



## State of New Jersey

DEPARTMENT OF THE TREASURY  
DIVISION OF INVESTMENT  
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*Lt. Governor*

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*Acting State Treasurer*

November 13, 2015

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough  
Director

SUBJECT: **Proposed Additional Investment in Knight TAO, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an additional investment of up to \$300 million to its separate account, Knight TAO, L.P. (“TAO”). In October 2014, the Division committed \$400 million to TAO. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

TPG Special Situation Partners (“TSSP”) is the dedicated credit platform of TPG Capital (“TPG”), and has four product lines: the mid-market loan origination platforms in the US and Europe (“TSLX” and “TSLE”), the special situations and distressed credit strategy (“TOP”), the broadly syndicated leveraged loan strategy (“TICP”), and a product that invests in overage from certain of the above Funds and in attractive risk-adjusted opportunities that fall outside the above mandates (“TAO”). The Division’s proposed additional investment in TAO expects to be allocated across three core components: (i) adjacent opportunities (attractive risk-adjusted reward transactions that do not fit the mandate of TSSP’s direct lending or special situations funds, including non-control opportunities, high return but low multiple of money/shorter duration situations, and selected longer duration opportunities with minimal macroeconomic correlations), (ii) direct lending co-investments alongside TSLX and TSLE (top of the capital structure, secured, floating-rate investments), and (iii) special situations co-investments alongside the TOP Funds (focus on control-oriented investments in distressed companies or the acquisition of non- or sub-performing loans or related businesses).

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

**Broad capability set and investment mandate:** The Fund’s ability to migrate across the capital structure, asset classes and geographies allows it to pursue opportunities during all parts of the credit cycle and generate returns that are not dependent on a high corporate default rate environment. Currently, the team believes the economy is in the later stages of a business cycle and has the following portfolio construction biases: mid-market focus, non-macro correlated situations, complex and niche themes, and emphasizing return of capital over higher return. To that end, some current themes include: highly structured medical royalty transactions, taking advantage

of a changing regulatory environment in the Euro renewable energy sector, highly fragmented and yield producing agriculture, Italian long-lease commercial real estate, asset backed lending opportunities in the energy sector, and US asset transactions from the Federal Deposit Insurance Corporation (“FDIC”).

**Established team:** TAO is led by Alan Waxman, a former Goldman Sachs partner who ran Goldman Sachs’ Americas Special Situations Group (“AmSSG”), an on-balance sheet proprietary investment platform. Six of the nine other TSSP partners worked with Mr. Waxman in AmSSG or one of its predecessor business units at Goldman Sachs. The senior leadership has generated consistent returns across various phases of the credit and economic cycles and has committed \$8.7 billion of capital since inception in May 2009.

**Sourcing capabilities/differentiated deal flow:** In addition to traditional sourcing relationships with sell-side trading desks, restructuring advisors and investment banks, TSSP has built an organized sourcing infrastructure as a standalone business unit. Within the TSSP platform, there are 21 investment professionals whose primary function is to originate investment opportunities. TSSP maintains a regular direct calling effort on over 300 commercial banks in the US and over 50 international banks as well as financial sponsors and their portfolio companies. TSSP has also developed 19 strategic relationships to source and service non-performing or stressed loans and various other asset classes. Finally, as the integrated special situations group within TPG, TSSP is directed relevant deal flow from TPG’s 18 global offices and 260 investment professionals.

**Consistent out-performance in related strategies:** The existing TAO portfolio well outperforms a public market proxy, the Credit Suisse High Yield Index. The team has also generated top quartile returns in the related special situations and direct lending strategies.

**Attractive terms:** The Division has negotiated attractive terms of a 1% management fee on invested capital, a 15% performance fee and a 6% hurdle rate.

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

Division Staff and its 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 23 and 69 of the Council's regulations. Knight TAO, L.P. will be considered a global diversified 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 Committee was held on November 10, 2015. 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 November 18, 2015 meeting.

