Morgan Stanley

Income Generating Private Equity Opportunities in a Low Yield Environment

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Morgan Stanley Alternative Investment Partners

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Introduction

Income-Oriented Private Equity – Definition: Investments in an Asset Class or Strategy that Typically Exhibit a Shorter-Duration Cash Flow Pattern not Traditionally Associated With Buyouts or Venture Capital

Characteristics of Yielding Private Markets Strategies:

- Deep opportunity set of sub-strategies
- Balance of yield and total return
- Shorter investment and harvesting period than traditional PE
- Lower fee burden than traditional PE
- Reduced blind pool risk
- Downside protection
- Low correlation and some inflation hedging

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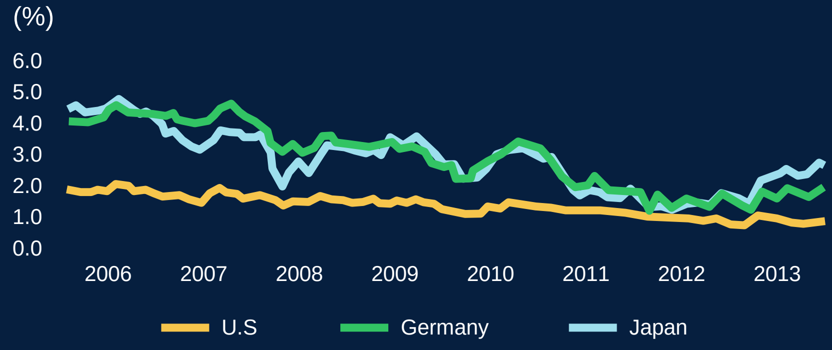
Compressing Investment Yields

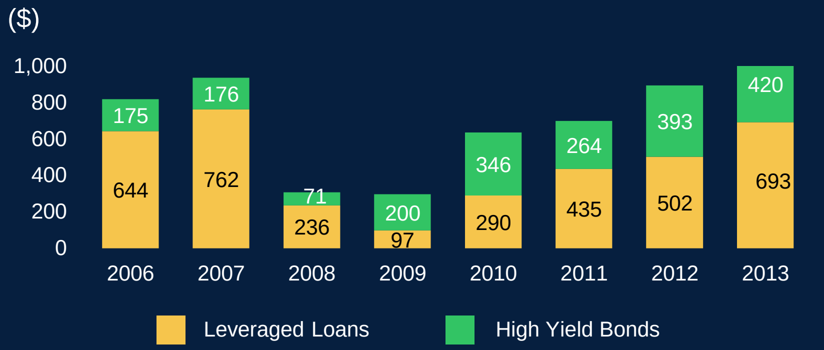
The Current Market Environment Is Causing Investors To Chase Yield

Low Interest Rates…



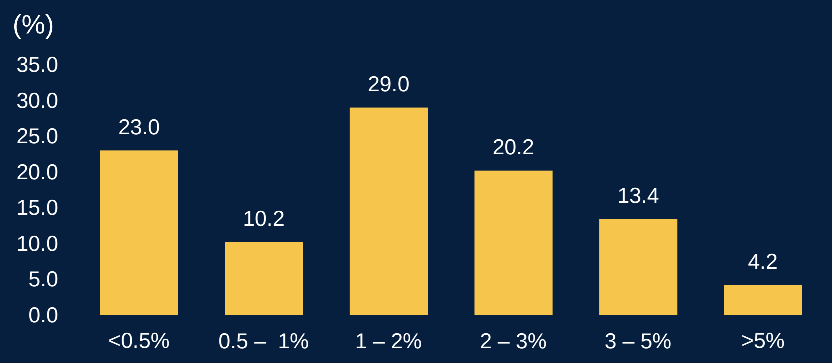
Source: Bloomberg (Government 10-Year Bond Yield as of December 2013)

