EDISON

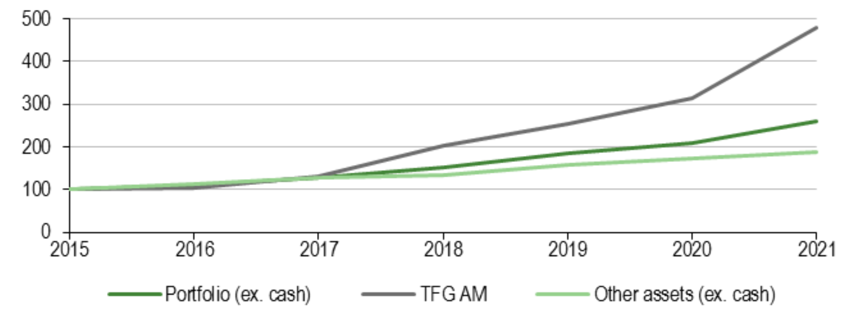
Tetragon Financial Group

Offering a diverse exposure to alternative assets

Investment companies
Alternative assets

Tetragon Financial Group (Tetragon) focuses on alternative asset classes offering excess risk-adjusted returns (ie 'intrinsic alpha'). This includes private equity holdings in alternative asset managers, investments in funds, as well as balance sheet investments in alternative assets. Tetragon posted a 14.1% NAV total return in FY21 in US dollar terms and so far saw only an 0.6% NAV decline in 2022 until end-April. It continues to make distributions to shareholders through NAV-accretive share buybacks (it completed a US$42m tender offer in April 2022) and dividends (with its LTM payout implying a 4.1% yield).

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



Source: Tetragon, Edison Investment Research. Note: *Not adjusted for investments/disposals during respective years.

Why invest in Tetragon Financial Group?

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

The analyst's view

TFG Asset Management remains the largest asset in Tetragon's portfolio (45% share of NAV) and management reiterated its intention to at least partially exit this position, with the sale of individual asset managers now more likely than an initial public offering (IPO) of the whole entity. In this context, we note that TFG Asset Management's valuation reflected in Tetragon's end-April NAV equals c 1.3x Tetragon's current market capitalisation. Within TFG Asset Management, management considers LCM (valued at 29% of Tetragon's current market cap) and BentallGreenOak (23% of market cap) as being more mature, while the largest position Equitix (71% of market cap) is still in its growth phase.

NOT INTENDED FOR PERSONS IN THE EEA.

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

27 June 2022

Price	**US$10.20**
Price (TFGS)	**830p**
Market cap	**US$946m**
NAV*	**US$2,731m**

NAV per share*	US$29.45
Discount to NAV	65.0%

*As at end-April 2022.

Yield		4.1%
Fully diluted shares in issue		92.7m
Code/ISIN		TFG/GG00B1RMC548
Primary exchange		Euronext Amsterdam
Secondary exchange		LSE Specialist Fund Segment
AIC sector		Flexible Investment
52-week high/low	US$10.75	US$8.06
NAV high/low	US$29.86	US$26.17
Net debt*		2.1%

*As at end-April 2022.

Fund objective

Tetragon Financial Group's 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, real estate, venture capital, infrastructure, bank loans and a diversified alternative asset management business.

Bull points

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

Bear points

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

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

Market outlook: Macro conditions favour alternative strategies

While the global economy recovers from the pandemic-induced slowdown, investors are now mostly concerned about high inflation and monetary tightening, as well as uncertainties on global supply chains and trade routes (further exacerbated by lockdowns as part of China's 'zero-COVID' policy, and sanctions on Russia following its invasion on Ukraine). The World Bank recently reduced its expected GDP growth in Europe to 2.5% in 2022 from 4.2% earlier (mostly due to rising energy prices) and cut the US growth forecast by 1.2pp to 2.0%. With slowing growth and high inflation, investors are likely to be drawn to (1) assets benefiting from rising interest rates or having embedded inflation protection and (2) alternative assets, which are exhibiting low correlation to equities.

Private infrastructure rises in popularity

One such low correlation asset is the global private infrastructure market, estimated at c US$1tn in 2019 by PwC. Infrastructure investments (which Bain & Company estimates in its Global Private Equity report 2022 attracted US$120bn of new capital in 2021) are sought by many investors for stability in the face of economic uncertainty and are also considered a natural hedge against inflation. As a result, Preqin expects it to become the largest real assets strategy by 2026 (overtaking real estate). Although the increased investor interest brought the dry powder in the sector to US$230bn in 2020 (after growing by 13% pa since 2010), it represents less than the global deal value in 2020 (and compares to the private equity market with about two years' worth of deal value currently, according to Preqin). This is coupled with unmet need for infrastructure investments. According to Global Infrastructure Hub, the gap between infrastructure investments needed to keep pace with economic growth (and meet the committed sustainable development goals) and government spending amounted to US$445bn globally in 2020 and is expected to widen to US$820bn by 2040. Tetragon's indirect exposure to infrastructure investments is its 75% stake in Equitix, which manages US$10.8bn of infrastructure assets and accounts for 25% of Tetragon's net asset value (NAV).

Real estate is considered an inflation hedge

Similarly, commercial and residential real estate investments are garnering interest as a potential hedge against inflation according to Savills. The total value of global commercial property amounted to US$32.6tn in 2020 and was down 5% y-o-y (Savills). The decrease is associated with the global economic contraction induced by the pandemic, amplified by the adoption of working from home and uncertainty over office space going forward. However, a revival of the market was seen in 2021 as life gradually returned to normal, as reported by JLL, with 21% y-o-y growth in leasing volumes globally. Residential real estate remains the world's most significant store of wealth (US$258.5tn) and increased by 8% in 2020. Real estate-related investments made up 13% of Tetragon's NAV at end-2021 and comprise investments in BentallGreenOak-managed funds, assets managed by third-party managers as well as a 13% stake in BentallGreenOak itself. The underlying assets include commercial, residential and agricultural real estate in the United States, Europe, Asia as well as South America.

