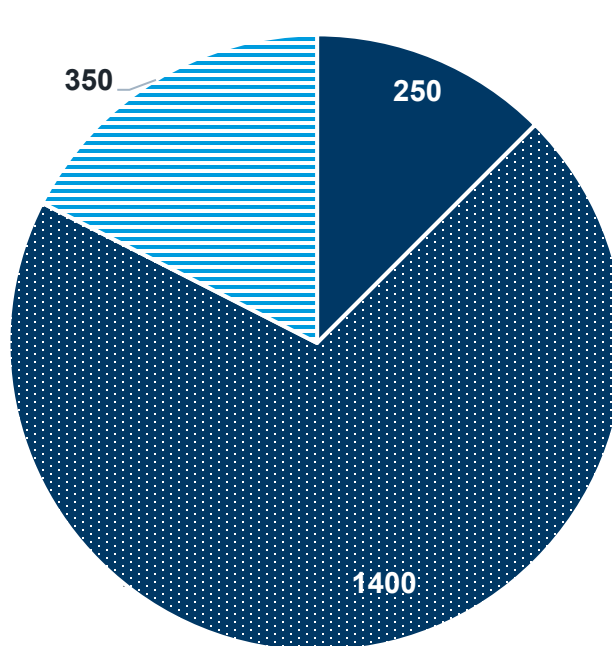


Economic Impact of Crystalizing Carry: Impactful Even When Carry Rate in Continuation Fund is Reduced

50% Status Quo Roll

50% Roll Into New Economics

- Rolling LPs
- GP (in respect of Rolling LPs)
- New LP
- GP (in respect of Selling / New LPs)
- Capital/Crystallized Carry
- Return on Capital/CC
- ≡ Carried Interest



Questions and Coffee Break

After the break:

