

Annual Board Review: Private Equity

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What is the Private Equity Asset Class?

It's lots of things, not just "private equity".

Private Equity –What people typically think of when they hear the term “private equity” is actually the main sub category of private equity called Buyout/Control. It is then used generically to represent the entire asset class. It is where a group of investors (like pension funds), buy most or all of an existing public or private business in order to fix it, or combine it with other businesses, and resell it at a profit.

It is also...

Venture Capital/Growth Equity – A minority ownership stake in a private company, which can vary, but typically represents less than 45% of a companies value. This capital is used to help grow a company quickly by bringing a new idea or product to market, or can be used to help a company expand its sales or market share.

Special Situations/ Opportunistic (Debt) – Unique situations where can earn equity like returns, typically using control-oriented debt investments, to help a company work through temporary or meaningful financial issues that a company cannot resolve on its own.

<u>TMRS Investment Policy Statement Strategy Limits</u>	
Buy-out/Control	40.0% to 75.0%
Venture/Growth	10.0% to 40.0%
Special Situations/Opportunistic (Debt)	5.0% to 35.0%

Why Does TMRS Invest in Private Equity?

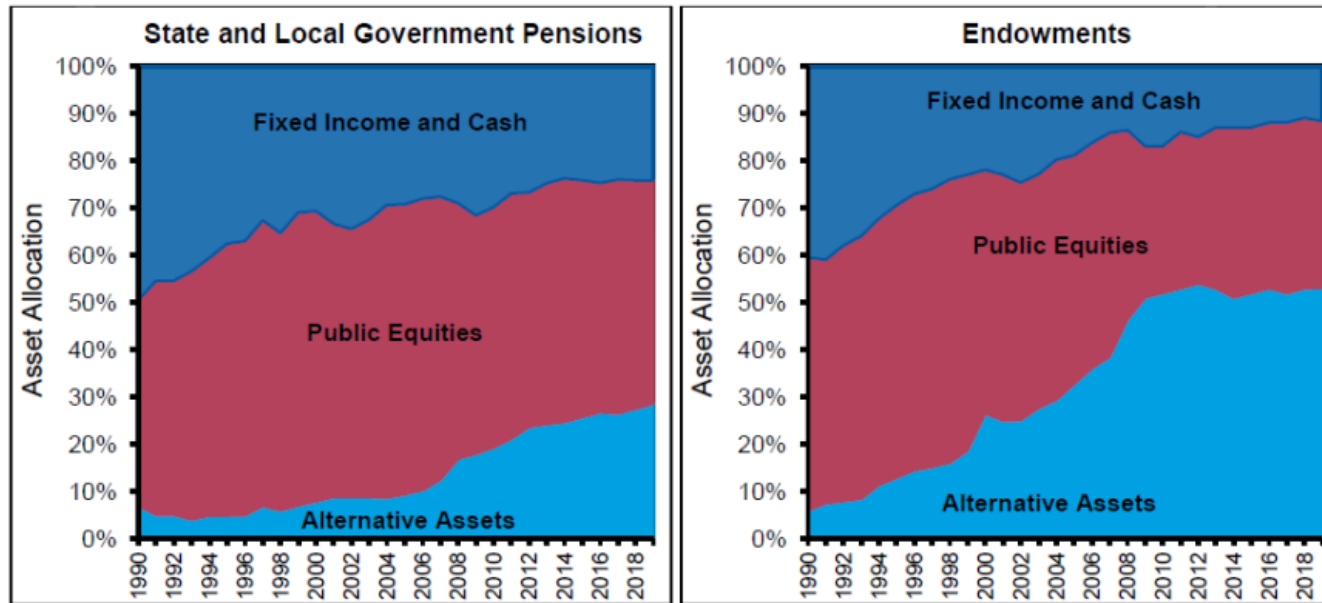
Because most U.S. companies are privately owned.

- The number of US publicly listed companies available to invest in has decreased by 45% over the last 25 years from approximately 7,200 companies to 3,900. (source: Journal of Financial Economics)
- Less than 1% of firms with employees in the US have publicly traded shares. (source: Forbes)
- Among firms with 500 or more employees, 86% are privately owned. (source: Forbes)

Why Does TMRS Invest in Private Equity? (continued)

Because of capital markets expectations.

11: U.S. Pensions and Endowments Move to Alternative Assets, 1990-2019



Source: Public Plans Database; Ronald J. Ryan and Frank J. Fabozzi, "The Pension Crisis Revealed," *Journal of Investing*, Fall 2003, 43-48; National Association of College and University Business Officers (NACUBO); and "Stephen G. Dimmock, Neng Wang, and Jinqiang, Yang, "The Endowment Model and Modern Portfolio Theory," Working Paper, April 23, 2018.

