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Private Equity

Seizing the Moment

The private equity market is experiencing great popularity right now. That's due to sustained low interest rates and the strong economic recovery. Investors are paying more attention to sustainability.

Dirk Wohleb, Düsseldorf – Every crisis has its losers. That currently includes Australian hotel and casino operator Crown Resorts. The pandemic meant hotels and casinos had to close. Revenues collapsed. At the same time, the company lost its licence because of a money laundering scandal. An opportunity not to be missed for a private equity firm like The Blackstone Group. The world's largest private equity company is competing with other bidders for the purchase. The strategy: get in cheap, restructure, make the business model fit for the future and then sell the company at a high markup.

Private equity firms invest in companies off-market. Above all, they set their sights on lucrative business models of the future. The pandemic is intensifying trends: "There's demand for companies from the medical technology, pharmaceuticals and biotech industry, as well as innovative companies whose business is connected with healthy nutrition," says Raoul Nacke, global CEO of international consultancy Eric Salmon & Partners. New forms of learning are being adopted as a result of the pandemic: "Accordingly, there's increased interest in companies that develop new digital learning and training formats or platforms," explains Nacke.

It's vital for companies to conduct a comprehensive sustainability analysis in order to identify opportunities and risks early on.

Raoul Nacke
CEO of international management consultancy Eric Salmon & Partners

Interest in off-market investments is booming, in part because of sustained low interest rates and the strong economic recovery. In the first three months of the year, private equity firms were able to collect $188 billion of capital. "After a turbulent 2020, the financial markets began to show signs of normality in the first quarter of 2021," says Cameron Joyce, a private equity expert at financial services provider Preqin.

Institutional investors are thus investing in companies whose value could increase significantly in the future, enabling them to diversify their investments and risks more broadly and achieve much higher returns as compared to fixed interest options. Private equity is still a domain for institutional investors. The reason: it takes time and patience to engage in the private equity market. But above all, money – lots of money.

High minimum investments

Professional investors offer shares in funds for a period of several years, during which time they are tied and cannot back out. Private equity funds are a popular vehicle. Minimum investments

usually start at around €100,000. Approx. 5,000 fund managers around the world offer clients their expertise. They invest in 10 to 15 companies and tend to specialise in particular industries or regions. Because they often operate in niches, they pick up on developments at a very early stage. As a result, they are able to react and invest in attractive business models before others do. A fund of funds, on the other hand, buys shares in several target funds and can therefore diversify its risks more broadly. Anybody who wants to make a direct investment in a company will usually have to come up with a seven-figure amount. While this type of investment can bring the highest returns, it also entails the biggest risks.

Private individuals can also invest in private equity, for instance by purchasing shares in listed private equity firms. The advantage: investors can buy and sell shares whenever they want, so they don't have to commit themselves for years at a time. The disadvantage: the share price often doesn't reflect the value of the investments one-to-one. As is the case with all other shares, price and valuation are affected by the stock market's mood. That results in significant fluctuations. Both upward and downward.

The Blackstone Group is the world's No. 1 listed private equity firm. At the end of March, the assets managed by the US corporation were valued at $649 billion, an all-time high. Business is booming: in the first three months of the year, the Blackstone Group recorded a net profit of $1.75 billion. The company has a positive rating: of 18 analysts, 12 recommend buying the shares, six advise holding onto them. But with a price-earnings ratio of 25, the stock certainly isn't cheap. On the other hand, investors have seen shares rise by 50% in the last 12 months.

The world's No. 2 private equity firm, KKR & Co., has $250 billion of assets under management. "Very early on, even before the markets had hit their lows, we said we have to take advantage of this crisis," says Johannes Huth of KKR & Co. 15 analysts recommend buying, four advise holding. In the last 12 months, the stock has risen by 82%. With a price-earnings ratio of 17.9, KKR is less expensive than the Blackstone Group.

One alternative is an investment in the LPX Major Market Index, which represents the performance of the world's 25 biggest listed private equity companies. An investment can for example be made via the Xtrackers LPX Private Equity Swap ETF (LU0322250712), which has achieved an increase of 13.2% p.a. over the last 10 years.

An industry in flux

Like many other sectors, the private equity industry is currently undergoing major change. Here too, sustainability is top of the agenda. Investors want to know whether a company's business model is future-proof, whether it is committed to conserving resources and whether it monitors the supply chain for human rights compliance. "It's vital for companies to conduct a comprehensive sustainability analysis in order to identify opportunities and risks early on," explains Nacke.

More and more, that means shining a spotlight on the company's culture. Nowadays it is becoming increasingly important to make executive committees as diverse as possible so as to ensure that a company's pool of top-level expertise is as wide-ranging as possible