

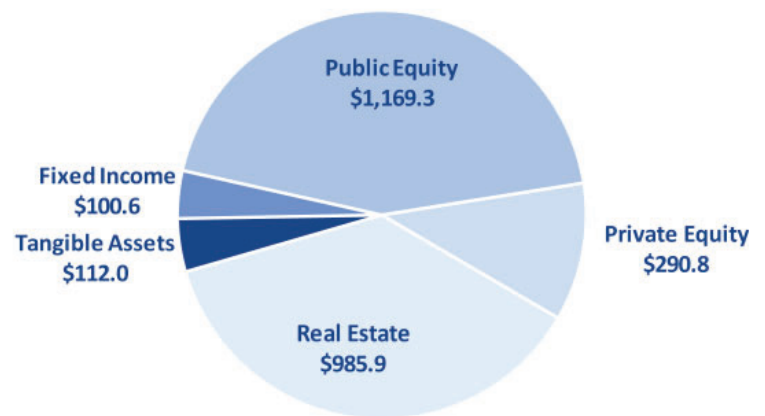


INVESTING IN WASHINGTON

While the Washington State Investment Board continually seeks the best investment opportunities no matter where they might be located worldwide, the state of Washington is home to many tremendous companies that offer the WSIB excellent investment opportunities. Many Washington investments can be found in all of the WSIB's investment portfolios.

The Economically Targeted Investment (ETI) Policy was adopted by the WSIB in March 2003 to confirm that the Investment Board will continue to seek quality investment opportunities in Washington state in accordance with established policies, statutory mandates and fiduciary duties.

The ETI policy directed WSIB staff to provide an annual progress report to the Board, beneficiaries, the Legislature and the Governor on Washington-based investment initiatives involving the WSIB, its private equity General Partners, and other groups and organizations working to improve economic opportunity and growth statewide.



Note: The private equity and real estate totals are WSIB's proportional share of the estimated fair market value of fund and property investments held by partnerships in which the WSIB participates.

Washington State Investment Board Economically Targeted Investments Policy



**2018 Annual Report
February 21, 2019**

Introduction and Summary

At the core of the Washington State Investment Board's (WSIB or the Board) risk management program is the fact that we build globally diversified investment portfolios. As of September 30, 2018, the Board managed \$132.3 billion in 34 funds investing on 6 continents, in 85 countries, within 44 currencies, and over 15,000 investment holdings. The Board conducts its investment activities in accordance with investment policies and procedures designed to maximize return at a prudent level of risk. Asset allocation explains over 90 percent of the variability of return. Accordingly, the WSIB invests in global asset classes including public equity, fixed income, real estate, tangible assets, and private equity to help control risk and ensure stronger overall performance.

This is the sixteenth annual report on the WSIB Economically Targeted Investments (ETI) policy. This year's annual poll of the WSIB's private equity general partners' (GPs) deal flow activity for the year ended September 30, 2018, shows continued interest and activity. Key findings include the following:

- 26 GPs looked at 346 Washington-based investment opportunities.
- 98 investment opportunities were still under consideration as of September 30, 2018.
- 19 investments were completed.
- Venture capital and private equity firms continue to look at investments in the region.

Washington is rich with investment opportunity and has earned the interest of and access to top quality GPs. The WSIB's GPs continue to actively seek quality Washington-based opportunities, and investments are being made in Washington based companies.

The WSIB believes the state of Washington is an excellent place in which to invest a portion of the trust funds under management by the Board. As of June 30, 2018, \$2.7 billion in value was held in the WSIB investment portfolio in Washington-based investments through its public equity, fixed income, real estate, tangible assets, and private equity investment programs. Each investment was made consistent with the WSIB's statutory mandate. This \$2.7 billion investment in Washington represents approximately 2.7 percent of the state's Commingled Trust Fund (CTF), while the state's gross domestic product (GDP) is only 0.6 percent of the GDP for the investible universe within which the WSIB invests. Private equity commitments of \$15.5 billion have yet to be called, representing significant capital ready to be put to work as qualified investment opportunities arise. Further, the Washington-based investments made by the WSIB's GPs significantly leverage additional capital from other sources to be put to work in the state.

