The GP-Led Secondaries Market: Growth and Opportunity

July 29, 2020
Featured speakers

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Agenda

• Eaton Partners and market overview
• Drivers of the GP-Led market
• Preferred equity and continuation vehicles
• Key considerations
• Q&A
INTRODUCTION TO EATON PARTNERS

INDUSTRY LEADING ADVISORY AND FUND PLACEMENT FIRM FOR ALTERNATIVE INVESTMENTS WITH UNPARALLELED EXPERIENCE RAISING CAPITAL ACROSS VARIOUS STRATEGIES AND MULTIPLE GEOGRAPHIES

- Over $100 billion raised for 140+ highly differentiated funds
- $27+ billion placed in the last three years
- 37 first-time funds raised (more than any of our peers)
- 32 oversubscribed funds in the last three years

- Primary Fundraising & Advisory: full process management and global LP targeting, new product development, positioning and market advice
- Secondary: liquidity solutions spanning diverse transaction structures to meet GP & LP goals
- Co-invest & directs: assist GPs in raising capital from attractive investor base for new investments and/or minority sales

- 25-person Distribution Team with 14 Marketing Associates for support
- 26-person Execution Team
- Nine offices across three continents
- Select JV partnerships in additional key geographies

- Industry leading middle market focused investment bank
- HNW/Private banking relationships commit >$1B/year to alternatives
- Growth equity provided to increase resources across the Eaton platform
- Strong technical and and valuation expertise
### FIRM ACHIEVEMENTS PAST THREE YEARS

<table>
<thead>
<tr>
<th>Category</th>
<th>Achievement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>$27+ billion</strong></td>
<td>Total capital placed for private funds</td>
</tr>
<tr>
<td><strong>40</strong></td>
<td>Funds closed</td>
</tr>
<tr>
<td><strong>32/40</strong></td>
<td>Funds exceeded the target amount or hit hard cap</td>
</tr>
<tr>
<td><strong>$2.5+ billion</strong></td>
<td>Closed for secondaries and directs</td>
</tr>
<tr>
<td><strong>700+</strong></td>
<td>Commitments closed</td>
</tr>
<tr>
<td><strong>2017 awards</strong></td>
<td>Placement Agent of the Year in North America and Asia</td>
</tr>
<tr>
<td><strong>2018 awards</strong></td>
<td>Placement Agent of the Year in Asia and Secondaries Advisor of the Year in Asia</td>
</tr>
</tbody>
</table>

**Private Equity**

- **Project Lyric**
  - Recapitalization of a Music Royalty Company with Additional Primary Commitments
  - $350M

- **Project Sauce**
  - Formation of a Fund IV in Conjunction with the Sale and Recapitalization of Fund III
  - $125M

- **Project Alpha**
  - Formation of a Fund IV in Conjunction with the Sale & Recapitalization of Fund III
  - $243M

- **Project Burrito**
  - Follow-on Capital Raise for Existing Portfolio Company to Complete Merger
  - $180M

- **Oak Hill Capital Partners IV**
  - Consumer Services & Industrial Buyout
  - $2.65B

- **Brightstar Capital Partners Fund I**
  - Business & Industrial Services
  - $710M

- **Fundamental Partners III**
  - Municipal Special Situations, Asset-Backed Credit
  - $993M

**Private Credit**

- **GLS Capital Partners Fund I**
  - Litigation Finance
  - $347M

- **First Infrastructure Capital**
  - Direct Energy Infrastructure Investments
  - $1.0B

- **Five Point Midstream Fund III**
  - Midstream Energy & Water
  - $750M

**Real Assets**

- **SDC Digital Infrastructure Opportunity Fund II**
  - Digital Infrastructure
  - $750M

- **Moorfield Real Estate Fund IV**
  - UK Value-Add Real Estate
  - €220M

**Select Mandates**

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Market overview
In 2019, secondary funds raised more than $50bn, while the five largest open secondaries funds are seeking to raise a combined $53bn in 2020.
SECONDARIES MARKET UPDATE: MAY 2020 – JULY 2020