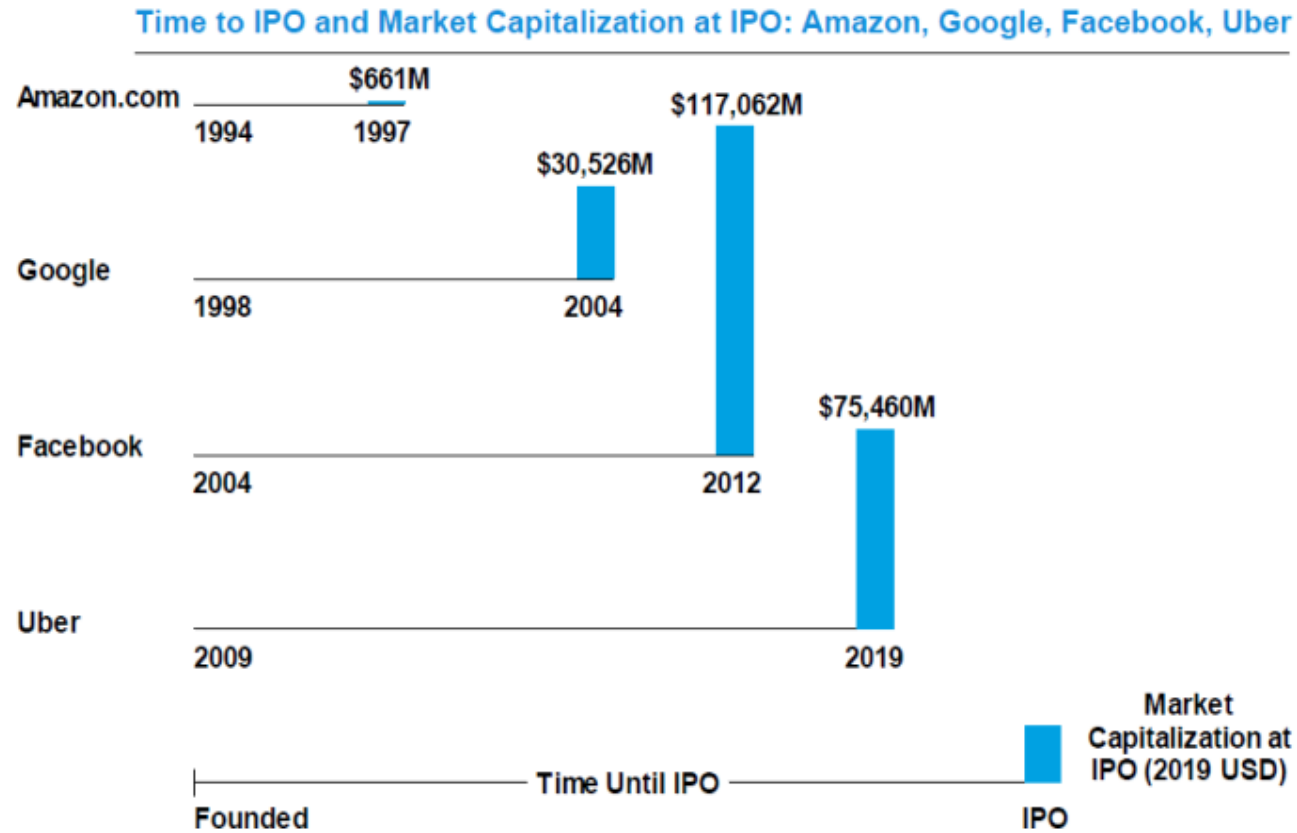
Note: Asset-weighted.

Private Equity is the only asset class expected to exceed TMRS' 6.75% discount rate on a stand-alone basis.

As you can see in the charts to the left, falling interest rates have caused pensions and endowments to seek out higher returning alternative asset classes.

Why Does TMRS Invest in Private Equity? (continued)

It's where value is created in today's capital markets.



Source: Company reports and Counterpoint Global.

The length of time a company stays private, before going public, has increased from 3 years, in the mid 1990's, to 10 years or more today.

Therefore, Private Equity has increasingly been where the actual value creation takes place...

