



State of Rhode Island
Office of the General Treasurer
TCG Crossover Fund II, L.P. – Staff Recommendation
May-2023

RECOMMENDATION:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): **Approve a commitment of up to \$15 million to TCG Crossover Fund II, L.P. (“TCGX II”)**. ERSRI committed \$25 million to TCG Crossover Fund I, L.P., a 2021 vintage fund (exposure shown in *Appendix 1*, performance shown in *Appendix 2*). ERSRI also committed \$12.5 million to The Column Group Fund V, L.P., and \$12.5 million to The Column Group Opportunity Fund III, L.P., two 2022 vintage funds. While TCGX and The Column Group operate as independent organizations, they share a strategic relationship.
- [Rhode Island OPEB System Trust \(“OPEB”\)](#): **Approve a commitment of up to \$1 million to TCG Crossover Fund II, L.P. (“TCGX II”)**.

ASSET CLASS: Private Equity (ERSRI), Private Growth – Private Equity (OPEB)

SUB-STRATEGY: Venture Capital

ALLOCATION:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): The target allocation for Private Equity is 12.5% and the allocation as of 4/30/2023 is ~16.4%. The current pacing plan for the 2023 vintage is \$200 million committed to 5-10 funds at \$15-40 million per fund. Pending approval of the recommendations above, ERSRI’s 2023 vintage commitments to Private Equity will be ~\$100 million.
- [Rhode Island OPEB System Trust \(“OPEB”\)](#): The target allocation for Private Growth is 5.0% and the Private Equity sub-strategy is targeted to be ~80% of the asset class (i.e., 4.0% at the OPEB Trust level). The actual allocation to Private Equity of 4/30/2023 is ~0.5%. The current pacing plan for 2023 is \$9 million committed to 5-10 primary funds at \$0.5-2 million per fund. Pending approval of the recommendations above, OPEB’s 2023 vintage commitments to Private Equity will be ~\$4 million.

PORTFOLIO FIT:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): ERSRI’s Private Equity allocation is composed of core of buyout strategies, complemented by venture capital, growth equity and opportunistic credit. Rhode Island targets up to 20% of the allocation to be in venture capital which provides access to earlier stage companies with high growth potential and diversification benefits relative to buyout. ERSRI seeks to build a diversified venture portfolio with exposure to varying vintages, stages, sectors, and geographies. The venture portfolio is centered around a core of five managers (see in *Appendix 3*), of which three focus on life sciences. ERSRI overweights early-stage venture where managers can build larger positions and exert greater influence. ERSRI selectively invests in late-stage strategies such as TCG Crossover (“TCGX”) that have unique access to deals and/or differentiated implementation. TCGX targets bio-pharma companies beginning at the late stages of venture with less technical risk than early-stage companies since they are often already in clinical trials. TCGX II will invest in private deals and public small/mid cap companies (market cap below \$1.5 billion). For private

investments, TCGX will invest in crossover rounds where investors participate in transactions ahead of a near term IPO or sale. Public investments will primarily be structured transactions such as IPOs, PIPEs, and registered directs. These structured investments require TCGX to build relationships with management teams, negotiate pricing and terms, and syndicate deals. TCGX II companies will primarily be based in the US or Europe (~95%) and to a lesser degree in China (~5%). The portfolio is expected to include 8-12 private and 20-25 public companies sized at \$30-40 million and \$15-20 million per deal, respectively. Pending approval of the recommendations, TCGX would represent ~1.6% of ERSRI's Private Equity exposure and ~11.5% of its venture capital exposure (see *Appendix 4*).

- [Rhode Island OPEB System Trust \(“OPEB”\)](#): The Private Growth portfolio allocates to Private Equity (as described above) and Non-Core Real Estate strategies and is ramping up to its target allocation through commitments made in tandem with ERSRI. Pending approval of the recommendations, TCGX would represent ~6.9% of OPEB's Private Growth exposure and ~8.4% of its Private Equity exposure (see *Appendix 5*).

