A Private Equity View of the Recession

PRESENTED BY PAUL HASTINGS

How to Best Position Clients to Weather the Next Economic Downturn

Though the economy is currently thriving, some may interpret warning signs that the next recession is nearing. What should attorneys representing private equity clients do now to help cushion the economic impact that the next recession may inflict?

Amit Mehta, Chair of Paul Hastings' Chicago office, Vice Chair of the firm's Global Corporate Practice and a partner in the firm's Private Equity and Mergers & Acquisition practice, says attorneys can help their clients weather whatever economic storm is over the horizon by initiating frank discussions, making smart investment choices – regardless of the state of the economy – and strategically planning for a worst-case scenario while driving for the best results.

Attorneys need to be open, honest counselors warning of risks ahead

While Paul Hastings' Private Equity and Mergers & Acquisitions practice guides clients no matter the shape of the economy, their advice and work may be especially needed to keep PE funds on course and profitable during a recession.

"Our best advice enables clients to see around the corners," says Mehta. "We need to be honest about the risks we see with their investments and try to prevent their desire to get a deal done from clouding their better judgment."

Mehta says the biggest impact from the previous recession is "how it has shaped our advice on borrower financing and how the interaction with lenders can be smoothed when a portfolio company's financials and operations may go sideways."

Has PE learned lessons from the prior recession? Being over-leveraged was a serious problem, Mehta says, and it is something about which PE funds should be concerned. While being too aggressive with debt caused problems, not being aggressive enough by failing to get back into the market at the right time, and therefore missing out on opportunities, also hurt PE.

No matter the economy's shape, private equity needs to make smart decisions

"There will always be opportunities for distressed assets in a recession," explains Mehta. "It all depends on how much of a chance PE firms are willing to take on those assets and their confidence in the ability to turn them around."

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Funds will benefit by having flexibility in their investment mandates to pursue opportunities that they may not otherwise have in a stronger market, according to Mehta. Whether or not there's a recession coming, he says there are always good investments to be found. "PE firms have a lot of capital ready to be deployed, so with economic headwinds could come more interesting investment opportunities."

Having a limited partnership group with patience and an understanding of market cycles helps a PE fund succeed. In fact, it may be the difference between those firms that succeed in a down market and those that fall by the side.

"As markets start to slow, there's more opportunity for those who are interested in distressed assets," Mehta says. "In addition, the benefits of long-term capital and flexibility to buy, build and fix distressed assets will be an important benefit of certain funds."

Private equity will need to decide if and when to cut costs and stop investing

PE may need to act now, before a recession starts, to lessen any potential harm when it does hit. Decisions should be made regarding whether the potential that originally made an investment attractive still exists and what course corrections may be needed to ride out a downturn, according to **Bain and Company**. Cutting costs and increasing revenues now may protect the fund's bottom line.

Mehta says a major issue for PE funds during a recession is deciding whether or not it's wise to continue to invest in a business that's suffering. "There is no question PE will want to invest in good assets in a downturn, but will they throw good money after bad? Sponsors will need to be disciplined when deciding if they should continue to invest in an asset."

Additionally, larger PE staffs can be a double-edged sword. Having the right talent in place is important, especially as PE funds move into new industries, Mehta says. As the economy slows, the right staff could be the difference between landing a deal or missing out on the asset. But PE funds may look to cut overhead and their staff in a downturn.

"PE funds would be benefitted by having enough flexibility in their investment mandates to pursue opportunities that they may not otherwise in a stronger market," says Mehta.

Hope for the best, plan for the worst

When Paul Hastings represents a PE fund, whether in its formation, its involvement in a transaction or a restructuring, the approach is a proactive one – considering and planning for problems that may lie ahead, including the effects of a recession.

"That can really pay off for a client when an economic slowdown happens," says Mehta. "The client is then prepared for it and well-positioned to make the most of the situation. Our help is a competitive advantage for our clients, which becomes more apparent as the economy slows down."

*For more information on legal services for private equity funds, please contact **Amit Mehta**, Chair of Paul Hastings' Chicago office, Vice Chair of the firm's Global Corporate Practice and a partner in the firm's Private Equity and Mergers & Acquisition practice, or visit **PaulHastings.com**.*