



## State of New Jersey

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*Director*

September 19, 2019

MEMORANDUM TO: The State Investment Council

FROM: Corey Amon  
Director

SUBJECT: **Proposed Investment in KPS Special Situations Fund V, L.P.  
and KPS Special Situations Mid-Cap Fund, L.P.**

The Division of Investment (the “Division”) is proposing a total investment of up to \$200 million (up to \$175 million and up to \$25 million, respectively) in KPS Special Situations Fund V, L.P. and KPS Special Situations Mid-Cap Fund, L.P. (the “Funds”). 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:

**Differentiated Investment Strategy with Demonstrated Long-Term Success Across Multiple Cycles:** KPS creates value through fundamental improvement in the business and operations of their portfolio companies, rather than relying on financial leverage or financial engineering to drive returns.

**Stable and Experienced Partnership: Accomplished and Long-Tenured Investment Team:** KPS has maintained continuity of its senior investment team that operates as a cohesive and effective unit. Michael Psaros and David Shapiro have worked together as a team for nearly 28 years, with Raquel Palmer for nearly 25 years, with Jay Bernstein for nearly 20 years, and with Ryan Baker and Kyle Mumford for over 10 years. From a bandwidth standpoint, KPS is industry leading in bandwidth metric for the Private Equity industry.

**Unique Approach with Labor Relations:** KPS has worked constructively with most of the major industrial and service unions in the United States, Canada and increasingly in Western Europe. KPS expects that many of their investments will involve meaningful participation from a company’s employees in the restructuring and turnaround process.

**Robust Deal Flows from Diversified Sources:** KPS has additional external sources of deal flow, including investment banks, the turnaround community, unions, large global corporations and restructuring firms that provide a consistent flow of compelling, highly differentiated and actionable investment opportunities in North America and Europe.

**Ability to Execute Complex Global Corporate-Carve Out Transactions:** Over 50% of KPS's investments involve creating new companies to acquire non-core assets or businesses divested by large global corporations in connection with highly complex carve-out transactions.

**Environmental, Social and Governance (ESG) Policy:** KPS integrates the firm's formal ESG policy into the investment and portfolio management process to achieve operational excellence, create value, and make businesses better. Primary responsibility for the integration of ESG considerations into the investment process lies with the KPS portfolio operations group; however, all KPS professionals are engaged in ESG management within their respective roles. KPS's approach to ESG within the investment process consists of pre-acquisition due diligence, oversight and implementation of improvement initiatives and reporting at portfolio companies, and integrating safety and environmental considerations throughout KPS' ownership and beyond.

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

Division Staff and its private equity consultant, TorreyCove Capital Partners, undertook extensive due diligence on the proposed investments in accordance with the Division's Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the Funds have engaged a third-party solicitor ("placement agent") in the fundraising of the Funds but no placement agent was engaged or paid in connection with the Pension Fund's potential investments.

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 investments. 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 investments are authorized pursuant to Articles 69 and 90 of the Council's regulations. KPS Special Situations Fund V, L.P. and KPS Special Situations Mid-Cap Fund, L.P. will both be considered private equity buyout investments, as defined under N.J.A.C. 17:16-90.1. Pursuant to N.J.A.C. 17:16-90.4(a)1, the aggregate market value of private equity investments shall not exceed 12% of the combined assets of all of the Pension and Annuity Funds. As of close of business on September 17, 2019, the aggregate market value of private equity investments is 11.27% of the combined assets of all the Pension and Annuity Funds excluding the Police and Fire Mortgage assets.

A formal written due diligence report for the proposed investments was sent to each member of the IPC and a meeting of the Committee was held on September 16, 2019. In addition to the formal written due diligence reports, all other information obtained by the Division on the investments was made available to the IPC.

We look forward to discussing the proposed investments at the Council's September 25, 2019 meeting.

