Up-C IPOs and Tax Receivable Agreements

April 1, 2025

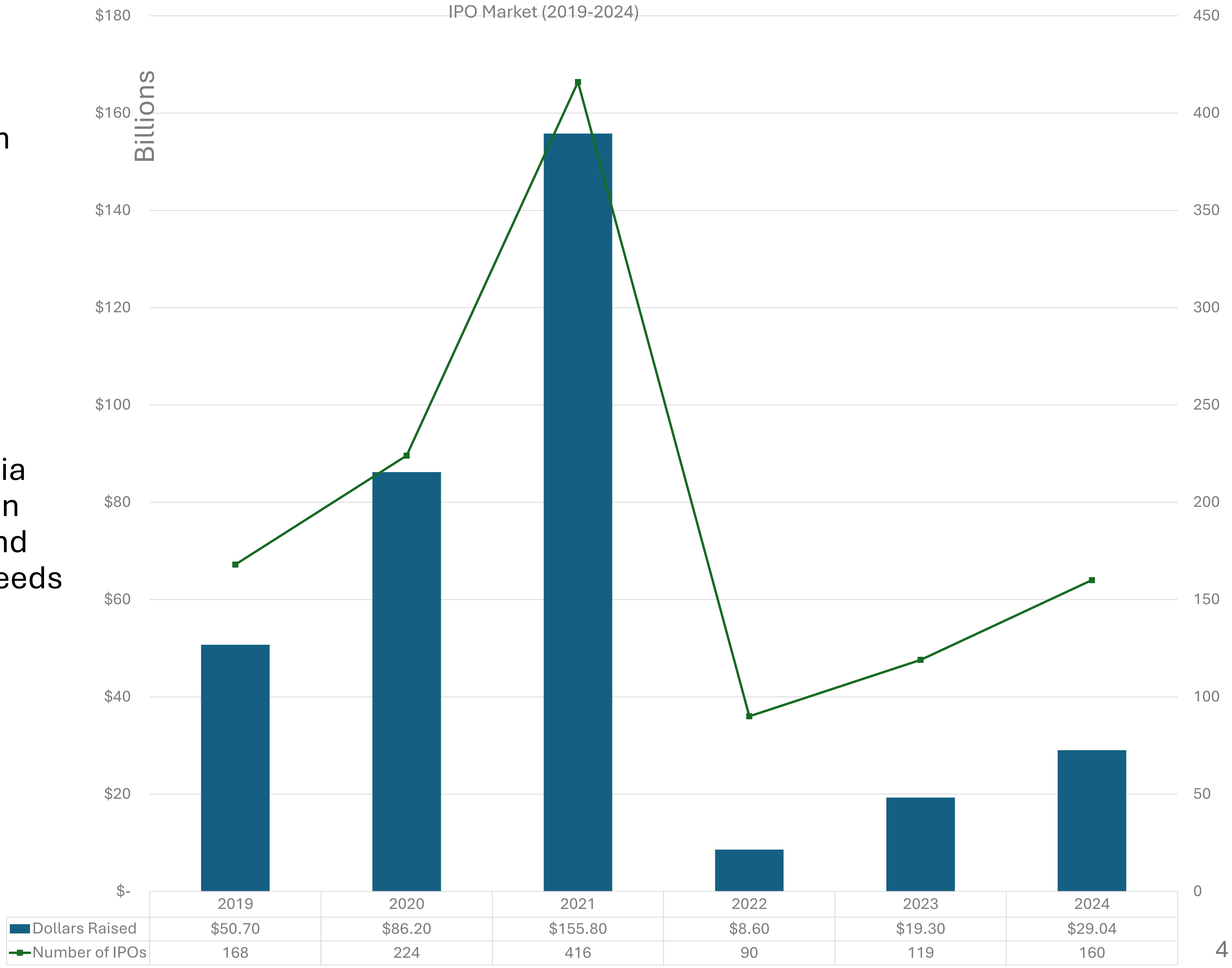
Agenda

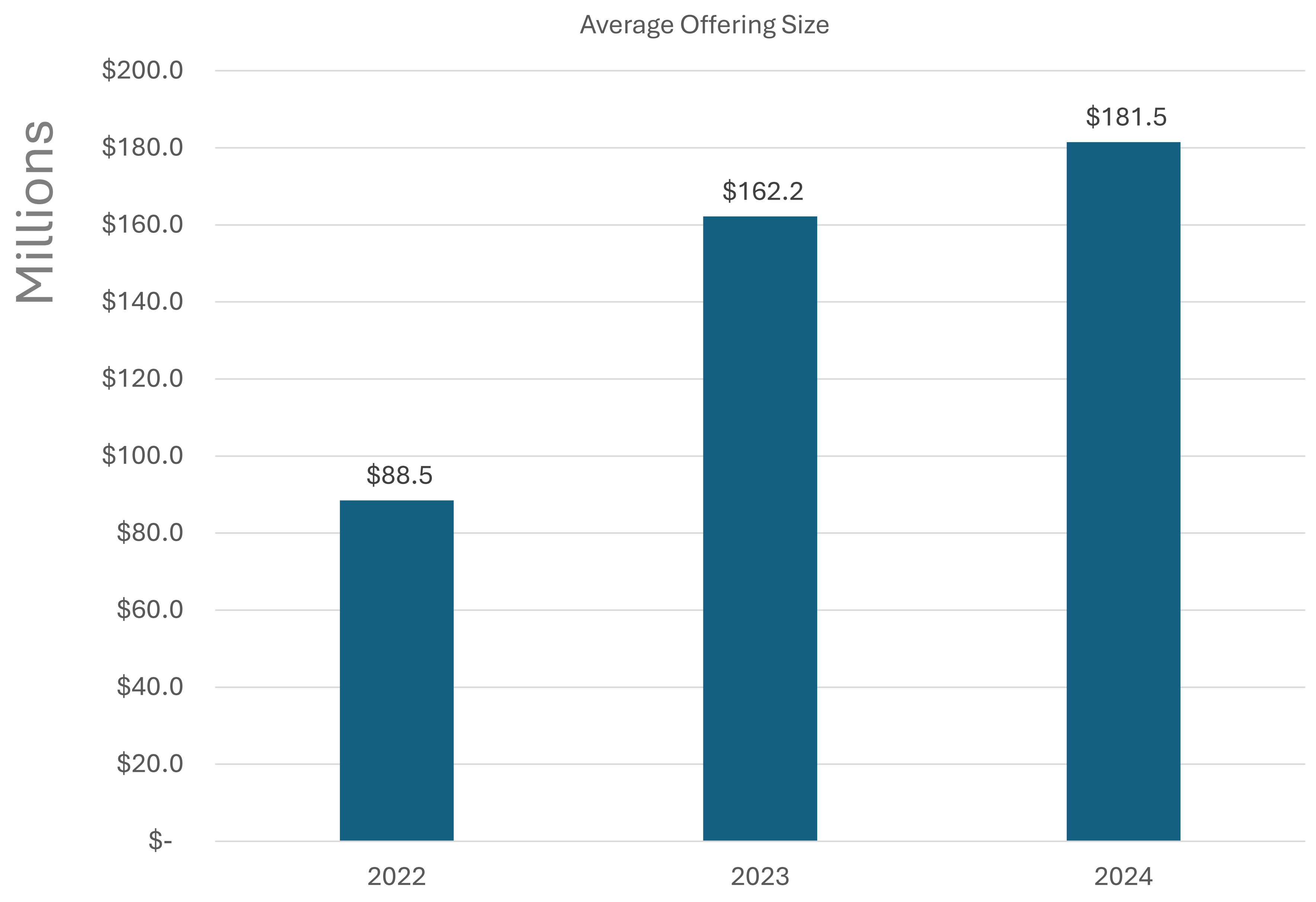
- Market developments and overview
- Basics of the structure
- Tax receivable agreement
- Securities law and corporate governance considerations
- Acquisition alternatives
- Unwinding an Up-C structure
- Certain litigation involving Up-C structures

