Summer 2025

MERCER CAPITAL | BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Fairness Opinions for Continuation Fund Transactions

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The Case for Fairness

Like most trends on Wall Street that are successful, too much capital finds its way to the asset and thereby depresses returns for late entrants. Private equity is in such a spot after a four-decade run that saw a niche become a large institutional asset class as interest rates trended lower, capital markets boomed, and valuation multiples expanded. Private equity's selling points have been returns that exceed public markets and limited price (i.e., mark) volatility with the trade-off being a lack of liquidity for LP investors. Harvesting of investments in years five to ten, on average, according to the model is when liquidity is realized via a return *of* and return *on* capital.

The harvest for LPs in recent years has been poor. According to Morgan Stanley, capital calls have exceeded distributions by $1.5 trillion since 2018. The issue is more than a couple years of sluggish IPO and M&A markets; rather, the industry deployed too much capital and paid too much for many investments. With upwards of one-half of US PE assets with a hold period over five years, the pipeline of companies to sell is akin to a parking lot according to industry observer Dan Rasmussen.

One of the attributes of US capital markets is the creativity of market participants, including GPs who can manufacture liquidity via:

- GP-led Secondaries
- Portfolio NAV Loans
- Dividend Recaps

Continuation funds address liquidity whereby GPs capitalize a new fund to purchase one or more assets from a fund the GP manages and thereby offer liquidity to LPs who want to cash-out or a vehicle for LPs to roll into who want to remain invested for upwards of another five years. Continuation funds have multiple corporate governance issues, but the most nettlesome is that of the GP as seller and buyer. Third party fairness opinions are more than a good governance protocol to follow. Fairness opinions are necessary to evaluate the process and terms of a GP-led secondary that the proposed consideration (or the transaction) is fair from a financial point of view to selling and rolling LPs. Absent that, a Limited Partner Advisory Committee ("LPAC") would be hard pressed to approve a conflict-of-interest waiver for the transaction to proceed.

The Evolving Market

Exits Boom

After six years of near zero rates, PE activity intensifies with robust capital raises, but exits outpace raises as PE funds realize stout exit multiples

2015-2016

2017-2019

Everything Works

Limited Fed rate hikes and corporate tax cuts support asset values and PE exits though capital raising exceeds distributions

Pandemic Shock

After an initial sharp drop in asset prices, markets begin a gradual recovery that accelerates late year as ZIRP, QE and stimulus drive rebounding values and booming IPO and M&A activity

2020

2021

Liquidity Market

The capital markets boom intensifies; US PE raises ~$400B vs ~$200B of distributions; SEC finalizes rule 2a-5 to update the process of how private fund advisors and BDCs determine fair value of illiquid assets

Inflation Surges

Rates spike due to inflation concluding the easy money era, markets and asset valuations sharply contract; SEC rule making proposes fairness opinions for GP-led secondary transactions

2022

2023

Exits Lagged

SVB collapse in March weighs on markets, traditional PE exits and secondaries in 1H23, but activity rebounds in 2H23 with $67B of GP/LP-led secondaries vs $43B in 1H23; SEC mandates third-party fairness opinions for GP-led secondaries

Secondaries Triumph

Fed eases, but not enough to trigger a boom in IPOs and M&A; secondaries become a booming asset class creating liquidity for LPs with $152B of GP-/LP-led secondaries vs ~$100B in 2022 and 2023

2024

Current Backlog & Solutions

According to the WSJ, over half of the ~30,000 companies represented in private equity portfolios have been held for more than five years. Fund tenure typically is for ten years excluding two one-year extension options a GP may elect. Estimates vary, but with ~1,500 of annual exits the industry has a liquidity issue as older investments approximate one-half of the industry's ~$4 trillion of assets and will take years to monetize absent fire sale pricing. Pitchbook estimates that the ratio of investments to exits during 1H25 was 3.1x, up from 2.6x in 2024 and 1.8x in 2015.

