

AIP CONVERTIBLE PRIVATE DEBT FUND

Q3 2021 Commentary

The AIP Convertible Private Debt Fund LP (“Fund”) provides access to senior secured convertible loans to North American small cap companies, with a focus on generating superior risk-adjusted returns and capital protection. The Fund focuses on generating synergies and value for the borrower by assisting with growth planning, while the conversion feature allows for participation in equity appreciation.

The Fund’s strategy is to capitalize on a lack of funding for publicly traded small and micro-cap companies in North America. With investors flocking to a passive investing strategy, companies that do not fit into an index tend to be overlooked and trade at a significant discount to the rest of the market.

Our experience in the space and a lack of competition allows us to negotiate favourable terms with borrowers. We typically negotiate significant equity participation, while having perfected senior security over Borrower’s assets.

Performance as at September 30th, 2021 – Class A (%)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2021	0.52	3.05	1.03	0.10	1.83	-0.35	0.28	0.40	0.32				7.36
2020	0.76	0.55	0.97	0.96	1.49	0.27	0.72	2.32	1.33	1.10	0.53	2.05	13.85
2019	1.07	0.92	1.96	1.15	3.30	0.63	0.62	1.10	0.05	1.96	1.07	2.89	18.15
2018	5.41	-0.46	0.52	1.49	4.28	7.19	4.57	10.70	-0.34	-2.40	1.56	-6.41	28.07
2017	3.26	-0.41	0.53	0.64	1.36	-0.18	-2.88	-0.09	1.99	8.53	9.36	-1.99	21.20
2016	31.65	-0.88	0.87	3.59	-2.28	1.52	2.51	2.35	-0.12	1.01	3.35	-1.15	46.28
2015	4.72	2.28	5.03	-1.52	0.77	2.30	2.52	3.61	4.19	3.59	0.84	34.09	77.04
2014	6.58	6.92	4.90	0.75	2.81	0.48	0.40	6.54	2.70	10.58	2.44	5.15	62.81

