4 Recession Strategies for Private Equity

CATALANT

Introduction

Inflation has remained sticky in the face of rising interest rates which has led us to a seemingly unavoidable recession.

In parallel, organizations across the world are navigating an energy crisis, continued supply chain disruption, changed consumer behaviors, and new workforce dynamics.

Private equity as a business sector can be resilient and capable of expansion throughout times of market volatility, weak economic growth, and recession. [There are three main reasons for this.]() Private equity:

1. Can invest at low valuations.
2. Has access to flexible capital.
3. Supports and backs their portfolio companies (and the leaders of those companies).

Read this playbook to learn from Catalant Experts about four recession strategies that private equity firms can deploy to outperform public markets, use times of uncertainty as an advantage, and recover quickly post-recession.

Private equity as a business sector can be resilient and capable of expansion throughout times of market volatility, weak economic growth, and recession.

Understand which sectors fare best during recessions and why.

An experienced consultant on Catalant's Expert Marketplace, Romain Ichbiah, and his team researched the Great Recession in 2008-2009 and for a number of sectors calculated 1) a "recession index" (how well or poorly those sectors fared during the downturn) and 2) a "recovery index", (how fast those sectors bounced back after the recession).

While the economy took a massive hit during the recession in 2008, there were sectors, and specific companies within those sectors, that came out of the global financial crisis relatively unscathed. According to Ichbiah and Company's analysis, the sectors which fared best then were Consumer Staples, Energy, Utilities, and Healthcare. These sectors represented non-discretionary expenses which are hard to cut back on.

Romain and his team also noticed that some of the best performing stocks over the period were in those sectors (shared on the next page).

Romain A. Ichbiah

Managing Director of [Ichbiah and Company]

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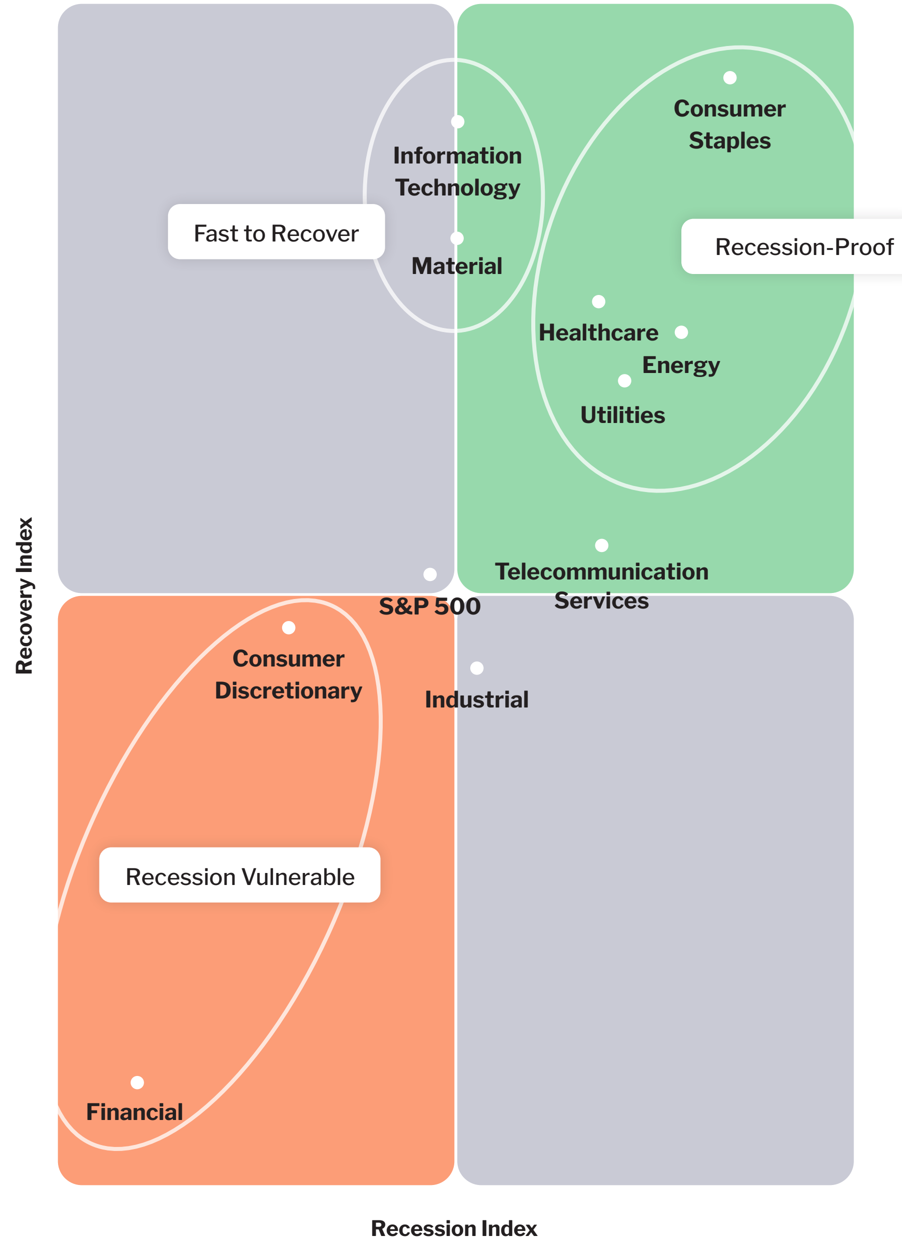
Sector Decline and Recovery: 2008 Recession



