



COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

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Public Investment Memorandum

**Clearlake Opportunities Partners (P) II, L.P.**

High Yield/Private Credit Commitment

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**James F. Del Gaudio**  
Portfolio Manager

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Senior Investment Professional

**February 15, 2019**



### **Recommendation:**

PSERS Investment Professionals, together with Hamilton Lane Advisors, L.L.C. (“Hamilton Lane”), recommends the Board commit up to \$100 million to Clearlake Opportunities Partners (P) II, L.P. (the “Fund”, or “COP II”). Clearlake Capital Group, L.P. (“Clearlake” or the “Firm”) is seeking to raise COP II to continue the Firm’s flexible investment strategy; focused on North American, non-control special situations investments in small- and medium-sized companies.

### **Firm Overview:**

Clearlake was established in 2006 and is currently managed by José E. Feliciano and Behdad Eghbali (the “Co-Founders”). Based in Santa Monica, California, Clearlake’s team consists of approximately 60 professionals, including 24 investment professionals, all of which are located in Clearlake’s sole office. Clearlake has been a Registered Investment Adviser with the Securities and Exchange Commission since March 2012. Clearlake has managed over \$8 billion of institutional capital since inception and its senior investment principals have led or co-led over 100 investments.

Strategy	AUM <sup>1</sup>	Focus
Clearlake Capital Partners (“CCP”)	\$7.3 billion	<ul style="list-style-type: none"><li>• Control Oriented</li><li>• Special Situations Equity</li><li>• Secondary Markets – for Control</li></ul>
Clearlake Opportunities Partners (“COP”)	\$573.1 million	<ul style="list-style-type: none"><li>• Non-Control Oriented</li><li>• Structured Credit and Equity</li><li>• Secondary Markets – for Yield</li></ul>
Co-Investment Vehicles	\$852.6 million <sup>2</sup>	<ul style="list-style-type: none"><li>• Value Private Equity</li><li>• Structured Equity</li></ul>

(1) AUM as of September 30, 2018. AUM was calculated using the total limited partner capital commitments plus any appreciation/depreciation in the individual funds. AUM may fluctuate over time as appreciated investments are exited and realized proceeds are distributed to limited partners.

(2) Excludes Ulysses Co-Investment Vehicle, which has an AUM of approximately \$302.2 million as of December 31, 2018.

Since inception, Clearlake has raised six distinct funds managed by the Co-Founders together with other Clearlake investment professionals. PSERS previously committed \$57.5 million to Clearlake Capital Partners IV, L.P. (“Fund IV”), a 2015 vintage, \$1.38 billion fund and \$100 million to Clearlake Capital Partners V, L.P. (“Fund V”), a 2018 vintage fund, and \$3.62 billion fund. Clearlake is currently seeking \$800 million for COP II to continue its focus on non-control, special situations investing strategy with targeted exposure to structured equity and special situations credit (including reorganization equity and opportunistic credit) within its target industry sectors (industrials and energy; software and technology-enabled services; and consumer). This would be PSERS’ first investment in Clearlake’s COP strategy.

### **Market Opportunity:**

Clearlake believes that there is an opportunity to pursue non-control special situations investments in small- and medium-sized companies, as these companies have historically faced unique challenges across different phases of the economic and credit cycles. Fundamentally sound, otherwise stable companies might otherwise face default due to lack of liquidity, inability to refinance maturing debt, or underperformance in underlying operations due to a slowing economy. While many investment opportunities are often generated during periods of significant economic uncertainty or a widespread economic downturn, Clearlake has demonstrated its ability to source and execute attractive investment opportunities during times of economic recovery and expansion as well.



### **Portfolio Fit:**

A commitment to the Fund allows PSERS to further expand its relationship with a high-conviction manager. The Fund's return target is in-line with PSERS' objective for the High Yield/Private Credit portfolio of generating double-digit net returns over the life of the investment, targeting ~15% net returns. COP II will be allocated to the Opportunistic bucket of PSERS' High Yield/Private Credit portfolio and the table below summarizes PSERS' projected exposure inclusive of a recommended \$100 million commitment:

Investment Type (\$M)	Market Value	%	Unfunded <sup>1</sup>	%	Total Exposure <sup>1</sup>	%
<b>Opportunistic</b>	\$ 2,327.6	46.2%	\$ 827.4	26.6%	\$ 3,155.0	38.7%
<b>Senior Loans</b>	1,554.7	30.8%	830.8	26.7%	2,385.5	29.3%
<b>Real Assets</b>	650.0	12.9%	1,035.9	33.3%	1,685.9	20.7%
<b>Mezzanine</b>	507.6	10.1%	412.5	13.3%	920.1	11.3%
<b>Total</b>	<b>\$ 5,039.9</b>	<b>100.0%</b>	<b>\$ 3,106.6</b>	<b>100.0%</b>	<b>\$ 8,146.5</b>	<b>100.0%</b>

(1) As of September 30, 2018. Includes post Q3'2018 pending/closed commitments.