Increasing interest rates support CLOs' cash generation in the near term

In the near term, the rising interest rates should have a positive impact on collateralised loan obligation (CLO) cash flow generation, especially by increasing the residual cash flow to CLO equity tranches. Since the beginning of 2022, three-month Libor increased from 0.21% to the current 2.20% (27 June) and given the record-high inflation (the US CPI hit a 40-year high of 8.5% in March 2022) the consensus expectation is for the Federal Reserve to continue raising rates throughout 2022. In the long run, however, the increasing cost of debt may translate into higher default rates and collateral quality deterioration. In this scenario, cash flow would be redirected from equity (and potentially also junior debt) tranches due to internal test breaches. So far, the default rate in the United States has increased only slightly (0.6% on a last 12 months (LTM) basis) and is expected to reach 1.5% in 2022 and be in the 1.25–1.75% range in 2023 according to Fitch. This compares to c 4% recorded at the pandemic peak (September 2020) and over 10% in late 2009 as a result of the global financial crisis (Fitch). Tetragon is currently invested only in US-based CLOs, predominantly in equity tranches. Tetragon is exposed to the CLO market in several ways. It owns a 100% stake in CLO manager LCM and CLO-investing asset manager Tetragon Credit Partners (TCIP). Tetragon also invests in TCIP-managed funds, as well as directly into CLOs managed predominantly by LCM but also third-party managers. The combined exposure amounts to 19% of Tetragon's NAV.

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 manager. 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 Asset Management), who all have experience in alternative investments. Tetragon and TFG Asset Management employees cumulatively held 34.5% of outstanding non-voting shares of Tetragon at end-April 2022.

Investment process: Targeting risk-adjusted returns

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

When assessing acquiring a stake in a new asset manager, TFM takes into consideration performance track record, reputation, regulatory requirements, infrastructure needs and asset-gathering capacity. To mitigate potential correlated risks across asset managers, Tetragon seeks to diversify exposure across asset classes, investment vehicles, durations and investor types.

Tetragon's approach to ESG

Tetragon acknowledges the importance of ESG factors in sustainable investing and sees evidence demonstrating a link between ESG performance and financial performance. In the investment process, the investment manager integrates ESG factors as supplementary information to investment decisions to help identify drivers of risk and return. It has also adopted a Statement on the UK Modern Slavery Act in its operations. Tetragon also reports against the Code of Corporate Governance of the AIC. The ESG policy is reviewed annually and TFM's Investment Committee and Risk Committee are responsible for overseeing ESG integration. We note that Tetragon's investment manager (Tetragon Financial Management) has not disclosed any ESG-related targets for its own operations. With respect to its governance structure, we note that Tetragon's listed shares are all non-voting (the only voting shares are held indirectly by its two co-founders. Neither Tetragon nor Tetragon Financial Management has been assigned any external ESG rating at present.

The fund manager: Tetragon Financial Management

Tetragon is managed by Tetragon Financial Management (TFM). TFM was founded and is owned by the co-founders of Tetragon (Reade Griffith and Paddy Dear), who also founded Tetragon in 2005 and launched Polygon in 2002 (currently wholly owned by Tetragon). While Tetragon pays management fees to TFM, in terms of decision making it can be viewed as a self-managed entity, because the investment manager is owned and run by the same two individuals who indirectly own voting shares of Tetragon.

The manager's view: Low correlation and diversification

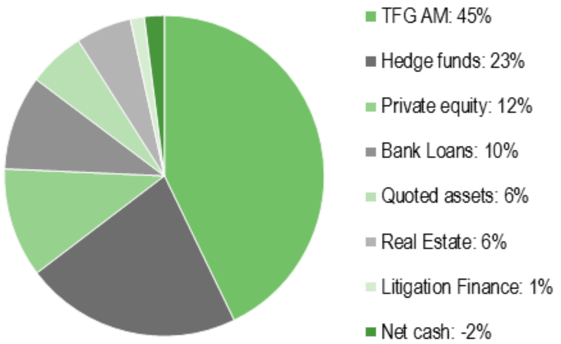
TFM aims to manage a diversified portfolio with limited correlation to broader macro factors rather than actively positioning the portfolio in anticipation of a given scenario materialising in financial markets. In the near term it plans to increase its allocation alongside newly set up managers Contingency Capital (legal assets) and Banyan Square Partners (private equity co-investments), which are part of TFG Asset Management. Tetragon plans to keep a broadly stable allocation to real estate and CLOs, with the distributions and amortisation planned to be offset with new investments into BentallGreenOak/Tetragon Credit Partners funds. Tetragon also highlights that it is considering new asset classes to invest in and is likely to slightly reduce its exposure to convertible bond strategies (managed by minority owned Acasta, formerly the Convertible Bonds strategy within Polygon).

Tetragon continues to see TFG Asset Management as its main value driver going forward, which was the case in each financial year from 2017–21. Tetragon aims to continuously expand the entity with new managers, asset classes and strategies and its aggregate assets under management (AUM) reached US$37bn at end FY21 (a 14% five-year CAGR). While Tetragon still considers an IPO of the whole entity as a viable exit route, it now expects that exit transactions of individual asset managers within TFG Asset Management are more likely in the mid-term. Currently, TFG Asset Management comprises nine asset managers, two of which Tetragon considers relatively mature. In the case of three it sees further potential for high growth, while the remaining four are in the early stages of development (see the Asset allocation section for more details on TFG Asset Management managers).

