MARTEN & CO

Initiation | Investment Companies

17 November 2015

GLI Alternative Finance

Sector	Debt
Ticker	GLAF
Base Currency	GBP
Price	102.25
NAV	100.18 *
Premium / (Discount)	2.1%
Yield %	8% (target)

* NAV as at 31/10/15

Off and running

GLI Alternative Finance (GLAF) IPO'd on 23 September 2015 with assets of £52m. One month later the issue proceeds were fully invested. The first monthly dividend will be declared in November for payment in December (the target is an annualised 8% yield on the issue price). The company is eager to grow and has a pipeline of investments that would allow it to deploy fresh capital quickly.

Attractive risk adjusted returns from SME loans

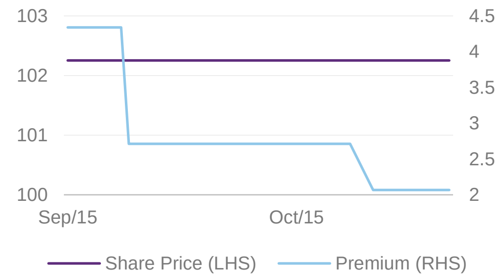
GLAF's investment objective is to provide its shareholders with attractive risk adjusted returns through investment, principally via GLI Finance's platforms, in a range of SME loan assets, diversified by way of asset class, geography and duration. GLAF may invest directly or indirectly into available opportunities, including by making investments in, or acquiring interests held by, third party alternative lending platforms and other lending related opportunities as identified by the Manager in accordance with the company's investment policy.

Conflict of Interest

With this sponsored research, it is important to bear in mind that Marten & Co is being paid to write research by GLI Alternative Finance. However we have an additional conflict in this case as one of the authors of this note, James Carthew, is also a director of GLI Finance Limited. Nevertheless, as always, we have tried to make the note as balanced as possible, giving you the information you need to make your own mind up. James was excluded from the editing process.

Share price and premium

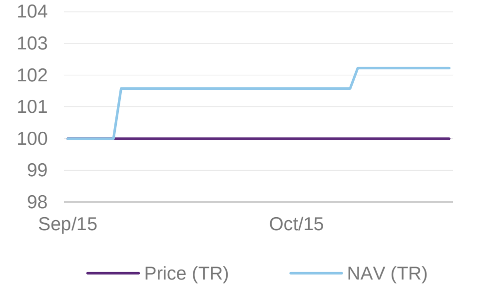
Time period 23/09/15 to 13/11/15



Source: Morningstar and Marten & Co

Performance from launch

Time period 23/09/15 to 13/11/15



Source: Marten & Co

Domicile	UK
Inception Date	23/09/15
Manager	GLI Asset Management
Market Cap (mlns)	53.8
Shares Outstanding	52.66m
Trading Volume	No data
Net Gearing	Nil

Contents

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GLI's first fund

GLAF is the first product launched by GLI Asset Management Limited (GLIAM or the Manager), a wholly owned subsidiary of AIM listed, GLI Finance (GLI).

GLI is invested in a range of twenty online lending platforms, matching providers of finance to borrowers, typically small and medium sized enterprises (SMEs). The platforms are growing fast and need finance and GLIAM and GLAF were created to help meet part of that need. To succeed and attract new investors GLAF needs to perform and so GLI has every incentive to make the fund work.

Straightforward loan portfolio, low management charge, no performance fee, regular redemption opportunity, monthly dividends

GLAF's privileged access to GLI's online lending platforms gives it greater clarity over its investment pipeline and more insight into the day-to-day performance of its portfolio than is available to GLAF's competitors. GLI is keen that the fund succeed and so they say they set out to design a fund that was as shareholder friendly as possible. Features unique to GLAF within its peer group are its focus on loans rather than loans plus equity, low management charge, no performance fee, regular redemption opportunity (post March 2017) and monthly dividends.

A lot simpler than it looks

GLAF is the fourth online lending fund to be launched (see pages 5 and 6 for an explanation of online lending) and, at the moment, the smallest – though it has big ambitions. This note goes into the detail of how the fund works and is managed.

At a first glance, GLAF might look quite complicated but in reality it is simply lending money to small and medium sized companies and deducting a relatively small fee to cover its running expenses before passing the interest back to GLAF shareholders in the form of dividends and modest capital growth.

Unlike the other funds in its peer group (which we examine on page 18), GLAF is not taking equity stakes in the online lending platforms. This removes one potential source of return but also a potentially quite considerable source of risk.

Investing through 20 strong network of online lending platforms

The complications in GLAF's structure, such as they are, arise from the manager's efforts to diversify the portfolio, using its 20 strong network of online lending platforms; the intention to hedge GLAF's currency exposure, to give investors one less thing to worry about; the decision to offer investors a regular exit; and GLI Finance's large stake in the fund, which meant that the fund had to be listed on the London Stock Exchange's Specialist Funds Market – this situation is intended to be temporary but, as we explain in the Corporate Structure section, need not put anyone off investing in the fund in the meantime.

As we'll outline later in the note, GLI's platforms are growing fast. GLAF is already fully invested and, although it has other sources of finance to draw on, GLI is keen that GLAF expands to help meet the platforms' demand for capital. That means a programme of "C share" issues – we explain how these work later in the note but they are designed in a way so that existing investors are unaffected by new issues, except that they should enhance the liquidity of GLAF's shares and spread the company's fixed costs over a wider base.

The online lending market

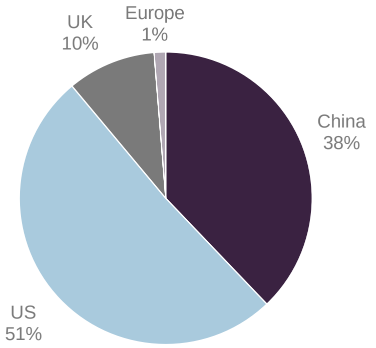
Online lending, alternative finance or peer to peer lending – all much the same thing

The online lending market brings together providers of capital with borrowers, outside of the traditional banking system. A large number of platforms have been launched which match lenders and borrowers in an auction process that aim to secure the best available rate for both lender and borrower. For the earliest platforms, both lenders and borrowers were individuals and so the industry became known as peer-to-peer lending. Today that moniker is increasingly looking outdated as platforms turn to institutional sources of finance, including funds like GLAF, to support their pace of growth.

