



State of New Jersey

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May 28, 2014

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Warburg Pincus Energy, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of \$100 million in Warburg Pincus Energy, L.P (the “fund”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

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

Attractive opportunity set: Favorable secular supply/demand trends in oil and gas are driven by increasing non-OECD consumption and limited production growth outside of North America. To keep up with the rising demand, the industry must target more complex reservoirs, resulting in increased capital costs to find and develop reserves and operate production. The sector’s capital intensity combined with forced divestitures of assets from public companies leads to attractive opportunities for private capital.

Track record: Since 2000, Warburg Pincus (“Warburg” or “firm”) has invested \$6.6 billion in 45 energy investments and generated an estimated Net Internal Rate of Return (“IRR”) and net multiple of 22.7% and 2.4x, respectively, as of December 31, 2013. For the realized energy investments only, the net IRR and net multiple are 25% and 3.0x, respectively. Compared to the public markets, the firm’s energy investments since 2000 have outperformed the S&P Energy index by over 700 bps. The energy investments also consistently ranked top quartile on a Net Total Value to Paid-In basis since 2000.

Investment style: Warburg emphasizes growth investing within the energy sector to build durable businesses of scale by backing operationally excellent management teams and providing them with the capital to grow their companies to the point where they become free cash flow positive. By building to the point of scale, it allows the fund to have multiple exit options ranging from a sale to a strategic partner or MLP to an IPO. Furthermore, by providing lines of equity based on milestones, it allows the firm to cap investments in poor deals early and significantly back good performers. Analysis of their performance supports this concept, with a loss ratio of 8% since 2000 and capital invested skewed towards higher returning deals.

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

Division Staff and its consultant, Strategic Investment Solutions, undertook extensive due diligence on the proposed investment in accordance with the Division’s Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with New Jersey’s potential investment.

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. In addition, the proposed investment must comply with the Council’s regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that the investment is authorized pursuant to Articles 69 and 71 of the Council’s regulations. The Warburg Pincus Energy, L.P. will be considered a commodity-related real asset investment, as defined under N.J.A.C. 17:16-71.1.

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 May 14, 2014. 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 May 28, 2014 meeting.

Attachments

Fund Name: Warburg Pincus Energy, L.P.

May 28, 2014

Contact Info: Steve Schneider, 450 Lexington Avenue, New York, New York 10017

Fund Details:

Total Firm Assets:	\$37.5 billion as of 9/30/2013	Key Investment Professionals: <u>Peter R. Kagan</u> , Managing Director. Mr. Kagan joined Warburg Pincus in 1997 and leads the firm's energy group. Mr. Kagan is also a member of the firm's executive management group. Prior to joining Warburg Pincus, he worked in investment banking at Salomon Brothers in New York and Hong Kong. <u>Simon W.C. Eyers</u> , Managing Director. Mr. Eyers joined Warburg Pincus in 2012 and focuses on energy investments. Previously, he served as a founding partner of 4D Global Energy Advisors, a private equity firm specializing in the energy sector. Prior to 4D, he worked in energy investment banking at SG Warburg, Goldman Sachs and Credit Suisse First Boston Europe. <u>In Seon Hwang</u> , Managing Director. Mr. Hwang joined Warburg Pincus in 2004 and focuses on energy investments. Previously, he worked at GSC Partners, Goldman Sachs and the Boston Consulting Group. <u>David B. Krieger</u> , Managing Director. Mr. Krieger joined Warburg Pincus in 2000 and focuses on energy investments. Previously, he worked at McKinsey & Company in Atlanta and Europe.
Strategy:	Real Assets	
Year Founded:	1966	
Headquarters:	New York, NY	
GP Commitment:	at least \$100 million	

Investment Summary

Warburg Pincus is one of the oldest and most established private equity firms in the world. The firm was founded in 1966 and raised its first fund in 1971. The firm's focus is to partner with skilled entrepreneurs and management teams with innovative investment ideas, and build durable businesses of scale with sustainable growth. Warburg Pincus Energy, L.P., is a companion energy fund to the firm's current flagship private equity fund. While the fund can invest across various areas of the energy sector, it will have a strong weighting towards oil and gas exploration and production. Additionally, the fund will also seek to invest in other segments of the oil and gas value chain, including midstream, downstream and oilfield services. Opportunistically, the team will pursue investments in other energy and natural resources sub-sectors, notably power and mining and metals. All investments will be divided between the energy companion fund and the then active flagship private equity fund (currently Warburg Pincus XI).

Existing and Prior Funds

<u>Funds</u>	<u>Strategy</u>	<u>** Returns as of 12/31/2013</u>
Warburg Pincus Energy Investments	Real Assets	22.7% Net IRR, 2.40x Net TVPI
IRR = Internal Rate of Return		
TVPI = Total Value to Paid-In		
** Return Data as of 12/31/13- Net IRRs and Multiples for Warburg's energy sector track record are estimated based on the aggregate Fund level gross to net spreads for the funds in which the energy deals were done (Exact Net IRRs and Net Multiples for industry sectors, including energy, cannot be calculated due to the lack of a mechanism to allocate fees, expenses and GP carried interest to each investment)		

Vehicle Information:

Inception:	2014
Fund Size (\$mil.):	\$3 billion
Management Fee:	1% on committed during investment period; 1% on invested post-investment period
Carry:	20%
Hurdle Rate:	N/A
Additional Expenses:	100% fee offset

Auditor:	Ernst & Young LLP
Legal Counsel:	Kirkland & Ellis LLP

NJ AIP Program

Recommended Allocation (\$mil.):	\$100,000,000.00	LP Advisory Board Membership:	Yes
% of Fund:	3.33%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		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.