Asset allocation

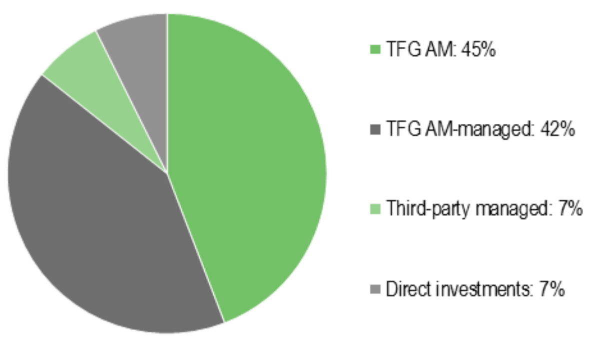
As at end-April 2022, Tetragon's NAV stood at US$2.7bn across various alternative asset allocations. TFG Asset Management remains its largest portfolio holding (making up 45% of the NAV). It is a wholly owned subsidiary, holding (mostly) majority stakes in alternative asset management companies generating stable fee income from AUM of US$37bn (at end-2021) in infrastructure, real estate, CLOs and private equity as well as hedge funds (see details below). Tetragon invests predominantly into strategies of these companies (42% of Tetragon's portfolio at end-March 2022). The remaining 14% of the portfolio is Tetragon's direct investments (7%) and assets managed by third-party managers (7%).

Exhibit 1: Portfolio by asset class (April 2022)



Source: Tetragon Financial Group, Edison Investment Research

Exhibit 2: Portfolio exposure by manager (March 2022)



Source: Tetragon Financial Group, Edison Investment Research

TFG Asset Management managers

BentallGreenOak is a mature real estate funds manager with AUM of US$74bn at end-2021. Tetragon already partially exited the position (GreenOak) through a merger with Bentall Kennedy in 2018 and now owns a 13% stake in the manager valued at US$222m (7.8% of Tetragon's NAV at end-March 2022).

LCM is a specialist in US below-investment grade leveraged loans. It currently manages 25 CLO structures with total AUM of US$11.2bn and is wholly owned by Tetragon (valued at US$278m, 9.9% of NAV).

The largest single-name asset held by Tetragon is the core infrastructure assets manager **Equitix**, which makes 23.7% of Tetragon's NAV (US$670m at end-March 2022). The recent popularity of real asset investments supported the rapid growth of Equitix's AUM (a five-year CAGR at 32% to end-2021, US$10.8bn) and is reflected in its valuation, as the company has been the main driver of Tetragon's NAV returns in each of the last three years (see below). Tetragon owns a 75% stake in Equitix, with the remainder being held by its management. While Tetragon is not invested in any of the Equitix-managed funds (a sole exception in the case of TFG Asset Management), Equitix does invest in its own funds according to the management.

Polygon manages open-ended hedge funds and private equity vehicles (AUM of US$1.8bn at end-2021). Its subsidiary (Polygon Convertible Opportunities) was renamed in 2022 after the CIO, Michael Humphries, became majority shareholder of the entity in 2020 into **Acasta Partners** (AUM of US$0.9bn at end-2021). Acasta manages convertible bond investments and continues to utilise TFG Asset Management's infrastructure.

The four remaining managers are in the early stages of development and manage combined AUM of US$1.1bn at end-2021. **Hawke's Point** (established in 2014) invests in mining assets, **Tetragon**

Credit Partners (2015) invests in CLO tranches, **Banyan Square Partners** (2019) is focused on private equity co-investments and **Contingency Capital** (2020) on legal assets.

Hedge funds

Within this asset class, Tetragon holds predominantly investments in event-driven equities funds managed by Polygon (98% at end-March 2022, mainly the European Equity Opportunity Fund). The portfolio has limited correlation to public markets as Polygon focuses on special situations (eg restructurings, M&A deals, market dislocation and corporate activism), which are driven by company-level catalysts and take time to unlock the value. Tetragon also invests in a convertible bond strategy managed by Acasta Partners, which is also a concentrated, catalyst-driven portfolio.

Private equity and venture capital

As at end-March 2022, Tetragon's exposure to private equity and venture capital assets amounted to US$321m (US$314m at end-April 2022), down from US$396m at end-FY20. The reduction is primarily due to early redemption of Ripple Labs' preferred shares, which generated a gain of c US$100m in FY21. Tetragon was the lead investor (US$150m) of the series C preferred stock issue in 2019 (investment described in detail in our April 2021 note), and in late 2021 Ripple elected to redeem the entire class at 1.5x purchase price plus accrued paid-in-kind dividends.

Apart from direct investments (US$34m at end-March 2022), Tetragon also invests in Banyan Square Partners managed funds focused on co-investments (US$112m), funds managed by Hawke's Point (US$58m), as well as externally managed investments (US$127m). Hawke's Point funds invest in mining assets, predominantly gold mines. Hawke's Point's projects are early stage, with their value equally dependent on the gold price and their progress in moving up the development curve. An illustration of this is the US$39m loss (30% decrease in value) in FY21, driven predominantly by developments in one gold mine project in Australia.

