California State Teachers' Retirement System

Private Equity Program – Q3 2016

Open Session

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Overview

This report provides a review of CalSTRS Private Equity Program as of September 30, 2016, and includes a review and outlook for the Private Equity industry. CalSTRS began investing in the private equity asset class in 1988. CalSTRS currently has a 9% target allocation to the private equity asset class, which will increase to a final target allocation of 13%. As of September 30, 2016, CalSTRS had 361 investments in the Active Portfolio, and 128 investments in the Exited Portfolio (no remaining value). The total value of the portfolio was $16.9 billion, with total exposure (including unfunded commitments) of $27.9 billion.

Executive Summary

Portfolio

- The portfolio is diversified by strategy, with Buyouts representing the largest exposure at 62% of total Private Equity.
  - Mega and Large buyout funds represent over 85% of CalSTRS' Buyouts exposure.
- United States is the largest geographic exposure at 69%.
- The commitments made to the 2005 – 2008 vintages represent 42% of CalSTRS total private equity commitments.
  - There are limited remaining uncalled commitments to these vintage funds, however.
- Fund investments represent 95% of exposure, with the balance in co-investments.

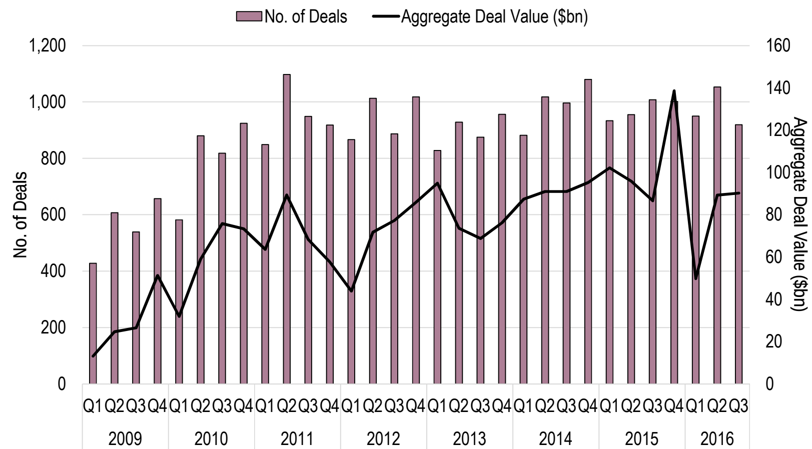
Performance

- The Private Equity Program has had mixed performance compared to benchmarks.
  - The Program has outperformed on a Since Inception basis, but underperformed in shorter periods.
- On a public market equivalent ("PME") basis, the Private Equity Program has generated significant value.
- Adjusting for cash flows, the portfolio value increased by $1.3 billion from April 1, 2016 to September 30, 2016.

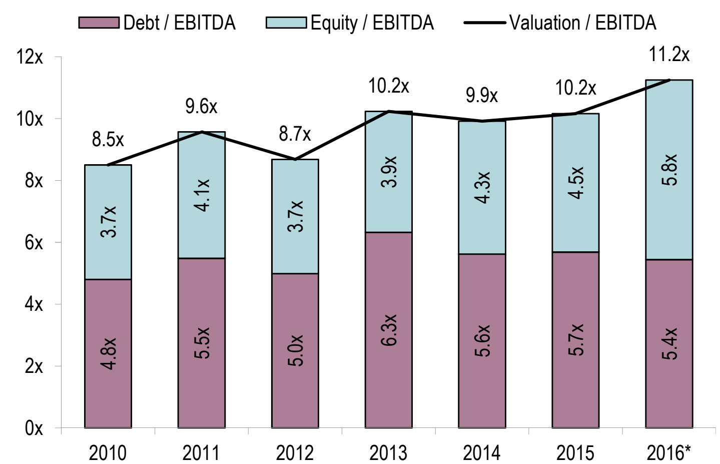
Activity

- The Private Equity Program experienced a net positive cash flow of $1.6 billion through Q1 2016 and Q3 2016.
- For the second half of 2016, Staff made $2.7 billion of commitments, including $1.5 billion during the fourth quarter.

Quarterly Number and Aggregate Value of Private Equity-Backed Buyouts Deals Globally, Q1 2009 – Q3 2016[1]



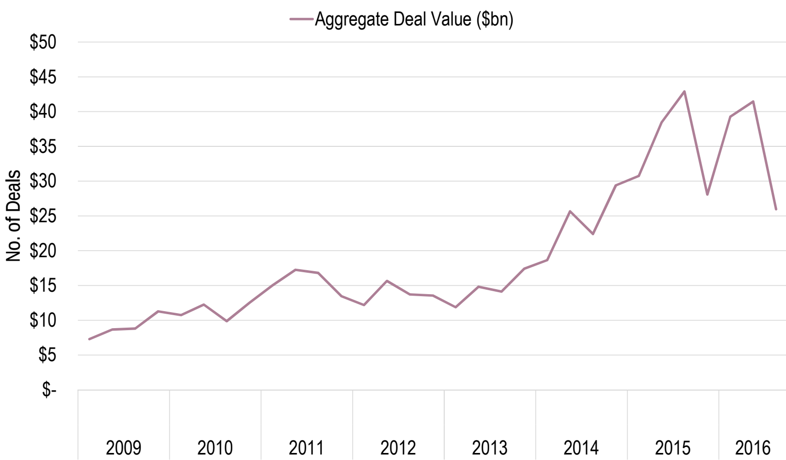
Price to EBITDA – US Buyouts Through 2010 - 2016[2]



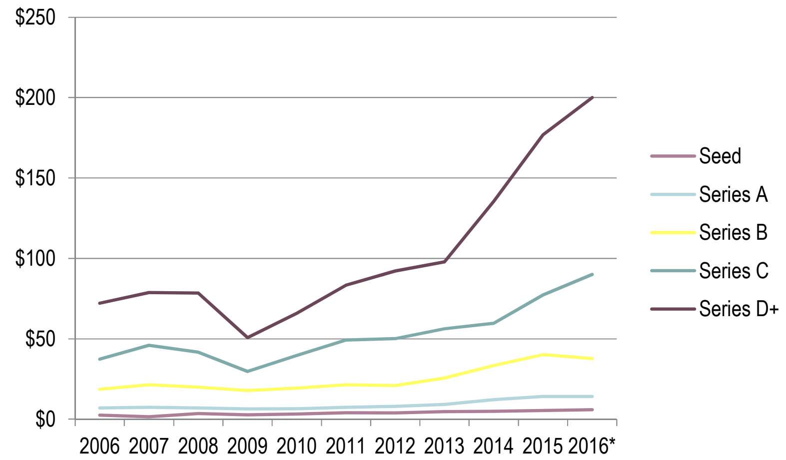
- Global buyouts activity saw a marked slowdown in the first quarter of 2016 compared to a post-financial crisis peak in the prior quarter, but recovered significantly in the second and third quarters. Aggregate buyouts deal volume, in dollar terms, increased by 81% from $49.8 billion during Q1 2016, the lowest quarterly figure since Q1 2012, to $89.2 billion during Q2 2016 and remained steady in Q3 2016.
- Buyouts activity in Europe picked up significantly with aggregate deal value increasing to $27 billion during the second quarter from approximately $11 billion in Q1, but fell back to around $15 billion in the third quarter.
- Transaction valuations increased meaningfully during the first three quarters of 2016 as buyouts investments data published by Pitchbook showed pricing at 11.2x trailing EBITDA for all buyouts transactions, compared to 10.2x trailing EBITDA for 2015. Even though the availability of debt remained high, most of these transactions were well capitalized with an equity ratio of 51.6%.

