EDISON

GLI Finance

Q413 NAV; dividend; acquisitions

Building peer-to-peer portfolio

Investment companies

GLI Finance (GLIF) has made seven investments, totalling over £4m, in peer-to-peer and SME lending platforms (bringing its total to 10). These vehicles provide optionality on lending growth and offer a unique opportunity for equity investors to access these high-growth markets. The proposed separation of GLIF's US CLO book will concentrate the business in this area. GLIF also announced its Q413 dividend of 1.25p, annual yield of c 10% and NAV of 50.0p.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/11	11.4	2.3	2.36	4.2	21.9	8.1
12/12	14.9	7.2	6.76	4.8	7.7	9.3
12/13e	15.8	6.6	5.38	5.0	9.6	9.7
12/14e	16.1	7.6	5.74	5.3	9.0	10.2

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

NAV and dividend

As expected, the dividend for Q413 was 1.25p, the same as previous quarters. The NAV at end Q413 was 50.0p against 51.8p end Q313. About half of this 3.5% drop was the strengthening of sterling against the US dollar (end Q3 $1.62/£ vs end Q4 $1.65/£) affecting the dollar loans primarily held in the CLO. We have also cut estimates for continued high levels of early repayments.

Portfolio investments

GLIF has confirmed it is preparing to transfer the CLO portfolio, the core of the current business, into a separately listed vehicle with a potential offering in H114.

GLIF also announced modest investments across a range of SME financing vehicles. These include: (i) TradeRiver Finance (£0.8m equity, £2m funding), UK trade finance; (ii) Finpoint UK (£1.25m), platform for institutional buyers of SME loans; (iii) Proplend (£1m), commercial property peer-to-peer platform; (iv) Raiseworks ($1.5m), US SME peer-to-peer lender, first loans expected Q214; (v) Sancus, Jersey-based offshore SME lender – high net worth investors targeted; (vi) Dansk Faktura Børs, Danish invoice discounter; and (vii) CrowdShed.

The investment in BMS is reported to be "trading successfully" and the last accounts saw an uplift in valuation, which GLIF expects to be recur. Investments in Platform Black (UK invoice financing) and FundingKnight (UK peer-to-peer SMEs) are progressing as expected.

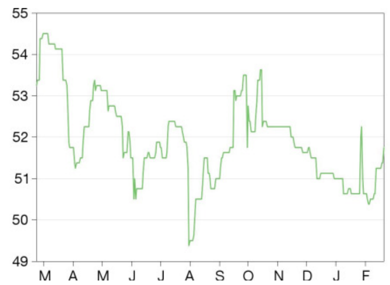
Valuation: In line as investment co, cheap as lender

GLIF is still predominantly an investment company with assets focused in US SME loans. As such, comparison with its NAV (end 2013: 50p) is an important valuation metric, as is yield (c 10%). The proposed CLO disposal (not in our numbers) may see depressed earnings and the dividend may be uncovered until the proceeds are fully redeployed. GLIF's investments mean it could be considered an SME financer. Applying peer comparators, Gordon's growth or discounted dividend models indicate that GLIF is trading well below fair value.

21 February 2014

Price	**51.75p**
Market cap	**£73m**
Net debt/cash (£m)	N/M
Shares in issue	140.3m
Free float	100%
Code	GLIF
Primary exchange	LSE

Share price performance



%	1m	3m	12m
Abs	2.2	0.0	(3.5)
Rel (local)	2.4	(2.8)	(11.1)
52-week high/low		54.5p	49.4p

Business description

GLI Finance is a Guernsey-domiciled closed-ended investment fund, which aims for NAV stability and a predictable yield. It invests in US and UK mid-corporate senior, secured loans and increasingly in specialist providers of SME finance.