Many within the industry, including this fund, have adopted the label "alternative finance". Over time though, these forms of lending should become more mainstream than alternative as existing players are joined by "old-fashioned" finance companies. We have used the term "online lending" to describe the industry, which encapsulates one of the main aims of the industry – to streamline the process of servicing the end borrower, slashing the cost of customer acquisition and loan administration and, crucially, speeding up the process relative to a traditional loan.

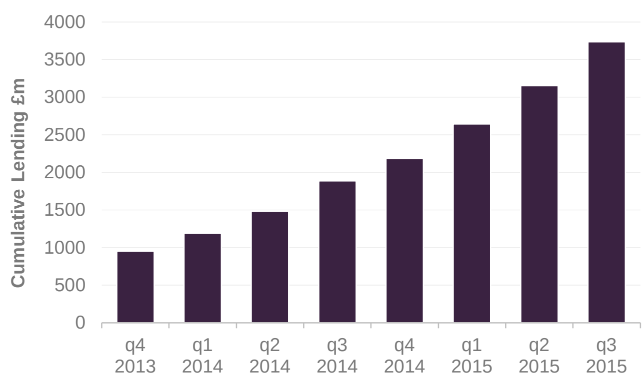
The online lending market is a global one – There is some dispute about whether China or the US is the largest market. The numbers in Figure 1 are based on a research report from Morgan Stanley. The Chinese market is dominated by short-term finance so loan origination is probably much higher. Europe is just getting started but AltFi data suggests that it is growing at 156% compound annually as at the end of September 2015.

Figure 1: Global online lending market



Source: Morgan Stanley, AltFi and Marten & Co

Figure 2: Growth of online lending market in the UK



Source: P2P Finance Association

Figure 2 illustrates the growth of the online lending market in the UK based on numbers published by the peer to peer finance association (a grouping of some of the largest platforms in the UK, comprising Zopa, Funding Circle, RateSetter, Market Invoice, LendInvest, Thincats, LendingWorks and Landbay). The figures show cumulative lending since the platforms were founded. The stock of outstanding loans on these platforms at the end of September 2015 was £1.874bn. These were financed by 225,064 borrowers and loans were outstanding to 121,441 borrowers. Net lending to consumers in Q3 2015 was £130m, net lending to SMEs £91m and net lending against property £30m.

The British Banking Association reckons outstanding loans to SMEs in the UK were about £110bn at the end of June 2015. The unmet need for finance is much harder to estimate though. Although they say they approve over 80% of all loans, there are no figures for how many businesses that would like credit but are not applying for it for fear of being turned down by their bank.

In the US the industry is dominated by Lending Club, SoFi and Prosper which major on consumer lending, notably credit card and student loan refinancing and auto loans.

New platforms are springing up all the time. Consumer loans still dominate the industry but, as banks have reined in lending, small and medium sized enterprises (SMEs) are increasingly turning to the online lending market for finance and this part of the sector is growing rapidly.

Online lenders try to simplify and speed up the process of lending

The banking industry has long struggled with disjointed legacy IT systems and complicated, bureaucratic credit approval processes. Couple this with a need to rebuild balance sheets in the aftermath of the bursting of the credit bubble and it is perhaps unsurprising that many SMEs find securing finance frustrating. Tales of spending months in a credit approval process only to be turned down at the last minute are commonplace. We have the lowest base rates in history yet many companies are still paying exorbitant rates of interest and companies that don't fit neatly within a bank's credit scoring model may struggle to find finance at all.

Due diligence and strong regulation are key to increasing investors' confidence

Given the buzz around the industry, it was bound to attract some less than salubrious players and this is one reason why GLI puts great emphasis on the due diligence it has carried out and the monitoring it undertakes on its platforms.

In the UK, after requests from GLI and others, the FCA has taken responsibility for regulating the industry. In the US, the Treasury is collecting responses on its "*Request for Information on Expanding Access to Credit through Online Marketplace Lending*". In China, alarmed by a number of frauds, the authorities are starting to clamp down on the industry. GLI think regulation is to be welcomed, it will increase investors' comfort with the industry and is a part of the growing up process that the industry needs to go through before it becomes truly mainstream. Hopefully it will also prevent abuses like those that seem to have occurred at Trustbuddy, Europe's first listed platform. It seems to have comingled client money with that of the platform and, allegedly, some has gone missing. GLI believes comingling should be banned and this is not a feature of any of its platforms.

Online lending funds aim to take the hassle out of lending for individual investors

As the industry moved beyond its initial growth phase, it became apparent to many platforms that corralling enough individual investors to match the demand for loans was hard work. At the same time, institutions started to notice the attractive rates of return available and enquired about accessing the platforms as lenders. Individuals lending money through the platforms also started to realise that, if they wanted to diversify their portfolio across a number of platforms, it was going to be a full-time job just to keep on top of loan maturities and monitoring auctions, let alone doing detailed due diligence on a platform before investing through it. The funds that have listed in London over the past year or so aim to take the hassle out of lending, increase diversification for lenders and pay attractive dividends. London is ahead of the game in this to date but we expect to see similar vehicles launched in other markets.

From a practical point of view, these assets sit much more comfortably in a closed ended fund than an open-ended one. Some of the loans in these portfolios are of relatively short duration but there is no real secondary market in them. If anyone tries to launch a similar open-ended fund, we would be extremely wary of it.

About GLI Finance

GLI lends money to SMEs through platforms it invests in

Figure 3: GLI's family of online lending platforms

Source: GLI Finance and Marten & Co

GLI Finance (GLI) has a somewhat complex history but, in essence, started off life in 2005 as a provider of credit, predominantly to US borrowers. It did this via a structure known as a CLO. Towards the end of November 2012, GLI began a transformation of it business by acquiring a specialist lending business, BMS Finance, and then began a programme of investments into a range of online lending businesses focused on the SME sector but diversified by type of lending and geography. GLI exited the last of its CLO business earlier this year. The graphic in Figure 3 illustrates the shape of GLI's operations today.

