Hamilton Lane

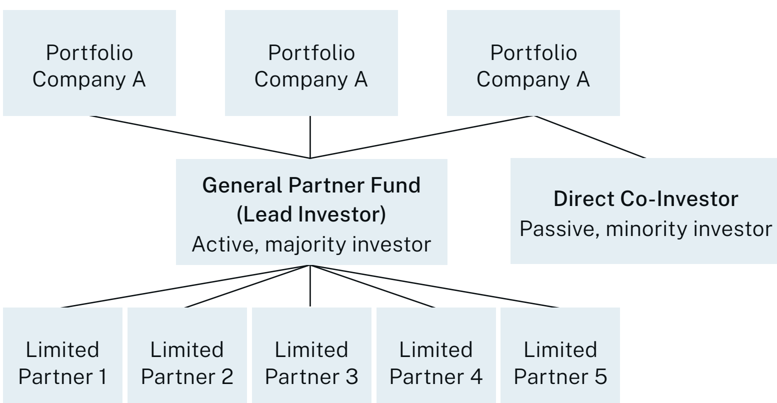
Knowledge Center
The Basics

Introduction to Co-Investments

What are Co-Investments?

There are several ways to participate in private market investing, one of which is direct equity co-investments. Direct equity co-investment refers to a collaborative investment structure in which a private equity firm (general partner or GP) and external investors collectively invest in a private company (portfolio company). This approach allows multiple parties to pool their financial resources, expertise, and networks to make a joint investment and share in the potential profits.

The Anatomy of Co-Investment Deals



To understand how private market investing works, and co-investments in particular, it's helpful to define the main players.

- A general partner (GP) manages a private equity fund (General Partner Fund). The GP is an active majority owner who is responsible for making investment decisions and managing the fund's operations. Thus, the GP is considered the 'lead' investor. When the fund invests in a private company, that company is referred to as a portfolio company, as the company is part of the fund's holdings – or its portfolio.

WHAT YOU SHOULD KNOW:

- Direct equity co-investment refers to a collaborative investment structure in which a private equity firm and external investors collectively invest in a private company.
- Co-investments present an opportunity to access attractive deals and benefit from the expertise and deal-sourcing capabilities of private equity firms.
- For investors, co-investments can be a good portfolio diversifier and a valuable tool for potentially generating high returns.

- A private equity limited partner (LP) refers to an individual investor or institutional entity that provides capital to a private equity fund. LPs are passive investors who commit capital to the fund and entrust day-to-day management of the fund to their GP partner.

Unlike a traditional buyout private equity fund, where investors become LPs in a fund, a co-investment is an investment in the actual portfolio company. Co-investments are passive, minority positions that allow LPs to invest in a private company on the same ownership terms, typically in line with the percentage of investment, as the GP.

Side-by-side Comparison: Traditional Buyout Funds versus Co-Investments

	Traditional Buyout Equity Fund	Direct Equity Co-Investment
Structure	A standalone fund managed by a GP	Collaborative investment structure
Capital Source	LPs	LPs and co-investors
Flexibility	Limited flexibility for LPs to choose specific investments	Co-investors have the flexibility to select which deals to join
Diversification	A narrower set of opportunities to choose from	Can build across geographies and strategies
Fees	Management fees are a percentage of the committed capital per annum. Managers also earn a performance fee of the realized profits, provided their returns exceed a minimum threshold.	Preferential fees and terms

An external investor, or LP, benefits from the GP's experience, access to investment opportunities and technical knowhow to successfully bring a deal to fruition. Moreover, from an asset allocation perspective, co-investing can give investors exposure to both alternative assets and equities.

How do Co-Investments Fit into Your Portfolio?

Overall, a fund that exclusively or partially contains co-investments can be a smart way for investors to diversify their portfolios and potentially earn high returns.

Here are some of the benefits:

- **Potential for Enhanced Returns:** Co-investments have the potential to generate attractive returns. By accessing deals typically reserved for private equity firms, investors can participate in investment opportunities that have strong growth prospects, favorable valuations, or strategic advantages. Co-investments may also have lower fees compared to traditional private equity funds, potentially increasing net returns.

- **Diversification:** Co-investments may provide portfolio diversification. By participating in different co-investment opportunities across various industries, sectors, and geographies, investors can reduce their exposure to specific risks associated with any single investment. Co-investing alongside a private equity firm can also provide exposure to different types of investments, such as buyouts or growth equity, which can further enhance diversification.

- **Access to Expertise:** Private equity firms often have specialized knowledge, industry insights, and extensive networks that can contribute to successful investment outcomes. By co-investing, investors can benefit from the firm's rigorous due diligence, operational improvement strategies, and value-creation techniques.

To learn more about co-investments, view our video on the co-investment landscape.

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