

Tetragon Financial Group

Improved returns but discount has widened

Tetragon Financial Group (TFG) delivered a strong relative performance in H118, with its +4.4% NAV total return comparing with the -0.1% and -0.7% US dollar total returns of the MSCI AC World and FTSE All-Share indices. The portfolio has been substantially diversified away from collateralised loan obligations (CLOs – now only 16% of NAV) across a range of other alternative asset classes in recent years, accompanied by lower returns. However, with positive returns from all but one asset class in the half year, Tetragon's return on equity (ROE) moved up to an annualised 10.5% in H118, back within its long-term 10-15% pa target range. Recent discount widening appears inconsistent with Tetragon's NAV performance, as well as its progressive dividend and peer group-leading 5.5% yield.

12 months ending	Share price (%)	NAV (%)	MSCI AC World (%)	FTSE All-Share (%)	US 10y Govt Bond Index (%)
30/06/14	(2.8)	15.7	23.6	27.5	3.0
30/06/15	6.7	7.2	1.2	(5.6)	3.8
30/06/16	6.1	17.1	(3.2)	(13.1)	10.1
30/06/17	36.4	4.8	19.4	14.8	(5.2)
30/06/18	1.9	10.7	11.3	10.8	(2.6)

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.

Positive performance across asset classes in H118

Tetragon achieved a +4.4% NAV total return and a 5.2% ROE in H118. Net investment gains totalled US\$144.6m compared with US\$99.5m in H117. Apart from hedge fund strategies, which included a US\$12m loss on the closure of the Polygon Distressed Opportunities Fund, all asset classes in the portfolio generated positive returns, with half of the net investment gains coming from TFG Asset Management. Tetragon's net asset value increased by US\$80.4m to US\$2,074.9m during H118, with NAV per share rising from US\$21.08 to US\$21.64.

Outlook: Potential to achieve historical rates of return

As the portfolio has been diversified away from CLOs in recent years, returns have been lower than achieved historically. However, the H118 performance shows that the current diversified portfolio of alternative assets can achieve Tetragon's long-term target-level returns. In the near term, promising investment opportunities continue to be found across the continuing hedge fund strategies, while TFG Asset Management continues to see strong growth in assets under management (AUM). In addition, an increasing number of direct investment opportunities are being identified that Tetragon believes are compelling, including direct private equity, private equity funds and co-investments, as well as listed equity investments.

Valuation: Above-average discount and yield

Tetragon's share price discount to NAV has experienced a noticeable widening in 2018 despite its NAV progressing steadily higher. The current 39.9% discount is wider than its 37.8% one-year average, but lower than its three-, five- and 10-year averages of 41.8%, 40.6% and 43.6% respectively. Quarterly dividend distributions continue to rise steadily and Tetragon's 5.5% yield is the highest in its peer group.

Investment companies

6 August 2018

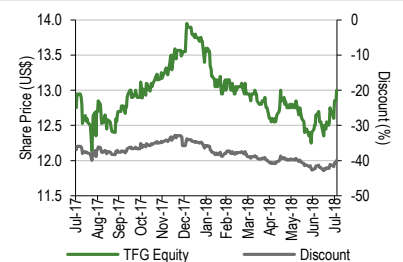
Price	US\$13.00
Price (TFGS)	985.0p
Market cap	US\$1,247m
NAV*	US\$2,075m

NAV per share*	US\$21.64
Discount to NAV	39.9%

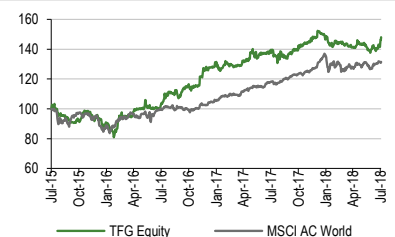
*NAV as at 30 June 2018.

Yield	5.5%
Fully diluted shares in issue	95.9m
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\$21.64	US\$20.10

*Including income.

Gearing

Gross borrowings*	1.9%
Net cash*	16.8%

*As at 30 June 2018.

Analysts

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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

- 31 July 2018: H118 results – NAV total return +4.4% vs MSCI AC World index -0.1% and FTSE All-Share index -0.7%, all in US dollar terms.
- 30 July 2018: US\$0.1800 Q218 dividend declared vs US\$0.1750 in Q217.
- 9 July 2018: Frederic Hervouet retired from the board after four years' service.
- 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.

