Jasmin capital

Private Markets Advisors

newsletter

N° **10** / 2023

AT GLANCE

In 2023, Jasmin Capital has strengthened its team with the appointments of:

Vincent Goupil, Partner,

Gilles Morel, Partner,

Carl Dionet, Vice-President,

Filippo Alberti, Senior Associate,

Marthe Fahre, Senior Associate,

alongside the recruitments of:

Kevin Li, Vice-President,

Jeremy Cerf, Senior Associate,

Pierre-Alexandre Anglards, Associate,

Bérengère Brun, Associate.

The Jasmin Capital team now comprises 20 individuals.

Jasmin Capital operates in Private Equity, Infrastructure, and Private Debt:

- Placement Agent
- Secondary transactions advisory
- Co-investment syndication
- Marketing and corporate image study
- Mergers of management companies
- Advisory services for family offices and institutional investors

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Continuation funds: valuation works are key to GPs/LPs relationships

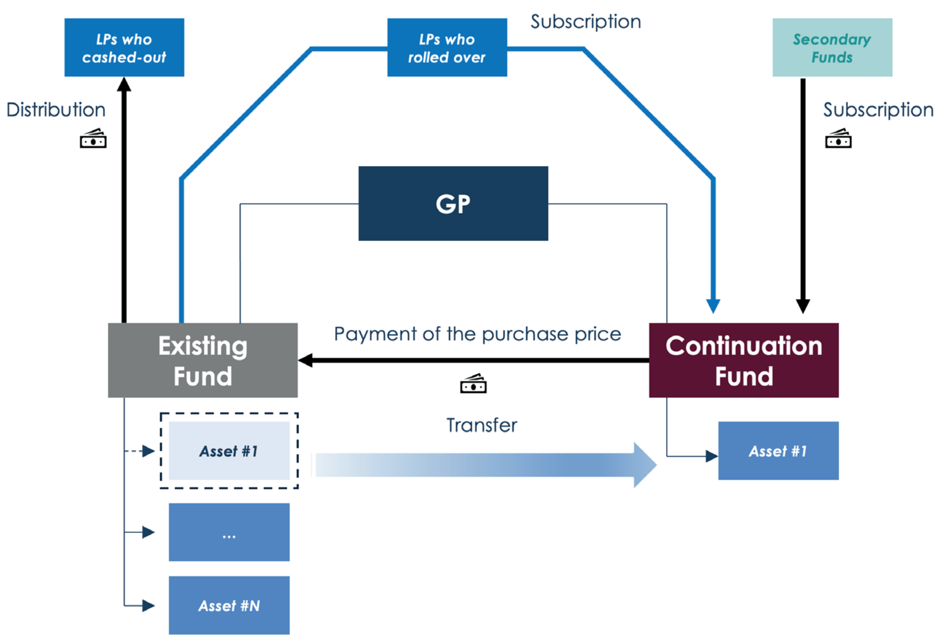
The trend is confirmed: General Partners (GPs) are increasingly using continuation funds – also known as GP-led transactions – as an active management tool. This trend has persisted, especially over the last few years due to the challenging landscape for traditional liquidity in the current market. The interest in this kind of liquidity option is growing. GP-led transactions now account for half of the transaction volume in the secondary markets.

Jasmin Capital expects this high level of interest to continue.

Continuation funds are investment vehicles that GPs can use to keep accompanying and supporting one or more companies in their portfolio over the medium term, to create additional value. GP-led transactions also provide a solution for Limited Partners (LPs) seeking a liquidity window.

