westbrooke dynamic opportunities UK fund PLC
2022 / 2023 vintage

information memorandum – Q3 2022

westbrooke
Alternative
Asset
Management

westbrooke.co.za

executive summary

investment highlights

A debt-led approach to UK private equity investing

Contractual revenue streams with the protections of debt

Additional potential upside through equity warrants / co-investment

3 – 5 year target duration on each underlying instrument, with proceeds returned to investors on exit

A diversified portfolio of 7 – 10 investments across the UK

Target investor IRR of 12%+ in GBP (net of all fees and costs)

Target cash yield of 4% p.a.

Returns linked to interest rates, providing an inflation hedge

background

Since the establishment of our presence in the UK in 2017, Westbrooke Alternative Asset Management UK ("WAAM UK" or "Westbrooke") has built a meaningful track record investing in a variety of debt instruments in the UK lower-middle market ("LMM") segment. To date, the business has successfully deployed over £250m across 110+ transactions, spanning across senior secured debt, mezzanine finance and preferred equity instruments in both real estate and corporate credit. Westbrooke shareholders and management have invested more than 20% of this capital alongside clients to date.

The LMM offers an attractive opportunity for a hybrid capital solution due to multiple structural factors:

- the accelerated retreat of banks from the LMM space since the global financial crisis due to increasing regulatory costs;
- the ending of Covid-19 lending schemes, leading to structural changes and an increasing opportunity to provide capital to the LMM segment;
- post-Covid-19 concerns regarding general market outlook going forward, an uncertainty that hybrid capital can capitalise on;
- a nascent alternative lending market which remains hamstrung by tight investment mandates; and
- an increasing desire on the part of incumbent equity investors to partner with flexible funding providers who can assist them in enhancing equity returns.

The combination of the above factors has created a unique gap which WAAM UK has increasingly capitalised on.

waam uk's hybrid capital platform

Since the beginning of 2021, WAAM UK has offered investors the opportunity to participate in deal-by-deal syndications in our hybrid capital platform.

Providing bespoke financing solutions to a range of UK companies alongside best of breed partners, WAAM UK's hybrid capital platform offers investors the ability to participate in a combination of senior debt, mezzanine debt and preferred equity financing transactions alongside Westbrooke shareholders and management.

By providing flexible funding solutions to a variety of sponsors in the LMM space, WAAM UK is able to structure tailored funding packages for clients. These are primarily debt finance (senior, junior and mezzanine) led solutions, but through the favourable negotiating position of being a key funder, we are able to participate in the businesses' inherent upside by negotiating an equity co-investment. This can take the form of preferred equity, equity warrants, direct equity co-investments or a combination of these instruments.

UK headquartered

Targeting businesses with operations and headquarters within the UK

Sector agnostic

With a focus on borrower and sponsor fundamentals

Established, performing businesses

Backing businesses with compelling financial metrics

Investing across the capital structure

Able to invest in debt and equity, to minimise risks while maximising returns

Best-of-breed partners

Backing like-minded partners in the form of private equity, management teams and entrepreneurs

the launch of the inaugural WDO UK fund

In this context, WAAM UK is pleased to launch the inaugural 2022 / 2023 vintage of Westbrooke Dynamic Opportunities UK Fund Plc ("WDO UK" or the "Fund), which aims to provide investors with a unique blend of debt-like risk protection (including an interest coupon, security, enforcement rights and a defined exit term) with the potential for equity-like returns. This is achieved by blending the above instruments, providing investors with a portfolio of capital preservation focused yielding debt investments, with the ability to achieve outperformance through the equity positions taken.

To date, WAAM UK has provided total funding packages of £58m across five transactions within the hybrid capital strategy. With an average 4-year investment horizon, the current portfolio targets an overall weighted average annual return of 12.0% + per annum in GBP (net of all fees and costs). This return is comprised of a weighted average annual debt yield of 10.0% per annum (of which 4.0% is cash paid and 6.0% is rolled up) and the remaining return being earned through the equity participations taken.*

**Please note that these historic transactions will not be included in the WDO UK Fund and that past performance is not necessarily an indication of future returns.*

The WDO UK Fund represents the next phase in the evolution of Westbrooke's UK hybrid capital strategy and will serve as the vehicle to house hybrid capital transactions going forward. The Fund has been established on the following basis:

- The Fund will raise capital on an annual, vintage basis. The first close of the current 2022 / 2023 vintage targets to raise a maximum amount of £50m, at which point it will be closed for new investments.
- It is envisaged that the 2022 / 2023 vintage will target to establish a portfolio of between 5 – 10 transactions, with no single investment comprising more than 20% of the Fund NAV.
- The Fund targets to generate a net annual IRR of 12%+ in GBP (after all fees and costs), comprising of:
  - Yield on debt positions taken:
    - Cash yield of 4% per annum;
    - Payment in kind ("PIK") yield of 6% per annum; and
  - Upside on equity positions taken: 2%+ per annum.
- The Fund will enjoy a first right to all investments concluded in the WAAM UK hybrid capital platform. No investors will be provided with the opportunity to co-invest alongside WAAM UK outside of the Fund unless the Fund has reached applicable exposure limitations, at which point Fund investors who have invested £1m and above will be provided with an exclusive first right to co-invest in these deals outside of the Fund.
- Once the 2022 / 2023 vintage has completed its investment mandate, the Fund will launch a second vintage by way of a separate capital raise in a new share class. Through this mechanism, investors are provided with the opportunity to vintage their allocations to the Fund on an annual basis.

timing and next steps

We believe that the timing for the launch of the Fund is opportune, for both investors and borrowers.

Many investors are currently seeking secured, higher yielding investment opportunities which have the ability to outperform, in the context of the current economic landscape, which is characterised by volatile and declining public markets, high inflation and rising interest rates. The WDO UK Fund provides such an opportunity.

For borrowers, the current UK market dynamics have created a strong demand for flexible funding solutions in the UK LMM. This has allowed WAAM UK to build a strong origination pipeline into which the Fund will be invested going forward.

Investors now have the opportunity to subscribe for an allocation to the inaugural WDO UK Fund, alongside Westbrooke group, its shareholders, and related entities. The Fund is targeting a maximum capital raise of £50m for the first close at the end of August 2022.

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1. an overview of westbrooke

westbrooke alternative asset management

Founded in 2004 and with offices in the UK, USA and South Africa, Westbrooke Alternative Asset Management invests, manages and advises capital in multiple geographies on behalf of its shareholders and investors in private debt, hybrid capital, real estate, private equity and venture capital.

Westbrooke Alternative Asset Management was established as a multi-asset, multi-strategy manager of alternative investment funds and products structured to preserve and compound our clients' wealth to cement their future prosperity.

Our team is comprised of experienced entrepreneurs and investment professionals who apply a broad range of experience and skills to deliver investment opportunities which offer a simple investable outcome – predictable, sustainable, risk managed long-term returns for investors in an increasingly complex environment.

We have a heritage as a shareholder and operator of assets, investing our own capital to develop and grow our businesses and assets. We believe our operational experience and expertise gives us and our investors a competitive advantage.

We are wholly committed to financial alignment. We invest materially alongside our clients and partners in all our funds and investments.

www.westbrooke.co.za

westbrooke alternative asset management UK

WAAM UK has been active in the UK LMM since its establishment in 2017, having successfully deployed over £250m across 110+ debt-led transactions. The team have invested across multiple sectors, asset classes and capital structures and hold a leading reputation within the UK market. Westbrooke shareholders and management have invested more than 20% of this capital alongside clients to date.

the WAAM UK investment team

James Stirling. James is the Head of WAAM UK's hybrid capital strategy. With over 20 years' experience in the UK M&A market, he was most recently Head of Growth and Acquisition Finance at Investec Bank Plc. James is a Fellow of the Institute of Chartered Accountants and holds an MA(Hons) from the University of Edinburgh.

Richard Asherson. Richard is the Managing Director of WAAM UK and a member of Westbrooke Alternative Asset Management's Executive Team. Richard was previously a consultant in the Structured and Acquisition Finance Team at Investec Bank Limited. Richard holds a BBusSci (Hons) in Finance, Economics and Strategy from the University of Cape Town.

Antimo Osato. Antimo is an Analyst in the WAAM UK investment team. Antimo trained and qualified as an attorney at Werksmans Inc in South Africa (a leading South African law firm), where he gained experience in mergers and acquisitions and international tax. Antimo holds holds stet, BCom and LLB degrees from the University of the Witwatersrand and an LLM from the London School of Economics.

Harry Newall. Harry is an Analyst in the Westbrooke UK investment team. Prior to joining the team, Harry worked as an analyst for a family office in London which was focused on early-stage venture capital. Prior to that, he was part of the founding team of a retail technology company. Harry holds a BA in Economics from University College London.

Kieran McKenzie. Kieran is an Investment Associate at WAAM UK. Prior to joining the team, he spent 3 years at Investec Bank Plc where he specialised in growth and acquisition Finance. Kieran holds an MSc in International Business from the Grenoble Graduate School of Business, as well as an MCom in Management from Stellenbosch University, and is a CFA Charterholder.

James Lightbody. Before joining WAAM UK as an Investment Associate, James spent 5 years at Rand Merchant Bank Limited in South Africa (a leading South African corporate and investment bank), focusing on a range of real estate and principal investment transactions. James holds a BBusSci from the University of Cape Town and is a CFA Charterholder.

Rob Grieve. Rob is Head of WAAM UK's private equity strategy. Rob has extensive investment banking and private equity experience having previously worked at Macquarie Capital, Investec Bank and RMB Corvest. While at RMB Corvest (a leading South African private equity firm) he was involved in a number of acquisitions, including Excellerate, Adcorp Support Services, Prime Light and Inscape.

the investment advisory committee

Martin Sacks. Martin is the Executive Chairman and Co-Founder of the Westbrooke Group and is also Chairman and Non-Executive Director of Westbrooke's subsidiaries and associates. Prior to founding the Westbrooke Group in 2004, Martin co-founded and led a number of businesses.

Robert Fihrer. Rob is a Non-executive Director on the Westbrooke Group Board. Rob founded Capricorn Capital Partners with two other partners and is currently the CEO. He sits on the board of Hollard Holdings and Anchor Group and is also the Chairman of the Hollard Investment Committee and Chairman of the Remuneration Committee.

Paul Stevens. Paul is a co-founder of ASK, and shares responsibility for credit, due diligence and investor relations. He has been involved in the banking sector for over 40 years, (the last 25 years exclusively in property finance) and as such has a deep and established network. In 1995, Paul established Investec Bank plc's European property finance business. Under his management the division's assets grew to over £3.5 billion, generating peak annual profits of circa £100m.

Chris Mullin. Chris joined Capricorn Capital Partners in 2007. He was appointed as an Executive Director in 2013 and has over 18 years' experience in investment management. Prior to joining Capricorn, Chris was a senior investment manager at the Industrial Development Corporation where he was responsible for sourcing and structuring transactions, managing due diligence teams and providing strategic support to the various investments.

Avron Epstein. Avron is seasoned financier and banking professional with over 25 years of banking experience. In 2002, Avron established Investec Bank Plc's Growth and Acquisition finance business and served as the CEO of the Investec Specialist Private Bank.

Simon Fifield. Simon is the CEO and Executive Director at Newpark REIT Ltd. Simon is also the co-founder of RMB Westport, a real estate development fund that is focused on property development in Sub-Saharan Africa. Prior to RMB Westport, Simon worked at Rand Merchant Bank Limited for 12 years, where he gained experience in the structured finance, private equity and global markets businesses before establishing himself in the investment banking division where he headed the real estate investment banking business for seven years.

the wider westbrooke team

Dino Zuccollo. Dino is Westbrooke Alternative Asset Management's Head of Product Development and Distribution and is a member of Westbrooke Alternative Asset Management's Executive Team. He has previous experience in Corporate Finance Investment Banking at Investec Bank Limited and Deloitte in both South Africa and the USA. A CA(SA), Dino also holds an MCom in Finance and a BAccSci (Hons) from the University of the Witwatersrand.

