



SCOTT ADELSON

Agenda

The co-president and global co-head of corporate finance at Houlihan Lokey talks to Danielle Myles about the firm's bull-bear balance, its ascent to the top of M&A league tables, and why independents are attracting the best talent.

NOT MANY BANKERS CAN CLAIM TO HAVE WORKED AT THE SAME GLOBAL INVESTMENT BANK FOR TWO-THIRDS OF ITS EXISTENCE. Scott Adelson, however, is one of them. He joined Houlihan Lokey in 1987, just 15 years after the Los Angeles-headquartered firm opened its doors, and has spent the past three decades helping build it into one of the world's leading independent investment banks.

Now co-president and global co-head of corporate finance, Mr Adelson has many reasons to be upbeat. In its fiscal year ending March 2017, the bank made a record total revenue and earnings-per-share growth of 48% year on year.

RESTRUCTURING TRAILBLAZER

Such figures suggest Houlihan Lokey's unconventional investment banking strategy is working. As with other independents, the bank does not use its balance sheet to serve clients, but what sets it apart is complementary strengths in both corporate finance advisory – encompassing mergers and acquisitions (M&A) and capital markets – and restructuring.

The latter is where Houlihan Lokey made its name. It effectively started the business of financial restructuring, having launched the US's first dedicated group after spotting a gap in the market.

“Back in the late 1980s, when complicated balance sheets with multiple layers of capital first came about, it became clear that creditors with claims to various parts of the business were not going to see eye to eye if things ran into trouble,” says Mr Adelson.

“When the downturn started a few years later, we were the first ones there restructuring some of the largest troubled companies,” he adds. “And that business has grown every cycle since then.” That opportunistic decision 30 years ago gave Houlihan Lokey a first-mover advantage; today it has the biggest (by head count), and arguably most sought-after, restructuring team in the world.

BULL-BEAR BALANCE

While Houlihan Lokey is renowned for its expertise dealing with financial distress, its M&A capabilities deserve as much kudos. The bank has made some big hires in recent years and now has dedicated bankers in 70-odd subsectors. It regularly tops M&A league tables for deal volumes in the sub-\$1bn category, and in 2016 claimed top spot for all US M&A (by number of deals).

“I've been here 30 years, and the fact that we now do more deals in the US than any-

body else – including the likes of Goldman Sachs or JPMorgan – is something I'm proud of, and means I have to pinch myself occasionally,” says Mr Adelson.

Strength in inversely correlated businesses, such as M&A and restructuring, creates what he describes as a bull-bear balance. The bank can win fees throughout each stage of the economic cycle, without having to shuffle staff between its divisions.

“Many institutions are what I'd call ‘run for the ball’. When markets turn down, they move everyone into restructuring, and when markets are hot they move everyone back into other businesses,” he says. “We have enough scale that we don't do that.”

MID-CAP BUOYANCY

Houlihan Lokey's ability to perform throughout the cycle is further buoyed by a sensible decision to focus predominantly on mid-cap M&A. More than 90% of US M&A deals are sub-\$1bn, and history shows that small to mid-cap M&A is more resistant to economic downturns than jumbo deals.

As a result, the firm's M&A business experiences less volatility than rivals that target \$1bn-plus deals. It also requires more patience from its bankers, who must act as true advisers rather than just deal-makers. “We really believe that you go about doing a \$750m transaction very differently than a \$75bn one,” says Mr Adelson. “We are very geared towards those mid-cap clients who may not have armies of professionals in house that do what we do for a living.”

This mid-cap strategy extends to other parts of corporate finance, and has proved particularly fruitful over recent years. As capital charges have curtailed banks' ability to lend, many borrowers have taken a closer look at alternative asset providers – including hedge funds, credit opportunity funds and business development companies.

“While the large institutions are certainly still in the business of lending, they aren't very focused on the mid-cap segment of the market,” says Mr Adelson. “So we continue to see a growing number of borrowers accessing those alternative sources of financing which are more opaque, and therefore benefit from having someone guide them in accessing that capital.” This, he says, bodes well for the bank.

SUPPORTIVE FUNDAMENTALS

After a strong 12 months, Mr Adelson feels positive about Houlihan Lokey's year ahead. Interest rates are still low enough to encourage financing, and 2016's healthy M&A market is continuing. It is underpinned by, inter

alia, the now established principle that value is created through consolidation, and private equity firms needing to deploy their huge amounts of dry powder.

