Proskauer

Private Market Talks:
Navigating PE Realization and Structuring Products for Wealthy Individuals with Hg Capital

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In this episode, we're joined by Steven Batchelor and Martina Sanow of Hg Capital, one of the largest and most successful private equity firms in the world. Specializing in technology, financial services software, and healthcare software companies in Europe and North America, Hg manages approximately $65 billion in funds and supports a portfolio of about 50 businesses worth an aggregate enterprise value of over $140 billion.

During our conversation with Steven and Martina, we discuss Hg's investment strategy; its innovative, disciplined approach to realization on investments; and the emerging trend in private capital to attract wealthy individual investors.

Peter Antoszyk: Hello and welcome to Private Market Talks. I'm your host, Peter Antoszyk. My guests today are Steven Batchelor and Martina Sanow of Hg Capital. Hg Capital is one of the largest and most successful private equity firms. It has over 400 employees and approximately $65 billion in funds under management and supports a portfolio of around 50 businesses worth over $140 billion aggregate enterprise value with around 110,000 employees. It specializes in investing in technology, financial services software and healthcare software companies in Europe and North America. The firm is headquartered in London with additional offices in Germany and the United States.

Steven joins me from London. He is a partner, member of Hg's board and sits on the senior leadership team. In addition to his role overseeing all client-facing activity, Steven sits on the Realization Committee and Valuation Committee, topics we will be exploring today. He was instrumental in the development of an active approach to PE fund management, and we get into what that means and how it is still unique in the world of private equity. We will also get his take on the current state of institutional fundraising.

Martina joins me from Munich, is a partner and responsible for the firm's private capital activities, leading the Hg Wealth team. Hg Wealth is a dedicated team that sits within Hg, providing investment opportunities exclusively to individual clients with their wealth advisors as well as to family offices. We will be discussing the drive of private capital to reach high net worth individuals, the implications for public markets and Hg's approach to this segment of investors.

As always, you can get a full transcript of this episode along with other helpful information at privatemarkettalks.com. And I want to thank my partner Nigel Van Zyl, who is Co-Head of Proskauer's Private Funds Group. He has been working with Steven and Martina for a long time and was instrumental in putting us together. You can find out more about Nigel by going to our website. And now, my conversation with Steven Bachelor and Martina Sanow of Hg capital.

Steven, Martina, welcome to Private Market Talks. Steven, I'd like start with you. Perhaps we could start with you giving a little background on Hg Capital and its investment strategy.

Steven Batchelor: Sure. Thanks, Peter. So if you look at Hg today, Hg is the largest European software investor. If you look at the relative scale in terms of what that means, whether it's size of overall portfolio, total AUM, total amount of pricings generated from our investments in software, we're typically three to four times bigger than the next largest competitor. We've got about $75 billion of assets under management. And over the last 20 years, we've developed an investment strategy that's really harnessed our potential to invest in this space at scale, building ubiquity from our smallest fund, Mercury, that focuses on the small end of the market, up to Genesis, which is the mid-market fund, all the way up to Saturn, which is our large cap fund. And that ubiquity has been incredibly powerful for us in terms of building a portfolio right across the spectrum of end markets and also different geographies, primarily in Europe and US, but again, under that mission-critical B2B software lens.

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Peter Antoszyk: I normally, in these discussions, focus on the investment strategy, but I'd like to start this conversation with you, not on the front end, which is the investment side, but on the back end, on the exit, because I think you have a unique approach to it. And as you know, managing exits is key for PE firms and it can be difficult in a tough exit market.

Steven Batchelor: Well, it's funny actually, even the way you phrase that question, Peter. I think actually it's an industry problem, in terms of everyone, tends to focus on the investment, so they build an investment committee. There's great kind of weight and attention focused on getting that part right. Yet on the other end, which is actually arguably one of the most important pieces in terms of crystallizing those returns, they often leave it to a marginal deal doer, who can basically sell at their own discretion. And they might just about get away with that, maybe. But what really causes that to be a major problem are things like market-related events, whether it's the GFC, whether it's Brexit, COVID, more laterally in the last few years as well, because that really damages a fund's returns.