You can read more about the individual platforms on pages 17 and 18.

Often, part of the finance for these businesses comes from GLI but, as they grow, the amount of capital they require is expanding rapidly. GLI got approval for its asset management business in June 2015. It is intended that the funds it manages will, in future, provide a significant proportion of the funding needs of its platforms and GLI hopes that GLAF will be a core part of GLI Asset Management (GLIAM)'s business.

GLIAM's team

Graham Glass is managing director of GLI Asset Management Limited. Graham has over twenty years' experience of investment in debt instruments as a fund manager including eight years with Generali, first in Guernsey and then in Paris where he managed over €30bn of assets. Latterly he was Head of Fixed Income at City Financial and a member of their investment management committee.

The Credit Committee

The Credit Committee comprises Geoff Miller, CEO of GLI Finance; Emma Stubbs, CFO of GLI Finance; Marc Krombach, managing director of GLI Finance; and Andrew Whelan, group director of lending at GLI Finance and CEO of Sancus.

Geoff Miller spent twenty years in the UK financial services industry, as an analyst and as a fund manager, focused within the Non-Bank Financials sector. He moved offshore in 2007, working in Moscow and Singapore before moving to Guernsey. He took the reins at GLI Finance in 2009, initially as chairman, now chief executive officer. Geoff sits on the Boards of each of the platform companies.

Andrew Whelan has over 25 years investment experience and is a Chartered Fellow of the CISI. Andrew started his career with Morgan Grenfell in 1987 and also worked for Kleinwort Benson, part of the Dresdner Private Banking Group, where he was a member of the Dresdner Private Banking Senior Investment Committee. He joined Liberty Ermitage in 2001 and was a founding partner of Ermitage Group following its MBO in 2006. Andrew left Ermitage in April 2012 to join International Asset Monitor as managing director to create a new Jersey Branch. Andrew has won numerous investment awards during his investment career.

Marc Krombach has spent 28 years in the Guernsey Banking sector. He was head of treasury at Investec from 2009 to September 2014 where he was also a member of the bank's leadership team. From 2000 to 2005 he was head of treasury at Hamburgische Landesbank and from 1995 to 2000 was based at Kleinwort Benson in charge of running their foreign exchange desk. Prior to this Marc spent five years at Chase Bank as a corporate treasury dealer as well as administrative roles at Hanson Bank.

Emma Stubbs was head of business analysis and projects at Sportingbet, an online gaming company from January 2007 to October 2013. From November 2004 to January 2007 Emma worked as an account manager at Marsh Management Services (Guernsey) Limited, a captive insurance company. Emma qualified as a Chartered Certified Accountant with Deloitte in Guernsey in July 2004.

The demand for credit

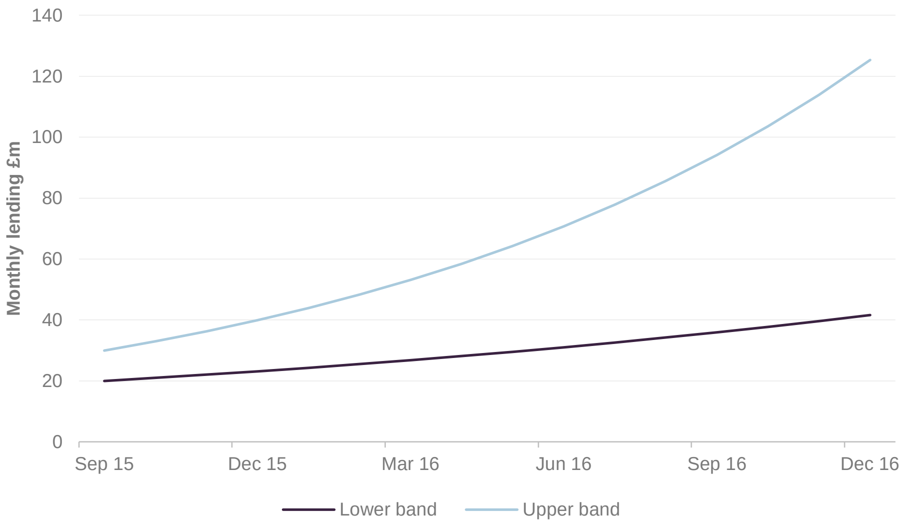
GLI Finance reported 45% year-on-year growth in the number of new loans made across its platforms over the twelve months to the end of June 2015. The average value of those loans rose by 52% year-on-year. These numbers translate into new loans of £227m over the year to the end of June.

GLAF was originally targeting £200m and some investors questioned whether GLI's platforms were of sufficient scale to absorb all of this money; we believe this is one reason why GLAF ended up launching with just £52m. That £52m was fully deployed within one month.

£20m-£30m of new loans a month growing at 5% to 10%

We won't have much concrete evidence on whether the pace of growth across all of GLI's platforms is sustained or even accelerates over the remainder of 2015 and into 2016 until it announces its results next Spring. However GLAF has announced that GLI's platforms are originating between £20m and £30m of new loans each month and GLIAM expects these volumes to grow between 5% and 10% per month. Figure 4 shows what this could look like in practice.

Figure 4: GLI estimates of monthly demand for loans on its platforms



Source: GLI Asset Management and Marten & Co

We can also point to snippets of information such as Trade River's website saying it is experiencing 34% growth in the number of transactions it is processing over a month. Finexkap saying it funded €1m of loans in 10 days in October and that it just signed a referral deal with CSOEC (French equivalent of the ICAEW) and AltFi saying Platform Black lent £5.8m in September which it described as "a notable uptick in activity".

In addition, as we describe later, GLAF can invest through non-GLI platforms.

How GLAF is managed

Credit approval

GLI closely monitors the activities and processes of its platforms

GLI has conducted extensive due diligence on the platforms and their credit approval processes, with the aim of ensuring their internal controls matched or exceeded the requirements of the Guernsey Financial Services Commission, GLI's regulator, before making investments in them. Post-acquisition, aided by having rights to information and a Board seat on each platform, GLI closely monitors the platforms, their processes and the development of their lending book. If rising default rates on a particular platform cause concern or, in the opinion of the manager, a platform's internal processes are inadequate, all new lending on that platform stops until it has rectified the situation.

