# Blackstone/GSO Loan Financing*

## A good time to buy into CLOs

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| Key details | EUR quote/in € | GBP quote/in £ |
|---|---|---|
| Bloomberg code | BGLF LN | BGLP LN |
| Share price | €0.8700 | 76.75p |
| Last NAV (ex-div) | €0.8720ps | 77.56pps |
| Premium/(discount) | (0.2%) | (1.0%) |
| Market cap | €352.1m | £310.6m |
| Net assets | €352.9m | £313.9m |

Source: Company, Bloomberg. Data as at 1 Aug. 2018. *Current corporate client of Fidante Capital. Each analyst individually certifies, in relation to each security or issuer referred to in this communication, that (1) the views expressed are an accurate reflection of his/her personal views and (2) no part of his/her compensation is linked directly or indirectly to the views so expressed in this communication. This communication contains written material that a third party firm has engaged Fidante Partners Europe Limited (trading as "Fidante Capital") to provide on an ongoing basis. The third party firm has paid Fidante Capital to provide this communication. This communication is made available at the same time to any investment firms who wish to receive it and to the public on www.fidante.com. Accordingly Fidante Capital is of the view that this communication constitutes a "minor non-monetary benefit".

## Executive summary

Blackstone/GSO Loan Financing ('BGLF') is the only listed investment company on the London Stock Exchange that invests in European and US CLOs, the former complying with European CLO risk retention rules. The company is run by an experienced manager, GSO Capital Partners, part of The Blackstone Group ('Blackstone'), in a low cost management structure with ongoing charges of just 0.5%. On top of that, the interests of company's managers are well aligned with investors, since Blackstone holds a substantial proportion of the company's shares.

We think BGLF is currently an attractive opportunity for investors seeking exposure to floating rate fixed income investments since CLOs have historically fared well, even during times of market stress, and the current NAV is significantly below fair value, in our view.

Over the last 18 months, the portfolio NAV has suffered from declining asset spreads which have reduced the value of existing CLOs. This trend has only partially been compensated by rising short-term rates in the US. Going forward we think that spreads are unlikely to compress much further from current levels because the US economy is growing strongly and is likely to experience a slight slowdown starting in 2019. At the same time, the European economy is already experiencing a slowdown. This implies rising spreads for both US and European loans going forward - in fact, asset spreads have increased in the US and Europe over the last month or two, on the back of strong loan issuance - which should have a positive impact on valuations.

Additional uplifts in the portfolio NAV are expected to come through from the refinancing of currently held CLO equity investments at lower rates, which can lead to higher net interest margins (the difference between loan spreads and the cost of borrowed capital). The rated liabilities of several CLO equity investments in the portfolio have already been refinanced, two more may be refinanced later this year, providing substantial upside potential for the BGLF NAV, and further refinancing is possible next year and beyond.

Furthermore, our analysis suggests that the current BGLF share price rating (that is, premium or discount) with respect to the NAV, which has declined from a premium of around 5% to a discount of 0.2% in 2018, is too low. And a fair value model for the share price rating, based on macroeconomic variables and investor sentiment analysis, indicates that by 30 June 2019 the rating could rise back towards previous premium levels.

This substantial upside potential for the NAV and the premium to NAV by the middle of next year is complemented by the good diversification benefits of BGLF in a multi-asset portfolio. Our analysis indicates that the share price of BGLF has low correlation (typically below 0.4) with all asset classes except for global fixed income, and hence even a small addition of BGLF to a portfolio can reduce portfolio risk in a meaningful way.

## The case for BGLF is easy to make

Blackstone/GSO Loan Financing ('BGLF') is an internally-managed, Jersey-domiciled investment company launched in July 2014 and traded on the London Stock Exchange. It invests in a portfolio of CLO equity positions (current leverage 8.5-8.9x), CLO warehouses (current leverage 4x) and a portfolio of directly held, broadly-syndicated European and US loans (current leverage 2.5x). All its investment decisions are made by staff seconded from GSO Capital Partners ('GSO'), the largest issuer and manager of CLOs globally, according to Creditflux.

The **investment case** for BGLF is built up from the following components:

- Loans are an attractive asset class at present, given their floating rate coupons in an environment of rising short-term rates (in the US primarily, but also in the UK), and default rates are still low.
- CLOs have proved to be resilient during volatile (credit) markets, for example during the last financial crisis.
- CLO warehouses also provide leveraged exposures to loan portfolios, in advance of being used as collateral for new CLO issuance.
- The introduction of risk retention rules for CLO issuers in Europe means that originators need to retain exposure to their CLOs, hence the launch of BGLF, which invests in CLOs via the originator, Blackstone/GSO Corporate Funding ('BGCF'). Similar US regulations were repealed earlier this year, though US CLOs will continue to be arranged through BGCF, subject to capital availability.
- By investing in the originator through a fee neutral vehicle, BGLF investors benefit from the cost efficiencies that can be derived from the structuring and issuance of new CLOs, as well as the credit underwriting experience of GSO.
- The current dividend (€0.10 per annum, paid quarterly) equates to a dividend yield of 11.5%. This is an attractive dividend yield compared to most listed structured credit peers, which range from 4.1% to 14.2%, based on share prices reported by Bloomberg.

BGLF has a number of **advantages** in the way it is structured and managed.

**Warehousing** – The managers acquire loans in a CLO warehouse facility before the CLOs are structured, meaning that expenses are saved by not having to pay an investment bank for this service. There is no pressure to ramp portfolios quickly just before the CLOs are structured, with the result that the portfolio's risk-return characteristics are likely to be better. Finally, with the capital already being deployed it can just be rolled into the CLO equity, meaning that BGCF can respond promptly, taking advantage of periods of market dislocation.

**Structuring** – GSO, as one of the largest and most experienced CLO managers, has a good track record in the efficient and flexible structuring of CLOs. Furthermore, costs are reduced as BGCF requires fewer structuring services from investment banks. BGCF controls the scheduling of the CLO issue, as it has self-sourced the majority of the equity, with GSO clients often taking the senior tranches.

