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Buyout Firms Tap Co-Investments for Deal Capital as Debt Costs Rise

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Bruce K. Fenton

Bruce K. Fenton, a partner in Troutman Pepper's Investment Funds + Investment Management Services Industry Group, was quoted in the April 12, 2023 *FundFire* article, "Buyout Firms Tap Co-Investments for Deal Capital as Debt Costs Rise."

The desire to avoid higher deal financing costs is driving some new co-investment activity as managers are seeking to move on deals after a drought of activity, and as buyers and sellers in the market are finally moving closer together on pricing, said Bruce Fenton, a partner in the private equity and investment funds law practice at Troutman Pepper Hamilton Sanders. Co-investment capital from LPs or professional funds helps buyers put more equity into the deal, he said.

"If you don't want to pay more in interest expense, if you don't want to worry about over-leveraging deals… co-investment helps keep the initial cost of capital low," he said. "The economic headwinds, combined with the instability in the banking universe at the moment, have created some real opportunities for co-investments to plug holes."

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Co-investing also increasingly has market-set terms and conditions, Fenton said.

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Co-investment funds are a key partner now to many primary buyout fund managers, though their importance to the market can be a double-edged sword, Fenton said. Availability of capital and steady deal participation from such dedicated vehicles offer a reliable partner to fund managers, but also present a greater likelihood that such investors will not be passive players and instead seek more input through board seats or deal covenants, he added.

Sidecar co-investing funds that managers raise alongside their flagship vehicles were a hotter item a few years ago, and while they still exist, they are not as prevalent, Fenton said. That may be due in part to hesitancy by managers in the face of greater regulatory scrutiny of co-investment policies by the Securities and Exchange Commission, he added.

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