

# **The Sterling Group, L.P.**

## **Part 2A of Form ADV The Brochure**

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This brochure provides information about the qualifications and business practices of The Sterling Group, L.P. If you have any questions about the contents of this brochure, please contact us at 713-877-8257. 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 The Sterling Group, L.P. is also available on the SEC's website at:  
[www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Item 2 – Material Changes**

The Sterling Group, L.P. filed its most recent Form ADV Part 2 on March 29, 2018. This annual amendment updates the description of the business practices of The Sterling Group, L.P. and supplements existing disclosure, including under “Item 5 - Fees and Compensation” and “Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss.”

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## **Item 4 – Advisory Business**

The Sterling Group, L.P. (together with its general partner, “Sterling Group”), a Texas limited partnership, together with any predecessors, has been in business since 1981 and is a private investment management firm that provides investment advisory services to private investment funds. The Sterling Group GP, LLC, a Delaware limited liability company, acts as the general partner of the Sterling Group. Sterling Group is not principally owned by any one individual or entity.

Sterling Group’s affiliated entities serve as the general partners of, Sterling Group Partners II, L.P., Sterling Group Partners III, L.P., Sterling Group Partners IV, L.P. (together with any parallel investment vehicles and alternative investment vehicles, the “Sterling Equity Funds”) and Sterling Group Credit Fund, L.P. (together with any parallel investment vehicles and alternative investment vehicles, the “Credit Fund”). The Sterling Equity Funds and Credit Fund, together with any future private investment fund to which Sterling Group or its affiliates provide investment advisory services, are collectively referred to herein as the “Private Investment

Funds”. The current Private Investment Funds have entered into management agreements with the following affiliated entities of Sterling Group to provide investment advisory services: Sterling Group Management, L.P. (“Sterling Management”), Sterling Group Management III, L.P. (“Sterling Management III”) Sterling Group Management IV, L.P. (“Sterling Management IV”), or Sterling Group Credit Management, L.P. (“Sterling Credit”). Sterling Group, Sterling Management, Sterling Management III, Sterling Management IV, and Sterling Credit are collectively referred to herein as “Sterling.” Sterling Management, Sterling Management III, Sterling Management IV, Sterling Credit and the general partners of the Private Investment Funds do not have any employees of their own. As a result, Sterling Management, Sterling Management III, Sterling Management IV and Sterling Credit have entered into sub-management agreements with Sterling Group to provide investment advisory services. Pursuant to the sub-management agreements described above, all investment advisory services are performed by employees of Sterling Group.

The Private Investment Funds are managed in accordance with their respective private equity or private credit strategies and invest through negotiated transactions in operating entities, generally referred to herein as “portfolio companies.” Sterling’s investment advisory services to the Sterling Equity Funds consist of identifying and evaluating investment opportunities, negotiating investments, managing and monitoring portfolio companies and achieving dispositions for such investments. Investments are made predominately in non-public companies, although investments in public companies are permitted. From time-to-time, Sterling personnel may serve on such portfolio companies’ respective boards of directors or otherwise act to influence control over management of portfolio companies. With respect to the Credit Fund, Sterling’s investment advisory services consist primarily of identifying and evaluating mezzanine and second lien loans to middle-market companies as well as equity co-investments alongside its loans. The Credit Fund expects to be a minority investor in such portfolio companies.

Sterling formulates the investment objective for each Private Investment Fund, directs and manages the investment and reinvestment of each Private Investment Fund’s assets, and provides periodic reports to investors in each Private Investment Fund. Investment advice is provided directly to each Private Investment Fund and not individually to the limited partners of the Private Investment Fund. The terms upon which Sterling and its affiliates serve as investment manager and general partner of a Private Investment Fund are established at the time of the organization of each Private Investment Fund and are generally set forth in the governing documents of such Private Investment Fund. Sterling’s investment strategies are discussed in further detail under Item 8 - *Methods of Analysis, Investment Strategies and Risk of Loss* below. Investors in Private Investment Funds participate in the overall investment program for the applicable Private Investment Fund, but may be excused from a particular investment due to legal, regulatory or other applicable constraints.

As of December 31, 2018, Sterling managed approximately \$1.9 billion in client assets on a discretionary basis.

## **Item 5 – Fees and Compensation**

### ***Management Fees and Performance Compensation***

Sterling receives both a management fee and a performance fee for providing investment advisory

services to the Private Investment Funds. Such fees differ for each Private Investment Fund, are negotiated with certain of the participating investors in each Private Investment Fund at the time of its organization and are generally not negotiable thereafter. Detailed information regarding the fees charged to each Private Investment Fund is provided in each Private Investment Fund's offering documents and governing documents.

### *Management Fees*

Management fees charged to each Private Investment Fund are generally payable quarterly in advance, are non-refundable, and are pro-rated for any period that is less than a full calendar quarter.

The management fee charged to each Private Investment Fund is specified in the governing documents of such Private Investment Fund and is generally determined based upon a percentage of capital commitments to such Private Investment Fund during its investment period, and a percentage of actively invested capital after the end of its investment period. The Private Investment Funds will pay Sterling an annual management fee based on a percentage as described above (the current maximum percentage of the existing Private Investment Funds is 2.0%) commencing, generally, from the initial closing or the commencement date of a Private Investment Fund (whether or not an investor was admitted at an initial or subsequent closing) until all portfolio investments are distributed. The annual management fee is subject to reduction over time and to potential reductions due to waivers and offsets under certain circumstances. Each limited partner in a Private Investment Fund bears its pro rata portion of the management fee, subject to Sterling's right to reduce or waive fees as described below.

The Private Investment Funds permit Sterling to elect to receive a portion of the management fees in the form of a credit to its capital account in the Private Investment Fund.

