Private Equity Stakeholder Project

September 2018

ENDEAVOUR CAPITAL PERFORMANCE LAGS PEERS

Private equity firm also slower at returning capital to investors

While some of Endeavour Capital's early funds were strong performers, the private equity firm has struggled to keep up with peers as it has raised larger funds in recent years.

KEY POINTS

- **Endeavour Capital is a Portland, Oregon-based private equity manager with investments focused on the Western US.**
- **While some of Endeavour Capital's early funds were strong performers, the private equity firm has struggled to keep up with peers as it has raised larger funds in recent years.**
- **As of the end of the fourth quarter 2017, Endeavour Capital's most recent funds–Endeavour Capital Fund V (2008), Endeavour Capital Fund VI (2011) and Fund VII (2014) all ranked in the 3rd or 4th quartiles relative to peers.**
- **Endeavour Capital has been slower to return capital to investors than peers. As of the first quarter 2018, Endeavour Capital's Fund V (2018), Fund VI (2011), and Fund VII (2014) all lagged the Cambridge Associates median in terms of Distributions to Paid-in Capital (DPI).**
- **The concentration of Endeavour Capital Funds V, VI and VII's value in current portfolio companies means that the funds' returns are more dependent on Endeavour's own valuations of its portfolio companies – and its ability to exit those companies at prices in line with or above those valuations.**

Endeavour Capital Fund VI owns Aladdin Bail Bonds, the largest bail bond company in the US. Photo: Jayne Lucas, California Dept. of Insurance.

As of the end of the fourth quarter 2017, data provider Pitchbook reported that Endeavour Capital's most recent funds – Endeavour Capital Fund V (2008), Endeavour Capital Fund VI (2011) and Fund VII (2014) all ranked in the 3rd or 4th quartiles relative to peers.[2]

As of the end of first quarter 2018, based on performance reported by one investor, both Endeavour Capital Fund V and Fund VI underperformed the median IRR for US private equity funds of the same vintage year as reported by Cambridge Associates.[3]

ENDEAVOUR SLOW TO RETURN CAPITAL TO INVESTORS

Endeavour Capital has been slower to return capital than peers. As of Q1 2018, Cambridge Associates reported that the median 2008 vintage fund had distributed 107% of its investors' called capital (1.07x distributions to paid in capital).[4] Endeavour Capital Fund V, however, had only returned 57% of the capital it called

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Recent Endeavour Capital funds have underperformed peers

FUND NAME	VINTAGE	SIZE	TVPI	IRR	BENCH	DIFF	QUARTILE
Endeavour Capital Fund VII	2014	$775.00M	1.16x	14.50%	14.68%	-0.18%	3 (Lower-Mid)
Endeavour Capital Fund VI	2011	$675.00M	1.45x	10.56%	14.70%	-4.14%	4 (Bottom)
Endeavour Capital Fund V	2008	$475.00M	1.69x	10.02%	11.75%	-1.73%	3 (Lower-Mid)

to investors.[5] Ten years after it launched, a greater share of Fund V's capital than peers' is locked up in investments it still owns – including K2 Insurance Services, medical device maker Providien, retailers New Seasons Market and Bristol Farms Market, and for-profit college chain Southern Careers Institute (Tall Oak Learning).

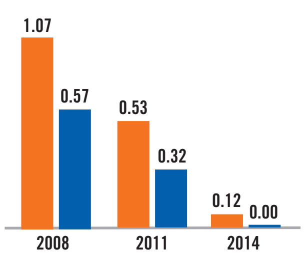
2011-vintage Endeavour Capital Fund VI has also lagged peers in returning capital. As of the end of the first quarter 2018, Fund VI had returned 33% of called capital versus 53% for the median US private equity fund.[6]

Finally, Endeavour Capital's newest fund, the 2014-vintage Endeavour Capital Fund VII had returned less than 1% of paid in capital as of first quarter 2018 versus 12% for the median 2014-vintage private equity fund.[7]

The concentration of Endeavour Capital Funds V, VI and VII's value in current portfolio companies means that their returns are more dependent on Endeavour's own valuations of its portfolio companies – and its ability to exit those companies at prices in line with or above those valuations.

A review of Endeavour Capital portfolio companies suggests investors may have reason to be concerned.