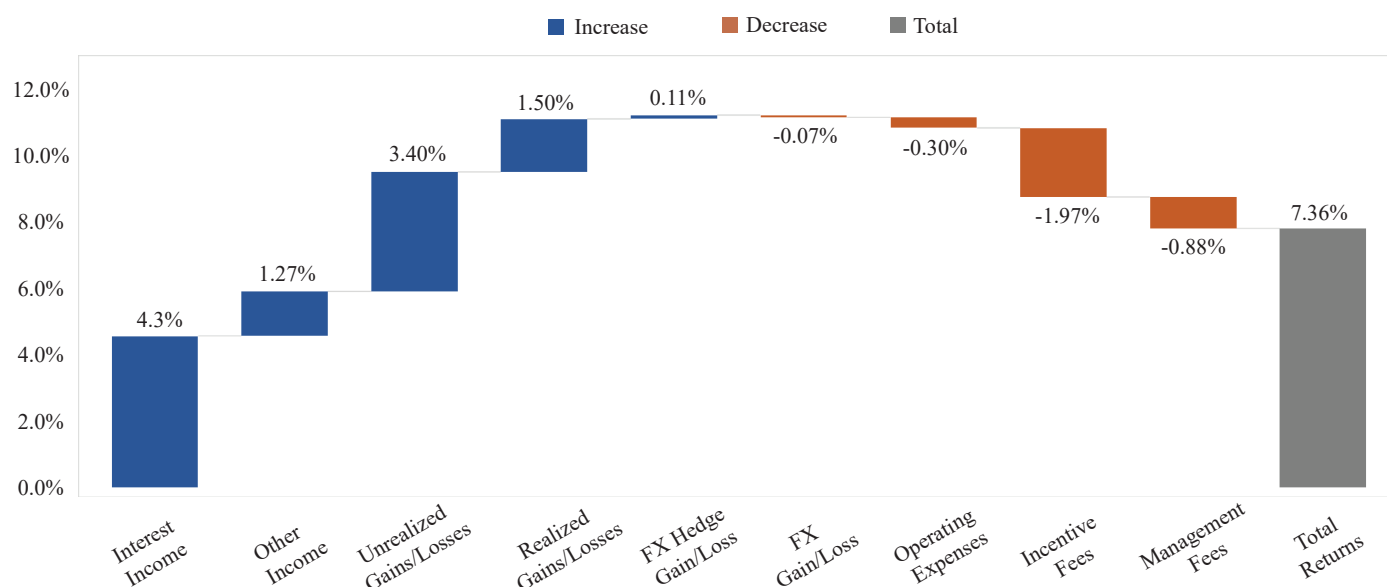
Source: AIP Management

The Fund returned +1.00% to Class A investors for the third quarter compared to +4.43% in the third quarter of 2020. The Net Asset Value of the Fund is \$89.4 million as of September 30th, 2021.

Based on our internal income attribution, about half of the Fund’s return YTD is attributable to the equity upside we were able to generate through our equity positions. Interest and other income provided a stable return as we expected, and FX was nearly a non-factor due to our USD hedging program.

As seen in the graph below, a significant portion of the equity upside is in an unrealized position in the portfolio, which may contribute to future volatility. As always, we enter any equity position (by conversion of debt or otherwise) because we believe in the underlying company’s ability to generate positive returns for the business and our investors.

Income Attribution YTD 2021



Source: AIP Management

Recent Activity

Our portfolio continues to show signs of strength and additional capital needs are anticipated. In the next few months, we anticipate a few of our positions will be exiting, which will give us further opportunity to deploy capital into new businesses. Some of the current borrowers have indicated interest in expanding their lines with AIP, happy with the way that we have managed the transactions thus far.

Issuer 9 has had significant interest from outside investors, including a joint venture between two-multibillion-dollar companies and a regional utility interested in taking an equity position in the company. To date, the company has raised an additional US\$ 8.7 million and remains on plan to up list to the NASDAQ in 2022. In accordance with the US\$ 2 million commitment from Q2, AIP issued an additional US \$1 million in notes through Q3. This position remains fully collateralized against the companies' prime assets and secured with a Corporate Guarantee, General Security Agreement, share lock ups and proxy votes from controlling shareholders. A recent industry report has priced assets of the company at US\$ 65 million, leaving a significant cushion on the AIP total position of US\$ 18.5 million. AIP has been working closely with management to drive the narrative for this business and we are excited about the potential upside this position offers to the portfolio.

Issuer 13 has recently been fielding offers from several parties interested in buying assets of the company. The borrower's business of holding a global portfolio of private investments has led to an attractive portfolio of Cannabis related businesses around the world. AIP's position is well covered by holdings in both private and public companies globally. Any sale of assets would be subject to approval by AIP and proceeds would either be used to pay down the Fund's position or make further acquisitions to strengthen upside.

Deals scheduled to close in Q3 were delayed or dropped due to issues identified during due diligence. While the Fund continues to sit on elevated cash levels, we refuse to compromise on the quality of transaction we enter in to. We continue to source new transactions and expect deployment to tick up during Q4 as borrowers seek financing to close out the year. We have term sheets signed in the consumer discretionary and cryptocurrency spaces, totalling an expected CAD 12 million in funding. We also expect financing within the portfolio to expand, with Issuer 11 actively seeking acquisition targets. We expect that this borrower will require additional capital in the near future to fund a transaction which will add meaningful revenue and assets to the business.

Portfolio

As of September 30th, there are six individual borrowers in the portfolio which is spread across financials, healthcare, consumer discretionary, and information technology sectors throughout North America. All interest from all borrowers in the portfolio have been received to date and all loans are in currently good standing.

