PSERS PRIVATE INVESTMENT PROGRAM

Recommendation for Investment in
StarVest Partners II, L.P.

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StarVest Partners II, L.P.

INTRODUCTION

StarVest Partners II, L.P. ("StarVest II" or the "Fund") is an expansion-stage venture capital fund based in New York City that will invest in technology-enabled business services companies nationwide. The Fund addresses the second generation of convergence of information technology and the Internet, business and consumer services, and digital media and content that has enabled the emergence of a new digital economy. The fund's investment focus builds on the knowledge base and relationships established by their successful first fund, StarVest Partners, L.P. ("StarVest I"). StarVest II is seeking $200 million in capital commitments.

The Fund's investment objective is to generate superior venture capital returns for its investors by identifying, investing in and building technology-enabled business services companies, with emphasis in key emerging areas including:

- Business Services delivered as Software-as-a-Service (SaaS)
- Technology-differentiated eCommerce services
- Internet-enabled marketing services
- Data and content-centric services
- Identity management and security services

StarVest II will invest in companies that differentiate themselves through the innovative use of information and Internet technologies, can emerge as leaders in their sectors, and can benefit from the Partners' extensive experience, proven investing skills, and deep resource network.

The investments in StarVest Partners I, L.P. are projected by its Partners to generate top quartile performance for its investors. The 24 portfolio company investments from StarVest I are expected to return between 1.5 and 1.8 times their cost, providing a gross internal rate of return of approximately 13%.

StarVest has a proactive process for identifying and qualifying opportunities in its areas of focus, starting with a research-oriented, market based approach that relies on finding attractive companies before they are in need of raising capital. In addition, StarVest has typically concentrated attention on relatively underserved geographic areas of the US within the Southwest, Southeast, Midwest, and the New York metropolitan area.

As a result of their differentiated deal sourcing strategy, over 60% of the capital in StarVest was invested in companies in which StarVest is the only institutional investor, or where StarVest is part of a small group of early venture investors. These investments are expected to generate over 80% of the anticipated return for StarVest I, and has resulted in a collection of companies that, to a large extent, are not represented in our Limited Partners' other private equity investments, adding diversity to their portfolio.

StarVest II will target growth companies in the expansion-stage of their development, usually with a minimum of $2 million in revenue, that are focused on large and growing market opportunities in their targeted sectors. Total investments will average $8-$14 million over several rounds of investment, with StarVest's final ownership ranging from 10%-25%. StarVest is an active investor and Board member in all its investments. The Partners have a demonstrated ability to add substantial value to the portfolio investments; they have been active with management teams in areas such as strategic planning, organizational design, recruiting, sales and marketing strategy, partnership development, financial planning and strategy, and planning for M&A and public offerings.

By utilizing their exceptional Advisory Board members and strong network of contacts, the Partners have been responsible for introductions and relationships which accounted for a significant amount of the aggregate revenue generated by the StarVest I portfolio companies. StarVest has a proven track record of helping management improve the performance of their businesses and enhance their competitive positioning, a record that the Partners will exploit in competing for the most attractive companies in the StarVest II opportunity set.

INVESTMENT HIGHLIGHTS

Since the founding of StarVest Partners I, L.P. in 1998, the Partners have developed and refined their differentiated strategy for investing in expansion-stage technology-enabled business services companies, and established a strong record of success. Their consistent, disciplined, and focused approach that allowed StarVest to source, fund, and help build those businesses during a highly volatile period in the venture industry will provide similarly attractive opportunities to the investors in StarVest Partners II, L.P.

Experienced Team of Investment Professionals

StarVest Partners professionals have over 85 years of professional investing and financial advisory experience in a variety of market conditions and sectors. The StarVest Partners team has worked together since 1998 when it organized and raised StarVest I and, since 1999, has invested approximately $140 million in 24 companies. Members of the team have worked together and co-invested since the early 1990s. The Partners bring deep domain expertise in StarVest's areas of focus, including technology, financial services, and pioneering digital media experience. Complementary skills among the StarVest team include direct operating responsibilities, securities analysis, management and extensive corporate organization, team building and corporate governance experience. The Partners have experience in all facets of the capital markets and have been intimately involved in guiding many companies through a variety of acquisition and exit strategies, including mergers, IPOs and strategic sales.

