

# WATER STREET HEALTHCARE PARTNERS, LLC

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**This Investment Adviser Brochure (“Brochure”) provides information about the qualifications and business practices of Water Street Healthcare Partners, LLC (the “Management Company”). If you have any questions about the contents of this Brochure, please contact us at (312) 506-2900. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (the “SEC”) or by any state authority.**

The Management Company is an investment adviser registered with the SEC under the Investment Advisers Act of 1940, as amended (the “**Advisers Act**”). However, such registration does not imply a certain level of skill or training.

Additional information regarding the Management Company is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **MATERIAL CHANGES**

Water Street Healthcare Partners, LLC filed its most recent Form ADV Part 2 on March 30, 2016. This other-than-annual amendment updates the description of certain of the business practices of Water Street Healthcare Partners, LLC and its affiliates.

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## ADVISORY BUSINESS

Water Street (as defined below) is a private investment management firm, including several registered investment advisory entities and other organizations affiliated with the Management Company (collectively, “**Water Street**”).

The Management Company, a Delaware limited liability company and a registered investment adviser, provides investment advisory services to private investment funds. The Management Company commenced operations in January 2005.

The following are the affiliated advisers of the Management Company (collectively with the Management Company, the “**Advisers**”):

- Water Street Healthcare Management, L.P. (“**GP I**”);
- Water Street Healthcare Management II, L.P. (“**GP II**”);
- WSHM II AIV, L.P. (“**GP II AIV**”); and
- Water Street Healthcare Management III, L.P. (“**GP III**” and collectively with GP I, GP II and GP II AIV, the “**General Partners**”)

The Advisers’ clients include the following (collectively the “**Partnerships**,” and together with any future private investment fund(s) to which Water Street or its affiliates provide investment advisory services, “**Private Investment Funds**”):

- Water Street Healthcare Partners, L.P. (“**Fund I**”);
- Water Street Healthcare Partners II, L.P. (“**Fund II**”);
- WSHP II AIV, L.P. (“**Fund II AIV**”); and
- Water Street Healthcare Partners III, L.P. (“**Fund III**”)

The General Partners each serve as general partner to one or more Partnerships and have the authority to make the investment decisions for the Partnerships to which they provide advisory services. The Management Company provides certain advisory services to the General Partners. Each General Partner is registered under the Advisers Act pursuant to the Management Company’s registration in accordance with SEC guidance. This Brochure also describes the business practices of the General Partners, which operate as a single advisory business together with the Management Company.

The Partnerships and any other Private Investment Funds that may be formed by a General Partner (or its affiliates) at a later date or that may otherwise become clients of a General Partner are expected to invest through negotiated transactions in operating entities, generally referred to herein as “**portfolio companies**.” The Advisers’ investment advisory services to the Partnerships consist of identifying and evaluating investment opportunities, negotiating the terms of investments, managing and monitoring investments and achieving dispositions for such

investments. Investments are made predominantly in non-public companies, although investments in public companies are permitted. From time to time, where investments consist of portfolio companies, the senior principals or other personnel of the Advisers or their affiliates generally serve on such portfolio companies' boards of directors or otherwise act to influence control over management of portfolio companies held by the Partnerships.

The Advisers' advisory services for Private Investment Funds are detailed in the applicable private placement memoranda or other offering documents (each, a "**Memorandum**") and limited partnership or other operating agreements (each, a "**Partnership Agreement**"), and are further described below under "Methods of Analysis, Investment Strategies and Risk of Loss." Investors in Private Investment Funds participate in the overall investment program for the applicable Partnership, but may be excused from a particular investment due to legal, regulatory or other applicable constraints or agreed upon circumstances pursuant to the relevant Partnership Agreement. The Partnerships or the General Partners generally have entered into side letters or other similar agreements with certain investors that have the effect of establishing rights (including economic or other terms) under, or altering or supplementing the terms of, the relevant Partnership Agreement with respect to such investors.

Additionally, from time to time, the Advisers expect to provide (or agree to provide) certain investors or other persons, including Water Street personnel and/or certain other persons associated with Water Street and/or its affiliates (to the extent not prohibited by the applicable Partnership Agreement), co-investment opportunities (including the opportunity to participate in co-invest vehicles) that will invest in certain portfolio companies alongside a Private Investment Fund. Such co-investments typically involve investment and disposal of interests in the applicable portfolio company at the same time and on the same terms as the Private Investment Fund making the investment. However, from time to time, for strategic and other reasons, a co-investor or co-invest vehicle may purchase a portion of an investment from one or more Private Investment Funds after such Funds have consummated their investment in the portfolio company (also known as a post-closing sell down or transfer). Any such purchase from a Private Investment Fund by a co-investor or co-invest vehicle generally occurs shortly after the Private Investment Fund's completion of the investment to avoid any changes in valuation of the investment, and the co-investor or co-invest vehicle may be charged interest on the purchase to compensate the relevant Private Investment Fund for the holding period.

As of December 31, 2015, the Management Company managed approximately \$1.62 billion in client assets on a discretionary basis. The only person with a 25% or more ownership interest in the Management Company is Timothy A. Dugan.

### **FEES AND COMPENSATION**

In general, the General Partners receive a Management Fee (as defined below) and a carried interest in connection with advisory services. The General Partners, the Management Company or other Water Street entities or affiliates receive additional compensation in connection with management and other services performed for portfolio companies of Partnerships and a portion of such additional compensation generally will offset in whole or in part the management fees otherwise payable to the applicable General Partner. Investors in the Partnerships also bear certain Partnership expenses. The following is a general description of

fees, compensation and expenses of the Partnerships. Differences exist from Partnership to Partnership, and certain Partnerships may not charge certain fees, compensation or expenses that other Partnerships charge. The Partnership Agreements of the Partnerships describe fees, compensation and expenses in greater detail.

## **Management Fee**

Each Partnership will pay the applicable General Partner a management fee (the “**Management Fee**”), partially in advance and partially in arrears, equal to 2.0% on an annual basis of aggregate Partnership investor capital commitments (“**Commitments**”), subject to reductions at the end of the investment period and in certain other circumstances, in each case, as specified in the applicable Partnership Agreement. The Management Fee will be payable until all portfolio investments are distributed or until the General Partner’s relationship with the Partnership is terminated for other reasons (as described in the applicable Partnership Agreement). Installments of the Management Fee payable for any period other than a full Management Fee period are adjusted on *pro rata* basis according to the actual number of days in such period.

Unless otherwise approved by the applicable Partnership’s advisory board, the Management Fee will be reduced by an offset credit equal to a specified percentage of the Partnership’s share of (i) directors’ fees paid by portfolio companies to partners or employees of the General Partner or certain of its affiliates; (ii) any net transaction fees, financial consulting fees or advisory fees paid to the applicable General Partner or certain of its affiliates with respect to any Partnership investment; and (iii) any net break-up fees with respect to Partnership transactions not completed that are paid to the applicable General Partner or certain of its affiliates (any such fees that such General Partner or another Water Street entity or person are permitted to retain are herein referred to as “**Supplemental Fees**”). To the extent that such an offset credit would reduce the Management Fee for a given Management Fee period below zero, the credit will be carried forward for future application against payable Management Fees. To the extent any such excess credit remains unapplied upon dissolution of a Partnership, each partner of such Partnership will receive its share of such unapplied excess, unless such partner elects not to receive its share. To the extent that any other Private Investment Fund or any other entity or individual co-invests alongside a Partnership in any portfolio company investment, any Supplemental Fees may, to the extent specified in the applicable Partnership Agreement, be allocated with respect to such Partnership and the co-investors in proportion to the cost of the investment or potential investment in the portfolio company held (or committed to be held) by each. Such co-investors generally do not pay Management Fees or carried interest and to the extent any allocation with respect to Supplemental Fees has been made concerning the Partnership and co-investors, and no Management Fees are charged to co-investors, the General Partner has no management fees to offset with respect to co-investors and, therefore, may retain the full amount of the Supplemental Fees and the General Partner’s Management Fee may be reduced to a lesser extent. The terms of the applicable Partnership Agreements provide the General Partner the ability to charge fees and/or carried interest in its discretion.

