Weil

A LOOK AT GOVERNANCE AND LIQUIDITY ARRANGEMENTS IN 2019 SPONSOR-BACKED

INITIAL PUBLIC OFFERINGS

May 2020

2020
Private Equity
Surveys

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INTRODUCTION & RESEARCH METHODOLOGY

Welcome to Weil, Gotshal & Manges LLP's survey of governance and liquidity arrangements in sponsor-backed initial public offerings ("IPOs") in the United States. In preparing this survey, we reviewed and analyzed the material terms of 11 IPOs consummated on United States listing exchanges in calendar year 2019 by companies that had one or more private equity sponsor owner(s) (each, a "Sponsor"). The 11 surveyed transactions consisted of 7 "club" deals (i.e., a deal that has more than one Sponsor with a material ownership position in the company) and 4 single-Sponsor deals. Specifically, the 11 surveyed transactions included the following Sponsor-backed companies:

- Avantor, Inc.
- BridgeBio Pharma, Inc.
- Brigham Minerals, Inc.
- Change Healthcare Inc.
- Dynatrace, Inc.
- Grocery Outlet Holding Corp.
- Palomar Holdings, Inc.
- Ping Identity Holdings Corp.
- ProSight Global, Inc.
- SmileDirectClub, Inc.
- SpringWorks Therapeutics, Inc.

In this survey, we focus on the areas that we believe are of unique interest to Sponsors contemplating an IPO of one of their portfolio companies. Given that Sponsors typically retain a majority (or significant minority) of the company's equity following an IPO, Sponsors are uniquely focused on maintaining (i) control or influence over the company while the Sponsor holds a meaningful (but decreasing) ownership interest in the public company, and (ii) the ability to sell down the Sponsor's remaining stake in the public company at a time (and valuation) of its choosing (and without being "front run" by other major shareholders).

We hope that you will find this survey useful and informative. We are happy to discuss with clients and friends the detailed findings and analyses underlying this survey.

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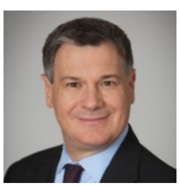

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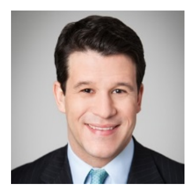

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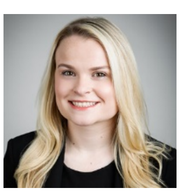

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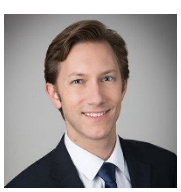

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SUMMARY OF KEY FINDINGS

- In the majority of surveyed deals (55%), Sponsor-backed IPO companies availed themselves of at least some “controlled company” exemptions available under applicable listing requirements, which, among other things, exempt such companies from certain board and committee director independence requirements (other than with respect to the audit committee).
- Sponsors typically (82%) adopted a classified board structure for the newly-public company in connection with an IPO.
- In a majority of surveyed deals (64%), Sponsors secured contractual rights to nominate or designate directors to serve on the public company’s board of directors (in some cases, including committees) following an IPO. 64% of surveyed deals also provided that compensating Sponsor-designated directors was at least permitted (although typically not expressly required).
- In 45% of surveyed deals, Sponsors secured shareholder consent or veto rights over the public company taking certain post-IPO actions (e.g., amendments to important sections of the company’s certificate of incorporation or bylaws, altering the size and/or composition of the board, change of control transactions, or effecting a voluntary liquidation). In a minority of surveyed deals (18%), Sponsors secured special information rights or access to management.
- In previous years, a limited number of Sponsors in “club” deals secured the ability to assign their governance rights to a transferee. Such provisions were not found in any of the deals (“club” or single-Sponsor) from this year’s survey.
- Sponsors typically (82%) included supermajority-voting requirements for the shareholders to take certain post-IPO actions in the organizational documents of the company.
- In a majority of surveyed deals (73%), Sponsors successfully negotiated for a waiver of corporate opportunity (in favor of the Sponsor) provision in the post-IPO company’s Charter.
- Share transfer restrictions (other than compliance with underwriters’ lock-ups and compliance with securities laws) rarely continue post-IPO in both single-Sponsor and “club” deals. These restrictions can include, among others, (a) transfer limitations based on the relative ownership of a shareholder as compared to other shareholders, (b) enhanced lock-up provisions, (c) a right of first offer in favor of the Sponsor or other shareholders on transfers, (d) tag-along rights, (e) drag-along rights and obligations, and (f) agreements requiring coordination among multiple shareholders on sales of shares. In “club” deals, Sponsors entering into voting agreements (including, depending on their terms, registration rights agreements) or other arrangements with respect to the voting or disposition of the company’s securities should be mindful of the possibility of forming a “group” under Section 13 of the Exchange Act.
- In 36% of surveyed transactions, companies adopted an “Umbrella partnership-C corporation” or “Up-C” structure (i.e., the publicly traded corporation is a holding company that holds an interest in another entity, typically an LLC, that holds all of the business’ operating assets and liabilities). While such structures introduce additional complexity, they may also provide significant benefits to Sponsors.

