



State of Rhode Island
Office of the General Treasurer

Parthenon Investors VII, L.P. - Staff Recommendation
February-2023

RECOMMENDATION:

- **Rhode Island Employees Retirement Systems Pooled Trust: Approve a commitment of up to \$35 million to Parthenon Investors VII, L.P. (“Fund VII”) and authorize potential follow-on investments of up to \$5 million in aggregate in Fund VII co-investments pending Staff, Cliffwater, and legal review.** ERSRI previously committed \$45 million to Parthenon Investors VI, L.P. (“Fund VI”), a 2020 vintage fund, \$23.96 million in Parthenon Investors II, L.P. (“Fund II”), a 2001 vintage fund, and \$15 million to Parthenon Investors, L.P. (“Fund I”), a 1998 vintage fund. Funds I and II were formed by the predecessor to Parthenon Capital Partners and the firm transitioned leadership teams late in the term of Fund II.
- **Rhode Island OPEB System Trust: Approve a commitment of up to \$1 million to Parthenon Investors VII, L.P.**

Active Parthenon Funds as of 9/30/2022			Values in USD				Net Performance		
Current Partnerships	Vintage Year/ Initial Investment	Type	Amount Committed	Amount Drawn	Amount Distributed	Amount Unfunded	Valuation	Net IRR (%)	Net Multiple of Investment
Parthenon Investors II, L.P.*	2001	Buyout	23,960,000	23,409,381	37,994,886	1,821,022	267,946	12.31%	1.63
Parthenon Investors VI, L.P.	2020	Buyout	45,000,000	14,507,757	-	30,490,808	18,117,227	22.23%	1.25

*Parthenon Investors II, L.P. was managed by the predecessor organization to Parthenon Capital Partners during its deployment period

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

SUB-STRATEGY: Buyout & Growth Equity

ALLOCATION:

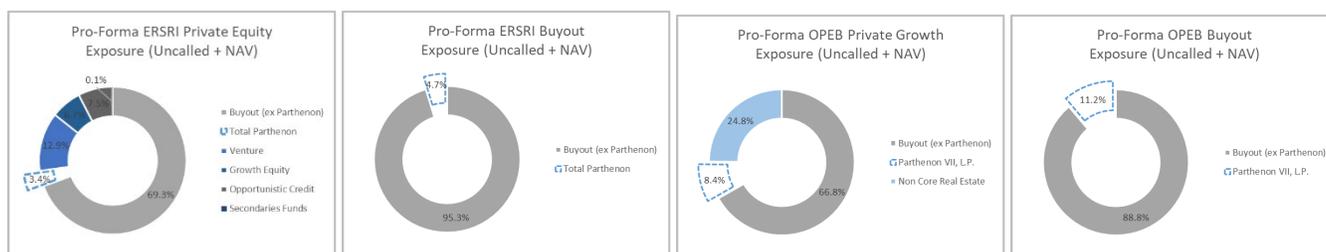
- **Rhode Island Employees Retirement Systems Pooled Trust:** The target allocation for Private Equity is 12.5% and the allocation as of 1/31/2023 is ~16.2%. The current pacing plan for the 2023 vintage is \$200 million committed to 5-10 funds at \$15-40 million per fund. Pending approval of the recommendations presented at the February 2023 SIC meeting, ERSRI’s 2023 vintage commitments will be \$50 million.
- **Rhode Island OPEB System Trust:** The target allocation for Private Growth is 5% and the actual allocation as of 1/31/2023 is ~0.3%. 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 presented at the February 2023 SIC meeting, OPEB’s 2023 vintage commitments will be \$2 million.

PORTFOLIO FIT:

- **Rhode Island Employees Retirement Systems Pooled Trust:** 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 approximately at 60-80% of the allocation to be in the buyout sub-strategy diversified by geography, sector, and company size. The core of the buyout exposure is composed of U.S. middle-market strategies with a sector focus and/or operational value-add strategy. Parthenon’s strategy fits well within this segment of the portfolio. The firm primarily invests in U.S. middle market control buyouts within healthcare services, financial services, and business and technology services industries. Approximately 75% of deals will be buyouts, with the remainder being growth equity deals with certain control rights. Parthenon will target a portfolio of 13-15 companies with the average investment sized between \$40-200 million. The strategy generally acquires companies with entry enterprise

values of \$100-750 million and EBITDA over \$7.5 million. Parthenon will take a hands-on value add approach to accelerate portfolio company growth through actions such as recruiting top tier management teams, completing add-on acquisitions, transforming technology, and pivoting the firm’s focus to attractive market segments. Pending approval of the proposed recommendations, Parthenon would represent ~3.4% of the Private Equity portfolio and ~4.7% of the buyout sub-strategy for ERSRI.

- **Rhode Island OPEB System Trust:** 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. To-date, OPEB’s exposure in the Private Equity sub-strategy have included four buyout commitments, each sized at \$2M. Pending approval of the proposed recommendation, Parthenon would represent ~8.4 % of Private Growth and ~11.2% of buyout within OPEB.



