



## Post-COVID private equity: Thriving in a bifurcated world of opportunity

A podcast series

### Interview with Aaron Black, Head of Private Equity, Deloitte Australia

#### Transcript

**Greg Jarrett:** Welcome to Deloitte's podcast series on thriving in a bifurcated world of opportunity post-COVID in the private equity industry. Today, we're speaking with Aaron Black, Head of Private Equity, Deloitte Australia. We're talking about how private equity firms can refocus their efforts to thrive in the new normal post-pandemic. What good is dry powder if it's never fired? That's the question some private equity investors have been asking in recent years as the amount of uninvested capital in the industry, also known as dry powder, reached record levels. Competition for deals was heated and many funds chose to sit on their hands, rather than pay a premium price that would hurt their ability to deliver on historically attractive returns. Investors could take solace in the theory that once the economy hit a soft spot, valuations would fall in line. Then, there'd be plenty of opportunities for target.

Aaron, do you have any view on when the economic impact from the COVID-19 pandemic might subside and activity could return to normal in Australia? It's time for your crystal ball.

**Aaron Black:** Yes, definitely a crystal ball type question, Greg, and so much is dependent on the vaccine and when that's available and then, how widely and how quickly that's able to be distributed. Australia's done a great job on the health fronts and puts us in good stead for recovery, but a lot of the strategies, based on the vaccine, and only time will tell how quickly that becomes available.

**Greg Jarrett:** Aaron, given the levels of dry powder noted by your analysis, could you explain for me the impact of the situation on fund returns and even more broadly on this particular asset class?

**Aaron Black:** So, our record levels of dry powder in the Australian market, like so many other markets, is 14 billion dollars of money on the sidelines at the moment, waiting and ready to deploy. The issue that we continue to see, is really an economic one across the economy. So, in terms of private equity finding the breadth of companies that are performing strongly, that is obviously more difficult in a challenged economic environment. We do

think that the return hurdles will calm down, private equity, we're typically solving for 20% plus IRRs pre-COVID.

In a post-COVID world, with an expectation of a very long period of low-interest rates, we expect limits of partners to not be requiring quite as high returns. That means that whilst we do think that private equity returns might come down as a whole, we certainly think that they'll continue to remain very attractive compared to other asset classes. Certainly, the equity markets have had a very strong rally from their March lows, but expectations moving forward that private equity can continue to outperform as an asset class

**Greg Jarrett:** Do you feel like the levels of available capital, Aaron, could affect the valuation or multiples paid for by market operators and if so, how so?

**Aaron Black:** It's definitely a scarcity factor out there at the moment in that pre-COVID, there were a number of processes being run for the sale of businesses. A lot of those were inevitably put on hold when COVID hit and during that March/April window where we saw a dramatic decline in M&A values both here and globally. Certainly, there is an uptick in activity levels at the moment and more processes starting to come to market, but there is definitely not the same volume that we saw pre-COVID.

So, with the dry powder sitting on the sidelines, it does mean that the private equity need to look for angles, need to find different ways to bring their skillset to bear to really drive per chance and justify valuations, and a lot of dry powder, scarcity, and at the moment, we're seeing private equity prepare to pay multiples not dissimilar to what they were prepared to pay pre-COVID. Certainly though, EBITDA numbers cashflow forecast has been impacted by COVID, so that all goes into the analysis. And we're certainly seeing in a greater a willingness from private equity to look at structuring transactions to bridge valuation gaps as well.

**Greg Jarrett:** It's an extraordinarily interesting environment for deal making, interesting in the sense that you want to be extremely careful. In fact, in a recent POV, you've outlined some of the impacts of the current environment on due diligence. Could you further comment on what you see happening on the market so far this year as well as what might be expected for Q4 2020 and even beyond?

