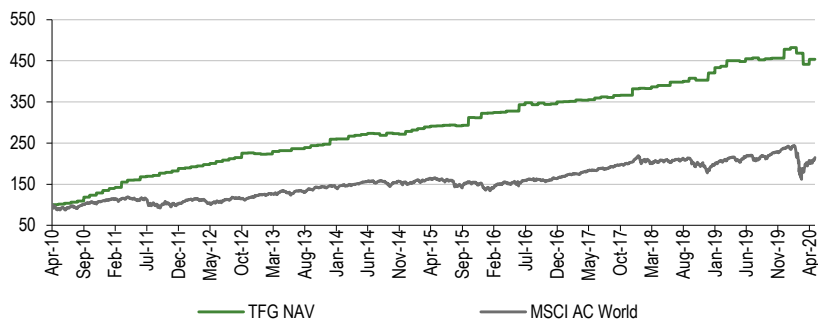


Tetragon Financial Group

Discount above peers despite solid performance

Tetragon Financial Group (TFG, Tetragon) achieved a 13.6% NAV/share total return and a 13.4% ROE in FY19, in line with its long-term target of 10–15%. The main driver of Tetragon's performance was its asset management business (TFG Asset Management), which comprises managers with a total AUM attributable to Tetragon of US\$27.4bn and generated an EBITDA of US\$59.5m in FY19 (up 51% y-o-y). The late-2019 investment activity left Tetragon with a relatively low net cash position (4.1% of NAV at end-April). The shares trade at a three-year average discount to NAV of 44% (currently at 62.7%), which is relatively wide compared to peers given the company's track record of delivering a 16% NAV TR pa over the last 10 years. The recent market sell-off has so far resulted in a 5.1% decrease in NAV (ytd to end-April 2020).

NAV total return outperformance* of MSCI AC World Index over 10 years



Source: Refinitiv, Edison Investment Research. Note: *NAV to end-April 2020.

The market opportunity

The global COVID-19 outbreak has led to concerns over economic growth and has resulted in a widespread selloff. Markets may remain volatile until there is more clarity over the impact on corporate earnings. While many investors turn to safe assets such as sovereign bonds, those looking for 'bottom fishing' opportunities may find Tetragon's diversified alternative portfolio compelling (especially given the wide discount to NAV). Moreover, Tetragon offers exposure to recurring fee income streams from its asset management holdings.

Why consider investing in Tetragon?

- Strong net returns (10-year NAV performance at 16.3% pa) despite above-average ongoing charges.
- Sustained dividend payment.
- Continuing growth in TFG Asset Management's third-party assets under management provides fee income and potential capital gains.

Valuation: Large discount to NAV, attractive yield

Tetragon historically traded at substantially larger discount to NAV than its peers, currently at 63%. We acknowledge though that the full impact of the recent market turmoil has not yet been fully reflected in Tetragon's NAV and may become more visible in the coming months. Based on the quarterly dividend paid in May, the current share price translates to an annualised 4.6% dividend yield.

Investment companies
Alternative assets

1 June 2020

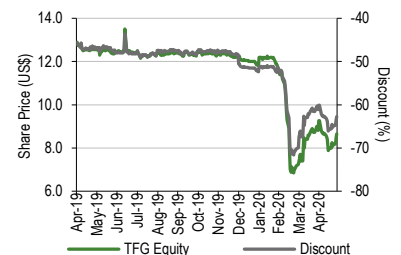
Price **US\$8.66**
Price (TFGS) **878p**
Market cap **US\$835m**
NAV* **US\$2,238m**

NAV per share* US\$23.23
Discount to NAV 62.7%

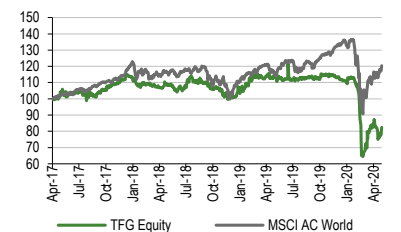
*As at end-March 2020.

Yield (trailing 12 months) 7.6%
Fully diluted shares in issue 96.4m
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\$13.50 US\$6.84
NAV* high/low US\$24.96 US\$22.69

*Including income.

Gearing

Gross borrowings* 6.3%
Net cash* 2.3%

*As at 31 December 2019.

Analyst

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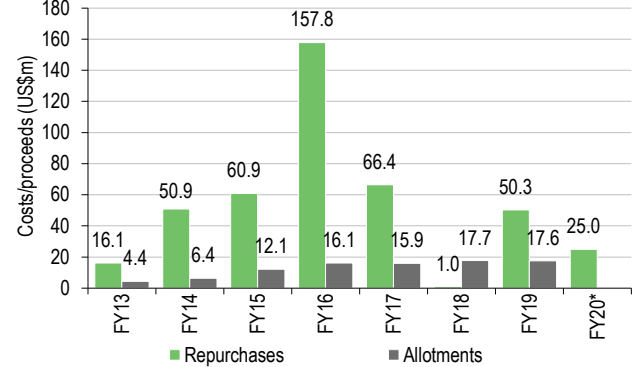
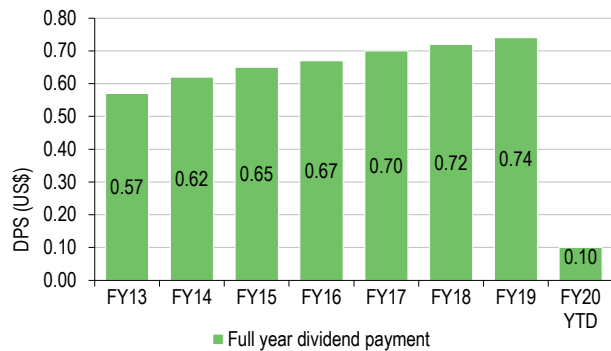
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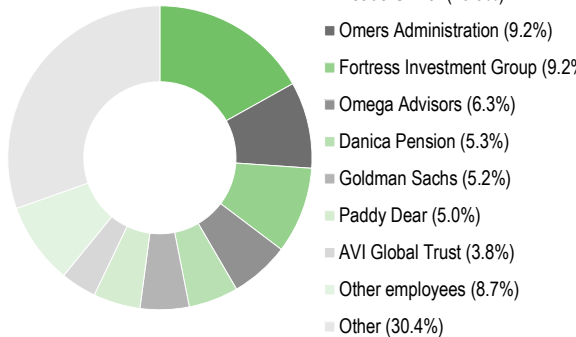
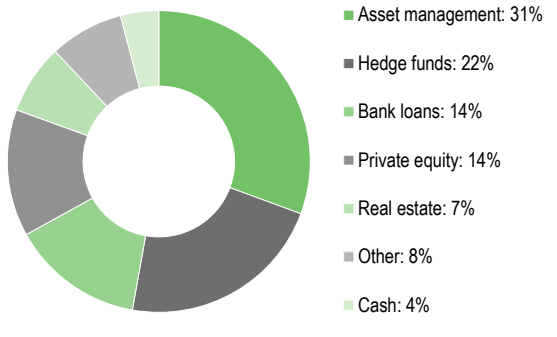
**Tetragon is a research client of
Edison Investment Research Limited**

