



## State of New Jersey

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November 22, 2017

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough  
Director

SUBJECT: **Proposed Investment in Sycamore Partners Fund III, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$150 million in Sycamore Partners Fund III, L.P (the “Fund”) managed by Sycamore Partners Management, L.P. (“Sycamore” or the “Firm”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

Sycamore Partners III, L.P. will focus on making control-oriented investments of North American middle-market businesses within the consumer and retail sectors. As in prior funds, the Fund will focus on acquiring undermanaged or underperforming businesses facing some form of distress or complexity where there is an opportunity to create value by stabilizing operations and improving profitability.

The Division is recommending this investment based on the following factors:

**Compelling Market Opportunity:** The consumer retail sector is currently undergoing a transformational, structural change with traditional brick-and-mortar retail displaced by online shopping along with a fear that Amazon will capture all market share in the industry. Meanwhile, according to the U.S. Department of Commerce and Bureau of Economic Analysis, U.S. retail sales grew at ~2% annually from ~\$3.8 trillion in 2006 to ~\$4.8 trillion in 2016. Few distressed or value-oriented private equity firms can match the advantage provided by Sycamore’s sector focus. The Firm’s explicit focus on retail and consumer opportunities allows it a distinct vantage point on underwriting complex transactions, while the negative market sentiment around the space and specific assets, enables less competition and lower entry valuations. Recent Sycamore transactions have been acquired between 5x and 7x Earnings before Interest, Taxes, Depreciation and Amortization (“EBITDA”), vs. record high valuations in the private equity industry of 10x or greater. This positions Sycamore well to generate highly attractive risk-adjusted outcomes.

**Strong track record:** Since inception, Sycamore has levered the co-founders deep sector investment experience to drive value creation through operational and strategic turnarounds to generate positive performance in its prior funds. Sycamore's performance in Fund I is decisively top quartile and Fund II, while still early in its life, is generating strong returns. Sycamore Fund I has generated a Net Multiple on Invested Capital ("MOIC") / Net Internal Rate of Return ("IRR") of 2.2x / 43%. Fund II is ~60% invested with the majority of investments transacted in 2016 and later. Fund II realized its first two deals which generated 1.9x gross MOIC and 43% Gross IRR. The third investment which has not yet been realized (Belk) is marked at Gross MOIC / Gross IRR of 1.4x/26.3%.

**Deep Value Approach with Growth Orientation:** Sycamore's deep value approach focuses on situations where it can add and create value by acquiring underperforming companies at attractive valuations and grow revenues and earnings. The investment approach aims to generate attractive investment returns with an asymmetric distribution of potential outcomes by protecting the downside through attractive purchasing and increasing upside potential through a data driven operating plan for profit improvement. Sycamore's historical acquisition multiples demonstrate their proven track record of purchasing at compelling values. Across Fund I and Fund II, the average capital weighted purchase price is 5.1x EBITDA. Further, where the Firm has paid higher multiples, these investments often contain strong growth elements (e.g., EMP Merchandising, a German E-commerce business, and Kurt Geiger, a UK-based footwear apparel retailer that was carved out of The Jones Group).

**Experienced and Stable Team:** Sycamore's founder and Managing Director Stefan Kaluzny brings longstanding industry experience, both as an operator, from serving as CEO of Delray Farms, and as an investor at Golden Gate Capital and Sycamore. Further, the Partnership is managed by an experienced and cohesive team that has worked together since 2011 at the Firm and, prior to that, for nine years at Golden Gate Capital. The Principals have worked on 30 portfolio company transactions within consumer and retail and served as directors of each of Fund I's and Fund II's portfolio companies. Collectively, the Principals have over 35 years of experience systematically analyzing, structuring, and investing in complex, change-intensive, middle-market and large enterprise buyout opportunities.

**Data driven and analytic approach:** Sycamore utilizes data-driven analysis on all prospective investments and after reaching consensus to move forward, Sycamore reviews key industry performance data on target companies, vendors, customers and competitors. This approach allows Sycamore to develop industry-specific operational elements into their value creation thesis before making an investment and it serves as the framework for executing complex investment opportunities.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its private equity consultant, TorreyCove Capital Partners, undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures.

The fund utilized Acalyx Advisors, Inc. (the "placement agent") as third-party solicitor in connection with the potential investment. Staff has determined that the placement agent and its representatives met the registration, licensing and experience requirements set forth in the Division's Placement Agent Policy (the "Policy"). Pursuant to the Policy, the fund has disclosed the contract between the fund and the placement agent, specifying the scope of services to be performed by the placement agent and the fee arrangement between the placement agent, the general partner and any other third party.

