Continuation Vehicles

Six month snapshot of the key terms of continuation vehicles

Paul Hastings Secondaries Practice Research

PAUL
HASTINGS

Paul Hastings LLP | www.paulhastings.com

Introduction

Methodology

The Paul Hastings Secondaries Practice has identified a number of key insights on Continuation Vehicles (“**CVs**”) having advised on a significant number over the six month period, from Q4 2021 through Q1 2022.

The CVs analysed span a variety of sectors, ranging from healthcare to media.

This paper gives a snapshot, identifying key trends and extracting key terms, to provide a useful insight into the provisions found in CVs’ legal documentation. We have also provided an example term sheet at Appendix 1.

Paul Hastings Secondaries Practice

We have extensive experience acting for buyers, sellers and GPs on direct and indirect secondary transactions, GP-led deals, preferred equity and other liquidity solutions, stapled secondaries and other structured transactions—globally and across asset classes.

Key Trends

A snapshot of terms from recent private equity continuation vehicles reflects a growing efficiency of the market

Across the CVs analysed

~70%
of the CVs were single-asset deals

$250M–$1.3BN
CV size ranging from circa

$700M
Average size of each CV

$5BN
Total commitments in excess of

The data shows that approximately 70% of the CVs were single-asset deals. The average size of each was $700m, while total commitments exceed $5bn.

The average term for a CV was 5.2 years, reaching an average of 7.3 years including extensions.

> “Two conclusions stand out from the Snapshot – the first being the standardisation of deals, and the second being the growing efficiency of the market. We have seen increased popularity of CVs over the past two years, forming a prominent trend in the private equity space, and one which we expect to continue throughout the next half of the year. The fact that we saw 100% rollover of sponsor commitment from existing funds is notable and speaks to the confidence that many share in this area of investment. The market has well and truly found its place.”
>
> **Ted Craig**, Private Investment Funds partner at Paul Hastings’ London office

Sponsor Commitment

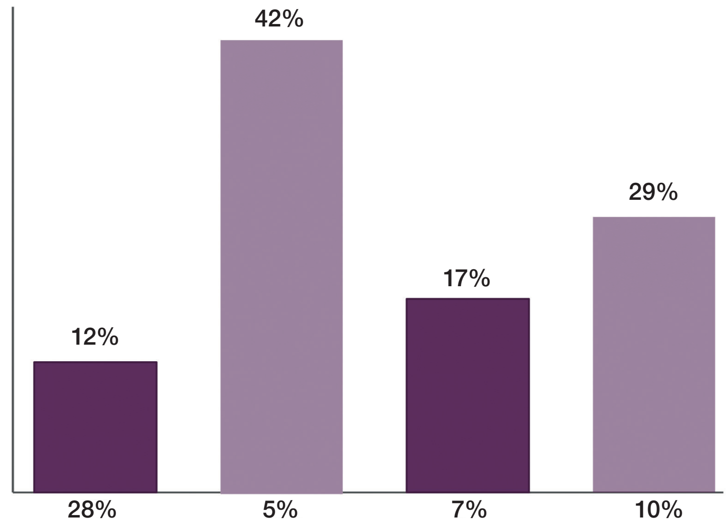
Points to note

Notably, almost a third (29%) of deals involved sponsors providing 10% of the investor commitment to the CV.

In addition, almost three-quarters (74%) of CV waterfalls have a ratchetted carry mechanic. In place of a direct sponsor commitment, CVs saw 100% rollover of sponsor commitment from existing funds, and 100% investment in the CV of crystallised carry from existing funds.

Other mechanics used in place of a direct sponsor commitment:

- **100%** rollover of sponsor commitment from existing fund
- **100%** investment in CV of crystallised carry from existing fund



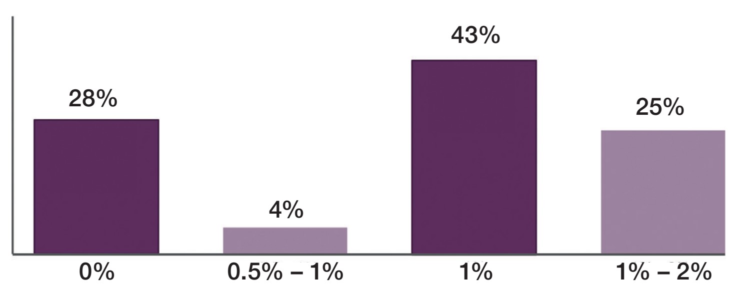
Sponsor commitment as a % of investor commitments to the CV

