
KEYNOTE INTERVIEW

Finding the silver linings



Private equity firms are having to adjust to a challenging fundraising environment, but there could be some interesting opportunities ahead for those with capital to deploy, says [Markus Benzler](#) at UBS

Public market corrections, inflation, increasing interest rates and political uncertainty are all having an impact on LPs' capacity to invest in private equity. This is already leading to a knock-on effect on private equity fundraising, but what might this mean for the industry over the short to medium term? And where are the bright spots for investors in today's environment and beyond? Markus Benzler, head of multi-managers private equity at UBS, gives his take on how the market will evolve.

Q What's in store for fundraising over the next 12 months?

Fundraising for single primary funds is very difficult currently – and that's true even for larger, branded funds. The

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denominator effect is really coming into play here as LPs that might previously have written, say, \$200 million tickets are now looking at \$30 million-\$50 million cheque sizes. In some cases, we are seeing commitments shrink by up to 90 percent from predecessor funds where LPs want to continue their relationships with larger funds. Elsewhere, smaller ticket sizes are often resulting in deployable capital flowing to smaller funds.

This will clearly have an impact on the market – we will see fewer funds able to raise and it is quite possible the industry will shrink from a deployable

capital point of view. With less debt available on the market, we may well see more co-investment opportunities, better priced secondaries and better deployment capacity with primary funds – and that will be a positive development for investors like us.

That said, the fund of funds, or multi-funds, fundraising market seems to be holding up relatively well. In the past 10-15 years, funds of funds have lagged behind the general private equity industry growth.

However, there is less competition than in the single fund market, and multi-fund managers have become very active in co-investments and secondaries in recent years, which has helped boost returns and differentiate their approach.

The market is seeing multi-fund managers generate well north of 15 percent net-net returns to investors, which is comparable to many single funds, so in effect, the extra layer of fees is not eating into returns. And, importantly, the risk position due to the higher diversification versus single funds is much better.

The other point about multi-fund managers is that they can systematically over-commit and re-invest early distributions into co-investments and secondaries. That can clearly improve returns.

Q How will today's difficult fundraising conditions affect first-time funds?

My advice for first-time funds would be that if they don't need to fundraise right now, not to do it, because the market is brutal at the moment.

That said, first-time funds that are already out on the road and are coming out of an established franchise, have a strong team, a verifiable track record, a differentiated offering, a good value proposition and value-creation skills, may be okay. They will usually need a cornerstone investor prepared to commit a minimum of around \$100 million, however. These are more likely to be family offices than institutional investors, but they will seek sweetened conditions, such as co-investment rights and better terms for the current fund and perhaps beyond.

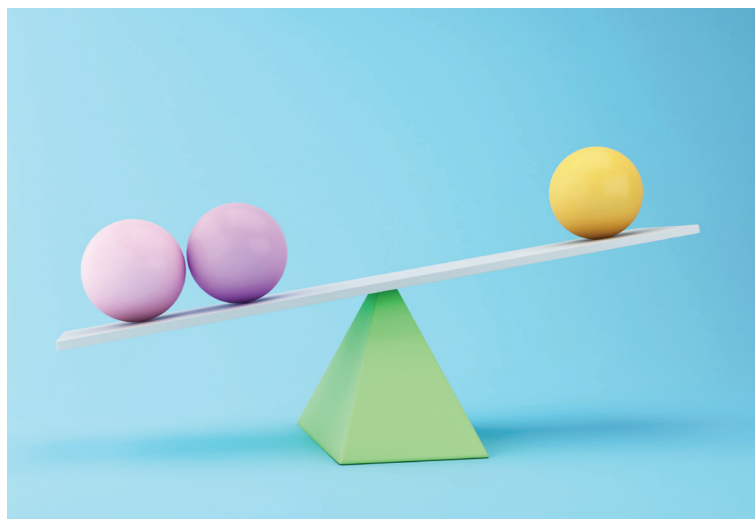
We back first-time funds (around one a year), but we rarely take a cornerstone position because it takes a lot of time and effort to conduct the due diligence, and then there is the risk that the fund may not get off the ground.

So, first-time funds will find the market very challenging. But, actually, in an even worse position will be the GPs with two generations of funds that have disappointed LPs. Investors may be understanding if one fund underperforms relative to expectations; if you have two, it is extremely difficult to pull back from that.

Q The challenging fundraising backdrop notwithstanding, how will the diversification of fund managers into other strategies change the asset class?

