# FAIR OAKS INCOME FUND

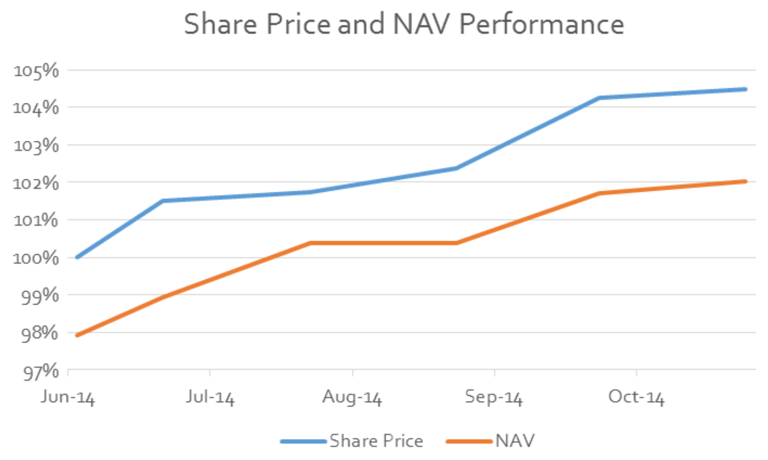
## Report to Shareholders

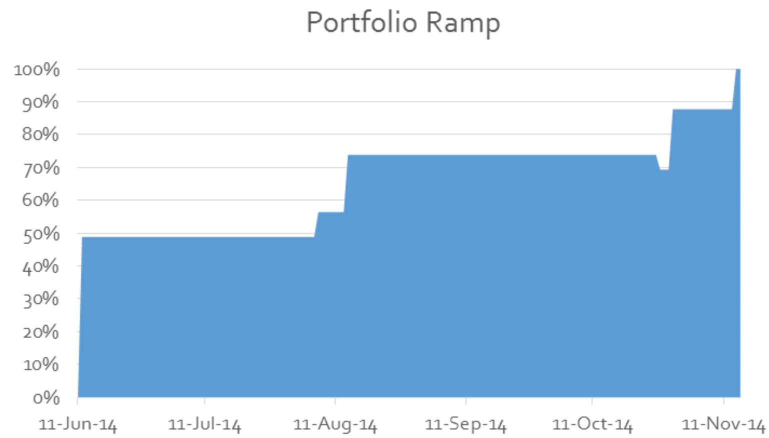
The following report relates to the period from 11 June 2014 to 31 October 2014 and has been prepared solely to provide information to Fair Oaks Income Fund Ltd's (the "Company") shareholders. It should not be relied upon by any other party or for any other purpose.

## Background and Investment Objective

The investment objective of the Company is to generate attractive, risk-adjusted returns, principally through income distributions. The Company will implement its investment policy by investing mainly in Fair Oaks Income Fund LP (the "Master Fund").

The investment policy of the Company is to seek exposure to US and European CLOs or other vehicles and structures which provide exposure to portfolios consisting primarily of US and European floating-rate senior secured loans and which may include non-recourse financing.




*+12.0%*

*Annualised share price total return, 11 June 2014 to 31 October 2014*[1]

*$ 127m*

*Fund size (market cap, as at 31 October 2014)*[1]

*4.5 years*

*Maturity*[2]

*12-14%*

*Target total return*[2]

*"The independent Board of the Company is delighted to present its Report to Shareholders for the period from 11 June to 31 October 2014. We are pleased to confirm that as at 14 November, all the IPO and October net placing proceeds have been committed. The Company has been able to raise additional capital to take advantage of what the General Partner of the Master Fund considers very attractive investment opportunities. The Boards of the Company and General Partner and the Investment Advisor would like to thank investors for their continued confidence and support."*

*Professor Claudio Albanese, Chairman of the Board*

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## Financial performance[1,3]

The Company NAV was up 4.2% in the period from 11 June 2014 to 31 October 2014. The shares closed at a mid-market price of 104.5c on 31 October, implying a 2.4% premium to NAV and a 4.5% total return since inception (12.0% annualised). Fair Oaks Income Fund LP (the "Master Fund") received $4.75 million worth of cash flows in the period or $0.0391 per share.

