



MEETING DATE

AUG 10 2011

AGENDA ITEM

13

Memorandum

Date: July 28, 2011
To: CCCERA
From: Bob Helliesen
Subject: Medley Opportunity Fund II LP

Recommendation

Milliman recommends that CCCERA fund a \$40 million investment in the Medley Opportunity Fund II. This is a private debt fund targeting \$1 billion of capital that lends to smaller companies that are unable to sell bonds in the public market or borrow from banks or insurance companies. In addition to receiving interest, Medley also receives an "equity kicker" in the form of warrants.

The fund is established to take advantage of the inability of banks and traditional lenders to provide debt to smaller companies due to ongoing weakness in the financial system following the recession and implosion of the banking system. While this is the first Medley fund to be broadly marketed to institutional investors, the management team is quite experienced in the private debt area. The fund is currently investing proceeds from its first closing which occurred in December 2010. The fund is seeking equity-like returns with the risk profile of secured debt.

We believe there is an unusual opportunity in private lending due to the un-willingness and/or inability of traditional sources of loans to lend to smaller companies. The fund has target returns net to the investor of 13-15%, with likely cash throw-off of 10% or more.

Opportunistic Mandate Review

In June 16, 2009, Milliman proposed that CCCERA establish a "Strategic Opportunity" allocation of up to 5% of the Total Fund to be used for unique investments that do not fit neatly within any of the existing asset classes and that seem to offer exceptional opportunity currently. The Board subsequently adopted the recommendation and we began the process of identifying opportunistic candidates.

In November, 2009, Milliman recommended the Board first take advantage of a broad opportunity strategy, then look into more specialized strategies. Milliman conducted a manager search and suggested the Board fund its first opportunistic strategy with a \$60 million investment in the Goldman Sachs Broad Opportunistic Credit strategy. The Board approved the investment recommendation, and Staff, Board representative and Milliman conducted a due diligence meeting with the Goldman Sachs Opportunistic Credit Strategy team in New York on January 15, 2009. To take further advantage of the unique opportunities available in the dislocated credit and structured debt markets, Milliman recommended that CCCERA invest in the Oaktree Private Investment Fund 2009, L.P.



The CCCERA Board committed \$40 million to this strategy in January, 2010. The mandate to invest up to 5% of the Total Fund still is in place. There is room to fund additional opportunities, since Goldman Sachs Opportunistic and Oaktree together recently made up less than 2% of the Total Fund.

Investment Thesis

The credit crisis of 2007-2009 has caused commercial banks and other lenders to curtail their lending. Banks have been reducing their exposure to middle market lending from 70% 15 years ago to 20% currently. Because there is less supply of capital to lend, higher returns from lending to high quality credits are available to those who are able to put money to work. Spreads between public market debt and private market debt are historically wide (although they have come down recently from the extremely high levels of late 2008 and early 2009). With less competition for deals, private lenders can demand better coverage and more equity in deals than before.

In addition, private equity capital raised in recent years is looking for equity investment. Such investment will create additional need for debt. As a result, equity-like returns can be achieved, taking secured positions against high-quality assets and enterprises.

Medley principals have been engaged in private lending successfully for many years and are positioned to take advantage of these opportunities. The estimated returns do not require a strong IPO market.

Overview of Medley

Medley Capital is an investment firm with approximately \$1.4 billion in assets under management. The firm specializes in direct lending to US middle market companies in amounts of \$10-50 million.

Typical transactions have returns of some 20%, composed of 12% cash interest, 4% PIK (payment in kind) paid off when the debt is retired and equity upside from options, warrants etc.

Medley principals have a successful track record in direct lending, with annual returns of 13% net for the 2003-2010 period. Medley has continued to deliver returns through the challenging environment that began in 2007. Medley has a team of 29 people, with experience in transaction sourcing, credit analysis and monitoring as well as restructuring, liquidation and bankruptcy experience. Medley Principals have worked together for the past eight years executing a consistent strategy. Fund I delivered attractive returns during the challenging market that began in 2007, and Fund II intends to employ the same strategy.



Key Employees

Andrew Fentress

Mr. Fentress is a Managing Partner of Medley Capital and Senior Portfolio Manager for the Medley Opportunity Funds. Mr. Fentress formed Medley Capital in 2006. Prior to forming Medley, Mr. Fentress was a Partner with CN Opportunity Fund where he was Portfolio Manager for the firm's global investment fund. Prior to CN Opportunity Fund, Mr. Fentress was a Partner and Portfolio Manager at CQ Partners, a global investment fund. Mr. Fentress began his investment career with Morgan Stanley & Co. where his last role was Principal in the Institutional Equity Division, where he managed a global trading business. Mr. Fentress received a B.A. from Boston College and an M.B.A. from the Kenan-Flagler School of Business at the University of North Carolina, Chapel Hill.