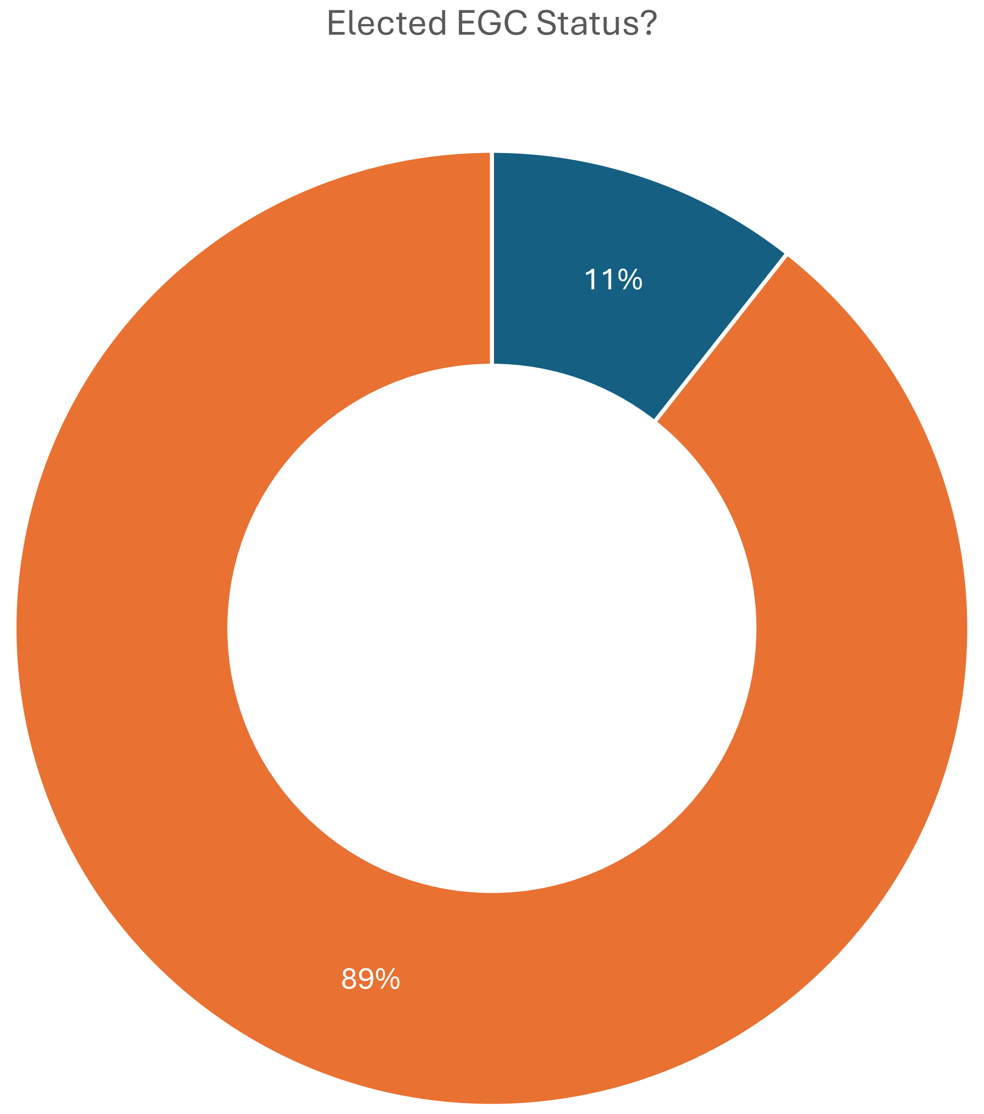
Market Developments

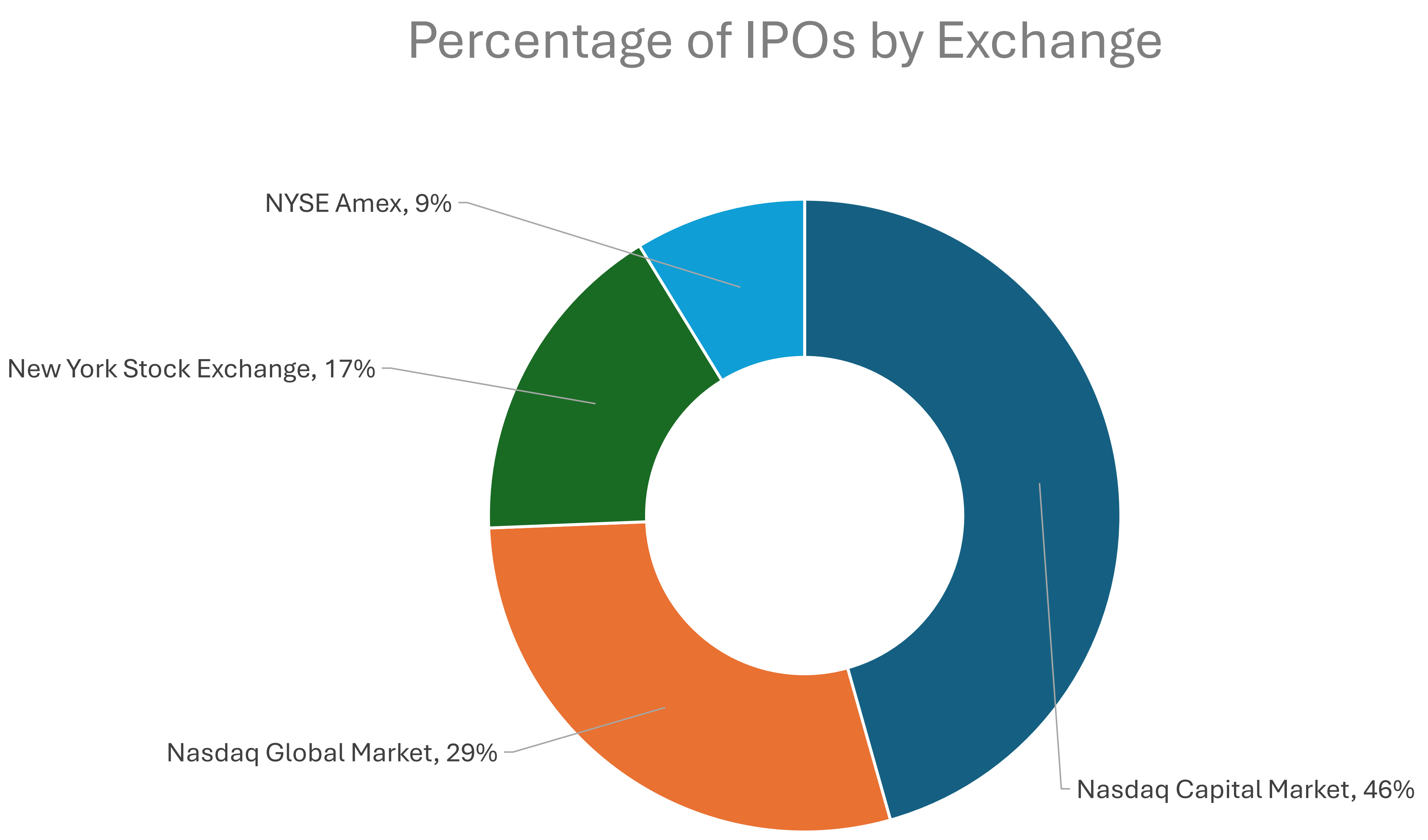
IPO Trends

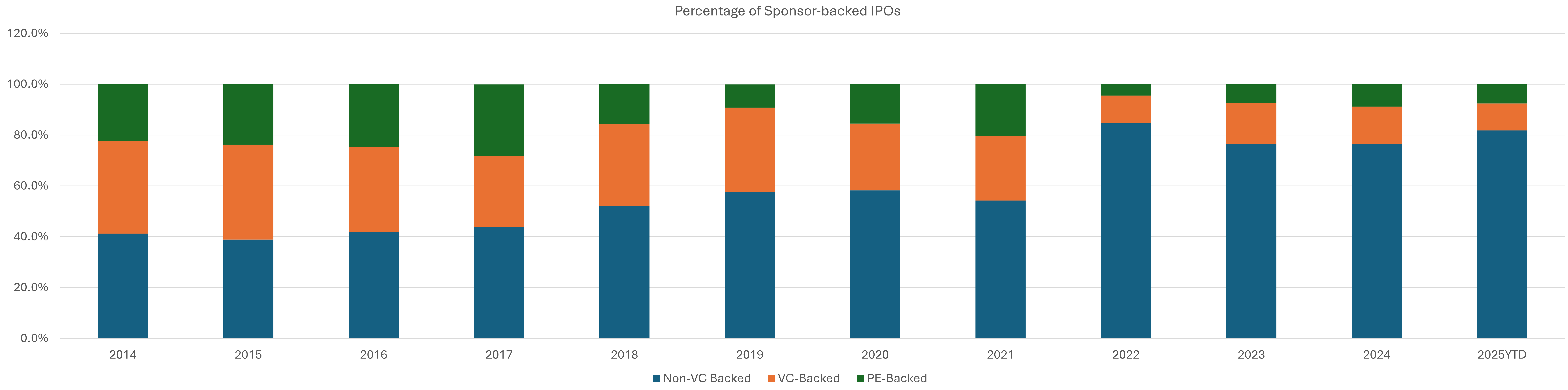
- In 2024, US IPO activity increased--in both the number of IPOs and the proceeds raised--compared to the previous year.
- The number of IPOs jumped by 38%. Proceeds rose by 48%, with 20 deals raising more than $500 million and seven deals topping $1 billion
- The healthcare and technology, media and telecom (TMT) sectors led IPOs in 2024, accounting for 61% of deals and 49% of proceeds for deals with proceeds of over $50 million.
- The US IPO market is improving, and there is renewed focus by both regulators and legislators on capital formation.




Average Offering Size
Millions
$200.0
$180.0
$160.0
$140.0
$120.0
$100.0
$80.0
$60.0
$40.0
$20.0
$-
$88.5
$162.2
$181.5
2022
2023
2024

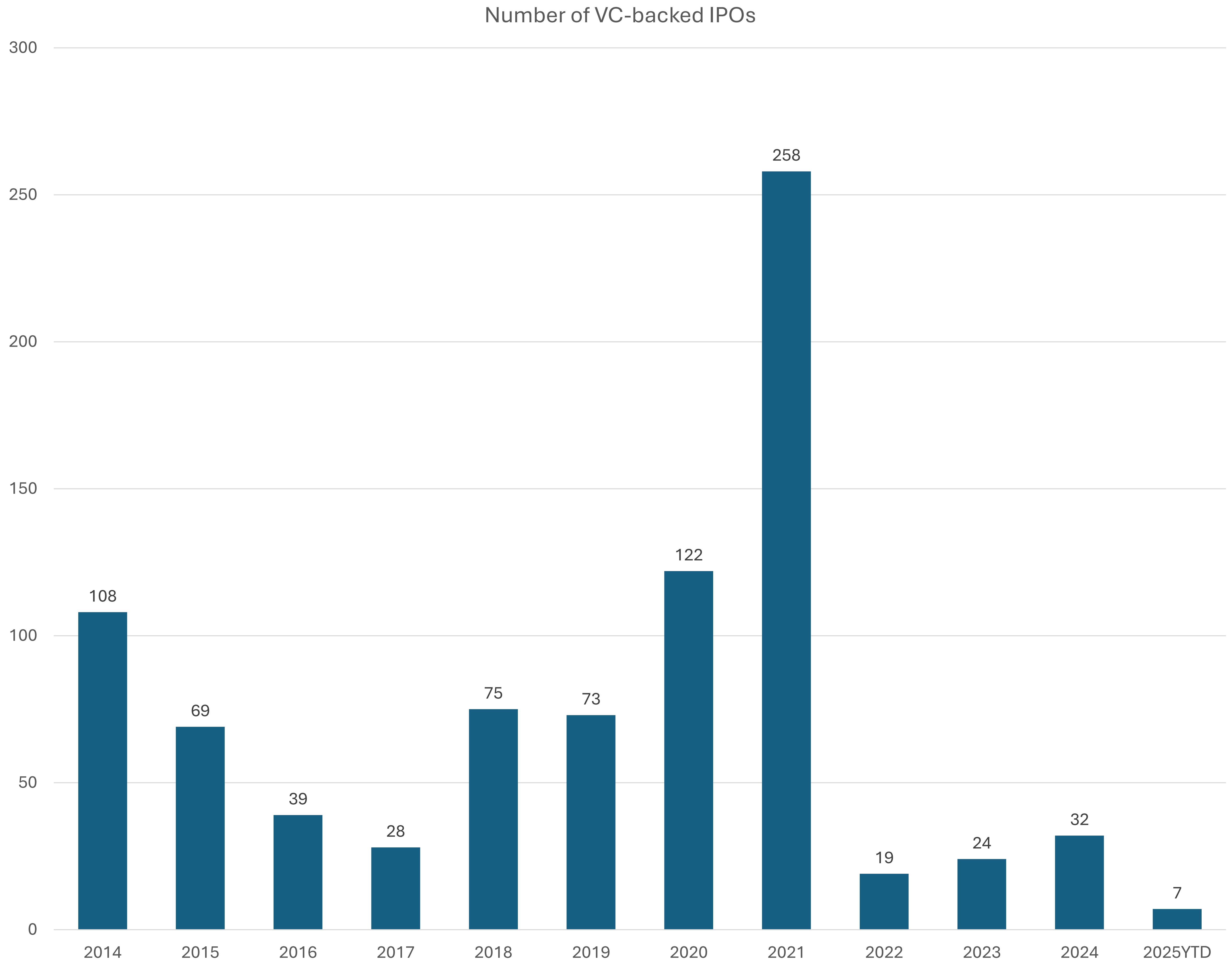

Elected EGC Status?
11%
89%


Percentage of IPOs by Exchange
NYSE Amex, 9%
New York Stock Exchange, 17%
Nasdaq Global Market, 29%
Nasdaq Capital Market, 46%


