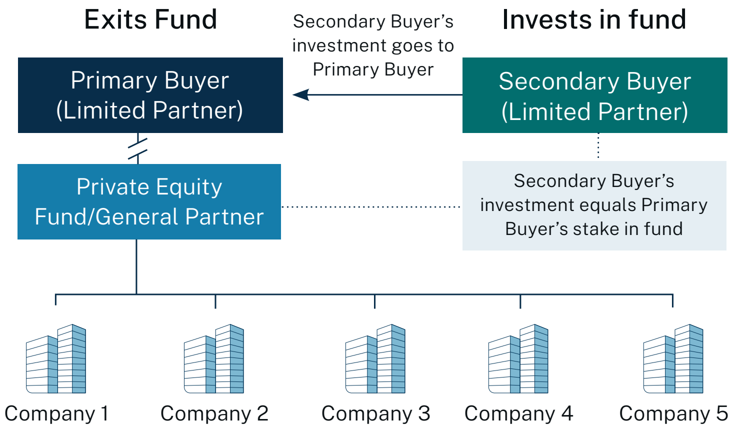
Secondaries: An Introduction

What are secondary investments?

Private equity secondary investments are a transfer of a private equity interest from one investor to another. Even if a private equity fund has been fully subscribed, investors have several options to access previously illiquid assets. One strategy uses secondaries whereby a new investor, or secondary buyer, purchases an existing investor's commitment to a private equity fund and effectively becomes a replacement investor as a limited partner (LP).

Private equity secondary funds provide an opportunity for LPs to sell their commitment in a private equity fund before the fund's underlying investments have fully matured. Secondary buyers assume the investment's rights and obligations, including future distributions from the underlying portfolio companies and unfunded liabilities.

The Anatomy of a Secondary Transaction



WHAT YOU SHOULD KNOW:

- Private equity secondary funds are a type of investment whereby a secondary buyer purchases a commitment to a private equity fund from the primary buyer or secondary seller – effectively becoming a replacement investor.
- Secondary buyers gain immediate exposure to an existing, mature portfolio which may generate cash flow sooner than primary funds.
- Secondaries may help reduce risk by offering a diversified portfolio across various vintage years, industries, geographies or even general partners (GPs).

Why do investors sell their private equity interest in a fund via a secondary investment?

LPs may choose to sell their positions for many reasons, including:

- **Liquidity:** One of the key considerations that every investor must keep in mind is liquidity – the ability to buy or sell interest in a fund without significantly changing valuation – and LPs are no different. An LP may sell their interest in a fund simply because they need cash and don't want to stay invested for the fund's entire life cycle.
- **Allocation:** Sometimes unforeseen overcommitments or changes in market valuations require an LP to modify their investment strategy and/or rebalance allocations.
- **Portfolio Management:** An LP may want to reduce their unfunded commitment balance or sell their interests in older funds to reduce the number of their GP relationships.

Why do investors buy an interest in a private equity fund via a secondary investment?

For investors looking to optimize their portfolio strategy, secondaries may be attractive for several reasons:

- **Diversification:** Secondary funds allow buyers to gain exposure to a diversified portfolio across multiple strategies, sectors, vintage years, geographies and GPs, potentially reducing risk. Buyers may also use secondaries to strategically manage their portfolios, tailoring their private equity exposure to complement their existing portfolios, target specific themes or risk profiles.
- **J-Curve Mitigation:** The term "J-Curve" refers to the typical pattern of returns for private equity investments – named because it resembles the letter "J." This pattern shows initial negative returns followed by positive returns in later years, reflecting the process of investing capital and creating value. By investing in a secondary fund, buyers can potentially avoid or reduce the impact of the J-Curve. (To learn more, see our Introduction to J-Curves piece here).
- **Liquidity:** Secondary funds provide access to a relatively more liquid market for private equity investments. Buyers can sell their interests in the secondary market to achieve liquidity and manage their portfolio more effectively.
- **Reduced Uncertainty:** Secondary funds offer buyers visibility into the underlying fund assets. Buyers can evaluate historical financials, track records and valuations of the portfolio companies, providing a more informed decision-making process compared to investing in "blind-pool" primary funds.[1]
- **Pricing Efficiency:** Secondary buyers generally acquire private equity investments at a discount to their net asset value (NAV) compared to their primary market counterparts. Secondary market pricing inefficiencies can provide attractive investment opportunities and potentially enhance overall risk-adjusted returns, including the potential for downside protection.

