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In his own words

Hamilton Lane chief executive officer Mario Giannini discusses his firm's IPO, co-investment and early meetings with Steve Schwarzman

Q&A

The chief executive of Hamilton Lane reflects on the firm's recent IPO, the perils of co-investment and early encounters with Stephen Schwarzman.

Mario Giannini

Words *Xxxxx*

Photography *Jemima Marriott*

Hamilton Lane recently completed its IPO, floating on the Nasdaq Stock Market. What was the thinking behind going public?

It's a tremendous branding event. When people look at a firm and see that you have the institutional wherewithal to be public, that is important and we have seen that in practice since. That was a big deal.

It is also a statement of independence. We got asked all the time: "Are you going to be taken over? You are really attractive." I got calls fairly often about that before the IPO, and this was a way to be able to affirm our independence.

We had explored the idea right before the market collapsed in 07/08 and obviously didn't go forward with it then. It was a question of: "Where do we want to be as a firm in five to ten years' time?" We have always been an equity-orientated firm – before the IPO, about a third of our staff were shareholders. When you think about how people look at their careers, you have to give them a path to liquidity. There are various ways to do that but an IPO made sense, much like Partners Group did ten years ago.

Did you consider any alternatives?

The alternatives are to get bought by someone else, and we knew we didn't want that. And then if you think about a strategic minority investor, most firms do that because they need capital or someone wants to sell, neither of which was the case for us, so it didn't really make sense.

How will being a public company affect how Hamilton Lane operates?

I've not seen any difference in terms of decision-making or behaviour around investments and clients. It has only been a couple of months and we don't know what will happen over a number of years, but we haven't seen any changes in our business operations so far.

The IPO is representative of a broader trend away from private equity's entrepreneurial roots to a more institutionalised asset class...

Yes. As you get bigger – and this is one of the things that will distinguish winners from losers – you will have to make the decision to either be a small boutique or a more established institutional player. You can't go halfway.

Everyone focuses on firms like us or the GPs becoming more institutional and that is certainly the case, but it's also happening on the LP side. Ten years ago, the industry was much more opaque – a lot of LPs were fine with fairly little information from their GPs – but that has all changed. There has been as much change on the LP side as there has been on the GP side. We talk about how the GPs have evolved, but one of the drivers of that has been LPs demanding more institutional-quality money management.

The asset class has matured and gotten bigger. Whereas five years ago it may have been five per cent of your allocation and people think it's this funny little asset class, now people may put in ten to 20 per cent. It's then very hard if you are a CIO to say: "I'm OK with no transparency, with a staff that doesn't really understand how the private markets operate." That doesn't work any more. So there is a real drive to get private equity and private markets to behave in a way that is more similar to the public markets.

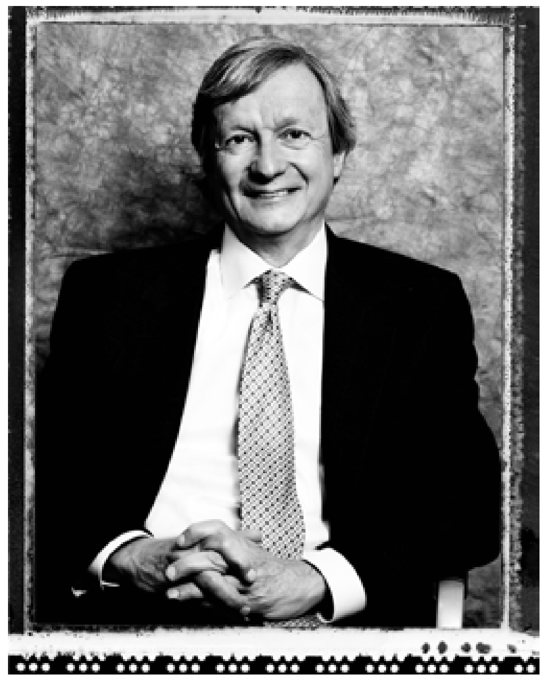
One of the biggest issues for dealmakers at the moment is pricing. Can GPs keep buying at such high multiples?

No. I think it is dangerous to use one indicator such as multiples to say that you are

at a market top, but I don't think there is any question that when multiples are consistently high, returns are going to struggle. You are seeing that now.

One of the interesting things about this cycle is that, if five years ago I had described to you the scenario of record amounts of dry powder, record low interest rates, capital markets at all-time highs, you would think that multiples would be well above prior records. But from what we have seen, they are not. They are at prior highs, but not way above them.

I think what that is telling us is that for the first time in a long time, GPs are being very disciplined. They view high multiples as a problem, but as long as capital markets stay high, the question is: "Will the markets go down first or will the GPs capitulate and start chasing prices?"' Thus far they have not. They all tell you they think the market is too high and they are waiting for a correction. What happens if a year from now there is no correction, and you have all this dry powder? I would say right now private equity is in a decent place – not bad, not great – but fully priced. We haven't seen the kind of undisciplined behaviour we saw in 2000 and 2007, and that's a good thing.



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A LOT OF CO-INVESTORS WHO DON'T HAVE THE STAFF AND RESOURCES WILL BE SORRY, AND THE WHOLE INDUSTRY WILL SUFFER AS A RESULT. FOR SOME, IT COULD BE A TRAIN WRECK WAITING TO HAPPEN

Many GPs are becoming more flexible in their approaches in order to avoid such high prices. Do you worry about strategy drift?

