

# Private Equity Search Process and Recommendations

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# Agenda

- I. Private Equity Search Process Timeline & Allocation Objectives
- II. Manager Search Process
- III. Portfolio Construction
- IV. Manager Selection & Recommendations\*
- V. Requested Board Action

\*Names used in throughout this presentation are the shortened version that is used for ease of communication purposes throughout this document. The formal recommendations to the Board on the last page of this presentation reflect the full legal name of the investment.

# I. Private Equity Search Process Timeline & Allocation Objectives



# Private Equity Search Process Timeline

Q2  
2015 –  
Ongoing

- Conduct manager reviews through a multi-phase evaluation process for all candidates.
- Multiple conference calls with StepStone to score and determine best candidates for TMRS, as well as incorporate their sourcing and due diligence.

Dec  
2015

- TMRS staff presented the 2016 Private Equity Pacing Plan recommending a commitment of up to \$600 million of Private Equity exposure.
- Board approved manager searches during 2016 totaling up to \$600 million.

Dec  
2015

- TMRS Staff formally launched the 2016 search process, in concert with StepStone.

Q1  
2016

- February 2016: The Board approved one manager recommendation for the Private Equity Asset Class for \$75 million.
- Legal negotiations ongoing.

Q2  
2016

- May 2016: Staff and StepStone currently presenting four manager recommendations for the Private Equity Asset Class for \$185 million.

# Private Equity Search Process Objectives

- **Excess Return Potential**

- Expected excess return consistent with TMRS' overall objective for Private Equity asset class: Russell 3000 + 3.00%.
- Identify best in class managers currently in fundraising.

- **Portfolio Diversification**

- Balance concentration and diversification across managers.
- Ensure sufficient strategy diversification, consistent with policy guidelines, and whenever possible incorporate tactical and opportunistic considerations into manager selection.

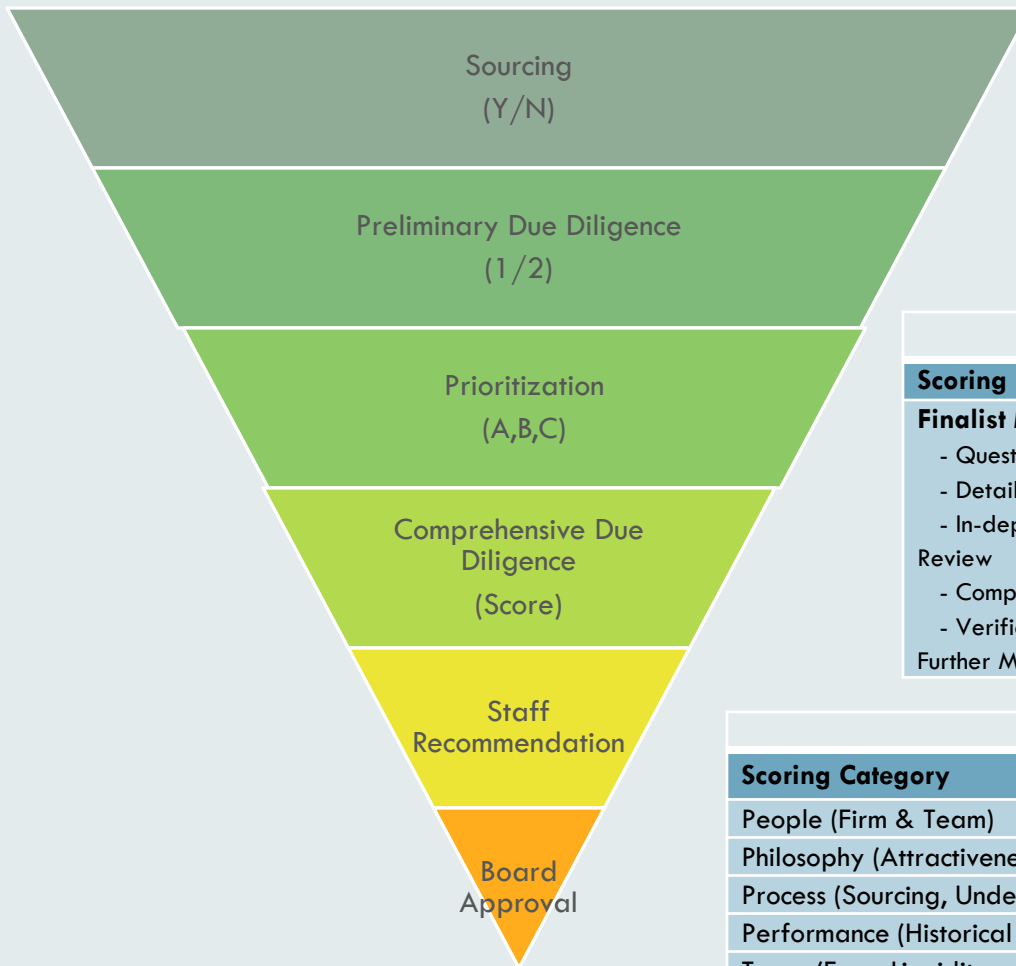
- **Targeted Commitment Level**

- Per the December 2015 Board approval, the targeted Private Equity Pacing Plan for 2016 is up to \$600 million.

