



PSERS PRIVATE EQUITY PARTNERSHIPS PROGRAM

**Recommendation for Investment in
Milestone Partners III, L.P.**

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Milestone Partners III, L.P.

EXECUTIVE SUMMARY

Overview

Milestone Partners III, L.P. ("**Milestone III**" or the "**Fund**") is seeking capital commitments of \$200-\$240 million to fund a portfolio of equity and equity like investments in lower middle market companies with superior management teams, stable financial performance and product and service lines that offer attractive risk/reward profiles. The goal is to achieve annual rates of return in excess of 30% for the Fund's limited partners (the "**Limited Partners**").

Founded in 1995 with predecessor vehicle Milestone Capital Partners, L.P. ("**Milestone I**"), Milestone Partners Management Co., LP (the "**Management Company**" or "**Milestone**") is a private equity firm based in the greater Philadelphia area that has become a recognized leader in acquiring controlling interests in companies with values generally between \$15 million and \$100 million. Milestone generally invests between \$5 million and \$25 million per company and targets seasoned, well-managed companies with niche market positions, stable cash flow and identifiable organic or acquisition related growth opportunities. Many of Milestone's targeted companies are closely held businesses or divisions of larger corporations to which Milestone provides capital to support ownership transitions, management buyouts, recapitalizations or pure growth initiatives. The Fund, Milestone Partners III GP, L.P. (the "**General Partner**"), the Management Company and the Principals are often referred to collectively as "**Milestone**".

Since inception, Milestone has consistently focused on acquiring companies through leveraged buyouts in the lower end of the middle market, a segment significantly underserved. The smaller transactions that define the lower middle market are attractive because they are typically less competitive, are often negotiated directly with business owners and are consistently acquired at lower purchase price multiples than transactions completed with larger companies, resulting in less financial risk without sacrificing the opportunity for private equity type returns.

INVESTMENT STRATEGY

Milestone generates deal flow through a highly disciplined, proactive and thesis-driven approach. In addition to being opportunistic on individual leads, the Principals also analyze selected markets from a macro perspective, assessing industry characteristics and competitive dynamics to aggressively seek the best companies within those sectors to purchase. Milestone is not in the business of acquiring struggling companies and trying to fix their flaws in a limited time frame. Instead, they target growth-oriented companies that are already successful. Milestone seeks businesses it can impact by providing fresh capital, and by leveraging their experience, knowledge and network to help take these companies from good to great. Milestone uses the following criteria as the core of a rigorous review process for identifying those investments, including initial screening, due diligence (with the assistance of outside parties) and management assessment:

Quality Management Teams with Demonstrated Industry Expertise – Milestone will generally invest only in companies with proven management teams that have demonstrated records of success, including profit and loss responsibility, within their respective industries. Milestone seeks entrepreneurs who are of the highest integrity, accept advice and criticism willingly, have a professional demeanor in their interactions with investors, customers, partners and advisors and possess the ability to attract and motivate talent. The Principals will generally avoid opportunities where the fundamental

components of a strong management team are not already in place and likely to remain in place after closing.

Sustainable Margins and Growth – Milestone targets companies that have attractive historical growth records and solid operating margins which are sustainable into the foreseeable future. These types of companies often benefit from identifiable and sustainable competitive advantages such as intellectual property, exclusive customer relationships, manufacturing processes or highly regarded branded products.

Market Leader or Leadership Potential – Milestone places paramount importance on investing in companies that have significant competitive advantages within a particular market that give them a defensible competitive position and the potential to emerge, or maintain their position, as market leaders in their industry.

Attractive Transaction Structure and Pricing – Milestone will seek to make investments for the Fund at attractive valuations relative to a company's existing cash flow and core asset base. Milestone will typically invest through common and preferred equity and equity related securities but may also utilize alternative deal structures to minimize risk and enhance the probability of upside success for each investment.

Clear Exit Strategy – A deep understanding of an investment's exit alternatives is a critical element in evaluating an investment opportunity. Investments must have multiple potential exit alternatives which should not be dependent on industry cycles. Milestone typically works closely with portfolio companies to improve financial controls, reinforce infrastructure and refine growth strategies in order to develop a company ready for sale to a universe of buyers that has often been identified prior to making the investment. The universe of buyers generally includes both strategic buyers in similar or related industries and larger financial buyers. In addition to carefully analyzing and considering the potential exit strategies before making an investment, the Principals will revisit the exit strategy on a regular basis during the Fund's ownership period.

