Riffs

With Mario Giannini, CEO

I’ve gotten some jabs from a few GPs who after reading the last few Riffs I’ve written have objected to my “piling on” them as the root of every private equity problem. There’s probably some truth to that charge as GPs often make such appealing targets. But fair is fair, so let me highlight 3 mistakes that LPs make that create disappointing PE portfolios.

1. No Numbers

As an industry, private equity continues to lack robust data sets with which to reliably perform relative performance analysis and benchmarking. Often used as a reason why so many poorly-performing GPs can continue to exist (remember, they all claim to be top quartile), it’s also a reason why so many LPs can continue to select those GPs. What I mean is, LPs blithely offer the same rationalizations for lousy performance that they use to criticize GPs. Here are just three:

- Boy, that J-curve is something, isn’t it?
- Returns just aren’t that meaningful for the first 800 years of my portfolio’s life…
- Well, it’s top quartile when I project the return I believe will be achieved 10 years from now

Few asset managers in any other asset class manage such large dollars with such relative inexperience or lack of performance data as we see in private equity. The combination of poor data and the longer-term nature of private equity investments allows many LPs to continue running PE portfolios when, in other asset classes, their demonstrated skill sets would have them looking for a new line of work. PE LPs should have the same defined, measurable benchmarks and relevant peer comparisons as other asset classes and should be accountable for superior or inferior performance. The fact that private equity has a different performance profile than other asset classes can account for some different comparison benchmarks, but not for a total absence of performance standards.

Read more on page 2
Firm News

Hamilton Lane is pleased to announce that we recently acquired Shott Capital Management (SCM), a leading provider of private equity separate account and distribution management services. Distribution management can help to enhance overall private equity returns through the active management of in-kind stock distributions.

This winter, Hamilton Lane welcomed Paul Waller to the firm in the newly-created role of Partner, where he will focus primarily on client development and overall firm marketing initiatives.

Paul Yett, Managing Director, has been named to the Governing Board of Directors of The Robert Toigo Foundation, a non-profit educational fellowship program focused on fostering leadership development and advanced career opportunities for diverse finance professionals.

Hamilton Lane held its Annual Offsite from March 5-7th in Philadelphia. The annual event brings together all Hamilton Lane employees from around the globe to meet, mingle and discuss the year ahead. This year’s theme was “The Hamilton Lane Puzzle” and highlighted how all of the pieces of our business - employees and clients, general partners and consultants - fit and work together to build a successful organization.

For more firm news, please visit our website.

Riffs (continued from Cover)

2. No Plan

Paul Simon said it more eloquently than I ever could: “Make a new plan, Stan.” So many LPs believe private equity is a bottom-up, manager-driven asset class. If you select the right managers, you’ll be fine. That is a generally true statement; yet, it ignores the pesky issue of that seemingly innocuous phrase “if you select the right managers.” Portfolios driven by a bottom-up approach often share characteristics: enormous over-diversification of managers; random vintage year pacing; bizarre clusters of managers in formerly “hot” investing areas; and, most persistently, lousy returns.

Not only is the bottom-up approach an incomplete methodology when it comes to portfolio construction, it’s also not enough to rely upon a plan formulated in the days when PE was a cottage industry. No doubt you’ve seen some variation of the “one-third diversification” plan before: 1/3 venture, 1/3 buyout, 1/3 special situation (that latter category really being the bucket containing random “managers I really like…”). It’s astounding to us that investors still employ this plan, but many do. Our experience is that the resulting investment portfolios feature a random array of managers forced into outdated designations and an almost complete failure to capture changes in the global private equity market.

LPs need to have a strategic plan for investing their alternatives portfolios. Simply having a thought-out strategic plan is actually more important than what the specific plan might be. We’ve seen successful plans defined by number of managers, by geographic guidelines, by sub-asset class parameters, or by a combination of those. Following any plan almost invariably leads to better results. It’s not as easy as it sounds, however. Adopting a strategic plan violates the cherished LP view that we are all “deal people” and that plans are for those who labor in the barren fields of public equity investing.

