Talks at GS
Scott Kapnick
Founder & CEO, HPS Investment Partners, LLC
Alison Mass, Moderator
Recorded: September 22, 2022

Scott Kapnick: We'd been through, probably, eight, nine cycles since I started. And you never know exactly how it's going to play out.

[AUDIO INTRO]

Alison Mass: Hi everyone and welcome to Talks at GS. I'm Allison Mass. I'm the Chairman of the Investment Banking Division. And I am delighted to welcome Goldman Sachs alum, Scott Kapnick.

Scott spent 21 years here at Goldman Sachs. He launched the firm's business in Germany, after the fall of the Berlin Wall. He rose to become the Co-Head of the Global Investment Bank. And he was my boss and the boss of a lot of people sitting in this room. And later, Co-CEO of Goldman Sachs International.

Since leaving Goldman, he served as a CEO of HPS

Investment Partners. And today, we're going to talk with him about deploying credit in the current economic environment. And how he sees the private credit landscape changing.

So, welcome back to Goldman Sachs, Scott.

Scott Kapnick: Thank you. Thank you for having me.

Alison Mass: I thought we'd kick off a conversation with a little trip down memory lane. So, I have in my hand your ID.

Scott Kapnick: Oh my God.

Alison Mass: Your Goldman Sachs ID from 1985.

Scott Kapnick: Wow. That's 37 years ago.

Alison Mass: That's a long time ago. You look the same. Actually, not.

Scott Kapnick: I don't think so. I don't think so.

Alison Mass: So, my question is, what thoughts come to mind when you look at this photo? And looking back to that time and all you've accomplished since then; how big a role has Goldman Sachs played in shaping your professional career and your leadership style?

Scott Kapnick: Great to be in the building and see everybody. 37 years ago, as most of us who start, I knew nothing when I joined. Some would say I haven't learned that much. But I started right out of JD MBA Chicago. Started in investment banking and corporate finance. In that day, the firm was very small. A private partnership still. And one of the things that when I was joining, and I think it's still true today and I hear it from the alumni network, is that Goldman will take time to train you and teach you. And that was certainly true of me.

I was fortunate to make partner in 1994. And that group, 58 partners at that time. And I was going through the group. It was an incredible group. You could spend three years of content interviewing just that group. And two of those partners from that class, Tom Montag and Paul Achleitner had left Goldman when I left and were critical that we wouldn't be here, you know, HPS wouldn't be where it is without their help, both Alliance and Bammel [PH]. So, just an incredible network of people that help you.

And I guess the message for all of you in the room is, you know, remember who you're working with. You never know who's going to help you.

Back in the day, we were hyper competitive. I know we're still a hyper competitive organization.

Alison Mass: Nah.

Scott Kapnick: But we would, literally, if you left, we would not talk to you for ten years. And we would never want to, "Oh, I don't want to talk to somebody at some other firm." And I would say for you all, maybe in this day and age learn from both your colleagues, but also some of those people that are out there on the street. It's okay. Lord knows we all needs friends in this industry. And it's okay to build those bridges because you never know what you're going to be doing and who's going to be helping you.

Alison Mass: You wore many hats here at Goldman. We talked about that. But the one I find the most fascinating is your experience launching the business in Germany right after the fall of the Berlin Wall, literally on the front lines of globalization. And describe what it was like to work at that time. And how was the investment world transformed at that time? And what strategies did you employ to seize the opportunities that were unlocked by the German reunification?

Scott Kapnick: It was an unbelievable time. The firm was just starting to really make the decision to be a global firm. I think that's really hard for people to understand sitting here right now given how big it is and how global and how important it is in financial markets.

And when you get into globalization, first, I don't love the deglobalization word. I think it's sort of realignment. But globalization had a lot of tailwinds that the world was-- and people forget, before the wall fell, probably half the world, 3 billion people, were really involved in democratic capitalism. And it shifted over the last 35 years, which we've all benefited, Goldman Sachs benefited incredibly from those tailwinds.

But that drive for efficiency, labor, arbitrage, all that was what really drove those markets. And what we were doing was bringing expertise from the US markets and Europe, London, from the big bang era into markets. There really wasn't a market for corporate control there. But mostly we learned to hire great people locally. And who understood the culture, understood the financial system. And then we were applying best practices from around the world to that. And that lasted. It's still today that the firm does that in various areas. And, you know, really as an opportunity.

Alison Mass: Are there lessons that you learned from being at the forefront of that period of time in Germany that you can apply today as the world trends towards, and I won't say the word, deglobalization, towards this shift?

Scott Kapnick: People, again, won't realize. When we started Germany, I think it was the first office that started with all four revenue producing divisions. Fixed income, equities, asset management, investment banking. And what was then called the federation. So, operations. And so, that, we were One GS before One GS was cool.

On the broader front, you know, the realignment, again, is a shifting of the, if you want to call it deglobalization, it's now a headwind to growth. But I do think, just Germany, I was talking to some people last week, they are going to realign. They're going to figure out how to move their manufacturing to low-cost energy. They're going to figure out how to adjust their system. It won't be a year. It might be a couple of years. But they will do that. And that realignment creates huge opportunities for the firm as people do that because it takes capital. And big opportunities for firms like ours to provide the capital to allow them to do that.

