Private Equity VISIONARY


GERALD PARSKY

talks with Brunswick's **HARRY W. CLARK** about how the pandemic is re-shaping the priorities of private equity and society.

GERALD PARSKY IS CHAIRMAN OF LOS ANGELES-based Aurora Capital, a private investment firm overseeing more than $4 billion in capital. After serving as Assistant Secretary of the US Treasury from 1974 to 1977, he became a Senior Partner at Gibson Dunn & Crutcher, before founding Aurora Capital in 1991. A graduate of Princeton University and University of Virginia School of Law, he served for 12 years as a Regent of the University of California.

That background gives him a singular perspective on the impacts of the pandemic, both economic and social. He offers the *Brunswick Review* his thoughts on the outlook for private equity firms, the role of government and the alienation of the younger generation. Where all else looks gloomy, he is heartened by what he sees as the basic goodness of Americans.

The pandemic has exposed "fault lines in private markets: deal leverage recently reached a new high, and multiples paid in recent months reached a multi-year high," says McKinsey. What will recovery look like for PE?

The situation was in part caused by too many PE firms having an enormous amount of "dry powder" to invest (about $900 billion). The recovery will be gradual, and the returns for investments already made could be much lower than in the past.

One positive consequence will be the PE industry's return to a more traditional investment approach; namely, paying a reasonable multiple for a company, applying financial and operating expertise, selling the company and achieving a net IRR that is meaningfully higher than investing in public equities during the same period. In this reshaping process, investors will reward PE firms that remained disciplined during the overheated years.

How should PE firms respond to COVID-19?

A PE firm should reach out to each of its portfolio companies to guide them through this difficult time. Each portfolio company should be asked to stress test its balance sheet and operations to evaluate the impact of a protracted downturn/recession, and determine whether it could withstand a 40 to 50 percent decline in revenue in 2020.

What's the best piece of advice you've heard during the crisis?

Do not underestimate the length of the economic downturn/recession and be sure each of your companies has adequate liquidity. Where appropriate, draw down credit lines to create cash reserves.

Is there a repercussion or effect from COVID-19 you're surprised isn't getting more attention?

There will be significant, negative, long-term effects of the magnitude of government debt that is being created—and more is coming. As a result, government will have an ever-increasing role in all of our lives and this needs to be carefully managed. Deficit financing carries with it a very real risk. When interest rates rise, the cost of this debt will be significant.

ILLUSTRATION: ANDREW COLIN BECK

Are there similarities with historic events here? Does this feel like a more accelerated version of previous crashes or is it uncharted territory?
Except perhaps for the Depression, we have not experienced anything like this in previous "crashes"; in part because this has involved a complete shutdown of the world economy. That was not the case in the 1970s, 1980s, 1990s, or in 2008. Specifically, there could be a 30 to 35 percent decline in GDP in the second quarter and it could remain for the rest of this year. Even before COVID-19, I thought it was likely that we would have a recession in 2021.

Has the move to remote working been seamless for Aurora, or has it required some fine tuning?
It has been relatively seamless. After the experience of 2008, we adopted a "disaster recovery plan." We took immediate action in line with the directive from the Governor of California. All staff were provided remote access to enable them to work as efficiently as possible from home to keep them safe.

Do well-managed companies welcome or resist the management partnership Aurora offers?
Bringing operating talent to a company is welcomed by management. However, the executives we bring need to provide a light, but effective touch or they will be resisted. My close friend and partner, Larry Bossidy, the former CEO of Honeywell, is a perfect example of how positive an operating executive can be in private equity. He chaired a number of companies for us, several of which faced stress in the economy. In each instance, the executives welcomed his advice, operations significantly improved, and we realized outstanding returns.

You talked in a recent interview about millennial anger over income inequality and the cost of education. Does that anger represent a threat to economic stability?
We cannot afford a generation lost in anger. The youth of today need to be the business leaders of tomorrow and many of them feel they are being left out. Before COVID-19, a survey of millennials indicated that 23 percent declared that "they have no friends." The COVID-19 pandemic, and the social distancing required, could increase this feeling of loneliness. As we come out of this crisis, we have to address the feelings of our youth. If we do not, we are planting the seeds of an "angry, lonely generation." Such a result will have a significant impact on our economy.

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Any personal thoughts, economic or otherwise, about life during lockdown?
It has made me realize how important family and friends are in one's life. It also can help you realize how fortunate you have been to have lived in a free society and a capitalistic economic system.

A crisis can help bring about the best in people. Just consider the number of Americans who risk their lives every day to help those who have been struck by the virus. I am optimistic that the kindness and support we have seen during these difficult days will continue to shape us as we recover.

The Los Angeles mayor appears to be a strong leader at this moment. Do you feel reassured or not by our political leadership in this pandemic, local and national?
There certainly are examples of leadership from our political figures. However, there remains too much emphasis by some on blaming others for this crisis. As a result, the public is not reassured enough that this crisis will be addressed effectively. There will be plenty of time to evaluate what was not done to prepare for this crisis. Now is the time to come together to address the present and prepare for the future.

Do you see any silver linings to the pandemic?
It has provided us many examples of the goodness of our people. All you have to do is observe members of the emergency response teams, who put themselves in real danger every day helping others, in order to understand what so many Americans are like.

Should the financial and environmental challenges facing California be an important concern for investors everywhere?
California is the fifth largest economy in the world; now larger than Great Britain. However, the State's Public Employee Pension Systems have enormous "unfunded liabilities," which, for healthcare alone, now approach several hundred billion dollars and growing. In addition, California has a tax system that relies too heavily on the personal income tax, the most volatile form of tax. As a result of COVID-19 and the recession to follow, California's revenue shortfall over a two-to-three-year period could approach $70 billion to $90 billion, thus dwarfing the budget reserve that existed before this crisis of about $20 billion to $25 billion. Such a situation for California's economy should be a concern to all investors. ◆

HARRY W. CLARK is a Senior Counselor to Brunswick. He was Counselor to Ambassador Bob Zoellick and the Office of the US Trade Representative.