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**This brochure provides information about the qualifications and business practices of Merced Capital, L.P. If you have any questions about the contents of this brochure, please contact us at (952) 476-7200 or by email to [Investor.Relations@ebf.com](mailto:Investor.Relations@ebf.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.**

**Additional information about Merced Capital, L.P. also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

**Merced Capital, L.P. is a registered investment advisor. Registration with the United States Securities and Exchange Commission does not imply a certain level of skill or training.**

**March 25, 2015**

## **Item 2**            **Material Changes.**

On June 23, 2014 EBF & Associates, L.P. changed its name to Merced Capital, L.P. The name change was made in order to align the name of the management company with the names of the firm's private investment funds. Merced Capital continues to be owned and managed by the same partners that have worked together at the firm for the past decade and who continue to invest opportunistically in a broad array of niche alternative sectors.

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#### **Item 4**      **Advisory Business**

##### ***Merced Capital Background and Ownership***

Merced Capital was formed in 1988 by three executives from the Cargill Inc. financial trading business. One of the three, Mike Frey, became a senior adviser to the firm in July of 2013; the other two founders retired in 1998 and in 2005. Merced Capital is owned by the senior members of management of Merced Capital. The general partners of the various Merced Capital-managed funds described below are also owned by members of Merced Capital's senior management. A description of the education and qualifications of these principals of the business is provided below.

Merced Capital provides investment advisory services to seven pooled investment vehicles, each of which is a Delaware limited partnership (each, a "Fund" and together, the "Funds"):

<b>Fund</b>	<b>Type</b>
Merced Partners Limited Partnership ("Merced") <i>General Partner: Merced Capital</i>	Annual Liquidity
Harrington Partners, L.P. ("Harrington") <i>General Partner: Lydiard Partners, L.P. ("Lydiard")</i>	Lock-up
Merced Partners II, L.P. ("Merced II") <i>General Partner: Lydiard</i>	Lock-up
ILS Partners, L.P. ("ILS") <i>General Partner: Lydiard Partners II, L.P. ("Lydiard II")</i>	Lock-up
Merced Partners III, L.P. ("Merced III") <i>General Partner: Lydiard Partners III, LLC ("Lydiard III")</i>	Lock-up
Merced Partners IV, L.P. ("Merced IV") <i>General Partner: Series M4 of Merced Capital Partners, LLC ("Series M4")</i>	Lock-up
Merced Shipping Partners, L.P. ("Merced Shipping") <i>General Partner: Series MSP of Merced Capital Partners, LLC ("Series MSP")</i>	Lock-up

The "lock-up" Funds do not permit their limited partners to withdraw invested capital except at the end of the life of the Funds; rather, capital is expected to be distributed by the general partner following the five year commitment period of Harrington, the three year commitment period of Merced II, Merced III and Merced IV, the one year period for ILS, and the 17-month commitment period for Merced Shipping.

All of the Fund general partners are owned and controlled by senior management of Merced Capital, and all have entered into written management agreements with Merced Capital pursuant to which Merced Capital provides investment advisory services to the Funds of which they are general partner. Other than Merced Capital, none of the Fund general partners has any employees.

**None of the lock-up Funds are open to new investors and none are accepting capital commitments in addition to existing commitments from existing investors.** Merced IV held its final closing on October 31, 2013. Interests in Merced IV were not offered to the public generally and Merced IV did not engage in a general solicitation. Merced Shipping held its final closing on January 31, 2014. Interests in Merced Shipping were not offered to the public generally and Merced Shipping did not engage in a general solicitation. Likewise, interests in Merced are not being offered to the public generally and Merced is not engaged in a general solicitation. Merced may accept a limited amount of new investments from investors meeting the

suitability standards set forth in its private placement memorandum. In addition, only Merced and Merced IV actively seek to make new investments. Harrington, Merced II, Merced III, and ILS have entered the “harvest” period set forth under their respective partnership agreements, and are in the process of liquidating investments they hold. Merced Shipping has entered into a shipbuilding agreement that commits the partnership to purchase a newly built ship using all of the Fund’s committed capital. Except in limited circumstances as set forth in its limited partnership agreement, Merced IV will not make additional investments after December 31, 2016, at which time it will enter its harvest period. During its respective harvest period, each Fund will liquidate investments held by it. This process is expected to take several years.

From time to time Merced Capital expects to form additional investment partnerships to pursue investment strategies it finds attractive. These strategies may be similar to strategies currently employed by Merced Capital and are likely to include new strategies as well.

Merced Capital does not currently provide investment advisory services directly to any investors in the Funds, or to any separately managed accounts, but it may do so in the future.

### ***Key Personnel***

Merced Capital relies on the following senior members of its management to advise the Funds and operate and manage its investment advisory business:

#### **David Ericson**

Mr. Ericson is a partner in Merced Capital and a co-founder of Lydiard, Lydiard II, Lydiard III, Series M4 and Series MSP. Private asset and distressed debt investing have been the focus of his professional career for 25 years. Prior to joining Merced Capital in 2001, Mr. Ericson managed capital at Morgens-Waterfall-Vintiadis, Touchstone Capital and Cargill Inc. Mr. Ericson received a B.A. in International Relations from the University of Minnesota in 1983 and a MBA from the University of Chicago in 1987. Mr. Ericson was born in 1959.

