
Proskauer» The Sports Law Firm
2020
SPORTS LAW
CLE SERIES
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Webinar Series

Emerging Capital Structures in Sports

Introductory Remarks

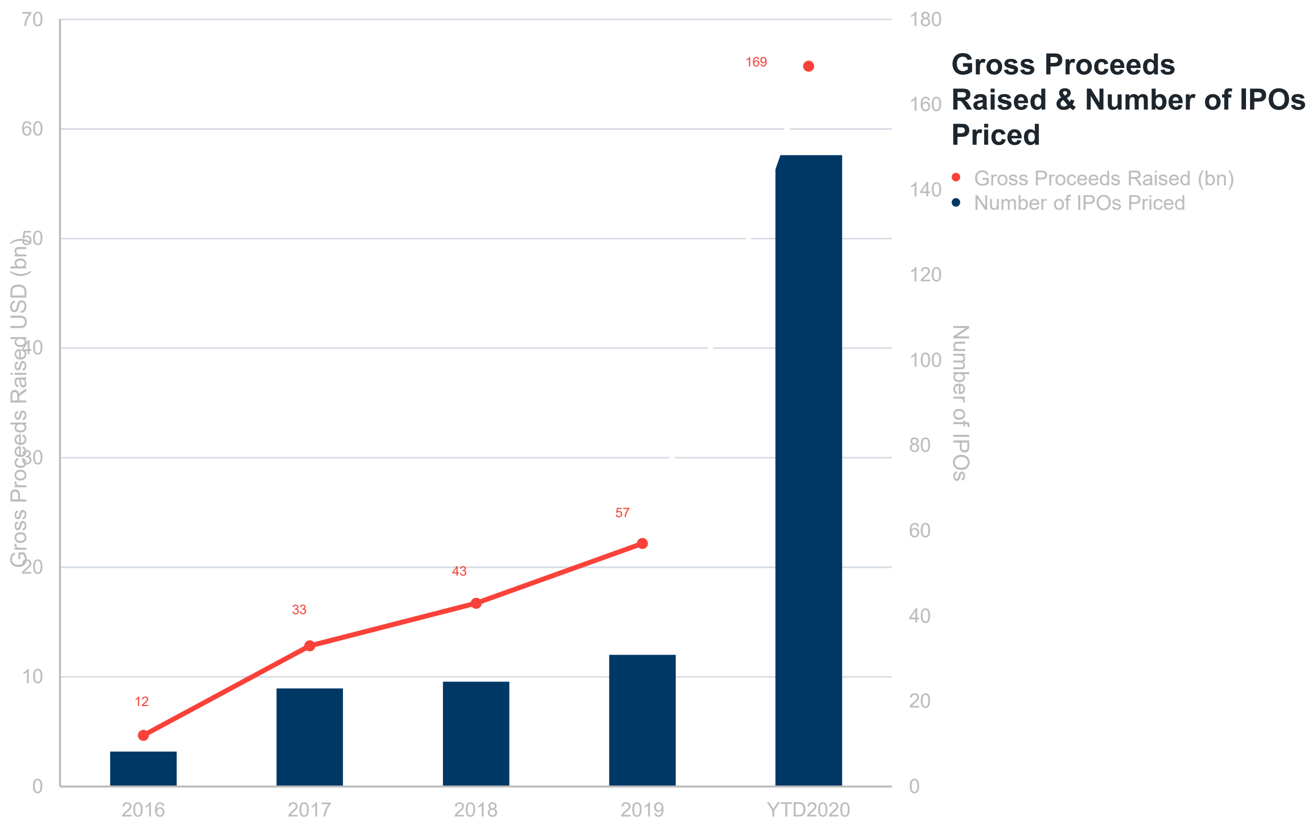
SPACs and Private Investment Funds

- SPACs
  - Some history of public company ownership of sports teams
  - Large “Diversified” public companies v. “Pure Plays”
  - Most “Diversifieds” divested and most “Pure Plays” went private
- PIFs
  - Much more limited history of sports ownership due to past PIF norms and league rules
  - Both Funds and Sports are evolving
- Why are both SPACs and Funds now interested in Sports?

Emerging Capital Structures in Sports

Special Purpose Acquisition Companies (SPACs)

Market Activity Overview



Source: Dealogic

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Market Activity Overview

There are currently over

175 SPACs

actively seeking targets with over

$60 billion

in dry powder for acquisitions.

Source: SPAC Research

Market Activity Overview

- Active sports-focused SPACs include:
  - Acies Acquisition Corp.
  - Ascendant Digital Acquisition Corp (eSports)
  - Bull Horn Holdings Corp.
  - Redball Acquisition Corp.
  - Sports Entertainment Acquisition Corp.
  - Tekkorp Digital Acquisition Corp.
  - Vistas Media Acquisition (eSports)

Source: SPAC Research

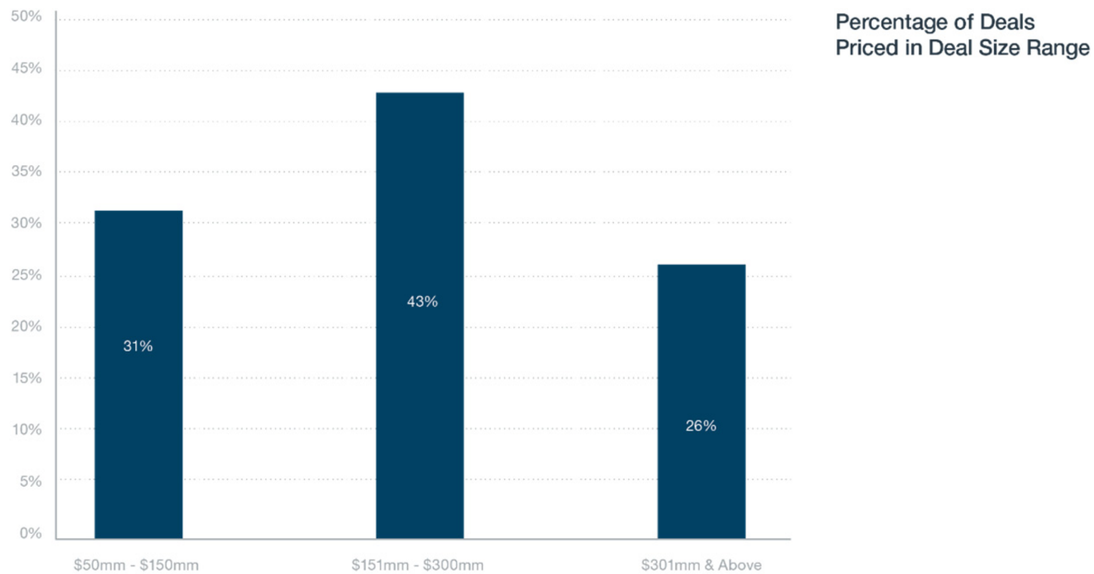
SPAC Basics

- A special purpose acquisition company (SPAC) is formed for the purpose of raising capital through an IPO and using those funds to acquire an operating business.
- SPACs bring together experienced management teams, often comprising industry veterans, private equity sponsors or other financing experts who can leverage their expertise to raise capital to acquire, then operate, a new public company.
- Within 24 months or less, a SPAC will seek out an attractive company to acquire and, once that transaction is completed, a new publicly traded company is formed.
- If a transaction is not completed within the allotted time frame, the SPAC liquidates and public stockholders receive their investment back; however, the SPAC sponsors lose their entire investment.

SPAC Initial Public Offering

- In order to raise capital, a SPAC will conduct an SEC-registered initial public offering (IPO) in which underwriters will sell the SPAC's securities to the public, often including both institutional and retail investors.
- The securities typically consist of units that are comprised of shares of common stock and warrants.
- An amount equal to the gross proceeds of the IPO is typically put into a trust account. Funds from the trust account are only released to the SPAC upon the completion of a business combination.

Deal Size



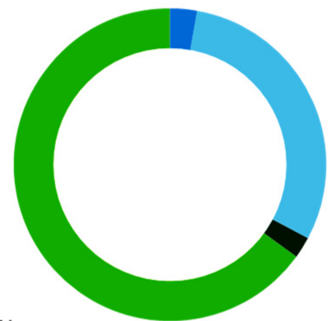
We are seeing almost half of deals in the mid-size range, but more than a quarter by deal count above $300mm.

Note: YTD 2020 shown in the chart above.

SPAC Acquisition Period

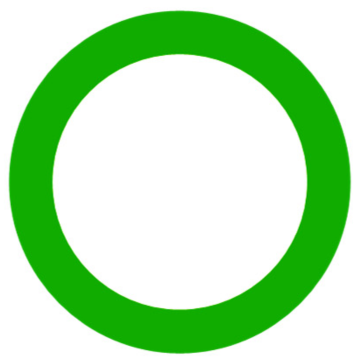
$50mm - $150mm

- 12 months - 23%
- 15 months - 3%
- 18 months - 37%
- 21 months - 14%
- 24 months - 23%



$151mm - $300mm

- 15 months - 3%
- 18 months - 30%
- 21 months - 2%
- 24 months - 65%



$301mm & Above

- 24 months - 100%

The Sponsor

- The sponsor entity typically receives a 20% promote, though there is some pressure on the amount of the promote in the current "frothy" market, with targets seeking to share in the sponsor promote
  - Initially, the sponsor owns 100% of the SPAC and purchases these equity interests for a nominal amount ($25,000).
  - As a result of the IPO, the sponsor is diluted down to an approximately 20% interest in the SPAC.
  - In the event a business combination is not completed, the promote becomes worthless.
- Unlike the promote to a PE sponsor, which typically requires that the transaction(s) achieve a defined level of financial success before the promote is earned, the SPAC sponsor`s promote "vests" upon the closing of the business combination.