Percentage of Sponsor-backed IPOs
120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025YTD
Non-VC Backed
VC-Backed
PE-Backed

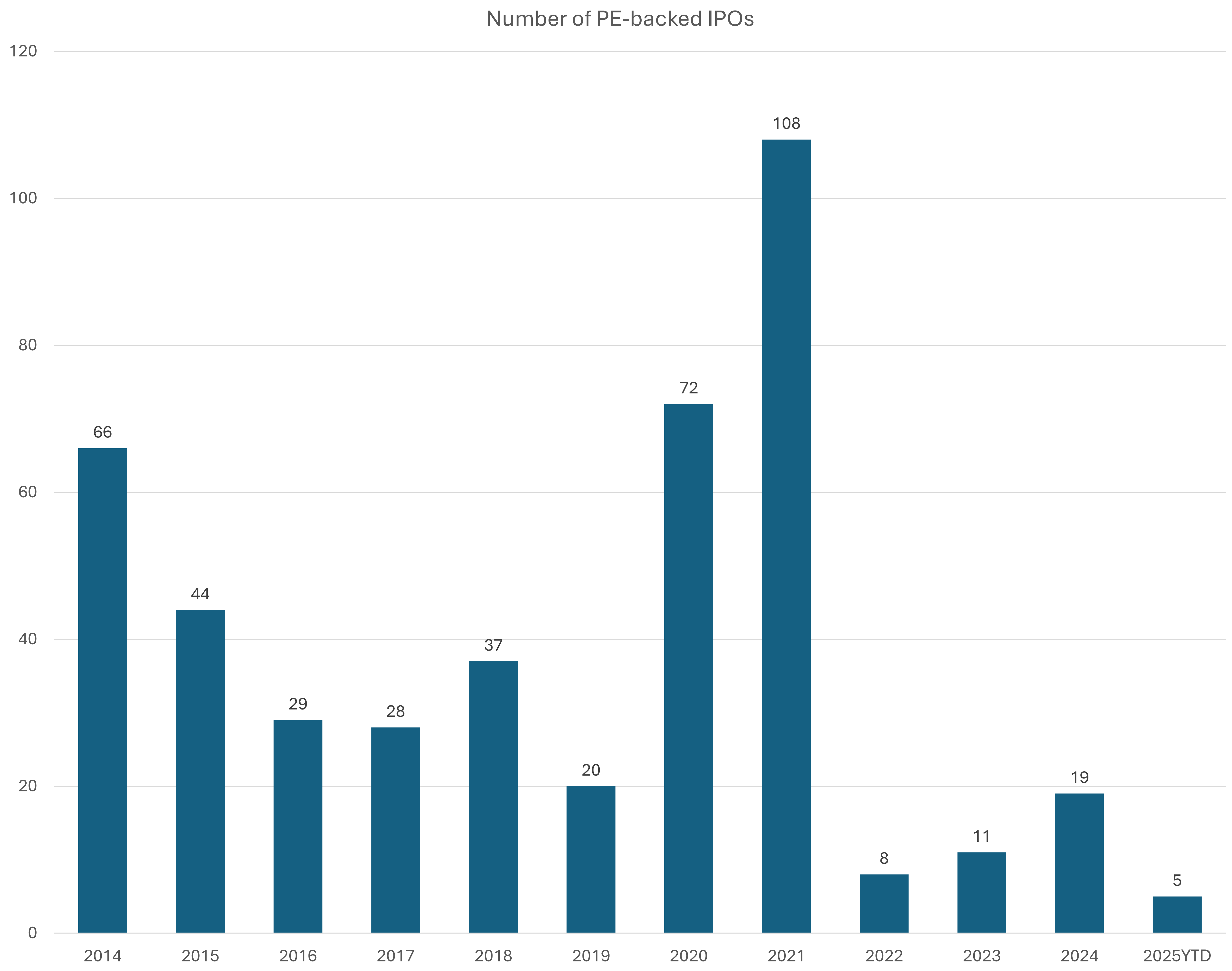
VC-backed IPOs

- Sponsor-backed IPOs (backed by either venture capital (VC) or private equity (PE)) represented nearly 30% of US exchange IPOs in 2024 compared with just 17% in 2023.
- The number of VC-backed IPOs grew steadily. Since the tail end of the pandemic, VC-backed IPOs have increased by 68%.
- In 2024, the number of VC-backed IPOs reached 32, a 33% increase over 2023.
- Up-C structures are most often employed by entities that are sponsor-backed so these trends are highly relevant.



PE-backed IPOs

- Given the relative dearth of private equity exits over the past few years, sponsors are expected to be active in the IPO market as the overall exit environment improves.
- Since 2022, PE-backed IPOs increased by 138%. Year-over-year, PE-backed IPOs increased by 33% to 19.



Up-C Structure: An Overview

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Overview: Primer on Tax Pass-Thrus

- Corporations are subject to 21% federal income tax; shareholders are subject to tax on dividends received at 37% maximum rate (20% for "qualified dividends")
- The Internal Revenue Code creates various pass-thru entities (no entity level tax; owners include share of income or distributions):
  - Partnerships (general partnerships, limited partnerships or limited liability companies under state law) that are not publicly traded
  - Publicly traded partnerships that engage in certain activities, such as oil and gas production
  - Real estate investment trusts ("REITs")—corporations for tax purposes that hold mostly real estate assets like real estate or mortgages and earn mostly passive income
  - Regulated investment companies ("RICs")—corporations for tax purposes that hold securities and earn mostly passive income

Common Theme

- Taxpayers generally gravitate over time to structures that optimize the different entity taxation regimes
- They will use tax pass-thru structures to the extent possible, with only those activities that must be in corporate form in corporations

The Basics of the Up-C Structure

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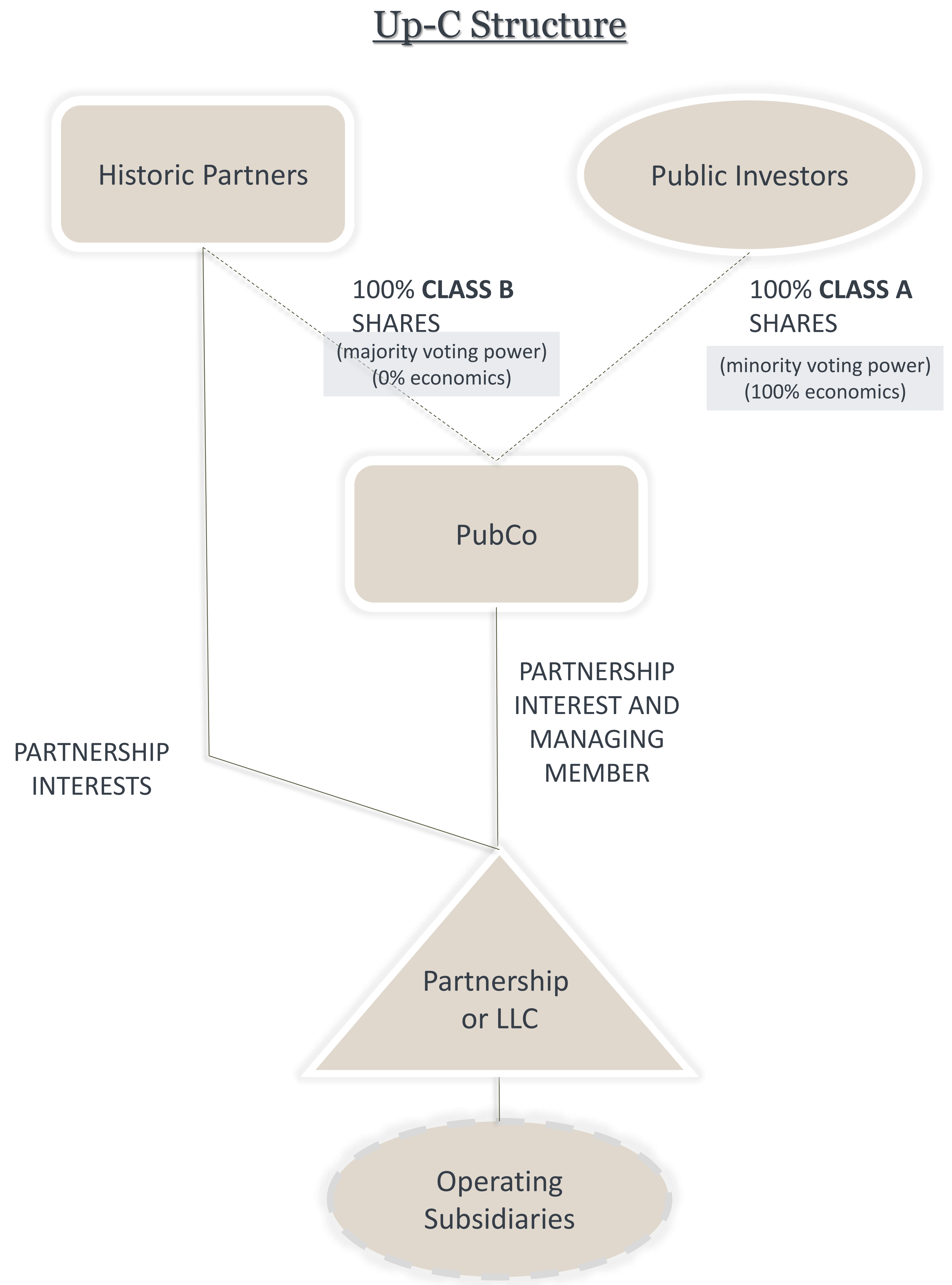
Up-C

- The Up-C structure is common for IPOs of companies that have historically operated as partnerships
- The Up-C structure derives its name from the UPREIT structure. Essentially, a newly formed corporation (“PubCo”) will be the entity that undertakes the IPO
- PubCo will sit above an existing limited liability company (the “LLC”)
- PubCo will be a holding company and will have as its subsidiary the LLC
- The principal assets/operating business will continue to be at (or below) the LLC level
- PubCo will receive the IPO proceeds and downstream the IPO proceeds to the LLC



