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Private Equity's COVID-19 Recovery Plan

Board members and senior managers can learn from the "structured crisis management" techniques PE firms are employing with their portfolio companies.

COVID-19 has accelerated many long-brewing developments in the business world, such as the ascent into respectability of working from home. Private equity (PE) has not been immune to this trend. By chilling the deal-making process for the time being, the pandemic has brought greater focus to **PE's involvement in active ownership** of portfolio companies, and an emphasis on **operational improvements** and other forms of **long-term value creation**. For the moment, PE firms have no choice but to concentrate on keeping their investees afloat, no easy task given the churning waters ahead.

14 May webinar moderated by INSEAD Professor **Claudia Zeisberger**, Oldroyd said, "The businesses I am involved with are still very much in the 'Recover' phase." As they navigate this crisis, board members and senior managers, whether or not they are involved with PE, can learn from the "structured crisis management" techniques general partners (GPs) are employing with their portfolio companies.

The L-shaped moment

Oldroyd described how the financial free fall observed in the earliest days of the pandemic has since given way to more stable doldrums. This makes it possible to look ahead to recovery. In the React phase, GPs and portfolio companies were preoccupied with liquidity, or, as Oldroyd bluntly put it, "ensuring they had enough cash to survive". Securing financing lines, cutting costs to the bone, instituting additional cash controls and signing onto government support schemes were among the measures that monopolised attention in those frantic days and weeks.

Now that portfolio companies have found the ground beneath them once again, a multi-faceted mission has taken hold. Working in concert with the PE firm's operating partners, investee company executives are carrying out robust scenario planning, along the necessary focus on immediate cash flow. They must consider all the issues that may affect funding over the next 12-18 months. This includes assessing when any deferred payments will need to be made, as well as the impact on financing requirements should there be a second wave of COVID-19 infections and a return of lockdowns. They must also examine how to meet increasing working capital requirements as economic activity begins to revive.

Operating partners and company managers work closely to create immediate (21 days), near-term (13 weeks) and just over the horizon (12 months) rolling cash forecasts for a range of scenarios. "Individually, any single scenario may not be [of] much use in such uncertain times, but together they can enable a company to judge whether it has enough cash resources to weather most circumstances. They can also help management model the likely financial consequences of different routes out of lockdown," Oldroyd said.

In addition, the project management offices (PMOs) that PE firms install in portfolio companies have been converted into de facto crisis management war rooms. Normally used for managing transformation programmes (such as transitioning to lean manufacturing), PMOs are perfectly perched at top level so as to monitor and guide each recovery initiative as a separate workstream, with centralised access to key information and relevant decision makers.

Opportunistic M&A

PE firms are also looking towards a future where COVID-19 has been conquered thanks to a vaccine, herd immunity, etc. It is not yet clear, Oldroyd said, who the winners and losers of the pandemic will ultimately be. Many firms are actively investigating their options for pre-emptive, opportunistic M&A.

For example, Oldroyd said he knows of one PE firm that just started searching for acquisition targets as part of a buy-and-build strategy for one of its portfolio companies. "While the sector is struggling now, the PE fund feels the team is well set to be the industry consolidator with excellent growth prospects post-COVID-19," he said.

However, the current situation is playing havoc with standard valuation metrics. In this uncertain climate, it would appear sensible to use lower multiples of earnings to measure value. But applying that lower multiple to a company's COVID-suppressed performance, rather than a normalised earnings forecast, may lead to "doubling up on the bad news" to produce an excessively discounted figure, Oldroyd explained.

Exit planning and incentives

Oldroyd expects that exit timelines will be profoundly disrupted. Companies that were doing well before the crisis hit, but are now struggling, will be held longer than expected. Some IPOs may be postponed. On the other hand, companies that have performed well under COVID-19 may be rushed to market.

In cases of deferred exit, managerial incentives will prove to be a thorny issue. "Many companies are now potentially so underwater that there is no incentive," Oldroyd said. Ratcheted compensation structures – which tie rewards to performance thresholds – may no longer make sense if still based on the old projections. However, PE funds are already looking into eventually revising these structures as they move into the Rebuild phase, so that the interests of portfolio company managers and the PE fund remain aligned.

"Private equity knows it needs to keep good managers," Oldroyd said.

Coming back stronger

COVID-19 has already yielded quite a few business surprises. "Who would have predicted that if you were a bicycle supplier in the UK, the onset of COVID-19 would **push up your share price** by over one-quarter? It's simply because that's what everyone wants now. I think imagination is needed [to spot untapped value] across individual sectors," Oldroyd commented.

On the whole, though, companies should look to the well-known fundamentals of business success as the crisis wears on. In the end, the winners, according to Oldroyd, will be the ones with "good management teams, innovative products and good services for their customers".

*INSEAD's webinar series "Navigating the Turbulence of COVID-19" feature expert inputs on key issues surrounding pandemic control and current countermeasures around the world. Sign up **here**.*

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