

Private Equity Update

9/24/2014



North Carolina Department of State Treasurer
Investment Management

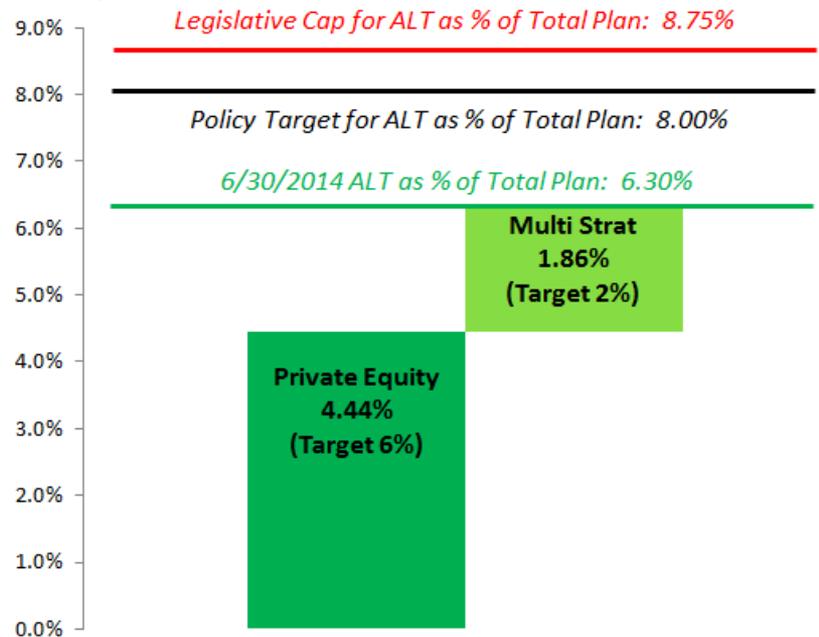
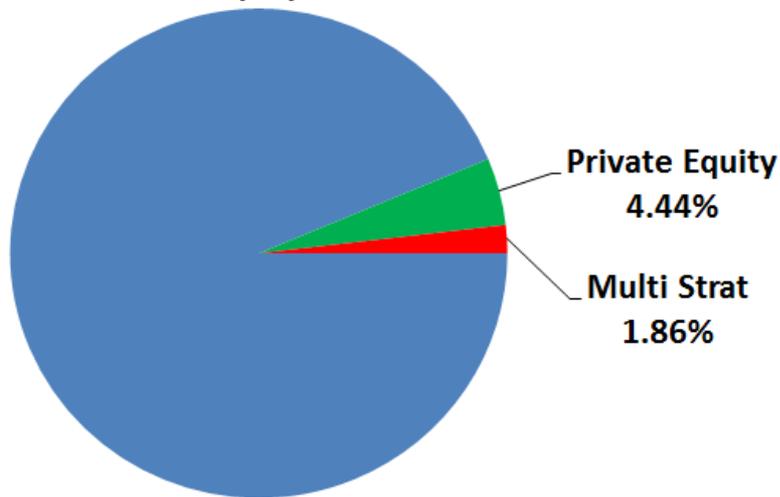
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Alternatives Allocation

As of June 30, 2014

- Alternatives represented 6.30% of the Total NCRS Plan
- Private Equity represented 4.44%, below the Policy Target of 6%

NCRS ALT Asset Allocation
based on 6/30/2014 MV



Private Equity Allocation

Strategic Allocation*

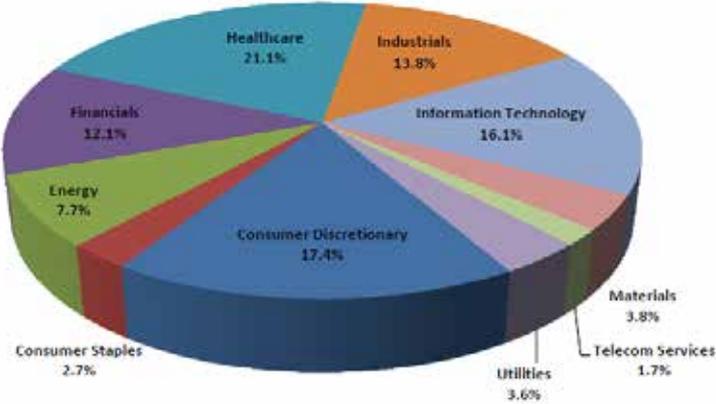


Policy Relative to Actual Portfolio Weights*

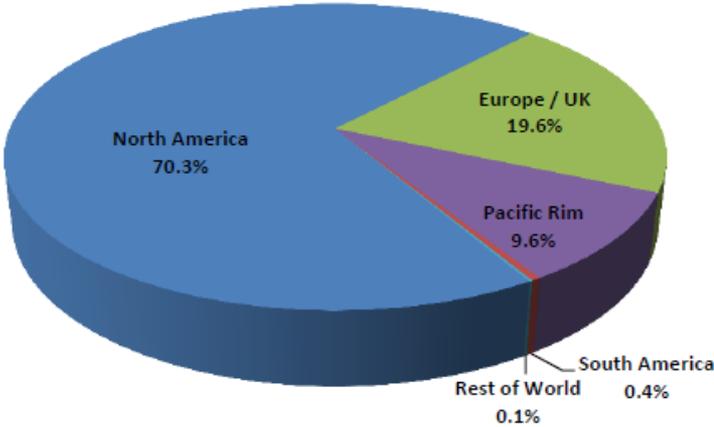
	Policy Range			Actual (FMV)
	MIN	TARGET	MAX	
Strategy				
Buyout	35%	50%	65%	49.83%
Growth/Venture	10%	20%	30%	32.01%
Special Situations	15%	30%	45%	18.16%

*Data includes Fund of Funds' underlying exposure to given strategy as of June 30, 2014.

