Co-Investment Lessons From The Trenches

By Richard C. Wilson
10,000 Foot View of the Co-Investment Forest

- Club Deals vs. Co-Investments
- Direct Investments vs. Co-Investments
- Co-Investment Funds
- Co-Investment Rights
The State of Private Equity Today

- **Industry Overview**
  - 3,300 Private Equity Firms in the U.S.
  - Estimated Global Dry Powder: $440 billion.
  - 11,130 Private Equity-Backed Companies in the U.S. (1)

- In North America, deals more than $1 billion in value made up more than 50% of the total spent in global buyouts. But, 75% of buyout deals were less than $250 million in size.(2)

- The lower and middle market remains highly active and valuations reflect increased buyer interest from private equity and other investors.

- **Recent Industry Trends**
  - Rising valuations and EBITDA multiples paid for acquisitions.
  - Many private equity-backed companies have been sold or exited through public markets.
  - Average EBITDA multiples were 9.2x in 2013, expected to rise above 10x in 2014, and one survey projects 11.3x in 2015. (3)
  - Private equity exit multiples rose to 9.5x in 2013 and deal volume in 2013 was 14,077. (3)

1 - Private Equity Growth Capital Council. *PE by the Numbers.*


Thriving Co-Investment Activity

- LP survey found huge investor interest in co-investing. (1)
  - 40% - Actively Co-Investing
  - 37% - Opportunistically Co-Investing
  - 16% - Considering Co-Investing in the Future
  - Only 7% are not co-investing and no plans to do so.

- Same survey showed that co-investors prefer to decide under deal-by-deal selection. (1)
  - Majority of LPs preferred co-investing as selective follower, making decisions on deal-by-deal basis after due diligence (55%)
  - 23% of LPs participated as passive follower.
  - 16% chose to co-sponsor and 7% of LPs invested as a co-lead on the deal.
  - Importantly, 55% of LPs in the survey saw co-investment returns as significantly better than fund investments; 33% perceived slightly better, 15% saw similar returns, and 0% reported worse performance. In other words 88% saw significantly better or better returns, and only 7% think that funds provide better returns.

- BlackRock co-investment report highlighted several reasons for growth in co-investments including: (2)
  - Source of capital for fundraising GPs in post-financial crisis.
  - Means for strengthening bond with LPs.
  - Helped replace capital lost from former LPs (financial institutions) that had to reduce exposure to private equity in compliance with Basel III and Volcker Rule.
  - Greater increase in deal flow to co-investors, presenting more opportunities for LPs.

Investors and Motivations

- **Types of Investors & Motivations**
  - **Corporate**
    - Opportunity to leverage corporate resources and invest in minority position, while still playing active role in generating returns.
  - **Family Office**
    - Willingness to build a strong investment team and take on a more operational role on a deal.
    - Demand for lower fees and greater transparency on deals.
  - **HNW Individual (Angels)**
    - Desire to focus on fewer deals and participate more.
  - **PE & VC Funds**
    - Diversifying investment structure by co-investing or clubbing with other strong GPs and participating on larger deals without committing majority equity.
  - **Institutional: Pensions, Insurance, Endowments & Foundations**
    - General desire for lower fees, greater control on investments, and expectations of higher returns co-investing.
Co-Investment Deal Sizes & Examples

- Scope of deals - $10k-$100k up to $1B+
- Pet, Food, Instrument & Supplement Examples
- Source: Family Office Benchmark Survey
Minority vs. Majority

- Control, Collective Control
- Roles
- Alignment of Interest
Co-Investment Deal Considerations

- Formation
- Member Selection
- Roles & Rules
- Strategy
- Syndicate Expenses
- Advisors
- Duties
- Communication
- Due Diligence
- Investment Vehicle
- Taxation
- Fees
- Governance
- Board
- Information
- Share Transfers
- Exits
- Conflicts
- Non-Competition
- Exclusivity
- Confidentiality
- Public Relations
- Arbitration
Free Direct Investment Worksheet

The more focused and formalized your direct and co-investment focus, and the more thorough your screening of deals (assuming you have enough deal flow) the better off you will be. This is why small teams have a hard time executing high quality deals.


Deal Flow Screening Table

<table>
<thead>
<tr>
<th>Top 3 Industry Focus</th>
<th>$X+ EBITDA ($1M+ EBITDA)</th>
<th>3 Year Operating Track Record</th>
<th>Clear Defendable Advantage</th>
<th>Relationship/Trust &amp; Transparency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term Sheet / Offering</td>
<td>Liquidity via Debt, Royalties, Dividends</td>
<td>Third Party Entities/Payments</td>
<td>Distressed, Bankrupt, or Broken</td>
<td>Current Capital Structure &amp; Debt</td>
</tr>
<tr>
<td>Ability to Adapt &amp; Listen to Input</td>
<td>CEO 100% Committed</td>
<td>Team Profit Sharing Incentives</td>
<td>Long-Term Cognitive Bias</td>
<td>Re-Investing vs. Harvesting Mode?</td>
</tr>
<tr>
<td>Internal Controls &amp; Clean Audit Reports</td>
<td>Team Experience &amp; Resilience</td>
<td>Outside Professional vs. Family Members</td>
<td>Pro-active Constant Improvement</td>
<td>Cohesive Team &amp; Fund Culture</td>
</tr>
</tbody>
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Note: Criteria should be based 100% on investor priorities, risk appetite, strategic industry focus, acquisition strategy, and other preferences.

Source: The Single Family Office: Creating, Operating and Managing Investments of a Single Family Office
Strategies for Attracting Deal Flow

1. Plant Your Flag

2. Proactive Relationship Management

3. Deal Partner Value Contribution
Free Podcast Episode on Co-Investments

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Reasons Co-Investment Deals Fall Apart

1. Fee Layering - Medical Industry Example

2. Valuation - Defense Industry Example

3. Over-Brokered Deals - High-Tech Secondary Example

4. Over-Shopped Auction Feeling to a Deal
Billionaire Family Office

1. **Leading Billionaire Network:** 55 families with $1B+ in net worth

2. **Proprietary Deal Flow Screening** 2,000+ Deals/Year

3. **Serving Buy-Side Clients, Direct & Co-Investments**

4. **Wilson Holding Company:** 1 Million Professionals a Week
   - **Assets:** Global M&A Association (32,000 Members), PrivateEquity.com, SingleFamilyOffices.com, & 77,000 member Family Offices Group Association
   - **11 Person Operational Team,** RainMaker Securities, LLC our Broker-Dealer with over 10 years of investment banking transaction experience. (Securities Offered by RainMaker Securities, LLC Member FINRA/SIPC)
Questions?

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