Tetragon Financial Group

Diversified alternative income and growth portfolio

Investment companies

Tetragon Financial Group (TFG) is a specialist closed-ended investment company, which aims to provide stable returns across economic and asset class cycles by investing in a diversified portfolio of selected alternative assets. Helped by the uplift to NAV per share from a US$65m tender offer in December 2017, Tetragon delivered a 9.0% NAV total return in US dollar terms in 2017, although currency moves held back returns in sterling terms. Tetragon's share price discount to NAV has widened in 2018, with the share price declining along with the broader stock market while NAV remained stable, increasing the scope for a narrowing discount to lift future shareholder returns. The total dividend for 2017 progressed 4.1% higher to US$0.70, giving Tetragon a sector-leading 5.6% yield.

12 months ending	Share price (%)	NAV (%)	MSCI AC World (%)	FTSE All-Share (%)	US 10y Govt Bond Index (%)
31/03/14	(0.4)	16.2	17.2	19.5	(4.3)
31/03/15	1.6	8.3	6.0	(5.1)	10.1
31/03/16	4.3	12.4	(3.8)	(7.0)	3.1
31/03/17	34.5	9.3	15.7	6.1	(3.0)
31/03/18	12.0	9.0	15.4	13.6	(1.1)

Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: 12-month rolling discrete total return performance in US dollar terms up to last reported NAV date.

Investment strategy: Diversified alternative approach

Tetragon's manager focuses on alternative asset classes, seeking uncorrelated, alpha-generating strategies that offer excess returns relative to their investment risk. Evaluations of risk/reward, correlation, duration and liquidity are used to gauge investment attractiveness and incremental effect on the portfolio. This approach has driven a steady increase in the diversification of Tetragon's portfolio to include bank loans, asset management businesses, hedge fund strategies, real estate, private equity and other direct investments. When allocating to a new asset class, Tetragon also seeks to take a stake in the asset manager, aiming to enhance asset level returns. Net cash of c 20% of NAV is typically held to fund cash flow commitments.

Market outlook: Recent volatility could continue

Current synchronised global economic growth provides a positive backdrop for corporate earnings growth to lead equity markets higher, but the potential duration of this economic upturn is uncertain. Geopolitical risks relating to the imposition of US trade barriers, and military developments in Syria could contribute to recent market volatility persisting. The potential for faster-than-expected interest rate hikes could also weigh on equity and bond markets. In this environment, alternative asset classes may appeal as a potential source of uncorrelated returns.

Valuation: Narrowing discount; above-average yield

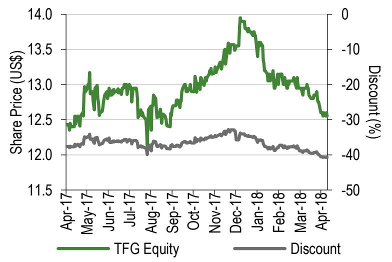
Tetragon's 40.8% share price discount to NAV is at a similar level to its 40.0% average over five years, but appreciably wider than its five-year low of 23.1%, suggesting that significant scope remains for it to narrow further. The 5.6% dividend yield ranks as the highest in the peer group and would remain among the highest even if the discount were to unwind fully.

10 May 2018

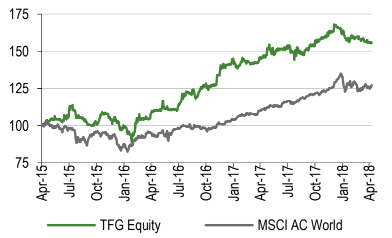
Price	**US$12.55**
Price (TFGS)	**927.50p**
Market cap	**US$1,195m**
NAV*	**US$2,018m**

NAV per share*	US$21.19
Discount to NAV	40.8%
*NAV as at 31 March 2018.	
Yield	5.6%
Fully diluted shares in issue	95.2m
Code	TFG/TFGS
Primary exchange	Euronext Amsterdam
Secondary exchange	LSE Specialist Fund Segment
AIC sector	Flexible Investment
Benchmark	N/A

Share price/discount performance



Three-year performance vs index



52-week high/low	US$13.95	US$12.13
NAV* high/low	US$21.19	US$19.92
*Including income.		

Gearing

Gross borrowings*	1.9%
Net cash*	16.6%
*As at 31 March 2018.	

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Edison profile page

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

Exhibit 1: Company at a glance

Investment objective and fund background

Tetragon's investment objective is to generate distributable income and capital appreciation, aiming to provide stable returns to investors across various credit, equity, interest rate, inflation and real estate cycles. Tetragon's investment portfolio comprises a broad range of assets, including a diversified alternative asset management business, TFG Asset Management, and covers bank loans, real estate, equities, credit, convertible bonds, private equity and infrastructure.

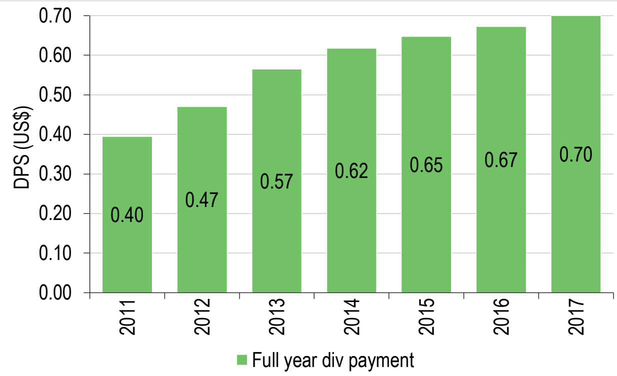
Recent developments

- 26 April 2018: US$0.1775 Q118 dividend declared vs US$0.1725 in Q117.
- 26 April 2018: Sterling LSE market quote introduced under ticker TFGS.
- 6 April 2018: J.P. Morgan Cazenove appointed as joint corporate broker, alongside Stifel Nicolaus Europe.
- 27 February 2018: FY17 results – NAV total return +9.0% vs MSCI AC World +24.6% and FTSE All-Share +23.8%, all in US dollar terms.
- 26 February 2018: US$0.1775 Q417 dividend declared vs US$0.1725 in Q416.
- 11 December 2017: US$65m tender offer – acceptances confirmed for 4.8m non-voting shares at US$13.60 per share.

