

# 2017 Private Equity Search Process and Recommendations

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# Agenda

- I. 2017 Private Equity Search Process Timeline & Allocation Objectives
- II. Manager Search Process
- III. Portfolio Construction
- IV. Manager Selection & Recommendation
- V. Requested Board Action

Section I

# 2017 PRIVATE EQUITY SEARCH PROCESS TIMELINE & ALLOCATION OBJECTIVES

# 2017 Private Equity Search Process Timeline



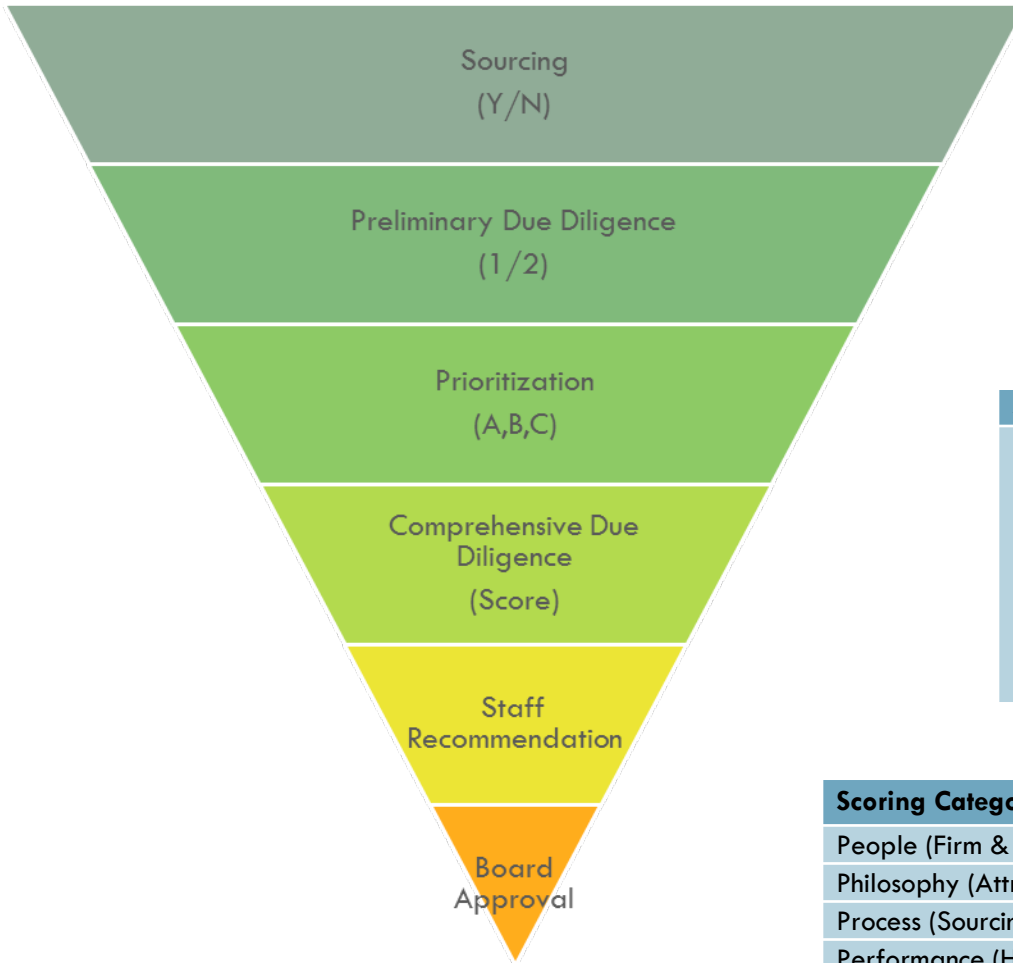
# 2017 Private Equity Search Process Objectives

- ▶ **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 2016 Board approval, the targeted Private Equity Pacing Plan for 2017 is for up to \$600 million.