**Issuance** – The cost of the CLO liabilities, a critical component of the transaction for CLO equity investors, is determined at launch. The ability to choose the timing of the pricing of a CLO issue is therefore important. GSO has a good track record in obtaining favourable margins on the liabilities versus its peers.

**Steady-state investing** – Other than the cost of the liabilities, the returns from CLOs depend on the performance of the underlying credit portfolio. The performance of GSO-managed CLOs has been strong within the industry, with a track record of low defaults. GSO applies a standardised and robust credit underwriting process for all the BGCF credit exposure.

**Calling of transaction** – Majority control equity investors in CLOs, such as BGCF, can call the CLO once the no-call period is over, in order to refinance the liabilities, re-leverage the transaction and/or crystallise a discount to the intrinsic NAV. BGCF can optimise when existing CLOs are called.

## SWOT analysis

| Strengths | Weaknesses |
|---|---|
| ▪ All credit risk is monitored and controlled by GSO, one of the leading loan managers in the industry<br>▪ Returns from loans benefit from rising interest rates and low default rate environments<br>▪ Long-term realised returns from loans and CLOs have been robust, in normal market conditions and during the last financial crisis<br>▪ No GSO-managed CLOs investing in European loans will be structured outside of BGCF, as long as BGCF can fund the CLO equity investments; BGCF has most favoured status over the terms relating to the acquired CLO equity investments<br>▪ Being exposed to the full life cycle of the CLOs means that returns are enhanced and the full value is captured<br>▪ Annualised dividend yield of 11.5% based on the current share price is sustainable given the current CLO distribution rates<br>▪ Under the AIC methodology, the ongoing charges are 0.5%, as no management fees are charged above the CLO level<br>▪ Substantial investment in BGLF by Blackstone provides investor alignment | ▪ Though a sterling quote was introduced in May 2017, the underlying FX exposure is in Euros and US Dollars and not hedged into Sterling, which may limit the appeal to some UK investors<br>▪ NAV performance can be negatively impacted by asset spread compression, as happened in 2017 and in 2018 so far, in particular for CLOs within their no-call periods; however, NAV performance is expected to improve due to, for example, the effects of CLO refinancings<br>▪ Limited liquidity in the BGLF shares, both for the EUR and GBP share classes, compared to the majority of listed structured credit peers<br>▪ Returns from loans are negatively impacted by falling interest rates and periods of higher default rates |
| **Opportunities** | **Threats** |
| ▪ The CLO warehouse structure allows the managers to take advantage of credit market dislocations and issue new CLOs quickly when the opportunities arise<br>▪ The calling of older CLOs and their refinancing at lower costs of debt will tend to enhance the NAV<br>▪ A drop in LIBOR rates below LIBOR floors, as the assets earn the floor rate and the CLOs pay a lower base rate on their liabilities; however, this is unlikely in the current environment<br>▪ As the only vehicle dedicated to CLO risk retention traded on the London Stock Exchange, BGLF has the potential to achieve significant critical mass, larger than its current market cap of c. €352m | ▪ A rise in realised loan defaults, negatively affecting the performance of the BGCF investments; however, the current expectation for loan default rates remains muted (JP Morgan predicts 2.0% default rates in Europe and the US in 2019); however, loan spreads would tend to widen if defaults picked up<br>▪ An inability to issue new CLOs due to lack of market demand for senior tranches (this has never happened historically)<br>▪ A repeal or otherwise unfavourable changes to the regulations in Europe in relation to risk retention rules; however, further support has been given by the EBA's final draft Regulatory Technical Standards, published on 31 July 2018 |

Source: Fidante Capital. AIC is the Association of Investment Companies.

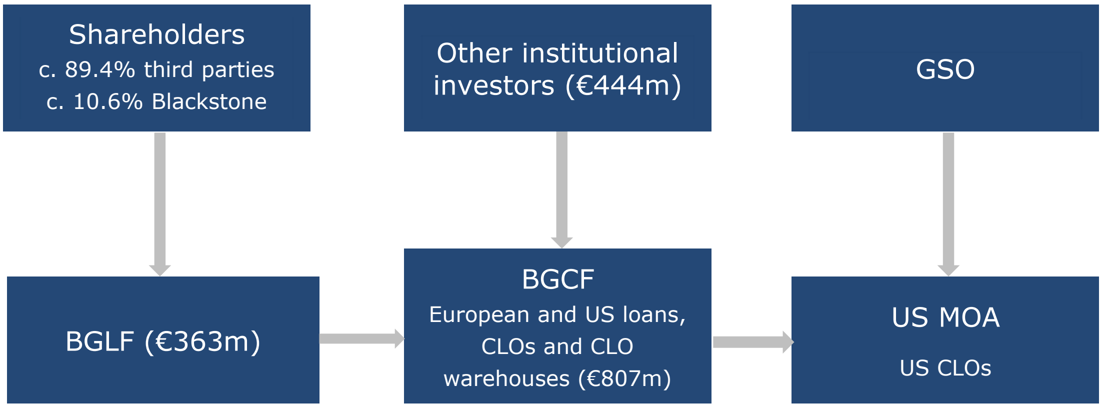
## Understanding the company structure

As previously stated, BGLF invests in BGCF, the risk retention company set up by GSO in order to comply with European risk retention requirements. BGCF can also invest in additional risk retention companies, and for this reason it is exposed to Blackstone / GSO US Corporate Funding, a US Majority Owned Affiliate ('US MOA') set up to obtain exposure to US risk retention compliant CLOs (as was required by the regulations at the time).