Attachment

**Fund Name:** KPS Special Situations Fund V, L.P. and KPS Special Situations Mid-Cap Fund L.P.

September 19, 2019

**Contact Info:** Shavonne Johnson Correia, 485 Lexington Avenue, 31st Floor, New York, NY 10017

**Fund Details:**

<b>Firm AUM (\$bil):</b>	\$5.1 billion	<b>Key Investment Professionals:</b> <b>Michael Psaros</b> - (Co-Founder, Managing Partner) Prior to joining its predecessor in 1991 and creating KPS in 1997, Mr. Psaros was an investment banker with Bear Stearns. <b>David Shapiro</b> - (Co-Founder, Managing Partner) Prior to joining its predecessor in 1991 and creating KPS in 1997, Mr. Shapiro was an investment banker with Drexel Burnham Lambert and Dean Witter Reynolds. <b>Raquel Palmer</b> - (Managing Partner) Prior to joining its predecessor in 1994 and creating KPS in 1997, Ms. Palmer was an investment banker with Kidder, Peabody & Co. <b>Jay Bernstein</b> - (Partner) Prior to joining KPS in 1999, Mr. Bernstein was an investment banker at Schroders. <b>Kyle Mumford</b> - (Partner) Prior to joining KPS in 2008, Mr. Mumford was an analyst with UBS Investment Bank. <b>Ryan Baker</b> - (Partner) Prior to joining KPS in 2007, Mr. Baker was an associate at Paul, Weiss, Rifkind, Wharton & Garrison in their Mergers & Acquisitions Group.
<b>Strategy:</b>	Private Equity Buyouts	
<b>Year Founded:</b>	1997	
<b>Headquarters:</b>	New York, NY	
<b>GP Commitment:</b>	2%	

Investment Summary	Existing and Prior Funds			
<p>KPS Special Situations Fund V will execute the same strategy implemented in the prior fund, targeting control-oriented opportunities generally in manufacturing and industrial companies. Specifically, KPS focuses on companies that manufacture a diverse array of products in a broad number of industries, including basic materials, branded consumer, healthcare and luxury products, automotive parts, capital equipment, and general manufacturing. Broadly speaking, KPS Special Situations Mid-Cap Fund will execute the same investment strategy pursued by the flagship funds, targeting control-oriented opportunities in companies based in North America and Europe within the industrials sector. That said, the Fund will seek out deals in the lower middle market that are deemed too small for the flagship platform. The Mid-Cap Fund will take a similar form to the earlier flagship funds and will focus on companies with a manufacturing focus that operate within the basic materials, branded consumer, healthcare and luxury products, automotive parts, capital equipment, and general manufacturing industries.</p>	<i>Funds</i>	<i>Vintage Year</i>	<i>Strategy</i>	<i>Returns as of 6/30/2019</i>
	Fund I	1999	Buyout	14.3% Net IRR, 1.64x Net TVPI, 1.64x Net DPI
	Fund II	2003	Buyout	56.1% Net IRR, 3.40x Net TVPI, 3.40x Net DPI
	Fund III	2007	Buyout	23.5% Net IRR, 2.39x Net TVPI, 2.16x Net DPI
	Fund IIIS	2009	Buyout	23.1% Net IRR, 2.27x Net TVPI, 1.96x Net DPI
	Fund IV	2014	Buyout	19.7% Net IRR, 1.28x Net TVPI, 0.38x Net DPI
*Data provided by KPS Capital Partners				
IRR = Internal Rate of Return; TVPI= Total Value to Paid-In Capital; DPI= Distributions to Paid-In				

**Vehicle Information:**

<b>Inception:</b>	2019	<b>Auditor:</b>	Ernst & Young LLP
<b>Fund Size:</b>	KPS V: \$5 billion (\$6 billion hard-cap); KPS Mid-Cap: \$750 million (\$1 billion hard-cap)	<b>Legal Counsel:</b>	Kirkland & Ellis LLP
<b>Management Fee:</b>	1.25%		
<b>Carry:</b>	30%		
<b>Hurdle Rate:</b>	8%		
<b>Additional Expenses:</b>	100% monitoring fee offset (80% of net transaction fees)		

NJ AIP Program			
<b>Recommended Allocation:</b>	Up to 200 million pro-rata (up to \$175 million in KPS V and up to \$25 million in KPS Mid-Cap)	<b>LP Advisory Board Membership:</b>	Yes
<b>% of Fund:</b>	KPS V: 3.5%; KPS Mid-Cap: 3.3%	<b>Consultant Recommendation:</b>	Yes
		<b>Placement Agent:</b>	No
		<b>Compliance w/ Division Placement Agent Policy:</b>	N/A
		<b>Compliance w/ SIC Political Contribution Reg:</b>	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.