



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Portfolio Advisors Secondary Fund III, L.P.

Secondary Fund Commitment

Luke M. Jacobs, CFA
Manager, Private Markets

September 20, 2017



Recommendation:

Staff, together with Hamilton Lane, recommends to the Board (i) a commitment of up to \$125 million to Portfolio Advisors Secondary Fund III, L.P., ("PASF III" or the "Fund") and (ii) the creation of a separately managed account with discretion for PSERS to invest additional capital to exploit market dislocations if and when they occur.

Portfolio Advisors ("Portfolio Advisors" or the "Firm") seeks to create a diversified portfolio of (i) private equity limited partnership interests purchased on the secondary market and (ii) a limited number of direct private equity co-investments that generate attractive risk adjusted returns. Portfolio Advisors, through PASF III, will leverage its extensive private market experience, proprietary resources and long-standing industry relationships to source, underwrite and execute attractive secondary investments and co-investments.

Firm Overview:

PASF III is sponsored and managed by Portfolio Advisors, an employee-owned firm founded in 1994 to provide a full range of private equity, investment advisory, and portfolio management services to sophisticated institutional investors. Portfolio Advisors brings significant resources to the activities of sourcing, analyzing, selecting, closing and managing private equity investments on behalf of institutional investors who are seeking attractive returns while striving to manage the risks of the private equity asset class. Since its formation, Portfolio Advisors has expanded to become a firm of over 90 professionals with offices in Darien, Connecticut (USA), Zurich, (Switzerland) and Hong Kong. The Firm has 23 Managing Directors that have over 450 years of combined experience in private market investing. Portfolio Advisors is registered with the U.S. Securities and Exchange Commission as an investment adviser pursuant to the Investment Advisers Act of 1940.

Portfolio Advisors invests on behalf of its sponsored-funds and separate account clients in buyout, growth, venture and special situations funds (such as mezzanine funds, distressed debt funds, energy funds and other alternative investments), private credit funds, real estate funds, secondary and co-investment opportunities and funds with a geographic focus, such as U.S., Europe and the Pan-Asia region. These investments generally fall into four categories: interests in private equity partnerships (primaries), purchases of existing interests in private equity funds on the secondary market (secondaries), co-investments in operating companies alongside fund sponsors (co-investments) and investments in private credit investment opportunities, including direct investments (private credit). By focusing on these areas, Portfolio Advisors is able to develop valuable insight into the portfolios and capabilities of private equity fund managers. Portfolio Advisors currently serves as the investment manager of 31 private equity, private credit and private real estate funds (four of which, Portfolio Advisors co-manages) and has established advisory relationships with many institutional clients.

Fund Size:

Fund III is seeking equity commitments of up to \$1.0 billion, with a hard cap of \$1.5 billion.

Investment Strategy:

PASF III intends to construct a mature, well-diversified private equity portfolio by vintage year and industry that is optimally structured to produce attractive risk-adjusted returns. PASF III expects to target a variety of fund strategies including buyout, growth, venture, distressed and special situations. PASF III expects to construct a portfolio of predominantly North American limited partnership interests. Portfolio Advisors seeks to invest in the best investment opportunities including portfolio transactions, single fund transfers, broken auctions, manager carve-outs and/or other relationship driven transactions. PASF III will also invest 15% of its capital in select co-investment opportunities. The actual number of secondary investments and co-investments within the Funds' portfolio will be primarily influenced by the quality of



the opportunities available during the investment period, and will depend in part upon the aggregate capital commitments of the investors in the Funds.

Investment Team:

The nine senior Portfolio Advisors professionals who constitute the voting members of the PASF III's Investment Committee together have approximately 170 years of combined experience in investing in the private markets. The Investment Committee is supported by the additional secondary team professionals and other investment professionals, including 15 additional Managing Directors, eight Senior Vice Presidents, ten Vice Presidents, the Chief Financial Officer, the General Counsel, two Deputy General Counsels and the Chief Compliance Officer who collectively have over 575 years of additional combined experience in the private equity asset class. The investment team has an extensive track record in sourcing, underwriting and executing attractive secondary opportunities across multiple transactions. This broad base of secondary investment experience supports the investment discipline necessary to effectively invest and manage a secondary fund.

Name	Title	Yrs. Experience Firm	Prior Experience
Hugh Perloff	Managing Director	19	Deloitte
Adam Clemens	Managing Director	7	New York Life
William Indelicato	Managing Director	22	Landmark Partners.
Brian Murphy	Managing Director	21	Morris Anderson
Ken Binick	Managing Director	9	CIBC World Markets
Gregory Garrett	Managing Director	7	Adams Street Partners
John Kyles	Managing Director	8	Citigroup
Patrick Gerbracht	Senior Vice President	7	Pomona Capital
Benjamin Hur	Senior Vice President	7	Citigroup
Justin Lux	Vice President	6	Lazard
Timothy Henn	Senior Associate	3	Raymond James
Jorge Rossello	Associate	1	SunTrust

Investment Instruments:

The Fund seeks to purchase and construct over time a mature, well-diversified private equity portfolio that is expected to produce attractive risk adjusted returns by investing in existing limited partnership interests in private equity funds and related assets purchased in the secondary market (i.e. "secondaries") as well as select direct co-investments. They may invest in equity or debt instruments. The fund may make investments in temporary (i.e. bridge) financing instruments too.

