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Greenhill's recap — first step to going private?

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Greenhill & Co. Inc.'s planned recapitalization shored up its share price, but did not outwardly address long-term issues. My views on the company can be summarized in an adage I heard years ago from a value investor, and a question: bought right is at least half right; and why is Greenhill a public company?

Greenhill announced on Sept. 25 that it would recap the company through borrowing $300 million and raising an additional $20 million via common shares sold to Chairman Bob Greenhill and CEO Scott Bok. The funds will be used to repay all of the company's bank debt, which approximated $80 million at June 30, and repurchase up to $235 million of common through a tender-offer for nine million shares at $17.00 per share and open market purchases thereafter. The dividend will be curtailed or eliminated, the prospect of which may cause a stampede among some shareholders to tender. If the dividend is completely eliminated, it will free roughly $60 million annually for debt service in which interest expense is tax deductible, while dividends are paid with after-tax earnings.

The Street gets paid, too. Every deal that involves cash has a simple table for sources and uses of cash. Sources total $320 million, while uses that I count total $305 million. Aside from miscellaneous items, I assume the Street is absorbing the rest in the form of advisory fees (Goldman Sachs is leading the syndicated loan) and legal counsel.

The recap potentially is a great trade by savvy bankers who have struggled the past several years to grow revenues and earnings. Year-to-date results are particularly disappointing with EBITDA of just $15 million, compared to $49 million to $94 million during fiscal years 2013 to 2016, according to S&P Global Market Intelligence data.

The shares have significantly underperformed publicly-traded investment bank peers by declining 40% year-to-date and 68% over the past five years, as of Sept. 29, a timespan that includes the 17% gain on Sept. 26, the day after the recap announcement. Ironically, or just sadly, the $17.00 per-share tender price to repurchase a large amount of equity is close to the $17.50 per-share price for the 2004 IPO. Another perspective is seen in the pricing of a follow-on offering in 2010 in which shareholders — the company received no proceeds — raised $253 million by selling three million shares for $84.45 per share, or about five times the tender-offer price.

The recap constitutes a partial going-private transaction, if there is such a thing. A company either is public or it is not. The plan to purchase up to $235 million of shares compares to the company's market cap as of Sept. 29 of $493 million. Greenhill is a small cap that is going to get smaller — though its enterprise value will not change immediately after the transaction occurs because debt will replace equity financing.

The recap may be the first of a two-step process to take the company private, depending upon the course of events. If the company performs okay and/or markets are depressed in a few years when the recap debt is presumably partially amortized, then it may make sense to buyout the remaining public shareholders. Alternatively, if the company does well or great, then existing shareholders and management will make a lot of money, if not make a ton of money. Going private then presumably would be too expensive, and employees holding restricted equity awards understandably would want to monetize the shares if the price is high.

Whether the proposed recap proves to be a blockbuster trade, a bust or something in between, I question whether Greenhill and similar advisory firms should be public companies. The transaction business, unlike asset management and commercial banking in which revenues accrue daily, is inherently lumpy. Plus, the assets walk out the door each day to go home, and sometimes they go to another firm. Is that a business model that merits much of a multiple of earnings, EBITDA or book value? I think not, but sometimes investors are willing to put generous multiples on businesses that seemingly do not merit it.

Before Wall Street partnerships went public, most partners bought and sold based upon the firm's book value. New partners might be granted units and/or have attractive financing arranged to fund the purchase. Selling partners did not necessarily obtain immediate liquidity. It would not be uncommon for selling partners with significant interests in their firms to have to wait several years to convert their partnership units into cash. An IPO "solves" this issue even if the firm's soul is sold to the devil. Selling partners get immediate liquidity, and perhaps at a multiple of book value rather than "just" book value. Plus, publicly traded shares provide the means to more easily acquire other firms and recruit new employees. But going public entails a high cost in the form of SEC registration, meeting (or failing) investor quarterly earnings expectations, and pressure to grow or else. Greenhill finds itself at the "or else" stage.

Wall Street's track record of partnerships morphing into public companies is not great, and for that matter many private firms have disappeared over the decades as inevitable downturns that follow booms consume the weak. Even Goldman Sachs Group Inc. and Morgan Stanley had to morph into bank holding companies to obtain TARP capital and the implicit backing of the government to make it through the financial crisis. KBW tried the private-to-public route when it went public in 2006 at $21.00 per share and then agreed to be acquired by Stifel Financial Corp. in late 2012 that, at announcement, valued the shares at $17.50 per share.

I have no idea what the future holds for Greenhill or the markets; nor does Greenhill management, although management more so than anyone else has a good sense about the company's prospects over the next couple of years. That said, the recap has the makings of a good and maybe great trade because the key variable any investor controls when committing capital is price paid. Or, more succinctly, bought right is at least half right. Perhaps Greenhill is buying right and will get lucky to buy the remaining public shares at a later date for an attractive price to go private. That seems logical to me, unless business soars over the next few years, at which point it would be prohibitively expensive to become a private company.

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