All loans offered to GLAF are reviewed by the Manager and are subject to the Manager's approval prior to funding. The review process is designed to enhance the underwriting processes and procedures carried out by the platforms rather than duplicate them.

All loans are checked but bigger loans attract more scrutiny

For small loans (under £100,000 or equivalent in another currency), generally the due diligence on the loan is outsourced to the underlying platform. The Manager may undertake additional checks if the loan is unusual or if the industry segment, the business' financial track record or the principals of the business, merit a more formal review. In these cases, the Manager will refer the loan to its credit committee.

The online lending process is designed to be as efficient as possible but also robust. Potential borrowers are subject to credit checks against publicly-sourced data, are contacted directly and, depending on the nature of the business and / or beyond a certain loan size, are interviewed before they are allowed to borrow money.

Apart from certain loans that the Manager believes are low risk (because they have very high levels of collateral), loans between £100,000 and £500,000, and any series of loans that might exceed £100,000 are reviewed by the Manager's credit committee of the Manager formally, in addition to the due diligence undertaken by the Platform. All loans greater than £500,000 are reviewed by the credit committee.

GLAF is allowed to make loans through platforms that aren't part of the GLI family. First though, the Manager would have to satisfy themselves that the credit approval processes and internal controls of these platforms are up to scratch. GLIAM has already identified a number of suitable platforms.

Monitoring loans and platforms

Regular monitoring of platforms

The Manager is able to monitor the performance and shape of the portfolio in real time. The Manager undertakes regular internal audits on the platform's processes as part of its business risk assessments, to ensure that each Investee Platform continues to maintain adequate procedures and that their internal policies continue to be followed to the appropriate standard. In addition, as we mentioned above, the Manager gets regular, detailed information on the development of each platform's loan book.

Defaults

GLIAM tell us the industry has experienced historic default rates of 3%-4% for invoice finance and 1%-2% for term lending and Geoff Miller is on record as saying that these could double in times of stress.

In the event of a default, the underlying platform will take charge of the recovery process but GLIAM will be notified and will monitor progress. The recovery rates will vary by platform. GLIAM points out that loans originated by Sancus have high levels of collateral, BMS has only experienced one loss it in its history and FundingKnight has had high recovery rates on the defaults it has experienced to date.

Managing conflicts

GLAF gets to cherry pick the loans it wants

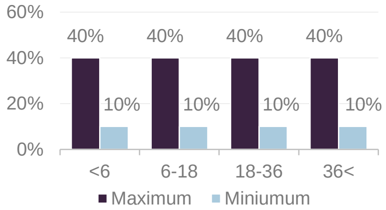
As GLAF and GLI are both buying loans from the platforms, there is obviously a potential for a conflict of interest to occur. To address this squarely, clients of GLIAM (currently just GLAF) have first refusal of any loan offered to GLI. The Managers talked us through an example of a large loan, secured against property, which suited GLAF but was too large for the portfolio. GLAF financed as much as they were comfortable with and GLI Finance financed the balance.

When GLIAM has more than one client whose investment criteria would allow them to invest in the same loans, the loans will be allocated between them on a pro-rata basis.

Risk controls

- GLAF will have no more than 70% of its gross assets invested in UK loan assets and at least 30% invested in loan assets from other jurisdictions around the world.
- Between 10% and 40% of gross assets will be invested in loan assets where the duration to maturity of the loan asset is less than six months; between 10% and 40% with a duration to maturity between six months and 18 months; between 10% and 40% in the 18 month to 36 month range and 10% to 40% in loan assets where the duration to maturity is 36 months or longer.
- No more than half of gross assets will be invested in unsecured loan assets.
- Loans to platforms, to provide them with working capital, will not exceed 5% of gross assets.
- Each of the top ten individual credit risks will not exceed 2.5% of gross assets and, outside the top ten, no more than 1% of gross assets.
- GLAF is investing mainly in loans but may, on occasion, end up with equity in businesses (if equity kickers form part of the loan structure for example). In these cases no value will be ascribed to the equity portion when determining whether the loan meets GLAF's target risk / return objectives. The equity will form part of the portfolio and will be managed by the Manager.

Figure 5: Target maturity split



Source: GLI Alternative Finance

Existing portfolio

GLAF was able to deploy its capital quickly by acquiring a block of loans from GLI immediately after launch. To this group of 55 separate loans worth £39.9m, made mostly to UK borrowers and ranging in value between £35,000 and £9.5m, has been added a second portfolio of loans worth £4.7m and yielding close to 10%, which they bought off GLI and Sancus.

Fully invested within a month

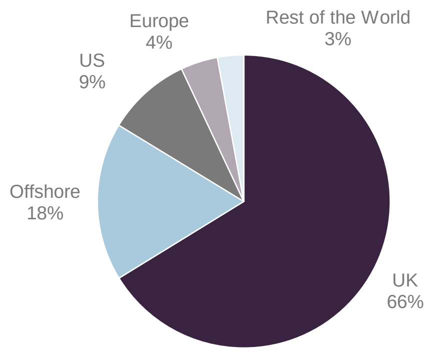
On 23 October 2015, one month after launch, GLAF announced it was fully invested. GLAF also announced that one of the loans it bought on the first day was too large a part of the portfolio (the trade was pre-arranged when it was hoped GLAF would be larger). This was rectified by selling down part of the loan. Other adjustments were made around the same time so that GLAF had 13% of its portfolio in cash at the end October but is reinvesting that now.

We understand GLAF holds around 200 loans sourced from a range of GLI's platforms and the gross income yield on the portfolio is around 8.5%.

GLAF is unable, because of data protection laws and restrictive covenants in loan agreements, to disclose the names of its borrowers. This is not ideal for shareholders who want to know where their money is invested but GLIAM has told us that they will publish as much information as they can about the nature of these exposures to give shareholders a better sense of what is in the portfolio.

