



**Houlihan
Lokey**

Continuation Fund
and Cross-Fund
Transactions
Remain Resilient
During Volatile
Markets

Throughout the year, macroeconomic challenges and geopolitical tensions led to widespread disruption in the public equity and credit markets. Despite these economic headwinds, we observed an increase in fund-level affiliate transactions in 2022, as sponsors utilized creative strategies to optimize portfolios and create liquidity in an environment where traditional exits were more challenging.

Regardless of market conditions, affiliate transactions are an important tool for GPs, and sponsors are undertaking an increasingly wide variety of transactions to retain attractive assets, maximize value potential, support/strengthen a portfolio company's financial profile, and manage end-of-life funds. Limited partner advisory committees (LPACs) are increasingly approached by sponsors in connection with such transactions, and GPs must implement best practices to manage the actual or perceived conflicts of interest. With increased regulatory and investor scrutiny, independent financial advisors can help sponsors mitigate legal, regulatory, and execution risk and improve the transparency of these transactions.

Types of Fund Affiliate Transactions

Fund affiliate transactions have taken many forms throughout 2022—some with a third-party process, such as GP-led continuation funds, and many other transaction types that do not involve a process or third-party price discovery. Examples include:

- **GP-Led Continuation Funds:** Transactions involving the sale of one or more assets, whether portfolio companies, credit positions, or real estate, in existing funds to a newly created vehicle in order to provide existing LPs with a liquidity option and give the sponsor additional time and capital to maximize value over an extended runway.
 - **Multi-Asset Continuation Funds:** Involve the sale of some or all of the remaining assets in one or more funds, oftentimes to manage end-of-life fund situations.
 - **Single-Asset Continuation Funds:** Involve the sale of one portfolio company, oftentimes a "trophy" asset, to crystallize returns for existing LPs while giving the sponsor time to further execute their value creation plan.
- **Cross-Fund Transactions:** Transactions between related funds, such as (i) mergers of portfolio companies held in different funds, (ii) sales of portfolio companies from one fund to another fund of the same sponsor, (iii) acquisitions of third-party targets by portfolio companies in which equity capital is provided by a subsequent fund, or (iv) carve-outs or divestitures of assets from existing portfolio companies.
- **Principal Trades:** Transactions between a GP or fund executive and a related fund or affiliate.
- **Fund Seeding:** The contribution of existing investments into a new fund vehicle prior to an external capital raise.

Key Observations Throughout the Year

GP-Led Transactions Remain Popular: GP-led continuation funds have gained prevalence in recent years and are now an accepted path to liquidity for funds. Based on market reports, GP-led transactions accounted for approximately \$50 billion of transaction volume globally in 2022, representing the second most active year on record.⁽¹⁾ Despite an approximate 25% decline vs. the peak in 2021, the GP-led market showed resilience and proved to be a valuable tool for sponsors facing challenging M&A and IPO markets.

Demand for Multi-Asset Transactions Grows: While single-asset GP-led transaction volume remained strong, demand for diversified portfolios grew in 2022, resulting in increased appetite for multi-asset deals. Following a stretch of high investment into single-asset deals over the past two years, a number of secondaries investors sought out a return to the multi-asset structure to mitigate concentration concerns. Going forward, although single-asset volume is expected to continue making up a significant portion of the overall GP-led market, multi-asset deals will present an attractive opportunity for investors seeking diversification.

Valuation Disconnects Between Buyers and Sellers: Against the challenging macroeconomic environment in 2022, a significant portion of GP-led transactions were priced at a discount to NAV. In contrast to 2021, where most deals were priced at or above reference NAV, buyers noted declining public market valuations, increased cost of capital, and lag time on reference date vs. pricing date as key drivers of NAV discounts. To help bridge the gap in value expectations between buyers and sellers, various structuring alternatives were put in place such as deferred payments or performance-based earnouts to facilitate getting transactions over the finish line.

Challenging Syndication Environment: As the supply of GP-led transactions in the market continues to grow, sponsors often need to find additional sources of capital (other than lead and syndicate investors) to cash out existing LPs. This trend increased in the second half of the year as secondaries buyers became increasingly selective and syndication processes lengthened. As a result, sponsors tapped other sources to fill out the capital requirements, including (i) the GP's most recent vintage fund, (ii) large LPs or co-investors who sought additional exposure, or (iii) unaffiliated third-party sponsors willing to take a minority stake in the portfolio company.

