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SHOAIB KHAN
Director

October 19, 2023

MEMORANDUM TO: The State Investment Council

FROM: Shoaib Khan
Director

SUBJECT: **Private Credit Investment – Separately Managed Account
Managed by Cerberus Business Finance and Potential Co-
Investment Vehicle Managed by Cerberus Business Finance**

The Division of Investment (the “Division”) is proposing an investment of up to \$225 million into a direct lending strategy managed by Cerberus Business Finance (“CBF”), the direct lending affiliate of Cerberus Capital Management, L.P. (“Cerberus” or the “Firm”), to be allocated as follows: (i) up to \$150 million into a Separately Managed Account (the “SMA” or “Fund”) and (ii) up to \$75 million into a potential co-investment vehicle or sleeve managed by CBF. 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:

Unique market opportunity. Over the past year, the Private Credit market conditions have moved in favor of lenders, and LPs are benefiting. Base rates have risen significantly as the Federal Reserve raised interest rates. Investment Banks have been sidelined, capital markets have been closed and banks are facing increased lending limits. Lack of bank capital has driven companies to the private market, and lenders are able to charge wider spreads and loan structures favor the lender.

Scale and origination capabilities. CBF’s lending business was founded in 1995 and it has completed over \$50 billion of loan commitments across over 1,100 loans since 2011. CBF originated and deployed \$4+ billion each year since 2016 and has scaled deployment in line with its AUM growth. In most instances, CBF will act as the lead agent on the transaction with meaningful control over structuring and negotiations and is able to generate additional income through syndications in certain instances. CBF’s scale and activity in the market has afforded it strong relationships with over 280 sponsors, most of which are repeat partners, attractive pricing, and improved diligence and monitoring insight. The team has been able to generate significant and consistent deal flow for its commingled funds and institutional SMA clients. Borrowers/sponsors may be more willing to borrow from CBF at a higher cost of capital in certain situations due to

CBF's scale and reputation in the market as a full senior capital solutions provider. The large existing portfolio should create many opportunities for follow-on investments.

Experienced and stable team. CBF has a highly experienced and tenured team, with average length of service at CBF of ~15 years (Senior MDs and MDs), that has been investing together over multiple credit cycles. The investment team includes seven Senior Managing Directors and 14 Managing Directors supported by a pool of mid-level and junior talent. Additionally, the team has remained stable over the past several years with a limited number of departures that CBF has been able to backfill through new hires and internal promotions. The team is also able to leverage the expertise of its operating advisors and global private equity platform in select instances.

Co-Investment Opportunities. CBF increasingly offers large financing packages to companies and are syndicated to other market participants. Based on the Division's long-term partnership with CBF, there is the potential opportunity for the Division to co-invest on a fee-free basis. This is a unique opportunity to increase our investment and lower fees.

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

Division Staff and its private credit consultant, Aksia 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 ("placement agent") in the fundraising of the Fund.

The Firm's environmental, social, and governance ("ESG") policy and related diligence disclosures were reviewed by the Division's Corporate Governance team in accordance with the Council's ESG Policy. CBF conducts ESG reviews by utilizing a proprietary ESG questionnaire that is sent to the prospective borrower and/or Private Equity sponsor. Oversight of ESG is the responsibility of the Cerberus ESG Committee (the "Committee"), which is composed of members of the Firm's senior management. The Committee is tasked with overseeing, in part, Cerberus' ESG performance, setting and overseeing ESG Policy and sub-policy, monitoring external ESG developments, overseeing ESG disclosures and communications, monitoring compliance with legal and regulatory requirements, and overseeing signatory status to any ESG-related frameworks.

Staff 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. A preliminary Disclosure Report of Political Contributions has been obtained in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4), and no political contributions have been disclosed. An updated Disclosure Report will be obtained at the time of closing.

Note that the investment is authorized pursuant to Articles 23 and 69 of the Council's regulations. The Fund is considered a private credit investment, 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 IPC was held on October 18, 2023. In addition to the formal written 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 October 25, 2023 meeting.

Attachment

Cerberus/NJ Separately Managed Account

- **DOI Commitment:** up to \$225 million (including up to \$75 million in co-investment opportunities)
- **Strategy:** Private Credit – Direct Lending
- **Investment Focus:** Primary focus on senior secured direct lending. The direct lending strategy will target sponsored, large and upper middle market companies primarily in North America.
- **Target Returns:** 10-12% net IRR
- **Investment Thesis:**
 - Over the past year, private credit market conditions have moved in favor of lenders, and LPs are benefiting. Base rates (SOFR/LIBOR) have risen significantly as the Federal Reserve raised interest rates. Lack of bank capital has driven companies to the private market, and lenders are able to charge wider spreads (+100-150 bps more) and loan structures favor the lender.
 - Cerberus Business Finance has a highly experienced and tenured team, with an average length of service at CBF of ~15 years (Senior MDs and MDs).
 - Cerberus Business Finance's lending team has completed over \$50 billion of loan commitments across over 1,100 transactions since 1995.
 - Dedicated and experienced workout team provides a competitive advantage over less-resourced peers, amid deteriorating economic conditions.