## II. Manager Search Process



# Manager Search Process



Manager Screen & Universe Analysis Scoring	
Scoring Category	Score / Outcome
<b>Manager Screen</b> - Is vehicle consistent w/ TMRS' objectives?	Yes - Take Meeting; No - Don't Take Meeting
<b>Manager Analysis</b> - Does vehicle have adequate capacity and timeline? - PPPPT* Preliminary Review	1 - Advance; 2 - Stop Research

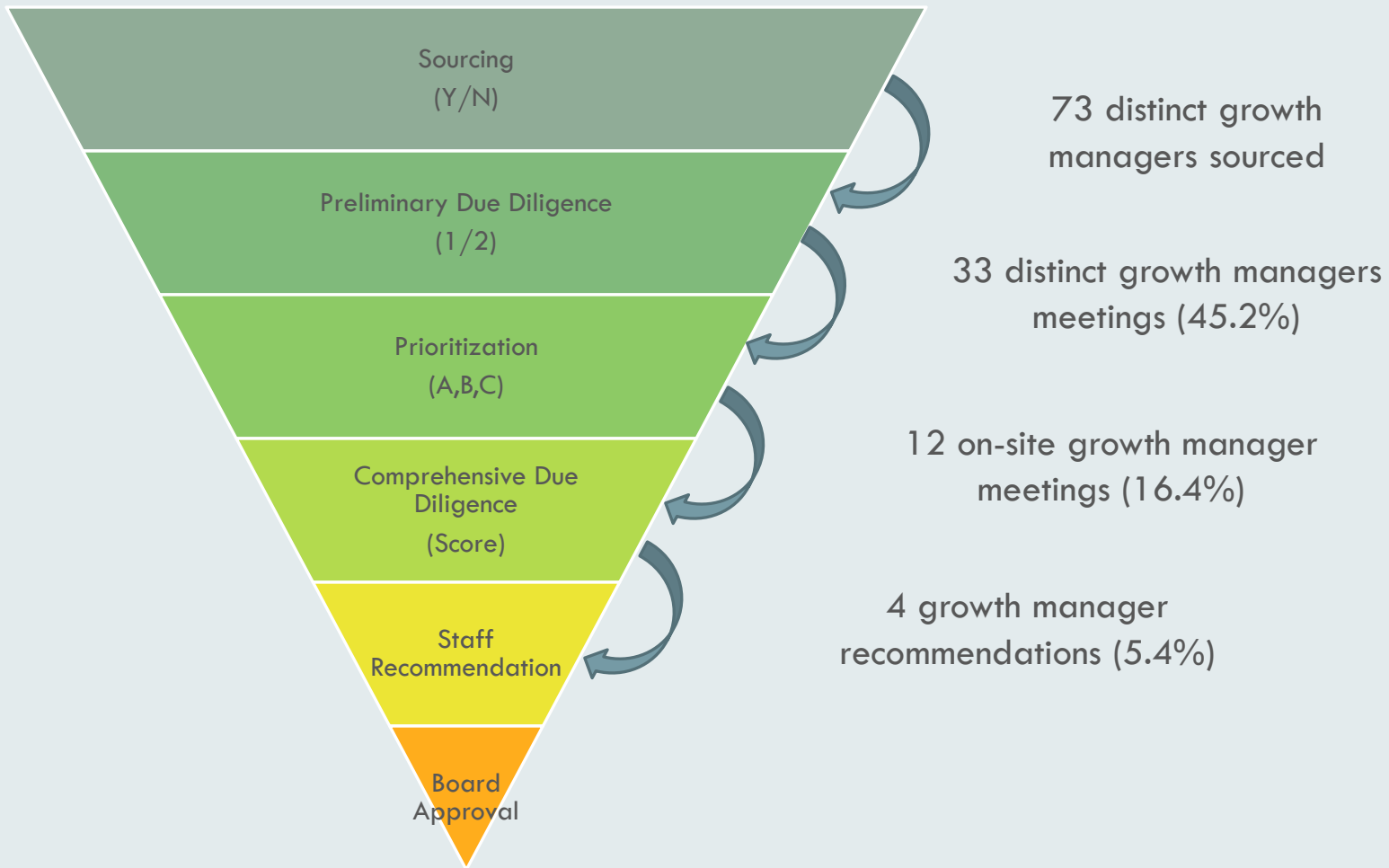
Semi-Finalist Scoring Matrix	
Scoring Category	Score
<b>Finalist Manager Review</b> - Questionnaire Review - Detailed PPPPT* Review - In-depth Manager Qualifications Review - Compliance with TMRS IPS - Verification of Research, References, Further Market Research	A - Prioritize for Final Due Diligence B - Perform More Research C - Stop Research / Manager not Selected

Final Due Diligence Scoring Matrix	
Scoring Category	Possible Points
People (Firm & Team)	0 - 40 points
Philosophy (Attractiveness of Opportunity / Portfolio Fit)	0 - 20 points
Process (Sourcing, Underwriting and Managing)	0 - 40 points
Performance (Historical / Expected)	0 - 40 points
Terms (Fees, Liquidity, etc.)	0 - 20 points
<b>Total</b>	<b>100†</b>

\*PPPPT – People, Philosophy, Process, Performance, Terms

†Selected managers standardized to a score of 100 to allow comparability among selected managers.