There are no management or performance fees at the company level. The company's adviser, Blackstone / GSO Debt Funds Management Europe ('DFME', a part of GSO), earns industry standard management fees (c. 50bps per annum) and performance fees (10bps of the aggregate principal balance of each CLO with an IRR trigger of 12%) on the CLOs it manages, in which BGCF invests. DFME provides a rebate to BGCF of 20% of the management fee it receives, pro rata to the CLO equity investments held by BGCF. The net rebate after costs allocated to BGCF by DFME is at least 10% of the management fees and is expected to meet the majority of the ongoing costs of BGCF and the company.

The key attributes of BGLF are given in the appendix.

**Fig 1:** Company structure



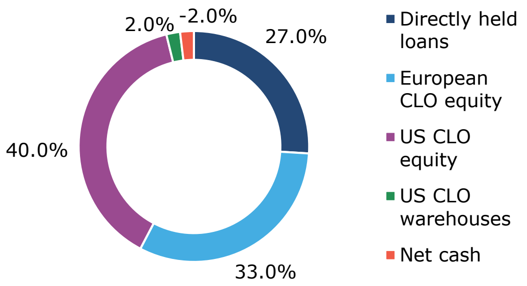

Source: Fidante Capital, Company. The Blackstone ownership will vary over time. BGLF owns c. 44% of BGCF and BCGF owns c. 86% of the US MOA. Numbers in brackets are the net assets as at 30 June 2018.

GSO is the credit platform of The Blackstone Group, one of the largest investment firms in the world with nearly 2,400 employees in 25 offices globally, and assets under management of around $450bn. GSO has c. 340 employees in New York, Dublin, London and Houston, with assets under management of $100bn across alternative investment funds ($60bn) and long-only customised credit strategies ($40bn). GSO has a strong track record managing CLOs in the US, going back to 2000, and in Europe from 2001. CLO performance has been aided by GSO's careful credit selection, which has helped drive down default and loss rates to below index levels.

## Assets, exposures and valuation

BGCF had net assets of c. €813m as at 30 June 2018, with around 44% of the total capital coming from BGLF. Directly held loans (less leverage) constituted 27% of its net asset value, with European and US CLO equity investments together comprising 73% of the net assets. The one US CLO warehouse investment constituted 2% of net assets.

Fig 2: BGCF portfolio allocation (% of net assets)




Source: Fidante Capital, Company. As at 30 June 2018.

BGLF has (par value) investments of €373m in 14 European CLO equity investments and $560m in ten US CLO equity investments. The end of the no-call periods are typically two to three years after the CLOs close, and the end of the re-investment periods are two to three years after that. Annualised distributions for those that have made distributions so far range from 11.5% (Elm Park, closed in May 2016) to 21.4% (Thayer Park, closed in May 2017). Further details of the retained CLO equity positions are given in Fig. 12 in the appendix.

CLOs have been priced at ever tighter levels over recent months and years. Marlay Park, a BGCF investment, closed in March 2018 at EURIBOR+74bps for the AAA tranche, while Cook Park, a US MOA investment, closed in April 2018 at LIBOR+92bps for the AAA tranche. Low discount margins compared to the market have a direct, positive impact on distributions to CLO equity holders. In addition, seven of the CLOs have now passed their no-call dates and been refinanced, at a lower weighted average cost of debt (on average, 1.60% now, as opposed to 2.14% previously). This refinancing had an average month-on-month positive impact on those CLO equity valuations of around 15%.

On a look-through basis, as at 30 June 2018, the BGCF portfolio was invested in 683 issuers, held both directly and indirectly, via CLOs and CLO warehouses. The BGCF portfolio assets were 98.3% senior secured and 97.8% floating rate. The largest country exposure was to the US (55.5%), with smaller exposures to France (8.5%) and Luxembourg (6.9%). The portfolio was well-diversified by sector, with the largest exposure being to Healthcare & Pharma (14.6%) and the top five sectors together making up around 49% of the portfolio.

Fig 3: BGCF portfolio snapshot

| | WA asset coupon | WA liability cost | WA lev. |
|---|---|---|---|
| EUR CLOs | 3.64% | 1.59% | 8.5x |
| US CLOs | 5.20% | 3.57% | 8.9x |
| US CLO warehouses | 5.51% | 3.49% | 4.0x |
| Directly held loans | 3.73% | 1.60% | 2.5x |
| **Total** | **4.30%** | **2.39%** | **7.0x** |

Source: Fidante Capital, Company. "WA" - weighted average; 'lev." - leverage. As at 30 June 2018.

Thomson Reuters provides the monthly, modelled marks for the valuation of the CLO positions within the BGCF portfolio. The valuation of each tranche of the CLOs is individually calculated using granular loan level detail, thorough structural analysis, Moody's Analytics CDOnet library and cash flow engine, scenario analysis (for example, prepayments, defaults and recoveries) and discount rates. The modelled marks for the CLO equity investments reflect the discounted loss-adjusted future cash flow projections using prevailing loan spread assumptions, and do not include the upside valuation potential from refinancing.

# Performance

## NAV, share price and rating

The BGLF total NAV return (in EUR) since launch to the end of June 2018 was 24.5%, which equates to an annualised total return of 5.8%, and the annualised volatility was 3.0%. The low volatility partly reflects the relative illiquidity of the assets held within the BGCF portfolio and consequently the relative importance of mark-to-model valuations, together with the long-term holding periods for these assets and their stability. The rolling 12-month NAV total return peaked at 13.3% in December 2016, but since then NAV performance has been negatively impacted by asset spread compression. One cause of this spread compression has been the refinancing at tighter spreads of the underlying loans, reducing the spread income received from the BGCF portfolio investments.

However, recent spread compression for US loan positions has, to some extent, been offset by base rate increases. For the equity positions of the refinanced CLOs, as stated previously, valuations have been positively impacted by the reduction of the CLO’s liability costs, which have also offset the spread compression experienced by the underlying assets.

