GP Dashboard

HAMILTON LANE 2019/2020

Hamilton Lane

We are pleased to present Hamilton Lane's 2019/2020 GP Dashboard.

Every year, the Dashboard captures the opinions and expectations of general partners from around the world, offering insight into where the GP community believes the markets are headed. This year's survey features responses from more than 130 of the most well-known and top-performing general partners, who share their views on the broader global markets as well as their specific private markets portfolios.

Highlights from the 2019/2020 GP Dashboard

A recession is certainly on the radar, but most GPs aren't too worried about a downturn just yet.
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With IPOs unlikely for most, what's topping the list of exit options in the coming year?
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Outperformance is still expected — a potential nod to the optimism this group continues to show.
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A surprising percentage of GPs are spending less than $500k annually on technology and infrastructure. We have some thoughts on that...
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GP Snapshot

31% increase in GP respondent base

50% increase in reported AUM

138 GPs

9,900+ Portfolio Companies Managed

$2.5T Reported AUM

Strategy

61% Buyout

12% Growth

10% Venture

9% Debt

8% Real Assets

Geography

71% North America

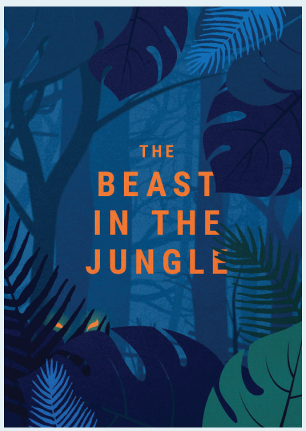
23% Europe

6% ROW

Source: Hamilton Lane General Partner Survey (July 2019).

For our 2019/2020 Market Overview, we selected a theme inspired by Henry James' brilliant, and rather heartbreaking, short novel, *The Beast in the Jungle.*

It's a title that evokes a sense of apprehension and foreboding; indeed, that's what we were going for, since it's a feeling we imagine many can relate to at this point in the market cycle. The risks – real or perceived – lurking within the global marketplace are greater today than they have been in years. Within the private markets, the beasts are out there and investors ought to be focusing on ways to minimize excessive risk within their portfolios – especially if they believe we're on the clock for a recession.



For our part, while we still see plenty of opportunities for outperformance in this asset class, we've never found ourselves in a more uncertain investing environment – which is really saying something since we've been doing this for almost 30 years.

And so, with those pleasantries behind us, let's dig in to our GP Dashboard to see how our general partner group is feeling.

Recession Probability

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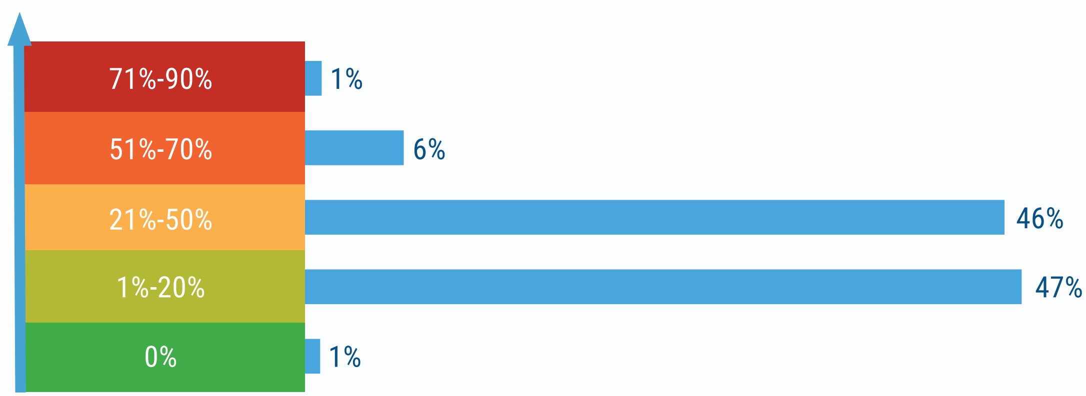
You might be wondering why we decided to kick things off this year with the ever-popular (err, ever-dreaded?) question of whether we should expect a global recession in the coming year. Well, in short, it's because we're at a point in the cycle where any review of market indicators – GP inputs or otherwise – ought to be considered within the context of a possible recession.

In fact, it's this notion of heightening recessionary fear that lies at the crux of our Market Overview this year and indeed had a big hand in inspiring the theme. Couldn't we make the argument that people are so preoccupied with worrying whether the approaching downturn is the "beast in the jungle" waiting to strike, they may be missing opportunities right in front of them? (We think we can; and, in fact, we do.) It's our belief, though, that the next recession, whenever it comes, may not be as large and detrimental as was the Global Financial Crisis (GFC). Faced with that reality, we'd suggest that rather than looking around incessantly for signs of doom and gloom, investors continue to invest in a consistent, balanced way.

But, enough about us. Let's get back to what the general partners think. For their part, GPs seem to be very much split between "low probability" (1%-20%) and "it's a possibility" (21%-50%). Either way, an overwhelming number of GPs think it is more likely that there will not be a recession in the next 12 months. It's important to note here that the geopolitical and macro-economic landscape continues to evolve quickly and with a high degree of volatility, so it's possible this picture may look different today than it did when we fielded this survey in July 2019.