### *Performance Compensation*

Each Private Investment Fund pays the general partner of such Private Investment Fund a "carried interest" equal to 20% of profits on distributions derived from the disposition of investments or securities, after accounting for expenses and a preferred return to limited partners of 8% per annum. The carried interest is paid to the general partner at the time of and out of the distribution of profits to limited partners. Carried interest that has been paid is subject to clawback under certain circumstances as set forth in each Private Investment Fund's governing documents.

It is expected that any future Private Investment Funds will have a similar fee structure.

### *General*

While Sterling's fees are generally not negotiable, the firm reserves the right to waive its fees for certain investors. In particular, the management fee and the carried interest for certain limited partners in the Private Investment Funds who are employees of Sterling or family members of such employees, may be waived or reduced at the discretion of Sterling.

### *Other Expenses*

In addition to management fees and carried interest, each Private Investment Fund (and indirectly its limited partners) is required to pay all fees and expenses relating to the Private Investment Fund's

activities, investments and business to the extent not paid or reimbursed by portfolio companies. Such fees and expenses are set forth in each Private Investment Fund's governing documents and may vary among Private Investment Funds, but typically will include those associated with making or selling portfolio investments, legal and accounting fees, taxes, fund administration fees, commissions and brokerage fees, registration expenses, the cost of directors' and officers' liability insurance and other expenses such as litigation or broken deal expenses (as described further below).

Expenses relating to proposed Private Investment Fund investments that are not ultimately consummated ("broken deal expenses") are generally allocated pro rata among the participating Private Investment Funds according to the amounts each such Private Investment Fund would have invested in the equity of the proposed investments, or by such other allocation method as Sterling believes, in good faith, would be more fair and equitable under the circumstances. Broken deal expenses are not generally allocated to any limited partner or third-party co-investors unless otherwise negotiated with such co-investors.

Each Private Investment Fund (and indirectly its limited partners) is also responsible for the costs and expenses relating to the organization of such Private Investment Fund, including travel, printing, legal, filing and accounting fees and expenses, up to a certain amount, as described in the offering materials and/or governing documents of such Private Investment Fund. Any such organizational expenses paid by a Private Investment Fund in excess of the specified amount for each Private Investment Fund will be applied to reduce management fees payable by such Private Investment Fund. A Private Investment Fund is also required to pay any placement agent fees that are incurred in connection with the marketing and offering of interests in such Private Investment Fund, provided, that any such payments will be applied to reduce the management fee payable by the Private Investment Fund, as described under Item 14 – *Client Referrals and Other Compensation*.

Detailed information regarding all of the costs and expenses to be paid by each Private Investment Fund is contained in the relevant fund's offering materials and governing documents.

### ***Other Compensation***

Sterling may receive transaction fees, director's fees, consulting fees, monitoring fees, termination fees and other similar fees in connection with a potential investment or investment (collectively, "Advisory Fees") and may also receive "breakup" fees in connection with transactions which are not consummated. A percentage of the Advisory Fees Sterling receives will be applied to reduce the quarterly management fee payable by the applicable Private Investment Funds, and "breakup" fees will be used to pay or reimburse the applicable Private Investment Funds for costs and expenses incurred by such Private Investment Fund in connection with any transaction (whether or not consummated) for which such Private Investment Fund has not previously been reimbursed, in each case as detailed in the governing documents of the Private Investment Funds. In applying the management fee reduction for Advisory Fees, the portion of Advisory Fees received by Sterling that is attributable to any co-investors' interest in a portfolio company (including interests held by the Credit Fund and whether made directly in such portfolio company or through a co-investment vehicle) is not counted (*i.e.*, such portion may either be retained by Sterling or allocated to co-investors and not applied as a reduction to the relevant Private Investment Fund's management fees). For purposes of the foregoing sentence, certain management rollover interests in a portfolio company are not considered to be part of a co-investor's interest in such portfolio company, and accordingly are counted when applying the management fee reduction for Advisory Fees.

Depending on the timing of the payment of Advisory Fees to Sterling, limited partners in a Private Investment Fund may not receive the benefit from a reduction of the management fee to the extent such Private Investment Fund is no longer charging management fees at the time the Advisory Fees are paid. For certain Private Investment Funds, the governing documents of such Private Investment Fund may provide limited partners with a right to elect to receive their proportionate share of any such Advisory Fees that were not applied to reduce management fees.

Sterling generally receives ongoing monitoring or advisory fees from portfolio companies either annually or quarterly in advance. If a portfolio company investment is realized during such a quarterly or annual period, Sterling is not obligated to refund the portfolio company for the period of time for which it will not provide services.

Detailed information regarding the types and amounts of Advisory Fees that may offset the management fees otherwise payable by a Private Investment Fund, and the mechanics for such offset, is provided in the offering documents and/or governing documents of such Private Investment Fund.

### ***Special Consultants***

Additionally, as may be described in the governing documents of the Private Investment Funds, Sterling may retain certain other companies and individuals (“Special Consultants”) to provide services to, or in connection with one or more Private Investment Funds or certain current or prospective portfolio companies. Such Special Consultants generally provide services in relation to the identification, acquisition, holding, improvement and disposition of portfolio companies. Special Consultants receive compensation that may include cash fees, retainers, transaction fees, a profits or equity interest in a portfolio company or other incentive-based compensation, which may be determined according to one or more methods. Additionally, portfolio companies may provide opportunities for Special Consultants to invest in such portfolio company and reimburse costs and expenses incurred by Special Consultants. Special Consultants also may receive remuneration from Sterling and/or a Private Investment Fund or affiliates and/or be entitled to other forms of compensation, including equity grants in portfolio companies. Such investment opportunities, reimbursements and other compensation paid to a Special Consultant generally will not offset the Management Fee.