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Examples of Up-C IPOs

- INFINITY NATURAL RESOURCES
  (2025, Oil & Gas)
- SMITH DOUGLAS HOMES
  (2024, Construction)
- CLARIOS (PRIVATE BUT WITH A TRA)
  (2024, Manufacturing)
- ONESTREAM
  (2024, Software)
- TWFG INSURANCE
  (2024, Insurance)
- HMH HOLDING
  (2024, Oil & Gas)
- FLOWCO
  (2024, Manufacturing)
- NEXTRACKER
  (2023, Software)
- BIRKENSTOCK (TRADITIONAL IPO BUT WITH A TRA)
  (2023, Retail Products)
- REAL GOOD FOOD COMPANY
  (2021, Food & Beverage)
- SOLO BRANDS
  (2021, Retail Products)
- FLUENCE ENERGY
  (2021, Energy storage)
- ENFUSION
  (2021, Software)
- PORTILLO'S
  (2021, Food & Beverage)
- STRONGHOLD DIGITAL MINING
  (2021, Cryptocurrency Mining)
- CLEARWATER ANALYTICS HOLDINGS
  (2021, Software)
- BRILLIANT EARTH GROUP
  (2021, Retail Products)
- DUTCH BROS
  (2021, Food & Beverage)
- DEFINITIVE HEALTHCARE CORP.
  (2021, Software)
- RANI THERAPEUTICS HOLDINGS
  (2021, Biotech)
- POWERSCHOOL HOLDINGS
  (2021, Education)
- CORE & MAIN
  (2021, Consumer Services)
- XPONENTIAL FITNESS
  (2021, Gyms)
- RYAN SPECIALTY GROUP HOLDINGS
  (2021, Insurance)

Examples of Up-C IPOs *(cont'd)*

- ZEVIA PBC
  (2021, Food & Beverage)
- ENDEAVOR GROUP HOLDINGS
  (2021, Entertainment)
- BUMBLE
  (2021, Mobile App)
- BIOVENTUS
  (2021, Healthcare)
- SIGNIFY HEALTH
  (2021, Healthcare)
- VIANT TECHNOLOGY
  (2021, Software)
- MARAVAI LIFESCIENCES HOLDINGS
  (2020, Biotech)
- MCAFEE CORP.
  (2020, Software)
- STEPSTONE GROUP
  (2020, Financial Services)
- ROCKET COMPANIES
  (2020, Financial Services)
- GOHEALTH
  (2020, Insurance)
- ROYALTY PHARMA PLC
  (2020, Biotech)
- SHIFT4 PAYMENTS
  (2020, Software)
- ZOOMINFO TECHNOLOGIES
  (2020, Software)
- ONEWATER MARINE
  (2020, Consumer Products)
- BRP GROUP
  (2019, Insurance)
- BELLRING BRANDS
  (2019, Food & Beverage)
- SMILEDIRECTCLUB
  (2019, Healthcare)
- CHANGE HEALTHCARE
  (2019, HealthTech)
- SCIPLAY CORP
  (2019, Software)
- GREENLANE HOLDINGS
  (2019, Consumer Products)
- TRADEWEB MARKETS
  (2019, Financial Services)

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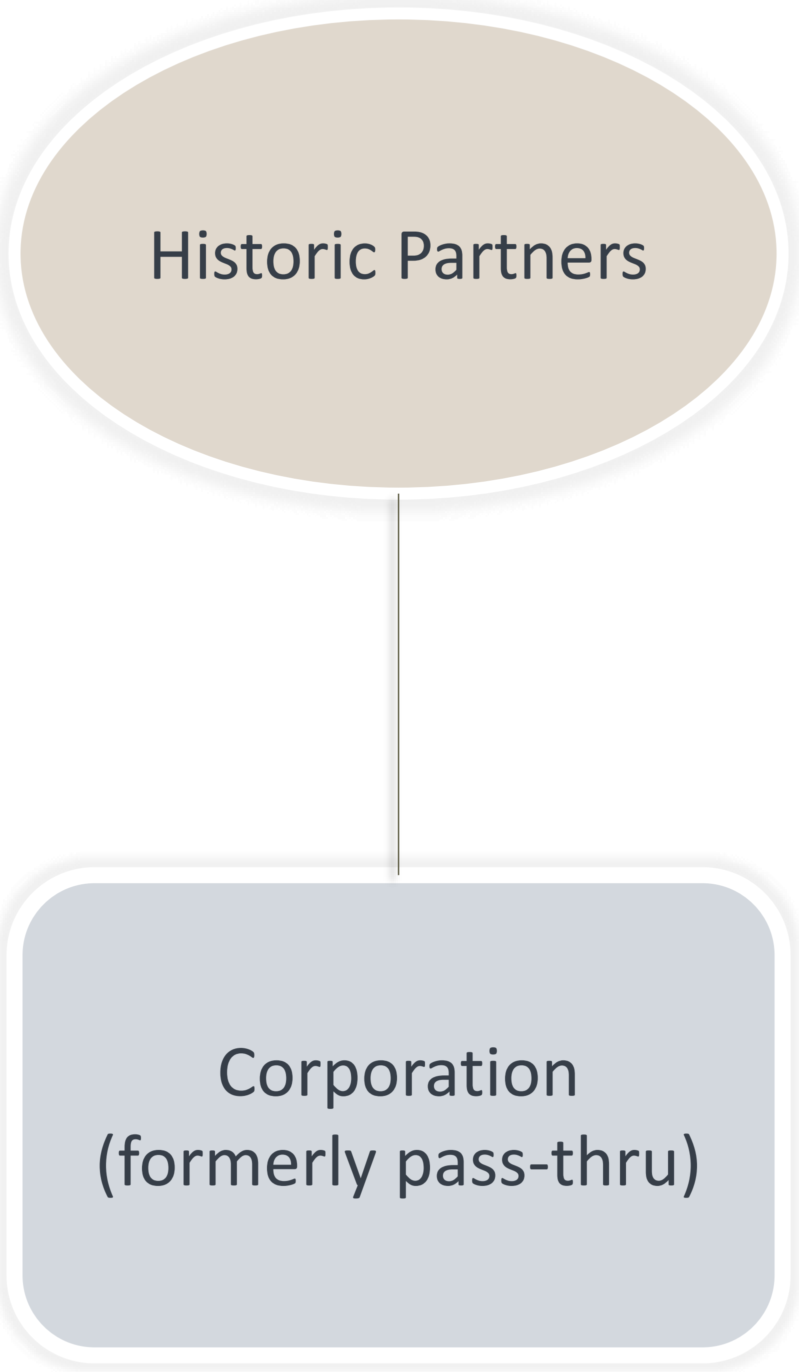
Examples of De-SPAC Up-Cs

- An Up-C structure also may be employed in the context of a de-SPAC transaction and during the SPAC and de-SPAC boom, there were numerous examples of such transactions, including, for example, the following:

  - VERDE CLEAN FUELS
    (Renewable Energy)
  - INTUITIVE MACHINES
    (Space Exploration)
  - ALVARIUM TIEDEMANN HOLDINGS, INC.
    (Financial Services)
  - BITCOIN DEPOT
    (Financial Services)
  - NETPOWER
    (Clean Energy)
  - CIBUS
    (Agricultural Biotech)
  - FLYEXCLUSIVE
    (Aviation)
  - FALCON'S BEYOND
    (Entertainment)
  - ZEO ENERGY
    (Renewable Energy)
  - INNVENTURE
    (Financial Services)
  - SWIFTMERGE
    (Financial Services)

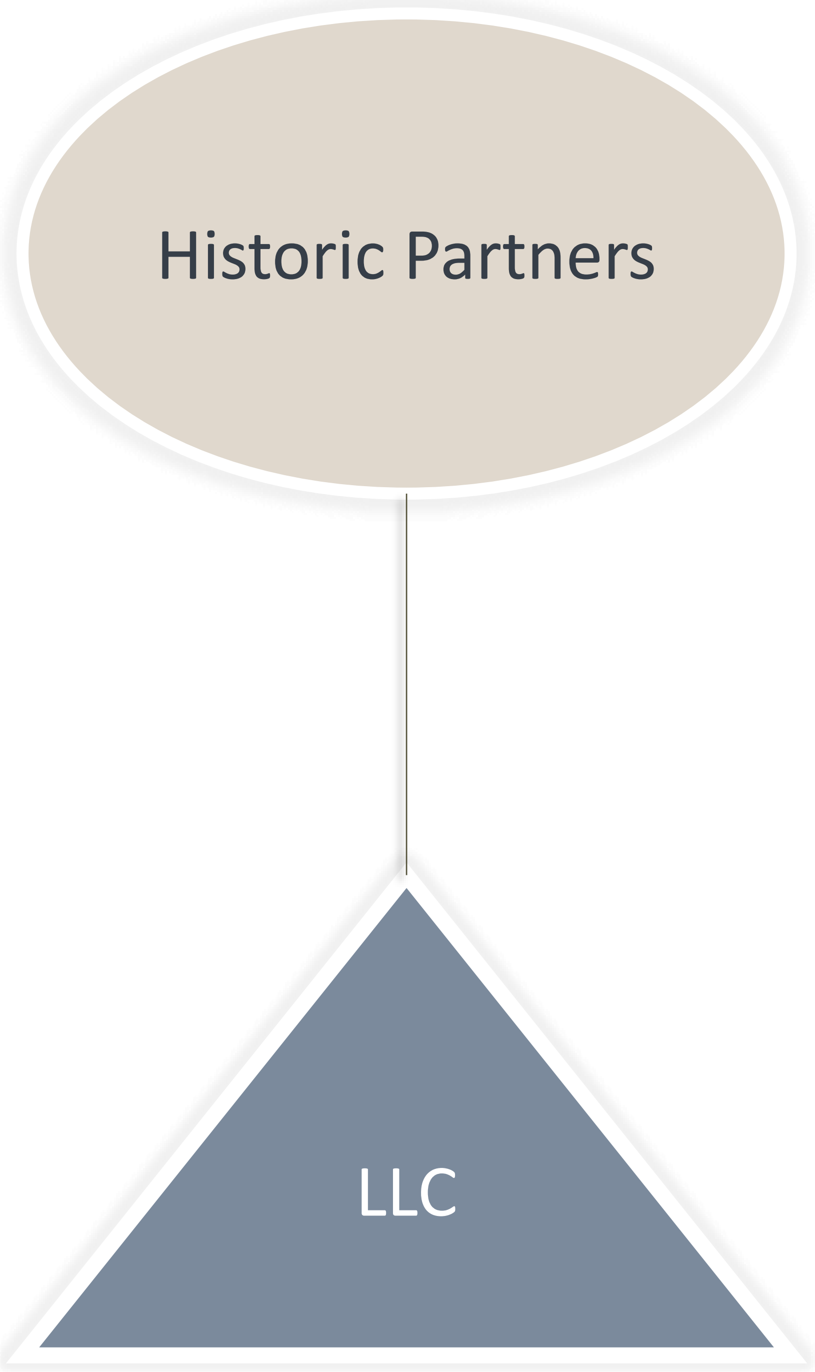
Typical Pre-IPO structure – Corporation



Disadvantages

- After pass-thru is converted to a corporation, income from operating subsidiaries subject to entity-level tax when earned by the corporation
- Historic partners (and other shareholders) subject to tax when they receive dividends

