EDISON

Tetragon Financial Group

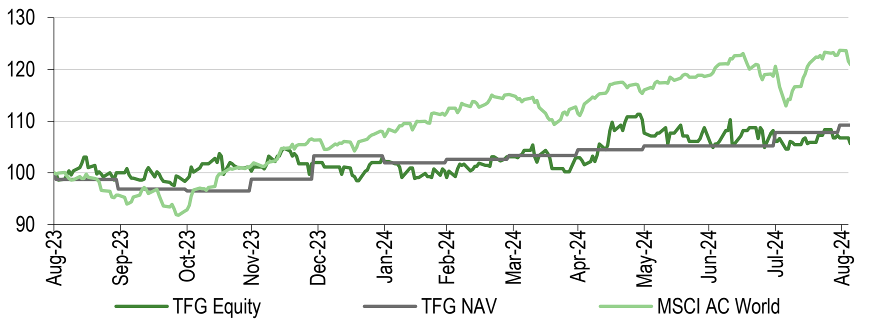
Tetragon maintains its investing pace

Investment companies
Alternative assets

3 October 2024

Tetragon Financial Group (Tetragon) reported a 1.3% return on equity (RoE) in H124, with its net asset value (NAV) per share increasing by 1.9% in US dollar total return (TR) terms, and further 3.8% to end-August. The portfolio continued to generate solid cash flow, predominantly from collateralised loan obligation (CLO) structures and through fees from asset management businesses, which Tetragon recycled back into the portfolio (mostly public stocks) and was a net investor in the period. Tetragon continues distributions to shareholders, with a dividend yield of 4.3% (above the peer average and on top of share repurchases). As a result, Tetragon increased the amount drawn on its revolving credit facility and its leverage at end-August 2024 stood at record-level of 13.1% of NAV.

Tetragon's performance against MSCI AC World over one year



Source: Tetragon Financial Group, LSEG Data and Analytics, Edison Investment Research. Note: US dollar terms.

Why consider Tetragon?

Tetragon invests in alternative assets with diverse exposure, providing returns with low correlation to traditional asset classes. This may appeal to investors seeking to expand their portfolios beyond traditional bond and equity exposures and into, for example, assets benefiting from rising interest rates (eg equity tranches of CLOs) or offering a certain degree of inflation protection. Tetragon-owned asset managers generate recurring fee income, which supports the group's ongoing costs and distributions to shareholders.

Tetragon is fully invested

Tetragon's exposure to public stocks increased to 28% of NAV (at end-August 2024), through both hedge funds and direct investments, and the group's stocks continue to consist of highly concentrated, catalyst-driven portfolios. High interest rates support the cash flow generation of CLO equity tranches (6% of Tetragon's NAV), but, at the same time, they are starting to seep into higher default risk for underlying loans, with Fitch increasing its 2024 forecast of the US leveraged loan default rate to 5.0–5.5%, from 3.5–4.0% previously. Tetragon has written down some of its older vintage CLO tranches in H124. The group is fully invested as at end-August 2024, and its commitment coverage of 90% at end-H124 was covered primarily by its available credit line. Tetragon's shares continue to trade at wide discount of 68.7%, in line with a three-year average of 67.1%.

All data presented in this report are provided by Tetragon unless stated otherwise.

Price*		**US$10.15**
Price (TFGS)*		**766p**
Market cap*		**US$903m**
NAV**		**US$2,899m**
NAV per share**		US$32.58
Discount to NAV*		68.7%
Yield*		4.3%
Fully diluted shares in issue		89.0m
Code/ISIN		TFG/GG00B1RMC548
Primary exchange		Euronext Amsterdam
Secondary exchange		LSE Specialist Fund Segment
AIC sector		Flexible Investment
52-week high/low*	US$10.55	US$9.54
NAV high/low	US$32.58	US$29.09

*Based on LSEG Data and Analytics.
**As at end-August 2024.

Gearing

Net gearing at 31 August 2024	13.1%

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 offering the potential for returns with low correlation to traditional assets.
- Recurring income from the asset management business (TFG Asset Management).
- Solid distributions to shareholders through dividends and share buybacks.