The WSIB has made a strong commitment to facilitate access to and awareness of quality in-state investment opportunities. Further, it has devoted resources to implement that policy and to track in-state investment activity. The WSIB continues to interact with regional partners and various economic development networks to assist Washington companies to achieve exposure to appropriate potential sources of capital.

Overview of Policy

The WSIB's private equity portfolio originated in 1981 and is invested in limited partnerships. Each partnership, which is managed by a GP, acquires or creates ongoing businesses or operating companies at the discretion of the GP. Ultimately, the companies are sold in the public market or to strategic or financial buyers, and only then can the true return on investment be accurately measured. To meet return and plan objectives, the WSIB's private equity portfolio has diversified investments in a broad cross section of sub-sectors, industries, and geographic regions, including Washington and other Northwest states.

In March 2003, the Board adopted an ETI policy to communicate the roles and responsibilities of the WSIB relative to such initiatives. ETIs are defined in this instance as investments having the primary objective of investment return to pension trust fund assets with the possible collateral effect of assisting the regional economy and the economic well-being of the state of Washington, its localities, and its residents.

In the ETI policy, the Board reiterated its “fiduciary duty to invest and to manage the entrusted funds in a manner consistent with statutes, regulations, Board policies, and the highest standard of professional conduct for the exclusive benefit of fund beneficiaries.” The Board has established written policies and procedures for all its investments “designed exclusively to maximize return at a prudent level of risk.” The Board will continue to seek quality investment opportunities within the state in accordance with its established policies, statutory mandates, and fiduciary duty.

The Board requests its private equity GPs report annually on Washington-based investments evaluated during the prior year. Private equity investments include securities that are generally not listed on a public exchange and are not easily accessible to most individuals. These investments range from initial capital in start-up enterprises to leveraged buyouts of mature corporations. Private equity investments are typically long-term commitments that may last up to 12 years or more. Although less liquid, and perhaps more risky than publicly traded investments, private equity investments can offer higher returns than traditional public equity and are an attractive asset when employed as part of a larger, balanced portfolio.

The Board established a staff role to facilitate the exchange of information between its private equity GPs and appropriate parties with knowledge of quality in-state investment opportunities and, in accordance with the ETI policy, provide this annual report of relative activities to the Board, beneficiaries, Legislature, and Governor.

Investment Environment

Although the WSIB portfolio comprises asset classes other than private equity, much of the following report focuses on private equity, including venture capital. This is due to the fact that the policy reporting is focused only on private equity, and much of the in-state investment activity of interest has been focused on the venture capital arena.

One way to view the investment environment is to start with a view from the top down and describe the climate at the national level, along with industry specific and investment stage indicators. Since the economic downturn in 2008 and 2009, venture capital investing in the U.S. has generally been strong and growing overall. However, the upward trend has been interrupted periodically by political or economic concerns. The periods of weakness have typically lasted only a quarter or two, and then been followed by recovery in the venture capital investment pace. The pace of investment during the last 5 years has been strong.

According to the *MoneyTree Report* by PricewaterhouseCoopers (PwC) and CB Insights (*MoneyTree Report*), U.S. venture capitalists invested \$27.5 billion in 1,229 deals in the third quarter of 2018. The dollar amount was a 17 percent increase compared to the second quarter, while the number of deals completed declined 18 percent. There have now been 20 consecutive quarters in which over \$10 billion was invested in a quarterly period. During the third quarter there were 55 transactions that had a value in excess of \$100 million and they represented 51 percent of total dollars invested in the quarter. This represents the continuation of the trend of firms remaining private for longer periods and leading to larger private market funding requirements.

Venture capital investments during the first 9 months of 2018 were \$73.7 billion in 4,119 deals. This was an increase of 32 percent on a dollar basis and a decrease of 6 percent for the number of deals completed compared with the same period in 2017, when \$55.9 billion was invested in

4,361 deals. The average deal size for this period was \$17.9 million compared to the prior year period amount of \$12.8 million, reflecting the impact of large transactions.

The internet sector received the highest level of funding in the third quarter of 2018, at \$10.7 billion and 43 percent of deals completed. Next highest was the healthcare sector at \$5.4 billion and 17 percent of deals completed, followed by mobile & telecommunications at \$4.1 billion and 12 percent of deals completed.