Distributions to Paid-In Capital (DPI), Endeavour Capital (blue) versus Cambridge Assoc median (orange)



Sample Endeavour Capital Portfolio Companies

ALADDIN BAIL BONDS/ SEAVIEW INSURANCE (ENDEAVOUR CAPITAL FUND VI)

In 2012, private equity firm Endeavour Capital invested in Aladdin Bail Bonds in order to "accelerate the timing of key strategic objectives, including vertical integration with a surety to provide bail bonds and expanding the brand across the U.S."[8]

Prior to Endeavour Capital's acquisition of Aladdin Bail Bonds and Seaview Surety, Aladdin operated 52 locations in three states – California, Idaho, and Washington.[9] Endeavour Capital's investment brought Aladdin and a surety company, Seaview Insurance, under common ownership, driving Aladdin's expansion.[10] Aladdin now operates in seven states – California, Idaho, Washington, Utah, Nevada, Ohio and South Carolina – and has applied to operate in at least one more (Texas).[11]

Seaview Insurance has paid out $7.4 million in dividends to its parent, controlled by Endeavour Capital, since 2016.[12]

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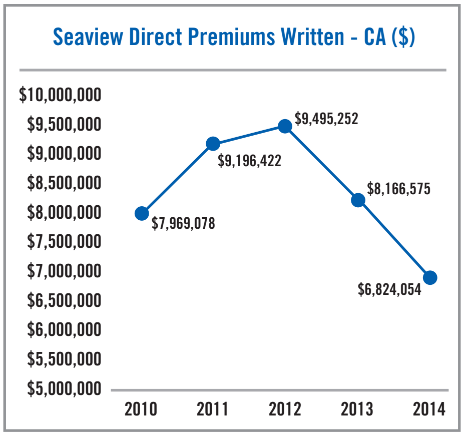

Yet a review of Seaview Insurance's annual statements suggest the bail bond insurer's revenue has dropped, particularly in Seaview/ Aladdin's core market of California.

In 2013, the year after Endeavour Capital acquired Seaview Insurance, it wrote $7.96 million in premiums, all in California.[13] Within two years, this had grown by 22% to $9.72 million in premiums in 2015. Yet the amount of premiums Seaview Insurance writes has since dropped to $7.15 million in 2017, 26% off of the peak and 10% less than in 2013. Since Seaview only writes bonds for Aladdin, the change in premiums written can be seen as a proxy for Aladdin's business more broadly.

The drop has been even sharper in California, where Seaview wrote 95% of its premiums in 2017.[14] Aladdin is the dominant bail bond agency in California. Premiums Seaview wrote in California rose from $7.97 million in 2013 to a peak of $9.50 million in 2015, but dropped by 28% to $6.82 million in 2017.[15]

The drop in Seaview's California premiums corresponds to the implementation of Proposition 47, a 2014 ballot measure aimed at reducing penalties for certain nonviolent drug and property crimes.[16]

While Seaview has sought to expand its geographic scope, states other than California still accounted for less than 5% of the premiums the company wrote in 2017.[17]

A recent report by insurance rating agency AM Best titled "Was 2017 the tipping point for the bail bonds industry" noted that Seaview and Aladdin's industry faces substantial headwinds driven by sentencing and bail reform efforts in several states.[18] From the report:

> State and federal lawmakers have proposed numerous bills aimed at reducing money bail as a means of pretrial detainment. With extensive reforms either enacted in 2017 or currently under consideration in a majority of states, a decided shift away from requiring money bail seems to be at hand. This appears to be particularly true with regard to misdemeanor and low-level felony cases and is likely going to be the rule more than the exception in the future. The impact could result in a significant shrinking of the surety bond market's bail bonds segment.[19]

The AM Best report notes that multiple states are debating changes that will limit—if not eliminate—cash bail and that Utah is working on changes to pretrial detention procedures.[20]

For the industry as a whole, bail bond premiums increased by double digits on a gross basis as well as net of commission and brokerage expenses in the five years before 2017, yet declined between 3% and 4% in 2017 compared to 2016.[21]

Seaview and Aladdin face shrinking premiums in a shrinking industry and increasingly find themselves at odds with bail and sentencing reform measures. In 2014 Aladdin was a funder of the (unsuccessful) opposition to Proposition 47 in California.[22]

In late August 2018, California adopted legislation banning for-profit bail, which will have a dramatic impact on Aladdin Bail Bonds' business.[23]

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ZOOM+CARE (ENDEAVOUR CAPITAL FUND VI)

In 2014, Endeavour Capital Fund VI invested in ZOOM+care, which operates a network of health clinics and a health insurance plan in the Portland and Seattle areas.[24]

In April 2017, Oregon insurance regulators took Zoom Health Plan into receivership after they "became aware of a material difference between the company's 2016 annual financial statement and its actual financial condition."[25]

Just months later, federal investigators began looking into the sudden demise of Zoom Health Plan.[26]

In September 2017, Endeavour Capital filed suit against Zoom Management Inc., alleging the company was "on the verge of running out of cash" and "on the brink of total failure."[27]

According to Endeavour Capital's complaint, "Since March of 2017, (Zoom Management) has faced repeated cash shortfalls, rendering it time and time again without sufficient funds to satisfy Zoom+Care's financial obligations and placing (Zoom Management) on the brink of insolvency."

