The Interview – Troy Duncan, J.P. Morgan Asset Management: “Market uncertainty makes this a very difficult time for investors to lock up funds in illiquid investments”

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Troy Duncan, co-portfolio manager of the London-listed J.P. Morgan Private Equity fund, a fund of funds that acquires fund interests from motivated or distressed sellers in the secondary market at a discount to their intrinsic value, says the investment team is currently looking at high-growth companies in Asia and other emerging regions, senior credit in the US, and special situations in Europe.

GFM: What is the background to your company and fund?

TD: J.P. Morgan Private Equity Limited, known as JPEL, is a private equity fund listed on the London Stock Exchange whose core strategy is to purchase private equity fund interests from motivated or distressed sellers in the secondary market at a discount to their intrinsic value.

JPEL, which also makes selective co-investments and primary commitments, has a highly diversified portfolio with 165 fund interests and more than 1,500 underlying portfolio companies. The fund was launched in June 2005 and currently has total assets of USD705m.

JPEL is managed by J.P. Morgan’s private equity advisors team, which is responsible for the management of various private equity funds with more than USD1.3bn in assets under management and more than 200 partnerships. The team consists of nine investment professionals and seven operational and administrative members.

The private equity advisors team, which was originally formed in 2004 when Bear Stearns Asset Management acquired BDC Financial, became part of J.P. Morgan Asset Management when J.P. Morgan Chase acquired Bear Stearns in 2008. The team’s co-portfolio managers, Gregory Getschow and myself, have worked together for more than 10 years, starting at BDC Financial. We follow a niche strategy focused on smaller, more complex transactions.

GFM: What is the structure of your fund?

TD: JPEL is a Guernsey-domiciled closed-ended investment company traded on the London Stock

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Exchange, co-managed by J.P. Morgan Asset Management (UK) and Bear Stearns Asset Management.

GFM: Who are your service providers?

TD: The company secretary and administrator is HSBC Management (Guernsey), and its auditor is KPMG Channel Islands. Our law firm is Herbert Smith in London and the company's registrar is Capita IRG (CI).

GFM: What is the profile of your investor base?

TD: As a publicly-traded company, investors may purchase shares in JPEL in the open market. Depending on market conditions, every year or two, the company offers new US dollar equity shares to eligible investors through a formal offering of new shares. The fund has a diversified investor base with around 50 per cent of investors based in Asia.

GFM: What is the investment focus of the fund?

TD: JPEL is the only listed private equity firm focused on secondary investments. The fund seeks assets with visibility to near-term return of capital. The team's strategy is to create a well diversified portfolio through investments in secondary interests in private equity funds and direct investments, liquid private equity positions including listed private equity and traded debt, and deep discounted purchases from distressed or motivated holders.

The team employs a global sourcing effort covering a broad range of investment strategies and deal types, as well as a combination of opportunistic and macro factors to prioritise the opportunity set generated by the team. JPEL invests in all facets of private equity including venture capital, growth equity, buyouts, infrastructure, debt-related strategies and special situation funds.

GFM: How do you make investments for the fund?

TD: The team employs a disciplined investment approach to sourcing, performing due diligence and valuation analysis on secondary transactions. JPEL has a strong pipeline of potential transactions, but in the absence of a formal secondary market, the team realises the importance of cultivating relationships that can lead to further deal flow.

As part of the detailed due diligence process, all valuation and secondary pricing analyses are performed in-house by private equity advisors team members. They will often draw on the wealth of knowledge available through J.P. Morgan, including research reports, economists and sector specialists. In certain cases, we may seek third-party research or independent analysis to verify and enhance existing investment theses.

The investment committee will approve or reject the investment or, in some cases, ask the deal team to perform further diligence or fact checking. Discussions will focus on the merits and risks of the investment as well as the suitability of the opportunity for the specific fund or mandate. A unanimous vote is required for investment approval.

GFM: What is your approach to managing risk?

TD: JPEL's risk management strategy emphasises diversification at all levels of the portfolio, which is reviewed by strategy, industry, geography, type of underlying security and currency. The company seeks to achieve significant diversification by strategy, geography, asset type, industry and company size.

At the company level, JPEL seeks to analyse the capital structure of major portfolio holdings, and all potential underlying portfolio acquisitions at the time of investment and uses value-based pricing for each transaction. In terms of security type, the fund seeks to structure investments that improve its risk/reward profile in areas such as legal, documentation and priority of payments. It also monitors local currency positions and hedges where appropriate.

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GFM: What opportunities are you currently looking at?

TD: Currently the investment team is interested in high-growth companies in Asia and other emerging markets, senior credit in the US, and special situations in Europe.

GFM: What developments do you expect to see in your target market over the year ahead, and in other political and economic areas that may impact it?

TD: We believe that instability in global financial markets will continue to facilitate a favourable investment environment for JPEL's core strategy. Events such as Europe's sovereign debt crisis and ongoing volatility in currency and public markets inevitably create more motivated or distressed sellers of illiquid assets.

Additionally, proposed financial regulation in the US and Europe may require financial institutions to divest their private equity assets. We expect that these factors will lead to increased deal flow and the possibility of purchasing assets at compelling prices.

Asia remains an area of interest for JPEL. Despite predictions that growth in the region might be slowing, Asian economies are still significantly outpacing North America and Europe. In addition, the underlying portfolio companies typically carry less leverage, which gives the fund the opportunity to buy into companies at more meaningful discounts to intrinsic value.

GFM: How will these developments affect your current and future investments?

TD: Our core focus is opportunistic, deep-value investing. As part of the investment decision and approval process, we consider near-term global macro conditions and then seek to 'overweight' the portfolio in private equity markets where it believes exits are more viable in the near term.

GFM: How do you see the current environment for existing investments?

TD: The current distressed markets offer an attractive secondary investment environment in terms of both supply of potential transactions and pricing. The need for liquidity on the part of institutions such as banks, insurance companies and hedge funds as well as high net worth individuals has a fuelled a robust supply of new investment opportunities.

More importantly, recent signs indicate that the pricing gap that has existed between sellers and buyers in the secondary market is narrowing as many sellers are finally accepting that the pricing paradigms have changed. The team anticipates a strong pipeline of value investments in the coming months.

GFM: What differentiates you from other firms in your sector?

TD: JPEL is the only London-listed private equity fund of funds that focuses on investing through the secondary market. The team employs an opportunistic approach to the market and focuses on sourcing smaller transactions where there is have limited competition.

The team has a proprietary global sourcing network with superior access to deal flow. With a streamlined investment process and the ability to structure complex transactions combined with a focus on traditional and non-traditional secondaries, JPEL offers a unique way to access the secondary market.

GFM: How would you assess investor attitudes currently toward the private equity and venture capital sector?

TD: In 2009, private equity firms raised a total of USD245bn, which is less than half the level of capital raised the year before, and 2010 is expected to be another challenging year for fundraising. Although historically the best private equity returns have been achieved during periods of economic contraction, market uncertainty makes this a very difficult time for investors to lock up funds in illiquid investments. As a listed fund, JPEL provides investors with the opportunity to access a mature

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portfolio of private equity investments but does not require the long-term commitment of a traditional limited partnership structure.

GFM: How do you see the outlook for fundraising over the current year and beyond?

TD: The current market environment has proven challenging for fundraising, but industry trends over the past 20 years suggest that private equity will continue to grow as an asset class.

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