

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

July 9, 2008

CALL TO ORDER

A Regular Meeting of the New Mexico Educational Retirement Board Private Equity Investment Committee commenced on this date at approximately 2:05 p.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

Roll Call indicated the presence of a quorum, as follows:

Members Present:

Mr. Bruce Malott, Chair
Mr. Gary Bland [teleconference]
Ms. Jan Goodwin
Mr. James Lewis [teleconference]

Members Excused:

None.

Other ERB Members Present:

None.

Legal Counsel Present:

Mr. Chris Schatzman

Staff Present:

Mr. Mark Canavan, Real Estate Portfolio Manager
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Portfolio Manager Manager
Mr. Jeffrey M. Riggs, Deputy Director

Others Present:

Mr. Bill Monagle, NEPC

BACKGROUND INFORMATION: Bob Jacksha

Mr. Jacksha reported that, as a follow-up to his discussion at the last retreat on the idea of private equity co-investment, staff consulted with NEPC, which has a history of selecting private markets managers, and NEPC recommended four marquee co-investment programs with institutional clients. He said the co-investment managers were Lexington Capital Partners, Credit Suisse First Boston, BlackRock and Aldus Equity.

Mr. Jacksha said staff and NEPC visited all four firms, three in New York and one in Dallas. He said three of those firms will make presentations to the Committee today. He said Lexington was excluded because their primary focus is on secondary investment strategies.

Mr. Jacksha said that, based on the due diligence, ERB staff recommends one to three commitments of \$50 million to each approved co-investment manager for total commitments of between \$50 million and \$150 million.

Mr. Jacksha said the two main advantages of a co-investment program are:

1. The economics. Instead of doing an 80/20 split, the split is 90/10, which gives ERB more of the profits. Additionally, management fees are generally lower.
2. It is also a way for a young program like the ERB's to get capital invested faster. Investment periods on all three programs are two years as opposed to four or five years.

Mr. Jacksha said another advantage is that all of these managers will tap into their network of top quality private equity firms.

Mr. Malott asked why, given the advantages, more of the portfolio isn't given over to this strategy.

Mr. Monagle explained that different strategies have different characteristics, and not all of them are in favor at the same time. He said the idea is to strike a balance among a number of strategies across the private equity continuum.

Mr. Monagle instructed Committee members on pertinent issues to raise with interviewees.

APPROVAL OF AGENDA

Mr. Bland moved for approval of the Agenda, as published. Mr. Lewis seconded the motion, which passed by voice vote.

APPROVAL OF MINUTES: June 11, 2008

Ms. Goodwin moved approval of the June 11 meeting Minutes, as submitted. Mr. Lewis seconded the motion, which passed by voice vote.

PRIVATE EQUITY — CO-INVESTMENTS

Aldus Equity

Aldus Equity Associates Saul Meyer, Molly Byrnes and Holland Gary gave a slide presentation.

Mr. Meyer said there are three basic elements that differentiate Aldus from its competitors: Aldus has top quality performance in the co-investment space; Aldus's existing relationship with the ERB offers an advantage and will help drive deal flow and other benefits; and Aldus has bid a price that removes any conflict.

Mr. Meyer stated that Aldus is a Dallas-based private equity, fund of funds and co-investment firm founded in 2003, and now has 17 investment professionals and 25 employees. He commented that this number is a bit misleading because they are genuinely integrated into the RREEF private equity office and work as one team, and there are an additional 17 individuals they work with on a daily basis. He said these individuals participate in all of Aldus's investment committee calls and numerous other functions within the firm. He stated that there are RREEF private equity employees in London, Milan, Chicago, New York and San Francisco, and REEF is the world's largest alternative investments manager with approximately \$91 billion of assets under management.

Mr. Meyer said the Partners have committed \$7 billion to more than 100 private equity funds, and clients include some of the largest U.S. pension funds.

In addressing the benefits of a co-investment fund, Mr. Gary pointed to Aldus's ability to generate strong returns: its two co-investment funds have generated gross IRRs of 38.3% and 57.6% respectively.