Being backed by a seasoned advisor with experience in GP-led structuring is the best way to ensure a comprehensive and fair process for both GPs and LPs, *and therefore to defend the interests of all stakeholders.*

How continuation funds work

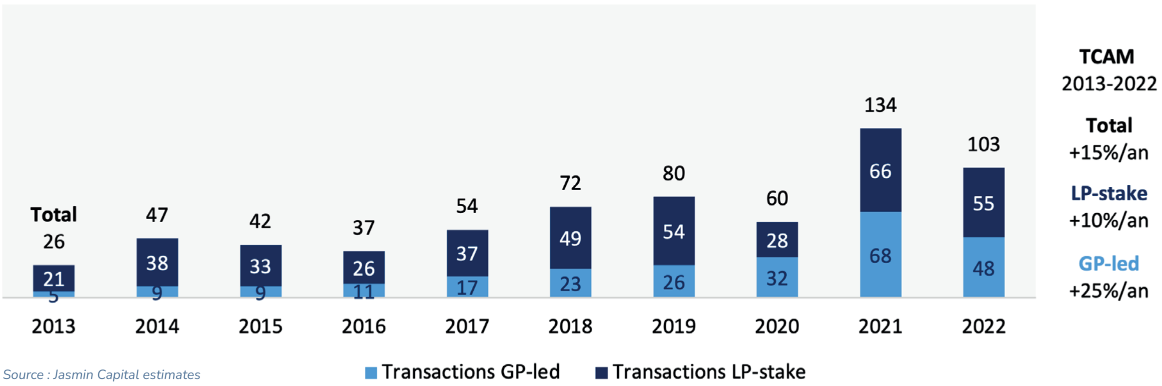


GILLES MOREL
Partner
Jasmin Capital

KEVIN LI
Vice President
Jasmin Capital

- Since 2020, continuation funds have been in the spotlight with a growing number of such transactions emerging. As GPs become more familiar with these operations, continuation fund transactions are now extending to the small- & mid-cap segments of the market.

Volume of Secondary transactions: the weight of GP-led transactions is on the rise since 2015 (in $bn)



Source : Jasmin Capital estimates

GP-led continuation funds are a useful tool for fund managers to extend the tenure of one or more portfolio companies while simultaneously providing distributions to LPs looking for liquidity, especially given today's remarkably slowed down IPO and M&A market.

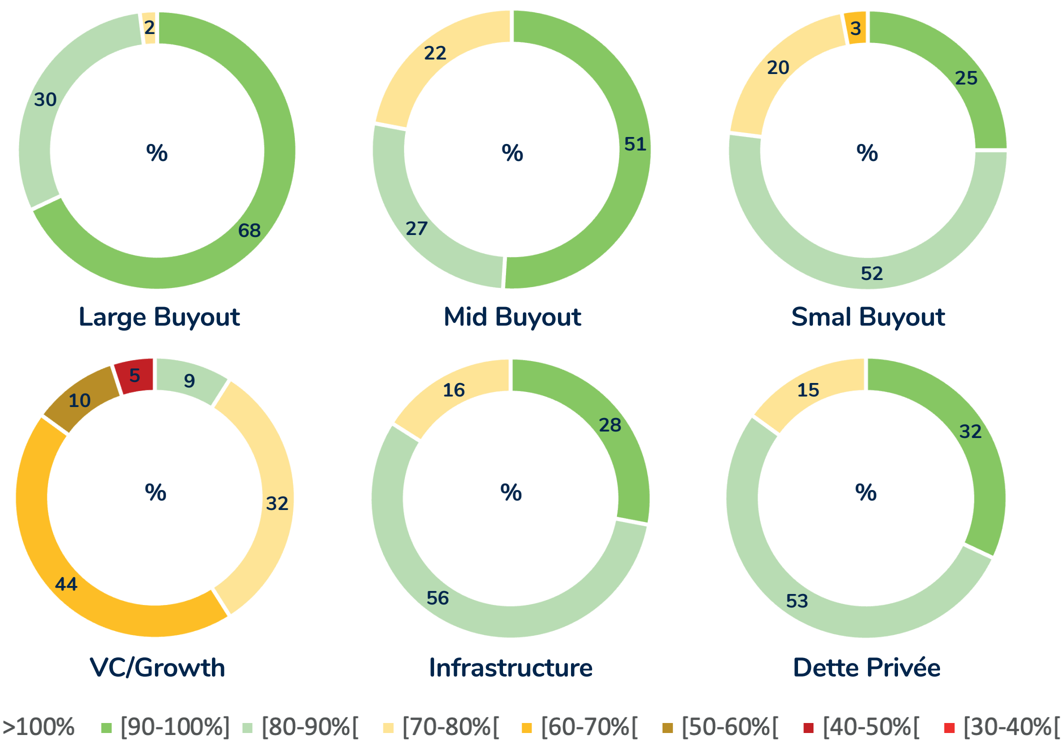
Continuation fund: a liquidity solution bound to fair valuations for LPs