Source: [Ichbiah and Company analysis]

S&P 500 - Top 40 Best Performing Stocks: January 2008 to December 2009

Ichbiah and Company's analysis shows the majority of the best performing stocks during this time period were in recession proof sectors or aligned with the trend of frugality.

● Recession Proof / Fast to Recover Sector

○ Sector Aligned With A "Thrift" Trend

Rank	Company	Share Price CAGR		Sector
1	Concho Resources Inc.	47.6%	●	Energy
2	Netflix, Inc.	43.9%	●	Information Technology
3	Westrock Company	40.8%		Containers/Packaging
4	Priceline (Booking)	37.9%		Other Consumer Services
5	Edwards Lifesciences	37.4%	●	Healthcare
6	Dollar Tree, Inc.	36.5%	○	Discount Stores
7	F5 Networks, Inc.	36.3%		Telecommunications
8	Vertex Pharma	35.8%	●	Healthcare
9	Ross Stores, Inc.	29.2%		Apparel Retail
10	Skyworks Solutions	29.2%		Information Technology
11	Ford Motor Company	21.9%		Motor Vehicles
12	Red Hat, Inc.	21.8%	●	Information Technology
13	Tractor Supply	21.4%		Specialty Stores
14	Cerner Corporation	20.9%	●	Information Technology
15	Western Digital	20.9%	●	Information Technology
16	Allergan PLC	20.8%	●	Healthcare
17	Micron Technology	20.7%	●	Information Technology
18	Amazon.com, Inc.	20.5%	○	ECommerce Store
19	Nektar Therapeutics	17.9%	●	Healthcare
20	Alaska Air Group, Inc.	17.6%		Airlines

Rank	Company	Share Price CAGR		Sector
21	Netapp, Inc.	17.3%	●	Information Technology
22	Cognizant Technology	15.6%	●	Information Technology
23	Autozone, Inc.	14.8%	○	Specialty Stores
24	Mylan N.V.	14.5%	●	Healthcare
25	Ralph Lauren	14.5%		Apparel/Footwear Retail
26	Digital Realty Trust	14.5%	●	Information Technology
27	Alexion Pharma	14.1%	●	Healthcare
28	AMD	13.6%	●	Information Technology
29	TJX Companies, Inc.	12.8%	○	Apparel Retail
30	Darden Restaurants	12.5%		Restaurants
31	Hasbro, Inc.	12.0%		Recreational Products
32	Cimarex Energy Co.	11.6%	●	Energy
33	General Mills, Inc.	11.5%	●	Consumer Staples
34	A.O. Smith Corporation	11.3%		Building Products
35	Carmax, Inc.	10.8%	○	Specialty Stores
36	Amgen, Inc.	10.4%	●	Healthcare
37	H&R Block, Inc.	10.4%		Other Consumer Services
38	IBM	10.0%	●	Information Technology
39	Celgene Corporation	9.8%	●	Healthcare
40	J.M. Smucker Company	9.6%	●	Consumer Staples

Source: Ichbiah and Company analysis

The outliers in the above list performed well in spite of the negative impact in their market. They pursued at least one of the following strategies: 1) Aggressive cost-cutting or divestitures, 2) M&A, and 3) Expansion into high growth regions.