# Manager Search Process





# Final Selected Managers Scoring Matrix

Final Due Diligence Scoring Matrix - Aggregated Results*			
Recommended Manager/Fund	Manager Score†	Comparable Mgr. 1 Score	Comparable Mgr. 2 Score
Providence	100	93.0	81.0
Updata	100	92.0	83.0
Mercato	100	96.0	81.0
Foundry	100	81.5	75.0

\*Scoring matrices utilize difference calibrations depending on the strategy being utilized.

†Selected managers standardized to a score of 100 to allow comparability among selected managers.

# III. Portfolio Construction



# Manager Selection Portfolio Considerations

## Strategy Diversification

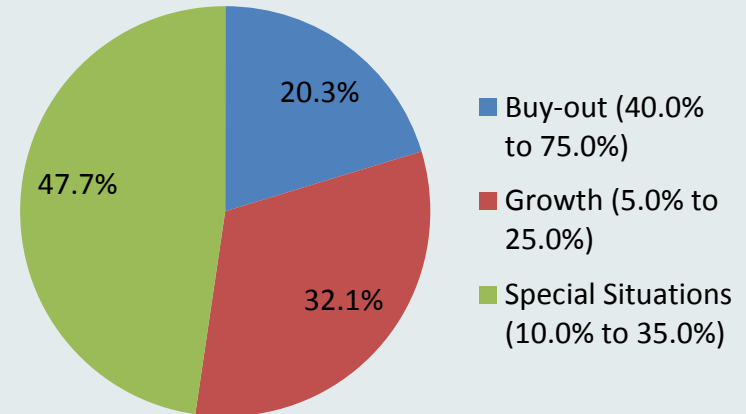
*Strategy considerations:*

*2015: Overweight special situations early for J-Curve mitigation, efficiency of capital deployment, and tactical opportunities.*

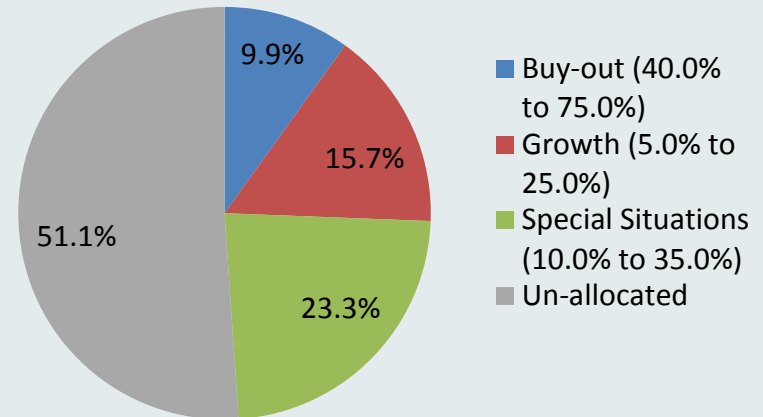
*2016: Focus on growth opportunity set and continue to add buy-out exposure.*

*2017: Round out buy-out portfolio, and opportunistically add to growth and credit.*

**Figure 2 : Private Equity Strategy Diversification by Commitment**



**Figure 3 : Private Equity Target Diversification**



# Manager Selection Portfolio Considerations

## Manager Implementation

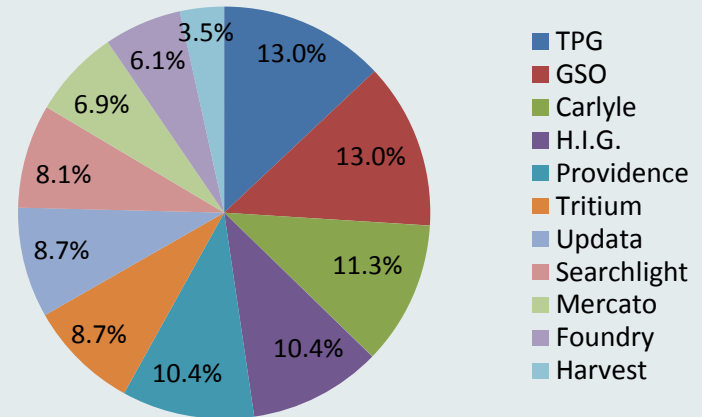
*The overall goal remains identifying top quartile performers to partner with.*

