

# TETRAGON

## TETRAGON FINANCIAL GROUP LIMITED

### Performance Report for July 2007

16 August 2007

Tetragon Financial Group Limited (TFG) is a Guernsey closed-ended investment company traded on the Euronext Amsterdam Exchange under the ticker symbol "TFG."

In this performance report, unless otherwise stated we report on the consolidated business incorporating TFG, Tetragon Financial Group LP and Tetragon Financial group Master Fund Limited <sup>(1)</sup>. References to "we" are to Polygon Credit Management LP, TFG's investment manager.

#### July 2007 results at a glance:

- ❖ **Overview:** The portfolio continued its strong performance in July 2007, consistent with stable corporate credit fundamentals, while incurring no credit losses. The Q2 dividend was declared at \$0.15, which was at the high end of our guidance. We look forward to what we think should be an opportune market environment for the investment portfolio.
- ❖ **Net Assets:** Consolidated net assets were \$1.26 billion as of July 31, 2007.
- ❖ **Income:** Consolidated net income rose to \$17.5 million in July 2007, up from \$14.9 million in June 2007.
- ❖ **Earnings per Share:** July 2007 EPS were \$0.14, up from \$0.12 per share in June 2007.
- ❖ **NAV per Share:** July 2007 net asset value (NAV) per share was \$10.07, after deducting the Q2 declared dividend of \$0.15 per share.
- ❖ **IRRs:** The weighted-average IRR on closed CDO transactions was 16.4% at the end of July 2007.
- ❖ **Life-to-Date Actual vs. Accrued Collateral Gains/(Losses):** Against the backdrop of resilient credit fundamentals, loss reserves continued to outpace actual life-to-date losses. To the end of July 2007, \$76.2 million of expected losses have been factored into the IRRs, versus an actual net gain of \$0.6 million.
- ❖ **New Deals:** One new transaction closed in July 2007, totaling approximately \$27 million in investment value.
- ❖ **Deal Pipeline:** We expect to settle two additional transactions in August 2007, with a total investment value of approximately \$60 million. Despite the slowdown in CLO issuance, we expect income to hold up well based on our current portfolio of closed and committed deals.
- ❖ **Leverage:** Month-end leverage as of July 30, 2007 was 1.10x compared to 1.04x at the end of June 2007.

#### Dividend:

- ❖ **Q2 2007 dividend of \$0.15 per share:** A dividend of \$0.15 per share was announced on July 31, 2007. The previously given guidance was \$0.13 to \$0.15 per share.

<sup>(1)</sup> TFG invests substantially all its capital through a master fund, Tetragon Financial Group Master Fund Limited ("TFGMF"), in which it holds an 93.6% share. Tetragon Financial Group LP (TFGLP), a U.S. "feeder fund", holds the remaining 6.4% interest in TFGMF. TFG and TFGLP receive a pro-rata allocation of the performance of TFGMF.

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- ❖ **Optional Stock Dividend Plan:** The company implemented an Optional Stock Dividend Plan allowing TFG's shareholders to elect to receive any declared dividends in the form of additional shares. Please refer to the website ([www.tetragoninv.com](http://www.tetragoninv.com)) for additional details.

#### Share Capital:

- ❖ **Shares in issue in TFG:** During July, some TFG LP investors exercised their conversion rights and exchanged their LP interests for shares in TFG. Consequently the number of TFG shares in issue increased to 117,464,830. Total shares in the TFG Master Fund remain the same at 125.45 million.

#### Portfolio summary (please refer to page 4 for more details):

- ❖ **Portfolio size:** \$1.44 billion invested as of the end of July 2007 across 66 settled transactions.
- ❖ **Portfolio composition:** The portfolio composition remained unchanged, with approximately 97% of risk capital allocated to CDO vehicles providing exposure to senior secured loans.

#### Market summary (please refer to page 4 & 5 for more details)

- ❖ **Defaults:** There was only one bankruptcy filing in July 2007 as the loan market continued to avoid defaults.
- ❖ **Market Dynamics:** Loan market conditions continued to shift in a manner that is favorable to lenders and other investors.