### **Investment Strategy:**

The Fund will seek to continue Clearlake's strategy of special situations investing by focusing on non-control investments, where the Clearlake team believes it has the opportunity to achieve superior risk-adjusted returns. The Firm maintains a flexible investment philosophy and will invest across the capital structure in debt or equity securities. The Fund will focus on structured equity investments and special situations credit in small- and medium-sized companies undergoing transformation or seeking a capital solution. Potential investments involve complex structures that may include convertible, participating or redeemable preferred equity and debt with warrants, earnouts, or other equity-linked features. Clearlake will continue to invest in the following sectors: technology, industrials, and consumer. Clearlake seeks to generate 20%+ gross returns for targeted investments over typical hold periods of three to five years.

Clearlake anticipates that the COP II portfolio will be comprised of 20 - 25 investments and several toehold investments. COP II will target investments of \$25 million to \$75 million and prospective investments with enterprise values between \$100 million and \$2 billion with a focus on North America (at least 75%). The specific breakdown of COP II's expected transaction types will depend on the market environment. Clearlake's flexibility should enable the Firm to structure transactions to achieve strong investment returns while emphasizing downside protection.

Clearlake takes a value-added approach towards its control and non-control investments as it seeks to identify situations that enable control or significant influence. In addition to value creation tools employed by traditional private equity investors, Clearlake believes it has the ability to drive value in special situations by providing resources and operational expertise that smaller private equity firms or distressed debt investors typically do not possess. Clearlake's operational improvement approach has evolved into a proprietary framework called *O.P.S.*®. Through *O.P.S.*®, Clearlake seeks to execute upon its investment thesis to implement change post-investment in conjunction with its Executive Council. As such, the Firm seeks to leverage its sector specific expertise, its strong combination of special situations, private equity and distressed investing experience, and its proprietary *O.P.S.*® framework to drive value at its portfolio companies.

### **Investment Structure:**

The Firm maintains a flexible investment philosophy in special situations, investing across the capital structure in debt or equity securities. This flexibility enables Clearlake to structure transactions to achieve strong investment returns while providing downside protection in a variety of market environments while creating significant equity upside potential. Clearlake expects COP II to minimize the J-curve through significant income generation from debt securities.



Clearlake takes a conservative approach to portfolio company leverage given the Firm's focus on operationally and financially challenged companies. Clearlake typically utilizes limited leverage at the fund level to deploy Clearlake Fund's commitment more efficiently. Fund level leverage is allowed by its LPA, but COP has not utilized permanent fund level leverage in the past.

**Investment Instruments:**

The following table summarizes the investment instruments used across the COP strategy:

COP Strategy	Instrument Description
<b>Structured Equity</b>	Structured equity is an investment approach that largely uses a preferred equity instrument (i.e., convertible, participating or redeemable structures) with assorted corporate governance and economic rights, including board representation, cash and/or PIK dividends, distribution and liquidation preferences, and negative covenants. An investment may include a contractual return or current yield component and/or a significant equity ownership stake.
<b>Opportunistic Credit</b>	For opportunistic credit, the Fund may, for example, (i) structure its investment in a company as senior secured debt, but employ the use of warrants and other instruments to create equity-like upside participation, or (ii) invest in debt of a fundamentally sound, company with a stressed capital structure that may have one or more tranches of debt trading at a discount to par. These investments will generally take the form of credit instruments with cash or PIK yield characteristics and may also have the opportunity for equity-like or other upside participation.
<b>Reorganization Equity</b>	For reorganization equity, Clearlake expects that a subset of the Fund's credit investments may go through further transition or need to reorganize, and Clearlake believes it has the sponsorship capability to shepherd these investments through reorganization by exerting significant influence during the restructuring process and be a value-added sponsor post restructuring. In these situations, the Fund may be involved in the restructuring process and may own reorganized equity securities upon completion of a restructuring.