The lawsuit surfaced a number of emails that suggest a long simmering dispute between ZOOM+Care's founders and Endeavour Capital and the dire situation Zoom found itself in:

"Life is too short. I don't want to work with you, I don't need to work with you, so I won't work with you. Your email has been blocked from our system. You're being uninvited from all meetings. You're being removed from all documents. I'm done with you." Email from Zoom CEO David Sanders to Endeavour Capital partner David Goldberg, February 11, 2017.[28]

"We are hiring people who are quitting good jobs to work for a company that cannot pay for basic services. We have patients who need flu shots, and we cannot pay the vendors. We have employees getting screaming phone calls from vendors. We have vendors who are small and suffering because of Zoom. We must decide. Are we going to continue to operate or shut down?" Email from Kathy McAleer, Zoom Management's senior vice president for operations, to Endeavour Capital Managing Partner Stephen Babson, June 19, 2017.[29]

In October 2017, Endeavour Capital reached a settlement with Zoom+Care and agreed to invest another $24 million in Zoom.[30]

The same month, Zoom+Care settled with Oregon insurance regulators, agreeing to pay $2.1 million. "The size of these fines shows that DCBS will not tolerate repeated violations of the insurance code," Jean Straight, acting director of the Oregon Department of Consumer and Business Service (DCBS), said in a statement.[31]

SOUTHERN CAREERS INSTITUTE (ENDEAVOUR CAPITAL FUND V)

In 2009 Endeavour Capital founded Tall Oak Learning LLC in partnership with former Corinthian Colleges and Delta Career Education executive Joe Fox. In October 2009 Tall Oak Learning acquired the seven campuses of Southern Careers Institute (SCI) in Texas.[32]

"Since March of 2017, (Zoom Management) has faced repeated cash shortfalls, rendering it time and time again without sufficient funds to satisfy Zoom+Care's financial obligations and placing (Zoom Management) on the brink of insolvency."

Endeavour Capital complaint, September 2017

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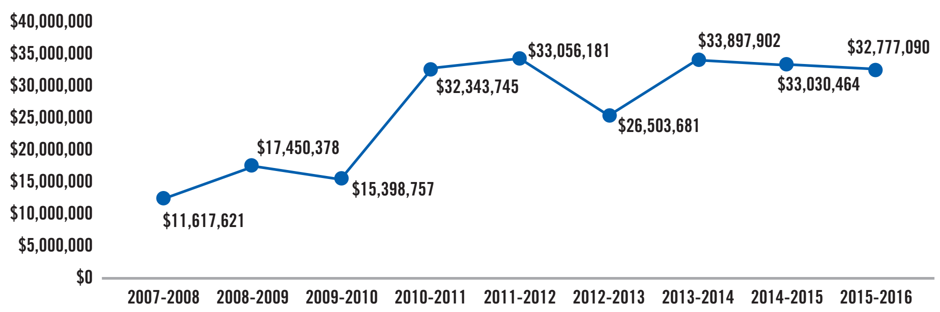
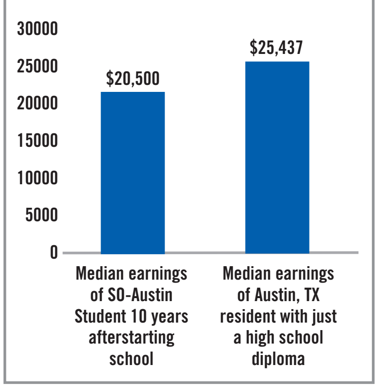
Southern Careers Insitute Revenue



Earnings of SCI-Austin student vs. high school graduate



Fox, who served as President and CEO of Southern Careers Institute, reported that he grew SCI's student population by 170% in first 24 months. In line with that growth, SCI's revenue grew from $15.4 million in the 2009-2010 academic year to $32.3 million just a year later.[33]

That rapid growth did not last, though. Southern Careers Institute's revenue peaked at $33.9 million in 2013-2014 and has since declined by 3.3% to $32.7 million.[34]

Southern Careers Institute President and CEO Joe Fox left the company in June 2013.[35]

Southern Careers Institute has aggressively drawn on federal student loan and grant revenue (i.e. Title IV revenue) to fund its operations. US Department of Education Title IV revenue has accounted for at least 87% of Southern Careers Institute's revenue in all but one year since Endeavour Capital acquired it.[36]

During the academic year ended June 2015 (SCI fiscal year ended December 2014), Southern Careers Institute violated the US Department of Education's 90/10 Rule[37] by deriving more than 98% of its revenue, $32.4 million out of $33.0 million, from federal government (Title IV) sources, the highest of any for profit college.[38]

Southern Careers Institute's growth under Endeavour Capital's ownership has not paid off for SCI students.

