



# 5 Private Equity Predictions for 2020

**Editor's Note:** We originally published our predictions for 2020 before the novel coronavirus (COVID-19) caused staggering global economic disruption. We revised our predictions to reflect this new reality, one in which the private equity industry—like others, as the virus has left none untouched—attempts to find its center of gravity in a vortex of uncertainty.

# At the beginning of a new decade, the private equity industry faces an unprecedented global crisis that has capsized business as usual.

At the same time, the industry closed 2019 with more dry powder on hand than ever—\$1.5 trillion—thanks to record fundraising last year. However, with the scale of chaos resulting from COVID-19, the global economy looks poised to slip into a recession. How will the private equity industry navigate this brave new world of deal making?



In the fall,  
**72%**  
of private equity executives  
said they expected a  
**market downturn** within  
the next two years

## PREDICTION #1

# Secondaries Await a 'View to a Deal'

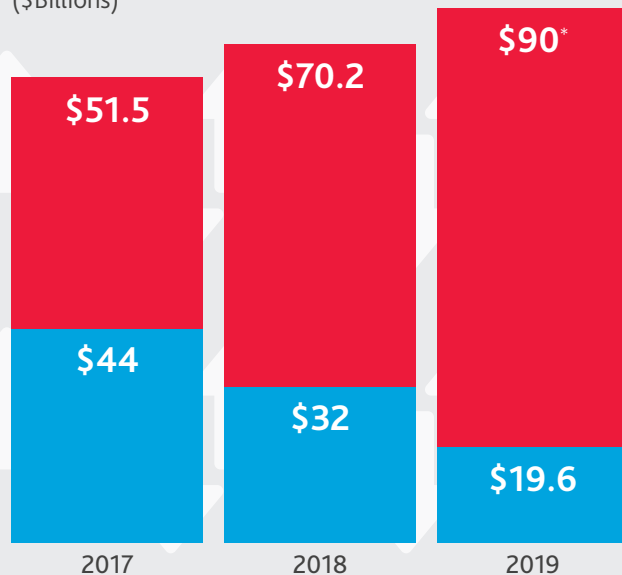
**In 2019, the secondary market transformed from private equity's sedate stepsister to one of the more explosive areas of growth among alternative investments.**

In 2002, the secondary market was about \$2 billion, according to Preqin. Fast forward to January 2020 and Lexington Partners' announcement that they raised the largest ever secondary fund of \$14 billion, and the year was off to a promising start.

But the volatility now in the markets has disrupted valuations. Expect deal volume to contract as funds monitor the effects of COVID-19 and navigate the uncertainty the pandemic has caused. However, we also expect secondary market activity to resume once the dust has settled and a "view to a deal" emerges—a line of sight that travels between a floor and a ceiling and yields a rational EBITDA multiple.

Private capital has grown in popularity as investors have sought higher returns than the public markets were offering, and alternative investments had emerged as a vehicle that offered a way around high management fees and illiquid assets. The secondary market, co-investments and direct investments were particularly frothy in 2019. As a result of the popularity of alternatives, in October 2019, 43% of private equity funds said they planned to offer co-investments to their limited partners, according to BDO's [2020 U.S. Private Capital Outlook](#) report.

## SECONDARY CAPITAL RAISED VS. DEAL VOLUME (\$Billions)



■ Deal Volume  
■ Secondary Capital Raised

*\*estimated*

Sources: Setter Capital, Secondaries Investor

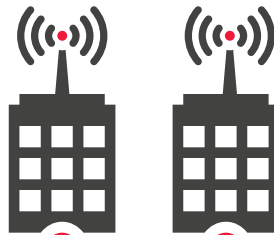
## COVID-19 Will Drive Digital Transformation

**The private equity industry has been trending toward adopting a more inward focus as funds evaluate their existing portfolios. COVID-19 has underscored this trend as funds in triage mode seek to create cash savings or rescue portfolio companies in danger.**

According to BDO's 2020 U.S. Private Capital Outlook report, there was a stark decline in the number of PE fund managers who said they would direct the most capital to new deals (50% in 2020 compared to 90% in 2019) and a corresponding increase in those who said they would direct the most capital to funding portfolio working capital needs (28% in 2020 versus 1% in 2010).

After the dust begins to settle from the COVID-19 outbreak, the virus' consequent impact on work culture—specifically working remotely—may accelerate, or at a minimum inspire more digital transformation initiatives.

