

Buying Discounts & Selling Premiums

IRONSIDES PARTNERS LLC

Robert Knapp

Fall 2011 *Grant's Interest Rate Observer* Conference

Please Note

This presentation is for informational purposes only and is not a recommendation to buy or sell any security. This presentation does not constitute investment advice and the information herein is not provided to any individual with a view toward their individual circumstances. The information and any data contained herein have been obtained from sources which we believe to be reliable, but we do not represent that they are definitive or complete, and they should not be relied upon as such. There is no guarantee that we hold or will continue to hold the securities discussed. All opinions expressed and data provided herein are subject to change or modification without notice. All investments involve different degrees of risk and this presentation makes no effort to forecast returns. You should research companies and securities before making any investments. This presentation is not an offer to sell or a solicitation of an offer to buy an interest in any investment vehicle or account managed by us.

Introduction

- Closed end funds and holding companies provide the opportunity to buy assets at a discount to intrinsic value or short them at a premium to intrinsic value.
- There is little debate that the share price is wrong. The only issues are timing and mechanism for realizing value. We like opportunities with an identifiable catalyst.
- Hedged investing requires we live by alpha.
- Three examples for today:
 - 3i Group plc (“III” on LSE) at a 32% discount to NAV (pp. 4 - 13)
 - American Capital Strategies (“ACAS” on Nasdaq) at a 43% discount to NAV (pp. 14 - 19)
 - Pimco High Income Fund (“PHK” on NYSE) at a 62% premium to NAV (pp. 20 - 24)

3i Group: Overview

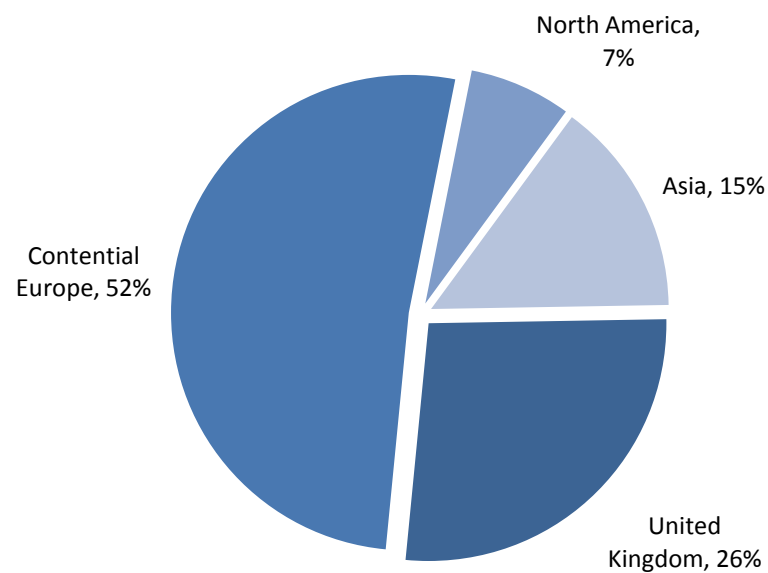
- 3i Group is a UK listed alternative asset manager focused on private equity, infrastructure, and debt. Market capitalization is £2 billion.
- Structured as an investment trust with a £4 billion balance sheet investment portfolio and £7 billion in external funds (31st March).
- Book equity is £3 billion, net borrowings are £0.5 billion.
- Private equity and infrastructure investments valued at 8.8x EV/Ebitda.
- Shares are trading at a significant discount to NAV, implying no value to the embedded alternative investment manager.
- Live NAV per share is estimated by Ironsides at 296p per share. Closing price on 14th October was 202p per share. The discount to the 31 March 2011 NAV is 43% and the discount to estimated live NAV is 32%.