Water Street works with a network of executives, generally former chief executive officers or other senior healthcare executives, who work in a third-party consulting role with Water Street. These executives, referred to herein as “**Operating Partners**” and “**Executive**

**Advisors,”** provide services to portfolio companies and are not employees of Water Street. The Operating Partners and Executive Advisors typically receive compensation from Water Street and/or directly from portfolio companies. In some instances, to the extent cash compensation is paid to the Operating Partners and Executive Advisors directly from portfolio companies over a specified amount, it reduces the amount of such compensation paid to such Operating Partners and Executive Advisors by Water Street. Operating Partners and Executive Advisors also generally receive equity-based compensation from portfolio companies in the form of grants or options for board membership and/or other consulting services. In certain cases, such equity-based compensation will be divided and allocated among a number of portfolio companies to provide ultimate payments that will occur over time and, if such structure is used, portfolio company equity-based compensation may include payments from portfolio companies where the Operating Partners and Executive Advisors have no direct involvement. No compensation paid by portfolio companies to (or with respect to) Operating Partners and Executive Advisors, whether paid directly to Operating Partners and Executive Advisors or through reimbursements to Water Street, will reduce or offset Management Fees payable to the Advisers. Operating Partners and Executive Advisors may also be offered co-investment opportunities in portfolio companies. Such co-investment opportunities are typically on terms more favorable than investments in such portfolio companies made by the Partnerships. The compensation and co-investment arrangements for Operating Partners and Executive Advisors could create an incentive for Water Street to arrange for retention of Operating Partners and Executive Advisors by portfolio companies.

Water Street also maintains certain operations executives as full-time employees, referred to herein as “**Employee Operating Partners,**” who do not receive any compensation from portfolio companies or the Partnerships. However, Employee Operating Partners may have received equity-based compensation from portfolio companies or the Partnerships prior to full-time employment with Water Street and may retain such equity-based compensation. As of the date of this Brochure, the Employee Operating Partners include: Jim Connelly and Kevin Swan. Only Mr. Swan has retained equity-based compensation received prior to his employment by Water Street.

Water Street also has a “**Corporate Resources Group**” that is comprised of functional specialists who are Water Street employees with experience in executing key strategic initiatives. The Corporate Resources Group is designed to supplement and/or provide expertise in a particular area for a portfolio company. Expenses of the Corporate Resources Group, including all compensation, benefits, overhead and travel costs, are passed through to portfolio companies and are either paid directly by Water Street and then reimbursed by portfolio companies or are paid directly by portfolio companies. Under the terms of the applicable Partnership Agreements, expenses of the Corporate Resources Group, whether initially incurred by Water Street directly and reimbursed by portfolio companies, or paid directly by portfolio companies, do not offset Management Fees payable to the Advisers by the respective Partnerships. Members of the Corporate Resources Group also may be offered co-investment opportunities in portfolio companies. Such co-investment opportunities are typically on terms more favorable than investments in such portfolio companies made by the Partnerships. The compensation and co-investment arrangements for Corporate Resources Group members could create an incentive for Water Street to arrange for retention of Corporate Resources Group members.

The compensation paid to and co-investments held by the Operating Partners, Executive Advisors and members of the Corporate Resources Group are presented annually to the the Partnerships respective advisory boards and are generally made available to the limited partners of the Partnerships unless the General Partner determines that the release of such information to a limited partner could put Water Street at a competitive disadvantage.

As permitted under the Partnership Agreement for each Partnership, the applicable General Partner may waive or agree to reduce the Management Fee. Any such waived or reduced portion of the Management Fee reduces the amount of capital such General Partner would otherwise be required to contribute to the Partnership. The limited partners of the Partnership may be required to make a *pro rata* contribution according to their respective Commitments to fund any contribution that would otherwise be required of the General Partner in connection with any such waiver or reduction as described above and, as a result, the exercise of such waiver may result in an acceleration (or delay) of investor capital contributions. Waived or reduced Management Fees are applied prior to the Management Fee offsets described above, and the amount of such waived or reduced Management Fees has the potential to be significant.

### **Carried Interest**

The General Partner of each Partnership will receive a carried interest with respect to the respective Partnership(s) it advises equal to 20% of all realized profits in excess of an 8% compound preferred return subject to a General Partner catch-up provision, as more fully described in the applicable Partnership Agreement. The carried interest distributed to a General Partner is subject to a potential giveback at specified points during the life of a Partnership if such General Partner has received excess cumulative distributions.

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

### **Other Information**

The Advisers may exempt certain investors in the Partnerships from payment of all or a portion of the Management Fee and/or carried interest. Any such exemption from fees and/or carried interest may be made by a direct exemption, a rebate by the Advisers and/or their affiliates, or through other Private Investment Funds which co-invest with a Partnership.

The Partnerships generally invest on a long-term basis. Accordingly, investment advisory and other fees are expected to be paid, except as otherwise described in the Partnership Agreement, over the term of the applicable Partnership, and investors generally are not permitted to withdraw or redeem interests in the Partnership.

Principals or other current or former employees of Water Street may receive a portion of the Management Fee, carried interest or other compensation received by the General Partners or their affiliates.

In addition to the Management Fee and carried interest payable to the applicable General Partner, each Partnership bears certain expenses. As set forth in more detail in the applicable



Memorandum and/or Partnership Agreement, a Partnership bears all Partnership expenses relating to such Partnership's activities, to the extent not paid by portfolio companies, including organizational expenses up to the expense cap specified in the applicable Partnership Agreement, legal, auditing, consulting (excluding fees for consulting services associated with overall strategy that are not performed as part of an investment initiative), travel (including, unless otherwise prohibited by the applicable Partnership Agreement, non-commercial air travel), administration, financing, accounting and custodian fees and expenses; expenses associated with the Partnership's financial statements, tax returns and Schedule K-1s; out of pocket expenses incurred in connection with transactions not consummated ("**Broken-Deal Expenses**"); expenses of any advisory board of limited partners; expenses of meetings with the Partnership's limited partners; insurance; other expenses associated with the acquisition, holding and disposition of its investments, including extraordinary expenses (such as litigation, if any); and any taxes, fees or other governmental charges levied against the Partnership, but not ordinary administrative and overhead expenses of the General Partner incurred in connection with maintaining and operating its offices, including employees' salaries, rent, utilities and other similar expenses specified in the Partnership Agreement. The Partnerships also bear expenses indirectly from the payment by portfolio companies of similar expenses, including Supplemental Fees. As is typical for private equity funds, the Partnerships likely bear additional and greater expenses, directly or indirectly, than many other pooled investment products, such as mutual funds. To the extent brokerage fees are incurred, they will be incurred in accordance with the general practices set forth in "Brokerage Practices."

The General Partners may permit certain investors to co-invest in portfolio companies alongside one or more Partnerships. If a co-invest vehicle is formed, such entity generally will bear expenses related to its formation and operation, many of which are similar in nature to those borne by the Partnerships. In the event that a transaction in which a co-investment was planned, including a transaction for which a co-investment was believed necessary in order to consummate such transaction, ultimately is not consummated, all Broken-Deal Expenses relating to such unconsummated transaction will be borne by the Partnership(s), and not by any prospective co-investors that were to have participated in such transaction. However, to the extent that such co-investors have already invested in a co-investment or other vehicle in connection with such transaction, such vehicle is expected to bear its share of such Broken-Deal Expenses. Notwithstanding the foregoing, Water Street has formed a vehicle through which certain of its employees invest alongside the Partnerships (the "**Co-Invest Fund**"), which does not pay a Management Fee or carried interest and does not pay partnership expenses or bear its share of Broken-Deal Expenses.

In certain circumstances, one Partnership is expected to pay an expense common to multiple Partnerships (including without limitation legal expenses for a transaction in which all such Partnerships participate, or other fees or expenses in connection with services the benefit of which are received by other Partnerships over time), and be reimbursed by the other Partnerships by their share of such expense, without interest. In certain circumstances, Water Street has the ability to advance amounts related to the foregoing and receive reimbursement from the Partnerships to which such expenses relate.