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2013 results	March 2014

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Summary of new investments

Exhibit 1: Summary of new investments

	Investment (£000s)	Share of equity (%)	Comment
TradeRiver Finance	800	10.0	Additional funding line of up to £2m. Income mainly from this loan. GLIF management involvement minimal.
Finpoint UK	1,250	75.0	UK JV with successful German developer. GLIF likely to source loans through the network and have material involvement.
Proplend	1,000	22.5	Commercial property loans, full launch Q114, peer-to-peer lender.
Raiseworks	$1,500	30.0	US SME peer-to-peer leveraging unique database.
Sancus	N/D	7.4	UK offshore SME peer-to-peer secured lender targeted at high net worth individuals, Geoff Miller on board.
Dansk Faktura Børs	N/D	5.0	GLIF management involvement small. Significant opportunity to source new business lending in different geographies.
CrowdShed	N/D	26.0	Full details of product launch expected now it has finalised equity.

Source: GLIF, Edison Investment Research

As can be seen in Exhibit 1 above, GLIF has made several different investments. In summary, we would comment:

- Equity stakes are likely to see greatest uplift if peer-to-peer companies start floating. We would expect the established businesses to start this process within the next two years and for GLIF's newer businesses to follow relatively shortly afterwards. Trade deals should also not be ruled out.
- Most of the businesses will originate new SME lending for GLIF with a geographic and product diversity that will earn interest directly. GLIF will also earn income on the preference share elements of its financing. Finpoint UK will be consolidated (with a non-controlling interest deduction of 25%), while the other investments will be fair valued.
- GLIF will have board representation in all the investments. There will be more operational involvement only in Finpoint, while the commitment to the other companies is more strategic. GLIF management believes this, and managing the relationships with these distribution channels, is possible within existing resources, although the capacity to control more deals in the near term is modest.
- We note that most of the new investments are at an early stage of development and so GLIF will be heavily involved in setting policies and practices. GLIF has done extensive due diligence on the established businesses, including using trade finance experts to review TradeRiver (where GLIF is not in any case exposed to specific customer risk) and GLIF's management personally examining DFB risk control areas (where the risk profile is more akin to supply chain finance than invoice discounting).

We would be surprised if all these investments progressed to develop good returns for GLIF. As a portfolio, and including GLIF's previous acquisitions, we believe it gives equity investors a unique, quoted exposure to the unquoted peer-to-peer and non-bank SME financing markets. If management plans to separately quote the CLO investments, GLIF will be focused in these areas that, while not risk free, are showing excellent growth (see market concerns section on page 7).

TradeRiver Finance: UK trade finance

TradeRiver Finance (www.traderiverfinance.com) is an online trade finance business established in 2009. Since then it has provided finance on 520 transactions to a value of £24m. We understand business growth is such that TradeRiver sought further funding. GLIF will be providing a £2m borrowing facility (ranking behind existing debt financing in the business) and is taking a 10% stake in the equity of the business for c £800k. GLIF expects the loan to be drawn down over time, as TradeRiver's book of business grows further.

The buyers of goods registered on TradeRiver have a revolving credit facility with which to pay cash to suppliers enabling better pricing and terms. There is no need for letters of credit, credit confirmations, guarantees and insurance as the whole process is automated within TradeRiver, reducing administration costs. Buyers are given a maximum credit limit (agreed with TradeRiver Finance funders and credit insurers), which can then be used in specific deals. Buyers have up to 120 days to settle the balance for any deal, which, once settled, creates new capacity under the maximum credit line to do further deals. The average duration of deals financed so far has been 99 days.

Sellers of goods also have to be registered with TradeRiver, but they get cash settlements when the buyer accepts the goods or services so see accelerated cash flow without resorting to existing alternatives such as receivables financing. This also reduces their administrative burden.

TradeRiver buyers range in turnover from £5m to £500m, with typical credit limits from £100,000 to £750,000. Transactions over £75,000 are more cost efficient and some customers combine multiple smaller purchases into single, larger transactions. There is no maximum transaction size limit in a buyer's available credit limit. TradeRiver protects itself from defaults through credit assessment and credit insurance.

GLIF will earn returns from its loan to TradeRiver, which earns an interest rate commensurate with the business of TradeRiver and the fact it ranks behind existing debt finance.

Finpoint: UK SME institutional financing

GLIF is investing £1.25m for a 75% equity stake and an unquantified amount of preference shares in a new UK joint venture with CRX (the owner of Finpoint in Germany) (www.finpoint.co.uk). The platform is business-to-business, allowing financial institutions to buy loans directly from SMEs. It typically has larger loans than those seen with retail investors. Being institutional reduces the cost and risk of regulation and compliance compared with a mass-market platform.