GICS Industry Allocation**



Geographic Allocation**

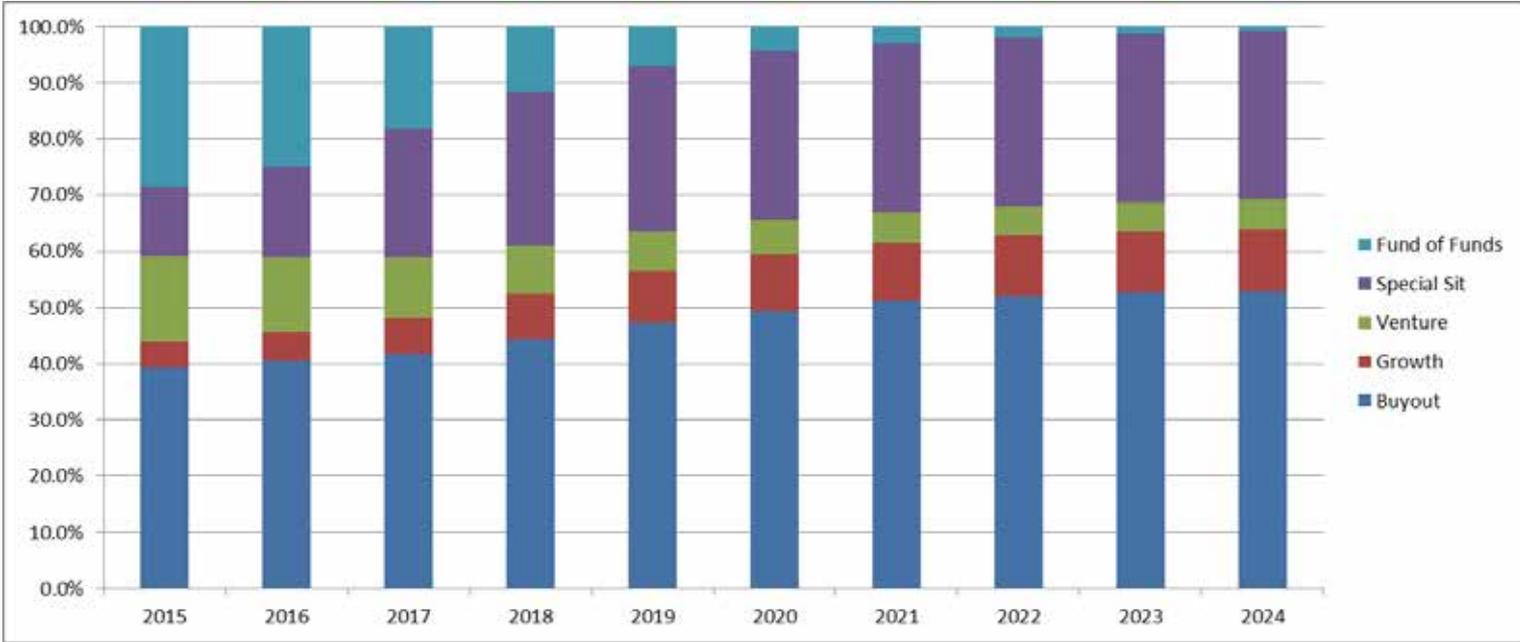


**Data includes Fund of Funds' underlying exposure to industry or geography, based on latest available FMV.



Future Portfolio Weighting

Strategy Allocation including Fund-of-Funds



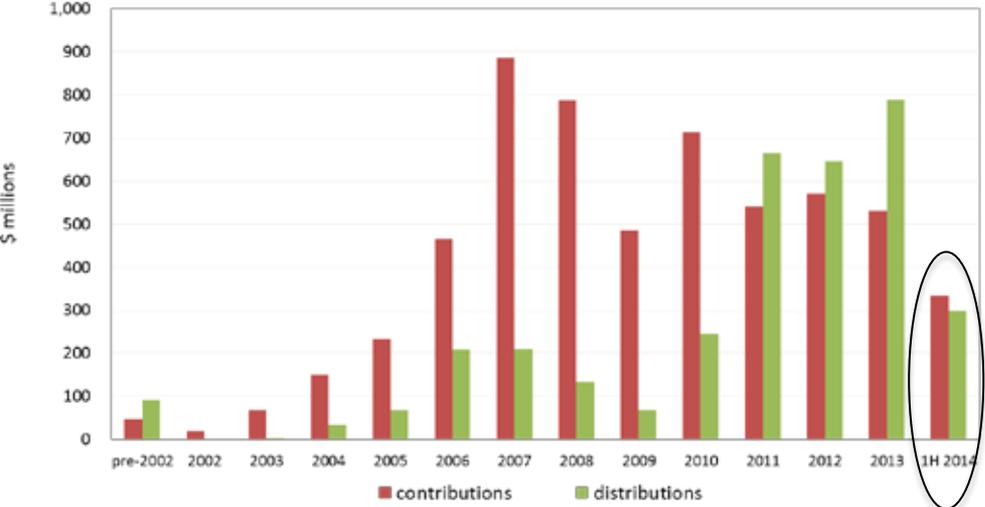
Commitment Pace = \$1.2 billion / year	
<u>Declining</u>	<u>Increasing</u>
Fund-of-Funds	Special Situations
VC / Growth Equity	Buyout



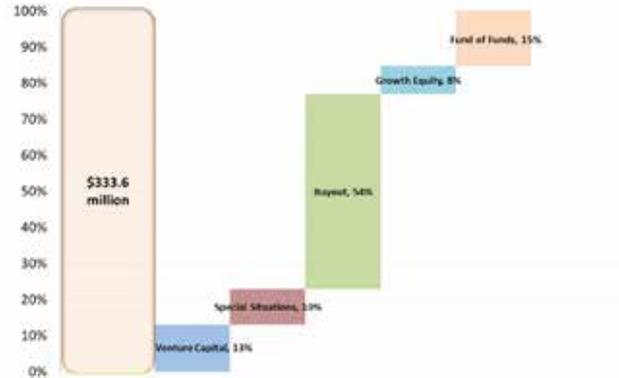
Private Equity Cash Flow Detail

In 2011, 2012, and 2013, Distributions have exceeded Contributions.
 1H 2014 – Contributions outweighed Distributions.

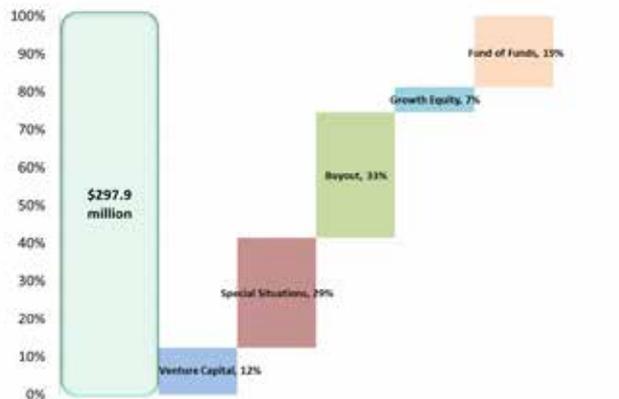
Private Equity Cashflows
by Calendar Year



1H 2014 Contributions
by Strategy



1H 2014 Distributions
by Strategy



Prior & Current Activities

Fund commitments by calendar year in which commitment was made.

FUND COMMITMENTS COMPLETED IN 2012				FUND COMMITMENTS COMPLETED IN 2013				FUND COMMITMENTS FOR 2014			
FUND	COMMITMENT AMOUNT (\$ millions)	VINTAGE YEAR	RELATIONSHIP	FUND	COMMITMENT AMOUNT (\$ millions)	VINTAGE YEAR	RELATIONSHIP	FUND	COMMITMENT AMOUNT (\$ millions)	VINTAGE YEAR	RELATIONSHIP
BUYOUT				BUYOUT				BUYOUT			
Accel-KKR Capital Partners IV	10	2013	NEW	Avista Capital Partners III	150	2011	existing	Crestview Capital Partners III	150	2013	existing
Carousel Capital Partners IV	25	2012	existing	Apollo Investment Fund VIII	220	2013	existing	<i>Pending - US Buyout Fund</i>	150	2015	
Halifax Capital Partners III	30	2012	existing	Catterton Partners VII	100	2013	existing				
				CVC Capital Partners VI	97.5	2014	existing				
				HgCapital 7	98.2	2013	NEW				
				Levine Leichtman Capital Partners V	150	2013	NEW				
				Milestone Partners IV	50	2011	NEW				
				Warburg Pincus XI	150	2012	existing				
				TOTAL BUYOUTS	1015.7						
VC / GROWTH				VC / GROWTH				VC / GROWTH			
NEA 14	45	2012	NEW	Catterton Growth Partners II	75	2013	existing	ARCH Venture Fund VIII	80	2014	existing
				TCV III	150	2014	existing	<i>Pending - VC Co-invest / Overage Vehicle</i>	50	2015	
								<i>Pending - US VC Fund</i>	90	2015	
SPECIAL SITUATION				SPECIAL SITUATION				SPECIAL SITUATION			
Mount Kellett Capital Partners II	75	2011	NEW	Marlin Equity IV	49	2013	NEW	Lexington Middle Market Investors III	150	2012	existing
				StepStone SYN	5	2006	existing	<i>Pending - Four Special Situations Funds</i>	800		
				GCM Grosvenor - NC Innovation Fund 2013	15	2013	existing				
TOTAL COMMITMENTS	185			TOTAL COMMITMENTS	1309.7			TOTAL COMMITMENTS	1470		

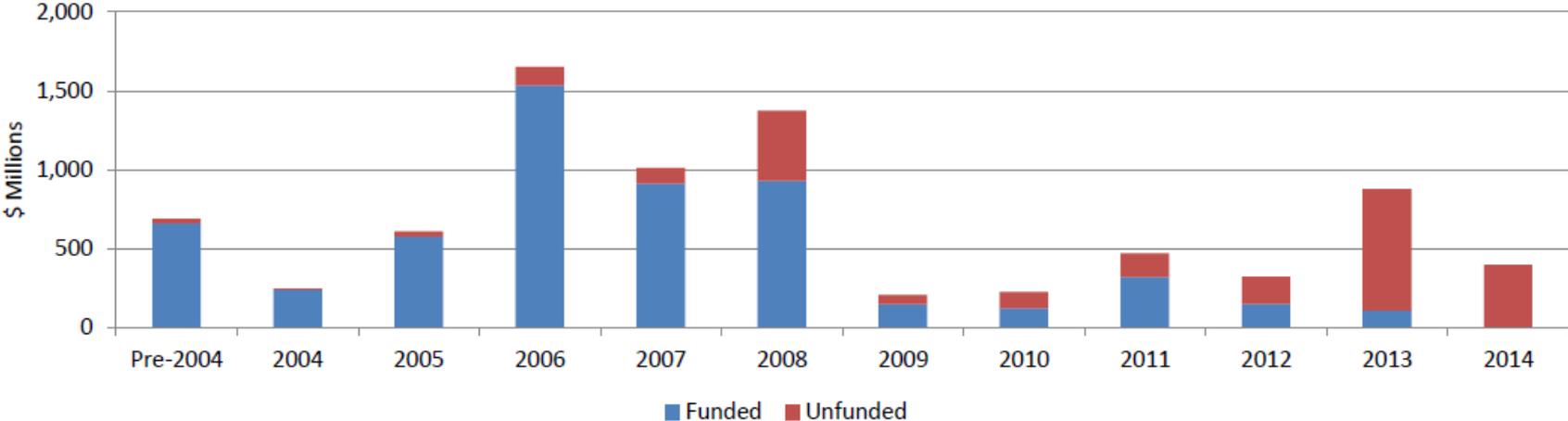
Vintage Year commitment translation:

Vintage	Commitment (\$s MM)
2011	275.0
2012	400.0
2013	867.2
2014	327.5



Private Equity Performance

Private Equity Commitments by Vintage Year



	IRR by Vintage Year (%)											
as of March	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total*
2014	8.00	6.00	3.97	7.90	10.95	17.07	20.08	8.02	8.69	-13.2	-12.94	7.78
2013	7.13	5.33	2.24	5.42	7.73	9.28	14.45	0.19	-23.73	-14.2	N/A	6.17
2012	6.99	6.61	2.34	4.54	6.16	2.59	5.22	-0.81	N/A	N/A	N/A	6.52

Note: data as of 3/31/14

* Total includes pre-2004 vintage year performance



Private Equity Performance (2000-3/31/14)