Bear points

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

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

Tetragon's NAV was up slightly in H124

Tetragon delivered a 1.9% NAV per share increase in H124 in TR US dollar terms. The performance was below Tetragon's long-term target of 10–15% RoE per annum, with annualised RoE at 1.3% in H124. The average RoE since Tetragon's IPO in 2007 stood at 11%, still within the target range of 10–15%. However, we note that its performance was below target in both 2022 and 2023. The NAV per share TR since its IPO to end-June 2024 stood at 10.3% per annum. Tetragon's H124 NAV performance in sterling was slightly higher than in US dollars, at 2.8%, due to the appreciation of the US dollar. In the two months to end-August 2024, Tetragon's NAV increased by further 3.8% in TR US dollar terms (0.2% NAV depreciation in sterling), implying a one-year total return of 10.6%.

Exhibit 1: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI AC World (%)	UK All-Share (%)	S&P 500 (%)
31/08/19	(30.2)	(4.2)	6.5	(12.6)	10.9
31/08/20	4.7	7.6	25.7	26.9	27.6
31/08/21	36.8	30.7	(0.0)	1.0	5.0
31/08/22	(8.9)	(3.1)	5.2	5.2	6.5
31/08/23	3.1	6.7	19.6	17.0	22.6

Source: LSEG Data and Analytics. Note: All percentages are on a TR basis in pounds sterling.

Performance is ahead of the peer group's average

In Exhibit 2 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 means none of the companies is a perfect direct comparator. That said, we consider Caledonia Investments, RIT Capital Partners and abrdn Diversified Income & Growth (ADIG) better comparators, given the relatively high share of private market investments in their portfolios. However, we note that ADIG is currently in a managed wind-down process. Tetragon shows above-average NAV returns in every presented period.

Exhibit 2: Selected AIC Flexible Investment sector peer group in sterling terms as at 2 October 2024*

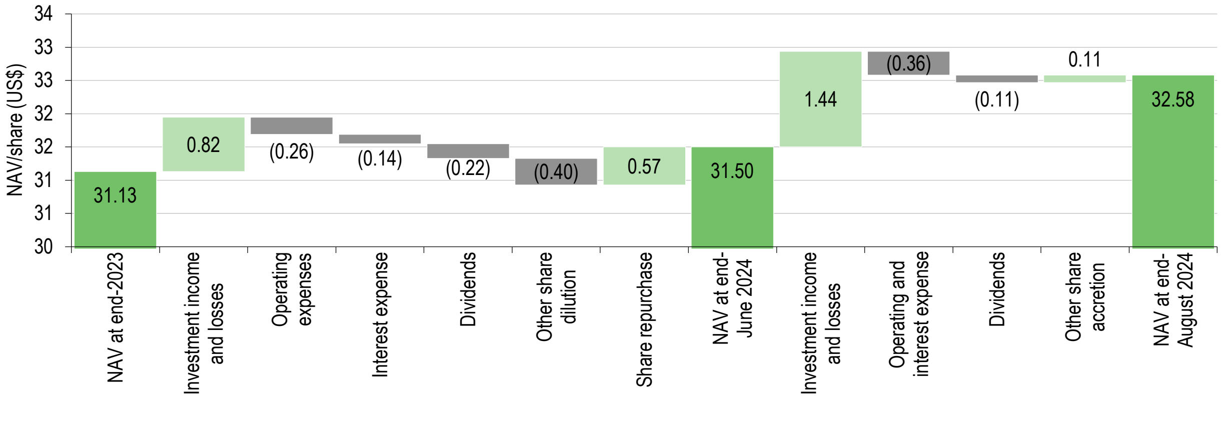
% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Premium/ (discount)	Ongoing charge	Perf fee	Net gearing	Dividend yield
Tetragon Financial Group	**638.1**	**10.6**	**28.9**	**50.2**	**152.3**	**(68.7)**	**1.75**	**Yes**	**113**	**4.3**
abrdn Diversified Income & Growth	129.5	(2.7)	(1.3)	6.7	12.3	(33.1)	1.74	Yes	100	17.0
Caledonia Investments	1,826.0	7.0	31.2	61.7	162.8	(37.6)	0.81	Yes	100	2.0
Capital Gearing	953.8	6.4	1.9	20.4	68.1	(2.4)	0.47	Yes	100	1.3
Hansa Trust 'A'	178.4	23.8	18.8	45.9	77.4	(42.0)	1.00	Yes	100	1.4
Personal Assets	1,606.9	6.4	4.9	24.6	67.3	(1.1)	0.65	Yes	100	1.6
RIT Capital Partners	2,639.4	9.2	(1.3)	42.1	117.0	(29.6)	1.59	Yes	111	2.2
Ruffer Investment Company	970.3	4.2	6.8	30.9	54.7	(5.5)	1.07	Yes	100	1.1
UIL	80.4	(21.7)	(57.7)	(53.4)	27.1	(36.5)	2.80	Yes	187	8.3
Average	**1,186.3**	**4.1**	**0.4**	**22.4**	**73.3**	**(23.5)**	**1.3**	**-**	**112**	**4.4**
Rank in peer group	**6**	**2**	**2**	**2**	**2**	**9**	**2**	**-**	**2**	**3**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 31 August 2024. Total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

