KEYNOTE INTERVIEW

Contributing to the democratisation of PE


The liquidity offered by the secondaries market has a critical role to play in opening up the asset class to a new set of investors, say UBS Asset Management's Jochen Mende and Tanja von Ehrlich

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Q How is LP secondaries dealflow responding to current market volatility?

Jochen Mende: We see less LP-led secondaries dealflow in the market today compared to a year ago, but that is a function of us not being out there aggressively sourcing these transactions right now. There is a simple reason for that: we find it extremely challenging to price a portfolio off March or December numbers, given everything that has happened since then.

Therefore, we focus on evaluating GP-led secondaries – particularly single-asset deals – as you can really dig deep into the underlying asset performance on a granular basis.

Where we have seen LP-led dealflow, it has primarily involved investors that are reconsidering their engagement with private equity. This could be because they have ended up with more than they bargained for in terms of their allocation. To be clear, it is not that we have seen any investors in distress yet – but some are clearly getting nervous and are looking to realign their portfolios in light of what has happened in the public markets.

However, in these situations, the quality of the underlying assets is much improved relative to the LP-led dealflow we saw six or nine months ago. Sellers are also starting to be more realistic on pricing. Earlier this year, vendors and their advisers were all demanding pricing at par, or even a premium, to recent NAVs. Now, those conversations have become a lot more realistic.

Q What trends are you seeing when it comes to GP-led secondaries?

JM: Almost every situation that we see involves a fund manager with an asset that they have owned for some time, where they want to get more time and raise incremental capital to continue pursuing the value creation strategies they have been pursuing since acquisition. Very rarely do we see situations where the capital being raised is required to fix a problem in an underlying asset. Furthermore, the quality of the GPs that are using this tool has improved drastically over the past three or four years, which is great news for secondaries buyers but bad news for GPs that may be facing challenges in their portfolio, because those deals are likely to attract less attention.

Q How do you expect the single-asset GP-led market to evolve in a more challenging economic environment, particularly one where alternative exit routes may close down?

JM: Our expectation is that we are just at the start of this single-asset GP-led trend. We think of GP-led secondaries as an additional exit route in parallel to selling to a strategic (or another private equity) buyer, or an IPO. In an environment where the traditional exit routes close down, we think GP-led secondaries will remain popular and might even increase in importance.

However, I think a potential hurdle to continued growth could be restrictions within the buying pool: many secondaries firms have marketed their funds as broadly diversified pools of capital, which at a minimum implies concentration limits for single assets. As a result, getting enough capital to complete some of the larger GP-led deals could remain a limiting factor.

Q What role do you think secondaries will play in the democratisation of private equity?

JM: Private equity has historically been geared almost entirely towards

> *"In an environment where the traditional exit routes close down… GP-led secondaries will remain popular"*
>
> **JOCHEN MENDE**

the institutional investor market. Even ultra-high-net-worth individuals have had to jump through a lot of hoops to gain exposure to the asset class. However, that is starting to change, and the regulatory framework is becoming more accommodating.

As a result, semi-liquid structures have become more prolific. The key question now is whether all distribution partners and individuals attracted to semi-liquid solutions fully understand the characteristics of such investment structures.

In our view, private equity will always be an illiquid asset class, and a semi-liquid structure only makes sense if the underlying asset base produces enough liquidity to fund redemption requests. That, of course, is where secondaries could play a very meaningful role.

Q While these semi-liquid structures are becoming increasingly common, feeder funds remain the dominant route into private equity for smaller investors. What challenges do those funds present?

Tanja von Ehrlich: Feeder fund vehicles provide individual investors with access to the institutional opportunities offered by managers and will typically involve blue-chip GPs. The problem, however, is that – with the exception of the minimum ticket size – these investors will have to behave like institutional customers. In other words, time horizons are long, and there is virtually no liquidity. Sometimes the strategies can also appear rather niche. All that combined can be a step too far for those that have previously only invested in the public markets.

Q What are the alternatives that could help resolve these liquidity issues?

TVE: We do see some players building customised products for our clients, such as fund of funds solutions. In addition to the reduced minimum tickets, these products are fully paid-in and offer enhanced diversification, but they still face the challenge of illiquidity – and that is typically our clients' number one concern.

While you could argue that smaller clients have a higher liquidity preference, in reality, even the ultra-wealthy tend not to be open to including private markets in their portfolio construction if there isn't a liquidity option. Even people who don't need the money like the option of getting their hands on it, just in case.

And that is why these semi-liquid investment structures are proving such an interesting proposition. But the big question, as Jochen said, is whether people really understand what semi-liquid means – and only the next crisis will tell. So far, I would say that our partners are being very prudent about how they promote these solutions because, of course, their reputations are also at stake.

Every precaution is being taken when it comes to explaining how these products work but, at the end of the day, it is on a best-effort basis. We are working hard to ensure we have trained our distribution partners in such a way that they have all the tools they require to properly educate investors. ■

Jochen Mende is head of secondaries and Tanja von Ehrlich is head of wholesale REPM at UBS Asset Management