FRANKLIN PARK

Illinois State Board of Investment

Private Equity
Fiduciary Training FY 2012
Presented December 6, 2011

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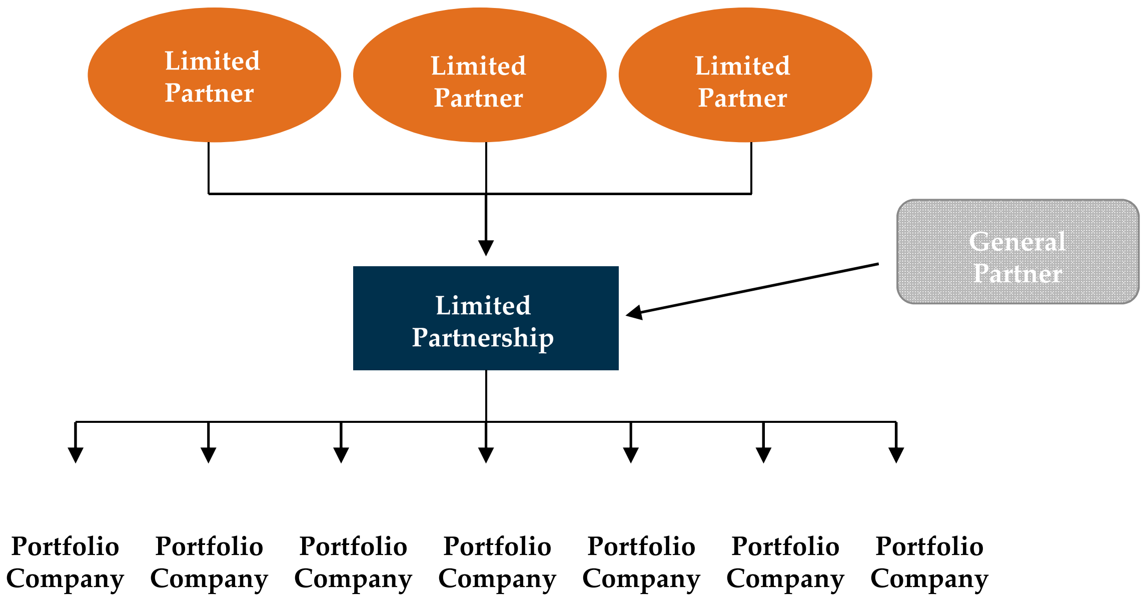
Private Equity Overview

Fund Structure

- Limited partnership (Fund)
  - Closed-end vehicle
  - Blind pool
- General partner (Fund Manager)
- Limited partners (Investors)
- Portfolio companies (Investments)



Fund Life Cycle

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Fundraising Period (6-18 months)

- General partner (GP) seeks to raise capital from investors
- Limited partners (LPs) commit capital to the fund; GP also commits capital
- At the expiration of the fundraising period, the fund closes to new investors

Investment Period (4-5 years)

- GP makes investments during the investment period
- Capital is "called" from LPs as investments are identified and closed
- Investments are completed and capital is locked-up until companies are sold ("realized")

Realization Period (4-6 years)

- Once investment period ends, the fund ceases to make new investments and focuses on realizing investments for a gain
- The average life cycle for investments is three to six years, depending on the type of transaction
- Some investments are structured to generate distributions to LPs in the form of interest and/or dividends
- The typical life of a fund is 10 - 12 years

Performance J-Curve

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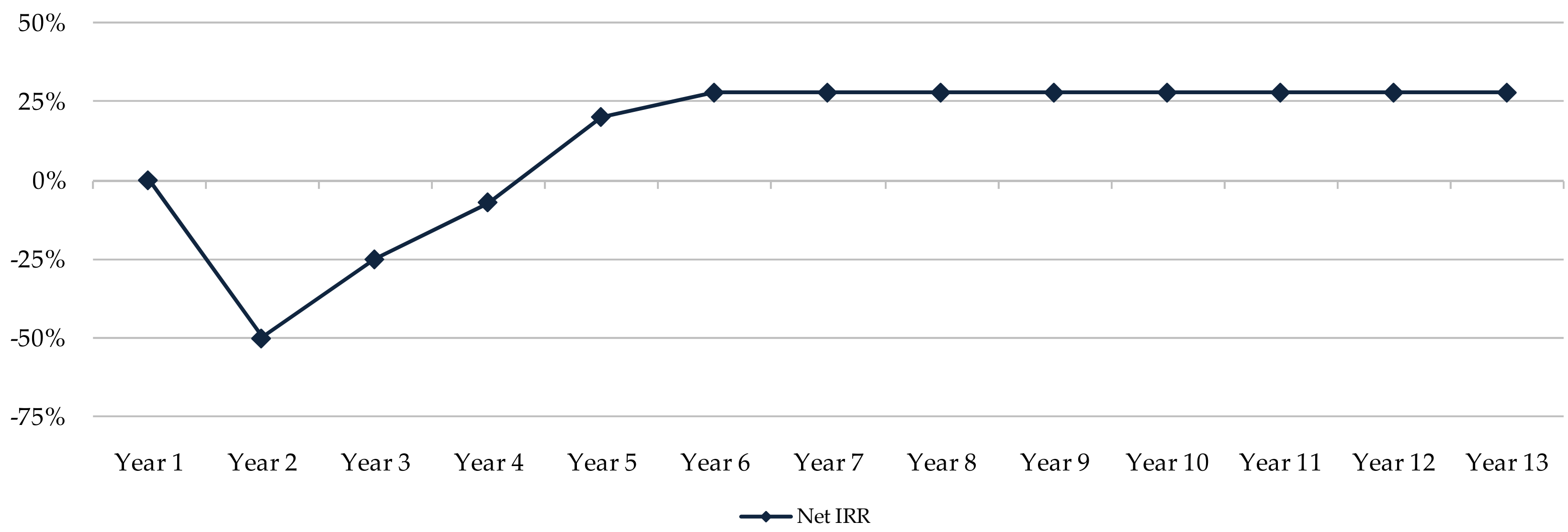
Private equity funds often produce negative or low IRRs during initial 5 years



