



Morgan Lewis

**ADVANCED TOPICS IN
HEDGE FUND PRACTICES
CONFERENCE**

Manager and Investor Perspectives

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Co-investments

Speakers



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What Is a Co-Investment?

What is a co-investment?

- A minority equity investment in a portfolio company made directly by a private fund investor together with, but not through, the private equity fund.
- The investment is often in addition to the investment in the private equity fund sponsor.

Co-Investment Structures

Portfolio Company Direct Investment

Co-investor contributes capital directly to the portfolio company in exchange for equity of the portfolio company.

Fund Investment Vehicle

Co-investor contributes capital to, and receives equity of, the entity used by the private equity fund to acquire and hold its portfolio company equity.

Co-Investment Aggregation Vehicle

Co-investor contributes capital to, and receives equity of, an investment vehicle managed by the fund sponsor into which all co-investment funds are pooled to acquire and hold portfolio company equity.

Single-Investor SPV

Co-investor contributes capital to, and receives equity of, a fund sponsor-managed special purpose vehicle (SPV) that acquires and holds portfolio company equity. If there is more than one co-investor, each co-investor comprises its own SPV.

Key Investor Objectives in Negotiating Co-Investments: Due Diligence

Sponsor's Due Diligence

- Legal due diligence summary
- Financial due diligence summary

Transaction Documents

- Underlying Purchase Agreement
- Disclosure Schedules
- RWI Policy, if any
- Ancillary documents (e.g., management agreement, shareholders' agreement)

Other Due Diligence

- Regulatory
- Tax
- ERISA
- AML – need complete structure chart with all subsidiaries – correct names and jurisdiction of organization

Key Investor Objectives in Negotiating Co-Investments: Alignment of Co-Investor and Sponsor Interests

Co-investor negotiates with fund sponsor and has limited or no contact with portfolio company

Maintain as much alignment as possible with sponsor to provide protection of the co-investors' interests such as:

- Price
- Type of security
- Terms of investment
- Simultaneous exit on same terms
- Expenses

Require sponsor to take same actions on behalf of co-investor as on behalf of sponsor

Investments in separate investment vehicles make it more difficult to ensure alignment of interests and ensure that the lead sponsor will govern co-investment vehicle in lockstep with its own fund vehicles

Key Investor Objectives in Negotiating Co-Investments: Limited Minority Protections

Minority protections depend on the structure of the co-investment and get increasing pushback from sponsors.

Types of minority protections:

- MFN – ensure no other investor receives superior investment rights, but becoming very rare
- Preemptive rights
- Board observer/Board seat
- Information rights
- Consent/amendment rights

Individual side letters are commonly negotiated with co-investors to address regulatory issues and specifically negotiated rights not given to other shareholders. Side letters can also be used to clarify terms of the investment agreement when a sponsor is unwilling to revise its form.

Transfer/Exit Rights



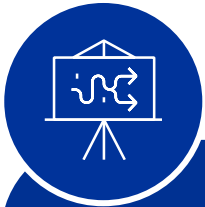
- The general goal is to be tied at the hip with the sponsor and to exit at the same time and on the same terms as the sponsor.
- Transfer of investors equity
- Types of exit rights:
 - Drag-along right
 - Tag-along/Co-sale right
 - Registration rights

Market Trends in Co-Investment Transactions



- Higher Expense Caps
- MFNs Becoming a Rarity
- Fewer Securities Covered by Tag-Along/Co-Sale Right
- Equity Commitment Letters Becoming More Popular
- Requests for Co-Investors to Cover a Pro Rata Portion of a Sponsor's Reverse Break Fee are Increasing
- Post-Closing Drawdowns of Capital
- Co-Investment Aggregation Vehicles Becoming the Norm

Market Trends in Co-Investment Transactions



- Syndications/Multistep Closings
- Closing Co-Investments Preacquisition
- Continuation Funds
- Multi-investment Co-Investment Funds
- Enhanced Regulatory Focus