#### **Vincent Vertin**

Mr. Vertin is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4 and Series MSP. A wide range of finance and investing activity has been the focus of his professional career for 19 years. Prior to joining Merced Capital in 2004, Mr. Vertin was an analyst at Providence Capital, an investment banker at JP Morgan and Dain Rauscher Wessels, a math instructor at the U.S. Naval Academy and a Captain in the U.S. Marine Corps. Mr. Vertin received a B.S. in Mathematics from the U.S. Naval Academy in 1992 as well as an M.S. in Applied Mathematics & Business from George Washington University in 1993. Mr. Vertin was born in 1969.

#### **Hendrik Vroege**

Mr. Vroege is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4 and Series MSP. Wind and other energy-related investing have been the focus of his professional career for 23 years. Prior to joining Merced Capital in 2004, Mr. Vroege managed capital at Fortis Group. Mr. Vroege received a B.A. in Finance from the University of Oregon in 1986, a MBA from Rotterdam School of Management in 1988, and completed the Tuck Executive Program at Dartmouth College in 2000. Mr. Vroege was born in 1964.

### Stuart Brown

Mr. Brown is a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4 and Series MSP. Distressed investing has been the focus of his professional career for 24 years. Prior to joining Merced Capital in 2003, Mr. Brown worked at Avenue Capital, Morgens-Waterfall-Vintiadis, Touchstone Capital and Cargill Inc. Mr. Brown received a B.A. in Economics from Northwestern University in 1986 and a MBA from Northwestern University in 1988. Mr. Brown was born in 1964.

### Thomas Rock

Mr. Rock is the General Counsel and Chief Compliance Officer of Merced Capital and a partner in Merced Capital, Lydiard, Lydiard II, Lydiard III, Series M4 and Series MSP. Transactional and other legal work have been the focus of his professional career for 24 years. Prior to joining Merced Capital in 2005, Mr. Rock was Associate General Counsel at GE Capital, General Counsel at Smarte Carte, and was a partner at Oppenheimer Wolf & Donnelly and Rider, Bennett, Egan & Arundel. Mr. Rock received a B.A. in English from Carleton College in 1984 and a J.D. from Boston College Law School in 1987. Mr. Rock was born in 1962.

### Joel W. Anderson

Mr. Anderson is the Chief Financial Officer of Merced Capital and a partner in Merced Capital, Series M4 and Series MSP. He has worked in the investment advisory industry for his entire professional career. He joined Merced Capital in 1998 and became CFO in 2008. Prior to joining Merced Capital in 1998 Mr. Anderson worked for another investment advisor in Minneapolis. Mr. Anderson received his Bachelor of Arts degree from the University of Minnesota – Morris in 1997, where he double-majored in Management and Economics and minored in Mathematics. He earned a Masters of Business Administration from the University of Minnesota in 2003. Mr. Anderson was born in 1975.

### ***Investment Philosophy and Strategy***

Merced Capital focuses on trading in debt and equity securities and other obligations of financially distressed entities, high yield, below investment-grade or unrated debt securities, special and control situation transactions, and other trades deemed appropriate by Merced Capital. In addition, Merced Capital-managed funds invest in real estate, aircraft and aircraft leases, ocean-going vessels, equipment, renewable energy, insurance-linked securities, natural resources, and other types of assets. The partnership agreements governing the Funds give Merced Capital wide discretion to determine the investment strategy for the Funds, except in cases where the Fund was established to pursue a very specific strategy (as in the case of ILS, which was organized to invest in insurance-related debt obligations). The investment strategy and objective of each Fund is set forth in the Fund's offering document. Merced Capital may expand its areas of expertise in response to market conditions or other external factors. A brief explanation of the primary strategies employed by Merced Capital follows:

- Financially distressed entities are those financially troubled entities on the verge or in the process of a major financial restructuring and involve deteriorating as well as defaulted securities. Restructuring of distressed entities is the process of re-balancing assets and liabilities in a more financially prudent fashion. This process can take place either

through a formal bankruptcy proceeding or restructuring outside of a court's supervision. This process creates opportunities to trade in different types of securities or obligations with different risk-reward profiles at different times in an entity's restructuring cycle. This cycle can last anywhere from a month to five years or longer.

- High yield, below investment-grade or unrated securities involve situations in which there is speculative credit risk and where the debtor is unlikely to obtain credit from traditional sources, such as banks.
- Special situation transactions are those assets that may be acquired at a discount to their inherent value. Typically, these situations arise because the assets lack transparency or liquidity. Some of these trades may arise as a result of Merced Capital's role as advisor to other entities. Trades in this area include equipment and real estate, where Merced Capital has historically concentrated a great deal of its investments.

Historically, Merced has traded primarily in below investment-grade or unrated securities and other obligations and acquired interests in financially distressed entities. Merced expects to continue to trade and invest with a similar risk profile. Merced has also allocated a material portion of its assets to "special situation" transactions. Typically these types of investments have been more difficult to exit, primarily because they consist of assets that are not traded on an exchange. For the foreseeable future, it is not anticipated that Merced will invest a material percentage of its assets in special situation opportunities (although it is not prohibited from doing so). Merced has acquired these special situation positions primarily through privately negotiated purchases ("Private Transactions"). Likewise, Merced IV intends to seek investments in Private Transactions and may invest in other assets and asset classes.

