

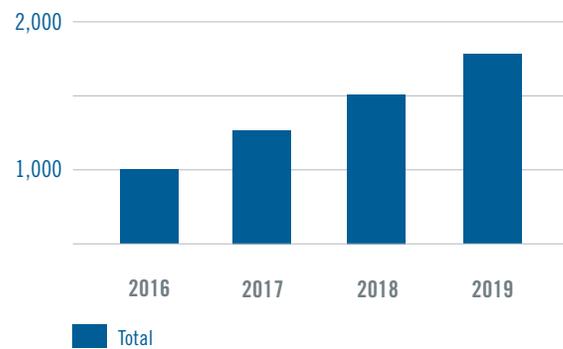
THE EFFECT OF COVID-19 ON GLOBAL PRIVATE EQUITY MARKETS

JULY 2020

NORTH AMERICAN PRIVATE EQUITY

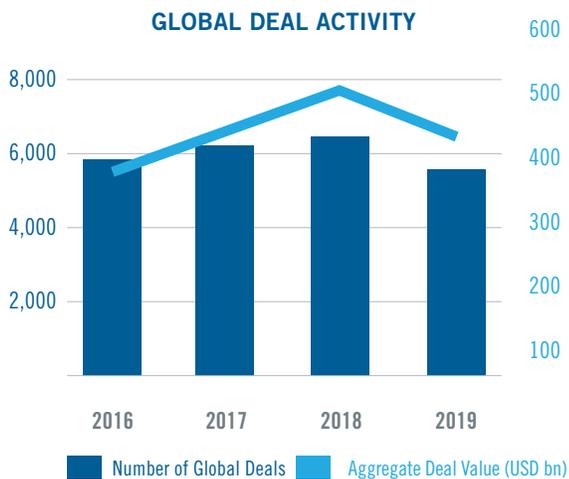
Before the COVID-19 pandemic, the private equity market looked to be as strong and resilient as ever. Each year from 2016 through 2019, we saw high levels of PE buyout activity in North America and around the globe, and there were few obvious signs of a slowdown in the U.S. economy, as demonstrated by continuing low unemployment, high consumer sentiment and record stock market highs.¹ A robust and efficient auction market drove strong sponsor-backed M&A transaction activity, aided by record levels of private equity dry powder and generally consistent credit markets. Against that backdrop, PE buyers and sellers were executing transactions in an extremely efficient manner, utilizing attractively priced representation and warranty insurance to all but eliminate post-closing entanglements for selling funds and agreeing to largely standardized terms allocating pre-closing risk.

GLOBAL PE DRY POWDER 2016-2019
(USD bn)



Source: Preqin

GLOBAL DEAL ACTIVITY



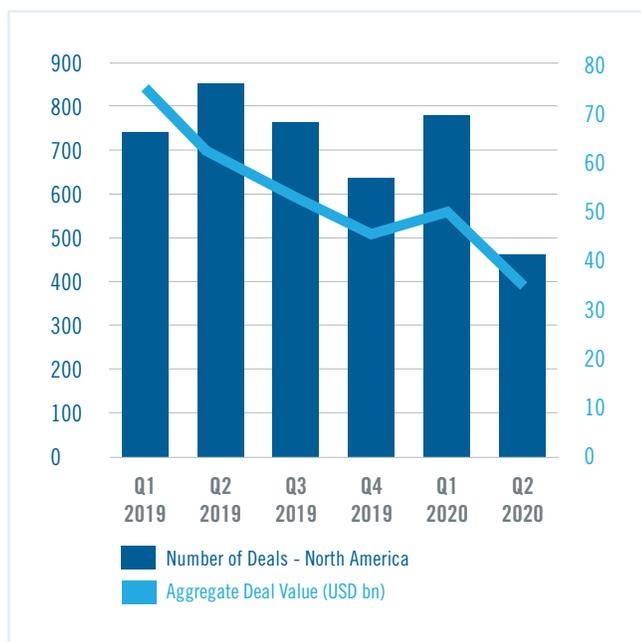
Source: Preqin

U.S. LEVERAGED LOAN VOLUME



Source: LCD

The COVID-19 pandemic that began in the U.S. in the middle of March 2020 has had an acute impact on the deal environment and the broader U.S. economy. The number of North American private equity deals fell from 851 in Q2 2019 to 456 in Q2 2020, and aggregate deal value for North American private equity deals fell from \$56.2 billion to \$30.9 billion from Q2 2019 to Q2 2020.² A substantial majority of transaction processes that were ongoing or starting up at the time that the pandemic struck in Europe and North America went on hold.³ PE fundraising activity has declined, with a more modest decline in the aggregate amount of capital raised as compared to the number of funds holding closings. On a worldwide basis, 372 funds raised approximately \$205 billion in the second quarter of 2020 as compared to 476 funds that raised approximately \$234 billion of capital in the first quarter of 2020.⁴ Available statistics also illustrate that the broader economy faced significant headwinds in the immediate aftermath of March 2020. The U.S. consumer sentiment index fell from 101 in February 2020 to 71.8 in April 2020, and the U.S. unemployment rate surged from 3.5% to nearly 14.7%.⁵ While several of these metrics have subsequently recovered to a degree as states ease lockdowns, none are yet close to their pre-crisis levels.