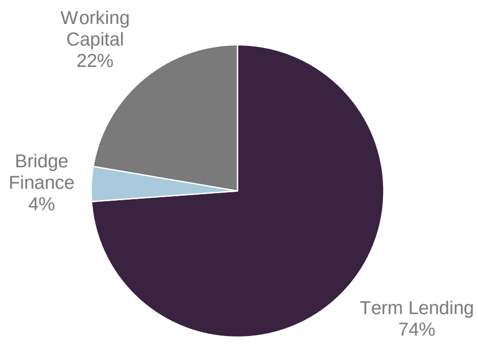
GLAF is publishing monthly factsheets. The latest has data as at 31 October 2015. Figures 6,7,8,9 and 10 are based on the information in that factsheet.

Figure 6: Geographic allocation at 31/10/15



Source: GLI Alternative Finance

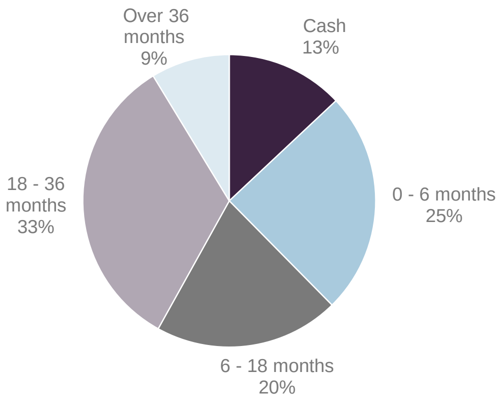
Figure 7: Breakdown by loan type at 31/10/15



Source: GLI Alternative Finance

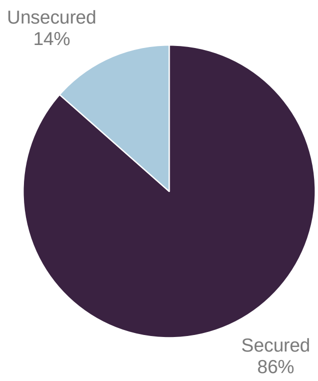
For the avoidance of doubt, we understand that "working capital" here relates to short-term finance such as invoice finance rather than working capital provided to platforms which, as you can see in Figure 10 below, was 3.9% of the portfolio at the end of October.

Figure 8: Breakdown by loan duration at 31/10/15



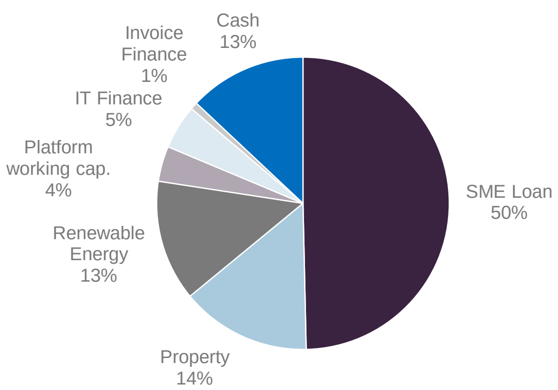
Source: GLI Alternative Finance

Figure 9: Breakdown by security at 31/10/15



Source: GLI Alternative Finance

Figure 10: Allocation by borrower type at 31/10/15



Source: GLI Alternative Finance

With respect to the top ten loans at 31 October 2015, GLAF disclosed the interest rates receivable on these which ranged between 8% and 10.5% and the maturity which ranged between 04/12/15 and 28/09/18.

GLAF reports that the exposure to renewable energy rose during October as they financed two wind turbines. They say these loans generate gross yields of approximately 10%. Other new loans in the month included a loan made to a cemetery / funeral business where the loan was backed by personal guarantees equivalent to ten times the loan value and they agreed to underwrite loans for a highly profitable software development company.

As at the date of this report GLAF had no gearing but it has powers to borrow up to 150% of net asset value (see hedging / gearing section on page 14).

Dividends

8% dividend target, paid monthly

GLAF will distribute at least 85 per cent. of its distributable income earned in each financial year by way of dividends. GLAF is targeting a net dividend yield of 8.0 per cent. per annum on its original £1 issue price. It will pay monthly dividends, with the first dividend expected to be declared in November 2015, covering income earned to the end of October, and this will be paid in December.

Fees

075% on first £100m and 0.5% thereafter

GLI Alternative Finance's charging structure is simpler and less expensive than competing funds (see the Peer Group section below). The management charge is 0.75% per annum on the first £100m of assets and 0.5% on the balance and there is no performance fee.

Elysium Fund Management Limited is the Administrator. They got a one-off fee of £25,000 immediately after listing. There is an annual administration fee of £100,000 per annum payable quarterly in arrears. This will increase annually in line with the change in the RPI index. GLAF will also pay the Administrator a time-based fee for placing, settlement and associated administration of investment transactions.

Butterfield Bank (Guernsey) is the Custodian. They get a fee of 0.02% of gross assets up to £250m, 0.015% on the next £250m and 0.01% thereafter with a minimum fee of £25,000. A transaction fee of £100 per lodgement or withdrawal of a loan document is also payable by GLAF.

It is also worth remembering that, like its peers, GLAF invests through platforms and as part of the auction process (see page 5 for discussion) the platforms earn a spread on the transaction (between the rates that borrowers are prepared to borrow at and lenders are prepared to lend at). These spreads vary between platforms will typically be between 1 and 2%. GLAF is investing on the same terms as any other lender on a platform.

Capital Structure and Trust Life

GLAF has a relatively simple corporate structure with just one class of ordinary shares listed on the Specialist Funds Market (SFM) of the London Stock Exchange (LSE). There are currently 52.66m shares in issue.

GLI holds 76.9% of GLAF but intends to reduce this.

GLAF is listed on the SFM because GLI held, at issue, 76.9% of GLAF's shares. GLI's intention is to reduce the percentage it holds as new investors buy into GLAF. Once GLAF's free float is sufficiently large, its Board will consider moving the listing to the main market of the LSE.

Suitability for retail investors

GLI says GLAF is suitable for retail investors but they should consider consulting a financial adviser

The original issue was designed to be suitable for institutional investors and professionally-advised private investors GLAF says its shares may also be suitable for non-advised private investors who are capable of evaluating the risks and merits of such an investment and who have sufficient resources to bear any loss which may result from such an investment though they suggest these investors may wish to consult an independent financial adviser before investing.