Mr. Gary noted that Aldus takes a portfolio-oriented approach—they don't just try to identify the best deals around and get into them. He said they will look to use mezzanine and other strategies to shorten the J-curve and reduce return volatility.

In addressing value-add, Mr. Meyer stated that Aldus is a consistent, non-competitive source of capital; in other words, they don't have conflicts and aren't competing with the GPs for deals. He said it allows lead sponsors to avoid clubbing deals and bringing other people to the table with different agendas.

Mr. Meyer also stated that Aldus has an efficient co-investment process—they can act as quickly as within 48 hours, although that is unusual. He said their normal timeframe is still streamlined, however, and they can come up with a good answer as to whether or not they can be there within seven days.

Mr. Meyer said Aldus has no requirement for board seats, and this lack of conflict makes them a very easy partner.

Mr. Meyer said Aldus's client base includes from ERB, New York City, New York State, Los Angeles and others—so Aldus is a steady pool of capital for these funds should they perform well.

Ms. Byrnes discussed co-investing in the current market environment. She stated that, given the volatility in the markets, reduced access to debt financing has led to increased co-investment opportunities. She said there is a lot less access to leverage, now, which has caused problems for the large and mega buyout funds; however, for co-investors, this presents a great opportunity. She said the lower leverage means that GPs have to invest more equity in their deals, and co-investors are often a preferred source of additional equity. She said this enables GPs to retain control and avoid club deals.

Ms. Byrnes stated that, while recessionary periods may be difficult times to exit, they are wonderful times to invest as sellers' expectations come down to meet current market conditions. She said this means good companies are available at lower purchase multiples.

Ms. Byrne also noted that some of the private equity strategies that Aldus will be pursuing are particularly well suited to the current economic environment. She said strong strategies include mezzanine, distressed debt, turnaround and bankruptcy oriented buyout funds, and buyout funds that are operationally focused. She said Aldus' history of forming relationships with managers across all strategies, including these, helps Aldus capture opportunities as they arise.

Mr. Gary reviewed Aldus's multilevel co-investment due diligence process. He commented that the abbreviated yet thorough process enables Aldus to quickly capture opportunities.

Mr. Meyer distributed Aldus most recent co-investment book, containing logs, standard reports and pie charts relative to two co-investment deals currently in process.

Mr. Gary noted that Aldus has closed on eight deals in 2008, and an additional three have been approved and are awaiting final close.

Mr. Jacksha asked if the increase in co-investment activity in 2007 and 2008 is because there is more capital allocated to co-investment, or is it a function of the market, or both.

Mr. Meyer responded that there is more capital to allocate, because Aldus is seeing many more deals than before because of its reputation.

Responding to questioning from Mr. Monagle, Mr. Meyer said Aldus will never take more than 50% of a whole deal and is generally less than 10% of it. He said Aldus is less than .1% of the Harrah's deal. He commented that Aldus is happy to be a tiny piece of a deal, since there is no additional benefit accrued whether they are 2% or 40%.

Mr. Meyer reviewed successes in the co-investment portfolio, as well as its single miss, which was in Allegro Biodiesel.

Mr. Meyer discussed proposed fees and economic terms.

Mr. Monagle asked if Aldus has a requirement to refer any of its deals back over to Deutsche Bank's investment team.

Mr. Meyer responded absolutely not. He said that the only requirement would kick in if Aldus bought a bank or financial institution; because they are subject to the Bank Holding Company Act, they have to verify with the lawyers at Deutsche Bank that they are not violating any of those statutes.

Mr. Meyer said Aldus is 100 percent separate in terms of its investments. He said Aldus makes all of the decisions, and no one at Deutsche Bank pulls the trigger on any of those decisions.

Mr. Jacksha commented that, often in a buyout deal, the fund doing the deal earns portfolio company fees on the deal. He asked if Aldus participates in those fees as a co-investor.

Mr. Meyer responded that Aldus turns all fees directly over to the ERB where there are fees, if any.

BlackRock Alternative Advisors

Sean Miller, Russ Steenberg and Stephen Kelly appeared before the Committee and gave a slide presentation.

