

The logo for K&L GATES is displayed in white, bold, sans-serif capital letters within an orange rectangular box. The background of the slide features a blurred cityscape at night with bokeh light effects, overlaid with a digital grid and a world map composed of blue dots. Several data points are scattered across the image, including '334 +7.09%', '56 +1.13%', '178 +3.28%', '206 +1.17%', '281 +1.07%', and '566 +2.08%'.

K&L GATES

Private Funds Industry Update

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TOPICS TO BE DISCUSSED

- Secondary Market Overview
- Continuation Funds
- Evergreen Funds
- NAV Borrowing Facilities





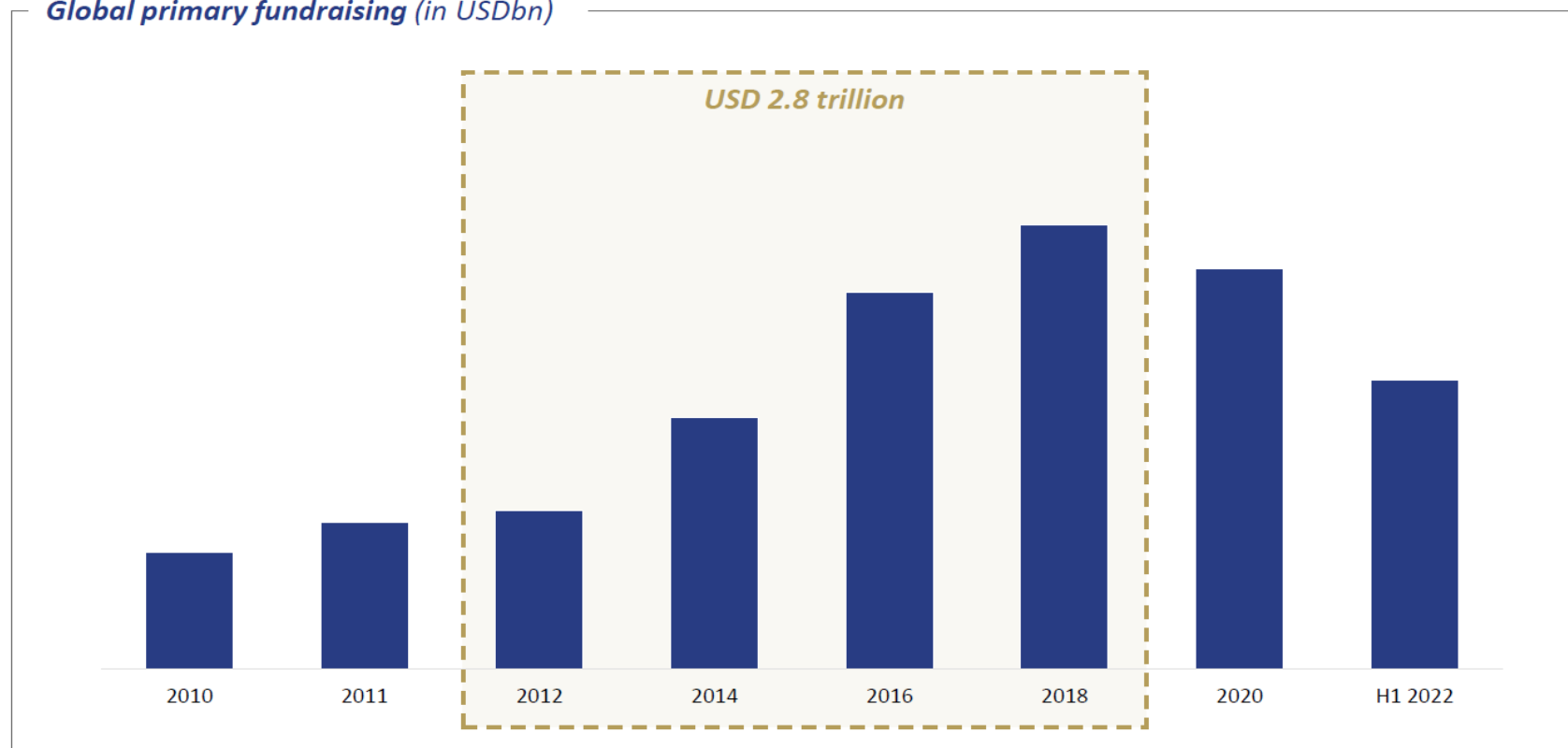
Secondary Market Overview





LPs – extremely high levels of commitments to private equity

Global primary fundraising (in USDbn)



Source: Preqin. Primary fundraising data as of 2 August 2022. Unrealized value data as of 30 September 2021 (retrieved on 05 May 2022), only private equity buyout data included.