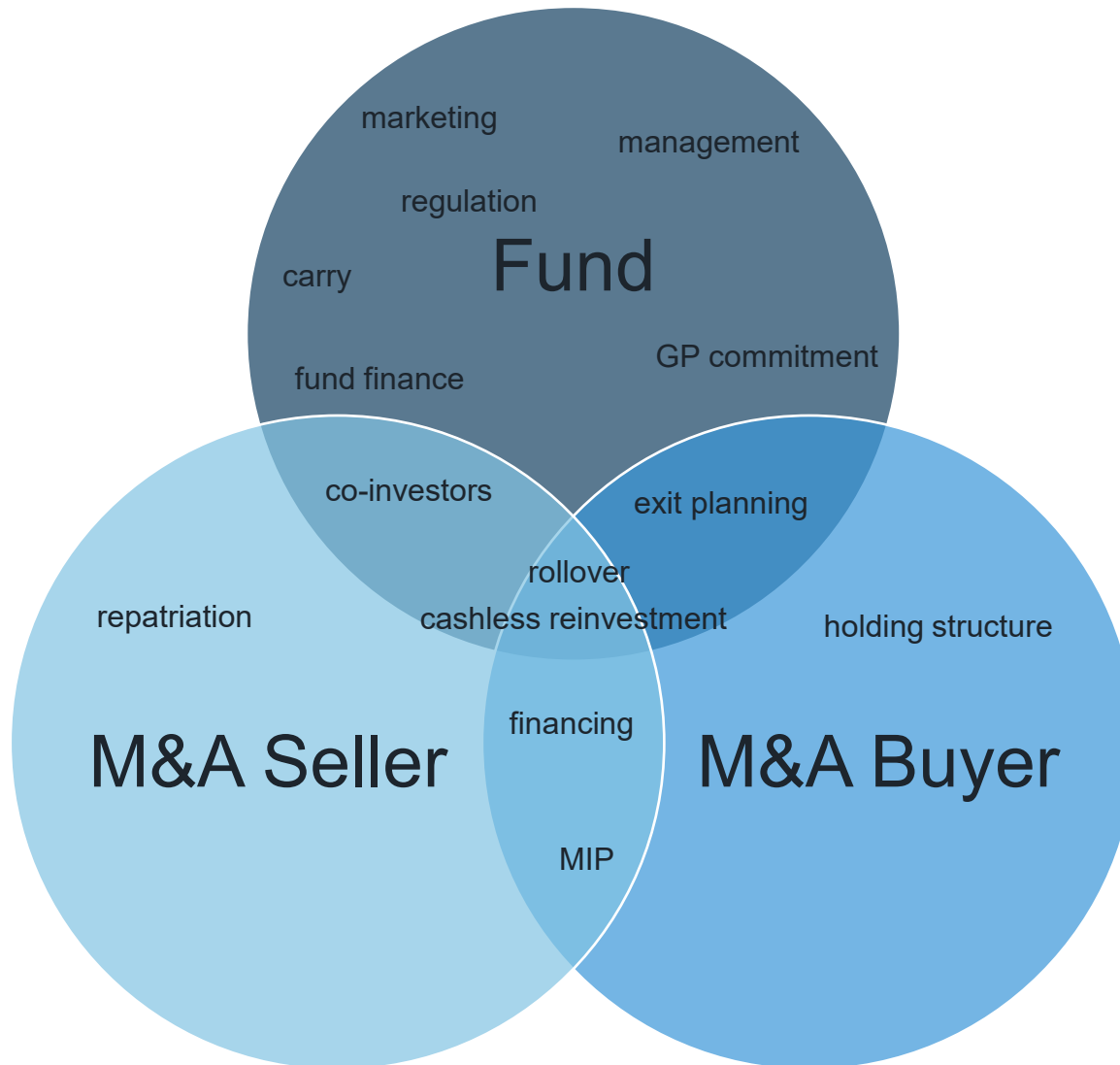
Structuring Continuation Funds

Process & Documentation

Key Fund Terms & Considerations