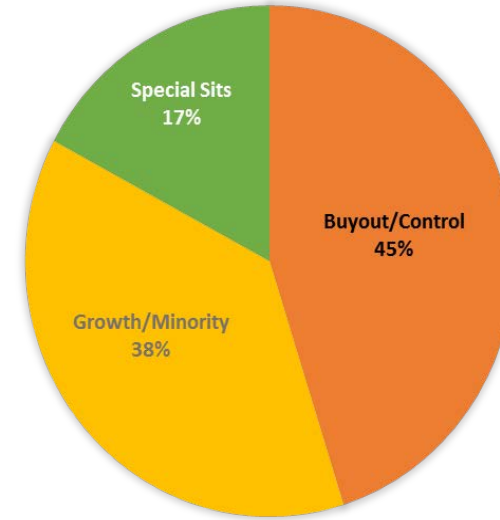
...and the public market IPO is where that value is realized.

Current TMRS Private Equity Portfolio

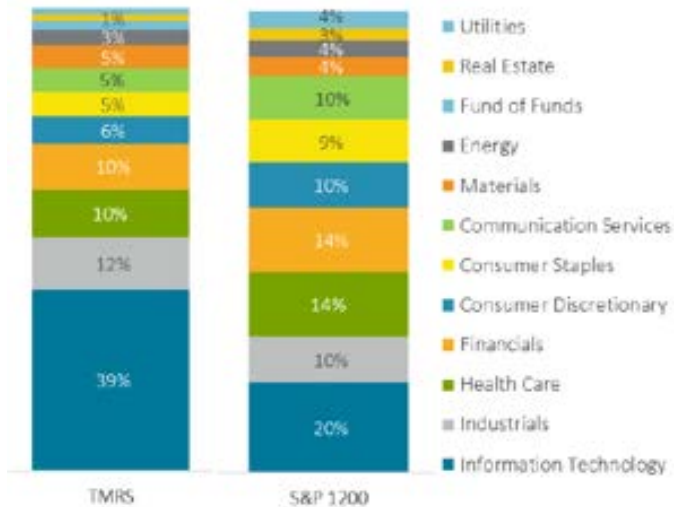
Allocation & Exposures

Total Commitments:	\$3.34 billion
Net Asset Value:	\$1.01 billion
Portfolio Weight:	3.36%
Target Portfolio Wgt.	10.0%
Investment Vehicles:	52
Investment Managers:	33

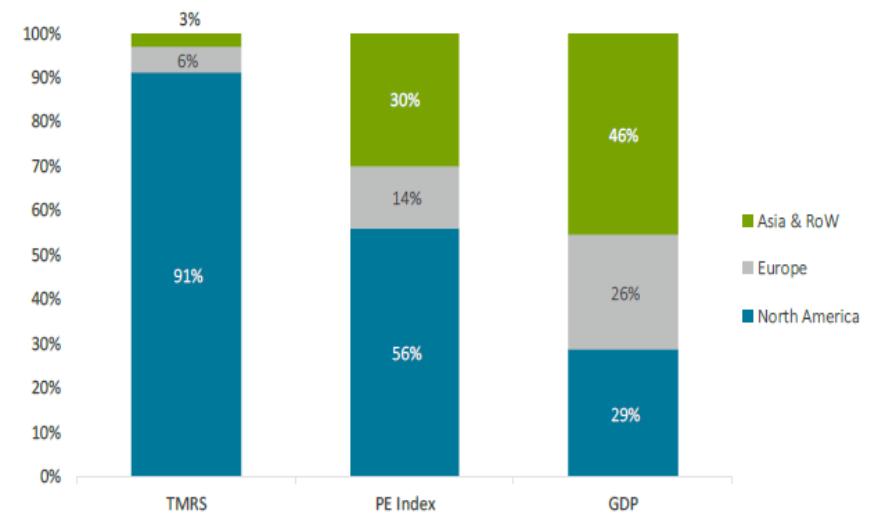
Strategy Exposure



Sector Exposure



Global Portfolio Exposure



Companies in the TMRS Private Equity Portfolio

OLDE THOMPSON
since 1944

NOT YOUR
M♥THER'S.

