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Is distressed best for LPs?

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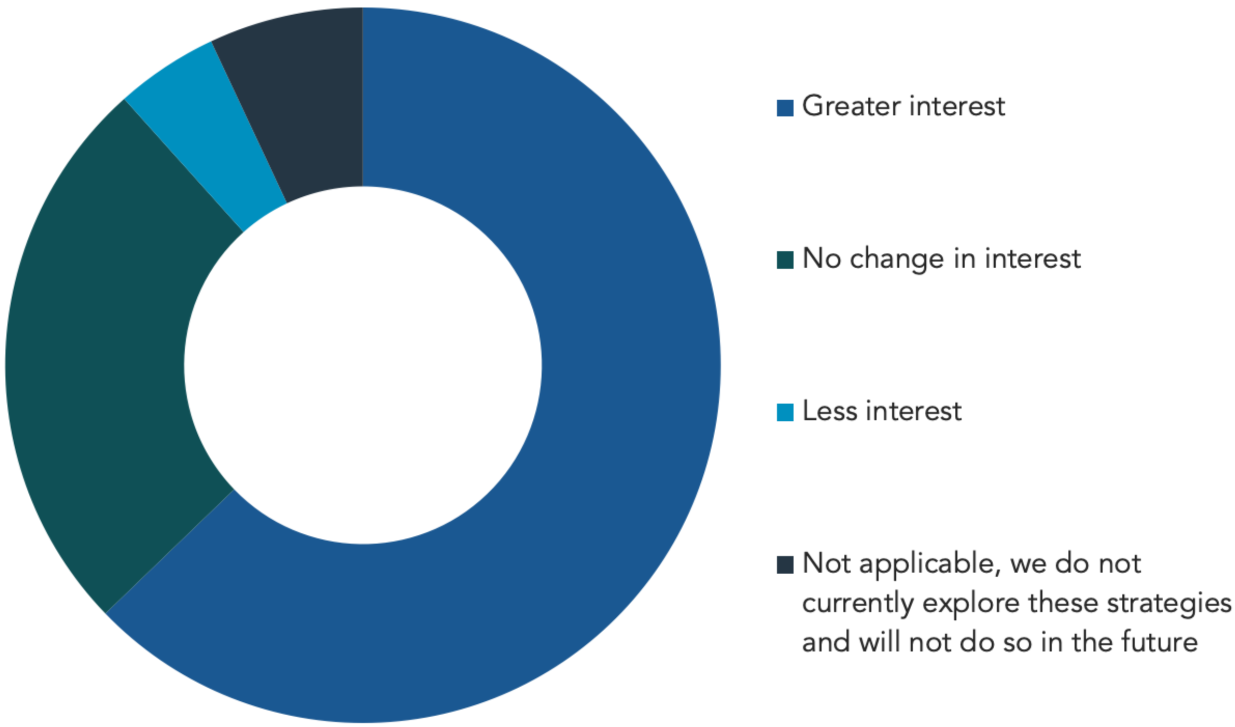

Fundraising targeting troubled companies is gathering pace, with surveys suggesting investors are keen to jump on board.

"We estimate that about half a trillion dollars across credit segments are trading at distressed levels," said Karim Cherif and Jay Lee of UBS Global Wealth Management in a report published in mid-June.

If this quote doesn't grab the attention of investors, it's hard to know what will. There's every sign that they are indeed sitting up and taking notice. A recent survey conducted by our colleagues on *Private Equity International* found that almost two-thirds of limited partners were expecting their interest in distressed debt to increase over the next six months (see chart above).

With LPs' focus turning to distressed, there is no shortage of new funds seeking to take advantage. We have seen many examples of dislocation funds, such as a $4 billion vehicle raised by KKR and $1.75 billion by Apollo. In recent weeks, Bain Capital closed a $3.2 billion global distressed and special situations fund and Balbec Capital raised $1.2 billion for a niche non-performing loan strategy. There are many other examples.

The UBS report indicates that distressed may be a long-lasting opportunity, which was not necessarily assumed in the early days of the covid-19 outbreak when some economists were predicting a rapid v-shaped recovery. The downturn in the debt markets and pick-up in default rates still have some way to run and there are plenty of troubled companies to be helped.

There is a hint in the report that the opportunity set could be even bigger had the monetary and fiscal policy response not been quite as dramatic. This intervention has succeeded in bringing the number of distressed credits down from the high point seen in March. However, the report also indicates that these actions are unlikely to save economies from long-term damage.

The ‘next phase’ of the opportunity – after the initial shocks felt mainly on public markets – relates to the longer-term issues that companies are facing and is where distressed specialists come in with their understanding of company fundamentals, capital structures, operating models and legal frameworks. There is much to be done.