And then the big issue with deglobalization is the focus now on resiliency of supply chain. So, we're a lender. We want to focus on how people are doing that and what's that mean. That means usually increased costs. Duplication. So, that means they're going to make less money. And they're going to have more capital into that, which is going to be huge for financial markets.

So, I don't really think that while growth needs to maintain, I think it's still an opportunity. It's just different.

Alison Mass: You mentioned energy. So, I want to talk a little bit about the energy crisis playing out in Germany and greater Europe now that Russia has cut off natural gas. Do you believe the desire for energy security will accelerate the adoption of renewables and other clean energy? Or do you see countries abandoning net zero commitments and resorting to using whatever's convenient as a source of fuel?

Scott Kapnick: No. I don't. And I know there are certain topics that come out in media. We have a lot of clients in institutions, pension funds, and European insurance companies. They still are very focused on net zero and achieving net zero. So, no, I don't think. I haven't heard that they're moving off that.

And again, you have to remember, people, financial institutions, the people that are here, the backdrop to that was climate. Temperatures were rising. Sea levels were rising. And the insurance industry, that's hard to insure those risks. So, some of this was driven by real insurance-based activities. And I don't think they want to back off that.

Now you have an energy crisis. So, now during a crisis, all energy is fungible. So, yes, that, as prices have risen, you'll have renewables come into play much more. But you'll also have fungibility. And people will try to find security of energy. Security of both energy and then they do want to move to less carbon. So, we'll see how that plays out.

And I think the debate has shifted back now. You're starting to get push back. And the realization that you absolutely need carbon-based energy. So, I think that's more a rational debate now.

Alison Mass: Like many of us, you know what it's like to enter a challenging cycle. You've weathered several recessions. The dotcom bubble for one. The global financial crisis actually altered the lending landscape in a big way. So, how did those times compare to the cycle we're in now, in your view, and how challenging do you expect the economic climate to be over the next year?

Scott Kapnick: You know, I think that most of us, at HPS and probably the average age at Goldman is in the thirties. Certainly, for us, it's thirties. So, almost none of those people have experienced an environment that we're in with rising rates and inflation. And so, you have to really roll out the education of, well, okay, what happens in those types of markets.

We've been through probably eight, nine cycles since I've started. And you never know exactly how it's going to play out. And so, I think that uncertainty, I remember, I think it was after the dotcom, I presented information IBD and used the Stockdale Paradox, which was this guy from the Hanoi Hilton, a very famous admiral, who said, "You've got to know that you'll get through it. But you know you don't know how long it's going to take. And you have to realize that there is a lot of uncertainty."

I think in this recession, the other thing that we have here that we have not experienced is quantitative tightening. So, you've got rising rates. Federal Reserve. Quantitative tightening. On top of a lot of the COVID-- we still have a pandemic. We have a war in Europe. So, we have a lot of uncertainty to resolve. And then we still have China locked down. So, how those factors play out are completely uncertain.

We're credit underwriters. So, we're more focused on downside. And we want to make sure that whatever we're lending to can weather through a recession and shrinking profit margins, things like that. And rising cost of capital.

Alison Mass: You've said that volatility is not necessarily a bad thing for HPS.

Scott Kapnick: Right. That's true.

Alison Mass: And in this challenging environment we've talked about, the inflation and rising rates, how have you positioned the firm to capitalize on this market dislocation and distress situations? And are there particular industries and regions that you see offering the greatest opportunities to deploy credit in the next couple years?

Scott Kapnick: Well, we've been fortunate as a firm after the great financial crisis and then the regulatory change that came after that. The regulators really were asking the banks-- charging higher capital charges in non-investment grade credit, which is private credit, what we do. And wanting depositors, and there was debate about this, I think the framework they set up was limits on lending. And that framework also raised the capital for banks.

And if you look at what's happened, private credit has grown immensely in the last since '08. It's grown from several hundred million to a trillion-and-a-half-dollar market, growing at 15 percent for the foreseeable future. So, it's going to double or triple. And the reason for that is that borrowers want certainty. They don't necessarily want a syndicated loan. The syndicated loan markets continue to grow, but at a much slower rate.

So, I think that the opportunities in private credit to deliver that solution, and larger scale, the larger and larger deals is what we positioned the firm to do. And we're one of the larger lenders to non-sponsors, as well as sponsors. And being able to do, we're one of the few that can do a billion-dollar deal and deliver certainty to the borrower for growth capital. And then really wanting to do whatever our investors find across the risk spectrum for a return, anywhere from sort of six to 15 plus, where they want to deploy capital that we can scale, that's what we're focused on.

Alison Mass: Because private markets lack the same level of transparency as the public markets, we're hearing more and more about the risk of them being over saturated and that they could be the next bubble to burst. I'm curious what your perspective is. Are the private markets at risk given their accelerated growth? And do you see any correction on the horizon?