Management Fee

Points to note

Management vs 'Other' fees

- When it comes to the management fees of such vehicls, **two thirds (67%)** of vehicles saw 1-2% of invested capital charged as a management fee.
- **One in four** CVs didn't charge fees at CV level but instead charged either an on-going monitoring fee and/or a one-off transaction fee at portfolio company level
- Where a monitoring fee was charged at portfolio company level, the average monitoring fee was **1.5%** of CV size per year
- Where a management fee is charged, **100%** of CVs management fees are charged on invested capital and not on committed capital



Management fee as a % of invested capital

Carry Waterfall

Points to note

- **74%** of CV waterfalls have a ratchetted carry mechanic
- **46%** of CV waterfalls included both IRR and MoIC return thresholds
- Once return thresholds are met, the lowest carry entitlement is **10%** and highest is **30%**
- Majority of CVs have **100%** GP catch-up at each level

Typical Example

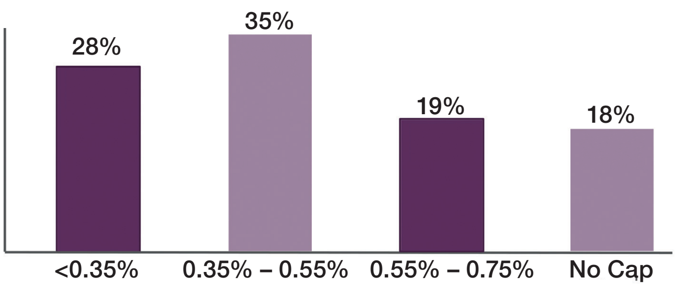
Three-level hurdle mechanism with 100% GP catch-up at each level

1. Investor capital contributions
2. **10%** hurdle and 1.5x Net MoIC – **10%** carry
3. **15%** hurdle and 1.75x Net MoIC – **15%** carry
4. **20%** hurdle and 2.0x Net MoIC – **20%** carry

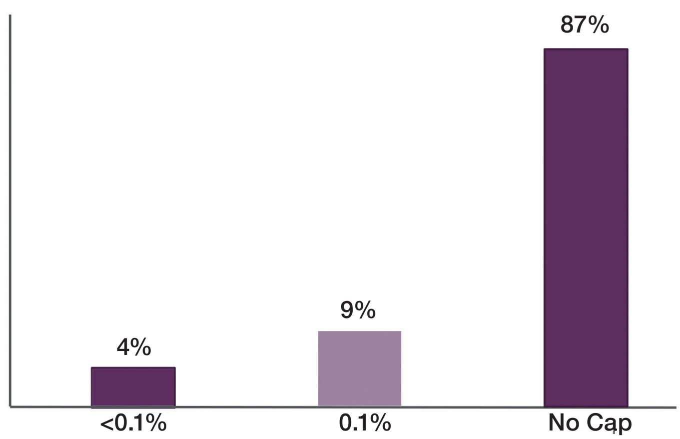
Costs and Expenses

Points to note

- **One in four** CVs also capped annual on-going costs and expenses of the CV
- Amounts incurred above any establishment costs or ongoing costs and expenses cap are payable by the sponsor



Establishment cost and expenses cap as a % of CV size



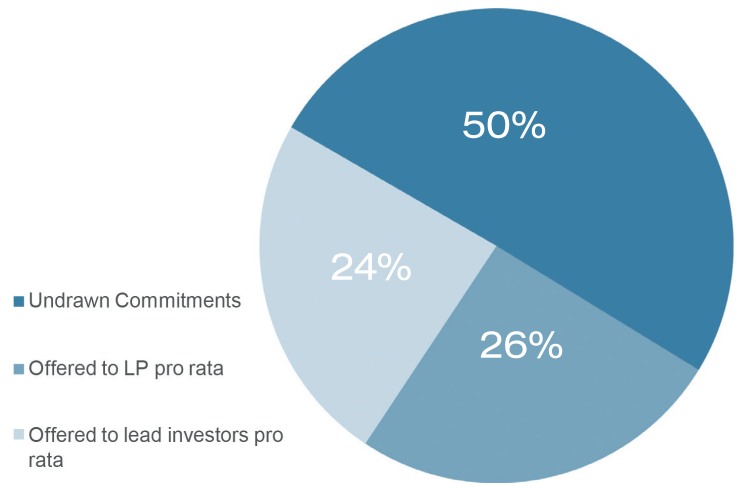
Annual on-going cost cap as a % of CV size

