
INVESTMENTS

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Private Equity Portfolio risk disclosures

1. Private Equity Portfolio risk disclosures

The risks and characteristics contained below represent some of the more general risks and characteristics prevalent in investing in Private Equity portfolios. The list below should not be seen as exhaustive. As more risks and characteristics are identified that were not initially mentioned below, then such risks and characteristics will, as they become prevalent, be included herein.

Prospective investors should also note that there are general risks associated with Investments in Private Equity portfolios including, but not limited, to the following:

- 1.1 The market for private equity investments is subject to fluctuations and may significantly diminish owing to changes in interest rates, availability of financing (including senior credit, mezzanine, bank debt and high yield) and general market conditions. A disruption in the market for private equity investments may have an impact in the underlying investments held via a Private Equity Building Block Portfolio.
- 1.2 The investment management companies that manage private equity investments often rely on the management talents, skills and efforts of a small group of specialist persons and as a result, the resignation, retirement, death, disability or otherwise of one or more of those persons could have a material adverse impact on the business and its prospects including on the investments already made.
- 1.3 Generally there is limited publically available information about companies which private equity investments are made, and investors in those companies rely on the ability of the sponsor to obtain adequate information for purposes of evaluating potential, and making fully informed investment decisions.
- 1.4 There may not be a liquid secondary market for limited interests and/or investments held in private equity investment structures. An investment of this type should be regarded as long-term in nature and may not be suitable for short term investment.
- 1.5 A significant portion of the investments are limited interests held in traditional private equity limited liability fund structures. The investment managers of such limited fund partnerships may not have active role in the day-to day management of the underlying portfolio companies. The private equity fund structure may hold non-controlling interests in the underlying portfolio companies and generally may only have a limited ability to protect the interests of the fund partnership and to influence such company's management.
- 1.6 The market for private equity investment opportunities is highly competitive. Identifying and consummating equity and debt investments is also highly competitive and may involve a degree of uncertainty.

2. Risk associated with investments in infrastructure assets

Investments in infrastructure will be subject to the risks incidental to the ownership, construction and operation of such assets, including risks associated with the general economic climate, geographic or market concentration, the ability of the underlying investment fund to manage the investment, technical problems, financial failures of operating or construction sub-contractors, government regulations, and fluctuations in interest rates.

In addition, general economic conditions in domestic and international financial markets, may adversely affect operations of the underlying investment fund. In particular, because of the long lead time between the inception of a project and its completion, a well-conceived project may become an economically unattractive investment as a result of changes in investor sentiment, the financial markets, economic, or other conditions prior to its completion.

2.1 Construction risk

The underlying investment fund may hold investments in a number of development or greenfield projects. The development of greenfield infrastructure includes a degree of risk associated with the construction of the asset, including the risk that the project will not be completed within budget, within the agreed timeframe, or to the agreed specification.

While this risk is typically mitigated to a large extent by provisions in the construction contract for payment by the construction contractor of liquidated damages and other penalties, investors may be exposed to any losses not covered by such provisions or to the financial failure of the contractor.

The underlying investment fund may remain at risk if, following construction completion, as a result of site defects that were not discovered or contamination of the site that may have been caused by the construction contractor, losses are incurred.

There may be a limit to the liquidated damages available to the underlying investment fund from the construction contractor, particularly in the event of the construction contractor's financial failure.

Should any of the above risks materialise in relation to any infrastructure investment of the underlying investment fund, they could have an adverse effect on the value of the relevant investment which could, in turn, have a corresponding effect on the underlying investment fund's financial position and/or its results.

2.2 Land ownership risk

In many cases, governments make use of a leasehold land system in order to ensure that development of the land, by the lessee, takes place within a reasonable period of time; failing which, such governments may refuse to renew the lease or concession and may reclaim the land. While the Fund will employ reliable local legal counsel to perform due diligence on land matters and will only proceed with Investments where there is certainty over the land ownership and lease obligations, the underlying investment fund may not be able to completely mitigate potential risks related to land rights or the renewal of any leases or concessions, and the related impact on underlying investment fund's ability to exit through the sale of the infrastructure assets due to the lease or concession terms.