Deborah A. Farrington, Founding Partner

- 19 years of private equity experience; 11 years investment banking
- Board of Directors of NetSuite, Fieldglass, Insurance.com and Perquest.
- President & CEO of Victory Capital. Invested over $50 million in 4 years (35% IRR)
- Chairman of a business services company that grew from $17m to $250m in sales
- 10 years at Merrill Lynch: Investment Banking, Securities Analysis and Management (Operating Committee ML International), in New York, Hong Kong, and Tokyo.
- Executive Committee of HBS Alumni Association Board of Directors
- Smith College AB; Harvard Business School MBA

Laura B. Sachar, Founding Partner

- 10 years of private equity experience; 14 years working with digital media companies.
- Board of Directors of a21, Inc., Newgistics, MessageOne; Board Observer iCrossing and Connected Corp prior to acquisition by Iron Mountain. Gabelli Securities, responsible for private equity investments. (165% IRR: represents $3.2 million which grew to $10 million. Identified Digital River, Multex and others)
- Founded Sachar Capital, Ltd., a financial advisory firm specializing in digital media.

- Founded NYNMA Angel Investor Program. Member of Young Presidents' Organization.
- Barnard College BA; Columbia University MBA

Jeanne M. Sullivan, Founding Partner

- 16 years of private equity experience; including 26 years of technology and digital media experience
- Board of Directors of BlueStreak, Blazent, and Tibersoft, and an active Observer of Mazu Networks
- Managing Director, Olivetti Ventures and 4C Ventures; invested in over 35 technology companies; Board of many tech companies (37% IRR on $68m of investing)
- AT&T/Bell Labs Venture Unit: Extensive operating experience-Product and Marketing Management – 9 years
- University of Illinois BS; Creighton University JD

Larry Bettino, General Partner

- 17 year private equity career; 4 years technical and management positions at IBM
- Partner and Managing Director Warburg Pincus, 2001 – 2006; Founding Partner, Baker Capital, 1996 – 2001; Partner, Dillon Read Venture Capital, 1989 – 1996
- Board member of many public and private technology companies, including most recently: LSSI - leading provider of international database services; MACH SA - global leader of mobile telephony data services; Telcordia Technologies - world's largest provider of Operational Support Software
- Formed Warburg Pincus CIO Council. Members include CIOs from Citigroup, Ford Motor Co., Cisco Systems, U.S. Army and AT&T
- Rensselaer Polytechnic Institute, BS Electrical Engineering; Harvard Business School, MBA

StarVest Partners Strong Track Record

Since it started investing in 1999, StarVest has invested close to $140 million in 24 companies over multiple rounds of investment. Despite investing during one of the most difficult periods ever in the venture capital industry, returns for StarVest I are expected by its Partners to be 1.5-1.8x cash on cash, and a gross IRR of approximately 13%. These returns would put the Fund's performance near the top of its industry during this highly volatile and difficult era in the venture capital business. Most significantly, the Firm identified and invested in leading businesses in several highly attractive segments of the business services marketplace - dynamic growth sectors such as web-based financial services, Internet search optimization, reverse logistics, Software-as-a-Service, and business continuity and recovery.

Differentiated Deal Flow Generation

StarVest has demonstrated an exceptional ability to generate unique and differentiated deal flow. Evidence of this ability is that 60% of the StarVest I portfolio is comprised of investments where StarVest is either the only venture capital investor, the first institutional capital, or one of only a small number of venture firms with an ownership position in the company. This characteristic of the portfolio also represents over 80% of the expected return of the Fund. StarVest's success in generating unique deal flow is attributable to several elements of their strategy: the Partners have successfully mined geographic areas that are relatively underserved by the venture capital industry within the Southwest, Southeast, Midwest and New York metropolitan area; StarVest employs a highly proactive, research-driven approach to identifying promising areas of opportunity and engaging companies prior to their needing capital; the team aggressively solicits ideas and opportunities from their substantial network of contacts established through years of involvement in their targeted sectors of interest. As a result, investors in StarVest will likely not find many of their deals replicated in a typical L.P.'s portfolio.

