Hamilton Lane

Trends and Opportunities in the Secondary Market

With Brian Gildea, Head of Investment Solutions; Keith Brittain, Managing Director, Secondaries; Antony Anastasiadis, Principal, Secondaries; and Ana Chapman, Managing Director, Client Solutions

ANA CHAPMAN: Welcome and thank you for joining our panel session today. I'm Ana Chapman, Managing Director on Hamilton Lane's Client Solutions team. We are pleased that you can join us to discuss today's topic, which is current trends and opportunities in the secondary market. Our panelists will discuss some of the factors fueling the opportunity set today and provide insights on pricing, supply/demand dynamics and how each segment of the secondary market is being impacted by today's macro backdrop.

A brief introduction on our panelists: Brian Gildea is Head of Hamilton Lane's Investments Solutions, a member of the Investment Committee and has been with our firm for 13 years. Keith Brittain is Managing Director on the Secondary Investment team, a member of the Investment Committee and has been with our firm for 12 years. And finally, Antony Anastasiadis is a Principal, joining us from London. He is part of the Secondary Investment team and has been with Hamilton Lane for five years.

We would like to hear from you. You can submit questions at any time throughout the broadcast, using the Q&A button at the bottom of your Zoom screen. We will answer your questions at the end of the discussion.

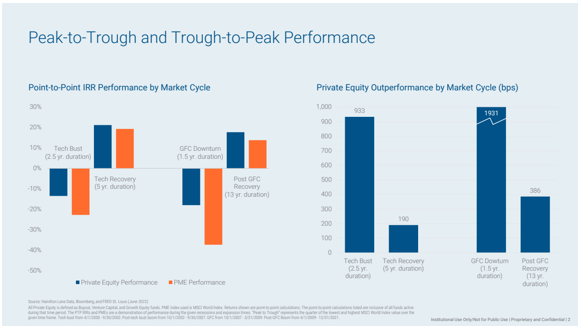
Macro Environment & Its Impact on Private Markets Portfolios

ANA: Without further ado, let's get started. Brian, before we dive into the secondary market, can you provide us with an update on the macro environment and how we think it is impacting private markets portfolios?

BRIAN GILDEA: Sure. Well, hello and good morning or good afternoon to everyone. I think it's fair to say that investors in the private markets are faced with many of the same challenges that investors in other asset classes are dealing with. The biggest issues currently are inflation and the corresponding interest rate rises, and valuations because when interest rates rise, asset prices almost have to come down.

And that's happened quite a bit in the public markets this year. The question for many private markets investors is how will the private markets adjust? The last challenge is the economic slowdown. What does a lower GDP environment mean for fundamental economic business performance? Investors need to ask the question, how do the private markets perform in this type of environment?

In this more challenging type of environment, valuations and return performance may come down. However, what's really important to remember is that it's the relative performance and not the absolute performance that you have to consider. The data here makes a really compelling case.



What we're showing in the left chart is private equity performance in blue compared to the public equivalent performance in orange during two periods of falling and then recovering market cycles, the dotcom bubble and the great financial crisis. The quick conclusion is that the private markets do better in environments that the publics are both up or in down. But if you look at the chart on the right, which shows outperformance of private equity compared to the publics, you actually see that private equity outperformance is greatest during periods of volatility and the downturns. For investors in our asset class, that means staying the course. You've done better by being in the private markets.

Now the other topic that is on everyone's minds is valuations. What will the Q2 marks look like once they're finalized? And we obviously can't know for certain just yet as the markets are still being set, but we've got a pretty good idea.

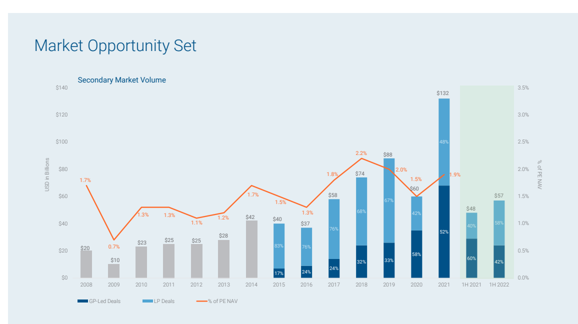
to create estimates for Q2 performance. You can see our Q2 return estimates. The forecasted returns do vary by strategy, but overall, we expect that most strategies will be down slightly in Q2. For example, small and mid-buyout will be down low single digits according to our models. Venture and growth, mid-to-high single digits. Now, these are our models. What I will add is that we know that at times general partners can be slow to markdown assets following large market moves, particularly when they see the public markets make a large move up the following month like they did in July. So, you may not see this level of markdown coming out of Q2.

Overall, what I would say, though, is that we see the current environment as one of thematic selections. It is certainly not an efficient market across the board and access and information are really key differentiators here.

What's Driving the Secondary Market?

ANA: Thank you for those remarks. We will now home in on the secondary market. Keith, the secondary market has become more mainstream in recent years. But, before we get into current conditions, can you level set us onto what has been happening over the last couple of years in the secondary market?

