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The Great Stay-In (Third of a Series)

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"The three main U.S. stock indices closed at record highs as concerns over the coronavirus outbreak's economic impact seemed to fade." – Barron's, February 12, 2020.

Perhaps not the "Dewey Beats Truman" of media misreads, but this quote reflected widely shared sentiments among market participants. "Can anything stop this rally?" the columnist went on to ask rhetorically.

Barely six weeks ago the Dow stood at 29,551. Today it's 10,000 points lower, the economy at a standstill, global markets in shambles, Americans locked at home.

This, then, is the picture private equity sponsors are facing. As value investors by nature, these firms know at some point properties will present themselves at significantly lower prices. But how can you analyze a new investment when revenues and cash flows are uncertain, and in some cases, non-existent?

So for new deals, buyers and sellers faced with extreme lack of clarity on valuations are on hold. As Jamie Dimon famously put it, selling a house is not the same as selling a house on fire. In the meantime, PE shops are looking closer to home.

A survey of top sponsors reveals a number of common elements. First, since the coronavirus began to emerge earlier in the year, firms have been working hard to analyze how it will affect both portfolio companies and add-on transactions. This exercise mirrors work done last year amid China trade/tariff concerns.

At the same time, PE is in frequent dialogue with lenders to ensure relationship credit providers are "still there." It's early days, but as assessments of borrowers' financial health continue, conversations will morph to specific requests for remedies to bridge issuers over the challenging quarters ahead.

In that regard, the often-heard watchword is "liquidity." With circumstances changing daily, if not hourly, private equity owners aren't looking too far ahead. In most cases the long-term value proposition of these properties remains sound. But does the company have enough cash to get through the next couple weeks?

Given the sweeping outages of employee attendance, few industries are being spared. Sponsors are triaging portfolio names, focusing on businesses requiring immediate financial support to make payroll. The others can wait until tomorrow.

Are screaming bargains to be had? Perhaps, but who's willing to step into a falling elevator? We suspect once some stability returns, big investors will start making big bets on brand names (cf. Warren Buffett, Goldman in 2008). New business will then open up for the rest of us. It's just a question of timing. Whenever that is.

? Next week: How are direct lenders supporting their private equity clients?