Hamilton Lane

Why Secondaries and Why Now?

A Primer for Today's Secondary Market Opportunity

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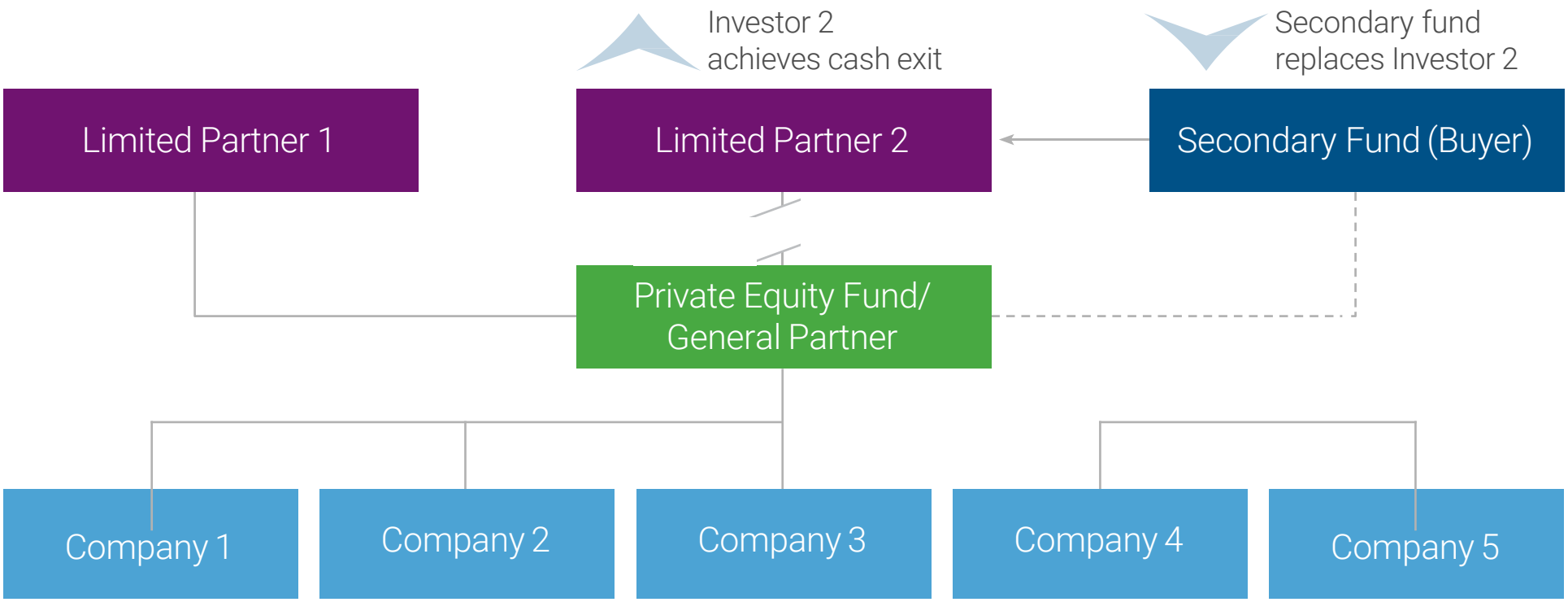
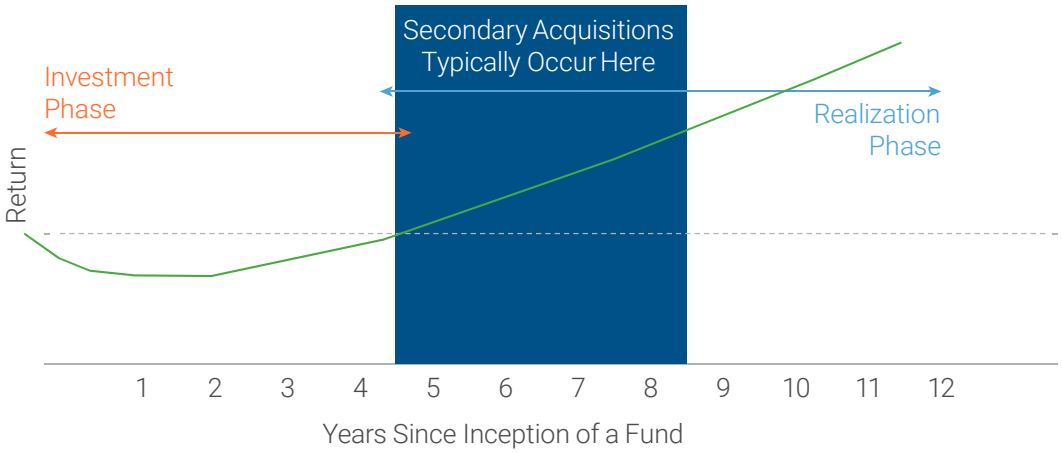
What is a Secondary?