Forthcoming

Investor day	9 October 2018
Final results	February 2019
Year end	31 December
Dividend paid	May, Aug, Nov, Mar
Launch date	19 April 2007
Continuation vote	N/A

Capital structure

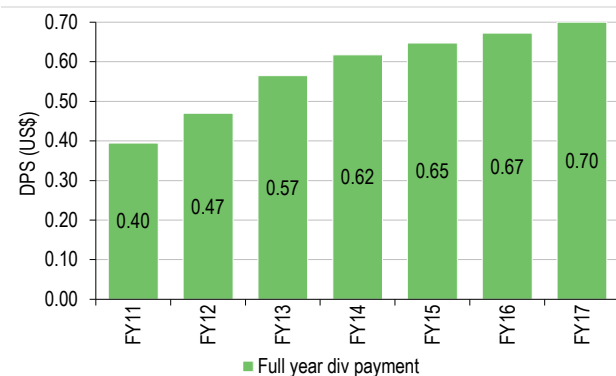
Ongoing charges	1.74%
Net cash	16.8%
Annual mgmt fee	1.5% of net assets
Performance fee	25% over Libor +2.65% hurdle
Company life	Indefinite
Loan facilities	US\$150m rolling credit facility

Fund details

Group	Tetragon Financial Group
Manager	Tetragon Financial Management
Address	1st Floor Dorey Court, Admiral Park St. Peter Port, Guernsey GY1 6HJ
Phone	+44 20 7901 8328
Website	www.tetragoninv.com

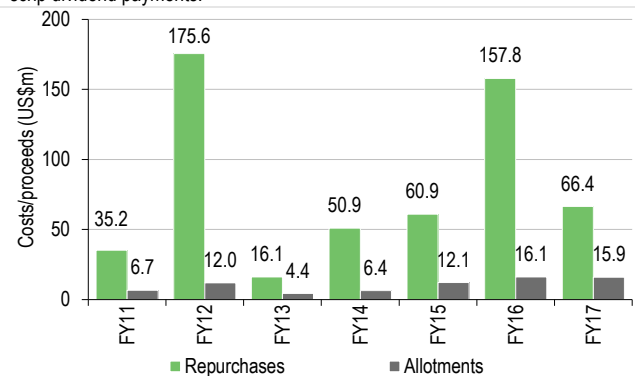
Dividend policy and history (financial years)

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

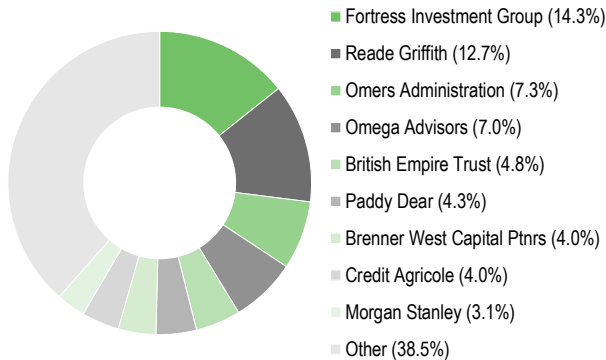


Share buyback policy and history (financial years)

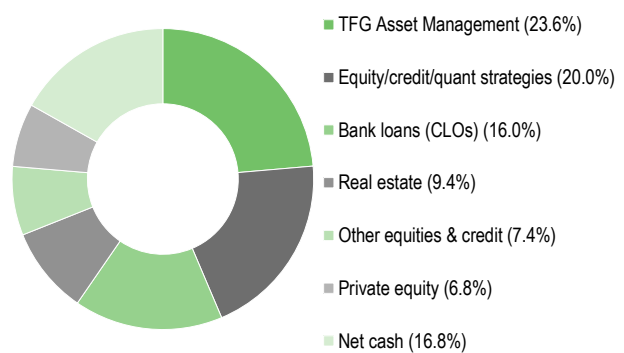
Tetragon made market share repurchases from 2007 to 2013 and has completed six tender offers totalling US\$475m since 2012. Share allotments mainly relate to scrip dividend payments.



Shareholder base (as at 30 July 2018)



Portfolio exposure by asset class (as at 30 June 2018)



Top 10 holdings (as at 30 June 2018)

Holding	Asset category	Investment structure	Description	% of NAV	
				30 June 2018	30 June 2017**
Polygon European Equity Opp Fund	Event-driven equities	Hedge fund	European event-driven equity hedge fund	12.8	10.3
Equitix*	TFG Asset Mgmt	Private equity	£2.8bn UK infrastructure fund asset manager	7.7	10.4
LCM*	TFG Asset Mgmt	Private equity	US\$7.4bn CLO manager	7.4	5.8
GreenOak Real Estate*	TFG Asset Mgmt	Private equity	US\$9.4bn global real estate asset manager	5.1	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	3.2	0.6
Polygon*	TFG Asset Mgmt	Private equity	US\$1.5bn hedge fund manager	2.8	3.0
QT Fund	Quantitative strategies	Hedge fund	Quantitative strategies hedge fund	2.5	1.2
Private equity investment	Private equity	Direct investment	Undisclosed direct balance sheet investment	2.4	N/A
Listed European equity investment	Other equities	Direct investment	Undisclosed direct balance sheet investment	2.2	N/A
Top 10 at each date				49.8	46.6

