

POWERHOUSES IN PRIVATE EQUITY

ANATOMY OF A PANDEMIC DOWNTURN

Having co-led the middle-market private equity business of The Carlyle Group, Rodney Cohen recently joined Connecticut-based Black Diamond Capital Management to lead the firm's distressed-for-control business. In a wide-ranging conversation with RSM's Don Lipari, Cohen describes his transition to Black Diamond, the firm's approach to investing, and the right way of thinking about the "real economy" in the U.S.



Rodney Cohen
Head of Private Equity
Black Diamond Capital Management



Don Lipari
National Industry Leader, Private Equity
RSM US LLP

Don Lipari, RSM: Talk about your brand-new role.

Rodney Cohen, Black Diamond Capital Management:

Well, it certainly was not what I had planned. I left Carlyle on March 2nd [2020]. I started with Black Diamond, running their private equity business, on March 3rd. Black Diamond is a special situations investor. They have three business lines: a standard credit business, which is more of a CLO business; a credit hedge fund; and private equity, which has largely been distressed-for-control.

Lipari: The team you now lead is not a bunch of rookies who haven't previously dealt with pressure situations. It sounds like your team really rose to the occasion.

Cohen: This is a team that is used to being under fire. In our first meeting, I asked about all the logical things you would think about: How's the portfolio? Do we have ample liquidity? What should we be doing? It was fascinating. We got on a Zoom call, I went around the room, and everybody had done probably 80 percent of what I was suggesting we do.

There are certain businesses that are obviously affected in ways where there's only so much you can do. It was really an eye-opener to see how different people reacted to this, how banks were reacting. There's a lot of forbearance agreements in place right now. There's a lot of handshakes right now. Everyone's hoping for a vaccine, but how quickly will that come? And how long is the runway for some of these businesses operating at 50 percent, 20 percent capacity?

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The equity markets are screaming hot. You look at your own personal portfolio, and say, "Wow! Things are really good!" And then, you look at what we call the "real economy." The government did the right thing stepping in. Standing by and doing nothing was not really an option. But whether it's a new administration or the same administration, there's going to be a moment where the foot is going to have to come off the gas, and this will be a telling moment about the real state of the economy.

Lipari: What was attractive to you about joining Black Diamond?

Cohen: Black Diamond financed one of our deals for us. There was a very, very successful transaction where we bought a refinery out of a bankruptcy proceeding. We were having a really tough time finding financing and, ultimately, we ended up with Black Diamond. The founder of Black Diamond and I went to high school together. We'd known each other a long time.

Our way of thinking about the world and thinking about downside protection is similar. You know, that credit orientation. To us, we come at everything as the glass is half empty. We're thinking about all the things that can go wrong, not the things that can go right. The analysis is real down and dirty: How protected are we? I grew up with that. At Black Diamond, that is what they do. They start with complicated, messy situations and analyze how we effectively get control over a business.

For years I felt like we were going to end up not with a pandemic, but in a space that would reset somewhat. I just didn't know when or why. With respect to what happens next, you see very conflicting things going on. Many people on unemployment are actually making more money now than they

"Many of these middle-market businesses may not come back."

—Rodney Cohen, Black Diamond Capital Management

were employed. There are a lot of things that the government has done that were necessary, otherwise we'd have Armageddon on our hands where everyone's out of work and we're in a depression. But I think many of these middle-market businesses may not come back. I question whether we're going to see a snap back to the way things were before. There was a lot of damage done, a lot of people that won't have jobs automatically, a lot of buildings that will never fill up again at the rates that they thought they would.

Surveying the Damage

Lipari: Rodney, talk about the sectors that you think are going to be particularly attractive to Black Diamond, and which ones are you going to steer clear from?

Cohen: We've been nervous about the energy sector. We feel there's no way to quantify the risk/reward proposition. There are many macro factors that are affecting energy that scare us. It may be an industry that's two bankruptcies away from getting cheap enough that it makes sense again.

We're not in restaurants. We're not in retail rollouts in general. There are some businesses that might even prosper out of this, but we're very cautious. We're intentionally a generalist. We've had real success in chemicals, basic industrial businesses, media, consumer brands. We deliberately want to be opportunistic. We love the finance industry, like the equipment rental business.

As the market stabilizes, what is going to pop back first? I worry about the travel sector. With that said, would we buy a casino or a hotel at a good price? If we're comfortable that we can wait this out for two years or three years. You have to go into it prepared for the worst. I always tell people that a category is never completely off the radar for us. You never want to miss a needle in a haystack.

Lipari: I think Black Diamond is well positioned to shine through the pandemic and on the other side of the pandemic.

Cohen: We focus on the middle market and distressed-for-control, not a trading strategy. We're not doing a trade and hoping to get taken out. We're really hoping to end up controlling the situation and creating the business at a price that makes sense for us. When you look at the giants of the industry – you know, the mega, mega capital firms – they're

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always going to do gigantic deals in that space. At our size, I might have to get involved initially by putting \$10 million or \$15 million to work. We're just playing in a different segment of the market. I've always liked the middle market. I've never really had an interest in bigger transactions because there's more competition and it's more efficient.

The middle market is a funny place. A lot of companies do end up in bankruptcy court, whether it's a restructuring or a 363 sale or reorganization. What's interesting about bankruptcy court is, if you don't really know what you're doing, it doesn't really happen the way you think it happens. If I was on trial for my life, I'd want someone representing me who had done that 350 times. I feel the same way about our business.

Lipari: What are your expectations with regard to a coming wave of distress?

Cohen: We think about it in two ways. One, which part of the curve are we in? Our belief is that there's a bunch more pain to come. A lot of the pain has been disguised by [government] support. That said, our internal discussion has been, "Look, if we find a deal we love, we're going to do it." We're not going to look for the very, very bottom.

We do believe that come year-end, there will be some companies that have been operating right on the margin, and people might start to say, "Enough." I'm not praying that we're going to have a massive dislocation, but I do think there will be some really interesting businesses that run out of cash. We can wear many different hats and sit down with them and offer equity, credit, a bridge loan.

Black Diamond has 60 people doing nothing but looking at credits. And we own a subset of the market, roughly 600 names. We're looking at their EBITDA and where their end markets are going. We can bring in different analysts that cover different end markets. I always say, leverage is king in this business, but not financial leverage – intellectual leverage. If you can get people around the table who have different ways of looking at things and different pieces of information and start to pull all those pieces together, it's not that you're always going to be right, you're just going to make more informed decisions.

I think we have a very special mousetrap. It's a very exciting place. And I think the last 10 years have taken a lot of competitors out of the business. They've just gotten tired of waiting. There should be a time for us where we really enjoy a cycle that should be incredibly prosperous for our investors. ■



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