Section 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

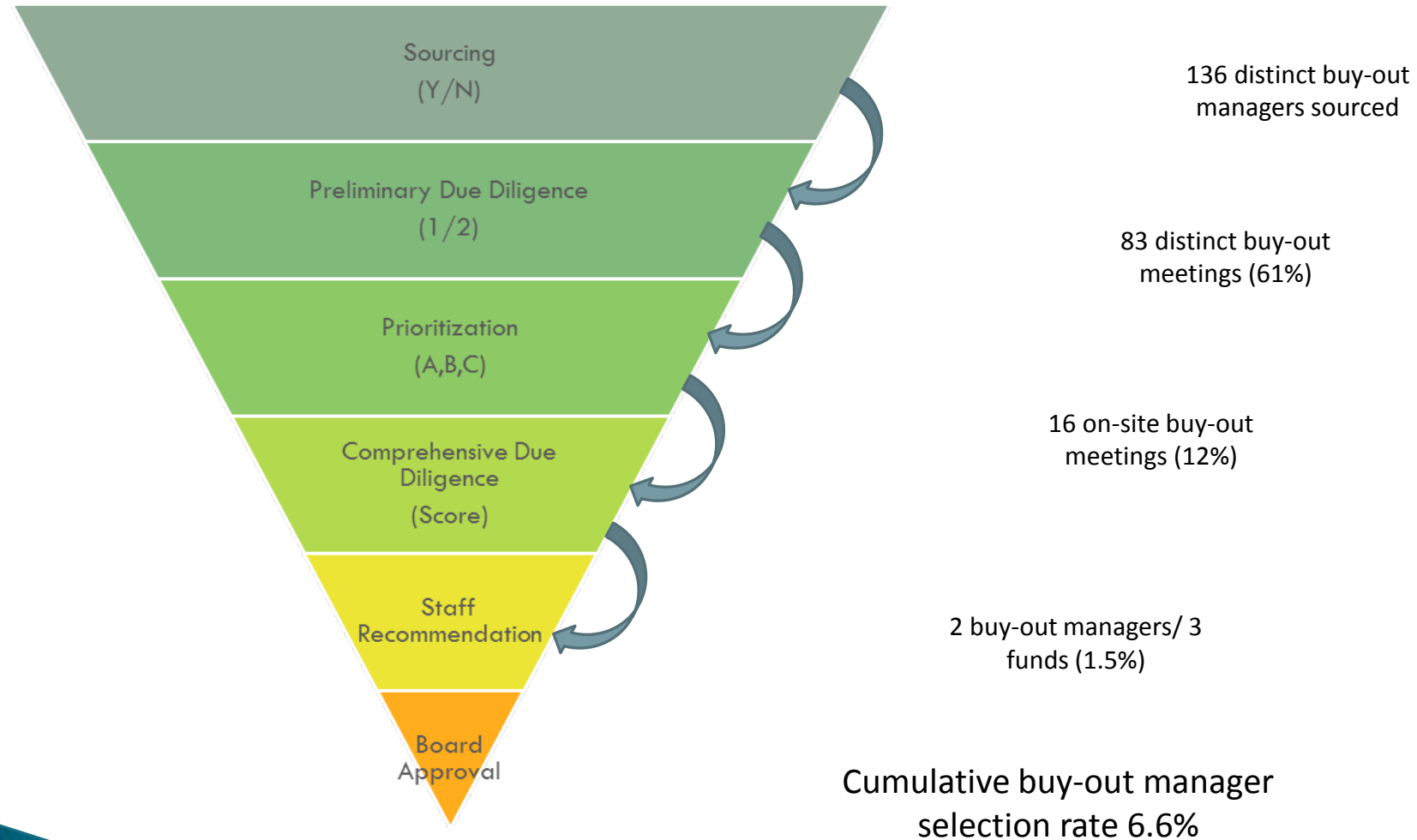
## Semi-Finalist Scoring Matrix

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>

# 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
Capital Partners Private Equity Income Fund III, L.P. (Capital Partners)	100.0	91.0	89.0
Altaris Health Partners IV, L.P. (Altaris)	100.0	95.0	83.0
Altaris Constellation Partners IV, L.P. (Constellation)	N/A	N/A	N/A

