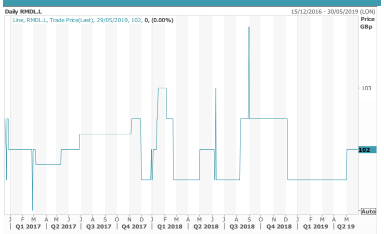
Premium Equity Closed Ended Investment Funds



Source: Refinitiv

Market data

EPIC/TKR	**RMDL / RMDZ**
Price (p)	**102/103.5**
12m High (p)	104.0
12m Low (p)	100.2
Shares (m)	112.20
Mkt Cap (£m)	114
NAV per ord. shr. (p)	98.95
Free Float*	100%
Market	LSE Equity Inv. Instruments

Description

RMDL aims to generate attractive and regular dividends through investment in debt instruments that are backed by real assets, led by exceptional management teams and that usually demonstrate high cashflow visibility.

Company information

Chairman	Norman Crighton
NED	Guy Heald
NED	Marlene Wood
Inv. Mgr.	RM
CIO	James Robson
Co. Manager	Pietro Nicholls
AIFM	IFM

Tel no (RM) +44 131 6037060
http://rmdl.co.uk

Key shareholders

CCLA	18%
Quilter	13%
Merian	13%%
Brooks MacDonald	5%
Hawksmoor	5%
CG AM	4%
Charles Taylor	3%
RM (Inv. Mgr.)	0.8%

Diary

Mid-Jun	May Factsheet

Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

RM SECURED DIRECT LENDING

Predictable revenue streams generating high yield

RM Secured Direct Lending (RMDL) offers investors an ongoing *ca.*6.5% dividend yield, whose sustainability is supported by multi-year assets, a rising revenue yield and economies of scale. Credit, we believe, is well controlled, and we provide readers with a detailed review of its assessment, monitoring and recovery. We believe the gearing level is appropriate, the investment manager's interests are aligned to shareholders, and that any discount will be actively managed. Like any lender, there are risks when the cycle turns; also, RMDL has some junior debt positions, and its book has shown a propensity to turn over, which in the future could see more external refinancing. The shares trade at a 3% premium to NAV.

- **Strategy:** RMDL operates where competition is moderate. Complex loans of £2m-£10m fall outside high-street banks' model-driven approach and are too small for market-driven competition. This, good service, structuring skills, well-developed origination and exploiting illiquidity, see RMDL deliver good returns.

- **Confidence in NAV:** RMDL has 44% of its book Level 2 accounted (significant market observable inputs), backing confidence that its NAV is real. It does not have legacy issues around historical loss situations, and the gain on its warrant sale shows an accounting conservatism. Mazars is the independent valuer.

- **Valuation:** RMDL trades at a small premium to NAV and to its closest peers' average. As well as the factors above, we estimate further equity issues at a premium to NAV will enhance current shareholders by 1%. RMDL has not seen a major loss and has no discount for uncertainty over loan realisable values.

- **Risks:** Credit remains key for any lender, and we examine in detail the investment manager's approach. We think the right approaches to limit both the probability of default and loss, given default, are in place. The book has shown a surprising propensity to turn over. There are modest currency and key personnel risks.

- **Investment summary:** Debt investment companies offer investors a different asset class with which to generate substantial yields on a sustainable basis from long-term assets with predictable income streams. Like any lending business, credit needs to be correctly assessed, and managed once drawn down and recovered. RMDL has all these characteristics. The market has given it a small premium to NAV, reflecting these traits, and a material element of market-driven valuation.

Financial summary and valuation

Year-end Dec (£000)	2018	2019E	2020E
Profit/loss on investments	-807	1,130	-450
Income	8,199	12,292	18,913
Investment manager's fee	-894	-1,276	-1,964
Other expenses	-1,134	-1,150	-1,350
Finance costs	-1,037	-380	-380
Pre-tax return	4,327	10,616	14,768
Dividend (p)	6.5	6.9	6.5
Dividend cover (Hardman & Co basis, x)	1.0	1.1	1.1
NAV (p)	0.97	1.00	1.01
S/P premium to NAV	5%	2%	1%
Loan book	102,581	180,000	245,000
Equity issued in year	40,920	77,801	77,250

Source: Hardman & Co Research

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An investment in the securities referred to herein and on the pages that follow are only suitable for institutional investors and professionally-advised private investors who understand and are capable of evaluating the merits and risks of such an investment and who have sufficient resources to be able to bear any losses (which may equal to whole amount of amount invested) that may result from such an investment.

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Executive summary

ca.6.5% dividend yield paid from predictable, multi-year income streams, with rising revenue yields and economies of scale

We believe two key investment attractions for RMDL are the high yield and the sustainability of the dividend. With regard to the former, the company's target annual yield of *ca.*6.5% appears credible and achievable. Sustainability is supported by predictable, multi-year income streams, a rising gross return on assets, and an improving efficiency ratio. The stability of returns has led to very limited NAV volatility since launch, which we believe investors will also value. We note the additional attraction that the economic drivers supporting this yield provide diversification from other asset classes.

Niche market with limited competition, where superior returns can be earned from structuring complex deals and illiquidity premium

RMDL is operating in a part of the market where competition is moderate. High-street banks have significantly withdrawn from non-standard lending, and the size of RMDL's participation (£2m-£10m+) is too small for many corporate lenders/capital market investors looking to structure complex deals. RMDL can thus charge for intellectual capital, and its permanent capital structure means it can also exploit illiquidity premiums. The spreads it charges reflect all these factors, as well as credit.

Right policies in place to assess credit and manage it once a loan is drawn down, and also to manage accounts in difficulty. High value of security, and risk is diversified.

Credit risk management is core to any lender. We conclude that credit at RMDL is well controlled, significantly reducing the risk that impairments will put the dividend under pressure. In particular, we note: i) robust credit assessment with appropriate measures specific to the bespoke nature of the clients; ii) the benefits from control post draw-down; iii) the value of security; and iv) the diversification of the portfolio. Credit risk management is about limiting the probability of default and reducing any loss in the event of default. RMDL's procedures appear well positioned to do both and, to date, there have been no major loss incidences.

Investment manager has ca. £1m in RMDL and aligned to shareholder interests

We note that the investment manager (RM) owns *ca.*0.8% of the company (nearly £1m invested), as it has reinvested part of the management fees since launch. These shares are locked in for 12 months from purchase and, with a three-year programme, the manager showed great confidence that targeted returns would be achieved.

Discount management policies in place likely to limit downside

RMDL has a number of discount management policies in place to limit any downside, in particular a buy-back programme should the discount hit 6% and a liquidity event at NAV (less costs) at year four. Having such policies may, of course, prevent the discount ever reaching 6%, as the market will expect the company to be a buyer at that level.

Appropriate gearing

We believe some gearing is appropriate to leverage returns. It is, in essence, taking some liquidity risk, instead of increasing credit risk, in order to achieve the same return. It must, however, be carefully managed to ensure that the company never gets into a position of being a forced seller of assets in times of distress. We believe RMDL achieves these objectives, with i) the total debt cap set at 20% of NAV, ii) the use of Zero Dividend Preference (ZDP) shares, which include no restrictive covenants, and iii) the use of a revolving facility to cover short-term needs and reduce a cash drag from issuing equity too far in advance of asset growth.

Other attractions include market presence of investment manager, income benefit from rising rates, limited number of warrant situations, and accounting significantly driven by observable inputs

Other attractions include the following: i) RM has significant scale and experience in niche markets, and has extensive and proven origination capacity; ii) with 38% of the portfolio on a floating/inflation-linked rate, RMDL has benefited from, and is likely to benefit from future, rising market interest rates; and iii) in a limited number of situations, RMDL has taken warrants as part of its remuneration, typically where it has wanted to share upside in growth company finance (in March 2019, this resulted in a gain over book value of £0.6m; we have not built anything further into our forecasts and regard such returns as icing on the cake, rather than core returns, but the gain on the sale of warrants does show accounting conservatism). We discuss accounting in more detail below but note that 44% of the book is on Level 2 accounting, where there are significant market inputs (peers either 100% Level 3 or value loans off IFRS9 models).

Credit key risk, especially as cycle is likely to turn. Gentle rise in impairments would also see improving income.

As with any lending business, investors need to focus on credit, credit, and then again credit. We believe that losses in medium-sized enterprises are likely to rise as the credit cycle turns from its current low level. This increases the risk that even good lenders may see losses, especially those with non-senior debt positions. We also note that the wide range of gross spreads RMDL generates (up to 12%) could be perceived as carrying a tail risk of a limited number of accounts, which are at well-above average credit risk. However, investors need to put any prospective turn in the credit cycle into perspective. The most likely outturn remains a gentle rise in impairments, which is highly likely to be accompanied by an increase in spreads (we have already seen some of the latter in recent months). The balance between higher fair value write downs against increased ongoing income may even be positive.

RMDL book appears to have above-average propensity to turn over

We note from the RMDL accounts that the RMDL book has an above-average propensity to turn over (the volume of investments being redeemed relative to opening stock). However, it is important to understand the business messages behind the accounting number. Only a third of the investments are seeing principal repaid, in line with the average life of loans. We understand that half of the 2018 turnover figure relates to syndicated facilities repricing or redocumenting rather than repayments of principal. In the near term, this may be considered an optical rather than real risk as RMDL has kept the relationship and substantially the revenue streams. There is a prospective danger such customers might seek better pricing in due course, so it is an area to watch. Noting RMDL is in a growth cycle and so already constantly seeking new investments, it will have to work even harder if more customers refinance externally in the future. It could also face periods of increased cash drag pending redeployment of loan repayment proceeds although repayment penalties are usually in place to cover such losses. We believe the risk, and at this stage it is only a potential risk, thus lies in getting the right reinvestments if more loans are repaid early.

Other risks, including key personnel, currency and potential conflicts of interest, appear modest

Other risks include i) key personnel risk (although we believe the long expected life of the loan book moderates the risk of losing key staff at the investment manager); ii) currency risk, as *ca.*20% of the book is in non-sterling loans/bonds (in addition to movements due directly to currency, the hedging policy currently segregates £1.5m of cash and, in extreme market conditions, could see further margin calls); and iii) perceived potential conflicts of interest (although we believe them to be more perception than reality).

Competitive advantages in origination

We review the business model, noting the competitive advantages in origination, the unique customer profile (including some of the specific aspects to consider when lending to private equity-backed deals, which account for 74% of book), and RM's approach to recoveries and arrears management. We also detail the current portfolio mix and compare it with peers. In addition, we consider the fee structure, for both the investment manager's fees and what the investors pay, together with the economies of scale noted above.

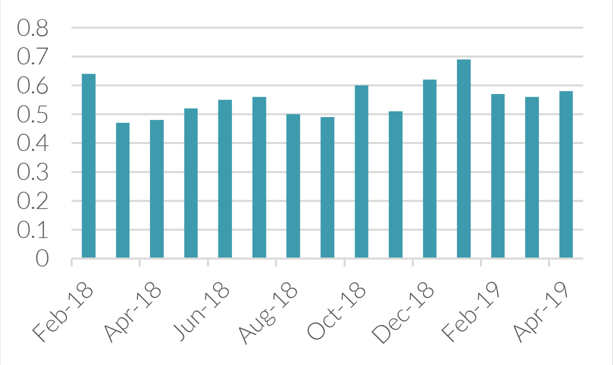
Fair value accounting may, in extreme downside scenario, see more volatility, as NAV will be market-sentiment-driven. In normal conditions, likely to be perceived as truer picture of realisable asset values at each accounting date

In the section on accounting, we detail the implications for RMDL in valuing its loan book. In normal market conditions, we do not believe this will make a material difference to peers, who value loans at amortised cost but, in adverse conditions, this may see a lower value at RMDL, as it will include a market-sentiment discount. There may also be more volatility. Such an approach, though, especially with 44% of assets based off observable market prices, is likely to be viewed by investors as more reflective of the actual realisable value of the assets at each valuation point. In the financial section, we provide a Hardman & Co adjusted profit and loss to give investors a view on what the profit and loss may look like on an amortised cost basis.

Yield key driver to valuation. Small premium to NAV but likely to see enhancement if equity issues made above NAV.

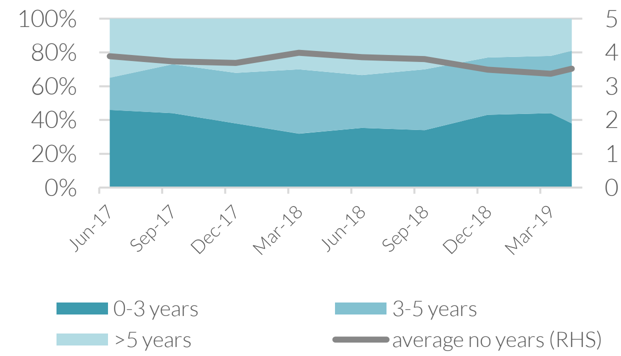
In terms of valuation, we believe the significant and sustainable yield will be a key investor consideration. RMDL trades at a small premium to NAV and to the average of its closest peers. In addition to the factors identified above, we estimate that further equity issues at a premium to NAV will enhance current shareholders by 1%. RMDL has not seen a major loss, and thus no valuation uncertainty and resource requirements that result from such an event.