StarVest utilizes its networks within the Harvard Business School Alumni Association Board of Directors, Young Presidents' Organization, Women's High Technology Coalition and Committee of 200, the pre-eminent group of women entrepreneurs and corporate executives; its extensive Fortune 1000 executive relationships, especially within the technology sector and within New York-based industries including financial services, communications, media and entertainment and advertising sectors; and its extensive experience investing with premier venture capital firms. Additionally, as several of their portfolio companies complete their plans to go public, StarVest is increasing its public profile as the largest majority women-owned venture fund building a sustainable firm investing in some of the leading businesses of the Internet era.

StarVest Partners Value Add

StarVest Partners has taken great pride in their ability to add value to their portfolio companies following an investment. The Partners collectively have over 85 years of experience working with management to build companies, and have provided assistance in key areas including: strategic planning, recruiting, negotiating and raising capital, advising on mergers and acquisitions, public offerings, and accessing and introducing strategic and corporate partners. StarVest has taken great advantage of its New York City location and relationships to make relevant customer introductions to major customers in many of New York's key vertical industries, including financial services, advertising, media, entertainment, retail, and communications. StarVest estimates that a significant amount of the aggregate portfolio company revenue has been generated as a result of introductions made by StarVest and its network.

OVERVIEW OF THE INVESTMENT PROCESS

Investment Process

StarVest employs a proactive, extremely selective, systematic investment process to business sectors where the Fund enjoys a competitive investment advantage due to the Partners deep domain knowledge and experience, and ability to add value post-investment. The Partners believe that long-term value is created by applying this systematic approach to growth markets and in companies having durable business models and talented management teams.

StarVest has generated proprietary deal flow through its network of contacts in its target industry sectors, the boards of current and former portfolio companies on which they serve, and their reputation for domain expertise in the Software-as-a Service, financial services, marketing services and eCommerce, among others. They have strong relationships with top tier venture funds and other investment groups with whom they have co-invested. Following their initial involvement, many well-known later-stage venture firms have found their portfolio to be an attractive source of later-round investments with most follow-on investments occurring at mark-ups to their entry valuation.

In StarVest I, over 50% of their investments were from their proprietary StarVest network, while 60% of the dollar commitments were in investments where they were the first, only or one of the few venture investors. The result for StarVest's Limited Partners is that their winning companies are found in few other venture funds' portfolios.

StarVest's investment process is briefly summarized in the five steps outlined below:

1. Deal Generation: Sourced and evaluated by Partners and team
2. Due Diligence: Prepare initial Gold Standard financial, business technical and legal diligence
3. Approval Process: Complete due diligence; Update Gold Standard; Discuss risks and merits with all 4 partners; Prepare Investment memo; Negotiate and sign Term Sheet
4. Closing: Negotiate documents; Finalize financing; Legal documentation and structuring
5. Portfolio Management: Quarterly financial and operational performance reviews; Board participation

In its investment selection process, StarVest screens businesses for an appropriate mix of:

- Committed and experienced management team
- Unique product or service addressing a large, robust market
- Defensible competitive advantage
- Potential for strong alliances and strategic partnering
- Opportunity to generate economies of scale across multiple business functions (in later stage companies)

StarVest seeks to reduce risk by:

- Focusing primarily on companies in the expansion-stage with $2 million+ in revenues that have lessened key risks such as product and customers, while still providing the greatest return upside
- Committing smaller amounts of capital in initial investment rounds of early stage companies
- Investing in companies that typically sell to corporations in a range of industries to mitigate industry concentration risk
- Actively assisting portfolio companies with sales execution and marketing strategy, financial engineering and product marketing and making introductions to indirect selling partners and potential customers

Liquidity and Exit

The Partners will analyze potential exit options at the time of the Fund's initial investment, as well as during the monitoring process. The Partners have broad experience in achieving liquidity through outright sales and initial public offerings. They will advise and assist management on the timing of these important steps in light of prevailing and expected capital market conditions.

