



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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State Treasurer

May 28, 2014

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in MHR Institutional Partners IV, L.P.**

The New Jersey Division of Investment ("Division") is proposing an investment of \$100 million in MHR Institutional Partners IV, L.P (the "Fund" or "Fund IV"). 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:

History of top-quartile performance with a strong record of downside protection: MHR Fund Management LLC ("MHR" or the "Firm") is a top-quartile manager, as its three previous funds have all ranked in or near the top quartile in terms of a Net Internal Rate of Return ("IRR"), Net Total Value to Paid-In and Net Distributions to Paid-In ("DPI") basis. As of 2/28/14, the Division's \$75 million commitment to MHR III realized a DPI ratio of 0.76 and a total value multiple of 1.54, resulting in a 10.99% IRR. MHR's prior funds have 44 materially realized investments, of which only four realized a loss, which in aggregate represents approximately 1.0% of the total realized material investments of approximately \$3.9 billion.

Focused Investment Strategy with proven record of value creation: MHR employs a differentiated approach to distress for control investing, enabling the Firm to consistently generate strong returns independent of the default rate environment for over 17 years. Utilizing a hands-on private equity approach to investing in distressed middle-market companies, the Firm has successfully leveraged its control or significant influence to work collaboratively with its portfolio companies, creating long-term value both during and after the turnaround process by improving operations, growing companies and effectuating successful exits.

Increased exposure to compelling opportunity set: MHR is currently evaluating over \$1 billion of potential investment opportunities, believing that the current market environment, characterized by global economic uncertainty, high levels of lower rated debt outstanding and escalating maturities, will augment the current pipeline with additional debt-for-control investments for Fund IV. MHR's investment thesis is highlighted by investors, rather than defensively focusing on protecting capital, becoming more desperate for yield. High yield and investment grade spreads continue to compress, the proliferation of dividend recap deals is ongoing, covenant lite structures are back and the increased proportional issuance of bonds rated

CCC and lower is increasingly evident. Additionally, according to the Bank of America/Merrill Lynch HY Index, the average yield on high yield bonds is 6% versus the ten year average of 9%, while leverage has risen to 5.0x versus 4.1x a year ago.

Complementary exposure to existing portfolio: MHR's niche investment strategy of focusing on distressed for control in the mid-market space provides a strong complement to the Division's existing investments in debt-related Private Equity.

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.

The Fund utilized UBS Securities LLC (the "placement agent") as third-party solicitor in connection with the potential investment. Staff has determined that the placement agent and its representatives met the registration, licensing and experience requirements set forth in the Division's Placement Agent Policy (the "Policy"). Pursuant to the Policy, the Fund has disclosed the contract between the fund and the placement agent, specifying the scope of services to be performed by the placement agent and the fee arrangement between the placement agent, the general partner and any other third party.

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. In addition, the proposed investment must comply with the Council's regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that the investment is authorized pursuant to Articles 69 and 90 of the Council's regulations. The MHR Institutional Partners IV, L.P. will be considered a debt-related private equity 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 May 14, 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 May 28, 2014 meeting.

Attachments

Fund Name: MHR Institutional Partners IV, L.P.

May 28, 2014

Contact Info: Kallie Steffes, 40 West 57th Street, 25th Fl., New York, NY 10019

Fund Details:

Total Firm Assets:	\$5 billion	Key Investment Professionals: Mark H. Rachesky, M.D. , President, Dr. Rachesky founded MHR Fund Management LLC in 1996 and is the President of the General Partner. Dr. Rachesky has been a hands-on investor in distressed companies for more than 20 years, with a focus on creating long-term value, often through his participation on Boards of Directors and Creditors' Committees. Prior to founding MHR in 1996, Dr. Rachesky was the sole Managing Director of Icahn Holdings Corporation and, in that capacity, acted as Carl C. Icahn's chief investment advisor. Dr. Rachesky currently serves as Chairman of the Boards of Telesat Canada, Loral Space and Communications Inc. and Lions Gate Entertainment Corp. Mark H. Rosenberg , Principal and Chief Operating Officer, Mr. Rosenberg joined MHR Fund Management LLC in 2002 and is a member of the investment team. In addition, he is responsible for all organizational aspects of the Firm. Mr. Rosenberg serves on the board of directors of Northern Offshore, Ltd. and Key Energy Services, Inc. From 2000 to 2002, Mr. Rosenberg was a Vice President at CRT Capital Group LLC, focusing on distressed debt research and analysis.
Strategy:	Distressed Debt Private Equity	
Year Founded:	1996	
Headquarters:	New York, NY	
GP Commitment:	2.0%	

Investment Summary

The Division is proposing an investment of \$100 million in MHR Institutional Partners IV LP, a top-quartile distressed debt fund targeting \$2.75 billion in aggregate commitments that will be primarily focused on the North American market. The Division has an existing relationship with MHR Fund Management LLC ("MHR" or the "Firm"), having previously committed \$75 million to MHR III (2007). MHR employs a differentiated approach to distressed for control investing, enabling the Firm to consistently generate strong returns independent of the default rate environment for over 17 years. Utilizing a hands-on private equity approach to investing in distressed, middle-market companies, the Firm has successfully leveraged its control or significant influence to work collaboratively with its portfolio companies, creating long-term value both during and after the turnaround process by improving operations, growing companies and effectuating successful exits.

Performance of Existing and Prior Funds (As of 12/31/2013)

<i>Funds</i>	<i>Vintage Year</i>	<i>Net IRR</i>	<i>Net TVPI</i>
MHR I	1998	14.50%	2.77x
MHR II	2003	14.30%	2.00x
MHR III	2007	11.10%	1.55x

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

Vehicle Information:

Inception:	2014	Auditor:	Rothstein Kass & Co.
Fund Size (\$mil.):	\$2.75 bil target; \$3.5 bil hard cap	Legal Counsel:	Akin Gump Strauss Hauer & Feld LLP
Management Fee:	1.75% on committed; 1.75% on invested	Placement Agent:	UBS Securities LLC
Carry:	20%		
Hurdle Rate:	8%		
Additional Expenses:	100% fee offset		

NJ AIP Program

Recommended Allocation (\$mil):	\$100,000,000	LP Advisory Board Membership:	Yes
% of Fund:	4%	Consultant Recommendation:	Yes
		Placement Agent:	Yes
		Compliance w/ Division Placement Agent Policy:	Yes
		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.