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Secondaries

IN FOCUS 2021



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Revelation Partners

GP-LED RESTRUCTURING
Benefits and key considerations for secondary market managers

LP-LED TRANSACTIONS
Deals led by investors expected to increase

MARKET REBOUND
Secondary market recovery continues into 2021

Revelation Partners

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A VALUED PARTNER TO COMPANIES AND INVESTORS

Revelation Partners is a dedicated secondary investor in the healthcare space. We specialize in providing both **capital** and **liquidity** solutions to healthcare investors, companies, founders, and funds.

We invest broadly across sectors, including medical devices, diagnostics, biopharmaceuticals, healthcare IT, and healthcare services.

- Over $1.0 billion of committed capital.
- Typical investment of $5.0 to $30.0 million.
- We can invest over $100.0 million in conjunction with our limited partners.
- Over 12-year track record dedicated to healthcare secondaries.
- Over 50 years of combined private healthcare investing experience.

Problem

- Founders or employees desire liquidity
- Existing investors lack reserves
- Investor syndicate is misaligned (in time horizon, financing strategy, etc.)
- Company seeks investors to complete a financing

Solution

- Acquire shares to provide liquidity
- Provide capital on behalf of existing investors
- Realign the investor base and participate in follow-on financings
- Structure and participate in financing (both primary and secondary)

Selected Portfolio Companies

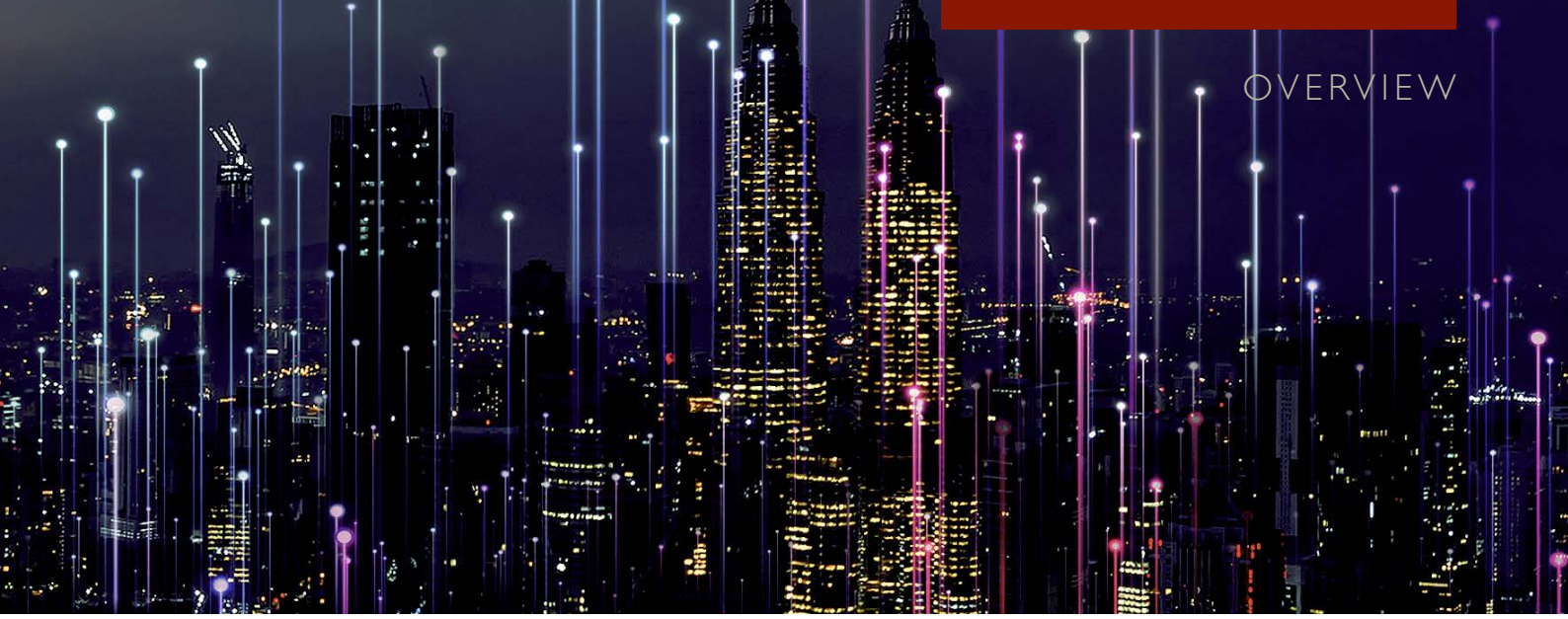
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More LP-led deals expected as GP-led deals still dominate

