

# Tax Receivable Agreements Market Update

## Q2 and Q3 2023



Houlihan Lokey is pleased to present its Tax Receivable Agreements Update for Q2 and Q3 2023, which overviews the market for both current and potential tax receivable agreement (TRA) holders, investors, and industry stakeholders.

We hope you find this update to be informative and that it serves as a valuable resource to you for staying up to date on the TRA market. If there is additional content you would find useful for future updates, please email us with your suggestions. We look forward to staying in touch with you.

### RECENT TRANSACTIONS IN Q2/Q3 2023

The below highlights recent public TRA issuances, M&A transactions, buybacks, and bankruptcies (if any) in Q2 and Q3 2023.

#### New TRA Issuances

There were four new public TRA issuances in Q2 and Q3 2023. All TRAs derive value from basis step-ups as part of the LLC unit conversions in an Up-C structure.

Target / Issuer	Transaction Type	IPO / Completion Date	Implied Market Cap (\$M) at 9/30/2023	Notes
<b>BITCOIN DEPOT</b>	Up-C DeSPAC	6/30/2023	148.5	<ul style="list-style-type: none"> <li>Most recent balance sheet liability totaled \$0.8 million</li> <li>Early termination payment would be expected to total \$90.2 million</li> </ul>
<b>GEN</b> <small>KOREAN BBQ HOUSE</small>	Up-C IPO	6/28/2023	375.8	<ul style="list-style-type: none"> <li>Per most recent 10-Q, total payments through 2037 are expected to be \$99.6 million</li> </ul>
<b>NETPOWER</b>	Up-C DeSPAC	6/14/2023	3,203.8	<ul style="list-style-type: none"> <li>No TRA liability has been recorded as no unit exchanges have occurred</li> </ul>
<b>CIBUS</b> <sup>TM</sup>	All-Stock Merger	5/31/2023	387.8	<ul style="list-style-type: none"> <li>Calyxt, Inc., combined with Cibus Inc. in an all-stock merger, creating a TRA</li> <li>No TRA liability has been recorded as no unit exchanges have occurred</li> </ul>

#### M&A Events Impacting TRAs

In total, there were seven completed or announced M&A transactions where the target was (or will be) the obligor to a TRA. These transactions continue to highlight that there are few rules of thumb with respect to the impact of M&A activity on TRAs due to myriad factors, including the parties to the M&A transactions, the transaction premia in M&A, and the creativity of dealmakers and TRA designers to close a deal.

Target	Acquirer (if any)	Deal Date	Approximate Transaction Value (\$M)	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	TRA Status / Full Payment or Negotiated Value	Notes
<b>Hostess BRANDS</b>	<b>SMUCKERS</b>	9/11/2023 (Announced)	5,600	124.6	TBD	TBD	<ul style="list-style-type: none"> <li>Most recent balance sheet liability totaled \$124.6 million</li> </ul>
<b>FOCUS</b> <small>FINANCIAL PARTNERS</small>	<b>CLAYTON DUBILIER &amp; RICE</b>	8/31/2023	7,000	224.6	300	Full Amount to Be Paid	<ul style="list-style-type: none"> <li>Per the TRA Waiver &amp; Exchange Agreement, the early termination payment to Stone Point and management will be paid in the form of a promissory note</li> </ul>
<b>Omni Logistics</b>	<b>Forward</b>	8/10/2023 (Announced)	3,200	N/A	--	TRA to Be Issued	<ul style="list-style-type: none"> <li>In connection with the closing, Omni Holders and certain other parties will receive a tax receivable agreement</li> </ul>
<b>SciPlay</b>	<b>LIGHT &amp; WONDER</b>	8/8/2023	422	64.3	--	TRA Presumed to Remain Outstanding	<ul style="list-style-type: none"> <li>Light &amp; Wonder will acquire the remaining 17.0% equity interest in SciPlay in an all-cash transaction</li> </ul>
<b>Sculptor</b> <small>CAPITAL MANAGEMENT</small>	<b>rithm</b>	7/24/2023 (Announced)	639	173.4	TBA	TBA	<ul style="list-style-type: none"> <li>Sculptor's TRA does not have an acceleration provision on a change of control</li> <li>Rithm likely to assume the liability though negotiations with the founders are ongoing</li> </ul>

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### M&A Events Impacting TRAs (cont.)

