

FLAG Squadron Asia Limited

Form ADV Part II Brochure

18 March 2013



**ITEM 1: COVER PAGE**

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Date of Brochure:	18 March 2013

This brochure provides information about the qualifications and business practices of FSAL. If you have any questions about the contents of this brochure, please contact us at +852 3756 0700 and/or [FundAdmin@flagcapital.com](mailto:FundAdmin@flagcapital.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority. Registration does not imply a certain level of skill or training.

Additional information about FSAL is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

**ITEM 2: MATERIAL CHANGES**

On December 31, 2012, Squadron Capital Management Limited was acquired by purchase by FLAG Capital Management, LLC ("FLAG") from Search Investment Office Limited. FLAG is registered as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended. Additional information about FLAG is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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## ITEM 4: ADVISORY BUSINESS

FLAG Squadron Asia Limited ("FSAL", formerly name as Squadron Capital Advisors Limited) is a company incorporated in Hong Kong that has been established since 2006. FSAL is licensed by the Hong Kong Securities and Futures Commission to engage in Type 4 (advising on securities) and Type 9 (asset management) activities. FSAL has also been an SEC registered investment adviser since 2009.

Squadron Capital Management Limited ("Squadron Capital Management") a Cayman Islands exempted company is the 100% owner of FSAL.

On December 31, 2012, Squadron Capital Management was acquired by purchase by FLAG Capital Management, LLC ("FLAG") from Search Investment Office Limited. FLAG is registered as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended. Additional information about FLAG is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). FLAG acts as investment advisor to the General Partners of the following funds ("the FLAG Squadron Funds") that invest in private equity opportunities in Asia:-

- Squadron Asia Pacific Fund, L.P.
- Squadron Asia Pacific Fund II, L.P.
- Squadron Emerging Asia Fund, L.P.
- FLAG Squadron Asia Pacific III, L.P.
- FSA III Ex-Co-Investment, L.P.
- FSA III Emerging Asia, L.P.

FSAL acts as the subadvisor to FLAG in connection with the FLAG Squadron Funds. The FLAG Squadron Funds invest primarily in Asian private equity funds (the "Portfolio Funds") but can co-invest alongside the Portfolio Funds. The FLAG Squadron Funds are fund of private equity funds. The investment objective of the FLAG Squadron Funds is to achieve attractive long-term capital appreciation through private equity investments in the Asia Pacific Region, in the case of the Asia Pacific Fund, or the Emerging Asia Region, in the case of the Emerging Asia Fund. The Portfolio Funds will usually have buyout and growth capital strategies but the FLAG Squadron Funds have the flexibility to invest in funds pursuing other private equity strategies, including distressed, special situations, mezzanine and venture capital strategies.

The FLAG Squadron Funds are available only to qualified institutional and professional investors. The FLAG Squadron Funds are formed as Cayman Islands exempted limited partnerships. The FLAG Squadron Funds are master feeder funds and are structured as closed ended funds with a term of 10 years from initial closing, subject to allowable extensions as stipulated in respective limited partnership agreements. The minimum commitment is \$5 million.

The general partner entities of the FLAG Squadron Funds, Squadron Capital Asia Pacific GP, L.P., Squadron Capital Asia Pacific II GP, L.P. and Squadron Capital Asia Pacific III GP, L.P. (the "General Partner Entities") are Cayman Islands

exempted limited partnerships with a common general partner, Squadron Capital Partners Limited ("Squadron Capital Partners"). Squadron Capital Partners is 100% owned by Squadron Capital Management.

In accordance with the Limited Partnership Agreements which establish the FLAG Squadron Funds, the General Partner Entities are permitted to delegate its management and administrative responsibilities. Under certain investment advisory agreements, the General Partner Entities have delegated investment management and administrative duties to FLAG. Under certain sub-advisory agreements, FLAG has delegated certain management and administrative duties to FSAL in connection with the FLAG Squadron Funds.

As of December 31, 2011, FSAL had \$1.9 billion in assets under management. All of these were discretionary assets.

FSAL and its employees are not required to advise or manage the FLAG Squadron Funds as its sole and exclusive function. FSAL and its employees may engage in other business activities and are only required to devote such time to managing the FLAG Squadron Funds as deemed necessary to accomplish the purposes of the FLAG Squadron Funds. For example, FSAL may act as the advisor or investment manager to other clients (including other funds) now or in the future.

