

# 2016 Private Equity Search Process and Recommendation

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# Agenda

- I. 2016 Private Equity Search Process Timeline & Allocation Objectives
- II. Manager Search Process
- III. Manager Selection Recommendation
- IV. 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 up to \$600 million of Private Equity commitments throughout 2016 which was approved by the Board.

Dec  
2015

- TMRS Staff moved forward with the first 2016 search process, in concert with StepStone.

Q2  
2015 –  
Q1  
2016

- Conducted 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.

Current

- February 2016: Staff and StepStone are currently presenting one manager recommendation for the Private Equity portfolio. The recommended commitment is \$75 million.

Q1-Q2  
2016

- Execution of the contract, and starting to fund capital calls.
- Continue second step of 2016 search process for May/June recommendation timeframe.

# 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 and strategies.
- Ensure sufficient 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 \$600 million in commitments.

## II. Manager Search Process



# Manager Search Process Review

## Step 1

- **Manager Universe Analysis & Screen**

- TMRS performs portfolio and market analysis
- Based on analysis, meetings are sought with qualified managers
- Meetings taken with qualified managers; others eliminated

## Step 2

- **Semi-Finalist Candidate Analysis**

- 55 Private Equity Meetings taken by Evaluation Team
- 44 Distinct Managers Assessed
- Managers scored 1 or 2 - Managers scored '1' advance

## Step 3

- **Finalist Candidate Analysis**

- 6 Managers Selected as Finalists
- Due Diligence Questionnaire and other Materials Reviewed
- Managers Scored A, B or C - Managers Scored 'A' Advance

## Step 4

- **Final Due Diligence & Manager Selection**

- A-rated Finalist Funds enter final due diligence
- Final Scoring Matrices are compiled for distinct possible recommended funds and immediately comparable fund products
- 1 Fund Selected for Recommendation to Board of Trustees

# Manager Scoring Matrix *(1 of 2)*

- Scoring was compiled by TMRS Investment Staff and discussed with StepStone Group to determine advancement in the search process:

Manager Screen & Universe Analysis Scoring Matrix / Semi-Finalist Selection	
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

- Based on initial scoring screen, further diligence efforts were prioritized based on a number of factors:

Finalist Scoring Matrix / Final Due Diligence Selection	
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

**44 Managers Advance Past Initial Screen → 6 Managers Scored '1' (13.6% Selection Rate)  
 → 1 Manager Scored 'A' (2.3% Selection Rate)**



# Manager Scoring Matrix (2 of 2)

- Scoring was provided by TMRS and discussed with StepStone to determine final Selection.
- Based on the above criteria, 6 managers were selected for finalist review & 1 manager was selected for final due diligence:
  - GSO Capital Opportunities Fund III (GSO COF III) (Final DD) • **44 Managers Selected for Semi Finalist Meetings**
  - Crescent Mezz Partners VII (Finalist) • **6 Managers Selected as Finalists**
  - Highbridge Mezz Partners Fund III (Finalist) • **4 On-Site Due Diligence Meetings**
  - Sankaty Middle Market Opportunities Fund III (Finalist) • **1 Manager Selected for Final DD**
  - KKR Private Credit Opps II (Finalist)
  - THL Fund III (Finalist)

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>

\*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. Manager Selection Recommendation



# Executive Summary of Manager Recommendation

**Figure 1: Summary of Recommendations**

Recommended Manager/Fund	Strategy Classification	Target Return	Recommended Amount
GSO COF III	Special Situations Strategy - Mezzanine	12% to 14%	\$75 million
Total Net Recommendations:			\$75 million

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

# Manager Selection Portfolio Considerations

## Strategy Diversification

*TMRS focuses on a portfolio approach to manager selection, performing searches aimed at selecting strategies and managers in a portfolio conscientious manner.*