Typical Pre-IPO structure – Partnership



Advantage

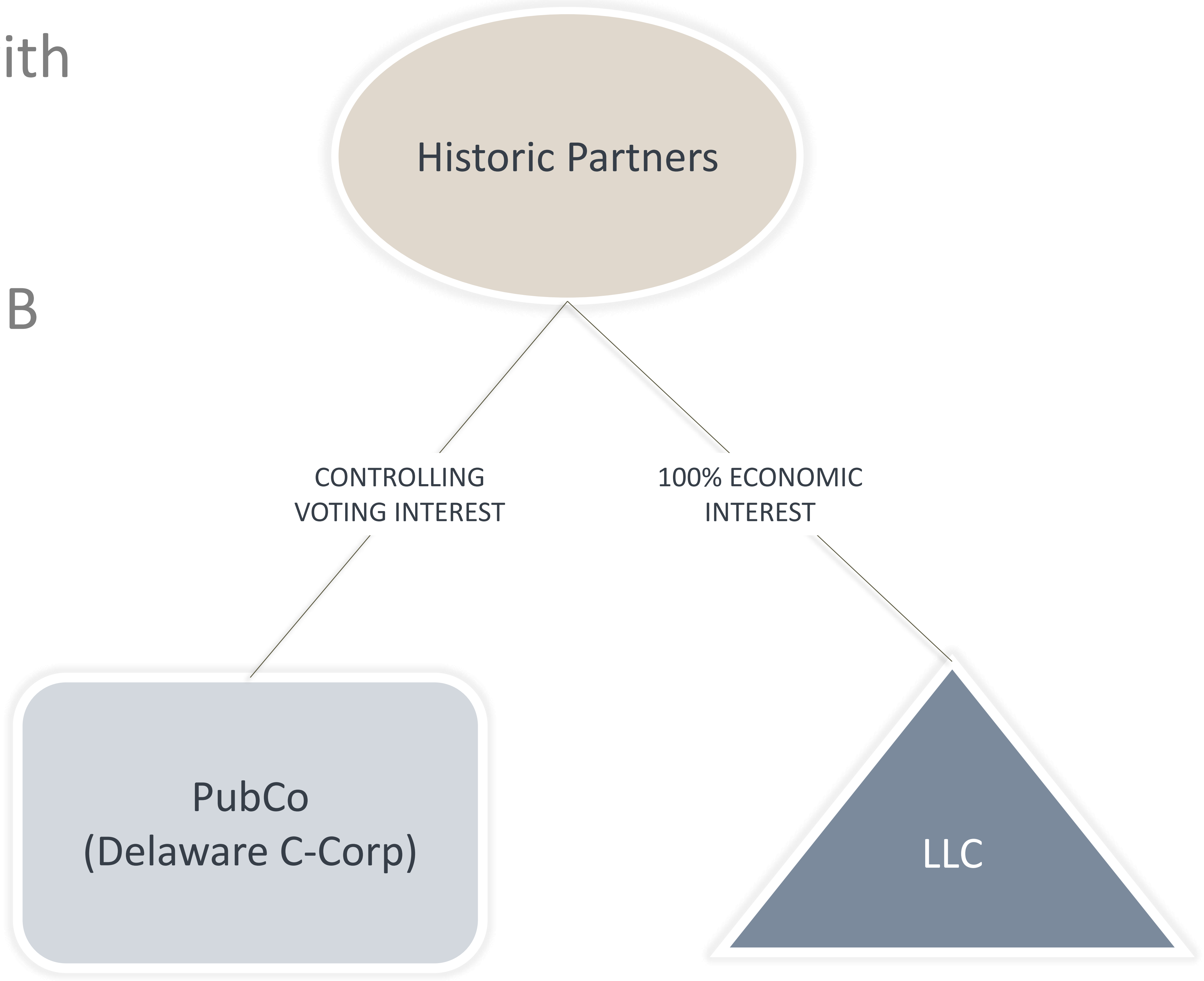
- Partnership not subject to tax; income earned by operating subsidiaries taxable directly to partners

Disadvantage

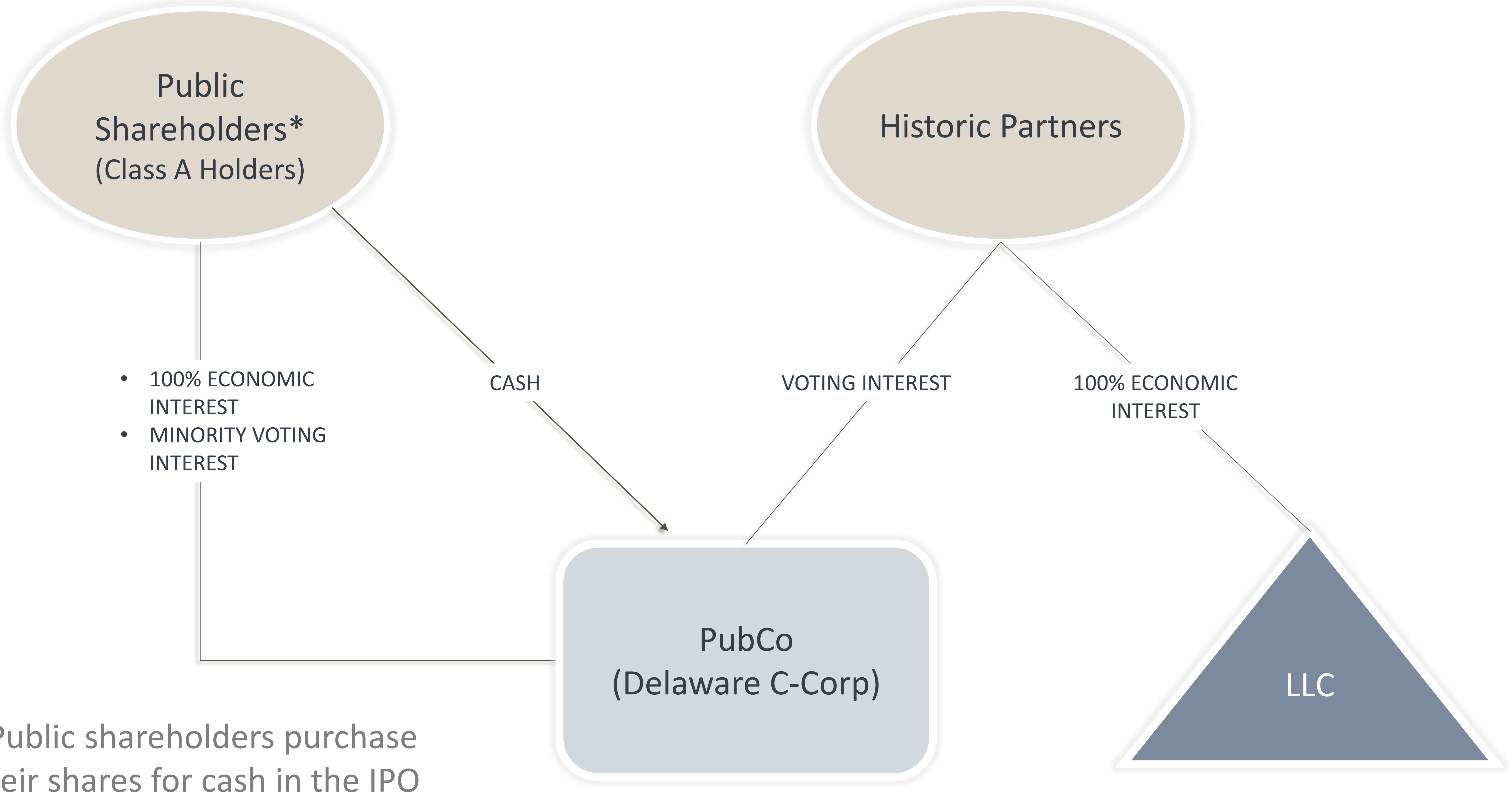
- Listing partnership when going public may result in the partnership being taxed as a corporation

Up-C Structure: Immediately after formation of C-Corp

- Company incorporated in Delaware with two classes of common stock, Class A and Class B
- Class A is offered in the IPO and Class B is held by the Historic Partners and provides no economic rights, only voting rights

