



SPECIAL WEBINAR: ACCESSING LIQUIDITY IN AN ILLIQUID MARKET

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AGENDA

- Introduction
- Revelation overview
- BDO overview
- Snapshot of today's market
- What secondaries can do
- Types of secondaries
- Key Considerations
- Finding the right secondary partner



Fred Lee

Partner, Revelation Partners

Over 14 years of banking and investment experience

Background:

- Managing Director at Bridge Bank
- Investment banker at Citigroup

Education:

- B.S., B.A., University of California, Berkeley



Suchira Sharma

Senior Associate, Revelation Partners

Over 6 years of experience in healthcare venture investing across debt and equity

Background:

- Senior Analyst at Hercules Capital (Life Sciences Group)

Education:

- B.S., Northeastern University



Chrissa Qiu

Principal, BDO

Over 20 years of financial and valuation advisory experience

Background:

- Senior Manager at KPMG
- Senior Associate at Standard & Poor's

Education:

- M.B.A., Temple University
- LL.B., Peking University



James Milkosky

Director, BDO

Over 16 years of audit experience in the venture and private equity industry

Background

- Previously spent 10 years at PwC in the Alternative Funds group specializing in venture and private equity space

Education:

- MSA, Boston College
- BS, Boston College



Kristin Peters

Managing Director, BDO

Over 15 years experience in Executive Tax – compensation and benefits

Background

- Career spent at BDO

Education:

- B.S., University of Colorado, Boulder

ABOUT REVELATION PARTNERS

- **Revelation Partners creates customized financing solutions for healthcare companies, investors, and funds**
 - 15-year track record dedicated to healthcare, investing across all sub-sectors
 - Over \$900 million of committed capital
- **Healthcare expertise allows us to optimize asset valuation and maximize long-term value**
 - Well-versed in the unique regulatory, commercial, and legal dynamics of the healthcare sector
- **Experience in managing complex transactions**
 - RP has partnered with over ten GPs to provide customized fund solutions
 - Ability to navigate a nuanced process while balancing different objectives of key stakeholder groups (GPs, LPs, LPAC, portfolio companies, etc.)
- **Dedicated long-term capital**
 - Strong capital base supports fund restructurings – redeem selling LPs and provide additional unfunded capital
 - Provides certainty of deal execution

ABOUT BDO

▶ **AUDIT AND ASSURANCE SERVICES**

We deliver comprehensive, independent, efficient, and effective audits of financial statements, including those that are integrated with an audit of internal controls. We also provide quality assurance services to help clients ensure their financial statements meet the complex regulatory and business requirements to which they are subject.

Our professionals around the world use a common global audit methodology that complies with International Standards of Auditing (“ISA”) and any applicable national or local country standards. This consistent approach to the audit of business means that, regardless of location, our professionals can understand and evaluate operations. This approach also allows us to quickly organize and deploy multinational audit teams should the need arise.

▶ **TAX ADVISORY AND COMPLIANCE SERVICES**

Taxation is an increasingly complex area, and we assist our clients with everything from compliance, to performing tax due diligence on potential acquisition targets, to ensuring that cross-border tax treaties are maximized and effective tax rates and transfer pricing risks are minimized. Clients can expect insightful professional advice and a seamless experience across the BDO network.

Because tax developments can be a moving target, it is important to stay on top of the latest changes. Our team will keep businesses abreast of proposed new laws and regulatory changes, helping remain tax compliant in the jurisdictions where operations are. Our full-service tax team is available to assist in any aspect of tax planning, compliance, analysis, income tax accounting, expatriate individual income tax assistance, and other specialized tax services.

In addition, BDO’s Green Energy Tax Services professionals provide a full complement of green energy-specific tax and consulting services. Our team is comprised of experienced tax professionals and licensed engineering and architectural consultants who can help clients identify, negotiate, and secure green energy tax incentives, obtain technical, engineering, and LEED® certifications, and identify and provide support for R&D tax credits.

▶ **ADVISORY**

BDO’s Advisory Practice provides transaction, risk, and executive services to clients navigating an exceptional range of challenges, changes, and opportunities.