Deal activity was highest for early stage deals at 27 percent of the total, followed by expansion stage at 24 percent and seed stage at 18 percent. Corporate participation increased to 29 percent of the transactions completed, compared to 26 percent in the prior quarter. Companies taking venture capital funding for the first time comprised 32 percent of the overall deal activity level and amounted to \$3.6 billion of the dollar amount.

As usual, California was the state that received the highest level of funding at \$14.6 billion from 477 transactions. This represented 53 percent of the dollar amount invested and 39 percent of the number of deals completed in the third quarter of 2018. Washington was in fifth place for the number of deals completed at 43, and fourth place for dollar amount invested at \$638 million in the period.

According to PwC/CB Insights MoneyTree data, for the 12-month period ended June 30, 2018, the number of deals done in the U.S. and Northwest increased slightly, while deals done in Washington decreased, as compared to the period ended June 30, 2017. Regarding dollars invested, the amounts were higher for the U.S., Northwest, and Washington, as compared to the period ended June 30, 2017. In the most current 12-month period, venture capital investments in the U.S. totaled \$84.5 billion in 5,394 deals, up 36 percent with respect to amount invested and up 1 percent for the number of deals. Of that U.S. total, \$2,810.4 million (up 51 percent) was invested in 235 deals (up 2 percent) in the Northwest region (defined as Washington, Oregon, Idaho, Montana, and Wyoming). Washington captured 170 of the Northwest deals (down 6 percent) and \$2,093 million of the newly invested dollars (up 37 percent). Venture backed transactions in Washington have exceeded \$1.0 billion in each of the last five 12-month periods ended June 30. Based on the PwC/CB Insights MoneyTree data, capital being invested into Washington companies appears to be continuing at an active level. During this same time frame, WSIB GPs called \$4.5 billion (WSIB's portion) of capital, including approximately \$18 million for Washington-based companies.

For the first three quarters of 2018, 230 U.S. venture capital funds raised \$32.4 billion, according to the PitchBook-National Venture Capital Association Venture Monitor (*PitchBook Report*). This amount compares to \$35.3 billion in 288 funds for all of 2017. The pace of capital raising continues to be healthy with over \$30 billion raised by venture funds during each of the last 5 years. The *PitchBook Report* also indicated that funds continue to increase in size. So far in 2018, 27 funds in the \$250 million-\$500 million range have been raised, surpassing 2017's final count of 25. In addition there have been five funds closed at \$1 billion or greater, as compared to three funds during 2017.

Firms with offices in the Northwest which reported raising funds during 2018 included Flying Fish Partners (Fund I for \$27.8 million), Founders' Co-op (Fund IV for \$10.7 million), Frazier Healthcare Partners (Health Care Growth Buyout Fund IX for \$720 million), Madrona Ventures (Fund VII for \$300 million), Pioneer Square Ventures (Fund I for \$80 million), and SeaChange Fund (Fund IV for \$4.6 million).

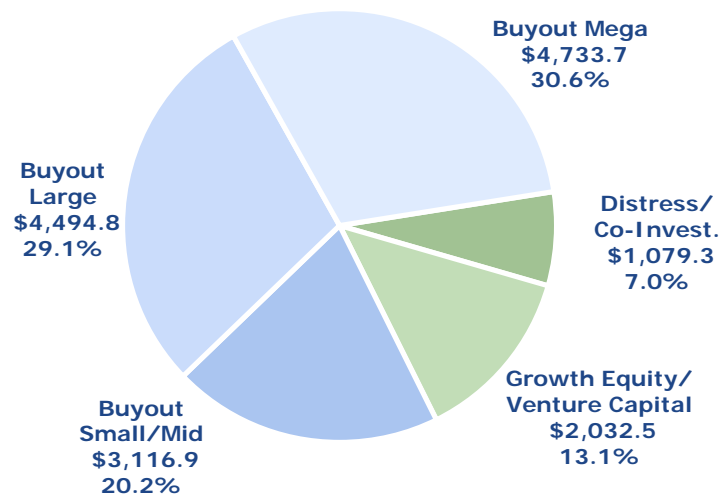
An October 2018 report in the *Puget Sound Business Journal* presented details on the largest venture capital and private equity firms in the Puget Sound region and investment activity in 2017. The 15 firms listed reported a total of \$14.8 billion of funds under management. Not all firms provided detail on deals done in Washington during 2017, but for those that did report, the total

invested was \$257.3 million in 117 Washington-based deals. This compares to \$16.6 billion of assets under management and \$212.7 million invested in 145 Washington based deals from the list presented last year for 2016.

According to a report prepared by Renaissance Capital, during 2018 there were 191 U.S. initial public offerings (IPOs), which raised \$46.8 billion. This was an increase of 19 percent in the number of IPOs and 32 percent in proceeds generated. Activity level was reported to have been driven by healthcare, technology, and Chinese issuers. There were four IPOs completed by Washington based companies in 2018: Avalara, Inc., Coastal Financial Corporation, nLight, Inc., and Smartsheet Inc. This is up from 2017 when two IPOs were completed by Washington based companies.

A review of the \$15.5 billion WSIB private equity overhang by strategy at June 30, 2018, points out that 79.9 percent of the unfunded commitments are in the area of corporate buyouts, including the Mega, Large, Medium, and Small strategies. The Growth Equity/Venture segment was 13.1 percent of the unfunded commitments and Distressed/Co-Investment was 7.0 percent. Overall the unfunded commitments increased \$2.8 billion, from \$12.7 billion last year, reflecting an active pace of new partnership commitments during the period. The unfunded commitment amount provides substantial capital for new private equity investments, including possible Washington-based investments.

Portfolio Allocation by Strategy Based on Unfunded Commitments at June 30, 2018 (\$ Millions)



Discussions regarding Washington-based investments often focus on the dollars WSIB has invested in Washington transactions through its GPs. While this is an important amount, it may also be useful to expand the perspective to consider the total amounts invested by WSIB GPs in Washington based transactions. For example, as of June 30, 2018, the WSIB had invested approximately \$546 million as a limited partner through the Private Equity program in Washington based transactions. However, the total amount invested by WSIB GPs in Washington based transactions was \$9.5 billion. This amount reflects capital from other limited partners and the GPs, which has been invested in the same transactions. The total amount invested is 17x the amount from only the WSIB. The true impact of the WSIB investment on the Washington economy is substantially enhanced by recognizing the total amount invested by the WSIB GPs, not simply the WSIB portion.

The Puget Sound has also given rise to the growth and development of numerous businesses and professional organizations in the past decade that provide entrepreneurs and small companies with guidance and mentoring, networking, and showcase events to potential investors.

It does appear that investment capital is available to support the growth of technology companies in Washington State and the U.S. Interesting investment opportunities continue to attract dollars, whether from local players or more remote sources.

Investments in Washington

The WSIB seeks the best investment opportunities no matter where they might be headquartered. The state of Washington is home to many successful companies, and Washington-based investments can be found in many WSIB investment portfolios. The following table reflects a summary of Washington investments in the WSIB CTF portfolio at each fiscal year ended June 30 for the years 2013 through 2018.

Washington Investments in the WSIB CTF Portfolio						
Investment Class	Value - Fiscal Year Ended June 30 (\$millions)					
	2013	2014	2015	2016	2017	2018
Public Equity	\$427.7	\$474.6	\$557.8	\$652.3	\$1,027.5	\$1,169.3
Fixed Income	63.3	68.6	66.3	66.3	104.9	100.6
Real Estate	622.3	789.5	847.9	906.0	1,043.1	985.9
Tangible Assets	41.0	24.5	23.6	23.2	80.8	112.0
Private Equity	185.5	234.1	269.3	211.1	190.8	290.8
Total	\$1,339.8	\$1,591.3	\$1,764.9	\$1,858.9	\$2,447.1	\$2,658.6

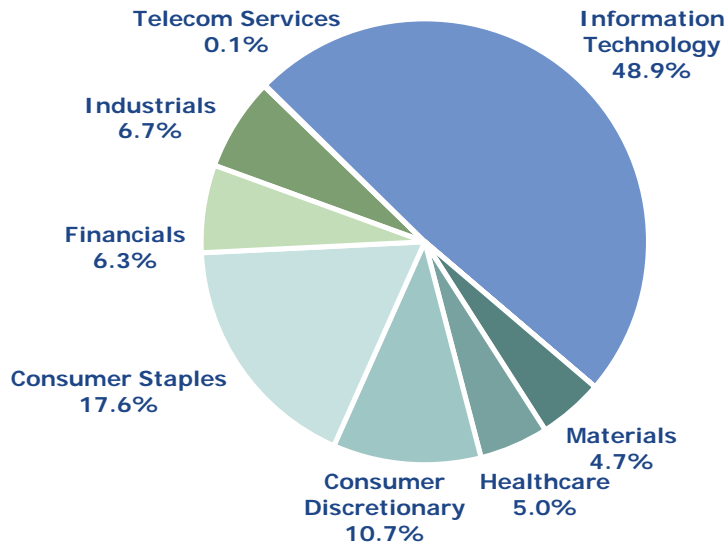
Notes: Values include Boeing. No Washington based investments held in the Innovation Portfolio.

The WSIB CTF portfolio contains numerous public equity and fixed income investments in Washington-based companies. In the year-over-year comparison, the June 30, 2018, total value was up \$211.5 million or 8.6 percent. The value of public equities increased 13.8 percent; this was due to the strong stock price performance of many large Washington-based companies that are heavily represented in the passive indices, somewhat offset by reductions in holdings by several active managers. The value for fixed income declined 4.1 percent and reflects the market value of holdings. The 5.5 percent decrease in investment value for real estate reflects a combination of acquisitions and dispositions, as well as increases and decreases in values at the property level. It also reflects, in some cases, changes due to financing and refinancing activities. The tangible assets investment value increased \$31.2 million, or 38.6 percent, due primarily to recent investments in Washington timberlands.

The 52.4 percent increase in value year-over-year for private equity was due to approximately \$18.1 million new in-state investments combined with substantial appreciation in the fair market value for various companies in the past fiscal year, less \$76.3 million returned in distributions. As of June 30, 2018, the WSIB had \$290.8 million of invested value in Washington-based companies in its private equity portfolio, representing approximately 2.2 percent of the total domestic private equity portfolio value. The fair market value is the value remaining of more than \$546 million invested by the WSIB since 1992 through its GPs. The current Washington-based investments have been made by 40 different funds managed by 24 individual GPs, 4 of which were regionally-based.

The following chart depicts the breakout of Washington-based investments in the private equity portfolio by industry. The largest concentration is in the Information Technology sector at 48.9 percent, followed by the Consumer Staples sector at 17.6 percent, and the Consumer Discretionary sector at 10.7 percent. The Information Technology sector increased from 43.4 percent last year to the current level, due mainly to capital appreciation during the past year. The Healthcare sector experienced the most significant decrease in exposure moving from 14.9 percent last year to the current level of 5.0 percent. The change was primarily due to a significant realization.

Private Equity Holdings in Washington-Based Companies by Industry at June 30, 2018



At June 30, 2018, the WSIB’s private equity portfolio, invested with 101 GPs in 267 partnership funds, was valued at \$21.8 billion. An additional \$15.5 billion had yet to be called by the GPs. The unfunded commitment represents a significant amount of capital to be invested in the future by current WSIB GPs, many of whom actively review and evaluate investments in Washington State.

Highlights of 2018 ETI Activity

WSIB staff has sustained program efforts to provide exposure and understanding of the Board’s policy in the state and establish contact with the local and regional organizations and networks in order to accomplish successful implementation of the ETI policy.

Regional Funds

Since 2000, the WSIB has invested in funds managed by six regional firms. Endeavour Capital is still actively investing funds to which the WSIB has made commitments. Endeavour SEAM, Evergreen Pacific Partners, Frazier Healthcare Ventures, OVP Venture Partners, and Polaris Venture Partners (Seattle office closed during 2011), are no longer in active investment periods. During 2018, staff continued to conduct meetings with regional funds. The meetings with over 100 firms and interested parties in the past 16 years have focused on developing strong relationships with fund managers and initiating a long, deep due diligence process on the funds and their portfolio companies.

Staff has performed due diligence on regional funds raising capital, although most of the fund sizes are smaller or the funds younger than those WSIB usually invests in directly.

Annual GP Deal Flow

The WSIB conducted its sixteenth annual survey of the WSIB private equity GPs by sending letters to 39 GPs requesting information about their deal flow review in Washington for the year ended September 30, 2018, including the number of transactions done, number passed, and any still in process. The poll was sent to GPs that manage funds that have not completed their investment periods and that do invest within the U.S. The results continue to show strong, consistent, and active Washington deal interest. The following table highlights the results.

