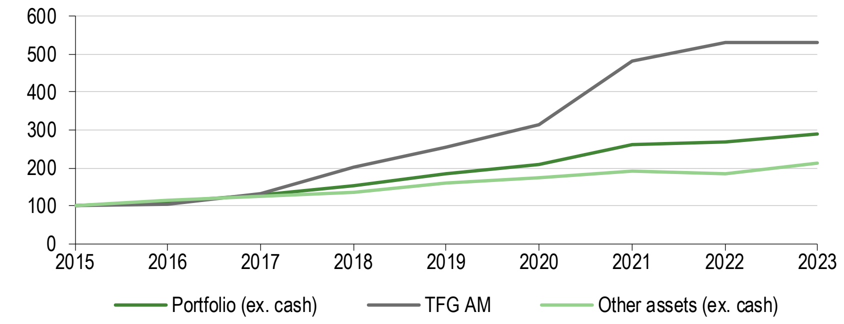
Tetragon Financial Group

FY23 growth driven by idiosyncratic factors

Investment companies
Alternative assets

Tetragon Financial Group (Tetragon) posted a 6.4% net asset value (NAV) per share total return (TR) in US dollar terms in FY23. Tetragon's returns normally have a low correlation with broader markets, and therefore its FY23 performance was below the 26.3% return of the S&P 500 Index, which rallied on the artificial intelligence (AI) theme. Tetragon's FY23 return on equity (RoE) of 5.5% was below its target of 10–15% pa. That said, its performance since listing was within the target range at 11.3%. Tetragon continues payouts to its shareholders, distributing US$83.6m in FY23 through buybacks and dividends (3.0% of opening NAV), with the dividend yield standing at 4.4%.

Cumulative gross returns of Tetragon's portfolio ex-cash (rebased)*



Source: Tetragon, Edison Investment Research. Note: *Calculated as gain/losses divided by opening fair value, ie not adjusted for investments or disposals during respective years.

Why invest in Tetragon Financial Group?

Tetragon invests in alternative assets with diverse exposure providing returns with a low correlation with traditional asset classes. This may be compelling for investors seeking to expand their portfolios beyond traditional bond and equity exposures, for instance into assets benefiting from high interest rates (eg equity tranches of collateralised loan obligations, CLOs) or offering a certain degree of inflation protection (real estate, for example). We also note that Tetragon-owned asset managers generate recurring fee income, which supports Tetragon's ongoing costs and distributions.

The analyst's view

Tetragon's performance in 2023 was primarily driven by idiosyncratic developments in portfolio companies – favourable rulings in the Ripple case, good operational developments in one of its Australian gold projects, one biotech company reporting encouraging developments for its potential cancer and autoimmune therapies, as well as exposure to companies positioned to benefit from AI infrastructure demand. After six consecutive years of TFG Asset Management being the main driver of growth (see chart above), its valuation remained broadly flat in 2023 (0.2pp contribution to NAV), while Tetragon's portfolio of listed equities contributed 4.5pp in growth (from biotech and AI) and private equity exposure added a further 3.3pp (from Ripple Labs and the above-mentioned gold project).

In this report, market data are derived from LSEG and company data are provided by Tetragon (unless otherwise specified).

16 April 2024

Price*		**US$10.00**
Price (TFGS)*		**803p**
Market cap*		**US$906m**
NAV**		**US$2,801m**
NAV per share**		US$30.93
Discount to NAV*		67.7%
Yield*		4.4%
Fully diluted shares in issue		90.6m
Code/ISIN		TFG/GG00B1RMC548
Primary exchange		Euronext Amsterdam
Secondary exchange		LSE Specialist Fund Segment
AIC sector		Flexible Investment
52-week high/low*	US$10.45	US$9.54
NAV high/low	US$31.13	US$29.09
Net debt**		6.5%

*Based on LSEG (formerly Refinitiv) data.
**As at end-February 2024.

Fund objective

Tetragon Financial Group's objective is to generate distributable income and capital appreciation. Tetragon's investment portfolio comprises a broad range of assets, including public and private equities and credit, real estate, venture capital, infrastructure, bank loans, legal assets and a diversified alternative asset management business.

Bull points

- Diverse portfolio with a proven track record.
- Recurring income from asset management business (TFG Asset Management).
- Shares available at a wide discount to NAV.

Bear points

- Above-average ongoing charge and performance fees.
- Only non-voting shares available for investors.
- Limited disclosure on some underlying investments means lower visibility of prospective returns.

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Tetragon Financial Group is a research client of Edison Investment Research Limited

Market outlook: The sky is clearing

2023 started off with lingering uncertainty driven by persistent inflation and fears of recession, which central banks addressed by the most aggressive rate hike cycles since 1980s. Over the course of the year, central banks' actions started to bear fruit, with headline inflation in the US decreasing from 6.5% in December 2022 to just 3.4% in February 2024, allowing the Federal Reserve to pause the cycle (last rate hike was in July), fuelling hopes for a soft landing. The markets expect that rate hikes are over and have started to price in rate cuts in the US, UK and EU by the end of 2024. Listed equities rallied in 2023, with the S&P 500 rising by 26.3% and the MSCI ACWI Local by 22.2%, driven by disruption from the adoption of AI, which initially drove the 'Magnificent Seven' stocks (Microsoft, Amazon, Apple, Alphabet, Nvidia, Tesla and Meta) to average 112% growth over the year. In the later part of the year it also prompted growth in the prices of companies that should be able to implement AI into their businesses. Tetragon expects its hedge fund positions focused on equities to benefit from this trend in 2024, while its AI-related tech stocks within the direct portfolio rallied in late 2023 (total direct stocks portfolio was up 69%).

