

Private Equity Fund of Funds & Secondaries – Certification Quiz Questions

Module SEC-02 – More Advanced LP-Led Secondary Deal Analysis (4-Hour Case Study)

15. You are now completing a more advanced analysis of a different LP-led secondary deal. To do this, you are evaluating Wellington Fund IV, which focuses on buyouts and growth equity deals in technology and healthcare.

The GP acquired an 18.5% stake in NetSentra, a cybersecurity company specializing in AI-driven endpoint protection, in FY 19. Over the next few years, its ownership was diluted down to 15.0% due to frequent Equity issuances to other investors and a lack of pro-rata follow-on investments from the GP.

Your current ~5-year forecast for NetSentra is shown in the image below this question. If the company raised additional Equity to offset its negative Free Cash Flow rather than drawing on Debt, how would the forecast change?

	A	B	C	D	J	K	L	M	N	O	P
					LTM	Projected:					
	Cash Flow Projections:			Units:	2024-09-30	2024-12-31	2025-12-31	2026-12-31	2027-12-31	2028-12-31	2029-12-31
42											
43											
44											
45				\$ M	\$ 770.1	\$ 821.2	\$ 1,026.5	\$ 1,242.0	\$ 1,465.6	\$ 1,700.1	\$ 1,938.1
46				%	34.4%	32.2%	25.0%	21.0%	18.0%	16.0%	14.0%
47											
48				\$ M	(290.9)	(298.9)	(205.3)	(124.2)	-	85.0	193.8
49				%	(37.8%)	(36.4%)	(20.0%)	(10.0%)	-	5.0%	10.0%
50											
51				\$ M	(35.1)	(37.0)	(44.1)	(52.2)	(60.1)	(68.0)	
52				%	4.6%	4.5%	4.3%	4.2%	4.1%	4.0%	
53											
54				\$ M	43.5	46.3	28.5	19.0	13.9	12.2	
55											
56				\$ M	(282.5)	(289.6)	(221.0)	(157.4)	(46.2)	29.2	
57				\$ M	(7.2)	-	-	-	-	(7.3)	
58				\$ M	(289.7)	(289.6)	(221.0)	(157.4)	(46.2)	21.9	
59				\$ M	35.1	37.0	44.1	52.2	60.1	68.0	
60				\$ M	285.5	210.0	195.0	183.2	178.8	175.9	
61				\$ M	(1.9)	(3.3)	(7.2)	(12.4)	(17.6)	(25.5)	
62				\$ M	29.0	(45.9)	11.0	65.6	175.1	240.2	
63											
64				\$ M	-	-	45.9	40.4	7.6	-	
65				\$ M	-	45.9	(5.5)	(32.8)	(7.6)	-	
66				\$ M	-	45.9	40.4	7.6	-	-	
67											
68				\$ M	798.0	926.0	724.5	555.0	412.8	405.4	
69				\$ M	29.0	(45.9)	11.0	65.6	175.1	240.2	
70				\$ M	-	45.9	(5.5)	(32.8)	(7.6)	-	
71				\$ M	(166.7)	(201.5)	(175.0)	(175.0)	(175.0)	(150.0)	
72				\$ M	660.3	724.5	555.0	412.8	405.4	495.6	
73											
74				x	NM	NM	NM	NM	NM	NM	
75											
76				\$ M	1,463.1	1,470.2	1,691.1	1,848.5	1,894.7	1,865.6	
77				\$ M	365.8	367.5	422.8	462.1	473.7	466.4	