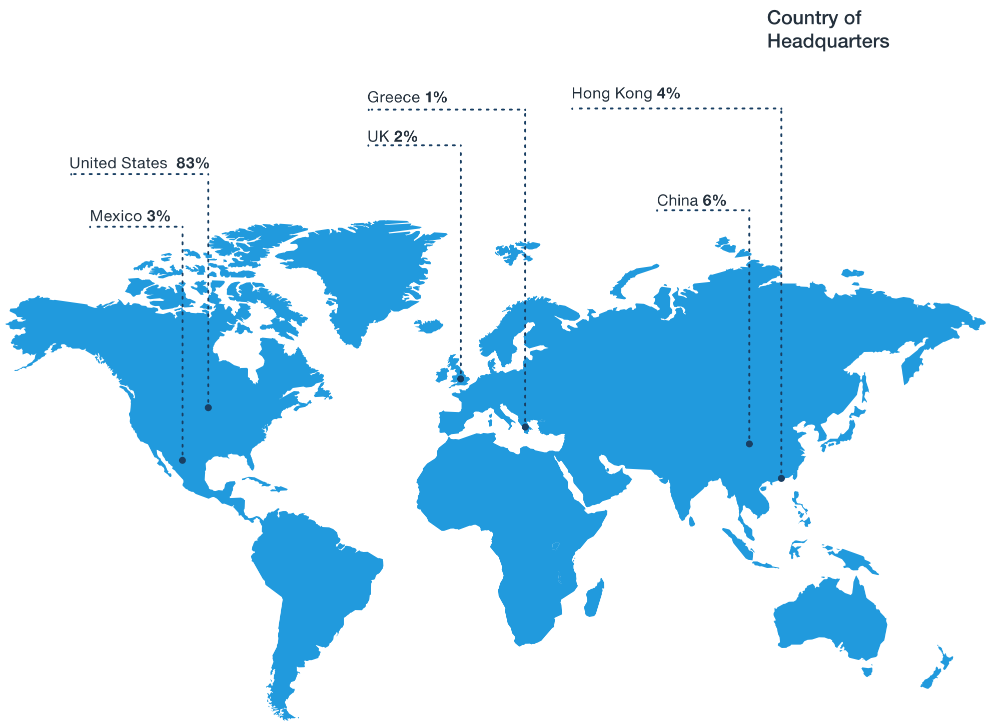
The Sponsor (continued)

- The amount earned will depend upon the share price at the conclusion of the sponsor`s lock-up and the timing of the sponsor`s sales of company shares.
- The sponsor may enter into certain other arrangements with the SPAC, including providing indemnity for certain claims on the trust account.
- The sponsor also may provide administrative services and office space to the SPAC or extend working capital loans to support the SPAC’s operations.

The Sponsor (continued)

- The sponsor is typically a Delaware or Cayman/BVI LLC and there is considerable flexibility as to the allocation of interests and securities among LLC members.
  - If it is possible that the SPAC's acquisition target will be outside of the United States, then consideration should be given to forming the SPAC offshore (Cayman, BVI, etc.).
  - Even if a domestic SPAC is initially formed, it does not mean that a foreign acquisition target is off the table.
- Asset management sponsors typically will work with established industry executives in establishing the SPAC and consummating a business combination.

Onshore vs Offshore



76% of the U.S.-based SPACs in our study were incorporated in Delaware while 20% were incorporated in the Cayman Islands and 4% were incorporated in the British Virgin Islands.

Of the non-U.S.-based SPACs in our study, 44% were incorporated in the Cayman Islands, 25% were incorporated in the British Virgin Islands, 19% were incorporated in Delaware and 13% were incorporated in the Marshall Islands.

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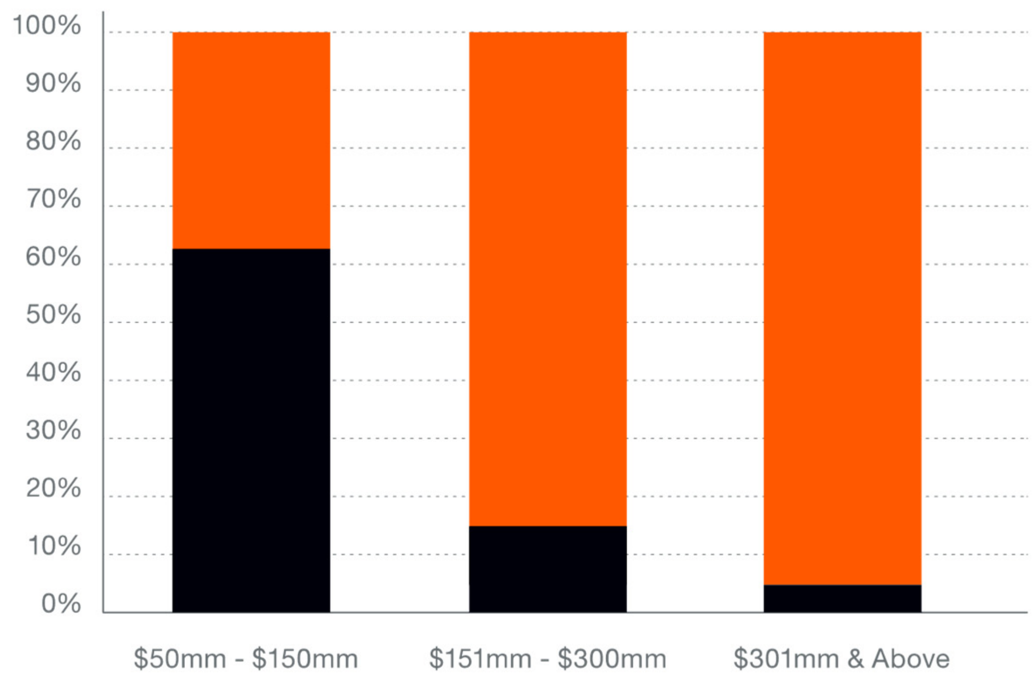
At-risk Capital

- Alongside the IPO, there is a concurrent private placement of securities sold to the sponsor to raise additional funds for the SPAC. This is the sponsor's "at-risk capital" and is approximately 3% - 5% of IPO gross proceeds.
- These additional funds are used to pay the non-deferred portion of the IPO underwriting fee (2% of IPO gross proceeds) and also provide working capital for the SPAC (between $750,000 and $2,000,000).
  - The underwriters are due an additional 3.5% of the IPO gross proceeds if and when a business combination is completed.
- The securities sold in the private placement consist of either warrants or units (comprised of shares of common stock and warrants).

Composition of Private Placement Units



Security Included in Concurrent Private Placement by Deal Size

- Unit
- Warrant

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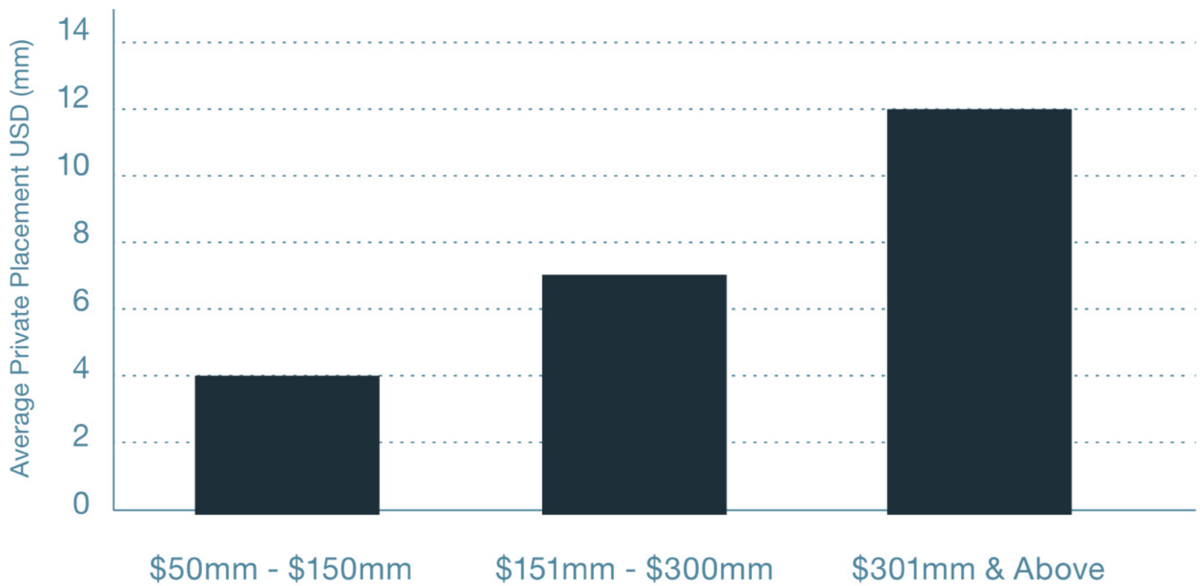
Concurrent Private Placement



Average Size of Concurrent Private Placement

Trust Account

- An amount equal to the gross proceeds of the IPO is typically put into the trust account.
- Amounts in the trust account may only be invested in eligible securities in order to avoid triggering investment company status.
- Cash from the trust account can only be released to the SPAC upon the completion of a business combination; interest may be used to pay certain taxes.
- If the SPAC is unable to complete a business combination, public stockholders receive their pro rata share of cash held in trust.
- Public stockholders may also elect to redeem shares for pro rata cash in connection with business combination or deadline extension votes.

