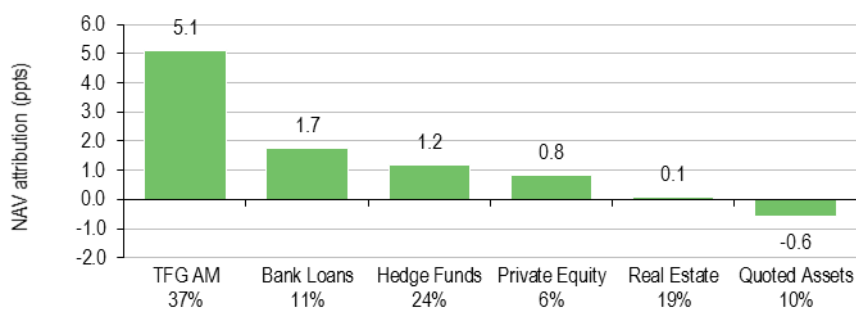


# Tetragon Financial Group

Performance remains subdued year to date

Tetragon Financial Group (Tetragon) reported a 2.6% NAV total return (TR) year to date (ytd) to end-October 2021 in US\$ terms. All asset classes except for quoted assets showed positive gross returns, with TFG Asset Management (TFG AM, 37% of portfolio) and bank loans delivering 15.1% and 15.5% returns, respectively. However, this performance was largely offset by ongoing charges and fees (including incentive fees) and share dilution, mostly from share-based compensation. Tetragon is fully invested and had US\$150m drawn out of its US\$250m revolving credit facility at end-September 2021, with a net gearing ratio at end-October of 7.4%.

## NAV return attribution by asset class (ppts, ytd to end-October 2021)



Source: Tetragon Financial Group, Edison Investment Research. Note: Share in Tetragon's total NAV indicated in the data labels.

## Why consider Tetragon Financial Group now?

Tetragon is a one-stop shop for alternative assets with a diversified exposure providing returns that are not correlated with major traditional asset classes. While Tetragon's recent performance was subdued, its long-term returns remain within its target range and visibly outperform the AIC Flexible Investment sector and public equity markets over the last 10 years. Historically, it has traded at a wide discount (10-year average at 45%), with the potential reasons described in our [June 2020 note](#). The discount stands at c 68% to NAV, which provides investors with a degree of downside protection.

## The analyst's view

Tetragon's listed equity portfolio is concentrated (10 positions) and focused on (bio)technology and financials, with value driven by company-specific developments. Polygon funds (making up 97% of Tetragon's hedge funds exposure) have concentrated portfolios focused on special situations. Meanwhile, the privately valued TFG Asset Management remains the main value driver of NAV returns. While Tetragon's historical long-term performance remains intact, the high concentration in some asset buckets, coupled with Tetragon's limited disclosure on individual underlying investments, translates into lower visibility of prospective returns. Tetragon's recent performance is significantly behind the bull market in public and private equity, although we note it aims to deliver returns that are not correlated with broader equity markets.

NOT INTENDED FOR PERSONS IN THE EEA

## Investment trusts

15 December 2021

**Price** US\$8.52  
**Price (TFGS)** 652.5p  
**Market cap** US\$813.7m  
**NAV\*** US\$2,566m

NAV per share\* US\$26.85

Discount to NAV 68.3%

\*At end-October 2021.

Yield 4.7%

Fully diluted shares in issue 95.5m

Code/ISIN TFG/GG00B1RMC548

Primary exchange Euronext Amsterdam

Secondary exchange LSE Specialist Fund Segment

AIC sector Flexible Investment

52-week high/low US\$10.60 US\$8.52

NAV high/low US\$26.85 US\$24.22

## Gearing

Net gearing at 31 October 2021 7.4%

## 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

- Diversified portfolio with a proven track record.
- Recurring income from asset management business (TFG Asset Management).
- The wide discount provides investors with some downside protection.

