Interview with Richard Parsons, Head of Private Equity Coverage, UK

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 Richard Parsons, the Head of Private Equity Coverage in the UK. 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 paying premium prices 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 would be plenty of opportunity for target.

Richard, let's talk about COVID-19. The immediate effect, the long lasting effect. Tell me, what happened to private equity when COVID-19 struck?

Richard Parsons: I mean, first of all, it was an incredibly fast-moving time. Two immediately obvious impacts; first of all, all the new deals that were being done, almost regardless of where they were, were put on pause. And I say pause because since then, a number of those have since mostly come back and have actually successfully traded in the market. The immediate focus from the private equity market from mid-March, pretty much to the period running up until Easter, so toward the end of April this year, was focusing on that portfolio. Clearly if the portfolio isn't performing, and that's their number one priority, nothing else is really going to work.

It was almost like a switch being flicked then, at the beginning of May. They've managed to get through the earlier challenges with covenant tests. Clearly there were a number of support schemes that were put in place in the UK, which were incredibly valuable and actually bought private equity firms and their businesses an awful lot of time. And they have managed to stabilize the ship from being in a position where a number of houses were almost reluctant to talk to the market. They were just focusing on dealing with their management teams, and that was a very intensive full-time job for all of the investment professionals in the market. To beginning of May, it was putting the head above the parapet, and let's start look for some more transactions.

The big difference between this year and 2009, was that over 2009, both the market paused in terms of taking businesses to market, but also private equity took their foot off the gas in terms of their appetite to invest. And a number of them spent, 12, 18 months without having done a transaction. Now if you're a private equity fund, and you're investing on a five plus five timescale, you need to keep deploying capital. And clearly, back in 2009, 2010, a number of those funds really struggled to deploy the funds and subsequently were unable to raise the same amount of money going forward. This year, they are very keen now to deploy capital.

Greg Jarrett: Speaking of capital, Richard, do you feel these levels of dry powder could affect the valuation or multiples paid for by market operators? And if so, how so in the UK and Europe?

Richard Parsons: It's fair to say that the industry has evolved significantly over the course of the last 5-10 years. And we've seen a material shift into sectors, which are able to demonstrate high levels of cash generation, high levels of revenue visibility, and businesses where there's an underlying growth in the market. And private equity always has been, winnings pay significant multiples for these businesses. There's clearly an awful lot of competition for those businesses. What we're seeing right now is a continuation of that theme. The market's looking at tech enabled services, TMT [technology, media and telecommunications], healthcare... businesses which have been resilient over the course of the last six months. And they are clearly the most popular sectors that are out there at the moment.

In many cases, they are the industries that private equity would have been looking to deploy capital into over the course of the last 5-10 years as well.

Greg Jarrett: It wasn't that long ago, Richard, that whenever we talked about private equity in Europe and the UK, we talked about Brexit and its effect. Now we've got the pandemic. How did the two go together?

Richard Parsons: I mean, Brexit has never really been taken off the table in the UK when it comes to getting transactions completed. Clearly, COVID was in many ways a distraction and an excuse for some slightly different headlines over the course of the last six months. But certainly what we've seen over the course of the last month or so, is that the Brexit word has appeared far more often in the news. And the big impact that I think that's having on how transactions are getting done, is that right now, yes, there's a lot of money chasing transactions. Actually, the market's surprisingly positive. We're seeing incredibly strong deal flow across the mid-market. So there's a lot of transactions in some of the sectors I've mentioned—resilient businesses, which have done well over the course of the last six months. But private equity doesn't want to get it wrong. They really want to do their homework, and there a number of black clouds on the horizon, Corona and COVID being one of them, but clearly there's Brexit. And you know, Brexit is a big unknown variable in the UK market, and therefore, the market doesn't like uncertainty. And something of this sort of scale is clearly going to have an impact on the type of businesses that people are prepared to invest into, and how they're going to do businesses. And I think the danger is that advisors are, in many cases, taking businesses to market quite aggressively. Private equity want to be able to do their homework. They want to be able to do their diligence on the businesses in an appropriate way. They also want to be able to spend time with management teams, to make sure they are backing the right teams to deliver the business plans. If processes are run in too aggressive a way, there is a chance that they will fall over.