The Partnerships generally utilize fund guaranteed capital call loans to fund new investments prior to calling capital from limited partners for administrative convenience. The

Partnerships also occasionally utilize longer term fund guaranteed credit facilities to bridge to future equity or portfolio company stand-alone credit facilities. The calculation of Partnership performance metrics may be favorably influenced by the use of these types of credit facilities.

Additionally, as described above and more fully in the applicable Memorandum and/or Partnership Agreement for each Private Investment Fund, Operating Partners, Executive Advisors and/or members of the Corporate Resources Group may receive fees and other compensation from portfolio companies of such Private Investment Fund in the form of cash and/or equity-based compensation. Such compensation does not reduce or offset Management Fees payable to the Advisers. Operating Partners, Executive Advisors and/or members of the Corporate Resources Group may be permitted to make co-investments alongside a Partnership and, as noted above, typically are not charged a Management Fee or carried interest on such co-investments, nor do they bear their share of any Broken-Deal Expenses with respect to such co-investments. Furthermore, to the extent any Executive Advisors are limited partners of a Partnership, such individuals will typically not be charged carried interest. As noted above, if an Operating Partner or Executive Advisor who is a third-party consultant receives equity-based compensation in a portfolio company and subsequently becomes an employee of Water Street, such person may retain such equity-based compensation received prior to his or her employment by Water Street. The use of Operating Partners, Executive Advisors and the Corporate Resources Group subjects the Advisers to potential conflicts of interest, as described under “Methods of Analysis, Investment Strategies and Risk of Loss — Conflicts of Interest,” below.

Water Street and/or its affiliates generally have discretion over whether to charge transaction fees, monitoring fees or other compensation to a portfolio company and, if so, the rate, timing and/or amount of such compensation. The receipt of such fees or other compensation generally will give rise to potential conflicts of interest between the Private Investment Funds, on the one hand, and Water Street and/or its affiliates on the other hand.

#### **PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

As described under “Fees and Compensation,” the General Partners typically receive a carried interest allocation on certain realized profits in the Partnerships. Water Street also advises the Co-Invest Fund, which is not subject to Management Fees or a carried interest. While this practice could present a conflict of interest in allocating investment opportunities and expenses because Water Street has an incentive to favor accounts for which it receives the highest performance based compensation, Water Street does not believe this arrangement poses a conflict of interest in practice because the Co-Invest Fund co-invests alongside the relevant Partnership at substantially the same time and on substantially the same terms as such Partnership and disposes of such investments in a similar manner.

#### **TYPES OF CLIENTS**

The Advisers provide investment advice to Private Investment Funds, including the Partnerships. Private Investment Funds are 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 “**Investment Company Act**”). The investors participating in Private Investment Funds may include individuals, banks or thrift

institutions, other investment entities, university endowments, sovereign wealth funds, family offices, pension and profit-sharing plans, trusts, estates or charitable organizations or other corporations or business entities and may include, directly or indirectly, principals or other employees of the Advisers and their affiliates and members of their families, Operating Partners, Executive Advisors or other service providers retained by Water Street.

Fund I has a minimum investment of \$5 million for third-party investors, while Fund II, Fund II AIV and Fund III have a minimum investment of \$10 million for third-party investors, each of which may be waived by the applicable General Partner. Investors in the Partnerships must meet certain suitability and net worth qualifications prior to making an investment. Investors must be (i) “accredited investors” as defined under Regulation D of the Securities Act of 1933, as amended, and (ii) either “qualified purchasers” or “knowledgeable employees” as defined under the Investment Company Act.

## **METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

### **General**

Water Street is a private investment firm focused on making investments in later-stage, middle-market healthcare companies. The Advisers’ investment advisory services consist of identifying and evaluating investment opportunities, negotiating investments, managing and monitoring investments and achieving dispositions for investments. Investments are predominantly of non-public companies although investments in public companies are permitted.

The following is a summary of the investment strategies and methods of analysis generally employed by Water Street on behalf of the Partnerships and a summary of certain risks involved with Water Street’s investment strategy and an investment in the Partnerships. More detailed descriptions of the Partnerships’ investment strategies and methods of analysis and risks are included in the applicable Memorandum and Partnership Agreement for each Partnership. The investment strategies and methods of analysis and risks described in this section also generally apply to the Co-Invest Fund.

The Advisers’ investment strategy for the Partnerships focuses on the acquisition of controlling interests in middle-market companies and divisions of global healthcare organizations that the Advisers believe have strong growth prospects to serve as potential platform companies. The Advisers focus on investments that require equity capital of approximately \$25 million to \$100 million, although the required capital may be greater or less than such amounts.

The Advisers’ investment strategy consists of the following phases: (i) sourcing proprietary investment opportunities through a direct calling program and conducting due diligence; (ii) creating customized transaction structures and innovative capital structures for sellers; (iii) growing portfolio companies through strategic combinations; (iv) maintaining active involvement with portfolio companies in an effort to improve operating performance; and (v) exit planning to position a portfolio company for strategic sale.

There can be no assurance that the Advisers will achieve the investment objectives of any of the Partnerships and a loss of investment is possible.

## **Investment and Operating Strategy**

*Deal Sourcing and Due Diligence.* The Advisers' deal sourcing program has two components: (i) a sourcing effort focusing on the 200 largest publicly-traded healthcare companies; and (ii) a segment-focused sourcing effort with middle-market companies. The first component serves as a method for the Advisers to propose and discuss creative ways to enhance the operations, market positions and value of certain of the public healthcare company's non-core businesses. The second component focuses on building a dialogue with middle-market companies in pre-selected areas of interest with a goal of partnering with them to seek to grow their businesses. The information gathered through the proactive sourcing program helps the Advisers to: (a) better understand trends and competitive dynamics in a segment by talking to key participants and competitors in that segment; (b) identify businesses that can most likely be combined to create a market leader in the segment of interest; and (c) identify likely strategic buyers of that business once successfully built and developed. Once a potential investment is identified, the Advisers develop an investment thesis and, through a detailed due diligence process, seek to verify such thesis and investigate the major business risks.

*Create Customized Transaction Structures for Sellers.* As part of its strategic dialogue with healthcare companies, the Advisers encourage owners to maintain ongoing ownership stakes in partnership with Water Street as a means of both: (i) providing corporate parents or private-company owners with the opportunity to benefit from future value creation; and (ii) differentiating the Advisers' discussion and proposed transaction from an outright sale. The Advisers expect to frequently structure their acquisitions as leveraged recapitalizations, allowing owners to achieve partial liquidity, while continuing to have meaningful equity stakes and remain involved in the governance of their companies. This structure is preferred for a larger corporation or entrepreneur that is looking for liquidity but also desires a financial partner to enhance the company's growth opportunities and the ability to participate in value creation.

*Grow Portfolio Companies Through Strategic Acquisitions.* The Advisers seek to build market-leading companies focused on adding value to end customers through broader product and/or service offerings. Post-acquisition, the Advisers encourage and facilitate significant operating investments in the infrastructure of their portfolio companies to better position such companies for future growth and value creation. Portfolio companies also may receive additional and more comprehensive support through Water Street's Corporate Resources Group (a group comprised of functional specialists who support portfolio companies with executing key strategic initiatives, including executive recruiting, corporate development and communications). Portfolio companies may request the services of the Corporate Resources Group to supplement and/or provide for the portfolio company's expertise in a particular area. Members of the Corporate Resources Group are employees of Water Street working substantially on portfolio companies' internal projects. As described above and as permitted under the Limited Partnership Agreement for the applicable Private Investment Fund, expenses of the Corporate Resources Group, including compensation, benefits, overhead and travel costs, are paid by portfolio companies without offsetting fees that are paid to the Advisers. The Advisers also seek to improve the competitive position and financial performance of portfolio companies through

transformational strategic acquisitions. The Advisers focus on acquisitions that they believe will: (i) offer customers improved product offerings and/or greater geographic coverage; (ii) leverage production and purchasing power to improve gross margins; (iii) leverage distribution strength into profitable and proprietary licensing or distribution relationships; (iv) consolidate selling and marketing efforts to reduce costs, improve margins and improve customer coverage; and/or (v) enhance investments in research and development.

