

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
PRIVATE EQUITY INVESTMENT COMMITTEE

March 14, 2007

CALL TO ORDER

A Regular Meeting of the New Mexico Educational Retirement Board Private Equity Investment Committee was called to order on this date at approximately 2:00 p.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

A quorum was present, as follows:

Members Present:

Mr. Bruce Malott, Chair

Mr. Gary Bland

Mr. Jeffrey M. Riggs, Acting Executive Director

[Present but not voting: Arthur "Larry" Castillo, representing Member Lewis.]

Members Excused:

Mr. James Lewis

Other ERB Members Present:

None.

Legal Counsel Present:

None.

Staff Present:

Mr. Steve Neel, Portfolio Manager

Others Present:

Mr. Bob Jacksha, Chief Investment Officer

Mr. Saul Meyer, Aldus Equity

Mr. Richard Ellman, Aldus Equity

Mr. Holland Gary, Aldus Equity

Ms. Judith Beatty, Recorder

APPROVAL OF AGENDA

The Agenda was reprioritized.

Mr. Bland moved approval of the Agenda, as amended. Mr. Riggs seconded the motion, which passed by voice vote.

APPROVAL OF MINUTES: January 10, 2007

Upon motion by Mr. Bland, seconded by Mr. Malott, the Minutes of the January 10 meeting were approved by voice vote, as submitted.

FUNDING UPDATE/LEVINE LEICHTMAN AND PERSEUS PARTNERS, LLC: ERB STAFF

Following up on the January meeting, when the Committee approved funding for Levine Leichtman Capital Partners and Perseus Partners, Mr. Neel reported that negotiations were completed, capital calls made, and LLCP has already begun distributing the funds.

APPROVE INVESTMENTS: ERB STAFF & ALDUS EQUITY

1. Newstone Capital Partners

Mr. Ellman stated that Newstone Capital Partners has exceeded its originally targeted fund size of \$500 million, and they are now expected to receive \$850 million in capital commitments in this mezzanine type fund.

Mr. Ellman reported that partners John Rocchio and Tim Costello were previously at TCW Crescent, where together they invested about \$2.4 billion over a period of 12 years, producing returns of 1.8x invested capital at 23.3% gross IRR. He said Messrs. Rocchio and Costello were two of the three principals primarily responsible for investing mezzanine funds at TCW.

Mr. Ellman stated that Mr. Rocchio, Mr. Costello and their partner, Rob Brougham, have combined experience of 60+ years, making this an exceedingly deep team with an outstanding track record in the target area.

Mr. Ellman said Aldus noted the team's success over different economic cycles, with consistent returns that have been on par with buyout equity firms, even though

the mezzanine structure of their investments is much more risk mitigated — so even during the liquidity crunch of 2000, they had no write-offs.

Mr. Ellman said Newstone structures their deals to facilitate capital preservation, and makes sure they have the opportunity to participate in the upside equity through warrants and other equity components. He said this has kept their loss ratio under 5%, and they do that by focusing on large, stable cash-flow businesses and they typically structure their deals to have a substantial cash coupon in the range of 10%-13%. He added that, while they target returns at 10%-20%, they have consistently exceeded that percentage.

Mr. Ellman noted that Newstone invests throughout the capital structure in order to maximize the risk-adjusted returns, and they typically combine securities with the debt investments in order to capture upside potential. He said they mitigate risk with prudent uses of leverage – their weighted leverage ratio is about 5x.

Mr. Ellman said Aldus was attracted to Newstone's mitigation of risk through diversification. He commented that they diversify across industries phenomenally well; they have their core mezzanine strategy along with expertise in multiple industries.

Mr. Ellman stated that LBO activity has been at record levels over the last couple of years, which has created tremendous opportunities, and U.S.-sponsored volume has been extremely high and continues into this year. He said this is a great time for management and Aldus believes that this trend will continue.

Mr. Ellman noted that Newstone has already done seven deals in this Fund, investing about \$190 million to date.

Mr. Ellman said Newstone also diversifies across sponsors, and has a competitive advantage through excellent relationships in the private equity community, investing alongside top tier firms such as Madison Dearborn, Oak Hill and Texas Pacific, and it is these relationships that enable them to source these top tier transactions.