**Investment Team:**

Clearlake is led by its two managing partners, José E. Feliciano and Behdad Eghbali, who co-founded the Firm in 2006. Clearlake's team consists of approximately 60 professionals, including 24 investment professionals. Clearlake's investment professionals include two Managing Partners, two Partners, two Managing Directors, five Principals, two Vice Presidents, nine Associates and two analysts. The Firm's senior investment professionals (VP and above) average over 16 years of experience driving deep expertise and networks within the Firm's target sectors and within the distressed and restructuring communities. The table below summarizes the experience of Clearlake's two managing partners:

Name	Title	Yrs. Experience Clearlake / Total	Prior Experience
José E. Feliciano	Managing Partner and Co-Founder	12 / 23	<ul style="list-style-type: none"> <li>● Tennenbaum Capital Partners</li> <li>● govWorks, Inc.</li> <li>● Goldman, Sachs &amp; Co.</li> </ul>
Behdad Eghbali	Managing Partner and Co-Founder	12 / 21	<ul style="list-style-type: none"> <li>● TPG Capital</li> <li>● Venus Capital Management</li> <li>● Turbolinux</li> <li>● Jefferies</li> <li>● Morgan Stanley</li> </ul>

Clearlake's Investment Committee ("IC") is comprised of the two Co-Founders, and the investment decisions formally require unanimous approval. Clearlake encourages a collaborative approach requiring all investment professionals to attend and participate in IC meetings.



As discussed above, *O.P.S.*<sup>®</sup> (Operations, People, Strategy) is the Firm's proprietary framework for active value enhancement in both traditional private equity and special situations investments. As part of the *O.P.S.*<sup>®</sup> team, Tony La Rosa, current Managing Director of Clearlake and previous Chief Information Officer of Ivanti, a cross-fund investment, helps implement various value add-initiatives at portfolio companies and oversees Clearlake's IT infrastructure operation.

Further supporting Clearlake's investment team is a network of operating advisors with substantial experience in the Firm's core target sectors (the "Executive Council") to provide industry expertise and additional insights into operating dynamics of businesses. Executive Council members are not employees of the Firm. As such, compensation and structure for Executive Council members may vary from full-time employment by a portfolio company to specific transactional work related to an individual investment opportunity or to less formal non-exclusive independent contractor consulting arrangements.

**Investment Highlights:**

- Flexible Investment Strategy
- Experienced and Cohesive Investment Team
- Strong Investment Performance Across Prior Funds
- Co-Investment Opportunities

**Investment / Risk Considerations:**

- Investment Overlap Across Firm Products
- Increased Fund Size / Growth of Team to Manage Increasing AUM
- Firm Ownership Transaction
- Liquidity & Leverage Profile

**PSERS History & Performance:**

PSERS previously committed \$57.5 million to Fund IV and \$100.0 million to Fund V as part of Clearlake's flagship, control-oriented strategy. The table below summarizes PSERS' performance with Clearlake as of September 30, 2018:

<u>Fund (\$M)</u>	<u>Portfolio</u>	<u>Vintage</u>	<u>Commitment</u>	<u>Contributions</u>	<u>Distributions</u>	<u>NAV</u>	<u>Net IRR</u>	<u>Net MoC</u>
Fund IV	SS	2015	\$ 57.5	\$ 68.0	\$ 38.0	\$ 54.6	33.4%	1.47x
Fund V	SS	2018	\$ 100.0	\$ 48.0	\$ 1.5	\$ 29.2	50.6%	1.33x
<b>Total</b>			<b>\$ 157.5</b>	<b>\$116.0</b>	<b>\$ 39.1</b>	<b>\$ 83.8</b>	<b>36.8%</b>	<b>1.43x</b>



**Investment Committee Disclosure:**

<b>Relationship with Hamilton Lane:</b>	Nineteen discretionary Hamilton Lane clients and commingled products have committed an aggregate \$263.5 million across prior Clearlake funds. Additionally, six discretionary Hamilton Lane clients and commingled products have made co-investments alongside Clearlake totaling approximately \$112.3 million.
<b>Introduction Source:</b>	Fund Sponsor
<b>Placement Agent:</b>	<p>Yes. In connection with the marketing of COP II, Clearlake has engaged Credit Suisse Securities (USA) LLC ("Credit Suisse") to assist in the marketing of COP II primarily to investors that have not previously invested in a Clearlake sponsored fund. Credit Suisse will be primarily compensated for new investors' commitments however the rate of their fee will be determined based on several factors including the aggregate amount of capital commitments from new and existing investors (such as PSERS) to determine whether certain minimums and other requirements were met. In addition, Credit Suisse's fee will exclude commitments by certain entities including entities that prohibit or limit the use and/or compensation of placement agents.</p> <p>Furthermore, only Limited Partners whose commitments to COP II are made in connection with the services provided by Credit Suisse will bear the cost of the fee received by Credit Suisse and the costs associated with the engagement of Credit Suisse will be borne by the Fund subject to a 100% offset against the amounts of management fees payable.</p>
<b>PA Political Contributions:</b>	None Disclosed
<b>PA Presence:</b>	No
<b>Potential Conflicts:</b>	We are not aware of Clearlake having any investment conflicts.
<b>First Time Fund With PSERS:</b>	No
<b>PSERS Allocation Implementation Committee Approval:</b>	February 15, 2019

**Oversight Responsibility:**

<b>Investment Office:</b>	<p>Charles J. Spiller      Deputy CIO, Non-Traditional Investments</p> <p>James F. Del Gaudio      Portfolio Manager</p>
<b>External Consultant:</b>	Hamilton Lane



January 28, 2019

Board of Trustees  
Commonwealth of Pennsylvania  
Public School Employees' Retirement System  
5 North 5<sup>th</sup> Street  
Harrisburg, PA 17101

Re: Clearlake Opportunities Partners II, L.P.

