PSERS PRIVATE INVESTMENT PROGRAM

Recommendation for Investment in
PNC Equity Partners II, L.P.

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PNC EQUITY PARTNERS II, L.P.

EXECUTIVE SUMMARY

PNC Equity Partners II, L.P. (the “Partnership” or “Fund II”) is being established by Allegheny Capital Partners II, LLC (the “General Partner”) with the primary objective of making equity investments of $10 million to $30 million in lower middle market companies engaged in leveraged transactions and other special opportunities. The Partnership will focus on change of control buyouts, corporate divestitures and large minority recapitalizations in the niche manufactured products, distribution services, and outsourced services sectors in the lower end of the United States middle market, an investment strategy that the General Partner has successfully executed for over 20 years. Fund II’s investment objective is to achieve a superior return on investment, principally in the form of long-term capital gains. The Partnership is seeking total committed capital of $300 - $350 million. The PNC Financial Services Group, Inc. (“PNC”) has committed to invest $75 million.

THE LOWER MIDDLE MARKET OPPORTUNITY

Fund II will focus on the lower end of the U.S. middle market, defined as companies with enterprise values between $20 million and $100 million. PNC Equity has historically focused on the lower middle market and believes it is the most attractive sector of the private equity market.

UNDERLYING MARKET IS LARGE

According to the most recently available U.S. Economic Census, a vast 96% of domestic companies have revenues between $10 million and $250 million. Also, the number of middle market companies for sale at any time is large. According to the Thomson Financial and Robert W. Baird & Co. Incorporated M&A Market Analysis, middle market transactions represented roughly 95% of all mergers and acquisitions volume with disclosed values in 2004.

RELATIVELY LOWER PURCHASE PRICE MULTIPLES

Purchase price multiples in the lower middle market tend to be lower as compared to multiples paid for larger businesses for several reasons. First, sale processes for lower middle market companies tend to be less efficient than those for larger companies. Smaller transactions are typically executed by investment banking boutiques and business brokers with fewer resources than their more sophisticated counterparts. Second, in addition to sales processes being less efficient, senior and mezzanine debt capital is often not as readily available in this segment of the market. Lastly, small companies frequently lack some key element of a complete business strategy or management team.

ROOM FOR IMPROVEMENT

Companies in the lower end of the middle market are appealing because they often have not fully exploited their competitive advantage and/or market opportunity. Accordingly, smaller companies are generally more responsive to changes which strengthen its management team, strategic plan and/or operations practices. In smaller companies, it is often easier to identify best practices and operational adjustments that will grow a company and enhance enterprise value beyond a strict reliance on financial leverage or exit multiple arbitrage.

ASSET CLASS HAS DEMONSTRATED STRONGER HISTORICAL PERFORMANCE

The overall success of private equity investing in the lower end of the middle market can be demonstrated by historical return data. Although prior performance is no guarantee of future results, in general, smaller private equity buyout funds historically outperformed larger private equity buyout funds.

INVESTMENT STRATEGY

The Partnership's investment objective is to generate superior investment returns primarily through the realization of long-term capital gains. In pursuit of this objective, the Partnership will continue to employ the investment strategy developed successfully by the Principals over their 23-year tenure in the private equity market and implemented in the deployment of PNC EPI. PNC Equity's track record is built on an investment philosophy that emphasizes a high percentage of successful investments as opposed to one in which a few highly successful investments are required to compensate for a large number of poor performers. The key elements of PNC Equity's current investment strategy include:

- Focusing on transactions in the relatively inefficient lower middle market with a particular interest in corporate divestitures;
- Targeting Special Opportunities where competition is limited as a result of unique capitalization or ownership requirements;
- Sourcing the majority of their transactions from situations where competition is limited as a result of relationships, reputation or transaction experience;
- Employing a value-oriented investment style which rewards the buyer rather than the seller for plans initiated and events occurring post-closing;
- Applying a disciplined, rigorous investment and diligence process;
- Emphasizing those industry segments in which the Principals have experience; and
- Working actively with portfolio companies before and after the transaction closes.

LOWER MIDDLE MARKET SPECIALIZATION

Fund II intends to continue its current strategy of pursuing investments in lower middle market companies, typically represented by businesses with enterprise values of $20 million to $100 million. The lower middle market will continue to offer attractive investment opportunities, particularly given the current economic and financing environment, because it remains relatively less efficient than the markets for larger companies. This inefficiency is manifest in smaller companies that are frequently valued at a discount relative to larger companies within the same industry and receive less attention from larger, more sophisticated intermediaries. In addition, companies in this market segment are more receptive to the operating and strategic discipline brought by PNC Equity's active investment style which can result in meaningful improvements in company performance.