Gold remains attractive

Tetragon's investments in gold projects in Australia (mining, exploration and development) were among its best performing investments in 2023, due to positive operational developments and favourable market environment. The gold price (up 13% in 2023) has been supported by a combination of geopolitical uncertainty (war in Ukraine, tensions over Taiwan, instability in the Middle East), expectations of a turn in the interest rate cycle in the US and economic woes in China. Interestingly, gold prices rebounded quite quickly after the sell-off during the monetary tightening in 2022. Moreover, we note that, according to the World Gold Council, central bank purchases of 1,037.4 tonnes in 2023 were the second highest in history (with the People's Bank of China being the largest buyer) and close to the all-time high of 1,081.9 tonnes in 2022. We dive deeper into the gold market in our thematic note Shades of the 1970s – Gold: September 1979 revisited.

Infrastructure investments as a hedge against inflation

According to infrastructure asset managers, the demand for infrastructure-focused funds remains high among investors, but liquidity constraints played a major role in lower than intended commitments to infrastructure. According to Infrastructure Investor, global fund-raising for closed-end infrastructure dropped by 35% y-o-y in 2023 to US$112bn (2022: US$172bn), but at the same time 40% of surveyed investors were willing to increase their allocation to infrastructure assets. While Tetragon does not invest directly in infrastructure, it has a 75% stake in infrastructure asset manager Equitix, its largest holding (26% of NAV), which increased its AUM by 16% in 2023 to US$13.9bn.

CLOs still healthy at aggregate level

In line with market expectations, the uncertainty around a looming recession and rising interest rates tamed the demand for new CLO issuance in early 2023 but, as the market revived in the later part of the year, the total issuance volume (in the US) exceeded market expectations, at US$116bn vs US$90bn expected at the beginning of the year. Nevertheless, total issuance was below the 2022 level (US$129bn). The default rates within CLO collateral remain low, despite higher interest rates and a visible uptick in defaults – Fitch increased its 2024 default forecast in May 2023 to 3.5–4.5% for US high-yield (HY) bonds (from 3.0–4.0% expected in January 2023 and 1.3% seen in 2022) and 3.5–4.5% for US leveraged loans (from 3.0–4.0% and 1.6%, respectively). Nevertheless, the cumulative expected default rate for 2023–24 stands at 8.25% compared to 22% in 2007–09.

Increasing defaults (preceded by rating downgrades) particularly affect CLO structures after their reinvestment period, that are no longer able to rotate their collateral portfolio. This will likely translate to more frequent redemptions and resets in structures of an older vintage at the discretion of equity tranche holders. Tetragon invests predominantly in equity tranches both directly and indirectly and took the opportunity for an optional redemption of one non-LCM structure in 2023. Importantly, none of Tetragon's CLO holdings failed their over-collateralisation test as at end-2023.

Fund profile: A broadly diversified portfolio

Tetragon Financial Group is a closed-ended investment company trading on the London Stock Exchange (LSE) and Euronext Amsterdam. It invests in a broad variety of asset classes with exposure to public and private equities and credit, convertible bonds, real estate, venture capital, infrastructure, CLOs, legal assets and TFG Asset Management, a diversified alternative asset manager. The company is domiciled in Guernsey and was founded in August 2005. Tetragon's shares were admitted to trading on Euronext Amsterdam in April 2007 and listed on the Specialist Fund Segment of the LSE in November 2015 (ticker: TFG). In April 2018, an additional sterling LSE market quote was introduced under the ticker TFGS and investors may elect to be paid cash dividends in sterling, instead of the company's base operating and reporting currency (US dollars), as well as in Tetragon shares. Tetragon's listed shares are all non-voting.

Tetragon is ultimately controlled by its co-founders, Reade Griffith and Paddy Dear. They own the voting shares in the company, as well as Tetragon's investment manager – Tetragon Financial Management (TFM). TFM's Investment and Risk Committee, which determines Tetragon's investment strategy and approves all major investments, comprises Griffith and Dear as voting members and Stephen Prince (CEO of TFG Asset Management), who all have experience in alternative investments. Tetragon and TFG Asset Management employees cumulatively held 39.2% of outstanding non-voting shares in Tetragon at end-December 2023.

Investment process: Targeting risk-adjusted returns

The investment manager focuses on alternative asset classes that it believes offer 'intrinsic alpha' (excess returns relative to their assessed investment risk) and aims to diversify its portfolio of assets that are relatively uncorrelated with broader financial markets. New investment analyses include evaluations of risk/reward, correlation, duration and liquidity characteristics. Tetragon searches for managers it believes are high-quality specialists with successful track records, and aims to invest not only in managed funds, but also in the manager to supplement its returns with stable fee income and capital appreciation from growing third-party capital.

When assessing whether to acquire a stake in a new asset manager, TFM takes into consideration performance track record, reputation, regulatory requirements, infrastructure needs and asset-gathering capacity. The potential profitability and scalability of the asset management business are also important considerations. To mitigate potential correlated risks across asset managers, Tetragon seeks to diversify exposure across asset classes, investment vehicles, duration and investor type.

The fund manager: TFM

Tetragon is managed by TFM. TFM was founded and is owned by the co-founders of Tetragon (Reade Griffith and Paddy Dear). While Tetragon pays management fees to TFM, in terms of decision making it can be viewed as a self-managed entity, because the investment manager is owned and run by the same two individuals who indirectly own voting shares in Tetragon.

