Private Equity and the response to COVID-19

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Partner Richard Dagett provided commentary for Citywealth earlier this month on current trends and prospects for the private equity market. Here are his full comments.

It is said that even though the Private equity industry is in triage, it can survive any capital calling because it has enough dry powder?

As is always the case, dry powder is not just for the high profile acquisitions – it is what transforms a target's potential into realisation. The ongoing investment by funds into their portfolio companies is what generates the long term returns on exit. However, that use of dry powder is not always about the growth of a company – sometimes it's about keeping that company going during tough times.

For those PE firms invested in sectors that are particularly suffering (think hospitality, travel, retail), decisions need to be made as to where suitable triage can be administered (for companies where there are good long term prospects) and where the patient is beyond help and it would be a case of good money being thrown after bad.

Investors will be analysing their portfolio with a fine toothcomb to determine which approach to take. Effectively used dry powder now on a company in difficulty but with strong fundamentals is dry powder well spent.

Is COVID-19 the same as 2008 crash, in impact?

I would certainly regard this as different. In 2008 the crisis was caused primarily by the financial system itself whereas this is an external crisis that has prevented the financial system operating normally.

From our discussions with PE firms and their advisors, we anticipate that they are well-placed to take advantage of targets at deeply discounted prices at the right time. Dry powder has, in many cases, already been raised for these acquisitions and there is not the lack of credit seen during the 2008 crash – deals are ready to be done when the time is right.

The other big difference I feel we will see from 2008 will be in the timing. In 2008, PE firms waited too long before acting and missed some of the double digit returns that fast movers could have enjoyed. Those lessons have been learnt and the best placed firms won't repeat those mistakes.

What kind of distressed deals to you expect to see?

Investors may well be re-examining deals they considered too expensive just months ago. However, there is no use in pursuing a deal for a target simply because it is now within the investor's price appetite. Careful analysis will need to be undertaken to ensure any acquisitions can still be considered viable in a post-COVID world. It may well be a case of quality over quantity.

Are there any other examples of private equity working or not working during this sharp decline and government interventions.

We have seen examples of portfolio companies hugely benefiting from PE-backing during this time due to their ability to scale up quickly through investment and to take advantage of a large surge in demand due to the lockdown. PE-backed companies with a focus on activities that have received renewed interest during our enforced confinement (home crafts, food delivery, home physical exercise) and tech-focused companies taking advantage of our move to living, working and socialising through screens are no doubt thankful for the investment in them to date and for the swift deployment of dry powder in recent months to avoid missing any opportunity to profit during the sharp spike in demand for their services.

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