HFR Investments

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Hedge Funds & Co-Investments

Planning and Communication

By: Gregory Neal

Traditionally, co-investments are thought of exclusively in context of private equity and debt funds, but that limited thinking will cause hedge fund managers and investors to miss out on a number of opportunities.

In terms of private funds, equity or debt, a co-investment is a minority investment made alongside the manager for a more concentrated single exposure to enhance returns, – at least, that's the idea. This model also keeps fees down, as the investment is usually a one-time event and continued strategy implementation isn't required.

For hedge fund managers the idea is the same, but instead of investing directly as part of a private investment, hedge funds can also use public securities to make their investments.

A recent survey on Co-Investments was issued by *Hedge Fund Research, Inc*. to hedge fund managers inquiring about their co-investment offerings. To the first question, **"Do you offer co-investments?"** 24% of managers responded "yes" – a figure much higher than we anticipated.

Do you offer Co-investments?	
Yes – 24%	No – 76%

There is already significant co-investment activity taking place, with strong potential for growth. This is probably due to multiple of reasons, with the predominate being:

1) Knowledge - Managers and investors are now more aware of co-investments and consider them a viable option.

2) Structuring – These deals have become easier and easier to put together due to platforms and outsourced structuring services.

When looking back at the last 20 to 30 years, I don't believe that the deal flow and opportunities have grown, but, rather, managers and investors have become more sophisticated. They understand co-investments are an option and are taking advantage.

I think the continued conversation about co-investments offered by hedge fund managers will propel the idea to become a more common and readily available investment approach in the coming years.

It's Time to Start Somewhere

As a manager, it's apparent your colleagues are starting to adopt these strategies and adding additional value for their investors – so why wouldn't you?

All things equal, allocators will tend to go with the manager that can offer more value. Offering co-investments just might be that value that puts you over the edge.

It doesn't take a large $250M dollar deal for a co-investment to make sense, you can start small. Of the survey respondents that offer co-investments, 60% said that a typical deal size is less $25M, and 85% say it is less than $50M.

To me, if you find an investment opportunity you love and plan to add it to your fund, why not think about making an additional investment outside the fund and present it to your investors. You've already done the work, you're confident it will perform, and you have investors that trust you – seems like a win, win, win.

This additional value offered to investors creates a new revenue streams to your business: the revenue generated from management fees, although nominal, and performance fees. For a high conviction investment, it's almost all upside.

And as the survey shows, even small deals are worth it. So, if you've been thinking about it but have been putting it off, now's the time to add additional value for your LPs.

Open Yourself to Opportunities

For Investors, the opportunities are out there, and the first place to go is directly to your current hedge fund managers. Have a discussion with them and inform them that you would be interested in co-investments if the opportunity ever came along.

Having these discussions early will allow managers to think about how to take advantage of opportunities as they go through their investment process. They'll look at deals with you in mind.

No matter the asset class you're looking for, hedge fund managers have you covered. As expected, public equity co-investments are the most common but beyond that there is a relatively even distribution across the remaining types, including private offerings:

Hedge Fund Co-Investment Offerings by Asset Class	
Private Equity	20.6%
Public Equity	34.6%
Private Debt	15.4%
Public Debt	14.0%
Other	15.4%

Co-investments from hedge fund managers may be even more opportunistic and flexible than in the private markets.

Ready to Pounce

This is all well and good, but there is still a key issue with co-investments that both managers and investors need to overcome: These investments usually based on a single, short-lived idea that might not be available in a few short weeks or months.

> *"If you're waiting until the investment ideas appear, you're already too late."*

For a co-investment to happen, a manager must find the idea, the investors, and then complete the deal all before the opportunity vanishes. It's easier said than done. If you're waiting until the investment ideas appear, you're already too late.

How does anyone combat a time crunch? Planning? Communication? Probably a little bit of both. First, planning on the side of the manager will allow them to act when the opportunity present itself. And second, there needs to be continued communication between LP and GP. I don't mean the investor and the IR team, I mean regular conversations between the investment team and decision makers at the allocators.

When considering such a time-sensitive tactical strategy, direct lines of communication between the partners are critical to successful co-investing.

Contact the Author
Gregory Neal, Director of Investments
gneal@hfr.com

Learn more about HFR Investments at:
hfr-investments.com
or reach out to
investments@hfr.com

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