



November 12, 2014

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

Re: Avenue Energy Opportunities Fund, L.P.

Dear Trustees:

Avenue Capital Group ("Avenue" or the "Firm") is seeking to raise up to \$750 million for Avenue Energy Opportunities Fund, L.P. ("AEOF" or the "Fund"). Avenue operates as both a private equity firm and a hedge fund and has approximately \$14.1 billion of assets under management. The Firm's core strategy is focused on distressed debt and equity securities, with the majority of AUM managed through a number of U.S., European and Asian targeted private investment funds. The Fund will seek to leverage the Firm's platform from both a strategic and operational perspective to pursue investments primarily in senior debt, select equity securities or other obligations of North American energy and utilities companies in financial stress or distress. Although Avenue has been investing in distressed debt since its inception in 1995, and has been active in the U.S. energy and utilities sector since 1997, the Fund will represent Avenue's first fund to be focused exclusively on energy and utilities. Avenue held a first close on approximately \$62 million of commitments earlier this year and expects to hold a final close in early 2015.

The Fund is being formed to take advantage of the increasing amount of distressed and stressed companies in the energy and utilities sector in North America. This situation is the result of a number of factors revolving around the technological and regulatory dislocations affecting this sector as well as the amount of debt amassed by many of the companies within the sector over the past several years. Avenue expects to make investments primarily in debt, select equity securities or other obligations of companies that have become stressed or distressed because of these dynamics. These investments will generally be backed by hard energy assets with discrete value catalysts, rather than be based on broad market opportunities. Avenue believes the current market dislocations have created attractive investment opportunities in four particular energy sectors, including: Independent Power Producers, Coal, Exploitation and Production and Energy Services/Pipelines/Refining.

The Fund's investments are expected to focus primarily on individual corporate, distressed debt securities and other special situations and are generally expected to be made in senior secured debt or other debt that is structurally senior to other portions of the capital structure. Many of these investments have significant current yields and are less volatile as a result of their position at the top of the capital structure. However, as market cycles evolve, the Fund may invest in more junior portions of the capital structure depending on the risk return profiles of an investment. Avenue also believes that returns will benefit from the capital



appreciation that occurs upon the re-adoption of bonds and bank debt by the high yield or near-par bank debt markets.

Portfolio Advisors' recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines.

- Detailed due diligence, including interviews with industry peers and private equity professionals. The on-site due diligence visit was performed on September 3, 2014.
- 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 High Yield Fixed Income component of the portfolio.

The individuals at Portfolio Advisors who were primarily involved in the due diligence process for the Fund are:

Donna Smolens – Managing Director, Connecticut Office
Amanda Peacock – Senior Associate, Connecticut Office

Based on the above, Portfolio Advisors recommends that PSERS commit to up to \$200 million of limited partnership interests in Avenue Energy Opportunities Fund, L.P. Portfolio Advisors 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. Portfolio Advisors does not provide legal or other non-investment-related advice.

Sincerely,

WILLIAM J. INDELICATO
MANAGING DIRECTOR

Opportunistic High Yield Allocation



Avenue Energy Opportunities Fund, L.P.

December 8, 2014

See Last Page for Disclaimer

Laurann H. Stepp
Senior Portfolio Manager

Avenue Energy Opportunities Fund, L.P.

Overview

- Fund size is anticipated to be \$750 million
- Investments primarily in debt, select equity securities or other obligations of stressed or distressed North American energy and utility companies
- Avenue Capital Group, formed in 1995, is a global alternative investment firm which has managed \$13.6 billion through U.S., European and Asian targeted distressed debt funds

Fund Strategy

- Focus on individual corporate distressed debt securities and other special situations investment opportunities of North American energy and utility companies. Over 50% of the investments are expected to be made in senior secured debt or other debt that is structurally senior to other portions of the capital structure
- Investments in energy and utility companies that: (i) are undergoing restructuring, reorganization or bankruptcy; (ii) are experiencing operational or financial difficulty in which Avenue Capital Management, “Avenue” anticipates a turnaround; (iii) are in turmoil; and (iv) are undervalued because of discrete extraordinary events

Avenue Energy Opportunities Fund, L.P.

