


## Commonwealth of Pennsylvania Public School Employees' Retirement System

**DATE:** September 16, 2013

**SUBJECT:** High Yield Debt Recommendation

**TO:** Members of the Board

**FROM:** Joseph W. Sheva, CPA   
Portfolio Manger

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At the October Finance Committee meeting, staff and Portfolio Advisors will recommend that PSERS commit \$200 million to the Summit Partners Credit Fund II, L.P.

The investment thesis for investing in the middle-market lending area of the high yield market is based upon a significant need for debt capital providers in the middle-market space where capital available to middle-market companies has been constrained due to a reduced appetite from banks and hedge funds for junior lending. This financing need creates opportunities for non-bank lenders and investors to secure attractive risk/reward opportunities. Summit is targeting low- to mid-teens net returns in Fund II.

Summit anticipates that Fund II investments will be allocated geographically focused on North America (75 – 100%) and Europe, with a limit of 25% of aggregate commitments invested in non-U.S. issuers. It is noted that PSERS has made commitments to Sankaty, Cerberus and LBC Funds, focused on U.S. middle-market lending and also made commitments to ICG and HayFin Funds, focused on European middle-market lending. Summit's primary differentiating factor is their proven deal-sourcing platform and network of relationships.

Summit is deemed to be an institutional quality global investment firm, specifically in both the U.S. and Europe which are geographic regions where staff and Portfolio Advisors believe attractive risk/return opportunities currently exist for middle market lending.

Included for your review are Portfolio Advisor's recommendation, a PowerPoint presentation prepared by staff, and the resolution recommending an investment in the Fund.

If you have any questions or comments prior to the meeting, please contact me at 717-720-4632.



September 16, 2013

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

Re: Summit Partners Credit Fund II, L.P.

Dear Trustees:

Summit Partners, L.P. (the "Firm" or "Summit") is targeting \$750 million of commitments for Summit Partners Credit Fund II, L.P. (the "Fund" or "Credit II") and expects to hold a first close in October, 2013. Summit Partners Credit Fund II will continue the strategy employed in Summit Credit Fund I, seeking to originate private corporate debt sourced directly through the Summit proprietary deal-sourcing platform. While investments may be senior or subordinated, the majority of these investments are anticipated to be secured by a first or second lien security interest in the assets of the borrower and will often require the borrower to comply with a set of maintenance covenants governing a series of operating financial metrics. Summit Credit will target mezzanine returns while lending to a structurally senior level in the capital structure. Summit Credit typically targets investments to be between 2.0x and 4.0x EBITDA and to be between 25%-55% of a company's capital structure (in terms of seniority). The average blended coupon across the first thirteen investments (including the three recent investments) in Fund I through September 3, 2013 is 13.8% with an average of 0.72% PIK plus 2.77% OID/closing fees.

By focusing on private origination, the Firm expects to be heavily involved in the negotiation of credit documents and corresponding covenants so that it may structure credit facilities to best protect itself from potential downside risks. In Credit Fund I, the Firm was the lead or co-lead investor in nine of the thirteen investments, representing this focus on origination. This focus stems from the Firm's fundamental view that liquidity is often mispriced in the marketplace and that private loans can offer an investor unrecognized value relative to more liquid investments.

The Fund intends to leverage the Firm's approach of proactively sourcing investments to exploit more unique opportunities within the middle market. Summit has successfully employed this approach over the past 25+ years in its core growth equity franchise. The Firm's extensive sourcing platform has created opportunities to invest in companies that do not fit the investment criteria of the Firm's main growth funds, but still offer attractive risk-adjusted return metrics. Summit believes that the middle market remains significantly under-served by traditional lenders, which has created an opportunity for able investors with strong sourcing and origination capabilities. Unlike many of its competitors who do not possess a dedicated calling program, Summit can capitalize on its platform to find attractive investment opportunities.



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.
- 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, Connecticut Office  
Jeffrey Gruccio – Vice President, Connecticut Office  
Geoffrey Kelleman – Associate, Connecticut Office

Based on the above, Portfolio Advisors recommends that PSERS commit to up to \$200 million of limited partnership interests in Summit Partners Credit Fund II, 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