3i Group: Sum of the Parts

3i Group Balance Sheet

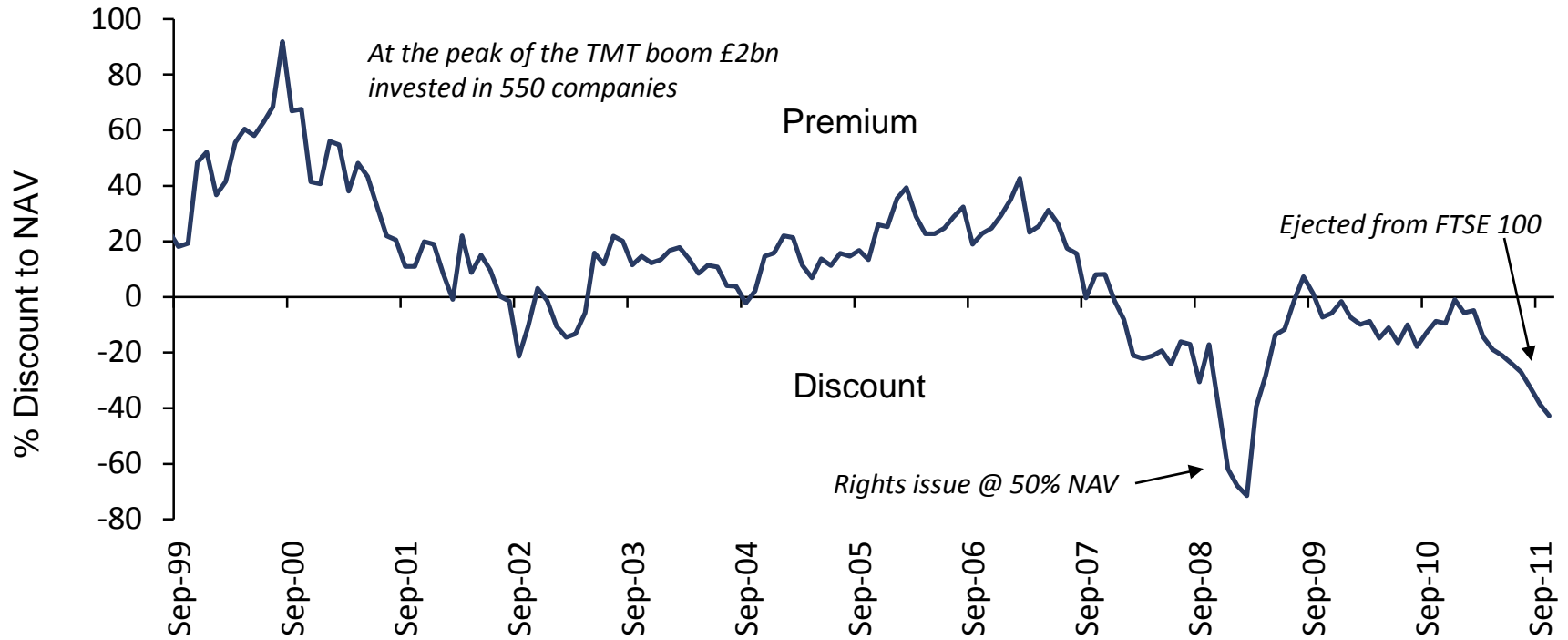
	31-Mar-11	Current
Investment Assets	3,993	3,417
Other Net Liabilities	(114)	(114)
	<u>3,879</u>	<u>3,300</u>
Gross Debt	2,043	1,907
Cash	<u>1,521</u>	<u>1,482</u>
Net borrowings	522	425
Equity	3,357	2,875
Market Capitalisation	2,853	1,961
Discount	-15%	-32%
Gearing	16%	15%
Liquidity	1,800	1,900