Finpoint has been operating for three years in Germany, completing more than 100 loans totalling €340m, with a further 181 loans totalling more than €400m under discussion.

The Finpoint Opportunities Board is populated with searchable summaries of borrowers' requirements, including an Experian credit score. When the lender finds a borrowing requirement that meets its criteria, it sends a message to the borrower indicating its interest via the platform. If the borrower accepts the interest, the lender is invited to enter into a confidentiality agreement. The borrower then allows the lender to access the details of its borrowing requirements. All communication is carried out via the platform, unless the lender provides other means of contact.

For the borrower, the Finpoint platform presents the borrowing requirement anonymously to multiple potential lenders, saving time and money. It covers a range of financing types, including factoring/invoice discounting, overdrafts, unsecured loans, loans secured against property and other secured loans.

Borrowers are charged an annual fee of £499 plus VAT. Other income may be expected to be generated from lenders. We would expect GLIF to participate in some of the lending, earning interest.

Proplend: UK commercial property peer-to-peer

Heads of terms have been signed for GLIF to invest £1m in Proplend (www.proplend.co.uk) in a combination of equity and preference shares for a 22.5% stake in the business. Proplend is a secured peer-to-peer lender run by an experienced property team. It has already completed its first loan and is expected to be fully launched online by the end of Q114.

Loans are for £500k to £5m (significantly higher than most peer-to-peer platforms) with durations of six months to five years. All are secured on pre-owned commercial property. The maximum overall loan will be 75% LTV and each loan will be backed by a first charge over the property, which will be registered with the Land Registry. A debenture, share charge or personal guarantee may be taken where appropriate, and registered at Companies House. In addition, the equivalent of six months' interest cover will be retained from the gross loan proceeds and used to pay the lenders if the borrower misses a repayment. Interest is fixed for the duration of the loan.

Lenders will be either professional or institutional investors, or those self-certified as high net worth individuals or sophisticated investors. A minimum lender deposit of £5,000 is required. Details of loans are provided in the loan request document, including the property and its tenants, the borrower and the loan matrix showing the tranches with their respective interest rates offered by the borrower. Further supporting information is available in a virtual data room, where lenders post information in greater detail than in the loan request document. Initially, funds will be locked in for the term of the loan, although we understand a secondary market is planned shortly allowing investors to on-sell their loans.

Proplend charges a servicing fee equal to 10% of the interest that lenders actually receive and the fees are paid monthly or quarterly, according to when interest is paid. The borrower is also charged a listing fee and completion fee.

Raiseworks: US SME lender

On 2 January 2014, GLIF announced it has invested $1.5m in national US peer-to-peer SME lending business Raiseworks (www.raiseworks.com), to fund the purchase of certain peer-to-peer business assets in a deal led by Gary Chodes, CEO of Raiseworks (who is also making a personal investment into the venture). In return for the investment, GLIF will have at least a 30% share in Raiseworks.

The seller in the transaction began Raiseworks in 2011 and has spent the past two years building the platform, developing the credit underwriting model, establishing partnerships and securing a broker dealer licence. The Raiseworks platform uses one of the largest private company databases in the US and a suite of proprietary, predictive algorithms in an effort to provide community members with an informational advantage. Raiseworks is expected to become a registered broker-dealer (necessary under the JOBS Act to distribute nationwide) and a member of FINRA/SIPC.

Loans are expected to have fixed monthly payments (fully amortising term), maturity of one to five years, interest rates of 6-20% based on financial strength and no prepayment penalties with unsecured and blanket lien options. The time commitment from the company is small, requiring registration (five minutes) and profile completion (about one hour). There is just one payment regardless of the number of lenders and lenders can be approved and get cash in two to 60 days. The first loans are expected to be made in Q2/Q314.

Raiseworks' income from the borrower will be from (i) loan listing fees to cover background checks and credit reports (Raiseworks requires financial data from the last two years, including income statement, balance sheet, tax returns and information about the primary owners of the business, ie

SSN, birth date, address); (ii) completion fees as a percentage of successfully funded loans (financed over repayment period); and (iii) loan servicing fee.