Source: Preqin

In the midst of this disruption and initial partial recovery, Ropes & Gray attorneys have continued to advise our PE clients and their portfolio companies on navigating these turbulent waters and on a cross-section of the world’s most high-profile private equity transactions. In this update, we discuss key trends that our clients and contacts should consider and the transaction and portfolio company dynamics that we see on the horizon.

NORTH AMERICAN PORTFOLIO COMPANIES AND PRIVATE EQUITY’S REACTION TO THE PANDEMIC

As the full impact of the pandemic and resulting lockdowns set in during the first half of 2020, private equity firms and the management teams of their portfolio companies brought intense focus to making the operational changes and taking the liquidity measures necessary to best navigate the unexpected challenges presented. During the initial weeks of the pandemic, this largely consisted of engaging in a combination of cost-cutting, deferring capital expenditures, ensuring compliance with governmental orders, liquidity forecasting and planning (including revolving loan draws), addressing supply chain issues, and operational and workforce adjustments. The pandemic also spurred on a flurry of credit agreement waivers and amendments for PE-owned portfolio companies (see *Credit Agreement Amendments and Waivers* below).

Despite the intense focus on liquidity, we have seen limited participation by PE-owned companies in the Paycheck Protection Program and the Main Street Lending Program. Although PE firms expressed significant interest in PPP loans initially, they grew increasingly cautious about receiving and retaining the funds as they learned more about the program, the certification requirements and the level of need in the wider economy. The portfolio companies that kept the funds did so based on careful compliance with certification requirements and restrictions on the use of the funds. We have seen essentially no participation by operating companies (whether owned by PE firms or not) in the Main Street Lending Program. However, some portfolio companies did benefit to a degree from programs specific to health care providers, payroll tax deferral (see *Negotiated Tax Provisions* below) and other tax relief programs.

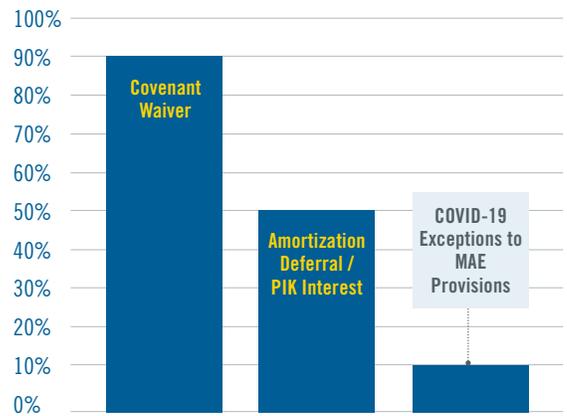
CREDIT AGREEMENT AMENDMENTS AND WAIVERS

COVID-19 was the primary driver of amendment and waiver activity during the period between March and June.⁶ However, to date, less than one-quarter of the portfolio companies with whom we regularly work in North America have obtained COVID-19-related waivers and amendments. Given the more substantial impact of COVID-19 after Q1 2020, a significant number of portfolio companies are likely to need waivers or amendments, or longer-term solutions, in connection with the delivery of June and September financial results, which typically occurs between 45 and 60 days after quarter end.

A majority of the COVID-19-related amendments and waivers we have seen have been in the health care and consumer/retail sectors, which have generally been most significantly impacted by state and local shutdown orders.

Although a minority of the COVID-19-related amendments and waivers provided for short-term reporting and payment relief, the majority of these amendments provided for longer-term financial covenant suspensions or resets of more than two fiscal quarters and, in some cases (principally in non-syndicated loan financings), longer-term liquidity relief in the form of interest and principal deferrals or payment in kind.

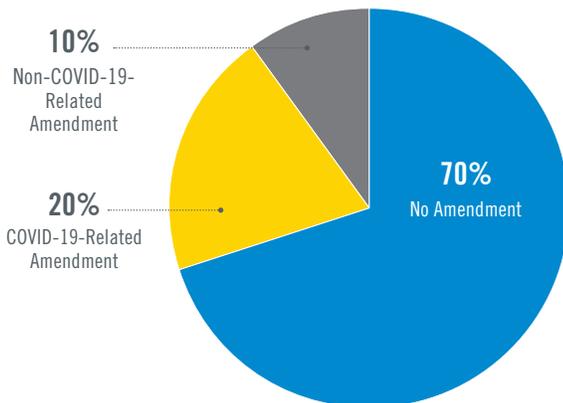
NATURE OF RELIEF IN LONG-TERM AMENDMENTS