Valuations driven mostly by market conditions

In H124 the portfolio valuation was up slightly, with a 2.6pp contribution to NAV performance that has covered the operating expenses and dividend distributions. In H124, Tetragon performed an NAV-accretive share buyback as it acquired shares close to market price, while trading at a discount to NAV of over 60%, which added c 1.8pp on per share basis. We have discussed the possible reasons for the discount in previous notes. The 1.3pp NAV decrease from 'other share dilution' (see Exhibit 3) represented predominantly share-based compensation (US$4.7m) and, as at end-August 2024, the employee ownership of the company stands at 40.3%. NAV per share increased by further 3.8% to end-August 2024, driven predominantly by the revaluation of Tetragon's exposure to private equity assets.

Exhibit 3: Tetragon's NAV per share development in 2024 until end-August (US$/share)

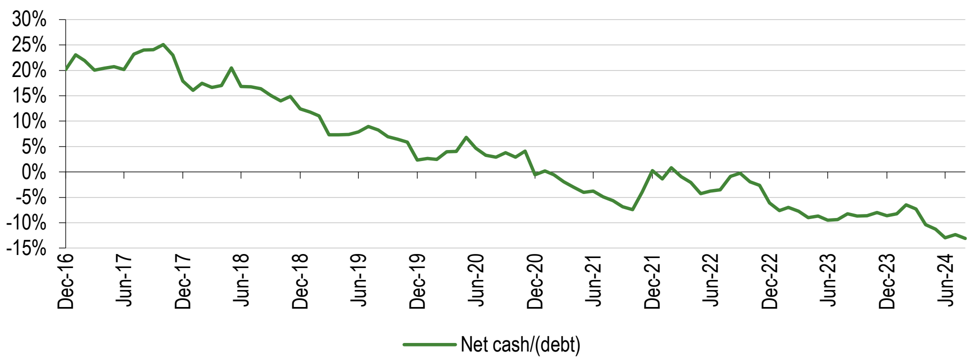


Source: Tetragon, Edison Investment Research

Tetragon was a net investor in the first eight months of 2024

In H124 Tetragon invested US$222.5m (predominantly in listed stocks), while its portfolio generated US$176.6m cash from disposals and distributions. Additionally, Tetragon used US$40.5m for distributions to shareholders (US$29.7m through share repurchases and US$10.8m through dividends), which implied 2.9% of opening NAV on an annualised basis. In July and August 2024 Tetragon received US$36.7m from its portfolio on net basis, as distributions (US$116.5m, mostly from stocks held on balance sheet) were not fully reinvested into the portfolio (US$51.3m), with majority of the investments made into private equity assets and TFG Asset Management's businesses. Including Tetragon's ongoing costs and interest paid on its revolving credit facility, the net leverage increased to US$379.5m, or 13.1% of NAV at end-August 2024, compared to 8.6% at end-2023. The net leverage reached a record level after gradually increasing over the last few years (see Exhibit 4).

