



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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Governor

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Lt. Governor

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State Treasurer

October 7, 2011

MEMORANDUM TO: State Investment Council

FROM: Timothy Walsh
Director

SUBJECT: **Proposed investment in ValueAct Capital Partners II, LP
Fund**

The New Jersey Division of Investment is proposing an investment of up to \$150 million in ValueAct Capital Partners II, LP Fund managed by ValueAct Capital. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9

ValueAct Capital ("VAC" or the "firm") was founded in 2000 by Jeffrey Ubben, George Hamel and Peter Kamin (retiring at end of 2011). The firm currently manages \$6.0 billion in its flagship activist fund, ValueAct Capital Master Fund, L.P. ("ValueAct" or the "fund"). ValueAct employs a total of 24 people of whom 11 are investment professionals. The firm is headquartered in San Francisco and has a satellite office in Boston. The firm is majority owned by eleven partners. At 8% of NAV, ValueAct's employees are, collectively, one of the fund's largest investors. ValueAct registered with the SEC in August 2010. No material departures from best practices were found in the operational review.

ValueAct runs a concentrated activist strategy focused on 10 to 18 core investments and 2 to 5 attractive, smaller positions requiring further intensive due. Investments are predominately in U.S. mid-cap equities. The fund acquires significant (typically 5% to 15%) ownership stakes in companies with high cash flow yield and cash flow growth which are trading at considerable discounts to comparable private market valuations. The investment team actively works with management and/or corporate boards to create value for shareholders in a collaborative manner. ValueAct will strive to obtain board seats if they ultimately believe it to be an advantage in the value realization process. In the past, VAC partners have held 31 board seats at 27 companies out of the 60 core investments it has made. The investment team seeks to unlock value through encouraging balance sheet restructurings, management changes, strategy changes, divestitures, and sales of companies. The manager has rarely used shorting or hedging but has legal authority to do so.

The fund has produced very strong absolute and risk-adjusted returns for over ten years. From its inception in December 2000 through June 2011, the fund generated an annualized return of 17.66% with a standard deviation of 16.35%, resulting in a Sharpe Ratio of 0.93. The returns place the fund in the top quartile among peers. The proposed investment has 3-year lock up (2-year hard lock, 1-year soft lock), a 1.25% management fee (reduced from 1.50% due to our planned investment of \$150 million) and a 20% performance fee with 8% preferred return.

The Division of Investment (“Division”) Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on these proposed investment. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

As part of its due diligence process, staff has determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with the 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 State Investment Council’s (the “Council”) regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that this investment is authorized pursuant to Articles 69 and 100 of the Council’s regulations. ValueAct Capital Partners II, LP Fund will be considered an equity oriented hedge fund, as defined under N.J.A.C. 17:16-100.1.

Formal written due diligence reports for the proposed investment were sent to each member of the Investment Policy Committee and a meeting of the Committee was held on September 8, 2011. In addition to the formal written due diligence reports, all other information obtained by the Division on the investments was made available to the Investment Policy Committee.

We look forward to discussing the proposed investment at the Council’s October 13, 2011 meeting.

Attachments

State Investment Council Fund Review Memo

To: State Investment Council
From: Division of Investment
Date: October 13, 2011
Subject: Hedge Fund Investment Recommendation

Fund Facts

Fund Name:	ValueAct Capital Partners II, L.P.
Fund Type:	Equity Oriented - Hedge Fund
Current Master Fund Size:	\$6.0 billion
Inception:	December-2000
Fund Address:	435 Pacific Avenue, 4th Floor San Francisco, CA 94133

GP Contact Info

Name:	Briana J. Zelaya
Telephone:	415-362-3700
Email:	bzelaya@valueact.com

Summary of Terms and Investment Strategy

Investment Strategy:	Concentrated activist strategy focused on 10 to 18 core investments and 2 to 5 attractive, smaller positions, predominately in U.S. equities. The fund acquires significant (typically 5% to 15%) ownership stakes in companies with high cash flow yield and cash flow growth which are trading at significant discounts to comparable private market valuations. The investment team actively works with management and/or corporate boards to create value for shareholders in a non-confrontational manner. The investment team seeks to unlock value through encouraging balance sheet restructurings, management changes, strategy changes, divestitures, and sales of companies. The manager has not used shorting or hedging but has legal authority to do so.
Fee Terms:	
Management and Performance Fees:	Management fee: 1.25% (Tranche 3) Performance fee: 20%
Other Fees:	Fund expenses: 13 bps
Hurdle Rate:	8% preferred return
Service Providers:	
Prime Broker(s):	BNP Paribas
Administrator(s):	International Fund Services
Auditor(s):	Pricewaterhouse Coopers
Legal Counsel:	Paul, Weiss, Rifkind & Garrison; Dechert
Liquidity/Redemption Terms:	
Lock-up:	2 year hard and 1 year soft (10% redemption charge)
Redemption:	Annual, can redeem 5% annually during lock-up period
Side Pocket:	Up to 10%

NJ AIP Program:

Recommended Allocation:	\$150 million
% of Master Fund:	2.50%
% of New Jersey State Pension Plan (\$72b):	0.21%
% of AIP Hedge Fund Allocation (\$4.0b):	3.75%

Consultant Recommendation:	Yes
*see due diligence memo	
Placement Agent:	None
Compliance with Division Placement Agent Policy:	N/A
Compliance with SIC Political Contribution Reg:	Yes