KEY FINDINGS

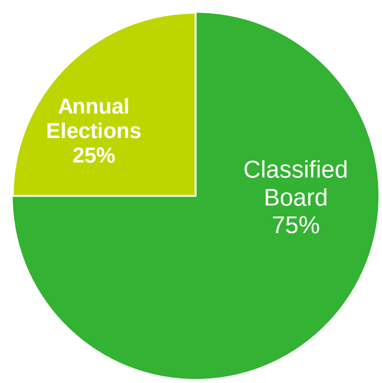
GOVERNANCE

In the majority of surveyed deals, Sponsor-backed IPO companies availed themselves of at least some "controlled company" exemptions available under applicable listing requirements. In 55% of the surveyed IPOs, the company disclosed in its prospectus that it would be treated as a "controlled company" under applicable listing requirements. A controlled company is a company in which more than 50% of the voting power for election of directors is held by an individual, a group or another company. Controlled companies are exempt from the listing requirements to have a majority of independent directors and from having fully independent compensation and nominating committees (but must have a fully independent audit committee).

Sponsors typically (82%) adopted a classified board structure for the newly-public company in connection with its IPO. In a classified board, directors are separated into a number of classes (typically three) that each serve "staggered," multi-year terms (typically three years), rather than a single class of directors where each director is elected on an annual basis.

- A classified board serves a number of functions: it helps ensure that the Sponsor is represented on the board for at least three years following an IPO since the last class will not be subject to election until the third year (assuming a three-year term) and it allows the Sponsor to retain some board representation following one or more offerings.

Use of Classified Boards



- Newly public companies adopting a classified board structure (especially if together with other defensive measures such as super-majority shareholder approval requirements) should understand that these practices are criticized by leading proxy advisory firms (ISS and Glass Lewis) due to concerns that such a structure limits the accountability of directors to shareholders. Directors should understand that they will receive a recommendation against their election at the annual meeting as a result of adopting these practices. Once the Sponsor fully or substantially exits, the portfolio company will come under increased pressure to eliminate the classified board and other provisions viewed as adverse to shareholder rights.

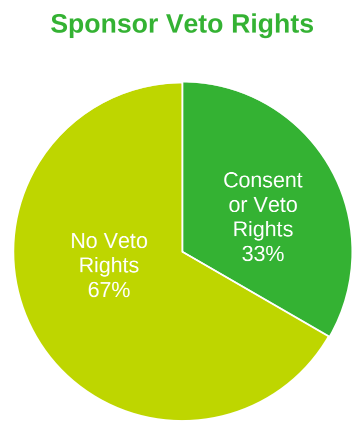
In a majority of the deals surveyed (64%), Sponsors secured contractual rights to nominate or designate directors to serve on the public company's board of directors (in some cases, including committees thereof) following an IPO.

These rights were typically structured as (1) a right for the Sponsor to nominate a certain number of directors to the board, (2) an agreement among pre-IPO shareholders to vote their shares in favor of a certain number of Sponsor nominees or (3) a combination of both.

- Generally, the number of directors a Sponsor was entitled to nominate or designate was proportional to (or otherwise tied to) its ownership position in the company post-IPO and fell away completely once the Sponsor's ownership level fell below a specified percentage of the company's outstanding equity (typically around 10%).