Key staff include Gary Chodes (CEO), who has experience building businesses with significant consumer direct marketing efforts and national distribution networks, which goes back nearly 20 years, and Vlad Uchenik, who has over 16 years' compliance (SEC, FINRA, MSRB, FRB and state), risk and operational expertise.

Sancus: Jersey-based SME lender

On 13 January 2014 GLIF announced it had invested in offshore peer-to-peer secured lender Sancus (www.sancuslimited.com). In return for the investment, GLIF will have a 7.41% share in the business (no consideration disclosed, although it will be available in the year-end accounts). Sancus is a new venture and launched with £23m of proprietary (equity and debt) capital on 7 November 2013, raised mostly from local entrepreneurs and professionals. In early February 2014 Sancus announced its first loans of £2.5m.

Sancus is a peer-to-peer secured SME lender (it does not offer consumer loans) with a minimum loan participation of £250,000 (clearly targeting high net worth investors). It will lend alongside, or in front of lenders to provide full confidence in the credit process. Returns will thus be a combination of fees (borrowers' deal-specific charges), interest (typically expected to be 10-12%) and potential capital gains. Borrowers are offshore.

Directors include:

- Andrew Whelan (CEO), who has over 25 years' investment experience and was a founding partner of Ermitage Group following its MBO in 2006 from Liberty Life.
- Geoff Miller (director), who is also the CEO of GLIF.
- John Davey (director), who has over 25 years' experience in the finance industry. In 2007 he joined the start-up business Spearpoint, where he was the CEO and largest shareholder. The company was sold to Brooks Macdonald Group in 2012.
- Nicky de Veulle (COO), who was selected to participate in PwC's global leadership programme, aimed at the top 5% of high-achieving individuals. In 2007 she joined Jersey Choice, a company operating in the mail order and internet sector.
- Richard Harrop (director), who has over 25 years' experience in the Jersey finance industry. In 1989 he developed the corporate finance arm of RoyScot Jersey (the largest asset and consumer finance business in the Channel Islands). He then founded Acorn Finance, which started trading in 2003 and won overall business of the year at the Jersey Enterprise Awards in 2009.

Others (no consideration disclosed)

- Terms have been agreed for GLIF to take a 5% stake in European Receivables Exchange (Dansk Faktura Børs (DFB, www.danskfakturabors.dk). It is an invoice discounting business, currently principally in Denmark, but with the potential to expand across Europe. It provides GLIF with geographic diversity. There is no fractional bidding (ie the whole invoice is bought) and bids are quoted as a percentage of the invoice face value. Investors are primarily institutional and with some high net worth individuals. DFB earns a seller's commission of 15% of the difference between the invoice and the purchase price to a maximum of 0.75% and a minimum of 0.50% of the invoice (minimum DKK250 per auction). It also charges a buyer's commission of 10% of the difference between the invoice and purchase price to a max 0.50% of the invoice.

- CrowdShed (www.crowdshed.com) aims to bring together rewards and donations with equity and commercial debt opportunities. It is raising capital before launch and GLIF has agreed a heads of terms for an investment to acquire a 26% stake in the business. CrowdShed will also provide opportunities for GLIF to participate in a variety of assets as different products and funding campaigns are launched on the platform.

Previously completed: Peer-to-peer deals

Platform Black: Peer-to-peer UK invoice finance

On 2 September 2013, GLIF announced a £2m investment in the SME invoice finance crowd-funder Platform Black (PB). GLIF will buy equity (minimum 20% holding) and preference shares. PB launched in June 2012 and has financed invoices of over £45m, advancing over £40m to date (the market leader MarketInvoice has financed £109m since launch in February 2011). GLIF has invested £163k in invoices, all of which have been repaid, at an average deal IRR (annualised) of 13%.

PB provides a proprietary online trading platform, which allows investor members to bid at auction for short-term asset-based debt from SME members in need of finance. So far, its c 150 members have offered invoices in c 1,000 auctions ranging in size from £5k to £500k (average £40k). The invoice is sold in 5% tranches to investors in the auction (for a fee), but is repurchased by the company at the end of the credit term (fixed at 30, 60 or 90 days). The invoices have been to companies such as Unilever, Google and Novartis.