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

As discussed under Item 5 - *Fees and Compensation* above, each Private Investment Fund pays a carried interest of up to 20% to the general partner of such Private Investment Fund. The Sterling general partners’ receipt of performance fees may create an incentive for Sterling and its affiliates to make more speculative investments than it would otherwise make in the absence of performance-based compensation. In order to minimize adverse consequences that might result from this risk, Sterling, through its affiliates, manages each Private Investment Fund in accordance with the investment strategies it has developed for such Private Investment Fund. Furthermore, the offering documents of a Private Investment Fund disclose material risks inherent in the investment strategies of a Private Investment Fund.

The relevant governing documents of each Private Investment Fund permit the general partner of the Private Investment Fund to offer limited partners or third parties co-investment opportunities. Such co-investors may include investors in the Private Investment Funds, employees or related persons of

Sterling, financing sources, portfolio company management, and others. Co- investors may participate directly in a portfolio company or through a vehicle controlled by Sterling. Depending on the structure of a co-investment, Sterling may have discretion with respect to co-investment acquisitions or dispositions. The terms of any co-investment is negotiated by Sterling and the potential co-investor on a case-by-case basis in their respective sole and absolute discretion. Subject to the terms of a Private Investment Fund's governing documents, Sterling may (or may not) in its discretion (i) charge carried interest, management fees or other similar fees to co-investors and (ii) collect customary fees in connection with actual or contemplated investments that are the subject of such co-investment arrangements.

## **Item 7 – Types of Clients**

Sterling provides investment advice to Private Investment Funds. Private Investment Funds may include investment partnerships or other investment entities formed under domestic or foreign laws and operated as exempt investment pools under the Investment Company Act of 1940, as amended. The investors participating in Private Investment Funds may include individuals, banks or thrift institutions, other investment entities, pension and profit-sharing plans, trusts, estates or charitable organizations or other corporations or business entities and may include, directly or indirectly, partners or other personnel of Sterling and its affiliates.

The Private Investment Funds generally have a minimum investment amount of \$5 million for third-party investors, and Private Investment Fund interests are offered and sold solely to qualified purchasers, accredited investors who are also qualified clients or qualified knowledgeable Sterling personnel. Such minimum investment amount may be waived by Sterling's affiliates in its capacity as general partner or managing partner of a Private Investment Fund.

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

### ***Investment Strategies and Methods of Analysis***

Sterling is a private investment firm specializing in acquiring controlling equity interests and minority mezzanine and second lien loans in middle-market companies and improving them through a combination of strategic and operational initiatives.

Once Sterling has identified a potential investment opportunity for the Private Investment Funds, it will undertake a comprehensive due diligence process, consisting of the following components, as relevant:

- Preparation of a preliminary financial model and collecting and analyzing industry, company specific and management information;
- Thorough study of the target company's industry, market share, competitive strengths and weaknesses, and internal operations, utilizing industry professionals or consultants to supplement internal findings and opinions where appropriate.
- Assessment of the target's management team, and, if management is underqualified (or does not exist) initiation of a search for qualified candidates. In these circumstances, Sterling will confirm that it can provide the operating resources to temporarily assume management responsibilities until qualified personnel are hired.

- Evaluation of the internal operations of the business, including (i) understanding components of cost and customer and product line profitability; (ii) identifying opportunities to streamline manufacturing processes and improve capacity utilization; (iii) identifying opportunities to improve product mix and quality; and (iv) developing strategic plans for internal growth and growth through acquisitions.
- Confirmatory due diligence conducted by outside professionals on matters such as accounting, tax, legal, environmental, human resources, technical (if necessary), risk management and employee benefits.

### ***Risk of Loss and Risks Associated with the Investment Strategy***

An investment in any Private Investment Fund may be deemed a speculative investment, and is designed for sophisticated investors who fully understand and are capable of bearing the risk of an investment in such Private Investment Fund. No guarantee or representation is made that the Private Investment Fund will achieve its investment objective or that limited partners will receive a return of their capital. Interests in a Private Investment Fund will not be registered under the federal securities laws and their transfer will be limited under federal and state securities laws and under the terms of the governing documents of such Private Investment Fund. There will be no public or private market in which Private Investment Fund interests may be sold. Consequently, each limited partner should view any investment in a Private Investment Fund as a long-term investment which it may not be able to liquidate for an indefinite period of time. Investors in any Private Investment Fund should be prepared to bear the loss of their investment.

Sterling's investment strategies and methods of analysis involve numerous risks that an investor or prospective investor should consider before making an investment in any Private Investment Fund that employs such strategies and methods of analysis. Set forth below is a description of some of these material risks. The following list of material risks is not intended to be an exhaustive list of the risks relating to Sterling's investment strategies and methods of analysis, and the descriptions of such risks herein are not intended to be comprehensive. Investors and prospective investors in any Private Investment Fund should review the offering documents with respect to such Private Investment Fund for a detailed description of the risks associated with an investment in such Private Investment Fund.

Investments in the Private Investment Funds are subject to many material risks, including the following:

#### ***General Business and Management Risk***

Investments in portfolio companies subject the Private Investment Funds to the general risks associated with the underlying businesses, including market conditions, changes in regulatory requirements, reliance on management at the company level, interest rate and currency fluctuations, general economic downturns, domestic and foreign political situations and other factors. With respect to management at the portfolio company level, many portfolio companies rely on the services of a limited number of key individuals, the loss of any one of whom could significantly and adversely affect the portfolio company's performance. While in all cases Sterling will monitor the management of portfolio companies, the day-to-day management of the portfolio companies is the responsibility of such portfolio company's executives and officers.