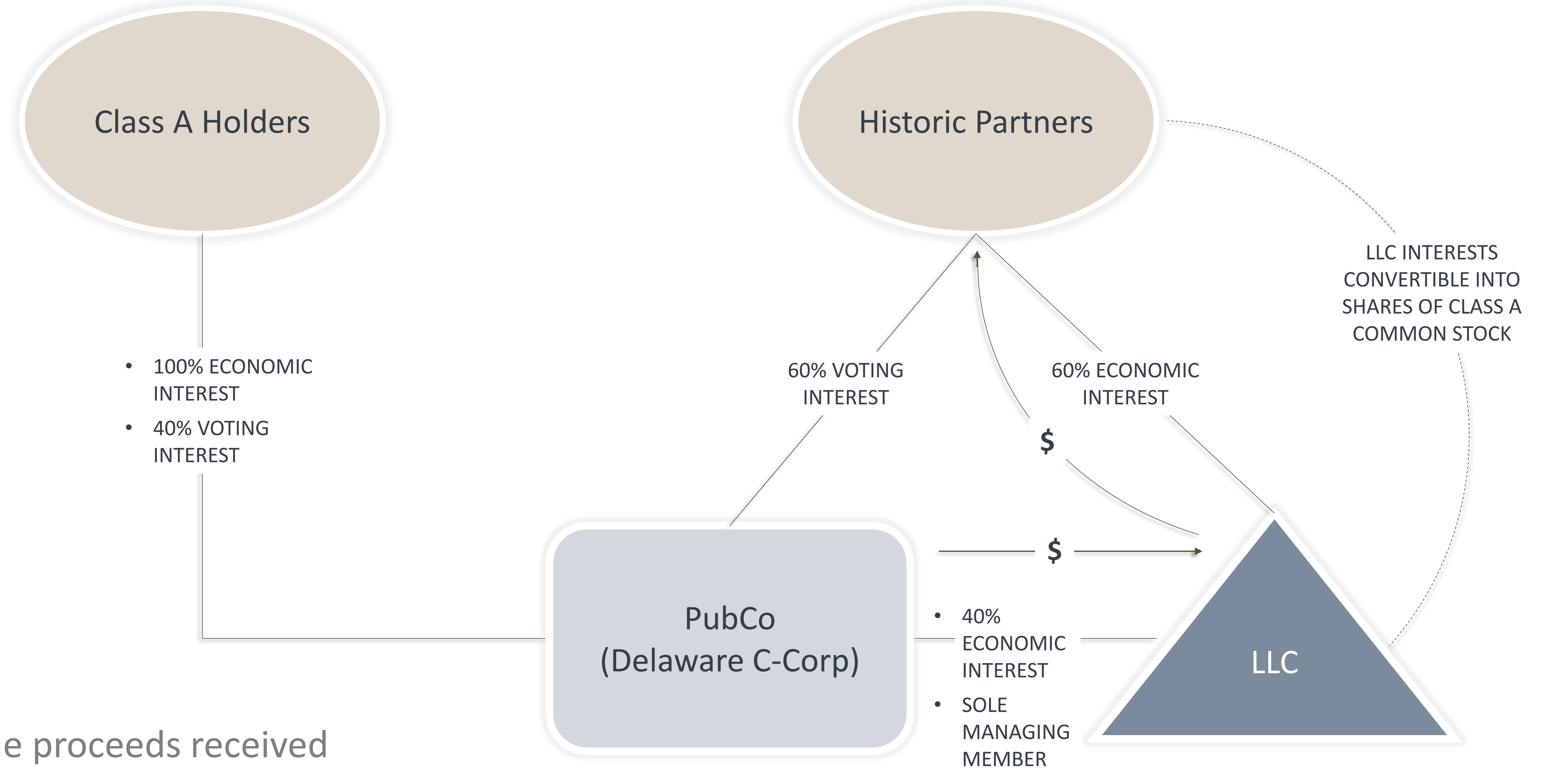


Up-C Structure: Immediately following IPO



*Public shareholders purchase their shares for cash in the IPO

Up-C Structure: Final structure



- PubCo uses the proceeds received in the IPO to purchase LLC interests
- LLC redeems partnership interests from the Historic Partners (treated for tax purposes as a "disguised sale" or direct purchase of partnership interests by PubCo from the Historic Partners)

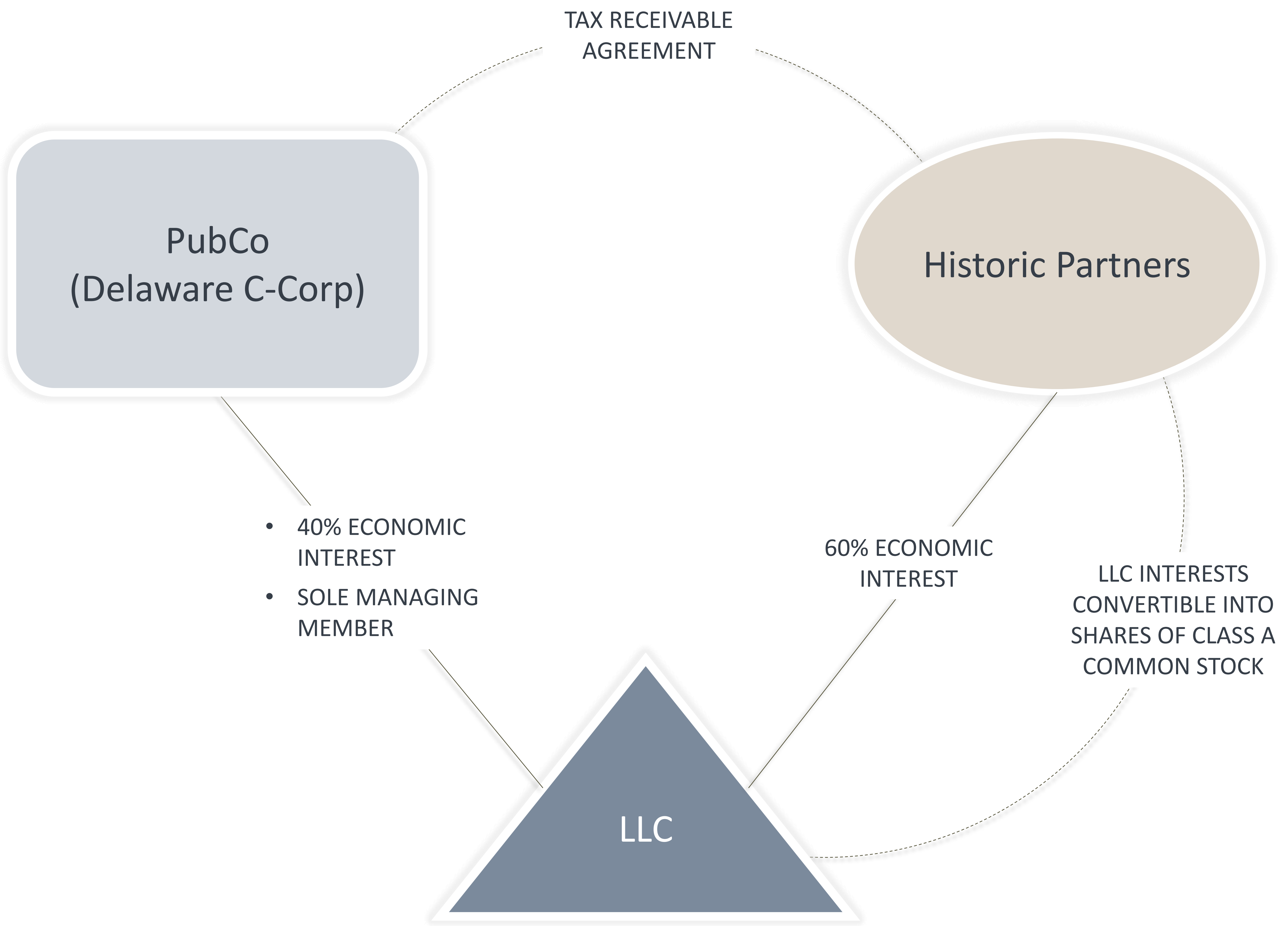
(percentages are included only for illustrative purposes)

Additional considerations related to Up-C structure

- The Up-C structure maintains continuing pass-thru treatment (single level taxation) for the historic partners with respect to their proportionate share of net income realized by the partnership
- The historic partners obtain liquidity through the right to exchange partnership units for Class A shares of PubCo
- The Up-C structure provides a range of options for making strategic acquisitions and compensating employees (*e.g.*, PubCo stock, PubCo options, and partnership units)
- PubCo becomes the managing member of the historic partnership and the historic partners retain voting control through Class B PubCo shares
- PubCo consolidates the historic partnership for financial statement purposes
- Tax receivable agreement ("TRA")

Tax Receivable Agreements

Taxable Receivable Agreements



(percentages are included only for illustrative purposes)

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Benefits of the Tax Receivable Agreement

- Because the historic partners sell partnership interests to PubCo (rather than stock, as in a traditional IPO structure), PubCo receives a "step-up" in the tax basis of its assets
- This tax basis step-up is allocated to PubCo's share of the historic partnership's assets, and in many cases the step-up is primarily allocable to intangible assets that are amortizable on a straight-line basis over 15 years (so-called "Section 197" intangibles)
- Through a TRA, the historic partners effectively capture the majority of the value associated with the PubCo's tax basis step-up
- Under the terms of the TRA, PubCo is obligated to pay the historic partners in cash an amount equal to a portion of PubCo's tax savings generated by the tax basis step-up (typically 85% of such savings)
- Payments under the TRA are effectively treated as additional purchase price paid by PubCo for its interest in the historic partnership
- The value of the TRA depends on whether PubCo is in a tax-paying position, and, if not currently in such a position, when it is forecasted to be in a tax-paying position

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Tax Receivable Agreement illustration

Illustration of Potential TRA Economics

•	Amount of PubCo Tax Basis Step-Up*	$300 million
•	Amortization Period	15 years
•	Annual Amortization	$20 million
•	PubCo Tax Rate (Federal & State)	25%
•	PubCo Annual Savings	$5 million
•	TRA Payout Ratio	85%
•	Annual Payment to Historic Partners**	$4.25 million
•	Total Payments to Historic Partners	$63.75 million

* Any future exchanges of partnership units for Class A shares of PubCo also may give rise to additional tax basis step-up for PubCo (thereby increasing the amounts payable under the TRA over time)

** Payments under the TRA also give rise to additional tax basis step-up for PubCo (thereby increasing the amounts payable under the TRA over time)

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Other Tax Receivable Agreement considerations

- TRAs often include provisions accelerating payments upon a change of control
- PubCo can elect to terminate the TRA triggering acceleration payments

Securities law and corporate governance considerations

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Securities disclosures

- The IPO prospectus will contain additional disclosures related to the Up-C structure
  - Cover page will highlight dual class of stock
  - Offering summary box usually will contain a structure diagram
  - Risk factors will highlight certain aspects of the structure
    - Only material asset of PubCo will be interest in the LLC
    - Payments to pre-IPO owners for certain tax benefits
    - Risks associated with dual class of stock and often risks associated with a controlled company
  - Formation transaction or organization description
  - Description of exchange agreement
  - Description of tax receivable agreement
  - Often there may be other agreements entered into in connection with the IPO, such as a voting agreement and a management agreement

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Controlled company status

- For the securities exchanges, a controlled company is one in which more than 50% of the voting power for the election of directors is held by a group
- Often the PE or VC sponsors in an Up-C structure will remain the control group
- A controlled company may rely on certain exemptions from the corporate governance requirements of the exchanges

SEC staff interpretive guidance

- The PubCo shares issued on an exchange by LLC holders are “restricted securities”
- Generally, a resale registration statement would have been required for the resale of these shares
- However, in 2016, the Staff of the SEC’s Division of Corporation Finance provided guidance regarding the application of Rule 144 in the context of the Up-C structure
- The Rule 144 holding period is deemed to commence when the holder has fully paid for its LLC interest to the extent that the exchange agreement allows LLC holders to exchange for PubCo shares with no additional consideration

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Miscellaneous issues related to Up-C structure