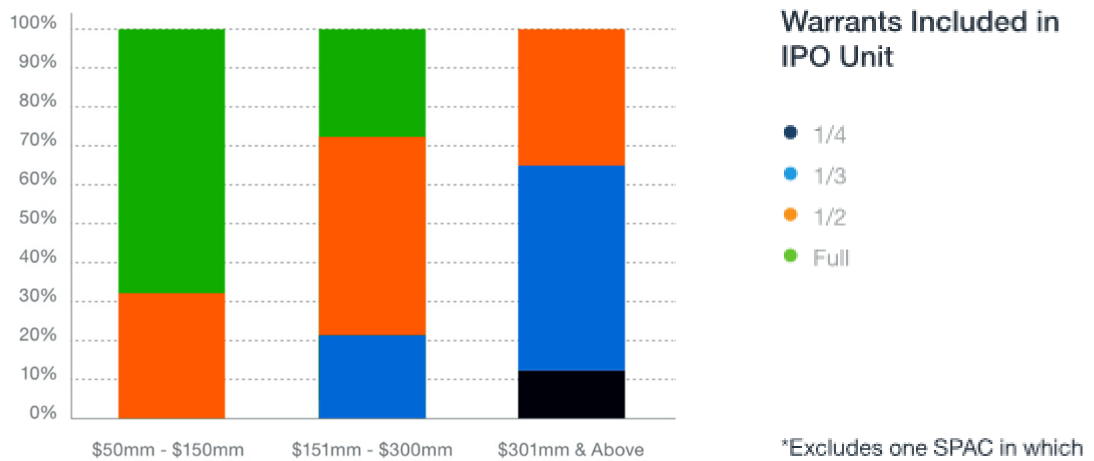
Public Units

- In the IPO, the SPAC sells units which are typically priced at $10.00 per unit and comprised of:
  - One share of common stock (or ordinary share)
  - A warrant or fraction of a warrant to purchase one share of common stock (or ordinary share)
- Following the IPO, the units become separable and are separately listed and traded.

Warrants

- The level of warrant coverage depends on the investors' confidence in the SPAC. Usually, larger SPACs with established sponsors are able to negotiate for lower warrant coverage.
- The warrants are struck out of the money and typically have an exercise price of $11.50 per share with a five-year term.
- Generally, warrants may only be exercised at the later of (i) 30 days after the business combination or (ii) one year after the SPAC IPO.
- The public warrants often include a company redemption feature frequently set at $18.00 per share.
- Note that the warrants pose potential dilution and overhang following the business combination and should be properly accounted for and considered in negotiations with targets.

Warrant Coverage



*Excludes one SPAC in which the IPO unit did not include a warrant.

Units offered in SPAC IPOs are typically comprised of one share of common stock and a warrant to purchase one-third, one-half or one full share of common stock, exercisable on a whole-warrant basis at $11.50 per share.

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Founders Shares and Warrants

- The shares purchased by the sponsor constituting promote mirror the public shares, except that they may contain certain anti-dilution provisions to gross up to 20% if additional shares are issued in connection with the business combination.
- Founder shares are also typically subject to a post-business combination lock-up period of one year (though may fall off sooner if trading value if above a specified threshold for a specified number of trading days) and may not be redeemed for any cash held in the trust account.
- Similarly, founder warrants mirror the public warrants except that they do not have a company redemption feature and have a cashless exercise feature.

Directors and Officers

- SPACs are required to meet stock exchange listing requirements for corporate governance, including with respect to director independent and board committees.
- SPACs typically have three independent directors on a board and they are often compensated with equity from the sponsor.
- Industry operators are often given a role on the board and in leading the SPAC towards its business combination goals.
- Officers may be affiliated with the sponsor and/or can receive compensation and equity incentives from the sponsor.

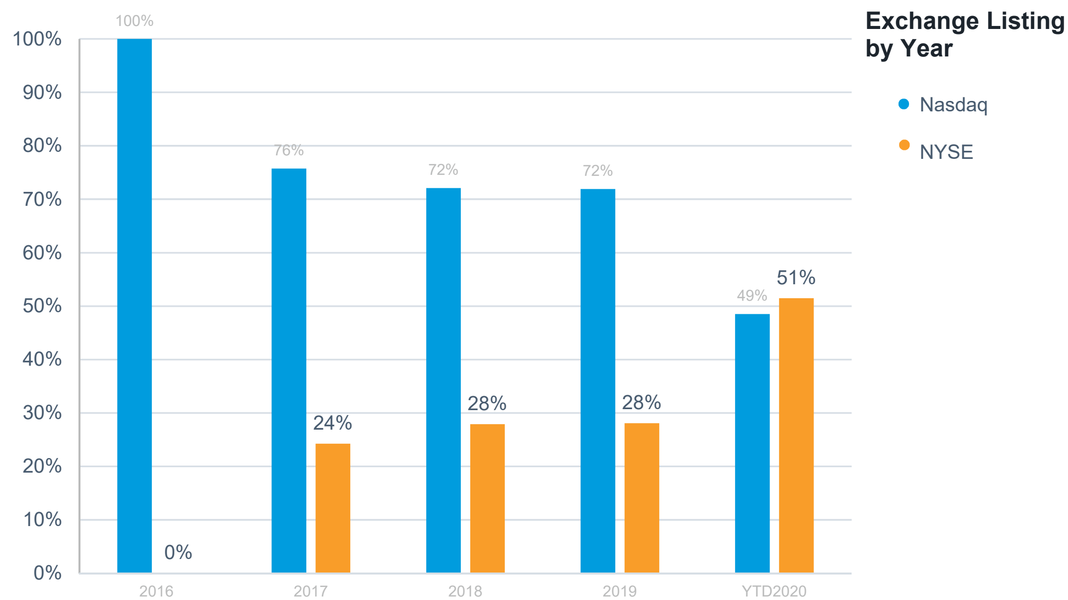
SPAC IPO and Listing Process

- Prepare and file Form S-1 with SEC
  - SPACs may take advantage of SEC's confidential review process
  - Initial review period of 30 days – can go from initial submission to pricing in two to three months
  - SEC comments have been focused on disclosure relating to conflicts, investor rights and management track record and experience
- Select listing exchange (Nasdaq or NYSE) and receive listing approval
- Testing-the-waters (TTW) and roadshow meetings
  - At TTW meetings, sponsor management team meets with potential investors and receives feedback on offering terms
- FINRA review process

SPAC IPO Timeline

Phase I – Initial Preparation and Structuring (2-4 weeks)	Phase II – Kick-off and Preparation and Filing of Registration Statement (2 – 4 weeks)	Phase III – SEC Review Period (4 – 6 weeks)	Phase IV – Marketing, Pricing and Closing (1-2 weeks)
• Structuring considerations (including location of incorporation of SPAC and sponsor, and composition and organization of sponsor entity) • Draft organizational documents and form SPAC and sponsor entities • Establish bank accounts and make initial contributions to sponsor and SPAC entities • Select legal counsel, underwriters, auditor and stock exchange	• Organizational meeting • Draft S-1 registration statement • Commence diligence process including management team background checks • Complete financials and audits of SPAC entity • Finalize and either confidentially furnish or publicly file S-1 with SEC • Apply to list on stock exchange	• SEC initial review period (30 days); review and respond to SEC comments; file S-1 amendments with SEC (if necessary) • Draft operative SPAC agreements and negotiate underwriting agreement • Begin preparation of marketing materials and commence testing-the-waters meetings • Receive conditional approval to list from stock exchange • Finalize S-1 and file publicly 15 days before roadshow (if confidentially submitted)	• Management presentation to salesforce and commence roadshow • Confirm stock exchange and FINRA clearances • SEC declares S-1 effective • Pricing and allocation of IPO units • Execute underwriting agreement and all other documents/ auditor delivers comfort letter • Trading of units commences on stock exchange • Print and distribute final prospectus • Closing & funding of trust account

Where to List?



The NYSE has seen a significant increase in market share this year for SPAC listings.

Note: YTD 2020 shown in the chart above.

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Operating a SPAC

- Pre-IPO, sponsors should **not** identify or reach out to potential targets (or traditional IPO level disclosures relating to the target would result)
- Should have majority independent board
  - Note that post-business combination company may be able to take advantage of controlled company exemption from exchange rules requiring majority independent board
- Subject to Exchange Act reporting regime (10-Ks, 10-Qs, 8-Ks, etc.)