Merced IV will likely continue to follow the same philosophies and strategies employed by predecessor funds managed by Merced Capital. Merced Shipping has entered into an agreement to purchase a single bulk cargo vessel which will be its only asset.

In the past the Funds have not used borrowed money (leverage) when acquiring assets, except in limited circumstances (for example, in leveraged aircraft sale-leaseback transactions). However, this policy is continuously reviewed, and the Funds may employ leverage in the future. In addition, to the extent the Funds own and control private operating companies, those companies may use debt as a part of their capital structure. The Funds are permitted to engage in short selling of securities, which involves borrowing securities and then selling them.

Merced Capital-managed funds' activities may include purchasing, short selling or spread trading any or all of the securities within different companies' capital structure. These securities may be publicly or privately traded.

Merced Capital has traditionally limited the number of trades made outside the United States and, accordingly, the Funds have incurred limited foreign exchange risk. While Merced and Merced IV are not precluded from trading in foreign assets or from incurring foreign exchange risk – and have recently commenced investing in European real estate assets – it is not anticipated that foreign transactions will be a major focus of Merced and Merced IV within the foreseeable future but they are not precluded from trading in foreign assets or from incurring foreign exchange risk. Merced Capital employs various strategies to hedge foreign exchange risk, including entering into forward purchase contracts with respect to currencies in which investments are denominated.

### ***Conflicts of Interest***

Conflicts of interest arise from time to time in the conduct of Merced Capital's advisory business. Merced Capital and the other general partners of the Funds are given very wide discretion and independence under the partnership agreements governing the Funds – which is typical in the private fund industry. Merced Capital and the other Fund general partners, and their respective members, managers, directors, officers, partners, shareholders, employees and agents may exercise investment responsibility, or otherwise engage, directly or indirectly, in any other business, irrespective of whether any such business is similar to, or identical with, the business of the Funds. These other activities may include purchasing, selling, holding or otherwise dealing with investments that would be suitable for the Funds.

Merced Capital, its affiliates, and their respective members, managers, directors, officers, partners, shareholders, employees and agents may directly or indirectly purchase, sell, hold or otherwise deal with investments for their own accounts, for their family members or for other Funds, irrespective of whether such investments are purchased, sold, held or otherwise dealt with for the account of one or more of the Funds. An investor will not, solely by reason of being a partner in a Fund, have any right to participate in any manner in any profits or income earned or derived by or accruing to the Fund's general partner, its members, Merced Capital, their affiliates, and their respective members, managers, directors, officers, partners, shareholders, employees and agents from the conduct of any business other than the business of the Fund or from any transaction or other investment effected by any such person for any account other than that of the Fund.

One Fund may take a position that is adverse to the interests of one or more of the other Funds. For example, one Fund may choose to short a security that another Fund holds. In such instances Merced Capital will attempt to protect the interests of all Fund investors.

Merced Capital may have conflicts of interest in allocating its time and activity among the Funds, other entities, or investments for their own accounts.

### ***Allocation, Aggregation and Brokerage***

Because Merced Capital manages multiple investment partnerships, Merced Capital and its affiliates, and their respective members, general partners, managers, directors, officers, partners, shareholders, employees and agents may advise one or more of the Funds to invest in the same assets or asset class. To the extent a particular investment is suitable for more than one Fund, Merced Capital will use good faith efforts to allocate such investments among the Funds in a fair and reasonable manner, and in accordance with its Allocation Policy. A copy of Merced Capital's Allocation Policy is available to investors in its Funds upon request. As a general rule, if two or more Funds have substantially similar or overlapping investment objectives and strategies and other factors being equal, allocation of a particular position will be based upon the relative size of the Funds. However, Merced Capital may also take into account any one or more of the following factors in allocating investments among Funds:

- Fund's investment objective and strategies (determined by reference to the investment objectives and strategies outlined in the Fund's partnership agreement and private placement memorandum);
- Fund's tax status, and tax status of investors in that Fund;
- any restrictions placed on a Fund's portfolio by the Fund or by virtue of federal or state law (such as the Employee Retirement Income Security Act of 1974, as amended);
- total portfolio invested position;

- available capital and available cash in Fund, taking into account any anticipated subscriptions and redemptions and any other reasonably foreseeable cash requirements of a Fund;
- existing exposure in Fund to issuer or to issuer's industry;
- nature of the security or asset to be allocated, including the liquidity of the asset and the availability of reliable price information;
- size of available position;
- supply or demand for a security at a given price level;
- the expected holding period of an investment in relation to a Fund's investment and harvest period;
- current market conditions; and
- any other information determined by Merced Capital to be relevant to the fair allocation of investments.