MERITS:

- **Highly Specialized Sector Expertise:** Parthenon’s core strength is its “micro-specialization” approach to identifying attractive subsegments within its three target sectors. The firm uses a rigorous thesis-driven approach to identify \$1-5 billion target niches at which size the firm can identify companies with current or potential for meaningful market participation. Parthenon investment professionals are formally incentivized to conduct regular sector research projects (“Deep Dives”) during which they will network with industry professionals, attend trade shows, identify and benchmark core operational metrics, and create market maps of key companies from which they will identify priority acquisition targets. The firm has conducted over 275 such Deep Dives over the past 15 years and 100% of their portfolio companies were acquired following a Deep Dive process.
- **Demonstrated Value-Add Success:** During the Deep Dive process, Parthenon identifies acquisition targets that exhibit one or more “discount criteria,” a set of 15 factors that Parthenon expects will allow it to acquire a company at a lower valuation than leading industry peers. Parthenon then works to address these discount criteria, which typically take the form of some departure from best practice that can be addressed over Parthenon’s hold period. About 75% of Parthenon companies have been founder-owned, making them well-suited to benefit from Parthenon’s value-add initiative. A common initiative of Parthenon is to make transformative acquisitions to gain share and over 70% of Parthenon’s companies have completed at least one add-on. Parthenon is often able to hit the ground running, implementing several value-add enhancements pre-closing or in-parallel to closing, including lining up add-ons and installing new management. As a result of these actions, Parthenon has generally been able to drive average annual portfolio EBITDA growth rates of over 15%.
- **Strong and Stable Team:** Leading this strategy is Parthenon’s strong senior team headed by co-CEOs Dave Ament and Brian Golson and supported by CIO Will Kissinger as well as four investment partners. The senior management team is deeply experienced in Parthenon’s investment process with an average tenure of over 15 years at the firm. The firm also benefits from a 9-person Resource Team that spearheads implementation of value-creation initiatives in areas such as capital markets, human capital, and technology strategy. Overlaying its full-time staff is Parthenon’s Industry Advisory Council, a collection of industry insiders that includes CEOs and executives within Parthenon’s three focus sectors that provide additional expertise and assist in sourcing new deals.

CONCERNS:

- **Concern – Fund Size Increase:** Fund VII’s will target \$3.5 billion of LP commitments with a hard cap of \$4.25 billion, an increase of ~55-90% from the \$2.2B committed to Fund VI. As a result of the increase, Parthenon may experience greater difficulty deploying capital and managing its growing portfolio of companies.
 - **Mitigant – Team Growth:** This is mitigated by fact that Parthenon has grown its employee count from 43 professionals to 61 between funds, with a particular focus on adding headcount in its Resource Team which is heavily involved in managing its companies.
 - **Mitigant – Added Flexibility:** The increase in capital should also help Parthenon invest in add-ons and could allow them to pursue larger companies.
- **Concern – Premium Carry Structure:** Fund VII charges an elevated carry fee structure, which is not in-line with peers (see Fees section).
 - **Mitigant – Differentiated Net Performance:** Parthenon has demonstrated a differentiated strategy which has generated premium net returns to its investors, with the manager’s mature funds ranking in the top quartile or decile of IRR and TVPI.
 - **Mitigant – High Level of GP Contribution:** Parthenon has historically contributed a greater share of capital to its funds than is standard in the industry and will target a GP contribution of 5% or greater to Fund VII, providing for strong alignment.
 - **Mitigant – Engagement on Co-Investment Opportunities:** To help address the fee burden, Parthenon has agreed to engage Rhode Island in potential Fund VII co-investment opportunities. Any such investment pursued by Rhode Island would be managed on a no-fee, no-carry basis and reduce the blended fee for capital invested in Fund VII companies in aggregate.

ESG:

- **ESG:** Parthenon is classified as an ESG **Integrator**. In 2021, Parthenon conducted its first strategic ESG/DEI review and developed a 2-year responsible investment plan for 2022-2023. This resulted in the creation of a responsible investment policy and a detailed social and governance (“S&G”) checklist which is reviewed during the due diligence process. Parthenon investment professionals will score various S&G criteria and plan remedies for factors that do not meet a minimal threshold. In 2022, Parthenon also began an annual portfolio company survey to assess corporate policies and collect certain KPIs to aid assessment of ESG and DEI factors. Parthenon intends to create a new 2-year responsible investment plan biennially.
- **DEI:** Parthenon is committed to a culture of equity and inclusion in its firm and portfolio companies. As part of its strategic ESG/DEI review, Parthenon adopted a DEI Statement and substantially revised its parental leave policy to provide more gender neutral and inclusive benefits. The firm also created two affinity groups focused on professional development and advancement of underrepresented groups in the private equity industry. As part of Parthenon’s annual portfolio company survey, it has also begun collecting employee diversity metrics and assessing company governance and DEI-related policies.

FEES: Fees for Fund VII are not in-line with industry standards.

- **Management Fees:** Fund VII will charge a 2% management fee on commitments during the investment period and 1.5% on invested capital thereafter, with a 100% offset for director, transaction, monitoring expenses.
- **Carried Interest:** Carried interest will be charged in a tiered structure over an 8% hurdle, beginning at 20% until LPs achieve a net return of 2x and increasing to 25% thereafter. Carry is on a deal-by-deal basis with a 100% GP catch up until the 20% carry level, and 50% to get from 20% to 25% carry if Parthenon exceeds the 2.0x threshold.
- **Potential Co-Investments:** Any potential co-investment opportunities offered to Rhode Island would have an attractive fee structure of 0% management fee and 0% carry.