COVID-19 AND THE IMPACT ON PRIVATE EQUITY

Key Findings

- Private equity has several structural advantages over other asset classes, which make it particularly well-suited to withstand market dislocations and crises. The long-term nature of the asset class, the stability of its capital base, and its active and control-oriented portfolio management model provide general partners the ability to take a longer-term view, move quickly and decisively to address issues at their portfolio companies, and take advantage of opportunities that may arise.

- The private equity model was put to test in the GFC and demonstrated its ability to withstand a severe market dislocation and economic recession. In 2009, the trailing 12-month leveraged loan default rate for private equity–backed companies was 7.2%, compared with 15.1% for non-private-equity-backed companies, according to Fitch Ratings. Further, the decline in private equity returns was shallower than the decline in public equity returns, and the asset class reclaimed its prior peak more than two years earlier than public equity did.

- In many respects, the private equity asset class is structurally stronger today than it was in the prior cycle. Many general partners shifted to a more-defensive stance beginning in 2016, mindful of late-cycle dynamics and determined not to indulge in the excesses of the prior cycle. In 2019, the average equity contribution rate for a new buyout investment was 43.5%, whereas the average interest coverage ratio was 2.7x, both significantly higher than the averages in 2007. Technology-related buyouts, which are expected to be more resilient in a downturn, accounted for 22% of the market in 2019, compared with 8% in 2007.

- Since the GFC, most private equity firms have embraced the importance of having a well-defined operational strategy and value-creation plan for their portfolio companies and have invested heavily in building out their operational resources and portfolio management capabilities, either through a dedicated in-house team of operating partners and professionals or by utilizing third-party resources and talent. These operating resources are expected to play an integral role in helping private equity–backed companies withstand this crisis.

- Private equity firms have diversified their debt financing sources since the GFC, which may mitigate a potential credit crunch in the leveraged credit markets. The direct lending asset class has an estimated $100 billion in dry powder as of year-end 2019 to potentially support a significant level of new private equity investment activity. Additionally, a significant number of loans used to finance existing middle-market buyout investments are held by direct lenders, who are primarily relationship-based lenders, allowing private equity sponsors the opportunity to more easily enter into bilateral discussions with their lenders as needed.

- The scale of the global governmental response to the pandemic has been unprecedented. In the U.S., the response includes a $2.2 trillion stimulus package, unlimited quantitative easing by the Federal Reserve, a reduction in the fed funds rate to 0%–0.25%, and new facilities to support main street businesses and corporate and municipal borrowers. Early signs show that these measures have already provided some stability to credit and equity markets.

If you would like to read the full report please send a request to PathwayResearch@pathwaycapital.com.

About Pathway Capital Management, LP

Founded in 1991, Pathway provides private market fund solutions for institutional investors worldwide. Pathway manages capital on behalf of some of the largest corporate and public pension plans, government entities, and financial institutions around the globe. Since its formation, the firm has committed more than $85 billion to more than 700 private market investments.

Pathway is registered as an investment adviser with the SEC in the United States and as a portfolio manager and exempt market dealer in Ontario, Quebec, and Saskatchewan, Canada. Pathway's wholly owned UK subsidiary is regulated in the UK by the Financial Conduct Authority. Pathway's wholly owned Hong Kong subsidiary is regulated in Hong Kong by the Securities and Futures Commission.

CALIFORNIA
Pathway Capital Management, LP
18575 Jamboree Road, 7th Floor
Irvine, CA 92612
Tel: 949-622-1000

RHODE ISLAND
Pathway Capital Management, LP
500 Exchange St.
Suite 1100, 11th Floor
Providence, RI 02903
Tel: 401-589-3400

LONDON
Pathway Capital Management (UK) Limited
15 Bedford Street
London WC2E 9HE
Tel: +44 (0) 20 7438 9700

HONG KONG
Pathway Capital Management (HK) Limited
Champion Tower, Level 44
3 Garden Road, Central, Hong Kong
Tel: +852-3798-2580

www.pathwaycapital.com

PATHWAY®
CAPITAL MANAGEMENT