Partner John Rocchio presented slides. He said he and partner Tim Costello founded this firm in early 2006 with the goal of building a world class mezzanine team fund and business as they did at TCW.

Mr. Rocchio stated that they have closed on \$660+ million through February 2007 and have hard commitments today in excess of \$800 million. He said they have agreed to cap the Fund at \$850 million.

Mr. Rocchio noted that they closed an eighth transaction two days ago with over \$200 million invested in total to date.

Mr. Rocchio stated that he and Mr. Costello have committed \$5 million each to the Fund, which was a meaningful part of their net worth. He said, "We're putting our money in side by side with you. This is no management fee offset. There's no loans here. You have a capital call, we have a capital call."

Mr. Rocchio stated that this is Newstone's fourth fund, and they have been dedicated to this category for 14 years. He said they are exercising exactly the same discipline, strategy and philosophy in this Fund as in the three previous funds.

Mr. Rocchio said Newstone invests with leading private equity sponsors; while a typical LBO has bank debt, a mezzanine tranche and then equity, the equity in all of Newstone's transactions averages 36% of the capital structure. He said this 36% cushion in the valuation of a company is critical to them, which is why they seek sponsor-driven strategy — they have money at risk, the management contacts, and the stewardship and control. He said these elements mitigate risk.

Mr. Rocchio also stated that most of the companies Newstone invests in could go public because of their size and scale, which gives them great exit opportunities.

Mr. Rocchio said all fees generated by the Fund will go back to the LPs, which has the effect of reducing the management fee by about 25 basis points. He said the GP fee split is 80/20 with an 8% preferred return.

Mr. Rocchio stated that they will no longer make capital calls for management fees and have not done that for the past nine months, and they will start making distributions in the third quarter of 2007, within the first year of operation.

Mr. Neel noted that the cofounders are in separate offices, with Mr. Costello in Dallas and Mr. Rocchio in Los Angeles, and asked how that works logistically.

Mr. Rocchio responded that Mr. Costello operates with an assistant in the Dallas office but spends an inordinate amount of time in Los Angeles, and that the firm has operated this way for the past 14 years. He added that the team spends a great deal of time on the road attending board meetings and visiting companies, and so where Mr. Costello is centrally located is not critical to the operation.

Responding to additional questioning from Mr. Neel, Mr. Rocchio said Newstone has a 1.25% management fee on committed capital, and pays its people out of that fee, but that is not the bulk of the partners' compensation. He said the bulk of their compensation will come from a carry if they are successful.

Mr. Jacksha said he understood the SIC has also committed funds to Newstone, and Mr. Meyer said the SIC committed almost \$30 million. He added that Aldus has

known the partners for a long time, and in fact knew them when they worked at TCW, when they had funds for up to ten years with them.

Mr. Bland moved that the PEIC recommend to the Educational Retirement Board a commitment of \$20 million, not to exceed 20% of the committed capital of the fund, to Newstone Capital Partners, L.P. subject to and contingent upon New Mexico state law, New Mexico Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Riggs seconded the motion, which passed by voice vote.

[Break.]

2. HM Capital 2006 Sector Performance Fund, L.P.

Mr. Gary introduced HM Capital Chairman John Muse as well as Ed Herring and Charles Bauer.

Mr. Gary said Aldus was recommending a \$20 million commitment to 2006 Sector Performance Fund, L.P., a middle market buyout fund with a target size of \$1 to \$1.5 billion.

Mr. Gary stated that the Fund's sector focus in energy, food and media is very attractive to Aldus because of the group's strong track record in these areas. He said this is one of the premier longstanding groups in the Southwest doing buyouts, and has a strong reputation in the energy space in particular.

Mr. Gary said HM Capital is the new brand name for Hicks, Muse, Tate & Furst Incorporated, a firm that goes back to 1989. He stated that the group has been consistently focused in this space for the past 17 years, and has some international exposure as well. He noted that HM Capital made a successful transition from the firm's original founders to the next generation of management, and two of the founders (including John Muse, present today) remain actively engaged with the Fund. He commented that making this kind of jump is a key risk with a lot of funds, but Aldus has observed that not only has HM effectively done this, but Fund V performance proves out the success of that transition.

Mr. Gary stated that the firm is weighted a little heavily toward the senior side, although there are plenty of partners to drive the process forward and who take active roles in each deal; in fact, their change-capital strategy actually demands senior level focus and engagement.