Ten years after they had started school, former students of Southern Careers Institute's Austin campus earned just $20,500 on average[39], almost $5,000 less than the average Austin resident with just a high school diploma.[40] Just 18.9% of Southern Careers Institute-Austin students had paid back any of their federal student loans three years after leaving school, compared to the national average of 46.4%.[41]

By comparison, students at the public Austin Community College paid substantially less in tuition but earned an average salary of $34,900 ten years after they had started school. 38.1% of Austin Community College students had started paying back federal student loans three years after leaving school – lower than the national average but more than twice as high has at Southern Careers Institute.

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Endnotes

1 Proprietary School Revenue Percentages Report for Financial Statements, US Dept of Education.

2 Pitchbook.com, accessed Aug 28, 2018.

3 Based on Endeavour Capital Fund V, VI IRRs of 9.9% and 10.2% as reported by Oregon Treasury, median IRRs for 2008, 2011, and vintage funds of 12.81%, 13.91%, and 15.64% as reported by Cambridge Associates. Oregon does not yet report IRR for Endeavour Capital Fund VII. Cambridge Associates US Private Equity Index and Selected Benchmark Statistics, Q1 2018. Private Equity Performance, Oregon Public Employees Retirement Fund, Mar 31, 2018.

4 Cambridge Associates US Private Equity Index and Selected Benchmark Statistics, Q1 2018. Private Equity Performance, Oregon Public Employees Retirement Fund, Mar 31, 2018.

5 Private Equity Performance, Oregon Public Employees Retirement Fund, Mar 31, 2018.

6 Cambridge Associates US Private Equity Index and Selected Benchmark Statistics, Q1 2018. Private Equity Performance, Oregon Public Employees Retirement Fund, Mar 31, 2018.

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8 https://endeavourcapital.com/ec/the-aladdin-group/, accessed May 29, 2018.

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15 Seaview Insurance Annual Statements, 2013-2017.

16 "A California initiative tried to keep people out of jail. It's working, report says." Sacramento Bee, June 13, 2018.

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24 https://endeavourcapital.com/ec/zoom/, accessed June 12, 2018.

25 "State takes Zoom Health into receivership amid financial discrepancy," The Oregonian, Apr 24, 2017.

26 "Feds come knocking at failed Zoom Health," The Oregonian, Jun 9, 2017.

27 "Inside the lawsuit: Endeavour claims Zoom on 'brink of total failure'," Portland Business Journal, Sept 26, 2017.

28 "Emails reveal war of words between Zoom, Endeavour execs," Portland Business Journal, Sept 27, 2017.

29 "Emails reveal war of words between Zoom, Endeavour execs," Portland Business Journal, Sept 27, 2017.

30 "Zoom+Care settles differences with major investor, will get another $25 million," Oregonian, Oct 4, 2017.

31 "Zoom settles suit over health plan, admits no wrongdoing but pays fines," Portland Business Journal, Oct 10, 2017.

32 Joe W. Fox LinkedIn profile, accessed June 16, 2018.

33 Proprietary School Revenue Percentages Report for Financial Statements, US Dept of Education.

34 Proprietary School Revenue Percentages Report for Financial Statements, US Dept of Education.

35 Joe W. Fox LinkedIn profile, accessed June 16, 2018.

36 During the 2010-2011 award year, federal Title IV revenue accounted for 84.3% of Southern Careers Institute Revenue.
Proprietary School Revenue Percentages Report for Financial Statements with Fiscal Year Ending Dates Between 07/01/10 –06/30/11, US Dept of Education.

37 "New Analysis Finds Many For-Profits Skirt Federal Funding Limits," US Dept of Education, Dec 21, 2016.[35] Joe W. Fox LinkedIn profile, accessed June 16, 2018.

38 Proprietary School Revenue Percentages Report for Financial Statements with Fiscal Year Ending Dates Between 07/01/14 –06/30/15, US Dept of Education.

39 VA GI Bill Comparison Tool profile for Southern Careers Institute-Austin, accessed June 16, 2018.

40 Based on estimated earnings of $25,437 in for a high school graduate in Austin, Texas, US Census Bureau American Community Survey 2015.

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