… Are Driving Demand for High Yield Bonds and Leveraged Loans



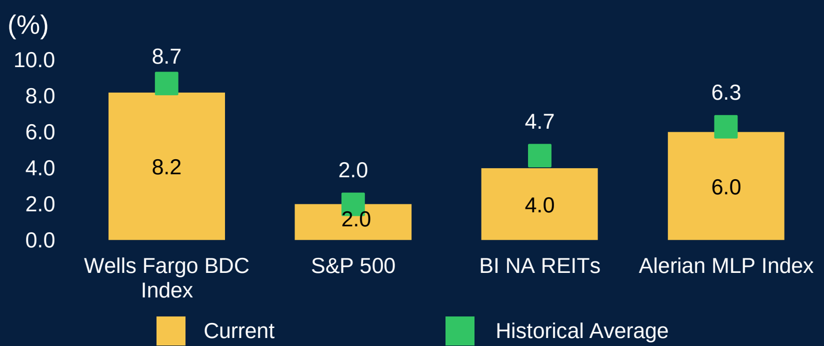
Source: LCD Comps (Issuance Volume in USD Billions as of December 2013)

Over 80% of S&P 500 Companies Have Dividend Yields of 3% or Less…



Source: Bloomberg (Annual Dividend Yield as of December 2013)

…And Yields on Equity Investments Are Below Historic Averages



Source: Bloomberg (Monthly – 12 Month Dividend Gross Yield as of December 2013)
Wells Fargo BDC Index : 2.6yrs, S&P 500: 10 yrs, BI NA REITs: 10 yrs & Alerian MLP: 7.6 yrs

A Differentiated Private Markets Opportunity Set

Global Niche Opportunities

AIP's Experience in "Off-the-Run", Private Investment Opportunities

- Consistent and long-standing focus on small to mid-cap opportunities
- AIP believes that less efficient market segments can present superior investment opportunities

Attractive Cash Flow Profile

Focus on "Income-Oriented" Opportunities

- Opportunistic private income-oriented investments have historically provided as much as 8 – 12% cash flow yields (1)
- Shorter investment period and harvesting period
- Active structuring to help minimize tail risk – self-liquidating assets, limited reinvestment, secondaries

Competitive Total Return

Balance of Yield and Total Return

- Control-oriented investment seeks to preserve upside return potential
- Lower correlation than other fixed income and opportunistic private equity strategies (1)

Emphasis on Risk Mitigation

Strategy Typically With Strong Risk Controls in Place

- Capital preservation – underwriting focused on the potential for downside protection, often to liquidation value
- Senior positions in capital structures, low leverage, multiple entry points, low entry valuations
- Natural inflation hedge in hard asset investment and floating rate securities

Lower Fee Burden

Income Opportunities Typically have Lower Management Fees and/or Carried Interest

- Based on AIP observations, the average management fee during the investment period of income oriented investments is lower than that of other private equity sectors

(1) Source: AIP

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Opportunity Set in Income-Oriented Strategies

We Believe that the Most Actionable Private Equity Opportunities in income-Oriented investing Fall Into Six Categories

Real Assets

- Transportation assets – shipping, aviation, rail
- Power and transmission

Royalties & Monetization

- Pharmaceutical Royalties
- Film Interests
- Patents and Trademarks

Asset-Linked Securities

- Life and structured settlements
- Mortgage servicing rights

Distressed

- Distressed debt
- NPL pools and structured products
- Other financial assets

Natural Resources

- Metals and Mining
- Oil and gas

Niche Credit Opportunities

- Specialty lending and niche credit
- Mezzanine debt/structured equity
- Regulatory capital relief

We estimate that income-oriented illiquids represent approximately $650 billion in private equity capital raised in the last 15 years by nearly 600 managers