PB's last reported rate of non-payment on loans was 0.18%. However, at this early stage of development for PB, we would expect this ratio to be sensitive to specific situations and (noting the invoice size above) a loss from any single invoice could easily see volatility in the ratio. As the business matures, this volatility should ease with a normal loss rate visible once the group has sufficient scale. We note that many peer-to-peer platform invoice sellers may have limited access to other financing solutions and that considerable effort needs to be spent to ensure that all contractual conditions are met. Across the industry, typical issues include disputes on the validity of invoices and payment to the invoice seller rather than the platform. PB now has dedicated risk staff to address these risks.

PB earns fees from the investors (10% of their gain), transaction fees (50bp for 30 days advance, 75bp for 60 days, 90bp for 90 days) and lifetime membership fees (£310 per member). PB pays away 20% of its transaction fees as commission to introducers. The SMEs pay financing fees to investors ranging from 50-150bp per 30-day term, with investors achieving net of costs double-digit yields.

PB, while still a crowd funder, is targeted at short-term cash release using invoices as security. Investors are restricted to sophisticated and/or professional investors, and include funds; family offices; asset based lenders; and high net worth individuals, given that this is not a retail product. Geoff Miller (CEO of GLIF) is on the PB board.

FundingKnight: UK peer-to-peer SME loans

On 16 July 2013, GLIF announced a £1.5m investment in the equity (minimum 20% stake) and preference shares of FundingKnight (FK), a peer-to-small-business loan organiser. FK was established in 2011 and went fully live early in 2013. It has lent a further £2.5m since GLIF invested (having lent £1m before), of which GLIF has funded £1m. SME loan proposals are reviewed by an experienced credit team and then given a rating. Through the website, multiple private investors (registered over 955 private lenders) then have a seven-day auction to bid on these loans (in lot sizes of £25) and ask questions publicly of the lender. Multiple funders to a single business is termed crowd funding. FK also manages a market place, where loans can be on-sold (Loan Exchange) and has executed over 4,147 deals on this platform.

Fees are earned from borrowers (arrangement 250bp, repayment 100bp) and from sellers in the Loan Exchange (100bp). By comparison, the market leader, Funding Circle, which launched in 2010, has now originated over £200m in loans, with c 65k investors.

Market concerns with peer-to-peer lending

Peer-to-peer lenders are showing exceptionally strong growth at the moment driven by a combination of constrained bank appetite to lend and investors seeking a better return than that available from bank deposits. These returns fell sharply with the introduction of the Funding for Lending Scheme, which meant banks had access to much cheaper liquidity through the Bank of England. Credit loss experience from peer-to-peer lenders has remained below expectations. In April 2013, NESTA, a lottery funded innovation charity, produced a report that said annual market lending could be £12.3bn within a decade. The market also has government support (including providing £25m to earlier entrants on a co-lent basis). These conditions are extremely favourable, but unlikely to be sustained in the long term.

There are some downside risks, including:

- We expect more competition (currently there are five players, including ThinCats and Zopa, but others such as City of London Group have expressed interest), but the potential growth in the market is material.
- The market leader is strongly positioned: Funding Circle has a proven track record, and has raised nearly 65x as much money and 70x the numbers of investors as FK. It also has government-matched funding. Why would a borrower or lender approach FK when it has a more comprehensive option available in Funding Circle?
- Adverse selection: It is a common feature for new lenders to attract business declined by existing players. For FK the issue is twofold – borrowers who may have been turned down by their bank are also likely to have considered competitor Funding Circle.
- Credit collections: Managing collections is critically important to any SME lender returns. Banks have specialist departments to identify and manage problems early, then manage the collections as appropriate. The crowd lenders do not have this infrastructure in place and do not have the business levels yet to support it.
- Sensitivity to rising rates/alternative investments: A significant part of the appeal to lenders is that they are unable to earn acceptable returns from other investments. When the Bank of England fully withdraws the Funding for Lending Scheme, it may be that customer deposit rates will rise and this may be expected to happen ahead of a general rise in interest rates. Alternatively, greater confidence in equity markets could also be a trigger for peer-to-peer investors to look elsewhere. At that stage, there could be a lot of sellers and few buyers on the loan exchange. Better returns elsewhere and an illiquid market in which to sell could both deter potential lenders.
- Customer reaction to credit losses: A major issue is how investors will react when credit losses start to materialise in significant numbers. While impairments are clearly highlighted as an issue on the websites and investor returns adjusted to reflect *expected* losses, to date experience has been good. We note management and peer comments that the investors are sophisticated (and shown by well-spread portfolios, with NESTA reporting an average portfolio

of £8,000 spread across 67 positions), but we question this. For example, credit losses increase materially with the duration of lending and yet the spread investor's demand on Funding Circle does not appear to reflect this risk.