## Bear points

- Above-average ongoing charge and performance fees.
- Only non-voting shares available for investors.
- Limited disclosure on underlying assets developments limiting investors' understanding.

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## NAV TR 2.6% in 2021 to date

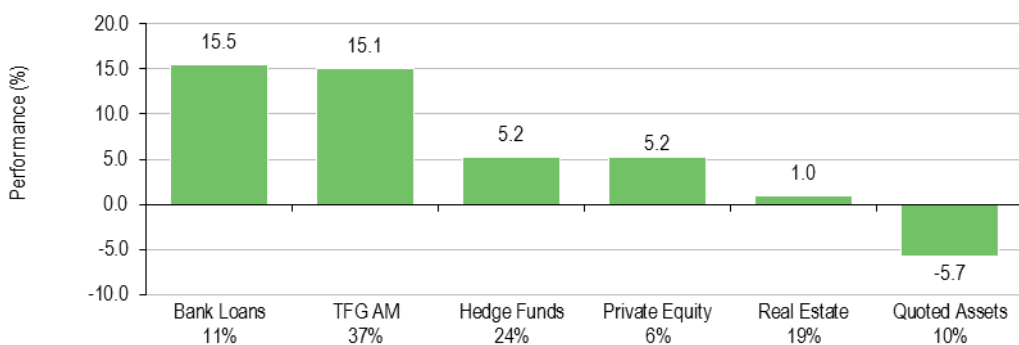
Tetragon's NAV per share increased by 2.6% to US\$26.85 between end-2020 and end-October 2021 in TR terms. The performance continues to fall behind both public and private markets, with the MSCI ACWI and LPX50 indices posting 17.2% and 63.3% TRs, respectively. The portfolio delivered an 7.9% gross return according to our calculations, which was largely consumed by ongoing costs and fees (2.9pp) and share dilution (2.3pp) stemming predominantly from share-based compensation. This also includes some minor impact of the interest expense on its credit facility (three-month LIBOR+3.25%). Tetragon expensed US\$6.0m incentive fees in H121 and a further US\$14.4m in Q321 (c 0.8% of opening NAV), equalling to 25% of profit over its hurdle rate (three-month LIBOR +2.6%). The employee ownership of the company increased to 35.0% at end-October (from 32.7% at end-2020).

During the period (10 months to end-October 2021) Tetragon was a net investor, deploying US\$75m on a net basis. The largest investments were made in private equity assets (US\$74m net) and listed equities and credit: US\$27m was invested through Polygon-managed funds and US\$15m directly through Tetragon's balance sheet. On contrast, the most cash-generative assets were collateralised loan obligations (CLOs) with net distributions of US\$40m, which we understand stems predominantly from coupon and amortisation payments rather than disposals (the exposure remained flat at 11% of the portfolio vs end-2020). Another US\$15m was received from TFG Asset Management, mostly from BentallGreenOak (US\$13m in the first nine months of 2021).

The additional investments translated into an increase in Tetragon's gearing to 7.4% of NAV (US\$190m) from 0.5% at end-2020. Historically, Tetragon held meaningful part of its portfolio in cash (2015–2019 end-year average at 14% of portfolio) to have flexibility in capturing investment opportunities. It has additional capital available from the undrawn part of its revolving credit facility (US\$100m at end-September 2021). Tetragon had US\$125m of hard commitments at end-June 2021 (last available data, mostly towards BentallGreenOak and private equity funds), and a further US\$76m 'soft' commitments towards Banyan Square and Contingency Capital funds. Given Tetragon's relatively limited dry powder at present, these could make up the majority of new investments in the near term (although we note that these commitments may be called gradually).

## TFG Asset Management remains the main driver

**Exhibit 1: YTD performance by asset class (% to end-October 2021)**



Source: Tetragon Financial Group, Edison Investment Research; Note: Share in Tetragon's total NAV indicated in the data labels.

