Top 10 with...

Interview with Markus Benzler on Multi-Managers Private Equity

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MMPE facts

1997

business established

USD 7.6bn

AuM[1]

4th

PE growth strategy[2]

100+

clients[1]

Markus Benzler, Head Multi-Managers Private Equity, Real Estate & Private Markets

Private equity insights from the ground up

The private equity industry is growing not just in size, but also through diversification of the types of investments. Markus Benzler, Head Multi-Managers Private Equity (MMPE) explains to us how the business continues to expand its global investment horizon to achieve growth for clients in the midst of a challenging period where new sciences and technologies are evolving in the private equity landscape.

UBS

UBS Asset Management

1
What does MMPE offer to clients?

MMPE offers extensive private equity expertise to institutional investors such as pension funds, family offices, insurances and sovereigns. The product offering comprises both individually tailored and managed accounts as well as private equity fund vehicles following our high conviction strategy. Thereby, we closely support our clients during the build-up and maintenance of their private equity allocation, offering broad diversification benefits and the ability to generate growth. Through operating in core markets globally, our business has developed into a core capability of the Real Estate & Private Markets (REPM) business.

2
How do you differ from your competitors?

Firstly, by European standards, MMPE is highly experienced and tested through many cycles having been active in the industry for over 20 years. Only a few of our US peers have been active longer than us and we have a long track-record of delivering private equity returns in the upper quartiles. This combined with our alternative approach to risk consideration and ultimately selection, differentiates us from other asset gathering peers in the market. Finally, we are a mid-sized player. We've found this to boost our capacity to deploy capital in comparison to our larger peers who have to deploy billions more per year. In addition, MMPE is able to leverage the significant resources of the broader UBS business. This has especially impacted magnitude of deal flow, as well as how we select and deploy money.

3
What are the trends and main drivers of private equity as opposed to public markets?

Private equity and public equity are indeed driven by different factors, with private equity being mainly driven by new technology, an innovative business model and access to talented employees and managers. On the other hand, public equity companies are more driven by macroeconomic factors which affect stock markets as a whole such as GDP, interest rates, exchange rates and stock market sentiment. One of the main trends we have seen in private equity is the rapid growth over the last 20 years and the spectrum of firms and strategies which one can invest in has become broader and more dynamic. As mentioned, a variety of strategies have emerged over the last few years and investors can choose from a range of strategies such as small to medium-buyout, large buyout, mega buyout, seed stage, early stage and late stage venture capital along with growth strategies.

If we look at why private equity has grown so much, one of the drivers has certainly been regulation and cost. Taking a company public can be an expensive exercise and means that the company has to comply with many more rules and regulations as a publicly listed company, which can discourage some companies from going public. There has also been a change in the way people do business. Taking a company public 20 years ago used to be the "next logical step." However, these days a company with cutting edge technology doesn't need to go public in order to be successful. In addition, a company wishing to expand can take over other companies and still remain private which ensures that the ownership of the firm stays in the hands of the original managers rather than having ownership watered down which can happen when a company goes public. The change in corporate mentality has resulted in many startups aiming to become "unicorns", the industry's term for a privately owned company worth over USD 1 billion rather than becoming a big, listed corporation.

4

What are the benefits of a multi-manager private equity platform?

There are basically three ways to access private equity. One could think that the simplest approach is to invest directly into privately held companies. However, this requires a strong level of sectoral expertise, especially for non-institutionalized investors as it increases the concentration and headline risk around single companies. Therefore, a lot of investors try to invest via fund managers into this space. The fund managers bring along the expertise and a certain level of diversification.

Historically, we have seen that only the best fund managers (usually in the top quartile) are capable of consistently outperforming which measured against typical equity benchmarks. The issue with these types of managers is that they are usually not in need of additional capital as their strategies are only scalable to a certain extent (in comparison to more liquid strategies). Multi-manager platforms can solve the riddles arising from the aforementioned dynamics: a good multi-manager set-up can provide access to top-notch fund managers either via primaries or secondaries and can participate into direct deals as a co-investor. This provides solid diversification but also ensures quality and execution capacities that only professional private equity investors can deliver.

5

What will be the key themes to drive industry growth over the next five years?