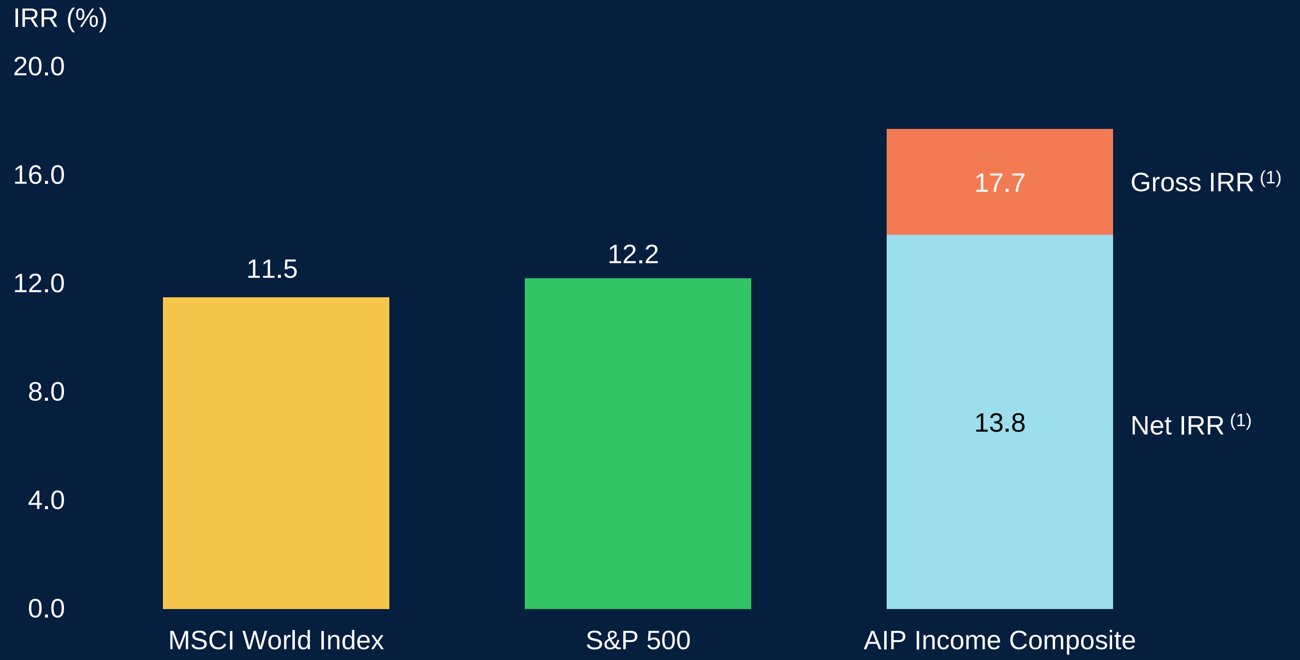
Source: AIP observation based on review of PPMs of funds with relevant strategies
The information above does not reflect the performance of any specific investment. There is no guarantee that the fund will achieve such results. The statements above reflect the views and opinions of AIP as of the date hereof and not as of any future date and will not be updated or supplemented.
For illustrative purposes only.

AIP Private Markets Income Composite Summary vs. Public Equities

- As of December 31, 2013, the since inception gross IRR on all private markets income investments made by AIP is 17.7% and the net IRR is 13.8% (1)
- This return is across $1.3 billion (2) committed to 26 primary funds, 6 co-investments and to 19 individual limited partner (LP) interests purchased on the secondary market

AIP Private Markets Income Composite ("AIP Income Composite") Performance

1999 – December 31, 2013



(1) Past performance is not indicative of future results. As of December 31, 2013. The Gross IRR is calculated using the investment cash flows and book values for the Included Investments, net of the fees and expenses of the managers of the Included Investments (including carried interest accrued or paid to date), which information with respect to the Included Investments was furnished to AIP by the applicable managers. The calculation does not take into account potential future carried interest payable to the managers of Included Investments that has not been already accrued by such managers or any fees and expenses of AIP. If fees and expenses of AIP were factored in, returns would be lower. The Net IRR was calculated using the Gross IRR by layering the effect of AIP's fees, expenses, and carried interests in the manner described on pages 14 and 15 in addition to the fees and expenses of underlying managers (including carried interest paid or accrued as of December 31, 2013) over the investment cash flows and book value for all the Included Investments. If the entire portfolio were distributed today at its current book value, the Net IRR could be reduced by additional carried interest payments to underlying managers and AIP. The Net IRR does not take into account (A) placement fees payable by certain investors or (B) taxes payable by the investors. The inclusion of these factors would reduce the return to such investors.

(2) Represents investments made since January 1, 1999 on behalf of portfolios advised Morgan Stanley AIP GP LP and its affiliate Morgan Stanley Investment Management Inc. As of December 31, 2013. The investments included in these performance data (the "Included Investments") include all primary, secondary, and co-investment investments made on behalf of AIP-managed fund of funds and separately managed accounts from January 1, 1999 to December 31, 2013 (excluding investments in real estate, hedge funds, and funds of funds) in the special situations and distressed categories, across all geographies, that were underwritten based on an expectation at the time of its initial investment of achieving distributions within a 12 to 24 month period. These investments were made in a number of different funds and accounts, each of which included other investments that are not reflected in this performance data, and the investment performance shown here was therefore not achieved by any individual fund or account. Including unfunded commitments. Non-U.S. denominated investment commitment amounts are presented using the exchange rate prevailing at the time of each commitment.