Exhibit 1: Company at a glance

Investment objective and fund background		Recent developments			
Tetragon Financial Group'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 public and private equities and credit (including distressed securities and structured credit), convertible bonds, real estate, venture capital, infrastructure, bank loans and TFG Asset Management, a diversified alternative asset management business.		<ul style="list-style-type: none"> 7 May 2020: tender offer for share repurchase will be conducted through modified Dutch auction with price range set to US\$7.75-US\$9.50 per share 30 April 2020: March 2020 factsheet, NAV TR -7.6% ytd. 30 April 2020: US\$0.10 Q120 dividend declared vs US\$0.1825 in Q119, change in dividend policy and US\$25m share repurchase announced. 28 February 2020: FY19 results – NAV TR +13.6% and share price TR +11.5% vs MSCI AC World Index +27.3%, all in US dollar terms. 2 July 2019: Closing of GreenOak Real Estate merger with Bentall Kennedy. 			
Forthcoming		Capital structure		Fund details	
Interim results	July 2020	Ongoing charges	1.73% (FY19)	Group	Tetragon Financial Group
Year end	31 December	Net cash	4.1% (April 2020)	Manager	Tetragon Financial Management
Dividend paid	May, Aug, Nov, Mar	Annual mgmt fee	1.5% of net assets	Address	Mill Court, La Charroterie, St. Peter Port, Guernsey, GY1 1EJ
Launch date	19 April 2007	Performance fee	25% over Libor +2.65% hurdle	Phone	+44 20 7901 8328
Continuation vote	N/A	Company life	Indefinite	Website	www.tetragoninv.com
		Loan facilities	US\$150m (fully drawn)		

Dividend policy and history (financial years)		Share buyback policy and history (financial years)	
Tetragon pays dividends quarterly and has recently changed its dividend policy to a flexible approach amid market volatility.		Market share repurchases made up to 2013. Seven tender offers totalling US\$525m completed since 2012. Allotments mainly relate to scrip dividends.	



Shareholder base (at 27 May 2020)		Portfolio exposure by asset class (at 30 April 2020)	
 <ul style="list-style-type: none"> Reade Griffith (16.9%) Omers Administration (9.2%) Fortress Investment Group (9.2%) Omega Advisors (6.3%) Danica Pension (5.3%) Goldman Sachs (5.2%) Paddy Dear (5.0%) AVI Global Trust (3.8%) Other employees (8.7%) Other (30.4%) 		 <ul style="list-style-type: none"> Asset management: 31% Hedge funds: 22% Bank loans: 14% Private equity: 14% Real estate: 7% Other: 8% Cash: 4% 	

Top 10 holdings (at April 2020)					
Holding	Asset category	Investment structure	Description	% of NAV**	
				Apr 2020	Apr 2019
Equitix	TFG Asset Management	Private equity	US\$7.1bn UK infrastructure fund asset manager	12.0	10.7
Polygon Euro Equity Opp Absolute Return	Event-driven equities	Hedge fund	European event-driven equity hedge fund	11.0	10.1
BentallGreenOak	TFG Asset Management	Private equity	US\$6.3bn global real estate asset manager	8.2	9.3
LCM	TFG Asset Management	Private equity	US\$9.1bn CLO manager	7.6	7.5
Ripple Labs Inc.	Private equity	Direct investment	US tech company	7.1	N/A
Polygon Euro Equity Opp Long Bias	Event-driven equities	Hedge fund	European event-driven equity hedge fund	4.6	4.7
Hawke's Point Fund 1	Private equity	PE fund	Mining assets	3.8	N/A
Polygon Convertible Opportunity Fund	Convertible bonds	Hedge fund	Event-driven credit hedge fund	3.6	3.5
TCI III	Bank loans	CLO fund	US broadly syndicated corporate loans	3.4	N/A
TCI II	Bank loans	CLO fund	US broadly syndicated corporate loans	2.4	2.9
Top 10 at each date				63.7	56.3

Source: Tetragon Financial Group, Edison Investment Research, Bloomberg, Refinitiv. Note: *Announced, not yet executed tender offer **N/A where not in end-April 2019 top 10.

The fund manager: Tetragon Financial Management

The manager's view: Opportunities outside of the mainstream

In recent years, central banks have adopted an accommodative monetary policy that has pushed valuations up in several credit and equity markets, and in turn lowered the expected returns compared to those achieved historically. This has also made valuations highly vulnerable to any major global shocks, as illustrated by the current impact of the coronavirus outbreak. The investment manager believes the majority of capital has been deployed passively into the most liquid assets, which results in a high level of disparity in market valuations of less liquid names. These investments often appear less expensive than the broader market, constituting potential opportunities for Tetragon. In this context, it is important to note that Tetragon's long-term investment approach allows it to invest in less liquid assets and retain these positions even if they temporarily fall out of favour. At the same time, the investment manager continues to believe that niche, capacity-constrained, specialist investment strategies can generate attractive risk-adjusted returns with lower market risk. Furthermore, TFG Asset Management (TFG AM) provides Tetragon investors with exposure to a number of asset management businesses. The potential growth in its AUM could be reflected in their carrying value and has the potential to increase Tetragon's income through collected fees.

Fund profile: A broadly diversified portfolio

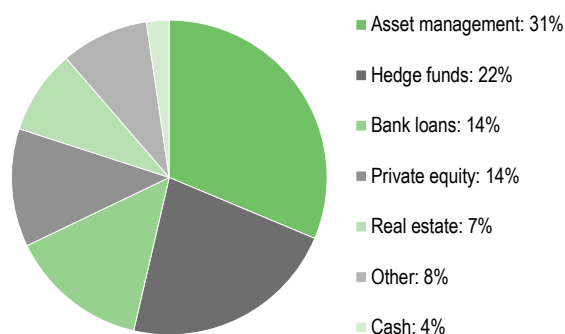
Tetragon Financial Group is a closed-ended investment company traded on the London Stock Exchange (LSE) and Euronext Amsterdam. It invests in a broad variety of asset classes with exposure to public and private equities and credit (including distressed securities and structured credit), convertible bonds, real estate, venture capital, infrastructure, bank loans and TFG Asset Management, a diversified alternative asset management. The company is domiciled in Guernsey and was founded in August 2005. Before 2018 Tetragon invested through the Tetragon Master Fund, which was amalgamated with Tetragon that year to simplify the structure and reporting. 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 cash dividends may be elected by investors to be paid in sterling, instead of the company's base operating and reporting currency (US dollars). The quoted shares available to investors on the listed exchanges do not hold any voting rights.

Tetragon is ultimately controlled by its co-founders Reade Griffith and Paddy Dear. They control the voting shares of the company, as well as Tetragon's investment manager – Tetragon Financial Management (TFM). They co-founded Polygon, which is wholly owned by TFG Asset Management, in 2002. TFM's investment committee, which determines Tetragon's investment strategy and approves every major investment, comprises Griffith and Dear as voting members, and Stephen Prince (head of TFG AM), who all have experience in alternative investments. Tetragon and Polygon employees cumulatively held 30.7% of outstanding non-voting shares of Tetragon at end-April 2020.

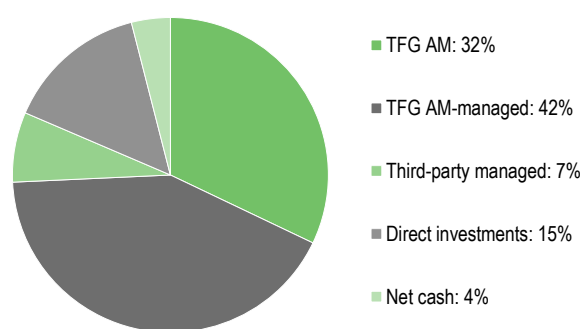
TFG Asset Management

One of the main investments in Tetragon's portfolio represents holdings (mostly majority stakes) in alternative asset management companies held through wholly owned TFG Asset Management. TFG Asset Management seeks to generate fee income and capital appreciation through growth in third-party assets under management.

