

Theta Deep Value Fund

Unlocking Deep Value from Special Situations

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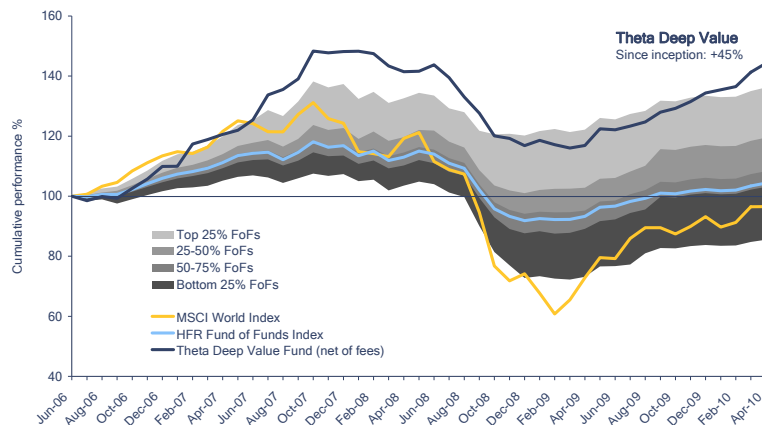
The Opportunity

- **Theta Deep Value Fund** was launched on 1 July 2006 with the aim to capture 'deep value' investment opportunities in less liquid situations. The fund was closed to new subscriptions in July 2007 with assets under management of around EUR 150 million.
- Partly based on compelling investment opportunities being created by the financial crisis, Theta has decided to **open the fund to new subscriptions and offer more liquid share classes per 1 January 2010**
- In today's hedge fund industry, we are seeing a convergence of public and private investment opportunities. Due to their active involvement in public markets and opportunistic investment approaches, hedge funds have very good access to these opportunities;
- **Theta Deep Value Fund** aims to capture the significant upside potential associated with **thematic investing**. Examples include being short subprime mortgages and corporate credit in 2007; long emerging market assets in 2006-2007; short European sovereign debt in 2008;
- Distressed debt will be an important investment theme in the coming years;
- **Theta Deep Value Fund** provides longer-term capital to hedge funds in opportunistic and event-driven strategies, with the objective of achieving absolute returns in the high-teens over a medium term horizon.
- It is important to note that **Theta Deep Value Fund is not a private equity investment**. Private equity investors tend to buy controlling stakes in companies (and in many cases whole companies), with the objective to leverage the company's capital structure and capitalize on an eventual exit.

Performance Theta Deep Value Fund (Series July 2006)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2006							-1.68%	1.19%	-0.75%	3.17%	2.90%	3.83%	8.83%
2007	-0.08%	6.60%	1.12%	1.36%	0.99%	2.80%	6.47%	1.26%	2.52%	6.65%	-0.45%	0.28%	33.38%
2008	0.17%	-0.45%	-2.39%	-1.18%	0.25%	1.69%	-2.80%	-4.48%	-3.94%	-5.78%	-0.58%	-1.82%	-19.57%
2009	1.61%	-1.11%	-0.91%	0.77%	4.90%	-0.22%	1.05%	1.12%	2.62%	1.00%	1.78%	2.20%	16.06%
2010	0.80%	0.80%	3.77%	1.73%									7.22%

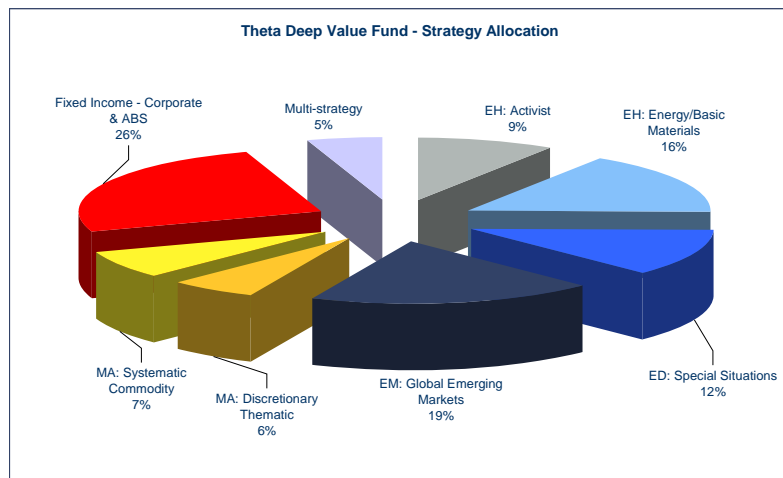
Outperformance versus equities and the HFR fund of funds universe