- A majority of the deals surveyed also provided that compensating Sponsor-designated directors was permitted (although typically not expressly required).

Sponsors sometimes secure a limited set of shareholder consent or veto rights over the public company taking certain actions following an IPO. In 45% of the surveyed IPOs, the Sponsor had consent or veto rights in its capacity as a shareholder with respect to the company taking certain actions following an IPO. In some cases, these consent and/or veto rights applied to a limited set of fundamental protections (e.g., amendments to important sections of the company's certificate of incorporation or bylaws, altering the size and/or composition of the board, change of control transactions, or effecting a voluntary liquidation). However, in other cases, a Sponsor's consent or veto rights extended to other more operational matters, including with respect to:



- Consummating acquisitions or dispositions in excess of a specified threshold and change of control transactions;
- Incurring indebtedness in excess of a specified threshold;
- Entering into new lines of business or materially changing existing lines of business;
- Appointing, removing or changing the compensation of certain senior executive officers;
- Initiating or settling litigation in excess of a specified threshold;
- Adopting a new equity incentive plan or modifying existing plans; and
- Effecting certain dividends, distributions, repurchases or redemptions of company shares.

Shareholder consent and veto rights provide an additional layer of protection for the Sponsor and permit the Sponsor to make decisions directly in its capacity as a shareholder.

These veto rights typically terminate when the Sponsor's equity ownership dropped below a specified threshold, sometimes as low as 10% of the company's outstanding shares.

In a minority of surveyed deals (18%), Sponsors were also able to secure special information rights or access to management.

No Sponsors secured the ability to assign their governance rights to a transferee. While in previous years Sponsors in a "club" deal secured such rights, no Sponsors in this year's survey had such rights. The ability to assign governance rights to a transferee could increase the value of a minority stake sold in a private transaction.

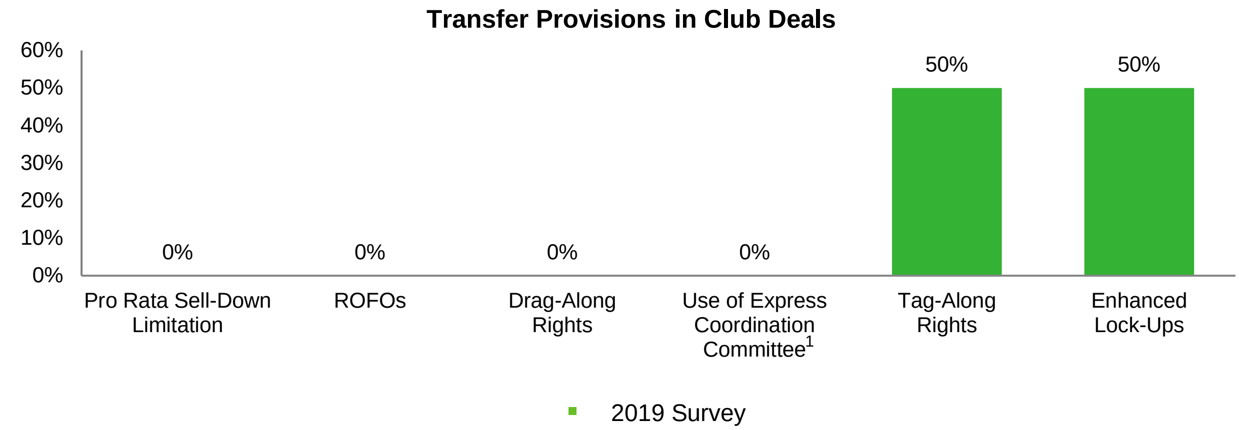
Sponsors typically included supermajority-voting requirements for the shareholders to take certain post-IPO actions in the organizational documents of the company. In 82% of the surveyed IPOs, the public company had supermajority-voting provisions that required a supermajority of the shareholders with respect to the company taking certain actions following an IPO. In most cases, the supermajority voting provisions applied to a limited number of fundamental protections.