2.3 Environmental risks

The operations of the infrastructure investment companies are subject to numerous statutes, rules and regulations relating to environmental protection. There is the possibility of existing or future environmental contamination, including soil and groundwater contamination, as a result of the spillage of hazardous materials or other pollutants.

Under various environmental statutes, rules and regulations, a current or previous owner or operator may be liable for non-compliance with the applicable environmental and health and safety requirements and for the costs of investigation, monitoring, removal, or remediation of hazardous materials. These laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of hazardous materials. The presence of these hazardous materials on a property could also result in personal injury, property damage or similar claims by private parties.

Any liability of underlying investment portfolio companies resulting from noncompliance or other claims relating to environmental matters could have an adverse effect on the value of the investments in such underlying investment portfolio companies.

2.4 Price or tariff rate risk

The underlying investment fund may invest in portfolio companies that derive all of their revenues from collecting tariffs from the public using the services. The tariffs that are applicable to such services are set forth in the respective concession agreements entered into by or on behalf of the underlying investment fund or the relevant portfolio company and the relevant government body.

After execution of a concession agreement, the relevant government bodies may seek to limit such portfolio company's ability to increase, or may seek to reduce tariffs outside the scope of the respective concession agreements, as a result of factors such as general economic conditions, negative consumer perceptions of increases in tariffs, the prevailing rate of inflation, use of the service, and public sentiment about prevailing tariffs.

2.5 Sovereign risk

The concessions of certain infrastructure investments are granted by government bodies and are subject to special risks, including the risk that the relevant government bodies will exercise sovereign rights and take actions contrary to the rights of the underlying investment fund or the relevant portfolio company under the relevant concession agreement. There can be no assurance that the relevant government bodies will not legislate, impose regulations or change applicable laws or act contrary to the law in a way that would adversely affect the business of the underlying investment fund's portfolio companies.

2.6 Competition risk

The underlying investment fund may invest in portfolio companies that construct or maintain and operate infrastructure assets in a highly competitive environment. The underlying investment fund will compete with other consortia and companies for infrastructure Investments. These competitors, which include large construction and engineering groups and financial investors, may have sizeable financial resources and may be able to present bids with competitive terms. As a result of such competition, the underlying investment fund may have difficulty in making certain infrastructure investments.

Additionally, the underlying investment fund may incur costs in unsuccessful tenders which it is unable to recover. The occurrence of bid costs is subject to approval from the underlying investment fund's governance structures.

Furthermore, during the commitment period the management fees are calculated based on the commitments to the underlying fund and not amounts committed to investments by the underlying investment fund, as such the payment of management fees will have an increased impact on the returns of the underlying investment fund where it has made fewer investments than would otherwise be the case if it had been fully committed to Investments. If the underlying investment fund fails to make new investments, is unsuccessful in tenders or makes investments under less favourable terms, the underlying investment fund's financial condition and results of operations could be adversely affected.

Furthermore, once infrastructure assets of investments become operational, they may face competition from other infrastructure assets in the vicinity of the assets they operate, the presence of which depends in part on government plans and policies. For example, an increase in the number and convenience of alternative routes and competition from other modes of transportation could reduce traffic on toll roads operated by the portfolio companies thus adversely affecting performance.

Such competition may adversely affect the underlying investment fund's business, financial conditions and results of operations.

2.7 Demand and usage risk

Even though the underlying investment fund will target assets with low demand and usage risk, variances in the demand and usage can affect the performance of investments. To the extent that the underlying fund manager's assumptions regarding the demand and usage of assets prove incorrect, returns to investors could be adversely affected.

2.8 Valuation risk

The executives of the fund manager for the underlying investment fund and its advisors will prepare the valuation of the assets owned by the underlying investment fund. Given the nature of infrastructure assets, such valuation may be complex and the fund manager may engage qualified valuation professionals to assist in this determination; however it is not required to do so. In addition, there may be a relative scarcity of market comparables on which to base the valuation of the underlying investment fund's assets.

Furthermore, the financing of infrastructure projects is inherently subjective as regards value due to the individual nature of each project, the potential lack of marketability and the potential unavailability of suitable information for determining the applicable value. As a result, valuations are subject to uncertainty. Valuation reports are made on the basis of certain assumptions which may not prove to reflect the true position.