\*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

Section III

# PORTFOLIO CONSTRUCTION

# Manager Selection Portfolio Considerations

## *Strategy Diversification*

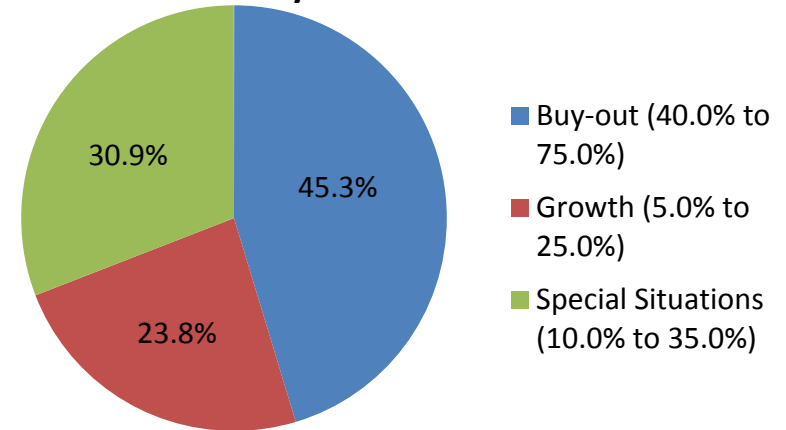
### *Strategy considerations:*

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

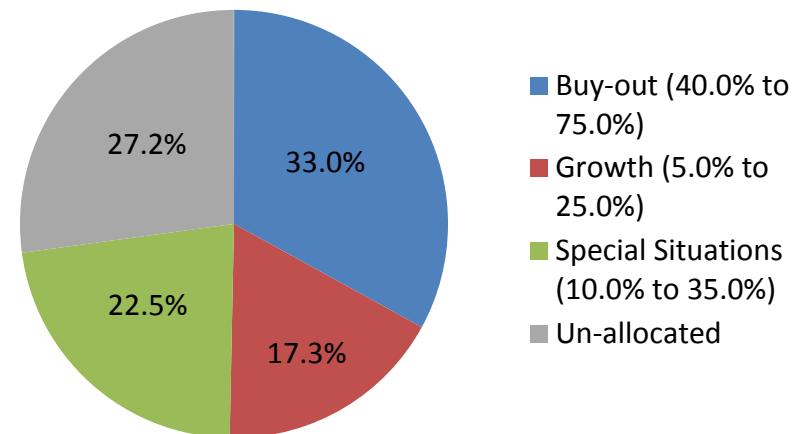
*2016: Focus on growth opportunity set and continue to add buy-out exposure.*

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

**Figure 1 : Private Equity Strategy Diversification by Commitment**



**Figure 2 : Private Equity Target Diversification**



# Manager Selection Portfolio Considerations

## *Manager Implementation*

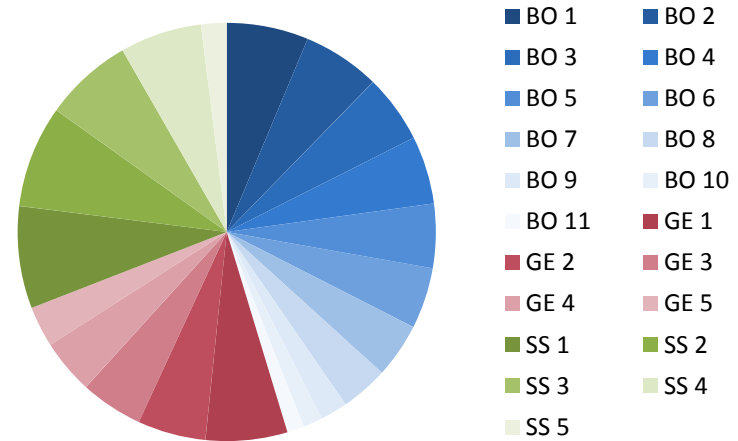
*The overall goal remains identifying top quartile performers to partner with.*