The manager's view: Low correlation and diversification

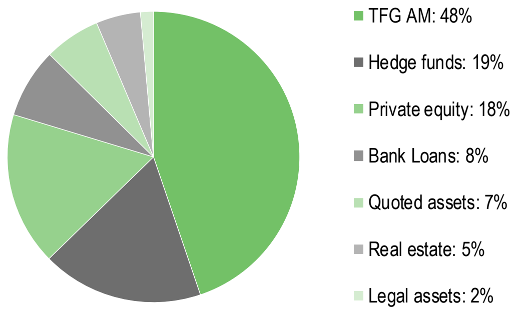
TFM aims to manage a diversified portfolio with limited correlation with broader macro factors rather than actively positioning the portfolio in anticipation of a particular scenario materialising in financial markets. In 2024, Tetragon plans to continue funding commitments towards TFG Asset Management and expects that allocation of capital to TFG Asset Management will therefore increase. Tetragon sees TFG Asset Management as its main value driver and is considering setting up new managers, acquisitions and partial disposals as viable future developments (including the disposal of BGO expected in 2026 based on SunLife's call option). The potential disposal/IPO of TFG Asset Management is being taken into account, although it is unlikely in the near future. Tetragon expects a stable allocation to most of its asset classes in 2024, as disposals and distributions are likely to be reinvested in new assets, and an increase in allocation to funds managed by Banyan Square Partners (private equity) and Contingency Capital (legal assets) in line with its investment commitments. Tetragon also hopes to make allocations to new asset classes, although it hasn't stated a particular direction.

For 2024, Tetragon expects the interest rate environment to ease, subject to an uncertain period of 'the last mile of disinflation'. It believes that the markets are balancing hopes of a 'soft landing' with concerns around slowing global GDP, exacerbated lately by hints of weakening in the US job market. Nevertheless, after the 2023 rally in tech stocks, Tetragon expects the valuations of equities in other sectors to improve, supporting returns in Tetragon's hedge fund strategies, which have limited exposure to stocks that have surged in 2023. Tetragon sees politics as the main risk factor for 2024, as growing geopolitical tensions across Europe, the Middle East and Asia add to overall economic uncertainty, as well as disturbing supply chains. In 2024, more than two billion voters in more than 50 countries will go to the polls, including in the US and UK, and Tetragon acknowledges that there could be significant political change against a geopolitically strained and economically complex backdrop.

Asset allocation

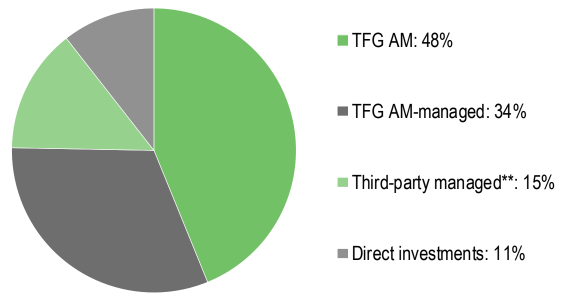
Tetragon manages a US$3.0bn (gross asset value) diversified portfolio of alternative assets as at end-February 2023. The vast majority of the portfolio is internally managed, as roughly half (data as at end-December 2023) is represented by TFG Asset Management (Tetragon's ownership of asset management businesses), a further 34% is managed by majority-owned asset managers and 11% is direct private equity and listed investments. While 15% of the portfolio is managed by third parties, we note that 8pp of that exposure is represented by funds managed by minority-owned asset managers within TFG Asset Management: BGO (3.9% of NAV) and Acasta Partners (3.8%). During 2023, Tetragon's portfolio generated US$307m in distributions (US$93m net of investments), representing 11% of its opening NAV (3% net). Nevertheless, this did not fully cover Tetragon's dividend distributions and ongoing costs, and in effect the net indebtedness increased to US$244m and 8.6% of NAV (from US$168m and 6.1% of NAV at end-2022), which was subsequently decreased to 6.5% at end-February 2024 following distributions predominantly from other equities and credit.

Exhibit 1: Portfolio* by asset class (February 2024)



Source: Tetragon Financial Group, Edison Investment Research. Note: *Excluding net negative cash of 6%.

Exhibit 2: Portfolio* exposure by manager (December 2023)



Source: Tetragon Financial Group, Edison Investment Research. Note: *Excluding net negative cash of 9%. **Including investments by minority-owned managers within TFG Asset Management (BGO and Acasta Partners).

TFG Asset Management

TFG Asset Management is an umbrella entity of Tetragon's stakes in asset managers with various investment mandates. It currently comprises 10 asset managers with combined AUM of US$41.5bn (including minority-owned BGO on a pro rata basis and minority-owned Acasta Partners in full). As at end-December 2023, TFG Asset Management is valued at US$1.3bn, representing 48% of Tetragon's NAV. In 2023, the company distributed US$5m to Tetragon on a net basis (US$65.7m distributions and US$61.0m investments), with the main distributions being the dividend from Equitix (US$28m) and contractual payments from BGO (US$18m), mostly offset by further investments including working capital support for managers in the ramp-up phase.

The largest asset within TFG Asset Management (and the largest single investment in Tetragon's portfolio) remains its 75% stake in the integrated core infrastructure manager, Equitix, representing 26% of Tetragon's NAV. Equitix manages a portfolio of more than 360 assets across 21 countries valued at £10.9bn as at end-2023, generating substantial fee income and the main driver of TFG Asset Management's 2023 US$77m net profit, according to our calculations.

A further 10% of Tetragon's NAV is represented by its 13% stake in BGO (formerly BentallGreenOak), which manages 64m square feet of real estate space around the world valued at US$83bn. The value of Tetragon's investment is based on an agreed series of fixed and variable distributions, as well as a put/call option valuation, which were put in place in 2019 following the merger of GreenOak Real Estate with Bentall Kennedy.

Wholly owned LCM represents 9% of Tetragon's NAV, valued at US$259m at end-2023. It is a CLO manager and originator with AUM of US$10.7bn, which decreased from US$12.5bn at end-2022. LCM did not launch any new structures in 2023 due to the unfavourable environment, while the continued distributions from existing structures diminished their size. Importantly, all LCM-managed CLOs were compliant with their junior-most over-collateralisation tests.

Five further asset managers are wholly owned by Tetragon. Westbourne River Partners (formerly Polygon) manages predominantly open-ended hedge funds as well as private equity vehicles with AUM of US$0.9bn. Tetragon Credit Partners manages US$0.9bn in CLO investments (focused on equity tranches). Hawke's Point provides capital to companies in the mining and resource sectors and its current portfolio comprises a series of gold and battery metal assets in North America and Australia valued at US$0.1bn in total. Banyan Square Partners focuses on minority PE investments in enterprise software and technology sectors, with current AUM of US$0.1bn.

