2017 Private Equity Search Process and Recommendations

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StepStone Group
September 21–22, 2017

Texas Municipal Retirement System
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

Dec 2016
- TMRS staff presented the 2017 Private Equity Pacing Plan recommending a commitment of up to $600 million of Private Equity exposure.
- Board approved manager searches during 2017 totaling $600 million.

Dec 2016
- TMRS Staff formally launched the 2017 search process, in concert with StepStone.

Q2 2016
- 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 2017
- February 2017: TMRS Board approved two managers/three funds for the Private Equity Asset Class for $125 million.
- Closed on all funds at $116.25 million.

Q2 2017
- May 2017: TMRS Board approved two managers/three funds for the Private Equity Asset Class for $132.5 million.
- Closed on all funds at $120.5 million.

Aug 2017
- TMRS Board approved one manager for a total of $75 million.
- Negotiations ongoing.

Sep 2017
- Presenting one manager to the Board for a total of $50 million.
- Continue 2017 search process for December recommendation timeframe.
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 $600 million.
Section II

MANAGER SEARCH PROCESS
Manager Search Process

Manager Screen & Universe Analysis Scoring

<table>
<thead>
<tr>
<th>Scoring Category</th>
<th>Score / Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manager Screen</td>
<td>Yes - Take Meeting; No - Don't Take Meeting</td>
</tr>
<tr>
<td>- Is vehicle consistent w/ TMRS' objectives?</td>
<td></td>
</tr>
<tr>
<td>Manager Analysis</td>
<td></td>
</tr>
<tr>
<td>- Does vehicle have adequate capacity and timeline?</td>
<td></td>
</tr>
<tr>
<td>- PPPPT* Preliminary Review</td>
<td></td>
</tr>
</tbody>
</table>

Semi-Finalist Scoring Matrix

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

Final Due Diligence Scoring Matrix

<table>
<thead>
<tr>
<th>Scoring Category</th>
<th>Possible Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>People (Firm &amp; Team)</td>
<td>0 - 40 points</td>
</tr>
<tr>
<td>Philosophy (Attractiveness of Opportunity / Portfolio Fit)</td>
<td>0 - 20 points</td>
</tr>
<tr>
<td>Process (Sourcing, Underwriting and Managing)</td>
<td>0 - 40 points</td>
</tr>
<tr>
<td>Performance (Historical / Expected)</td>
<td>0 - 40 points</td>
</tr>
<tr>
<td>Terms (Fees, Liquidity, etc.)</td>
<td>0 - 20 points</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100†</strong></td>
</tr>
</tbody>
</table>
Manager Search Process

- 146 distinct buy-out managers sourced
- 94 distinct buy-out meetings (64%)
- 15 on-site growth buy-out meetings (10%)
- 1 buy-out manager (>1%)

Cumulative buy-out manager selection rate 8.2%
Final Selected Managers Scoring Matrix

**Final Due Diligence Scoring Matrix - Aggregated Results***

<table>
<thead>
<tr>
<th>Recommended Manager/Fund</th>
<th>Manager Score†</th>
<th>Comparable Mgr. 1 Score</th>
<th>Comparable Mgr. 2 Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dunes Point Capital Fund II, L.P.</td>
<td>100.0</td>
<td>92.0</td>
<td>85.0</td>
</tr>
</tbody>
</table>

*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.
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.
Manager Selection Portfolio Considerations

Geographic Diversification

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

The Target Portfolio keeps a conservative stance on international exposure.

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

- U.S.A.: 81.8%
- International: 18.2%

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

- U.S.A.: 64.5%
- International: 21.1%
- Un-Allocated: 14.3%
Section IV

MANAGER SELECTION & RECOMMENDATION
Private Equity Pacing model as approved by the TMRS Board of Trustees in December 2016 established $600 million as the targeted level of commitments for 2017.

### Executive Summary of Manager Recommendation

<table>
<thead>
<tr>
<th>Recommended Manager/Fund</th>
<th>Strategy Classification</th>
<th>Target Return</th>
<th>Recommended Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dunes Point Capital Fund II, L.P.</td>
<td>Buy-Out Strategy</td>
<td>25% / 2.5x</td>
<td>$50 million</td>
</tr>
<tr>
<td><strong>Total Net Recommendations</strong></td>
<td></td>
<td></td>
<td><strong>$50 million</strong></td>
</tr>
</tbody>
</table>
Top Candidate Characteristics – Dunes Point

$50 million Recommendation

Dunes Point Capital is a Rye, New York based Small Market private equity buy-out firm focused on North American Small and Middle Market companies within the industrials sector. The Firm was founded in 2013 by Timothy White, who was formerly a Senior Managing Director of Blackstone and GSO Capital Partners, a Managing Director in the private equity group of Audax Group, and a Principal with DLJ Merchant Banking Partners. Prior to founding DPC, Mr. White was Head of GSO Private Equity, Co-Head of GSO Mezzanine Investing, and Co-Portfolio Manager of GSO’s Capital Opportunities Fund I. The Firm is currently seeking to raise its first institutional fund, Dunes Point Capital Fund II, LP, targeting $600 million of capital commitments, with an $800 million hard cap. The Fund will pursue control equity investments in North American Small and Middle Market companies generally focused on the industrials sector.

<table>
<thead>
<tr>
<th>Category</th>
<th>Dunes Point</th>
<th>Buyout Comp 1</th>
<th>Buyout Comp 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>People</td>
<td>21</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>Philosophy</td>
<td>19</td>
<td>15</td>
<td>14</td>
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<tr>
<td>Process</td>
<td>23</td>
<td>22</td>
<td>22</td>
</tr>
<tr>
<td>Performance</td>
<td>22</td>
<td>24</td>
<td>23</td>
</tr>
<tr>
<td>Terms</td>
<td>15</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>92</strong></td>
<td><strong>85</strong></td>
</tr>
</tbody>
</table>

**Reasons to Invest**

- Experienced leader with history of success – Founder, CEO and CIO Tim White has originated or led the investment of $4 billion in private investments.
- Strong Pre-Fund Track Record – these investments were marked at a 2.3x/61% gross TVM/IRR and a 2.1x/51% net TVM/IRR.
- GP Alignment / Economics - The GP will contribute at least $25 million, or 4% of the Fund's target size. The team will also share broadly in economics.

**Risks & Mitigants**

- Key man risk – While the team behind Tim is strong, and continues to be bolstered with new hires, Dunes Point is clearly highly reliant upon Tim White’s acumen and decision making. Key man language appropriately reflects this.
- Lack of prior realizations – the Fund I/Pre-Fund track record is light on realizations, but financial and operating performance is quite strong. Pre-fund realizations are also quite strong, providing evidence of the strategy’s success.
Section V
REQUESTED BOARD ACTION
Approval of Recommendations

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

- Dunes Point Capital Fund II, L.P.: $50 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.