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Weil Private Equity Sponsor Sync

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FROM THE EDITORS

As we step into the second half of 2024, the private equity landscape continues to evolve, as debt markets thaw and "meeting of the (creative) minds" is the new mantra to getting transactions across the line. Our summer issue features our quarterly U.S. Leveraged Finance Market Update, highlighting trends and pricing. We also give a glimpse of where PE deal-making is heading, with aggregated data on our engagements this quarter, showing healthy activity across many sectors (and in particular, software & tech). In "Bridging Valuation Gaps: An Alternative to the Earn Out," we present new strategies for closing valuation gaps in deals through "Rollover Ratchets". This quarter's Partner Perspectives from Goldman Sachs provides a forward-looking view on private markets for the remainder of the year, while our AI & PE Primer examines the transformative impact of AI and a view to how our sponsor clients are looking to use gen AI. Strategic insights from Marco Compagnoni on European private equity and a recap of our global PE summit with Axios provides a global perspective. Lastly, we also cover the latest developments in the IPO market, a notable and bizarre arbitration dispute where a seller had to pay a buyer to acquire a business, and other regulatory updates. As with every issue, we aim to equip readers with powerful knowledge and practical insights to be at the forefront of private equity — from fundraising, to execution, to exits and everything in between.

IN THIS ISSUE

P02 U.S. Leveraged Finance Market Update. We provide the latest pricing information on corporate debt and our quarterly market commentary.

P04 See Around the Corner with Weil PE. We take a look at our latest data on Weil private equity representations as a leading indicator of the direction of private equity transactions and sector activity.

P05 Bridging Valuation Gaps: An Alternative to the Earn Out. Matt Stewart, Travis Michaud and Matt Bernstein provide commentary on valuation gaps which persist and propose a new tool, the "Rollover Ratchet".

P08 Partner Perspectives: Goldman Sachs on the Future of Private Markets in 2024. Our friends at Goldman Sachs weigh in on the future of private markets for the remainder of 2024.

P10 AI & PE: A Primer. Consensus is that AI is a game-changer for investors, but how are sponsors actually using it? We provide a snapshot of the most impactful use cases of AI our private equity clients have grappled with to date.

P12 Strategic Insights: Marco Compagnoni on PE Investment in Europe. Building on our transatlantic Q2'24, the Editors sat down with senior partner and co-head of Weil's global Private Equity group in London, Marco Compagnoni, on trends and developments in European private equity.

P14 Axios x Weil – The Next Era: Private Equity's Global Path. Weil partnered with Axios for a premier, first-of-its-kind, trans-oceanic private equity event. We provide a short synopsis and a link to watch in full.

P15 Turning the Corner – Tracking Trends in the Sponsor-Backed IPO Market. We reflect on the state of the IPO market for sponsor-backed companies with Solebury Capital.

P20 Post-Closing Purchase Price Adjustments Gone wrong: The Save Mart/Kingswood Capital Dispute. Glenn West offers a deeper look into an arbitration dispute that resulted in a bizarre outcome of sellers being ordered to pay a buyer $70M to acquire a company.

P27 State of Play: Private Fund Adviser Rule. We provide the latest on the SEC's Private Fund Adviser Rules.

P28 Legal Lens: Supreme Court Rejects Non-Consensual Third-Party Releases. We overview the recent *Purdue Pharma* decision and its impact on private equity sponsors of bankrupt companies.

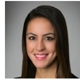
PROUDLY ANNOUNCING OUR LAUNCH IN
LOS ANGELES
AND
SAN FRANCISCO
PAGE 7

WEIL LOAN TRACKER

Q2'24

Average First-Lien Broadly Syndicated Spread for B Rated Borrowers:	Average First-Lien Broadly Syndicated Spread for B-Minus Rated Borrowers:	Average Spread Differential for Private Credit:	Volume of Refinancings of U.S. Private Credit Loans into Syndicated Loan Market:	Volume of Repricings of U.S. Leveraged Loans:
S + 369 (down 36 bps Q over Q)	**S + 410** (down 31 bps from Q2)	**~100 bps higher than BSL**	**$16 billion**	**$378 billion**

U.S. LEVERAGED FINANCE MARKET UPDATE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Kate Swain
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Associate
Banking & Finance

SMART SUMMARY

- With the dearth of new money transactions, lenders have been willing to consider riskier profiles on repricing and refinancing transactions, even revisiting deals they overlooked earlier in the year.
- The traditional spread gap between private credit loans and broadly syndicated loans has narrowed as private credit lenders vie to compete with the re-opened syndicated loan market.
- The surge of repricings, refinancings, amend-and-extend transactions and dividend recaps that began in Q1'24 continued into the second quarter with added fervor.

Continuing the momentum from Q1'24, the U.S. leveraged loan market in Q2'24 has been replete with investor activity, with demand far outpacing supply and boasting the highest level of sponsored loan volume since 2017. Much of the market activity in the second quarter has been driven by opportunistic transactions, in particular refinancings, repricings, amend-to-extends and dividend recaps. With institutional lenders regaining their footing in the market in early 2024 after being all but displaced in 2023 by private credit lenders, the competition between the broadly syndicated and private credit markets is also heating up.

Second Quarter Recap

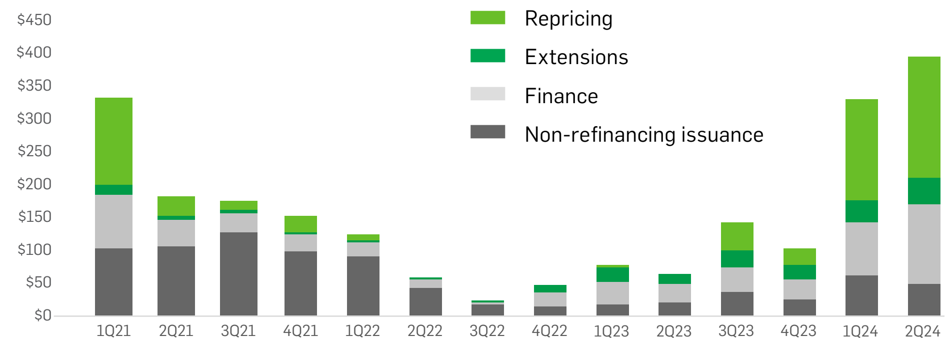
A Healthy Appetite for Risk, Repricings and Refinancings

Q2'24 has been marked by strong investor demand which, when coupled with minimal new deal supply, has left lenders willing to revisit pricing on existing deals with greater risk appetite.

The first half of 2024 boasted the highest level of sponsored loan volume since the prior post-Global Financial Crisis peak in 2017, driven by opportunistic repricing and refinancing activity. In the second quarter of 2024 alone, there was a total of $396 billion of U.S. leveraged loan volume, a record high and up from $331 billion in the first quarter.[1]

But despite strong investor activity in the U.S. leveraged loan market, new-issue loan volume has remained muted. Year-to-date new money volume (not related to refinancings or amending existing debt) has totaled only 13% of total institutional loan activity in Q2'24, compared with an average of 52% of total deal activity during the five-year period from 2017 to 2021.[2]

Share of Allocated U.S. Leveraged Loan Volume



Source: Pitchbook | LCD + Date through May 31, 2024

With limited new-money opportunities in the market, borrowers have taken advantage of strong lender appetite by seeking out repricings and refinancings at a record pace. By mid-June, U.S. borrowers had completed a record-breaking $617 billion YTD of refinancings, repricings and maturity extensions.[3] So far in 2024, 29% of the leveraged loans that were outstanding as of the beginning of the year have been repriced, resulting in average spread reduction of 54 bps and over $2.1 billion of annual interest expense savings.[4] And there seems to be no end in sight for the repricing boom, with 34% of the market trading above par as of the end of June.[5]

Amend-and-extend activity has also been robust. With a year-to-date total of $69 billion through the end of June, this year is on track to beat out last year's record level.[6]

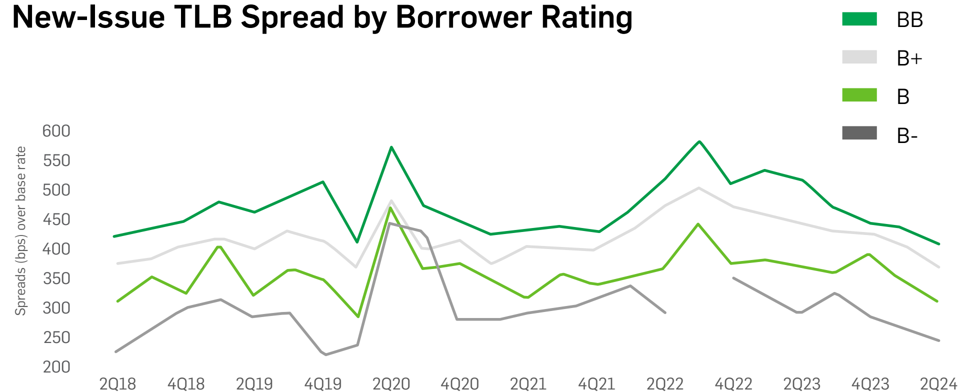
Private Credit and Broadly Syndicated Lenders Vie for Supply

Borrowers have flocked to the broadly syndicated loan market to refinance more expensive debt previously provided by direct lenders, including unitranche loans and second lien debt. Coupled with diminished LBO and M&A activity overall, many private lenders have cut spreads and foregone some of the spread premium that private credit has traditionally offered in order to compete.

In 2024 thus far, the spreads in the broadly syndicated market have ranged from 350 to 500 bps compared with 450 to 625 bps in the private credit market.[7] This average spread gap of just over 100 bps is much narrower than the 212.5 bps average spread gap in 2023, demonstrating just how much direct lenders have been willing to forego to stay in the mix.[8]

Nonetheless, certain borrowers have taken the opposite approach and refinanced their broadly syndicated loans into the private credit market.[9] This may appeal to certain borrowers who are willing to pay a premium in exchange for certainty of execution and/or sweeteners that the private credit market more commonly offers, such as PIK interest, amortization holidays and generously-sized DDTLs.