Tetragon also has a non-controlling stake in Acasta Partners, which invests predominantly in convertible bonds and volatility-linked instruments, while having a multi-disciplinary approach and broad investment mandate including commodities and other opportunities across the credit markets. While Tetragon sold the majority of its stake in a management buyout in 2021, it still provides infrastructure and other services to the manager, which remains closely linked to TFG Asset Management. Similarly, Tetragon holds minority stake and provides all infrastructure for Contingency Capital, which invests in credit-oriented legal assets and has AUM of US$0.7bn.

Hedge funds

Tetragon's investments in open-ended hedge funds made up 20% of its NAV at end-2023. It invests predominantly in funds managed by TFG Asset Management's managers – Westbourne River Partners (79% of the exposure) and Acasta Partners (19%). The largest exposure is to Westbourne River Event Fund, which is focused on high-conviction, catalyst-driven European stocks, and its portfolio is relatively concentrated. In 2023, Tetragon invested US$32m in hedge funds (US$29m of which was into Westbourne River Event Fund) and sold US$17m (US$10m of which was from Acasta funds), implying a net investment of US$16m.

Private equity and venture capital

Tetragon invests in private equity assets through funds and directly on its balance sheet. The majority of the exposure is through funds managed by wholly owned managers (Banyan Square Partners 25%, Hawke's Point 23%) and direct investments (22%), with the remaining 30% (5% of total NAV) managed by third-party managers. Third-party exposure is granular and consists of 36 positions across Europe and North America. The direct investments pool represents mainly (93%) Tetragon investment in preferred shares of Ripple Labs, a cryptocurrency-focused technology company developing a payment protocol and an exchange network. Tetragon invested US$41m on a net basis in private equity assets, predominantly in third-party managed funds (US$19m net in six new positions) and direct investments (US$15m net).

Bank loans

Tetragon invests predominantly through equity positions in CLO structures, both through its own balance sheet (55%) and through Tetragon Credit Partners' funds (45%) and its exposure to bank loans represents 9% of its NAV. The direct investments are predominantly made into CLO structures originated and managed by fully owned LCM (96% of direct CLO investments). At the same time, Tetragon Credit Partners invests a part of its funds in CLOs launched by LCM. Over 2023, CLOs distributed US$77m to Tetragon, predominantly through amortisations, while Tetragon invested a modest US$6m into Tetragon Credit Partners' funds amid subdued new CLO issuance during the year, effectively reducing its exposure to bank loans by US$60m.

Other equities and credit

Tetragon's exposure to equities and credit increased to US$212m and 8% of NAV over 2023 (reflecting the strong performance of stocks, see below), despite hefty disposals of US$119m. The exposure consists mainly of a concentrated portfolio of a few high-conviction stocks (93%), supplemented by minor public debt investments.

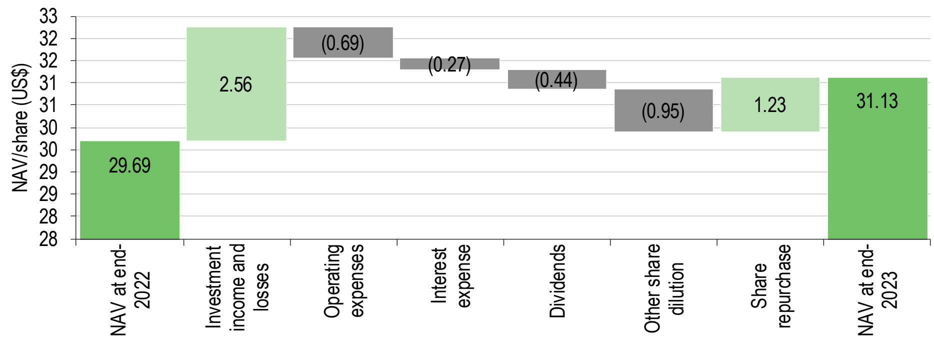
Real estate

The majority (74%) of Tetragon's US$148m (5% of NAV) real estate investments are allocated to funds managed by BGO. The funds focus on opportunistic investments in the mid-market across the US, Europe and Asia (predominantly Tokyo). The remaining real estate exposure consists of an investment in commercial farmland in Paraguay managed by Scimitar.

Performance

In 2023, Tetragon delivered a 6.4% NAV TR and a 5.5% RoE, which was below its target range (RoE of 10–15%), and in the first two months of 2024 its NAV decreased by 0.6%. Meanwhile, long-term performance remains within its target, with 11.1% RoE since inception to end-February 2024. Tetragon's portfolio of alternative assets that present a low correlation with equity and credit markets naturally did not follow the equities rally of 2023, with the MSCI AC World delivering a 22.8% return. Having said that, the main driver of Tetragon's NAV accretion was performance of its stock portfolio (led by one biotech stock), which delivered a 68% increase in value and 4.5pp in NAV return. The second best performing assets were private equity positions, predominantly Hawke's Point's gold mining projects and Ripple Labs. Overall, all Tetragon's asset classes delivered a profit in 2023, except for real estate investments, which posted a 4% loss.