From 2020 onwards, we expect the private equity industry to be much more insulated from economic and political volatility in comparison to other asset classes. Both current trends and investor sentiment are indicative of increased appeal into the asset class. According to Preqin, at the end of 2019 we saw around USD 595 billion[3] worth of commitments flow into private equity. We expect fundraising in 2020 to come down a bit from the very high levels seen in 2016-2019, but we still expect fundraising to be relatively high as fund managers are still hungry to lock down capital in the current market.

The continued high appetite from investors means that capital will continue to flow into funds. The record level of dry powder will afford more cash to be spent than at any other time in history. Private equity firms are, as a result developing the resources to take on strategic buyers head-to-head. We also expect to see new strategies and firms widening their scope in regions such as Africa.

Selection and diversification will play an even more significant role in investors' portfolio construction process as a means for increased downside protection. For our flagship products, this has been instrumental in order to avoid cycle-related concentration and return dependence risks. In general, we aim to have no less than four to five fund positions of equal size per year. This translates to roughly 40 to 100 companies per vintage year given a fund usually invests in 10-20 companies.

Appropriate sector diversification in order to avoid region specific concentration and return dependence, will also be a key driver of growth. In general, we take a top-down approach regarding the regional allocation of the underlying assets. This general strategic allocation is overlaid with tactical considerations influenced by the concrete investment opportunities available.

6

What impact has the COVID-19 crisis had on UBS Asset Management's private equity portfolios?

In our opinion, the COVID-19 crisis has confirmed the benefits of having a broadly diversified private equity portfolio. Our portfolios are not only well diversified across sectors and fund managers, but also across various regions, each having been affected by the crisis to varying degrees.

As a private equity investor that focuses on the long-term, we concentrate on funds that invest in companies with long-term growth potential. We also invest in experienced fund managers who have successfully steered their portfolio companies through recent financial crises. Looking back on the global financial crisis of 2008, many private equity fund managers realized that they had missed or failed to take full advantage of an exceptionally favorable buying opportunity. In the current pandemic, fund managers and their investors are expected to adopt a more proactive strategy to avoid "wasting another crisis."

Our portfolios typically have high allocations in IT, healthcare, digital business models and new technology sectors, which we expect to perform well or be only minimally impacted by this crisis. For example, our fourth private equity growth strategy's portfolio is in the build-up phase and we expect that it could even benefit from the COVID-19 crisis in the long-term due to favorable company valuations available in the market at the moment.

7

How will blockchain technology and cryptocurrencies impact private equity in the future?

Most people who have been following recent developments have almost certainly come across a discussion about blockchain, distributed ledger technology (DLT) and cryptocurrencies. While blockchain technology holds great potential, it is still a nascent technology comparable to the Internet in the early 1990s. Nevertheless, it has become a focus for major players in and around the financial system – from central banks to regulators to Fintech startups to global firms like UBS.

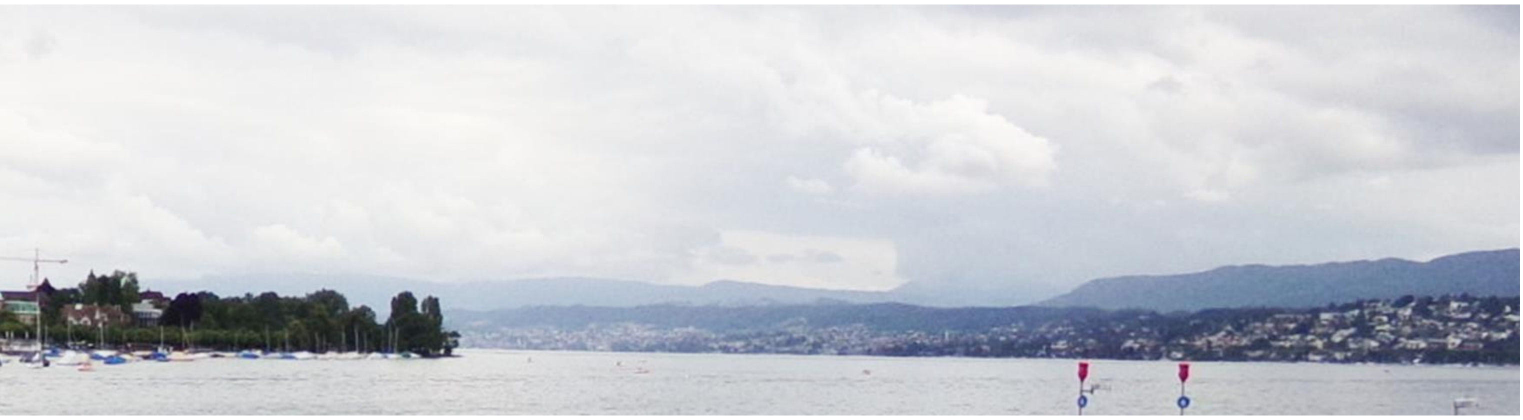
In the realm of private equity and venture capital, the impact of blockchain technology has been moderate to date. At the fund level, there exist a number of future efficiency gains that may result from adopting these technologies for fund administration and capital call management. On the investment side, many venture funds consider this an exciting technological frontier, with an emerging group of specialized venture capital fund managers already investing in the sector at an institutional level.