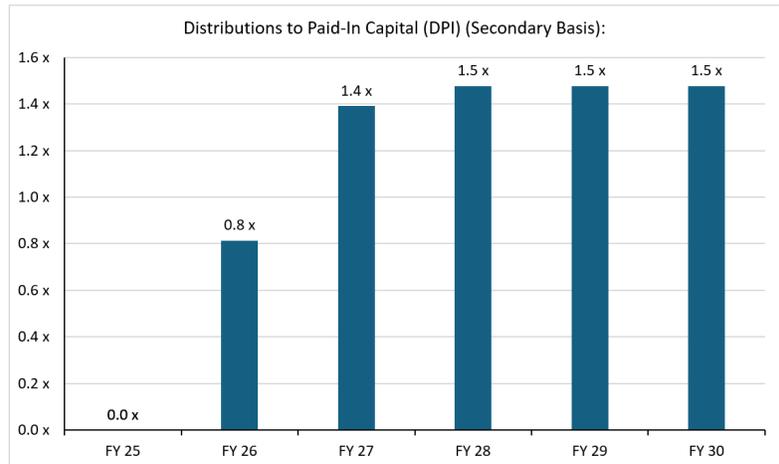
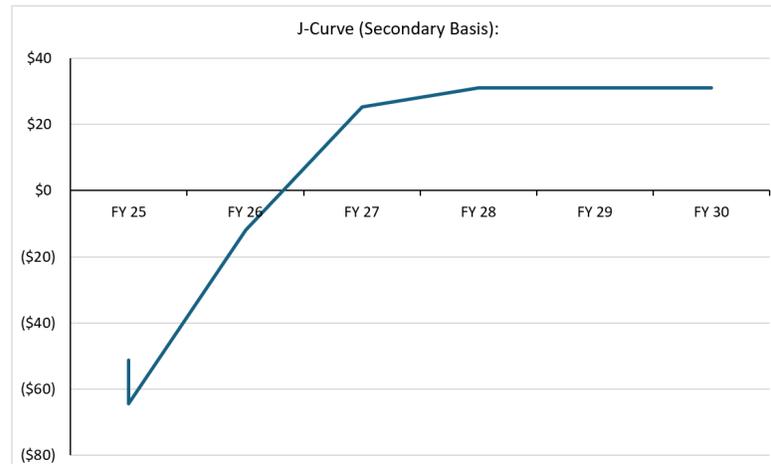
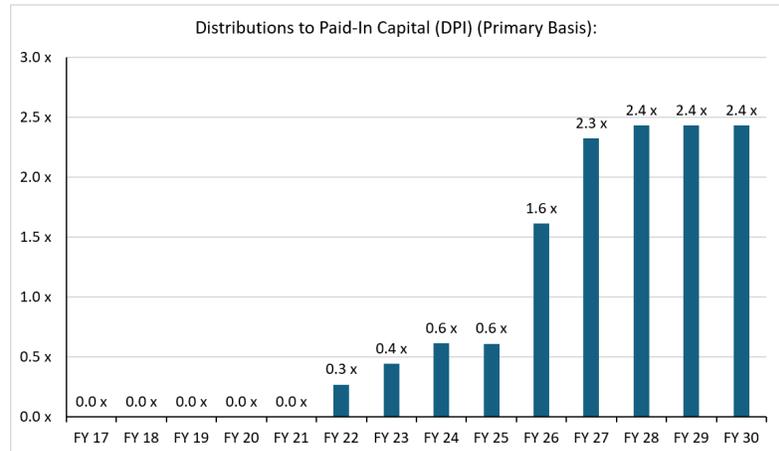
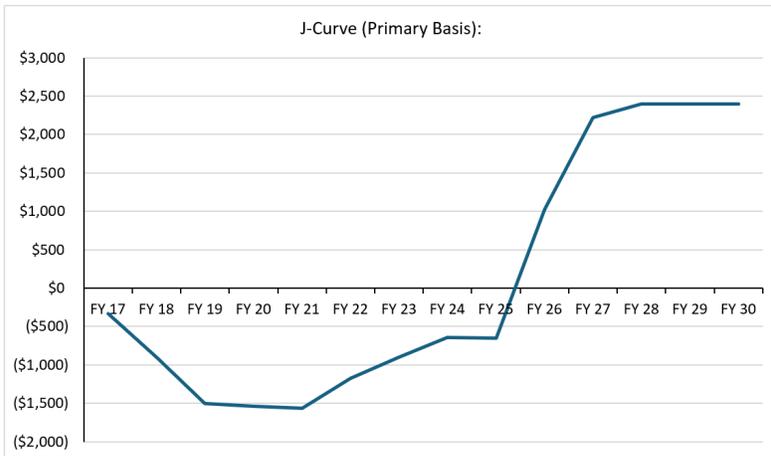
- The Interest Expense would be much lower with less Debt, so the NOL balance would also grow to a much lower value by the end.
- The PE firm's ownership upon exit would be slightly less than 15.0%, depending on the terms attached to the Equity.
- The revenue growth rates might be substantially higher by the end of the forecast period (e.g., the 20%+ range) since the company would be able to re-invest more of its FCF into future growth opportunities.
- The company's ROIC would likely improve, boosting its EBITDA exit multiple.

