

SARS-COV-2: WHAT'S NEXT FOR PRIVATE EQUITY?

Impact on the Private Equity market, exit strategies and opportunities ahead

Highlights:

- The average investment period will be delayed by at least 1-2 years.
- A defensive scenario will be followed by a growth scenario. We expect the defensive scenario to last 3 to 8 months.
- Some fund managers are taking advantage of the liquidity provided by central banks and governments to switch their private debt to bank debt.
- There will be opportunities to identify companies at lower valuations.
- We foresee strong developments in areas related to healthcare and digital space.
- The creativity and entrepreneurial capabilities of the management teams are key success factors for exit strategies.
- Many leveraged portfolio firms will breach covenant clauses.

An analysis performed by the Private Equity Practice Group of Pedersen & Partners following conversations with dozens of mid-sized PE funds in Europe has reached a conclusion that is in line with the opinions of the majority of the macroeconomic analyst firms. The impact on fund managers depends on two main factors: the fund type and the situation of the fund at the start of the crisis. The average investment period will be delayed by at least 1-2 years.

As for portfolio management, we foresee a defensive scenario followed by a growth scenario. However, analysts are failing to take the human factor into account, specifically the influence and capacity of skilful executives to lead their teams and manage their businesses through the complex situation caused by the SARS-CoV-2 pandemic.

Impact on Private Equity fund managers

Some funds are better designed to overcome this situation, and a few have even benefited. These are secondary funds, special situations and hybrids that have greater flexibility to consider alternatives when the crisis recedes.

For the fund managers that have done well, there is a certain luck factor which should not be overlooked. Many fund managers have benefited from a good cash position and the recent closing of a new fund, while others have a relatively broad portfolio of companies. Conversely the fund managers that will encounter the greatest obstacles to recovery are those who have acquired companies which are highly leveraged in vulnerable sectors such as entertainment, tourism and hospitality. Many leveraged portfolio firms will breach covenant clauses as EBITDA declines. Fund managers expect most debt providers to be flexible, but admit that debt providers will have a bigger say.

Some fund managers are taking advantage of the liquidity provided by central banks and governments to switch their private debt to bank debt, benefiting from lower interest rates and obtaining a liquidity security support.

Impact on Portfolio Firms

The members of our Private Equity Practice have had conversations with multiple funds and CEOs, and our conclusion is that a defensive strategy will be initiated first, followed by a growth scenario.

We expect this defensive scenario to last from 3 to 8 months, depending on the leadership skills of the fund managers, their management teams and the particular situation of each investee. During this phase, management teams will address the immediate problems related to liquidity, and will improve cost burdens, while effecting a redesign of business plans and a re-orientation of strategy.

Once this initial defensive stage is overcome, the fund managers will refocus on growth. There will be opportunities to identify companies at lower valuations. Before the crisis, there had been a problem of inflation in company valuations, and this will be eliminated. Furthermore, competition will decrease as some fund managers will take longer than others to recover.

In our opinion, the success factors for portfolio firms will be:

- Management teams with strong leadership capable of maintaining the focus on business, while motivating teams with the creative and entrepreneurial capacity to look for alternatives.
- A timely transition from the defensive phase to the growth phase.
- The ability to align the entire organisation in refocusing from the defensive phase to the growth phase.

Investment opportunities

In terms of areas of opportunity, we foresee strong developments in areas related to healthcare and digital space.

For a long time, Private Equity has seen Tech and BioTech/MedTech/Health Technologies as highly attractive industry segments for investment, and we have heard this stated repeatedly at the Pedersen & Partners PE Breakfasts that we have hosted

across the world. The Covid-19 pandemic is creating disruption and uncertainty for the medical technology industry in ways that were unimaginable a few short weeks ago. Potential risks and opportunities lie ahead in this precarious business environment; whilst clinical studies are suffering from the priority given to battling the pandemic crisis, pre-clinical Biotech is seeing 'business as usual'. Moreover, MedTech and Health Technologies could gain traction, with new ways of working more rapidly embraced by hospitals and other healthcare institutions during and following this crisis.

The Covid-19 crisis has already sparked a review of legislation and policies on broadband connectivity, e-learning, e-government, e-health, sustainable mobility and data sharing. Regulatory initiatives will accelerate the adaptation of these technologies. Foundational technologies such as IoT (Internet of Things), machine learning and AI will get a further boost as they enable further automation and the release of human capacity. Finally, IT developments will further dissolve borders between classic industry verticals, and disintermediate related value chains.

Meet the team



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