## Portfolio[2,3]

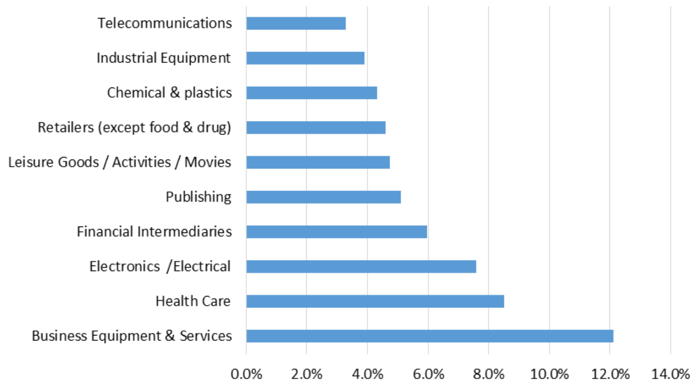
The Master Fund has now invested in nine individual CLO tranches offering exposure to over 700 single issuers across 41 sectors. 94% of the CLO income notes held by the Master Fund are control positions. The GP estimates that the co-investment by the CLO managers in the transactions held by the Master Fund exceeds $60 million, ensuring a strong alignment of interests.

The GP estimates that the weighted average spread for the Master Fund's gross portfolio is Libor+4.52% and the weighted average cost of CLO financing is Libor+1.76%. The weighted average exposure to single issuers in the gross portfolio is 0.3%, with the top ten issuers accounting for an estimated 7.8% of the total exposure. The exposure to European CLOs continues to be below the Master Fund's original target as the GP considers that investments backed by US loans currently represent more attractive relative value given the returns available and the weaker economic and corporate environment in Europe.

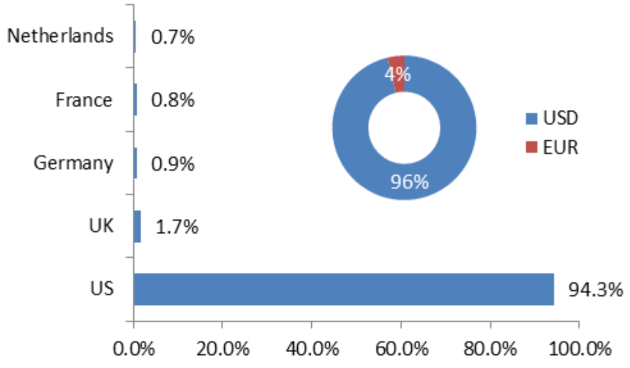
The following table summarises the top ten exposures on a look-through basis:

| | 1 month | 3 month | 1 year | ITD |
|---|---|---|---|---|
| Share Price | +0.24% | +2.70% | n/a | +4.50% |
| NAV | +0.32% | +1.64% | n/a | +4.21% |
| CS Leveraged Loan Index | +0.29% | +0.00% | | +0.28% |

## Industry Breakdown[3]




## Geographical and Currency Breakdown[3]



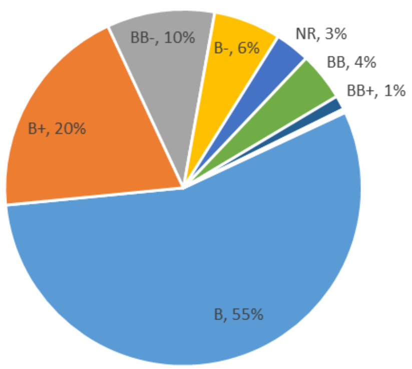

## Top 10 Issuers and Portfolio Data[3]

| Issuer | S&P | % Gross [1] | Industry | Country |
|---|---|---|---|---|
| First Data | B | 1.21% | Financial Intermediaries | US |
| Community Health Systems | B+ | 0.98% | Health Care | US |
| Asurion | B | 0.87% | Property & Casualty Insurance | US |
| Blue Coat Systems | B | 0.83% | Electronics /Electrical | US |
| iEnergizer Limited | B | 0.73% | Publishing | UK |
| Dell | BB- | 0.71% | Electronics /Electrical | US |
| Advantage Sales & Marketing | B | 0.68% | Business Equipment & Services | US |
| Grifols Worldwide | BB | 0.66% | Health Care | US |
| Protection One | B | 0.59% | Business Equipment & Services | US |
| Tribune Company | BB- | 0.57% | Publishing | US |
| **Total Number of Issuers in the Portfolio:** | | | **705** | |
| **Weighted Average Asset Spread:** | | | **Libor+4.52%** | |
| **Weighted Average Cost of CLO Financing[2]:** | | | **Libor+1.76%** | |

(1) Based on propotional exposure to par portfolios of CLO investments as at the month end.
Source: Intex and CLO manager reports