Forthcoming		Capital structure		Fund details	
Investor day	2018 date TBC	Ongoing charges	1.74%	Group	Tetragon Financial Group
Interim results	July 2018	Net cash	16.6%	Manager	Tetragon Financial Management
Year end	31 December	Annual mgmt fee	1.5% of net assets	Address	1st Floor Dorey Court, Admiral Park
Dividend paid	May, Aug, Nov, Mar	Performance fee	25% over Libor+2.65% hurdle		St. Peter Port, Guernsey GY1 6HJ
Launch date	19 April 2007	Company life	Indefinite	Phone	+44 20 7901 8328
Continuation vote	N/A	Loan facilities	US$150m rolling credit facility	Website	www.tetragoninv.com

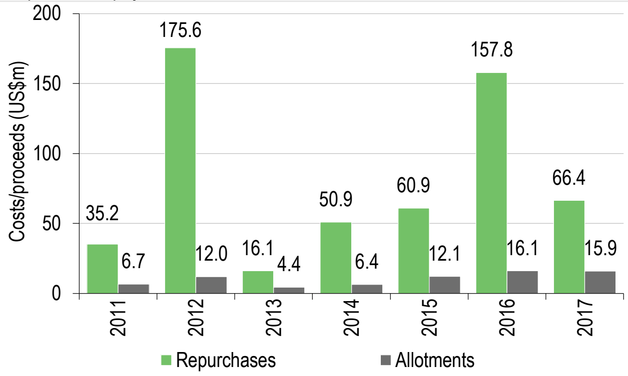
Dividend policy and history

Tetragon pays dividends quarterly and has a progressive dividend policy, targeting to pay out 30-50% of normalised earnings.

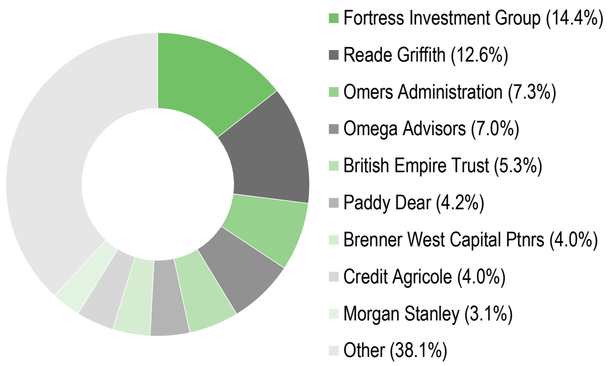


Share buyback policy and history

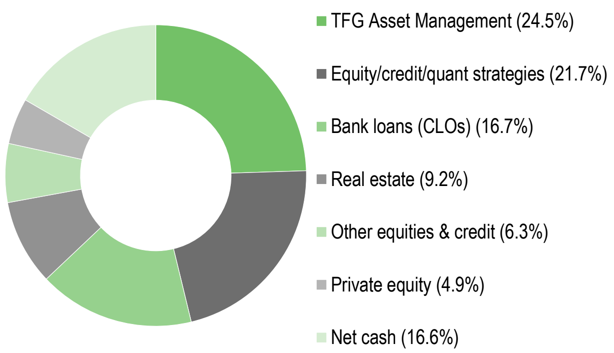
Tetragon made market share repurchases from 2007 to 2013 and has completed six tender offers totalling US$475m since 2012. Share allotments mainly relate to scrip dividend payments.



Shareholder base (as at 9 May 2018)



Portfolio exposure by asset class (as at 31 March 2018)



Top 10 holdings (as at 31 March 2018)

				% of NAV	
Holding	**Asset category**	**Investment structure**	**Description**	**31 Mar 2018**	**31 Mar 2017***
Polygon European Equity Opp Fund	Event-driven equities	Hedge fund	European event-driven equity hedge fund	12.8	10.2
Equitix*	TFG Asset Mgmt	Private equity	£2.7bn UK infrastructure fund asset manager	8.3	9.6
LCM*	TFG Asset Mgmt	Private equity	US$6.5bn CLO manager	7.4	5.5
GreenOak Real Estate*	TFG Asset Mgmt	Private equity	US$7.6bn global real estate asset manager	5.2	3.4
Polygon Convertible Opp Fund	Convertible bonds	Hedge fund	Event-driven credit hedge fund	3.7	2.7
TCI II	Bank loans	CLO fund	US broadly syndicated corporate loans	3.3	0.7
Polygon*	TFG Asset Mgmt	Private equity	US$1.6bn hedge fund manager	3.1	3.1
Polygon Distressed Opps Fund	Distressed opps	Hedge fund	Distressed opportunities hedge fund	2.8	5.4
Private investment	Private equity	Direct investment	Undisclosed direct balance sheet investment	2.1	N/A
GreenOak US II Fund	Real estate	Private equity-style fund	US real estate fund	2.1	2.0
Top 10 at each date				**50.8**	**45.2**

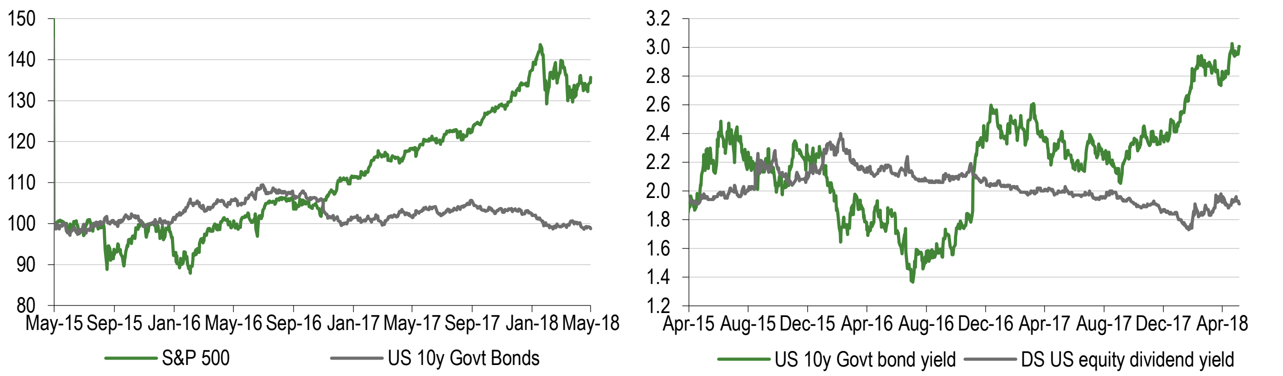
Source: Tetragon, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in March 2017 top 10.

