Today's Webinar Presentation

# COVID-19 Related Impacts to Financial Markets

*Presented by*

*FEI Dallas Chapter*

*August 31, 2020*





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3

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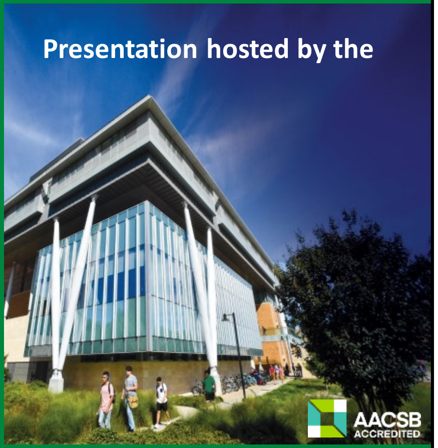


4

## Thanks to our Presenters


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5

# *Covid-19 related impacts to financial markets*


Stuart Gillan
Meredith Rhodes
Jon McCarry

UNT | G. BRINT RYAN COLLEGE OF BUSINESS Department of Finance, Insurance, Real Estate & Law


6

## Quick introductions

Stuart Gillan

Meredith Rhodes

Jon McCarry

7

## Overview of the session

Stuart Gillan
- Governance and strategy considerations

Meredith Rhodes
- Fed and Treasury actions & cost of capital

Jon McCarry
- Evolving strategies of players in private markets

Q&A

8

*Governance and strategy in the Covid-19 environment*

Stuart Gillan

G. Brint Ryan Professor of Finance

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9

## Time of unprecedented scrutiny

- Broad societal focus on companies and Environmental, Social, and Governance actions
  - Stakeholders vs shareholders
- Increased oversight of corporate behavior and performance
  - Investors, Media, Regulators, Ratings Agencies
  - Both private and public firms

10

# Be aware of optics

- Taking PPP loans/grants
- Announcement of COVID-related business developments
  - Employee stock trading?
    - Particularly prior to the release of non-public information
    - Even if you are not public but have public partners
- Timing and size of equity-based pay relative to COVID-related developments

11

11

# Some high-level capital market developments

- Regulatory changes from the SEC
  - Opening Private Equity Funds and Hedge Funds to more investors
  - NYSE direct listing plan approved by SEC
    - Nasdaq's in process
- Increased SPAC activity
- Bankruptcies on the rise
- Ratings agencies are increasingly ready to downgrade

12

12

## Short term strategies

- Focus on working capital management
  - Cut unnecessary expenses
  - Freeze hiring
  - Pay reductions/furloughs, layoffs?
  - Suspension of buybacks/dividends
- Freeze investment
- Asset sales
  - Non core assets
- Debt restructuring
- Strategic bankruptcy
  - Restructure / liquidate

13

## Financing strategies

- Alternative types of financing
  - Factoring receivables
  - Sale and lease back of assets
  - Convertible preferred
- Leveraged loans / high yield debt markets
- Fed facilities e.g.
  - Primary Market Corporate Credit Facility
    - Investment grade firms
  - Main Street Lending Program
    - Financially sound small to mid-sized firms sans capital market access

14

## Longer term

- Ongoing consideration of factors listed in the short term strategies
- Refinancing
  - Lower cost of debt?
    - Subject to current covenants & tax considerations
- Be cognizant of "Zombie" customers/suppliers
  - Current government actions may be supporting some firms on the precipice
- Ongoing relationships with stakeholders
  - Customers, Suppliers, Employees, Providers of capital

15

## Longer term

- V-shaped stock market recovery
  - But a disconnect from the economy as a whole
- Many observers are confident that a biological solution will lead to economic recovery
  - Albeit with structural changes for many industries/individuals
  - Concern that other pandemics may occur
- Use this experience to assess
  - Business strategies
  - Crisis response strategies
  - ESG and stakeholder relationships

16

## *Federal Reserve's COVID-19 Response*

Meredith E. Rhodes, PhD CFA

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17

## Overview of the Fed's Response

- Total of 9 emergency lending facilities
- Designed to support:
  - State and local governments
  - Bank lending
  - Market function
  - Corporations and small businesses

