State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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May 12, 2006

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Private Equity Investments in Lindsay Goldberg & Bessemer II, Lexington Capital Partners VI and Partners Group Secondary 2006**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.12 (a) to report on three proposed private equity investments: a $100 million commitment to Lindsay Goldberg & Bessemer II, a $50 million commitment to Lexington Capital Partners VI, and a $50 million commitment to Partners Group Secondary 2006.

Please note that these investments will be authorized pursuant to Articles 69 and 90 of the Council's regulations which became effective on June 20, 2005. All three investments will be considered to be "Buyout Investments" as defined under N.J.A.C. 17:16-90.2 (a).

The Alternative Investments Procedures adopted by the Council on January 20, 2005 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (myself in an acting capacity) and the applicable Asset Class Consultant (Strategic Investment Solutions for private equity, or "SIS") in coordination with the DOI Investment Committee (Ike Michaels acting as Deputy Director and myself).

As a result of internal and external sourcing, the DOI Investment Committee identified these proposed investments. As a result, SIS and Division staff proceeded to undertake extensive due diligence on these three proposed investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Based on this due diligence, the Division has determined that each of the proposed investments meets the criteria for investments set forth in the Alternative Investment Procedures.

The investments that we are proposing focus on middle market buyouts (Lindsay Goldberg & Bessemer II) and secondary market buyout funds (Lexington Capital Partners VI and Partners Group Secondary 2006).

The general partner for Lindsay Goldberg & Bessemer II has assembled an excellent investment track record that demonstrates their ability to cultivate proprietary deal sources, convert them into well-priced investments, execute active growth strategies to create significant value post-investment, and adhere to a disciplined investment process. The general partner will be investing a significant amount in the Fund, ensuring that the limited partners' interests are aligned with those of the general partner. The management fees are reasonable, and all the legal and economic terms associated with the partnership are fair and consistent with market standards.

Before describing the remaining two investments, let me provide some background information on secondary funds since this represents our initial investment in this segment of the private equity market. Secondary investments (or secondaries) are investments in existing private equity interests previously owned by other limited partners. Over the past decade, the secondary market has grown rapidly and now provides liquidity options for owners of private equity interests and attractive opportunities for secondary investors. When compared to primary private equity investments, secondary investments generally offer reduced holding periods, accelerated distributions and the ability to quickly diversify the segment and vintage year exposure of a private equity portfolio. Given that we only recently initiated our private equity program, we believe that this added diversification will benefit the portfolio.

Lexington Capital Partners VI will focus on assembling a diversified global portfolio comprised of private equity fund interests with the expectation of achieving superior returns at a well-diversified level of risk, while generating cash distributions beginning in the Partnership's first year. The general partner has produced attractive investment returns utilizing this strategy since 1990. These returns have been achieved through varying economic cycles and are the result of Lexington's disciplined and tested investment process. Again, we believe the management fees are reasonable, and all other legal and economic terms associated with the partnership are fair and consistent with market standards.

Partners Group Secondary 2006 will seek to capitalize on Partners Group's extensive resources to source and execute attractive secondary investments on a global basis. The general partner's strategy is to acquire secondary investments at an attractive discount to their intrinsic value. Accordingly, Partners Group seeks (1) to invest in high-quality funds and managers based on an accurate assessment of intrinsic value, and (2) to obtain favorable deal flow and purchase prices through an edge in sourcing, structuring and closing transactions. Through the disciplined execution of this strategy, Partners Group has built a highly successful track record. We believe the management fees are reasonable, and all other legal and economic terms are fair and consistent with market standards.

A formal written due diligence report for each of the proposed investments was sent to each member of the Investment Policy Committee of the Council on May 5, 2006, and a meeting of the Committee was held on May 10, 2006. In addition to the formal written due diligence reports, all other information obtained by the Division on these investments was made available to the Investment Policy Committee.

After review of the extensive due diligence, the Investment Policy Committee of the Council decided to report on these proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures. Under these procedures, the Council may adopt or otherwise act on this report.

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 each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution will not be reached with one or the other of these general partners.

We look forward to discussing these proposed private equity investments at the Council's May 18, 2006 meeting.

WGC:cae
Attachments

*SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: May 18, 2006
Subject: Lexington Capital Partners VI Recommendation

Fund Facts

Fund Name:	Lexington Capital Partners VI
Fund Type:	Secondaries / Private Equity
Current Fund Size:	$3.0 billion
Previous Fund Size/Vintage:	$2.0 billion / 2001
Final Close:	June-06
Fund Address:	660 Lexington Avenue New York, NY 10021

GP Contact Info

Name:	Wilson Warren, Partner
Telephone:	212-754-0411
Email:	wswarren@lexpartners.com

Summary of Terms and Investment Strategy

Investment Strategy:	Assemble, hold and realize a diversified portfolio of interests in established buyout, mezzanine and venture capital funds, primarily through secondary transactions.
Geographic Focus:	Predominantly U.S.
GP Co-Investment Amount:	1% of contributed capital
Terms:	
Investment Period:	5 years from the final Closing
Term:	Ten years from the Initial Closing; subject to two one-year extensions unless a majority in interest of investors objects
Management Fee:	1.00% of committed capital during investment period, dropping to 0.85% on Reported Value thereafter
Offset / Other Fees:	The Fee Offset Amounts will reduce the Investment Advisory Fee on a dollar for dollar basis.
Hurdle Rate:	n/a

NJ AIP Program:

Recommended Allocation:	$50 million
% of Fund:	1.67%
% of New Jersey State Pension Plan:	0.07%
% of AIP Private Equity Allocation ($3.5b):	1.43%
% of Buyout Allocation for FY06 ($1.75b):	2.86%

LP Advisory Board Membership:	To be determined
Consultant Recommendation:	Yes
Compliance with SIC "Pay to Play" Reg:	Side letter required

*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.