

# Private Equity and COVID-19

Cause for concern?



Allocators need timely asset and market prices to effectively make portfolio management decisions. While some private equity investors see the lack of frequent valuations as a positive characteristic, access to timely information is especially important where there appears to be a regime shift in markets, and the COVID-19 pandemic certainly qualifies for that. Investors are rightly asking themselves “should I top up my exposure to private equity?” or “should I reduce it via the secondary market?”.

Solving for this is not easy. Portfolio companies are typically only independently assessed annually. Fund managers do provide more frequent interim quarterly valuations, but these do not always match the economic reality for the companies being valued as managers retain discretion to “smooth out” valuation volatility. Lagged and smoothed valuations do not aid timely portfolio management decisions.

So, how can investors get this information in a timely manner? Rather than wait for valuations, we decided to get a better sense of the impact of the COVID-19 crisis on the capital structure, demand for goods and services, on the supply chain and the operations of the underlying companies we are invested in. At the end of Q1 2020 we surveyed several of the private equity managers we invest with, representing 300+ portfolio companies, across 36 funds, to understand how their businesses were performing and their expectations for the next 2-3 months. Responses were gathered over the month of April and further details of the survey questions are at the end of this document.

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**high-return private**  
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**across the world**



December 31, 2019

**Willis Towers Watson**

## Surveyed managers by geography, strategy and sector:

Figure 1: Company sector

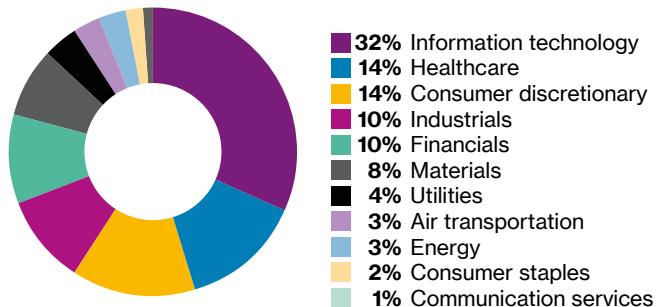


Figure 2: Geographic focus

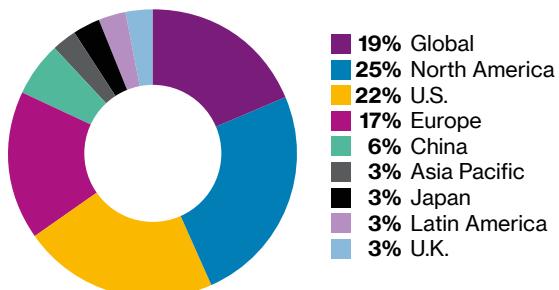
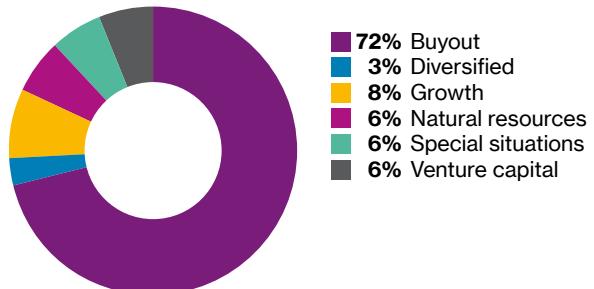


Figure 3: Strategy focus



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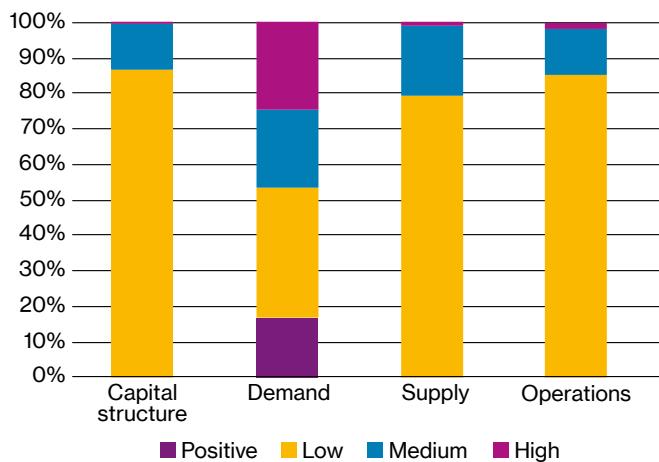
## The results

A common theme we observed across respondents was “robustness” across most areas of focus. The turmoil in capital markets had little effect on the capital structures of portfolio companies, with over 80% of respondents indicating that their portfolio holdings are not likely to breach covenants as a result. The growth in “covenant lite” loans and looser financial terms for private equity gives managers significantly more flexibility to manage capital through the crisis.

