



ARC

INVESTMENTS

2022

Integrated Annual Report

RISK REPORT

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The ARC Fund benefited from the diverse nature of the investments in its portfolio which continues to mitigate against excessive concentration risk within particular sectors of the economy, and which was of particular relevance in the challenging environment caused by the Covid-19 pandemic.

Overview

The ARC Investments Board is responsible and accountable for implementing an effective policy framework to ensure adequate risk assessment, management and oversight. The Board is supported by the Audit and Risk Committee in fulfilment of these responsibilities, with input from the respective Board Committees.

The Fund and its underlying investee companies are predominantly exposed to market conditions, as well as the performance of the South African economy. The following factors impacted the operating environment :

- sovereign credit risk;

- societal/global issues;
- poor management of public funds and related allegations of grand-scale corruption and how it affects business sentiment;
- investment market performance;
- significant increases in interest rates;
- increase in global inflation and yield curves rates;
- volatile exchange rates; and
- disruption in the supply chain

The diverse nature of our portfolio allows us to mitigate concentration risk.

□ [Refer to page xx for more information on the operating context](#)

Enterprise risk management journey

The following journey has been followed by the management team to establish the risks to the business and develop action plans and possible opportunities resulting from those risks.



Risk philosophy

Ethical leadership and high calibre of human capital are the cornerstones of the Company's risk management philosophy, as these ensure entrepreneurial flair, sensible business decision-making, sound corporate reputation and effective governance.

Risk tolerance

The Company encourages the taking of controlled risks, the grasping of new opportunities and the use of innovation to further the interest of the organisation and achieve its objectives, provided the resultant exposures are within the pre-defined risk tolerance range of the Company. The assumption of any substantial risk outside its predetermined tolerance levels requires specific discussion and approval at the Board level.

Actions leading to the following constitute unacceptable risk:

- non-adherence to applicable laws and regulations;
- censure/fines by regulatory bodies;
- threat to the existence of the Company;
- engaging in activities that impair objectivity and independence in decision-making; and
- creation of a material level of adverse publicity and reputational damages.

Risk appetite

Being a listed investment holding entity, the Company follows a moderate risk approach on a combined-portfolio level considering:

- an appropriate balance between early-stage (start-up) businesses, which generally carry a relatively higher business risk and increased uncertainty in terms of cash generation and cash flow cycle, versus more mature businesses, which generally display relatively lower business risk, as well as a history of cash flow generation and a more predictable cash flow cycle;
- capable and experienced investment partners with an alignment of interest between the ARC Fund and the leadership at the respective investee companies;
- a market-appropriate blend of risk and return profile of the investment portfolio;
- potential concentration risk within the portfolio;
- financial ratios relevant to measuring performance ;
- the risk-reward profile of prospective opportunities;
- liquidity risk, including the availability of funding and the capital and cash flow needs of the underlying investments; and
- current and expected future funding costs.

Our approach covers a wide spectrum of risks including:



□ For more information on our investment philosophy, refer to page xx

Risk governance and management process

Given that UBI GP Co, as the General Partner, has the responsibility to manage the ARC Fund, it applies the same principles and standards for risk management as approved by the ARC Investments Board. The ARC Fund’s approach to risk management is an ongoing coordinated process that identifies, assesses, controls and monitors risks, to increase the probability of success and reduce the likelihood of failure.

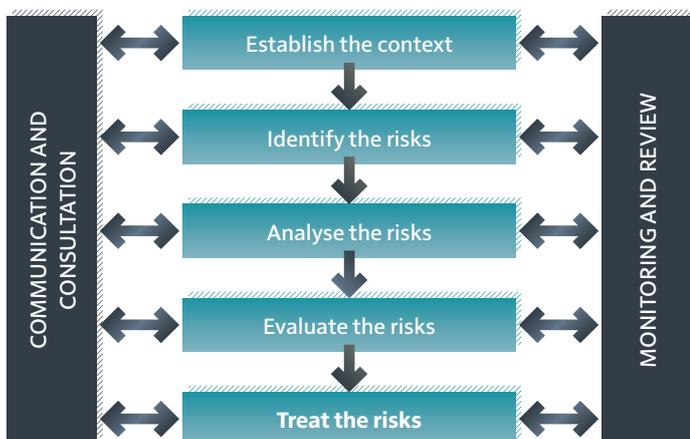
Governance and oversight

The Board has overall responsibility for the entire risk management process, as well as the effectiveness of the process.