## ITEM 5: FEES AND COMPENSATION

Fees for each Squadron Fund are described in its Private Placement Memorandum ("PPM").

Each of the FLAG Squadron Funds pays a management fee to the General Partner in advance on a quarterly basis.

The General Partner pays FLAG for its services, and FLAG, in turn, pays FSAL for its services on a cost basis.

The General Partner has made a Capital Commitment to the Asia Pacific Fund. As such the General Partner will share in the net proceeds attributable to the disposition, payment upon maturity, prepayment or redemption of an investment in a Fund Investment, together with any dividends, interest and other current cash income with respect to such investment, are first be apportioned among Partners *pro rata* based upon their Capital Contributions to the Fund Investment from which the proceeds are derived (a "**Share**"). The General Partner's Share will be distributed entirely to the General Partner. Each Limited Partner's Share will be distributed between the Limited Partner and the General Partner in accordance with the distribution schedule agreed between the Limited Partners and the General Partner, taking into account the return of capitals, preferred return to the Limited Partner and carried interest to the General Partner. Distributions during the life of the FLAG Squadron Funds are made primarily in cash.

The General Partner pays all of its administrative and overhead expenses.

The FLAG Squadron Funds will be subject to fees charged by the underlying portfolio funds and managers. Fees of placement agents are paid by the General Partner from the management fee payable by the Limited Partners.

**ITEM 6: PERFORMANCE BASED FEES**

FSAL does not receive a performance-based fee.

However, FSAL or a related entity of FSAL, as general partner of a FLAG Squadron Fund or adviser to a separate account client, will typically receive certain allocations or fees calculated and charged based on a share of capital gains on or capital appreciation of the assets of such FLAG Squadron Fund or separate account client.

The performance-based allocation arrangements discussed above comply with Rule 205-3 under the Investment Advisers Act of 1940 (together with all rules and regulations promulgated thereunder, the "Advisers Act"). Any share of profits allocated or paid to FSAL or the general partners of the FLAG Squadron Funds is separate and distinct from the advisory fees charged by FSAL for advisory services.

Performance-based allocation arrangements received by FSAL or any of its related entities may create an incentive for FSAL to recommend investments that may be riskier or more speculative than those that would be recommended under a different fee arrangement. Please refer to the governing documents of the applicable FLAG Squadron Fund (or the investment advisory agreement of the applicable separate account client) for complete information on the performance-based compensation arrangements entered into with respect to such client.

## ITEM 7: TYPES OF CLIENTS

FSAL advises on the investment of the FLAG Squadron Funds.

Squadron Asia Pacific Fund, L.P. / Squadron Asia Pacific Fund II, L.P. / Squadron Emerging Asia Fund, L.P.

Each of the above FLAG Squadron Funds has the option of two feeder funds: one to accommodate U.S. taxable investors (each, an “**Onshore Fund**”) and one to accommodate non-U.S. investors and U.S. tax exempt investors (each, an “**Offshore Fund**”).

Investments in an Onshore Fund will be accepted from U.S. investors that are both (a) “accredited investors” as defined in Rule 501(a) of Regulation D under the U.S. Securities Act of 1933 (the “**Securities Act**”); and (b) “qualified purchasers” as defined in Section 2(a)(51) and Rule 2a51-1 of the U.S. Investment Company Act of 1940, as amended (the “**Investment Company Act**”). The General Partner, in its discretion, may admit non-U.S. investors to an Onshore Fund.

Investments in an Offshore Fund will be accepted from non-U.S. investors as well as U.S. investors that are U.S. tax-exempt entities, and that are both “accredited investors” and “qualified purchasers”.

Each of the above FLAG Squadron Funds has held a final closing and is closed to new investors.

FLAG Squadron Asia Pacific III, L.P. / FSA III Ex-Co-Investment, L.P. / FSA III Emerging Asia, L.P.

Each of the above FLAG Squadron Funds has the option of investing into the master fund, to accommodate U.S. taxable investors and non-U.S. investors (each, a “**FSA III Master Fund**”) and the feeder fund, to accommodate U.S. tax exempt investors (each, a “**FSA III Offshore Fund**”).