Choosing the appropriate exit and guiding portfolio companies successfully through the liquidity process during a variety of business cycles is essential to the investing process. The Partners have had experience in many cycles over a period of three decades. Utilizing their experience and knowledge of capital markets, extensive investment banking experience and wide network of contacts within the business community, the Partners will provide guidance and access to the appropriate resources in assisting the portfolio companies with exit strategies. It is expected that most portfolio companies will achieve liquidity through strategic sales rather than public offerings.

With respect to initial public offerings, the Partners have experience taking companies public both as experienced investment bankers and long time private equity investors. The Partners are of the view that, in the current regulatory and market environment, critical mass is an important component in being a successful public company. They define this as revenue visibility of $100 million within a short time of being public. While only a minority of most venture backed companies have the ability to go public in the US, three of StarVest I's portfolio companies have plans to go public and will meet the $100 million in revenues criteria.

Strategic sales will be the expected liquidity route for most portfolio companies. Their goal is for best of breed companies (those with a specialized product or service contrasted with a broad platform) to achieve a 2.5 – 4.5x return on capital at a sale price of $100 million on revenues of $15-$30 million, depending on the sector. Buyers view young companies as providing (1) new product development, and/or (2) a rapid route to gaining critical mass, (3) certain research or development functions, (4) new applications of technology, such as use of the Internet as a new distribution channel. Companies with broader applications and customer bases will be merger candidates or standalone entities that can command higher sales prices. The Partners expect sales to strategic investors to remain an attractive and viable exit for the companies in the Fund's target sectors.

INVESTMENT STRATEGY

StarVest's investment strategy has the following six elements:

- Be the **first, only, or one of the few** professional institutional investors in a majority of the companies in the portfolio.
- Be highly **proactive** in opportunity identification through a **research-driven, market-based** approach to deal flow generation while leveraging unique network of sources.
- Target growth companies raising **expansion capital** and, opportunistically, on early and later stage businesses.
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- Concentrate on **underserved U.S. geographic technology business markets** to find **expansion-stage companies at earlier-stage valuations.**
- Target industry sectors that can benefit from StarVest's **New York City location and relationships** and the Partners **deep domain expertise** in these sectors.
- Maximize the advantages of StarVest's **women majority-ownership.**

StarVest will target companies that operate in large markets, and have the ability to be leaders within StarVest's sector focus: Software-as-a-Service, eCommerce, Internet Marketing Services, Data and Content-centric Services and Identity Management and Security Services.

First, Only, or One of the Few

StarVest will generally target companies that have had no or relatively few institutional venture capital investors at the time of our initial investment. It has been the Partners' experience that large investor syndicates, particularly earlier in a company's development, leads to ineffective and inefficient board decision-making. Also, the diverse interests of different types of institutional investors (particularly those of a larger or smaller size that have a different risk profile) may not align with StarVest's. StarVest has been very successful in generating opportunities where it is the first, only, or one the few venture investors in its portfolio companies. NetSuite, Insurance.com, iCrossing, and Newgistics are outstanding examples where this principle has proven to be highly advantageous.

Proactive, Research-driven, Market-based Approach

StarVest employs a proactive research-driven process to identify and analyze business sector opportunities that focuses on market dynamics and business model analysis. StarVest believes that the traditional funnel-based, triage approach typical in venture investing leads to follow-the-herd, me-too investments with weaker management in overheated sectors. Their process begins with markets, rather than technology. Once the Fund determines a particular area is attractive for potential investment, they initiate an intensive investigation into the sector, typically employing a subject matter expert (a respected industry executive or consultant) to augment the domain expertise of the Partners and their Advisors. Next, a list of potential targets for investment are compiled, and ranked according to their attractiveness, with the management team high on the list. The Partners then contact the priority targets to explore the opportunity to invest and build a relationship. By taking an approach which inverts the typical venture investment process, StarVest increases the likelihood of finding the most talented industry sector management and the likely market leaders in their respective areas. They have learned that it is the execution of an opportunity and not the technology that most frequently determines success. In parallel to this process, StarVest utilizes its network of sources to identify attractive companies that fit its research criteria.