(2) Excludes investment in mezzanine CLO notes. Based on stated coupons

## S&P Rating Distribution[3]




**Important Information**

The Net Asset Value in this report is an estimate, and is based on unaudited estimated valuations. The final Net Asset Value of the Company may be materially different from the estimated value, which should only be taken as an indicative value which has been provided for information only and upon which no reliance should be placed. Actual results, performance or achievements may differ materially from estimated results, performance or achievements. Except as required by applicable law, the Company expressly disclaims any obligation to update or revise such estimates to reflect any change in expectations, new information, subsequent events or otherwise. This document is for information purposes only and is not an offer to invest. All investments are subject to risk. Past performance is no guarantee of future returns. Prospective investors are advised to seek expert legal, financial, tax and other professional advice before making any investment decisions. Month to date and year to date performance figures are calculated by reference to the estimated NAV on 12 June 2014, the date of admission to trading of the Company's shares. Due to applicable legal restrictions, electronic versions of these materials are not directed at, or accessible by, US Persons (as defined in Regulation S under the US Securities Act of 1933) or persons located in the United States, Australia, Canada, Japan, the EEA (except the UK and Spain) or South Africa, or any other jurisdiction where to do so would constitute a violation of the relevant laws of such jurisdiction.

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## Market commentary

During the period between the Company's IPO and 31October, longstanding concerns about the valuation of credit assets were heightened by geopolitical tensions, disappointing US and European economic data, hawkish Fed comments, the Argentinian default and a banking crisis in Portugal, which all contributed to a risk-off movement in broader markets. Weekly outflows from high yield funds reached record levels and loan fund flows were also negative.

The average price of Credit Suisse Leveraged Loan index was down 1.40% in the period, with the discount margin to a three year life widening from L+4.58% to L+5.15%[5]. As the General Partner of the Master Fund (the "GP") expected, bank loans have seen increasing volatility due primarily to technical factors. The 60 day historical volatility in the iShares Bank Loan ETF has increased from 1.7% in mid-July to 3.9% as at 31 October. The implied volatility in three-month at-the-money options on this ETF was 8.1% on 31 October[1]. The GP expects technical factors to continue to drive high volatility in loan prices, benefitting the Master Fund's CLO income note investments as a consequence of the fixed spread financing of the CLOs and their "hold to maturity" advantages. The Master Fund's portfolio is biased towards "nimble" managers with very strong credit discipline, able to react quickly and effectively to price movements in the loan market. The GP expects the Master Fund CLO investments to continue to benefit from high diversification and low idiosyncratic risk.

There were no defaults in the US leveraged loan index in August, September or October. The US bank loan 12m rolling issuer weighted default rate fell from 1.01% in June to 0.64% in October. The "shadow" default index stood at 0.29% at the end of October. The index includes Gymboree and Education Management[6] (the Master Fund has no exposure to either of these stressed issuers).

The discount margin to a three year call of the Credit Suisse European Loan index widened to Euribor+5.03% from Euribor+4.59% in the period. The default rate for the S&P European Leveraged Loan Index "ELLI" stood at 5.3% at the end of October vs. 5.8% in May. The ELLI distressed ratio edged down from 10.3% in May to 8.4%[6].

Rolling one year CLO spreads were 0.19% wider in the period[7]. Given the 0.57% discount margin widening in the Credit Suisse Leverage Loan index, the Company believes that the funding margin for new CLOs continues to be attractive.

*Outperformance*
*+610 bps*

*Annualised share total return (Fair Oaks Income Fund Ltd vs comparable funds, 11 June 2014 to 31 October 2014)[4]*

*+12.0%*

*FAIR LN annualised share price total return, 11 June 2014 to 31 October 2014[1]*

*+5.9%*

*Annualised share price total return for an average of comparable funds , 11 June 2014 to 31 October 2014[4]*

*+0.28%*

*Credit Suisse Leveraged Loan Index, 11 June 2014 to 31 October 2014[5]*

*-0.61%*

*Credit Suisse High Yield Index, 11 June 2014 to 31 October 2014[5]*

*Default rate*
*0.00%*

*Fair Oaks Income Fund LP CLO portfolios IPO to 31 October 2014 [6]*

*0.64%*

*12m US bank loan default rate to 31 October 2014[6]*

*5.30%*

*12m European bank loan default rate to 31 October 2014[6]*

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## Outlook

The Company expects that the Master Fund will continue to benefit from the resources of Fair Oaks Capital Ltd, its advisor, to source, analyse and negotiate attractive investment opportunities. The independence and investment policy of the Master Fund have the potential to make the Master Fund a preferred partner for a large number of CLO managers and underwriting banks. The Company expects that the value added by the GP and advisor in terms of analysing and monitoring the underlying portfolios, optimising the CLO's structure and minimising fees and expenses for the Master Fund will become apparent once the investments made since IPO start making distributions.