Follow-on Investments

Points to note

Where follow-on investments were addressed, funding requirements have either:

- been contemplated when determining the size of the CV—here follow-ons are to be funded by undrawn commitments; or
- not been included in the CV size—here follow-ons are either offered to all LPs pro rata or to lead investors only, again pro rata

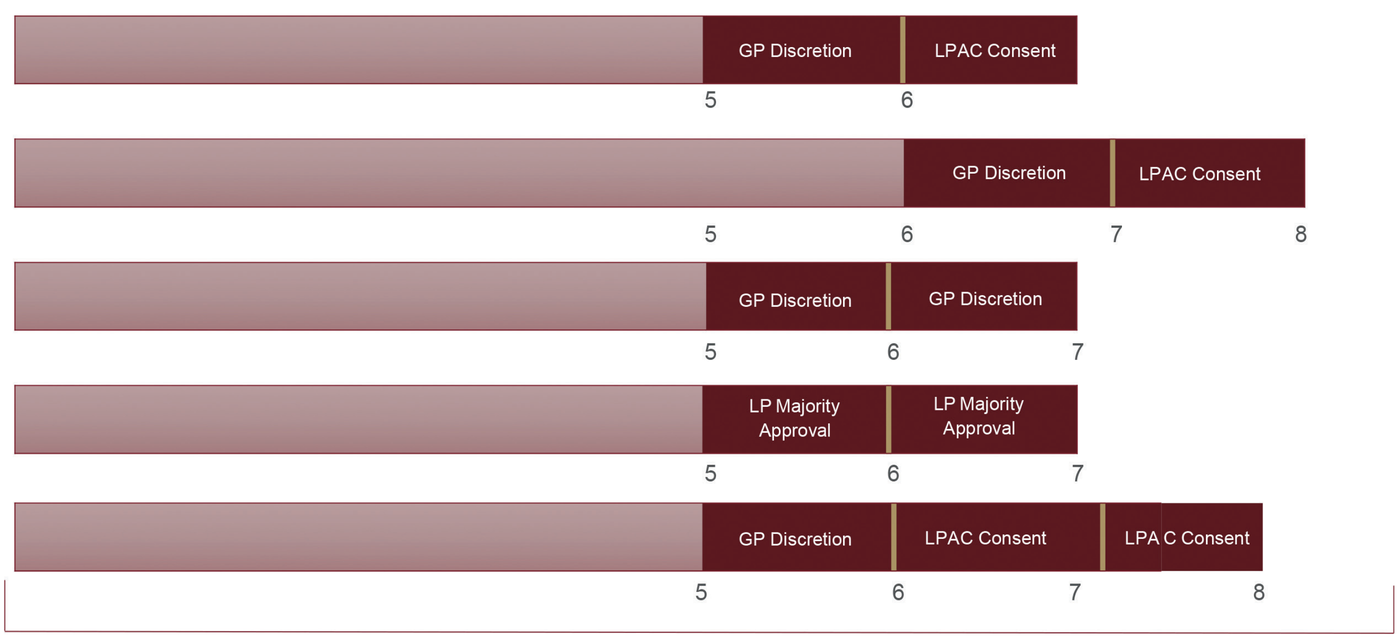


CV Term

Points to note

- Average CV term: **5.2 years**
- Average CV term plus extensions: **7.3 years**

Example Extension Mechanics



CV term plus extensions (years).

Other Key Provisions

Points to note

- **LPAC**: 100% of CVs included LPAC
- **Key Person**: 37.5% of CVs included a key person provision
- **No-Fault Removal**: 12.5% of CVs included a no-fault GP removal
- **Removal for Cause**: 100% of CVs included a fault GP removal
- **Borrowing**: 96% of CVs explicitly permitted short-term borrowing
- **GP Clawback**: 96% of CVs included a GP Clawback provision

Secondaries Practice Overview

Market Leading

We have extensive experience acting for buyers, sellers and GPs on direct and indirect secondary transactions, GP-led deals, preferred equity and other liquidity solutions, stapled secondaries and other structured transactions—globally and across asset classes.

We are frequently called upon to work on market-leading deals, regularly advising on complex private fund secondaries. We have the specialist experience needed to guide stakeholders through the life-cycle of these transactions.

In the last six months alone, our team has advised on secondaries transactions with an overall deal value in excess of $6bn.

In October 2021 we advised on an innovative secondaries transaction that was recently voted Secondaries Deal of the Year in Asia at the Private Equity International Awards 2021.