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Performance Metrics and Drivers			
Performance Metrics	Q1 2007	Q2 2007	Jul-07
Pre IPO return - Class C shares	3.7%	N/A	N/A
Return on average equity for the period	4.7%	3.5%	1.4%
EPS (\$)	\$0.35	\$0.33	\$0.14
Dividend (\$M)	N/A	18.8 <sup>(1)</sup>	N/A
DPS (\$)	N/A	0.15	N/A
Operating cost - income ratio <sup>(2)</sup>	31.4%	29.6%	38.2%
Performance Drivers	Q1 2007	Q2 2007	Jul-07
Number of investments	56	65	66
Weighted Average IRR on completed transactions	16.3%	16.5%	16.4%
Leverage at end of period	1.12	1.08	1.10
Net assets (\$M)	\$989	\$1,265	\$1,264
Number of shares in issue (million)	89.1	125.5	125.5
Life to date accrued collateral losses (\$M)	(37.0)	(60.6)	(76.2)
Life to date actual collateral gains/ (losses) (\$M)	0.8	0.4	0.6

<sup>(1)</sup> Dividend for Q2 declared in July and liability recognised in the Net Assets at that point

<sup>(2)</sup> "Operating cost-income ratio" replaces "cost-income ratio" as a more meaningful metric.

Operating cost includes operating expenses and performance fees but excludes hedging costs.

Expected Upcoming Events	Date
Dividend payment date	August 27, 2007
TFG presentation at the Lehman Brothers Financial Services conference (3:45 PM)	September 10, 2007
August monthly results reported	September 18, 2007
Q3 financial statements released (including dividend announcement)	October 30, 2007

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### Portfolio and Market Commentary for July 2007

#### Portfolio Size and Composition

- ❖ **Portfolio size: \$1.44 billion invested as of the end of July 2007 across 66 settled transactions.**

On a look-through basis, the portfolio exposure to leveraged loans increased to approximately \$15.5 billion during the month of July 2007, as we closed our 66<sup>th</sup> CLO transaction. We feel that the portfolio is sufficiently invested in the current environment, although we will consider opportunistically adding to the portfolio over the near term.

- ❖ **Portfolio composition: The portfolio's focus on exposure to senior secured bank loans remains unchanged.**

Through the end of July 2007, we had invested 94.9% of our capital in transactions providing exposure to broadly syndicated and middle market senior secured loans across the U.S. and Europe. 3.7% was invested in CDO<sup>2</sup> transactions and 1.3% in ABS and Structured Finance CDOs. Of the CDO<sup>2</sup> transactions, more than half are primarily exposed to senior secured bank loan risk.

#### Market Developments

- ❖ **Defaults: There was only one market bankruptcy filing in July as the loan market continued to avoid defaults.**

The loan market's default-free streak ended as Bally Total Fitness filed for bankruptcy on July 31, 2007. This pushed the S&P 12-month lagging default rate to 0.42% by number of loans, and 0.21% by principal amount, levels that are still well below the historical average of 3.15% and 3.45%, by number of loans and principal amount, respectively. The portfolio did not have exposure to Bally Total Fitness. Given that there were no payment defaults in TFG's portfolio during July 2007, our inception-to-date default rate remained at 0.04% (or 0.02% on an annualized basis) as we continued to build a reserve against future losses.

- ❖ **Market Dynamics: Loan market conditions continued to shift in the favor of lenders and other investors.**

The broad market rejection of "covenant-lite" structures observed in June 2007 widened its scope in July to include most loans, as investors anticipated the \$200+ billion pipeline from the arrangers and began to demand additional concessions in the form of better pricing, original issue discounts (OIDs), and stronger covenants. As such, the primary market slowed considerably, with 27 transactions canceled or postponed during the month. According to S&P, the benchmark BB/BB- institutional spread average increased to L+250bps, and the B+/B average climbed to L+336bps, the highest levels since the fourth quarter of 2003. Since cash flow CLO structures are broadly unaffected by mark-to-market volatility, the current market environment may create potential investment opportunities for our collateral managers and allow them to make strategic trades into loans with wider spreads and better structures.

The loan market supply/demand imbalance was clearly impacted by the reduced "CLO bid". While nearly \$22 billion of CLO paper was issued worldwide during the month, this represents a 12% decrease from the previous month, according to Morgan Stanley research. Looking forward, we expect that the slowed pace of CLO issuance will continue over the coming months as only the most established and successful portfolio managers will be able to access the market.

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## ❖ **Market Dynamics: Loan market conditions continued to shift in the favor of lenders and other investors (continued)**

TFG has already fully invested its capital and is therefore not dependent on the CLO market operating at the pace of the last few years to preserve its current returns. Given TFG's permanent capital base, we may be able to take advantage of certain opportunistic situations in the future that would not otherwise be available.