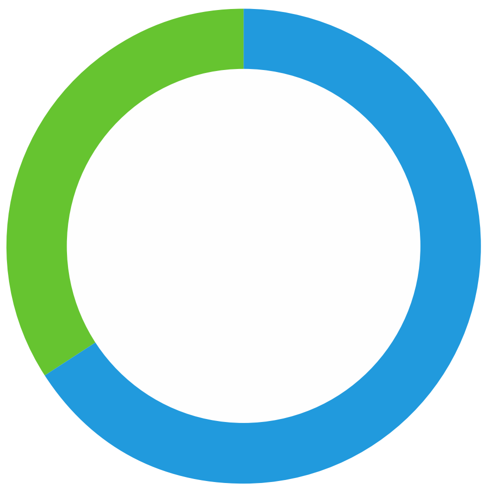
Sourcing and Signing the Business Combination

- As soon as the IPO closes, the SPAC will begin sourcing and vetting targets.
- The SPAC will then engage in discussions with select targets.
- Upon the signing of a business combination agreement, the SPAC is required to announce the transaction to the market.
- In accordance with stock exchange rules, the fair market value of the business combination must be at least 80% of the value of cash in the trust account.
- If the business combination is with an affiliate of the sponsor, then an independent fairness opinion is typically required.

Raising Additional Funds for the Business Combination

- In advance of signing and announcing the business combination, a SPAC and its target will typically seek to raise additional funds in the form of a PIPE (Private Investment in Public Equity) to backstop potential redemptions and/or provide deal certainty to target.
- Business combination targets have, on average, enterprise values three to five times the gross proceeds amount raised in the SPAC IPO.
  - For example, a SPAC that raised $200 mm in its IPO will likely acquire a business with a post-business combination enterprise value of between $600 mm and $1 billion.
  - SPAC shareholders typically end up holding less than a majority of equity interests in post-business combination company
  - IPO proceeds in trust often supplemented with PIPE proceeds and sometimes additional leverage
- Often SPAC stockholders end up in a minority position in the post-business combination company.

Business Combinations – PIPEs



PIPE at Closing of Business Combination

- Yes - 66%
- No - 34%

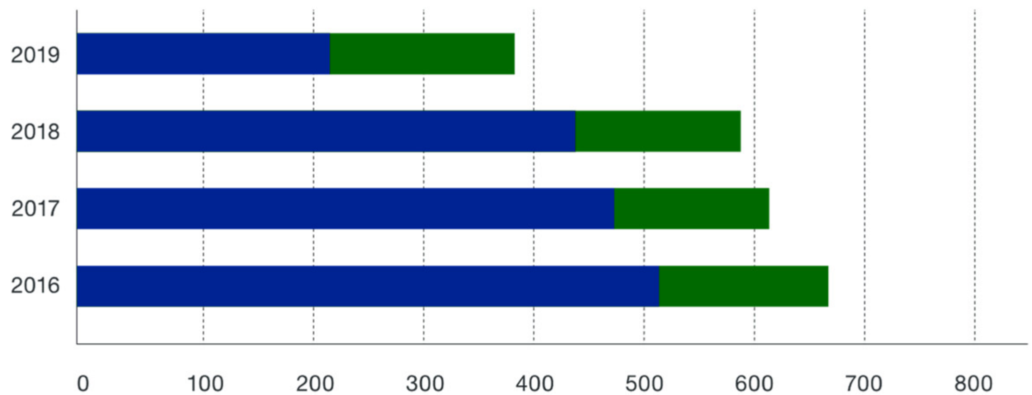
*Business Combination data excludes 1H2020 SPACs. The data on this page includes only SPACs from our study that have completed a business combination as of 7/31/2020.

Approximately two-thirds of the SPACs in our study that completed initial business combinations raised additional equity financing in the form of a PIPE (private investment in public equity) concurrently with the closing of the business combination.

Closing the Business Combination

- The SPAC will almost always require a stockholder vote to approve the business combination.
- In addition, the SPAC will need to register with the SEC any additional securities issued to the target's shareholders.
- The proxy statement and registration statement require SEC review, which can take eight to twelve weeks or more.
- In connection with the vote, public stockholders have the ability to redeem their shares pro rata for cash held in trust, whether or not they support acquisition or the trust liquidates.
- If stockholders approve of the business combination, the transaction closes within a matter of days (assuming no other regulatory approvals needed).

Business Combinations – Time to Signing



Average Days from IPO Pricing to Closing Break Down

- Average days from IPO pricing to signing
- Average days from signing to closing

*Business Combination data excludes 1H 2020 SPACs.

*Data excludes SPACS that had not completed a business combination as of 7/31/2020.

The average number of days it took for a SPAC to sign an agreement for its initial business combination was 440. It then took, on average, an additional 148 days to close the initial business combination.

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Business Combinations – Enterprise Value

Average Announced Enterprise Value

*Business Combination data excludes 1H2020 SPACs. The data on this page includes only SPACs from our study that have completed a business combination as of 7/31/2020.

The average announced pro forma enterprise value of the post-business combination company in our study was $889mm. This represents a ratio of 4.19 to the average deal size of $212mm for SPAC IPOs in our study that completed a business combination.

Going Public Considerations

- For private companies, a de-SPAC transaction provides an opportunity to access the public capital markets similar to a traditional IPO.
  - The company can raise funds through the sale of equity capital.
  - Existing shareholders can gain liquidity through public market.
- Both the de-SPAC and traditional IPO process involve the creation and regulatory review of SEC-level disclosures.
- **Following both the de-SPAC and IPO, the resulting public company will have the same continuing reporting and other obligations to regulators and the public markets.**

Going Public Considerations (continued)

- A de-SPAC transaction may be more attractive to some private companies as compared to a traditional IPO
  - Valuation is negotiated by SPAC and target and not tied to market demand; large number of SPACs may be driving prices higher
  - Ability for target shareholders to share in sponsor economics
  - Marginally less expensive process because no underwriting fees paid by target (SPAC pays on IPO proceeds only), but still significant transactional expenses
  - Private companies are permitted to disclose forward-looking statements and financial projections as part of de-SPAC process (but may create liability risk)

Going Public Considerations (continued)

- On the other hand, a traditional IPO may have certain advantages
  - Other things being equal, an IPO produces more value for the issuer because there is no “sponsor promote“
  - Valuation from public markets may be better than what can be privately negotiated with SPAC depending on market conditions
  - SPAC may create potential significant warrant overhang
  - SPAC sponsor may seek board representation
  - Traditional IPO vetting and diligence process perceived as more thorough than de-SPAC
  - IPO process could result in better research coverage and shareholder composition

Summary of SPAC / Going Public Considerations for Sports Teams

- Is being Public Appropriate for Your Business and Your Ownership?
  - will you be a micro or small cap "Pure Play" or a Larger Diversified Entity?
  - is Ownership prepared for the transparency, costs, risks (litigation, activists and otherwise), and regulatory and other burdens of running a public company?
  - is Ownership prepared for a continuing public disclosure obligation?
  - is Ownership prepared to be vulnerable to all future regulatory initiatives?
- What is Ownership's motivation for the transaction?
  - is it monetization for ownership (if so, compare debt, private LP, PIF and IPO v. SPAC)?
  - is it to have access to public capital markets (consider ramifications of market or financial performance contexts where stock price may not be robust)?
  - what does TeamCo need the capital for? is it to fund capital investments or for operating costs?

Summary of SPAC / Going Public Considerations for Sports Teams (continued)

- Valuation
  - recall that if you are contemplating an initial 80%-20% private/public equity split, you will still own the 80% after the big "pop" if the stock trades down, that will be your value absent a change of control or other strategic transaction
  - sports valuations are influenced by tax benefits and the value of the control premium; it is possible that neither will be recognized in the typical public company context and your public valuation may, over time, be less than your Private or Forbes valuation
  - past "pure plays" were characterized by low trading volumes, which can create price volatility; you may not be getting a sufficiently deep and liquid market for price integrity
  - with some exceptions, over time public company valuations tend to be tied to financial performance and expected profits/cash flows

Summary of SPAC / Going Public Considerations for Sports Teams (continued)

- Control
  - leagues will require that there be a "control person" and Ownership typically wants to retain control
  - in a SPAC or IPO's, this may necessitate super voting or golden shares

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SPAC vs IPO

- If Ownership crosses the public company bridge and your league will allow it (no sure thing), consider the Pros and Cons of SPACs vs IPO
- **Pro/Cons Include:**
- SPACs will set the price up-front and competition among SPACs for deals may drive a premium price
  - **BUT** markets could rise later, making an IPO preferable; private sale might achieve a similar value; also, equity markets could get disrupted between contract and closing with a SPAC, creating a closing risk

SPAC vs IPO (continued)

- **Pro/Cons Include:**
- SPACs are "faster" than IPOs
  - **BUT** there will be months of SEC and shareholder effort between contract and closing that eliminate some of the timing advantage; also, the SPAC sponsor gets substantial economics via the 20% carry that could be captured by Ownership in an IPO or other transaction (or needs to be negotiated in the combination); assess the SPAC costs/benefits carefully because they may not be the same for everyone

SPAC vs IPO (continued)

- **Pro/Cons Include:**
- SPACs sometimes have knowledgeable Sponsors
  - **BUT** will most sponsors really add management value, especially given the "Control Person" concept in sports?
- SPACs can get a company's "story told"
  - **BUT** do sports teams really need their story told?
- SPACs make forward looking statements and projections
  - **BUT** is Ownership (and its league) comfortable? it also creates some risk

SPAC vs IPO (continued)

- **Pro/Cons Include:**
- SPACs can bring PIPE money and leverage
  - **BUT** some may be used in the redemption process and both sources of capital may raise league rule issues
- SPACs have a built in shareholder base
  - **BUT** data suggests that shareholder base often sells out quickly

There will be a host of League issues as well

Emerging Capital Structures in Sports

Private Investment Funds

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An Introduction to Private Investment Funds

Chip Parsons
Brian Schwartz

Proskauer

What is a “Private Investment Fund”?