WHOOOP®

asurion 

 airbnb



RVshare

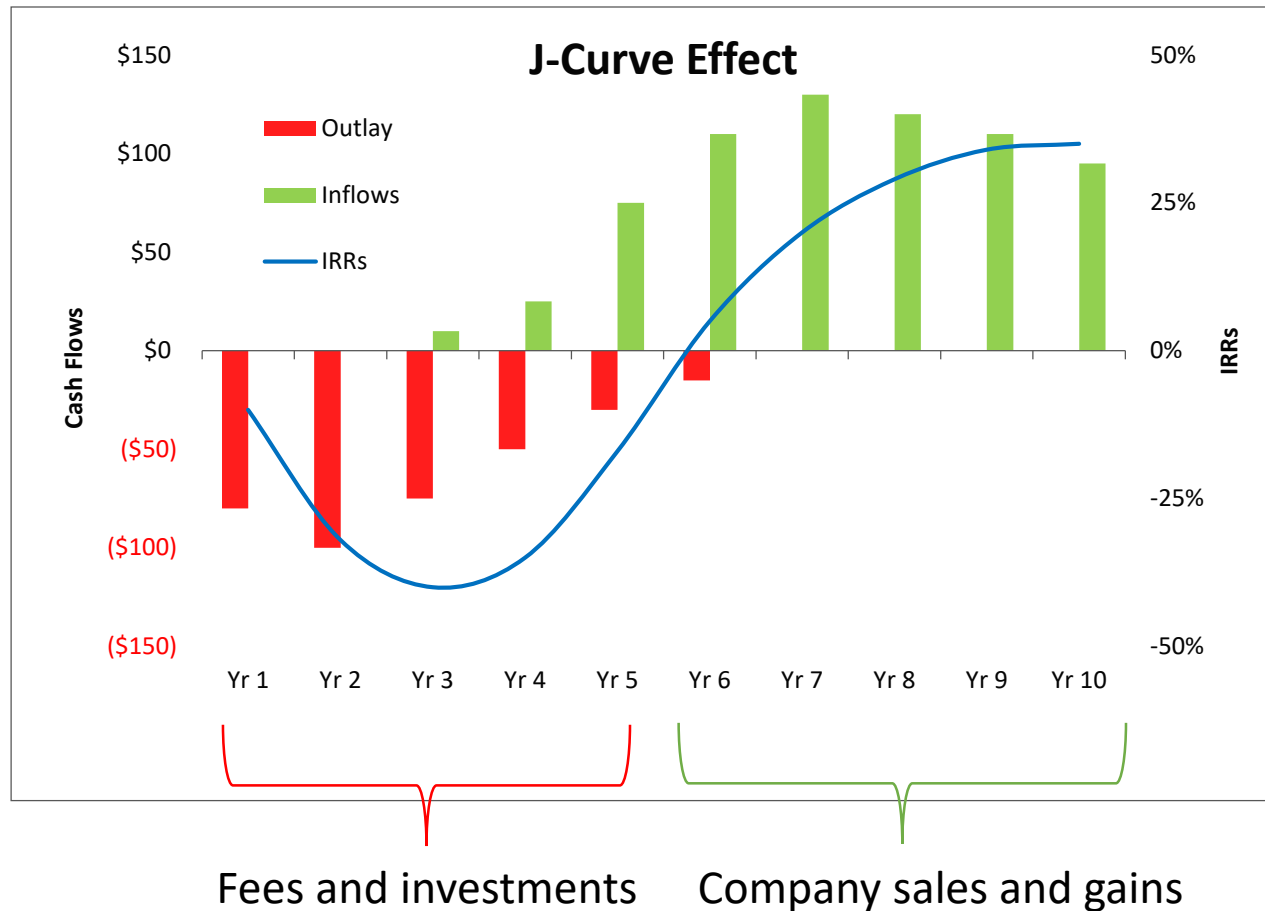
 VMG
HEALTH


gogo®

 Rover

FASTSIGNS®
More than fast. More than signs.®

Private Equity: The “J” curve



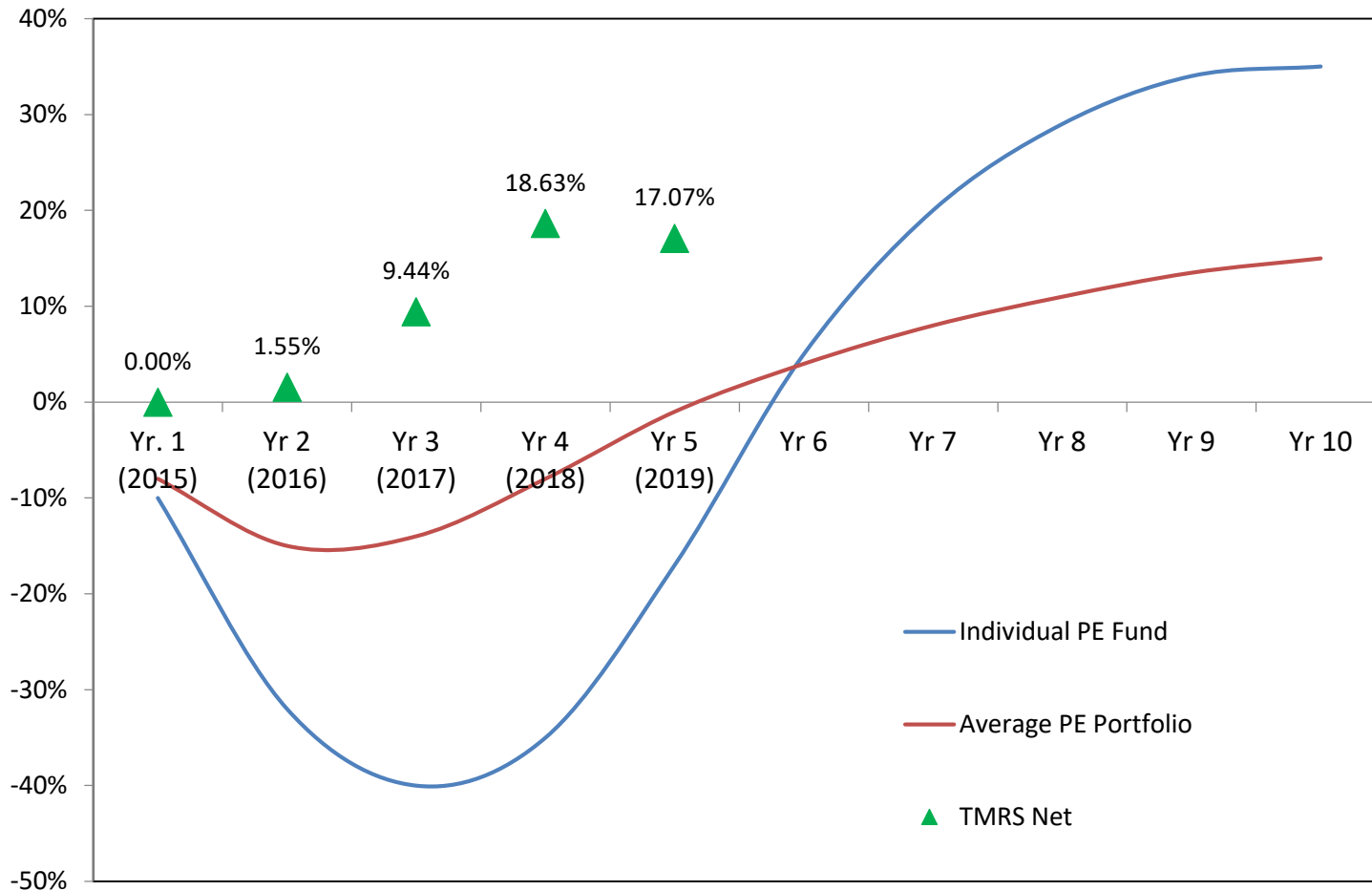
Early on, private equity fund returns are usually negative due to the payment of management fees and asset purchases. (Red outflows)

During the later years, company sales provide profits to private equity investors. (Green inflows)

The typical net cash flow totals over time (blue line) tend to look like a tilted letter “j” thus the name “j-curve”.

TMRS Private Equity Performance: No “J” curve

Private Equity J-Curve



The blue line shows a typical j-curve for a single private equity fund

The red line shows the average private equity portfolio return and its composite j-curve effect.

The TMRS Portfolio Performance is shown with green triangles.

Not only is the portfolio tracking ahead of expectations, but we avoided the typical early negative returns.

Source: State Street Bank, 12/31/19

TMRS Performance

Strategy	Internal Rate of Return (IRR)	Total Value Multiple (TVM)	Public Market Equivalent (PME)
Growth Capital	29.1%	1.5x	12.1%
Buyout	15.1%	1.2x	-0.8%
Venture	8.3%	1.1x	-9.9%
Special Situations	8.1%	1.1x	-6.5%
Total	17.1%	1.3x	1.3%
Total Equity Focused	20.4%	1.3x	4.2%

Source: Stepstone as of 12/31/19

The private equity portfolio has been TMRS' star performer recently. Within private equity, Growth Capital is exceeding expectations, while the other allocations are in line with expectations at this stage of portfolio development.

Accomplishments & Planning

2020 Checklist



Commit \$750mm – \$1B of capital.

\$863mm committed YTD with more planned activity prior to year end.



Meet/Exceed Performance expectations.

Portfolio continues to track at, or ahead of, expectations. Longer term effects of COVID remain to be seen.



Subscribe to Co-Investment Mandate.

Diligence and recommendation completed and approved. Legal negotiations expected to conclude in Q4.

2021 Goals



Commit \$900mm – \$1.2B of capital.

Moderately increased allocation goals for 2021. Most allocation likely to be taken up by TMRS' existing managers.



Implement Co-Investment Mandate.

Phase in operational implementation and successfully deploy capital. Target deployment is ~\$100mm per year



Improve capital deployment traction.

TMRS can't directly affect manager deployment, but portfolio management approaches can affect over time.

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.