By A. Paris

The shock of the Covid-19 pandemic led to a significant increase in GP-led deals across the private equity secondary market as managers sought to provide investors with liquidity as funds expired.

In Q2 2020, the market was hit by Covid-19 and there was a shock effect with many deals being put on hold, volumes falling around 50 percent and secondary prices dropping 15-20 percent. This was followed by a strong rebound in late 2020, driven mainly by GP-led deals (catch-up effect, liquidity need for tail-end assets / funds and in general alternative funding / portfolio support solutions)," says Christian Bohler, head of secondaries at Unigestion. "This rebound has continued into 2021 and we believe that volumes will go back to 2019 levels but with a higher ratio, around 50 percent, of this being made up of GP-led deals."

"PE managers explored the GP-led route during the pandemic due to the difficult selling environment, which left many unable to realise expected returns and make distributions to their limited partner (LP) investors," write Nicola Chapman, Martin Forbes, Colin Harley and Sherri Snelson, of White & Case.

For example, they note there were only 1,467 PE exits in 2020, down from 1,718 in 2019 and the lowest annual total since 2013. "Managers were reluctant to proceed with company sales in a volatile market that could compromise exit valuations," the lawyers outline.

In June 2020, when the world was still at the sharper end of the pandemic, Christophe De Vusser, Partner, Bain & Company observed: "Cash flow, will be a critical issue for both LPs and GPs in coming months. To the extent portfolio companies need more capital and LPs are pressed to provide it given other demands on cash, different sources of capital will likely step up... The system has ample capital. It will inevitably flow to where it's needed most."

The secondaries market has proven to be a primary way for GPs to make sure liquidity flowed where it was meant to.

LP-led deals rising

Over the course of the rest of 2021, industry commentators anticipate the return of LP-led transactions.

"As the market recovers, we expect to see a few key trends that will influence the global secondary market's future direction and growth. These include a rebound in LP-led transaction volumes, growing appetite from institutional LP and greater specialisation across secondary buyers," details Gerald Cooper, partner and head of US secondaries, Campbell Lutyens, in a 2021 secondary market overview.

In Bohler's view: "The LP-led market is coming back slowly but steadily and a key consideration for sellers is the cut-off date and where the valuation stands in the longer term. They should also consider what the appetite is and the likely target price for the portfolios."

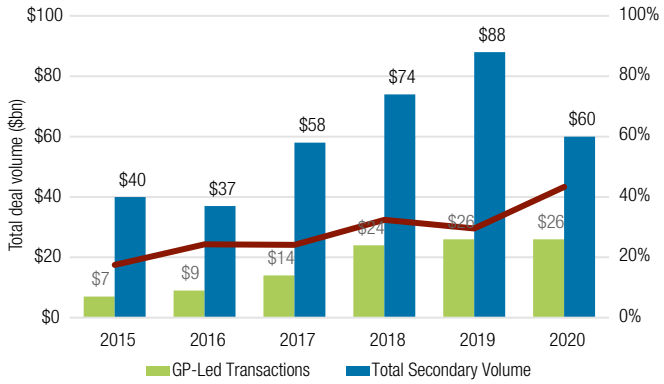
As transaction volumes increase through the year, Bohler advises secondary managers to stick to their strategy, whether they're focused on large or small transations; LP- or GP-led deals. "At the same time, they need to stay flexible and opportunistic to take advantage of deal opportunities that arise," he stresses. ■

Considerations for GP-led restructuring

By Fred Lee

Transactions led by GPs, including GP-led restructurings, are used as a tool for efficient fund management, benefiting both GPs and LPs. The volume of GP-led transactions has grown alongside volume in the broader secondary market. In 2020, GP-led deals accounted for USD26 billion of deal volume – more than 40 percent of total secondary activity.

