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Venture capital struggles for liquidity to avoid future restructuring
by Araceli Munoz

Liquidity has become the most repeated word in recent weeks by all companies, whether or not they are owned by private equity funds. In a situation in which almost all of the country's productive activity has been paralyzed, the fight to achieve or maintain liquidity has become a priority for all companies that see how the coronavirus is going to strongly impact their income statement. In this context, private equity funds are approaching this risk in different ways: from those who are requesting lines of credit to financial institutions or a capital advance from their investors, to those who are studying the possibility of making massive debt buybacks. . The objective? Avoid a possible restructuring in a few months.

According to Manuel Martínez-Fidalgo, head of the restructuring area of Houlihan Lokey for Spain and Portugal, "right now, any company needs liquidity: the one that had a problem before the crisis began and the one that was fine. Those that had a problem now they have a bigger one and the ones that were good are now having problems too. Few businesses can withstand the drop in activity we are experiencing. The most interesting thing is to see what happens next year. In the previous crisis, the restructurings came 12 months later " "In addition, this crisis also entails many more changes that are going to be more profound and permanent. All the aid that the Government is giving, who is going to pay for it? In the end they translate into more taxes and that in less purchasing power."

In this sense, many companies have applied to the ICO for loans guaranteed by the Government, as has been the case with Goiko - owned by L Capital (the LVMH fund) and Capza . However, the experts consulted explain to *the Private Equity Economist*that not all companies will have access to these loans due to the requirements that financial institutions will impose and many will have to resort to other alternative financing channels. Thus, Francisco García-Ginovart, director of the restructuring area of Houlihan Lokey, argues that "the Royal Decree established generic criteria for who could access ICO resources, but then there has been much confusion until the framework has been finally landed collaboration between the ICO and the banks. There are companies that are also the ones that need more funds, but they probably will not be able to access them since the banks are going to prioritize their best clients or situations where they have a high exposure. "

For Ángel Martín, Global Partner responsible for Financial Restructuring at KPMG, "financial institutions are asking companies to do a very logical exercise, to present how their business was doing before the situation we are experiencing today, and to think about how it will be when we can get out of this business confinement, in order to understand the financing needs that are being raised and the return of it. Alternative financing will be more for companies that need more capital and more in the long term. for example, there are many funds interested in lending money, but there are not many companies that are resorting to this type of financing if you can obtain from banks with an ICO guarantee, which is a State guarantee and with market conditions. "

To analyze the situation

In this sense, beyond the requirements that banks are imposing to access their financing, the managers consulted highlight the importance of thinking about whether they need this type of resource due to a specific problem or other circumstances when it comes to seeing which option it is the best for them. For example, the Gordon Brothers firm - also specialized in corporate restructuring - is working on different projects to obtain financing based on the liquidation of assets. Álvaro Cobo, managing director and head of the firm for Spain and Portugal, explains that "we are working hard on how to ensure liquidity in the short term beyond traditional sources ... from store restructuring to managing stock liquidations in the textile sector". "It is a reality that many companies are going to need financing, but they must analyze if it is a conjunctural or structural thing. Consider whether those that are subject to a temporary liquidity shock should go to*private equity* or debt. We believe that there are better alternatives to cover a temporary treasury situation. There are many companies that are looking for bridge financing for the next 12-24 months, "he adds.

In this line, the experts point out that there are two key reasons to resort to this type of investor. On the one hand, they give companies a longer horizon of stability and help them to professionalize their business. On the other hand, they are usually faster to offer solutions than a financial institution. "Giving a third party entry into the capital of a company can help in a moment of transformation of the company - whether in growth or *distressed*- and generate value. It is always better than over-indebted or keeping 100% of the capital without being able to undertake actions that allow you to grow or transform, "adds the KPMG partner.

Once the decision has been made to use an alternative source of financing, the company will have to decide which investor profile best suits its needs. Colloquially it is spoken of the funds as a whole, when the strategies vary enormously from one manager -or vehicle- to another. Experts explain to this publication that, for now, funds specializing in special situations are the ones that are seeing the most opportunities in the country. For Ignacio Gómez-Sancha, managing partner of the Madrid office of Latham & Watkins, " *distressed* debt funds and *special situations* are studying less liquid investment opportunities, while *direct lending funds* are being more cautious waiting for the situation stabilize. "

Martínez-Fidalgo, for his part, adds that "there has been a first phase in which the funds had to lick their wounds, everything has dropped and it is a good opportunity to invest, but the portfolios have lost a value of between 20 and 30%. Creditors are, at the moment, supporting companies in the form of *waivers* that sometimes allow things that in a normal market would not be acceptable to creditors. It remains to be seen what will happen when companies have *defaults* and creditors of these are *distressed* funds ... where garment executions will surely be seen. "

In the case of *private equity* , despite the fact that this situation may represent an opportunity due to the drop in valuations, most are more concerned with managing their portfolio companies and, many of them, have closed their investment committees. Gómez-Sancha explains that "in the world of M&A we expect the *deal flow* to increase a lot at the end of the year. Many *private equity* funds have a lot of *dry powder*- money available to invest-, although right now they are more focused on managing their portfolios than in making new investments. "

José María Gil-Robles: "There will be much more M&A in the coming months, but sellers will have price expectations that will not be met"

In this sense, the partner of Latham & Watkins exposes that one of the strategies that these investors are considering is the massive repurchase of debt: "The *private equity* funds with investees that have issued bonds whose prices are badly punished are considering buying back massive debt. This requires additional disbursements and raises a profitability problem (IRR) of that new disbursement. In addition, there is a subordination risk if there is a bankruptcy in the future. When the owner of a business lends money, if the company goes bankrupt , that debt is subordinated and is the last to be recovered. "

Regarding this, Martínez-Fidalgo argues that "there should be repurchases of bonds by *private equity* funds these months, but everyone's priority now is liquidity. If you have an unlimited amount of *dry powder* , the temptation is to buy bonds or secondary bank debt, but you have to be very clear that you are not going to run out of money in the company. "

Regarding the future, José María Gil-Robles, partner in charge of the Corporate department at DLA Piper, points out that "there will be much more M&A in the coming months, but sellers will have price expectations that will not be met. " "All the *private equity* funds , which have a lot of money to put into operation, have seen this situation as a great opportunity to invest at reasonable prices," he adds. "In general, taking positions that do not imply control within a company will be easy to carry out and in the *mid-market there* will continue to be good opportunities. However, we will see how the operations that require takeover or take longer require a lot of funding, "continues DLA partner Piper.

On this, Ramón Galcelán, Managing Partner of Financial Advisory Grant Thornton adds that "within the *private equity* of *mid-market* have different feelings, but in general all are taking it calmly. When finance operations, departments Risk managers are telling them that they can bring the approval of these transactions to a committee, but that they now have other priorities - especially liquidity - the funds don't mind waiting for a while because they can see the company's evolution and be clear about the impact of this crisis on their accounts. "