



# ARC INVESTMENTS

## Risk Report 2023

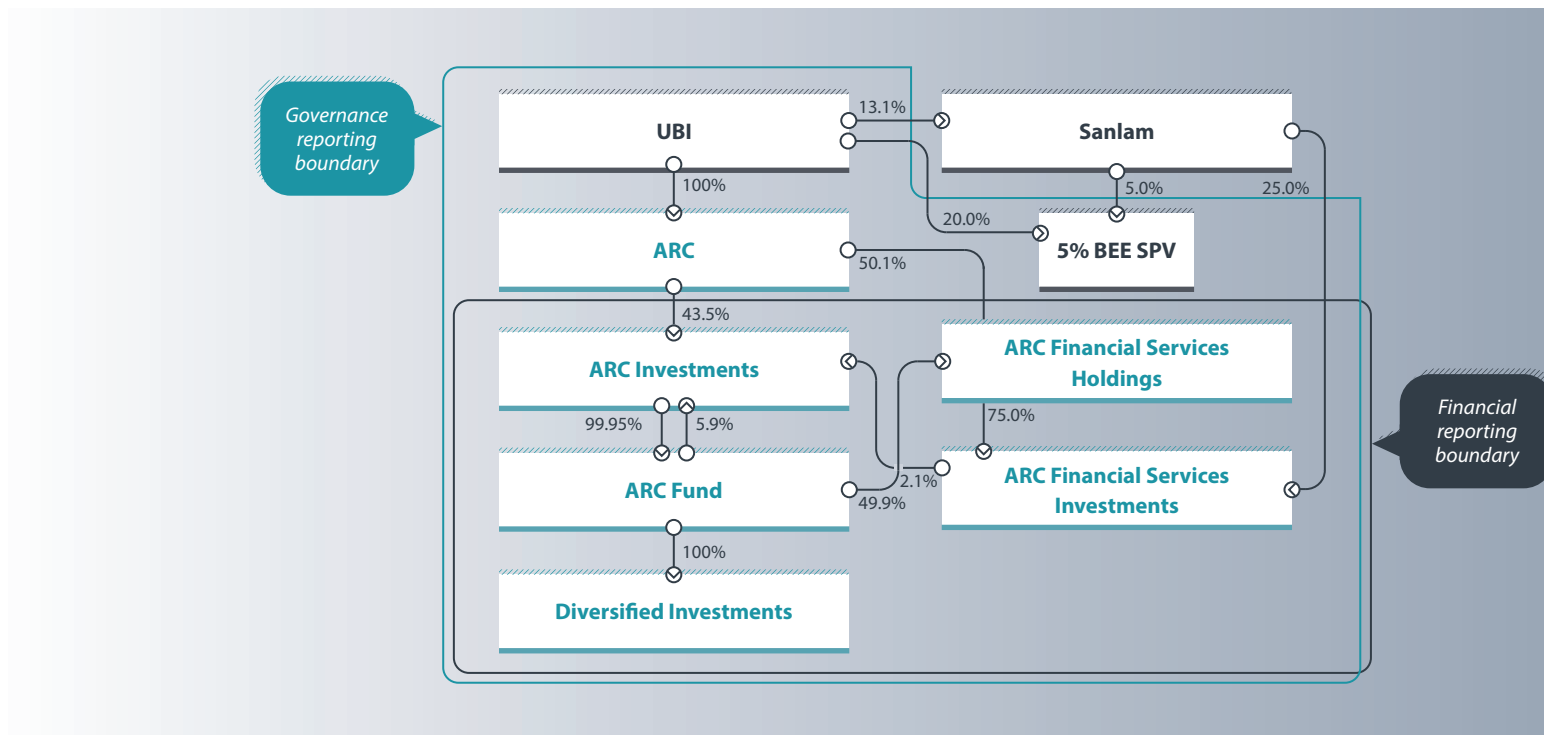


# RISK REPORT

ARC Investments Limited is an investment holding company that acquires minority interests in quality unlisted and listed businesses at a discount by leveraging its compelling empowerment credentials. The Company manages a portfolio of 52 mainly South African investments, valued at R16 363 million. ARC Investments Limited forms an integral part of the Ubuntu-Botho Investments (UBI) Group structure. The Company is incorporated in the Republic of Mauritius and listed on the Johannesburg Stock Exchange (JSE), with a secondary listing on A2X.