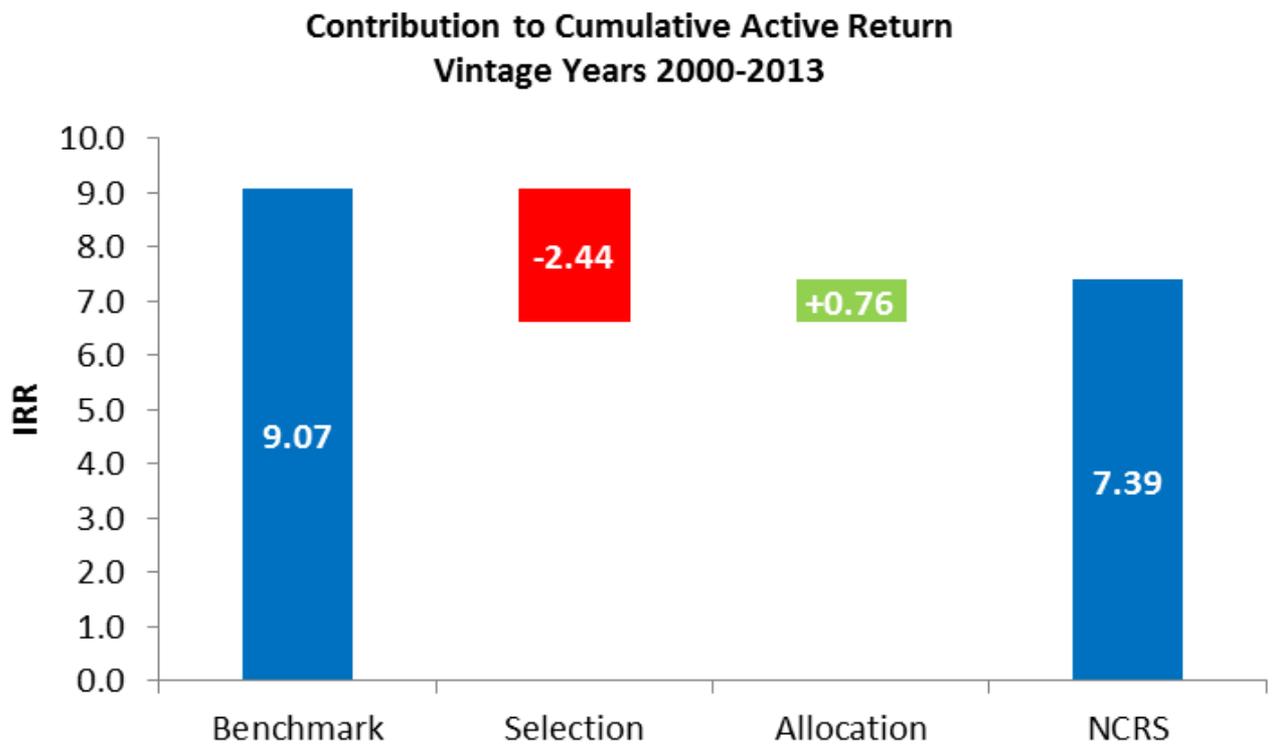
Private Equity Attribution Analysis						
Strategy	NC IRR	NC IRR absent Fund-of-Funds	Contribution to NC IRR (A)	Benchmark IRR	Contribution to Benchmark IRR (B)	Contribution to Active IRR (A – B)
VC / Growth Equity	8.02	8.02	1.52	6.57	0.55	0.97
Buyout	6.90	6.90	2.92	12.15	8.43	-5.51
Special Situations	8.55	8.55	1.15	5.63	0.10	1.05
Fund-of-Funds	7.11	N/A	1.79	N/A	N/A	1.79
Total	7.38	7.47	7.38	9.08	9.08	-1.70

∅ The NCRS Buyout performance was impacted by the secondary sale. Rebuilding the portfolio with these commitments results in a Buyout IRR of 9.35% including commitments from 2000 through 3/31/14.

Note: Performance excludes pre-2000 vintage funds, through 3/31/14



Performance Attribution by Vintage Year (Cumulative)



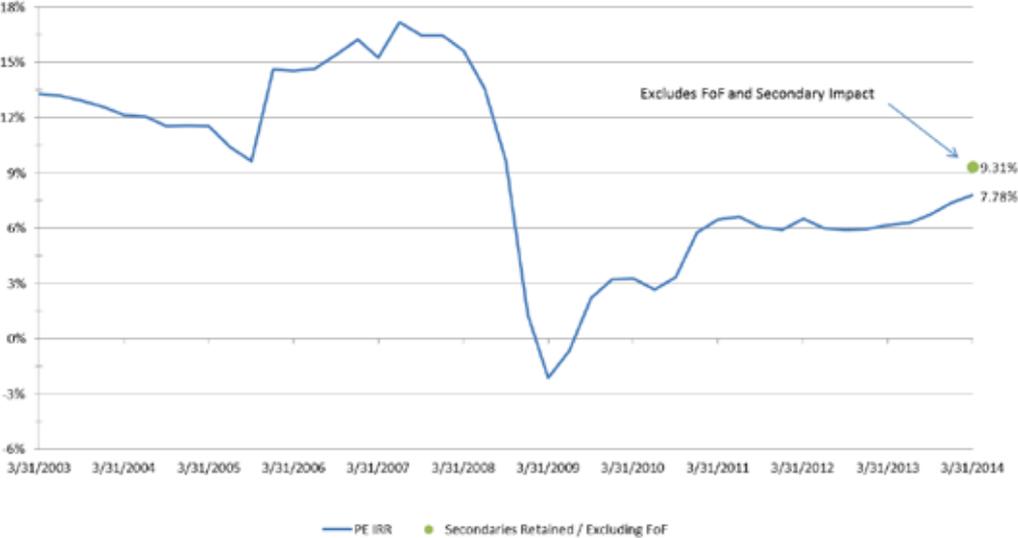
- Ø Selection variance has been the primary discrepancy between the Benchmark returns and the portfolio returns
- Ø 79% of the cumulative difference between the Benchmark and the portfolio return is attributable to Vintage Year 2000 investments

Note: For the purpose of this analysis, Pre-2000 are excluded, thus the cumulative IRR of 7.39% does not include the impact of returns generated from these earlier vintage years.



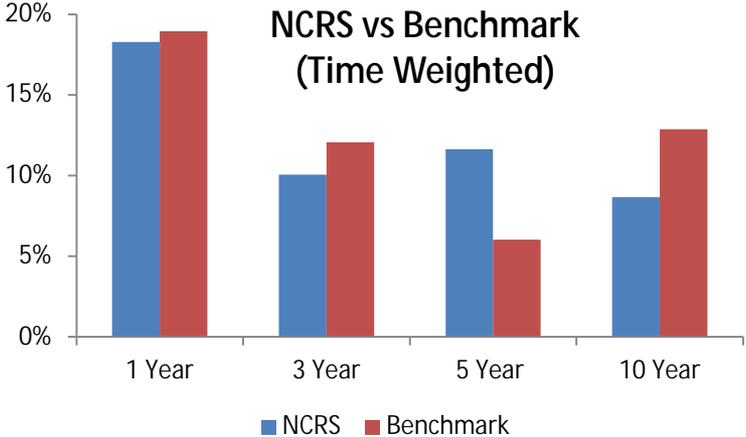
Private Equity Performance

PE IRR inception through 3/31/14



Ø IRR from inception impacted by 153 basis points on secondary sale and Fund-of-Fund commitments.

Ø Time weighted performance exceeding the benchmark over 5 years, but lagging over 10 years.



Private Equity: Overview / Key Takeaways

Robust Credit Supply

- Ø Low interest rate environment and search for yield have facilitated favorable lending terms
 - Covenant Light
 - 1H14 sponsored loan volume on pace to exceed full year 2013 (which exceeded 2007)
 - 2013 record high yield bond issuance → continued with 2Q14 experiencing a record quarter
 - Average debt multiples appear to have normalized at more conservative levels relative to pre-crisis period

Valuations have risen significantly

- Ø Purchase price multiples continued upward trend, close to pre-crisis levels

SEEING A SELLERS' MARKET

Fundraising - 2013 set a Post-Crisis Record Year, only eclipsed by 2007 and 2008

- Ø Significant capital being returned to LPs
- Ø Funds that withstood the recession are rewarded with abbreviated fundraising periods