Eager to deploy capital, lenders have also been increasingly willing to look at riskier profiles. Even lower-rated borrowers have been able to bring lenders to the table for repricing amendments. 32% of the repricing amendments in 2024 have been for companies rated B-minus by at least one ratings agency, compared to just 5% of B-minus repricings in 2023.[10] Deals that faced turbulence in the market earlier in the year also managed to reprice in May and June amidst demand for new paper.[11]



Source: Pitchbook | LCD + Date through June 24, 2024

LBO's and M&A Financings

LBO activity is on the mend with slow, but promising momentum. After the two-year decline that closed out 2023, sponsors have been able to raise $30 billion of syndicated loans year-to-date for LBO activity, which is more than double last year's pace.[12] M&A-related issuance, too, is ahead of the $26 billion of issuance at this point last year with $28 billion of issuance through June 30, 2024.[13] As a promising sign for LBO activity, certain new money loans hit the market in late June (e.g., Copeland and Darktrace), which priced with favorable terms and pricing for the borrowers in light of excess demand and overall market conditions.[14]

Despite the uptick, acquisition

financing volume is still below the comparable periods of every year between 2017 and 2022 due to a variety of factors, including high interest rates and borrowing costs, a general decline in sponsor exit activity and a continued valuation gap between buyers' and sellers'.[15]

Dividend Recaps

Although the repricing and refinancing surge has been the hot topic of the summer, dividend recaps have also basked in the sunshine with $35.3 billion in dividend recap loan issuance through the end of June, representing the highest total since 2013[16]. The heightened volume of dividend recaps comes amidst a difficult exit environment for private equity firms, with average hold times for PE portfolio companies at an all-time high.

2H 2024 Outlook

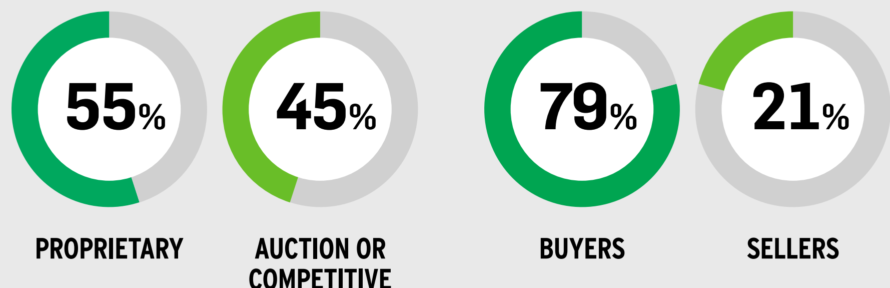
As we look toward the latter half of 2024, we expect repricing, refinancing and amend-and-extend activity will continue to dominate the U.S. leveraged loan market at least until the doldrums of summer through late August.

While we may see an uptick in buyout activity, meaningful growth may be tempered in 2H'24 as uncertainty related to the upcoming U.S. presidential election begins to trickle into the market. The market is hopeful that rate cuts down the line will translate to an uptick in M&A activity, but the timing of rate cuts remains uncertain.

Stabilized interest rates – with the prospect of cuts ahead – are beginning to indicate a more palatable environment for leveraged buyouts, with historic amounts of capital standing ready to be deployed. An increasing number of sponsors are getting more comfortable deploying capital at the first signs of a warming market rather than prolonging 2+ years of dormancy. This demand will meet a host of PE sellers who are nearing the end of their desired holding periods and are eager to return capital to investors. Dividend recaps are a stopgap for would-be sellers who are on the less liquid side of the years-long valuation gap, but that gap has narrowed from this time last year. Say hello to the deal market of Summer of 2024 – First movers welcome. This quarter, Weil Private Equity has been engaged on the following (most of which are still "in process"), which we suggest are leading indicators for the Private Equity market, generally:

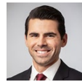
- **Weil is representing buyers in 78% of our mandates, as opposed to seller in 22% of mandates**
- **53% of our engagements are for proprietary processes, while 47% are in the context of competitive processes**
- **Our most active sector this quarter was Software & Tech, which is making a strong comeback in PE and M&A markets from 2023 lows**

Weil Representation Q1 2024



BRIDGING VALUATION GAPS: AN ALTERNATIVE TO THE EARN-OUT

Matt Stewart
Partner
Private Equity


Travis Michaud
Associate
Private Equity

Matthew Bernstein
Associate
Private Equity

SMART SUMMARY

- As valuation gaps persist in the private equity market, sponsors have been considering alternatives to the typical tools for bridging such gaps.
- The "rollover ratchet"—which involves the clawback and/or issuance of rollover equity tied to post-closing performance metrics of the acquired company—offers certain key advantages compared to a traditional, cash-based earn-out.
- We have seen the rollover ratchet used to bridge valuation gaps, align incentives on a long-term basis, and reduce the cost of capital.
- Careful structuring and drafting is required to successfully implement the rollover ratchet.

Yes, Valuation Gaps Persist

In the past two years, interest rate volatility[17], non-transitory inflation[18], aggressive antitrust enforcement[19], increasing geopolitical conflict[20], and a host of other factors[21] caused significant headwinds for U.S. dealmakers. In the same period, those headwinds were exacerbated by a de-coupling of private company valuations from comparable public company valuations[22]. The predictable result of these headwinds is a persistent valuation disconnect between private company buyers and sellers.

In response, private equity sponsors have increasingly (re)turned to using traditional tools to bridge valuation gaps, including structured securities, seller financing, and earn-outs. Indeed, according to a recent survey of 2023 private company acquisitions, approximately 33% of the surveyed transactions included an earn-out—representing a 50%+ increase compared to each of the five previous years[23].

So ... earn-outs are (still) a tool to bridge valuation gaps. But what else might a private equity sponsor use to blend down its cost of capital, underwrite management's business case, share the risk/reward of an underperforming/overperforming asset, and bridge a valuation gap?

The Rollover Ratchet

Faced with a competitive bidding process or a valuation gap, private equity sponsors may be well-advised to consider a one-way or two-way rollover equity ratchet. In this scenario, the parties could agree to a deal construct along the following lines:

- A total enterprise value of $X+Y, where X represents the valuation at which the private equity sponsor is comfortable and X+Y represents

the valuation at which the seller is willing to transact.

- On the sources and uses, an amount equal to $Y is funded through an equity rollover. We'll call this the "Contingent Consideration".
- In a one-way (downside only) ratchet, up to 100% of the Contingent Consideration would be subject to forfeiture if specified performance metrics were not met.
- In a two-way ratchet, depending on the acquired company's performance against the specified metrics, the Contingent Consideration could be forfeited (buyer's downside protection) or, e.g., doubled (to create upside incentive for the rollover seller).

Such a construct would confront the issues implicit in a traditional earn-out arrangement, such as (1) defining performance metrics, (2) legislating control of the business during the contingent consideration testing period, (3) specifying whether the contingent consideration is earned on a linear, cliff, or other basis, and (4) outlining dispute resolution mechanisms—all of which should be carefully considered by buyers and sellers in any transaction with contingent consideration, including a rollover ratchet.

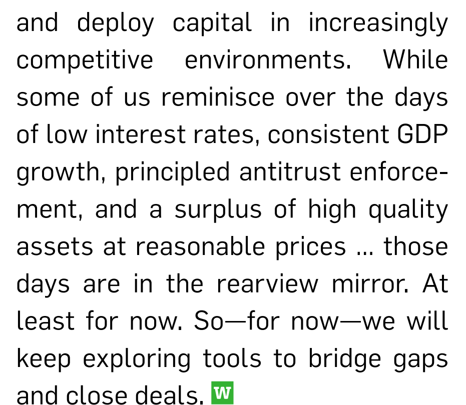
However, unlike a traditional, cash-based earn-out, the rollover ratchet:

- De-risks valuation for both buyer and seller
- Decreases buyer's cost of capital
- Does not constitute an interest-free loan from seller to buyer
- Does not render seller susceptible to buyer's credit risk or necessitate holding the earn-out consideration in a third-party escrow account
- Incentivizes the recipient to maximize company value both during and after the measurement period

From a tax standpoint, a **downside ratchet** requires careful review and input from tax advisors to ensure that a forfeiture of equity would be treated as an adjustment to the original transaction consideration and not as a taxable event (or otherwise have unanticipated tax consequences). With an **upside ratchet**, the parties will generally want to confirm that any additional equity issued as contingent consideration will be afforded the same tax treatment as the baseline rollover equity issued at the closing. In any case, because the tax implications of a rollover ratchet can vary depending on the particular facts and structure of the deal, tax structuring advice will be an important part of implementing a rollover ratchet.

So What's Next?

As long as valuation gaps persist, creative private equity sponsors will search for tools to bridge such gaps



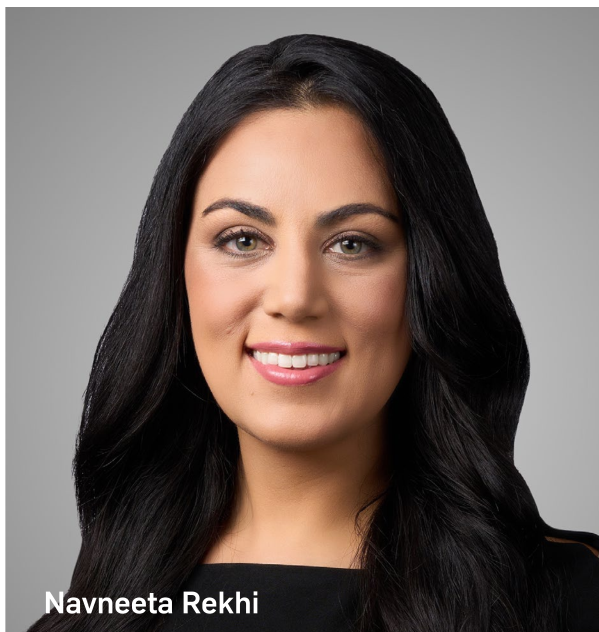
and deploy capital in increasingly competitive environments. While some of us reminisce over the days of low interest rates, consistent GDP growth, principled antitrust enforcement, and a surplus of high quality assets at reasonable prices … those days are in the rearview mirror. At least for now. So—for now—we will keep exploring tools to bridge gaps and close deals.

Unlike a traditional, cash-based earn-out, the rollover ratchet:

- **De-risks valuation for both buyer and seller**
- **Decreases buyer's cost of capital**
- **Does not constitute an interest-free loan from seller to buyer**
- **Does not render seller susceptible to buyer's credit risk or necessitate holding the earn-out consideration in a third-party escrow account**
- **Incentivizes the recipient to maximize company value both during and after the measurement period**

WEIL ANNOUNCES NEW CALIFORNIA OFFICE OPENINGS AND PE TEAM EXPANSION

Tana Ryan


Navneeta Rekhi

Weil's Private Equity Group is pleased to welcome dealmakers Tana Ryan and Navneeta (Nav) Rekhi, and is excited to announce the opening of offices in Los Angeles and San Francisco to serve the growing sponsor community in California and across the broader West Coast region.

"The arrivals of Tana and Nav – and our office openings in Los Angeles and San Francisco – are significant developments for our Private Equity Group and the firm as a whole, but this is just the first step," said Kyle Krpata, Co-Head of Weil's U.S. Private Equity Group, and based in the Silicon Valley office. **"We have deep relationships with sponsors in both markets and are looking forward to working with Tana and Nav to add additional partners to our team and leverage our collective network to attract new sponsor clients. They are a perfect fit with our team-oriented culture, and we are thrilled to have them on board."**

Both Tana and Nav are joining from Latham & Watkins, where they were partners in the private equity practice group. Tana and Nav will be collaborating with a presence in both Los Angeles and San Francisco to anchor Weil's expansion.