The diversified nature of the ARC Fund investment portfolio serves as an essential mitigator against excessive concentration risk within particular sectors of the economy. It again contributed to a resilient portfolio performance notwithstanding a particularly weak South African economy.

## REPORT BOUNDARY AND SCOPE



# RISK REPORT

## OVERVIEW

The responsibility and accountability for implementing an effective policy framework to enable proper risk assessment, management and oversight rests with the ARC Investments Board. The Audit and Risk Committee assists the Board in carrying out these duties, with input from the relevant Board Committees.

The risk in the ARC Fund and its underlying investee companies' ecosystem is predominantly determined by the performance of the South African economy and related market conditions. **The following factors impacted the operating environment:**

- 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;
- disruption in the supply chain;
- prolonged status as a grey listed country (refers to a global attempt to prevent illicit funds from being channelled toward terrorism);
- load shedding; and
- the risk of potential sanctions or loss of trade agreement with South Africa.

 **Refer to page 10 in the Integrated Annual Report for more information on the operating context.**

## THE ENTERPRISE RISK MANAGEMENT JOURNEY



## RISK PHILOSOPHY

Ethical leadership and a 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 seizing of new opportunities and the use of innovation to further the interest of the organisation and achieve its objectives, provided that 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 that may result in any of the following outcomes constitute prohibited risk:

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

# RISK REPORT

## RISK APPETITE

Being a listed investment holding entity, the Company's investment philosophy is predicated on 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, and 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 considers a wide spectrum of risks including:



 For more information on our investment philosophy, refer to page 9 in the Integrated Annual Report

## RISK GOVERNANCE AND MANAGEMENT PROCESSES

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.

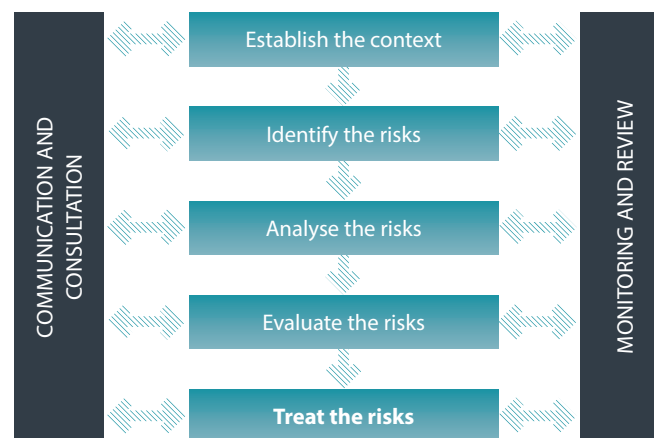
## GOVERNANCE AND OVERSIGHT

The ARC Investments 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 (2023 World Economic Forum report);
- extreme weather (2023 Work Economic Forum report); and
- technological risk - cyber (2023 World Economic Forum report);

## FOCUS AREAS FOR THE REPORTING YEAR

The focus for risk management in the current year was predominantly aimed at:

- managing and monitoring the overall adverse impact of the weak South African economy;
- establishing risk management practices by embedding the combined assurance model; and
- formulating a robust risk management framework which enables the Company to predict and prevent critical events in future.

# RISK REPORT

## 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



- Continue to monitor risks based on the risk appetite levels and risk tolerance levels with a particular focus on liquidity levels; and
- Continue to identify opportunities to mitigate risk; and
- Promote an agile approach to risk management through continuous monitoring of risk appetite and risk tolerance levels.




