NEW CAPITAL – WHAT WE WANT TO SEE

Buyout

Sector expertise
Operating Ability
Low Leverage

VC/Growth Equity

Maintain High Bar
Grow Relationships

Special Sits - Secondaries

Regulations Enhancing Supply
Structured Transactions
Separate Accounts

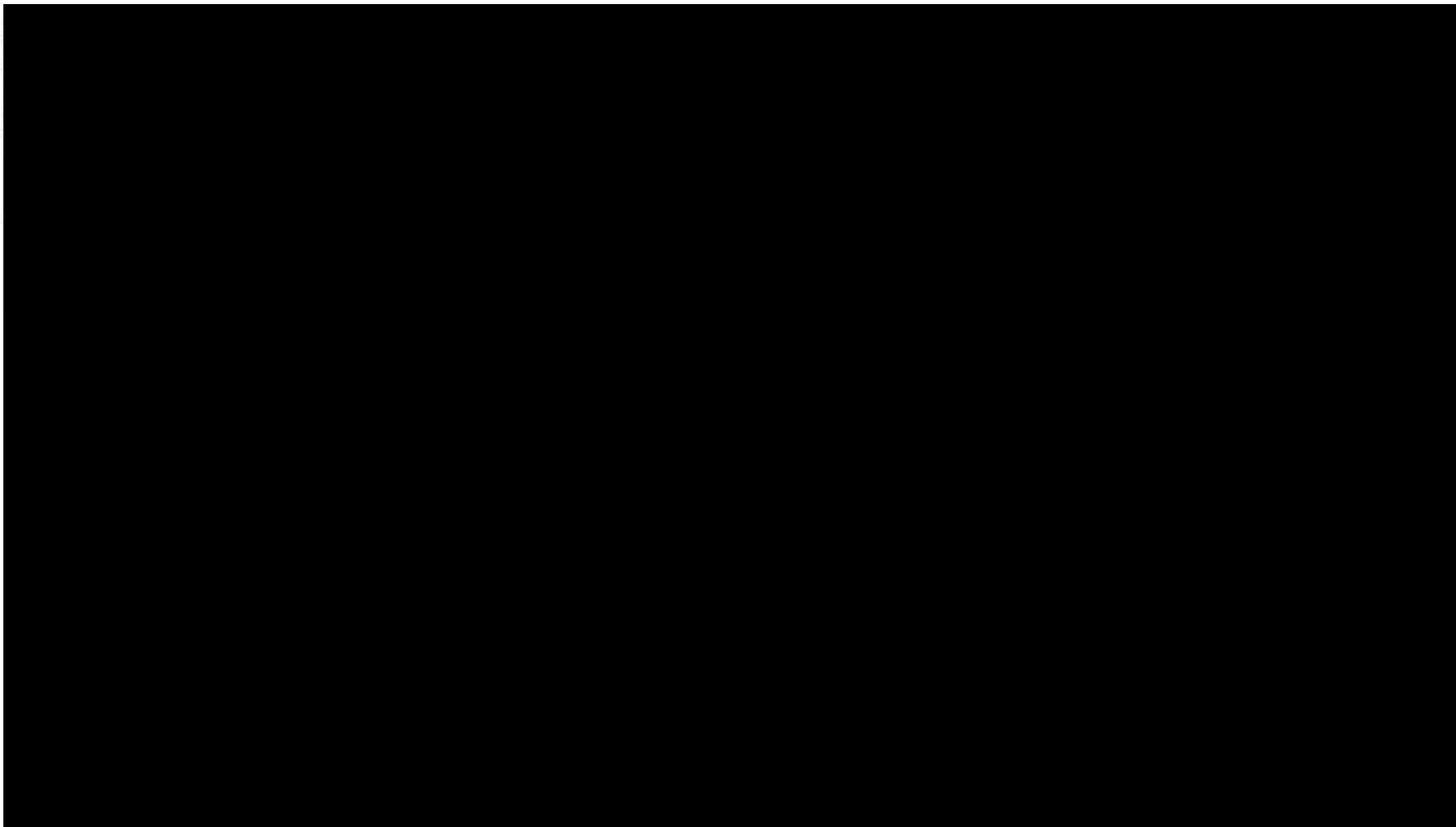
Opportunistic Strategies

Co-Investments



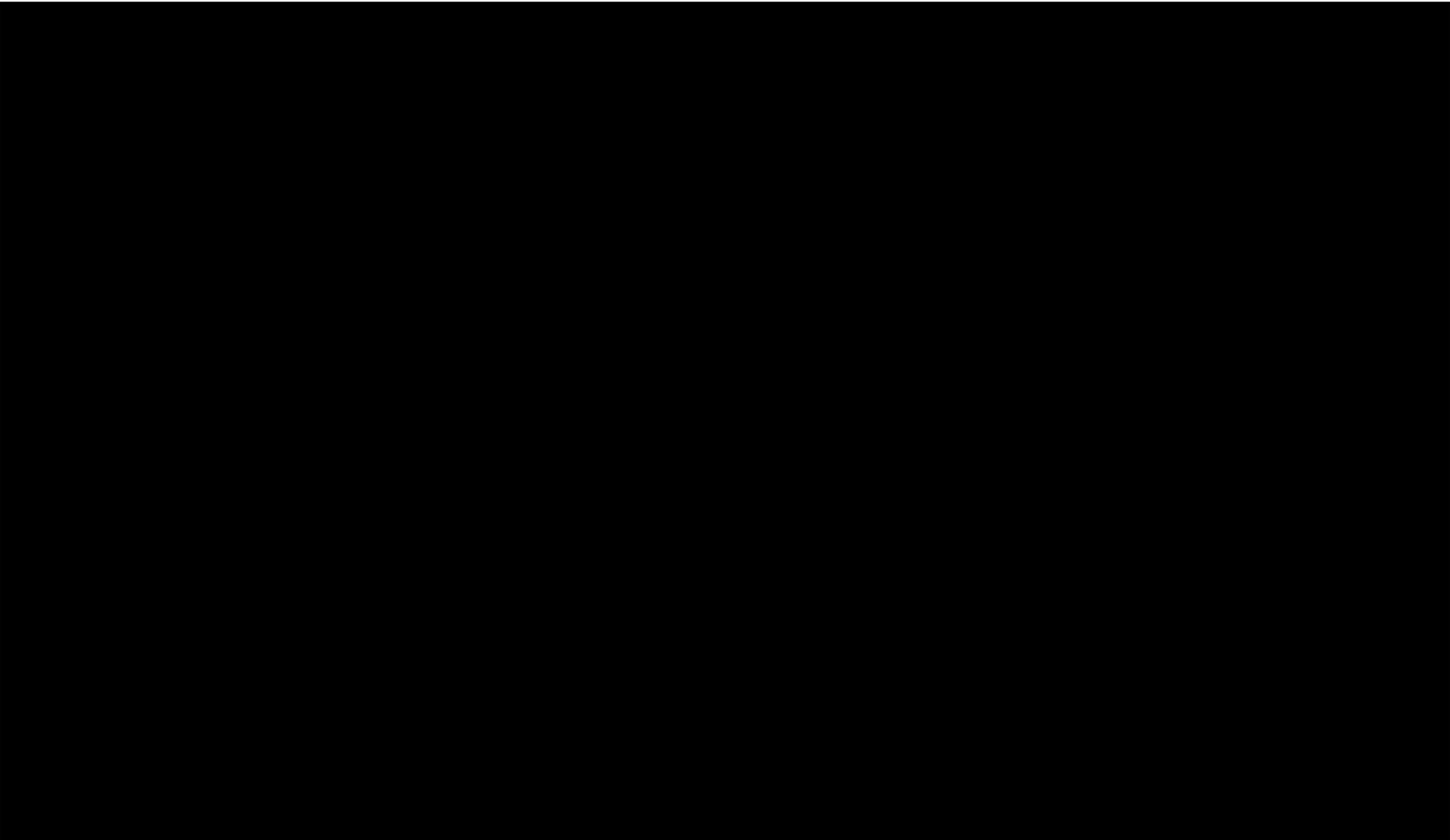
Private Equity Fundraising (excluding VC)

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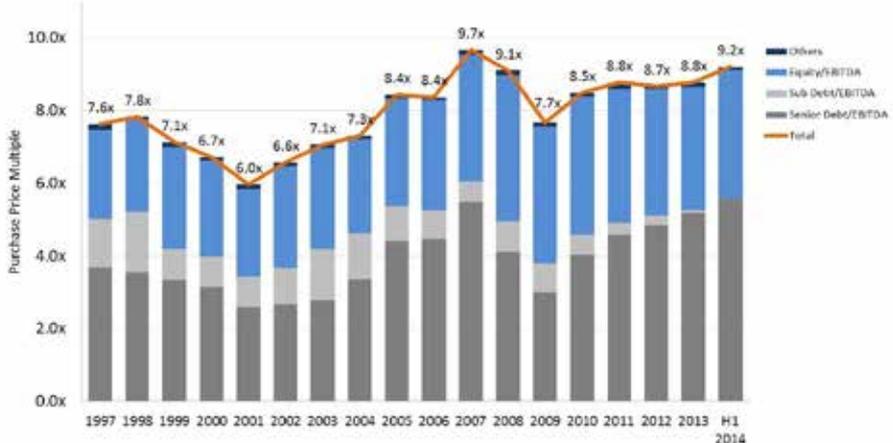
Private Equity Overhang (excluding VC)

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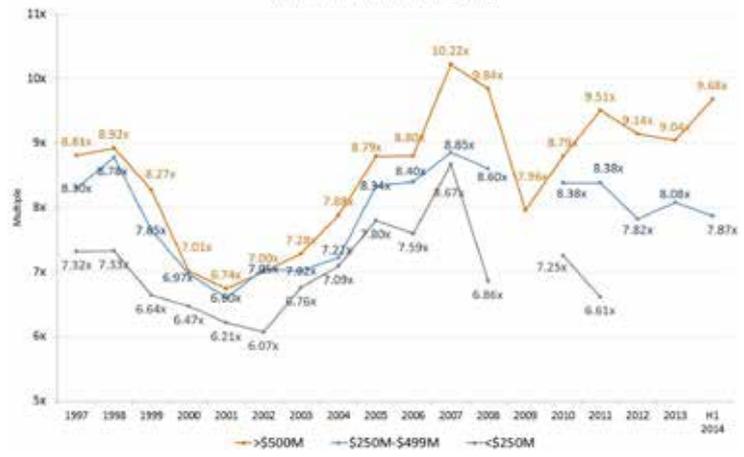