The Board provides oversight regarding risk management by:

- monitoring the extent to which management has established effective risk management in the organisation;
- approving the Company’s risk appetite;
- reviewing and assessing risk within the Company’s portfolio and considering it against the ARC Investments’ risk appetite; and
- being apprised of the most significant risks and whether management is responding appropriately and timeously.

Risk management processes



Source: ISO 31000: 2018

Assurance processes

The Company and the ARC Fund use four levels of oversight to achieve a high level of combined assurance.



Emerging risks

ARC Investments and the ARC Fund recognise effective identification and monitoring of, and response to, emerging risks as a critical component of the Group’s value creation and value preservation efforts. The Company takes cognisance of the following emerging risks to the extent that they have a bearing on the Company itself, as well as on its underlying investee companies:

- restoring livelihoods and social cohesion (2022 World Economic Forum report);
- extreme weather (2022 Work Economic Forum report); and
- technological risk - cyber (2022 World Economic Forum report);

Focus areas for the reporting year

The focus areas for risk management in the current year include managing and monitoring the overall adverse impact of the weak South African economy, which was exacerbated by the Covid-19 pandemic and civil unrest.

Effectiveness of risk management

Our approach to risk management is to support and assist the management of our respective investee companies with the achievement of their strategic objectives. This would naturally include a focus on the execution of the risk management process. Risks are analysed and evaluated based on their potential exposure and the impact on our ability to achieve our strategic objectives.

Our risk management process includes specific provisions for identifying and realising business opportunities. We define an opportunity as a set of circumstances with an uncertain outcome that can be capitalised upon, requiring the commitment of resources and that may involve risk exposure. The Board is satisfied that a robust risk management framework is in place and that the Company is adhering to its approved risk philosophy and tolerances.

Internally, management is engaging in formal quarterly discussions to assess the risk environment. Key decisions are included in the updated risk dashboard.

Future focus areas

- Establish risk management practices by embedding the combined assurance model
- Continue to monitor risks based on the risk appetite levels and risk tolerance levels

RISK REPORT

Key risks

The topics addressed on the following pages represent the most significant areas of risk for ARC Investments. The table should be read in conjunction with our material matters to obtain a comprehensive view of the investment strategy within which the Company, through the ARC Fund, operates.

□ For our material matters, refer to page xx

OUR STRATEGY	OUR CAPITALS IMPACTED	RISK RATING
Build Optimise Grow	Financial Capital Human Capital Social and relational Capital Intellectual Capital Manufactured Capital Natural Capital	LOW MEDIUM HIGH

MATERIAL MATTERS		
Capital allocation targeted at investments where returns exceed the hurdle rate	Driving synergies	Global societal issues
Growth in assets under management	Good stakeholder relations and networks	B-BBEE Maintaining the ARC Fund's Black ownership status
Market-related portfolio performance		

ARC INVESTMENTS RISK REGISTER							
Risk Component	Risk	Mitigating factors and controls in place as well as action items and opportunities	Inherent risk rating	Residual risk rating	Capitals applied/ impacted	Material matters	Strategic linkage
SA COUNTRY RISK	THE DOWNGRADE OF SA INVESTMENT STATUS Empowerment, which is central to our value proposition, is anchored in South African legislation. Therefore, our investment focus is on South Africa, where we can add value to our business partners.	Mitigating factors • Market segment diversification in the portfolio Action items/opportunities • Continue to see diversification opportunities outside South Africa and invest in defensive assets			 		 GROW
	POOR ECONOMIC GROWTH IN SOUTH AFRICA Our investment focus is mainly on South Africa.	Mitigating factors • Market segment diversification in the portfolio			 		 GROW
	INCREASE IN INTEREST RATES Capacity roll-up of up to 120% of the facility amount. Capacity will change when the investments in the ARC Fund start declaring dividends.	Mitigating factors • Monitor the impact of the interest rate			 		 OPTIMISE