From time to time Merced Capital may aggregate Fund orders for the purchase or sale of securities. Merced Capital will generally follow the guidelines set forth below in aggregating orders for securities:

- no Fund will be favored over any other Fund;
- each Fund that participates in an aggregated order will participate at the average share price for all Merced Capital's transactions in that security on a given business day and transaction costs will be shared pro rata based on each Fund's participation in the transaction;
- if the aggregated order is filled in its entirety, it will be allocated among Funds in accordance with Merced Capital's allocation policy described above;
- if the aggregated order is partially filled, it will be allocated among Funds pro rata (i.e., taking into account the relative size of each Fund account to which it is to be allocated) and in accordance with Merced Capital's allocation policy described above;

In connection with the purchase and sale of investments for the Fund, the General Partner may elect to pay higher commissions to brokerage firms that provide it with investment and research information than to firms that do not provide such services if the General Partner determines that such commissions are reasonable in relation to the overall services provided. The information received may be used by the General Partner in managing the assets of Funds other than the Fund that paid the higher commission.

### ***Assets Under Management***

As of December 31, 2013, Merced Capital managed \$2,081,218,897 (including \$356,620,000 of committed but undrawn capital) in capital across seven funds.

### **Item 5 Fees and Compensation**

The Funds pay their respective general partners a quarterly management fee between 0.75% and 1.5% per annum of capital under management. In addition, the general partners are entitled to receive incentive compensation of between 15% and 20% of investment gains. In certain cases, the Funds must earn a minimum amount, or a "hurdle" or "preferred return", before the general partner of the Fund is entitled to receive its incentive compensation. The fees paid by the Funds are outlined in further detail in their respective partnership agreements and private placement



memoranda. Fees are not negotiable. However, upon the creation of new investment funds, Merced Capital will review its fee structure and in certain cases seek input from prospective investors prior to establishing management and incentive fee levels. Fees are paid by the Funds either monthly (in the case of Merced) or quarterly (in the case of the other Funds) in advance. In the case of Merced, incentive fees are earned and paid annually on the value of investments in the fund as of the last business day of the year. In the case of the other Funds, incentive fees are paid after all invested capital has been returned to the partners in the Fund and, if the partnership agreement requires that a minimum hurdle or preferred return be met and paid, after such minimum has been paid. In the case of all Funds other than Merced, incentive fees are paid only on realized gains.

Merced Capital will value each Fund's portfolio. In the case of Merced, which pays an incentive fee based on the year-over-year increase in value of its investments, and which pays a management fee based on the value of assets under management, Merced Capital could increase its management and annual incentive fees by overstating the increase in value of Merced's assets. To protect against this risk, Merced Capital has established a valuation policy to assure that its investment reflect fair value. In addition, Merced, like all of the Funds, is audited on an annual basis. The audit includes an audit of the value of the investments in each Fund.

Merced Capital's valuation policy is available to investors in its Funds upon request. The policy provides that securities which are widely traded will be valued by reference to quoted market prices. Where reliable market quotations are not available, Merced Capital will value these securities and other assets in good faith using such methods as they consider appropriate. Valuation methods include, as appropriate, financial models, appraisals, reference to sales of comparable assets, bids received from third parties, and other methods which Merced Capital determines are likely to be reliable. Except to the extent required by applicable law, Merced Capital is not required to have valuations independently determined.

In addition to management and incentive fees, the Funds reimburse the general partners of the Funds for certain expenses. These expense reimbursement items vary by Fund, but typically include tax advice and preparation expenses, accounting expense, custodial fees, brokerage commissions, legal, and other operational expenses. The Funds do not reimburse their general partners for rent, infrastructure costs and compensation of investment personnel.

#### **Item 6                    Performance-Based Fees and Side-by-Side Management**

Merced Capital does not provide investment advisory services to clients other than the Funds. Accordingly, Merced Capital cannot favor accounts which are charged an incentive fee over accounts that do not pay incentive fees.

#### **Item 7                    Types of Clients**

The Funds are all limited partnerships organized under the laws of the State of Delaware. The Funds' limited partnership interests are offered to investors pursuant to exemptions from registration available under state and Federal securities laws. The Funds do not offer interests outside the United States. Merced interests are offered on a "rolling" basis to "qualified purchasers" as defined in Section 2(a)(51) of the Investment Company Act of 1940, subject to the limitations of the other limited offering exemptions under the Federal securities laws. None of the other Funds are offering interests to investors.

Investors in the Funds include public and private pension funds, foundations, endowment funds, "funds of funds", high net worth individuals and family offices. The minimum investment in

Merced is \$1,000,000, though this minimum can be waived by Merced Capital. Merced Capital typically sets a minimum of \$5,000,000 for investors in lock-up Funds, and has the ability to waive this minimum as well.

## **Item 8            Methods of Analysis, Investment Strategies and Risk Factors**

### *Methods of Analysis and Investment Strategies*

A portfolio approach to trading is employed, so that risk to the Funds is mitigated by avoiding significant concentrations in a limited number of investments. However, at times individual positions may be material. The strategy used in any individual situation will be affected by the types of financial instruments and assets involved and the desired risk-reward profile. Merced Capital takes a fundamental approach to analyzing an investment, taking into account the fair value of an investment, down-side protection, and expected cash flows. Merced Capital investment personnel rigorously review all aspects of a proposed investment, taking into account both factors specific to the investment as well as factors affecting the particular industry and the economy as a whole.