*Position sizing considerations:*

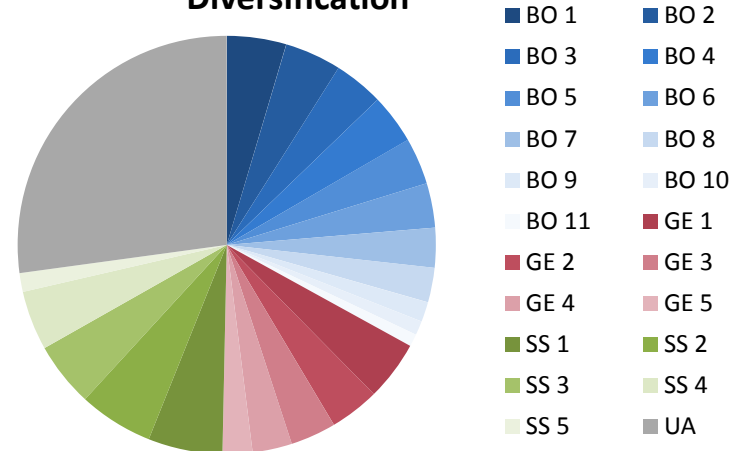
*Continue to reduce the unallocated portion of the private equity portfolio while sensibly balancing the trade-off between diversification and concentration.*