Issuer 7's small loan outstanding continues to accrue interest as the company pursues an M&A transaction. AIP has agreed to extend the loan until the transaction has taken place, easing pressure on the management team and allowing the company to negotiate without burdensome covenants restricting their cash flow. As mentioned in our Q2 letter this position is near exit, with only CAD 269K outstanding on the loan. The remaining position is made entirely up of fees and interest accrued on the previous loan i.e., all principal has been repaid. AIP holds CAD 820K in company equity and expects any upcoming transaction to benefit the Fund and its investors through equity appreciation in the short term.

Issuer 15 has continued to make strides in the medical pain management space, providing alternatives to opioid based therapeutics. In an interview, the CEO of issuer 15 indicated that the scrutiny and lawsuits against opioid manufacturers are a major catalyst for their later stage pain management drugs. AIP continues to work with the company to unlock value through organic growth and acquisitions. AIP is standing by for a potential increase to this position, however the business has had incredible success through equity raises to generate cashflow for R&D. Proceeds on equity transactions flow to a Blocked Account which AIP maintains oversight and control of, providing meaningful security to the loan position.

In May 2021, we adjusted our hedging mechanics to use currency options in favor of the rolling FX forward we had been using. During this time of heightened volatility and potential gains for the USD vs CAD, we feel that there is an opportunity to capture upside potential should the USD make a significant positive move. This option strategy allows us to maintain our downside protection while participating in the upside.

With the recent increase in investor interest and investment in the Fund, we are working to transition pipeline deals into portfolio positions. Often, it can take several weeks to months to transition a transaction from initial discussions through a term sheet and legal documentation. This process is sometimes subject to delays during negotiation, with closing timeline becoming more certain as it becomes nearer. Our efforts to build the pipeline have led to a significant funnel of deals, however the cash position as of September month end is CAD 39.7 million, leaving the portfolio with enough cash to fund transactions expected to close in the immediate future. We have decided to continue to limit subscriptions to the fund while we execute on transactions and further season our pipeline. This is in the best interest of current and future investors, by allowing our team to focus our efforts on deploying investor capital. Going forward, we will evaluate our cash need month to month and expect to start taking subscriptions again as our cash balances normalize.