Olivia Kamungoma. Olivia is a Finance and Operations Analyst at Westbrooke UK. Prior to this, she worked as an Operations Consultant at Allan Gray. Olivia obtained her BCom Honours in Investment Management at the University of Pretoria and is studying towards her Chartered Financial Analyst qualification.

Claire Uren. Claire is the Financial Manager for Westbrooke Alternative Asset Management. She is a qualified CA(SA) and completed her articles at Deloitte, where she also spent time as a manager in the Accounting and Financial Advisory division. Claire was the Financial Manager at Vumatel in its start-up phase, and thereafter gained experience in the private equity space, at an Africa-focused fund of funds with an offshore investor base.

Emma Marais. Emma is a Manager of Operations and Finance at Westbrooke UK. Emma spent 4 years at JTC Fund Solutions as a Fund Accounting Supervisor and holds a BBusSci and BCom (Hons) in Taxation from the University of Cape Town. She is currently studying towards her MCom in International Taxation.

Laura Breytenbach. Laura is an Operations Executive at Westbrooke Alternative Asset Management. Laura is a qualified CA(SA) and completed her articles at Deloitte in London. She also holds a Postgraduate Diploma in Financial Planning. Laura has spent the vast majority of her career to date in the wealth and financial planning industry with a specific focus on operations and project execution.

2. the market opportunity in the UK lower-mid-market

This section outlines the addressable market for lower-mid-market ("LMM") investments in the UK. It explains why the supply of lending capital is decreasing and why demand from private equity ("PE") and entrepreneurs is stable and how this creates a gap in the market. It then assesses the key economic trends that result in uncertainty and outlines why a combination of debt and equity (referred to in this document as hybrid capital) is an appropriate solution in the current climate.

an overview of the UK private capital markets landscape

Lending to the LMM is a c.£30bn-£50bn a year market*, with inherent diversity and attractive risk-return dynamics. It consists primarily of privately held business that have c.£2m - £10m of earnings before interest, taxation, depreciation and amortisation ("EBITDA").

** Source: British Business Bank & Westbrooke analysis*

The broader UK private capital markets are segregated by several distinct features, including:

- the size of the underlying borrower (large-cap, mid-market and SME);
- the underlying asset class (i.e. real estate or corporate); and
- the type of capital provided (equity vs debt).

Focusing specifically on the size of the underlying borrower - the large-cap market is dominated by the 'mega-funds' which provide syndicated facilities into the hundreds of millions of pounds to the largest companies in the UK and Europe. These funds are backed exclusively by institutional investors.

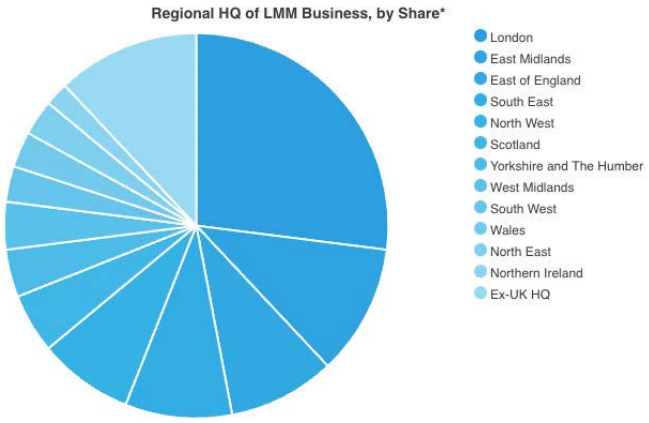
At the opposite end of the spectrum is the algorithmic SME finance market, where small enterprises require 'micro-loans' ranging from a few thousand pounds and above. These loans are typically unsecured and higher risk, with the leading player, Funding Circle, quoting an estimated lifetime weighted average default rate across cohorts of 20.5% (FY 2020)*.

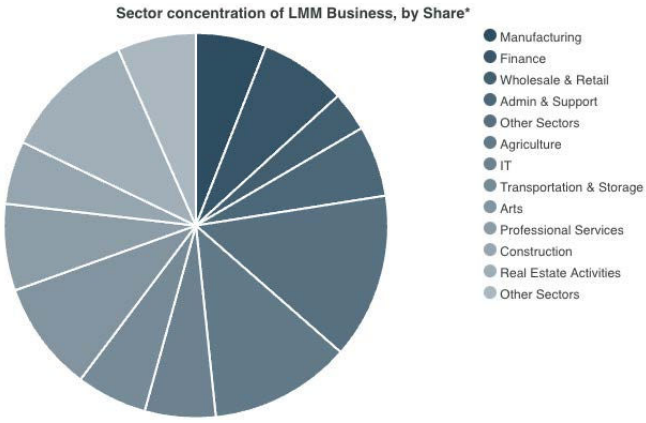
** Source: https://corporate.fundingcircle.com/media/press-releases/full-year-2020-results/*

The LMM offers an attractive risk profile and a multi-billion pound lending opportunity.

The LMM comprises an estimated 35,000* established businesses, that are diversified across regions and sectors.

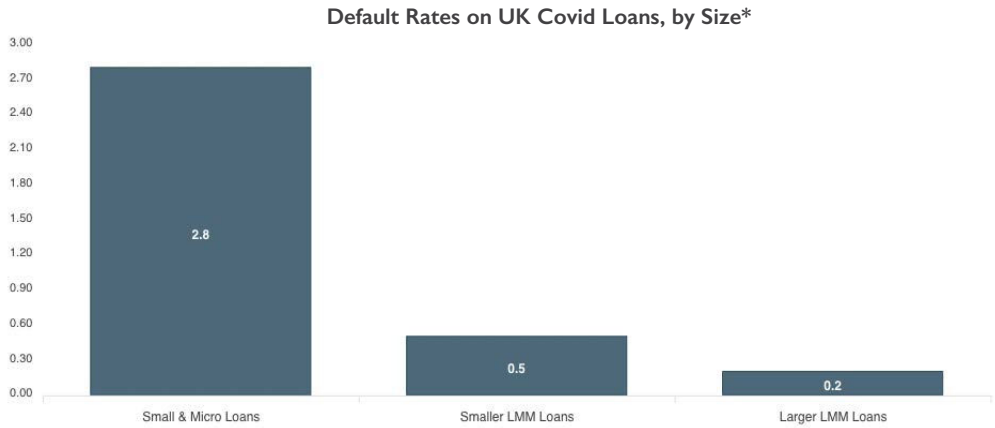
** Source: FAME*





** Source: FAME*

As well as being diversified, the underlying businesses also offer an attractive risk profile. Historic default rates for LMM businesses, are substantially lower than SMEs.



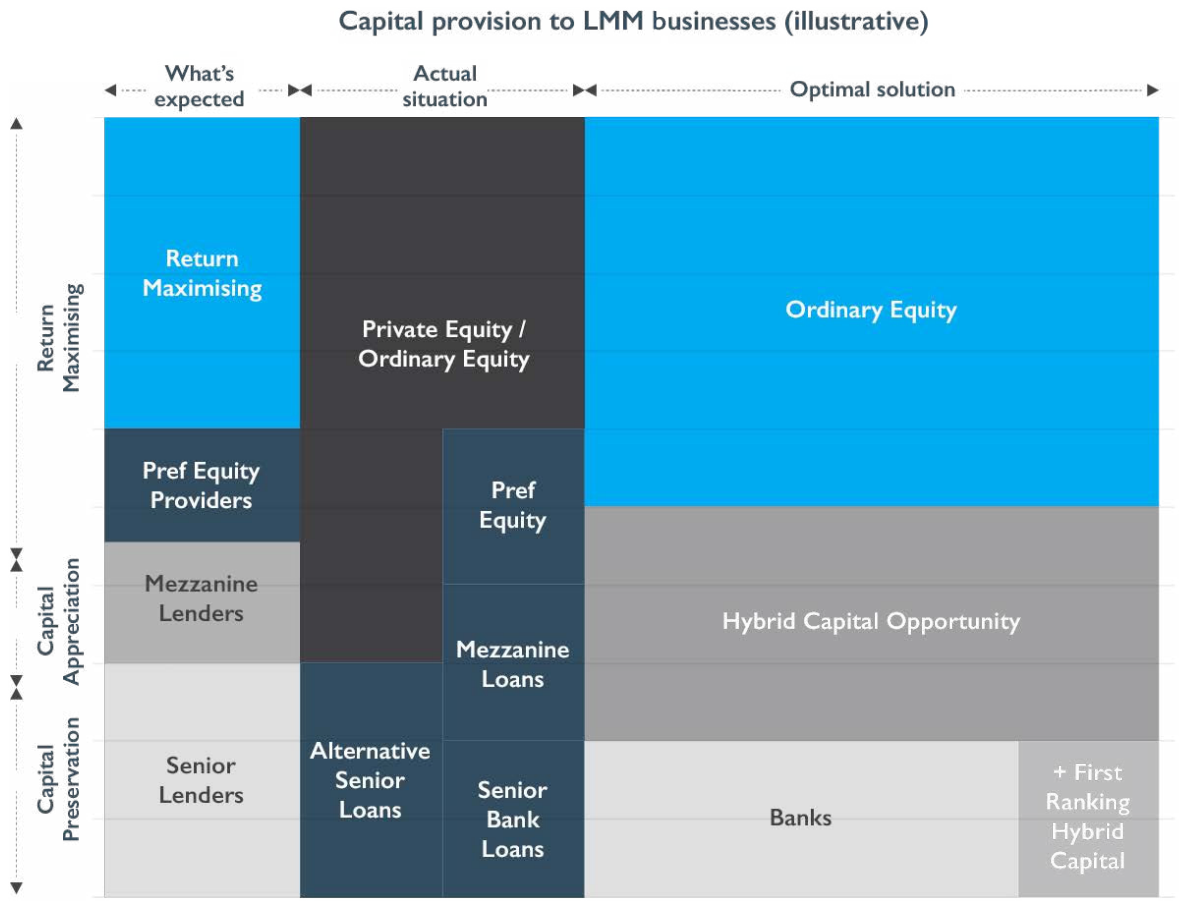
Source: British Business Bank

Assuming a conservative recovery rate of 50%, the expected loss for LMM loans is between 25bps and 10bps across the entire market.

The WDO UK Fund aims to further reduce this loss, by implementing the capital preservation strategy which is covered later in this document.

Competition exists to serve the LMM, but lenders have structural challenges that cause a dislocation in supply.

Capital markets within the LMM are dislocated because expectations regarding the availability of capital often do not meet reality. The current market is complicated by multiple independent stakeholders that do not collaborate effectively; this leaves a dearth of adequate capital provision that in turn causes dislocation. The illustrative chart below shows how capital to LMM businesses is typically provided, distinguishing between what is expected, the actual provision and Westbrooke's view of the optimal solution. We explain the market dynamics below.



