What are Co-Investments?

A co-investment is a direct investment made alongside a fund manager but separate from the main fund. Co-investments are most often associated with private equity (PE) and typically involve an investment in a specific company. They occur for several reasons, including a desire for the PE fund to raise additional capital to make a larger investment than would otherwise be possible, an opportunity for the fund to access more capital, and/or a way for the investor to increase exposure in a high conviction investment.

HOW CO-INVESTMENTS WORK

On the demand side, investors, or limited partners (LPs), typically express their interest in co-investment opportunities at the time they make their commitment to the primary PE fund. This interest is stated in the subscription agreement or in a separate side letter. LPs can also see specific deal flow on an ad hoc basis if offered or syndicated by the general partner (GP), or PE fund manager.

On the supply side, GPs offer co-investment opportunities to a select list of LPs based on their stated interest, past participation or for other reasons such as an effort to build relationships with new investors.

Once an LP expresses interest in a specific transaction, an enhanced due diligence process by the LP begins in order to evaluate the investment. This evaluation period can last several weeks before the investment is completed. The GP will often set up a special purpose vehicle (SPV) to hold the asset and the LP's commitment, which is invested almost immediately (versus capital calls for a main PE fund). In other cases, a co-investment can be arranged as a direct investment in the company.

BENEFITS TO INVESTORS/LPs

- Co-investments allow investors to make a targeted investment in a desirable company or asset.
- Investors have transparency to specific investments with discretion as to whether to invest or not. This is in contrast to a primary PE fund where LPs commit capital without knowing how the money will be invested.
- Co-investments are typically offered without management or performance fees, offering an opportunity for enhanced returns. Although, other fees such as transaction charges may be incurred.

BENEFITS TO FUND MANAGERS/GPs

- Co-investments are a method to make a larger investment in a specific company than otherwise would be possible in the primary PE fund due to concentration or diversification requirements. This can also enable a GP to acquire larger assets.
- GPs can offer co-investments as a method to make or strengthen relationships with new or existing investors.

KEY RISK CONSIDERATIONS

- **Potential conflicts of interest.** GPs could offer co-investment opportunities for specific reasons, such as pre-existing relationships with a portfolio company or to entice new investors. Conflicts could also arise in how and to whom deals are offered.
- **Fee transparency.** While many co-investment opportunities come without standard management or performance fees, other less common fees, such as monitoring costs or transaction charges, could apply.
- **Deal quality and diligence risk.** The quality of co-investments can vary widely, and enhanced due diligence is required by the LP.
- **Concentration risk.** Making larger investments into specific companies to which they may already have exposure within their underlying GP fund commitment.
- **Strategy drift.** A risk that the GP deviates from its initial agreed-upon objection, specifically when focusing on larger investments.

Please contact your financial professional or a fund manager to learn more.

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