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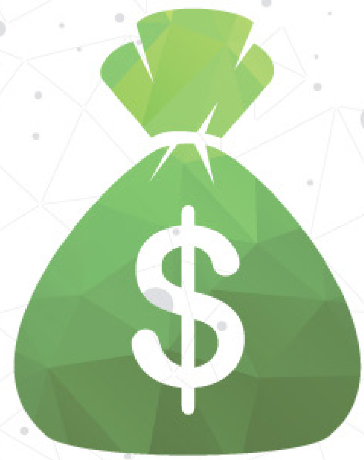
Private Equity Intelligence



Private Equity as an Exit Option for Venture-Backed Startups

By Alan N. Wink

In the past, private equity groups (PEGs) seldom invested in venture capital backed startups or even in companies known for innovation. Investing in the next "big thing" was not part of the vocabulary of the typical buyout fund. PEGs more likely were looking for companies that dominated a market, had significant customer traction, manageable cash requirements, and recurring and predictable cash flow to pay back debt. Going a step further, startups were also not very appealing to debt providers since they are unproven and typically have no tangible assets. However, let's fast forward to 2018 and the world is certainly changing with PEGs definitely becoming a significant exit option for venture capital-backed companies.

Over the last couple of years, there has certainly been a shift in strategy for PEGs and maybe one of the most important reasons for the shift has been the tremendous amount of dry powder presently sitting on the sidelines. Private equity buyouts represented 18.5% of all venture capital-backed exits in North America and Europe in 2017, which was a significant increase from 14% in 2016 and only 10% in 2008. In fact, several prominent PEGs, have even raised significant funds to focus exclusively on tech deals.

Today, venture capital investment continues later into the company's lifecycle. In today's capital markets, venture-backed companies are staying private longer and postponing exits because they continue to have access to large rounds of private capital. In fact, 2018 might be the first year since the late 1990s that venture capital deal values surpass $100 billion. Since venture capital-backed companies are pursuing exits later in their lifecycles, they are beginning to generate growth rates, revenue numbers and profitability that are catching the attention of PEGs. These companies are making the transition from burning cash to support growth, to having sustainable and predictable earnings. These later-stage startups are generating significant and sustainable revenues that cannot be overlooked by PEGs aggressively looking for places to invest their capital.

PEGs are primarily acquiring venture capital-backed companies as add-ons to existing portfolio company investments. These investments help platform investments achieve immediate revenue increases as opposed to slower organic growth. As PEGs gather more experience in the technology space, platform investments of late-stage technology companies will definitely become more common.

PEGs certainly understand the competitive environment driving up multiples of venture-backed companies with significant customer traction and solid recurring and predictable revenues. In fact, PEGs are completing buyouts at valuations that are comparable to public market valuations and to prices being paid by strategic buyers. An argument can be made that PEGs are actually a strategic buyer, since a majority of their venture-backed deals have been add-ons to existing portfolio companies.

As an exit option, a private equity buyout might be advantageous to a venture-backed company for several reasons. First of all, PEGs are offering prices on par or even greater than strategic buyers and public market comparables. Second, a private equity buyout can provide original shareholders with the opportunity to rollover some of their equity into the new entity and then have a second liquidation event when the PEG exits. Finally, unlike an IPO, a buyout does not create lockup periods for shares that might create valuation uncertainty for shareholders.

With PEGs sitting on enormous pools of capital, the challenge to find good deals has never been greater. PEGs need to continue to explore for more opportunities for growth and one of those opportunities is certainly in the area of later-stage venture-backed companies. Today, these venture-backed companies -- with predictable and sustainable revenue streams, potential for cost cutting and ability to take on debt -- are beginning to match the investment criteria of many PEGs. For many venture capitalists, having a company exit through an IPO might have been a sign of great success, but today the choice of a PEG buyout might be a better financial alternative for your limited partners.

Alan Wink is an EisnerAmper partner and the firm's director – capital markets. Questions? You can reach Alan at 732.243.7196 or alan.wink@eisneramper.com.