Figure 2 : Private Equity Strategy Diversification by Commitment

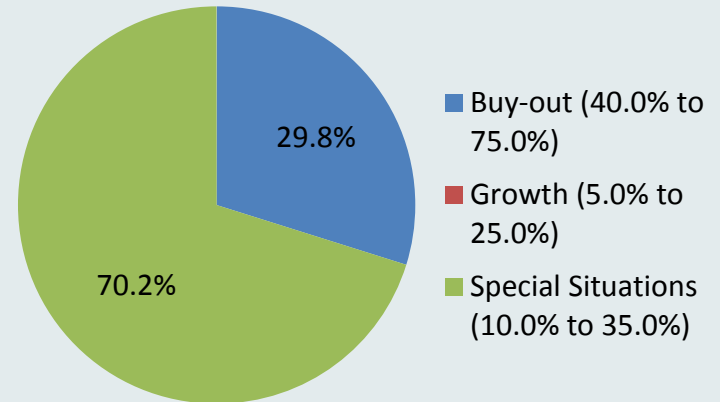
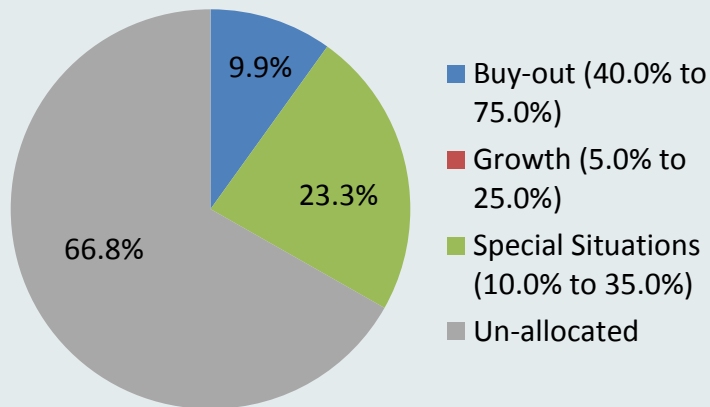


Figure 3 : Private Equity Target Diversification



**The Target Portfolio moves closer to TMRS targeted allocations, overweighting special situations for: capital deployment, J-curve mitigation and tactical opportunity**

# Manager Selection Portfolio Considerations

## Manager Implementation

*TMRS is focused on enhancing manager diversification, building strategic relationships, and reducing the unallocated portion of the private equity portfolio in a manner consistent with TMRS' broader policy goals.*

**The Target Portfolio continues to reduce unallocated private equity exposure, and sensibly balances the trade-off between diversification and concentration.**

Figure 4: Private Equity Manager Diversification by Commitment

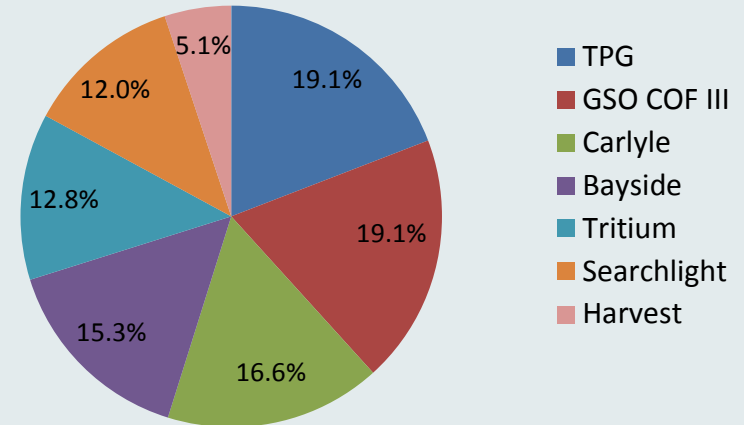
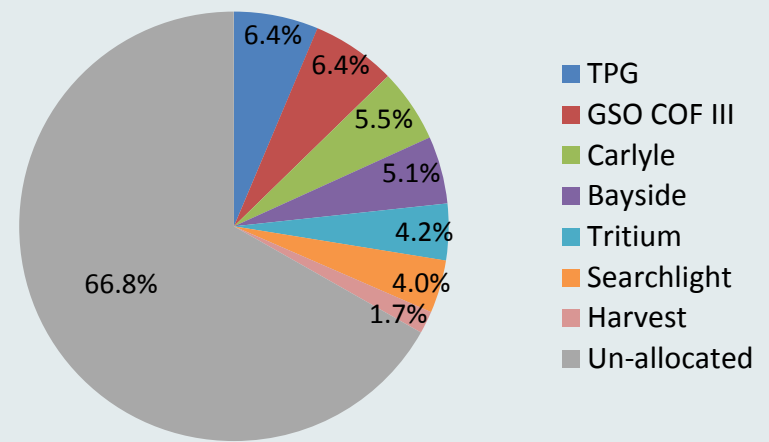