Private Equity Portfolio Geography



Source: Report and Accounts 2011 and Ironsides Estimates

3i Group: Premium/Discount History

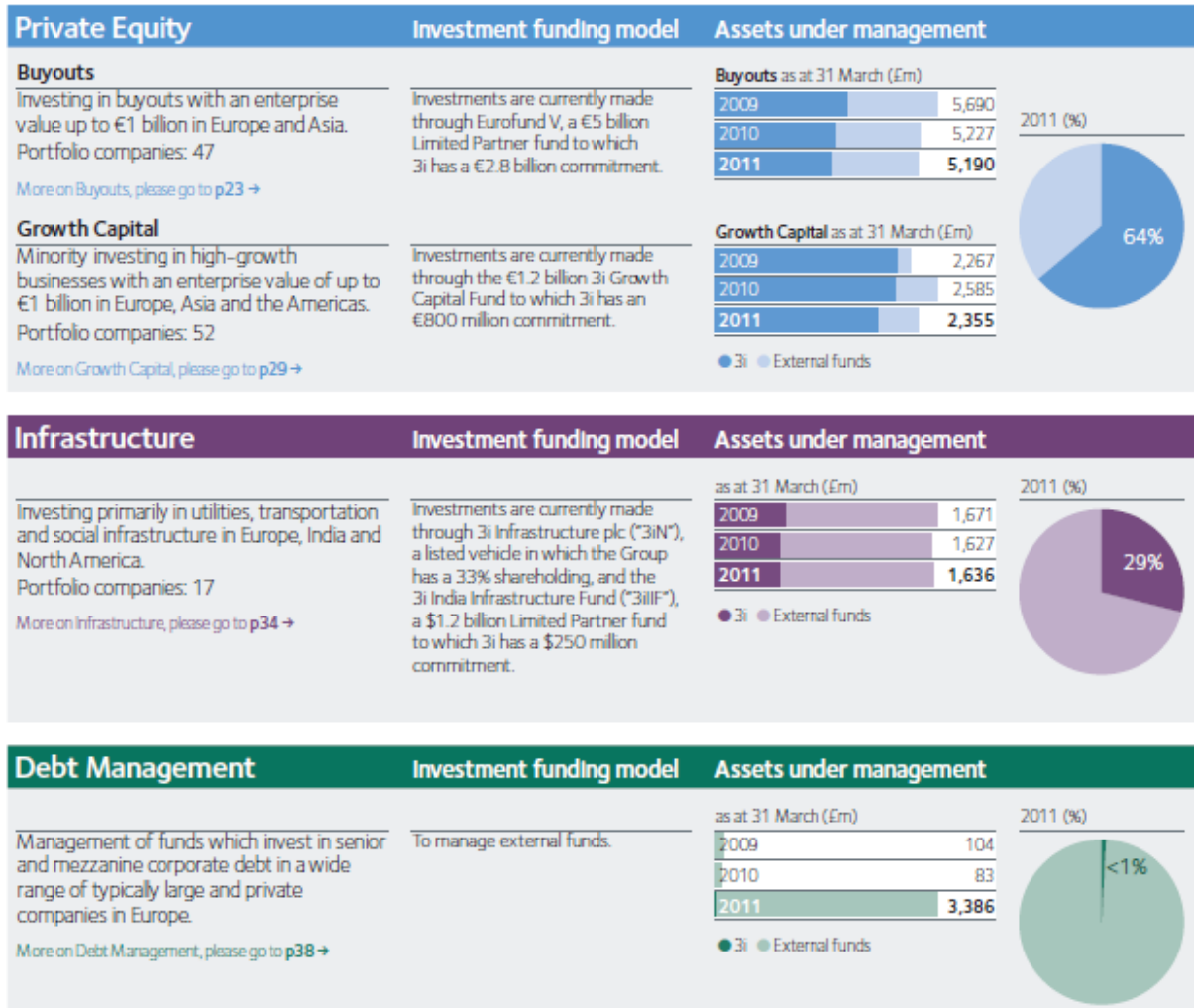


Source: Datastream, Bloomberg

3i Group: History

- 1945 Atlee Government forms investment entities called “Investors in Industry” targeting UK middle market.
- 1990s Rebranded “3i”, listed on LSE. Joins FTSE 100 & expands into Europe.
- 2000 Pursues TMT boom, investing £2 billion into 550 companies (mostly tech start-ups) before markets collapse.
- 2006 Raises €5 billion mid-market buyout fund Eurofund V.
- 2007 Raises £973 million 3i Infrastructure fund.
- 2008 Borrows £430 million via CB, returns £800 million in cash to shareholders, and invests £2 billion in balance sheet assets into buyouts before markets collapse.
- 2009 Conducts 9 for 7 rights issue raising £732 million, a 45% discount to the market price and a 50% discount to the new diluted NAV.
- 2010 Raises €1.2bn growth capital fund, purchases Mizuho Investment Management forming a debt team with £3.8 billion AUM.

3i Group: Asset Composition



Source: Report and Accounts 2011 p. 10

3i Group: Funds Managed

	Close date	Original fund size	Original 3i commitment	% invested at March 2011	Gross money multiple at March 2011 ¹	AUM
Private Equity						
3i Eurofund III	July 1999	€1,990m	€995m	91%	2.1	€99m
3i Eurofund IV	June 2004	€3,067m	€1,941m	96%	2.3	€910m
3i Eurofund V	Nov 2006	€5,000m	€2,780m	71%	0.8	€5,000m
3i Growth Capital Fund	March 2010	€1,192m	€800m	46%	1.2	€1,192m
Growth Capital non-fund	various	various	various	various	n/a	€1,081m
Other	various	various	various	various	n/a	€243m
Infrastructure						
3i India Infrastructure Fund	March 2008	\$1,195m	\$250m	65%	1.3	\$945m ²
3i Infrastructure plc	March 2007	£973m ³	£320m ⁴	n/a	n/a	£973m
Other	various	various	various	various	n/a	£74m
Debt Management						
Harvest I	April 2004	€514m	€15m	100%	n/a ⁵	€345m
Harvest II	April 2005	€552m	€5m	100%	n/a ⁵	€514m
Harvest III	April 2006	€660m	€5m	100%	n/a ⁵	€618m
Harvest IV	June 2006	€752m	€6m	100%	n/a ⁵	€716m
Harvest V	April 2007	€650m	€10m	100%	n/a ⁵	€598m
Windmill I	Oct 2007	€600m	€5m	100%	n/a ⁵	€490m
3i Debt Warehouse	Oct 2007	€325m	€120m	4% ⁶	n/a ⁵	€13m
Friday Street	Aug 2006	€300m	nil	100%	n/a ⁵	€180m
Vintage I	March 2007	€500m	nil	100%	n/a ⁵	€360m
Non-core						€118m
Total AUM (in sterling)						£12,686m