Investment Team

- The fund will be overseen by CEO and Co-Founding Partner Marc Lasry, and Portfolio Manager Matthew Kimble. Four additional investment professionals will be focused on the fund
- Avenue Capital Group has approximately 200 employees, including a 24 person U.S. investment team located in New York City

GP “Value Add”

- Avenue’s comprehensive and deep credit and sector knowledge, led by an experienced team of portfolio managers and restructuring experts, affords them strong positioning in the market

Performance (as of 9.30.14)

- Invested \$7.5B in energy and utility sector since 1997 across all US Funds with a 22.9% gross IRR and a 1.3x gross MOC^(a)
- US Fund II has a net 1.6x MOC and a 20.7% IRR
- US Fund III has a net 1.3x MOC and a 18.4% IRR
- US Fund IV has a net 1.4x MOC and a 8.7% IRR
- US Fund V has a net 1.3x MOC and a 11.8% IRR
- US Fund VI has a net 1.3x MOC and a 8.2% IRR
- Avenue Energy Opportunities Fund, L.P. will target 20% gross IRR with a 8% current yield

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(a) Based on Portfolio Advisors’ analysis [as of June 30, 2014]

Avenue Energy Opportunities Fund, L.P.

Market Opportunity

- Technological and regulatory dislocations are occurring in the North American energy sector. Significant leverage taken on by energy and utility companies to address the dislocations has created stressed capital structures needing recapitalization
- Avenue estimates \$109 billion in distressed opportunities across 55 companies in: i) independent power producers, (ii) coal, (iii) exploration and production, and (iv) energy service/pipelines/refining

Potential Risks

- First dedicated energy fund; will opportunity be enduring

Avenue has been successfully investing in the energy and utility space within other investment platforms since 1997. The opportunity set has grown significantly during that time due to the energy boom in the US. The distressed energy opportunity set has become more attractive as oil prices have come down in recent months. The increase in the number of companies in this space should ensure a sufficient opportunity going forward

- New additions to team

In addition to Marc Lasry, there are three Avenue professionals that have worked together over the past six years in the energy space covering divergent areas. Earlier this year Avenue hired Craig Hart as a Managing Director and critical part of this team. He brought with him an associate to round out the current team, as well as many years of experience derived from his work with US Power Generating Company

Avenue Energy Opportunities Fund, L.P.

History with PSERS

- This will be PSERS' eleventh fund investment with Avenue Capital Group. PSERS is an LP in the following Avenue Funds: Asia II, Asia III, Asia IV, Europe I, US Fund II, US Fund III, US Fund IV, US Fund V, US Fund VI and Real Estate Fund

Board Issues

- Pennsylvania Presence – Avenue does not currently have a PA presence
- Placement agents – In the process of negotiating several agreements. No placement agent is being employed with regard to PSERS
- PA political contributions – Over the past three years, Avenue Capital Group and related persons have made one or more contribution(s) to Joe Sestak, U.S. Senate, totaling \$24,687; Marjorie Margolies, U.S. House, totaling \$15,400
- Relationship with consultant – Portfolio Advisors Fund of Funds investments: \$10 million in US Fund IV; \$30 million in US Fund V

Recommendation

- Staff, together with Portfolio Advisors, recommends that the Board invest \$200 million plus reasonable normal investment expenses

Notice: This document was presented to the Public School Employees' Retirement Board at the public meeting at which the Board acted on the resolution to which the information relates. The sole purpose for posting the presentation information on this website is to enable the public to have access to documents that were utilized at a public meeting of the Public School Employees' Retirement Board, and no other purpose or use is intended.