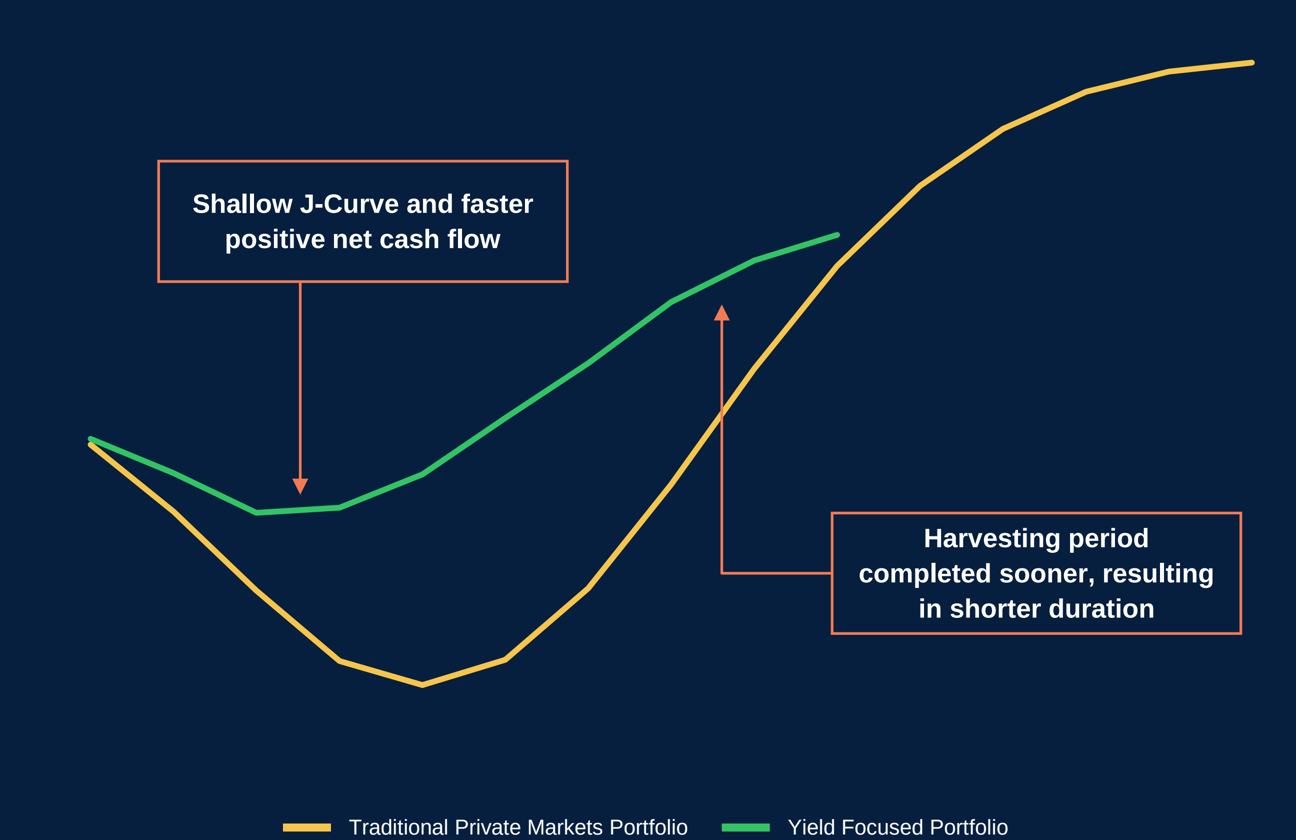
Past performance is not indicative of future results. This information is provided for illustrative purposes only. In reviewing the performance above, please keep in mind the inherent limitations of the reliability of certain of the valuations upon which that performance presentation is made. The performance information provided herein is denominated in U.S. Dollars. Returns on investments made in currencies other than U.S. Dollars may increase or decrease as a result of currency fluctuations. Please see pages 14 and 15 for important notes and disclosures, including the effect of fees on performance.