*Maintain Active Involvement in Portfolio Companies.* Post-closing, the Advisers will establish a detailed governance program that includes a regular calendar of organization planning, strategic planning, corporate development, executive compensation and operations analysis. Additionally, the Advisers seek to implement an authorities matrix that explicitly outlines approval authorities for management and ensures that the board of directors of a company (the “**Board**”) gets appropriately involved in decisions of significance for each company. The Advisers will also develop, together with management, a reporting package that is focused on operating metrics that the Advisers believe are critical in monitoring the progress of the company. In most companies, an Employee Operating Partner, other operating executive from Water Street or an Operating Partner or Executive Advisor generally serves as a lead director, working closely with company management on operating and strategic priorities. In addition to its personnel, including the Employee Operating Partners, Water Street also seeks to supplement its knowledge, experience and contacts with a network of executives that serve as Operating Partners or Executive Advisors. Operating Partners and Executive Advisors are experienced industry executives, generally former Chief Executive Officers, who work in a consulting role that is exclusive to Water Street, while Employee Operating Partners are full-time employees of Water Street. Operating Partners, Executive Advisors and Employee Operating Partners may serve as members of the Board or, in special cases, as operating executives of portfolio companies. The compensation of Operating Partners, Executive Advisors and Employee Operating Partners is described above under “Fees and Compensation — Management Fee.” Water Street also may make resources available to portfolio companies through senior advisers, who serve a similar purpose as Operating Partners and Executive Advisors, but who are not exclusive to Partnerships’ portfolio companies.

*Exit Strategy.* The Advisers seek to develop companies with the objective of building businesses that will become compelling and dynamic acquisition candidates for a strategic buyer. The Advisers seek to develop portfolio companies into market leaders that have the financial scale to be meaningful to a strategic buyer and that are run with the discipline and reporting standards of a public company. The Advisers believe that keeping management focused on the standards required for an independent public company improves the strategic decisions made in the development of the company and best positions the business for sale to a strategic buyer. Although the Advisers will analyze whether a portfolio company is appropriate for public offering, the Advisers’ primary exit strategy is a cash sale to a strategic buyer.

## **Risks of Investment**

A Partnership and its investors bear the risk of loss that the Advisers’ investment strategy entails. The risks involved with the Advisers’ investment strategy and an investment in a Partnership are detailed in such Partnership’s Memorandum. In general, these risks include, but are not limited to:

*Business Risks.* The Partnership's investment portfolio may consist primarily of securities issued by privately held companies, and operating results in a specified period will be difficult to predict. Such investments involve a high degree of business and financial risk that can result in substantial losses.

*Investment in Junior Securities.* The securities in which the Partnership will invest may be among the most junior in a portfolio company's capital structure, and thus subject to the greatest risk of loss. Generally, there will be no collateral to protect the Partnership's investment once made.

*Concentration of Investments.* The Partnership will participate in a limited number of investments and intends to make most of its investments in one industry or one industry segment. As a result, the Partnership's investment portfolio could become highly concentrated, and the performance of a few holdings or of a particular industry may substantially affect its aggregate return. Furthermore, to the extent that the capital raised is less than the targeted amount, the Partnership may invest in fewer portfolio companies and thus be less diversified.

*Lack of Sufficient Investment Opportunities.* The business of identifying, structuring and completing private equity transactions is highly competitive and involves a high degree of uncertainty. It is possible that the Partnership will never be fully invested if enough sufficiently attractive investments are not identified. However, the limited partners will be required to bear the Management Fee during the investment period based on the aggregate amount of all Commitments to the Partnership and other expenses as set forth in the Partnership Agreement.

*Leveraged Investments.* The Partnership may make use of leverage by having a portfolio company incur debt to finance a portion of its investment in such portfolio company, including in respect of companies not rated by credit agencies. Leverage generally magnifies both the Partnership's opportunities for gain and its risk of loss from a particular investment. The cost and availability of leverage is highly dependent on the state of the broader credit markets (and such credit markets may be impacted by regulatory restrictions and guidelines), which state is difficult to accurately forecast, and at times it may be difficult to obtain or maintain the desired degree of leverage. The use of leverage also imposes restrictive financial and operating covenants on a company, in addition to the burden of debt service, and may impair its ability to operate its business as desired and/or finance future operations and capital needs. The leveraged capital structure of portfolio companies will increase the exposure of the Partnership's investments to any deterioration in a company's condition or industry, competitive pressures, an adverse economic environment or rising interest rates and could accelerate and magnify declines in the value of the Partnership's investments in the leveraged portfolio companies in a down market. In the event any portfolio company cannot generate adequate cash flow to meet its debt service, the Partnership may suffer a partial or total loss of capital invested in the portfolio company, which could adversely affect the returns of the Partnership. Furthermore, should the credit markets be limited or costly at the time the Partnership determines that it is desirable to sell all or a part of a portfolio company, the Partnership may not achieve an exit multiple or enterprise valuation consistent with its forecasts. Moreover, the companies in which the Partnership will invest generally will not be rated by a credit rating agency.

*Restricted Nature of Investment Positions.* Generally, there will be no readily available market for Partnership investments, and hence, most of the Partnership's investments will be difficult to value. Certain investments may be distributed in kind to the partners of the Partnership and it may be difficult to liquidate the securities received at a price or within a time period that is determined to be ideal by such partners. After a distribution of securities is made to the partners of the Partnership, many partners may decide to liquidate such securities within a short period of time, which could have an adverse impact on the price of such securities. The price at which such securities may be sold by such partners may be lower than the value of such securities determined pursuant to the Partnership Agreement, including the value used to determine the amount of carried interest available to the General Partner with respect to such investment.

*Reliance on Portfolio Company Management.* Although the General Partner will monitor the performance of each Partnership investment, it will primarily be the responsibility of each portfolio company's management team to operate such portfolio company on a day-to-day basis. Although the Partnership generally intends to invest in companies with strong management or recruit strong management to such companies, there can be no assurance that the management of such companies will be able or willing to successfully operate a company in accordance with the Partnership's objectives.

*Projections.* Projected operating results of a company in which the Partnership invests normally will be based primarily on financial projections prepared by such company's management, with adjustments to such projections made by the General Partner in its discretion. In all cases, projections are only estimates of future results that are based upon information received from the company and third parties and assumptions made at the time the projections are developed. There can be no assurance that the results set forth in the projections will be attained, and actual results may be significantly different from the projections. Also, general economic factors, which are not predictable, can have a material effect on the reliability of projections.

*Need for Follow-On Investments.* Following its initial investment in a given portfolio company, the Partnership may decide to provide additional funds to such portfolio company or may have the opportunity to increase its investment in a successful portfolio company (whether for opportunistic reasons, to fund the needs of the business, or as an equity cure under applicable debt documents or for other reasons). There is no assurance that the Partnership will make follow-on investments or that the Partnership will have sufficient funds to make all or any of such investments. Any decision by the Partnership not to make follow-on investments or its inability to make such investments may have a substantial negative effect on a portfolio company in need of such an investment (including an event of default under applicable debt documents in the event an equity cure cannot be made). Additionally, such failure to make such investments may result in a lost opportunity for the Partnership to increase its participation in a successful portfolio company or the dilution of the Partnership's ownership in a portfolio company if a third party invests in such portfolio company.

*Non-U.S. Investments.* The Partnership may invest in portfolio companies that are organized or headquartered and/or have substantial sales or operations outside of the United States, its territories and possessions. Such investments may be subject to certain additional risk

due to, among other things, potentially unsettled points of applicable governing law, the risks associated with fluctuating currency exchange rates, capital repatriation regulations (as such regulations may be given effect during the term of the Partnership), the application of complex U.S. and non-U.S. tax rules to cross-border investments, possible imposition of non-U.S. taxes on the Partnership and/or the limited partners with respect to the Partnership's income, and possible non-U.S. tax return filing requirements for the Partnership and/or the limited partners.

Additional risks of non-U.S. investments include: (a) economic dislocations in the host country; (b) less publicly available information; (c) less well-developed and/or more restrictive laws, regulations, regulatory institutions and judicial systems; (d) greater difficulty of enforcing legal rights in a non-U.S. jurisdiction; (e) civil disturbances; (f) government instability; and (g) nationalization and expropriation of private assets. Moreover, non-U.S. companies may not be subject to uniform accounting, auditing and financial reporting standards, practices and requirements comparable to those that apply to U.S. companies.