Our Services

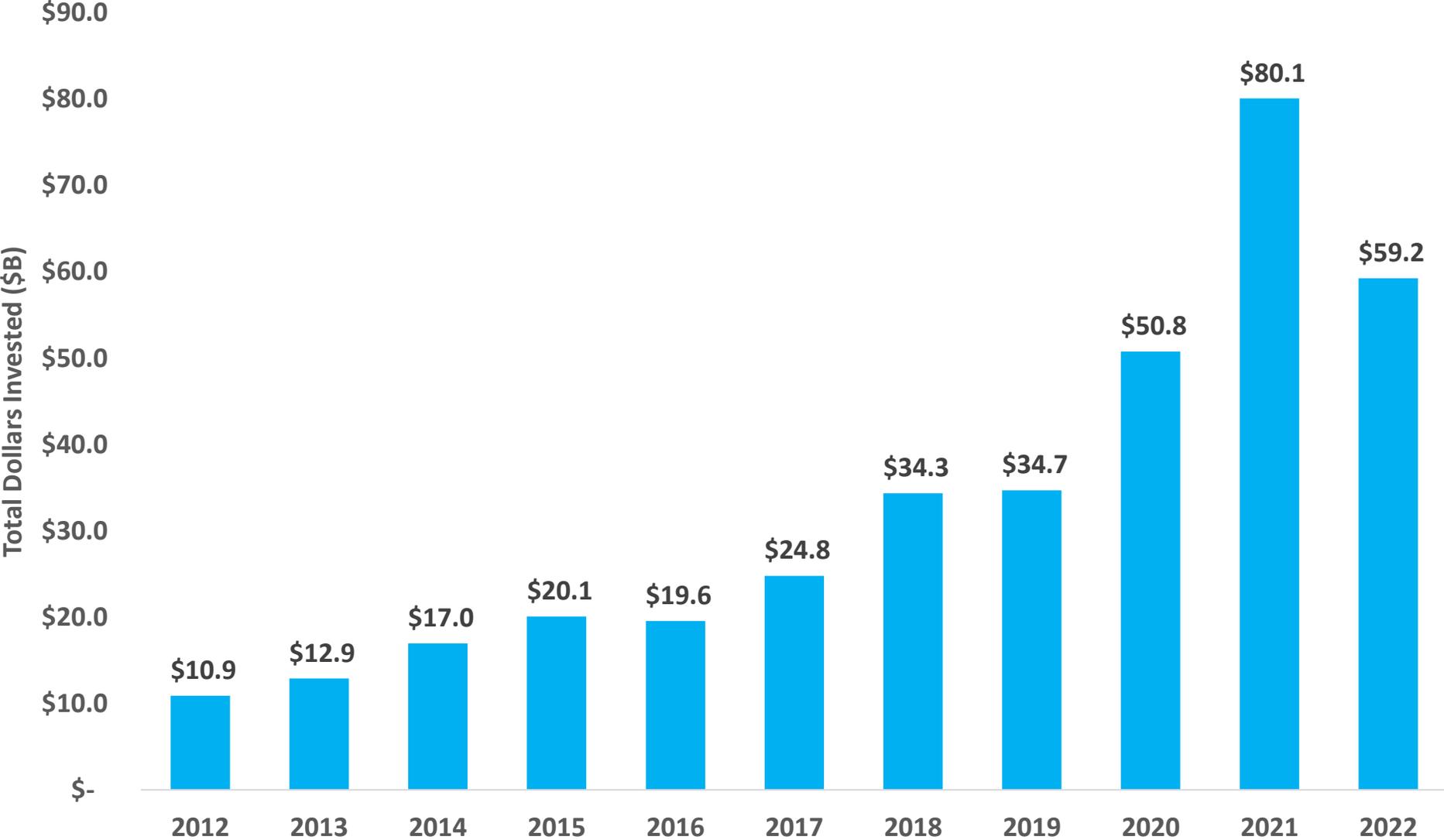
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- ▶ Healthcare Advisory Services
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SNAPSHOT OF TODAY'S MARKET