- A secondary transaction is the transfer of a limited partnership interest from the selling Limited Partner ("Seller") to the new owner ("Buyer"), who assumes all rights and obligations of the Seller, including any remaining open commitments to the funds being sold
- Typically, this transfer process requires the consent of the General Partner of the respective fund



Mechanics of a Secondary Transaction

Timing

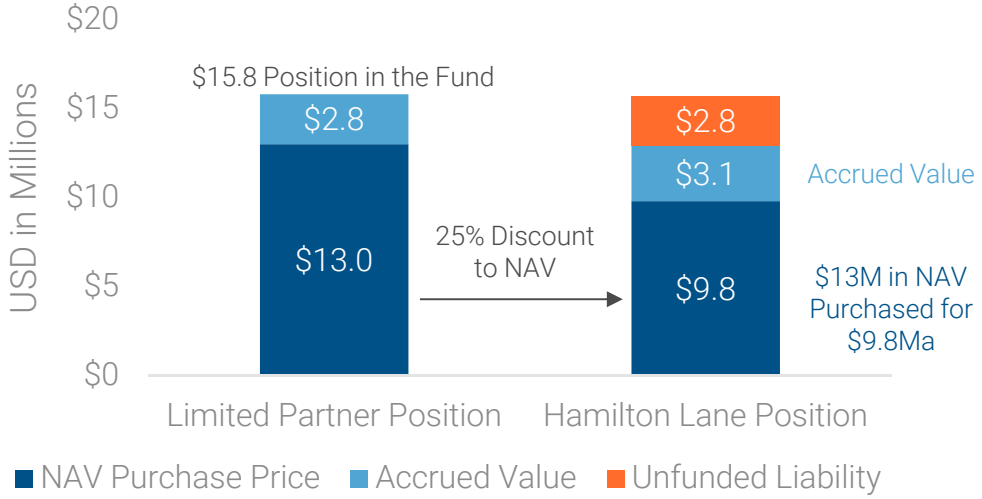


For illustrative purposes only

- In the initial years of a traditional primary private equity investment, a fund will exhibit low or negative returns - known as the J-curve
- Secondary acquisitions typically occur well into a funds life, typically over five years old and >50% drawn

✓ "See-what-you-buy" advantage ✓ Eliminate J-curve ✓ Maturity leads to early distributions

Pricing



For illustrative purposes only

- Private equity positions are often bought at a discount

✓ Risk Mitigating through pricing ✓ IRR performance through discount

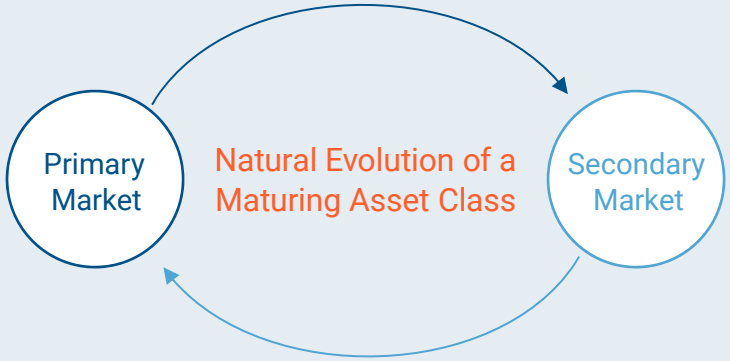
Transaction Example: *The LP was looking to sell a mostly-funded position with a current NAV of $13 million and $2.8 million in unfunded obligations. Our competitive position - a deep familiarity with the GP, multiple advisory board seats on their funds, and limited competition for the secondary - allowed us to buy the position at a 25% discount.*

Why Does the Secondary Market Exist?

Secondaries are a way to provide liquidity

Private Equity Fund Investments

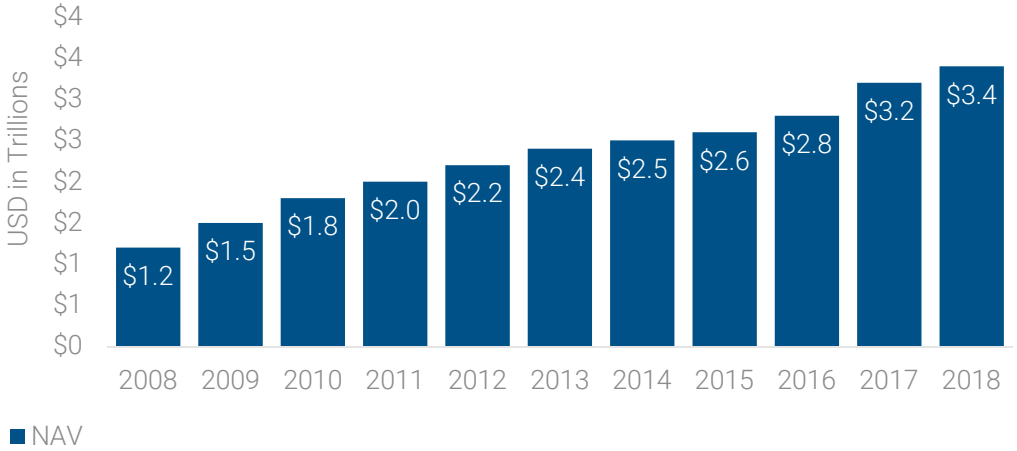
- Long-term commitment
- Illiquid by nature
- Life of fund is typically 12+ years
- Asset class has seen sustained growth