Source: Ropes & Gray

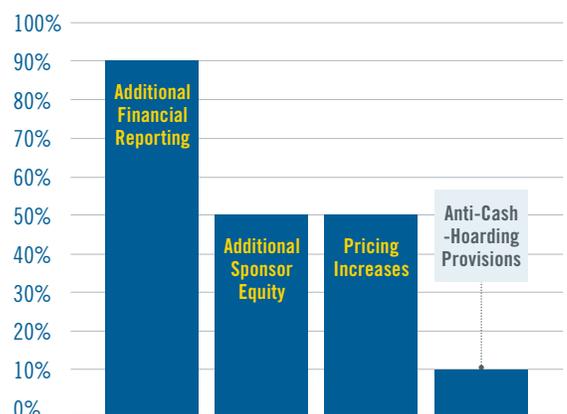
Additional sponsor equity capital and pricing increases were required in approximately half of these longer-term COVID-19-related credit agreement amendments. A majority of the COVID-19-related amendments also included additional financial reporting requirements (e.g., cash flow projections, lender calls and monthly financial reporting packages). Other related concessions required by lenders have included new liquidity maintenance covenants during the financial covenant suspension period and, in a minority of cases, the inclusion of cash hoarding restraints, typically in the form of a revolving facility drawing condition.

NORTH AMERICA AMENDMENTS MARCH - JUNE 2020



Source: Ropes & Gray

FREQUENT AMENDMENT / WAIVER CONCESSIONS



Source: Ropes & Gray

SPONSOR-BACKED M&A TRANSACTIONS, POST-COVID-19 EMERGENCE

Since March, we have seen a “tale of two markets” for North American sponsor-backed M&A deals. For those businesses that were *not* heavily impacted (or, in some cases, were even positively impacted) by COVID-19, a significant number of transactions did go forward following initial disruptions, but often at a slower pace and with more difficult debt financings than would have been expected pre-pandemic. Even with such relatively unaffected businesses, it has been a challenge to align buyers’ and sellers’ price expectations, as there is concern about the duration and depth of the global recession and how to assess projections in this environment. Frothy public equity markets are adding to the disconnect between value expectations of sellers and buyers. In contrast, M&A deals involving businesses that have been significantly adversely impacted by COVID-19 came to an almost immediate complete halt and have remained stalled as the pandemic has progressed. (For discussion of transactions that had signed but not yet closed at the time the pandemic arrived, see the *Litigation and Closing Risk* below.)

In those transactions that have been negotiated and signed since the emergence of the pandemic, many of the typical key pre-COVID-19 standard PE transaction terms have survived with limited modification. Broadly, there has been a focus on allocating the pandemic risk to the buyer and allowing flexibility for the target to make changes to its operations in the interim period. “Material Adverse Effect” (“MAE”) definitions have typically included specific carve-outs for the adverse effects of pandemics and related governmental orders and closures, to the extent that the target business is not disproportionately impacted as compared to similarly situated businesses. In other words, COVID-19’s effects on the broader economy or industry are “carved out” and therefore not taken into account in determining whether there has been an MAE. In these negotiations, parties have focused in a fact-specific way on the possible disruptions at the target businesses and whether they would likely satisfy the “disproportionate

impact” carve-out. For example, parties have needed to examine the potential impact of COVID-19 infection breakouts at target facilities, sickness of key personnel, unique supply chain disruption issues, uniquely localized impacts of government lockdown orders and many other potentially disproportionate effects.

Covenants that require the target business to operate in the “ordinary course of business” between signing and closing have for the most part provided the target management reasonably broad flexibility to take appropriate actions in response to the pandemic, including various combinations of the following:

- actions required by governmental orders;
- planned actions that were specifically disclosed at signing;
- actions consistent with the pandemic response of the target taken prior to signing;
- actions of the target that are consistent with what similar businesses are doing in response to the pandemic; and
- actions that are commercially reasonable or determined by the target management to be necessary in light of the pandemic (often in management’s reasonable or good-faith discretion).

We believe that sellers and buyers may increasingly try to better define what is “ordinary course of business” given the recent disruption of many businesses as a result of COVID-19 and the real possibility of a new wave of lockdowns.

For the interim period between signing and closing, buyers have most often secured information, consultation and some consent rights with respect to the target business’s pandemic response so that buyers have an opportunity to provide input on some actions rather than be taken by surprise.

Buyers have also been successful in adding reps and warranties that elicit specific disclosure around pandemic operations responses, continuation of regular capital expenditures, absence of PPP loans, or compliance with laws relating to the borrowing of PPP loans and their terms. We have also seen buyers push harder for the last month of financials to be provided before closing and covering those latest financials in the financial statement reps and warranties.