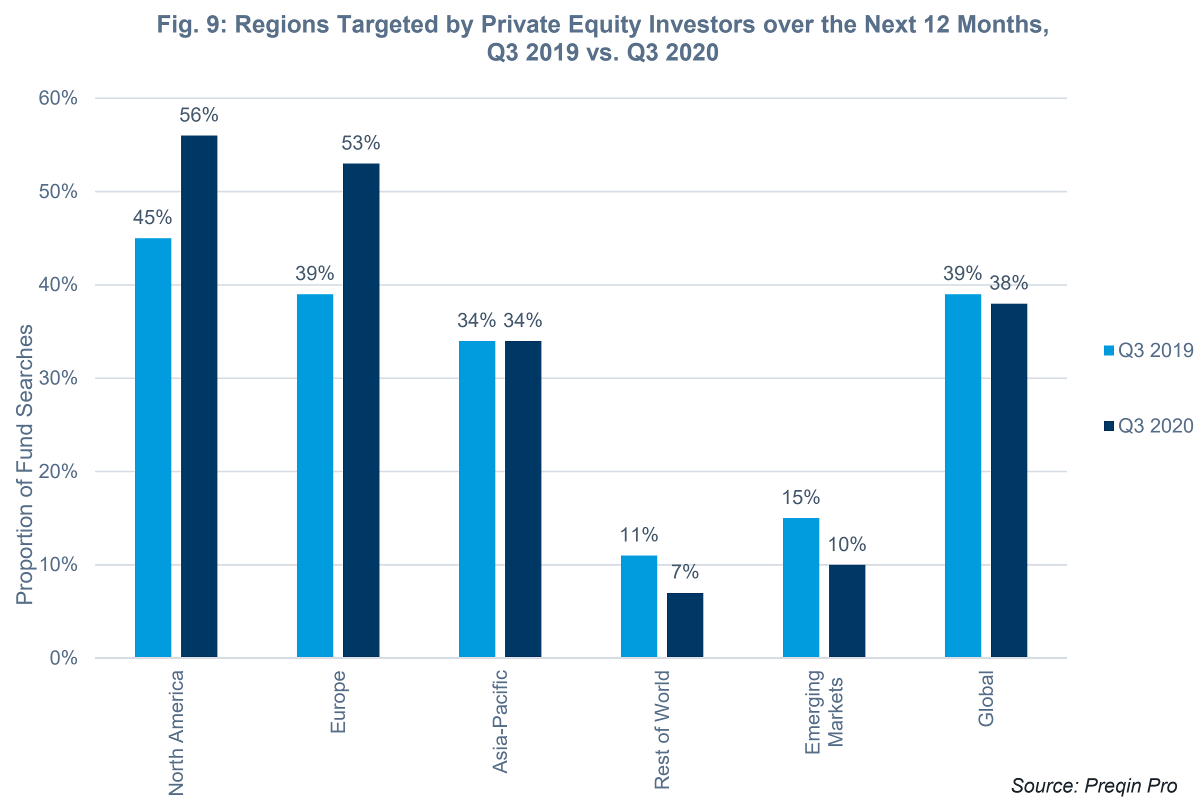
- Closed-ended, pooled investment vehicle
- Generally no ability for investors to withdraw capital from or transfer investment in a fund
- Investors make capital contributions over time, up to a commitment amount
- Fixed term (often 10+ years) with periodic distributions of cash/securities
  - Often in connection with the realization of one or more portfolio investments
- Equity interests in a fund are not registered under the Securities Act of 1933
- Fund is not registered as an “investment company” under the Investment Company Act of 1940

Types of Closed-Ended Private Investment Funds

- Private Equity
  - Venture Capital
  - Buyout
  - Growth Equity
- Private Debt
  - Senior Debt
  - Mezzanine Debt
  - Distressed Debt
- Funds of Funds
- Real Assets
  - Real Estate
  - Infrastructure
  - Natural Resources and Energy
- Managed Accounts/Funds of One
- Secondary Funds

Sectors and Geography

- Biotech & Healthcare
- Technology, Media & Telecom
- Consumer & Retail
- Industrials
- Energy
- Real Estate
- Natural Resources
- Infrastructure
- …Sports



Source: Preqin Pro

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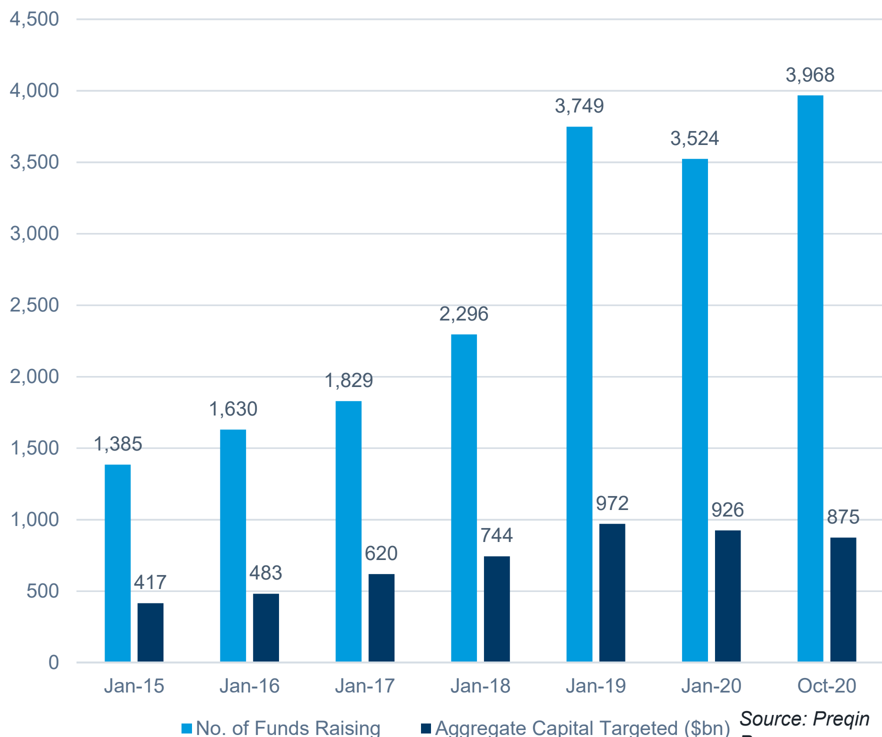
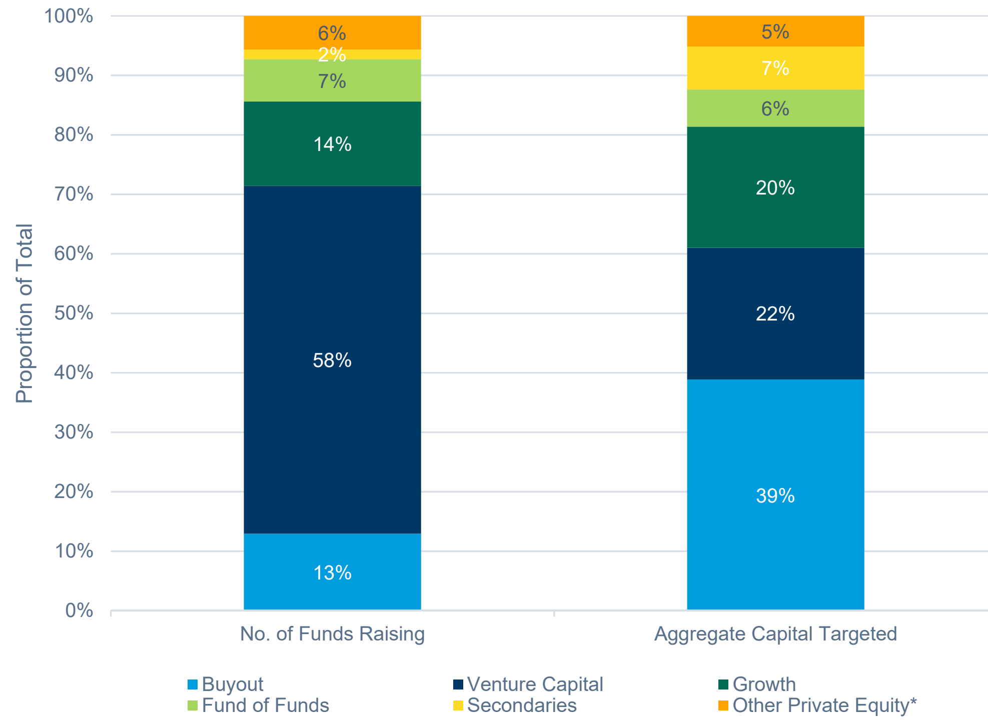
Recent Statistics