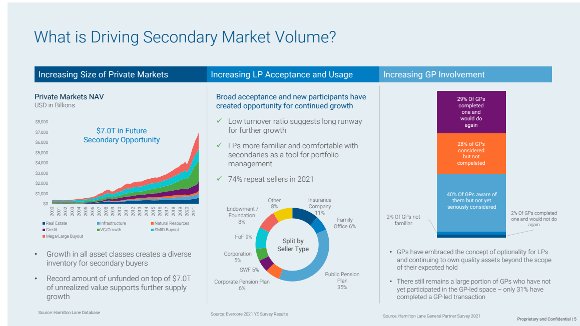
KEITH BRITTAIN: Thanks, Ana. And a big thanks to everyone in the audience for joining us. We did want to just touch on two more slides to set the stage and then we'll have a lively discussion.



Let’s set the stage with one of the biggest themes in the secondary market, which is growth. Growth and the opportunity set and volume growth in the turnover rate, growth in the way LPs and GPs are using the secondary market. On this slide we show secondary market volume over the past 15 years and you can see the growth. It certainly hasn’t been in a straight line upwards each year, but over the past 15 years it has grown at a 15 to 20% compound annual rate. One of the biggest takeaways from this chart is that last year was a record year for volume, and despite weaker macro conditions this year and lower secondary pricing this year, the volume in the first half was still higher than last year’s record. So, just remarkable. There are lots of things driving this. And in a few minutes, Tony and I are going to drill down into themes like volume trends, pricing trends, outlook and much more.

But before we get there, notice that beginning in 2015 on this chart, we show volume separated between LP deals and GP-led deals. The secondary market is now generally characterized by these two types of deals. LP deals are the traditional secondary deal, where a buyer becomes a replacement LP. On the other hand, a GP-led secondary is a transaction initiated by a GP that impacts all LPs in the fund. The most common form is a continuation fund in which secondary buyers purchase one or more assets from an existing fund. As for why this audience should care, it is because the market has exploded.

GP-led secondaries in 2021 were larger than the entire secondary market was just four years ago. So, what’s driving the growth of the overall market? If we skip ahead to the next slide, we can explore three themes.



The first theme, the first big driver of growth is what you see on the left, which is the overall private markets growing. Net asset value in the entire private markets is $6.5 trillion today. Secondary buyers get really excited by this chart because this is our inventory to buy. Every one of these dollars is a chance for a secondary. This inventory is growing and it really provides fuel for the secondary market.

The second reason for massive growth is there is increasing LP acceptance to execute secondaries. More and more LPs are using the secondary market to their benefit by managing their portfolios and exposures. It is now a very common tool for many LPs, and LPs have really embraced using the secondary market.

The third driver of growth is increasing GP involvement. GPs have really embraced the concept of providing liquidity to LPs. Hamilton Lane conducted a survey by asking GPs their opinion of these types of transactions. Look at the results. Nearly every single GP who has completed a GP-led secondary said they would do it again. The other takeaway from the survey is that 96% of GPs indicated they are aware of them, are considering one or have done one and would do it again.

We think this will provide a backdrop for a continued wave of secondary deals. These are the three main drivers of secondary growth and we think these dynamics will persist for some time, creating more market growth in the future.

ANA: Thank you, Keith. As Keith has described, there are really two broad types of transactions.

There are the LP-driven transactions and the GP-led transactions. Antony on our team works closely with LPs looking for liquidity solutions in this market. For the purpose of the ongoing discussion, we are going to have Antony address questions with regards to LP-driven trends and Keith focusing on the GP-led market. With that in mind, what effect has the macro environment had on the secondary market? Let's start with Antony.

ANTONY: Thanks and nice to be here with you all today. Looking at the macro environment, the biggest impact has been forcing LPs into an overallocated position as part of their private markets program and in some cases way over-allocated. This is obviously driven by public markets declining while private markets have remained flat this year, both on Q4 and Q1 marks.

Taking a step back and looking at this, private equity has done exactly what it should do. It's outperformed in times of declining markets. Looking at this problem, we would categorize this is a good problem to have. We expect it in declining markets. Looking ahead and how this relates to secondary deal flow, we need to think through the decision points that LPs have to solve this problem.

There are three potential decision tree matrixes that they can take. One, they can stop committing to private equity, let their programs naturally correct over time. I think looking at some empirical data, it all suggests that this is probably the wrong decision. You want to be diversified by vintage, by manager, and you want to have a stable program in order to maximize your returns.

The second thing you can do is temporarily increase your allocation – take from the public markets or take it from fixed income and temporarily solve your problem by selectively committing to core GPs or cutting your commitments, but still committing.

And the third option you can do is sell. Looking at the groups that sold and looking at the LP interactions is here, the minority of groups have chosen to sell. On the backdrop of that, as you heard Keith say earlier, we had a record amount of supply and transactions happening in the market. Now, as we fast-forward 6-18 months, when groups that are doing one and two actually move to selling, you're going to have a tremendous amount of volume that we expect to come to fruition.

Keith, I'll hand it to you for the GP perspective.

KEITH: Sure. If you think back to my slides, in the first half of this year compared to the first half of last year, GP-led deals completed were actually down by about 15%. That slight contraction is partly the result of what we're seeing in the market conditions and an overall valuation reset. We actually did see some GP-led deals get launched and get pulled because of valuation macro concerns.