Scott Kapnick: Yeah. I mean, you hear a lot about it. And you hear a lot about shadow banking. I think when people talk about shadow banking, they're really talking more about, sort of, very liquid funds that have illiquid and may break the buck or things like that that we saw some in the crisis. Or people that have matched illiquid assets and liquid vehicles. We don't tend to do that.

The market has grown so much. So, a trillion and a half, any time you get a recessionary environment, you're going to have surprises. So, I'm sure there are going to be some.

Where we said, A, we don't think there's risk to the financial system. And B, we think that we have a lot of capital below us in equity. And we have companies that are earning, in most cases, hundreds of millions of dollars of EBITDA. So, they're operating performing credit, we think, will weather the storm. I'm sure we'll have our moments of stress. But we'll weather the storm. So, I don't really think that it's a risk to the financial system.

Alison Mass: What's the most important economic statistic for business leaders to follow over the next ten years?

Scott Kapnick: For me, it goes back to the globalization. Global growth, real global growth is critical. And it has to be economic value added. It won't be sustainable if it's all government funded. It has to be real economic growth around the world. And to the extent that we can do that, you know, you can get a lot of people out of poverty.

Alison Mass: So, let's talk a little bit about leadership. As you know, we're living in an era that's been governed by leadership in crisis. Business leaders across all sectors really stepped up and led during the pandemic. We now have a war in the Ukraine. And leaders have had to step up in ways they never imagined. So, how has this time, the last few years, shaped your perspective as a leader? And how do you think it will change the way executives lead their companies moving forward?

Scott Kapnick: I'm a big believer in great institutions where you learn-- leadership is sort of a function of culture and what you stand for, what you say yes to and what you say no to. And leader, it's more about what you do and less about what's on the social media.

I think that in periods that we're living through now, the COVID experience, there were many places where you needed to do the right thing. And yet, it was an experience where you hadn't been through it before. So, you know, the whole work from home environment. And we learned a lot about-- it did remind me a little bit of 9/11 in some regards that safety became the number one priority. So, really for running an organization, you want to make sure your people are safe. They have a good environment they're working in.

And then, people also, we all learned being at home was a hard environment for a lot of young mothers and young fathers because they were in an environment where they couldn't really work. And so, you needed to try to give them what you could give them to support. And I think you've just got to change and adapt to the environment that you're facing as leaders.

I think one of the other leadership things after the George Floyd murder here, we got together as a group and people decided, we want to do something. We want to do something, and we want it to be significant. So, with you know, created the partnership with Howard where we gave them $10 million to really help broaden some of the activities that they're doing in asset management. Created a Center for Financial Excellence. And really trying to provide scholarships and work at the school, plus internships, to get people. And they've done an incredible job for people to know, they've done an incredible job in medicine and in law. And we're trying to bring that to asset management. And I've been thrilled with the support that the financial community has given to, yeah, let's help. Let's get focused on it.

Alison Mass: You talked about the average age of the people at HPS. We have many young people who work here as well. What advice do you have for the next generation on how to be good stewards of the firm?

Scott Kapnick: When I left, I think investment banking was a couple of billion of revenues. And you've broadened it out to every--

Alison Mass: That's like a week for [UNINTEL].

Scott Kapnick: Yeah, every industry group has multiples of that. And regions. So, my hat's off to everybody.

I would say for people who are in the firm, any time anybody asks me, you only get to leave Goldman once. You all hear that. But that is true. So, I think broadly, my father used to say this about Arthur Anderson, I think people do leave too early most of the time. Of course, I would never say that I left too early. So, nobody says they left too early. But they oftentimes don't realize they can get through to the next level and their career is going to have a huge rocket.

And people who've stayed, you're a great witness, have done really, really well. And so, I do think that the common theme out there now for young people is you shouldn't stay at a firm for long. You should move. Go from three. You know? And I would push back on that.

Most of the young people in the firm are going to live to 90- or 100-year life expectancy. So, you've got a long time. Take your time.

And then I also think, you know, times have changed with technology. And people who are in the firm that have then gotten more senior have to remember to look down and be a mentor, practically, and you know this as well as anybody, mentoring, particularly, women and minorities. You have to mentor people. You have to find them mentors. And you have to help them.

Look back. I always say this to people. I'm like, whenever I have a conversation, and no matter where it's been really, people will always say, "Well, I look up. I should be that. I should be that." And you say, "Well, have you looked down?" And you've got to look both down, laterally, and try to help people in the organization.

Alison Mass: What is your definition of success, Scott? And how did Goldman help you shape it?

Scott Kapnick: Well, I had the good fortune of having a father that I was very close to and, you know, sort of taught me that you want to build a balanced life. You want to give back to your community. It's making the world a better place. That sounds trite, but Goldman's done that. A lot of those lessons that we try to apply to HPS. And then most importantly, it's your family and what you create with your family. And you know, what you do to help others in making the world a better place. So, that really is success.

Alison Mass: Well, Scott, thank you so much.

Scott Kapnick: Thank you.

Alison Mass: And please join me in thanking Scott.

Scott Kapnick: Thank you.