Secondaries

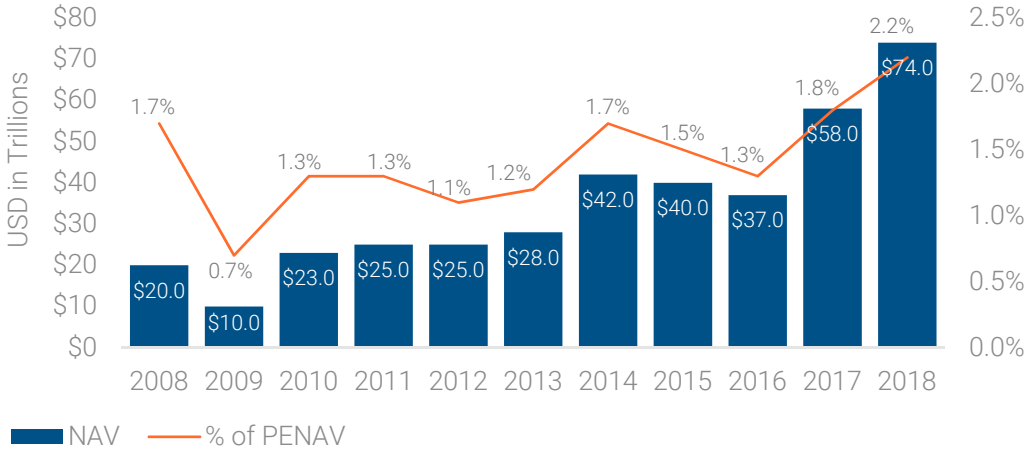
- Mechanism for liquidity for an illiquid asset class
- Offers investors the option to sell and transfer interest in a fund/asset to another investor

Private Market AUM



Source: Hamilton Lane Database (March 2019)

