Top 10 with...

Jochen Mende on private equity secondaries | **May 2022**

Key facts:

20+

years' experience[1]

~12bn

USD invested since inception[1]

~7.6bn

USD advised in assets[1]

~75%

Portfolio with secondaries[1]

"In recent years, the secondary market has evolved into a vibrant, fully accepted part of the private equity investment ecosystem."

Jochen Mende, Head of Secondaries

Getting ahead with private equity secondaries

Private equity secondaries have evolved from a relatively small, somewhat obscure niche into an integrated part of the overall private equity ecosystem. Secondary strategies can offer significantly accelerated diversification across managers, industries, geographies, strategies, and vintage years. The market has experienced significant growth in deal volumes and investor interest in recent years.

Jochen Mende, Head of Secondaries, explains the key trends in the secondaries market, how investors are benefitting from them and what differentiates the business from other players in this space.

1

What are private equity secondaries?

Private equity as an asset class offers investors exposure to companies that are not publicly traded and is an important source of capital for startups, young companies, firms in financial distress and companies that are seeking growth or buyout capital. As opposed to many other investment styles, private equity is an inherently activist asset class whereby the fund managers often exert significant influence over the underlying investments.

Thus, investors in the asset class not only benefit from gaining exposure to otherwise inaccessible, unquoted/privately owned companies, but also from the skill sets that fund managers bring to bear to improve a company's long-term value. Investors' capital is typically pooled in strategy-specific, closed-ended funds, e.g. funds that focus on buyouts in specific geographies or industries and have a fixed lifespan of 10 years or more. While this setup allows the private equity fund managers, also referred to as the General Partners (GPs), to take a long-term view on implementing value creation strategies in the underlying portfolio companies, it also has certain drawbacks.

Most importantly for investors – or Limited Partners (LPs) – in private equity funds, there is no pre-defined liquidation mechanism. In other words, if an LP's circumstances change over the 10-plus years of a private equity fund's life, there is no pre-defined way out. This is where the private equity secondary market comes in: a private equity secondary buyer acts as liquidity provider to private equity investors who wish to sell their positions and do not have the time or desire to hold on to their investments until the end of the regular lifespan.

In recent years, the secondary market has evolved into a vibrant, fully accepted part of the private equity investment ecosystem and is increasingly being used by the GP community to address some of the shortcomings of the traditional *closed-ended fund model*. For example, GPs have embraced the secondary market as a tool to obtain more time and/or capital, to work with select assets in order to maximize long-term value.

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2

How can investors benefit from current trends in the secondary market?

The secondary market has experienced dramatic change and growth since the financial crisis: transaction velocity, standards and the level of intermediation and competition in the market have increased substantially, as has the diversity in transaction types and structures. For example, transactions that are driven by a private equity fund manager to secure more time or capital (or both) to work with select companies in 2021 accounted for an estimated USD 68 billion, or just over 50% of aggregate 2021 secondary transaction volume of USD 134 billion[2]. For comparison, these deals accounted for less than 20% of overall volume – a *measly* USD 7 billion – in 2015.

The increased breadth and depth of transactions has several implications for investors: for new entrants to the asset class, it is possible to relatively quickly scale-up diversified private equity exposure and thus minimize the initial period of negative returns (j-curve) typically inherent in the asset class. However, transaction timelines have become much compressed and competition for quality assets is fierce, especially in larger deals. GP-centric transactions allow for a more targeted approach to a portfolio build-up but are complex, time- and resource-intensive.

Existing private equity investors need to rethink their approach to portfolio management: while traditionally, most investors pursued a *hold-to-maturity model*, it is now possible – some would argue imperative – to actively manage portfolios and for example *right size* select sub-allocations via selling positions.

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3

How can an investor gain exposure to secondaries?

Unless an investor has the resources and the determination to build (or buy!) their own secondaries team, there are a number of institutional quality investment houses that offer access to this sub-asset class. Given the evolution of the secondary market – which initially was the domain of a few institutions with the vision to realize its inherent potential – it is maybe no surprise that most, if not all offerings, are geared to institutional investors.

Ironically, these offerings are, for the most part, organized as closed-end fund structures with all of the associated issues, such as finite (and long!) fund lives and a lack of pre-designed liquidity mechanisms, to name a few. In developing our private equity evergreen secondary strategy, we have designed a solution that solves these issues and provides access to investors that otherwise might have been excluded from investing in private equity.

