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Sense of the Markets: Europe's Coming Restructuring Boom

Companies will struggle as governments reduce support post-pandemic; but other dynamics are also at work in Europe.

By Jonathan Braude

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Bankruptcies tend to rise when economies pull out of recession. Companies that have survived the downturn by borrowing, cutting costs and running down their reserves, are left without capital to invest in growth when demand picks up and either go bust or seek additional financial support.

In preparation for the upturn, law firms and consultancies across Europe are hiring restructuring specialists, who will be ready to start work once government support for businesses winds down and the Covid-19 pandemic is brought under control. As The Deal's reporting has shown, some are even setting up new corporate restructuring practices from scratch.

In the past few weeks, for example, law firm Dechert LLP has hired Adam Plainer to expand its London restructuring practice while Simpson Thacher & Bartlett LLP has brought in Adam Gallagher and James Watson to start a new restructuring practice in the U.K. Both firms are stepping into a market previously dominated by Kirkland & Ellis LLP.

Elsewhere, turnaround and restructuring advisory firm Alvarez & Marsal LLC has picked off Deloitte partner Christian Ebner to focus on the German and Italian markets, and EY partner Thomas Marcorelles to join its Paris office. It made similar hires during the course of 2020 in Switzerland, the Nordics and Spain.

Yet two of the Big Four accountancy firms, have taken the opposite path. Deloitte LLP has sold its entire U.K. restructuring practice to CVC Capital Partners Group-backed consultancy Teneo Holdings LLC while KPMG's even larger U.K. restructuring group is has been bought by another private equity firm, H.I.G. Capital LLC, to be established as an independent company to be called Interpath Advisory.

When the time comes newly configured teams in the U.K. and in continental Europe will be ready to tackle the restructuring needs of struggling businesses as they arise.

To some extent, Europe is behind the U.S. in this. While the U.S. has largely made financial support available to individuals, Europe, because of its traditional focus on preserving jobs, has supported companies through government-backed loans and state-subsidized furlough plans that keep idled employees on the payroll.

"The U.S. economic model provides employers the necessary tools to address a sustained downturn in demand," says Joseph Swanson, Houlihan Lokey Inc. co-head of restructuring for Europe the Middle East

and Africa and co-head of Asia. "You can deal with your cost base quite efficiently by laying off staff.

"It follows logically, that as we come out of recession, the level of activity in Europe should be higher than in the U.S. We think a wave is coming, but because of repayment deferrals and other forms of support that were given across Europe, the activity will be spread out over time."

Those deferrals will likely also mean there will be a pipeline of work for restructuring professionals for years to come.

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wave will involve.

Restructuring Reigns

In the years since the financial crisis, there has been a shift in Europe and the U.K. away from the traditional path for troubled companies that led straight from insolvency to asset sales and liquidation. Instead there is greater reliance on U.S. style workarounds and debt restructuring.

"Healthy businesses don't liquidate, they restructure," says Swanson. "Permanently damaged businesses liquidate."

The old-style insolvency administrator and liquidator is having to move with the times and become a restructuring expert, working with creditors

to enable consensual agreements on debt for equity swaps and recovery programs.

These are processes to which the U.S. law firms have been better attuned than their U.K. or European counterparts, although that may change as European firms learn to compete.

The shift has been driven, in part, by a change in culture that no longer sees all insolvency as moral failure, a change that has led to gradual changes in insolvency law across Europe

More, importantly, it has also coincided with the move from bank-loans to leveraged debt, to direct lending by non-bank players and to investment by debt funds.

These funds have become an increasingly important part of the market, and have taken over from the banks providing non-investment grade credit.

Swanson describes Houlihan Lokey as structured around providing a range of investment banking services to a focused clientele of private capital providers, including private equity funds, alternative credit funds, direct lenders and other forms of private credit. It is prepared to leave public debt and equity to what he calls "the legacy banking world."

"The new generation of investment banks is, not exclusively, but mainly geared around the emergence of growing private capital markets, which are becoming massive," he says.

This fragmentation of the market for financial services into specialist areas with different strengths and clientele may also help to explain the moves by Deloitte and KPMG to exit what has traditionally been a lucrative business for the big accountancy firms.

In recent years, Deloitte, KPMG, PricewaterhouseCoopers LLP and Ernst & Young LLP, have seen themselves as professional services firms rather than accountants. They Big Four have acted as one-stop shops, providing M&A advice to mid-market companies, consultancy, restructuring and insolvency services, and acting as liquidators, as well as their core auditing and accountancy work.

They have come under regulatory pressure to separate their audit work from their investment banking and consultancy work, to avoid any perception of conflicts of interest. But they have also been less able than more focused institutions to provide the niche services required by different specialist clients.

"The one-stop shop model for financial advisory services worked best before there was sufficient size and depth to the market to support specialist offerings," argues Swanson.

"This is the story of a maturation of European capital markets, with a deepening and diversification of product offerings providing companies with increased options to raise debt and equity," he concludes.

"As you get more sophisticated and deeper capital markets, you are clearly going to get an evolution of the service provider community and that is

what you have seen happen in London over the past few decades."

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