Bank loans

Tetragon invests in bank loans through CLO structures, predominantly in equity tranches, which see growing distributions when interest rates increase due to their waterfall structure (see our Edison explains piece on CLOs). Bank loans generated a cash inflow of US$73m in FY21 for Tetragon, up 32% y-o-y (which however may include undisclosed disposals). Tetragon's investments in CLOs are made either directly (US$142m, 54% of the exposure at end-March 2022), of which 90% are CLOs managed by the fully owned LCM; or through CLO-investing funds managed by fully owned Tetragon Credit Partners (46%). Additionally, Tetragon holds exposure to the CLO market through stakes in asset managers LCM and Tetragon Credit Partners, translating to total portfolio exposure of 19% of NAV at end-FY21 (last available data). As at end of last year, there were no internal test breaches on any CLO structures held by Tetragon.

Other

Tetragon's **quoted assets** portfolio ('other equities and credit', 6% of portfolio at end-April 2022) is concentrated in several high-conviction positions, including in particular tech and biotech stocks. Its **real estate** investments are executed through or alongside BentallGreenOak's managed private equity-style funds and co-investment vehicles that focus on opportunistic investments in the US, Europe and Asia (except for the Paraguayan farmland managed by Scimitar). **Litigation Finance** is a new endeavour for Tetragon and comprise funds managed by Contingency Capital (investing in legal assets). These make up only a minor part of Tetragon's portfolio for now (c 1% of NAV at end-March 2022).

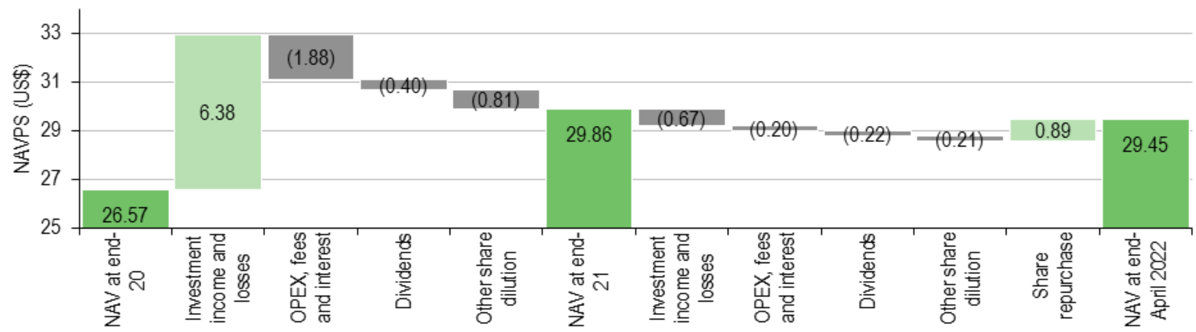
Performance

Tetragon posted a 14.1% NAV per share total return (TR) in dollar terms (15.2% in sterling terms) in FY21, which is slightly below the results of broad equity markets (19% by MSCI AC World Index) and slightly above the peer group average (see Exhibit 9). Having said that, we note that Tetragon targets returns with a low correlation to broader markets and the FY21 return is in line with its long-term NAV performance (10-year average annual return of 12.3%). Moreover, Tetragon reported a 17.3% return on equity (RoE) in FY21, which is ahead of its 10–15% target. The largest single contributor to Tetragon's return in FY21 was the revaluation of Equitix, adding US$348.8m to Tetragon's NAV (14.1pp NAV attribution out of 17.9pp from TFG Asset Management). Excluding TFG Asset Management, the remaining assets contributed 6.8pp to the NAV increase (a US$167m uplift).

Tetragon's reported ongoing charge ratio was 1.70% (flat year-on-year) and included the 1.50% annual management fee. In FY21 Tetragon expensed US$162.1m in management and incentive fees to TFM, which translates to 6.6% of the opening NAV and compares to US$107.1m expensed in FY20 (4.5% of NAV) when the NAV total return stood at 9.5%.

In the first four months of 2022, Tetragon's NAV decreased 0.6% in total return terms, compared to a 12.8% decrease in the MSCI ACWI Index. Portfolio revaluations reduced NAV by 2.5pp, which was offset by a 3.3pp NAV per share accretion stemming from a share buyback. Tetragon conducted a US$42m tender offer, buying back 4.3m shares at US$9.75 per share (compared to end-FY21 NAVPS of US$29.86 – a 67% discount). Asset-wise, the main drivers of ytd performance were directly held public investments shedding almost half of their value (part of which came from one biotechnology stock) and a 3% downward revaluation of TFG Asset Management. As investments and distributions were broadly equal in the period (net distributions of 0.6% of opening NAV at US$17m), Tetragon's net debt increased to 2.1% of NAV (from 0.3% net cash at end-2021) due to share repurchase and ongoing costs.

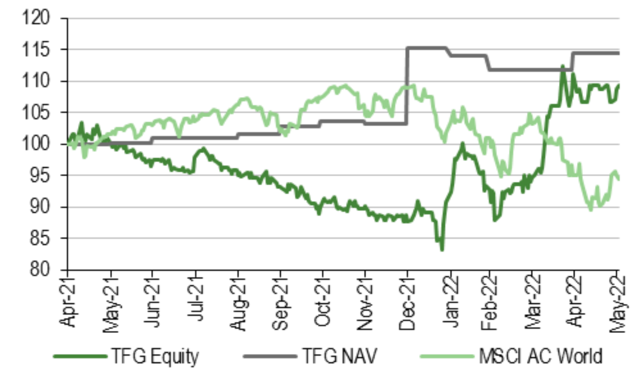
Exhibit 3: Tetragon's NAV per share development in FY21 and until April 2022 (US$/share)

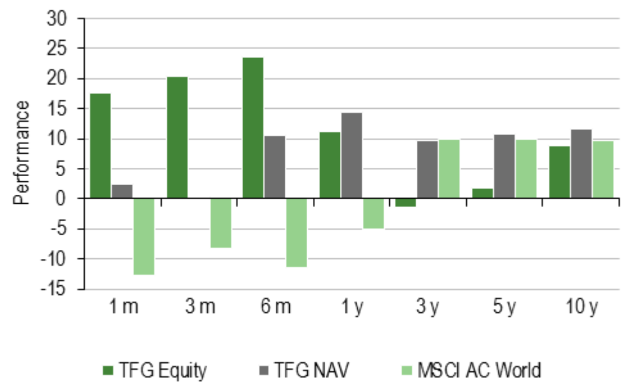


Source: Tetragon, Edison Investment Research

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

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





Source: Refinitiv, Bloomberg, Edison Investment Research. Note: *Performance data to end-April 2022, three-, five-, and 10-year performance annualised.