1 Covers net asset value of private equity buyout funds with 2014-2018 vintage year.

Trends depicted here are for illustrative purposes, there is no assurance or guarantee that trends depicted will continue.

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LPs – fundraising dynamics add pressure for LPs

Average time between US PE funds (years)

0.1x D/PI

on average from last fund until the launch of next fund

95% step-up in average fund size

compared to previous fund¹

4.7 years

2.6 years

2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021

Source: LGT Capital Partners analysis, Pitchbook.

¹ For US private equity funds.

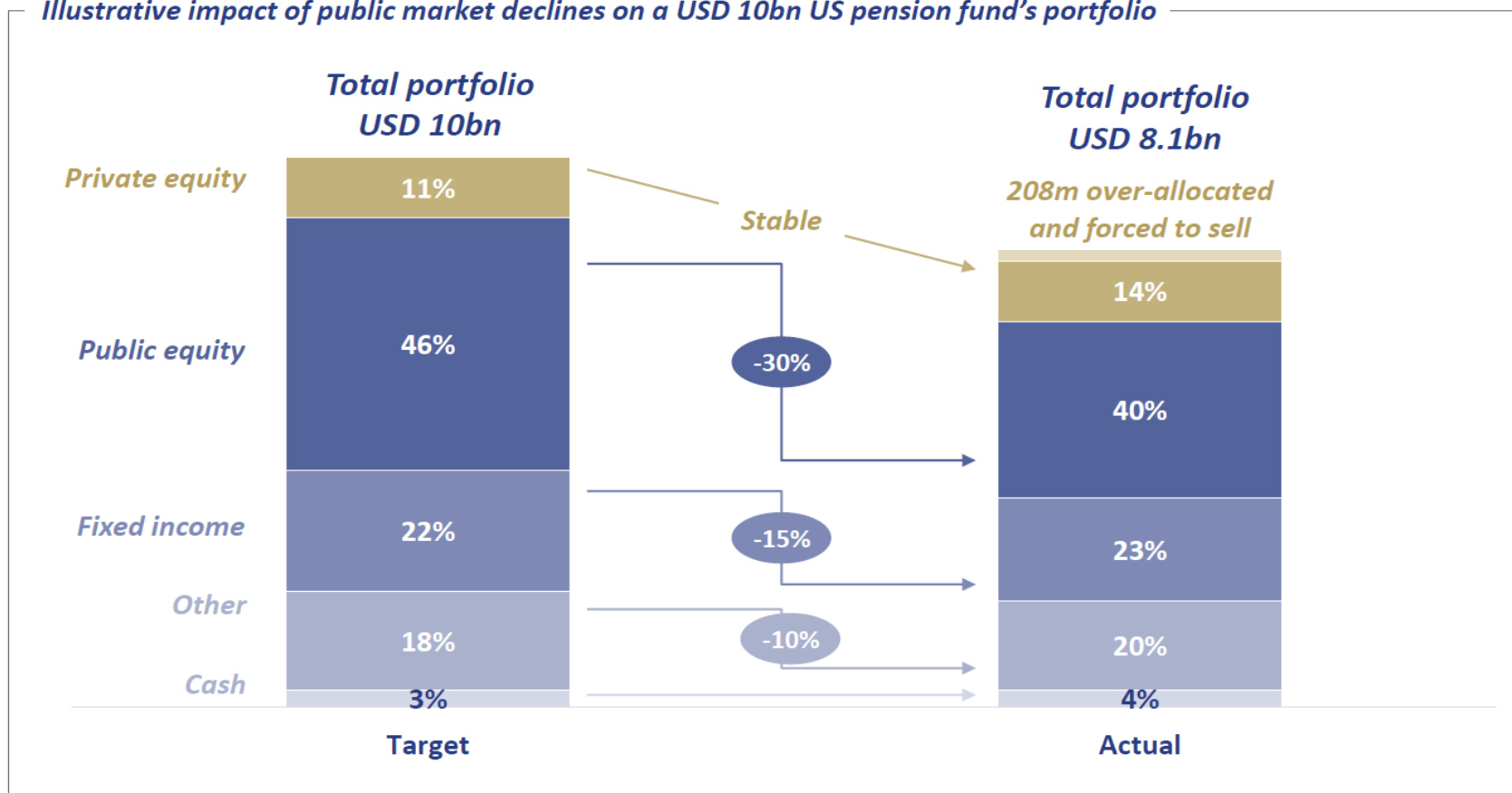
Data as of 31 December 2021. Trends depicted here are for illustrative purposes, there is no assurance or guarantee that trends depicted will continue.

