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May 18, 2018

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Vista Equity Partners Fund VII, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$300 million in Vista Equity Partners Fund VII, L.P. (the “Fund”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

The Fund is the seventh generation fund of the Vista Equity Flagship platform. The Fund presents an attractive opportunity to expand the Division’s relationship with Vista, one of the top-performing relationships in the Division’s Private Equity Portfolio. The Division has been a long-term investor in the Flagship funds, having committed to each of their past four funds.

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

Compelling Market Opportunity: Vista is solely focused on the enterprise software sector, whose technology spans across many major industries from healthcare to real estate to financial services. The sector is typically characterized as being stable with a secure revenue stream and has been one of the key drivers behind efficiency gains and innovation for large and small businesses over the last 20 years. The stability of the sector is exemplified with steady cash flow and relatively high profit margins, which can make it an excellent source of potential investments. Companies in the sector often provide mission-critical software solutions to customers, have high switching costs, and have high recurring revenue providing a secure revenue stream. The software industry in general is attractive economically because of low fixed costs with declining marginal costs due to the one-time expense of developing the software followed by mass reproduction and distribution, resulting in high free cash flow conversion rates.

Strong track record: The Vista private equity platform has a history of outperformance, with all of the Funds II-IV being ranked in or near the top quartile in terms of net Internal Rate of Return and net Total Value to Paid-In when compared against the North American buyout funds in the Cambridge Index. In addition, Vista has an extremely low loss ratio of 0.2% over the last six Flagship funds and has a 0% loss ratio since inception on fully realized control transactions.

Funds V and VI are relatively young, with most of its portfolio companies still held at cost. However, the underlying performance metrics of those companies continue to impress. Since inception, the Vista Equity flagship funds have distributed \$573 million to the Division with a projected additional \$814 million of distributions over the three-year period of 2018 to 2020.

Experienced and Stable Team: The strength of the team and culture is reflected in the two decade tenure of the senior management team as well as the exceptionally low investment professional turnover since its inception. The Vista team has deployed over \$22 billion in equity across their Flagship, Foundation and Endeavor funds in 75 platform and 164 add-on investments. Of the 75 platform investments, Vista has successfully realized, either fully or partially, 28 of these platform investments

Operational Value-Add: The Vista Consulting Group (“VCG”) team was started in 2006 to work in conjunction with the Vista investment professionals and portfolio company management to help current and newly acquired businesses strengthen their operations through the implementation of standardized, repeatable and proven processes and methodologies known as the Vista Best Practices. The creation of VCG was to centralize the delivery of the Vista Best Practices and have a dedicated team, which now numbers greater than 100 members, that provides direct oversight across all portfolios. In addition, these Vista Best Practices are continually developed and improved upon as portfolio companies that have been through the Vista Best Practices implementation provide feedback on lessons learned. These operating procedures have materially improved sales prospects over ~15x, customer satisfaction from 86% to 90%, R&D throughput by 2-3x on average and price increases of up to ~3% annual revenue sweeps at Vista portfolio companies. Vista portfolio company CEOs that have gone through the process have all expressed the value-add VCG brings, which is evident in the growth of revenues and recurring revenues from the initial investment through present day. Across the portfolio, Vista has a strong and growing stable of Vista-trained executives, and has successfully redeployed over 100 managers who are all experienced in driving the Vista Best Practices into two or more Vista companies, thus providing additional scalability and the ability to realize value quickly.

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. Vista Equity Partners Fund VII, L.P. will be considered a private equity buyout 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 16, 2018. 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 23, 2018 meeting.

Attachments

Fund Name: Vista Equity Partners Fund VII, L.P.

May 18, 2018

Contact Info: John Warnken-Brill, Four Embarcadero Center, 20th Floor, San Francisco, CA 94111

Fund Details:

Firm AUM (\$bil.):	\$35 billion as of December 31, 2017	Key Investment Professionals: <u>Robert Smith</u> , Chairman & CEO. Mr. Smith founded Vista Equity Partners in 2000 and is the firm's Chairman and CEO. He currently sits on or participates in the boards of all Vista portfolio companies. He is Chairman of the investment committee and is actively involved in Vista's direction, investment decisions, executive development and operational strategies. <u>Brian Sheth</u> , President. Mr. Sheth co-founded Vista with Robert Smith in 2000 and is the firm's President. He is Vice-Chairman of the investment committee and is actively involved in the execution of the all of the investment activities for the portfolio. He is also focused on the development of Vista's personnel and executive leadership of the portfolio companies.
Strategy:	Large Buyout	
Year Founded:	2000	
Headquarters:	Austin, TX	
GP Commitment:	at least 2%	

Investment Summary

The Fund will be managed by Robert Smith and Brian Sheth, supported by four Principals, four Operating Principals, two Senior Vice Presidents, six Vice Presidents, and six Senior Associates. The Fund will seek to acquire controlling interests in 15 upper middle-market and large cap companies within the enterprise software, data, and technology-enabled solutions space that are primarily headquartered in North America. Vista seeks to invest in companies in which the Firm believes they can drive operational change, leveraging their in-house consultancy as well as their Operating Principals. A key component of Vista's Fund strategy has been the Firm's ability to effect substantial operating improvements in its companies through the implementation of Vista Best Practices. In addition to implementing its best practices, Vista seeks to create value for its portfolio companies by assisting with add-on acquisitions to enhance market position, create cross selling opportunities, or enter new markets entirely.

Existing and Prior Funds

<u>Funds</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 12/31/17</u>
Fund II	2000	Buyout	29.2% Net IRR, 2.73x Net TVPI, 2.73x DPI
Fund III	2007	Buyout	27.9% Net IRR, 2.54x Net TVPI, 2.27x DPI
Fund IV	2011	Buyout	19.2% Net IRR, 1.85x Net TVPI, 1.10x DPI
Fund V	2014	Buyout	14.6% Net IRR, 1.33x Net TVPI, 0.26x DPI
Fund VI	2016	Buyout	5.1% Net IRR, 1.04x Net TVPI, 0.11x DPI

IRR = Internal Rate of Return; TVPI = Total Value to Paid-In Capital; DPI= Distributions to Paid-In

Vehicle Information:

Inception:	2018	Auditor:	Deloitte & Touche LLP
Fund Size (\$mil.):	\$12 billion	Legal Counsel:	Kirkland & Ellis LLP
Management Fee:	1.5% of capital commitments during the investment period; thereafter, 1.5% of net invested capital		
Carry:	20%		
Hurdle Rate:	8%		
Additional Expenses:	100% fee offset		

NJ AIP Program

Recommended Allocation (\$mil.):	up to \$300 million	LP Advisory Board Membership:	TBD
% of Fund:	2.5%	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.