

# 2018 ROLLOVER SURVEY

ROLLOVER AND INCENTIVE EQUITY TERMS  
IN MIDDLE MARKET PRIVATE EQUITY



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# ABOUT THIS SURVEY

This survey is the third iteration of our signature survey, originally published in 2013, covering terms of rollovers and incentive equity in middle market buyouts and majority recaps. Our initial survey was prompted by the lack of studies or data on these topics. We found this particularly striking given the importance of these topics to private equity investors, entrepreneurs and managers alike, especially in light of the existence of exhaustive studies on other matters such as M&A terms for private acquisitions.

## How We Did It

We sent out the 2018 survey to our network of private equity clients and friends. The survey questions covered a wide range of issues critical to understanding the overall approaches and trends in this space. Respondents were promised and will receive confidentiality as to both their identities and their specific responses. Our inquiry was limited to transactions involving acquisitions of a controlling interest. There was no focus on any particular industry segment or geography. We received completed responses from over 55 private equity firms.

## How It Can Be Helpful

Being able to cite a study on a particular point rarely, if ever, wins a point for your side on its own. However, the use of such studies can quickly and efficiently convince the other side that your position is not novel, or unheard of, and is within the range of “market.” This study is intended to be a tool to help facilitate discussion of what terms are appropriate in the context of a particular transaction, and more broadly to provide insight into a key aspect of middle market transactions.

More significantly, getting rollover and management incentive equity terms right is one of the principal ways a private equity investor can win over a founder or management team. From the perspective of a founder or manager, rollover and incentive equity are among the most important economic aspects of any deal. Knowing how to structure win-win solutions and the unwritten rules and norms of the middle market are therefore critical.

## The Future of This Study

We consider this study a living document that will be updated and expanded periodically over time. We send our thanks to all who helped us with its development and continued participation. We plan to capture the evolution of trends and along the way, add areas of subject matter that are of interest to the participants in and readers of this study. To that end, if you have not yet participated and would like to do so, or if you would like additional information, please contact either **John LeClaire** (jleclaire@goodwinlaw.com) or **Jon Herzog** (jherzog@goodwinlaw.com).



## TRENDS WE OBSERVED

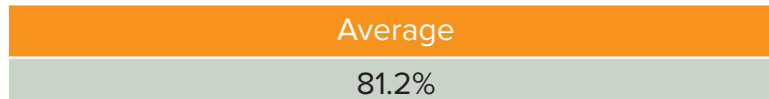
- Relative to our 2015 study, the size of actual rollovers has decreased as a percentage of equity value. We hypothesize that this is occurring as a result of a combination of the continued robust debt market and higher valuations which enable sellers to rollover a meaningful amount of capital even at a lower percentage.
- The practice of requiring some level of rollover has also decreased, down to 63% from just over 70% in 2015.
- Rollover securities generally continue to rank *pari passu* with sponsor equity; however, there was a shift toward subjecting manager's rollover equity to vesting and/or buyback on termination in certain circumstances. Finally, 94% of respondents stated that their firms always subject rollover interest to drag-along rights, up from 75% in our 2015 study. Viewing all of these items together, we posit that higher valuations have put pressure on rollover terms.
- There has been a shift toward the use of profits interests to incent managers (even when the underlying business is a C corporation) from 22.8% up to 43% of respondents, indicating that this is the preferred structure for management equity in their transactions. Profits interests pools are being granted deeper into the management stack as the percentage of sponsors granting profits interests to all plan participants doubled in 2018.
- The average size of the management equity incentive pools offered by the sponsors responding to this survey was 9.51%, down from 11.3% in our 2015 survey and further down from 12.6% in our 2013 survey. We posit that this may be a result of increased valuations driving an enhanced sensitivity to dilution from a manager pool.
- It appears that a larger portion of the pools is being reserved for independent directors – and that portion is coming from the CFOs and other C-level officers but not from the CEOs.
- Buyback and vesting terms for the managers have changed. First, it is now more common for issuers to have buyback rights on vested equity. Second, there is a significant uptick in the percentage of respondents indicating that they always provide for some mandatory acceleration of unvested equity on change of control.

# I. ROLLOVERS

## SCOPE AND NATURE OF ROLLOVER INTERESTS

### FREQUENCY OF ROLLOVER

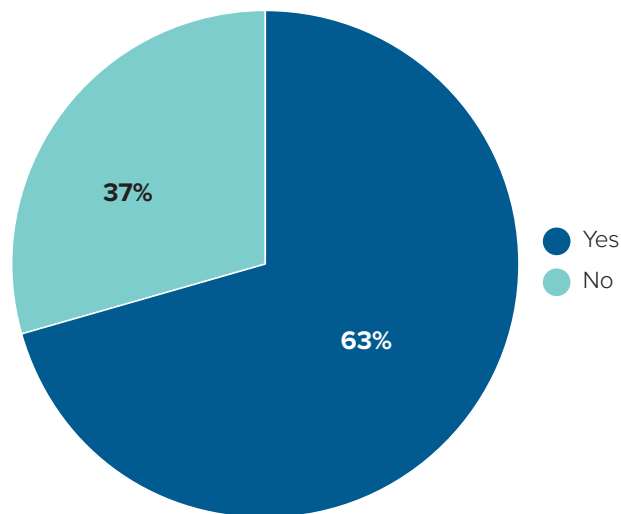
What percentage of your buyout transactions involve rollover equity investments by existing owners?



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### ROLLOVER REQUIRED

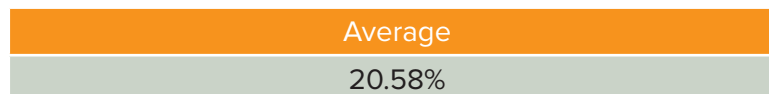
Do you typically REQUIRE existing owners to roll over a portion of their equity in your buyout/majority recap transactions?



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### MINIMUM ROLLOVER

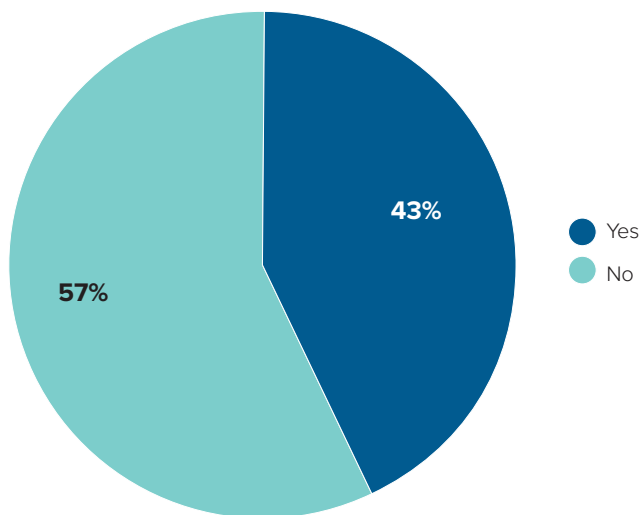
What do you require as a minimum rollover (expressed as a percentage of proceeds payable to rollover investors) in a buyout/majority recap transaction?



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## SIZE OF REQUIRED ROLLOVER RELATED TO SIZE OF DEAL

Does your minimum rollover threshold vary based on transaction size?



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## SIZE OF REQUIRED ROLLOVER RELATED TO ENTERPRISE VALUE

What is your typical minimum rollover requirement (expressed as a percentage of proceeds payable to rollover investors) in a transaction involving an enterprise value of:

Average
\$100MM or below: 22.28%
>\$100MM - \$500MM: 20.82%
>\$500MM: 17.82%

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## SIZE OF ROLLOVER RELATED TO EQUITY VALUE

What is the average percentage (expressed as a percentage of total equity value) of rollover investment in your buyout and majority recap transactions?