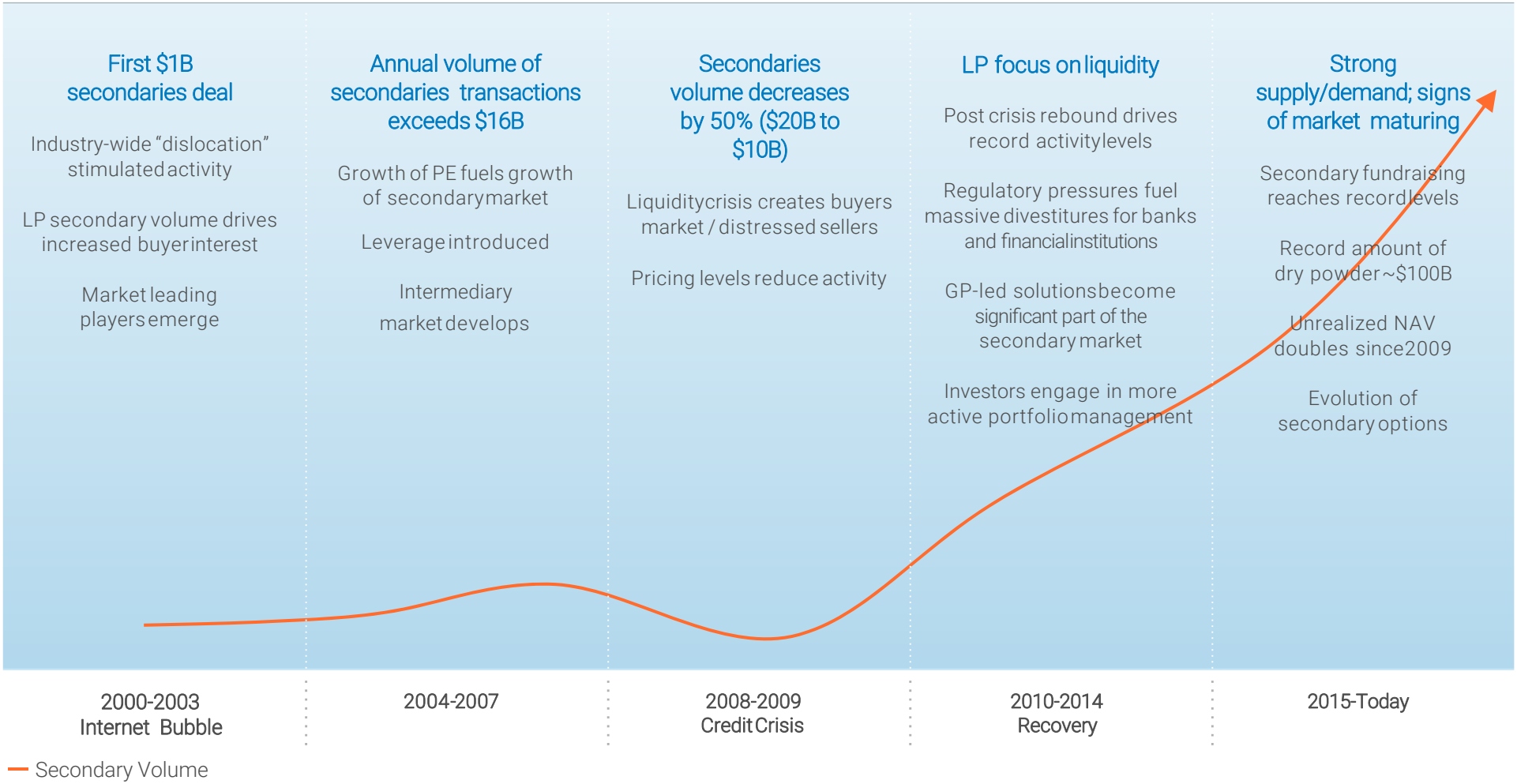
Secondary Market Transaction Volume



Source: Greenhill Secondary Market Trends & Outlook (January 2019)

Why is the Secondary Market Growing?

The liquidity landscape for private market interests has continued to expand



Key Growth Drivers

Capital Inflows
- Private markets growth

Expanding Opportunity Set
- Capital inflows are creating more options

Investor Mindset
- Goal oriented liquidity solutions

Longer Investment Duration
- Private market hold periods are extending, which leads to more unrealized NAV

Why Investors Sell in the Secondary Market

Desire to sell an interest in a secondary transaction can come as a result of various reasons:

Liquidity Management

- Cash needs
- Needs to reduce unfunded commitment balance
- GP perspective: fund wind-downs / restructurings

Strategy Shift

- Changes in investment team / new view points
- Changes in private equity investment strategy

Portfolio Management

- May need to sell existing interest to permit investments in new funds
- "Clean up exercise"
- Selling interest in older funds to reduce number of GP relationships

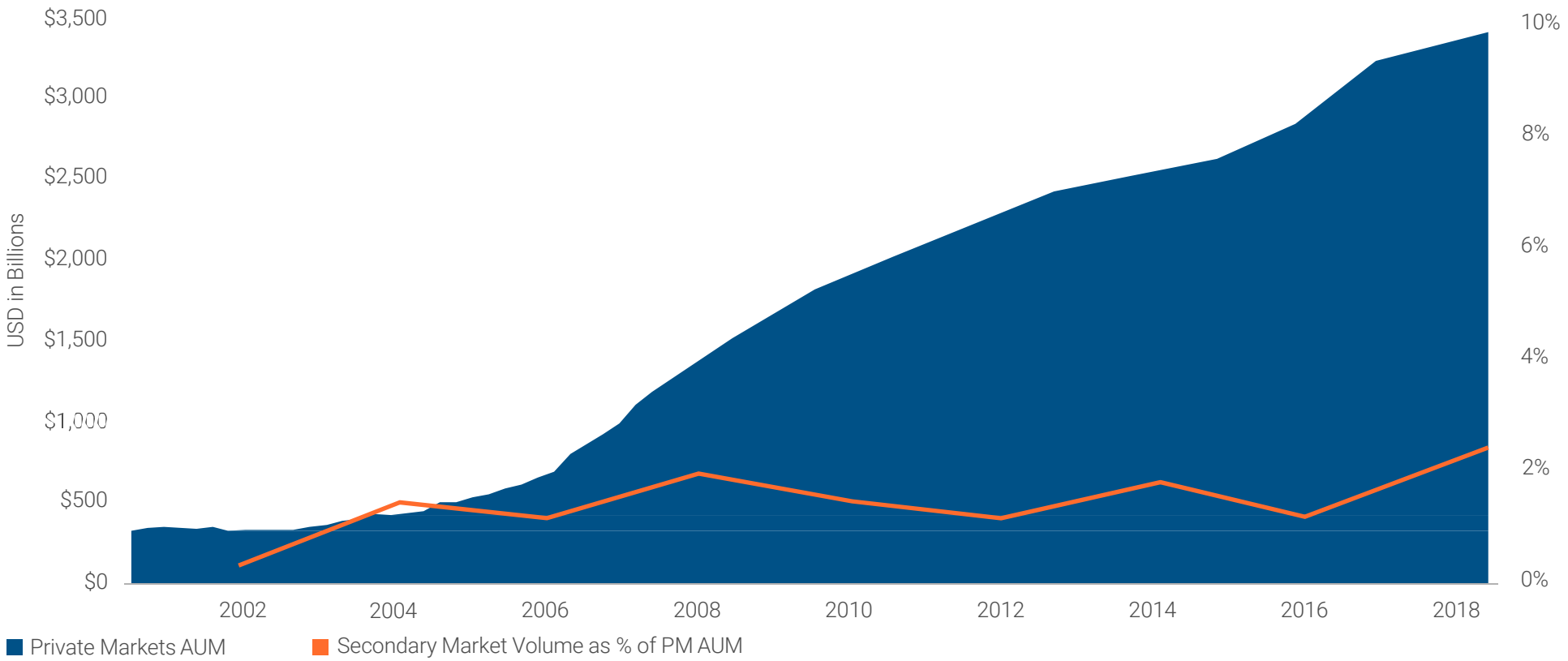
Achieve Liquidity	Reduce unfunded commitment liability	Free up allocation for new commitments	Change in investment outlook/strategy	Monetize performing or tail-end private equity exposure	Rationalize non-core GP relationships	Reduce overweight to private equity	Rebalance/ optimize private equity portfolio