Key Transaction Terms & Considerations

Structuring Continuation Funds



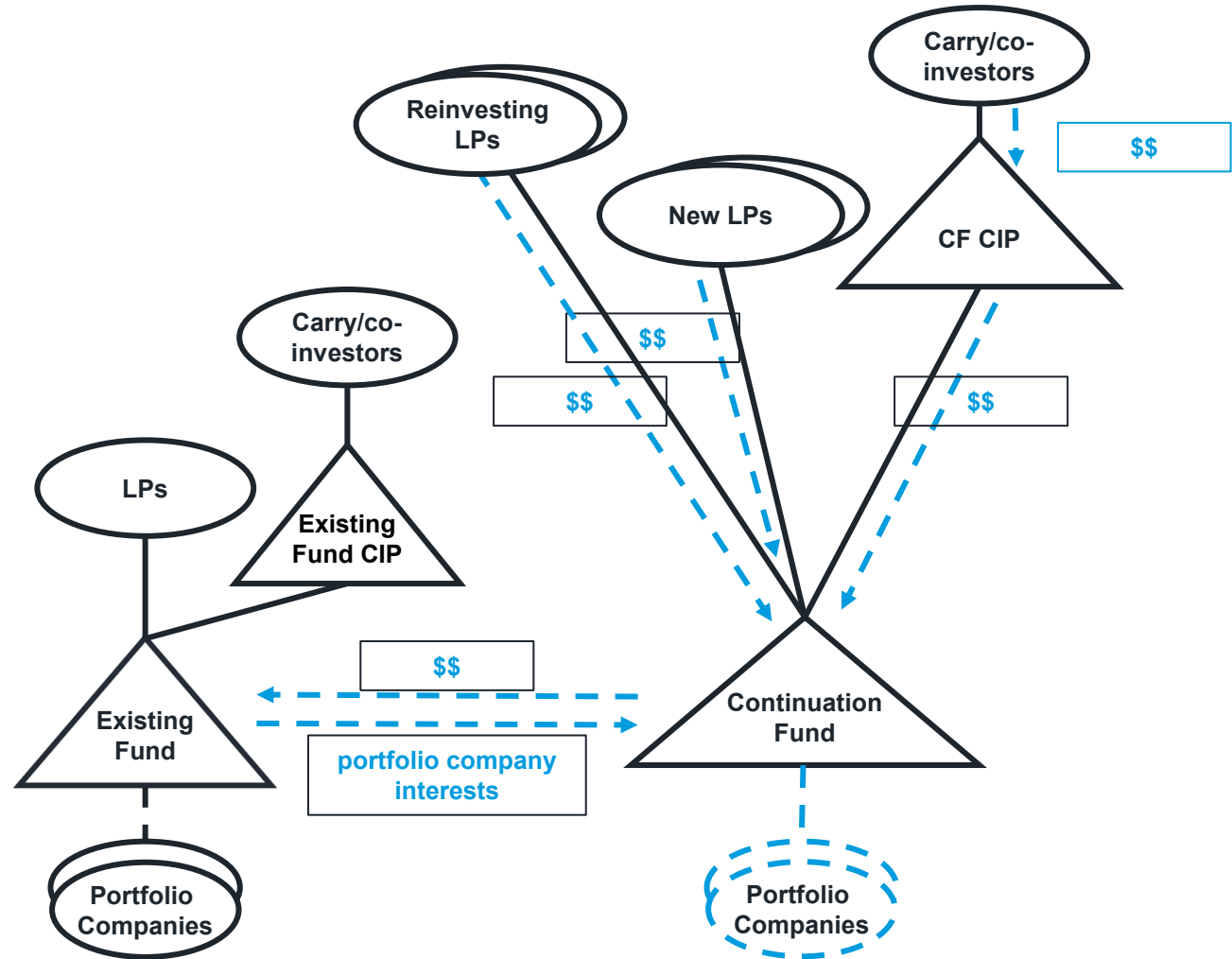
Cash Sale Structure

- **Pros**