Net Interest income (pence per share per month)



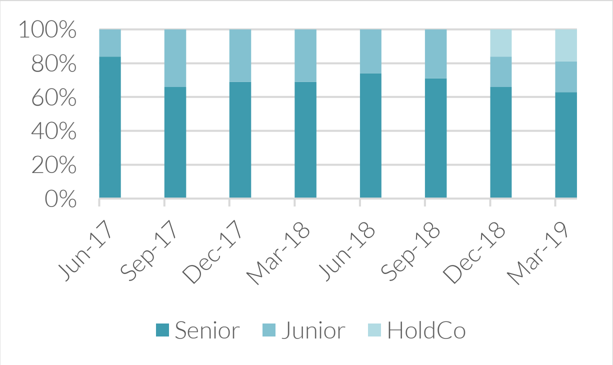
- Revenue is significantly generated from regular net interest income
- Average since February 2018 has been 0.55p per month, against a dividend cost of 1.125p per quarter
- Volatility very low, with small variances due to i) number of days in month and ii) timing of loan draw-down/early repayment

Weighted average life of loans (%)



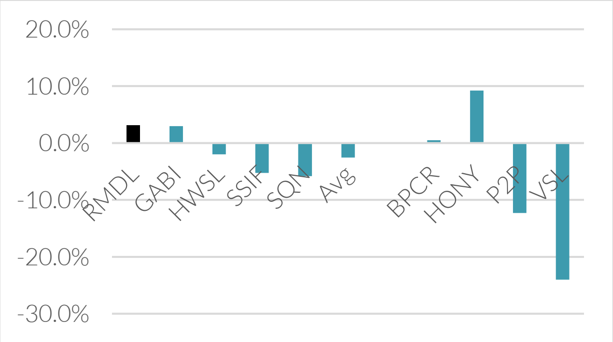
- Average life of loans 3.5 years
- Around a fifth of the book has a life over 5 years
- Not only assists in visibility of earnings outlook, but also reduces key personnel risk
- RMDL has a limited appetite for short-term lending, but the exact maturity profile drops out from its structuring facilities, rather than being a management target

Mix of business by type (%)



- Most important issue for credit is culture of conservatism of management, and must also consider how risk is assessed, how loans are managed once draw down, and how recoveries are made
- RMDL appears conservative, with majority of book senior-secured and significant proportion of HoldCo exposures. Senior offers best security protection, while HoldCo, with the right covenants, allows early control.
- April split was 56% senior, 28% Junior and 16% HoldCo

Premium/discount to NAV for RMDL and peers (%)



- *ca.*6.5% annual yield, with sustainability supported by predictable income streams, multi-year income streams, a rising gross return on assets, and an improving efficiency ratio
- Trading on small premium to NAV and peers
- No legacy credit issues, 44% of portfolio on Level 2 fair value accounting, likely to issue new shares at premium, enhancing existing shareholders, and strong discount management indicated

Source: Company data, Hardman & Co Research

Investment attractions

Yield

Yield ca.6.5%...

The company targets an annualised ongoing dividend yield of *ca.* 6.5%, with quarterly payments of 1.625p. Where there have been exceptional gains, a special dividend has been declared (e.g. 1Q'19 0.375p). We believe this is around twice the level of the AIC average yield. It is broadly in line with all debt investment companies' average, although this group includes some especially high-yielding CLO companies. The economic drivers supporting this yield provide some diversification from other asset classes.

Sustainability of dividend

...supported by long-term cashflows, predictable income streams and further economies of scale

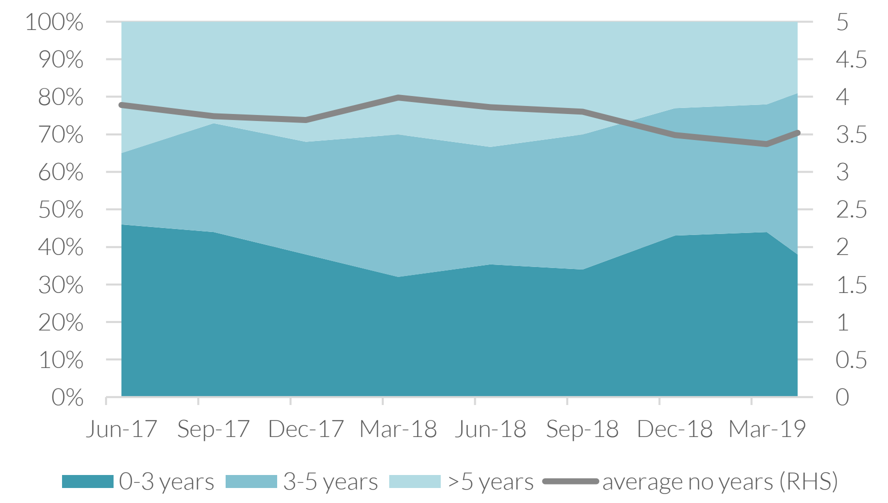
Critical to the value of the yield is its sustainability. RMDL's revenue it is driven by long-term assets (average weighted life 3.5 years), an increasing gross return on assets (April 2019 8.70%, vs. 8.26% in March 2018), predictable income streams and improving efficiency (estimated cost to NAV ratio improves by 10%, as NAV rises from £75m to £150m).

Long-term assets

Average life of assets 3.5 years; 22% of assets have a life of more than 5 years.

The chart below shows the trend in the weighted average life of the loan book. As can be seen, the average duration of the book is currently 3.5 years, which provides a long-term revenue stream with which to keep paying the dividend. The modest fall in the average life through 2018 was the result of the portfolio mix, and is not a target being managed.

Weighted average life (WAL) of loan book (years)



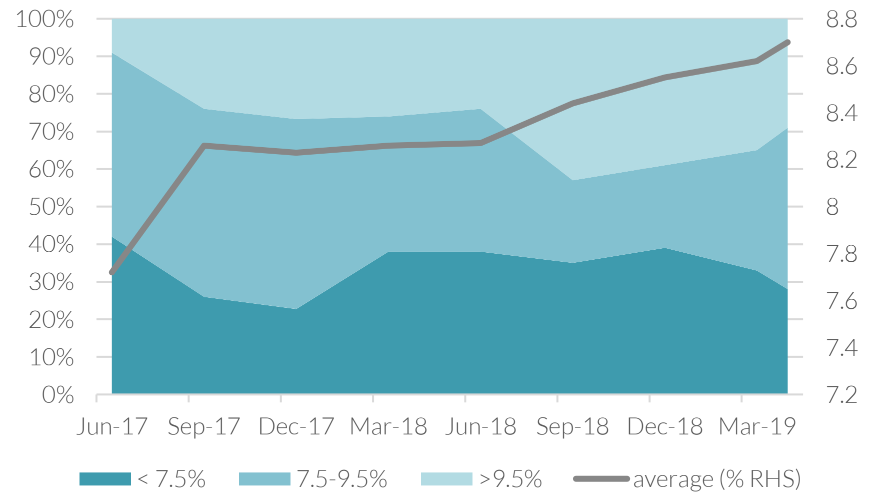
Source: Company factsheets, Hardman & Co Research

Growth in gross yield

Gross yield rising strongly, with both market rate rises and increased new business pricing

As can be seen in the chart below, the average gross yield on the book has been rising steadily and is now 8.70%. The rise in the gross yield over the past six months has been due primarily to i) a rise in the 3-month Libor of 43bps (in September 2018, 64% of the book was floating rate), and ii) new business pricing increasing by 25bps-50bps, with wider market pricing reflecting an uncertain economic outlook. There have been a number of largely offsetting smaller mix effects, including a falling proportion of senior- ranked advances (should increase rates), a smaller average loan size (positive), a shorter weighted average life (reduces rates), more floating vs. fixed (reduces rates) and an increasing percentage of € (reduces rates). We would characterise these latter factors as the results of loan decisions, rather than targets being actively managed.

Annualised yields by level and average (%)



Source: Company factsheets, Hardman & Co Research

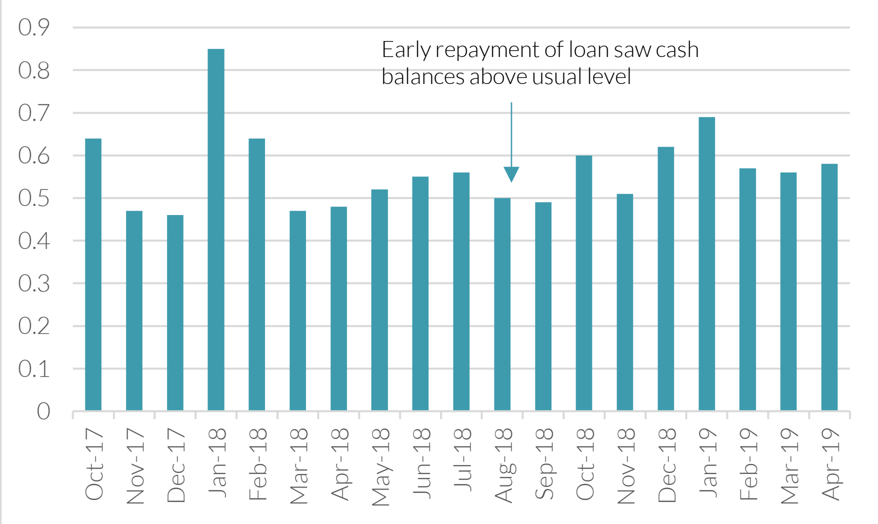
We note that the mix has been quite variable, a feature that we believe is driven by the relatively small number of accounts. As the business grows, we would expect a more stable mix outlook.

Predictable income streams

Income driven by predictable net interest income, with average of 0.57p per month since January 2018 (quarterly dividend 1.625p)

RMDL's income is driven significantly by net interest income, which is earned month in, month out. As can be seen in the chart below, the net interest income in pence per month has averaged 0.57p since December 2017, and this can be compared with the quarterly dividend of 1.625p. The chart has a little volatility, due to the historical inclusion of modest pre-payment penalties (e.g. January 2018) and the drag in subsequent months from above-average cash levels (for example, August and September 2018).

Net interest income (pence per month)

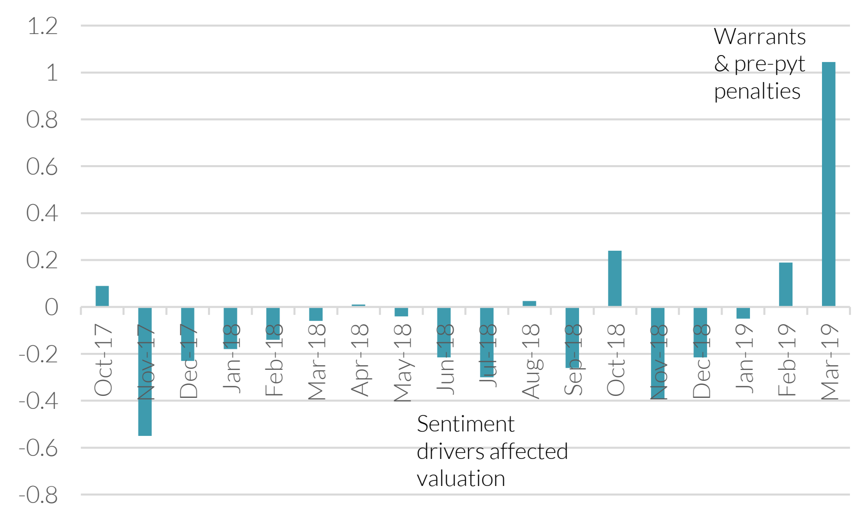


Source: Company factsheets, Hardman & Co Research

Expenses ca.15bp. Noise from marking to market modest. March 2019 saw one-off gain on warrants – uplift is indicative of conservative approach to valuation.

While net interest income (NII) is the key predictable income stream, it is worth considering the effects of other items. In the chart below, we have aggregated the effect of all the other factors, including costs (*ca*.0.15p per month), fair value adjustments (positive and negative), the benefits of warrants and early payment penalties. While there is some volatility, in most months, the net negative impact has been broadly stable.

Impact of all other items (excluding dividend) (pence per month)



Source: Company factsheets (April not disclosed), Hardman & Co Research

Costs as % of NAV fall from 2018 level 193bps to 160bps, when NAV rises to £250m

Economies of scale

We note that RMDL is still in growth mode and has only recently reached a critical scale. With the March £14m placement, the ordinary NAV is still only £111m and gross assets £122m. Looking forward, we expect further equity issuance to fund further growth, and this should deliver economies of scale as fixed costs are spread over the bigger book. We have estimated fixed costs at £550k p.a. from the details in the 2018 accounts, which means that this growth should deliver a meaningful improvement in the cost to NAV ratio.

Impact of costs (bps) at differing levels of NAV

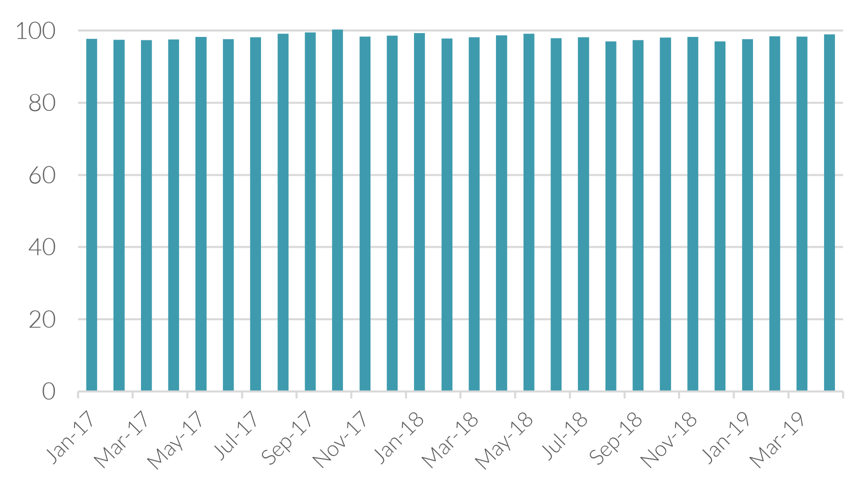
NAV (£m)	100	150	250
Investment manager's fee	0.875	0.875	0.875
Fixed costs	0.55	0.37	0.22
Other variable costs	0.50	0.50	0.50
Total costs to NAV	**1.93**	**1.74**	**1.60**

Source: Hardman & Co Research

Stability in NAV

The chart below shows how stable the NAV has been, with a high to low range of 100.24p to 97.01 (i.e. just 3% volatility) since the start of 2017. This reflects the high proportion of income generated from highly predictable interest income. The model is not one driven by unforecastable capital gains. It is worth noting that even this volatility is driven primarily by the timing of dividends, with a small build-up in NAV in the months ahead of the quarterly payment, and then modest falls in that month.

NAV (p)



Source: Company factsheets, Cum income basis, Hardman & Co Research

Niche market, competition is moderate

RMDL generates an average gross revenue yield of close to 9%, a wide spread over the risk-free rate of *ca.*1%. There are a number of factors driving this, including the following.