Source: Bloomberg, Theta Capital Management, HFR FoF database. FoF peer group comprises all FoFs from HFR Hedge Fund Database, adjusted for duplicate share classes (704 FoFs in total). Outliers of top 5% and bottom 5% FoFs are omitted for illustration purposes.

The Proposition

- **Portfolio of hedge funds in opportunistic and less liquid investment strategies** where the inherent value is likely to be unlocked but this may take longer to materialize;
- Return target: **15-20% per annum** over an investment cycle of 3-5 years;
- Investors will capture the inherent illiquidity premium and significant upside return potential by providing locked-up capital for a minimum of two years;
- *Theta Deep Value Fund* will maintain a **concentrated portfolio of around 10-15 hedge funds** with highly diverse investment strategies. Interestingly, the average correlation between funds in the portfolio is less than 0.15
- Reduced management fee and profit sharing only above a return of 8% ensure the **alignment of investors' and Theta's interest in maximizing performance.**



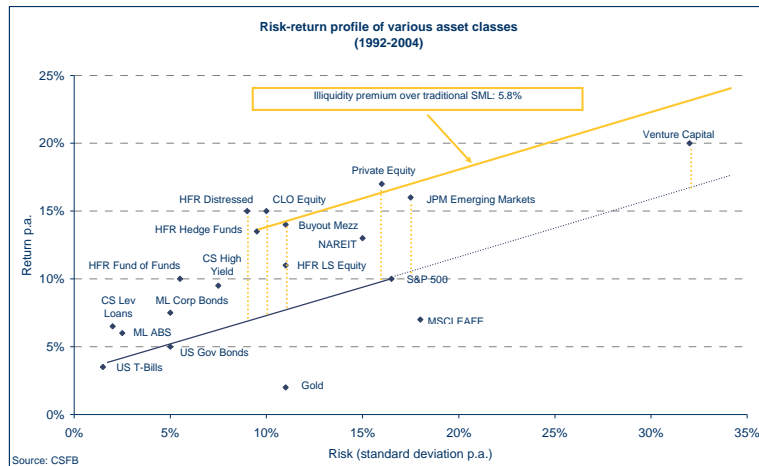
Premium for less liquid investments

Hedge funds have always been providers of otherwise unavailable liquidity and part of their return has been a reward for taking on the risk of not being able to step out of an investment at any time. The option to trade in and out of a position has value, but most market players overpay for this tradability, which means that serious investors can get an attractive premium for illiquidity.

The chart below illustrates this point. The blue diagonal line plots the risk-return relationship for traditional liquid asset classes such as stocks, bonds, and Treasury bills. The red diagonal line plots the same relationship, but now for less liquid assets and investment strategies such as private equity, hedge funds, buyout mezzanine and emerging markets debt. It reveals that a **significant premium of almost 6%** can be received in exchange for giving up

(part of) the tradability. Other studies analyzing the various asset classes show comparable results¹.

Interestingly, various academic studies have looked at the impact of lockup provisions of hedge funds in more detail and found that **excess returns of hedge funds with lockup restrictions are approximately 4%-7% per year higher than those of non-lockup funds**²



Returns bear little relation to broad market movements

Returns on most liquid financial instruments and investment strategies can be described by a single common market exposure. This is referred to as systematic risk, or beta (e.g. interest rates for bonds, earnings expectations for equities). In contrast, returns of the investment strategies in Theta Deep Value Fund have little relationship with traditional equity and fixed income markets, but are the result of unique characteristics and events specific to a small number of positions. In other words, returns are predominantly driven by *non-systematic risk drivers*. This makes Theta Deep Value Fund an **excellent diversification tool** in any traditional investment portfolio.

