Tetragon Financial Group

Positive returns from all asset classes in H117

Investment companies

Tetragon Financial Group (TFG) reported a 2.8% NAV total return for H117, with positive contributions made by all asset classes in the portfolio. Although below the target 10-15% range, annualised return on equity for the half year of 7.2% was ahead of the 6.3% achieved in 2016. Tetragon's share price total return was 7.4% for the six months to end-June 2017, with the discount narrowing by 2.1pp to 36.4% over the period. Dividends continue their steady progression, with the Q217 dividend increased by 4.5% from Q216 to US$0.1750 per share, and Tetragon's 5.3% dividend yield ranks as the second highest in the Flexible Investment sector.

12 months ending	Share price total return (%)	NAV total return (%)	MSCI AC World (%)	FTSE All-Share (%)	US 10y Govt Bond Index (%)
30/06/13	55.8	15.2	17.2	14.0	(4.1)
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)

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

Steady progress across all asset classes in H117

Tetragon generated fair value net income of US$70.0m in H117, equating to an investment return on equity (ROE) of 3.6%, with a slightly lower 2.8% NAV total return as a result of share dilution, mainly due to the issue of scrip dividends and recognition of additional equity-based compensation shares. The 7.2% annualised ROE is modestly ahead of the 6.3% achieved in 2016 but slightly below the comparable 8.2% ROE in 2015. Total investment gains of US$99.5m in the half year compare with US$68.9m in H116. All asset classes in the portfolio made a positive contribution, with the largest gains generated by TFG Asset Management and CLO investments (which now represent less than 20% of net assets).

Outlook: Near-term potential for certain asset classes

Tetragon's management sees near-term potential for several asset classes in the portfolio. Investing in US CLO equity when funding costs are low is seen as compelling despite current tight credit spreads, as these investments should benefit from relatively attractive financing costs in the event of greater spread volatility. There is optimism over the potential for European event-driven equities to perform well, given that Europe remains some years behind the US in terms of its economic recovery. In addition, there is the prospect that Tetragon's large cash balance could be partly used to fund compelling opportunities that may emerge as markets adapt to a shift from quantitative easing to balance sheet reduction by central banks.

Valuation: Narrowing discount; superior yield

Tetragon's share price discount to NAV has steadily contracted since February 2016. The current 36.2% discount is narrower than its 39.5% five-year average but is wider than its five-year low of 20.4%, leaving significant scope for the narrowing trend to continue. Tetragon's 5.3% dividend yield ranks as second highest in its Flexible Investment sector peer group, significantly ahead of the 2.2% average.

10 August 2017

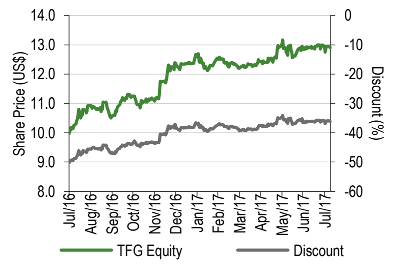
Price	**US$12.90**
Market cap	**US$1,264m**
NAV*	**US$1,982m**

NAV per share*	US$20.22
Discount to NAV	36.2%

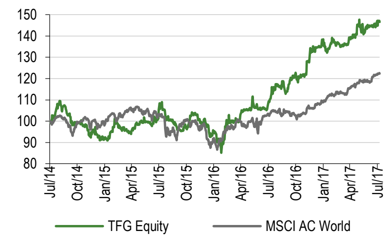
*NAV as at 30 June 2017.

Yield	5.3%
Fully diluted shares in issue	98.0m
Code	TFG
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$13.17	US$10.40
NAV high/low	US$20.22	US$19.66

Gearing

Gross borrowings*	1.9%
Net cash*	20.2%

*As at 30 June 2017.