If you put this into context though, GP-led volume is still up over 70% compared to the first half of 2019. Looking forward, an indicator of future deal closings is the volume of new deals being launched. The top of our deal funnel that we see today. First half of this year, we screened 35% more GP-led deals than we screened in the first half of last year. We would expect the back half of this year to be really strong. If you think about market conditions, the macro environment has obviously created a slower M&A environment and a virtually non-existent IPO window. At the same time, you have GPs that need to generate liquidity for their LPs to manage the ten-year fund life, and also to show DPI for fundraising, and there are a lot of GPs that are fundraising right now. When you look at the GP world, you have this continued pressure to create liquidity. I think they continue to turn to the secondary market in an attempt to generate that liquidity because number one, GPs are having really good experiences with these solutions. Think back again to the results of our survey. And number two, GPs are trying to manage LP liquidity in a very lukewarm capital markets environment. But the secondary market does remain open. So, I think as a result of the macro environment, what you have on one hand is a lower deal success rate and on the other hand many more deals to evaluate given that the secondary exit path is open.

Pricing

ANA: Thank you for that. Let's shift the discussion to pricing. How has the public market downturn that has taken effect in the first half of this year had an effect of on pricing in secondary deals? We'll kick it off with Antony first.

ANTONY: Thanks, Ana. The obvious answer is pricing's declined over the first half of this year. It's on the backdrop of what both Keith and Brian mentioned. First you have valuation concerns. You also have M&A and exit activity slowing down. So, distribution expectations are slowing down, which is directly impacting what buyers are willing to pay in this market.

I think to discuss pricing in this market, we really have to bifurcate between venture and growth and buyout right now. Focusing on venture and growth first, we've seen the most material decreases in pricing in this market over the first half of this year. It's two stories. One, buyers have bought an incredible amount of this exposure over the last 18 months, so the demand side of the equation and the capacity side is less than it has been. On the other side, you have LPs and folks that hold these assets wanting to crystallize gains on very high watermarks. I think buyers are taking more of a skeptical lens to these types of deals.

On the buyout side, it's a bit different. You've seen pricing declined modestly so far over the first half of this year. You continue to see a bid-ask spread between buyers and sellers. But, a lot of times there have been structures put in place to bridge this gap. Whether that be payment deferrals, where a seller is accepting maybe half the payment upfront today and half two years from today to bridge that price gap, or closing times being pushed out. The buyer can pay later, owning assets sooner. Focusing on pricing a little bit closer, I think the best way to back this up is with some data. One of the brokers in the market, Greenhill Cogent, came out with their first-half pricing report. Some of the interesting takeaways specifically on the buyout funds is last year, in 2021, the average high bid for a buyout fund was $0.98 on the dollar. Pretty close to par. Now, fast forward to today. Pricing for the first half of this year came in at about $0.88 on the dollar. So, a 10% decline, which we think is certainly interesting. Looking ahead to what might come on pricing in the secondary market is going to really come down to valuations. Like Brian mentioned earlier, Q2 marks are just starting to roll in now. We don't know exactly what those have in store. Obviously, we have models, but those models can differ from what GPs actually report. Then we have September valuations and we think if GPs mark down their portfolios to reflect the current market environment, secondary pricing is going to go up and that's going to be very conducive to deal making and transactions happening in this market.

Keith, over to you on the GP side.

KEITH: Sure. The pricing in the GP world has been interesting, right? If you look over the past few years, the default pricing for GP-led deals was par. Deals had a price at least at par in order for GPs to take the deal to their LP base and in order for LPs to feel good about selling into the transaction. Sure, we saw some exceptions, right? There were some deals over the years that traded at a discount and some deals even traded at massive premiums. When you look at our data, and we have a lot of clients in a lot of funds, and therefore we see most of the GP-led deals when they're complete, in the election period because we help our clients make a decision to sell or roll into these transactions. When you look at that data and look back to 2021, only about 12% of GP-led deals were priced below par. When you look at the current year, 2022, our data shows that 35% of GP-led deals tradeable low par or had some sort of structure like a referral. That's over one third of all GP-led deals this year traded below par. The data gets even more interesting when you break it down by quarter. In the first quarter of this year, zero deals that we evaluated during election period were priced below NAV. That's because those deals were likely priced late in 2021, and got launched in the first quarter, so they were pre-priced before Q1. When you look at the second and third quarter so far this year, 50% of the GP-led deals we evaluated were priced below par. It's pretty fascinating that many more deals today are trading at a discount. We believe that's largely a function of the current macro.

Trends Across Different Markets & Geographies

ANA: Thank you. Now, let's shift the view to different markets, different geographies. Are we seeing different trends across different parts of the world? Are they similar? Maybe it's helpful to bring Brian back into the conversation to give us some context on macro backdrop internationally.

BRIAN: Thank you. I'd just say as a starting point, keep in mind that North America and Western Europe remain the majority of the private markets, and we're not seeing huge shifts in those preferences, although on the margin, there is some tilt away from Europe given some of the concerns about the war in Ukraine, surging energy prices and the corresponding economic impacts.