[1] Source: Prequin.
[2] Source: Pitchbook.

Value of Venture Deals, Globally[1]



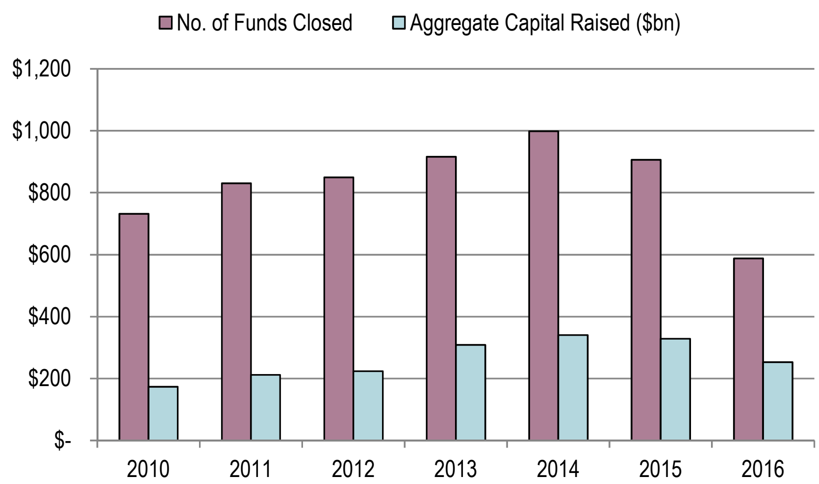
Venture Round Valuation Trends[2]



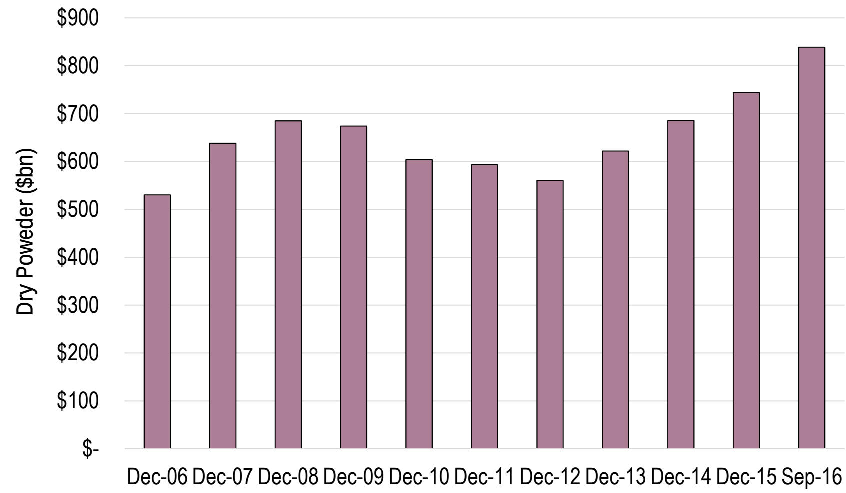
- The value of venture capital deals decreased significantly during the third quarter of 2016 to $26 billion from $42 billion in the prior quarter, but remained above quarterly deal volumes reached prior to Q3 2015.
- The number of venture deals in North America made up 38% of the global venture capital market during the third quarter.
- While venture round valuations have remained strong, they generally declined in the latter part of 2016.
- Angel/seed financings remained the most common stage of venture capital deals, representing 33% of all deals; however, this percentage has dropped since 2014.

[1] Source: Preqin.
[2] Source: Pitchbook. Data as of 8/1/2016.

Global Fundraising Activity 2010 through Q3 2016[1]



Private Equity Dry Powder, December 2006 – September 2016[1]



- Buyouts fundraising activity experienced a minor slowdown during Q3 2016 as 36 funds raised a total of $36 billion compared with $45 billion raised during the same period last year. The average fund size continued to increase through the first quarter ($510 million in Q1 2016 versus $398 million in Q4 2015 and $480 million in Q3 2015), but dropped in 3Q 2016 to $365 million. North America-focused buyouts strategies received the majority of raised capital.
- Global venture capital fundraising remained strong during the third quarter, accounting for 76 funds closed and 19% ($11.9 billion) of capital raised.
- The total amount of private equity "dry powder" has increased each year since 2012.

[1] Source: Preqin.

CalSTRS Private Equity Overview

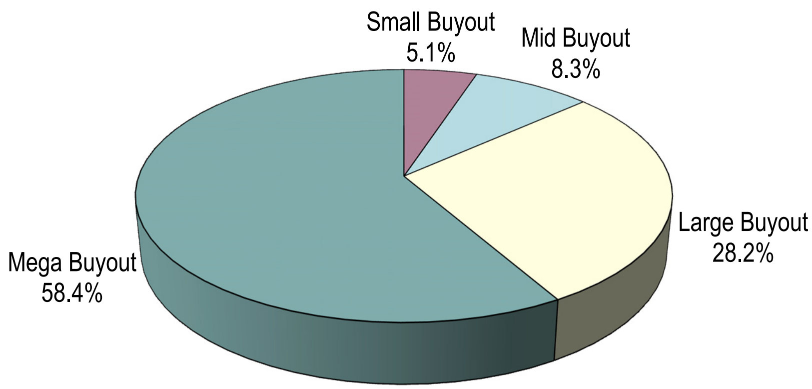
As of September 30, 2016

Strategy[1]	Remaining Value ($ mm)	Unfunded Commitments ($ mm)	Total Exposure ($ mm)	Percent of Exposure (%)	CalSTRS Target (%)	Target Range (%)
Buyouts	10,344	6,934	17,278	61.9	70	50-85
Expansion Capital	2,696	1,900	4,596	16.5	10	5-15
Venture Capital	1,516	754	2,270	8.1	5	5-15
Distressed Debt	2,102	1,092	3,195	11.5	15[2]	5-20[2]
Mezzanine	202	358	559	2.0	NA	NA
Total Program	16,861	11,038	27,899	8.9[3]	9[3]	NA[4]

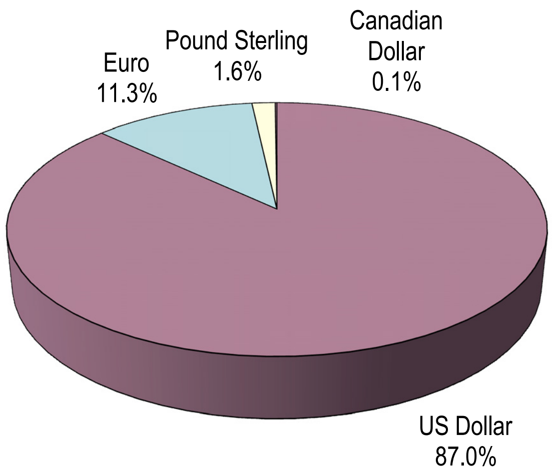
- The CalSTRS private equity program was within the diversification ranges outlined in the Private Equity Policy Statement. Buyouts exposure is below target, and Expansion Capital and Venture are above target.
- The overall private equity program is at the current target of 9%. The long-term target for private equity is 13%.