PARTNER PERSPECTIVES

Goldman Sachs on the Future of Private Markets in 2024

Rob Pulford
Head of Americas Financial and Strategic Investors Group

David Kamo
Global Head of Financial Sponsor M&A

Michael Voris
Head of Structured Equity and Alternative Capital Solutions

We expect 2024 to be a year of rebalancing – bolstered by renewed optimism, fresh pools of capital and pent-up demand. A recalibration of markets and alignment of valuations, aided by multiple liquid pools of capital, have created a unique set of opportunities.

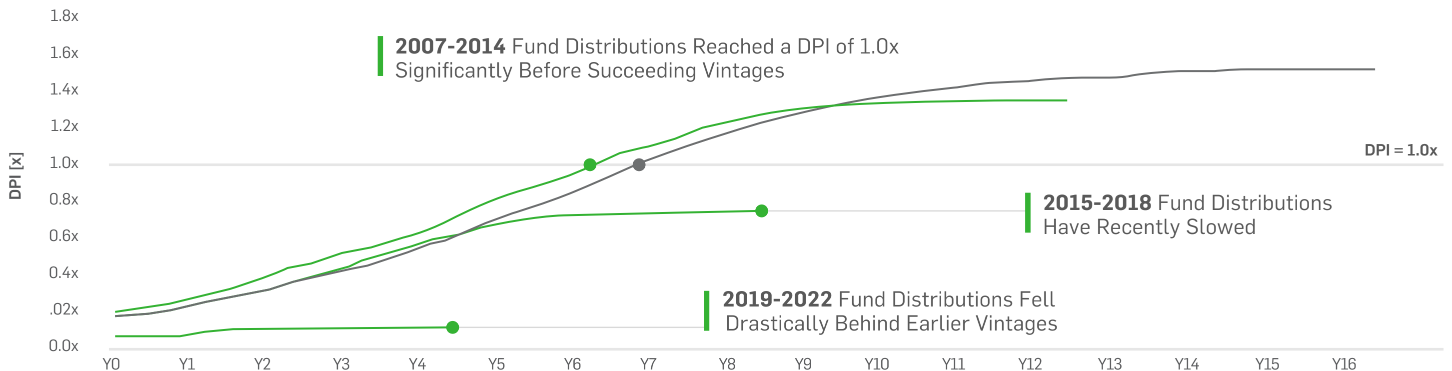
Alternatives dry powder is estimated at approximately $3.9T, with private equity (PE) and private credit hovering at $1.2T and $443B respectively[24]. As the broader universe of alternatives — which includes venture capital, infrastructure, growth equity, and secondaries — continues to expand, we expect that activity among financial sponsors broadly, and PE in particular, will become a catalyst for activity across many markets.

Although sponsor-driven M&A is only up modestly YTD, we expect this dry powder to contribute to both strategic and financial sponsor activity through the remainder of 2024 and beyond, as the desire for sponsors to monetize their portfolios and return capital to limited partners (LPs) begins to steadily increase.

2023 was underscored by sponsors' conservative posture, forcing PE M&A volumes to a 10-year low (28% of total activity, down from nearly 40% in 2022) amid increased borrowing costs, heightened macro and operational risks, and a challenged institutional loan market. Sponsor exit activity saw a 15-year low.[25]

As the rate environment becomes more constructive and the institutional leveraged loan market increasingly supports M&A financing, sponsor M&A is primed to strengthen. DPI has been very low over the last four years, and investors have experienced net drawdowns since 2018 with limited capital return. LPs are more focused on DPI from prior funds as a key metric for evaluating capital deployment opportunities, creating a persistent headwind for fundraising. As a result, we expect to see continued pressure on sponsors to monetize their portfolio companies through full or partial sales, dividend recaps, and continuation vehicles. The growing dry powder surplus has only added to that

Global Average Distributions to Paid-In Capital (X) (Rebased at T=0)



Source: Dealogic as of 11/30/23
Source: Prequin as of 4/3/24
Note: Date of first non-zero DPI defined as T=0 for each fund in given vintage (i.e., Y1 represents -2017 for 2016 vintage funds, but -2019 for 2018 vintage funds). Slight variations in values relative to the "Current Performance Metrics" page are the result of rebasing the analysis to T=0 on a fund-by-fund basis.

pressure to deploy capital as interest rates hold steady and the gradual re-opening of the IPO market fuels momentum for sponsors to act on opportunities.

As activity has contracted over the last two years, nontraditional deal structures and flexible financing solutions have also become strategic avenues for realizations. As M&A continues to rebound, we expect there will be more opportunity for bespoke structured transactions. For example, private credit is increasingly becoming an attractive option for investors as a distinct and scalable asset class capable of generating flexible financing opportunities. Private credit and capital solutions strategies are participating in junior capital to help facilitate M&A and recapitalizations for DPI, and to replace cash-pay debt with payment-in-kind (PIK) alongside an amend-and-extend. Flexible pools of capital allow these private credit instruments to take shape across holding company PIK, preferred equity, and convertible instruments, tailored to bespoke needs.

Global recovery is clear. In the US, there is an eagerness to complete deals ahead of the presidential election and momentum in Europe is reflected in both a strengthening of M&A and a reopening of the capital markets. While appetite in China continues to be muted, India and Japan (followed closely by Korea, Australia, and New Zealand) are increasingly attracting greater attention from investors, driven primarily by more stable geopolitics and a conducive growth environment for the medium–long term. W

Rob Pulford on the future of PE ...

We are at a unique moment in time in the private equity industry. We expect to see refinancing activity to continue to address the maturity wall ahead of us. That will then evolve into dividend recaps and preferred equity issuance to help solve the DPI problem. In the longer term, the backlog will unwind and we will see a material increase in sponsor M&A and IPO activity.

David Kamo on DPI ...

Given the need for liquidity, LPs are increasingly focused on DPI as a key metric when evaluating fund performance; accordingly, the expectation is that pressure to return capital via sales, IPOs and other monetizations (continuation vehicles, recaps, etc.) will continue to build.

Michael Voris on Flexible Transactions ...

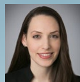
Creative financing solutions exist across the private markets to meet the needs of key stakeholders – issuers, existing investors, founders, and employees.

Download the Goldman Sachs Private Equity Inflection Point report here for more analysis.

AI & PE

Weil is advising sponsors and other clients in connection with varied AI use cases, and has gathered intelligence on many of the tools available to and used by sponsors to drive efficiencies and maximize returns. We work to help clients across all sectors capitalize on the opportunities of generative AI and to assess and manage associated risks, from the development of foundation models, to the integration of third-party tools, and from vendor agreements to internal governance frameworks.

Zack Tripp
Co-Head Appeals and Strategic Counseling


Olivia J. Greer
Head of U.S. Privacy and Cybersecurity

Dennis F. Adams III
Partner
Technology & IP Transactions

Arnie Fridhandler
Partner
Private Equity

Parker Lawter
Incoming Private Equity Associate, Publisher of M&AImpact

RESEARCH/ LEARNING

LEARN ABOUT NEW SECTORS AND INDUSTRIES.
AI tools synthesize and summarize large volumes of information and can provide digestible insights for PE professionals exploring a new area.

IDENTIFY TARGETS.
AI tools loaded with private company information allow investors to find businesses that match their investment criteria.

IDENTIFY TRANSACTION RISK.
AI tools can provide insights into risks associated with industries and targets.

DILIGENCE/ NEGOTIATION

TRACK DEAL STATUS THROUGH ANALYSIS OF DOCUMENTS.
AI can "read" emails and transaction documents and offer insight into status and recommended next steps.

DRAFT DUE DILIGENCE QUESTIONS.
Generative AI can help PE professionals brainstorm diligence questions by using target-specific, industry-specific, or deal-specific prompts.

ANALYZE DILIGENCE MATERIALS.
AI-enabled data rooms provide dealmakers easy access to relevant diligence materials via natural language search.

DRAFT DILIGENCE CALL AGENDAS.
AI tools can digest diligence materials, transaction documents, and other data to generate draft agendas and interview guides.

TRANSCRIBE AND ANALYZE CALLS.
AI tools can transcribe diligence calls and other transaction-related discussions and provide summaries and analyses based on prompts.

TRACKING/ IMPROVEMENT

ENHANCED FINANCIAL MODELS.
AI tools can create and digest spreadsheets and can increase the speed and accuracy of financial modeling.

TRACK PORTFOLIO COMPANY PERFORMANCE.
AI tools can digest and synthesize data across a range of vectors (company, portfolio, industry, etc.) and draft performance reports.

ENRICH SPONSOR-PORTFOLIO COMMUNICATIONS.
Sponsors with playbooks and other standard guidelines for portfolio companies can train chatbots and other tools to give portfolio companies efficient access to basic expectations and offerings.

BOOST PORTFOLIO OFFERINGS.
AI integration by portfolio companies in areas like customer service, HR, and marketing can enhance ROI.

SPONSOR EFFICIENCIES

KNOWLEDGE MANAGEMENT.
AI tools can integrate with a sponsor's knowledge database to make it accessible through natural language search and question-and-answer formats.

GENERATE FIRST DRAFTS.
AI tools can generate first drafts of an array of written and visual work product (decks, IC memos, etc.), using the sponsor's preferred style and referencing all necessary data and information.

RESPOND TO LP DILIGENCE REQUESTS.
AI tools can be trained on sponsor information, including prior LP questionnaires, to create first draft diligence responses.

PROBE INVESTMENT STRATEGIES.
AI tools can be prompted to analyze and ask targeted follow-up questions about strategy and investment parameters.

STRATEGIC INSIGHTS: MARCO COMPAGNONI ON PE INVESTMENT IN EUROPE

Marco Compagnoni
Co-Head
Global Private Equity

Arnie Fridhandler
Partner
Private Equity

David Gail
Partner
Private Equity

In recent years, Europe has been a dynamic hub for private equity investment – replete with both risks and opportunities, slow (or no) growth, and sparks of activity in nascent sectors. European investment firms have been particularly successful deploying capital and investment methodologies overseas, and as global markets navigate various challenges, from war to interest rates to inflation, the private equity sector in Europe continues to find ways to generate significant value, both at home and abroad. With a significantly higher proportion of businesses in Europe still in the hands of families and founders, European private equity has home field advantage for opportunistic acquisitions and operational improvements that the average U.S. transaction may not include.