Most importantly, we have designed a fully paid-in, open-ended, semi-liquid structure which offers investors the option to subscribe to and redeem shares on a quarterly basis, with very low minimum investments.

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4

How do secondaries play into the trend towards semi-liquid investment solutions?

While semi-liquid investment solutions can help to address a number of issues that deter investors from accessing private assets via closed-end fund structures, they work best when paired with asset classes that produce relatively regular and stable levels of liquidity from an asset base which is inherently illiquid, i.e. being bought and sold outside the public markets. Historically, that was mainly the case for real assets (real estate and infrastructure).

However, within private equity, the secondaries sub-asset class has demonstrated a remarkably consistent ability to produce liquidity across market cycles, making it ideally suited for semi-liquid investment solutions.

Also, given the increased depth and breadth of the private equity secondaries market, semi-liquid investment solutions will play a bigger role for private equity, and specifically for private equity multi-manager solutions.

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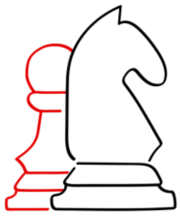
5 How do you ensure liquidity within your strategy?



Semi-liquid, open-ended investment solutions work best in our opinion when paired with asset classes that produce relatively regular and stable levels of liquidity. Within the private equity investment universe, secondaries historically have demonstrated the most consistent, resilient ability to generate liquidity across market cycles and are the most liquid sub-asset class. Therefore, secondaries are ideally suited for semi-liquid offerings. The growth of the secondary market in breadth, depth and sophistication since the Great Financial Crisis has only strengthened that characteristic. Nevertheless, we have a number of safeguards in place to ensure that our semi-liquid solutions will be able to serve investor redemptions in normal market circumstances.

Firstly, we cap redemptions at 5% of NAV of any given share class per quarter. That way, we ensure that all investors are being treated equally and that smaller investors are not crowded out by larger ones. In order to fund redemptions, we have various sources of capital available: we have aligned subscription and redemptions timelines and will aim to match the two wherever possible.

Further, the strategy will utilize any proceeds received from the underlying portfolio to fund operating expenses, new transaction activity and investor redemptions. Therefore, we will always have a substantial amount of cash on the balance sheet of the strategy – we estimate at least 10% of the strategy's NAV at any given point in time. Also, we will be able to use the acquired portfolio as collateral for a credit line which will be available to fund the operations of the strategy, including redemptions.

Last but not least, where appropriate, we plan to actively manage the portfolio and selectively sell assets on the private equity secondaries market, e.g. if we have hit our target returns earlier than our initial investment case or when we have more attractive reinvestment options available. However, it is important to note that the strategy is semi-liquid in nature and that there is no guarantee that investors can fully redeem their shares at all times. We believe that the strategy is most suitable for investors that can tolerate some degree of illiquidity.

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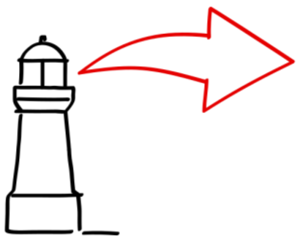
6 What are the challenges of secondaries investing?



Secondaries investing is a highly resource-intense, selective process. While it is relatively easy to generate deal flow given the increased level of intermediation and professionalization in the market, it is quite labor-intensive to develop *off-market*, *proprietary* deal flow. Prioritizing deal flow and picking out the *right* opportunities for a given strategy is driven by qualitative and quantitative factors.

In our view, there are several key success factors: given that secondary investors are acquiring a set of assets that are ultimately managed by a GP on their behalf, understanding the strengths and weaknesses of the respective GP in charge is key. Equally important is an understanding for the quality of the underlying asset base – for example the strength and motivation of management teams, the credibility of a business plan in place and so on – and of course the implied valuations: valuing private companies is complex, and approaches across the industry can vary substantially. Last, but certainly not least, is understanding of transaction dynamics and the motivations of the counterparties involved. We believe having an established, well-known, active primary investment platform is a big advantage: not only are we being viewed as a reliable, long-term partner in the GP community, we also have access to information from our primary investing business, and this enables us to move quickly and decisively.

