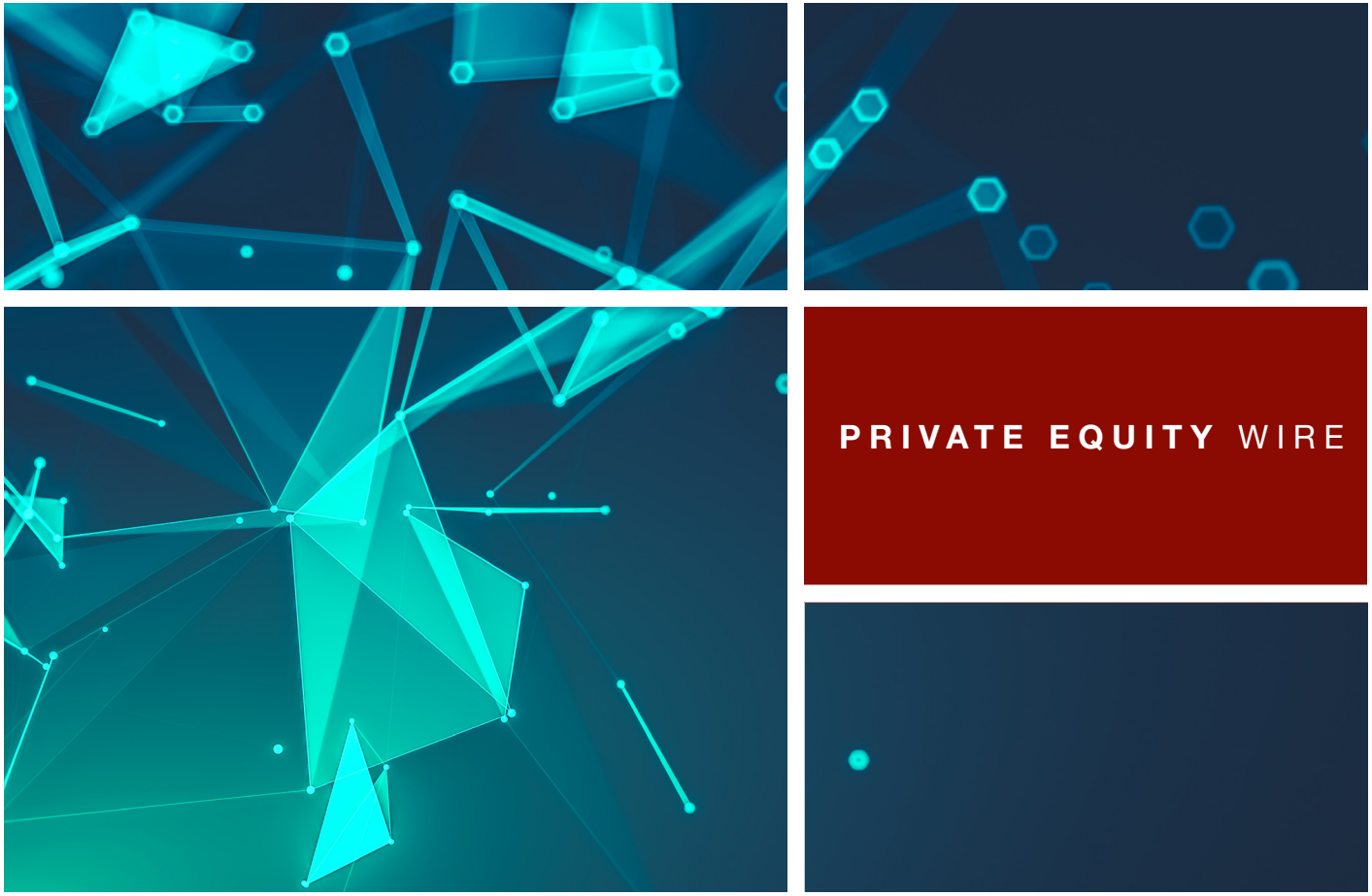
INSIGHTS

MAY 2023



BRACED FOR IMPACT

A PIVOTAL YEAR FOR TECH BUYOUTS

EXECUTIVE SUMMARY

Private equity's ego was battered in 2022 and the bruises remain in 2023. For GPs focused on the tech sector, that impact was felt more than most. However, the majority are still standing, despite their fund valuations taking a hit as the worst buyout performers for two consecutive years.

This month, Private Equity Wire delves into the industry-shifting challenges and opportunities in tech buyouts, finding a sector that has – perhaps – turned a corner. The investment environment may be no less challenging, but tech-focused GPs are adapting, better braced for impact, and – dare it be said – rolling with the punches.

Of course, few funds will publicly admit that further corrections could be due in Silicon Valley and beyond, and notably in their portfolios. That said, they are preparing for it, which is why deals are getting done – just not how they used to.

We discuss deal developments in Chapter 1 and 2, where we uncover the asset class's biggest challenges, alternative investment models and the ongoing emergence of private credit as a force within the sector.

In Chapter 3, we look at how AI, among other disruptive tech, is being used by tech-enabled portfolio companies and funds who want to improve their performance, deal origination and investment thesis.

Whatever the second half of 2023 brings, private equity – and tech buyout funds in particular – will be better positioned than most, in part due to the hardening experience of the past 12 months.

KATHERINE STEINER-DICKS
REPORT AUTHOR

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METHODOLOGY

Private Equity Wire surveyed more than 60 private equity professionals during March 2023 on their views around private equity buyouts and the tech sector. The results of the survey were analysed by Private Equity Wire and during April 2023 they were discussed with a range of named and unnamed private equity sources primarily based or working in technology-focused private equity.

KEY FINDINGS

1

High asset prices are GPs' #1 challenge

The tech buyout market's greatest challenge in 2023 so far has been inflated asset prices, followed by gaps in tech sector knowledge and lack of buying opportunities. Deal closings are expected to protract for the first half of 2023 as buyers come against the increased cost of capital, lack of LBOs and hits in seller's valuations due to macroeconomic factors. But deals are getting done, which we discuss in Section 1.

2

Equity buyouts: the new way to get deals done

Most GPs surveyed suggest that private equity funds will choose to write larger equity cheques in 2023 as interest rates and the cost of capital remain high. Leveraged buyouts for the time being are being replaced with new investment models including earnouts, seller loans, and direct lending. However, a quarter of respondents believe buyout funds and their LPs are not so willing to put so much skin in the game.

3

Tech valuations are like goldilocks' porridge

Reports of one tech fund seeing billions of dollars shaved off the value of its portfolio at the end of 2022 could be an indicator that 2023 will see more corrections emerge out of privately held tech funds, notably in Silicon Valley. Our survey found GPs evenly divided when assessing the performance of their tech portfolios over the past two years: losses, 32%; gains, 32%; no change, 36%. Not too hot, not too cold.

4

AI is getting private equity firms excited

Artificial intelligence and machine learning are keeping tech buyout funds excited about deal possibilities – survey respondents ranked it as the tech sector they are most positive about. Microsoft's $10bn investment in Open AI – and by extension Chat GPT – is the very definition of a market disrupting deal. Developers are already creating businesses off ChatGPT, but company-bespoke accuracy driven product development is the future.



ROLLING WITH THE PUNCHES

The tech buyout market has watched deal activity take a downward trend through Q1 2023. But there are signs a new valuation environment is turning back in its favour.

All bank crises and sour macroeconomic conditions considered, the absence of the uptick in deal activity that buyers and sellers were hoping for at the start of 2023 is – according to some commentors – justifiable.

Why? Hunter Lewis, co-founder and former chief executive of Cambridge Associates, tells Private Equity Wire that the current buyout model has "ruffled some feathers" and possibly "spooked some LPs".