Fig. 4: Private Equity Funds in Market over Time, 2015 - 2020



Source: Preqin Pro

Fig. 5: Private Equity Funds in Market by Fund Type



Source: Preqin Pro. Data as of October 2020

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Structure of a Fund

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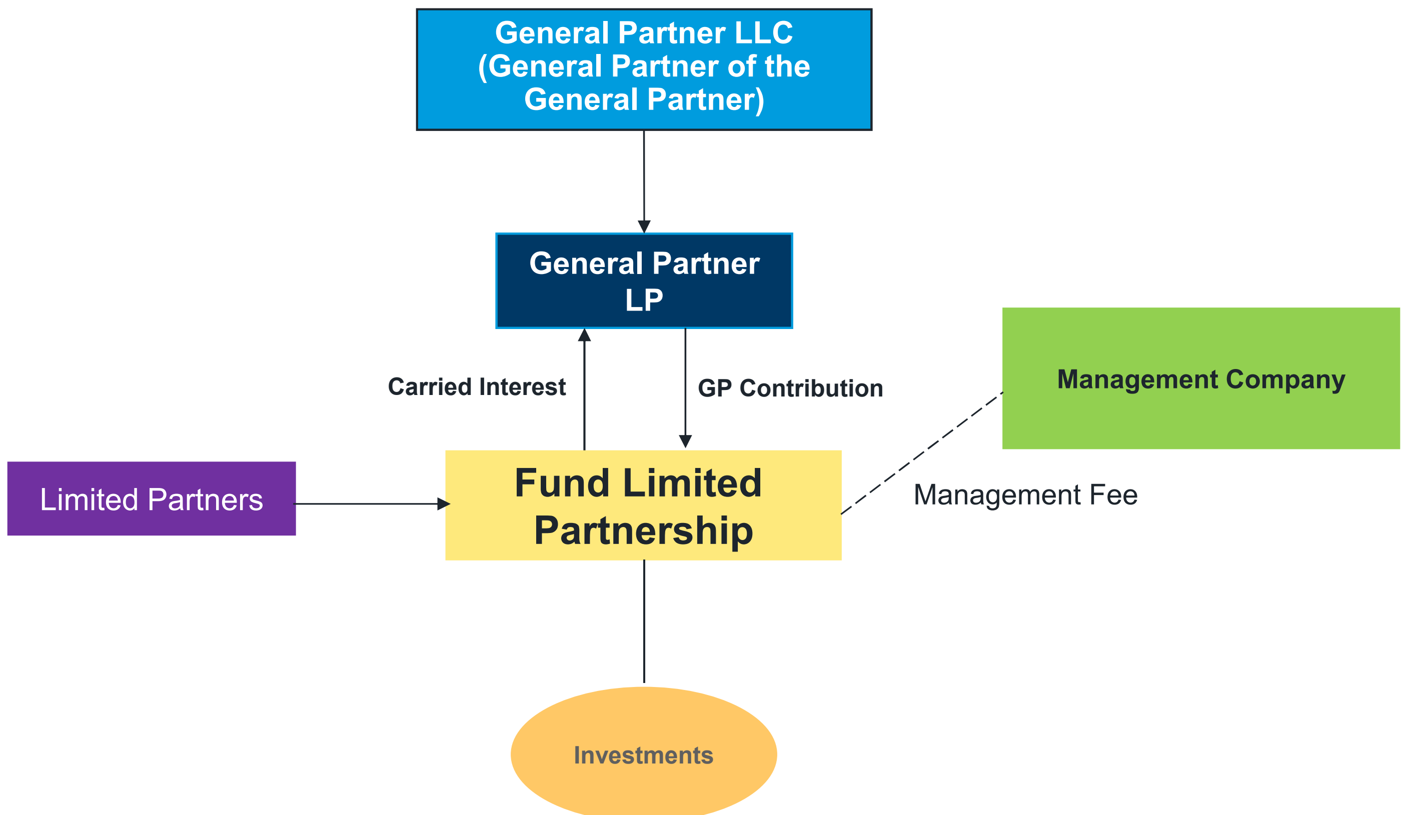
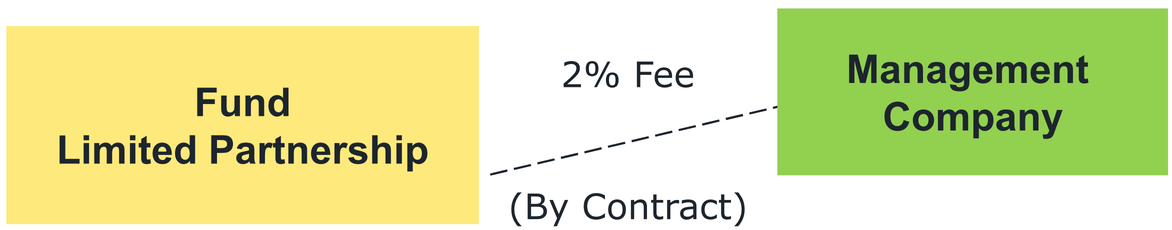
Organizational Framework



Management Company



- Management company employs the investment team, pays salaries and other overhead costs
- Management company enters into an advisory agreement with the fund
- Typically closely held by founders / senior investment professionals (but a number are publicly traded)

General Partner (GPLP and GPLLC)

- General Partner LLC
  - Control entity for the underlying GP and Fund
  - Often structured as an LLC
- General Partner LP
  - Divides up carry and capital among investment team
  - Often structured as an LP
  - Can have single-tier GP structured as an LLC

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Common Fund Jurisdictions

- Delaware
  - Sponsor-favorable
  - Flexible statutes
  - Up to date
  - Well-developed jurisprudence
  - Business courts
  - Known commodity

- Cayman Islands
  - Cayman partnership law is similar to Delaware partnership law
  - Tax advantages for non-U.S. investments
  - No taxes payable in Cayman Islands on fund income
  - Familiar jurisdiction to investors

Typical Investors in a Private Fund

- Public and private pensions
  - U.S. state and local governmental plans
  - Corporate pension plans / ERISA plans
- Sovereign wealth funds
- Endowments and foundations
- Insurance companies
- Fund-of-funds
- High-net worth individuals and family offices

Use of Leverage

- Fund-level
  - Short-term capital call credit facilities
    - Borrowings can be drawn between 90-180 days
    - Reduces the need to make frequent capital calls to investors
    - Typically secured by a fund's uncalled capital
  - Longer-term leverage
    - Less common among private equity funds
    - More common among debt and real estate funds
    - Typically secured by the fund's assets

- Investment level
  - Portfolio companies generally can borrow without limitation
  - Buyout funds generally borrow at the portfolio company level in connection with leveraged acquisitions or dividend recapitalizations
  - Temporary bridge financings to portfolio companies provided by funds

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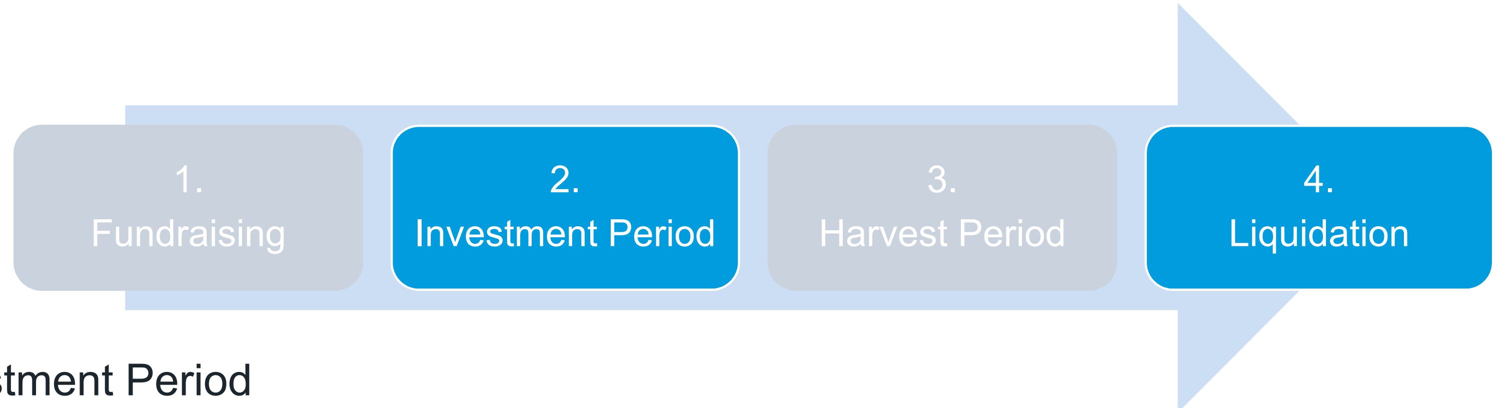
Stages of Life of a Fund



- Investment Period
  - Typically 3-6 years from closing
  - After expiration, fund is prohibited from making investments in new portfolio companies
  - Capital may still be called for expenses and follow-on investments (may be capped)
- Fund Term
  - Typically 10 years
  - Term can be extended (GP discretion, LP vote, LPAC vote)
  - No time limit on post-term liquidation