Brook Taube, CFA

Mr. Taube is a Managing Partner and Chief Investment Officer of Medley Capital. Mr. Taube formed Medley Capital in 2006. Prior to forming Medley Capital, Mr. Taube was a Partner with CN Opportunity Fund where he was Portfolio Manager for the firm's global investment fund. Prior to CN Opportunity Fund, Mr. Taube founded T3 Group, a principal and advisory firm focused on distressed asset and credit investments. Before T3, Mr. Taube was a Partner with Griphon Capital Management. Mr. Taube began his career at Bankers Trust in 1992, where his last role was Vice President in Structured Finance and Capital Markets. Mr. Taube received a B.A. from Harvard University and currently serves as a Board member for both the New Amsterdam Symphony Orchestra and the New York Philharmonic.

Seth Taube, CFA

Mr. Taube is a Managing Partner of Medley Capital and Senior Portfolio Manager of the Medley Opportunity Funds. Mr. Taube formed Medley Capital in 2006. Prior to forming Medley Capital, Mr. Taube was a Partner with CN Opportunity Fund where he was Portfolio Manager for the firm's global investment fund. Before CN Opportunity Fund, Mr. Taube co-founded T3 Group, a principal and advisory firm focused on distressed asset and credit investments. Prior to T3, Mr. Taube worked with Griphon Capital Management, serving as Managing Director of the firm's private investment activities. Before Griphon, Mr. Taube was a Vice President with Tiger Management, and held positions with Morgan Stanley & Co. in the Investment Banking and Institutional Equity Divisions. Mr. Taube received a B.A. from Harvard University, an M.Litt. in Economics from St. Andrew's University in Great Britain, where he was a Rotary Foundation Fellow, and an M.B.A. from the Wharton School at the University of Pennsylvania.

Joseph Schmuckler

Mr. Schmuckler is a Managing Partner with Medley Capital, responsible for client relations and firm management. Before Medley, Mr. Schmuckler was a Senior Executive Officer of Mitsubishi UFJ Securities Co., Ltd. where he oversaw international business functions with responsibility for the firm's business activities outside of Japan. Prior to



joining MTU, Mr. Schmuckler was the Chief Operating Officer and member of the Board of Directors of Nomura Holding America, Inc. Mr. Schmuckler also previously served as a partner at Kidder Peabody & Co. Inc. Mr. Schmuckler has served on the Board of Directors of the Securities Industry Association, on the Board of Governors of the Boston Stock Exchange, on the Board of Trustees of the Hudson Institute, on the Board of Directors and Executive Committee of Empower America, and on the Board of Directors of The Reform Institute. Mr. Schmuckler earned a B.S. in Finance from the University of Delaware and an MBA in Finance from New York University.

Investment Process

Medley has a selective origination and underwriting process. The 16 person team reviews more than 1,000 deals a year, seriously reviews around 200, and executes only 25-35. Almost half of the actual transactions are either repeats of earlier deals or referrals. Many deals come from the borrowers approaching Medley. The firm avoids widely syndicated deals. The firm's principals have closed more than 60 deals in last seven years.

The industry focus of the company is the following:

- Industrial/Transportation
- Energy/Natural Resources
- Financial
- Real estate

Medley conducts a detailed due diligence process, which includes in-house financial, legal and business diligence as well as outside appraisals, audits, industry analysis, background and compliance checks and external legal counsel.

Once investments have been selected, Medley monitors them closely, maintaining contact via weekly calls and quarterly visits. It monitors reporting, collateral valuation and cash on a regular basis. Medley's monitoring includes frequent interaction with management including attending board meetings, consulting with industry experts, and working with equity investors to develop company strategy.

Medley has a proprietary asset monitoring system which includes all portfolio data by investment. The system keeps track of operations and finances of companies, compliance, asset valuations, call notes, industry reports and other relevant information, and it generates standardized reports for the use of Medley's investment team. Medley investors can have direct access to portfolio information from this system.



Medley II Fund Terms

Name:	Medley Opportunity Fund II LP
Target size:	\$1 billion
Investment period:	Two years from final close
Fund term:	Seven years, with two one-year extensions
Management fee:	1.75% (1.33% on commitments over \$100 million)
Carried interest:	20%
Preferred return:	8%
GP Commitment:	1% of Committed Capital