Market outlook: Market volatility could persist

As illustrated in Exhibit 2 (left-hand chart), US equities have performed strongly over the last two years, but they experienced a sharp increase in volatility in the first few months of 2018. Returns on US government bonds have been lacklustre over the last three years, pressured by the outlook for interest rate hikes. However, recent bond market weakness has seen yields rise significantly (see Exhibit 2 right-hand chart) and pushed the yield premium of bonds relative to equities to its highest level in over five years, increasing the relative appeal of bonds as an asset class.

Exhibit 2: US equity returns and yields vs government bonds over three years

S&P 500 Index returns versus US government bonds | **US 10-year government bond yield versus US equities dividend yield**



Source: Thomson Datastream, Edison Investment Research. Note: Data to 9 May 2018.

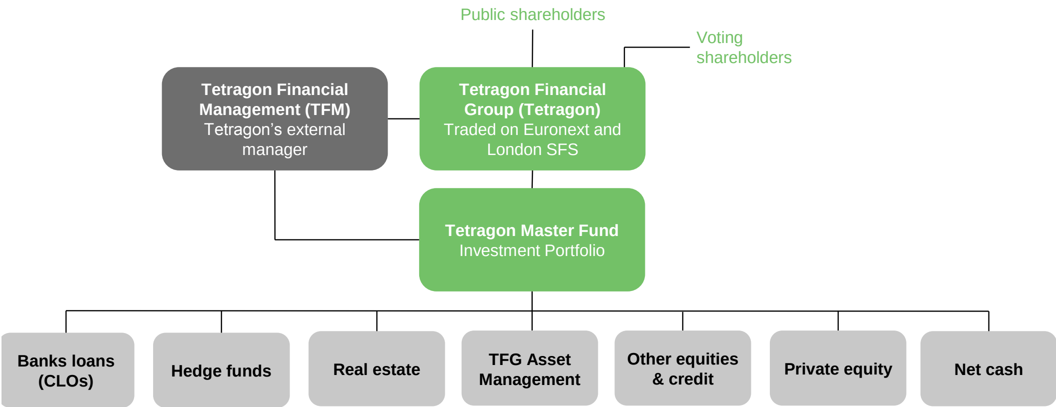
Although global equity market valuations have fallen from their recent peaks, Datastream data show that forward P/E multiples for most regional stock markets are still more than 10% above 10-year average levels. The data also show that stock market dividend yields are c 10% lower than 10-year average levels for most regions. This suggests that relatively limited scope exists for re-rating to lead equity markets higher, leaving corporate earnings growth as the main driver.

The global economy's current synchronised economic growth provides a positive backdrop for corporate earnings prospects, which could lead equity markets higher, but there is uncertainty over the potential duration of this economic upturn. A number of geopolitical risks exist, including over the imposition of US trade barriers, and political and military developments in the Middle East, which could contribute to market volatility. The investment outlook is also clouded by the potential for faster-than-expected rises in interest rates to weigh on the progress of equity and bond markets. In this environment, investors may wish to consider alternative asset classes as a potential source of uncorrelated returns.

Fund profile: Global alternative assets income portfolio

Founded in August 2005, Tetragon Financial Group is a Guernsey-domiciled, closed-ended investment company with the objective of generating distributable income and capital appreciation, aiming to provide stable returns to investors across various credit, equity, interest rate, inflation and real estate cycles. Tetragon's investment portfolio comprises a broad range of assets, including a diversified alternative asset management business, TFG Asset Management, and covers bank loans, real estate, equities, credit, convertible bonds, private equity and infrastructure. Tetragon's investment structure is such that its only direct investment is in shares of the Tetragon Master Fund, in which it holds 100% of the issued and outstanding non-voting shares (see Exhibit 3). Tetragon's shares were admitted to trading on Euronext Amsterdam in April 2007 and have also been listed on the Specialist Fund Segment of the London Stock Exchange since November 2015.

Exhibit 3: Tetragon group structure



Source: Tetragon Financial Group, Edison Investment Research

Tetragon's investment manager is Tetragon Financial Management (TFM), a company controlled by Reade Griffith and Paddy Dear, co-founders of Tetragon and Polygon (now part of TFG Asset Management), who also control Tetragon's voting shares. Griffith and Dear are the voting members of TFM's investment committee, which determines Tetragon's investment strategy and approves each significant investment. The committee also comprises Jeffrey Herlyn (due to retire in September 2018), Michael Rosenberg, David Wishnow and Stephen Prince (head of TFG Asset Management), who all have extensive experience in alternative investments.

Tetragon's investment strategy has four key elements:

- To identify attractive asset classes and investment strategies.
- To identify asset managers that demonstrate superior skill and experience.
- Using TFM's market experience to negotiate favourable terms for investments.
- Where appropriate, to take significant stakes in the asset management companies with which it invests, to enhance the returns achieved on its capital.

In addition, TFM seeks to continue to grow Tetragon's diversified alternative asset management business, TFG Asset Management, with a medium-term view to a possible initial public offering.

