

## 2016 Private Equity Search Process and Recommendations

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Chris Schelling, Director of Private Equity

Chris Tindell, Investment Analyst, Private Equity  
StepStone Group



# Agenda

- I. 2016 Private Equity Search Process Timeline & Allocation Objectives
- II. Manager Search Process
- III. Portfolio Construction
- IV. Manager Selection & Recommendation
- V. Requested Board Action

# I. 2016 Private Equity Search Process Timeline & Allocation Objectives



# 2016 Private Search Process Timeline

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 continued with the 2016 search process, in concert with StepStone.

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.

Q1  
2016

- February 2016: The Board approved one manager recommendation for the Private Equity Asset Class for \$75 million.
- Negotiations completed and contract executed on \$75 million.

Q2  
2016

- May 2016: The Board approved four manager recommendations for the Private Equity Asset Class for \$185 million.
- Negotiations completed and contracts executed on \$180 million.

Aug  
2016

- Investment Staff and StepStone are currently recommending two managers for the Private Equity Asset Class for a total of \$100 million.

# 2016 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.

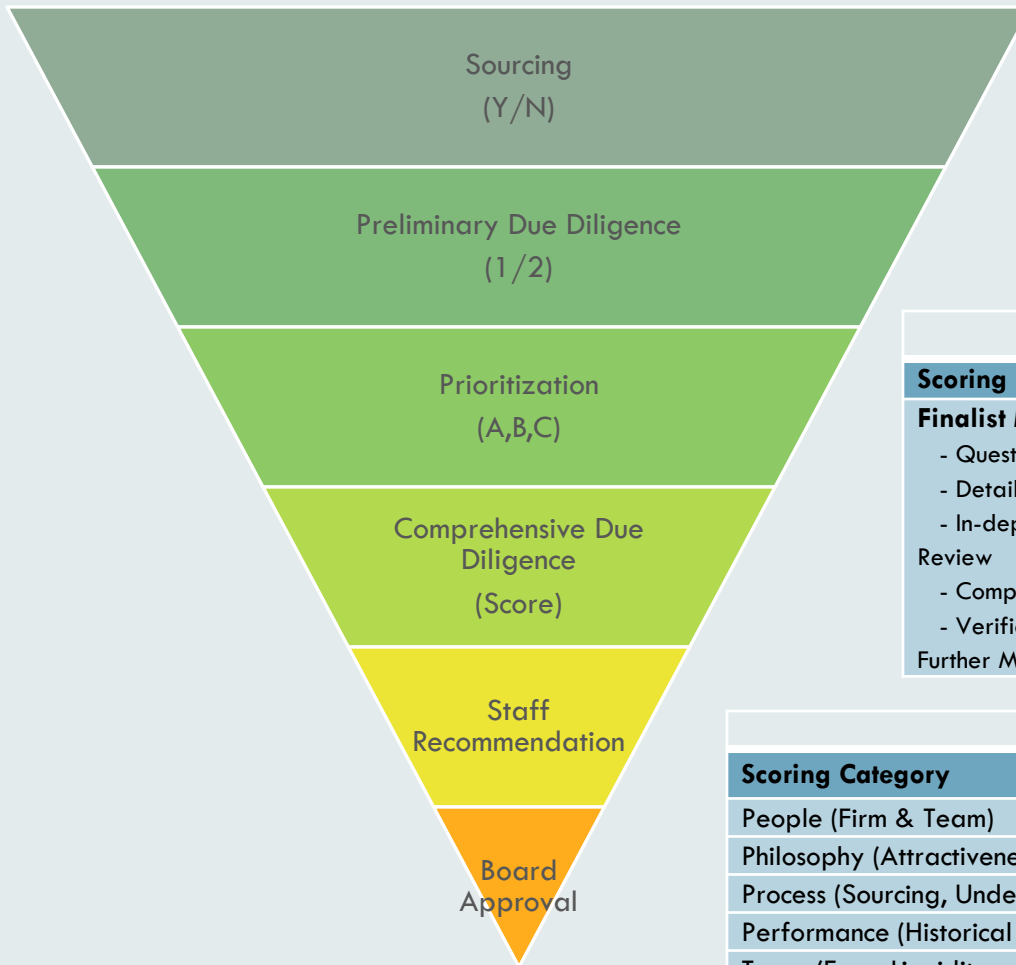
- **Targeted Commitment Level**

- 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

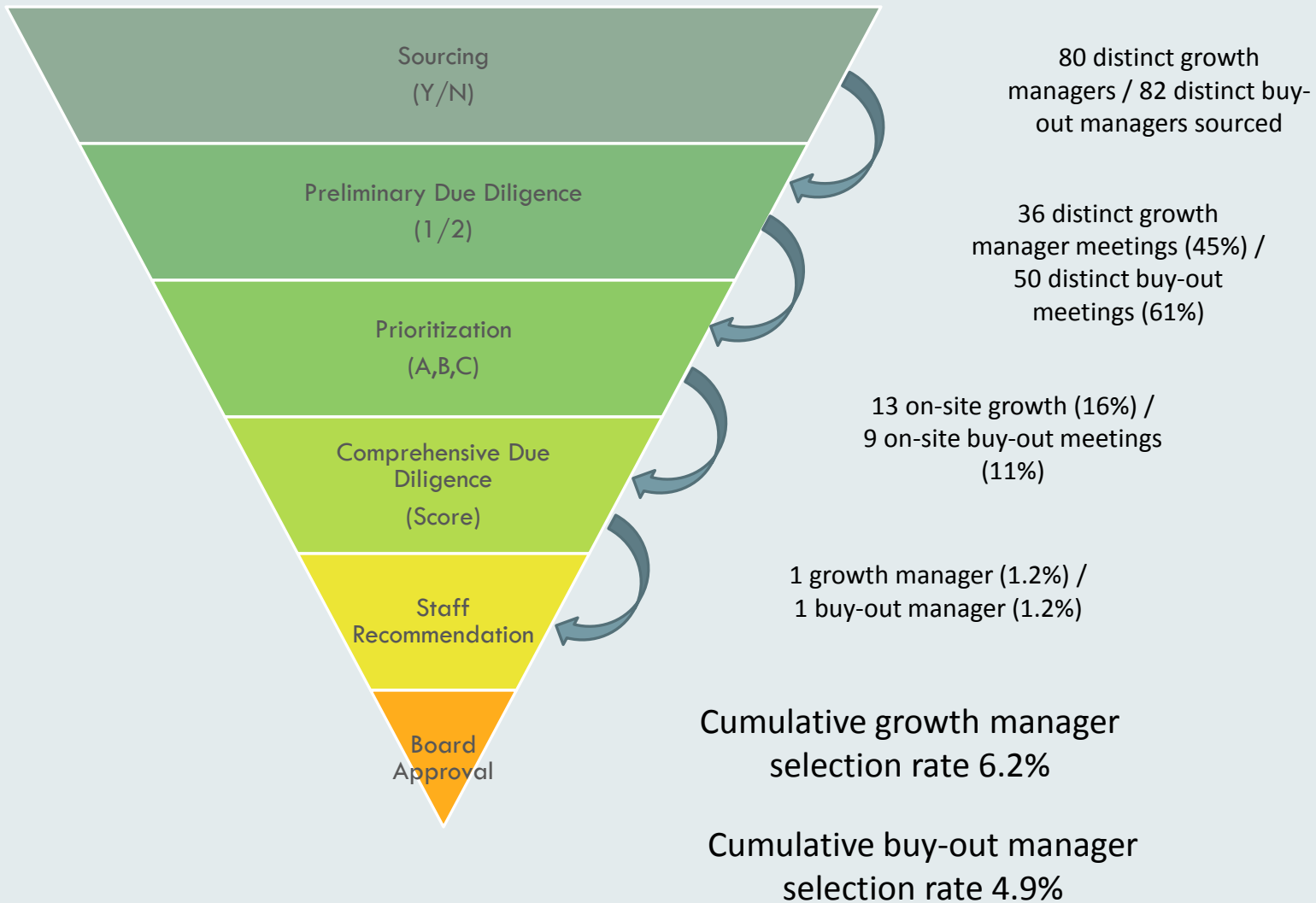
Semi-Finalist Scoring Matrix	
Scoring Category	Score
<b>Finalist Manager Review</b> - Questionnaire Review - Detailed PPPPT* Review - In-depth Manager Qualifications Review - Compliance with TMRS IPS - Verification of Research, References, Further Market Research	A - Prioritize for Final Due Diligence 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
Kainos Capital Partners II, LP (Kainos)	100.0	92.0	81.0
FTV V LP (FTV)	100.0	93.0	81.0