*Position sizing considerations:*

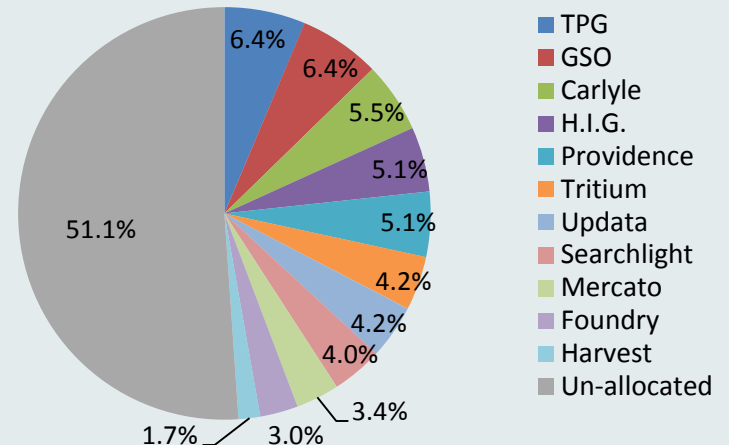
*Continue to reduce the unallocated portion of the private equity portfolio while sensibly balancing the trade-off between diversification and concentration.*

*Areas of focus are enhancing manager diversification, and building strategic relationships where possible/appropriate.*

**Figure 4: Private Equity Manager Diversification by Commitment**



**Figure 5 : Private Equity Target Manager Diversification**

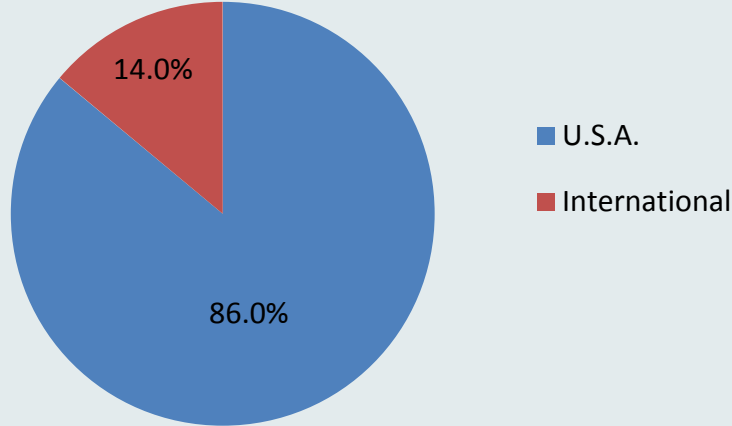


# Manager Selection Portfolio Considerations

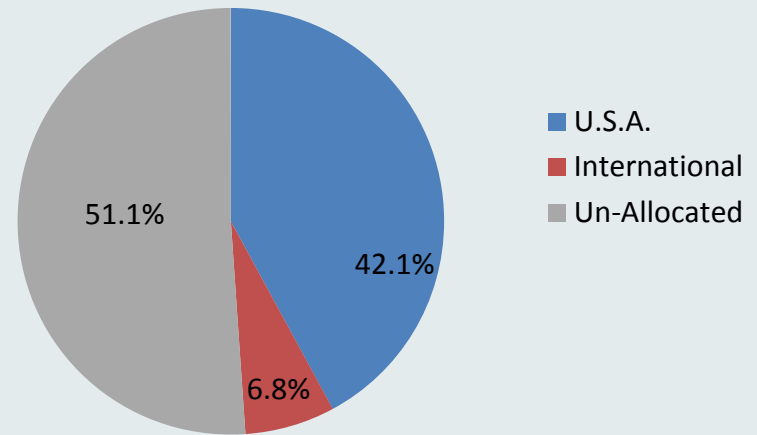
## Geographic Diversification

*TMRS is focused on taking a measured approach to global geographic diversification.*