We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern the investment. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 69 and 90 of the Council's regulations. Sycamore Partners Fund III, L.P. will be considered a private equity buyout investment, as defined under N.J.A.C. 17:16-90.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC and a meeting of the Committee was held on November 17, 2017. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's November 29, 2017 meeting.

Attachments

Fund Name: Sycamore Partners III, L.P.

November 22, 2017

Contact Info: Stefan Kaluzny, 9 West 57th Street, 31st Floor, New York, New York 10019

Fund Details:

Firm AUM (\$bil):	\$3.5 billion	<p><b>Key Investment Professionals:</b></p> <p><b>Stefan Kaluzny</b>, Managing Director Mr. Kaluzny has been a Managing Director of Sycamore Partners since 2011. Prior to Sycamore Partners, Mr. Kaluzny was a Managing Director at Golden Gate Capital. Mr. Kaluzny was with Golden Gate Capital from its inception in 2000 until January 2011. While at Golden Gate Capital, Mr. Kaluzny was involved in investments across a variety of transaction types and industries, including software, semiconductors, consumer products and retailing.</p> <p><b>Peter Morrow</b>, Managing Director Mr. Morrow has been a Managing Director of Sycamore Partners since 2011. Prior to Sycamore Partners, Mr. Morrow was a Principal of Golden Gate Capital. Mr. Morrow was with Golden Gate Capital from 2002 until January 2011. While at Golden Gate Capital, Mr. Morrow worked on transactions in the technology, business services, consumer products and retailing sectors.</p> <p><b>Paul Fossati</b>, Managing Director, Mr. Fossati has been with Sycamore Partners since 2015. Mr. Fossati serves as Director of Capital Markets and is responsible for managing the Firm's relationships with debt investors and financing partners both for new acquisitions and for existing portfolio companies. From 2006 until 2015, Mr. Fossati was a Managing Director at Morgan Stanley where he was the head of consumer and retail leveraged finance.</p> <p><b>Ryan McClendon</b>, Managing Director, Mr. McClendon has been with Sycamore Partners since 2011. Prior to Sycamore Partners, Mr. McClendon was a Senior Associate at Golden Gate Capital. Mr. McClendon was with Golden Gate Capital from 2006 until January 2011. While at Golden Gate Capital, Mr. McClendon worked on transactions in the technology, financial services, consumer products and retailing sectors.</p> <p><b>Emmelyn O'Meara</b>, Managing Director, Ms. O'Meara has been with Sycamore Partners since 2016. Ms. O'Meara is focused on cultivating the firm's extensive executive network in order to create deeper relationships with high performing leaders and talent across a broad range of positions</p>
Strategy:	Buyout	
Year Founded:	2011	
Headquarters:	New York	
GP Commitment:	at least \$100 million	

Investment Summary

The team will utilize its deep industry knowledge and operating experience in the consumer/retail industry to make control-oriented equity investments in North American middle-market businesses within the sector. Sycamore Partners seeks situations where there is a clear opportunity to buy assets at below market prices. Consistent with that of the prior funds, the Fund will focus on acquiring undermanaged or underperforming businesses facing some form of distress or complexity where there is an opportunity to create value by stabilizing operations and improving profitability. Across the consumer and retail spectrum, Sycamore will generally target established brands, retailers and distributors, or various industry utilities. Transactions will typically take the form of traditional buyouts, complex corporate carve-outs, bankruptcies, distressed situations, and take-privates. To accomplish this, the Principals focus on situations where there is less competition and/or some ability to "win" on non-economic terms due to transactional complexity.

Existing and Prior Funds

Funds	Vintage Year	Strategy	Returns as of 6/30/2017*
Fund I	2011	Buyout	42.9% Net IRR, 2.22x Net TVPI, 1.04x Net DPI
Fund II	2014	Buyout	3.3% Net IRR, 1.04x Net TVPI, 0.23x Net DPI

\*Data provided by Sycamore Partners  
IRR = Internal Rate of Return; TVPI = Total Value to Paid-In Capital; DPI= Distributions to Paid-In

Vehicle Information:

Inception:	2017	Auditor:	PricewaterhouseCoopers LLP
Fund Size (\$mil.):	\$4.5 billion	Legal Counsel:	Kirkland & Ellis LLP
Management Fee:	During the investment period, 2% per annum of commitments; thereafter, 2% per annum of invested capital		
Carry:	20%		
Hurdle Rate:	8%		
Management Fee Offset:	100%		

NJ AIP Program

Recommended Allocation (\$mil)	up to \$150 million	LP Advisory Board Membership:	TBD
% of Fund:	3.75%	Consultant Recommendation:	Yes
		Placement Agent:	Yes
		Compliance w/ Division Placement Agent Policy:	Yes
		Compliance w/ SIC Political Contribution Reg:	Yes

\*This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.