Investments in a FSA III Master Fund will be accepted from non-U.S. investors as well as U.S. investors that are both (a) “accredited investors” as defined in Rule 501(a) of Regulation D under the U.S. Securities Act of 1933 (the “**Securities Act**”); and (b) “qualified purchasers” as defined in Section 2(a)(51) and Rule 2a51-1 of the U.S. Investment Company Act of 1940, as amended (the “**Investment Company Act**”). The General Partner, in its discretion, may admit U.S. tax exempt investors to a FSA III Master Fund.

Investments in a FSA III Offshore Fund will be accepted from U.S. investors that are U.S. tax-exempt entities, and that are both “accredited investors” and “qualified purchasers”.



## ITEM 8: METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

FSAL's investment philosophy is based on a bottom-up approach where manager selection is the key driver of its investment approach. This bottom-up process is supplemented with market and portfolio considerations which - although secondary in importance to manager selection - are still key to the achievement of the FLAG Squadron Funds' key objective of achieving superior long-term capital appreciation.

In selecting potential, FSAL will follow a multi-stage due diligence process to review the large number of investment opportunities effectively examining primarily:

- Potential investee fund strategy: the logic, consistency, sustainability and uniqueness of a manager's investment strategy
- Potential investee manager team: the size and composition of the management team taking into account the background of key individuals within the team; and
- Potential investee manager track record: in terms of track record, the prior investment returns are reviewed and benchmarked against industry data as well as FSAL's own internal data to validate the strength of the manager's performance.

FSAL has a strong preference for teams who have demonstrated consistently high levels of net returns and that have been sustained over a meaningful period of time. The concentration of returns within a fund is also important, with returns being generated broadly across a portfolio being preferable to highly concentrated returns.

After the initial due diligence process is completed, FSAL may choose to conduct full due diligence on a smaller group of managers to establish the accuracy of the unrealized values to distinguish how returns have been generated, the manner in which a manager tracks its performance record, the tracking of cash flows, the application of industry standards as regards accounting for investments and the experience and qualifications of the relevant personnel. In addition references are taken from existing and potential investors, management of portfolio companies, transaction intermediaries and/or other industry sources. A broad range of other factors are examined which include:

- The portfolio fund manager's own due diligence process on potential investments, as well as their planning process for post-investment value-add;
- An analysis and review of the deal structuring mechanisms and investor protections that the Portfolio fund manager negotiates in its investments;
- A review of how each fund manager has changed organizationally over time; and
- The compensation practices of the underlying portfolio fund manager.

Before making a decision to invest in a Portfolio Fund, FSAL also considers broader market considerations which may affect the private equity environment. These factors include but are not limited to:

- The availability of private equity investment opportunities in the sector in which the fund manager operates;
- The potential degree of competition in the sector in which the fund manager operates; and
- The likely risk-reward profile of the fund under review, bearing in mind the key potential market, political, interest rate, exchange rate, regulatory and other risks.

Further before making a recommendation to invest in a Portfolio Fund FSAL takes into account a broad range of portfolio considerations for the FLAG Squadron Funds such as

- A sufficiently broad geographical diversification in FLAG Squadron Funds;
- A level of diversification with regard to strategy with the caveat that, as bottom-up investors, the Squadron Capital team does not pursue top-down allocation and targets in respect of strategy or geography;
- The timing and returns profiles of funds across the portfolio (e.g. the likely pace of contributions and distributions between various different geographies and strategies); and
- Capacity and access considerations, including the timing of the fund-raising schedules of underlying managers and their likely fund sizes.

Our clients are aware that there can be no assurance that the FLAG Squadron Funds will be successful or that the investments purchased by the FLAG Squadron Funds will increase in value. Investing into the FLAG Squadron Funds is only suitable for sophisticated investors able to assume the risk of loss and degree of illiquidity that investment in such a fund entails. Notwithstanding the above, the fact that the FLAG Squadron Funds are multi-manager vehicles increases the degree of portfolio diversification, thereby reducing the degree of non-systemic risks, as well as systemic risks that are particular to a specific country or jurisdiction within the overall Asia Pacific region.

An investment into the FLAG Squadron Funds exposes investors to the generic risks associated with private equity fund investments including: (a) the absence of liquidity of investments in unlisted companies, (b) the holding of minority (non-controlling) interests in companies, (c) the potential inability by underlying managers to source and consummate investments at acceptable terms due to market conditions, (d) financial structuring risk, and (e) unforeseen issues arising at one or more of portfolio companies.