[1] "Blind pool risk refers" to the potential risks associated with investing in a blind pool investment vehicle where investors contribute funds without knowing the specific investments that will be made on their behalf. Most primary funds are blind-pool. In other words, the investors are "blind" to the specific assets in which their money will be invested. The main risk associated with blind pools is the lack of transparency and control. Since investors do not have detailed information about the specific investments, they are unable to assess the risk and potential returns associated with those investments.

How can secondary investments fit in your portfolio?

Secondary investments may not be top of mind when liquidity is ample. But, when liquidity is at a premium, secondary investments may provide sought-after optionality. Additionally, secondaries bring with them the ability to diversify exposure across different vintage years, industries, geographies or even fund managers, so LPs can balance portfolios selectively and optimize for performance. Overall, this translates into more efficient portfolio pricing and better cash flow.

Benefits of Secondary Investments in a Portfolio

For investors looking to optimize their portfolio strategy, secondaries may be attractive for several reasons.

J-Curve Mitigation	Portfolio/Vintage Diversification	Risk Reduction From Knowledge of Underlying Assets
Investments are purchased further along in their life cycle, with the potential to reduce the negative impact of management fees and accelerating the pace and timing of distributions.	Secondaries may provide investors with the ability to quickly diversify a portfolio by vintage year, investment strategy, industry sector and fund manager.	When evaluating a secondary transaction, the portfolio companies can be carefully analyzed, reducing the "blind pool" risk associated with primary investments.

With historical returns for secondary funds performing similarly to (if not better than) primary private equity funds, the benefits are worth considering.

To learn more, please see our primer on secondaries here.

DISCLOSURES

As of November 16, 2023 unless otherwise noted.

This document 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 document are requested to maintain the confidentiality of the information contained herein. This document may not be copied or distributed, in whole or in part, without the prior written consent of Hamilton Lane.

There are a number of factors that can affect the private markets which can have a substantial impact on the results included in this analysis. There is no guarantee that this analysis will accurately reflect actual results which may differ materially. These valuations do not necessarily reflect current values in light of market disruptions and volatility experienced in the fourth quarter of 2020, particularly in relation to the evolving impact of COVID-19, which is affecting markets globally.

The information contained in this presentation may include forward-looking statements. Forward-looking statements include a number of risks, uncertainties and other factors beyond our control 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 contained herein are based on information available to Hamilton Lane as of the date of this presentation and are subject to change. The information included in this presentation has not been reviewed or audited by independent public accountants. 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.

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.

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 Conducts Authority. In the UK this communication is directed solely at persons who would be classified as a professional client or eligible counterparty under the FCA 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.

Hamilton Lane Advisors, L.L.C. is exempt from the requirement to hold an Australian financial services license under the Corporations Act 2001 in respect of the financial services by operation of ASIC Class Order 03/1100: U.S. SEC regulated financial service providers. Hamilton Lane Advisors, L.L.C. is regulated by the SEC under U.S. laws, which differ from Australian laws. The PDS and target market determination for the Hamilton Lane Global Private assets Fund (AUD) can be obtained by calling 02 9293 7950 or visiting our website www.hamiltonlane.com.au.

Hamilton Lane (Germany) GmbH is a wholly-owned subsidiary of Hamilton Lane Advisors, L.L.C. Hamilton Lane (Germany) GmbH is authorised and regulated by the Federal Financial Supervisory Authority (BaFin). In the European Economic Area this communication is directed solely at persons who would be classified as professional investors within the meaning of Directive 2011/61/EU (AIFMD). Its contents are not directed at, may not be suitable for and should not be relied upon by retail clients.

