Investment Summary

Sell Recommendation

We issue a **SELL** recommendation for Houlihan Lokey (HLI) based on our **estimated price of 92.95**, triangulated between our Dividend Discount Model, Excess Return Discount Model, and Price to Book (P/B) multiplier model. Our target price represents a **19% downside from the closing price of 114.96** on Jan 14, 2022. We believe that HLI share price has likely overshot its fundamental value as investors overreacted to the historically positive returns of the past year.

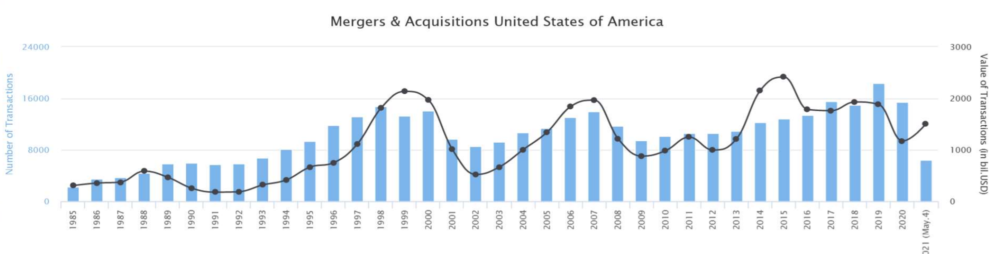
114.96 -2.51 (-2.14%)
At close: January 14 04:00PM EST

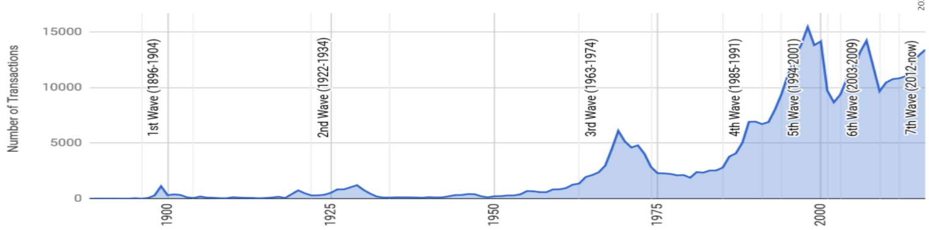
Previous Close	117.47
Open	116.74
Bid	0.00 x 4000
Ask	0.00 x 1100
Day's Range	113.37 - 116.74
52 Week Range	63.38 - 122.62
Volume	666,289
Avg. Volume	388,004
Market Cap	7.852B
Beta (5Y Monthly)	0.70
PE Ratio (TTM)	19.00
EPS (TTM)	6.05
Earnings Date	Jan 26, 2022 - Jan 31, 2022
Forward Dividend & Yield	1.72 (1.50%)
Ex-Dividend Date	Dec 01, 2021
1y Target Est	111.14

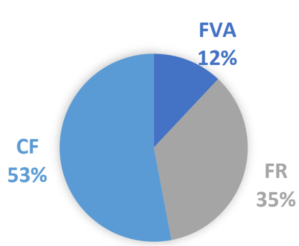
Source: Yahoo Finance

We believe that an analysis of the major economic events and political decisions that occured during the peculiar period 2020-2021 can explain much of these returns and why we should not expect similar performance in the near future.

Using the graph below, we can see that times of financial stress (dot com bubble, financial crisis), coupled with Central Bank's expansionary monetary policies (low-interest rate) have historically created favorable M&A environments.





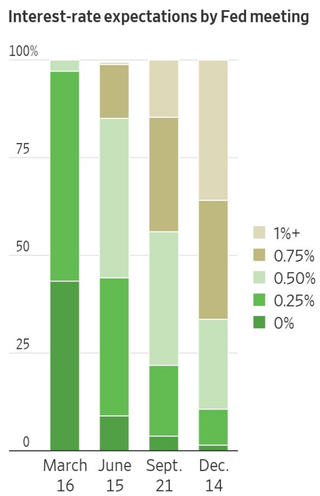


The COVID-19 induced crisis has created the perfect market conditions for investment banks to thrive. In the past year, high levels of liquidity and low-interest rates have pushed buy-side activities, and in many industries, digitization and the emergence of new business models have driven M&A-enabled transformations.

The financial restructuring segment has further supported the company's strong performance, boosted by the COVID-19-induced disruption of businesses worldwide. This single segment's growth in profit has, in fact, exceeded 100% in 2020.

Looking at HLI market price between February and April 2020, the Financial Restructuring business is likely the core reason for HLI to not have fallen as much as their peers and the index.

Looking Forward

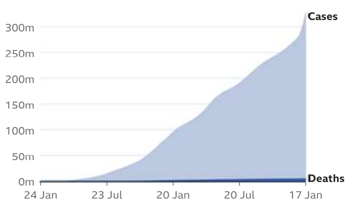


Fed officials recently pointed to a stronger outlook for economic growth and the labor market as well as continuing inflation than previously forecasted. Central bankers projected last month that they would raise interest rates three times in 2022 as the economy heals and inflation remains above the Fed's target. We think that those increases could begin as soon as March and, according to San Francisco Federal Reserve President Mary Daly, they could be quickly followed by the Fed's wrapping up of the large-scale bond-buying program that has been used in tandem with low rates to stoke the economy.

Following these decisions, we expect lowered M&A demand and Houlihan Lokey's revenue growth .

The rapid spread of the Omicron variant, its milder symptoms, and lower hospitalization compared to previous variants have seen numerous countries around the world starting the societal transition from pandemic to endemic. We believe that all US states will embrace this same approach by the end of 2022.

Historic examples provide evidence that the virus will probably never be eliminated entirely, but as more people get vaccinated and become exposed to it, infections will eventually arise at a consistently low rate, and fewer people will become severely ill.
Importantly, the return to normalcy won't happen evenly across the globe. An area where vaccination and booster rates are high will probably see endemicity sooner than a region with lower rates.