Liquidity ← → Portfolio Management

Growth Drivers of Secondary Market

Rising PE NAV Provides More Supply of Potential Opportunities

Private Markets Assets Under Management



Source: Hamilton Lane Fund Investment Database (March 2019)

Portfolio Management	Strategy Shift	Change in Investment Team	Fund Wind-downs

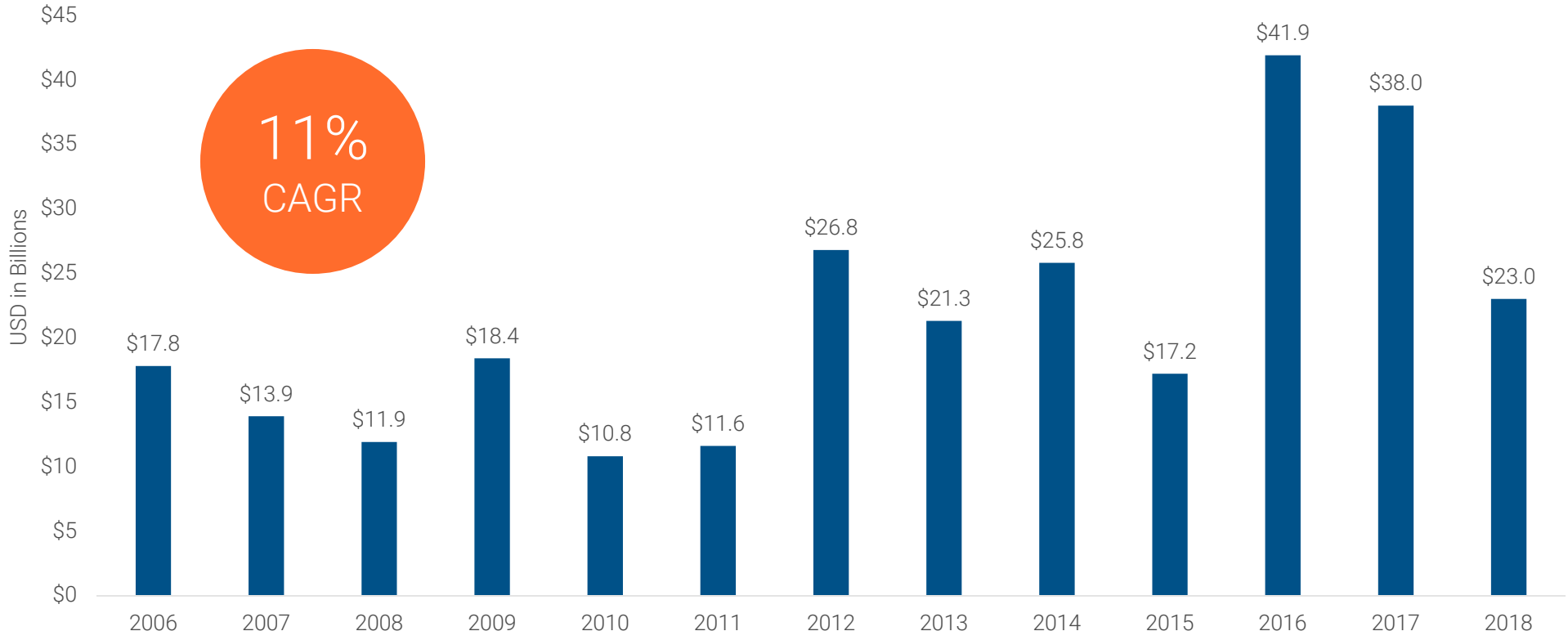
Why Investors Buy Secondaries?