MERITS:

- [Differentiated Sourcing and Execution](#): TCGX uses its proprietary database of ~500 public companies to track clinical trial data and anticipate value-inflating drug discovery milestones. For public investments, TCGX will often approach a company facing challenges raising capital ahead of the release of key clinical data and convince it to grant TCGX confidential early access to the data. If the data is promising, TCGX will negotiate a structured transaction to directly buy stock from the company under preferential terms such as discounts, warrants, and/or royalties. TCGX's closed-end structure allows it to act as “patient” capital and hold investments over long periods, helping it build trust with companies seeking long-term investors. TCGX's structure can also help it achieve better outcomes as it holds positions through short-term volatility until the realization of its underwritten catalysts, which can take 18 months or more. For private investments, TCGX has unique access to pro rata rights in venture rounds of high performing companies within The Column Group portfolio due to the firms' partnership. The Column Group is a leading early-stage life science venture investor with a strong record of building successful companies.
- [Opportunistic Strategy](#): TCGX invests across public and private markets, providing valuable flexibility to manage through “hot” and “cold” market cycles. Late-stage private investments will often be more attractive in “hot” markets when crossover rounds are soon followed by IPOs or sales at increased valuations. In these environments, TCGX expects most deals to be in private companies. However, in “cold” markets where public issuance and M&A slow as valuations decline, late-stage private investing can be challenging. In these “cold” markets, TCGX can pivot to public markets opportunities and invest in smaller drug companies that need funding for research but cannot access traditional financing and turn to investors like TCGX for structured solutions.
- [Strong Team and Sector Expertise](#): TCGX is a life science specialist with an experienced team. Before TCGX, Managing Partner, Dr. Chen Yu, spent 16 years at healthcare investment firm Vivo Capital, where he executed a similar investment strategy targeting private and public life sciences companies. Dr. Yu is supported by two Partners, Dr. Cariad Chester and Dr. Simon Basseyn, who each have years of healthcare investing experience. Dr. Chester previously led investments in biotechnology companies at Aquilo Capital and Dr. Simon Basseyn worked for Ghost Tree Capital, a life sciences focused hedge fund. TCGX also benefits from a strategic relationship with The Column Group, a leading early-stage life science venture capital investor focusing on creating new companies that target large unmet therapeutic needs. The Column Group's senior investment partners have decades of experience as investors, entrepreneurs, operators, and researchers. The firm also leverages a team of ten Science Partners that includes several Nobel laureates who assist in thesis development, deal sourcing, and value creation.

CONCERNS:

- **Key Person Risk:** The Fund will be led by Managing Partner Dr. Chen Yu, who brings decades of experience investing in and as an operator of public and private drug discover companies and has served on the boards of over a dozen life sciences companies. Dr. Yu has meaningfully contributed to substantially all investments made by TCGX to-date and the firm relies considerably on the meaningful network he has built to source deals.
 - **Mitigant – Key Person Clause:** If Dr. Yu stops dedicating most of his time to TCGX II, the fund would lose the ability to call capital and reinvest proceeds in new deals. TCGX would need to present a resolution that receives approval from investors representing 2/3 of fund interest to resume investing.
 - **Mitigant – Strong Team and Processes:** Dr. Yu is supported by two experienced Partners who are involved in all facets of the investment process. The firm operates in a team-oriented approach and maintains well-documented policies and procedures that ensure intellectual capital is being shared as best as possible.
- **Volatile Markets:** A substantial portion of TCGX II's invested capital (60-70%) is expected to be invested in public equity of small biotech companies which can be highly cyclical and may be subject to illiquidity constraints given limited float. As a result, the fund may be more impacted by fluctuations in public markets early in its life relative to peers, which may lead to underperformance as peers may mark down private investments less frequently.
 - **Mitigant – Patient Capital:** As a private vehicle with limited liquidity constraints, TCGX can invest in long-dated theses around publicly traded names without being impeded by short-term incentives that can lead peers to sell at inopportune moments. Additionally, TCGX's fund structure allows it to credibly demonstrate an ability to hold positions for long periods, helping it to source structured public equity deals.
 - **Mitigant – Preferential Terms for Structure Public Investments:** Most TCGX public investments are expected to be negotiated transactions where it often can negotiate preferential terms. This can create favorable asymmetrical return profiles where TCGX benefits more in upside scenarios relative to its risk.