Source: Report and Accounts 2011 p.18

3i Group: Top 10 Investments

Company	Ticker	Valuation £mm	Cost £mm	Business	Website
3i Infrastructure plc	3IN LN	320	270	Infrastructure Fund	www.3i-infrastructure.com
NORMA Group Holding GmbH	n/a	197	33	Engineered Joining Technology	www.normagroup.com
MWM GmbH	n/a	191	70	Power Generation Systems	www.mwm.net
Hyva Investments BV	n/a	181	16	Automobile Hydraulics	www.hyva.com
ACR Capital Holdings PTE Ltd	n/a	146	105	Reinsurance	www.asiacapitalre.com
Foster + Partners	n/a	132	<i>undisc</i>	Architectural Services	www.fosterpartners.com
Älö Intressenter AB	n/a	129	39	Front End Loader Manufacturer	www.alo.se
Mémora Servicios Funerarias	n/a	118	109	Funeral Services	www.memora.es
Quintiles Transnational Corp	n/a	108	74	Clinical Research Outsourcing	www.quintiles.com
Scandferries Holding GmbH	n/a	102	45	Ferry Operator - Baltic Sea	www.scandlines.de
Top 10 investments		1,624			

Source: Report and Accounts 2011 p.132-133, all valuations are as at 31-Mar-11

3i Group: Shareholders

	As at 31 March 2011	% of issued share capital	As at 11 May 2011	% of issued share capital	Nature of holding
BlackRock, Inc	125,860,652	12.968	125,860,652	12.968	Indirect
Legal & General Group Plc and/or its subsidiaries	38,620,595	3.980	38,620,595	3.980	Direct
Deutsche Bank AG	49,065,391	5.055	49,065,391	5.055	Direct and indirect
Schroders Plc	47,870,160	4.933	47,870,160	4.933	Indirect
Ameriprise Financial, Inc. and its group	66,041,715	6.805	66,041,715	6.805	Direct and indirect
Standard Life Investments plc	48,482,387	4.996	48,482,387	4.996	Direct and indirect
Government of Singapore Investment Corporation Pte Ltd	29,029,897	2.991	29,029,897	2.991	Direct

Source: Report and Accounts 2011 p.65

3i Group: Potential Manager Valuation

Company	Market Cap	Enterprise Value	AUM	EV / AUM	P/B	T12 Fees	Fees / AUM
	£GBP mm	£GBP mm	£GBP mm			£GBP mm	
Blackstone	£9,213	£17,473	£100,585	17.4%	3.2x	£1,004	1.0%
KKR	£5,453	£5,600	£39,257	14.2%	5.4x	£287	0.7%
Fortress	£1,030	£1,408	£27,775	5.1%	3.6x	£298	1.1%
Apollo	£2,493	£4,888	£45,452	10.8%	4.9x	£87	0.2%
Partners Group	£2,949	£3,564	£16,095	22.1%	9.4x	£266	1.7%
3i Group	£1,976	£3,030	£12,686	23.9%	0.7x	£67	0.5%
			Average	13.9%	5.4x		0.9%
Restructured 3i	£520	£720	£7,200	10.0%	1.1x		

- Restructured 3i assumes balance sheet with £700 million of investments and £200mm of debt.
- Embedded Investment Manager potentially could be worth £520 million, or more than 25% of existing market capitalization.

Source: Bloomberg, Annual Reports

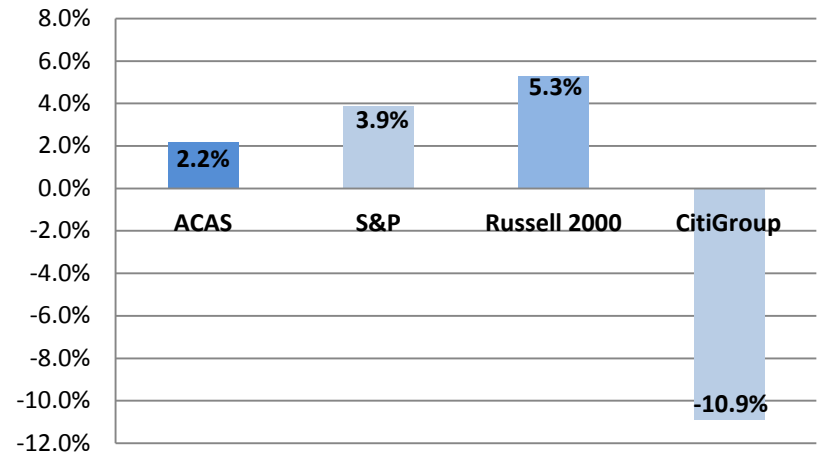
3i Group: Restructuring Opportunity

- Immediate Special Dividend:
 - Sell position in listed 3i Infrastructure Fund, realizing equivalent of 38p in cash while suffering no loss in AUM.
 - Pay special dividend worth 20% of current share price.
- Three-Year Balance Sheet Unwind:
 - Realize balance sheet investments over time and focus on third party fund raising.
 - Return potentially 150% of current market capitalization while retaining £7.2 billion in external funds.
 - Potential valuation of ongoing business is 10% of AUM, or 25% of additional value to existing market capitalization
- Challenges:
 - Management likely to oppose a restructuring.
 - High cost structure requires significant overhead reduction. Operating expenses run at 6% of NAV, with 400 employees in 13 countries.

