



State of New Jersey

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September 23, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Warburg Pincus China, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$100 million in Warburg Pincus China, 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 a \$2 billion companion fund that is expected to invest 50/50 alongside Warburg Pincus Global in growth equity investments within China and 50/25/25 alongside Warburg Pincus Global and the Firm’s companion Energy fund in China opportunities in the energy sector, employing a thesis-driven investing approach across sectors that Warburg Pincus (the “Firm”) believes have the potential to grow 15-25% annually, particularly in areas that will benefit from economic and structural transformations, such as: (i) healthcare, (ii) logistics, (iii) e-commerce, (iv) technology, (v) consumer and retail (vi) and businesses focused on environmental improvements and protections. Warburg Pincus maintains the flexibility to invest across the spectrum from early-stage and start-up companies to later-stage companies, but in general expects to deploy approximately 65% to 75% of capital commitments in growth capital transactions and the remaining balance in later-stage growth/buyout transactions.

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

Strong performance over a large number of investments: Since 2005, Warburg Pincus China has invested \$6 billion in 67 Chinese investments and generated an estimated Net Internal Rate of Return (“IRR”) of 17% and a net 1.8x multiple of investment capital (“MOIC”). On its realized and partially realized investments, Warburg Pincus China has realized \$6.1 billion and generated an estimated net IRR of 18% and net MOIC of 2.2x. Finally, the Firm’s China investments have a loss ratio of only 4.6% during this time frame, which is low relative to the strategy and geography.

Long history of investing in China: Warburg Pincus China has successfully invested through several economic, credit, and political cycles in China over the past 22 years. In addition, the China

team is deep, consisting of 35 investment professionals, and 18 additional professionals focused on portfolio company operational support, asset management and research.

Large investment opportunity: China has developed into the second largest economy in the world and is undergoing a significant economic transition. The resulting key trends include a move to a consumption-driven economy, growth of technology-enabled businesses, rising healthcare expenditures as China's society ages, rapid urbanization and the implementation of financial reforms.

Attractive risk-adjusted returns: Since this is a companion fund with Warburg Pincus Private Equity XII, L.P. ("Warburg Pincus Global" or "WPG"), each potential China investment opportunity must compete against potential investment opportunities within the broader WPG fund's global mandate.

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. Warburg Pincus China, L.P. will be considered a private equity venture capital 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 September 14, 2016. 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 September 28, 2016 meeting.

Attachments

Fund Name: Warburg Pincus China, L.P. **September 28, 2016**

Contact Info: Gregory Baecher, 450 Lexington Avenue, New York, NY 10017

Fund Details:

Firm AUM (\$bil.):	\$42.6 billion	Key Investment Professionals: Julian Cheng , Managing Director, is based in Hong Kong, joined Warburg Pincus in 2000 and co-leads the firm’s business in China. Prior to joining Warburg Pincus, Mr. Cheng worked in investment banking with Salomon Smith Barney and Bankers Trust. Frank Z. Wei , Managing Director, is based in Shanghai, joined Warburg Pincus in 2002 and co-leads the firm’s business in China. Prior to Warburg Pincus, Mr. Wei was with the investment banking division of Morgan Stanley in Hong Kong, and McKinsey & Company in Shanghai. Charles R. Kaye , Co-Chief Executive Officer, has been with Warburg Pincus since 1986. He has been jointly responsible for the management of the firm since 2000, including the formulation of strategy, oversight of investment policy and decisions, leadership of the firm’s Executive Management Group and the coordination of limited partner communications. Mr. Kaye lived in Hong Kong from 1994 to 1999, where he was instrumental in the launch and development of Warburg Pincus’ Asia operations Joseph P. Landy , Co-Chief Executive Officer, has been engaged in all aspects of private equity investing since 1985. He has been jointly responsible for the management of the firm since 2000, including the formulation of strategy, oversight of investment policy and decisions, leadership of the firm’s Executive Management Group and the coordination of limited partner communications.
Strategy:	Venture/Growth	
Year Founded:	1966	
Headquarters:	New York, NY	
GP Commitment:	minimum of \$100 million	

Investment Summary	Existing and Prior Funds			
<p>Warburg Pincus China, L.P. (“WPC”) will serve as a companion fund to WP XII, the Firm’s \$13.4 billion global fund raised in 2015, and its successors, to make China-based investments. This is the Firm’s first standalone China vehicle, as prior Chinese investments have been made in either the global funds or other sector funds. The strategy will focus on high growth subsectors of the Chinese economy, that will benefit from the ongoing economic & structural transformations, such as: (i) healthcare, (ii) logistics, (iii) e-commerce, (iv) technology, (v) consumer & retail, (vi) and businesses focused on environmental improvements & protections. The China Team routinely collaborates with dozens of Warburg Pincus managing directors and other investment professionals based outside of the region who provide additional perspective, sector expertise and support in developing investment theses. The Fund is a \$2 billion companion fund that is expected to invest 50/50 alongside Warburg Pincus Global in growth equity investments within China and 50/25/25 alongside Warburg Pincus Global and the Firm’s companion Energy fund in China opportunities in the energy sector. The Fund may opportunistically invest up to 15% in Southeast Asia as well.</p>	<i>Funds</i>	<i>Vintage Year</i>	<i>Strategy</i>	<i>Returns as of 3/31/2016*</i>
	WP IX (China)	2005	Venture/Growth	19% Net IRR, 1.9x Net TVPI, 1.8x DPI
	WP X (China)	2007	Venture/Growth	15% Net IRR, 1.8x Net TVPI, 1.1x DPI
	WP XI (China)	2012	Venture/Growth	37% Net IRR, 1.7x Net TVPI, 0.4x DPI
	<p>*Net returns are estimated for the Firm’s China investments based upon the ratio of net fund IRR/TVPI to the gross IRR/TVPI of several completed Warburg Pincus private equity funds as outlined further in the WPC PPM.</p> <p>IRR = Internal Rate of Return; TVPI = Total Value to Paid-In; DPI= Distributions to Paid-In</p>			

Vehicle Information:

Inception:	2016	Auditor:	Ernst & Young LLP
Fund Size (\$mil.):	\$2 billion	Legal Counsel:	Kirkland & Ellis LLP
Management Fee:	1.4% on commitments during the investment term (up to year 6) 1.4% on cost of investments (less permanent write-offs) from years 6-8 1.25% on cost of investments (less permanent write offs) from years 8-10 1% on cost of investments (less permanent write-offs) thereafter		
Carry:	20%		
Hurdle Rate:	n/a		
Additional Expenses:	100% fee offset		

NJ AIP Program			
Recommended Allocation (\$mil.):	Up to \$100 million	LP Advisory Board Membership:	Yes
% of Fund:	5.00%	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.