Interested in more?

Ichbiah and Company LLC can share the full set of data and specific approaches taken by some of these leading brands.

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Align your strategic response with the **recession profile** of your sector.

Ichbiah and Company continued their work in building specific response strategies for both PE firms and for portfolio companies. The following matrix outlines some recommended steps for PE firms, based on sector type - including seeking M&A bargains, consolidation, or simply weathering the storm.

Potential Recession Response Strategies for PE Firms

	Sector Dynamics		
Typology	**Behavior During The Recession**	**Behavior During The Recovery**	**Recommended Fund Strategies/Theses**
"Recession-Proof"	Same or better than usual growth	Same or better than usual growth	• Continue investing in the space but expect more competition/high valuation for deals • Be prepared to invest for growth
"Slow to Recover"	Same or worse than before growth	Same as usual growth	• Seek "bargains" but with a long-term horizon only
"Fast to Recover"	Same or better than usual growth	Better than usual growth	• Seek "bargains" with short-term return potential • Invest in growth, early on
"Very Recession Vulnerable"	Much worse than before growth	Same or better than usual growth	• Potential to consolidate sector (roll-up), adding distressed assets; in those spaces even more than elsewhere, this will become a buyer's market

Very Negative | Somewhat Negative | Neutral | Somewhat Positive | Very Positive

Source: Ichbiah and Company analysis

Align your strategic response with the **recession profile** of your sector.

Ichbiah and Company continued their work in building specific response strategies for both PE firms and for portfolio companies. The following matrix outlines some recommended steps for Portfolio Companies - including layering sector dynamics and competitive response to build a response.

Potential Recession Response Strategies for Corporate and PE Portfolio Companies

	Sector Dynamics		Recommended Company Strategies	
Typology	**Behavior During The Recession**	**Behavior During The Recovery**	**Strong Competitive Position**	**Challenged Competitive Position**
"Recession-Proof"	Same or better than usual growth	Same or better than usual growth	• Stay the course / business as usual and potentially do opportunistic M&A	
"Slow to Recover"	Same or worse than before growth	Same as usual growth	• Weather the storm • Capture near-term efficiencies • Continue investing for the long-term • Seek efficiency-driven M&A opportunities	• Capture near-term efficiencies
"Fast to Recover"	Same or better than usual growth	Better than usual growth	• Weather the storm • Continue investing in growth to prepare for the strong uptick	• Capture near-term efficiencies • Agile investments in innovation
"Very Recession Vulnerable"	Much worse than before growth	Same or better than usual growth	• Cost-Efficiency play • Seek efficiency-driven M&A opportunities	• Consider a potential sale or exit

Very Negative | Somewhat Negative | Neutral | Somewhat Positive | Very Positive

Source: Ichbiah and Company analysis

Align your strategic response with the **recession profile** of your sector.

M&A Trend: The Silver Tsunami

Many PE firms see success today when they take advantage of the Silver Tsunami. About 45% of small businesses are owned by Baby Boomers — millions of those Boomers are retiring every year and selling their businesses in order to do so. This creates a unique opportunity for private equity firms that are seeking bargains to acquire dozens of these deals as valuable roll-ups or tuck-ins.

Due to the nature and size of these acquisitions, firms are also staying operationally and cost efficient by leveraging independent consultants for these deals rather than traditional consulting firms (as they would for bigger acquisitions). Independent consultants often have experience at high-end consulting firms and can manage deals and flip those newly-acquired small businesses across your portfolio at a lower price point than a traditional firm. In fact, that's what Sean O'Dowd, an Expert on Catalant's Marketplace and ex-BCG consultant, has been hired time and again to help his clients with.

Sean has helped several PE firms take advantage of the Silver Tsunami. "With such a high volume of such small deals, firms don't need the same type of support they historically needed for acquisitions. Independent consultants are the right people to manage these deals due to their expertise and price point," he says. Independent consultants like Sean are also able to support post-close deal team needs — especially during the first 100 days — to establish a strong foundation for the newly-acquired small businesses.