Mr. Miller noted that BlackRock is an investment management firm only, which means they do not do brokerage or investment banking activities, which is a benefit in terms of any potential conflicts of interest.

Mr. Miller said BlackRock has 6,000 employees in 19 countries with about \$1.3 trillion in assets under management. He stated that the platform has no majority owners: 49% is owned by Merrill Lynch, 33% is owned by PNC Bank, and 18% is publicly owned and owned by the employees.

Mr. Steenberg stated that BlackRock's senior investment team spans three decades of experience, and the senior partners average 20 years of private equity experience.

Mr. Steenberg reviewed BlackRock's direct co-investment portfolio, with \$1.2 billion invested since 2000 in 51 companies around the world, with a 42.6% realized gross IRR and a 2.7x realized gross multiple.

Mr. Steenberg stated that BlackRock does not pay fees and carry for co-investments. He said this means there is no double layer of fees, and the pension fund would essentially be paying whatever the fees is, which would be significantly less than what would be paid to a GP.

Mr. Monagle observed that some of the deals in the portfolio are very large, and asked if BlackRock participates on the boards of some of these larger deals, either actively or as observer, as opposed to the boards on some of the smaller deals.

Mr. Steenberg responded that there is an inverse relationship; the larger the deal, the more likely BlackRock will be a smaller percentage in it. He said BlackRock therefore asks for rights to receive all of the financials and have access to management and the GP, so they can very closely monitor the larger transactions. With the smaller sized deals, he said BlackRock will have a larger percentage. He cited EvenFlo as an example, where BlackRock has a 30% stake with Western Presidio as lead GP, and a BlackRock senior investment professional is a full board member who is heavily involved with the management of the company.

Mr. Monagle asked if BlackRock gets any monitoring or transaction fees for the fund, and Mr. Steenberg responded that, if a board member is paid or there is

portfolio management fees, those will go to the limited partners. He said BlackRock gets expenses covered, but nothing else.

Mr. Monagle asked if BlackRock is obligated to turn any deal flow over to the investment banks (Merrill Lynch or PNC) and Mr. Steenberg responded no.

Mr. Monagle asked if recent events in connection with Merrill Lynch have resulted in any movement among people on the BlackRock team, and Mr. Steenberg responded no. He said that, when Merrill Lynch Investment Managers merged with BlackRock, Merrill Lynch took a 49.9% ownership stake in BlackRock. He said there is a three-year block on that beginning in October 2006, where Merrill Lynch can do nothing unless BlackRock agrees to it.

Mr. Kelly reviewed BlackRock's history of co-investment deals across all investment pools, with a 42.6% gross IRR on fully realized investments, and 41.5% on partially realized investments. He said BlackRock's goal is to build diversified portfolios along as many metrics as it can, and pointed out that the 30 different general partners in their unrealized investments include media, telecom, communications, business services, healthcare, industrial products, and consumer products. He said these are all buyout-related transactions, and BlackRock will not be doing any venture capital deals on the co-investment side. He said this is not risk capital; they want to do traditional LBO deals across the spectrum.

Mr. Steenberg said their senior investment professionals are responsible for a series of relationships with general partners. He stated that the investment professionals have to know the organizations inside out, from what is in their pipeline to what is in their portfolio, and how BlackRock can be a "friendly provider of capital." He said BlackRock doesn't originate its own deals to avoid becoming competitive with the GP base that exists.

Mr. Kelly reviewed a portfolio that BlackRock manages for New Jersey's pension fund as an example of what the ERB might expect in its own portfolio. He noted solid non-U.S. exposure, at 30-40%. He said BlackRock likes to put at least three years of vintage year diversification in a portfolio, as opposed to the two years requested by the ERB. He also pointed out that, in terms of dollars invested, on a notional \$100 million account, there are two 10% positions, which is BlackRock's maximum.

Mr. Kelly discussed how BlackRock adds value, which is through a broad and deep set of relationships and through its reputation in the marketplace.

