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**Confidential Private Placement Memorandum**

**Fund Name CAPITAL FINANCIALS FUND**

*a Cayman Islands exempted company registered as a regulated mutual fund   
with the Cayman Islands Monetary Authority*

**[NOVEMBER] 2019**

**DIRECTORY**

|  |  |
| --- | --- |
| **FUND**  Fund Name Capital Financials Fund | **MASTER FUND**  Fund Name Capital Financials Master Fund |
| **INVESTMENT MANAGER**  Name |  |
|  |  |

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**Fund Name Financials Fund**

# SUMMARY OF KEY INFORMATION

This summary only contains selected information about the Fund and is qualified in its entirety by the more detailed information set forth in this Memorandum, any supplement to this Memorandum, the Articles, any Investor Disclosures and the Memorandum of Association and Articles of Association of the Master Fund (the “**Master Fund Articles**”), each of which is available upon request, and each Shareholder’s Subscription Agreement (collectively, the “**Fund Documents**”). In the event that any information in this Memorandum contradicts information set forth in any other Fund Document, the applicable Fund Document will control. Reference is made to the “Index of Defined Terms” section for any capitalised terms used herein but not defined.

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| --- | --- |
| **THE FUNDS:** | *The Fund*  AL Capital Financials Fundis a Cayman Islands exempted company formed to operate as a private investment fund primarily for the benefit of non-US Persons and Permitted US Persons. |
|  | *The Master Fund*  The Fund invests all of its investable assets through a “master-feeder” fund structure in AL Capital Financials Master Fund (the “**Master Fund**”), a Cayman Islands exempted company. F |
|  | *General*  Other feeder funds may be established from time to time; however, it is not currently anticipated that there will be any other investors in the Master Fund. |
| **INVESTMENT OBJECTIVE AND PROGRAM:** | The investment objective of the Fund and the Master Fund is to seek to generate superior absolute returns by investing predominantly in the securities of financial sector companies including regulatory and legacy capital securities issued by Banks and Insurance companies, going long or short risk. There will be particular focus on Western Europe and the wider EMEA region, although investments in other regions may also be considered. The Fund will pursue its investment objective by investing all of its investable assets in the Master Fund.  The Investment Manager believes that continued shifts in regulatory focus will result in issuers of such securities being increasingly required to retire existing securities, issue new securities to comply with regulatory requirements, face challenges to their existing business models, and/or undertake modifications to their business models to seek superior returns, and accordingly create opportunities to take advantage of asset classes with the potential to offer superior risk-adjusted returns to investors. The Investment Manager will seek to create a liquid portfolio for the Master Fund which can achieve stable returns by undertaking extensive and detailed bottom-up fundamental analysis of investment opportunities in the Financials sector.  The Investment Manager’s investment strategy will principally focus on performing credit and the Master Fund will typically invest in financial credit securities but retains the flexibility to invest in any type of securities, which may include fixed income securities, preferred stocks, American Depository Receipts, exchange-traded funds, unregistered or restricted securities, convertible securities, warrants, futures, forward contracts, cash and cash equivalents, interest-rate and other swaps, options and other derivatives.  All investments are based on a detailed bottom up analysis of the fundamentals which affect the economic outcome, including financials, industry and legal risks. Market risk is also taken into account. Each investment strategy will put different weights on each of these components.  ***The investment program of the Master Fund is speculative and may entail substantial risks.*** |
| **REDEMPTIONS:** | *General*  Subject to the limitations on redemptions set forth herein, each Shareholder may as of the last day of each calendar quarter (each such date, and any other day on which a redemption is permitted or required by the Board of Directors, a “**Redemption Date**”), upon at least 60 days’ prior written notice to the Administrator, redeem all or a portion of its Shares up to the Applicable Percentage (as defined below) of the net asset value of each series of Shares of such Shareholder as of a Redemption Date (such limitation on redemption, the “**Investor-Level Gate**”). |
|  | *Investor-Level Gate*  A Shareholder may redeem all of its Shares by submitting a single redemption request for all such Shares or submitting redemption requests for successive Redemption Dates for the Applicable Percentage applicable to each such successive Redemption Date.  A Shareholder seeking to redeem all of its Shares may submit a redemption request for an amount equal to the net asset value of such Shares and such redemption will be effected in stages over four successive Redemption Dates so that 25% of the net asset value of such Shares will be redeemed as of the initial Redemption Date and the remaining amount of such redemption request will be satisfied over the next three Redemption Dates in amounts equal to 33⅓%, 50% and 100%, respectively (such 25%, 33⅓%, 50% and 100% amounts, the “**Applicable Percentage**” for a particular Redemption Date), of the then-current net asset value of such Shares as of each such subsequent Redemption Date (prior to reduction for any Incentive Fee attributable to the amount redeemed as of each such Redemption Date).  If a Shareholder redeems less than the Applicable Percentage as of any Redemption Date, then the Applicable Percentage for the next Redemption Date on which the Shareholder requests a redemption will be reset to 25%. |