The Editors of Sponsor Sync connected with Marco Compagnoni, senior partner and co-head of Weil's global Private Equity group on trends and developments in private equity transactions and fundraising in Europe in 2024, and predictions for 2025 and the future.

Q1: How would you describe the current state of the PE market in Europe and what trends are you seeing in terms of investment sectors and strategies?

After a long 12 to 15 months in doldrums in most sectors, the market in Europe is seeing something of a recovery. Stabilized interest rates (albeit still relatively high compared to the recent past), improved liquidity in the debt markets and a greater alignment of buyer and seller price expectations appear to have come together to make this happen. No doubt there is an increasing sense of the need to deploy capital, but this doesn't seem to be making investment committees feel compelled to go after less-than-premium assets, but those premium assets are being bought/sold very quickly and at high multiples. We are also seeing more settled techniques whereby sellers are rolling into buyer purchase structures, or using earn outs linked to buyer returns, which also helps with buyer-seller alignment.

We are seeing activity and interest in virtually all sectors, and it is the quality of the asset being sold which is driving demand rather than any single sector being particularly hotter than another. That said, we are seeing particular interest in tech enabled businesses, testing and inspection businesses, financial services, aerospace and defense, education and luxury consumer (to name but a few).

Q2: How are recent regulatory changes in Europe impacting PE investing and sentiment?

The increased willingness of regulators to look at and intervene in transactions (which is predicted to continue rather than to diminish), together with higher scrutiny of buyers and sources of funds, is causing some head scratching and caution, but has not impacted

positive sentiment. Navigating regulatory clearances is taking longer and therefore closings are being pushed out longer in many cases. This has an obvious impact on the need for debt to be certain for longer periods before actually being drawn down. And it makes it all the more important to select consortium partners carefully with an eye also on their potential impact on regulatory clearances and timings. It is not really possible to predict how this increased willingness on the part of the regulators to intervene will play out in the medium term, but it is something which makes it harder to predict successful ultimate exit strategies when looking at a new investment.

Q3: What are the biggest challenges and opportunities you foresee for PE in Europe over the next few years?

I don't think there is anything particular to Europe which is going to present challenges or opportunities which won't apply elsewhere. Obviously (and as already mentioned) regulatory trends will play their part, as will changing taxation regimes (for example, on carried interest and around capital gains for founders), and IPO markets and the continuing drift towards US listings. We've learned we can't plan for further and continuing geopolitical impacts, but these impacts are in play everywhere and not just in Europe.

Q4: Turning to exits, in what sectors and geographies, and how, are exits happening in Europe? How are European PE firms leveraging secondary transactions, and what are current trends in secondaries

A meaningful increase in the number of completed exits has yet to work through, but that will come as the uptick in transaction activity comes to fruition. That said, sectors where we have seen successfully concluded exits include: infrastructure (particularly transportation and energy), pharmaceutical and tech. Also, the DACH (Germany, Austria and Switzerland) region and Italy have been more active. Secondaries have become an active exit route, including larger single-asset secondaries. Continuation funds are very common now, with reasonably accepted market terms settling for their use, including single asset continuation funds and even continuation funds of continuations funds.

Q5: What are the key factors driving successful fundraises for PE firms?

The usual ingredients continue to apply. These include strong track records and consistency in applying investment strategies, differentiation in terms of strategy and sourcing (increasingly important in a difficult transaction market), senior investment/leadership team continuity (especially where a number of funds are navigating succession issues), sensible fundraising targets (adding 50%+ is very 2021, and most managers are now being more conservative on fund targets to ensure a successful close), a strong recent exit track record, and of course, strong support from existing investors.

"Local relationships and knowledge matter in Europe, so being ready to invest time and resources in developing those relationships is important. Be patient on the regulatory complexity in dealing across multiple jurisdictions. Be ready to engage with more seller-friendly transaction terms than you might be accustomed to. The market for really good assets is highly competitive so be ready to execute very quickly"

It appears to be increasingly attractive to some larger LPs to be able to offer them an ability to deploy capital at scale (whether into a single fund or across multiple products) or to offer market beating returns through a differentiated strategy (for example, very sector or geography specific). This can make it more difficult for some mid-market generalist funds where their fund size doesn't give these large LPs the chance to deploy at scale.

Q6: What advice would you give to U.S. PE investors looking to enter or invest into the European PE market? What about European PE investors looking to deploy capital in North America?

Local relationships and knowledge matter in Europe, so being ready to invest time and resources in developing those relationships is important. Be patient on the regulatory complexity in dealing across multiple jurisdictions. Be ready to engage with more seller-friendly transaction terms than you might be accustomed to. The market for really good assets is highly competitive so be ready to execute very quickly on a hot asset in a competitive situation (which will mean that being already familiar with a sector and/or specific target is key).

European-based PE funds are already active in the US, with people on the ground in the US. They are following a similar strategy as new US entrants into the European market – which is reassuring!

AXIOS X WEIL – THE NEXT ERA: PRIVATE EQUITY'S GLOBAL PATH

Weil Private Equity is at the forefront of global PE and has led and shaped critical discussions, pioneered fundraising strategies and executed landmark transactions for decades. Weil is proud to have partnered with Axios for a premier trans-oceanic event hosted in both New York City and London, examining the complexities of navigating diverse regulatory environments, cultural differences around dealmaking and investment opportunities in the U.S. vs Europe.

In New York, more than 120 influential leaders from across the private equity landscape convened at Moonlight Studios, where Axios business editor **Dan Primack** moderated discussions with **Erik Hirsch** (Co-CEO, **Hamilton Lane**), **Eric Liu** (Head of Private Equity, North America & Global, Co-Head of Healthcare, **EQT Group**) and **Lynn Martin** (President, **New York Stock Exchange**), and Axios publisher **Nick Johnston** hosted a segment featuring Weil's U.S. Private Equity Co-Head **Christopher Machera** and partner **Robert Rizzo**.

The following day, in London, an exclusive, invitation-only event saw over 50 private equity leaders congregate at the renowned Dover Yard in Mayfair for the second day of the series where Axios fintech reporter **Lucinda Shen** conducted interviews with **Andrew Sillitoe** (Co-CEO & Partner, Apax Partners), **Philipp Freise** (Co-Head of European Private Equity at KKR), and Weil's Co-Head of Global Private Equity **Marco Compagnoni** and Co-Managing Partner of Weil's London office **Jonathan Wood.**

To view a recording of the event, **click here**.

TURNING THE CORNER – TRACKING TRENDS IN THE SPONSOR-BACKED IPO MARKET

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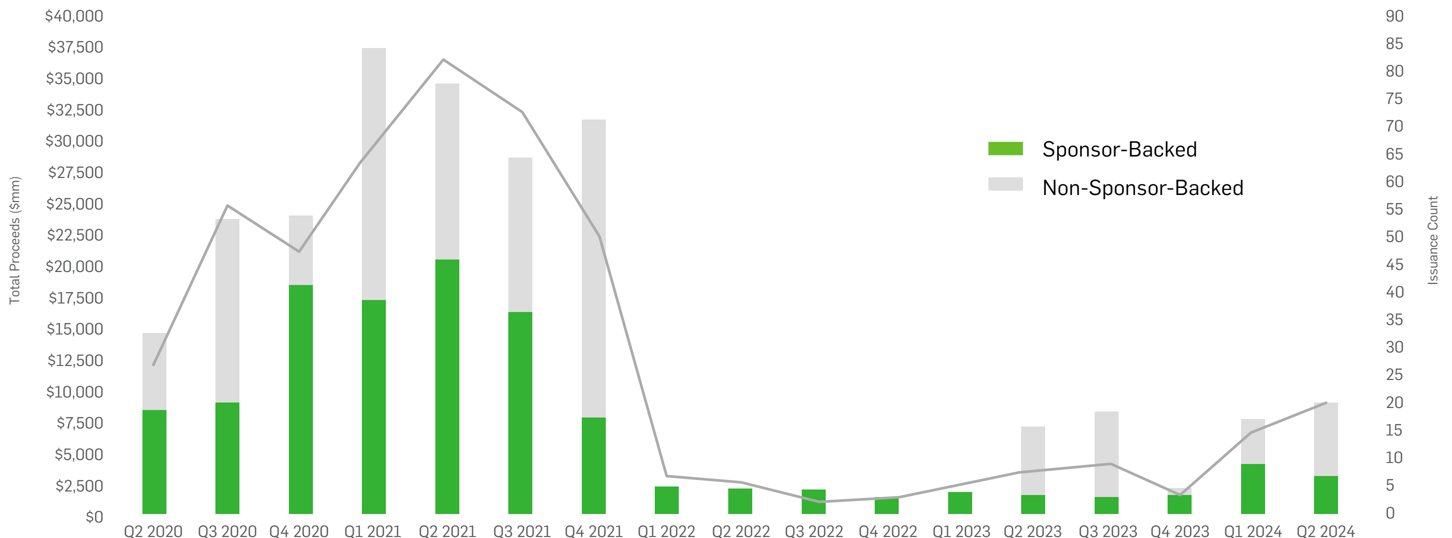
SMART SUMMARY

- The IPO market is improving but sponsors have been slow to access the IPO market for their portfolio companies given valuation realities and steeper than normal IPO discounts.
- The lack of exit opportunities over the last few years should lead sponsors to increasingly explore IPOs as a source of liquidity.
- Assuming a more benign interest rate environment, sponsor-backed IPOs should return to their historic percentage of the overall IPO market in 2025.

Since the frothy IPO market of 2021, sponsors have been waiting for the IPO market to return. A strong IPO market provides a direct means of liquidity for sponsors and provides the necessary market tension to maximize the effectiveness of a "dual track" exit strategy (where sponsors pursue an IPO and an M&A process at the same time). Since 2021, those in the financial world have been flooded with endless speculation about when the IPO market will be "back." While the answer is not entirely clear, halfway through 2024, we are afforded with a fresh perspective from which to take stock of where the IPO market for sponsor-backed companies stands and where we think it is going. We believe that the overarching trend for sponsor-backed IPOs is a positive one. The data is clear that the IPO market bottomed-out in 2022 and that the rebound is underway and accelerating. While uncertainty remains around the timing and scale of a potential resurgence in sponsor-backed IPOs, we are seeing a substantial pipeline of sponsor-backed operating companies looking to go public and sponsors looking to access liquidity and monetize their portfolios through the IPO markets. Improving macroeconomic conditions, combined with stabilizing stock valuations and recalibrated expectations,

U.S. IPO Volume: Sponsor-Backed vs. Non-Sponsor-Backed Volumes



Source: Dealogic as of 7/2/2024
1. Includes U.S. IPOs greater than $50mm. Excludes BDCs, SPACs, ADRs, REITs. MLPs, Chinese issuers, IDS', CEFs.

point toward a more positive second half of 2024 for sponsor-backed IPOs and real optimism for 2025 and 2026. A positive IPO market combined with an improving M&A market should enhance the effectiveness of the dual track strategy as well.