SECONDARY FIRMS FUNDRAISING NEWS

- **July 2020** – ODDO raised €358M for ODDO BHF Secondaries Fund, its debut secondaries fund, surpassing its original €300M target
- **June 2020** – eQ held final close on eQ PE SF III, their third dedicated secondaries fund, with €155M, surpassing its original €150M target
- **June 2020** – Intermediate Capital Group will launch ICG LP Secondaries Fund I, an LP stakes fund, with an unknown target and launch date
- **June 2020** – Ardian closed its $19B Secondary Fund VIII, making it the world’s largest secondaries fund
- **May 2020** – Goldman Sachs raised $2.75B for its Vintage Real Estate Partners II Fund, surpassing its original $1.25B target
- **May 2020** – Commonfund Capital returned to market with its third dedicated secondaries fund, seeking $550M in capital

2019 SECONDARIES VOLUME BREAKDOWN

GP-led transactions accounted for 32% or $28bn of total secondaries volume in 2019

RECENT TRANSACTIONS

<table>
<thead>
<tr>
<th>Fund / Headquarters</th>
<th>Transaction Type</th>
<th>Transaction Size</th>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ottawa Avenue</td>
<td>Limited Partner</td>
<td>$1.5B</td>
<td>Ongoing</td>
<td>Ottawa Avenue Private Capital, the investment unit associated with the DeVos family office, is selling up to $2B of its private equity stakes</td>
</tr>
<tr>
<td></td>
<td>Interests Sale</td>
<td></td>
<td></td>
<td>HarbourVest Partners is the lead investor, and they will invest $1.5B, with $1B of that on a preferred equity basis, into the secondaries process</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The deal is one of the largest on the market in the pandemic downturn, which has stopped most secondaries deal activity due to uncertain private equity valuations</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The Ottawa Avenue portfolio is fairly concentrated, investing into a few fund managers including Vista Equity and AEA Investors</td>
</tr>
</tbody>
</table>

Note: Data as of July 2020. Source: Preqin, Company Websites, Secondaries Investor, Wall Street Journal
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| Exponent            | Preferred Equity     | $156M            | July 2020 | • Exponent Private Equity closed a preferred equity deal that will allow it to fund add-on acquisitions for its Exponent Private Equity Partners III, a 2015-vintage fund that closed on $1.25B  
• Exponent secured preferred equity from 17Capital for up to $156M  
• The preferred equity transaction comes 18 months after Exponent suspended plans to run a tender offer process on Fund III, a result of market volatility caused by the UK’s uncertain future relationship with the EU |
| London, UK          | Securitization       | $1B              | June 2020 | • Dyal Capital Partners suspended its plans to run a GP-led secondaries process and, instead, closed a $1B securitization  
• The securitization will offer liquidity to LPs by returning distributions in its 2015-vintage Dyal Capital III fund, which has 20 investors  
• The securitization bundles future cash flows from the management fees of the fund’s underlying 10 GPs  
• Dyal Capital III fund holds minority stakes in firms including Vista Equity Partners, Silver Lake, and HIG Capital |
| New York, NY        | Single-Asset Recap   | $600M            | Ongoing   | • Intermediate Capital Group is backing a $600M NAV single-asset recap of Providence Equity Partners VI, a 2007-vintage fund  
• Providence is moving HSE24 Multichannel GmbH, a home shopping TV network, into a continuation vehicle to offer liquidity to limited partners and provide the GP more time to manage the company  
• Providence is preparing HSE24 for an IPO |
| Providence          | Continuation Fund    | Not Reported     | June 2020 | • Idinvest Partners closed a GP-led process, transferring 12 assets from several growth and venture capital vehicles into a five-year continuation fund in a deal led by Pantheon Ventures  
• The transaction offered liquidity to existing investors and provided the GP more time to support the portfolio companies in the continuation fund  
• The assets were lifted out of French investment vehicles for retail investors; retail investors averaged a 3.0x gross MOIC return |
| Providence, RI      |                      |                  |           | Note: Data as of July 2020. Source: Preqin, Company Websites, Secondaries Investor, Wall Street Journal, Buyoutinsider.com  
EATON PARTNERS
Drivers of the GP-led market

• Liquidity demands from limited partners
• Additional capital needs for existing portfolio companies (defensive and offensive purposes)
• Timing mismatch between fund life and asset/portfolio maturation
• Global pandemic has magnified each of these
  – IPO and M&A markets have stalled
  – Traditional secondaries market has “shut” pending return in NAV-based pricing confidence, creating need for alternative capital deployment strategies
  – Traditional short-term solutions (such as term extension) may not address needs in light of market uncertainty
GP-led transaction types
## SELECT TRANSACTION TYPES

