



COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

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Public Investment Memorandum

**HGGC Fund III, L.P.**

Private Equity Commitment

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**Darren C. Foreman**  
Senior Portfolio Manager

**November 4, 2016**



### **Recommendation:**

Staff, together with Portfolio Advisors, recommends to the Board a commitment of up to \$125 million to HGGC Fund III, L.P. (the "Fund"). HGGC (or the "Firm"), a Palo Alto, CA based, private investment firm, is sponsoring the Fund to make investments in control North American middle-market buyouts with equity investments between \$50 million and \$200 million.

### **Firm Overview:**

Since the firm's inception in 2007, HGGC has made 53 portfolio investments in control North American middle market buyouts worth a total enterprise value of approximately \$12 billion.

The following table lists all private equity funds raised and/or managed by HGGC.

| <b>Fund</b>             | <b>Vintage</b> | <b>Fund Size</b> |
|-------------------------|----------------|------------------|
| Huntsman Gay I (Fund I) | 2008           | \$ 1.1 Billion   |
| HGGC Fund II            | 2014           | \$ 1.3 Billion   |

### **Market Opportunity:**

HGGC's sourcing strategy has led to over 3,000 evaluated deal opportunities since inception and 53 closed transactions. Nineteen of the twenty control middle-market platform investments across Fund I and Fund II were proprietary/semi-proprietary situations in which HGGC was able to eliminate or preempt a competitive auction process.

### **Portfolio Fit:**

A commitment to HGGC Fund III will give PSERS' Private Markets portfolio exposure to middle buyout market in North America. The Fund would be complementary to PSERS' Private Markets portfolio by giving exposure to the information technology sector. The firm focuses on control investments that allow them to lead the company strategy, have control over management and control over the capital structure which should allow the Fund to be a top performer.

### **Investment Strategy:**

HGGC will target equity investments of between \$50 million and \$200 million. The Fund will invest in the information technology services, business services and industrial sectors. HGGC splits the Fund into high growers and scale ebitda (earnings before interest, taxes, depreciation and amortization) companies. The Firm will use less leverage for high growth investments that have lower ebitda generation due to rapid expansion and working capital needs while using more leverage for scale ebitda investments that have stronger cash flow generation which can support interest service needs and principal repayment.

Sellers of businesses typically rollover (reinvest) in each HGGC transaction to maintain an equity position alongside HGGC's control investment. This helps HGGC receive a slightly lower purchase price and the seller stays aligned in focusing on the vision for the business and assists in driving future value.

### **Investment Team:**

HGGC's team has differentiated skill sets that combine significant private equity experience with diverse backgrounds across investment banking, management consulting, finance and accounting, corporate, industrial, manufacturing, distribution and legal.

The investment team of 20 professionals is supported by 12 operations (operations, finance & accounting, compliance & legal and IT) professionals and 3 administrative support staff.



The Fund's Investment Committee will consist of five Managing Directors: Gregory Benson, Leslie Brown, Richard Lawson, Neil White and Steven Young as well as Kurt Krieger, General Counsel & Chief Compliance Officer and Robert Gay, Executive Director & Co-Founder.

The table that follows highlights the experience of HGGC's Investment Committee:

| Name            | Title                                | Yrs. PE Experience HGGC / Total | Prior Experience                                      |
|-----------------|--------------------------------------|---------------------------------|---|
| Richard Lawson  | Managing Director, CEO, Co-Founder   | 9 / 16                          | Sorenson Capital, CEO of Found, Inc.                  |
| J. Steven Young | Managing Director and Co-Founder     | 9 / 15                          | Sorenson Capital, Northgate Capital                   |
| Gregory Benson  | Managing Director and Co-Founder     | 9 / 25                          | Bain Capital, President at General Electric           |
| Neil White      | Managing Director                    | 7 / 12                          | Och-Ziff, Bain Capital, Boston Consulting             |
| Leslie Brown    | Managing Director and COO            | 9 / 9                           | CFO at Neways Intl, SVP Nutraceutical Inc.            |
| Kurt Krieger    | General Counsel and Chief Compliance | 8 / 8                           | The Church of Latter-day Saints, Private Law Practice |
| Robert Gay      | Executive Director and Co-Founder    | 9 / 30                          | Bain Capital, GE Capital, McKinsey                    |

**Investment Highlights:**

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|---|
| <b>Sellers re-invest in the deals</b>   |
| Sellers of businesses have re-invested \$641M in Fund I and \$270M in Fund II deals. This "buy in" further cements HGGC's alignment with the sellers, which should lead to better outcomes for LPs.   |
| <b>Staff with strong operating experience</b>   |
| Richard Lawson was a CEO of enterprise software company Found, Inc. which was a Bain Capital portfolio company. Leslie Brown was the CFO of Neways International a Golden Gate Capital portfolio company. Robert Gay was a senior partner at Bain Capital and oversaw Bain Capital Europe. Greg Benson was President of General Electric's Capital Markets Group. Steven Young has been Chairman of the Board of five HGGC portfolio companies. |
| <b>Non-auction deal flow</b>  |
| Nineteen of the twenty control middle-market investments across Fund I and Fund II were proprietary or semi-proprietary in which HGGC was able to eliminate or preempt an auction process or reduce the number of bidders due to the relationship with the seller(s).   |
| <b>Solid investment performance</b>   |
| Fund I has a 17.1% net IRR and Fund II has a 19.3% net IRR as of June 30, 2016.   |

