

The Co-Investment Landscape

With Demetrius Sidberry, Managing Director and Stephanie Davis, Principal

STEPHANIE DAVIS: Thanks everybody for joining us today. Joining us today is Demetrius Sidberry, a managing director on our Direct Equity team here at Hamilton Lane, and he's going to be talking about the concept of co-investing. Demetrius, thank you so much for joining us today.

DEMETRIUS SIDBERRY: Thanks for having me.

An Overview of the Co-Investing & Where It Fits within a Portfolio

STEPHANIE: Sure. Well, I'm going to jump in with a couple of questions. The first important one is what is a co-investment, how does it work and how does it fit into the private equity landscape?

DEMETRIUS: Sure. It's a great place to start. A co-investment is essentially another way of accessing privately held companies. As you know, the premise of the private markets is allowing investors to access privately held businesses that aren't generally available through the public markets, so that's a fairly expansive opportunity set - a lot of innovative companies driving growth in economies across the world - and the private markets have allowed for investors to access those. The co-investment product or the co-investment vehicle is simply a way of accessing that by investing into

companies alongside a sponsor or a general partner or a private equity fund. We'll use those terms interchangeably. And it's unique in the sense that you are really attaching yourself to some of what we believe are the best investors in the world in particular areas of focus to access companies directly. In terms of where they fit in a portfolio or how they fit in the landscape, I would say it's becoming a more and more important part of what clients are doing inside of their portfolios, and it's a pretty significant source of capital for the private markets, and a part of the growth that we've seen in the private markets over the last decade or so.

Drivers of Growth Within Co-Investing

STEPHANIE: Appreciating that they become a meaningful part of the private equity landscape, the growth we've seen in the space: What do you think is driving that growth, and can you talk about it from the viewpoint of a private equity firm and also from the end investor perspective?

DEMETRIUS: I think it's important to talk about it from both perspectives. There's a little bit of a supply and demand dynamic that plays out between GPs and LPs. I think for both, there are some real tangible benefits. For a general partner, there's the simplest way of thinking about

co-invest capital, which is, I need capital in order to get a deal done, it's an asset I should own, or perhaps it's a little bit larger than the check I should be writing for my fund. Co-invest capital has a come in to fill that void. In many instances, the other piece of that is in a relationship business. The number of touch points you have to build a relationship can be very helpful for your franchise, so co-investing has become another way of building relationships with general partners and showing them how they operate on specific deals. I think from an LP's perspective, it's important for an LP to feel like they have a shot at generating attractive returns, and our view is that doing co-investment right gives you a good shot at being able to produce strong returns. That's certainly been one of the reasons why LPs have done it.

I think the other piece that holds true is from a relationship perspective, a tactical investment in capital deployment perspective, and last but certainly not least, is that co-investing has been a very fee-efficient way of accessing the private markets. Typically, what you see, what they call investment structure is a 1-in 10 model - 1% management fee, 10% carried interest - versus what you would see with a general partner where they pay or fund a private equity fund, where you typically pay 2 and 20 [%], so it's a very attractive feature for LPs.

Due Diligence in Co-Investing

STEPHANIE: So, somewhat of a complex asset class. Let's talk a little bit about the due diligence process. How do we look at the space? How do we think about due diligence? I know that lots of work probably goes into vetting these businesses. Talk a little bit about the due diligence involved and what an investor should look for.

DEMETRIUS: I think you're right, there's a ton of work that goes into figuring out whether or not you want to own an asset and then actually owning that asset. There are a lot of similarities

between what a strong co-investment platform will do from a diligence perspective and what a private equity firm will do, and then there's some key differences. I think the similarities are, you're trying to understand the asset, you're trying to understand industry trends, management team, what's becoming more and more important in today's market, and it's always been important for us, is ESG, making sure those pieces are in place. I think the other component where it gets a little bit different for a co-investor is really understanding the partner that you're doing the deal alongside. So again, I mentioned earlier that that's a key component of co-investing, so understanding the value creation thesis and the ability for that general partner to execute on that is absolutely an important part of diligence. I think for us, the way we think about it is getting that appropriate marriage of asset and industry quality and sponsor capabilities is important and certainly increases your likelihood of having a successful outcome in a co-investment.

Co-Investing vs. Buyout: Key Differences

STEPHANIE: So, you're sitting alongside private equity firms, the diligence process might be somewhat similar, so can you give us an idea of how co-investment could be ultimately different than investing in a traditional buyout fund?