*Director Liability.* The Partnership will often seek to obtain the right to appoint one or more representatives to the board of directors (or similar governing body) of the companies in which it invests. Serving on the board of directors (or similar governing body) of a portfolio company exposes the Partnership's representatives, and ultimately the Partnership, to potential liability. Not all portfolio companies may obtain insurance with respect to such liability, and the insurance that portfolio companies do obtain may be insufficient to adequately protect officers and directors from such liability. In addition, involvement in litigation can be time consuming for such persons and can divert the attention of such persons from the Partnership's investment activities.

*Uncertain Economic, Social and Political Environment.* Consumer, corporate and financial confidence may be adversely affected by current or future tensions around the world, fear of terrorist activity and/or military conflicts, localized or global financial crises or other sources of political, social or economic unrest. Such erosion of confidence may lead to or extend a localized or global economic downturn. A climate of uncertainty may reduce the availability of potential investment opportunities, and may increase the difficulty of modeling market conditions, potentially reducing the accuracy of financial projections. In addition, limited availability of credit for consumers, homeowners and businesses, including credit used to acquire businesses, in an uncertain environment or economic downturn may have an adverse effect on the economy generally and on the ability of the Partnership and its portfolio companies to execute their respective strategies and to receive an attractive multiple of earnings on the disposition of businesses. This may slow the rate of future investments by the Partnership and result in longer holding periods for investments. Furthermore, such uncertainty or general economic downturn may have an adverse effect upon the Partnership's portfolio companies.

*Market Conditions.* The capital markets have experienced great volatility and financial turmoil. Moreover, governmental measures undertaken in response to such turmoil (whether regulatory or financial in nature) may have a negative effect on market conditions. General fluctuations in the market prices of securities and economic conditions generally may reduce the availability of attractive investment opportunities for the Partnership and may affect the Partnership's ability to make investments. Instability in the securities markets and economic conditions generally (including a slow-down in economic growth and/or changes in interest rates



or foreign exchange rates) may also increase the risks inherent in the Partnership's investments and could have a negative impact on the performance and/or valuation of the portfolio companies. The Partnership's performance can be affected by deterioration in the capital markets and by market events, such as the onset of the credit crisis in the summer of 2007 or the downgrading of the credit rating of the United States in 2011, which, among other things, can impact the public market comparable earnings multiples used to value privately held portfolio companies and investors' risk-free rate of return. Movements in foreign exchange rates may adversely affect the value of investments in portfolio companies and the Partnership's performance. Volatility and illiquidity in the financial sector may have an adverse effect on the ability of the Partnership to sell and/or partially dispose of its portfolio company investments. Such adverse effects may include the requirement of the Partnership to pay break-up, termination or other fees and expenses in the event the Partnership is not able to close a transaction (whether due to the lenders' unwillingness to provide previously committed financing or otherwise) and/or the inability of the Partnership to dispose of investments at prices that the General Partner believes reflect the fair value of such investments. The impact of market and other economic events may also affect the Partnership's ability to raise funding to support its investment objective.

*Deterioration of Credit Markets May Affect Ability to Finance and Consummate Investments.* The recent deterioration of the global credit markets has made it more difficult for investment funds such as the Partnership to obtain favorable financing for investments. A widening of credit spreads, coupled with the deterioration of the sub-prime and global debt markets and a rise in interest rates, has dramatically reduced investor demand for high yield debt and senior bank debt, which in turn has led some investment banks and other lenders to be unwilling to finance new private equity investments or to only offer committed financing for these investments on unattractive terms. The Partnership's ability to generate attractive investment returns may be adversely affected to the extent the Partnership is unable to obtain favorable financing terms for its investments. Moreover, to the extent that such marketplace events are not temporary and continue, they may have an adverse impact on the availability of credit to businesses generally and could lead to an overall weakening of the U.S. and global economies. Such marketplace events also may restrict the ability of the Partnership to realize its investments at favorable times or for favorable prices.

*Healthcare Regulation, Reimbursement and Reform.* Various segments of the healthcare industry are (or may become) (i) highly regulated at both the state and federal levels in the United States and internationally, (ii) subject to frequent regulatory change and (iii) dependent upon various government or private insurance reimbursement programs. While the Partnership intends to make investments in companies that comply with relevant laws and regulations, certain aspects of their operations may not have been subject to judicial or regulatory interpretation. An adverse review or determination by any one of such authorities, or an adverse change in the regulatory requirements or reimbursement programs, could have a material adverse effect on the operations of the companies in which the Partnership invests. Recent legislative changes have had, and will likely continue to have, a significant impact on the healthcare industry. In addition, various legislative proposals related to the healthcare industry are introduced from time to time at the United States federal and state level, and any such proposals, if adopted, could have a significant impact on the healthcare industry. The U.S. healthcare industry continues to undergo significant changes designed to increase access to medical care,

improve safety and contain costs. Generally, Medicare and Medicaid reimbursement levels have declined; the use of managed care has increased; distributors, manufacturers, healthcare providers and pharmacy chains have consolidated; and large purchasing groups are more prevalent.

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively the “**Affordable Care Act**”) were enacted. Among other things, the Affordable Care Act seeks to expand health insurance coverage to approximately 32 million uninsured Americans. Many of the significant changes in the Affordable Care Act did not take effect until 2014, including a requirement that most Americans carry health insurance. While expansion of access to health insurance may increase the demand for various healthcare products and services, other provisions of the Affordable Care Act could affect the Partnership and its investments adversely. The Affordable Care Act contains many provisions designed to generate the revenues necessary to fund the coverage expansions and to reduce costs of Medicare and Medicaid. The Partnership’s portfolio companies may be subject to certain taxes as a result of the Affordable Care Act. Additionally, the Affordable Care Act changed the federal upper payment limit for Medicaid reimbursement to no less than 175 percent of the average weighted manufacturer’s price from 250 percent of the lowest average manufacturer’s price for generic pharmaceuticals. The Partnership and its investments could be adversely affected by, among other things, changes in the delivery or pricing of or reimbursement for pharmaceuticals, medical devices or healthcare services.

Congress may withhold the funding necessary to implement provisions of the Affordable Care Act, or may attempt to replace the legislation with amended provisions or repeal it altogether. Due to its complexity, the impact of the Affordable Care Act remains difficult to predict and is not yet fully known. The Affordable Care Act could negatively impact the Partnership and its portfolio companies or could alternatively create new or expand existing opportunities for investment.

*Healthcare Research and Innovation.* The healthcare industry spends heavily on research and development. Research findings (e.g., regarding side effects or comparative benefits of one or more particular treatments, services or products) and technological innovation (together with patent expirations) may make any particular treatment, service or product less attractive if previously unknown or underappreciated risks are revealed, or if a more effective, less costly or less risky solution is or becomes available. Any such development could have a material adverse effect on the companies in which the Partnership invests.

*Valuation of Investments.* Generally, the General Partner will determine the value of all of the Partnership’s investments for which market quotations are available based on publicly available quotations. However, market quotations will not be available for virtually all of the Partnership’s investments because, among other things, the securities of portfolio companies held by the Partnership generally will be illiquid and not quoted on any exchange. There can be no assurance that the valuation decision of the General Partner with respect to an investment will represent the value realized by the Partnership on the eventual disposition of such investment or that would, in fact, be realized upon an immediate disposition of such investment on the date of its valuation.

*Cybersecurity Risks.* Recent events have illustrated the ongoing cybersecurity risks to which operating companies are subject. To the extent that a portfolio company is subject to cyber-attack or other unauthorized access is gained to a portfolio company's systems, such portfolio company may be subject to substantial losses in the form of stolen, lost or corrupted (i) customer data or payment information; (ii) customer or portfolio company financial information; (iii) portfolio company software, contact lists or other databases; (iv) portfolio company proprietary information or trade secrets; or (v) other items. In certain events, a portfolio company's failure or deemed failure to address and mitigate cybersecurity risks may be the subject of civil litigation or regulatory or other action. Any of such circumstances could subject a portfolio company, or the Partnership, to substantial losses. In addition, in the event that such a cyber-attack or other unauthorized access is directed at Water Street or one of its service providers holding its financial or investor data, Water Street, its affiliates or the Partnerships may also be at risk of loss.