Why U.S. Private Equity Funds Should Adopt Sell-Side (Vendor) Due Diligence with a Twist

By Ted D. Rosen, Esq., Partner, Mergers & Acquisitions and Private Equity, Akerman LLP

As a busy U.S. sell-side lawyer, I am finding that private equity buyers and sellers are becoming extremely fatigued with the buyer due diligence process. Repetitive buyer due diligence requests and management meetings are taking too much time and effort, distracting management from running the business and slowing the sale process (with every day of delay increasing the chances that customers, suppliers and employees will learn of the deal). Furthermore, buyers sometimes use the due diligence process to negotiate down the purchase price after a "winning" bid based upon due diligence uncovered later in the buy-side process (increasing the risk of a busted deal). If a seller can expedite and control the due diligence process, then there is a better probability of accomplishing the primary seller goals of increasing the likelihood that a deal will close quickly and confidentially and on the price and terms contemplated by the letter of intent, while reducing overall professional fees and transaction costs.

In Europe, the seller (vendor), prior to going to market, retains legal, accounting, and other relevant advisors to prepare the vendor due diligence reports (VDDR). In this process, the seller can get ahead of any issues that might result in the lowering of a bid or even having a bidder walk away from the bidding process. Having worked on European VDDR concerning U.S. legal, regulatory, and political risks, it seems appropriate that U.S. private equity funds should consider utilizing a sell-side process in which all prospective buyers are presented with a VDDR (subject to a twist as suggested below) and given a more limited period of time to buyers to conduct their due diligence.

ADVANTAGES OF VENDOR DUE DILIGENCE

Vendor due diligence has advantages to the sellers and the buyers.

Advantages to vendor due diligence to the seller include:

1. The due diligence process would be much more efficient if all prospective buyers receive the exact same information packaged in one report and group informational answer sessions can be set up.
2. Buyers' ability to conduct an initial due diligence analysis would be accelerated by the VDDR. Shortening the due diligence timeline reduces the seller's professional fees as the process becomes much more streamlined and efficient. Sellers may require written questions to the VDDR. Sellers can then respond at one time to major issues that may arise to one or all parties.
3. Having fewer advisors involved reduces the risk that news of a confidential sales process could be leaked.

4. Post-bid price reductions are reduced, as there are fewer due diligence concerns popping up later in the due diligence process.
5. With less uncertainty as to unknown risks, buyers may be more likely to make higher bids rather than building in reduced pricing due to unknown or undisclosed risks.

Advantages of vendor due diligence to the buyer include:

1. Reduced initial due diligence costs as the seller has incurred the initial costs. With less upfront costs, buyers may be more inclined to look at the seller as a potential target.
2. Buyers can focus their advisors on major issues which should reduce costs in terms of having a VDDR reviewed as opposed to prepared de novo.
3. European buyers will be attracted to U.S. sellers with the foresight to utilize a VDDR.

DOWNSIDES TO VENDOR DUE DILIGENCE

There are certain potential negatives in vendor due diligence. For example, from the seller's perspective, potential disadvantages largely consist of (i) increased upfront time and associated (and potentially significant) cost involved in having outside advisors prepare the VDDR, (ii) the prospect that the items disclosed will affect negatively the sales price, (iii) concerns, in the case of disclosures about pending or threatened litigation and/or governmental investigations and proceedings, of waivers of attorney-client privilege, (iv) the prospect that, notwithstanding the seller's best efforts, it will still be forced to respond to multiple, conflicting and time-consuming requests for follow up diligence and meetings, and (v) the risk that there will not be any tangible benefit to it in terms of an increased sales price and/or more favorable indemnification terms than it would otherwise have achieved had it simply left each bidder to its own device in carrying out diligence.*

PROFESSIONAL LIABILITY ISSUE

In Europe, it is standard practice is to provide the recipients of VDDR final reports the right to rely on the report subject to certain caveats, such as a cap on liability. U.S. advisors either cannot or will not want to create an attorney-client or professional service client relationship with an unknown third party. Thus, a non-reliance letter, in the context of a legal due diligence report, serves primarily to record the recipient's acknowledgment that delivery of the report does not establish an attorney-client relationship between the law firm and the recipient of the report. It also contains disclaimers to the effect that the preparing firm has not consulted with the recipient in connection with defining the scope of the report and, as a result, it is possible that the recipient may have different interests and views of materiality from those expressed by the preparer of the report. Finally, the non-reliance letter contains a waiver and release by the recipient of any and all claims it may have against the preparing firm with respect to the report. Thus, the recipient uses the report at its own risk and the provider takes no responsibility for its contents and disclaims any responsibility to update the report. However, it is generally much easier and cheaper to confirm a VDDR report than to prepare one de novo.

