CO-INVESTMENTS – STRUCTURAL CONSIDERATIONS (PART 1 OF 2)

INTRODUCTION

Persisting macroeconomic challenges, lengthier fundraising periods and allocators' desire to deploy capital to pre-identified assets have fuelled the popularity of co-investments. Given the increased attention, we have prepared this two-part refresher on co-investments. We will first provide an overview of the main structural factors to be taken into account by both sponsors and investors, including examining the differences between direct and indirect co-investments and participation by investors at the bidding stage versus the syndication stage. In the next briefing, we will explore some of the more heavily negotiated terms with indirect co-investment transactions.

WIN-WIN

Co-investments offer unique advantages for both sponsors and investors. For well-established sponsors, offering co-investment opportunities to their existing investors can help build goodwill, strengthen relationships, be a differentiating factor from other sponsors and result in obtaining new commitments for their next blind pool fund. Startup managers may use co-investments to build a track record to in turn accelerate their fundraising efforts. In each case, co-investments may also facilitate executing transactions which would otherwise exceed a fund's investment limitations.

For investors, given that co-investments are often offered on a "no fee, no carry" (or at least on a reduced fee) basis, these transactions offer obvious economic benefits with minimal costs involved. Strategic investors and those wishing to have enhanced governance rights, also benefit from co-investments by being closer to the asset and enabling them to add value with their relevant expertise.

DIRECT VS. INDIRECT CO-INVESTMENTS

Co-investments generally fall into two broad categories: direct and indirect. Each approach offers a unique set of features, benefits, and legal considerations.

In a direct co-investment, the co-investor typically acquires an interest directly in the target company or asset. This structure provides the co-investor with increased visibility over the terms of the underlying investment, including the ability to negotiate specific minority shareholder rights, governance provisions, and exit arrangements. Direct co-investments tend to appeal to strategic investors, who might have sector-specific expertise which they can share with the sponsor or the target as a value add. Investors participating in direct co-

AT A GLANCE

- **Mutual Benefits:** Co-investments help sponsors build investor relationships while offering investors access to transactions on favourable economic terms, often on a "no fees no carry" basis.
- **Market Momentum:** Macroeconomic pressures and longer fundraising cycles have increased the appeal and prevalence of co-investments across the industry.
- **Direct vs. Indirect:** Direct co-investments offer control and visibility over the terms of the investment, suited for experienced or strategic investors; indirect co-investments are ideal for passive investors who wish to benefit from a simplified due diligence process and administrative efficiencies.
- **Timing Matters:** Participating at the bid stage offers influence but higher execution risk; joining at syndication provides deal certainty but less negotiating power.

investment opportunities typically have the necessary internal resources, industry-specific and/or transaction-related expertise to conduct their own due diligence, ability to negotiate the transaction documents, execution capabilities and experience in handling the complexities and administrative aspects of direct ownership, including ongoing monitoring.

By contrast, indirect co-investments are structured through a vehicle established by the sponsor and which may aggregate the commitments of all co-investors with those of its main fund vehicles that also invest in the relevant asset. This approach is often favoured where the co-investor may not have the resources and/or the desire to engage directly with the asset. Such investors tend to be content with being a passive investor relying on the expertise and infrastructure of the sponsor to manage the investment. While this entails that indirect co-investors cede control to the sponsor and need to pay for expenses at the pooling-entity level, they may benefit from a simplified due diligence process, the administrative efficiencies of participating through a pooled vehicle and negotiating familiar fund documents, instead of the underlying transaction documents, while still accessing the economic benefits of a co-investment.

BID STAGE VERSUS SYNDICATION STAGE?

An additional key strategic decision for sponsors and co-investors alike is whether the co-investor should participate at the bid stage or join at the later deal syndication stage. The former can afford co-investors greater influence over deal terms, allow them to negotiate specific rights, governance provisions, and exit arrangements from the outset. Strategic investors may also have sector-specific expertise which may add value for the sponsor and other co-investors and influence the transaction documents. However, participating at the bid stage typically requires significant resources, swift internal approval processes, and a willingness to assume higher transaction execution risk.

By contrast, joining at the syndication stage allows co-investors to benefit from greater deal certainty and rely on the sponsor's completed due diligence. However, this may come with less negotiating leverage, limited visibility over key structuring decisions, and more restrictive terms given that the co-investor will not be able to obtain rights vis-à-vis the asset which the sponsor itself does not have.

CONCLUSION

Sponsors and investors alike should carefully consider the type and timing of co-investment opportunities, as these fundamental structural considerations will significantly shape the relationship among the parties involved.

If you would like to discuss co-investments, including their structuring, market terms, or explore how they fit within your investment strategy, please feel free to contact us. Our team would be delighted to share our insights and assist you in navigating co-investments with confidence.

In the second part of this series, we will explore some of the more heavily negotiated terms with respect to indirect co-investments.

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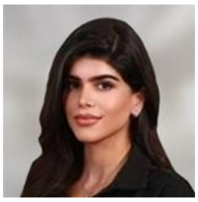

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