Recommendation for Tenex Capital Partners III, L.P.

To:	RISIC
Prepared:	November 9, 2020
From:	Thomas Lynch, CFA, Senior Managing Director

The purpose of this memo is to provide RISIC with a summary of Cliffwater's recommendation on Tenex Capital Partners III, L.P. ("Tenex III" or the "Fund"). Cliffwater has completed its investment due diligence and operational due diligence and recommends the Fund as part of ERSRI's Private Equity allocation.

<u>Summary of Tenex III</u>
Fund Overview: Tenex III will make control-oriented investments in U.S. middle-market companies with a post-acquisition strategy of operational improvements. ERSRI committed $25 million to the previous fund, Tenex II, in 2016.

People and Organization: Tenex Capital Management ("Tenex" or the "Firm") was formed in 2010 to continue its predecessor firm's operationally focused middle-market investment strategy. The predecessor firm, TenX Capital Partners ("TenX"), was founded in 1999 by Michael Green as a pledge fund to invest in underperforming middle-market companies. TenX was acquired by Cerberus in 2003, and the Firm added Varun Bedi, Joe Cottone, J.P. Bretl, and Chad Spooner as senior professionals. While at Cerberus, the team completed nine investments that generated an aggregate gross return of 2.8 times invested capital. The Tenex team established itself as an independent investment firm in 2010. Currently, Tenex is led by managing partner Michael Green and six managing directors. The Firm, headquarted in New York City, has a total of 23 professionals including 18 investment professionals.

Investment Strategy and Process: Tenex targets control investments of underperforming companies in the middle market. The Firm's goal is to increase margins by at least 300 basis points by placing Tenex operating executives at portfolio companies to guide fixed cost reductions, drive operational improvement initiatives, and source and execute add-on acquisitions. Tenex's target companies are family owned, private equity owned, or corporate carve-outs that are primarily underperforming due to inefficient management of operating assets. Tenex focuses on companies underperforming in their market primarily due to inefficient management of their operating assets. Fund III will target 15 platform companies with equity investments ranging from $25 to $100 million per company. Target companies typically have revenue up to $300 million and enterprise values up to $250 million.

Performance: Tenex has previously invested two institutional funds. The funds have generated a net return of 1.4 times invested capital, 13.3% net IRR, and 0.54 times net DPI. Fund II, a 2016 vintage, has thus far generated second quartile performance across all metrics. The fund is relatively young, with an average age across active investments of approximately two years. Fund I was challenged, generating below median performance on a net IRR and net TVPI basis. The Firm adjusted its strategy during the investment period of Fund II, aimed at limiting highly cyclical investments and implementing more downside protection. As of June 30, 2020, the Firm's two institutional funds have generated a net IRR of 13.3%. Investing in the Russell 2000 during the same period would have generated a return of 5.8%. Tenex has outperformed the Index by 7.5% in aggregate. Fund I outperformed the index by 300 bps. Fund II, a 2016 vintage, has outperformed the index by 14.2%.

Investment Terms: Cliffwater finds the investment terms, taken as a whole, to be in accordance with industry standards. The Fund has a five-year investment period and a ten-year term. The Fund will charge a management fee equal to 2% of total commitments during the Fund's investment period and 1.75% of net invested capital thereafter. The management fee will be offset by 100% of all directors', consulting, break-up, and equivalent fees. The Fund will charge a 20% carried interest with a preferred return of 8%.

Cliffwater Recommendation

Cliffwater recommends an investment of up to $30 million Tenex Capital Partners III, L.P. as part of ERSRI's Private Equity allocation.