Defensible and Validated Financial Assumptions – A company's projected financial assumptions must be defensible based on historical financial performance and comparable industry metrics. Future revenue projections will be analyzed thoroughly through customer interviews and overall market analysis. Above all, the target company must demonstrate the ability to achieve its projected growth rates and maintain attractive gross margins through both a history of meeting earnings targets and systematic and sound financial analyses.

Platforms Ready to Achieve Growth Through Acquisition – Milestone generally seeks to invest in companies that can become platforms for add-on acquisitions. These add-on acquisitions can often be executed at lower entrance multiples than their related platform companies due to size, customer concentration and lack of well developed systems, among other factors. Once integrated, these add-on acquisitions can provide meaningful multiple accretion upon exit. However, Milestone has also demonstrated the ability to invest successfully in companies that can achieve substantial organic growth and are not dependent on their ability to complete add-on acquisitions to meet their return objectives.

Solid Business Culture – Success depends on more than a strong management team and a positive, hard working, profit-oriented corporate culture is crucial to the future success of a business. A business should have a history of meeting its projections, managing its profit and loss, maintaining an efficient balance sheet and continuously improving itself in all operational aspects. If such a culture does not exist, it is a

daunting task, even for a superior management team, to create this culture on the timetable necessary for achieving superior returns for investors within a three to seven year time horizon.

Impact Potential – Milestone generally seeks to make investments that have the potential to provide investors with at least three times their invested capital and represent anticipated gross proceeds on exit equal or greater in value to 15% of the committed capital of the Fund. This scale is critical since significant time, attention and resources will be invested in each portfolio company.

INVESTMENT PROCESS

Due Diligence

Milestone brings to bear a comprehensive and complementary set of experiences in completing due diligence on prospective investments. Pre-acquisition, Milestone evaluates an acquisition candidate's management, culture, market, financials, operations, systems and procedures. Milestone makes judicious use of outside advisors during the pre-acquisition process. In general, the outside advisors fall into one of two categories: third-party consultants or operating partners. Customary advice required on every investment includes accounting, background checks, market intelligence, consulting, legal, benefits and insurance, asset appraisals and environmental diligence. When using third-party consultants, Milestone is careful to minimize any potential broken deal costs by leveraging its long-term relationships and by focusing on transactions with a high likelihood of closing. Operating partners are typically individuals known to Milestone from previous investments or through other relationships. These operating partners may accompany Milestone on initial company visits and due diligence trips, as well as participate in internal meetings. Their compensation is usually structured as a reimbursement of expenses and sometimes as a modest consulting fee.

ACTIVE PORTFOLIO COMPANY MANAGEMENT

The most significant value creation occurs after the closing of an acquisition. Utilizing their collective experience, including serving on the boards of more than 45 companies throughout their careers, and acting as advisors to many other boards, the Principals take an active role in portfolio companies. The Principals build the management teams, advise on strategy and develop operating guidelines (both financial and non-financial) that contribute to success and position the company for a successful exit. Their overall approach is to be a resource, not a burden, to their management partners.

Post acquisition, Milestone does not rely on financial engineering to create returns for its investors. Rather, they acquire companies with the goal of not only building a larger, more profitable company for the next owner but also building one that is "turn-key" ready to provide the new owner with ample identifiable upside with the appropriate operational foundation. This approach involves developing and proving out the business strategy, enhancing and closing gaps in the management team, investing in systems and refining operational procedures. Achievement of these objectives requires the creation of a comprehensive, customized strategic plan, along with a list of critical action items necessary to create both short-term profits and long-term enterprise value. Examples of specific action items that Milestone would typically assist a portfolio company in handling include:

- addressing succession planning or senior management issues;
- discontinuing unprofitable product or service lines;
- developing a focused growth strategy;

- enhancing product design or development capabilities;
- streamlining manufacturing or warehousing operations;
- analyzing and improving existing sourcing procedures and vendors;
- reducing working capital requirements;
- promoting cross-fertilization among portfolio companies to capitalize on “low hanging fruit” in product sales and cost savings initiatives;
- enhancing data gathering systems and reporting;
- developing standardized monthly reporting and quarterly board packages; and
- changing or enhancing management information systems.