**Investment / Risk Considerations:**

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| <b>Staff turnover</b>   |
| HGGC has had more than average turnover at the firm. This is mitigated due to the fact that the key investment professionals remain with the firm. Rich Lawson, Steve Young and Greg Benson are key senior investment professionals. Robert Gay will remain on the Investment Committee. Lawson, Young, Benson and Gay founded the firm back in 2007. All 7 members of the Investment Committee have been with the firm 7 years or longer. This risk is further mitigated as PSERS negotiated a sole key person on Richard Lawson who is Chief Executive Officer of HGGC. |
| <b>Increase in fund size</b>  |
| The fund size target for HGGC Fund III is \$1.5B which would be approximately 13% larger than Fund II. If Fund III hits \$1.8B this would be a 38% increase. Some of HGGC's competitors have doubled (or more) their fund sizes recently. With HGGC's seasoned, well-experienced Managing Directors and esteemed Principals, I believe the firm can handle the expected fund size increase previously noted.  |



**PSERS History & Performance:**

PSERS has committed to one HGGC Fund, HGGC Fund II, LP. The table that follows summarizes HGGC's investment performance as of June 30, 2016:

| (\$ in millions)     | Portfolio | Vintage | # of investments | Fund Size | Realized | NAV    | Net IRR | MOIC |
|----------------------|-----------|---------|------------------|-----------|----------|--------|---------|------|
| Huntsman Gay I, L.P. | PE        | 2008    | 13               | \$1.1B    | \$1.6B   | \$488M | 17.1%   | 1.6x |
| HGGC Fund II, L.P.   | PE        | 2014    | 9                | \$1.33B   | \$127M   | \$846M | 19.3%   | 1.2x |

**Finance Committee Disclosure:**

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| <b>Relationship with Portfolio Advisors:</b> | Portfolio Advisors fund of fund commitments to HGGC Funds: \$10M to HGGC III, \$5M to HGGC II, \$15M to Huntsman Gay I |
| <b>Placement Agent:</b>                      | Evercore's was used as a placement agent for some LPs but not to solicit PSERS commitment. HGGC will pay this fee      |
| <b>PA Political Contributions:</b>           | None   |
| <b>Conflicts:</b>                            | None reported  |
| <b>History with PSERS:</b>                   | PSERS committed \$100 million to HGGC Fund II  |
| <b>PSERS Internal (AIC) Approval:</b>        | November 4, 2016   |

**Oversight Responsibility:**

|                             |   |   |
|-----------------------------|---|---|
| <b>Investment Office:</b>   | Charles J. Spiller<br>Darren C. Foreman | Deputy CIO, Non-Traditional Investments<br>Senior Portfolio Manager |
| <b>External Consultant:</b> | Portfolio Advisors LLC                  |   |



October 20, 2016

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

Re: HGGC Fund III, L.P.

Dear Trustees:

Founded in 2007 and formerly known as Huntsman Gay Global Capital, HGGC, LLC (“HGGC” or the “Firm”) is a leading middle market private equity firm based in Palo Alto, California. The Firm recently launched fundraising for HGGC Fund III, L.P. (“Fund III” or the “Fund”) and is targeting \$1.5 billion of limited partner capital commitments with a first closing expected at the end of October. Note that a hard cap has not yet been set, but is expected to be in the \$1.8 billion to \$2.0 billion range. The General Partner will make a commitment of at least 3% of the limited partner capital commitments up to \$50 million.

Fund III will continue the Firm’s strategy of investing in North American middle market companies that have leading competitive positions in defensible market niches. The Firm leverages its team of multi-industry specialists with extensive investing and operating expertise to drive value in these companies through its relationships and operating skills. HGGC seeks to make equity investments of \$50 million to \$200 million in companies that generally have no more than \$100 million of EBITDA. HGGC takes what it refers to as a “barbell” approach to investing where about half of the capital will be deployed in rapidly growing companies (referred to by the Firm as “high growth” investments) and the other have in larger, more stable businesses (referred to as “scale EBITDA” investments). In all cases, HGGC seeks to utilize the appropriate capital structure to support the business. In its “high growth” investments, the Firm will use less leverage to allow the company the ability to invest in driving further growth going forward. On the contrary, the “scale EBITDA” companies will have stronger cash flow characteristics that can support higher leverage levels.

HGGC seeks to generate long-term value by leveraging the Firm’s broad experience, extensive relationships and reputation to generate superior deal flow and execute transactions, partnering with portfolio company management teams to effect operational and strategic improvements and seeking to align incentives among all transaction participants. The Firm believes that outstanding investment outcomes driven by its “Advantage Investing” approach will result in strong management references that in turn further enhance HGGC’s network and reputation. These references also further augment the Firm’s ability to successfully source, execute, grow and exit its portfolio companies. These outcomes become important reference points for potential future founder-owners, management teams and/or sponsors, which HGGC is



looking to transact with. In the end, the Firm believes its “Advantaged Investing” approach should lead to increased opportunities for preferred-partner investments at attractive valuations.

Portfolio Advisors’ 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 18, 2016.
- 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 Portfolio Advisors who were primarily involved in the due diligence process for the Fund are:

Gregory Garrett – Managing Director, Darien Office  
Geoffrey Kelleman – Vice President, Darien Office

Based on the above, Portfolio Advisors recommends that PSERS commit to up to \$125 million in HGGC Fund III, 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