Average
16.61%

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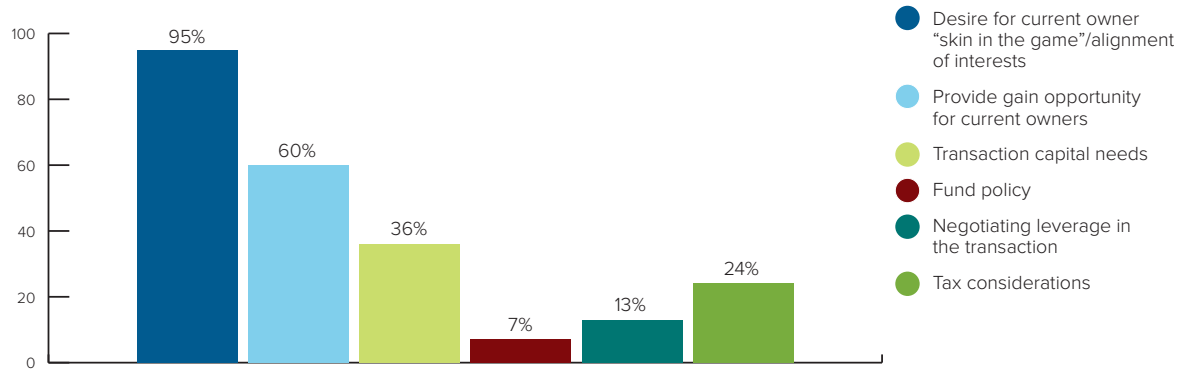
## SIZE OF ROLLOVER RELATED TO SIZE OF EQUITY INVESTMENT

Apart from minimum rollover requirements, what is the average rollover percentage (expressed as a percentage of proceeds payable to rollover investors) in buyouts and majority recap transactions where the aggregate equity investment is:

Average
\$100MM or below: 25.33%
>\$100MM - \$500MM: 19.13%
>\$500MM: 14.89%

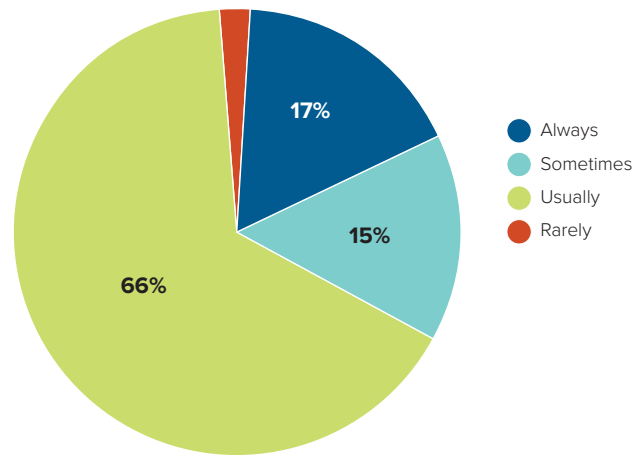
## KEY DRIVERS OF ROLLOVER SIZE

What drives the determination of the size of rollover investments in your buyouts and majority recaps?  
(You may choose more than one.)



## TAX-DEFERRED ROLLOVERS

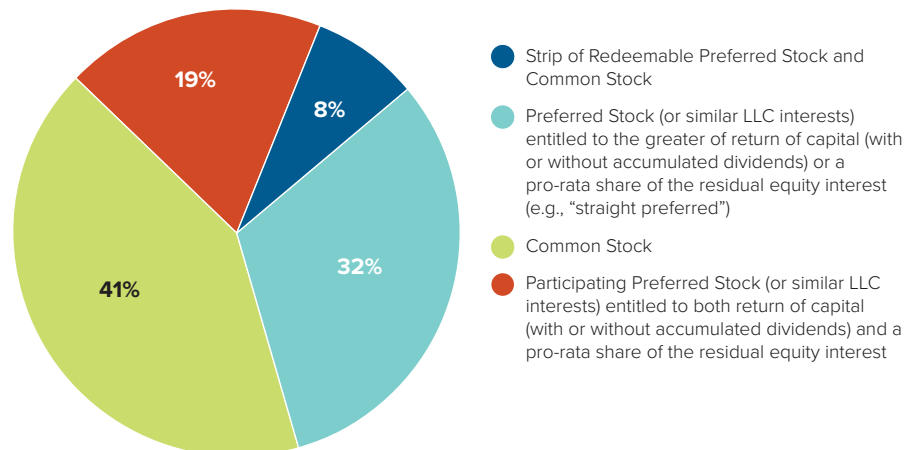
Are rollover investments in your buyout and majority recap transactions effected on a tax-deferred basis?



## CHARACTERISTICS OF SPONSOR SECURITIES

### SPONSOR SECURITIES IN A DEAL WITH ROLLOVER

In transactions where there is a rollover of equity by current owners, what are the typical securities purchased by your fund?

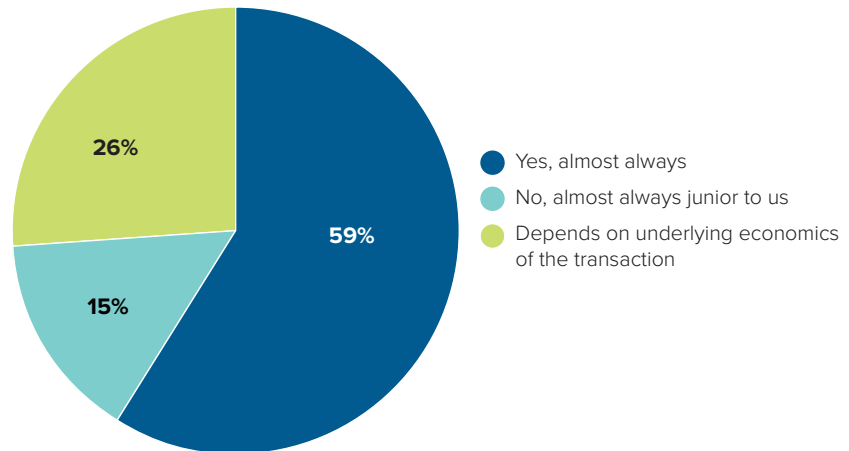




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## SENIORITY OF ROLLOVER

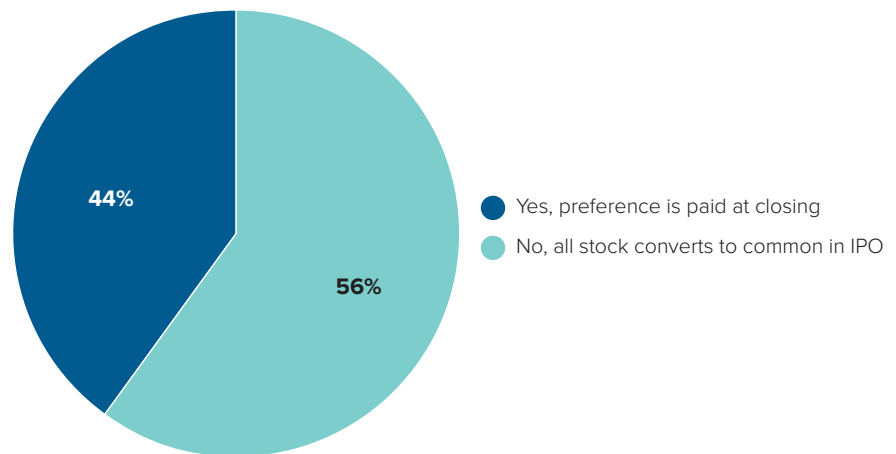
Do sellers' rollover securities rank *pari passu* with securities purchased by your fund?



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## SPONSOR PARTICIPATING PREFERRED TREATMENT ON IPO

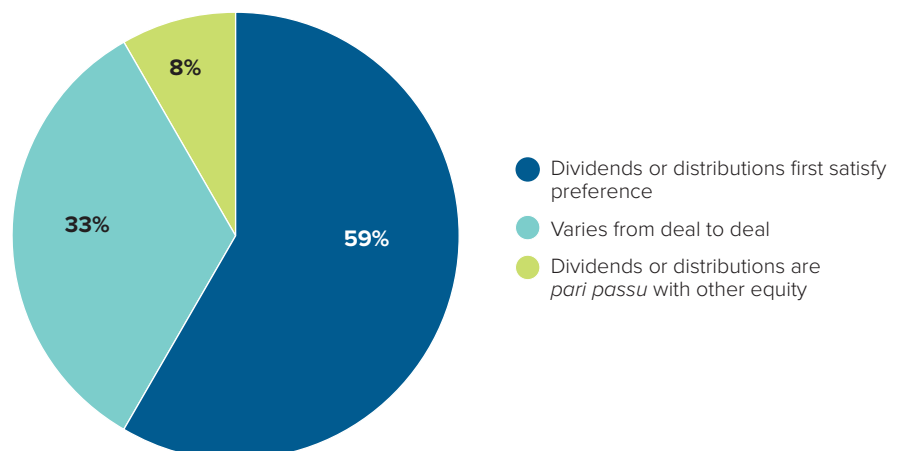
If your fund acquires a participating preferred equity (e.g., "double-dip" preferred), do you get your preference/capital returned as a priority upon IPO?