#### ***Risk of Limited Number of Investments and Portfolio Valuation***



Since each Private Investment Fund may only make a limited number of investments and such investments generally will involve a high degree of risk, poor performance by even a single portfolio company could severely affect the total returns to investors.

### ***Competitive Market for Investment Opportunities***

The Private Investment Funds will be competing with a significant number of private equity and credit funds, as well as institutional investors, for suitable investments. As a result of this competition, there can be no assurance that the Private Investment Funds will be able to locate suitable investment opportunities, acquire them for an appropriate level of consideration, achieve their targeted rate of return or fully invest their respective committed capital.

### ***Liquidity Issues***

The Private Investment Funds will invest in certain instruments where there is likely to be no actively traded market. Moreover, many of the Private Investment Funds' investments may be held by relatively few other investors. Under adverse market or economic conditions or in the event of adverse changes in the financial condition of the issuer or of the asset, the Private Investment Funds may find it more difficult to sell such instruments when Sterling believes it advisable to do so or may be forced to sell them at prices lower than if the instruments were widely held. Thus, the range of disposal strategies available to the Private Investment Funds may be further limited. Finally, dispositions of investments may be subject to contractual and other limitations on transfer, or other restrictions that would interfere with subsequent sales of such investments or adversely affect the terms obtainable upon a disposition.

### ***Leverage***

The Private Investment Funds' investments are expected to include portfolio companies whose capital structures may have significant leverage. Although the portfolio companies will seek to use leverage in a manner they believe to be prudent, the leveraged capital structure of such portfolio companies will increase the exposure of the portfolio companies to adverse economic factors such as rising interest rates, downturns in the economy or deterioration in the conditions of the portfolio company or its industry. Further, leveraged buyouts by their nature require companies to undertake a high ratio of fixed charges to available income. Such investments are inherently more sensitive to declines in revenues and to increases in expenses. If a portfolio company defaults on its indebtedness, lenders may foreclose and a Private Investment Fund could lose its entire investment in such portfolio company.

### ***Subscription Lines***

A Private Investment Fund may enter into a subscription line with one or more lenders in order to finance its operations (including the acquisition of the Private Investment Fund's investments). Fund-level borrowing subjects limited partners to certain risks and costs. For example, any limited partner claim against the Fund would likely be subordinate to the Private Investment Fund's obligations to a subscription line's creditors.

In addition, Fund-level borrowing will result in incremental partnership expenses that will be borne by investors. These expenses typically include interest on the amounts borrowed, unused

commitment fees on the committed but unfunded portion of a subscription line, an upfront fee for establishing a subscription line, and other one-time and recurring fees and/or expenses, as well as legal fees relating to the establishment and negotiation of the terms of the borrowing facility. Because a subscription line's interest rate is based in part on the creditworthiness of the relevant Fund's limited partners and the terms of the governing documents, it may be higher than the interest rate a limited partner could obtain individually. To the extent a particular limited partner's cost of capital is lower than the Private Investment Fund's cost of borrowing, Fund-level borrowing can negatively impact a limited partner's overall individual financial returns even if it increases the Private Investment Fund's reported net returns in certain methods of calculation.

A credit agreement may contain other terms that restrict the activities of a Private Investment Fund and the limited partners or impose additional obligations on them. For example, a subscription line may impose restrictions on Sterling's ability to consent to the transfer of a limited partner's interest in the Private Investment Fund. In addition, in order to secure a subscription line, Sterling may request certain financial information and other documentation from limited partners to share with lenders. Sterling will have significant discretion in negotiating the terms of any subscription line and may agree to terms that are not the most favorable to one or more limited partners.

### ***Valuation of Assets***

There is not expected to be an actively traded market for most of the securities owned by the Private Investment Funds. When estimating fair value, Sterling will apply a methodology based on its best judgment that is appropriate in light of the nature, facts and circumstances of the respective investments. Valuations are subject to levels of review and final approval by the valuation committee comprised of certain senior Sterling Group personnel, including its Chief Compliance Officer. The process of valuing securities for which reliable market quotations are not available is based on inherent uncertainties and the resulting values may differ from values that would have been determined had an active market existed for such securities and may differ from the prices at which such securities ultimately may be sold. The exercise of discretion in valuation by Sterling may give rise to conflicts of interest, including in connection with determining the amount and timing of distributions of carried interest and the calculation of management fees.

### ***Material Non-Public Information***

As a result of the operations of Sterling and its affiliates, Sterling and its personnel may come into possession of confidential or material, non-public information, including as a result of certain Sterling personnel serving on the boards of directors of portfolio companies. Therefore, Sterling and its affiliates may have access to material, non-public information that may be relevant to an investment decision to be made by a Private Investment Fund. Consequently, a Private Investment Fund may be restricted from initiating a transaction or selling an investment which, if such information had not been known to it, may have been undertaken on account of applicable securities laws or Sterling's internal policies. Due to these restrictions, the Private Investment Fund may not be able to make an investment that it otherwise might have made or sell an investment that it otherwise might have sold.

### ***Investment Expenses and Broken Deal Expenses***

Investments of the Private Investment Funds will require extensive due diligence, legal, and other

costs prior to their consummation and may be subject to broken deal expenses if they are not consummated. A Private Investment Fund will pay any fees, costs, and expenses incurred in discovering, developing, negotiating, evaluating, acquiring and structuring any investment opportunities it pursues, whether or not such investments are ultimately consummated. Additionally, a Private Investment Fund may enter into agreements that involve payments, such as reverse break-up fees, by such Private Investment Fund if it does not consummate the transaction. These expenses can be significant and may be material to a Private Investment Fund. A Private Investment Fund may incur, either directly or pursuant to its obligation to reimburse Sterling for any such expenses advanced by it, significant expenses in connection with proposed investments that are not consummated without the opportunity for gain or recoupment of such expenses.