From the private equity investor's perspective, secondaries offer a number of diversification and return benefits relative to primary fund investments

J-Curve Mitigation	• Investments are purchased farther along in their life cycle, with the potential to reduce the negative impact of management fees and accelerating the pace and timing of distributions
Instant Portfolio Diversification	• Secondaries may provide investors with the ability to quickly diversify a portfolio by vintage year, investment strategy, industry sector and fund manager
Risk Reduction from Knowledge of Underlying Assets	• When evaluating a secondary transaction, the portfolio companies can be carefully analyzed, reducing the "blind pool" risk associated with primary investments
Increased Pace of Capital Deployment	• Investments are typically at or near their investment periods when purchased
Yield	• Maturity leads to early distributions • Benefit of adding seasoned private market stakes to an existing portfolio

Secondaries are a Popular Tool for PE Portfolios

Secondary Fundraising



Source: Private Equity Analyst, Lexington Partners, LP (January 2019)

* The 2018 fundraising figure is somewhat misleading as the largest secondary funds that are currently raising will hold significant closes in 2019

Yield	J-Curve Mitigation	Increase Pace of Deployment	Risk Reduction From Knowledge of Assets	Instant Portfolio Diversification

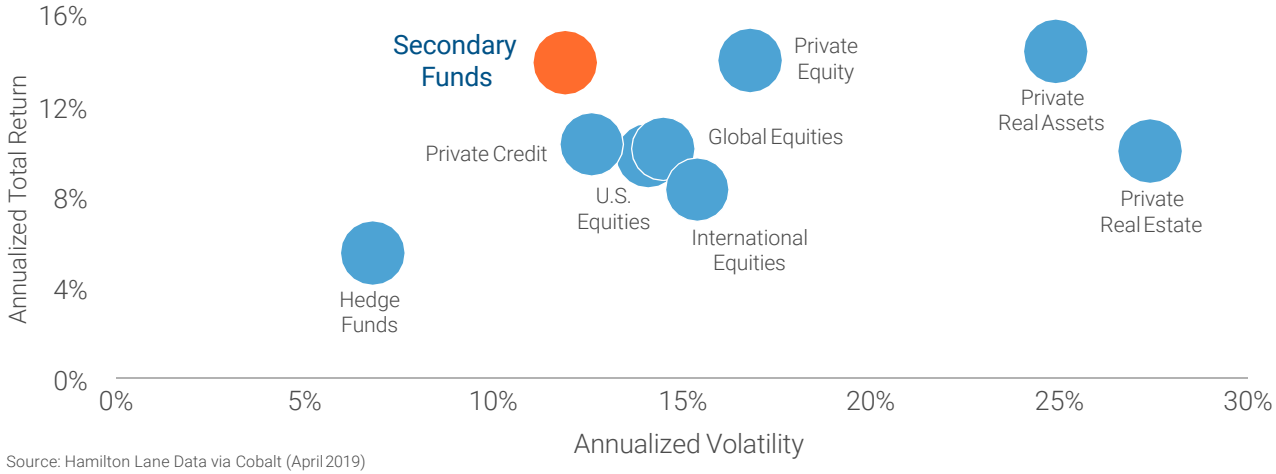
Why Secondaries?

Limited Partners:

- Increasing allocations to secondary funds
- Diversifying exposure across secondary firms/strategies
- Seeking portfolio benefits:
  - ➢ Attractive Risk-Adjusted Returns
  - ➢ Accelerated cash flow profile
  - ➢ Shorter Duration Relative to Other Strategies
  - ➢ J-Curve Mitigating