At inception, Tetragon focused on debt markets, in particular collateralised loan obligations (CLOs), but has substantially diversified its portfolio since 2010, currently deploying its capital across the following alternative asset categories (see Exhibit 4 for a description of the asset managers):

- **Bank loans** – third-party, TCICM and LCM-managed CLO equity investments primarily in US CLO transactions. At end-2017, the portfolio effectively comprised 22 direct CLO transactions and two investments in CLO investment vehicles through TCIP.
- **Hedge funds** – event-driven equity, convertible bond and distressed debt fund investments managed by Polygon and a quantitative strategies fund managed by Credit Suisse.
- **Real estate** – primarily investments in c 10 GreenOak-managed private equity-style funds and co-investment vehicles that concentrate on opportunistic investments targeting middle-market situations in the US, Europe and Asia.
- **TFG Asset Management** – private equity investments in a portfolio of asset managers, each specialising in a niche alternative investment strategy.
- **Private equity** – directly held private equity stakes and small allocations to various third-party managed private equity funds and a first investment in Hawke's Point.
- **Other equities & credit** – directly held investments in single strategy ideas, either co-investments with underlying managers or idiosyncratic investments which may be unsuitable for inclusion in TFG Asset Management vehicles.

TFG Asset Management

TFG Asset Management is Tetragon's alternative asset management platform, which owns majority and minority private equity stakes in asset managers. Tetragon may invest in funds managed by a TFG Asset Management business and also provide financial support to any fund, where it will benefit from value creation through its stake in the business. TFG Asset Management seeks to generate income and value through its businesses' managing and growing third-party investor capital. At end-2017, TFG Asset Management had aggregate client assets of US$23bn, with c 300 employees and main offices in New York and London.

Since its inception on Tetragon's acquisition of LCM in 2010, the platform has grown to include seven distinct asset management brands: LCM, GreenOak, Polygon, Equitix, Hawke's Point, TCIP and TCICM (see Exhibit 4). Majority stakes are held in all of the managers except the GreenOak joint venture and TCICM (a subsidiary of the TCI II fund managed by TCIP).

Exhibit 4: TFG Asset Management businesses as at 31 December 2017

Manager	Tetragon stake	Description	Asset class	Funds managed	AUM (US$bn)	Tetragon investment in funds (US$m)
LCM Asset Management	100%	CLO asset manager	Bank loans	16 CLOs	6.5	191.9
GreenOak joint venture	23%	Real estate-focused principal investing, lending and advisory firm	Real estate	15 funds and investment vehicles	7.6	132.9
Polygon Global Partners	100%	Manager of open-ended hedge fund and private equity vehicles across a number of strategies	Hedge funds Private equity	4** unlimited life funds 1 fixed life fund	1.6	424.3
Equitix	85%	Integrated core infrastructure asset management and primary project platform	Infrastructure	7 funds and investment vehicles	3.6	No direct fund exposure
Hawke's Point	100%	Asset manager that seeks to provide capital to companies in the mining and resource sectors	Mining finance	Hawke's Point Holdings	US$7.5m	7.4
Tetragon Credit Income Partners (TCIP)	100%	General partner of two private equity vehicles that invest in TCICM and LCM-managed CLOs	CLO equity	Tetragon Credit Income II & III (TCI II & TCI III)	0.6	68.1
TCI Capital Management (TCICM)*	N/A	CLO asset manager	Bank loans	6 CLOs	3.1	No direct fund exposure
					23.0	**824.6**

Source: Tetragon, Edison Investment Research. Note: *TCICM is a subsidiary of TCI II. **Will reduce to three unlimited life funds on closure of the Polygon Distressed Opportunities Fund.

Tetragon's investment manager, TFM, is responsible for acquisitions and disposals of asset management businesses. However, on acquisition these businesses become part of TFG Asset Management, which has its own management team responsible for the business as a whole, including oversight of the managers as they form and grow funds under management, and managing the cost base. From an operational perspective, each individual asset management business may be run autonomously or utilising the wider resources of TFG Asset Management's platform. In either case, the aim is for the business to benefit from an established infrastructure, which can assist in essential management functions such as risk management, investor relations, financial control, technology, and compliance/legal matters, while maintaining entrepreneurial independence. The platform currently provides infrastructure services to LCM and the GreenOak joint venture, infrastructure and investment management services to Hawke's Point and the TCI general partner, and oversight services with respect to Equitix.

Exhibit 5: Polygon fund assets and performance as at 31 December 2017

Fund	Description	AUM (US$m)	Tetragon investment (US$m)	Fund 2017 net return	Fund inception	Fund annualised net performance since inception
Convertible Opportunity	Primarily investing in North American and European convertible securities	532.5	55.3	7.9%	20 May 2009	15.4%
European Equity Opportunity	Primarily investing in major European equity markets with an event-driven focus	777.4	234.8	5.4%	8 July 2009	10.0%
Distressed Opportunities	Focused on opportunities in companies undergoing, or about to undergo, balance sheet restructuring	133.1	114.6	8.9%	2 Sept 2013	7.6%
Global Equities	Event-driven fund focused on global equity markets	22.4	19.6	6.8%	12 Sept 2011	12.4%
		1,465.4	**424.3**			

Source: Tetragon, Edison Investment Research. Note: Excludes Polygon's private equity Recovery fund (AUM: US$130.0m).

TFM's approach to growing TFG Asset Management takes into account the risk and reward of the opportunity. Within TFG Asset Management, maintaining the discipline to close businesses that do not deliver adequate returns is considered as important as identifying new businesses to add to the platform. This is reflected in the decision in late 2017 to close the Polygon Distressed Opportunities Fund. The fund's returns since inception were positive and attractive relative to its peers but, in light of other opportunities, it was determined that expected returns did not support Tetragon maintaining its investment in the fund and the portfolio manager, within the TFG Asset Management platform.

Exhibit 6: Valuation of TFG Asset Management businesses at 31 December 2017

Asset manager	Tetragon holding	Fair value (US$m)	Value % of Tetragon NAV	Valuation approach	Discount rate	Earnings multiple	Valuation % of AUM
Equitix	85%	152.2	7.6	Discounted cash flow analysis and cross-check to quoted market multiples. Debt at par + accrued interest	8.75% 15% DLOL	6.75x EBITDA	N/A
LCM	100%	144.3	7.2	Discounted cash flow analysis, cross-checked to market multiples	11.0% 15% DLOL	N/A	2.10%
GreenOak	23%	69.6	3.5	Quoted market multiples and cross-check using blended EBITDA and quoted market multiples	N/A	11.1x Blended EBITDA	N/A
Polygon	100%	56.0	2.8	Discounted cash flow analysis and cross-check to quoted market multiples	12.5% 20% DLOL	7.0x EBITDA	N/A
TCIP	100%	7.8	0.4	Discounted cash flow analysis	11.00%	N/A	N/A
Hawke's Point	100%	0.8	0.0	Replacement cost approach	N/A	N/A	N/A
		430.7	**21.6**				

Source: Tetragon, Edison Investment Research. Note: DLOL = discount for lack of liquidity.

