Correct

Correct Answer	Your Answer
A	
B	
C	✓

Confidence Level:
Not Selected

Continue

Related Lessons:
Learn more about this topic

Shoshone Capital Case Scenario

Shoshone Capital is a private equity firm that structures funds as limited partnerships for which it serves as the general partner. The funds focus on buyouts of publicly traded companies. Shoshone has produced a new marketing brochure that it will use to solicit capital investments. The first section of the brochure describes the common characteristics of buyout investments, including the following:

Characteristic 1	The target firms generally have experienced management teams.
Characteristic 2	The target firms often have the potential for substantial cost reductions.
Characteristic 3	The deals are generally arranged through relationships with the existing shareholders.

Section 2 of the brochure discusses how Shoshone aligns its interests with those of the managers of its portfolio companies.

Shoshone's brochure provides an example of a typical acquisition, in which it purchased LUW, Inc., for $160 million. After the acquisition, LUW's new capital structure consisted of $80 million in debt, $65 million in preference shares, and $15 million in common equity. After six years, Shoshone sold LUW, Inc., to another private equity firm for $285 million.

The brochure also provides an example of a private equity fund called Tensleep Fund, which has committed capital of $150 million, a management fee of 2%, carried interest of 20%, and a hurdle rate of 9%. Carried interest is paid on a deal-by-deal basis. In the example, the fund calls $100 million in commitments at the beginning of the first year and invests $40 million in Firm A and $60 million in Firm B. At the beginning of the second year, it calls the remaining $50 million and invests it in Firm C. At the end of the second year, the investment in Firm B is sold for $70 million. At the end of the third year, the fund's investment in Firm A is worth $54 million, its investment in Firm C is worth $40 million, and it has $46 million in cash.

The brochure concludes with the history of a second private equity fund called Pocatello Fund. The first five years of this fund's cash flows and distributions are presented in Exhibit 1.

Exhibit 1

Support

Year	Paid-In Capital	Mgmt. Fees	Operating Results	NAV before Distributions	Carried Interest	Dist
2005	40	0.8	–3	36.2		
2006	55	1.1	4	54.1		
2007	80	1.6	11	88.5		
2008	100	2	27	133.5	4.2	
2009	125	2	34	167.3	6.6	

Note: NAV is net asset value.

Correct Answer	Your Answer
A	
B	
C	✓

Confidence Level:
Not Selected

Continue

Related Lessons:
Learn more about this topic

Q. Which of the following clauses is *most likely* to be included in Section 2 of Shoshone's brochure?

A. Liquidation preference
B. Reserved matters
C. Tag-along, drag-along rights

Solution

C is correct. Tag-along, drag-along rights protect the interests of managers, not the private equity firm. Tag-along, drag-along rights ensure that any potential future acquirer of the company may not acquire control without extending an acquisition offer to all shareholders, including the management of the company.

A is incorrect because liquidation preferences place the returns of the private equity firm ahead of those of other investors, including the portfolio firm's managers.

B is incorrect because private equity firms may require that certain strategically important decisions (such as acquisitions or divestitures) be approved by the private equity firm, protecting its equity interests, not those of managers.

© 2022 CFA Institute. All Rights Reserved.