While the first generation of breakout companies in the sector have often had a narrow focus on cryptocurrencies and the protocol layer, the expectation is that there will be a number of interesting future uses that will emerge from the blockchain infrastructure which is being built upon by the next generation of companies.

8

What do you see as the biggest challenges in the industry, and how are you responding?

Given the market disruptions and the ensuing uncertainty brought about by the COVID-19 crisis, we expect smaller, less frequent capital calls to take place alongside fewer distributions in the coming months. The surge in competition in the private equity industry will prove to be challenging for many players. Both dry powder levels and the number of players remain high, resulting in increased competition for the best opportunities. Another important point to note is that once capital has been raised, deals also have to be made without firms appearing as if they're not able to deploy capital. With increased competition, comes the need for speed in order to get to the best deals first. This requires us to continually improve our processes but also increase our search for talent in the industry in order to be ready for these industry shifts. Furthermore, we will likely continue to remain very disciplined and diligent in how we manage capital for our investors. In addition, we are enhancing our skills on the secondary and co-investment side.



9

How can investors search for value in a crowded market?

Today's crowded market means that fund managers have to think more carefully about how they deploy capital. Over the last five years, investors have allocated more capital to the private equity industry than at any other time in history. There is a disparity between value and the number of deals. Increased competition and an unclear macroeconomic outlook only exacerbated by the COVID-19 crisis, are contributing to the difficulties in calculating future values. This competitive market is causing firms to re-examine their strategies, focusing on those that can deliver the most returns. MMPE for example, invests in proven managers and strategies which have worked well for our business in the past. At the same time, it's important for investors to stay in close touch with managers and markets to assess the relative attractiveness of the strategy in light of macro or strategy-specific developments.

10

Will private equity continue to outperform in the next few years?

History has shown private equity can consistently deliver strong risk-adjusted returns, ahead of the public market. Tough economic times such as the 2008 GFC have not swayed private equity's capacity to perform well. A majority of funds with 2008-09 vintages delivered strong returns in spite of market volatility and outperformed the public market. This prompted the number of players active in the market and existing investors to increase their allocations. We expect the private equity market to remain strong in the event of future cyclical changes, not just in terms of absolute returns but also as a diversifier to the public market. In the face of market disruptions such as large portions of the population working from home, supply chain disruptions and technological change we believe that private equity may even benefit from such disruptions unlike traditional asset classes. This is due to its focus on firms driven by innovative business models, new products and the latest technology.

> Our private equity solutions offer both new and existing investors the possibility of earning solid expected returns despite the volatile market environment. Our strong track-record is based on our expertise in sourcing some of the best investment opportunities for clients in the fund-of-funds market.

Note: **Past performance is not an indicator for future result.**

1 Figure as of 31 December 2019; includes joint venture assets with UBS-WM of USD 4.1bn
2 Refers to the fourth MMPE Growth Strategy, vintage years 2000-2019
3 2020 Preqin Global Private Equity & Venture Capital Report

For more information, please contact:

UBS Asset Management Switzerland AG
Real Estate & Private Markets (REPM)

Markus Benzler
Head Multi-Managers Private Equity
Tel. +41 44 235 57 14
markus.benzler@ubs.com

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