

Private Equity Secondaries Market Adapts to COVID-19

March 9, 2020

The rapid spread of the COVID-19 coronavirus has dominated headlines and roiled markets so far in 2020. With epidemiologists and economists forecasting coronavirus-related disruptions that may endure for months and possibly much longer, COVID-19 presents significant challenges to private equity for the foreseeable future, in particular in the secondaries market where pricing of fund interests is typically based on historic pre-signing net asset value (NAV) determinations and larger, complex transactions can be subject to a lag of many months between pricing being agreed and final closing occurring.

In past periods of market volatility, such as the global financial crisis of 2008-2009, the secondaries market has typically experienced a lull in activity while buyers and sellers adjusted to new pricing expectations. However, COVID-19 presents a very different threat than the global financial crisis in that the risk of protracted market volatility may be too long to wait out, particularly for those facing near-term liquidity needs in a low-yield environment where traditional M&A exit activity may be diminished. We can expect secondary buyers to explore creative means of price protection in purchase agreements, while secondary sellers may face difficult decisions around accepting price reductions, price uncertainty and/or transaction risk.

We anticipate buyers will consider introducing variations on traditional contractual provisions, such as material adverse change (MAC) closing conditions or force majeure clauses, to protect their interests. However, with secondary portfolios usually comprised of assets operating in multiple geographies and reliant on global production and supply chains, drafting MAC or force majeure triggers that would both function as intended and allocate risk in a manner acceptable to both buyers and sellers will present significant challenges. And the consequence of a MAC or force majeure clause that is triggered—a walk away right for the buyer—is extreme from a seller’s perspective. In addition or as an alternative to walk away rights, buyers may seek to negotiate new pre-closing price review and adjustment mechanisms to be incorporated into purchase agreements, or change their transaction execution processes, such as by consummating more transactions on a simultaneous “sign-and-close” basis, as more seller-friendly approaches to mitigate the volatility risk.

Given the wide variation in underlying portfolios and commercial rationales in secondaries transactions, a “one-size-fits-all” solution is unlikely to emerge. It is far more likely that bespoke structuring solutions will be agreed on a per transaction basis, which could involve greater complexity in the transaction legal documentation, in particular in the traditional LP interest secondary transfer market which has typically employed one or two relatively straightforward accepted forms of purchase agreement in the market. The Debevoise team is ready to discuss available options with you, compare market views and share our insights from the wide range of secondaries transactions we have acted on in recent months.



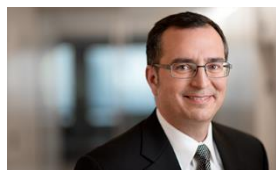
Andrew M. Ahern
Partner, New York
+1 212 909 6081
amahern@debevoise.com



Gavin Anderson
Partner, Hong Kong
+852 2160 9866
ganderson@debevoise.com



Katherine Ashton
Partner, London
+44 20 7786 9040
kashton@debevoise.com



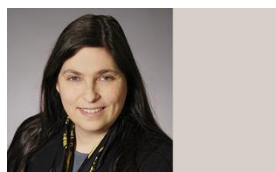
Ezra Borut
Partner, Tokyo
+81 3 4570 6695
eborut@debevoise.com



Geoffrey P. Burgess
Partner, London
+44 20 7786 9075
gpburgess@debevoise.com



E. Drew Dutton
Partner, New York
+1 212 909 6718
eddutton@debevoise.com



Jane Engelhardt
Partner, New York
+1 212 909 7308
jengelhardt@debevoise.com



John W. Rife III
Partner, London
+44 20 7786 5530
jrife@debevoise.com



David J. Schwartz
Partner, New York
+1 212 909 6631
djschwartz@debevoise.com



Andrew C. Rearick
International Counsel, London
+44 20 7786 9158
acrearick@debevoise.com