PNC Equity has also been successful in exiting investments by "selling up the food chain" to larger private equity funds or larger corporate buyers. The opportunity to exit an investment in this manner best presents itself when a company's growth has been limited by inattention or lack of capital from its owner(s) prior to PNC Equity. In these instances, the discipline and rigor of PNC Equity's active involvement at the Board level helps to further professionalize management practices and creates a clearer strategic focus for the business. PNC Equity has also demonstrated its ability to assist these businesses by identifying and evaluating acquisitions and managing the company's capital structure and financing needs in order to optimize the growth rate of the business. For the types of businesses targeted by Fund II, these efforts create value to be realized when the companies are sold by broadening the pool of potential acquirers to include larger, more sophisticated buyers.

TARGET SPECIAL OPPORTUNITIES WITH THE NICHE

PNC Equity's Special Opportunities focus fills a void in the lower end of today's private equity market. These Special Opportunities are typically transactions that have capitalization and ownership structures that are difficult for traditional venture capital firms or middle market buyout firms to finance. On the one hand, these Special Opportunities may be difficult for traditional venture capital firms who do not have the buy-side mergers and acquisitions skill set and who are not active in the leveraged financial capital markets. Similarly, these Special Opportunities may be difficult for traditional buyout firms who are uncomfortable with control-oriented minority ownership positions. In such instances, PNC Equity typically has the contractual right, under certain circumstances, to name additional directors and/or pursue a company sale without the consent of the company's other shareholders. PNC Equity's historical experience with these transactions enables it to target these less-competitive transactions that may otherwise "fall through the cracks" among today's middle market financing sources.

In addition, Fund II's Special Opportunities focus is well-suited for economic periods where availability of senior debt financing is less robust. When senior debt financing cycles force more conservative structures, there is typically a three to twelve month lag before sellers' expectations of value for their businesses realign with the reality of lower debt multiples and corresponding purchase multiples. This often leads to many deals being pulled from the market as the bid and the ask are simply too far apart. While some sellers will wait for more favorable capital markets to return, others will decide that the risk of waiting for such a period to return is outweighed by their needs for liquidity (e.g. advanced age or poor health of the owner). In this latter instance, Fund II's Special Opportunities focus can address a seller's preference to monetize a portion of its holdings while waiting for more robust capital markets to sell its remaining ownership.

SOURCE DEALS FROM LIMITED COMPETITIVE SETS

With over 150 total transactions as either an investor or seller, PNC Equity has established a recognized franchise in the market and has developed deep, personal relationships among a wide variety of investment banks, business brokers, accountants and other deal sources in both primary and secondary markets. PNC Equity regularly calls directly on these intermediaries and is a frequent exhibitor at local and regional deal professional forums across the country. Cultivating these relationships has enabled PNC Equity to see transactions on a non-auction or limited auction basis in which only a small group of firms are invited to compete or in which PNC Equity is invited to make a preemptive investment proposal prior to a broader marketing process. In other situations, PNC Equity has been effective when the competitive set was limited in some fashion as a result of 1) constraints on the target company's time to closing, 2) the Principals' personal relationship with one or more members of the management team or one of its advisors and/or 3) the target company's predisposition to working with a known equity sponsor group. In these limited auctions, PNC Equity has been successful competing on qualitative factors such as "fit" and "philosophy" rather than on price.

A large percentage of PNC Equity's historical transactions sourced from personal business contacts are a direct result of the Principals' long tenure in the business and positive reputation for building partnerships with management teams. Leveraged buyouts and Special Opportunities pursued directly with management teams to accomplish ownership changes, acquisitions or recapitalizations typically require PNC Equity to provide its structuring and mergers and acquisitions experience along with its capital. An even more important point is that in these situations management is often looking for a partner who can assist it in planning and guiding the growth of the business. PNC Equity's reputation and reference base of former management teams, lenders and co-investors provide it with a strong competitive advantage in such transactions.

Value-Oriented Investment Style

Fund II will continue the Principals' historical emphasis on value in its investments. By investing at lower than market multiples, PNC Equity has been able to reduce the financial risk of its investments while improving the likelihood for achieving its target returns. The Principals' adherence to this approach results from a disciplined investment process, pursuing transactions sourced from limited competitive sets and targeting Special Opportunities not easily financed by other private equity firms.