Significant Growth in Cross-Fund Transactions: Sponsors today have increasingly complex fund family dynamics as they manage multiple asset classes, maintain concurrent active funds, and have increased co-investor participation. As a result, sponsors have explored an ever-increasing set of transactions between funds and used cross-fund transactions to generate liquidity events, manage portfolios, and provide support to portfolio companies where necessary. In 2022, we observed a record number of these transactions that crossed funds or otherwise placed the sponsor in a potential conflict-of-interest position, and we expect that volume to continue increasing into 2023 given the current market dynamics.*

*Note that cross-fund transactions that do not involve a third-party agent are not counted in the reported GP-led volume.

⁽¹⁾ Estimated transaction volume of \$50 billion based on publicly available Wall Street research.

Growing Complexity in Cross-Fund Transactions: Sponsors are increasingly pursuing more complex cross-fund transactions to optimize opportunities. Throughout the year, we observed numerous situations with highly complex transaction structures, including:

- i. Buy-and-Split Transactions: The sponsor acquires a third-party target, splits the target into two or more distinct companies or “perimeters,” and either merges the newly formed perimeters with existing portfolio companies or becomes an independent portfolio company.
- ii. Fund Mergers: The sponsor combines the assets from two or more existing funds into a single fund (open or closed-ended) with an indefinite life.

Fiduciary Considerations for Sponsors

Fund affiliate transactions present potential conflicts of interest, valuation complexities, and enhanced execution risk. Such transactions have come under heightened scrutiny in recent years given (i) recent changes to the regulatory environment and (ii) increased investor oversight.

- i. On February 9, 2022, the U.S. Securities and Exchange Commission (SEC) voted 3-1 to propose new rules and amendments under the Investment Advisers Act of 1940 designed to increase the regulation of private fund advisors. Included in the new rules was a requirement for private fund advisors to obtain a fairness opinion in connection with advisor-led secondaries transactions. According to the SEC, the fairness opinion “provides an important check against an advisor’s conflicts of interest in structuring and leading a transaction from which it may stand to profit at the expense of private fund investors.” The proposed rules, and particularly the fairness opinion requirement, signal the SEC’s intention to focus on and increase regulation over GP-led transactions going forward.
- ii. As affiliate transactions continue to gain widespread adoption, funds’ LPs or LPACs are regularly approached to waive conflicts. We expect investors will continue to increase their oversight of these transaction processes.

As investors and regulators increase their examination of affiliate transactions, sponsors must implement best practices to manage the actual or perceived conflicts of interest despite best intentions. An independent financial advisor can assist sponsors in satisfying their legal, regulatory, and contractual duties in connection with an affiliate transaction. Fairness or valuation opinions may serve to both protect the sponsor and facilitate discussions about the transaction with the LPAC and other parties. The receipt of independent advice and a financial opinion by a sponsor in affiliate transactions has become a widely adopted best practice.

Selected Houlihan Lokey 2022 Transactions

Houlihan Lokey has been at the forefront of providing fairness opinions to sponsors in many of the largest and most complex affiliate transactions. We assisted dozens of sponsors in 2022 across a wide range of GP-led portfolio, single-asset, and cross-fund transactions.