15 Year Asset Class Risk-Adjusted Returns

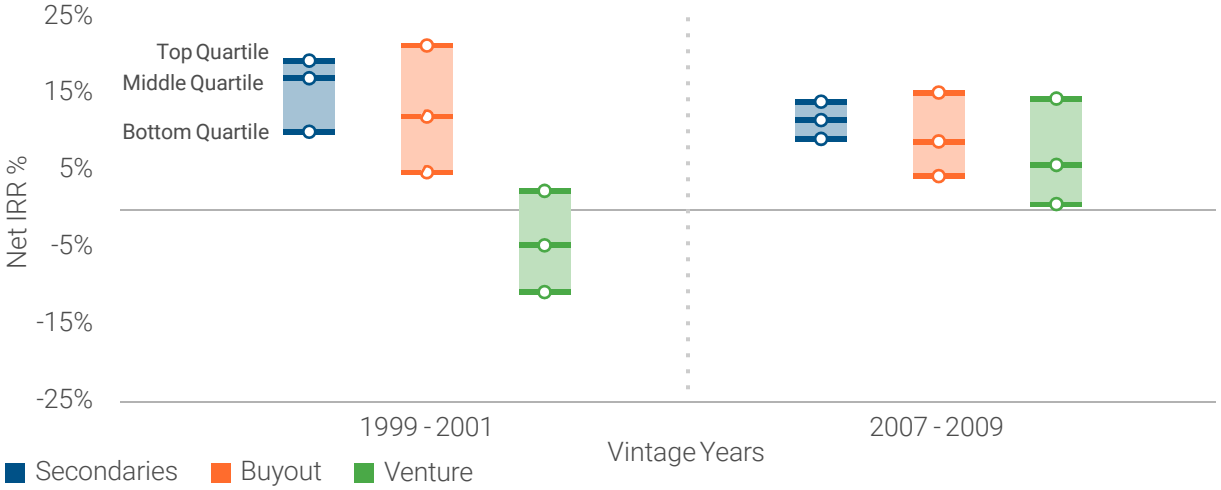
As of 9/30/2018



Source: Hamilton Lane Data via Cobalt (April 2019)

Dispersion of Returns During Market Downturns

As of 6/30/2018



Source: Hamilton Lane Data via Cobalt (April 2019)

Why Now?

As the secondary market continues to grow, we believe it offers an attractive opportunity set

Growth and Opportunity

- ✓ Increasingly active market that we believe continues to offer attractive conditions

New Entrants

- ✓ Broad market acceptance of expanding activity = more participants
- ✓ More creativity
- ✓ GP led transaction volume

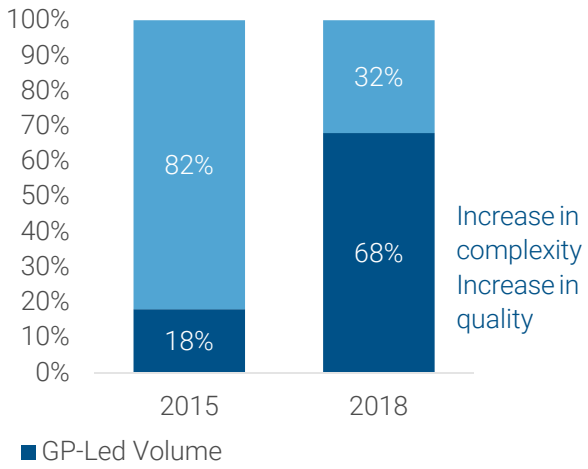
Liquidity for the Private Markets

- ✓ Secondary market has mitigated concerns over PE liquidity
- ✓ Event driven to goal-oriented liquidity solutions

$74B Volume in 2018

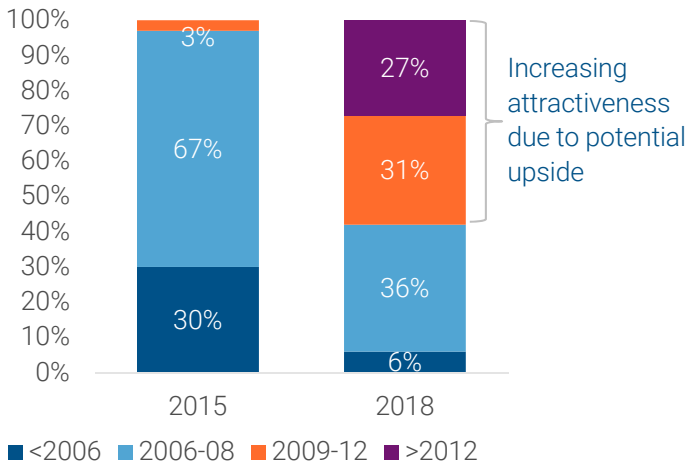
28% YoY Growth

GP-Led Transaction Volume and Activity



Source: Greenhill Cogent January 2019

Vintage Year Mix Has Shifted



Source: Greenhill Cogent March 2019

What is Important in this Market?

Given the growth and evolution of the secondary market, we believe the following qualifications are necessary in order to be best positioned to succeed:

Unique Access

- **Relationships:** represent long-term strategic partner.
- **Information:** not rely solely on information provided by brokers or GPs. Have internal proprietary data that provides deep intel and perspective.
- **Deal Flow:** leverage relationships and market position to drive access to differentiated and proprietary opportunities globally.