[1] Commitments to secondary, proactive and co-investments are allocated based on their strategy.
[2] CalSTRS private debt target is combined with Distressed Debt and Mezzanine.
[3] PE program Remaining Value as a percent of total CalSTRS portfolio.
[4] CalSTRS has a long-term target of 13% for Private Equity.

Buyouts Exposure[1]



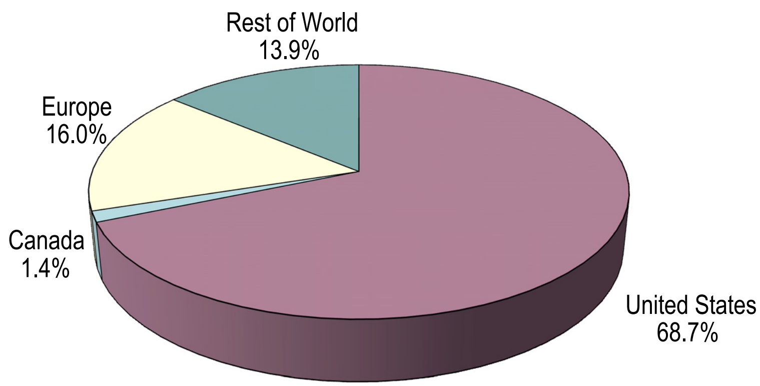
Fund Currency Exposure[2]



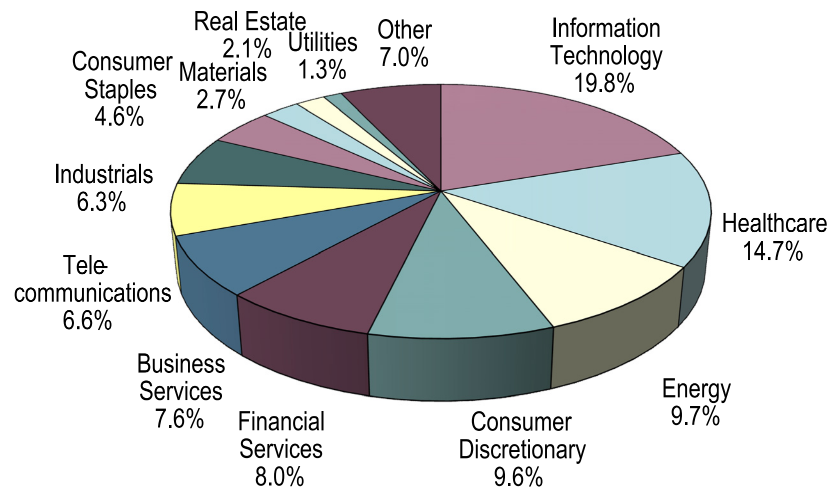
- The CalSTRS Buyouts portfolio is largely allocated to mega and large buyouts, which collectively represent over 85% of overall buyout exposure.
- CalSTRS investments are primarily denominated in U.S. dollars with the Euro accounting for most of the balance.

[1] This chart was created using the sum of reported value and unfunded commitments of the Private Equity Program's buyout investments as of 9/30/2016. Segment size for funds is based on Preqin's 2014 Global Private Equity Report.
[2] This chart was created using the sum of reported value and unfunded commitments of the Private Equity Program's aggregate investments as of 9/30/2016.

Regional Exposure[1]



Industry Exposure[1]

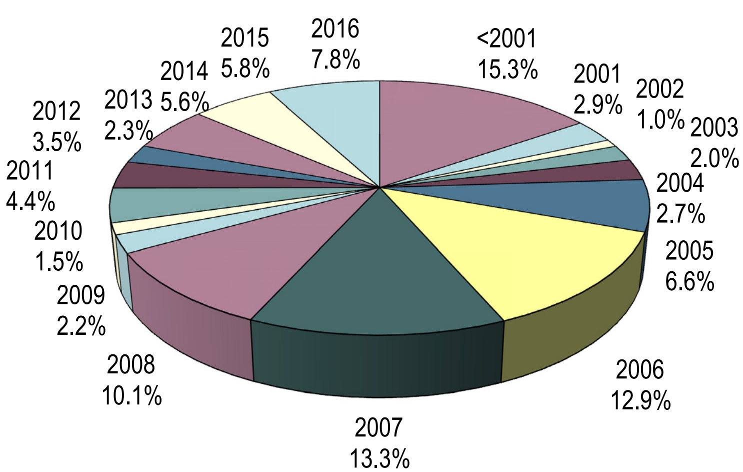


- The private equity program's geographic exposure is primarily to U.S. companies, with Europe as the next highest exposure. U.S. exposure is at the lower end of the target range (65% to 85%).
- The PE Program is broadly diversified across industries. Information Technologies and Healthcare are the most significant industry exposures in the PE Program.

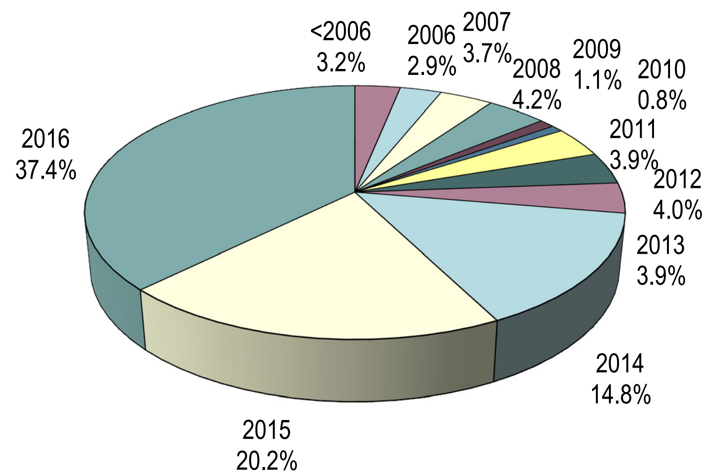
[1] These charts were created using the value of the Private Equity Program's underlying company exposure as of 9/30/2016. Source: State Street.