Private markets have done well over the past 20 years, and this has led to the expansion of private markets strategies

– these are no longer confined to private equity and venture capital or to the US and Europe. The landscape is much more complex as Asian markets have grown and infrastructure, private debt, special situations and growth capital have emerged strongly. There is still room for growth into new strategies and territories, including Latin



Q As fundraising becomes tougher, how are LP-GP relations being affected?

The balance of power has shifted towards LPs with capital. Terms in limited partnership agreements had moved very much in GPs' favour previously and timelines for making re-up and other commitment decisions had shortened. LPs were finding that if they couldn't accommodate a GP's timeline, then they would be out of the fund. That has shifted back considerably – we have had funds giving us a deadline, we have told them we are prioritising the opportunities in front of us and then the funds have come back to us a little while later realising they had played their cards wrong.

In today's market, GPs need to realise that LPs, especially multi-fund managers, have a range of opportunities in front of them – we are seeing attractive co-investment and secondaries deals right now, for example, and these may take priority.

Other than super-carry falling away, we haven't yet seen a big shift in terms, but I would expect this to happen. We are likely to see changes in cost allocations so that more deal fees are likely to be credited against the management fee, no-fault divorce clauses will strengthen, LPs will be able to gain advisory board seats more easily and we will see more side-letters on co-investments. One area we are just starting to see some movement on is fund hard-caps. These were previously difficult to impose with the best fund managers, but we are now at a point where 10 percent or 15 percent more than the fund's target size is the expected maximum – gone are the days when GPs could just raise double their target size.

America, Africa and Southeast Asia. The market is likely to become more granular and managers will increasingly offer specialist funds.

Sustainability is another key trend here as infrastructure, agriculture, food and food security are being joined by energy transition-backed themes in areas such as transportation, storage, sustainable real estate and so on.

Finally, I see a shift in the venture capital space. To date, we have seen a lot of focus on software and the internet, but real technology and innovation will become ever more important. This will require an evolution in the way VCs invest, much as we have seen in the life sciences space. Here, businesses are capital-intensive and VCs need to deploy carefully and cautiously – they need to be capital efficient.

They also need to tailor the assets they back according to what potential buyers will want. As drones, robotics, climate tech and deep technology become more investable, VCs will need to follow the same path to capital efficiency and building businesses to buyers' strategic needs.

Q Democratisation is a big theme in private markets right now. Will this continue?

This will definitely continue because there are a lot of drivers behind it, like regulation, technology, offering and, most importantly, client demand. The new version of the European Long-Term Investment Fund is broader with more investment stages, and so that will encourage more individual investors. Technology is now being used to process and present information and package up products, making the process of investing more straightforward.

There are also far more products on the market today – just two years ago, there were only a few handfuls of semi-liquid funds in existence; this has doubled in the past year, and I see much more growth ahead.

Lastly, client demand has increased

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markedly. There is a recognition today that the kinds of businesses that investors used to be able to access on the public markets are now in private markets as companies remain private for longer.

We have seen interest in private markets move down several levels – initially, it was family offices, then ultra-high-net-worth individuals, then high-net-worths, and now we're seeing the

mass affluent looking to invest. Even that evolution leaves a lot of the population not yet covered.

Q You mentioned that secondaries are offering some good opportunities today. What trends are you seeing there?

We have been investing in secondaries deals since around 2003 and in the last five years we have been accelerating our exposure there. Secondaries are the most undercapitalised part of the private markets arena. Private equity has between two and three years of dry powder; secondaries have roughly a year of dry powder currently and this may reduce over time as the denominator effect impacts secondaries fundraising.

At the same time, however, there is a big wave of opportunities coming up. Activity will be stronger than in 2021, in part because the private equity market has grown substantially in recent years, but also because there is a backlog from last year.

In 2022, the price mismatch between buyers and sellers stopped some deals from happening; now, sellers recognise that prices will have to come down if they want to sell. They may not have wanted to take a loss on their private markets portfolios last year, perhaps because they had large losses in public equities and fixed income. But now things have stabilised, they are accepting larger double-digit percent discounts.

I'm also expecting to see discounts on GP-led secondaries deals – and that is not something we have really seen much to date. In the second half of 2022, we saw a lot of GP-led deals going to brokers, but only the very best survived the deal process. If the GPs still want to transact on the deals that didn't get through, they will need to do so at a discount.

So, there is a big opportunity in secondaries – we will be busy in this field and we are likely to prioritise secondaries over primaries in many cases. ■