

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

**April 9, 2008**

**ROLL CALL — NO QUORUM**

A Regular Meeting of the New Mexico Educational Retirement Board Private Equity Investment Committee commenced on this date at approximately 9:10 a.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

*A quorum was not present:*

**Members Present:**

Ms. Jan Goodwin

**Members Excused:**

Mr. Bruce Malott, Chair

Mr. Gary Bland

Mr. James Lewis

**Other ERB Members Present:**

None.

**Legal Counsel Present:**

None.

**Staff Present:**

Mr. Bob Jacksha, CIO

Mr. Steve Neel, Portfolio Manager

Ms. LeAnne Larrañaga-Ruffy, Investment Officer

Mr. Jeffrey M. Riggs, Deputy Director

Mr. Greg Trujillo, IT Director

**Others Present:**

Ms. Judith Beatty, Recorder

Mr. Holland Gary, Aldus Equity

Mr. Saul Meyer, Aldus Equity

[Because a quorum was not present, the Committee proceeded with non-action items.]

### **FUNDING UPDATE: ERB STAFF**

Mr. Neel reported that the market value of the private equity portfolio is now at about \$73 million. He said approval of the two recommendations on today's agenda would bring the total to \$455 million in commitments in 19 partnerships.

Mr. Neel stated that contracts with Apollo and Fletcher Spaght have been executed, and staff is finishing up negotiations with Bridgepoint, Ares and Platinum. He said Leeds Equity is next in the queue and should be fully executed by the next meeting (in June).

Mr. Neel also reported that, with respect to Fletcher Spaght, the firm anticipated a slightly higher commitment than would have been allowable under the ERB's 20% limit on the committed capital of a fund, so staff has had to cut back to about \$21 million. He said Fletcher Spaght has gone back to their LPs to see about extending the commitment period.

Mr. Meyer reported that \$400 million has been allocated for this year, with about 51% to Leveraged Buyout, 10% to Venture, 23% to Mezzanine and 16% to Special Situations.

### **APPROVE PRIVATE EQUITY INVESTMENTS: ERB STAFF AND ALDUS EQUITY**

#### **1. ComVest Investment Partners III, L.P.**

Mr. Gary reviewed Aldus Equity's recommendation of a \$25 million commitment to Comvest Investment Partners III, L.P., a \$400 million fund that makes control-oriented investments in financially or operationally stressed or distressed companies. He said ComVest focuses primarily on small and micro-cap business in the manufacturing, healthcare, information technology and communication sectors, and the Fund will target lesser followed, thinly traded, out-of-favor companies with enterprise values under \$250 million.

ComVest partners Michael Falk and Mark Hughes joined the proceedings.

Mr. Gary reported that Mr. Falk co-founded Commonwealth Associates, an investment banking firm with offices in West Palm Beach and New York City, in 1988, and in 1993 began partnering with Robert Priddy on investment transactions.

He said ComVest launched ComVest Venture Partners in 2000, their first private equity fund, and since then have had strong performance in that space.

Mr. Gary stated that, with respect to potential concerns about conflicts of interest, each division of ComVest has a fairly bright line between the other divisions from a strategy perspective, and all control distressed private equity investing will solely come out of this Fund. He said there is also a dedicated team focused around this Fund. Finally, he said, there will be a conflict management board, composed primarily of limited partners with only one representative of the general partner, that will provide the appropriate governance with respect to potential investments and conflict opportunities that might arise.

Mr. Gary commented that the team is quite large and deep for a fund of this size; and with this strategy around micro-cap potentially public entities, there is an excellent combination of financial expertise, investment banking expertise and transactional expertise, all augmented with very strong operational expertise.

Mr. Gary discussed ComVest's unique sourcing model of pursuing proprietary, non-auction transactions, which enables them to benefit from less competitive pricing. He said this is not a group out looking at general auctions or through investment banking books that come across their desks; rather, they go out and develop their own proprietary database that leverages all of their relationships both from the parent entity but also from proprietary relationships that they have developed from being in this space for a period of years.

Mr. Gary commented that there are not many groups targeting this specific space of distressed micro-cap companies, and this type of investing requires detailed negotiated deal structures as well as active involvement and oversight of a company. He noted that few investors possess the requisite experience and skill, including legal expertise, required to undertake such transactions.