18

# Support Financial Market Function

- Quantitative easing (QE)
- Money market mutual fund liquidity facility (MMLF)
- Primary Dealer Credit Facility (PDCF)

19

# Support of Businesses

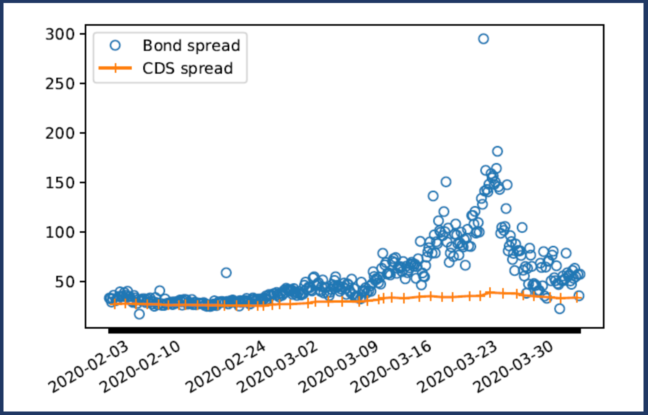
- Primary Market Corporate Credit Facility (PMCCF)
- Secondary Market Corporate Credit Facility (SMCCF)
- Commercial Paper Funding Facility (CPFF)
- Main Street Lending Program
  - New Loans Facility
  - Expanded Loans Facility
  - Priority Loans Facility

20

# *Impact on Corporate Debt Markets*

21

# *Market Distress*




Source: Haddad, Moreira, and Muir (2020)

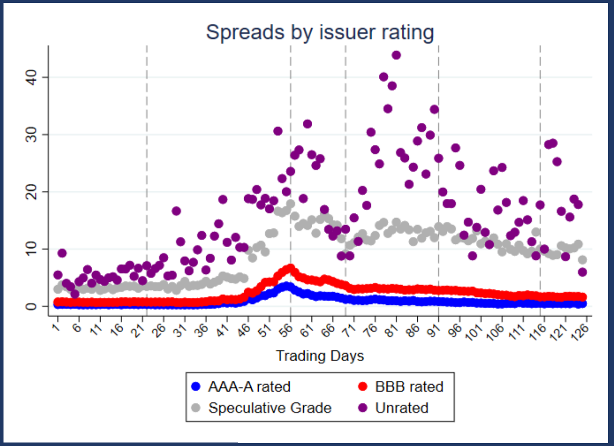
22

# Significant Events & Dates

- March 23:
  - Primary and Secondary Corporate Credit Market Facilities (PCCMF, SCCMF)
- April 9:
  - Expansion of PCCMF and SCCMF (size and scope)
  - Mitigated Fallen Angel Risk
- May 12:
  - Fed began buying ETFs
- June 16:
  - Fed began buying individual corporate bonds

23

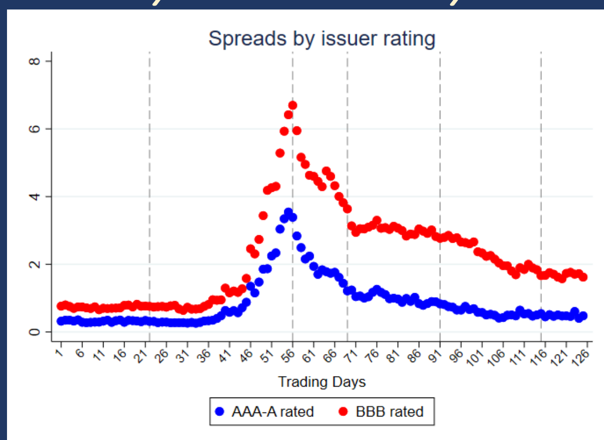
# Secondary Market Activity




Source: Arnold and Rhodes (2020)