Lewis is reflecting on his recent opinion piece in The FT, titled, Why I am not investing in a buyout for a long time to come, where he indicated that buyouts are currently guilty of "inflated returns, denial of volatility, high prices and fees, excessive leverage, and absence of covenants on buyout debt."

"GPs and the LPs that are heavily invested in buyout strategies in the current economic climate could spook LPs about large tech buyouts," he adds.

Indeed, tech buyouts have been hit harder than most. In Q1 2023, large global tech buyouts in the US, UK, EU, and Asia accounted for $79.4bn across 597 deals. This marked a drop of 50% in deal value and 35% in volume on Q1 2022 (see fig. 1.1). A new survey of investors and deal advisers conducted by Private Equity Wire found high asset prices were the number one challenge when considering tech firms (see fig. 1.2).

However, despite the dive in deal flow and

questions around value, wider Private Equity Research suggests transactions are starting to pick up in Q2 of 2023 – they're just taking longer to negotiate and complete.

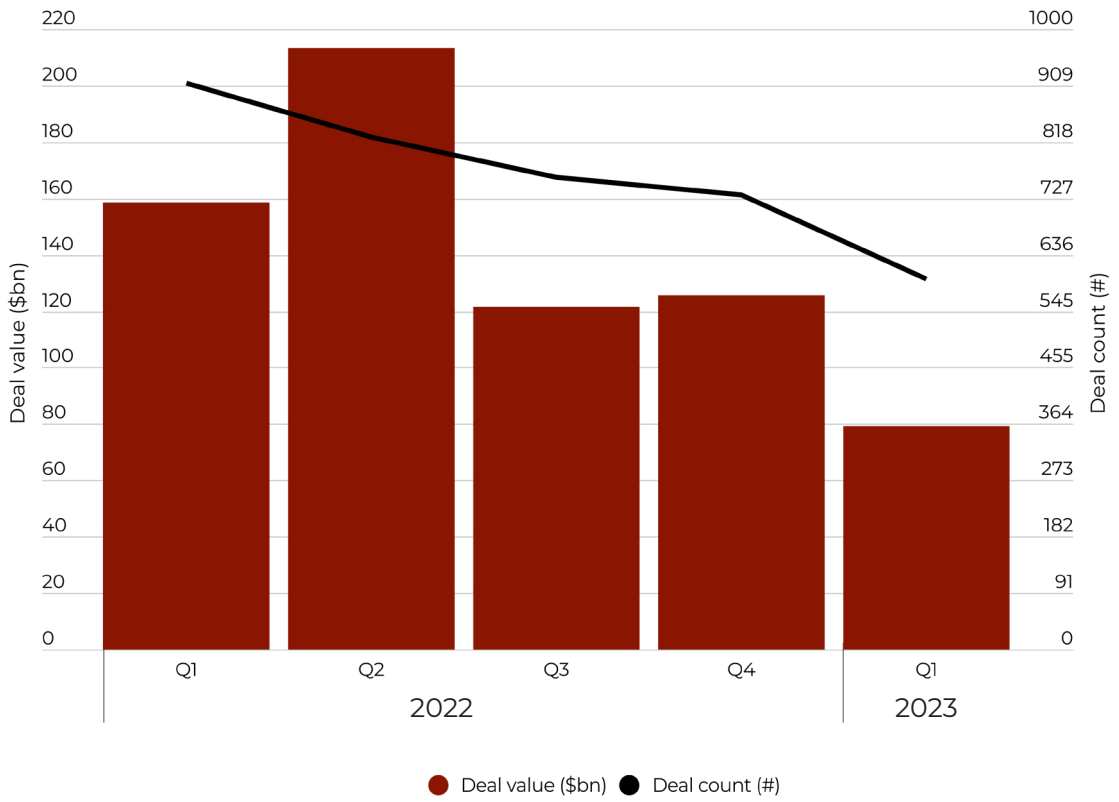
"Deals are getting done, all you have to do is look to the take-privates to see that," says Ryan Lanpher, a partner in Permira's Technology Team. "It's a classic case of mismatch between buyer and seller expectations," says Lanpher who is a non-executive director at companies including Genesys, Informatica, Seismic, Synamedia, Mimecast, and Zendesk.

"On the take private side, the premiums are much higher than they have been in historical periods," Lanpher continues. "Private investors have so far been willing to pay a large premium to the classic 20 to 30%. In some cases, premiums on public market trading are being negotiated at 50 to 100% even if perhaps they shouldn't. It's a sign the public markets are partially disconnected from fundamental value."

In March, Permira made a final close of its latest flagship buyout fund, Permira VIII with total capital commitments of €16.7bn. The Fund closed above its target size of €15bn – an increase of over a third compared to its predecessor, P7, which closed at €11bn in 2019.

Salim Nathoo, a Partner in Apax's Tech team in London, expects more take-privates to be added to deal tally in 2023. That's because "boards are now becoming more reasonable as the new valuation environment sets in."

Figure 1.1 Global tech private equity buyout deal activity by quarter, Q1 2022 - Q1 2023



Analyst note: *Deal values are extrapolated. Global refers to US, UK, EU and Asia.*

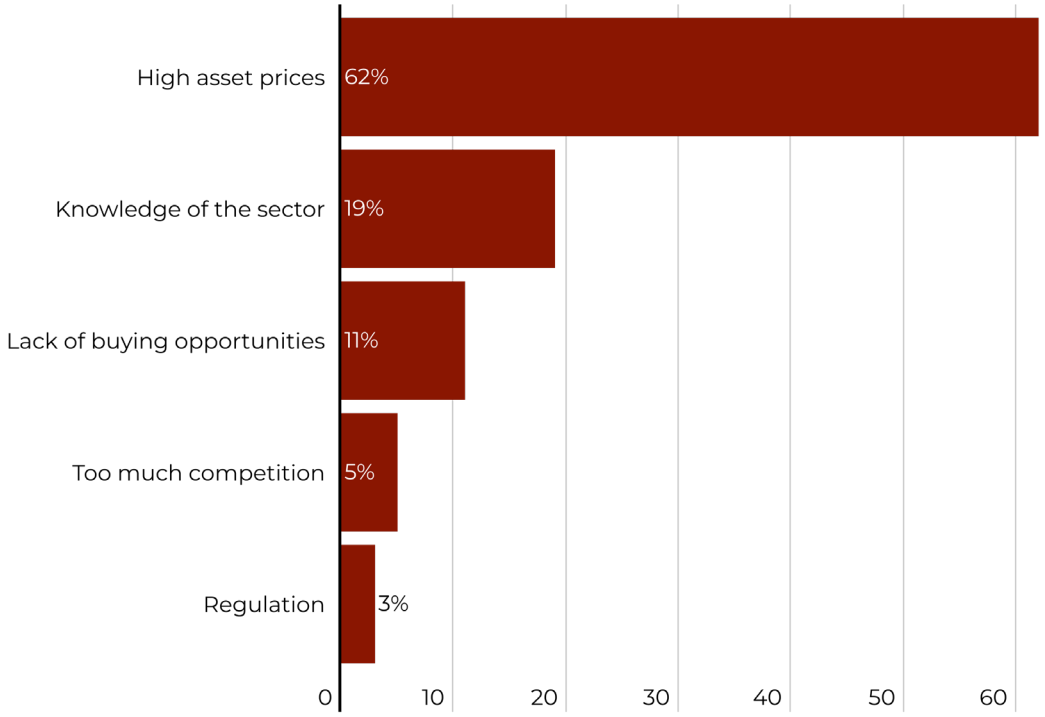
Source: Pitchbook

“

Deals are getting done, all you have to do is look to the take-privates to see that

Ryan Lanpher
Partner, Permira

Figure 1.2 The greatest challenge to investing in tech companies according to private equity market participants



Analyst note: *Survey respondents were asked, 'What is the greatest challenge to acquiring/investing in tech companies?'*

Source: Private Equity Wire Readers Survey

"The last 12 months' highs of stock prices are dropping, and equity fund managers are pressuring companies to accept bids at reasonable premiums," he says. Adding, "More broadly, 2021 was the anomaly with valuations in extremely high territory. While valuations have come down, it is hard to argue they are particularly cheap by historical standards, especially when you factor in the premia needed for a take private."