A HYBRID APPROACH TO U.S. VENDOR DUE DILIGENCE

I would suggest that the private equity funds also consider modifying the European style of VDDR to include a quality of earnings analysis as well as a tax analysis, which could include deal structure issues, confirmation of payment of U.S. state and local taxes and foreign taxes (as applicable), support for projections and EBITDA or adjusted EBITDA, verification of tax elections, etc. In addition, cybersecurity and technology risks could also be added to the U.S. VDDR disclosures.

Furthermore, U.S. professional service firms will prefer non-reliance language which should help keep the cost down on the projects. In today's competitive sales market, this hybrid approach should be very attractive to both sellers and buyers. As to the acceptance of non-reliance language in the VDDR, this author's opinion is that buyers can understand the risks and make their own determination what their own professional advisor need to focus on.

Lastly, the primary goals of an efficient sell-side process are: (i) closing quickly, confidentially and efficiently, and (ii) maximizing after tax and claims consideration. A VDDR or other front-end loaded process accomplishes both goals. Thus, even if the VDDR process is not followed exactly, the aforesaid goals are much more likely to be accomplished if the seller proactively takes the front-end actions discussed above (e.g., sell-side quality of earnings, sell-side diligence, etc.) and perhaps also sends out a proposed purchase agreement with complete schedules.

** United States: Vendor Due Diligence Reports: A Tale Of Two Markets, by Jeremy W. Dickens, Esq., Mondaq and previously published in The International Comparative Legal Guide to: Private Equity 2015.*

Please contact Ted D. Rosen, Esq. at ted.rosen@akerman.com or 212.259.8711 if you have any questions regarding this article. Special thanks to Carl D. Roston, Co-Chair, Corporate Practice Group at Akerman LLP for his insightful comments to this article. This article is intended for discussion purposes only and should not be relied on without obtaining legal counsel.

Private Equity and Venture Capital Activity in Southeast Asia

By Grady Poon, EisnerAmper Singapore

In 2000, venture capital outside of the U.S. was in a nascent form: such investment was in a proto-embryonic stage in the major cities of Western Europe and virtually non-existent in Asia-Pacific. Today the Asia-Pacific region challenges North America as one of two key global venues for venture capital investment, mirroring the geo-political shift from the Atlantic to the Pacific witnessed in the first two decades of the 21st Century.

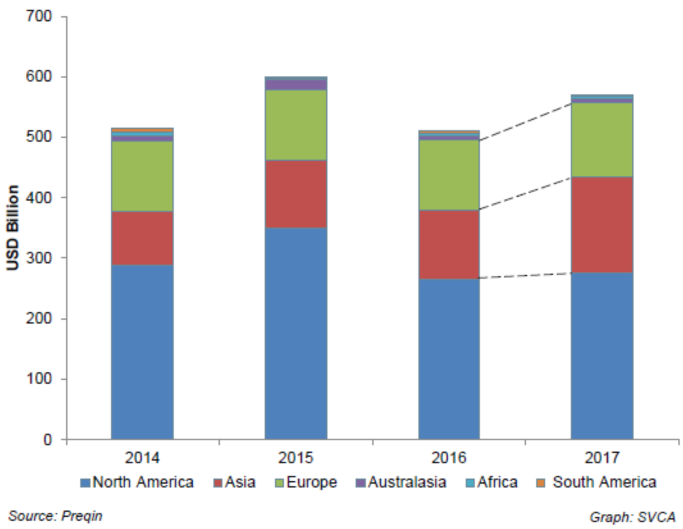
In Southeast Asia (SEA) alone, the region experienced a bumper year for both PE and VC investments, and grew almost three times to reach $23.5 billion in 2017.

The global private equity industry continues to outperform other assets classes in 2017.

The Singapore Venture Capital & Private Equity Association (SVCA) published an annual report on the Southeast Asian private equity (PE) and venture capital (VC) industry in May 2018, which gives an overview in the PE and VC industry globally and in Southeast Asia.

SVCA has kindly allowed EisnerAmper Singapore to highlight key points from the annual report. To read SVCA's annual report and other publications, please visit: *www.svca.org.sg/publications*.