Milestone also encourages the senior management of its portfolio companies to leverage their complementary expertise in overlapping areas of interest. To that end, Milestone holds an annual “**Executive Conference**” for the key senior managers of its portfolio companies to foster a support network. One of the results of these efforts is that Milestone developed a shared services program among its portfolio companies with a goal of realizing cost savings on the procurement of common goods and services.

As a portfolio company’s operations mature, their Principals develop a sound understanding of the strengths and weaknesses of an entrepreneurial management team and its capacity for growth. Their Principals will also actively identify acquisition and merger candidates through their extensive network of industry contacts. Once an attractive add-on candidate is identified, Milestone typically leads the negotiations relating to the purchase of any acquisition. In addition, Milestone assumes the responsibility for structuring and assembling required financing and enhancing management’s financial credibility with lenders and underwriters.

EXIT STRATEGY

Milestone begins with the end in mind, exerting significant influence over each portfolio company with respect to growth and exit strategies. Generally, the Fund anticipates a typical holding period of three to seven years during which Milestone controls the acquired company’s board and utilizes its own expertise as well as the specialized knowledge of the appropriate individuals from its group of operating partners. Milestone establishes a formal reporting procedure for each portfolio company, meeting and speaking regularly with the portfolio company’s management between board meetings. Their Principals develop options for and eventually implement the timing and strategy for exiting each investment, typically through a sale. They may, at times, realize increases in portfolio company equity value through partial recapitalizations in which they maintain their equity position in the portfolio company. Although they typically engage investment banks to run competitive sales processes to facilitate their exit from investments, Milestone takes an active role in negotiating and closing the sale of each of its portfolio companies.

OPERATING PARTNERS

Milestone’s relationships with and access to a large and diverse network of operating partners provide strong support to Milestone’s ability to successfully source, diligence, negotiate and close transactions as well as their ability to add value to their portfolio companies through add-on acquisitions or organic growth. No individual operating partner will have relevant experience for every opportunity evaluated. Therefore, their Principals leverage their network to find the most appropriate operating partner for each situation based on experience and personality. Before closing, operating partners are usually compensated on a per diem basis. If a transaction is completed, the operating partner may receive the opportunity to co-invest in the

transaction and, if appropriate, may also assume a position on the board of the portfolio company. In summary, operating partners supplement and complement the experiences of the Principals and further their ability to add value to the portfolio companies and generate returns for their investors in line with their investment objectives.

MANAGEMENT

Milestone's four Principals are Brooke B. Hayes, Robert G. Levine, John P. Shoemaker and W. Scott Warren, each of whom has significant and extensive experience in the lower middle market. The four Principals have worked together since 2002 and have interacted with each other in various capacities for over twenty years. The Principals, along with Milestone's other investment professionals and support personnel, have demonstrated the ability to work together as an effective and cohesive team. Biographies and transaction experience for the Principals are set forth below.

Brooke B. Hayes, Partner - Mr. Hayes joined Milestone in 2002, having spent most of his career in middle market corporate finance and private equity. From 1999 to 2002, he was an Associate in the Investment Banking Group of J.P. Morgan H&Q in San Francisco and New York, where he focused on executing mergers and acquisitions, equity and debt transactions. From 1995 to 1997, Mr. Hayes worked for the Stratum Group in New York, where he analyzed and invested in numerous middle market transactions utilizing senior and mezzanine capital. Prior to his tenure at Stratum, Mr. Hayes worked in the corporate finance group at First Fidelity Bank (First Union). Mr. Hayes earned his BS in Economics and an MBA from The Wharton School of the University of Pennsylvania. He is married with four children.

Robert G. Levine, Partner - Mr. Levine started Milestone in 1995 after previously focusing his career on executing middle market merger and acquisition transactions and practicing business law. From 1985 to 1995, first in the Investment Banking Group of Lehman Brothers and subsequently as a Principal at Legg Mason Wood Walker, Mr. Levine completed dozens of middle market transactions, primarily for niche manufacturing and distribution companies. Prior to transitioning to investment banking, Mr. Levine practiced business law for three years in Denver, Colorado with the firm of Atler, Zall and Haligman. Mr. Levine earned a BA from Northwestern University, a JD from George Washington University and an MBA from the Wharton School of the University of Pennsylvania. He is married with two children.