PURCHASE PRICE CALCULATION

In cases where a target borrowed and did not repay PPP loans, buyers and sellers have negotiated whether the PPP loans should be counted as a debt-like item and repaid (regardless of whether they would otherwise ultimately be forgiven). This negotiation has occurred against the backdrop of many sponsor-backed portfolio companies either not participating in the PPP loans or borrowing and subsequently repaying them, and the presence of mandatory change-of-control prepayment provisions in most PPP loans. Negotiations around net working capital have also become more complex in the COVID-19 context. Trailing 12-month net working capital averages are not necessarily useful at this time in determining the appropriate level of net working capital in COVID-19-impacted businesses with declining or delayed accounts receivable (and increasing levels of bad debt), aging accounts payable, lower levels of inventory, and a revised operating trajectory going forward. Sellers and buyers must also consider the potential impact on working capital that could occur if the target business is subject to a renewal of business or social lockdowns.

BRIDGING VALUATION AND FINANCING GAPS

There continues to be a valuation disconnect between bullish public equity markets, on the one hand, and a global recession resulting from the impact of COVID-19, on the other hand. In view of this valuation gap, along with the fact that financing for new transactions remains difficult, we are starting to see creative means for bridging these gaps. Here are several such approaches:

- **EARNOUTS** Earnouts based on the continuing recovery of the target business have been commonly discussed and adopted in certain cases. In other cases, we have even seen earnouts tied very directly to COVID-19, such as manufacturing goals for COVID-19-related products.
- **PARTIAL FINANCING THROUGH SELLER DEBT** Seller debt has become a more frequent element of the capital structure as third-party financing has become more challenging. The terms of the seller debt have often been subject to intense negotiation, since most sellers have been reluctant lenders. Key sticking points include negative covenants that would restrict further borrowing, M&A or other activities pending a full refinancing and interest rate (including escalation over time to encourage repayment, cash pay versus PIK features, and the inclusion or absence of set-off features).
- **INCREASED ROLLOVER** Increased seller rollover has been an additional source of financing for PE deals in the second quarter, and the issuance of rollover equity that is junior to the sponsor equity (preferred with a downside accruing coupon) is becoming more common.
- **SPONSOR DEBT BRIDGES** Sponsors have been bridging third-party debt financing at closing, pending better financing markets and/or target business growth at a rate that is greater than before the pandemic.
- **ROLLOVER DEBT** We have seen parties increasingly looking to negotiate with incumbent lenders to effectively “roll over” existing debt through amendment, waiver, and amend and extend arrangements, typically in exchange for some pricing and term accommodations.

As the effects of the pandemic decline, and more businesses that are recovering from the impacts of COVID-19 and are presumably marketed on the basis of “COVID-

Adjusted EBITDA” begin to come to market, we expect these sorts of measures to be considered often and used with increasing frequency.

LITIGATION AND CLOSING RISK

North American private equity M&A transactions signed prior to COVID-19’s impact that involved businesses that were hit hard by the pandemic generally either closed in the second quarter (in several cases on revised terms, including with respect to price and seller rollover) or ended up as the subject of disputes, including several settled or pending litigations. In these disputes, the buyers’ rationale for not closing has focused mainly on the failure of closing conditions arising out of a combination of specifically negotiated MAE language and violations of interim operating covenants triggered by the target’s actions taken in response to the pandemic and related lockdowns.

As was the case in the aftermath of the 2007-2008 financial crisis, the 2020 market dislocation is likely to lead buyers, sellers and their counsel to closely examine certain typical deal terms related to closing certainty, and may result in the evolution of some of these provisions. For example:

- a further increase in the number of successful bids involving full equity backstop commitments from PE sponsors (a trend that had preceded 2020 and appears to have further accelerated in the pandemic);
- increased focus on the size of reverse termination fees in transactions where a full equity backstop is not available;
- variation in the size of the reverse termination fees, depending on whether payment of the fee is triggered by the buyer’s willful breach or solely as a result of a debt financing failure;
- closing any “daylight” in the interim “ordinary course of business” covenant; and

- changes to the “conditional” or “limited” specific performance construct (i.e., the deal construct that allows the seller to force the buyer to close, as opposed to paying a reverse termination fee when closing conditions are satisfied and the buyer’s debt financing is or would be available at a closing).

In addition, because court closures and related obstacles encountered during the COVID-19 pandemic have demonstrated that speedy access to courts for resolution of disputes may not always be as readily available as was previously assumed, buyers, sellers and their counsel may increasingly focus on the remedy and dispute resolution provisions of M&A-related agreements, including:

- the length of lender financing commitments and whether such commitments would extend pending resolution of deal-related litigation;
- the inclusion of provisions requiring the parties to seek expedited court proceedings in the event of deal-related litigation; and
- other related terms of the buyer’s financing covenants and financing commitments.

A few post-COVID-19 platform deals, and many post-COVID-19 add-on deals, have been purposely structured as simultaneous sign-and-close transactions to avoid these risk allocation discussions. We believe that this trend has been aided by the fact that smaller transactions (under the HSR filing threshold) were somewhat more likely to survive the broader process disruptions resulting from COVID-19.