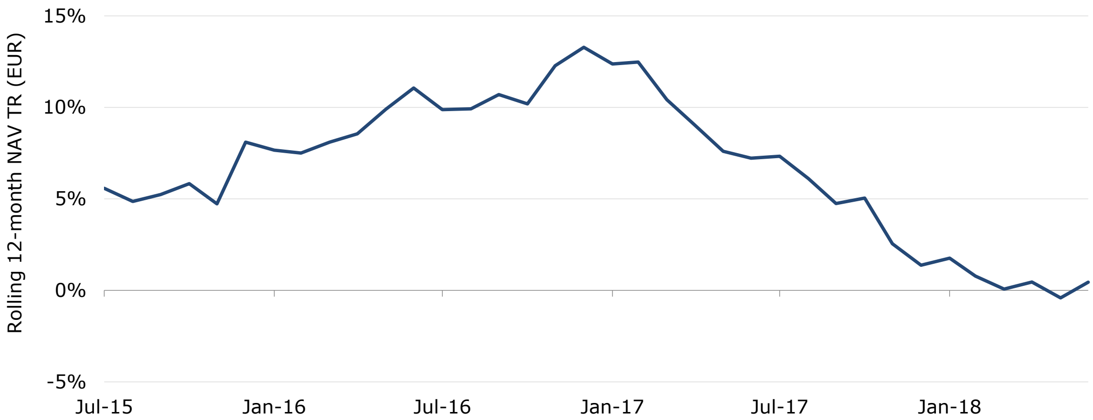
Going forward, we are optimistic that the NAV will start to rise from current levels. This optimism is based on two distinct developments in the US and European loan markets.

In the US, the economy is growing strongly and high yield spreads have tightened, to the lowest levels since the end of the last financial crisis. However, as the fiscal impulse from the recent tax reforms in the US starts to wane, we expect spreads to bottom out in the second half of this year and to rise gradually thereafter (in fact, there are early indications that spreads may have already bottomed out this summer due to strong loan issuance). At the same time, it is likely that the Federal Reserve will continue to gradually increase short-term interest rates. Both these effects should combine to provide more favourable net interest margins and higher valuations.

In Europe, on the other hand, we cannot expect higher short-term interest rates in the next twelve months. But unlike in the US, we do see an economic slowdown from recent cyclical peaks and with it an increase in spreads, which bodes well for European CLO equity going forward. Higher spreads should translate into higher net interest margins and mark-to-market gains for the existing CLO equity investments.

Overall, we expect a gradual increase in the BGLF NAV over the coming twelve months.

**Fig 4:** Rolling 12-month NAV TR for BGLF




Source: Fidante Capital, Company. To 30 June 2018.

**Fig 5:** Modelled BGLF NAV sensitivity to changes in net interest margin (NIM)

| Change in NIM | +0.0% | +0.2% | +0.4% | +0.6% | +0.8% | +1.0% |
|---|---|---|---|---|---|---|
| NAV per share (EUR) | 0.8970 | 0.9382 | 0.9739 | 1.0047 | 1.0424 | 1.0814 |
| NAV per share uplift (EUR) | 0.0000 | 0.0412 | 0.0769 | 0.1077 | 0.1454 | 0.1844 |
| NAV per share uplift (%) | 0.0% | 4.6% | 8.6% | 12.0% | 16.2% | 20.6% |

Source: Fidante Capital, GSO. Based on modelled results provided by GSO. BGLF NAV and BGCF portfolio as at 30 June 2018.

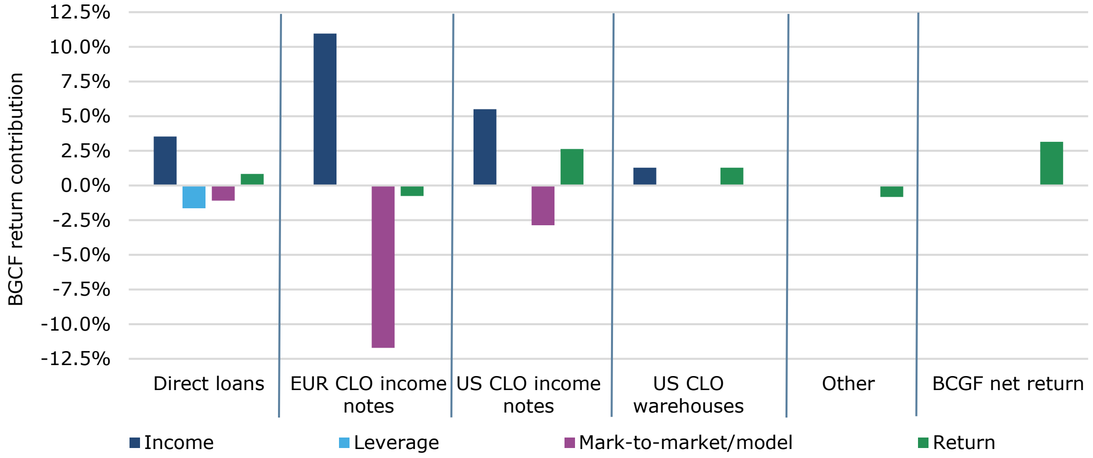
The BGLF NAV sensitivity to changes in the net interest margin has been modelled and is shown in Fig. 5. Analysis carried out by GSO gives the potential movement in CLO valuations for a range of extensions to the re-investment period (up to two years) and a range of changes in net interest margin (up to 1.0%), for CLO equity investments with two years left until the expiry of their re-investment periods. For the portfolio as at 30 June 2018, valuation uplifts across the 24 CLO equity investments are derived (using the par values of the CLO investments), interpolating linearly (a good approximation for the non-linear relationship) between the discrete re-investment period data points provided by GSO, for net interest margins ranging from 0.0% to 1.0%. The valuation gain is then scaled down by the exposure to CLO equity investments in the BGCF portfolio (73% as at 30 June 2018).