Addressing track record, Mr. Gary said Fund I was a blended strategy of both venture and distressed control-oriented investments; and excluding venture investments, a strategy ComVest abandoned in 2002, Fund I generated a 40.8% gross IRR and a 1.9% investment multiple. He said Fund II, a control-oriented distressed fund, has generated a 60.2% gross IRR and a 2.4% investment multiple.

Mr. Falk and Mr. Hughes presented slides to the Committee.

Mr. Falk stated that he and co-founder Robert Priddy have worked together for 19 years and are significant personal investors in the Fund, with \$50 million invested. He said the remainder of the team are investing \$1-\$2 million per member.

At Mr. Neel's request, Mr. Falk reviewed ComVest's strategy with EVCI, one of its four investments in the portfolio.

Mr. Hughes discussed upcoming investment opportunities in the auto parts aftermarket and apparel retail space.

Responding to questioning from Mr. Neel, Mr. Falk said ComVest usually brings in outside consultants to complement their own legal, accounting and technical due diligence work.

Mr. Neel observed there are few attorneys on the ComVest team, and asked how they cover that given the intensity of legal work required in this distressed space.

Mr. Falk responded that ComVest has developed very close relationships with bankruptcy counsels over the years who assist ComVest when necessary. He added that ComVest really isn't a distressed debt trader, though, so a lot of what they do doesn't necessarily go through bankruptcy. He added that Larry Lenig, who was formerly a chief restructuring officer and interim CEO, joined the team four years ago and has excellent skillsets in bankruptcy and financial negotiations; and if ComVest needs someone to do the legal work, they will outsource that.

Mr. Falk clarified that the terms on the sharing of fees have been changed and are now two-thirds for the LP and one-third for the GP. He pointed out that the fees charged in their last fund were very small.

Mr. Neel noted from the LPA that the advisory committee members can be removed by the GP without cause, and asked if that has been addressed.

Mr. Falk responded that he doubted that was still the case, but would have no problem revising the documents as necessary.

Mr. Neel asked for discussion on the ComVest umbrella and the firewalls that they employ to avoid conflict problems.

Mr. Falk responded that Commonwealth Associates is based in New York City, and he has sold the majority of his interest to the management team. He said Robert Priddy has no ownership in Commonwealth, and they have no inter-business. He said ComVest's finance and administration staff helps Commonwealth take care of their back office accounting, but that is the only association.

Mr. Falk clarified that their hedge fund is a fund-of-funds that invests in absolute return funds, involves \$3 million of his own money and about \$10 million of Mr. Priddy's, and has nothing at all to do with the business.

Mr. Falk also clarified that he has \$2 million in the lending fund and Mr. Priddy has \$3 million in the lending fund.

Mr. Falk stated that he has \$15 million in Fund III and Mr. Priddy has \$35 million in Fund III.

Mr. Falk said the only area of potential conflict is the lending fund, which makes secured loans to small businesses between \$5 million and \$15 million. He said it is managed by a completely different team that is led by a secured lender out of Wachovia and GE Capital. He stated that there could be a potential conflict if the lending fund were lending to a company in which his fund was making an equity investment. He added that this has not happened, however.

Mr. Falk said another conflict could arise where his company might want to make an investment in or to buy a company that has taken out a loan from the lending company. He added that this is a real possibility, because the loan portfolio is growing and there are some promising opportunities beginning to appear in that fund. He stated that this was the reason for setting up the fund to start with, because their business origination group was being approached by small distressed companies that were looking for capital but weren't interested in changing control at that time.

Mr. Falk stated that their institutional conflict committee/advisory board always looks at these issues, giving them the necessary degree of comfort.

[Action on this item was deferred to the April 22 Investment Committee meeting.]

## **2. Clayton, Dubilier & Rice Fund VIII, L.P.**

Dave Wasserman, financial partner in Clayton, Dubilier & Rice, was present.

Mr. Meyer pointed out that, while Aldus is traditionally reticent about going heavily into the very large buyout firms, CD&R has always been different, because they very much on the operating end of the spectrum between those who focus on financial engineering versus operations. He commented that the challenges Aldus has seen with the very large buyout firms are around the ability to truly make operational changes and provide value, and CD&R's consistent operational focus has driven a lot of their returns, which makes Aldus very comfortable.