### **Conflicts of Interest**

Water Street and its related entities engage in a broad range of advisory and non-advisory activities. Water Street will devote such time, personnel and internal resources as are necessary to conduct the business affairs of the Partnerships in an appropriate manner, as required by the relevant Partnership Agreement, although the Partnerships and their respective investments will place varying levels of demand on these over time. In the ordinary course of the Advisers conducting their activities, the interests of a Partnership may conflict with the interests of the Advisers, one or more other Partnerships or Private Investment Funds, portfolio companies or their respective affiliates. Certain of these conflicts of interest are discussed herein. As a general matter, the Advisers will determine all matters relating to structuring transactions and Partnership operations using their best judgment considering all factors they deem relevant, but in their sole discretion, subject in certain cases to the required approvals by the advisory committees of the participating Partnerships.

During the investment period of a given Partnership, all appropriate investment opportunities that meet the investment criteria of the Partnership will be pursued by the Advisers through such Partnership, subject to certain limited exceptions set forth in the applicable Partnership Agreement. Without limitation, the Advisers' principals currently, and may in the future, manage several investment vehicles and other investments similar to a given Partnership and those investments in which such Partnership invests. The Advisers' principals and the Advisers' investment staff will continue to manage and monitor such investment vehicles and such investments until their expiration or realization, as applicable. Such other investments that the Advisers' principals may control or manage may potentially compete with companies acquired by a given Partnership. Following the investment period of a Partnership, the Advisers' principals may and likely will focus their investment activities on other opportunities and areas unrelated to such Partnership's investments, possibly including successor funds. In addition, the Advisers' principals may spend a portion of their business time and attention pursuing investment opportunities that do not fall within the investment objectives of a Partnership for other investment vehicles and other than on behalf of such Partnership. The significant investment of the Advisers' principals in a given Partnership, as well as the Advisers' principals' interest in the carried interest, operate to align, to some extent, the interest of the Advisers' principals with the interest of the limited partners of such Partnership, although the Advisers'

principals have economic interests in such other investment vehicles and investments, as well, and may receive management fees and carried interest relating to such other investment vehicles and investments.

From time to time, the Advisers will be presented with investment opportunities that would be suitable not only for a given Partnership, but also for other Private Investment Funds and other investment vehicles operated by advisory affiliates of the Management Company. In determining which investment vehicles should participate in such investment opportunities and the amount of such participation, the Advisers and their affiliates are subject to conflicts of interest among the investors in such investment vehicles. The Advisers attempt to resolve such conflicts of interest in light of their obligations to investors in the applicable Partnership, Private Investment Funds and other investment vehicles managed by them, and attempt to allocate investment opportunities among a Partnership, other Private Investment Funds and such investment vehicles in a fair and equitable manner. Where necessary, the Advisers consult and receive consent to conflicts from an advisory committee consisting of limited partners of the applicable Partnership and such other investment vehicles.

The Advisers must first determine which Partnership(s) will, or are required to, participate in the relevant investment opportunity. The Advisers generally assess whether an investment opportunity is appropriate for a particular Partnership based on the applicable Partnership Agreement, investment objectives, strategies, life-cycle and structure. For example, a newly organized Partnership generally will seek to purchase a disproportionate amount of investments until it is substantially invested. The Advisers will determine if the amount of an investment opportunity in which a Partnership will invest exceeds the amount that would be appropriate for such Partnership and any such excess may be offered to one or more potential co-investors, as determined by the Partnership Agreements, side letters arrangements and the Advisers' policies and procedures regarding investment allocations and co-investments. The Advisers' procedures permit them to take into consideration a variety of factors in making such determinations, including but not limited to: conflict provisions in the relevant Partnership Agreements, investment and operating guidelines, diversification limitations, tax and regulatory considerations, minimum dollar limits and other relevant factors, including risk.

Co-investment opportunities may, and typically will, be offered to some and not to other Partnership investors. When and to the extent that employees and related persons of Water Street and its affiliates make capital investments in or alongside certain Partnerships, the Advisers and their affiliates are subject to conflicting interests in connection with such investments. There can be no assurance that any Partnership's return from a transaction would be equal to and not less than another Partnership or Private Investment Fund participating in the same transaction or that it would have been as favorable as it would have been had such conflict not existed.

The Advisers' allocation of investment opportunities among the persons and in the manner discussed herein may not, and often will not, result in proportional allocations among such persons, and such allocations may be more or less advantageous to some such persons relative to others. While the Advisers will allocate investment opportunities in a manner that they believe in good faith to be fair and equitable to their clients under the circumstances over time and considering relevant factors, there can be no assurance that a Private Investment Fund's

actual allocation of an investment opportunity, if any, or the terms on which that allocation is made, will be as favorable as they would be if the conflicts of interest to which the Advisers may be subject, discussed herein, did not exist.

Conflicts may arise when a Partnership makes investments in conjunction with an investment being made by another Partnership or other Private Investment Fund, or if it were to invest in the securities of a company in which another Private Investment Fund has already made an investment. A Partnership may not, for example, invest through the same investment vehicles, have the same access to credit or employ the same hedging or investment strategies as other Private Investment Funds. This may result in differences in price, terms, leverage and associated costs. Further, there can be no assurance that the relevant Partnership and the other Private Investment Fund(s) or vehicle(s) with which it co-invests will exit such investment at the same time or on the same terms. There can be no assurance that the return on one Private Investment Fund's investments will be the same as the returns obtained by other Private Investment Funds participating in a given transaction. Given the nature of the relevant conflicts there can be no assurance that any such conflict can be resolved in a manner that is beneficial to both Private Investment Funds. In that regard, actions may be taken for one or more Private Investment Funds that adversely affect other Private Investment Funds.

Subject to any relevant restrictions or other limitations contained in the Partnership Agreements, the Advisers will allocate fees and expenses in a manner that they believe in good faith to be fair and equitable to their clients under the circumstances and considering such factors as they deem relevant, but in their sole discretion. In exercising such discretion, the Advisers may be faced with a variety of potential conflicts of interest.

As a general matter, except with respect to the Co-Invest Fund as described in "Fees and Compensation," Partnership expenses typically will be allocated among all relevant Partnerships or co-invest vehicles eligible to reimburse expenses of that kind. In all such cases, subject to applicable legal, contractual or similar restrictions, expense allocation decisions will generally be made by the Advisers or their affiliates using their best judgment, considering such factors as they deem relevant, but in their sole discretion. The allocations of such expenses may not be proportional. The Partnerships have different expense reimbursement terms, including with respect to Management Fee offsets, which may result in the Partnerships bearing different levels of expenses with respect to the same investment.

Because the General Partners' carried interest is based on a percentage of certain net profits, it may create an incentive for the Advisers to cause the Partnerships to make riskier or more speculative investments than would otherwise be the case. Also, because there is a fixed investment period after which capital from investors in a Partnership may only be drawn down in limited circumstances and because the Management Fee is, at certain times during the life of a Partnership, based upon capital invested by such Partnership, this fee structure may create an incentive to deploy capital when the the General Partner of such Partnership may not otherwise have done so. Since the General Partners are permitted to retain certain Supplemental Fees (as described under "Fees and Compensation") in connection with Partnership investments, the Advisers could have a conflict of interest in connection with approving transactions and setting such compensation. The Advisers also could have a conflict of interest in allocating investment opportunities and related fees and expenses to the Partnerships and co-investors.

The Management Company may cause its affiliates, including a Partnership, to purchase different classes of debt and/or equity of the same borrower or issuer. These and other investments may be deemed to create conflicts of interest, particularly because the Advisers' principals and/or other employees of the Management Company may take certain actions for affiliates with respect to one class of debt or equity that may be adverse to other affiliates who hold other classes of debt or equity of the same borrower or issuer. In such cases, the Advisers' principals will seek to act in a manner they believe in good faith to be fair to clients under the circumstances.