COMPELLING OPPORTUNITIES

Nathoo believes it is hard to say that any sub-sector in tech is undervalued given the rise in interest rates and the macro-outlook. "However, tech valuations have come down from very high levels in 2021 for both high growth and mid-growth businesses," he adds.

Apax has a number of interesting opportunities in the pipeline across its three core tech subsectors of software, tech services and telecoms, Nathoo says.

Swedish investment firm EQT is seeing opportunities in the US and Europe, says Arvindh Kumar, Partner and Co-Head of the firm's Technology Sector Team, while noting that the underlying financials are very different.

"The US has more unprofitable software companies trading at a lower revenue multiple than in Europe, presenting a number of compelling buyout candidates," he says.

The US tech buyout market invested $47.3bn across 249 deals in Q1 2023. This was in

Multinational carve outs on the cards in China

Buyouts account for just 9% of Greater China's total deal value in 2023, however, that's set to change as the "increasing amount of assets held by private equity funds entering the exit time window, and the increase of multinational carve-outs under the current geopolitical situation," according to Hao Zhou, head of Bain & Company's Greater China PE practice in Hong Kong.

The tech sector continues to account for the lion's share of private equity capital in Greater China, however, deal values are dropping as they are in other markets falling 62% year-on-year, led by the cloud services (down 88%) and software (down 59%) subsectors. India, and Southeast Asia— all experienced sharp declines in 2022. However, in Greater China, semiconductors and components "helped pick up some slack" as the government doubled down on national security, says Bain & Company.

Founder generational change is also set to spark more buyout activity in China as is a shift in investment thesis from top-line growth to much consolidation plays of smaller players to build a single big tech company and identify multinational carve-out opportunities.

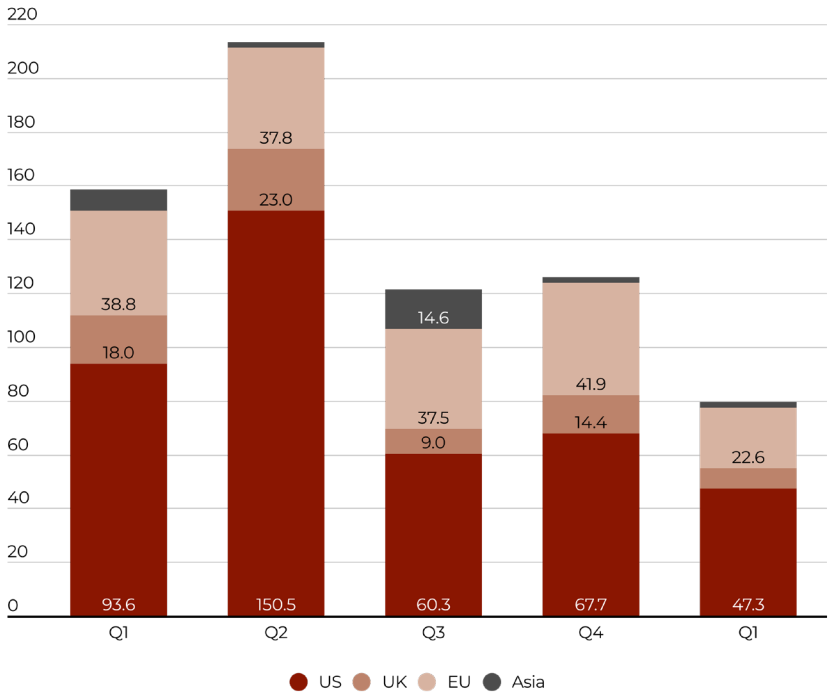
Emmanuel Daniel, founder of TAB Global, says fintechs and foreign fund managers entering the China market and targeting the wealth management segment could be at a technological disadvantage.

"[In China] technology commoditises financial services," says Daniel. "It levels the playing field for big and small players, so all players will be scrambling to identify a value proposition that could set them apart," he says.

In his view, technologies in China have made end users more powerful than service providers. "In fact, many funds in China today are essentially users banding together to set up their own product designs."

The caveat, of course, remains US-China trade tensions. But if they start to ease, the opportunity set around multinational deals could make Asia a destination of choice.

Figure 1.3 Global tech private equity buyout deal value by quarter, Q1 2022 - Q1 2023, by region



Analyst note: *Deal values are extrapolated. Global refers to US, UK, EU and Asia. EU excludes UK.*

Source: Pitchbook

> **The US has more unprofitable software companies trading at a lower revenue multiple than in Europe, presenting a number of compelling buyout candidates.**

stark contrast to Q1 2022 which saw 424 large buyout deals close worth $93.6bn (see fig. 1.3).

Take-privates in the US have accounted for all but one of the top ten largest tech buyouts closed in the past year. The odd one out was a corporate divestiture, Emerson Electric.

The top tech buyout deal over the past year has been Elon Musk's Twitter bid, which closed at $44bn and included a Who's Who of investors from private equity, family offices and sovereign wealth investors.

Only one US mega buyout closed so far in 2023 comes close to rubbing shoulders with the 2022 top 10 deals and that is Qualtrics, which was taken private in March of this year in an all-cash deal worth $12.5bn by CPP Investments and Silver Lake (see fig. 1.4). The take-private deal has since run into troubled waters. Kaskela Law announced that it is investigating Qualtrics International Inc. on behalf of the company's shareholders (since March 2022, the value of Qualtrics' shares have fallen 38% and the investigation seeks to determine whether the decline is attributable to the prior issuance of false and/or misleading statements and/or the failure to disclose material information to Qualtrics investors, in violation of the securities laws).

In Europe, five of the top 10 deals are from 2023, with the ranking topped by Saudi Arabia's Public Investment Fund's $17.3bn buyout of German telecoms business Vantage Towers from March.

EMEA Private Capital Pitchbook Analyst Nalin Patel says deal count in Europe has "remained fairly resilient" despite challenging trading conditions in large tech caused by factors such as weaker corporate spending on cloud services and digital ad spend.

That's because sponsors have "avoided larger deals in favour of smaller transactions," says Patel.

EQT's Kumar calls the opportunities in Europe "compelling," highlighting strong products with a need for new owners that bring strong operations, a different perspective and a profitable growth mindset.

In Asia, meanwhile, China is again the one to watch. Over the next five years Greater China's buyout deals are expected to outgrow other asset classes, according to Bain & Company (see boxout).

