KAI Core Equity Pool - Fact Sheet

KCEP

This Fact Sheet provides important information about the KAI Core Equity Pool. You are encouraged to read this in conjunction with additional related disclosure set out in the *Relationship Disclosure Document (RDD)*, in your *Investment Policy Statement* and the *KAI Health Services Inc. - Fact Sheet* and the *KAI Properties Inc. - Fact Sheet*, (together the KAI Issuer *Fact Sheets*). This Fact Sheet is intended for clients who hold units of the KAI Core Equity Pool.

Objectives

KAI Asset Management Inc.'s (KAM) investment objective for the KAI Core Equity Pool (KCEP or Pool) is to deliver consistent and positive total returns to unitholders, with a focus on reducing the risk of permanent capital loss.

- KCEP will be predominately invested in listed equities and private securities. At times, the Pool may hold minimal amounts of cash, listed option contracts, and over the counter (OTC) derivative contracts. As such, the Pool will be subject to certain risk factors related to various asset classes and security exposures.
- The asset allocation approach in KCEP is intended to provide KAM clients with an investment return profile similar to a basket of listed equities but with the distinctive feature of an allocation to private equity.
- The allocation to the various asset classes and securities is intended to reduce volatility beyond an allocation to listed equities and to also improve risk-adjusted returns.

Valuation

The Net Asset Value (NAV) of the KCEP is valued on a weekly basis at the close of trading each Tuesday. The pool issues and redeems units to and from unitholders of the KCEP on that date using the current NAV. The NAV of pool units can increase or decrease and it is possible that you will incur a loss of capital.

Risks

The following is a summary of the risks of investing. Please note that this list is not exhaustive and has been provided to give you an indication of the factors that can affect the value of KCEP.

- **Market risk:** This is the impact of an increase or decline in the overall market (i.e. equity market, fixed income market, real estate market, etc.) on the value of your portfolio. These markets may fluctuate based on a variety of factors, including general economic and market conditions, interest rates, regulatory changes, political developments, and investor sentiment.
- **Equity Risk:** This is the risk associated with ownership of equity as individual portfolio investments. Unlike debt securities, equity securities do not have a fixed principal amount and do not mature at a stated period.
- **Interest rate risk:** This is the impact of a change in the level of interest rates on the value of your portfolio of income-based equities (dividend paying companies) and fixed income instruments. As interest rates rise, the value of these investments may fall.
- **Inflation risk:** This is the risk of a decline in the purchasing power of your savings due to a general rise in prices which reduces the real rate of return to investors. Inflation can also have an adverse impact on business operations as the rise in key input costs could materially impact profitability.
- **Currency risk:** This is the risk of a decline in the value of securities held in a foreign currency, due to an appreciation in the value of the Canadian dollar relative to that of the foreign currency. It also addresses the risk of a decline in the profits of a company due to fluctuations in the value of currencies in which the company transacts with customers or suppliers, or currencies in which the company holds foreign assets.
- **Company specific risk:** This is the risk of unexpected company specific events that can affect the value of its stock, bond or investment in real estate or a private business such as, changes in market share, competitive environment, significant unexpected costs, and the departure of key personnel. This risk is more pronounced in the private equity securities KCEP invests in due to a higher capital allocation as compared to public equity investments.
- **Concentration risk:** This is the risk that any one security or group of securities may have concentrated investment exposure such as to a geographical area, a business model, or a management team. KCEP holds investments in "connected issuers" to KAM, specifically KAI Health Services Inc. (KHS), and KAI Properties Inc. (KPI), (together the KAI Issuers). There is common mind and management between KAM and the KAI Issuers which contributes to an increase of concentration risk to investors in KCEP.
- **Liquidity risk:** This is the risk that an investment cannot be readily sold to cash and that process might take an elongated period of time with no guarantee that it would be done in a timely fashion. The KAI Issuers are all illiquid securities. There

is no market in which the shares of KAI Issuers can be sold and you should expect the KCEP to hold KAI Issuers shares for a period of at least 10 years and perhaps for a longer period of time.