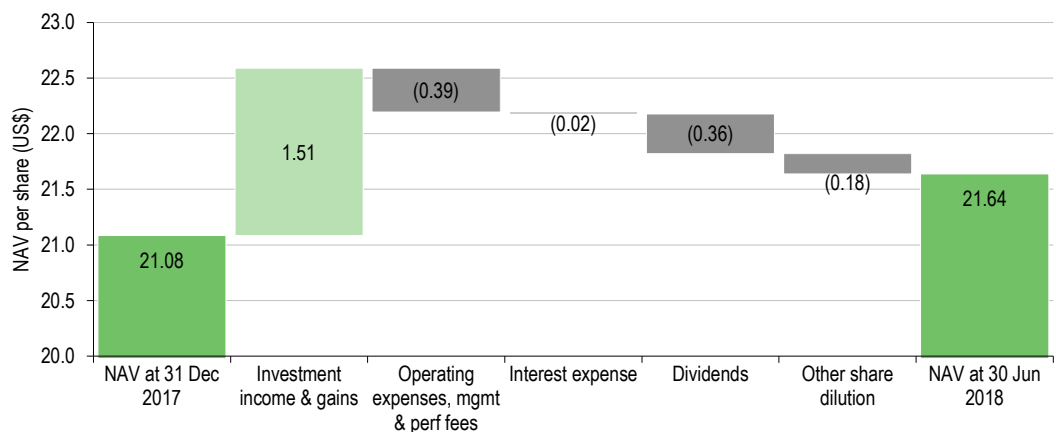
Source: Tetragon, Edison Investment Research, Bloomberg. Note: *Part of TFG Asset Management. **N/A where not in June 2017 disclosed holdings.

Improved positive performance in H118

Tetragon delivered a strong relative performance in the first six months of 2018, with a +4.4% NAV total return and a 5.2% ROE, which excludes the share dilution effects of the stock dividend (dividend reinvestment) plan. This compares favourably to broad equity market returns, with the MSCI AC World and FTSE All-Share indices achieving total returns of -0.1% and -0.7% in US dollar terms in the half year. Net investment gains were US\$144.6m in H118 and fair value net income was US\$104.3m, compared with US\$99.5m and US\$70.0m respectively in H117. Annualised ROE for the half-year was 10.5%, within Tetragon's long-term target 10-15% pa range, which is higher than the ROE achieved in each of the last four financial years (range: 6.3% to 8.9% on a like-for-like basis).

Apart from the hedge fund strategies category, which was negatively affected by a US\$12m loss on Tetragon's investment in the Polygon Distressed Opportunities Fund (wound down and closed during H118), all asset classes in the portfolio generated positive returns in the period, with half of the net investment gains coming from Tetragon's stakes in the TFG Asset Management businesses. Tetragon's net asset value increased by US\$80.4m to US\$2,074.9m during H118, with NAV per share rising from US\$21.08 to US\$21.64, as illustrated in Exhibit 2.

Exhibit 2: Tetragon's fully diluted NAV per share progression in H118



Source: Tetragon Financial Group, Edison Investment Research

Within the US\$72.5m gain from TFG Asset Management, the largest contribution was a US\$44.1m gain on Tetragon's investment in GreenOak Real Estate, comprising receipt of carried interest (performance fees), the first non-carry distribution and significant valuation gains. Valuation gains resulted from a material increase in AUM, which translates into much higher profitability. GreenOak's AUM increased from US\$7.6bn at end-December 2017 to US\$9.4bn at end-June 2018.

Tetragon's real estate investments generated a US\$30.2m gain, including US\$18.2m of gains on investments in GreenOak funds (primarily European and Asian funds). A US\$12.0m gain was recorded on Tetragon's Paraguayan farmland investments (managed by South American farmland specialist Scimitar), which were revalued by an independent valuation specialist during the period.

Other equities and credit, which comprises direct balance sheet investments, contributed a gain of US\$20.6m in the half-year, with a US\$29.5m gain on equity investments partly offset by a US\$8.9m loss on a distressed credit position that has since been sold, leaving one remaining credit position. Positive returns were generated by six of the seven directly held equity investments, which comprise European and US-listed equities, with one of these holdings reaching US\$49.9m and moving into Tetragon's top 10 investments at end-June 2018 (see Exhibit 1).