U.S. Buyout – Entry Valuations

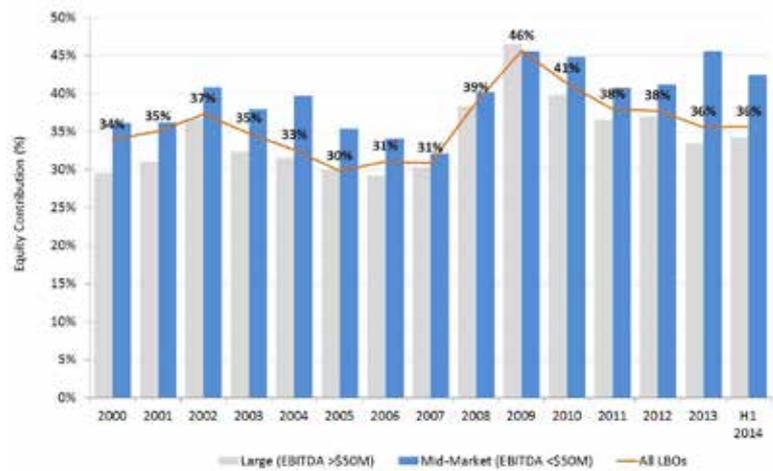
All LBOs: Purchase Price Multiple Contribution



Purchase Multiples by Transaction Size
(Enterprise Value to Pro Forma Trailing EBITDA)



LBO Equity Contributions by Company Size



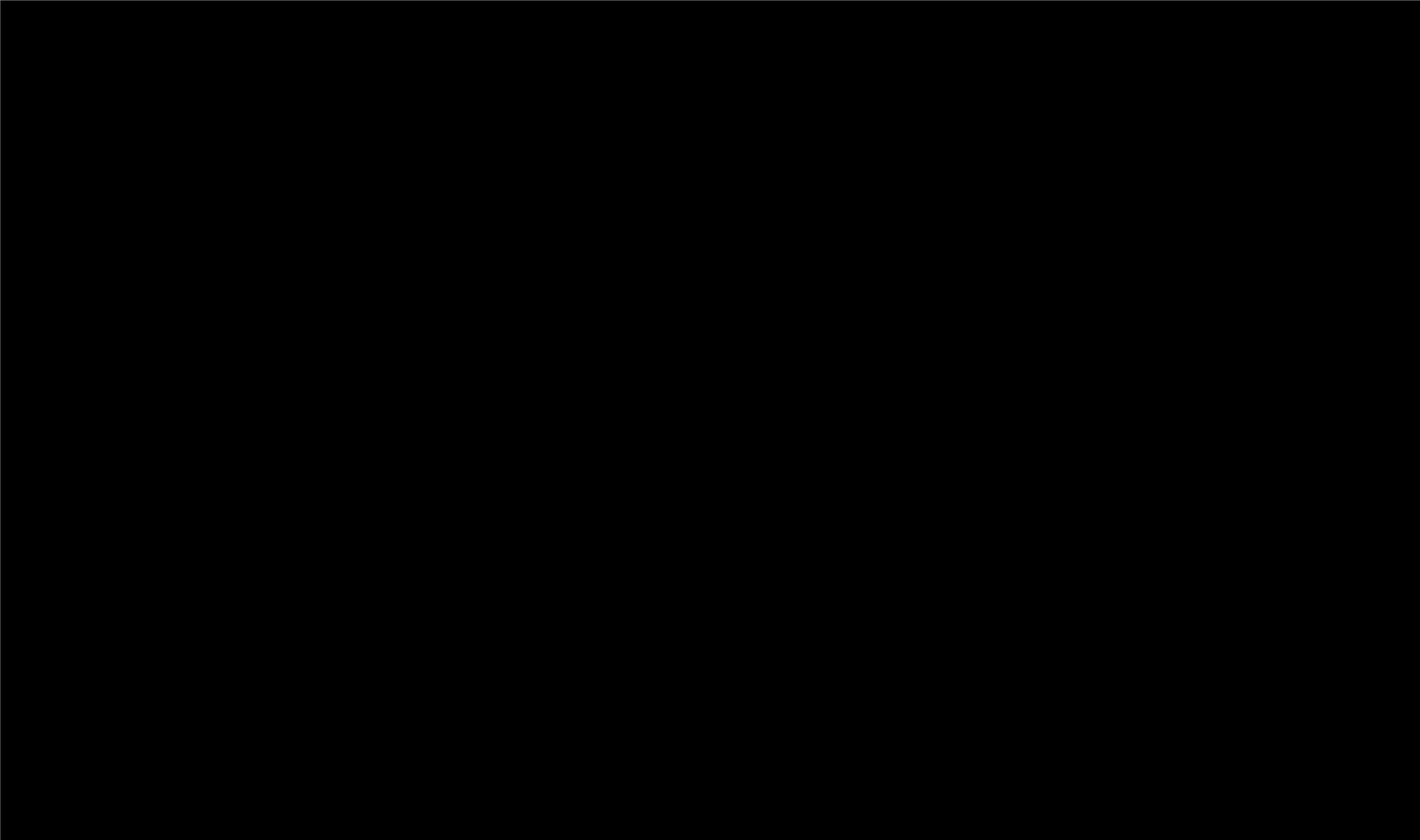
- At 36% for All LBOs in H1 2014, equity contributions remained above the pre-crisis levels.
- Mid-market transactions consistently show higher equity contributions, as credit is more readily available to finance transactions involving larger, more stable companies.
- Average debt multiples for 1H14 for issuers with EBITDA >\$50M were 5.6x (below 6.2x in 2007) EBITDA <\$50M were 5.2x (below 5.6x in 2007)

Source: S&P Capital IQ LCD 's Leveraged Buyout Review



U.S. Buyout – Market Transaction Activity

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U.S. Private Equity – Exit Environment

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Buyouts - NCRS Strategy

∅ Preference for middle market funds and a limited number of large funds

∅ Attractive investment strategies:

- q Sector focus
- q Deep value
- q Structured transactions or securities
- q Operational expertise
- q **Less reliance on Leverage**

Bloomberg

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Top LBO Fund Investors Pile on Leverage to Boost Returns

By KGI Porter and Sabina Wilmer - Sep 9, 2014

Some of the world's biggest investors in leveraged-buyout funds are themselves using unprecedented levels of debt to boost returns.

"Leverage is a double-edged sword," said Oliver Gottschalg, a professor at French business school HEC Paris. "It can boost the performance on the upside and rapidly eat into capital on the downside. The more leverage you apply, the more extreme the outcome will be for the investor."

New issuance of sponsored and covenant-lite loans in 1H14 was on pace to exceed full year 2013 volume, which previously had peaked in 2007.

§ 2Q14 was a record quarter of \$105 billion in issuance

§ issuers continue to enjoy low coupons and issuer-friendly covenant packages

∅ Mix of re-ups with existing managers and select new relationships

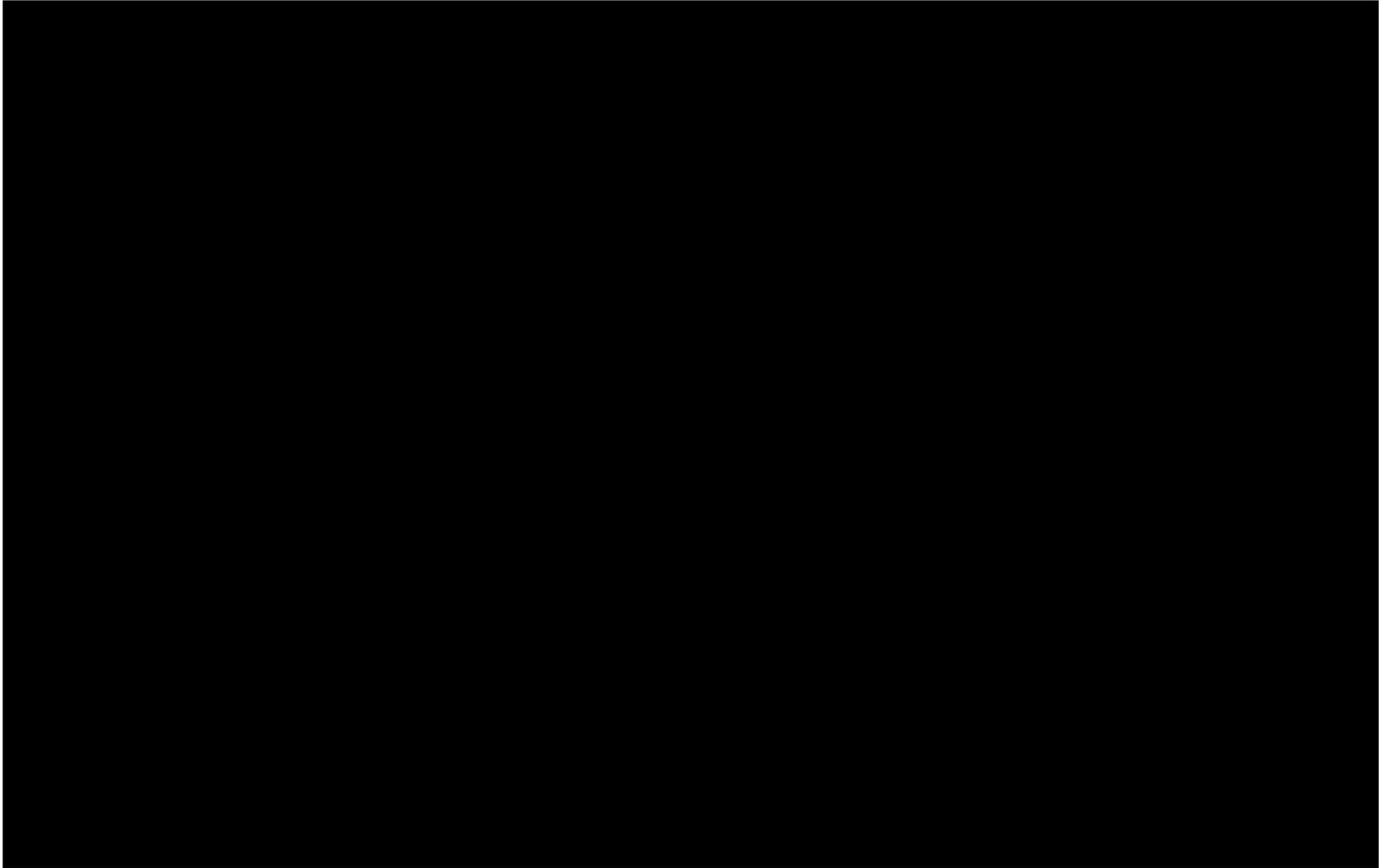
∅ Typical Buyout commitment size going forward = \$150-\$200 MM