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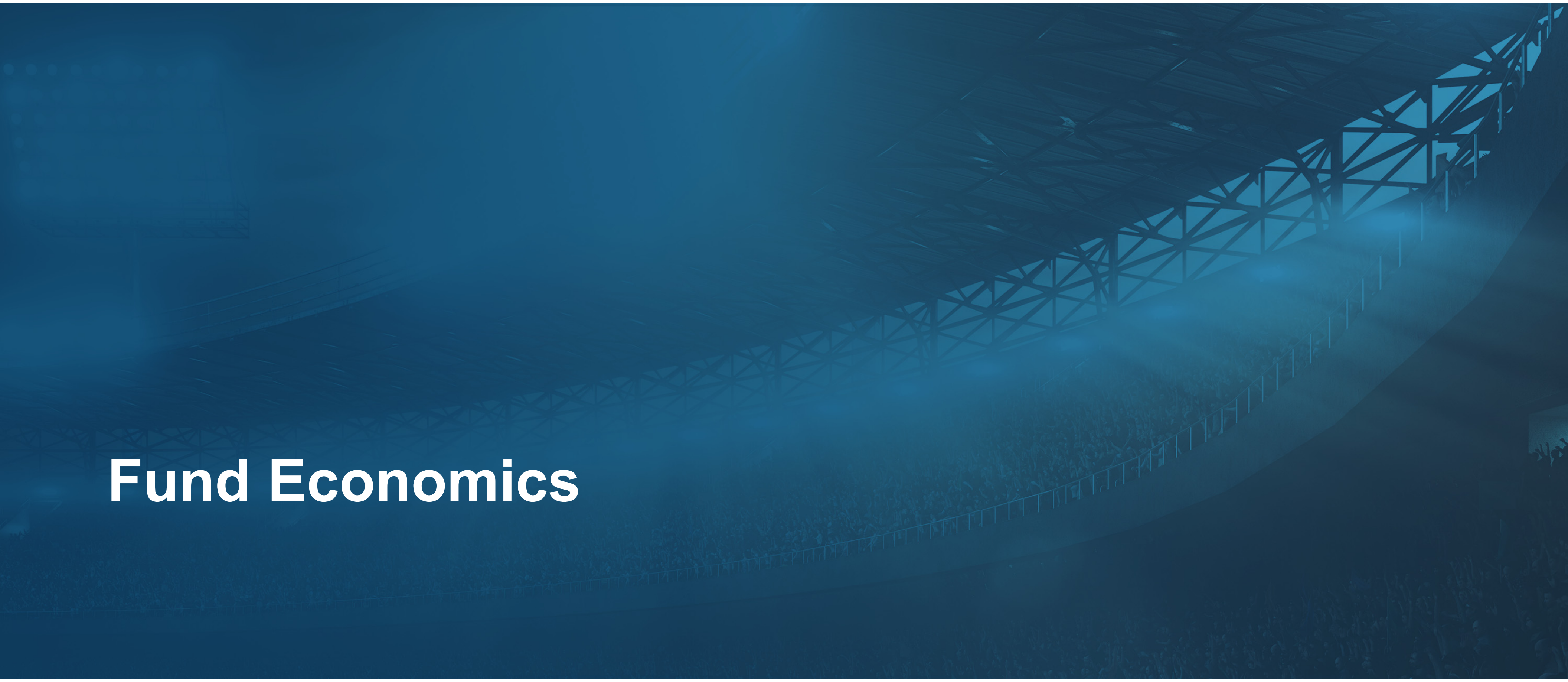

Fund Economics

Management Fees, “Carried Interest,” Sponsor Commitment and Expenses

Fund Economics – Management Fees

- Typical Fee
  - Venture Capital Fund – 2.0% to 2.5% of committed capital
  - Buyout Fund – 1.5% to 2.0% of committed capital
  - Debt Fund – 1.0-1.75% of invested capital
- Sliding Scale Fees
  - Decline in later years – fixed vs. formula
  - Percentage of prior year fee
  - Invested capital
- Fee period
  - Rampdown after Investment Period
  - Early Termination of Investment Period Rampdowns
  - Successor Fund Rampdowns
  - Duration of Term/Full Liquidation (Extension periods)

Fund Economics – "Carried Interest" and Distribution Waterfalls

- "Carried Interest" is the General Partner's share of the profits that the fund earns after LPs have received a return of their capital
- 20% is industry "standard"
  - Certain funds may be more likely to have lower carry (e.g., debt) or higher carry (venture)
  - Variable Carried Interest, IRR Hurdles and Return Multiples
- Most funds (other than venture) require a return of invested capital (either with respect to realized investments ("deal-by-deal") or all invested capital ("return of all capital") plus a preferred return on invested capital before any carried interest is distributed to the General Partner
- Preferred return
  - 8% is industry standard for private equity funds, but recently has trended downwards as cost of capital has fallen. Debt funds tend to be lower 5-7% (depending on nature of underlying loans and use of leverage).

Fund Economics – “Carried Interest” and Distribution Waterfalls (cont.)

- Following the return of capital plus the preferred return, the General Partner is entitled to “catch-up” on its 20% share of the profits previously distributed
  - The General Partner’s catch-up rate varies from 50% (real estate funds) to 100% (top-tier buyout and growth funds)
  - Once the General Partner has “caught up” and received 20% of the profits, the split of profits returns to 20% to the General Partner and 80% to the limited partners
- Venture
  - Cash-on-Cash Hurdles
    - Return of Committed Capital
    - Return of Contributed Capital
    - Deal by deal – NAV Cushions
- Buyout
  - Deal by deal – “Disposed of” capital with or without all or some attributed expenses
    - Write offs, write downs, dividend recapitalizations, attributed expenses
  - Cash-on-Cash Preferences - “True” or “Disappearing”
- If early payouts of carried interest result in the General Partner receiving more than 20% of the profits then the General Partner may be subject to a clawback

Fund Economics – General Partner Commitment

- Sponsor expected to invest its own capital in or alongside the fund (i.e. "skin in the game")
- Traditionally had been 1% of total capital commitments
  - Recent LP pressure to increase sponsor commitments; 3-5% increasingly common
  - Often focus on carry position of prior funds
- Some funds permit the Sponsor to satisfy a portion of its capital commitment pursuant to a cashless/deemed contribution mechanism

Fund Economics – Organizational Costs and Partnership Expenses

- Organizational Expenses
  - Fund generally pays for the cost of its own set-up; often capped at certain $ amount (frequently, 0.1% - 0.3% of the capital commitments to the fund)
- Partnership Expenses
  - Fund generally pays for its own operating costs
  - Deal-related expenses
  - Third-party services (investment banking, consulting, legal, accounting, audit)
  - Travel for investment team
  - Regulatory compliance costs: fund v. advisor
  - Very specific expense disclosure in legal documents
- Management Company and GP generally pay for their own overhead (e.g., employee salaries, rent, utilities)

Fundraising Process

Fundraising Process – Environment & Competitive Pressures

- Robust interest from investors in private funds
  - Returns from many private fund managers have often out-performed public equities
- In a low yield environment, certain LPs are seeking higher-yielding investments (e.g., pensions and endowments)
- At the same time, there is an increased number of sponsors competing for investor’s money across strategies
- Increasing number of institutional investors focusing on investing with fewer managers with superior track records (reduced administrative burden and cost)
- Once a fund has been raised, sponsors must deal with an extremely competitive landscape for deal-making

Fundraising Process – Timeframe & Closings

- Marketing to potential investors typically begins several months prior to first closing of the fund
- Closing
  - An initial closing won't take place until a critical mass of investors is reached
  - Funds can stage rolling closings, admitting investors as they are ready to commit
  - Fundraising period is often 12 months, sometimes longer
  - Closings are typically "dry" with no money due from investors at closing
- Late Admission
  - Later-admitted investors typically participate in all investments made prior to their admission
  - Generally buy-in at cost plus interest (which is payable to the earlier-closing investors)
  - Allows late closing investors to "preview" a fund's portfolio

Fundraising Process - Key Investor Documents

- Limited Partnership Agreement
  - Details all terms and conditions of the investment
- Subscription Agreement
  - Securities law compliance/representations and warranties
- Side Letter
- Private Placement Memorandum
  - Detailed description of the fund’s investment strategy and objectives
  - Disclosure of risks and conflicts

Fundraising Process – Negotiating with Investors

- Partnership Agreement Terms
  - Economic terms
    - Management fee, carried interest, expenses
  - Governance
    - Investment restrictions, advisory committee, key person trigger, sponsor removal
- Side Letter Rights
  - MFN
  - Confidentiality/Disclosure rights
  - Preferential economic terms
  - Regulatory and investment restrictions

Certain Additional Fund Terms

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Additional Fund Terms – Capital Calls, Default, Recycling

- Capital Calls
  - Capital is called on an "as needed" basis
  - Typically must give ten (10) days' notice (often shorter for initial capital call)
  - Excuse/exclusion
- Default
  - Penalties and remedies
- Recycling
  - Internal recycling
  - External recycling: ability to call back prior distributions for reinvestment
  - Limit on amount that may be reinvested (for example, 110%-125% of commitments or amount of capital returned during the investment period)

Additional Fund Terms – Governance Terms

- Investment Restrictions / Investment Focus
  - Concentration limits, geography, hostile takeovers, debt restrictions
- Key Person
  - Time and attention requirements
  - Triggering events
  - Consequences
- GP Removal / Fund Termination
  - For-Cause vs No-Fault
- Role of Limited Partner Advisory Committee

