DEBT BUSINESS

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Corporate credit markets in the US

How the pandemic and its economic fallout are affecting PE and other types of alternative financing

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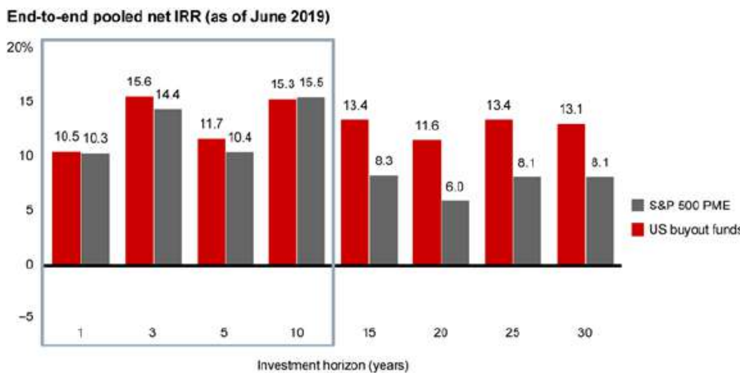
Brazil - Protagonist of the Latin American NPL market

NPL Investing & Management Greece 2021 (Part 2)

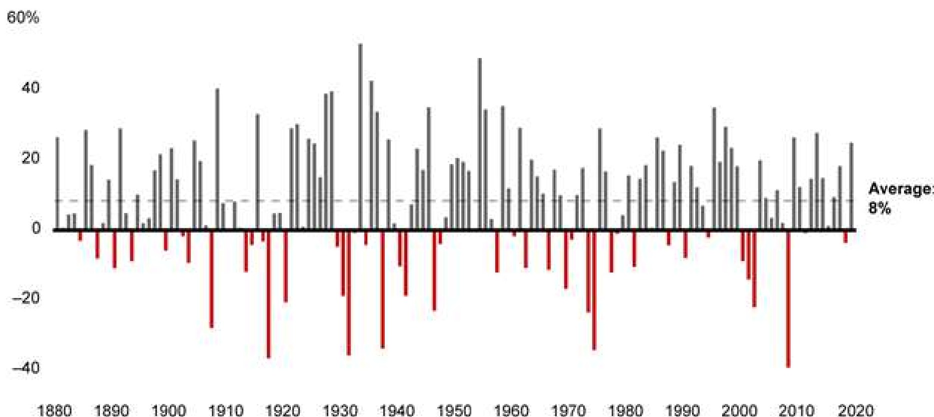
MacroView: The FED will monetize all debt issuance

How the pandemic and its economic fallout are affecting PE and other types of alternative financing

According to Bain & Company, investors have deposited over $2 trillion into private equity buyout funds over the past decade. People deposit into PE firms in the hope of getting returns outsized to the general market. However, the picture isn't what most PE investors were expecting. Since the Great Recession in 2009 US public equity returns equal returns from PE at ~15% .



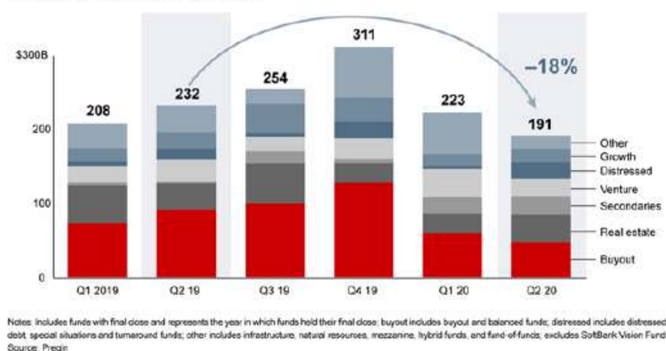
There are many factors for this, not including the unpredictable COVID rally. However, the function of PE is very different from that of the public markets. PE invests over a long period of time and has the patience needed to wait on selling assets until valuations make sense, while the public markets are driven often by emotion, computerized algorithms, and quarterly needs. Add into that a very accommodating worldwide tax policy and cheap money and you have all the ingredients for a rapid rise in public markets and thus conversely potential bubbles that when they burst leave investors hurting and plunging economies into recession. Eventually, logic tells us that returns should come to the mean preferring PE over equities. As shown below, about 30% of the time the S&P is in negative territory while for PE the number is closer to 10%.



The above history lesson sets us up to discuss how PE looks for the duration of COVID and thereafter. In the first half of 2020 deal count for PE fell by a third around the world. Investment has picked up greatly in the second half of 2020 and firms, including my own, have stepped up efforts to close transactions or at least re-engage in looking for them. One reason is a lot of dry powder, $2.6T to be exact and PE has only so much time to

spend that money before it must return it to investors. PE has also learned a lot from the Great Recession insofar as the time to make investments is when things are still bad. Now with a vaccine in sight, despite the worst of the pandemic still in front of us, many in PE feel they might have missed the boat for making the higher yielding investments in part due to overall sound fundamentals in the economy and the lack of the big bubble, such as housing during the Great Recession. Yes, consumer demand may be sapped due to higher unemployment, but thanks to governments around the world providing consumers with liquidity combined with the consumers willingness to use it to either pay down debt or spend it, companies are in better shape than they otherwise would have been. Certainly, there are winners and losers, such as cyber shopping vs. brick and mortar, but when looking at the economy as a whole it has performed better than most thought back in the first quarter of 2020.

At Vion we have recently been involved in a few exit attempts where the seller eventually decided not to sell as valuations were still not where they wanted it, but that is the beauty of PE. PE can wait, but the pressure to sell will grow as funds come to end-of-life where they must dispose of assets. This built up pressure should result in as boom of opportunities in 2021. Funds trying to raise new rounds in a COVID world have struggled and are down ~18% (see chart below), but everything is relative. Distressed funds have benefitted as one might expect.



Where PE will succeed or fail comes down to understanding how the world has fundamentally changed post-COVID. For example, how has medicine changed forever with the advent of telemedicine, will shopping centers continue to have relevance or offices for that matter? Many get groceries delivered to the door now, but that also means less impulse shopping at the store and that costs retailers money. If you are used to going to conferences, there are generational issues that have emerged. In an informal survey it appears those over 40 prefer having in-person meet and greets with parties and all that comes with it while the under 40 crowd are very open and even prefer virtual conferences.

The nature of marketing might have changed forever. Further, if you are part of a fund or invest on behalf of one it will be more and more important to not be a generalist, as sector expertise is becoming more and more important. There is one thing certain; all businesses must be investing in technology to survive, regardless of sector. Whether your business is dry cleaning for people who don't wear dress shirts or dresses, consumer lending to those who don't want to walk into a bank, leasing office space to those who might need a different flexible set up or a marketing company trying to reach customers in this new paradigm, technology will help determine the winners and losers in the coming years. Those who don't change fast enough will be gobbled up or cease to exist.

Contributing Editor

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Stacey J. Schacter is the founder and CEO of VION Investments which provides liquidity solutions based on performing and non-performing consumer and commercial cash flowing assets. Since 1990, Stacey has focused on receivable buying, servicing and collections in the financial services industry, serving as President of OSI Portfolio Services; President, Chief Executive Officer and Chief Legal Officer of EMCC, Inc.; and attorney and advisor to several debt and receivable purchasing firms.

Mr. Schacter has had several publications and speaking engagements, including talks on the economy and its effects on the receivables industry, collection practices, and bankruptcy. He is a former member of the Debt Buyer's Association Board of Directors and was the organizations first chair of its Certification Task Force to create standards for the debt purchasing industry resulting in the first published standards for debt buying in the United States.