Exhibit 4: Tetragon's net cash/(debt) position as % of NAV since December 2016



Source: Tetragon, Edison Investment Research

As at end-June 2024, Tetragon had access to US$100m remaining on its US$400m credit facility, and a US$7m cash balance. This compared to US$111.9m in unfunded commitments, implying a 90% coverage ratio. We note that 46% of Tetragon's commitments have been made to funds managed by wholly owned managers (mostly Contingency Capital), with the rest attributable to funds managed by BentallGreenOak (BGO) and third-party private equity (PE) managers. Taking into account Tetragon's operating expenses (US$36.0m in H124, including incentive fees and interest on debt), we see that Tetragon has limited headroom to keep its current investment pace, highlighted by net distributions in July 2024. A meaningful part of Tetragon's portfolio is represented by relatively liquid investments, such as public stocks (US$206.9m at end-August, down from US$239.0m at end-June) and hedge funds (US$602.0m at end August). Although we note that the potential liquidation of Tetragon's exposures to stocks and hedge funds will depend on the liquidity of individual names, as these are concentrated, catalyst-driven portfolios.

TFG Asset Management: Value gain on multiples expansion

TFG Asset Management remains the largest asset in Tetragon's portfolio, representing 50% of its NAV. As at end-June 2024, TFG Asset Management comprised 10 asset managers, with combined assets under management (AUM) of US$40.5bn, slightly down from US$41.5bn at end-2023 (predominantly due to the amortisation of CLOs managed by LCM). TFG Asset Management was also the main value driver of Tetragon's H124 NAV performance and continued its growth post H124, as per Tetragon's August 2024 factsheet. In H124, TFG Asset Management's value increased by US$91.7m (or 6.8%), driven predominantly by core infrastructure manager Equitix (up US$76.7m and 10.4% vs end-2023), which benefited from the expansion of market multiples, while its AUM remained flat. 30% of Equitix's value is derived from market multiples, while a 70% weight is applied to the discounted cash flow (DCF) method. Equitix continues to be the powerhouse of TFG Asset Management's results, according to Edison calculations, and it was able to distribute US$19.2m in dividends to Tetragon (implying a 5.2% yield on an annualised basis). The value of Tetragon's stake in BGO (based on call/put options to be exercised in 2026 and 2027 and the sum of expected contractual payments) increased by US$25.5m, or 9.4%, due to a combination of a reduced discount rate and an increase in expected carried interest. The remaining asset managers decreased in value by 3.1% and represent 12% of Tetragon's NAV in aggregate.

TFG Asset Management's income in H124 increased by 5% y-o-y to US$142.4m mainly on the back of Equitix's earnings on its management services contracts (reflected in a 22% y-o-y increase in 'other fee income'). Meanwhile, the increase in operating costs (mostly higher headcount aimed at enhancing operational capability) has led to a 14% y-o-y decrease in TFG Asset Management's net income to US$29.2m. The US$13.3m minority interest (up 33% y-o-y) represents the income of other shareholders in Equitix and Acasta Partners. Tetragon owns 75% of Equitix and a non-controlling interest in Acasta Partners.

Exhibit 5: TFG Asset Management pro forma statement of operations

US$m	H124	H123	H122
Management fee income	88.7	89.8	80.6
Performance and success fees	18.0	16.7	20.7
Other fee income	23.4	19.2	13.4
Distributions from BGO	9.5	9.4	10.1
Interest income	2.8	0.6	2.8
Total income	**142.4**	**135.7**	**127.6**
Operating, employee and administrative expenses	(99.9)	(91.9)	(86.4)
Minority Interest	(13.3)	(10.0)	(8.9)
Net Income	**29.2**	**33.8**	**32.3**

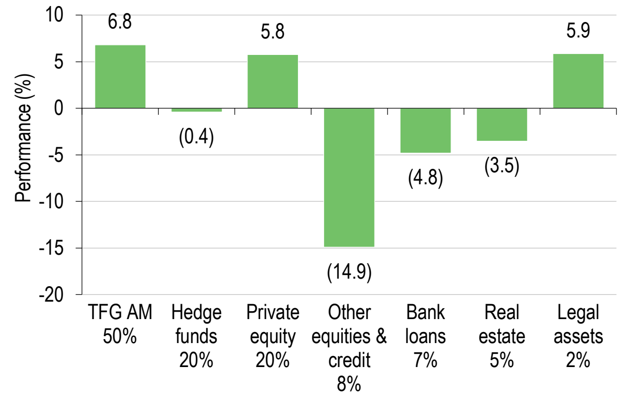
Source: Tetragon

Private equity: Good progress from a gold mining project

Tetragon invests in PE assets directly, through TFG Asset Management managers' funds and externally managed funds. These investments were the second-largest value driver of Tetragon in H124, increasing in value by 5.8% and contributing 1.0pp to Tetragon's NAV performance (US$29.3m value gain), and the largest driver of the 3.8% NAV growth in the two months since end-June 2024. The best-performing assets in H124 were those managed by the wholly owned Hawke's