# INVESTMENT OBJECTIVE AND PROGRAM

**Investment Objective and Program**

The investment objective of the Fund and the Master Fund is to seek to generate superior absolute returns by investing predominantly in the securities of financial sector companies including regulatory and legacy capital securities issued by Banks and Insurance companies, going long or short risk. There will be particular focus on Western Europe and the wider EMEA region, although investments in other regions may also be considered. The Fund will pursue its investment objective by investing all of its investable assets in the Master Fund.

**Investment Process**

*Idea generation*

The Investment Manager seeks to identify credit segments and regulatory themes, where individual investment opportunities could be found that benefit from supportive market, regulatory or industry wide trends. The Investment Manager anticipates that the portfolio will always have a concentration around specific regulatory themes, although a significant proportion of the portfolio will also be completely opportunistic.

This idea generation process leads to a “Target Market”, which is the total opportunity set available for investments by the Master Fund. The Target Market includes opportunities in performing credit, distressed credit, event driven credit and high yield. In the Investment Manager’s experience, this Target Market is currently approximately US$200bn, but can be much larger through the cycle depending on the state of the credit markets and the underlying fundamentals. Out of this Target Market, the Investment Manager selects the individual investment ideas where research will be focussed.

*Research process – detailed, comprehensive, culminating in financial model*

Each investment opportunity is allocated to a specific member of the Investment Manager’s team, who diligences it with a focus on four key areas, financials, industry, valuation and legal/regulatory framework. The comprehensive research and rigorous analysis will involve outside sources as appropriate, including industry consultants and lawyers. The key outputs are i) a detailed integrated financial model of the company’s historic performance and projections, including P&L, balance sheet, regulatory capital position where relevant ii) an analysis of industry fundamentals and trends, iii) a comprehensive valuation analysis based on comparable publicly listed companies, M&A transactions, and break-up/ asset valuation, and iv) an assessment of the legal/regulatory environment including a review of credit documentation and relevant regulatory trends that may impact the company’s business model or securities. These four analytical outputs are combined to form a risk reward profile for each element of the capital structure, including the equity. This fundamental analysis is complemented by a market assessment, which takes into account liquidity, corporate events which could impact on price and credit/ equity market risk. A number of different scenarios are examined.

During this process, most investment opportunities fall away because of significant risks uncovered. However, for a small group of investment opportunities, research confirms the preliminary views and lead to an “Investment Recommendation”.

*Decision making process – involvement of team*

The Investment Recommendation is then assessed in a team meeting. In some rare, but important, cases the discussion uncovers new risks and the Investment Recommendation is rejected. However, in most situations, the fundamental Investment Recommendation is confirmed, whilst the intense discussion within a group of experienced individuals, leads to additional questions, which are researched before a final decision is taken. The responsibility for the final decision rests with the [Co-Portfolio Managers].

*Position sizing and hedging decisions – careful neutralisation of unwanted risks*

Once the fundamental investment decision is taken, a subset of the team will discuss sizing of the position, hedging of individual risks and timing of the investment. Sizing will take into account the attractiveness of the investment, which includes upside and potential downside, portfolio concentration in this theme, and liquidity.

Key risks that may be hedged include market risk, interest rate risk, industry, valuation and currency risk. Of these, the Investment Manager will attempt to largely eliminate interest rate and currency risks, and significantly reduce market risk by entering into respective compensating transactions. Industry and valuation risks are situation dependent and whilst they may also be hedged, they may often be part of the investment thesis.

Timing looks at technical factors, expectations of demand/ supply in the credit, corporate events and observable market intelligence.