And talking to many peers in the industry, the bit I'm always struck by is almost everyone has an annual investment budget that they adhere to, which, actually, I think is more dangerous because the market can move and sometimes it's better or less good to invest, but they rarely actually have realization targets. And to the extent they do, it's often kind of top down in moments of extremis where people sort of panic and say we need to sell things. Usually, sad to say, ahead of a fundraising, that's normally the traditional kind of response, or the deal doer that I spoke about before has hit a certain threshold that satisfies their desire to then sell the investment. Might be a 2X return, 3X, 4X. And anything that interferes with that is essentially not something that can be managed until that's dealt with and then the business can be sold.

So essentially, no one's taking a broad view of what's actually best for the investor and what's best for the investor on a net basis because that's the bit that really matters. What do they get after fees and what generates the best possible return? So, what we really try to do is invert the traditional market approach to this over the last 10 to 12 years, because, you know, we used to be the same as the market and our approach has evolved fairly substantially over that last period that I described.

Peter Antoszyk: So just to put in perspective for our listeners, the M&A market activity, as you well know, in 2023 was one of the lowest levels in 10 years as a result of a variety of factors, including higher for longer interest rates, cost of capital, valuation, bid ask spreads, etc., and Bain and Company came out recently with its annual private equity report and they reported that there were about 28,000 unsold companies with a valuation excess of $3 trillion dollars, and amazingly, about 40% of those were in excess of four years old, which is, as you know, for a PE firm, a three to five year hold period, four years is an inflection point, but you seem to have some secret sauce.

Steven Batchelor: I think what we've done is trying to apply logic to a world which is sometimes illogical in what I've described, you know? Typically, firms have these very deep and detailed investment committees as I mentioned before. But actually, they don't have a committee that thinks about what we should sell, and that was the first part of the puzzle when building a committee that was purely focused on that. But actually, really coming at it from the perspective of, again, what is going to slow down IRR degradation because that's the enemy of returns? What proportion of capital is needed to be returned to do that? And it's actually about 80% of your invested costs, but over appreciated five-year period. The market takes on average about eight years. We used to take eight years as well, actually, if you go back 15 or 20 years.

So, that's the first kind of puzzle. You know. Can you compel, can you drive as a KPI, a return of cash that's sufficient to basically slow, if not stop, the clock in due course? And then essentially, you focus on holding the best investments, the most predictable investments, the sleep at night investments, for longer because those are the ones where you have most conviction. And again, if you look at the typical firm or fund, what tends to happen is those conviction investments are often sold very early, again, usually because they can generate the best early returns. Because often when firms come back to fundraise, they want to show a few big early wins for their most recent fund. This is a good way of doing it and they always can hide away the weaker, more problematic investments, because no one wants to kind of crystallize, you know, the worst loss ratio because everyone looks at loss ratio.

I think the way of breaking free from that a little bit is to change the rules of the game a bit. So, the way we think about it, for us, our loss ratio is 2X, it's not 1X. And the reason our loss ratio is 2X is no investment is ever underwritten to less than 2X. So, clearly, therefore, if you generate an outcome that's less than 2X, something's gone wrong somewhere. So, you've got to be honest and admit what's happened there. And essentially that's what we're really trying to do, which is, quite early in the course of the investment, work out the ones that have the potential to be pure kind of cash back drivers, so the typical kind of 2 to 3X kind of range kind of outcomes, the ones that have the ability for long term compounding returns that can make 4, 5,6X by virtue of holding them longer, and then determine if there are any problem children, you always have one or two in the course of the portfolio or maybe more than that. Deliver like 2X because essentially, you really want to be selling the weaker companies first. And I don't want to put it in the parlance of a hedge fund, but the analogy is not completely misplaced in the sense that we're focused on selling the relatively weaker companies earlier.

Having said that, you're also looking across at those winners as well and saying, "Are there other, unintended risks coming on those companies down the line? Have they got too big in the context of the fund because we might want to top slice some of those?" But you're moving those pieces around the jigsaw with an underlying kind of approach of saying, "We want to get to at least 3X, create a small bit of money on the fund, or 2.5X now, at least 20% net IRR and we want to give you your money back after five years." Because that's slightly above the threshold that really stops slowing, kind of IRR degradation. And essentially, the bit where we're fortunate I would say, which lends itself to this, is having the raw ingredients to make that a really feasible possibility.

So as I mentioned before, we're obviously very focused on the B2B software space. You know. Particularly mission critical, very predictable investments that are very highly recurring in nature. And the beauty of investing in and buying those investments is you tend to have relatively good visibility on their long-range performance, and essentially what that means is if you look at our track record, we've never ever had an investment that's generated more than 10 times money ever in our whole history, but equally, we've only had less than 1% that's been less than cost and we've actually had 91% of our investments ever, if you look at all of the realized investments, that would be at least 2X and 20% IRR.