Analysts

Gavin Wood	+44 (0)20 3681 2503
Sarah Godfrey	+44 (0)20 3681 2519

investmenttrusts@edisongroup.com

Edison profile page

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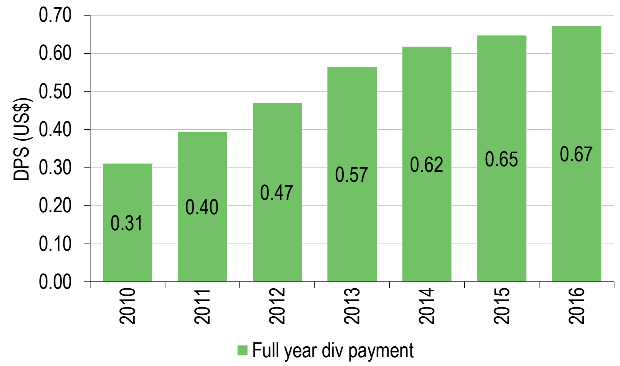
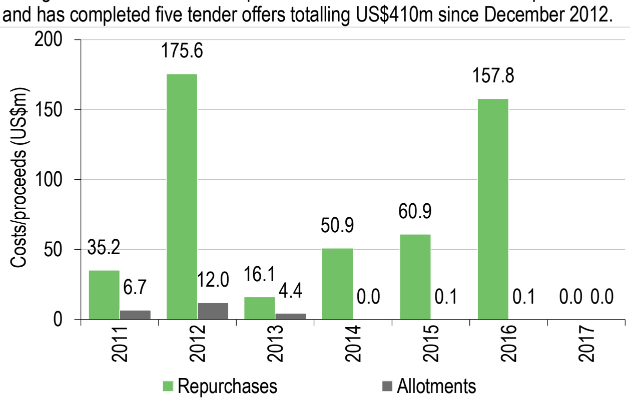
Exhibit 1: Company at a glance

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 a diversified alternative asset management business, TFG Asset Management, and covers bank loans, real estate, equities, credit, convertible bonds and infrastructure.	■ 31 July 2017: FY17 interim results – NAV total return +2.8% vs MSCI AC World +11.8% and FTSE All-Share +10.9%, all in US dollar terms. ■ 28 July 2017: US$0.1750 Q217 dividend declared vs US$0.1675 in Q216. ■ 27 April 2017: US$0.1725 Q117 dividend declared vs US$0.1650 in Q116. ■ 21 April 2017: 2.4m Tetragon shares issued for cashless settlement of 12.5m US$10.00 share options exercised by TFM at US$12.34 prevailing share price.

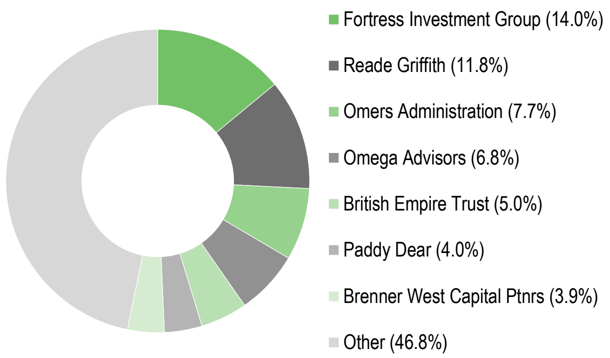
Forthcoming		Capital structure		Fund details	
Investor day	2018 date TBC	Ongoing charges	1.64%	Group	Tetragon Financial Group
Final results	March 2018	Net cash	20.2%	Manager	Tetragon Financial Management
Year end	31 December	Annual mgmt fee	1.5% of net assets	Address	1st Floor Dorey Court, Admiral Park
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

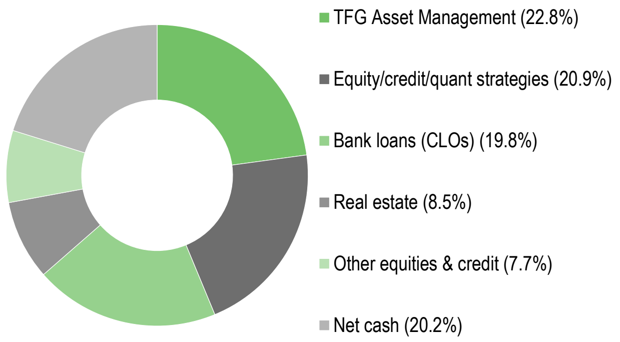
Dividend policy and history	Share buyback policy and history
Tetragon pursues a progressive dividend policy with a target payout ratio of 30-50% of normalised earnings. Dividends are paid quarterly.	Tetragon made market share repurchases from December 2007 to April 2013 and has completed five tender offers totalling US$410m since December 2012.