- q Expect to concentrate on fewer number of high conviction managers/GPs



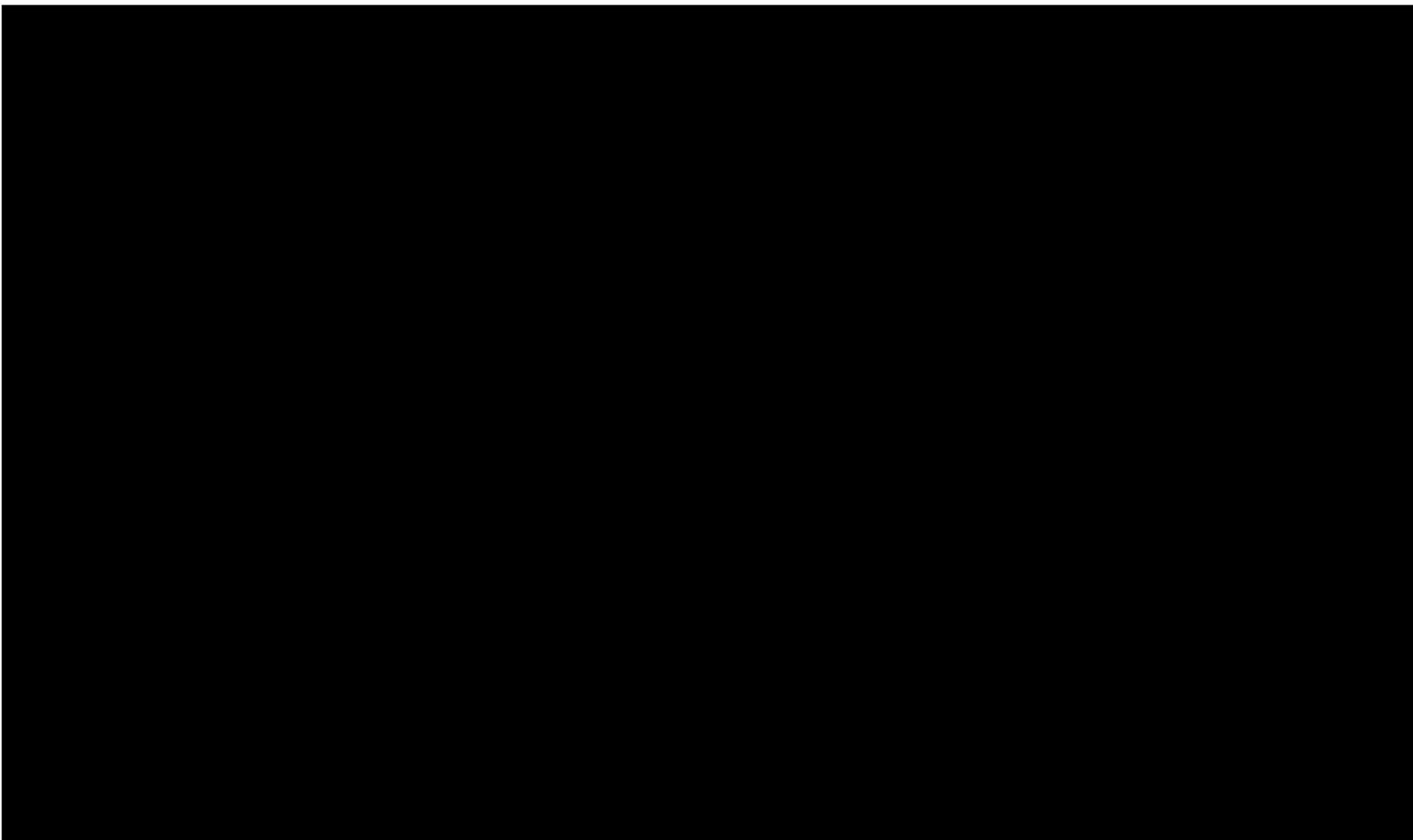
Venture Capital Fundraising

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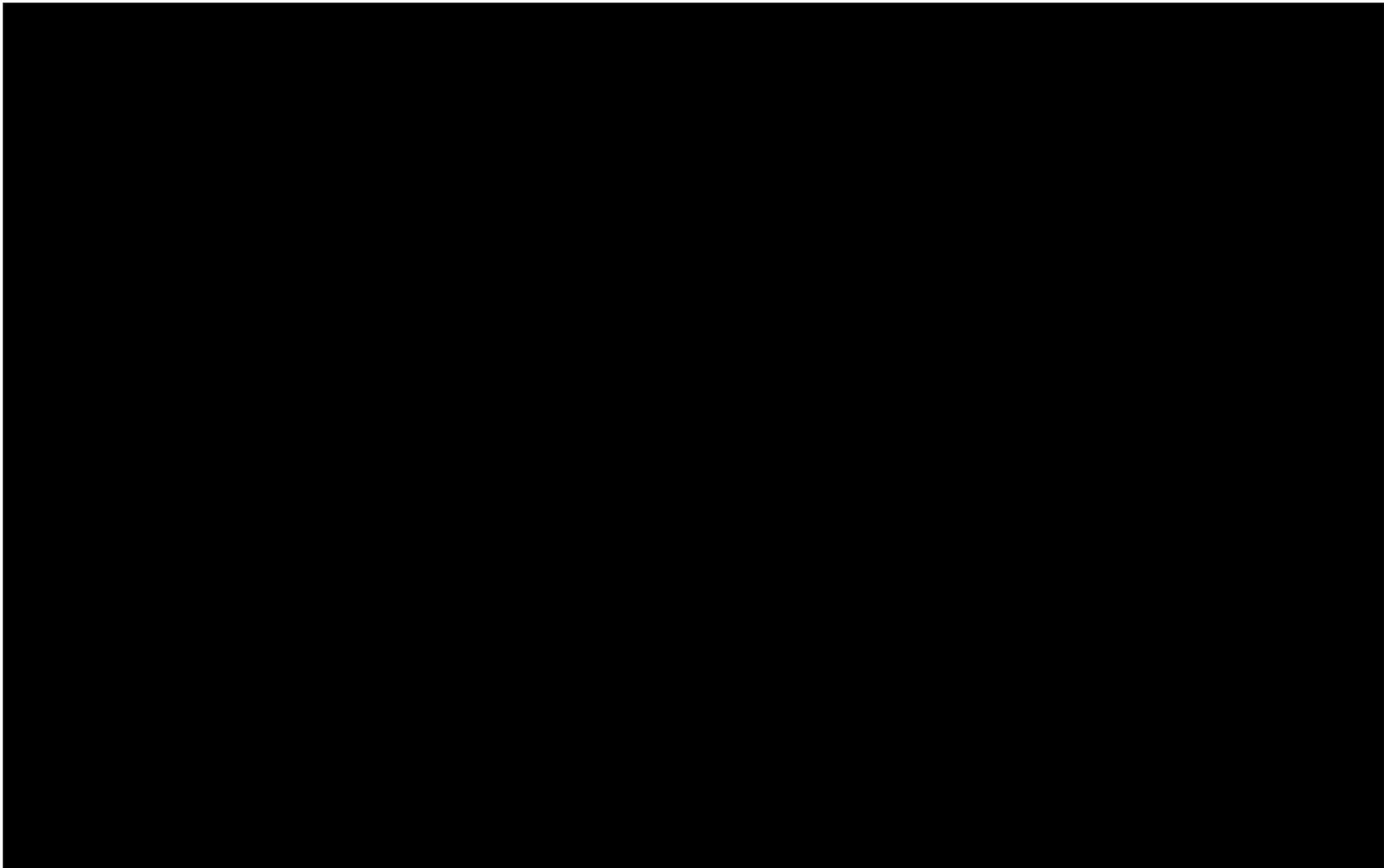
Venture Capital Overhang