Investment Strategies

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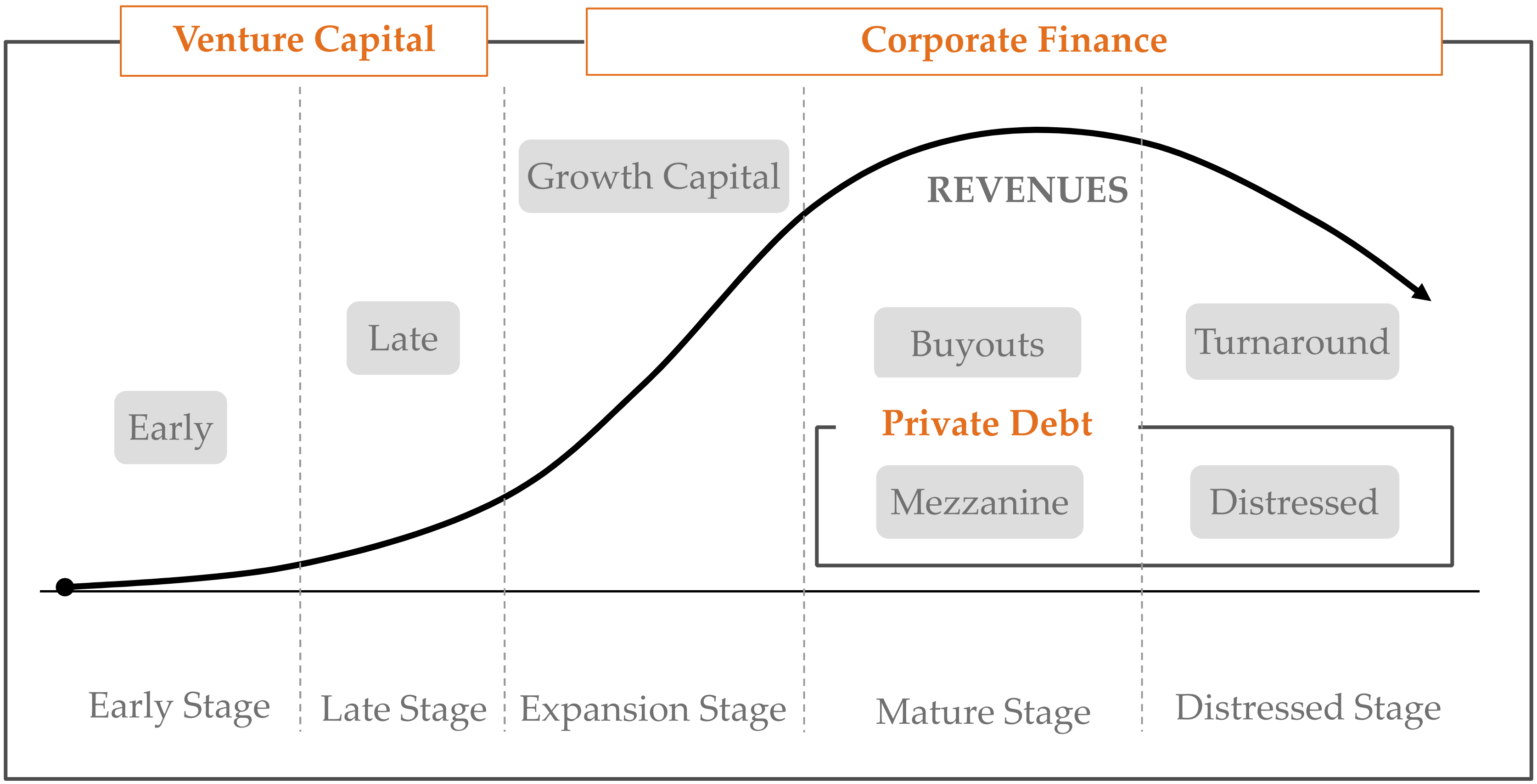

Asset Classes

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Financial Assets

Corporate Finance

Buyout
Acquiring controlling ownership in a business and creating synergies or growth to enhance enterprise valuation

Growth Equity
Investing in high growth companies to refinance the balance sheet or raise capital used for expansion or acquisitions

Turnaround
Acquiring and turning around the operational performance of underperforming businesses

Mezzanine
Providing subordinated debt and/or financing structured with a combination of debt and equity like securities

Venture Capital

Early Stage
Investing equity capital in young businesses creating new technologies, products, or services, with enterprise value growth potential

Late Stage
Investing expansion capital in small, revenue-generating, but not necessarily profitable, high growth companies

Secondary Strategies

Opportunistic Credit
Acquiring interests in asset-backed securities, non-performing loans, and securitized loan pools at distressed prices

Distressed Debt
Acquiring corporate debt at a discount to par value

Secondaries
Acquiring partnership interests in funds or direct equity stakes through the secondary market

Special Assets
Acquiring assets such as commercial aircraft, life insurance policies, royalties, and patents at distressed prices

Hard Assets

Infrastructure

Telecom
Greenfield, development, and acquisitions of wireline, cable, satellite, and cellular tower facilities

Maritime Facilities
Greenfield, development, and acquisitions of container port facilities

Water Facilities
Greenfield, development, and acquisitions of water and waste water pipelines, plants, sewers and reservoirs

Transportation
Greenfield, development, and acquisitions of toll roads, tunnels, bridges, airports, parking lots and mass transit

Public Institutions
Greenfield, development, and acquisitions of public parks & buildings, hospitals, post offices, prisons, public housing, and schools

Power
Greenfield, development, and acquisitions of power plants, distributed generation units, alternative power generators, and transmission networks

Natural Resources

Timberland
Acquiring forested land containing timber of commercial value

Conventional Energy
Acquiring companies in the business of developmental drilling and mining of oil, gas, and coal reserves

Agriculture
Acquiring farmland and agricultural infrastructure such as milling and processing facilities

Mined Resources
Acquiring mining rights, mines, and mined commodities such as gold, silver, zinc, and copper

Real Estate

Core Plus
Acquiring core properties that require some form of value enhancement and with some financial leverage

Value Add
Acquiring commercial, industrial, office, multi-family, mixed-use properties and making operational and physical improvements

Opportunistic
Investing in distressed properties needing significant enhancement or development properties

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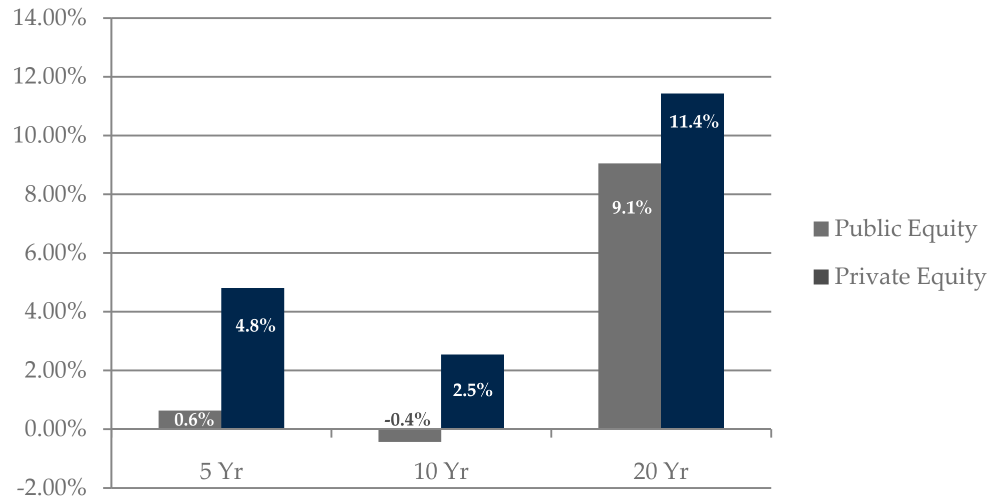
- (green) "Private Equity" Strategies
- (yellow) "Real Asset" Strategies
- (blue) "Debt & Secondary" Strategies
- (red) "Real Estate" Strategies