RMDL operating in niche from which mainstream banks have significantly withdrawn

- Competition: The investment manager expects the majority of transactions to range from £2m to £10m (current cap £13m) and have a range of maturities, with most loans having maturities of two to seven years. There is limited competition for deals of this size. Banks have significantly withdrawn into mainstream, vanilla products. Anything in RMDL's sweet spot of up to £10m, which has complex features, is unattractive to banks. For the syndicated market, anything that is a non-benchmark size or does not fit within CLO structures, especially those that are second lien, again has fewer buyers, making pricing and lender protections more attractive. Finally, we note the comments in the section of the turn of the cycle reported in the Secure Trust Bank 15 May AGM statement: "The Group has been presented with additional opportunities to successfully deploy its capital and funding in the first four months of 2019 as a result of a number of non-bank lenders citing difficulties in obtaining or renewing credit lines." This suggests that non-bank competition may be facing its own difficulties.

Spread reflects complexity of deals and payment for intellectual capital used in structuring deals

- Complexity: As we detail in the customer profile section below, the characteristics of the borrowers, most notably the exposure to private equity clients, mean that RMDL is not doing vanilla lending. This requires specialist lending skills, and RM aims to capture "complexity premium"/intellectual capital cost. Management is of the view that, on average, a structuring premium may be expected to add a couple of percentage points to returns, although, for more complex deals, it will be a higher number than this.

- Origination: As we detail below, RM has the ability to originate high-quality opportunities, and then to structure, monitor and manage them, providing high barriers to entry. RM has operated in these markets for many years and, being a long-term player, is hugely important to intermediaries in this space.

- Macro: QE flowed into liquid areas of the market, driving down pricing in investment-grade lending, but it did not flow into "lower-middle market" private debt, where RMDL is focused. The market pricing was thus not distorted by government policy.

RMDL's permanent capital can capture illiquidity premium

- Permanent capital: RMDL's closed-ended structure means it can capture the illiquidity premium of smaller syndicated/traded transactions because it has permanent capital. Management indicates that, on average, the illiquidity premium may be around 0.5%, although this varies significantly with each transaction. It is also likely to be an attractive syndicate partner, as it will not be forced into selling loans due to liquidity capital constraints.

RMDL not seen covenant loosening reported for other parts of market

These factors also mean that some headline market trends may not apply to this business. We note that market-wide security covenants have eased over the past few years. A senior credit officer at a North American bank told us that the enforceability of recovery in European debt was now weaker than in 2007. However, where there is a specialist skill in a non-standard market, such market pressures have not been seen, and RMDL reports it has seen little, if any, pressure on its covenants.

Credit (1): credit assessment

The chart below shows a schematic of RMDL's approach to credit assessment. We believe the process outlined is robust and, in the section below, we examine, in a bit more detail, some of the practical implications that impact on, and result from, this process. In our view, there is nothing that should be unique in the process below, but investors need to make a judgement call on whether the processes are effectively adopted in practice. This is what we explore in more detail below and, from our discussions with management, we believe that the theory and practice are well aligned.

RMDL's secured credit assessment process

Most deals fail pre IC presounding stage.

Sector Analysis
Review of sector, including regulatory issues, legal factors, macro considerations (cyclical sector etc), ESG considerations

Company Analysis
Management & Sponsor, focus on track record in the sector / industry, character, skin-in the game / alignment. High level review of historical financials.
RM will meet and speak with mgt, around 15-20x during a deal.

Deals will usually be discussed with IC at this stage. IC focused on specific credit.

Financial Analysis
Detailed review of company financials, projections, assets, accounting etc. all aspects balance sheet, cashflow generation, revenue recognition etc
This stage will be the first in which RM will appoint (borrower pays) for external due diligence, by reputable firms such as Grant Thornton etc
A financial model will be built in-house, to model the performance of the borrower against RM's base case.

Credit, Capital Structure Analysis
Post review of the financial and legal information, RM will have a complete picture of the borrower's health, financial performance, the financing structure.
RM need to consider technical factors such as where we will 'sit' within the capital structure, what controls we need within the documentation, what their rights will be if holding 2nd charge etc
RM also consider our security, recoverability, debt serviceability etc

Since inception, three deals have collapsed at this stage - 2x deals RM walked away from due to adverse DD.

Due Diligence & Covenants
At this stage, further due diligence is performed: this is lend specific for example (external valuations, appointment of lender QS for property developments etc)
Covenants are set with respective to our financial model and requirements to control the situation in the event of a downside scenario

Pricing
Post IC approval, docs are executed, security registered with appropriate authority etc.

Source: Report and accounts, Hardman & Co Research

While not explicitly adopted in credit process, the principles of CAMPARI canons of lending are applied

We understand that RM typically sees two to three transactions per day and that less than 5% of these potential transactions actually convert. RM's policies follow the approaches we believe to be core to good lending and as outlined in our sector review, Debt Investment Companies: Diving deep finds you the treasure, published on 25 February 2019, and summarised in the "canons of lending" table below. We understand it is not a tool on which management focuses directly, but, as can see from the table below, RMDL's actions show that the principles are being applied in practice.

CAMPARI and ICE: the canons of lending

Requirement	Hardman & Co comment
Character	In all the project finance and asset finance lending, RM will meet directly with management – usually multiple times. For syndicated loans, the team will usually join either a conference call or a lender meeting. Where appropriate, professional firms will be employed to review the business and security, thus giving further, independent confirmation of the borrower's character. With a significant element of the book being sponsor-backed, there is a second layer of character built into the debt assessment.
Ability	All corporate lending (56% portfolio) is focused on the cashflow, with the security providing insight into the recovery opportunity. Project finance (20%) is a blend of both cashflow and security; without an appropriate hard asset (such as a hydro power asset), the cashflow cannot be generated. Asset finance (24%) is focused on the assets, and the counterparty risk, collateral value, etc, and the ability to recover against such assets.
Means	Any proposition must have a clear outline of what is needed in a "bankable format", and this is provided by either the bank or borrower's advisor. As would be expected, the credit assessment process models both base-case and downside scenarios.
Purpose	RMDL will lend for most purposes, with any obvious anomalies raising questions during the credit assessment.
Amount	We detail elsewhere the loan to value (LTV) split. Recognising the specific nature of the book, having under a fifth at LTVs in excess of 75% does not appear unreasonable. Any money lent needs to be accounted for in a sources and uses analysis. Money for development is retained by RM and released subject to sign-off by third parties at each stage of development.
Repayment	Deals are, by their nature, structured to the client needs. We note the credit assessment process determines what control, post drawdown, will be built into the lending covenants.
Interest	We note, in the section on controlling credit post drawdown below, that an account saw a pricing increase as soon as one covenant had breached, even though the loan was performing. Our discussions with RM give us confidence that risk-adjusted pricing is a core principle to the group. RMDL will consider a broad range of gross yields to deliver the target portfolio returns.
Insurance	Corporate lending: full all-asset debentures, are taken over the company and all its assets (share pledge, fixed and floating charge, etc), including plant, property and equipment, receivables, bank accounts, etc. Limitations are put in place on distributions. Project finance: ring-fenced all asset debenture over the SPV and all its assets (share pledge, fixed and floating charge etc), including plant, property and equipment, receivables, bank accounts, etc. Limitations on distributions. Additional protections provided via insurance contracts, assignment of contractor warranties, etc, step-in agreements, etc. Asset finance: ring-fenced all asset debenture over the SPV and all its assets (share pledge, fixed and floating charge, etc), including plant, property and equipment, receivables, bank accounts, etc. Limitations on distributions. Often a charge over the holding company also, which provides additional security.
Commissions	Not meaningful.
Extras	Not meaningful. Occasionally warrant uplift, but not core to returns.

Source: Hardman & Co Research

Risk-adjusted pricing

We are encouraged that risk-adjusted pricing appears endemic to the RMDL approach. This is visible in, for example, the monthly disclosures of the top 10 holdings. While each exposure is individually assessed, we note, for example, that what may be regarded as lower-risk healthcare is at a lower yield than a more cyclical business, such as hospitality. More specifically, we note that management will consider investing in different parts of the capital structure if it can offer the same protections but at a higher rate. For example, in a HoldCo structure, while the borrower is performing, RMDL earns higher risk-adjusted returns than other parts of the capital structure. It also typically improves the recovery experience (compared with another junior part of the capital structure) and may have the right to buy-out the senior debt as an additional feature. The downside in the structure is weaker immediate security on an operating subsidiary's assets. We believe the important takeaway for investors from this is that RM has conducted a detailed risk-adjusted return review and is not simply focused on either the risk or the return in isolation.

Critically important conservative culture endemic in process and evidenced, for example, by sector limits, due diligence, corporate governance and loan sizing

In our report, *Debt Investment Companies: Diving deep finds you the treasure,* published on 25 February 2019, we emphasised many times the importance of the credit culture and conservative corporate governance. Evidence that these exist at RMDL includes:

- Sector limits based off risk (e.g. the social infrastructure sector cap is 40%, while retail is 25%). There are no geographical concentrations of note.
- Appropriate due diligence, including, but not limited to, legal, technical, financial, insurance, tax and credit research.
- Review by the investment committee (IC). We believe this is especially important for sentiment to a new fund, which has yet to establish a track record of

performance. Having an investment committee is like insurance in that, ideally, it should not be required. The manager should have filtered out unacceptable deals before they get to stage. We understand that, to date, RMDL's IC has not declined any proposition, but it has, on several occasions, led to a review of terms.

- Loan sizing is determined by the levels of visible net cashflows the borrower has.

Project finance drawdowns against proven work completed and with borrower equity at first risk of loss

We are encouraged that, in terms of project finance, drawdowns are on a staged basis. RM typically uses a professional external quantity surveyor/engineer to monitor progress. Actions include site visits, reports on the development, verifying invoices and documentation on work completed to date, flagging any issues and submitting appropriate certification. The borrower can then use this certificate as evidence to draw down against the facility. Such an approach ensures that value is protected for RMDL as much as possible. These are standard approaches to managing risk in this area.

By way of a case study, RMDL advised on a project where the property had an initial value pre-planning permission of £900k (RMDL would not be involved at this stage of the development). With planning permission, the value nearly doubled. RMDL would provide only limited value to implied equity (RM prefers hard cash equity, i.e. the £900k purchase price, rather than the development "profit" uplift). Once developed, the property had an expected market value of £5.5m, rising to £5.9m once it had achieved the usual 97% occupancy ratio. RMDL makes advances in tranches of £250k and £500k against specific proof of progress. By the end, the total advance was *ca.*£4m (72% of the final market value on completion and 67% of the expected fully-let value). Effectively, the developer was on risk with the initial equity, and RMDL's exposure rose only as the development approached completion. The closer the project got to completion, the easier it would have been to sell, and so RMDL's rising LTV would be offset by having as asset that was easier to sell. In this example, the realisable security value considered not only a firesale of the asset but also whether more value could be obtained by selling the SPV shares with valuation discounts for asset sales against share sales with a variance of 3%-5%. It also looked at the appropriate haircuts against the valuation agent assumptions.

Sponsor-backed (PE) deals bring different risk exposures, and these risks are clearly identified in credit assessment process

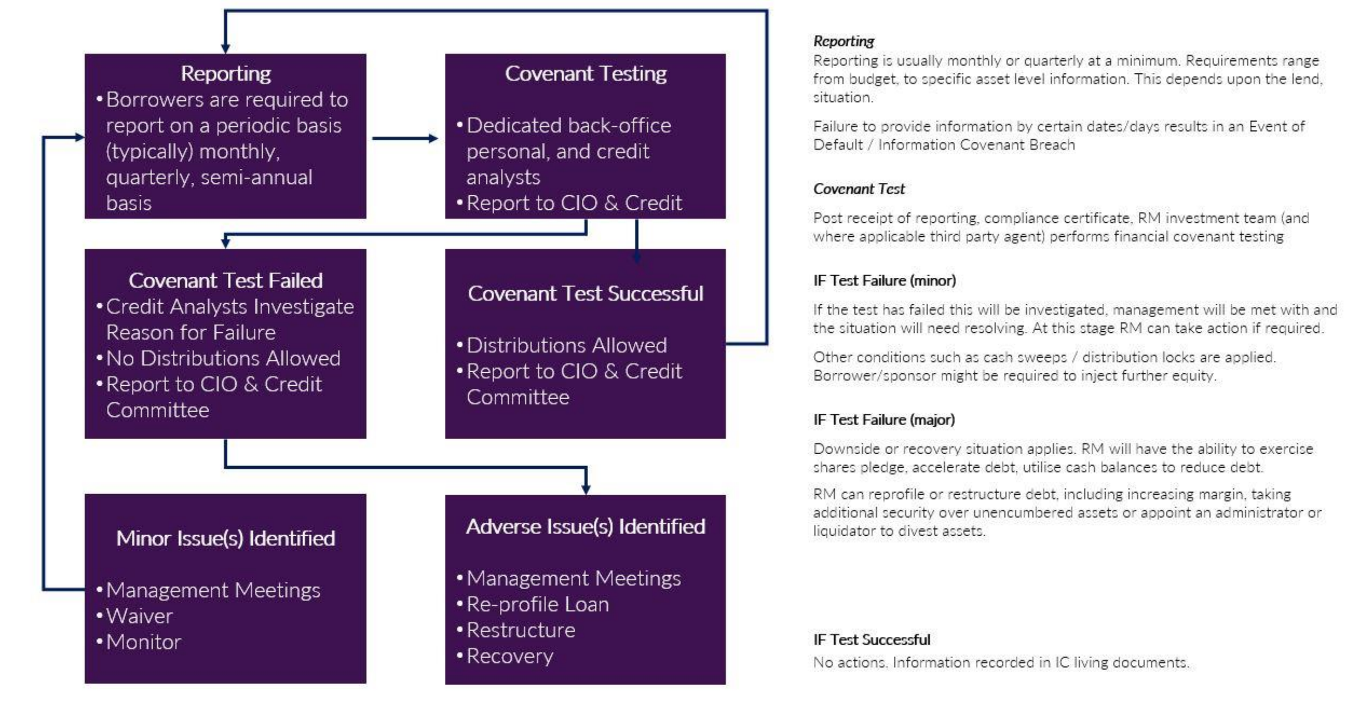
In the section *Business Model* later in this report, we highlight that 74% of the portfolio is private sponsor-backed (i.e. private equity). Focusing on those businesses' credit implications, we note that sponsor-backed companies typically operate with a professional management team, with rigid reporting structures and clearly defined roles. There is a focus on financial returns (rather than softer factors) and often potential economies of scale through further acquisitions. On the downside, such firms require careful oversight, as the ultimate objectives of the sponsor (i.e. geared returns and distributions) can diverge significantly from those of the lender. The professionalism that applies to running the business is also a downside in that the firms are more likely to push for more advantageous borrowing terms – to the detriment of the lender. The key issue is understanding the dynamics of the customer and, in our discussions with management, we took comfort that the specific dynamics here were fully appreciated.

