



State of Rhode Island  
Office of the General Treasurer

## Tenex Capital Partners IV, L.P. - Staff Recommendation

March-2024

### RECOMMENDATION:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): **Approve a commitment of up to \$30 million to Tenex Capital Partners IV, L.P. (“Tenex IV”)**. ERSRI previously committed \$30 million to Tenex Capital Partners III, L.P. (“Tenex III”), a 2021 vintage fund (exposure in *Appendix 1*, performance in *Appendix 2*).
- [Rhode Island OPEB System Trust \(“OPEB”\)](#): **Approve a commitment of up to \$1 million to Tenex Capital Partners IV, L.P. (“Tenex IV”)**.

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

**SUB-STRATEGY:** Middle Market Buyout

### ALLOCATION:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): The target allocation for private equity is 12.5% and the allocation as of 2/29/2024 is ~16.6%. The preliminary pacing plan for the 2024 vintage is \$240 million committed to 5-10 funds at \$15-40 million per fund. Pending approval of the recommendations presented at the march 2024 SIC meeting, ERSRI’s 2024 vintage commitments to Private Equity will be \$88 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 as of 2/29/2024 is ~0.81%. The preliminary pacing plan for the 2024 vintage is \$9 million committed to 5-10 primary funds at \$0.5-2 million per fund. Pending approval of the recommendations presented at the March 2024 SIC meeting, OPEB’s 2024 vintage commitments to Private Equity will be \$2.75 million.

### PORTFOLIO FIT:

- [Rhode Island Employees Retirement Systems Pooled Trust \(“ERSRI”\)](#): ERSRI’s Private Equity allocation is composed of a core of buyout strategies, complemented by venture capital, growth equity, and opportunistic credit investments. Rhode Island targets 60-80% of the allocation to be in buyout strategies and seeks to build a portfolio diversified by geography, sector, and company size. The fund’s strategy fits well within this portion of the buyout portfolio as it will target small and middle market fundamentally sound but operationally underperforming companies in North America within the sectors of Diversified Industrials, Business & Tech Services, and Healthcare. Tenex targets majority equity ownership in companies that are family owned, private equity owned, or corporate carve-outs and seeks to drive investment performance through operational improvements to bring portfolio companies from below market in their sectors to average. These companies operate in desirable end markets with strong product or service offerings but are typically underperforming due to underinvestment and inefficient management of operating assets. Tenex IV will seek to invest in 16 to 18 portfolio companies over 5 years, targeting equity investments of \$50 million to \$100 million each. Pending approval of the proposed recommendations, Tenex would represent 3.5% of ERSRI’s Private Equity portfolio and 4.7% of the buyout exposure (NAV + uncalled commitment) (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, Tenex would represent ~4.9% of OPEB’s Private Growth exposure and ~6.6% of its Private Equity exposure (see *Appendix 5*).

## MERITS:

- **Strong Team:** Tenex has 7 managing directors who have worked together for an average of 16 years. Tenex has a 24-person hybrid investment-operating team which focuses on performing due diligence, executing transactions, and driving value creation initiatives. They also have a 10-person professional team that focuses on administration. Additionally, they have a team of 22 “Operating Advisors”; this group takes an active “boots on the ground” position in portfolio companies where needed to manage and drive day to day changes alongside the company employees. The Operating Advisors team is divided into general leadership and subject matter experts and are deployed to portfolio companies, full time. Additionally, all team members have carry, which creates an alignment of interest.
- **Sourcing:** Tenex typically sources deals through relationships with boutique investment banks who have strong connections to local businesses. Additionally, the firm focuses on sourcing via “long tail” brokers, which is where they find family-owned businesses. Utilizing this smaller intermediary community to source deals helps to reduce competition from other firms as these deals are typically harder to find. Tenex sees around 1,600 deals a year. They are able to acquire these family businesses as a result of their strong reputation for keeping the culture and legacy of the family business intact. They employ a “buy like they are going to own forever” mentality that resonates with sellers.
- **Established and Repeatable Process:** Tenex has a process called the “Three-Step Tenex Approach”, which is a repeatable approach they have successfully employed across their funds. This process involves reducing fixed costs, improving operations to reduce variable costs and create efficiency through automation and process, and inorganically growing the company through complementary “add-ons”. Additionally, the firm utilizes the “Tenex Tech Stack”, which consists of Tech enabled operational improvements such as data analytics tools to track and visualize performance metrics. The firm’s ideal target is a company where implementation of increased operating leverage, rather than just high financial leverage, can significantly increase the efficiency and output of a portfolio company’s assets. Tenex prefers to use balance sheet leverage over debt leverage because it is less risky.

