# Committed Capital

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COMMITTED CAPITAL PODCAST SERIES

# Private Equity Secondary Transactions – Continuation Funds

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Dechert's global private equity group presented "Private Equity Secondary Transactions – Continuation Funds," an episode of the firm's Committed Capital podcast series. The episode was hosted by Thiha Tun (moderator), a London-based partner in the firm's private funds practice, and featured David Lee, managing director at Kroll, and Michael Tose, co-founder and partner at Columna Capital.

Rolling portfolio company assets into continuation funds has been a key feature of a surge in general partner ("**GP**")-led secondaries transactions, which has in turn been a primary driver behind last year's record-breaking US$130 billion+ secondaries market activity as a whole. Is this trend, which offers GPs more flexibility on hold periods and value creation for their limited partners ("**LP**"), set to continue? This podcast summarized the use of continuation funds as part of private equity secondary transactions.

## HIGHLIGHTS FROM THE EPISODE

**Overview of Secondary Market in 2021** – Based on several reports published by secondary advisors, 2021 saw an unprecedented level of over US$130 billion in deal volume, more than double the volume in 2020, and more than half of that can be attributed to GP-led secondary recapitalization activities. This has been driven by high levels of available capital and robust buyer demand. The level of GP-led secondary activities is expected to continue to exceed that of LP-led transactions going forward. In 2021, approximately 85 percent of the GP-led transactions were in the form of continuation funds. GP-led secondary transactions have now become an accepted part of a GP's toolkit, when looking for liquidity solutions.

**Considerations for New Entrants** – The sponsor should (i) ensure that it has credible grounds for undertaking transactions of this nature; (ii) maintain a high level of transparency with LPs and portfolio company management; (iii) engage appropriate advisors, particularly legal and financial advisors; and (iv) have a realistic timetable for the transaction, as transactions of this nature usually take slightly longer than expected.

**Structures of Secondary Transactions** – (i) Competitive auction: Has the advantage of delivering price discovery in a transparent manner. However, the GP should be aware that they will be subject to extensive due diligence requirements. It also usually takes more time and is often a more complex process; (ii) Bilateral negotiation: Primarily deals with a fund's existing investors. A fairness opinion should normally be obtained in this latter type of secondary transaction. The key solution to the challenges an auction or a bilateral negotiation process may present will be to engage the appropriate advisors and service providers, ensuring that the transaction is properly supported; and (iii) Stapled secondary transactions: As the secondary market is quite saturated, this route may not be attractive to some investors.

**Fairness Opinion** – A GP should carefully analyze conflicts of interest and seek out a fairness opinion as early as possible in the transaction timeline. A data room will usually be established, containing essential due diligence information such as business plans and historical financial statements. As approval from a limited partner advisory committee ("**LPAC**") is usually typical in transactions of such nature, specialist advisors should ensure that an opinion will be ready for circulation upon request when an LPAC meeting has been scheduled. In formulating an opinion, advisors will normally look to indicators other than the net asset value ("**NAV**"), in the case where the NAV deviates significantly from the intrinsic value of the asset as and when it is acquired. GPs should also ensure that the opinion will only be delivered to them after detailed, comprehensive internal review and verification have been undertaken by the service provider.

**Characteristics of a GP-Led Exit** – From the perspective of management, there is greater ability to maintain stability throughout a transition of the business. From the perspective of a GP, there is often a strong rationale for them to continue sponsoring a particular business e.g., highly visible growth, strong alignment with management, to navigate constraints in funding structures etc. It can also create momentum for fundraising by offering existing investors a promising continuation opportunity and attracting new investors. From the perspective of an LP, this may be an avenue for them to maintain exposure to an existing high-quality asset.

To hear the episode in full, click here. For all episodes in our series, click here.