**Figure 6 : Private Equity Geographic Diversification by Commitment**



**Figure 7 : Private Equity Target Geographic Diversification**

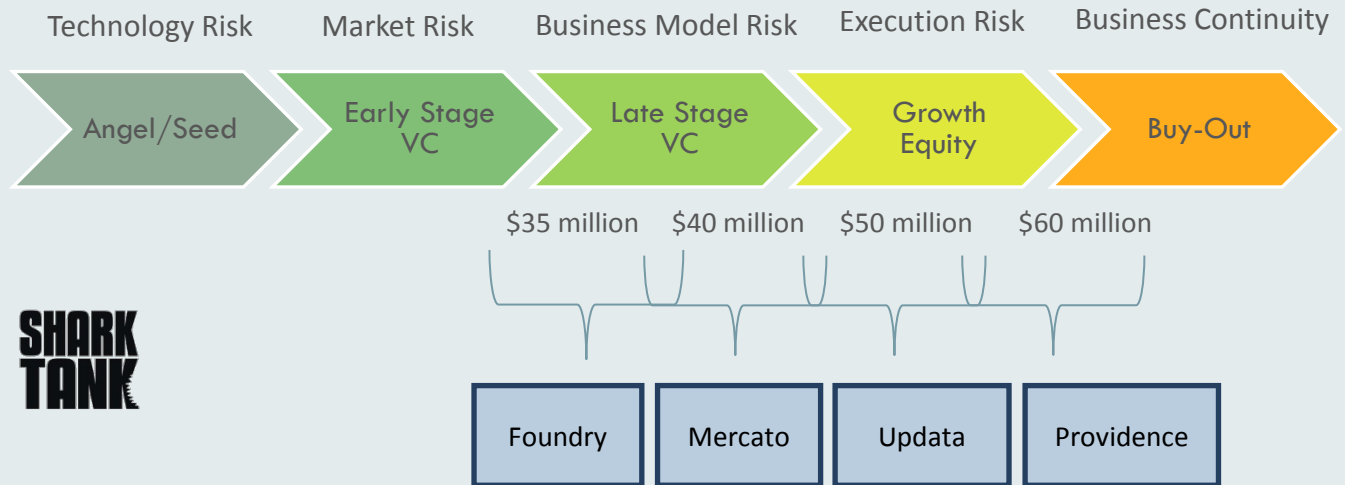


**The Target Portfolio keeps a conservative stance on international exposure.**

# Manager Selection Portfolio Considerations

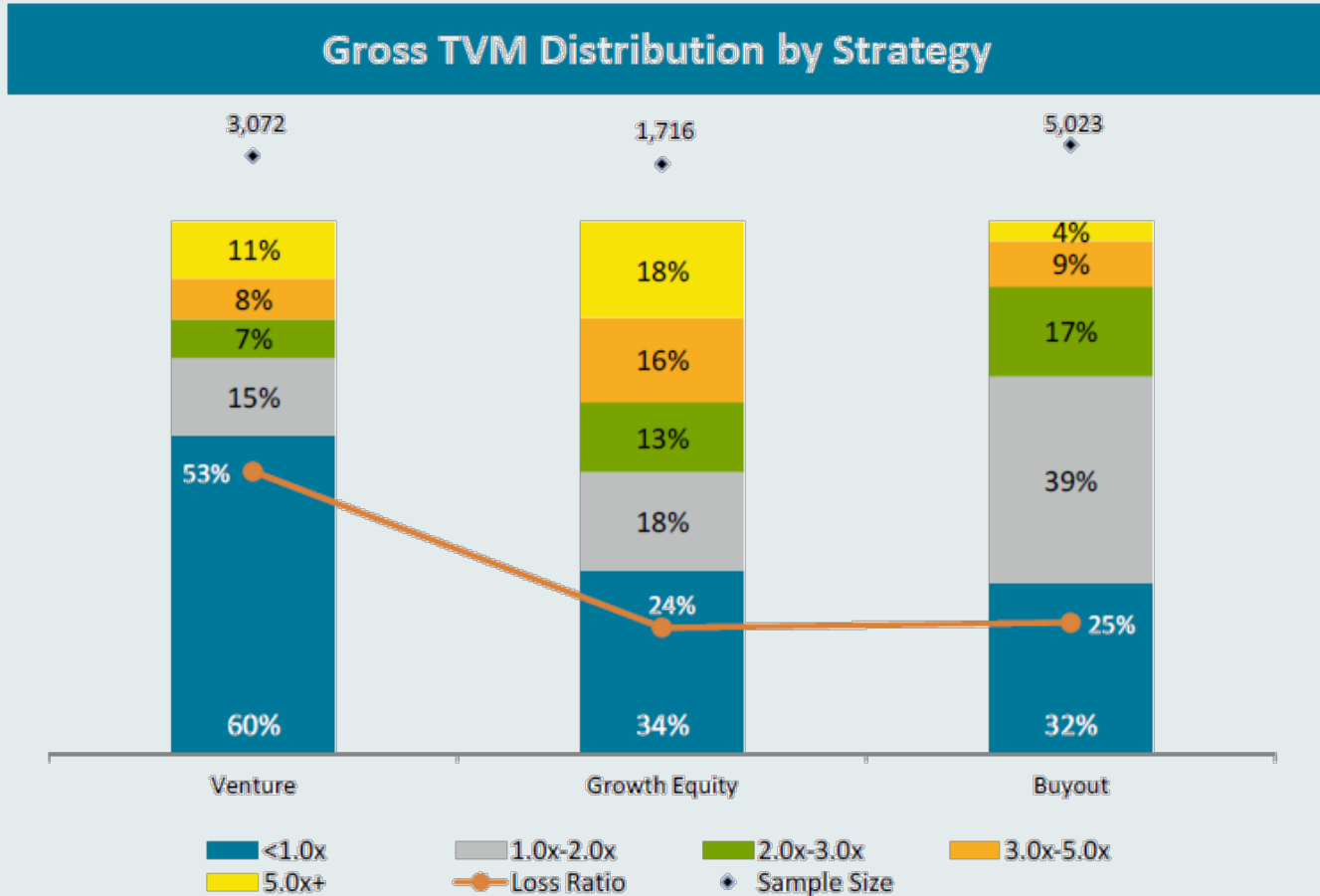
*Growth Risk and Return*

## Development Risk and Portfolio Construction



# Manager Selection Portfolio Considerations

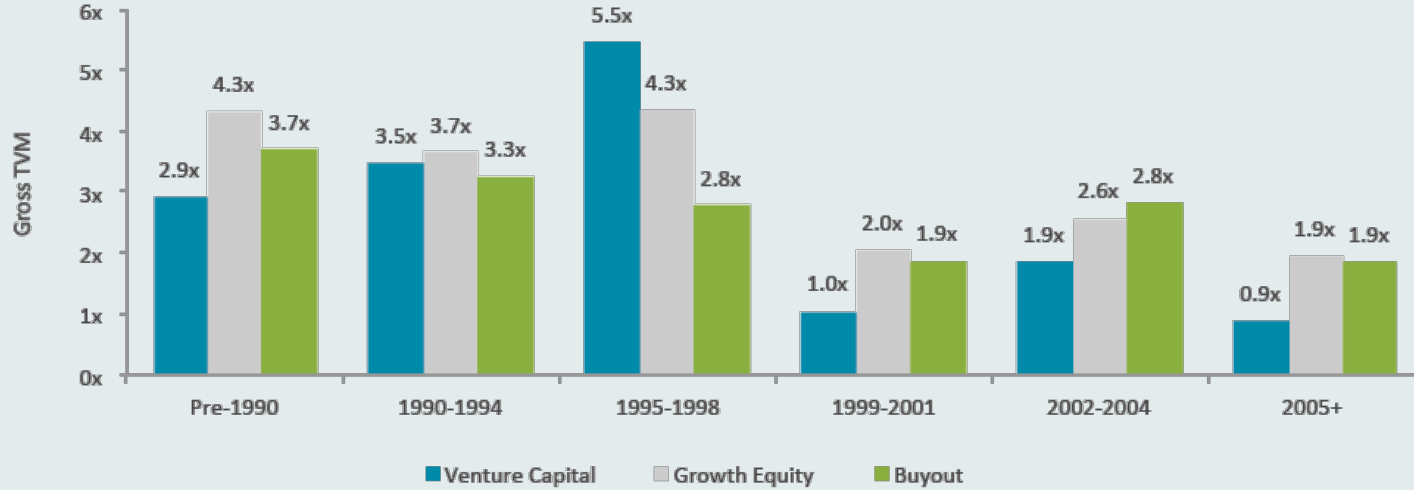
Growth Risk and Return



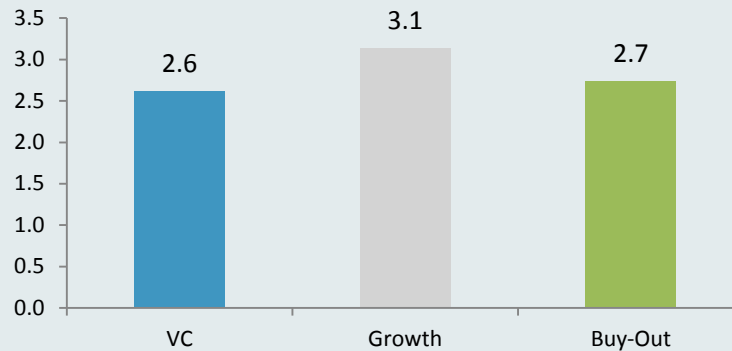
# Manager Selection Portfolio Considerations

## Growth Risk and Return

US Venture Capital, Growth Equity and Buyout Deal Performance by Vintage Year



Average TVM





## IV. Manager Selection & Recommendations



# Executive Summary of Manager Recommendation

Summary of Recommendations			
Recommended Manager/Fund	Strategy Classification	Target Return	Recommended Amount
Providence	Growth Equity	20% / 2.5X	\$60 million
Udata	Growth Equity	20% / 2.5X	\$50 million
Mercato	Growth Equity	20% / 2.5X	\$40 million
Foundry	Venture Capital	25% / 3.0X	\$35 million
Total Net Recommendations:			\$185 million

*Private Equity Pacing model as approved by the TMRS Board of Trustees in December 2015 established an amount up to \$600 million as the targeted level of commitments for 2016.*

# Top Candidate Characteristics – Providence

**\$60 million Recommendation**

## Scoring Matrix

Category	Providence	Growth Comp 1	Growth Comp 2
People	22.0	21.0	18.0
Philosophy	20.0	19.0	18.0
Process	19.0	19.0	17.0
Performance	24.0	22.0	18.0
Terms	15.0	12.0	10.0
<b>Total</b>	<b>100.0</b>	<b>93.0</b>	<b>81.0</b>



### Reasons to Invest

- Global brand and ability to leverage Providence platform and research
- Deep team with extensive strategy experience – strategy pure to founder lead sourcing and first institutional capital
- Strong alignment of interest - \$60 million GP commit, 12% of fund
- Extremely strong absolute and relative return and relatively quick return of capital (top decile return and loss ratio)

### Issues to Watch

- Providence ownership and carry split 50/50 – team has demonstrated significant value add from the parent
- Team is growing and still relatively new together – senior members have 15 year plus relationships
- Increase in fund size and competition in sector – team has grown and demonstrated ability to deploy capital effectively and remained disciplined
- Fund I largely unrealized