Annual Report for the Year:						
	2013	2014	2015	2016	2017	2018
Number of GPs involved	31 of 48	36 of 47	35 of 51	31 of 51	25 of 35	26 of 39
Transactions reviewed	1,515	1,029	747	879	413	346
Transactions not pursued	537	693	264	233	213	229
Number of GPs involved	26	22	22	19	11	13
Transactions in pipeline	956	310	447	616	187	98
Number of GPs involved	10	13	12	12	4	9
Transactions Completed	22	26	36	30	13	19

These responses suggest that Washington companies continue to earn the interest of top-quality GPs. It should be noted the private equity program transitioned to a lesser number of venture capital focused funds which are active in the WSIB portfolio. As such, they are no longer included in the GP survey. Primarily due to the lower number of active venture capital funds the number of GPs contacted, total transactions reviewed, and transactions still in the pipeline has declined compared to the 2013 to 2016 periods. However, the data continues to suggest that WSIB's GPs consistently review and do deals in Washington in the normal course of their business, aside from the advent of reporting that activity. Washington is rich with investment opportunity and does not appear to have a problem attracting venture capital and private equity firms to come to the region to check out companies, review deals, and fund their choice of opportunities. The data is also an important reminder that not all deals get done.

Regional Networks

Staff represented the WSIB at regional meetings and events. Each of these presented an opportunity to participate and, hopefully, contribute to the regional investment environment, broaden the WSIB regional contact base, and enhance the WSIB image. Staff will continue to build and strengthen these relationships over the long term to the benefit of all parties.

Looking Forward

The flexibility of the WSIB policy allows staff to respond to needs effectively as they arise. Personal contacts remain an important means to maintain valuable relationships with networks and interested parties in the state. Staff interaction with GPs will encourage sustained access and interest in Washington deal flow. The WSIB will continue to work with the Washington individuals and networks in place to:

- Assist Washington companies to achieve exposure to appropriate potential sources of capital through the WSIB's relationship with both local and national GPs and other funding sources.
- Expand ways the WSIB contributes and adds value to the regional environment.
- Enhance relationship building with regional GPs and other investment organizations.
- Continue to develop WSIB GPs' awareness of, and accessibility to, potential Washington opportunities.
- Maintain monitoring of targeted investment policies and programs in other states.

Staff will build on the policy implementation efforts to date to generate long-term results and continue to reflect the WSIB as a strong, interested ally and resource for the Washington investment environment.

Appendix

Dollars Invested and Number of Deals July 1, 2017, through June 30, 2018 (\$ Millions)

Washington

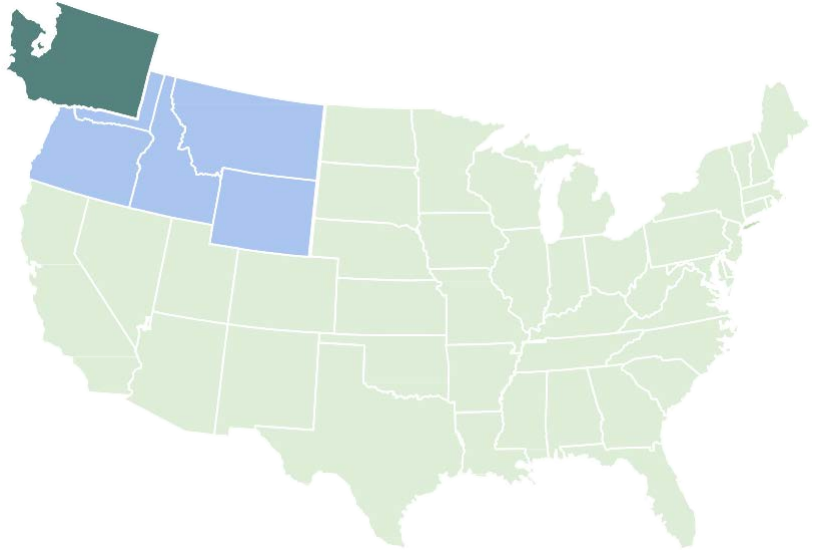
Number of Deals: 170
Amount: \$2,093

Northwest

Number of Deals: 235
Amount: \$2,810

U.S.

Number of Deals: 5,394
Amount: \$84,684



Source: PwC/CB Insights MoneyTree Report