Mr. Steenberg discussed a successful deal (VWR International) and an unsuccessful deal (NerveWire).

Mr. Bland asked what size BlackRock's co-investment portfolio will be relative to its overall assets, his concern being that the ERB's investment could get lost.

Mr. Steenberg responded that BlackRock has allocation rules, so if they had a separate account with the ERB for \$50 million, they would invest pro rata within the pool of capital active at that time. He said this is how BlackRock makes sure it gets the size and scale in the marketplace, and by the same token it does not get lost.

Mr. Steenberg discussed proposed fees and terms.

Mr. Steenberg said BlackRock prefers a three-year time period on the portfolio.

Credit Suisse/First Boston

Credit Suisse representatives Kelly Williams, Nadim Barakat, Mina Pacheco Nazemi, Elise Wood and Derek Jones appeared before the Committee and gave a slide presentation.

Ms. Williams said that Credit Suisse's Customized Fund Investment Group ("CFIG") is an industry leader in co-investments, managing over \$1.4 billion in co-investment mandates. She said they have invested in 55 co-investments to date, representing \$600 million in aggregate, and CFIG's senior investment professionals have spent most of their careers acting as professional fiduciaries for public pension plans, insurance companies, banks and other entities.

Ms. Williams noted that CFIG has achieved an approximate 23% net return to clients; and on their co-investment activities, they have achieved gross returns of 20% on a realized and unrealized basis, and a 92% gross realized return on realized co-investments.

Ms. Williams said Credit Suisse acquired DLJ in 2000, and CFIG's team comes from DLJ. She stated that Credit Suisse Private Equity has about \$37 billion of assets under management allocated to its buyout, venture capital, mezzanine, secondary and fund of funds businesses, and CFIG manages \$21 billion of commitments to fund and co-investment programs. She said a competitive advantage is that there is an investment bank within the organization, so they can avail themselves of the knowledge that the bankers have across all sectors.

Mr. Bland asked if CFIG would invest in deals done by its firm, and Ms. Williams responded that they generally are investing in deals where they are co-investing alongside general partners in which they have invested.

Mr. Bland asked if Credit Suisse investment bank is also invested, and Ms. Williams responded that the investment bank doesn't invest in CFG's deals. Mr. Bland asked if Credit Suisse's banking operations has interest in these programs or receives fees. Ms. Williams responded that it would be theoretically possible that Credit Suisse might have a banking relationship with one of the general partners, but CFG has no control over that. She said CFG is a different part of the organization with a completely different reporting chain, etc. She said that, within the CFG team, there is no one from other parts of the bank who is part of the investment committee.

Mr. Jacksha stated that, if Credit Suisse investment bank is somehow engaged with a company in a buyout—they are banking the deal, are advisor and are receiving a fee—would CFG make a co-investment in that deal, and how does it manage a potential conflict in such a case.

Ms. Williams responded that, in the context of the deals CFG looks at, it is possible a general partner might have engaged Credit Suisse as an investment banker to represent the company, or the company may have engaged them. In terms of handling the conflicts, she said CFG doesn't derive any economics from that and has no influence one way or the other. She commented that CFG is essentially indifferent—they don't which investment bank is hired.

Ms. Williams added that, were there a specific concern on the part of ERB about the involvement of Credit Suisse's investment banking team in any deal, CFG would be very comfortable in either excluding those deals from the portfolio or at least giving ERB a veto opportunity.

Ms. Williams said CFG has no obligation to tell the investment bank about anything that they are doing on behalf of their clients, and there is no visibility into any of their portfolios by the investment bank.

Ms. Williams stated that most of CFG's clients are public pension plans: their select mandates include \$340 million for the Municipal Employees' Retirement System of Michigan; \$229 million for New York State Common; \$129 million for an unspecified Southeastern U.S. state pension plan; and \$150 million for State of Michigan Retirement Systems. She said they have just added New York City Retirement Systems to their client base.

Mr. Jones, Mr. Barakat and Ms. Pacheco discussed their backgrounds prior to joining CFG.

