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PE Tech Funds II

A new wave of specialists and generalists floods tech-fund sector

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Key takeaways

- **Large generalists have become enamored with the tech sector, with some debuting tech-focused funds while others are doubling down on the sector with increased investment.** These massive generalist firms often have large networks and vast numbers of portfolio companies, which can provide a unique advantage as they compete with specialist tech funds for assets.

- **A new wave of specialist tech firms is making a name for itself.** These newer firms have come to prominence in the shadows of the big three (Vista, Thoma Bravo, and Silver Lake) and are poised to compete in the tech investment space as their fund sizes grow.

- **The infosec subsector deserves attention from sector-focused managers.** Infosec tends to be resilient during downturns, and vendors in the space often have sticky revenue bases. Furthermore, several private equity GPs are already making investments in the space.

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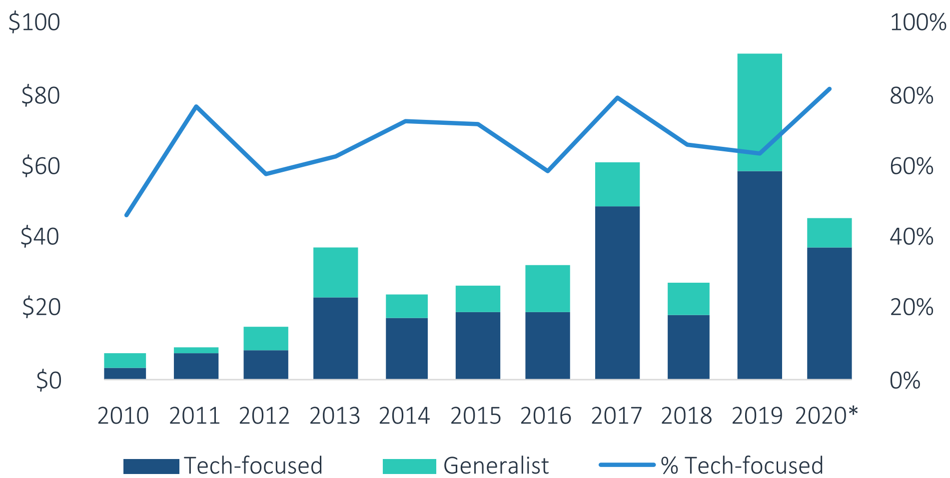
Introduction

As we noted in our last installment on this topic, over the past decade, tech-focused PE funds have outperformed non-tech buyout and non-tech growth-equity strategies in terms of IRR and TVPI. Furthermore, the volatility in PE pricing due to the COVID-19 pandemic has made investment in this space even more attractive due to tech's high-growth prospects and resiliency in a downturn. In fact, as of September 15, tech funds accounted for 22.5% of all PE capital closings in 2020. This percentage of funds raised is significantly more than the 14.1% five-year average and even greater than the 21.1% raised in 2019—a banner year for tech funds in which Vista Equity Partners and Thoma Bravo raised flagship funds. This analysis seeks to build on our previous tech funds research; explore new entrants into the tech-fund space, as well as examine some of their respective strategies; and discuss potential areas of PE tech-fund investment.

Generalists enter the fray

PE capital raised ($B) by generalists vs. tech-focused investors

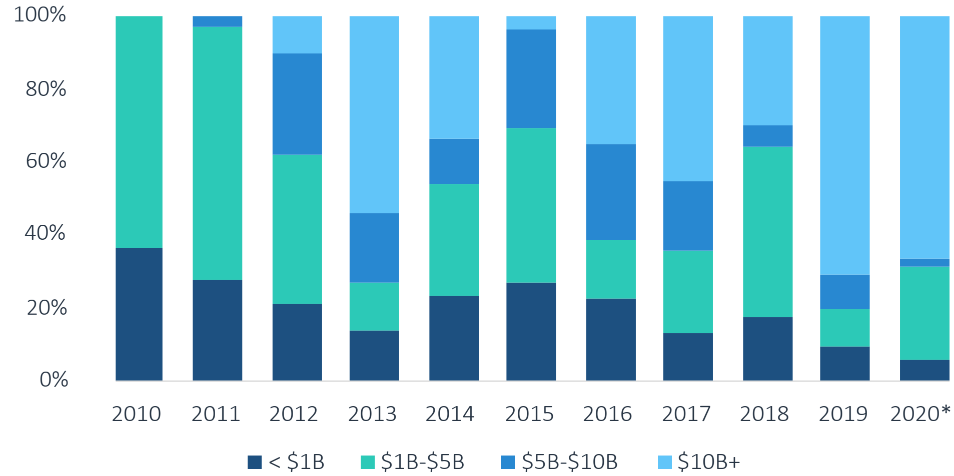


Source: PitchBook | **Geography:** North America and Europe
*As of September 15, 2020