Read more on page 4
**Insights**

- Private equity continues to outperform public market investments over a long-term horizon\(^1\).
- In 2012, private equity funds distributed $413B or 23% of prior year end’s market value, with $161B distributed in Q4.
- Distributions in Q1 2013 totaled $78B, a decrease of 51% from Q4 2012 but an increase of 29% from Q1 2012 distributions.
- Adjusting for recent cash flows and extrapolating from funds currently reporting end of year financials:
  - Total unrealized NAV fell to an estimated $1,793B from $1,841B at year end 2012.
  - Unfunded capital, or dry powder, decreased to an estimated $735B from $774B at year end 2012.

**Global Annual Cash Flows**

- USD in Billions
- % of Prior Year End NAV Distributed

**Current Unfunded By Vintage Year Groups**

- 2008-2010: 32%
- 2005-2007: 18%
- 2008-2010: 31%
- 2005-2007: 47%

**Current NAV By Vintage Year Groups**

- 2011+: 5%
- 2002-2004: 2%
- 2002-2004: 8%

**Horizon Returns**

<table>
<thead>
<tr>
<th>Horizon Returns</th>
<th>Quarterly</th>
<th>Annualized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q4 2012(^2)</td>
<td>1 Year</td>
<td>5 Year</td>
</tr>
<tr>
<td>All Private Equity(^3)</td>
<td>2.9%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Buyouts</td>
<td>2.9%</td>
<td>12.5%</td>
</tr>
<tr>
<td>U.S. Buyouts</td>
<td>4.0%</td>
<td>13.0%</td>
</tr>
<tr>
<td>European Buyouts</td>
<td>0.7%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Distressed Debt</td>
<td>3.7%</td>
<td>17.3%</td>
</tr>
<tr>
<td>Venture Capital</td>
<td>2.8%</td>
<td>7.6%</td>
</tr>
<tr>
<td>ROW Strategies</td>
<td>3.9%</td>
<td>9.6%</td>
</tr>
<tr>
<td>S&amp;P 500 Total Return</td>
<td>-0.4%</td>
<td>16.0%</td>
</tr>
</tbody>
</table>

Please refer to page 6 for endnotes.

---

1. Private equity continues to outperform public market investments over a long-term horizon.
2. Quarterly results may not sum to annualized returns due to the nature of the data.
3. All Private Equity includes buyouts, venture capital, distressed debt, and ROW strategies.
Riffs (continued)

3. No Company

My favorite mistake is related to the one justification we've all heard for why a particular manager was selected: "Well, this manager is in a very niche strategy that no one else is pursuing, and surely that spells success" or "this manager is off-the-beaten-path and undiscovered, and I like that." People tend to have a romantic notion that there are Shakespeares and Picassos out there in all lines of work toiling away in anonymity and just waiting to be found - miraculously, by us.

There aren’t.

The automotive designer, Strother McMinn, once remarked, “There is no such thing as an undiscovered genius.” He's right. Not in art, not in design and certainly not in private equity.

We inherit and examine a lot of portfolios. If our fund diligence team says they’ve never heard of more than 20% of the names in a portfolio, the only thing I can promise you is that the portfolio’s performance has not been very good.

Yet, this belief that outsized returns can only come from undiscovered GPs endures across vast swaths of the LP community. It is a heady, and toxic, combination of beliefs that (a) you can find what no one else can find, and (b) if everyone else believes something is good, then there must be something inherently wrong with the idea.

Some years ago, I was listening to an LP deliver the “boldly go with me, fellow LPs, where few dare to go and vast PE riches await!” line. I challenged the LP to choose 5 favorite “undiscovered gems” of the last couple of years, then to make a list of the 50 most “generic” GPs in the market. I bet that 5 of those would out-perform the LP’s picks. I even let this LP choose the 5 “generic” GPs, assuming they would under-perform.

Thus far, the contest isn’t even close. This LP’s gems are as sparkling as still water. But perhaps it’s still too early to tell and we should wait until the next appearance of Halley's Comet before making a final judgment.

The one consistent theme around each of these mistakes is the persistent refusal to believe that any of the rules that spell success in other asset classes could possibly apply to PE. It’s simply not true. The use of data, strategic plans and common sense in choosing managers is a hallmark of good PE portfolios. We are not as charmingly idiosyncratic and unique (and therefore above criticism) as we often like to believe. ☹

The automotive designer, Strother McMinn, once remarked, “There is no such thing as an undiscovered genius.”
Is Energy Private Equity Getting Too Hot?  
John Shea  
Investment Director, Fund Investment Team

Common wisdom is that there’s too much private equity capital chasing the energy sector. We believe that common wisdom is wrong...again.