So, you have investments that start in a relatively tight range, banded of outcomes. I think if we were a firm that had a few consumer investments, you know, some hardware, you know, coffee company, etc., etc., the relative gauging of what to hold and what to sell would be harder just by definition, that UN market-related risks and opportunities, and how you think about those, can be different in each case. We're buying businesses across eight clusters which is our word for subsectors, where essentially our day one investment case, we're underwriting with 80% confidence on day one that's going to generate that 2 to 3X kind of outcome. And then, what we're looking for is four to five breakout areas in terms of our value creation that can potentially elevate that to a 4, 5, 6, 7, 8X. That's what we're really trying to do. And essentially, the companies that we want to be holding for longer are the ones that have that potential, the ones that, that basically deliver the investment case and that's it. You should be selling those quite directly.

The problem comes if you don't delineate between those DPI drivers that deliver an investment case and that's it. And the ones that have a second, third, fourth leg to them, you end up with the problem, of course, that you have individual deal doers independently deciding what constitutes a winner versus a more mediocre performer. And you don't have that intellectual independence and honesty that arbitrates these decisions and that's where the Realization Committee comes in. And what we've deliberately tried to do is essentially fill the Realization Committee with people who are suited to that role. And, you know, we're very big on kind of cognitive diversity as a firm and thinking about wisdom of crowds and how people who work together can work together towards better outcomes. But if you think about a Realization Committee, it's going to be a little bit different in terms of composition to the Investment Committee.

So, the commonality is you want those senior people because, you know, you need to have the kind of top-down ability to drive outcomes and have support to do what you need to do. But equally, what we're trying to look for are people with a slight trader mindset, I suppose. The ability to problem solve, the ability to kind of think about crystallizing liquidity across cycles because it's somewhat of a mathematical exercise, versus the Investment Committee, which is much more around long-term trends, longer-term investment theses, but less around the smarts of, kind of, essentially getting out of the investments you manage. And essentially, because we are aiming at this 1X DPI, we are aiming at a 3X fund outcome, what we're really trying to do is engineer real honesty on that because we're the European waterfall. If Martina invests in a company that's better than mine, I should be really happy to sell it because I'm going to make more carry than I would if we have one count because Martina's company's better than mine. Our investors are going to make better net returns. That's good for our investors. And essentially, we sell that into all our appraisals, the way we think about bonuses, the way we think about any carried interest that we reserve or hold back, to make sure the whole ecosystem supports the mechanism that the Realization Committee is delivering.

And what that means is every year we do have, surprisingly versus the market, an annual realization budget. We actually don't have, surprising as it may sound, we don't have annual investment budgets. We have a look across to check we're investing at the pace required for a three, four, five-year fund, but we don't say "you're compelled to invest" because I think that can drive bad behaviors. You invest in the best risk-adjusted opportunities. You don't do it because you have to. And I think some of these funds that have invested in, you know, less than two years or 12 months, it's kind of crazy. What you really want to have a consistent pace on, though, is that pace of liquidity. And where it's really been tested for us, I guess, is the last two-and-a-bit years, two-and-a-half years, I suppose, since the start of '22, because at that point, you could see the market was kind of coming off. But because our approach is mathematical, it's not like we're trying to time the market. We're not clever enough to do that, you know? All of those kinds of things.

Essentially, what it’s meant is, of course all the funds, we have the targets that I spoke about before as your guide and our budgets say we’re going to sell these companies to drive these KPI’s at a fund level consistently on a fairly linear basis based on the raw ingredients over the coming years. And what that meant is between the start of 2022 and today, so nearly two-and-a-half years now, we’ve actually had 34 individual liquidity events. But what’s interesting is those being across actually technically eight funds, they’ve been across each of the strategies I’ve described before: Mercury, Genesis and Saturn.

If I think on Mercury, just to give you one example over that period, we’ve had realizations for Mercury 1, which was essentially a fund that’s now 10 years old. That fund is now fully realized. We’ve had realizations from Mercury 2, that’s a 2017 fund, and we’ve even had the first realization from Mercury 3, which is a 2021 fund. So, we’re not thinking about this in the context of each of those individual deals. It’s much wider than that. It’s basically at each vintage level how quickly can we de-risk. How quickly can we build optionality, so when we do run those winners for longer, we don’t have pressure on IRR. Because the problem is if you don’t return capital and de-risk that element, and something goes wrong or there’s a market interruption, you’ve bought yourself a problem.