Source: BBC

Given that Houlihan Lokey operates mainly in developed countries, and earns 78% of its revenue from US operations only, we expect that the company's business operation will be affected by the (likely parallel) end of covid restrictions in developed countries and that the financial restructuring business will have considerably poorer performance in the next few years.

Conclusion

Given the above considerations, we forecast Houlihan Lokey's recent performance to slow and future annual growth to mirror the levels seen in the pre-pandemic era. Consequently, we forecast a stock price reversion towards our estimated intrinsic value of 92.95 and we reiterate our SELL recommendation.

COMPANY AND BUSINESS DESCRIPTION

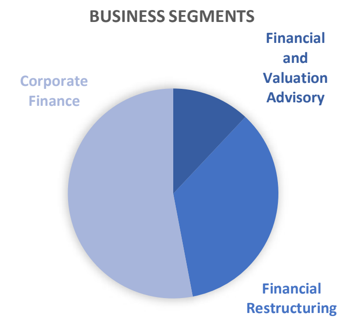
Overview

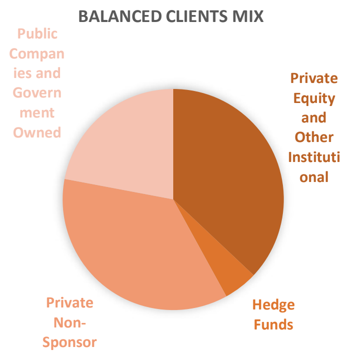
Established in 1972, Houlihan Lokey, Inc. is a leading global independent investment bank with expertise in mergers and acquisitions (M&A), capital markets, financial restructurings, and financial and valuation advisory.
The company serves a diverse set of clients worldwide, including corporations, financial sponsors, and government agencies, and operates three primary business practices: Corporate Finance, encompassing M&A and capital markets advisory; Financial Restructuring, both out-of-court and in formal bankruptcy or insolvency proceedings; and Financial and Valuation Advisory, including financial opinions and a variety of valuation and financial consulting services.
Nearly 80% of total revenue comes from US customers.

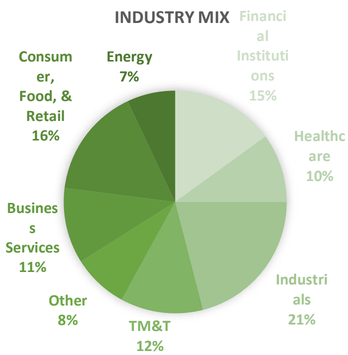
Public Offering

Houlihan Lokey held its initial public offering (IPO) on August 13, 2015 on the New York Stock Exchange under the ticker symbol HLI. An affiliate of Orix USA Corporation and certain employees sold the firm's shares of common stock at an initial price of $21 per share and raised approximately $220.5 million by the market's close.

Operating Structure







Source: HL Sustainability Report 2021

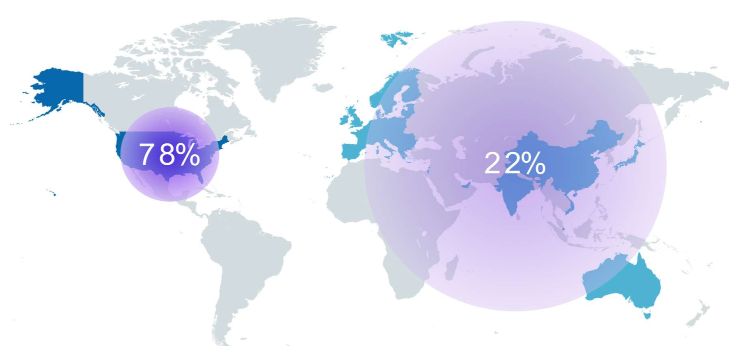
Houlihan Lokey operates in three segments: Corporate Finance (CF); Financial Restructuring (FR); and Financial and Valuation Advisory (FVA).

CF provides general financial advisory services in addition to advice on mergers and acquisitions and capital markets offerings. It advises public and private institutions on a wide variety of situations, including buy-side and sell-side transactions, as well as leveraged loans, private mezzanine debt, high-yield debt, initial public offerings, follow-ons, convertibles, equity private placements, private equity, and liability management transactions, and advise financial sponsors on all types of transactions. The segment generates nearly 55% of total revenue.

FR accounts about 35% of total revenue and provides advice to debtors, creditors, and other parties-in-interest in connection with recapitalization/deleveraging transactions implemented both through bankruptcy proceedings and through out-of-court exchanges, consent solicitations or other mechanisms, as well as in distressed mergers and acquisitions and capital markets activities. As part of these engagements, its FR business segment offers a wide range of advisory services to its clients, including the structuring, negotiation, and confirmation of plans of reorganization; structuring and analysis of exchange offers; corporate viability assessment; dispute resolution and expert testimony; and procuring debtor-in-possession financing.

FVA (more than 10% of revenue) primarily provides valuations of various assets, including companies; illiquid debt and equity securities; and intellectual property (among other assets and liabilities). These valuations are used for financial reporting, tax reporting, and other purposes. In addition, its FVA business segment renders fairness opinions in connection with mergers and acquisitions and other transactions, and solvency opinions in connection with corporate spin-offs and dividend recapitalizations, and other types of financial opinions in connection with other transactions. Also, its FVA business segment provides dispute resolution services to clients where fees are usually based on the hourly rates of its financial professionals.