The energy industry is large, complex, capital intensive, global and growing – all important characteristics that have captured the attention and, more importantly, the capital of general partners and limited partners alike.

Natural Resources Fundraising

In 2012, the aggregate amount raised by energy-focused funds came close to surpassing the highs achieved in 2006 and 2009. In addition, 29 funds are currently in the market targeting $30 billion in commitments. Keep in mind these figures don’t include generalist private equity firms with an allocation to energy. All of this has limited partners wondering: is there too much private equity capital chasing energy?

The simple answer is “no.”

We believe that despite press headlines that suggest energy activity may be overheating (pun intended), the size of the market, long-term growth prospects and the complex nature of the energy value-chain will continue to present investment opportunity.

1 BP Energy Outlook 2012
2 U.S. Energy Information Administration (July 2012)

Spotlight

Global Energy Spending vs. PE Dry Powder

Simply put, the massive capital spending requirements to meet expected global demand dwarf the amount of private equity capital available today. With newfound wealth, developing economies are demanding basic services, which include energy sources and infrastructure. Global demand for new energy supply is projected to grow nearly 1% per year over the next 20+ years, largely driven by non-OECD countries, particularly China. In North America, the application of new technologies to abundant shale resources has helped to transform the U.S. into a major supplier of natural gas and the fastest growing non-OPEC oil producer in the world. All of this means that the energy industry must continue to attract more private capital not only to develop new sources of energy but also to build and replace existing supply infrastructure and services.

Hamilton Lane Key Notes | April 2013

Proprietary and Confidential | www.hamiltonlane.com
Endnotes

Page 3

1 Compared to the S&P 500.

2 Q4 2012 return is an early look based on approximately 60% of funds in sample reporting as of April 1, 2013.

3 All Private Equity includes all primary investments in private equity partnerships, including but not limited to funds targeting buyout, growth equity, venture capital, distressed debt, mezzanine, infrastructure, co-investment, and special situation strategies. This analysis excludes real estate investments.

Disclosures

This presentation has been prepared solely for informational purposes and contains confidential and proprietary information, the disclosure of which could be harmful to Hamilton Lane. Accordingly, the recipients of this presentation are requested to maintain the confidentiality of the information contained herein. This presentation may not be copied or distributed, in whole or in part, without the prior written consent of Hamilton Lane.

The information contained in this presentation may include forward-looking statements regarding returns, performance, opinions, the fund presented or its portfolio companies, or other events contained herein. Forward-looking statements include a number of risks, uncertainties and other factors beyond our control, or the control of the fund or the portfolio companies, which may result in material differences in actual results, performance or other expectations. The opinions, estimates and analyses reflect our current judgment, which may change in the future.

All opinions, estimates and forecasts of future performance or other events contained herein are based on information available to Hamilton Lane as of the date of this presentation and are subject to change. In addition, nothing contained herein shall be deemed to be a prediction of future performance. Certain information included herein has been obtained from sources that Hamilton Lane believes to be reliable but the accuracy of such information cannot be guaranteed.

This presentation is not an offer to sell, or a solicitation of any offer to buy, any security or to enter into any agreement with Hamilton Lane or any of its affiliates. Any such offering will be made only at your request. We do not intend that any public offering will be made by us at any time with respect to any potential transaction discussed in this presentation. Any offering or potential transaction will be made pursuant to separate documentation negotiated between us, which will supersede entirely the information contained herein.

Hamilton Lane (UK) Limited is a wholly-owned subsidiary of Hamilton Lane Advisors, L.L.C. Hamilton Lane (UK) Limited is authorized and regulated by the Financial Services Authority. In the UK this communication is directed solely at persons who would be classified as a professional client or eligible counterparty under the FSA Handbook of Rules and Guidance. Its contents are not directed at, may not be suitable for and should not be relied upon by retail clients.

The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice, or investment recommendations. You should consult your accounting, legal, tax or other advisors about the matters discussed herein.

As of April 8, 2013