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CUTTING THROUGH THE COVID-19 CHAOS: STRATEGIES FOR MAKING DIRECT INVESTMENTS & CO-INVESTMENT OPPORTUNITIES IN UNCERTAIN TIMES

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QUESTION SUBMISSIONS

During this webinar you can submit questions through the Zoom Q&A function

- We would like the presentation to be as interactive as possible
- Questions will be visible to the presenters immediately after you submit your question
- The presenters will answer as many questions as possible live

INVESTMENT OPPORTUNITIES – DIRECT INVESTING

- **Structural and duration elements to today's risks and opportunities**
  - Changed consumer behavior/preference and acceleration of industry evolution
  - Fleeting or long-lasting change
- **Certain industries will need to restructure/consolidate with a shakeout among stronger and weaker competitors**
  - Producers/Customers are learning lessons from supply chain disruptions

INVESTMENT OPPORTUNITIES – DIRECT INVESTING

- **Categorization of opportunities**
  - Distressed companies looking for a fundamental recapitalization in an industry dealing with change
  - Solid companies looking for a partner in the storm and supplemental capital
  - Strong companies looking for a partner and/or capital to go on the offense
- **Sellers in every market – today options are more limited**
  - Families can be even more differentiated and therefore preferred
  - Seeing some family businesses looking for capital/partner today who normally would not even contemplate the option

INVESTMENT OPPORTUNITIES – DIRECT INVESTING

- **Returns in an uncertain world**
  - Returns like truth are absolute – not relative – because risk is absolute
  - Balance between stability of returns versus upside returns
  - Family capital has value to the certain sellers beyond the money – that should be rewarded
  - Nearer term higher risk for the opportunity to invest in an attractive business for the long term
- **Downside potential is real**
  - Evaluating bankruptcy options
  - Selling in bankruptcy – Section 363 sales

INVESTMENT STRUCTURING – DIRECT INVESTING

- **Majority/Control investments**
  - Limited new transaction debt available today (but that will change)
  - Buyer/seller valuation disconnect – especially in the early days of a downturn
  - Significant change of control capital on the sidelines
  - Comeback of bridging solutions like seller notes and earnouts
  - Can over-equitize leaving existing debt in place and refinancing out equity when debt markets strengthen

INVESTMENT STRUCTURING – DIRECT INVESTING

- **Minority equity investments**
  - Less threatening/often more acceptable to sellers who need a solution and will not consider selling control
  - Structured equity (dividend plus penny warrants) minimizes need to determine a fair value
  - Much less minority capital available from traditional sources
  - Equity substitution opportunities where debt financing stays in place
  - Family-owned businesses are not as aware of this option versus tradition debt and control equity options
- **Control investments becoming minority investments (and vice versa)**

RESOURCES & CAPABILITIES – DIRECT INVESTING

- **Right strategy, right team and right resources especially critical today for family direct investors**
- **Long cycle game which requires resources and staying power**
  - Less than a 1% business in finding the right opportunity (sourcing and sifting capability)
  - Doing the deal just gets you out of the dugout and onto the field
- **Long cycle often in dialogue with family sellers**
  - Have to plant seeds now to begin harvesting over the next few quarters
- **Family capital has unique advantages over traditional sources of capital – especially in this kind of market**
  - In a frothy market capital becomes more of a commodity and its unique advantages can be overpowered by high prices
  - Family capital has real advantages to sellers who care about their companies after close
- **Family capital advantages: long duration, structure flexibility, family business understanding, culture/values systems, etc.**

SOURCING – DIRECT INVESTING

- **Deal sourcing in a world with limited new deals**
  - Can't rely on opportunities coming to you – create your own
  - People remember a kind outreach/offer to help in difficult times
  - Army of underutilized bankers, brokers and advisors who have a network of relationships
  - Best marketing is when the opportunity comes to you but very, very few have the Berkshire Hathaway aura
  - Normal family approach of keeping a low profile is not the best posture to find interesting opportunities
  - Being top of mind is important when the family decides they need capital and a partner
  - Remember the 1% rule