What is the probability of a global recession in the next 12 months?



Source: Hamilton Lane General Partner Survey (July 2019)
Percentages may not add up to 100 due to rounding. Please refer to endnotes on the last page.

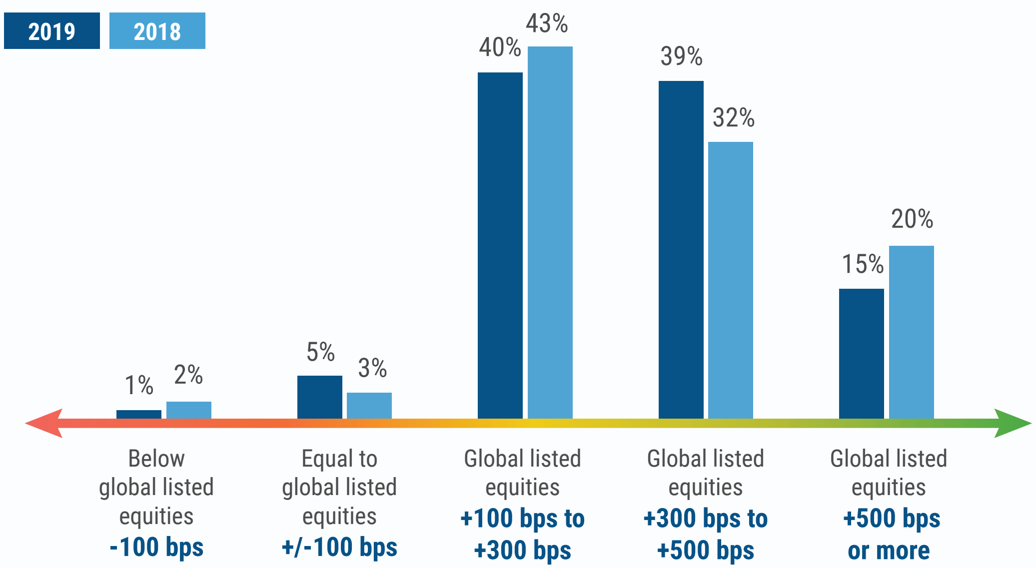
Net Returns

Cautiously Optimistic

So, if they don't believe a recession is imminent, that probably means GPs remain fairly optimistic about private markets returns, right? Precisely. (You're getting pretty good at this.)

When it comes to expected private markets returns over the next three years, our GP respondent base remains roughly as bullish overall as they were last year with the vast majority expecting outperformance greater than 101 bps over global listed equities and more than half (55%) expecting outperformance of over 300 bps. Interestingly, there was a slight pullback in the percentage of respondents anticipating 500+ bps outperformance; possibly an indication of either an increasingly uncertain macro environment or an industry that's simply gaining a better understanding of expectations within the private markets.

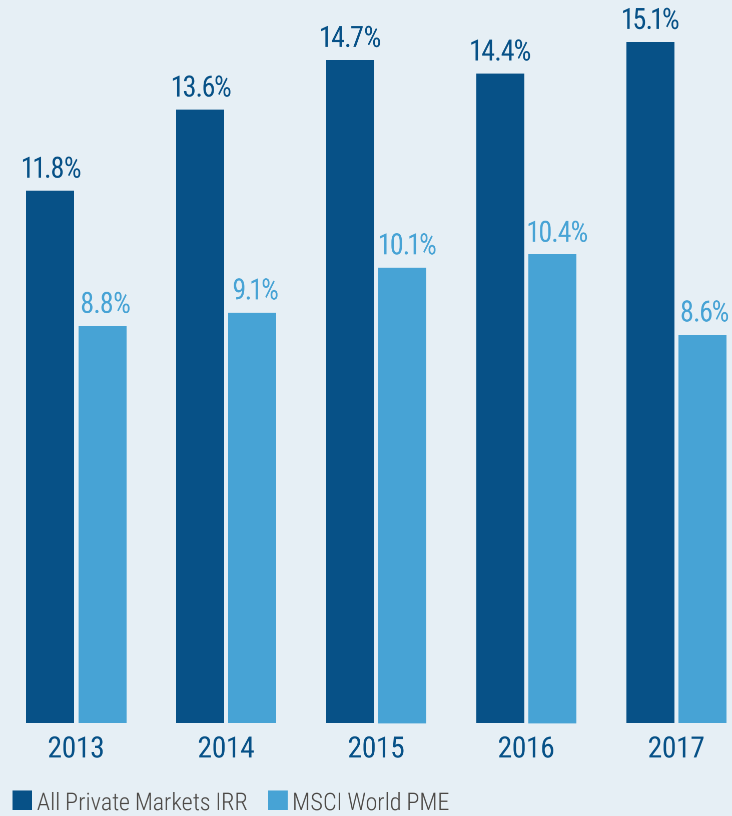
Net returns for all private markets for the following three vintages will be...



Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on the last page.

Much like they have the past few years, our GP group continues to expect that the private markets will outperform the public markets by meaningful margins.

