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How Houlihan Lokey views the corona crisis

By Philipp Habdank

Definitely more restructuring business and soon more M&A mandates again? The investment bank Houlihan Lokey has not yet written off the year 2020 despite Corona - partly because of cases like Takko. The coronavirus pandemic has dried up the M&A market: ongoing M&A deals are on hold, financing for new transactions is expensive and on top of that limited. M&A advisors and investment banks are also feeling the effects of this, but they do not want to write off the year 2020 completely.

Two reasons are cited for this: On the one hand, the first M&A buy-side mandates could come into sight after the summer, especially if private equity looks ahead again. Above all, however, after years of sluggishness the order books are filling up with restructuring projects, as the negative consequences of the corona crisis are now likely to materialise in corporate balance sheets.

Corporate finance advisors who are active in both areas should be able to compensate at least partially for the decline in M&A business via the increasing number of restructuring mandates. One such boutique is Houlihan Lokey. Headquartered in the US, the investment bank has 22 offices worldwide, one of them in Frankfurt, where Tobias Rieg heads the corporate finance business.

The boutique is active in three business areas: More than half of the global turnover comes from corporate finance business. Restructuring mandates account for 30 percent of revenues, Financial and Valuation Advisory for 15 percent.

Houlihan Lokey has grown strongly in Germany

In Europe, Houlihan Lokey has recently grown primarily in the area of corporate finance, also through the acquisition of smaller M&A boutiques such as Leonardo in 2015. According to its own statement, Houlihan Lokey has tripled the number of employees in corporate finance in Europe to around 170 bankers in the past five years. Of these, 25 are members of the German corporate finance team, where the focus is on the SME business.

Private equity investors are a key customer group of Houlihan Lokey. The boutique maintains a separate global unit to serve them. In Germany, Managing Director Christian Keller is responsible for the private equity business. He came to the boutique last year from HSBC, where he was responsible for the leveraged finance business and acquisition financing.

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Christian Keller, Managing Director, Houlihan Lokey

Keller assesses the situation in the private equity industry as follows: "At the beginning of the crisis, the focus was on portfolio companies to secure their liquidity and business operations. Credit lines were drawn down, working capital was reduced, short-time work was introduced, investments were postponed. But most of the measures have now been implemented."

Private equity must now position itself

Now many funds are already looking ahead again, reports Keller: "The funds have a lot of capital, and the machine keeps running. The question for private equity investors is now which companies, sectors and deal structures they should now focus on".

This is where every investor has to ask himself some tough questions: Do you invest exclusively in crisis-resistant companies or do you also dare to invest in restructuring cases? Do you dare to make the new platform deal or do you initially rely on cheaper add-ons? Is a majority shareholding absolutely necessary or is a minority shareholding sufficient at first? Can the financing be initially "all equity"?

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Tobias Rieg, Managing Director, Houlihan Lokey

"Many private equity houses say that they are relatively flexible when it comes to the question of majority or minority. But few can be as flexible and go into debt," Keller is certain. The LBO banker expects more creative transaction structures and can envisage more cases where the buyer initially enters into a minority stake but secures a call option to take over the company completely later. Managing Director Tobias Rieg from the Corporate Finance team has a similar view: "We expect more carve-outs from strategists. In the private equity sector, there will be more transactions, initially purely equity-financed, to make deals. We will also see more vendor loans." For private equity investors these are rather atypical financing channels, but the market for classic LBO loans is currently very limited.

What debt funds demand from private equity

According to Houlihan Lokey, the banks in particular are currently finding it difficult to grant new LBO loans. "One reason is that they have a lot to do with getting the flood of applications for KfW loans under control. On the other hand, it is currently difficult to correctly determine the EBITDA and leverage for new deals," says Patrick Schoennagel from Houlihan Lokey's Debt Capital Markets team.

Private Debt is more flexible in this situation, as seen in EQT's acquisition of Schülke or in the recent deals of Gimv and Hannover Finanz. However, the debt funds are also charging for their willingness to finance. According to Schoennagel, credit funds demand not only higher interest rates but above all the certainty that loans at these conditions will be outstanding longer.

"Do I accept these conditions or do I initially finance the takeover all equity and bet that the market will improve again?"
Patrick Schoennagel, Managing Director, Houlihan Lokey

Private equity investors must therefore weigh up the options now: "Do I accept these conditions or do I initially finance the takeover all equity and bet that the market will improve again and that the leverage can be followed later on at better conditions," asks Schoennagel.

Houlihan Lokey is involved in the restructuring of Takko

It is also questionable who is the less complicated financing partner in crisis situations: bank or debt fund? Credit funds in Germany advertise being more flexible than most banks. But lenders in this country have not yet shown how constructively they deal with restructuring and how high their own restructuring competence actually is.

This is attracting restructuring experts. Houlihan Lokey, for example, is currently involved in the restructuring of Takko, according to a report by the rating agency Moody's. The fashion company cannot pay its bond interest and is facing a comprehensive balance sheet restructuring. In this case, Houlihan Lokey represents the interests of a group of bondholders.

Whether it's a new private equity deal or a restructuring case: In the corona uncertainty, Houlihan Lokey believes that sector know-how is more important than ever. Last year the boutique brought in Martin Bastian, a sector specialist from Credit Suisse, to head Houlihan Lokey's European chemicals sector team. More are to follow.

Keller finds that many private equity investors have also taken advantage of the lull in the M&A market to build up specialist knowledge. "We have an incredible number of discussions with private equity about where the investment opportunities lie now and in the future," says Keller. The second half of the year will show whether private equity can take advantage of them.

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