GLAF is not an NMPI

The LSE does not offer advice on or regulate which particular clients can invest in funds listed on its SFM. The SFM has guidance describing the complexities of securities on that market. There is also guidance that those funds should be targeting institutional, professional and highly knowledgeable investors.

It was originally intended that GLAF would list on the main market of the LSE and offer its shares to the general public. It would have done so except that GLI Finance ended up being a much bigger shareholder in GLAF than originally intended and this forced an SFM listing. With that caveat, that the fund has a large controlling shareholder, GLAF is in other respects the same fund as would have listed on the main market. In addition, under the FCA's regulations, GLAF has said that it is not a Non-Mainstream Pooled Investment (NMPI). This means that, in the regulator's eyes, GLAF is suitable for retail investors.

GLAF can be held in an ISA or a SIPP subject to your choice of provider.

Not covered by the Financial Services Compensation Scheme

Investors should bear in mind though that an investment in GLAF or any of the listed online lending funds is not the same as a bank deposit and it is not covered by the Financial Services Compensation Scheme.

Future C shares

C shares designed to protect existing investors

The Board of GLAF intends that the fund will expand through issues of C shares. C shares are a different class of shares from ordinary shares. The C shares have their own portfolio while the money raised by issuing them is invested. When the Board judges that the C share portfolio is sufficiently invested, the C share portfolio will be merged with the normal portfolio and the C shares converted into ordinary shares (using a formula based on their respective net asset values). The reason for doing this is to avoid the returns that the original shareholders earn from their portfolio being diluted by a huge injection of cash and them having to bear the costs of investing that cash. Increasing the size of the fund should help increase liquidity in the fund's shares and reduce its ongoing expenses ratio as fixed costs are shared over a wider base.

Hedging / Gearing

GLAF is permitted to borrow up to 150% of its net asset value (in line with P2P Global and VPC Speciality Lending, other funds in its peer group). This is calculated on a look-through basis including any borrowings on the underlying portfolio. Part of the attraction of leveraging the fund is to enhance returns for shareholders but they also plan to use leverage to hedge the fund's US dollar and Euro currency exposures.

GLAF had no hedging or gearing at the end of September 2015. Negotiations are ongoing with regards to leverage for the Fund

If they don't use borrowings to hedge the currency exposure, they have the option of using currency swaps, futures, options and other derivative contracts but borrowing against the currency exposure is more flexible and is GLAF's preferred method.

Premium / Discount management

Aim to keep the shares trading close to asset value

The Board wants GLAF to trade close to net asset value, so investors don't have to worry about big premiums unwinding or large discounts emerging. GLAF has powers to issue up to 200 million shares at any time up to its first Annual General Meeting and so clearly has ample headroom to manage the premium by issuing stock. The directors don't want new issues to have an impact on existing investors however (except to the extent that they benefit from increased liquidity and a lower ongoing charges ratio as fixed expenses are spread over a wider base). This is why they intend to issue C shares rather than tap issues. The C shares have the added benefit for ordinary shareholders in that they are effectively issued at asset value plus the costs related to that issue. – so there is no chance of ordinary shareholders having their net asset value diluted. For this reason, GLAF has been able to disapply pre-emption rights on the new shares. Meaning that they don't have to be offered first to existing investors – this makes them cheaper to issue.

GLAF has powers to buy back up to 14.99% of its shares and will use this to help manage any short-term discount. Shares will be held in Treasury and reissued at net asset value or higher.

Redemption facility

Regular six-monthly redemption opportunities at 0.5% discount for up to 20% from March 2017

Every six months from 31 March 2017 shareholders will, if the Board decides, be offered the chance to redeem all or part of their holding. The first redemption was delayed until 2017 to give the fund time to expand before potentially shrinking again. The plan is to try to find matching buyers for these shares but, failing this, the shares will be redeemed at a 0.5% discount to net asset value at the month end before the redemption date. The maximum number of shares redeemed will be 20% of the shares in issue and so, if redemption requests exceed this figure, selling shareholders may be scaled back. Selling shareholders will get their cash within 90 days – giving the Manager time to raise the cash from the portfolio.

Continuation / Discontinuation

Continuation vote if trades at wide discount

GLAF has an unlimited life. However, if the ordinary shares trade at wider than a 10% discount for three consecutive months (calculated on a rolling three monthly average of daily numbers), a general meeting will be held at which shareholders will be asked if they want the company to continue. If shareholders approve continuation then GLAF doesn't need to hold a similar vote for another year.

The Board

All the board members are non-executive, independent of the manager and were appointed just prior to the listing of the fund.

Figure 11: Board members

Heading	Position	Fee (£)	Shareholding
Norman Crighton	Chairman	35,000	20,000
Richard Hills	Chairman of Audit and Valuation Committee	30,000	
David Stevenson	Director	25,000	10,000
Nick Brind	Director	25,000	

Source: GLI Alternative Finance

Norman Crighton (aged 49) (Chairman)

Norman was, until May 2011, an investment manager at Metage Capital Limited where he was responsible for the management of a portfolio of closed-ended funds and has more than 22 years' experience in closed-ended funds having worked at Olliff and Partners, LCF Edmond de Rothschild, Merrill Lynch, Jefferies International Limited and latterly Metage Capital Limited. His experience covers analysis and research as well as sales and corporate finance. Norman is the chairman of Weiss Korea Opportunity Fund and a non-executive director of Private Equity Investor plc and Global Fixed Income Realisation Limited.

Richard Hills (aged 60)

Richard has substantial investment experience, having held senior positions at major fund management houses and a number of non-executive directorships at investment companies, both public and private, covering all the major asset classes with significant experience within the natural resources sector including shale gas, forestry and potash. Richard also built and sold his own investment management company and has been involved in a number of start-up situations including FairFX, a prepaid currency card provider. He chairs the Aztec Group Ltd, which is one of the largest Channel Islands private equity fund administrators. He is currently chairman of Strategic Equity Capital plc and Henderson Global Trust plc and a director of JPMorgan Income & Capital Trust plc.