** Source: Westbrooke research*

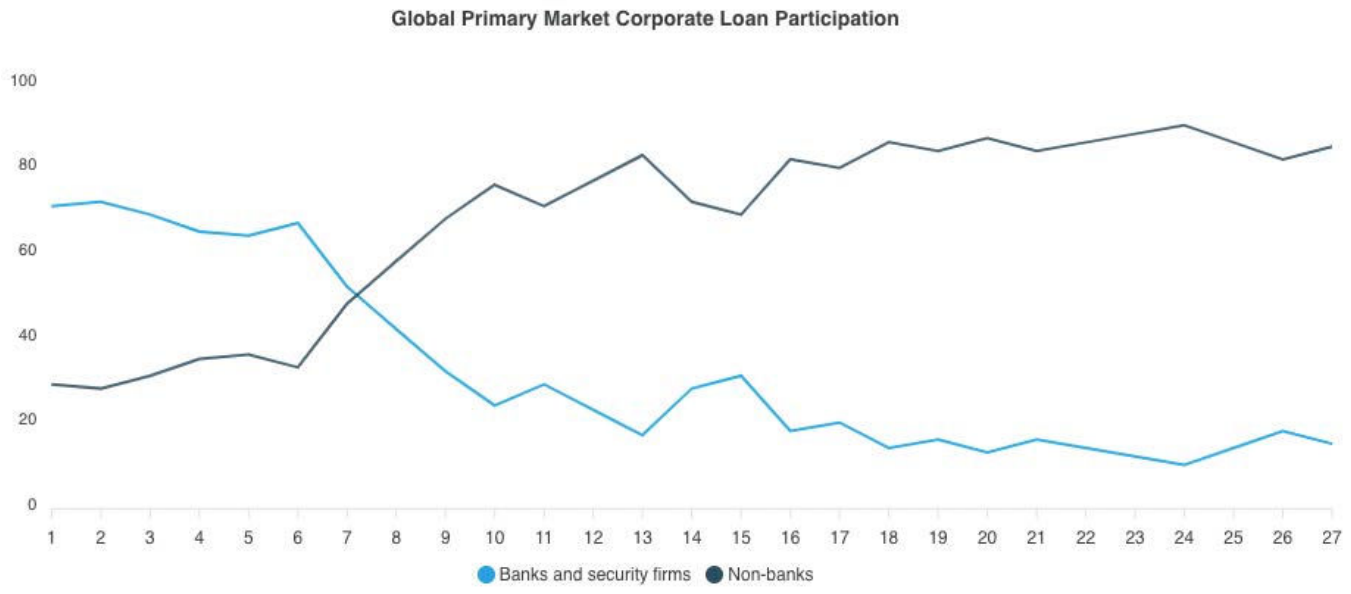
Business owners expect to be able to tranche capital effectively, using a combination of equity, preferred equity, mezzanine and senior lending. Realistically the LMM tranches differently, with equity and senior lending from banks being the largest providers of capital. However, in many cases banks offer insufficient leverage for equity providers meaning borrowers increasingly require alternative solutions. Westbrooke's hybrid capital solution is consciously focused to overlap with the space where highly conservative lending (i.e. banks) ends and intermediate capital starts.

Banks were already decreasing their LMM lending stock before the onset of Covid-19 due to the increasing burden of regulatory requirements.

Banks are the largest suppliers of capital to the LMM but have been retreating for a number of reasons. A tightening of credit policies following the global financial crisis ("GFC") saw banks becoming increasingly risk averse when participating in the LMM - appetite often sits at 2x EBITDA or 50% LTV for non-mortgage real estate lending, creating a gap in the market for alternative lenders.

The implementation of the regulatory risk management framework under Basel III further hastened the retreat of banks from the LMM. Basel III, amongst other requirements, required banks to increase risk weighted capital for unrated loans (which most LMM businesses are), in turn making this a capital intensive and therefore less profitable area for them.

The high degree of regulation means that banks incur similar absolute transaction costs for £50m loans as they do for £10m loans, leading to a preference to allocate to larger transactions.

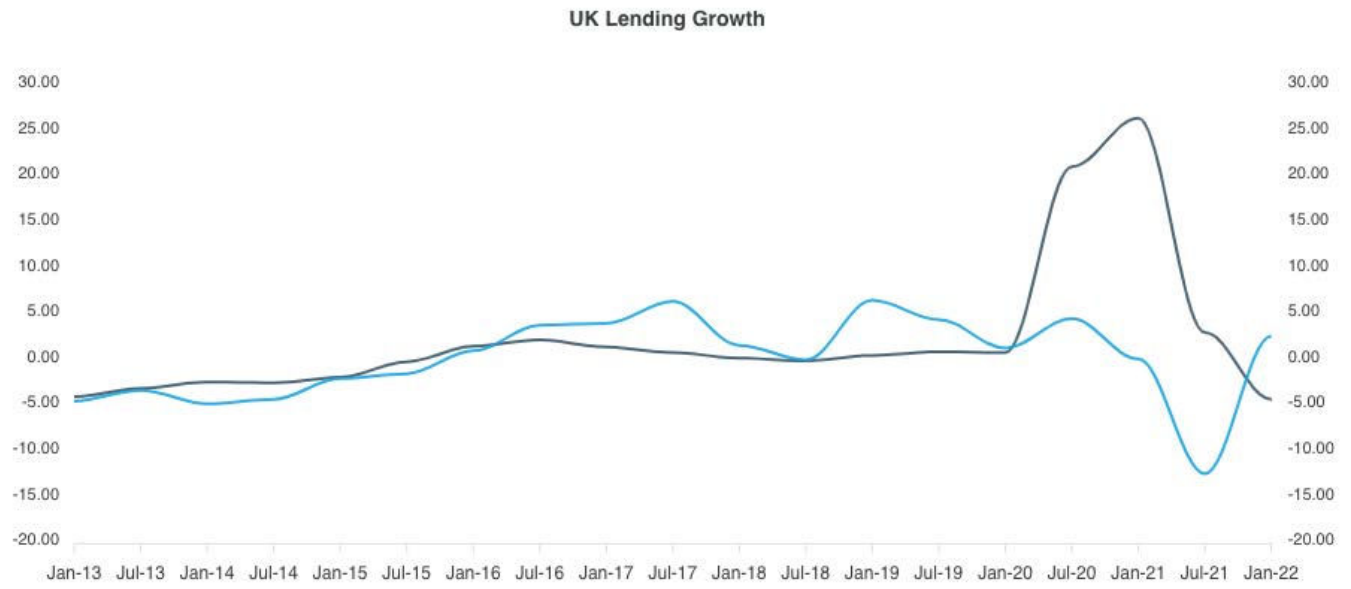


Source: https://www.spglobal.com/marketintelligence/en/solutions/leveraged-commentary-data

Banks' complex systems and operational issues have made them less competitive and less business friendly in the LMM.

Siloed internal lending functions and bureaucratic processes create long lead times than borrowers cannot afford to wait on.

High staff turnover rate at banks further creates a lack of personal relationships with borrowers.



Source: BoE Statistics

Bank lending increased substantially during Covid, driven by government support/guarantees, but is now declining due to a focus on portfolio management, offering an opportunity for non-bank lenders.

Supply of bank lending to SMEs increased during the Covid-19 pandemic, with the support of the government backed lending schemes including the Bounce Back Loan Scheme ("BBLS"), the Coronavirus Business Interruption Loan Scheme ("CBILS") and the Coronavirus Large Business Interruption Loan Scheme ("CLBILS"). Businesses had to prove that they were negatively impacted by Covid-19 and the loans could generally not be used for M&A. The government paid all borrower interest and arrangement fees in the first year which facilitated >£75bn of additional lending.

The government forced banks to focus on the riskiest SME segment by providing BBLS loans of up to £50k. More than £45bn was lent to an approximate 1.5m SMEs through BBLS. This caused banks to allocate additional resources to these loans away from larger tickets in the LMM.

In October 2020, the National Audit Office outlined that 60% of BBLS loans were unlikely to be repaid. Banks are responsible for remediating these loans, which requires additional resource and again moves their focus away from deployment in the LMM to portfolio management. The BBLS scheme was closed to new applicants in March 2021.

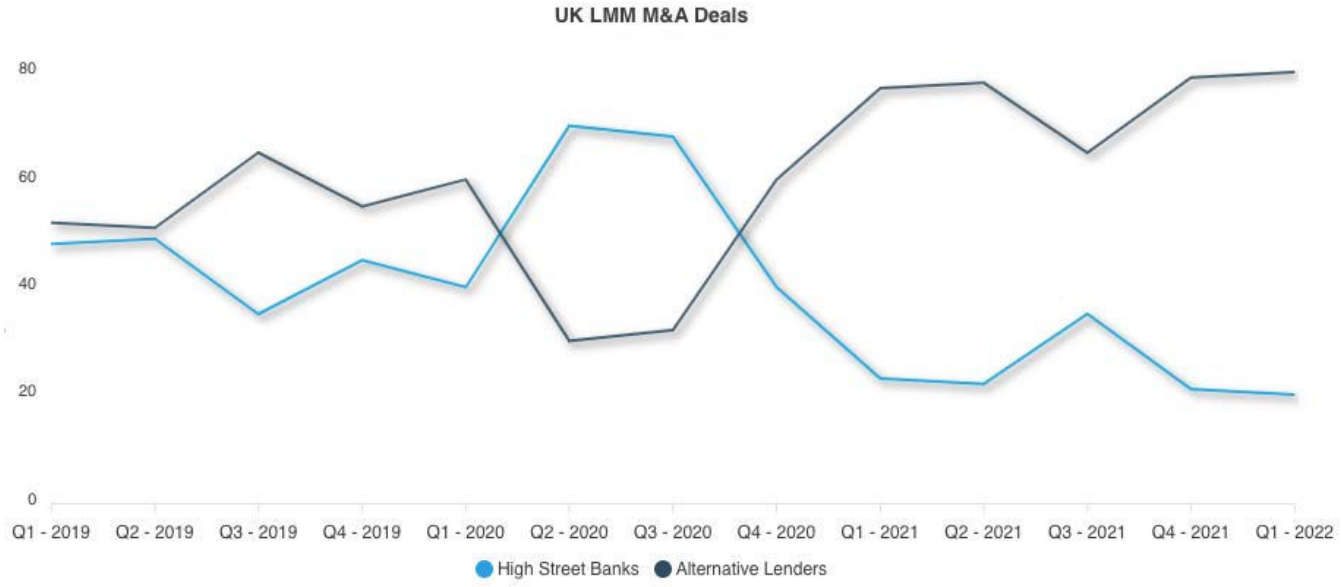
Just over 100k of CBILS loans (up to £5m) were provided, totalling £26bn. Only 753 CLBILS loans (from £5m-£200m) were provided, totalling £5.56bn. In the British Business Bank's latest reporting, less than 750 CBILS loans (0.5% of total value lent), and only 4 CLBILS loans have defaulted (0.2% of total value lent).

The CBILS and CLBILS schemes have also since expired, which offers opportunities for non-bank lenders to refinance the best loans in this segment.

The combination of bank's withdrawal, their inherent inefficiencies and focus on existing portfolio management drive borrowers to new forms of faster, leaner financing solutions such as hybrid capital.

Alternative lenders have increased market share in the LMM as banks have withdrawn, but internal restrictions and low volumes mean they are unable to fully solve the dislocation

80% of mergers and acquisition ("M&A") transactions in the LMM are now funded by alternative lenders, who have gained market share as banks have retreated from the market post Covid-19.



Source: Experian

Alternative lenders operating in the LMM offer loans of £1m-£15m at up to c.3x EBITDA or 75% of LTV, filling some of the gap left post many of the banks' withdrawal from the space. These lenders compete directly with banks for senior loans, taking security in the form of a first ranking fixed and floating debenture

In exchange for multiple benefits, such as faster lending, better structuring and higher gearing levels, these alternative lenders generally price up for the privilege, at c.8% - 10% gross lending rates.

Alternative lenders are funded in one of two ways, namely through high-net-worth (HNW) investors or through institutional capital, both of which have limitations:

- Alternative lenders with HNW investor backing are competitive, both on leverage (which can exceed 3x EBITDA) and on structuring which often contains a large bullet component (up to 100%). However, because of the source of capital, loans rarely exceed £10m and the total corporate lending books rarely exceed £100m. As such, these lenders are generally competitive but due to size limitations only cover a limited proportion of the market.
- Alternative lenders funded through structured institutional capital are usually focused on lending greater volumes than those funded by HNWs, with the ultimate goal being to build a loan book of c.£250m in 2 to 3 years and then securitise this on the public markets. No lender targeting the LMM in the UK has yet been able to successfully securitise, though they have built books. Leverage offered by these lenders is typically in the range of 3x EBITDA. In addition, these lenders are subject to further requirements based around tight sector concentration, regional concentration, and obligor limits (total loan to ultimate borrower). Additionally, the investor structuring often requires individual underwriting authorisation from the lender, an external ratings agency and the SPV investors (equity, mezzanine & senior investors). These additional requirements lead institutionally funded alternative lenders to be less competitive and slower in extending credit. Currently, these lenders also cover a small proportion of the market and will remain constrained due to the restrictions placed on them by their funding base.