ESG: TCGX is rated as **Neutral** with respect to their ESG practices.

- **ESG:** TCG Crossover recently adopted a formal ESG policy. As a minority investor, TCGX typically does not have control over its portfolio companies, but the firm supports the development and evolution of ESG policies within its portfolio. While not an impact strategy, TCGX's investments focus on developing new therapeutics for diseases that address societal needs. The drug development industry is highly regulated and clinical trials require Institutional Review Board review of protocols to ensure research is ethically conducted.
- **DEI:** TCGX is a diverse-owned investment manager and over 50% of its staff are women or come from diverse backgrounds. The firm is committed to promoting an environment of equity and inclusion. The firm seeks to promote diversity in its team by evaluating a diverse group of candidates when hiring. TCGX has an Anti-harassment and Anti-discrimination Policy to further their efforts of attaining a diverse workplace.

FEES: Fees for TCGX II are in-line with industry standards.

- **Management Fee:** TCGX II will charge 2.5% of committed capital during the four-year investment period, 1.5% in year 5, and 1.0% thereafter. If TCGX raises a subsequent fund with at least \$500 million of commitments before year 5, the fee will decline by 0.25% per year until year 5 at which time it will drop to 1.5% and 1.0% in year 6.
- **Carried Interest:** Carried interest is 20% until distributions reach 2.5x aggregate contributions, followed by a 90% catch-up until the GP receives 25% of all profits, and then 25% thereafter. Carry is charged on a fund-wide basis.

Appendix 1: ERSRI Prior Fund Exposure

Fund Exposure*

Current Partnerships	Vintage Year/ Initial Investment	Type	Amount Committed	Amount Drawn	Amount Distributed	Amount Unfunded	Valuation
TCG Crossover Fund I, L.P.	2021	Venture Capital	\$25,000,000	\$17,625,000	\$1,675,441	\$7,375,000	\$19,828,102

*Data as of 12/31/2022

Appendix 2: ERSRI Prior Fund Performance

Current Partnerships	Vintage Year/ Initial Investment	Type	Net Performance*		Public Market Equivalent (PME)	
			Net IRR (%)	Net Multiple of Investment	MSCI ACWI Net Index PME IRR**	Fund Excess Return (Fund IRR - PME)
TCG Crossover Fund I, L.P.	2021	Venture Capital	22.45%	1.22	-8.92%	31.37%

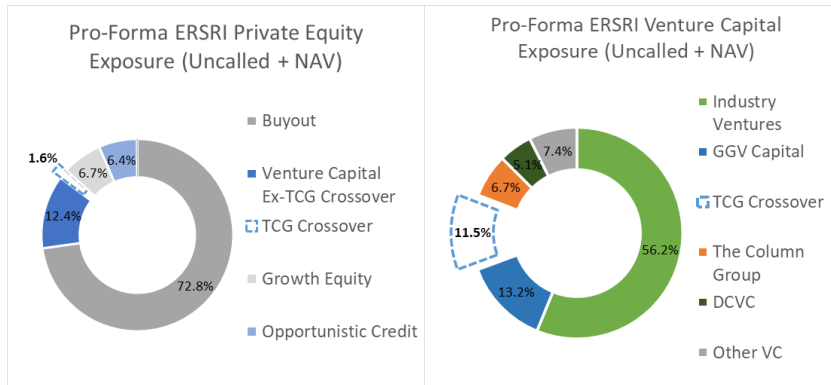
*Data of 12/31/2022

**Long Nickels PME Methodology

Appendix 3: Core ERSRI Venture Capital Managers

Manager	Type	Sector	Stage	Geography
Industry Ventures	Hybrid FoF	Technology	Early	U.S.
GGV	Primary	Technology	Multi-Stage	Global
TCG Crossover	Primary	Life Science	Crossover	U.S., Europe, & Asia
The Column Group	Primary	Life Science	Early	U.S.
DCVC	Primary	Life Science	Early	U.S.

Appendix 4: ERSRI Portfolio Fit



Appendix 5: OPEB Portfolio Fit