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## DIVIDENDS ON SPONSOR STOCK — PRIORITY VS. PRO-RATA

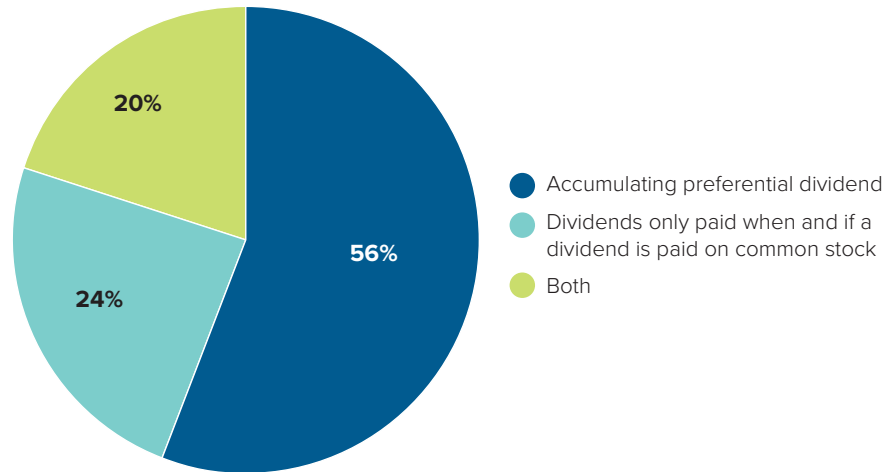
In transactions where your fund holds preferred equity, do all dividends or distributions go first toward satisfying the preference (e.g., in a leveraged dividend recap), or are dividends distributed on a *pari passu* basis with other equity?



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## SPONSOR DIVIDEND RIGHTS

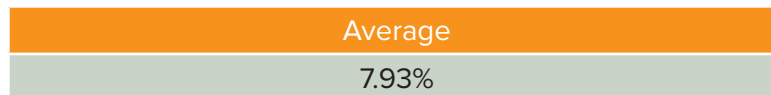
What type of dividend rights do the securities your fund acquires typically carry?



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## AVERAGE DIVIDEND RATE

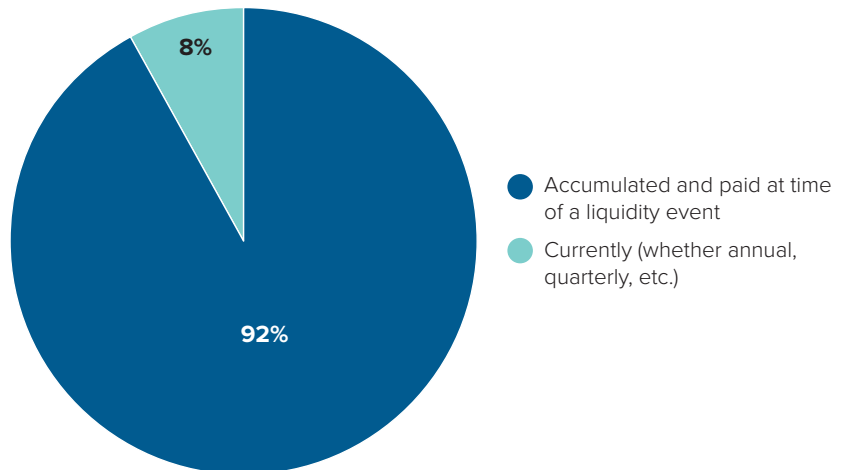
In transactions with an accumulating annual preferred dividend, the average dividend rate reported was:



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## WHEN ARE SPONSOR DIVIDENDS PAID

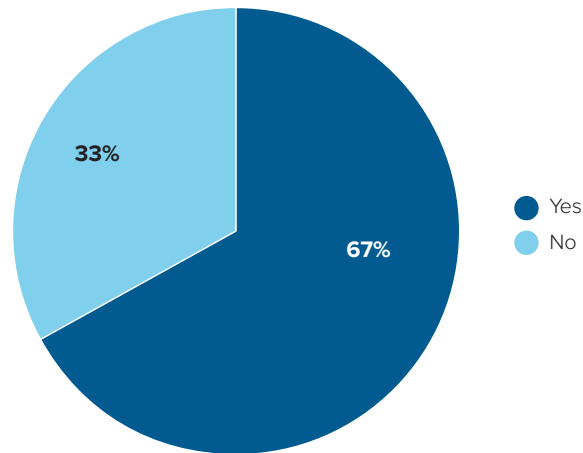
If you are entitled to preferential dividends, when are they paid?



# TERMS OF SELLERS' ROLLOVER SECURITIES

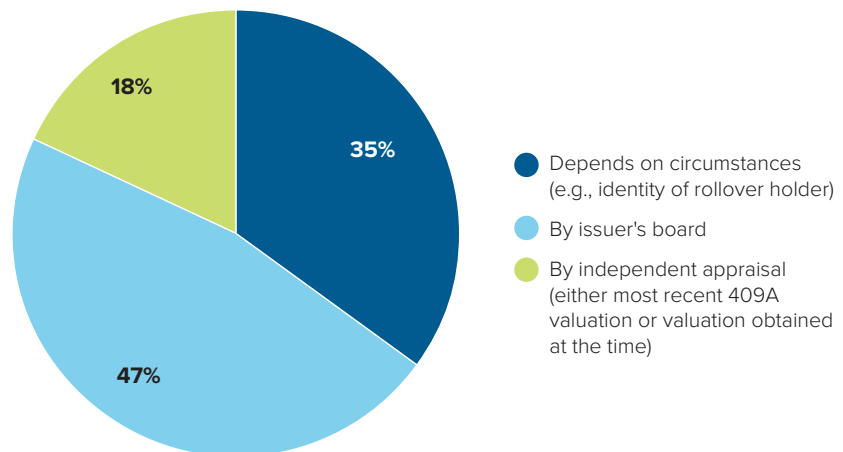
## ROLLOVER SUBJECT TO CALL OR FORFEITURE

In your buyout and recap transactions with rolled equity, do you place buyback rights on such rolled equity for termination of employment with the company?



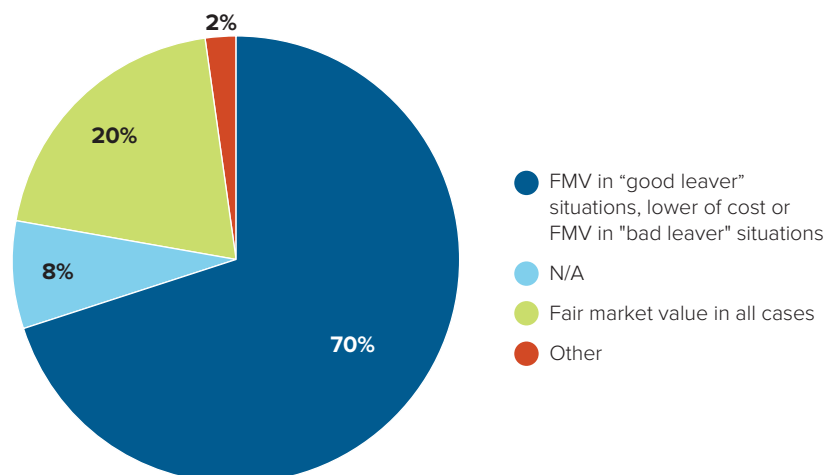
## FAIR MARKET VALUE DETERMINATION

When rollover securities are subject to an FMV buyback, how is FMV typically determined?



## PRICE PAID ON A REPURCHASE

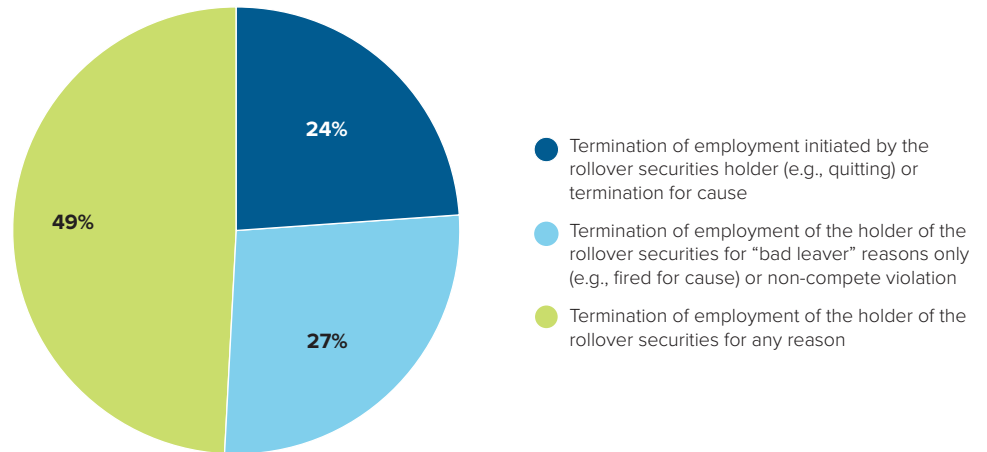
What price does the issuer or sponsor typically pay on a repurchase/clawback of vested rollover equity?