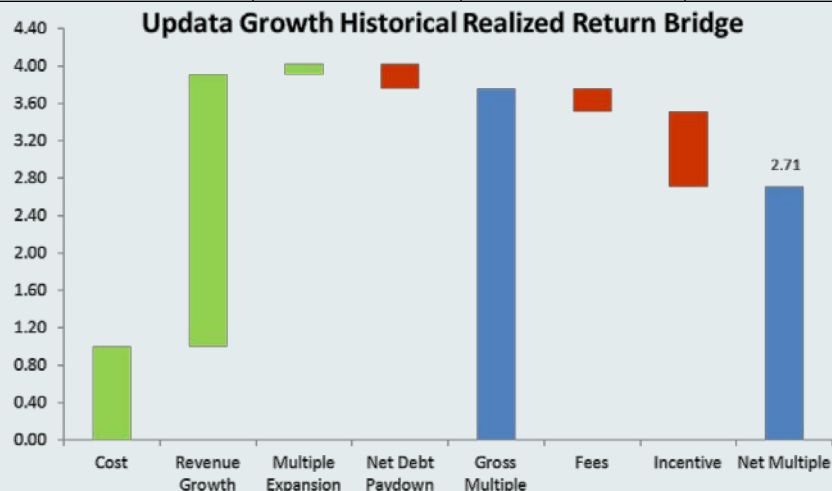
Providence Strategic Growth (“PSG,” the “GP” or the “Firm”) is an affiliate of the Providence Equity Partners (“PEP”) platform, which oversees more than US\$45 billion of AUM and is headquartered in Providence, Rhode Island. PSG targets growth equity investments in Lower Middle Market technology-enabled companies in North America. PSG will make both majority and significant minority investments in breakeven or profitable companies with an emphasis on companies that have not taken prior institutional capital. The GP will partner with founders and entrepreneurs to invest between US\$5-50 million in companies with revenues between US\$5-75 million. Providence will target \$500 million.

# Top Candidate Characteristics – Udata

**\$50 million Recommendation**

## Scoring Matrix

Category	Udata	Growth Comp 1	Growth Comp 2
People	21.0	14.5	17.0
Philosophy	20.0	20.0	18.0
Process	20.0	19.5	18.0
Performance	24.0	22.0	19.0
Terms	15.0	16.0	11.0
<b>Total</b>	<b>100.0</b>	<b>92.0</b>	<b>83.0</b>



### Reasons to Invest

- Investment team heritage – The partners have extensive histories of founding and exiting technology companies
- Top quartile performance of Fund III and IV – The last 10 realizations generated proceeds at a 54% premium to valuations two quarters prior to sale.
- Limited use of leverage and low loss ratio in growth equity
- Visibility into the fund – 4 deals in the ground and attractive pipeline

### Issues to Watch

- Partner level turnover – were asked to leave for performance; stronger team today
- Underperformance in non-core strategies – going forward, no more venture or buy-out
- Previous cross-fund investments – The GP has confirmed that cross-fund investments will not occur in Udata

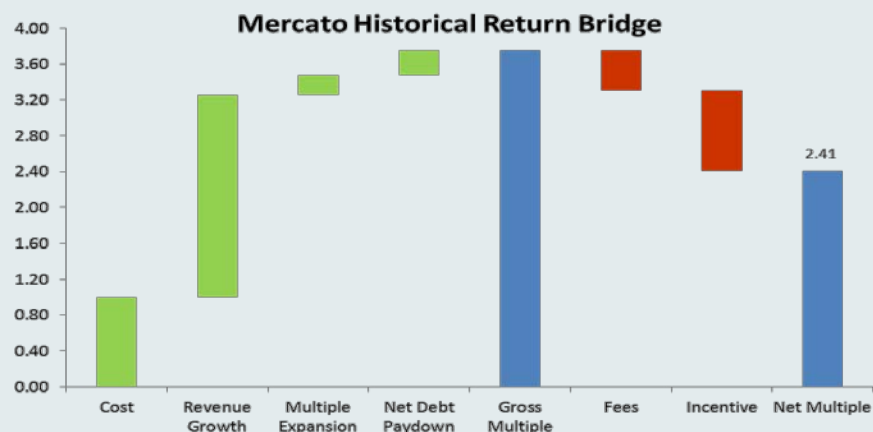
Udata Partners has invested \$331 million in 37 companies across four prior funds. Udata will focus on providing growth equity to software and tech-enabled services businesses in the lower middle market, typically as the first institutional capital into founder-owned companies. Udata will make both minority and control investments, targeting companies with revenues between \$5M and \$50M and growing at above 25% YoY. Udata seeks to mitigate risks by structuring attractive preferred or participating preferred securities as well as ensuring significant influence through board seats and ownership stakes above 25%. The fund is targeting \$225M, with a \$275M hard cap.