The GP expects the Master Fund's portfolio to continue to be biased towards US bank loan issuers based on the stronger fundamental outlook in the US vs Europe and the more attractive returns it expects from US CLOs. Although the GP will continue to actively explore opportunities to act as an originator for European transactions, it does not believe that the current available terms will support a significant allocation to these investments.

The GP believes that it has built a strong and attractive portfolio of potential investments for the Master Fund, balancing diversified exposure to over 700 issuers with a manageable number of investments which allow the GP and Advisor to monitor the investments regularly and effectively. Furthermore, the pipeline of potential investments for 4Q14 and 1Q15 is strong and will facilitate the investment of new capital or the reallocation of any principal receipts from the portfolio.

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**Regulatory update**

The GP believes that the Master Fund may benefit from recent regulatory developments given its structure and two year investment period. The following section summarises recent regulatory developments and their expected impact on the Master Fund.

*Credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934, as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*

In general, the final rules require that a "sponsor" of an asset-backed securitization transaction retain credit risk of the securitized assets in one of several permitted forms. The "sponsor" for this purpose is a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, to the issuing vehicle. The final rules allow sponsors to choose from the following alternative methods of retaining the required credit risk: 1) retaining a proportionate 5% interest in every tranche of a securitization, 2) retaining a proportionate interest in the equity/first loss tranche of a securitization with a market value at least equal to 5% of the market value of all the securities issued in the transaction, or 3) combined vertical and horizontal interests.

*CLOs will need to comply with this regulation in 2016 (two years after it is officially published) but its impact may be felt earlier. The new issue market is likely to be active over the next few months. The GP of the Master Fund believes that the Master Fund is well positioned to be able to react quickly to opportunities created by this rule.*

*(Article 122a) of Directive 2006/48/EC of January 1 2011 ("CRD")*

It is expected that the European Banking Authority will opine on the various originator structures that are being worked on when it publishes its update on CLO risk retention by the end of the year. Should any originator structure be found non-compliant, the main impact would be on debt holders who may be forced to liquidate the investment. Any changes may also affect originator vehicles' ability to attract financing for new CLOs.

*The GP believes that the Master Fund or vehicles seeded by it could act as originator of European CLOs managed by third party, unaffiliated managers. Although the GP has analysed a number of these opportunities, to date it does not believe that they would have enhanced the Maser Fund's target returns.*

*Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 ("AIFMD")*

Under AIFMD, alternative investment fund managers ("AIFM") may only assume exposure to securitisations as defined therein on behalf of one or more alternative investment funds ("AIFs") if the originator, sponsor or original lender of the securitisation has explicitly disclosed to the AIFM that it retains, on an ongoing basis, a material net economic interest in the securitisation, which shall not be less than 5% (the "retention requirement"). Non-EU AIFM are not yet subject to the retention requirement as there is a transitional period to 22 July 2015 before they must comply in full with AIFMD. If and when applicable, the retention requirement could operate as a material restriction on the investment activities of non-EU AIFMs holding CLOs which do not meet with the retention requirements.

*The Master Fund is not affected by this regulation but may benefit from potential forced sales of non compliant transactions (a significant majority of US CLOs and older EUR CLOs) by other market participants.*

**Material events and transactions**

The board of the Company announced on 27 October that the Company had raised USD 7.5 million before costs and expenses through the issue of 7,228,916 new ordinary shares at USD 1.0375 per share, representing c.2% premium to the NAV per share as at 30 September 2014. As a result of this issue, the Company's issued share capital will consist of 121,728,916 Ordinary shares.

**Further Information**

Further information regarding the Company, including monthly factsheets, can be found at the Company's website at [www.fairoaksincomefund.com](www.fairoaksincomefund.com)

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## Notes

1. Source: Bloomberg
2. Source: Company's Prospectus. Note that the Company has an unlimited life but is solely invested in the Master Fund which has a duration to June 2019, subject to potential extensions by up to 24 months.
3. Source: Portfolio information based on par value of loans in gross portfolio.
4. Source: Bloomberg and Creditflux. Arithmetic average of comparable funds defined as London Stock Exchanged listed CLO/CDO funds as defined by Creditflux in their "credit permanent vehicles ranking" as at 31 October 2014, includes funds seeking admission to the London Stock Exchange. Total return from 11 June 2014 except for funds whose IPO took place after this date in which case their total return is calculated from their respective IPO dates.
5. Source: Credit Suisse
6. Source: Standard & Poor's LCD
7. Source: JP Morgan, based on sample 2013 CLO