16. You are still working on an analysis of this secondary deal involving a stake in Wellington Fund IV.

Below this question are images representing the fund’s J-Curve and DPI evolution on both a Primary and Secondary basis. The secondary deal is set to close in the middle of FY 25.

This PE fund’s portfolio is currently marked at a 2.5x Gross MOIC just before the secondary deal, and the buyer and seller are discussing a possible 5% Bid Discount and 20% Purchase Price Deferral, payable ~9 months after the deal closes. The Secondary Basis graphs reflect both these deal terms.

Based on this information and the graphs below, which of the following statements is **MOST ACCURATE?**



- a. The original, selling LPs are highly dependent on the valuation and other terms in this secondary deal because the Primary J-Curve is negative and the Primary DPI is below 1.0x through FY 25.
 - b. The original LPs that retain their stake rather than selling in the secondary deal appear to earn higher returns than the new secondary investors because their final DPI is higher.
 - c. The original LPs that sell in this secondary deal are likely to lose money because of the negative J-Curve through the expected close date.
 - d. Both the Bid Discount and the Purchase Price Deferral make a significant difference on the Secondary DPI Evolution and the J-Curve.
17. The returns calculations for the new secondary investors in this deal are shown in the image below this question.

The deal, currently with a 5% Bid Discount and 20% Purchase Price Deferral attached, meets your firm's 1.5x TVPI and 20% Net IRR targets, even without fund recycling.

However, the selling LPs are reluctant to accept these terms because they will earn only a ~12% Net IRR due to the discount and timing, which is below their 15% target.

How could you address this point and revise the deal terms so that your firm still achieves its 1.5x TVPI and 20% Net IRR targets while boosting the selling LPs' Net IRR closer to 15%?

	A	B	C	D	E	F	G	H	I	J
79										
80	Returns Calculations:			<i>Units:</i>	2024-12-31	2025-03-31	2025-12-31	2026-12-31	2027-12-31	2028-12-31
81										
82			(-) Upfront Purchase Price:	\$ M		(51.2)	-	-	-	-
83			(-) Deferred Purchase Price:	\$ M		-	(12.8)	-	-	-
84			(-) Management Fees:	\$ M		-	(0.3)	(0.3)	(0.2)	-
85			Called Amount:	\$ M		(51.2)	(13.1)	(0.3)	(0.2)	-
86										
87			Distribution:	\$ M		-	-	53.3	54.3	7.0
88			(-) Carried Interest:	\$ M		-	-	(0.7)	(16.7)	(1.4)
89			Net Distribution:	\$ M		-	-	52.6	37.6	5.6
90										
91			Net Cash Flow:	\$ M		(51.2)	(13.1)	52.3	37.4	5.6
92										
93			Total Value to Paid-In Capital (TVPI):	x		1.48 x				
94			Net Internal Rate of Return (IRR):	%		20.7%				
95										
96			TVPI with Recycling:	x		1.48 x				
97			Net IRR with Recycling:	%		20.7%				
98										

- A Purchase Price Deferral over multiple years or for more than 20% of the total price might fix this issue.
- Your firm could offer a Bid Premium to the selling LPs in exchange for reduced Management Fees and Carry in the forecast period, which would boost the Net Cash Flows for both LP groups.
- You could offer a Bid Premium to the selling LPs, but only if the GP agrees to exit its portfolio companies earlier than planned, which should boost your firm's Net IRR.
- There are no great options; only a Bid Premium combined with significantly higher exit values for the portfolio companies in the secondary period would resolve this.