Current State of the IPO Market

The past few years have been characterized by extreme volatility in the IPO market. In 2021, we witnessed the highest number of operating companies going public since 2000, with 311 IPOs completed in the U.S. that year.[26] 2021 was also the high-water mark for special purpose acquisition company (SPAC) IPOs. In stark contrast, 2022 saw a record low number of operating companies going public, with only 38 IPOs completed in the U.S. in that year.[27] For the U.S. and global IPO markets, 2022 was rock bottom. Despite increased optimism, 2023 only saw a modest increase over 2022, with 54 operating companies going public in the U.S.[28] In 2024, the IPO market had a slow start but the pace has increased through the second quarter. The first quarter of 2024 saw the highest number of traditional IPOs since the fourth quarter of 2021.[29] As of June 30, 2024, we have seen a 32.7% increase in the number of U.S. IPOs that have priced from the same date last year.[30] The healthcare sector, dominated by biotech companies, has been the most active in the IPO markets so far this year, accounting for 23% of the U.S. IPOs priced as of June 30, 2024.[31]

The performance of companies who have tested the IPO markets so far in 2024 has been mixed. A majority of IPOs are pricing at or above their IPO price range in 2024, according to Solebury Capital. Several notable companies, such as Astera Labs, Inc., Reddit, Inc., UL Solutions Inc., Loar Holdings, Inc. and Viking Holdings Ltd., have also seen their stock consistently trade above their IPO price. Other companies who have gone public this year, including Tempus AI, Inc., Auna S.A. and BrightSpring Health Services, Inc., have not performed as well and their stock was trading below its IPO price as of June 30, 2024

GS IPO Issuance Barometer (Indexed to 100=median number of IPOs)

Source: Pitchbook | LCD + Date through April 30, 2024 [32]

The numbers reveal a slow but steady recovery in the U.S. IPO markets since 2022. In order to assess how favorable the market environment is for sponsor-backed IPOs, we must look behind the numbers to understand the forces driving the trends. The steep drop off in IPO activity between 2021 and 2022 was attributable to a number of factors. Primary among them were the challenging macroeconomic conditions of 2022 and much of 2023, including high inflation, the rapid increase in interest rates, lingering supply chain disruptions resulting from the COVID-19 pandemic and a volatile U.S. stock market. Global geopolitical insecurity, highlighted by the Russian invasion of Ukraine, also contributed to uncertainty amongst sponsors and companies who might have otherwise explored the possibility of going public. To some extent there was also a natural "hangover" following the large number of IPOs, SPAC acquisitions and other capital markets activity in 2020 and 2021, which resulted in fewer viable companies positioned to go public immediately following the flurry of 2021. In addition, from the end of 2021 through late 2023, there was a general lack of alignment in the valuation expectations between buyers and sellers and issuers and investors. In particular, given the performance of many of the IPOs in the class of 2020 and 2021 was

poor to significantly down into 2022 and 2023, there was a considerable amount of "scar tissue" in the buy-side community that made this cohort gun-shy about new issue participation unless at very steep discounts.

Beginning in late 2023, the U.S. has experienced a decreasing rate of inflation, corrections to supply chain disruptions, a robust job market, increased consumer confidence and a strong and less volatile stock market. The US stock market reached record highs in the first quarter of 2024, although a small number of tech companies that have capitalized on artificial intelligence (AI) enthusiasm have driven a lot of the market growth. Significantly, market participants have also adapted to the "higher for longer" interest rate environment. All of these factors have led to improved valuations for IPO companies and better alignment in valuation expectations between buyers and sellers, which have encouraged sponsor-backed portfolio companies and others to begin testing the IPO markets once again.

The IPO Issuance Barometer, tracked by Goldman Sachs Research, quantifies how conducive the current macro environment is to IPO activity. In March 2024, the IPO Issuance Barometer, which is scaled to 100 as the typical IPO frequency, rose to 137, which is the highest level measured since February 2022.

The Case for Sponsor-Backed IPOs

Amidst renewed optimism about the broader IPO market, there is reason to

Recently Priced U.S. IPOs: 1H 2024 U.S. IPOs Greater Than $250mm

Pricing Date	Issuer	Ticker	Total Amt at Offer ($MM)	Offering as % Mkt Cap	Pricing Relative to Range	% Secondary	% Change Offer to				Bookrunner(s)	Industry
							1 Day	7 Days	30 Days	Current		
06/26/24	WEBTOON Entertainment	WBTN	$315	12%	Within	0%	9.5%	-	-	2.8%	GS; MS; JPM; EVR; DB; UBS; HSBC	Publishing
06/13/24	Tempus AI Inc.	TEM	$411	7%	Within	0%	8.8%	(26.3%)	-	(9.9%)	MS; JPM; ALLENL; BOAML; TD	Healthcare
06/06/24	Waystar Holding Corp	WAY	$968	27%	Within	0%	(3.7%)	3.0%	-	0.1%	JPM; GS; BAR; WBLR; EVR; BOAMI; RBC; DB	Computers & Electronics
04/30/24	Viking Holdings Ltd	VIK	$1,768	17%	Within	83%	8.8%	19.4%	30.9%	38.6%	BOAML; JPM; UBS; WLF; HSBC; MS	Leisure & Recreation
04/24/24	Marex Group plc	MRX	$321	24%	Within	75%	(0.1%)	0.0%	7.9%	2.3%	GS; BAR; JEFF; STFL; CITI; UBS;PSC;HSBC	Finance
04/24/24	Rubrick Inc	RBRK	$863	15%	Above	0%	15.6%	2.6%	4.9%	(6.3%)	GS; BAR; CITI; WLF; GUGPAR; MIZ; TRUIST; BMOCM; DB	Computers & Electronics
04/24/24	Loar Holdings Inc	LOAR	$354	14%	Above	0%	74.3%	75.1%	97.2%	90.5%	JEFF; MS; MOELIS; CITI; RBC	Aeropsace
04/17/24	Centri Holdings Inc	CTRI	$299	16%	Within	0%	10.1%	19.1%	27.5%	(9.5%)	UBS; BOAML; JPM WLF	Construction/Building
04/17/24	Ibotta Inc	IBTA	$644	25%	Above	62%	17.3%	19.5%	20.7%	(18.5%)	GS; CITI; BOAML; EVR; UBS; WLF	Computers & Electronics
04/11/24	UL Solutions Inc	ULS	$1,088	41%	Within	100%	24.3%	19.5%	31.0%	49.9%	GS; JPM; BOAML; CITI; JEFF; UBS	Professional Services
04/10/24	PACS Group Inc	PACS	$518	16%	Within	0%	9.5%	11.4%	18.4%	39.3%	CITI; JPM; TRUIST; RBC; GS	Healthcare
03/21/24	Grupo Auna	AUNA	$360	41%	Below	0%	(20.0%)	(11.3%)	(43.3%)	(34.0%)	MS; JPM; BTGP; SANT; CITI; HSBC	Healthcare
03/20/24	Reddit Inc	RDDT	$860	16%	Within	31%	48.4%	69.9%	20.2%	95.9%	MS; JPM; BOAML; CITI; DB; MUFG	Computers & Electronics
03/19/24	Astera Labs Inc	ALAB	$820	15%	Above	15%	72.3%	131.6%	79.1%	59.8%	MS; JPM; BAR; DB; EVR; JEFF	Computers & Electronics
02/08/24	BBB Foods Inc	TBBB	$677	35%	Above	17%	8.9%	16.7%	19.8%	34.3%	JPM; MS; BOAML; SBGBM; UBS	Retail
02/07/24	Kyema Therapeutics Inc	KYTX	$367	39%	Above	0%	36.4%	35.9%	30.8%	(64.5%)	JPM; MS; LEER; WLF	Healthcare
01/31/24	Amer Sports Inc	AS	$1,570	24%	Below	0%	3.1%	15.8%	25.5%	(4.5%)	GS; BOAML; JPM; MS; CITI; UBS; BAIRD; BNP; CICC; CITIC; EVR; TD; WLF; DB; HSBC	Consumer Products
01/25/24	Brightspring Health Services Inc	BTSG	$693	31%	Below	0%	(15.4%)	(13.0%)	(28.3%)	(15.7%)	GS; KKRCLP; JEFF; MS; UBS; BOAML; GUGPAR; LEER; WLF; DB; HSBC; MIZ; BMOCM; LCM	Healthcare
01/24/24	CG Oncology Inc	CGON	$437	35%	Above	0%	95.6%	96.1%	129.5%	67.0%	MS; GS; CANTOR	Healthcare
01/19/24	Kaspiks JSC	KSPI	$1,040	6%	Below	100%	4.3%	(1.4%)	3.9%	36.8%	MS; JPM; CITI; NOM; WRSEC	Computers & Electronics
	Mean		**$720**	**22%**		**24%**	**20.4%**	**25.5%**	**28.0%**	**17.9%**		
	Median		**$671**	**18%**		**0%**	**9.5%**	**16.7%**	**20.7%**	**2.5%**		

Source: Dealogic as of 7/2/2024

1. Includes U.S. IPOs greater than $50mm. Excludes BDCs, SPACs, ADRs, REITs. MLPs, Chinese issuers, IDS', CEFs. Includes all Solebury-advised deals.

question whether sponsor-backed IPOs will participate in the increasingly active IPO market. Sponsor-backed IPOs have typically followed the trends of the broader IPO market and made up a significant portion of IPOs. However, sponsor-backed IPOs have not participated in the recent broader IPO market recovery to the same extent as they have historically. Notably, only ten private equity-backed companies completed "sizable IPOs" in 2023, and only three completed in the first four months of 2024.[33]

"Improving macroeconomic conditions, combined with stabilizing stock valuations and recalibrated expectations, point toward a more positive second half of 2024 for sponsor-backed IPOs and real optimism for 2025 and 2026."

There are a number of reasons why private equity sponsor-backed portfolio companies have been comparatively absent from the U.S. IPO market's recovery. First, a considerable portion of the large class of sponsor-backed companies that went public in 2021 have not performed particularly well since going public, which has left sponsors with limited opportunities to exit through secondary or follow-on offerings. As a result, private equity sponsors may be less inclined to view IPOs as an effective means of liquidating their portfolios given the experience of the "class of 2020/2021." Second, the perceived lack of effectiveness of dual track processes in reaching its objective of creating pricing tension over the past two years due to challenges in the M&A and private equity markets. Third, high inflation and interest rates may have had an impact on the growth trajectory of portfolio companies, which can affect IPO valuations. Fourth, as a result of the high interest rate environment, IPO investors are increasingly sensitive to leverage and are focused on investing in companies with pro forma 3x leverage or less rather than 5x leverage that was common in 2021.