Historically, tech investing has mostly been done by a select group of specialized players, although recently, large generalist players have been vying for a piece of the action. These generalists have been raising their own large tech funds, which has led to increased competition for tech assets. Some of these firms, such as Bain and Advent, are raising initial tech funds, whereas others, such as KKR and The Carlyle Group, have raised tech funds previously and continue to make inroads into the sector. Advent closed on its debut $2.0 billion tech fund in September 2019, while Bain Capital closed on its $1.1 billion Tech Opportunities Fund in June 2019. At the same time, KKR raised its Next Generation Growth Fund II in January 2020. The fund's $2.2 billion close figure was a massive 3x step-up from the $711.0 million KKR's first Next Generation Growth Fund raised in 2016. Carlyle is another firm that saw large step-ups with its latest tech fund. Carlyle Europe Technology Partners IV closed in December 2019 at $1.54 billion, a 110% increase from the firm's 2014 vintage Europe Technology Partners III. The common denominator among all these shops is the discrepancy in fund size between them and the tech-focused shops. Specialized tech firms, such as the big three in Vista, Thoma Bravo, and Silver Lake, raise flagship funds 5x to 10x the size of the generalists' funds. In fact, Thoma Bravo and Vista now manage secondary and tertiary software buyout strategies that are more directly comparable to the generalists' tech funds.[1]

Size advantage

PE tech fundraising by size of firm**



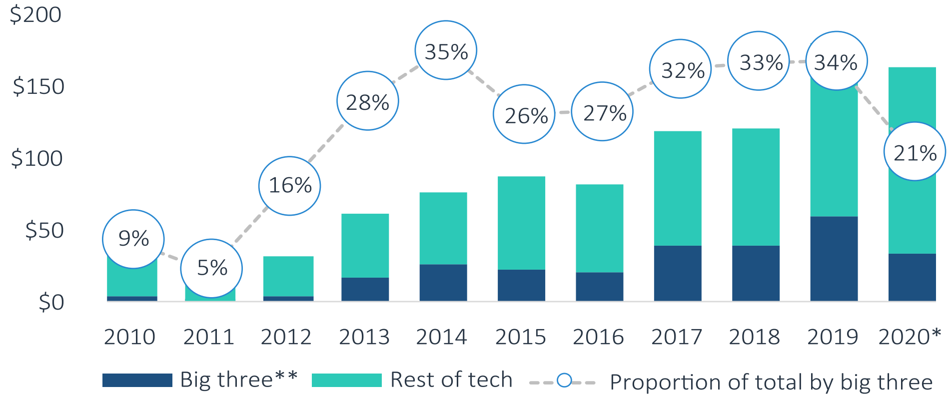
Source: PitchBook | **Geography:** North America and Europe
*As of September 15, 2020
**For size of firm we use prior 10-years of total PE fundraising as a proxy.

While the generalist players may be at a disadvantage when it comes to expertise gained from specialization, their scale may help level the playing field. The sheer size of many of these generalist firms translates to relationships with a large network of industry experts, government officials, and service providers, as well as substantial resources stemming from the size and number of their portfolio companies. The networks acquired by generalist firms may give these companies an edge over the competition in various ways. For instance, Zoominfo's CEO, Henry Schuck, recounted to Business Insider how Carlyle (one of Zoominfo's investors) was able to facilitate interactions with potential customers and give Zoominfo the ability to increase sales.[2,3] Large generalists can also look to the specialized players for ways to use their portfolio companies to their advantage. For example, after it bought Marketo, Vista standardized the Marketo platform on Vista's other portfolio companies. Creating these potential synergies and taking advantage of them is something many of the large generalist players may be able to capitalize on going forward. Given that generalist firms are often larger than tech-focused specialists, the generalists may be able to execute on this strategy more efficiently than their specialist counterparts; however, both generalists and specialists have levers they can pull to create value from tech investments. As competition between the generalists and specialist firms continues, we will keep a close eye on activity in the space.