New investments, cash and borrowings

During H118, Tetragon's portfolio additions (including forex effects) totalled US\$180.8m, with the most significant allocations made to hedge fund strategies and private equity. US\$25.0m was added to the investment in Polygon European Equity Opportunity Fund, which was up 2.35% in H118, mainly driven by trades related to announced M&A situations, which represent around half of the fund's portfolio at end-June 2018. US\$24.7m was added to the investment in the Credit Suisse-managed QT Fund, which recorded a small gain in the half-year from its systematic data-driven investment strategies. US\$20.0m was added to the Polygon Convertible Opportunity Fund, which generated a small gain in the half-year despite a negative event in a distressed trade during March, with an increased opportunity set due to the large number of new issues, particularly in the US.

During the half-year, Tetragon made a number of direct balance sheet investments that it believes are compelling idiosyncratic opportunities. US\$40.0m was added to direct private equity investments; US\$26.7m to private equity funds and co-investments; and US\$15.6m was added to listed equity investments, including increased investment in one UK-listed equity and a new US-listed equity. At end-June 2018, direct balance sheet investments made up 14.2% of Tetragon's NAV, spread across private equity, listed equity and credit (see Exhibit 1).

During the six-month period, Tetragon income and disposal receipts included US\$102.5m from the closure of the Polygon Distressed Opportunities Fund, which was largely reallocated to other hedge fund strategies, as noted above. Other significant receipts were US\$63.0m from CLO bank loan investments (primarily non-LCM US CLOs), as these continued to amortise, and US\$23.5m from exiting direct listed equity investments.

During the six months to end-June 2018, Tetragon's net cash position declined modestly from US\$357.2m to US\$349.3m, representing 16.8% of net assets. A substantial cash position is maintained to cover future commitments and also to provide scope for Tetragon to take advantage of opportunistic investments and new business opportunities. Tetragon's outstanding cash commitments at end-June 2018 amounted to c US\$260m, comprising investment commitments (GreenOak US\$118m, TCI III US\$65m, direct private equity funds US\$9m), potential investments (Hawke's Point US\$69m), with additional financial resources required to cover ongoing dividends and fees. Tetragon currently has a US\$150.0m revolving credit facility in place, of which US\$38.0m was drawn at end-June 2018, unchanged since end-2016.

Dividends and share dilution

During the half-year, Tetragon's Q417 and Q118 dividends, both US\$0.1775 per share, became payable, with the total dividend distribution amounting to US\$32.2m. US\$24.0m was paid in cash, with the remaining US\$8.2m reinvested under Tetragon's optional stock dividend plan, resulting in 0.9m shares being issued from treasury. The Q218 dividend, which was increased to US\$0.1800 per share, continuing the historical pattern of the quarterly dividend being increased in the second and fourth quarters and held steady in the first and third quarters, is payable on 24 August 2018.

Tetragon's fully diluted share count increased from 94.6m to 95.9m during the first half of 2018. The increase of 1.3m shares comprises 0.6m in relation to the vesting of shares under equity-based compensation awards and 0.7m in relation to the issue of shares as scrip dividends.

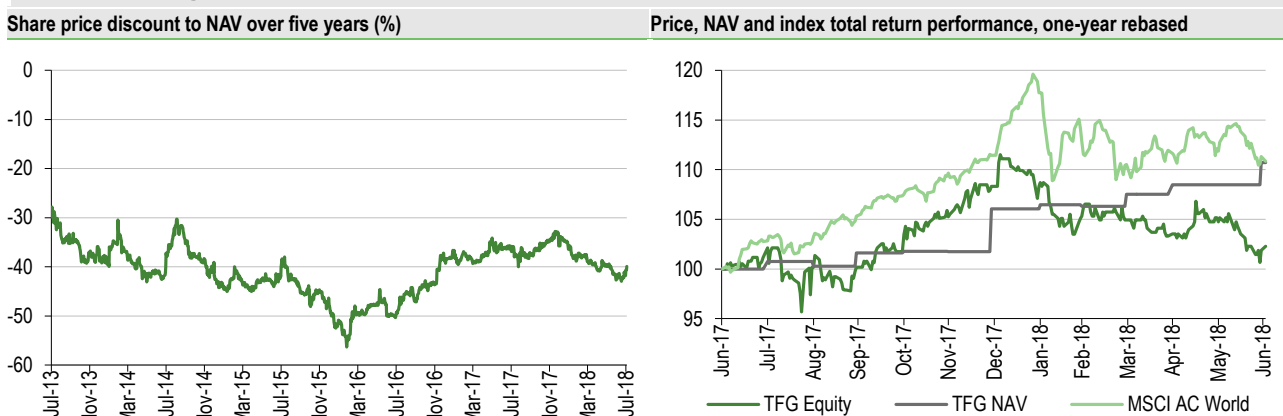
Board change

In July 2018, Frederic Hervouet retired from Tetragon's board after four years' service as a non-executive director. This reduces the board to five directors, three of whom are independent. No immediate decision has been made by Tetragon regarding any possible addition to the board.