Investment Considerations

Rationale for Private Equity Allocation

- To generate premium returns relative to traditional equity markets
- Diversification benefits are limited, as private equity is correlated to public equity
- Private equity returns have outperformed public equity returns over the long term

Dispersion between Public Equity and Private Equity Returns

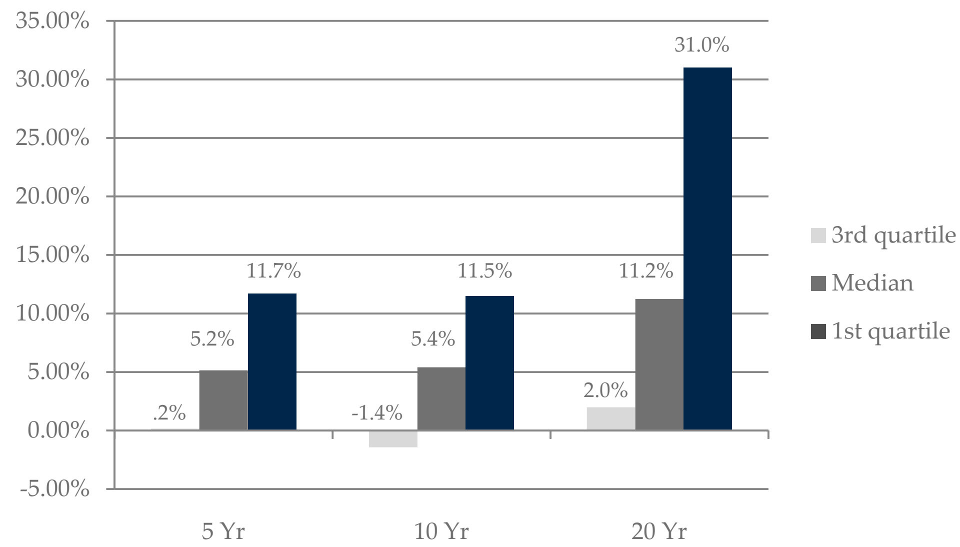


Notes
1. Public Equity reflects the total return for the S&P 500, which assumes reinvestment of dividends into the index, through September 30, 2010
2. Private Equity data represents pooled IRRs for All U.S. Private Equity as of September 30, 2010 per Thomson Reuters

Importance of Manager Selection

- Wide dispersion exists between top quartile and median returns
- Top quartile returns are necessary to compensate investors for risk and illiquidity
- ‘Skilled managers’ can leverage competitive advantages such as proprietary deal flow, industry expertise or relationship networks
- Manager selection should take precedence over sub-asset class, sector and geographic region allocations

Dispersion between Top Quartile and Median Private Equity Returns



Note: Data includes All Private Equity as of December 31, 2010 per Thomson Reuters

Risk-Return Profile

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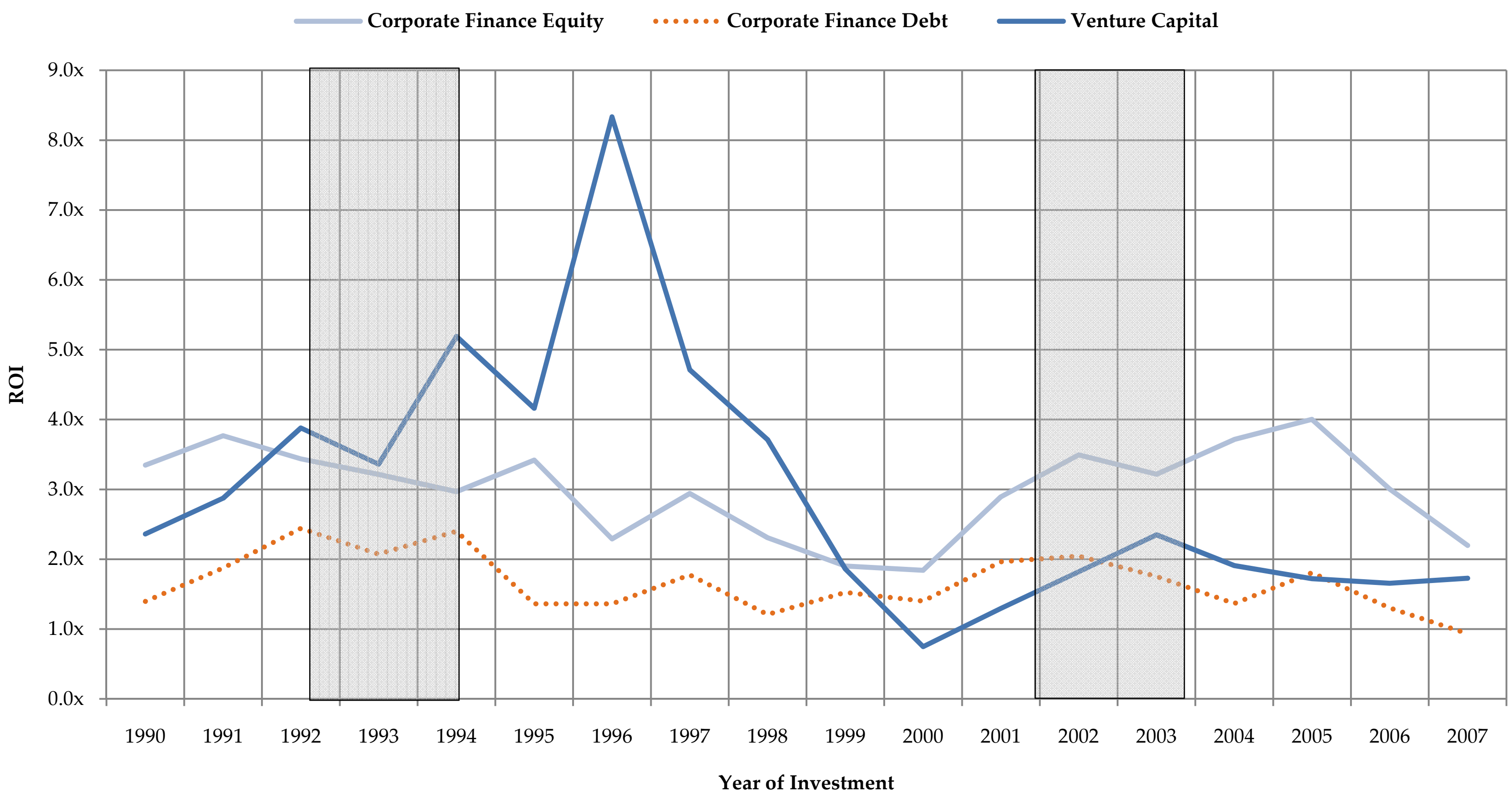
This graph depicts the realized return on investment (ROI) performance of investments by strategy



Source: Franklin Park realized deal database.