Expansion-Stage Investments; Opportunistic in Early and Later Stage

StarVest Partners II will target companies that are attacking attractive growth markets and have shown tangible progress by generating revenue from multiple satisfied customers. The majority of the portfolio will consist of expansion-stage companies, defined as having run-rate revenue of at least $2 million. Companies in this stage have proven products, established customers, are ready to expand their product, sales and marketing capabilities and headcount. The Fund will opportunistically include exceptional companies at the early and later-stage ends of the investment spectrum where we have special relationships or knowledge. They do not invest in unproven "raw" technologies or in unproven markets.

This expansion focus, while opportunistically investing in earlier and later-stage situations, will produce a larger universe of worthwhile opportunities, diversifies the risk of a single investment category and investing cycle, and takes full advantage of StarVest Partners' skill sets and deep experience in multiple stages of investment and in the capital markets, which many firms do not have. The risk reward profile of expansion-stage investments is particularly attractive at this time, given their focus on generating deal flow from underserved markets where there is less competition in their target sectors. Their ability to add value at the expansion-stage differentiates the firm.

A typical first investment in a company would be $4-6 million, increasing to $8-14 million on average over the life of a successful investment, with a maximum of approximately $20 million, or no more than 10% of the Fund's capital. They anticipate making approximately 20-25 investments in StarVest II, compared with 24 company investments in StarVest I. Their target ownership is 10-25%.

Geographic Focus on Underserved U.S. Business Centers

StarVest will focus on geographic areas that are generally underserved by national institutional sources of expansion-stage venture capital. StarVest will tend to avoid those geographies having an oversupply of local venture capital (Boston/Silicon Valley) that often translates into multiple me-too investments at high valuations. Underserved emerging business centers - in the Southeast, Southwest, Midwest, and Rocky Mountain States - are typically served by regional firms with relatively less aggregate capital, and resident businesses are more likely to go outside their area for expansion capital. The less competitive nature of these markets creates opportunities to find more established companies at relatively more attractive valuations. While they have been successful in sourcing attractive deals in Silicon Valley and Boston, many of their outstanding investments are in underserved markets, including Cleveland, OH, Austin, TX, Scottsdale, AZ and Chicago, IL. StarVest Partners will continue to develop its network of deal sources, co-investors, and business executives in these markets, which will be exploited in the new Fund.

Target Sectors Benefit from our New York City Location

StarVest will target companies in business sectors that benefit from the network and strategic relationships we have in industries based in the New York City metropolitan area. The Partners have worked in or are subject matter experts in many of these industries. StarVest will market these benefits to promising businesses and management teams in the underserved U.S. business centers mentioned above, increasing the probability of finding and closing attractive investments. These business sectors include:

- Financial Services
- Advertising
- Media and Entertainment
- Consumer Products
- Telecommunications
- Retailing

StarVest will continue to build on and add to its outstanding network of thought leaders in these industries through membership on our Advisory Board, Executive-in-Residence, and other network development programs.

OVERVIEW OF TARGET INVESTMENT SECTORS

The technology landscape is undergoing a continued period of extraordinary change that is characterized by innovation, growth and the exploding use of new Internet applications and services by both enterprises and consumers.

Just over a decade into the launch of the commercial Internet investors continue to underestimate the impact the Internet will continue to have in changing business processes and consumer behavior on a global basis. The first wave of change has occurred but there is much more ahead and this represents investing opportunity. In 2006, there were an estimated one billion global Internet users and 209 million global broadband subscribers (up 41% year over year) while global search query volume expanded 28% year over year. These are huge numbers that are expected to continue to grow: from 2005 -2010, Morgan Stanley estimates annual global growth of 10-15% for Internet users, 20-30% for usage and 30%+ for monetization and additional substantial annual growth in global broadband users.