Modelling the potential negative impact on the BGLF NAV coming from other market factors, such as loan default and recovery rates, is a complex process. Instead of presenting such analysis, we believe it is better to look at historical evidence and examine the experience with two CLOs (one in Europe and one in the US) managed by current GSO entities that were launched back in 2007, just before the last financial crisis. In the immediate aftermath of the crisis, loan defaults in Europe and the US peaked at more than 12%, much higher than the current expectations of 2.0% from JP Morgan for 2019. The equity distributions for the European CLO were diminished (but still positive) in 2009 but recovered in 2010, and the US CLO equity distributions were not impacted at all.

The contributions to the BGCF net return between the start of 2017 and the end of Q2 2018 (c. 3.2%) are shown in Fig. 6. They confirm that while income, across all the assets held in the portfolio, contributed around 21.3%, the negative impact from the mark-to-market on the CLO equity investments was c. -14.6%. Smaller negative contributions came from the cost of leverage for the directly held loan portfolio (-1.6%), mark-to-market movements on these loans (-1.1%), and other net contributions of -0.8% (these include expenses, FX effects and rebates paid to BGCF).

Since inception and up to the end of Q1 2018, the fee rebate paid to BGCF contributed c. 7.7% of BGCF's cumulative return, or around 0.5% on the NAV per year. The actual contribution from the rebate over the 15-month period from the start of 2017 was around 0.8% on the NAV.

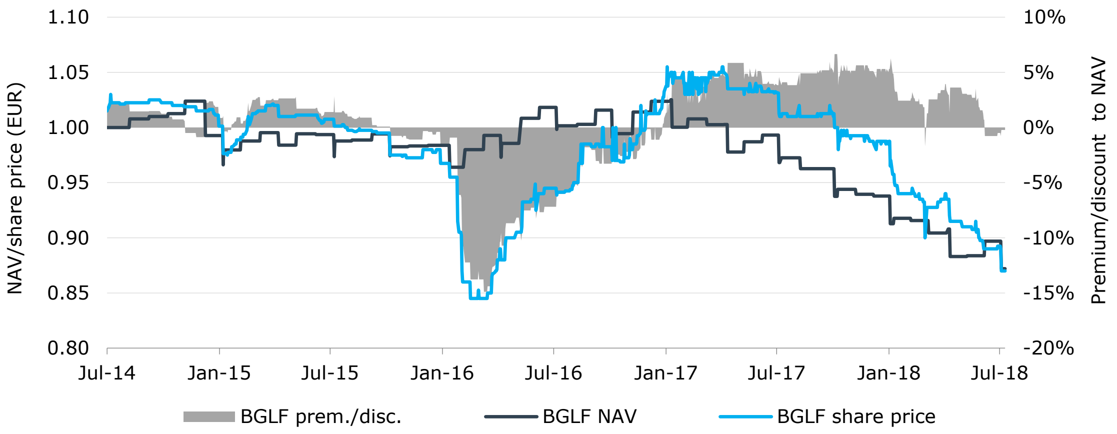
**Fig 6:** Contributions to BGCF performance




Source: Fidante Capital, Company. Aggregated over 2017 and Q2 2018.

The company's EUR-quoted shares traded largely at a premium to NAV for most of the period to the end of 2015. A wide discount approaching 15% opened up during H1 2016 as a result of risk aversion in the markets and technical pressures on the share price, which subsequently narrowed with the help of share buybacks (during June 2016, c. €6.3m (£4.9m) worth of shares were repurchased) and improving market sentiment. The discount closed by the end of 2016 and since then shares have traded almost continuously at a premium, averaging c. 3.7%. The EUR-quoted shares are currently trading at a 0.2% discount to the NAV as at 30 June 2018.

**Fig 7:** BGLF share price premium/discount




Source: Fidante Capital, Company, Bloomberg. From 22 July 2014 to 1 August 2018.

## Is the premium justified?

Given the fact that the EUR-quoted shares have traded at an average 3.7% premium to NAV since the start of 2017, investors may be wondering whether this premium is justified, or whether shares could be trading lower in the future.

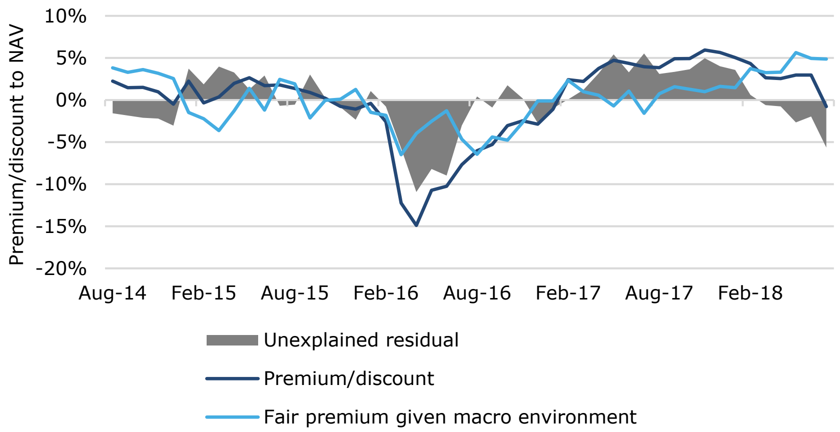
In order to address this question, we have analysed the BGLF premium and discount to NAV as a function of the prevailing economic conditions in the Eurozone and the US. Short-term interest rates in the Eurozone have been at or below zero for several years now and the European Central Bank (ECB) has indicated that the first rate hike is only likely to materialise in mid-2019. At the same time, the ECB has announced it will stop purchasing government bonds at the end of this year, which may put some upward pressure on long-term bond yields in the Eurozone. In the US, on the other hand, the Fed is expected to gradually hike short-term rates while long-term rates are likely to remain range-bound.