In terms of ROW, Latin America continues to be out of favor. Currency has been a real challenge for foreign investors in many parts of those markets. ROW for the last few years has really been about Asia and in particular, China. Remember that China has been more of a growth and a venture capital market than a buyout market. Within Asia, we have seen a bit of a shift towards countries outside of China as a result of reduced interest in growth and venture capital, and some of the China-specific concerns as well. Perhaps, Keith, you can comment on that as it relates to the secondary market.

KEITH: From a secondary perspective, most of the deals completed were in North America and Europe in the first half of this year. I think any time there's volatility and more of a risk-off mentality, less is done in other parts of the world. What is done in those regions is generally done at higher discounts and higher discounts, in fact, deal flow and therefore deal completion rates.

Trends and Takeaways in GP and LP Markets

ANA: Thank you. So, let's shift back to a GP versus LP perspective. What are our biggest trends and takeaways that we're seeing in both markets? Kicking it off with Antony on the LP side.

ANTONY: This one is simple for us. It's really the reemergence of motivated sellers and their ability to transact directly with secondary buyers and buyers in the market that can offer speed and certainty in a very uncertain environment. One of the things this means is the quality of funds being sold is much higher today than it was a year ago. You have to think of the pricing and how that might play into this. Lower-quality funds, funds that might have underperformed or funds where the general partner quality is lower, used to price at modest discounts. Today those are going to price at material discounts. If you have a portfolio with a mix of assets, I think buyers today are gravitating towards buying highest-quality funds, very much cherry picking those funds at a modest discount, which we think is very interesting in this market.

I think the other thing it allows a buyer to do is really focus on the micro in the fund. You have more conviction in the GP. You can do more diligence on the underlying assets, the operating performance, the exits, the path to exits and valuation. For a market that needs to build conviction in order to buy something, we think this is really helpful in this environment. Keith, off to you on the GP side.

KEITH: On the GP side, I do think there are lots of trends. There are two that are really noteworthy. One, over the past few years, I think GPs have become much more active and much more influential in secondaries obviously in the GP-led market, but really also in the LP-interest market. We have seen GPs, for example, introduce us proactively to some of their non-core LPs because GPs know that eventually those LPs will sell their interest. This didn't really happen in any sort of scale five, 10 years ago and it's happening more and more today. GPs recognize that primaries, co-investments, secondaries, all the investment worlds are colliding and GPs also recognize that they can use the secondary market to build relationships with those LPs who they want to get closer to.

The other trend that we think is noteworthy is, and this is really more of a point-in-time trend, we're beginning to see an uptick in LP tender offers being discussed, being contemplated and ultimately being launched by GPs. This isn't really a big chunk of the market, but it has entered many conversations recently and if you think about it, it makes sense. A lot of GPs are fundraising. As Tony said, a lot of LPs are overallocated to private equity and they're cutting back on commitment size of relationships. What LP tenders do is they allow GPs to give non-core LPs liquidity and even allow core LPs to free up capital to commit to the GP's next fund. And, that's what they want. Of course the tenders usually come with the stable into the GP's next fund. As fundraising becomes more difficult, given the LP overallocation issue,

we do expect to see more of these LP tenders, so we'll see if this trend materializes.

Outlook on the Secondary Market

ANA: Thank you for that. We've addressed a number of past trends and current developments in the secondary market. Let's shift our sights into the future. What is your outlook for the secondary market in the next 1 to 3 years?

ANTONY: I'll just pull out my crystal ball. I think it's simple on the LP market, we expect it to grow steadily and it's been growing steadily for the last two decades. Looking back is important here. It's been a resilient market with a growing amount of inventory. Something Keith spoke about earlier in terms of the primary market now, plus unfunded really going up and that turnover rate staying relatively flat. You're going to see a huge increase in supply in this market and we think that will continue to take place. I think looking at the other side, the LPs, is this still offering a solution? Is this helping them transition their portfolios, rebalance, reposition an illiquid part of the portfolio, which has proven to be difficult to do? We think it is. We think it's still offering a solution to LPs to do these things that they'd like to do going forward. The supply side is going to be there. The importance to LPs in terms of helping their portfolio construction is there. But the key question for us on this one is the demand side and whether secondary market participants will be well-capitalized enough to actually take advantage of the opportunity set that there is today because it doesn't feel like it right now.

Keith, on the GP side?

KEITH: On the GP side, our outlook over the next several years is, we think GP-leds will continue to be popular. They will allow GPs to send cash back to LPs who want liquidity in their portfolio.

They will allow GPs to develop new relationships and they will allow us to keep existing portfolio companies as long as possible. A lot of wins there. GPs used to consider the M&A market and the IPO market as their exit options. They now consider the secondary market as a viable exit option. GPs obviously have a significant amount of influence in these deals. They also have lots of motivations. They obviously want to maximize price for LPs, but they're also using these types of transactions to refresh their LP base with strategic secondary capital. GPs are looking to partner with buyers who possess that investment scale across the primaries, investments, co-investments and secondaries.