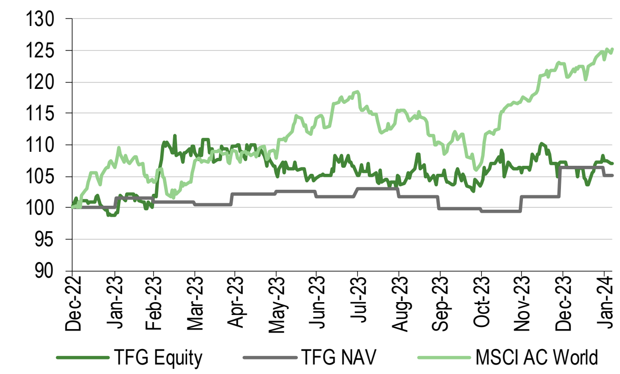
Exhibit 3: Tetragon's NAV per share development in FY22 (US$/share)



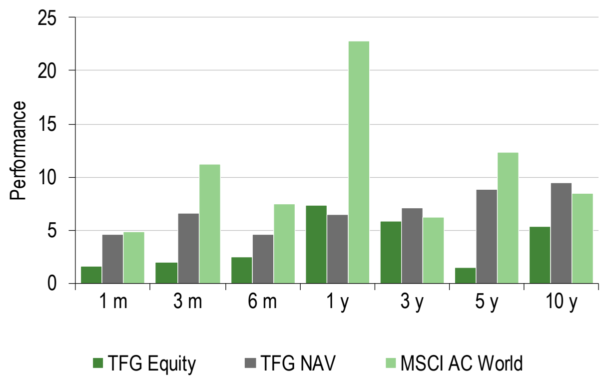
Source: Tetragon Financial Group, Edison Investment Research

Exhibit 4: Tetragon share price discount to NAV and performance data in US dollar terms

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance* (%)



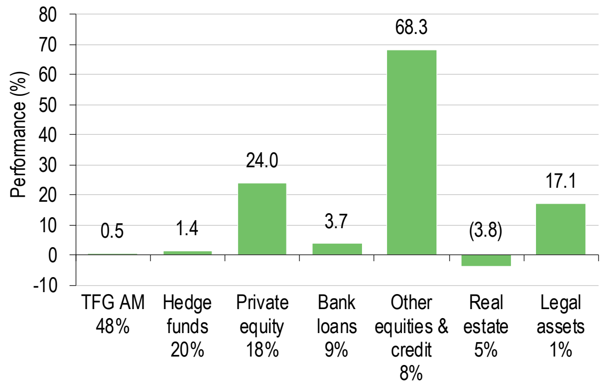
Source: LSEG, Bloomberg, Edison Investment Research. Note: *Performance data to end-December 2023, three-, five- and 10-year performance annualised.

Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI AC World (%)	UK All-Share (%)	S&P 500 (%)
31/12/19	11.5	13.6	27.3	24.0	31.5
31/12/20	(18.5)	9.5	16.8	(6.9)	18.4
31/12/21	(6.8)	14.1	19.0	17.2	28.7
31/12/22	18.5	1.0	(18.0)	(10.9)	(18.1)
31/12/23	7.3	6.4	22.8	14.4	26.3

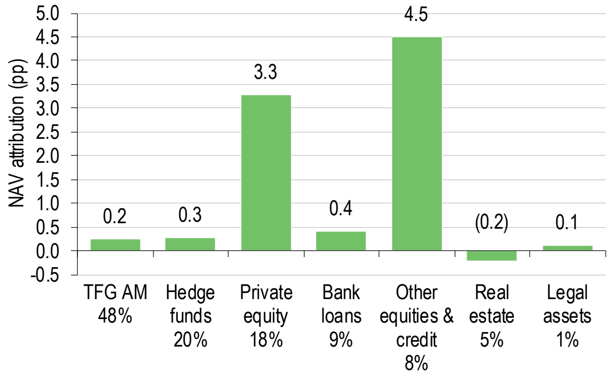
Source: LSEG. Note: All % on a total return basis in pounds sterling.

Exhibit 6: FY23 performance by asset class (%)



Source: Tetragon Financial Group, Edison Investment Research. Note: Calculated as gain/losses divided by opening fair value. Share of Tetragon's NAV at end-December 2023 stated on x-axis labels.

Exhibit 7: FY23 NAV attribution by asset class (pp)

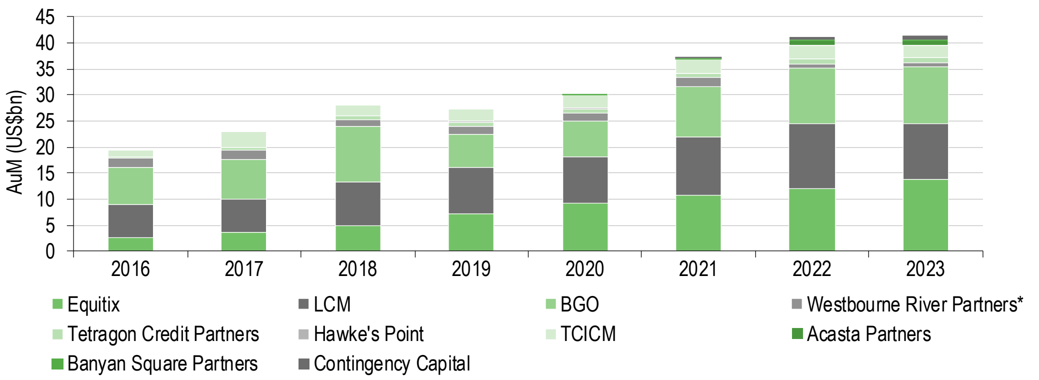


Source: Tetragon Financial Group, Edison Investment Research Note: Calculated as gain/losses divided by opening NAV. Share of Tetragon's NAV at end- December 2023 stated on x-axis labels.

TFG Asset Management's profit up 6% y-o-y

TFG Asset Management's value remained broadly flat in 2023 (up 0.5%) as the growth of Equitix (up 7.8%) was mostly offset by LCM (down 12.2%) and the remaining asset managers (down 2.9% in total). Equitix continues its solid growth – in 2023 its AUM increased to £10.9bn (from £10bn at end-2022), stemming from fund-raising in its managed accounts and initial commitments towards Fund VII. It posted a US$53m gain in valuation mainly on the back of solid results momentum, despite a 14% contraction in market multiples. On the other hand, LCM's AUM decreased by 14% y-o-y to US$10.7bn, reflecting a combination of not issuing any new deals due to market conditions and amortising some existing deals, which directly translated to a lower valuation based on AUM multiples.