Credit (2): relationship post drawdown

Regular reporting with covenants, including requirements for timely information

We believe that effective monitoring and management of loans once they have been made is critical to both a lower probability of default and a lower loss once a default has occurred. RMDL is not a business that "lends and then leaves" but rather it regularly monitors and reviews its positions. The chart below shows a diagrammatic view of how RM manages a loan once it has been advanced. RM continually monitors the progress of investments through regular technical reporting in respect of each loan (most monthly, with a few quarterly), and it will seek ad hoc additional reporting and updates where there has been a material event. In practice, what this means is that, at each reporting date, covenants will be tested, and issues identified or not. Covenant breaches do not have to be financial, and therefore failure by the borrower to submit accounts within a specified number of days could lead to RM taking action under the security/facility documents. To date, the lending has been of such a quality that these procedures have not been thoroughly battle-tested, but we consider the right structures have been put in place.

Post-loan drawdown procedure



Source: Report and accounts, Hardman & Co Research

In project finance and asset lending, the assets and/or contracts of the borrower are placed within a special purpose vehicle (SPV), and then security, in the form of a share pledge and debenture over the SPV, is granted in favour of RMDL. This is in order to segregate the assets from the borrower entity in the event of the borrower becoming insolvent. RM will also use separate bank accounts in order to control and project cashflows, combined with additional lender protection through reporting covenants, representations and warranties.

Where assets in security pool repay (e.g. funding asset financers), RM has control over new assets put into security vehicle

Where RMDL is funding asset finance providers, it has two layers of protection: it has a claim against the borrowing entity but also on a specified asset pool level. RM controls the types of assets that go into the pool of collateral, with various restrictions ranging from eligibility, to sector, to type, to LTV, to geography. RMDL employs external agent monitoring. These rights are ongoing, so new assets going into the pool can be different from pre-existing ones.

Process means RM can intervene, even for change in risk outlook, not solely default event

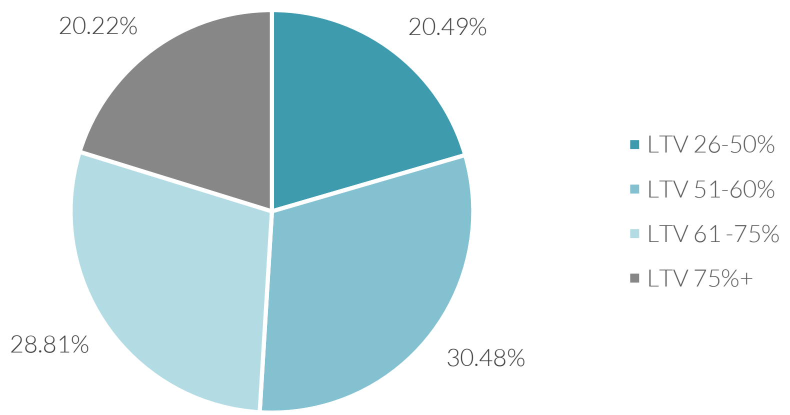
We were given a specific example where a borrower with a three-year loan, on a moderate LTV, tripped a debt:EBITDA financial covenant picked up at quarterly reporting early on. RM initiated rapid discussions with the borrower that led to i) a reduction of the facility tenor, and ii) an increase in price. The loan continued to perform with interest being serviced, but as RM did not like the direction of travel, it intervened to ensure that an appropriate risk- adjusted return was generated.

Credit (3): value of security

80% of portfolio on less than 75% LTV

Secured lending typically sees a lower loss in the event of default, and, in many cases, also a lower probability of default (not least because it is a much cheaper source of funding than unsecured lending). In its Report and Accounts, RMDL reports that 80% of the portfolio is on an LTV of under 75%. If the borrower faces a liquidity issue, the security would thus need to see a substantial fall in value before RMDL would face a loss. We believe it is worth exploring the value of the security in some more detail.

Proportion of portfolio by different LTV ratios (%)



Source: Report and accounts, Hardman & Co Research

Valuations by large professional firms, and kept current

- Who made the valuation and when? RM's choice of valuer depends on the assets. The names with which we were provided tended to be larger national professional firms such as Grant Thornton, Ernst and Young, CBRE, JLL, Savills, and, for hard assets, companies such as SIA (http://www.sia-group.co.uk/). We understand that asset finance lending is subject to a quarterly valuation review by SIA, given the nature of the exposure.

Nature of security enhances recovery potential. By way of example, funding asset financers has multiple cashflows and equity support.

- The nature of the assets. For RMDL, we highlight, by way of example, its funding of asset finance businesses. RMDL has claims on both the corporate entity to which it is lending, but also a broadly diversified segregated pool of underlying assets held in an RM-controlled SPV. Until the contract is fully repaid, RMDL has ownership of the underlying asset and, as each underlying borrower has paid a deposit, there should be equity in each of the underlying assets, in addition to an equity cushion from the corporate customer. As repayments are made, the equity in the underlying assets increases. The diversity of the underlying portfolio is important, as a loan of £10m by RMDL is likely to have hundreds of underling borrowers. We understand that the capital treatment for banks on this type of finance is relatively high, and so RMDL can charge a good rate, even though it has multiple layers of security, with equity in the corporate borrower, equity in the underlying exposures, which increase over time, and highly diversified contractual cashflows.

Modest number of deals helps ensure security is correctly documented. RMDL does follow-ups as standard course of business.

- How is the security executed? We note that around half the commercial real estate security taken in HBOS's commercial division had ineffective security. The execution of security is hugely important. RMDL's portfolio is obviously much smaller, making visibility on document execution that much easier. For its own accounts, RMDL obviously takes legal advice, but then ensures confirmation from the appropriate authority (such as the Land Registry or Companies House). The legal advisors have a contractual obligation to process this on RMDL's behalf providing a further potential source of redress if the documentation is not completed correctly. RMDL invests in a few secondary investments per year and, with these exposures, the documentation and due diligence are prepared by the lead lender, and are available for review, but the due diligence has already been performed. RM would then just review such information.

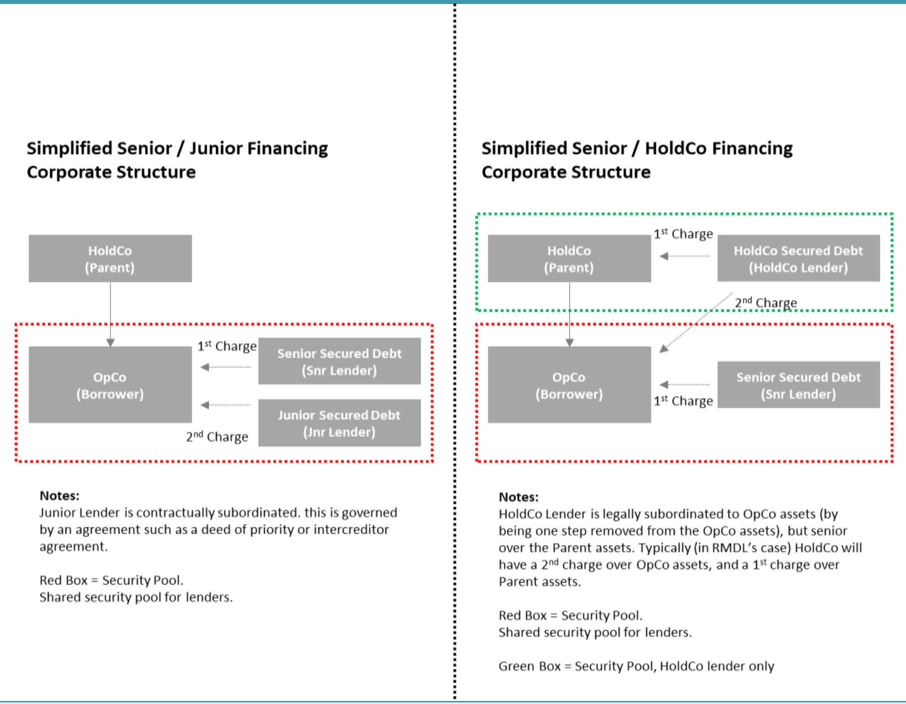
Appreciation of importance in real resale value against open market valuation

- The resale value of assets. Hard assets, such as property, have a higher value as security than assets that can be removed as the company gets into difficulty (like cars). In our discussions with RM, we took comfort from their appreciation of the importance of resale value. For example, where the asset has multiple uses and so a ready resale market, it would be considered differently for, say, a petrol forecourt. Management's perception on appropriate discounts are in line with our own. An occupied commercial property with an open market value of, say, 100, could only have a value of 90 if vacant and only 70 if it were to be repossessed and subject to a forced sale programme. The credit assessment of the value of security considers this range of valuations.

HoldCo structures also assist early intervention and losses are lower when action taken quickly

- When security can be realised. RM highlights that one of the benefits of a HoldCo structure (with tight covenants) is that it believes it can enforce security earlier. By having a first charge over the HoldCo assets, RM can intervene and, for example, require the sale of an operating company, before a senior debt lender to the operating company is able to enforce its security. HoldCo loans allow RM to enforce security and control the subsidiary without forcing the group into default. This can mean better value/recovery by retaining control ahead of any other lenders that could be secured over specific assets. In our view, this is predicated on having the right covenants/documentation, but the principle of early action reduces losses in the event of default being well established.

Lending to "HoldCo" structures



Source: RMDL, Hardman & Co Research

Credit (4): diversification of portfolio

Largest exposures broadly diversified

Since the end of 2017, the top 10 exposures have ranged from 56% of the portfolio to 73%. Within these accounts, there is a huge diversity by type of borrower (from asset finance portfolio, through forecourt operator, to healthcare), yield (5.36% to 12.18%), and average life (0.13 years to 5.93 years). We believe that there is a broad economic and geographical mix, reducing the probability of a correlated loss.

Over half exposure in low cyclicality sectors

We note that, among the largest sector exposures at the end of December 2018 (latest published information), were healthcare and pharmaceuticals at 19%, consumer goods (primarily non-economically-sensitive forecourt operators) at 14%, and social infrastructure at 12%. Nearly half the portfolio is in these non-cyclically-exposed sectors. There is another 16% in funding broad asset-finance portfolios and 6% in energy infrastructure. In terms of what may be perceived as higher-risk sectors, we note, from the April Factsheet, that hospitality is now approaching *ca.* 20% (of which around a quarter matures in two months' time).

The investment restrictions are given in Appendix 1 and would suggest that, looking forward, good diversity should be maintained.

Manager alignment with shareholders

Managers holding ca.£1m, 0.8% of RMDL and aligned to shareholder interests

RMDL has agreed with the investment manager that half its fees are used to buy shares that will then be locked in for 12 months. The shares are bought in the market (or could be issued at NAV), quarterly in arrears. With a holding of 961k shares (ca.£1m), we believe this generates a significant alignment between the investment manager's interest and shareholders. While the lock-in is for a year, the programme was committed until December 2019, i.e. three years after RMDL launched. This appears a reasonable balance between allowing the investment manager access to cash for its own business needs and ensuring that it will be on risk should performance disappoint.

Recently, shares released from lock-in have been offset against new shares due, so holding is increasing but at slower pace than past

As can be seen in the 17 April announcement, as the programme has become more established, in practice the investment manager makes a net purchase, with the shares coming out of lock-in partially offsetting the gross purchases that would otherwise be due. In April, this meant 29,084 shares were bought. 92,214 shares acquired by the investment manager prior to 16 April 2018 were eligible for sale and were netted off against the 121,298 ordinary shares, which would have otherwise been acquired. This agreement is due to end-December 2019, but RMDL notes that RM is highly incentivised with *ca.*£1m invested in the company.

RMDL is not alone in having such an alignment (for example, the key investment manager personnel and family members have ca.£2m in GABI) but, as a proportion of the company, it appears to be highest in the immediate peer group.

Discount management

As well as the investment manager buying shares in the company on a quarterly basis, we believe RMDL will use a number of discount management tools to manage the level of discount, as we highlight below.

Can buy back if discount >6% (set at around one-year return)

- Its policy allows it to buy back shares (of any class) should those shares trade at an average discount to NAV of more than 6% over the preceding six-month trading period. We understand the 6% criteria was set to approximate the annual expected return – a level viewed as a fair maximum loss that investors could reasonably be expected to bear.

Can make market purchases

- The Directors can make market purchases of ordinary shares at a maximum price that must not be more than the higher of i) 5% above the average of the mid-market for the previous five business days before the purchase is made, or ii) the higher of the price of the last independent trade and the highest current independent bid. Ordinary shares will be purchased only at prices below the prevailing NAV, which should have the effect of increasing the NAV per ordinary share for the remaining shareholders.

Liquidity event at year 4 at NAV less costs

Before the fourth AGM, and at subsequent three-yearly intervals, the Board has stated that it intends to formulate and submit to shareholders proposals to provide an opportunity to realise the value of their shares at, or near, the prevailing NAV less costs. This could be via a tender offer or similar distribution. This structure was put in place as RMDL was a new fund with a fund management group that was new to the closed-end fund sector. RMDL felt it was only right, on launch, that shareholders should be given the chance to exit at close to NAV if the fund subsequently underperformed. The Board and management may be expected to consult widely with shareholders ahead of the fourth year and to position the group investments accordingly. If performance continues in line with expectations, as it has to date, we would expect shareholders to be happy to continue.