What's our outlook? When we speak to you in three years from now, we think that GP-led volume will be much higher than it is now. It may not be a straight line up and to the right, but it will be higher. Think back to our survey results. GPs are having good experiences with these and many more are considering using them in the future. As Tony said, as we think about the LP volume as well, we think three years from today that, like the GP market, will be bigger. I think fundamentally all the supply characteristics we've been talking to you about will remain intact for a while and that will drive secondary volume in the years to come.

What's Driving the Excitement about the Secondary Market?

ANA: Thanks, Keith. I know you're super excited about this market, so why don't you walk us through the key things that drive that excitement today?

KEITH: I think the most exciting things about the opportunity set today as we break it down comes down to two items. One is a better pricing environment. We talked about pricing for both LP-interest market and for GP-leds. In both cases, pricing is better today than it was 12 months ago, and this better pricing environment is against a backdrop of increasing secondary volume. We're seeing an increasing number of LPs become overallocated that Tony talked about, driven by declines across many asset classes, while private equity valuations didn't move materially in Q1 and likely won't move materially in Q2. We think back to the data that Brian showed. This dynamic should support deal flow over the next several quarters. At the same time, LPs are discount sensitive, right? They tend to sell higher-quality funds to minimize the discount taken. For GP-led deals, the need to generate liquidity, and the desire to hold trophy assets longer will persist. They're having good experiences. They're going to keep using the market and while the M&A market is flattish, if you will, and the IPO window is not there, they will continually use the secondary market to drive that volume.

The second reason why we're really excited is the supply-demand imbalance we're seeing between the volume of deals and the lack of secondary capital to invest in all those deals. This is a very real thing. The dry powder-to-deal volume ratio is the lowest I remember ever seeing. Secondary fundraising just hasn't kept up with secondary deal volume, and that has created a situation where there's less competition for deals. The overall shortage of capital to invest in all the available deals really has created a buyer's market. For those two reasons, we are pretty excited about the opportunity set today.

Taking Advantage of This Opportunity Set

ANA: Thank you. Shifting to Antony, how do you best take advantage of this opportunity set and what are the characteristics that you think you need to be successful in this market?

ANTONY: Thanks, Ana. As you've been hearing from all of us, we expect an incredible amount of deal flow. I think in order to be successful in this market, you need to be selective. Very selective. That's going to be key. How do you screen deals? How do you prosecute deals and how do you build the conviction quickly?

We think there are a few things that are critical here. One, information, having access to information. Having access to insight and making that available immediately. I look at us and we're in such an advantageous position where we have primary teams, co-investment teams, credit teams, secondary teams, folks out there talking to GPs every day, getting the intelligence on exits, on trends, on operating performance, on valuations, all the things that you need in order to really, really understand how to price things in this market. The information's critical. Now, all that raw data isn't useful unless you have an engine to actually spit out an answer. You need processes, you need technologies, you need things in place in order to disseminate that information from one place to the other, where you can really see undervalued assets, embedded value within assets, and the trends going forward in those asset classes.

I think lastly, and this is something that is often not mentioned enough, the team. We invest an incredible amount of time in our team. This means hiring, developing individuals, and creating and fostering a good atmosphere for them to grow and become cohesive together. We think the longer they work together, the better as a group they're going to be.

Ultimately, how do you take advantage of the opportunities? I think it's the recipe of these three ingredients that are critical to being successful in the secondary market.

Q&A

ANA: Thank you, Antony. I think given the sheer volume of questions that we have, it's probably best that we shift our attention to those. I will start reading them and we'll take it from there. There are a number of questions around some being surprised regarding the estimated future returns for us, mega buyouts being below growth and venture. Can we explain why we expect this to be the case? I'll turn it over to Brian for that.

BRIAN: Sure. Thank you. Again, these are our estimated Q2 valuations based on our models. The way that our models work is they look at the underlying reference public benchmarks and, they extrapolate based on historical correlations and market moves. The question here specifically was about the U.S. large and mega being below in terms of having weaker performance or having higher down moves than some of the other segments. Really what drives that in the models is that we have found that historically the mega and the large buyout market are more correlated to the public market than the small and mid or some of the other segments are. What you're seeing here is in a quarter where there were big declines in the public market, a little bit more correlation of the down moves for the large and mega. What you would expect then is when the public markets bounce back up in July, not that they mark every month, but that that segment of the market also would have a bigger move back up in line with those public markets. I think that's really what you see showing up in that large and mega segment particularly in the U.S., but also in Europe.

ANA: Thanks, Brian. Here's another question: Will increased secondary transaction volume erode the return valuation gap between public and private markets? Who wants to take a crack at that one?

KEITH: I can take that, Ana. I think the question is: With the discounts in the secondary market today, will that impact portfolios and therefore bridge the gap between public and private markets? I think when you look at secondary volume overall and compare that to the overall private markets, NAV, we call that the turnover rate, every year, about 1 to 2% of all private markets NAV turns over. If you assume this year that only 1 or 2% of the entire private market turns over and that's at a discount, I don't think that's big enough to impact the overall private markets return. I wouldn't expect there to be a big difference there.

ANA: Okay, thank you. There is another question about what we're seeing in terms of the impact of debt drying up. What are we seeing with regards to leverage and what effect might this have on the secondary market?