Market Opportunity:

The secondary market has grown significantly over the past few years. Total secondary transaction volume has increased recently from \$10 billion in 2009 to \$37 billion in 2016. Secondary transaction volume is expected to be robust in most market conditions. Sellers may choose to sell limited partnership interests for the following reasons:

- regulatory constraints;
- changes in capital market conditions;
- reallocation of resources to core private equity relationships;



- rebalancing of portfolio among private equity strategies;
- redirection of capital to other asset classes;
- need for increased liquidity to manage cash flow issues;
- desire to lock in returns; and
- reduction of administrative burden.

In addition, primary inflows remain robust. Historically, approximately 3% to 5% of primary fund commitments are ultimately sold in the secondary market. Primary fundraising levels serve as the driver of future secondary transactions and the secondary market will continue to benefit from the increase in primary capital fundraising since the financial crisis.

Investment Highlights:

Broad Platform Creates Informational Advantage
Portfolio Advisors is a full service private equity manager that offers advisory services, fund administration, and sponsored investment vehicles. They maintain relationships with over 250 GPs and hold over 150 advisory board seats. Through its platform and longstanding GP relationships, the secondary investment team often has an information advantage that allows the firm to accurately price and participate in secondary transactions that stand-alone secondary managers may otherwise decline due to a lack of knowledge.
Attractive Fee Structure
PASF III offers investors the choice between two different low-management fee structures. In addition to the management fee, PASF III has a 10% contingent performance allocation that would apply to net gains and be distributed to the General Partner only after the return of such investor's funded capital commitment and a 10% preferred return on the investor's invested capital.
Ability to Add Capital Quickly
In addition to PSERS' original commitment, creating a separately managed account format, will allow us to add capital to funds and/or strategies quickly and take advantage of any perceived mispricing in the market.
Extensive Experience
Portfolio Advisors has executed more than \$4.0 billion of secondary transactions across 18 vehicles since 2002. Their investment professionals have over 575 years of combined private market experience across all private equity asset classes.

Investment/Risk Considerations:

Largest Secondary Fund Size
PASF III will be the largest secondary fund Portfolio Advisors has raised. We think this is mitigated by the firm displaying increased and consistent investment pacing over the past five years.
Risks of Secondary Investments
The Portfolio Advisors team has historically targeted portfolios that are completing their investment periods with significant time for portfolio appreciation. They also seek to invest in more mature funds with the potential of generating near term liquidity. These factors help mitigate some of the risks inherent with other peers in the secondary funds space. (See Confidential Memo for additional details).

PSERS History & Performance:

This will be PSERS first commitment to a Portfolio Advisors secondary fund.

Portfolio Fit:

A commitment to Fund III will give PSERS' Private Markets portfolio continued exposure to the secondary space. The advantages of investing in the secondary space include:

- The private equity market's illiquidity, combined with the liquidity needs of sellers, often allows for a purchase price discount from the net asset value of the underlying assets.



- Exposure to secondary investments may reduce the length and depth of a portfolio's "J-curve," especially in new programs. This characteristic is an important consideration for portfolio management.
- Secondary investments can reduce some of the uncertainty traditionally associated with investing in a "blind pool" as secondary investments are often purchased well into a partnership's life generally allowing a secondary purchaser to conduct due diligence on the partnership's underlying investments.
- The secondary purchase of a partnership at a later stage in the fund's life generally results in shortened holding periods and often results in earlier distributions as compared to investing on a primary basis.
- The purchase of a portfolio of mature funds can provide immediate diversification across vintage years, industries and companies.

A commitment to PASF III will be allocated to the Private Equity sleeve of PSERS' Private Markets portfolio. As of March 31, 2017, the Private Markets portfolio was allocated 68.7% Private Equity, 14.3% Special Situations, 12.1% Venture Capital and 4.8% PE Internal (based on total exposure). The table below summarizes PSERS' projected Private Markets exposure exclusive of a recommended \$125 million commitment to Fund III:

Investment Type (\$mm)	Active Commitments	%	Market Value	%	Unfunded	%	Total Exposure	%
Private Equity	\$ 14,696.9	65.3%	\$ 5,357.8	67.6%	\$ 3,406.8	70.5%	\$ 8,764.6	68.7%
Special Situations	4,554.8	20.2%	1,033.0	13.0%	791.7	16.4%	1,824.7	14.3%
Venture Capital	2,797.0	12.4%	973.8	12.3%	574.8	11.9%	1,548.6	12.1%
PE Internal	465.4	2.1%	555.3	7.0%	61.6	1.3%	616.9	4.8%
Total	\$ 22,514.1	100.0%	\$ 7,710.7	100.0%	\$ 4,834.9	100.0%	\$ 12,754.8	100.0%