GLOBAL OVERVIEW ON AUM OF PE AND VC

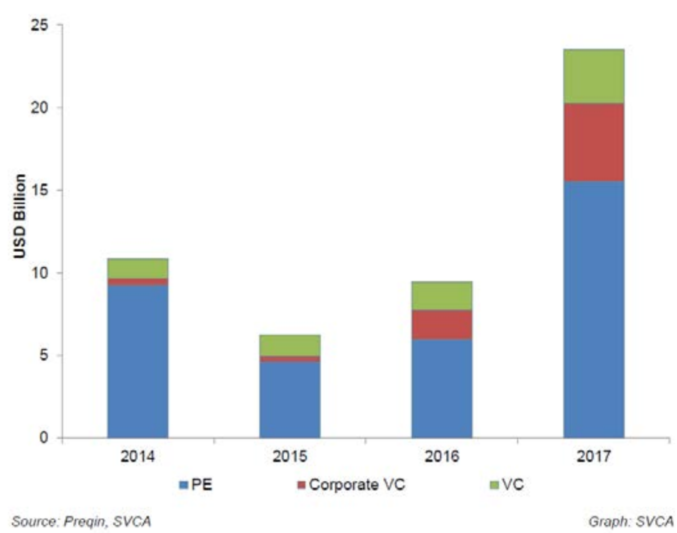


Asia PE and VC AUM grew by 37.6% to reach $158.4 billion, constituting 27.8% of global investments surpassing Europe for the first time.

Asia's strong fundamentals, growing economies, and advancing technological capabilities are becoming increasingly attractive to global sources of funds chasing for yield.

OVERVIEW OF SOUTHEAST ASIA

PE/VC investments into Southeast Asia reach 4 year high



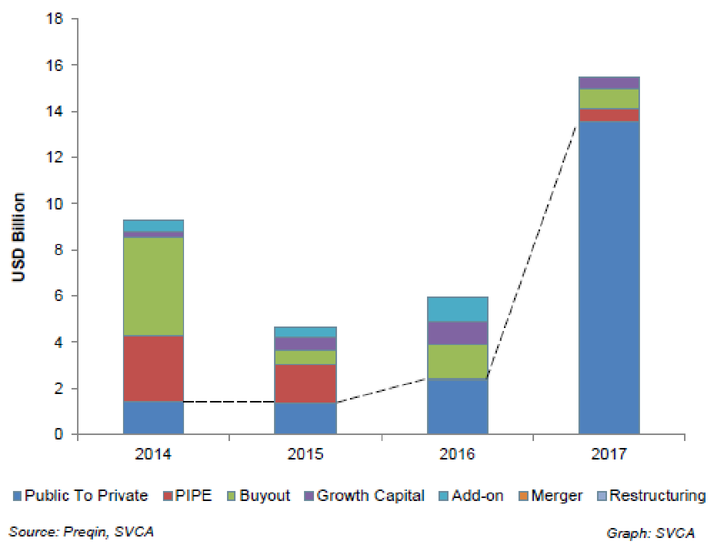
The estimated PE/VC investments into SEA hit the $23.5 billion in 2017. This is the highest recorded level by SVCA.

"For those PE players in the middle market that have good deal sourcing capabilities, a differentiated strategy and a strong value proposition for founders, there are great opportunities at often attractive valuations," said Ralph Keitel, Regional Lead for PE Funds in East Asia and Pacific, IFC.

"Most LPs now have meaningful allocations for Asia. But the majority of that goes to either pan-regional funds or China. Lesser developed markets such as India, and Southeast Asia in particular, are still considered to be too risky for many institutional LPs. As a result, fundraising for all but the largest funds remains very challenging."

SOUTHEAST ASIA PRIVATE EQUITY

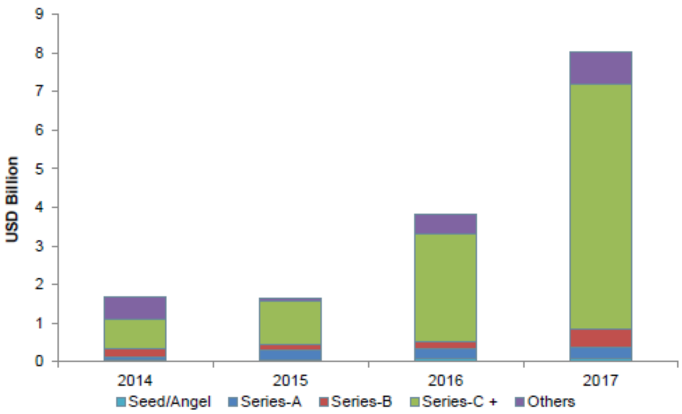
PE investments reach 4 year high dominated by public to private deals