### ***Co-Investments***

Where appropriate, Sterling may, but is not obligated to, provide co-investment opportunities to the limited partners of the Private Investment Funds and/or other third parties. Such investments may involve additional risks not present in investments where a co-investor is not involved, including, where the co-investor is a third party, the possibility that the third party co-investor may have interests or objectives that are inconsistent with those of the Private Investment Funds or may be in a position to take (or block) action in a manner contrary to the Private Investment Funds' investment objectives. From time to time, Sterling may elect to facilitate co-investments with respect to a particular investment within a certain period of time after such investment is consummated by a Private Investment Fund through subsequent sales or dispositions of portions of such investment to co-investors. If a Private Investment Fund elects to facilitate a co-investment in this manner, it will bear the risk that any or all of the excess portion of such investment may not be sold or may only be sold on unattractive terms and that, as a consequence, among other things, such fund may hold a larger than expected interest in such investment, or may realize lower than expected returns from such investment.

### ***Service Providers***

Service providers or affiliates of service providers (including lenders, brokers, accountants, administrators, bankers, consultants, attorneys, and investment banking firms) of the Private Investment Funds may be in a position to provide certain services to employees of Sterling and Sterling itself with respect to non-fund related matters. Sterling may recommend to a Private Investment Fund or a portfolio company that it contract for services with such service providers. The receipt of services with respect to non-fund related matters may influence or have the appearance of influencing Sterling's decision whether to select such service provider for Sterling or the Private Investment Funds or whether to recommend such service provider to a portfolio company. In addition, if such service provider relies or depends on the referrals or direction of Sterling for work performed for a Private Investment Fund, such service provider may be inclined to provide better or more resources to the work of Sterling or Sterling personnel than to the work of such fund. Sterling addresses these conflicts of interest by using reasonable diligence to ascertain whether each service provider provides its service on a "best execution" basis, taking into account factors such as expertise, operational and regulatory controls, availability and quality of service and the competitiveness of compensation rates in comparison with other service providers satisfying Sterling's service provider selection criteria.

In addition, Sterling may from time to time enter into arrangements with service providers that provide fee discounts for certain services. Generally, Sterling will not itself receive, or permit the

general partner of a Private Investment Fund to receive, discounts with respect to services that are also provided to the Private Investment Funds or portfolio companies unless such funds or companies are charged similar rates. However, a portfolio company may not enjoy such discounts to the extent it engages such service provider on its own behalf and on independent terms.

Finally, on occasion, employees of certain key service providers engaged by Sterling or the Private Investment Funds may invest in the Private Investment Funds. Investments from these parties are subject to the same subscription process as other investors in the funds.

### ***Enhanced Relationships with Certain Limited Partners***

In some cases, investors may also directly or indirectly (through an affiliate) provide financing, insurance, advisory or other services to Sterling, the Private Investment Funds or one or more of their respective portfolio companies. To the extent Sterling, any such fund or any such portfolio company is seeking a provider of such services, they may be incentivized to procure such services from an investor (or one of its affiliates) on a basis other than best execution, best price or other similar basis. Such investors may also be aligned with Sterling, such Private Investment Fund or one or more of their portfolio companies in a manner that could give rise to conflicts of interest to the extent such investors are represented on the respective Private Investment Fund's advisory board.

### ***Nature of Mezzanine and Other Subordinated Investments***

Mezzanine and other subordinated debt investments involve a high degree of risk with no certainty of any return of capital. Although mezzanine debt obligations are senior to common stock and other equity securities in the capital structure, they may be subordinated to large amounts of senior debt and are often unsecured. The ability of the subordinated debt holders to influence a company's affairs, especially during periods of financial distress or following an insolvency, is likely to be substantially less than that of senior creditors. For example, under terms of subordination agreements, senior creditors are typically able to block the acceleration of the mezzanine debt or other exercises by the subordinated creditors of their rights. Accordingly, the Credit Fund may not be able to take the steps necessary to protect its investments in a timely manner or at all.

If a portfolio company becomes subject to insolvency proceedings in any jurisdiction, the rights of holders of mezzanine and subordinated debt may be adversely affected. Such proceedings and related laws and remedies may vary substantially from jurisdiction to jurisdiction, may create the right of such portfolio company to avoid certain unfavorable contracts or obligations and may result in significant delay and/or limitations on repayment of amounts owed to the Credit Fund. With respect to the Credit Fund's investments in the form of subordinated debt instruments, upon any distribution to the relevant borrower's creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of such borrower's senior and/or secured indebtedness (to the extent of the collateral securing such obligation) will be entitled to be paid in full before any payment may be made on the Credit Fund's investment. In the event of a bankruptcy, liquidation or reorganization or similar proceeding relating to such a borrower, the Credit Fund will typically participate with all other holders of such borrower's indebtedness in the assets remaining after the borrower has paid all of its senior and/or secured indebtedness (to the extent of the collateral securing such obligation). Such borrower may not have sufficient funds to pay all of its creditors, and the Credit Fund may receive nothing, or less, ratably, than the holders of senior and/or secured indebtedness of such borrower or the holders of indebtedness that is not subordinated.

The Credit Fund may make equity investments in connection with its mezzanine investments. Certain mezzanine investments may be convertible, by the terms thereof, into equity securities after a triggering event. These equity securities will generally be the most junior in what typically will be a complex capital structure, and thus subject to the greatest risk of loss. Depending on fluctuations of the equity markets and other factors, warrants and other equity securities may become worthless.

