The Rise of Private Equity Continuation Funds

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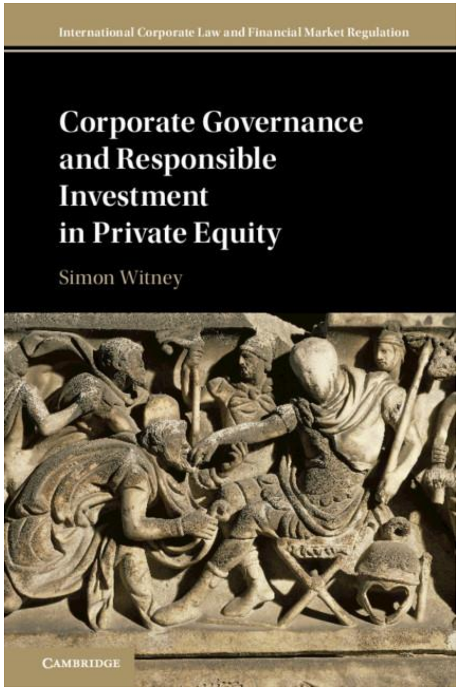
Barbarians at the Gate?



- Continuation funds are a solution to a problem created by a (structural) solution to a problem
- PE funds invest in illiquid and hard to value assets, but investors need the certainty of liquidity
- Limited life, closed ended funds are the answer
- Investors like the market discipline
- Most PE strategies are 3-7 years
- But 3-7 years isn't always optimal
- Fund extensions are one obvious solution
- But investors will have different time horizons that evolve over time, and some will need the promised liquidity at the promised time

Continuation funds: a win-win-win-win?

- Some investors want to stay invested in the asset(s)
- Some investors want to exit at the current price (and many opt to do so), and new investors are willing to buy them out
- The fund manager wants to continue to manage the asset
- The underlying business avoids the distraction and disruption of an M&A deal, and may benefit from additional capital
- In many cases, the sale price should be higher: the GP knows the asset and its upside potential, and transaction costs should be lower – <u>but clearly if there is a better price available the GP should take it …</u>

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Mitigating conflicts

- If the “agency” costs (including the costs of mitigation) are outweighed by the benefits of the arrangement, we create efficiency
- The questions are:
  - How should we manage the conflicts?
  - Having done that, are continuation funds a positive development to increase overall efficiency in the private markets?
- This paper makes a very important contribution to those questions
- The key question is about valuation and market-testing
- ILPA principles offer various solutions, recognising that “one size will not fit all”

CD&R Fund X Sells Belron Stake in Transaction that Values Belron at €21 Billion

39% of CD&R Position Sold to Funds Managed by Hellman & Friedman, GIC, and BlackRock Private Equity Partners

61% Sold to New $4 Billion CD&R Special Purpose Vehicle to Extend Successful Partnership between CD&R, D'leteren Group, and Belron Management

Friday, December 17, 2021
London and New York

Clayton, Dubilier & Rice Fund X today announced the sale of its investment in Belron, a worldwide leader in vehicle glass repair and replacement. The two-part transaction included the sale of approximately 39% of CD&R Fund X's stake to funds managed by Hellman & Friedman, GIC, and BlackRock Private Equity Partners, valuing Belron at €21 billion. The remaining 61% of the CD&R Fund X ownership position was sold to CD&R Value Building Partners I, L.P. and related vehicles (the "SPV"), new special purpose vehicles formed to continue CD&R's partnership with Belron.

Belron operates in 41 countries through wholly-owned businesses and franchises, with market leading brands – including Carglass®, Safelite® and Autoglass®. In addition, Belron manages vehicle glass and other insurance claims on behalf of insurance customers. Sales and adjusted operating results for the period ending December 2020 reached €3.9 billion and €583 million, respectively.

CD&R Fund X acquired a 40% stake in Belron in February 2018 in a transaction that valued the company at €3 billion. Since its initial investment, CD&R has worked in a close partnership—which will be extended by the new SPV—with D'leteren Group and the Belron management team to drive growth and margin improvement. Following the transaction, CD&R vehicles will hold a 20% stake in Belron and remain the company's second largest shareholder, primarily through the approximately $4 billion CD&R-managed SPV.

"We are very pleased to welcome new, high quality investors at Belron and to continue our strong partnership with the Belron team and the D'leteren Group in a business that we believe has tremendous runway for growth and value creation," said CD&R Partner Christian Rochat. "Importantly, we are excited to deliver a creative solution that has given our investors an array of attractive options."

"Belron has grown steadily over the last 20 years, and we believe it is now regarded as one of the leading, best-in-class global services businesses that reflects its global and local market presence, exceptional customer satisfaction, and strong financial performance," said CD&R Partner Eric Rouzier. "We expect to continue to benefit from structural growth tailwinds, driven by long-term secular increases in miles driven and windshield technology and complexity."

Think before you regulate

- Even if there is a residual issue, can the regulator do a better job than the market?
- As this paper points out, the SEC's proposed insistence on a fairness or (cheaper) valuation opinion was inflexible and, in many cases, wasteful – neither GPs or LPs wanted it
- Regulator can facilitate market solutions
- Principles based regulation, properly enforced, would be better:
  - Fiduciary duty / fair treatment of investors
  - Conflicts management procedures
  - Regulation of preferential treatment

Solutions

- Ban them: no one is suggesting that – prevents value enhancing transactions
- Enhanced disclosure and more time (ILPA recommendations)
- Status quo option: is it viable? The authors note various limitations
- Empowering legacy fund LPs (eg votes), but what about something similar to a committee of non-executive directors (as on a takeover)?
- Note that the whole scheme only works if a significant number of investors choose to cash in: secondary investors won't buy otherwise, and a fund extension or LP secondary makes more sense

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