\*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

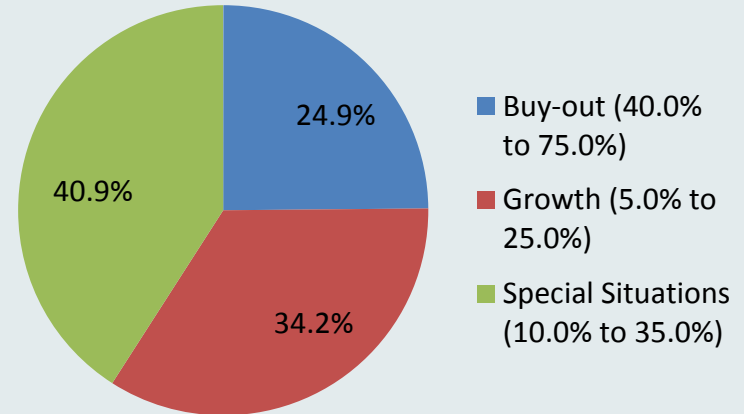
*Strategy considerations:*

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

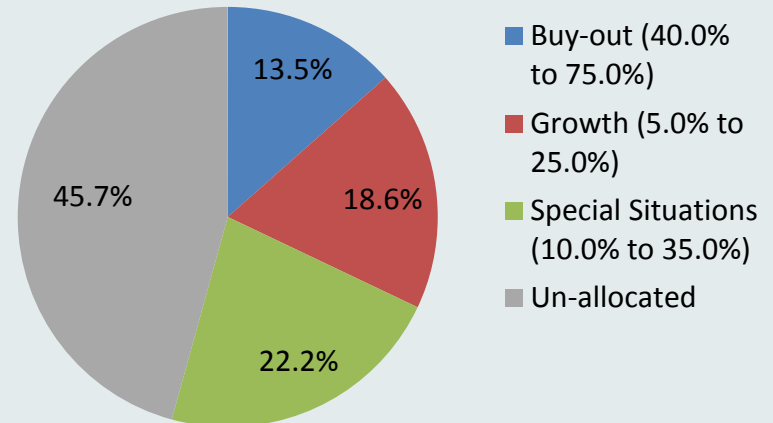
*2016: Focus on growth opportunity set and continue to add buy-out exposure.*

*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

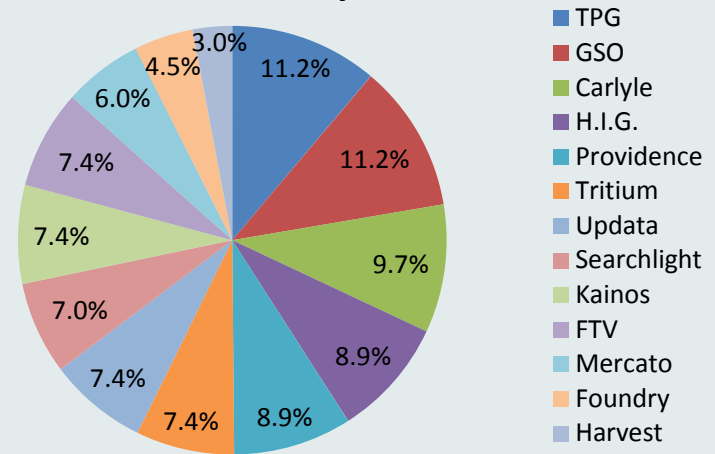
*The overall goal remains identifying and partnering with top quartile performers.*

*Position sizing considerations:*

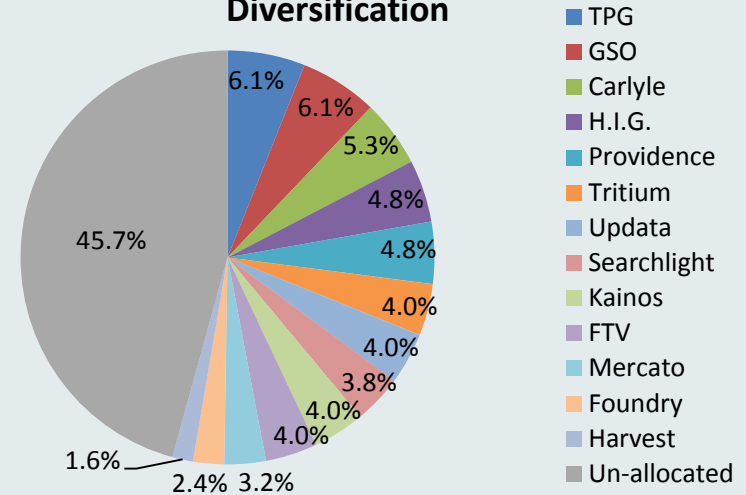
*Continue to reduce the unallocated portion of the private equity portfolio while sensibly balancing the trade-off between diversification and concentration.*