### ***Management of Multiple Private Investment Funds***

Various actual and potential conflicts will arise from Sterling's management of multiple Private Investment Funds. If any matter arises that Sterling determines in its good faith judgment constitutes an actual or potential conflict of interest, Sterling may take such actions as may be necessary or appropriate to ameliorate such conflict. There can be no assurance that Sterling will identify or resolve all conflicts of interest and, if resolved, that such conflicts will be resolved in a manner that is favorable to any particular Private Investment Fund. Certain of these conflicts are described herein.

Allocation of Investment Opportunities. Sterling currently and expects to continue to sponsor and manage multiple Private Investment Funds. Certain investment opportunities suitable for one Private Investment Fund may also be suitable for other Private Investment Fund. Conflicts of interest may arise in determining which Private Investment Funds should participate in investment opportunities. Sterling will determine the allocation of investment opportunities among Private Investment Funds in such manner as the Sterling, in its sole discretion, determines in good faith to be fair and equitable, consistent with the applicable governing documents. There can be no assurances that all investment opportunities identified by Sterling will be made available to any Particular Private Investment Fund.

Sterling's allocation of investment opportunities among the Private Investment Funds may not always, and often will not, be proportional, and such allocations may be more advantageous to certain Private Investment Funds than to others. While Sterling will allocate investment opportunities in a way that it believes in good faith is fair and equitable, there can be no assurance that a Private Investment Fund's actual allocation of an investment opportunity, if any, or terms on which the allocation is made, will be as favorable as they would be if the potential conflicts of interest did not exist.

Investing in Different Levels of the Capital Structure. The Credit Fund is expected to hold interests in portfolio companies that are of a different class or type than the class or type of interests held by the Sterling Equity Funds. For example, a Sterling Equity Fund is expected to hold equity securities while the Credit Fund may hold debt of the same portfolio company. To the extent that the Credit Fund invests in a debt instrument of a portfolio company in which a Sterling Equity Fund holds equity securities, Sterling and relevant general partners would be subject to conflicts of interest in determining the terms of such debt instrument and in managing the Credit Fund's and such Sterling Equity Fund's investments in such portfolio company on a going-forward basis. Because of the different legal rights associated with debt and equity investments, Sterling and relevant general partners may face a conflict of interest in respect of the advice it gives to, and the actions it takes on behalf of, the Credit Fund versus the relevant Sterling Equity Fund. For example, questions may arise as to whether payment obligations and covenants should be enforced, modified or waived, or whether debt investments should be refinanced or restructured. In addition, to the extent that the Credit Fund invests in a debt instrument of a portfolio company in which a Sterling Equity Fund holds more senior or more junior debt securities, Sterling and relevant general partners would be subject to conflicts of interest in determining the terms of the Credit Fund's debt instrument and in

managing the Credit Fund's and such Sterling Equity Fund's investments in such portfolio company on a going-forward basis.

Sterling intends to ameliorate and/or manage such conflicts of interest to the extent possible, by holding a minority of any class or tranche of debt issued by a portfolio company in which a Sterling Equity Fund holds outstanding equity or debt interests and allowing the "lead" investors in the debt to negotiate structure pricing and terms. In addition, the Credit Fund will not seek voting control of any class or tranche of debt issued by a portfolio company in which a Sterling Equity Fund holds outstanding equity or debt interests and may agree to vote its debt securities in accordance with the debt holders of the same class or abstain from voting or taking certain actions not approved by the other holders of such class (however the Credit Fund and/or Sterling and relevant general partners will be under no obligation to do so). While not required, Sterling may seek the approval or recommendation of relevant Advisory Boards if a known or potential conflict of interest arises with between the Credit Fund and a Sterling Equity Fund.

## **Item 9 – Disciplinary Information**

Sterling and its management persons have not been involved in legal or disciplinary events in the past 10 years that would be material to an investor's evaluation of Sterling or its personnel.

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

As discussed above, Sterling provides investment advice to the Private Investment Funds. Otherwise, Sterling and its employees do not have any relationships or arrangements with other financial services companies that pose material conflicts of interest.

Sterling's employees and related persons may serve as directors and officers of, and provide advice to, publicly traded companies and private companies. Receipt of material non-public information by Sterling's employees and related persons regarding these companies could preclude Sterling from effecting transactions in the securities of such companies.

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

Sterling employees are subject to a Code of Ethics (the "Code"). The Code prohibits personnel from engaging in personal investment activities which compete with or attempt to take advantage of planned portfolio transactions. Among the objectives of the Code is for Sterling to act in its clients' best interests. As such, Sterling employees are prohibited from using the influence of their position to obtain a personal trading advantage.

Subject to certain exceptions consistent with industry requirements (e.g., U.S. government securities, open-end investment companies, etc.), the Code requires employees to report securities transactions each quarter in accounts in which they have a "beneficial interest." Employees must also report any newly opened accounts on an ongoing basis. Additionally employees certify annually in writing regarding holdings and existing accounts as well as compliance with the terms of the Code. The Code also requires employees to receive pre-clearance before entering into purchases and sales (investments and redemptions) involving IPOs or Private Placements. A copy of the Code is available to clients and prospective clients upon request.

Investors or prospective investors may obtain a copy of the Code by sending a written request to Sterling Group's Chief Compliance Officer at the address set forth on the cover page of this Brochure.

Sterling and/or its affiliates have an economic interest in the Private Investment Funds and these funds may have different investment objectives or considerations. Decisions as to purchases and sales for each Private Investment Fund are made separately and independently in light of their respective objectives and purposes and may differ, depending on the fund. As such, investment decisions made on behalf of one fund may not always be consistent with investment decisions made on behalf of another fund.