Active management strategies are particularly suitable for inefficient markets where market returns contribute very little to ultimate results and investment selection (manager skill) provides the fundamental source of return. The table below illustrates this point: for illiquid asset classes such as leveraged loans, CDO equity and private equity, less than half of the risk is related to broad market movements. In contrast, for liquid instruments such as stocks and bonds, this number is 99% and 92%, respectively.

¹ *The Premium for Non-Traded Assets* (Citigroup Alternative Investments, 2006) estimates that premium vary from 3% for real estate to 6% for leveraged buyouts.

² See for example G. Aragon (2006), *Share restriction and asset pricing*, forthcoming in the *Journal of Financial Economics*. All publications are available upon request from Theta Capital Management.

Non-systematic risk drivers of various asset classes (1992-2004)

	US Government bonds	S&P 500	Non-systematic risk drivers*
	Correlation with:		
Leveraged buyouts	-0.08	0.07	90%
Buyout & Mezzanine	-0.15	0.15	70%
CDO Equity	0.00	0.39	70%
Private Equity	-0.22	0.36	60%
Venture Capital	-0.23	0.34	50%
High Yield Bonds	0.50	0.48	40%
Government Bonds	0.89	0.29	11%
Mortgage Bonds	0.90	0.24	10%
Investment Grade	0.92	0.33	8%
Equity (Wilshire 5000)	0.21	0.99	1%

* (1-R2). Source: CS Leveraged Finance

Strategies & Investment Themes

Due to their active involvement in public markets and opportunistic investment approaches, hedge funds have very good access to quality deal flow in asset classes and sectors (such as private enterprise, physical assets, energy, non-syndicated lending, select real estate opportunities and intellectual property) that have traditionally been the domain of corporate and institutional entities.

Common denominator across these investment strategies is that there is a need for longer-term capital and the provider of this capital aims to gain significant equity-like upside. Therefore, in many cases the hedge fund manager will prefer to be (partial) owner instead of lender to a company. Below, we will describe some examples of strategies (non-exhaustive) that would fit into the profile of the *Theta Deep Value Fund*.

Activist Investing

- Specialist hedge funds take significant stakes in public companies and work with management to strengthen operational and financial performance;
- Direct participation in the event stream with a strong focus on legal issues, for which the pay-off is uncorrelated to market movements;

Recovery in financials

- Bank stocks tend to move together in the short run, but ultimately prices will reflect fundamentals regarding profitability, expected loan losses and the outlook for a successful restructuring
- Regional US banks have more exposure to commercial and residential mortgage markets: 12% of banks have commercial real estate exposure exceeding 5X their Tier 1 capital
- Opportunity in debt of finance companies: the alphabet soup of TARP, TALF, PPIP and TLGP will prevent defaults, but recapitalizations will dilute the equity. Some yields on debt of financials are still in the 20%+ range
- Focus on asset side of banks' balance sheets, credit costs and required recapitalizations
- This will be a multi-year process driven by company-specific events

Distressed Investing

- As a result of their active involvement in the restructuring process, hedge funds' investments in public debt securities may evolve into private investments (takeover bids from private equity companies);
- Given the amount of capital raised by private equity firms in recent years (which, in many cases, still has to be put to work), this creates very attractive exit opportunities for distressed debt investors;
- Strategies may be based on obtaining large minority positions (minimum 15% of debt outstanding) which enable hedge funds to take an activist approach and a leading role in restructuring processes;
- Financial structuring and servicing of hard assets (real estate, airplanes, power plants etc.).