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LPs – market volatility drives over-allocation to private markets

Illustrative impact of public market declines on a USD 10bn US pension fund's portfolio



Source: LGT Capital Partners, American Investment Council.

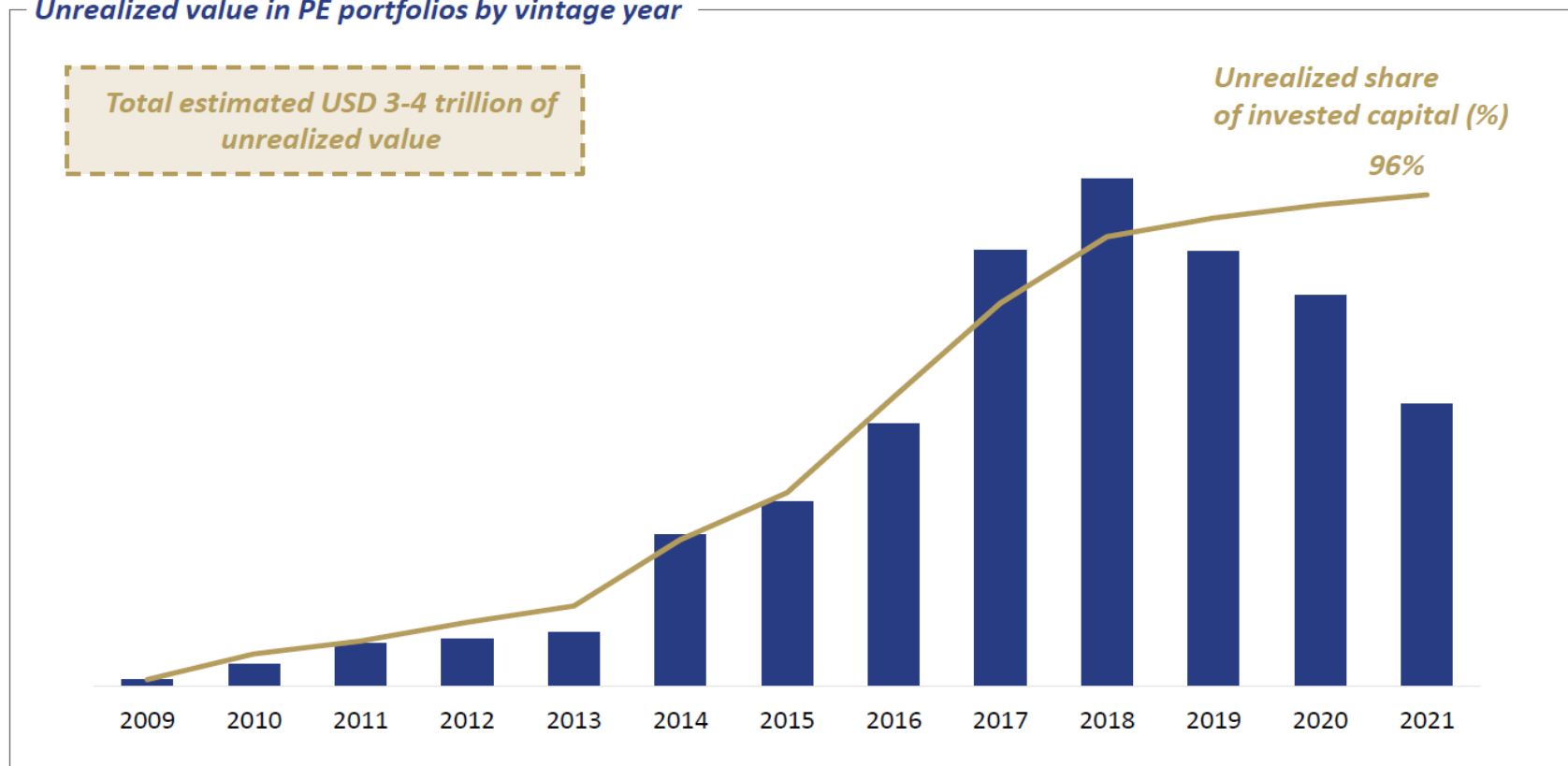
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GPs – unrealized private equity NAV needs a solution