At the same time, a significant part of Tetragon's remaining investments is executed through funds managed by these asset managers co-owned by TFG Asset Management (42% at March 2020, see Exhibit 3). Consequently, a large part of Tetragon's portfolio offers exposure to a blend of fund investment returns and corresponding management/performance fees on third-party assets. Based on our discussion with management, we understand that Tetragon has the same LP rights as all the other limited partners in the funds. Each holding in an asset manager is valued separately and in aggregate TFG Asset Management represented 32% of Tetragon's NAV at March 2020. Tetragon's remaining portfolio consists of its direct investments (15%) and investments managed by external managers (7%).

Exhibit 2: Portfolio by asset class (April 2020)


Source: Tetragon Financial Group, Edison Investment Research

Exhibit 3: Portfolio exposure by manager (March 2020)


Source: Tetragon Financial Group, Edison Investment Research

At present, TFG Asset Management holds stakes in eight asset management companies, seven of which are wholly/majority owned (the exception is BentallGreenOak). Their total combined AUM attributable to TFG Asset Management amounted to US\$27.4bn at end-2019 (of which Tetragon investments make up only c 4%). Tetragon is steadily building up the scale of TFG Asset Management through acquisitions and by creating new fund management entities with the intention to conduct an IPO of the TFG Asset Management business at some stage.

Exhibit 4: TFG Asset Management businesses at 31 December 2019

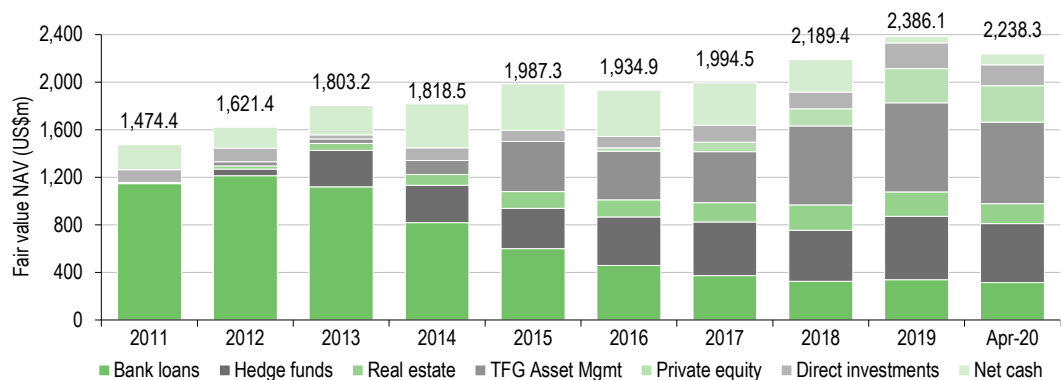
Manager	Tetragon stake	Acq. date	Description	Asset class	Managed funds/ investments	AUM (US\$bn)	TFG's investment in funds (US\$m)
LCM Asset Management	100%	2009	CLO asset manager	Bank loans	19 CLOs	9.1	190.5
BentallGreenOak	13%	2010* (founded)	Real estate-focused principal investing, lending and advisory firm	Real estate	14 funds and investment vehicles	6.3**	168.1
Polygon Global Partners	100%	2012	Manager of open-ended hedge fund and private equity vehicles across a number of strategies	Hedge funds, private equity	Four hedge funds	1.5	480.3
Equitix	75%***	2015	Integrated core infrastructure asset management and primary project platform	Infrastructure	Nine funds and managed accounts	7.1	0
Hawke's Point	100%	2014 (founded)	Asset manager that seeks to provide capital to companies in the mining and resource sectors	Mining finance	Two investments in early-stage gold miners	0.1	81.1
Tetragon Credit Partners	100%	2015 (founded)	General partner of two private equity vehicles that invest in TCICM and LCM-managed CLOs	CLO equity	Tetragon Credit Income II and III (TCI II and TCI III) and Tetragon Credit Partners Opportunity Fund	0.8	129.4
Banyan Square Partners	100%	2019 (founded)	Private equity and growth financing-focused funds	Private equity	-	-	-
						27.4****	1,049.4

Source: Tetragon Financial Group, Edison Investment Research. Note: *Initial investment in GreenOak, in 2019 merged with Bentall Kennedy. **Pro-rata TFG's share, total AUM at US\$49.1bn. ***TFG Asset Management has an 85% effective economic share of Equitix's business. ****This includes US\$2.6bn AUM of TCICM, which is a collateral manager collecting insignificant fees and not expected to be further developed given the recent changes to the US risk retention rules.

Current portfolio positioning

Tetragon's portfolio reported a NAV of c US\$2.2bn at end-April 2020 and remains diversified across a range of alternative asset classes. Over time, Tetragon's focus has shifted away from a portfolio dominated by bank loans (mainly via CLO equity tranches), with TFG Asset Management becoming its largest portfolio holding, see Exhibit 5. That said, Tetragon continues to perceive CLOs as an attractive route to gain exposure to leveraged loans (see below for 2019 and Q120 investment highlights). The recent market volatility has led to a 5.8% NAV decrease in March stemming from valuation losses in all asset classes except real estate. During April the NAV partially recovered by 2.8% m-o-m, and the ytd total return stands at a negative 5.1%.

Exhibit 5: Progression of Tetragon's net assets by value – 2011 to Q120



Source: Tetragon Financial Group, Edison Investment Research

With respect to other major new and follow-on investments, Tetragon was the lead investor in the series C financing round of **Ripple Labs** in December 2019 (providing US\$150m of the total US\$200m), which became its fifth largest holding (7.1% of NAV at end-April 2020). Ripple's previous funding rounds were backed by investors such as Google, Santander, Accenture, Andreessen Horowitz and IDG Capital Partners. Ripple operates a real-time global payments network developed in 2012 that is based on the XRP cryptocurrency. Importantly, so far Ripple has largely funded its development through the ongoing sale of the XRP tokens (US\$500m in 2019) and has conducted the recent funding round predominantly to obtain a pre-IPO valuation. With this investment, Tetragon has gained exposure to the upcoming blockchain disruption in the financial industry – for more details, see our recent [sector report](#). Tetragon made c US\$48.7m of other private equity investments (mostly through Hawke's Point and Banyan Square) in 2019, and a further US\$6m in ytd in 2020.

While Tetragon did not make any new direct **CLO** investments in the US in 2019 nor Q120 (and exited its direct European CLO investments), it has funded US\$83.6m (of which US\$14.1m in Q120) in commitments to the TCI III fund (managed by Tetragon Credit Partners), which had its final close with total committed capital at US\$429m. As a result, at end Q120 Tetragon's commitments to TCI III (US\$85.9m) and TCI II (US\$70m) have been fully drawn. At the same time, we underline that Tetragon continued to receive a steady cash inflow from the regular amortisation of existing direct CLO positions, with total cash proceeds from these positions of US\$71.9m in FY19 and US\$10m in Q120 (with additional cash flow from TCI funds of US\$15.2m and US\$5.4m, respectively). Consequently, Tetragon's outstanding CLO position stood at US\$327.6m at end-March 2020 (up by c 8% y-o-y) and represented 15.0% of its NAV (vs 14.8% at end-2018). It is also worth noting CLO managers can actively manage the underlying loan portfolio up to the end of the reinvestment period, and redirect part of the underlying cash flow into new investments. Acquiring discounted assets amid market turmoil is beneficial for equity tranche investors, as the coupons on the debt tranches are fixed on setting up the structure. Having said that, we note that as at end-

2019 55% of Tetragon's direct US CLO equity tranches had their reinvestment period ending after 2020 (c 8% end their reinvestment period in 2020). The remaining 38% of the exposure consisted of positions that have ended their reinvestment periods earlier. We understand that Tetragon Credit Partners launched the Tetragon Credit Partners Opportunity Fund in May 2020 to invest opportunistically in senior and/or mezzanine US CLO debt tranches with the goal of capturing strong total return opportunities, and expects to launch TCI IV in 2020.