So, what we’re trying to do is just invert that broader market behavior. And like I said, the raw ingredients massively help. So, I saw some research that said, basically, the average top quartile private equity fund, after five years, has a realized multiple of money on its realizations of about three-and-a-half times, which is pretty good. But then after 10 years, the same took quartile fund is at two-and-a-half X. So, your pace of appreciation has clearly slowed over the latter five years. Still look at outcome, but it’s less good than it was and that’s because they have sold those winners earlier on. If you look at our funds, typically after five years, the realized multiple of money is more like 2X. It’s funny, cause if you’re looking at that market saying, “Wow. These funds are going to be pretty bad. Because,” you know, you follow that same trend, one-and-a-half kind of outcome is going to be pretty awful.

But because of our kind of strategy of doing what I've described, what it's meant is our average kind of end outcome, if I take one of Mercury 1 and Genesis 7 as examples, both of which are just over 10 years old, they have ended up at kind of 3.2X and 3.4X respectively. So, they've almost followed the complete inverted path to the rest of the industry. And again, if you want to do that, you've got to make the tough decisions around it as well. So, you're going to tell clients, "We're not going to sell the winners ahead of a fundraising." You basically got to manage your culture and your teams that adhere to the same behaviors you expect from the committee. It's a complete reboot and a complete change to the mindset, really. But it, in my experience, it takes about four or five years to get it going, and even now, we're still learning. Even now, we're still making innovations. We've got a, a head of Saturn DPI in our colleague, Lucy Armstrong. We're still innovating, and anyone who's looking to move towards a different model, I highly recommend it, but it takes time and you need buy-in from the top and you need buy in-from the broader organization. Otherwise, you're destined to fail.

Peter Antoszyk: It sounds like a highly disciplined approach. By the way, you mentioned DPI. For our listeners, that's distributions to paid in capital rate, which is cumulative distributions paid by PE firms to LPs relative to the amount that the LPs have invested. So, it's a measure of return of capital effectively.

So, you, you mentioned quite a bit there. If I were to boil it down, what you're saying is you've put in a disciplined structure, which is separate from the origination function, particularly the individual who is or individuals who are doing the origination, that you have a disciplined underwriting which is geared towards realization, but then you have separately institutionalized the realization process in this Realization Committee. Is that a fair summary?

Steven Batchelor: That's fair. And I think what it means in the long run is every now and then, the Realization Committee will essentially tell the deal team that they have to sell because at 1X DPI, their company is the bottom of the stack from less good to better. And the problem is, of course, if they don't sell their company, and later on because of the market interruption or whatever else that we can't sell that company in a year, we're going to have to tell one of the best companies to compensate. So every now and then, you have to intervene to drive and really show that that discipline is there. But actually, over time, deal teams actually become quite good at self-enforcing this actually because they get the joke. You know. This is a team game. You generate overall outcomes, not individual deal outcomes. I do think the European waterfall helps in that regard.

But you're absolutely right, Peter. You know that, that discipline is critical. You need accountability, who you're going to blame, internally, if we don't hit the targets, whether it's going to be the Realization Committee. Who's the Realization Committee going to hold feet to the fire for this? It's going to be the individual fund heads and the individual deal teams. But essentially, the end goal here, if we all get it right, is going to be, you know, better returns for our clients and we'll carry for ourselves. So, it should be pretty well aligned. But you're, you're right. Without the discipline, it all falls apart. And I think actually quite a few funds out there which, for example, are geographically driven in the sense that they operate more by geography then cluster or kind of depth of software knowledge, for example, it's quite hard to make it work full stop. Because just say, you know, you're in the London office, Peter. I'm in New York. Martina's in Munich. I tell you to sell your company because it's not quite as good as mine. It's still going to be a difficult conversation because there's always a slight eye on the fact that you might spin out at some point and have your own UK franchise or Martina might be the same, you know? So again, there's some of the structural reasons why you can't have that discipline. The raw ingredients point around commonality of portfolio, and also the set up and culture and incentives that drive behavior are absolutely critical prerequisites I would say.

Peter Antoszyk: And you also touched upon that the compensation structure has to take this all into account, I assume.