As a result of the Private Investment Funds' controlling interests in portfolio companies, Water Street and/or its affiliates typically have the right to appoint board members to such portfolio companies, or to influence their appointment, and to determine or influence a determination of their compensation. From time to time, portfolio company board members approve compensation and/or other amounts payable to Water Street and/or its affiliates. Such amounts will be in addition to any Management Fee or carried interest paid by a Partnership to its respective General Partner.

Additionally, a portfolio company typically will reimburse the Advisers or service providers retained at the Advisers' discretion for expenses (including without limitation travel expenses) incurred by the Advisers or such service providers in connection with performance of services for such portfolio company. This subjects the Advisers and their affiliates to conflicts of interest because the Partnerships generally do not have an interest or share in these reimbursements, and the amount of such reimbursements over time is expected to be substantial. The Advisers determine the amount of these reimbursements for such services in their own discretion, subject to Water Street's internal reimbursement policies and practices.

Water Street and/or its affiliates may also, from time to time, employ personnel with pre-existing ownership interests in portfolio companies owned by the Private Investment Funds or other investment vehicles advised by Water Street and/or its affiliates; conversely, former personnel or executives of Water Street and/or its affiliates may serve in significant management roles at portfolio companies or service providers recommended by Water Street and/or its affiliates. Similarly, Water Street, its affiliates and/or personnel maintain relationships with (or may invest in) financial institutions, service providers and other market participants, including managers of private funds, banks and brokers. Certain of these persons or entities will invest (or will be affiliated with an investor) in, engage in transactions with and/or provide services (including services at reduced rates) to, Water Street and/or its affiliates, and/or the Partnerships or other investment vehicles they advise. Water Street and/or its affiliates may have a conflict of interest with a Partnership in recommending the retention or continuation of a third-party service provider to such Partnership or a portfolio company if such recommendation, for example, is motivated by a belief that the service provider or its affiliate(s) will continue to invest in one or more Partnerships, will provide Water Street and/or its affiliates with information about markets and industries in which Water Street and/or its affiliates operates (or are contemplating operations) or will provide other services that are beneficial to Water Street and/or its affiliates. Water Street and/or its affiliates may have a conflict of interest in making such recommendations, in that Water Street and/or its affiliates has an incentive to maintain goodwill between it and the existing and prospective portfolio companies for a Partnership, while the

products or services recommended may not necessarily be the best available to the portfolio companies held by a Partnership.

Water Street, its affiliates, and equityholders, officers, principals and employees of Water Street and its affiliates may buy or sell securities or other instruments that the Advisers have recommended to a Partnership. The investment policies, fee arrangements and other circumstances of these investments generally vary from those of any Partnership.

In addition, as described above, portfolio companies (and, to a lesser extent, the Private Investment Funds) may from time to time pay certain fees to certain consultants (including consultants introduced or arranged by Water Street and/or its affiliates that may regularly provide services to one or more portfolio companies, such as Operating Partners and Executive Advisors, senior advisers and members of the Corporate Resources Group), and such fees will not offset the Management Fee as described herein. Such consultants may make use of Water Street's resources or otherwise be associated with (and in the case of members of the Corporate Resources Group are employed by) Water Street and/or its affiliates. Such compensation is expected to include cash fees and equity-based compensation. Although the use of such consultants and the allocation of compensation paid to them by Water Street, its affiliates and/or the portfolio companies subjects Water Street to potential conflicts of interest, Water Street believes that such potential conflicts may be reduced by the anticipated cost savings to portfolio companies (which is expected to be to the benefit of the applicable Private Investment Fund(s)) that will result if the cost of such consultant(s) is lower than market rates for the services provided and/or if the services of such consultant(s) align with Water Street's model for the applicable portfolio company and improve such portfolio company's performance. Although Water Street seeks to retain such consultants with a view to reducing costs to portfolio companies (and, ultimately, the Private Investment Funds) and/or improving portfolio company performance, a number of factors may result in limited or no cost savings from such retention. Water Street also seeks to reduce potential conflicts of interest resulting from such arrangements by structuring compensation packages for such persons in a manner that Water Street believes will align such persons' interests with those of the Private Investment Funds' limited partners, and seeks to retain consultants which it believes provide a level of service at a value generally consistent with other relevant market alternatives. However, there can be no assurance that no other consultant is more qualified to provide the applicable services or could provide such services at a lesser cost.

An Adviser may enter into side letter arrangements with certain investors in a given Partnership providing such investors with different or preferential rights or terms, including but not limited to different fee structures, information rights, co-investment rights, and liquidity or transfer rights.

Any of these situations subjects Water Street and/or its affiliates to potential conflicts of interest. Water Street and its affiliates attempt to resolve such conflicts of interest in light of their obligations to investors in the Partnerships and the obligations owed by Water Street's advisory affiliates to investors in investment vehicles managed by them, and attempt to allocate investment opportunities among a Partnership, other Private Investment Funds and such investment vehicles in a fair and equitable manner. To the extent that an investment or relationship raises particular conflicts of interest, Water Street and/or its affiliates will review the

circumstances of such investment or relationship with a view to addressing and reducing the potential for conflict. Where necessary, Water Street and/or its affiliates consult and receive consent to conflicts from an advisory committee consisting of limited partners of the relevant Partnership and such other investment vehicles.

### **DISCIPLINARY INFORMATION**

The Management Company and its management persons have not been subject to any material legal or disciplinary events required to be discussed in this Brochure.

### **OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

The Management Company serves as the general partner of each of the General Partners, each of which is registered with the SEC under the Advisers Act pursuant to the Management Company's registration in accordance with SEC guidance. The Management Company and the General Partners operate as a single investment advisory business and the General Partners serve as general partners of private investment funds and other pooled vehicles or of other affiliated investment advisers and may share common owners, officers, partners, employees, consultants or persons occupying similar positions.

### **CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING**

The Advisers have adopted the Water Street Code of Ethics and Securities Trading Policy and Procedures (the “**Code**”), which sets forth standards of conduct that are expected of the Advisers' principals and employees and addresses conflicts that arise from personal trading. The Code requires certain of the Advisers' personnel to:

- report their personal securities transactions;
- pre-clear any proposed purchase of an initial public offering or a limited offering; and
- comply with policies and procedures reasonably designed to prevent the misuse of, or trading upon, material non-public information.

A copy of the Code will be provided to any investor or prospective investor upon request to Jeff Holway, the Water Street Chief Compliance Officer, at (312) 506-2900. Personal securities transactions by employees who manage client accounts are required to be conducted in a manner that prioritizes the client's interests in client-eligible investments.

The Advisers and their affiliated persons may come into possession, from time to time, of material nonpublic or other confidential information about companies which, if disclosed, might affect an investor's decision to buy, sell or hold a security. Under applicable law, the Advisers and their affiliated persons would be prohibited from improperly disclosing or using such information for their personal benefit or for the benefit of any person, regardless of whether such person is a client of the Advisers. Accordingly, should the Advisers or any of their affiliated persons come into possession of material nonpublic or other confidential information with



respect to any company, the Advisers generally would be prohibited from communicating such information to clients, and the Advisers will have no responsibility or liability for failing to disclose such information to clients as a result of following their policies and procedures designed to comply with applicable law. Similar restrictions may be applicable as a result of Water Street personnel serving as directors of public companies and may restrict trading on behalf of clients, including the Partnerships.

Principals, Operating Partners, Executive Advisors and employees of the Advisers and their affiliates may directly or indirectly own an interest in Private Investment Funds or certain co-investment vehicles. To the extent that co-investment vehicles exist, such vehicles may invest in one or more of the same portfolio companies as a Partnership. Operating Partners, Executive Advisors and Employee Operating Partners could also own direct interests in portfolio companies.

Co-investment opportunities may also be presented to certain affiliates of Water Street, as well as third-party investors and other persons, and such co-investments may be effected through co-investment vehicles or directly in a particular portfolio company. The Partnerships and other Private Investment Funds may invest together with other investment vehicles advised by an affiliated adviser of Water Street in the manner set forth in the applicable Partnership Agreement. In addition, certain Operating Partners, Executive Advisors, other consultants, employees of Water Street that are not partners of the General Partners and members of the Corporate Resources Group may be offered the opportunity to co-invest in each portfolio company investment of the Partnerships. The Advisers will determine allocation of investment opportunities in a manner that they believe is fair and equitable to their clients consistent with the Advisers' fiduciary obligations and Water Street's Investment Allocations/Co-Investment Policy. In the case of co-investments, the Advisers may grant certain third-party investors the opportunity to evaluate specified amounts of prospective co-investments in a Private Investment Fund's portfolio companies or otherwise to have priority in co-investment opportunities. Co-investors described above may, but, typically do not pay management fees or carried interest.