Sterling personnel may directly or indirectly own an interest in one or more Private Investment Funds, including certain co-invest vehicles. To the extent that co-invest vehicles exist, such vehicles may invest in one or more of the same portfolio companies as a Private Investment Fund. Co-invest opportunities may also be presented to third-party investors and other persons, and such co-investments may be effected through co-invest vehicles or directly in a particular portfolio company. When and to the extent Sterling personnel and related persons make capital investments in or alongside a Private Investment Fund, Sterling is subject to conflicting interests in connection with these investments. Sterling's allocation of co-investment opportunities among the parties and in the manner discussed herein may not, and often will not, result in proportional allocations among such parties, and such allocations may be more or less advantageous to some such parties relative to others. Such co-investment opportunities generally will be allocated in the manner described under "Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss."

With respect to investments made by Sterling Group Partners II, L.P. and Sterling Group Partners III, L.P., it is possible that Sterling personnel may personally invest alongside such Private Investment Funds in certain investments. Such Sterling personnel must obtain the pre-approval of the Chief Compliance Officer before engaging in any transaction in such securities so that the Chief Compliance Officer may evaluate any conflicts of interest or other issues resulting from the employee's proposed ownership or disposition. Sterling personnel may personally invest at the same time as an employee offering by the companies held by such Private Investment Funds. This may create a conflict of interest if Sterling personnel are aware of events that may be material to the portfolio company's financial performance that have occurred between the closing of the transaction and the equity offering through the stock participation plan since Sterling personnel would participate at the same closing price of the transaction as the Private Investment Fund.

## **Item 12 – Brokerage Practice**

Sterling focuses on making investments in private securities, thus it does not ordinarily deal with a financial intermediary such as a broker-dealer in connection with the execution of transactions in public securities, and commissions are not ordinarily payable in connection with such investments. To the extent Sterling transacts in public securities for portions of the Private Investment Funds, it intends to select brokers based upon the broker's ability to provide best execution for the Private Investment Funds. Sterling is generally authorized to make the following determinations, subject to the Private Investment Funds' investment objectives and restrictions, without obtaining prior consent from the relevant Private Investment Fund or any of their investors: (i) which securities or other instruments to buy or sell; (ii) the total amount of securities or other instruments to buy or sell; (iii) the executing broker or dealer for any transaction; and (iv) the commission rates or commission equivalents charged for transactions.

In making its decisions regarding the allocation of brokerage transactions for Private Investment Funds, Sterling will consider a variety of factors including but not limited to: (i) the ability to effect prompt and reliable executions at favorable prices (including the applicable dealer spread or commission, if any); (ii) the operational efficiency with which transactions are effected (such as prompt and accurate confirmation and delivery), taking into account the size of order and difficulty of execution; (iii) the financial strength, integrity and stability of the broker-dealer or counter party; and (iv) the competitiveness of commission rates in comparison with other broker-dealers. Although Sterling generally seeks competitive commission rates and commission equivalents, including mark-ups, it will not necessarily pay the lowest commission or equivalent. Transactions may involve specialized services on the part of a broker-dealer, which may justify higher commissions and equivalents than would be the case for more routine services.

Brokers through which Sterling effects transactions may provide Sterling with investment research and other products and services that are generally made available to all institutional investors doing business with such brokers. These bundled services are made available to Sterling on an unsolicited basis and without regard to the rates of commissions or spreads charged or paid by Sterling or the volume of business Sterling directs to such broker-dealers. Since these products and services are merely made available by brokers as part of a bundled business package to Sterling, which may or may not use them, it is Sterling's understanding that such brokers do not set discrete prices for such products and services. Accordingly, Sterling does not separately compensate such brokers for the provision of such services and does not believe that it "pays-up" for such brokers' services since the brokers do not break out the costs for such services.

From time to time, Sterling may, but is not obligated to, purchase or sell securities for several client accounts at approximately the same time. Such orders may be combined or "batched" to facilitate obtaining best execution and/or to reduce brokerage commissions or other costs. Batched transactions are executed in a manner intended to ensure that no participating Private Investment Fund of Sterling is favored over any other Private Investment Fund. When an aggregated order is filled in its entirety, each participating Private Investment Fund generally will receive the average price obtained on all such purchases or sales made during such trading day.

To the extent a trade error occurs, it will be resolved promptly. Any gain associated with any trade error shall be retained by the affected Private Investment Fund(s) and any loss to a Private Investment Fund resulting from a trade error shall be reimbursed to the relevant Private Investment Fund(s).

### **Item 13 – Review of Accounts**

The investments made by the Private Investment Funds are generally private, illiquid and long-term in nature. Accordingly, the review process is not directed toward a short-term decision to dispose of securities. However, Sterling closely monitors companies in which the Private Investment Funds invest and generally maintains an ongoing oversight position in such companies. Partners or other personnel of Sterling may serve on a Sterling Equity Fund portfolio company's board of directors or otherwise act to influence management of companies held by the Sterling Equity Funds. In addition, the Sterling Equity Funds' Investment Committee, composed of the entire professional staff of Sterling, with certain senior Sterling personnel who are responsible for each Sterling Equity Fund having formal voting rights, monitors and reviews investments of the Sterling Equity Funds on a



regular and recurring basis. The Credit Fund maintains a separate Transaction Evaluation Committee which includes three senior Sterling personnel and requires unanimous approvals for all investment decisions.

Sterling's Chief Compliance Officer is included on the Investment Committee and Transaction Evaluation Committee and periodically checks to confirm that each Private Investment Fund is maintained in accordance with its stated objectives.

The Private Investment Funds will provide to its limited partners (i) annual audited financial statements prepared in accordance with generally accepted accounting principles consistently applied in the United States, (ii) quarterly unaudited financial statements and statement of such limited partner's capital account and changes thereto for such quarter, and (iii) annual tax information necessary for each limited partner's preparation of its tax return.