All Private Markets IRR vs. PME



Source: Hamilton Lane Data, Bloomberg (October 2019)

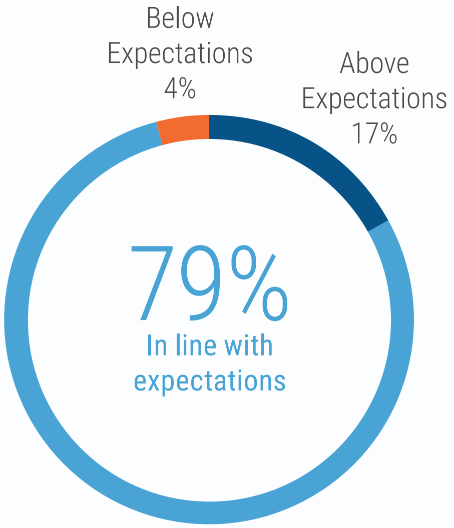
Revenue Growth

Meeting Expectations is a Good Thing

Let's turn for a moment to our group's predictions around revenue growth at their underlying portfolio companies. While a lesser percentage than in last year's survey expect revenue to exceed expectations, the vast majority of GPs nevertheless reported that growth was in line with expectations. We would note that the "above expectations" category has decreased marginally the last three years, perhaps an indication that growth could be slowing overall.

Still, while we think the recession clock has in fact started ticking, our GP friends aren't necessarily seeing that reflected in the topline performance figures just yet, which is likely the first place we would see it. Then again, remember that most of our GPs don't anticipate a recession happening in the next 12 months, so maybe they're on to something...

How do you describe revenue growth across your portfolio companies over the past year?



Source: Hamilton Lane General Partner Survey (July 2019)

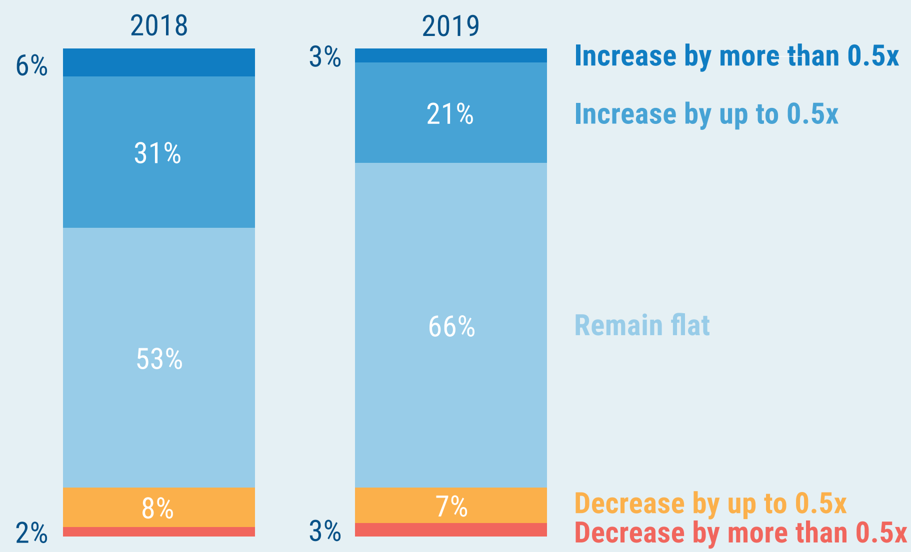
Purchase Prices

Don't Get Too Comfortable

And now for some less-than-stellar news: 96% of our GP respondents expect purchase prices to remain flat or increase in the coming year. This may be an acknowledgment of where we are in the cycle or an indication of where we're headed.

At any rate, the consistently high purchase price multiples, coupled with leverage multiples now at 2007 levels and marked deterioration in coverage ratios at acquisition – particularly in North America – would naturally trigger alarm bells.

Purchase prices over the next 12 months will...



Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on the last page.