The fund manager: Tetragon Financial Management

The manager's view: Optimistic on key allocations

Co-founder Reade Griffith observes that the investment manager has attempted to construct a portfolio for Tetragon that can generate positive returns in a variety of economic environments. He also argues that, particularly in the current environment, a portfolio diversified by asset class, geography, strategy and liquidity has a greater likelihood of producing returns within Tetragon's long-term target range. While he reflects that there may be market conditions in the future where the risk/reward of a particular asset class is such that a slightly less diversified portfolio would be favoured, he does not see any justification for this in the current environment. Griffith considers that the portfolio's performance in 2017 exemplified this approach in a number of ways. Firstly, gains were broad-based, with many different performance drivers across the portfolio. Secondly, the investment manager was able to source and invest in a number of discrete and profitable direct balance sheet investments, taking advantage of Tetragon's strong cash position.

The manager remains positive on Tetragon's CLO equity allocations, highlighting a number of attractive aspects to CLO equity in the current environment. Firstly, CLO equity provides investors with relatively short duration, and therefore less sensitivity to potential rises in interest rates. In addition, CLO equity provides investors with the opportunity to benefit from spread widening, due to a combination of fixed liabilities and floating-rate assets, as long as loan defaults are well-managed.

The manager also continues to be optimistic about the outlook for European event-driven equity investments, based on the view that the economic recovery in Europe remains a few years behind that of the US, with corporate profit margins in Europe having room to expand further, and the additional benefit of an increasingly stable political background. While emphasising that positive performance from Tetragon's allocation to European event-driven equities is not contingent on a strong economic backdrop, the manager believes that a more favourable economic environment could provide a tailwind to the strategy. It is noted that the strategy has historically achieved positive returns during weak economic periods as well as uncertain political environments.

TFM continues to seek new idiosyncratic direct investments across debt and equity, both private and public. In addition, the investment manager plans to broaden its direct investing capabilities to take further advantage of the deal flow generated by its third-party manager relationships. The manager aims to develop an investment process that is as replicable as practicable for these types of investments, observing that they often have the following common attributes:

- a strong degree of investment confidence regarding the potential risk and reward (where, for example, the situation has sourcing, legal or evaluation complexity); and
- Tetragon's long-term approach puts it in a favourable position versus other potential investors.

TFM also reiterates that TFG Asset Management continues its plan to grow its existing businesses through performance and growth in assets under management. A particular and uncommon set of attributes is seen by the manager to underpin Tetragon's ability to build asset management businesses: long-duration investment capital, global infrastructure within TFG Asset Management, and Tetragon's experience in building these businesses. It argues that a key element is Tetragon's ability to focus on the most compelling business opportunities at any particular time, considering current valuations against the long-term investment outlook.

Asset allocation

Investment process: Seeking excess risk-adjusted returns

To achieve Tetragon's objective of generating distributable income and capital appreciation, the investment manager focuses on alternative asset classes, seeking uncorrelated, alpha-generating strategies. TFM seeks to identify asset classes that offer excess returns relative to their appraised investment risk ("intrinsic alpha"). Analysis of prospective investments includes evaluations of risk/reward, correlation, duration and liquidity characteristics to gauge attractiveness and expected incremental effect on the portfolio. This approach has driven the steadily increasing diversification of Tetragon's portfolio to comprise a range of income-generating alternative investment strategies.

When a new attractive asset class is identified, TFM searches out high-quality specialist managers with a successful track record of investment across strategies within the asset class. TFM also reviews the range of investment vehicles that could be utilised, before selecting the most appropriate investment structure for Tetragon to optimise its risk-adjusted returns. To highlight the advantage that can be gained from combining the two aspects of this approach, the manager points to the superior returns achieved by Tetragon's US CLO equity strategy compared with the wider US CLO market. US CLOs delivered positive average annual returns on invested capital in each year from 2008 to 2015, with Tetragon's US CLO equity strategy outperforming the market in each year.

Where appropriate, TFM also seeks the opportunity for Tetragon to own a share of the asset manager, aiming to generate asset-level investment returns and enhance these returns with capital appreciation and income generation from the fees on third-party capital managed by the underlying asset management businesses. Tetragon uses its financial resources and experience to support the growth of these unlisted businesses, similar to a private equity or venture capital investor.

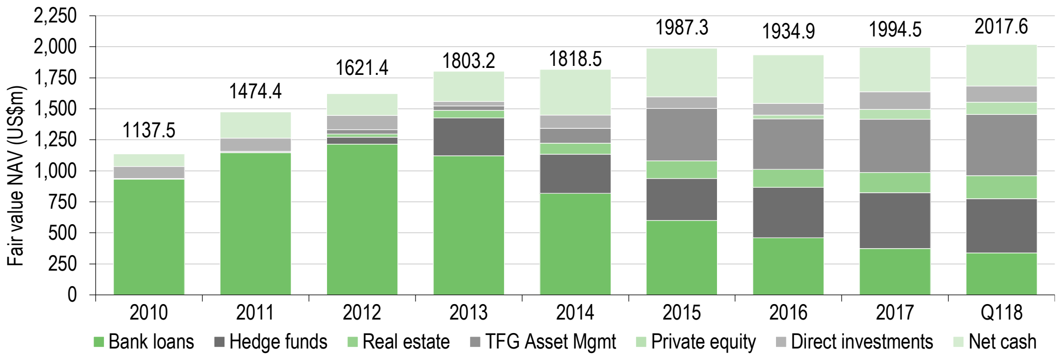
Evaluation of a potential asset manager to add to the TFG Asset Management platform typically includes consideration of performance track record, reputation, regulatory requirements, infrastructure needs and asset-gathering capacity. Potential profitability and scalability of the business are also important factors. Additionally, the core capabilities, investment focus and strategy of any new business should be complementary to TFG Asset Management's existing businesses. To mitigate potential correlated risks across investment managers, TFM seeks to diversify exposure across asset classes, investment vehicles, durations, and investor types.

