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Hg's Steven Batchelor: You can be IRR and MOIC driven

DPI targets, mathematics and intellectual honesty are at the core of Hg's exit approach, according to Batchelor.

Managing exits actively with clear distributed to paid-in capital (DPI) targets allowed Hg to be consistent in a tough exit market, partner and board member Steven Batchelor told PE Hub Europe.

Private equity exits have had a muted couple of years. In 2022, exits declined each quarter, and in 2023, while activity increased, it remained subdued, according to S&P Global Market Intelligence. But during those years, software-focused investor Hg, which is based in London, had 29 cashback events across its buyout funds.

"It's not because we're very clever, it's because it's just been mathematical for us," Batchelor said.

Hg's mathematical approach started when Batchelor viewed how some of the firm's industry peers approached exits. He found that most exits were driven by the dealmaker, instead of the firm or a committee. "No one just lets anyone wander around and do deals for the sake of doing deals," he added. "But they do let people do exactly that for exits. It's complete madness, because in a good market they might be fine, but it's harder in a bad market."

Many private equity firms now have exit committees to consider which assets to hold and which to exit, Bain & Co partner Alexander De Mol told PE Hub Europe earlier this week.

In his scan of the market, Batchelor also noted a lack of realisation budgets. "When you get a year or two of limited liquidity, because of a market interruption as we've seen, your IRR goes south pretty quickly," he said. "You perpetuate a problem: you must sell your best assets to solve it and hold on to your weaker assets to drive your multiple on invested capital (MOIC)."

Batchelor's suggestion to this was having a 1x DPI target to reach within five years. By driving to hit that target, "you lock in IRR to a relative degree", he said. "In terms of the rest of the fund, you have your good investments and hopefully great investments," he added. "The great investments are the ones which you want to hold on to for longer.

"At the back of the fund – years eight, nine and 10 – when you want to be sleeping at night in terms of performance, those great investments kick along your MOIC."

Hg's 2017-18 vintage funds have a DPI ranging from 1.7x to 2.5x, according to Batchelor. "Those can never be bad funds," he added. "They can be good, really good or fantastic, but they can't really be bad."

Most GPs orient themselves as either IRR or MOIC driven, according to Batchelor. "Our belief is that you can be both."

Foot on the pedal

Setting up a realisation committee was also a key change Hg made. "The name is deliberate, a sign of intent," Batchelor explained. "The main role of it within the firm is ensuring that we deliver the cashback targets we set ourselves."

Holding a "moment of truth" meeting falls under the committee's tasks. "The whole point of that conversation is: what did we think we were buying versus what we actually bought," said Batchelor. "That starts the calibration of all the investments we manage. It's about intellectual honesty, rather than pointing the finger."

Hg exited its investment in a market intelligence provider, Argus Media Group, in January. Earlier in the same month, the firm sold MeinAuto and Mobility Concept divisions of MeinAuto Group to Mobilize Lease & Co, a subsidiary of Mobilize Financial Services, part of the Renault Group.

Batchelor expects the momentum to continue. "We've been so active over the last two years that we've got no pressure to do anything," he said. "It doesn't mean we take our foot off the pedal, because we have the 2020 funds where we want to hit the same targets."