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Investment Process

Investment Process

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Sourcing

- Manager outreach
- Manager database and forward calendar
- Research
- Established relationships
- Client referrals
- Placement agents
- Networking

Preliminary Review

- Summary of fund offering
- Overview of merits, issues and initial questions

Initial Interview

- Meeting with senior team members
- Address preliminary issues and questions

Preliminary Evaluation

- Review GP questionnaire
- Preliminary team, strategy and track record analyses
- Select reference calls
- Summary of key legal terms

Investment & Operational Due Diligence

- Team, strategy and track record evaluation
- Site visits
- Reference checks
- Team interviews
- Background checks

Legal Due Diligence & Closing

- Full review of limited partnership agreement
- Negotiation of key terms (including side letters)

Monitoring

- Track investment and capital activity
- Review financial statements and performance reports
- Attend update meetings
- Review amendments

Operational Due Diligence

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Challenges of Private Equity Asset Class

- Private investments
- Lack of transparency
- Lack of standardization

Purpose

- Assessment of 'institutional quality' fund management practices
- Evaluation of internal controls, governance and resources to mitigate operational risks

Due diligence focus areas

- Experience and depth of finance & operations team
- Fund administration and reporting practices
- Valuation practices
- Technology and systems
- Conflicts of interest
- Legal liability and business insurance

Legal Due Diligence

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Review limited partnership agreement

- Identify key terms
  - Economics: *management fees, carried interest distributions, clawback provisions*
  - Governance: *Key person provision, termination provisions, investment restrictions/limitations*
  - Transparency: *Conflicts of interest, Advisory board involvement, reporting obligations*

Negotiate key terms, including side letter

- Investor specific policies (i.e. Sudan)
- Advisory board membership

Monitoring

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Interactions

- Advisory board meetings
- Manager/fund update meetings and calls
- Annual meetings

Activities

- Compliance reviews
- Financial report reviews
- Portfolio company operating performance commentary
- Review legal amendments, waivers, etc.

Value

- Identify issues/red flags early
- Fee recoveries and savings for investors
- Early look at subsequent funds

Corporate Finance Market

Value Creation

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Purchase price multiples

Earnings growth

	Sample Operating Metrics (USD in millions)															
	At Entry						At Exit									
Company	Ownership	Revenues	EBITDA	Net Debt	Multiple	Leverage	Ownership	Revenues	EBITDA	Net Debt	Multiple	Leverage	Revenue Growth	EBITDA Growth	Implied Equity Value Creation	Change in Trans. Value
1	75%	55	6	15	4.5 x	2.5 x	75%	95	11	14	6.0 x	1.3 x	73%	83%	3.0 x	4.3 x
2	80%	75	9	28	6.3 x	3.1 x	80%	95	11	48	8.8 x	4.4 x	27%	22%	0.7 x	1.7 x
3	55%	120	9	36	6.0 x	4.0 x	55%	140	6	50	7.0 x	8.3 x	17%	-33%	-0.8x	0.0 x
4	90%	310	20	80	7.0 x	4.0 x	90%	360	21	60	7.5 x	2.9 x	16%	5%	1.5 x	1.6 x
5	60%	275	40	200	8.8 x	5.0 x	60%	290	50	200	9.0 x	4.0 x	5%	25%	1.6 x	1.6 x
6	51%	3,000	310	1,200	9.5 x	3.9 x	51%	3,300	350	1,400	11.0 x	4.0 x	10%	13%	1.1 x	1.4 x
7	60%	2,500	350	2,100	10.5 x	6.0 x	60%	3,500	440	2,400	12.0 x	5.5 x	40%	26%	1.4 x	1.8 x

Use of financial leverage increases risk-return profile

Multiple expansion

Universe of Target Companies

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There are significantly more small companies versus large companies

	Number of Companies		
Revenue	**1985**	**2010**	**Growth**
$50 million - $1 billion	13,891	20,092	6,201
Over $1 billion	1,015	2,413	1,398
Total	**14,906**	**22,505**	**7,599**

Source: Dun & Bradstreet

Transaction Prices

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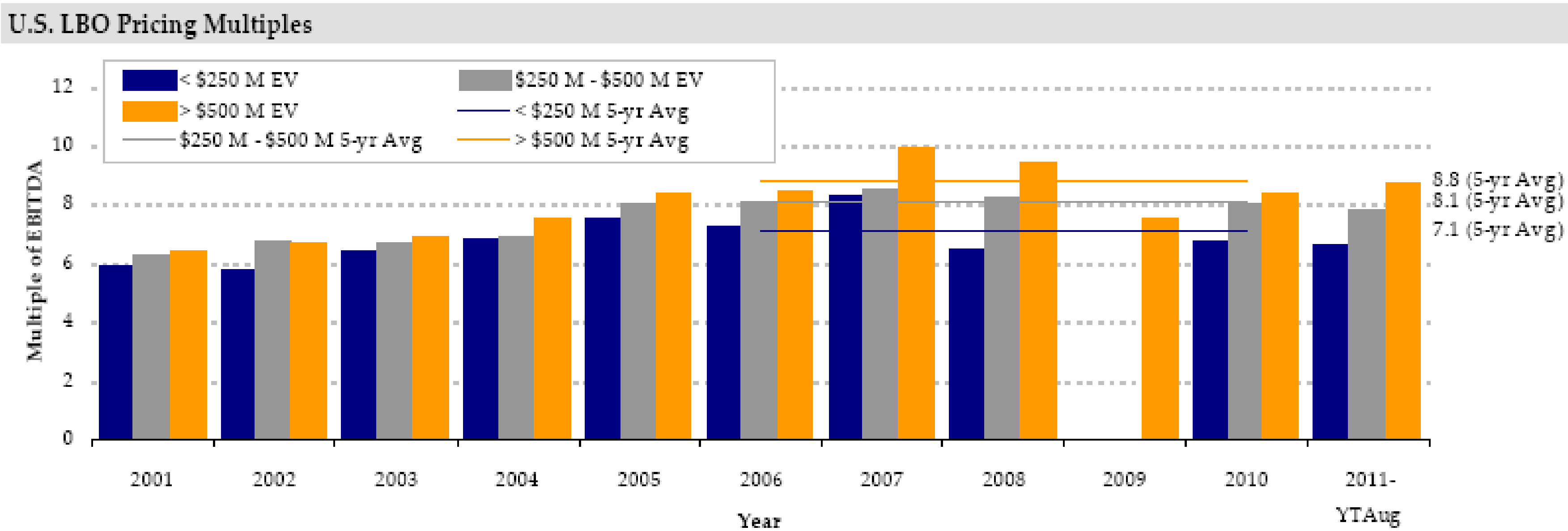