Given the recent dearth of private equity and M&A activity in combination with a less active IPO market, private equity sponsors have not had many liquidity opportunities over the last few years, which is likely to increase their willingness to explore options to monetize their portfolios and return capital to limited partners (LPs) through the IPO market. This is especially true for sponsor-backed companies that have experienced substantial growth over the last few years, as a result of business performance and acquisitions, and may be too big to generate substantial M&A interest. We also expect the demand for liquidity and the anticipated improvement in the M&A and private equity markets to drive sponsors back towards engaging in dual-track exit processes for certain of their portfolio companies in the near future.[34] The desire for liquidity should ensure that IPOs have a larger role in monetizing the portfolios of sponsors, regardless of whether they opt for a dual track process or decide to pursue an IPO and sell-down strategy. Momentum has already started to build behind private equity-backed IPOs exits in 2024 and will continue to do so as inflation continues to moderate and the principal global central banks cut interest rates (hopefully…). A recent study estimated that two-thirds of private equity firms predict a rise in IPO-exit activity this year.[35]

Lingering Uncertainty

While we expect the IPO market for sponsor-backed companies to continue to improve, challenges remain. The factors that have so far largely kept sponsor-backed IPOs shelved during the recent uptick in IPO activity may continue to keep private equity-backed companies on the sidelines. Private equity sponsors may continue to be deterred by the uneven price performance and limited follow-on activity among the massive cohort of companies that went public in 2020 and 2021. Hardened by past experience, investors are also more

valuation sensitive. This is reflected in higher IPO discounts, which are ranging from 20-30% as compared to their public company peers (up from 10-15% in a "normal" market). Leading IPO investors will only invest in companies that have certain positive key metrics like substantial revenue and EBITDA growth, large total addressable markets and a clear path to profitability if not already profitable. This is leading investors to limit their interest to companies of scale with larger market capitalizations and significant public float. Investors may continue to steer clear of companies with lower market capitalizations, which have proven more difficult to build positions in early and more challenging to sell in a market downturn.

There also remains lingering uncertainty around macroeconomic conditions. Inflation has remained persistent. The U.S. Federal Reserve has indicated that they only expect to make minor cuts to interest rates for the remainder of the year. Despite a strong labor market, it is not certain that jobless claims will remain low. Many are skeptical about how substantive and diversified the growth underlying rising stock market indexes really is. Geopolitical instability remains present, especially with the continuation of the Ukraine war and the Israel-Palestine conflict. The rise of AI introduces its own set of questions as companies jockey to best position themselves for the future of AI. A divisive U.S. Presidential election looms large in November. We could see sponsors pushing their portfolio companies to complete IPOs ahead of the election or, more likely, deferring an IPO launch until 2025.

Continued Momentum into 2025

As for what the future will hold, only time will tell whether improved market conditions and sponsors demand for liquidity will propel a surge in sponsor-backed IPO activity or whether the aforementioned challenges and uncertainties will continue to temper sponsor-backed activity in the public equity markets. We tend to think the overall upward trends in U.S. and global IPO markets will persist and sponsor-backed IPOs will be active participants in the rally. There is an expanding pipeline looking towards the pre-election period in 2024 and in 2025 and beyond, including a substantial number of companies who have confidentially filed registration statements, the so-called "shadow backlog." [36] It is looking less likely that 2024 will be the turnaround year for sponsor-backed IPOs that many had projected. Too many companies considering going public are still not receiving the valuations they would need to test the market. That dynamic combined with the uncertainty of the election may slow IPO activity later this year. Nonetheless, we believe that 2024 will exhibit an increase in sponsor-backed IPO activity compared to the two previous years and will set the stage for an even more active market in 2025.

"Solebury Capital is an independent Equity Capital Markets Advisory firm that is purpose-built to give clients an edge as they pursue mission critical equity capital markets transactions. Solebury's decades of Wall Street experience help clients make more informed decisions, run more efficient processes and optimize stakeholder value in Initial Public Offerings, Follow-on Offerings and Block Trades. Since their founding in 2005, Solebury has advised on nearly 250 IPOs representing approximately $130 billion in proceeds and they currently have 150 IPOs in their back-log." W

"We tend to think the overall upward trends in U.S. and global IPO markets will persist and sponsor-backed IPOs will be active participants in the rally. There is an expanding pipeline looking towards the pre-election period in 2024 and in 2025 and beyond, including a substantial number of companies who have confidentially filed registration statements, the so-called 'shadow backlog.'"

POST-CLOSING PURCHASE PRICE ADJUSTMENTS GONE WRONG: THE SAVE MART/KINGSWOOD CAPITAL DISPUTE

Glenn D. West
Retired Partner
Private Equity

SMART SUMMARY

- Sellers being required to pay a buyer approximately $70 million for the buyer to acquire a company has many in the deal community gobsmacked
- Typical "cash-free debt-free" purchase price adjustment mechanics resulted in a negative purchase price calculation that was enforced by the courts
- Careful attention to the nexus between agreement definitions, company accounts and example calculations are the best antidote to such unintended and absurd results

An April 11, 2024, article in the *Financial Times*, "The inequity method of accounting: California family learns about private-equity hardball while selling supermarket chain," has created a stir in the private equity deal community. The article details a dispute that arose between the prior owners of Save Mart, a California supermarket chain, and Kingswood Capital Management, a Los Angeles–based, lower-middle-market private equity firm. While the article is recent, the arbitration award detailed in the article was handed down on September 5, 2023, and confirmed by the Delaware Court of Chancery on February 28, 2024. Prior to the *Financial Times* article, the case received little attention. But the seeming harshness of the arbitration decision as detailed in the article (selling stockholders being required to pay the buyer approximately $70 million for the buyer to acquire the company), coupled with the Court of Chancery's confirmation of it, has many in the deal community gobsmacked.

So, I decided to delve into it a bit more deeply and look at the actual provisions at issue to the extent obtainable. (Because the otherwise private arbitration ruling was posted by the *Financial Times* and is therefore publicly available, we have direct quotations from the purchase agreement to review.) What I have managed to learn from the available documents follows.

Save Mart Supermarkets, LLC operated over two hundred stores in California and Nevada. Save Mart also was a general partner in (and owned an equity interest of approximately 52

percent of) Super Store Industries ("SSI"), a separately run partnership with two other partners that operated a wholesale grocery distributor business. SSI had debt on its balance sheet of approximately $109 million. This debt was not on Save Mart's balance sheet because SSI was an unconsolidated subsidiary, and Save Mart had elected to account for the SSI partnership using the equity investment method, meaning that Save Mart reflected on its balance sheet its net investment in SSI (SSI's asset value less SSI's debt, multiplied by Save Mart's ownership interest). Save Mart's latest balance sheet prior to its sale reflected its joint venture investment in SSI at a net $22.5 million. In other words, the SSI debt was well covered by the assets of SSI (and the SSI debt was current and had never been in default).

Kingswood Capital formed SM Buyer LLC ("Buyer") to acquire Save Mart from its owners ("Sellers"). Buyer and Sellers entered into an Equity Purchase Agreement ("EPA") on March 7, 2022. The deal was structured as a "cash free, debt free" deal, with an agreed "Base Value" of $245 million. Consistent with the "cash free" concept, the EPA permitted the Sellers to sweep all cash out of Save Mart prior to closing, and they in fact swept $205 million out of Save Mart prior to closing.

As is typical, the purchase price was determined by a formula that started with the base value and then subtracted closing date indebtedness and transaction expenses and added or subtracted other items, such as working capital excesses or deficiencies. The EPA contained a purchase price adjustment mechanism to address that calculation. It provided for (a) the Sellers to prepare an estimated closing statement a few days prior to closing (which the Buyer was entitled to comment upon and which provided the basis for the estimated purchase price to be paid at closing), (b) the Buyer to then, within ninety days after the closing, prepare its own closing statement consistent with the contractual guard rails, and (c) any dispute between the Sellers' estimated and Buyer's closing statements to be resolved by accountants or courts depending on the issue.

"As is typical, the purchase price was determined by a formula that started with the base value and then subtracted closing date indebtedness and transaction expenses and added or subtracted other items, such as working capital excesses or deficiencies."

The definition of "Purchase Price" read as follows in the EPA (prior to an amendment that separated the sale of the SSI joint venture interest from the sale of the rest of Save Mart):

> The aggregate consideration payable by Buyer in respect of the Company Membership Interests shall be an amount equal to (a) the Base Value, plus (b) the amount, if any, by which the Working Capital exceeds the Working Capital Target, minus (c) the amount, if any, by which the Working Capital Target exceeds the Working Capital, plus (d) the Closing Cash (which may be a negative number, in which case, Closing Cash shall reduce the Base Value), minus (e) Closing Date Indebtedness, minus (f) Transaction Expenses, minus (g) Deemed Accrual Amount (such resulting amount pursuant to clauses (a)-(g), and as such amount may be adjusted pursuant to the provisions of Section 1.4, the "Purchase Price").

The key deduction from Base Value here was "Closing Date Indebtedness." Closing Date Indebtedness was defined in the EPA as "the aggregate amount of all Indebtedness of the Group Companies as of the Adjustment Time."

Indebtedness was defined very broadly to include, among other things:

> (i) the outstanding principal amount of and accrued or unpaid interest of (A) indebtedness of such Person or its Subsidiaries for borrowed money (including Debt Breakage Costs) and (B) indebtedness evidenced by notes, debentures, bonds or other similar instruments for the payment of which such Person or its Subsidiaries is responsible or liable,

and

> (xi) all liabilities and obligations of the type referred to in clauses (i) - (x) of other Persons for the payment of which such Person or its Subsidiaries is responsible or liable, directly or indirectly, as obligor, guarantor or surety.

Group Companies was defined to include Save Mart and its "Operating Subsidiaries." Operating Subsidiaries was defined to include "all direct and indirect Subsidiaries of the Company [listed on Section 3.4(b) of the Company Disclosure Schedule]." SSI was in fact listed as an Operating Subsidiary on Schedule 3.4(b). Adjustment Time was defined as 11:59 p.m. PT on March 27, 2022, which was the day before the closing at 8:00 a.m. PT on March 28, 2022.

However absurd it may seem given the balance sheet accounting treatment of the SSI investment (net equity value), the strict language of the definition of Closing Date Indebtedness appears to cause all of the SSI debt (a revolver and a real estate loan, totaling $109 million) to be included.