24

## Secondary Market Activity



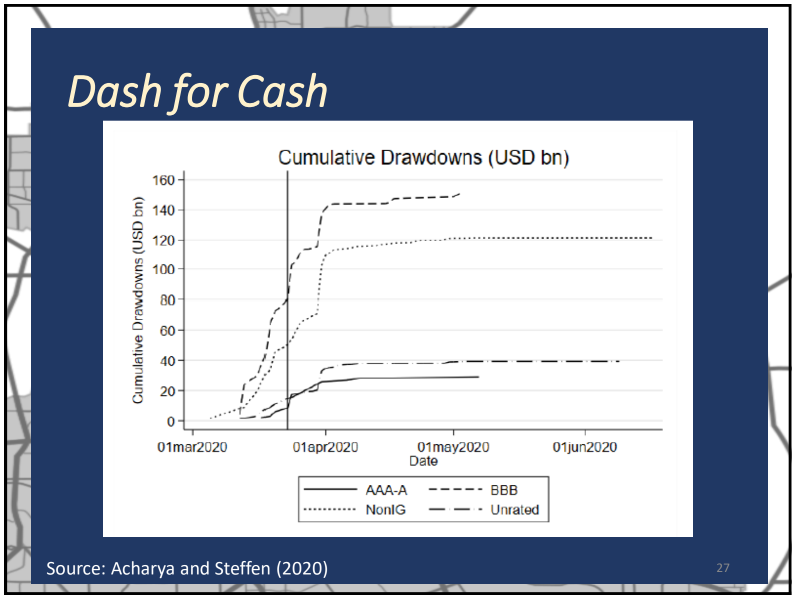

Source: Arnold and Rhodes (2020)



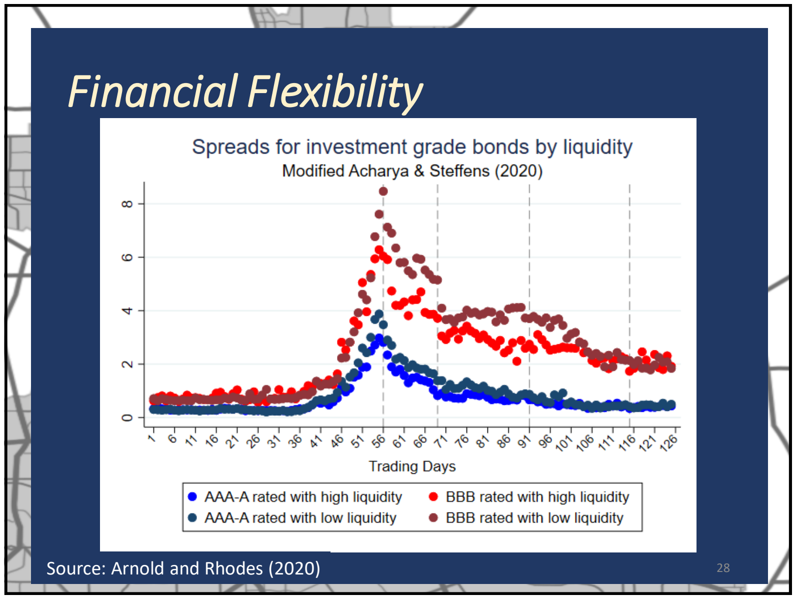


## Corporate Flexibility

- Onset of Crisis:
  - Companies drew down credit lines and increased cash holdings ("Dash for Cash")
- After PCCMF & SCCMF announcement (March 23)
  - High quality companies switched to capital markets to raise cash
  - Market differentiated across firms with financial and operating flexibility
- Fed's verbal commitment vs. actions