Steven Batchelor: Yeah. So, if Martina's going to sell one of her companies early, what's the incentive to do it? So, we have detailed kind of records for every deal across the fund, what that generates in terms of the fund overall outcomes, what does that mean in terms of the carry that people should have versus what they already have; and at the end, we reserve up to 30% of the carry to reward people who should have more. We can scale back partners who have done deals that have been less good to give that to other people across the firm. But also, if Martina does sell that company and the IRR on that outcome is better than the fund outcome, there's a multiplier on what the cap value is of her return. Equally, if her IRR is worse because she's held it on longer in that regard, but the IRR is worse than the fund IRR, you have a negative multiplier. So, your attribution catches up with you, anyway. So whichever way you turn, you're kind of caught because the Realization Committee will hold you accountable.

It's not in your economic interest, but actually it's not in your personal interest either in the sense of appraisals or what that means if you ever get on that route either. So, it's building a system where I think everyone then recognizes that playing the team game is the best way for all of us to behave and engage together. I do think you need that culture of collegiality to make it easier, because otherwise, you just probably have to fight all the time to make it happen. You know. We're not that kind of culture. We're nice people. Sometimes we have to be tougher than other times, but, you know, fundamentally, I really like the people that we work with. So therefore, again, you know, we have to engineer a culture where people feel trust that the system works, that it works to their benefit if they adhere to it.

And again, that's been a big focus over the last kind of decade really, trying to make that work. And the most pleasing thing is actually, I mean, we reallocated carry on one of our funds where one individual, who was at that time relatively mid-level in the firm, now much more senior, had actually had a pivotal role in the fund, kind of halfway through, and generated one big winner that we held for longer. That was recognized in the carry and his carry went up multiple times over the life of the fund. And when you see that happen, that's a real kind of validation for them to see that it's real; that you walk the walk as well as talk the talk. But also, you know, it's a good incentive for everyone else. You know. If you can help kind of adhere and behave in the ways that we expect in terms of fund management, you will get better economic outcomes as well. So, you know, there's lots of good examples you build up over a long period of time.

Peter Antoszyk: Yeah. You're obviously fighting human nature. You want to hold on to the good ones because you think they're going to get better. And you don't want to necessarily let go of the ones that aren't performing, because you're hoping that they will at some point turn around.

Steven Batchelor: It's 100% that. It's a great Buffet quote about, you know, don't water the weeds. You want to water the flowers. You want to cut the weeds. And if you go back, it's fun, actually. We've actually run the data on this cause we're quite sad. But if you go back about 10, 15 years ago, back to the very beginning of Hg, we used to hold the weaker company, so, you know, called it less than two-and-a-half-times money, for actually longer than the winners. Not because we're like stupid, hopefully, or that we meant to do that. But, you know, it's a problem to sort out at the end of the fund. But then, you end up in the perverse situation at the end of the fund when you should just be reliably accreting value of actually having some uncertainty, because the weaker companies, you don't really know what they're going to do, to the same extent at least, and the ones that are really driving the ROIC, or not driving the ROIC like as reality, will kind of contend.

And since we've changed that over the last decade, we are now running the winners longer and holding the weaker companies for about half the time that we used to. What's really interesting is the returns of the weaker companies have actually gone up despite the fact that we're holding them half as long; and that's because there is a right time to sell a company. There's a great stat that I read, again, on the back of a bunch of data, that says, "If you own an investment and it's valued at cost or less after two years, your chance of ever beating 2X as an outcome is 8%." So, you got a 92% chance of failure. Yet how many people in that position tried to get to 2X because it's good for their individual track record? It doesn't look so bad in, you know, the track record of the firm. But what that does, that extra few years you're holding on for, in hope rather than real judgment, is what kills your fund IRR.

Those are the investments you should, you should be selling to build velocity of capital back to stop the IRR degradation and the real truth is, I mean, Genesis 6 was like this for us, if I'm totally honest, which was an '08 fund. You know, I could return half your capital back as an investor and feel quite good about it. "I've had a few Xs, aren't I clever," etc., etc. That does nothing to stop IRR degradation. It's window dressing. There's absolutely nothing. You need a criticality in terms of amount of capital within a time period. Otherwise, it's just optics. And the problem is I return half your capital back, I feel good. I then have two years where it's challenging to sell anything. By the time you get to the end of that two years, you bought yourself a massive IRR problem, and you're probably having to sell your winners then because you've got no choice. You need to fundraise. You need to show DPI because everyone's complaining about it. So, you know, probably of all the things we've done actually in the last 5, 10 years, that track record over the last two-and-a-half years of basically having more than one liquidity, more than one exit event per month, I'm really proud of because, like I said, the thing that makes me most proud is we weren't clever in the slightest. It was literally mathematical. There is basically a target for the funds. There was a budget. We delivered the budget.