While IPO and M&A activity improved during the first half of 2025, secondaries are set for another record year as LPs access the market to sell interests and GPs access the market to generate liquidity for LPs who want it while moving assets into new vehicles with the expectation (or hope) that a materially higher exit price can be realized in a few years.

While a secondaries market for private equity interests has existed for decades, the stars have aligned in recent years that "secondaries" have become a stand-alone asset class rather than a subset of private equity investing. The market consists of two components:

- GP-led led secondaries whereby a GP will hire a financial advisor to solicit offers from institutional investors (i.e., secondary investors) to capitalize a continuation fund to purchase one or more assets from an existing fund while also offering a cash-out option to LPs who desire liquidity
- LP-led secondaries involve LPs selling interest to existing LPs, new LPs (subject to governance hurdles) and occasionally GPs

Motivations will vary. For LPs, the need for liquidity and/or doubt about the viability of an asset or portfolio to produce sufficient returns to remain invested will drive the decision. For GPs, the decision to capitalize a continuation fund will be driven by a view that the exit market will be better in the future and/or the subject asset(s) will produce attractive returns over the extended holding period. Also, the extended holding period will produce more fees and carry. For all market participants, one measuring stick will be the transaction price as a percent of the asset's carrying value or fund's NAV. ***Discounts incurred by sellers represent potential return to buyers, perhaps a discount for lack of marketability ("DLOM," i.e., illiquidity), or recognition of a mismarked asset via the bloodless verdict of the market***.

What is a Continuation Fund?

- **What:** A specialized fund to acquire and continue managing certain portfolio companies from an existing fund beyond its typical lifespan, allowing LP investors to either sell their interest to generate liquidity or roll into the new fund to potentially realize more value

- **Who**: Created by the GP of the existing private equity fund who, in effect, sits on both sides of a transaction as seller and buyer. It is most common for the GP of the legacy fund to remain as the GP of the continuation fund

- **When**: At or near the end of the initial fund time horizon (e.g., 10-12 years)

- **Why**: To satisfy two* camps of LPs:
  - Those who prefer liquidity and are ready to sell
  - Those who want to remain invested to potentially realize greater returns (or who don't like the offer price)

  LPs can also do partial liquidation, a hybrid of the above – taking some chips off the table while also maintaining a lesser exposure

More on Continuation Funds

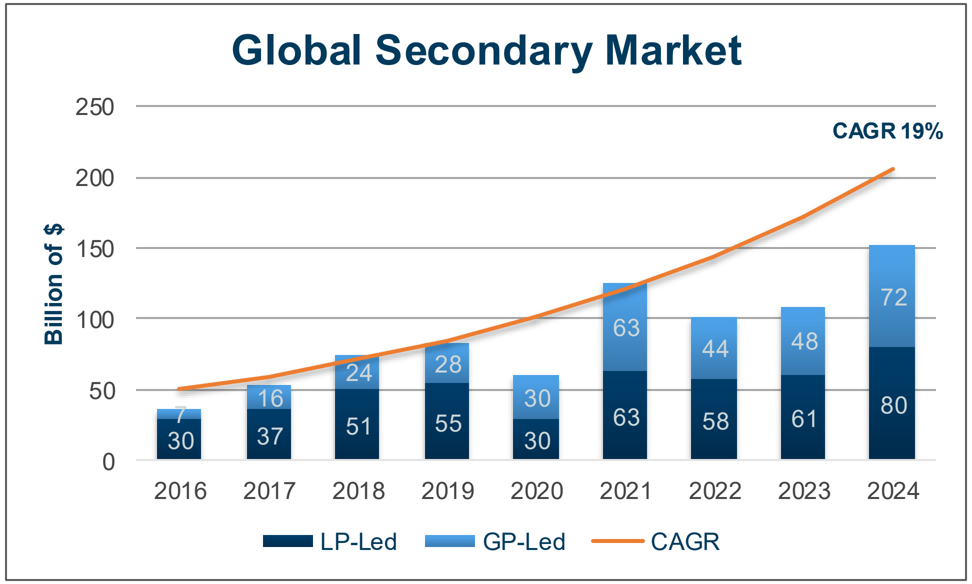
- Are continuation funds common?
  - Over the last 10 years, continuation funds have evolved to be a well-established exit route for private fund sponsors
  - According to Lazard, GP-led secondary volume accounted for 48% of $150 billion of deal volume in 2024 compared to 44% of $109 billion in 2023
- What is the history of continuation funds?
  - Historically, continuation funds were used for distressed assets that were struggling in the aftermath of the 2008 global financial crisis – they were then known as “restructuring funds” or “zombie funds”
  - Now continuation funds are used for “trophy assets” to extend the investment period to potentially realize substantially more value vs a current sale
- How does the process work?
  - Typically, the GP hires an investment banker to market the asset(s) to institutional investors to thereby obtain multiple indications of value
  - Price and especially terms may vary as some bidders may propose a syndication to raise sufficient capital
  - The LPAC hires a financial advisor to review the process and express an opinion of fairness to thereby approve a conflict-of-interest waiver
- How can conflicts of interest be managed?
  - In 2023, the Institutional Limited Partner Association (ILPA) issued guidance for industry-wide best practices
  - Best practice is for the LPAC to appoint an independent advisor both on legal and valuation (e.g., Mercer Capital fairness opinion)
  - In most continuation funds that closed in 2023, GPs reinvested 100% of their carried interest in line with the ILPA Guidance
- Are these transactions complex?
  - Yes – in addition to convoluted structures on both the buy and sell side, these transactions commonly include earn-out provisions
  - Securing consents from existing LPs, lenders, and portfolio companies is time-intensive and requires detailed disclosures
  - Designing the continuation fund's legal form, jurisdiction, fees, and carried interest requires balancing existing and new investors' interests

The Rise of Continuation Funds

The increase in interest rates during 22-23 and ~70bps increase in long-term rates during 4Q24 has weighted on IPO and M&A activity and thereby limited PE exits after an extended period of heavy investment such that it will take upwards of a decade to monetize over $4T of existing investments.

Source: S&P Global Market Intelligence

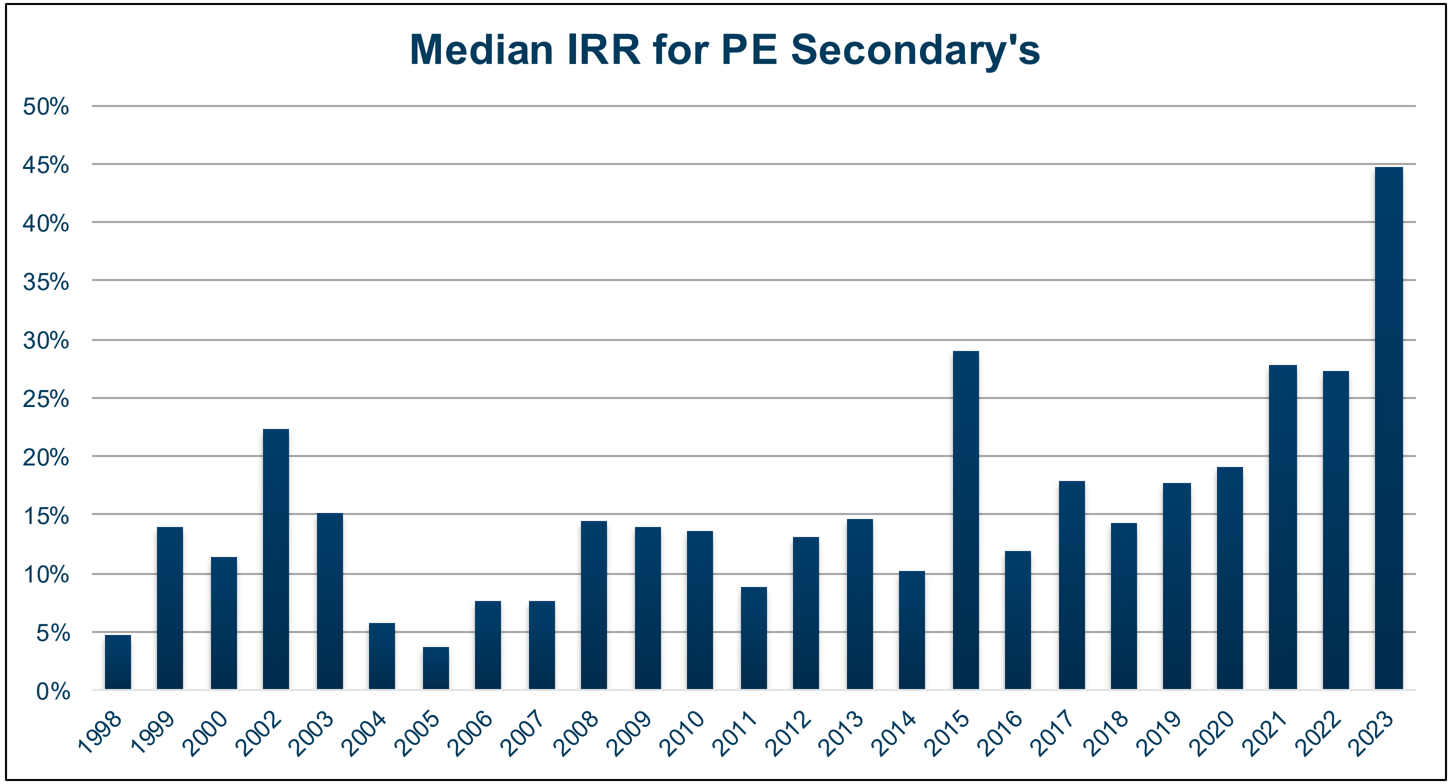
The secondaries market has experienced dramatic growth and is expected to continue as deal making remains low. Continuation funds have a CAGR of 34% highlighting their increased demand.



Source: Lazard

Returns of Continuation Funds

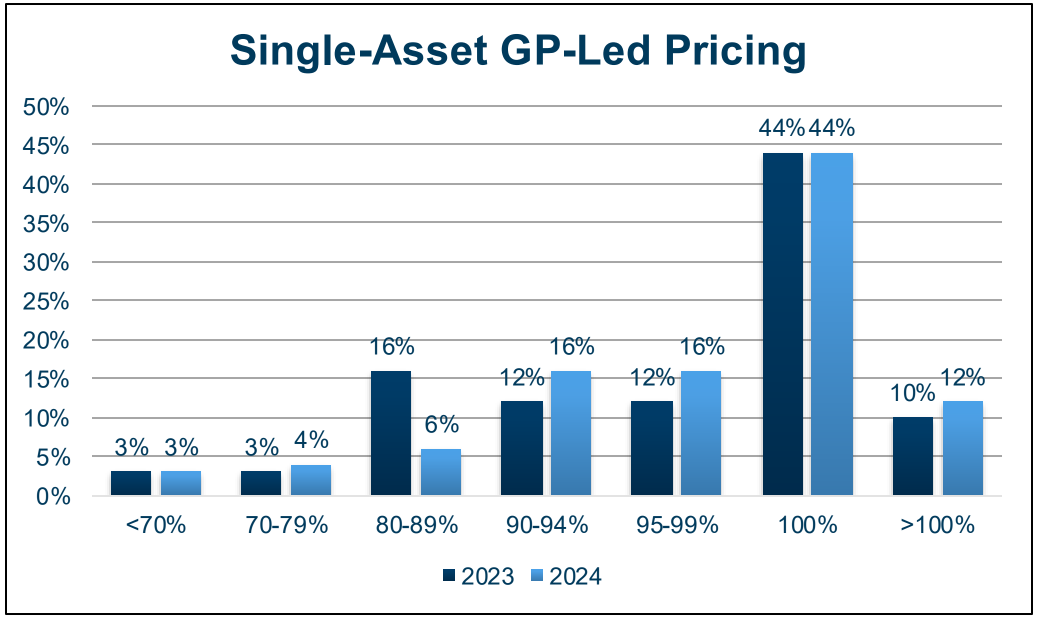
Throughout the 21st century secondary funds have shown positive results. Market events such as the energy bust of 2015 and the spike in rates during 2022-2023 provide a backdrop for higher returns as acquisition prices all else equal are lower (i.e., the market saw, "bought righ t is half right"); however, the absence of negative returns (on average) could lead one to conclude that purchase prices are too low.



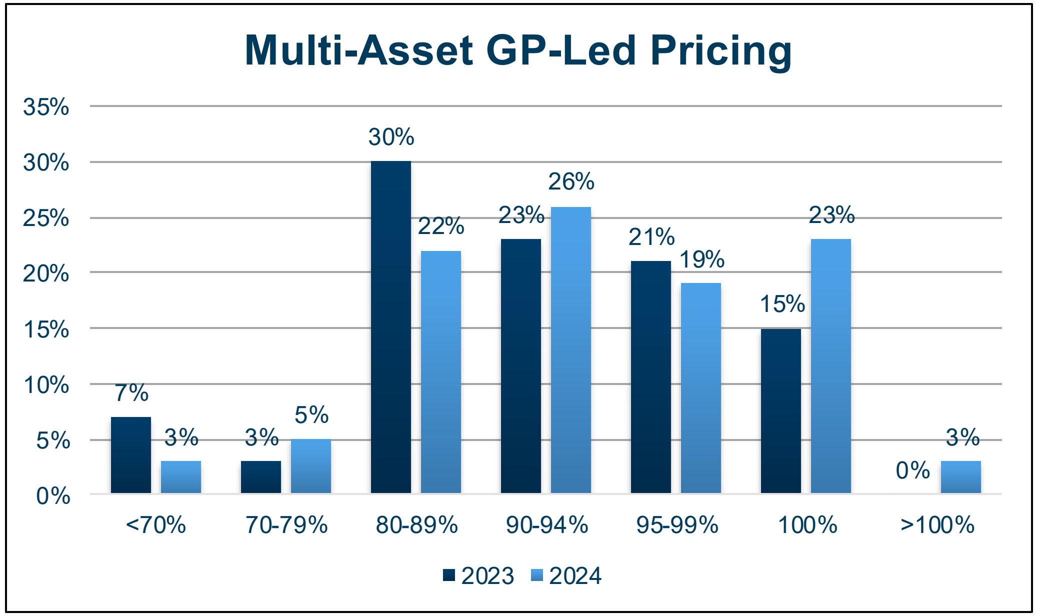
Source: Pitchbook

Pricing for Continuation Funds

Data indicates a significant dispersion of pricing as a percent of NAV whether a single-asset or multi-asset GP-led transaction … Pricing that approximates NAV or that occurs at a significant discount does not necessarily affirm or disprove fairness of a proposed GP-led transaction



Source: Lazard



Source: Lazard

ILPA Best Practices and Fairness Opinions

- **Principle:** Continuation funds should maximize LP value while ensuring that rolling LPs are no worse off because of the transaction
- **How:** To demonstrate transparency, the GP should disclose all necessary information to the LPAC and LPs (e.g., GP should fully disclose all conflicts, and a third-party fairness opinion should be obtained to determine the price and terms are fair prior to the conflict-of-interest waiver)
- **When:** The GP should involve LPAC through the whole process and engage with experienced advisors to facilitate the transaction
- **Disclosure:** Rolling LP's should experience the same deal structure as the existing fund terms or better if applicable
- **Significance:**
  - Forces the GP to justify their rationale, outlook, capital needs, fund duration, and exit strategy to create transparency and thereby reduce the likelihood of litigation with disgruntled LPs
  - LPACs must delve into conflict-of-interest issues as part of the transaction vetting process before providing a conflict waiver to the GP
  - A comprehensive process should be run akin to a corporate board's "Revlon duties" to ensure fair pricing and terms
  - Although not mandated, a third-party financial advisor should review the proposed transaction process, consideration to be paid, terms and other aspects of a proposed transaction to provide an independent opinion of value and fairness (Note: in June 2024, the 5th U.S. Circuit Court of Appeals overturned an SEC rule adopted in 2022 that mandated fairness opinions from an independent advisor under the Private Fund Advisor Rules on the basis that the SEC over-stepped its rule-making authority)