*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**

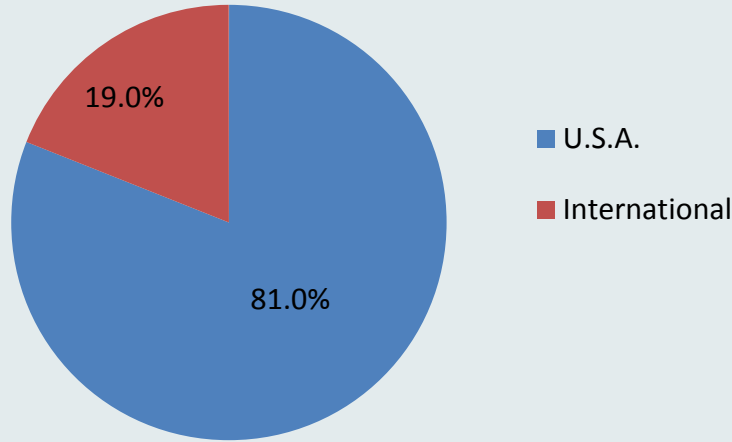


# Manager Selection Portfolio Considerations

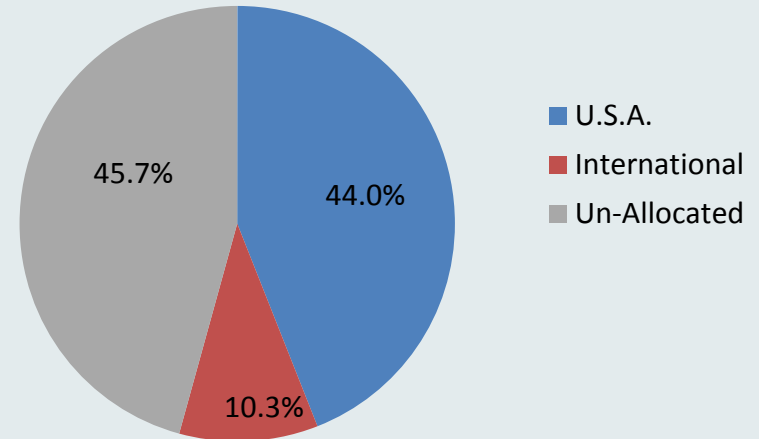
## Geographic Diversification

*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.**

## IV. Manager Selection & Recommendation



# Executive Summary of Manager Recommendation

Summary of Recommendations			
Recommended Manager/Fund	Strategy Classification	Target Return	Recommended Amount
Kainos	Buy-out Strategy	18% / 2.0X	\$50 million
FTV	Growth Equity	20% / 2.5X	\$50 million
Total Net Recommendations:			\$100 million

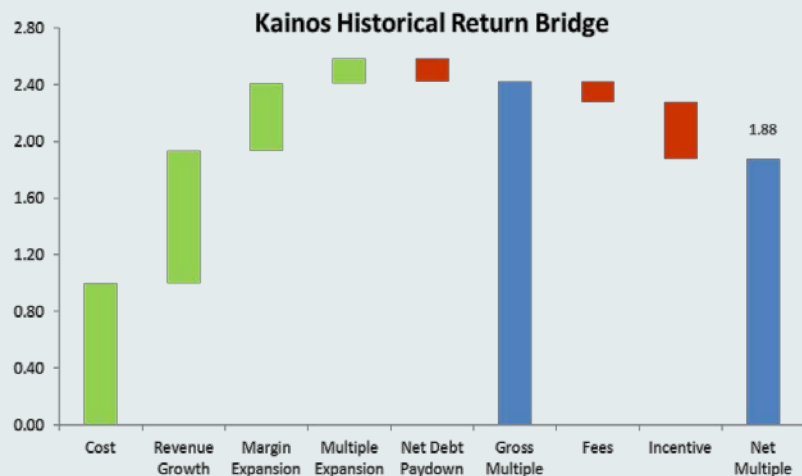
*Private Equity Pacing model as approved by the TMRS Board of Trustees in December 2015 established up to \$600 million as the targeted level of commitments for 2016.*

# Top Candidate Characteristics – Kainos

**\$50 million Recommendation**

## Scoring Matrix

Category	Kainos	Buy-out Comp 1	Buy-out Comp 2
People	24.0	21.0	19.0
Philosophy	22.0	20.0	19.0
Process	21.0	20.0	17.0
Performance	19.0	18.0	15.0
Terms	14.0	13.0	11.0
<b>Total</b>	<b>100.0</b>	<b>92.0</b>	<b>81.0</b>