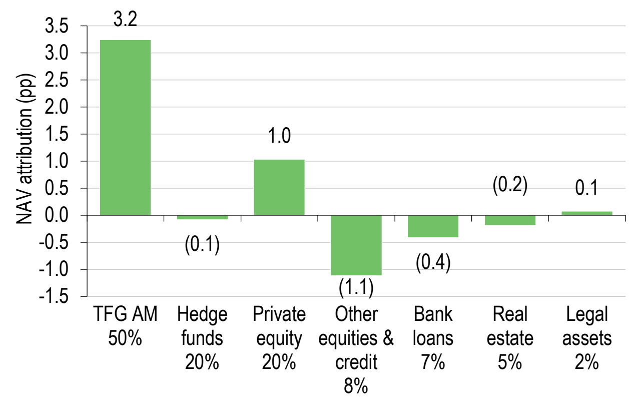
Point (funds and Tetragon's direct co-investments), which showed a US$29.4m gain (25.2% vs end-2023). The growth was driven predominantly by operational improvement at one of its Australian gold projects. Importantly, Hawke's Point's investments' growth in H124 follows a US$50.7m gain in 2023 (up 86% y-o-y), which was also attributed to an Australian gold project, and remained important value driver in July and August 2024. The H124 PE performance was also supported by revaluation of preferred stock Ripple Labs (direct PE investments were up US$5.3m), which has recently reached a court ruling with a US$125m civil penalty, compared to US$2bn initially sought by the US Securities and Exchange Commission (SEC). We have described the Ripple case in detail in our April 2021 note and the SEC can still appeal the ruling. The funds managed by Banyan Square Partners, and external managers, delivered a combined US$5.4m loss on valuation in H124.

Exhibit 6: H124 performance by asset class (%)



Source: Tetragon Financial Group, Edison Investment Research. Note: Calculated as gain/losses divided by opening fair value. Share of Tetragon's NAV at end-June 2024 stated on x-axis labels.

Exhibit 7: H124 NAV attribution by asset class (pp)



Source: Tetragon Financial Group, Edison Investment Research Note: Calculated as gain/losses divided by opening NAV. Share of Tetragon's NAV at end-June 2024 stated on x-axis labels.

Public equities: Opportunity to increase stakes

Tetragon's 'other equities and credit' assets consisted of public stock positions at end-H124. These stocks were the main negative contributor to Tetragon's performance, losing 14.9% (1.1pp of Tetragon's NAV performance). The losses were driven mostly by two stocks: a biotech company developing an autoimmune disease treatment, and an IT company focused on AI-assisted workflow automation. According to Tetragon, the sell-off of the biotech company was induced by overall reduced investor enthusiasm towards autoimmune therapies, due to unfavourable trial results of peer companies. The share price decrease of the IT company was likely related to the CEO change and the lowering of the company's sales guidance. Tetragon welcomed the change in the CEO position and used the opportunity to increase its stake. Overall, in H124 Tetragon invested US$58.4m in public stocks net of distributions (which included an exit from its only credit asset) and later it released US$43.7m net of investments in July and August (nature of transactions were not disclosed yet). As of end-June 2024, Tetragon's equities portfolio consisted of 15 high-conviction positions and represented 8.5% of its total NAV, with a total value of US$239m (end-August 2024: 7.1% and US$206.9m, respectively).