1: Such as Thoma Bravo's Discover Fund and Special Opportunities Funds, and Vista's Endeavor Fund and Foundation Funds.
2: "The Biggest Private Equity Firms Are Ramping Up Tech Investments," Business Insider, Casey Sullivan and Meghan Morris, August 28, 2020.
3: The deal for Zoominfo was done out of Carlyle's flagship (non-tech) fund, Carlyle Partners VI. However, the advantage still stands.

Specialists not slowing down

Rolling 3-year fundraising by big three vs. rest of tech funds ($B)



Source: PitchBook | **Geography:** North America and Europe
*As of September 15, 2020
**Vista Equity, Thoma Bravo, Silver Lake

Despite the increasing encroachment of generalists into the tech space, the specialists do not seem to be slowing down. In August 2020, reports surfaced that specialist tech investor Thoma Bravo is approaching a final close on three tech funds that could raise over $21 billion combined. The bulk of the capital would be committed to Thoma Bravo's flagship fund, Thoma Bravo Fund XIV, but a further $3.5 billion+ is slated to be committed to the Discover Fund IV and another $1.3 billion+ is headed to the newly formed Explore Fund I. These two smaller funds are likely to directly compete with generalist firms' current tech offerings. The quick return to market and sheer scale of the combined funds is noteworthy. A May filing with the Securities and Exchange Commission indicated that the firm's flagship fund was targeting at least $16.5 billion, a 31% increase from the firm's 2019 flagship vintage, Thoma Bravo XIII, which raised $12.6 billion. The large step-up in fund size in less than two years speaks to the past success of previous funds, even if much of that gain has yet to be realized.

Furthermore, in August 2020 Silver Lake had reportedly surpassed the $18.0 billion target on its flagship tech vehicle, Silver Lake Partner VI. Expectations are that Silver Lake could be targeting a $20.0 billion final close. One investor in Silver Lake's most recent offering is the New York State Teachers Retirement System (NYSTRS). NYSTRS, which is one of the largest pension funds in the US and a previous investor in Silver Lake, committed $300.0 million. NYSTRS has committed to every Silver Lake flagship fund since its debut fund. Moreover, NYSTRS has increased its commitment size for each Silver Lake flagship fund, except for Silver Lake's 2017 vintage fund, Silver Lake Partners V. The large commitment by a reputable LP corroborates the thought that LPs have been pleased with fund returns and performance by the specialist shops thus far.

In addition to raising new funds, Silver Lake is expanding its offerings. In September of 2020, the Wall Street Journal reported that Silver Lake is in the process of raising a new long-dated fund. In conjunction with Mubadala Investment Company (a sovereign wealth fund, or SWF)—which is contributing $2.0 billion to this effort—Silver Lake will be raising a fund with a 25-year life span.[4] The fund's broad mandate allows investment in debt and equity securities across various sectors and geographies, and also permits investment into companies at different stages in their life cycles. Long-dated funds have come into prominence over the last few years as PE GPs seek perpetual pools of investment capital without having to constantly fundraise.

Rise of the next tier of specialists

Further compounding the competition for assets in the tech space is the rise of second-tier specialized tech funds. This group, which includes firms such as Clearlake Partners, Providence Equity, Insight Partners, and Francisco Partners, has carved out a viable niche investing in tech firms, and is raising funds that increasingly compete with other notable players in the space. In April 2020, for instance, Santa Monica-based Clearlake Partners closed on its $7.0 billion flagship fund. The fund surpassed its target of $5.0 billion and was a near 100% step-up from the firm's $3.62 billion 2018 vintage flagship fund. Another rising firm from this tier is Francisco Partners. In June 2020, the firm closed on three funds simultaneously, raising nearly $10 billion in total. The firm raised $7.45 billion for its flagship fund, Francisco Partners VI, and another $1.5 billion for its agility fund. The former fund is a sizeable step-up from Francisco Partners' $4.04 billion 2018 vintage, from which they are still investing. The agility fund makes investments (less than $125 million) that are too small for the firm's flagship fund. Francisco Partners also raised its debut $750.0 million credit fund, echoing trends seen across PE as GPs diversify their offerings and raise credit funds as an adjacent strategy to take advantage of their expertise with archetypal investment patterns.