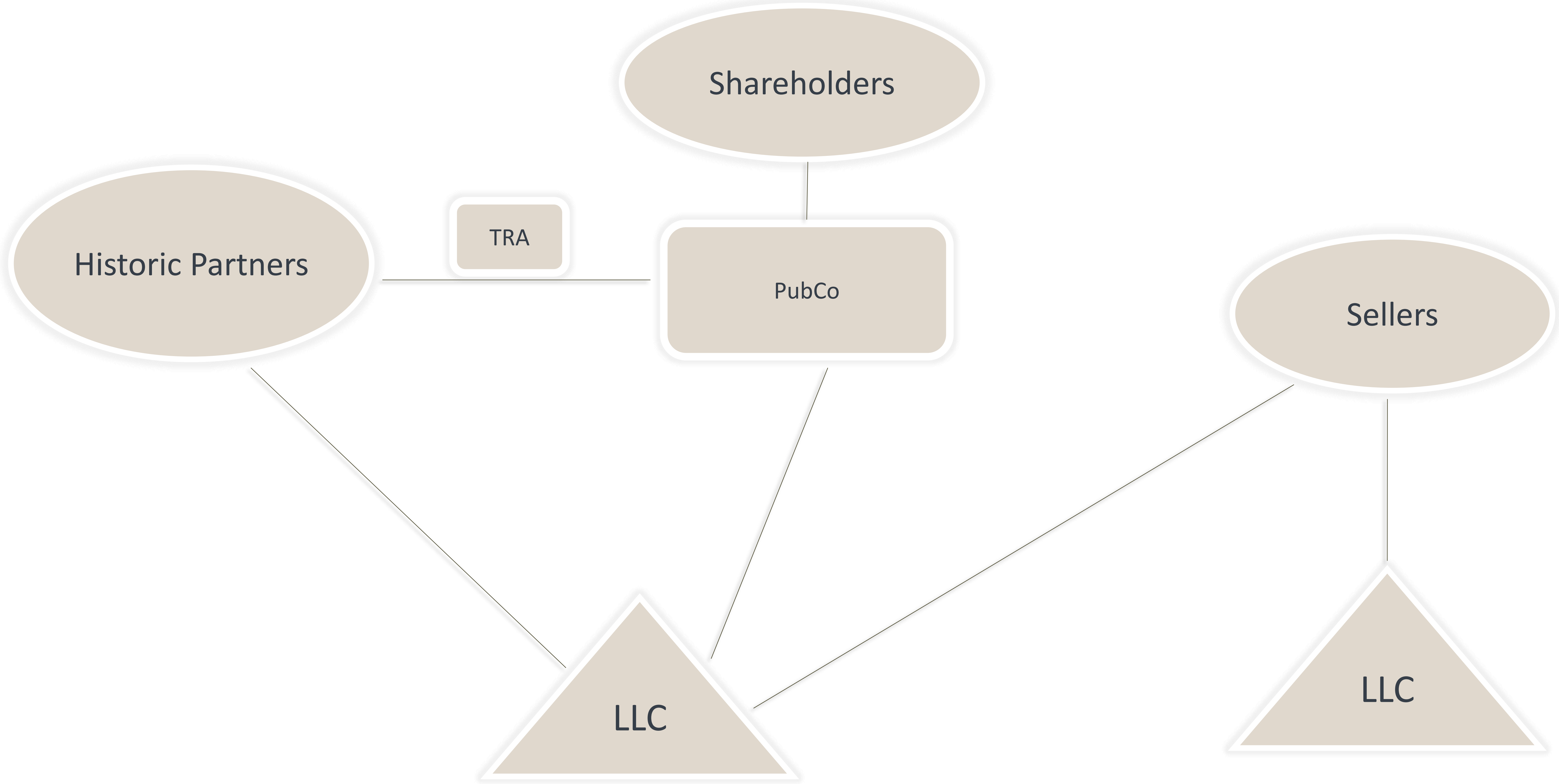
- “Anti-churning rules” under Section 197 of the Internal Revenue Code
- Tax distributions to PubCo and historic partners
- Continuing administration of TRA and determination of annual payments to be made by PubCo to historic partners (reviewed and approved by PubCo audit committee in conjunction with outside advisors)
- Investment Company Act (“40 Act”) status of PubCo
- Eligibility of the PubCo’s securities for inclusion in indices

Acquisition alternatives

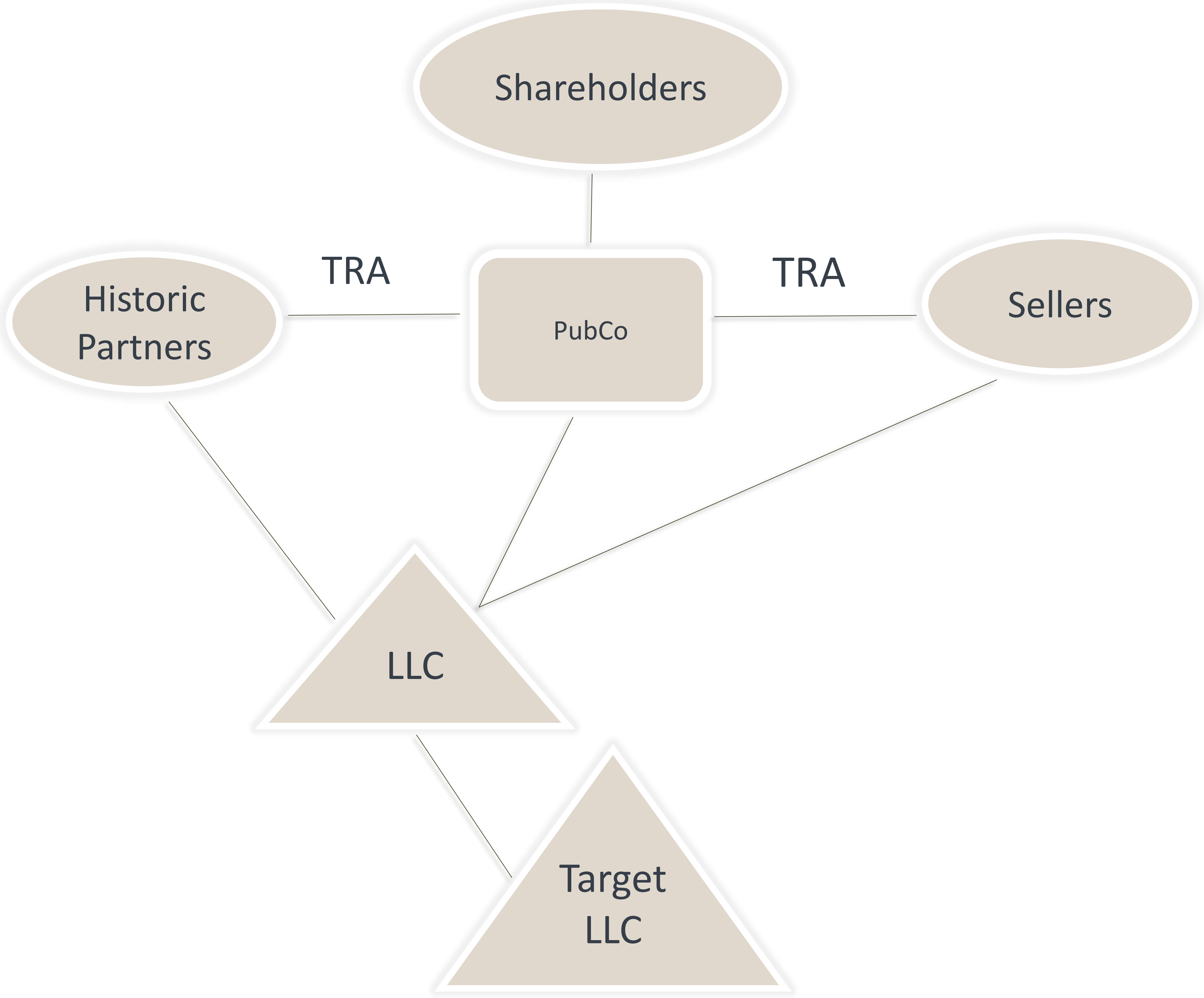
Acquisitions using an Up-C structure

- An Up-C structure can use multiple forms of acquisition currency:
  - PubCo stock
  - Cash
  - LLC units
- Use of LLC units provides benefits to sellers:
  - Tax deferral
  - Single layer of tax
  - Liquidity through conversion

Acquisitions using an Up-C structure *(cont'd)*



Acquisitions using an Up-C structure *(cont'd)*



- Sellers contribute Target to LLC in exchange for LLC units
- LLC units are exchanged for PubCo shares
- Sellers enter into TRA with PubCo
- Sellers continue to benefit from pass-thru treatment
- Target becomes disregarded entity for tax purposes

Unwinding an Up-C structure

“Unwinding” an Up-C structure

- Why unwind an Up-C structure?
  - Weighing the benefits vs detriments
  - Change of control considerations
  - PubCo stock price
- How to unwind an Up-C structure?
  - Gain 100% ownership of underlying partnership/LLC
  - Eliminate dual class share structure
- What are consequences/costs of an unwind?
  - TRA acceleration