## CONCERNS:

- **Key Person Succession Plan:** Co-founder Mike Green is in his mid-60’s and will be moving into a chairman position for fund V. There is currently no established succession plan.
  - **Mitigant – Building a Succession Plan:** Tenex is in the process of creating a succession plan for Mike Green. Currently they are looking at three of their managing directors. They would also be okay with co-presidents, even having all 3 of them take over. These plans have been discussed with all managing directors and seem to be well received.
- **Rapid Growth:** The firm has grown quite a bit in a short period of time which could cause a lack of integration with the new team members as well as a change in organizational culture.
  - **Mitigant – Long-Tenured Team:** The three co-founder managing directors have been working together for an average of 20 years. Additionally, a majority of the new hires have been recruited at the associate level which will allow the team to grow organically.
- **Strategy Shift:** Tenex recently pivoted their strategy away from deep value and turnaround-type of situations and are not as focused on purchasing companies at low multiples. They are now looking for companies that need operational improvements but are stable overall. This has performed well in the previous market regime, but we are yet to see if this strong performance will continue in today’s more challenging environment.
  - **Mitigant – Long-Tenured Team:** This shift was made due to poor fund I performance which required them to reassess and adjust strategically. As a result, they were able to produce strong performance in funds II and III. Tenex still aims to purchase companies for lower entry multiples, but this shift should reduce risk as the companies will be more established with less capital required to make the company operationally sound and a lower risk of failure.

**ESG:** Tenex Capital Partners is rated as an **Integrator** with respect to their ESG practices.

- **ESG:** Tenex considers ESG in their due diligence process. In January 2023, Tenex became a signatory to the ESG Data Convergence Initiative (“EDCI”). Tenex has established an informal ESG Committee that meets biannually and oversees the overall strategic ESG direction of the Firm. Tenex provides annual ESG training to the Firm and Operating Advisors. Additionally, Tenex recently began utilizing an external ESG due diligence

provider, Environmental Resource Management (ERM) in addition to their own internal review. Tenex aims to improve the ESG metrics of portfolio companies.

- **DEI:** Tenex engages with recruiting Firms to ensure a diverse candidate pool during the hiring process. Additionally, the firm hosts special events, removes gendered language in job postings, utilizes diverse interview panels, and uses an interview scorecard in order to attract and hire diverse candidates. Tenex also provides unconscious bias training for employees in addition to conducting an annual employee engagement survey.

**FEES:** Fees for Tenex are in-line with industry standards.

- **Management Fee:** The Fund will charge a 2% management fee during the investment period and 1.75% of net invested capital thereafter. The management fee will be offset by 100% of fees.
- **Carried Interest:** 20% carried interest on a deal-by-deal basis. 8% preferred return. Catchup 80% GP / 20% LP

## Appendix 1: ERSRI Prior Fund Exposure

Current Partnerships	Fund Exposure*						
	Vintage Year/ Initial Investment	Type	Amount Committed	Amount Drawn	Amount Distributed	Amount Unfunded	Valuation
Tenex Capital Partners II, L.P.	2016	Buyout	\$25,000,000	\$ 28,450,239	\$ 38,848,649	\$ 3,423,489	\$23,876,095
Tenex Capital Partners III, L.P.	2021	Buyout	\$30,000,000	\$ 19,952,834	\$ 10,767,937	\$12,579,114	\$25,113,983

\*Data as of 9/30/2023

## 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	Distributed to Paid-In Capital	MSCI ACWI Net Index PME IRR**	Fund Excess Return (Fund IRR - PME)
Tenex Capital Partners II, L.P.	2016	Buyout	24.73%	2.20	1.37	11.71%	13.02%
Tenex Capital Partners III, L.P.	2021	Buyout	204.80%	1.80	0.54	25.26%	179.54%

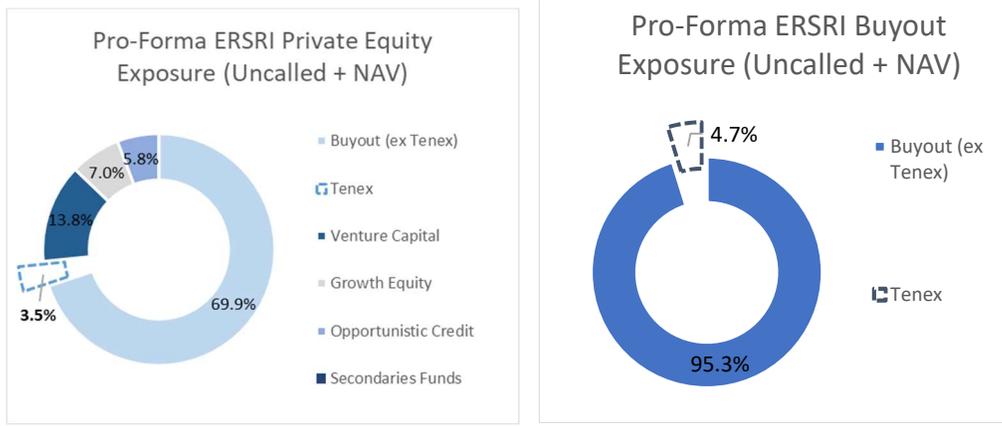
\*Data as of 9/30/2023

\*\* Long Nickels PME Methodology

## Appendix 3: ERSRI Private Equity Buyout Managers

Manager	Buyout (ERSRI)		
	Geographic Focus	Sector Focus	Size
Advent International	Global	Diversified	Large
Altaris Capital Partners	North America	Healthcare & Lifesciences	Middle
Bain Capital	North America	Diversified	Large
Baring Private Equity Asia	Asia	Diversified	Large
Birch Hill Equity Partners	North America	Diversified	Middle
Carlyle Group	Asia	Diversified	Large
Centerbridge Partners	Global	Diversified	Middle
Charlesbank Capital Partners	North America	Diversified	Middle
CVC Capital Partners	Europe	Diversified	Large
EnCap Investments	North America	Energy	Middle
Endeavor Capital	North America	Diversified	Small
Eureka Equity Partners	North America	Diversified	Small
First Reserve	Global	Energy	Middle
ECM Equity Capital Management	Europe	Diversified	Middle
Green Equity - Leonard Green & Partners	North America	Diversified	Middle
Hastings Equity Partners	North America	Energy	Small
Havencrest Capital Management	North America	Healthcare & Lifesciences	Small
Nautic Partners	North America	Diversified	Middle
Nordic Capital	Europe	Diversified	Middle
Oaktree Capital Management	Europe	Diversified	Middle
Odyssey Investment Partners	North America	Diversified	Middle
Paine Schwartz Partners	North America	Diversified	Middle
Parthenon Capital	North America	Diversified	Middle
Pollen Street Capital	Europe	Business & Financial Services	Middle
Providence Equity Partners	North America	Media, Entertainment, & Communication	Middle
Riverside Company	North America	Diversified	Middle
RLH	North America	Business & Financial Services	Middle
Siris Capital Group	North America	Software & IT	Middle
Southvest - Gen Cap America	North America	Diversified	Small
Tenex Capital Management	North America	Diversified	Middle
Thoma Bravo	North America	Software & IT	Middle
TPG Capital	Global	Diversified	Large
Trilantic Capital Management	Global	Diversified	Middle
Vinci Capital	Latin America	Diversified	Middle
Wynnchurch Capital	North America	Manufacturing & Industrial	Middle

## Appendix 4: ERSRI Portfolio Fit



## Appendix 5: OPEB Portfolio Fit