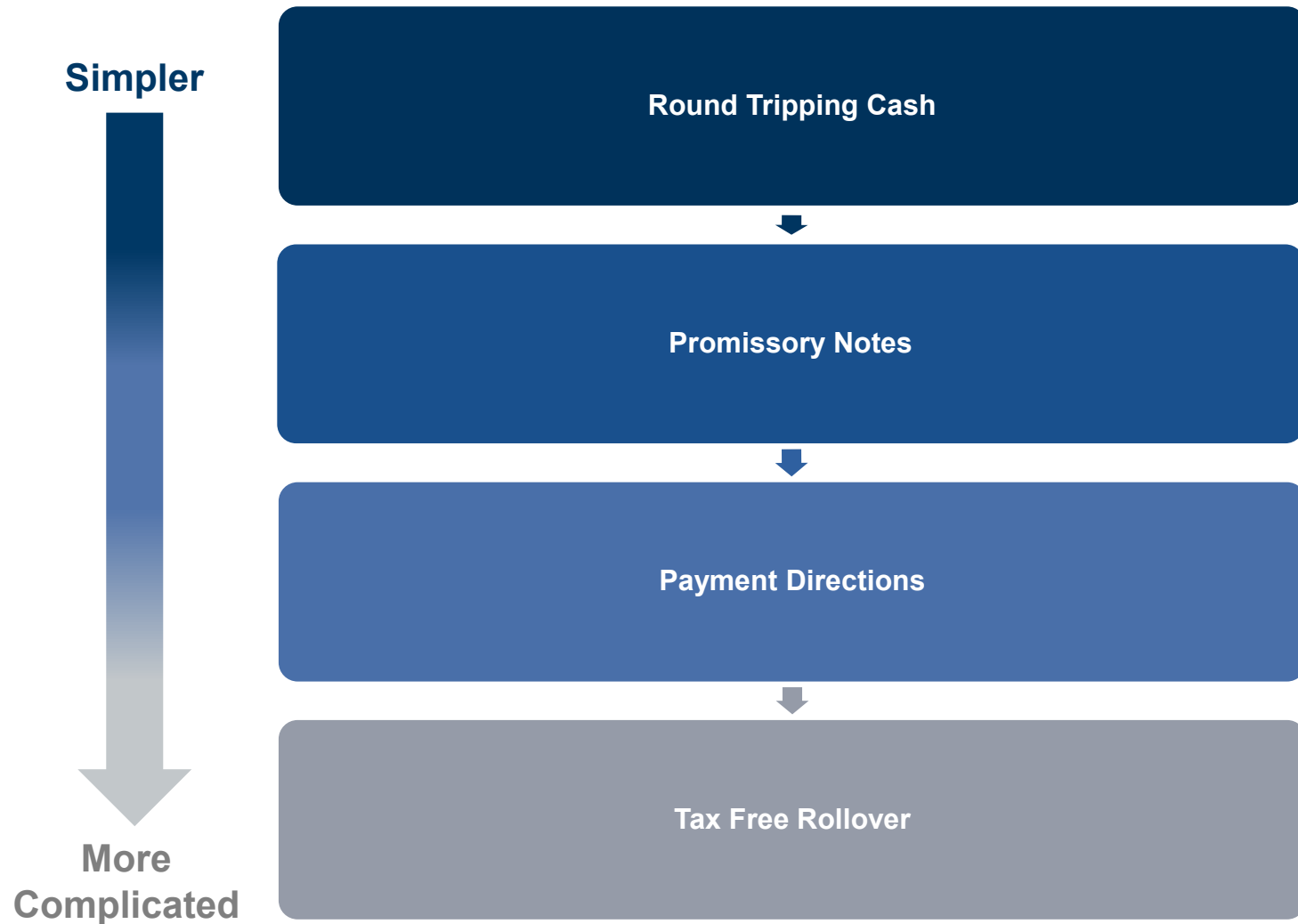
- Simplicity.
- Taxable to investors.

- **Cons**

- Taxable to investors.
- Cashflow issues for reinvesting LPs.



Reinvestment Options



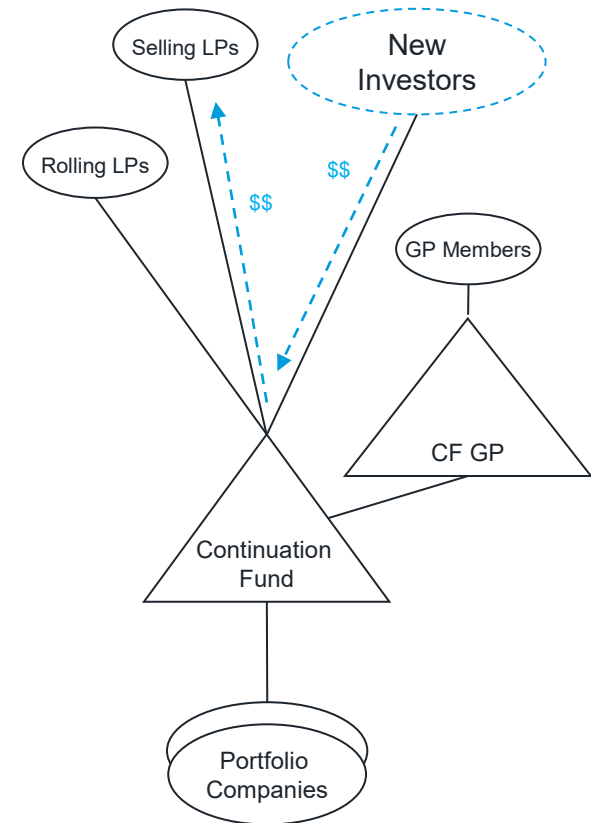
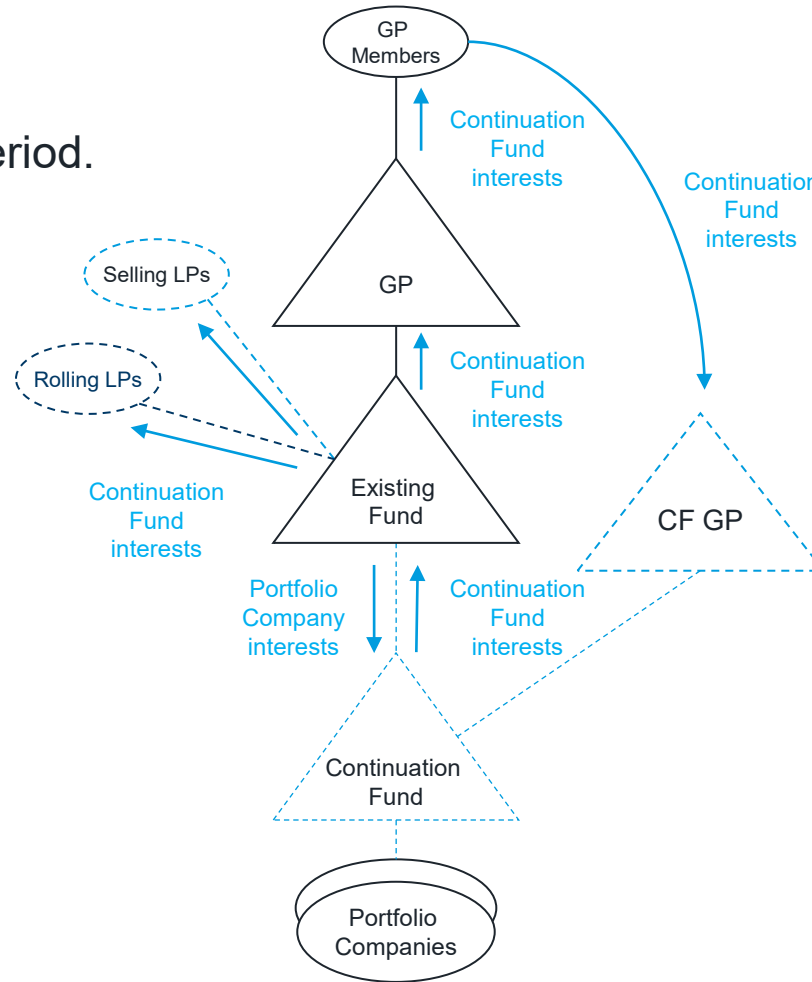
U.S. Tax-Free Rollover

- **Pros**

- Tax-free rollover.
- Tacked holding period.

- **Cons**

- Complexity.
- Withholding tax considerations.

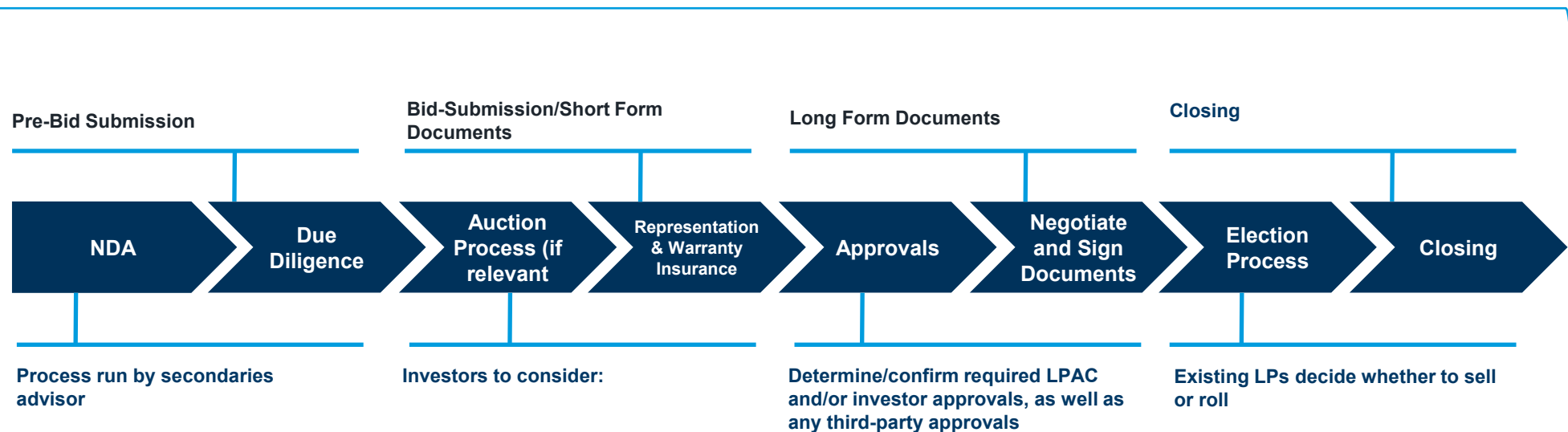


How U.S. Blockers Can Impact Economics

- Corporate tax on sale of target assets out of the blocker.
 - Up to 44.7% tax drag (based on current tax rates).
- Magnitude of unrealized gain in the blocker.
- Size of blocked interest being acquired relative to total transaction value.
- Ability of new investors to make future investments/follow-on investments unblocked.
- Blocker sale covenants.
- Where the sponsor takes its new carried interest pre- and post-transaction.
 - Above the blocker (i.e., net of any applicable blocker taxes)?
 - Below the blocker?
- Purchase price discount?

Indicative Timeline: Continuation Fund

Typically 3-6 months (for buy side)



Key Fund Terms – Commitments



**Allocation of
commitments**

**Purchase price
commitment**

**Unfunded
commitments**

Key Fund Terms – Expense Sharing



Seller expenses

**Continuation fund
expenses**

**Transaction
expenses**

Key Fund Terms – Economics



**Distribution
waterfall**

**Management
fee**

**Borrowing and
indebtedness**

**Recycling /
Reinvestment**

Continuation Funds – Dilution & Governance





Questions?

Key Transaction Terms & Considerations

Key Transaction Terms – Sources of Recovery and Limitations

CONSIDERATION

COMMENTS

Source of Recovery

- Warranty & Indemnity Insurance
- Holdbacks

Limitations of Liability

- Non-Fundamental Warranties: Tipping Basket v. Deductible
 - Non-Fundamental Warranties: Cap and Survival Period
 - Fundamental Warranties: Cap and Survival Period
 - Excluded Obligations
 - Fraud
-

Key Transaction Terms – Warranties and Excluded Obligations

CONSIDERATION	COMMENTS
Scope of Warranty Coverage	<ul style="list-style-type: none">• Fundamental Warranties• Non-Fundamental Warranties• Disclosure
Definition of “Knowledge Parties”	<ul style="list-style-type: none">• Identity of Individuals
Excluded Obligations	<ul style="list-style-type: none">• Excluded Obligations• Excluded Tax Liabilities

Key Transaction Terms – Closing Conditions and Tax Covenants

CONSIDERATION

COMMENTS

Customary Closing Conditions

- **Customary Examples of Closing Conditions:**
 - Expiry of election period and receipt of required level of financial commitment
 - Receipt of all anti-trust/regulatory approvals
 - Approval of limited partners
 - No laws prohibiting the transaction
 - Fundamental warranties being true as at signing and closing, and no material breach of non-fundamental warranties
 - Receipt of W&I policy
 - No event of default under any group financing arrangements

Tax Covenants

- 754 election (if applicable)
 - Push-out election for pre-closing partnership tax liabilities imposed on audit (if applicable)
-



Questions?

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First for Market Insights



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