DEMETRIUS: I think if I had to sum it up in a couple of words, I would say diversification, and I mentioned the other one earlier, fee efficiency. On the diversification part, if you think about the average private equity firm, particularly the part of the market where a lot of co-investment programs are targeting the small to mid-sized businesses, a private equity firm has a limited or more narrow set of opportunities that they're focusing on, whether it's geographically, by strategy, by company size, or all of the above. With the co-investment strategy, you can build a very diversified portfolio across a variety of industries, geography, strategies, enterprise value and do so effectively because

you're attaching yourself to managers that are experts in those areas or who you believe are experts in those areas. I think that diversification point is important, and as I mentioned earlier, again, one of the favorite things about the co-investment market is really the fee efficiency. That is absolutely a key distinction between most co-investment programs and what you would see with general partners.

Hamilton Lane's Co-Investing Process Explained

STEPHANIE: We're going to point specifically to Hamilton Lane and our presence in the co-investing space. Just to give the audience an idea of what goes into making a co-investment, so how would you describe our efforts in the co-investing space?

DEMETRIUS: Long standing, as a firm, we just had our 30th anniversary. 25 of those 30 years, we've co-invested alongside general partners in some shape or form, so we've been doing it for a long time. We've lived through different market cycles, we've scaled up the program meaningfully. Over that 25-year time frame, we've invested over \$8 billion of capital across 400 deals, industry, diversification, sector, etc. It's a really, really important part of what we do. I think what makes us special or helps us to generate some success in this area is really the deal flow. Even in a year where we saw depressed deal flow for a month or two at the hands of COVID, we were able to see close to \$18 billion in deal flow. That's important -- to have a lot to choose from, be selective, to have that process in place that we talked about earlier and be thoughtful around portfolio construction.

The other piece to the equation is just the team. We have a very big infrastructure in place, a 20-person team on a global basis, understanding local market trends, having relationships with general partners to generate the deal flow and

execute on it, and the data and technology. I don't think we can ignore that. In a market environment where there is a lot to see and a lot to do, having as much information to distill what are some interesting trends versus things that are less sustainable is important. That's how we think about it as a platform.

Market Opportunities & Trends

STEPHANIE: Talking about trends, market opportunity, it seems like the market opportunity is there. What are you seeing in terms of trends and the market opportunity?

DEMETRIUS: I think it's a great question. It's one we get often. I like to draw a distinction between what we're seeing and what we're doing. What we're seeing is a little bit of any and everything in terms of all the things I mentioned earlier from a diversification standpoint. If you look at the pie chart -- geography, industry, strategy -- we're seeing a little bit of it all. What we really focused in on, and even before the pandemic, has been in growth areas and areas of resilience. If you can find a combination of the two, we particularly like those areas, so software as a service, tech more broadly, healthcare opportunities, certain areas and professional services. We play consumer staples, consumer discretionary opportunistically as well as other areas. I think the great thing about co-investing in general is that often you get to see a broad market opportunity set, but then you can be very tactical and very nimble in terms of how you're building out your portfolio.

How Smaller Investors can Gain Access to Co-Investments

STEPHANIE: So Demetrius, lots of opportunity in the asset class, somewhat of a complex investment for, say, a smaller investor to get into, think non-institutional investor. What is a way where that smaller, maybe more retail-looking investor can access these direct transactions?

DEMETRIUS: I think it's a great question, an important question. Typically, the way a smaller investor accesses this part of the market is through a fund structure set up by a firm, and the reason for that is you get the benefits of an infrastructure - the team, the deal flow, the know-how of engaging with the general partners and working through a transaction. As you said, it's very difficult for that for the smaller investor to access it directly and do the deals directly, so I think it's important to understand that one of the more successful ways of attaching to that is really just to do it through a fund structure alongside a firm.

STEPHANIE: How do you think an investor should look at this in terms of portfolio allocation. These are direct equity investments. Where would they fit?

DEMETRIUS: I think in the alternative bucket more broadly, and equity more specifically, in terms of what we're talking about here today. I'm sure you're going to have sessions down the road where you'll talk about other strategies that have a co-investment element to them but different parts of the capital structure, but what we're talking about specifically today falls into that alternative equity bucket.

Why More Investors are Considering Co-Investing

STEPHANIE: Before we wrap up, do you have any other comments or key takeaways that you'd like to share with the audience before we wrap up on our co-investment session?

DEMETRIUS: Well, one I want to, as Stephanie mentioned earlier, thank everyone for joining us, as you hopefully can tell from our conversation, we're excited about the opportunity set from a co-investment perspective, the deal flow that the market has made available and the thoughtfulness that is going into building portfolios in this area. Again, we think this is a very interesting way of attaching to the private markets for the things that I just mentioned, the fee efficiency and everything else that we've covered in this conversation, so we're excited about the opportunity set that is in front of us.

STEPHANIE: Great, thanks everybody for joining us for our session today on co-investing. You can find more information on our strategies on the Hamilton Lane website or you can reach out to us directly. We hope that you join us for our next session on all things private markets.

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