According to a **survey conducted by Private Equity International, 90% of LPs believe** mandatory independent **third-party valuations are essential in GP-led secondary processes.** Pricing is a sensitive aspect of continuation fund projects from two perspectives: **LPs need to be sure that the price was negotiated in their best interest** and that a **better outcome could not have been achieved through more traditional exit routes** such as IPO or M&A processes.

In the market context, transactions involving LP interests typically trade at discounts up to 15% on the latest reported net asset value (NAV) in the small- & mid-market buyout space (vs. below 10% in large buyout strategies). As private equity valuations have remained relatively resilient compared to public market valuations, secondary funds' discounts are often optically material as they aim to value the assets on a mark-to-market basis using listed peers.

When a GP conducts a secondary auction process and presents a discounted valuation to its LPs, challenges can arise either by casting doubt on the relevance of the NAV provided, or by raising questions about whether the secondary market has truly delivered the best valuation outcome for the LPs.

Pricing expectations from secondary funds (vs. last known NAV)



Source : Estimations Jasmin Capital

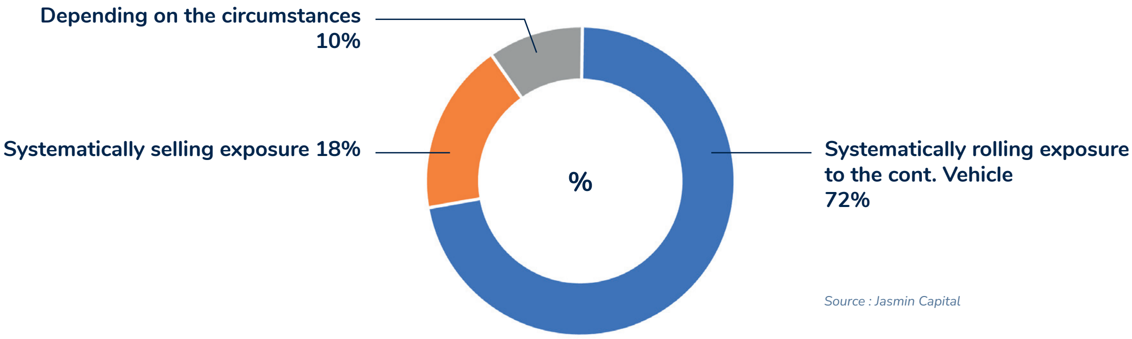
Limited Partners: from passive capital providers to active decision makers

Over the years, LPs have become more involved in the decision-making process of their investments. This shift is partly due to the **growing trend of LPs wanting more transparency and control** over their investments. Moreover, the **rise of co-investments** requires LPs to **be more structured and agile.** To be a good investment partner, they need to **build out capacities to quickly evaluate deal flow.**

Furthermore, the **rise of continuation funds** has added a further layer of "pressure" on LPs, demanding their attention and resources.

It is the responsibility of the GP to facilitate the work of existing LPs during the election period, when existing LPs are expected to assess their options to roll-over or sell. Beyond well preparing the LPs for these transactions via LPACs, discussions, and presentations, GPs can be help by **demonstrating that the pricing is accurate.** To achieve this, GPs can rely on the experience of its Private Markets advisor in structuring GP-led and on several tools that can provide reassurance.