While a tremendous amount of technological change has occurred over the last decade, key trends indicate that the pace of change will only accelerate:

- Consumers increasingly buy everything over the Internet from shoes to insurance as consumers become more empowered, demand more choice and embrace self-service models.
- Communities and communication from FaceBook to blogging are becoming ubiquitous and are changing the nature of interaction and personal behavior.
- As a result, Internet advertising and marketing are rapidly taking an increasing share of expenditures from traditional media to reach consumers in new ways and target select groups in a manner and at prices never before possible.
- Enterprises of all sizes are outsourcing more activities via the web to parts of the world where these needs can be met most efficiently at the lowest cost, thus fueling growth in Asia and other developing parts of the world and creating global shifts in wealth and resources.
- Business processes are being transformed and streamlined using the web, producing both savings and enabling innovation that provides new sources of growth in products and services for enterprises.
- The content and data that is captured and aggregated using new technologies provides opportunity for monetization and creation of new businesses.
- Security for eCommerce and point of sale transactions and protection of identity and personal data is of increasing importance in an electronic Internet age where both individuals and nations face unprecedented physical and financial threats.
- New business models have emerged that have been made possible by the Internet. Foremost among these is Software-as-a-Service ("SaaS") or on-demand software that is delivered over the Internet, hosted by the provider and is redefining the software industry in a challenge to entrenched providers of legacy systems. An entire breed of young companies is emerging that employ this model to service customers with low initial entry prices, ease of use and deployment.

To capitalize on these trends, StarVest has identified certain key sectors within technology enabled business services for the focus of StarVest Partners II. Leveraging their track record in StarVest I of identifying leaders in many of these sectors, StarVest expects the following sectors to experience continued high growth during the life of the Fund and expects to make investments in the following areas:

- Software as a Service
- Internet Marketing Services
- eCommerce
- Data and data centric services
- Identity Management and Security Services

Software-as-a-Service ("SaaS")

Software offered on a subscription basis and delivered over the Internet. SaaS is one of the most important and disruptive changes in the structure of the software industry in the last decade. SaaS, or on-demand software, effectively redefines the software deployment model from packaged applications with up-front licensing fees and lengthy implementations to one that constitutes a "pay-as-you-go" service relationship while SaaS is gaining acceptance with enterprise clients, it will be particularly effective in selling to the small and medium business ("SMB") market, the fastest growing segment of IT demand which is estimated to account for 60% of the demand for these products. SaaS will grow rapidly as Web based applications gain broad acceptance due to their cost advantages and ease of deployment and use. StarVest believes attractive investment areas are:

financial applications, human capital management, enterprise resource planning and supply chain.

Internet Marketing Services

Software technologies and services used by marketers and professionals to acquire and retain customers and build brands on the Internet. This includes customer acquisition, retention and analytics on the Internet, online advertising, marketplaces and search engine marketing. On-line ad spending relative to usage remains low so that advertising and marketing spend will continue to shift to the Internet, along with the increasing need to measure, target and personalize offerings to specific customers and groups. Key sectors with expected high growth are search, rich media (particularly Internet video), email and web analytics.

Technology Differentiated eCommerce

Electronic commerce, or eCommerce generally refers to the buying and selling of products and services over the Internet and the marketplaces that enable transactions. StarVest seeks to identify companies that develop and sell products and services that enable business to business (B2B) and business to consumer (B2C) transactions employing differentiated technology that enables them to build defensible positions.

Data and Content-Centric Services

New systems and Internet technologies enable the collection and aggregation of data in forms and volumes not possible previously. As a result, new businesses are being built based on the data and content that is created or aggregated using the new technologies. This often specialized content or data associated around a community of interest or vertical business markets such as financial, media and other services and niche market segments.

Particular sectors of interest in this area that have the greatest possibilities are free data collectors, paid listing services, measurement and rating services and information co-ops.

Identity Management and Security Services

Products, applications and solutions that address the needs of businesses and consumers for ensuring the integrity and continuous operation of the systems, transactions and activities upon which they rely. With the increasing use of the Internet by consumers to purchase virtually everything, the problem of identity theft and the need for authentication in eCommerce and point of sale transactions has expanded dramatically. IT security spending is growing faster that overall IT spending and a recent Gartner survey of CIOs found that security is their top technology priority and reducing risks is their top business priority.

Sectors that are poised for growth and investment are biometrics, unified threat management and secure content management. In summary, StarVest II will continue to build upon the strategy and successes of StarVest I and is well positioned to take advantage of the huge growth in Internet usage and key investment sectors as outlined above.

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Portfolio Advisors, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed $50 million plus reasonable normal investment expenses, in StarVest Partners II, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.