Vintage Year Composition

Vintage Year (Total Commitments)[1]



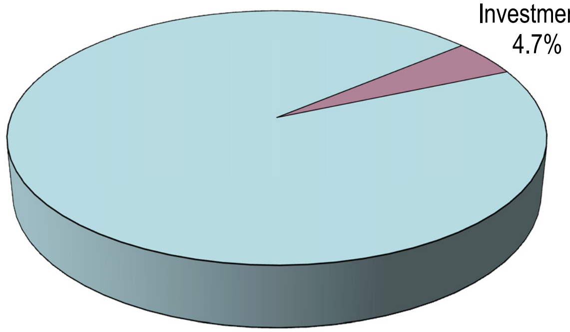
Vintage Year (Unfunded Commitments)[2]



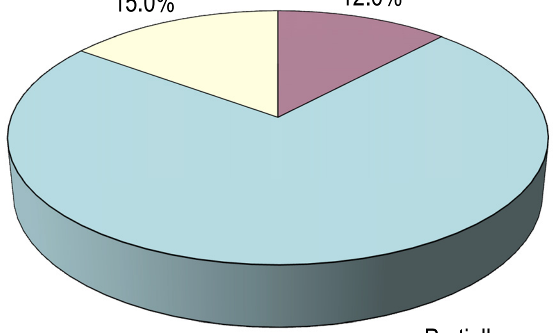
- The PE program made significant commitments to the 2005-2008 vintage years, which represent 42% of total historical commitments. However, these vintages represent a small portion of uncalled capital currently.
- Vintage years 2014-2016 account for approximately 72% of the program's current unfunded commitments.

1 This chart was created using the total commitments of the Private Equity Program's aggregate investments as of 9/30/2016.
2 This chart was created using the total unfunded commitments of the Private Equity Program's aggregate investments as of 9/30/2016.

Co-investment Exposure[1]



Realization Status[2]



- The PE program is substantially focused on Fund Investments, with Co-investments representing about 5% of the total portfolio.
- Approximately 12% of investments have been fully realized as of September 30, 2016. Unrealized investments are related to those that have yet to draw capital or are in early stages of deploying capital.

[1] This chart was created using the sum of remaining value and unfunded commitments of the Private Equity Program’s aggregate investments as of 9/30/2016.
[2] This chart was created using the total commitments of the Private Equity Program’s aggregate investments as of 9/30/2016.

Largest Manager Relationships
As of September 30, 2016

Manager	Number of Vehicles	Remaining Value ($ mm)	Unfunded Commitment ($ mm)	Total Exposure ($ mm)	Total Program Exposure (%)
The Blackstone Group[1]	15	1,222	1,190	2,412	8.6
TPG Capital[2]	14	1,250	442	1,692	6.1
Carlyle Group[3]	8	586	455	1,041	3.7
Permira[4]	6	553	413	966	3.5
Centerbridge Capital	7	506	419	924	3.3

- CalSTRS PE program has regularly committed across several vehicles offered by the managers listed above, including select co-investments. In several cases, the commitments are managed by separate teams within the manager and execute on different strategies.
- New commitments to GSO Capital Opportunities Fund III (Blackstone), Permira VI, Centerbridge Special Credit Partners III, and Centerbridge Special Credit – Flex were made during the third quarter of 2016.

1 Includes three co-investments and fund investments in five GSO partnerships.
2 Includes two co-investments and fund investments in NewBridge Asia IV, TPG Asia V, TPG Growth II/III (A), and TPG Opportunities II/III (A).
3 Includes two co-investments.
4 Includes one co-investment.

Annual Cash Flows – Total Program
Through September 30, 2016

- Since 2011, CalSTRS has received more in distributions than it has paid in contributions due to the strong exit environment and managers' efforts to sell assets from 2005 to 2008 vintage funds.
- This trend continued in the third quarter of 2016, however at a somewhat slower pace.

Proactive Portfolio Review
As of September 30, 2016

Vintage Year	Commitment ($ mm)	Unfunded Commitments ($ mm)	Reported Remaining Value ($ mm)	Distributions Plus Remaining Value ($ mm)	Since Inception Net IRR (%)
2003	225	12	56	141	-3.5
2005	100	32	69	140	9.9
2006	155	14	68	286	15.7
2007	280	24	158	254	1.4
2008	200	82	157	194	8.5
2009	50	1	28	42	-2.0
2011	200	58	142	193	13.5
2012	425	212	225	238	3.5
2013	40	11	31	34	6.9
2014	200	131	65	68	-1.7
CalSTRS Proactive Total	1,875	577	1,000	1,590	4.4

- CalSTRS has made 21 investments across a range of managers and vehicles in the Proactive Portfolio. Several investments are made to funds, with the majority of commitments made to fund-of-funds managed by HarbourVest (BAML Capital Access), INVESCO, and Muller & Monroe.
- No new commitments to the Proactive Portfolio have been made since 2014, although several are currently being considered.
- The total Proactive program Since Inception Net IRR has increased 20 basis points to 4.4% since March, 2016.

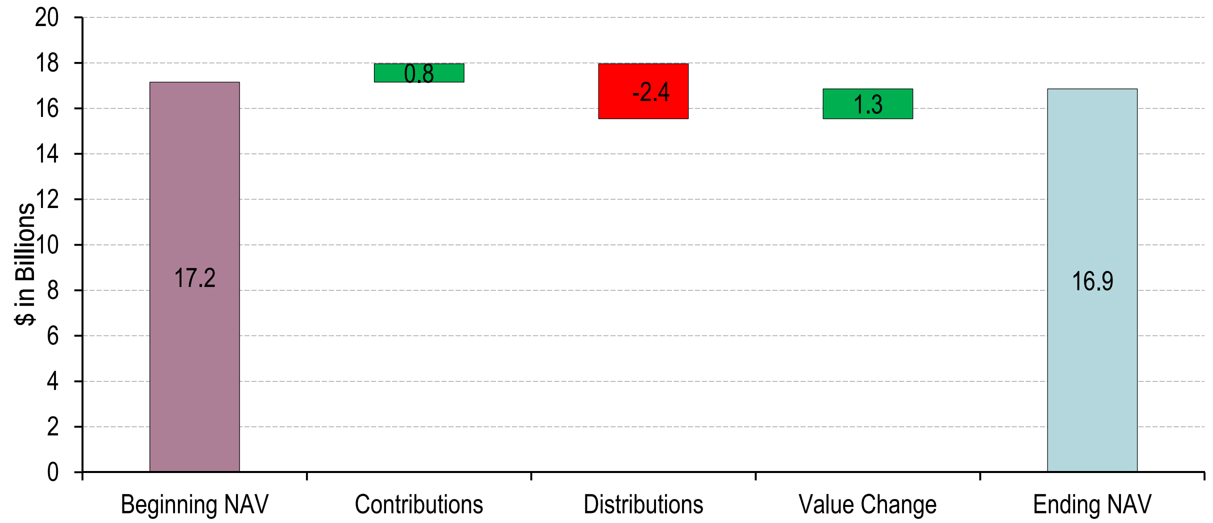
Performance Versus Benchmarks

	1 Year	3 Year	5 Year	10 Year	Since Inception
CalSTRS PE Program	8.4	9.8	12.5	8.7	12.9
State Street PE Index[1]	*8.7*	*11.4*	*12.9*	*10.4*	*12.5*
Custom Benchmark[2]	*18.3*	*14.5*	*21.4*	*11.4*	*12.9*
Excess vs. State Street PE Index (%)[3]	-0.3	-1.6	-0.4	-1.7	0.4
Excess vs. Custom Benchmark (%)[3]	-9.9	-4.7	-8.9	-2.7	0.1

- The State Street PE Index is utilized to review performance of the PE Program for periods 10 years or less, while the Custom Benchmark is utilized to assess performance over longer time periods.
- The CalSTRS PE Program's since inception performance has increased very slightly (by less than 1 basis point) compared to Q1 2016. Both the State Street PE Index and the Custom Benchmark also increased slightly.
- The CalSTRS PE Program's overall performance has been mixed compared to its benchmarks. The PE Program has not met the State Street PE Index or the Custom Benchmark for periods shorter than ten years.
- Over long periods, CalSTRS PE program has achieved strong returns.
- Calculation of a PME indicates that since inception CalSTRS PE Program has generated significant value compared to having had invested in the Russell 3000.

1 The State Street PE Index return was calculated by the State Street Global Exchange. The Since Inception return is a pooled return for all Private Equity funds with vintage years of 1990 or later.
2 Custom Benchmark is a composite of a) the Russell 3000 Index plus 300 basis points since 7/1/08, and b) the Russell 3000 Index plus 500 basis points, adjusted for 3 years of cash flows at the 90-day T-bill rate for periods before 7/1/08. Calculated by State Street.
3 Excess returns may not equal the difference between the CalSTRS PE Program and benchmarks due to rounding.

Program Value Change – April 1 to September 30, 2016



- The CalSTRS PE program total value decreased by $0.3 billion in the six months from April 2016 to September 2016, largely driven by strong distributions received during this period.
- Adjusting for cash flows, the Private Equity portfolio had a positive value change of approximately $1.3 billion during this time period.

Strategy Performance Versus Benchmarks[1]

	1 Year	3 Year	5 Year	10 Year	Since Inception
Buyouts	8.9 ↓	10.0 ↓	12.8 ↓	8.7 ↓	11.9 ↓
SSGX – Buyouts[2]	*10.4*	*11.0*	*12.9*	*10.6*	*12.5*
Venture Capital	4.2 ↓	10.0 ↓	10.1 ↓	7.3 ↓	16.2 ↑
SSGX – Venture Capital[2]	*4.7*	*16.1*	*13.9*	*10.6*	*13.9*
Equity Expansion	13.2 ↑	12.0 ↓	14.3 ↓	13.0 ↑	21.5 ↑
SSGX – Growth Equity[2,3]	*10.9*	*13.5*	*15.2*	*12.6*	*14.7*
Mezzanine	4.9 ↓	8.7 ↑	11.5 ↑	8.2 ↓	13.1 ↑
SSGX – Mezzanine[2]	*7.6*	*7.3*	*9.4*	*8.7*	*10.1*
Distressed Debt	7.1 ↑	7.1 ↑	12.2 ■	8.4 ↓	9.5 ↓
SSGX – Distressed Debt[2]	*5.6*	*7.0*	*12.2*	*9.9*	*11.4*
Proactive Portfolio	2.7 ↓	8.7 ↓	8.0 ↓	4.3 ↓	4.4 ↓
SSGX – All Private Equity[2]	8.7	11.4	12.9	10.4	*12.5*

- CalSTRS Private Equity portfolio had delivered mixed performance compared to strategy benchmarks. In general, Equity Expansion and Mezzanine have outperformed, while Buyouts, Venture, Distressed Debt, and Proactive Portfolio have underperformed.

1 Arrows indicate program outperformance or underperformance against benchmark.
2 SSGX benchmark returns were calculated by the State Street Global Exchange for each listed strategy. The Since Inception returns for each strategy are SSGX pooled returns for matching funds with vintage years of 1990 or later.
3 SSGX – Growth Equity Since Inception return is a pooled return for Growth Equity funds with vintage years of 1992 or later.

Performance By Investment Vehicle

	1 Year	3 Year	5 Year	10 Year	Since Inception[1]
Funds	8.9	9.8	12.5	8.9	13.3
Co-Investments	1.8	10.1	12.2	6.9	7.9

- Co-investment performance has lagged fund performance on a 1-year basis, while 3- and 5-year returns were relatively even.
- The Co-investment program suffered some early losses, contributing to the lower returns on a Since Inception basis.

[1] Fund investments began in 1988 and co-investments began in 1996.

Performance by Geography

	1 Year	3 Year	5 Year	10 Year	Since Inception
United States	6.4	9.1	12.5	8.4	12.8
SSGX – U.S. Funds[1]	*8.0*	*11.9*	*13.7*	*10.6*	*12.8*
Europe	17.3	9.4	11.7	9.9	14.6
SSGX – Europe Fund[1]	*10.8*	*9.5*	*10.9*	*9.7*	*12.2*
Rest of World	9.7	14.8	13.8	9.5	10.1
SSGX – Europe Funds[1]	*9.7*	*11.4*	*10.6*	*10.1*	*9.3*

- Rest of World and European investments have been the source of the stronger returns.
- U.S. returns have matched the benchmark on a since inception basis, but have lagged in more recent periods.

[1] SSGX benchmark returns were calculated by the State Street Global Exchange for each listed region. The Since Inception returns for U.S. Funds, Europe Funds, and Rest of World Funds are pooled returns for matching funds with vintage years beginning 1990, 1994, and 1996 respectively.

CalSTRS Private Equity Completed Investments – H2 2016

Investment	Geography	Strategy	Fund Size ($ mm)	Commitment ($ mm)
FountainVest China Growth Cap III	China	Buyout	2,100	150
Permira VI	Europe	Buyout	7,150	316
Strategic Partners VII	Global	Secondary	7,150	250
GSO COF III	US/Europe	Mezzanine	6,500	250
Centerbridge Special Credit III	North America	Credit	5,000	125
Shasta Venture Partners V	North America	VC	300	35
SVB Capital VIII	North America	VC F-of-F	350	40
KKR Americas XII	North America	Buyout	12,500	300
Francisco Partners Small Cap (Agility)	North America	Buyout & Growth	500	50
Arsenal IV	North America	Buyout & Growth	1,300	83
Co-investment	North America	Energy	3	3
Co-investment	North America	Technology	40	40
HGGC III	North America	Buyout	1,840	100
Encap Energy Capital VIII Co-Investors Follow-on	North America	Equity Expansion	570	10
MBK IV	Asia	Buyout	4,000	150
GSO Co-Invest COF III	US/Europe	Mezzanine	3,000	250
Co-investment	North America	Healthcare	65	65
HG Capital VIII	Europe	Buyout	2,510	82

[1] Source: CalSTRS Deal Log.

CalSTRS Private Equity Completed Investments – H2 2016 (Continued)

Investment	Geography	Strategy	Fund Size ($ mm)	Commitment ($ mm)
Summit GE IX Follow-on	North America	Growth Equity	3,000	100
BC Partners X	Global	Buyout	7,000	266
Co-investment	Poland	Technology	51	51

- During the second half of 2016, CalSTRS made $2.7 billion in commitments to 17 Funds and 4 Co-investments.
- The majority of commitments made in the second half of 2016 were made in Buyouts.

[1] Source: CalSTRS Deal Log.

Vintage Years	# of Investments	Capital Committed ($ mm)	Total Contributions ($ mm)	Unfunded Commitment ($ mm)	Total Distributions ($ mm)	Reported Value ($ mm)	Distributions Plus Reported Value ($ mm)	Inv. Multiple (x)	Program Net IRR (%)	State Street PE Index IRR (%)[1]
Vintage Year 1988	1	100.0	88.7	0.0	168.6	0.0	168.6	1.9	14.2	NA
Vintage Year 1989	6	239.2	227.7	0.0	598.2	0.0	598.2	2.6	18.4	NA
Vintage Year 1990	4	77.0	77.0	0.0	161.6	0.0	161.6	2.1	20.2	20.1
Vintage Year 1991	4	37.9	36.9	0.0	89.7	0.0	89.7	2.4	24.3	23.5
Vintage Year 1992	7	158.6	157.1	0.0	435.6	0.0	435.6	2.8	31.8	25.7
Vintage Year 1993	12	376.5	374.8	0.0	1,147.7	0.0	1,147.7	3.1	32.8	26.2
Vintage Year 1994	12	351.3	350.5	0.0	1,026.0	0.0	1,026.0	2.9	31.8	34.0
Vintage Year 1995	7	425.1	380.4	0.0	827.8	0.1	827.9	2.2	23.3	23.5
Vintage Year 1996	8	302.0	298.2	0.0	437.9	1.0	438.8	1.5	9.1	17.8
Vintage Year 1997	12	986.1	945.7	0.0	1,827.5	0.1	1,827.6	1.9	14.9	9.6
Vintage Year 1998	12	1,441.1	1,354.1	24.6	2,149.7	10.4	2,160.2	1.6	9.2	7.8
Vintage Year 1999	16	1,161.1	1,097.7	12.7	1,316.8	9.3	1,326.0	1.2	3.1	5.6
Vintage Year 2000	21	2,853.2	2,718.4	18.1	4,900.0	127.2	5,027.2	1.8	14.9	10.5
Vintage Year 2001	14	1,630.8	1,597.8	8.0	3,292.3	51.5	3,343.7	2.1	22.0	17.1
Vintage Year 2002	6	538.9	471.3	5.9	726.8	79.7	806.5	1.7	18.9	19.9
Vintage Year 2003	10	1,110.9	970.4	80.3	1,617.4	186.0	1,803.4	1.9	12.9	17.7
Vintage Year 2004	23	1,494.7	1,454.9	26.2	2,493.6	178.5	2,672.1	1.8	19.6	13.2
Vintage Year 2005	36	3,656.1	3,468.3	174.1	4,938.3	689.7	5,628.1	1.6	9.3	9.6
Vintage Year 2006	38	7,170.8	6,743.7	318.4	8,168.3	1,829.7	9,997.9	1.5	7.0	6.3
Vintage Year 2007	40	7,363.3	6,887.5	412.1	7,332.5	2,603.0	9,935.5	1.4	7.2	9.4
Vintage Year 2008	30	5,587.2	4,966.0	463.6	4,569.4	2,557.2	7,126.6	1.4	8.7	11.6
Vintage Year 2009	10	1,246.2	1,075.1	118.8	1,074.4	547.2	1,621.6	1.5	11.1	12.7
Vintage Year 2010	12	812.1	627.8	92.7	530.5	442.6	973.0	1.6	13.3	12.1
Vintage Year 2011	24	2,421.8	1,965.4	425.2	620.2	2,333.8	2,954.0	1.5	14.7	15.5
Vintage Year 2012	21	1,934.6	1,488.1	446.5	436.2	1,500.7	1,936.9	1.3	10.8	14.5
Vintage Year 2013	20	1,302.3	864.8	426.9	309.1	935.1	1,244.2	1.4	20.6	10.5
Vintage Year 2014	32	3,130.5	1,498.4	1,632.0	69.0	1,602.2	1,671.1	1.1	8.3	10.1
Vintage Year 2015	29	3,197.0	970.5	2,226.5	7.0	979.0	985.9	1.0	1.6	3.0
Vintage Year 2016	29	4,332.1	206.6	4,125.5	2.7	196.8	199.4	1.0	NM	NM

1 The State Street PE Index All Private Equity median return as September 30, 2016.

Strategies	# of Investments	Capital Committed ($ mm)	Total Contributions ($ mm)	Unfunded Commitment ($ mm)	Total Distributions ($ mm)	Reported Value ($ mm)	Distributions Plus Reported Value ($ mm)	Inv. Multiple (x)	Program Net IRR (%)	State Street PE Index IRR (%)[1]
Buyouts	239	35,898.7	28,719.1	6,692	36,036.5	9,731	45,767.3	1.6	11.9	12.5
Distressed Debt	48	6,187.1	4,785.4	1,092	4,737.3	2,102	6,839.7	1.4	9.5	11.4
Equity Expansion	75	6,183.5	4,496.1	1,565	5,348.7	2,315	7,664.0	1.7	21.5	14.7
Mezzanine	17	1,152.5	776.3	358	1,011.6	202	1,213.2	1.6	13.1	10.1
Venture Capital	96	4,116.5	3,301.3	754	3,532.3	1,510	5,042.7	1.5	16.2	13.9
Proactive Portfolio	21	1,900.3	1,285.4	577	608.2	1,000	1,608.3	1.3	4.4	12.5

[1] The State Street PE Index All Private Equity Pooled Average Return as of September 30, 2016.

Glossary of Terms
As of September 30, 2016

Private equity investors have developed a number of unique terms to describe their investment work. The following glossary of private equity terms is intended to help make sense of these terms.

Advisory Board: Private equity partnerships often establish an advisory board comprised of representatives of the Limited Partners to oversee the on-going work of the General Partners. Advisory boards typically meet once each year to review the partnership's investments. It is important to note that unlike the Board of Directors of a public company, the advisory board has very little power to control the activities of the General Partners.

Angel Investor: Angel investors are individuals who invest their own capital directly in small, early stage companies. Angels are an alternative source of funding for entrepreneurs. Such investments are characterized by high levels of risk and potentially a large return on investment.

Blind Pool: Most private equity partnerships are organized as blind pools, meaning that Limited Partners commit capital to the partnership before any actual investments are made. At the point of commitment, the Limited Partners do not know specifically how their money will be used (hence the term blind pool), and must therefore rely entirely upon the track record and experience of the General Partner.

Buyout Fund: A buyout partnership uses the partners' capital to purchase existing, established businesses. The acquired firms may be family owned prior to purchase, or may be operating divisions of larger companies seeking to restructure their businesses. In a few cases, the buyout partners may purchase all of the outstanding shares of a publicly traded company, effectively taking it private. Buyout funds are not involved in venture capital or startups.

Buyout partnerships own the acquired companies outright, or in combination with other buyout partnerships. In some cases the buyout partners will replace the existing management with a new team, or the acquired firm will be left autonomous. The buyout partners frequently take one or more board seats in order to ensure control of the business.

Capital Call (Contribution): Once a partnership has declared its first close, the General Partners will begin to make portfolio investments. As each investment is made, the capital necessary to fund the investment is "called" from the Limited Partners.

