



2023 Continuation Fund and Cross-Fund Market Insights

March 2024



Houlihan Lokey

Introduction

Throughout the year, we observed an increase in fund-level affiliate transactions, as sponsors utilized creative strategies to optimize portfolios and create liquidity in an environment where traditional exits were more challenging. With declines in IPO volume, M&A volume and private equity exits, sponsors looked to continuation funds and other cross-fund transactions to drive returns and distributions for investors.

Fund-level affiliate transactions have proven to be an important tool for GPs across the economic cycle. 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 risks and improve the transparency of these transactions.

Houlihan Lokey has been the market leader in providing fairness and valuation opinions to sponsors. We have provided over 350 opinions to leading sponsors across a wide range of continuation and cross-fund transactions.

2023 Highlights

- ❖ Continuation funds remained a prominent feature of the private funds industry, with GP-led transaction volumes of approximately \$52 billion, representing the second highest year on record.⁽¹⁾ Momentum was particularly strong in the second half of the year as increased stability in the economic outlook and strength in the public equity markets narrowed the bid-ask spread between buyers and sellers, driving deal flow.
- ❖ The makeup of the continuation fund market continues to evolve in order to meet the goals of GPs, LPs, and new investors. Throughout the year, we saw an increase in multi-asset continuation funds relative to single-assets, as LPs sought liquidity and buyers looked to mitigate concentration concerns. Additionally, we saw increasingly complex structures, including (i) multi-fund, multi-asset continuation funds, and (ii) the use of deferred payments and performance-based earnouts to bridge valuation differences.
- ❖ In addition to continuation funds, sponsors continued to use a variety of other cross-fund transactions to identify opportunities, manage investments, and optimize portfolio companies. In 2023, we observed a record number of these transactions that crossed funds or otherwise placed the sponsor in a potential conflict-of-interest position and expect this trend will continue increasing throughout 2024 given current industry and market dynamics.
- ❖ We observed a notable uptick in transactions completed in asset classes outside of buyout, including credit, venture, energy, and real estate. With each asset class facing a unique set of market forces, affiliate transactions were utilized in different ways to navigate the current opportunities and challenges. While buyout remains the dominant asset class, we expect the overall share of the market to shift towards other strategies as new investors enter the space and market adoption increases.
- ❖ As affiliate transactions have now become more common across the industry, regulators and investors have ramped up scrutiny. In 2023, each of the SEC and ILPA issued new rules/guidance with the aim of increasing transparency and ensuring processes are in place to limit inherent conflicts of interest. Included within these new regulations was a requirement by the SEC that a fairness or valuation opinion be obtained in connection with GP-led continuation fund transactions.

(1) Estimated transaction volume of \$52 billion based on publicly available Wall Street research.



Types of Fund-Level Affiliate Transactions

Fund affiliate transactions can take many forms and are broadly categorized into either (i) continuation fund transactions or (ii) cross-fund transactions.

While there is overlap in the benefits each can offer, such as the ability to generate liquidity for LPs or the opportunity to provide portfolio companies with additional capital, they also have distinct advantages relative to each other.

Continuation funds generally offer LPs a “cash or roll” option in which they are offered the opportunity to receive cash based on the transaction price or reinvest into the continuation fund if they choose to retain exposure. This offers LPs a unique level of flexibility that other structures do not provide. Additionally, continuation funds generally involve an auction process, providing third-party price discovery and enhanced transparency.

Cross-fund transactions generally occur between funds of the same sponsor and may not involve new third-party investors. This can offer distinct benefits for a sponsor, including (i) allowing a newly raised fund the ability to deploy capital quickly into a high-conviction opportunity, (ii) unlocking potential synergies between portfolio companies, or (iii) transferring companies/assets to other vehicles within the fund family that may have better strategic alignment.

Continuation Fund Transactions

- ❖ Transactions involving the sale of one or more assets 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 funds of the same sponsor, including:
 - Mergers of portfolio companies held in different funds.
 - Sales of portfolio companies from one fund to another fund of the same sponsor.
 - Acquisitions of third-party targets by portfolio companies in which equity capital is provided by a subsequent fund.
 - Carve-outs or divestitures of assets from existing portfolio companies.
 - Fund seeding in which existing investments are contributed to a new fund vehicle prior to an external capital raise.