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## TRIGGER OF CALL OR FORFEITURE

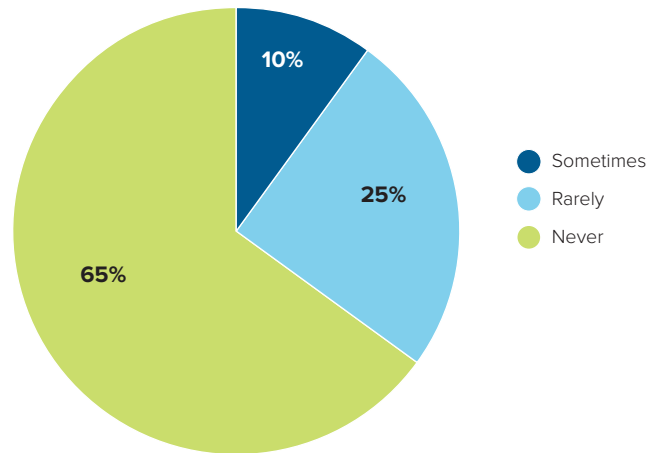
If rollover securities are subject to buyback rights, when are call/repurchase rights typically triggered?



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## PUT RIGHTS FOR ROLLOVER SHARES

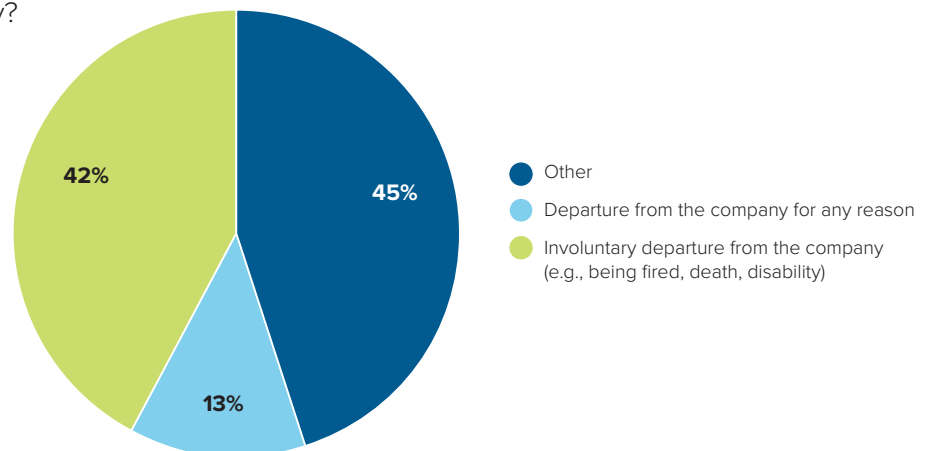
Do rollover securities in your buyout and majority recap transactions have put rights (e.g., the holder has the right to require the company to buy back his or her rollover securities in specified circumstances)?



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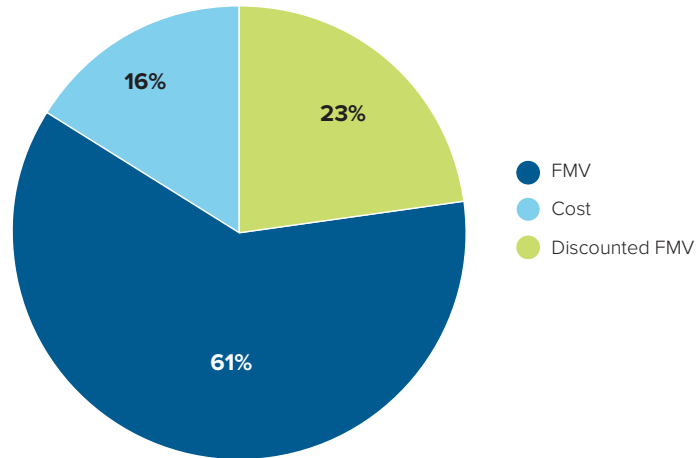
## TRIGGER OF PUT RIGHTS

What typically triggers put rights, if any?



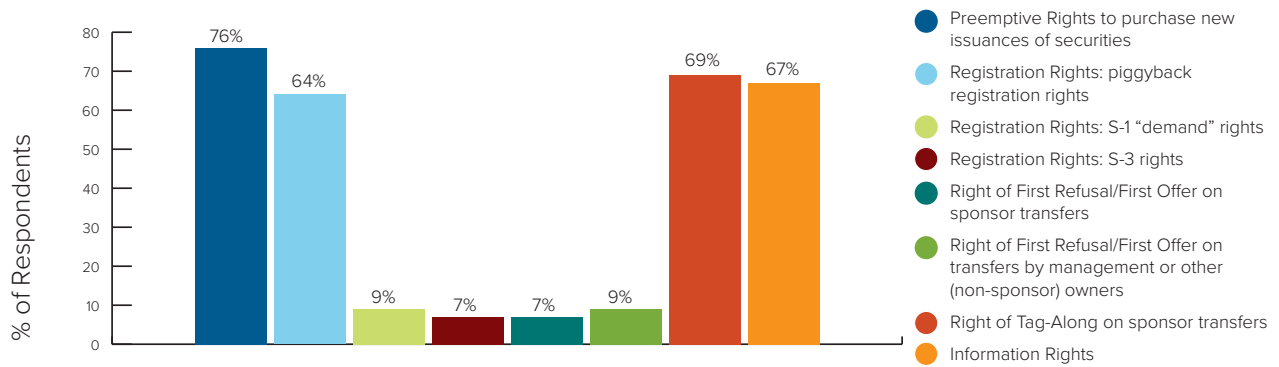
## PUT PRICE

When put rights exist, what is the typical price paid to acquire rollover securities when the put is exercised?



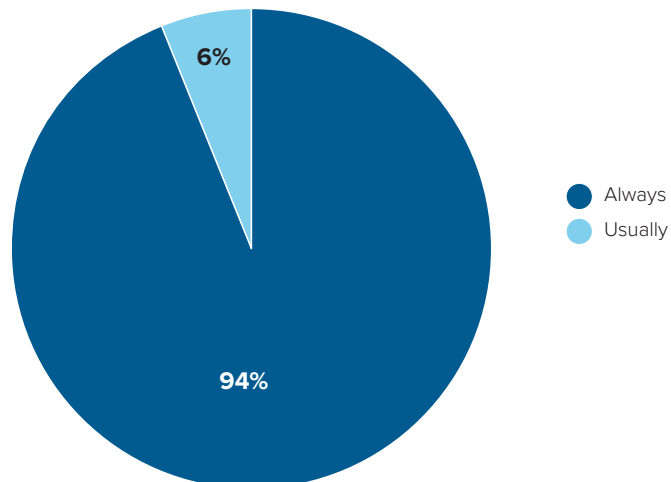
## OTHER SHAREHOLDER RIGHTS FOR ROLLOVER SHARES

What rights do you typically offer holders of rollover securities? (please check all that apply)



## DRAG-ALONG ON ROLLOVER SECURITIES

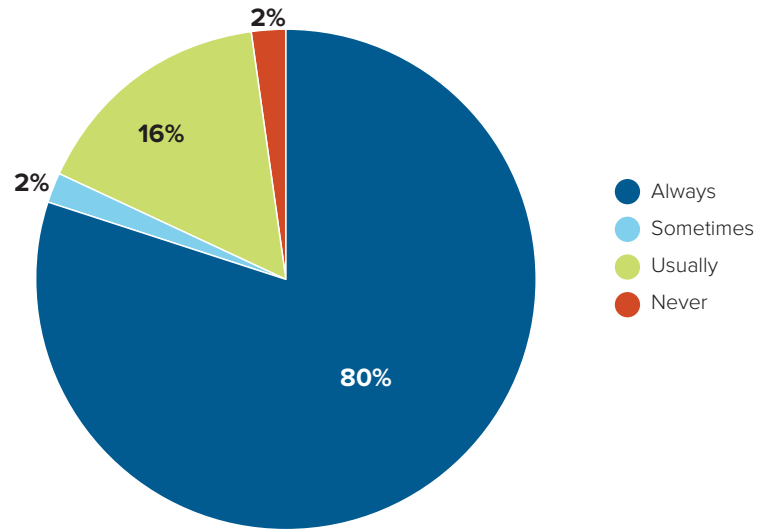
Are rollover securities subject to drag-along/forced sale provisions in favor of the sponsor upon an exit?