Past performance does not predict future returns

Unrealized value in PE portfolios by vintage year

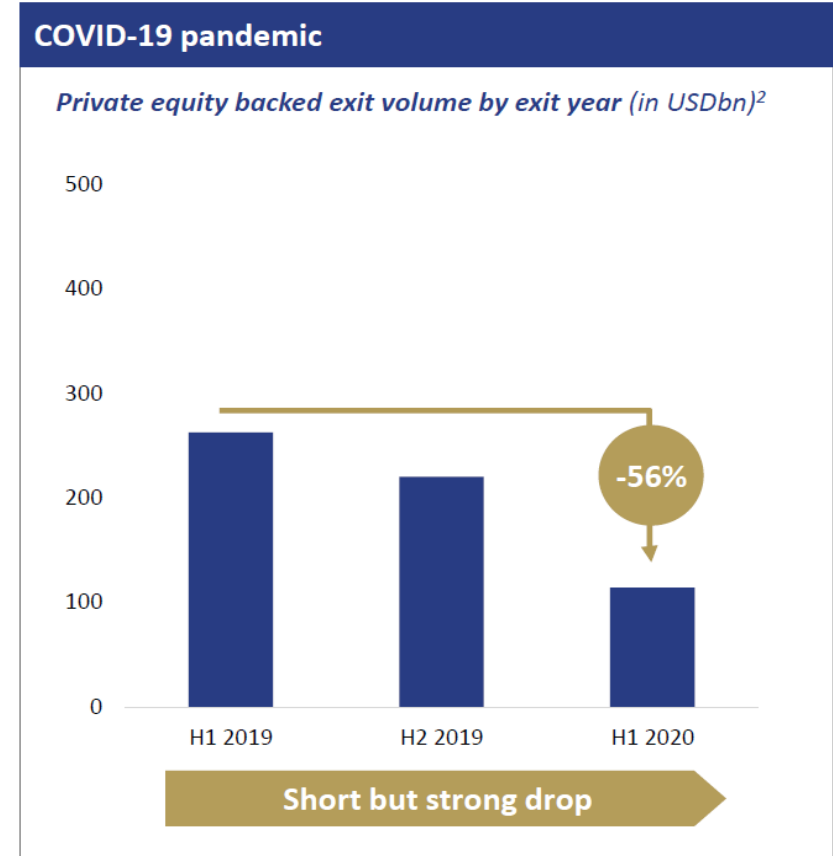
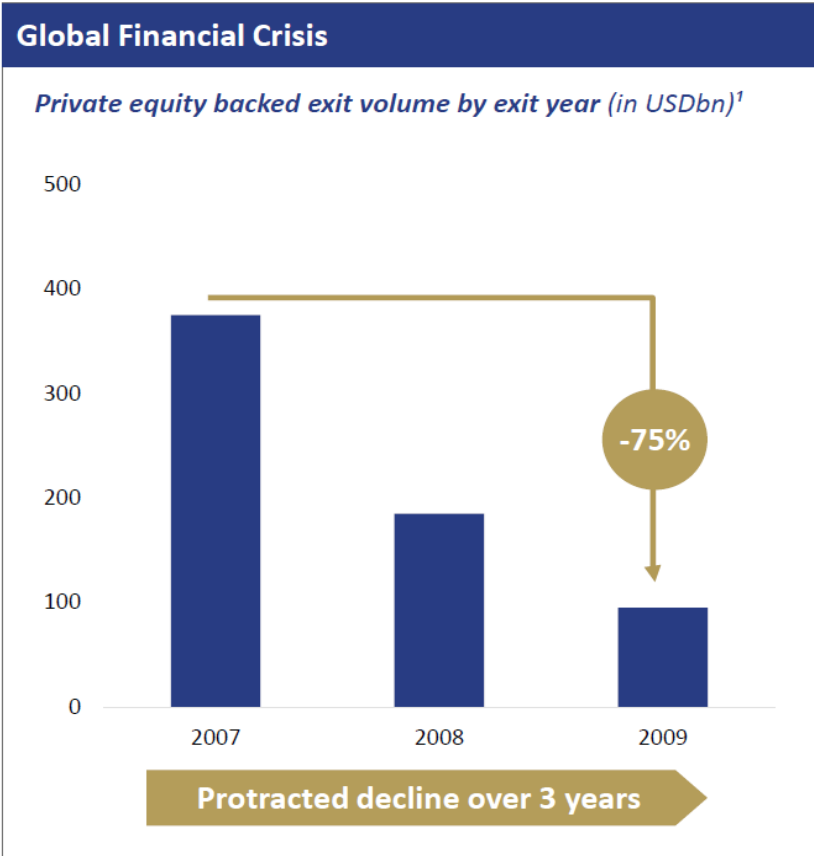