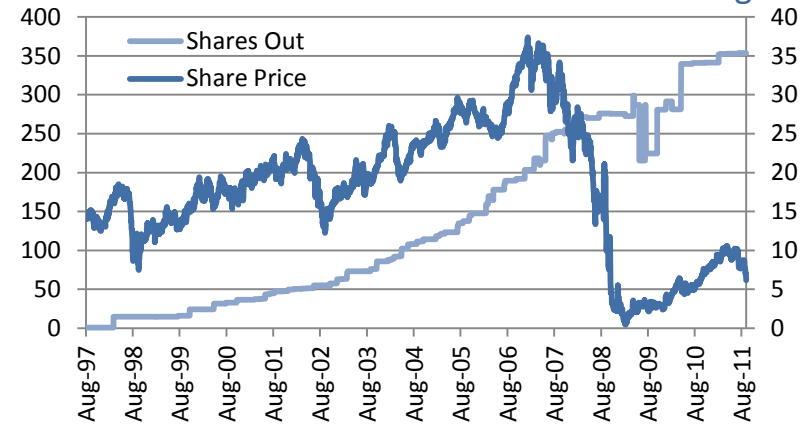
American Capital: Overview

- Middle Market Lender, Buyout Sponsor & Mortgage REIT Manager
- Business Development Company Regulated by the 1940 Act.
- \$6.3 billion in balance sheet assets and \$7.1 billion in external funds. \$2.4 billion market capitalization.
- 344 million shares outstanding, following 31 equity offerings since IPO in 1997 with 8.4 million shares.
- Live NAV per share is estimated by Ironsides at \$12.37 per share. Price on 14th October was \$7.09. Discount to live NAV is 43% and discount to 30th June NAV is 46% .

Annual Share Price Return with Divs Reinvested



Historic Share Price and Shares Outstanding



Source: Bloomberg 8/29/97 – 10/14/2011

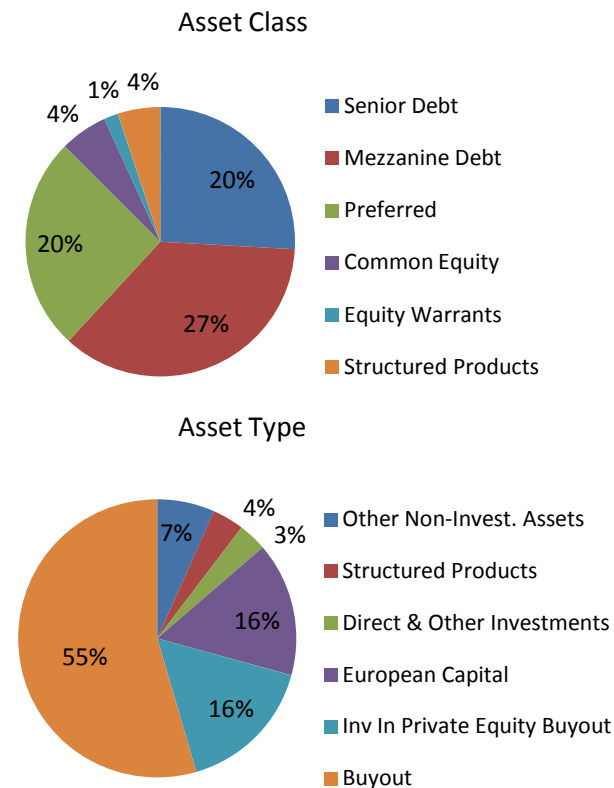
American Capital: Sum of Parts

- 207 Portfolio Companies with average EBITDA margin of 21%.
- 5% ROA & 7% ROE
- \$280 million operating income per year.
- Investment portfolio at 82% of cost.
- Expense Ratio 3.5%, Loans on Non-Accrual 9%.
- Embedded asset manager is valued on balance sheet at \$336 million (5% of AUM).