Exhibit 5: Five-year discrete performance data

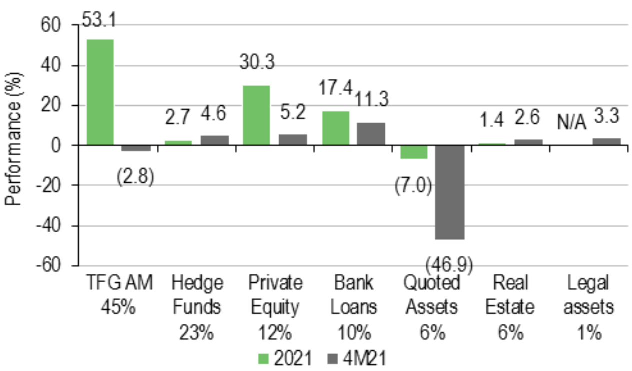
12 months ending	Share price (%)	NAV (%)	MSCI AC World (%)	UK All-Share (%)	S&P 500 (%)
30/04/18	0.5	3.4	7.8	8.2	6.4
30/04/19	12.9	22.0	11.6	2.6	19.9
30/04/20	(21.2)	4.1	(1.2)	(16.7)	4.2
30/04/21	2.7	4.1	33.4	25.9	33.0
30/04/22	22.7	26.2	4.7	8.7	10.5

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

Performance by asset class

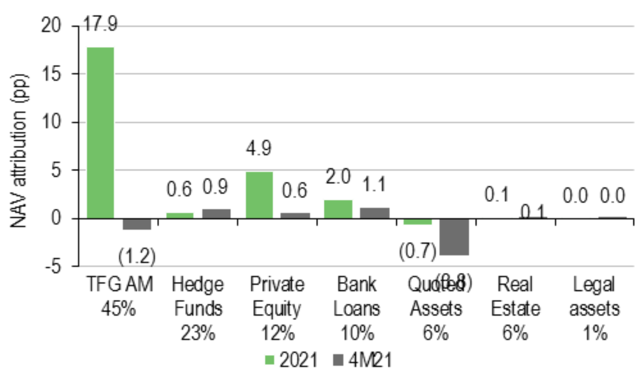
As presented in Exhibits 6 and 7, Tetragon's best-performing assets in FY21 were TFG Asset Management increasing in value 53% y-o-y and contributing 17.9pp to Tetragon's NAV performance, followed by private equity (+30% y-o-y; +4.9pp NAV) and bank loans (+17% y-o-y; +2.0pp NAV). The remaining assets performed broadly flat and had limited impact on Tetragon's NAV in FY21. So far in 2022, the best performing asset class has been bank loans, with their 11% value increase adding 1.1pp to Tetragon's NAV in the first four months of FY22 (4M22). However, the largest impact on NAV development came from quoted assets (down 47% since end-21; -3.8pp impact on NAV). In 2022 year to date, the portfolio lost 47% of its value, reducing Tetragon's NAV by 3.8pp, driven predominantly by a significant price decline at one biotechnology company.

Exhibit 6: FY21 and 4M22 performance by asset class (%)



Source: Tetragon Financial Group, Edison Investment Research. Note: Share of Tetragon's NAV at end-April 2022 stated on x-axis labels.

Exhibit 7: FY21 and 4M22 NAV attribution by asset class (pp)



Source: Tetragon Financial Group, Edison Investment Research Note: Share of Tetragon's NAV at end-April 2022 stated on x-axis labels.

TFG Asset Management

Given the high share in Tetragon's overall portfolio value, we examine the FY21 performance of TFG Asset Management in more detail. Similarly to FY20, Tetragon's major NAV TR driver in FY21 was the year-end revaluation of TFG Asset Management (for which earnings forecasts are updated annually), which overall contributed US$442.2m in gains in FY21. As a result, Tetragon's private equity investments in asset management companies represented 44% of NAV at end-2021 (vs 34% at end-2020). The majority of the gains came from the core infrastructure asset manager Equitix (US$348.8m), followed by the CLO manager LCM (US$59.8m) and real estate manager BentallGreenOak (US$34.3m). In 4M22, the carrying value of TFG Asset Management was down by 3% (or US$34.9m).

As a result, **Equitix** represented 25.3% of Tetragon's NAV at end-2021 and given Tetragon's high discount to NAV (see below for details), it now equals 71% of its market capitalisation. The business grew its AUM by c 23% to £8.0bn (US$10.8bn) in FY21, resulting in a 13% y-o-y increase in management fees (though its primary income declined in FY21). Equitix also increased its income from management services contracts (EMS business) by 21% y-o-y. It expanded its headcount during the year to further stimulate growth in the business and as a result the increase in its operating expenses was responsible for little over half of the US$32.5m opex growth of TFG Asset Management during the year (see below).