Our views on discount management were outlined in our report, Investment Companies: Understanding the deepest discounts, published on 14 May 2019. In summary, we see that, on the upside: i) It creates a buyer for the shares; ii) the liquidity provided by buy-backs may encourage buyers, as it provides them with an exit route without disrupting the market price; iii) it may be perceived as putting a cap on the discount, which the market might then close itself; and iv) it is "fairer" to all shareholders. A seller may arise for specific reasons (such as death, divorce or liquidity calls) and, by keeping the discount tightly controlled, such sellers do not lose out to discount variability.

Cognizant of downsides risks in execution

We believe that, in the execution of any discount management programme, RMDL is fully cognizant of the potential downsides that we also highlighted in the above-mentioned report, notably: i) it could create liquidity problems; ii) the returns that could be earned on the capital deployed in the fund; iii) by shrinking the business, it worsens the total expense ratio, and increases leverage where there is debt; and iv) it sends a very mixed message, to investors especially, if the company later comes back to the market for further equity funding, and to staff.

Appropriate gearing

Gearing capped at 20%, including ZDPs

RMDL has announced that it intends to utilise borrowings for investment purposes, as well as for share buybacks and short-term liquidity purposes. Its gearing limit is that debt, including Zero Dividend Preference shares (ZDPs), will not, in aggregate, exceed 20% of NAV calculated at the time of drawdown. We believe gearing is a sensible way to enhance returns and that, in RMDL's case, this is a value-creation policy. In reaching that conclusion, we considered the following points.

Structure means unlikely ever to be forced seller of assets at distressed time

- The covenants in the debt mean that RMDL would never become a forced seller of assets at a time of distress. The ZDPs do not include any covenants and the OakNorth £10m revolving facility is less than 10% of assets.

- The principal repayment terms mean that RMDL would not need to be a forced seller of assets at that time. We note that the ZDPs are broadly covered by the revolving facility, were *ca.*6x covered by 2018 loan repayments and debt sales, and that their redemption date is well-known in advance.

A revolving facility reduces the cash drag for a growing business

- Instead of raising equity in advance of lending and then depressing returns by holding cash pending deployment, the group temporarily funds growth with debt, which is then repaid with a later equity raise, thereby reducing the period of holding excess cash. GCP Asset Backed, in its recent results, reported temporary debt for exactly this reason.

Low rate gives opportunity to profitably leverage

- The interest cost on borrowing is low relative to investment returns, allowing a proportionate improvement in return for the gearing risk taken. We note that the ZDPs' gross redemption yield is 3.5%, well under half the expected investment return on deployment.

May broaden investor appeal

An additional benefit is that issues such as the ZDPs have the potential to broaden RMDL's investor appeal and base. Looking forward, we understand that the revolving facility may be expected to grow with the business. We are very comfortable with the gearing and structure of debt in RMDL.

It should be noted that RMDL's investments in syndicated loans have greater liquidity than normal private loans (as evidenced by its Level 2 accounting – see accounting section later in this report). We do not believe RMDL has any intention to sell such positions for liquidity purposes, but we note that the positions are more liquid if required.

Other attractions

Benefits of RM as the investment manager

Founded in 2010, the investment manager (RM) has offices in Edinburgh and London, and is a specialist alternative credit manager. RM has transacted in excess of £50bn of bonds and loans since inception and, in addition, has advised or originated, structured and conducted, or managed, the due diligence process for over £1bn of sterling credit transactions and *ca.*€600m of Euro-based transactions since 2012. Given the niche nature of RMDL's operations, having an experienced manager with the specific skills is a core requirement. As we outline below, we believe RM has proved its origination capacity and market credibility.

Service-driven proposition

We believe the main proof of management's claim to offer a high-quality service proposition is the flow of new business. We take comfort from its statements that deal completion times can take two weeks to two months – a claim that every deal could be done more quickly would, in our opinion, reflect a focus on speed and not on quality.

Rising income if market rates rise

We note that part of the rising yield RMDL has seen over the past nine months has been associated with rising benchmark interest rates. With 37% of the book on floating rate terms (September 2018 64%), a rise in rates generates more income. It is not risk-free. Rising rates can put a strain on customers' finances – directly through higher funding costs, but also through reduced demand (although we note that sponsor-backed deals have a high propensity to hedge away the majority of the former risk). We took considerable comfort in our discussions with the company that, if a corporate has a less developed treasury function, RM prefers fixed-rate loans, as this reduces the client's exposure to this risk.

Incremental revenue streams

March 2019 saw a jump in NAV from the "prepayment and the sale of warrants", adding £1.5m to that month's income. We believe management views early repayment penalties as replacement for income lost pending redeployment (ranging from an immediate benefit when used to repay the revolving credit facility borrowings through to up to eight weeks to redeploy in new loans), rather than being a core income stream. We understand that warrants have been taken on rare occasions, and we have not factored further gains into our forecast returns.

Uplift shows accounting conservatism

We note that the warrants sold in March had previously been included in the balance sheet (and so NAV), with the valuation independently verified by Mazars. The fact that there was such a large uplift on the sale is an encouraging sign of management conservatism in its approach to accounting.

Investment risks

Credit risk: turn in cycle

Like for any lender, credit is key, and we expect conditions to steadily deteriorate from here. May also see further pricing uplift and reduced competition.

Credit risk remains the key issue for any lender. We believe that market-wide credit impairments will rise from their current levels and that investors should be prepared for this. By way of example, CYBG on 15 May reported exactly this trend, noting that impairments were showing "a return to more normal levels in SME". The critical issues are as follows.

- The speed of deterioration. We expect a steady, rather than sharp, increase in losses.
- The impact on existing accounts not paying interest due – again, in our view, this is likely to be modest.
- Any changes in interest rates. At end-April 2019, 38% of loans were on floating rates, and conditions with a sharp credit deterioration may see benchmark rates fall.
- The benefit from a widening spread. A business with a rapid propensity to turn over will see a greater proportionate benefit.
- The degree to which competitive pressures ease, as marginal players, especially non-bank financers, withdraw from the market. We note the comments in the *Secure Trust Bank AGM statement* that "The Group has been presented with additional opportunities to successfully deploy its capital and funding in the first four months of 2019 as a result of a number of non-bank lenders citing difficulties in obtaining or renewing credit lines." In recent months, spreads have already started to widen – a trend we expect to continue should the credit cycle turn.

Non-linear risk

A portfolio with yields ranging from ca.5% to 12% may be perceived as risker than one with yields ranging from 7% to 9%. While variety of factors drive yield, the higher rates may be seen as higher-risk.

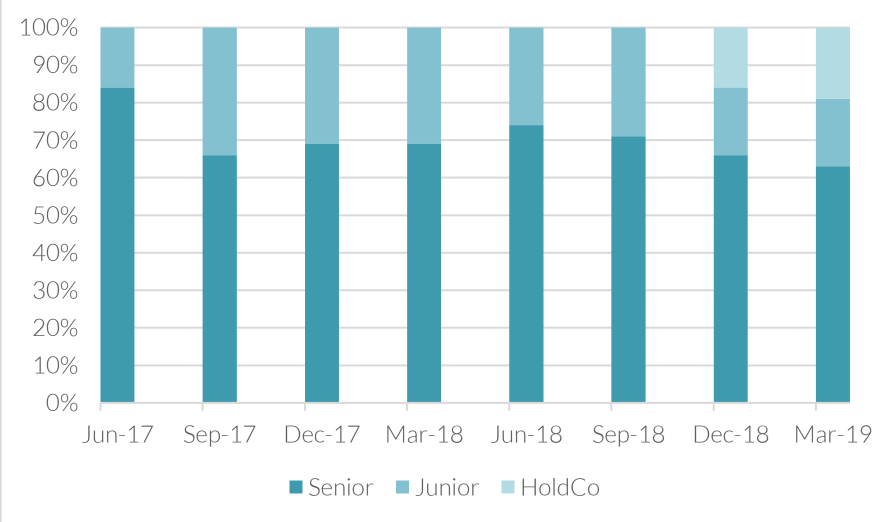
We note that the management of the portfolio has led to a wide distribution of expected yields. Among the top 10 holdings, the yields range from 5.4% to 12.2%. As we have identified throughout this report, such yields can be generated from a range of sources, including limited competition, service, acceptable gearing levels, structuring skills, etc. They may also be generated from taking more risk, or perhaps very importantly, perceived as taking more risk. For investors with that view, a portfolio with a range of yields like RMDL would be at greater risk than one that had a range of 7%-9%, as the highest-yielding loans would be at a greater risk of default than lower-yielding ones.

Non-senior positions

RMDL does hold non-senior positions, which are riskier than senior ones. The complexity of HoldCo position may not help.

The chart below shows the portfolio by the level of security. RMDL has enhanced the disclosure by splitting out HoldCo risk, which, while technically senior investments, do carry more risk than traditional senior-secured investments. The junior subordinated debt has been falling (now 18% of the portfolio), but it has been more than replaced by "HoldCo" exposures, which we discussed above. Junior secured debt is obviously better than being an unsecured lender, but it does not give the same control over security and is likely to see a much higher loss in the event of default than senior-secured. We note, for example, that there is a proposal to change Crown Preference, largely restoring HMRC's historical preference as a creditor. Fixed charge holders (both first and second charges) are unlikely to be affected by this change, but those with floating charges could be. Part of RMDL's security is All Asset Debentures (which includes both a Fixed and Floating Charge) over all assets (shares, tangible assets, intangible assets, bank accounts, etc).

Investment type (%)



Source: Company factsheets, Hardman & Co Research April 2019 was 56% senior, 28% junior and 16% HoldCo?

Portfolio turnover/reinvestment risk

Accounts show surprising degree of purchases and proceeds from sales. In 2018, saw a number of material internal restructurings.

Note 3b on page 48 of the 2018 Report and Accounts shows that, in 2018, RMDL saw £60m of repayments/bond sale proceeds against the book cost at the start of the year of £77m or, put another way, *ca.*78% of loans ended in the year. We understand approximately half saw repricing or redocumentation, internally with RMDL, a third were repaid (broadly in line with the expected repayment rate) and the residual sixth were positions sold by RMDL. We understand that, in 2017 and 2018, there had been investment in some shorter-dated securities to deploy cash temporarily at slightly higher returns. An element of redocumentation and repricing is to be expected and, as noted in the example on p15, this may actually improve terms for RMDL. The downside risk is that if the customers have a propensity to refinance, and they choose in future to do it externally, RMDL will have to constantly find new business streams to replace the maturing assets.

As can be seen in the table below, the number of accounts rose significantly from late 2017 to mid-2018, but they have shown much more subdued growth since. We understand from RM that this reflected a commitment not to raise capital for a while and deliver proof that the investment proposition worked. RM reports that the pipeline of opportunities has remained at two to three per day and that the broad stability over recent quarters is not a reflection of historical loans repaying. While still small numbers, we note that the total number of clients rose in April 2019 and that the 10 largest exposures saw some significant new loans.

Number of loans

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Apr-19
No loans	21	24	25	30	29	35	33	35

Source: Company factsheets, Hardman & Co Research

Other risks

Key personnel less due to long-term nature of assets

As with any investment company, the sudden unavailability of key staff in the investment manager would have implications for RMDL. Unlike many, though, the long-term nature of the assets is such that, except in unusual market conditions, there should be time for the portfolio to be managed. It is a risk, but we see it as a minor one.

RMDL provides €/$ loans as part of customers' normal activities –ca.20% of portfolio

Significantly hedges via forward contracts with £1.5m of cash held in segregated accounts as margin (and so not available for lending)

RMDL has US$ exposure to one borrower and three Euro borrowers. RM invests for attractive risk-adjusted returns and is agnostic to currency. Some UK borrowers have multi-currency borrowing requirements (e.g. Satcom), while others have operations in multiple jurisdictions. Where a customer runs an overall currency exposure (not just to the debt), it is part of the credit assessment process to review this risk. To hedge against this risk, RMDL has taken a number of forward contracts. This results in cash being deposited as a collateral call (we understand *ca.*£1.5m currently), with the consequent drag to earnings, as it cannot be deployed in more profitable lending. In theory, a material movement against RMDL's position could see margin calls, but we understand they would need to be significant movements. The hedge is against $/€ loans and so, on the hedge, RMDL is long £ and short $/€. Consequently, those currencies would need to weaken significantly against sterling for there to be any further cash calls on RMDL.

We understand the hedge is against the capital value of loans, and so there could be a profit and loss account effect too. The total currency exposure was *ca.* 20% of loans/bonds.

RM has extensive activities in credit markets, but governed by conflict of interest policy agreed by RMDL board

We note that, in the 2018 prospectus (page 64), RM reported that it was involved in over £50bn of bonds/loans, which could raise the question of how RMDL could ensure it got the right priority from RM. There is a detailed conflict of interest policy within the RM funds' business procedures. The specific comments noted above refer to an agency broking business, which acts as agent and therefore does not conflict with the activities of RM. It is also being wound down as the firm focuses on its alternative investment management business. RM is far from unique in managing more than one fund and having clear policies in place that are overseen by the RMDL board appear an appropriate control. As noted earlier, RM has a *ca.*£1m investment in RMDL.

RM Alternative Income fund not a direct competitor

We also note that RM is manager for another fund (RM Alternative Income), which, inter alia, invests in potential competitors to RMDL. Management comments that the RM Alternative Income (RMAI) mandate is a multi-asset alternatives fund, which can only invest in liquid securities (listed equities and liquid corporate debt). RMAI itself does not provide financing, so there are no direct conflicts of interest with RMDL's niche.

Arrangement fees paid to RM by borrowers, but relatively modest

As we discuss in the fees section later in this report, RM can keep up to 1.25% of the arrangement fee typically paid by the borrower. This is a slightly higher proportion retained by the investment manager than some peers (e.g. GABI cap is 1%). We note that, in 2018, RMDL received arrangement fees of £354k on originating £88.6m of bonds/loans (40bp average fee), when, by comparison, in the year to June 2018, GABI booked £431k on £66m originations (65bp average fee). While there are business mix differences RMDL receives lower arrangement fees than GABI. The amounts are relatively modest (compared with the *ca.* £1m RM has in shares in the company), and we understand that all arrangement fees paid by borrowers to RM are reported to the RMDL board. We do not believe there is a material incentivisation to turn over the book.