Mr. Barakat reviewed the benefits of CFG's customized investment program. He said the customized approach provides flexibility to develop a program that complements a client's existing portfolio. He pointed out that a co-investment

strategy enables investors to capitalize on relationships with top private equity funds in order to generate outsized returns. He said investors are investing at reduced fees, thus enhancing overall returns, and the 2-3 year investment period lessens the J-curve effect.

Mr. Barakat stated that CFG has unparalleled resources and market information from Credit Suisse and the CFG platform, and in fact CFG has access to 30 different sector teams.

Mr. Barakat said CFG has relationships with 750+ private equity funds and has access to 7,500 companies in its underlying private equity portfolio, which gives CFG an unusual ability to find value in a given space.

Mr. Barakat referred to a sampling of high quality fund managers who have offered co-investment opportunities to CFG. He said they have a team approach to deal sourcing, and have 47 people who call each of CFG's sponsors on a quarterly basis. He said the calls are to follow up on investments and to seek co-investment deal flow. He commented that CFG is viewed as a group that can quickly understand an opportunity, do the necessary vetting very efficiently, and very quickly make a decision. He stated that CFG gets about 300 investments a year from top sponsors based on CFG's strengths in this area.

Mr. Barakat discussed the investment and due diligence process. He said CFG reviews more than 180 deals a year.

Mr. Jones stated that CFG's portfolio, with strong fundamental EBITDA growth and debt pay-down, allows CFG to overcome challenges in the market. He reviewed a bar chart reflecting the aggregate cash flow of all of CFG's companies at the time they entered these businesses, which have grown from \$5.3 billion to \$6.7 billion in 2008. He said their debt has gone down by 7.5% across the whole portfolio, which has enhanced value.

Mr. Jones said CFG has reviewed 75 deals this year in the middle market, committed to 13 and is on track to deploy \$300 million in co-investment capital in 2008.

Mr. Barakat reviewed a successful deal and an unsuccessful deal (UFC Interlake Holding Company).

Ms. Williams and Ms. Pacheco discussed additional value-added services that CFG would offer the ERB, including regularly scheduled deal flow calls to review investment progress and new investments, full access to proprietary systems, and assistance to ERB staff through seminars and teach-ins.

Ms. Williams discussed proposed fees and economic terms.

DISCUSSION AND ACTION

Mr. Bland stated that he could not support a decision in favor of Credit Suisse/First Boston based on concerns he has discussed with staff.

Mr. Malott said he felt Credit Suisse/First Boston should be eliminated because their fees are the highest of the three.

Mr. Jacksha stated that staff is comfortable allocating money to any or all three candidates.

Ms. Goodwin moved that the Private Equity Investment Committee approve a commitment of \$75 million to BlackRock Alternative Advisors, subject to and contingent upon New Mexico state law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Bland seconded the motion.

Mr. Neel questioned whether it might make more sense to allocate \$100 million to BlackRock and \$50 million to Aldus. He commented that BlackRock is the more seasoned of the two, while Aldus would appear to be more of an emerging manager given their assets under management.

Mr. Malott responded that, after listening to their presentations today, he personally preferred splitting the \$150 million evenly between the two.

Mr. Bland said he was comfortable with that. He said he felt Aldus had the capacity to handle the \$75 million. He added that both BlackRock and Aldus would probably have significant participations in the same investments.

Mr. Lewis agreed with earlier remarks by Mr. Bland that BlackRock is a very large corporation, which is an advantage in terms of opportunities globally, although bigger is not always better because there is no close personal relationship between client and manager. He said he felt Aldus and BlackRock should share equally in the \$150 million. He commented that this is essentially a trial period anyway, where the ERB will have an opportunity to compare performance between the two groups.

The motion passed by voice vote.

Ms. Goodwin moved that the Private Equity Investment Committee approve a commitment of \$75 million to Aldus Equity, subject to and contingent upon New Mexico state law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork.

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

ADJOURN

Its business completed, the Private Equity Investment Committee adjourned at approximately 5:00 p.m.

Accepted by:



Bruce Malott, Chair