The PE deal value increased to $15.5 billion in 2017 from $9.2 billion in 2014. In particular, PE involvement in public to private transactions grew exponentially at 113% annually from 2014 to 2017. In 2017, public to private transactions grew 5.8x year-on-year dominated by the $12 billion privatization of Global Logistic Properties.

SOUTHEAST ASIA VENTURE CAPITAL

Mega-round in venture financing attracting PE, Hedge and Corporate Funds



Source: Preqin, SVCA *Graph: SVCA*

From 2014 to 2017, the venture financing increased from $1.7 billion to $8.0 billion. While early stage investment (Seed and Series-A investments) increased to $83.1 million. The successive rounds (Series-C) have increased significantly to $6.3 billion, which represent 79% of total venture investment in 2017.

SPOTLIGHT ON IPO OF SOUTHEAST ASIAN UNICORNS IN 2017

RAZER LTD.

Gaming tech firm Razer Ltd., a leading maker and marketer of gaming peripherals such as gaming laptops, mice, and gaming controllers, is one of Singapore's start-up success stories. Razer launched an initial public offering in November 2017, raising HK$4.12 billion to much publicity and fanfare.

SEA LIMITED

Sea Limited, which attracted mega-rounds of investment from VC, PE, CVC and pension funds, began as Garena, hosting a platform for popular online games. It has since grown into a Southeast Asian powerhouse with interests in internet gaming, payment and ecommerce. Sea Limited launched an initial public offering on NYSE in October 2017 raising $884m. The IPO of two of Southeast Asia's "unicorns" created some excitement in 2017 although stock prices of Sea Limited and Razer have since seesawed above and below their IPO price. Nevertheless, their IPOs have rewarded early investors and bode well for PE and VC investment into SEA.

The Monetary Authority of Singapore (MAS) seeks to build a vibrant VC and PE ecosystem, as part of broader efforts to develop Singapore as a financing hub for growth companies in Singapore and the region. MAS is working with the industry and government stakeholders on initiatives designed to:

- Simplify authorization processes and regulatory framework for VC managers;
- Anchor top-tier regional and global VC and PE players in Singapore;
- Deepen the talent pool;
- Enhance ancillary professional services ecosystem; and
- Build a pipeline of alternative market platforms that can facilitate private market exits for VC and PE investors.

EisnerAmper Singapore hears that the outlook for the rest of 2018 will remain strong. Companies in Asia, particularly Southeast Asia, will likely to seek earlier and larger rounds of funding from the global market. Singapore companies are also likely to be more aggressive in seeking earlier and larger rounds of funding from the local, US, China and overseas markets. Such developments will continue to drive global and local PE and VC investment and momentum to the next level.

Grady Poon is head of financial services with EisnerAmper Singapore. Questions? He can be reached at +65 6305 9919 or grady.poon@eisneramper.sg.

The New Kid on the Block – Here to Play, Here to Stay: The Institutionalization of the Family Office