Focus on Core Business Sectors

The Partnership will continue to focus on making investments in the Core Business Sectors which the Principals have considerable prior investment experience: niche manufactured products, outsourced services and distribution services. By focusing on the Core Business Sectors, PNC Equity is able to respond quickly and more thoroughly investigate the investment opportunities it has sourced. Investment opportunities that fall outside of these Core Business Sectors are rarely pursued.

It is expected that the Principals will continue to leverage their industry experience for the benefit of Fund II.

In considering a new investment, the Principals bring to bear their experience in investing in these industries based on thousands of examined opportunities and the successful management of a portfolio of 57 companies over 20+ years. The experience of the Principals improves the investment process in a number of ways, including: 1) establishing a base for assessing best-in-class performance in each business segment, 2) allowing for ready identification of true market leadership in a given segment and 3) creating a network of industry experts, former CEOs and managers and third-party consultants to draw on during the diligence process. The Principals' long investment history and broad portfolio experience contribute to their reputation as a knowledgeable and capable financing partner with an ability to manage the diligence process, facilitate a transaction closing and add value during the investment period.

Within the Core Business Sectors, PNC Equity focuses on businesses which are leaders in the markets they serve. These markets are typically less than $500 million and/or are often limited by geographical boundaries. PNC Equity often invests in companies that are one of the top three participants in their industries.

Disciplined Investment Review and Due Diligence Process

In pursuing the Partnership's strategy, the Principals will continue to utilize a rigorous investment process that has been refined over their long tenure in the business and has resulted in superior investment performance. This process allows the firm to focus resources on those transactions that fit PNC Equity's investment strategy while dismissing other transactions quickly. Initial evaluations of transactions are discussed among all members of PNC Equity at regularly scheduled meetings during which key issues are identified and further due diligence areas are defined. As an opportunity becomes more actively considered, PNC Equity works closely with company management and, if applicable, the intermediary to complete its evaluation with particular emphasis placed upon these key issues. Concurrently, PNC Equity will market and negotiate debt financing based on its assessment of the appropriate capital structure. To determine the appropriate capital structure and valuation, PNC Equity uses a cash flow evaluation system developed by the Principals over 10 years ago to ensure adherence to a set of historically proven investment criteria balanced against the opportunity for return. Investment proposals are then delivered to the company based on a capital structure, incentive plan, employment provisions and other factors which are customized for each opportunity. After acceptance of an investment proposal, PNC Equity will lead the due diligence process, manage the scope of work to be performed by the necessary third-party consultants, secure debt financing commitments and negotiate appropriate legal documents. As part of the due diligence process, PNC Equity will typically perform primary management, market, financial, accounting, environmental and customer reference research. The findings of PNC Equity's due diligence are compiled and presented along with debt financing commitments for formal investment committee approval after the investment team has reached consensus support for the investment.

The Principals have developed a formal screening and diligence process which has been an important factor in their consistent track record. The process is divided into discrete stages of evaluation during which the Principals constantly make decisions regarding the investment opportunity in question.

PNC Equity's strong reputation and on-going marketing programs create a large number of transaction inquiries each year. The majority of these inquiries do not pass an initial screen of the executive summary materials. Inquiries that the Principals feel offer a legitimate investment opportunity are subject to an in-depth review of the transaction that emphasizes adherence to key investment criteria, understanding of the potential return opportunity and the surfacing of key issues. The key investment criteria provide the Principals with a basis for comparing new transactions against select criteria that have been distilled from PNC Equity's investment experience over the last 23 years.

Those key criteria which are identified as absent or present to only a limited extent are subject to more extensive diligence within the entire investment process. Included in the initial review process is the assessment of the return opportunity and the surfacing of key diligence issues. This assessment assists the Principals in allocating resources to the transactions that demonstrate the most attractive risk/reward characteristics.

When key issues, structure and pricing issues are well understood, PNC Equity will issue a comprehensive letter of intent. At this point, PNC Equity is typically granted a period of time in which it will pursue the transaction on an exclusive basis. From the letter of intent stage to closing, PNC Equity along with its due diligence partners perform thorough diligence including general business due diligence, legal reviews, forensic accounting analysis, competitive and market analysis, environmental assessments, insurance policy coverage reviews, management criminal and media searches, asset appraisals and customer and supplier reference calls. Concurrently, PNC Equity will arrange and negotiate the senior and mezzanine debt financing, negotiate legal documentation and negotiate management's employment agreements and incentive plans. As a result of this time and resource consuming process, PNC Equity expects to close three to five transactions during each year of the Partnership's investment period.

