



# Uncovering Opportunity in Private Equity

## Your top five questions answered

10 June 2021



**Dana Haimoff**

Portfolio Manager,  
Private Equity Group



**Michael Bell**

Global Market Strategist

In our 2Q 2021 *Guide to Alternatives*, we explore how trends in key areas of alternatives are evolving as economies begin to re-open.

We take a closer look at private equity this quarter as [Dana Haimoff](#), *Portfolio Manager, Private Equity Group*, answers questions from [Michael Bell](#), *Global Market Strategist*.

### Q1. How has private equity coped during the pandemic?

The private equity market essentially shut down in March 2020. But as the first lockdowns lifted over the summer, the pent-up demand fuelled robust deal activity by September. In fact, US private equity deals in 2020 surpassed 2017 volumes, and almost reached levels seen in 2019.

The market was split not just by timing but also by industry. Sectors such as leisure, restaurants and bricks-and-mortar retailers were severely impacted by the shutdown. However, we were able to take a value approach to select opportunities that were trading well below their pre-Covid multiples and were based on conservative business recovery assumptions. At the same time, the huge spike in digitalisation and online shopping created new opportunities and we made a number of investments to take advantage of the rapidly increasing growth.

---

**Q2. What is the outlook for private equity, especially in light of valuations and the sense that there is a lot of money chasing few opportunities?**

We have been looking critically at valuations since about 2014, so this is not a new consideration. While it is more challenging to find attractively priced opportunities today, investors are benefiting from the current exit environment driven by similar market dynamics.

It's also important to consider why prices are higher than historical levels. Debt is cheap and readily available so companies can access more leverage, which raises the equity portion of their overall value as well. The mix of investments has also shifted to include more technology and health care companies, which may have greater resiliency, more recurring revenue and cash flow, and may offer more resilient performance.

Cumulative dry powder is about USD 2.5 trillion—a significant increase over USD 1 trillion in 2012 and much of it raised only in the past couple of years. The issue is less about the cumulative dollar amount, but the clock ticking, as a significant amount of that capital has to be deployed over the next three to four years. This timing is putting pressure on private equity fund managers and we are watching carefully for signs of firms paying too high a price for investments or raising more capital without the resources to properly manage it.

**Q3. Which areas of the market look most attractive?**

We're somewhat agnostic to sector and geography as we take a bottom-up approach to investing. We're really looking everywhere to underwrite and generate at least a 2x return and 20% internal rate of return (IRR) and we're mindful of factors like cyclicity, volatility and disruption.

We like to be local and approximately 70% to 75% of investments are based in the US, although we have also been investing in Europe and Asia for decades. Currently, depending on the sector, we see that average prices are not as high in Europe as they are in the US. In Europe we are seeing growth around tech-enabled business services and software at the moment, particularly in northern Europe. We also see a lot of growth in Asia and are starting to look more closely at buyout opportunities in the region.

We have always liked and invested in the small- to mid-size end of the market - which accounts for 90% of businesses in the US. We see a lot of good businesses and management teams in fragmented industries, meaning there is opportunity to grow and create value. These businesses are often cheaper than their public-market or larger peers and are less leveraged.

---

**Q4. How should investors think about measuring performance, when it comes to IRRs, benchmarks and fees?**

Some institutional investors are focused on IRR, in part because their compensation may be tied to it. Others care more about the multiple on invested capital. We look at both. We underwrite to net-net 20% IRR and a 2x multiple on invested capital, which is our clients' experience net of all underlying fees and expenses. That's the hurdle that we consider when we're looking to make a new investment. We are highly focused on fees, as are our clients, which is why we always look at everything on a net-net basis. Fees are naturally starting to creep up in some areas, but by looking at opportunities net of fees, we can make a more informed decision about whether a deal really makes sense.

We do believe benchmarking to public equity indices is important and that investors should choose one appropriate to their region and private equity portfolio construction. When using private equity benchmarks, they should contain enough comparisons from each vintage year to make it a meaningful sample size.

**Q5. What do special purpose acquisition vehicles (SPACs) mean for private equity – are they here to stay or a bubble?**

A tremendous amount of capital has flowed to SPACs and so far, while limited, our investments have benefited from SPACs as an attractive exit route for select existing investments. However, all that dry powder must now be deployed in roughly a two-year time frame and we believe the longer-term performance will determine the staying power of SPACs. For investors, it's important to consider whether firms are raising SPACs inside of a fund or outside, where it may be detracting from resources and investments expected to be devoted to the management of other private equity investments.

---

For more insights on trends in alternatives – from ESG to the impact of inflation – please view the replay of our 2Q 2021 Guide to Alternatives webcast [here](#).

---

**FOR PROFESSIONAL CLIENTS/ QUALIFIED INVESTORS ONLY – NOT FOR RETAIL USE OR DISTRIBUTION**

This is a marketing communication and as such the views contained herein are not to be taken as advice or a recommendation to buy or sell any investment or interest thereto. Reliance upon information in this material is at the sole discretion of the reader. Any research in this document has been obtained and may have been acted upon by J.P. Morgan Asset Management for its own purpose. The results of such research are being made available as additional information and do not necessarily reflect the views of J.P. Morgan Asset Management. Any forecasts, figures, opinions, statements of financial market trends or investment techniques and strategies expressed are, unless otherwise stated, J.P. Morgan Asset Management's own at the date of this document. They are considered to be reliable at the time of writing, may not necessarily be all inclusive and are not guaranteed as to accuracy. They may be subject to change without reference or notification to you. It should be noted that the value of investments and the income from them may fluctuate in accordance with market conditions and investors may not get back the full amount invested. Past performance and yield are not a reliable indicator of current and future results. There is no guarantee that any forecast made will come to pass. J.P. Morgan Asset Management is the brand name for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our EMEA Privacy Policy. This communication is issued in Europe (excluding UK) by JPMorgan Asset Management (Europe) S.à r.l., 6 route de Trèves, L-2633 Senningerberg, Grand Duchy of Luxembourg, R.C.S. Luxembourg B27900, corporate capital EUR 10.000.000. This communication is issued in the UK by JPMorgan Asset Management (UK) Limited, which is authorised and regulated by the Financial Conduct Authority. Registered in England No. 01161446. Registered address: 25 Bank Street, Canary Wharf, London E14 5JP.

LV-JPM53268 | 07/21 | 096a211806112634