Source: LGT Capital Partners proprietary database. Net asset value by vintage year for private equity buyout, funds as of 30 June 2022. For illustrative purposes only. Trends depicted here are for illustrative purposes, there is no assurance or guarantee that trends depicted will continue.

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GPs – market volatility often results in reduction of exit options



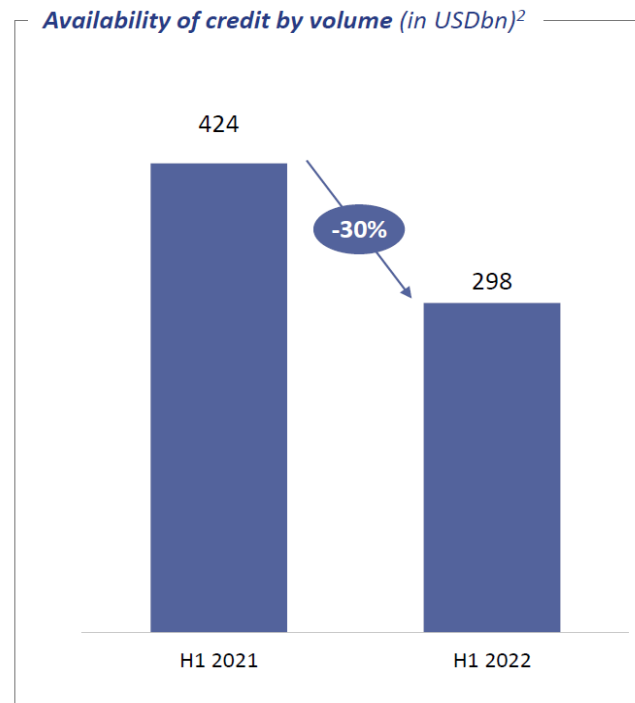
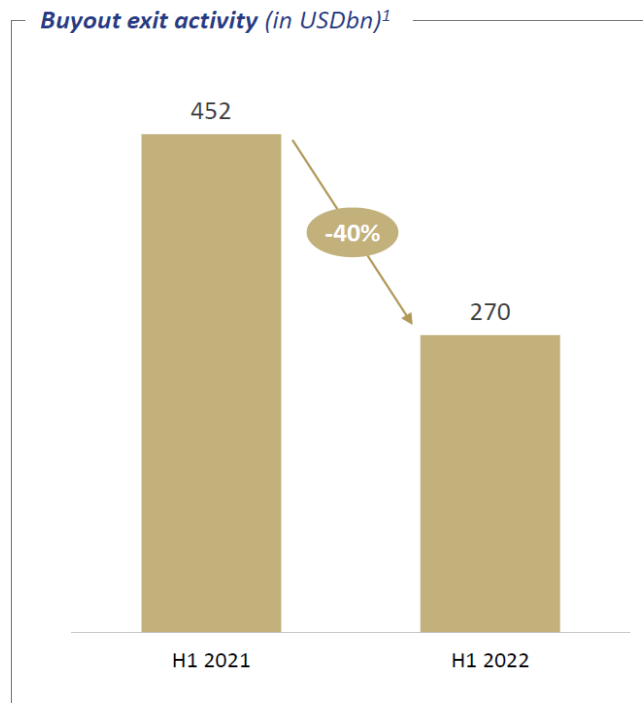
¹ Global Private Equity Report 2019 (Bain & Company), June 2019.

² Preqin, data retrieved on 04 March 2022.