Illustrative Cash Flow Profile of a Diversified Private Markets Yield Portfolio

Key Outcomes

- Expected J-curve for the yield focused portfolio can be shallow, as early distributions can be used to off-set capital calls
- Return driven by yield and capital appreciation, may lead to a shorter duration but lower overall cash on cash multiple

Illustrative Net Cash Flow Profile for a Traditional PE Portfolio and a Yield Focused Portfolio



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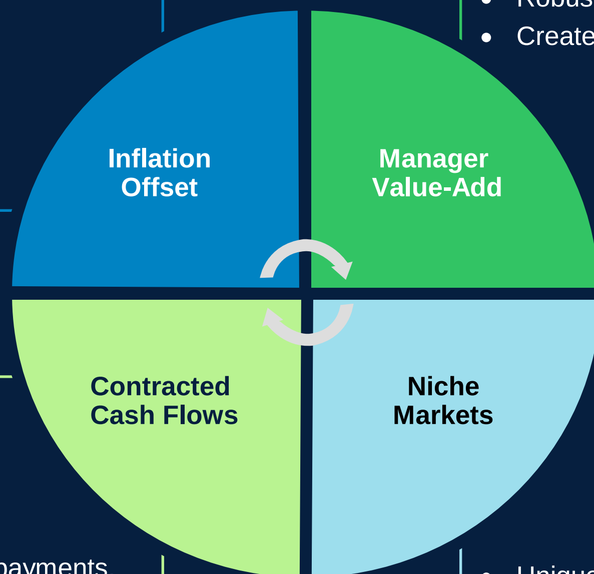
The cash flow profiles are illustrative and do not display the performance of any specific current or future investment. There is no guarantee that an investor will achieve such performance. For illustrative purposes only.

Investment Criteria Related to Income-Oriented Strategies

AIP Investment Selection Process – Primaries, Co-Investments, Secondaries

- Backed by either real, financial or intellectual property assets
- Floating rate securities
- CPI Adjustments

- Typically, control-oriented
- Unique sourcing capabilities
- Technical expertise
- Robust professional networks
- Creates upside optionality



- Seek investments that may be cash generative within 12 – 24 months
- Contracted cash flow streams such as lease payments, royalties, interest payments
- Seek investments that may generate cash yields of 8 – 12%
- Typically have shorter duration than traditional PE

- Unique investment opportunities derived from top-down sector themes
- Dislocations in peripheral markets resultant from economic, political and structural imbalances – e.g. shipping, specialty lending, regulatory capital relief

Primary Case Study: Drug Royalty Fund

Fund Overview – North America, Special Situations

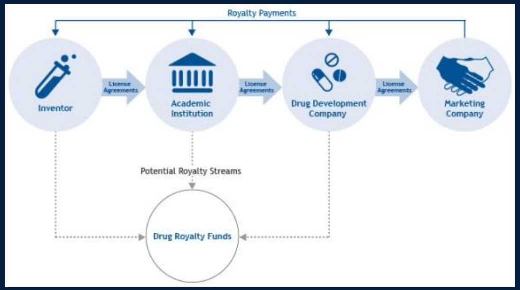
- Canadian special situations investor
- Exclusive focus on royalty streams derived from the sale of approved pharmaceutical products

Investment Thesis

- Complex market with limited competition
- Purpose built team with uniquely disciplined approach
- Attractive risk-adjusted return pattern, with cash flow derived from top line revenue sharing arrangements based on intellectual property use

AIP Advantage

- Decade long experience at AIP of investing in medical royalties
- Long-standing relationship with manager via primary and secondary investments
- Ability to negotiate advantaged terms
- Broader firm experience in the area provides advantaged perspective on the sector (1)



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Co-Investment Case Study: U.K. Loan Portfolio (1)

Transaction Overview – Europe, Special Situations

- Pool of U.K. residential mortgage-backed non-performing and sub-performing loans
- Fourth portfolio with similar characteristics bought from the seller, allowing the sponsor to draw on their experience for more detailed underwriting

Investment Thesis

- Seller was a financial institution under pressure to sell and the sponsor was the only reliable and fast buyer
- Sponsor is specialised on acquisition of loans from impaired financial owners; diligence and pricing through unique databases and owned entities

AIP Advantage

- Long-standing relationship with manager via primary and co-investment
- AIP had co-invested alongside the sponsor in a very similar transaction in the prior year

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Secondary Case Study: Shipping Fund Restructuring