Q2 Balance Sheet

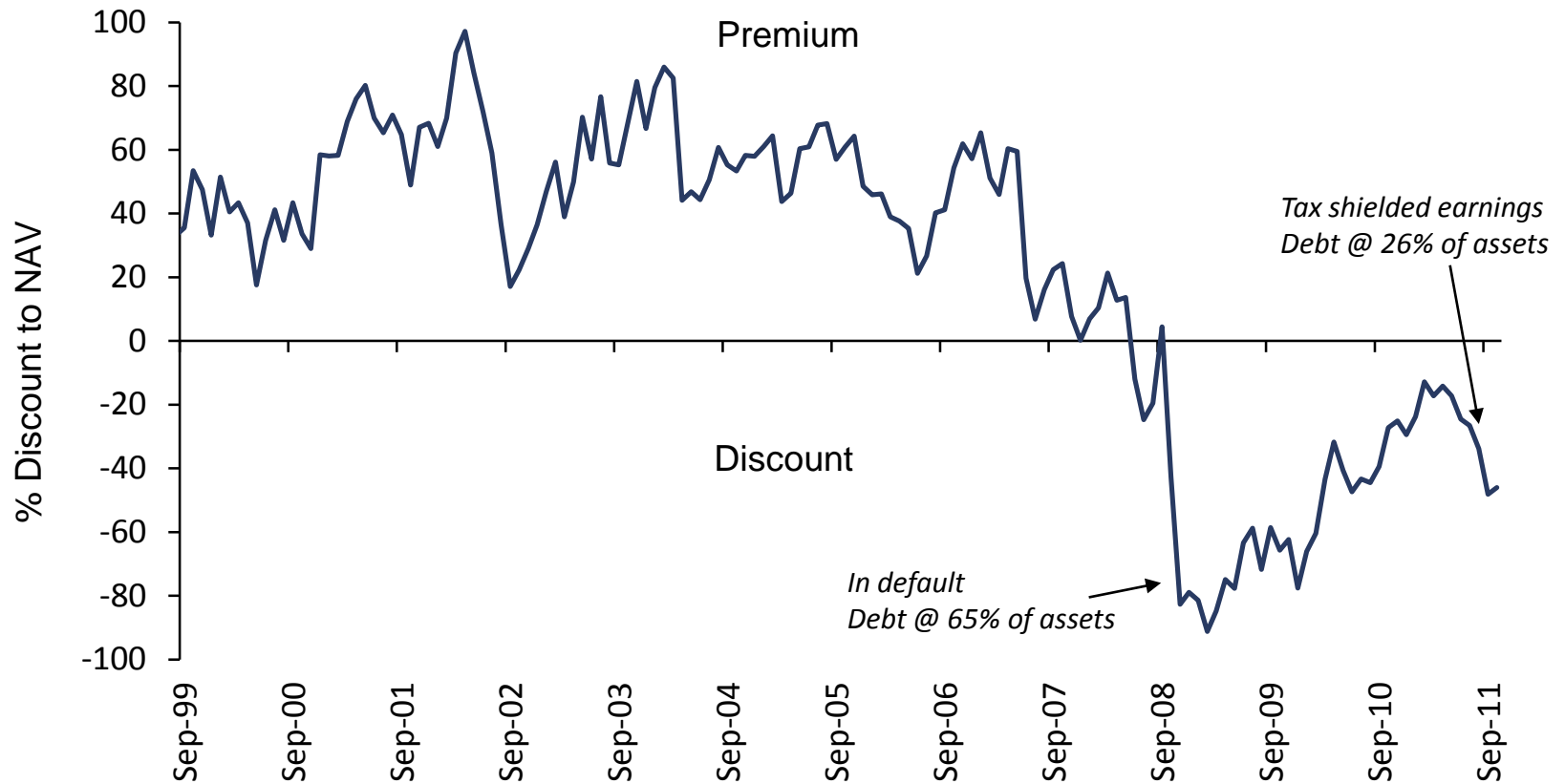
Assets	\$ MM
Cash and cash equivalents	186
Restricted Cash	116
Senior Debt	1,174
Mezzanine Debt	1,652
Preferred	1,162
Common Equity	1,611
Equity Warrants	79
Structured Products	231
Investments at fair value	5,909
Other	122
Total assets	6,333
Liabilities	\$ MM
Fixed private sec. notes 12/2013	111
Float prvt sec. loans due 12/2013	61
Fixed public secured notes 12/2013	524
Floating public sec. notes 12/2013	4
Unsecured public debt 12/2012	11
ACAS Business Loan Trust 2004-1	54
ACAS Business Loan Trust 2005-1	360
ACAS Business Loan Trust 2006-1	239
ACAS Business Loan Trust 2007-1	165
ACAS Business Loan Trust 2007-2	113
Total Debt	1,642
Other Short term Liabs	150
Total Liabilities	1,792
Net Assets	4,541
Shares Outstanding	345.1
Book Value Per Share	13.16
Share Price	7.09
Discount	-46%

Portfolio



Source: Bloomberg, ACAS 10Q

American Capital: Premium/Discount History



Source: Bloomberg

American Capital: Recent Drama

- Q4 2008 Book value decreases 37% q-o-q from \$18.33 to \$11.57. Falls to \$7.80 by Q3 2009.
- Q1 2009 Defaults on \$2.4 billion unsecured debt with debt at 65% of total assets. Shares fall below \$1 from over \$19 in Q3 2008.
- Q2 2010 Completes debt restructuring. Paulson & Co invests \$221 million for 15.5% of shares outstanding.
- Q2 2011 Book value is \$13.16 after repaying \$3.7 billion in debt since Q2 2008. Debt is 25% of total assets. Changes from RIC to C corporation.
- Q2 2011 External mortgage REIT, American Capital Agency (AGNC), reaches market capitalization of \$5 billion.
- Q3 2011 IPOs 2nd Mortgage REIT, American Capital Mortgage (MTGE), with 8 million shares at \$20.
- Q3 2011 Buys 9 million shares (3%) on open market for cancellation.