- Derivative investment risk: This is the risk that a counterparty to a derivative contract is unable to meet its obligations.
- Cease trading risk: This is the risk that an individual security within the portfolio investments held by the Pool may be cease-traded by order of a securities regulatory authority or in the event of a trading halt, circuit breaker, or market closure by order of an exchange.
- Pool run risk: This is the risk that a substantial number of unitholders redeem out of the Pool all at once or within a short period of time. In such an event the Trustees of the Pool may take action to protect the interest of all unitholders, including the remaining unitholders who are not seeking to redeem which would result in the Pool becoming illiquid to all unitholders.
- Disposition risk: KAI Holdings Inc. (KHI) may determine that a disposition of all or any part of a KAI Issuer is a valid business decision. Any such transaction would be carried out in accordance with applicable law, and unitholders of KCEP would not, as such, have any right to approve or disapprove such a transaction. Any cash received by KCEP as a result of such a transaction would be invested by KAM in accordance with KCEP's investment objective.
- Pool unitholder liability risk: The trust agreement for each Pool provides that no unitholder will be subject to any liability whatsoever, in tort, contract or otherwise, to any person in connection with the investment obligations, affairs or assets of the Pool and all such persons shall look solely to the Pool's assets for satisfaction of claims of any nature arising out of or in connection therewith. There is a risk, which is considered by KAM to be remote in the circumstances, that a unitholder could be held personally liable, notwithstanding the foregoing statement in the trust agreement, for obligations of the Pool to the extent that claims are not satisfied out of the assets of the Pool. It is intended that the operations of the Pool will be conducted in such manner so as to minimize such risk. In the event that a unitholder should be required to satisfy any obligation of the Pool, such unitholder will be entitled to reimbursement from any available assets of the Pool.

Risks related to private equity investing

The KAI Issuer shares are illiquid securities and will only be allocated to accounts where it is deemed to be suitable based on the information collected by KAM. KCEP invests between 15% and 25% of the pool in the KAI Issuers, with a target of 20%. The KAI Issuers present specific risks not commonly found in publicly available securities. Risks specific to private equity investing and investments in the KAI Issuers specifically are outlined in section *Investment risks* of the *Relationship Disclosure Document* and the KAI Issuer *Fact Sheets* included in your client document package.

Related and connected issuer conflicts of interest

Under applicable securities laws, KCEP is a “connected issuer” of KAI Asset Management Inc. (KAM) as Paul Allard and Robert MacKay are advising representatives, directors, and officers of KAM which is the trustee and investment manager of KCEP. KAI Holdings Inc. (KHI) is a “related issuer” to KAM as it controls KAM. Paul Allard and Robert MacKay are the directors and officers of KHI, and indirectly own substantially all the equity of and control KHI. In addition, the KAI Issuers are all “connected issuers” of KAM. In consideration of management services that KHI provides to the KAI Issuers pursuant to management agreements with the KAI Issuers, KHI receives fees (KAI Issuer Fees), which indirectly benefit Mr. Allard and Mr. MacKay. The KAI Issuer Fees are paid by the KAI Issuers directly, which has the effect of reducing funds that might otherwise be available to be paid as distributions to the owners of the KAI Issuers including clients invested in KCEP.

Mitigation of related and connected issuer conflicts of interest

As registrants under applicable securities laws, and as CFA Charterholders, each of Mr. Allard and Mr. MacKay are obligated to act in the best interests of their clients. KAM has established policies, internal controls, and independent processes that are intended to safeguard client interests and to provide reasonable assurance that activities are carried out appropriately. In order to ensure that all proposed material transactions involving the KAI Issuers are considered independently from the interests of Mr. Allard and Mr. MacKay, the Board of Directors of KAM has appointed an Independent Acquisitions and Compliance Committee (IACC) comprised of two independent professionals whose role is to review each such matter referred to the IACC by management and assess whether KAM has addressed conflict matters in the best interest of KAM's clients. This committee is intended to provide assurance that the conflicts of interest that may exist in the organizational structure are managed appropriately and do not disadvantage KAM clients.

KAI Issuer Fees

Your managed account will effectively bear a share of the below fees based on its proportionate ownership of the KAI Issuers within KCEP. Please refer to the KAI Issuer *Fact Sheets* for a detailed explanation of the specific fee structures within those entities. The *KAI Issuer Fees* section in the example below refers to the numerical examples given in the KAI Issuer *Fact Sheets*.

The following illustrates a hypothetical example of the different fee components charged within the KAI Issuers that have an effect on KCEP and its unitholders. The fees charged to the KAI Issuers are variable from year to year depending on performance, acquisition/disposition activity however this example is intended to give an accurate representation:

KCEP - Annual KAI Issuer Fees Example				
KCEP Investor		$1,000,000		
Allocation Breakdown				
	80% Cash and Public Securities	$800,000	KAI Issuer Fees	
	14% KAI Properties Inc.	$140,000	3.1%	$4,326
	6% KAI Health Services Inc.	$60,000	7.7%	$4,620
KAI Issuer Fees Within KCEP				$8,946
KAI Issuer Fees as a % of Funds Invested in KAI Issuers				4.5%
KAI Issuer Fees as a % of Total Investment in KCEP				0.9%

KAI Issuer expense recoveries

KAM provides the services of certain KAM employees to the KAI Issuers which the directors of the KAI Issuers have determined to be necessary for the operations of the KAI Issuers. KAM charges the KAI Issuers on a cost recovery basis with no mark-up for the services.