Exhibit 8: TFG Asset Management's AUM (US$bn)



Source: LSEG, Tetragon Financial Group, Edison Investment Research. Note:*Formerly Polygon

TFG Asset Management generated a US$77m profit, 6% higher y-o-y. Tetragon recognised US$18.4m income from BGO, reflecting its fixed quarterly contractual payments, variable payments and carried interest, which amounted to US$17.8m on a cash basis. Management fees increased by 6% to US$180m, which was predominantly attributable to the increasing AUM of Equitix, as well as the full-year effect of CLOs launched by LCM in 2022. Performance fees increased by 33.3%, but this was mostly driven by minority owned Acasta Partners. On the other hand, operating costs increased by 12% y-o-y to US$205m, with 67% of the increase attributable to Equitix as it added headcount and continued to scale up.

Exhibit 9: TFG Asset Management pro forma income statement (US$m)

	2019	2020	2021	2022	2023
Management fee income	111.2	125.8	143.4	169.4	179.5
Performance and success fees	51.8	81.6	59.6	48.9	65.2
Other fee income	15.5	18.9	24.0	30.5	40.5
Distributions from BGO	10.8	18.1	21.6	19.7	18.4
Interest income	3.8	4.1	0.5	5.4	2.8
Total income	**193.1**	**248.5**	**249.1**	**273.9**	**306.4**
Operating, employee and administrative expenses	(124.3)	(145.8)	(178.3)	(182.8)	(204.8)
Minority interest	(9.3)	(27.5)	(20.1)	(18.8)	(24.8)
Net income – 'EBITDA equivalent'	**59.5**	**75.2**	**50.7**	**72.3**	**76.8**

Source: Tetragon Financial Group

Other equities and credit

The portfolio of stocks was the largest contributor to Tetragon's NAV performance, rallying 68% year-on-year and providing US$124m in gains in FY23. Approximately two-thirds of gains was driven by companies providing AI infrastructure and AI applications, and the remaining part was largely attributable to a UK-based biotech company reporting encouraging developments for its potential cancer and autoimmune therapies. Tetragon used the opportunity to sell part of the portfolio, realising US$119m cash inflow.

Private equity

Tetragon's private equity investments were the second-best performing asset class within its portfolio. The US$91m gain (24% of opening value) was driven by 86% y-o-y valuation growth in funds managed by Hawke's Point and a 50% gain on Ripple Labs. The valuation gain of the Hawke's Point fund was driven by operational progress at one of its Australian gold project investments. Ripple Labs (issuer of XRP token) benefited from good newsflow. In July 2023, a US judge ruled that Ripple Labs did not violate federal securities law by selling its XRP token on public exchanges, and the court subsequently dismissed the Securities and Exchange Commission's (SEC's) request for an interlocutory appeal. Simultaneously, crypto markets and related assets rallied on the back of expectations that the SEC is preparing to approve the first spot bitcoin ETFs.

Bank loans

Tetragon investments in CLO equity tranches delivered a 3.7% valuation gain in 2023, contributing 0.4pp to NAV accretion. CLO equity positions benefit from rising risk-free rates, which translates to higher residual payments as well as good reinvestment opportunities, which materialised predominantly in LCM-managed positions. The loan losses level remains benign and all CLO structures, in which Tetragon held direct and indirect interest, passed their junior-most over-collateralisation tests, although Tetragon saw some realisation of losses on loans of older vintage, which partially offset revaluation gains. Tetragon also directed the optional redemption of one non LCM-managed CLO, which increased the cash distributions received in 2023.

Other assets

The remaining assets in Tetragon's portfolio (hedge funds, real estate and legal assets, comprising 27% of NAV at end-2023) were broadly flat in 2023 (see Exhibits 6 and 7) and did not contribute to NAV development meaningfully.

Peer group comparison

In Exhibit 10 we present a sterling-based comparison of Tetragon with eight members of the AIC Flexible Investment sector. We note that the Flexible Investment sector varies widely in terms of investment strategies and mandates, and Tetragon's investment approach is very diversified, which means none of the companies is a perfect direct comparator. That said, we consider Caledonia Investments, RIT Capital Partners and abrdn Diversified Income & Growth (ADIG) better comparators, given the relatively high share of private market investments in their portfolios. However, we note that ADIG's managed wind-down was recently approved by shareholders. Tetragon shows above-average NAV returns in every presented period. Despite this and having an above-average dividend yield, Tetragon trades at the widest discount among peers.

Exhibit 10: Selected AIC Flexible Investment sector peer group in sterling terms at 16 April 2024*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Premium/ (discount)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Tetragon Financial Group	**669.0**	**4.1**	**22.1**	**45.0**	**143.5**	**(67.7)**	**1.75**	**Yes**	**106**	**4.4**
abrdn Diversified Income & Growth	224.7	(0.4)	10.7	12.5	16.1	(30.4)	1.74	Yes	100	9.8
Caledonia Investments	1,886.3	5.3	60.5	65.7	167.2	(35.6)	0.77	Yes	100	2.0
Capital Gearing	1,033.3	(0.7)	8.1	24.8	64.2	(2.0)	0.46	Yes	100	1.3
Hansa Trust 'A'	161.6	19.1	25.4	35.4	75.8	(46.0)	1.20	Yes	100	1.6
Personal Assets	1,653.6	3.1	13.7	30.0	66.6	(1.2)	0.65	Yes	100	1.6
RIT Capital Partners	2,626.6	3.3	11.6	42.1	111.9	(27.5)	1.59	Yes	112	2.2
Ruffer Investment Company	992.1	(6.4)	5.0	34.0	49.1	(6.1)	1.07	Yes	100	1.1
UIL	88.9	(12.6)	(42.2)	(29.0)	86.3	(43.2)	2.80	Yes	175	7.5
Average	**1,225.5**	**1.4**	**11.6**	**26.9**	**79.7**	**(24.0)**	**1.3**	**-**	**111**	**3.4**
Rank in peer group	**6**	**3**	**3**	**2**	**2**	**9**	**2**	**-**	**3**	**3**