In 2019, BentallGreenOak agreed on a number of disposals of **real estate** investments, partially settled in Q120. This resulted in net distributions attributable to Tetragon of US\$33.6m in FY19 and US\$33.5m in Q120. The investment manager highlights that these disposals were made before the recent broader market downturn and as a result these funds have ample dry powder at their disposal to search for opportunities at present. According to the investment manager, the exposure to the hardest-hit sectors such as leisure and retail on a look-through basis is low.

In other asset classes, Tetragon invests in publicly traded assets mainly through funds managed by the fully owned Polygon, with largest exposure to the **European Equity Opportunity Fund**. Tetragon contributed US\$48.6m to the fund in 2019, and US\$18.4m in Q120. Moreover, in FY19 it made US\$116.7m of investments in other equities and credit (versus US\$30.1m in disposals/receipts). Ytd the asset class generated net distributions of US\$22m, while delivering US\$16m in valuation loss (both realised and unrealised).

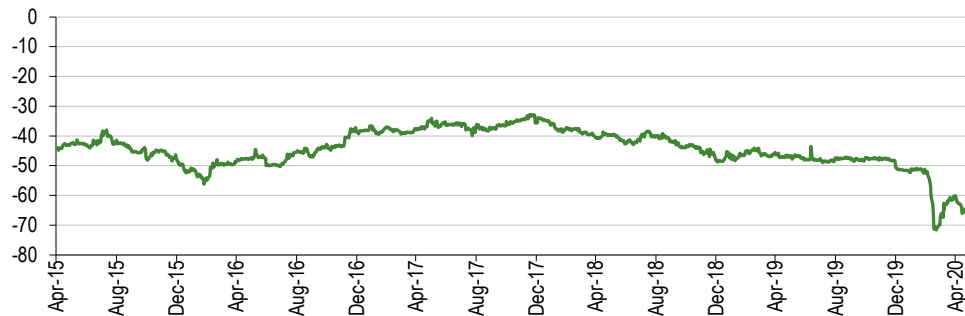
Cash position and investment commitments

Tetragon's net cash is relatively low at US\$91.1m or 4.1% at end-April 2020 (2.3% of NAV at end-2019) () compared to c 10–20% at year-end over 2011–2018. With its US\$150m credit facility fully drawn, this implies US\$241m cash available for investments. As at end Q120, the company had c US\$200m of unfunded investment commitments (fully covered by the gross cash position, and translating into a coverage ratio of c 40% on a net basis), although these include hard commitments to BentallGreenOak (c US\$50m) and private equity funds (c US\$35m), as well as soft (ie non-binding) commitments to Hawke's Point and Banyan Square Partners (c US\$115m). We note that Tetragon's prospective liquidity should be supported by regular inflows from fees (TFG Asset Management), as well as interest-bearing investments (CLOs and bonds). As a reference point, TFG Asset Management posted an EBITDA of US\$59.5m in FY19 (which should be a good approximation of cash flow generated from the asset management businesses). CLOs generate stable cash flows as well, with US\$71.9m inflow from amortisations in FY19. However, we note that cash flows from some of the CLO equity tranches may prospectively be diverted to more senior tranches if the CLOs fail their overcollateralisation tests. Moreover, CLO managers are currently increasingly forced to conduct a fire sale of CCC-rated loans.

Tetragon continues to trade at a wide discount

Tetragon's 10-year average discount to its reported NAV stands at c 41% and since mid-2013 until recent sell-off it remained in a broad corridor of 30–50%. Since December 2017, the discount widened gradually from 33% and reached 51% at the brink of the downturn. While recent volatility has brought the discount to a 10-year record of 72%, Tetragon's share price recovered in line with the broader market and the discount stands at 63%. It is worth noting that the actual discount is likely to be lower, because the end-April NAV does not fully reflect the valuation impact from the recent market downturn on Tetragon's assets due to the frequency of revaluations in some asset classes as described below.

Exhibit 6: Share price discount to NAV over five years (%)



Source: Refinitiv, Edison Investment Research

The discount to NAV is quite high relative to the broad listed investment trust space. We understand that investors highlight the following factors as potential justification for the above-average discount:

- Uncertainty around the carrying value of portfolio positions (which are mostly unlisted and less liquid).
- High fees (particularly the performance fee).
- Listed shares are all non-voting.
- Distributions in the form of buybacks/scrip dividends executed below NAV.

We address each of these concerns in the later part of this section.

Carrying value of portfolio holdings

TFG Asset Management valuation

The largest position in Tetragon’s portfolio (31% of NAV at end-April 2020) is **TFG Asset Management**, with its value derived from the valuations of its asset manager holdings. These are prepared by external independent valuation appraisers and are predominantly based on a discounted cash flow (DCF) model (blended with the market multiples method in the case of LCM) and are subject to an illiquidity discount of 15–20%. An exception here is Hawke’s Point, which is valued at replacement cost, and Banyan Square Partners, which had not been valued by the valuation specialist and was not included in the Q120 NAV. TFG Asset Management’s valuation at end-2019 amounted to US\$747.5m (up 12.9% y-o-y), which together with its FY19 reported earnings (EBITDA equivalent) attributable to Tetragon of US\$59.5m implies a market cap/EBITDA ratio of 12.6x. This is below the average for the broad group of listed asset management companies¹ of 13.7x at end-FY19, implying an 8% discount, which could be explained by the liquidity discount applied by Tetragon.

When examining Tetragon’s valuation of its stakes in asset managers, we need to highlight that on merger of GreenOak with Bentall Kennedy back in 2018, Tetragon’s investment in GreenOak has been subject to an 89% valuation uplift. Having said that, the above conclusion is underpinned, for instance, by the 89% valuation uplift on Tetragon’s GreenOak holding following its merger with Bentall Kennedy back in 2018. The new valuation of Tetragon’s 13% stake in BentallGreenOak was based on a number of components, including an upfront cash payment received by Tetragon, subsequent fixed quarterly distributions, certain variable distributions, carried interest from existing

¹ 3i Group, Ashmore Group, Blackstone Group, Brookfield Asset Management, Intermediate Capital, Janus Henderson Group, Jupiter Fund Management, KKR&Co, Man Group, Partners Group, Schroders, Tikehau Capital

and future funds and Tetragon's put option. We acknowledge the value of some of these components may change.

Having said that, since end-2019 TFG Asset Management valuation decreased by 8.3%, which was a result of the quarterly update from appraisers. We note that quarterly updates cover only model assumptions, while earnings forecasts are updated annually. In Q120 revaluation, the rate used to discount future projected cashflows was increased by 100–225bp and the P/E multiple used in LCM (and part of BentallGreenOak) valuation was decreased by approximately 10%. We calculate that since end-2019 the peer¹ average multiple decreased to 12.4x (which already captures the recent rebound in April) amid broader market weakness, which may also reflect concerns around prospective fee income. Tetragon may conduct an IPO of TFG Asset Management at some stage, though the timing and IPO valuation are uncertain at this stage.

Fees at underlying funds are collected by TFG Asset Management

With respect to other positions within Tetragon's portfolio, we have decided to examine the discount/premium to NAV at which listed investment trusts with similar exposure are normally traded. Similar to other investment companies, these positions are subject to external independent valuations. In this context, we note that 49% of Tetragon's NAV (or 73% of the portfolio excluding TFG Asset Management itself) at end-Q120 represent fund investments, which at first glance suggests that our peer group should be largely composed of listed fund of funds. The remaining 19% of the portfolio comprises Tetragon's direct investments and net cash position.

