



## State of New Jersey

DEPARTMENT OF THE TREASURY  
DIVISION OF INVESTMENT  
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June 23, 2014

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough  
Director

SUBJECT: **Proposed Additional Investment in Dyal NJ Investors, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an additional investment of up to \$250 million in Dyal NJ Investors, L.P. (the “Fund”), allocating up to \$200 million in Dyal Capital Partners II, L.P. and up to \$50 million in co-investment opportunities. The Division originally committed \$200 million to the Fund in August 2012. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-95.2.

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

**Attractive Overall Returns/High Cash Flows:** Investments are expected to provide steady and increasing cash flows from management fees supplemented by variable incentive fees earned by underlying funds. Overall, the investment is conservatively expected to earn low to mid-teen annualized returns with low volatility and significant upside potential.

**Attractive Strategy given Hedge Fund AUM Growth and Limited Competition:** Total Hedge Fund capital rose to \$2.73 trillion at the end of Q1 2014 with \$26.3 billion in net inflows during the quarter, according to Hedge Fund Research, Inc. Sellers are often motivated not only by financial but also strategic considerations. Partnering with Dyal and leveraging the Neuberger Berman platform provides Hedge Fund managers with strategic advice regarding growth and diversification of product mix, especially with the recent proliferation of popular 40 Act Funds in the marketplace. Traditional buyers of hedge fund businesses, such as banks, have largely exited the space. Dyal’s most direct competitor in the market is Blackstone, who is raising a larger fund to focus on larger firms.

**Ability to Leverage Neuberger Berman Platform:** Dyal's ability to leverage Neuberger’s platform to provide hedge funds with client introductions, consultant coverage, and other support services make them an attractive partner for hedge funds considering selling stakes in their firms. Testimony from many of the underlying hedge funds in Dyal Capital Partners I have attested to Dyal’s abilities.

**Experienced Investment Team:** Dedicated investment team of Michael Rees, Sean Ward, and Mark O’Sullivan worked together at Lehman Brothers and were instrumental in acquiring minority equity stakes in hedge funds such as D.E. Shaw & Co., GLG Partners, and Spinnaker Group. The group has successfully pursued the same strategy at Dyal.

**Attractive negotiated fee structure:** The Division's proposed investment carries the same very attractive fee structure as the Division's prior commitment, which includes a 0% management fee on uninvested capital, 1.25% management fee on invested capital during the 5-year investment period, and a 0.75% management fee on invested cost after the investment period, which steps down to 0% after the 10<sup>th</sup> year of the partnership. The investment carries a 20% performance fee subject to an 8% annualized preferred return. Proposed co-investments are subject to no fee and no carry.

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

Division Staff and its consultant, Cliffwater LLC, 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.

The Dyal NJ Investors, L.P. investment is authorized pursuant to Article 95 of the Council's regulations. The Fund will be considered an opportunistic investment, as defined under N.J.A.C. 17:16-95.1. The Divisions' existing investment in the Fund is currently classified as a Multi-Strategy hedge fund investment, but will be reclassified as an opportunistic investment.

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 June 9, 2014. 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 June 23, 2014 meeting.

Attachments

**Fund Name: Dyal NJ Investors, L.P.** **June 23, 2014**

**Contact Info:** Sean Ward, Dyal Capital Partners, 605 Third Ave, New York NY 10158

<b>Fund Details:</b>		
Total Firm Assets:	\$242 billion	<b>Key Investment Professionals:</b> <i>Michael Rees</i> , Managing Director and a Senior Principal of Dyal, was a founding employee and shareholder of Neuberger Berman Group, transitioning from Lehman Brothers as part of the management buyout transaction in May of 2009. Michael had numerous roles at Lehman Brothers and was responsible for strategic acquisitions for the Investment Management Division at Lehman Brothers. <i>Sean Ward</i> , Managing Director and Senior Principal of Dyal. Sean has held several roles at Neuberger Berman since it became an independent firm, including Senior Counsel for NB Alternatives. Prior to joining the firm, he was an attorney with Covington & Burling LLP. <i>Mark O'Sullivan</i> , Managing Director and Senior Principal of Dyal. Mark was previously a Senior Vice President in the Private Equity & Principal Investments group at LAMCO LLC.
Strategy:	Opportunistic	
Assets in Strategy(\$bil.):	\$2.5 billion	
Year Founded:	2010	
SEC Registration:	Yes	
GP Commitment:	1.00%	

Investment Summary	Performance as of 12/31/2013, as adjusted for March 2014 Distribution (in millions)		
Dyal Capital Partners is one of six businesses within the \$20 billion Neuberger Berman Alternatives platform. The dedicated investment team of Michael Rees, Sean Ward, and Mark O'Sullivan worked together at Lehman Brothers and were instrumental in acquiring minority equity stakes in hedge funds such as D.E. Shaw & Co., GLG Partners, and Spinnaker Group. The Division initially committed \$200 million to Dyal Capital Partners I through its existing structure, Dyal NJ Investors, L.P. Dyal will continue its successful strategy of purchasing minority stakes in established hedge fund managers (AUM of \$1.5 to \$5 billion) through Dyal Capital Partners II, which is targeting \$1.5 billion in aggregate commitments. Investments are expected to generate steady and rising cash flow from management fees supplemented by variable cash flow from incentive fees earned by underlying funds. Overall, the investment is conservatively expected to earn low to mid-teen annualized return with low volatility and significant upside potential. Through the Division's existing structure, up to \$200mm will be committed to Dyal II with an additional allocation of up to \$50mm for co-investments at the discretion of the Division.	Fund	Dyal NJ Investors	
		Vintage Year	2012
	(A)	Committed Capital	\$200.0
	(B)	Paid-In Capital	\$109.9
	(C)	Total Distributions	\$17.7
	(D)	Fair Value	\$113.9
	(C+D)	Total Value	\$131.6
	(C+D) / (B)	Total Value to Paid-In Capital	1.20x
		Net IRR	20%

**Vehicle Information:**

<b>Dyal NJ Investors Fund Inception:</b>	2012	<b>Subscriptions:</b>	Capital Calls
<b>Dyal NJ Investors Fund Size:</b>	\$453 million (pro forma commitments including additional \$250 million)	<b>Redemptions (notice):</b>	N/A
<b>Dyal Capital Partners II Fund Inception:</b>	2014	<b>Investment period:</b>	5 years
<b>Dyal Capital Partners II Fund Size:</b>	\$1.5 billion	<b>Administrator:</b>	Capital Analytics
<b>Management Fee:</b>	Fund: 0% on committed, 1.25% on invested capital during inv. period, 0.75% on invested thereafter, 0% after Year 10; 0% on co-investments	<b>Auditor:</b>	KPMG
<b>Profit Allocation:</b>	20% on Dyal II; 0% on co-investments	<b>Legal Counsel:</b>	Covington & Burling LLP (US); Walkers (Cayman)
<b>Hurdle Rate:</b>	8%		
<b>Additional Expenses:</b>	15-20 bps		

NJ AIP Program			
Recommended Allocation (\$mil):	additional \$250mm (Dyal II: \$200mm; co-investments: \$50mm)	LP Advisory Board Membership:	Yes
% of Dyal NJ Investors Fund:	55%	Consultant Recommendation:	Yes
% of Dyal Capital Partners II Fund:	13%	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.