*Monitoring – continuous assessment of the investment*

Once the Master Fund is invested in a name, an analyst will be responsible for monitoring it. This monitoring includes daily reviews of relevant news reports, periodically contacting the company, maintaining close contact with sell side analysts, arranging site visits to the company and competitors, being involved with other buy side analysts who are also invested in the name, and using industry and market data. Important changes will be brought to the Principals’ attention immediately; however most information will be discussed in the daily team meetings, during which the investment thesis is reassessed against its market price. The Investment Manager continuously assesses the attractiveness of an investment against its available market price and actively seeks to sell when the risk reward is no longer attractive.

**Portfolio Construction**

It is expected that the portfolio will hold a significant concentration in identified dislocated credit segments and regulatory themes, ranging from 1/3rd to 2/3rds of the portfolio. The remainder is invested in opportunistic credit opportunities.

The portfolio is predominantly composed of credit instruments including bonds, loans and credit derivatives. Equities may be considered as investment opportunities to the extent they form part of a levered capital structure. The portfolio offers good liquidity as per the underlying instrument, aided by the Master Fund only holding minority positions in each capital structure. The Master Fund does not invest in credit opportunities which require significant leverage to achieve target return.

Whilst the Investment Manager seeks to generate good risk-adjusted returns via long and short investments, the nature of levered capital structures implies that in most circumstances the Master Fund will own more investments on the long side. The Investment Manager balances these single name positions with index shorts at the portfolio level as appropriate. However, the Investment Manager expects the portfolio to retain a long bias most of the time.

The portfolio is expected to have reasonable diversification with concentration in conviction opportunities.. The Master Fund’s investments will typically have an investment horizon of 3-18 months, with an identifiable catalyst within that period, which creates a relatively low trading intensity.

The securities that the Master Fund invests in may be listed or unlisted and additionally such securities may not have any credit rating.

Whilst the Master Fund’s investment may be denominated in any currency, including basket or notional currencies, the Master Fund will be seeking to maximise total returns on a Euro basis. The Investment Manager expects to, but is not obliged to, seek to hedge the non-Euro currency exposure of any designation of Shares denominated in a currency other than Euro. Any such hedging will be performed at the Master Fund-level.

**Risk Management**

The Investment Manager believes that preservation of capital and minimising risk of loss are central to the investment program.

Whilst there are no formulaic ways to achieve investment success, there are a number of tools and processes that the Investment Manager employs to reduce risk:

1. Portfolio risks are monitored continuously using qualitative and quantitative tools including stress tests and scenario analysis;
2. A focus on corporate, event and industrial risks in leveraged capital structures and extensive hedging of other risk components (FX, market, commodity);
3. Position sizing with a view to a maximum impairment loss of 2% of the Master Fund’s net asset value in each position;
4. Re-appraisal of investment opportunity fundamentals if a debt position loses 3-5% or an equity position loses 5-8%;
5. Active portfolio management via daily monitoring and trading of individual positions;
6. None to low Master Fund level leverage; and
7. Liquidity based on tradable underlying securities and minority positions in capital structures.

The risk profile of the Master Fund will be disclosed to Shareholders, including, (i) the measures taken to assess the sensitivity of the Master Fund’s portfolio to the most relevant risks to which the Master Fund is or could be exposed, and (ii) a description of the circumstances where the risk limits, if any, set by the Investment Manager have been exceeded (or are likely to be exceeded) and the remedial measures taken. The Fund or the Investment Manager will make this information available to all Shareholders to the extent not already made through this Memorandum through appropriate Investor Disclosure at least annually or sooner if required by applicable law.

## Leverage

*Leverage for Investment Purposes*

The Master Fund has the authority to borrow, trade on margin, utilise derivatives and otherwise obtain leverage from brokers, banks and others on a secured or unsecured basis.

Subject to the limit set out below, the Master Fund may utilise leverage to the extent deemed appropriate by the Investment Manager, and the amount of leverage utilised by the Master Fund is not in the ordinary course expected to exceed 150% of the Master Fund’s net asset value, but may from time to time do so.

Themaximum level of leverage that may be employed in connection with the Master Fund’s investment program calculated in accordance with the AIFM Directive’s gross method and commitment method is 1000% and 500%, respectively, of the Master Fund’s net asset value.