KEITH: I think debt comes in a couple of forms. One is you can go to the bank, you can borrow money and make a portfolio purchase with half of debt and half of capital calls from LPs. You'd tend to see that a lot in larger transactions over the prior years. Another form of debt is deferral, deferring your purchase price for a year or two years or some period of time. I think the question is right. It does feel like in the first half of this year, the ability for secondary funds to go to a bank and borrow a big chunk of the purchase price has come down, so there's still a little bit of debt available. We are seeing some people use debt – not nearly as much as they used to – but what is taking the place of that is a lot of purchase price deferrals that helps bridge the bid-ask spread between buyers and sellers when discounts become larger. You tend to see in larger portfolio trades this past year more deferred purchase prices, less going to the bank and borrowing cash to make that purchase.

ANA: Thank you, Keith. There is another question that takes us back to our pricing discussion. What are we seeing in terms of discounts, in terms of overall pricing trends for venture capital in particular? Antony discussed an example on LBOs, but I'm wondering what we're seeing in venture capital trends specifically? A secondary addition to that question is whether Hamilton Lane or any other firm has an industry tool where you can monitor pricing trends by segment?

ANTONY: Thanks. I'll take the first part of that. We didn't really go into detail on the venture and growth fund pricing. I think both of those are different – venture and growth – but both are down significantly this year in the same Greenhill report. I don't remember what the 2021 average price was, but I do remember that the average price for these funds in the first half of this year is $0.75 on the dollar. So, you've seen that decrease and that decrease larger than the buyout portion. But I think the other thing to this is, there aren't that many data points because these funds and these assets aren't transacting in a big way in this market. We like to focus on a lot of data, and it's just not out there yet.

I think the other thing behind this that really underpins a question that came up earlier with the mega buyout and the decline that we're going to see potentially off Q2, what our model suggests, is venture capital gets marked differently than buyout. These are assets that are being done on rounds. If a round isn't done, then there's no appetite to change the valuation from the last round. You can have a stagnant valuation for one or two years until a new round gets raised.

That makes this market, the venture market, in terms of pricing, even more challenging.

ANA: Thank you, Antony. Another question takes us back to pricing and what our thoughts on pricing for LP-driven transactions are if you see valuations remaining stable over the coming months. Anyone want to take that? It's an LP-interest-focused question. If valuations remain stable over the next couple of months in terms of pricing for funds, what effect do we think this will have on discounts or pricing for LP-led transactions?

KEITH: Theoretically, discounts should remain wide. If you don't see a material markdown in NAV – if you think about how secondary buyers underwrite, they're trying to project out what the future value is of a portfolio company, when that's going to exit, and if that future value forecast doesn't change and the price, or the NAV, remain stable doesn't come down, then secondary buyers adjust for that with discounts. If NAVs don't move materially, we would expect secondary discounts to remain wide and similar to where they are today.

ANA: Thanks, Keith. I have another question on whether we have thoughts or data on what percentage of secondaries are sold via brokers versus direct.

KEITH: I think Mario says private equity is a lot of anecdotes. I don't think we're ever going to have complete data on that. What we have seen in some of the survey results is around 70% +/- 5-10 points is sold via brokers. I think anecdotally it feels like that number has come down. It is coming down. There are a lot of secondary deals that don't get reported. Tony can talk about his conversations with LPs, but over the past several years, it has felt to us like LPs are more willing to transact with buyers directly because they might have done it before. They feel like they can get a quick read and it's a much shorter process. Is that your experience, Tony, when you're talking to the LPs?

ANTONY: It is. I think LPs move around a lot at different shops. Once one has done a sale somewhere and they have experience doing it, they're more likely to do it somewhere else. That's one thing. I think the other thing is once they have experience with law firms, with the transfer processes, what goes into these sales, how the brokers operate, they can choose which they'd like to do depending on the mix of assets that they're doing. We think and what we've seen is the more nimble, sophisticated groups that are trying to do something more targeted, perhaps not sell an entire portfolio, but sell 1 to 3 assets, they know who the buyers are for these funds. They can do that themselves.

ANA: Thank you, Antony. There's a broader question more about private markets and the impact of interest rate increases and the performance of, say, buyout funds, vis-à-vis credit and infrastructure assets and how this will play out in the secondary market. Brian, do you want to take a crack at that? What are we seeing in terms of the impact of rising interest rates in different segments of the private markets asset class?

BRIAN: Sure. Thank you. I think the biggest impact we've actually seen is around that valuation point that I made earlier. Rising rates reflect the higher cost of capital, which means lower valuation multiples. We've seen those valuations compress as a result of that. Overall, we would say that we've seen the underlying company health, you see this in credit defaults and things like that too, continue to be very strong. Underlying economic performance has been good despite slightly higher interest rates. It's that valuation impact that we've seen to date. The forward-looking question is about that economic performance element. Can these businesses continue to perform as strongly as they have over the recent past?

ANA: Thanks, Brian. There is a question about GP-led secondaries and a potential conflict of interest. What is Hamilton Lane's view on these issues and what are the things that an investor needs to watch out for to be successful in investing alongside a GP-led transaction?

