How Will Private Equity Respond to Economic Volatility?

Recession expectations were high before the pandemic hit and, two years later, they're high again. The economic landscape, however, is quite different. Inflation, as measured by the Consumer Price Index, surged to 9.1% for the 12 months ending in June, and to keep it in check the Fed has raised interest rates 150 basis points so far in 2022. It is an environment not well-suited to the risk averse.

Private equity fund managers are weighing their options: Invest through the volatility to capture the returns waiting on the other side of a downturn or hunker down and focus on shepherding their portfolio companies through financial hardship. Looking to the balance of this year, the sky-high asset prices we saw in 1Q22, caused by the elevated levels of deal activity of the last two years, are expected to return to lower levels: 62% of individuals polled during our July 14 webinar 2022: A Pivotal Year for Fund Managers said asset prices were trading lower than they were at the beginning of the year.

Bracing for Stormy Economic Weather

80% expect a **recession** to occur within 12 months

How Are You Preparing for an Economic Downturn?

- Reevaluating value creation strategies / 32%
- Revisiting capital structure / 24%
- Significant changes to valuation assumptions / 20%
- Accelerating exits / 16%
- Delaying exits / 8%

9.1% inflation June 2022

150 bps rate hike in 2022

Source: BDO Webinar "2022: A Pivotal Year for Fund Managers" – July 14, 2022

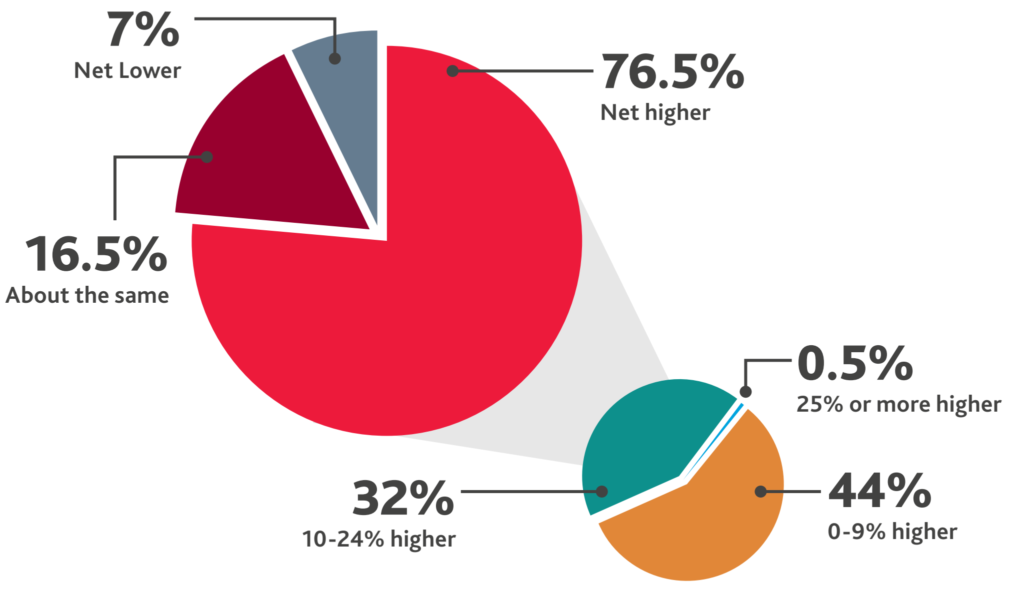
Expected Asset Price Downswing

In just a few months, perspectives on asset prices have changed drastically. More than half of polled individuals in July said asset prices would be lower (54%) or about the same (20%). In our spring survey, fielded in March 2022, sentiment around asset prices was significantly more bullish. Just 7% said they expected asset prices to be lower.

LOWER	54%
About the same	20%
0-9% higher	18%
10-24% higher	3%
25% or more higher	5%

Source: BDO Webinar "2022: A Pivotal Year for Fund Managers" – July 14, 2022

How Will Assets Trade in the Next 6 Months?



Source: BDO Private Capital Pulse Survey – Spring 2022

Conditions Ripe for New Deal Activity

Fund managers will revisit value creation strategies to ensure they address evolving market conditions. Opportunistic players will invest through the downcycle to capture returns when the market improves — in fact, according to poll respondents, the focus within the industry has shifted significantly to deal making.

Where do you plan to direct the most capital in the next 6 months?

SUMMER 2022		SPRING 2022	DIFFERENCE
51%	New deals/investments	12%	39% ↑
15%	Consolidating current portfolio companies in preparation for exit	N/A	
15%	Add-on acquisitions/ follow-on investments	8%	7% ↑
9%	Setting up impact funds/ investing in targets with ESG-focused themes	50%	41% ↓
9%	Applying equity relief to portfolio companies	14%	5% ↓

As a whole, the industry appears to be digesting current economic volatility in two ways: Making sure value creation strategies are sound and evaluating targets with an eye toward returns post-recovery.

Sources: Webinar poll and BDO's spring survey

BDO advises across the private equity lifecycle, bringing a holistic perspective fueled by multidisciplinary practices through its M&A Powered Platform™. Got questions? Reach out.

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