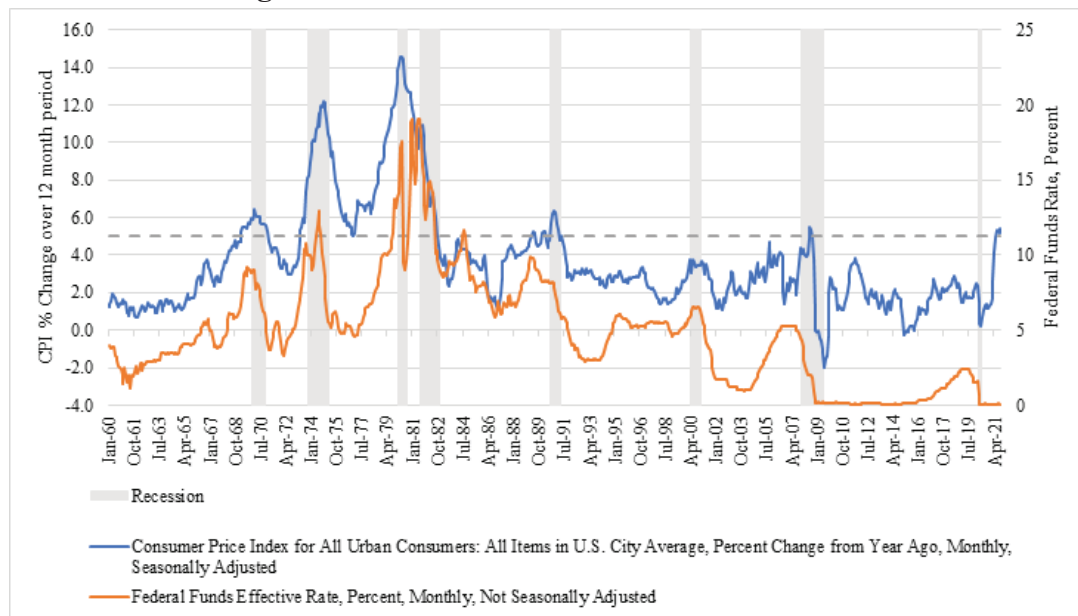
Outlook

We continue to see a frothy equity market, given the amount of liquidity being injected by Central Banks in Canada and the US, this comes as no surprise. As some might have expected, the excess cash in the economy has driven a rise in real asset prices reflected in above average inflation¹. Despite recent statements indicating this inflationary period is transitory, we are monitoring the situation closely. Federal rates are still sitting at all time lows while the CPI has been rising over 5% YoY, the transitory inflation looks to be stickier than previously thought. Businesses are still in recovery from the impact of COVID-19 making the prospect of raising interest rates difficult for the economy to swallow.

It is rare for the YoY change in inflation to hold above 5%, in fact since 1960 this has only occurred 4 times, albeit one of those was a lengthy period in the 1970's where interest rates reached the high teens. What we find disconcerting is that each time this level of inflation has been achieved, it has always been met with rising interest rates to combat the inflationary pressure in the economy. In today's example, the lack of reaction on behalf of the federal reserve could lead to a knee jerk reaction later if the expected transitory nature of the inflation does not materialize.

¹Source: FRED Economic Data, BLS, Board of Governors

Change in CPI vs Federal Funds Effective Rate



Source: FRED Economic Data, BLS, Board of Governors

We still believe that there are good deals to be found in today's market. We continue to search for small cap businesses that have been overlooked by traditional lenders, have growth potential and an immediate use for cash.

The markets remain bifurcated as ETFs and index funds continue to prefer large cap names over small and micro cap stocks. We feel that in some ways the small cap space is insulated from the tremors of headline driven volatility, with equity volumes driven by news of the actual business rather than massive sweeping market shifts. This gap in liquidity and capital was the thesis behind our strategy and still holds true.

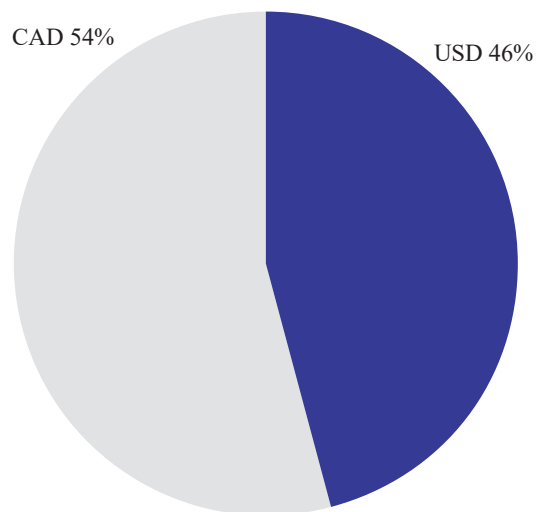
Our deal pipeline is more than CAD 700 million with over \$126 million in term sheets under negotiation for near term transactions. The bulk of our pipeline growth has come from the Consumer Staples, Financial Services, Cannabis and Technology sectors. In Q4 we expect to see more deal flow coming from the real economy as businesses can operate at increasing capacity.