LPs make decision on a case-by-case basis when it comes to decide about their options in a continuation fund project



Source : Jasmin Capital

Secondary funds: delivering fair asset valuations

Having built a solid track-record in structuration of continuation funds, Jasmin Capital has **compiled several types of valuations** that can be used to support valuations proposed by secondary funds.

We break down valuation types in two groups: **deal-related** and **book/analytical valuations.** As outlined in the analysis below, **book/analytical valuations** are **traditionally seller-oriented valuation exercises,** whereas **deal-related valuations** are preferred by **buyers.**

As continuation funds are getting increasingly popular while secondary funds are continuously sharpening their valuation knowledge, the **GP-led target base is expanding day by day.** Such trends translate into even more competitive bidding processes, and **healthy price tension.**

Secondaries boasts an extensive valuation toolkit

Deal-related valuation	**Dual track M&A et GP-led**	▪ Most indisputable reference for GPs and LPs in terms of pricing, but requires appetite for the asset from two distinct investors bases and more resources to address the dual track day-to-day	Robustness
	Stopped M&A auction process	▪ Stopped M&A process pricings show well the valuation of an asset in a given economic environment	
	Unsolicited LOI	▪ Incoming offers give a preliminary idea about the current possible valuation ranges of the asset	
	SHA liquidity clause	▪ A sell option is a strong point of reference helping to evaluate the attractiveness of secondary funds' offers	
Book/ analytical valuation	**Third party valuation**	▪ Third party valuations carried out by an independent expert can give additional comfort on the fairness of a secondary pricing	Robustness
	Trading peers / M&A multiples	▪ Multiples of comparable listed companies and transactions give a marked-to-market valuation applicable to the asset	
	GP's valuation in the books	▪ Based on valuation guidelines, most of the time prudent and below the market value of the asset but could be deemed as too discretionary	

Source : Jasmin Capital

- ### GP's internal valuations

Fund managers typically calculate the **NAV on a regular basis (quarterly, semesterly),** to provide investors with a snapshot of the fund's value. Guidelines recommend that fund managers provide LPs with **detailed information** on the valuation process, including the **assumptions** and **inputs used,** as well as **any adjustments or discounts applied** to avoid any doubts on a potentially unfair discretionary valuation.

In direct private equity funds, NAVs tend to be rather conservative and aligned with industry best practices. In many cases, we observe that **final exits are made at a sizeable markup compared to the last NAV.** As such, some funds managers successfully hit a 30% premium over a long period of time.

- **Peers trading multiples and transaction multiples**

These valuation methods – widely used to determine the enterprise value of a company – involve **direct comparisons to trading peers** or to **other transactions within the same industry.** This approach allows for a realistic assessment of value by looking at transactions that have occurred in the market.

The **difficulty lies in selecting appropriate peers** and **interpreting the final result** given the current market context. It is important to note that buyers could pay higher prices if an acquisition is of **strategic interest**, or if **anticipated** synergies are significant. Therefore, valuations based on trading multiples can provide a **rough idea of a company's value** but may not fully reflect what the market would be willing to pay, considering the company's specific strengths and weaknesses.

- **External valuation / fairness opinion**

In a continuation fund project, a fairness opinion is a valuable tool to ensure that all stakeholders receive fair value for their investment. This opinion is **typically provided by an independent third-party advisor** who evaluates the value of the private company and provides an opinion on **whether the proposed terms of the continuation fund are fair and reasonable for all parties involved.**

The fairness opinion considers various factors, such as financial projections, industry trends, and comparable transactions. By providing an **objective view on valuation** and the terms of the vehicle, it will ensure that all stakeholders are treated fairly and that the project can move forward with confidence.

To provide more transparency and to limit potential conflicts of interest; the US Securities and Exchange Commission (SEC) introduced a new set of rules as of August 23rd, 2023 to add an extra layer of protection to private market investors. **From now on, SEC-registered advisors must obtain either a fairness opinion or valuation opinion** for any GP-led secondary transactions.

