Business Transition Advisory Group

Private equity shifts gears for the recovery

As COVID-19 has made its way through the economy and the business community, it's crippled some businesses, boosted others, and affected all. Whether your company already has a private equity investment, wants to have one, or competes with a business that has one, you need to understand how the pandemic will affect private equity firms and how they will respond as the recovery progresses.

Truist Wealth and Truist Securities are deeply engaged with companies and private equity investors at all stages of investment, management, and business transition. We asked a few of our experts to provide their perspectives on private equity in today's world.

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How has COVID-19 affected private equity?

Speegle: When the pandemic hit, private equity firms turned at once to understand the pandemic's effects on the firms' portfolio companies and found enough liquidity to ensure their survival. Most portfolio companies, like the public equity markets, were affected, but not terribly. Everybody had some portfolios—such as retail and restaurants—that were in the direct path of the storm.

Calfo: Now that we're well into the pandemic, private equity is back with a vengeance. Business development has been ramped up as firms focus on new investments.

Sanders: There's this assumption that everything was devastated by the pandemic, but from what I see, that's not true. Some businesses out there, especially the ones attracting private equity investments, have done well. Take the medical field for example. Sure, there were businesses that were hurt, but there were plenty of businesses that did better during the pandemic.

What's happening to private equity deals? How is due diligence, usually in person, being handled?

Sanders: The deal-making environment is like the U.S. economy: it's going to roll until it hits a roadblock, such as the beginning of this pandemic. Everybody's uncomfortable with the unknown, so we had to stop and assess the situation. Now that we've gotten over that roadblock, it's rolling again. The next question is, "With reoccurrences and virus flareups, what happens next to businesses?"

Speegle: Most private equity firms initially turned toward large private investment in public equity (PIPEs) to make capital injections. Leveraged buy-out (LBO) count was down and exits were down. There's a huge amount of capital looking for mergers and acquisitions (M&A) transactions. Investors are willing to pay for businesses that performed well during the pandemic and have proven their resiliency. Most M&A processes are back in the works with bidders.

Calfo: We've been encouraged by the number of private equity investments making an initial investment in a new industry or space as a starting point for follow-on investments in the same areas (known as "platform companies"). While the appetite for new platform transactions is a bit softer, there's a desire to invest in platform companies that are holding their own during this pandemic with a strong track record of performing during recent months. Transactions are starting to close again, but the process is taking longer. Most of the transactions we're seeing were already started with an in-person meeting some time ago. While established processes seem to be able to move along virtually, new transaction velocity will likely be hampered while people are reluctant to travel and have face-to-face meetings.

What has happened in industries temporarily or premanently hurt by the pandemic?

Calfo: If a business has been hurt by the pandemic, there's a legitimate chance that company will fully recover within the next three years. That may stretch the transition window for some businesses. But it's important to remember the world of private equity had an unprecedented five years of capital-raising success with billions of dollars pouring in on the backs of shrewd investments from 2010 to 2013. This may be another golden opportunity for investors, and no one wants to be left behind. From what we're hearing, the amount of inbound calls is higher than it was last January.

What about private equity's outlook on family owned businesses?

Sanders: Firms want to invest in a company with management that will go to great lengths to ensure its success, so they have found family businesses to be an ideal investment, especially those that have continued to conduct business as normally as possible and proven their reliability in a crisis. Those businesses essentially passed a stress test.

Speegle: Lots of companies that performed well with private equity were family businesses, where the owners; after having their entire net worth at stake during the months of March and April, might be more willing to sell now that things have stabilized.

Calfo: Investors are back, but the difference between what sellers project and what buyers expect is more subjective now. Eager sellers need to understand they need to accept more risk. The consideration for their business is likely to be more contingent on future performance.

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What's the effect on private equity portfolios?

Speegle: Much the same as in all business. If I ask private equity partners how their portfolios are adapting to COVID-19, they tell me companies are cutting costs, accessing government loans, shoring up liquidity, increasing technology investments, and offering remote working options. The good news for portfolio companies is that being part of a private equity portfolio can help a company meet a variety of challenges. If a business owner asks, "How do I evaluate commercial real estate right now?" another portfolio company can often help them.

Sanders: Look at the demographics and ages of the people running these businesses. Many have been on the fence about private equity investments and being part of a portfolio. Now they're saying, "Now that I've made it through the crisis, I need to do something." A business that was slow to embrace technology before may now need an investor to inject capital to build the technical infrastructure required to keep the business afloat.

Calfo: The pandemic is another example of where scale is beneficial, whether it's the scale of your business or the scale of your private equity partner with access to resources. That's what's on leaders' minds.

What advice would you offer business leaders interested in new private equity investments?

Calfo: Private equity firms are being much more flexible on security. They're saying, "We now have a debt fund, so we can provide debt options, if that's what's best." Or, "You know what? We'll take a minority share of the business as a first step instead of requiring you to sell the majority of your business." I'm seeing firms trying to be as flexible as their mandate allows them to be in order to get capital invested.

Speegle: The capital that private equity firms have raised is not callable—it's essentially permanent capital. When a private equity firm goes through a relatively dry period from a deal perspective, it must be more creative and pay a little bit more than it first hoped. Firms will bet on you if you offer a better vision of future earnings, and they may be more flexible with you on ongoing terms as a minority owner.

Sanders: Successful people have a way of adapting, dealing with the circumstances, and figuring out how to move forward and get ahead. Private equity fits into that category. Private equity leaders have the capital and bandwidth. They're smart and creative, and they can come up with a variety of ways to make high-return investments.

Discuss your plans with your relationship manager or Truist Wealth advisor to see how the team can help you during your recovery.

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