State of New Jersey

**CHRIS CHRISTIE**
*Governor*

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*Lt. Governor*

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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**ROBERT A. ROMANO**
*Acting State Treasurer*

July 22, 2015

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Excellere Capital Fund III, L.P.**

The New Jersey Division of Investment ("Division") is proposing an investment of $50 million in Excellere Capital Fund III, L.P ("Fund III"). This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

Excellere Partners LLC ("Excellere" or the "Firm") is a lower mid-market private equity investor which partners with entrepreneurs and management teams in high-growth industries with a buy-and-build strategy. Fund III will target companies with primary operations in North America within the business services, energy services, healthcare, and industrial technology & service industries.

The Division is recommending this investment based on the following factors:
**Strong Track Record:** Excellere's prior two funds are consistently top-quartile (Fund I (2007) – 33.00% Net Internal Rate of Return ("IRR"), 2.13x Multiple of Invested Capital ("MOIC"); Fund II (2011) – 45.89% Net IRR, 1.51x). Also noteworthy, the two previous funds have already returned 1.82x and 0.91x of called capital, respectively.
**Operational Performance:** Since inception, the Firm's 16 portfolio companies have averaged revenue and Earnings Before Interest, Tax, Depreciation and Amortization ("EBITDA") growth of 93% and 40%, respectively. In addition, Fund II's unrealized portfolio has achieved organic revenue and EBITDA growth of 18% and 25%, respectively. Excellere's transaction entry multiple, including add-ons, has also been impressive. For the nine realized investments, the blended entry multiple was approximately 6.5x while the blended exit multiple was over 10.0x.
**Differentiated Investment Strategy:** Excellere's strategy is very process-oriented and regimented. The Firm's focus on its core industries and insistence on becoming experts in those areas positions them favorably and allows them to generate unique deal flow. Even more unique is the Fund's value creation process, which hinges on partnering with entrepreneurs. Entrepreneurs typically roll over 20-40% ownership into the new transaction, while objectives and plans are laid out very early (often before the deal is closed) to make sure both buyer and seller are aligned with the plan for the company. This plan typically entails putting processes,

compliance and systems in place at the portfolio company so it can then grow as an institutional quality company and be attractive to corporate and larger financial buyers.

**Firm Discipline:** Fund III is well oversubscribed and could raise multiples above its hard cap of $550 million. However, the Firm has chosen not to raise additional capital and will continue at a fund size in which they've been extremely successful. This is not common among the majority of private equity funds, which typically start with small fund sizes, have success and go on to raise much more sizeable amounts of capital. Excellere believes that model could lead to lower returns.

**Conservative Use of Leverage:** Excellere's investment strategy is based upon growth and strategic and operational enhancements; therefore the Firm is less reliant on the use of leverage and conservatively capitalizes its portfolio companies. The weighted average net total leverage of Fund I and Fund II's sixteen platform investments at acquisition was 2.5x EBITDA.

**GP Commitment/Team Alignment:** The GP's commitment of 5% of committed capital is well above the industry norm and its commitments to this fund and prior funds makes up a substantial portion of the GP's net worth. It should also be noted that carry distribution from the Firm's top partners to the rest of the team has increased from 10% in Fund I to 37% in Fund III. In addition, as the Firm promotes or hires during the Fund's life, the increase in carry only comes out of the co-founders' portion, therefore not diluting the rest of the team.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its private equity consultant, Strategic Investment Solutions, undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with New Jersey's potential investment.

We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern the investment. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 69 and 90 of the Council's regulations. Excellere Capital Fund III, L.P. will be considered a private equity buyout investment, as defined under N.J.A.C. 17:16-90.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC and a meeting of the Committee was held on July 9, 2015. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's July 22, 2015 meeting.

Attachments

## Fund Name: Excellere Capital Fund III, L.P. — July 22, 2015

*Contact Info:* *David L Kessenic, 3033 East First Avenue, Suite 700, Denver, CO 80206*

*Fund Details:*

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|---|---|
| **Firm AUM ($bil.):** | $737 million |
| **Strategy:** | Mid-Market buyout |
| **Year Founded:** | 2006 |
| **Headquarters:** | Denver, CO |
| **GP Commitment:** | 5% |

*Key Investment Professionals:*

**David L. Kessenich,** Managing Partner and co-founder of Excellere Partners. Prior to forming Excellere Partners, Mr. Kessenich was a senior investment professional and served on the investment committee at KRG Capital Partners as well as two other middle-market private equity firms. He has more than 25 years of principal investing and investment banking experience, including originating investment opportunities, leading investment teams, providing strategic and operational oversight, and board governance.

**Robert A. Martin,** Managing Partner and co-founder of Excellere Partners. Prior to forming Excellere Partners, Mr. Martin was a senior investment professional at KRG Capital Partners, a middle-market private equity group. He has spent virtually his entire career as an entrepreneur (founded two companies) or working with entrepreneurs as a middle-market investment banker and a private equity investment professional.

**Matthew C. Hicks,** Partner and co-founder of Excellere Partners. Prior to forming Excellere Partners, Mr. Hicks served as an investment professional at Stone Arch Capital, an Upper Midwest focused middle-market private equity firm, and at George K. Baum Merchant Banc, a private equity firm with a buy-and-build investment strategy focused primarily within the food and beverage, consumer products, industrial manufacturing, and business services industries.

### Investment Summary

Excellere Partners ("Excellere" or the "Firm") was founded in 2006 by David Kessenich and Rob Martin who both spun out of KRG Capital Partners as senior investment professionals. Excellere focuses on lower middle-market companies with primary operations in North America with $4 million to $25 million of EBITDA. The Firm employs a top-down, research-driven investment strategy targeting industry niches that it believes are positioned to benefit from favorable macro-economic and demographic trends and consolidation. Within its industries of focus (business services, energy services, healthcare, and industrial technology & services), Excellere executes a targeted, firm-wide and multifaceted deal sourcing strategy.

### Existing and Prior Funds

| Funds | Vintage Year | Strategy | Returns as of 3/31/2015 |
|---|---|---|---|
| Fund I | 2007 | buyout | 33.00% Net IRR, 2.13x Net TVPI, 2.10x Net DPI |
| Fund II | 2011 | buyout | 45.89% Net IRR, 1.51x Net TVPI, 0.61x Net DPI |

IRR = Internal Rate of Return; Total Value to Paid -In; DPI= Distributions to Paid-In

## Vehicle Information:

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|---|---|---|---|
| **Inception:** | 2015 | **Auditor:** | **Crowe GHP Horwath** |
| **Fund Size ($mil.):** | $550 million | **Legal Counsel:** | **Latham & Watkins LLP** |
| **Management Fee:** | 2%, post-investment period 2% on existing deals' cost basis | | |
| **Carry:** | 25% , with a 75% catch up | | |
| **Hurdle Rate:** | 8% | | |
| **Fee Offsets:** | 100% of directors' fees or any other fee that is not a break up or advisory fee; 80% of transaction, break-up or advisory up to $28 million; then 100% over $28 million | | |

### NJ AIP Program

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| **Recommended Allocation ($mil):** | $50 million | **LP Advisory Board Membership:** | **TBD** |
| **% of Fund:** | 9.00% | **Consultant Recommendation:** | **Yes** |
| | | **Placement Agent:** | **No** |
| | | **Compliance w/ Division Placement Agent Policy:** | **N/A** |
| | | **Compliance w/ SIC Political Contribution Reg:** | **Yes** |

*This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.