- **Options (SHA)**

Put options are occasionally included in shareholder agreements (SHAs) of private companies to provide liquidity to shareholders. **Such options could be used as a reference point** when presenting an offer from a secondary fund to the LPs of the existing fund. This reference price can help in preventing doubts regarding valuation.

- **Unsolicited Letter of Intent (LOI)**

An unsolicited LOI from a potential buyer can provide a useful reference point for the value of the shares of a private company, albeit sometimes far from the GP's internal valuations. The LOI typically includes a proposed purchase price for the shares, which can serve as a **starting point for negotiations** between the GP and interested secondary funds. **If the proposed price is comparable to the offers made by secondary funds, LPs can become more comfortable with the valuations** being proposed for the continuation fund process.

- **Stopped M&A process**

In a turbulent economic context, the number of failed M&A transactions usually rises. During the pandemic, Jasmin Capital observed several instances where companies in the very late stages of M&A saw buyers either decrease their offer price between the indicative and the binding offers or pull out of the process entirely. **While closely linked to the context,** these **company valuations originating from real potential buyers serve as a crucial point of reference** for existing LPs when presented with a secondary offer.

- **Dual track**

A dual track process is likely to provide **the highest level of comfort.** The GP can provide a market-tested price to its LPs, thereby eliminating doubts about the relevancy of the secondary valuation.

In a dual-track process, the GP and its advisors concurrently run both an M&A and a secondary sale process:

- In the M&A process, potential strategic or financial buyers are invited to submit acquisition bids for the asset;
- In the secondary sale process, secondary funds are invited to bid to subscribe to the continuation fund that will manage the asset.

Potential buyers in both processes conduct their own due diligence and valuation analysis and submit bids. If the valuation proposed in the M&A process is in line with the bids received in the secondary process, the GP will be more confident in presenting the continuation fund process to its LPs.

Nevertheless, dual-track processes are complex and require precise execution plans carried out by experienced advisors. Yet, one of the two processes is usually dropped at the end of the first round, so no additional resources are unnecessary spent on performing further due diligence.

Preparing the discussions tied to continuation funds

The first and most important factor in valuation is **the quality, operational performance, and growth/profitability perspective of the underlying asset,** indicating the expected attractiveness of the secondary funds. Higher exit multiples provide a solid foundation, **reducing the reliance on external valuation references.** While these initial indicators guide valuation discussions towards a consensus, they are typically validated by external assessments, aligning with market practice.