Figure 5 : Private Equity Target Manager Diversification

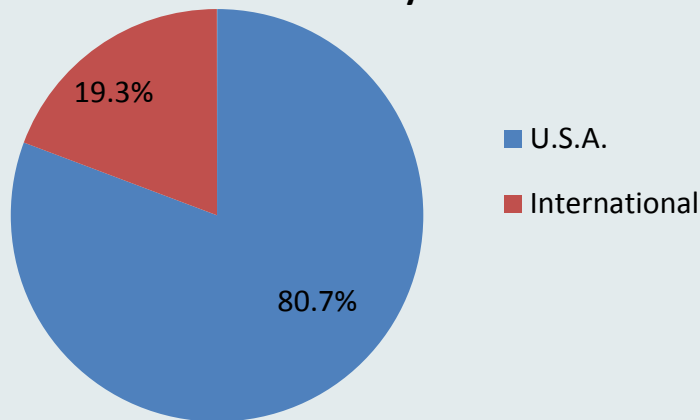


# Manager Selection Portfolio Considerations

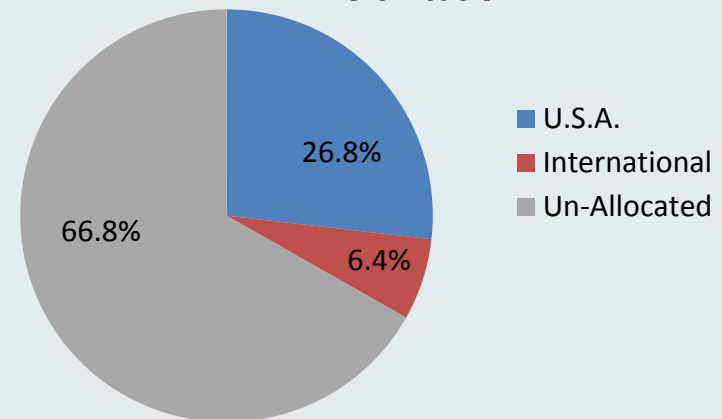
## Geographic Diversification

*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, within the IPS limits.**

# Final Selected Manager Scoring Matrix

Final Due Diligence Scoring Matrix			
Recommended Manager/Fund	Manager Score	Comparable Mgr. 1 Score	Comparable Mgr. 2 Score
GSO COF III	100	88.5	82.5

\*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.

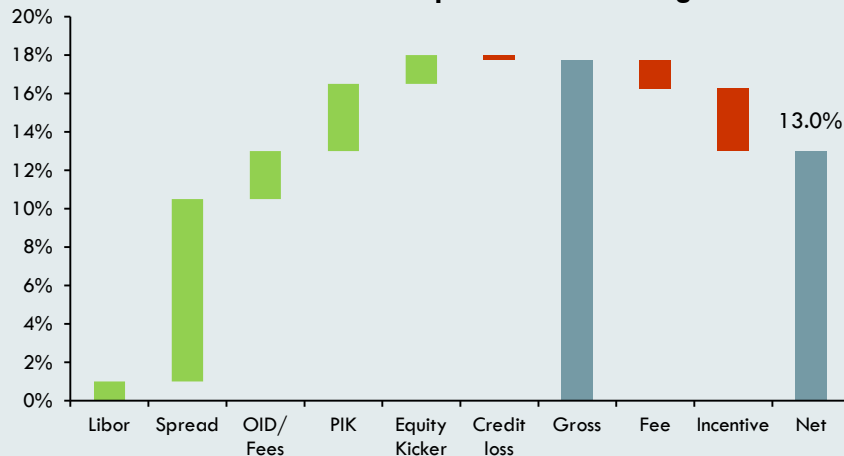
# Top Candidate Characteristics – GSO COF III

**\$75 million Recommendation**

## Scoring Matrix

Category	GSO COF III	Special Sits Mgr. 1	Special Sits Mgr. 2
People	24.5	19.5	18.0
Philosophy	21.0	20.0	19.0
Process	22.5	20.0	20.0
Performance	21.0	18.0	14.5
Terms	11.0	11.0	11.0
<b>Total</b>	<b>100.0</b>	<b>88.5</b>	<b>82.5</b>

## GSO COF III Expected Return Bridge



### Reasons to Invest

- Deep, experienced and stable team.
- Strong credit underwriting and focus on downside protection.
- Top quartile performance, realized/unrealized and MOIC/IRR.
- Very well resourced operationally and strong ODD.

### Risks & Mitigants

- Blackstone ownership – GSO owns 15% of the equity and 50% of the carry. GSO benefits from Blackstone’s expansive resources.
- AUM growth – Extremely deep resources. Also, the mezzanine strategy is only 7.5% of the total AUM.
- Market risk – Excellent structuring and asset selection will mitigate the downside.

GSO COF III will make investments in performing companies in need of financing, but which are unable to access it through typical capital markets channels. The types of investments made will include unitranche debt, second lien, subordinated debt, structured equity or preferred equity, among others. The Fund’s strategy focuses on providing capital to upper middle market companies and private equity sponsors for leveraged buy-outs, mergers & acquisitions, recapitalizations, and growth financing primarily.



## IV. Requested Board Action



# Requested Board Action

- TMRS Staff and StepStone Group recommend that the Board of Trustees approve the selection of the following manager or their affiliates as referenced in the Board Communication Memo for investment in the specified strategy below:
  - GSO COF III: \$75 mm, a Special Situations Strategy

Approval is contingent upon final Investment Committee approval from the StepStone Group, favorable background checks and successful negotiation of the investment agreements. Note: Once final approval is given by the StepStone Investment Committee, their updated investment memo will be sent to all Board members for review with a request for ratification at the next Board meeting.