What is a Fairness Opinion?

- **What:** a professional opinion about whether the consideration to be paid/received in a merger/acquisition or other significant corporate transaction is "fair" (i.e., reasonable, within the expected range, etc. and not that it is the best obtainable value/outcome)
- **Who**: Provided by an investment bank or other financial advisor (e.g., Mercer Capital) that all else equal will carry more weight if the opinion provider did not negotiate the transaction for which it will receive a success fee
- **When**: Typically provided immediately before the board approves the transaction while sometimes an affirming "take-down" opinion is provided immediately prior to closing (excludes M&A with public companies as the legal view is the deal was agreed when signed and any material changes would be covered in the MAE clause in the merger agreement)
- **Why**: Fairness opinions are regularly obtained by boards, special committees and other fiduciaries to gain a comprehensive understanding of the financial aspects of a transaction and to demonstrate they have made their decision with due care

Are fairness opinions "required"?

- No - but fairness opinions have become de rigueur ever since the Delaware Supreme Court ruled in Smith v Van Gorkum (1985) that the Trans Union board breached its fiduciary obligation to carry out its "duty of care" by approving a merger without adequate information
- In that case, even though the purchase offer represented a 50% premium over the pre-deal trading price, the court held that the board acted with gross negligence and imposed personal liability on its directors
- In response to that ruling, boards have routinely sought fairness opinions to demonstrate that they have thoroughly considered the transaction terms and, thus, have satisfied their fiduciary duties
- Courts have found that relying in good faith on fairness opinions is one way that a board can demonstrate that it met its duty of care

Fairness

A board's fiduciary duty to shareholders is encapsulated by three mandates:

- Act in Good Faith
- Duty of Care (informed decision making)
- Duty of Loyalty (no self-dealing; conflicts disclosed)

There are three standards of review for Delaware corporations:

- Business Judgment Rule
- Enhanced Scrutiny
- Entire Fairness

Directors are generally shielded from courts second guessing their decisions by the ***business judgment rule*** provided there is no breach of duty to shareholders. The presumption is that non-conflicted directors made an informed decision in good faith. As a result, the burden of proof that a transaction is not fair and/or there was a breach of duty resides with the plaintiffs.

However, the burden of proof shifts to the directors if it is determined there was a breach of duty. If so, the decision will be judged based upon the ***entire fairness standard***—i.e., fair price *and* fair dealing.

The intermediate ***enhanced scrutiny*** standard of review covers possible conflicts of interest that may impact decision making. The standard is most often applied when a board moves to sell a company, cash out certain shareholders, or block a hostile takeover by adopting defensive measures.

Fairness Opinions for Continuation Funds

A third party fairness opinion that is supported with a comprehensive fairness (and valuation) analysis is a key threshold item for an LPAC to obtain to provide a conflict-of-interest waiver for a GP to proceed with a proposed transaction.

Key Points

- Reinforces fiduciary duty and builds LP confidence in the process followed by the GP and the transaction advisor
- May shield the LPAC and GP from potential legal exposure
- De facto necessary for the LPAC to provide the GP with a conflict-of-interests waiver

Why Fairness Opinions Matter

- Provides independent financial assessment of whether deal terms are fair to LPs
- Assists LPACs in evaluating a course of action that may not be crystal clear or even controversial
- Often commissioned by LPACs as part of best practice under ILPA guidance

About Mercer Capital

Mercer Capital is a national valuation and financial advisory firm that was founded in 1982. Clients include private and public companies, financial institutions, private equity/credit funds, asset managers, high-net worth families and trustees. With over 40 years of valuation experience Mercer Capital has completed more than 15,000 engagements that includes hundreds of fairness opinions provided for a range of clients by industry and transaction type.