- Regulatory risk: With an average investment of £8k, a typical crowd lender is firmly in the space of retail investor. Market regulations are expected in 2014 with some increased cost expected, but how the regulator will react if there are significant customer losses is unclear. Recent experience with, say, PPI would suggest customer compensation has become the norm for financial services.
- Crowd behaviour: One danger is that in good times rates are bid down to uneconomic levels by investors who do not understand credit risk. It also means that in the bad times too many investors will try and exit simultaneously, making the loan market place unworkable. We suspect that many investors take comfort from, say, Funding Circle highlighting that on average it takes just two days for a sale to be completed, so if it then takes two weeks the investor outcry could make the model unworkable.
- Banks lending again: The appetite of the retail banks to lend to SMEs is important. Given the political pressure they are currently under, we believe that SME lending will be an area to which banks will make a relatively early return to lending. The areas they may avoid (perhaps commercial property) will be the highest-risk areas, raising the issue of adverse selection.

We note that current conditions are good and the longer they persist, the more likely it is that customers will be loyal. If the model proves successful, the potential upside is huge. We also note that GLIF's involvement is likely to help the model succeed as it can provide liquidity, which may make borrowers more likely to use the site. In addition, investors in high-yield GLIF are likely to be the type of investors that would be attracted to the returns on offer through the platforms and GLIF thus becomes a free advertising tool for the site.

Impact of CLO spin-off

As we have outlined in previous notes, the CLO structure has ensured that GLIF benefited from low-cost and low-covenant funding through the financial crisis. It is now out of the re-investment phase, so any loan repayments are used to reduce debt (at par). Good conditions in the US loan markets have seen a much higher level of early redemptions accelerating this trend. Having examined a range of strategic options including new CLO structures, funding outside CLOs etc, GLIF has concluded that shareholder value will be optimised though the spin-off of the CLO into a separately listed vehicle. This will clearly be dependent on market conditions, but the indications are that it could be tried in H114. As it is likely to take time to redeploy the CLO proceeds in the new channels, it is probable that the completion of the disposal will see forecasts reduce for a period.

Valuation

GLIF is still an investment company and many investors will continue to value it on what they consider to be an appropriate discount to the reported NAV (noting there are several logical ways to come to the NAV figure). Its yield of c 10% covered by cash earnings will also be an important factor.

It is worth noting that the new business is increasingly a mix of venture capital-style investments (for example the portfolio of peer-to-peer funders) and an SME specialist lender. Looking at valuation metrics applicable to that type of company sees considerable upside.

Gordon's growth model: 84p

We believe an SME lender through the cycle should earn a mid-teens type of return above a cost of capital around 10%, as the pricing power of providers relative to SMEs is likely to remain strong. For GLIF, we assume a slightly higher cost of capital given it is migrating from being a US loan vehicle. With growth assumed at 5%, the implied price to book is 1.75x. This is adjusted for near-term performance (low-teens ROE expected) and produces an implied valuation of c 84p.

Exhibit 2: Gordon's growth model and sensitivity

	Central	ROE +1%	COE -1%	G+1%
Return on equity (%)	15	16	15	15
Cost of equity (%)	11	11	10	11
Growth (%)	5	5	5	6
Implied P/BV (x)	1.67	1.83	2.00	1.80
NAV 2015e (p)	52.8	52.8	52.8	52.8
Implied price (p)	88.0	96.8	105.6	95.1
Discount/premium re ST performance (%)	-5%	-5%	-5%	-5%
Implied price (p)	83.6	92.0	100.4	90.3

Source: Edison Investment Research

Dividend discount (68p)

We have taken our forecast dividends (2014-15), grown them at 5% for 10 years and applied a 10x terminal value at this point. All the dividends are then discounted at the implied cost of capital above (11%) producing a fair value of 68p. This approach is conservative, in that it only takes 10 years' growth beyond our forecast period (taking 20 years would increase the value to 76p), although the payout ratio is high.