## **Outlook**

While the past few months have been volatile for the credit markets, we continue to believe that the portfolio is well-positioned to benefit from the recent and anticipated spread-widening environment. Because we have secured locked-in liability costs for the life of our transactions (typically 12+ years), our funding gap arbitrage will increase should our loan exposures repay and reprice at wider spreads. Finally, we think that our conservative approach to portfolio construction and hedging will augment this natural increase in arbitrage and further protect returns.

## **About Tetragon**

Tetragon Financial Group Limited (TFG) currently invests through long-term funding vehicles such as collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs) in selected securitized asset classes and aims to provide stable returns to investors across various interest rate and credit cycles.

## **Investor and Press contact details**

If you have questions on any aspect of the TFG business, please contact the Investor Relations team at [ir@polygoninv.com](mailto:ir@polygoninv.com). For press inquiries, please contact Simon Moyse at Finsbury on + 44 20 7251 3801.

## **Market data sources**

Morgan Stanley – “CDO Market Update” – August 7, 2007

LCD – “LCD Weekly Institutional Loan Market Technicals” – August 8, 2007

S&P – “Bally breaks default-free streak; near-term outlook still bright” – August 2, 2007

S&P – “LCD Weekly Wrap” – July 26, 2007

S&P – “LoanStats Weekly Supplemental” – August 2, 2007

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Snapshot of Portfolio Held by TFG Master Fund Limited (unless otherwise stated)

As of July 31, 2007

Report Date	TFG Share Price (\$)	TFG group Market Cap (\$MM) <sup>(1)</sup>	TFG group Net Assets (\$MM)	No. of Closed Transactions									
31 July 2007	\$8.50	\$1,066.4	\$1,263.6	66									
Capital Allocation by Asset Class													
	Risk Capital Allocation	Investment - Amortized Cost (\$MM) <sup>(2)</sup>	Investment - Amortized Cost B/Fwd (\$MM) <sup>(3)</sup>	Overall Leverage <sup>(4)</sup>	Asset Class Allocation								
Broadly Syndicated Senior Secured Loans: US	61.1%	\$877.9	\$849.4										
Broadly Syndicated Senior Secured Loans: Europe	18.2%	\$262.0	\$252.4										
Middle Market Senior Secured Loans: US	15.6%	\$224.5	\$218.6										
CDOs Squared: US	3.7%	\$53.2	\$51.8										
ABS and Structured Finance: US	1.3%	\$18.5	\$17.6										
<b>Total</b>	<b>100%</b>	<b>\$1,436.2</b>	<b>\$1,389.7</b>	<b>1.10</b>									
Geographic Allocation by Asset Class													
	USA	Europe	Asia Pacific	Total	Geographic Allocation								
Broadly Syndicated Senior Secured Loans	77%	23%	0%	100%									
Middle Market Senior Secured Loans	100%	0%	0%	100%									
CDOs Squared	100%	0%	0%	100%									
ABS and Structured Finance	100%	0%	0%	100%									
	<b>84%</b>	<b>16%</b>		<b>100%</b>									
Top 15 Underlying Bank Loan Credits													
Bank Loan Exposure <sup>(5)</sup>	Top 10 Bank Loan Industry Exposures												
GEORGIA PACIFIC	0.85%												
HCA	0.83%												
ARAMARK	0.70%												
IDEARC	0.66%												
INEOS	0.60%												
OSHKOSH TRUCK	0.60%												
FREESCALE SEMICONDUCTOR	0.58%												
UNIVISION	0.54%												
CSC (CABLEVISION)	0.51%												
VNU	0.52%												
INTELSAT	0.49%												
MGM GRAND	0.48%												
HEXION	0.47%												
CEQUEL	0.46%												
LYONDELL CHEMICAL	0.44%												
Performance <sup>(6)</sup>													
Illustrative Historical Hedge Fund Performance													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
2005								0.41%	0.64%	0.94%	1.13%	1.16%	4.34
2006	1.34%	1.23%	1.44%	1.40%	1.22%	1.16%	1.13%	1.10%	1.00%	1.01%	1.21%	1.25%	15.48%
2007	1.32%	1.15%	1.14%										3.66%
Earnings per Share <sup>(7)</sup>													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
2007		EPS of \$0.35 for Q1 <sup>(8)</sup>		\$0.10	\$0.11	\$0.12	\$0.14						\$0.81

EUR-US\$ Fx: 1.37

<sup>(1)</sup> Includes exchange rights held by Tetragon Financial Group LP investors as if they had been converted to TFG shares and valued at the closing share price.