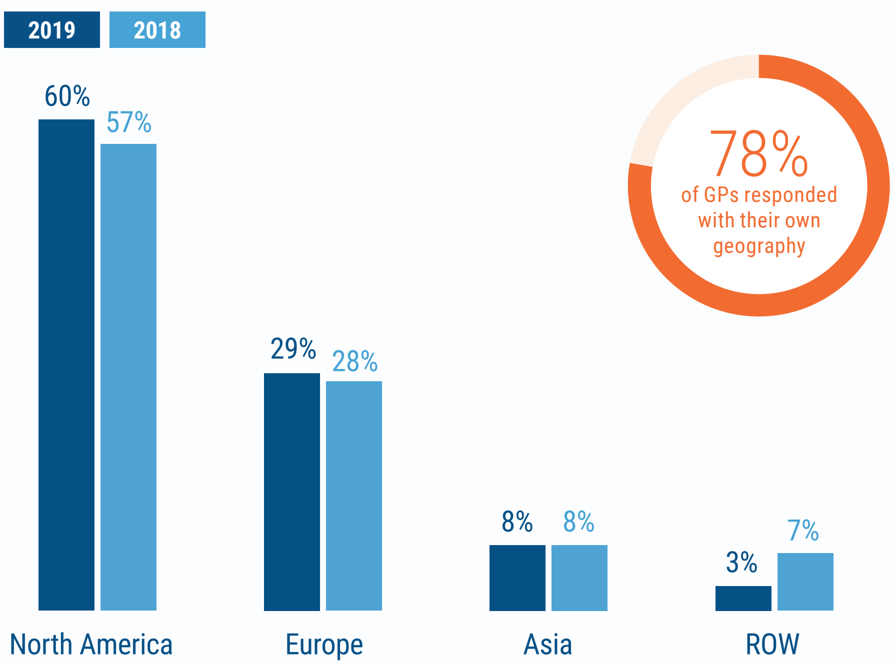
Most Attractive Geographies

With a Dash of Home Bias

With purchase prices high and coverage ratios worrisome, where are managers seeing the most opportunities from an investing perspective? Again this year, North America claims the top spot for most attractive geography, which it's had since 2017 when favor went to Europe.

We advise interpreting this question with a "grain of salt" mentality, as 78% of GPs in the survey selected their home geography. Still, there continues to be less and less interest in ROW, which received 3% of the votes in this year's survey, down from 8% in 2016 and 2017.

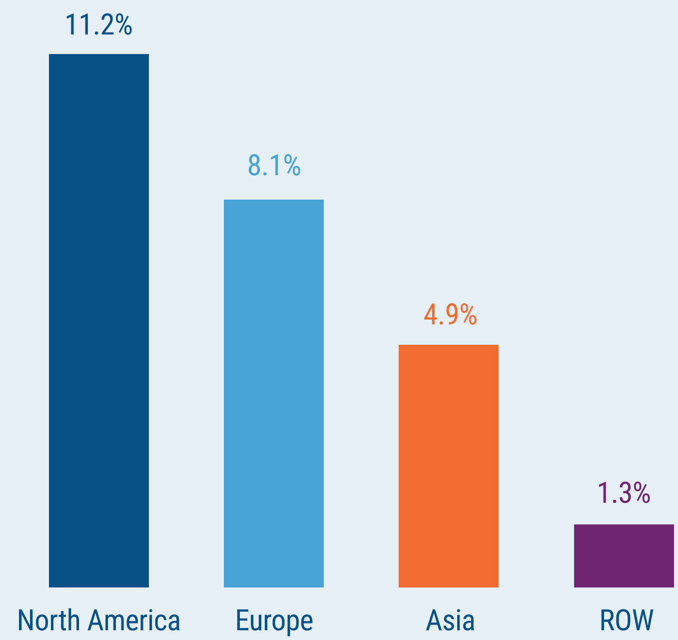
Which of the following private equity markets do you see providing the best risk/reward trade off over the next 12 months?



Source: Hamilton Lane General Partner Survey 2019, 2018 (August 2019)
Please refer to endnotes on the last page.

We took a peek at last year's responses to see how GPs fared in predicting the future. Turns out they were pretty spot on. Despite a bit of home bias, North America did in fact lead the pack in 2018 as most attractive geography, followed by Europe, then Asia and ROW. Only time will tell if GPs go 2-for-2 in 2019.

2018 TWR by Geography



Source: Hamilton Lane Data via Cobalt. Excludes Fund of Funds and Secondary strategies (December 2019)

Exits

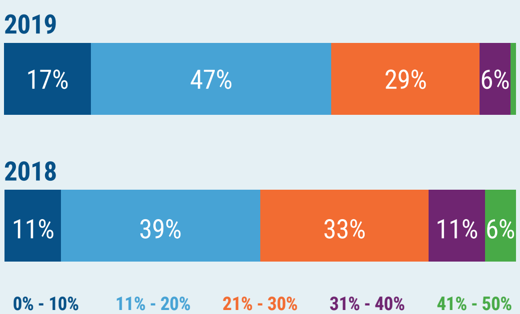
How 'Bout Those GP-to-GPs

Let's shift to a conversation around how GPs are thinking about exits within their portfolios and what that might indicate about today's exit environment more broadly.

On the whole, the percentage of GPs expecting between 11-30% of their portfolio to exit positions in the next year is similar to last year with just under three-quarters of respondents in this bucket. The proportion of GPs expecting more exit activity – in excess of 31% - shrank compared to the last two years. This may be a reflection of where we are in the market cycle, with the last few years having seen a quite active exit environment, due to a significant amount of the '08 crisis activity being sold.

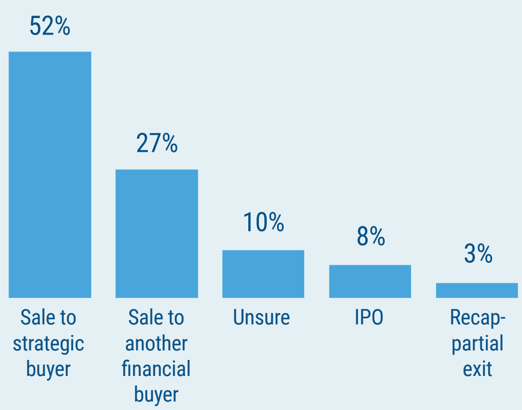
Interestingly, despite a robust IPO market in the last year and much discussion around PE-owned companies entering the public markets, only 8% of our respondent base expects to exit an investment through an IPO. Instead, a sale to either a strategic or other financial buyer is the more frequently-reported method, accounting for 79% of responses. While IPO exits have been in the spotlight recently, it's understandable that GP-to-GP deals take the cake because the majority of GP deals are simply too small for the IPO market. And yet, in certain circles, they elicit skeptical reactions...