Discount: Recent widening to three-year average level

As illustrated in Exhibit 3 (left-hand chart), having narrowed steadily from 56.3% in February 2016 to 32.8% in December 2017, Tetragon's share price discount to NAV has seen a widening trend emerge in 2018. While the current 39.9% discount is wider than its 37.8% one-year average, it is narrower than its three-, five- and 10-year averages of 41.8%, 40.6% and 43.6% respectively. Tetragon's share price has declined in 2018, despite its NAV continuing to move higher, leading to a marked widening of its discount, with the share price at 30 June 2018 standing c 3% lower than a year earlier, while its NAV per share was c 7% higher. Exhibit 3 (right-hand chart) clearly illustrates the divergence in share price and NAV total return performance since December 2017. The decline in Tetragon's share price accompanied a rise in equity market volatility, suggesting that increased investor risk aversion may have affected the share price, while returns from Tetragon's diversified alternative asset portfolio appear largely unaffected by the change in stock market conditions.

Exhibit 3: Tetragon share price discount to NAV and performance data in US dollar terms



Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Performance data to end-June 2018.

Peer group comparison

Exhibit 4 shows a comparison in sterling terms of Tetragon with the other members of the AIC Flexible Investment sector that have a market cap higher than £100m. The investment mandates of the funds in the peer group vary widely and, while none is considered as a direct comparator for Tetragon, the peer group average provides a broad context for comparison. Tetragon's NAV total return leads the peer group by a considerable margin over the 10 years to end-June 2018, which includes the 2008 global financial crisis that had a significant adverse effect on a number of funds in the group. Over one, three and five years, Tetragon's NAV total return ranks second out of the peer group of 10, with returns significantly higher than the peer group average over three and five years. US dollar strength versus sterling over the three months to end-June 2018 largely offset the weakness in the second half of 2017, making currency effects less significant on sterling performance over one year. Over three, five and 10 years, US dollar strength versus sterling (+19.1%, +14.9%, +50.7% respectively) had a positive effect on performance in sterling terms.

Tetragon's share price discount to NAV is at the wider end of the peer group range, but at a comparable level with two other funds, while four of its peers are trading at a premium to NAV. 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 most of its peers, Tetragon has no corporate level net gearing, while its 5.5% dividend yield is the highest in the peer group, significantly above the 2.2% average yield. We note that if Tetragon's discount was to fully unwind, the shares would have a yield of c 3.3%, still at the higher end of the peer group range.

Exhibit 4: Selected AIC Flexible Investment sector peer group in sterling terms as at 3 August 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	956.7	8.9	61.9	93.6	340.6	(39.9)	1.74	Yes	100	5.5
Aberdeen Diversified Income & Growth	409.9	(0.3)	4.8	15.1	56.5	(2.9)	0.58	No	111	4.2
Capital Gearing	255.2	3.5	24.2	31.4	102.4	2.3	0.77	No	100	0.5
Hansa Trust A	256.8	7.3	24.2	47.4	72.6	(28.2)	0.00	No	100	1.5
Henderson Alternative Strategies Trust	112.2	5.5	26.2	26.2	(9.5)	(14.5)	1.06	No	100	1.6
JZ Capital Partners	363.7	(2.9)	15.1	29.0	6.9	(41.5)	2.92	Yes	106	0.0
Personal Assets	906.4	(1.2)	20.4	27.2	82.0	0.4	0.89	No	100	1.4
RIT Capital Partners	3,285.7	5.9	27.4	54.7	97.3	10.5	1.02	Yes	107	1.6
Ruffer Investment Company	416.6	1.3	9.5	15.0	108.1	1.0	1.16	No	100	0.8
UIL	160.2	18.4	91.0	144.9	85.6	(44.5)	1.55	Yes	118	4.5
Average	712.3	4.6	30.5	48.5	94.2	(15.7)	1.17		104	2.2
Rank in peer group	2	2	2	2	1	8	2		5=	1

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

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