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GPs – exit activity and debt markets already pulling back

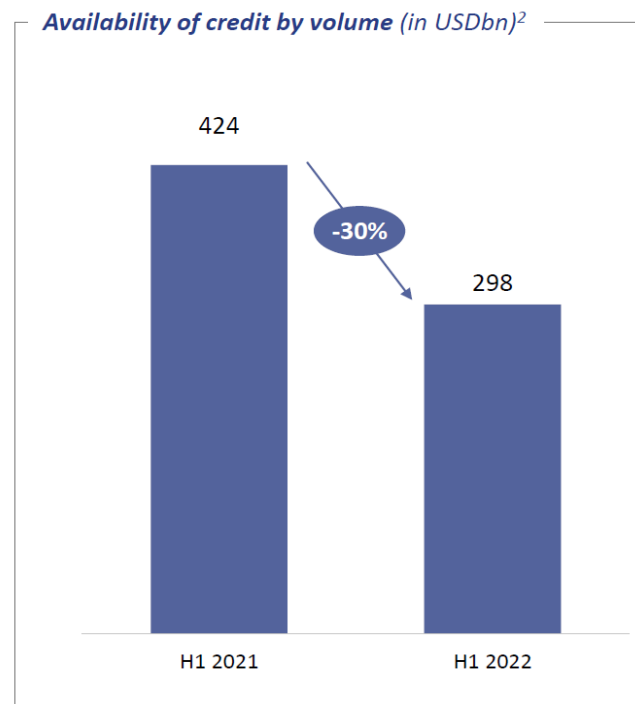
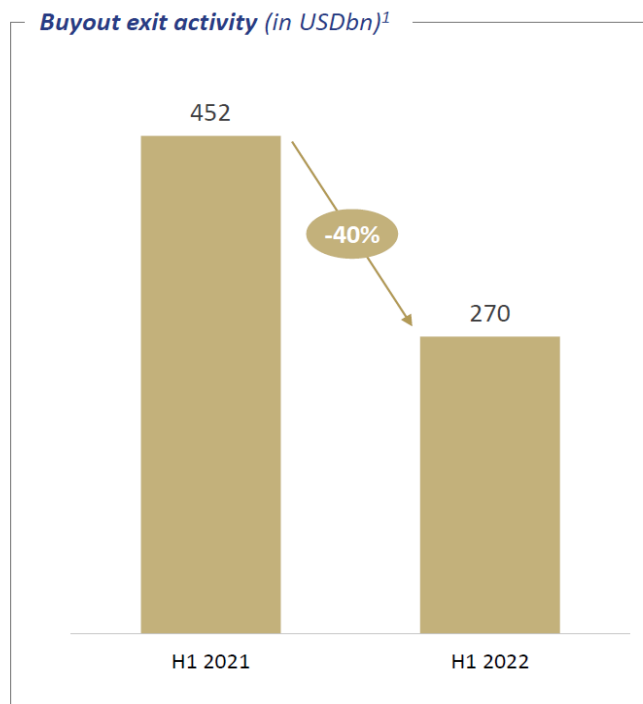


1 Preqin. Data as of 26 April 2022. 1 Private equity includes the following categories: buyout, growth, co-investment, co-investment multi-manager, turnaround (as defined by Preqin). 2 Source: S&P LCD LoanStats Weekly, data as of 22 September 2022. Excludes existing tranches of add-ons, amendments and restatements with no new money. These numbers comprise loans denominated in all currencies, converted to USD, and are subject to revision as LCD collects additional data. Trends depicted here are for illustrative purposes, there is no assurance or guarantee that trends depicted will continue. © LGT Capital Partners 2022





GPs – exit activity and debt markets already pulling back



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Many flexible structures to unlock secondaries opportunities

Liquidity solutions for LPs

Traditional secondaries

Acquiring private equity fund positions

Asset-level liquidity solutions for GPs

GP-led situations

Liquidity solutions managed with GP

Follow-on

New capital to finance add-ons

Equity recaps

Purchase of minority stake while GP retains control

Source: LGT Capital Partners.
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Continuation Funds (aka GP-Led Secondaries or Adviser-Led Secondaries)



REASON FOR INITIATING A CONTINUATION FUND

- Means to transfer un-matured investments out of a Fund's portfolio when the Fund is near end of term
 - Gives the sponsor more time to develop investments
 - Provide liquidity for investors
 - Gives the sponsor an influx of new capital for follow-on investments



Transaction Overview: General

- GP transfers one or more investments from its existing Fund to a new vehicle managed by the GP (the “Continuation Fund”) and gives each existing LP the option to:
 - a) Convert or exchange the ratable portion of its Fund interest for an interest of the Continuation Fund (of equal value);
 - b) Receive a cash distribution in respect of the ratable portion of its Fund interest (funded by new investors’ cash contributions to the Continuation Fund); or
 - c) Hybrid where a portion is converted into an interest in the Continuation Fund and a portion is distributed as cash.