And yeah, a few cases we had to sort of make things happen, but now we all look back on it and really pleased that we did that because a few of the companies we sold at the start of ‘22, I don’t think you could have sold them today, probably. So, you’d have a different type of problem. You’d have less liquidity events that were generated and we’d probably be having to sell some of the better companies like the P&Is or the Vismas or the Iris’s, which are precisely the kind of companies you don’t want to sell, because over the last 10, 15, 20 years, these are the kind of companies that grow every year, every quarter, every month. They’re proper sleep at night companies. You don’t want to be selling them too early, and again, just to finish on something self-critical because I prefer that part, Genesis 5 which was an ‘06 fund, we worked with Nigel, you know, on that fund as well. And our first big exit from that fund was Visma. Visma has ended up being 100X plus outcome if you’d held that equity, but we sold it just before a fundraising because it was a big investment that would generate a good return. You know. It was stupid. And again, we didn’t do it deliberately and hopefully, like again, like I said, not because we’re completely stupid, but it seemed like it was a logical thing to do. But looking back on it, it was completely illogical. So, I think we just need to break this circle of illogical behavior as a, as a starting point and then things become a lot more sensible from there. But unless you break that chain, it’s hard, I would say.

Peter Antoszyk: So, what’s your view on M&A activity for the balance of ‘24 and going into 2025?

Steven Batchelor: There’s some evidence that things are looking a little bit better, certainly than they were looking last year. There’s some green sheets. There’s a little bit of uncertainty still in some pockets on pricing. You’re seeing some pricing pay that is more akin to ‘21 again, which is slightly concerning. And it’s not always for the very best quality investments either actually, which is also a concern. I mean we think about it as a pacing model as well as an investment quality model. So, we’re looking at the very best businesses that we can make even better, but essentially the minimum threshold for us is investing over three calendar years. So if I look at the funds we have now, we think we can afford to be patient and afford to be picky and we don’t want to rush to deploy unnecessarily.

The cap markets are, are definitely kind of better than they were. I mean they were always actually open for the right opportunity, I would argue in certain situations. But again, confidence, I think, is coming back there. Rates are higher, which is a problem for everyone, you know, there's debate about when those come down, but I think rates coming down will help as well. But I think we're at that point where things feel a bit better, but we've not truly turned the corner in terms of evidence of that on deal flow and pricing and other associated kind of linked kind of areas to that. So, yeah. We're watching it quite closely as you can imagine.

Peter Antoszyk: Yeah. I'd like to pivot and bring Martina into the conversation and sort of pivot the conversation a little bit at this point. One of the trends in the private markets is tapping into, to a much greater degree, the high net worth individual and family office as sources of capital. And Martina, this is a trend that I think the industry is pursuing really aggressively, and certainly, you're right in the thick of it. I'm curious your view as to kind of what's driving this and, and putting perspective, you know, the magnitude of what this could look like.

Martina Sanow: Yeah. Absolutely, Peter. And I think as you say, it's a bit of a hype going on at the moment and it's a space that is moving really fast. I think though what is quite interesting at the moment there's a big debate going on around sort of public versus private markets. And if you look back probably 20, 30 years, you know, if you were an investor on the stock market, you could actually have quite a nicely diversified portfolio. You had good access to sort of representation of the global economy in terms of the companies that were listed. I mean fast forward sort of 20, 30 years later, so today, that is looking very different. I want to use one stat to describe this.

If you look in the US, and if you look at companies that have revenues of over $100 million, it's quite a big universe. Only 15%, one-five, of those companies are today publicly listed. So, you have 85% of companies that are, you know, growing, thriving in the private, and in Europe, you know, slightly different stats but similar picture. And I think that's what has happened over the last five, 10 years, and this is not something that sort of happened yesterday, but yes. Things are moving faster today but investors have sort of woken up to look at this 60/40 traditional type portfolio. It's not as exciting anymore. And it's not only about returns and about hopefully improving returns by adding private markets and private equity to your portfolio, but it's about getting more diversification and access into a better representation of the economy.

