MEKETA CAPITAL

What are Co-Investments?

A private equity ("PE") co-investment is a type of investment strategy where an investor (limited partner or LP) makes a direct investment in a private company (portfolio company) alongside a private equity fund manager (general partner or GP). This differs from the typical "blind pool" private equity fund structure due to the LP having knowledge of the specific portfolio company into which they would be investing.

Typical Private Equity Fund Structure

Limited partners select their private equity fund managers, but may not have control over capital flows into specific portfolio companies.

"Blind Pool" Structure

LPs in traditional private equity funds can provide capital to GPs for them to invest in portfolio companies, however they may not know portfolio company specifics.

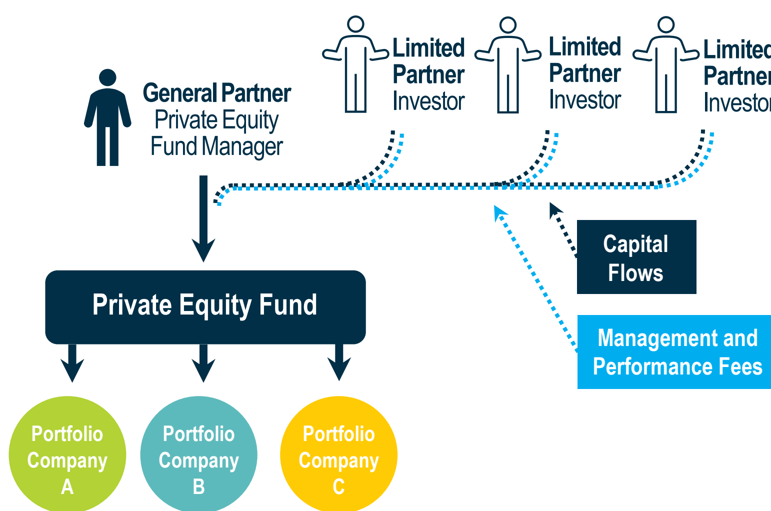

FIGURE 1
Blind Pool Structure

Source: Meketa Investment Group.

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Co-Investment Structure

Limited partners in a co-investment structure may have more control over investments in specific portfolio companies.

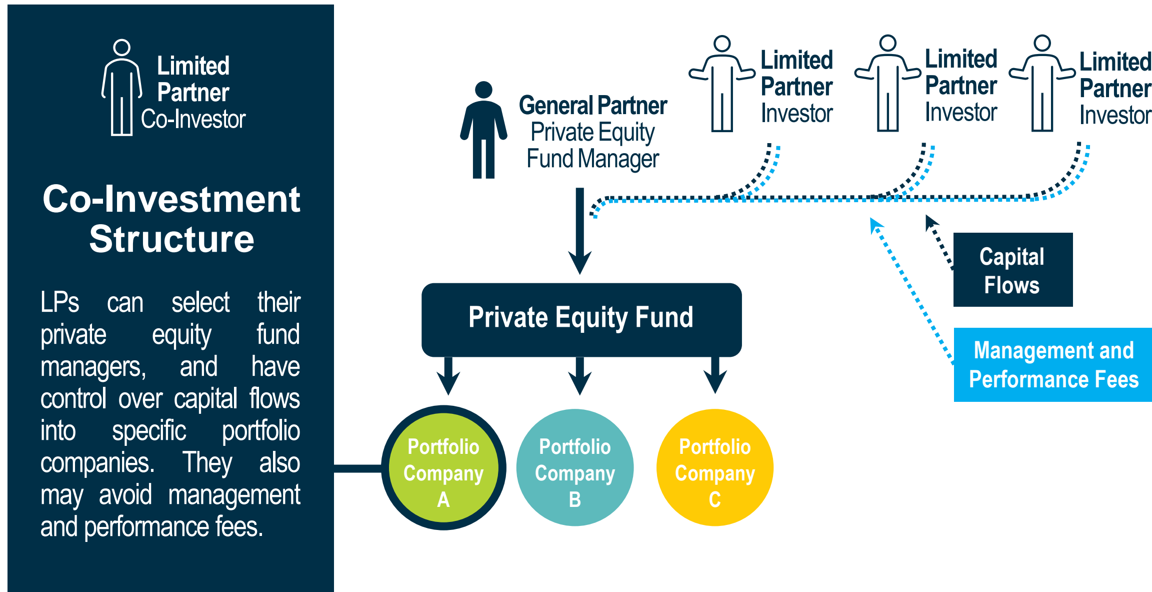

FIGURE 2
Co-Investment Structure

Source: Meketa Investment Group

For illustrative purposes only.

Co-Investor Underwriting Considerations

- Opportunity Sourcing
- Investment Screening
- Internal Review Process
- Due Diligence
- Investment Approval
- Legal
- Closing and Funding

Co-Investment Portfolio Company Considerations

As private equity investors consider a co-investment approach, an investor may want to consider how they might approach the underwriting of a particular investment opportunity. Opportunity sourcing, initial screening for investment potential, internal governance reviews, investment due diligence, and ultimately investment execution all fall within the purview of a co-investor.

While LPs may make the decision to be a more passive participant partnering closely with their chosen GP, there is an expectation that LPs communicate clearly with their GP regarding their specific investment factors regarding co-investment.

Why might co-investments be attractive to private equity investors?

Potential Lower Fees

Unlike traditional private equity funds, co-investments are not typically charged certain fees like management fees (generally 1.5% to 2.0% per year) and carried interest (generally 20% of profits).

Potential Higher Returns

Because co-investments are typically structured with lower fees, there is the potential for higher net returns.

Greater Portfolio Exposure Control

Through the transparency offered by the co-investment structure, portfolio construction factors such as strategy, geography, and industry can be individually evaluated. The opportunity to undertake target-specific due diligence allows the co-investor to gauge portfolio 'fit'.

What are potential risks of co-investments?

Increased Portfolio Concentration

As a co-investor, there is an active decision made to direct capital towards a specific portfolio company. This may result in increased volatility as company valuations fluctuate. This may also result in broad portfolio concentrations by tilting the overall portfolio towards a particular strategy, geography, or industry.

Need for Additional Governance & Administration

Co-investments are investments into specific portfolio companies which may raise the complexity of an investor's portfolio operations. Investors may need to develop new internal governance processes to evaluate and approve investments. Opportunities also need to be evaluate quickly which may also increase operational complexity.

Direct Involvement and Risk

In contrast to traditional private equity fund structures, a co-investor has a direct relationship with the portfolio company. By more directly engaging in the management of the portfolio company, influencing its direction, operations, and strategy, the co-investor takes on both the upside and downside of the companies performance. This may result in greater headline risk to the co-investor.

Glossary

Buyout	Invests in established companies, often with the intention of improving operations and/or financials. Investment often involves the use of leverage.
Growth	Typically takes significant minority positions in companies without the use of leverage. Targets profitable, but still maturing, investee companies with significant scope for growth. Investment horizons are mid-to-long term, similar to those seen with buyout funds.
Venture Capital (general)	Provides capital to new or growing businesses with perceived long-term growth potential.

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