Geographic Locations

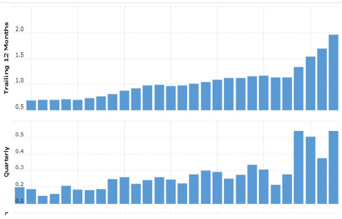


Revenue Distribution by Geographic Area

Headquartered in Los Angeles, California, Houlihan Lokey has US offices in Atlanta, Chicago, Dallas, Boston, Houston, Minneapolis, Miami, New York City, San Francisco, and Washington D.C.; and internationally in Amsterdam, Beijing, Dubai, Frankfurt, Hong Kong, London, Madrid, Milan, Paris, Singapore, Sydney and Tokyo. The company has more than 1,100 financial professionals across some 25 offices globally, serving more than 1,000 clients annually, ranging from closely held companies to Fortune Global 500 corporations.

Financial Performance

Revenue Growth over the years



The company, in FY2020, had revenues of $1.5 billion, a 32% increase compared with $1.2 billion for the year 2019. For the year ended 2021, CF revenues increased 24%, FR revenues increased 52%, and FVA revenues increased 17% when compared with the year ended 2020. In FY2020, the company had a net income of $312.8 million, a $129 million or 70% increase from the previous year. The company's cash at the end of FY2020 was $847.2 million. Operating activities generated $579.8 million, while investing activities used $99.7 million, primarily for purchases of investment securities. Financing activities used another $26.8 million, mainly for share repurchases and dividends paid.

Business Strategy

Houlihan Lokey executes on several growth initiatives, strategies and operating plans designed to enhance its business. For example, the company intends to continue to expand its platform into new industry and product sectors, both organically and through acquisitions, and to expand its existing expertise into new geographies.

In 2020, Houlihan Lokey agreed to acquire MVP Capital (MVP), an independent advisory firm that provides a range of advisory services to clients in the technology, media, and telecom (TMT) sector. The transaction adds substantially to the firm's coverage of the telecommunications sector and expands Houlihan Lokey's footprint in the US. The acquisition will add 25 financial professionals to Houlihan Lokey's TMT Group, including MVP's seven managing directors, bringing the global TMT team to more than 60 financial professionals.

INDUSTY OVERVIEW AND COMPETITIVE POSITIONING

Overview

Industries

- Business Services
- Energy
- Healthcare
- Real Estate, Lodging, and Leisure
- Financial Sponsors Coverage
- Consumer, Food, and Retail
- Financial Institutions
- Industrials
- Technology

Investment banks are financial intermediaries that performs various activities such as mergers and acquisitions, raising capital and security underwriting, retail and commercial trading, and sales and trading. The current investment banking industry has undergone significant changes that offer both an opportunity for success and the threat of future disruption.

For instance, higher capital charges, stuck cost base, market electronification and digitalization, inflexible and layered technology, and complexity of regulation and reporting are some of the factors that have become a key feature of the current investment banking, both regionally and globally.

Corporate Finance

Services

- Corporate Finance
- Financial Restructuring
- Financial and Valuation Advisory

In corporate finance, Houlihan Lokey has created a strong focus on the middle market where competition from big banks is lower and transactions are smaller. Over the long-term, HL is better positioned to enjoy the benefits of multiple tailwinds such as the booming middle-market M&A activities, prompted by the increasing private equity involvements and the baby boomers who are aging out their businesses; and the high performing bankers' preference to join boutique firms with favorable cultures and more job stability .

Financial Restructuring

Location

- North America
- Europe and Middle East
- Asia-Pacific

The key competitive advantage for HL is the positive reputation it has gained as a premier investments bank in restructuring transactions. In 2018, HL advised more restructuring deals than any of their competitors, having advised 12 of the 15 largest United States bankruptcies for the past 20 years. As a result, the company has seen incresed growth in demand for financial restructuring services during the coronavirus pandemic.

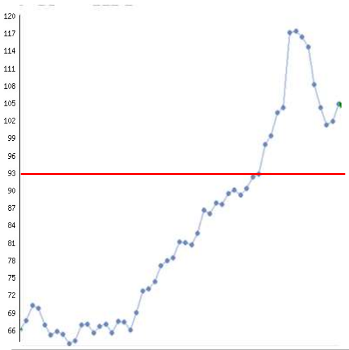
Source: hl.com

Financial Valuation Advisory

Houlihan Lokey is a global leader in valuation and advisory services. Within this service line, HL has positioned itself as an independent company free from corporate conflicts. As a result, Houlihan Lokey has profited from organizations' predisposition to hiring self-governing advisors. The company's independence in offering financial valuation advisory was a major factor for its success after the Global Financial Crisis.

VALUATION

Target Pricing



Our target price of $92.95 was derived as the weighted average of a combination of intrinsic and relative valuation methodologies including:

- dividend discount model [10%]
- excess return discount model [30%]
- P/B multiplier model [60%]

Given the peculiar financial structure of financial services firms which requires a unique treatment of debt, interest and regulatory capital, equity-side valuation approaches and multiples were deployed to incorporate the effects of financing directly.

Cash Flows Discounting Models

Excess Return to Equity Model

Our two-stage Excess Return model valued HLI at 111.61 USD per share assuming a cost of equity of 7% and a ROE of 21% in the next 3 years, followed by a terminal cost of equity and a terminal sustainable ROE of 6%, 13.7%, respectively. The forecast horizon of 3 years was used given the maturity of the business (operating since 1972) and the intrinsic inaccuracy that accompanies longer horizons' estimations. In the mature stage we assume the company risk will approach the market with a β of 1.

The excess return model is about discounting the value of equity in the firm to the present. We see the value of equity as the sum of the equity that is currently invested in the firm and the present value of the expected excess returns to equity from current and future investments:

$$\text{Value of Equity} = \text{Equity Capital invested currently} + \text{Present Value of Expected Excess}$$

The equity capital invested currently in the firm is measured as the firm's book value of equity. Although the book value of equity is an accounting measure and, as such, is affected by accounting decisions, we believe it is a reliable measure for Houlihan Lokey because:

- assets are periodically marked to market
- depreciation is negligible

To forecast excess returns to equity in the next 3 years we assume the near-future return on equity to be fairly approximated by the average ROE (Return on Beginning Shareholders' Equity) over the past 5 years (21%). Net income for the next 3 years is computed by multiplying the beginning book value of equity by the average ROE. Dividends payments are assumed to follow a Dividend Payout Ratio of 78%, which reflects the average payout for the past 5 years (38%) adjusted for the shares' buybacks. Book value of equity each year is augmented by the portion of earnings that is not paid out as dividends.