2.9 Community risk

The investments made by the underlying investment fund may be subject to backlash from a community in which such Investments are made. Local communities may oppose an investment arguing that the unrestrictive entrance of the underlying investment fund into that community's infrastructure market may cause the decline, or even the closure, of local businesses and consequently the loss of many jobs due to, amongst others, a potential increase of imports over local suppliers. Local labour and civil society groups may add to such backlash if portfolio companies are unable to ensure business-friendly treatment of local firms and acceptable conditions of work for low-skilled workers from the outset.

Upon making an investment, the underlying investment fund may have difficulty proving to community leaders that the benefits outweigh the economic and political costs, especially since infrastructure is a visible sector and the return of capital and the realization of gains, if any, from an investment may not occur until the partial or complete disposition of such investment. Upon the underlying investment fund's exit from an investment, the infrastructure assets will remain, however, the technical and capital input provided by the underlying investment fund will no longer be available. Community leaders may therefore oppose an investment in their community given the underlying investment fund's inevitable exit from such an investment.

In order to achieve the desired returns for the underlying investment fund, portfolio companies in which the underlying investment fund invests must often raise charges, rates and tariffs early on. Electricity rates, telephone bills, toll-road fees, and other similar charges, rates or tariffs are often immediately apparent to a broad range of users, including retail consumers and industrial customers. Users of the services provided by portfolio companies may react negatively to any adjustment to the applicable charges, rates or tariffs, or public pressure may cause relevant government authorities to challenge the same.

For example, motorists may react adversely to toll rates by avoiding tolls or refusing to pay tolls, resulting in lower traffic volumes and reduced toll revenues. In addition, adverse public opinion or lobbying efforts by specific interest groups could result in governmental pressure on portfolio companies to reduce their tariffs or to forgo planned rate increases. The fund manager cannot guarantee that government bodies with which portfolio companies have concession agreements will not try to exempt certain users or negotiate lower charges, rates or tariffs. If public pressure or government action forces portfolio companies to restrict their charges, rates or tariffs, and they are not able to secure adequate compensation to restore the economic balance of the relevant concession agreement, the underlying investment fund's business, financial condition and results of operations could be adversely affected.

2.10 Investment term risk

The underlying investment fund may make Investments that may not be advantageously disposed of prior to the date that the underlying investment fund will be dissolved, either by expiration of the underlying investment fund's term or otherwise. Although the fund manager expects that investments will be disposed of prior to dissolution or be suitable for in-kind distribution at dissolution and the general partner has a limited ability to extend the term of the underlying investment fund, the underlying investment fund may have to sell, distribute or otherwise dispose of Investments at a disadvantageous time as a result of dissolution. In addition, although upon the dissolution of the underlying investment fund the general partner (or the relevant liquidator) will attempt to reduce to cash and cash equivalents such assets of the underlying investment fund as the general partner or such liquidator shall deem it advisable to sell, subject to obtaining fair value for such assets and any tax or other legal considerations, there can be no assurances with respect to the time frame in which the winding-up and the final distribution of proceeds to the relevant investors will occur.

2.11 Creditworthiness of the issuer

The value of debt securities may change significantly depending on economic and interest rate conditions as well as the credit worthiness of the issuer. Issuers of debt securities may fail to meet payment obligations or the credit rating of debt securities may be downgraded. These risks are typically increased for emerging market and below investment grade debt securities.

2.12 Unrated unlisted debt

The credit worthiness of unrated securities is not measured by reference to an Independent credit rating agency.

2.13 Convertible Securities

Convertible securities may subject to the risks associated with both debt and equity securities, and to risks specific to convertible securities. Their value may change significantly depending on economic and interest rate conditions, the creditworthiness of the issuer, the performance of the underlying equity and general financial market conditions.

In addition, issuers of convertible bonds may fail to meet payment obligations and their credit ratings may be downgraded. Convertible bonds may also be subject to lower liquidity than the underlying equities.

2.14 Prepayment of debt by portfolio companies

The underlying fund is subject to the risk that the investments made in the portfolio companies may be repaid prior to maturity. When this occurs, the prepayment proceeds will generally be reinvested in temporary investments, pending their future investment in new portfolio companies. These temporary investments will typically have substantially lower yields than the debt being prepaid and we could experience significant delays in reinvesting these amounts.

Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. As a result, the investment returns of the underlying fund could be materially adversely affected if one or more of the portfolio companies elect to prepay amounts owed to the underlying fund. Additionally, prepayments, net of prepayment fees, could negatively impact the return on equity.

2.15 Corporate debt

Where the underlying fund acquires interests in corporate debt, it depends primarily upon the creditworthiness of the borrower or issuer for payment of principal and interest (as well as the creditworthiness of the institution selling the participation where an interest is acquired by way of participation).

Corporate debt may not be rated by any nationally recognised rating agency. Corporate debt that is fully secured offers an underlying fund more protections than unsecured corporate debt in the event of non-payment of scheduled interest or principal. However, there is no assurance that the liquidation of collateral from corporate debt would satisfy the borrower's or issuer's obligation, or that the collateral can be liquidated. Indebtedness of borrowers or issuers whose creditworthiness is poor involves substantially greater risks, and may be highly speculative.

Borrowers or issuers that are in insolvent or restructuring may never pay off their indebtedness, or may pay only a small fraction of the amount owed. The market for lower-rated or unrated corporate debt may be more severely affected than some other financial markets by economic recession or substantial interest rate increases, by changing public perceptions of this market or by legislation that limits the amounts to be invested in these securities. It is likely that any economic downturn could adversely affect the ability of the issuers of corporate debt to repay principal and pay interest thereon and increase the incidence of default for such assets.

In addition, the secondary market may be less liquid for lower rated or unrated corporate debt. This reduced liquidity at certain times may affect the value of these assets, may make the valuation and sale of these assets more difficult and may result in greater volatility in these assets. As such assets are difficult to value, particularly during erratic markets, and the values realised upon the sale of such assets may differ from the values at which they are carried by the underlying fund. Assets in the lowest rating categories or which are unrated may be in poor standing or likely to be affected by events of default.

2.16 Subordinated debt

Investments made an underlying fund into subordinated debt investments will generally rank junior in priority of payment to senior debt and will generally be unsecured. This may result in a heightened level of risk and volatility or a loss of principal, which could lead to the loss of the entire investment. These investments may involve additional risks that could adversely affect investment returns. To the extent interest payments associated with such debt are deferred, such debt may be subject to greater fluctuations in valuations, and such debt could subject the underlying fund to non-cash income.

2.17 Mezzanine debt

Where the underlying fund invests in Mezzanine debt securities, generally Mezzanine debt securities will have ratings or implied ratings below investment grade. They will be obligations of companies, partnerships or other entities that are generally unsecured, typically are subordinated to other obligations of the borrower and generally have greater credit and liquidity risk than is typically associated with investment grade corporate obligations. Accordingly, the risks associated with mezzanine debt securities include a greater possibility that adverse changes in the financial condition of the borrower or in general economic conditions (including a sustained period of rising interest rates or an economic downturn) may adversely affect the borrower's ability to pay principal and interest on its debt.

Many borrowers on mezzanine debt securities are highly leveraged, and specific developments affecting such borrowers, including reduced cash flow from operations or the inability to refinance debt at maturity, may also adversely affect such borrowers' ability to meet debt service obligations.

Mezzanine debt securities are often issued in connection with leveraged acquisitions or recapitalizations, in which the issuers incur a substantially higher amount of indebtedness than the level at which they had previously operated. Default rates for mezzanine debt securities have historically been higher than has been the case for investment grade securities.

2.18 Impact of economic recessions or downturns on portfolio companies

Many of the portfolio companies into which the underlying fund may invest are be susceptible to economic recessions or downturns and may be unable to repay the debt investments during these periods. Therefore, non-performing assets are likely to increase, and the value of our portfolio is likely to decrease during these periods.

Adverse economic conditions may also decrease the value of any collateral securing our senior secured debt. A prolonged recession may further decrease the value of such collateral and result in losses of value in our portfolio and a decrease in the NAV of the underlying fund.

Unfavourable economic conditions also could increase in funding costs, limit access to the capital markets or result in a decision by lenders not to extend credit on the terms deemed acceptable. These events could increase defaults and prevent the underlying funds from increasing investments and adversely affect portfolio returns.