Diversified Platform with Strong Capital Base

- Primary scale to leverage general partner relationships to secure non-competitive transactions and exploit information advantages.
- Secondary scale to offer comprehensive portfolio solutions in a market that increasingly prefers limited counterparties. Lacking scale severely limits competitive positioning.

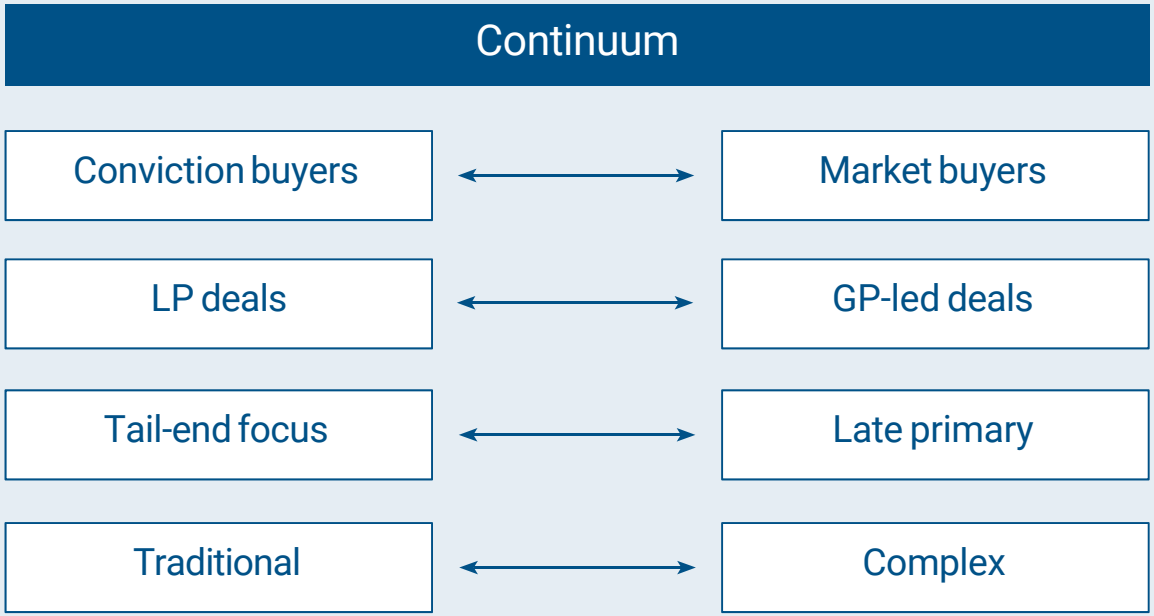
Experience and Credibility

- Proven ability to invest across region, strategy and transaction type.
- Ability to offer comprehensive solutions to brokers, limited partners and general partners.
- Firms that commit capital across the entire private equity landscape and that also have secondary teams experienced in structured, complex transactions will be the ones most capable of navigating the increasingly competitive, but increasingly diverse secondary market.

Considerations for LPs

Limited Partners' Perspective

- Analysis/evaluation of secondary funds is more complicated as market has evolved
- More choices
- Vary by size, geography, sophistication and focus
- How do secondary funds generate returns?



Not All Secondary Funds are the Same

Appendix

Endnotes

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[1] Desmoothing – A mathematical process to remove serial autocorrelation in the return stream of assets that experience infrequent appraisal pricing, such as private equity. Desmoothed returns may more accurately capture volatility than reported returns. The formula used here for desmoothing is: where: rD(t) = the desmoothed return for period t r(t) = the return for period t ρ = the autocorrelation r D (t) = (r(t) – r(t-1) * ρ) / (1 - ρ)

Index Definitions Barclays U.S. Corporate Aggregate Index – Tracks the performance of U.S. fixed rate corporate debt rated as investment grade. HFRI Composite Index – The HFRI Composite Index reflects hedge fund industry performance.

MSCI Emerging Markets Index – T he M SCI E merging M arkets I ndex i s a f ree fl oat-adjusted m arket capitalization index that is designed to measure equity market performance of emerging markets. MSCI World Energy Sector Index – The MSCI world Energy Sector Index measures the performance of securities classified in the GICS Energy sector. MSCI World ex U.S. Index – The MSCI World ex U.S. Index tracks large and mid-cap equity performance in developed market countries, excluding the U.S. MSCI World Index – The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

Russell 3000 Index – The Russell 3000 Index is composed of 3000 large U.S. companies, as determined by market capitalization. Russell 3000 Net Total Return Index – The Russell 3000 Index is composed of 3000 large U.S. companies,as determined by market capitalization with net dividends reinvested. VIX – The Volatility Index is an index created by the Chicago Board Options Exchange (CBOE) which shows the market's expectation of 30-day volatility.

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