Mr. Meyer commented that operational engineering was very big in the 2001-02 period, when people were bringing in teams with deep operational expertise, and now that is coming back into vogue.

Mr. Meyer said Aldus recommends a \$40 million commitment to CD&R, which is raising \$7.5 billion in Fund VIII. He stated that Aldus feels this is an appropriate size given the size of the investment commitments they make. He stated that five of their seven funds are, or have been, in the top quartile, and six are in the top half and 50% of them have generated greater than a 30% gross IRR.

Mr. Meyer said CD&R has 33 investment professionals based in New York in London, and the firm has a very deep history; the average tenure of the professionals at CD&R is 12 years. He stated that key to their success is that they have five dedicated operating partners and one of their special partners is Jack Welch, which demonstrates a lot of the operational expertise that the firm brings to bear.

Mr. Meyer stated that Aldus likes the fact that CD&R has a very flat structure, and their incentive structure is that of a single firm culture. He said this is a common theme in a lot of groups that have restructured and reorganized after going through a generational shift, and CD&R has successfully gone through that transformation. He commented that a lot of firms with long histories will experience a stumble that necessitates a generational shift, and Aldus prefers to wait for that, since they believe this allows a firm to fix a lot of problems and improve performance.

Mr. Meyer said the \$200 million commitment by the GP to the Fund is impressive; and while the 1.5% management fee during the commitment period is still significant for a \$7.5 billion fund, the step-down to .75% thereafter is well below market.

Mr. Meyer noted that, since 2003, seven of the last eight companies CD&R has purchased have been carve-outs and not public-to-private transactions. He said this is a very different model from most of the other large firms, and Aldus believes that the firm going forward will have a greater ability to source deals as more and more companies they are tracking are sold off by the large corporations in a less favorable market.

Addressing the firm's focus on returns driven through operational improvement, Mr. Meyer presented a graph reflecting that 89% of the growth of a company operated by CD&R is realized through EBITDA enhancement.

Mr. Wasserman gave a slide presentation.

Mr. Wasserman pointed out that three things distinguish CD&R from many other investment firms: 1) There is deep integration of operating and financial skills. 2) They are more focused than most firms. They have done only nine deals in the last five years, and they typically source deals for three or four years to make sure they have a very deep understanding of a business they are planning to buy and how they will drive value. 3) Their whole strategy is around controllable operating

improvement and mitigating uncontrollable risks, which is where they stumbled in 1998-2000. Today the firm is very focused on mitigating uncontrollable risks through transactions—market risks, financial risks and exogenous risks.

Mr. Neel asked Mr. Wasserman to discuss the investment in Homeland Stores in Fund III and Fund VI.

Mr. Wasserman responded that this investment preceded his joining the firm in 1988, so he could not knowledgeably discuss the thought process that was followed in putting additional capital. He said the business was essentially wiped out by Wal-Mart.

Mr. Jacksha asked what CD&R's policy was on cross-fund investments, and Mr. Wasserman responded that they really don't like to do it, and only do it by extreme exception and with a lot of consideration by their advisory board. He said they did this in Acterna when they owned a leading telecom test equipment business in the U.S. and had the chance to buy a leading business in Europe. He said they were out of money in Fund V, so bought the European firm with Fund VI money after a lot of thought. He stated that, despite efforts to save the business after the 2001 telecom meltdown, they were unsuccessful.

Mr. Neel asked why there was a gap between funds from 1999 to 2005.

Mr. Wasserman responded that this was a period when CD&R was reflecting on investments it had made between 1998 and 2000 that in hindsight they felt they shouldn't have made. During that time, he said, they closely monitored the investments they already had made, and then began looking inward and made three significant changes to the firm: 1) They changed some of the partners, since most of the deals that went wrong were attributable to two of them. 2) They reaffirmed their strike zone and made sure that the businesses they bought had good downside protection and great spread of risk. 3) They added the screening committee process and operating review process, which Jack Welch helped them with when he joined the firm in 2001.

[Action on this item was deferred to the April 22 Investment Committee meeting.]

**CONCLUSION OF SESSION**

Its business completed, the Private Equity Investment Committee concluded its session at 10:30 a.m.

Accepted by:

A handwritten signature in black ink, appearing to read 'Bruce Malott', written over a horizontal line.

Bruce Malott, Chair