A WORD FROM CHURCHILL ASSET MANAGEMENT

Unpacking continuation vehicle rationale

The use cases of GP-led continuation vehicles (CVs) and the importance of creating a win-win-win

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1. **How have you seen the use cases for continuation vehicles evolve as the market has become more mainstream?**

The GP-led market generated approximately $71 billion of transaction volume globally in 2024, of which continuation vehicles represented approximately $55 billion.[1] The proliferation of middle-market transactions has been a fundamental driver of this growth; however, we have also noticed a shift in how GPs utilize CV structures to achieve their desired outcome.

Though CV transactions were born out of fund restructurings in the wake of the global financial crisis, the CVs we generally think of today, those associated with "trophy assets," came into vogue in the 2018-2019 time frame. In these transactions, sponsors seek to extend the duration of their highest-performing portfolio companies to continue compounding and executing on proven value creation plans (VCP). Churchill, for instance, focuses almost exclusively on this channel, where go-forward VCPs represent a true "continuation" of what has been successfully executed to date. These are typically assets that have generated returns well above the sponsor's initial base case, where GPs could sell the business outright but prefer to continue compounding returns, while typically raising incremental capital to support future growth initiatives.

But, over the past several years we have witnessed the development of several new subcategories of transactions, most notably fund wrap-ups and complex midlife situations.

Fund wrap-ups are typically associated with multi-asset continuation vehicles and encompass all remaining portfolio companies within a fund. These transactions are executed near, or after, the fund's original maturity (over 10 years old) to wind down the fund vehicle while providing GPs additional time and capital to optimize portfolio companies prior to a full sale. Fund wrap-ups can be an eloquent solution to offer existing LPs full liquidity for a fund that is now long in the tooth while avoiding a forced sale of companies that may yield a less-than-desired outcome. The challenge, however, often comes in the form of mixed asset quality—perhaps the fund has some outperforming assets and some underperforming assets. As an investor in these types of deals, you effectively have to take the good with the bad, and that is priced appropriately (often at a more material discount than single-asset trophy CVs).

The second area of growth we have observed in the CV market is around complex midlife situations, generally for a single asset. This could be a portfolio company that has been a longer hold, but where a business model shift is required to reposition the company before a natural exit (such as the need to diversify revenue streams or customer concentration, expand into new product categories or geographies, and more). Or, these transactions may occur earlier in the investment's life as the result of a significant opportunity, such as a transformative merger that requires materially

1: "FY 2024 Secondary Market Review," Evercore Private Capital Advisory, December 2024.

more capital and subsequent time to integrate, optimize, and grow prior to a full sale. In both cases, the go-forward VCP is fundamentally different from what the company has executed previously. The deviation in strategy, coupled with the introduction of operational or execution requirements, introduces new risks that weren't present at the outset.

1. **How do you think about transaction rationale and structuring that ensures all parties receive a fair outcome?**

In our view, one element is critical to all CVs regardless of the transaction type: creating a win-win-win for current LPs, the GP, and secondary buyers.

The GPs goal is to secure additional time, and/or capital (often both), for one or more companies while providing LPs a liquidity option. Successfully raising a CV that provides the appropriate balance of both is the key "win" for the GP, but transactions can also serve to introduce new LPs, reallocate economics, or cash out inactive shareholders. At the same time, CVs are inherently conflicted in nature with the GP on both sides of the transaction. So, how do you ensure it's a win for current LPs as well as secondary buyers?

The Institutional Limited Partners Association published guidance in 2023 to protect LPs, ensure adequate disclosure and information sharing, and provide appropriate time for decision-making. In practice, we believe the vast majority of the secondary market was already following these principles. As buyers, we cannot emphasize enough the importance of communication, transaction rationale, and alignment in a CV.

Starting with trophy asset CVs, it's important the portfolio company has outperformed the GPs base case, been owned sufficiently long (meaning 3-5 years or more), and has a clear need for additional capital (such as fund concentration limits) and time. We prioritize opportunities where a GP could easily exit the business today, but they believe the next 3-5 years are as good, or better, than the first. For fund wrap-ups and complex midlife transactions, the rationale will vary transaction-to-transaction, but LPs should have a clear desire for liquidity or an understanding of capital needs above the fund's capacity. Additionally, for LPs that don't desire to take liquidity, a status quo rollover option should be made available.

For us, CVs can offer the opportunity to invest in what should be one of the highest-performing companies in a fund, where value creation plans are proven and the outlook remains strong. GP alignment is often superior in CVs as GPs roll most, if not all, of their economic interest and crystallized carry into the transaction. And since the sponsor has owned a business for several years, there is an expectation that much of the basic business building has been completed. As such, investments should be somewhat derisked and benefit from momentum built during the first holding period.

As we have stated though, not all CVs are created equally and not all transactions are structured equally.

2. **CVs have been a useful tool for GPs to deliver distributions to investors in recent years. Do you expect to see volumes decline when the sponsor-backed exit environment returns to historical levels?**

CVs as a percent of global sponsor-backed exit volume have grown from 5% in 2020 to 13% in 2024,[2] implying that CVs are taking market share from traditional exit paths. Sceptics, however, have pointed to the significant decline in broader M&A activity and that CVs are simply "filling a void" until the exit market returns to normalized levels.

At Churchill, we see a healthy mix of both in the numbers. We do expect some moderation in volumes for fund wrap-ups and complex midlife transactions as the broader M&A environment returns to normalized levels. These transactions serve unique purposes for both LPs and GPs, but distributions are clearly a fundamental driver. At the same time, CVs are now very much a viable exit option for GPs, behind strategic sales, sponsor-backed sales, and IPOs, and CVs have and will continue to take share from other exit avenues. More recently, GPs have commented that when they are looking at acquiring a company, no longer are they thinking about a VCP with a five-year time horizon, but instead, taking a 10-to 20-year view and evaluating if there is enough opportunity to generate 3x returns or better multiple times while utilizing CV technology along the way to offer periods of liquidity for their investors. Our perspective is that the desire for GPs to retain their highest-performing assets for longer will flourish across all exit environments.

2: "Global Secondary Market Review," Jefferies, January 2025.