KEITH: There are a lot of these transactions that happen and they've been going on for a number of years. I think the general theme we're seeing is the LPAC tends to have to wave or not wave the conflict of interest. I would say that our view in these transactions is there's a lot of different ways that GPs can communicate with LPs. If done right, if communicating with LPs, getting the LP's view before you contemplate, before you launch a GP-led transaction, that helps. I think when the LPAC and the options that the GP provides to its LP, our view is that you should have a status quo option. If you're an LP, you're not necessarily being forced into a sale. You might have an option to have a status quo into the continuation fund. That helps with the conflict of interest. There are a lot of ways that GPs can manage these GP-leds. On one hand it's bad, on one hand it's very good. I think you have seen GPs over time understand the processes. They're getting a lot of advice from counsel. A lot of these have the status quo option, which helps to minimize those conflicts. There have been a lot of learning curve done in this asset class, I think more to do. Often that status quo option goes a long way in minimizing that.

BRIAN: If I could just add on that, I would just reinforce that point. As this market has developed, there have become best standards, best practices that really are set up to help minimize all those things. It's a much more standardized market than it was a couple of years ago and that's a good thing for the GPs and LPs alike.

ANA: Thanks, Brian. Keith, I have another question more specifically about GP-led deals and venture capital funds. Are VC funds embracing GP-led deals more so today than they have been in the past? Anything you can comment on trends there?

KEITH: Yes, it feels that way. I think when you look at the VC world versus the buyout world, there seems to be less liquidity today coming out of VC funds than buyout funds. I think a lot of the VC funds made investments last year or the year before at rounds that could have been perceived as pretty high.

I think a lot of the VC managers are trying to find ways to get liquidity back to their LPs. We have seen some VC deals in the GP world get launched and not go through. We have seen some get launched and go through. We have seen some more. A common shift in the GP-led world among these managers might be a strip sale, where you're selling a portion of all your assets instead of selling 100% of all your assets. We have seen, I think, more creativity among secondary buyers in the VC world for GP-leds. Anecdotally we probably have seen a higher deal failure rate in that segment of the market, at least in the first six months of the year. I do expect more creativity in that segment of the market going forward.

ANA: Thanks, Keith. I have a question about timing for transactions and if this has changed at all in the current environment, both for LP and GP-led deals. Are deals taking longer? Any thoughts on that front?

ANTONY: The short is yes, it's taking longer on the LP side to get this done. I think the reason why that is, is because we are in a pretty uncertain environment, so buyers are having to do more diligence on these assets. They're having to understand the changes that have happened quarter over quarter. The pricing that a buyer might have given for a fund six months ago has changed in a material way. They need time to recalibrate that. They need time to figure out, speak to the GPs and really get to the bottom of what they're buying. That's been causing these processes to elongate. I think sellers understand that. They're providing buyers with more time because they do want to maximize price.

KEITH: I think on the GP side there are two components of the time element. One is the diligence process and we have seen that become longer in GP-leds. I think the second part of the time issue is around syndication. Some of these larger GP-led deals require a lot of syndication because they're big, they're chunky, they're large and as we've seen a bit of a shift, secondary buyers have reduced their check size, and some of these, on average. I think the supply-demand imbalance I talked about before, where there are a ton of deals and a lot of capital, that has taken syndication process longer because there's just less capital available to support all of these deals. The timeline has really elongated because of that supply-demand imbalance.

ANA: Great. Thank you. The next question is on our thoughts on energy secondaries. What are we seeing in the market on that front?

KEITH: I think the sentiment among the secondary universe – ten years, you saw a very robust secondary market in energy funds. I think that changed five years ago. Over the past few years, if LPs wanted to sell their commitments to energy bonds, there wasn't a market for it, right? There was a lot of volatility in oil prices. There was uncertainty around the exit environment. There weren't a whole lot of exits being made out of the energy funds. I think if you fast-forward to an inflationary environment, what you're seeing today is energy prices have risen. The exit environment isn't great, but it is there. If you have an energy fund you want to sell, you're starting to see somewhat of a secondary market emerge again for energy funds just given where prices have gone and where the exit environment is.

ANA: Thanks. The next question is from an LP potentially thinking about selling into the secondary market. Do we have any thoughts on timing? Transacting on September 30 versus December 31? Anyone want to try a crystal ball?

ANTONY: It's a question everybody asks. Is it a good time to sell? Is it a good time to sell later? Was last year a good time to sell? It's hard to answer. You're selling for your own reasons. If the reasons are right, if you're doing it for portfolio rebalancing and there are other better places where that capital can go and the opportunity cost is there for you to switch, then make the decision. We never advise folks to sell now or later. It's whatever timing works for them. I think on the backdrop of this, what you've heard is there are going to be a lot of folks selling. It's up to you. You are going to be selling in a market with a lot of supply, which isn't a good thing if you're a seller, but you have to pick your spots and you have to understand what you're selling and the value of it.

ANA: Thank you, Antony. We have a handful of further questions left, but in the interest of time and in wrapping up this session in a timely manner, we can address those directly. If you have any further questions regarding what we have discussed here, please reach out to any of us or your Hamilton Lane relationship manager, and we'd be happy to dive further into that.