As part of its investment strategy, TFM may employ hedging strategies and leverage in seeking to provide attractive returns while managing risk. However, in practice, Tetragon typically holds net cash equating to c 20% of its net asset value to fund cash flow commitments for existing and new investments, as well as dividends, fees payable to TFM and other potential uses of cash.

Current portfolio positioning

As illustrated in Exhibit 7, Tetragon has substantially diversified its portfolio across alternative asset classes since 2010. Having invested primarily in bank loans (mainly via CLO equity) from its inception, the first investments in asset managers (LCM and GreenOak) were made in 2010, while hedge fund strategies were introduced to the portfolio along with the acquisition of Polygon in 2012. Over the subsequent five years, portfolio diversification steadily increased, with TFG Asset Management expanding through the acquisition of Equitix in 2015, as well as the establishment of Hawke's Point and TCIP, in 2014 and 2015 respectively. The portfolio is now broadly diversified, with c 60% of net assets spread across asset managers, hedge fund strategies and bank loans, and c 20% spread across real estate, private equity and other direct investments. Tetragon also has exposure to a number of infrastructure investments through its ownership of Equitix (which holds stakes in the projects that it manages). Net cash has remained at c 20% of net assets since 2014.

Exhibit 7: Progression of Tetragon's net assets by value – 2010 to Q118



Source: Tetragon, Edison Investment Research. Note: Year-end net asset values shown.

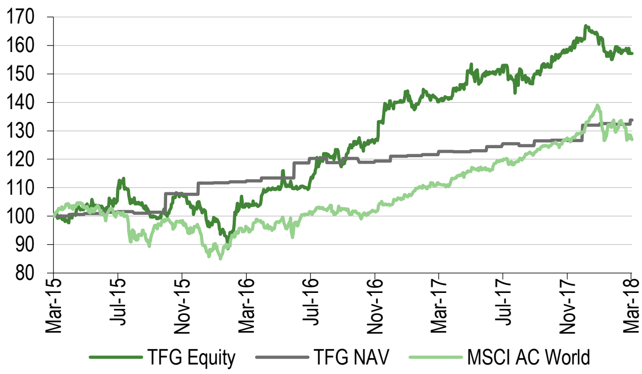
Tetragon's net asset value grew rapidly from US$1.1bn at end-2010 to US$2.0bn at end 2015 but has remained stable over the last two years. Although underlying NAV growth has been slower, this stabilisation reflects the US$349.2m of distributions that Tetragon has made over the last two years through dividends and share repurchases (mainly via tender offers). NAV per share has increased by 10.5% over this period, while NAV total return was 18.3%.

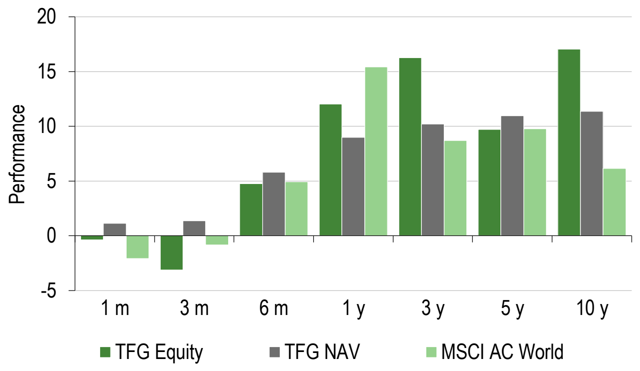
Performance: Steady upward NAV progression

Tetragon targets an absolute return of 10-15% pa and does not measure its performance against any equity benchmark, but comparison against the MSCI AC World index is provided as a reference for investors. As shown in Exhibit 8, in US dollar terms, Tetragon's NAV total return was ahead of the MSCI AC World index over three and five years to end-March 2018, and it substantially outperformed over 10 years. Over one year, Tetragon's share price and NAV total returns lagged the index rally, although neither experienced the level of volatility shown by the index in the first three months of 2018. Tetragon's NAV continued its steady upward progression, with a noticeably strong uplift in December 2017, due in part to the US$65m tender offer (priced at a 33% discount to NAV). As shown in Exhibit 9, Tetragon's NAV total return has significantly outperformed the FTSE All-Share index over three, five and 10 years, and has been considerably higher than the returns from US 10-year government bonds (treasuries) over one, three, five and 10 years. As illustrated in Exhibit 10, Tetragon's absolute return approach has achieved a slightly higher return than the MSCI AC World index over five years, significantly outperforming the index during the market weakness from February 2015 to February 2016, while lagging the market rally over the following two years.

Exhibit 8: Investment company performance to 31 March 2018 in US dollar terms

Price, NAV and index total return performance, three-years rebased	Price, NAV and index total return performance (%)