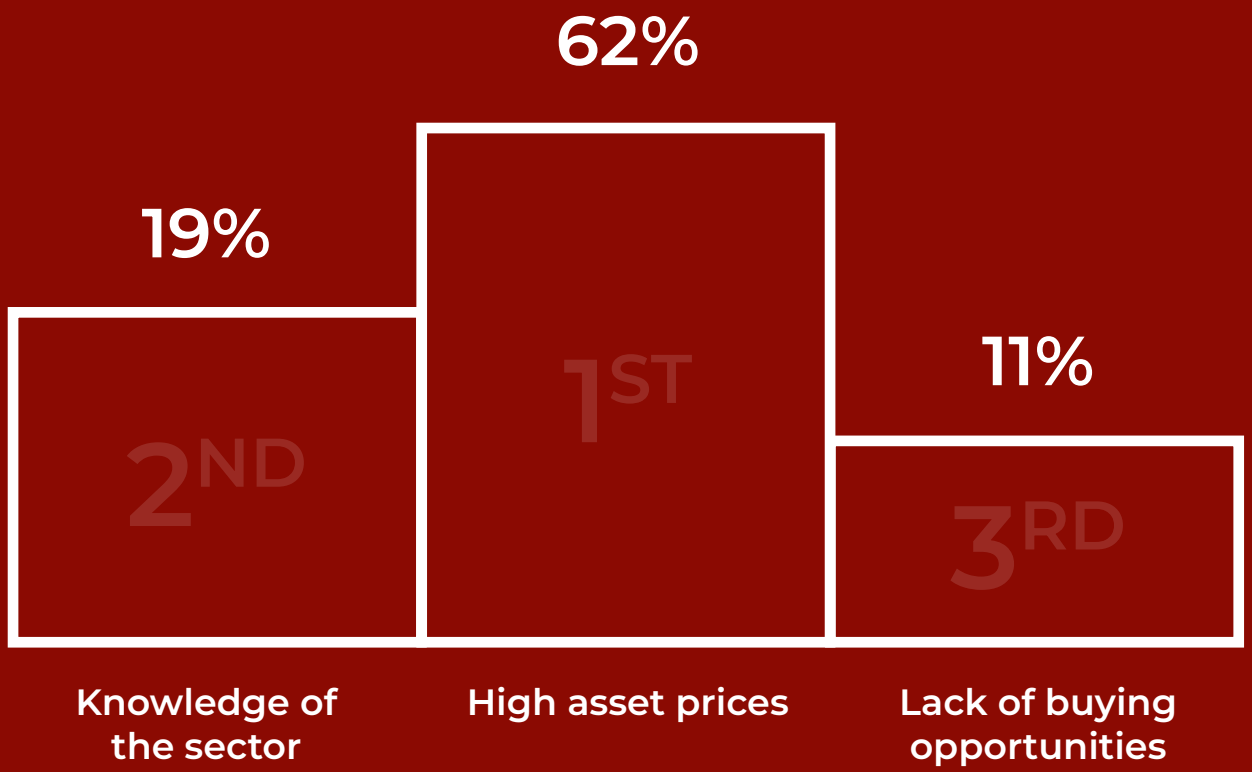
THE NEXT CYCLE

"The rise in interest rates has set the stage to separate the men from the boys in private equity,"

KEY FINDINGS

High asset prices is the biggest challenge for tech investors

Top challenges to investing in tech companies according to respondents of Private Equity Wire's latest readers survey



INSIGHTS

Figure 1.4 Top 10 tech private equity buyout deals by deal size ($bn), 2022-2023

	Company name	Industry	Country	Investors	Deal type	Close date	Deal size ($bn)
1	Twitter	Software	US	Multiple, inc. Andreessen Horowitz, Brookfield Asset Management, Elon Musk, Qatar Investment Authority	Public to private transaction	27-Oct-22	44.0
2	Vantage Towers	Comms and networking	Germany	Global Infrastructure Partners, Kohlberg Kravis Roberts, Saudi Arabia's Public Investment Fund	-	23-Mar-23	17.4
3	The Nielsen Company	Commercial services	US	Brookfield Business Partners, Evergreen Coast Capital	Public to private transaction	11-Oct-22	16.0
4	Emerson Electric (Climate-Technologies Business)	Commercial products	US	Abu Dhabi Investment Authority, Blackstone, GIC (Singapore)	Corporate Divestiture	31-Oct-22	14.0
5	Qualtrics	Software	US	CPP Investments, Silver Lake	Public to private transaction	12-Mar-23	12.5
6	Switch (Systems and Information Management)	IT Services	US	DigitalBridge Group, IFM Investors	Public to private transaction	6-Dec-22	11.0
7	Anaplan	Software	US	Thoma Bravo	Public to private transaction	21-Jun-22	10.7
8	The Access Group	Software	UK	GIC (Singapore), Hg, Horizon Capital (London), TA Associates Management	Secondary Buyout	3-Oct-22	10.4
9	Zendesk	Software	US	Abu Dhabi Investment Authority, Ares Management, GIC (Singapore), Hellman & Friedman, Permira	Public to private transaction	22-Nov-22	10.2
10	Deutsche Funkturm	Comms and networking	Germany	Brookfield Infrastructure Partners, DigitalBridge Group	-	13-Jul-22	9.3

Analyst note: *As of 25 April 2023.*

Source: Pitchbook

Emmanuel Daniel, fintech commentator and founder of TABInsights, tells Private Equity Wire. Daniel is of the opinion that buyout funds that have been too reliant on leverage to boost valuations in recent years, rather than inherent value, could be weeded out in the next fundraising cycle.

Those funds that nurture portfolio companies are most likely to survive this period, especially in the fintech sector's buy-now-pay-later segment, he says, which companies have found out is "not a technology innovation, but rather a balance sheet-defined innovation." ■

KEY TAKEAWAY

Mega private tech buyouts have taken a pause in the first quarter of 2023 while the cost of capital remains comparatively high, placing buyers' radars instead on opportunistic mid-market buyouts and take-privates where valuations are gradually coming down to earth.

CREDIT CRUSADERS FILL THE WALL STREET VOID

Private credit funds could become a more permanent fixture in tech's leveraged buyout market thanks to their speed of execution and reliability, especially in challenging macroeconomic conditions

Tech buyout firms may be looking to deploy capital to take advantage of lower valuations and improved long-term returns, but market forces are requiring them to manage their expectations.

As Nalin Patel, an analysist in Pitchbook's EMEA Private Capital team, says: "Higher interest rates could offset gains with increased costs associated with debt portions of deals." Patel's observation rings true with Private Equity Wire's research, which found that most investors and deal advisers expect to see funds write bigger equity cheques as interest rates could still rise in the US and Europe (see fig. 2.1).

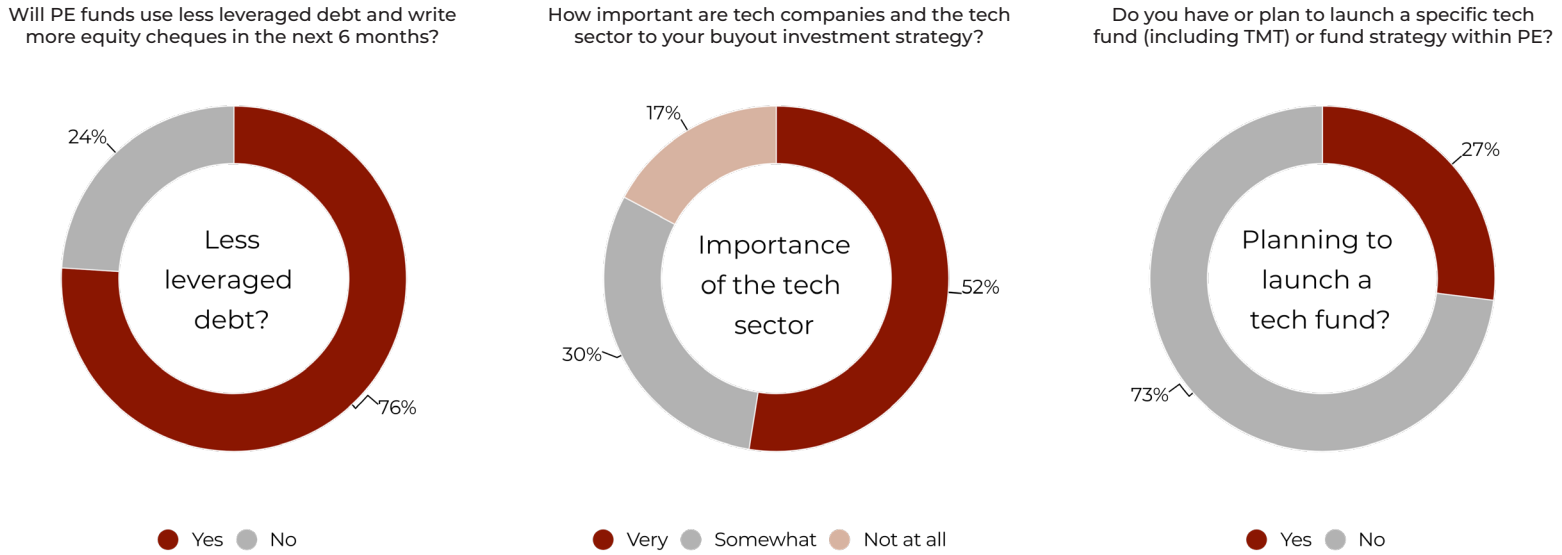
With low interest rates not expected to return anytime soon, active tech buyout players such as EQT are approaching deal negotiations in different ways to get deals over the finish line. "Some deal structures we explore include using more equity than debt given the uncertainty in debt markets and using more earn-outs in certain add-on transactions to bridge the gap between buyer and seller expectations," says Arvindh Kumar, Partner and Co-Head of EQT's Technology Sector Team.