Attachments

**Fund Name:** Knight TAO, L.P.

November 13, 2015

**Contact Info:** Brian D'Arcy, 345 California Street, Suite 3300, San Francisco, 94104

**Fund Details:**

<b>Total Firm Assets:</b>	\$75 billion	<b>Key Investment Professionals:</b> <b>Alan Waxman</b> – Managing Partner and Chief Investment Officer of TSSP, and a TPG Partner and member of TPG’s Executive Committee. Prior to joining TPG, he was a Partner at Goldman Sachs. During his career at Goldman Sachs, he co-headed AmSSG, which invested Goldman Sachs’ capital in both the public markets and private transactions in distressed and special situations. <b>Joshua Easterly</b> – TPG Partner and Partner Managing Director of TSSP. Based in New York, Mr. Easterly is also the Co-Chief Investment Officer of TSL Advisers, LLC, the investment adviser for TSL. Mr. Easterly serves as the Chairman of TSL’s Board of Directors. Prior to joining TSSP, Mr. Easterly was a Managing Director at Goldman Sachs, where he worked in AmSSG with Alan Waxman and most recently held the position of AmSSG’s Chief Investment Officer. <b>Clint Kollar</b> - TPG Partner and Partner Managing Director of TSSP. Mr. Kollar is responsible for TSSP’s investment sourcing initiatives. Prior to joining TSSP, Mr. Kollar was the Head Trader for Greywolf Capital for five years. <b>Vijay Mohan</b> - TPG Partners and Partner Managing Director of TSSP. Mr. Mohan focuses on Coporate Special Situations. Prior to joining TSSP, Mr. Mohan was a Managing Principal at Halcyon Asset Management. <b>Michael Muscolino</b> - Partner Managing Director of TSSP. Mr. Muscolino is based in London focusing on Asset Special Situations. Prior to joining TSSP, Mr. Muscolino was a Principal at FG Companies.
<b>Strategy:</b>	Global Diversified Credit	
<b>Year Founded:</b>	1992	
<b>Headquarters:</b>	San Francisco, CA	
<b>GP Commitment:</b>	1%	

**Investment Summary** **Existing and Prior Funds**

TPG Special Situation Partners (“TSSP”) is the private credit arm of TPG Capital (“TPG”), and has four product lines: the mid-market loan origination platforms in the US and Europe (“TSLX” and “TSLE”), the special situations and distressed credit strategy (“TOP”), the broadly syndicated leveraged loan strategy (“TICP”), and a product that invests in coverage from the above Funds and in attractive risk-adjusted opportunities that fall outside the above mandates (“TAO”). The Division’s proposed additional investment in TAO expects to be allocated across three core components: (i) adjacent opportunities (attractive risk-adjusted reward transactions that do not fit the mandate of TSSP’s direct lending or special situations funds, including non-control opportunities, high return but low multiple of money/shorter duration situations, and selected longer duration opportunities with minimal macroeconomic correlations), (ii) direct lending co-investments alongside TSLX and TSLE (top of the capital structure, secured, floating-rate investments), and (iii) special situations co-investments alongside the TOP Funds (focus on control-oriented investments in distressed companies or the acquisition of non- or sub-performing loans or related businesses).

Funds	Vintage Year	Strategy	Returns as of June 30, 2015*
TAO 1.0	2012	Debt Related	19.0% Net IRR, 1.41x Net TVPI
TAO 2.0	2014	Debt Related	16.4% Net IRR, 1.06x Net TVPI

\*Returns as provided by TSSP  
IRR = Internal Rate of Return ; TVPI = Total Value to Paid-In

**Vehicle Information:**

<b>Inception:</b>	2014
<b>Separate Account size:</b>	\$711 million
<b>Management Fee:</b>	1% on invested
<b>Carry:</b>	15%
<b>Hurdle Rate:</b>	6%
<b>Additional Expenses:</b>	100% Fee offset

<b>Auditor:</b>	<b>KPMG LLP</b>
<b>Legal Counsel:</b>	<b>Cleary, Gottlieb, Steen &amp; Hamilton LLP</b>

**NJ AIP Program**

<b>Recommended Additional Allocation:</b>	\$300 million add-on	<b>LP Advisory Board Membership:</b>	Yes
<b>% of Fund:</b>	99%	<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.