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

### ***Compensation for Client Referrals***

Sterling may enter into written agreements with and compensate unaffiliated third parties for soliciting new investors to certain of the Private Investment Funds. Under such agreements, Sterling agrees to pay a placement agent a percentage of the amounts invested into a Private Investment Fund to the extent the investors were referred by the placement agent. Such placement fees are paid initially by the applicable Private Investment Fund, but management fees owed by such Private Investment Fund to Sterling are correspondingly reduced so that Sterling, and not the Private Investment Fund (or its investors), bears the cost of placement fees. The use of a placement agent is fully disclosed to investors referred by such placement agent.

### ***Economic Benefits from Non-Clients***

As discussed in Item 5 - *Fees and Compensation* above, Sterling may receive Advisory Fees in respect of services it provides to portfolio companies. The Advisory Fees are agreed upon with each portfolio company in a Management Services Agreement. In cases where a management team is not in place at the time the Management Services Agreement is executed, a Sterling employee may sign the agreement on behalf of both counterparties. Therefore, a conflict of interest may exist in the Advisory Fee negotiation process since there is no involvement of an independent representative of the relevant portfolio company. In addition, Sterling may receive "breakup" fees in connection with proposed investments which are not consummated. A percentage of the Advisory Fees Sterling receives will be applied to reduce the quarterly management fee payable by the applicable Private Investment Funds, as detailed in the governing documents of the Private Investment Funds. If Sterling receives any breakup fees in connection with an unconsummated transaction, such breakup fees will be used to pay or reimburse the applicable Private Investment Fund for costs and expenses incurred by such Private Investment Fund in connection with any transaction (whether or not consummated) for which the Private Investment Fund has not previously been reimbursed. The portion of Advisory Fees allocable to co-investors is retained by Sterling in accordance with the relevant governing documents and not applied as a reduction of management fees.

## **Item 15 – Custody**

Sterling and its affiliates have custody over the Private Investment Funds' funds and securities because they serve as the general partners of the Private Investment Funds. With the exception of uncertificated privately offered securities, all assets of the Private Investment Funds are held in custody by unaffiliated broker/dealers or banks. Limited partners will not receive statements from the custodians. Instead the Private Investment Funds are subject to an annual audit and the audited financial statements are distributed to each limited partner. The audited financial statements will be prepared in accordance with generally accepted accounting principles and distributed within 120 days of each Private Investment Fund's fiscal year end or earlier as required by the relevant governing documents of the Private Investment Funds.

## **Item 16 – Investment Discretion**

Sterling's affiliates, through their positions as general partners, have discretionary authority to manage investments on behalf of the Private Investment Funds. As a general policy, Sterling and the general partners of the Private Investment Funds do not allow investors to place limitations on this authority. Pursuant to the terms of the Private Investment Funds' governing documents, however, Sterling's general partners may enter into "side letter" arrangements with certain limited partners whereby the terms applicable to such limited partner's investment in the Private Investment Funds may be altered or varied, including, in some cases, the right to opt-out of certain investments for legal, tax, regulatory or other similar reasons. Sterling and the general partners assume this discretionary authority pursuant to the terms of the governing documents and powers of attorney executed by the limited partners of the Private Investment Funds.

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

Sterling focuses on securities transactions of private companies and therefore generally the Private Investment Funds portfolio companies typically do not issue proxies. On occasion, Sterling will receive proxies in connection with its publicly traded portfolio companies, in which case it is Sterling's policy to exercise the proxy vote in the best interest of the Private Investment Funds, taking into consideration all relevant factors, including without limitation, acting in a manner that Sterling believes will (i) maximize the economic benefits to the Private Investment Funds and (ii) promote sound corporate governance by the issuer. On rare occasions, Sterling may be required to exercise a vote for a privately-held portfolio company, in which case the same procedures apply.

Sterling has adopted a Proxy Policies and Procedures (the "Proxy Policy") to address how it will vote proxies, as applicable, for the Private Investment Funds' portfolio investments. The Proxy Policy seeks to ensure that Sterling votes proxies (or similar instruments) in the best interest of the Private Investment Funds, including where there may be material conflicts of interest in voting proxies. Sterling generally believes its interests are aligned with those of the Private Investment Funds' investors through the Sterling's beneficial ownership interests in the Private Investment Funds and therefore will not seek investor approval or direction when voting proxies. In the event that there is or may be a conflict of interest in voting proxies, the Proxy Policy provides that Sterling may address the conflict using several alternatives, including by seeking the approval or concurrence of the relevant Private Investment Fund's advisory board on the proposed proxy vote or through other alternatives set forth in the Proxy Policy. Additionally, the relevant Private Investment Fund's advisory board may approve Sterling's vote in a particular solicitation. Sterling does not consider service on portfolio company boards by Sterling personnel or Sterling's receipt of management or

other fees from portfolio companies to create a material conflict of interest in voting proxies with respect to such companies. In addition, the Proxy Policy sets forth certain specific proxy voting guidelines followed by Sterling when voting proxies on behalf of the Private Investment Funds. A copy of the Proxy Policy is available to clients and prospective clients upon request. Investors or prospective investors may obtain a copy of the Proxy Policy by sending a written request to Sterling Group's Chief Compliance Officer at the address set forth on the cover page of this Brochure. In addition, information regarding how Sterling voted proxies for particular portfolio companies is available to investors in the relevant Private Investment Funds upon written request to Sterling Group's Chief Compliance Officer at the address set forth on the cover page of this Brochure.

Sterling is authorized to direct the Private Investment Funds' participation in class actions. The relevant deal team will determine whether Private Investment Funds will participate in a recovery achieved through class actions.

## **Item 18 – Financial Information**

Sterling does not require prepayment of management fees more than six months in advance or have any other events requiring disclosure under this item of the Brochure.

Sterling has never filed for bankruptcy and is not aware of any financial condition that is expected to affect its ability to manage client accounts.