What % of your current portfolio is actively pursuing an exit process with expected closings in the next 12 months?



Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on the last page.

What is the most likely exit option for the portfolio companies you expect to exit in the next 12 months?



So, what are the advantages and drawbacks of a GP-to-GP deal?

Pros:

- Efficient diligence, since both the buyer and seller understand the process and expectations on each side.
- Risk mitigation, as the existing sponsor is likely to have dealt with any undisclosed issues that often arise in a non-GP-to-GP deal.
- Complementary competencies of the new GP that can be applied to the company at a different point in its life cycle.
- Savvy participants on both the buy- and sell-side, which makes for a better transaction overall.

Cons:

- Additional fees like transaction fees and costs associated with the purchase and sale. There are also likely to be higher management fees and longer management deal streams as the company moves from one GP to another.
- Potential for more limited value creation, as some of the easier operational and financial improvements were made during the first partnership.

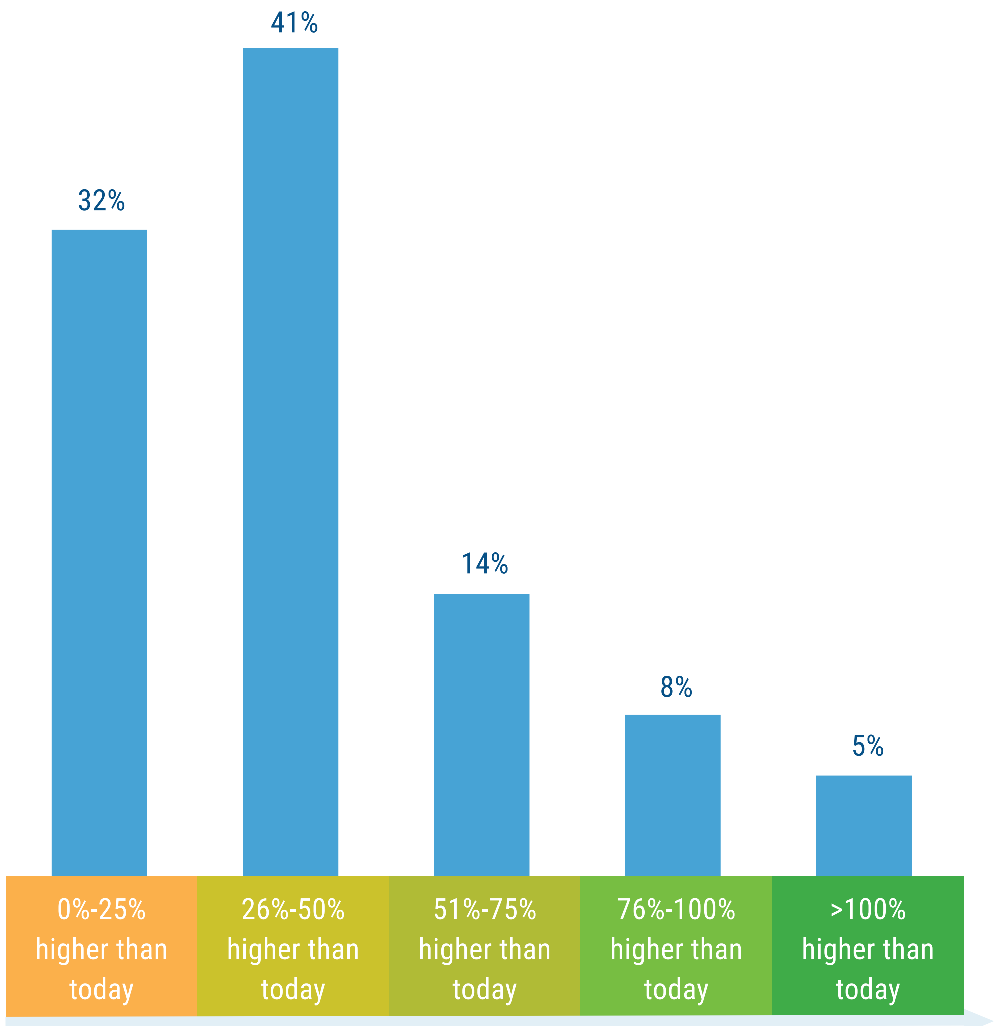
Projected AUM
Up and to the Right

Bringing it back to the fund managers themselves, the not-so-surprising news is that no GP expects its AUM to shrink over the next five years (who would?). About one-third of respondents expect to grow incrementally (up to 25% higher AUM), while on the other end of the spectrum, almost one-third (27%) expect more than 50% growth in AUM. While we think this is a muted response from a rather bullish group, we can attribute their cautiousness to the possibility of a coming recession.