Our suite of services encompasses two integrated service areas: valuation advisory and opinions & financial advisory services.

- Sell-Side Advisory Services
- Buy-Side Advisory Services
- Fairness & Solvency Opinions
- Strategic Advisory
- Quality of Earnings Analysis

- Corporate M&A
- Capital Raising (*re pricing*)
- Recapitalization
- ESOP Advisory
- Bankruptcy & Restructuring Analysis

The valuation advisory & opinions and financial advisory service lines are interrelated. The technical discipline of providing well-grounded valuation opinions is buttressed by real world experience gained in providing advisory services. Likewise, the market-centered orientation of financial advisory services has as its foundation a keen understanding of valuation drivers.

Recent Representative Transactions

Business First Bancshares, Inc.

b1BANK

Baton Rouge, Louisiana

has agreed to acquire

Progressive Bancorp, Inc.

PROGRESSIVE BANK

Monroe, Louisiana

Mercer Capital served as financial advisor to Progressive Bancorp, Inc.

— **July 2025** —

Y-12 Federal Credit Union

Y-12 CREDIT UNION

Oak Ridge, Tennessee

has acquired

First State Bank of the Southeast

FSB First State Bank

Middlesboro, Kentucky

Mercer Capital served as financial advisor to Y-12 Credit Union.

— **July 2025** —

innovations FINANCIAL CREDIT UNION

Panama City, FL

has acquired

FIRST NATIONAL BANK NORTHWEST FLORIDA

Panama City, FL

Mercer Capital provided valuation and advisory services to Innovations

— **August 2024** —

ASPIRANT

Louisville, KY

has partnered with

point·c

Chicago, IL

Mercer Capital served as financial advisor to Aspirant

— **May 2024** —

U.S. Based Manufacturer of Flow Control and Process Equipment

Mercer Capital rendered a solvency opinion for the manufacturer related to payment of a $200 million dividend following the sale of a business unit

— **June 2024** —

Specialty Construction Materials Dealer / Distributor

Mercer Capital served as financial advisor to the seller in connection with an $81 million transaction

— **May 2024** —

The Neverleak Company LP

ROOF FLASHINGS SINCE 1943

Olive Branch, MS

sold the majority of its assets to

NPG NORTH PARK GROUP

Chicago, IL

Mercer Capital served as financial advisor to The Neverleak Company LP

— **April 2024** —

Levo Credit Union

Sioux Falls, SD

has announced it's intent to acquire a bank branch in Sioux City, Iowa from

HERITAGE BANK N.A. Employee Owned

Spicer, MN

Mercer Capital served as financial advisor to Levo

— **April 2024** —

HOSE of South Texas, Inc.

www.hose-etc.com

Corpus Christi, Texas

has formed a partnership with

TIPCO TECHNOLOGIES Focused Flexible Solutions

Owings Mills, Maryland

Mercer Capital served as financial advisor to Hose of South Texas

— **April 2024** —

WORLDWIDE ELECTRIC CORPORATION

ROCHESTER, NY

has acquired

North American Electric

Hernando, MS

Mercer Capital served as the financial advisor to North American Electric.

— **January 2024** —

Apex BANK

Camden, TN

has acquired two branches from

United Community Bank

Greenville, SC

Mercer Capital served as the exclusive financial advisor to Apex Bank

— **July 2023** —

CAMBER ENERGY

Houston, TX

has agreed to acquire the remaining ~39% common share interest in

Viking Energy Group, Inc.

Houston, TX

Mercer Capital rendered a fairness opinion on behalf of Camber Energy

— **April 2023** —

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