Q&A

CO-INVESTMENTS I ADDING VALUE

Building a successful co-investment portfolio is about working with the right manager on the right deal, says Pantheon's Jeff Miller

Co-investing has been a growth area within the private equity landscape for a number of years – and appetite from investors appears to be undiminished by the pandemic. According to a survey taken in late 2020 by *Private Equity International*, three-quarters of LPs were considering investing in transactions alongside GPs in 2021[1]. Meanwhile, a number of managers are raising and closing funds dedicated to co-investing alongside primary fund managers.

Part of the appeal of co-investing is economics: typically, investors do not pay fees or carry on commitments made directly alongside the GP. But for Pantheon Partner **Jeff Miller**, Global Head of Co-investments, the potential benefits of co-investing also lie in selecting a portfolio of concentrated bets on high-quality companies – and doing so alongside managers who can add real value for investors.

How are you approaching co-investing in the current environment?

We work with sponsors who really know their sectors and bring a wealth of experience, established networks and operational acumen, all of which are extremely valuable attributes in the current market where trends can be volatile or divergent. Co-investments are also ultimately partnerships. What we offer in return is the certainty to help get transactions over the line, especially as a co-investor with sufficient scale to underwrite larger equity tickets. That can be really critical, particularly in highly competitive processes.

In most cases we know the managers well through our global platform. We have more than $33bn under management across our primary platform, through close to 800 fund investments[2]. Not only does that provide access to many top tier managers with strong track records[3], but it also means we have a large funnel of potential co-investment deal flow that allows us to be highly selective in our own investments. Between 2012 and 2020 we transacted on around 200 co-investments, which equates to around 15% of the deals we sourced.

> "Co-investments are ultimately partnerships."

In addition, as an established co-investor we're often partnering not only with managers that we know well through our primary relationships, but with which we've co-invested successfully in the past. That provides another layer of reassurance on any given transaction because it means we've seen how the deal sponsors work, as well as how they support and seek to add value to portfolio companies.

You say you are able to be selective, so what do you look for in potential investments?

One area of focus is companies benefitting from strong secular tailwinds, often in broader industries such as technology and healthcare where we have a global focus as a firm. For example, earlier this year we co-invested in a company that provides cloud-based point-of-sale (POS) systems across a variety of sectors and which has been growing its customer base as businesses seek to modernize legacy systems and migrate to cloud offerings.

> "We might also look at companies in more impacted sectors that have proven themselves to be fundamentally resilient."

Another area we target is businesses with defensive characteristics, such as those where a large majority recurring annual revenue is contractually committed. Given the context of the pandemic, we might also look at companies in more impacted sectors that have proven themselves to be fundamentally resilient. In these cases, which are often more complex to execute, we will often be compensated through the price of the deal, or by building in some downside protection in the way the deal is structured.

For example, a transaction might involve investors taking preferred equity positions that mean the investee company would have to fall in value precipitously before the original commitment is impacted. Given that we're still always investing in companies that we believe have the potential for significant growth, this can help to underpin an asymmetric risk/return profile for our investors.

Are there any other key trends or opportunities in the post-Covid market?

One of the opportunities that has been widely observed since the pandemic hit is the potential to add significant value to portfolio companies through M&A. Obviously in a lot of sectors there has been an impact on valuations, which brings the opportunity to make accretive acquisitions that can blend down the entry multiple. In some cases, a manager might even specifically target an asset because it presents a clear roll-up opportunity in a sector that is ripe for consolidation.

> "In some cases, a manager might even specifically target an asset because it presents a clear roll-up opportunity in a sector that is ripe for consolidation."

An example here is a technology and operations service provider that we invested in this year, which provides services to a number of government clients. The business was itself a product of a number of mergers – and the industry landscape in that sector is highly fragmented so there is real potential to grow through acquisitions, not least because the deal sponsor is extremely well established in that space and so will be able to help make connections and evaluate opportunities.

In another case we co-invested in a buyout this year that was bringing together two companies providing workforce engagement software in a high-growth end market. The deal was creating the number two player in this space – and alongside a number of other growth levers, there is a potential M&A pipeline to expand the sector reach of the company. It's a really exciting opportunity to support growth and build scale.

[1] See article, 'Strong appetite for co-investing is music to PEI 300's ears', published 1 June 2021: https://www.privateequityinternational.com/strong-appetite-for-co-investing-is-music-to-pei-300s-ears.

[2] Pantheon internal data, as of December 31, 2020.

[3] Pantheon opinion. Past performance is not indicative of future results. Future results are not guaranteed and loss of principal can occur.

BIOGRAPHY

Jeff Miller, Partner

Jeff is a Partner and Global Head of Co-investments, leading all underlying co-investment activities and team management. He is a member of Pantheon's Global Partnership Board, International Investment Committee, Co-investment Committee, U.S. Investment Committee and Global Credit Committee. Prior to joining Pantheon, Jeff was a Principal at Allied Capital where he was responsible for evaluating and executing private equity and mezzanine investments. Previously, Jeff was a Vice President in Lehman Brothers' investment banking division and an Associate in Wells Fargo's leveraged finance division. Jeff received his MBA with Honors from Northwestern University and a BA in economics and mathematics from Gustavus Adolphus College. Jeff is a CFA Charterholder and is based in San Francisco.

Important Disclosure

The views and opinions expressed herein by Jeff Miller are his own views as of the date of the publication, and may change in response to changing circumstances and market conditions. Under no circumstances should these views and opinions in this article be construed by any reader as investment, securities, legal, or tax advice. The information contained herein should not be deemed as a recommendation to purchase or sell any securities or investments. No representation or warranty, express or implied, is made or can be given with respect to the accuracy or completeness of the information in this article. In general, alternative investments such as private equity involve a high degree of risk, including potential loss of principal invested, are highly illiquid, can charge higher fees than other investments, and typically do not grow at an even rate of return and may decline in value.

Information, opinions, or commentary concerning the financial markets, economic conditions, or other topical subject matter were prepared, written, or created prior to posting this article on this Site and do not reflect current, up-to-date, market or economic conditions. Pantheon disclaims any responsibility to update such information, opinions, or commentary. In addition, past performance is not indicative of future results, future results are not guaranteed, and loss of principal may occur. This article may include “forward-looking statements”. All projections, forecasts or related statements or expressions of opinion are forward-looking statements. Although the interviewee believe that the expectations reflected in such forward-looking statements are reasonable, they can give no assurance that such expectations will prove to be correct, and such forward-looking statements should not be regarded as a guarantee, prediction or definitive statement of fact or probability.