Adams Street

Global Trends in Co-Investments: A Q&A with Dave Brett

David Brett, Partner and Head of Co-Investments, spoke with Jeffrey Diehl, Managing Partner and Head of Investments, about trends in global co-investments and how Adams Street views the future of this expanding opportunity set.

Q: Has COVID-19 impacted the resiliency of co-investments and portfolio companies differently based on company size or sector?

DB: While larger companies had more resources to survive the downdraft in their demand or their supply chain, to me, resiliency was determined less by the size of the company and more by the sector focus. There were sectors identified early in the pandemic as potentially problematic - tourism and retail, for instance, where demand evaporated or was at best deferred - in contrast to other sectors such as healthcare that experienced a more attractive swing. While there was little demand in some non-essential healthcare sectors at the onset of the pandemic, it quickly recovered back to 90-95% of pre-Covid volumes and in some cases even higher in order to "catch up". So healthcare, along with other high-performing sectors like technology and software where product demand was more critical or sticky, proved to be the most resilient during the pandemic, regardless of company size.

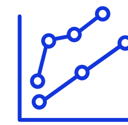
Q: How does deal flow vary between GPs you are currently invested in versus those you are not? Do the economics vary?

DB: We generally see higher conversion rates with our existing GPs. Since I joined Adams Street in 2005, we have typically closed on around 10% of all the co-investment opportunities we find – while not an intentional target, it signals that we're remaining disciplined and selective about the quality of deals we close. Of those deals closed, roughly 80%-90% are from existing GP relationships.

In our experience, the economics are typically better with an existing GP relationship (no fee/no carry). For deals seen from GPs that would be new relationships, there may be some form of fee/carry negotiated. In any deal reviewed with economics attached, when evaluating the deal overall we would layer in those additional costs to our return assumptions to ensure the risk/return profile still makes sense. While we don't pay economics often, we view our willingness to do so for the right deal a differentiator in the market to some degree.

Q: You've previously mentioned trends toward GP-led secondaries and continuation vehicles, both for whole portfolios and for single-company transactions. There are often different economics with these types of transactions, with some looking more similar to primary investments. How do you think about those transactions in the broader context of the co-investment model?

DB: The GP-led secondaries and continuation vehicle trend expands the co-investment opportunity set which we view as a good thing; depending on the economics/alignment of the transaction, it may provide a great opportunity to transact on high-quality assets, known well to the lead GP. Given the complicated structure of these deals, however, we seek to be incredibly diligent with our evaluation in order to ensure that we accurately assess our risk and alignment. Little or no carry rollover or new fresh capital from the GP is in our view bad alignment. In all cases, it boils down to needing to quickly assess the transaction and triage the alignment, as not all deals are created equal.



The GP-led secondaries and continuation vehicle trend expands the co-investment opportunity set

Q: Is your team seeing differences in deal flow activity and valuation trends across geographies?

DB: Broadly speaking, valuations globally have held up quite well, most notably with respect to high-quality assets in more resilient sectors. As for deal flow, activity in the US and Asia is back up to pre-Covid levels. US credit market activity is also very healthy, further supporting new deal flow. Asia co-investment deal flow was increasing prior to Covid, and has rebounded nicely since the onset of the pandemic.

We are currently seeing good deal flow in Europe, although it is lagging behind slightly, in part due to the number of active managers in Europe versus those in the US. At Adams Street, approximately 25-40% of our co-investments are in Europe, and we anticipate activity levels will catch up soon.

Q: What are common reasons you turn down or pass on deals? Are there any major themes there?

DB: We evaluate deals primarily on three criteria:

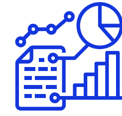
Expected Risk/Return	▪ Most of our declined opportunities fall into this bucket. ▪ We look at the GP's assessment, and also consider key future assumptions like total addressable growth and the competitive dynamics within that market. ▪ We typically err on the conservative side, and turn down an opportunity we don't believe offers the appropriate risk-return trade-off.
Alignment	▪ We look for investments where the deal is a good fit with the GP, for instance sector, or value creation drivers and also where the GP is meaningfully invested. ▪ If their investment is undersized relative to the fund size, and we are not happy with their reasons for being so, we see it as a red flag and in that case would typically move on to another opportunity.
Portfolio Construction	▪ Portfolio construction is critical. ▪ We vet a lot of deals and often see interesting opportunities that we ultimately turn down because they don't fit into our broader portfolio strategy. ▪ We aim to build a pool of high-quality assets appropriately diversified across sector, geography, company size, and investment thesis.

Q: Are you obligated to put capital into your co-investments?

DB: We typically receive standard minority investor rights, including the ability to invest more and prevent dilution after a lead GP puts in additional capital. Our goal with "buy and build" investments is to be thoughtful in these circumstances and respectful of our GPs; we are happy to invest additional funds if the opportunity calls for it.

For unexpected circumstances outside of the "buy and build" model, we may be willing to take the risk if our GP's conviction in the investment is strong enough. The bottom line is that our investment thesis needs to still be in play, and the company needs to plan for enough liquidity and capital to support itself regardless of the duration of any uncertainty.

Importantly, in all cases, any follow-on investment decisions within our control go through our normal investment due diligence and decision-making process.



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Q: Given current valuations, do you anticipate forward returns will be lower in the future?

DB: This depends heavily on interest rates. If rates remain low for long, we'll be talking about high valuations (and returns) for the next few years. We do anticipate contraction at some point – likely when interest rates rise – and pressure in the co-investment space is inevitable. Because of this, Adams Street will remain very selective with our transactions and sensitive to constructing a portfolio resilient enough to handle multiple contractions. We review historical growth trends to ensure that we are able to underwrite a growth profile that we believe in. ■

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