



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



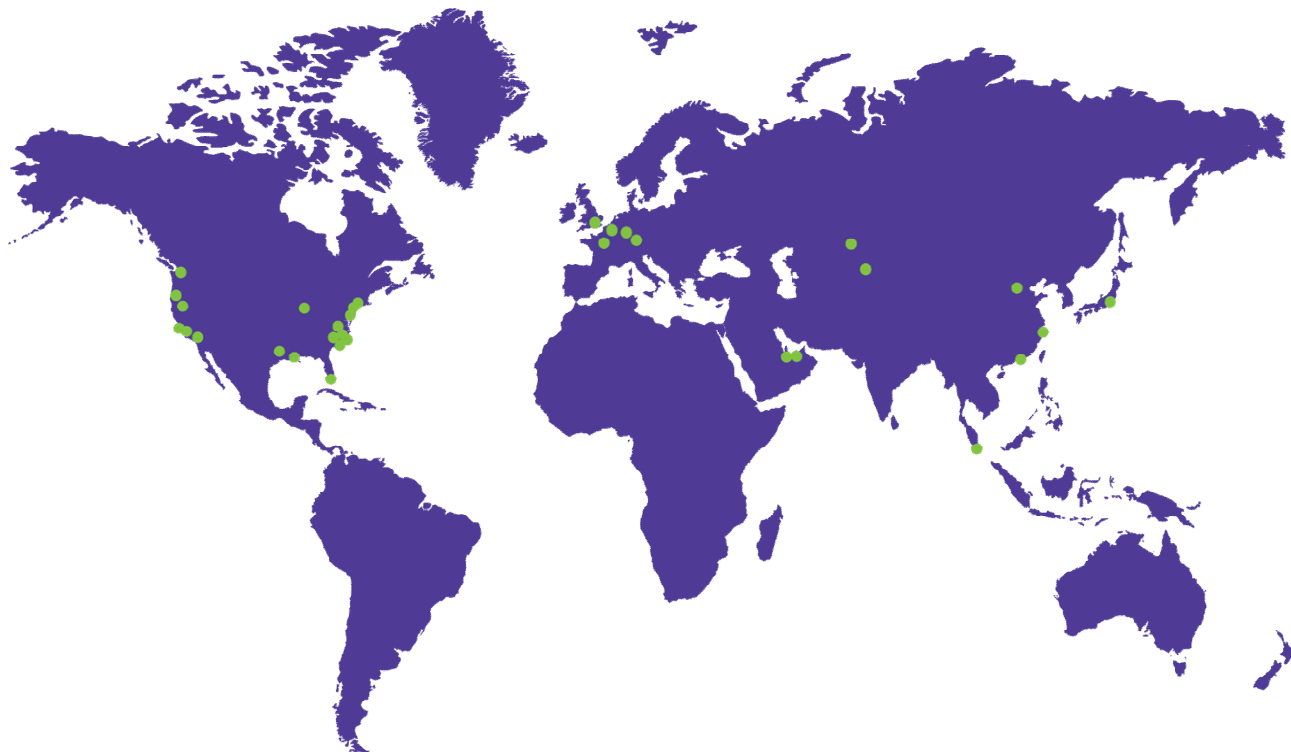
- Syndications/Multistep Closings
- Closing Co-Investments Preacquisition
- Continuation Funds
- Multi-investment Co-Investment Funds
- Enhanced Regulatory Focus

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Astana
Beijing
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong
Houston
London
Los Angeles
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