<p>ROARK CAPITAL GROUP</p> <p>has completed a continuation fund that includes its investments in Focus Brands and Primrose and a portion of its investment in Inspire Brands</p> <p>Fairness Opinion</p>	<p>AEA</p> <p>has completed a continuation fund transaction related to its investment in</p> <p>EXCELITAS TECHNOLOGIES</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>WINDPOINT PARTNERS</p> <p>has acquired</p> <p>CRASH CHAMPIONS</p> <p>which was subsequently combined with</p> <p>ServiceKing COLLISION</p> <p>Financial Advisor</p>	<p>ATLAS HOLDINGS</p> <p>has completed a continuation fund transaction related to its investments in</p> <p>WINSTON TWIN RIVERS</p> <p>BRIDGEWELL RedBUILT</p> <p>Veritas STEEL Spark</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>TPG</p> <p>have completed an equity investment into</p> <p>acorns</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>FORTRESS</p> <p>transferred interest in</p> <p>United and Alta</p> <p>Financial Opinion</p>
<p>Centerbridge</p> <p>and</p> <p>VISTRIA</p> <p>have completed a recapitalization transaction involving</p> <p>Sevita</p> <p>Financial Opinion</p>	<p>LorientCapital</p> <p>has completed a continuation fund transaction related to its investment in</p> <p>shiftkey</p> <p>Fairness Opinion</p>	<p>element MARKETS</p> <p>a portfolio company of</p> <p>TPG RISE</p> <p>has acquired</p> <p>bluesource</p> <p>Fairness Opinion</p>	<p>QHP CAPITAL</p> <p>has completed a continuation fund transaction for</p> <p>CATALYST CLINICAL RESEARCH</p> <p>Fairness Opinion</p>	<p>Transaction Pending</p> <p>HMH</p> <p>a portfolio company of</p> <p>VERITAS CAPITAL</p> <p>has agreed to acquire</p> <p>nwea</p> <p>Valuation Opinion</p>	<p>STARWOOD CAPITAL GROUP</p> <p>InTown SUITES</p> <p>Funds of Starwood have sold certain ownership interests in InTown Suites to newly formed vehicles</p> <p>Fairness Opinion</p>
<p>Funds managed by</p> <p>JMI EQUITY</p> <p>have transferred certain ownership interests in</p> <p>businessolver</p> <p>to affiliated funds</p> <p>Fairness Opinion</p>	<p>LEEDS Equity Partners</p> <p>has completed a continuation fund transaction related to its investment in</p> <p>exterro</p> <p>Fairness Opinion</p>	<p>eagle foods.</p> <p>a portfolio company of</p> <p>KELSO</p> <p>has acquired the Helper and Suddenly Salad businesses from</p> <p>General Mills</p> <p>Fairness Opinion</p>	<p>STG Logistics</p> <p>Our People Are the Difference</p> <p>a portfolio company of</p> <p>WIND POINT PARTNERS</p> <p>has completed a recapitalization and acquired</p> <p>XPO Logistics Intermodal & Drayage Division</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>hrynwood partners</p> <p>have combined</p> <p>Hometown FOOD COOPERATIVE and WINDMILL</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>TPG RISE</p> <p>have completed an equity investment into</p> <p>MATRIX RENEWABLES</p> <p>Fairness Opinion</p>
<p>Audax Private Equity</p> <p>has completed a continuation fund transaction related to its investment in</p> <p>aspensurgical.</p> <p>Fairness Opinion</p>	<p>AMBERJACK CAPITAL PARTNERS</p> <p>has completed a continuation fund transaction related to its investment in</p> <p>INNOVEX</p> <p>Fairness Opinion</p>	<p>GRAHAM PARTNERS</p> <p>has completed a continuation fund transaction for</p> <p>OptConnect MANAGED WIRELESS SOLUTIONS</p> <p>Fairness Opinion</p>	<p>TORQUEST</p> <p>has completed a continuation vehicle transaction for</p> <p>CAN ART ALUMINUM EXTRUSION L.P.</p> <p>Financial Advisor</p>	<p>TRINITY HUNT PARTNERS</p> <p>has completed a continuation fund transaction related to its investments in</p> <p>argano</p> <p>improving</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>J.F. Lehman & Company</p> <p>have entered into an agreement to combine its two portfolio companies</p> <p>TRIDENT and AGI</p> <p>Valuation Opinion</p>
<p>Funds managed by</p> <p>TPG</p> <p>have made additional investments into</p> <p>SAUCE LABS</p> <p>Fairness Opinion</p>	<p>anthology</p> <p>has sold certain assets to</p> <p>FINALSITE</p> <p>both portfolio companies of</p> <p>VERITAS CAPITAL</p> <p>Valuation Opinion</p>	<p>Funds managed by</p> <p>JMI EQUITY</p> <p>have transferred certain ownership interests in</p> <p>Unanet</p> <p>to affiliated funds.</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>hrynwood partners</p> <p>have transferred certain ownership interests in a portfolio company to affiliated funds</p> <p>Fairness Opinion</p>	<p>Funds managed by</p> <p>STG SYMPHONY TECHNOLOGY GROUP</p> <p>has completed an equity investment in its existing portfolio company</p> <p>nomis</p> <p>Financial Opinion</p>	<p>Funds managed by</p> <p>CHAPFORD CAPITAL GROUP</p> <p>have sold certain life insurance backed assets to a portfolio company of Blue Owl's Direct Lending BDCs</p> <p>Fairness Opinion</p>

Partnering With the Right Advisor

Houlihan Lokey is the market leader in providing valuation and fairness opinions to sponsors in connection with affiliate transactions. We have provided numerous opinions to leading sponsors in connection with fund transfers, fund restructurings, and other portfolio company transactions. Our Fund Opinions team can leverage the firm's broad capabilities during an affiliate transaction in ways unlike any other advisor. These capabilities include:

- **No. 1 Global M&A Fairness Opinion Advisor Over the Past 25 Years***
- **No. 1 M&A Advisor for Global Transactions Under \$1 Billion****
- **No. 1 Global Investment Banking Restructuring Advisor**
- **Named Best Valuations Firm for Hard to Value Assets by With Intelligence HFM's U.S. and European Services Awards in 2022**
- **Eight dedicated industry groups**
- **Among the largest financial sponsors and capital markets groups with unique access to investors and insights**

These capabilities provide an unparalleled offering to the market and distinguish Houlihan Lokey as a trusted advisor to both GPs and LPs.

Source: Refinitiv.

*Announced or completed transactions.

**Excludes accounting firms and brokers.

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