# Top Candidate Characteristics – Mercato

**\$40 million Recommendation**

## Scoring Matrix

Category	Mercato	Growth Comp 1	Growth Comp 2
People	21.0	22.0	17.0
Philosophy	22.5	21.0	18.0
Process	19.0	17.0	18.0
Performance	24.5	21.0	14.0
Terms	13.0	15.0	14.0
<b>Total</b>	<b>100.0</b>	<b>96.0</b>	<b>81.0</b>



### Reasons to Invest

- Large and experienced team relative to their size
- Attractive growth equity strategy focused on sector and functional value added expertise
- Compelling absolute and relative performance – top decile plus
- Low loss ratio – Only 5% since inception
- Proprietary sourcing in underserved and less competitive Mountain West region

### Issues to Watch

- Team turnover has been a bit higher than ideal, but idiosyncratic reasons
- Team capacity and fund growth – fund diversification will increase instead of deal size
- Significant exposure to late stage venture deals – this segment of the portfolio has been the strongest performing

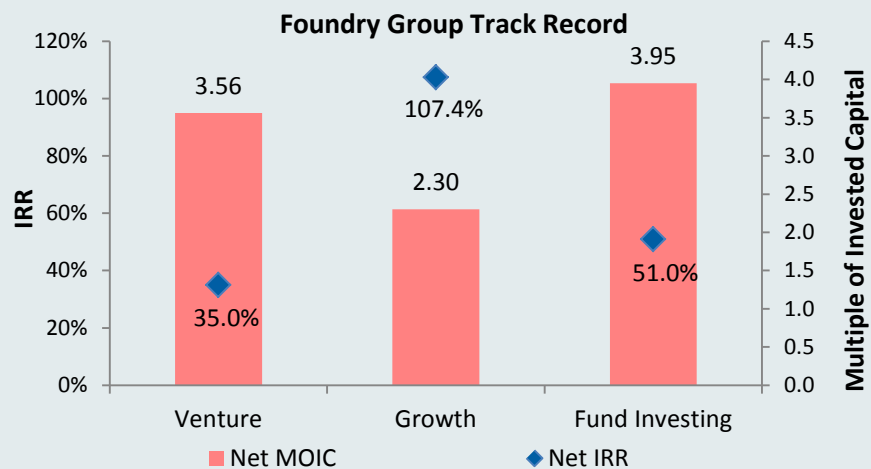
Mercato will invest in lower middle market, growth stage companies primarily located in the underserved Mountain West region. Mercato targets high potential companies in the Technology, Branded Consumer Products, and Digital Media sectors. Mercato will emphasize companies with historically high revenue growth, scalable business models, growth-oriented management teams, and an established product and customer base. Typical investment sizes will range from \$5-\$15M per deal, and target companies will generally be EBITDA-positive (or within the next 12-18 months). Mercato will seek to invest in founder-owned companies as the first institutional investor in minority growth equity transactions, structuring deals for strong downside protection. The Fund is targeting \$175M with a hard cap at \$250.

# Top Candidate Characteristics – Foundry

**\$35 million Recommendation**

## Scoring Matrix

Category	Foundry	Venture Comp 2	Venture Comp 1
People	20.0	19.0	16.5
Philosophy	23.0	18.0	14.0
Process	20.0	16.5	15.5
Performance	23.0	17.0	17.0
Terms	14.0	11.0	12.0
<b>Total</b>	<b>100.0</b>	<b>81.5</b>	<b>75.0</b>



### Reasons to Invest

- *Unique structure: de-risked later stage deals combined with access constrained early stage funds*
- *Strong historical performance: outsized realized returns coupled with low loss ratio*
- *Strong brand reputation and senior team with regional and thematic sourcing and information advantages*
- *Favorable terms and low fees*

### Issues to Watch

- *Team capacity and high board load – Load sharing approach and addition of Eakman mitigates this. Team has managed it in the past.*
- *Higher valuations in venture – Very low loss ratios and de-risked later stage deals*
- *Adverse selection bias – Demonstrated success in backing early stage winners*

Foundry Group is a venture capital firm formed in 2007 by Brad Feld, Seth Levine, Ryan McIntyre and Jason Mendelson to make investments in early and late stage IT, Internet and software startups. Foundry will invest 50% of its capital in later stage rounds of existing Foundry Group portfolio companies, 25% in Series B+ rounds of new portfolio companies where they have a deeply entrenched relationship with the existing investors, and 25% in LP commitments to 12-15 high-performing small VC funds, overseen by new partner Lindel Eakman. Foundry Group currently manages assets in excess of \$1.1 billion in total. Foundry is targeting \$500 million in capital.

# V. Requested Board Action



# Recommendations

- TMRS Staff and StepStone Group recommend that the Board of Trustees approve the selection of the following funds as referenced in the Board Communication Memo for investment in the specified funds below:

• Providence Strategic Growth II L.P.	\$60 Million
• Updata Partners V, L.P.	\$50 Million
• Mercato Partners Growth III, L.P.	\$40 Million
• Foundry Group Next, L.P.	\$35 Million