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Sean O'Dowd
Strategy Consultant | Ex BCG | Wharton

Get In Touch

Improve active management through an agile workforce.

One of the reasons private equity can succeed during economic downturns and recover faster than public markets is due to active management. Throughout times of uncertainty and recession, as well as hiring freezes and layoffs, critical work throughout the entire deal cycle still needs to get done. That's why an agile workforce — or agile consulting — is so beneficial. An agile workforce enables active management at all times because it entails quickly harnessing the power of flexible and agile/independent consultants, who often have prior work experience at "Big 4" and F500s, to accomplish your critical and strategic goals across operating roles and your portfolio.

For example, research shows that PE firms with value creation teams outperformed firms without them during the 2008 global financial crisis. Establishing an agile workforce that can manage value creation and has operating experience in areas that typically require "hard-to-access expertise" (such as transformation management or data and analytics) is the key to giving your PE firm a competitive advantage.

Here are three ways leveraging an agile workforce at your firm enables active management:

1. **Hire for the job to be done.** Rather than hiring a full-time employee or using a traditional consulting firm (through which you may be assigned a consultant who doesn't have much — or any — experience working on a project like yours), quickly hire for the precise expertise that your projects require on an as-needed basis.

2. **Create a proactive and flexible talent bench.** Base your bench on immediate and future needs to efficiently complete high-quality portfolio projects so investments are likely to quickly reach their full potential.

3. **Work with the person who is actually doing your work.** Unlike when working with a traditional consulting firm where you'd find yourself communicating with a Partner, communicate with the consultant who is actually on the ground and executing your projects.

Leverage An Agile Workforce To Enable Active Management Across The Entire Deal Cycle

Prioritize **understanding** consumer behaviors and **improving** CX across your portfolio.

One value creation strategy used by the PE firms that have succeeded throughout past recessions is focusing on consumer behaviors and customer experience (CX). Throughout times of economic uncertainty and recession, it's important to consistently evaluate consumer behaviors and trends, and use CX to identify the best investment opportunities to differentiate your portfolio from the competition.

> "Companies across nearly every industry are adjusting to new consumer behaviors and undergoing digital transformations. These fundamental shifts are happening faster than ever before and require changes to **operating models, workforce design, market strategies, and brand differentiation.**"

Pat Petitti
Catalant Co-founder and CEO

Customer experience is a company's ultimate differentiator. As Jeff Weiser, former CMO of Shopify and Shutterstock and current Operating Partner at L Catterton, said in an interview, companies that have reached "true exit velocity" are those that create "brand affiliation that drives repeat purchase, advocacy, etc." **A key benchmark for anyone investing and gauging the starting point from which they'd create value is to understand how customers are experiencing the product/service and the business.** This entails analyzing customer experience metrics including NPS and brand awareness funnels, and understanding how that experience is being created through activities across different channels and where improvements can be made.

Perform due diligence across potential and current portfolio investments to identify challenges that have surfaced as a result of factors like economic volatility and COVID-19. Then think about how each company has worked to manage those challenges. For example,

- Have there been several digital transformations?
- Have the customer journey and customer segments been updated to reflect the business today?

Then ask yourself how these challenges, and the changes company leadership has made as a result, impact customers.

- How does the company's main product/service stack up against your competitors in the current environment?
- Has the product/service use case changed?
- Does the operating model need to be updated to accurately reflect new consumer behaviors and expectations?

By implementing a customer-centric approach and performing both quantitative and qualitative due diligence, you'll:

1. Improve customer loyalty and retention across the portfolio.
2. Adjust offerings according to consumer demand, needs, and behaviors.
3. Identify areas of the business can be trimmed or cut to effectively use resources.

Catalant's **Impact**

The world's leading private equity firms leverage agile consulting to solve their strategic business problems.

Access highly-skilled independent consultants with experience at top consulting firms and Fortune 500 giants for projects across the deal lifecycle.

8,000+

Experts from top consultancies

10,000+

Experts with Fortune 500 experience

19+

Average years of experience

Ready to learn more about how private equity firms and their leadership teams are using Catalant to gain a competitive edge?

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