Bank loans: CLOs remain the source of cash

Tetragon's exposure to CLO equity tranches continues to generate healthy cash flow and, in H124, Tetragon received US$42.5m from the structures. While this represents a high 17.4% of the opening value of CLO investments, we note that it includes disposals. However, the CLOs posted a US$11.7m loss on revaluation in H124 (4.8% of opening value) as the write-downs on older vintages (both in Tetragon Credit Partners' funds and invested directly) were not fully offset by disposals above carrying value, combined with an increase in expected cash flow generation (on the back of higher risk-free rates). We note that Tetragon continues to gradually diminish its exposure to CLOs, reinvesting a limited amount of the generated cash into new structures (in H124 the new investments amounted to US$6.0m and remaining commitments to Tetragon Credit Partners' funds amounted to US$6.1m at end-H124). In July and August Tetragon's exposure to bank loans generated further US$16.3m distributions (with no investments) and a US$9.4m loss on valuation. Currently, CLOs represent 5.8% of Tetragon's NAV, down from 8.6% at end-2023 and compared to 30% back in 2015.

Legal assets: Tetragon is committed to invest

Legal assets still represent only a minor part of Tetragon's portfolio (1.6% of NAV at end-June 2024), at US$45.8m. However, Tetragon is committed to provide a further US$31.8m to the funds managed by the fully owned Contingency Capital. The Contingency Capital Fund I is almost fully invested and Fund II had its first close in July 2024. The manager also launched an evergreen structure, which had its first close in June 2024. In H124, the legal assets posted the second-best performance among Tetragon's exposures, with a 5.9% valuation gain (as Fund I performed ahead of the underwritten projections and performance targets).

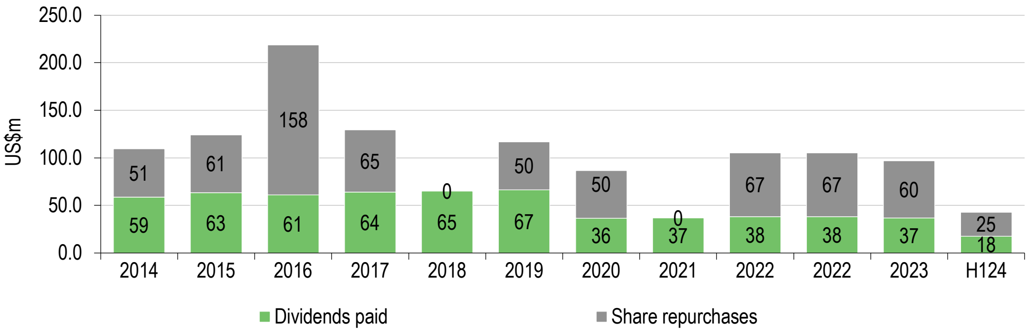
Hedge funds and real estate with a minor impact on H124 NAV

Hedge funds and real estate represent 21% and 5% of Tetragon's NAV at end-August 2024, respectively. Their H124 performances were -0.4% and -3.5%, which had a combined -0.3pp impact on Tetragon's NAV performance. Importantly, the hedge funds performed well after end-June 2024, increasing by 4.2% (up US$24.4m) to end-August 2024, and being the second largest value driver of Tetragon's NAV in this two-month period. The hedge fund exposure represents Tetragon's investments in funds managed by the fully owned Westbourne River Partners (76% of the hedge fund exposure at end-H124), the minority-owned Acasta Partners (20%) and other managers' funds (4%). Westbourne River Partners invests in a concentrated portfolio of event-driven stocks, which recorded a 2.9% return in H124, and Acasta Partners, which invests across the credit universe (predominantly in convertibles) delivered an 8.2% gain. The real estate exposure, consisting predominantly of funds managed by BGO and a direct stake in Paraguayan farmland, posted a 3.5% decrease in value mostly due to funds focused on US real estate, and further 4.8% until end-August 2024.

Tetragon continues distributions

Tetragon continues to distribute its income to shareholders through quarterly dividends paid in March, April, July and October, as well as regular share buybacks performed through modified Dutch auctions (with shares acquired close to market price of the shares). The US$42.8m distributions in H124 were in line with previous distributions and implied a 3.0% yield on opening NAV on an annualised basis. Given Tetragon's discount to NAV, the distributions made to shareholders in H124 implied a 9.5% yield (annualised) on Tetragon's end-2023 market capitalisation (dividends alone implied a 3.9% yield).

Exhibit 8: Tetragon's distributions to shareholders (US$m)



Source: Tetragon, Edison Investment Research