The relatively small scale of alternative lenders provides a further opportunity for a hybrid capital solution.

Mezzanine lending and preferred equity are useful solutions but only account for a small niche because of their inherent complexity.

Mezzanine lending comprises loans that sit behind a senior lender (be it a bank or an alternative lender) taking second ranking security. They offer additional leverage to a potential borrower and because of their ranking, they obtain a risk premium. They are often flexible on structuring, mainly offering a 100% bullet over a 4-year or 5-year term and usually include a small warrant.

Preferred equity comprises minority equity positions that have certain debt-like characteristics (such as a first claim to dividends or repayment before equity) but which remain subordinated to senior debt providers. As LMM businesses rarely pay substantial dividends (they prefer to retain cash in the business for growth or to repay senior debt), preferred equity's returns are dependent on growth, with some downside protections. Preferred equity typically sits just below ordinary equity.

Both mezzanine lending and preferred equity are inherently complicated structures that require sophisticated investors to underwrite and manage them. Most individuals with this sophistication choose to focus on larger tickets than the LMM and as such there is limited provision of mezzanine lending and preferred equity in the LMM.

In this context, whilst mezzanine lending and preferred equity are potentially attractive solutions, there are a limited number of providers who focus on the UK LMM segment, offering an opportunity for Westbrooke to become a key player in this space.

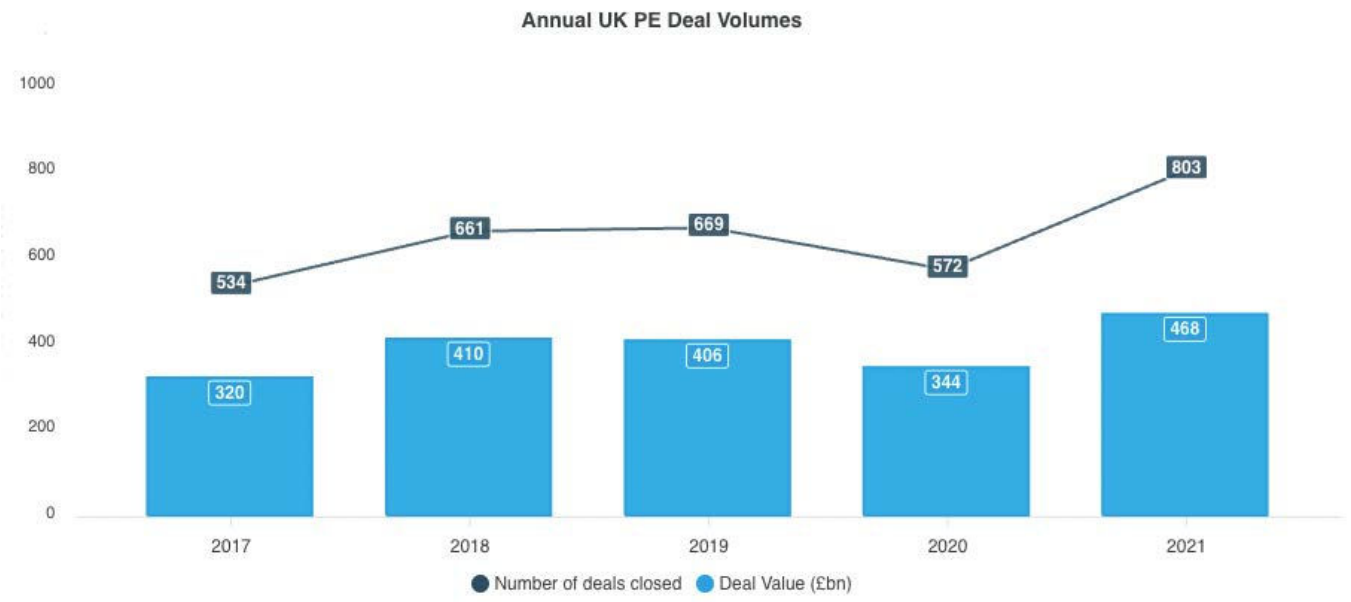
Supply for LMM equity funding mainly comes from private equity, who require lending solutions in order to make their business models work.

PE firms generally purchase businesses directly from entrepreneurs or other PE firms. While not lenders, their investments fill some of the financing gap for the LMM.

As PE firms are focused on equity investing at higher returns, their funding alone is insufficient in order to address the full funding shortage faced by the LMM. They require cheaper debt solutions in order to enhance equity returns to suitable levels for their investors.

Annual deal volumes for mid-market private equity houses have risen from £32bn in 2017 to £46.8bn in 2021. Investment remained above 2017 levels in 2020 despite Covid-19 and grew substantially in 2021, following the reopening of the economy*.

Source: KPMG mid market lending report



Purchase multiples remain high (>10x EV/EBITDA), though they have fallen since 2017 as PE buyers have shifted from purchasing high growth technology businesses to focusing more on traditional growth sectors such as business services and healthcare. Lowering multiples and high levels of dry powder are causing increased demand from PE buyers.

Source: KPMG mid-market lending report / Preqin

Source: KPMG mid-market lending report

The gap between the average PE valuation multiple (of 10x) and the 2x-3x multiple that can typically be achieved from senior lenders, leaves a gap which provides the opportunity for hybrid capital in conjunction with other forms of capital.

While a funding gap clearly exists in the LMM, the economic condition in the UK is uncertain. From our investor perspective, the desirability of the hybrid capital solution, which offers a unique asymmetry between risk and return, has rarely been higher.

The lingering impact of Covid-19 and the implications of the Ukraine crisis are continuing to impact key UK macro indicators, with GDP growth forecasts suggesting a challenging period ahead.

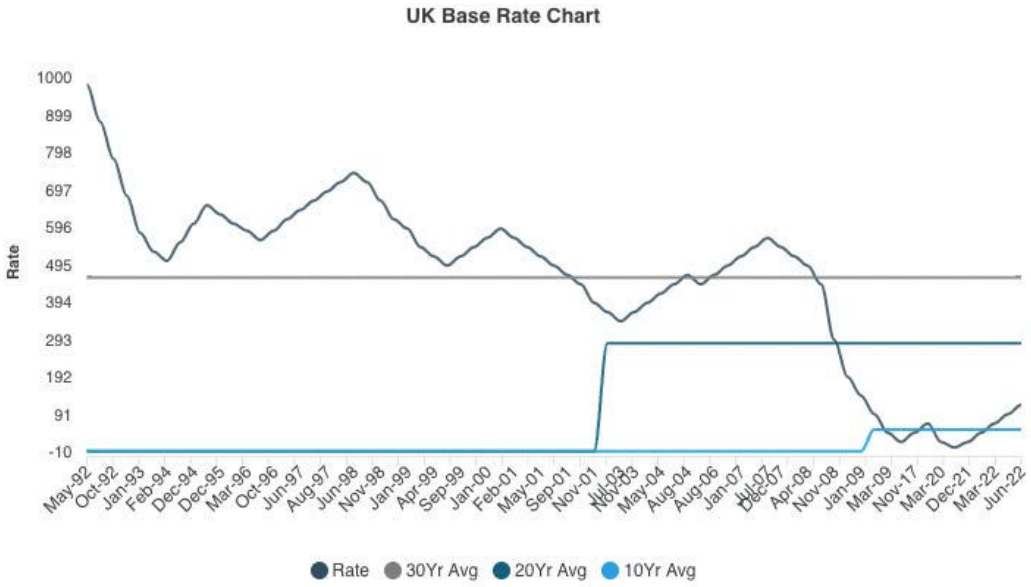
In the UK, input costs have risen at their fastest rate in over a decade, driven by the war in Ukraine and Brexit. With no slow down expected in the next 12 months and many businesses looking to pass these costs on to consumers, inflation is a key concern for lenders that needs to be underwritten when assessing any potential borrower. The ability to manage the cost base, both in raw materials and in wage costs, and in pricing power, are key considerations.

This has continued to fuel inflation, with UK inflation having reached its highest level in 40 years in May 2022.

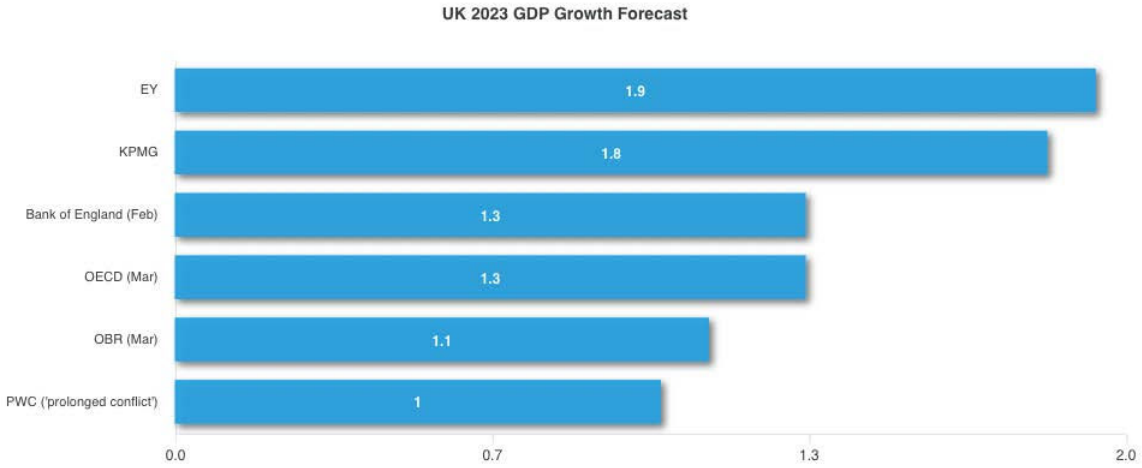
Source: ICAEW - Note: data not recorded for Q3 2020 due to Covid-19.

Sustained inflation has triggered successive increases in base rates across the developed world, following the previous cuts in rates to all-time lows in response to Covid-19. The Bank of England has now increased rates to 1.25% in June 2022, the highest level in 10 years. Further rate hikes are imminent with the consensus being that rates may hit 3.0% within the year.

In this context, it is essential that loans written by the WDO UK fund are variable rate in nature. This can be achieved by pricing with reference to either SONIA or the Bank of England Base Rate. Such pricing can also provided enhance protection to lenders.



The fear of rising inflation has resulted in tempered expectations regarding UK economic growth post-Covid-19. GDP growth expectations for FY22 are now well below the initially expected 4.0%, with FY23 closer to c.1.0% and broad consensus that a recession is now imminent.



Within this uncertain backdrop, it is important to focus on the highest quality businesses that offer superior risk-adjusted returns by providing a solutions driven approach but also protected capital structures to mitigate risk in these environments.

In addition, it is highly likely that both banks and alternative lenders will focus on protecting and managing their existing portfolios going forward, rather than focusing on new business. This is likely to lead to a further reduction in competition, offering greater opportunity for Westbrooke to improve terms and pricing.

In this context, it becomes clear that a hybrid capital funding solution offers a potential solution to the complexities in obtaining funding faced by businesses operating in the LMM.

Hybrid capital works by providing the borrower with a package of debt and protected equity (often by way of a warrant, liquidation preference, etc.)

In the UK LMM context, ticket sizes range between £1m and £20m.

Hybrid capital is appealing as it provides the borrower with a blended offering, allowing them to deal with a single counterparty which plays across the capital stack. This can add additional flexibility, improved process efficiency and additional leverage when compared to what a traditional lender is typically able to offer.

This offering is appealing to a wide variety of partners:

- Entrepreneurs can use hybrid capital to finance growth, while minimising dilution;
- PE can use hybrid capital to complement their offering, obtaining reasonable leverage while sharing their equity upside with hybrid capital;
- Banks and alternative lenders can work alongside hybrid capital, to increase their ability to serve clients within their lending parameters.

The funding gap created by the mix of a lack of a ready supply of capital, set against the backdrop of increasing demand for capital, presents a unique opportunity within the UK lower-mid-market, especially for market participants who are correctly positioned to support growing business with flexible capital. It is this market dynamic that the WDO UK Fund seeks to capitalise on.