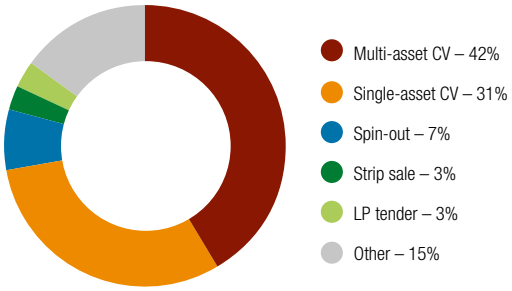
GP-led transaction volume vs total secondary market



Source: Greenhill Global Secondary Market Review, January 2021

There are several motivations for a GP-led fund restructuring. Most commonly, GPs seek to extend the fund's life to manage the assets beyond the originally prescribed term and maximise the value of remaining fund assets. Restructurings may also provide access to additional capital, provide liquidity to existing LPs, realign the overall LP base, and reset GP economics. In 2020, fund restructurings into continuation vehicles (CVs) accounted for 73 percent of all GP-led secondary volume.

GP-led volume by deal type



Source: Greenhill Global Secondary Market Review, January 2021

Potential benefits of GP-led fund structurings:

- Extend fund life
- Maximise the value of remaining assets
- Provide access to additional/unfunded capital
- Provide liquidity to existing LPs
- Realign overall LP base

Key components of the restructuring process include defining the deal structure, managing communications to existing LPs, ensuring proper legal documentation, and finding the right secondary partner.

Deal structure

A GP-led restructuring typically occurs when the remaining assets of a fund are rehoused into a new vehicle. The target fund will typically work with a secondary partner to purchase the fund's assets for a negotiated price. Existing LPs are given the option to either:

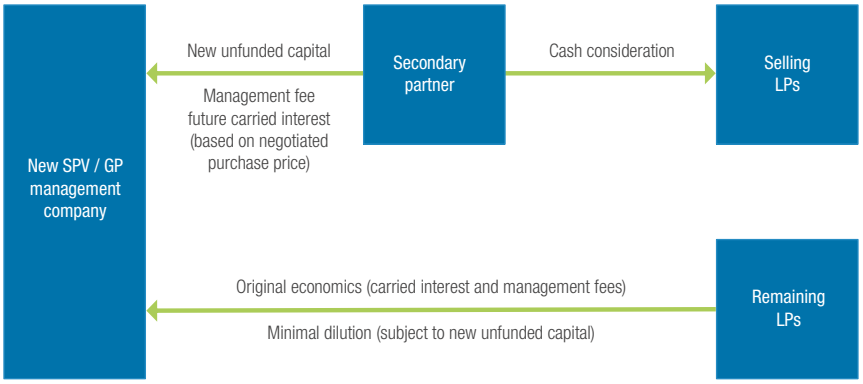
- Sell their interest at the agreed-upon price;
- Roll their interest into a special purpose vehicle (SPV) established to purchase the assets of the target fund; or
- Some combination thereof.

The SPV will typically include new, unfunded capital from the secondary partner to support the portfolio assets. LPs that elect to roll into the new fund will be diluted by this unfunded capital component.

The SPV is typically managed by the existing GP of the target fund, although subject to a new partnership agreement. This agreement will provide for a number of "resets," in terms of economics (carry and management fee), fund life, and follow-on capital commitment. As part of the reset economics, secondary partners and LPs will typically expect the GP to invest alongside in the transaction. This GP capital commitment is usually satisfied through a 100 percent roll of any after-tax carried interest proceeds that are realised as part of the transaction.

Each fund restructuring is unique, and as such, these specific terms tend to vary for each deal. Unlike a typical blind-pool fund, these terms are negotiated and customised to reflect the composition of the LP base, secondary partner, and requirements of the remaining assets (time and capital).