By Jaclyn Greco

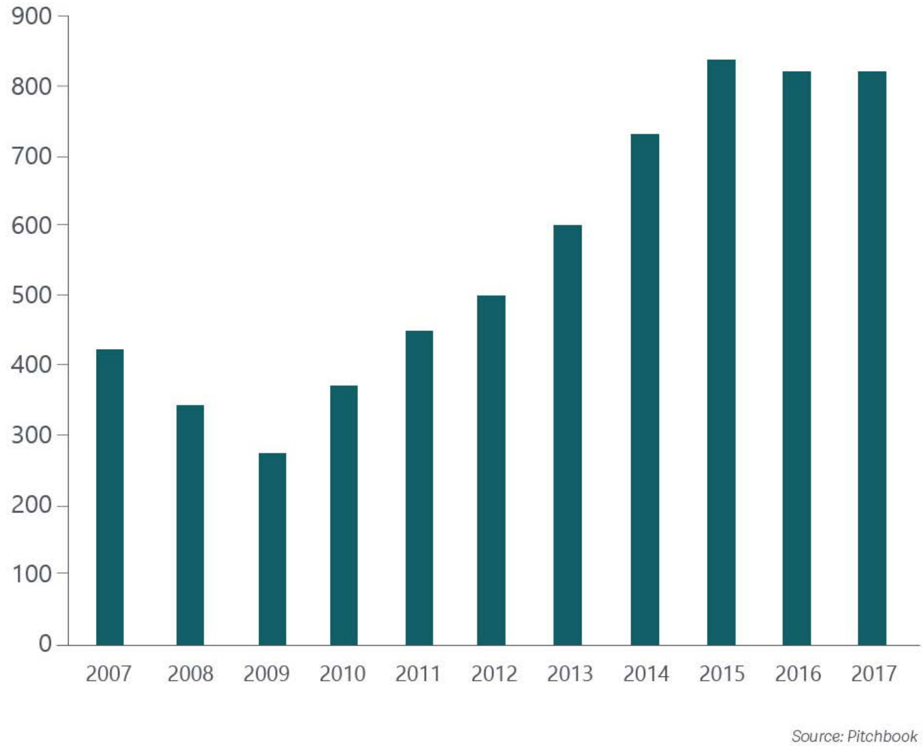
If you believe Albert Einstein's saying "The measure of intelligence is the ability to change," then family offices are looking very intelligent these days -- like their investment strategy and approach, family offices continue to evolve. While family offices making direct investments is not revolutionary, more often today they are bypassing investments in a fund structure and investing directly; many times taking a control position in an investment. Although investing direct presents opportunities for higher returns, complete transparency and discretion, it does not come without its own set of challenges. Direct investing requires a unique and not insignificant list of barriers to entry. The family office playing this hand must have a more robust infrastructure versus a skeleton team of investors, including talent for deal origination, valuation, financial and operational due diligence and more.

A large factor in the acceleration of family offices institutionalizing further and investing directly was the '08 financial crisis. While alignment of LP and GP interests has always been a focal point, the financial crisis catapulted a new approach to the forefront: investing directly and avoiding paying fees to outside managers, specifically, retaining up to one fifth of the returns through carry.

> "Family offices have an interesting angle where they can play like private equity but are able to be more flexible in deal structures and seek to preserve their investments across generations, unlike PE firms which have contractually short (3-5 year) time horizons. This alternative can be attractive to owners seeking a longer-term partner who can help them grow their business without the pressure of short-term capital cycles."
>
> \- Michael Mas of Pinecrest Capital Partners

According to Pitchbook data, over the past ten years, U.S. family offices participating in direct deals has increased almost 70% and more than 175% since the 2008 financial crisis. On a global level, the data further highlights the shift, with a 96% increase in direct deals over the last decade, while increasing by more than 210% since the '08 financial crisis.

DEAL COUNT ACTIVITY - GLOBALLY



For family offices, going direct presents several benefits including:

1. Economics: Family offices can cut their costs by bypassing the 2% management and 20% carry on profits through direct investments and
2. Transparency: By investing directly, the family office team will have full transparency into the business they are purchasing, as they will be the sole owners and operators of that business.

However, the competitive advantage(s) of family offices to a seller cannot be overlooked and is something many investment bankers have seen an uptick in when marketing a deal.

- Sticky Capital: Family offices have the ability to invest long-term. Unlike a traditional private equity fund, which has LPs to answer to and a fund expiration date, family offices are investing on their own behalf and have the ability to be longer-term capital as compared to a private equity fund.
- Family-to-Family deals: Successful family-owned and operated companies revel in the idea of selling to a like-minded family entity. While the seller has decided to sell, they can be emotionally attached to their business. Selling to a family office offers a layer of familiarity to the seller; whereas, private equity funds can be perceived to be more impersonal and transactional – wanting to acquire the business, ramp it up, and sell at higher multiples in three to five years.
- Creativity and flexibility: Family offices have less red tape, especially as former private equity individuals who have experienced the good, the bad and the ugly, and tweak their approach at the FO for the better. They can get creative in their leverage profile, timeline and structure of a deal.

Jaclyn Greco is a manager in the firm's financial services and private equity groups. For more information, contact Jaclyn at 212.891.6986 or jaclyn.greco@eisneramper.com.