Equitix was revalued by 90% (US$349m) in FY21 on the back of (1) a revised five-year AUM growth assumption of 14.1% (vs 6.6% previously and Equitix's 2016–21 five-year CAGR of 31%), (2) the introduction of a 20% premium for control (Equitix has been majority-owned by TFG Asset Management since 2015) and (3) a reduction in the illiquidity discount from 15% to 10%. Moreover, we note that Equitix was valued using a blended discounted cash flow (DCF, with 9.5% discount rate) and market multiples approach. The latter was reintroduced by Tetragon's third-party valuation agent this year (after switching to a pure DCF approach in FY19), which the agent justified by recent listings of more directly comparable asset managers. In this context, we note for instance the recent IPO of Antin, an infrastructure asset manager focused on investments in energy and environment, telecom, transportation and social sectors with AUM of US$20.3bn at end-2021 (of which US$13.8bn is fee-paying). Equitix was also an important driver of ytd 2022 NAV changes, with a US$60m (8.2%) decrease in valuation in Q122 (latest available data) due to contraction in the multiples of publicly quoted peers.

LCM (8.3% of Tetragon's NAV at end-2021) grew its AUM by 26% y-o-y to US$11.2bn after launching six new CLOs in FY21 with an aggregate AUM of US$2.8bn. The business was revalued by c 34% in FY21, assisted by a revised five-year AUM growth assumption of 10% from 6.5% previously and the introduction of a 20% premium for control. LCM continues to be valued using a blended DCF (12.25% discount rate) and market multiples approach, but in the latter case the ratio was changed from 2.5% price/AUM to 12.5x EV/EBITDA as it is a more forward-looking ratio. The prospective AUM growth assumptions were also revised for BentallGreenOak (to 18.4% from 11.9%) and Polygon (to 9.9% from 8.6%). The valuation of LCM further increased in Q122 by US$37m (16%).

Overall, TFG Asset Management's pro forma income remained broadly stable in FY21 at US$249.1m, as higher management fees (up by 14.0% to US$143.4m), other fees (up 27.0% to US$24.0m) and distributions from BentallGreenOak (up 19.3% to US$21.6m), were offset by lower performance and success fees (US$59.6m vs US$81.6m in FY20) and lower interest income. TFG Asset Management's total income includes US$12.0m management fees and US$5.0m performance fees charged on Tetragon's own investments in funds managed by TFG Asset Management. Coupled with an increase in operating expenses related primarily to team expansion (Equitix, Contingency Capital) and scaling up of the infrastructure (Contingency Capital) to facilitate further AUM growth, this led to a 32.6% decline in net income ('EBITDA equivalent') to US$50.7m in FY21.

Exhibit 8: TFG Asset Management pro-forma income statement (US$m)

	2017	2018	2019	2020	2021
Management fee income	74.8	85.7	111.2	125.8	143.4
Performance and success fees	45.8	24	51.8	81.6	59.6
Other fee income	12.4	13	15.5	18.9	24.0
Distributions from BentallGreenOak	8.4	13.2	10.8	18.1	21.6
Interest income	4.1	3.6	3.8	4.1	0.5
Total income	**145.5**	**139.5**	**193.1**	**248.5**	**249.1**
Operating, employee and administrative expenses	(83.5)	(93.9)	(124.3)	(145.8)	(178.3)
Minority interest	(7.4)	(6.3)	(9.3)	(27.5)	(20.1)
Net income – 'EBITDA equivalent'	**54.6**	**39.3**	**59.5**	**75.2**	**50.7**

Source: Tetragon

Peer group comparison

In Exhibit 9 we present a sterling-based comparison of Tetragon with eight members of the AIC Flexible Investment sector. We note that the Flexible Investment sector varies widely in terms of investment strategies and mandates, and Tetragon's investment approach is very diversified, which renders none of the companies a perfect direct comparator. Tetragon shows above-average NAV returns in every presented period, and over the long term (five-year and 10-year return) is the top performer in the peer group. Meanwhile Tetragon's share price performance has lagged the group (it was one of the worst performing over three and five years), leading to the widest discount to NAV, despite Tetragon's shares being the second-best performing over a one-year period. Currently, Tetragon's shares trade at a 65% discount to end-April NAV, compared to the peer average of 12%.

Exhibit 9: Selected AIC Flexible Investment sector peer group in sterling terms at 27 June 2022*

% 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	**769.4**	**26.2**	**36.8**	**72.6**	**288.9**	**(65.0)**	**1.7**	**Yes**	**102**	**4.1**
Aberdeen Diversified Income & Growth	305.7	8.5	11.5	13.0	48.2	(16.8)	0.6	Yes	101	5.6
Caledonia Investments	2,022.6	28.6	47.0	68.9	223.1	(26.8)	0.9	Yes	100	1.7
Capital Gearing	1,158.2	7.9	26.9	37.1	85.7	1.1	0.5	Yes	100	0.9
Hansa Trust 'A'	148.0	(2.4)	10.6	25.8	57.9	(37.6)	1.1	Yes	100	1.7
Personal Assets	1,828.0	5.8	25.7	31.3	68.1	1.0	0.7	Yes	100	1.2
RIT Capital Partners	3,680.3	2.4	46.5	63.6	163.9	(10.3)	0.7	Yes	111	1.5
Ruffer Investment Company	993.2	7.6	37.7	35.4	75.0	4.5	1.1	Yes	100	0.8
UIL	160.1	0.6	10.7	50.0	122.3	(27.0)	2.2	Yes	195	4.2
Average	**1,448.0**	**8.3**	**29.4**	**39.3**	**103.2**	**(12.1)**	**0.8**	**-**	**102**	**1.9**
Rank in peer group	**6**	**2**	**4**	**1**	**1**	**9**	**2**	**-**	**3**	**3**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 30 April 2022. TR = total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