ACTIVE PORTFOLIO INVOLVEMENT

The companies targeted by Fund II are of a size where consistent involvement by their equity partner in assessing strategies, supporting growth, improving business practices and capital efficiency and making acquisitions or addressing challenges, can result in meaningful improvements in company performance. Active involvement on each of its companies' board of directors will exert influence as necessary to achieve PNC Equity's investment management plan. PNC Equity holds two or more board seats in each of its PNC EPI platform companies and, historically, has held at least one Board seat in substantially all of its investments. Also, in instances where it does not hold a majority ownership position, PNC Equity typically has the contractual right, under certain circumstances, to name additional directors and/or pursue a sale of the company without the consent of the company's other shareholders. The Principals intend to pursue only investments for Fund II that will provide one or more Board seat(s) to be held by PNC Equity representative(s).

The close monitoring of portfolio companies improves the Principals' ability to optimize decisions with respect to portfolio liquidity. Throughout the life cycle of an investment, an equity sponsor can face a number of decision points that may affect liquidity and investment outcome including opportunities for refinancing, issuing shareholder dividends, and/or initiating a company sale. The Principals treat each circumstance in this regard as an opportunity to revisit their investment thesis and regard their active portfolio involvement as an important knowledge base to assist in making these decisions. Further, the Principals' active involvement serves as an early warning system for portfolio companies that face significant challenges due to sudden or unexpected shifts in the market or competitive landscape. In these situations, the Principals have demonstrated a strong history of addressing challenges proactively to encourage positive outcomes as demonstrated by the low loss ratio of 10.5%. Importantly, during the life of each investment, the Principals strive to develop constructive relationships with senior lenders, mezzanine lenders and portfolio company executives that often become critical in negotiating positive outcomes in difficult circumstances.

MANAGEMENT OF THE PARTNERSHIP

The General Partner of the Partnership will be Allegheny Capital Partners II, LLC, the managing members of which are David McL. Hillman, Peter V. Del Presto, and John C. Glover ("Managing Principals"). PNC is a non-managing member of the General Partner. The Manager of the Partnership will be PNC Equity Management Corp (the "Manager"), a wholly-owned subsidiary of PNC, the principals of which are Messrs. Hillman, Del Presto, Glover, Bacdayan, Bertram and Lewis. The Manager represents a cohesive and experienced team of investment professionals.

The Manager has overall responsibility for the management of the business affairs of the Partnership. The Managing Principals oversee the day-to-day activities of the Manager and the Partnership. Messrs. Hillman, Del Presto, and Glover, along with Mr. Gary J. Zentner and Mr. Peter M. Chiste are expected to be the members of the Investment Committee of the Partnership. Mr. Zentner was one of the founders of PNC Equity in 1982 and was a Partner until his retirement in August 2005, and will serve as a PNC representative. Mr. Chiste also serves as a representative of PNC and is responsible for monitoring PNC's investments in third-party private equity funds, including its investment in the Partnership. Investment approval requires a simple majority of the five individuals on the Investment Committee including at least two of the three Managing Principals.

MANAGEMENT TEAM

David McL. Hillman, Partner (52), joined PNC Equity as one of its founders in 1982. Previously, David joined the management training program of PNC's affiliate, PNC Bank, in 1976. He subsequently held several positions in the Corporate Banking Division.

David is a director of Tangent Rail Corporation and Cavert Wire. He is a former member of the board of governors and executive committee of the National Association of Small Business Investment Companies (NASBIC).

David earned his BA from Williams College and his MBA from the Darden Graduate School of Business Administration at The University of Virginia.

Peter V. Del Presto, Partner (55), joined PNC Equity in 1985. Peter's career began with E.R. Squibb and Sons, where he worked as a research scientist in the Department of Toxicology. He also served as director of the Federal Systems Division of Commonwealth Clinical Systems, a health care information services company.

Peter is a director of Cavert Wire, Griffith Energy, Home Made Brand Foods, Inc., M&R Marking Systems, Porcelain Industries, Inc. and Portec Group International.

Peter received a BS from the University of Notre Dame. He also holds an ME in biomedical engineering and an MBA from the Darden Graduate School of Business Administration at The University of Virginia.

John C. Glover, Partner (39), joined PNC Equity in 1996. Previously, Jack worked as an investment banker with Wheat First Butcher Singer, where he specialized in providing capital raising and financial advisory services for middle market companies. Prior to Wheat First, he was an investment analyst in the corporate finance department of Westinghouse Credit Corporation. During business school, Jack was a summer associate at Salomon Brothers Inc.