## 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.

# RISK REPORT

## Keys used in the table below:

OUR STRATEGY	OUR CAPITALS IMPACTED	RISK RATING
 Build  Optimise  Grow	 Financial Capital  Social and relational Capital  Manufactured Capital  Human Capital  Intellectual Capital  Natural Capital	 LOW  MEDIUM  HIGH
MATERIAL MATTERS		
 Capital allocation targeted at investments where returns exceed the hurdle rate  Growth in assets under management  Enhance portfolio performance through synergies  Load shedding impact  Global societal issues  Good stakeholder relations and networks  B-BBEE Maintaining the ARC Fund's Black ownership status		

 Our material matters are available at: <https://arci.mu/investor-relations/#integrated-reports>

## 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	<b>THE DOWNGRADE OF SOUTH AFRICA'S INVESTMENT STATUS</b> 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.	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Market segment diversification in the portfolio</li> </ul> <b>Action items/opportunities</b> <ul style="list-style-type: none"> <li>Continue to seek diversification through opportunities outside South Africa and invest in defensive assets</li> </ul>			  		GROW 
	<b>POOR ECONOMIC GROWTH IN SOUTH AFRICA</b> Our investment focus is mainly on South Africa	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Market segment diversification in the portfolio</li> </ul> <b>Action items/opportunities</b> <ul style="list-style-type: none"> <li>Continue to seek diversification through opportunities outside South Africa and invest in defensive assets</li> </ul>			 	 	GROW 
	<b>INCREASE IN INTEREST RATES</b>	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Monitor the impact of the interest rate</li> <li>Capacity will change when the investments in the ARC Fund start declaring dividends</li> </ul>			 		OPTIMISE 

# RISK REPORT

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INVESTMENT RISK	<b>FAILURE OF MAJOR/SIGNIFICANT INVESTMENT</b> No appetite for actions that threaten the existence of the Company.	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Quarterly management review of the portfolio</li> <li>Investment Committee oversight and Board delegations</li> <li>Sector contribution is limited to 40%.</li> <li>Any single investment will be capped at 35% of the total portfolio value – when the percentage is triggered, the portfolio will be rebalanced</li> </ul> <b>Action items/opportunities</b> <ul style="list-style-type: none"> <li>Continue to diversify and rebalance the portfolio with a mix of assets that provide growth in the portfolio, are future focused and/or technology-driven businesses and can generate cash and dividends</li> </ul>			  	   	BUILD
	<b>CONCENTRATION RISK WHICH CANNOT BE MITIGATED</b>	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Sector contribution is limited to 40%</li> <li>Any single investment will be capped at 35% of the total portfolio value</li> <li>Apply thresholds for investment limits in the context of concentration risk</li> <li>Investment Committee oversight and Board delegations</li> </ul>			 		BUILD OPTIMISE
	<b>DISCOUNT TO NAV DOES NOT REDUCE SIGNIFICANTLY</b>	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Continuous communication of our business case and performance through quarterly and annual reports</li> <li>Demonstrate intrinsic value through high sales proceeds on disposals</li> <li>Semi-annual review of the portfolio</li> <li>Reduction of management fees</li> </ul> <b>Action items/opportunities</b> <ul style="list-style-type: none"> <li>Continuous reporting of the disposals' IRR rate achieved at the exit stage</li> <li>Consider disposals that are not part of the investment strategy and contribute 2% or less of the total portfolio value</li> <li>Pursue fewer investments that are in the pre-revenue stage and not part of the ecosystem</li> </ul>			  	   	OPTIMISE
	<b>NON-PERFORMANCE OF THE UNDERLYING INVESTMENTS</b>	<b>Mitigating factors</b> <ul style="list-style-type: none"> <li>Semi-annual portfolio reviews</li> <li>Investment Committee oversight</li> <li>Regular meetings with investee company leadership to discuss strategy, progress and performance of the underlying businesses</li> <li>Drive strategic direction by exercising the minority protections</li> <li>Promotion of synergies/collaborations amongst the investee companies through the Partners Conference</li> <li>Appointment of Board members to respective Boards</li> </ul> <b>Action items/opportunities</b> <ul style="list-style-type: none"> <li>Continuous monitoring and implementation of synergies identified during the deal-making stage</li> </ul>			  	  	OPTIMISE