JOHN P. SHOEMAKER, PARTNER - Mr. Shoemaker joined Milestone in 2002 having spent most of his career in the lower middle market private equity field. He was previously a Managing Director of Internet Capital Group, where he developed and executed a strategy for building a portfolio of investments in the financial services area. From 1996 to 2000, Mr. Shoemaker was a Managing Director and the head of the Philadelphia office of Mellon Ventures, where he focused on sourcing and executing lower middle market leveraged buyouts. From 1994 to 1996, Mr. Shoemaker was Vice President of Corporate Development for RAF Industries, focusing on acquiring lower middle market manufacturing companies. He was also both a corporate lawyer for Reed Smith Shaw & McClay in Philadelphia and an investment banker for Morgan Stanley in New York. Mr. Shoemaker holds a BA from the University of Pennsylvania and a JD from Boston College Law School. He is married with two children.

W. SCOTT WARREN, PARTNER - Mr. Warren started Milestone in 1995 after devoting most of his prior career to middle market leveraged buyouts and corporate finance. From 1989 to 1995, he was a Managing Director at both Philadelphia First Group and at Beacon Capital, private merchant banking firms with a primary emphasis on arranging middle market leveraged buyouts, recapitalizations and growth financings. From 1986 to 1989, Mr. Warren was a Vice President in the Investment Banking Group of Lehman Brothers where he represented buyers

and sellers of middle market companies. From 1979 to 1986, Mr. Warren was with the investment arm of the Philadelphia National Bank, first in international private equity investing and then as head of the Private Placement Department. Mr. Warren graduated from the University of Virginia's McIntire School of Commerce with a BS in Finance. He is married with two children.

Adam H. Curtin, Vice President - Mr. Curtin joined Milestone in 2003 from Merrill Lynch where he contributed to the completion of a variety of mergers and acquisitions, equity and debt transactions as an Analyst in both the Consumer Products and High Yield groups within the Investment Banking Group in New York. Mr. Curtin graduated from The Pennsylvania State University with a BS in Finance and a Minor in Economics.

Geoffrey B. Veale, Vice President - Mr. Veale joined Milestone in 2005 from Jefferies Capital Partners, a middle market private equity firm in New York, where he was an Associate focused on sourcing and executing leveraged buyout transactions in the industrial and consumer industries. Prior to joining Jefferies Capital Partners, Mr. Veale was an Associate in the Mergers and Acquisitions Group of J.P. Morgan. Mr. Veale graduated from Washington & Lee University with a BS in Business Administration. He is married.

John J. Nowaczyk, Director of Business Development - Mr. Nowaczyk joined Milestone in 2007, bringing with him 15 years of investment banking and consulting experience focused on mergers and acquisitions and private finance, primarily with lower middle market and emerging growth companies. He was previously a Vice President in the Strategic Advisory Group of Legg Mason Wood Walker. Prior to that, he served as an Associate in the investment banking department with Paine Webber, Incorporated. He began his career as a Financial Analyst in the investment banking department of Kidder, Peabody & Co. Incorporated. Mr. Nowaczyk received a BA from Harvard College. He is married with two children.

David J. Andrzejewski, Analyst - Mr. Andrzejewski joined Milestone in 2006 after graduating from the University of Pennsylvania with a BA in International Relations. Mr. Andrzejewski previously worked as an intern for Northrop Grumman in the Program Finance and Marketing & Business Development departments over two summers.

Mark B. Martinelli, Chief Financial Officer - Mr. Martinelli joined Milestone in 2004 having spent his prior career in public accounting, private equity and investment consulting. Previously, he was with Berwind Capital Partners where he served as Vice President of Finance and Administration and was responsible for fund accounting. Before joining Berwind, Mr. Martinelli served as Chief Financial Officer for Brinker Capital Holdings, Inc. and was responsible for accounting, tax, insurance, cash management, banking, financial reporting and human resources. Prior to entering the private company arena, Mr. Martinelli was in Public Accounting with PricewaterhouseCoopers. Mr. Martinelli is a non-active CPA and earned his BS in Accounting from the University of Delaware. He is married with three children.

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 90.9 percent of the committed capital, but not to exceed \$60 million plus reasonable normal investment expenses, in a side fund to Milestone Partners III, 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.