****Often there is a new commitment associated with option (a).*

****Often there is a discount associated with option (b).*

SUCH TRANSACTIONS MAY INCLUDE

- Single asset transactions – such as the Fund selling a single asset to a new vehicle managed by the adviser
- Multiple asset transactions – the same as single asset transactions, except the Fund is selling multiple assets into a new vehicle managed by the advisor
- Strip sale transactions – such as the Fund selling a portion of multiple assets to a new vehicle managed by the adviser
- Full fund restructurings - such as the fund selling all of its assets to a new vehicle managed by the adviser
- Tender offer - such as an adviser arranging for new investors to purchase Fund interests directly from existing LPs



CONFLICTS

- The sponsor generally has a conflict of interest in setting and negotiating the transaction terms because it is on both sides of the transaction.
- This is because the sponsor may have the opportunity to earn economic and other benefits conditioned upon the closing of the secondary transaction.



CONFLICTS

■ Primary Conflicts

- Additional management fees - possibly from both new and rolling investors
- Crystallization of carry at the Fund level - possibly for both selling and rolling investors
- Additional carry at the Continuation Fund level - possibly from both new and rolling investors
- Sponsor may provide services and/or receive compensation from the portfolio companies, which will not offset the management fee
- Sponsor controls the pricing (except where the price is set by an auction process)
- Treated like a regular exit at the Fund level – this can be favorable to the sponsor’s track record



CONFLICTS

- To entice new investors to participate in a Continuation Fund:
 - New investors may participate in a Continuation Fund on terms that are more favorable than those offered to rolling investors, which could result in dilution of such rolling investors' interests in the underlying investments.
 - Returns to the new investors may be paid in priority to returns to the rolling investors.



BEST OUTCOME FOR EXISTING INVESTORS

- Rolling investors not subject to management fees in Continuation Fund
- For a rolling investor, no crystallization of carry until it exits the Continuation Fund – **or** – no carry at Continuation Fund level
- Sponsor rolls capital and crystallized carry into the Continuation Fund
- Pricing should be timely and ideally set by an auction process rather than supported by a fairness opinion
- Existing side letter applies to Continuation Fund
- No taxable event for rolling investors (in-kind contribution/distribution)



OTHER CONSIDERATIONS FOR INVESTORS

- Waiving conflicts of interest – prospective waivers?
- Reps and warranties
- Track Record
- Meaningful liquidity opportunity?





Evergreen Funds



BENEFITS

- Sponsor continually raise capital through a single fund
- Avoids timing constraints on raising, deploying, and realizing capital
- Offer increased liquidity - attractive to smaller investors
- Offer large institutional investors the ability to remain invested on an ongoing basis



STRUCTURES

- **Two Types of Evergreen Fund Structures** (there are no consistent “market” terms for either variety):
 1. **Multi-Tranche**
 - Same as closed-end fund structure, except that the fund may access the market at specific intervals to sell more subscriptions (after a certain percentage of capital commitments from the previous capital raising period has been invested)
 - Capital commitments accepted during subsequent capital raising periods participate only in new investments



STRUCTURE

- **Multi-Tranche Continued**
 - All investment proceeds distributed by the fund may be recalled and invested in follow-on investments or “rolled” into a “new” tranche of capital commitments
 - Investors may eventually opt against rolling distributions into the next tranche and terminate their investment (same as for a traditional closed-end fund)
 - Economics follow those of traditional closed-end funds



STRUCTURES

- **Challenges of Multi-Tranche Structure**
 - Administrative burden of investor and investment tracking as investors roll recycled investment proceeds across successive tranches of interests
 - Cross-collateralization (multi-series entities can mitigate, but probably cannot eliminate, this risk)
 - Investor's only liquidity option is to opt-out of recycling of investment proceeds