Source: Morningstar, the AIC, Edison Investment Research. Note: *Performance data to 28 February 2024. TR, total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

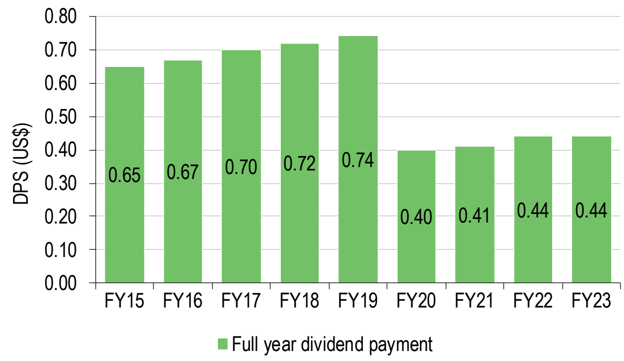
Dividends and share repurchases

Tetragon does not target a specific dividend payout ratio. Its board declares dividends, based on the recommendation of the investment manager, subject to the approval of Tetragon's voting shareholder and adherence to applicable law. Dividends are paid quarterly in May, August, November and March each year. Additionally, Tetragon regularly buys back shares from the market, with the programmes conducted through a Dutch auction at a price close to the shares' market price, resulting in NAV accretion.

In 2023, Tetragon distributed US$60m to shareholders by purchasing 5.7m shares through auctions, and a further US$23m in dividends, which translates to 3.0% of opening NAV in total. It has also recently concluded another US$25m tender offer. Tetragon repurchased 2.4m shares at US$10.25 per share – a 67% discount to end-February NAV and 2.5% premium to current share price. The tender was subject to 25% reduction, as 3.3m shares were tendered by investors.

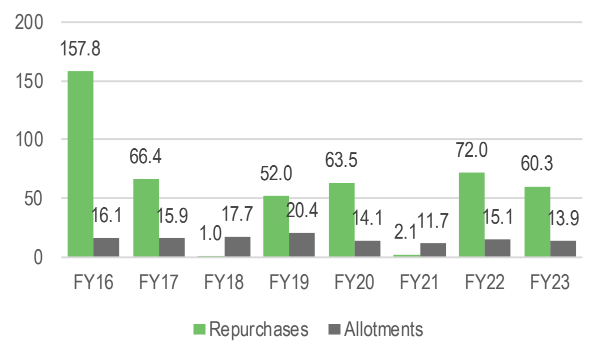
Shareholders may elect to receive dividends in the form of Tetragon shares and to receive dividends in sterling rather than in US dollars. The next US$0.11 quarterly dividend payment will be made on 3 April 2024 and DPS of US$0.44 paid from FY23 profits implies a 4.4% dividend yield. Tetragon has been gradually increasing its dividend per share over FY20–23, although payments have not yet returned to pre-pandemic levels. On the other hand, the lower DPS has been offset by higher share buybacks and the aggregate distributions are broadly in line with the pre-pandemic level. Having said that, the total distribution from FY23 profits was down 14% y-o-y.

Exhibit 11: Dividend paid from period earnings (US$)



Source: Tetragon Financial Group, Edison Investment Research

Exhibit 12: Shares repurchased and granted (US$m)



Source: Tetragon Financial Group, Edison Investment Research

Discount

Tetragon shares currently trade at a 68% discount to last reported NAV per share, which is broadly in line with its three-year average of 66%. Tetragon persistently trades at a significantly higher discount than its peers (see Exhibit 10), and we have discussed the possible reasons (including the fact that shareholders only have access to non-voting shares, a complex structure that is difficult to understand, as well as limited disclosures on some of the underlying assets) in previous notes.

Exhibit 13: Share price discount to NAV over five years (%)

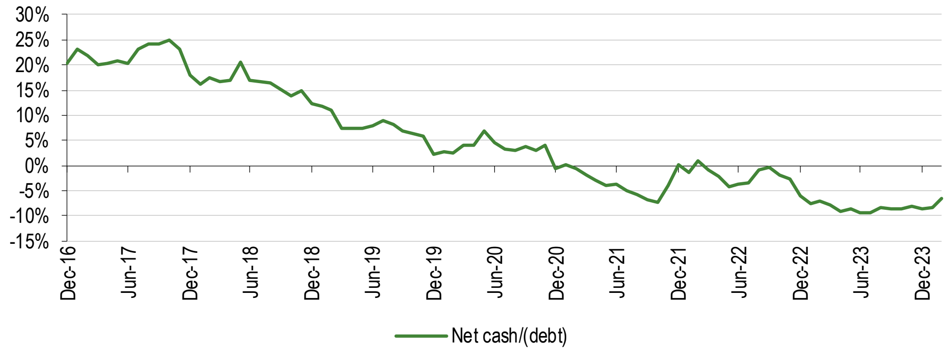
Source: LSEG, Tetragon Financial Group, Edison Investment Research

Gearing: Fully invested and slightly levered

Tetragon has a US$400m revolving credit facility in place, which was set up to manage portfolio liquidity and bridge any timing mismatches between investments and realisations. Having said that, Tetragon has remained in a slightly geared position for most of the time since 2020, with net gearing at end-2023 at 8.6% of NAV. The facility expires in 2032 and bears the following interest: a servicing fee of 0.015% of the total amount, a non-usage fee of 0.5% on any undrawn amount (US$150m at end-2023) and the Secured Overnight Financing Rate (SOFR) + 3.40% on the drawn amount (US$250m at end-2023). As at end-February 2024, net gearing has reduced to 6.5%.