Business model

Origination

Competitive advantages in distribution across all three business lines

RMDL quite rightfully, in our view, looks through the structure of a deal to its exposure. Whether a deal is a loan (bilateral or syndicate), loan note or bond is broadly irrelevant. Being flexible on the asset class means that RMDL is open to more investment opportunities.

RMDL is focused on three types of transactions with different sources of origination, as we highlight below.

- Corporate loan – usually as part of a syndicate given the size of corporates lent to. RMDL is an attractive syndicate partner, as its permanent capital structure means it will not be a seller of the loan for reasons such as a liquidity squeeze or changing regulatory capital requirements. The experience it brings may also give comfort to a syndicate manager that complex structures will be understood quickly, as well as it being a good "second pair of eyes" reviewing the deal.

- Asset finance – pools of physical assets, usually bilateral and structured by RM. We note that, for mainstream banks, providing finance to funders of asset finance has not been an attractive area.

- Project finance – a specific asset or a grouping of assets, usually bilateral and structured by RM. The team has publicly closed transactions with Macquarie, Aviva Global Investors, GCP, Aberdeen Standard Life and Blackrock, and notable transactions include £43m for Gilkes Energy and £45m Good Energy transactions.

In our discussions with RM, it outlined the following key origination strengths:

Speed & ability to execute

- Merger and acquisition financing can require considerable resources and commitment; RM believes it has the ability to manage such processes efficiently and to deliver.

Solution-led

- Given the experience of the team, RM works with borrowers and their advisors to structure bespoke financing solutions that meet the needs of RMDL and provide the flexibility that borrowers require. RM noted that its experience in leasing and hire purchase investments was a competitive advantage with borrowers holding non-standardised assets that require funding. One size does not fit all.

Leverage

- RMDL will typically provide higher leverage than that of a clearing bank; as an example, a clearing bank might fund up to 65% LTV, whereas, for the same asset, RMDL could fund 70%-75%. This higher leverage is driven primarily by specialist skills in assessing a non-standard credit, rather than higher-risk appetite.

Sourcing/origination relationships

- RM has operated as a business for over 10 years, across the credit markets and in most sectors. It has well-established relationships with borrowers, advisors and financial institutions, and it believes this leads to a high-quality pipeline, to which peers do not have access.

We believe these claims are all credible. Ultimately, the poof of the pudding is in the eating. RM successfully originated nearly £200m in gross lending and bond purchases for RMDL in 2017/2018.

Customer profile

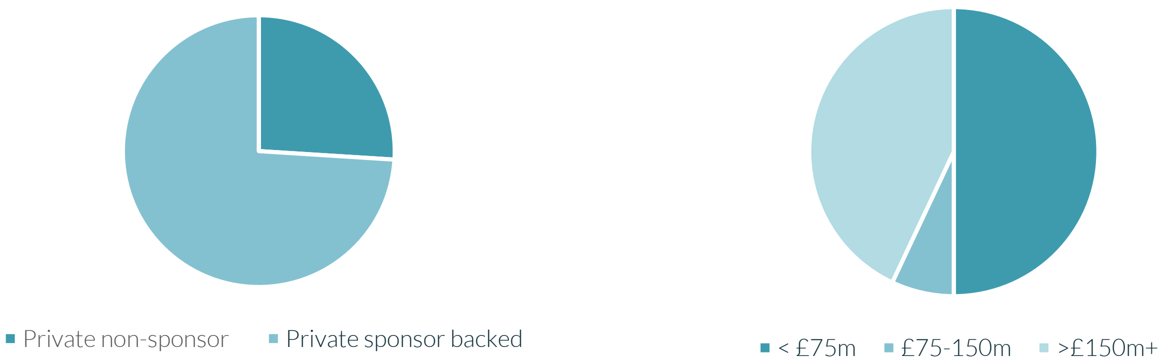
In its annual report, RMDL gave some more detailed disclosure about the customer profile and its targeted niche.

Portfolio dominated by private equity clients, most with large turnover; very much medium-sized entities, not SME end of market.

- Firstly, 43% of borrowers have revenue in excess of £150m. RMDL's customer base is of substantial businesses not focused on the smaller end of SMEs.

- Secondly, 74% of debt is to borrowers who have a private sponsor backing (i.e. PE houses). We believe this is important, given the different profile that these customers have compared with private non-sponsored borrowers. They are not standard lending propositions, as often there is higher gearing, changing management and the potential that a series of acquisitions will bulk up the businesses. This puts them firmly outside the mainstream lending, which we believe high-street banks have been prioritising. The PE exposure makes the loan origination deal specific, and market sentiment can play significantly on timing. We note, for example, that in the March 2018 prospectus (page 63), there were six £10m deals in the pipeline, of which we understand two have converted at lower amounts. For investors wanting an alternative view of the timing of deal completion, they may wish to look at K3Capital (LSE ticker: K3C), where deal completion has also seen delays.

End-2018 ownership profile of borrowers and scale of borrowers' revenue (% of portfolio)



Source: RMDL Report and Accounts, December 2018, Hardman & Co Research

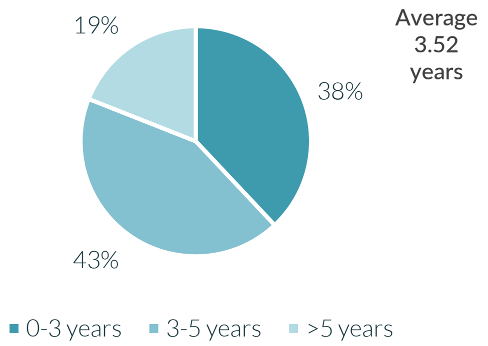
Recoveries

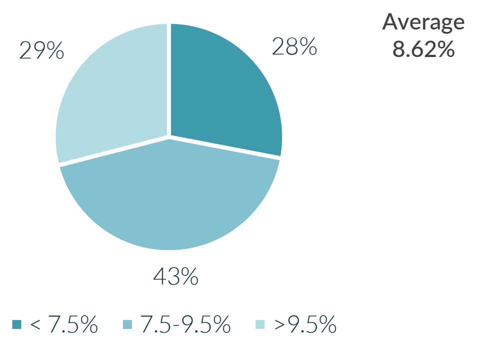
Arrears and bad debt management will be internally controlled. RMDL's covenants allow early intervention and reduced risk of forced sale discount.

RM manages all aspects of credit internally, thereby ensuring it has complete control of the process. As noted earlier, it has a number of levers, with monitoring and covenants combined, which means that it can intervene at an early stage to limit loss. We believe, and this is consistent with RM's view, that the forced sale of an asset may be *ca.* 30% below its ongoing market value – so being able to manage an asset sale, if required, is very important to the ultimate realised value. RM specifically commented that the timing on asset sales varies depending on whether the asset is income-generating or not, what the asset is, etc. The internal management of recoveries has the advantage of control, but it can divert management resources from growth options. It is also a very specific skill.

Latest portfolio analysis

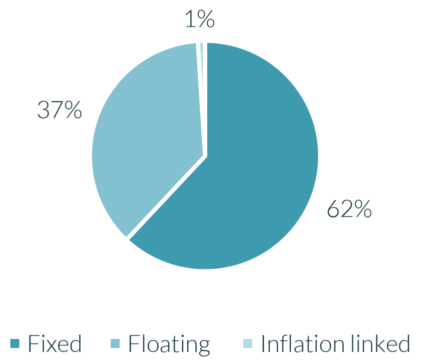
Portfolio mix by weighted average life (%) and yield (%)

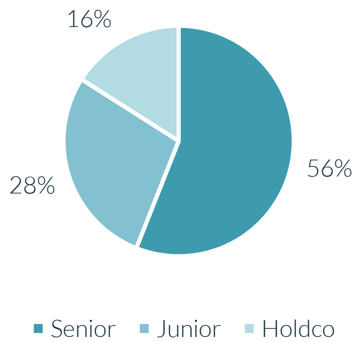




Source: RMDL April Factsheet, Hardman & Co Research

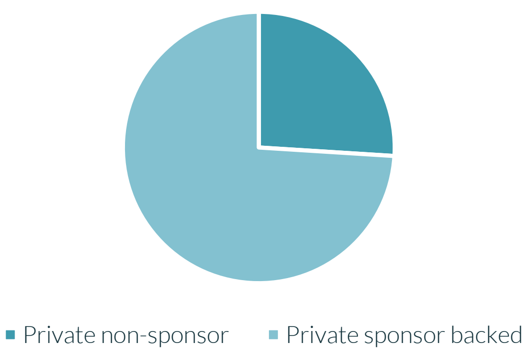
Portfolio mix by coupon type and investment type (%)

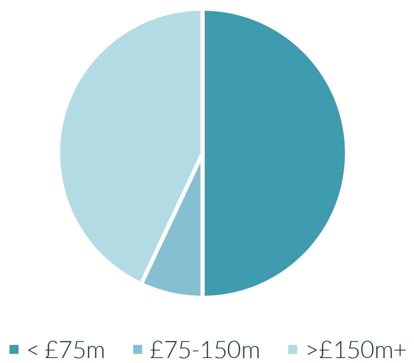




Source: RMDL April factsheet, Hardman & Co Research

Portfolio mix by customer type and customer revenue (%)





Source: RMDL Report and Accounts, December 2018, Hardman & Co Research

Largest loan	Loan value (£m)	Expected yield (%)	Weighted average life (years)
Asset finance	10.19	8.00	4.67
Forecourt operator	8.70	5.36	3.21
Hospitality	8.50	9.00	4.93
Hospitality	8.30	9.00	4.93
Telecommunications	7.44	11.24	1.93
Business services	7.00	6.53	5.57
Automotive parts manufacturer	6.49	12.00	3.66
Healthcare	6.00	6.28	5.96
Hospitality	4.58	12.18	0.13
Student accommodation	4.42	9.5	0.70

Source: Latest KID disclosure, Hardman & Co Research

Quoted peer portfolio

GCP Asset-Backed Income Fund (GABI) portfolio analysis

Factor	Mix
Sector	Social Infrastructure 38%, Property 44%, Energy and Infrastructure 13%, Asset Finance 5%
Security	Senior 60%, Mezzanine 40%
Interest rate	>8% 38%, 7%-8% 50%, <7% 12%, average rate 8%
Duration	>15 years 17%, 10%-15% 17%, <10 years 66%, average life 8 years
Largest exposures	Residential property co-living 9.2% (total asset), buy-to-let mortgages 6%, development residential finance 5.5%, student accommodation (two positions at 5.3% and 5.2%, respectively)
Summary	39 holdings, £398m value

Source: March Factsheet, Hardman & Co Research

Hadrian's Wall Secured Investments (HWSL) Limited portfolio analysis

Factor	Mix
Sector	Manufacturing 23%, Admin & Support 13%, Professional, Scientific & Technical 12%, Construction 9%, Property Trading 6%, Retail, excluding motor, 5%
Security	Portfolio weighted-average initial LTV and advance rate 76%
Interest rate	7.5%-15% (average 9.3%)
Duration	2.9 years' average
Largest exposures	Engineering 9.24% (NAV), Property Trading 7.46%, Manufacturing 4.8%, Retail 3.9%
Summary	n/a

Source: March Quarterly report, Hardman & Co Research

SQN Asset Finance Income Fund (SQN) portfolio analysis

Factor	Mix
Sector	Agriculture 19%, Waste Processing 15%, Transportation 10%, Diversified portfolios 9%, Environment 6% UK 67%, US 18%, France 6%, Ireland 3%, Netherlands 1.6%, Mexico 1.4%, Iceland 1.3%
Security	not disclosed
Interest rate	Weighted average portfolio yield >9.4%
Duration	Weighted average remaining term 81 months
Largest exposures	Vehicles and helicopters 7.9% (NAV), anaerobic digestion plant 7.4%, portfolio interests 6.5%, 5.8%, 4.8%, combined heat and power centre 4.8%, Solar Manufacturing 4.8%, averages size £8.4m
Summary	£481m, 57 positions

Source: Hardman & Co Research

Fees

As can be seen in the table below, RMDL has the lowest investment manager fee of the quoted peers, although the difference is modest.

Summary of issues driving discounts

Company	Fee structure
RMDL	0.875% p.a. once NAV >£75m. All assets referable to the issue of ZDP shares will be counted as though they were assets of the company, but, for the avoidance of doubt, no liabilities referable to the issue of any ZDP shares will be deducted
GABI	Annual rate of 0.9% p.a. of the prevailing NAV of the company, less the value of the cash holdings paid quarterly in arrears
HWSL	Investment Adviser 1% of NAV, Investment Management (IFM ltd) 0.1% p.a. of NAV (up to £150m), 0.08% p.a. of NAV (£150-250m), 0.06% p.a. of NAV (>£250m, annual min. £85k)
SQN	1.0% up to £300m, 0.9% over £300m-£500m, 0.8% over £500m

Source: Hardman & Co Research

As can be seen in the next table, the investment manager makes up any shortfall in fees through arrangement fees, which are paid for by the borrower, not the fund.

Other investment manager fees

Company	Fee structure
RMDL	The investment manager is also entitled to retain an arrangement fee if, on the making of any loan, the arrangement fee charged to the borrower is equal to, or lower than, 1.25% of the principal amount of the loan
GABI	Arrangement fee of up to 1% of the value of each investment (usually paid by borrower) Additional fees from any issue of new shares, in consideration for the provision of marketing and investor introduction services
HWSL	Not disclosed
SQN	An additional fee where either SQN or its affiliates provides structuring advice and/or services in connection with the acquisition (but not the disposal) of any investment. The fee will be equal to 1% of the transaction amount.

Source: Hardman & Co Research

Customer fees

While we caution against over-reliance on Key Information Documents (KID) disclosure, anecdotally, it does have an impact on investor sentiment – more so on institutional than private investors.