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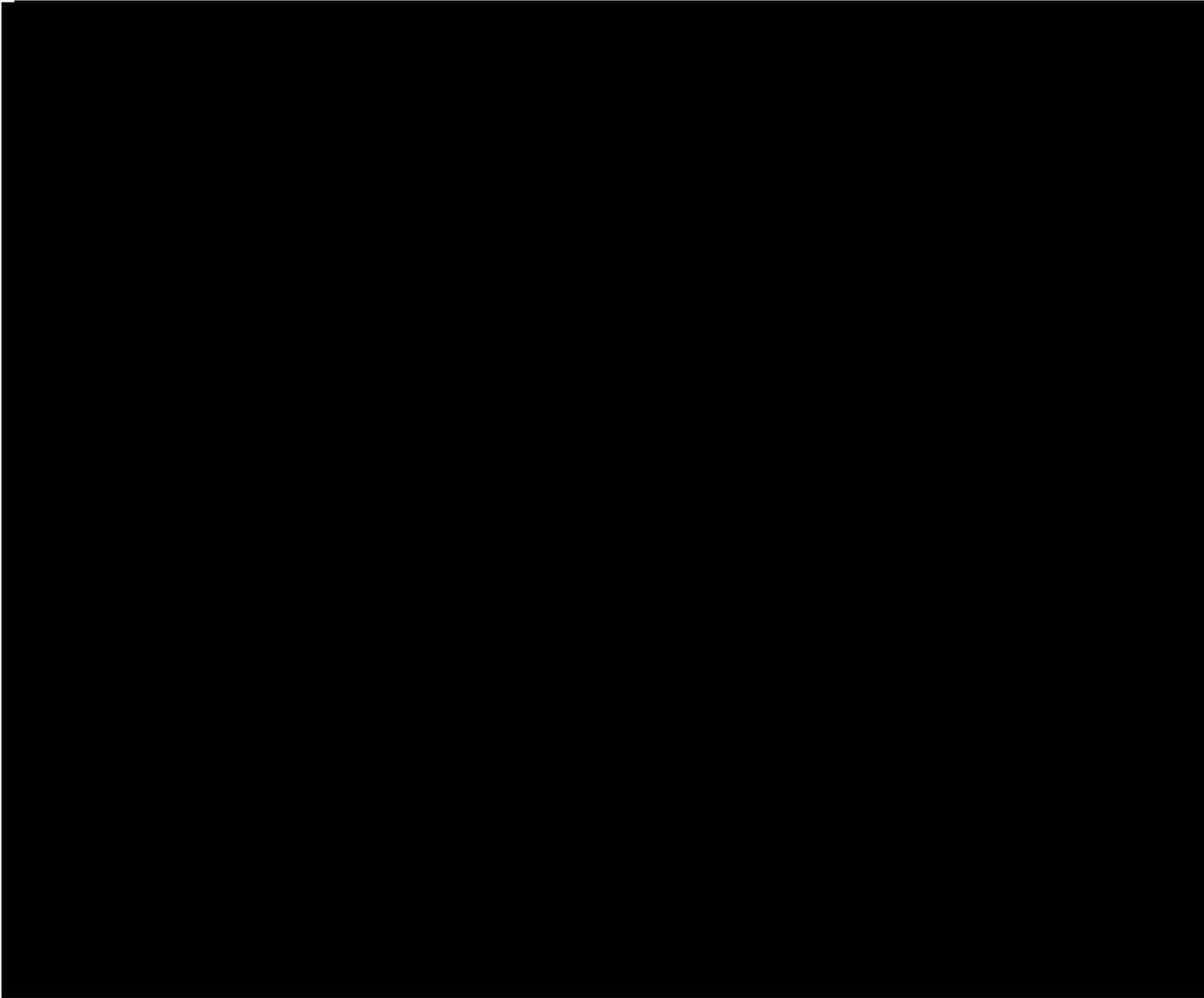
Venture Capital – Valuations

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Venture Capital – Exit Environment

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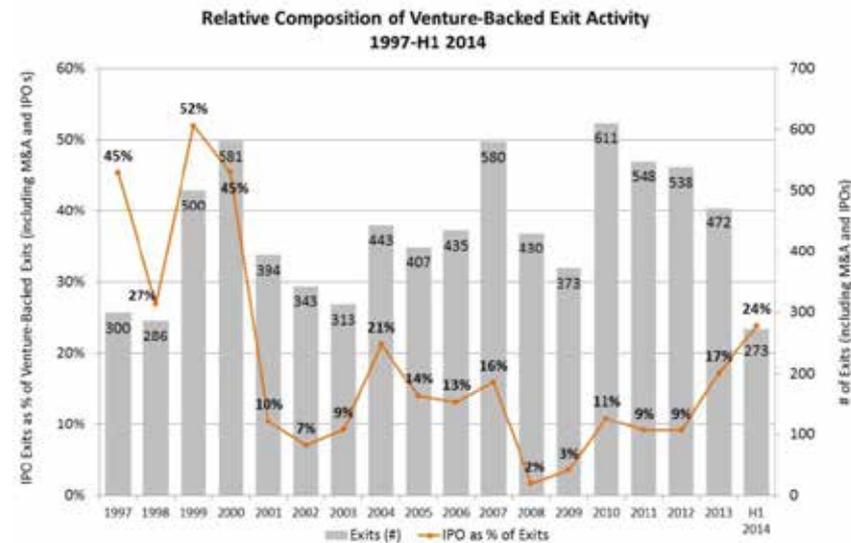


Venture Capital – IPO Exit Environment



The U.S. IPO Market hit a 14 year record high in 2Q14 with 83 IPOs priced and \$21 billion raised.

Source: Renaissance Capital



Venture-backed IPO activity extended its streak of 20+ offerings for the 5th consecutive quarter

IPO exits as a percentage of venture-backed exit activity have tracked economic cycles.

- 1999 = 52%
- Increased since recession, but not 90's peak

Source: Thomson Reuters / NVCA



Venture Capital / Growth Equity – NCRS Strategy

- ∅ Allocation is currently above policy range
 - Expect this to be short term
 - Committing more to other strategies

VC + Growth Equity Portfolio Weight				
	Policy Range			Actual
Strategy	MIN	TARGET	MAX	(FMV)
Growth/Venture	10%	20%	30%	32.01%

- ∅ Do not force VC
 - Access to best managers is critical
 - Maintain relationships as warranted with consistent participation
 - Commitments will be lumpy by vintage year due to a small number of expected relationships

- ∅ Growth Equity allocation 7.5% as of 6/30/14
 - Similar strategy as VC
 - Allocation expected to grow over time at the expense of VC



Special Situations - Secondary Market

NCRS Strategy:

- Separate Account – preferred economics
- Manager utilizing structured transactions – risk mitigation

Benefits:

- J-Curve mitigant
- Less “blind pool” risk
- Accelerated Investment Exposure (cash flow)

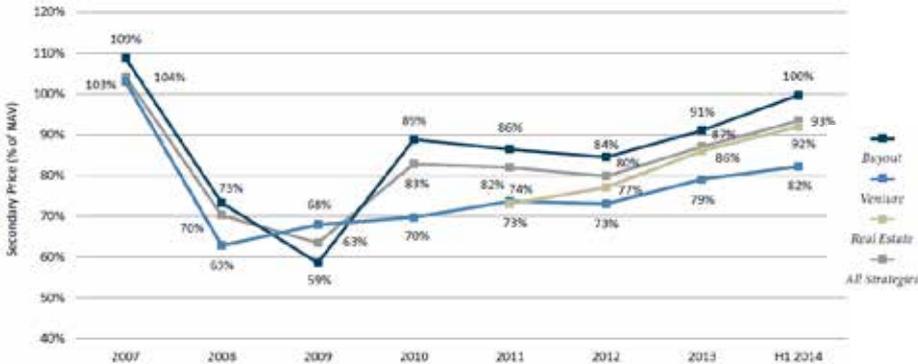
Pricing across all strategies continues to rise

Secondary volume is on track to surpass 2013 record

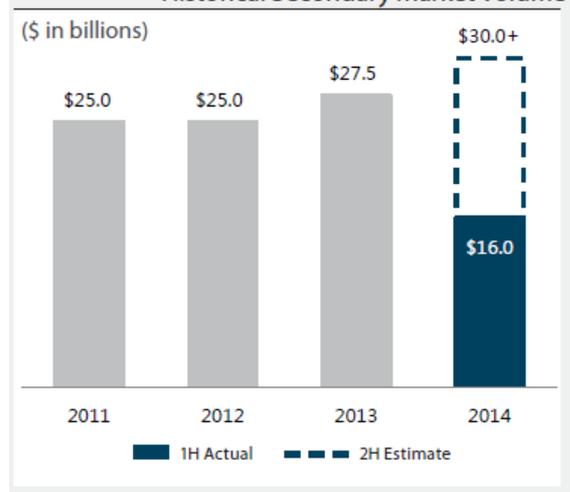
LP reasons for sale:

- opportunistic sellers
- focus on high conviction managers
- Regulations – Volcker Rule, Basel III, Solvency II

Pricing Trends



Historical Secondary Market Volume



Source: Cogent Partners



Current Initiatives

- ∅ Staff Expansion / Onboarding
 - Portfolio Manager & Analyst
 - New Positions

- ∅ Capital Deployment – new commitments of approximately \$1.2 billion per year
 - Target 6.0% allocation over multi-year period
 - Expect to be underweight in coming years as exercise vintage year commitment discipline and cognizant of valuations

- ∅ Non-Core Residual Funds / Portfolio Construction
 - Fund “Tail” Analysis
 - Fund-of-Funds – restructure / decrease fees