Mr. Gary noted that Hicks, Muse, Tate & Furst is credited with initiating the term for buy-and-build strategies, and “change capital” is the next evolution of that. He said a big part of their change capital initiative was taking the experience gained from the first four funds and refocusing it in Fund V into under-managed, under-capitalized and underappreciated companies, so the capital isn’t just infused for a financial investment but actually is a catalyst for unlocking the next stage of value within the target companies.

Mr. Gary said Aldus looked at HM’s entire track record and then at their representative investments that would be pursued in Fund VI. He said a set of investments in Funds III and IV that were outside their strategy were not brought into Fund V and would not be brought into Fund VI, either.

Mr. Gary reviewed HM’s overall track record against the relative peer group and noted very consistent above-median performance across the board. He stated that Fund V had low volatility, did quite well, and all of the exited investments to date have been strong. He added that Aldus took a longer look at the significant number of unrealized investments remaining in Fund V and observed that a number of the change capital initiatives have been executed and the Fund should realize strong value from those activities.

Messrs. Muse, Herring and Bauer gave a slide presentation that included the strategies used in HM Capital’s “success formula.”

Mr. Muse stated that HM Capital announced last week that Eric Lindberg, one of HM’s younger media partners, would be leaving the firm to do something more entrepreneurial in earlier stage investing in technology surrounding media. He said this area is not in HM’s strategy nor in its mandate with its investors. Mr. Muse said Mr. Lindberg will see out two portfolio exits that HM is in the process of completing, and will not be part of Fund VI. He said partner Peter Brodsky has expertise in media and he and some of the other professional staff can easily cover cable TV, which is where Mr. Lindberg spent most of his time.

Mr. Neel asked Mr. Muse how HM’s change capital thesis differs between its energy space and its food service space.

Mr. Muse responded that it was hard to generalize about a sector, industry or a company. He said there may be an organic opportunity, for instance, in the media sector where they can launch in a market where there is no competition versus going into a market primarily through acquisitions. Addressing energy, Mr. Muse stated that it is currently not possible to buy a scale asset (\$200-\$300+ million) in the midstream sector unless there is something that needs to be changed or restructured. He said right now HM looks more at buildup, i.e., taking a base asset and then growing around it.

Mr. Herring stated that they try to have downside protection while buying cheap optionality with a focused effort for value-add. He said energy is all volume-driven, although obviously there is commodity price sensitivity at time of exit, so they try to be up to date with the trends. He said period-to-period commodity price fluctuation, however, does not dictate their investment returns.

Mr. Muse said the profile for food companies looks somewhat different, because usually there is an element of under-management in the business. He stated that they bring in top-flight management teams and optimize the business after taking it from the previous owner. He said this is where HM Capital's "buy and build" strategy came from.

Mr. Muse stated that HM is really agnostic when it comes to which way is the best way to grow a business (through acquisition or organic growth), although lately they have been focusing on organic growth.

Mr. Jacksha observed that Aldus's analysis excluded HM's returns in the Latin American and European markets, and asked Mr. Muse if those markets did not work well for HM.

Mr. Muse explained that Europe worked very well, but that team is now independent of HM. He said the Latin American market was really a macro issue. He stated that most of their investments were in Argentina, and they invested at a time when there was 8% GDP growth, Carlos Menem was in power, there was a lot of economic and political reform, and HM could buy things with a higher growth rate at better relative value in Argentina. He stated that most of their assets were in media, when they had two very successful early investments, and then literally overnight the peso was devalued to 78%. He said the result was cataclysmic, and HM decided in 2001 it would not invest outside of Canada and the U.S. He added that they have since made a nice recovery and will get 75-80 cents on the dollar. Mr. Muse said the only other large Latin American fund of the same vintage was Excel, which lost control of all their companies.

Mr. Bland moved that the PEIC recommend to the Educational Retirement Board a commitment of \$20 million, not to exceed 20% of the committed capital of the fund, to HM Capital 2006 Sector Performance Fund, L.P. subject to and contingent upon New Mexico state law, New Mexico Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Riggs seconded the motion, which passed by voice vote.

3. Industrial Opportunity Partners, L.P. [IOP]

Mr. Meyer introduced IOP partners Bob Vedra, Ken Tallering and Andy Weller.