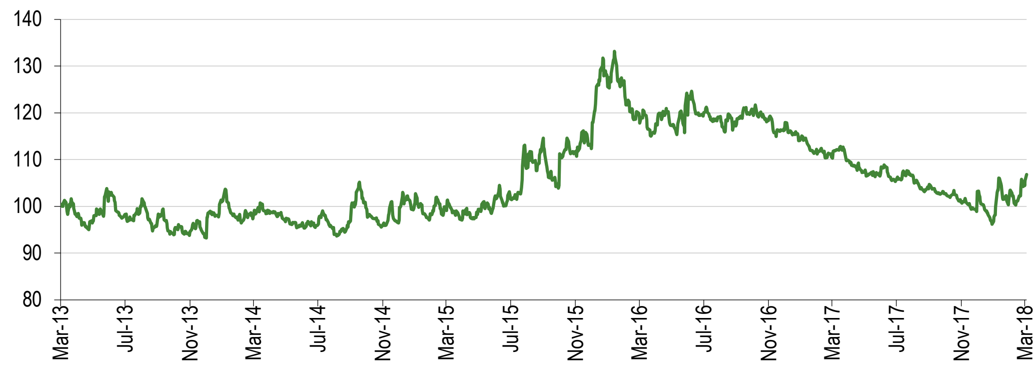
Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 9: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI AC World	1.7	(2.3)	(0.2)	(2.9)	22.3	(0.3)	165.7
NAV relative to MSCI AC World	3.3	2.2	0.8	(5.6)	4.2	5.5	61.5
Price relative to FTSE All-Share	(0.3)	0.3	2.5	(1.4)	40.2	25.1	258.8
NAV relative to FTSE All-Share	1.2	5.0	3.5	(4.0)	19.4	32.4	118.1
Price relative to US 10y Govt Bonds	(1.6)	(0.7)	7.6	13.3	58.8	52.5	237.3
NAV relative to US 10y Govt Bonds	(0.1)	3.9	8.7	10.2	35.3	61.4	105.0

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2018. Geometric calculation.

Exhibit 10: NAV total return performance relative to MSCI AC World index over five years

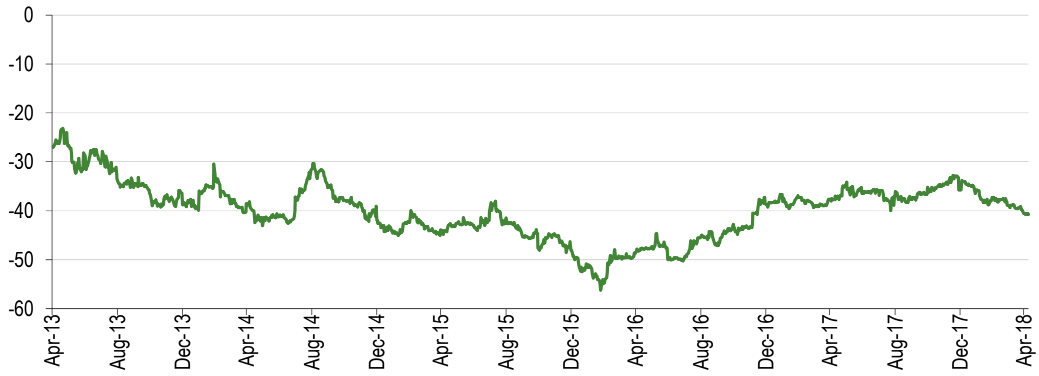


Source: Thomson Datastream, Edison Investment Research

Discount: Scope for narrowing to resume

As illustrated in Exhibit 11, while it has been relatively stable over the last 12 months, Tetragon's share price discount to NAV has narrowed significantly since February 2016, and is now close to the mid-point of its five-year range. However, the discount is still appreciably wider than its five-year low of 23.1%, suggesting that significant scope remains for it to continue narrowing. The current 40.8% discount is wider than its 36.7% one-year average, but narrower than its 42.0% average over three years. The widening of the discount at the start of 2018 reflects Tetragon's share price declining along with the broader stock market, while its NAV has continued to move higher following strong performance in December 2017.

Exhibit 11: Share price discount to NAV over five years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

Tetragon has two share classes, with 10 voting shares and 139.7m non-voting shares in issue. Voting shareholders may vote on the election of board directors and other matters, but do not receive dividends. Non-voting shareholders are entitled to receive dividends and other distributions.

At end-March 2018, 40.5m non-voting shares were held in treasury and 8.4m in escrow, leaving 90.8m shares outstanding. On a fully diluted basis, there were 95.2m shares outstanding at end-March 2018, including 2.1m escrow shares relating to deferred incentive fees payable to TFM, 2.1m in equity-based awards[1] to senior employees of TFG Asset Management (of the total 6.2m award-related shares in escrow), and 0.2m shares representing the intrinsic value of unexercised options issued as part of the acquisition of a 10% stake in GreenOak in 2010. The 10 voting shares are controlled by Tetragon co-founders Reade Griffith and Paddy Dear, who also hold significant stakes in Tetragon's non-voting shares (see Exhibit 1). In total, principal and employee holdings (including equity-based awards) represent 26.4% of Tetragon's outstanding shares.

Tetragon does not employ structural gearing at the corporate level but has access to a three-year US$150m revolving credit facility, which provides additional flexibility to the manager, in particular to exploit opportunistic investments. At end-March 2018, US$38m was drawn against this facility, representing 1.9% gross gearing, while Tetragon held a US$335.7m net cash position, equating to 16.6% of NAV. Similar to many private equity investment companies, Tetragon typically maintains a net cash position of c 20% of NAV to fund its new investment commitments, dividends and fees, partly due to the illiquid nature of its underlying investments.

Prospectively, the manager expects the following investment commitments to be drawn: GreenOak US$126.0m, TCI III US$65.0m, Hawke's Point US$87.2m, as well as two private equity commitments totalling US$8.6m. Not all of these commitments may be called in 2018, leaving scope for a proportion of the currently available cash to be used to fund the development of new businesses, opportunistic investments and acquisitions.

Tetragon pays management fees to TFM equivalent to 1.5% pa of Tetragon's net assets. Each quarter, TFM is also eligible to receive a 25% incentive fee on the increase in NAV above a hurdle. The hurdle is calculated as the higher of the two prior quarter-end NAVs (adjusted for dividends and capital adjustments) plus a hurdle rate, equal to three-month US dollar Libor plus 2.65% pa (giving hurdle rates of 3.95% and 3.98% for Q317 and Q417, and 4.34% for Q118). If the hurdle is not met in any calculation period, the shortfall is not carried forward to future periods.

1 TFG Asset Management's employee reward schemes typically have multiple vesting dates up to 2024. The shares are held in escrow until they vest and the dilutive effect is reflected over the life of the plans.

Management and incentive fee structures vary across Tetragon's investments, but we note that since May 2017, Tetragon has paid full fees on its investments in the Polygon European Equity Opportunity Fund (1.5% management fee, 20% incentive fee), Polygon Convertible Opportunity Fund (1.5% management fee, 20% incentive fee) and Polygon Distressed Opportunities Fund (2.0% management fee, 20% incentive fee).