Source: S&P LCD

Returns

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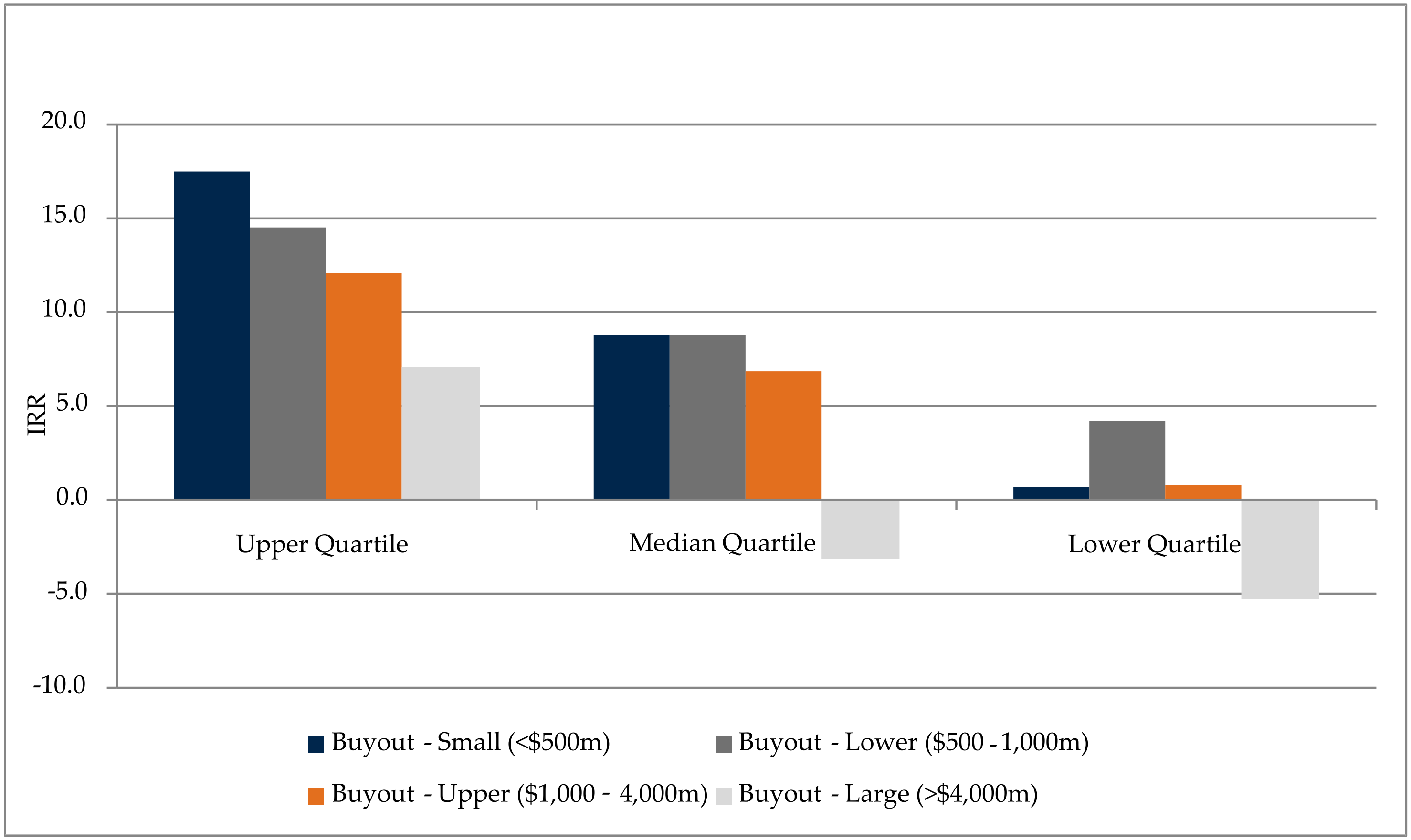
Quartile Performance by Fund Size



Source: Thomson Reuters, U.S. Buyout Funds. Performance presented for 30 year period ended 12/31/10

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Venture Market

Returns

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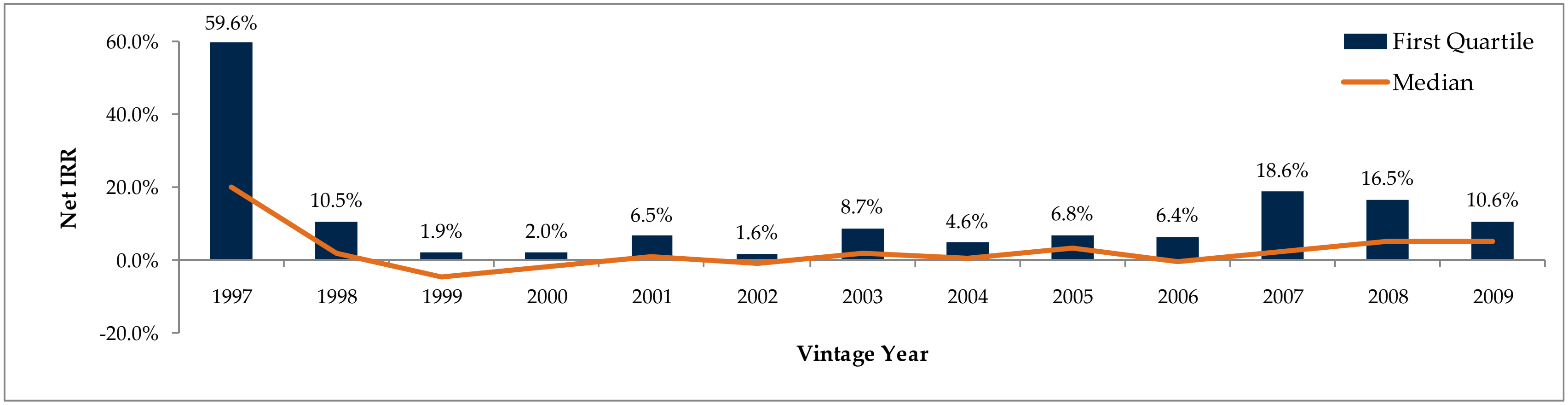
Returns have shown improvement in recent vintage years