They are doing anything they can to find an angle where they don't have to pay a high multiple on a vanilla asset. That is to their credit, but again, it's because they believe public markets are too high, and I don't know what happens when they give up on that belief.

For us, and it varies for any LP, amid the range of concerns, we are less worried about flexibility. Part of the decision we make on a GP is that they are going to know where to go for the best opportunities, so straying a little from their classic strategy isn't the biggest issue if there is a reason.

What GPs are doing if they think there is an opportunity in venture capital, for example, is forming a fund dedicated to that. The proliferation of funds is unbelievable. I think you see fewer GPs drifting within their main fund, but lots of side funds. That then raises the question of where they are directing their time and attention. You can't have a GP building a proliferation of products without the necessary infrastructure.

What would be nearer the top of your list of concerns then?

The pace of investment is a worry for us. There is a pretty high correlation between how quickly a GP invests capital and comes back to market, and market tops, so we look at that pretty carefully. Also, as an LP, if you are with a GP who has invested very quickly and you go back into the next fund, you're doubling down because you already have a ton of unrealised NAV in the portfolio. That's a big deal for us.

Are there any areas of the market that you are finding particularly hard to access at the moment?

Oddly enough, the larger end is almost harder to access for some people because these funds are so rapidly oversubscribed. We're fortunate in that we have had long relationships with many of the larger GPs and haven't experienced meaningful cutbacks – but if you are a new investor, you are not likely getting into those funds, and we've never seen that before. I don't know if that's the sign of a new market top.

The small and middle end of the market is a place where we have had great access, but we have to be much more careful at the larger end where these funds are oversubscribed almost instantly. That's a completely new phenomenon.

This trend is also affecting terms and fee structures. Do you think such entrenched structures are due a rethink?

Terms and fees have been an issue, but not yet a deal breaker because the movement is more marginal from our perspective. But if the trend continues, it will become more and more of an issue.

The GP argument has always been that the eight per cent hurdle rate was designed for when interest rates were higher. I don't have that much sympathy for that argument. At least in our investor base, they are not looking for a substitute to the risk-free rate of return. If you told our clients that private equity would return seven per cent and the public markets would return two or three, I bet a lot of them would rather not be in private equity. What they are looking for is something over ten per cent. I think there is a real disconnect when LPs and GPs talk about the hurdle rate.

Consider real estate in the 1980s. It had very similar terms to what you see in private equity today. Then the industry had an enormous collapse and terms really changed; it became much more NAV-orientated. I'm not suggesting that will happen for private equity, but most asset classes change as they mature.

As long as private equity does what it has been doing, which in general is perform solidly and give back money regularly, there will be no push back from LPs. On a net basis, they are getting what they want.

Co-investment has been one of the prevalent trends of recent years. Do you agree with some of the concerns that have been raised about such deals?

Very much so. There is this notion that co-investment is easy and great and reduces fees. A lot of LPs are used to making a $10m commitment to a fund. If a company goes bad in that, you could lose five per cent, three per cent of your investment. You make a $10m co-investment and it goes bad, you could lose it all. I'm just not sure a lot of investors understand that whole dynamic. For some investors who lack a more thoughtful co-investment strategy, it could be a train wreck waiting to happen.

Anecdotally, we hear from GPs that 50 LPs will say they want co-investment and 40 of them do no work. This lack of LP engagement is worrisome. Data has shown that if you know what you are doing, co-investment is typically very positive – the Canadians and Australians have made a living from it. But done poorly, a lot of co-investors who don't have the staff and resources will be sorry, and the whole industry will suffer as a result.

What is one piece of advice you would give to someone entering the private equity industry today?

Think long and hard about whether you want to be in it. It is a more mature industry. We recruit people at colleges and they all either want to be Steve Schwarzman or found the next Uber. That might happen, but it is harder in this era. Think about what you want out of it. It's important to think about what the industry is becoming, and what it might look like in ten years.

What are some of the more memorable deals or moments from your career?

It's interesting to think how the industry has evolved in the last 25 years. Remembering Steve Schwarzman the first time I met him, or David Bonderman and Jim Coulter. I was talking to David Rubenstein the other day and he recalled the first time I met him outside the halls at CalPERS – I didn't know who he was, and he certainly didn't know who I was.

Steve [Schwarzman] tells this story. The first time he came to our office, our conference room was a card table, and one of the legs was broken and taped together. He was thinking: "Where the hell am I?" We didn't really know who he was, but he seemed to know what he was talking about. We've come a long way since then, and to see the firm he has also built since then – it's remarkable.

What is the worst thing a GP can do in a meeting?

Be arrogant. I understand there are egos in this industry and it is necessary for success, but nothing turns off a prospective investor more than someone who comes in and acts like it's a favour that they are present, and are almost offended that you would dare question them. One of the things GPs don't understand is how many firms LPs talk to, and that they are not as unique-sounding as they think they are. GPs that understand the concept that LPs are entering into a long-term relationship with them – because we are all stuck together for ten to 12 years – tend to be successful.

What is your long-term vision for Hamilton Lane?

We want to be one of the industry leaders – be that in terms of the clients that we have, the quality of our people, the size of our assets, or the thought leadership we produce on the industry. Exactly how we look in ten years, I just don't know, because part of that will be determined by what the industry overall looks like.

Ten years ago, I wouldn't have imagined we'd have as large a private debt practice or be as global as we are, but that is where the industry went. What we do know is that we want to stay at the cutting edge of the industry's ongoing evolution. ●