Transaction Overview – Norway, Special Situations

- The secondary transaction involved the restructuring of global shipping fund. The fund was managed by a Norwegian asset management and syndication house that focuses on shipping
- Portfolio was a diversified set of 63 offshore and shipping vessels with 67% of the portfolio by NAV under long-term charter
- AIP's restructuring solution allowed existing investors to either sell their shares or roll their shares into a new entity

Investment Thesis

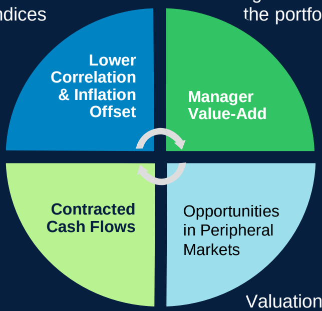
- Opportunity to acquire an asset-backed yielding portfolio of shipping assets
- Limited competition due to the complex nature of the transaction and restructuring process
- Manager is part one of the largest independent financial services companies focused on the maritime sector

AIP Advantage

- AIP leveraged Morgan Stanley's shipping research team [1] and third-party experts to provide due diligence and value each of the key vessels
- Restructuring experience enabled AIP to complete transaction

Offshore vessels and shipping assets have historically had a low correlation with broader liquid market indices

Experienced management team coupled with strong in-house resources to manage and exit vessels in the portfolio



Predictable income stream from contractual charter payments

Valuations in the offshore vessel and shipping sectors appear to be improving due to a positive supply-demand dynamic

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Speaker Biography

Neil Harper, CA, CAIA
Managing Director

Neil is a portfolio manager and Chief Investment Officer for the Morgan Stanley Alternative Investment Partners Private Equity Fund of Funds group, and leads Europe, Middle East, and Africa (“EMEA”) investment activities from the London office. He has 24 years of relevant industry experience. Prior to joining AIP, he was a partner at McKinsey & Company operating in Europe, North America and Asia providing consulting services to corporate and private equity clients on strategy, performance improvement, mergers and acquisitions and corporate finance. Previously, he worked for Arthur Andersen providing audit, corporate finance and financial advisory services. Mr. Harper received an M.A. with first class honours in economics and accounting from the University of Edinburgh and an M.B.A. with honours in finance and strategy from the University of Chicago. He is a member of the Institute of Chartered Accountants of Scotland and holds the Chartered Alternative Investment Analyst (CAIA) designation

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How We Calculate Our Performance

AIP Private Markets Income Composite

The AIP Private Markets Income Composite includes investments made between January 1, 1999 and December 31, 2013 (the "Included Investments"). The AIP Private Markets Income Composite represents all private market investments made by AIP-managed funds and separate accounts during the applicable time period. The "AIP Private Markets Income Composite" is calculated by aggregating the performance of all Included Investments, regardless of the year in which they were made, as of December 31, 2012.

The AIP-managed funds and separate accounts that made the Included Investments are PMF I, PMF II, PMF III, Morgan Stanley Private Markets Fund Employee Investors III LP1, PMF IV and PMF V, Morgan Stanley Global Distressed Opportunities Fund LP ("GDOF"), Morgan Stanley Emerging Private Markets Fund LP ("EPMF I"), Morgan Stanley Global Secondary Opportunities Fund I LP ("GSOF I"), Morgan Stanley Global Secondary Opportunities Fund II LP ("GSOF II") (collectively, the "PMF Funds"), Morgan Stanley Advantage Fund I LP (the "Advantage Fund"), private markets focused separate accounts2 (the "Other Separate Accounts") and private markets investments made by Weyerhaeuser Corporation Master Retirement Trust ("WCMRT") and Aurora Cayman Ltd. ("ACL"). Taken together the PMF Funds, the Advantage Fund, the Other Separate Accounts, WCMRT and ACL are the "AIP Portfolios". The private markets investments made on behalf of WCMRT and ACL were not managed as separate private markets portfolios on a stand-alone basis (as were the investments of the PMF Funds, the Advantage Funds and the Other Separate Accounts), but, rather, their selection was influenced by the presence of other types of investments held in the WCMRT and ACL portfolios, including real estate and hedge fund investments. Had the private markets portions of the WCMRT and ACL portfolios been managed on a stand-alone basis, different decisions may have been made regarding the nature, timing and/or size of the investments. Certain AIP-related funds and separate accounts are excluded from the AIP Composite because such funds and separate accounts make investments that differ from the type targeted by PMF VI. Among the investments excluded from the AIP Composite are Morgan Stanley Private Equity Access Fund LP, Morgan Stanley Private Equity Access Fund II LP and Morgan Stanley Private Equity Opportunities Fund 2006 LP, as well as investments in real estate, hedge funds, private equity investments selected by the hedge fund team. In compiling the information used in the AIP Composite, certain investments were selected on a subjective basis, in good faith, as either falling within or outside of a "private markets" investment strategy.