These interest rate developments, together with the prevailing inflation outlook and economic growth, will undoubtedly influence investor sentiment over the next twelve months or so. In order to calculate the impact of changing interest rates, inflation expectations and economic growth on the premium/discount to NAV of BGLF, we have run a regression model that enables us to determine the share of the premium/discount that can be explained by these factors. This regression analysis is able to explain about half of the variation in premium/discount to NAV over time and indicates that, as at 30 June 2018, the rating was not justified. It was, in fact, perhaps too low. Our analysis shows that the unexplained part of the premium/discount was around -5.6%, indicating that it could have been more than five percentage points higher. This suggests that investors may have become too sceptical about BGLF, with the result that the rating may have declined by too much.

Our model also allows us to calculate a fair premium/discount with respect to the NAV given the expected changes in interest rates. We have taken Bloomberg consensus estimates for 3-month and 10-year yields in mid-2019 (i.e. in twelve months from 30 June 2018), as well as estimates for inflation, and used these to predict the rating in the twelve months following 30 June 2018. Because there is no twelve-month forecast for Eurozone and US PMIs (the indicators we use to assess business climate and growth), we assume a cooling off of European and US growth towards 10-year averages.

Given these inputs, our model estimates a fair premium to NAV for BGLF in mid-2019 of 6.1%, or 6.9% above the end of June 2018 level. This is at the upper end of the historical range of premiums to NAV for BGLF, in October 2017. This estimate confirms that the current rating (a 0.2% discount) is probably too low and investors should anticipate a c. 6% rating increase.

Fig 8: Explainable and unexplainable parts of the BGLF share price premium/discount to NAV



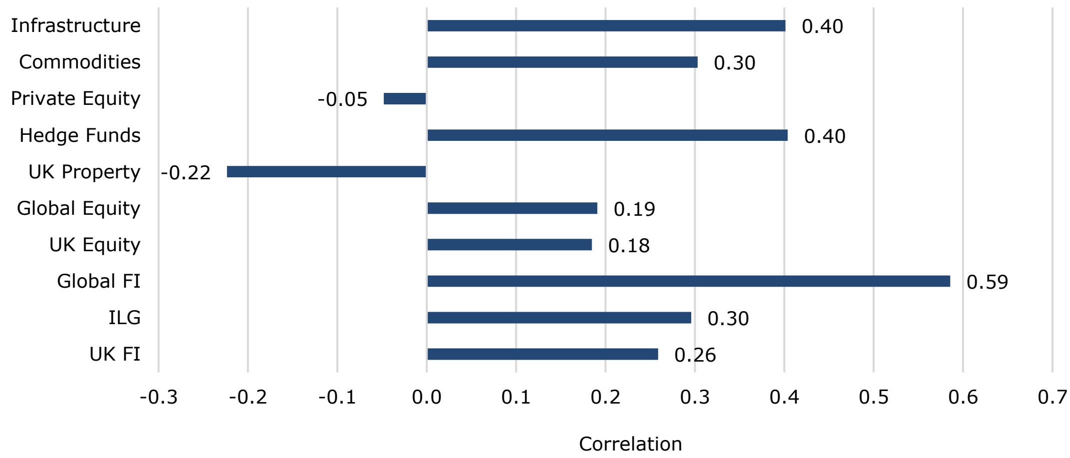

Source: Fidante Capital, Company, Bloomberg. From 22 July 2014 to 30 June 2018.

## BGLF in a portfolio context

Chief Investment Officers, asset allocators and portfolio managers also need to understand how BGLF will behave in a portfolio context. While it is impossible to assess the exact impact an addition of BGLF has on each individual portfolio, we can provide some general insights. In order to do this, we will take the viewpoint of a Sterling-based institutional investor who adds BGLF to their portfolio without hedging currency risks. Some investors may prefer to hedge currency risks in order to reduce the volatility of BGLF from a Sterling perspective, but we use an unhedged exposure to provide a conservative estimate of the diversification benefits of BGLF including all potential risk factors.

Fig. 9 shows the correlation of BGLF with other asset classes commonly invested in by institutional investors. With the exception of global fixed income, the correlation between BGLF and other asset classes is always below 0.4. Correlations are particularly low, or even negative, with equity markets, private equity and UK property investments. This indicates that allocating even small amounts of the portfolio to BGLF has the potential to enhance the risk-return-profile of the portfolio and provide some downside protection when equity markets decline.

**Fig 9:** Correlation of BGLF with other asset classes




Source: Bloomberg, Fidante Capital. Global FI = Global fixed income; ILG = Inflation-linked Gilts; UK FI = UK fixed income.

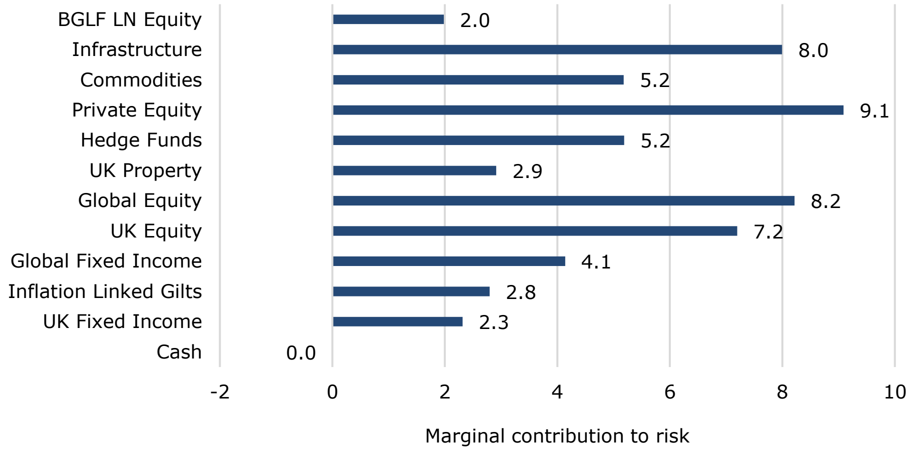
Historically (i.e. going back to July 2014), allocating 1% of the portfolio to BGLF would have reduced the maximum drawdown of a UK equity portfolio by 20bps and the VaR (95% probability, one month time horizon) by 5bps. To assess the impact of BGLF in a multi-asset portfolio, we use the average asset allocation of UK pension funds as published by UBS in July 2017. This average UK pension fund portfolio was invested 45% in equities, 37% in fixed income investments (out of which 32% is Sterling fixed income) and 16% in alternative assets (see Fig. 14 in the appendix for a detailed asset allocation). Allocating 1% of the portfolio to this portfolio while proportionally reducing all the other asset classes would lead to a 10bps reduction in maximum drawdown.

