

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Searchlight Capital II, L.P.

Private Debt Commitment

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Senior Investment Professional

September 22, 2015



Recommendation:

Staff, together with Portfolio Advisors, recommends to the Board a commitment of up to \$100 million to Searchlight Capital II, L.P. ("Fund II" or the "Fund"). Searchlight Capital Partners, L.P. ("Searchlight" or the "Firm") is sponsoring the Fund to make value oriented investments in private equity and distressed situations across North America and Europe.

Firm Overview:

Searchlight was founded in 2010 by Oliver Haarmann, Erol Uzumeri and Eric Zinterhofer (collectively, the "Founding Partners"). At that time, Searchlight established three offices, one in each of New York, London and Toronto. Searchlight completed the final closing of its first fund, Searchlight Capital, L.P. ("Fund I") in March 2012, with \$864 million of committed capital. The Firm has 31 employees; including 18 investment professionals and seven finance, legal and investor relations professionals.

The Founding Partners of Searchlight have invested over \$6.6 billion during their careers and have over 60 years of collective experience. Prior to co-founding Searchlight, Oliver Haarmann was a senior partner of KKR in London, Erol Uzumeri was the head of Private Equity for the Ontario Teachers' Pension Plan in Toronto and Eric Zinterhofer was a senior partner at Apollo in New York.

Investment Strategy:

Searchlight employs a value-oriented investment philosophy which seeks to deliver strong performance across economic cycles. The Fund will pursue private equity and distressed investments in leading North American and European businesses. Searchlight is focused on making investments at attractive values relative to intrinsic value, resulting in an asymmetric risk/reward profile. The ability to invest across a company's capital structure is critical to Searchlight's ability to make investments at attractive valuations. During times of dislocation, when M&A activity is limited for traditional private equity firms, Searchlight pursues distressed opportunities. During periods of recovery, when distressed opportunities are less attractive, Searchlight can pursue private equity investments. As such, Searchlight can remain selective and disciplined during periods of frothiness.

In terms of sector focus, Searchlight is recognized for its deep expertise and relationships in several industries, including the media, communication, consumer business services and education fields. Searchlight will also look to other industries to find attractive risk-adjusted returns for investors. Some of the strategies Searchlight focuses on to drive value creation include enhancing management, re-setting the company's strategy, pursuing mergers and acquisitions, and driving efficiencies.

Searchlight expects to allocate Fund II as follows:

Strategy	Allocation
Private Equity	2/3
Distressed Situations	1/3

Investment Instruments:

Searchlight will continue to pursue its fundamental, value-oriented investment philosophy through the purchase of debt and equity securities within a company's capital structure. Fund II will pursue complex transactions including: distressed debt purchases; post-reorganization equity purchases; bankruptcy reorganizations followed by debt-for-equity swaps; minority private equity investments; leveraged buyouts; corporate partnerships; public equity purchases; and subordinated debt instruments with equity optionality.



Investment Structure:

Searchlight has historically invested across a variety of transaction structures and investment securities, including: common equity; senior debt; subordinated debt; and preferred equity. Searchlight is focused on making investments at attractive values relative to intrinsic value, resulting in an asymmetric risk/reward profile. Searchlight’s ability to make investments at attractive entry valuations is evidenced by Fund I’s 6.0x average entry multiple, reflecting a ~35% discount relative to market. In Fund I, four of Searchlight’s ten investments had built-in structural downside protection at entry and Fund II will pursue similar investment structures. Searchlight’s focus on downside protection often results in more conservative leverage levels, evidenced by Fund I’s 3.6x EBITDA average. Searchlight also pursues investments that result in significant influence or control, allowing it to enhance returns through its strategic, operational and industry expertise.

Investment Team:

The Firm’s investment activities are led by the Founding Partners who have over 60 years of combined investment experience and have invested over \$6.6 billion over their careers. In total, Searchlight has an experienced team of 18 dedicated investment professionals with offices in New York, London and Toronto. The Founding Partners comprise the formal Investment Committee (“IC”) but all investment professionals are expected to participate and contribute. The table below highlights the experience of Searchlight’s Founding Partners and additional investment partners:

Name	Prior Experience	Yrs. Exp.	Education
Eric Zinterhoffer – <i>Founding Partner</i>	Apollo, Morgan Stanley, JP Morgan	20	Harvard (MBA), U. Penn (BA)
Oliver Haarmann - <i>Founding Partner</i>	KKR, Dillon Read, Bankers Trust	21	Harvard (MBA), Brown (BA)
Erol Uzumeri - <i>Founding Partner</i>	Ontario Teachers', CVC International	22	London Bus. School (MSc), U. Toronto (BAsc)
François Dekker - <i>Partner</i>	Bain Capital, Morgan Stanley	15	U. St. Gallen (MA), Switzerland
Andrew Frey - <i>Partner</i>	Quadrangle, TPG, Blackstone, Lehman	17	U. Penn (BS & BAS)
Darren Glatt - <i>Partner</i>	Apollo, Apax, Cypress, Bear Stearns	15	Harvard (MBA), GWU (BBA)
Eric Sondag - <i>Partner</i>	GTCR, Golder Rauner, Wasserstein	16	Georgetown U. (BSc), INSEAD (Exec. Program)

Searchlight also has access to four highly experienced Senior Advisors with deep industry expertise and networks¹. These individuals can assist the Firm with sourcing, due diligence, consulting projects and advising management teams: The Senior Advisors include Gonzalo Diaz-Rato (former Partner at Gala Fund Management and a Founder of Suala Capital Partners, both Spain-focused private equity funds), Gordon McCallum (former Virgin Group Senior Executive and current board member of Virgin Atlantic Airways and Virgin Money), Doug Hutcheson (formerly the CEO and a board member of Leap Wireless International) and Mitchell Ring (former Senior Vice President of Business Development at H.J. Heinz Company).

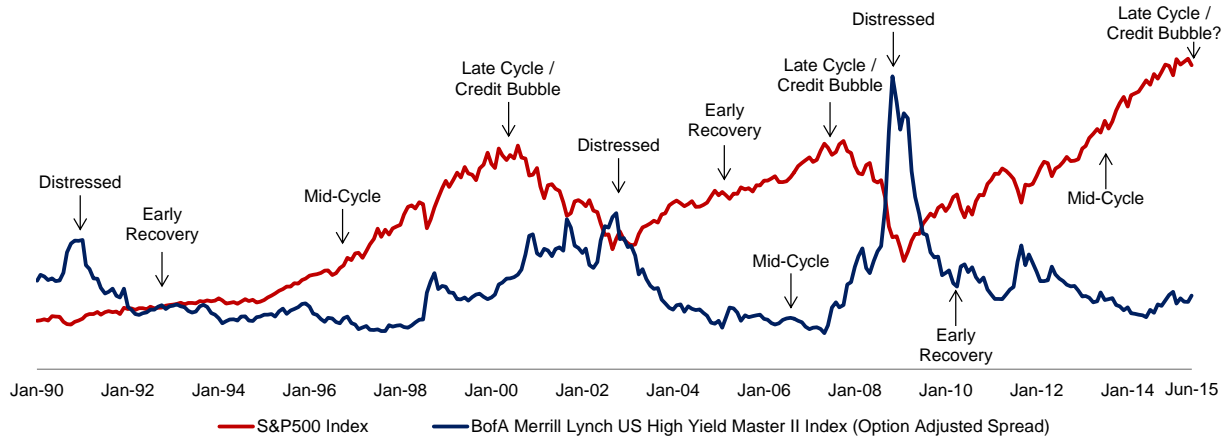
(1) Note: Senior Advisors are not employees of Searchlight. They are third party consultants with industry experience.

Market Opportunity:

The U.S. economy is in its sixth year of an economic recovery which began in 2009 and European fundamentals have continued to weaken. Equity and credit markets fluctuate along short-to-medium term cycles, presenting opportunities to shift between private equity and distressed debt investments. Low credit spreads and inflated equity markets are not likely to persist over the long-term and Searchlight’s distressed expertise and value orientation can enable them to capitalize during such times. The chart on the following page indicates that the U.S. is in the late stages of a market cycle and inflated equity markets are unlikely to persist over the long-term; creating the likelihood that some period of market dislocation will exist during the Fund’s six-year investment period.



CREDIT & EQUITY CYCLES – LAST 25 YEARS



Investment Highlights:

<p>Flexible Investment Strategy</p> <p>Searchlight’s dual-prong investment strategy, pursuing both private equity and distressed investments, should position the Fund to deliver strong performance across economic cycles. Searchlight also has flexibility in terms of its geographic focus with the ability to invest across North America and Europe. This capability is unique among middle-market firms who do not typically pursue a transatlantic strategy. Finally, Searchlight’s ability to invest across the capital structure will help the Fund create investments offering the best risk/reward profile.</p>
<p>Deep Value Approach</p> <p>Searchlight is focused on making investments at attractive values relative to intrinsic value, resulting in an asymmetric risk/reward profile. During a rising valuation environment, Searchlight has constructed its Fund I portfolio at a 6.0x average entry multiple compared to the 9.3x market average.</p>
<p>Experienced Senior Management Team</p> <p>The Firm’s three founders have over 60 years of combined investment experience and have invested over \$6.6 billion over their careers. The three co-founders came from top-tier investment organizations and Searchlight is able to draw on that prior experience and benefit from each founder’s complementary skill set. Searchlight’s senior professionals maintain deep sector knowledge and long-standing relationships with key industry executives and intermediaries.</p>
<p>Proprietary Sourcing</p> <p>Given Searchlight’s value-oriented investment strategy, the Firm does not typically pursue competitive processes. Of the ten deals completed in Fund I, Searchlight sourced eight in a proprietary manner. Five transactions resulted from Searchlight’s ability to conduct a proprietary process, while three transactions were developed as a result of Searchlight’s proprietary market screens.</p>
<p>Outlook for Fund I Portfolio</p> <p>As of June 30, 2015, Fund I (a 2012-vintage fund) generated a 31.2% gross IRR (14.7% net) and a 1.5x gross MOIC (1.3x net). While still young and largely unrealized, Fund I is progressing well and Searchlight ultimately expects the fund to generate net returns in excess of 20%/2.0x.</p>



Investment Considerations:

Fund I - Unrealized Value
As of June 30, 2015, the Fund I portfolio generated minimal realizations (~\$11.1 million). Through August 2015, Fund I generated ~\$59.7 million in realizations as a result of two dividend recapitalizations. While we would like to see a greater level of realization activity, the Fund I portfolio is still very young, having invested/committed greater than 75% of invested capital post-January 2014. Searchlight is highly selective in its investment approach as evidenced in their ability to deploy Fund I at attractive entry valuations relative to market with below-market leverage. Searchlight ultimately expects Fund I to generate net returns in excess of 20%/2.0x.
Increase in Fund Size
Searchlight is targeting \$1.5 billion in commitments for Fund II (\$1.8 billion hard-cap) relative to Fund I which was capitalized on \$864 million. Searchlight expects to consummate investments squarely within its "sweet spot" of \$50 to \$200 million and that the increase in fund size will result in Fund II making two to three additional investments as compared to Fund I (12 vs. 10). It is also important to note that Fund I generated approximately \$400 million of LP co-investment. Therefore, Searchlight is effectively managing ~\$1.25 billion across the Fund I complex. Lastly, with seven investment partners and 11 additional investment professionals, Searchlight should have ample bandwidth to maintain its Fund I investment pace of two to three new deals per year.
Competition
While competition does exist in the U.S. mid-market, Searchlight's platform is differentiated due to their transatlantic strategy and ability to pursue both private equity and distressed investments. Other firms pursuing a similar investment strategy are generally much larger than Searchlight, and as a result, they typically invest in a different opportunity set.

Track Record:

Searchlight launched Fund I in late-2010 and held a final close on \$864 million in March 2012. Fund I is fully called and committed as of September 2015. As of June 30, 2015, Fund I generated a 31.2% gross IRR (14.7% net) and a 1.5x gross MOIC (1.3x net). The table below summarizes Searchlight's track record:

Fund (\$mm)	Vintage	Fund Size	Invested & Committed Capital ¹	Realized Value ¹	Unrealized Value	Total Value	Gross IRR ²	Gross MOIC ²
Searchlight Capital - Fund I	2012	\$864.0	\$699.5	\$59.7	\$947.9	\$1,007.6	31.2%	1.5x
Net:							14.7%	1.3x

(1) Includes additional investment activity to August 31, 2015.

(2) Investments made after June 30, 2015 are not included in fund performance.

According to Cambridge Associates (based on Q1'15 Global Private Equity Benchmark), Fund I is a top-quartile performer for its vintage year.



Portfolio Fit:

Searchlight's investment strategy will serve to complement PSERS' existing portfolio and a commitment to Fund II will enable PSERS to establish a relationship with a high-conviction manager. Other firms pursuing a similar investment strategy are generally much larger than Searchlight, and as a result, they typically invest in different opportunities.

A commitment to Fund II will be allocated to the Private Debt bucket of PSERS' Private Markets portfolio. As of March 31, 2015, the Private Markets portfolio (based on total exposure) was allocated 73% Private Equity, 16% Private Debt and 11% Venture Capital.