Shareholder base (as at 31 July 2017)	Portfolio exposure by asset class (as at 30 June 2017)





Top 10 holdings (as at 30 June 2017)

Holding	Asset category	Investment structure	Description	% of NAV 30 June 2017	% of NAV 30 June 2016**
Equitix*	TFG Asset Mgmt	Private equity	£2.3bn UK infrastructure fund asset manager	10.4	8.8
Polygon European Equity Opp Fund	Event-driven equities	Hedge fund	European event-driven equity hedge fund	10.3	7.8
LCM*	TFG Asset Mgmt	Private equity	US$6.4bn CLO manager	5.8	5.4
Polygon Distressed Opp Fund	Distressed Opps	Hedge fund	Distressed opportunities hedge fund	5.5	5.0
GreenOak Real Estate*	TFG Asset Mgmt	Private equity	US$7.3bn global real estate asset manager	3.4	3.5
Polygon*	TFG Asset Mgmt	Private equity	US$1.6bn hedge fund manager	3.0	3.3
Polygon Convertible Opp Fund	Convertible bonds	Hedge fund	Event-driven credit hedge fund	2.7	2.5
GreenOak US II Fund	Real estate	Private equity-style fund	US real estate fund	1.9	1.9
LCM XV LP	Bank loans	CLO	US broadly syndicated corporate loans	1.9	N/A
LCM XXIV Ltd	Bank loans	CLO	US broadly syndicated corporate loans	1.7	N/A
Top 10 at each date				**46.6**	**42.1**

Source: Tetragon Financial Group, Morningstar, Thomson Reuters, Bloomberg, Edison Investment Research. Note: *Part of TFG Asset Management. **N/A where not in June 2016 top 10.

All asset classes achieved positive returns in H117

Tetragon generated US$70.0m fair value net income in the first half of 2017, equating to an investment return on equity (ROE) of 3.6%, with a slightly lower NAV total return of 2.8% due to share dilution. Annualised ROE of 7.2% is modestly ahead of the 6.3% achieved in 2016 and slightly below the comparable 8.2% ROE in 2015. During the period, all asset classes in Tetragon's portfolio achieved positive returns, with total investment gains of US$99.5m, which compares with US$68.9m in H116. The largest gains were generated by TFG Asset Management and CLOs, with meaningful contributions also made by hedge fund investments, direct balance sheet investments and real estate. Management and performance fees for the half year totalled US$26.0m, including an incentive fee of US$11.4m, while other operating expenses amounted to US$2.0m.

Exhibit 2: Tetragon's fully diluted NAV per share progression in H117

Source: Tetragon Financial Group

TFG Asset Management

TFG Asset Management, which comprises a diverse portfolio of alternative asset managers, recorded a gain of US$38.7m, with positive contributions from all of the established businesses. Tetragon's investment in Equitix saw the largest gain of US$23.3m, mainly due to favourable movements in market valuation metrics. The underlying business also continued to perform well, with its fourth fund oversubscribed and closing at its £750m fund-raising cap post the half-year end. Equitix also completed the refinancing of its debt facilities in July 2017, resulting in £63.6m of proceeds to Tetragon. The investment in LCM saw a significant gain of US$9.4m, also as a result of a favourable movement in market multiples as well as the performance of the underlying business.

In May 2017, TCI II had its final close with c US$350m of capital, and this contributed to an increase of US$2.7m in the fair value of TCIP, its general partner. TCICM, the CLO manager and subsidiary of TCI II, now manages c US$1.4bn of US broadly syndicated leveraged loans. The investment in GreenOak also recorded a US$2.7m gain, which reflected the crystallisation and distribution of carried interest from its first Japan fund, while the investment in Polygon recorded an investment gain of US$0.6m as that business added third-party capital to its European Equity fund.