Despite debt markets being relatively weaker, one Private Equity Wire source said they have improved significantly in the last couple of months, and even sees syndicated loans easing back this year.

In fact, one segment of the debt market continues to be something of a deal saver – private credit.



Figure 2.1 Industry sentiment of private equity market participants, April 2023



Source: Private Equity Wire Readers Survey

Back in September 2022, KKR's $3 billion buyout of Spain-based fertility specialist IVIRMA could have crumbled when banks decided to pull out of the deal. Concerned about their debt exposure, Morgan Stanley, Credit Suisse, and other lenders sold their $800 million of loan obligations and relinquished deal-related fees to private credit firms including Park Square Capital and Intermediate Capital Group, according to a Bloomberg Law report.

One interviewee familiar with the market said going the private credit "route" probably means paying a higher rate on an ongoing basis, but with lower risk around the transaction getting done. "There have been various deals that have gotten hung up by the different lender groups. And what happens when deals get hung up? The ability to flex the agreement can be worse for you. Deal certainty in the current market is certainly worth more," they said.

A STRUCTURAL ADVANTAGE

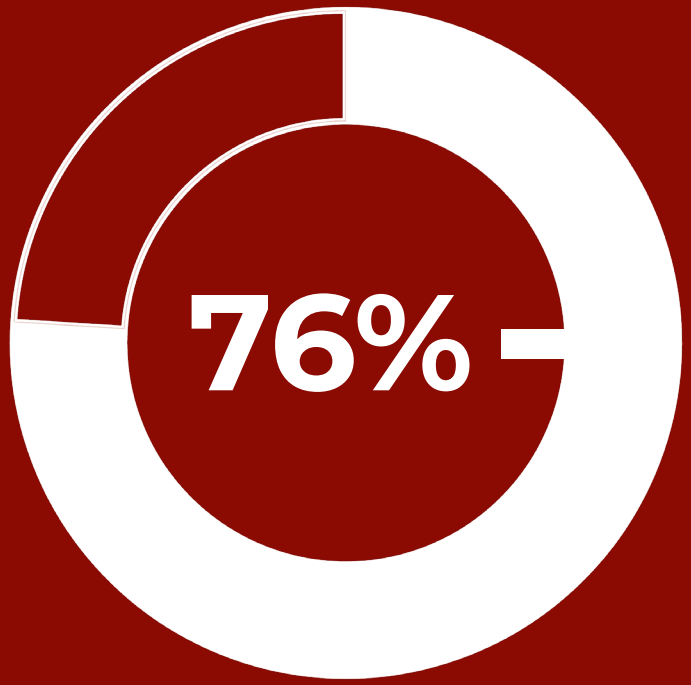
Edward Green, CEO of Equipped AI, a UK-based analytics solutions provider for alternative asset management firms, says in addition to buyouts moving away from the LBO model due to "the changes in the tech buyout environment and a more volatile macro environment," the firm is observing a "structural advantage".

Green says some organisations are distilling insights from their existing portfolio to surface

KEY FINDINGS

Less debt please – private equity funds are expected to write more equity cheques in the next 6 months

Proportion of Private Equity Wire survey respondents expecting PE funds to use less leveraged debt and write more equity cheques in the next 6 months



INSIGHTS

meaningful trend analysis that can support new underwriting decisions or structure a deal framework to mitigate against potential volatility.

"We see an increase in the deployment of data analytics and tools to provide more sophisticated information on the sell-side – for example, to provide an improved empirical basis to support investment cases," says Green.

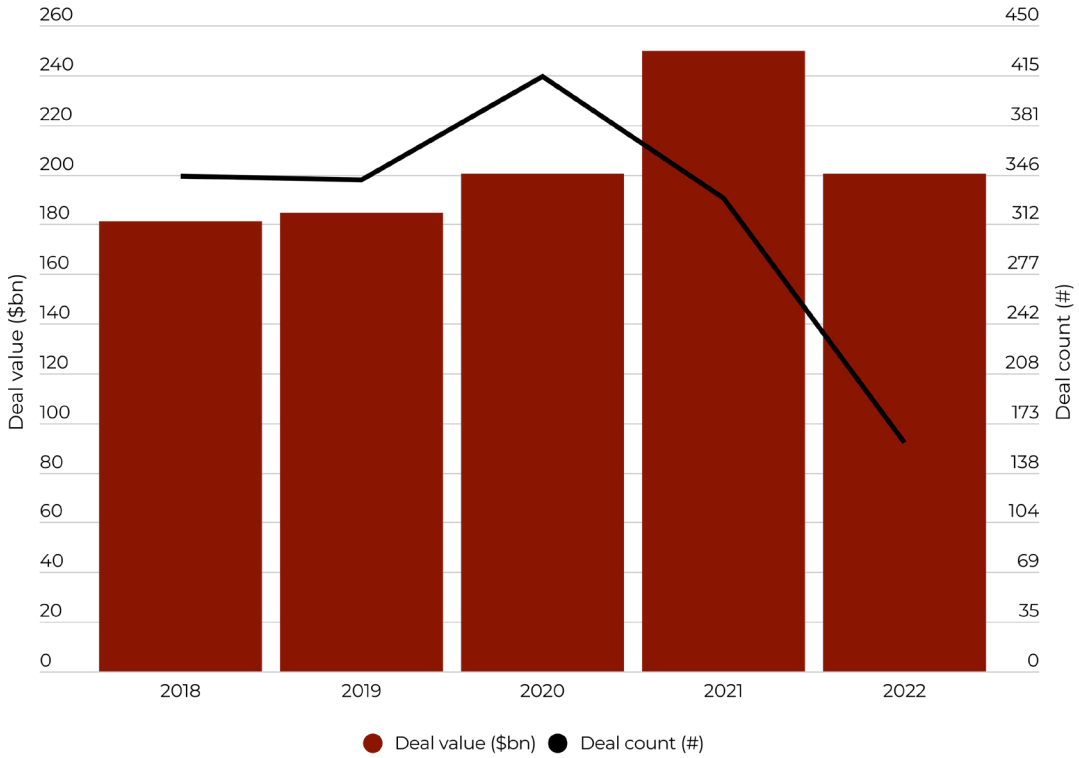
"We are also seeing an increase in demand from Technology / SaaS sponsors using analytics projects aimed at improving client retention through more informed client segmentation and more sophisticated pricing," he says.

Private credit funds are also being approached by buyout funds to refinance portfolio company debt. In April, it was reported that Vista Equity Partners, which favours software-based investments, is in talks with private credit funds to seal a $6 billion deal to refinance in part $4 billion in debt maturities for portfolio company Finastra Group Holdings Ltd.

The London-based fintech business provides lending solutions across syndicated, commercial, consumer, and mortgage lending.

Sources have indicated that two options could be on the table. One being a record unitranche of between $5.3 billion and $5.4 billion, that would be combined with a junior debt element between $500 million and $700 million. The second a $4 billion first-lien term loan and a $2

Figure 2.2 Private debt fundraising activity, 2018-2022



Analyst note: *2022 data as of 31 December 2022.*

Source: Pitchbook, Global Private Debt Report 2022

> Private debt fundraising has been on the up since 2022, raising $60.7 billion in total fundraising in Q4

billion second-lien term loan.

Likely credit players including Oak Hill Advisors, Sixth Street Partners and Ares Management Corp are said to be involved in the discussions, according to unnamed sources.

Should the debt financing complete, it could be one if not the largest private financing of its kind to date.

“Debt is available for all but the very large buyouts, albeit it is materially more expensive than in 2021,” says Salim Nathoo, a Partner in Apax’s Tech team in London.

Lack of credit, however, has not prevented the Apax Funds from doing a deal, he says.

Private debt fundraising has been on the up since 2022, raising $60.7 billion in total fundraising in Q4 and surpassing the $200 billion full-year fundraising mark for the third consecutive year, according to Pitchbook’s 2022 private Debt Report (see fig. 2.2). Mezzanine also had a “stellar year of fundraising”, says the report and contributed to several of the largest funds (see fig. 2.3).

And the best could be yet to come. Funds being raised include: Blackstone’s $10 billion new direct lending fund, which launched in the first quarter of 2023; HPS Investment Partners’ $12 billion junior credit fund; and a $10 billion raise by Oaktree Capital looking to finance large private equity backed buyouts.

Consolidation in the private credit market is also emerging. A notable recent example is General Atlantic (GA) Credit, formed in April following GA’s completed acquisition of Iron Park Capital Partners, a firm with a track record in the public and private credit.

Other consolidation plays this year have been MetLife Investment Management’s take-over of privately-owned alternative credit specialist Raven Capital Management, which has $2.1bn AUM.

Jeff Diehl, Managing Partner and Head of Investments at Adams Street says a high-quality private credit fund has the potential to produce a 14-15% gross IRR, mostly realised through quarterly cash distributions. The median buyout fund will be challenged, according to Adams Street research, to replicate 18% in today’s market.

Globally, private credit funds had $1.4 trillion of AUM at the end of 2022, up from $250 billion in 2010, according to Preqin. By 2027, private credit assets under management are expected to grow to $2.3 trillion.

THE VIEW FROM ASIA

Lim Cheng Khai, Executive Director at The Monetary Authority of Singapore, said at a recent event that “private credit is the next key driver of growth in the private markets.”

“

Debt is available for all but the very large buyouts, albeit it is materially more expensive than in 2021

Salim Nathoo
Partner, Apax

Figure 2.3 Top 10 private debt funds closed in H2 2022

	Fund	Fund type	Location	Fund value ($bn)
1	West Street Mezzanine Partners VIII	Mezzanine	US	11.7
2	ICG Europe Fund VIII	Mezzanine	UK	8.2
3	Barings European Private Loan Fund III	Direct lending	US	7.4
4	Ares Special Opportunities Fund II	Distressed debt	US	7.1
5	CVC Credit Partners European Direct Lending Fund III	Direct lending	UK	6.8
6	Ares Infrastructure Debt Fund V	Infrastructure debt	US	5.0
7	Ardian Private Debt V	Direct lending	UK	4.9
8	Churchill Middle Market Senior Loan Fund IV	Direct lending	US	4.6
9	Ares Sports, Media & Entertainment Finance Fund	Mezzanine	US	3.7
10	Tikehau Capital Direct Lending Fund V	Direct lending	France	3.4

Analyst note: *2022 data as of 31 December 2022.*

Source: Pitchbook, Global Private Debt Report 2022

However, Khai says global players will have to keep in mind that the "Asian private debt market is more fragmented and challenging to navigate than the US and Europe. The legal framework in parts of emerging Asia poses additional risks or challenges to lenders and investors in private credit."

Talent in the private credit could also be hard to come by when it comes to competencies in deal sourcing, structuring, financial modelling, and execution. There's also the diverse culture and language in the region to accommodate. Kai says MAS is prepared to support private credit managers when they expand to Asia to overcome these challenges. ■

KEY TAKEAWAY

A third of tech buyout sponsors suggest that PE funds will write larger equity cheques in 2023 as interest rates and the cost of capital remain high. However, a quarter of respondents believe buyout funds will not put as much skin in the game and will fund deals through mostly debt – the rise in private credit funds is providing a lifeline for buyout deal completions and refinancing portfolio company debt.



AI TAKES OVER

New advances in artificial intelligence are creating a buzz in tech M&A in 2023, that if backed up by capital deployment could make up for the dip in private investment into the sector in 2022.

Tech buyouts may be trickling to the surface in the first half of 2023, but technology in some segments is moving fast. So fast, that some private equity funds, 19% according to our survey, have admitted that their lack of knowledge could prove an initial challenge to doing deals (as seen previously in fig.1.2).

Private equity professionals in sectors such as telecommunications are reporting that the inability to quantify return on investment of AI trials is going to hold back AI adoption in their industry. This is particularly the case in large language models (LLMs) such as Microsoft-Open AI's Chat GPT.

But at the same time, the buzz about generative AI, such as Chat GPT, is prompting others to venture forth – over one quarter of investors surveyed by Private Equity Wire said AI was the technology sector they were most positive on for opportunities in 2023, followed by healthcare, SaaS, climate and cyber (see fig. 3.1).

By focus area, private investment in AI is already on a similar trend, with healthcare ($6.1 billion), fintech ($5.5 billion) and cybersecurity ($5.4 billion) among the top four areas by total investment, according to Stanford University's annual AI Index Report (data management and cloud completes the top four at $5.9 billion, while energy-based cleantech AI investment is not as high as one might anticipate given zero carbon targets and the rise in oil prices due to the conflict in Ukraine, attracting less than $2.0 billion).

The report identifies 2022's largest AI private investment event as the $2.5 billion spent on China-based unicorn and electrical vehicle manufacturer GAC Aion New Energy Automobile.

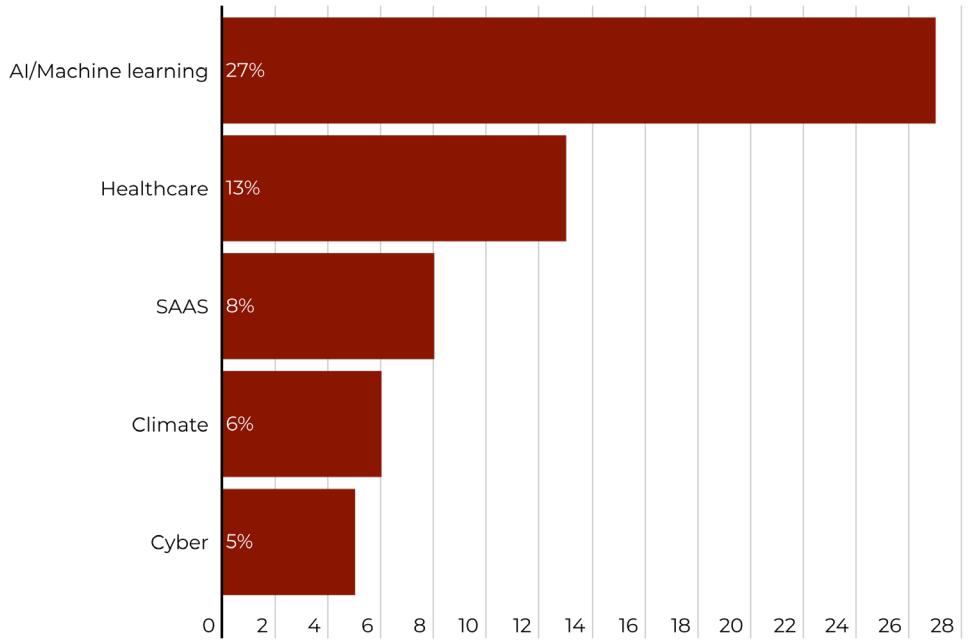
So, in this down cycle, is now the time to invest in more nascent technologies or tried and tested ones in, for example, industrial tech? Private Equity Wire put this question to EQT partner Arvindh Kumar.

"EQT has always invested in nascent technologies in our early-stage strategy, particularly through our Venture Capital fund," says Kumar.

In November 2022, EQT held a final close on its EQT Ventures III fund at €1.1 billion of total commitments, to invest in European and North American early-stage tech startups. This makes it the largest fund of its kind targeting early-stage European startups. The firm is making it known that AI is definitely going to have a large influence in this latest fund, and across existing portfolio companies.

And the larger end of the deal market? "In our buyout fund, we have made several excellent investments in Industrial Tech, for example, AutoStore, an automated storage and retrieval system equipment manufacturer," says Kumar. "Within buyouts, we continue to get deeper into food tech and sustainability tech and apply newer generative AI technologies to mature businesses to ensure that AI is a tailwind rather than a headwind."

Figure 3.1 Areas of the tech sector private equity firms are most positive on in 2023



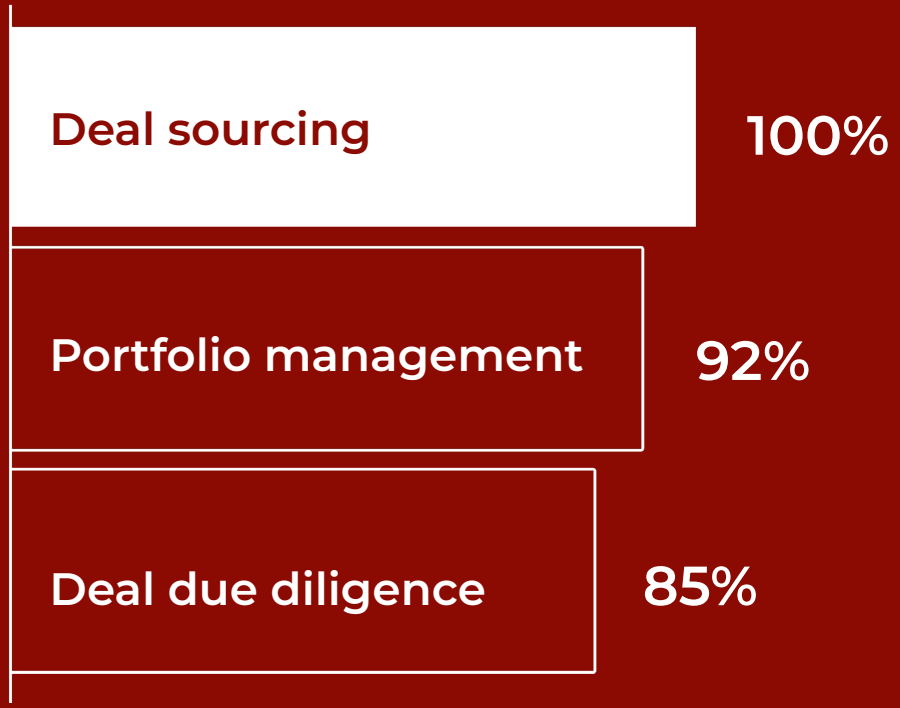
Analyst note: *Survey respondents were asked the open ended question of, 'What areas of the tech sector are you most positive on in 2023? Chart features results for groups of similar/related responses.*

Source: Private Equity Wire Readers Survey

KEY FINDINGS

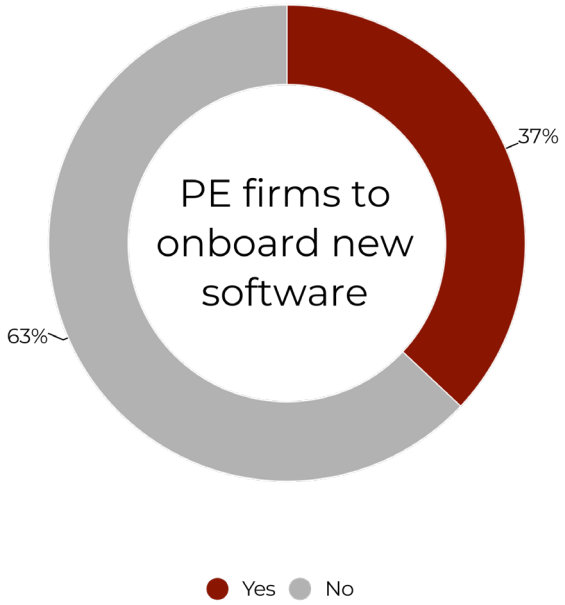
(At least) one quarter of PE deal sourcing is being driven by AI

Areas AI is being applied by the 27% of Private Equity Wire survey respondents using the technology



INSIGHTS

Figure 3.2 Private equity firms that have onboarded new software to improve origination in the past 12 months



Analyst note: *Survey respondents were asked, 'Have you onboarded new software to improve your origination process in the past 12 months?'*

Source: Private Equity Wire Readers Survey

The AI investment anomaly

Despite China claiming the largest AI private investment deal in 2022 (GAC Aion New Energy Automobile), when it came to overall private investment in AI, the US led the pack, followed by China, the UK and Israel and India (see fig. 3.4).

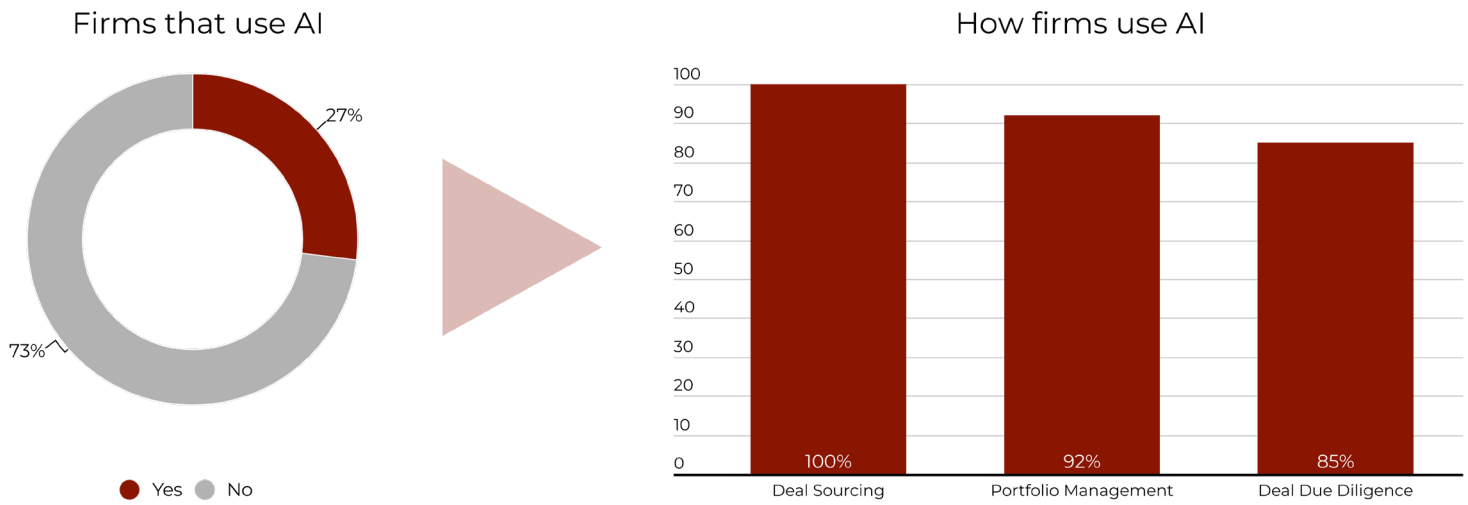
However, the only countries in the top five whose citizens exhibited great trust and perceived understanding of the technology were China and India, according to a 2022 IPSOS survey. IPSOS found that 78% of Chinese respondents believed products and services using AI had "more benefits than drawbacks". Respondents from Saudi Arabia (76%) and India (71%) were among the second and third respectively who also felt the most positive about AI products.

Unexpectedly, based on investment levels in AI, the five countries exhibiting the lowest levels of trust in AI offering more benefits than drawbacks were France (31%), Canada (32%), Netherlands (33%), the US (35%) and Germany (37%). Arguably, signs of 'NIMBYism' (not in my back yard) are already emerging, with sceptics fortified by the warnings of AI pioneers such as Geoffrey Hinton, who recently resigned from Google and voiced concerns that AI would eliminate jobs and disseminate false information. These risks, he suggested, were more severe and urgent to humanity than climate change.

With AI-inaccuracies could come reputational damage and subsequently court cases, something with which tech funds and their limited partners want no association. Therefore, as AI becomes more ingrained in portfolios, and cases of conflicts emerge, so, too, can sponsors expect more AI government regulation.

Until then, any buyout with AI capabilities will be wise to welcome ethical scrutiny to mitigate risk.

Figure 3.3 Private equity market participants' use of AI



Analyst note: *Survey respondents were asked two questions, 'Is your firm already using artificial intelligence?' and 'In which areas is your firm using AI?'*

Source: Private Equity Wire Readers Survey

GROWING PAINS

Certainly, headwinds for the industry at large remain. For example, there appears to be a disconnect between the countries that have invested the most into AI companies and the public opinion of the citizens of those nations (see boxout) – which may help explain the dip in AI led investment last year.

According to Stanford University's report, global private investment in AI totalled $93.5 billion – more than double the 2020 total and the greatest year-over-year spike since 2014 when investment doubled. But in 2022, activity slowed, with global AI private investment accounting for $91.9 billion.

Of course, LLMs such as Chat GPT are industry-shifting, but like all new technology there are drawbacks – not least ChatGPT's limit on using data beyond 2021.

NVIDIA claims its product NeMo is improving the data "time capsule" in today's language models since it can include information beyond 2021 and augment client LLMs with proprietary data, enabling them to frequently update a model's knowledge base without having to further train it or start from scratch.

Still, the onset of and a growing familiarity with ChatGPT and the likes will surely see uptake of AI technology (and investment) accelerate again – especially if those firms using new technologies show signs of an advantage.

Deal origination could be key. Some 37% investors surveyed by Private Equity Wire have integrated new software in the past 12 months to help (see fig. 3.2). Among the 27% of respondents to integrate AI, all were doing so to improve deal sourcing, 92% portfolio management, and 85% deal due diligence (see fig. 3.3).

At EQT, the firm's hardest working team

“

We continue to… apply newer generative AI technologies to mature businesses to ensure that AI is a tailwind rather than a headwind

Arvindh Kumar
Partner and Co-Head of Technology Sector Team, EQT

member is an app – Motherbrain – built in-house by a team of developers, engineers, and data scientists in 2016 to help EQT Ventures unearth tech start-ups to invest in.

EQT Ventures' investment thesis has been proven with nine investments fully sourced by Motherbrain, says the firm on its site. These include Peakon, AnyDesk, CodeSandbox, Griffin, Handshake, WarDucks, Standard Cognition, Netlify and Anyfin.

"All of these are companies would not have been identified without Motherbrain," EQT confirms.

Motherbrain is also using ChatGPT to help integrate language model-based applications in EQT portfolio companies, the company has recently reported in Business Insider.

MORE EXPERIMENTATION

"We have indeed seen an uptick in the experimentation and application of ML and AI among our clients and it's obviously more than just a passing trend," says Edward Green, CEO of Equipped AI, a UK-based analytics solutions provider for alternative asset management firms.

Green was formerly Partner and Head of Asset Management at AnaCap Financial Partners before taking over the helm following its Equipped AI's spinout from Anacap in 2021.

The company's clients include Tristan Capital Partners, John Laing Group, Amitra Capital, Veld Capital, Quilam Capital, RCapital and Blazehill alongside AnaCap and the portfolio firms in which it currently invests.

"Machine learning and artificial intelligence present powerful opportunities to drive more sophisticated decision making, but at this stage do not substitute for ensuring that the core information flows within an organisation are delivering the right insights to key decision makers," says Green.

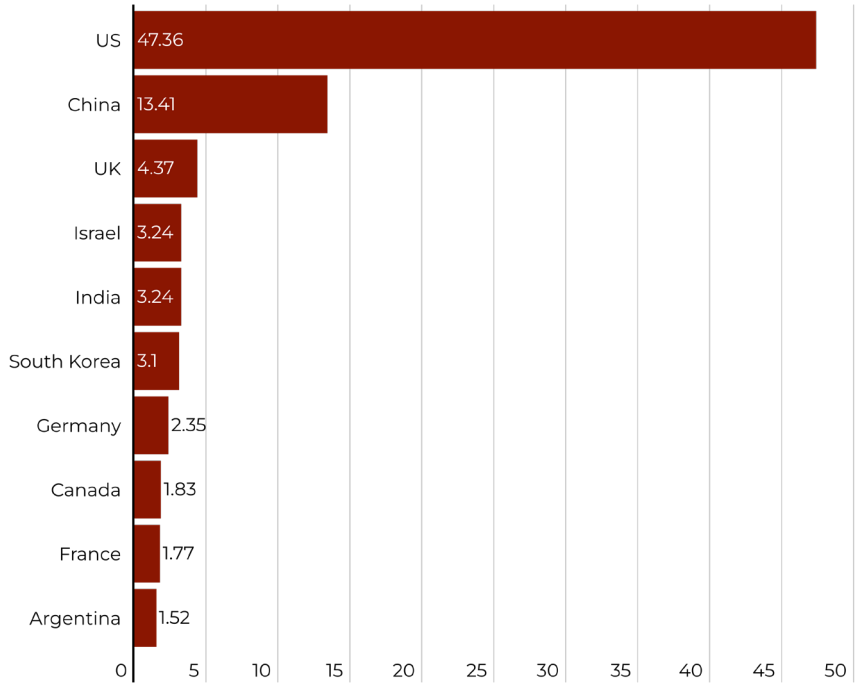
"In our experience these are the key foundational steps required before embarking on a productive pilot exercise that deploys ML or AI techniques," says Green.

Green says the spinout will keep investing in its technology, but when it comes to larger technology acquisitions, he adds, "they are not a priority now, though we will continue to remain open minded." ■

KEY TAKEAWAY

Tech sponsors are still upbeat about technology advances in 2023, with AI being the sector they are most positive about in 2023. However, with generative AI being increasingly integrated into most sectors from healthcare to finance, there is much to learn by the humans that develop it to ensure an equally ethical and optimal return on investment.

Figure 3.4 Top ten geographic areas by private investment in AI, 2022 ($bn)



Source: NetBase Quid, 2022 | Chart: 2023 AI Index Report

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Published by: Global Fund Media, Lion Court, 25 Procter St, London WC1V 6NY

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