Dear Trustees:

Clearlake Capital Group, L.P. ("Clearlake") was founded by José Feliciano, Behdad Eghbali and Steve Chang in 2006 and subsequently raised its first investment vehicle focused on making both control and non-control investments across distressed and special situations opportunities. Messrs. Feliciano and Eghbali continue to lead the firm and remain heavily involved throughout the firm's investment activities. The General Partner consists of 49 professionals, split between 21 investment professionals and 28 other employees; the investment team is comprised of 2 Managers Partners / Co-Founders, 2 Partners, 5 Principals, 2 Vice Presidents, 3 Senior Associates, 5 Associates and 2 Analysts. Investment professionals actively participate across the majority of portfolio companies' board of directors and credit committees to ensure preferential governance rights. The investment team is supported by an in-house operations team and third-party network of executives who help implement and execute post-investment value creation initiatives. Clearlake is targeting \$800 million in commitments for its second dedicated non-control distressed debt fund, Clearlake Opportunities Partners II, L.P. (the "Fund"). Clearlake expects to hold a first close in March 2019 and a final close in July 2019. The General Partner will commit at least 3% of commitments to invest in the Fund.

Consistent with the General Partner's prior fund dedicated to this strategy, Clearlake will seek to construct a diversified portfolio with exposure across three identified special situations investment types: structured equity, reorganization equity and opportunistic credit. While the General Partner will pursue both direct origination and secondary positions across the capital structure, Clearlake seeks to obtain securities higher in the capital structure across targeted transaction types. Clearlake employs a flexible approach and intends to invest across the Fund's target investment types on an opportunistic basis; additionally, the General Partner remains thoughtful when selecting target security types, with strong consideration of the underlying health of target companies. Consistent with prior funds, Clearlake seeks to primarily invest in North American technology and industrial companies, while additionally targeting select consumer businesses. The General Partner expects to target small- to medium-sized companies, across a wide range of enterprise values at entry. Clearlake expects to pursue companies with strong underlying fundamentals that often do not possess the resources to adapt to market changes and do not have access to the debt or equity capital markets to fund growth initiatives or stabilize business operations. Clearlake benefits from advantaged sourcing capabilities, often initiated by prior diligence activities of the flagship fund line which are continuously monitored for future potential investment opportunities. Additionally, the General Partner leverages prior knowledge of target company financial information to assist in pricing and negotiating governance and control rights. The Fund will target 20 to 25 equity investments in the range of \$25 million to \$75 million. The General Partner has consistently generated attractive net performance across Fund I and its prior flagship private equity funds.

Clearlake Opportunities Partners II's investment thesis can be summarized as follows:

- Experienced senior investment team supported by growing investment team and back-office team



# Hamilton Lane

- Flexible approach toward distressed and special situations opportunities across core sectors within the middle-market
- Industry relationships and broader platform investment activities drive significant direct deal flow
- Attractive performance across Fund I and prior flagship funds

Hamilton Lane's recommendation is based upon the following analytical factors and is made within the context of Commonwealth of Pennsylvania, Public School Employees' Retirement System's ("PSERS") investment guidelines.

- Detailed due diligence, including interviews with industry peers and private markets professionals. The initial review was completed December 10, 2018; the on-site due diligence was conducted January 14, 2019; the Fund was approved by Hamilton Lane's Investment Committee on January 28, 2019 and the recommendation to PSERS was issued January 28, 2019
- 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
- Detailed operational due diligence, including interviews with Clearlake's back office team to review the controls and processes surrounding the firm's finance, fund administration, tax, legal, compliance, IT, HR, and accounting functions
- 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 High Yield / Private Credit component of the portfolio

The individuals at Hamilton Lane who were involved in the due diligence process for the Fund are:

Andrea Kramer – Managing Director, Bala Cynwyd Office

Victor DeVincenzo – Associate, Bala Cynwyd Office

Patrick Burnette – Analyst, Bala Cynwyd Office

Based on the above, Hamilton Lane recommends that PSERS commit up to \$100 million in Clearlake Opportunities Partners II, L.P. Hamilton Lane 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. Hamilton Lane does not provide legal or other non-investment-related advice.

Sincerely,

Michael Koenig,  
Chief Client Officer

Corina English,  
Principal