Merced Capital strives to diversify investments in number, industry focus, and geographic region. However, none of the Funds are precluded from investing a substantial amount of its capital in a single holding, industry, or geographic area. Merced and Merced IV may invest outside the United States and, therefore, may incur foreign exchange or political risk, and they may enter into hedging arrangements with the intent to protect against foreign exchange risks.

Merced Capital expects to control and be actively involved in the stewardship of many of the companies and assets in which Merced and Merced IV invest. Merced Capital intends to seek out investments wherein strong management and attentive ownership add meaningful value. However, the Fund may own interests in companies and assets that it does not control and over which it has little, if any, influence.

Merced Capital uses a wide variety of sources to find investments. Investments are evaluated by Merced Capital by thorough in-house analysis and assessment of the multitude of financial, legal, market, operational, industry and other factors that impact credit profile, business prospects, and asset and enterprise value. Merced Capital also retains outside legal, tax, industry-specific and other advisors to help it analyze the potential downside and upside of an investment.

### *Risk Factors*

An investment in Funds managed by Merced Capital involves various risks, including the risk that an investor may lose part or all of its capital.\* While Merced Capital will attempt to attain a Fund's investment objectives through its research and portfolio management skills, there is no guarantee of successful performance, that the investment objective can be reached, or that a positive return will be achieved. As a general rule, investors should expect that investments with higher return potential will also have higher potential of risk of loss to capital and/or income. In addition, the Funds' investments may fluctuate in market value from day to day and, therefore, the value of an investment in the Funds could decrease as well as increase. The Funds, individually or taken together, do not constitute a balanced investment program for purposes of an investor's portfolio diversification needs and, therefore, investors should consult with their own financial advisers for the appropriateness of an investment in one or more of the Funds for

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\* For purposes of the discussion of the risks of investing in a fund managed by Merced Capital, we have assumed that any fund formed after the date of this brochure will employ most if not all of the same strategies employed by existing funds, and that the risks of investing in any such fund will be similar. A prospective investor in any fund managed by Merced Capital should carefully read and understand the offering memorandum for the fund. Investors should also consult with their professional advisors.

their overall investment program. A prospective Fund investor should consider the following factors and other considerations. The following risk factors do not purport to be a complete examination of all of the risks involved in investments typically considered by Merced Capital.

- General Economic Conditions and Market Risks. All investments risk the loss of capital and are subject to investment-specific price fluctuations as well as to macro-economic, market and industry-specific conditions, including but not limited to national and international economic conditions, domestic and international financial policies and performance, conditions affecting particular investments such as the financial viability, sales and product lines of corporate issuers, national and international politics and governmental events, and changes in income tax and other laws and regulations. Investment recommended by Merced Capital to the Funds may involve risks associated with limited diversification and significant concentration, leverage, investments in speculative assets and financial instruments and the use of speculative investment strategies and techniques, interest rates, volatility, tracking risks in hedged positions, credit deterioration or default risks, systems risks and other risks inherent in the Funds' activities. Certain investment techniques of Merced Capital can, in certain circumstances, magnify the impact of adverse market moves to which the Funds may be subject. In addition, the Funds' investments may be materially affected by conditions in real estate, financial and other markets and overall economic conditions occurring globally and in particular markets where the Funds may invest their assets.

Merced Capital may not accurately predict future risk exposures relating to the Funds. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger than historical indicators. Also, information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted.

- Industry Specific Risks. A Fund may take significant positions in particular industries that are subject to risks unique to those industries. For example:
  - *Aircraft.* Merced Capital-managed Funds participate in the business of purchasing and leasing commercial jet aircraft. Investors should consider the risks associated with the aircraft sale and leaseback business, which include, for example, the uncertain business environment for the airline industry, the risk that a lessee's credit profile will deteriorate, the risk of a decline in the value of aircraft or rental rates, risks associated with inaccurate appraised values for aircraft, risks associated with loss of or damage to an aircraft, and the risk that liens on aircraft will have priority over payments to the Funds.
  - *Insurance.* The Funds may also make investments in debt and equity instruments that allow life insurance-related risk and return to be transferred to investors and thus will be subject to the general risks facing the insurance industry. These risks include, among others, the uncertainty associated with (i) projecting mortality rates, interest rates and life insurance policy lapse rates, (ii) methodologies used to value assets owned by such companies, (iii) the general market and business environment for the insurance industry, (iv) counter-party risk and (v) the risk of regulatory changes, among other factors. The insurance industry is highly regulated, and there is no guarantee that changes will not occur to regulations affecting the insurance and reinsurance businesses, and such changes may adversely affect the value of the Funds and their investments. There may be other risks unique to these and other particular industries in which the Funds invest. The Funds have very few limits on the types of investments they might make.