The table below summarizes PSERS' projected Private Markets exposure inclusive of a recommended \$100 million commitment to Fund II:

Investment Type	Active Commitments ¹	%	Market Value	%	Unfunded ¹	%	Total Exposure ¹	%
Private Equity	\$ 14,741.0	67.7%	\$ 5,928.0	73.76%	\$ 3,766.7	69.78%	\$ 9,694.7	72.2%
Private Debt	4,449.3	20.4%	1,170.3	14.56%	1,046.4	19.39%	2,216.7	16.5%
Venture Capital	2,570.0	11.8%	938.6	11.68%	584.7	10.83%	1,523.3	11.3%
Total	\$ 21,760.3	100.0%	\$ 8,036.8	100.0%	\$ 5,397.9	100.0%	\$ 13,434.7	100.0%

(1) Include post Q1'2015 pending/closed commitments.

Liquidity & Leverage Profile:

The Fund is expected to be invested within six years of its final closing (the "Investment Period"). After the Investment Period, the Fund will have a four-year harvesting period in which to realize investments. Searchlight will not employ fund-level leverage.

Finance Committee Disclosure:

Relationship with Portfolio Advisors:	Searchlight Capital II: PAPEF VIII: \$15mm
Placement Agent:	Park Hill Group (100% of any fees will offset the management fee)
PA Political Contributions:	None Disclosed
PA Presence:	No
Conflicts:	None Disclosed
First Time Fund With PSERS:	Yes
PSERS Internal Alpha Committee Approval:	September 22, 2015

Oversight Responsibility:

Investment Office:	Charles J. Spiller Managing Director James F. Del Gaudio Senior Investment Professional
External Consultant:	Portfolio Advisors LLC



September 14, 2015

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Searchlight Capital II, L.P.

Dear Trustees:

Searchlight Capital Partners, LP ("Searchlight" or the "Firm") was founded in 2010 by Eric Zinterhofer, Oliver Haarmann and Erol Uzumeri (the "Founding Partners") after extensive careers at Apollo Global Management ("Apollo"), KKR & Co. LP ("KKR") and Ontario Teachers' Pension Plan ("OTPP"), respectively. The Firm recently initiated fundraising efforts for Searchlight Capital II, L.P. ("Fund II" or the "Fund") with a target of \$1.5 billion of limited partner commitments and a hard cap of \$1.8 billion. On July 15, 2015, the Firm held a first closing on approximately \$900 million of capital commitments. A final close is anticipated in late fall at the \$1.8 billion hard cap. The General Partner will make a \$35 million commitment to the Fund.

Fund II will continue the Firm's strategy of making private equity and distressed investments in leading North American and European businesses at attractive valuations. Searchlight seeks opportunities to invest at entry valuations that are attractive relative to intrinsic values with asymmetric risk/return characteristics. Given its value orientation, Searchlight pursues a flexible investment mandate focused on identifying the best investment opportunities regardless of transaction type, security, geography or industry. Unlike most other middle market private equity firms, Searchlight will invest in both private equity and distressed opportunities. During periods of market dislocation, when investment activity is typically limited for traditional private equity firms, the Firm will pursue distressed investment opportunities. On the other hand, during periods of market stability or recovery, when distressed opportunities are less attractive, the Firm will pursue private equity investments. This flexibility allows the Firm to be proactive and selective across market cycles.

The ability to invest across the capital structure is critical to the Firm's value investment philosophy. Searchlight's investment team is experienced in navigating a company's capital structure and is able to identify or create the security the will offer the best risk/reward profile. In order to enhance its risk/return potential, the Firm will often invest in structured securities that offer strong downside protection, while maintaining the upside characteristics of an equity investment. These types of investments typically take the form of preferred stock or debt. Searchlight focuses its investment activities on North America and Europe. This transatlantic approach enhances the Firm's ability to be flexible as investment cycles can occur at different times and with varying degrees of severity across markets. Searchlight will pursue investment



opportunities across a variety of industries, but has extensive experience and relationships in the Communications, Media, Education and Consumer sectors.

Portfolio Advisors' recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines.

- Detailed due diligence, including interviews with industry peers and private equity professionals. The on-site due diligence visit was performed on April 17, 2015.
- Evaluation of the composition of the investment team, how they work together, compensation structure and other factors that help determine whether a group is likely to be able to replicate past successes as currently configured.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- The strategy proposed for the Fund is appropriate for the Private Debt Partnership component of the portfolio.

The individuals at Portfolio Advisors who were primarily involved in the due diligence process for the Fund are:

John Kyles – Managing Director, Darien Office
Geoffrey Kelleman – Senior Associate, Darien Office

Based on the above, Portfolio Advisors recommends that PSERS commit up to \$100 million in Searchlight Capital II, L.P. Portfolio Advisors makes this recommendation considering the General Partner's qualifications and PSERS' overall investment guidelines.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. Portfolio Advisors does not provide legal or other non-investment-related advice.

Sincerely,

WILLIAM J. INDELICATO
MANAGING DIRECTOR