Tax and Regulatory Expertise

Our team includes dedicated U.S. and European tax and regulatory expertise.

We can help navigate key U.S. tax matters including publicly traded partnership regulations and withholding tax requirements under the Internal Revenue Code.

We can help to determine the most practical approach to transfer taxes such as U.K. stamp duty. Our Regulatory team can advise on the key U.S. and European regulatory and securities laws including the U.S. Securities Act of 1933 and U.S. Investment Company Act of 1940 and AIFMD.

A Global Practice

Our team operates a global practice, covering the U.S., Europe, Asia and South America. This coverage ensures the breadth of our offering and our understanding of the asset classes, transaction types and participants in the private fund space globally.

Our focus

- **GP-led transactions;**
- **Continuation Vehicles;**
- **LP interest portfolio acquisitions and disposals;**
- **Preferred Equity;**
- **Leveraged acquisitions;**
- **Stapled secondaries;**
- **Tender offers;**
- **Strip Sales; and**
- **Late-stage primaries.**

For more information, visit:
www.paulhastings.com/practice-areas/private-investment-funds

Key Contacts

Ted Craig
Author
Partner, London
44-020-3023-5211
tedcraig@paulhastings.com

Ted Craig is a partner in the Private Investment Funds practice, and is based in the Firm's London office.

Brian Richards
Partner, Chicago
1-312-499-6070
brianrichards@paulhastings.com

Brian Richards is Chair of the Firm's Global Private Equity Practice and is a partner in the Private Equity and M&A practices, and is based in the Chicago office.

Appendix 1: Example Term Sheet*

Fund	Continuation Vehicle LP (the "**Partnership**"). Additional parallel, feeder or alternative investment vehicles may be established as required for legal, regulatory or tax reasons (together with the Partnership, the "**Fund**").
Investment Objective	The primary objective of the Partnership is to generate medium to long-term returns for its investors through its investment in Target Company Ltd (the "**Portfolio Company**").
General Partner	CV GP Ltd, the general partner of the Partnership (the "**General Partner**").
Limited Partners	The limited partners of the Partnership (the "**Limited Partners**"), including the re-investing investors (the "**Reinvesting Investors**") and third party investors (the "**Syndicate Investors**").
Manager	Sponsor LLP, the manager of the Partnership, who has been appointed to provide management services to the General Partner with respect to the Partnership (the "**Manager**").
Carried Interest Partner	Carry LP, will be entitled to receive distributions of Carried Interest (the "**Carried Interest Partner**").
Advisory Committee	The General Partner will invite representatives of investors to join the advisory Committee as voting members (the "**Advisory Committee**"). The Advisory Committee will meet as required to consult with the General Partner as to the Partnership's performance and to consider any potential conflicts of interest.
Term	The Partnership has a term of five (5) years (the "**Term**") from the date of the closing which may be extended the for up to two (2) additional one-year periods subject to prior approval of the Advisory Committee.
Management Fee	The Manager shall receive a management fee of 1% of invested capital of the Partnership throughout the initial 5-year Term ("**Management Fee**"). The Management Fee shall be renegotiated in good faith by the General Partner and the Advisory Committee upon the occurrence of: a) any Term extension; and b) the commencement of the liquidation process of the Partnership.
Management Fee Offset	One hundred percent (100%) of any Partnership investment related fees and commissions received directly or indirectly by the Manager (other than the Management Fee and the Carried Interest) shall be offset against the Management Fee.
Commitments	Total commitments to the Partnership will not exceed $700m (the "**Commitments**") being the sum of: (a) $550 million (the "**Purchase Price**"); and (b) Up to $150 million of undrawn commitments (the "**Unfunded Commitment**") which shall be used for follow-on investments in the Portfolio Company ("**Follow-On Investments**") and fund expenses (including the Management Fee). All Limited Partners will participate on a pro rata basis in respect of both limbs of the Commitments.
Currency	All Commitments, distributions and calculations in respect of the Partnership will be denominated in Dollars ($).

<table>
<tr><td>Borrowing</td><td>The Partnership may borrow money for up to 12 months for purposes including bridging, working capital or liquidity purposes.