3. westbrooke dynamic opportunities (WDO) – the hybrid capital platform

As highlighted in the market overview section above, a funding gap exists in the UK LMM segment. The WDO UK Fund seeks to capitalise on this by providing the market with a flexible, solution-driven approach to providing capital.

investment thesis

The WDO UK Fund has been established by WAAM UK to take advantage of the dislocation in the LMM and to provide investors with the opportunity to invest alongside Westbrooke and related parties in hybrid capital transactions in the LMM.

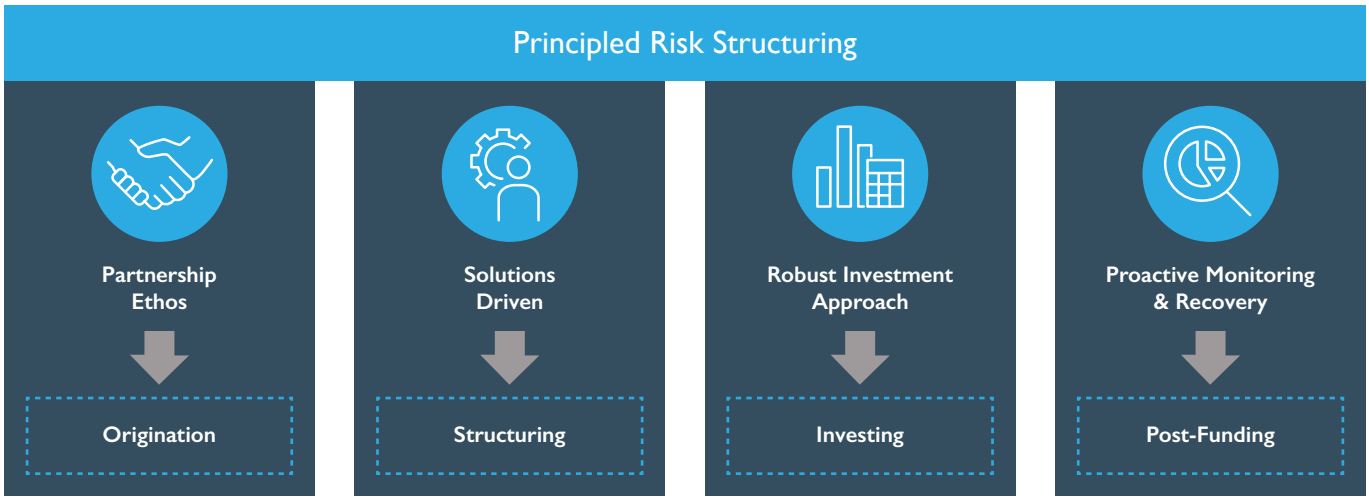
WDO provides investors with the ability to access a diversified pool of opportunities which target an equity-style return whilst utilising debt-like characteristics to mitigate capital loss, creating a debt-like risk profile.

Utilising our existing UK origination network of reputable and experienced specialist loan originators, family offices, private debt and equity funds and investors ("Originating Partners"), WDO UK focuses on providing investors with unique access to transactions which demonstrate a distinct asymmetric risk return profile:

- WDO sources, structures and executes on transactions (the "Transactions") across the capital spectrum, ranging from high-yielding secured loans, to mezzanine finance, preferred equity and equity to businesses in the LMM segment
- The Transactions typically take the form of a hybrid capital instrument, which derive income and capital growth from two components being:
  - an interest-bearing coupon, and;
  - a variable performance-based instrument (i.e. warrant, option, equity).
- In addition, the Transactions will benefit from having security, monitoring and financial covenants, demonstrable route to exit/ liquidity and significant equity cushions.

the philosophy

The thesis is centered around the Westbrooke risk philosophy and approach underpinned by four key pillars:



- **Principled risk structuring** – WDO adheres to a consistently applied set of principles and risk philosophy, focusing on capital preservation, sensible leverage, probabilistic investment upside and full alignment with our partners. Our experienced investment team follow these principles, focusing their time on conducting thorough analysis to understand the risks and opportunities contained within the best LMM assets.
- **Partnership ethos** – we have aligned with best of breed partners in private equity, banking, advisory and the entrepreneurial community. This network has provided a continual flow of quality opportunities in the LMM since inception.
- **Solutions driven** – by embracing an investment's inherent operational, structural and market complexity, we are able to deliver tailored and differentiated solutions for our partners. This improves Westbrooke's screening process and conversion rates to be substantially above market levels.
- **Robust investment approach** – our risk philosophy focuses on capital preservation first, designed to minimise risk. Our investment process (outlined in more detail below) ensures that risks are identified quickly for any sector/situation and that our internal operations are efficient which results in high-quality Transactions being processed quickly.
- **Proactive monitoring and recovery** – the investment team monitors each transaction regularly, to ensure performance and identify early warning signals. We typically hold observer/board positions on transactions providing additional visibility. Westbrooke's strong relationships and continual communication with our sponsors, portfolio companies and advisors assist in mitigating risk and pre-empting situations.

The sections below outline how we approach and implement each of these pillars, in more detail.

Principled risk structuring that protects investor capital and provides investor upside

The Westbrooke risk philosophy can be distilled into the key principles outlined in the table below. These principles form the basis for risk assessment across each Transaction and enables a consistent approach irrespective of the nuances a Transaction may present. They represent a culmination of skills obtained from a deeply experienced investment and advisory team, many of whom have 20+ years UK investing experience.

WDO UK uses these principles as a means to approach complex event driven Transactions (often where the structuring opportunity is not always apparent), driving enhanced investor returns through the ability to assess and price risk accordingly.

Principled Risk Structuring

Focus on capital preservation

- We are defensive when the upside is capped. We adopt a conservative investment strategy where the primary goal is to preserve capital and prevent loss in each transaction.
- We invest our own capital into every transaction so that we are aligned with our investors.

"Make sure that the probability of the unacceptable (i.e. risk of ruin) is NIL"
Ray Dalio

Maintain leading credit structuring and investment expertise

- We understand that gearing increases the risk of capital loss and absolute loss of capital materially – it is an armed and dangerous missile which we treat with care.
  - We understand and explain ungeared returns and risk we are taking on when gearing; and what happens if it goes wrong.
  - High gearing rarely if ever favours the lender, so we act with caution.
- We rely on the deep experience of the investment team and the investment committee (see the Westbrooke team and track record sections), to decide the correct level of risk to take. Our strong heritage as business owners and investors, provides a unique understanding of risk and reward.

"Loose credit conditions and a rising tide can make it easy for individuals to make money "accidentally." But making money in strong markets can be short-lived. Smart investors perform well through a combination of self-discipline and sound risk assessment, even when market conditions reverse."
Steven Schwarzman

Rigorously test assumptions and beliefs

- We challenge and debate all aspects of a transaction ensuring underlying assumptions on performance and credit are tested, quantified and robust.
- We focus on probabilities – forecasts are always wrong, so we do not focus on them intensely. We focus on the probabilities of gain / loss under various scenarios and make sure the probable outcomes are reasonable, acceptable and antifragile:
  - In subjective areas, such as uncertain future projections, non-linear thinking is required. We are comfortable dealing in shades of grey and probabilities – we know there is no correct answer
  - We model various scenarios and ensure survival and success under all possible outcomes
  - We never compare returns on deals without a deep understanding of the different risks
  - We believe that you make money where you have a different view of the future than the seller **and** you are right

"It's not whether you're right or wrong, but how much money you make when you're right and how much you lose when you're wrong"
George Soros

Align with the best partners

- We do not deal with people whose reputation and track record we cannot reliably verify through a trusted and respected associate.
- Prospective investment companies, sponsors and partners share our values, which allows us to establish an open and honest working relationship.
- We require continual commitment from the entrepreneur, management, lender or private equity. We align expectations and risk by requiring appropriate capital commitments.

"I learned to go into business only with people whom I like, trust, and admire."
Warren Buffet

These principles have resulted in us being able to successfully build the investment performance which is further outlined in the Westbrooke's hybrid capital track record section of this document.

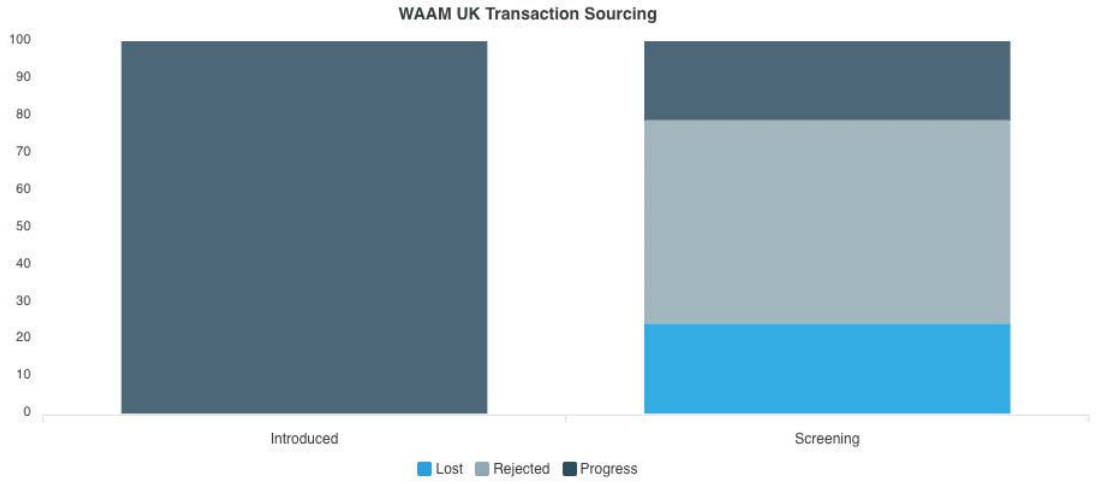
Partnership ethos which builds long-standing relationships

"Partnership is not a posture but a process – a continuous process that grows stronger each year as we devote ourselves to common tasks."
John F. Kennedy

Westbrooke partners with intermediaries, sponsors (in the form of private equity houses), banks, management teams and/or entrepreneurs to solve a partner's problems and build a working relationship based on trust.

By aligning WDO UK with partners with shared values and who are focused on a partnership-first approach to investing, Westbrooke mitigates risk and efficiently sources new opportunities.

Chart: Last twelve months origination pipeline

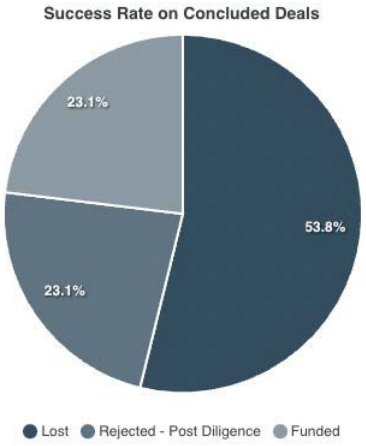


Solutions driven approach which offers differentiation and investor upside

"In investing you have to be defensive and aggressive at the same time. If you are not aggressive, you are not going to make money, and if you are not defensive, you are not going to keep money."
Ray Dalio

The WDO UK Fund serves the market as a solutions driven funding partner, built on a reputation for deliverability, creativity, and flexibility in its approach to complex financing situations and needs. Partners look to WDO UK for solutions of up to £20m to fund established growing UK companies whose EBITDA's typically fall in the range of £2m - £10m.

By providing a hybrid solution that combines a debt-type instrument together with a minority equity position, Westbrooke's WDO UK Fund provides the flexibility that partners look for. The combination is tailored to the partner's needs and allows WDO UK to approach each financing request with an open mindset to deliver a holistic funding solution across the capital structure, rather than the traditional single loan product approach normally adopted within the market. This tailored approach has allowed Westbrooke to achieve a success rate from issuing terms through to funding, which is substantially above the market rate of <5%.



WDO UK provides Borrowers with a simplified, differentiated and efficient capital raising process in a challenging and unstructured capital environment, while delivering investors with a superior and differentiated investment opportunity providing compelling risk and return dynamics.

Robust investment approach that focuses on capital protection

"In a probabilistic environment, you are better served by focusing on the process by which you make a decision than on the outcome"-
Michael Mauboussin

Transactions are assessed through a rigorous screening process comprised of 4 distinct phases designed to thoroughly test and scrutinise investment propositions. This allows WDO UK to assess the nuanced complexity of each transaction to find opportunity and deliver outsized returns relative to the underlying risks:

Phase I: Transaction Introduction

Initial transaction Screening
Company overview, historical financials, forecasts, proposed transaction

Inputs	*Process*	*Outputs*
Initial review of quantitative and qualitative elements of the transaction, short form discussion papers and indicative pricing and credit models.	Investment team assess output of quantitative and qualitative analysis and determine whether to proceed or decline the transaction further.	Decision on whether there may be opportunity or if the transaction is a no-go. Questions from investment team are shared with the client along with indicative pricing and deal structure.

Phase II: Terms to Borrower

Further Desktop Research / Management Meeting
further detail on all aspects of the transaction, modelling, preparation of term sheet

Inputs	*Process*	*Outputs*
Initial review of quantitative and qualitative elements of the transaction, short form discussion papers and indicative pricing and credit models.	Investment team assess output of quantitative and qualitative analysis and determine whether to proceed or decline the transaction further.	Decision on whether there may be opportunity or if the transaction is a no-go. Questions from investment team are shared with the client along with indicative pricing and deal structure.

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Proactive monitoring and recovery that further ensures capital protection

"Returns matter a lot. It's our capital."
Abigail Johnson

Investee businesses are monitored regularly to ensure that they are performing and have adequate capital to service current and future obligations. Management provides trading information to the investment team on a monthly basis.

The WAAM UK team typically also takes a board seat, or board observer seat, on every transaction within the WDO UK strategy. This regular contact deepens the relationships with management while providing strategic insight on how the Transaction is performing.

Data collection

Data Gathered	Description	Cadence		
		Monthly	Quarterly	Annual
Financial information	Actual profit & loss, balance sheet and cash flow statements. Management forecasts vs budget / original projections & forecast budget.	✓	✓	✓
Strategic plan / board packs	Qualitative overview of management plan, including revenue growth, cost management, competitive positioning, opportunities and threats.	✓	✓	✓
Board meetings	The investment team attend board meetings and receive minutes. This provides insight on management dynamics, strategy and additional investor considerations.	✓		✓
Co-investor communication	Strong relationships with co-investors allow Westbrooke to gauge market sentiment on portfolio companies and the wider market.	✓		
Covenant compliance	The investee company certificates that they are covenant compliant.		✓	
Market assessment	Assessment of business against relevant market indicators which vary dependent on the sector and size of the transaction.		✓	

All performance information is tracked against forecasts and budgets, with formal investment reports compiled on a semi-annual basis.

Early warning signals (EWS)

EWS help the WAAM UK team to identify where a Transaction is underperforming and may default. WAAM UK is vigilant in tracking this information, focusing on mitigating potential risk before it happens. Westbrooke uses the following information to identify EWS:

Information gathered	Rationale & description
Financials	Assess if covenant breaches are imminent or have occurred, considering financial performance against covenants. WAAM UK details additional performance against management budget and assess trends that may indicate future covenant breaches
Market update	Understand if any market trends may drive future underperformance for the Transaction. WAAM UK assess third-party market reports and compare these with management's assessment of the trends and their overarching strategy.
Management & strategic changes	Assess the growth plans, cost management and competitive positioning of the business and whether these may cause future underperformance. WAAM UK uses a combination of board meetings and additional formal statements from management.
Fraud & governance issues	Ensure that the business is acting with integrity. Use third party data to assess the validity of information provided by management. Also assess the dynamics of management at board meetings and through additional interaction.

Performance monitoring

Rank	Detail
Performing	On track and not underperforming, or indicating to underperform, on any obligation.
Underperforming	At least one sign of underperformance, i.e. against market trends or against budget.
Soft default	One breach of loan documentation, i.e. not providing financial information in the agreed timeframe (not including covenant breaches).
Hard default risk	Trending towards one or more covenant breach.
Non-performing-loan (default)	A material breach of any covenant set by WAAM UK which leads to an enforcement event.

All non-performing transactions require additional information. In these instances, the management team of an investee company is required to meet with us to discuss the situation. Further information, such as a new business plan or rationale for sub-performance, may be requested.

WAAM UK assesses each case and decides where a plan can be implemented to improve the performance, if amendments / waivers to the facilities are required or if an impairment charge should be implemented.

Defaults and recovery

Westbrooke manages each default to protect capital invested. The first goal is to minimise any loss that may be incurred. While the documentation and ranking provides security to the position, and to our investors, the strong relationships with equity partners and the reputation of WAAM UK creates a reputational risk for equity partners involved with defaults. This provides a strong negotiating position for Westbrooke which incentives equity co-investors to remediate any defaulted position. Typically defaults include, but are not limited to:

- Lack of repayment
- Lack of financial disclosure that is not remediated
- Fraud or misrepresentation
- Insolvency

If a default occurs, we follow the process below:

1. Our investment team uses our principled risk structuring approach to outline the potential scenarios available to us. The immediate focus is to ensure that capital is preserved, and that the WDO UK investment value is maintained. In the majority of scenarios, remediation will be completed quickly, with the business or the sponsor(s) paying their obligations to WDO UK on request from WAAM UK.
2. In more complex cases, the investment team may work with third-party lawyers and advisors to assess the business and understand further viable solutions which may include restructuring, re-capitalisation, administration or a business sale. In addition, the investment team would build related forecasts in order to recommend the best solutions to the investment committee, who would then approve the proposed solution. Solutions would be tested against the probable expected recovery, time to recover and the cost of the recovery. Once a solution is validated, the investment team then make a request to the defaulted business that they confirm it will be implemented. In the event that it is confirmed, then a detailed plan will be requested from the management and weekly monitoring will be conducted. In the event that request is rejected, or unable to be honored, we then move to the following procedure.
3. Legal advisors would be engaged to enforce the solution on the defaulted business. They prepare the required documentation and share this with the defaulted business and its investors. This route may require additional involvement of a third-party who specialises in restructuring and/or the specific sector. All additional costs will be incurred with the overarching goal to resolve the issue with the best financial outcome for investors. The costs are ultimately borne by the defaulted business.

4. westbrooke's hybrid capital track record

Westbrooke has been actively investing in the UK LLM market since the establishment of our UK business in 2017. Since then, we have invested in excess of £250m across 110+ private transactions in and around the UK. These transactions have been offered to investors primarily though our Westbrooke Yield Plus secured private debt platform, which currently manages in excess of £100 million of third-party and shareholder capital. Westbrooke shareholders and management have invested more than 20% of this capital alongside clients to date.

Driven by the structural shifts in the market as outlined in the market overview section above, Westbrooke began investing in hybrid capital transactions in early 2021. We have provided total funding packages of £58m across five transactions in debt, preferred equity and equity in the building products, special education needs schools, electrical components, hotel and pub sectors.

The existing portfolio of transactions targets an overall weighted average annual return of 12.0%+ per annum (net of all fees and costs). This is comprised of a weighted average debt yield of 10% per annum (of which 4.0% is cash paid) plus the upside anticipated through the applicable equity participations in the investee businesses,.

The table below summarises the key features of the five transactions completed to date:

	Project Talbot	Project Melrose	Project Beta	Project Sky	Project Brew
Date closed	December 2020	August 2021	November 2021	April 2022	May 2022
Borrower / investee	Folkestone Fixings	Melrose Education Group	Acal BFi	New SPV with a lease to StayCity Aparthotels	New SPV with a lease to Marston's Plc
Sector	Building products	Special education needs schools	Electrical components	Hotels	Pubs
Facility type	Debt + preferred equity	Preferred equity	Debt + equity participation	Preferred equity	Debt + equity participation
Total funding package	£19.6m	£7.0m	£10.5m	€15.0m	£7.8m
Total hybrid capital instrument size	£7.6m	£7.0m	£8.0m	€6.5m	£3.8m
Overall expected IRR	12.5% - 17.5% p.a.	11.3% - 22.6% p.a.	12.5% p.a.	10.1% - 24.0% p.a.	9.0% - 11.0%
Target yield – cash	4.75% p.a.	–	5.0% p.a.	–	8.0% p.a.
Target yield – PIK	5.25% p.a.	9.0% p.a.	6.0% p.a.	11.5% p.a.	-
Equity stake taken	7.9%	30%	2.8%	50% (with a ratchet mechanism)	3.5%
Target return from equity participation	2.5% - 7.5% p.a.	2.3% - 13.6% p.a.	1.5% p.a.	0% - 12.5% p.a.	1.0% - 3.0% p.a.
Transaction term – debt	5 years	n/a	3.25 years	4 years	4 years
Transaction term – equity	5 years	6 years	5 years	4 years	4 years
Transaction partner	H2 Equity Partners	Innervation Capital Partners	H2 Equity Partners	Song Capital	Song Capital and Cerberus Capital
Percentage of overall portfolio	24.6%	16.2%	25.9%	20.9%	12.3%

A narrative summary of each transaction is presented below:

Project Melrose

Westbrooke structured a £5.0m preferred equity investment to support Innervation Capital Partners' establishment of the Melrose Education Group, a UK special education needs school group. Melrose Education was established as a 'buy-and-build' strategy to consolidate and expand smaller, UK special education needs schools, a highly fragmented and operationally complex sector with high barriers-to-entry.

Melrose Education presents the opportunity to create a pan-UK group of special education needs schools at exit and achieve multiple arbitrage due to scale.

Westbrooke investors were invited to invest in a £5.0m preferred equity note, which targets a 15.3% net IRR under the base case, comprising a 9.0% annual PIK yield and the remainder being generated by way of a 30% equity stake in the business.

To date, Melrose Education has exceeded expectations in terms of its ability to execute the buy-and-build strategy, and in July 2022 completed its fifth acquisition, bringing consolidated pro forma run rate group EBITDA to £3.6m. In this context, we believe the cover implied in our preferred equity position to have improved and that our equity stake now carries a material level of value.

Project Beta

Westbrooke provided £10.5m of funding to support H2 Equity Partners' ("H2") acquisition of Acal BFi ("Acal"), one of Europe's leading value-add distributors of electrical components, serving over 6,000 original equipment manufacturers across several geographies and multiple end markets, with a key focus on the transport, industrial, energy and medical markets, all of which are supported by strong secular growth trends.

The facility comprised £10.0m of second-ranking mezzanine funding (£2.5m of which was provided by the Westbrooke Yield Plus secured private debt fund as an "A-Note") plus a £0.5m pro-rata equity investment alongside £15.8m of additional equity being invested by H2 and management.

The transaction provided investors with the opportunity to fund a well-established and successful business presenting strong downside mitigants, with a conservative investment strategy and multiple paths to exit underpinning the equity co-invest.

Westbrooke investors were invited to commit to a £8.0m stapled note, comprising £7.5m of the mezzanine funding (through a secured, second charge "B-Note") and £0.5m of pro-rata equity investment. The investment targets an 11.0% - 12.5% overall net IRR, comprising an 11.0% annual yield (5.0% cash paid and 6.0% PIK), with the remainder being generated through a 2.8% equity participation in the business.

The transaction was concluded towards the end of 2021 and Acal has continued to trade ahead of expectations since making the investment.

Project Talbot

Westbrooke lead arranged a total £19.5m investment via a £15.5m senior debt facility and £4.0m preferred equity facility to support H2 Equity Partners' management buyout of Folkestone Fixings Ltd (trading as "FFX"). Based in Kent, UK, FFX is a fast-growing, cash-generative, market-leading e-commerce distributor of power tools to a well-diversified B2B customer base in the UK. FFX benefits from an attractive, growing market segment driven by a shift from offline to online, further accelerated by Covid-19.

The Transaction valued FFX at £35.3m (6.8x Dec-20 last twelve months EBITDA of c.£5.2m), with FFX presenting the opportunity to deliver a 'polished asset' on exit and achieve multiple arbitrage due to the long-term attractions of the end market.

Westbrooke investors were invited to subscribe for a £7.6m hybrid capital note, comprising £3.5m of senior debt and £4.1m of preferred equity, the combination of which targets a 12.5% - 17.5% net IRR. This IRR is comprised of a target 10.0% annual yield (4.75% of which is cash yield and 5.25% is PIK), with the remaining return to be derived through 7.99% equity stake in the business.

Since inception, FFX has traded slightly behind budget, driven primarily by Covid-19 lockdowns and the related supply chain issues arising from both Covid-19 and the Ukraine crisis. Our debt position in the business remains well covered, with all interest obligations having been serviced to date. We are yet to see a material level of equity value built up in our equity stake, although this may change as the market continues to open up into the future.

Project Sky

Westbrooke provided a €6.45m secured preferred equity note to support the acquisition of the leasehold interest in a newly constructed 340-key aparthotel in Dublin, Ireland. The transaction was concluded alongside Song Capital, a trusted and experienced operational real estate sponsor with whom Westbrooke has transacted in the past.

The transaction was structured in two stages, with Song Capital initially acquiring a full interest in the hotel for €93.2m, and simultaneously selling the freehold interest to an investment buyer for €71.7m in return for a 99-year lease over the property. The remainder of the hotel cost, being €21.5m, forms the purchase price of the leasehold asset which the secured preferred equity note part-funded.

In order to monetise the value inherent in the leasehold interest, the hotel property was then let to StayCity on an inflation-linked 25-year triple net lease paying €4.46m p.a. StayCity is an established UK and Ireland focused apart hotel operator backed by the Irish Sovereign Wealth Fund, with 23 sites across Europe and the UK.

The secured preferred equity note offered to investors is forecast to earn a total 21.5% net IRR in the base case scenario, with 11.5% thereof being contractually payable via a PIK note (and ranking ahead of Song's equity) and the remaining 10.0% being a share in the equity participation from any proceeds on sale of the leasehold asset.

The Project Sky transaction has been implemented in line with the investment strategy to date. Initial indications suggest that the leasehold interest might be capable of being sold at a premium earlier than initially anticipated.

Project Brew

Westbrooke provided a £7.4m senior debt facility to support the acquisition of a portfolio of 99 leasehold pub assets in Wales alongside the partners of Cerberus Capital Management ("Cerberus") and Song Capital ("Song") (collectively, the "Consortium"), experienced sponsors with an over 12-year track record in pub ownership and operations in the UK.

The transaction was structured in two stages, with the Consortium initially acquiring the pub portfolio for £75.7m and simultaneously selling the freehold to an investment buyer for £60.0m in return for a 150-year lease over the pub portfolio. The remainder of the cost, being £15.7, forms the pub portfolio purchase price which is what the Westbrooke debt facility part-funded.

In order to monetise the value inherent in the leasehold interest, the Portfolio was let to Marston's PLC on a 15-year triple net lease, paying £5.2m per annum. Marston's is a listed, c.£420m market cap* pub operator which focuses on pubs outside of urban areas across the UK.

** As of July 2022*

Of the debt package, the Westbrooke Yield Plus senior secured debt fund provided the first £4.0m as an "A-Note". Westbrooke investors and management invested in a £3.8m "B-Note" (£3.4m debt and £0.4m of co-invest equity and deal costs), which ranks behind the A-Note and targets to generate a net 9.0% - 11.0% return under the base case, comprising an 8.0% annual cash yield, with the remaining 2.0% - 3.0% annual return being generated by way of a 3.5% equity stake in the business.

The Project Sky transaction has been implemented in line with the investment strategy to date.

5. portfolio construction and expected returns

investment parameters

The WDO UK Fund targets to invest between £5m and £20m per transaction in hybrid capital opportunities in the LMM.

The WDO UK Fund invests in consistently cash-generative, primarily UK headquartered businesses. The investment parameters of the WDO UK Fund are further detailed in the table below:

fund investment parameters

Business types	
Geography	Primarily UK headquartered
Sector	Agnostic
EBITDA	Target minimum of £2m
Cash flow	Performing businesses with consistent cash flows
Management	Proven track record and aligned (no county-court-judgments (CCJS) or historic defaults on debt)
Transaction types	
WDO facility size	Target of £5m - £20m
Term	Target 2 – 5 years
Repayment profiles	Bullet / amortising / bespoke
Return components	Yield (cash and / or accrued) and equity participation
Ranking	Senior / mezzanine / preferred equity
Covenants	Quarterly on leverage, cash flow cover, capex, cash balance and others by exception
Fund portfolio limits	
Maximum obligor exposure per transaction	Maximum of 20%
Minimum diversification	5 transactions
Target diversification	5 - 10 transactions

Transaction characteristics

The WDO UK Fund typically invests in transactions which can broadly be segmented into the following five categories:

Core characteristic / target parameters					
Transaction type	**Type I**	**Type II**	**Type III**	**Type IV**	**Type V**
Description	**High-yield only**	**Unirate**	**Mezzanine I**	**Mezzanine II**	**Preferred equity**
Total investment amounts	up to £20m	up to £20m	up to £15m	up to £15m	up to £7.5m
Target term	2 - 4 years	3 - 5 years	3 - 5 years	3 - 5 years	3 - 5 years
Ranking	Senior / junior	Senior	Junior	Junior	Junior
Target investment IRR (gross)	10% - 12%	10% - 15%	12% - 15%	15% - 17%	20% - 25%
Target cash yield (gross)	8% - 12%	8% - 12%	5% - 10%	3% - 8%	0%
Target money multiplier	1.2x - 1.57x	1.3x - 2.0x	1.4x - 2.0x	1.5x - 2.2x	1.75x - 3.0x
Equity participation?	No	Yes	Yes	Yes	Yes
Security	Yes	Yes	Yes	Yes	No
Financial covenants & enforcement rights	Yes	Yes	Yes	Yes	No
Indicative return profile					
Cash yield	80%	70%	40%	40%	0%
Accrued yield	20%	25%	40%	30%	30%
Variable return (equity component)	0%	5%	20%	30%	70%
% Return contribution	**100%**	**100%**	**100%**	**100%**	**100%**

The aforementioned transaction categories are outlined in more detail below

Type I – high-yield only

- Structured as a senior / junior secured loan facility with a high-yielding contractual coupon
- The majority of the coupon is typically cash paid, and partially accrued
- No equity participation is taken
- Targets a total base gross IRR of between 10% - 12% per annum

Type II – unirate

- Structured as a senior 'stretch' secured loan facility consisting of a contractual coupon with small equity participation
- The majority of the coupon is cash paid and partly accrued
- A small proportion of the return is generated via equity
- Targets a base gross IRR of between 10% - 15% per annum

Type III – mezzanine I

- Structured as junior secured loan facility consisting of a contractual coupon with small equity participation
- The coupon is evenly split between cash paid and accrued
- A moderate proportion of the return is generated via equity participation
- Targets a base gross IRR of between 12%-15% per annum

Type IV – mezzanine II

- Structured as a junior secured loan facility consisting of a contractual coupon with higher equity participation
- The coupon is partly cash paid with the remainder accrued
- A high proportion of the return is generated via equity participation
- Targets a base gross IRR of between 15% - 17% per annum

Type V – preferred equity

- Structured as a preferred equity investment with a contractual accrued coupon and significant equity participation
- The coupon is fully accrued and not paid through the term
- The majority return is generated via equity participation
- Targets a base Gross IRR of 20% - 25% per annum

Pricing methodology

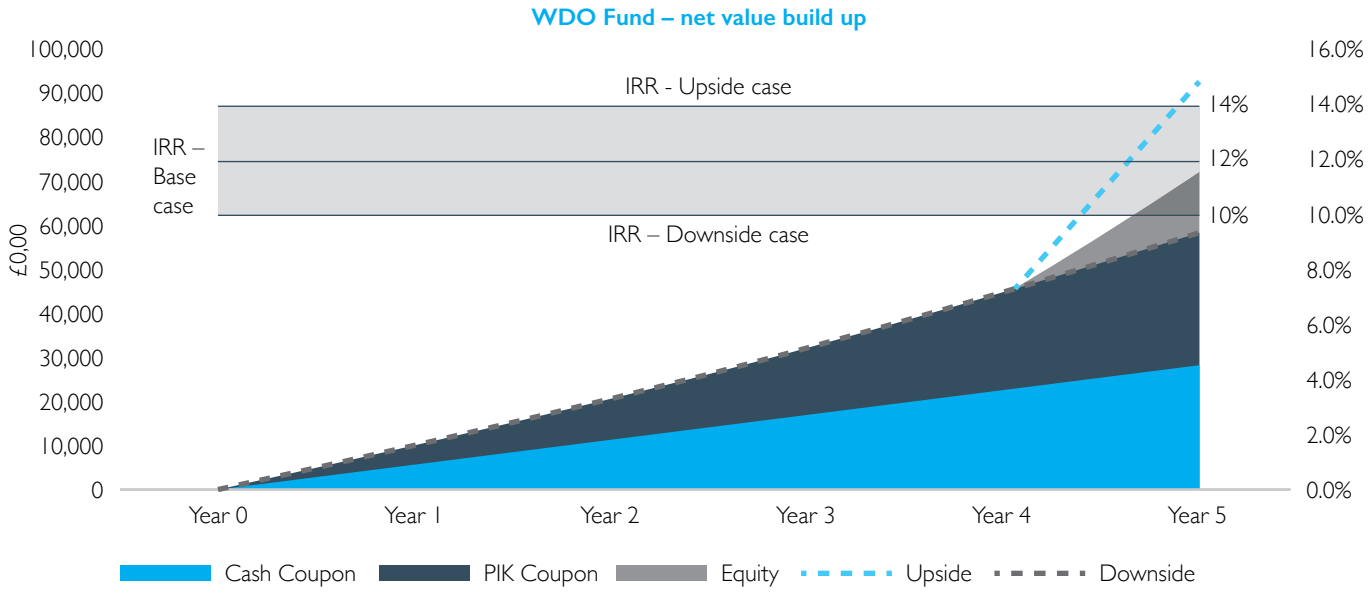
- **Debt:** debt facilities charge coupons which are priced dependent on the risk and ranking that WDO UK takes in the capital stack. WDO UK ensures that the gross coupon is priced above 8% + UK Base rate, unless the equity participation justifies a lower margin. The coupon may comprise a cash paid and accrued interest component, dependent on the facility type. Cash payment provides a periodic/annual return to WDO UK and may be between 50% and 80% of the overall coupon, although this is highly transaction specific.
- **Equity:** WDO UK generally takes equity in the form of warrant or option instruments, and on occasion will invest directly in equity. The size of the stake depends on the investment team's projected enterprise value of the business, the business fundamentals and the competitive dynamics.

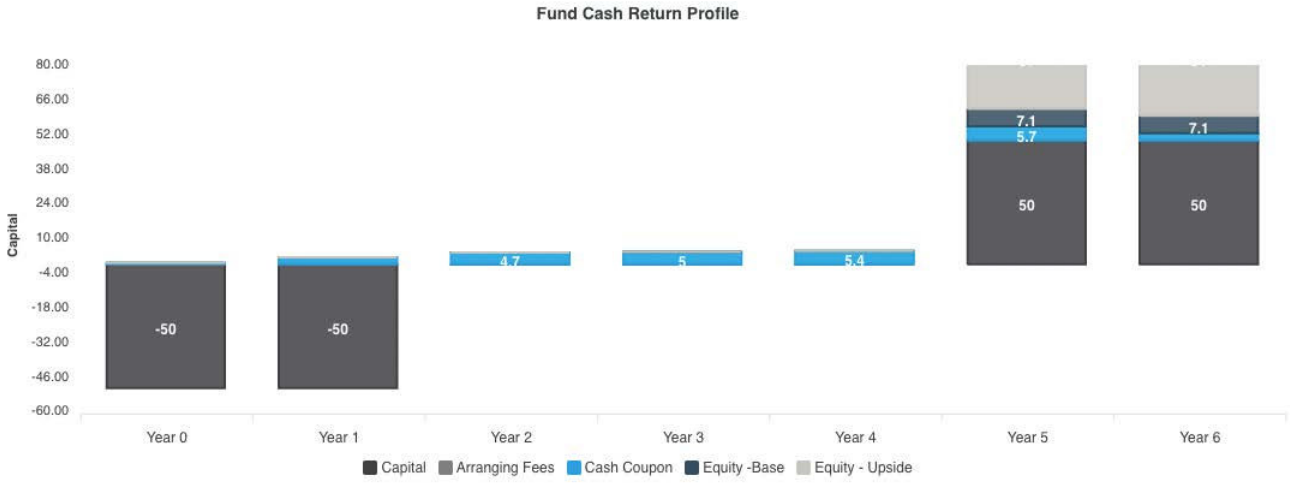
Expected returns

WDO targets a net investor return of 12%+ (IRR). For illustrative purposes only, we have modelled an illustrative portfolio under the following scenarios:

- The base case profiles no multiple expansion with a c.6% EBITDA growth for the portfolio. This results in net c.12.0% IRR and a 1.67x money-on-money return for investors.
- The upside case assumes higher EBITDA growth of c.10-15% and a multiple expansion on exit of one turn. This results in a net c14.0% IRR and 1.85x money-on-money for investors.
- The downside case assumes that the portfolio businesses EBITDA flatlines and that multiples contract. This all but eliminates equity upside for the fund, but it is worth noting that the debt return is not impaired. In the downside case investors still achieve a net c.10.0% IRR and 1.54x money-on-money.

Expected return profile by fee component and model scenarios



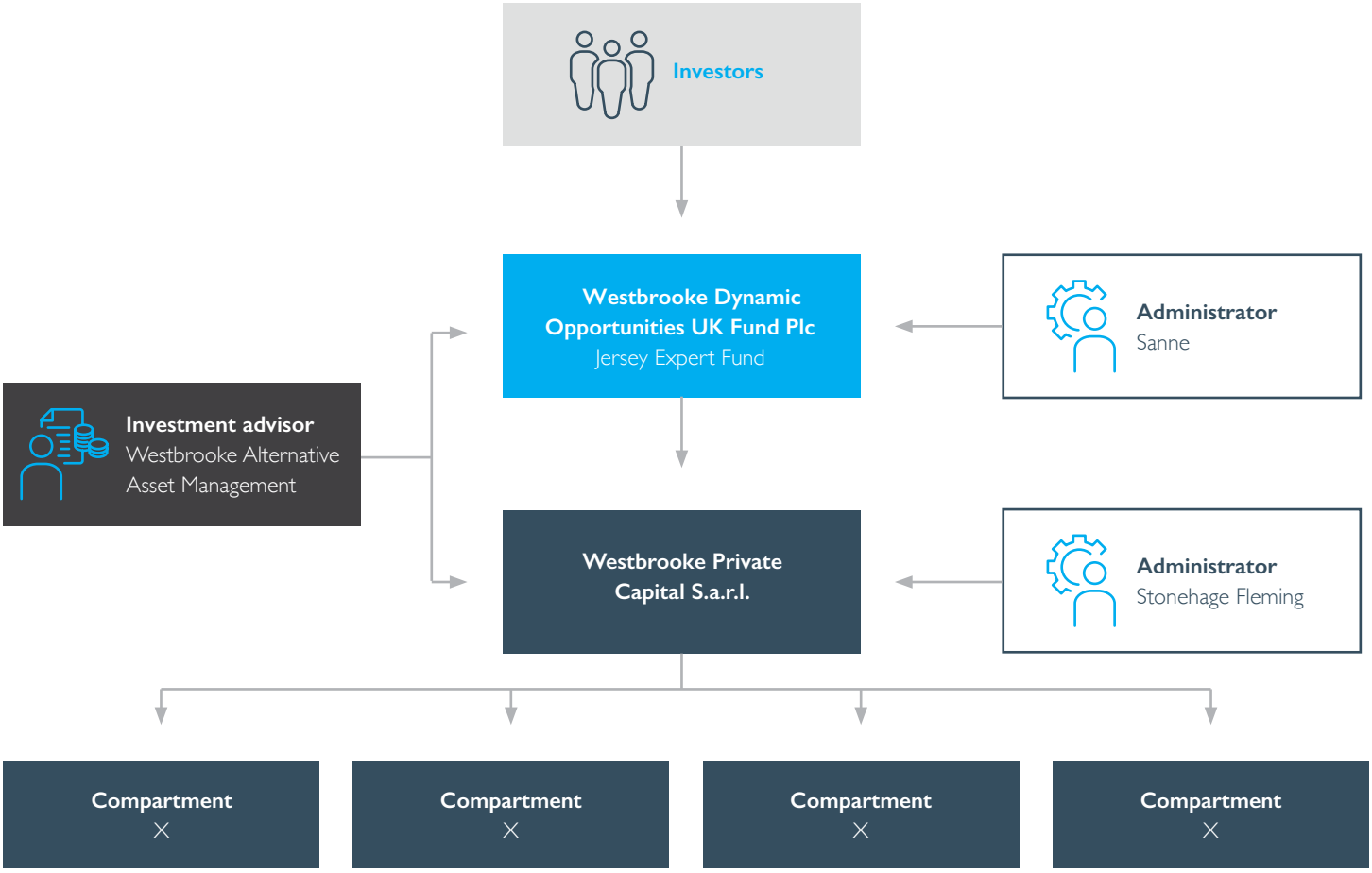

Fund Cash Return Profile
Capital
80.00
66.00
52.00
38.00
24.00
10.00
-4.00
-18.00
-32.00
-46.00
-60.00
-50
-50
4.7
5
5.4
50
7.1
5.7
50
7.1
Year 0
Year 1
Year 2
Year 3
Year 4
Year 5
Year 6
Capital
Arranging Fees
Cash Coupon
Equity -Base
Equity - Upside

6. fund term sheet

Company	Westbrooke Dynamic Opportunities UK Fund Plc
Investment advisor	Westbrooke Alternative Asset Management UK Limited
Regulation	Jersey Expert Fund, regulated by the Jersey Financial Services Commission
Currency	Pound Sterling (GBP/ £)
Year end	March
Administrator	Sanne Group Plc
Legal counsel	Walkers Inc. (Jersey)
Accountant	Bracken Rothwell
Leverage	Maximum 25%
Target investment profile	24-month investment period and 60-month hold period (underlying loans target a 2 - 5 year term)
Minimum investment amount	Direct investors: £250,000 (lower amounts might be accepted on application) Wealth manager advised: £100,000
Target IRR and return	The Fund is targeting a net IRR to investors of 12%+ per annum (after fees and costs), calculated from the date of a drawdown of capital with the return comprising the following components: • Cash yield from the underlying instruments, with a target cash yield of 4.0% p.a. paid semi-annually in March and September; • Accrued yield paid at maturity of the underlying instrument (target 6.0% p.a.); and • Capital appreciation through equity participation (target 2.0%+).
Distribution profile	The Fund will not reinvest any income or capital received. • All interest proceeds received (net of fees) will be distributed from day 1 back to investors, with a target cash yield of 4.0% paid semi-annually. • All capital returned to the Fund will be distributed to investors, subject to a portion being withheld to fund fees and costs.
Portfolio composition	The portfolio will be diversified against a target of 5 - 10 transactions, with a maximum single investment exposure of 20%. The Fund has the first right to invest in all hybrid capital transactions originated by WAAM UK. To the extent that a transaction exceeds the exposure limits of the Fund, the excess transaction will first be offered to existing Fund investors of £1m and above.
Investor reporting	• Ad hoc investor updates upon: – Successful completion of a transaction; – Successful exit of a transaction; – Any other material event affecting the portfolio (at WAAM UK's discretion). • Semi-annual fact sheet and valuations providing a general update on the portfolio and performance for the half-year period ending in March and September; and • Quarterly investment statements
Share classes	Investors will be invited to invest in the following share classes: • Class A1 shares (drawdown share class) • Class A2 shares (fully drawn share class)
Drawdowns	• Clients can either fully fund their commitment up front or fund their commitment in line with the capital calls issued by WAAM UK. • Funds in the fully funded share class will be invested by WAAM in accordance with a treasury management strategy in a combination of money market and high-yield credit funds. These may include Westbrooke managed funds / products. • Where clients fully fund their commitments upfront, their capital will only be considered to be invested as if it had been invested in line with the capital calls issued to class A1 shareholders.

Management fees	Management fees will be calculated, accrued and paid semi-annually in advance in line with the below: • Undeployed capital - 0.75% p.a. on total committed capital committed by not yet drawn • Deployed capital - 1.50% p.a. on total capital invested Fees in the A2 share class will mirror those charged to class A1 investors i.e. there is no financial penalty to the investor for investing in the A1 share class On a best endeavors basis, WAAM UK will attempt to secure an upfront arranging or structuring fee as well as an exit or refinance fee, payable by the investee businesses. If obtained, WAAM UK will be entitled to up to 2.0% of the transaction value, thereafter, any additional fees or remuneration obtained will be for the benefit of the Fund. This is neither an expense of the company, nor of the fund.
Performance fees	Performance fees will be tiered based on the below: • 15.0% performance fee (with catch-up) above a hurdle IRR of 8.0% • 20.0% performance fee (with catch-up) above a hurdle IRR of 15.0%
Other fees and expenses	The fund will target a total expense ratio ("TER") of 0.6% p.a., which will comprise the following: **Set-up costs and fees:** **Fund administration costs:** The following annual administration fees are payable by the Fund to the Administrator, subject to a minimum ongoing fee of £70,000 per annum or: i. where the Company's NAV is up to £30 million, the fee shall be 16bps of the Company's NAV; ii. where the Company's NAV is above £30 million the fee shall be 10bps of the Company's NAV; Plus an additional £27,500 per annum for regulatory and directorship services. The Administrator fee shall be payable quarterly in advance. **Luxembourg investment vehicle fees:** The investment vehicle shall pay the following fees to the investment vehicle's administrator annually: i. Ongoing administration fees of £45,000 p.a.; and ii. Ongoing accounting fees (including annual audited annual financial statements and monthly NAV reporting) of £35,000 p.a. **Audit fees:** The annual audit costs for the Fund will be £13,500. These costs will be reviewed and renewed on an annual basis.
NAV methodology	The Fund will calculate its net asset value ("NAV") on a semi-annual basis (March and September), being the value of the assets held by the Fund less the total liabilities of the Fund. Equity positions held by the Fund will be valued at the lower of cost and market value (i.e. there will be no marking up on equity positions held by the Fund)

7. fund structure:



Fund investors will invest into a Jersey domiciled closed-ended expert fund prior to the Fund's financial close.

The Fund's assets will be invested into Westbrooke Private Capital S.à.r.l (the "Investment Vehicle") via a subscription for loan notes. The Fund will invest predominately via its own bankruptcy remote compartment of the Investment Vehicle ("Compartment 28") although WDO UK may invest in other compartments of the Investment Vehicle at the discretion of the Directors.

The Fund may not be the sole investor in the Investment Vehicle, although it will be the sole investor in a Compartment. The Investment Vehicle may create additional compartments and third-party investors may invest directly into these compartments of the Investment Vehicle alongside the Fund.

The Investment Vehicle in turn invests into the assets of the Fund and the transactions.

Fund investors will be distributed any proceeds (net of expenses) from the underlying investments when they are received by the Luxembourg investment vehicle.

8. timing and next steps

The deadline for applications for the Fund's first close is Wednesday, 31 August 2022.

Launch:
July 2022

→

First close:
August 2022

→

Application deadline:
31 August 2022

how to invest?

queries

to apply

compliance disclosure

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Westbrooke is a registered financial services provider.

For more information, or to find out how to invest, please contact us.

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