- *Real Estate.* The Funds may invest directly in real estate that Merced Capital believes is undervalued or under circumstances where Merced Capital believes that relevant market values will appreciate, non-recourse mortgages where the mortgagor is not a significant operating company and in the securities or obligations of single purpose companies whose primary asset is real estate. Risks associated with real estate investments include, among other things, (i) lack of demand for commercial or housing space in a locale, (ii) changes in general economic or local conditions, (iii) changes in supply of, or demand for, similar or competing properties in an area, (iv) uncertainty of cash flow to meet loan and other fixed obligations, (v) changes in interest rates, (vi) unavailability of mortgage financing which may render the sale or refinancing of a property difficult and (vii) changes in tax, real estate, environmental, and zoning laws. Additionally, in connection with the ownership (direct or indirect) of real properties, a Fund or an entity in which a Fund invests may face potential costs and liabilities related to environmental laws, such as those related to the removal of hazardous or toxic substances.

With respect to investments in mortgage loans, the Funds will in large part be dependent on the ability of third parties to successfully operate the underlying properties. In addition, certain of the mortgage loans may be structured so that all or a substantial portion of the principal will not be paid until maturity, which increases the risk of default at that time. The possibility of partial or total loss of capital will exist and investors should not subscribe unless they can readily bear the consequences of such loss.

- Special Situation Transactions. The Funds may invest and trade in situations that Merced Capital believes offer opportunity due to some identifiable dislocation, such as lack of market transparency or liquidity. Risks to a Fund in this type of investing and trading include misjudging the nature or magnitude of the factors that have caused this dislocation, the quality of the position's fundamental assets, the scope of the position's liabilities and the Funds' ability to exit the position in a timely and profitable fashion.
- Investments in Financially Distressed Entities and Restructurings. The Funds may acquire debt, other obligations and equity of financially distressed entities. Although such positions may bring high returns to the Funds, they involve varying degrees of risk. The financial difficulties of such entities may never be overcome and may cause such entities to become subject to bankruptcy proceedings. The timing and outcome of any bankruptcy or restructuring is unpredictable. Any one or all of the entities in which the Fund acquires interests may be unsuccessful in its attempts to restructure and become profitable or the positions may not show any return for a considerable period of time. In any bankruptcy or restructuring, a Fund may lose its entire investment, may be required to accept cash or securities with a value less than its original investment, or may be forced to liquidate its investment at a substantial loss. In addition, under certain circumstances, payments to the Funds and distributions by the Funds to their limited partners may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance, a preferential payment or similar transaction under applicable bankruptcy and insolvency laws. Furthermore, investments in restructurings may be adversely affected by statutes related to, among other things, fraudulent conveyances, voidable preferences, lender liability, and the bankruptcy court's discretionary power to disallow, subordinate or disenfranchise particular claims or re-characterize investments made in the form of debt as equity contributions.
- High Yield, Below Investment-Grade or Unrated Securities. The Funds may invest in high-yield or non-investment grade securities. Such securities are generally not exchange-traded and, as a result, these instruments trade in the over-the-counter

marketplace, which is less transparent and less liquid than the exchange-traded marketplace. In addition, the Funds may invest in bonds of issuers that do not have publicly traded equity securities, making it more difficult to hedge the risks associated with such investments. Non-investment grade securities face ongoing uncertainties and exposure to adverse business, financial or economic conditions which could lead to the issuer's inability to make timely interest and principal payments. The market values of certain of these lower-rated and unrated debt securities tend to reflect individual corporate developments to a greater extent than do higher-rated securities that react primarily to fluctuations in the general level of interest rates, and tend to be more sensitive to economic conditions than are higher-rated securities. Companies that issue such securities are often highly leveraged and may not have available to them more traditional methods of financing. It is possible that a major economic recession could severely disrupt the market for such securities and may have an adverse impact on the value of such securities. In addition, it is possible that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default of such securities.

- Hedging Transactions. The Funds may hedge their investments, including by investing in derivatives and other financial instruments. In the event of an imperfect correlation between a position in a hedging instrument and the portfolio position that it is intended to hedge, the desired protection may not be obtained and the Funds may be exposed to additional risk of loss. Certain of the Funds' hedging transactions may be undertaken through brokers, banks or other organizations, and the Funds will be subject to risk of default or insolvency of such organizations. In such event, there can be no assurance that any money advanced to such organizations would be repaid or that the Funds would have any recourse in the event of default.
- Portfolio Investment Ratings. The Funds' investments are expected to include commercial loans and high yield corporate or other debt obligations of both U.S. and non-U.S. obligors rated below investment grade (or which are not rated at all), which have greater credit and liquidity risk than more highly rated obligations. Downgrades and negative rating actions may occur with respect to these investments and in such case there is no requirement to sell any such investment. Investments with lower ratings will have greater credit, insolvency and liquidity risk than more highly rated obligations and, therefore, a greater risk of loss. In addition to credit and liquidity risk, lower rated obligations have greater volatility than more highly rated obligations. Future periods of uncertainty in the United States economy and the possibility of increased volatility and default rates may further adversely affect the price and liquidity of the Funds' investments. Consequently, the Funds will bear a higher risk of losing all or part of an investment if the investment is downgraded or put on a watch list for downgrade. In addition, any reductions in ratings of or similar rating action with respect to investments may adversely affect the value of such investments.
- Investments in Private Companies. Investments made in private companies involve a number of particular risks, including:
  - Limited financial resources and limited access to additional financing, which may increase the risk of their defaulting on their obligations, leaving creditors such as the Funds dependent on any guarantees or collateral they may have obtained;
  - Shorter operating histories, narrower product lines and smaller market shares than larger businesses, which render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns;