However, 42% of Tetragon's total NAV at end-Q120 (or 62% of investment portfolio excluding TFG Asset Management) are investments in funds whose asset managers are majority owned by TFG Asset Management (except for BentallGreenOak where TFG Asset Management has a 13% stake). The management/performance fees charged at the underlying fund level constitute a corresponding fee income for TFG Asset Management (fully owned by Tetragon). In FY19 TFG Asset Management received US\$19.3m in fees related to capital invested by Tetragon. At the same time, Tetragon's fund investments managed by external entities made up only 7% of Tetragon's NAV at end-Q120. Consequently, we treat Tetragon as one-layer fee structure for the purpose of our analysis, and we have broadened the peer group to include funds with a direct strategy. We also exclude Tetragon's investments from TFG Asset Management's fee income. As this is minor (c 10% at end-2019, see Exhibit 4), it translates to a 3% discount to Tetragon's total NAV.

We acknowledge that the current discount to last reported NAV is affected by the recent high volatility in asset prices. NAV comparability across investment trusts may be limited due to different timing of NAV publication, as well as varying revaluation frequency among the various asset classes. While we present current discounts as a main reference point, we have also examined the discounts on a three-year average basis.

Three-year average peer discount for remaining asset classes at c 4–27%

Tetragon's second-largest exposure by asset class (22% of NAV) are investments in **hedge funds** covering predominantly event-driven equities including special situations and M&A (74% of this subgroup's value at end-Q120, managed by Polygon) and to a lesser extent convertible bonds (17%, also managed by Polygon) and quantitative strategies (9%, position to be redeemed soon with c US\$52m cash proceeds). We have eased the peer group criteria to funds investing broadly in publicly quoted assets, as direct peers to Tetragon's strategy tend to have an open-ended structure or are privately held. Listed equity funds² tend to trade at a discount of around 4% to NAV (three-

² Aberforth Smaller Companies Trust, Alliance Trust, Alpha Trust-Andromeda Investment Trust, Dunedin Income Growth Investment, Diverse Income Trust, Edinburgh Investment Trust, Henderson European Focus Trust, Henderson Eurotrust, RIT Capital Partners, Scottish Investment Trust

year average) and currently trade 10% below NAV. We note, that as the underlying assets are marked to market, valuations in this asset class largely reflect the recent broader market sell-off.

Tetragon's exposure to **bank loans** (c 14% of NAV at end-April 2020) consists of investments in **CLO** tranches and funds specialising in CLO investments (with a focus on majority positions in equity tranches). We have selected a peer group of funds that predominantly or exclusively invest in CLOs (both debt and equity tranches).³ They trade at a discount to NAV of c 19%, with a three-year average of c 9%. It is important to highlight that CLO tranche valuations may be either marked to market based on market quotes (received, for example, from arranging banks or services such as JPM's PricingDirect) or marked to model and based on models provided by external valuers (Tetragon applies the latter approach). While we acknowledge that quotes (especially from arranging banks) sometimes respond to market conditions with a lag and can be inconsistent between providers, they still have the advantage over mark-to-model valuations of being market driven (potentially warranting a lower discount to NAV).

We note that, for instance, Blackstone/GSO Loan Financing and Marble Point Loan Financing, which also use the mark-to-model approach, have been trading at a similar discount to peers applying the mark-to-market approach, with a three-year average discount at 1% and current discount of 8%. After examining the underlying valuation assumptions applied to Tetragon's CLO investments at end-2019 (latest available data), we conclude they were broadly in line with peers, although the assumed recovery rate was somewhat higher (at 75% compared to Volta Finance at 65% as per FY19 report or Blackstone/GSO Loan Financing at 70% as per its Q319 report). Moody's expectations with respect to recovery rates for first-lien leveraged loans stand at 61%.

We also note that on a look-through basis (including Tetragon's investments through TCI II and TCI III funds), LCM manages 68% of the CLOs Tetragon was invested in at end-2019. Such a high exposure to a single CLO manager may translate into a higher collateral overlap (same issuers across different structures) and potentially lead to higher losses in a corporate distress environment. However, some of the peers we have selected share that characteristic with Tetragon, such as Blackstone/GSO Loan Financing and Marble Point Loan Financing, which operate as risk retention vehicles and all instruments in their portfolios are managed by their respective investment managers).

Private equity made up 14% of Tetragon's portfolio at end-April 2020. The broad listed private equity funds spectrum (represented by the LPX Direct index) historically traded at a 0–20% discount and now trades at 25% discount after recovering from 45% amid the coronavirus outbreak. For our selected narrower peer group,⁴ these figures stand at 27% (three-year average) and 38% (currently). While we assume a discount in line with peers for the purpose of the analysis, it is important to highlight that US\$158.3m, or 52% of the carrying value of Tetragon's private equity holdings, represents its recent investment in Ripple Labs (described above), which is valued in line with Ripple's series C funding round concluded in December (through which Tetragon acquired its stake in the company). Tetragon holds Ripple as a direct balance sheet investment; it also invests in private equity and venture capital through third-party private equity funds and co-investments (total exposure at 16% at end-Q120) and into private equity funds managed by TFG Asset Management managers (26%), in particular Hawke's Point and Banyan Square. Tetragon's private equity positions based on end-2019 valuations amount to US\$60m according to the management.

Tetragon's **real estate** investments (7% of NAV at end-April 2020) are executed through or alongside BentallGreenOak, except for the Paraguayan farmland managed by Scimitar. Similarly to

³ Blackstone/GSO Loan Financing, Carador Income Fund, Chenavari Toro Income Fund, Fair Oaks Income, Marble Point Loan Financing, Volta Finance

⁴ Apax Global Alpha, Better Capital, BMO Private Equity Trust, Dunedin Enterprise, Electra Private Equity, HgCapital Trust, ICG Enterprise Trust, LMS Capital, Oakley Capital Investments, Origo Partners, Pantheon International, Standard Life Private Equity

private equity investments the real estate assets are accounted for at end-2019 valuations. We benchmark Tetragon's real estate assets to a peer group⁵ that is characterised by a three-year average discount to NAV at 6% and a current discount at 34%.

The remaining 12% of Tetragon's NAV comes from publicly traded assets, which are valued at market price, and its net cash position. To publicly quoted assets, we apply the discount of funds investing in public assets to maintain our one-tier fees approach.

Blended three-year average discount of 17% compared to Tetragon's 44%

Based on the above discounts to NAV at which pure-play peers within the respective asset classes are traded, we arrive at a current weighted average discount of 27% and a discount based on the three-year average of 17% (see Exhibit 7) for a target portfolio matching the same allocations as Tetragon, as described above. This compares with 63% and 44% for Tetragon, respectively.

Exhibit 7: Tetragon's portfolio valuation in comparison to various peers				
Asset class	Share in TFG's portfolio	Charges* (peer average)	Three-year average discount** (peer average)	Current discount (peer average)
TFG Asset Management	31%	1.8%	34%***	45%***
Hedge funds	22%	0.8%	4%	10%
Bank loans	14%	2.6%	8%	19%
Private equity	14%	1.9%	27%	38%
Real estate	7%	1.6%	6%	34%
Other	8%	0.8%	4%****	10%****
Cash	4%	0.0%	0%	0%
Weighted average	-	1.5%	17%	27%
		Charges*	Three-year average discount	Discount
Tetragon	-	4.5%	44%	63%

Source: Tetragon Financial Group, Refinitiv, Edison Investment Research. Note: *Total charges including incentive and performance fees, based on peers that reported the figure later than June 2019. **Three-year average discount of respective peer group. ***Average discount of private equity funds adjusted for TFG's investments. ****Average discount of hedge funds investing in public equities.