REPRESENTATION AND WARRANTY INSURANCE

The representation and warranty insurance market has remained robust and active in the U.S., with premium rates and retentions generally stable relative to the pre-COVID-19 period. In our experience, insurers are still very eager to place policies. While insurers initially proposed broad exclusions from coverage for COVID-

19-related matters, the recent trend in the market (with some exceptions) has been toward more narrowly tailored exclusions, depending on the nature of the target’s business. On the claims side, the market has not yet seen a widespread increase in claims under existing representation and warranty insurance policies; however, we are monitoring whether claims activity will increase in the second half of the year and, if so, whether that dynamic reinforces the pre-COVID market forces that were driving some carriers to consider increasing premiums.

NEGOTIATED TAX PROVISIONS

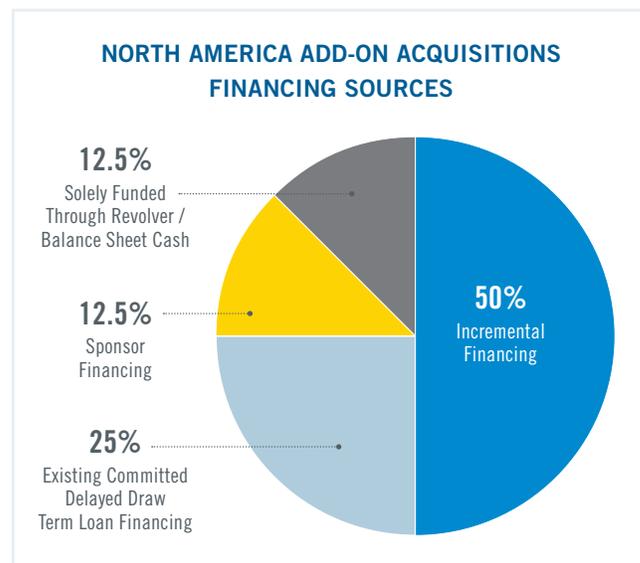
In order to provide immediate financial relief to employers, Section 2302 of the CARES Act permits employers to defer payment of the employer portion of social security payroll taxes arising during the period beginning March 27, 2020 and ending December 31, 2020. Fifty percent of the deferred portion of such payroll taxes is due on December 31, 2021, with the remaining amount due on December 31, 2022.⁷ Buyers and sellers are increasingly looking to specify whether, to the extent these taxes are explicitly allocated among the parties, the taxes should be calculated with or without giving effect to the payroll tax deferral benefits provided by the CARES Act.

The CARES Act also created additional flexibility to utilize net operating losses (“NOLs”), which has become a negotiated point in transactions. For background, the 2017 Tax Cuts and Jobs Act (“TCJA”) imposed significant limitations on the use of NOLs—most significantly, this legislation (1) eliminated the ability of taxpayers to carry back net operating losses realized in one tax year to a prior tax year, and (2) limited the ability of NOL carryforwards from a taxpayer’s prior tax year to offset only 80% of the taxpayer’s income for a subsequent tax year. As a result, after the TCJA passed, sellers increasingly have sought to negotiate rights to be paid for actual or projected tax savings to be realized in post-closing periods because of pre-closing period NOLs that were carried forward. The CARES Act significantly altered the status quo by enabling taxpayers to carry back NOLs arising in the 2018 and 2019 tax years to

the preceding five years. It also provides that the 80% limitation specified in the TCJA will only apply in respect of tax years beginning after December 31, 2020 (i.e., 100% of NOLs are generally available to offset income taxes in tax years 2018, 2019 and 2020). Due to these changes, in addition to determining whether sellers should get purchase price credit for actual or projected tax savings from NOL carryforwards, negotiations have also focused on whether sellers will be paid for the benefit of tax refunds that may be realized from the carryback of 2018, 2019 and 2020 NOLs to pre-closing periods.

TRANSACTION FINANCING

COVID-19 continues to impact the ability of financial sponsors to obtain financing for new platform deals at acceptable yields. Add-on activity was marginally better than new platform transaction activity during the period from March to June, with close to 20% of the portfolio companies we regularly advise continuing to pursue and/or consummate add-on acquisitions. Debt financing for such add-on acquisitions was typically available in the form of (in many cases uncommitted) accordion credit facility increases and incremental loan tranches under existing loan agreements, as well as through utilization of committed delayed draw term loan facilities.



Source: Ropes & Gray

PIPE AND OTHER MINORITY INVESTMENT TRANSACTIONS

The COVID-19 pandemic has created some opportunity for private equity funds to make minority preferred equity and debt investments into impacted U.S. businesses. During the second quarter of 2020, we saw a moderate level of minority investment activity, including PIPE (private investment in public entity) investments into struggling public companies that were disproportionately impacted by the pandemic and looking for liquidity. In many of these situations, the issuer found itself unable to access unsecured debt markets, unwilling to issue additional common stock as the pandemic initially depressed share prices, and generally unwilling or unable to take advantage of PPP loans and other government programs.