ARC INVESTMENTS RISK REGISTER							
Risk Component	Risk	Mitigating factors and controls in place as well as action items and opportunities	Inherent risk rating	Residual risk rating	Capitals applied/ impacted	Material matters	Strategic linkage
INVESTMENT RISK	<p>FAILURE OF MAJOR/SIGNIFICANT INVESTMENT</p> <p>Any single investment will be capped at 35% of the total portfolio value - when the percentage is triggered, the portfolio will be rebalanced. No appetite for actions that threaten the existence of the Company.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Quarterly management review of the portfolio Investment Committee oversight and Board delegations <p>Action items/opportunities</p> <ul style="list-style-type: none"> Continue to diversify and rebalance the portfolio with a mix of assets that are listed, provide growth in the portfolio and generate cash 			 	 	 BUILD
	<p>CONCENTRATION RISK WHICH CANNOT BE MITIGATED</p> <p>Any single investment will be capped at 35% of the total portfolio value.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Quarterly management review of the portfolio Investment Committee oversight and Board delegations <p>Action items/opportunities</p> <ul style="list-style-type: none"> Continue to diversify and rebalance the portfolio with a mix of assets that are listed, provide growth in the portfolio and generate cash 			 	 	 BUILD OPTIMISE
	<p>DISCOUNT TO NAV DOES NOT REDUCE SIGNIFICANTLY</p> <p>Pursuing investment in the sector of our choice with a yielding potential of 16% IRR. Low appetite for start-ups and pre-revenue generating investments not part of the investment strategy.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Continuous communication of our business case and performance through quarterly and annual reports Demonstrate intrinsic value through high sales proceeds on disposals Quarterly review of the portfolio <p>Action items/opportunities</p> <ul style="list-style-type: none"> Continuous reporting of the disposals' IRR rate achieved at the exit stage Consider disposals that are not part of the investment strategy and contribute 2% or less of the total portfolio value Pursue fewer investments that are in the pre-revenue stage and not part of the investment strategy 			 	 	 OPTIMISE
	<p>NON-PERFORMANCE OF THE UNDERLYING INVESTMENTS</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Semi-annual portfolio reviews Investment Committee oversight Regular meetings with investee company leadership to discuss strategy, progress and performance of the underlying businesses Drive strategic direction by exercising the minority protections Promotion of synergies/collaborations amongst the investee companies through the Partners Conference Appointment of Board members to respective Boards <p>Action items/opportunities</p> <ul style="list-style-type: none"> Continuous monitoring and implementation of synergies identified during the deal-making stage 			 	 	 OPTIMISE