The important takeaway here, though, is the positive direction in which the GPs themselves are headed. They continue to develop business plans for real growth, which is key, especially headed into a potential downturn.

What may account for that continued growth? In our Market Overview, we outlined several of the reasons that growth in the private markets is likely to continue: historical outperformance; downside risk protection; familiarity with industry structures and performance characteristics on the part of investors; a low interest rate environment making private strategies more attractive; and a growing opportunity set relative to the public markets.

What do you project your AUM will be in five years?



Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on the last page.

Differentiators

(Depends on Who You Ask...)

Now that we've established that all of the GPs surveyed anticipate growing over the next five years (hey, a healthy self-esteem is a good thing), what do they view as their biggest competitive advantages?

When we posed this question in last year's survey, the resounding answer was firm culture. "Strength of the operating partner network" and "transparency and reporting" came in second and third, respectively. This year, in order to dissect the responses a bit more, we removed "firm culture" as an option.

The interesting picture this now paints is the disparity between expectations of GPs and LPs. LPs have stated their need for GP transparency time and time again, so you would expect that to be a core business focus for GPs. They've also named the need for friendly fund terms and ESG as other key priorities. According to this survey, though, GPs are more interested in the value creation of their partnerships, while the LP requests lag behind. So, what does that say for GP/LP relationships moving forward? It's something to keep an eye on.

Other than track record / investment performance, what is your firm's most important differentiator relative to your peers?

1	Strength of Operating Partner Network	178 points
2	Other*	165 points
3	Transparency and Reporting	128 points
4	Availability of Co-Investment Opportunities	84 points
5	Risk Management Policies	65 points
6	Thought Leadership Publication of Research / Articles / Videos	49 points
7	LP Friendly Fund Terms	43 points
8	Diversity & ESG Policies	40 points
9	Investment in Technology & Back Office	32 points
10	Offer Separate Accounts / Custom Investment Structures	26 points

*"Other" includes various responses such as "firm culture" and "deal-sourcing capabilities."
Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on last page

Technology & Infrastructure

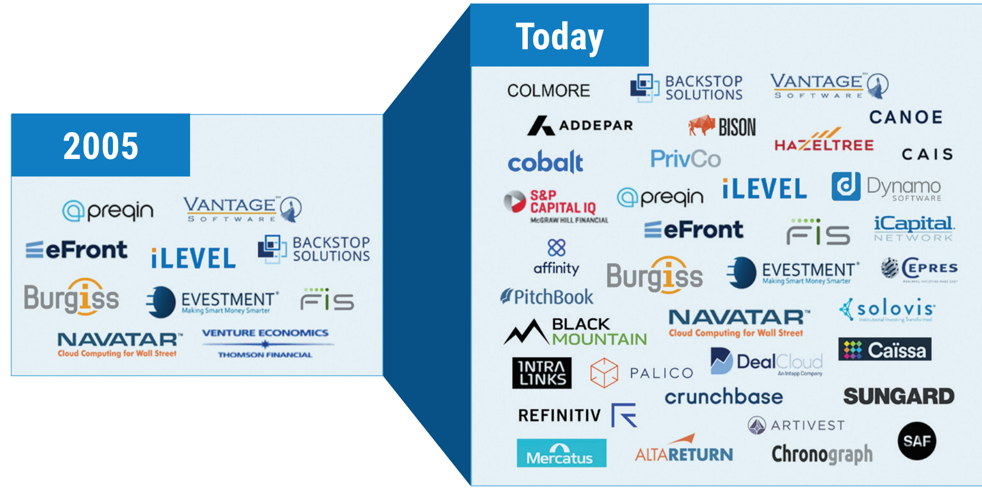
Get Woke or Get Left Behind

Technology. Infrastructure. They seem like innocuous enough words, especially in today's world of incessant connectivity. And, yet, we'd argue that they will contribute to a growing bifurcation of winners and losers in this asset class, especially once a downturn occurs. What's bringing us to such a Darwinian conclusion?

As you've heard from us many a time before, we believe that investing in technology and infrastructure is one of the wisest things private markets investors can do. The need for higher-quality data, coupled with the ability to analyze that data appropriately, is increasingly crucial in order to not only remain competitive in this asset class, but also to enable LPs to demonstrate that their managers are sufficiently and strategically investing in their businesses.

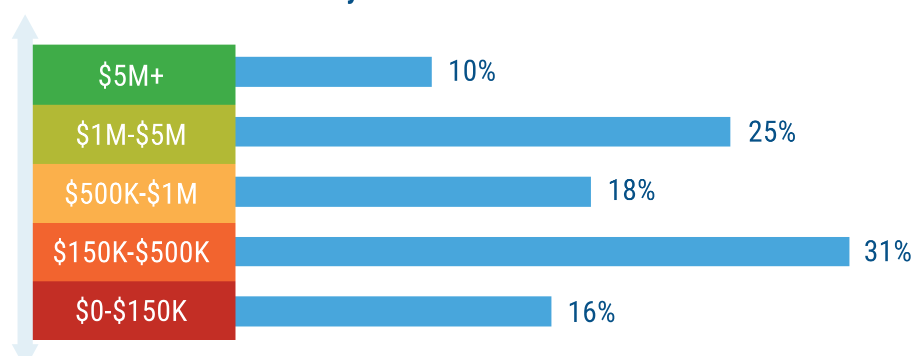
Given that, we asked our GP respondent base to give us a sense for how much they're investing in tech and infrastructure. More than one-third (35%) spend more than $1M a year in this area; a significant portion of GPs in this category are those with more than $10B in AUM. However, and more glaring in our minds, approximately half of the respondents (47%) spend less than $500K annually. Really?! Come on, people.