In a majority of surveyed deals (73%), Sponsors successfully negotiated for a waiver of corporate opportunity (in favor of the Sponsor) provision in the post-IPO company's Charter in favor of the Sponsor. Delaware General Corporation Law permits a corporation to waive its expectancy in "specified business opportunities" in its organizational documents. By putting such waivers in place, Sponsors can mitigate some of the restrictions that would otherwise be imposed on their other businesses associated with holding one or more directorships on portfolio company boards.

LIQUIDITY

In both club deals and single-Sponsor deals, share transfer restrictions on pre-IPO shareholders (other than compliance with underwriters' lock-ups and compliance with securities laws) rarely continue post-IPO. Typically, transfer restrictions are more common in club deals, as Sponsor shareholders, who usually hold substantial stakes in the public company, wish to control the timing and volume of any sales of shares by other Sponsors to reduce the risk of "front running."

- In a majority of the club deals we surveyed, Sponsors included in post-IPO shareholder agreements some of the legal mechanisms typically included in private company shareholder agreements with respect to transfer restrictions, rights and obligations, as highlighted in the chart below.



[1] A coordination committee is designed to prevent "front-running" or uncoordinated selling by co-investors, each of which may adversely affect the market price of the public company's stock.

In each surveyed deal, Sponsors secured demand registration rights following an IPO. In all of the surveyed IPOs, the Sponsor had the right to demand registration of its company shares on at least one occasion following an IPO (and in the vast majority of cases for both single-Sponsor deals and club deals, the Sponsor(s) had a right to unlimited demand registrations or shelf registration rights). Sponsors also typically had piggyback registration rights on the registration of company shares by the company or another major shareholder. In a minority of surveyed deals (18%) certain management shareholders also received piggyback registration rights; however, they did not receive demand registration rights in any of the surveyed deals.

UP-C STRUCTURES

In 36% of surveyed transactions, companies adopted an "Umbrella partnership-C corporation" or "Up-C" structure (i.e., the publicly traded corporation is a holding company that holds an interest in another entity, typically an LLC, that holds all of the business' operating assets and liabilities). In such a structure, Sponsors typically would retain their economic ownership in the business through ownership of equity in the holding company LLC, which is a flow-through entity for tax purposes; at the time that the Sponsor wishes to dispose of all or a portion of their interest in the business, they would exchange the equity interests in the LLC holding company for shares of the publicly-traded corporate parent, which they would then transfer. While the Up-C structure introduces additional complexity, it allows Sponsors to achieve significant benefits through a tax receivable agreement, in which the post-IPO company agrees to pay to the Sponsor a percentage (typically, 85%) of the tax benefits that result from a step-up in tax basis created when equity interests in the LLC holding company are exchanged for shares of the publicly-traded corporate parent. While the ability to utilize an Up-C structure will depend significantly on the particular structure of a given portfolio company, it can, in the right circumstances, be a very attractive structure for Sponsors.

REPRESENTATIVE U.S. IPOs

CERIDIAN HCM HOLDING INC.	**SENTINEL ENERGY SERVICES INC.**	**RMG ACQUISITION CORP.**
ELANCO ANIMAL HEALTH INCORPORATED	**FEDERAL STREET ACQUISITION CORP.**	**MOSAIC ACQUISITION CORP.**
GORES HOLDINGS III, INC.	**GORES METROPOULOS, INC.**	**SWITCHBACK ENERGY ACQUISTION CORPORATION** *(COUNSEL TO UNDERWRITERS)*
NCS MULTISTAGE, LLC	**TPG PACE ENERGY HOLDINGS CORP.**	**TPG PACE HOLDINGS CORP.**

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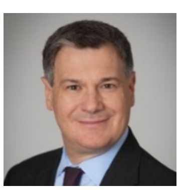
KEY CONTACTS



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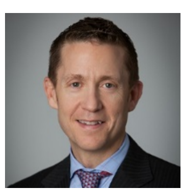

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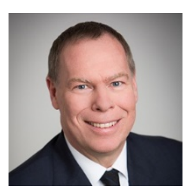

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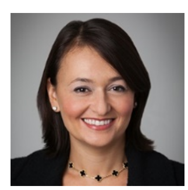

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