Overview Exhibit A – Portfolio Overview as at September 30th, 2021

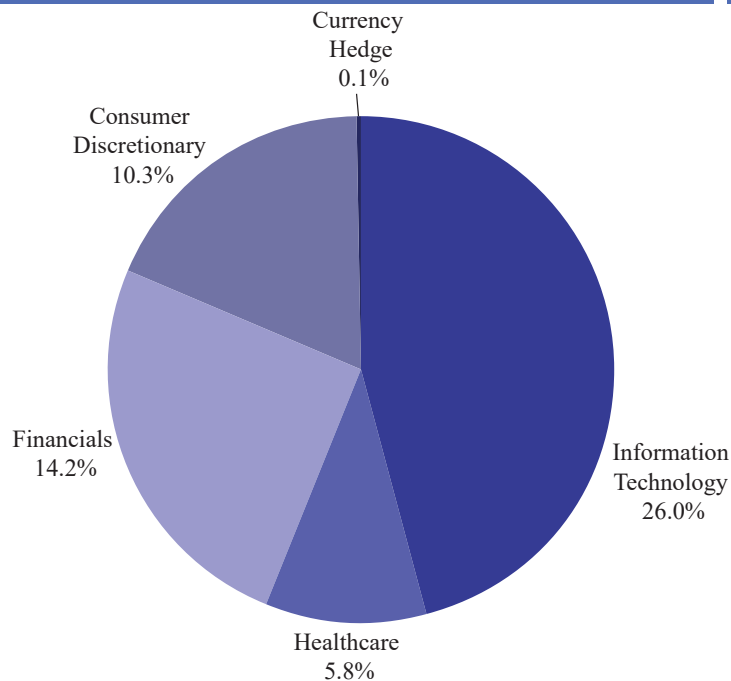
Key Statistics

Portfolio Summary	Sep-30-2021
Loan Amount Outstanding (\$000)	\$38,056
Cash Outstanding (\$000)	\$39,702
Net Working Capital (\$000)	(\$730)
Equity (\$000)	\$12,231
Other (\$000)	\$132
Portfolio Provision	-
Weighted Average Loan Term (Months)	27.16
Weighted Average TTM (Months)	10.53
Weighted Average LTV	30.3%
Portfolio LTV	17.8%
Average Loan Outstanding (\$000)	\$2,718

