



State of New Jersey

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January 29, 2015

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in TCW Direct Lending**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$300 million in the TCW Direct Lending strategy (generally referred to as “TCW Direct Lending”), allocating up to \$150 million to TCW Direct Lending LLC and up to \$150 million to a TCW Direct Lending Separate Account. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

The Division is recommending this investment based on the following factors:

Attractive US Middle Market Opportunity: TCW Direct Lending is targeting companies in the U.S. middle market (annual revenues between \$10 million and \$1 billion), which comprises approximately 195,000 companies, equivalent in size to the world’s 5th largest economy at \$4.3 trillion. Banks once were the traditional lenders to the middle market but have steadily exited the space, accelerated by the 2007/2008 financial crisis as capital markets froze. As the capital markets are typically inaccessible to middle market companies due to their size, the need for alternative forms of lending through alternative private or public structures has become increasingly important in the middle market.

Dedicated focus on risk-adjusted returns and capital preservation: The group remains mindful of preservation of capital, seeking a target risk-adjusted return profile of 8-12% by maintaining a priority position in the capital structure, seeking collateral in senior secured loans, and arranging custom-tailored documents, ensuring that operational and performance-based covenants are designed to protect the lender. Thus, TCW Direct Lending has not had a realized loss in any of its investments in Funds I through V.

Successful Track Record across Firm’s History: Since 2001 and across five funds, TCW’s disciplined underwriting standards and investment process has served investors well, as all five funds have generated attractive returns and outperformed the Credit Suisse Leveraged Loan Index on a standalone basis. Combined, the return of these five funds has exceeded the Credit Suisse Leveraged Loan Index by 228 basis points on an IRR basis.

Portfolio Fit: The Division’s Global Diversified Credit (“GDC”) portfolio has been an exceptional performer over the last few years given the opportunities to buy assets at historically low prices and take advantage of bank disintermediation. The Division continues to see

attractive opportunities in this space. In addition, the asset allocation set by the SIC set the GDC portfolio's target exposure at 3.5%, to which we are about \$320 million under exposed. The current GDC portfolio has very little dry powder left due to portfolios in run-off mode or fully invested. A commitment to TCW Direct Lending will round out and compliment the Division's middle market lending portfolio which includes Cerberus and TPG's Specialty Lending group, both of whom have performed very well since the Division's investments.

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

Division Staff and its 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 23 and 69 of the Council's regulations. TCW Direct Lending VI and TCW Direct Lending Separate Account will be considered global diversified credit investments, as defined under N.J.A.C. 17:16-23.1.

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 September 9, 2014 and on January 14, 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 January 29, 2015 meeting.

Attachments

Fund Name: TCW Direct Lending LLC/ TCW/NJ Separate Account **January 29, 2015**

Contact Info: Jack Lazzaro, 1251 Avenue of the Americas, Suite 4700, New York, New York 10020, 212-771-4076

Fund Details:		<p>Key Investment Professionals: Richard T. Miller, Managing Director. Mr. Miller joined TCW in December 2012 with the acquisition of the Special Situations Funds Group from Regiment Capital Advisors, LP. He is in charge of the firm's Direct Lending effort. Suzanne Grosso, Managing Director. Ms. Grosso joined the TCW Direct lending group as a Managing Director in December 2012 with the acquisition of the Special Situations Funds Group from Regiment Capital Advisors, LP. She joined Regiment Capital Advisors in 2004 and is involved in the origination, due diligence review, structuring, and execution of new investments, and the ongoing management of portfolio companies. Matthew J. Whitcomb, Managing Director. Mr. Whitcomb joined the TCW Direct lending group as a Managing Director in December 2012 with the acquisition of the Special Situations Funds Group from Regiment Capital Advisors, LP. He joined Regiment Capital Advisors in 2005 and is involved in the origination, due diligence review, structuring, and execution of new investments, and the ongoing management of portfolio companies. James S. Bold, Managing Director. Mr. Bold joined the TCW Direct lending group as a Managing Director in December 2012 with the acquisition of the Special Situations Funds Group from Regiment Capital Advisors, LP. He joined Regiment Capital Advisors in 2005 and is involved in the origination, due diligence review, structuring, and execution of new investments, and the ongoing management of portfolio companies.</p>
Total Firm Assets (\$bil):	\$163.4 billion as of 12/31/14	
Strategy:	Middle Market Lending	
Year Founded:	1971	
Headquarters:	Los Angeles, CA	
GP Commitment:	TCW Direct Lending LLC \$32.2 million TCW/NJ Separate Account up to 1%	

Investment Summary **Existing and Prior Funds**

TCW Direct Lending ("TCW DL") was established in December 2000 as a part of Regiment Capital Management, LLC, an independent investment manager based in Boston, and was acquired by TCW in December 2012. TCW DL began managing its first fund in 2001, having raised five dedicated direct lending vehicles with approximately \$3.9 billion in total committed capital spread across a primarily institutional client base and a sixth fund. TCW Direct Lending LLC is in its current offering period, and as of Jan. 15, 2015 has approximately \$1.44 billion in committed capital. The group of 10 investment professionals is led by Richard Miller, who has 23 years of experience with a background in high yield research, leveraged finance, and M&A. The investment approach of TCW DL is to originate and invest in loans to middle market companies, focusing on principal preservation and absolute returns by investing in adjustable-rate, senior secured investment opportunities.

<u>Funds</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 6/30/2014</u>
Fund I	2001	Middle Market Lending	10.0% Net IRR, 1.14x Net TVPI, 1.14x Net DPI
Fund II	2002	Middle Market Lending	11.9% Net IRR, 1.14x Net TVPI, 1.14x Net DPI
Fund III**	2004	Middle Market Lending	6.0% Net IRR, 1.14x Net TVPI, 1.00x Net DPI
Fund IV	2008	Middle Market Lending	11.2% Net IRR, 1.15x Net TVPI, 1.15x Net DPI
Fund V**	2011	Middle Market Lending	7.3% Net IRR, 1.06x Net TVPI, 0.69x Net DPI

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

Vehicle Information:

Inception:	2015	Auditor:	Deloitte & Touche LLP
Fund Size (\$mil.):	TCW Direct Lending Fund VI: \$2.5 billion with a hard cap of \$3.0 billion	Legal Counsel:	Fried, Frank, Harris, Shriver & Jacobson LLP and Paul Hastings LLP
Management Fee:	TCW Direct Lending LLC: 1.50% on committed capital during the investment period, .75% thereafter TCW/NJ Separate Account: .50% on committed capital		
Carry:	TCW Direct Lending LLC: 20%		
	TCW/NJ Separate Account: 14%		
Preferred return:	TCW Direct Lending LLC: 9%		
Preferred return:	TCW/NJ Separate Account: 7%		

NJ AIP Program

Recommended Allocation (\$mil.):	TCW Direct Lending LLC up to \$150 million	LP Advisory Board Membership:	TBD
	TCW/NJ Separate Account up to \$150 million		Yes
% of Fund:	5% - 9.4% (TCW)/99% (Sep. Acct.)	Consultant Recommendation:	No
		Placement Agent:	N/A
		Compliance w/ Division Placement Agent Policy:	Yes
		Compliance w/ SIC Political Contribution Reg:	Yes

**This IRR is an estimated calculation based on the actual dates of cash inflows and outflows and assumes a final outflow equal to the common LPs NAV plus any fee income received but not yet recognized as 9/30/14.

*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.