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## TRANSFER RESTRICTIONS ON ROLLOVER SECURITIES

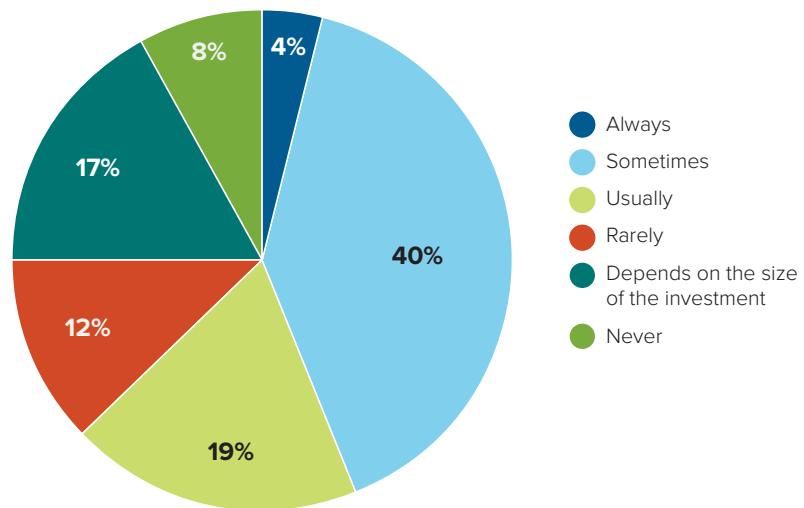
Are rollover securities subject to prohibitions or restrictions on transfer?



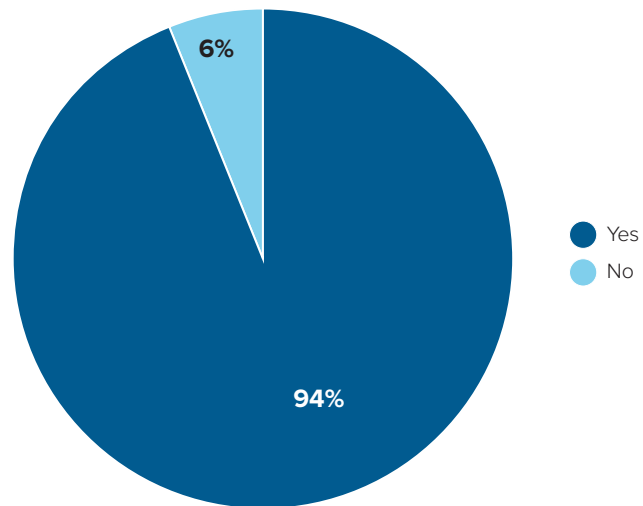
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## ROLLOVER BOARD SEATS

Do rollover security holders typically have the right to a board seat or seats?



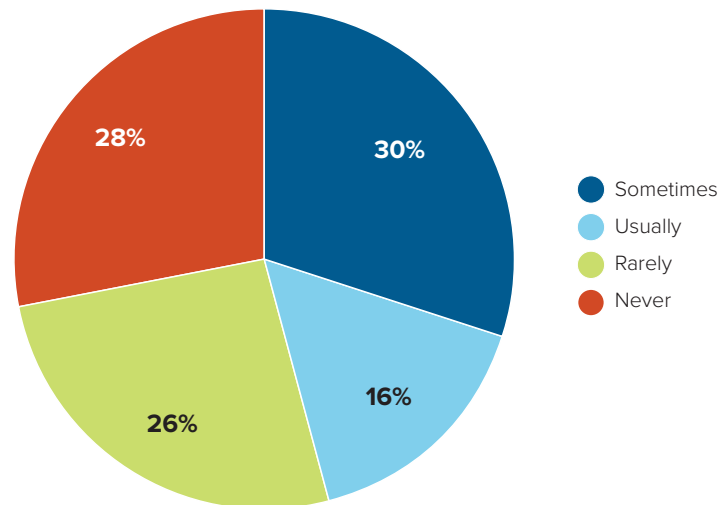
If yes, do security holders have to maintain an ownership % to keep their rights to board seat or seats?



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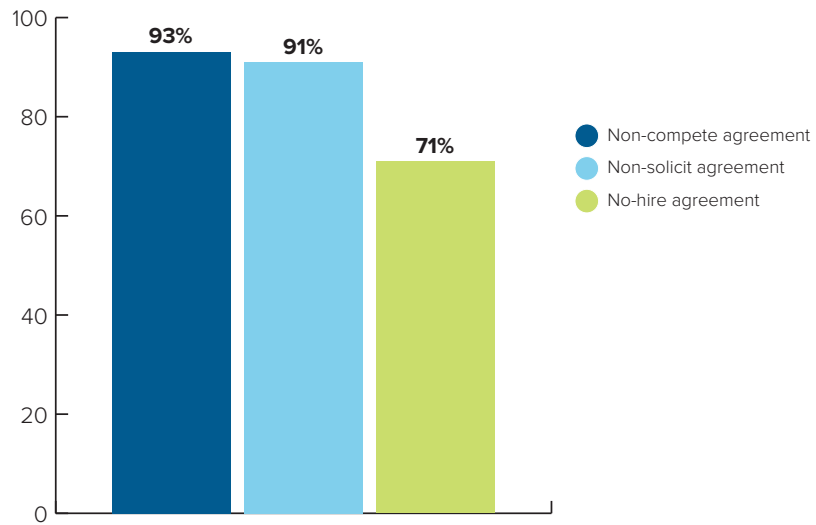
## OPTIONS AND BONUSES

Do you allow “rollovers” of interests such as bonus rights or unexercised options, in addition to actual equity interests?

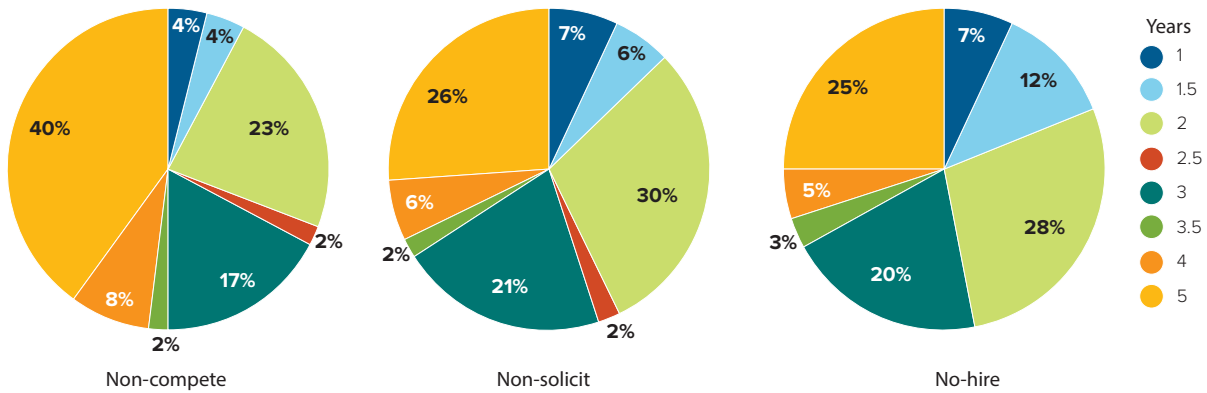


## RESTRICTIVE COVENANTS

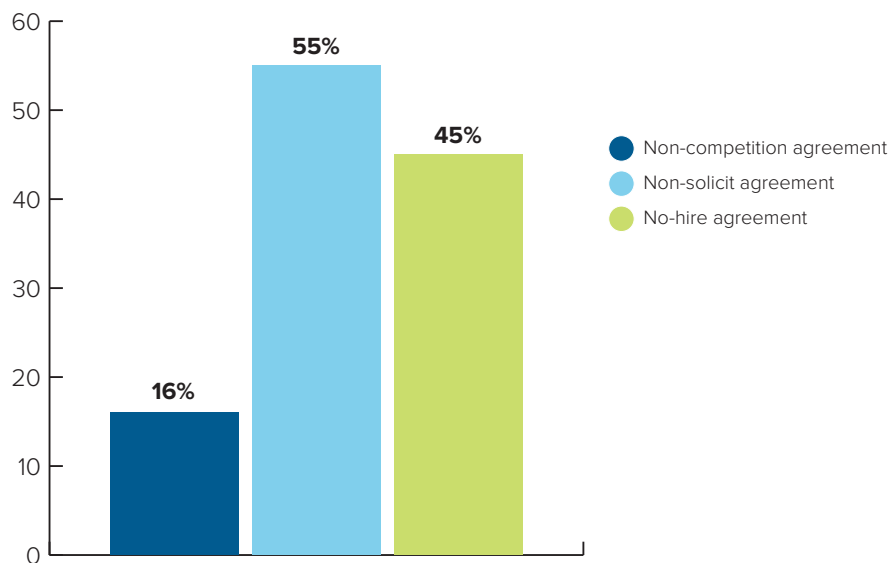
Do you require any of the following provisions from rollover participants?