In total, the March through June period saw approximately 30 liquidity-driven PIPE transactions consummated by U.S. public companies with market caps in excess of \$250 million. Transaction execution was aided by a temporary suspension of certain exchange rules requiring stockholder approval of 20% or greater equity issuances.

In general, we have seen limited instances of sponsor-backed private companies going to third-party sources of preferred equity or mezzanine capital; and that activity may increase if the pandemic and resulting recession worsen or drag on for more than one or two additional quarters, as successful lender negotiations may require additional equity and not all existing sponsors will be able (including due to fund age and concentration limits) or willing to provide additional equity.

MANAGEMENT EQUITY INCENTIVE PLANS

Existing management equity incentive plans have remained largely untouched. Sponsors have typically not reset valuations under such plans thus far during the pandemic, and those resets that have occurred have generally followed additional sponsor equity being invested at a new lower equity valuation. However, new grants to management have reflected the current, lower valuations in many cases. We believe that sponsors and

their senior portfolio company management teams are seeking additional economic and valuation stability before making such adjustments, and we expect to see more of these adjustments as the valuation effects of the pandemic become more clear.

NON-U.S. MARKETS

ASIAN MARKETS

In China, many transaction processes that began before the pandemic were initially put on hold, but a substantial number of them have gotten back on track (albeit typically on a slower timeline) once the initial spread of the virus appeared to have been under control in mainland China and Hong Kong and positive case levels dropped. Few new auction processes were launched in China during the first half of 2020. However, we expect there to be a resurgence of new auctions during the second half of the year absent a resurgence of the virus. Take-privates of both U.S.-listed Chinese companies and Hong Kong-listed companies have been active deal flow sources as valuations have become attractive relative to 2019 valuations. Going forward, primary and secondary listings on the Hong Kong Stock Exchange are expected to become one of the most popular venues—if not the most popular—for PE-sponsor exits of China-based portfolio companies due to increased U.S.-China economic tension.

In Korea, the introduction of new auctions and other sales processes have generally kept pace at pre-pandemic rates, although there have been timing delays in several processes due to logistical difficulties, especially during the early days of the pandemic when various lockdown measures were in place. The failure rate of these sales processes in Korea has increased, however, due to more pronounced valuation gaps between buyers and sellers stemming from COVID-19-related macroeconomic uncertainties. In certain (typically smaller) Korean domestic deals, we are seeing a push to use quantitative thresholds in MAE definitions (e.g., by establishing closing conditions based on a

threshold percentage decrease in specific financial metrics between signing and closing) to reduce uncertainty in determining whether an MAE has occurred based on COVID-19 impacts. Private equity investors are also continuing to evaluate a variety of minority investment opportunities in Korean companies, driven primarily by the ongoing internal restructuring activities of large Korean conglomerates looking to shed non-core business segments. To date, the Korean debt markets have not significantly tightened in response to COVID-19.

In Japan, deal activity levels have generally kept pace at pre-pandemic rates. Most deal processes have continued to move forward despite periodic disruptions caused by the pandemic, albeit typically at a slower pace and often with lower leverage levels. Delays have often been attributable to buyers and their lenders taking more time on diligence. Auction processes in business sectors that are perceived to benefit from or be less affected by the pandemic (e.g., pharmaceutical, health care and infrastructure) are attracting high levels of interest. In the hardest-hit sectors (e.g., hotel chains, automobile manufacturing and advertising), there have been numerous debt and preferred equity investment opportunities as these companies seek to strengthen their balance sheets.

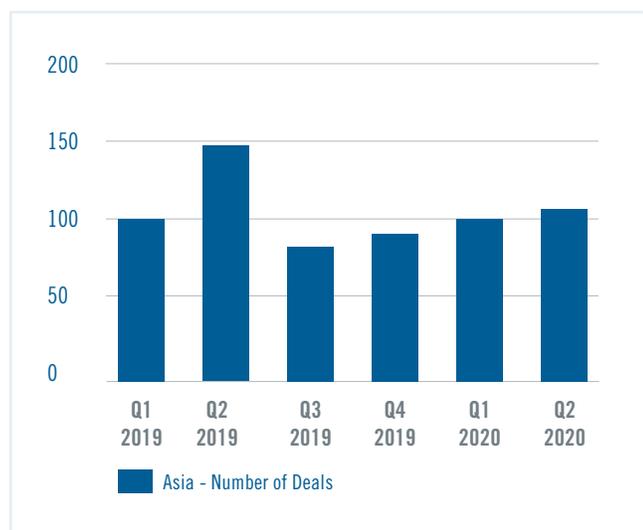
In general, there has been little bankruptcy and distressed M&A activity in Asia to date due, at least in part, to the fact that Asian companies are typically less leveraged in comparison to those operating in other markets, and Asian lenders (China-based lenders in particular) have generally been amenable to renegotiation of terms and restructuring of capital structures as needed.