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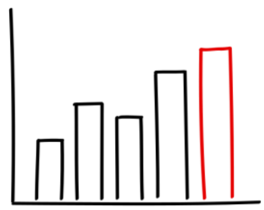
7

What is your experience and track record in this area?

UBS Asset Management (UBS-AM) has been managing open-ended, semi-liquid solutions in various asset classes since 2008 and is one of the most experienced operators of semi-liquid investment solutions globally. The UBS-AM Multi-Managers Private Equity (MMPE) team has a track record of investing in private equity that goes back to 2000.



Since then, we have invested and committed nearly USD 12 billion[1] across various client mandates and products and boast one of the longest and deepest track records in Switzerland. Our team has been investing in secondaries since 2003 on an opportunistic basis. However, given increased client-demand for secondary and co-investment solutions, I joined the business in 2018. Valerie Wong then joined in 2021 as a dedicated transaction-focused professional.

Prior to joining UBS, I spent over 12 years with another Swiss private asset management firm focused on private equity. And Valerie started her career in 2008 in the private equity secondaries group of an international multi-asset manager. The strategy-relevant track record is comprised of over 20 transactions which exhibited a gross IRR of 22% (as per 30 September 2021) and a multiple-of-invested capital of 1.79x[3].

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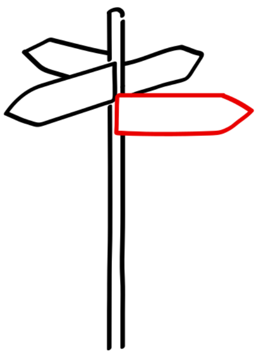
How do you differentiate from your competitors?



As one of Europe's largest providers of private equity fund-of-funds and mandates, with nearly USD 12 billion[1] invested and committed across the globe, we are specialists in primaries, secondaries and co-investments, with experience investing across all major private equity strategies and regions. We offer different investment styles depending on investors' risk appetite, experience and liquidity preference. The solutions we are offering to our clients are bespoke, and tailored to their specific needs and requirements leveraging the entire resource base of UBS. The flagship secondary strategy we are currently raising is one of the first dedicated semi-liquid private equity secondary solutions in the European market. Additionally, we leverage the UBS brand, reputation and global reach which enhances our own networks and make us a partner of choice within the private equity community.

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9 How important is your secondaries offering when compared to your other strategies?

Our secondaries solution complements the existing offerings of our MMPE platform, which comprises both individually tailored and managed accounts as well as private equity strategies following high conviction themes.

Each of our clients, products and mandates has the ability to dedicate a portion of their asset allocation to transactions, including secondaries, and benefit from our fully integrated team and investment process. The current private equity secondary evergreen strategy, is a natural extension of our offering and leverages the available resource base and our expertise in managing open-ended, semi-liquid solutions.

While it is hard to predict how large the open-ended strategy will be in terms of AuM relative to the rest of the existing platform, we have the aspiration to grow it into a substantial contributor on par with the main primaries offering and mandates business.

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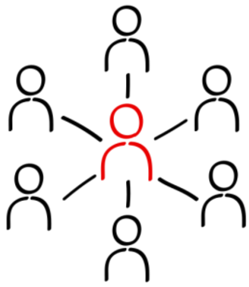
10 How do you ensure alignment of interest with your investors?



We believe our investors pay us to invest their money wisely as opposed to *putting it to work*. Therefore, the fee mechanism for our flagship private equity evergreen secondaries strategy is designed to reward investment pacing and performance. Our fee mechanism consists of two elements: a management fee, and a performance fee.

The amount of management fee is tied to the value of the portfolio and the level of capital earmarked for future investments. This means that capital that is not used or reserved for a period of time does not incur any management fees. Also, tying management fees to the value of the underlying portfolio means that we sit in the same boat as our investors.

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Our performance fee mechanism is designed to ensure that we get rewarded for outperformance. To ensure performance fee is crystalized on realized gains, we introduced a liquidity test in addition to a typical preferred return test. That way, we ensure that performance fees are only paid-out when the portfolio has generated enough liquidity to do so.

Source: UBS Asset Management, Real Estate & Private Markets (REPM); May 2022. Notes: **1** Data as at 31 December 2022. **2** Greenhill, Global Secondary Market Review, January 2022. **3** Past performance is not indicative for future results. For indicative purpose only.

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