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Risk Component	Risk	Mitigating factors and controls in place as well as action items and opportunities	Inherent risk rating	Residual risk rating	Capitals applied/ impacted	Material matters	Strategic linkage
FINANCIAL RISK	INABILITY TO RAISE CAPITAL Capacity and appetite to increase the facility to R1.5 billion or 10% of NAV. Capacity will increase with growth in dividends from investee companies. The Company's appetite for new investment commitments is limited to its ability to raise cash through disposals.	Mitigating factors <ul style="list-style-type: none"> • Good relationships with corporate funders • Being part of the UBI Group affords the ARC Fund access to a strong Group backing • Ongoing monitoring of debt levels • Continuous monitoring of the covenants • Adhere to the funding contract and compliance terms • Pro-active engagement with banks to determine appetite to refinance before the debt becomes due for refinancing. Action items/opportunities <ul style="list-style-type: none"> • The debt in ARC was refinanced with 3-year debt to be repaid in December 2025 • Monitoring of dividend and cash levels in the underlying entities to ensure that there is no excess capital that destroys value which can be distributed to the holding company • Dispose of assets that are earmarked for sale to enable the ARC Fund to fund capital commitments 			 	 	OPTIMISE
	LIQUIDITY RISK Keeping cash resources of 5% of the NAV to enable the support of the underlying entities, honour commitments and meet the operational requirements.	Mitigating factors <ul style="list-style-type: none"> • The ARC Fund's ability to leverage the Fund as well as portfolio assets • Having strong financial monitoring and reporting processes in place • Being part of the UBI Group affords the ARC Fund access to a strong Group backing • Ongoing cash flow management of dividend income, preference shares, investments and disposals Action items/opportunities <ul style="list-style-type: none"> • Dispose of assets that are earmarked for sale to enable the ARC Fund to run its operation until its able to generate adequate dividends 			 		OPTIMISE GROW
REGULATORY RISK	ADVERSE CHANGES IN B-BBEE CODES Striving to maintain the Black ownership status for the Fund and UBP GP.	Mitigating factors <ul style="list-style-type: none"> • Keeping broad base of UBI shareholders intact • Pro-active engagement with the regulator • Structuring of the terms of the C-share in ARC Investments • Ongoing monitoring of the donation's payments by the trust on an annual basis to enable UBI to claim the BEE points • External BEE rating of UBI and its subsidiaries • Pro-active monitoring of the impact of BEE on the restructuring and implementation of new deals Action items/opportunities <ul style="list-style-type: none"> • Consideration of dividend declaration to curb the sale of shares at Provincial levels • The Trustees should consider donation's annually, based on Trust deed 			 	B-BBEE	OPTIMISE

ARC INVESTMENTS RISK REGISTER							
Risk Component	Risk	Mitigating factors and controls in place as well as action items and opportunities	Inherent risk rating	Residual risk rating	Capitals applied/ impacted	Material matters	Strategic linkage
REGULATORY RISK	<p>FAILURE TO MEET REGULATORY REQUIREMENTS</p> <p>No appetite for activities that lead to the non-adherence to the applicable laws and regulations.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Active monitoring by legal and compliance team with the assistance of deal executives on the underlying investee entities where UBI/ ARC FSH/ ARC FSI is a significant owner. Annual declaration on compliance by investee companies 			 		 OPTIMISE
REPUTATIONAL RISK	<p>POLITICALLY EXPOSED PEOPLE (PEP)</p> <p>No appetite for action that could lead to the creation of a material level of adverse publicity and reputational damages.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Key shareholders, Board members and the leadership are aware and sensitive to governance and reputation concerns within national government and ruling political party regarding PEPs 			 		 OPTIMISE
	<p>INVESTMENT DECISIONS THAT COULD RESULT IN ENVIRONMENTAL AND SOCIETAL ISSUES</p> <p>No appetite for risks which result in environmental and social issues. However, where the exposure has occurred, the Company will engage its partners to assist them and expect that appropriate steps will be actioned.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Active monitoring where investee companies are involved to avoid major environmental or societal impact issues 			 	 	 OPTIMISE
	<p>INVESTMENT PARTNERS WHO ARE EMBROILED IN GOVERNANCE ISSUES</p> <p>No appetite for risks which results in environmental and social issues. However, where the exposure has occurred, the Company will engage its partners to assist them and expect that appropriate steps will be actioned.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Active monitoring and actual disinvestments where the leadership of investee companies are embroiled in governance irregularities 			 		 OPTIMISE
	<p>CYBER RISK</p> <p>Cyber security poses risks to the Company's daily operations. An external service provider has been contracted to monitor and treat any potential risks to the business.</p>	<p>Mitigating factors</p> <ul style="list-style-type: none"> Preventative controls have been implemented to check incoming emails for authenticity Controls have been implemented to ensure that external parties do not attempt to impersonate the ARC domain 			 		 OPTIMISE