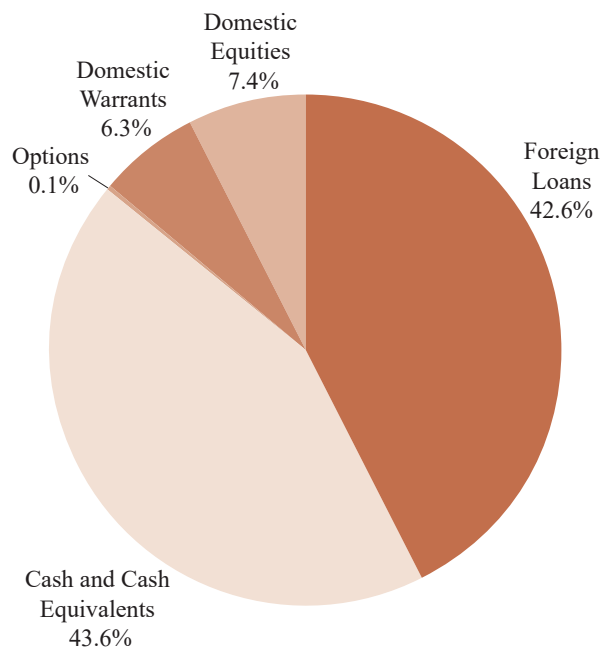
Currency Breakdown



Sector Breakdown



Asset Breakdown



Source: AIP Asset Management

Exhibit B: Loans Outstanding as of September 30th, 2021

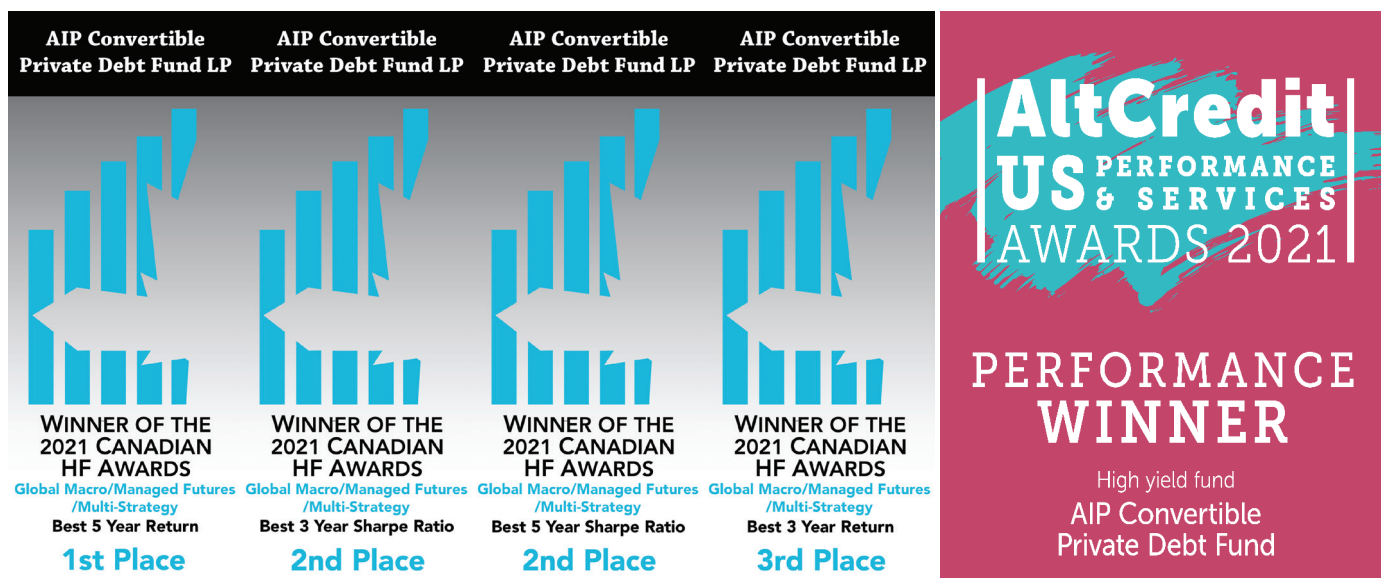
Issuer #	No. of Notes Issued	Location	Industry	Lien	Main Collateral	Estimated Collateral FMV (\$CA '000's)	Loan Amount Outstanding (\$CA '000s)	Loan LTV	Equity Position (\$CA, '000's)	Enterprise Value
7	2	Canada	Healthcare	1st	All Assets - A/R & Inventory, Subsidiary Shares	3,799	278	7%	828	\$6,956,962
9	6	USA	Information Technology	1st	All Assets - A/R, Inventory	83,085	23,212	28%	-	\$44,318,888
11	1	Canada	Consumer Discretionary	1st	All Assets - A/R, IP	9,339	6,211	67%	3,028	\$8,529,530
13	2	Canada	Financials	1st	Portfolio holdings and related royalties	25,805	4,315	17%	8,354	\$22,670,636
14	1	Canada	Healthcare	1st	Unconditional guarantee from Parent, IP, inventory, receivables	45,317	1,411	3%	21	\$4,484,468
15	2	Canada	Healthcare	1st	All Assets - AR, Cash, Intangibles	46,989	2,629	6%	-	\$94,435,513

Source: AIP Asset Management

Fund and AIP Developments

As part of our quarterly valuation process, we have reviewed the independent valuator's report for Q3-2021 and have no material changes to the value of the loan portfolio. We feel this is an important step to take as the fund grows, stemming from AIP's goal of full transparency with current and future investors.

Recently, the AIP Convertible Private Debt Fund LP was awarded recognition at the 2021 Canadian Hedge Fund Awards, placing top 3 in multiple categories. The Fund was also recognized at the Alt Credit US Performance Awards. These wins are attributable to all of us here at AIP Asset Management and we are extremely proud of our team's ability to deliver on promises to our investors.



Source: <https://aipassetmanagement.com/news/news-press-releases/>

Thank you for your investment and continued support, we continue to strive for excellence on behalf of the Fund and our investors.

Jay Bala

CEO and Senior Portfolio Manager

AIP Asset Management

Manager to the AIP Convertible Private Debt Fund LP

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