### SINGLE-ASSET RECAP (CONTINUATION VEHICLE)

<table>
<thead>
<tr>
<th>Scenarios &amp; Rationales:</th>
<th>CONTINUATION FUND</th>
<th>PREFERRED EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Duration mismatch between asset harvest period and fund life</td>
<td>- Duration mismatch between a portfolio of assets and the fund life</td>
<td>- Portfolio requires follow-on capital or equity cure</td>
</tr>
<tr>
<td>- Asset requires more capital or time to meet expectations</td>
<td>- Portfolio requires more capital or time to meet expectations</td>
<td>- Distribution to LPs to satisfy liquidity demands</td>
</tr>
<tr>
<td>- Asset has significant upside remaining</td>
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</tr>
<tr>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
</tr>
<tr>
<td>- New vehicle established to acquire the asset with potential for follow-on capital. Existing LPs will be given roll or sell options</td>
<td>- New vehicle is established to acquire the assets, with potential for follow-on capital. Existing LPs will be given roll/sell option</td>
<td>- New vehicle is established to provide preferred equity financing in exchange for priority right to distributions from the Fund’s portfolio companies</td>
</tr>
</tbody>
</table>

### PORTFOLIO STRIP SALE

<table>
<thead>
<tr>
<th>Scenarios &amp; Rationales:</th>
<th>MINORITY SALE</th>
<th>SPIN-OUT</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Strong unrealized returns in a mature fund with limited liquidity</td>
<td>- Sponsor looking to generate liquidity without raising additional debt or exiting the investment</td>
<td>- Wind down of a corporate investment program through the buyout of assets and team</td>
</tr>
<tr>
<td>- Investors require liquidity in an older fund before committing to the newest fund</td>
<td>- Opportunity to obtain institutional investors to act as passive equity alongside sponsor</td>
<td>- Investment manager looking to sell group of assets to existing members of the firm</td>
</tr>
<tr>
<td>- Outsized exposure to a particular segment</td>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
</tr>
<tr>
<td><strong>Structure:</strong></td>
<td>- The institutional investor purchases an equity stake from the selling sponsor</td>
<td>- New management company and vehicle are established to purchase and manage assets</td>
</tr>
<tr>
<td>- New vehicle is established to purchase a portion of each asset and will be liable for future calls on a pro-rata basis with the main fund</td>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
</tr>
</tbody>
</table>
### SELECT TRANSACTION TYPES (CONT’D)

<table>
<thead>
<tr>
<th>Tender Offer</th>
<th>Limited Partner Interest(S) Trade</th>
<th>Seeded Fund / Late Primary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scenarios &amp; Rationales:</strong></td>
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</tr>
<tr>
<td>• Group of LPs indicated their interest in liquidity</td>
<td>• LP looking to divest of non-core relationships</td>
<td>• Fund has made a number of investments that have performed well</td>
</tr>
<tr>
<td>• LP(s) has not committed to the latest fund</td>
<td>• LP looking to reduce private equity exposure</td>
<td>• Opportunity to bring in new long-term relationships through secondary angle</td>
</tr>
<tr>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
<td><strong>Structure:</strong></td>
</tr>
<tr>
<td>• Facilitate competitive process where a group of buyers bid on purchasing a maximum amount of LP interests</td>
<td>• Purchase of LP Interest(s)</td>
<td>• New investor would make a primary commitment to the fund</td>
</tr>
<tr>
<td>• The process is often accompanied by a staple to the latest fund</td>
<td>• In sponsor-led processes, the outreach to investors is often based on strength of primary program</td>
<td></td>
</tr>
</tbody>
</table>

### SECURITIZATION

<table>
<thead>
<tr>
<th>Scenarios &amp; Rationales:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• LPs indicated their interest in a near term liquidity option</td>
</tr>
<tr>
<td>• Fund investments have predictable future cash flows</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Structure:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• GP obtains loan from an alternative investment manager secured against future cash flows</td>
</tr>
<tr>
<td>• GP distributes up front cash sum to LPs</td>
</tr>
</tbody>
</table>