Fund Name: *Cerberus Business Finance Separately Managed Account and Potential Co-Investment Vehicle* **October 19, 2023**

Contact Info: *Cerberus Business Finance, 875 Third Avenue, New York, NY 10022*

Fund Details:

Total Firm Assets:	\$65 billion	Key Investment Professionals: Stephen Feinberg: Mr. Feinberg is the Co-Founder and Co-Chief Executive Officer of Cerberus Capital Management. He also founded or co-founded the other Cerberus affiliates and Cerberus Funds. Prior to founding Cerberus in 1992, Mr. Feinberg managed separate pools of capital for Gruntal & Co and certain other accounts from 1985 to 1992. Mr. Feinberg began his career at Drexel Burnham Lambert, where he was actively involved in trading large pools of firm capital. Daniel Wolf: Mr. Wolf is the Chief Executive Officer, Cerberus Business Finance, and Senior Managing Director, Cerberus Capital Management. Since Mr. Wolf joined Cerberus' lending platform in 1997, Cerberus Business Finance has become a recognized leader and innovator in the leveraged finance industry with one of the largest origination platforms in the United States. Prior to joining the firm, Mr. Wolf was Senior Vice President at Congress Financial Corporation within its business development group and was also a member of the company's Credit Committee, where he was active in loan origination. Mr. Wolf started his career at the Federal Reserve Bank of Boston. Keith Read: Mr. Read is the President, Cerberus Business Finance, and Senior Managing Director, Cerberus Capital Management. Prior to joining the firm in 2006, he was a Managing Director at CIBC World Markets from 1995 to 2005, where he was responsible for the distribution of structured finance products including CLOs and CBOs, mezzanine financings, leveraged finance, and direct fund raising. From 1993 to 1995, Mr. Read was an Executive Vice President at The Argosy Securities Group, a boutique high-yield advisory firm. Joseph Naccarato: Mr. Naccarato is the Chief Operating Officer and Chief Credit Officer, Cerberus Business Finance, and Senior Managing Director, Cerberus Capital Management. He joined Cerberus in 2000 and provides operational oversight for Cerberus Business Finance, which includes approximately 80 professionals across six offices in the United States. Additionally, in his role, he is responsible for overseeing the business' credit function and is active in the turnaround positions for the portfolio. Prior to joining Cerberus, Mr. Naccarato was a Vice President and Senior Credit Officer at Bank of America Commercial Funding, where he was responsible for managing all aspects of credit relating to a loan portfolio consisting of middle-market asset-backed credit facilities. At Bank of America, he was instrumental in establishing the middle-market asset-based lending division. Kevin McLeod: Mr. McLeod is Head of Fund Development, Cerberus Business Finance and Senior Managing Director, Cerberus Capital Management. He has been instrumental in establishing Cerberus Business Finance as a globally recognized market leader in U.S. middle-market lending. In his role, he manages the formation, structuring, development and marketing of the investing funds and fund leverage facilities. He also oversees Cerberus Business Finance's investor and lender relationships, ensuring a continued commitment to high standards for communication and reporting. Prior to his current role, he had various responsibilities at Cerberus Business Finance, including loan investment origination, underwriting, monitoring and capital markets activities. Prior to joining the firm in 2006, Mr. McLeod managed the leveraged finance origination and execution activities at CIBC Work Markets and separately, was a member of the investment Banking division of the Paine Webber Group. From 1986 to 1994, he worked as a mechanical and aerospace engineer for various organizations including the Pratt & Whitney Division of United Technologies.
Strategy:	Direct Lending	
Year Founded:	1992	
Headquarters:	New York	
GP Commitment:	\$1.5 million	

Investment Summary **Existing and Prior Funds**

Cerberus Business Finance ("CBF") Separately Managed Account (the "NJ SMA") and the potential co-investment vehicle, will follow the investment strategy of the Cerberus Loan Opportunities Funds, CBF's flagship middle-market senior direct lending platform with a 27 year track record. The platform has a consistent track record of low volatility performance across multiple credit cycles. The strategy primarily targets first lien, senior secured loans to middle and upper mid-market U.S. borrowers that are private equity owned. The portfolios will be well diversified across underlying borrowers as well as industry and sponsor mix. In some instances, CBF may also make opportunistic investments across its Loan Opportunities Strategy, which should provide flexibility to take advantage of market dislocations.

<u>Funds</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 3/31/2023</u>
<i>Commingled Funds</i>			
Cerberus Loan Opportunities I	2011	Direct Lending	9.8% Net IRR; 1.3X Net TPI
Cerberus Loan Opportunities II	2012	Direct Lending	5.9% Net IRR; 1.2X Net TPI
Cerberus Loan Opportunities III	2016	Direct Lending	8.9% Net IRR; 1.4X Net TPI
Cerberus Loan Opportunities IV	2019	Direct Lending	12.7% Net IRR; 1.2X Net TPI
SMA			
Cerberus NJ Loan Fund	2012	Direct Lending	9.0% Net IRR
Source of Commingled Funds Returns - Aksia. Source of NJ SMA Returns - CBF.			
IRR = Internal Rate of Return; TVPI = Total Value to Paid-In			

Vehicle Information:

Inception:	2023	Auditor:	PricewaterhouseCoopers LLP
Fund Size:	N/A	Legal Counsel:	Lowenstein Sandler LLP
Investment:	NJ SMA	Potential Co-investment Vehicle	
Management Fee:	0.80% on the greater of AUM or committed capital during the investment period and NAV thereafter	No Fee	
Incentive Fee:	12.375% with a 8.25% Preferred Return	No Incentive Fee	
Additional Expenses:	Partnership Expenses		

NJ AIP Program

Recommended Allocation (\$mil) SMA	up to \$150 million	LP Advisory Board Membership:	N/A
Recommended Allocation (\$mil) Potential Co-Investment Vehicle	up to \$75 million	Consultant Recommendation:	YES
		Placement Agent:	N/A
		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.