KEYNOTE INTERVIEW

Why tech will remain a top priority

Technology will continue to be a core sector in private equity portfolios despite the recent correction, says UBS Asset Management's head of multi-manager private equity Americas, Nicola Goll

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Q How important is technology to your private equity strategy?
Technology is the single most heavily weighted sector for us and this is completely by design, given that it has outperformed other key industries so significantly and for so long. Data from the World Bank estimates that the digital economy contributes to more than 15 percent of global gross domestic product, and in the past decade it has been growing two and a half times faster than the GDP of the physical world.

Technology has been responsible for creating so many new business models and applications. It is interwoven into so many processes today that, quite simply, no business can exist without it. All of this makes technology a critical sector for us across our venture capital, growth equity and buyout investment strategies.

Q What are some of the core tech themes that you and your GPs are focusing on?
Artificial intelligence is the elephant in the room. Everyone is spending a lot of time trying to figure it out and it remains to be seen which companies will emerge as winners. Aside from time and cost efficiencies, it isn't entirely clear how all AI applications can be monetised, but it is a key theme that we are exploring. The continued migration to cloud solutions remains a hot topic, as does the digitisation of payments. I would also point to security infrastructure and, of course, data analytics, which has been a prominent theme throughout multiple fund cycles and which continues to command a lot of attention due to the sheer volume of data that exists on those investments.

Finally, digital health solutions represent a very interesting area. It isn't always clear if these investments sit clearly within the healthcare or technology vertical – for us, it depends on the business model – but the digitisation of healthcare clearly accelerated significantly during covid-19 and digital health solutions such as telemedicine, remote patient monitoring, personalised healthcare and healthcare analytics are areas where we are spending significant time.

Q Given that technology plays such an important role in your business, how have you navigated the recent tech correction?

The impact of the tech correction has been limited for us, and that is largely due to the areas where we have historically focused our efforts and investments. When it comes to venture capital, we tend to focus on the earlier stages – the seed and Series A managers. There has still been a meaningful increase in valuations in that space, of course, but those increases fall well shy of what we have seen in crossover and pre-IPO tech strategies.

On the growth capital side, we have favoured bootstrapped business models. This will often involve companies founded by previous operators at big software companies such as Microsoft, SAP or Oracle, for example. These individuals may have identified a mission-critical solution that then creates a very sticky tech platform. The businesses may still be small – with annual recurring revenues of less than $10 million – but given the typically low item price relative to the importance of the solution, they don't cycle out that frequently and can reach breakeven with relative speed.

By contrast, we have typically shied away from business models that require a huge amount of investment and where cash burn is extremely high. The focus of our growth capital is still on scaling up, of course, but should our GPs dial down sales and marketing spend, these platforms could move rapidly towards positive EBITDA territory. Equally, these businesses have multiple potential exit routes, also by virtue of the lower mid-market segment which we like, rather than relying exclusively on the IPO window being open. Strategics play a key role here, and many upmarket financial sponsors are able to acquire these platforms. In other words, we are very focused on the value chain and where these businesses sit within it.

We apply these themes to our growth capital investment strategy, but a lot of them are also relevant for buyouts. We still prefer to focus on the lower mid-market where valuations have remained moderate, compared to other segments. Companies can be acquired directly from owners and there are plenty of opportunities to professionalise these businesses by introducing or updating KPI systems or customer relationship management systems, for example, or by bringing in

Q Has there been any shift in emphasis in what you look for in a tech manager in the current environment?

I would say that there has been an increase in our focus on runway and cash burn, because we expect the capital raising environment to be tougher than it has been in the past. A lot of companies received far more funding than they probably should have over the past five to six years. We are moreover zooming in on how open a GP is to raising a structured round over taking a valuation cut, which was less of a focus five years ago. Generally speaking, however, I would not say that our due diligence has materially changed; it has become a bit more nuanced pertaining to specific areas.

A thematic approach to sourcing continues to be paramount. We like GPs that are true specialists – those that create white papers and go very deep on subsectors, in a way that enables them to confront founders with a different approach and a new perspective on their industry. That opens doors in a way that generic sourcing never can. But these are things that we have always focused on.

a proper chief financial officer to help take the business to the next stage of its development.

All of this has meant that even in an elevated valuation environment, our GPs have been able to execute on multiple arbitrage. As such, while we have of course seen a market correction and valuations have come down, given where we sit within the overall market segment, the impact has been less extreme for us than it may have been for some of our peers.

Q Have you shifted your allocations at all due to recent changes in the tech environment?

I would say that if you are a technology specialist that we have not tracked for a while, it might be a little more difficult to make your way into our portfolios than it may have been in the past. Venture, specifically, is a longer-duration asset class and we are seeing more extensions coming from the venture space.

For some of our very established separate accounts, we are currently more cautious about committing to dedicated tech players because we are taking a top-down view as well as a bottom-up view, and we don't want to overexpose those specific clients to tech segments. However, we remain very comfortable with where we sit in the tech universe so there has been no real change to our allocation policies, and we are certainly not shifting away from the sector.

Q What feedback are you getting from tech-orientated GPs that are currently in the fundraising market?

There are still some highly oversubscribed funds experiencing no issues whatsoever, but a lot of GPs are finding it more difficult to reach their target fund size. That isn't necessarily due to poor performance but rather caused by LPs being focused on the denominator effect or the lack of distributions and realisations. It has taken some time to come through, but we are increasingly seeing GPs moderating their fundraising targets and they are taking a lot longer to reach a final close.

I would say that the venture and growth markets have been more impacted than buyouts, but, across the board, GPs are spending more time on the road. This isn't an ideal situation for any market participant – we would much prefer GPs to focus on their investments – but in this environment, it is inevitable.

> *"The continued migration to cloud solutions remains a hot topic, as does the digitisation of payments"*

> *"Technology has become critical to the overall growth of our economies"*

Q Are there other areas of emerging tech that you believe will become important?

I think the use of technology to manage and mitigate heatwaves, droughts, fires and floods – to make the planet more sustainable – will become an increasingly important topic. Food security plays into this trend as well. There are already GPs focusing on this space but for now they tend to be niche specialists. I think these planetary health themes will increasingly find their way into more mainstream tech strategies over time.

Q What is your approach to co-investment in the technology space?

When it comes to co-investment, we tend to focus more on buyouts and sometimes growth capital deals. The hurdle is significantly higher for early-stage venture capital. Like others, we are focused on the rule of 40 – the idea that the revenue growth rate plus profit margin should exceed 40 percent. As always, we favour bootstrapped companies with healthy margins.

Valuations are also a critical point of consideration and one which, given how rich the market became in 2020 and 2021, has been discussed even more intensely than ever in investment committee discussions in recent years.

Q What are your expectations for tech allocations in PE portfolios?

I think technology will remain a core part of the vast majority of private equity portfolios, particularly for investors that are open to venture capital. It comes down to the fact that tech growth is consistently outpacing GDP growth, and that recurring revenues are a core feature. Technology has become critical to the overall growth of our economies.

It could be that we see a greater focus on value-orientated tech plays, but I certainly don't see tech allocations reducing materially within private equity portfolios any time soon. ■