



State of New Jersey

CHRIS CHRISTIE
Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290
Telephone (609) 292-5106
Facsimile (609) 984-4425

FORD M. SCUDDER
State Treasurer

KIM GUADAGNO
Lt. Governor

CHRIS MCDONOUGH
Director

March 24, 2017

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Neuberger Berman New Jersey Custom Fund III, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$200 million to Neuberger Berman New Jersey Custom Fund III, L.P. (“NB/NJ Custom Fund III”) managed by the Neuberger Berman Private Equity Team (“the Team”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

NB/NJ Custom Fund III will continue the Division’s successful relationship with Neuberger Berman Private Equity, which has dated back to 2007. The Fund will invest opportunistically across sectors and private equity disciplines, including buyout, growth and special situations, all on a global basis.

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

Strong Co-investment Track Record: The NB/NJ Custom Fund II (2012) portfolio has delivered top-quartile performance compared to the Cambridge Associates All PE Index as of September 30, 2016, generating a net 44.1% Internal Rate of Return (“IRR”) and a net 2.0x Multiple on Invested Capital (“MOIC”). In aggregate, the NB/NJ Custom Funds co-investments have generated a gross 2.3x MOIC.

Deep and Experienced Private Equity and Co-investment Platform: Since 2009, the Team has invested \$3.1 billion of capital in 151 co-investments generating gross realized returns of 44.5% IRR and 2.5x MOIC. Neuberger Berman Private Equity has a large, deep and experienced team of 115 professionals, many of whom focus on equity co-investments. The Team has invested in over 400 GPs, historically, and during 2016, they invested over \$1.3 billion in 43 co-investments across the Large Cap, Small/Mid Cap, Special Situations and VC/Growth strategies.

Continued Co-Investment Capability: The co-investment program allows for the Division to continue to lower its overall costs as typical PE co-investments are no fee and no carry and the overall fee structure with Neuberger Berman is well below market terms for a typical PE Fund. Additionally, the due diligence of co-investment opportunities alongside Neuberger Berman provides the staff with greater transparency of the underlying GPs, providing the Division with valuable insight when considering investing in a given GP's commingled fund. Furthermore, the account allows the Division to be relevant with existing and prospective partners as they may need extra capital from time to time to execute certain transactions and would rather syndicate to a friendly partner than a competitor fund.

Control of Capital Deployment: Unlike the typical private equity fund, New Jersey's veto right on this account will allow the Division to control the pacing of the Fund and where capital is deployed, ensuring discipline in the current environment of high purchase multiples and geopolitical uncertainty.

Ability to Leverage Resources: The Division's relationship with Neuberger Berman has been extremely productive over time with the Division leveraging Neuberger Berman's resources to help with underwriting, sharing notes on new investments and opportunities, providing research and training sessions for team members, providing helpful analysis when requested across the portfolio and generally providing advice when appropriate.

Attractive Terms: The fees and structure of NB/NJ Custom Fund III have improved from the prior programs, with reduced management fees and carry, while maintaining the Division's veto right on all proposed transactions.

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

Division Staff and its private equity consultant, TorreyCove Capital Partners, 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 69 and 90 of the Council's regulations. Neuberger Berman New Jersey Custom Fund III, L.P. will be considered a private equity buy-out 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 March 15, 2017. 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 March 29, 2017 meeting.

Attachments

Fund Name: Neuberger Berman New Jersey Custom Fund III, L.P.

March 24, 2017

Contact Info: Jonathan Shofet, 1290 Avenue of the Americas, New York, NY 10104

Fund Details:

Firm AUM:	\$255.0 billion as of December 31, 2016	<p>Key Investment Professionals:</p> <p>Anthony Tutrone: Managing Director, Investment Committee Member and Global Head of NB Alternatives. Prior to Neuberger Berman, from 1994-2001, Mr. Tutrone was a managing director and founding member of the Cypress Group. Prior to the Cypress Group, Mr. Tutrone began his career at Lehman Brothers in 1986, starting in Investment Banking and in 1987 becoming one of the original members of the firm's Merchant Banking Group. Mr. Tutrone is a member of Neuberger Berman's Partnership and Operating Committees. He earned an MBA from Harvard Business School and a BA in Economics from Columbia University.</p> <p>Jonathan Shofet: Managing Director, Investment Committee Member and Program Manager for the NB/NJ Custom Fund investment programs. Prior to joining Neuberger Berman Private Equity in 2005, Mr. Shofet was a member of the Lehman Brothers Private Equity Group for five years, focusing on direct equity investments. Prior to that, Mr. Shofet worked in investment banking for three years. Mr. Shofet is on the Advisory Board of several private equity funds and is a Board Observer for several private equity backed companies. Mr. Shofet holds a BA from Binghamton University where he graduated summa cum laude, Phi Beta Kappa.</p> <p>David Stonberg: Managing Director, Investment Committee Member and Global Co-Head of Private Equity Co-Investments. Before joining Neuberger Berman in 2002, Mr. Stonberg held several positions within Lehman Brothers' Investment Banking Division including providing traditional corporate and advisory services to clients as well as leading internal strategic and organizational initiatives for Lehman Brothers. Mr. Stonberg began his career in the Mergers and Acquisitions Group at Lazard Frères. Mr. Stonberg holds an M.B.A. from the Stern School of New York University and a BSE from the Wharton School of the University of Pennsylvania.</p>
Strategy:	Buyout	
Year Founded:	1939	
Headquarters:	New York	
GP Commitment:	1%	

Investment Summary Existing and Prior Funds

Established in 1939, Neuberger Berman is an employee-owned investment manager providing global investment solutions. As of December 31, 2016, the Firm had assets under management of \$255 billion, approximately 1,915 employees including approximately 525 investment professionals and presence in 19 countries worldwide. Neuberger Berman manages \$45 billion in private equity, of which over \$8 billion is in equity co-investments. Neuberger Berman has a team of over 115 investment professionals focused on private equity. NB/NJ Fund III will invest up to \$200 million, primarily in equity co-investments in the buyout, growth equity and special situations asset classes on a global basis. The co-investment size ranges per investment are expected to be between \$5 million to \$15 million.

Funds	Vintage Year	Strategy	Returns as of 9/30/2016
NBNJ Fund I	2007	Buyout	10.9% Net IRR, 1.67x Net MOIC, 0.82x DPI
NBNJ Fund II	2012	Buyout	44.1% Net IRR, 2.02x Net MOIC, 0.94x DPI

IRR = Internal Rate of Return; MOIC = Multiple on Invested Capital; DPI= Distributions to Paid-In

Vehicle Information:

Inception:	2017	Auditor:	KPMG
Fund Size:	\$200 million LP Commitment	Legal Counsel:	Haynes and Boone, LLP
Management Fee:	0.5% on actively invested capital of unrealized co-investments and 0.10% on committed capital for fund commitments during the investment period; thereafter, 0.3% on actively invested capital of unrealized co-investments and no fee on committed capital for fund investments.		
Carry:	10% carried interest subject to 8% preferred return; 15% carried interest subject to 15% preferred return; no carried interest on fund investments		
Hurdle Rate:	see above		
Additional Expenses:	100% fee offset		

NJ AIP Program			
Recommended Allocation:	Up to \$200 million	LP Advisory Board Membership:	N/A
% of Fund:	99.00%	Consultant Recommendation:	YES
		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.