Of course, asset allocators do not reduce all asset classes proportionally in order to add a new investment. They typically choose one asset class to reduce in order to increase the allocation to another asset. In order to help investors with this task, we have calculated the marginal contribution to risk of each asset class in the average UK pension fund. Fig. 10 shows the impact of a 1% increase in the allocation to each asset class and BGLF. For example, if an investor shifts 1% of cash into BGLF the expected increase in portfolio volatility is 2bps (top bar of Fig. 10).

If, on the other hand, the investor chooses to reduce to sell 1% of their global fixed income investments in favour of BGLF, then the portfolio volatility is expected to decline by 2.1bps. This is the net effect of a reduction in portfolio volatility by 4.1bps from the sale of the global fixed income investments and an increase of portfolio volatility of 2bps from the investment in BGLF.

This analysis shows that the potential to diversify portfolio risk with a small allocation in BGLF can be meaningful and that the contribution to portfolio risk from BGLF is typically substantially lower than adding other fixed income or alternative investments.

Fig 10: Marginal contribution to portfolio risk




Source: Fidante Capital.

## Summary

BGLF is, in our view, an attractive investment for a wide range of investors. Income oriented investors can benefit from a dividend yield of 11.5%, one of the highest amongst listed structured credit peers and significantly higher than what can be achieved in other yield-oriented investments. Investors looking for high quality companies with good management and a relatively high level of security should be aware that BGLF is currently the only UK-listed investment trust that satisfies European risk retention rules, which substantially reduces the risk of moral hazard. Also, GSO is not only the biggest but also one of the most experienced CLO managers in the world, with a 17-year track record sourcing European loan deals.

Finally, asset allocators can find in BGLF an investment that has very low correlation to equities, other alternative investments and UK fixed income investments. Adding BGLF to an existing multi-asset portfolio has the potential to meaningfully reduce portfolio risk while keeping the overall expected return and income from the portfolio at high levels.

We have also shown that the current rating for BGLF shares is too low and should be about two percentage points higher than current levels. Given the current consensus outlook for interest rates, inflation and economic growth, we expect the rating to increase to a premium of more than 6% by the middle of 2019.

# Appendix

Fig 11: Key attributes of the company

| Attribute | |
|---|---|
| **Company name** | Blackstone / GSO Loan Financing Limited |
| **Sector** | Alternative income – structured credit |
| **Listing** | Initial admission 22 July 2014 (London Stock Exchange/Specialist Fund Segment); moved to London Stock Exchange/Premium Segment from 29 June 2017 |
| **Domicile** | Jersey |
| **Base currency** | EUR |
| **Share quote** | EUR since IPO; in addition, GBP from 29 June 2017 |
| **Management** | Blackstone / GSO Debt Funds Management Europe ('DFME') is the company's adviser; GSO advises Blackstone / GSO Corporate Funding ('BGCF') on credit; independent non-executive board |
| **Investment objective** | To provide shareholders with stable and growing income returns and to grow the capital value of the investment portfolio by exposure predominantly to floating rate senior secured loans held directly and indirectly through CLO securities; investment objective to be achieved through exposure to BGCF |
| **Target performance** | Mid-teens net total return per annum; predominantly dividend income |
| **Dividends** | Target 10% p.a. (on the €1.00 per share IPO issue price); paid quarterly |
| **Gearing** | None at the company level; currently 2.5x for senior secured loans (with term finance); currently 8.5-9.0x for CLO equity; currently 4.0x for externally-financed CLO warehouses |
| **FX hedging** | Non-EUR underlying FX exposures hedged into EUR |
| **Fees** | No management or performance fees at the company level; DFME earns an industry standard c. 50bps management fee and a performance fee of 10bps of the aggregate principal balance of each CLO with an IRR trigger of 12% |
| **Fee rebates** | BGCF receives a rebate of the CLO management fees pro rata to the CLO investment held (20% on horizontal strips); GSO charges costs to BGCF; the net rebate after these costs is expected to meet the majority of the ongoing annual expenses of BGCF and the Company |
| **Ongoing charges*** | 0.5% of NAV (operating expenses in 2017) |
| **Reporting** | December year-end; monthly NAV estimates |
| **Discount management** | The directors may, at their discretion, repurchase shares when the average discount is more than 7.5% over rolling six month periods |
| **Life** | Unlimited |
| **Board** | Charlotte Valeur (Chair), Gary Clark (Chair of the Remuneration and Nomination Committee and the NAV Review Committee); Heather MacCallum (Chair of the Audit Committee); Steven Wilderspin (Chair of the Risk Committee); all directors non-executive |
| **Website** | www/blackstone.com/bglf |

Source: Fidante Capital, Company. *Ratio to average net assets.