David Stevenson (aged 49)

David is a financial journalist and commentator for a number of leading publications including The Financial Times (the Adventurous Investor), Investment Week (The Contrarian), Money Week and the Investors Chronicle. He is also executive director of www.altfi.com, which focusses on covering major trends in marketplace lending, crowd funding and working capital provision for small to medium sized enterprises. David is also the author of a number of books on investment and was a director at The Rocket Science Group and before that a senior producer in business and science in BBC TV.

Nick Brind (aged 43)

Nick is a partner of Polar Capital LLP and has over 21 years' investment experience focussing, more recently, on the equity and debt securities of financial services companies globally but also across many other asset classes. Previously he worked for HIM Capital, which was acquired by Polar Capital in 2010, New Star Asset Management, Exeter Asset Management and Capel-Cure Myers. He has invested extensively in the investment trust sector over that period having previously managed funds that invested significantly in the sector. Nick has a Masters in Finance from London Business School.

GLI's platforms

The UK Term Lenders

In the UK, FundingKnight provides loans for SMEs of up to £1m. They aim to turn these around within 21 days but nevertheless they apply some fairly rigorous underwriting standards including a telephone interview with every borrower. They recently introduced property bridging loans and funding for green energy projects. Borrowers come to them directly but they also are brought business by introducers.

Finpoint and Funding Options are "neutral platforms" that connect borrowers with a choice of multiple lenders. Finpoint has a deal with Leeds City Enterprise Partnership, helping to streamline loan applications for its members. It also is partnering with the National Association of Commercial Finance Brokers to offer their members a white label platform. Both firms are on the shortlist for designation as Neutral Finance Platforms by HM Treasury. The winning platforms would automatically be referred loans that the major UK banks had turned down. The size of this opportunity is considerable. The British Business Bank reckons that most SMEs will only consider the major banks when applying for a loan and 50% of applications are turned down.

Proplend offers secured property lending. BMS Finance offers bespoke loans to businesses that don't fit neatly into the credit scoring models of most lenders, including many that aren't profitable. Sancus targets offshore financial centres and has operations now in Jersey, Guernsey and Gibraltar and significant expansion plans. It offers loans to asset rich but cash constrained borrowers.

The US Term Lenders

LiftForward offers term loans from $10,000 to $1m to US SMEs, promising a maximum 48 hour turnaround. It operates in partnership with a number of businesses including Microsoft Stores. OpenEnergy provides between $0.5m and $10m in non-recourse debt financing for solar projects and promises to turn around applications within 30 days. Raiseworks offers loans from $10,000 to $250,000 and reckons it can turn round loan applications in 24 to 48 hours.

Short-term Finance

Platform Black is a UK based invoice finance company. SMEs that are owed money by creditworthy businesses can quickly turn their outstanding invoices into cash. Verus 360 is part of the Bibby group of companies. It is offering SMEs a product akin to an overdraft facility. Finexkap is also offering invoice finance services in France, Danske Factura Bors in Denmark and The Credit Junction in the US. Platform Black, Finexkap and The Credit Junction are also taking advantage of the opportunity of managing supply chain finance, where a big firm's debts to its suppliers are handled by the platform. The firm can lengthen its payment terms but the suppliers get paid much sooner. MyTriple A offers invoice finance but is also set up to offer insurance guaranteed loans and non-guaranteed loans (which come at higher interest rates) to SMEs in Spain, Ovamba facilitates secured, short-term (less than six months) loans to borrowers in Cameroon and is expanding its operations into nearby countries in West Africa

Trade Finance

Trade River and Trade River USA operate with similar business models. They help SMEs engaging in cross-border deals. Sellers and exporters get paid faster, importers and buyers can delay payments, improving their working capital position.

Other

UK Bond Network helps SMEs create high yield fixed rate bonds tailored to their needs. Their main focus is on businesses looking to borrow between £0.5m and £4m over one to three years. The bonds are auctioned through UK Bond Network's website. Crowdshed is a crowdfunding and online lending platform.

Peer Group

Collectively, the four listed online lending investment companies have assets of £1.4bn. No two funds are identical. In this section we explain a bit about how GLAF relates to its competitors.

Looking at Figure 12, the most obvious difference is in GLAF's fee structure. Factoring in performance fees, Investors in the competing funds are paying a significant multiple of the fee charged to GLAF, which potentially puts the fees on the competing funds amongst the highest in the UK closed-end fund industry. The other funds are charging a 1% base fee and then 15%, in the case of P2P and VSL and 10%, in the case of RDL of the total NAV return generated by the fund, subject to a high watermark but not a hurdle.

Figure 12: Comparing GLI Alternative Finance with the three existing listed online loan finance companies

Heading	Net Assets £m	Yield target	Impact of management fees on £50m fund delivering 10% return	Investment focus	Premium/ (Discount) to NAV
GLI Alternative Finance	52.4	8%	0.75%	Global SME	2.1
P2P Global Investments	872.4	6%-8%	2.5%	Global consumer and SME	(3.7) / (2.8)*
VPC Speciality Lending	383.0	8%	2.5%	Global consumer and SME	(2.5) / (5.4)*
Ranger Direct Lending	136.3	10%	2.0%	Global SME and consumer	2.3

Source: Morningstar, Marten & Co. based on prospectus information and factsheets provided by the platforms and RNS announcements. *Note: Ordinary shares / C-shares.

The second difference is GLAF's focus on SME lending. All the other funds include an element of consumer lending which we believe has a different risk profile to SME lending.

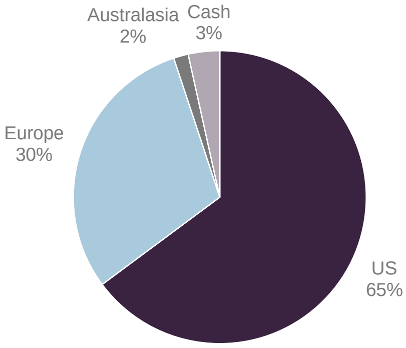
All of the funds aim to take stakes in some of the platforms they lend through except for GLAF where GLI holds the investment. The equity exposure in the competing funds is only a small part of their portfolios however. GLI's thinking when establishing GLAF was that, rather than creating a hybrid vehicle, investors who wanted the risk and rewards of investing in platform equity (and they are not a one way bet) could invest in GLI while investors who wanted an investment more akin to a high rate long-term deposit, could invest in GLAF.