**Aaron Black:** So, it definitely comes back to the crystal ball that we tried to get out at the start of this discussion, in that certainly a lot of planning is required to be done in these markets, just to understand the impact of the epidemic might be continuing to move forward. Some of the assets that we have seen frayed in this market, particularly in the healthcare space, have been, in some cases, volumes, and their profits have been good as a result of COVID, but equally, we've seen some transactions now signed to come through in asset classes, or sectors that've been heavily impacted by COVID and that's where, really, doing the scenario analysis to make sure that whatever you buy does stand the test of, perhaps a longer impact than is currently expected is critically important.

The other area that is definitely continuing to emerge and perhaps has been accelerated as a result of COVID is looking at the particular area of due diligence. Certainly through the COVID period, there has been a massive move online, both from a consumer spending perspective, from a corporate perspective, and as a result, we're seeing cyber become more of an area of due diligence, focus then has perhaps been near in the past and we expect that trend to continue. And we certainly expect the typical areas of due diligence to continue to remain heavily important, such as financial tax and legal.

- Greg Jarrett:** You've talked about scenarios in this last answer. I'm wondering as those scenarios played out, are there significant variations from one industry to the next and which industries ended up better or worse than you might have expected?
- Aaron Black:** So, tourism and education are big parts of the market here that have been heavily impacted, perhaps more so than would've been initially thought when the virus hit the world. Some sectors, certainly anything online, has gone better than expected pre-COVID. Certainly, a number of IPOs, for example, coming to the market here. Some of those potentially sponsor exits where we are seeing online businesses that have just thrived and really taken a quantum leap forward because of changed consumer behavior that has occurred as a result of the pandemic.
- Greg Jarrett:** I'm going to need you to get out your crystal ball again or maybe I, maybe I should refer to it as your educated crystal ball. Do you see a return of significant levels of deal activity happening any time in the short term and would these deals be mostly defensive, offensive? What are the differences from industries and geographies?
- Aaron Black:** The private equity are looking to be active, so they're definitely looking at opportunities. They're looking for companies that are willing to transact. They're very happy to build relationships and take a longer-term view and are certainly looking at transactions now that might be able to be consummated in the new year. We're seeing activity levels peak up dramatically from the depths in any event, but we certainly think that there'll be a more normal level of activity from an M&A perspective and that's probably more a comment on the offensive side for those companies that are seeking capital to grow.
- In terms of the defensive sides, the federal government has put a lot of stimulus and support into the market that has resulted in not as much distress as may have been expected. Government programs won't last forever, so if we do see a situation next year where there just isn't as much economic support being provided, we may see more companies going to private equity to look to raise capital for defensive. The early expectations during the first few months of COVID were that, we'd see that economic impact happening right around now, but there've been additional government packages put in place that have really pushed that into the new year, into that March April time frame.
- Greg Jarrett:** With all that information, Aaron, what's your prognosis for the health of private equities and asset class when we compare to the other broad categories, public equities or even the bond market?
- Aaron Black:** The views around private equity are that it continues to be an asset class that has the ability to provide above market returns. In terms of bonds, for example, with an extremely low interest rate environment which is expected globally for some period of time, bonds obviously begin to be a low returning class of investment. To me, the public markets had a very strong run from their lows in that March period. Again, the expectations moving forward in a difficult economic environment is that the listed markets as a whole will really struggle to return anywhere near the type of returns that private equity has the potential to generate as an asset class. The feedback from limited partners is that they remain attracted to private equity and so, with the dry powder levels available, we certainly expect strong deployments as I say, most likely, next year. From there, we can continue to see particularly good opportunity for private equity.

I think it's worth saying that the best buying really, would happen from an economic cycle perspective, was the buying that occurred coming out of the global financial crisis and we think certainly we'll see a similar type of investment opportunity in the next year or two.

**Greg Jarrett:** Thanks to Aaron Black, Head of Private Equity, Deloitte Australia for talking to us about the private equity industry and how it will thrive coming out of COVID-19 in Australia. For more insight on similar topics, stay tune for the next Deloitte podcast. I'm Greg Jarrett, until next time.

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