The Advisers and their affiliates, principals and employees may carry on investment activities for their own accounts and for family members, friends or others who do not invest in the Partnerships, and may give advice and recommend securities to other accounts or certain vehicles which may differ from advice given to, or securities recommended or bought for, any Partnership, even though their investment objectives may be the same or similar. The operative documents and investment programs of certain vehicles sponsored by Water Street (the "**Reference Funds**") may restrict, limit or prohibit, in whole or subject to certain procedural requirements, investments of certain other vehicles in issuers held by such Reference Funds or may give priority with respect to investments to such Reference Funds. Some of these restrictions could be waived by investors (or their representatives) in such Reference Funds.

From time to time, the General Partners may borrow funds on behalf of the Partnerships or the Private Investment Funds and contribute such borrowed amounts to the Partnerships (or relevant Private Investment Fund, as applicable) as a special capital contribution for investment, to be returned to the General Partner at a later date. Interest in connection with such borrowing is borne by the Partnerships (or the relevant Private Investment Fund, as applicable) as a Partnership expense, consistent with the applicable Partnership Agreement (or other governing

document) and the expense policy described under “Fees and Compensation.” In borrowing on behalf of the Partnerships or any Private Investment Fund, the General Partners are subject to conflicts of interest between repaying their obligations and retaining such borrowed amounts for the benefit of the Partnerships or such Private Investment Fund(s), as applicable. The General Partners will effect such borrowings in a manner that they believe to be fair and equitable to the Partnerships or Private Investment Fund(s), as applicable, and consistent with the General Partners’ obligations to the Partnerships and the applicable Partnership Agreement (or other governing document).

### **BROKERAGE PRACTICES**

The Advisers focus on securities transactions of private companies and generally purchase and sell such companies through privately-negotiated transactions in which the services of a broker-dealer may be retained. However, the Advisers may also distribute securities to investors in a Private Investment Fund or sell such securities, including through using a broker-dealer, if a public trading market exists. Although the Advisers do not intend to regularly engage in public securities transactions, to the extent they do so, they follow the brokerage practices described below.

If the Advisers sell publicly traded securities for a Private Investment Fund, they are responsible for directing orders to broker-dealers to effect securities transactions for accounts managed by the Advisers. In such event, the Advisers will seek to select brokers on the basis of best price and execution capability. In selecting a broker to execute client transactions, the Advisers may consider a variety of factors, including: (i) execution capabilities with respect to the relevant type of order; (ii) commissions charged; (iii) the reputation of the firm being considered; and (iv) responsiveness to requests for trade data and other financial information.

The Advisers have no duty or obligation to seek in advance competitive bidding for the most favorable commission rate applicable to any particular client transaction or to select any broker on the basis of its purported or “posted” commission rate, but will endeavor to be aware of the current level of the charges of eligible brokers and to reduce the expenses incurred for effecting client transactions to the extent consistent with the interests of such clients. Although the Advisers generally seek competitive commission rates, they may not necessarily pay the lowest commission or commission equivalent. Transactions may involve specialized services on the part of the broker involved and thereby entail higher commissions or their equivalents than would be the case with other transactions requiring more routine services.

Consistent with the Advisers seeking to obtain best execution, brokerage commissions on client transactions may be directed to brokers in recognition of research furnished by them, although the Advisers generally do not make use of such services at the current time and have not made use of such services since their inception.

The Advisers do not anticipate engaging in significant public securities transactions; however, to the extent that the Advisers engage in any such transactions, orders for purchase or sale of securities placed first will be executed first, and within a reasonable amount of time of order receipt. To the extent that orders for Private Investment Funds are completed independently, the Advisers may also purchase or sell the same securities or instruments for

several Private Investment Funds simultaneously. From time to time, the Advisers may, but are 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 the Advisers 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 such orders are not batched, they may have the effect of increasing brokerage commissions or other costs.

When an aggregate order is partially filled, the securities purchased or sold will normally be allocated on a *pro rata* basis to each Private Investment Fund participating in such buy or sell order in accordance with the amount of securities originally requested for such Private Investment Funds.

Each Private Investment Fund generally will receive the average price obtained on all such purchases or sales made during such trading day. Exceptions to *pro rata* allocations are permissible provided they are fair and equitable to Private Investment Funds over time.

#### **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, the Advisers closely monitor companies in which the Private Investment Funds invest, and the Water Street Chief Compliance Officer periodically checks to confirm that each Private Investment Fund is maintained in accordance with its stated objectives.

The Partnerships will provide to their limited partners (i) GAAP audited financial statements annually, (ii) unaudited financial statements for the first three quarters of each fiscal year, (iii) annual tax information necessary for each limited partner’s tax returns, and (iv) descriptive investment information for each portfolio company periodically.

#### **CLIENT REFERRALS AND OTHER COMPENSATION**

The Advisers and/or their affiliates may provide certain business or consulting services to companies in the Partnerships’ respective portfolios and may receive compensation from these companies in connection with such services. As described in the applicable Partnership Agreement, this compensation may, in many cases, offset a portion of the Management Fee paid by such Partnership. However, in other cases (e.g., reimbursements for out of pocket expenses directly related to a portfolio company or with the Partnership’s advisory board consent), these fees may be in addition to the Management Fee. See “Fees and Compensation.”

From time to time, the Advisers may enter into solicitation arrangements pursuant to which they compensate third parties for referrals that result in a potential investor becoming a limited partner in an applicable Partnership or other Private Investment Fund. Any fees payable to any such placement agents are borne by the Advisers indirectly through an offset against the

Management Fee, although related expenses incurred pursuant to the relevant placement agent or similar agreement, including but not limited to placement agent travel, meal and entertainment expenses, typically are borne by the relevant Partnership(s).

### **CUSTODY**

The Advisers maintain custody of the Partnerships' assets held in the Partnerships' names with the following qualified custodians: Merrill Lynch, Pierce, Fenner & Smith Inc., located at 101 California Street, Suite 1300, San Francisco, CA 94111 and BMO Harris Bank, located at 111 West Monroe St., 9<sup>th</sup> Floor East, Chicago, IL 60603.

### **INVESTMENT DISCRETION**

The Advisers have discretionary authority to manage investments on behalf of each Partnership. As a general policy, the Advisers do not allow limited partners to place limitations on this authority. Pursuant to the terms of the Partnership Agreement, however, an Adviser may enter into "side letter" arrangements with certain limited partners whereby the terms applicable to such limited partner's investment in a Partnership 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. The Advisers assume this discretionary authority pursuant to the terms of the Partnership Agreement and powers of attorney executed by the limited partners of each Partnership.

### **VOTING CLIENT SECURITIES**

The Advisers have adopted the Water Street Proxy Voting Policies and Procedures (the "**Proxy Policy**") to address how they will vote proxies, as applicable, for the Partnerships' portfolio investments. The Proxy Policy seeks to ensure that the Advisers vote proxies (or similar instruments) in the best interest of the Partnerships, including where there may be material conflicts of interest in voting proxies. The Advisers generally believe their interests are aligned with those of the Partnerships' investors, for example, through the principals' beneficial ownership interests in the Partnerships 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 the Advisers may address the conflict using several alternatives, including by seeking the approval or concurrence of a Partnership's advisory board on the proposed proxy vote or through other alternatives set forth in the Proxy Policy. The Advisers do not consider service on portfolio company boards by Water Street personnel or the Advisers' 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 the Advisers when voting proxies on behalf of the Partnerships. Investors or prospective investors should contact Jeff Holway, the Water Street Chief Compliance Officer, at (312) 506-2900, if they would like a copy of the Advisers' complete Proxy Policy or information regarding how the Advisers voted proxies for particular portfolio companies. Such information will be provided to such persons at no charge.

## **FINANCIAL INFORMATION**

The Management Company 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.