In Q321 Tetragon reported US\$88m in net valuation uplift across its portfolio, of which US\$57m was related to TFG Asset Management. The revaluation was made on the back of operating performance, as its aggregate AUM increased to US\$34.9bn at end-September 2021 from US\$30.1bn at the beginning of the year (up 16% ytd), as well as market multiples expansion. Within TFG Asset Management businesses, the largest uplifts in Q321 alone were recognised on BentallGreenOak (US\$32m) and LCM (US\$18m). BentallGreenOak, in which Tetragon holds 13% stake, is valued using present value of cash flow elements of the GreenOak/Bentall Kennedy merger deal (fixed quarterly contractual payments, variable payments and carried interest) and the put/call option in place. The valuation uplift was due to strong performance in terms of AUM and projected EBITDA growth, as illustrated by the 13% y-o-y increase in the payments received by Tetragon in the first nine months of 2021. LCM has successfully launched two new CLOs, LCM 33 (US\$509.2m) and LCM 34 (US\$509.8m), and significantly increased its AUM. TFG Asset Management's value is determined by a third-party valuation specialist using predominantly DCF models based on expected fee income. At end-October 2021 the business remains Tetragon's largest portfolio holding (37% of the portfolio) and the main value driver (5.1pp out of 7.9% gross return in 2021 YTD, and 7.5pp out of 12.8% in 2020). The underlying performance drivers of other asset classes within Tetragon's portfolio remained broadly unchanged between end-June 2021 and end-October 2021 compared to H121 (we discussed these in detail in our [previous note](#)).

## Still outperforming its peers over a 10-year period

We compare Tetragon to other members of the AIC Flexible Investment sector (Exhibit 2) and despite the short-term returns falling behind the broad markets, it still significantly outperforms its peers over a 10-year perspective. Tetragon stands out from the group, with one of the highest dividend yields and ongoing charges, and the widest discount. Its discount has been wider than peers in the long term (10-year average at 45%), and we explored potential underlying factors in our [June 2020](#) note. The recent somewhat underwhelming performance may have contributed to the widening compared to the long-term average.

**Exhibit 2: Selected AIC Flexible Investment sector peer group in sterling terms at 14 December 2021\***

% 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
<b>Tetragon Financial Group</b>	<b>575.1</b>	<b>8.0</b>	<b>24.4</b>	<b>39.2</b>	<b>253.1</b>	<b>(68.3)</b>	<b>1.7</b>	<b>Yes</b>	<b>107</b>	<b>4.7</b>
Aberdeen Diversified Income & Growth	308.6	7.7	10.7	20.7	55.9	(18.5)	0.6	Yes	102	5.5
Caledonia Investments	2,041.6	32.1	35.7	64.6	194.2	(23.3)	1.0	Yes	100	1.7
Capital Gearing	963.5	14.7	27.4	38.6	87.0	1.9	0.6	Yes	100	0.9
Hansa Trust 'A'	172.0	28.6	27.5	46.4	70.3	(35.6)	1.1	Yes	100	1.5
Personal Assets	1,765.1	12.9	28.6	32.2	73.4	1.0	0.7	Yes	100	1.1
RIT Capital Partners	4,230.2	36.9	54.7	71.5	180.8	(0.6)	0.7	Yes	108	1.3
Ruffer Investment Company	680.2	19.9	32.6	31.4	70.3	3.7	1.1	Yes	100	0.6
UIL	195.7	32.4	34.3	32.4	129.3	(35.7)	2.2	Yes	168	3.4
<b>Average</b>	<b>1,451.6</b>	<b>21.8</b>	<b>31.0</b>	<b>43.6</b>	<b>104.6</b>	<b>(10.2)</b>	<b>0.8</b>		<b>101</b>	<b>1.8</b>
<b>Rank in peer group</b>	<b>6</b>	<b>8</b>	<b>8</b>	<b>4</b>	<b>1</b>	<b>9</b>	<b>2</b>		<b>3</b>	<b>2</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance data to 31 October 2021. TR in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

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