Management fees for 2017 were US$29.5m, compared with US$27.8m for 2016. Incentive fees for 2017 were US$32.2m (of which US$13.9m related to Q417), compared with US$22.0m for 2016. Tetragon's ongoing charges (excluding incentive fees) for 2017 were 1.74% of average net assets, slightly higher than the 1.64% in 2016, and we estimate that ongoing charges including incentive fees were 3.38% in 2017 and 2.83% in 2016.

Dividend policy and record

Tetragon has maintained a progressive dividend policy since 2009, targeting to pay out 30-50% of normalised earnings (comprising investment income and capital gains), based on its long-term target ROE of 10-15%. Scrip dividends are paid through an optional dividend reinvestment programme. The board declares dividend payments subject to the approval of Tetragon's voting shareholders, with the level of dividend reflecting the following considerations:

- the expected sustainability of Tetragon's cash generation;
- Tetragon's recent performance and anticipated future returns;
- the outlook for the operating and economic environment; and
- other potential uses of cash, such as new investment opportunities.

Since its launch in 2007, Tetragon has paid regular quarterly dividends in May, August, November and March each year, with the quarterly dividend having progressed steadily higher since it was rebased at the beginning of 2009. Following a similar progression to previous years, in April 2018 Tetragon declared a US$0.1775 per share first interim dividend for FY18, in line with the dividend paid for Q417, 1.4% higher than the US$0.1750 dividends paid for Q2 and Q317, and 2.9% higher than the US$0.1725 dividend paid for Q117. The US$0.70 total dividend paid for FY17 represented a 4.1% increase over FY16 and equates to a 5.6% yield on the current share price.

Peer group comparison

Exhibit 12 shows a comparison in sterling terms of Tetragon with the nine other AIC Flexible Investment sector funds that have a market cap of more than £100m. Tetragon's NAV total return leads the peer group by a substantial margin over five and 10 years to end-March 2018, and is considerably higher than the average over three years. Currency movements have weighed heavily on Tetragon's one-year performance in sterling terms, with sterling strengthening by 12.2% versus the US dollar, leaving Tetragon's NAV total return over one year at the lower end of the peer group range on a currency adjusted basis. We note that Tetragon's 9.0% NAV total return over one year in US dollar terms (its functional currency) compares favourably to the sterling returns of its sterling-based peers. Tetragon's share price discount to NAV has narrowed appreciably over the last two years but remains the widest in the peer group, with the differential relative to peers suggesting scope for Tetragon's discount to narrow further. Tetragon's ongoing charge is at the higher end of the peer group range and it is one of four funds that charge a performance fee. Similar to the majority of peers, Tetragon has no corporate level gearing. Tetragon's 5.6% dividend yield ranks as the highest in the peer group, significantly ahead of the 2.2% average yield, and we note that the yield would remain at the higher end of the peer group even if the discount were to fully unwind.

Exhibit 12: Selected AIC Flexible Investment sector peer group in sterling terms as at 9 May 2018*										
% 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	879.9	(2.8)	41.6	82.2	315.6	(40.8)	1.74	Yes	100	5.6
Aberdeen Diversified Income & Growth	404.1	2.9	1.2	10.4	48.4	(3.8)	0.38	No	111	4.3
Capital Gearing	232.7	0.2	17.3	21.4	90.8	3.0	0.86	No	100	0.5
Hansa Trust A	234.6	6.2	23.4	34.3	71.1	(30.1)	1.09	No	100	1.6
Henderson Alternative Strategies Trust	107.9	2.4	19.4	19.1	(14.8)	(16.3)	1.06	No	100	1.7
JZ Capital Partners	408.5	(13.2)	5.5	24.4	1.8	(31.7)	2.91	Yes	100	0.0
Personal Assets	871.6	(1.5)	16.3	17.2	82.6	0.8	0.95	No	100	1.4
RIT Capital Partners	3,138.1	4.2	22.4	49.7	93.0	8.8	1.05	Yes	107	1.6
Ruffer Investment Company	408.5	(1.4)	5.4	12.5	96.9	2.3	1.16	No	100	0.8
UIL	150.8	(1.6)	68.1	29.3	46.8	(33.5)	1.24	Yes	100	4.5
Average	**683.7**	**(0.5)**	**22.1**	**30.1**	**83.2**	**(14.1)**	**1.24**		**102**	**2.2**
Tetragon rank in peer group	**2**	**9**	**2**	**1**	**1**	**10**	**2**		**3=**	**1**

Source: Morningstar, Edison Investment Research. Note: *Performance data to end-March 2018. TR = total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

Tetragon's board comprises six directors, four of whom are independent. Each board member is elected annually by Tetragon's voting shareholders. The non-independent directors are Tetragon co-founders Reade Griffith (appointed April 2007) and Paddy Dear (appointed August 2005), who also control Tetragon's voting shares. Griffith is a principal of TFM, CIO of Polygon's European event-driven equities strategy and a member of the Investment & Management Committee of TCIP and TCI II. He was previously a partner and senior managing director at multi-strategy hedge fund Citadel Investment Group. Dear is a principal of TFM and a member of the Investment & Management Committee of TCIP and TCI II. He was previously managing director and global head of hedge fund coverage at UBS Warburg Equities.

The independent directors are Rupert Dorey (appointed August 2005), Frederic Hervouet (appointed July 2014), David Jeffreys (appointed August 2005) and William Rogers (appointed June 2016). Dorey has over 30 years' experience in financial markets, including 17 years at Credit Suisse First Boston. He is a director of NB Global Floating Rate Income Fund and AAA Guernsey (AP Alternative Assets). Hervouet has over 17 years' experience in financial markets and hedge funds. Qualified chartered accountant Jeffreys spent 15 years at Scandinavian private equity group EQT and 11 years as managing director of Abacus Fund Managers. Rogers retired from law firm Cravath, Swaine & Moore in December 2015 after 36 years.

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