- Less publicly available information about these companies than for public companies and such information may not be of the same quality; and
  - Increased dependence on the management talents and efforts of a small group of persons; as a result, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on these companies' ability to meet their obligations.
- Foreign Investments. Investing in securities of non-U.S. companies or other entities, which are generally denominated in non-U.S. currencies, involves certain risks not typically associated with investing in securities of U.S. entities. These considerations include changes in exchange rates and exchange control regulations, political and social instability, expropriation, imposition of foreign taxes, less liquid markets and less available information than is generally the case in the U.S., higher transaction costs, less government supervision of exchanges, brokers and issuers, greater risks associated with counterparties and settlement, difficulty in enforcing contractual obligations, lack of uniform accounting and auditing standards and greater price volatility. Foreign countries may impose financial, legal, or regulatory restrictions that would not exist in the U.S. These risks may adversely affect the Funds' investments.
  - Currency Exchange Risk. A portion of the Funds' investments may be denominated in various foreign currencies and in other financial instruments, the price of which is determined with reference to such foreign currencies. The Funds will, however, value their investments and other assets in U.S. dollars. The value of the Funds' net assets not denominated in U.S. dollars will fluctuate with U.S. dollar exchange rates as well as the price changes of the Funds' investments in the various local markets and currencies. The Funds will incur costs in converting investment proceeds from one currency to another. The Funds are not obligated to engage in any currency hedging operations, and there can be no assurance as to the success of any hedging operations that the Funds may implement.
  - Illiquidity of Investments. A Fund's portfolio is likely to consist of a number of securities and other obligations for which no significant market exists or which require a substantial period of time before a significant market develops. A Fund's investments may include public and private senior and senior secured debt, unsecured loans, second lien loans, debtor-in-possession financings, delayed drawdown loans, term and revolving bank loans, commercial mortgage-backed securities and residential mortgage-backed securities. Trading in loans is often subject to delays as transfers may require extensive and customized documentation, the payment of significant fees and the consent of the agent bank or underlying obligor. In addition, the Funds may make investments that are subject to legal or contractual restrictions or requirements that limit a Fund's ability to transfer them or sell them for cash. Other investments may be private, direct investments with no trading market at all. The resulting illiquidity of an investment may make it difficult for the Fund to sell such investments if the need arises. If a Fund needs to sell all or a portion of its portfolio over a short period of time, it may realize value significantly less than the value at which it had previously recorded those investments. There can be no assurance that the Funds will be able to generate returns for investors or that the returns will be commensurate with the risks of investing in the types of instruments described herein.
  - Lack of Diversification. Merced Capital is under no obligation to diversify a Fund's investments, whether by reference to the amount invested or the industries or geographical areas in which portfolio companies operate. A Fund may invest in a limited number of investments, and as a consequence the aggregate returns realized by the

- partners may be adversely affected by the unfavorable performance of one or a small number of such investments. If Merced Capital elects to concentrate a Fund's investments in a particular industry, issuer, or geographic region, that Fund's portfolio will then become more susceptible to fluctuations in value resulting from adverse economic conditions affecting that particular industry, issuer, or geographic region.
- Restrictions on Transfer and Investor Liquidity. Interests in a Fund will be issued in reliance upon certain exemptions from registration or qualification under applicable Federal and State securities laws and, therefore, will be subject to certain restrictions on transferability. There is no public or other market for interests in any of the Funds and none is expected ever to develop. Interests cannot be assigned, transferred or encumbered (e.g., as security for a loan) without the consent of the respective general partner of the Fund. Accordingly, Fund interests constitute illiquid investments and should only be purchased by persons that are able to bear the risk of their investment for an indefinite time.
  - Long Term Investment. Although certain investments by a Fund may generate current income, the return of capital and the realization of gains, if any, will generally occur only upon the partial or complete disposition of such investments by the Fund. While an investment may be sold by a Fund at any time, it is not generally expected that this will occur for a number of years after an initial investment has been made.
  - Sophisticated Investors. While investment in a Fund can offer the potential of higher than average returns, it also exposes investors to a correspondingly higher degree of risk and is therefore considered appropriate only for sophisticated investors who can afford to assume this risk. Investors must have knowledge and experience in financial and business matters and be capable of evaluating such merits and risks. Each investor in a Fund will be required to represent that he satisfies these criteria and that he is acquiring the interest for investment.

#### **Item 9                    Disciplinary Information**

There are no legal or disciplinary events involving Merced Capital or its employees that are related to Merced Capital's business or the Funds. From time to time the Funds and Merced Capital are parties to litigation involving investments by the Fund. There is currently no material litigation involving Merced Capital or the Funds.

#### **Item 10                Other Financial Industry Activities and Affiliations**

Neither Merced Capital nor any of its affiliates is registered under any financial regulatory authority outside the United States. None of Merced Capital's employees is a registered broker or affiliated with any such securities broker or dealer. Merced Capital's sole business is management of private investment funds.