The performance of the AIP Private Markets Income Core Composite is calculated gross of Morgan Stanley fees, expenses and carried interest but net of all underlying managers' fees, expenses and carried interest paid or accrued. While AIP believes that the co-investments included in the AIP PEFOF Core Composite (i.e., direct investments in portfolio companies) are analogous to the portfolio company holdings of the funds that are included in the private equity benchmarks (which also make direct investments in portfolio companies), adjusting the AIP Private Markets Income Composite to exclude co-investments would reduce the returns of the AIP Private Markets Income Composite. Such reduction in returns would impact the relative performance of the AIP Private Markets Income Composite against the benchmarks.

The Overall Composite Included Investments generated an annualized gross IRR of 17.7% cumulatively through December 31, 2013. Adjusting the performance of the Included Investments to be net of Morgan Stanley fees (at the lowest break point), carried interest and cash drag would reduce the returns by as much as 5.0% (such reduction in returns, the "**gross-to-net spread**").

The gross-to-net spread analysis calculates the net IRR by layering the effect of AIP fees, expenses and carried interest in the manner described below in addition to the fees and expenses of the underlying managers (including carried interest paid or accrued to date) over the investment cash flows and book values for all of the Included Investments. AIP has modeled the effect of its fees and expenses by making the following assumptions with respect to the cash drag, fees and expenses: (i) with respect to the cash drag, capital is assumed to be called from investors quarterly in advance in amounts sufficient to cover capital calls from the Included Investments occurring in such quarter, and distributions from the Included Investments are assumed to be distributed to Investors at the end of the quarter in which they were received; (ii) the management fee is assumed to be paid quarterly in advance in an amount equal to 1.35% per annum multiplied by the "cumulative client capital commitments to AIP-managed funds and separate accounts" as described below; (iii) expenses are assumed to be equal to 0.2% per annum multiplied by the "cumulative client capital commitments to AIP-managed funds and separate accounts;" and (iv) carried interest is assumed to be equal to 5% of the total profits of all Included Investments, net of the management fees and expenses set forth in (ii) and (iii) above. The model does not take into account (A) earned carried interest by the managers of Included Investments that has not been reflected in the capital balances provided to AIP, (B) placement fees payable by certain investors or (C) taxes payable by investors.

For purposes of determining the "cumulative client capital commitments to AIP-managed funds and separate accounts" as such terminology is used in (ii) and (iii) of the preceding paragraph, AIP uses the actual aggregate capital commitments to the AIP-managed funds and separate accounts, and such amounts are taken into account as of the dates on which such capital commitments were actually made by investors to such funds or separate accounts. With respect to certain separate accounts that do not have fixed capital commitments, the following methodology is used to approximate such a capital commitment: the actual aggregate commitments made by the applicable client during successive periods of 5 years are treated as the "capital commitment" for such separate account in the first year of each such 5 year period. Finally, in order to reflect the fact that management fees typically step down after an initial "commitment period," AIP models the initial step down for each capital commitment as 15% of such capital commitment, occurring at the end of the fifth year after such capital commitment is made, followed by another step down of 15% of the resulting amount each year thereafter until the end of the thirteenth year.

The historical performance data used to create the AIP Private Markets Income Composite is based upon account records and information provided by underlying managers and believed by AIP to be reliable but which AIP cannot warrant as accurate or complete. To the extent permitted by law, AIP is not responsible or liable for errors in account records or in connection with its compilation of such records and related information in preparing the AIP Private Markets Income Composite.

How We Calculate Our Performance (cont'd)

AIP Private Markets Income Composite

The Included Investments represent all of the Private Markets Income Investments made on behalf of Morgan Stanley AIP-managed fund of funds and separately managed accounts (the "Portfolios") from January 1, 1999 to December 31, 2013.