At the same time, we underline that the high level of portfolio diversification reduces the volatility of Tetragon's NAV returns. Over the last 10 years, 79% of Tetragon's monthly returns have been positive, while the largest single monthly decrease was 5.8%. Moreover, Tetragon generates sizeable and regular fee income from managing over US\$20bn of third-party capital (end-2019) through majority-owned asset managers. This, in our view, makes the structure more resilient to market volatility than regular PE funds, as it is less likely to make forced disposals to finance its ongoing charges; over the last three years income generated from TFG Asset Management covered 1.2x Tetragon's costs (excluding incentive fee) on average. Having said that, the fee income would decrease if TFG Asset Management's AUM declines due to the weak price performance of underlying assets, or outflow of external investors' capital.

The above comparison shows that Tetragon's discount to NAV is wider than that for the pure-play peers. We note that there may be other potential factors explaining this, some of which we discuss below.

High fees

As shown in Exhibit 8, Tetragon's ongoing charge (ongoing costs and management fee) is 1.73%, higher than its direct peer average of 0.80%. Similarly, in FY19 Tetragon's incentive fee was higher at 4.5% than the weighted average of pure-play peers focused on the respective asset classes as presented in Exhibit 8. Tetragon's incentive fee has a relatively low hurdle rate (Libor +2.65%) and has a high-water mark that only accounts for the most recent two quarters, which means TFM can

⁵ Regional REIT, Circle Property, Custodian, Picton, Real Estate Investors, Schroder REIT, Palace Capital, UK Commercial Property Trust, BMO Commercial Property Trust, BMO Real Estate Investments

collect it soon after NAV starts to rebound from a considerable decline. This was, for instance, the case following the 2008/09 financial crisis, when the investment manager collected US\$120m in incentive fees on the back of an NAV rebound during 2010, even though the NAV did not reach pre-crisis levels until February 2011. We note, however, that over the long term (since end-2007) incentive fees consumed c 15% of the NAV increase (pre-fees). We also stress that Tetragon's outperformance over the long term (NAV TR 11.4% per year vs MSCI ACWI 5.7% per year since inception to end-FY19) is already calculated post-fees. This has allowed Tetragon to outperform its peer group as presented below.

Exhibit 8 shows a sterling-based comparison of Tetragon with the other seven members of the AIC Flexible Investment sector that have a market cap of more than £100m. While the investment mandates of the peer group funds vary widely, none are a perfect direct comparator for Tetragon, but we believe the peer average still provides a good broad context for comparison. Tetragon's NAV total return is ahead of the peer group average over one year to end-April 2020 and more than double the return of the second-ranked fund over three, five and ten years. Despite its near- and long-term relative outperformance, Tetragon's share price discount to NAV is the widest in the peer group. While historically Tetragon's dividend yield is ahead of peers, with a trailing yield of 7.6% compared to the 3.4% peer average, the impact of coronavirus outbreak can affect Tetragon's income and in turn disturb the dividend payments. Nonetheless, this also applies to its peers.

Exhibit 8: Selected AIC Flexible Investment sector peer group in sterling terms at 28 May 2020*

% 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	Net gearing	LTM dividend yield
Tetragon Financial Group	683.6	4.1	31.4	90.2	450.8	(62.7)	1.7	100	7.6
Aberdeen Diversified Income & Growth	290.6	(5.2)	(3.9)	(2.6)	38.2	(15.4)	0.6	108	5.9
Caledonia Investments	1,450.4	(6.9)	7.0	27.6	96.6	(20.4)	0.9	100	2.3
Capital Gearing	508.8	2.8	11.1	31.4	77.8	0.9	0.7	100	0.8
Hansa Trust 'A'	184.8	(15.1)	(3.4)	10.0	51.1	(39.8)	0.6	100	6.2
Personal Assets	1,223.0	6.9	11.6	31.2	73.0	1.6	0.9	100	1.3
RIT Capital Partners	2,886.0	(0.4)	11.2	29.9	87.7	(0.5)	0.7	112	2.2
Ruffer Investment Company	444.7	10.0	8.2	15.2	50.6	1.0	1.1	100	0.7
Average	998.3	(1.1)	6.0	20.4	67.9	(10.4)	0.8	103	3.4
Rank in peer group	4	3	1	1	1	8	1	3=	1

Source: Morningstar, Edison Investment Research. Note: *Performance data to 30 April 2020. TR = total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

All ordinary shares are non-voting

Tetragon's ownership structure could be viewed as unfavourable, given Tetragon's co-founders (Reade Griffith and Paddy Dear) hold 100% of the voting shares in Tetragon as well as its investment manager (TFM). This may sometimes lead to a divergence between interests (and resulting decisions) of the founders and investors holding non-voting shares. For instance, investors cannot vote in favour of a reduction in fees that some consider (too) high. As all ordinary shares are non-voting, Tetragon cannot enter LSE's premium segment and thus is excluded from any of the main market indices, which means certain investor groups (eg passive funds) are not able to invest in Tetragon's shares (which could otherwise help reduce the discount to NAV).

Buybacks/DRIP dividends at market price not NAV

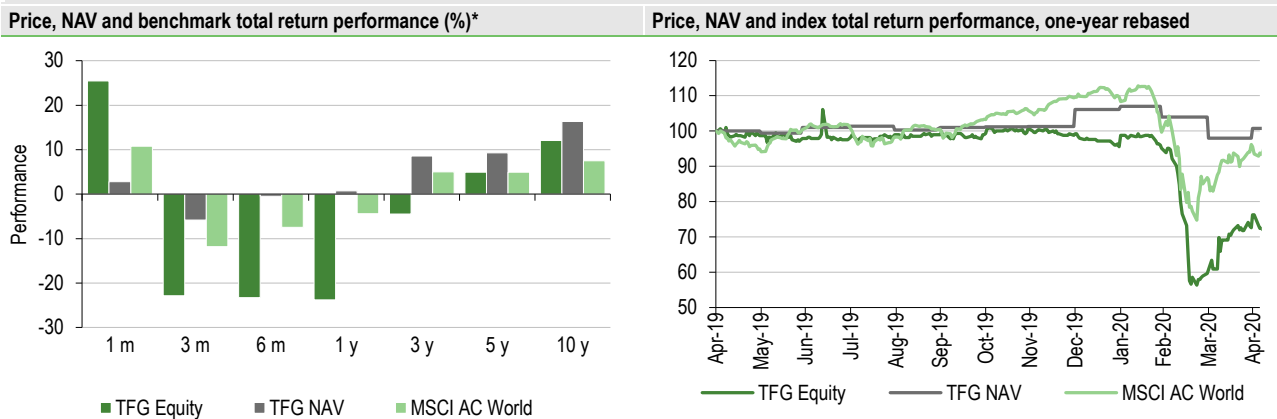
Tetragon occasionally buys back its shares as a form of distribution. The repurchases are performed through a Dutch auction at a price close to the market price of the shares, which results in significant NAV accretion. In 2017–19 Tetragon repurchased 9.1m shares (for US\$115m in total) through two tenders, which we estimate translated into a total NAV accretion of US\$0.88 per share, or 4.4pp NAV/share return since the beginning of 2017. In late April 2020, Tetragon announced that it intends to conduct a US\$25m tender offer for its shares given the depressed share price. While NAV accretive and favourable to investors, we need to point out that this contributes to the

prevailing discount. Theoretically, buybacks at NAV would be more effective in reducing discount to NAV. The manager highlights that since inception Tetragon has bought back US\$660m worth of shares, which had a limited impact on the fund's discount. Tetragon also allows for dividend reinvestment plan (DRIP) dividends at market price, which are distributed from treasury shares.