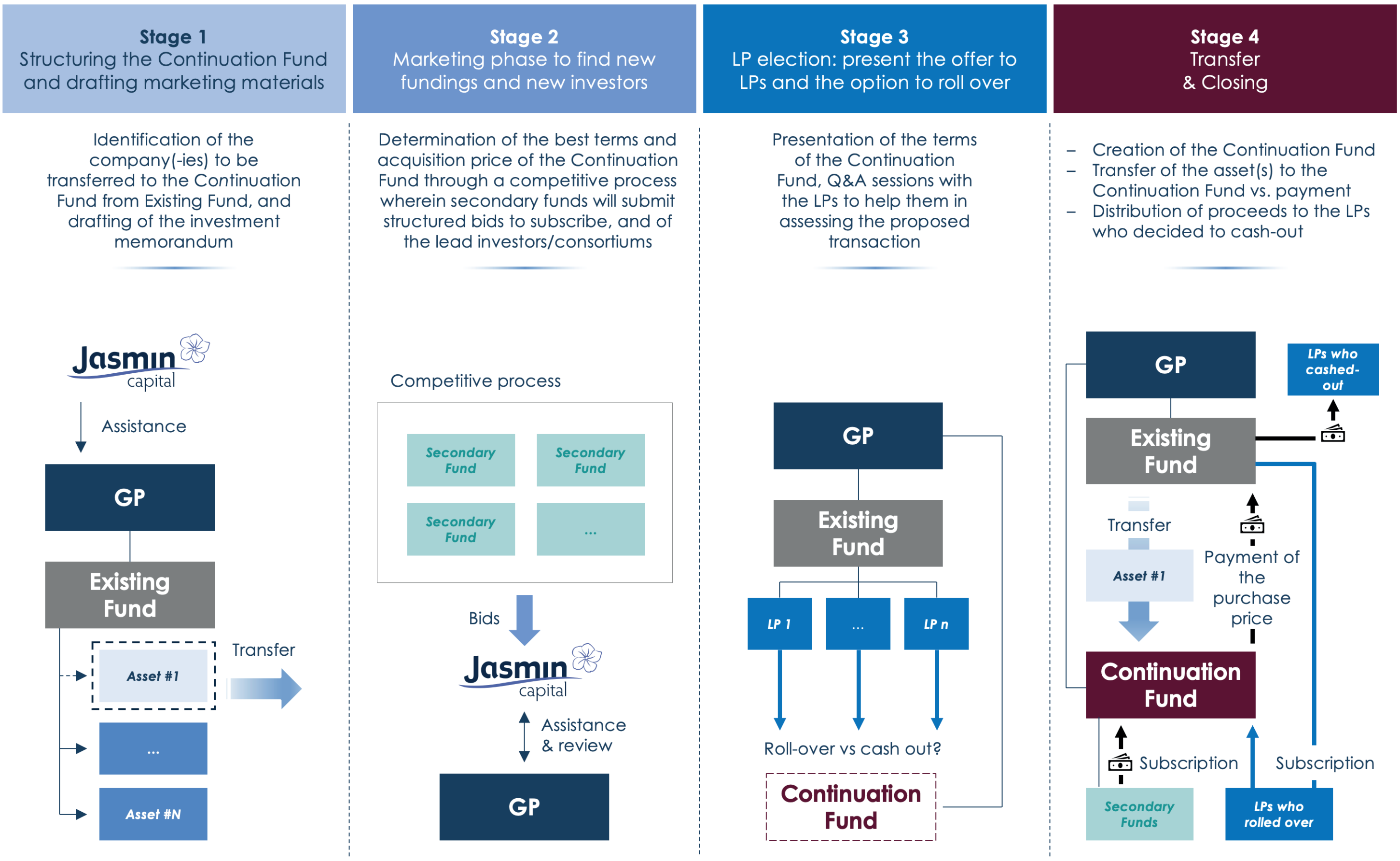
Secondary funds, which utilize the same toolkit and boast the same skills than **M&A bankers and traditional direct fund managers,** conduct **proper valuation exercises that are regarded as “fair” and “solid” market references, akin to valuations derived from an IPO or an M&A process.**

Nevertheless, **entrusting a well-established secondary market advisor** in continuation fund projects **will ensure a comprehensive transaction with a competitive auction process to benefit from price tension.**

Leveraging on its wide network of secondary funds, Jasmin Capital can collect as many valuation points as needed to **get the most competitive and relevant market price.** Additionally, a well-connected advisor will accompany the GP in thoroughly explain the price building and the GP-led transaction process to LPs. Similarly, secondary funds are keen on speaking with us to **get valuation benchmarks and market insights to drive their own price discovery works** towards the fair market value.

For GPs, having recourse to external resources **from an advisor is a guarantee of the seriousness that will drive the operation.** This also means the GPs will benefit from the track-record and the experience of an advisor highly regarded by both the GPs and the LPs, during the discussions with the LPs. Such advisory is also key to reassure LPs that everything possible has been done to ensure the preservation of all stakeholders' interests, in line with market's highest standards.

Continuation funds in 4 steps



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Private Markets Advisor

Advisor for Family Offices and Institutionals

Placement Agent

PRIVATE EQUITY
PRIVATE DEBT
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Secondary Transaction

Mergers & Acquisitions on GPs

Marketing Advisor / Image Study

Co-investment

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