KID fee cost disclosure – impact on returns (%)

	One-off	Transaction	Other ongoing	Performance
RMDL	**n/a**	**n/a**	**1.50%**	**n/a**
GABI	n/a	0.01%	1.35%	n/a
HWSL	n/a	n/a	1.52%	n/a
SQN	n/a	0.11%	1.21%	n/a

Source: Latest KID disclosure, Hardman & Co Research

Accounting

Accounting valuation reflects management view within rules overseen by external auditors. Culture hugely important to the outcome.

In our report, Debt Investment Companies: Diving deep finds you the treasure, published on 25 February 2019, we emphasised the importance of understanding the accounting principles adopted by the company. RMDL values its loans and bonds at fair value through the profit and loss, as they are included in a group of financial assets that are managed, and their performance is evaluated on a fair value basis (as is the case for GABI). In contrast, SQN and HWSL value their loans at amortised cost. In normal markets, we do not believe the difference is likely to be material, and we see merits in both approaches, but investors need to understand the subtleties that the different accounting methods introduce. Investors should recognise that, through either approach, a conservative management will be conservative and an aggressive one aggressive, and the accounts are a reflection of the management view of the assets within an accounting framework. We believe management culture is more important than the methodology.

43% of loans and bonds have observable pricing and are not driven by management models

Under IFRS13, RMDL discloses its investments in a fair value hierarchy that reflects the significance of the inputs used in making the valuation measurements. The three levels of fair value hierarchy are: i) Level 1 – inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date; ii) Level 2 – inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and iii) Level 3 – inputs are unobservable for the asset or liability. We believe that Level 1 accounted assets are likely to have the greatest investor confidence, as they are a current price in a liquid market. As a loan book is not usually traded in this way, however, we would not expect any Level 1 assets. Page 61 of RMDL's 2018 Report and Accounts shows that an impressive 43% (2017 47%) of its loans and bonds actually fall into Level 2, where there are significant observable prices and where the valuation is thus not driven by modelling assumptions. GABI, by contrast (page 92 of its Report and Accounts) reports a 100% Level 3 categorisation. We understand that such a significant element of Level 2 assets reflects the syndicated loan element to RMDL's corporate lending book. The size and nature of the deals in which RMDL is involved mean that the pricing is sufficiently robust as to be Level 2.

In normal conditions, market expectation of loss likely to be similar on both accounting approaches

In a normal market, we would not expect the difference in capital value to be huge. While a loan at amortised costs sees IFRS9 impairments driven by an expected loss through the life of the loan, a market valuation (and so fair value) should be driven by the expected loss expectation affecting the discount rate being applied. There are therefore two ways to come to the same answer. We recognise that 57% of the loans and bonds are still on Level 3 accounting, which is model-driven, and again may be expected to reach a very similar valuation outturn as the same approach used by HWSL and SQN.

Implications: i) value will reflect market sentiment, as well as long-term expected cashflows; ii) introduces interest and currency rate sensitivity

By valuing at fair value and not amortised costs, there are a number of implications if market conditions are unusually volatile, and during periods of uncertainty, as we highlight below.

- Valuations reflect market sentiment, in addition to changes in expected cashflows. By being based off market prices, if there is uncertainty, the loans and bonds are likely to have a lower valuation than ones based off cashflow-modelled assumptions.

- It introduces sensitivity to interest rate movements for fixed-rate lending. On an amortised cost basis, the value of a fixed rate loan does not change if market rates change. For a fair valued loan, if market rates rise, the value of the loan is likely to fall; if rates fall, the value is likely to rise. There is no change to the ultimate cashflows, but there is potentially more volatility under fair value accounting.

- Revenue under IFRS9 is recognised on an effective interest rate basis – so it is smoothed over the life of the loan, including fees related directly to the life of the loan. With the fair value, accounting interest income is recognised on a time-apportioned basis – so, for example, arrangement fees will be spread over the life of the loan. All other income, including deposit interest, is accounted on an accrual basis, and early settlement fees received are recognised upon the early repayment of the loan.

Credit impairments go through P&L with no stock of provisions to judge adequacy of cover

- Under fair value accounting, there are no visible stock of impairment provisions. We believe some investors get comfort from being able to assess the level of credit impairment provisions against the loans and use this measure to assess management conservatism.

Evidence accounting approach is conservative

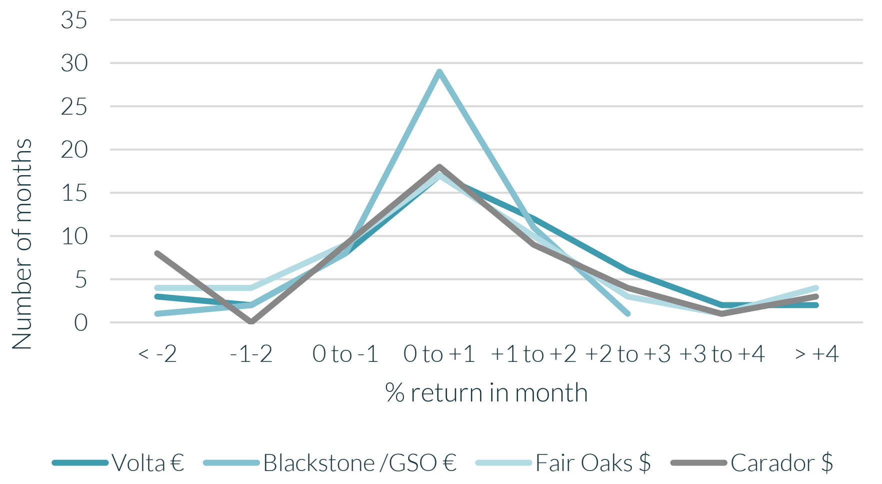
- RM does not mark up loans where a loan amortises. If you fair value a fixed-rate loan, in theory you could make an unrealised gain through its life. A three-year loan would normally have a higher rate than a one-year loan. When the former has just one year left, it would earn more than a new one-year loan and so should trade above par. Such a gain is illusory (the loan is repaid at par), and RMDL does not write up such loans. The reason we labour the point here is that it is indicative of a conservative approach to accounting, which is likely to be applied across the whole book.

- It is also important to understand what is driving the realised losses reported by RMDL (£399k in 2018). We understand that the majority are driven by situations where RMDL has deployed funds post a capital raise in short-term instruments to generate more income than it would in cash. These instruments are sold as loans are made and liquidity required. RMDL incurs a loss from the bid-offer spread, but this is a known cost and more than compensated for by the higher carry interest earned from these instruments relative to holding cash. It is not a credit-related loss. RMDL is regularly reviewing its portfolio, and there have been incidences where the current risk-reward looks less favourable than when a loan was originated. There may not have been a default event but with the more liquid syndicated loans, positions can be sold in such circumstances. We understand that these represent a smaller proportion of the 2018 losses.

In uncertain times, likely to see lower NAV and more volatility

The overall conclusion is that, in periods of uncertainty, RMDL is likely to have a lower reported NAV and one that is more volatile. In the chart below, we show the effect over time for companies in the CLO space. The exception is Blackstone GSO, which uses a more marked-to-model approach than its peers and which, as a consequence, has a much less volatile NAV performance.

CLO companies: number of months with different returns over past five years



Source: Company factsheets, Hardman & Co Research

Other accounting issues

The C share finance cost went through the capital account as a finance cost and not below the line as a divided payment. On conversion to ordinary shares, this cost will drop below the line.

Financials

Some of the key assumptions in our profit and loss forecasts are as follows.

- We assume two ordinary share capital raises with issues of around £75m at the end of June in both 2019 and 2020, and expect the capital raised to be deployed by the year-end.
- We assume a gentle rise in gross spreads from here (slower increases than seen over the past year).
- The management fee is formulaically driven by the opening balance sheet and our assumed capital raise in June. We believe that just under half the costs are fixed and half are variable – so costs rise more slowly than revenue.
- In the capital account, we note the 1.35p gain in NAV in March 2019 from pre-payment penalties and the sale of warrants, which we have assumed were valued at nil before. This sees a material capital gain, which is partially offset by the fair value impact from impairments (we assume 15bps of the opening loan book).
- The cost of C shares drops out of the finance costs, as they have now converted to ordinary shares and thus pay a dividend.
- Further special dividends from the warrant sale gains in 2019 are possible.

Profit and loss account

Year-end Dec (£000)		2018			2019E			2020E	
	Revenue	Capital	Total	Revenue	Capital	Total	Revenue	Capital	Total
Loss on investments	0	-807	-807	0	1,130	1,130	0	-450	-450
Income	8,199	0	8,199	12,292	0	12,292	18,913	0	18,913
Investment manager's fee	-894	0	-894	-1,276	0	-1,276	-1,964	0	-1,964
Other expenses	-978	-156	-1,134	-1,150	0	-1,150	-1,350	0	-1,350
Return before finance costs and tax	**6,327**	**-963**	**5,364**	**9,867**	**1,130**	**10,996**	**15,598**	**-450**	**15,148**
Finance costs	-380	-657	-1,037	-380	0	-380	-380	0	-380
Return on ordinary activities before tax	**5,947**	**-1,620**	**4,327**	**9,487**	**1,130**	**10,616**	**15,218**	**-450**	**14,768**
Taxation	-37	17	-20	-100	0	-100	-150	0	-150
Return on ordinary activities after tax	**5,910**	**-1,603**	**4,307**	**9,387**	**1,130**	**10,516**	**15,068**	**-450**	**14,618**

Source: Company, Hardman & Co Research

To assist readers who are more comfortable with IFRS9 accounting, we have created an adjusted profit and loss account, identifying credit impairments separately.

Hardman & Co adjusted profit and loss account (£000)

Year-end Dec (£000)	2018	2019E	2020E
Income	8,199	12,292	18,913
Irregular income (e.g. sale of warrants)	0	1,283	0
Credit impairment	0	-154	-450
Investment manager's fee	-894	-1,276	-1,964
Other expenses	-978	-1,150	-1,350
Return before finance costs and taxation	**6,327**	**10,996**	**15,148**
Finance costs	-380	-380	-380
Return on ordinary activities before taxation	5,947	10,616	14,768
Taxation	-37	-100.0	-150.0
Return on ordinary activities after tax	**5,910**	**10,516**	**14,618**
Dividend cover (x)	**1.02**	**1.13**	**1.06**

Source: Hardman & Co Research

Balance sheet				
@31 Dec (£000)	2017	2018	2019E	2020E
Investments at fair value through the profit or loss	**76,957**	**102,581**	**180,000**	**245,000**
Current assets				
Receivables	1,069	2,602	3,602	4,602
Cash and cash equivalents	15,441	8,138	5,274	18,330
Total assets	93,467	113,321	188,876	267,932
Current liabilities				
Payables	-7,624	-6,446	-3,000	-4,000
C shares in issue	-29,574	0	0	0
Total current liabilities	-37,198	-6,446	-3,000	-4,000
Net current assets	-20,688	4,294	5,876	18,932
Long-term liabilities				
Zero dividend preference shares	0	-11,155	-11,155	-11,155
Total liabilities	-37,198	-17,601	-14,155	-15,155
Net assets	**56,269**	**95,720**	**174,721**	**252,777**
NAV (per share, p)	**0.98**	**0.97**	**1.00**	**1.01**

Source: Company September 2018 presentation, Hardman & Co Research

Cashflow				
Year-end Dec (£000)	2017	2018	2019E	2020E
Return on ordinary activities before finance costs and taxation	1,586	5,364	10,996	15,144
Adjustments for losses on investments	844	807	0	0
Increase in debtors	-1,069	-1,533	-1,100	-1,150
Increase in creditors	691	1,023	-3,446	1,000
Net cash inflow/(outflow) from operating activities	**2,052**	**5,661**	**6,450**	**14,994**
Cashflow from investing activities				
Purchase of financial assets	-100,617	-88,580	-150,000	-200,000
Proceeds from sales of financial assets	29,676	60,111	72,581	135,000
Net cash outflow from investing activities	**-70,941**	**-28,469**	**-77,419**	**-65,000**
Cashflows from financing activities				
Finance costs		-95	-380	-380
Dividends paid	-1,260	-5,776	-9,316	-13,813
Net preference shares (net of costs)		10,870	0	0
Net C shares		11,065	0	0
Net sales of ordinary shares	85,590	0	77,801	77,250
Other costs charged to capital		-156	0	0
FX losses		-403	0	0
Net cash inflow from financing activities	**84,330**	**15,505**	**68,105**	**63,058**
Net increase in cash and cash equivalents	15,441	-7,303	-2,864	13,052
Opening cash and cash equivalents	0	15,441	8,138	5,274
Closing cash and cash equivalents	15,441	8,138	5,274	18,330

Source: Company September 2018 presentation, Hardman & Co Research

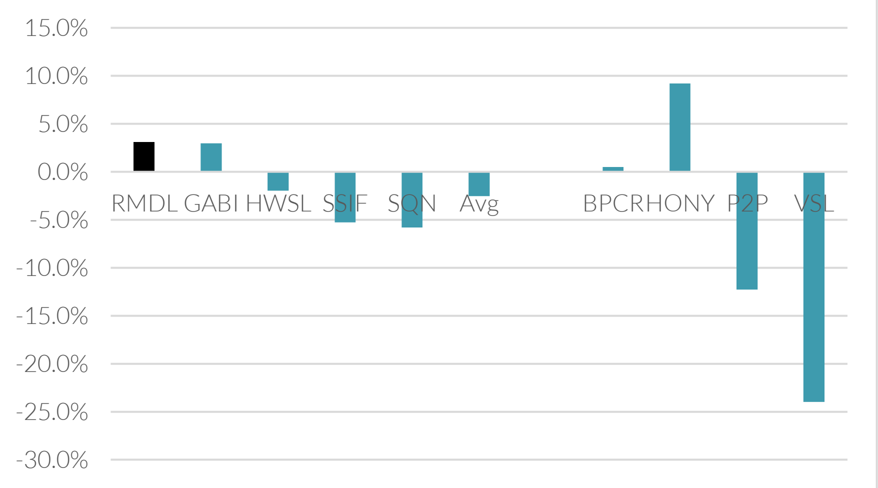
Valuation

Yield attractions above those of peers; for peers, we focus on GABI, HWSL and SQN, and, to lesser extent, SSIF

We discussed the yield and its sustainability earlier in the report. We believe this is a key attraction for investors. In the table below, we compare the premium/discount to NAV of RMDL with its immediate peers (tickers: GABI, HWSL, SQN). We have also included the much smaller SSIF as an asset-backed vehicle. This group, we believe, has the closest economic risk sensitivity to RMDL and represents a tighter segregation of the companies than the recent AIC review. For the sake of completeness, we have included, in the chart below, those companies in the AIC sector (tickers: BPCR, HONY, P2P and VSL, excluding those in wind-down mode), but we do not believe that investors should focus on them.