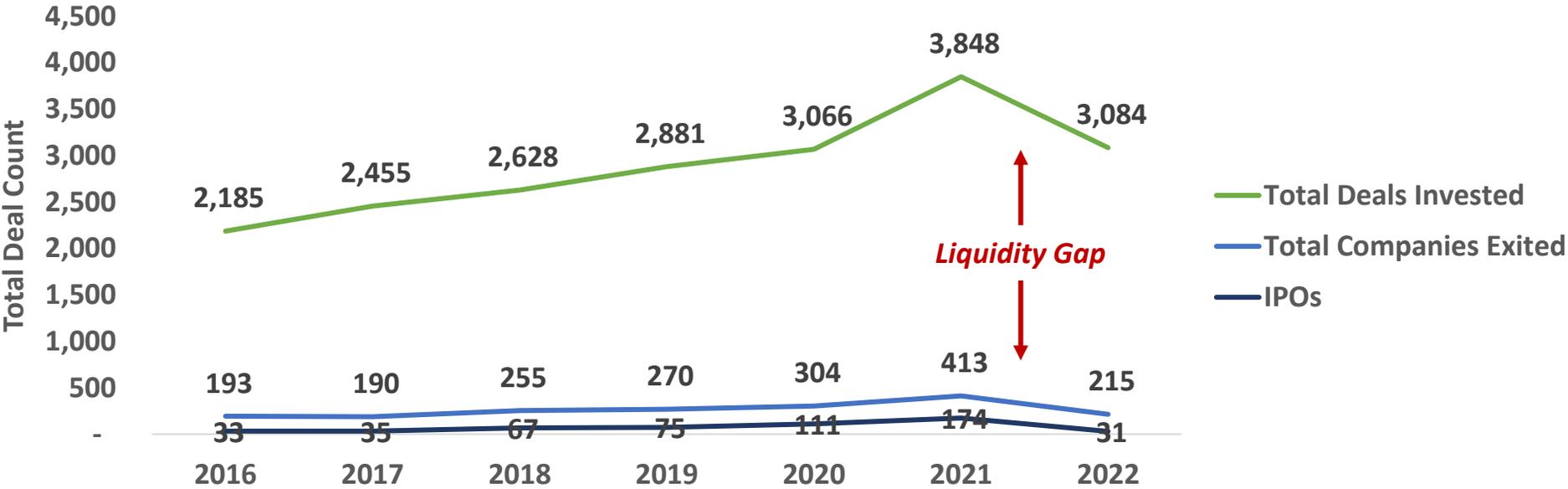
OVER THE PAST 10 YEARS, THERE HAS BEEN SIGNIFICANT PRIVATE INVESTMENT IN HEALTHCARE