Mr. Meyer stated that Aldus was recommending a \$20 million commitment to IOP, a \$150 million LBO fund focused on difficult companies with turnaround situations. He said IOP has a very deep and very broad team.

Mr. Meyer said they have closed on \$95 million to date, with \$20 million coming in the next close, \$170 million circled, and a \$185 million cap.

Addressing strategy, Mr. Meyer said IOP is looking at Old Economy investments and is focused on targeting underperforming companies. He said they use deep operational talent on their staff to complement their strong private equity expertise, and have a hands-on operational focus. He stated that this approach has created a favorable risk return profile.

Mr. Meyer said the buyout market in this area has grown incredibly fast, and debt is very loose right now. He stated that this firm buys companies at 4x multiples rather than the usual 7x or 8x. He commented that this represents a great diversifier in a frothy market.

Addressing IOP's heavy operational focus, Mr. Meyer said they utilize their operating partners to actually become senior and key management in the companies, and quite often they move to replace large portions of the management when purchasing companies.

Mr. Meyer stated that this is a firm with relatively low volatility, yet the historic IRRs and historic multiples are 4x and 70%.

Mr. Meyer stated that, although this is a first time fund — and Aldus has seen funds operating similar spaces continue to grow and be in incredible demand lately — the staff has a lot of connections and have worked together in the past in various lives.

Mr. Meyer said that, while the Fund's management fee of 2.5% seems high, it is relatively low in the context of a \$150 billion fund versus, for instance, a 1.25% fee on a \$1 billion fund.

Noting that this is a first time fund, Mr. Meyer stated that Aldus did a simulated fund by taking deals from the various principals and combining them into a single portfolio. He pointed out that, on a gross basis realized, the result was 90+% IRR and 13x; and on a combined basis unrealized, the result was 66% and 6x.

Looking at a peer group analysis, Mr. Meyer contrasted the simulated fund against 2000 U.S. buyouts and noted that IOP significantly outperformed their peers in that vintage year and were in the top decile of funds. He contrasted a 17% net IRR in U.S. venture economics in 2000 versus IOP's 53.1%.

Mr. Meyer said there are several transactions in the portfolio that Aldus will be watching. He said one is the Algoma Group, a manufacturer of architectural wood doors, which was purchased April and has already doubled their EBITDA. He stated that there is already a lot of value in the portfolio to quickly come out of the J-curve.

Messrs. Vedra, Tallering and Weller presented slides.

Responding to questioning from Mr. Malott on deal sourcing, Mr. Tallering commented that, even in this floppy market, IOP is still buying companies between 4 and 5 times EBITDA. He said these companies are underperforming in some way, which doesn't mean they are all distressed or in bankruptcy; rather, they don't have the right management or they have a cost structure or operational type issue that is holding them back.

Mr. Tallering explained that, when IOP took over Algoma last April, they bolstered the senior management team by putting IOP's operating principal as the CEO, and then recruited a new CFO and an operating person from IOP's past and supported the existing management team with these people. He said IOP also shifted door production from a high cost Wisconsin facility to a lower cost Tennessee facility.

Mr. Vedra also stated that, when IOP goes into a deal and it works right and they can turn it around in a year or 18 months, and if the market is strong to exit on it, they will do a fix-and-sale and let the next buyer do the job of growing the business back up from there.

Mr. Weller said some businesses have longer holding periods because the requirements that will be needed in order to fix the company will take longer — so having a 3-5 year horizon is possible.

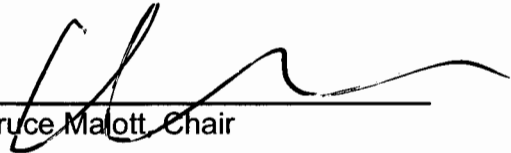
Mr. Bland moved that the PEIC recommend to the Educational Retirement Board a commitment of \$20 million, not to exceed 20% of the committed capital of the fund, to Industrial Opportunity Partners, L.P. subject to and contingent upon New Mexico state law, New Mexico Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Riggs seconded the motion, which passed by voice vote.

ADJOURN

Its business completed, the Private Equity Investment Committee adjourned at approximately 3:30 p.m.

Accepted by:



Bruce Malott, Chair