As can be seen from the chart, the average rating for the close peers is a 2.5% discount to NAV. RMDL's 3% premium is thus better than average but only modestly so, and it is not the largest premium. The wider peers – not unsurprisingly given their broad sensitivity and history – have a much broader range of valuations.

Premium/discount to latest NAV (%)



Source: Company factsheets, Hardman & Co Research, Priced at 3 June 2019

In our review, *Investment Companies: Understanding the deepest discounts*, published on 14 May 2019, we identified a number of factors driving discounts/premiums to NAV. Applying these factors to RMDL and its close peers, we note the following.

Legacy issues re accounts in difficulty at SQN and HWSL

- A material account has run into distress at both SQN and HWSL. While management appears confident at both companies in making recoveries, there may be a degree of uncertainty in investors' minds until investors have a clearer understanding about the likely loss, if any. IFRS9 accounting requires expected cashflows to be discounted, and so a recovery may see an unwind of current provisions, but we believe investors are unlikely to give the NAV the same confidence as for companies that have not shown the same exposure until there is more certainty.

Prospective risk

- We totally support the market's antipathy towards the KID disclosure and its value to understanding risk. Having said that, in our report mentioned above, we did identify a correlation between the KID stress test scenario and companies with the biggest discounts. We recognise that this calculation is driven by historical share price movements but, given the correlation we identified, we believe that at least some investors do view it as indicative of prospective risk. For RMDL and its peers, those companies with the largest stress downsides are trading at a premium, which suggests this is not a factor.

Upside from issuing shares above NAV

- Like several debt investment companies, we believe further equity issuance is probable to fund growth. Should RMDL issue them around the current level, i.e. at a premium to NAV, this will enhance the value for existing shareholders.

We also identified a number of other prospective risks, including the following.

Cyclicality

- It may be an over-simplification, but the market may be taking revenue yield as indicative of risk and cyclicality. The order of revenue yield (lowest to high) is GABI, RMDL, HWSL and SQN, which is also the order of the largest premium down to largest discount.

Volatility

- The volatility of NAV returns is relatively modest for all the companies. We do note, though, that in terms of share price volatility, RMDL has been very low (high to low 104p to 100.15p) compared with its peers (GABI 111p to 101p), HWSL (104p to 93p) and SQN (100p to 89.2p).

Other prospective risks

- We do not believe the other prospective risks we identified in our report (asset illiquidity, competition, regulatory risk, concentration risk, diversity by asset class and key staff) are likely to be material drivers.

Accounting

Earlier, we discussed in detail the impact of RMDL's and GABI's approach to accounting (fair value through profit and loss) being different from that of peers (SQN, HWSL), who adopt loans at amortised cost. It is interesting that the two adopting fair value accounting are at premiums. In our report, *Debt Investment Companies: Diving deep finds you the treasure,* published on 25 February 2019, we reviewed accounting in some detail. As discussed above, for us, the critical issue is how conservative a company is in its application of accounting rules. We believe we have identified, through this report, multiple examples of RMDL's conservatism.

Fees

In our review, *Investment Companies: Understanding the deepest discounts*, published on 14 May 2019, we identified that, as a group, the companies with the biggest discounts had fees *ca.* 3x the whole closed-ended IC average. We also identified that there was no correlation within those companies. In the section on fees in this report, we note that the difference in fees is not material.

Corporate governance

We do not believe that corporate governance in terms of voting structure or related parties is a material issue. The major shareholders are listed below but, again, should not be an issue. As RMDL is trading at a premium, we do not believe that its discount management policies are a material factor at present.

Major shareholders (%)

Company	Largest shareholders
RMDL	CCLA 18%, Quilter 13%, Merian 13%, Brooks MacDonald 5%, Hawksmoor 5%, CG AM 4%, Charles Taylor 3%, Axa 3%, Seneca 3%, Jupiter AM 3%
GABI	CCLA 10%, Close Brothers AM 8%, Premier AM 5%, Gravis CM 4%, BMO Global 4%, West Yorkshire 4%, Valu-trac IM 4%, EFG Harris Allday 3%, Brooks MacDonald 3%, Investec 3%
HWSL	Quilter 25%, Invesco 20%, Investec Wealth 13%, Premier AM 11%, CCLA 8%
SQN	Investec 15%, Schroder 12%, Sarasin 6%, Rathbone UT 5%, CCLA 5%, Baillie Gifford 3%, BMO 3%, West Yorkshire Pension Fund 3%
SSIF	Somerston Golf GP 28%, WM & sons 6%, SQN CM 6%, Albion Resources 6%, CG AM 6%, CQS 5%, Axa 5%, Pictet 5%, Jupiter 5%, Canaccord WM 3%, Killik 3%

Source: Refinitiv (accessed 19 May 2019), Hardman & Co Research

Appendix 1: investment policy

Investment policy	
Company	**Fee structure**
Investment	UK & European SMEs and mid-market corporates
Eligible investments	Across the capital structure, with a focus on first- and second-ranking secured and unitranche investments, either bi-laterally or in a club. No equity-only positions.
Target deal size	£2.5m- £10m
Duration	1-10 years
Performance Objective	8.5% target return (across investments)
Investment diversity	Investments may be made on a fixed, floating and index-linked basis
Currency	GBP/EUR preference. All currencies to be hedged to GBP.
Sector preference	Beverage & Food, Capital Equipment, Technology, Media & Telecoms, Healthcare & Pharma, Property, Social Infrastructure, Energy & Waste, Maximum Single Sector Exposure: 40%

Source: Company September 2018 presentation, Hardman & Co Research

Investment restrictions

The investment policy restrictions are outlined below:

- the amount of no single loan shall exceed 10% of gross assets;
- exposure to a single borrower shall not exceed 10% of gross assets;
- loans will be made across not less than four market sectors;
- not less than 70% of gross assets will be represented by loans denominated in sterling or hedged back to sterling;
- loans made to borrowers in any one market sector shall not exceed 40% of gross assets (we note, from the March 2018 prospectus, that this limit is in a "safe" sector, such as social infrastructure/utilities; higher-risk sectors are capped at a lower level, e.g. automotive components 10%, or commercial restate lending 25%);
- loans with exposure to project development/construction assets shall not exceed 20% of gross assets;
- the company will not provide loans to borrowers whose principal business is defence, weapons, munitions or gambling;
- the company will not provide loans to borrowers who generate their annual turnover predominantly from tobacco, alcohol or pornography;
- the company will not invest in other listed closed-ended funds; and
- loans will be directly originated or sourced by the investment manager, who will not invest in loans sourced via, or participations through, peer-to-peer lending platforms.

Appendix 2: company Information

Directors

Norman Crighton (aged 51) (Non-executive Chairman)

Mr. Crighton is the Chairman of both Weiss Korea Opportunity Fund and AVI Japan Opportunity Trust. Mr. Crighton 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 almost 30 years' experience in closed-ended funds, having led teams 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.

Guy Heald (aged 67) (Non-executive Director)

Mr. Heald has spent most of his career in banking, specialising not only in markets, but also in general management positions, overseeing all aspects of banking, including lending. He has worked in London, New York and Tokyo, and has an extensive knowledge of companies' needs for financing and managing interest rate, liquidity and foreign exchange risks. During his career, he has worked for Brown Shipley, Chemical Bank and HSBC, where he has held senior positions, including Head of Global Markets and Chief Executive Office at HSBC Japan. After leaving banking in 2003, he has served as an adviser, non-executive director and trustee of several charities, as well as starting a number of successful family companies of his own. The SME market is of particular interest to him, specifically the challenges facing companies in their pursuit for growth, as he invests in venture and growth capital himself.

Marlene Wood (aged 55) (Non-executive Director and Chair of the Audit Committee)

Mrs. Wood is a chartered accountant, and currently non-executive director and audit committee chair of GCP Student Living plc, and non-executive director and finance committee chair of the Scottish Funding Council for Further and Higher Education. She has also recently chaired the strategy working group for the University of the Highlands and Islands. Mrs. Wood has 20 years' experience in the commercial property sector, having been finance director for Miller Developments, raising finance for major property transactions in both the UK and Europe. Her experience covers governance and risk management, as well as financial oversight and debt raising.

Investment manager

James Robson (Chief Investment Officer, Principal, Co-Manager)

James has 20 years of experience in capital markets and credit products. He founded RM Capital Markets Limited in 2010, and currently leads the business, and is a member of the Credit Committee of the Investment Manager. Prior to founding RM Capital Markets Limited, James was a credit trader for RBS and Dresdner, and was the former head of the European corporate credit trading business at HSBC. James has a BSc in Economics and Business Management from Newcastle University.

Pietro Nicholls (Principal, Co-Manager)

Pietro has 12 years of experience in investment banking, capital markets, project finance and corporate lending. Pietro has extensive experience in advising publicly-listed, unlisted and government-related entities on investment, financing, M&A and liability management solutions. Pietro is a member of the investment committee. Prior to the trust's launch, his team advised on, sourced and/or arranged over €2bn of debt finance transactions located within Western Europe. Pietro played a role in the development of the UK retail bond market, a now established form of funding for corporates.

Both James and Pietro are voting members of the investment committee.

Investment committee

Henry Chaplin (Chair of the Credit Committee)

Henry has 26 years of experience in capital markets, corporate finance advisory and custody. Henry acts as chairman of NCM Fund Services, which he led as a buy-out from Noble Group in 2009. Henry is also a non-executive director of N+1 Singer Advisory LLP and a board member of UKFTF, a £200m private equity fund. Henry was an officer in the Royal Green Jackets for 5 years, and has also worked in management consultancy.

Ian Cunningham (External Credit Committee Member)

Ian has 40 years of experience in lending and banking at RBS, with a focus on SME and corporate lending. Ian was the former Head of Corporate & Commercial Credit for RBS (Scotland), a position that he held for 13 years until 2009. Ian was also a former member of RBS's Global Credit Committee and was responsible for all credit risk training globally. He is recently stepped down as Head of Credit at the LendingCrowd, Edinburgh. Ian is a fellow of the Institute of Bankers in Scotland.

Malcolm Hayday CBE (External Credit Committee Member)

Malcolm has 40 years' experience in corporate lending and banking, with a focus on SMEs, social enterprises and community finance. Malcolm was awarded a CBE in 2013 for services to charities and social enterprises. He is the founder and was the first chief executive of The Charity Bank, the world's only registered charity and authorised bank. He was also chair of the internal credit committee. Malcolm's previous experience was in lending and credit and included establishing a European credit function within a major bank. Malcolm is a Fellow of the Royal Society for the Arts, a Senior Fellow at the Finance Innovation Lab and Associate of the Institute for Social Banking. He has co-authored a recipe book for social finance for the European Commission.

Registration

Incorporated with company registration number 10449530 and with registered address, RM Secured Direct Lending PLC, Mermaid House, 2 Puddle Dock, London, EC4V 3DB.

Appendix 3: Hardman & Co tick sheet

Hardman & Co – specific questions for secured lenders	
Question	**Hardman & Co response**
Strategic	
To what extent do you earn higher returns by being willing to accept more (leveraged) risk, and to what extent is it about exploiting opportunities where a lack of understanding means risk may have been mis-priced?	Returns reflect niche markets with limited competition. Complex deals also earn intellectual capital returns. Permanent capital means RMDL can capture illiquidity premium.
What competitive advantage does the asset manager have to deliver superior returns?	Structuring skills, origination relationships, permanent capital.
How broad a range of asset classes does the mandate/manager's expertise allow?	Reasonably broad by level of security, and includes warrants.
What discount management programmes are in place?	Intervention at 6% discount to NAV (see section in report).
What is the portfolio approach to managing risk – are there elements in the portfolio that have materially different risks from others, and how is this managed?	Sector exposure capped at varying risk-identified levels. While still a small portfolio, there is diversification.
Why would borrowers come to you, rather than to their bank?	Service levels, skills in structuring deals.
For property lenders, do you see yourself as a property company that happens to invest in debt, or are you a debt company that specialises in real estate?	n/a
Valuation	
Can you give details of how you get to your IFRS9 impairment calculation?	Minimal impact on transition.
What external verification (other than auditors), if any, is there to verify valuations?	Professional valuers used for physical security.
Do you have any measure of the credit volatility seen by your niche in a range of economic scenarios?	n/a
What would the value of security be on a forced sale basis?	Early intervention reduces risk of forced sale.
Risk	
What evidence can you provide that security has been effectively executed?	Follow-up checks with Land Registry/Companies House is core part of procedures.
What measures are in place to ensure security is effectively monitored, and to what extent is this external?	SPV structures for majority of lending, with covenants including timeliness of reporting,
What has been the historical recovery rate on security taken?	Have seen early interventions.
How would the collection of debt be enforced in the event of the counterparty defaulting? What expertise does the team have in collections?	Internally, early intervention reduces risk of loss.
What is the overall interest rate sensitivity and what are the key dynamics driving it?	Some upside to revenue from rising rates.
Does the change in Crown Preference have any direct or indirect effects, and what is its likely impact on borrowers?	Some impact but unlikely to be meaningful.
What is the exposure to high-risk sectors (such as retail) and how is this risk managed? Have CVAs had a material effect?	Small.
What are the resale market conditions should the security need to be realised? How specific are the assets that form the security to the borrower, or is there general demand for them?	Focus on management attention. In things like funding asset financers, more important to control the cash-generating assets.
For invoice finance providers, what are the characteristics of the end-invoice payers compared with the borrowers?	n/a
Reinvestment	
How can we be confident that there will be material reinvestment opportunities to deploy maturing debt?	Highly

Source: Hardman & Co Research

Notes

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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