>\$330B of private investment in private healthcare companies over 10 years

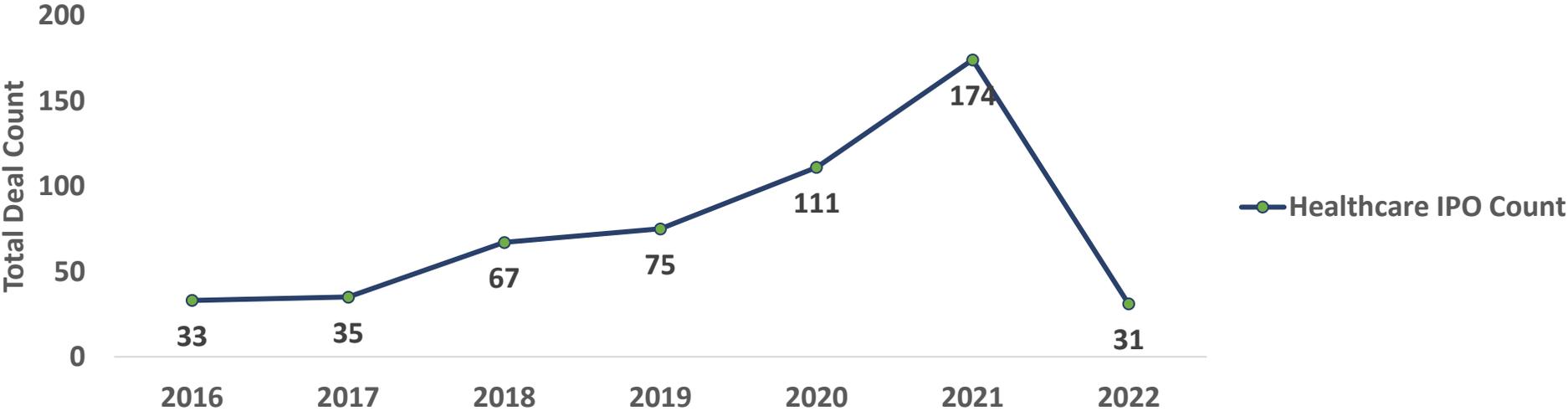


Source: Q4_2022_Pitchbook_NVCA_Venture_Monitor

HOWEVER, THE NUMBER OF TRANSACTIONS INVESTED IN, VERSUS THE NUMBER OF COMPANIES EXITED DEMONSTRATES A LIQUIDITY GAP



Source: Q4_2022_Pitchbook_NVCA_Venture_Monitor. SVB – Healthcare Investments and Exits – Annual Report 2022



Source: SVB – Healthcare Investments and Exits – Annual Report 2022

WHAT CAN SECONDARIES DO?



WHAT CAN SECONDARIES DO?

Realign the Investor Syndicate

- Early investors, particularly non-institutional investors (i.e., angel groups or “friends and family”), have a different time horizon for liquidity than later groups
- Different types of investors (i.e., corporates, venture capital firms, crossover funds, and family offices) may also have different underlying objectives and shifting motivations over time
- A secondary transaction can act as a “relief valve” to re-align investors

Please see Slide 2 for Important Disclosures

WHAT CAN SECONDARIES DO?

Ensuring the Availability of Follow-On Financing

- As companies raise multiple rounds of private financing, its capitalization table may become crowded with older, early investors
- Members of the existing syndicate may vary in their ability or willingness to invest additional capital
- Some investment funds may be constrained by their own fund limitations, such as impending end of fund life or lack of dry powder
- A committed secondary investor can not only satisfy the demands of these “older” investors, but also “refresh” the investor syndicate, serving as a source of fresh capital

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WHAT CAN SECONDARIES DO?

Retaining and Motivating Employees

- In recent years, restricted stock grants and stock options have become a larger component of employee compensation packages
- Many employees may elect to work for early-stage companies in part for the equity upside
- By allowing employees to sell small amounts of vested shares or options in secondary transactions, a company can not only reward its loyal employees, but also retain, motivate, and attract employees going forward

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TYPES OF SECONDARIES



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Company Tender / Preferred Buyer Program

- A preferred buyer program may be informal (the company refers secondary interest to a small group of preferred funds) or formal (the company assigns a Right of First Refusal to selected secondary partners)
- Formal program: a secondary investor may sign a term sheet or letter of intent with the company, designating a certain capacity to purchase stock and formulaic pricing (i.e., certain percentage discount to the last round, or predefined revenue multiple for company valuation)
- The company can identify a trusted partner who is well-aligned with its strategic and financial objectives
- By identifying a single secondary partner, it reduces the burden on the company to share information with multiple parties. Lastly, by designating a preferred buyer, the company can more effectively stay at an “arms-length,” minimizing the potential impact to the 409A valuation

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TYPES OF SECONDARIES

One-off Shareholder Liquidity

- A secondary partner can also provide liquidity to shareholders and limited partners on an ad-hoc basis
- Individual shareholders of companies such as founders, early investors, or management team members may seek to diversify their holdings while the company waits for a formal exit

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KEY CONSIDERATIONS



409A VALUATION CONSIDERATIONS

Relevance of Secondary Transactions

- Is the Secondary Transaction relevant for determining valuation?
 - Understand the transaction dynamic, value drivers, or strategic components
 - Identical security or different security
- AICPA Guidance -
 - Secondary transactions should be considered if the transactions are orderly
 - Significant judgment is required in assessing how much weight should be given to these transactions in the valuation
- Unlike primary transactions, the Company may not be a party to the secondary transactions

Weighting Considerations

- Timing of transaction date
 - Proximity of the transaction date to the valuation date
- Sufficient sophisticated bidders
 - Limited pool of buyers
- Sufficient information to make an investment decision
 - Buyer and sellers have access to information similar to other market participants
- Pattern of trades
 - Volume of the transactions
 - One-off or multiple transactions
 - Multiple transactions with consistent price
- Other biases or costs of holding, hedging, or trading the securities
 - Additional costs may apply in the secondary transactions