At some point, the Buyer's financing sources had apparently expressed concern about the potential for a creditor of SSI to directly sue Save Mart as a general partner of SSI. As a result, the Buyer asked the Sellers to restructure the deal so that Save Mart was no longer a direct partner of SSI immediately prior to the closing. They did this by amending the EPA (the "EPA Amendment") to provide that immediately prior to the closing, Save Mart's partnership interest in SSI would be distributed to the Sellers, who would then contribute that partnership interest to a newly formed entity ("SSI Holdco"). The Sellers would then sell the equity in SSI Holdco to a newly formed affiliate of the Buyer ("Topco") for a fixed purchase price (not subject to any adjustment) of $90 million. As a result of the proposed pre-closing SSI spinoff required by the EPA Amendment, as of the closing date (a) Save Mart would no longer be a general partner of SSI, and (b) SSI would no longer be an Operating Subsidiary of Save Mart.

In the Amended EPA, the definition of Purchase Price was changed to read as follows (changes in bold):

> The aggregate consideration payable by Buyer in respect of the Company Membership Interests shall be an amount equal to (a) the Base Value, plus (b) the amount, if any, by which the Working Capital exceeds the Working Capital Target, minus (c) the amount, if any, by which the Working Capital Target exceeds the Working Capital, plus (d) the Closing Cash (which may be a negative number, in which case, Closing Cash shall reduce the Base Value), minus (e) Closing Date Indebtedness, minus (f) Transaction Expenses, minus (g) Deemed Accrual Amount, **minus (h) the SSI Purchase Price (such resulting amount pursuant to clauses (a)-(h), and as such amount may be adjusted pursuant to the provisions of Section 1.4, the "Purchase Price"), and the aggregate consideration payable by Topco in respect of the SSI Holdco Membership Interests shall be an amount**

"There were disputes beyond whether the $109 million should have been included as part of Closing Date Indebtedness, and those disputes were referred to an accounting referee for resolution. But for reasons that are unknown (and must now be regretted by the Sellers), the parties agreed to submit the SSI debt inclusion dispute to binding arbitration before a retired former vice chancellor of the Delaware Court of Chancery (the "Arbitrator"), as opposed to litigating the dispute in court. "

> **equal to $90,000,000 ("SSI Purchase Price").**

But the definitions of Group Companies, Indebtedness, Closing Date Indebtedness, and Operating Subsidiary all remained unchanged. And notably, Schedule 3.4(b) continued to list SSI as an Operating Subsidiary, which was accurate pre-closing, but not post-closing when it mattered. Including all SSI debt in Closing Date Indebtedness made little sense before the SSI spinoff given the accounting treatment on Save Mart's balance sheet, but it made no sense following the SSI spinoff because, post-closing, SSI was no longer a Group Company of Save Mart.

As required by the EPA, the Sellers prepared an estimated closing statement three days prior to the closing. The Buyer made several comments, and the Sellers made revisions to accommodate the Buyer's comments. Notably, the Sellers did not include the SSI debt in the Closing Date Indebtedness for purposes of computing the estimated purchase price, and the Buyers did not object to the Sellers' failure to do so. The estimated closing statement prepared by the Sellers reflected a purchase price to be paid by the Buyer to Sellers for Save Mart of approximately $39.5 million, of which approximately $7 million was to be deposited into an escrow account. The closing was then consummated based upon that estimated closing statement.

Pursuant to the terms of the EPA, the Buyer then prepared its own closing statement within ninety days after the closing; in that statement, the Buyer included the $109 million of SSI debt as a deduction from the Base Value for the purposes of determining the final purchase price. The provision in the EPA detailing how the Buyer was supposed to prepare its closing statement is set forth below in relevant part:

> Closing Statement. No later than ninety (90) days after the Closing Date, Buyer shall cause to be prepared in good faith and delivered to Seller a statement (the "Closing Statement") setting forth Buyer's calculation of the Purchase Price (the "Closing Date Purchase Price"). *The Closing Statement shall be prepared in a manner consistent with the definitions of the terms Working Capital, Closing Cash, Closing Date Indebtedness, Transaction Expenses, including, as applicable, the Accounting Rules* (including as reflected on Exhibit A). *The Parties agree that the purpose of preparing the Closing Statement and determining the Working Capital, Closing Cash, Closing Date Indebtedness, and Transaction Expenses is to measure the amount of the Working Capital, Closing Cash, Closing Date Indebtedness, and Transaction Expenses and such processes are not intended to (x) permit the introduction of accounting methods, policies, principles, practices, procedures, classifications or estimation methodologies for the purpose of determining the Working Capital, Closing Cash, Closing Date Indebtedness, or Transaction Expenses that are different than the Accounting Rules* or (y) adjust for errors or

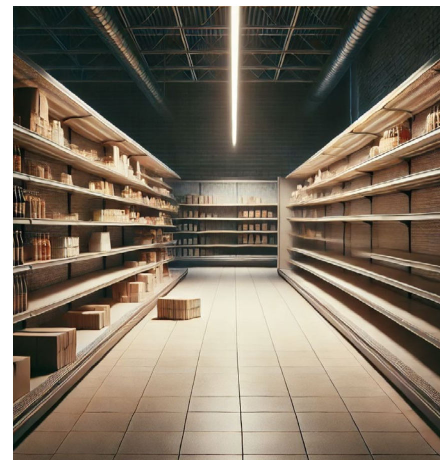
omissions that may be found with respect to the Company Financial Statements or any inconsistencies between the Company Financial Statements and GAAP (except to the extent resulting from the application of the Accounting Rules in accordance with this Agreement).

There were disputes beyond whether the $109 million should have been included as part of Closing Date Indebtedness, and those disputes were referred to an accounting referee for resolution. But for reasons that are unknown (and must now be regretted by the Sellers), the parties agreed to submit the SSI debt inclusion dispute to binding arbitration before a retired former vice chancellor of the Delaware Court of Chancery (the "Arbitrator"), as opposed to litigating the dispute in court.

In the final arbitration award, the Arbitrator appears to concede that all of the extrinsic evidence suggests that the SSI debt was never intended to be a deduction to the purchase price. However, based upon Delaware's strong contractarianism, he concludes early on that:

> As explained below, the issues as framed by the parties distill down to a choice between two arguably unsatisfying outcomes: apply the clear and unambiguous terms of the operative contract and reach a result that is in tension with the extrinsic evidence; or follow that extrinsic evidence to a result that cannot be squared with the clear and unambiguous contract as written. That the resolution of the dispute, either way, will effect a material shift in the deal dynamics makes the choice between these outcomes all the more unsatisfying. But the choice, ultimately, is not difficult. The parties contractually invoked Delaware law and that election is consequential. Delaware law is more contractarian than most, and Delaware courts will enforce the letter of the parties' contract without regard for whether they have struck a good deal or bad deal. Absent a contractual ambiguity, extrinsic evidence is inadmissible to construe the contract. The purchase agreement is not ambiguous. And the buyer has proffered the only reasonable construction of the contract's operative provisions. Delaware law accordingly mandates that I adopt the buyer's interpretation and ignore the extrinsic evidence.

The Sellers valiantly attempted to find places in the agreement (which after all must be read as a whole) to suggest that Buyer's interpretation was not in fact the only reasonable interpretation, and that there was a perfectly valid interpretation that supported the Sellers' view of the meaning of the term Closing Date Indebtedness in context of these other provisions (without necessarily relying on extrinsic evidence). Among those other provisions were the references to Accounting Rules and the fact that the EPA expressly forbade the "introduction of accounting methods, policies, principles, practices, procedures, classifications or estimation methodologies for the purpose of determining the Working Capital, Closing Cash, Closing Date Indebtedness, or Transaction Expenses that are different



than the Accounting Rules." The argument was that since the SSI debt had always been recorded under the net equity method of accounting, treating the entire SSI debt as if it were Indebtedness would be violating this provision. But after extensive analysis, the Arbitrator concluded that the Accounting Rules largely pertained to the calculation of Working Capital and could not overcome the clear definition of Closing Date Indebtedness. It is important to note here that the comparison was not to alternative balance sheets and differing methods of accounting for the debt, where the prohibition of changing methods of accounting may have had some applicability; instead this was a simple calculation of defined debt (which never mentioned applying accounting methods to determine the components of that defined debt).

There were other arguments based on isolated provisions of the EPA, including the fact that the SSI debt was listed as an Undisclosed Liability in the representations and warranties section of the EPA and, in context,

Undisclosed Liabilities were stated as being in addition to Indebtedness that was otherwise included in calculation of the Purchase Price:

> Undisclosed Liabilities. *Except as set forth on Section 3.6 of the Company Disclosure Schedule [which listed the SSI debt only], neither the Company nor any of the Operating Subsidiaries have any material Liabilities, other than* (a) as disclosed in, set forth on, or reflected and adequately reserved against in the Balance Sheet, (b) those incurred in the Ordinary Course of Business since the Balance Sheet Date (none of which arises from or relates to any violation of Law, tort, breach of Contract, environmental, health or safety matter or infringement or violation of Law or misappropriation or is otherwise material), and (c) those Transaction Expenses, *Indebtedness*, Working Capital and unpaid credit card processor's fees, costs and expense items *fully included in the calculation of the Closing Payments*.

The argument was that if the scheduled SSI debt was intended to be included in the Indebtedness that was a part of the Closing Date Indebtedness deducted in determining the Purchase Price, then there was no reason to schedule it as an Undisclosed Liability in the first place. Again, the Arbitrator made short work of this argument (even though I kind of liked it) by simply noting that disclosures against representations and warranties are often broader than strictly necessary, and they don't override the actual defined terms for purposes of calculating the Purchase Price.

"Deal lawyers tend to like Delaware's strict contractarianism – it provides certainty that the documented deal is the deal. But that certainty can sometimes come at a cost in situations like this, particularly once an arbitrator applies that strict contractarianism."

The Sellers also tried to argue that SSI was not an Operating Subsidiary as of the Adjustment Time because the spinoff was supposed to happen one business day before the closing, which would have been prior to 11:59 PM PT on March 27, 2022. But the actual spinoff occurred immediately prior to the closing, which by definition was after the Adjustment Time. And the Sellers conceded at the arbitration hearing that the SSI spinoff, "without a novation from [the SSI lenders,] would not by itself discharge Save Mart's theoretical general partner liability" on the SSI debt. With that concession, the Arbitrator was able to conclude that even if the SSI debt was not Indebtedness of an Operating Subsidiary as of the Adjustment Time, it could still qualify as Indebtedness for which Save Mart was otherwise liable (as a former general partner presumably) pursuant to clause (xi) of the definition of Indebtedness. If the spinoff did not eliminate the risk of the SSI lenders pursuing claims against Save Mart for the SSI debt, the Buyer's financing sources must have been concerned about ongoing creditors other than the known SSI debt. In other words, the risk of Save Mart having to answer for the SSI debt directly did not appear to have been a driving concern for the Buyer or its financing sources, and there was no reason to expect that getting the benefit of a credit of $109 million against the Purchase Price (and the resulting payment of approximately $70 million to the Buyer by the Sellers) was going to result in the Buyer using that money to actually pay the SSI debt.