Jack is a director of Advanced Disposal Services, Griffith Energy, The F.B. Leopold Company, GTS, Inc. and Mainline Supply, Inc.

Jack received a BS with honors from Duquesne University. He also received an MBA from the University of Chicago Graduate School of Business.

Wali C. Bacdayan, Managing Director (35), joined PNC Equity in 1997. Previously, Wali worked as an investment banker in the Acquisition and Private Finance Group of Dean Witter Reynolds Inc., where he focused on mergers and acquisitions and private financings for middle market companies. During business school, Wali was a summer associate at Schering-Plough Corporation.

Wali is a director of The F.B. Leopold Company, GTS, Inc., Home Made Brand Foods, Inc. and The Schumacher Group.

Wali graduated Phi Beta Kappa from Washington and Lee University with a BA in Mathematics and Economics. He also received an MBA from the J.L. Kellogg Graduate School of Management at Northwestern University.

Justin L. Bertram, Vice President (33), joined PNC Equity in 1998. Prior to joining PNC Equity, Justin worked as an investment banker with Bear, Stearns & Co. Inc., where he specialized in capital raising and financial advisory services.

Justin is a director of Griffith Energy, Mainline Supply, Portec Group International and Tangent Rail Corporation.

Justin received a BS in mechanical engineering from Columbia University and a BS in mathematics from Allegheny College. He also received an MBA from the Tepper School of Business at Carnegie Mellon University.

Jonathan B. Lewis, Senior Associate (30), joined PNC Equity in 2005. Previously, Jonathan was an associate at William Blair Capital Partners, a middle market private equity firm. Prior to that, Jonathan worked as an investment banker with Bowles Hollowell Conner, an investment bank specializing in mergers and acquisitions and private financings for middle market companies. During business school, Jonathan was a summer associate with Lake Capital in Chicago.

Jonathan received a BA with honors in English, French, and philosophy from Furman University, where he was a Fulbright Scholar. He also received an MBA from the Tuck School of Business at Dartmouth College, where he was president of his class.

Michael B. Hand, Associate (28), joined PNC Equity in 2003. Previously, Mike worked as an investment banker at Raymond James & Associates where he focused on mergers and acquisitions, public offerings and private placements. Mike received a BA with highest honors in Economics from the University of Florida.

FINANCIAL REPORTING AND ACCOUNTING

The Manager will receive financial and accounting services consistent with those historically received by PNC Equity from the finance team within PNC managed by Deanna Barry. The Manager will pay PNC a ratable fee for these services rendered.

Deanna P. Barry (38), Chief Financial Officer, joined PNC Equity in 1996. Previously, Dee was an Assistant Vice President with PNC's SEC and Credit reporting groups. Dee joined PNC from KPMG Peat Marwick where she was an audit supervisor in the financial services industry. Dee is a Certified Public Accountant and graduated summa cum laude with a BS degree in Accounting from Duquesne University.

ADDITIONAL INVESTMENT COMMITTEE MEMBERS

The Investment Committee will approve all investments of the Partnership. Investment Committee approval will require three of the five members of the Investment Committee including at least two of the three Managing Principals. In addition to the Managing Principals, the Investment Committee will include Mr. Zentner and Mr. Chiste.

Gary J. Zentner (62) was President of PNC Equity from its inception in 1982 until his retirement in 2005. Prior to his involvement with PNC Equity, Gary was responsible for management of PNC Merchant Banking Company, a wholly-owned subsidiary of PNC Bank, which was involved in various corporate finance and capital markets activities. Gary started his career in 1965 in the Corporate Banking Division of PNC Bank. Gary received his BBA from the University of Wisconsin.

Peter M. Chiste (46), Vice President & Director of Fund Investments, joined PNC in 2001. Previously, Pete was a Vice President in the Venture Fund Investments Unit of Banc One Venture Partners, where he focused on private equity fund investments and development of a fund-of-funds product offering. Before joining Banc One Venture Partners, Pete was a Managing Director of Banc One Investment Advisors where he led private equity fund investment management for institutional and wealthy clients. Pete graduated from Rutgers College with a BA in Business Administration and English Literature, received a JD from Rutgers School of Law and received an MBA in Finance from the Stern School of Business at New York University. Pete is an inactive member of the New Jersey Bar. He has also received the Chartered Financial Analyst designation.

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Portfolio Advisors, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed $75 million plus reasonable normal investment expenses, in PNC Equity Partners II, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.