To conclude on a couple of key takeaways from today's conversation. First of all, we hope that it was informative and that whether you're thinking about selling into this market or thinking of buying into a secondaries or secondary funds, I hope we were able to share insights that will help make a more informed decision. Some important takeaways: Our view is that GP-led deals aren't going away and will grow in volume over time. It is important for LPs to have processes in place to deal with the increasing number of elections that you will have to make associated with these transactions. Secondly, I think it's been said over and over again, we are seeing a very robust secondary opportunity set today. This is a market that's been characterized by high growth, improving deal liquidity and currently a supply-demand imbalance that is favoring secondary buyers.

And lastly, we believe that secondary buyers with primary platforms, that is investors with strong GP legacy relationships and access to plentiful information, are best positioned to identify and access high-quality deals. Several of you have asked whether there will be copies of the slides that will be distributed. The copies of the slides will be distributed to everybody who registered and participated in the session. There is also going to be a recording available shortly, which we will be sending to you. Keep an eye out for that. Again, if you have any further questions, don't hesitate to reach out. We look forward to hearing from you. Thank you again for joining us today.

*As March 31, 2022

ENDNOTES

The projections published herein are based on a regression of quarterly public market index returns against quarterly private market index returns. This regression generates an alpha and a beta by strategy which can be used as inputs into the single-index model of pricing assets (Sharpe 1964, Lintner 1965). The formula for the single-index model is:

$$r_{\text{Private Markets}} = \alpha_{\text{Private Markets}} + \beta_{\text{Private Markets}} (r_{\text{Public Markets}} - r_{\text{Risk Free}}) + r_{\text{Risk Free}}$$

Where:

$r_{\text{Private Markets}}$ = Return of Private Markets

$r_{\text{Public Markets}}$ = Return of Public Markets

$\alpha_{\text{Private Markets}}$ = Alpha of Private Markets

$\beta_{\text{Private Markets}}$ = Beta of Private Markets

$r_{\text{Risk Free}}$ = Risk Free Rate

The regression formulas for Core and Non-Core Real Estate differ slightly from the single-index model in that the regressions are multi-index models, which include multiple betas and public market returns to better predict private market returns, such as the U.S. Regression Indicator Index.

Once all inputs are obtained, we create a 75% confidence interval for our expected returns. This should denote the inherent uncertainty in these sorts of predictions. In general, we expect to be accurate within a 400 basis point spread with 75% confidence in quarters of normal stock market volatility. During periods of outsized positive or negative returns in the public markets, we would expect to either be less accurate or for the confidence interval to expand meaningfully. We also expect individual portfolios to vary meaningfully from these projections, as individual portfolio returns vary from the industry's returns for many reasons, including concentration of assets, different investment pacing, and different strategy/geography makeups, to name a few. Larger and more mature portfolios should be expected to have a performance more similar to the market, and therefore more reflective of these estimates, than other portfolios might be.

To estimate the next quarter's valuation for a portfolio, you can apply the estimated quarterly growth rate associated with it. The quarterly growth rate should be applied after adjusting for all fund contributions and distributions made during the quarter, in accordance with the Simple-Dietz methodology for calculating returns. Note that all calculations shown in the document are in USD. Therefore, the formula for calculating rPrivate Markets shown above yields a return in USD. To apply the rPrivate Markets to a portfolio with valuation and cash flow information already in USD, use the formula below:

$$\text{Predicted NAV}_{\text{Ending}} = (\text{NAV}_{\text{Beginning}})(1 + r_{\text{Private Markets}}) + ((1 + r_{\text{Private Markets}})/2)(\text{Period Capital Calls} - \text{Period Distributions})$$

If the portfolio valuation and cash flow information is not in USD OR you wish to convert a USD return to a non-USD currency, an "FX Effect" factor must be applied. The formula should be adjusted as shown below:

$$\text{Predicted NAV}_{\text{Ending}} = (\text{NAV}_{\text{Beginning}})(1 + r_{\text{Private Markets}} + \text{FX Effect}) + (1 + (r_{\text{Private Markets}} + \text{FX Effect})/2)(\text{Period Capital Calls} - \text{Period Distributions})$$

Strategy Definitions:

Credit: This strategy focuses on providing debt capital.

EU Buyout: Any buyout fund primarily investing in the European Union.

Mega/Large Buyout: Any buyout fund larger than a certain fund size that depends on the vintage year.

Real Estate: Any closed-end fund that primarily invests in non-core real estate, excluding separate accounts and joint ventures.

SMID Buyout: Any buyout fund smaller than a certain fund size, dependent on vintage year.

VC/Growth: Includes all funds with a strategy of venture capital or growth equity.

Index Definitions:

MSCI Europe Index: The MSCI Europe Index tracks large and mid-cap equity performance across 15 developed market countries in Europe.

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

S&P 500 Index: The S&P 500 Index tracks 500 largest companies based on market capitalization of companies listed on NYSE or NASDAQ.TVC/Growth: Includes all funds with a strategy of venture capital or growth equity.

Index Definitions:

MSCI Europe Index: The MSCI Europe Index tracks large and mid-cap equity performance across 15 developed market countries in Europe.

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

S&P 500 Index: The S&P 500 Index tracks 500 largest companies based on market capitalization of companies listed on NYSE or NASDAQ.

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As of August 31, 2022