Other asset classes

Tetragon's bank loan investments through CLOs benefited from proactive efforts by the CLO managers to offset the effects of spread tightening across the capital structure and a shift in the Libor curve, which were the main challenges within the asset class during the half year. The managers took advantage of tightening credit spreads and strong demand for leveraged loans to refinance and reset a number of CLO transactions, resulting in a US$28.0m net investment gain.

Hedge fund investments made a US$14.2m contribution, with positive returns from all of the open Polygon funds. The largest gain was US$11.8m from event-driven equities, through the investment in Polygon European Equity Opportunity Fund. Small gains were made in Tetragon's convertible bonds and distressed opportunities investments, outweighing small losses on the Mining Opportunity Fund (which is being wound up) and the QT Fund (a new quantitative strategies investment initiated in March 2017).

Other equities and credit, which comprises Tetragon's direct balance sheet investments in single strategy ideas, and real estate investments also generated positive returns. All but one of the direct balance sheet investments, primarily consisting of listed and unlisted equities, made a positive contribution to the overall US$9.5m gain. GreenOak investments generated positive returns totalling US$7.5m across all three investment regions, with more than half of the gains from Asia-based investments, including GreenOak Japan Fund I. Other real estate investments, comprising commercial farmland investments in Paraguay managed by South American farmland specialist Scimitar, recorded a US$0.3m loss reflecting ongoing fees and expenses.

Dividends and share dilution

During the half year, Tetragon's Q416 and Q117 dividends, both US$0.1725 per share, were payable, with the total dividend distribution amounting to US$30.7m. US$23.2m was paid in cash, with the remaining US$7.5m reinvested under Tetragon's optional stock dividend plan, resulting in 0.6m shares being issued from treasury. The Q217 dividend, which was increased to US$0.1750 per share, is payable on 23 August 2017.

Tetragon's fully diluted share count increased from 96.7m to 98.0m during H117. In addition to the issue of 0.6m shares as scrip dividends, fully diluted shares in issue increased due to recognition of an additional 0.5m shares in equity-based compensation and an increase in the intrinsic value of in-the-money options resulting from the 4.5% rise in Tetragon's share price over the half year. The 2.4m shares issued to settle the exercise of 12.5m options by Tetragon's investment manager TFM were already included in the fully diluted share count at end-2016, as were the 2.0m treasury shares transferred to escrow in relation to the deferred US$25.1m incentive fee payable to TFM (triggered by Tetragon's adoption of IFRS from end-2016 and the consequent uplift in the NAV of certain TFG Asset Management businesses). Tetragon also issued 0.4m shares to settle options exercised by GreenOak founding partners, representing 67% of their options exercisable in 2017.

With respect to the half year to end-June 2017, Frederic Hervouet has elected to receive shares in lieu of his full compensation as a non-executive director, and William Rogers has elected to receive shares in lieu of half of his compensation as a non-executive director. During the period, Hervouet and Rogers received 4,019 and 1,009 shares, respectively. The number of shares to be issued in lieu of fees for Q217 will be determined as part of the Q217 dividend process.

Cash and borrowings

Tetragon continues to maintain a substantial cash position to cover future commitments and also enable it to capitalise on opportunistic investments and new business opportunities. At end-June 2017, Tetragon held net cash of US$400.0m, representing 20.2% of net assets. All Tetragon's cash is held at highly rated banking institutions, in on-demand arrangements, to ensure that it is not exposed to any term risk.

During H117, Tetragon deployed US$134.6m of cash in new investments and paid US$23.2m in cash dividends. A new investment was made in the majority of the equity tranche of a new issue LCM-managed CLO in March, and additional investments were made in the equity tranche of an LCM-managed CLO that was 'reset' (CLO liabilities refinanced and the reinvestment period, final maturity, and other duration-related terms extended by more than five years) at the end of May.

Tetragon's outstanding cash commitments at end-June 2017 were c US$275.8m, comprising investment commitments (GreenOak US$129.0m, TCI II US$57.0m), potential investments (Hawke's Point US$89.8m), 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 2017.

Outlook

Tetragon's management highlights that the current investment environment remains difficult, with 10-year US government bond yields not far off their historical lows and the effects of quantitative easing and bond buying by central banks continuing to influence financial markets. Against the current backdrop of tightly priced credit and elevated price/earnings ratios, Tetragon's management emphasises that its focus continues to be on generating returns from investments that generally produce idiosyncratic results, rather than trying to predict the future returns of passive investments.