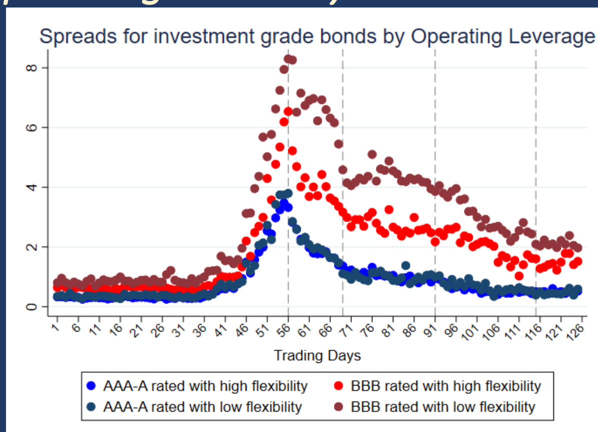

Dash for Cash
Cumulative Drawdowns (USD bn)
Cumulative Drawdowns (USD bn)
0
20
40
60
80
100
120
140
160
01mar2020
01apr2020
01may2020
01jun2020
Date
AAA-A
BBB
NonIG
Unrated
Source: Acharya and Steffen (2020)
27

27


Financial Flexibility
Spreads for investment grade bonds by liquidity
Modified Acharya & Steffens (2020)
0
2
4
6
8
Trading Days
AAA-A rated with high liquidity
AAA-A rated with low liquidity
BBB rated with high liquidity
BBB rated with low liquidity
Source: Arnold and Rhodes (2020)
28

28

## Operating Flexibility




Source: Arnold and Rhodes (2020)

29

## Covid-19 related impacts to financial markets

Jon McCarry

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30

## Valuation & Investments

- Valuations dwindled less than many industry professionals expected
- Ample dry powder in the industry has allowed VCs to continue making investments—even large ones—during the second quarter
- Venture firms generally more conservative, leading to downturn in capital invested and number of deals completed in Q2

31

## Valuation & Investments (cont’d)

- Portfolio companies became cautious and reduced their burn rate through layoffs, cost-cutting, and curtailed expansion plans
- Late-stage VC deals outpaced early stage in Q2, as investors protected their largest and “best” investments
- First-time financings fallen sharply to multi-year lows as a proportion of overall VC activity
- Uncertainty will persist in the next few quarters

32

## Fundraising

- Top 15 funds raised in H1 2020 totaled USD 22.7 B
  - Over half of all VC fundraising
  - VC mega-funds (funds USD 500+ M) contributed to a spike in the average fund size to USD 300.9 M
  - LPs consolidating manager relationships and investing in top-quartile managers
  - Much of success related to positive historical performance and name recognition, helpful when no face-to-face meetings possible
  - First-time funds saw noticeable drop in new closed funds (only USD 1.5 B across 14 funds in H1)
- VC managers becoming more traditional multi-strategy asset managers utilizing different strategies

33

## Fundraising (cont'd)

- Over past few years, strong returns by VC funds and distributions back to LPs have allowed GPs to raise larger funds and encourage larger allocations to VC
- As of Q3 2019, net cash flow moved into negative territory for the first time since 2011, potentially signaling future changes

34

## Exit Environment

- Venture shown exit and fundraising strength over the past few years
  - Large stockpile of dry powder and net cash flows to LPs
  - Developed a material amount of goodwill in the industry
  - Many GPs should weather a short-term liquidity blip
- 2020 exits trending to be the lowest since 2011
- Exit value trending below pre-2017

35

## Exit Environment (cont’d)

- Q2 saw 147 exits close with a value of USD 21.2 B
  - Half-year total capital exited USD 45.3 B
- An extended economic decline would change longer-term behaviors around VC commitments
- Funds may take longer to liquidate and have higher proportions of unrealized value than in the past
- Sharpest drop in count of IPOs and buyouts of VC-backed companies (50% of 2019 totals)
- Signs decline could be a short-term disruption

36

# Exit Environment (cont'd)

- By end of Q2 IPOs had some positive momentum
  - Companies outside of the biotech industry
  - Special purpose acquisition companies (SPACs)
  - More tied to the rebound in public equity prices and government stimulus rather than a full recovery
- Some companies choosing to return to private markets for large fundraises; delay a public listing
- Longer liquidation cycle means more risk builds
  - 2012 vintage funds still have a pooled RVPI of 1.34x at the seven-year mark, whereas that value is less than 0.90x for every vintage before 2006

37

37

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38

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## Thanks to our Presenters

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40