Carried Interest: The share of profits that the fund manager is due once it has returned the cost of investment to investors. Carried interest is normally expressed as a percentage of the total profits of the fund. The industry norm is 20%. The fund manager will normally therefore receive 20% of the profits generated by the fund and distribute the remaining 80% of the profits to investors.

Carrying Value: The General Partner must list on the partnership's balance sheet a value for every investment held. These valuations are called carrying values, and in most cases are simply the original cost of the investment. Note that carrying values in most cases are not audited and do not represent actual market values.

Cash Flow Positive: When a company generates more free cash than it consumes in normal operations, it is deemed to be cash flow positive. Such companies may not need extra financing or debt in order to grow.

Cash on Cash Return: The simple gross total return earned by the Limited Partners, calculated as the total distributions received divided by the total contributions made. Thus, if an investor supplied a total of $100 in cash calls and contributions, and received over the life of the partnership $200 in distributions, the cash on cash return would be 100%. The cash on cash return is typically reported as a multiple. In the example above, the investment returned 2x (two times).

Claw-Back Provision: A claw-back provision ensures that a General Partner does not receive more than its agreed percentage of carried interest over the life of the fund. So, for example, if a General Partner receives 21% of the partnership's profits instead of the agreed 20%, Limited Partners can claw back the extra one percent.

Closings and Closing Dates: Every partnership must specify the date upon which the General Partners will cease fundraising and begin making actual investments with the Limited Partners' committed capital. That date is called the closing date, and defines the vintage year of the partnership. Most partnerships, however, have several closing dates, and all partnerships must eventually have a final closing. In most cases, the final closing lags six to nine months after the first closing. If a majority of the original Limited Partners consent, a partnership can remain open to new investors after the final closing and while early investments are being made, in order to have time to attract additional investors.

Co-Investment: In some cases, Limited Partners want the right to make additional direct investments in one or more of the underlying companies purchased by the General Partner. If the partnership agreement gives co-investment rights to specific Limited Partners, then they may elect to invest additional monies "along side" the General Partner in various deals. In these cases, the co-investing Limited Partners would have two investments in an underlying property: their share of the partnership's investment, and their direct additional co-investment on the side. Note that co-investment rights may be available only to the largest Limited Partners.

Co-investment rights are often negotiated by very large Limited Partners when they have strong convictions about the deal finding skills of the General Partners, because co-investment rights permit them to make even larger investments in the underlying properties than would otherwise be possible, without paying carried interest.

Committed Capital: When a private equity Limited Partnership is formed, each Limited Partner agrees to contribute a specific amount of capital to be invested over the life of the partnership. Once the agreement is signed, the Limited Partners are legally bound and committed to supply the agreed upon capital when it is called for by the General Partner.

Consolidation (Roll Up): Many industries in America are highly fragmented, as the market space is serviced by a large number of locally owned businesses. By consolidating fragmented industries (i.e., purchasing many local businesses), private equity firms can create a single larger company with greater market control, more attractive financial characteristics, and potentially, better pricing flexibility and lower costs.

Convertible Bonds: Some private equity partnerships, generally those that provide mezzanine financing, may take convertible bonds as part of their compensation for providing investment capital. The convertible bond pays interest like other bonds, but can be exchanged for shares of the company stock at a favorable price if certain conditions are met, hence the term convertible.

Direct Investment: Partnerships that invest in companies are said to make direct investments. The alternative is a partnership that invests in other partnerships, a fund of funds.

EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization): The "top line" profits of a private company are the monies earned before paying interest and taxes, and adding back depreciation and amortization. Unlike public companies, which are valued as the multiple of bottom line earnings to the stock price (P/E or price to earnings), private companies are valued as the multiple of EBITDA to the price of the stock.

There is no simple conversion factor that will convert an EBITDA multiple to a P/E for all companies, but in general, a factor of 2 is appropriate. Thus, a private company selling for an EBITDA multiple of 6 is priced about as richly as a public company with a P/E of 12.

EBITDA Multiples: The ratio of a private company's top line earnings to the price of its shares. See EBITDA above.

Enterprise Value: A measure of a company's value, often used as an alternative to straightforward market capitalization. Enterprise Value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Fee Income: The General Partners in a private equity partnership generally receive two types of compensation: fee income as payment for their portfolio management services, and a share of any profits (carried interest) as incentive compensation.

Fund of Funds: A private equity partnership that consists primarily of investments in other partnerships, as opposed to direct investments in individual companies and deals. The General Partners of a fund of funds thus act as a manager of managers to create a diversified portfolio of partnerships, each of which in turn consists of a portfolio of direct investment deals.

Although a fund of funds is a collection of partnerships, the fund of funds itself is a partnership, and therefore has a vintage year, a commitment period, a distribution phase, and a final end. Thus, fund of funds have finite lifetimes, just like their underlying partnerships.

The advantages of a fund of funds are high diversification and "one stop shopping," i.e., the client has a single relationship with the fund of funds manager.

The disadvantages of fund of funds are higher costs (another entire layer of management fees and carried interest), an additional loss of liquidity, and an additional loss of control by the Limited Partners. Just as with direct private equity funds, a fund of funds is organized as a blind pool. That is, when a new fund of funds is announced, and a subscription target set, early investors do not know what specific sub-funds will be selected by the manager. Generally, the Private Placement Memorandum gives the General Partner almost unlimited latitude in making subsequent investments.

General Partner: The control partner in private equity partnerships, analogous to the portfolio manager in a public stock portfolio. Under the IRS code, the General Partner must commit some personal capital to the partnership (a minimum of 1% of the partnership's committed capital), and unlike the Limited Partners, is liable for leverage and other losses generated by the partnership.

Growth (Expansion Capital): A strategy that entails providing capital to a private company with the intention that the capital be used to expand operations. Generally, expansion capital strategies result in minority equity positions in companies, but with some degree of control over how the expansion capital is spent.

Hurdle Rate: The minimum rate of return that the Limited Partners must receive before the General Partners have a right to a share of any additional profits (carried interest) produced by the partnership's investments. For example, the partnership may specify that once the Limited Partners have received distributions representing an 8% total return on their commitment (the hurdle rate), the General Partner will share in all future distributions until they have been allocated 80% to the Limited Partners, and 20% to the General Partners (their carried interest).

In-Kind Distribution: Most distributions from private equity partnerships are in cash. However, in some cases, a private deal will be taken public through an initial public offering (IPO), or through a trade sale for stock to a public company. In these cases, the Limited Partners will receive their distributions in the form of publicly traded common stocks and/or rights and warrants.

Investment Period: The period of time after the first closing during which the General Partner will call capital from the Limited Partners and make partnership investments. Legally, the investment period is usually six years. Practically, it is three to four years. Not to be confused with the term of the partnership, generally ten to twelve years.

IPO (Initial Public Offering): When a private company issues publicly traded stock, it becomes known as a public company. The initial sale of publicly available stock is called the initial public offering, or IPO.

IRR (Internal Rate of Return): The annualized rate of return on capital that is generated or capable of being generated within an investment or portfolio over a period of time, assuming all cash flows can be reinvested at the same rate. Mathematically, the IRR of an investment is the discount rate applied to that investment such that the net present value of the investment is zero. IRR is commonly used to measure profitability by applying the calculation to the after tax cash flows to arrive at an after-tax equity yield rate.

J-Curve: Many private equity partnerships have small negative returns in their first years of operation as capital is invested. The negative returns result because the partnership's investments have not matured and turned a profit, but the partnership has nevertheless experienced various operating costs. When early deals begin to mature and are liquidated at a profit, the partnership's returns should become positive. Thus, the graph of the partnership's returns versus time can resemble the capital letter "J."

Later Stage Fund: A venture capital partnership that specializes in investing in startup companies that have already achieved at least some actual revenues, or a venture fund that provides subsequent rounds of venture financing after all of the capital provided in the first rounds has been consumed.

Lead Investor: Describes a General Partner who is the "lead" investor in a deal, as opposed to co-investors or follow-on investors. The term implies that the lead investor has taken the lead in sourcing, evaluating, and executing the deal.

Leverage: Many General Partners use both equity capital provided by the Limited Partners and money borrowed from banks or other lenders to finance their investments. Any borrowed money is called leverage. If a deal is successful, leverage can often enhance the returns of the Limited Partners substantially. On the other hand, too much leverage can cripple an investment with interest and financing costs. It is important to note that the Limited Partners are not responsible for the repayment of any borrowed money.

Leveraged Buyouts: The purchase of a private or public company wherein the bulk of the purchase price is paid using borrowed money.

Limited Partner: All investors in a Limited Partnership other than the named General Partner are defined under the IRS code as Limited Partners. Limited Partners have only the control rights defined for them in the Private Placement Memorandum, and are generally passive investors in the partnership's deals.

A very important point is that Limited Partner's total liability for all deals made by the partnership are limited strictly by law to the Limited Partner's committed capital. Thus, even if the General Partners borrow a great deal of money (leverage), and lose it all, the lenders have no recourse to the assets of the Limited Partners. In effect, a Limited Partner can lose no more than the amount of money invested.

Look-Back Provision: See Claw-Back Provision above.

Mezzanine Financing: An additional level of financing provided to a private company to expand sales, market share, or develop new products. Most mezzanine financing is structured as a package of high coupon bonds with equity "kickers," i.e., rights to acquire the company's stock at a favorable price at a future point. Companies seeking mezzanine financing often have substantial revenues, and if not actual profits, the expectation of imminent profitability.

Multiples and Multiple Expansion: Managers purchasing public common stocks often buy companies with low price to earnings multiples when they believe some factor will induce other investors to bid up the price of the stock without an increase in actual earnings, thus causing the price multiple to expand. In the same fashion, a General Partner may purchase a private company with a low EBITDA multiple, expecting to profit through an expansion of that multiple. A typical example of a multiple expansion plan is consolidation. Many small companies, operating independently, may each be priced at relatively low multiples. But if purchased and combined into a larger, cohesive entity, investors might be willing to pay a higher multiple for the aggregate than for any individual component.

Placement Agent: Unlike public stock management companies, most of whom utilize an in-house sales force to market their services, private equity partnerships are generally marketed by third-party placement agents. These outside marketing firms and individuals are paid a commission by the General Partner.

Platform Company: Some private equity buyout funds attempt to add value by merging companies into larger, more cost efficient enterprises. This strategy generally begins with the acquisition of a platform company, often a market leader, to which other companies are added.

PPM (Private Placement Memorandum): Because Limited Partnership interests are not registered with the SEC, private equity managers must distribute a comprehensive document to prospective investors that describes the broad investment thesis of the partnership, and highlights any risks involved in the partnership. This document is called a Private Placement Memorandum.

Public to Private: If a private partnership (or group of private partnerships) purchases all of the outstanding shares of a publicly traded company, the company's shares may be de-listed from the stock exchange. The company is then said to have been "taken private." For example, in June 1989, the private partnership Wings Holdings acquired the public stock of Northwest Airlines in a $3.65 billion-dollar leveraged buyout. Following this acquisition, Northwest became a privately held corporation for the first time since 1941.

Secondary Fund: Occasionally, a Limited Partner will wish to sell his interest in a partnership before the term of the partnership is completed. Any such sale is termed a secondary market sale. A secondary fund creates a portfolio of partnership interests from earlier partnerships purchased in the secondary market. The advantage of a secondary fund is that it gives investors an opportunity to invest in seasoned partnerships from closed funds of prior vintage years.

Sponsor: Every private equity opportunity that Meketa Investment Group evaluates is assigned to a sponsor. This individual, who is a member of Meketa Investment Group's Private Equity Investment Committee, is responsible for the collection of information and the evaluation of the opportunity.

Take Down/Draw Down: A take down or a draw down is the same as a capital call.

Term: The term of a private equity partnership is its expected lifetime, and is specified in the Private Placement Memorandum. Most partnerships have a term of ten years, with the option to extend the term once or twice by an additional year if the Limited Partners approve.

The term of a partnership consists of several phases. After the final closing, no new commitments are accepted and the partnership enters the commitment phase or investment phase, legally lasting up to six years, but generally lasting three to four years, during which the individual investments are made. A distribution phase follows, during which mature investments are realized and profits distributed to the partners. The final phase is the liquidation phase, during which all remaining properties and assets are sold in order to terminate the partnership.

Trade Sale: The most prevalent exit strategy for many private equity managers involves selling a company in the private markets, usually through an auction process, to other private equity investors or to larger companies. This type of exit is termed a trade sale.

Turnaround: A turnaround strategy involves buying a troubled company, usually for a relatively low price, and making significant managerial or organizational changes to better the company's operations and enhance profitability.

VCOC (Venture Capital Operating Company): The IRS code defines one category of private partnerships to be venture capital operating companies for tax purposes. The General Partners of VCOCs are not required to register with the SEC as investment advisors. The name venture capital operating company relates only to the partnership's legal and tax structure, and does not imply that the partnership will invest in venture capital deals. For example, a middle market buyout fund, which invests only in mature companies with enterprise values of between $200 million and $1 billion, may be structured as a venture capital operating company.

Venture Capital: Money supplied to entrepreneurs to create new businesses is called venture capital. It is the first stage of financing for any new venture.

Traditionally, the recipient of the venture capital was a small group of entrepreneurs with an idea and a business plan, but no management team, corporate structure, revenues or profits. In the 1990s, however, venture capital was often used to seed established teams of entrepreneurs with well-defined products and in-place corporate structures. Thus, there is great variability in the meaning of venture capital and in the types of deals financed with venture capital money.

Vintage Year: The calendar year in which the first cash flow to a partnership occurred. This cash flow can be intended for management fees or investment capital. Vintage year can be used to differentiate the partnerships established over time by a General Partner, to track portfolio commitment pacing, and to benchmark portfolio performance.

Warrants: Just like publicly traded companies, private companies may issue warrants to their shareholders or to other groups providing some form of financing. A warrant is the right to purchase shares of the company's stock at a future date at a predetermined price, called the exercise price. Warrants become valuable if the exercise price is below the market price of the stock.