Notably, Mr Adelson says the cross-border deal outlook is still robust despite the protectionist and anti-globalisation sentiment emanating from the new US administration.

“Foreign companies want to get into the US, and businesses still want to expand their geographies, so we continue to see a meaningful number of cross-border deals,” he says. “On the whole, I would say businesses take a longer term view. For those wanting to build a global business a year ago, they’d probably still feel the same today.”

Although default rates are low, the bank’s restructuring group has plenty to keep it busy. Irrespective of the economic backdrop, there are always individual sectors experiencing periods of upheaval. Good examples today are petroleum, which is still reeling from the 2014 collapse in oil prices, and retail, which is battling to adapt to customers’ shift to online shopping.

Houlihan Lokey has led some of these sectors’ most notable deals from the past 12 months, including SandRidge Energy’s pre-arranged Chapter 11 plan, which eliminated \$3.7bn of debt and preferred stock, and the R29bn (\$334.7m) debt restructure of Edcon, South Africa’s biggest clothing retailer.

BATTLE OF THE MODELS

Independents such as Houlihan Lokey have a key vantage point of the changing investment banking business model. They bear witness to the growing number of specialist boutiques doing advisory work, and are taking mandates away from the historically dominant bulge-bracket firms.

Mr Adelson views some start-ups with a little scepticism. “Many of them have been set up by a couple of superstar bankers who continue to work for a handful of their large clients,” he says. “Some of those businesses built around the persona of those individuals have grown to become more institutionalised, but the majority [of them] plateau and don’t reach any true scale.”

He is equally quick to point out the drawbacks of being a bulge-bracket investment bank today. These include higher capital charges (which have hit full-service investment banks harder than advisory firms), but also difficulties attracting – and keeping – the most talented investment bankers.

He sees it as a matter of priorities. “When you are responsible for capital, your first, second and third responsibilities have to be to that money,” he says. “Whereas, if

I’m an independent adviser who doesn’t control capital, my first, second and third responsibilities are to the employees that drive the business.”

Looking at the challenges faced by its smaller and bigger competitors, Mr Adelson considers Houlihan Lokey to be in the sweet spot for increasing its share of the global investment banking wallet and building the best advisory teams.

“I do believe that investment banking as a whole hasn’t done a particularly good job of promoting itself in recent years to attract the best and brightest,” he adds. “[But] it is proving much harder for the depository institutions to compete for talent, so I think the independents will be the ones continuing to grow.”

PARTNERSHIP-STYLE CULTURE

For those wanting proof that independents are good at keeping bankers happy, they need look no further than Houlihan Lokey; its top management has, by and large, been at the bank for 30 years. Mr Adelson says it is surprising how little the culture has changed since he joined 30 years ago: it still fosters a collaborative, collegial and entrepreneurial work environment.

He puts this down to continuity of management and of team structure. “That bull-bear balance means we don’t expand and contract like an accordion, as most investment banks do as markets change,” he says. “It means people have worked together for a really long period of time, and has perhaps helped maintain the partnership-style culture.”

Equally impressive is that this culture has survived, despite Houlihan Lokey’s developing into a truly global bank. Its first overseas office, London, opened just 16 years ago, yet today it has operations in some 24 cities spanning each major region. This was through a combination of organic growth and growth through acquisition, but in every case the driver has been clients. Bigger clients need servicing around the globe, while others need to be connected to foreign capital, buyers and sellers.

In addition to serving Houlihan Lokey well as a business, this client-centric approach paves the way for some rewarding relationships. It is epitomised by one of Mr Adelson’s transactions in which he helped sell the business of a 90-year-old client.

“At that point, he explained how we changed the life of his children and family for generations to come,” Mr Adelson says. “That man is now 101, and he still calls me every six months to say thank you.” **FB**

Career history

Scott Adelson

- 2013** Co-president, Houlihan Lokey
- 2006** Senior managing director, Houlihan Lokey
- 2000** Global co-head of corporate finance, Houlihan Lokey
- 1995** Managing director, Houlihan Lokey
- 1993** Senior vice-president, Houlihan Lokey
- 1991** Vice-president, Houlihan Lokey
- 1990** Senior associate, Houlihan Lokey