Now, we'll acknowledge that some GPs may not have been considering their back-office spending when answering this question, and we'd like to think that doing so would have shifted the results more favorably. Regardless, we're interpreting the answers here to be generally representative of the ways GPs think about investing in their businesses as a whole – R&D, sales and marketing, the executive suite, etc. – and that the lack of investment in technology and infrastructure is really symptomatic of a broader issue. When we analyze the behavior this way, it creates a much more stark and worrisome picture.



We believe this means we'll continue to see the leading GPs – who have put an emphasis on evolving their back office and investing meaningfully in their technology infrastructure – creating a wider dispersion for themselves either at the company, sector or even industry level. And, we're calling it: Many of the GPs rejecting this universal tech-focused shift will likely be left behind.

Approximately how much does your firm spend on technology infrastructure/data annually?



Source: Hamilton Lane General Partner Survey (July 2019)
Please refer to endnotes on last page

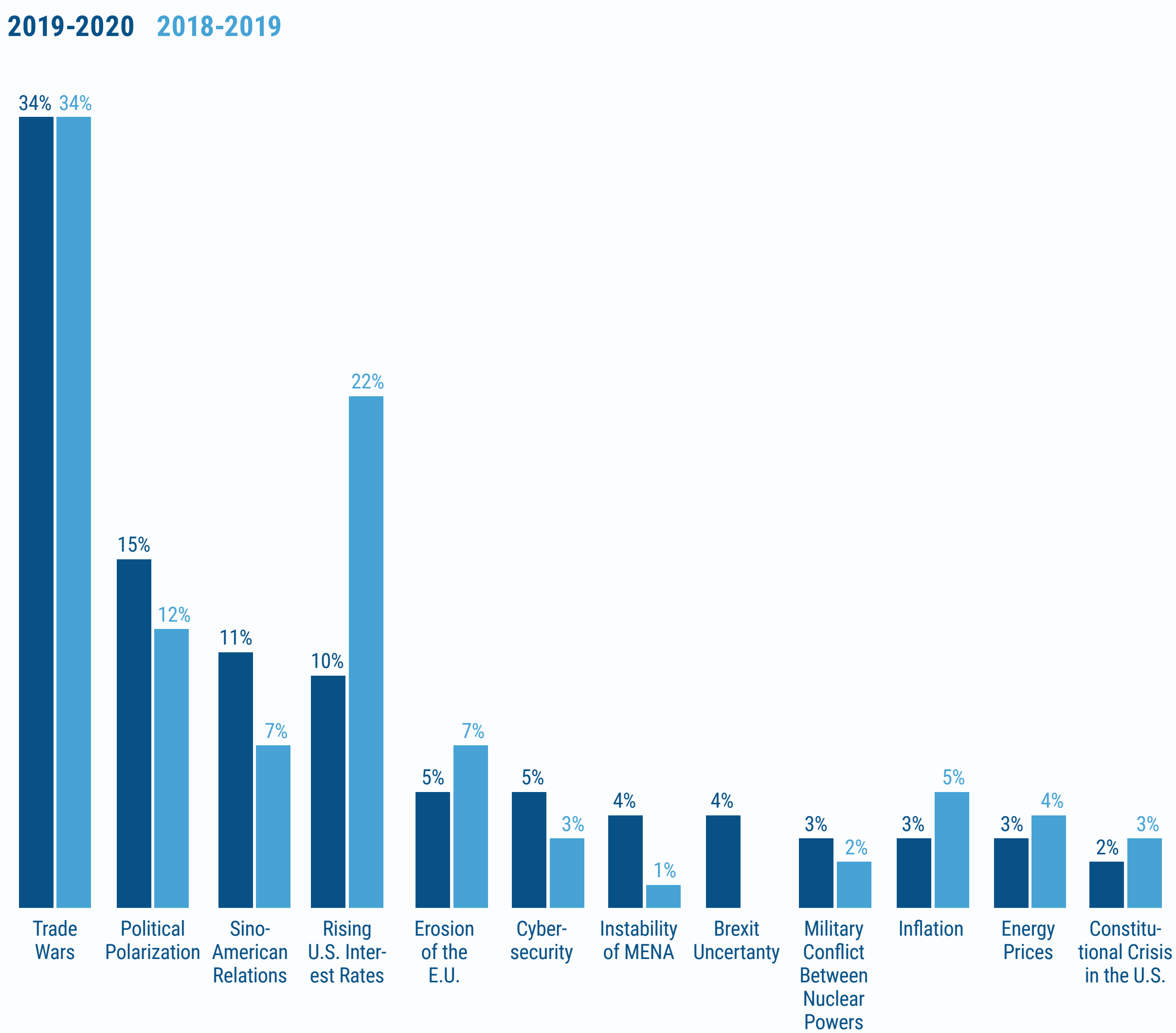
Macro Risks

They're Out There, People

Again this year, and perhaps not surprisingly, trade wars topped the list of biggest risks for the global macro economy in 2019-2020. Political polarization took the number two spot, up from number three in 2018, and Sino-American relations ranked third, up from fifth place last year. Taken together, GPs seem to view increasingly nationalistic governmental views, friction between the U.S. and China and current and potential implications from a trade war as the biggest risks in the coming year.