Fig 12: Retained CLO equity investments

| | Close | Refi. close | RP left (years) | Deal size (m) | Equity tranche (m) | Position (% of tranche) | Dist. (ann.) | Dist. (cum.) |
|---|---|---|---|---|---|---|---|---|
| **EUR CLOs** | | | **2.0** | **€6,077** | **€640** | **58.5%** | **15.4%** | **34.5%** |
| Phoenix Park | Jul-14 | Jan-17 | 0.1 | €413 | €45.3 | 51.4% | 17.5% | 65.8% |
| Sorrento Park | Oct-14 | May-17 | 0.4 | €517 | €57.0 | 51.8% | 18.2% | 65.1% |
| Castle Park | Dec-14 | Mar-17 | 0.5 | €415 | €46.0 | 80.4% | 17.8% | 59.0% |
| Dartry Park | Mar-15 | Jul-17 | 0.8 | €411 | €44.6 | 51.1% | 15.7% | 49.0% |
| Orwell Park | Jun-15 | Aug-17 | 1.1 | €415 | €47.5 | 51.0% | 16.8% | 48.3% |
| Tymon Park | Dec-15 | Jan-18 | 1.6 | €414 | €44.5 | 51.0% | 14.8% | 34.6% |
| Elm Park | May-16 | Apr-18 | 1.8 | €558 | €56.9 | 56.1% | 11.5% | 21.6% |
| Griffith Park | Sep-16 | *Oct-18* | 2.2 | €454 | €48.7 | 59.5% | 11.7% | 18.7% |
| Clarinda Park | Nov-16 | *Nov-18* | 2.4 | €415 | €45.1 | 51.2% | 11.6% | 17.4% |
| Palmerston Park | Apr-17 | *Apr-19* | 2.8 | €415 | €45.0 | 62.2% | 15.6% | 15.9% |
| Clontarf Park | Jul-17 | *Aug-19* | 3.1 | €414 | €43.3 | 66.9% | 14.4% | 11.7% |
| Willow Park | Nov-17 | *Jan-20* | 4.0 | €412 | €38.4 | 60.9% | 19.5% | 7.3% |
| Marlay Park | Mar-18 | *Apr-20* | 3.8 | €413 | €41.0 | 60.0% | n/a | n/a |
| Milltown Park | Jun-18 | *Jul-20* | 4.0 | €411 | €37.1 | 65.0% | n/a | n/a |
| **US CLOs** | | | **3.9** | **$7,915** | **$910** | **60.8%** | **18.1%** | **17.9%** |
| Dorchester Park | Feb-15 | *Jan-17* | 0.6 | $533 | $66.4 | 73.0% | 15.2% | 47.8% |
| Grippen Park | Mar-17 | *Apr-19* | 3.8 | $611 | $59.4 | 60.0% | 12.6% | 13.8% |
| Thayer Park | May-17 | *Apr-19* | 3.8 | $515 | $54.6 | 54.6% | 21.4% | 19.8% |
| Catskill Park | May-17 | *Apr-19* | 3.8 | $1,029 | $108.5 | 60.0% | 19.5% | 18.0% |
| Dewolf Park | Aug-17 | *Oct-19* | 4.3 | $614 | $61.5 | 60.0% | 19.1% | 12.0% |
| Gilbert Park | Oct-17 | *Oct-19* | 4.3 | $1,022 | $102.0 | 59.0% | 19.2% | 9.1% |
| Long Point Park | Dec-17 | *Jan-20* | 4.6 | $611 | $58.7 | 56.9% | n/a | n/a |
| Stewart Park | Jan-18 | *Jan-20* | 4.5 | $881 | $183.9 | 69.0% | 19.4% | 4.7% |
| Greenwood Park | Mar-18 | *Jan-20* | 4.8 | $1,074 | $107.6 | 59.1% | n/a | n/a |
| Cook Park | Apr-18 | *Apr-20* | 4.8 | $1,025 | $107.0 | 56.1% | n/a | n/a |
| **Average** | | | **3.1** | | | **59.6%** | **16.7%** | **26.2%** |

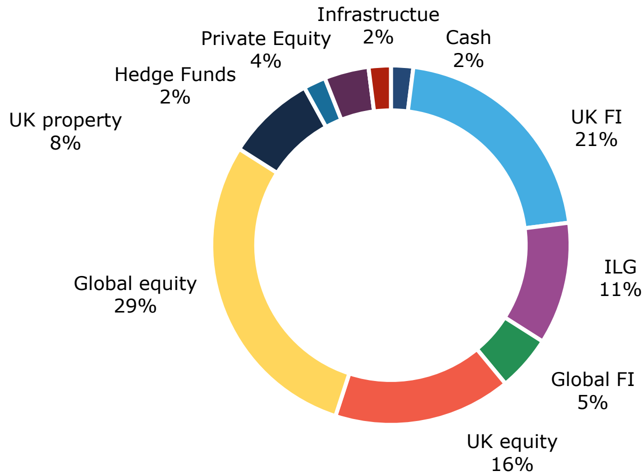
Source: Fidante Capital, Company. Future refinancing eligibility dates given in italics. "RP" – re-investment period. Sums for US CLOs converted at the FX rate as at 30 June 2018.

**Fig 13:** BGLF monthly NAV total return (%, EUR)

| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Ann |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2014 | | | | | | | | 0.78 | 0.21 | 0.26 | 1.12 | -3.05 | -0.73 |
| 2015 | 1.36 | 0.82 | 0.76 | 0.86 | 1.05 | -0.07 | 1.42 | 0.09 | 0.57 | 0.83 | 0.07 | 0.07 | 8.11 |
| 2016 | 0.95 | 0.67 | 1.32 | 1.28 | 2.31 | 0.98 | 0.34 | 0.13 | 1.28 | 0.37 | 1.96 | 0.97 | 13.29 |
| 2017 | 0.14 | 0.76 | -0.53 | 0.02 | 0.95 | 0.63 | 0.44 | -1.01 | -0.02 | 0.65 | -0.46 | -0.18 | 1.38 |
| 2018 | 0.52 | -0.21 | -1.23 | 0.40 | 0.08 | 1.50 | | | | | | | 1.04 |

Source: Fidante Capital, Company. If upfront costs had been paid at the IPO, the December 2014 and 2014 returns would have been -0.95% and 1.42%, respectively.

**Fig 14:** Average asset allocation of UK pension funds




Source: UBS Pension Fund Indicators 2017. As at July 2017.

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