Infosec

As tech—and software, more specifically—continue to outperform, tech funds have ample targets from which to choose. One space we believe may be of particular interest is the information security (Infosec) space. In line with other areas of tech, Infosec software tends to be resilient in a downturn, which automatically increases GP attraction to the space, especially during the COVID-19 pandemic. Cybersecurity vendors have sticky revenue bases and the ability to up-sell additional products across enterprise threat surfaces,[5] with some enterprise SaaS vendors achieving among the highest public market net retention rates. Thoma Bravo, Francisco Partners, Warburg Pincus, and TPG Capital are actively pursuing investments in the space. There is no panacea for cybersecurity threats, so enterprises employ a "defense in depth strategy" in which point solutions are layered together to provide redundancies at each layer.[6] This creates an opportunity for investors to deploy capital across the value chain and pick a winner for each niche in the market—or create a platform strategy that stitches complimentary assets together.

4: "Silver Lake Launches New 25-Year Investment Strategy Backed by Mubadala," Wall Street Journal, Miriam Gottfried, September 30, 2020.
5: "Enterprise threat surface" refers to the different points from which an unauthorized user can gain access or retrieve data.
6: A point solution is a tool, service, or software that solves a particular problem. This is often contrasted with platform solutions, which solve multiple issues.

Spotlight: Jio

One company that highlights the growing importance of tech investment in PE (and in general) is Jio. The Indian broadband and telecom services company raised more than $20 billion in less than 6 months in 2020. To put this in perspective, in 2019 Indian tech start-ups raised a total of $14.5 billion, which was itself seen as a massive sum given that the previous high was the $10.6 billion raised in 2018. Corporates and private equity firms alike (as well as notable SWFs) have piled into Jio at a rapid pace, and the Indian firm has seen strategic investments from the likes of Google, Qualcomm, Intel, and Facebook. At the same time, PE tech specialists and generalists have also made significant investments in the firm, highlighting the fact that these two groups are targeting the same companies. For instance, KKR, Vista, and TPG were all in the same growth round for Jio, meaning that specialists such as Vista were working alongside generalists such as KKR. Jio also saw investment from L Catteron, General Atlantic, and Silverlake in July 2020. While a colossal investment project such as Jio's may be considered an anomaly, the various PE actors converging on a single tech company signal the growing importance of tech investment by PE firms as well as continued competition between these players down the line.

Conclusion

We expect competition in the tech investment space to continue with both established and newer players coming to the fore. We will be watching to see if the generalists are able to compete with the specialists by using their vast networks and relationships, and we will also be following the up-and-coming tier of specialist firms to see if their performance can match the performance figures put up by the initial group of specialist players. Currently, tech-focused funds do not seem poised to fall out of favor with either GPs or LPs as performance figures remain attractive, and we will be paying close attention to happenings in this space going forward.

Open tech funds on the market

Investor Name	Fund Name	Fund Type
Silver Lake Management	Silver Lake Partners VI	Buyout
Bain Capital Tech Opportunities	Bain Capital Tech Opportunities Fund	Buyout
Terminus Technologies	CEL AI Economy Fund	Buyout
Peppertree Capital Management	Peppertree Capital Fund VIII	PE growth-expansion
Providence Equity Partners	Providence Strategic Growth Europe	PE growth-expansion
Avista Capital Partners	Avista Capital Partners V	Buyout
Accel-KKR	Accel-KKR Capital Partners VI	Buyout
WM Partners	HPH II Investments Master Fund	Buyout
Pontifax Global Food and Agriculture Technology Fund	Pontifax Global Food & Agriculture Technology Fund II	PE growth-expansion
Sheridan Capital Partners	Sheridan Capital Partners Fund II	PE growth-expansion

Source: PitchBook | **Geography:** North America and Europe
*As of September 15, 2020

Recent PE tech fund closings by size

Investor Name	Fund Name	Fund Type	Fund Size ($M)
Vista Equity Partners	Vista Equity Partners Fund VII	Buyout	$16,000
Thoma Bravo	Thoma Bravo Fund XIII	Buyout	$12,600
TPG	TPG Partners VIII	Buyout	$11,200
Alphabet	Google for India Digitization Fund	Buyout	$10,000
Insight Partners	Insight Venture Partners XI	PE growth-expansion	$9,500
Francisco Partners	Francisco Partners VI	Buyout	$7,450
Veritas Capital	Veritas Capital Fund VII	Buyout	$6,500
Providence Equity Partners	Providence Equity Partners VIII	Buyout	$6,000
Siris Capital	Siris Partners IV	Buyout	$3,450

Source: PitchBook | **Geography:** North America and Europe
*As of September 15, 2020