Source: Thomson Reuters

Fundraising

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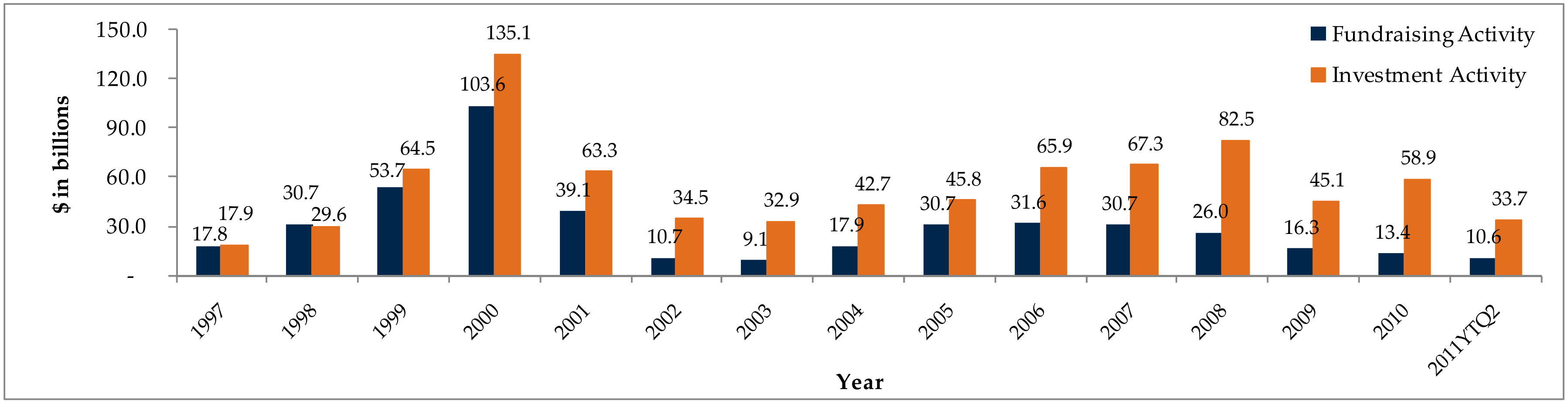
Recent fundraising activity has been modest and investment activity has been relatively stable



Source: Thomson Reuters

IPO Exits

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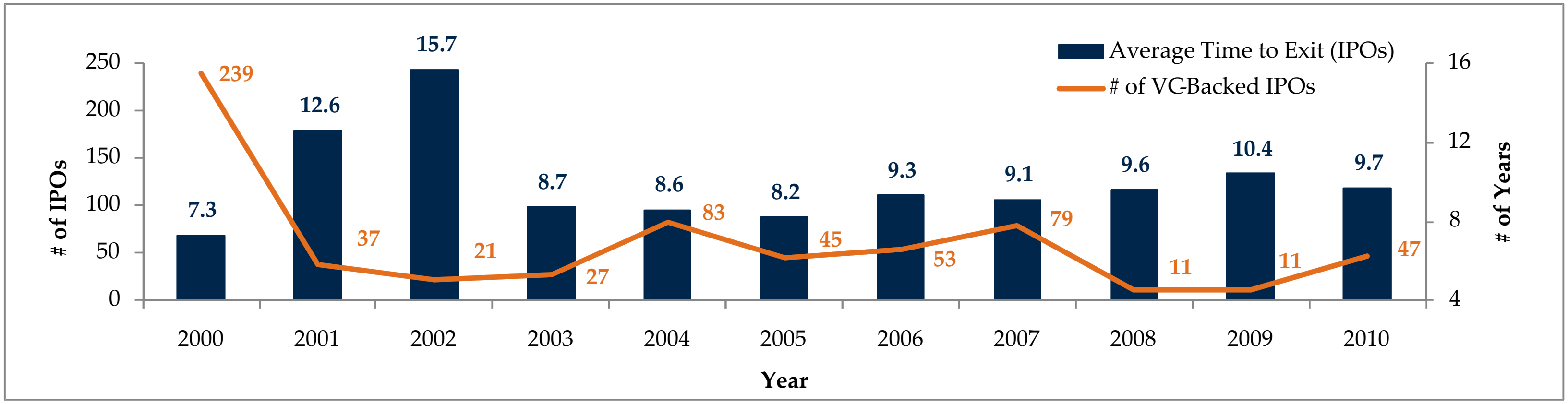
IPO activity has been sluggish and the time required to IPO is long



Note: The average time to exit represents the number of years between a venture-backed company receiving its first equity investment to its IPO exit.

Source: Thomson Reuters

M&A Exits

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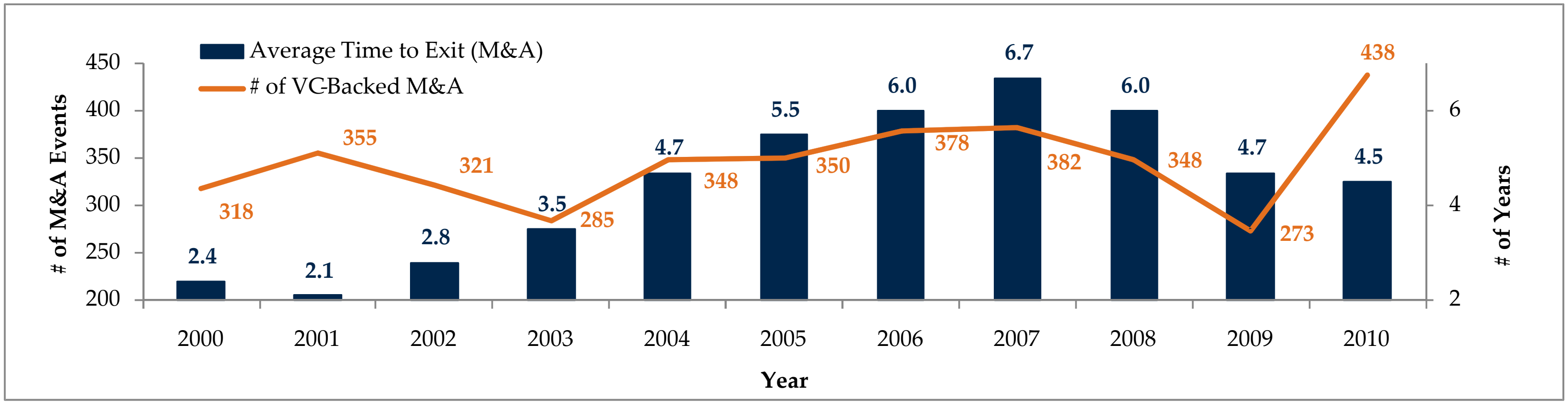
M&A activity has been robust, with typical exits occurring after a 4-6 year holding period



Note: The average time to exit represents the number of years between a venture-backed company receiving its first equity investment to its M&A exit.