INVESTMENT STRUCTURING – CO-INVESTMENT

- **Co-Investment with private equity funds**
  - Need for additional liquidity creates new opportunities for co-investment
  - Typical private equity co-investment terms
    - No management fee and no carried interest
    - Limited oversight/veto rights for larger investors
  - Investors should carefully review its co-investments rights
    - Prioritization
    - Conflicts of Interest
  - Some additional recent interest in non-traditional co-investment (i.e., “overage” vehicles, opt-in/opt-out vehicles, limited investment co-investment, etc.)
  - Direct co-investment alongside a private equity fund is generally limited to the largest investors
- **Co-Investing watchouts**
  - Families have to be careful about overconcentrating by selectively co-investing in only some of a PE funds deals
  - Does the family have the expertise to determine the better co-invest deals being offered to them
  - Limited opportunities to invest capital this way as few traditional PE funds deploying significant capital today

INVESTMENT STRUCTURING – CO-INVESTMENT

- **Co-Investment with other family offices**
  - Family office co-investment funds/vehicles
  - Option to co-invest on direct investments
  - Pooled capital vs. opt-in/opt-out
  - Governance and control
- **Securities law and corporate liability considerations for co-investment vs. traditional PE fund investment**
- **Pass the hat models can be slow/cumbersome and leave the syndicate without a clear leader to drive the investment**

INDUSTRY/SECTOR FOCUS

- **Industry differentiation**
  - While COVID-19 has impacted most industries adversely, there are some – certain healthcare and technology subsectors, in particular – that are seeing an increase in revenue
  - Late cycle oil and gas funds, materials, consumer discretionary (retail, leisure, travel) some of the most adversely affected
    - Potential opportunities for distressed companies and assets in these industries, but it may take some time for prices to reflect new reality
- **Other interesting sectors today**
  - Food
  - Packaging
  - Healthcare services
  - Logistics services

DISTRESSED INVESTING

- **Distressed investment opportunities**
  - Many investors already anticipating a recession or slow down
  - Investment objective shifting to distressed opportunities
  - PE funds may be constrained by the limited objectives/investment purposes in fund documentation based on contractual obligations
    - Unless permitted and/or there is overlap (i.e., healthcare and real estate); investors should review marketing material and operating agreement investment objectives to ensure that sponsors are operating within contractual mandate
    - Co-investment may provide alternative opportunities for exposure to distressed companies and assets
    - Family office flexible capital creates opportunity for distressed opportunities
    - Importance of investment team managing turnaround
  - Buying assets out of bankruptcy – bankruptcy court process

REAL ESTATE/JOINT VENTURE INVESTMENTS

- **Subsector differentiation**
  - After a brief pause, real estate funds and investors are showing signs of life in certain segments
    - Multi-family residential
    - Commercial and retail
  - COVID-19 accelerating existing commercial and retail trends
  - Core, Core-Plus, Value-Add, Opportunistic investment considerations
  - **Real estate regulation**
  - Direct real property investment treatment under certain securities laws and regulations
  - Under certain conditions, such real estate may not be considered a “security”
  - By avoiding investments in “securities”, family office investors may be able to stay outside Advisers Act and Investment Company Act, even if managing third-party capital

REAL ESTATE/JOINT VENTURE INVESTMENTS

- **Joint venture terms**
  - Typically more bespoke structuring in real estate than other areas of private investing
  - Joint ventures suitable for investors seeking greater oversight and more active management of real estate investments
  - Terms typically include budget veto rights, right to force sale after specified term and drag/tag rights
  - If structured properly, joint venture investments also avoid certain securities laws and regulations that would apply to managed funds and their advisers

VIRTUAL DUE DILIGENCE

- **Some core diligence processes remains the same**
- **Deploying capital through Zoom – due diligence in a locked down world**
  - Fact checking
  - Forecasting and predicting future outcomes (past as prologue?)
  - Assessing execution/implementation risk (management team)
  - Balancing risk and return

THANK YOU

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