Additional Fund Terms – Conflicts, Deal Flow, Successor Funds

- Conflicts of Interest
  - Transactions with affiliates
  - Allocation of investment opportunities
  - Allocation of expenses
- Successor Fund Restrictions
  - X% “invested, committed or reserved for expenses or investments”
  - Restrictions on fund type, strategy, geography; “substantially similar”
  - Management fee step down

Additional Fund Terms – Reporting and Information Rights

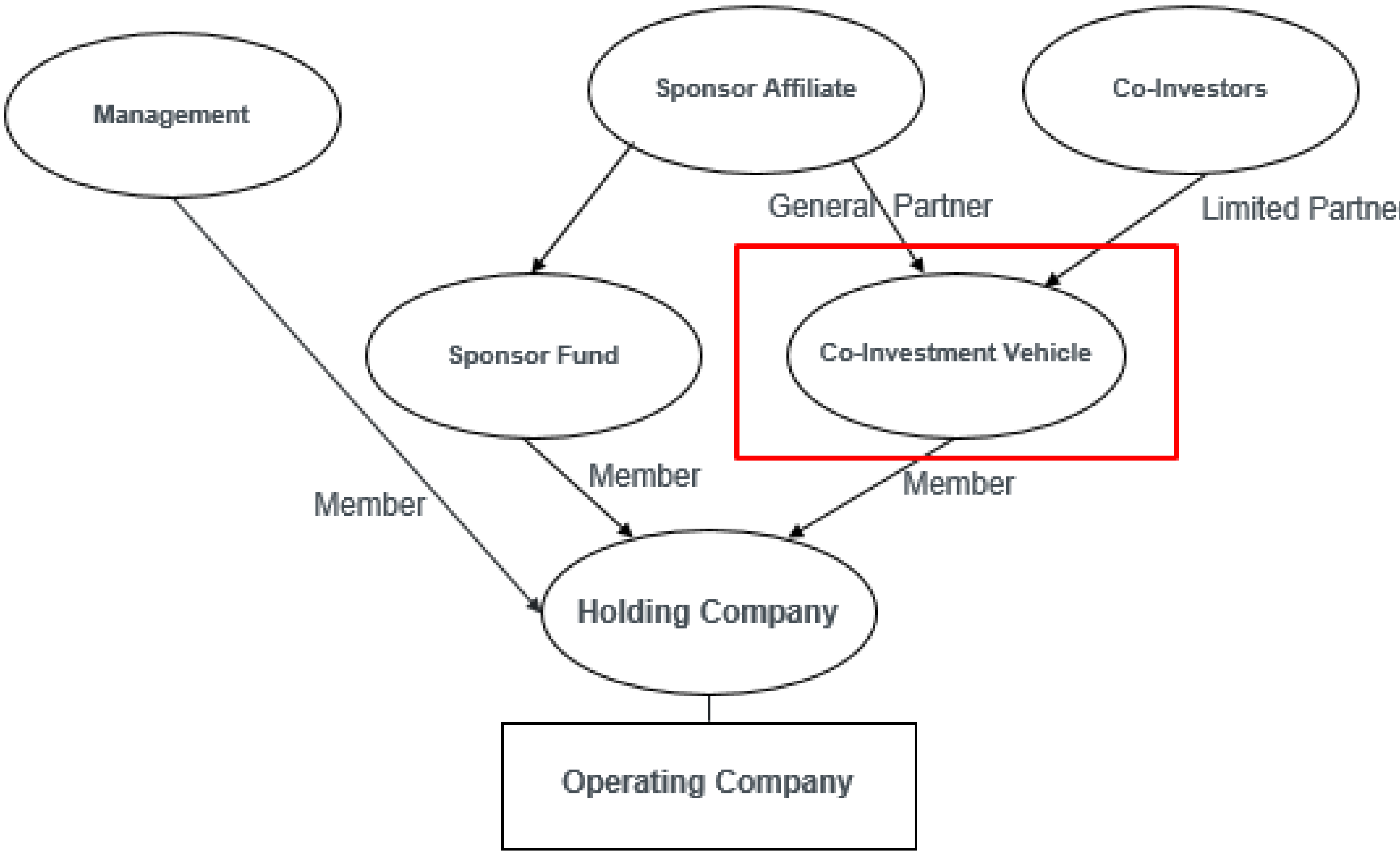
- LP Reporting
  - Annual and quarterly reports
  - Schedule K-1s
  - Customized reporting, fund of funds reporting
- Confidentiality
  - Fund-level information
  - Portfolio company-level information
  - FOIA

Co-Investments

Co-Investments

- Investment alongside a “main fund” in a portfolio company
  - Participation by “main fund” limited partners and/or third party investors
  - Investors often piggy-back on sponsor’s due diligence
- Allows investors to have increased exposure to portfolio companies on a deal-by-deal basis
  - Most often structured through sponsor-controlled SPVs, although co-investors sometimes structured as investments directly into portfolio companies
- Co-investors generally have same securities, same rights as “main fund”
  - Tag/drag-along rights
  - Pre-emptive rights
- Economics
  - Often have no management fee, no or reduced carried interest
  - Transaction fees go to sponsor

Co-Investment Structure (SPV)



Alternative Types of Fund Structures

Evergreen Funds, Funds of One, BDCs, Restructurings

Alternative Types of Fund Structures

- Evergreen Funds
  - Open-end funds with no termination date
  - Periodic investor liquidity event
- Funds of One / Separate Managed Accounts (SMAs)
  - Single investor or affiliated investor vehicles
  - Customized for investor based on strategy/goals
- Business Development Companies (BDCs)
  - Often publicly traded; Exchange Act reporting obligations
  - Access to retail investors
  - Tend to focus on debt investments

Secondary Market

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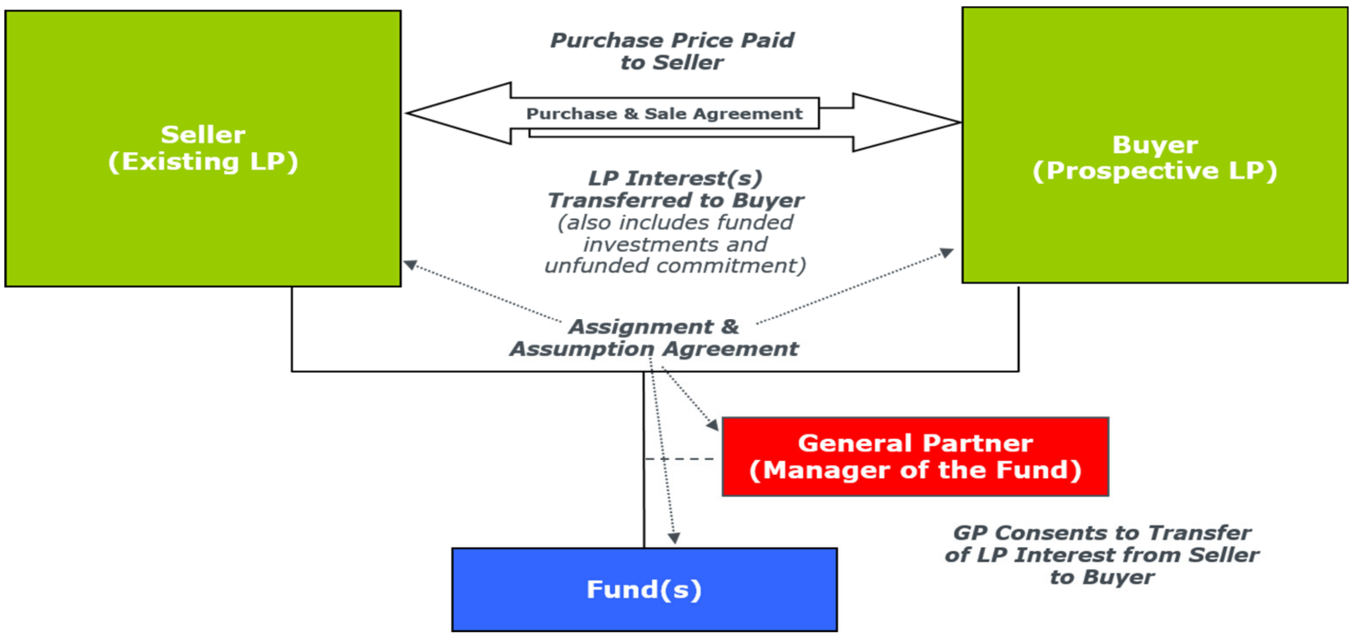
Secondary Market



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Regulatory & Tax Issues

Securities Act, Investment Company Act, Advisers Act, Tax & ERISA

Certain Regulatory Issues

- Securities Act of 1933
  - Regulation D
  - No general solicitations
  - Investors must be “accredited investors”
- Investment Company Act of 1940
  - 3(c)(7) and 3(c)(1) exemptions from registration; most funds rely on 3(c)(7) – investors must be qualified purchasers
- Investment Advisers Act of 1940
  - Registered investment advisers versus exempt reporting advisers
  - Venture capital adviser exemption
  - Private fund adviser exemption ($150 million AUM)
- EU Alternative Investment Fund Managers Directive (AIFMD)
- CFIUS
- FINRA

Tax & ERISA Issues

- Tax
  - Non-US investors and ECI
  - Tax-exempt investors and UBTI
  - Funds are generally formed using tax-transparent entities
- ERISA
  - Benefit plan investors
  - 25% Test
  - VCOC

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