How long is the time period of such restricted covenant in years?



If the seller is a financial institution, do you require any of the following regardless of rollover?



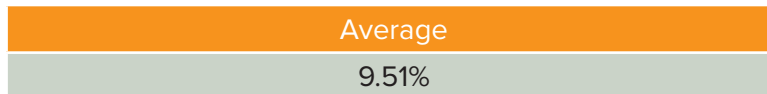


## II. INCENTIVE EQUITY

### MANAGEMENT EQUITY INCENTIVE

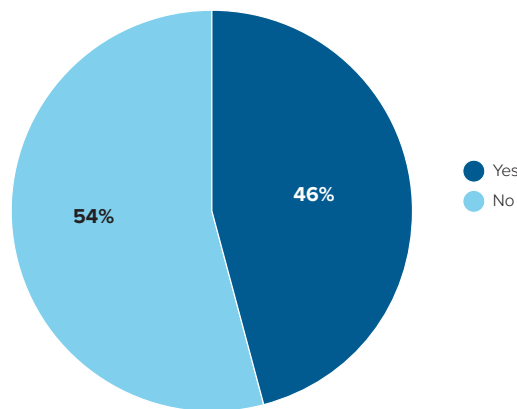
#### SIZE OF POOL

What is the average size of the management equity incentive pool in your buyout and majority recap transactions (expressed as a percentage of the fully diluted equity capitalization)?

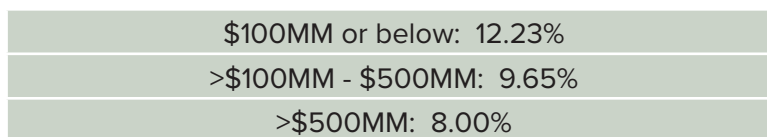


#### SIZE OF POOL RELATED TO SIZE OF DEAL

Does the size of the management equity incentive pool you offer vary in relation to the size of the transaction/ equity investment involved?

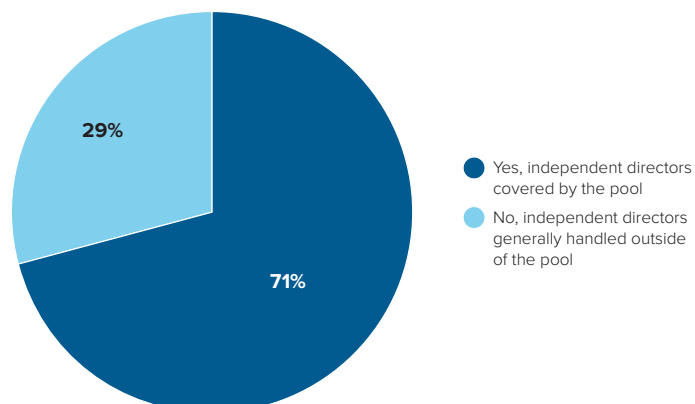


If the answer to the preceding question is yes, what is the typical management equity incentive pool size in a transaction involving an aggregate equity contribution of (expressed as a percentage of the fully diluted equity capitalization and not as a percentage of the pool):



#### DIRECTORS INCLUDED IN POOL

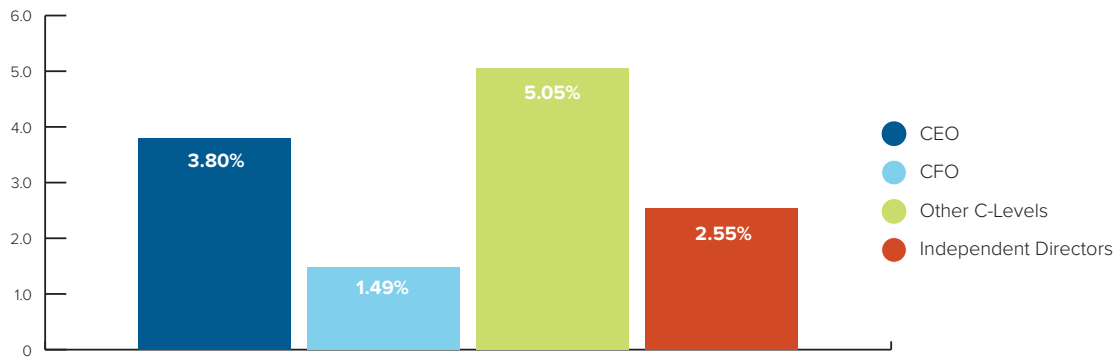
Does this pool typically cover awards to independent directors or are any such awards granted outside of the incentive pool?



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## FULLY DILUTED EQUITY POOL

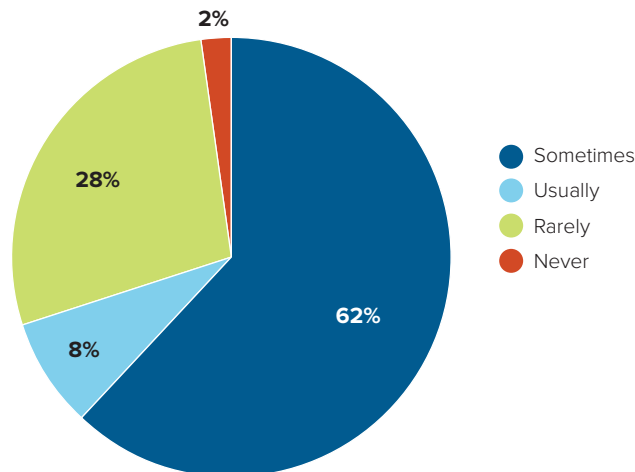
What percentage of the company's fully diluted equity is set aside for each of the following (expressed as a percentage of the fully diluted equity capitalization and not as a percentage of the pool)?



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## NEGOTIATION OF POOL SIZE

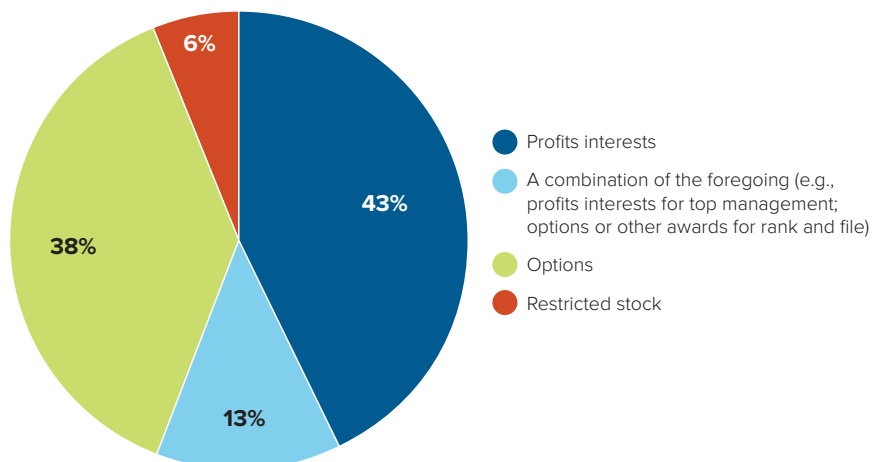
How often does management succeed in increasing the size of the equity incentive pool you initially propose through negotiation?



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## STRUCTURE OF MANAGEMENT EQUITY INCENTIVE POOL

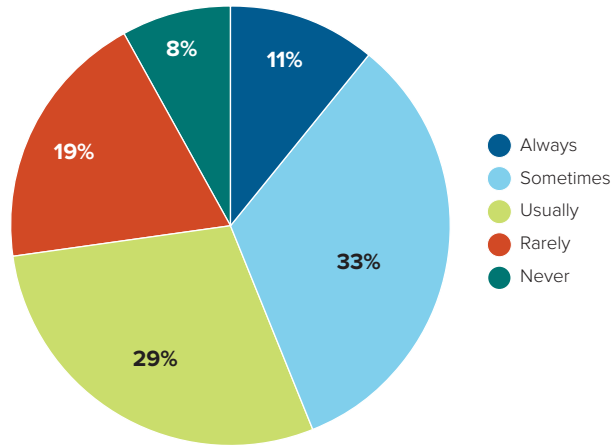
How is the management equity incentive pool structured in your buyout and majority recap transactions?