The Sellers also sought to reform the EPA based on unilateral or mutual mistake. Unfortunately, to prevail on these arguments, the Sellers were required to show "that the parties came to a specific prior understanding that differed materially from the written agreement." And in this case the Arbitrator found that:

> Seller fails to support this critical element. It has not produced clear and convincing evidence of a pre-existing agreement between the parties to exclude the SSI Debt from the definition of Indebtedness. To be sure, Kingswood's original letter of intent did not include any SSI Debt in its sample Indebtedness calculation. But there is no evidence, never mind clear and convincing evidence, that the sample Indebtedness calculation caused the parties to reach a "specific prior understanding that differed materially from the written agreement." In fact, witnesses from both sides repeatedly testified that the two sides simply never discussed the treatment of the SSI Debt in the Acquisition. This mutual silence is a far cry from the sort of clear and convincing evidence that could support a claim for reformation based on a mistake. Delaware law is clear that claims for mistake are not supported by "poor contract drafting" and "cannot save a party from its agreement to unambiguous contract provisions that later prove disadvantageous."

The Sellers also argued that the "forthright negotiator principle" should result in a finding in favor of the Sellers. Application of the forthright negotiator principle, however, requires that there be an ambiguity in the contractual language that cannot be resolved by extrinsic evidence that leads "to a single, commonly held understanding of the contract's meaning." In such cases, "the court, in considering alternative reasonable interpretations of contract language, [may] resort to evidence of what one side in fact believed the obligation to be, coupled with evidence showing that the other party knew or should have known of such belief." But here, according to the Arbitrator, "Buyer's alleged lack of forthright negotiation [is] irrelevant because the EPA is unambiguous."

Following the issuance of the final arbitration award in favor of the Buyers, the Buyers immediately sought to confirm the award in the Delaware Court of Chancery. Vice Chancellor J. Travis Laster, on February 28, 2024, in *SM Buyer LLC v. RMP Seller Holdings, LLC*, 2024 WL 8652024 (Del. Ch. (Trial Order) Feb. 28, 2024), granted the Buyer's motion for summary judgment confirming the final arbitration award. In his order, Vice Chancellor Laster noted that "review of an arbitration award is one of the narrowest standards of judicial review in all of American jurisprudence." To do so based on "manifest disregard of the law," which was the ground asserted by the Sellers, requires "that the arbitrator (1) knew of the relevant legal principle, (2) appreciated that this principle controlled the outcome of the disputed issue, and (3) nonetheless willfully flouted the governing law by refusing to apply it." Applying this standard, Vice Chancellor Laster concluded that:

> [T]he Arbitrator strictly applied the literal words of the definition of Closing Date Indebtedness. The Arbitrator analyzed the Agreement as a whole and interpreted its language consistent with recent trends in Delaware law towards a highly contractarian jurisprudence.

Given this record, it is not possible to find that the Arbitrator manifestly disregarded the law. He diligently applied the law.

But then Vice Chancellor Laster noted that even though he had to confirm the Arbitrator's arbitration award in favor of the Buyer, he believed that "the outcome that the Buyer achieved in this case was . . . economically divorced from the intended transaction," and that he "would have ruled differently than the Arbitrator" because:

> I think the agreed-upon accounting principles and the mandate to prepare the reference statement and the final statement consistently meant that the Buyer's adjustment was contrary to the plain meaning of the Agreement. At a minimum, I think the Agreement, read in conjunction with the Amendment and the separate treatment of the GP Interest [SSI], rendered the parties' treatment of Closing Debt Indebtedness ambiguous.

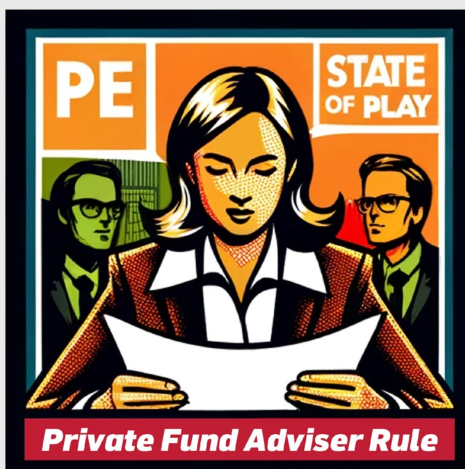
Had the Sellers not agreed to submit this dispute to binding arbitration, they may still have had an appeal to the Delaware Supreme Court to right this apparent wrong, without the almost impossible burden of undoing the binding arbitration award. The appeal that is presumably in progress to the Delaware Supreme Court in the face of the final arbitration award is a much heavier lift than would have been the case had the final arbitration award simply been an opinion of the Delaware Court of Chancery.

This case raises some serious questions about deal-making ethics depending on who understood what and

when about the potential inclusion of the SSI debt as a deduction to the Purchase Price. During my career I was once faced with a client pursuing a course of action that I believed was legally correct, but morally wrong, and my response was to refuse to represent them in the resulting dispute. Typically, sharp business practices will catch up with you eventually.

The obvious fix here, of course, was to amend the definition of Indebtedness to expressly exclude the SSI debt (and there were in fact a healthy list of exclusions to the definition of Indebtedness). That clearly should have happened. Another mitigating provision, which is often found in deals involving a private-equity-backed seller (which Save Mart was not), is to put a cap on any purchase price adjustment equal to the agreed escrow (which here was $7 million)—at least that would have resulted in a smaller ouch.

Deal lawyers tend to like Delaware's strict contractarianism—it provides certainty that the documented deal is the deal. But that certainty can sometimes come at a cost in situations like this, particularly once an arbitrator applies that strict contractarianism. W

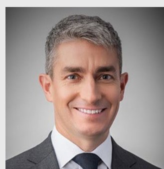


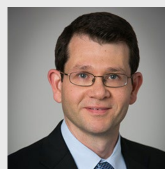
On June 12th, Co-Head of Weil's Appeals and Strategic Counseling Practice, **Zack Tripp**, and Private Funds Regulatory Partners **David Wohl**, **Chris Scully** and **Chris Mulligan** held a client webinar discussing the Fifth Circuit's June 5th vacatur of the SEC's Private Fund Adviser Rules (the "Rules"). The Rules, originally adopted by the SEC in August of 2023, would have established a more prescriptive, rules-based regulatory regime for private fund advisers and significantly increased the regulation of the private funds industry.

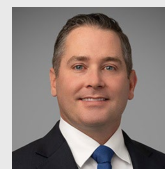
In its decision, the Court held that the SEC exceeded its statutory authority in adopting the Rules. Specifically, the Court's opinion focused on sections 211(h) and 206(4) of the Investment Advisers Act of 1940, as amended, the statutes principally relied on by the SEC as rulemaking authority for the Rules' adoption (as well as for the adoption of other proposed rules). In concluding its opinion, the Court stated that "[b]ecause the promulgation of the Rule[s] was unauthorized, no part of it can stand."

The webinar included a discussion of the options the SEC may have going forward and the impact this decision may have on future rulemakings, as well as the lessons that can be learned by private fund advisers from the now vacated Rules (*e.g.*, hot-button SEC examination and enforcement issues identified in the Rules' adopting release) and whether these issues may continue to be a focus of SEC examination and/or enforcement staff.

For your convenience, a recording of the presentation is available here.


Zack Tripp

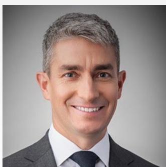

David Wohl


Chris Scully

Chris Mulligan

SUPREME COURT REJECTS NON-CONSENSUAL THIRD-PARTY RELEASES

In *Harrington v. Purdue Pharma LP*, the Supreme Court held that the Bankruptcy Code does not authorize bankruptcy courts to discharge creditors' claims against third parties without the consent of the affected claimants. The case centers on a provision in Purdue's Chapter 11 bankruptcy plan that released creditors' claims against Purdue Pharma's owners (the Sackler family) as part of the bankruptcy process, even though the Sackler family did not file Chapter 11. The Court emphasized that the Bankruptcy Code provides substantial benefits to debtors—most notably a discharge—but only if they file for bankruptcy and put all of their assets on the table. Third parties seeking broad releases from creditor claims have to either allow individual creditors to opt out of the release, or file Chapter 11 themselves. The decision should not impact the ability of third parties, including sponsors, to settle and receive the benefit of obtaining so-called "debtor releases"—releases of claims held by the bankrupt debtor against such third parties. The broader impact of this decision on bankruptcies going forward, particularly those precipitated by mass tort claims, remains to be seen, though practically we expect debtor releases and consensual third party releases to continue to be the focal points of settlements with sponsors and other third party participants in the bankruptcy process.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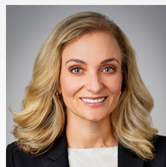
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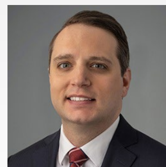
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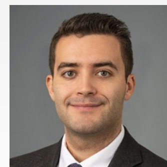
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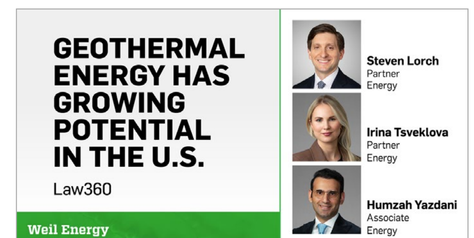

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RECENT HIGHLIGHTS

Weil Private Equity is proud of our broad representations and the successes of our clients. Below is a small sampling of our recent work:

- Weil is advising Advent International and its portfolio company Cobham Group in its approximately $1.9B sale of CAES Systems Holdings, LLC to Honeywell International, Inc.
- Weil advised American Securities LLC in its sale of ASP Acuren Holdings Inc.
- Weil advised Centerbridge Partners L.P. and its portfolio company KIK Custom Products Inc. in the sale of its automotive chemicals manufacturing business
- Weil advised CFGI, a portfolio company of Carlyle and CVC Capital Partners, in its acquisition of PAS Financial Advisory AG
- Weil is advising Goldman Sachs in its sale of Marcus Invest's digital investing accounts to advisor Betterment LLC
- Weil advised Greater Sum Ventures in its acquisition of Kologik, LLC
- Weil advised NRDC Equity Partners, alongside BB Kapital SA, in its acquisition of Galeria Karstadt Kaufhof GmbH
- Weil is advising Providence Equity Partners and its portfolio company TAIT in the sale of TAIT to the Private Equity business at Goldman Sachs Alternatives
- Weil advised PSG and its portfolio company Formstack in the acquisition of Open Raven, Inc.
- Weil advised TCV in the sale of Venafi Holdings, Inc. to CyberArk Software Ltd.

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