### Reasons to Invest

- Experienced, cohesive and well-aligned team – 130 years of combined experience
- Compelling absolute and relative performance – top decile +
- Low loss ratios (9%) and short duration (3.5 average hold) help minimize risk
- Value creation drivers includes cost reduction and margin expansion capabilities

### Risks & Mitigants

- Growth in fund size – Fund I was too small and performance on larger deals historically even better
- Fund I largely unrealized – portfolio is performing well with likely near term exits
- Key man risk in Rosen, but deep senior team and key man clause

Kainos Capital is a Dallas, Texas based private equity firm formed in 2012 by Andrew Rosen, Robert Sperry and Sarah Bradley to make Lower Middle Market investments in North American food and consumer products companies. The Firm makes control equity investments in buyouts, corporate carve-outs, and later-stage growth companies. Kainos' 12-person investment team is led by six Partners, including the three Founding Partners. The six Partners have worked together for an average of 10 years and have 130 years of combined experience investing and operating companies in the food and consumer products industries. Fund II will close on its hard cap of \$875 million by September 2016.

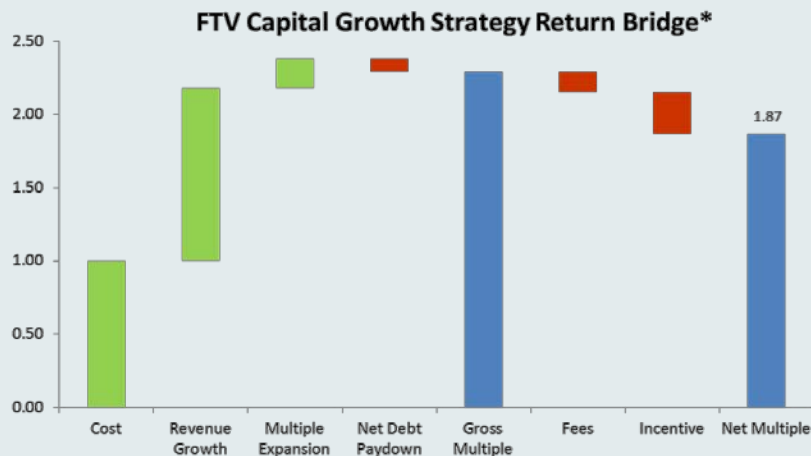


# Top Candidate Characteristics – FTV

**\$50 million Recommendation**

## Scoring Matrix

Category	FTV	Growth Comp 1	Growth Comp 2
People	20.5	17.0	14.0
Philosophy	19.5	18.0	17.0
Process	25.0	23.0	21.0
Performance	21.0	20.0	16.0
Terms	14.0	15.0	13.0
<b>Total</b>	<b>100.0</b>	<b>93.0</b>	<b>81.0</b>



\* Adjusted for realized and unrealized growth strategy performance only

### Reasons to Invest

- Large, experienced and cohesive team aided by its Global Partner Network
- Consistent and improving performance – Net IRR has increased every fund, while loss ratios have declined – evidence of process improvement
- Deep operating and sector knowledge in payments and financial technology
- Very institutional infrastructure and transparent reporting for small firm

### Risks & Mitigants

- Partner level turnover – staff has conducted significant diligence and believes departures unlikely to impact performance
- Increased fund size - FTV has historically performed well in larger deals, and their current pacing can support this deployment.
- Weaker historical performance in venture deals – FTV is fully transitioned away from earlier stage venture.

FTV Capital is a bi-coastal growth equity firm with offices in San Francisco, CA and New York, NY. Originally founded in 1998 as a financial technology-focused venture capital firm, FTV has evolved into a growth equity platform targeting investments in fast growing, Lower Middle Market companies with US\$10 million to US\$100 million of revenue across the following three sectors: Enterprise Technology & Services; Financial Services; and Payments & Transaction Processing. FTV Capital is a flexible investor, seeking both minority and control positions. FTV is targeting \$700 million with a \$850 million cap.

# V. Board Action



# Approval of Recommendation

- 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:

- Kainos Capital Partners II LP \$50 mm
- FTV V, LP \$50 mm

## **DISCLOSURE**

*TMRS periodically discloses public information that is not excepted from disclosure under Section 552.0225(b) of the Texas Public Information Act. Information provided by a manager, a general partner or other data provider to TMRS or a TMRS service provider, and contained in these materials, may have been independently produced or modified by TMRS or the TMRS service provider.*