Performance: Broad based and in line with target

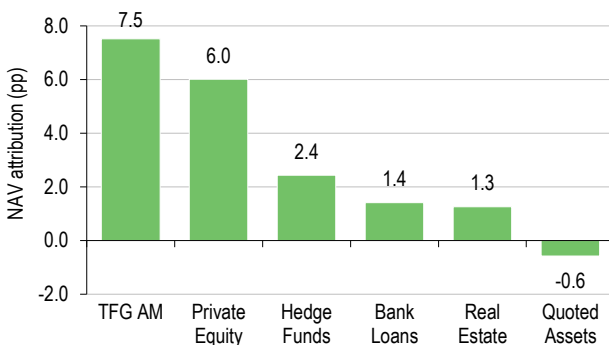
In 2019 Tetragon reported an ROE of 13.4% (within its target of 10–15% pa) and an NAV total return of 13.6% (compared to the MSCI ACWI Index return of 8.4%). The NAV TR was ahead of Tetragon's hurdle rate of Libor +2.65%, which was 5.2% in FY19 and 4.9% in FY18. The ytd performance was a negative ROE of 4.8% (and -5.1% NAV TR), yet the manager remains optimistic towards FY20 performance, highlighting low correlation among its asset classes. In FY19 all asset classes (except for the 'other equities and credit' group) contributed positively to NAV TR (see Exhibit 10), and in Q120 all asset classes posted a reduction in the valuation. In March Tetragon posted the largest monthly NAV decline in 10 years of 5.8% in total return terms, driven mostly by its hedge funds exposure, which contributed 1.9pp to this decline.

Exhibit 9: Tetragon share price discount to NAV and performance data in US dollar terms



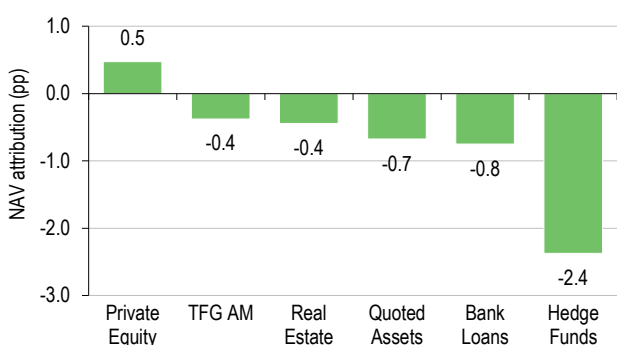
Source: Refinitiv, Bloomberg, Edison Investment Research. Note: *Performance data to end-April 2020, three-, five-, and 10-year performance annualised.

Exhibit 10: 2019 NAV TR attribution (percentage points)



Source: Source: Tetragon, Edison Investment Research.

Exhibit 11: Ytd (to end-April 2020) NAV TR attribution (percentage points)

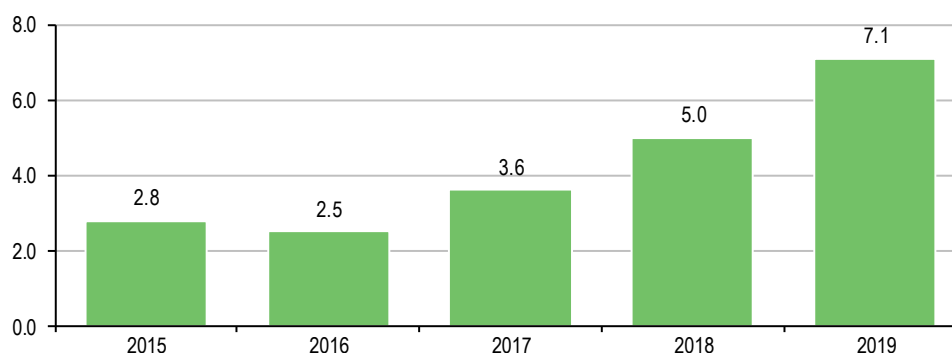


Source: Source: Tetragon, Edison Investment Research.

In FY19, the major contributor to portfolio valuation gains was TFG Asset Management, adding 7.5pp to NAV TR. As described above, we note that TFG Asset Management's valuation is based on end-2019 earnings forecasts and was a resilient asset in the Q120 downturn. FY19 performance was particularly driven by **Equitix** (12.0% of Tetragon's NAV at end-April 2020 and 5.5pp contribution to Tetragon's FY19 NAV TR), which was revalued on the back of a good investment

performance, successful fund-raising and progress in capital deployment. Moreover, the discount rate applied in its DCF model was reduced by 25bp to 9.50%. Equitix's AUM increased by 40% to US\$7.1bn in FY19 (see Exhibit 12) with management fee income up 47% y-o-y to US\$17.3m. Its Fund V closed in Q219 at £1.0bn, while Euro Fund I raised €0.5bn in 2019 and the first close of Fund VI was concluded in Q120 and allowed for positive revaluation in Q120 as the only exception within TFG Asset Management. We note that Equitix repaid US\$54.9m of loan notes (including accrued interest) to Tetragon in 2019.

Exhibit 12: Equitix AUM history (US\$bn)



Source: Tetragon Financial Group

LCM (a CLO manager fully owned by TFG Asset Management) contributed 1.3pp to Tetragon's NAV TR in FY19, which is a function of growing AUM (from US\$8.3bn to US\$9.1bn) and an increase in market multiples used in its blended valuation (P/AUM increased from 2.3% in FY18 to 2.7% in FY19). **BentallGreenOak** added 0.6pp on the back of carried interest distribution, a reduction in discount rate applied in its valuation model, as well as the unwinding of discount (as future dates for the call and put options have become fixed as a result of the Bentall Kennedy and GreenOak merger). BentallGreenOak has raised more than US\$3.2bn across the US core, European debt and equity, as well as Asia-value add strategies in FY19 and, as a result, ended the year with AUM of US\$49.1bn (of which US\$6.3bn is attributable to Tetragon).

With respect to other TFG Asset Management holdings, **Polygon's** value declined by US\$7.8m in FY19 (ie a minor impact on Tetragon's NAV TR) due to slower capital raising and change in assumed future UK tax rate in the DCF model. This was offset by the US\$8.5m gain from **Tetragon Credit Partners** (assisted by capital deployment into existing funds and higher projected carry).

Private Equity was the second-largest NAV trigger (+5.2pp) in FY19, mostly on the back of a partial exit from two pre-IPO investments that we understand took place in December 2019. If we assume that in December gains on the asset class of US\$102.3m (FY19: US\$131.7m) as well as disposals/receipts of US\$128.2m (FY19: US\$186.5m) exclusively represented the above two exits, we arrive at an uplift of c 80% versus carrying value (Tetragon realised two further investments after the balance sheet date). Moreover, investments through Hawke's Point provided an additional US\$36.1m due to substantial project development and corporate progress in two Australian gold projects (both expected to commence production in 2021). The significant recovery during April 2020 allowed this asset class to contribute a positive 0.5pp to total NAV attribution, despite high volatility during Q120.

The return attributed to the **hedge fund** bucket (+2.4pp in FY19) came predominantly from the Polygon European Equity Opportunity Fund, with both strategies performing well in terms of returns (absolute return strategy at 13.4% and long bias at 31.0% in 2019). On the other hand, these funds delivered most losses ytd, contributing 2.4pp to the NAV decrease. We note, that while 11% NAV loss ytd is considerable, the funds still outperformed broad equity indices with MSCI AW and FTSE All-Share down 13% 25%, respectively. Since its inception in 2009 to end-FY19, the fund delivered

a gross annualised alpha over STOXX Europe 600 of 10.8% (net alpha at 7.8%). With respect to investments in **bank loans** (+1.4pp in FY19, -0.8pp in ytd 2020), US CLOs held directly by Tetragon generated an income of c US\$25.5m and offer a projected IRR of 15.1% (according to company data). Amid the recent rate cuts announced by major central banks to curb a potential economic slowdown triggered by the coronavirus outbreak, we note the vast majority of CLO collateral has a Libor/Euribor floor in place, while a large proportion of CLO debt tranches have no floor, which is beneficial for CLO equity tranches. Having said that, the management highlights that the cash flow generation of CLOs has not been affected yet, and it is difficult to determine the effect the current lockdown will have on underlying loans' default rate. Finally, **real estate** holdings added +1.3pp to Tetragon's FY19 NAV TR, with the main driver being Asian funds. In 2020 so far settlements of previously agreed disposals from European funds partially offset losses and this class contributed -0.4pp to the NAV TR.