Historically, Tetragon kept 10–20% of its NAV in cash available for new investments and has gradually reduced its net cash position over the last years (see Exhibit 14). Maintaining a lower cash balance was allowed by entering into a revolving credit facility. The undrawn amount of credit facility (US$150m) covers Tetragon's unfunded commitments (US$95m) in full.

Exhibit 14: Tetragon's net cash/(debt) position since 2016 (%)



Source: Tetragon Financial Group, Edison Investment Research

Fees and charges

Tetragon pays a management fee of 1.5% of NAV pa to TFM, calculated monthly. In addition, it pays a quarterly incentive fee of 25% of NAV accretion, subject to a hurdle rate of term SOFR[1] + 2.75% recalculated each quarter (Q124: 8.1% in total). The incentive fee is also subject to a high-water mark and the shortfall below the hurdle rate is not carried forward. However, the high-water mark is calculated based only on the previous quarter's NAV, which effectively means the high-water mark only applies to the two prior quarters.

Tetragon's ongoing charge ratio stood at 1.75% in FY22, broadly flat from 1.74% in FY22. Incentive fees in FY23 amounted to US$16.3m (down from 26.5m in FY22 and US$124.6m in 2021), which translated to 0.6% of opening NAV (0.9% and 5.0% in FY22 and FY21, respectively). Therefore, the overall ongoing charge (including incentive fees) ratio stood at 2.34%, down from 2.66% in FY22, according to our calculations.

From 2024, the board of directors will be entitled to a fixed fee of US$0.45m pa (US$150k for each member, up from US$125k previously; Dear and Griffith waived their fee). The directors have the option to elect to receive Tetragon shares instead of their quarterly fee, and 6.2k shares were granted in 2023 (versus 6.5k in 2022). Tetragon has an equity-based compensation scheme for some of its senior employees. The shares are bought from the market and held in an escrow account until they are vested on fulfilment of certain targets. In 2023, Tetragon bought 5.7m shares from the market via modified Dutch auctions and released 1.3m from treasury and escrow.

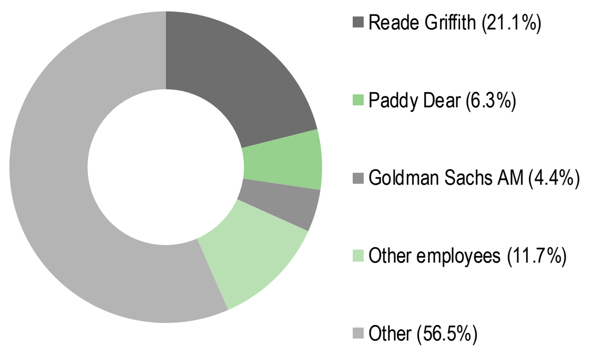
Capital structure

Tetragon's issued share capital consists of 10 voting shares and 139.7m non-voting shares. The voting shares are indirectly owned by the co-founders and are not entitled to any distributions. However, the co-founders also hold large stakes in Tetragon's non-voting shares. Excluding shares held in treasury (48m) and escrow (11m, see fees and charges section above), the total outstanding number of shares stood at 81m (91m on a fully diluted basis, including equity-based awards). Tetragon has strong employee ownership, aligning the interests of the company with those of shareholders, which stood at 39.2% as at end-December 2023.

[1] Term SOFR means a rate per year equal to the forward-looking term rate, based on the secured overnight financing rate published by the Federal Reserve Bank of New York.

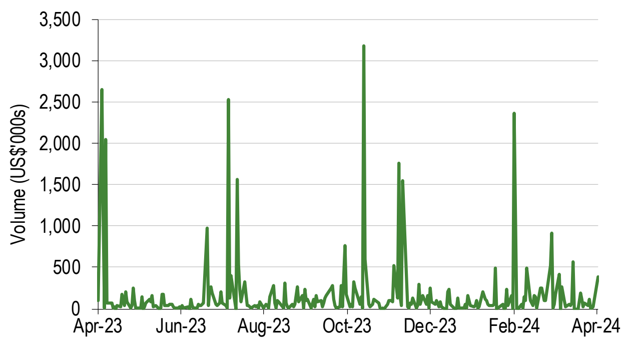
Tetragon's shares are traded on the Euronext Amsterdam and the LSE, with median daily turnover of US$34k and US$10k over the last 12 months, respectively. Management highlights that due to Tetragon's focus on professional institutions, the majority of turnover on its shares takes place on the OTC markets and in batches. Taking OTC trading into account, the average daily volume amounts to US$59k (see Exhibit 16).

Exhibit 15: Major shareholders



Source: LSEG, Tetragon Financial Group, as at 16 April 2024.

Exhibit 16: Average daily volume



Source: LSEG. Note: 12 months to 15 April 2023. Combined traded volume on Euronext Amsterdam, LSE and OTC markets.

The board

Tetragon's board comprises five directors, three of whom are independent. Each board member stands for re-election by Tetragon's voting shareholders each year at the AGM, with the voting shares controlled by Reade Griffith and Paddy Dear, non-independent board directors appointed in 2007 and 2005, respectively. Both are co-founders of Tetragon, Westbourne River Partners, TFG Asset Management and TFM. Reade Griffith is also employed by TFG Asset Management. For detailed biographies of the board members see our April 2019 note.

Exhibit 17: Tetragon Financial Group's board of directors

Board member	Date of appointment	Remuneration in FY23	Shareholdings at end-FY23
Reade Griffith	2007 (co-founder)	US$125,000*	21.02%
Paddy Dear	2005 (co-founder)	US$125,000*	6.25%
Deron J Haley	December 2018	US$125,000	0.04%
Steven W Hart	December 2018	US$125,000	0.04%
David C O'Leary	December 2018	US$125,000	0.07%

Source: Tetragon Financial Group. Note: *Reade Griffith and Paddy Dear have waived their fee (see capital structure and fees sections for details).

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