American Capital: Comparable Valuation

Company	Ticker	Price	Mkt Cap \$mm	Div Yield	NAV	P/B	Debt/Equity
Ares Capital	ARCC	14.44	2,962	9.7%	15.28	0.95	51.7
Apollo Investment	AINV	7.74	1,520	14.5%	9.76	0.79	65.4
Prospect Capital	PSEC	9.05	989	13.4%	10.36	0.87	7.6
Solar Capital	SLRC	21.20	774	11.3%	23.22	0.91	51.4
Fifth Street Capital	FSC	9.77	707	13.1%	10.72	0.91	38.9
Blackrock Kelso	BKCC	8.08	592	12.9%	9.83	0.82	38.3
Pennant Park	PNNT	9.97	456	10.8%	11.08	0.90	49.4
Mainstreet Capital	MAIN	17.49	406	9.3%	14.24	1.23	77.9
Hercules Technolo	HTGC	9.21	404	9.6%	9.67	0.95	61.0
MCG Capital	MCGC	4.41	340	15.4%	6.93	0.64	95.7
Golub Capital BDC	GBDC	15.05	327	8.5%	14.75	1.02	69.4
Triangle Capital	TCAP	15.96	353	11.0%	13.79	1.16	87.3
BDC Total Average			819	11.6%		0.93	57.8
American Capital	ACAS	6.77	2,395	0.0%	13.16	0.51	36.2

Source: Bloomberg

American Capital: Return Thesis

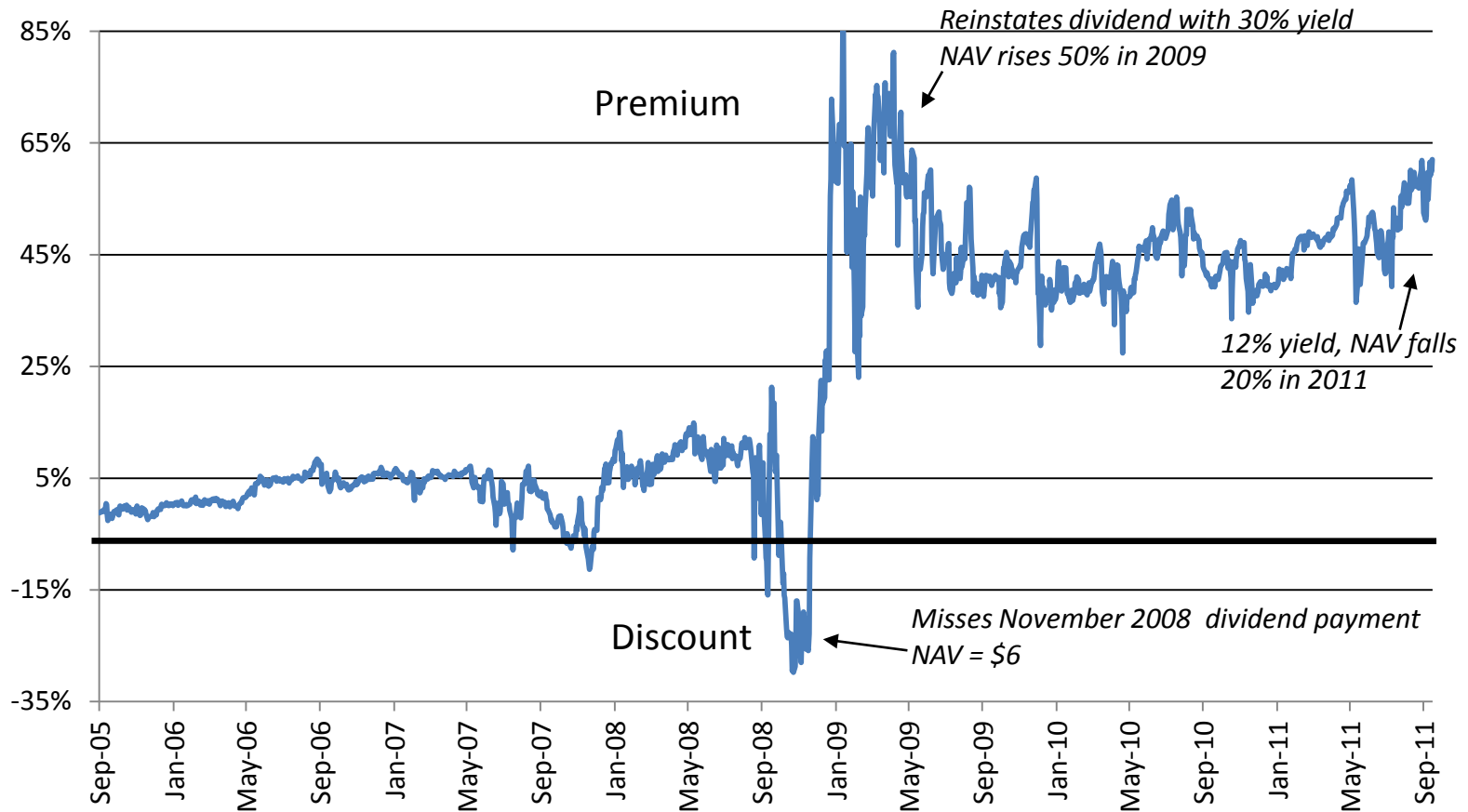
- American Capital's losses and change in tax status create an implicit tax arbitrage vs. peers
 - \$749 million tax shelter in NOLs (\$138 mm) and capital losses (\$611 mm)
 - Will have further losses in Q3 2011 which will add to shelter
 - Change from tax-free registered investment company (RIC) to C Corp allows earnings to compound NAV through 2012 tax free
 - Investors in other BDCs pay income tax rate on dividends
- Retained earnings allow NAV to grow at 7% for next two years taking it towards \$15, over 100% higher than current share price.
- Reinstatement of dividend in 2012/2013 should take shares towards NAV.
- American Capital cannot issue shares while trading below book – it's the law according to the 1940 Act, so further dilution risk is negligible.
- Significant scope for enlightened management to enhance NAV per share with buybacks while focusing on growing external AUM.