<sup>(2)</sup> Equivalent to Investment in Securities at Fair Value in the US GAAP Financial Statements.

<sup>(3)</sup> Investments at Amortized Cost less interest accrued since last payment date. Internal Rate of Return (IRR) x Amortized Cost B/Fwd determines CDO Income.

<sup>(4)</sup> Equals CDO Amortized Cost B/Fwd / Book Value.

<sup>(5)</sup> Calculated as a percentage of total Loan Assets that Tetragon has exposure to net of any single name CDS hedges held against that credit. The value of both the Loan Credit and the Total Loan exposure are calculated at cost of purchase.

<sup>(6)</sup> Actual performance for Tetragon Credit Income Fund Limited Class C, calculated as a change in Net Asset Value per Share for the period July 06 - Mar 07. Illustrative results for the period from Aug05 - Jun 06 as if Class C shares had been in place since the launch of the Company. Performance is net of (a) 1.5% management fee per annum, (b) incentive fees of 25% the increase in NAV over a hurdle rate of 8% per annum and (c) expenses, and reflect an investment in the company since inception without additions, withdrawals or redemptions.

<sup>(7)</sup> Number of shares is illustrative for the pre IPO period as the structure of the share classes changed at IPO closing.

<sup>(8)</sup> Q1 EPS is derived from the illustrative historical hedge fund performance during Q1 2007.

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Consolidated Performance (US\$MM)

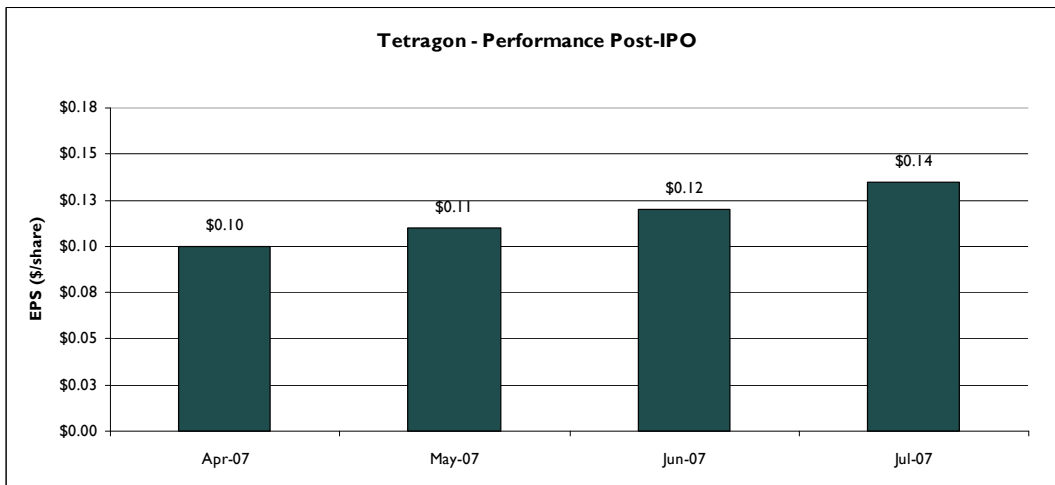
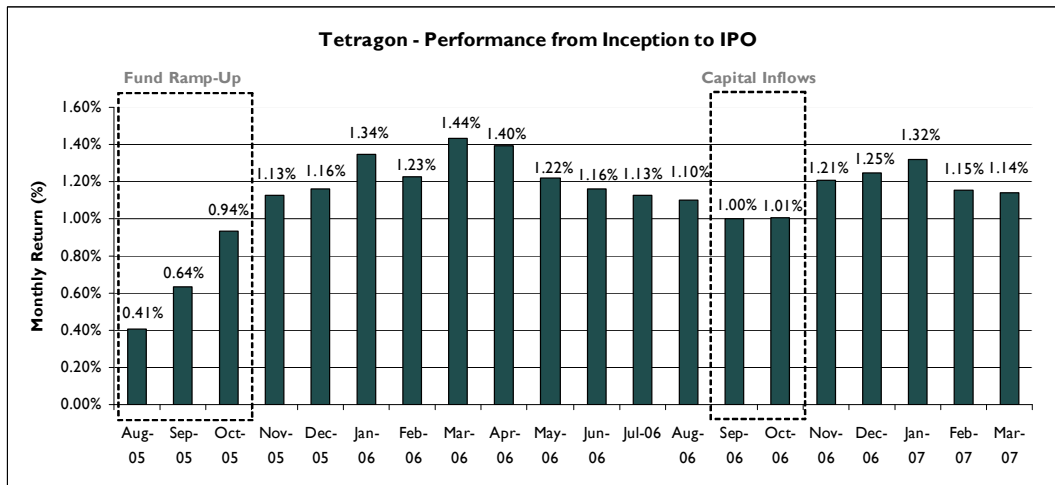
Statement of Operations	Q1 2007 (\$MM)	Q2 2007 (\$MM)	Jul-07 (\$MM)
Interest Income from Investments	38.0	48.4	19.2
Interest Income from Cash	2.9	3.5	1.1
<b>Investment Income</b>	<b>40.9</b>	<b>51.8</b>	<b>20.3</b>
Management Fees	(3.8)	(4.7)	(1.6)
Admin/ Custody and Other Fees	(0.3)	(0.3)	(0.2)
Interest Expense	(4.0)	(4.7)	(2.0)
<b>Total Operating Expenses Excluding Performance Fee</b>	<b>(8.1)</b>	<b>(9.7)</b>	<b>(3.8)</b>
<b>Net Investment Income</b>	<b>32.8</b>	<b>42.1</b>	<b>16.5</b>
Realised and Unrealised Gains/ (Losses) From Hedging	(1.0)	2.0	6.8
Net Increase/(Decrease) in Unrealised Appreciation/(Depreciation) in Investments	0.0	1.0	(3.0)
Net Realised Gain on Investments	0.8	0.0	0.0
<b>Net Realised and Unrealised Gains (Losses) from Investments and FX</b>	<b>(0.2)</b>	<b>3.0</b>	<b>3.8</b>
<b>Net Increase in Net Assets From Operation Before Performance Fees</b>	<b>32.6</b>	<b>45.1</b>	<b>20.3</b>
Performance Fees	(5.0)	(5.9)	(2.8)
<b>Net Increase in Net Assets from Operations</b>	<b>27.6</b>	<b>39.1</b>	<b>17.5</b>