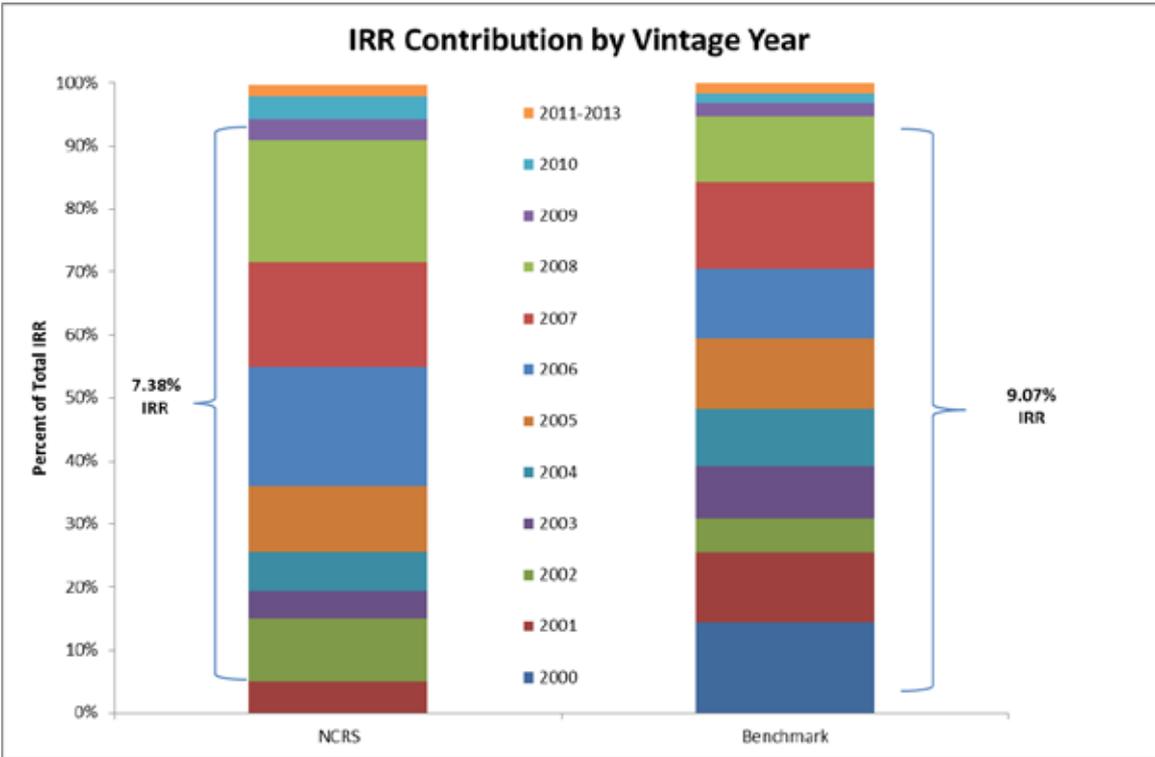
- ∅ Fee Monitoring and Review

- ∅ Risk Analytics Platform

- ∅ Special Programs
 - In-State Program – success of the NC Innovation Fund I / Fund II in diligence
 - Small / Emerging Manager Program – access to smaller funds efficiently, incorporating co-investment
 - Co-Investment Program – cross collaboration with other asset classes
 - Secondary Program – cross collaboration with other asset classes



Appendix - Performance Attribution by Vintage Year

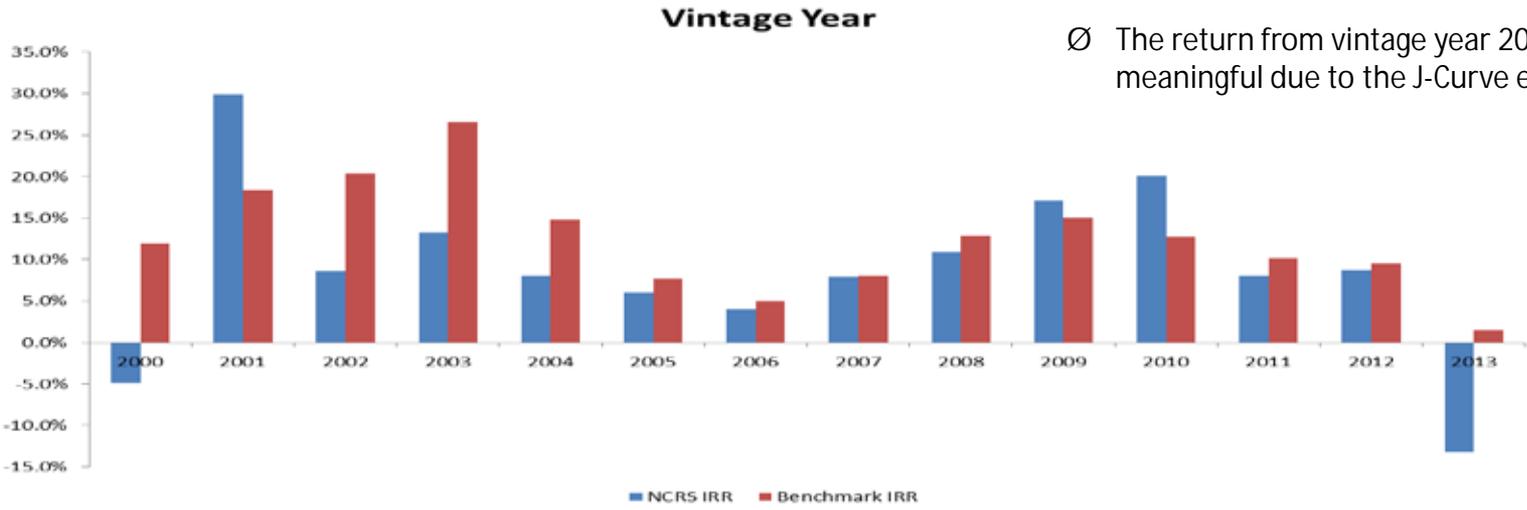


- Ø Thus far, vintage years 2011-2013 have had limited impact on returns for both NCRS and the benchmark
- Ø Vintage years 2005-2008 account for approximately 65% of NCRS returns, which is meaningfully greater than the Benchmark
- Ø Vintage year 2000 has a dramatic impact on the Benchmark
 - Essentially no impact act on NCRS returns

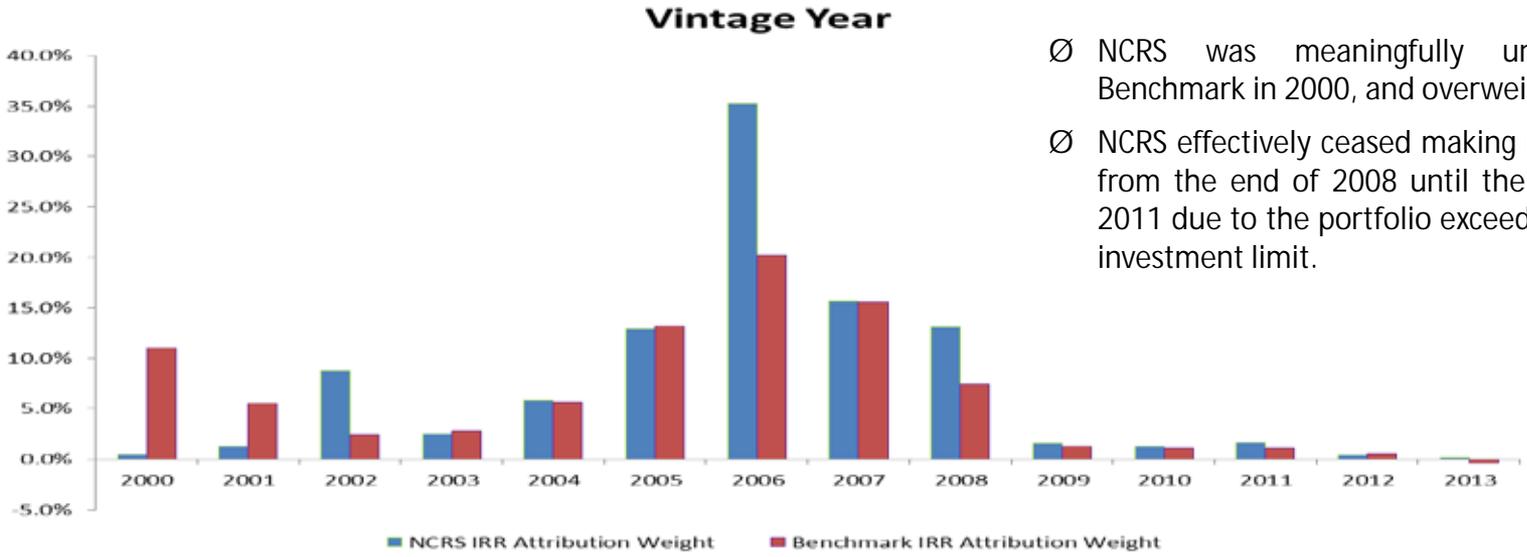
Note: For the purpose of this analysis, vintage years prior to 2000 are excluded, thus the above IRR of 7.38% does not include the impact of returns generated from these earlier vintage years.

*as of 3/31/14

Appendix - Attribution Weight and IRR



∅ The return from vintage year 2013 is not yet meaningful due to the J-Curve effect.



- ∅ NCRS was meaningfully underweight the Benchmark in 2000, and overweight in 2006
- ∅ NCRS effectively ceased making new investments from the end of 2008 until the third quarter of 2011 due to the portfolio exceeding the statutory investment limit.





Thank You!

Together we can build and maintain a fiscally strong and prosperous North Carolina.

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Investment Management

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