Borrowing and any amount outstanding under guarantees shall not exceed thirty percent (30%) of the aggregate Commitments.
The Partnership is authorised to grant security over any of the assets of the Partnership, any Unfunded Commitments, the right to deliver drawdown notices and the right to exercise any remedies against Defaulting Investors provided for under the limited partnership agreement (the "Partnership Agreement").</td></tr>
<tr><td>Recycling</td><td>The General Partner may determine in its sole discretion to retain and use distributable proceeds instead of issuing drawdown notices to Limited Partners as long as a drawdown notice could still be issued at that time for the proposed use of such funds. The General Partner undertakes that the invested capital, including any reinvestments from recycled distributable proceeds, shall not exceed one hundred and twenty percent (120%) of the Partnership's aggregate Commitments.</td></tr>
<tr><td>Distributions</td><td>Investment proceeds will be distributed in the following order of priority:

(a) <u>Return of Capital:</u> First, one hundred percent (100%) to the Limited Partners until the cumulative amount distributed to the Limited Partners (taking into account all prior distributions made pursuant to this limb (a)) is equal to the Limited Partners' aggregate capital contributions at the time of such distribution;
(b) <u>Relevant Return:</u> Second, between the Limited Partners and the Carried Interest Partner in the ratio specified in the table below until the cumulative distributions to the Limited Partners are sufficient to provide an annualised effective internal rate of return ("Net IRR") and (where applicable) a net multiple on invested capital ("Net MoIC") on the capital contributions of the Limited Partners as specified in the table below (each a "Relevant Return");
(c) <u>Catch-Up and Carried Interest:</u> After each Relevant Return is satisfied, the Carried Interest Partner's carried interest percentage will be increased and the Carried Interest Partner will receive catch-up distributions according to the Relevant Return that has been satisfied:

<table>
<tr><th>LP/GP Split</th><th>Relevant Return</th><th>Carried Interest</th><th>GP Catch-up</th></tr>
<tr><td>90:10</td><td>Net IRR 10%</td><td>10%</td><td>100%</td></tr>
<tr><td>85:15</td><td>1.5x Net MoIC and Net IRR 15%</td><td>15%</td><td>100%</td></tr>
<tr><td>80:20</td><td>2.0x Net MoIC and Net IRR 20%</td><td>20%</td><td>100%</td></tr>
</table>
(d) <u>80/20 split:</u> Thereafter, eighty percent (80%) to the Limited Partners and twenty percent (20%) to the Carried Interest Partner.</td></tr>
<tr><td>Carried Interest Clawback</td><td>Upon the termination of the Partnership, the General Partner will undertake a calculation pursuant to the formula provided in the "Distributions" section of this term sheet to determine whether there has been any overpayment of Carried Interest to the Carried Interest Partner.

To the extent that there has been an overpayment, the Carried Interest Partner will return to the Partnership (which will in turn distribute to the Investors) any excess amounts received by the Carried Interest Partner.</td></tr>
</table>

	In no event, however, will the Carried Interest Partner be required to return more than the cumulative Carried Interest received by the Carried Interest Partner, net of amounts in respect of taxes paid or payable thereon. Each carry recipient will guarantee such carry recipient's share of the Carried Interest Partner clawback obligations on a several but not joint basis.
Establishment Expenses	The Partnership will bear all legal, organisational and offering expenses, including the out-of-pocket expenses of the General Partner and the Manager and their agents, actually incurred in the formation of the Partnership and the General Partner, and the negotiation, execution and delivery of the Partnership Agreement and related agreements, up to a maximum amount of $3,500,000.
On-going Expenses	The Partnership will bear all of its on-going expenses and expenses incurred during the life of the Partnership, including ongoing legal, audit, regulatory and administration fees, any costs and expenses incurred with respect to third parties providing services to the Partnership and all expenses associated with the acquisition, restructuring or disposal of investments. The General Partner or the Manager will be responsible for all of its own normal overhead and administrative costs including salaries and benefits, rent and office furniture and shall not be entitled to recover such costs from the Partnership.
Defaulting Investor	A Limited Partner that defaults in respect of its obligation to make capital contributions (a "**Defaulting Investor**"), shall be liable to interest on the amount outstanding at the rate equal to EURIBOR plus four percent (4%) for the period from the drawdown date until the date on which such outstanding amount and interest thereon shall have been paid in full ("**Default Interest**"). In the event that the Defaulting Investor has not cured the default within 30 days of the date of the notice from the General Partner requiring it to do so, the General Partner shall have the right: • to forfeit the capital contribution of the Defaulting Investor, in which case the rights of such Defaulting Investor shall be limited to the right, on termination of the Fund, to payment (after all other Investors have received payment of their capital contributions and the first hurdle, and the Carried Interest Partner has received the first catch-up) of the lesser of the amounts it has advanced to the Fund and the fair market value of its interest at the time of the distribution; or • to act as selling agent and the Defaulting Investor's appointed attorney, in disposing of the interest of the Defaulting Investor to a third party at such reasonable price agreed between the General Partner (acting in good faith) and the relevant third party. The availability of the remedies set out above is without prejudice to any other legal or equitable remedies the General Partner may have in respect of any default under the terms of the Partnership Agreement.
Removal for Cause	The appointment of the General Partner may be terminated by vote of greater than two-thirds of the interest of the Limited Partners in the event that there is a final determination that such termination is as a result of a cause event.