Of more concern is the customer demand for products/services, with over 45% of respondents reporting that their companies were feeling a medium/high impact from the slowdown in global economies. As expected, the consumer discretionary sector with client-facing businesses such as restaurants, fitness centers and retail took a large hit, with 40% of respondents indicating a high impact to customer demand. Industrials, energy and materials were also impacted, with > 20% indicating a high impact on demand as factories shut down, global trade collapsed, and oil prices hit record lows. Not all sectors were impacted negatively however with commercial services remaining robust and 20% of consumer staples reporting a positive impact on demand.

We were pleased to see that the reported impact to supply and operations remained low, with around 80% of respondents showing low levels of concern. Though some sectors like energy reported small disruptions to their supply, the results were broadly positive across both supply and operations, indicating that businesses were able to effectively implement alternative working arrangements, as well as work around any disruptions to supply from the COVID-19 crisis. An encouraging data point to support what many anecdotally have observed during the pandemic – that of adaptability.

Figure 4: Combined survey results – Impact of COVID-19 on portfolio companies:



Source: Managers, Willis Towers Watson, June 2020.

## Conclusion

Private equity-owned companies have some structural advantages that allow them to navigate crises better. They have access to high-quality expertise from managers, access to equity and debt capital from their sponsors, and active owners that are well aligned to business success. While the impact of the COVID-19 pandemic on global economies is still evolving, firms and companies have the right tools to tackle issues that arise.

The listed equity market and global M&A appetite remain key avenues for managers to exit companies and return profits to investors. While the first half of the year has seen market volatility and a subdued environment for exit deals, investors should not forget that managers maintain significant flexibility over the timing and terms of company exits. So far, we have seen little evidence of forced exits into a depressed market and long-term investors who are patient can ride out any short-term volatility.



**The results confirm our initial view that our private equity investments are well placed to weather the crisis.**

Strong, cash-generating businesses are typically favored by our managers and we focus on those with strong operational skill as this is a key tool to add value. Beyond the short-term dislocation, we see clear opportunities where we can continue to deploy capital, notably in technology, healthcare, and consumer staples. With deal volumes depressed, there is less competition for opportunities and potentially better entry pricing. Long-term private equity investors should remain disciplined and continue to deploy capital in line with their programs and investors considering the asset class could be facing one of the better periods to invest in the past decade.

## Survey Detail

Impact on capital structure	Description
1 – Low	Low/minimal impact: The company is not in covenant breach and is not expected to breach covenants within the next 2-3 months.
2 – Medium	Medium impact: The company is close to covenant breach or is likely to breach covenants in the next 2-3 months.
3 – High	High impact: The company is in covenant breach and is at risk of defaulting on its debt obligations in the next 2-3 months.
Impact on demand	Description
0 – Positive	Positive impact: The company is expected to experience an increase in demand for its products/services as a result of the crisis with an expected positive impact on revenues relative to budget.
1 – Low	Low/minimal impact: The crisis is expected to have a low/minimal negative impact on demand for the company's products/services with an expected neutral or mildly negative impact on revenues (i.e. up to -5% relative to budget).
2 – Medium	Medium impact: The crisis is expected to have a material negative impact on demand for the company's products/services with a marked negative impact on revenues (i.e. up to -20% relative to budget).
3 – High	High impact: The crisis is expected to have a very severe negative impact on demand for the company's products/services with a very sharp negative impact on revenues (i.e. >20% relative to budget).
Impact on supply	Description
1 – Low	Low/minimal impact: The company's suppliers have been able to and are expected to continue to be able to supply it with minimal disruption for the next 2-3 months.
2 – Medium	Medium impact: The company's suppliers have experienced or are expected to experience some disruption affecting its ability to supply the company for the next 2-3 months.
3 – High	High impact: The company's suppliers have experienced or are expected to experience significant disruption which will significantly affect the company's ability to obtain key inputs for its production process in the next 2-3 months.
Impact on operations	Description
1 – Low	Low/minimal impact: All internal functions have been able to and will likely continue to operate with low/no disruption for the next 2-3 months.
2 – Medium	Medium impact: Some elements of the company's internal operations have or are expected to have materially impaired functionality over the next 2-3 months.
3 – High	High impact: The company has not been able to or is unlikely to be able to operate majority of its core operations during the next 2-3 months.



For more information please contact

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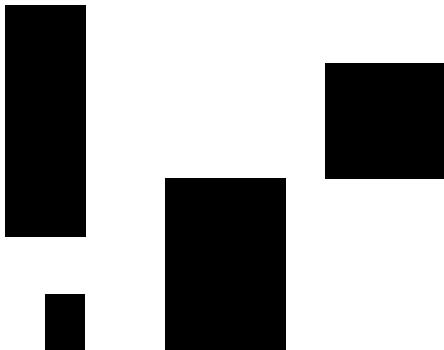
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WTW-HP-2020-0320

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