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

**Figure 3: Private Equity Manager Diversification by Commitment**



**Figure 4: Private Equity Target Manager Diversification**

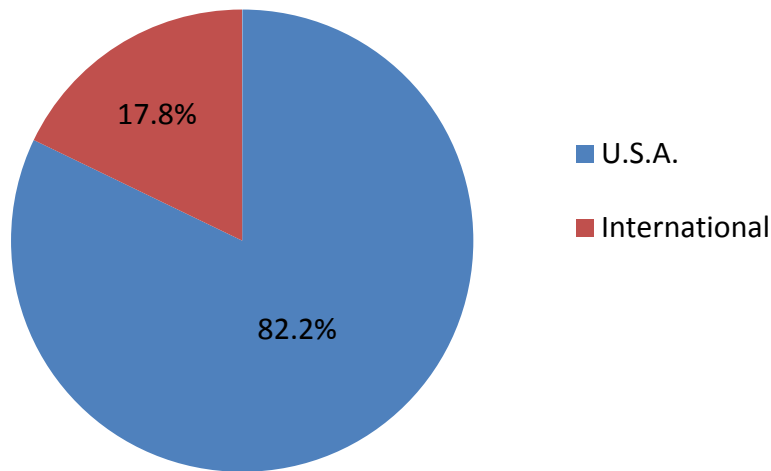


# Manager Selection Portfolio Considerations

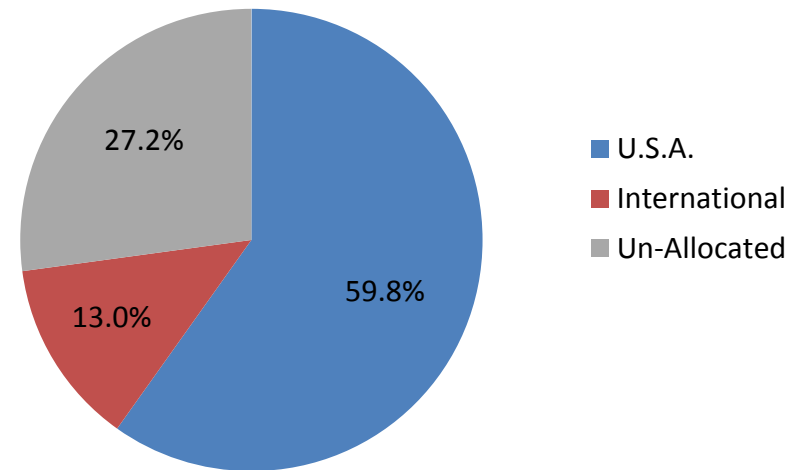
## *Geographic Diversification*

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

**Figure 5 : Private Equity Geographic Diversification by Commitment**



**Figure 6 : Private Equity Target Geographic Diversification**



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

Section IV

# MANAGER SELECTION & RECOMMENDATION

# Executive Summary of Manager Recommendation

Summary of Recommendations			
Recommended Manager/Fund	Strategy Classification	Target Return	Recommended Amount
Capital Partners Private Equity Income Fund III, L.P. (Capital Partners)	Buy-out Strategy	18% / 1.8X	\$70 million
Altaris Health Partners IV, L.P. (Altaris)	Buy-out Strategy	20% / 2.0X	\$50 million
Altaris Constellation Partners IV, L.P. (Constellation)	Buy-out Strategy	25% / 2.5X	\$12.5 million
Total Net Recommendations:			\$132.5 million

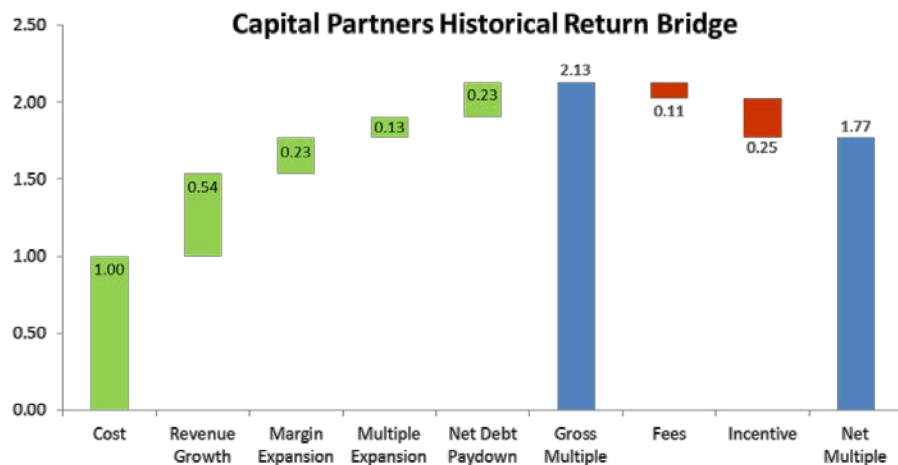
*Private Equity Pacing model as approved by the TMRS Board of Trustees in December 2016 established up to \$600 million as the targeted level of commitments for 2017.*

# Top Candidate Characteristics – Capital Partners

## \$70 million Recommendation

*Capital Partners (the firm) is a Norwalk, CT based lower middle market private equity firm with 17 professionals focused on making control equity investments with the objective of generating attractive risk-adjusted returns through a combination of low leverage, quarterly cash distributions to investors, and longer-term capital appreciation. As with prior funds, Capital Partners will seek to acquire family or founder owned companies with \$4–25M of EBITDA which possess relatively stable cash flows and modest capital expenditure requirements within the business services, distribution and manufacturing, and consumer products sectors. Capital Partners is seeking \$500 million in capital commitments with the goal of investing in 10 to 12 portfolio companies.*

Category	Capital Partners	Small Buyout Comp 1	Small Buyout Comp 2
People	21	18	20
Philosophy	21	16	20
Process	22	22	19
Performance	21	22	19
Terms	15	13	11
<b>Total</b>	<b>100</b>	<b>91</b>	<b>89</b>



### Reasons to Invest

- Experienced investment team with no turnover – The 3 Managing Directors have substantial experience in the U.S. lower middle market, with an average of 29 years-experience focused on private equity investing.
- Attractive strategy - The Firm differentiates itself by employing a low-debt capital structure to enable quarterly cash distributions to investors, in addition to longer-term capital appreciation through realizations.
- Loss ratio of 0% and very low entry multiples (6x – 7.5x EBITDA).

### Risks & Mitigants

- Fund II performance – Fund II is still largely unrealized, but is tracking similarly to Fund I at this stage. Also, one platform company is still being held cost and will likely be written-up as the company's infrastructure is improved.
- Mixed sourcing strategy – Significant deal flow generated via auction process. However, most deals have been completed via broken/limited auctions or directly negotiated with owners.