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## USE OF PROFITS INTERESTS

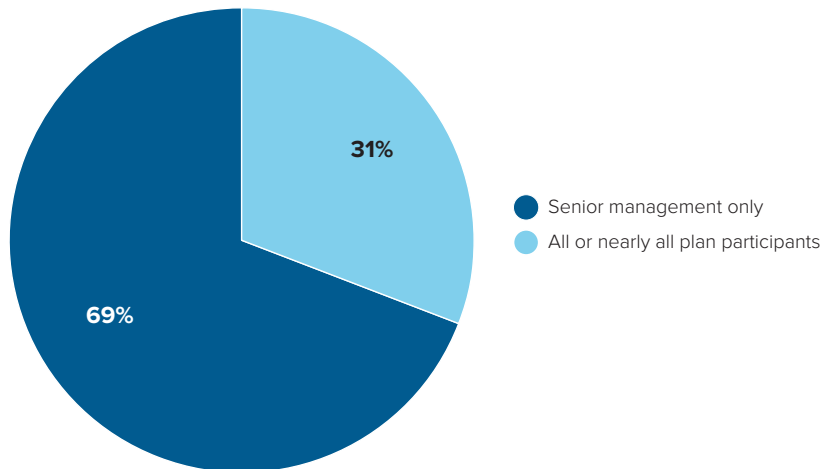
Do you use profits interests (whether in an operating company or in a holding company on top of a corporation) as an equity incentive tool for management?



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## PROFITS INTERESTS ALLOCATION

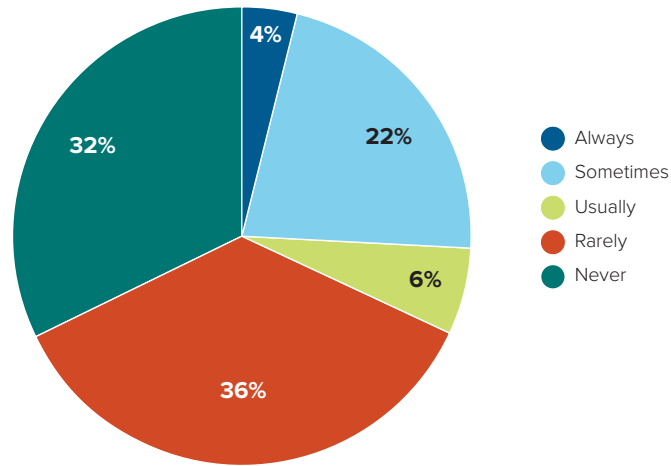
If profits interests are used to provide equity incentives for management, how deep within the organization are they awarded?



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## ANTI-DILUTION FOR MANAGEMENT POOL

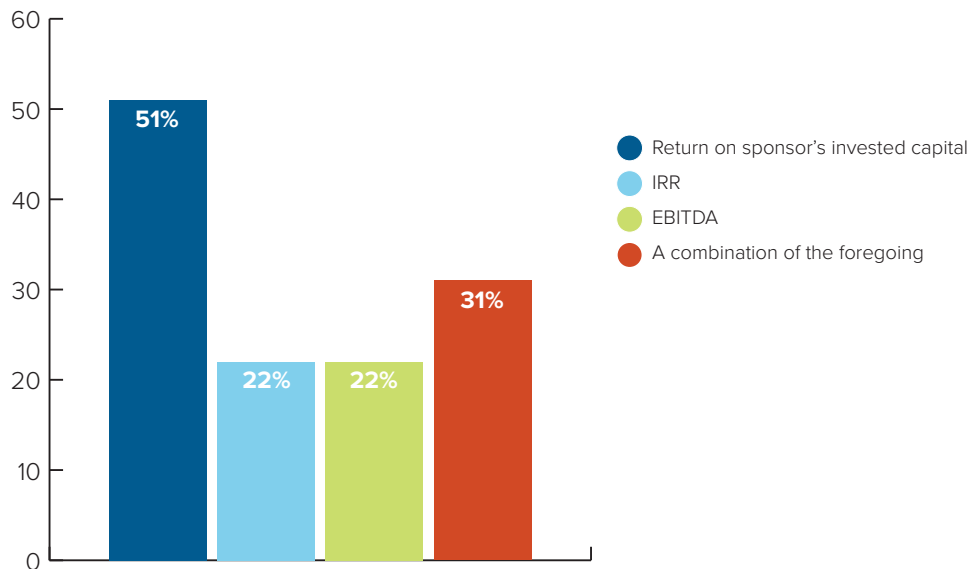
Do your management equity incentive pool terms include some type of anti-dilution protection, or “ever-green” provision for management other than preemptive rights?



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## PERFORMANCE-BASED VESTING CRITERIA

If you use performance-based vesting, which metrics do you tie to vesting?



# OPTIONS FOR INCENTIVE EQUITY

## TIME-BASED VESTING

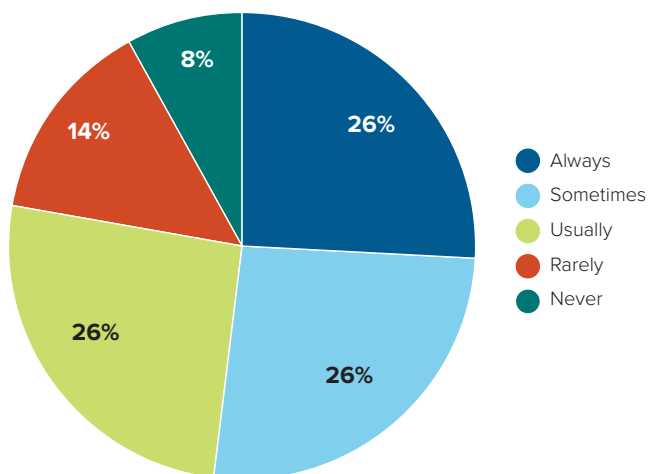
What is the typical period for time-based vesting (expressed as a number of months)?



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## BUYBACK OF VESTED EQUITY

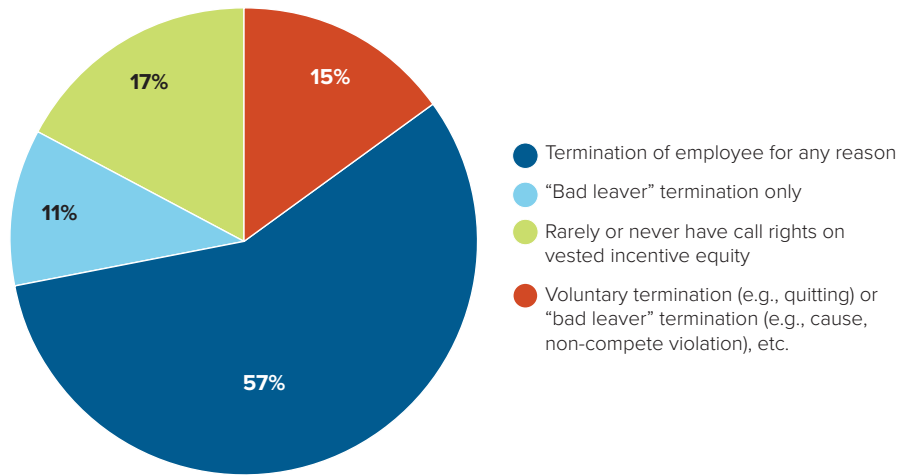
Does the issuer have the right to repurchase vested management equity incentive awards?



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## TRIGGER OF VESTED EQUITY BUYBACK

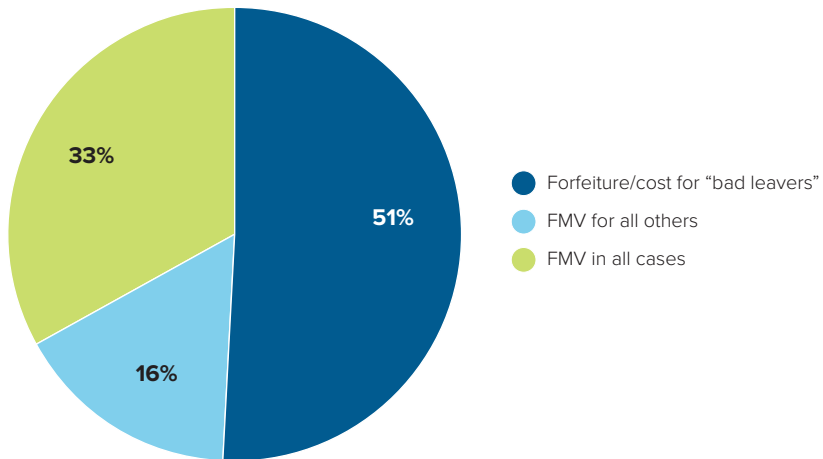
If the issuer has the right to repurchase vested equity incentive awards, when does this right arise?