Capital structure and fees

Tetragon's issued share capital consists of 10 voting shares and 139.7m non-voting shares. The voting shares are owned by co-founders and are not entitled to any distributions; however, the co-founders also hold large stakes in Tetragon's non-voting shares (see Exhibit 1). At end-FY19 92.2m shares were outstanding (96.4m on fully diluted basis). Tetragon holds 35.4m shares in treasury (25% of the shares issued) and the remaining 12.1m are to be issued as granted equity-based awards including shares held in escrow to fulfil future expected equity-based awards. Co-founders and employees hold a total stake of 30.7% in Tetragon at end-April 2020.

Tetragon has a three-year US\$150m revolving credit facility that provides additional flexibility to the manager to take advantage of investment opportunities and temporarily bridge the gap between new investments and realisations. At end-December 2019, the facility was fully drawn (representing a 6.3% gross gearing), while Tetragon held net cash of US\$55.4m (equating to 2.3% of NAV). At end-April 2020 Tetragon held US\$91m in cash translating to net cash position of 4.1% of NAV; we note that Tetragon presents net cash on transaction basis, ie including agreed but not yet executed transactions. Historically, Tetragon has typically maintained a c 14% net cash position (five-year average) to meet its new investment commitments and pay dividends and fees, partly due to the illiquid nature of its underlying investments.

Tetragon pays a 1.5% pa management fee to TFM based on its net assets. TFM is also eligible to receive a quarterly incentive fee at a rate of 25% on the increase in NAV above a hurdle. The latter is calculated as the higher of the two prior quarter-end NAVs (adjusted for dividends and capital adjustments) plus a hurdle rate, which is equal to three-month US dollar Libor plus 2.65% per year (currently c 4.08% for Q220). If the hurdle is not met in any calculation period, the shortfall is not carried forward to future periods, which effectively means the high-water mark applies only to two prior quarters. Tetragon pays a reduced fee on its investments in funds managed by some of the TFG Asset Management managers. Full incentive and management fees are paid in Polygon funds. While it is neutral to Tetragon's overall performance (as the fees ultimately return to Tetragon through TFG Asset Management), they are reflected in Polygon funds' performance. Similarly, TFG Asset Management performs services for TFM (in particular the use of TFG Asset Management's personnel), which is recharged to TFM (US\$19.4m in FY19) and reflected in TFG Asset Management results and subsequently in Tetragon's NAV.

In 2019 the management fees paid to TFM were US\$33.5m (up 9% y-o-y, in line with NAV build-up). The incentive fees were US\$63.4m (up 33% y-o-y from US\$47.6m in 2018) of which US\$34.0m remained accrued at end-FY19. Tetragon's ongoing charges (excluding incentive fees) for 2019 were 1.73% of average net assets, in line with 2018. Including the FY19 incentive fee, the ongoing charge increased to 4.5% (FY18: 4.0%) according to our calculations. While the fees may

seem relatively high, Tetragon's healthy performance (eg in terms of NAV returns) is stated net of all fees.

The board of directors is entitled to a fixed fee of US\$0.4m pa (US\$125k each member; Dear and Griffith waived their fee), which can be realised in the form of shares. The three independent directors have also been awarded, in January 2020, 73k shares in total to be received at end-2022 (US\$0.9m at US\$12.25 per share). The equity-based compensation plan is also eligible to some senior employees of the structure. The shares are vested from the escrow account and have been bought back earlier from the market. During FY19, 0.3m shares were released from escrow through the plan and 5.6m shares were transferred to the escrow account from treasury shares. At end-FY19 12.1m shares were held on escrow for equity-based awards, of which 4.2m are included in the reported NAV performance.

At end FY19, in the escrow account Tetragon held 12.1m shares, which are related to equity-based compensation. We note that in FY19 the remaining 2.4m shares related to IFRS implementation in 2016 were released from the account. By implementing IFRS in 2016, Tetragon changed to recognising the majority-owned managers at fair value (vs at equity value previously), which resulted in an increase in NAV, and in turn an incentive fee for TFM. It has been agreed that this fee will not be paid immediately, but once a realisation event occurs. This has been fulfilled by the aforementioned BentallGreenOak merger.

Reade Griffith and Paddy Dear are employed on multiple levels of the structure. Both are directors of Tetragon, entitled to a fixed director's fee (waived) and the owners of TFM. Mr Griffith is employed by TFG Asset Management and is (among other roles) the chief investment officer of Polygon's event-driven European equity strategies. The current contract has been in place since July 2019 and includes US\$9.5m paid in cash upon signing, US\$3.75m to be paid in 2020 and up to 5.6m shares to be granted over seven years depending on performance, which are held in escrow. The employment replaces an earlier agreement, which included US\$0.1m annual salary, which is still in place for Dear.

Dividend policy and record

Tetragon followed a progressive dividend policy since 2009, aiming to pay out 30–50% of normalised earnings (which includes investment income and capital gains), based on its long-term target ROE of 10–15%. The policy was recently revised, given current uncertain market conditions, to a flexible approach, and the dividend paid in May (DPS at US\$0.10), was 47% lower than the prior quarterly payment. This still translates to an annualised dividend yield of 4.6% due to Tetragon's share price drop. Dividends continue to be paid in May, August, November and March each year. Tetragon also sustained an optional dividend reinvestment programme through which DRIP dividends are paid. In 2019 Tetragon issued 3.8m scrip shares (2.2m out of treasury), with the issue price calculated at five-day volume weighted average price (VWAP) post ex-div date. Dividend payments in FY19 summed up to US\$65.2m (FY18: US\$65.1m) of which US\$20.4m (FY18: US\$17.6m) was paid in the form of shares. Tetragon also occasionally uses share repurchases as a form of distribution (as discussed earlier in the note). Management considers prioritising liquidity for new opportunities and share repurchase as more important than high dividend payments at present.

Shareholders have an option to receive dividends in the form of shares at the market price. In FY19 31% of the dividend payment (US\$20.4m) was realised via a DRIP. The fund uses the amount of dividend declared to be received in shares, to buy shares from the market. Over the last five years Tetragon paid 20–31% of the dividend through DRIP.

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, who co-founded Tetragon and Polygon.

Reade Griffith (appointed April 2007) and Paddy Dear (appointed August 2005) are Tetragon's non-independent board directors. Griffith is head of Tetragon Financial Management's investment and risk committees, CIO of TFG Asset Management and CIO of Polygon's European event-driven equities strategy. He was previously a partner and senior managing director at multi-strategy hedge fund Citadel Investment Group. Dear is a member of TFM's investment and risk committees. He was previously a managing director and global head of hedge fund coverage at UBS Warburg Equities.

Deron Haley, Steven Hart and David O'Leary were appointed independent directors in December 2018. They bring extensive private equity and asset management expertise to the board, as well as considerable operational and administrative experience. Deron Haley is a founding partner and chief operating officer at the New York-based private equity firm Durational Capital Management. Steven Hart serves as president of Hart Capital, which he founded in 1998 as a family office to invest in a diversified portfolio of assets. David O'Leary retired from State Street Corporation in 2012, having served latterly as chief administrative officer and formerly as global head of human resources.

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