*Illustrative purposes only

Global Resources

The Americas

Atlanta
Century City
Chicago
Houston
Los Angeles
New York
Orange County
Palo Alto
San Diego
San Francisco
São Paulo
Washington, D.C.

Europe

Brussels
Frankfurt
London
Paris

Asia

Beijing
Hong Kong
Seoul
Shanghai
Tokyo

21 Offices Across the Americas, Asia and Europe

1 Legal Team To integrate with the strategic goals of your business

Our Offices

The Americas

Atlanta
1170 Peachtree Street, N.E.
Suite 100
Atlanta, GA 30309
t: +1.404.815.2400
f: +1.404.815.2424

Century City
1999 Avenue of the Stars
Los Angeles, CA 90067
t: +1.310.620.5700
f: +1.310.620.5899

Chicago
71 S. Wacker Drive
Forty-fifth Floor
Chicago, IL 60606
t: +1.312.499.6000
f: +1.312.499.6100

Houston
600 Travis Street
Fifty-Eighth Floor
Houston, TX 77002
t: +1.713.860.7300
f: +1.713.353.3100

Los Angeles
515 South Flower Street
Twenty-Fifth Floor
Los Angeles, CA 90071
t: +1.213.683.6000
f: +1.213.627.0705

New York
200 Park Avenue
New York, NY 10166
t: +1.212.318.6000
f: +1.212.319.4090

Orange County
695 Town Center Drive
Seventeenth Floor
Costa Mesa, CA 92626
t: +1.714.668.6200
f: +1.714.979.1921

Palo Alto
1117 S. California Ave.
Palo Alto, CA 94304
t: +1.650.320.1800
f: +1.650.320.1900

San Diego
4747 Executive Drive
Twelfth Floor
San Diego, CA 92121
t: +1.858.458.3000
f: +1.858.458.3005

San Francisco
101 California Street
Forty-Eighth Floor
San Francisco, CA 94111
t: +1.415.856.7000
f: +1.415.856.7100

São Paulo
Av. Presidente Juscelino
Kubitschek, 2041
Torre D, 21º andar
Sao Paulo, SP
04543-011
Brazil
t: +55.11.3521.7109
f: +1.212.230.7647

Washington, D.C.
2050 M Street NW
Washington, DC, 20036
t: +1.202.551.1700
f: +1.202.551.1705

Europe

Brussels
Avenue Louise 222
1050 Brussels
Belgium
t: +32.2.641.7460
f: +32.2.641.7461

Frankfurt
TaunusTurm
Taunustor 1
60310 Frankfurt am Main
Germany
t: +49.69.907485.0
f: +49.69.907485.499

London
100 Bishopsgate
London EC2N 4AG
United Kingdom
t: +44.20.3023.5100
f: +44.20.3023.5109

Paris
32, rue de Monceau
75008 Paris
France
t: +33.1.42.99.04.50
f: +33.1.45.63.91.49

Asia

Beijing
Suite 2601, 26/F
Yintai Center Office Tower
2 Jianguomenwai Avenue
Chaoyang District
Beijing 100022 China
t: +86.10.8567.5300
f: +86.10.8567.5400

Hong Kong
22/F Bank of China Tower
1 Garden Road
Central Hong Kong SAR, China
t: +852.2867.1288
f: +852.2526.2119

Seoul
33/F West Tower
Mirae Asset Center1
26, Eulji-ro 5-gil, Jung-gu
Seoul, 04539, Korea
t: +82.2.6321.3800
f: +82.2.6321.3900

Shanghai
43/F Jing An Kerry Center Tower II
1539 Nanjing West Road
Shanghai 200040, China
t: +86.21.6103.2900
f: +86.21.6103.2990

Tokyo
Ark Hills Sengokuyama Mori Tower
40th Floor, 1-9-10 Roppongi
Minato-ku, Tokyo 106-0032
Japan
t: +81.3.6229.6100
f: +81.3.6229.7100