### OTHER CONSIDERATIONS

- Many of the transaction types listed often include a primary commitment, also known as a staple
- Transaction types and structures are not confined to what is included in this presentation
- Structures are not mutually exclusive in all cases – may be prudent to deploy multiple strategies to achieve objective
Preferred equity and continuation vehicles
Introduction
- Preferred equity is a NAV-based financing solution that is a non-dilutive source of capital
- It is also a flexible use of capital for the following purposes:
  - Follow-on for portfolio companies and M&A activities
  - Distribution to LPs
  - Reduce leverage of portfolio companies (i.e. equity cure for a pending covenant breach or the repurchase of debt obligations)

Process Summary
- The GP issues a newly created preferred equity security to a new SPV financed by a preferred equity investor
- The Fund issues a security to new Investors with a priority right to distributions from the Fund’s portfolio companies until the Investor has received a certain return, represented either as target multiple and/or a minimum hurdle
- All assets remain in the Fund, but financing provider receives a priority claim on future distributions. The proceeds may be used for multiple purposes

Benefits
- No fixed maturity
- No financial covenants or asset-level security
- Typically higher LTV than versus other NAV-based options
- LPAC approval usually is not needed, which streamlines the funding process
CONTINUATION VEHICLES

**PROCESS OVERVIEW**

• In this process, the GP will sell its existing portfolio from its existing vehicle to a newly established special purpose vehicle, the Continuation Fund.

• Once the Lead Investor is identified, the GP will offer its existing LPs with the following options:
  
  • **Liquidity**: Sell interests and be entitled to receive proceeds equal to the net purchase price.
  
  • **Maintain**: Roll-over current investment and maintain status quo under existing terms.
  
  • **Additional Investment**: Invest additional capital net, pro-rata alongside the new investors in the Continuation Fund on the same price and terms.

• Prospective investor(s) will commit capital to the Continuation Fund to fund the liquidity option, receiving limited partner interests in the Continuation Fund with mutually agreed upon new terms and conditions.

• Additionally, investors will be expected to commit additional capital to fund potential follow-on investments.

**ILLUSTRATIVE TRANSACTION STRUCTURE**

- **Status Quo Vehicle**
  - Limited Partners
    - Selling
    - Status Quo
    - Re-Invest
  - GP
    - Existing Portfolio
  - New Investors
    - Purchase Price
    - Interest in SPV
    - Follow-on Capital Commitment
  - Continuation Fund
    - Portfolio
      - GP Commitment
      - Management Fees
  - Follow-on Capital
    - GP Commitment
    - Management Fees
Preferred equity

- Valuation: favorable LTV and therefore no need to exactly price the equity of the portfolio companies
- Speed of execution/approval process: may not need LPAC approval as no conflict of interest; may not count as leverage under the fund documents; no amendments needed to LPA.
  - Exception if preferred equity goes through fund (and therefore waterfall needs to be amended)
- Flexible use of capital
- Complete fix?
Continuation vehicles

• Liquidity for LPs
• Valuation
  – Problematic during the early stages of the pandemic, particularly for single assets
  – With lower NAV valuations, the GP has the opportunity to use these to reset carry
• Approval process, both fund and portfolio company level
• Opportunity to fix more issues
• Longer process due to complexities
  – Conflicts
  – Disclosure
  – Rollover/reinvestment
    • New capital
    • Status quo
Key considerations

• Preparation! What is the rationale for the transaction?
  – GP and underlying management team see growth opportunities beyond fund life
  – Bolt-on opportunities that need additional capital
  – Exit strategy (perhaps linked to sector and/or market conditions) require longer hold period

• Know your LPs. Involve your LPs and/or the LPAC.
  – Communication is critical
  – Valuation – how determined?
  – Conflicts of interest
  – GP Alignment (e.g., management fee, carried interest, GP commitment, etc.)
  – Anticipate issues – tax consequences, indemnification obligations, etc.
SBIA’s Fall webinars | Save the date

PPP Part 2 – Legal Issues Regarding Compliance to the Act
Wednesday, September 2 | 12:00 – 1:00 pm ET

Managing Credit in a Downturn
Tuesday, September 15 | 12:00 – 1:00 pm ET

A Lookback on Valuations: What Did GPs Do?
Tuesday, September 22 | 12:00 – 1:00 pm ET

Financial Performance Insights for Portfolio Companies: Reporting & Analytics
Tuesday, September 29 | 12:00 – 1:00 pm ET

Evolving Debt Financing Terms
Tuesday, October 6 | 12:00 – 1:00 pm ET
Thank you for joining us today.