P2P Global

As you can see from the charts below (which show data as at 30 September 2015), P2P Global ("P2P"), the largest fund in the peer group has a strong bias to consumer loans and to the US. It is targeting returns in the range of 6% to 8% and, at the end of September At the end of September 2015, it had generated a return for 2015 of 5.19% which is 6.92% annualised.

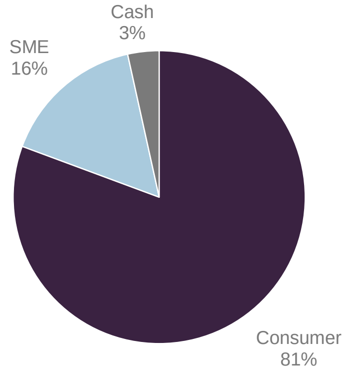
P2P had £476m of assets in its ordinary share portfolio invested as shown in Figures 13 and 14.

Figure 13: P2P Ord geographic split



Source: P2P Global

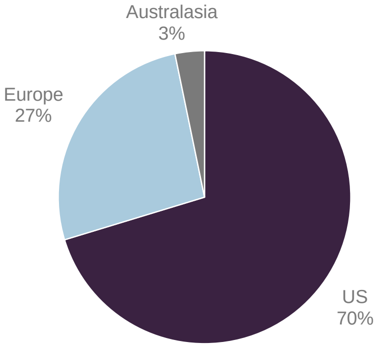
Figure14: P2P Ord loan type split



Source: P2P Global

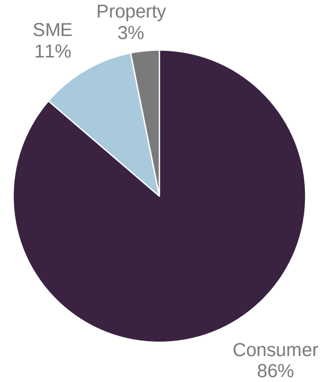
The C share portfolio was 20% invested at the end of September. The split of the invested portion is shown in Figures 15 and 16.

Figure 15: P2P C share geographic split



Source: P2P Global

Figure 16: P2P C share loan type split



Source: P2P Global

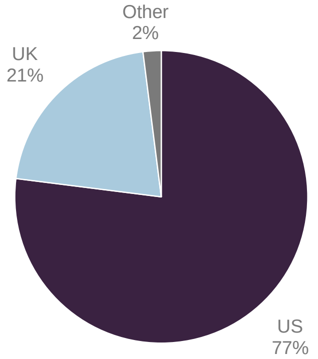
3.5% of the Ordinary share portfolio was invested in equity, options, warrants or convertibles issued by platforms.

VPC Speciality Lending Investments

Figures 17 and 18 show the breakdown of VPC Speciality Lending ("VSL")'s Ordinary share portfolio as at the end of September. Again there is a bias to US and consumer lending but VSL has more SME lending than P2P.

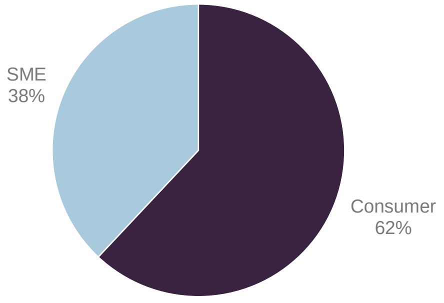
VSL is targeting annual returns of 8%. Its Ordinary share portfolio returned 3.60% from inception on 17 March 2015 to the end of September. Annualising its returns for the quarter to the end of September gives a figure of 7.64%.

Figure 17: VSL Ord geographic split



Source: VPC Speciality Lending

Figure 18: VSL Ord loan type split



Source: VPC Speciality Lending

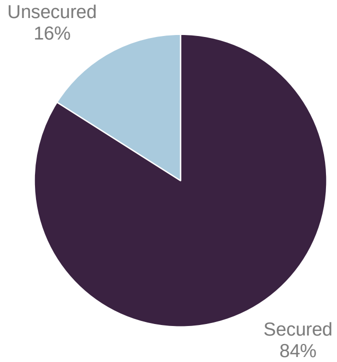
Ranger Direct Lending

Ranger Direct Lending ("RDL") listed on 1 May 2015. At 11 November 2015 it had only deployed 77% of the money it raised and did not anticipate being fully invested until early December.

Figures 19 and 20 have some information on its portfolio at the end of September 2015. It doesn't disclose the geographic breakdown of its investments on its monthly factsheets but it does show the split between secured and unsecured loans.

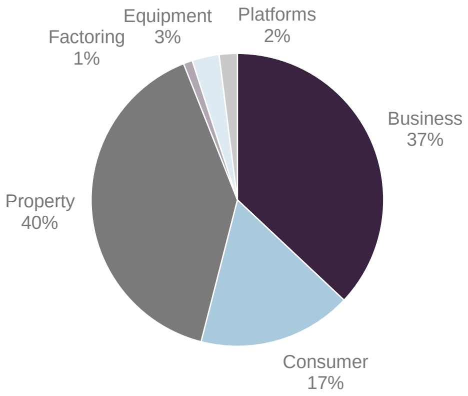
RDL has the closest asset allocation to that of GLAF although it does have 17% exposure to consumer loans.

Figure 19: RDL security split



Source: Ranger Direct Lending

Figure 20: RDL loan type split



Source: Ranger Direct Lending

RDL's returns reflect the relatively low exposure to loans in the portfolio. At end of October it had generated a net asset value return of 1.4% since launch – some way off its 10% target.

You can access up to date performance information on the debt sector on our website. Further information can be found on GLI Alternative Finance at the company's website www.glialternativefinance.com.

MARTEN & CO

Authorised and regulated by the Financial Conduct Authority
123a Kings Road, London SW3 4PL
0203 691 9430

www.martenandco.com

Registered in England & Wales number 07981621,
135a Munster Road, London SW6 6DD

Edward Marten
(em@martenandco.com)

James Carthew
(jc@martenandco.com)

Matthew Read
(mr@martenandco.com)