Source: Thomson Reuters

International Market

Transformation of the Global Economy

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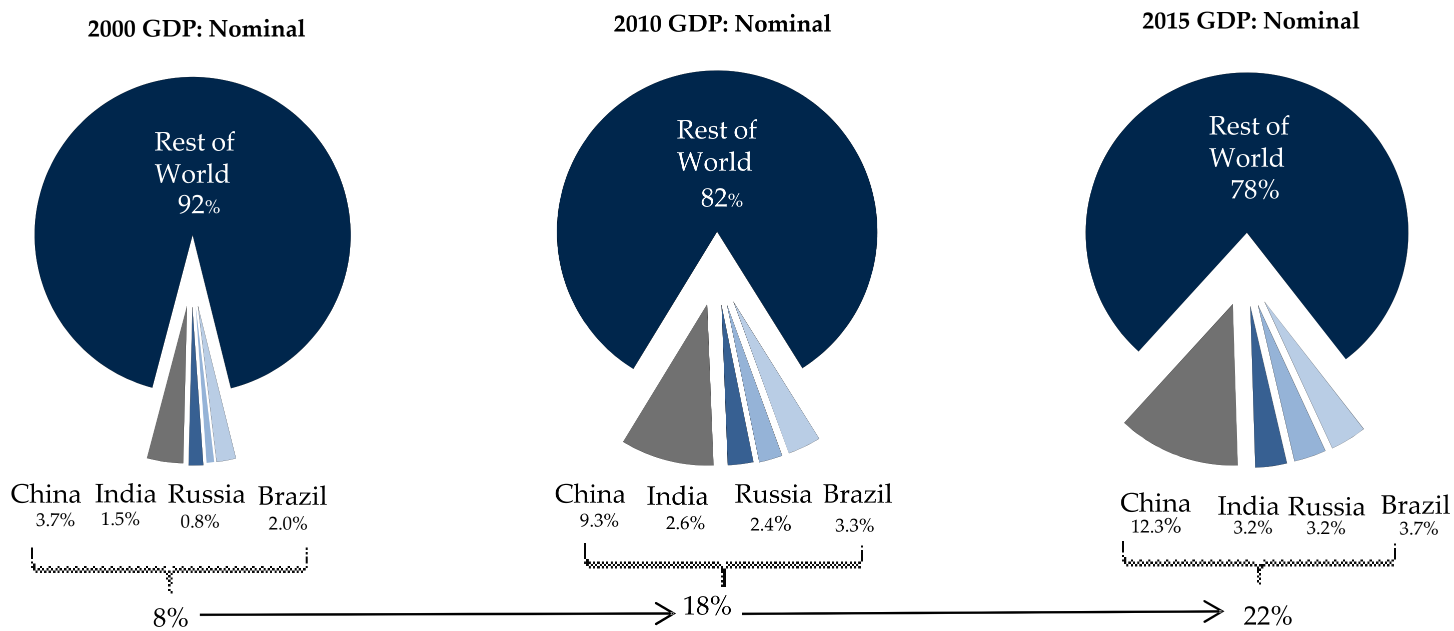
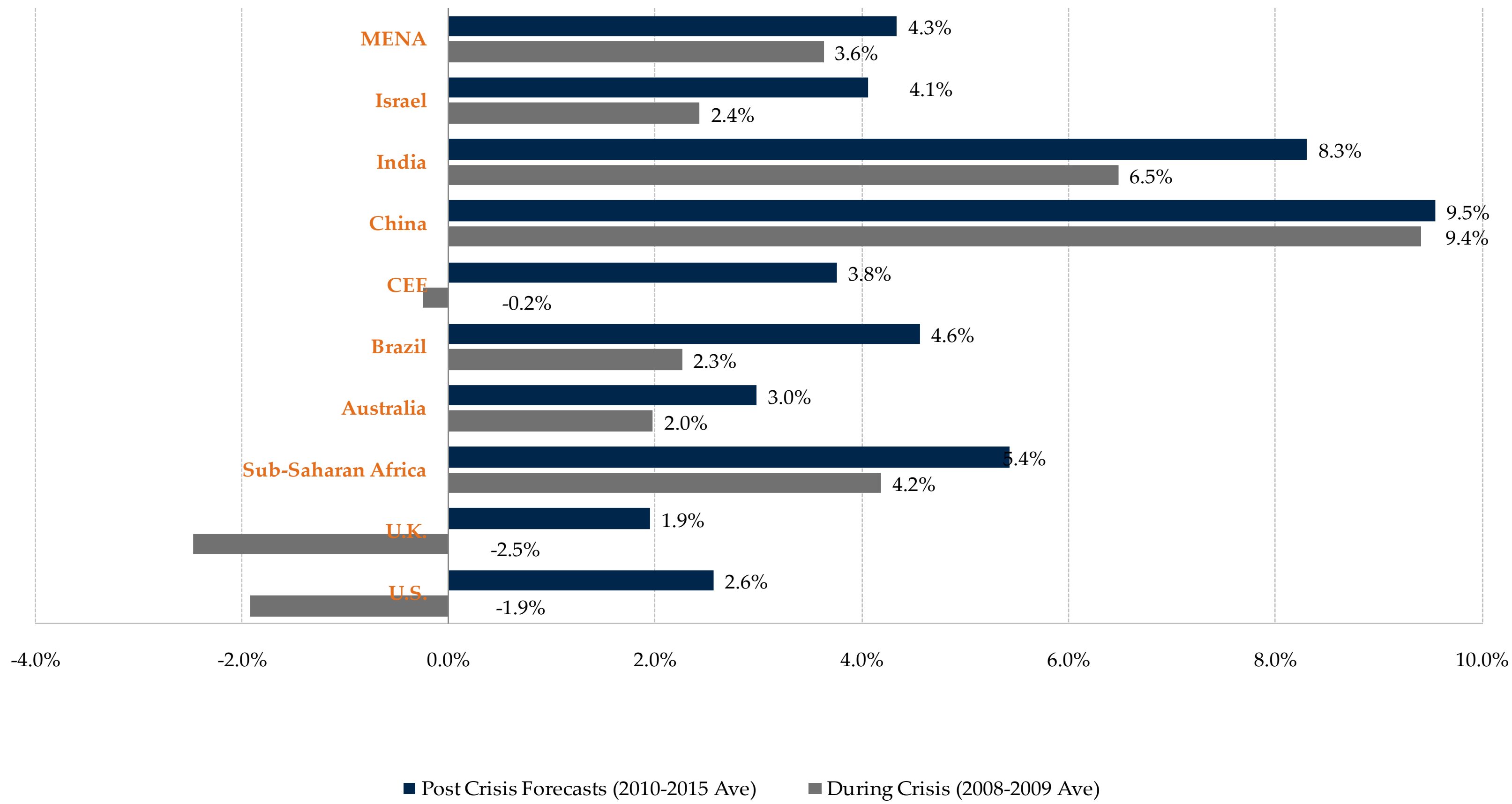
Growing economic relevance of emerging markets