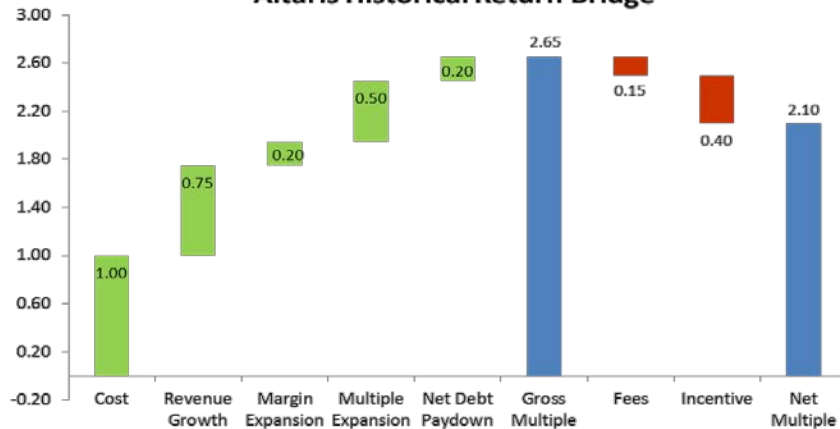
# Top Candidate Characteristics – Altaris and Constellation

## *\$50 million and \$12.5 million Recommendations (Respectively)*

Altaris Capital Partners (ACP) is an investment firm focused exclusively on the healthcare industry. Altaris is raising Altaris Health Partners IV (an \$800 million fund) and Constellation IV (a \$200 million co-investment vehicle) to continue the Firm's strategy of investing in companies that operate across the healthcare industry, including the pharmaceuticals, medical devices, services and IT sectors. ACP has historically invested the majority of capital in North America but will opportunistically pursue foreign investments. The Firm targets 12 to 18 businesses that are generating revenue and addressing the needs of the healthcare system by improving patient outcomes, reducing costs and increasing efficiency.

Category	Altaris and Constellation	HC Buyout Comp 1	HC Buyout Comp 2
People	19	19	17
Philosophy	21	20	18
Process	25	24	21
Performance	20	18	15
Terms	15	14	12
<b>Total</b>	<b>100</b>	<b>95</b>	<b>83</b>

**Altaris Historical Return Bridge**



### Reasons to Invest

- Experienced, cohesive team – The two Co-Founders and Managing Directors have an average of 20 years working in private equity and an average of 28 years of relevant experience.
- Healthcare industry expertise – Altaris has repeatedly proven their ability to add value to Lower Middle Market healthcare companies by employing their industry knowledge and expertise.
- Impressive, low loss ratio – loss ratio of just 6% across all funds.

### Risks & Mitigants

- Relatively small team – However, the Firm has made two recent promotions to the Managing Director role and has hired two additional junior resources.
- Fund III largely unrealized – Fund III has no fully realized investments, has four nearly entirely unrealized investments, and the fund's overall unrealized value represents just under 60% of its total value.
- Fund size increase – Represents significant increase, but team has success with larger deals.

Section V

## **V. REQUESTED BOARD ACTION**

# Approval of Recommendations

- TMRS Staff and StepStone Group recommend that the Board of Trustees approve investments in the specified strategies below:
  - Capital Partners Private Equity Income Fund III, L.P.: \$70 mm to Buy-out Strategy
  - Altaris Health Partners IV, L.P.: \$50 mm to Buy-out Strategy
  - Altaris Constellation Partners IV, L.P.: \$12.5 mm to Buy-out Strategy

## **DISCLOSURES**

***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 Managing General Partner (GP), any of its Associates or other data provider to TMRS or a TMRS service provider, and contained in these materials (i) may have been independently produced or modified by TMRS or the TMRS service provider; (ii) has not been reviewed or approved by the manager, Managing GP or any of its Associates; and (iii) may not reflect the historical performance or asset value reflected in the manager's, Managing GP's or any of its Associates' records and, therefore, should not be used for comparative purposes.***