EUROPEAN MARKETS

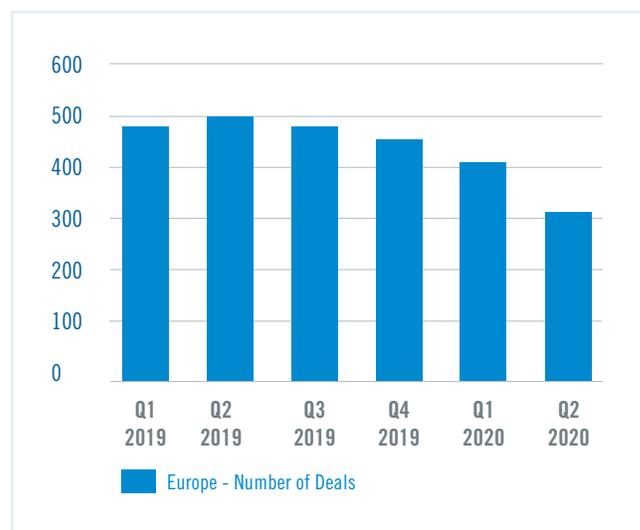
The European private equity M&A market has been hit hard by COVID-19, with deal volumes down by 31.5% for Q2 2020 compared to Q2 2019,⁸ following a record Q1 2020. The UK and Ireland saw the largest drop, with a 62.3% decrease compared to 2019. In part, this probably reflects the pending “no-deal” Brexit disruption that will finally become reality on January 1, 2021.

The decrease in deal volume and value was less pronounced in the French/Benelux and Scandinavian markets, which is representative of the continued shift of capital toward those jurisdictions since the Brexit vote.

PE investors are hoping that 2020 and 2021 will prove to be excellent vintage fund years, with market pressures finally bringing long-desired multiple decreases and forced sales.



Source: Preqin



Source: Preqin

There have already been a number of significant restructurings and distressed sales in hospitality and brick-and-mortar retail in H1 2020. While a number of these were long anticipated, the sudden shutdown and subsequent drop in consumer spending have hit these sectors hard in Europe. More distressed sales are expected in H2 2020 in the hospitality, retail and travel sectors as government support packages start to be withdrawn across Europe and the COVID-19 impact is truly seen.

After the initial shock of the March M&A freeze, some exit processes restarted in May, with deals managing to close on restructured terms or pricing. The technology and health care sectors proved to be particularly resilient. But with the lockdown preventing site visits and face-to-face management meetings, most London advisers expect that deal flow will not get back to normal levels until lockdowns fully ease across Europe in Q4 2020.

For now, teams are focused on supporting their existing portfolio companies and negotiating “amend & pretend/extend” packages with their existing lenders. It is expected that many non-distressed exit processes originally slated for H2 2020 / H1 2021 will be pushed back to H2 2021 and beyond to allow portfolio company valuations and trading to recover.

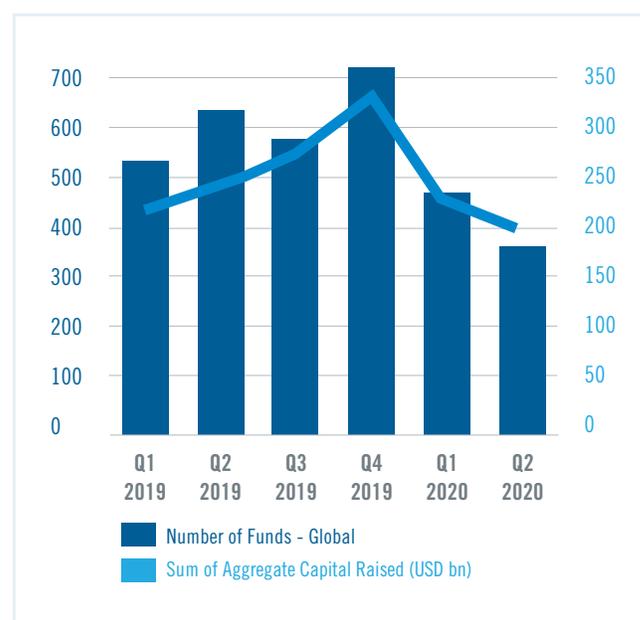
FUNDS UPDATE⁹

Early days of the pandemic saw private equity sponsors scrambling to complete fundraisings that were far enough along to have a finish line in sight. In many instances, closings were accelerated or rolling closings were instituted. Even for sponsors at the beginning or midway through their fundraisings, the pandemic often did not create as much disruption as might have been feared, particularly for sponsors with long track records and strong investor relationships.