Waiver of KAI Issuer Fees

KHI shall waive all or the necessary part of the KAI Issuer Fees for any given quarter if KHI reasonably determines, acting in good faith, that the KAI Issuer will be unable to satisfy payment of its then-current debt obligations. For sake of certainty, any KAI Issuer Fees that are waived pursuant to this paragraph are not accrued or deferred; they are waived.

KAI Issuers Valuations

KAI Issuer valuations are prepared on a quarterly basis to determine the share price of KAI Issuers, which is then reflected in managed accounts and in the KCEP. KAM engages an independent Chartered Business Valuator firm (CBV) to prepare valuations for each of the KAI Issuers. The Independent Acquisition and Compliance Committee must approve the KAI Issuer Valuation policy and must review the appointment of the independent valuators.

For each KAI Issuer the CBV prepares a *Comprehensive Valuation Report* in accordance with the practice standards set out by the Canadian Institute of Chartered Business Valuators on an annual basis. Comprehensive valuation procedures performed by the CBV involve the highest standard of review and analysis including comprehensive review and analysis of the business and the industry and all other relevant information and factors used in the calculation. Interim quarterly valuations are determined by the independent CBV based on Estimation Valuation Procedures.

In any interim quarter where a significant “trigger event” occurs, KAM will consult with the CBV on the appropriate valuation report standard and may request a comprehensive valuation for that period. A “trigger event” is an event which may result in the impairment of assets, as described in *IAS 36.12*, which lays out external and internal indications of impairment. A trigger event will be considered significant if it would result in a material increase or decline in the share price of a KAI Issuer.

Treatment of KAI Issuer Fees in relation to KAI Issuer Valuations

KHI charges KAI Issuer fees to the KAI Issuers as explained above in consideration of management services that it provides the KAI Issuers pursuant to management services agreements. The KAI Issuer Fees currently include performance fees and monitoring fees. Prior to November 1, 2019, KAI Issuer Fees also included shareholder equity management fees. KAI Issuer Fees do not relate to operational corporate overhead but relate to asset management activities provided by KHI to the KAI Issuers. Shareholders of the KAI Issuers do not pay these expenses directly.

BDO Canada LLP (the CBV) performs quarterly independent valuations of the KAI Issuers for KAM. The CBV utilizes a valuation methodology using a cost assumption that excludes the future impact of the KAI Issuer Fees. The CBV has determined that this cost assumption is appropriate as they have assumed that a prospective purchaser of the KAI Issuers may not be required to incur the KAI Issuer Fees if they intend to manage the investments directly. If the CBV determines that the KAI Issuer Fees are likely to remain in place for any and all third-party purchasers, then their conclusion of Fair Market Value would decrease. It should be noted that historical KAI Issuer Fees are accounted for in each valuation as the KAI Issuer Fees incurred reduce cash balances which directly impact equity value at the valuation date. This approach is set out in detail in the independent valuation reports of the KAI Issuers which establish these valuations and are in conformity with the standards of the Canadian Institute of Chartered Business Valuators (CICBV). The valuations are used for purposes of determining the KAI Issuer share prices, portfolio management fees charged to clients, and calculating performance results.

The cost assumption utilized within the methodology presents the potential for a conflict of interest for KAM because excluding the future impact of KAI Issuer Fees has the effect of producing a higher reported Fair Market Value for the KAI Issuers which would determine higher investment portfolio management fees and performance results. KAM has thoughtfully considered this cost assumption and has determined that the CBV's methodology achieves a result which is fair to clients as it best reflects the value the KAI Issuers in a prospective sale situation. Regardless of KAM's opinion concerning the fairness of the approach chosen by the CBV, KAM has taken multiple steps to respond to this potential conflict, specifically:

- The appointment of the CBV was approved by the IACC who confirmed that the firm was independent from KAM and properly qualified.
- The CBV performed the KAI Issuer valuations in accordance with CICBV standards and determined appropriate methodology and assumptions independently, without influence by KAM.
- KAM presented the potential conflict of interest related to the CBV's treatment of the KAI Issuer Fees to the IACC who determined that KAM's response achieves a fair and reasonable result for clients.
- KAM has disclosed the cost assumption to clients.