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FINANCIAL RISK	<b>INABILITY TO RAISE CAPITAL</b>	<p><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>• Good relationships with corporate funders</li> <li>• Being part of the UBI Group affords the ARC Fund access to a strong Group backing</li> <li>• Ongoing monitoring of our capacity to raise debt</li> <li>• Ongoing monitoring of debt levels</li> <li>• Continuous monitoring of the covenants</li> <li>• Adhere to the funding contract and compliance terms</li> <li>• Pro-active engagement with banks to determine the banks' appetite to refinance before the debt becomes due for refinancing</li> </ul> <p><b>Action items/opportunities</b></p> <ul style="list-style-type: none"> <li>• The debt in ARC was refinanced with 3-year debt to be repaid in June 2026</li> <li>• 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</li> <li>• Disposal of assets that are earmarked for sale to enable the ARC Fund to fund capital commitments</li> <li>• Rewards to encourage growth and cash flow generation</li> </ul>			  	  	OPTIMISE
	<b>LIQUIDITY RISK</b>	<p><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>• The ARC Fund's ability to leverage the Fund as well as portfolio assets</li> <li>• Having strong financial monitoring and reporting processes in place</li> <li>• Being part of the UBI Group affords the ARC Fund access to a strong Group backing</li> <li>• Ongoing cash flow management of dividend income, preference shares, investments and disposals</li> </ul> <p><b>Action items/opportunities</b></p> <ul style="list-style-type: none"> <li>• Disposal of assets that are earmarked for sale to enable the ARC Fund to run its operation until its able to generate adequate dividends</li> <li>• Optimum capital allocation geared towards dividend generation</li> </ul>			  		OPTIMISE GROW
REGULATORY RISK	<p><b>ADVERSE CHANGES IN B-BBEE CODES</b></p> <p>Striving to maintain the Black ownership status for the Fund and UBP GP</p>	<p><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>• Keeping a broad base of UBI shareholders intact</li> <li>• Pro-active engagement with the regulator</li> <li>• Structuring of the terms of the C-share in ARC Investments</li> <li>• Ongoing monitoring of the donation's payments by the trust on an annual basis to enable UBI to claim the BEE points</li> <li>• External BEE rating of UBI and its subsidiaries</li> <li>• Pro-active monitoring of the impact of BEE on the restructuring and implementation of new deals</li> <li>• Continuous donations annually, based on Trust deed</li> </ul> <p><b>Action items/opportunities</b></p> <ul style="list-style-type: none"> <li>• Consideration of dividend declaration to curb the sale of shares at Provincial levels</li> </ul>			 	B-BBEE	OPTIMISE



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## ARC INVESTMENTS RISK REGISTER

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<b>REGULATORY RISK</b>	<p><b>FAILURE TO MEET REGULATORY REQUIREMENTS</b></p> <p>No appetite for activities that lead to the non-adherence to the applicable laws and regulations</p>	<p><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>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.</li> <li>Annual declaration on compliance by investee companies</li> </ul>			 		OPTIMISE
<b>REPUTATIONAL RISK</b>	<p><b>POLITICALLY EXPOSED PEOPLE (PEP)</b></p> <p>No appetite for action that could lead to the creation of a material level of adverse publicity and reputational damages</p>	<p><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>Key shareholders, Board members and the leadership are aware and sensitive to governance and reputation concerns within the national government and ruling political party regarding PEPs</li> </ul>			  		OPTIMISE
	<p><b>INVESTMENT DECISIONS THAT COULD RESULT IN ENVIRONMENTAL AND SOCIETAL ISSUES</b></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><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>Active monitoring where investee companies are involved to avoid major environmental or societal impact issues</li> </ul>			  	 	OPTIMISE
	<p><b>INVESTMENT PARTNERS WHO ARE EMBROILED IN GOVERNANCE ISSUES</b></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><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>Active monitoring and actual disinvestments where the leadership of investee companies are embroiled in governance irregularities</li> </ul>			  		OPTIMISE
	<p><b>CYBER RISK</b></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><b>Mitigating factors</b></p> <ul style="list-style-type: none"> <li>Preventative controls have been implemented to check incoming emails for authenticity</li> <li>Controls have been implemented to ensure that external parties do not attempt to impersonate the ARC domain</li> </ul>			  		OPTIMISE