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## BUYBACK PRICE FOR VESTED EQUITY

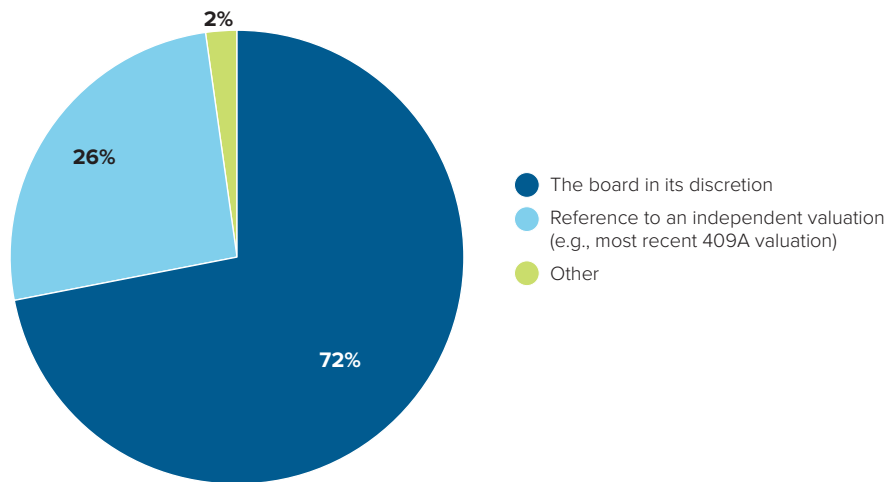
What is the typical price paid to acquire vested management equity incentive interests?



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## DETERMINATION OF FMV FOR BUYBACK

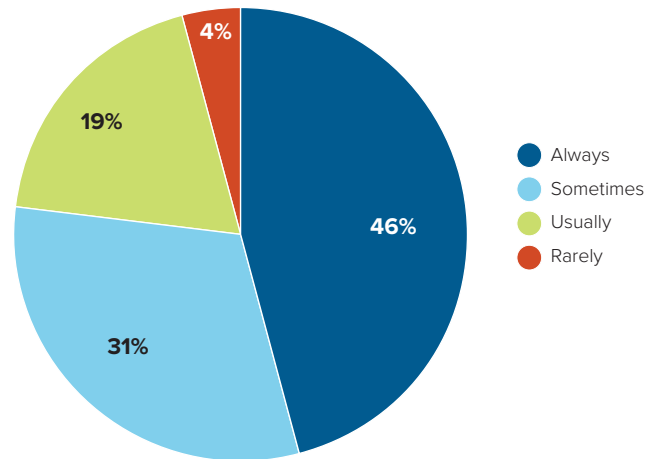
FMV typically determined by:



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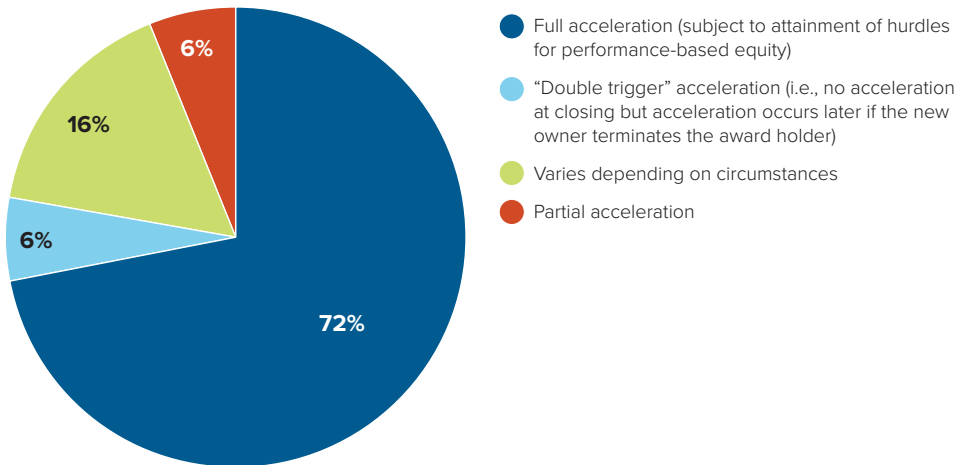
## ACCELERATION OF VESTING ON SALE

Does time-based vesting of time-based management equity incentive pool interests automatically accelerate on a sale of the company:

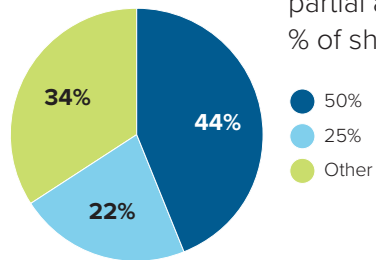


## TERMS OF ACCELERATION

When time-based vesting accelerates on a sale of the company, do you typically provide:



For those respondents indicating partial acceleration of vesting, the % of shares accelerating was:

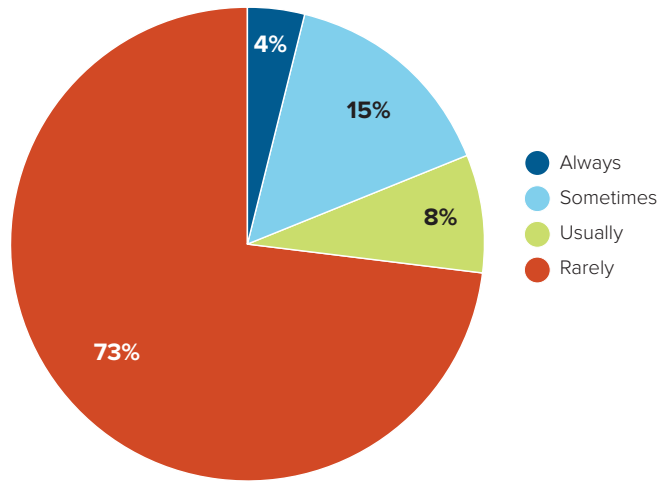




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## ACCELERATION ON TERMINATION

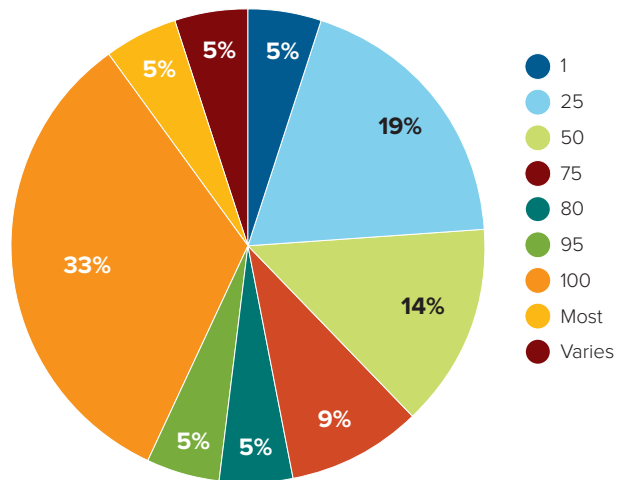
Do you typically provide for acceleration of vesting for some or all of the unvested time-based management equity incentive on involuntary termination of the award holder's employment?



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## VOLUNTARY ACCELERATION

In your deals where there is not automatic acceleration, what percentage of shares do you voluntarily accelerate?



## ABOUT US

Goodwin is a leading global firm, with 1000+ lawyers in offices across the United States, in Europe and in Asia. For more than 100 years, our lawyers have excelled at complex transactional work and high-stakes litigation. The firm combines in-depth legal knowledge with practical business experience to help clients maximize opportunities and manage risk. The firm focuses on matters involving financial institutions, intellectual property, private equity, real estate capital markets, securities litigation/white collar defense, and technology/life sciences.

Our private equity practice has earned a position as one of the leading private equity practices in the U.S., with particular prominence in the middle market and with dramatically accelerated growth in Europe. We have extensive experience and a long list of clients in a number of key industries including healthcare, technology, life sciences, Fin Tech, financial services, consumer products, and education. With a team of over 200 private equity attorneys, we represent early through late stage investors and companies, lenders and financial institutions, covering the full life cycle of their investments and financings. For more information about our private equity practice, please visit us at <https://www.goodwinlaw.com/services/industries/private-equity> or contact Co-Founder and Co-Chair of the Private Equity practice, **John LeClaire** at [jleclaire@goodwinlaw.com](mailto:jleclaire@goodwinlaw.com) or partner, **Jon Herzog** at [jherzog@goodwinlaw.com](mailto:jherzog@goodwinlaw.com).





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