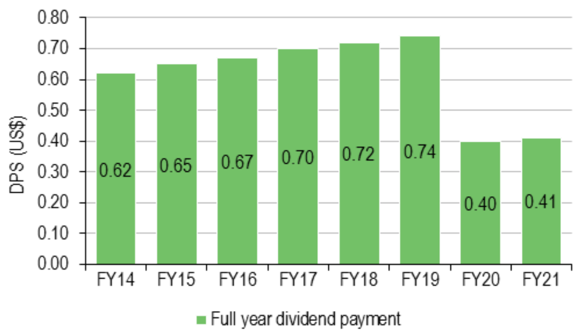
Dividends and share repurchases

Tetragon does not target any specific dividend payout ratio. Tetragon's board declares dividends, based on the recommendation of the investment manager, subject to the approval of Tetragon's voting shareholder and adherence to applicable law. We note, as described in capital structure section on page 13, that all voting shares are ultimately owned by the co-founders. Dividends are paid quarterly in May, August, November and March each year. Additionally, Tetragon regularly buys back shares from the market, with the programmes conducted through a Dutch auction at a price close to the market price of the shares, resulting in NAV accretion.

Dividend payments decreased in response to the COVID-19 outbreak, with DPS paid from FY20 profits reduced by 46% y-o-y versus FY19 to US$0.40. Consequently, US$44.8m was paid out during 2020 versus US$65.2m in 2019 (down 31% y-o-y, due to the Q419 dividend being paid in 2020), but this was mostly offset by a higher buyback amount (see Exhibit 11). In FY21, DPS was increased by just 2% to US$0.41 (although this now implies a solid yield of 4.1% on a last 12-month basis). While no buybacks were performed in FY21, Tetragon conducted a tender offer in April 2022, buying back over 4m shares for a total consideration of US$42m at US$9.75 per share. During 2021, Tetragon acquired 219k shares from TFG Asset Management for a total consideration of US$2.1m.

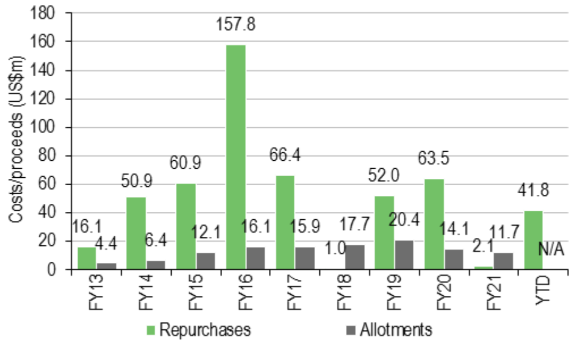
Shareholders have an option to receive dividends in the form of shares and in FY21 US$11.6m (FY20: US$14.1m) out of the US$35.8m gross dividend paid during the year (FY20: US$44.8m) has been taken in shares by investors. The dividends paid in cash during 2021 amounted to US$24.2m (down from US$30.7m paid in 2020).

Exhibit 10: Dividend paid from period earnings (US$)



Source: Tetragon Financial Group, Edison Investment Research

Exhibit 11: Repurchases and allotments (US$m)

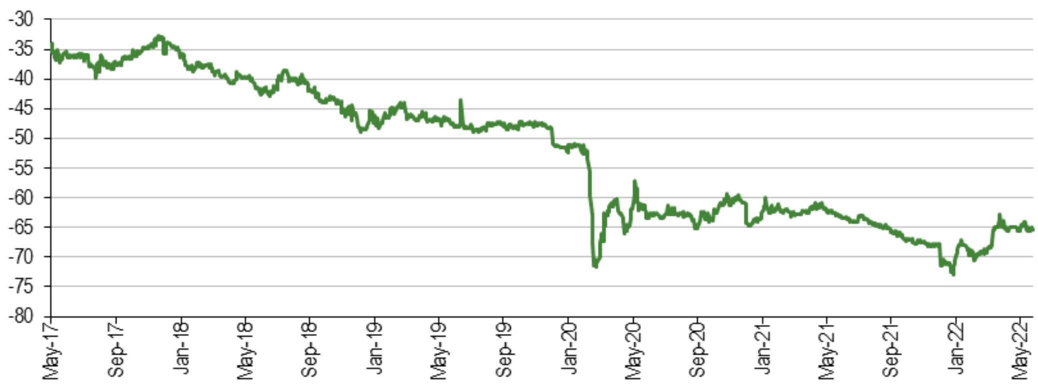


Source: Tetragon Financial Group, Edison Investment Research

Discount

Tetragon's 10-year average discount to NAV stands at 45% compared to the usual range of 10–30% seen in alternative assets and private equity investment companies. We described some possible reasons behind the prevailing wide discount in our previous notes. Tetragon's current discount is wider than its long-term average and stands at 65% as of 24 June 2022. Tetragon did not return to pre-COVID-19 dividend payments (see Exhibit 10) and its current dividend yield stands at 4.1%, whereas before the onset of the pandemic-induced sell-off it stood at 6.5% (despite a 20% higher share price). However, we note that Tetragon's current yield is still the second highest in the peer group (see Exhibit 9). Lower dividend payments may also be partially offset by recently reintroduced buybacks.

Exhibit 12: Share price discount to NAV over five years (%)



Source: Refinitiv, Tetragon Financial Group, Edison Investment Research

Gearing: Fully invested and ungeared

Tetragon does not use structural gearing and uses external debt financing only to temporarily bridge the gap between new investments and realisations to take advantage of arising investment opportunities. Tetragon had a minor net debt position as at end-April 2022 of US$57.1m (2.1% of its NAV) and has been fully invested since late 2019. This compares to a significant cash reserve kept historically to maintain flexibility for opportunistic investments (2015–18 average net cash at 18% at year-end). Tetragon has a US$250m revolving credit facility in place, which was fully drawn as at end-March 2022. The current allocation should limit the portfolio's cash drag, while available cash leaves Tetragon with ample dry powder to pursue new opportunities; we calculate that Tetragon had c US$193m (or 7% of its NAV) available to invest as at end-April 2022.