Transactions may have elements of both a continuation fund and a cross-fund transaction. For example, sponsors may have their latest fund participate as an investor in a continuation fund or may merge two portfolio companies together prior to selling to a continuation fund.



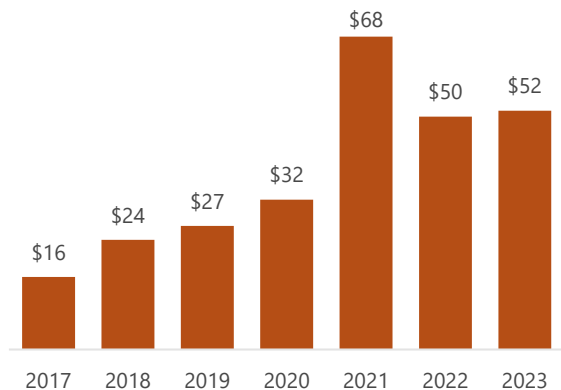
GP-Led Continuation Funds

Continuation funds have gained prevalence in recent years and are now an accepted path to liquidity for sponsors. GP-led transactions accounted for approximately \$52 billion of transaction volume globally in 2023, representing the second most active year on record. Despite a decline vs. the peak in 2021, the continuation fund market proved to be a resilient and valuable tool for sponsors facing challenging M&A and IPO markets.

Continuation funds provide a highly effective channel for generating liquidity in difficult exit markets. Relative to IPO, M&A, and buyout-backed exit volume, which were down ~73%, ~52%, and ~51% in 2023 from their 2021 record levels, respectively, GP-led transaction volume was only down ~24% vs. the 2021 peak.

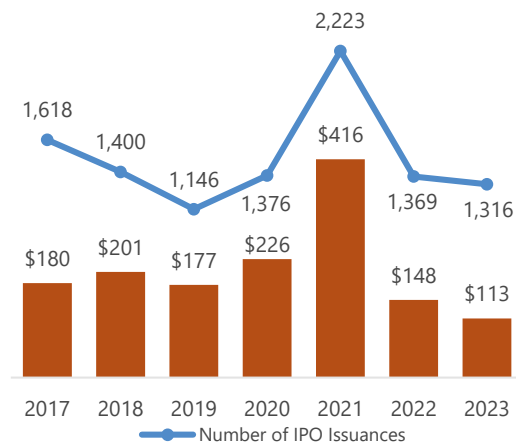
GP-Led Transaction Volume

Dollars in Billions



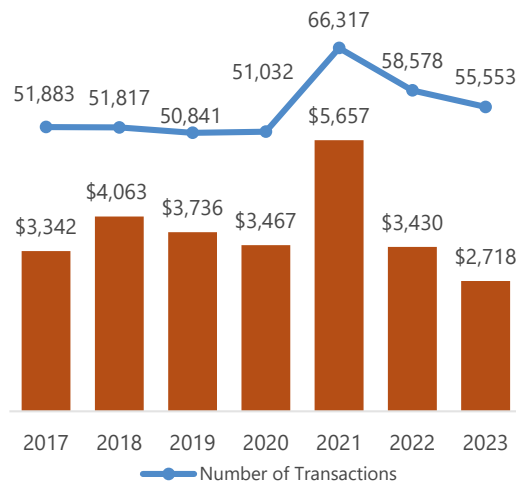
Global IPO Issuance Summary

Dollars in Billions



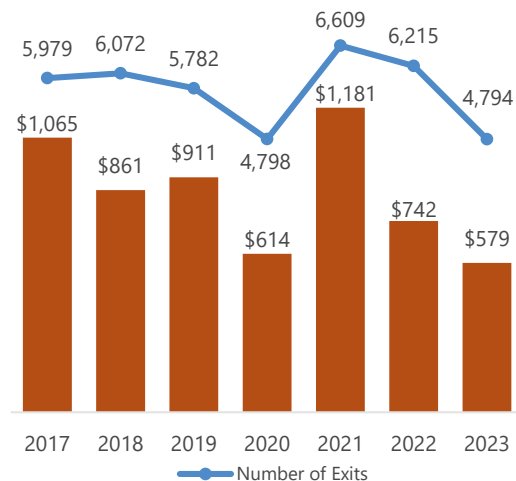
Global M&A Transaction Volume

Dollars in Billions



Global Buyout-Backed Exit Volume

Dollars in Billions



Sources: LSEG (formerly Refinitiv), publicly available Wall Street research.



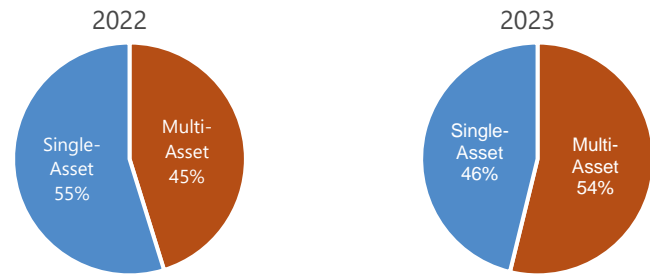
GP-Led Continuation Funds (cont.)

Multi-asset continuation funds gained an increasing share of total continuation fund activity in 2023, making up ~54% of volume in 2023 compared to ~45% in 2022. This increase is driven by both buy-side and sell-side factors. In particular, buy-side investors sought to mitigate concentration concerns following a stretch of investment into single-asset deals, increasing the appetite for larger, multi-asset transactions. For selling GPs, multi-asset deals can provide liquidity at scale, something LPs were in search of in 2023.

This year also saw an increase in “multi-asset, multi-fund” continuation funds, in which certain assets held in two or more funds of the same sponsor are sold to a continuation fund. This allows the sponsor to manage multiple portfolios in one transaction, but increases deal complexity, including the allocation of value between each of the funds.

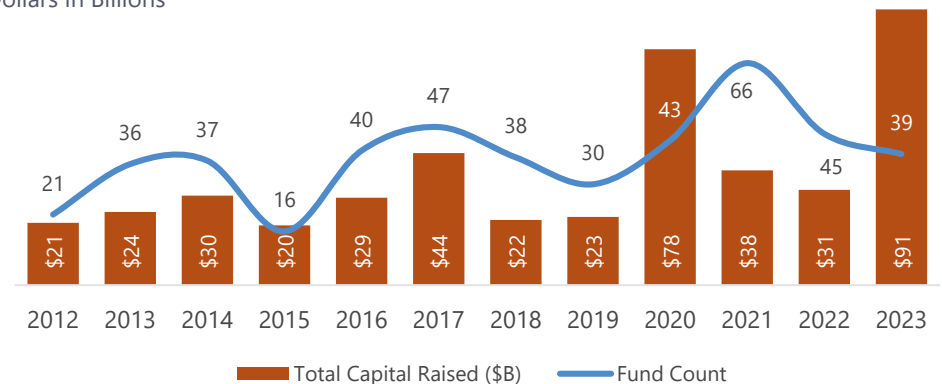
Heading into 2024, the market is poised to continue its upward trajectory. With strong momentum throughout the back half of 2023, record fundraising by secondary funds, an increasing universe of potential lead and syndicate investors, increasing familiarity with the continuation fund technology, and a record number of PE companies held for more than five years, expectations are set for significant growth this year.

Single-Asset vs. Multi-Asset Continuation Funds

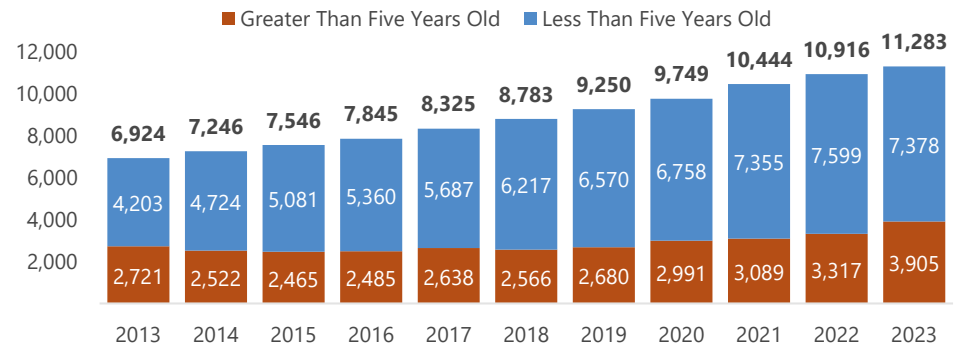


Secondaries Fundraising Activity

Dollars in Billions



Inventory of U.S. PE-Backed Companies



Sources: Preqin, publicly available Wall Street research.



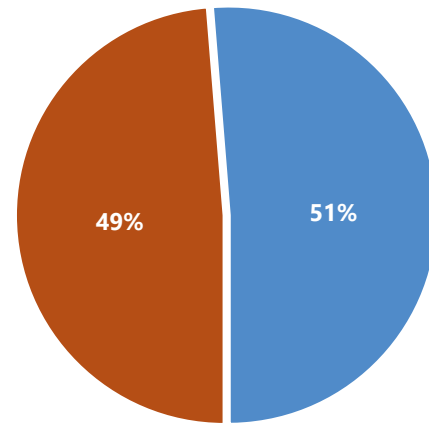
Cross-Fund Transactions

Sponsors today have increasingly complex fund family dynamics as they manage multiple asset classes, maintain concurrent active funds, and have increased co-investor participation. This has resulted in sponsors exploring an ever-increasing set of transactions between funds and using cross-fund transactions to generate liquidity events, manage portfolios, and provide support to portfolio companies where necessary.

In 2023, we observed a record number of these transactions that crossed funds or otherwise placed the sponsor in a potential conflict-of-interest position. While the size of the overall cross-fund market is largely unknown due to difficulty tracking private/internal deals, based on Houlihan Lokey internal data, including the size and number of deals we have supported, we estimate this market to be at least the size of the continuation fund market, highlighting the importance of these transactions to the private capital industry.

Fund-Affiliate Transaction Breakdown

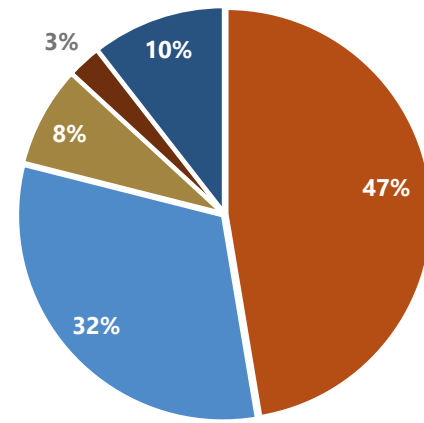
% Based on Houlihan Lokey Opinion Engagements in 2023



■ Cross-Fund ■ Continuation Fund

Types of Cross-Fund Transactions

% Based on Houlihan Lokey Opinion Engagements in 2023



■ Fund Transfer
■ Cross-Fund Investments
■ Merger of Portfolio Companies
■ Divestiture of Assets
■ Other

We supported a wide range of cross-fund transactions in 2023 across all industries and asset classes, including:

- ❖ Merger of two complementary software companies held in different funds of the same sponsor to (i) increase market share, (ii) drive cross-selling initiatives, and (iii) unlock cost synergies.
- ❖ Equity investment by a sponsor from its most recent vintage fund into a digital infrastructure company, which was held by an older vintage fund to support the company's expansion plan and cash out certain co-investors.
- ❖ Sale of an existing portfolio company in the facility-based service sector from an older fund to the sponsor's most recent fund in order to generate liquidity for LPs after a lengthy hold period.
- ❖ Sale of a portfolio of ~100 credit positions from an older fund, which was out of dry powder to its newly raised fund to provide necessary capital to service the portfolio and capitalize on potential opportunities.



Fiduciary Considerations for Sponsors

Continuation fund and cross-fund transactions present potential conflicts of interest, valuation complexities, and enhanced execution risk. Such transactions have come under heightened scrutiny in recent years from both regulators and investors, which was highlighted throughout 2023, as both the SEC and ILPA issued new rules/guidance around GP-led continuation fund transactions.

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. As highlighted by the recent releases by the SEC and ILPA, the receipt of independent advice and a fairness or valuation opinion by a sponsor in affiliate transactions has become a widely adopted best practice.

SEC Fairness or Valuation Opinion Rule

- ❖ On August 23, 2023, the SEC adopted new rules, which included a requirement for fund advisors to obtain a fairness or valuation opinion in connection with advisor-led secondary transactions.
- ❖ This rule marks the first time the SEC has mandated a fairness opinion be obtained prior to the consummation of a transaction, highlighting the increased scrutiny the SEC is putting on sponsor-led deals.
- ❖ Per the SEC, the fairness or valuation opinion requirement (i) 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 and (ii) helps ensure that investors receive the benefit of an independent price assessment, which will improve their decision-making abilities and overall confidence in the transaction.
- ❖ Examples of transactions included in the SEC's rules include single-asset continuation funds, multi-asset continuation funds, and strip sale continuation funds.

ILPA's Continuation Fund Considerations

- ❖ In May 2023, the ILPA announced new guidance around continuation fund transactions for GPs and LPs.
- ❖ ILPA states within its guidance that continuation funds have been a prominent feature of the PE industry over the past few years, and as these deals increase in prevalence, greater transparency will be critical to their efficiency and quality of execution.
- ❖ ILPA notes that selling LPs may benefit from an independent assessment of the value of the underlying assets, together with a formal opinion stating that the cash price offered is fair from a financial point of view.
- ❖ ILPA further notes that the fairness opinion is relevant as the NAV is determined by the GP, and typically, a trailing number will be used for discussion purposes during the solicitation process, which may or may not be relevant to the current valuation.



Fairness vs. Valuation Opinions

Given the SEC's rules allow for either a fairness opinion or a valuation opinion to be obtained in connection with a continuation fund transaction, questions have been raised about the differences between these two types of opinions and what market participants should receive.

A fairness opinion is often considered the preferred financial opinion standard because it directly addresses the consideration to be received by a specific selling party (or to be paid by a specific buying party) in a transaction. A valuation opinion is conducted with a similar process and level of rigor as a fairness opinion but affords additional flexibility as to the securities or asset(s) addressed by such valuation conclusions.

Historically, fairness opinions have been the primary deliverable to sponsors in connection with continuation fund transactions. Going forward, we expect this to remain the case, while valuation opinions can offer additional analytical flexibility or transaction versatility.

Fairness Opinions

- ❖ Written opinion letter addressing the fairness of consideration to be received by a specific selling party (or to be paid by a specific buying party) in the transaction, along with a presentation containing supporting analysis.
- ❖ Analysis and opinion address specifically the sold securities or asset(s) that are the subject of the transaction or transfer.
- ❖ Requires details of the contemplated transaction terms and either definitive transaction documents or a detailed term sheet describing a purchase and sale of subject securities or assets for specific transaction consideration.
- ❖ Addressed to the retaining party (typically the GP); informational copies are typically shared with the constituents of the retaining party.



Similarities

- ❖ The financial analysis of the subject securities or assets underlying both a fairness opinion and a valuation opinion is conducted with a similar level of analytical rigor.
- ❖ Each type of opinion can be used by the sponsor to assist in the evaluation of a transaction in connection with the opinion recipient's exercise of its fiduciary duties.
- ❖ Subject to agreed-upon engagement terms, informational copies of each opinion may be shared with certain parties, including LPAC members and the fund's LPs.

























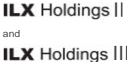








































Valuation Opinions

- ❖ Written opinion letter expressing conclusions of fair market value range of selected asset(s), along with a report containing supporting analysis.
- ❖ Flexibility as to what asset(s) and what "level" the valuation addresses. Conclusions can be expressed at the total enterprise value level, total equity, or a specific interest or security.
- ❖ May be performed without documentation of the transaction and does not specifically address transaction consideration.
- ❖ Addressed to the retaining party (typically the GP); informational copies are typically shared with multiple parties.



Selected Recent Houlihan Lokey 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 2023 across a wide range of GP-led, single-asset, multi-asset, and cross-fund transactions.

 both portfolio companies of  NEW MOUNTAIN CAPITAL LLC have completed a merger Fairness Opinion	Funds managed by  sold ownership interests in  to other Aquiline Funds and other institutional investors Fairness Opinion	 has completed a continuation fund transaction for  Fairness Opinion	Funds managed by  have completed an equity investment into  Fairness Opinion	 has completed a continuation fund transaction related to its investments in   Fairness Opinion	 Houlihan Lokey Capital, Inc. has provided fairness opinions for the JMI Extended Value Fund in connection with a continuation fund transaction Fairness Opinion
 NEW MOUNTAIN CAPITAL LLC has combined its portfolio companies  Fairness Opinion	Transaction Pending Funds managed by  have announced an equity investment into  Fairness Opinion	 a portfolio company of  has acquired  Valuation Opinion	Transaction Pending Funds managed by  have engaged in a recapitalization transaction involving  Fairness Opinion	 has completed a continuation fund transaction related to its investments in  Fairness Opinion	 has completed a transaction related to its investment in  and acquired certain additional assets Fairness Opinion
A Pre-Fund SPV managed by  has transferred certain ownership interests in ServiceMaster Restoration Services, a franchisee of  to affiliated funds Valuation Opinion	 has completed a continuation fund transaction related to its investment in  Fairness Opinion	 has completed a continuation fund transaction related to its investment in  Fairness Opinion	Funds managed by  have transferred certain ownership interests in  to affiliated funds Fairness Opinion	 has sold Peregrine Energy Solutions and CL Energy Transition Holdings, LLC to  Financial Opinion	Funds managed by  have entered into an agreement to combine  Financial Opinion
 has completed a continuation fund transaction related to its investments in  Fairness Opinion	 has completed a continuation fund transaction related to its investment in  Fairness Opinion	 has completed a continuation fund transaction related to its investments in five healthcare services companies Fairness Opinion	 has completed a continuation fund transaction related to its investment in  Fairness Opinion	 on its merger with  through a newly formed company controlled by  &  Financial Advisor	 has completed a continuation fund transaction for  Fairness Opinion
Funds managed by  have combined  Fairness Opinion	 has completed a continuation fund transaction related to its investments in  Fairness Opinion	Funds managed by  have entered into an agreement to combine  Financial Opinion	 has completed a continuation fund transaction related to its investment in  Fairness Opinion	Funds managed by  has acquired  which was subsequently combined with  Financial Advisor	 has completed a continuation fund transaction related to its investment in  Fairness Opinion

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 continuation fund, cross-fund, 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 the following:
 - No. 1 global M&A fairness opinion advisor over the past 25 years.*
 - No. 1 global M&A advisor** and No. 1 U.S. M&A advisor
 - No. 1 global investment banking restructuring advisor.
 - Named "Best Valuations Firm for Hard to Value Assets" at the 2023 With Intelligence HFM U.S. and European Services Awards.
 - Nine 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.

Contacts



Mark Schade
Managing Director
+1 212.497.4166
MSchade@HL.com



Helen Cheng
Managing Director
+1 212.497.4134
HCheng@HL.com



Tad Flynn
Senior Advisor
+1 212.497.7852
TFlynn@HL.com



Milko Pavlov
Managing Director
+44 (0) 20 7747 2788
MPavlov@HL.com



Peter Mullen
Director
+1 312.462.6435
PMullen@HL.com



Lee Sussman
Director
+1 212.497.7818
LSussman@HL.com



Nikita Kuznetsov
Senior Vice President
+44 (0) 20 7484 1534
Nikita.Kuznetsov@HL.com



Mike Hakimi
Vice President
+1 212.331.8169
MHakimi@HL.com

Source: LSEG (formerly Refinitiv).

*Announced or completed transactions.

**Excludes accounting firms and brokers.

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