Peers

There are few direct competitors, but as can be seen from the exhibit below, peers trade on much higher multiples of book value and do not have the same yield as GLIF. There are currently no publically available forecasts for Renovo (which took over Ultimate Finance Group).

Exhibit 3: Peers comparisons

	Price (p)	Ticker	Market cap (£m)	2013 P/E (x)	2014 P/E (x)	2014 yield (%)	P/BV (x)
GLIF	51.6	GLIF	72	9.6	9.0	10.3	1.0
Tungsten Corporation *	285.0	TUNG	285	loss	66.3	0	1.6
1PM **	65.5	OPM	20	21.1	16.6	0	3.0
3i **	406.6	III	3,951	9.1	8.7	3.3	1.3

Source: Thomson Datastream, Edison Investment Research. * April following year, ** May following year Note: Priced as at 20 February 2014

Financials

We have repeatedly cautioned against over reliance on statutory accounts, which include capital movements in the earnings statement and operating cash flows. Our forecasts below exclude all such items, so should prove conservative over the long term – the whole purpose of the loan portfolio is to identify loans that are underpriced by the market.

Estimate changes

We have adjusted our estimates for:

- The effect of sterling strengthening against the dollar – with most revenue in dollars, but central costs in sterling, this has an adverse effect on profits.

- The continued high level of loan repayments in the US. This is adversely affecting income, as the CLO structure is now out of its re-investment period so early repayments are used to reduce debt rather than be re-invested in new loans. The good loan conditions in the US, which have encouraged the high level of early redemptions, accelerate this reduction. We have not built in the effect of the sale of the CLO, which may be expected to see reduced earnings while the proceeds are being redeployed. It is probable that this could see a dividend uncovered by our real earnings measure.
- We have included in our statutory numbers the effect of repaying debt at par, which for accounting purposes has been valued at (the lower) market price.
- We have trimmed our BMS equity valuation increase (from £1.6m to £1.3m). The scale of business is currently such that BMS loan income covers the costs of that business, with BMS warrant realisations then being the main driver to the valuation uplift. These are by nature lumpy and we understand H113 was somewhat above an average rate, implying H213 will be somewhat lower.
- We have also changed our treatment of the non-controlling interests to include the deduction. These have been somewhat offset by a generally positive trading statement.

Exhibit 4: Estimate changes

	Revenue (£m)		%	Cash rev operating profit (£m)		%	EPS (p)		%	Dividend (p)		%
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
FY13e	17.8	15.8	-11%	9.7	6.6	-32%	7.2	5.4	-25%	5.0	5.0	+0%
FY14e	18.0	16.1	-20%	9.7	7.6	-21%	6.8	5.7	-16%	5.3	5.3	+0%
FY15e		16.6	N/M		9.1	N/M		6.8	N/M		5.5	N/M

Source: Edison Investment Research

Exhibit 5: Key financials – profit and loss (£)