In the fall, **68%** of PE fund managers said **digital potential in a target** is “very” important



“Private equity is looking for an angle with respect to technology to become more efficient and drive top-line growth in their portfolio companies, and they see digitalization and digital transformation as a way to help them achieve that. Digitally transforming is a vehicle for better profits, more streamlined operations, better security and smarter, more strategic growth, so it's no surprise that private equity is prioritizing it.”



LEE DURAN  
Assurance Partner and  
Co-Leader of BDO's  
Private Equity Practice

## Distressed Deals Will (Finally) Get Some Momentum

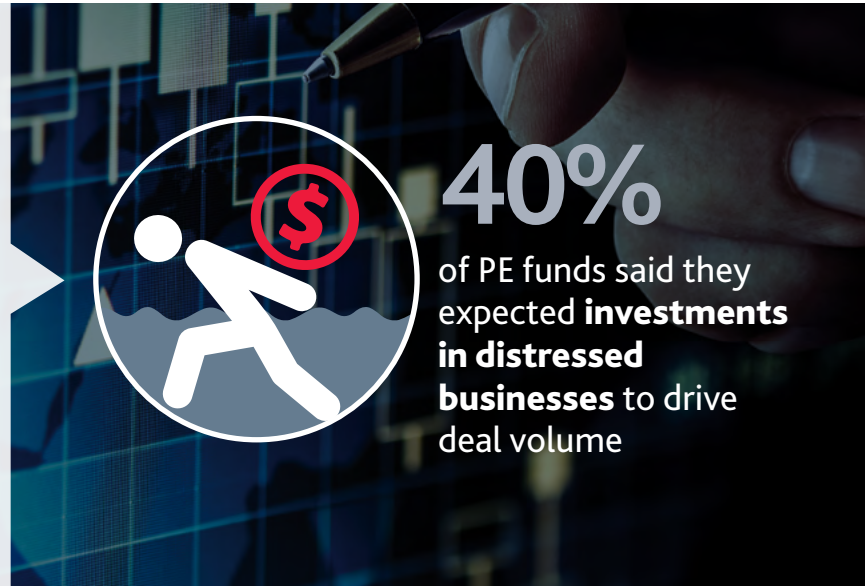
**Underscoring the expectation that a recession is on the horizon, private equity fund managers said they expect investments in distressed businesses will be a top deal driver in the next 12 months, according to BDO's 2020 U.S. Private Capital Outlook report.**

COVID-19 will accelerate distressed investing. With certain sectors hit especially hard, such as the energy and hospitality industries, private equity funds will chase more distressed opportunities.

“*There will be opportunities for those who are prepared to step into a distressed situation that others are trying to move out of. A combination of having a lot of leverage but lower demand for certain services allows lenders or distressed investors to come in at more realistic valuations, take over ownership and wait for the economy to come back for the business to perform better and see great returns.*”



**JOHN KRUPAR**  
Managing Director,  
Restructuring & Turnaround Services, BDO



**40%**  
of PE funds said they expected **investments in distressed businesses** to drive deal volume

## PREDICTION #4

# Business Developers Will Be Kissing More Frogs

**Up until early 2020, as a byproduct of the intensity and volume of competition in the market, we were seeing more of our private equity clients create roles for business development representatives.**

This was corroborated by a Navatar poll, which found four of five PE firms either already have or are considering hiring a business development professional. Tasked with identifying and drumming up prospective deals, they are out in the market "kissing more frogs" to increase the likelihood of opportunities turning into proverbial princes.

As part of their role, business development representatives are also tasked with parsing troves of data in order to aid that identification process. Data analysis can reveal the extent of a prospective target's engagement with a fund's messaging and marketing—a strong tell. It also allows business developers to ascertain, through tracking deal flow quality and quantity, which bankers lead the best deals and which may need help with their investment criteria, according to Navatar.



## PREDICTION #5

# Fund Managers Will Become Specialists

PE execs will continue to scrutinize opportunities closely as they seek quality deals to put their capital to work. Part of this process means becoming industry specialists.

## HOW PRIVATE EQUITY IS PREPARING FOR A POTENTIAL RECESSION

Being more selective when evaluating highly valued deals

50%

Holding current investments for longer periods

46%

Raising additional capital

41%

Exiting current investments

30%

Lowering terminal valuation assumptions

23%

None of the above

1%

“ There is more and more industry specialization each year. Private equity firms are going deep in industries to get smarter, so that if they're overpaying, they're educated on how they'll be able to get returns and have a well-considered thesis. ”



SCOTT HENDON  
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