The terminal value of excess returns (after 3 years) is computed using a Gordon Growth Model.

$$\text{Terminal Value of Excess Returns} = \frac{\text{Net Income}_{2025} - \text{Cost of Equity}_{2025}(\text{BV of Equity}_{2025})}{\text{Cost of Equity} - \text{Expected Growth Rate}}$$

Hence, we obtain:

Book value of Equity Invested currently	1,383,561,000.00
PV of Equity Excess Return – next 3 years	522,191,679.00
PV of terminal value of excess returns	5,436,712,416.00
Value of Equity	7,342,465,095.00
Number of shares	65,785,042.00
Value Per Share	111.61

Dividend Discount Model

Our two-stage Dividend Discount model valued HLI at 90.71 USD per share assuming a cost of equity of 7% and a yearly dividend growth of 4.6% in the next 3 years, followed by a terminal cost of equity and a terminal sustainable growth rate of 6% and 3%, respectively.

The dividend growth for the first 3 years is computed considering the adjusted payout ratio of 78% and a roe of 0.21 After the third year we assumed the company to reach a sustainable mature phase with an annual growth of 3%. As noted previously, cash dividends are not the only yearly payment to shareholders. In fact, since its public offering in 2015, Houlihan Lokey has been repurchasing its shares yearly, implicitly benefiting shareholders. We thus believe that share buybacks should also be included in the model to get a more accurate picture of the company value.

$$\text{Intrinsic Value} = \frac{\sum_{t=0}^{T} (D_t + \text{Average Yearly Buyback})(1 + \text{Initial Growth Rate})^t}{(1 + \text{Cost of Equity})^t} + \frac{\text{Terminal Value}_T}{(1 + \text{Cost of Equity})^T}$$

$$\text{Terminal Value}_T = \frac{\text{Dividend}_T(1 + \text{Expected Growth Rate})}{\text{Terminal Cost of Equity} - \text{Expected Growth Rate}}$$

Ex-Dividend Date	Dividend
Dec 01, 2021	0.43
Sep 01, 2021	0.43
Jun 01, 2021	0.43
Mar 01, 2021	0.33
Dec 01, 2020	0.33
Sep 01, 2020	0.33
Jun 04, 2020	0.31
Mar 04, 2020	0.31
Dec 04, 2019	0.31
Sep 04, 2019	0.31
May 31, 2019	0.31
Mar 01, 2019	0.27

PV at t=1	2.31
PV at t=2	2.35
PV at t=3	2.51
PV stable dividend	2.42
Sum of PV	9.61
PV Terminal Value	81.10
Value Per Share	90.71

Relative Valuation

P/E

P/E Ratio TTM	19.01
Price to Sales TTM	4.03
Price to Cash Flow MRQ	16.58
Price to Free Cash Flow TTM	13.35
Price to Book MRQ	5.46
Price to Tangible Book MRQ	14.18

An issue that is specific to financial service firms is the use of provisions for expected expenses. These provisions reduce the reported income and affect the reported price earnings ratio. Consequently, banks that are more conservative about categorizing bad loans will report lower earnings and have higher price earnings ratios, whereas banks that are less conservative will report higher earnings and lower price earnings ratios. Another consideration in the use of earnings multiples is the diversification of financial service firms

PE Ratio Range, Past 5 Years

13.53 Minimum DEC 24 2018	23.60 Maximum MAR 30 2017
18.90 Average	19.09 Median

earnings from commercial lending should be very different than the multiple that the same investor is willing to pay for a dollar in earnings from trading. When a firm is in multiple businesses with different risk, growth and return characteristics, it is very difficult to find truly comparable firms and to compare the multiples of earnings paid across firms. Based on this considerations we do not consider the P/E multiple as a reliable estimator of the company value.

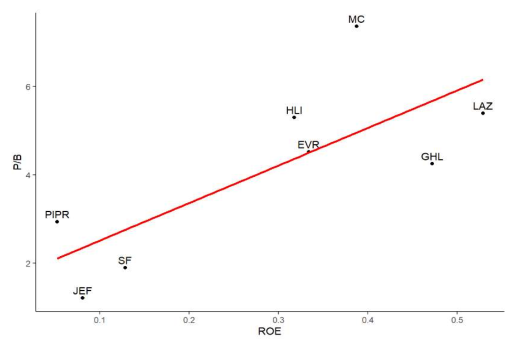
P/B

The price to book value ratio for a financial service firm is the ratio of the price per share to the book value of equity per share.

$$P/B = \frac{P}{\text{Book Value of Equity Per Share}}$$

P/B provides greater explanatory power for financial services firms (vs. non-FS firms) given that banks' assets and liabilities are periodically marked to market. Other things remaining equal, higher growth rates in earnings, higher payout ratios, lower costs of equity and higher returns on equity should all result in higher price to book ratios. Of these four variables, the return on equity has the biggest impact on the price to book ratio, leading us to identify it as the companion variable for the ratio. We therefore regressed P/B against ROE for the companies we believe are better suited for comparison with HLI. The consequent estimated value for Houlihan Lokey is 83.99 USD The strength of the relationship between price to book ratios and returns on equity should be stronger for financial service firms than for other firms, because the book value of equity is much more likely to track the market value of equity invested in existing assets. Similarly, the return on equity is less likely to be affected by accounting decisions.

Company	P/B	ROE
HLI	5.29x	0.3177334
JEF	1.21x	0.0806130
LAZ	5.39x	0.5289404
MC	7.36x	0.3875939
PIPR	2.93x	0.0519046
SF	1.9x	0.1282150



Financial Analysis

Overview

As the economy and the financial industry continues to recover in 2021 after a slump caused by COVID in 2020, Houlihan Lokey was able to manage a healthy performance of the company with high efficiency and strong financial strength, as reported by the lated financial statements for the quarter ended on September 30th, 2021. We measure Houlihan Lokey's profitability, productivity, and the ability to meet its obligations using various ratios that are calculated with raw numbers from the company's income statement and balance sheet.

Revenue	537M
Profit Margin Ratio	21.39%
Diluted EPS	\$1.65
Efficiency Ratio	70.88%
Quarterly ROCE	38.53%
Return on Equity	32%
Return on Asset	20.04%
Operating Leverage	0.5089
Total Debt	175.33M
Total Equity	2.43B
Current Ratio	1.69
PE Ratio	19.3

Profitability and Capital Efficiency

Holihan Lokey's overall performance of the quarter ended on September 30th 2021 was a profitable growth. The company's revenue for the quarter was \$537 million, which represents a 94.5% year-over-year growth.

Houlihan's net profit margin ratio as of 3rd quarter of 2021 is 21.39%, which represents a neutral performance of profitability among the company's peers such as Moelis & Company and Lazard, whose net profit margin ratios as of September 30th, 2021 were 25.54% and 16.07%, respectively. Although COVID caused business slowdowns in the entire economy at first, Houlihan Lokey along with the financial industry managed t effectively conduct business virtually, partly increasing efficiency and reducing costs.

Another figure that demonstrates Houlihan Lokey's performance is the Diluted EPS, which for the three months ended in September 2021 was $1.65, much higher than many of its competitors such as Lazard, whose quarterly EPS was $0.94 for the quarter ended in September 2021. We believe that one significant reason for Houlihan Lokey's profitability is the company's ability to efficiently allocate capital and resources. The company's efficiency measurement ratios, the efficiency ratio and ROCE (return on capital employed ratio) outperformed many of its competitors in the industry. Its quarterly ROCE of 38.53% highlights the company's business strategy of profitability and efficiency, while the efficiency ratio of 70.88% indicates the company's ability to minimize expense and maximize output. Furthermore, the Return on Asset ratio and Return on Equity ratio which are 20.04% and 32% respectively further illustrate Houlihan's outstanding earning capacity among its peers of investment banks.

Leverage and Financial Strength

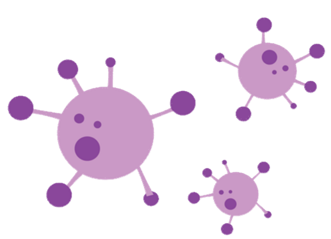
The company's healthy performance can also be illustrated through its leverage and liquidity ratios. The operating leverage shows a positive 0.5089, which includes a 982% liability year-over-year increase and a decrease of equity of 62.8% year over year. Debt growth does not conclude that the company's incapability to meet its obligations, and in fact it indicates healthy financials and the company's ability to carry out business and invest. Another important ratio to look at is the current ratio. Houlihan Lokey's current ratio of 1.69 shows that the company has 1.69 times of equity to cover its liabilities and thus a healthy liquidity and strong financial strength.

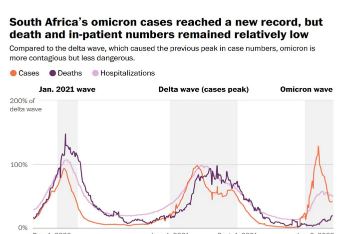
Potential Risk of Stock Mispricing

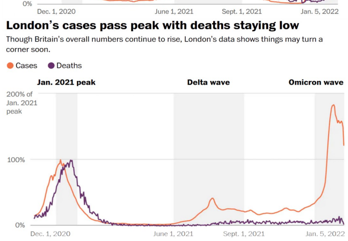
Although Houlihan Lokey shows a positive growth of the company's overall performance, other ratios indicate Houlihan's weaknesses and potential risks. During the past eight years, Holihan Lokey's median PE ratio was 18.9, with the current PE ratio floating around 19.3. The figures exceed that of many firms in the financial services sector, whose average PE ratio as of August 2021 was 7.6. As shown by the analysis of the company's historical stock price for the period of November 11th 2021 to January 12th 2022, we believe that Houlihan Lokey has entered a trend of short term reversal which is accompanied with volatile fluctuation of stock prices.

COVID-19 IMPACT AND RESPONSE

Case of Houlihan Lokey







Although COVID-19 had a huge impact on major economies worldwide, it did not have a material adverse effect on Houlihan's business in fiscal 2021.

Negative Effects: The COVID travel restrictions and social distancing requirements that have been put in place have, for the short-term, been eliminated, and may, over a long-term, greatly diminish Houlihan Lokey employees' ability to travel and attend meetings in person. Meetings have been conducted successfully using technology, however the company believes that the business will benefit from unconstrained travels and in-person meeting. We should not ignore that the remote-working environment additionally increases cybersecurity and other operational risks. Lastly, as a result of the pandemic, the closing of transactions has taken longer than in prior periods, delaying the company's recognition of revenue. We do not expect this latter event to affect the business in the future.

Positive Effects:Non-compensation expenses, as a component of operating expenses, were $146 million for the year ended March 31, 2021, compared with $192 million for the year ended March 31, 2020, a decrease of 24%. The decrease in non-compensation expenses was primarily driven by lower travel, meals, and entertainment expenses and other operating expenses. The financial restructuring segment, that is designed to be a countercyclical hedge across macroeconomic cycles, was positively impacted by the global distruption brought by the pandemic, and saw a 108% increase in profit compared to the previous year. Although COVID halted economic activities at the beginning of the pandemic, Houlihan's primary businesses and profitability was not negatively impacted. The M&A Business has seen a meaningful increase in revenue due to the favorable economic conditions brought by worldwide central bank's expansionary policies.

INVESTMENT RISKS

• A substantial portion of revenue is derived from advisory engagements in the CF and FR business segments, including engagements under which fees include a significant component based upon goals, such as the completion of a transaction. As a result, revenue and profits are highly volatile on a quarterly basis and may cause the price of our Class A common stock to fluctuate and decline.

• As a result of the company's multiple acquisitions, Houlihan's balance sheet presents a considerable amount of Goodwill, which is reviewed at least annually for impairment. Any future impairment of goodwill or other intangible assets would result in non-cash charges against earnings, which would adversely affect future results of operations.

• The company intends to continue to grow its non-United States business, including growth into new regions with which they have less familiarity and experience. Although this growth is important for the firm's overall success, it exposes them to multiple uncertainty along with special financial and business risks.

• As a participant in the financial services industry and because of its international business operations, the company is subject to many distinct laws and regulations. The requirement to comply with new regulations or new interpretations of existing regulations, or the inability to comply with these regulations or interpretations, could adversely affect the existing operations, or the cost of compliance may make it difficult to expand into new international markets.

• As a result of the process spawned by Brexit, there is considerable uncertainty as to the ramifications of the regulatory framework that now govern transactions and business undertaken by our UK-based subsidiaries in the EU, both in the near term and the long term. As a result, the company faces numerous risks that could adversely affect profitability and liquidity.

• Houlihan Lokey is a Controlled company, meaning that the HL Voting Trust controls a majority of the voting power (76.8%) of the outstanding common stocks. As such, the company may elect not to comply with certain corporate governance standards and make decisions whose interests may differ from those of Class A common stockholders.
The financial services industry is intensely competitive, highly fragmented and subject to rapid change, and we expect it to remain so. For all HLI segments there are usually no long-term contracted sources of revenue. Each revenue-generating engagement typically is separately solicited, awarded and negotiated.

• The financial services industry is intensely competitive, highly fragmented and subject to rapid change, and we expect it to remain so. For all HLI segments there are usually no long-term contracted sources of revenue. Each revenue-generating engagement typically is separately solicited, awarded and negotiated. The inability to compete successfully with competitors could materially adversely affect the business, financial condition and results of operations.

• In recent years, the volume of claims and amount of damages claimed in litigation and regulatory proceedings against financial services companies have been increasing. Financial Valuation and Advisory roles involve complex analysis and the exercise of professional judgment, including rendering fairness opinions in connection with mergers and other transactions. These activities may subject the company to the risk of significant legal liabilities to clients and affected third parties.

Environmental, Social and Governance

Overview

Aiming to promote a sustainable culture within the corporation and to better service clients, Houlihan Lokey formed an ESG Working Group comprising members of various internal departments and external advisors, who review the firm's policies and practices on a regular basis with an emphasis on the United Nations Sustainable Development Goals.

Environment

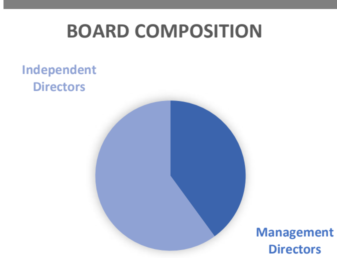
Houlihan Lokey has implemented a number of company and office-wide environmental stewardship programs in day-to-day operations, in order to promote sustainable communities for both the company's employees and clients. The numerous progran Houlihan Lokey has implemented include encouraging cycling to work and carpooling, energy-saving practices through the use o LED lighting with timed sensors, paperless operation that eliminate filing cabinets, and employee-led sustainability committee tł promotes environment-consciousness. In addition, the company's real estate has provided additional opportunities to engage ir environment-friendly practices. Approximately 70% of the U.S. offices are Green Building Certified.

Social

THRIVE SCHOLARS

From joining the CEO Action for Diversity and Inclusiveness program to launching firm-wide unconscious bias training programs, Houlihan Lokey has made various efforts to promote workplace diversity and inclusiveness. Houlihan Lokey created The Diversity, Equity, and Inclusion (DE&I) Council that was designed to recruit a diverse pool of talent, enhance communication throughout the company, and cultivate an inclusive culture. Furthermore, the company has also contributed $1.5 million to partner with INROADS, Thrive Scholars, and The Opportunity Network to sponsor scholarships for young talents in high school coming from different backgrounds. In addition, Houlihan Lokey established a Charitable Giving Program th aims to promote economic, societal, and environmental well-being across the globe. The company has also established a "Give a Day to Charity" program which encourages employees to spend two working days each year at a charity to volunteer. During the fiscal year of 2021, the company has directly donated $3.6 million to charities, and 900 employees participated in the "Give a Day to Charity" program.

Governance



Houlihan Lokey is committed to good governance with efforts dedicated to improving organizational structures by enhancing team communication and risk management strategy. 26% of the firm's outstanding shares are currently owned by its employees, and the Houlihan Lokey Voting Trust Agreement has imposed a 20% employee-held threshold as a trigger to eventually cease the company's structure of controlled ownership. Employee ownership incentivizes productivity of employees and profitability of the company. The board of director is served by three standing committees of Audit, Compensation, and Nominating and Corpora Governance under the Corporate Governance Guidelines with six of the 10 directors who are independent.

Income Statement

HOULIHAN LOKEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except share and per share data)	Year Ended March 31, 2021	2020	2019
Revenues	$ 1,525,452	$ 1,159,368	$ 1,084,385
Operating expenses:			
Employee compensation and benefits	971,195	737,762	692,073
Travel, meals, and entertainment	6,527	41,945	42,862
Rent	39,233	44,693	38,672
Depreciation and amortization	15,228	17,291	14,475
Information technology and communications	31,646	26,904	21,512
Professional fees	24,681	21,704	23,035
Other operating expenses	28,785	39,468	32,659
Total operating expenses	1,117,295	929,767	865,288
Operating income	408,157	229,601	219,097
Other (income)/expense, net	(1,071)	(6,046)	(5,223)
Income before provision for income taxes	409,228	235,647	224,320
Provision for income taxes	96,457	51,854	65,214
Net income	312,771	183,793	159,106
Other comprehensive income, net of tax:			
Foreign currency translation adjustments	22,932	(12,814)	(16,338)
Comprehensive income	$ 335,703	$ 170,979	$ 142,768
Attributable to Houlihan Lokey, Inc. common stockholders:			
Weighted average shares of common stock outstanding:			
Basic	65,785,042	62,152,870	62,213,414
Fully diluted	68,671,248	65,725,516	65,846,132
Earnings per share (Note 13)			
Basic	$ 4.75	$ 2.96	$ 2.56
Fully diluted	$ 4.55	$ 2.80	$ 2.42

Balance Sheet

HOULIHAN LOKEY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data and par value)	March 31, 2021	March 31, 2020
Assets		
Cash and cash equivalents	$ 846,851	$ 380,373
Restricted cash	373	373
Investment securities	208,618	135,389
Accounts receivable, net of allowance for credit losses of $8,262 and $5,587, respectively	108,409	80,912
Unbilled work in progress, net of allowance for credit losses of $3,520 and $1,302, respectively	118,115	39,821
Income taxes receivable	—	4,282
Deferred income taxes	28,332	6,507
Property and equipment, net	46,370	42,372
Operating lease right-of-use assets	152,031	135,240
Goodwill and other intangibles, net	866,221	812,844
Other assets	50,747	38,890
Total assets	$ 2,426,067	$ 1,677,003
Liabilities and Stockholders' Equity		
Liabilities:		
Accrued salaries and bonuses	$ 648,399	$ 420,376
Accounts payable and accrued expenses	67,468	53,883
Deferred income	27,868	26,780
Income taxes payable	68,339	—
Deferred income taxes	52	664
Loans payable to former shareholders	818	1,393
Loan payable to non-affiliate	—	3,283
Operating lease liabilities	174,516	154,218
Other liabilities	55,046	32,024
Total liabilities	1,042,506	692,621
Commitments and contingencies (Note 17)		
Stockholders' equity:		
Class A common stock, $0.001 par value. Authorized 1,000,000,000 shares; issued and outstanding 51,245,442 and 46,178,633 shares, respectively	51	46
Class B common stock, $0.001 par value. Authorized 1,000,000,000 shares; issued and outstanding 16,951,696 and 19,345,277 shares, respectively	17	19
Additional paid-in capital	803,573	649,954
Retained earnings	600,096	377,471
Accumulated other comprehensive (loss)	(20,176)	(43,108)
Total stockholders' equity	1,383,561	984,382
Total liabilities and stockholders' equity	$ 2,426,067	$ 1,677,003

Statement of Cash Flow

HOULIHAN LOKEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Year Ended March 31, 2021	2020	2019
Cash flows from operating activities:			
Net income	$ 312,771	$ 183,793	$ 159,106
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred tax benefit	(21,237)	(9,654)	(10,687)
Provision for bad debts, net	7,290	4,873	1,707
Unrealized gains on investment securities	(99)	(75)	(430)
Non-cash lease expense	22,756	24,654	—
Depreciation and amortization	15,228	17,291	14,475
Contingent consideration valuation	478	(1,220)	(708)
Compensation expense — equity and liability classified share awards (Note 14)	62,421	64,345	56,561
Changes in operating assets and liabilities:			
Accounts receivable	(32,965)	(13,387)	21,611
Unbilled work in progress	(78,526)	32,423	(26,029)
Other assets	(11,579)	(4,515)	(12,706)
Accrued salaries and bonuses	228,546	11,351	18,868
Accounts payable and accrued expenses and other	535	(8,709)	11,542
Deferred income	991	(1,058)	(6,661)
Income taxes payable/(receivable)	73,227	(12,443)	(2,375)
Net cash provided by operating activities	579,837	287,669	224,274
Cash flows from investing activities:			
Purchases of investment securities	(391,555)	(350,679)	(146,969)
Sales or maturities of investment securities	318,425	340,624	231,460
Acquisition of business, net of cash acquired	(12,470)	(2,197)	(71,407)
Receivables from affiliates	—	(170)	101
Purchase of property and equipment, net	(14,148)	(20,722)	(6,726)
Net cash provided by/(used in) investing activities	(99,748)	(33,144)	6,459
Cash flows from financing activities:			
Dividends paid	(92,006)	(80,655)	(66,928)
Settlement of forward purchase contract	—	—	(93,500)
Share repurchases	(102,224)	(29,641)	(69,563)
Payments to settle employee tax obligations on share-based awards	(17,810)	(31,477)	(1,947)
Proceeds from issuance of Class A shares	189,060	—	—
Earnouts paid	—	—	(1,923)
Loans payable to former shareholders redeemed	(575)	(654)	(989)
Repayments of loans to non-affiliates	(3,601)	(10,081)	(1,475)
Other financing activities	333	369	187
Net cash (used in) financing activities	(26,823)	(152,139)	(236,138)
Effects of exchange rate changes on cash and cash equivalents	13,212	(7,755)	(8,703)
Net increase/(decrease) in cash, cash equivalents, and restricted cash	466,478	94,631	(14,108)
Cash, cash equivalents and restricted cash – beginning of period	380,746	286,115	300,223
Cash, cash equivalents and restricted cash – end of period	$ 847,224	$ 380,746	$ 286,115
Supplemental disclosures of non-cash activities:			
Shares issued via vesting of liability classified awards	$ 7,511	$ 6,555	$ 5,005
Shares issued as consideration for acquisitions	1,050	—	1,744
Cash acquired through acquisitions	$ 88	$ 15,755	$ 16,141
Cash paid during the year:			
Interest	$ 989	$ 1,049	$ 977
Taxes, net of refunds	44,202	73,881	80,841

Statement of Stockholders' Equity

HOULIHAN LOKEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Class A common stock		Class B common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total stockholders' equity
(In thousands, except share data)	Shares	$	Shares	$	$	$	$	$
Balances – April 1, 2020	46,178,633	$ 46	19,345,277	$ 19	$ 649,954	$377,471	$ (43,108)	$ 984,382
Cumulative effect of the change in accounting principle related to credit losses, net of tax	—	—	—	—	—	(682)	—	(682)
Shares issued	3,000,000	3	1,612,091	2	223,168	—	—	223,173
Stock compensation vesting (Note 14)	—	—	—	—	50,152	—	—	50,152
Dividends	—	—	—	—	—	(89,464)	—	(89,464)
Conversion of Class B to Class A shares	3,650,053	4	(3,650,053)	(4)	—	—	—	—
Shares issued to non-employee directors (Note 14)	8,751	—	—	—	333	—	—	333
Other shares repurchased/forfeited	(1,591,995)	(2)	(355,619)	—	(120,034)	—	—	(120,036)
Net income	—	—	—	—	—	312,771	—	312,771
Change in unrealized translation	—	—	—	—	—	—	22,932	22,932
Total comprehensive income	—	—	—	—	—	312,771	22,932	335,703
Balances – March 31, 2021	51,245,442	$ 51	16,951,696	$ 17	$ 803,573	$600,096	$ (20,176)	$ 1,383,561

General Valuation Assumptions

The valuation of a financial services firm presents a number of challenges:

• debt is difficult to define and measure. In a way, it is more akin to raw material than to a source of capital, making it difficult to estimate firm value or costs of capital. Consequently, it is far easier to value the equity directly by discounting cash flows to equity at the cost of equity.
• capital expenditures and working capital, which are required inputs to estimating cash flows, are not easily estimated, and much of the reinvestment that occurs at these firms is categorized under operating expenses. To estimate cashflows to equity, therefore, we use dividends (and assume that what is not paid out as dividend is the reinvestment).
• Firm value multiples such as Value to EBITDA or Value to EBIT cannot be easily adapted to value financial service firms, becaus neither value nor operating income can be easily estimated. Difficulties associated with defining debt make equity multiples suc as price to book value ratios better suited for comparing financial service firms than value multiples.

Cost of Capital

A number of assumption has been made in using cash flows discounting models, beginning with the company's cost of capital. Because debt and debt payments cannot be easily identified for financial service firms we opted to discount cash flows to equity at the cost of equity. To compute the firm's cost of equity we used a CAPM model, with the following inputs:

• risk free rate Rf: 1.47%
• HLI risk compared to the market β: 1.21
• US Equity Risk Premium ERP: 4.72%

Risk Free Rate The risk free rate of 1.47 used in the analysis is the latest 10-year T-bond yield. We considered a 10-year bond as a valid risk free rate for two reasons:

• we assume that the company operations and cash flows continue into perpetuity. Therefore, we can safely assume that the duration of the firm's cash flows will be high. ClearBridge Investments estimates the duration of equity in the S&P 500 to be about 35 years. Since dividends are lower than cashflows to equity, however, we would expect the true duration to be lower.
• The 10-year T-bond yield is largely used as reference risk free rate in equity valuation.

Beta The beta of 1.21 used in the analysis is computed as the average beta among Houlihan's Lokey peer companies. The peer companies were identified based o similarity of business and size, and main risk drivers. The reasons why we did not use a regression beta in the model are:

• noise in the estimates (standard errors)
• possibility that the firm has changed over the period of the regression
• few years of data available.

Furthermore, we chose not to adjust the sector beta for financial leverage because financial service firms tend to be much more homogeneous in terms of capital structure (than non-financial firms) primarily due to regulations, and because of the difficulty i estimating debt. We decided, however, to average betas across a limited number of comparable companies, instead of the whol financial sector, in order to exclude those companies that carry a significantly different level of risk, because of the nature of the operations.

ERP The US Equity Risk Premium ERP o 4.72 used in the model is the *current implied premium* reported by S&P 500 on January 1, 2021

APPENDIX II

Retained Capital

A second assumption relates to the company retained capital. At a first look Houlihan Lokey's dividend to shareholders (1.5%) is on the low side when compared to its peer companies and the financial sector as a whole (3%). However, since it went public, the company has regularly engaged in consistent shares repurchase, for amounts that have often exceeded the yearly cash payment to shareholders. Therefore, we believe that shares' buybacks should be factored into the computation of the company dividend payout ratio for our analysis, to present a more realistic picture of the company's repayment to shareholders. Not considering buybacks would, in fact, overstate the amount of capital that the company retains each period, leading to a misleading figure of reinvested capital and company's value. Unlike dividends, however, shares' buybacks have a tendency to vary widely across time. We thus consider the average shares buyback's over a 5-year period to more fairly represent the yearly buybacks contribution that we expect in the future. We computed the adjusted dividend payout ratio as the sum of average yearly buybacks and yearly dividend payments, averaged across the past 5 years.

$$\text{Adjusted Payout Ratio} = \frac{\sum_{t=0}^{T} D_t + \text{Average Yearly Buyback}}{N}$$

We believe that this figure more fairly represents true shareholders' returns.

Sustainable Growth Rate

A third assumption relates to the long-term sustainable growth rate of 3%. We assumed that, in its mature stage, the company will have the same growth rate of the US economy. As an estimation for the expected future growth rate, we considered the average growth during the period 2010-2020 (stable period of the economic cycle between the financial crisis and the COVID-19 crisis).

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