Examples of the implications of the above on risks associated with the FLAG Squadron Funds are:-

- Competition for investment opportunities by funds which have a similar focus to that of our underlying managers' funds, which may lead to an increase in the entry valuations of our underlying funds' portfolios, thus reducing the potential upside and/or increasing the risk of multiple contraction at exit;
- The amount of reliance that has to be placed on the managers of the Portfolio Funds which means that the FLAG Squadron Funds could be adversely affected by the unfavorable performance of the Portfolio Funds;
- The underlying investments of a Portfolio Fund and the co-Investments may consist of significant amounts of securities and other financial instruments that are very thinly traded, for which no market exists, or which are restricted as to their transferability under securities laws. In some cases, Portfolio Funds or the FLAG Squadron Funds may also be prohibited by contract from selling such securities for a period of time. In other cases, the types of investments made by Portfolio Funds or the FLAG Squadron Funds may require a substantial length of time to liquidate. Consequently, there is a significant risk that the Portfolio Funds or the FLAG Squadron Funds will be unable to realize their investment objectives by sale or other disposition of portfolio company securities at attractive prices or will otherwise be unable to complete any exit strategy with respect to their portfolio companies. These risks can be further increased by changes in the financial condition or business prospects of the portfolio companies, changes in economic conditions and changes in law.

Specific Portfolio Funds also have risks associated with them:

- The FLAG Squadron Funds allocate to Portfolio Funds which emphasize buyout and growth and such investments often involve leverage. Companies with leveraged capital structures can be adversely affected by extreme economic conditions and a rise in interest rates;
- The FLAG Squadron Funds may allocate to Portfolio Funds that concentrate on special situations such as reorganized companies emerging from bankruptcy or distressed companies. There is a significant risk that the turnaround of such companies may not be successful;
- The FLAG Squadron Funds may allocate to Portfolio Funds that concentrate on venture capital investments. Companies requiring venture capital often have limited revenues and need funding from the capital markets and can be adversely affected by extreme economic conditions and a rise in interest rates; and
- The FLAG Squadron Funds may allocate to Portfolio Funds that concentrate on mezzanine investments. Investment in mezzanine securities of highly leveraged companies involves a high degree of risk as mezzanine securities are usually subordinated to senior debt which is often secured and distributions to holders of mezzanine securities only occurs after satisfying the claims of senior creditors.

The full risks of investing in the FLAG Squadron Funds are disclosed to investors in the relevant PPMs.

**ITEM 9: DISCIPLINARY INFORMATION**

FSAL has not been subject to any disciplinary action, whether criminal, civil or administrative (including regulatory) in any jurisdiction. Likewise, no persons involved in the management of FSAL have been subject to such action.

**ITEM 10. OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

Squadron Capital Management Limited (“Squadron Capital Management”) a Cayman Islands exempted company is the 100% owner of FSAL.

On December 31, 2012, Squadron Capital Management was acquired by purchase by FLAG Capital Management, LLC (“FLAG”) from Search Investment Office Limited. FLAG is registered as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended. Additional information about FLAG is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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FSAL acts as the subadvisor to FLAG in connection with the FLAG Squadron Funds.

The general partner entities of the FLAG Squadron Funds, Squadron Capital Asia Pacific GP, L.P., Squadron Capital Asia Pacific II GP, L.P. and Squadron Capital Asia Pacific III GP, L.P. (the “General Partner Entities”) are Cayman Islands exempted limited partnerships with a common general partner, Squadron Capital Partners Limited (“Squadron Capital Partners”). Squadron Capital Partners is 100% owned by Squadron Capital Management.

## ITEM 11: CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING

### Code of Ethics Pursuant to Rule 204A-1 of the Advisers Act and Personal Trading

Pursuant to Rule 204A-1 of the Advisers Act, FSAL has adopted a Code of Ethics and an Employee Investment Policy that establishes various procedures with respect to investment transactions in accounts in which employees of FSAL or related persons have a beneficial interest or accounts over which an employee has investment discretion.

FSAL's Code of Ethics was adopted to avoid possible conflicts of interest, avoid the inappropriate use of material, nonpublic information and ensure the propriety of its employees' and principals' trading activity.