The "AIP Private Markets Income Composite Net IRR" or "Net IRR" was derived by assuming that Included Investments were committed over a period of time that corresponds to the investment periods of approximately five successive AIP private equity funds of funds, each with an approximately two-year commitment period. In simulating the effect of placing the investments in such a fund structure, the $65.0 million committed by AIP to three Private Markets Income investments from January 1, 1999 to December 31, 2001 were placed in a 1999 vintage year fund of funds ("Cohort I"), $87.1 million committed by AIP to seven Private Markets Income investments from January 1, 2002 to December 31, 2004 were placed in a 2002 vintage year fund of funds ("Cohort II"), $148.1 million committed by AIP to seven Private Markets Income investments from January 1, 2005 to December 31, 2007 were placed in a 2005 vintage year fund of funds ("Cohort III"), the $555.2 million committed by AIP to 18 Private Markets Income investments from January 1, 2008 to December 31, 2010 were placed in a 2008 vintage year fund of funds ("Cohort IV"), and the $384.7 million committed by AIP to 15 Private Markets Income investments from January 1, 2011 to December 31, 2013 were placed in a 2011 vintage year fund of funds ("Cohort V"). In this way, the effect of a fund of funds structure has been layered over the investment cash flows and book values for the Included Investments, net of the fees and expenses of the managers of the Included Investments (including carried interest accrued or paid to date). AIP modeled the effect of the fund of funds structure by making the following assumptions with respect to the cash drag, fees and expenses, in each case at the fund of funds level: (i) it is assumed that capital calls from the underlying investments will be funded primarily through the use of a credit facility and the balance of such credit facility will be paid in full each quarter at the end of the quarter through the issuance of capital calls to investors, net of distributions from the underlying investments received during the quarter; (ii) the management fee is assumed to be paid quarterly in advance in an amount equal to 1.35% times the management fee basis per annum and such management fee basis is equal to total commitments during the first five years and adjusted commitments after the fifth year (with adjusted commitments estimated to fall by 25% each successive year after the fifth year); (iii) expenses are assumed to be equal to 0.2% per annum multiplied by the amounts described above in (ii); (iv) commitments were assumed to have been made in equal parts in each year of the 3-year investment period for each cohort and (v) carried interest is assumed to be equal to 5% of the total profits of all investments, net of the management fees and expenses set forth in (ii) and (iii) above. The model does not take into account (A) placement fees payable by certain investors or (B) taxes payable by the investors. Inclusion of these factors on each hypothetical fund would reduce the Net IRR. On a modeled net basis as of December 31, 2013, Cohorts I, II, III, IV and V have returned 12.2%, 19.5%, 9.4%, 15.5%, and 23.0% respectively, based on management fees of 1.0%-1.35%.

Private Equity and Public Equity Benchmarks

The "**MSCI World Index**" or "**MSCI World**" means the MSCI World Total Return Gross. The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. This index is unmanaged and may not be invested in directly. The MSCI World Index consists of the following 24 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. The MSCI World Total Return Gross takes into account reinvestments of dividends before withholding taxes, but excludes special tax credits declared by the companies. The MSCI World Index is used as a benchmark to evaluate the performance of each of the AIP PEFOF Core Overall Composite, PMF I, PMF II, PMF III and PMF IV because AIP believes the MSCI World Index to be representative of the markets in which the Included Investments are made and in which PMF I, PMF II, PMF III and PMF IV invest. Each time period appearing parenthetically in the charts herein with respect to the MSCI World Index indicates the start date and end date of the period over which the performance of the MSCI World Index was calculated. For example, the chart "AIP Historic Performance by Fund" features performance data for the MSCI World Index (1999 – June 30. 2013), which represents the annualized return of the MSCI World Index beginning in 1999 through June 30, 2013. The chart "PMF Performance vs. Benchmarks" features the performance of the MSCI World Index for the time period that reflects the investment period of the individual PMF funds. Matched cash flow analysis equates the time-weighted return of public benchmarks to the IRR of private markets investment. It compares the IRR achieved by PMF I, PMF II, PMF III and PMF IV to the IRR achieved by investing and divesting from an index in the same proportion as PMF I, PMF II, PMF III and PMF IV's capital calls and distributions. There are no transaction fees assumed for the purchases and sales of the index.