STRUCTURES (CONTINUED)

2. Modified Open-End

- Standard open-end terms, modified to accommodate illiquid investments
- Key characteristic: No obligation to sell any investments in order to satisfy redemption requests
- Redemption requests satisfied either through capital contributions from other investors, investment proceeds or credit facilities
- If necessary, interests may also be redeemed:
 - based on the order redemption requests were submitted or pro rata with all other outstanding redemption requests as of the relevant redemption date; or



STRUCTURES (CONTINUED)

- Modified Open-End Continued
 - under a slow-pay arrangement (redeeming investors receive an interest in a redemption account corresponding to their pro rata shares of the fund's illiquid assets and are paid as those assets are liquidated)
 - Sponsor receives management fees + incentive allocations tested over longer periods than for open-end funds (three to five years)



STRUCTURES (CONTINUED)

- **Challenges of Modified Open-End Structure**
 - Reliance on ability of the fund sponsor to attract new commitments in all market conditions
 - Reliance on fund NAV / difficulty in accurately assessing the value of fund's underlying investments





NAV Borrowing Facilities



TIMING

- **Subscription Facility** – attractive in early stages of fund. Collateral is uncalled capital of creditworthy investors
- **NAV Facility** – attractive after the fund has called capital and acquired a portfolio of assets. Collateral is liquidation value or cash flows from those assets
 - LTV ratios typically around 25%
 - Interest 8-15% + upfront arrangement fee (usually funded from the first draw on NAV facility)



JUSTIFICATION AND BUSINESS NEED

- Provide funding to investments in the latter stages of the Fund – after investment period – when investments unexpectedly could benefit from additional capital influx.
- Provide follow-on capital to support the portfolio during COVID.
- Approach used by other managers that should be granted across the board for the benefit of the Fund.



CONCERNS

- Adds additional layer of debt to the investment program. Asset level debt, subscription facility debt, and then NAV debt.
- Potential cross-collateralization of assets to support the NAV facility
- Used to push out anticipated profits to help increase IRR for the fund.



LIMITS FOR CONSIDERATION

- Use for limited purposes only
 - Investors can support NAV borrowing for legitimate business purposes.
 - It can be difficult to support NAV borrowing when used to push out unrealized, but anticipated, gains.
- Include in debt limits imposed under the LPA such that all debt that is recourse to the Fund – including NAV borrowing - is included
 - Overall debt caps tied to commitments (e.g., lesser of 25% of commitments and uncalled commitments)
 - Duration limits (e.g., debt cannot remain outstanding longer than 12 months)





Outsourced Chief Investment Officer ("OCIO")



BACKGROUND

- An investment manager hired to provide total portfolio management services for a fiduciary portfolio such as an endowment, foundation or pension fund
- Independently makes and executes a variety of decisions and performs certain services, such as:
 - Investment policy development
 - Asset allocation / active rebalancing
 - Manager selection/termination
 - Performance monitoring
 - Meetings with staff and board
 - Oversight and management of custodian
 - Regulatory filing support



FACTORS SUPPORTING RISE IN POPULARITY

- Investment matters historically have been under the purview of the organization's fiduciary committee
 - Broadening of potential tools and strategies has increased the complexity of institutional portfolios
 - An investment committee that meets quarterly may have difficulty making and executing timely decisions and may miss out on opportunities
 - Difficulty of a committee to act on staff or consultant recommendations can cause confusion around who is ultimately responsible for results
 - Anticipated cost savings due to reduced staff and employee benefit costs



ADVANTAGES

- Flexible design elements in discretionary versus non-discretionary advice
- Experience making tough decisions that may be difficult for committees:
 - Rebalancing after a significant market correction
 - Funding a good manager when performance is weak
 - Investing in a unique strategy
- Scale / cost savings available through OCIO:
 - Leverage to negotiate better economic terms or access with managers
 - Reduced fees or aggregation of assets for fee-schedules and MFN rights



DISADVANTAGES

- Internal board is giving up control
 - Meaningful role in manager selection and portfolio management decisions provides emotional value for volunteer committee members
 - Risk that members may be less willing to commit their time under an OCIO relationship
- OCIO may not put forward board's stance and approach to investment process in the same way.
- OCIO may forgo meaningful negotiations on terms in favor of ensuring access to fund sponsor on the sponsor's terms.

