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KPS's Psaros: 'Some companies are going to blow up'

A number of turnaround investors have applied their models to healthier businesses over the past decade amid a shortage of distressed opportunities.

A combination of interest rate hikes, elevated leverage and heaps of dry powder could present restructuring opportunities for private equity buyers, according to Michael Psaros, founder of manufacturing and industrials specialist KPS Capital Partners.

Businesses in these sectors are having to contend with spiky inflation and disruption to global supply chains, Psaros told Private Equity International. This dynamic is likely to create a bifurcation between those that can find alternate sources of supply and pass costs on to the customer, and those that cannot.

"Some companies are going to blow up," he said.

KPS, the 80th largest private equity manager in the world according to the PEI 300, has been busy during the pandemic. The New York-headquartered special situations firm has completed $9.5 billion in acquisitions since June 2020, $8 billion of which came from Europe, Psaros said.

He added that only one of the firm's investments in this period could be considered distressed in the traditional sense, and noted that – with the exception of Q2 and Q3 of 2020 – there have been few distressed industrial opportunities since the global financial crisis.

In the 30 years since its inception, one fifth of KPS's transactions have been in connection with bankruptcies, mostly in the late 1990s and 2000s, according to a spokesperson for the firm. Over the past 11 years, the firm has completed only two such deals.

Psaros said that two-thirds of KPS's investments have been complex corporate carve-outs that presented opportunities to make the most of "undermanaged" assets, with the firm having found ways to apply its turnaround toolkit to traditional, non-distressed investing.

Psaros: Any opportunity to make a company better is a turnaround

"Any opportunity to make a company better is a turnaround," he added.

Such transactions typically enable the strategic seller to de-consolidate and receive meaningful proceeds, while continuing to participate in the upside value creation. The deals end up looking a lot like "continuation vehicles for corporates", Psaros said.

One such example is golf brand TaylorMade, which KPS acquired from German sports goods company Adidas and exited last year. The firm invested $175 million in cash and returned $1.6 billion to its investors, having taken the business from a negative $150 million EBITDA to a positive $200 million.

Less distress

KPS is not the only firm that has adjusted to fewer distressed opportunities over the past decade.

Though Boca Raton-headquartered Sun Capital Partners has historically been associated with distressed investing, the majority of its portfolio is now understood to comprise healthier companies with the potential for operational value-add. Its holdings range from fourth-quartile distressed assets through to second-quartile performers.

When investing on the more distressed end of that spectrum, Sun Capital places greater emphasis on specific sub-industries to identify appealing targets, co-chief executive Marc Leder said. "If the industries or sub-sectors weren't healthy, the turnaround measures wouldn't stick," he added.

Simon Finn, managing partner of London-based special situations firm Intriva and a former managing director at Apollo Global Management, also believes there is a "false dichotomy" between value and growth.

Intriva looks "to invest in situations where we can assist management teams to grow," Finn said, noting that the firm prioritises day-one operational impact regardless of whether the business is well-capitalised or distressed.

"You need to have far more than just the capability of producing a presentation and talking to LPs," he added. "That's 'been there and bought the t-shirt'. This is the second rodeo."

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