The facility has an interest rate of three-month US Libor +3.25%, and Tetragon is also obliged to pay a servicing fee of 0.015% of the total amount and non-usage fee of 0.5% on the undrawn amount. In 2021 the total costs of the credit facility totalled US$5.1m (FY20: US$6.2m), which translates to 0.2% of Tetragon's opening NAV. During the year, Tetragon repaid US$25m of the facility on a net basis.

Fees and charges

Tetragon pays a 1.5% pa management fee to TFM based on its net assets calculated monthly. TFM is also eligible to receive a quarterly incentive fee at a rate of 25% on the increase in NAV (before any dividends or other relevant capital adjustments such as share repurchases) 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 2.86% for Q121). 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 the two prior quarters. We also note that as at end-2021 Tetragon had US$104.1m of accrued fees (3.7% of NAV).

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. Additionally, some senior employees of the structure are eligible to equity-based compensation. The shares are bought from the market and held in an escrow account until they are vested upon fulfilment of certain targets. During FY20, Tetragon released 0.4m shares from escrow and 1.6m from treasury shares as stock dividends and equity-based compensation. During FY21 Tetragon bought 0.2m shares from the market, which compares to 6.6m acquired in FY20.

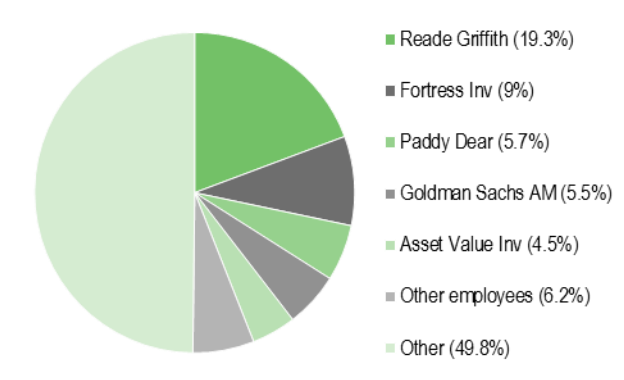
Reade Griffith and Paddy Dear are owners of TFM. Mr Griffith is also employed by TFG Asset Management and is the chief investment officer of Polygon's event-driven European equity strategies. His current contract has been in place since July 2019 and includes US$9.5m paid in cash upon signing, US$3.75m paid in 2020 and up to 5.6m shares to be granted over seven years depending on performance (of which 0.3m were granted in FY21), which are held in escrow. The employment agreement replaces an earlier agreement, which included a US$0.1m annual salary.

Capital structure

Tetragon's issued share capital consists of 10 voting shares and 139.7m non-voting shares. The voting shares are indirectly owned by the co-founders and are not entitled to any distributions; however, the co-founders also hold large stakes in Tetragon's non-voting shares. At end-2021 90.2m shares were outstanding (96.4m on a fully diluted basis after accounting for potential dilution from equity-based awards). Tetragon holds 38.5m shares in treasury and further 10.9m in an escrow account (dedicated to fulfilling certain equity-based compensation obligations), and in total shares held by Tetragon make up 35% of the shares issued. Co-founders and employees own 34.7% of the non-voting shares outstanding as at end-January 2022.

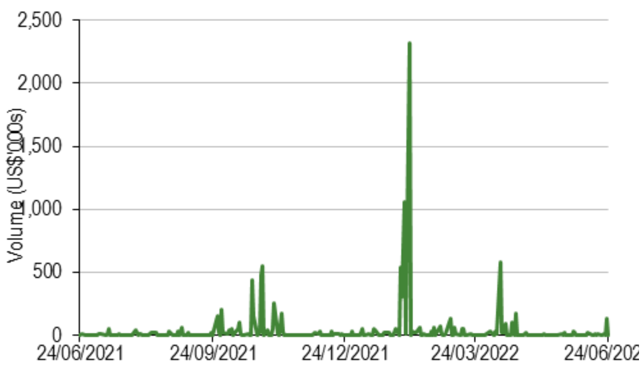
Tetragon's shares are traded on the Euronext Amsterdam and the LSE, with median daily turnover at US$12k and US$2k, respectively. Management highlights that due to Tetragon's focus on professional institutions, the majority of turnover on Tetragon's shares is taking place in OTC markets and in batches. Taking into account the OTC trading, the average daily volume amounts to US$58k.

Exhibit 13: Major shareholders



Source: Bloomberg, Tetragon Financial Group, as at 24 June 2022.

Exhibit 14: Average daily volume



Source: Refinitiv. Note: 12 months to 24 June 2022. Combined traded volume on Euronext Amsterdam, LSE and OTC markets.

The board

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

Exhibit 15: Tetragon Financial Group's board of directors

Board member	Date of appointment	Remuneration in FY21	Shareholdings at end-FY21
Reade Griffith	2007 (co-founder)	US$125,000*	12.65%
Paddy Dear	2005 (co-founder)	US$125,000*	3.72%
Deron J Haley	December 2018	US$125,000	N/D
Steven W Hart	December 2018	US$125,000	N/D
David C O'Leary	December 2018	US$125,000	0.01%

Source: Tetragon Financial Group. Note: *Reade Griffith and Paddy Dear have waived their fee; see the Capital structure and fees section for details.

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