The foundation of the Code of Ethics is based on the underlying principles that:

- Employees must at all times place the interests of the client first;
- Employees must make sure that all personal securities transactions are conducted consistent with the Code of Ethics; and
- Employees should not take inappropriate advantage of their position.

FSAL employees must adhere to the Employee Investment Policy for any personal investments. Employees must place the interests of the client and FSAL first at all times and avoid, and be seen to avoid, actual or potential conflict between personal interest and duty to clients and to FSAL.

Employees (and any beneficiary accounts) must obtain written authorization from the CCO prior to making a personal investment or engaging in private placement in other collective investment schemes. The spirit of the Code of Ethics is to discourage frequent trading in personal employee accounts. Employees may not engage in any outside business activities or invest in private companies before obtaining authorization from the CCO.

All FSAL employees must provide duplicate copies of brokerage statements to the CCO. These records are used to monitor compliance with the foregoing policies.

FSAL's Code of Ethics and Employee Investment Policy is available to any investor or prospective investor upon request.

FSAL provides an opportunity for its employees to invest in the FLAG Squadron Funds via a dedicated Limited Partnership that invests alongside the other Limited Partners and which participates in the FLAG Squadron Funds on the same basis as all other Limited Partner except that the employee Limited Partnership is not subject to the carried interest and management fee applicable to the FLAG Squadron Funds.

**ITEM 12: BROKERAGE PRACTICES**

FSAL does not trade securities in the capital markets and therefore this item is not applicable to FSAL.



**ITEM 13: REVIEW OF ACCOUNTS**

FSAL provides written reports to the General Partners of the FLAG Squadron Funds on a quarterly basis which are then provided to the investors in the FLAG Squadron Funds.

**ITEM 14: CLIENT REFERRALS AND OTHER COMPENSATION**

The General Partner of the FLAG Squadron Funds may, from time to time, engage the services of third-party placement agent firms. When dealing with potential clients in the U.S., such groups will provide prospective clients with a current copy of FSAL's ADV Part 2A and the solicitor's written disclosure statement, if relevant. Any marketing fee or commission in connection with any investor referral activities, including ongoing payments, are paid by the General Partner from the management fees otherwise payable by the Squadron Fund's Limited Partners.

**ITEM 15: CUSTODY**

The amended and revised Rule 206(4)-2 of the Advisers Act sets forth extensive requirements regarding possession or custody of client funds or securities.

FSAL is not subject to the Custody Rule as FSAL is an offshore (non-US) adviser to offshore pooled investment vehicles.

**ITEM 16: INVESTMENT DISCRETION**

FSAL is given discretionary authority to indirectly manage the FLAG Squadron Funds by way of delegation by FLAG, which in turn is delegated discretionary authority by the General Partner of the FLAG Squadron Funds

The investment guidelines governing the management of the FLAG Squadron Funds are specified under the FLAG Squadron Funds' PPM, where investment limits are intended to minimize investment risk and maximize return. The investment limits mainly cover concentration limits on underlying funds, concentration limits on illiquid investments and co-investments and concentration limits on specific countries.

**ITEM 17: VOTING CLIENT SECURITIES**

FSAL may sometimes be required to vote on corporate action regarding a Portfolio Manager or Portfolio Fund. FSAL will ensure that proxies or corporate action matters regarding the Portfolio Managers or Portfolio Funds are voted in the best interest of the relevant FLAG Squadron Funds.

FSAL does not anticipate owning on behalf of any investor or fund any equity securities granting it, or its clients, the right to vote proxies. However, in the unlikely event that FSAL is required to vote a proxy for certain investments or if FSAL is required to vote on a corporate action regarding a Portfolio Manager or Portfolio Fund, FSAL will ensure that proxies or corporate action matters regarding the Portfolio Managers or Portfolio Funds are voted in the best interest of the relevant FLAG Squadron Funds.

Upon request, FSAL will provide an investor with information on how the proxies/corporate actions were voted.

**ITEM 18: FINANCIAL INFORMATION**

Each of the FLAG Squadron Funds is required to pay a management fee to the General Partner in advance on a quarterly basis.

FSAL does not solicit or require pre-payment of any client fees in advance.

FSAL has no financial commitment that impairs its ability to meet contractual and fiduciary commitments to clients, and has not been the subject of a bankruptcy proceeding.