Corporate & ABS Credit

- Deep value distressed opportunities in structured credit (CDO's and asset-backed securities), which may arise from investor constraints regarding: ratings, short-term volatility and potential illiquidity;
- The CDO and ABS market is dominated by investors with short-term horizons (investment banks & leveraged investment vehicles) and longer-term capital will allow the hedge fund manager to focus on fundamental value, which is ultimately determined by the cash flows.

Emerging Markets

- Underbanked and capital-starved Eastern European regions have compelling financing opportunities for providers of longer-term capital;
- Global capital inflows will improve corporate governance practices and structural reforms;
- Opportunities include shareholder activism, pre-IPO, selected private equity, mezzanine finance, buy-out and corporate restructuring situations;
- Second and third-tier listed companies which will benefit from substantial P/E multiple expansion.

Commodities / Energy

- As a result of a backlog of investments in production capacity, inelastic energy supply meets rising global energy demand. Funds may invest in oil & gas supply infrastructure (such as offshore drilling rigs) and these are often private family-owned enterprises;
- Funds may trade energy futures and other derivatives, but also invest in timber, mining, biofuels and other natural resource investments;
- Hedge funds use strategic investment partners with operating experience to structure investments in basic industries, commodity and energy-related sectors and work on potential exit opportunities.

The Investment Manager

Theta Capital Management is an independent investment boutique with an exclusive focus on hedge funds, based in Amsterdam, the Netherlands. Theta Capital has been successfully managing hedge fund portfolios for private and institutional investors since 2001. Theta Capital has a demonstrated expertise in distressed and event-driven investing and is currently managing about EUR 500 million across various hedge fund strategies.

Key element of the Theta investment approach is a research-driven bottom-up investment process, where decisions are made based on thorough analysis but also with a healthy dose of common sense and expert judgment. Our Advisory Board of hedge fund and private equity experts and our extensive industry network enable us access to many promising funds at an early stage. Our investment philosophy of allowing hedge fund managers full flexibility in implementing their strategies has been the basis for many long-standing relationships with outstanding hedge fund managers, some of which are candidates for investment in the *Theta Deep Value Fund*.

The investment team of Theta Capital Management will bring to *Theta Deep Value Fund* over 80 years combined experience in corporate finance, structured finance and financial markets.

Portfolio Profile

- Concentrated portfolio of approximately 10-15 hedge funds;
- Dominant risk in the portfolio is idiosyncratic risk relating to individual positions, rather than general market risk or hedge fund strategy risk;
- Diversification is achieved through underlying securities, strategies and investment region, rather than the number of managers;
- In selecting candidates for the Theta Deep Value Fund, the manager will focus on the potential for high returns with an option-like profile, while accepting a higher level of intermediate volatility.

Investment Terms

Target return	15-20% per annum over a 5-year horizon	
Investment styles	Distressed Corporate & ABS Credit, Event-Driven, Global Macro/Commodities	
Subscriptions	Quarterly	
Redemptions	Quarterly with 90 day notice period	
Minimum initial investment	EUR 25,000 or USD 25,000	
	Class A	Class B
Initial lockup	2 years	None
Management fee	0.50% per annum	0.50% per annum
Performance fee	10% per annum	15% per annum
Hurdle rate	8% per annum	
Gate (investor level)	25% per quarterly redemption date	
Legal structure	Open-ended fund, regulated by AFM in Netherlands	

Important Risk Considerations

- **Performance risk.** No assurance can be given that *Theta Deep Value Fund* will achieve its investment objectives, and investment results may vary substantially over time and from period to period. Past performance is no indication for future results;
- **Valuation risk.** The underlying hedge funds of *Theta Deep Value Fund* may engage in privately placed, illiquid investments for which no proper valuation may exist until a transaction is executed;
- **Concentration risk.** *Theta Deep Value Fund* may have significant exposure to a limited number of hedge funds who, in turn, may have significant exposure to a limited number of positions. As a consequence, the value of the fund may display a high sensitivity to adverse developments in any particular hedge fund;
- **Restrictions on redemptions.** Quarterly redemptions are subject to a gate and for Class A, redemptions are not allowed during the first two years;