While the pandemic created challenges (in terms of both pure marketing and assessment by investors of their portfolio

construction needs), substantial fundraising activity continued in the first half of 2020, with only modest declines in aggregate capital raised as compared to the equivalent period in 2019 and declines that have been far less severe than those immediately following the onset of the 2008–2009 global financial crisis. In Q1 of 2020, approximately \$234 billion was raised globally across nearly 480 funds. Q2 saw approximately \$205 billion raised globally across 372 funds. As a result, H1 2020 aggregate capital raised globally remained only slightly below the pace of H1 2019 (approximately \$440 billion in H1 2020 as compared to approximately \$468 billion in H1 2019). However, the number of funds raised declined much more meaningfully (848 funds in H1 2020 as compared to 1,154 funds in H1 2019). In the first half of 2020, fundraising was more concentrated among larger and longtime sponsors, especially those with significant loyalty among their existing investor base and who proceeded to complete or launch fundraisings with only limited disruption.

The situation of longtime sponsors often contrasts with first-time sponsors or those otherwise needing to fill investor holes. Many such sponsors are more heavily reliant



Source: Preqin

on welcoming prospective investors to their offices and hosting them for lunches and dinners to build relationships, and found the lockdown particularly burdensome. For these sponsors, the pandemic was highly disruptive even as many pivoted to Skype, Zoom or other similar technology to connect with prospective investors. Many extended their fundraising timelines or, in some cases, postponed fundraisings altogether.

As sponsors continued fundraising efforts in the first half of the year, they were also talking with existing investors on another front: providing liquidity to struggling portfolio companies. Despite the approximately \$800 billion in uncalled capital commitments held by buyout-focused funds as of the end of May 2020, in many cases, this capital is not available to address the liquidity needs of portfolio companies for one or more predecessor funds (due to funding constraints, conflicts, timing, etc.). In instances where a fund did not have the unfunded capital commitments or the ability to invest effectively on behalf of the applicable legacy fund, we have seen liquidity discussions focus around four options:

- **NAV FACILITY** A fund (or a special-purpose vehicle held by such fund) borrows under a so-called net-asset-value (“NAV”) credit facility. Unlike a capital call facility, a NAV facility is backed by the value of a fund’s investment portfolio (and not based upon undrawn capital commitments). We have also seen such facilities backed by a subset of investments, rather than across the whole portfolio.

- **EXPAND LPA RECYCLING PERMISSION** For example, if the fund LPA limited recycling to no more than 20% of committed capital, the limitation could be increased to 30%. Similarly, if recycling was limited to capital recovered within one year of deployment, the provision could be amended to permit recycling of capital recovered within three years of deployment.
- **RAISE FOLLOW-ON/SIDECAR FUND** The sponsor raises a new follow-on fund (also sometimes referred to as a sidecar or annex fund) for the purpose of providing capital to portfolio companies of a legacy fund. Typically, all limited partners in the legacy fund would be given a pro rata option to participate. The follow-on fund may be dedicated to specific portfolio companies identified at the time of fundraising, but also may permit investment in other unspecified portfolio companies with future capital needs.
- **ALLOW CURRENT FUND TO SUPPORT LEGACY PORTFOLIO** In order to obtain needed capital, a currently investing fund of the sponsor provides the capital to the portfolio companies held by a legacy fund. New investment may be in the form of debt or equity and may have priorities over existing investments in the portfolio company, including investments made by the legacy fund.

On the whole, the first two options were utilized more often, as they generally presented fewer conflicts and a quicker path to deployment of capital to the struggling portfolio companies.

ENDNOTES

¹ Tradingeconomics.com; U.S. Bureau of Labor Statistics; *S&P 500 and Nasdaq jump to record highs, Dow climbs more than 100 points*, CNBC.com, Feb 19, 2020, <https://www.cnbc.com/2020/02/19/stock-market-wall-street-in-focus-amid-coronavirus-outbreak.html>

² Preqin

³ See *The Impact Of The Coronavirus Crisis On Mergers And Acquisitions*, Forbes, Apr 17, 2020. <https://www.forbes.com/sites/allbusiness/2020/04/17/impact-of-coronavirus-crisis-on-mergers-and-acquisitions/#15393c82200a>

⁴ Preqin

⁵ Tradingeconomics.com; U.S. Bureau of Labor Statistics

⁶ Our internal survey covered hundreds of portfolio companies with whom we

regularly work. The vast majority of the credit facilities involved were private market (as opposed to syndicated).

⁷ Although the CARES Act initially prevented any such deferral if the employer received a PPP loan that was forgiven by the lender, the PPP Flexibility Act eliminated this limitation to permit deferral following forgiveness of a PPP loan, if applicable.

⁸ *European PE deal volume Q2 dips to lowest level since 2013, says Pitchbook*, Private Equity Wire, <https://www.privateequitywire.co.uk/2020/07/16/287622/european-pe-deal-volume-q2-dips-lowest-level-2013-says-pitchbook>

⁹ Fundraising data sourced by Preqin