Worth considering: With such a fast-moving and complex global macro environment, we wonder how different these responses might look were we to ask this same question today, as compared to July 2019 when the survey was administered.

What are the biggest risks/concerns for the macro economy?



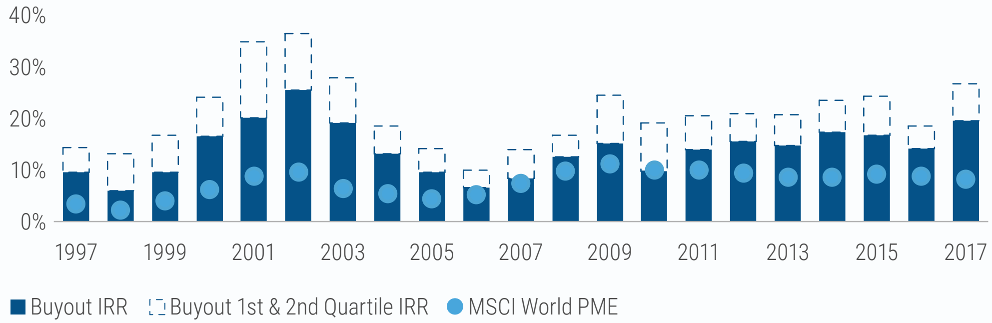
Source: Hamilton Lane General Partner Survey (July 2019 & July 2018)
Percentages may not add up to 100 due to rounding. Please refer to endnotes on the last page.

Conclusion

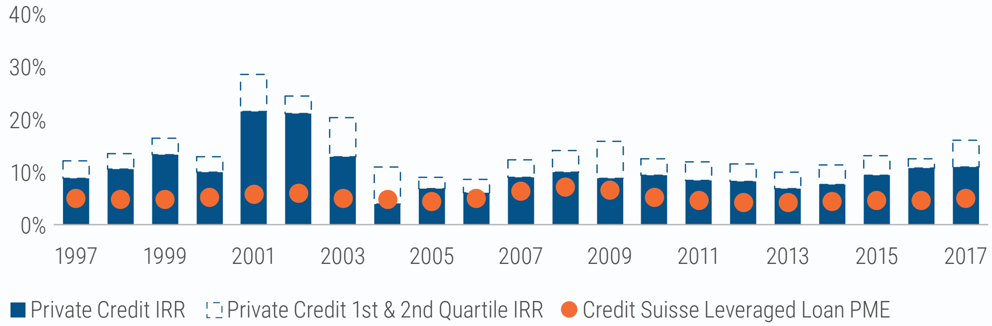
So there you have it: another edition of Hamilton Lane's GP Dashboard. For all of the uncertainty in the market and despite what beasts may be lurking, our GPs still seem to be fairly bullish on the opportunities in our asset class. They're staying focused and demonstrating good discipline as we all prepare to head into another new year in the private markets jungle.

Pooled Returns by Vintage Year

Buyout IRR vs. PME
By Vintage Year



Private Credit IRR vs. PME
By Vintage Year



Source: Hamilton Lane, Bloomberg (October 2019)

Thank you for reading this sixth edition of the Hamilton Lane GP Dashboard. We will continue to conduct this survey and analysis annually, and hope this year's findings were of interest. As always, we welcome the opportunity to discuss any reactions or questions you may have about the GP Dashboard or the private markets more broadly.

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Endnotes

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Definitions

Index Definitions

Credit Suisse Leveraged Loan Index – The CS Leveraged Loan Index represents tradable, senior-secured, U.S. dollar-denominated non-investment-grade loans.

The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

Strategy Definitions

All Private Markets – Hamilton Lane's definition of "All Private Markets" includes all private commingled funds excluding fund-of-funds, and secondary fund-of-funds.

Corporate Finance/Buyout – Any PE fund that generally takes a control position by buying a company.

Credit – This strategy focuses on providing debt capital.

PME (Public Market Equivalent) – Calculated by taking the fund cash flows and investing them in a relevant index. The fund cash flows are pooled such that capital calls are simulated as index share purchases and distributions as index share sales. Contributions are scaled by a factor such that the ending portfolio balance is equal to the private equity net asset value (equal ending exposures for both portfolios). This seeks to prevent shorting of the public market equivalent portfolio. Distributions are not scaled by this factor. The IRR is calculated based off of these adjusted cash flows.

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As of December 14, 2019

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