Target	Acquirer (if any)	Deal Date	Approximate Transaction Value (\$M)	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	TRA Status / Full Payment or Negotiated Value	Notes
FIS worldpay	GTCR	7/6/2023	18,500	138.0	--	Unclear	<ul style="list-style-type: none"> <li>A 2019 amendment to the FIS/Worldpay TRAs provides for call and put options on certain of the obligations</li> <li>In January 2023, FIS exercised its final call option, resulting in a \$138 million fixed cash payment to Fifth Third that will occur after transaction close</li> </ul>
Diversey	SOLENIS	6/7/2023	4,600	200.4	--	Payment Waived in Full	<ul style="list-style-type: none"> <li>TRA obligated issuer to remunerate former shareholders for Dutch income tax attributes, NOLs, foreign tax credits, and amortization deductions</li> </ul>
W	ENDEAVOR	4/3/2023 (Announced)	9,300	993.4	--	TBA	<ul style="list-style-type: none"> <li>A new combined entity will be formed, of which Endeavor will retain 51.0% ownership</li> <li>Endeavor's original TRA from its IPO is not expected to be impacted by the transaction</li> </ul>

### TRA Buybacks

On August 18, 2023, Summit Materials, Inc., restructured its TRA obligation to Blackstone through a negotiated buyout.

TRA Company	Buyback Date	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	Full Payment or Negotiated Value	Notes
SUMMIT Materials	8/18/2023	322.6	115.0	Negotiated Value	<ul style="list-style-type: none"> <li>Blackstone transferred all rights under the TRA to Summit for a cash payment of \$115 million, eliminating ~\$256 million in future TRA payables to Blackstone through 2039</li> <li>A \$72 million obligation remains under the TRA</li> </ul>

### Bankruptcies and Chapter 11 Filings

Three TRA obligors entered into Chapter 11 bankruptcy proceedings in Q2 and Q3 2023.

TRA Company	Petition Date	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	Notes
smile DIRECT CLUB	9/29/2023	--	TBA	<ul style="list-style-type: none"> <li>Smile Direct had a full valuation allowance against its DTAs on its most recent 10-Q and a total unrecorded TRA liability of \$54 million</li> </ul>
ALPINE SUMMIT ENERGY PARTNERS	7/5/2023	--	TBA	<ul style="list-style-type: none"> <li>Alpine had a full valuation allowance against its DTAs on its most recent 10-K</li> </ul>
QUALTEK	5/24/2023	15.1	0	<ul style="list-style-type: none"> <li>CH. 11 petition lists a ~\$15 million general unsecured TRA claim, which matches Qualtek's crystallized cash flows per its 10-K, net of a valuation allowance</li> <li>Per its 10-K, TRA claims are likely to be impaired and canceled without any recovery</li> </ul>
NCM	4/11/2023	50.1	Uncertain	<ul style="list-style-type: none"> <li>One or more TRA holders waived rights under the TRA</li> <li>NCM emerged from Chapter 11 on August 7, 2023; the impact of the reorganization on the TRA is uncertain</li> </ul>

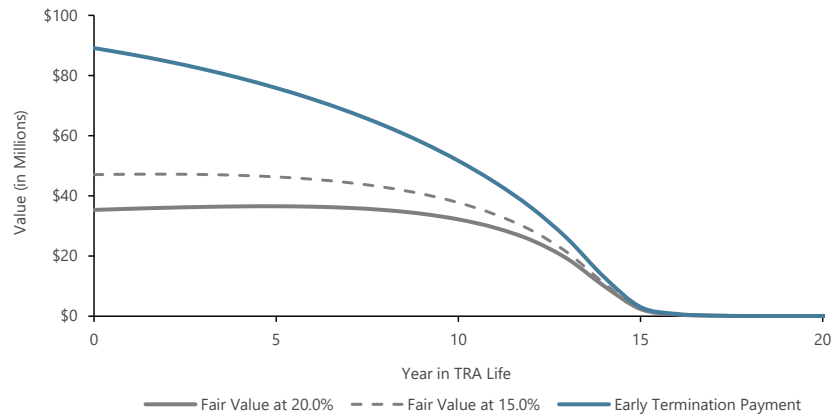
### EARLY TERMINATION PAYMENTS

Nearly all TRAs contain a clause stating that, in the event of early termination, either at the company's election or on a change of control, the company is required to pay each TRA holder an early termination payment equal to the present value of all unpaid payments. The calculation generally assumes (i) all shares are exchanged at the current stock price, (ii) attributes will be utilized pursuant to their contractual amortization schedule, and (iii) a discount rate of LIBOR/SOFR plus a nominal margin (e.g., 100 basis points).

## An Opportunity for Enhanced Yield and Multiples of Invested Capital

For illustrative purposes, assume a hypothetical TRA holder is owed approximately \$150 million in equal payments over a 15-year horizon. Figure 1 below compares the contractual early termination payment with the theoretical fair value of a TRA from inception through its maturity. As shown in Figure 1, the early termination payment provides greater value enhancement the earlier it occurs in the life of the TRA as more TRA payments are discounted at the contractually defined early termination payment discount rate as opposed to an investor's required rate of return.

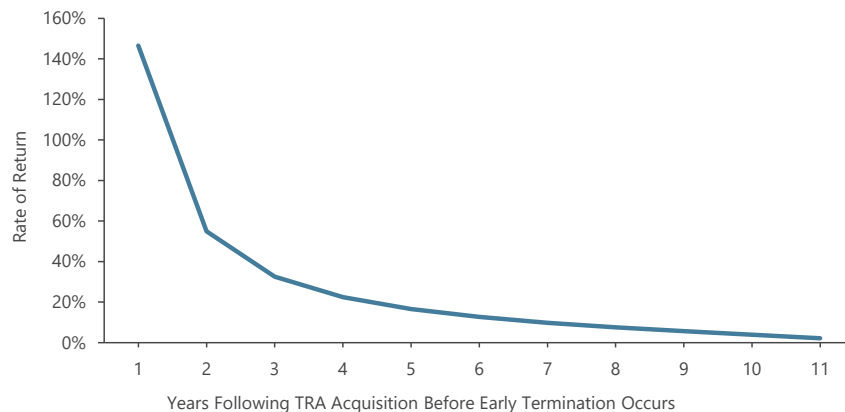
Figure 1: Early Termination Payment vs. Fair Value Over a TRA's Life<sup>(1)</sup>



As an extension of Figure 1, Figure 2 below illustrates how the timing of an early termination event impacts an investor's realized return. In the latter years of a TRA's life, an early termination event provides a modest yield enhancement to the TRA holder, whereas in the earlier years, it can provide a multiple on invested capital (MOIC) of 2x-3x the purchase price, providing returns more akin to instruments with option-like payouts, albeit with low expected correlation with company stock price.

A review of more than 30 change-of-control transactions and 15 corporate buybacks in the past 15 years shows that the median term length between the initiation of the TRA and its subsequent early termination was approximately 2.9 years and 3.0 years, respectively. In instances where the subject company's stock price declines, a change of control may become more likely.

Figure 2: Evolution of Early Termination Payment IRR Over Time<sup>(2)</sup>



(1) For illustrative purposes, the early termination payment and hypothetical fair value were estimated using an assumed basis step-up of \$500 million and interest rate comprising SOFR (as of September 15, 2023) of 5.31% plus a 100-basis-point margin. The early termination payment was calculated using a discount rate of 6.0% to approximate SOFR plus a nominal spread.

(2) Assumes that the TRA is acquired by a third-party investor at fair value at inception, i.e., year 0 in Figure 1.

## Early Terminations in Practice

Despite the contractual early termination payment clause in most TRAs, early termination payments historically have not always been paid out, even when early termination events are triggered. In instances where an M&A event occurs or where the company elects to “buy back” their TRA from the TRA holders, there is often a negotiation process through which the magnitude of the early termination payment is frequently reduced and, at times, entirely waived. Below are excerpts of public company filings and press releases discussing the treatment of TRAs in various M&A and buyback events.



PREM14A Filing,  
September 6, 2022

**Early Termination Payment Reduced Via Negotiation:** “In connection with the termination, EVO has agreed to pay the TRA Payment Recipients an aggregate termination payment equal to \$225 million... Such aggregate termination payment is expected to be less than the aggregate payment that would have been payable under the TRA absent the TRA amendment (based on certain facts and assumptions, including as to interest rates at closing, the reduction was estimated to be approximately \$97 million, constituting an approximate 30.1% discount to the estimated aggregate payment of approximately \$322 million that would have otherwise been payable to the TRA Payment Recipients under the terms of the TRA).”

**MEDLEY**

Press Release,  
July 29, 2019

**Full Waiver of Early Termination Payment:** “Sierra Income Corporation (‘Sierra’), Medley Capital Corporation (‘MCC’), and Medley Management Inc. (‘Medley’) today announced that they have entered into definitive amended agreements under which MCC will merge with and into Sierra... As part of the transaction, Medley LLC Unitholders have agreed to forgo all payments that would be due to them under the existing Tax Receivable Agreement with Medley for the benefit of the Combined Company.”

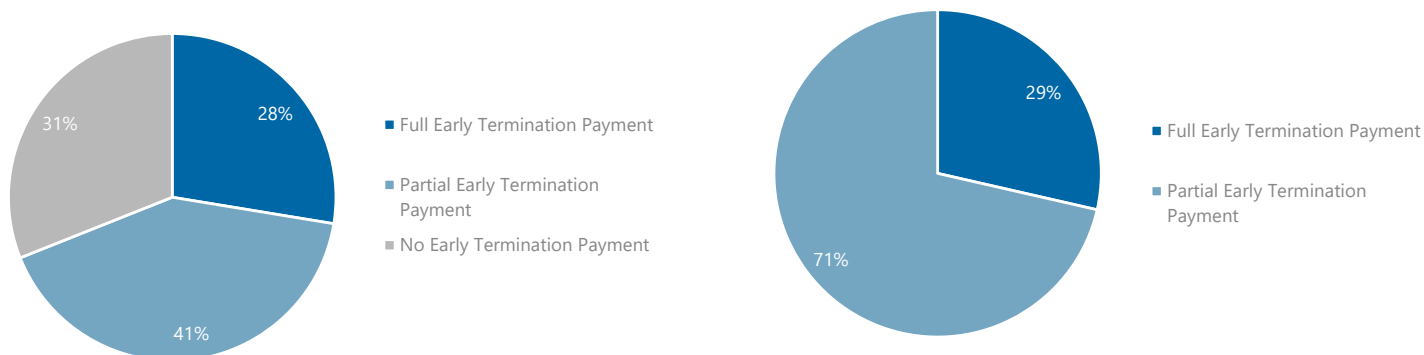


Form 8-K,  
May 4, 2017

**Full Early Termination Payment:** “Pursuant to the Tax Receivables Agreement, including Section 4.03 thereof, VWR is required to pay to VDH an amount equal to sum of the Early Termination Payment and the other amounts described in Section 4.01(c) of the Tax Receivables Agreement (such sum, the ‘Change of Control Payment’) no later than the date on which the Closing occurs. Solely for purposes of the Change of Control Payment that is required to be paid in connection with the Closing, VWR and VDH hereby agree that such Change of Control Payment will be an amount equal to \$56,238,010 and VWR will pay, or cause to be paid, such amount to VDH on the Closing Date...”

Figures 3 and 4 below show the proportion of 43 early termination events (29 M&A and 14 buybacks), which resulted in (i) transfer of the full early termination payment, (ii) payment to TRA holders that is less than the contractually stipulated early termination payment, and (iii) waiver of the early termination payment in its entirety.

Figures 3 and 4: Proportion of Early Termination Payment Outcomes<sup>(3)</sup>



In nearly all instances of partial and no early termination payments reflected in the above figures, the TRA holders were also equity holders in the public company. When TRA holders are also equity shareholders of the public company, accepting a reduced early termination payment may help facilitate a sale of the subject company where returns are earned primarily on equity shares as opposed to the TRA.

## HOW HOULIHAN LOKEY CAN HELP

TRAs represent a unique and growing asset class that provides a bridge in negotiations between buyers and sellers when tax assets are present. Houlihan Lokey’s cross-functional team, with expertise spanning investment banking, tax, board advisory, and complex illiquid financial instruments, can advise on a wide breadth of subject matters that arise in connection with originating, holding, transacting, or terminating a TRA. We are actively conversing with investors, TRA holders, and industry stakeholders to develop a secondary market for these unique assets. In addition, we provide independent advice and opinions of value to special committees, sponsors considering continuation vehicle transactions, and lenders or holders with respect to collateral value assessments. Finally, Houlihan Lokey can also provide compliance-driven valuations for financial and tax reporting purposes grounded in real market dynamics for TRAs.

Please reach out to [TRA@HL.com](mailto:TRA@HL.com) with any feedback or questions, or if you have a TRA-related topic you’d like to see in future editions of this newsletter.

(3) Based on public company filings and press releases.

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