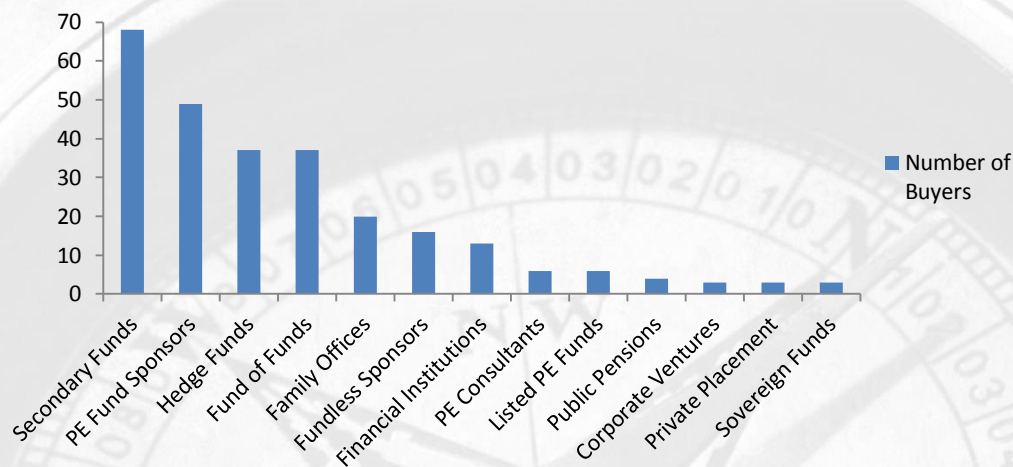


An increasing number of private equity funds raised in the early/pre-2000's period have completed their term and are in an extension period. For many managers these older funds have become an administrative burden (for which they may not even be compensated) relative to their remaining, size and a distraction from more recent funds and projects. Similarly, for the investors in these funds, the tail-end exposure represents a *de minimis* line item which consumes monitoring resources. In some cases the manager may also believe that there is meaningful additional value to be extracted from the portfolio or that the timing is not right for a sale, but nonetheless a significant portion of their investors would rather exit the investment or at least generate some interim distributions. Investors and managers in these situations should be sure to understand the entire suite of options that are available to address their various goals.

The market for restructurings and liquidations has matured considerably in recent years. Currently Setter Capital tracks over 200 secondary buyers who are interested in fund-wide transactions and secondaries of direct investments, and a much higher number of sophisticated major primary investors that look to opportunistically back managers with mature portfolios. As a result, it has become possible to generate truly market-driven outcomes in the context of these processes.

Buyers of Direct Investments Covered by Setter Capital



Options Available to Managers and Investors in Mature Funds

Complete fund liquidation: In cases where both the manager and investors want to end the fund, the most obvious option is a simple liquidation of the remaining assets. Depending on the circumstances, the manager may wish to continue to manage the assets for the new investor(s). Alternatively, the buyer can manage the assets or arrange for new management.

Fund extension with investor liquidity option: In cases where a manager would like to continue managing the portfolio, they may wish to explore a fund extension combined with a liquidity option for LPs. This provides the maximum amount of flexibility for investors and is particularly suited to funds where the LPs have diverging interests and time horizons. Typically this would involve a competitive process whereby the winning bidder makes an offer to the entire investor base for their shares in the fund. In conjunction with transferring

interests between buyers and sellers, the term of the fund is extended and manager economics may be re-set or re-calibrated. Those investors who wish to gain immediate liquidity may opt to accept the winning offer while those that wish to stay the course benefit from a structure that better aligns the management team with value maximization.

Partial Liquidity: There are a variety of fund-wide transactions that enable sellers to generate a significant liquidity event while retaining equity participation in the portfolio. These primarily include: 1) fund-level dividend recapitalizations where the manager takes a loan against the portfolio as a whole and distributes the proceeds to investors, 2) so-called 'structured' portfolio sales which are similar to dividend re-caps but where the secondary investor takes a hybrid debt/equity style interest in the portfolio instead of treating the investment strictly as a loan, and 3) so-called 'strip sales' where the manager sells a subset or a pro-rata strip of the portfolio in order to make a distribution to investors.

Benefits to a Manager

Potential benefits to a manager in a liquidity process include fund extensions, re-setting or re-calibrating management economics, and adding fresh capital for follow-on or new investments. In some cases, the manager may seek a 'staple commitment', where the successful purchaser(s) commit primary capital to a new fund the manager is raising as part of the terms of the secondary purchase.

Value Add of an Advisor

By involving Setter Capital, the manager benefits from a significantly enhanced process. The manager may be confident that they are both maximizing price for investors, and obtaining the most attractive and incentivizing terms for themselves. The involvement of an intermediary may also mitigate the appearance of conflicts of interest on the part of the manager and allow them to stay at arms-length from negotiations, to the extent that is necessary or desirable. Leaving the process in the hands of a capable advisor will also allow the manager to minimize their own time spent on the process and stay focused on managing the portfolio. Setter Capital provides validation for both the manager and their investors by providing a fully documented process.

An important tool for PE fund managers in the years ahead

In the years ahead, many more funds will continue beyond their term, making the secondary market an increasingly important tool for managers and their investors. The increasing depth of the buy-side means that both the cost of this type of capital and the execution risk associated with the process are also diminishing.

Simren Desai co-leads Setter Capital's fund liquidation and restructuring practice

Setter Capital is a leading advisor to participants in the private equity secondary market, with a dedicated practice in the fund liquidation and restructuring space. If you are interested in discussing the contents of this article or the secondary market in more detail, we would welcome hearing from you