SECONDARY MARKET Q&A

WITH LONDON-BASED MANAGING DIRECTOR DAVID ATTERBURY

How has the secondary market evolved over the past year—especially in terms of types of deals, deal size, company stage, and sectors and regions seeing deals?

The secondary market represents a constantly changing landscape. It is usually weighted towards the U.S. in terms of deal flow, with the buyout space dominating the types of assets for sale. Probably the biggest change we saw in 2015 was the slowdown in the volume of assets sold by financial institutions in the second half of the year as regulatory deadlines were delayed. This has been coupled with a reduction in the number of large ($1 billion plus) traditional portfolios of limited partnership interests for sale given the volatility in the markets in the third quarter of 2015. However, we expect overall market volumes to be close to the record levels experienced in 2014 ($42 billion) as the frequency of general-partner led whole fund liquidity solutions increased dramatically over the course of 2015.

What have been the three major drivers of the market's growth? Do you expect these to continue going forward?

The development of whole fund liquidity solutions, a major driver of deal volumes in 2015, is expected to remain a significant opportunity for the market for many years to come. Just for mid-cap buyouts in the U.S. and Europe, there is an estimated $270 billion of remaining value in funds over five years old, many of which are performing successfully (see chart below). Furthermore, this is not a one-off phenomenon but instead a natural evolution of the market. Few private equity funds are fully realized within their 10-year life cycle. We now have a tested and successful mechanism to provide liquidity to investors and general partners (GPs) who want to liquidate their investments in older funds.

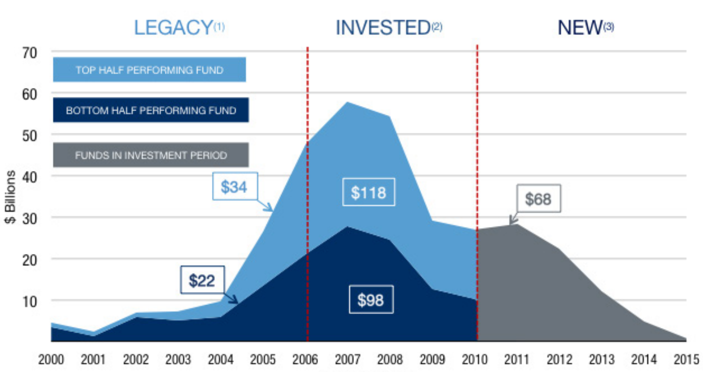
When you think about drivers of growth in recent years, we have seen a large boost as a result of financial institutions selling for regulatory reasons. This has slowed temporarily, but we expect it to increase again as the deadline for banking entities' compliance with the Volcker Rule and Basel III approaches. Perhaps more importantly for future growth, the increased acceptance of the secondary market means sellers are actively using secondary asset sales to manage their private equity exposure. This trend should continue.

Can you point to any examples from 2015 where HarbourVest added value to a client seeking a whole fund liquidity solution?

We had been an investor with a mid-market Spanish manager since 2005 and we saw an opportunity to acquire the residual assets in the GP's second fund, a 2006 vintage fund approaching the end of its life. Given the depth of the recent financial crisis in Spain, the fund still held seven assets. These companies were for the most part successful market-leading businesses, which were potentially attractive targets for buyers.

WHOLE FUND LIQUIDITY SOLUTIONS

Total unrealized NAV in Western Europe and North America (mid-cap buyout funds $200m-$3bn)



1 Funds raised over 10 years ago.
2 Funds raised between 2006-2010.
3 Funds raised since 2010.
4 NAV of funds where performance data is not available has been allocated 50:50 to top half/bottom half GPs.

Our solution was to acquire the entire portfolio and allow the client to continue managing the companies. This allowed the manager to return capital to its investors rather than sell the assets on a piecemeal basis over the next few years, thereby locking in attractive returns for its original limited partners (LPs). In turn, we were able to acquire a highly attractive portfolio in conjunction with the existing manager in an off-market transaction. This exemplifies the type of deals we find attractive and where we can add value.

How do you expect the secondary market to change over the next three to five years?

I think the industry specialization will continue, especially as competition grows. Investors are able to differentiate between the major secondary players. At its most basic level fund size influences strategy, with the very large secondary funds tending to look at the larger end of the traditional market. By contrast, HarbourVest is focused on the complex end of the market such as public-to-private deals and whole fund liquidity solutions. We have a competitive advantage in this space from a sourcing and information perspective. This is based on our global primary, secondary, and co-investment platform, as well as our long track record of execution and experience.

You can also see differentiation between market participants in terms of the use of leverage within larger traditional deals, and the types of underlying assets and managers targeted. HarbourVest's focus is on acquiring funds managed by high-quality managers that overlap with our primary funds. This means that we seek to generate our returns through long-term value appreciation in the assets acquired. Conversely, some secondary-focused groups specialize in looking for tail-end fund portfolios and generating returns by buying at steeper discounts. In a growing market, there is room for all of these strategies, and importantly, investors now have a choice. When compared to the broader industry, however this choice may still be limited given that there are relatively few secondary buyers with scale in many of the different parts of the market.