Tetragon's management sees near-term potential for several of the asset classes in the portfolio. First, it considers that investing in US CLO equity when funding costs are low remains compelling despite current tight credit spreads, noting that in the event of greater spread volatility, these investments should benefit from their relatively attractive financing costs. Within hedge fund allocations, management is optimistic on the potential for the allocation to European event-driven equities to perform well, given that Europe remains some years behind the US in terms of its economic recovery. Lastly, while Tetragon's large cash balance may potentially drag on current performance, the cash could be partly used to fund compelling opportunities that may emerge as markets adapt to a shift from quantitative easing to balance sheet reduction by central banks.

In respect of European CLOs, management expects c 40% of the current portfolio to amortise over the next few quarters and does not plan to add any additional exposure, in contrast to US CLOs. The wind-down of the Polygon Mining Opportunity Fund has progressed according to plan and was largely completed at end-June 2017, when it represented only 0.2% of Tetragon's NAV.

No new businesses have been added to TFG Asset Management recently, but management reports that opportunities are continually being reviewed, and detailed discussions are being held with several businesses that could potentially conclude in an investment within the next 12 months.

Discount: Narrowing trend established

As illustrated in Exhibit 3, having followed a widening trend for the previous three years, Tetragon's share price discount to NAV has been steadily contracting over the last 17 months. The current 36.2% discount is narrower than its 39.5% five-year average but remains considerably wider than its five-year low of 20.4%, leaving significant scope for the narrowing trend to continue.

Exhibit 3: Share price discount to NAV over five years (%)

Source: Thomson Datastream, Edison Investment Research

Peer group comparison

Exhibit 4 shows a comparison of Tetragon with the other AIC Flexible Investment sector funds over £100m market cap in sterling terms. We no longer include AIC Sector Specialist: Debt sector funds focused on CLO securities in the comparison, as Tetragon's bank loan exposure via CLOs has declined to less than 20% of NAV at end-June 2017 (see Exhibit 1). Tetragon's NAV total return has outperformed the rest of the peer group by a considerable margin over three, five and 10 years to end-June 2017, while performance over one year has been weaker, ranking Tetragon in the lower half of the peer group.

Exhibit 4: Selected flexible investment fund peer group in sterling terms as at 8 August 2017*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Tetragon Financial Group	975.5	7.9	73.2	111.7	347.6	(36.7)	1.64	Yes	100	5.3
Aberdeen Diversified Income & Growth	393.4	10.0	5.4	34.5	28.7	(9.7)	0.62	No	108	5.5
Capital Gearing	189.0	11.4	24.7	35.0	105.2	2.4	1.03	No	100	0.5
Henderson Alternative Strategies Trust	112.5	21.0	17.3	5.9	(16.5)	(14.0)	1.01	Yes	100	1.3
Personal Assets	840.0	4.8	25.0	28.3	79.2	0.8	0.95	No	100	1.4
RIT Capital Partners	3,026.2	12.6	36.4	66.5	82.6	10.3	1.14	Yes	104	1.6
Ruffer Investment Company	388.1	9.8	17.1	30.1	134.3	2.2	1.17	No	100	0.8
Syncona	1,122.6	18.7	28.7			20.9	1.50	No	100	1.3
Peer group average	**880.9**	**12.0**	**28.5**	**44.6**	**108.7**	**(3.0)**	**1.13**		**102**	**2.2**
Tetragon's rank in peer group	**3**	**7**	**1**	**1**	**1**	**8**	**1**		**3**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to end-June 2017. TR = total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

Tetragon's share price discount to NAV has narrowed by more than 10 percentage points over the last year but remains the widest in the peer group, suggesting scope for improving investor awareness to support further narrowing. Tetragon's ongoing charge is the highest in the peer group and it is one of three funds to charge a performance fee, while its structural cash position means that it has no net gearing, similar to the majority of peers. Tetragon's 5.3% dividend yield ranks as one of the highest in the peer group, significantly ahead of the 2.2% average yield.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia