

Tax Receivable Agreements Market Update

Q1 2024



Houlihan Lokey is pleased to present its Tax Receivable Agreements Market Update for Q1 2024, which presents an overview of the market for tax receivable agreement (TRA) holders, investors, and industry stakeholders.





In this issue, we highlight recent public TRA issuances, buybacks, M&A transactions, and bankruptcies in Q1 2024. We also discuss tax receivable agreements in traditional IPOs.

We hope you find this quarterly 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 Q4 2023

New TRA Issuances

There were three new public TRA issuances in Q1 2024.⁽¹⁾

Target/Issuer	Transaction Type	IPO/Completion Date	Implied Market Cap (\$M) at 3/31/2024	Notes
 	Up-C M&A	1/25/24	\$820.4	<ul style="list-style-type: none"> The TRA was created following Forward Air's purchase of Omni Logistics using an Up-C structure. TRA payments will be based on 83.5% of future tax benefits realized by Forward Air. If an early termination event occurs, under certain circumstances, Forward may elect to pay the early termination payment over a 15-year period.
	Up-C	1/11/24	\$229.5	<ul style="list-style-type: none"> Pro forma TRA liability is \$5.4 million. Total payments are expected to be \$202.3 million over a 26-year period, assuming all exchanges occur after IPO at a price of \$21.00. Early termination payment is discounted at SOFR + 500 bps.
	Up-C De-SPAC	3/13/24	\$1,595.4	<ul style="list-style-type: none"> If terminated as of the Completion Date, early termination payment is estimated to be \$66.4 million. Early termination payment is discounted at SOFR + 150 bps.

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

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M&A Events Impacting TRAs

In total, there were four M&A transactions where the target was the obligor to a TRA.

Target	Acquirer (If Any)	Deal Date	Approximate Transaction Value (\$M)	Stated TRA Liability at Last Filing Date (\$M)	TRA Status/Full Payment or Negotiated Value	Notes
HIRE RIGHT	GENERAL ATLANTIC STONE POINT CAPITAL	12/8/23 (Announced)	TBD	\$211.0	TRA Still in Effect	<ul style="list-style-type: none"> General Atlantic and Stone Point made a nonbinding proposal to acquire all of the company's outstanding shares of common stock that they do not already own at \$14.35 per share. The present value of tax attributes under the TRA was determined to be \$0.31 to \$0.32 per share, using a WACC-based discount rate of 11.75% to 13.00%. The transaction does not constitute a change of control; TRA will not be accelerated.
FATHOM	CORE INDUSTRIAL	11/27/23 (Announced)	TBD	\$25.8	Payment Waived in Full	<ul style="list-style-type: none"> Fathom was acquired by CORE Industrial Partners in 2021 and taken public in the same year in a de-SPAC. At the time of CORE's nonbinding proposal to reacquire Fathom, CORE held equity in Fathom, representing 63% of the company's outstanding voting power.
agiliti	THL Thomas H. Lee Partners	2/26/24 (Announced)	\$2,500.0	\$23.3	TBD	<ul style="list-style-type: none"> After January 4, 2024 (the fifth anniversary of the initial de-SPAC event), TRA payments to holders of company options or RSUs will be made only if either: <ul style="list-style-type: none"> (i) the holder is employed by the company on the first day of the calendar year following the taxable year the TRA payment was calculated, or (ii) Agiliti records \$225 million of revenue for the first two quarters following the taxable year the TRA payment was calculated.
ENDEAVOR	SILVER LAKE	2/22/24 (Announced)	\$7,400.0	\$990.5	TBD	<ul style="list-style-type: none"> Of the \$990.5 million in total payment obligations, \$156.2 million was paid in February 2024. The TRA payment made in 2023 was \$37.5 million.

TRA Buybacks

One TRA obligor repurchased a proportion of its TRA obligations in Q1 2024.

TRA Issuer	Buyback Date	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	Full Payment or Negotiated Value	Notes
VISTRA	1/11/24 – 2/13/24	\$171.0	\$148.0	Negotiated Value	<ul style="list-style-type: none"> From January 11 through February 13, 2024, Vistra repurchased approximately 24% of the original outstanding TRA rights for \$1.50 per TRA right, i.e., \$148 million in the aggregate, paid using cash on hand. From February 13 through February 28, 2024, Vistra may repurchase additional TRA rights for \$1.45 per TRA right. Undiscounted payments are expected to be approximately \$350 million.

Bankruptcies and Chapter 11 Filings

One TRA obligor entered into Chapter 11 bankruptcy proceedings in Q1 2024.




TRA Issuer	Petition Date	Stated TRA Liability at Last Filing Date (\$M)	Settled TRA Value (\$M)	Notes
Cano Health	2/4/24	--	TBA	<ul style="list-style-type: none"> Positive future taxable income was not deemed to be probable in the near future, so no TRA liability was recorded.

Introduction

Approximately 85% to 90% of the public company TRAs outstanding were created in connection with an umbrella partnership C corporation IPO (Up-C IPO).⁽²⁾ For this reason, many industry stakeholders tend to think of the TRA contract and Up-C IPO as one and the same despite the fact that TRAs are not intrinsically linked to an Up-C IPO. A tax receivable agreement is a contract in which the tax savings from future deductions are shared with a third party. A TRA can be used to share future tax savings in a number of situations outside of the Up-C IPO, including regular-way IPOs that are not organized as Up-C IPOs.

Non-Up-C TRAs

There have been a handful of instances where an operating C corporation listed securities on a public exchange and issued a TRA. The similarity with the Up-C IPO lies in the creation of the TRA agreement at exit (i.e., IPO). However, different from the Up-C IPO, the corporate structure and IPO exit do not generate significant tax deductions. Instead, the deductions, such as accumulated NOLs or an amortizable tax basis from prior acquisitions, are accumulated prior to exit—during the pre-IPO period of the C corporation. The table below highlights a few examples of TRAs that represent monetization of C corporation tax assets that accumulated during the pre-IPO ownership period.

TRA Issuer	IPO Date	Notes
	10/2023	<ul style="list-style-type: none"> ▪ Birkenstock Holding PLC (Birkenstock) went public as a traditional C corporation offering ordinary shares to the public in its IPO. ▪ In connection with the IPO, Birkenstock entered into a TRA with its pre-IPO owner, which pays 85% of the income tax savings due to amortization and depreciation deductions in the U.S. and Germany as well as carryforwards of disallowed interest under Section 163(j). ▪ Birkenstock estimates total TRA payments of approximately \$550.0 million.
	10/2021	<ul style="list-style-type: none"> ▪ HireRight Holdings Corporation (HireRight) went public as a traditional C corporation offering common stock to the public in its IPO. ▪ In connection with the IPO, HireRight entered into a TRA with its pre-IPO owners, which pays 85% of the savings in U.S. income tax due to depreciation and amortization deductions, net operating loss deductions, and disallowed interest expense carryforwards. ▪ HireRight estimates total TRA payments of approximately \$210 million.
	1/2021	<ul style="list-style-type: none"> ▪ Driven Brands Holdings Inc. (Driven Brands) went public as a traditional C corporation offering common stock to the public in its IPO. ▪ In connection with the IPO, Driven Brands entered into a TRA with its pre-IPO owners, which pays 85% of the savings due to depreciation and amortization deductions, net operating loss deductions, disallowed interest expense carryforwards, and tax credit carryforwards as well as deductions associated with debt financing costs and offering costs in the U.S. and Canada. ▪ Driven Brands estimates total TRA payments of approximately \$155 million–\$175 million, with the majority to be paid from 2021 to 2025.

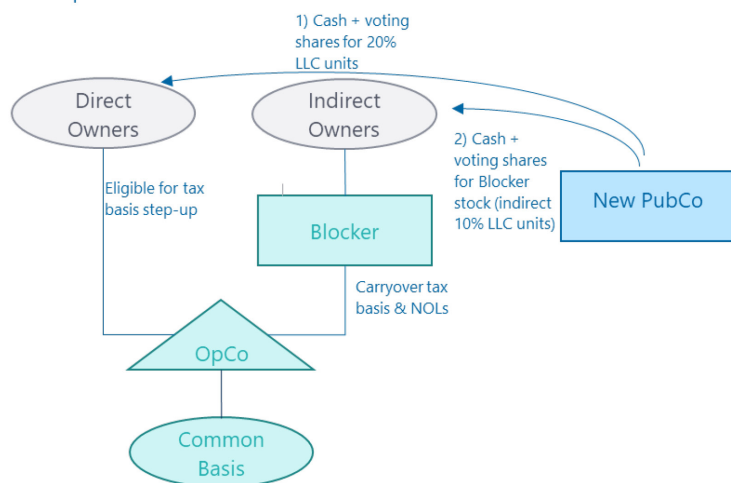
The Logic

The case for issuing TRAs in regular-way IPOs is compelling when compared to most Up-C IPOs. In most Up-C IPOs, especially those in which the pre-IPO owners include a financial sponsor, the Up-C IPO occurs with two separate acquisitions:

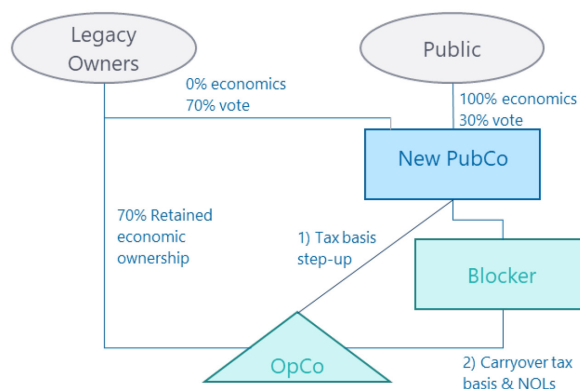
- The public C corporation acquires units in a partnership (giving rise to the almighty step-up on which most TRA conversations focus).
- The public C corporation acquires a blocker C corporation in a transaction in which the public C corporation takes a carryover tax basis in the assets of the blocker C corporation (and thus, no tax basis step-up).

⁽²⁾ An Up-C IPO is a form of IPO in which a legal entity taxed as a partnership accesses the public markets through the formation of a parent C corporation, which issues shares to the public in exchange for cash. Subsequent to the issuance, the parent C corporation uses the proceeds raised to acquire units in the operating partnership either directly from the operating partnership or both from the operating partnership and the pre-IPO owners. This transaction type results in a tax basis step-up and future deductions to the C corporation. The tax receivable agreement provides for an economic sharing in the tax savings from future deductions between the C corporation and the pre-IPO owners.

IPO Acquisition



Up-C Structure After IPO



Most Up-C IPO TRAs provide that pre-IPO owners will share in the tax benefits achieved by the public C corporation for (i) the step-up on the purchase of partnership units, which occurs at IPO and after IPO, and (ii) the tax benefits of previously acquired amortizable tax basis and NOLs of the blocker corporation. It is this second component that can be analogized to regular-way IPOs where pre-IPO tax benefits are shared with pre-IPO owners through a TRA.

To take it one step further, many TRAs issued in Up-C IPOs now also call for tax sharing with respect to “common basis” of the operating partnership. Common basis of the operating partnership is an abbreviated way to describe the future deductions available to the operating partnership on account of normal course depreciation or amortization arising from acquisitions previously undertaken by the operating partnership. This, too, is very much analogous to the type of deduction that a C corporation will receive post-IPO from pre-IPO activities—these deductions are not caused by the basis step-up on IPO but rather carryover from historical activities to the post-IPO period.

Additional Considerations

One potential downside to an Up-C is the annual maintenance cost. From a compliance perspective, there can be thousands of shareholder exchanges in an Up-C that ultimately impact the TRA calculations. With a TRA issued in a regular-way IPO, the administrative burden is substantially reduced because the pre-IPO tax attributes are generally fixed and relatively certain at the time of the IPO. Therefore, the ongoing costs of calculating and reporting the TRA liability to investors is significantly easier than that of an Up-C structure.

In addition, with respect to the secondary market for TRAs, a TRA in which all tax attributes are fixed, or crystallized, at IPO would command a premium over one with uncrystallized tax attributes, as future shareholder transactions could dilute the value of outstanding TRA rights.

The Takeaway

Pre-IPO owners should evaluate their options with respect to a TRA in connection with regular-way IPOs. For the past two decades, many of the Up-C IPOs that already include a TRA have fact patterns analogous to a regular-way IPO. Nonetheless, market adoption for TRAs in regular-way IPOs has been minimal, resulting in pre-IPO owners receiving a suboptimal value for tax attributes.

In situations where tax assets have accumulated within a C corporation IPO candidate, sponsors and founders have an opportunity to capture incremental value derived from tax assets through a TRA. In such instances, a TRA can be established without the need for more complex corporate structuring or increased compliance costs. Once the TRA is established, the sponsor and founders can decide whether to retain the TRA to receive the annual cash flows or monetize the future tax savings by selling 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.

If you have any feedback or questions, or if there is a TRA-related topic you'd like to see in future editions of this newsletter, please reach out to the TRA team at TRA@HL.com.

Want to see previous updates and other TRA content? Visit us at [HL.com/insights/tax-receivable-agreements](https://hl.com/insights/tax-receivable-agreements).

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