Source: IMF as of 9/11, Thomson Reuters

GDP Growth

Higher growth potential in developing markets



MENA = Middle East and North Africa Region
CEE = Central and Eastern Europe

Source: IMF as of 9/11, Thomson Reuters

Private Capital Penetration

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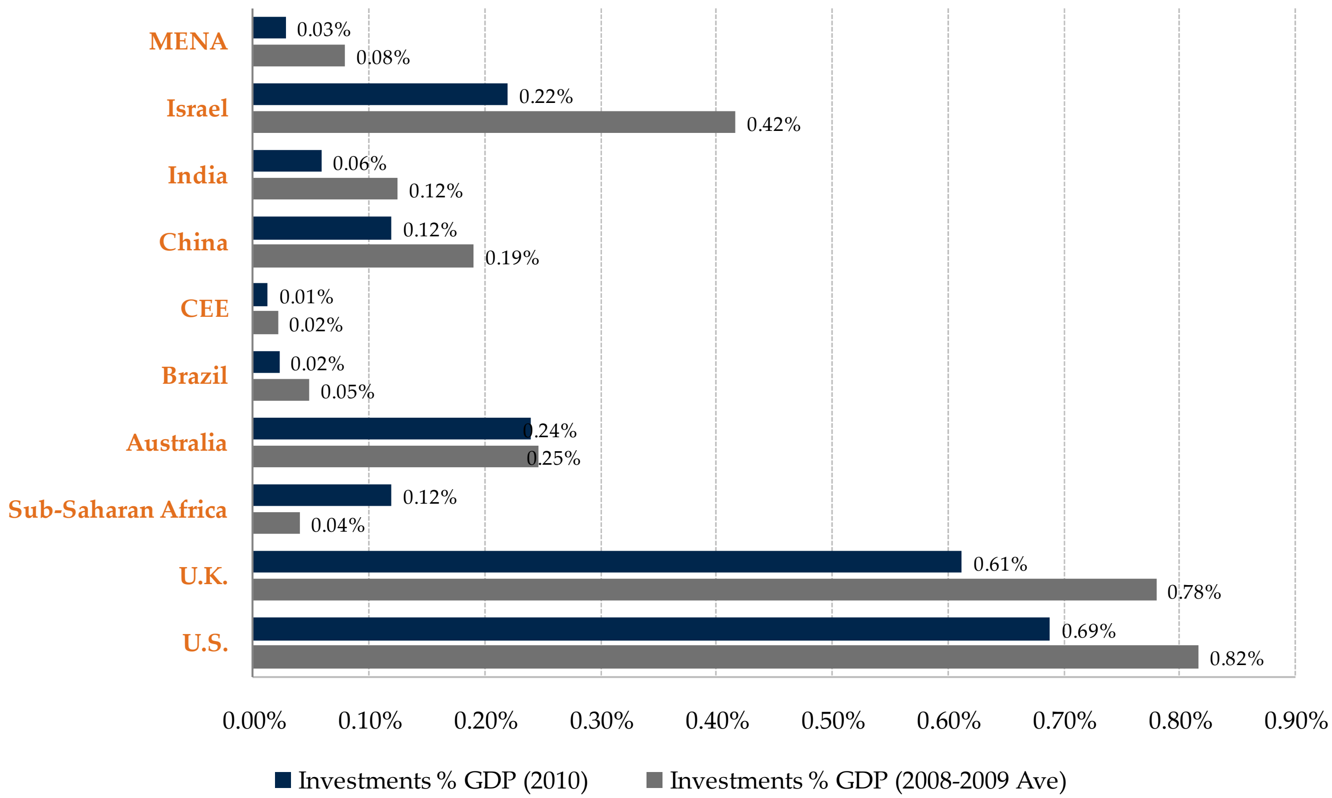
Less deal competition in developing markets



MENA = Middle East and North Africa Region
CEE = Central and Eastern Europe

Source: IMF as of 9/11, Thomson Reuters

Private Equity Returns by Region

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Net IRR to LPs	1 Year	3 Year	5 Year	10 Year	15 Year	20 Year
Global Emerging Private Equity and Venture Capital Index[1]	25.9%	10.1%	15.8%	11.7%	9.5%	9.3%
MSCI Emerging Markets Index[1,3]	18.8%	4.6%	11.0%	17.1%	8.7%	10.9%
Western European Private Equity and Venture Capital Index[1]	18.8%	0.8%	9.5%	11.1%	14.3%	14.1%
U.S. Private Equity Index[1,2]	19.9%	2.8%	9.5%	9.7%	12.2%	13.1%

[1] Data as of 3/31/2011
[2] Includes buyout, growth capital, energy and mezzanine strategies
[3] An index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets

Recent Legislation and Governance

Recent Legislation

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Dodd Frank (Fund Manager Registration)

- In general, Fund managers with greater than $150 million in assets under management must register with the SEC under the Investment Advisers Act of 1940
    - Venture capital firms, family offices and certain foreign advisers are exempt

- Registration is required by March 30, 2012

- Registered Fund Managers are required to:
    - Prepare and publicly file Form ADV (Parts 1 and 2)
    - Prepare and submit confidential Form PF
    - Designate a Chief Compliance Officer
    - Adopt compliance policies and procedures
    - Follow rules pertaining to Marketing, Custody, Conflicts of Interest and Recordkeeping

Governance

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Institutional Limited Partners Association (ILPA)

- ILPA is dedicated to advancing the interests of private equity limited partners through industry-leading education programs, independent research, best practices, networking opportunities and global collaborations

- In January 2011, ILPA issued version 2.0 of its Private Equity Principles which outline best practices with respect to establishing strong governance, appropriate transparency and the alignment of interests between LPs and GPs.

- ILPA also issued a series of standardized industry reporting templates (i.e. capital notices and quarterly reports)