Year-end 31 December	2010	2011	2012	2013e	2014e	2015e
Interest income	9,756,442	10,934,279	12,634,355	12,750,000	13,000,000	13,500,000
Dividend revenue	0	484,706	2,229,126	1,750,000	1,750,000	1,750,000
Cash revenue	**9,756,442**	**11,418,985**	**14,863,481**	**14,500,000**	**14,750,000**	**15,250,000**
Other income BMS re-valuation	0	0	0	1,300,000	1,300,000	1,300,000
Total revenue (real)	**9,756,442**	**11,418,985**	**14,863,481**	**15,800,000**	**16,050,000**	**16,550,000**
Loss/gain on financial asset/liabilities at fair value through P&L						
Realised	1,209,950	57,392	3,719,522	0	0	0
Unrealised	7,456,803	(1,109,389)	(18,578,336)	0	(1,600,000)	(2,000,000)
Net gain on financial assets and liabilities at amortised cost	0	0	0	0	0	0
Realised	0	1,489,252	0	0	0	0
Unrealised	80,746	(116,499)	0	0	0	0
Total investment revenue	**8,747,499**	**320,756**	**(14,858,814)**	**0**	**(1,600,000)**	**(2,000,000)**
Other	0	0	0	0	0	0
Other Income	5,168	800,930	579,439	0	0	0
Loss/gain on foreign currency transaction	295,642	(198,610)	(272,547)	0	0	0
Statutory Income	**18,804,751**	**12,342,061**	**311,559**	**15,800,000**	**14,450,000**	**14,550,000**
Finance Costs	(1,716,936)	(2,363,289)	(2,289,156)	(2,500,000)	(2,000,000)	(1,500,000)
Cash revenue net of finance costs	**8,039,506**	**9,055,696**	**12,574,325**	**12,000,000**	**12,750,000**	**13,750,000**
Real revenue net of finance costs	**8,039,506**	**9,055,696**	**12,574,325**	**13,300,000**	**14,050,000**	**15,050,000**
Statutory income net of finance costs	**17,087,815**	**9,978,772**	**(1,977,597)**	**13,300,000**	**12,450,000**	**13,050,000**
Management fees	(3,990,969)	(4,002,524)	(1,852,473)	(2,000,000)	(1,650,000)	(1,400,000)
Administration and secretarial fees	(113,274)	(181,655)	(167,336)	(167,336)	(167,336)	(167,336)
Custodian fees	(15,154)	(18,600)	(15,010)	(15,010)	(15,010)	(15,010)
Legal and Professional fees	(127,504)	(273,156)	(712,629)	(712,629)	(890,786)	(668,090)
Directors Remuneration	(110,000)	(85,659)	(90,000)	(90,000)	(90,000)	(90,000)
Executive directors remuneration	0	(444,295)	(1,094,509)	(200,000)	(200,000)	(200,000)
Directors and Officers insurance	(61,095)	(62,482)	(50,730)	(35,000)	(35,000)	(35,000)
Audit fees	(61,000)	(47,000)	(46,100)	(46,100)	(46,100)	(46,100)
Share option expense	0	0	0	0	0	0
Loan note expenses	0	0	0	0	0	0
Other expenses	(1,555,739)	(1,638,409)	(1,391,042)	(2,133,925)	(2,055,768)	(2,078,464)
Total costs	**(6,034,735)**	**(6,753,780)**	**(5,419,829)**	**(5,400,000)**	**(5,150,000)**	**(4,700,000)**
Cash revenue operating profit	**2,004,771**	**2,301,916**	**7,154,496**	**6,600,000**	**7,600,000**	**9,050,000**
Real revenue operating profit	**2,004,771**	**2,301,916**	**7,154,496**	**7,900,000**	**8,900,000**	**10,350,000**
Statutory operating profit	**11,053,080**	**3,224,992**	**(7,397,426)**	**7,900,000**	**7,300,000**	**8,350,000**
Net Expense from discontinued	0	0	0	(175,439)	0	0
Profit in period	**11,053,080**	**3,224,992**	**(7,397,426)**	**7,724,561**	**7,300,000**	**8,350,000**
Non-controlling interests	0	0	(301,608)	(800,000)	(800,000)	(800,000)
Attributable to equity shareholders	**11,053,080**	**3,224,992**	**(7,699,034)**	**6,924,561**	**6,500,000**	**7,550,000**
Profit in period	11,053,080	3,224,992	(7,397,426)	7,724,561	7,300,000	8,350,000
Other com income - FX on consolidation	342,922	681,013	(755,434)	0	0	0
Total com income	11,396,002	3,906,005	(8,152,860)	7,724,561	7,300,000	8,350,000
Number of shares (m)	87.3	97.7	101.4	132	141.0	141.0
Basic EPS (p)	12.66	3.30	(7.59)	5.25	4.61	5.35
Adjusted EPS (p)	**2.30**	**2.36**	**6.76**	**5.38**	**5.74**	**6.77**
DPS (p) - declared	4.00	4.15	4.80	5.00	5.25	5.50
Div cover normalised earnings	0.57	0.57	1.41	1.08	1.09	1.23

Source: GLIF, Edison Investment Research

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