So, I think there's, there's definitely a sort of push from private investors, family offices, etc., to continue to do more into private markets and that's what we are seeing. And at Hg, we have over the past couple of fund vintages in particular seen a very fast growth of entrepreneurs, founders, company CEOs that want to sort of reinvest back with us and want to access the Hg platform and the Hg investment. So, that's been something that has happened, you know, and moving quite significantly. We also have a quite a large base of family offices today. That has again continued to grow and do so quite quickly. So, I think it's the, you know, it's getting diversification, very, very important for investors, and you can't sort of get that through being fully in the public markets. And I think it also, there's been a couple of sort of hurdles, quite big ones in the past where it's just been hard frankly for private investors to access private equity and private markets more broadly. You know. Fund structures have been sort of quite set for decades and minimum ticket sizes have been very high. There hasn't been much technology in this space in terms of how you can onboard and make that whole sort of process much easier, and I think that's where we start to see a shift today as well.

Peter Antoszyk: And wealth advisors haven't been particularly sophisticated in understanding the, the investment universe to even explain to their clients, I think, and they've become more educated.

Martina Sanow: Absolutely. And I think the word education is mentioned a lot nowadays and I do think it's super important. Educate about, you know, the industry, about what is private equity, how does it work, what are the risks, and then, of course, as newer fund structures are coming on board, those will also require education to both advisors and investors and that is something that, you know, us as private equity investors need to take responsibility for, but also as you say the advisors and the private banks and the wealth managers.

Peter Antoszyk: So, I'm curious about your view and how you think about, what have been some of the challenges of investing in private equity funds or other private market vehicles? So, some of the challenges have included liquidity, the ability to exit, how do you think about that and how has the market changed to address that?

Martina Sanow: Yeah. Absolutely. I fully agree and, and that's the reason why also many haven't invested in private equity is not only the sort of minimum ticket sizes to get in, but then it's a question; how do you get out? And in a traditional private equity sort of close-ended fund structure, and you are, as an investor, you have to expect to be locked in, so to speak, for at least 10 years, and that's a long time. And that's actually what we started having conversations with our investors at Hg where they said, "Look. We love what you do." You know, exactly what Steve described before, these sort of resilient, sort of highly growing profitable businesses that we invest into and they started saying, "How can we access these investments and how can we do that in a more flexible way and how do we think about liquidity? And of course, people have life events, there are, things are changing or you have to buy a house or getting divorced or whatever can happen, and how do I then get my money out?"

We started having kind of more and more of those discussions and feedback and that's actually what, in the end, led us to thinking that there is a need here for an additional access point into Hg, which is, you know, beyond the, the traditional close-ended funds. That is something that is, you know, more open-ended, that offers earlier liquidity, and I think we have to be very clear within private equity, it's not, of course, a liquid asset class. So, you need to find the balance. But there are, of course, today, structures, and they're becoming much more popular where you can at least offer sort of quarterly or, what have you, liquidity to investors so they can have some more flexibility. And I think that's really where the industry is moving and I think that's also what clients are asking for.

Peter Antoszyk: So, you have set up a vehicle. Can you talk about that and what it looks like and the structure and how it works?

Martina Sanow: Yeah. Absolutely. So, we did launch a sort of dedicated vehicle for eligible professionals, investors, their advisors, family offices, private banks, back end of last year.

Peter Antoszyk: And are those for qualified investors?

Martina Sanow: Yeah. Exactly. I think that's important to call out. It is still not for everyone. You have to qualify and you have to go through suitability assessment and so forth. And again, it's probably a whole separate topic, but especially Europe, that is a market where each jurisdiction have different definitions and regulations. So, you, of course, need to adhere to all of that, so it's not one fit all, but once you kind of get through that, we did launch a vehicle.

It's a Luxembourg incorporated part two, UCI fund, back end of last year that is an evergreen structure, so open-ended fund structure, where investors can subscribe on a quarterly basis. They can also redeem on a quarterly basis. There is a quarterly gate at 5% of fund NAV, so just to control again that everyone is redeeming at the same time. And I think one thing to point out, and that's also what investors and clients are asking us for, this drawdown model that you'll have in close-ended funds where, you know, money is being drawn down over an investment period of three, four, five years, and you have to sort of think about how you manage the cash that is not used for the drawdowns and so forth, and it can be —

Peter Antoszyk: So, individuals have to reserve, at some pace, some amount of cash available, so that when a draw request comes in, they can fund that draw request. That's how a traditional model works.