Pimco High Income Fund: Overview

- Pimco High Income is a closed end fund managed by Bill Gross with a \$1.4 billion market capitalization. Ticker “PHK” on NYSE.
- Launched in 2003 at \$15 per share. High was \$16.50 reached in June 2007. Low was \$2.88 reached in November 2008.
- Total assets / net assets = 150%. Average portfolio coupon = 7.8%.
- PHK is paying a monthly dividend equal to 20% of NAV.
- PHK shares are trading at a 62% premium to NAV. Shares closed October 14 at \$11.86, NAV closed at \$7.32. Large premium has prevailed since 2008.
- AIG is largest issuer in portfolio, representing 23%. The AIG £8.625% 2038 is 7% and the \$8.175% 2058 is 6.5%.

Source: Bloomberg, www.allianzinvestors.com

Pimco High Income: Premium/Discount History



Source: Bloomberg

Pimco High Income: Portfolio Details

Investment Breakdown	% of NAV
High-Yield	28%
Investment Grade Corporate	24%
Non-US Developed	16%
Municipal	16%
Mortgage	11%
Other	6%
Emerging Markets	1%
Net Cash & Equivalents	-2%
<i>Total</i>	<i>100%</i>

Top 10 Issuers	% of NAV
AIG	23%
Munis	16%
Mortgage Tranches	10%
Sallie Mae	6%
ALLY	5%
BARC	4%
TXU	4%
Treasury	4%
Capital One	3%
Norther Star	3%
<i>Total</i>	<i>78%</i>

Source: Pimco High Yield Annual Report and www.allianzinvestors.com

Pimco High Income: Distribution Analysis

Distributions	per Share	% of NAV	Fund Income	per Share	% of NAV
Normal distributions	\$1.46	20%	Net Portfolio Yield	\$0.88	12%
			Derived from:		
			Average Coupon		7.8%
			Portfolio Price		90%
			Expense Ratio		1%
			Leverage Factor		1.5x

Source: Bloomberg, Pimco High Yield Annual Report ,and www.allianzinvestors.com

- PHK has never missed monthly \$0.12 dividend except November 2008.
- If a fund does not earn its distribution, it is self-liquidating and a dividend cut is eventually inevitable.

Pimco High Income: Insanity?

- Fund pays dividend regardless of earnings. Currently paying 20% of NAV while earning 12%. NAV is down 20% in 2011.
- Yahoo message board: “there is over \$1 billion in net assets, the dividend can last a long while, the shorts need to look themselves in the mirror”.
- Shame on Bill Gross: PHK encourages dividend reinvestment and issues new shares at 95% of share price. Investors get 8% of their own capital back to reinvest at 150% of NAV. Good for Pimco and no one else.
- How do brokers explain this to clients?

Contact Details



Ironsides Partners LLC

100 Summer Street

Boston, MA 02110

Tel: +1 617 368 3900

Ironsides Partners UK LLP

112 Jermyn Street

London, SW1 6LS

Tel: +44 (0)207 321 6030

contact@ironsidespartners.com

www.ironsidespartners.com