Greg Jarrett: Rich, experience would indicate that the longer the pandemic lasts, the longer it's economic impact will last as well. Do you have any inkling about how long it's going to take for the effects of the pandemic to subside, and activity might return to some sense of normal in Europe and the UK?

Richard Parsons: I would love to be able to give you a straight forward answer on that. But I'd be impressed if you can find anyone who can give you a definitive answer as to how long it's going to take. Clearly, you know, the longer there is uncertainty, the more damage that will be done to both the economy and to businesses. One of the challenges that we're seeing is that we have never really got through the other side of lockdown. Clearly, there have been really significant government support schemes, which a lot of the businesses have benefited from. In the UK, we've had a furlough scheme, which has helped support a large number of the businesses which are particularly in the front line of C-19 and its impact in the leisure and in the hospitality, in the airline industry for example.

What we haven't seen yet is what's going to happen to the broader economic environment, and what's that impact going to be on the performance of businesses? Actually, we've seen a number of businesses within private equity portfolios, which have rebounded pretty rapidly over the course of the later part of the summer. There's been a bounce in a lot of sectors, pent up demand. And that's actually led to a short-term boost in the trading of a number of businesses. And clearly if you're looking to sell those businesses, the investors themselves have an even more of a challenge in unpicking what the sustainable, normal trading of a business is going to look like over the course of the next 12, 24, 36 months... whatever the hold period's looking to be.

Greg Jarrett: Do you have some observations for us, Rich, on the use of functional expertise, like IT, data science, accounting, and so on within the fund and portfolio companies?

Richard Parsons: One of the things that really benefits private equity in this sort of crisis... they look to back the best management teams. And they have an incentive structure, which is very much aligned with the performance of the teams doing well. If it's a great investment, then the management team will make out, and it will be a very lucrative period for them. The last few months have demonstrated that private equity is able to be very fleet of foot. Yes, it's been a very intense period. Yes, it's been a lot of challenge. But actually, those management teams have been very reactive and have been able to transition, in a lot of cases very successfully, the businesses that they're running. To manage, actually pretty effectively in, with the current environment that we're facing, where we've still got significant portions of the UK population who are working from home.

If the same challenge were to have happened five years or so, we wouldn't have had the same level of technology that we do now. And therefore, you know, our ability to transition and work as effectively from home, would be significantly compromised. So, I do think that private equity is being very innovative. They've been very successful at addressing some of the challenges. Clearly in a lot of cases, if you're directly impacted, you know, your front line, given the sector that you're in... those businesses will have had a more significant material knock to their trading. But ultimately, it's the strength of the management team, combined with an effective use of the technology that we've got, to manage those businesses and their portfolio businesses as effectively as possible. In a lot of cases, I think some behavior will change permanently.

And I've had the observation made to me a couple of times that people have seen the behavior within their businesses, on the level of innovation, which has been at an unprecedented level. More people are now thinking about how they can continue and stay in that level of innovation over the next 12, 18 months. But actually in many cases, I think, entering into lockdown and managing the business for that was one exercise. It's a much bigger exercise to get your business up and running, and reshape it for the current market, given some of the significant uncertainties as we've touched on. With things like Brexit, and potentially a second wave in various different jurisdictions and potentially there could be a recessionary environment going forward.

Greg Jarrett: Thanks to Richard Parsons, Head of Private Equity Coverage in the United Kingdom, for talking to us about how the private equity industry will strive coming out of COVID-19. For more insight on similar topics, stay tuned for the next Deloitte Podcast. I'm Greg Jarrett. Until next time.