Martina Sanow: Exactly. That's how a traditional model works. And you have then investors that had invested with us for now a number of funds. And of course, then it gets even more complex. And what you have with these evergreen funds and the fund that we launched is that you commit essentially 100% of your commitment upfront. So, you essentially trust us to manage that commitment and invest it wisely, and, of course, manage the cash portion, as well. So, I think that really removes kind of huge admin sort of burden for many investors that, you know, you invest, and if you don't want to top up, you can sort of sit back and you don't really need to think much about —

Peter Antoszyk: How do you deal with the J curve? The pace of investing? Has this vehicle been seeded with investments coming out of the gate or is it starting fresh?

Martina Sanow: Yeah. It's a good question. There was something they, it probably took us, you know, a year, 18 months to really get the structure right and think about how we get this going. So, we did actually launch with the secondary portfolio, so a number of Hg funds from prime integers. They were then already sort of ticking along at a nice net IRR of sort of 25% plus. And starting off with that and then adding new investments as you go, that helps mitigate the J curve. So, that's one way to do it. We've been sort of very fortunate with the support for this fund. So we have had sort of only two quarters in, but we had a kind of steady inflow of subscriptions very much from our network of investors and clients. So, but yeah. Only a few quarters in so far, but it's exciting.

Peter Antoszyk: Yeah. And do you allow the trading of the interests? You know. So, if an investor didn't necessarily want to redeem, but rather trade on the secondary market, is that available to them as well?

Martina Sanow: Not yet. It's something we do think about and I think as the fund is getting bigger, and then it is increasing, and you sort of get through the initial sort of soft lock periods, and that could be an option, so there are some versions of it out there.

Peter Antoszyk: Well, this has been really interesting, Steven and Martina. I just have one final question to wrap up with both of you and either one of you can go first. But my question is what superpower do you have that makes you successful in your jobs that is least appreciated? Let me rephrase this. What superpower do you have that is most underappreciated that makes you successful in your business?

Steven Batchelor: It's funny. It's definitely not a superpower. It's more of a reflection on the broader industry. So, I'd say 100% in that context that, it's funny, isn't it? The private equity industry, I don't think it's known, how would I put it, for its kind of humility, I would say, you know, it's, it has a particular reputation. I think some of that's deserved, some of it's not deserved. I just think kind of if you treat people with respect and you're nice to them and you do what you say, you end up in this industry being the top decile. It is crazy. In any other kind of other society, you'll be average. But an average person is top decile in private equity. If you're fundamentally decent, do what you say and you're nice. It sounds ridiculous and it has to be kind of natural if that's the case, but I really do think you can set yourself apart and surprise, maybe, but it's much more a reflection of the whole industry than any superpower I would say, but yeah.

Martina Sanow: Yeah. It's interesting what Steve says. And I think, frankly, that's probably what's, why I've been at Hg for 15 years now and Steve even longer. It's all about the people in the end, right? So, that's so important. Well, I, unfortunately, I don't think I have a superpower. I wish. But what I would say is, I think what I've learned, and I think what you learn when you've been in the industry for long, I would say two things. It's extremely important to get people with you on the journey. And I think I have a leadership style that is very much getting people on the journey and getting people with you that sort of collaborative element.

And I think that’s extremely important where you build new businesses within the business. Like that’s something that I’ve been, you know, what we’re doing in private wealth is just one example. I tend to be thrown into situations where we need to go and build new areas or develop new thinking and I think it takes back a little bit to the people aspect. But I think that’s extremely important and maybe not always viewed as, you know, a superpower, but you know, getting people with you, getting that consensus and get on with things. The other thing I would say is, you know, I have a habit of saying “yes” for good or bad. So, yeah. Being asked to get involved in various things, whether it’s building out private wealth and thinking about what we do with investors and new structure and vehicle and so forth, or setting up our charity foundation versus time one over the past kind of five years, or stepping in as deputy COO alongside Steve, yeah. I tend to say “yes” without much thinking, which, yeah. Whether that is a superpower or not, that’s a good question. But —

Peter Antoszyk: Well, it sounds to me, based, you know, listening to both of you, that collaboration, collegiality is a core attribute of the culture that both of you embody, and you can hear it in how you speak and how you speak about the firm. So, it doesn’t surprise me to hear that that is one of the underappreciated superpowers. I want to thank both of you for appearing on Private Market Talks. I think this has been a really interesting conversation. Thank you. And thank you, listeners, for listening to another episode of Private Market Talks, and don’t forget to subscribe.

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