Illustration: fund restructuring



By restructuring into a new vehicle, the GP effectively extends the life of the fund. This relieves pressure on the GP to exit investments before key value-creation milestones have occurred, and in many cases, provides additional capital for both offensive and defensive investment opportunities.

Key considerations

The restructuring process can be complex, with multiple steps, decision points, and disclosures required. Properly managing key components of the process can assure a greater likelihood of success.

Asset Valuation: Pricing for a fund restructuring is highly-specific. A sophisticated secondary partner will account for many factors in determining the right asset valuation, including LP and GP dynamics, attractiveness of portfolio assets, portfolio concentration (across number of assets, sector, stage, etc), projected appreciation in asset value, future capital needs of portfolio companies, and timeframes for exits / liquidity.

Deal Process and LP Engagement: In April 2019, the Institutional Limited Partners Association (ILPA) issued guidance for both GPs and LPs, with four main procedural recommendations:

- When GPs initiate a restructuring process, the overarching objective should be to provide efficiency and transparency for all LPs;
- GPs should engage LPs as early as possible to provide rationale for the restructuring and any alternatives considered;
- The GP should provide detailed disclosures, along with sufficient time (at least 30 calendar days) for LPs to fully consider the terms of the proposed transaction; and
- GPs and LPs must have clear expectations around identifying and mitigating conflicts.

Tax Considerations: GPs should seek to maintain the same tax structure in the new SPV as the original fund, and operate the new vehicle in the same manner (i.e., short-term vs long-term gain considerations, use of tax blockers, etc). GPs should also maintain relevant tax protections for investors, such as avoiding unrelated business taxable income (for applicable tax-exempt investors). Lastly, LPs who roll into the new fund will typically receive a distribution in kind, to avoid an immediate tax liability. The GP should coordinate with existing investors prior to finalising the deal structure and rollover process; LPs may wish to consult with their own tax advisors to ensure alignment with the GPs approach.

Manager Economics: In most instances, the GP will seek "reset" economic rights for the new vehicle, including carried interest and management fees. Intended to incentivise individual managers to continue managing the portfolio assets, these economics are typically calculated based on the negotiated purchase price for the vehicle. However, in certain instances, including when the assets are sold at a steep discount to net asset value (i.e. an underperforming fund), rolling LPs may object to the lower cost basis for calculating carried interest. The GP may need to negotiate a customised waterfall, with certain tiers based on performance milestones (including gross multiple and/or IRR hurdles).

Finding the right secondary partner

Finding the right secondary partner is not only critical to a deal's success, but also an opportunity to reshape the fund's ongoing LP base. This has long-term ramifications for portfolio management and overall value creation.

A number of factors may complicate a potential restructuring process and necessitate a specialised secondary partner. The most common consideration is sector focus – for example, a portfolio of healthcare assets will require a partner with sector-specific expertise and alignment, as opposed to a generalist. Other factors may include portfolio concentration or assets that are early-stage or distressed in nature. When evaluating potential secondary partners, fund managers should seek a dedicated partner who not only has the deal experience and financial wherewithal to complete a restructuring, but also the expertise to maximise both near-term and long-term value. ■

Fred Lee
Managing Director, Revelation Partners



Fred Lee is Head of Business Origination at Revelation Partners. With over 14 years of banking and investment experience, Fred focuses on identifying and reviewing new investment opportunities, as well as managing the firm's industry relationships. Prior to Revelation Partners, Fred was a Managing Director in the Life Sciences Group at Bridge Bank, where he executed venture debt investments across all healthcare sectors. He began his career in Citi's Healthcare Investment Banking group.

Revelation Partners

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REVELATION PARTNERS

Revelation Partners provides flexible capital solutions to the healthcare ecosystem. We specialise in providing liquidity for illiquid, private holdings and growth capital to allow investors to maximise their return.

We invest broadly across all healthcare sub-sectors, including medical devices, diagnostics, biotech, healthcare technology, and healthcare services.

With decades of investing experience, deep sector expertise, an extensive industry network, and over USD1 billion of committed capital, Revelation Partners is a trusted partner to healthcare companies, investors, founders, and funds.

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