Investment Committee Disclosure:

Relationship with Hamilton Lane:	No
Placement Agent:	No
PA Political Contributions:	None Disclosed
PA Presence:	No
Conflicts:	None Disclosed
History with PSERS:	Yes (through their advisory platform)
PSERS AIC Meeting Approval:	September 20, 2017

Oversight Responsibility:

Investment Office:	Charles J. Spiller Deputy CIO, Non-Traditional Investments	Luke M. Jacobs, CFA Manager
External Consultant:	Hamilton Lane	



Hamilton Lane

September 7, 2017

Board of Trustees
Commonwealth of Pennsylvania
Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Portfolio Advisors Secondary Fund III

Dear Trustees:

Portfolio Advisors, LLC ("Portfolio Advisors") was initially founded as the private equity investment platform for General Reinsurance before spinning out and forming a separate firm in 1994. Portfolio Advisors has built a team of eleven secondaries professionals that have extensive industry experience and long tenures with the General Partner, averaging 19 years and 11 years, respectively. The investment team leverages a large database of primary fund investments to assist with its underwriting process and utilizes its broad primary investment platform to assist with sourcing. The secondary investment committee includes group heads from other Portfolio Advisors products who have complementary experience. The General Partner is targeting \$1.0 billion in commitments from limited partners for its third secondaries fund, Portfolio Advisors Secondary Fund III L.P. (the "Fund"). The Fund expects to make equity investments between \$5 and \$200 million in 40 to 50 investments, with no more than 20% exposure to any single secondary investment. As of August 2017, Portfolio Advisors has raised \$883.4 million in limited partner commitments for the Fund and expects to hold two additional closes by December 2017. The General Partner will commit 2.0% of commitments (at least \$20 million) alongside the Fund.

Portfolio Advisors is a well-known General Partner and has created deep networks with limited partners, general partners, brokers and intermediaries through its consistent activity in the private markets, which has led to advantaged sourcing. Similar to prior funds, Portfolio Advisors will primarily target middle-market focused buyout funds and funds with diversified strategies as a result of the attractive risk-return profile. The General Partner will seek to allocate roughly 25% of the Fund to venture- and growth-focused strategies in order to capture additional upside. Additionally, the Fund expects to deploy 10% of commitments in distressed or special situations funds and 10% of commitments in opportunistic strategies based on market dynamics. The General Partner has identified a core group of managers within the buyout and venture strategies and expects to allocate a majority of the Fund's capital to these groups. Portfolio Advisors seeks to invest with managers that are not concentrated in one industry and prefers defensible industries. From a geographic perspective, the General Partner will seek to acquire interests in U.S. focused funds, expecting approximately 80% of the Fund's investments to be made within the region. The General Partner aims to primarily generate returns through portfolio appreciation, rather than obtaining limited partner interests at large discounts to NAV. Portfolio Advisors has generated attractive, top-quartile net IRR returns in its prior funds, generating an aggregate net IRR of 15.3% as of December 31, 2016. The General Partner has a large focus on capital preservation, having only one write-off in its prior funds, and with the exception of a short-term line of credit, Portfolio Advisors will not use leverage. This focus on downside protection has driven the General Partner's ability to consistently generate attractive returns.

The Portfolio Advisors Secondary Fund III investment thesis can be summarized as follows:

- Portfolio Advisors has an experienced and cohesive senior investment team that benefits from the broader platform



Hamilton Lane

- Consistent approach of targeting smaller, traditional secondary transactions
- Portfolio Advisors has demonstrated their ability to generate attractive performance across prior funds, without the use of fund-level leverage

Hamilton Lane's recommendation is based upon the following analytical factors and is made within the context of Commonwealth of Pennsylvania Public School Employees' Retirement System's ("PSERS") investment guidelines.

- Detailed due diligence, including interviews with industry peers and private equity professionals. The on-site due diligence visit was performed on August 28, 2017.
- Evaluation of the composition of the investment team, how they work together, compensation structure and other factors that help determine whether a group is likely to be able to replicate past successes as currently configured.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- The strategy proposed for the Fund is appropriate for the Private Equity Partnership component of the portfolio.

The individuals at Hamilton Lane who were involved in the due diligence process for the Fund are:

Andrea Kramer – Managing Director, Bala Cynwyd Office
John Stake – Vice President, Bala Cynwyd Office
Victor DeVincenzo – Associate, Bala Cynwyd Office
Spencer Reiter – Analyst, Bala Cynwyd Office

Based on the above, Hamilton Lane recommends that PSERS commit up to \$125 million in Portfolio Advisors Secondary Fund III, L.P. In addition, Hamilton Lane is supportive of the creation of a separately managed account with discretion for PSERS to invest additional capital to exploit market dislocations if and when they occur. Hamilton Lane makes this recommendation considering the General Partner's qualifications and PSERS' overall investment guidelines.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors, considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. Hamilton Lane does not provide legal or other non-investment-related advice.

Sincerely,

Michael Koenig,
Managing Director

Corina English,
Vice President