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TAX CONSIDERATIONS

Initial Company Tax Considerations	<ul style="list-style-type: none">• Sale Price = Current FMV (i.e., 409A valuation) or above FMV?• If above FMV, is it a capital or compensatory transaction?• Differences in tax rates (23.8% vs. 37%)• If compensatory, Company generally has obligations for<ul style="list-style-type: none">• Reporting, withholding and remitting taxes, FICA taxes.• Will receive a corporate tax deduction
Some factors to consider in assessment of whether it's a Capital or Compensatory transaction	<ul style="list-style-type: none">• Who is entitled to participate?• Company Involvement?• Who is the buyer?• What is the purpose of the transaction?• How often the Company has secondaries• Other important considerations

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TAX CONSIDERATIONS

What Shares are being sold?	<ul style="list-style-type: none">• Owned Shares• Shares from exercises of ISOs that result in a disqualifying disposition?<ul style="list-style-type: none">• Company may have reporting obligation even if transaction is treated as a capital• Shares from previously unexercised options<ul style="list-style-type: none">• Company may still have reporting and withholding obligations even if transaction is treated as a capital transaction• Is there a tender offer period? If so, this could affect what value is being used as FMV
Risks associated with mis-treatment of transaction (i.e., auditor determined should have been treated as compensatory)	<ul style="list-style-type: none">• Failure to withhold – results in potential assessment of taxes required to be withheld, penalties and interest.• FICA tax assessments• Incorrect reporting and related penalties and interest• Potential gross-ups? Some companies choose to pay the difference in the tax rates for their employees• In some cases, a company's auditors may require an ASC 450 reserve for financial statement purposes
Other Considerations	<ul style="list-style-type: none">• Accounting – generally GAAP will require an additional compensation charge. Tax and GAAP can differ but be prepared to document the reasons.• Before a transaction occurs, work with your tax, legal and audit teams to determine treatment.• Foreign participants – be sure to check other jurisdiction requirements prior to transactions.• If treated as a capital transaction, could be a dividend?• May blow Section 1202 Qualified Small Business Stock exclusion.

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PRICING AND PROCESS

PRICING AND VALUATION

Pricing for secondary shares is highly specific

- Generally, secondary buyers begin with a market value approach, performing an independent valuation of the company, accounting for its core business model, market dynamics, and IP, among other factors
- This valuation then informs the pricing of various classes of securities in a company

Secondary investors typically desire a reasonable level of information disclosure to evaluate a private company

- Common pieces of requested information include the corporate presentation, financial statements, overview of key clinical/regulatory/commercial milestones, current capitalization table, and key corporate documents (including the Articles of Incorporation)
- Access to and support from the company's management may also support a robust diligence process

HOW TO MANAGE A ROFR / CO-SALE

Private company stock is typically subject to transfer restrictions

- The two most common of which are ROFR and Co-Sale
- These provisions can complicate a secondary process, and in extreme cases, can even deter potential secondary buyers

An experienced and well-known secondary partner may be better positioned to work with the company's Board of Directors and existing investor syndicate to manage the impact of these provisions

Additionally, the company or selling individual may seek an upfront waiver of these rights from the major investors

- The other investors may be willing to waive these rights if the secondary transaction provides certain benefits, such as resolving conflicts amongst the investor base or bringing a new, well-capitalized investor to support future follow-on needs

FINDING THE RIGHT SECONDARY PARTNER

Key Considerations when choosing a Secondary Partner	
Sector Expertise	<ul style="list-style-type: none">• Smoother diligence process• Optimized pricing for shares, based on an understanding of the specific regulator, commercial, and legal dynamics a company may face• Will be able to transact even if information is limited
Transaction Experience	<ul style="list-style-type: none">• Secondary transactions may be more complex than primary investments• The right partner understands the structure, legal, and tax related considerations of the process
Dedicated Capital	<ul style="list-style-type: none">• A well-capitalized partner can ensure a timely and prompt close• Can also provide future support to the company, including capital reserves to participate in follow-on financings or execute future secondary transactions with existing shareholders