#### **Item 11                Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Merced Capital has adopted a Code of Ethics pursuant to SEC Rule 204A-1. Upon request, Merced Capital will provide the Code of Ethics to any investor in any Fund managed by Merced Capital. The Code of Ethics requires that Merced Capital employees disclose information regarding their personal securities accounts, and that they refrain from trading in securities about which they possess material, non-public information.

Merced Capital employees are not permitted to invest in equity securities in which the Funds invest.

#### **Item 12 Brokerage Practices**

Merced Capital maintains relationships with a large number of executing brokers. Merced Capital considers a variety of factors in selecting executing brokers, including ability to locate inventory, speed and reliability of execution, cost, and asset type. Executing brokers do not have access to or custody of assets of the Funds. Each of the Funds (except for Merced Shipping) maintains a custodial account with a large, super-regional national bank with an office in Minneapolis, and each Fund maintains bank accounts with another super-regional national bank.

Merced Capital does not receive so-called “soft dollar” benefits from any broker, other than various forms of research received from time to time, including brokers’ own research reports on companies, industries and the economy as well as research prepared by third parties and made available to Merced Capital by brokers that execute Fund transactions. The research provided by executing brokers benefits Merced Capital in the sense that it does not have to produce or pay for the research itself, which creates an incentive for Merced Capital to select a broker based on this benefit rather than on Merced Capital’s obligation to seek best execution on behalf of the Funds. However, Merced Capital does not “pay up” for such research and the receipt of any such research is not a material factor in the selection of brokers to execute Fund transactions.

Merced Capital monitors the Funds’ bank and custodial accounts on a daily basis and reconciles cash and securities on a daily basis. Merced Capital also monitors the safety and soundness of its bank and custodian and takes appropriate action to assure that cash balances are invested in a secure manner.

Merced, Merced III and Merced IV maintain accounts with prime brokers, but their activity in those accounts is not material in relation to the overall activities of the Funds. The Funds may enter into additional prime brokerage arrangements if Merced Capital determines that it would be beneficial to the Funds.

#### **Item 13 Review of Accounts**

Merced Capital monitors Fund investments on a daily, weekly, monthly or quarterly basis, depending on the nature of the investment. Quoted securities are tracked and monitored daily. Less liquid, longer-term investments (such as equipment, real estate or operating companies) are monitored weekly or monthly, unless there is a change or potential disposition pending.

All Fund investors receive quarterly letters from Merced Capital regarding the prior quarter’s Fund performance and discussing any changes to the portfolio of the Fund.

Investors in Merced receive a monthly statement showing the investor’s capital account and gain or loss for the year to date. Investors in the lock-up Funds receive quarterly statements. Each of the Funds is audited following the close of each calendar year. Ernst & Young LLP has been the auditor of all funds managed by Merced Capital since Merced Capital was founded. Audited financial statements are provided to all investors in March of each year.

#### **Item 14 Client Referrals and Other Compensation**

Merced Capital does not pay any third party for client referrals and has never retained a placement agent or other type of capital raising firm.



#### **Item 15**      **Custody**

The Funds receive monthly statements from their banks and custodians. Merced Capital provides monthly statements to investors in Merced and quarterly statements to investors in the other Funds. Cash balances and positions held by custodians are monitored and reconciled daily.

#### **Item 16**      **Investment Discretion**

As noted above, the partnership agreements for the Funds give the general partner of each Fund broad discretion to make investment decisions on behalf of the Funds. No limited partner in any Fund has any authority to direct or manage the investment of the Fund's assets. Merced Capital is the general partner of Merced and exercises this authority in its capacity as general partner, and the general partners of the other Funds delegate this authority to Merced Capital pursuant to written agreement.

#### **Item 17**      **Voting Client Securities**

As adviser to the Funds, Merced Capital is responsible for voting all proxies and bankruptcy claims with respect to investments held by the Funds. Merced Capital will vote proxies in the best interests of each particular Fund, which may result in different voting results for proxies for the same issuer. Merced Capital believes that voting proxies in accordance with the following guidelines is in the best interests of its clients:

- Generally, Merced Capital will vote in favor of routine corporate housekeeping proposals, including election of directors (where no corporate governance issues are implicated), selection of auditors, and increases in or reclassification of common stock.
- Generally, Merced Capital will vote against proposals that make it more difficult to replace members of the issuer's board of directors, including proposals to stagger the board, cause management to be overrepresented on the board, introduce cumulative voting, introduce unequal voting rights, and create supermajority voting.

For other proposals, Merced Capital will determine whether a proposal is in the best interests of its clients and may take into account the following factors, among others:

- whether the proposal was recommended by management and Merced Capital's opinion of management;
- whether the proposal acts to entrench existing management; and
- whether the proposal fairly compensates management for past and future performance.

Merced Capital will maintain a record of all votes and will consider any investor request to review such votes.

#### **Item 18**      **Financial Information**

Merced Capital does not solicit the prepayment of fees from clients six months or more in advance. There is no financial condition that is reasonably likely to impair Merced Capital's ability to meet its contractual commitments to the Funds.

Merced Capital has never been the subject of a bankruptcy petition.

**Item 19**      **Requirements for State-Registered Advisers**

Merced Capital is not registered with any state securities authority.