Shareholdings at July 31, 2007	Number of shares (millions)	% Holding in Tetragon Financial Group Master Fund Limited
Tetragon Financial Group Limited ("TFG") - listed shares	117.46	93.6%
Tetragon Financial Group LP ("TFGLP") - conversion rights	7.99	6.4%
<b>TOTAL SHARES AND CONVERSION RIGHTS</b>	<b>125.45</b>	<b>100.0%</b>

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## TETRAGON FINANCIAL GROUP LIMITED

### Performance highlights for July 2007



**Notes:**

1. August 2005-June 2006 reflects illustrative performance using Class A share performance and adjusting to reflect Class C levels of management fee and incentive fee.
2. July 2006-March 2007 reflects actual per share performance for Class C shares (1.5% management fee; 25% incentive fee over a hurdle rate of 8%).
3. April 2007 reflects Earnings per Share (EPS) base on average shares in issue in the month after translating pre IPO shares into post IPO equivalents.
4. May 2007 onwards reflects EPS based on post IPO shares only.

This release includes statements that are, or may be deemed to be, "forward-looking statements". These forward-looking statements include all matters that are not historical facts, and include statements regarding the intentions, beliefs or current expectations of TFG concerning, among other things, the investment performance, results of operations, financial condition, liquidity and prospects of TFG. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance. TFG's actual investment performance, results of operations, financial condition and liquidity may differ materially from the impression created by the forward-looking statements contained in this release. In addition, even if the investment performance, results of operations, financial condition and liquidity of TFG are consistent with the forward-looking statements contained in this release, those results or developments may not be indicative of results or developments in subsequent periods. TFG does not undertake to update any of these forward-looking statements.

This release does not contain or constitute an offer to sell or a solicitation of an offer to purchase securities in the United States. The securities of TFG have not been and will not be registered under the US Securities Act of 1933 (the "Securities Act"), as amended, and may not be offered or sold in the United States or to US persons unless they are registered under applicable law or exempt from registration. TFG does not intend to register any portion of its securities in the United States or to conduct a public offer of securities in the United States. In addition, TFG has not been and will not be registered under the US Investment Company Act of 1940, and investors will not be entitled to the benefits of such Act.