TRA terminations & monetizations

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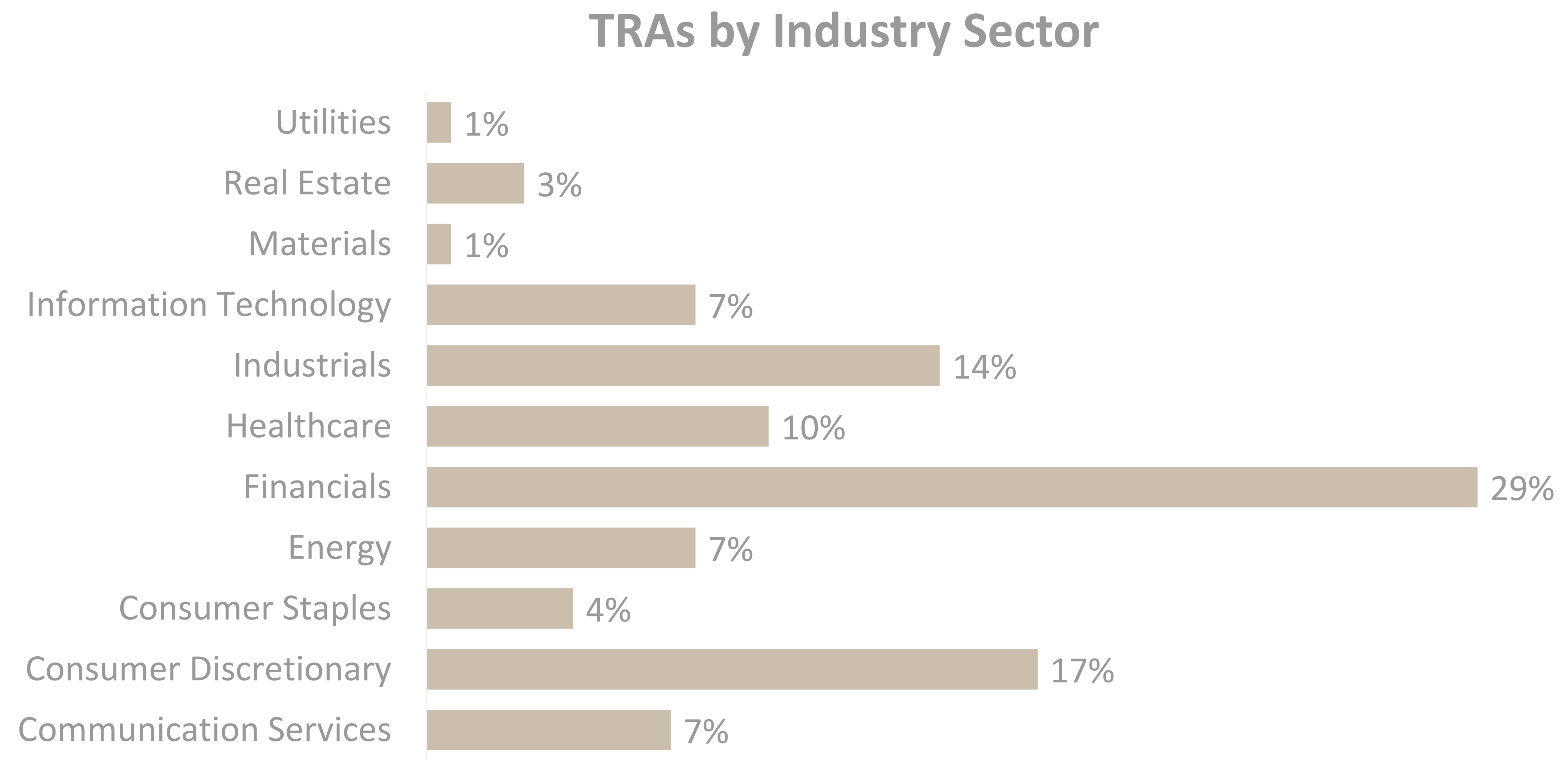
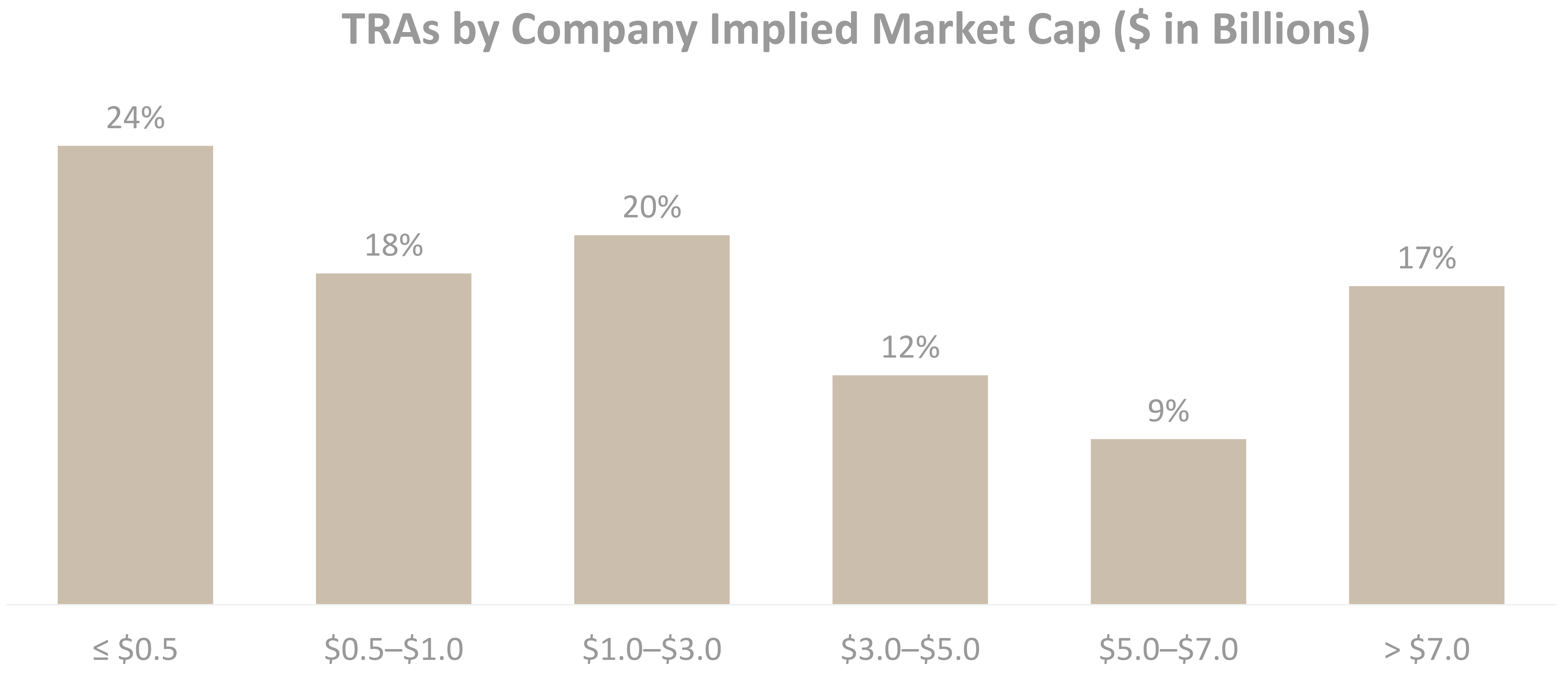
TRA market overview

- ~150 TRAs outstanding as of Q1 2025, over half were issued in the past five years
  - Sector- and size-agnostic, but more concentrated within growth/asset-light industries and the middle-market
- Historically, there have been ~50 TRA terminations in conjunction with M&A/take-private events, ~20 from corporate buybacks, and ~20 due to bankruptcy





Source: SEC filings and S&P Capital IQ as of December 31, 2024

TRA terminations

- Public company repurchase
  - Scrutiny abounds on triggering early termination payment under valuation assumptions of TRA
  - Negotiated settlements:
    - Minimal price discovery in TRA market clearing value subjecting public company and holder to valuation risk
    - May be advantageous to public company when the TRA holder still owns equity in the business
  - Structure of repurchase likely to consider public company's capital constraints
  - Often conducted between related parties such that independent, special committees should be considered
- M&A transactions
  - Trigger early termination payment provisions on change of control events
  - Often result in negotiated settlements based on facts and circumstances of the M&A transaction
- Bankruptcy

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TRA monetizations in the secondary market

- Secondary market transaction
  - Typically, a 2 – 4 month process
  - Provides price discovery to asset’s market clearing value
  - More likely to reflect all cash purchase relative to public company
- Partial monetization
  - Structured transactions (i.e. loan collateralized by the TRA, first in / last out structure)
  - Provides flexibility whereby a sponsor may retain residuals and CoC optionality
- Investor considerations
  - TRA Representative rights
  - Contract amendment procedures/requirements
  - Attribute coverage ratio
  - Remaining expected life of the contract
  - % Crystalized / Un-crystalized

TRA value considerations

- Types of buyers / financiers
  - Special Opportunities / Opportunistic credit
  - Structured equity
  - Evergreen funds / family offices
  - Private credit funds
  - Large diversified multi-strategy asset managers
- Rates of returns
  - Typically, mid teens for the equity purchase
  - Discount rates only have meaning when paired with the expected cash flows
- Depth of market
  - Processes have double digit bids in first rounds
  - Investors across the spectrum interested in $25 mm asset to north of $500 million

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TRA risk characteristics

- TRAs have risk vs. return characteristics that can be analogized to debt and equity instruments.
- This does not mean that it necessarily places between equity and debt on the risk spectrum.

Equity-Like	Debt-Like	Unique
• Payments are based on taxable income	• Crystallized portions have fixed “notional”	• Positive exposure to tax rate increases
• Un-crystallized portions have exposure to future 1-5 year stock price returns	• Lack of upside participation in taxable income	• Certain corporate decisions can extend can extend duration
• Little downside protection in default • scenarios	• In instances with non-volatile, robust taxable income, TRAs may behave like amortizing bonds	
• Lack of contractual maturity causes uncertain duration which can be decades long	• Change of control make-whole payment is based on future expected payments • discounted at LIBOR / SOFR plus a spread	
• Accelerated participation in expected future taxable income (savings) upon a change of control		

Certain litigation involving Up-C structures

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TRA and other Up-C litigation

- GoDaddy
  - TRA liability recorded by PubCo at $175 million
  - TRA buyout for $850 million
- Apollo and Carlyle
  - Tax free exchanges not resulting in a tax basis step up
  - Payment for purchase of TRA
- Schumacher v. Mariotti
  - Alleging dividend/distribution double dipping

Houlihan Lokey Speakers

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Mr. Goldrick is a Managing Director in Houlihan Lokey's Transaction Advisory Services practice and Head of M&A Tax Services. He primarily focuses on buyside and sellside tax consulting services for transactions involving private equity and strategic buyers.

Mr. Goldrick has more than a decade of experience advising on transactions in North America, Europe, and the Asia-Pacific region, and his transactional experience spans numerous sectors, including industrials, healthcare, technology, financial services, and retail. He is based in the firm's Chicago office.

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Mr. Mulkerin is a Managing Director in the Corporate Valuation Advisory Services practice within Houlihan Lokey's Financial and Valuation Advisory business, where he leads the complex securities team. He is also a member of the firm's Technical Standards Committee and is based in the Los Angeles office.

Mr. Mulkerin has a decade of experience providing valuation advisory services to corporate clients with regard to convertible debt, contingent considerations, fixed income and equity derivatives, incremental borrowing rates, and pricing risk across the capital structure.

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Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including IPOs and other public offerings and private placements of equity and debt securities.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including tech, telecommunications, healthcare, financial institutions, REITs and consumer and specialty finance.

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Remmelt is a partner in Mayer Brown’s Palo Alto office and a member of the Tax Transactions & Consulting practice. He concentrates his practice on federal and international tax matters. Remmelt advises on a wide variety of sophisticated capital markets transactions and represents issuers, investment banks/financial institutions and investors in financing transactions, including public offerings and private placements of equity, debt and hybrid securities, as well as structured products.

Remmelt's areas of experience also include restructurings (both in and out of bankruptcy), debt and equity workouts, domestic and international mergers, acquisitions, reorganizations and joint ventures.

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